FLASH - ECONOMY

AGAINST ALL ODDS BREXIT FINALLY STRONGLY OUTWEIGHS WITH 52% AGAINST 48%

WHAT WILL BE THE IMPACT ON FINANCIAL ASSETS IN THE MEDIUM-TERM?

It's a rude awakening for most observers who were betting on the status quo. The vote of the British slaps investor confidence and opens a new phase of uncertainty in the financial markets. Although it is quite clear to everyone that the short-term economic effects will be limited to the UK, for the EU and the global economy, the long-term impact could be significant. A recession in the UK is possible in 2016 and the EU's outlook could be less optimistic. The United States has little reason to worry about this and so have most other regions. Global growth is not in danger and recession risks are limited to the UK.

This morning, the financial markets reacted instantly by taking into account the uncertainties generated by UK vote for Brexit. Contagion risks are clearly mentioned on the eve of the upcoming Spanish elections this weekend and voices already raised concerns to revive a referendum in Scotland and Ireland in particular, but certainly in other EU countries that could reinforce the uncertainty caused by this historic vote.

Political reactions in the coming days will be crucial for estimating future risks. We have already discussed the consequences and the subsequent exit procedure to be followed by the United Kingdom to implement its decision to leave the EU in our last weekly analysis of 15 June which is at your disposal on our website www.bbgigroup.ch.

The announced resignation of Prime Minister Cameron should be followed by a change of leadership and the constitution of the team that will be responsible to start negotiations with the EU.

Today the financial markets will re-evaluate the risks, having considered these last days the chances of Brexit were limited.

We are witnessing this morning a strong resurgence of 'safe haven' assets such as gold (up + 5%), the dollar, the yen, the Swiss franc and treasury bonds and adjustments on risky assets causing falls during more than 10% on most European stock markets.

The first reactions are as follows:

- The pound sterling is the main victim of the referendum
- The risk associated with European equity exceeds that of British values
- The banking sector is at the forefront of readjustments
- Even the stock markets of countries unaffected by European risk are suffering from the shockwaves of returning uncertainties in Europe

But according to the current adjustments and asset prices, real opportunities could fairly quickly emerge.

Central banks at maneuver

Central banks are ready for action this Friday to help curb the excesses and extreme valuation gaps that could cause panic in the financial markets. Early interventions should be observed on currency markets after the first magnitude movements. The effectiveness of these interventions could be short but they could also be crucial to limit volatility to those assets actually affected by the vote.

Monetary policies will always be more accommodating after Brexit in all regions. Rising interest rates in the US will be postponed. A BOE rate cut is likely, while the ECB will step up its QE program.

Expected medium-term impact on key asset classes:

Currencies:

• The dollar regains its safe haven role by taking advantage of more its solid fundamentals, the US economy shall remain relatively unaffected by the uncertainty in Europe.
• The Swiss franc and the yen temporarily remain attractive, but the BOJ will act to reverse the trend. The Swiss National Bank shall in the meantime intervene in the markets to curb any excessive appreciation of the Swiss Franc.
• The Euro will remain penalized for a while by the risks of contagion of the "precedent" set by the Brexit vote.
• The pressure on the pound was already high before the vote; it will remain present, but should stabilize after extreme volatility and a correction of -10% to -15%.

Bond markets:

• US government bonds benefit from the repositioning of investors to safer assets.
• In the Eurozone, the Bund enjoys the same phenomenon which should drag long rates below zero perhaps longer than expected.
• In Switzerland, the Confederation long rates trend downward deeper below zero.
• In the United Kingdom, the BOE is expected to lower interest rates which shall translate into a short term effect on long bonds, particularly if the country goes into recession, but on the long run, long British rates are expected to rise in order to offer a sufficient risk premium to investors stung by the collapse of the pound and rising uncertainties. Rating agencies have already announced a deterioration in the creditworthiness the UK in light of this historic vote.
• The surprise past, we expect a gradual rise in long rates in most economic areas, starting with an increase in the United States.

Equity markets:

• In the UK, the drop in share prices could be limited by the expected positive effects on profits arising from the fall of the pound sterling. The companies making the most of their results abroad could benefit from this positive currency effect. Hopes for improved competitiveness could also potentially support equity values.
• In Europe, the currency impact will not play to compensate for the increased uncertainty about future economic prospects. However, we do not anticipate a collapse in growth prospects of the Eurozone that could significantly affect profit estimates for year 2016 and 2017. The crisis of confidence initiated will be a destabilizing factor but not necessarily decisive for the evolution of markets and asset valuation. The financial sector may be more at risk. The aggressive asset pricing adjustments caused by the surprise of Brexit, just days before the end of the quarter, would certainly be an investment opportunity.
• In the United States, growth is on a good momentum and will not be affected by the Brexit unduly. The equity market hesitation to cross new highs will be in the short term supported by the event, but the pressures are not expected to increase.
• In Asia, Japan is primarily impacted by the rising yen. It will expect effective action from BOJ to find better prospects. China still shows in this specific case the lack of correlation with stock markets of industrialized countries, its reaction is in effect limited by international standards.
• In Switzerland, the reactions were sharp at the opening, but the Swiss market does not deserve to suffer the same correction as those in the Eurozone, even if this may be a new challenge for our SNB. We do not anticipate a sustained and uncontrollable rise of the franc. Excessive correction would therefore certainly a

medium-term investment opportunity.

Commodities:

• Gold and silver benefit from uncertainty to record new highs after an initial increase of approximately 5%. The next few weeks should promptly bring new reasons to strengthen the allocation to precious metals. Investor interest observed on the flow of funds towards the ETF on physical gold should increase.
• With regard to crude prices, uncertainty caused profit taking above $ 50, but we remain confident that the fundamentals support a continued rise.

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