Heartwood
Investment Management

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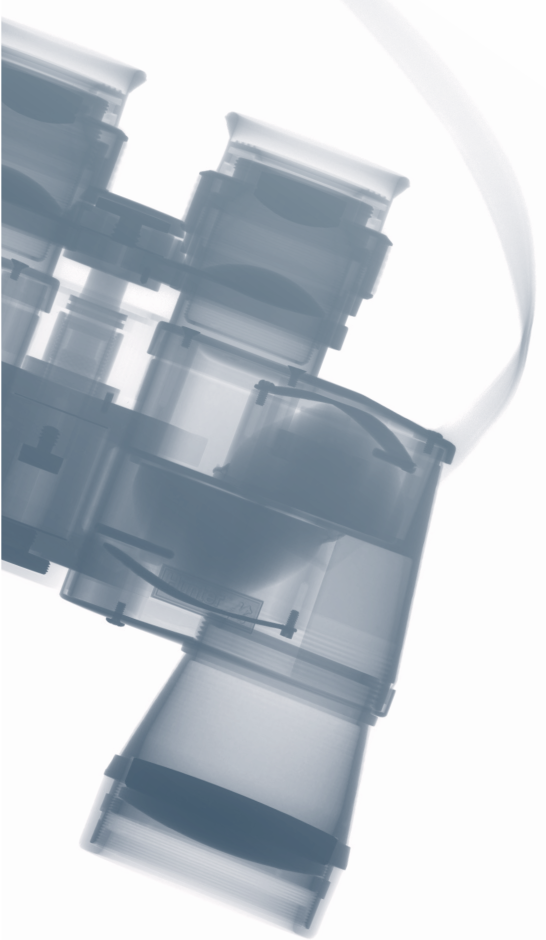
Investment Insight

# Weekly Insight



## Politicians are going on a Brexit hunt..but investors should not run for the hills

The well-known children's story "We're All Going on a Bear Hunt" depicts a family that courageously struggle through fields, rivers, mud, forests and snowstorms in search of the bear. They eventually find the bear in a cave, but upon discovery the family quickly reverses course and flees to the safety of their home, having not really wanted to go on the adventure in the first place.

This depiction is a bit like the current state of British politics. We have come through the adventure of the referendum campaign and are now at the point where the country has to face the challenges of withdrawing European Union membership. The vacuum of political leadership means that no roadmap has yet been set out - is the UK In, Out or is there a flexi-option?

We are continuing to digest the enormity of events in the last week, but although these are unsettling times, financial markets are adjusting.

## Five reasons why the current period is not a re-run of 2008

1. We have a more stable financial system. Banks have raised significant levels of capital in the post-crisis years and balance sheets are much stronger than in 2008. UK banks have strong capital ratios. The 2014 stress tests revealed that UK banks' balance sheets could withstand a 2008 scenario; in other words, a meaningful contraction in economic growth, falls in house prices and falls in financial markets.

2. Central banks are proactive and will support growth. The Bank of England is expected to cut interest rates and increase its quantitative easing programme. The immediate focus of policymakers will be boosting aggregate demand in the economy. Policymakers will therefore overlook, in the short-term, the inflationary impact of a weaker sterling. Furthermore, central banks globally are also better prepared and liquidity lines are open if needed to support the banking system and financial markets.

3. Equity markets have corrected meaningfully over the last few months in local currency terms. Unlike the financial crisis in 2008, the UK referendum has been a well-flagged risk event and there has, so far, been an orderly unwind in markets. Over the last 12 months ended 30 June 2016, European equities are down 9%, Japanese equities are 23% lower and emerging market equities have fallen 7% [Source: MSCI]. It is worth highlighting that performance dispersion between sectors and stocks should present opportunities for investors in search of fundamental value.

4. Currency moves are opening opportunities across global asset markets. Over time, we would expect a weaker sterling to attract international investors back into UK assets, such as property.

5. Fiscal levers will need to be eventually pulled and governments will have to increase spending to boost growth. While economic fundamentals have been improving across developed economies, global growth remains low relative to recent history. Central banks cannot be the "only game in town". There is more pressure on Japan's government to support the economy through fiscal measures, but we would look to the US to create a programme of spending that would have a real world impact.

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To find out more about the Heartwood strategies, visit our website or contact your local representative.




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