

# BRITAIN VOTES TO LEAVE THE EU

## *More market volatility expected*

SADIQ S. ADATIA  
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### FLASH MARKET UPDATE

After nearly three years of increasingly contentious debate, the British public voted to withdraw from the European Union today – sending financial markets into a tailspin and raising uncertainty about the EU's future.

British Prime Minister David Cameron accepted responsibility for the outcome. It was his decision to call the referendum to appease a growing element within his Conservative party that opposed what they (and now a large segment of the population) see as the growing concentration of economic and political power in Brussels.

The British are gambling that even though their economy is doing relatively well, they will be better off outside of what the British media likes to call the “Euro mess.” But it will be some time before they’ll know if their bet will pay off.

In the meantime, financial markets clearly don't like the odds, with Euro STOXX 600, a bellwether for both U.K. and eurozone equities, falling almost 10% (in euros) during the run up to the vote. And Bank of England Governor Mark Carney has warned that the country will now have to absorb a number of economic blows, including a possible recession and a run on the value of the pound as international investors dump the currency.

### MORE TROUBLE AHEAD FOR THE EU?

The EU is already struggling through a period of slow growth. And its fragile economy could suffer further if the British decision raises fears of the EU unraveling, causing business confidence to dry up and an outflow of capital to safe havens.

There could also be negative implications for the global economy, with G7 leaders warning that the U.K.'s exit from the EU could reverse the trend towards greater global trade and investment and the jobs it creates.

The future of the EU will be debated in a number of European general elections next year, and Britain's move to go it alone could galvanize anti-EU political forces. And the leadership in some of those countries has no doubt noted that Cameron was able to negotiate concessions from the EU after the referendum date was set. They may now use that same strategy to negotiate their own side deals, potentially further weakening the EU.

## WHERE DO WE GO FROM HERE?

We expect the EU to calm the water by reassuring financial markets that it has a credible post-referendum strategy in place. It will also have to engage the U.K., which under treaty, has two years to negotiate a withdrawal agreement.

If a deal cannot be reached all treaty obligations would lapse, which would be damaging for all parties. This is especially true for the U.K., with exports to the EU accounting for 13% of its £1.8 trillion GDP, while the EU's exports to Britain represent just 3% of its £11.7 trillion GDP.

Due to the U.K.'s dependency on EU markets, Britain will likely attempt to hammer out a comprehensive free trade agreement with the EU, such as Turkey has done. Or like Switzerland, it could try to negotiate a series of separate deals giving it access to European markets while leaving it with control of its own border and economy.

But negotiating a new financial relationship in the heated post-referendum atmosphere will likely be a very long and difficult process.

## OUR TACTICAL APPROACH – POST REFERENDUM

In the months leading up to the referendum, we lowered our exposure to British and eurozone equities in our Sun Life Granite suite of funds in the belief that volatility would increase as we headed into the vote, and afterward if Britain voted to leave.

Still, we have a strategic view that includes investing in Europe, but only when we think valuations and risk have come back into line. That could take a while or happen quickly. In either case, we employ a number of tactical tools that will enable us to fine-tune our investment views based on market conditions.

For now, we believe investors should avoid getting caught up in all the dire commentaries about Britain's and Europe's future. Instead, be patient – opportunities to invest will emerge as the two parties settle their divorce and come to a new arrangement.

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