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Matthews Asia

Matthews Asia Perspective: Brexit

The recent announcement affirming the U.K.'s vote to exit the European Union has many ramifications—many of which affect millions of people in a negative way. Some refer to Friday's announcement as a Black Swan event. Regardless of how the event is characterized , the fact is that the exact implications are largely unknown, the potential for a domino effect is real, governments and companies will need to re-think strategy and individuals will be impacted. Hopefully we will have more clarity in the days ahead, but it is always difficult to predict macro influences or investor sentiment. What is more apparent to us is that good businesses exist regardless of macro movements.

Reactions since Announcement:

The FTSE 100, a cap-weighted index traded on the London Stock Exchange, has suffered significantly—down 15.79% in USD terms in two trading days since the announcement.

Initially, Japan certainly was Asia's worst performing stock market with the Nikkei down the day after the announcement, almost 8% in local terms and 4.8% in USD terms. Japan was affected by worries that a stronger yen would negatively impact future earnings, especially for global exporters. The Japanese yen hit 100 vs. the U.S. dollar early in the trading session which sparked a stronger-than-anticipated equity reaction. The Nikkei recovered slightly overnight bringing its two day loss in USD terms to -2.10%.

The worst performing equity sectors within Asia ex Japan were energy, industrials and materials while the best performing sectors were consumer staples, health care and utilities. Asian currencies generally outperformed the Euro and GBP with export/commodity related currencies performing worst (Korean won, Australian dollar, and Malaysian ringgit). Interestingly, local Chinese shares, represented by the Shanghai Composite performed relatively well, down less than 1% in USD terms since the Brexit announcement.

Matthews Asia Investment Team Thoughts:

A combination of an unexpected result not priced into markets and a likely prolonged period of uncertainty were the main negative drivers of markets across all asset classes. Risk-off sentiment could continue in the short term and because Brexit negotiations are expected to extend for many months, a period of ongoing uncertainty will keep markets unsettled for quite some time. That said, we also expect that global central bank coordination is ready to add stimulus as needed which should add liquidity—potentially mitigating market volatility.

In an already slow growth environment, added uncertainty will not help Europe's fragile recovery. Prolonged uncertainty will cause a slow-down in investment, capex and European growth which in turn will increase the length of the current credit cycle, spur further central bank stimulus and liquidity, and ultimately drag out the "low growth for longer" thesis. In this scenario, we envision that cyclical sectors—especially those exposed to the EU—are most at risk. Winners could include defensive sectors and those that focus on domestic demand. Within Asia, we see both potential winners and losers if the turmoil in Europe continues to unfold.

Portfolio Implications:

We believe successful investing in Asia includes an increased focus on domestic demand and regional growth—finding businesses that are less dependent on global growth and more dependent on regional growth of middle class consumers. And although growth may be increasingly difficult to find in Europe, our conviction for the long-term growth of Asia remains intact. We believe the ability to capture that growth—through domestic demand oriented businesses, attempting to mitigate macro influences wherever possible—have never been more important. While we don't yet know what the long-term ramifications are for Europe and the U.K., we can be a little more certain about the future for Asia's economy and its growing contribution to global growth.

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