MILLEN CAPITAL

The outcome of the referendum and your portfolio

Summary

With the UK's referendum vote on whether or not to remain in the EU almost upon us, this note looks at the impact that BREXIT could potentially have on client portfolios. The market risks may seem material, but they are mitigated by the ownership of robustly structured, well-diversified portfolios. The key is to stay calm in the face of market uncertainty. *'This too shall pass'* as the investment sage John Bogle has said many times before at other seemingly concerning times.

Client Communication

June 2016

The impact of a leave vote on your portfolio

As the referendum to remain in, or leave, the European Union draws near, we thought it would be a useful time to touch base and provide some reassurance that the investment portfolio that we look after for you is well positioned to weather any investment storms ahead.

In this brief note, we raise a number of potential risks that exist and how these are mitigated, to a large extent, by the current structure of your portfolio. We do not seek to analyse the debate, provide our slant on it, or steer you in any direction. We do, however, encourage you to vote as part of our robust democracy – in whatever way you see fit – because a high turnout gives legitimacy to the vote, dilutes extreme views and provides you with the right to complain, if the vote goes against you.

How did we get to this?

There is no doubt that the decision that UK voters will make is a big one, with material consequences for the long-term nature of who/what we want to be as a nation. It is by no means an easy decision and is made no easier by the polarised positions of both camps that has resulted in unedifying personal attacks, the loose use of data, personal ambition and party division.

Today's referendum is a long way from the heady days of 1973 when the UK – urged on by Ted Heath - became a fully paid-up member of the European Economic Community (EEC), by an emphatic margin of two to one. It may surprise some that back then those pushing for entry were the Tories and it was the Labour Party that was riven with in-fighting. Thatcher's EU budget rebate in 1985 – which still rankles with some – and our short-lived membership of the Exchange Rate Mechanism in 1992, were early milestones in the up-and-down relationship between the UK and the EU.

Despite the EU's faults and challenges – not least the future of the Euro and coping with mass migration – it is easy to overlook the fact that, in all of its guises since the Treaty of Rome in 1957, the EU has been central to co-operation and peace between the nations of Europe, extending the principles of democracy and tolerance to its expanded ex-Soviet bloc members. That in itself is quite an achievement not to be dismissed – or risked - lightly.

How does all this relate to your portfolio?

Much has been written in the financial media about the need to position investor portfolios for a vote to leave (Brexit). Yet that presupposes that we, as your advisers (or any other investment professional for that matter) can, in some way, foresee what is going to occur and thus reposition your portfolio accordingly. It also presupposes that BREXIT is a bigger risk to your portfolio than, say Putin's increasing militarism, the enduring tragedy of events in the Middle East, North Korea's nuclear sabre rattling, Donald Trump becoming the next US president, or some other geo-political event or natural disaster that we cannot foresee.

When we established your portfolio, we did so knowing that any number of such events would be likely to occur with monotonous regularity over the time you will be invested. The aim therefore is not to try to reposition the portfolio for each such event – remember that the market's view of potential outcomes is already reflected to some extent in market prices – but to build a robust, well-diversified portfolio to weather all investment seasons, with an appropriate level of risk for you, and to stay the course.

That said, we believe that there are short-term market risks to a vote to leave the EU that are worth understanding, which we highlight below:

Risk 1: Greater volatility in the UK (and other) equity market

It is certainly possible that the UK equity market could suffer increased volatility – including a market fall - as the market tries to come to terms with what this means for the UK economy and the impact on the wider global economy.

Risk 2: A fall in Sterling against other currencies

Much has been made of a fall in Sterling against other global currencies, which has already been reflected to some degree in exchange rate movements since the start of 2016. For example, Sterling has fallen from 1.48 against the US dollar to 1.45 and from 1.36 to 1.27 against the Euro.

Risk 3: A rise in UK bond yields (and thus a fall in bond prices)

The Chancellor, amongst others, has stated that the cost of borrowing might rise as investors looking to hold bonds issued by the UK Government (and UK corporations), will demand higher yields on these bonds in compensation for the greater perceived risks of the uncertainty surrounding the decision to leave the EU.

