



RBC Capital Markets Brexit Publications

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STRATEGY

Will Brexit send waves across the Atlantic?: Uncertainty about Single Market access is expected to result in a slowdown in the UK economy, sterling depreciation, and monetary policy stimulus from the Bank of England. The UK is one of Canada's top trading and investment partners, however the small relative size of these relationships points to a muted direct effect on Canada's economy. Knock on effects could weaken the euro area and remaining EU economies with which Canada also has important trade and investment relationships. A return to risk aversion in financial markets is expected to put downward pressure on oil prices, government bond yields, and the Canadian dollar (relative to USD). In a more severe reaction, upward pressure on peripheral spreads in the euro area risks replaying the volatility seen during the European debt crisis.

Commodity Strategy: Post-Brexit – Keep Calm and Carry On: RBC CM believes that the selloff will be limited in duration and that the floor remains quite firm with US production down significantly, unplanned outages on the rise (as fragile sovereign producers reach their breaking points), and the demand picture will remain constructive. Fears about a strong dollar weighing on crude prices could reach a fever pitch in the coming days, but ultimately RBC CM believes that supply and demand fundamentals will still drive the oil bus. On the other hand, RBC CM believes that there remains limited price upside for gold from current levels after today's safe-haven driven jump higher. Once the Brexit headlines and media commentary has been fully digested, gold will have to contend with a strong dollar and will likely refocus on global monetary policy (namely the Fed) for the remainder of 2016.

Unhappy but Not Unruly: RBC CM believes it is critical to have a dispassionate framework for contextualizing the fallout from this macro shock. Several months ago, RBC CM introduced a series of risk dashboards specifically for this purpose. A review of the data indicates that markets might be unhappy but are not unruly. While U.S. Treasury yields are down (along with global bank stocks) the impact on U.S. equities at this point appears to be contained with the S&P 500 down 2.9% today (just 1.6% over the past 2 days). Volatility has risen on this event. Similarly, credit spreads are modestly wider but well below stressed levels, such as around the U.S. debt downgrade. Bank CDS and implied volatility for non-U.K. asset classes appear within normal ranges. Only the British Pound and select U.K. / European Banks are showing signs of stress.

Friday FX Focus – Britain votes out: GBP/USD has traded down to levels not seen since 1985 (1.3228 the low so far). While there are some looking for it to bottom here, GBP/USD could sink twice as much if this morphs into a full balance of payments crisis. Most investors were following bookies' odds, which had been consistently calling for a Remain vote until halfway through last night. Markets were entirely unpriced for this outcome.

CANADA:

Canadian Credit Insights: CAD credit – Brexit exposure: RBC CM recommends investors focus on Lifecos, to a much lesser extent banks, and select issuers in other sectors with more meaningful exposure to Europe. Many sectors in the Canadian bond market are largely domestic businesses, and as such have no or negligible exposure from a business and/or currency perspective to the UK or Europe. Canadian credit spreads are generically 5-7bps wider this morning in the mid-term and out the curve. Issuers with higher exposure have seen credit spreads widen more than average.

The U.K. opts for Brexit – What’s the near-term impact on the TSX and its major sectors and sub-sectors:

While RBC CM doesn't think there are many recent historic parallels that fit the events of last night, RBC CM believes that the U.S. debt downgrade by S&P in 2011 might offer some guidance as to the impact on stocks. RBC CM believes that although direct exposure to the U.K. and Europe is not significant for the Canadian banks and Lifecos, the potential sharp decline in global bond yields and fears over financial contagion are likely to weigh on shares. Energy and Materials stocks (ex-gold) are likely to get hit hard as most commodities react negatively to U.S. dollar strength and concerns over global growth. Add to this the high beta nature of many of the names and RBC CM would not be surprised to see significant near-term weakness. Defensive sectors such as Utilities, Telecom, REITs and Consumer Staples could see positive fund flows as investors look for places to hide. Gold and gold stocks should also be beneficiaries as concerns over Brexit-contagion take hold.

U.S.

