First views from our institutional fund managers

24 June 2016

Today, the United Kingdom has voted to leave the European Union. M&G's institutional fund managers share their thoughts on the impact of the referendum outcome on their markets.

Institutional public debt

David Lloyd, Head of Institutional Fund Management

Financial markets were expecting a victory for Remain in yesterday's referendum, so the Leave vote has prompted significant moves in equity, bond and currency markets. Sterling has fallen some 6% on a trade weighted basis, equities are sharply lower and yields on safe haven government bonds have fallen to new lows.

It is noteworthy, however, that in all these markets there have been a significant retracement of the initial aggressive moves. It is equally noteworthy that market reaction to the result is not confined to the UK and Europe – there have been large market moves globally.

It will take some time for the initial dust to settle, but we will surely be left in an environment of increased uncertainty. The economic impact on the UK and on economies further afield will take time to become clear. Moreover, the uncertainty is political as well as economic; the negotiations to determine the terms of the UK's departure will take place under a new Prime Minister following David Cameron's announcement this morning.

Uncertainty is unlikely to be confined to the UK; already there are indications that euro-sceptic parties across Europe feel emboldened by today's result.

It seems probable, then, that we will continue to witness episodes of market volatility as the processes set in train by today's result unfold. As has been the case on a number of occasions in recent years (the global financial crisis, the euro sovereign debt crisis) these episodes provide numerous opportunities that disciplined value investors like M&G can exploit to the benefit of our clients.

Multi-asset and equities

Steven Andrew, Fund Manager

There have been significant movements across global financial markets overnight and this morning – some of these moves seem rational, but others may be an over-reaction.

Confirmation of the referendum result removes some uncertainty and creates some other uncertainties. There is always uncertainty but markets tend to react most when we can put a name to it. We have to admit that at this stage, there is a lot that we do not know, so let's focus on what we do know – how asset prices are moving and how that relates to a broad range of factors likely to influence the global economic outlook over meaningful time horizons.

As global investors, we have to step back from the enormous media attention on this topic here in the UK and Europe and ask whether our perspective has changed on the global outlook.

So far, from that perspective, we can say that the “story” – in terms of a narrative of broad political disaffection across many regions, not just the UK – has moved along a bit. Other than that, there is very little we can know. Nobody likes political uncertainty, but there is little sign that this represents a change in regime in that this is not about changing to anti-capital models. Therefore, we should question it when we see markets behaving as if that is what’s going on.

European stockmarkets have seen double-digit declines this morning. This is unsurprising given that the DAX fell 7% at one point in the run-up to the referendum, so we would not be surprised to see bigger moves than that now that the “Leave” result is confirmed. However, declines of that magnitude may represent an opportunity. In European bonds, spreads on core bonds are narrowing and peripheral bonds widening – indicating risk-off and potentially panicked sentiment.

We are watching carefully for buying opportunities in areas which are selling off too aggressively, away from the ‘epicentre’ of events, if we believe markets are over-extending this news as a “negative” for everything globally. On the other hand, we would be likely to reduce any holdings in things which are rallying to unjustifiable levels, such as ‘safe-haven’ bonds.

In summary, while this is a significant development, we must be careful of drawing a straight line between this one event and saying that the world has changed in a singularly negative way. There will be many pushes and pulls for the global economy over the next few years. We have to make sure we are always weighing up all of these things and being mindful of the different risks and opportunities they present in terms of how they affect asset prices.

European leveraged loans

Fiona Hagdrup, Deputy Fund Manager

European loans are relatively calm compared to other markets – generically, loans are 1% - 3% lower for larger issuers that also have bonds, but the bulk of the market is far less affected (0.5% - 1%). If anything, the discernible market bias is towards buying. We shall await developments; buying opportunities may ensue.

We expect a number of factors to support the stability of the European loan market. The investor base is characterised by long-term investors – there are no ETFs and hardly any retail investor presence – of which a substantial portion are ‘locked-in’. There will likely be a hiatus in new CLO issuance in Europe from here, but extant structured funds have cash and are buyers.

There is little refinancing pressure on issuers in the European loan market, so there should be no liquidity pressure on our companies even if markets prove extremely volatile for an extended period. Finally, it is our contention that the credit fundamentals of both the UK and European secured loan issuers we hold are solid.

