Brexit

as at 28/06/2016

WELL!

Here we have the result that no-one saw coming.

There was very little work done here in the office on Friday afternoon as I sat and hit “refresh” on the BBC website every 2 minutes as the results came in.

The Brit in me was going YES! and the investment adviser in me was going OH NO!!!!

So, on Friday, we started at the point that the investment markets had all closed up on Thursday. The markets clearly did not believe that we would get a Brexit. On that basis, they were going to get a “shock” and basically, just had further to fall.

Investment markets do not like shocks.

On Friday, as the results started to come through around lunchtime, the NZ market closed down 1.1%.

The Australian market closed three hours later with a 3.4% drop.

After a huge drop on Friday, the FTSE 100 (the UK index) recovered later in the day and closed down 3.15%.

The Dow Jones dropped 3.39% on Friday, but it was only a 1.9% drop for the overall week.

The biggest losers on Friday were the Japanese Nikkei 225, down 7.92%, the German DAX was down 6.82% and the French CAC down 8.04%.

Part of the Japanese drop had to do with their currency movement on Friday….as Asian investors fled for the Asian safe haven of the yen.

Over the weekend (NZ time) we had the notice of intent of resignation from the Prime Minister, David Cameron, who then went into hiding for three days.

We then had the implosion of the Labour Party, the main opposition party in the UK, with the resignation of 6 cabinet ministers over the weekend (which has now risen to 38 as of 3pm Tuesday NZ time) and the Chancellor of the Exchequer, George Osborne, waited for 2 ½ days to make a statement to reassure trading partners and investors that the UK would be fine.

Having previously said that pensions would be at risk, that mortgage rates would rise, that tens of thousands of jobs would be lost and that lost tax revenue would be the equivalent of a third of the National Health service budget, it is no wonder that the investment markets really paid no attention to his “we will be just fine” speech.

Another factor that has to be mentioned is the fall in value of the Great British Pound.

The pound has fallen around 12% since the announcement of the BREXIT results, which is not necessarily a bad thing for Britain.

In the last couple of days, Britain's exports just became 12% more competitive in price. On the other side of the coin, it becomes more expensive to import items and my poor cousin Ian, who has a wedding to pay for in Canada, just had the bill go up 12%!

The euro has only dropped around 5% at this point.

Yesterday – Monday – I spent the day visiting clients in Rotorua and trying to get the radio news each hour to hear how the investment markets were coping with the continuing fallout over the weekend.

I arrived home mid evening and jumped straight on the computer to find that the Asian markets (including NZ and Australia) were all UP except for Hong Kong.

The Dow Jones dropped a further 1.5%.

The British FTSE was down another 6.96%.

The Germans and the French were down another 3%. I was flabbergasted!

Where was the end of the world??

Where to from here?

Britain has to invoke "article 50", which is a 5 step legal process for any country to leave the EU.

Notification of the intent to invoke article 50 must come in writing and it starts the clock on the 2 year time frame to negotiate an exit.

EU leaders, such an Angela Merkel, Francois Hollande and Matteo Renzi have indicated that they would like Britain to invoke article 50 as soon as possible.

It appears that the EU is likely to take the stance (at this point) that they would like Britain to get out as quickly and quietly as possible, to minimise the disruption to the EU.

The other possibility is that they would play hardball and make it as difficult as possible to discourage other members going down this track, but that tack appears increasingly unlikely.

This is going to be a long divorce.

What does this appear to mean for you, and for NZ at this point?

It is starting to look like it will be a short term issue for financial markets. I was hearing commentators say over the weekend that it will be an event of weeks rather than months, and I didn't believe them. I am starting to believe them now.

We will continue to add to the defensive positions that we have in your portfolios.

The short term (next 12 – 18 months) could be quite volatile (up and down) for investment markets, as I have previously mentioned to you all.

I had a quick chat with Tim Farrelly from Sydney at the Portfolio Construction Conference in May, during the cocktail evening event. Many of you have heard me rave about Tim in the past. The man is a genius who can explain hugely complex financial thinking in words that anyone can understand.

We use Farrelly's input as the main source of our asset allocation research.

Tim said (and I quote)……

> *Mate, all this talk about the next 18 months is going to mean nothing in the 10 year picture. We will look back in 10 years and go "well, that was a big fuss about nothing". Real (inflation adjusted returns) are going to be about the same for the next 10 years as they have for the last 10 years and it is all a storm in a tea cup. Here, have a beer."*

Have I ever found Tim to be wrong about anything in the 6 years that I have known Tim and we sat on the old TNP investment committee together? NO.

In terms of NZ – we export about 3% of our exports by value to the United Kingdom and 3% to the EU.

Lamb is our largest export to the UK, and it just got 12% more expensive.

Visitors from the United Kingdom make up the 4th highest number of tourists for the year ended 31 May 2016 (According to the Statistics NZ website).

Now that the pound is going to not stretch as far, we may see fewer UK tourists over the next 12 months.

And British cousins who need to pay for weddings may be sending emails to their favourite NZ cousin asking for a donation!