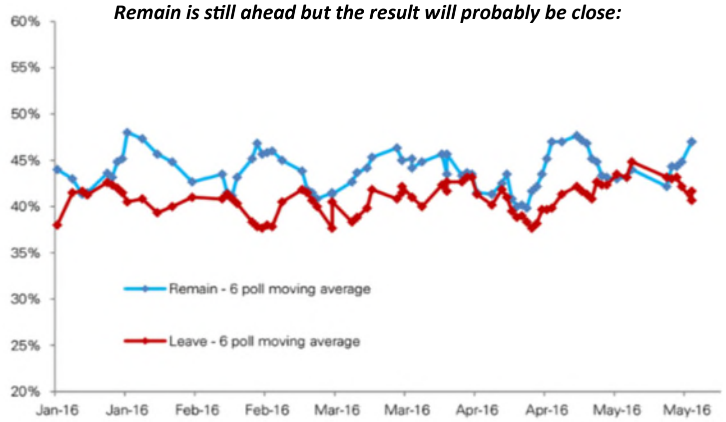
Over the past couple of months, we have seen the odds of a Brexit ebb and flow in sync with the latest sensationalist propaganda from either 'Leave' or 'Remain'. At one stage last week 'Leave' was 4/1 at the bookies; but can it really be so unlikely that the UK leaves the EU? We doubt it. Given the many conversations that we have had both in and outside of the office with clients, friends, strangers and family we believe that the vote may well be closer than these odds suggest. This is supported by the data emanating from the polls, for example the Guardian/ICM poll released on June 1st has voters split 52%-48% in favour of Brexit. However who really believes the polls these days?

Whatever the outcome on June 23rd and whatever your voting intentions on the day, it's the uncertainty surrounding both the result and also the longer term implications that have caused such volatility.

Shortly after David Cameron announced the date of the referendum we reviewed what we felt was at stake from an economic perspective and no clear arguments have been put forward by either side to lead us to revise our conclusions. However, this month we assess how differing asset classes have fared since the referendum announcement and in the run up to the vote. We also consider whether or not any conclusions can be drawn from how various asset classes have performed in the run up to the vote and therefore whether it is possible to anticipate the behaviour of these asset classes after June 23rd.

Remain is still ahead but the result will probably be close:



Source: YouGov, Ipsos Mori, ICM, ORB, TNS, Opinium, Survation, ComRes, BMG Research, Populus

Heading for the hills?

The Investment Association data to the end of April shows that over the past three months, investors have looked to significantly reduce their exposure to the UK equity market and in particular to those companies that are more orientated towards growth rather than dividends. Indeed, in April alone £669 million was withdrawn from funds within the UK All Companies sector (funds categorised in this sector invest at least 80% of their assets in UK equities which have a primary objective of achieving capital growth).

Sentiment towards funds invested in companies on the continent was not much better, with a further £442 million withdrawn from European (ex-UK) funds. In fact, total equity fund outflows over the past 3 months have reached their highest point since 2012, with net outflows of over £1 billion this year.

Whilst net equity flows have been sharply negative in 2016, there have actually been steady in-flows into 'UK Equity Income' and 'Global Equity' funds. The predominance of this is seemingly money switched from selling down UK Growth and European exposure as retail and institutional investors have sought to 'de-risk'. Another major beneficiary of this 'risk rotation' is the catchily titled 'Targeted Absolute Return' fund sector. This is a rag tag bunch of funds covering a myriad of different strategies that the IMA classifies as aiming to deliver "positive returns in any market conditions" (yes please!); however, the IMA is keen to quickly caveat this with "but returns are not guaranteed". Investors seem to like them and over 25% of net sales have been switched into Targeted Absolute Return funds since Jan 2016. We feel that many of these funds should be considered as hedge funds and treated with caution befitting the hedge fund sector. However, there is no doubt that some of these funds can add value and help to diversify risk, reflecting our move to increase exposure to the sector in mid-2015.

