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Brexit: initial thoughts

Neil Woodford, 24 June 2016, 07:41

The people of Britain have voted to leave the European Union. This clearly represents a very significant decision for the UK, for the European Union and indeed for the wider global economy. Markets are clearly shocked by the decision but, in our view, it is not as negative a development as the market's initial reaction appears to imply.

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We have been clear in our thinking on the economic implications of Brexit for some time. The independent report that we commissioned on the subject (if you haven't read it, please do, particularly if you need reassuring on what this decision is likely to mean for the economy), concluded that Britain's long-term economic future would be largely unaffected by a decision to leave the European Union. We stand by these conclusions.

That is not to say there won't be challenges in the near-term. There will. We now face a period of uncertainty as the exact terms of Britain's exit from Europe are negotiated. Financial markets loathe uncertainty as amply demonstrated by this morning's reaction across all asset classes.

On this momentous day, it is worth reminding our clients of a few important things. On the 20 February 2016, when David Cameron announced that the EU referendum would take place, the FTSE 100 index was at 5950, the 10 year Gilt yield stood at 1.41% and the sterling / dollar exchange rate was 1.44. Since then the equity market has risen 6.5% but that rally has been quite narrow, being led by oils (+15%), and the mining sector (+18%). Banks have performed well too, up just under 10%, with pharma flat, tobacco up 7%, utilities up 4% and general retail up 5%.

Clearly, on a day like this, markets have responded negatively to the uncertainty that follows this vote, and may continue to do so for some while. However, my job is to peer through this short-term uncertainty and focus on the long-term fundamentals of the economy and the businesses in which we invest.

As I have said on a number of occasions recently, the global economic backdrop will continue to be challenging, regardless of our membership of the EU. Many of the greatest economic challenges that we face now and in the future, in my view, dwarf the economic issues associated with today's outcome.

Nevertheless, in the near-term it is likely that UK GDP will be lower over the next 18 months or so than if we had voted to remain. But, because inflation will (temporarily) be higher following the fall in the pound, nominal GDP could well be little changed. Growth in consumer cash flow will be marginally lower, principally because fuel prices will be higher but of course exporters will enjoy something of a windfall.

In the longer term, it is my view that the trajectory of the UK economy, and more importantly the world economy, will not be influenced significantly by today's outcome. Consequently, the portfolio strategy will not change. It was designed for a challenging world, characterised by low growth, deflation, debt problems, weak productivity and troubling demographics. Despite these headwinds, I remain confident that the portfolio will deliver the returns we have targeted over the three-to-five year time horizon that we continue to focus on.

Although market conditions such as these can be unsettling, we would strongly urge investors to look through this period of uncertainty and focus on the long-term opportunity which, in our view, continues to remain attractive.

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