# Brexit Implications on International Equities

## Manager Call with Canterbury Consulting & Tony Cousins of Pyrford International

*On June 28, 2016, Tony Cousins, CFA, Chief Executive and Chief Investment Officer of Pyrford International, addressed today's international developed equities landscape and outlined specific opportunities and risks, including the impact of the recent 'Brexit' referendum. Below are the key takeaways from the conference call. This summary does not necessarily represent the views of Canterbury Consulting.*

### BREXIT

— Expect parliament to confirm referendum. The chance of Brexit not happening is slim. It would be unconstitutional and undemocratic for parliament to go against the will of the people. However, the lack of direction on the Brexit process will surely create uncertainty.

— Britain's withdrawal will be especially bad for peripheral countries that rely on the EU. If Brexit is successful, other EU members may be emboldened to do the same.

— Scotland may have another referendum to remain with the EU.

— Growth expectations in the UK and Europe have come down, which will lead central bankers to remain accommodative. U.S. tightening will be put on hold, and there could even be a resumption of quantitative easing ("QE"), putting downward pressure on U.S. interest rates.

— The UK may adopt a similar arrangement to Norway, in which they will still have access to markets and remain economically intertwined.

— The UK could potentially benefit from leaving the EU by escaping the EU's heavy regulations which tend to hinder growth.

### GENERAL MARKET CONDITIONS

— Economic growth is driven by labor growth and productivity improvements—both are generally not taking place in developing economies.

— The only tool left in the box to avoid recession is the manipulation of interest rates, however, this does not work as QE does not generate growth.

  - QE inflated asset prices, but asset prices are not good indicators of successful recovery—one must look at real returns.
  - QE in the United States has resulted in the weakest recovery since World War II in terms of employment.

### EUROZONE

— Two tiers of economies: northern/core countries and peripheral countries

  - Core countries (France, Germany, Netherlands) are experiencing modest growth
  - Growth in peripheral countries is poor, especially in Portugal, Italy, Greece, and Spain

— Poor growth in the peripheral countries can be attributed to:

  - Lack of productivity increase
  - High wages resulting from a lack of wage growth restraint during the 2001-2009 boom
  - High levels of indebtedness (e.g. Greece is at 190% debt/GDP)

— Countries have previously deflated their own currencies in an attempt to compensate for poor growth and high wages.

— Since joining the EU, devaluation is no longer an option as they are tied into a common currency.

— Peripheral countries must take on debt in order to finance their nations; there is no clear path to repayment.

- The unemployment rate among people aged under 25 in peripheral countries is as high as 50%, and the situation is worsening as young people are leaving their home countries to pursue employment.
- There are still many good businesses to invest in. Good business traits include: global scaling, minimal exposure to Brexit, debt management.

## UNITED KINGDOM

- Wage growth is low in real terms and is currently below the pre-2008 crisis level.
- The energy crisis had a large negative effect on inflation rates.
- Housing growth is increasing, thereby increasing consumption, which currently represents 70% of the economy.
- In order to stimulate housing, many mortgage lenders are increasing the loan amount. This may not be a good idea because poor lending practices led to the original 2008 housing crisis.
- 85% of mortgages are currently floating rate; a move in rates could be very disruptive.
- Market seems overpriced; UK is not discounting the negative times ahead. The UK dividend yield is currently at 3.7, which is low by historical standards.

## JAPAN

- Japan has gone through approximately 25 years of little to no growth.
- With a debt/GDP ratio of 200%, the nation must print money in order to keep the yield curve down (keep the cost of debt down).
- Labor growth is important, but Japan's working age population is declining. The non-working class will make up 95% of the population by 2050.
- The household savings rate has been steadily declining since the 70's, and is now near zero.
- 'Abenomics' is promising but so far there hasn't been much in the way of action.
- Japan does not offer many investment opportunities; healthcare may be an exception.

## ASIA EX-JAPAN

- Asia ex-Japan has great demographics and accounts for a quarter of worldwide GDP.
- The dependency ratio (non-working age vs. working age) is much lower than the global average.
- China's manufacturing edge comes from its low wages; unfortunately, as wages increase, China's competitive edge will decline.
- To accommodate the decline in its competitive edge, China is transitioning from an investment-based economy to a consumption-based economy.
- China is not a welfare state. The population has been required to build up their own savings.
- China will implement rudimentary safety net to free up savings for consumption use.
- Private consumption in China is relatively low at 35%, with much room to grow. As a comparison, developed world consumption is between 55% and 65%.
- China is likely to grow between 4% to 6%.

## MARKET OUTLOOK/PORTFOLIO POSITIONING

- Overweight Asia ex Japan–sustainable tailwinds, no money printing activity
- Underweight Japan and UK due to massive debt
- No exposure to Portugal, Italy, Greece, Spain
- Avoid highly indebted countries such as South Africa, Brazil, and Russia
- Taiwan and Malaysia are compelling EM countries to invest in; they have strong export markets
- Underweight financials although they may provide a unique opportunity due to recent selling
- Focus on high value/quality/ROE investments; opportunities may appear in northern Europe

**Tony Cousins, CFA**

*Pyrford International*

After graduating from Cambridge University in 1985 with a Bachelor of Arts, Tony joined Daiwa International Capital Management in London as an Equity Portfolio Manager. He joined Pyrford in 1989 and obtained his Master of Arts and became a CFA charterholder in 1990.

Tony headed Pyrford's European and UK investment management activities for Pyrford for almost 20 years and was promoted to the position of Joint Chief Investment Officer in November 2009. On 1 January 2011 Tony was further promoted to the roles of Chief Executive and Chief Investment Officer.

**Matthew Lui, CFA**

*Associate, Investment Research*

Mr. Lui is a member of Canterbury's Research Group and is responsible for sourcing, evaluating, and monitoring traditional, long-only equity managers. Mr. Lui serves as the Chair of Canterbury's Global Equity Research Committee and he also sits on the Capital Markets Committee. Prior to joining Canterbury, Mr. Lui was a trader and research analyst at Knightsbridge Asset Management. Mr. Lui received a degree in Economics from U.C. Berkeley and is a CFA charterholder.

## About Canterbury

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