Market commentary

CI Investments

Brexit implications update

June 24, 2016

On Thursday, June 23, 2016, U.K. citizens voted to exit the European Union. Here is a selection of commentary from CI Investments' portfolio management teams about the implications after the referendum vote. For additional insights into this historic vote, please join us for a webcast with CI's portfolio management teams on Monday, June 27, 2016 at 2 p.m. ET. For more information on the webcast, please click here.

Signature Global Asset Management

At Signature, we have been defensively positioned in all mandates for some time now. In our Canadian balanced products we are underweight equity by approximately 7% absolute, and in global balanced products we are underweight by 20% absolute. Within our equity holdings, we have a strong bias towards non-cyclical sectors.

We are generally overweight in gold through a combination of bullion and gold equity exposure.

Throughout most of our mandates we are generally overweight U.S. dollar exposure.

Going into the referendum, the global funds were 60% currency hedged on the euro and 50% on the British pound (i.e. short euro and sterling). We adjusted these currency hedges lower as the election results became clearer to 40% and 20% respectively.

Hedges continue to favour a weaker CAD although hedges were trimmed marginally overnight.

The financial stability of the banking system and the central bank commitments to provide liquidity suggests to us that markets will be able to absorb the Brexit vote without any significant near-term contagion. In light of this, we are positioned for selling government bonds and buying additional equity weight as opportunities arise.

Cambridge Global Asset Management

As we stated last week, the Cambridge team believed that the market was not properly pricing the risk of Brexit. That it was a binary, not linear event.

As we have long discussed, we have been concerned over paltry global growth, yet expectations and valuations were pricing in much greater expectations. This has been the reason for our cautious stance, and elevated cash holdings. With Brexit, global growth expectations will be revised lower and valuations will need to adjust to these lowered expectations.

While the current market dislocation provides us with some opportunities to put cash to work (we have been buying since 3:30 a.m.), the price behaviour is just now beginning to reflect a more difficult economic environment.

Over the weekend, central bankers will be formulating their stimulus packages, but investors are growing wary of how many more levers they can pull and what effectiveness, if any, they possess. We are and will continue to add to positions, but will remain underweight equities until valuations more accurately reflect global realities.

As Bob Dylan sang, " the times, they are a changin'."

Harbour Advisors

Contrary to market positioning, Britons voted yesterday to leave the European Union (EU). Prime Minister David Cameron has announced his resignation. Equity markets in Europe and U.S. futures are selling off hard, bond yields have fallen and both the U.S. dollar and gold are rallying.

U.K. bank stocks have opened down 30%. A number of peripheral European banks have not opened as “the market can’t price them.” Having the European banking sector get shelled is one of the things that are not good for overall liquidity and growth in Europe.

Immediate questions for market participants to consider include:

- Will other EU nations advance secession initiatives? Right-wing parties in France, Italy and the Netherlands have already been vocal on this subject.
- Will there be further implications for the integrity of the U.K.?
- What other second-order effects will there be in the U.K.? How quickly, for example, will London’s property prices be affected?
- Will huge market volatility and forced margin selling cause problems anywhere in the European financial or macro hedge fund sectors?
- With European yields falling, is a U.S. Federal Reserve interest rate increase now off the table for 2016?
- Is the populist Brexit outcome a harbinger for political outcomes elsewhere? Like the U.S.?

The Harbour balanced funds are well positioned for this outcome. Broadly speaking, we have underweight allocations to equities, Europe and financials and an overweight position in gold.

Harbour Global Growth & Income Corporate Class

- The fund has a non-gold equity weight of 50%, 7.2% in gold equities, or 12.6% of total equity exposure and holds 23% cash.
- European equity exposure (including the U.K.) is 11.6% of equity versus the benchmark weight of 22.5% (MSCI World Index).
- U.K. equity weight is 4.7% of equity vs. the benchmark of 7.3% and is overweight the U.S.
- The fund holds less than 1% exposure to European financials (Prudential, an Asian-centric U.K. life insurance company).
- The fund is 95% hedged on sterling, 50% on euro, 40% on U.S. dollars and unhedged on Japanese yen and the Swiss franc – this will generate substantial gains on currency Friday.

Harbour Growth & Income Fund

- The fund has a non-gold equity weight of 58% and 9.6% in gold equities, or 14% of total equity exposure.
- European equity exposure is 8%, of which 39% is in Switzerland, with the currency unhedged. The Swiss franc is flat against the CAD as of Friday (June 24) morning.
- U.K. exposure is 3.3%, mostly in Vodafone, which yields 5.4% and is 16% of revenues. With rates falling everywhere, yield stocks should perform better than the market.
- The fund is 95% hedged on sterling, 75% on euro, 50% on U.S. dollars and unhedged on Japanese yen and Swiss franc.

CI Investment Consulting

The United Kingdom's exit from the European Union will take years to play out, but impacts to the currency and the global capital markets have been immediate. We are seeing the classic "sell before asking" behaviour play out in the markets.

We do not believe Brexit to be a black swan event. While it was considered less probable, it was still a live possibility. A 10% correction in the broad equity markets is not unreasonable given the outcome of the referendum and it will bring us to fair valuation levels.

While global stocks are selling off aggressively, there are pockets that are doing extremely well, such as US Treasuries, the US dollar, the Yen and gold. We have not attempted to call for an exit or remain. In line with our process, we have positioned our portfolios based on long term fundamentals and valuations. News does change valuations and we react to that. In advance of the referendum, we had been selling Sterling, buying bonds and the US dollar and trimming equity.

Our objective in this environment is to harvest opportunities from market inefficiencies and take advantage of extreme pessimism.

Income-oriented portfolios

We have been favouring "out of favour" asset classes such as the U.S. dollar and long term sovereign bonds. As Brexit has effectively unlocked some of the value in these asset classes, we are taking some profits but still have meaningful positions as they are attractive in this environment. In the CI Select Income Managed Fund, bond duration is at 5 years (down from 5.5 two weeks ago) and we are overweight the long end of the yield curve. We own 30% U.S. dollar exposure. We have kept equity at a low level of 12% and have room to add. Across all of our more income-oriented portfolios, we are delivering low volatility in a highly volatile environment for our most conservative investors.

Medium risk, balanced portfolios

We also favour U.S. dollars and sovereign bonds. The equity weighting has been lowered consistently over the last 12 months due to market valuations; this was not a call on Brexit. Some short-term downside volatility is expected but we are confident that we will achieve attractive returns for the clients' investment horizon, which is typically five to seven years. We have the ability to bargain hunt in these portfolios while remaining within our risk budgets. We will likely sell some bonds as they have gone from being "out of favour" to "in favour".

Growth and maximum growth portfolios

These portfolios typically invest the majority of assets in stocks for the highest long-term growth potential. Declines in the stock markets will have a larger impact on these portfolios. However, given the long investment horizon, short-term events are unlikely to leave a permanent effect on long term returns. Valuations will normalize over time. Our ability to reposition the portfolios provides opportunities to enhance long term returns for our growth-oriented investors.

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