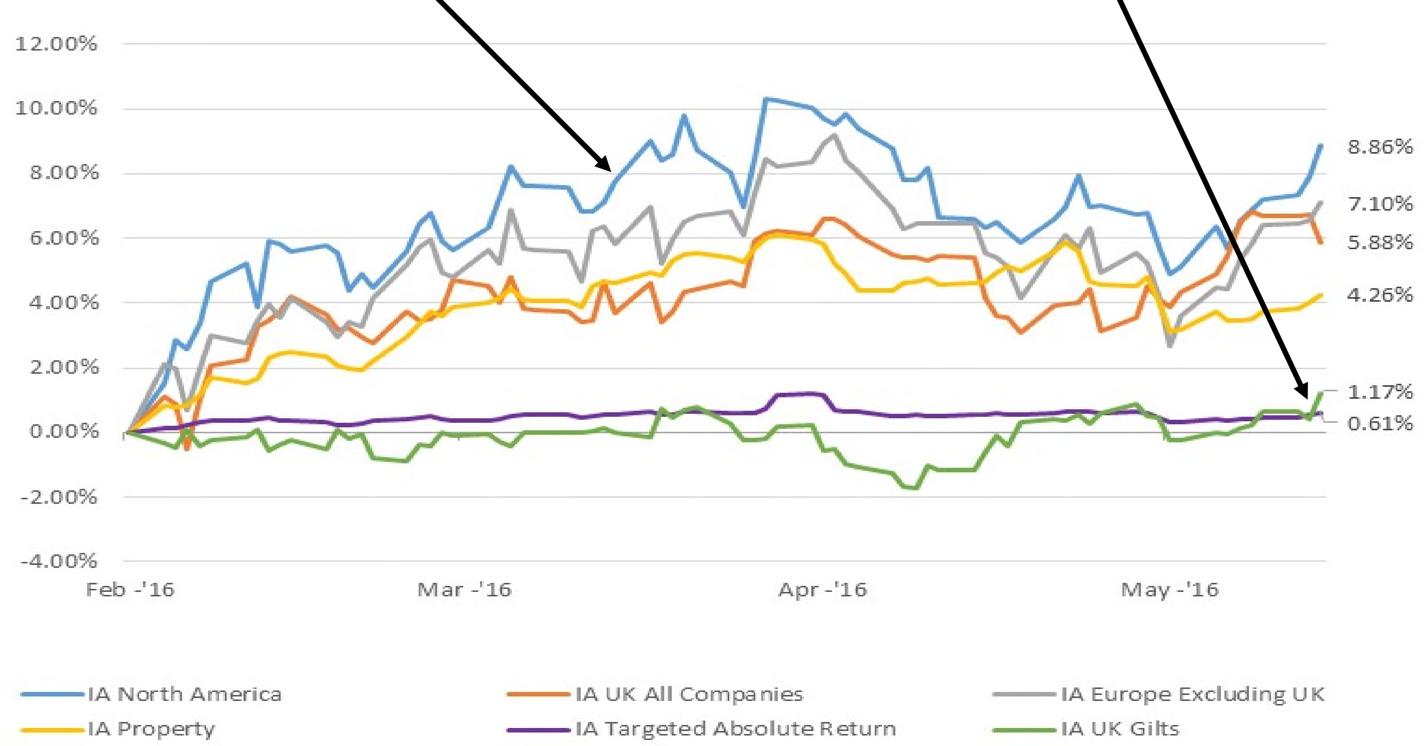
Apr-16	Total
IA Sector	**Net retail sales - £m**
Targeted Absolute Return	742
Global	439
UK Equity Income	342
£ Corporate Bond	205
Property	-137
Japan	-436
Europe Excluding UK	-442
UK All Companies	-669

Has it been right to back the favourite?

So the general trend in-terms of fund flows has been out of higher risk equity into defensive equity in the run up to Brexit; however, the referendum can't take all the blame for volatile markets. China, weak corporate earnings and uncertainty surrounding rate rises in the US have all contributed to choppy market conditions. That said, most of the attention is focused on the Brexit issue and the knock-on effect that a close vote or a vote to leave may have in the short-term on global 'risk' assets. History has proven that investment markets don't like uncertainty and with such a binary outcome the referendum is almost certainly the driving force behind the significant outflows from the UK and European markets.

Surprisingly perhaps (and partly as a result of the significant sell-off that global equity markets had already endured in January and February), since Cameron's speech on 20th February announcing the date of the referendum, equity markets (as shown in the graph overleaf) have both appreciated and significantly outperformed the UK Gilt and Targeted Absolute Return Sectors.

Equity markets, from the FTSE 100 to the S&P 500 have all outperformed Gilts and 'Targeted Absolute Return' funds since the announcement of a Brexit vote, yet most of the 'hot' money has still flooded to the Targeted Absolute Return sector:



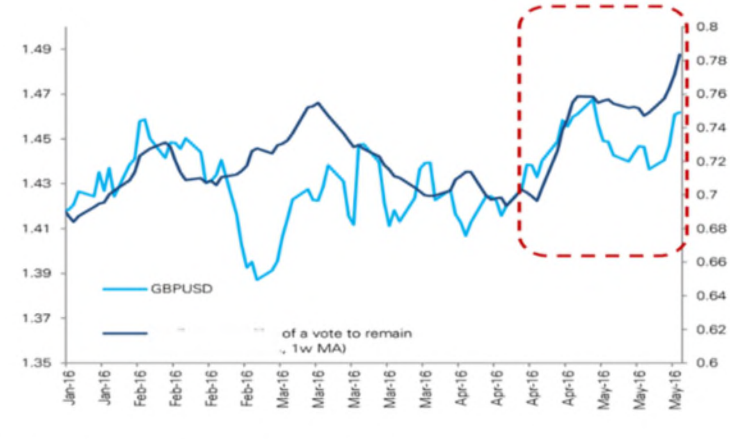
There is also a widely held view that the threat of Brexit would most severely impact upon those companies that are more domestically focused, in the main constituents of either the FTSE250 or FTSE Small-cap indices. This is because the impact of a deterioration in UK growth prospects resulting from a Brexit 'shock' could lower their earnings growth to a greater degree than the FTSE100 constituents, which derive circa 75% of their earnings from overseas and may actually benefit from the potential weakness in sterling. However once again contrary to general perception the mid and smaller market capitalisation indices have not only kept up with the FTSE 100 but marginally outperformed their larger brethren.

