AllianzGI perspective: **UK votes Leave**

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AllianzGI's View on UK EU Referendum Results

With the UK electorate voting to leave the EU, investors will need to brace themselves for the political, economic and market impact of this watershed moment.

What seemed unthinkable to many as recently as two weeks ago has now happened: The UK electorate has voted to leave the European Union after 43 years of membership.

Technically, nothing has changed yet. The UK is still a member of the EU and will likely remain so for at least two more years, if not many more. Yet in other respects, the result of this plebiscite changes everything - it is truly a watershed moment:

- It is the first time that a member state has elected to leave the EU since the European economic bloc was established.
- It opens up the prospect of contentious, multi-year negotiations. The UK must agree upon the terms of separation with its biggest trading partner, and it must form a new trading relationship with the EU and the world.
- It is the most pronounced example yet of how malaise with the establishment is affecting Western democracies.

While it should be presumed that the UK will eventually establish new, productive trading relationships with the EU and other nations, these will take time and significant effort to negotiate, during which time a cloud of uncertainty may well hang over the UK. The level of economic damage wrought by that uncertainty remains to be seen.

Political impact

The political fallout in the UK of this decision is likely to be widespread and long-lasting, but also immediate, with David Cameron's decision to stand down as prime minister.

Of greater significance than changes in political leadership is the basis upon which the UK government will seek to extricate the country from the EU. What new arrangement will it negotiate with the EU and other nations? This will be a massive undertaking for which there is currently no blueprint or political vision. Indeed the "success" of Brexit campaigners lay in how they focused their message only on what they sought to leave behind ("liberty from") without addressing the thornier but crucial question of what to replace EU membership with ("liberty to").

It will therefore take several months, and perhaps another general election, to gain more insight into what shape the UK's future will take.

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Amid a potential power vacuum, we may well see calls for a rerun of the Scottish independence referendum, where many Scots could argue that their people were sold a bill of goods that persuaded them to vote in favour of the Union in 2014.

In the meantime, we can also expect heightened speculation around the knock-on consequences elsewhere in Europe - and indeed for the European project itself should other nations seek to follow suit and leave the EU. Forthcoming general elections in other European countries - most immediately in Spain - will be watched with great interest, as will the constitutional reforms that Italy will consider this coming autumn.

Further afield, the Brexit vote may be seen as a harbinger of things to come in the US presidential election, where Donald Trump has made effective use of populist slogans to tap into a general malaise with the establishment among some sections of the electorate, which would raise the spectre of protectionism and anti-globalisation measures. It should be noted that many other parties in Europe's vicinity, such as Turkey and Russia, may see opportunities to gain from Europe's weakness and lack of cohesion.

Market impact

The effect of Brexit upon the markets is already and most acutely evident in UK assets: the British pound has fallen, volatility has spiked and UK equities have dropped sharply.

While the immediate down-draught in UK asset prices may subside after a week or two, investors should brace themselves for renewed bouts of price drops whenever there is unfavourable economic data or when political developments, as alluded to above, run their course.

Some UK-listed companies - especially those with diversified sources of non-sterling income, as well as domestic firms that do not have much exposure to imported materials - should fare reasonably well in this environment.

Elsewhere in Europe, we expect to see some spread-widening in the bond market, especially among those issuers on the periphery that are seen as more vulnerable to contagion from the Brexit vote. Overall, what is bad for equities is usually bad for credit, and there are well-founded concerns that Brexit will harm European assets in general if global investor confidence weakens once again.

Economic impact

While the terms of trade as they stand now have been unaffected by the vote itself, the uncertainty cast by an impending British exit will take its toll on UK and EU economic activity during the upcoming negotiation period. Indeed, there is evidence that the run-up to the vote was already having an impact in the UK, with some inward investment decisions being put on ice. The Bank of England expects a technical recession, but it will stand ready to offset any significant financial dislocations. This readiness will probably support gilts.

Investment implications

Given the political, market and economic effects of the referendum result, investors will be in for a choppy ride. However, it won't be without opportunity, especially for investors with long term outlooks, a healthy risk appetites and the latitude to invest actively. Moreover, in our estimation, this is a market where investors will benefit from paying closer attention to the shifting political realities associated with the ongoing financial repression dynamic, which has been the single largest force driving the markets since the global financial crisis began.

Business implications

For AllianzGI, the Brexit vote will have no immediate impact on our business. We will continue to serve clients as we have in the past. It should be noted that as a truly global firm we have a track record of recruiting investment talent wherever it is without being restricted by a head office location, say.

The principal consideration for further down the road will be how the UK's departure from the EU will affect whether as a firm we will continue to be able to make use of EU passporting arrangements for services in the UK. The impact of any changes in passporting arrangements is likely to be limited, though, given the strong role of Luxembourg as our hub for fund registrations across Europe and plans already underway to introduce OEIC products to UK investors' clients.

While these will be challenging times for clients in the UK, the rest of Europe and beyond, we remain committed to using our skills as active investment manager and our reach as a global firm to help clients wherever they are to meet their investment needs.

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