IT Hardware & Semis: 3 Names to Buy Given Brexit Fallout (APH, AVGO, CDW): RBC CM highlights three stocks within its coverage that it would recommend buying given the expected pullback today: APH, AVGO, and CDW. Fundamentally all three companies are positioned to control their own destiny and historically all have been able to navigate macro and micro issues successfully.

Networking and Semi-Cap Equipment: Where to Look Post Brexit – Thinking Through Brexit: With the UK voting to leave the European Union, RBC CM thinks the three companies to own (Networking and Semi-Cap) given the increase in volatility are Cisco, Cadence Design, and Synopsys. While equity markets will likely be notably down today, RBC CM thinks investors will shift to "risk-off" mode, thereby benefiting companies with less volatility (lower beta and higher visibility).

Biotech: Brexit/EU uncertainty; noting the sales/currency “exposure” – AMGN, BIIB, CELG, GILD, VRTX: As equity markets are expected to engage in a swift "risk-off" environment based on EU economic uncertainty, RBC CM believes it would be helpful to at least understand what if any theoretical (or real) risk there is to estimates and outlook based on the amount of EU exposure the large cap biotechnology companies have and exposure to the UK Pound and Euro currency. However, RBC CM expects biotechs to be generally somewhat insulated from EU economic uncertainty and do not believe there should be any material risk or shift in our investment thesis in large cap biotech.

Market Update Post Brexit – Holding key levels – Long-term Cycle Intact – Post Brexit equity markets support-resistance cheat table: Major European and US equity markets have sold-off, but held important technical levels AND have subsequently rebounded relatively strongly from key technical levels. RBC CM had noted that Brexit/Bremain were unforecastable events, but the overall technical backdrop for equities remains positive from its perspective.

Homebuilders & Building Products – Assessing Exposure to Brexit and Domestic Opportunities: The UK's decision to exit the European Union increases near-term uncertainty that could affect U.S. based companies that have significant European exposure. These political developments also makes domestic plays like homebuilders, branded consumer products distributors, aggregates, and commercial construction companies comparatively more appealing.

IT Hardware/Networking & Semis: Implications from Brexit/FX + IT Pushouts?: RBC CM thinks it is prudent to assess the potential future period currency impact for its coverage universe. Its analysis is based on current spot rates which imply a -9% decline in the British Pound's and a -3% decline in the euro vs. the USD. Its initial take is that today's decision will likely create material currency headwinds for its coverage companies with significant UK/Europe exposure. RBC CM notes that the ancillary impact from the U.K. exit will likely create further fundamental revenue headwinds for its coverage. With that said, within our coverage, RBC CM sees today's market weakness as a buying opportunity for APH, AVGO, and CDW. For the purposes of this analysis, RBC CM will assume most companies receive ~17.5% of their Europe/EMEA revenue in British Pounds and the balance in euros as most companies do not disclose a breakdown between GBP and EUR revenues (17.5% is the GDP % of UK vs. total EU).

EUROPE

Brexit – the early reaction for Euro Utilities: There are many stocks that are single currency, or largely single currency; these should be unaffected by currency movements (other than the interplay of currency into underlying commodities). The others all have material business interests outside their country of listing, but it is those with £ exposure that matter. From an interest rate perspective/flight to quality, the regulateds should do well, a positive for NG, and the UK waters which should outperform the UK benchmark. The European regulateds also have their merits, but these being in Spain/Italy, there could be concern about periphery risk. As for power prices, the impact on the continent is from \$/€, so the moves may not be too marked.

RBC European Rates & Economics Daily: Despite the official result not having been announced yet, it seems likely at the time of writing that the EU referendum will lead to a 'leave' vote. Markets across the globe reacted viciously and all risky assets sold off hard. In terms of the process for leaving the EU one of the immediate questions will be about the point at which formal notice is given to the EU under Article 50 of the Lisbon Treaty. David Cameron has indicated he would choose to serve notice straight away and start the up to 2- year process. By contrast Vote Leave campaigners have favoured an initial period of negotiation with the EU before triggering Article 50. It is not clear at this stage which outcome will prevail on that issue.