Empire Life Investments

Brexit: Where do we go from here?

Investors woke this morning to the surprising news that British voters have opted to leave the European Union. Yes, with 52% voting to leave and 48% to stay, Brexit is a reality. While the situation remains very fluid today, here are some of the highlights:

- International stock markets have sold off at the time of writing, with the UK (FTSE 100) down 2.3%, Germany (DAX Index) down 6.3% ,France (CAC Index) down 6.9% and Japan (Nikkei 225) dropping 7.9% overnight
- North American markets have held up better but are also weaker to start the day, with Canadian stocks (S&P/TSX Composite) down 1.6% and U.S. equities (S&P 500 Index) trading down 2.7% at the time of writing
- Gold has rallied over 4%
- After a strong run-up in the British currency leading up to the vote, the UK pound sterling has dipped to its lowest level in over 30 years
- British Prime Minister David Cameron has announced his resignation

With this news, all eyes will to turn to central bank activity and the Bank of England has indicated that they will take all necessary steps to secure monetary and financial stability. It's also important to keep in mind that the democratic process for a formal UK exit from the EU could take up to two years.

What does this mean? What are we doing about it?

While this is significant news and has resulted in a very volatile day in the markets, we believe it is important to avoid having a knee-jerk reaction. Markets tend to overreact in the short-term, creating investment opportunities for conservative, patient investors.

Uncertain events like today create opportunities for our active management approach. Leading up to the vote, our investment team had built up cash positions and a stock idea list, anticipating potential opportunities, which we have been able to act upon today. In our bond portfolios, we had lengthened duration in anticipation of continued falling yields and we witnessed the US 10-year hit our 1.4% target today. Overall, we have maintained our bond outlook, that rates will remain low and that there is good value in short-term corporate bonds.

From an asset allocation perspective, we have incrementally increased our allocation to U.S. equities, which we believe will be more defensive, offering currency strength and downside protection. We are taking this incremental approach, recognizing that Spanish elections on the weekend may create additional volatility and opportunities in the market. While days like today can create uncertainty, rest assured that our investment process remains sound and that our portfolios continue to be managed with a value-oriented, conservative approach, focusing on high-quality companies.

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