Trade Idea – Foreign Exchange

Brexit: The Aftermath

24th June 2016

Markets blindsided

- After a week of tracking increasingly optimistic voting polls, financial markets have been caught off guard by the surprise decision of the British public to leave the European Union. At the time of writing, the primary victims of the decision to leave have been European equity indices and the Sterling, both of which have experienced sharp falls in the 6-12% range. Conversely, traditional safe haven assets like gold have climbed, as investors seek a store of value amongst falling risky asset prices. The actual economic impact of the vote will not be known until a new relationship is agreed between the UK and the EU, a negotiation process that could span years and has an array of potential outcomes. Therefore, we believe uncertainty is likely to remain an integral feature of financial markets for some time to come, making sentiment a key driver of returns going forward. The main factors that we believe will drive confidence in the near term are the selection of a competent successor to David Cameron and the degree of anti-establishment support on the continent.

![Figure 1: Brexit rocks financial markets](image)

Confidence is king

- Confidence in the ability of the UK to secure a beneficial trade deal with the EU will be vital in stabilising financial markets. After David Cameron announced his decision to stand down as Prime Minister this morning, focus turned to who his replacement would be and how quickly he/she would be installed. In our view, what is important to markets is the capacity for Cameron’s successor to unite the Conservative party and instil political stability. The more cohesive the leading party is, the more positively it will be reflected in the Sterling and UK equity markets.

Anti-establishment contagion

- A prominent risk for the EU is that the UK’s decision to leave fuels support for anti-establishment parties at a time where four of the largest countries in the monetary union face key elections in the next 15 months. Parties in France, Germany, Spain and the Netherlands have already gained momentum and this outcome could garner further backing. If calls for referendums in these states grow the stability of the EU will be threatened, which will be unfavourable for European assets.

*All figures quoted are sourced from Bloomberg unless stated otherwise.
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- ETFS 3x Long EUR Short GBP (EUP3)
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- ETFS 3x Daily Short FTSE 100 (UK3S)
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- ETFS 3x Daily Short CAC 40 (FR3S)
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