Maybank Asset Management Commentary

Brexit Implications and Strategy

Robin Yeoh
Acting Regional Chief Investment Officer
27 June 2016

1 Event

Process of leaving the EU will likely take two or more years. UK will continue to be part of the EU until new agreements have been negotiated between UK and the EU.

2 Implications for the UK

- Slower growth, maybe even a recession in the second half of the year?
- Policy easing from the Bank of England.
- Prolonged uncertainty for UK businesses and markets as leaving the EU is a protracted process; domestic political turbulence complicating the process of actually leaving the EU.
- Opens the possibility of Scotland going for a 2nd independence vote to leave the UK given the large difference in opinion compared to the rest of the UK.
- UK PM Cameron resigns.

3 Implications for the EU

- Euro area economy to slow.
- Risk of further fragmentation of the EU as separatists movements (e.g., in Greece, Spain, Scotland) may gain momentum.
- Modest ECB policy easing.
- Raises EUR risk premiums.

4 Implications for the US & Globally

- Stronger USD.
- Delays Fed rate hikes, Fed on hold until December.
- Market may focus more on upcoming US elections - will Trump win?
- Uncertainty may see companies more reluctant to invest leading to a further slowdown in the Global growth.

5 Implications for Asia

- Financial contagion, not trade, is the main risk from Brexit; risk that financial turbulence has a real economy impact.
- Direct impact should be more muted.
- UK weight in Asian exports is relatively low; Europe weight is more significant so Asian exports might be hit. UK accounts for less than 2% of Malaysia's exports and less than 3% of China's exports.
- North Asia's cyclical markets (Japan, Korea, Taiwan) are more vulnerable than the rest of the region to concerns around how much EU growth will slow.
- ASEAN and Hong Kong equities will probably continue to derive relief from less likelihood of Fed hikes.

6 Implications for Equities

- Equities will be negatively impacted as investors unwind their risk positions in favour of safe haven assets (e.g., gold, JPY, government bonds).
- Brexit introduces market risk at a time when concerns about US and global growth are growing.

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7 Implications for Fixed Income

- Central Banks Globally likely to maintain easy monetary policy and some may even cut rates.
- Government benchmark bonds are likely to rally further (Government bond yields going lower). High Grade Bonds continue to do well as investors seek safety.
- Investors may continue to chase yield given low growth leading to yield compression even for High Yield bonds.

8 Implications for FX

- Stronger USD on demand as safe haven currency.
- Stronger JPY, another safe haven currency.
- Weaker GBP and EUR.
- Generally weaker Asia ex-Japan currencies against the USD.

9 Implications for Commodities

- Against a background of growth concerns, a Brexit vote is a shock to risk appetite and risks contributing to a renewed period of commodity price weakness.
- Most commodities correlated to Global growth and with growth prospects likely lower, commodity price will be weaker.
- A strong USD is associated with weaker commodity prices.
- Gold as a safe refuge commodity to rally.

10 Implications for Sectors/ Companies

- In general, bad for companies with significant UK/EU exposure but weaker GBP/EUR may help some exporters from UK/EU.
- May be good (bad) for Asian exporters (importers) as Asian currencies likely to weaken against the USD but economic outlook/sentiment may be poor.
- Good for yield names (eg REITs, telcos, utilities) as rates will be lower for longer.
- Lower rates supportive of property & autos but may be offset by weaker economy/sentiment.
- Lower rates to keep bank margins low.
- Commodity prices may remain low so bad for producers/exporters but good for consumers/importers.

11 Strategy Forward

- The outcome does not change our overall investment strategy and theme that has been in place since the start of the year, It is still "Maneuvering Around the Potholes".
- We have shared on various occasions that the investment environment in 2016 would be challenging right from the start, generally favouring fixed income more than equities.
- So on the lead up to Brexit we have positioned our portfolios to be more conservative.

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12 Equity Strategy

- For regional equity portfolios, we have been advocating a more conservative strategy focusing on stocks that have a more consistent earnings and dividend profile.
- In terms of country allocations, we are also overweight countries that are less exposed to the global macro environment and that have internal growth drivers including Indonesia and India.
- For Malaysia, our equity portfolios are already positioned defensively with a relatively high proportion of companies that provide defensive dividend yield in order to ride out the volatility in the market.

13 Fixed Income Strategy

- Regional fixed income, given the weak macro-economic environment where rates are expected to stay lower for longer we have progressively become more overweight longer duration high grade credits.
- Malaysian Fixed income portfolios. Similarly for Malaysian fixed income portfolios we are also overweight longer duration high grade credits.

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