The sun will shine again

Deon Gouws - CIO, Credo Wealth - 24 June 2016

The much-anticipated UK referendum has come and gone and it is fair to say that the outcome has taken most commentators by surprise (ourselves included).

This has already resulted in extreme financial market volatility, not only in the UK itself, but indeed around the world. Equities across the board are down materially, and the pound has touched a 30 year low.

From an investment point of view, perspective is required. Dislocations such as this happen from time to time, and those with long enough memories will agree that markets tend to over-react in such situations.

In this regard, we would like to reiterate the main message from a communique sent to clients earlier this week. That piece included the following few paragraphs:

We would like to stress that we build our portfolios at Credo on a bottom-up basis, taking into account company fundamentals when selecting securities. The bottom-line of all this, is that we believe our investments should over time be able to withstand most of the volatility that we see in markets, whatever the reason.

Ultimately we believe that a potential Brexit (and all the speculation and mixed messages from a variety of politicians in this regard, etc.) largely boils down to the kind of "noise" that we choose not to focus on when investing client portfolios. We acknowledge that money can potentially be made by those who take a short term trading view, call the outcome of the referendum correctly and position their portfolio accordingly (in terms of currency exposures, specific company investments etc.) - but that is simply not our philosophy.

At Credo, we prefer to take a longer term view (focusing on potential holding periods of 5 years, if not more) and invest in good quality businesses that we believe we understand and where we are able to gain exposure at reasonable valuations. In our view, very little if any of this is likely to be affected materially by the outcome of the referendum (that is if one ignores the shorter term noise referred to above): the businesses we invest in should continue to trade well, grow their profits and potentially enjoy multiple expansion over time.

For what it's worth, I would also point out that the majority of the counters that we've been adding to our equity portfolios over the past year or so have in fact been US companies, resulting in a situation where we are essentially overweight to the US at this point in time. Purely based on this, I would therefore suggest that the risk of a possible Brexit affecting our portfolios is somewhat limited, in any event.

Or, as Cullen Roche from Orcam Financial Group was quoted as saying last night:

"If Brexit matters to your portfolio then you're doing it wrong. Really wrong."

Personally, I could not agree more.

Markets are discounting mechanisms... What variables to discount though in times of such uncertainty? Quoting again from our piece earlier this week:

If the Leave side wins, the consensus expectation appears to be that both the pound and UK share prices are likely to decline at first, before potentially starting to recover and settle into a new trading range based on fundamentals once that particular outcome is fully understood. Bear in mind that the actual economic and other consequences of a Brexit decision will not be obvious for a couple of years (in terms of Clause 50 of the Lisbon Treaty, the UK will have no less than 2 years to negotiate the terms of a prospective exit from the EU).

Put differently, I would suggest that today's weakness is largely a function of all the uncertainty related to the situation, rather than being reflective of any specific fundamentals which have necessarily deteriorated overnight.

As far as longer term economic prospects for the UK post-Brexit are concerned, it should be borne in mind that there is indeed a strong argument that the country (and therefore many of its companies) will be better off once the dust is settled. This is also partly why it was so difficult for some of us to decide exactly how to deploy our vote (I am personally on record as having been in the confused camp until only a few days ago).

Against this background, we would urge clients to keep calm and wait for markets to settle down before attempting to restructure portfolios. It is trite to say that selling into weakness is seldom a good idea, and it is very possible that we will see gyrations (downwards as well as upwards) in days to come. For those with additional cash reserves, this could be a good time to deploy money.

As people went to the polling stations yesterday, we experienced some of the worst thunderstorms that we have seen in the UK in many years. But the clouds will lift as they always do, and the sun will shine again... perhaps even sooner than we think. ■