

CIO MONTHLY NOTE

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Impact of Brexit on Australian investors



The UK's Brexit vote sent the ASX into a tailspin. What will the impact on Australia be?

After a bruising campaign, the UK voted to leave the European Union (EU) in spite of warnings that such a decision would be bad for the economy. Most

economists are now forecasting a recession in the UK and a 0.5% hit to growth in the EU.

Slower growth, political uncertainty and contagion fears in the world's largest single-market are all obviously bad for the global economy.

The shock will likely delay the Fed's next rate hike and force both the ECB and BoJ to undertake additional policy easing. This will push down global interest rates even further and weaken the EUR and Yen.

In such an environment, Australian investors should brace themselves for lower growth, lower interest rates and a higher Australian dollar.

Given London is the financial capital of Europe, it was not surprising to see British banks sold off after the result. Australian financials also underperformed with the selling focused in UK exposed stocks such as Henderson Group, CYBG Plc and BT Investment Management.

It is not just Australian financials that are exposed to a Brexit. Australia and the UK have an extensive trade relationship and the UK is Australia's seventh largest two-way trading partner with total trade worth around \$21 billion per year.

On the merchandise side, Australian exports include gold, alcoholic beverages and a range of other commodities. It is interesting to note that the UK is Australia's second most valuable wine export market and one in five imported bottles of wine consumed in the UK is Australian.

So what should Australian investors do?

Despite a record low cash rate, Australian interest rates are still relatively high compared to the rest of the world. If the ECB and BoJ undertake additional easing, this premium will widen and, coupled with Australia's AAA credit rating (and now on negative watch), make our market a very attractive place to invest.

The yield premium will attract capital and put upward pressure on the exchange rate. This will be a very unwelcome development for the RBA who is looking for a lower currency to simultaneously support growth and ward off deflation. As a result, the RBA will be forced to cut rates further in 2016.

Investors should embrace this 'lower for longer' interest rate environment and focus on companies that pay a sustainable and growing dividend.

Finally, there is a question that remains unanswered: Will Diego Costa still be allowed to play for Chelsea? We can only hope.

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