Looked at in isolation, these may appear to be significant risks. Yet as part of a well-diversified and sensibly constructed portfolio, their impact can be greatly reduced.

Mitigant 1: Global diversification of equity exposure

It is worth remembering that the UK economy represents less than 5% of global GDP, and its equity market is around 6% of global market capitalisation. The stock market is also not a direct proxy for the UK economy as many of its constituents have considerable overseas operations, such as HSBC and Shell. In fact, around 70% of earnings from FTSE 100 companies come from overseas.

Your portfolio has well-diversified exposure to other developed equity markets (e.g. the US, Japan, Germany and Australia) and emerging markets economies and companies (e.g. Taiwan, China, India and South Korea), which will help to mitigate any UK-specific market fall. Equity markets as a whole might be volatile, but that is the nature of equity investing, and being diversified will help. Changing the mix between bonds and equities would be ill-advised. Provided you do not need the money today – which you do not - you should hold your nerve and stick with your strategy.

Mitigant 2: Owning non-Sterling assets and currencies in the growth assets

In the event that Sterling takes a beating, it is worth remembering that the overseas equities that you own come with the currency exposure linked to those assets. For example, owning US equities comes with US dollar exposure, as we do not hedge the exposure out. If the Pound falls e.g. against the US dollar, these US assets are now worth more in Sterling terms, thus mitigating the fall in Sterling to some extent. In short, a fall in Sterling has a positive effect on non-UK assets that are unhedged.

The bond element of your portfolio has no non-Sterling currency exposure to avoid mixing the higher volatility of currency movements with the lower volatility of short-dated bonds.

Mitigant 3: Owning short-dated, high quality and globally diversified bonds

The primary defensive assets in your portfolio are short-dated, high quality bonds, diversified on a global basis. Short-dated bonds are less volatile than longer-dated bonds and their prices will be less affected by any rise in yields. High quality bonds, tend to be where money flows to at times of equity market trauma, driving yields down and prices up, at least in the short term. Your bond holdings are also diversified across a number of different global bond markets, which mitigates the risk of a rise in UK yields (and thus falling prices), as the cost of borrowing in other markets will not be impacted in the same way.

Sticking to your strategy

At times like this, it is easy to become overly concerned about near-term events, such as the outcome of this referendum. Your life as an investor will inevitably be punctuated by an ongoing series of near-term events, making life continually uncomfortable, unless you view them in context. Below we reiterate a few thoughts that might be helpful. Remember:

- The value of your portfolio simply tells you how much money you would have if you liquidated your portfolio today, which you have no intention of doing. You only make actual losses if you sell assets. If you don't sell them, they remain in your portfolio to deliver future returns.
- Your portfolio has a well-thought-out structure – as we explored above – that has been designed to provide you with the best chance of a favourable long-term investment experience. Stick with it.
- Some assets will be doing well at times and others less so. No-one knows which asset(s) it will be at any point in time. Markets work well enough to make jumping from one asset class to another a dangerous gambling strategy.
- Your adviser cannot control what markets do, nor can fund managers. Markets will do what they do.

Whether your inclination is to remain or leave, try not to worry too much about the consequences on your portfolio as you are well-positioned to weather any storms. *'This too shall pass',* as the investment sage John Bogle has said many times before at other seemingly concerning times.

Do not forget to vote.

Other notes and risk warnings

This article is distributed for educational purposes and should not be considered investment advice or an offer of any product for sale. This article contains the opinions of the author but not necessarily the Firm and does not represent a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable, but is not guaranteed.

Past performance is not indicative of future results and no representation is made that the stated results will be replicated.

Errors and omissions excepted.

About us

Millen Capital Partners LLP is authorised and regulated in the United Kingdom by the Financial Conduct Authority (FCA) (FRN: 518934), is registered in England and Wales under Company No. (OC351596).

The registered office address of the Firm is: 10th Floor, Horton House, Exchange Flags, Liverpool, L2 3YL.

Contact us

Please contact us on +44(0) 151 236 4988 or via email:

Angus Millen, Chartered MCSI

Chartered Wealth Manager & Founding Partner

E: angus@millencapital.com

Gareth Lyttle, BA (Hons), Chartered FCSI

Chartered Wealth Manager

E: gareth@millencapital.com