Asset-backed securities

James King, Fund Manager

Clearly markets were very surprised by the UK referendum result. ABS, along with all risk markets, has opened lower as anticipated, but in reality we expect very little trading over the next few days. Markets will likely be very choppy for the next several weeks, and obviously we are entering into a possibly lengthy risk-off phase.

Given the technical factors that have been at play in keeping ABS an area of very strong relative value for many years still hold, we expect ABS may perform better than broader markets, but widening bid / offer spreads (which have doubled since yesterday) will have an inevitable impact.

Clearly the implications run beyond the UK. It is interesting to see that Portuguese bonds have sold off significantly more than the UK at this stage.

We would expect a period of economic weakness, with a technical recession a clear possibility, and probably likely in the UK. However, it is important to emphasise that European ABS has a very low historical default rate (0% in 2015 for instance) and we believe its secured nature means it is a defensive alternative to other areas of European fixed income.

In our view there was a certain amount of Brexit risk priced into UK RMBS already while the wider ABS market had not rallied as much as corporate credit for instance since the latest ECB interventions in early Q2 2016.

Given the risk-off sentiment, our base case at this point is that in the absence of external support the ABS market will see weakness (along with all markets), but relatively it should be one of the better areas of credit to be invested in.

We also anticipate further macro intervention from the Bank of England, European Central Bank and other agents in the days and weeks ahead.

About the authors

David Lloyd
Head of Institutional Fund Management

David joined M&G Investments in 2006 as Head of Institutional Portfolio Management in the fixed income team.

Prior to joining M&G, David worked for Merrill Lynch Investment Managers (MLIM) as head of their Global Bond Team. He was responsible for all global portfolios managed in London, and managed funds for MLIM's most prestigious institutional global bond clients. Previously, David worked for AMP Asset Management / Henderson Global Investors, Crown Agents Asset Management, and Eagle Star Insurance Ltd.

David graduated from the Open University Business School with an MBA.

Steven Andrew
Fund Manager

Steven Andrew joined M&G in 2005 as a member of the portfolio strategy & risk team, before moving to the Multi Asset team, where he helped to formulate asset allocation strategies for M&G's multi-asset fund range.

In November 2010, Steven was appointed manager of the M&G Episode Income Fund. Three years later, he became manager of the M&G Income Allocation Fund upon its launch. Steven began his career at the Bank of England in 1987 and subsequently worked at F&C Asset Management and Merrill Lynch before joining M&G.

He holds a BSc (Hons) degree in financial economics from the University of London.

Fiona Hagdrup
Deputy Fund Manager

Fiona joined M&G Investments as a Director in August 2003. She is a portfolio manager for some separate market value accounts and the M&G European Loan Fund as well as being responsible for the structured vehicles investing in loans.

Prior to joining M&G, Fiona was a corporate Debt Capital Markets origination executive at BNP Paribas, responsible for the Nordic region. Before that, Fiona worked for 9 years at SEB, a Nordic financial institution, involved in both loan and fixed income origination.

Fiona is a Chartered Accountant, having qualified with Ernst & Young and has a MA in history from Cambridge University.

She is M&G's representative on the Board of the Loan Market Association, the industry trade body.

James King
Fund Manager

James joined M&G Investments in 2003 as a fund manager within the Alternative Credit group and is responsible for the ongoing development of our ABS business.

Prior to M&G, James worked for Citigroup, initially in the corporate bank and, latterly, in the alternative investments group as portfolio manager and credit analyst focusing on asset backed securities and industrials.

James graduated from Durham University with a degree in Business Economics.

For more information contact:

Fixed Income

Andrew Swan	+44 (0)20 7548 2375	andrew.swan@mandg.co.uk
John Atkin	+44 (0)20 7548 3466	john.atkin@mandg.co.uk
Henry Barstow	+44 (0)20 7548 3469	henry.barstow@mandg.co.uk
Sunita Dey	+44 (0)20 7548 3393	sunita.dey@mandg.co.uk

Multi Asset and Equities

Nick Robert-Nicoud	+44 (0)20 7548 3252	nick.robert-nicoud@mandg.co.uk

www.mandg.co.uk/institutions **institutional.clients@mandg.co.uk**