ROYAL LONDON

ASSET MANAGEMENT

RLAM'S INVESTMENT SPECIALISTS COMMENT ON THE RESULT OF THE EU REFERENDUM

Economic view

Ian Kernohan, Economist

Given the sharp rise in uncertainty for households and firms, it now seems sensible to assume a UK recession in the second half of this year, with spending decisions postponed until the situation becomes clearer. The longer-term impact on economic activity depends on the new trading arrangements which the UK must now negotiate with the EU and the rest of the world. As of today, the UK remains a member of the EU and new arrangements will take some years to arrange. Despite the drop in sterling, I do not believe the Bank of England will raise interest rates in such circumstances; it is more likely to cut interest rates, as a measure to build confidence. The fall in sterling will act as a support for economic activity and help to attract the capital inflows necessary to finance the large current account deficit, but it will also push up import inflation. I would expect government's fiscal strategy to be reassessed in the light of these events: while the budget deficit is still high relative to the rest of the G7, there is some room to slow the pace of fiscal austerity, especially when government borrowing costs are so low.

US Federal Reserve rate hikes will now be off the table until after the November election.

Fixed income

Ewan McAlpine, Senior Client Portfolio manager

Markets around the globe have reacted sharply to a surprising result versus the expectations of the final run-up to the referendum. So far in UK markets, what we have seen is something of an over-reaction: gilt yields have fallen below last week's lows, reflecting the degree of uncertainty in outlook for the future and in risk assets, and credit spreads have widened so far, undoing the tightening of recent weeks. While the outcome is a negative one for the UK economy, there are many details of the UK's separation from the EU and of new trading arrangements and so forth still to be decided. We would expect to see some recovery from initial short-term moves. Portfolios remain positioned for a medium to longer-term view that the global economic situation will continue to improve; we believe that government bond yields will rise, but positioning in portfolios will continue to be tactically managed amid high levels of volatility. We believe credit bonds will outperform government bonds and that portfolios should focus on security of cashflows and the delivery of stable and attractive returns over the medium to long term.

UK equities

Richard Marwood, UK equity Senior Fund manager

The devaluation of the pound sterling will provide a boost to companies with large amounts of overseas earnings, as the sterling value of those earnings will be higher. It should also improve the competitiveness of UK companies that export and make the UK more attractive as a destination for overseas tourists. This currency move, coupled with share price declines, could also make some UK companies more attractive as bid targets for overseas companies, although potential overseas bidders are likely to be deterred by the uncertain backdrop.

The weak pound is going to increase the cost of imported goods for many companies, which may ultimately be inflationary. With so much uncertainty around, companies and individuals are likely to delay major financial decisions, leading to deferral of investment and hiring of staff by firms, and reduced activity in the housing market.

Ultimately, the equity market does not like uncertainty and the 'Leave' decision will result in a prolonged period of such uncertainty. We should expect share price weakness and very high market volatility.

Multi asset

Trevor Greetham, Head of Multi Asset

The outcome of the referendum is a major shock to stock markets and sterling which were trading positively as the Vote Leave camp lost its lead in the polls.

Uncertainty about future trading and regulatory arrangements will act as a major drag on the UK economy, the world's fifth largest, and will have a knock on effect in Europe.

Unsurprisingly, stock markets have been hit very hard. This could create a longer term buying opportunity for stocks as markets tend to overreact to bad news in the short term and there is a silver lining - turmoil in Europe will stay the Federal Reserve's hand in hiking interest rates and will probably trigger a new round of stimulus.

Whatever the UK is doing, most economies are expanding, monetary policy is loose and this is a positive backdrop for stocks.