

BREXIT

The lessons of History

The British, under the eyes of the whole world, have made their choice: it is a massive victory for "Leave". While this vote certainly expresses a rejection of membership of the European Union, it is even more an expression of a rejection of a social model that populations no longer feel reflects their own aspirations. That is why a number of events over the next few months (such as the Spanish elections this weekend, the Italian referendum on reform of the Senate and the American elections) must be followed with particular vigilance. After years of financial and economic crisis, the political and social risks are beginning to materialize.

■ **In the short term, a negative shock "specific" to the United Kingdom, with transmission to the rest of Europe via the financial markets**

Firstly, Brexit is a negative shock with "specific" impact on the growth of the United Kingdom

On the political level, a period of high political uncertainty is beginning in the United Kingdom, accentuated by the possibility of a new referendum on the independence of Scotland and questions regarding the future of Northern Ireland.

On the economic level, the increased uncertainty will depress investment and cause us to revise our growth and inflation forecasts.

The economic impact, combined with durably unbalanced growth (high private sector debt, the "twin" deficits in the public sector and balance of trade, an economic system centred on finance and real estate) increases the country risk and will lead to a downgrading of the UK's credit rating (loss of AAA rating for

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S&P, and drop from stable Aa1 to a negative perspective for Moody's)

On the monetary level, financial uncertainty will immediately force the Bank of England to inject all the liquidity necessary to prevent a liquidity crisis and maintain financial stability

The transmission of these shock waves to the rest of the world (in particular the Eurozone) will depend on the scale of the financial and political impact

Even if the rest of the world today seems able to absorb an exogenous shock by means of increasingly accommodating monetary and budgetary policies, Brexit is nevertheless an additional blow in a context of weak and fragile growth.

In view of the major financial instability, the impact of Brexit on other countries in the short term will essentially be transmitted via the political and financial channels (not the commercial channel) and will be reflected in falling equity markets, wider credit spreads and an increase in the value of other currencies against the pound. The political

and institutional logjams and tightening financial conditions could, if they persist, weigh heavily on investment. It is still too early to quantify the impact on growth, which will depend on the amplitude and in particular the persistence of the impact on financial markets.

At the very least, like the Bank of England, all the central banks (Fed, ECB, SNB etc.) will not take any risk in their management of liquidity against the financial returns. The widening of credit spreads could lead the ECB to increase its purchases of corporate debt. This acceleration is fully anticipated in the mechanism of the CSPP, which is extremely flexible in this respect; the implementation of this flexibility should provide sufficient easing to meet the rising uncertainties. With regard to the Fed, we will see some tightening in 2016, in September or probably in December, after the elections.

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■ **In the medium term, the economic impact could be exacerbated for the United Kingdom, while the institutional challenge could become more urgent in the Eurozone.**

In the medium term, the scale of the economic impact for the United Kingdom will depend on the negotiation of new trade agreements.

In the medium/long term, Brexit will engender higher costs for the United Kingdom, induced mainly by the freeze on investment (both foreign and domestic) and the limitation of immigration. The additional negative impact on GDP will only be quantifiable once we know the terms and time-scales necessary for the signature of new trade agreements

between the United Kingdom and the rest of the world.

For the Eurozone, Brexit increases the pressure on the institutional stakes

Brexit could constitute a major new political shock, because the unhitching of the United Kingdom from the European continent could create a precedent that opens the way for other countries flirting with the idea of leaving the European Union.

In this context, the founding countries, in particular the Franco-German tandem, will have a central role to play in continuing the European project. If a new political will is found rapidly, with a new social project meeting the aspirations of public opinion in the various countries, this event could provide the opportunity to accelerate the construction of Europe, in particular through the practical implementation of the Five Presidents' Report.

The principal challenge over the next two years will be the negotiations that will start between the two parties, both on the terms of leaving the EU and on the establishment of new agreements. It should also be noted that the United Kingdom will have to negotiate new trade agreements with 53 countries.

> THE IMPLICATION FOR THE MANAGEMENT OF OUR PORTFOLIOS

The decision of the British people plunges world markets into a period of major uncertainty. We are now entering unknown territory.

The immediate reaction of the markets when they opened has been violent: high risk assets are dropping dramatically, and interest rates are falling to unprecedented levels. A new wave of volatility has struck the markets.

In these highly turbulent times, we should nevertheless step back and take a calmer view of the impacts on markets. In fact, although the pound and "core" rates are hitting low points, by the end of the morning equity and credit spreads were back to their levels of mid-June when forecasts were predicting a high probability of Brexit.

It is now important to monitor the possible effects of contagion of the political risk in Europe, given the major events now on the calendar, in particular in Spain.

The expected interventions of the central banks and politicians in this context will be key factors for stabilizing the markets. The BoE has already reported exceptional liquidity measures and is announcing the possibility of further action. Central banks seem to be in the process of coordinating.

Positioning of our funds upstream of the referendum

In terms of positioning, before the vote, since the outcome was uncertain, we had reduced the relative and absolute risks of our funds.

We have globally reduced our exposure to British risk, both in credit and equity.

With regard to interest rates, we have reduced our exposure to peripheral debt,

reinforced our flattening positions on the yield curves of the "core" countries and purchased credit protection.

With regard to equity, we mainly have an underweight in the banking sector.

With regard to our multi-active funds, protection has been established via dollar or GBP currency exchange.

And now, what will we do next?

The coming period will be a period of great political, economic and financial uncertainty. In this context, volatility will be the keyword on the markets.

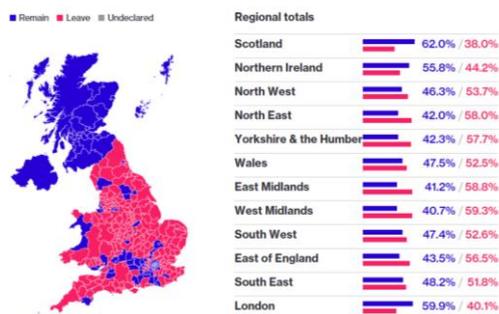
In the absence of visibility, we are maintaining our position: risk premiums on high-risk assets should remain high, and interest rates will be at unprecedented levels.

We remain vigilant with regard to the political risk in our funds. We are waiting to see the initiatives taken by governments and central banks before reactivating our risk exposure. Pending these interventions we will be taking advantage of the opportunities offered by the significant market variations.

In conclusion, profound imbalances that were revealed almost ten years ago during the financial and economic crisis are leading to a rejection of globalization, which is seen by public opinion as a synonym for unemployment, increased inequality and impoverishment of the middle class. It is no coincidence that the advocates of Brexit based their campaign on questions of sovereignty and immigration, which are highly populist themes in periods of upheaval.

By choosing a leap into the unknown, the British people have expressed their exasperation with a world governed by financial markets and the economy. Is the United Kingdom, which has often played the role of "laboratory", heralding a new era for us?

Results of the referendum vote by region



Pound against the Dollar

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