Cutting through the spin

Ben Barlow examines how UK stocks and markets will be affected by Brexit

At present, not even a single day can pass without some reference to Brexit and the potential impact that this will have on the UK economy and financial markets. Most recently, UK central banks have warned that important and impactful economic decisions are already being delayed by the pending EU referendum vote, with interest rates left on hold until a final decision has been announced[1]. In many ways, this reflects the fact that the uncertainty surrounding Brexit is arguably more damaging than the vote itself, particularly for economists and investors.

Another issue facing investors (and all voters, in truth) is the heavy emphasis being placed on spin by the leave and remain campaigns. In what seems to be a growing trend for modern-day politics, we are seeing lobbyists become embroiled in personal attacks rather than debate the true pros and cons of the UK exiting the EU. With this in mind, it is extremely hard to determine the precise outcome that Brexit would have on the financial markets and stock exchange from a UK investor perspective.

Twist or stick: how has Brexit created such uncertainty and confusion among investors?

Investors can already testify to the impact of Brexit speculation, as stock values and trading volumes have plummeted as the respective campaigns have gathered momentum in recent weeks. Further to this, the media have also reported that they expect a post-referendum boom among UK stocks and businesses should Britain choose to leave the European Union, although this needs to be placed in context.

More specifically, this increase in share prices and trading volumes would simply represent a short-term outpouring of relief before the true economic reality of Brexit began to hit home.

What about the longer-term impact of Brexit, however? If we assume that market sentiment and price points will improve for a short but indefinite period of time, how will UK investors be forced to change their strategies in the longer-term?

To understand this, we need to consider the fall-out post Brexit. After all, it would simply be the case that the UK leaves the EU the day after the referendum results are announced, before entering into negotiations to determine independent trading terms with nations across the globe. Instead, the UK would have two years to negotiate[2] the terms of its exit, leaving plenty of time for further speculation and market volatility. Then, the UK would have to implement a chosen model with which to operate, before entering into complex and potentially drawn-out negotiations with trading partners.

From complacency to panic: the challenge facing investors

As we can see, there are numerous ifs, buts and grey areas to consider even after a decision has been made and the UK has voted to leave the EU. This explains why there is an uneasy meld of uncertainty and complacency in the market at present, as it is simply impossible to calculate the fall-out from Brexit or even a final exit date for Britain. So while some adopt a risk-averse approach and minimise UK market activity, others simply choose to focus on more tangible issues that can guide their trading strategy.

The mild uncertainty and apathy that exists among investors could quickly be replaced with panic, especially if Britain does vote to leave the EU and regain its sovereignty. This would provide a sharp does of realism for investors, many of whom have become all too accustomed to financial market scaremongering and the seemingly omnipresent spectre of crisis and despair. For those in the know, however, Brexit provides the single largest macroeconomic risk to investors and one that dwarves single events such as oil price spikes or rising interest rates.

The biggest reason for this is the cumulative impact that Brexit could have on the EU as a whole. After all, British stocks and markets also rely on heavy, overseas investment, many of which is directed from inside the EU. Should Brexit compound the existing level of Euroscepticism and encourage similar member nations to follow suit and terminate their arrangements, we could ultimately see the disbandment of the EU and a disjointed market that deters both domestic and international investors.

"... there are numerous ifs, buts and grey areas to consider"

This also applies to investors outside of the EU, including influential markets in China, America and the Asia-Pacific region. If Britain choose to leave the EU but had yet to negotiate the terms of separation (while the fate of the single market also remained unknown), it is hard imagine investors committing to UK shares or those affiliated with any European nation. Instead, such investors would seek out less volatile opportunities, while waiting for UK and the single market to regain some semblance of equilibrium and direction.

What does the future hold for UK and the EU post-Brexit?

Regardless of whether you choose to invest in stocks and shares or more speculative derivatives like spread betting[3], a post-Brexit seems decidedly bleak. This does not mean that existing the EU is necessary a bad thing for UK markets or the economy as a whole, but more that the volatility an uncertainty that it brings will cause considerable disruption. When you consider that this will apply for a considerable period of time after British voters have deigned to leave the EU, this is something that requires a huge amount of forethought.

On another note, we must also realise that the British Pound is also underweight at present, losing ground to both the Euro and the US Dollar (USD). With equities also losing value, there is a pressing need for the UK government to present a post-Brexit plan rather than simply releasing subjective propaganda and engaging in puerile rivalries with opposing politicians. This would at least afford some assurances to investors, while potentially helping to avoid the further depreciation of UK markets, currency and equities. ■

1. https://www.theguardian.com/business/live/2016/jun/16/markets-fall-bank-of-england-interest-rates-business-live
2. https://www.fundstrategy.co.uk/what-does-brexit-mean-for-markets/
3. http://www.etxcapital.co.uk/spread-betting