Equities have held up well but it's not been so great for Sterling...

Domestic UK and other global equity markets have weathered the storm of impending Brexit but the same cannot be said of the value of GBP relative to both the Euro and the US dollar. Indeed, the value of sterling has closely tracked the probability of a vote to remain as measured by the bookmakers odds. When polls have favoured remain then sterling has moved higher and vice versa.

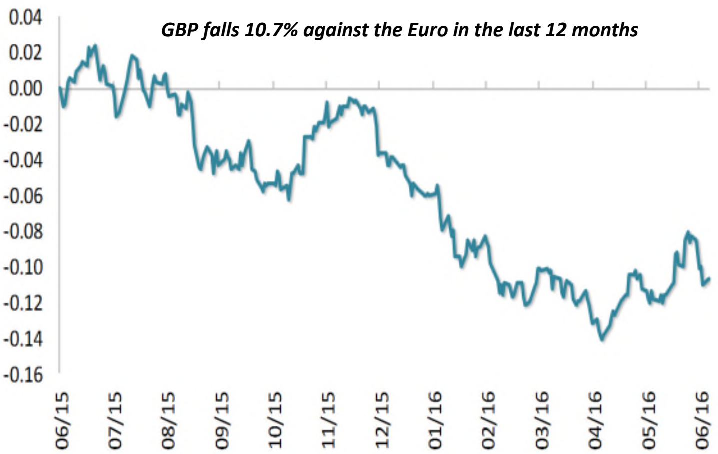
Sterling started to weaken in earnest at the time that David Cameron set out his EU reform goals and it then suffered again when Boris Johnson joined the Vote Leave campaign. As blunders and sensationalism abound on both sides so Sterling has danced to the Brexit tune. From peak to trough Sterling has weakened by around 10%; however recently as the bookies' odds of Brexit have lengthened so we have seen Sterling gain more than 5% as a result. We expect more volatility from the pound in the run up to the vote and for it to be far more sensitive to the result either way than any of the world's equity markets.

GBP/USD has tracked the possible Brexit vote outcome:



Source: Deutsche Bank, Bloomberg Finance LP, Oddschecker.com

GBP has struggled against the Euro, falling as low as £1/€1.238 in the early part of April before rebounding to around £1/€1.285, as per the chart below:



What about other sectors?

The UK commercial property sector has also suffered, most notably housebuilders and also the property investment fund sector. Four of the leading property fund managers are so concerned by the potential run on property in the event of Brexit that they have recently moved their pricing from an offer to mid or bid price to try to restrict outflows and to protect longer term investors. This has led to an immediate fall in the unit prices of the funds by about 5% and whilst there may be a commensurate uplift in the event of a remain vote the uncertainty created is unlikely to improve sentiment towards the sector in the near term. If we do see a vote to Leave, we will want to take action for clients to sell any property funds that will come under pressure as a result.

Can we expect anything different in the run up to or post the vote?

In the run up to the vote we anticipate that it will continue to be Sterling that most closely reflects the oscillations in the opinion polls and bookmakers' odds.

If the vote to remain is as convincing as the current odds suggest then it is likely that Sterling will strengthen significantly, potentially testing the highs of last year against the US dollar ($1.58). We would also anticipate some strength against the Euro but given that there is likely to be an element of relief that the EU project as a whole is unlikely to unravel anytime soon, the moves against Euro could be less aggressive.

In contrast if we vote for Brexit, it is likely that the US Dollar will strengthen significantly against both GBP and Euro.

Equity markets have in general been largely unaffected by the call for a referendum. If we see a convincing vote to remain then there may be a relief rally, in particular within the banking and property sectors, but we do not believe that it will necessarily be sensible to increase equity immediately, particularly given that markets have been fairly stable so far.

Consider that almost as soon as we are through the referendum vote the political focus will shift across the pond with Trump and Clinton going head to head in November to become the most unpopular President in US history. Here the outcome is also far from certain, although we believe that the result could have less impact on the markets than the result on June 23rd. Either way a shift of focus away from our own blundering politicians onto those in the US may do us here in the UK a world of good.

Finally we will leave you with the ironic (and improbable) thought of England lifting the Euro 2016 trophy on July 10th as 'Champions of Europe'.

We can't help but wonder whether or not David Cameron will still be our Prime Minister and if he is, whether or not he would be in France to cheer England to victory. History teaches us that it's probably not something that we really need to worry about.