28 June 2016 FUNDSPEOPLE

Brexit: the best opportunities in the weeks to come will be in subordinate securities


immagine concessa

That's where credit risk will offer yields that more than offset the duration effect (fall in yields) that has already been seen with higher-quality securities. In terms of stocks, in Europe we'll continue to be cautious with banks, at least until we've seen some decisive interventions. These are the words of Giacomo Mergoni, CEO of Banor Capital Ltd.

The United Kingdom's vote to leave the European Union produced a seismic wave that swept through all the financial markets. Many operators were surprised by the referendum result and it seems that before the vote they'd adopted positions not entirely appropriate for a Brexit outcome. In the last week, risky assets have seen a strong rally, both in the UK and at the global level, because investors had convinced themselves that the "Bremain" front would win. And now? In addition to the marked volatility, the depreciation of the pound and the collapse of the indices in the immediate term, what can we expect? Considering that speculative trends will be very strong…

In the short term it's difficult and pretty meaningless to make forecasts. For the coming months we expect that some of the panic we've seen today will subside when investors understand that the risk of a domino effect on the other countries of Europe is real but improbable. The price movements seen today on European banks were triggered by the vote in Great Britain but they conceal difficulties that already existed. Paradoxically, Brexit could provide an impetus driving the other European countries to a stronger union, both in terms of a more expansionary fiscal policy and in terms of EU guarantees for bank deposits. The greatest risk in Europe is and remains deflation. And this event, with its negative impact on trade and growth, has certainly not helped avert it.

Now that the result is clear, will the reaction of the central banks and the politicians continue to play a key role in

limiting the negative consequences? Which sectors should we be focusing on right now, and what will the consequences be for stocks and bonds?

The central banks have confirmed their support for the markets and we don't see any risks in terms of liquidity, of the sort that we saw after the failure of Lehman Brothers. Right now we're seeing too much uncertainty to take on significant positions and we're glad to have ample liquidity in our portfolios. The best opportunities in the weeks to come will be in subordinate bonds, where the credit risk will offer yields that more than offset the duration effect (fall in yields) that has already been seen with higher-quality securities. In terms of stocks, in Europe we'll continue to be cautious with banks, at least until we've seen some decisive interventions (non-performing loans, capital increase, cost-cutting exercises). We'll continue to focus on securities with exposure to the domestic economy and which don't take into account even a timid recovery of the cycle in Europe. In the USA we like the big global banks that are quoted at below book value and don't discount the growth potential that's emerging again after the years of post-financial crisis "purgatory".

The short-term market reaction was negative, naturally, but how do you see the long-term outlook for the economy of the United Kingdom and for the financial markets? Potentially worse, given that the details of the new commercial relations between the UK and the EU will not be defined for many months. Will this level of uncertainty have a significant impact on investment?

On the UK market we expect stocks exposed to the domestic economy to be very weak, while the effects will be moderately positive for the many exporters making up the list. We were short on house-builders. We can't predict the effects on trade right now but we're confident that the key players in the future UK-EU negotiations will behave rationally.

Could we see manufacturing companies based in the United Kingdom shift production to continental Europe, in view of the expectation of trade and tariff barriers for goods produced outside the EU?

The movement of goods doesn't just depend on where they're produced, but also on production costs and sales prices. These variables are difficult to predict right now but we expect in the long term to see a balance that's not too different from the present one. Countries like the United States produce and export a great deal to the EU without customs duties, even though they're outside the EU. Of course, some companies will find it easier to relocate to EU countries, as long as they provide the same stability and competitiveness as the British model.

And what impact do you see for Italy, considering that the FTSE MIB [the index for Italian equity markets] lost up to 10% on Friday?

In Italy we've seen movements that frankly can hardly be justified by an event like Brexit. We know what problems we're exposed to but we feel that the selling was exaggerated and we wouldn't be surprised if we saw a rebound in the coming sessions. The dollar is back at 1.10 and the ECB can intervene to limit the spread. We'll soon have other things to worry about: the Spanish elections, Greece, the US elections. We'll continue to be cautious but we'll always try to distinguish between emotional and more rational reactions.