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ZINNECKER MONTHLY 07 - 08 / 2016

Review

The Brexit vote came as a shock to all European political institutions, the media, industrial companies and to the whole financial community. The Western equity markets have sold off immediately after the unexpected results. While the moves were abrupt and crash like it should be noted, however, that the Asian stock markets were hardly affected; the UK has nearly reversed its sell off and the US S&P 500 index has lost only 2% from its April highs. Only European equity markets have sold off by 7 to 9% as the pretended long term losers of the potential breakup of the EU. In addition the Pound Sterling went to its lowest level against the US$ in 30 years, while the Euro with a slight bias to the downside stayed range bound. And only the Yen has further revalued. The FED has put rate increases on hold and therefore long term Bunds and US Treasuries have risen by up to 3% as safe haven investments. Gold and gold mines have also performed well in times of uncertainty.
Allover price volatility has increased but looking at recent fundamental data, it looks like global growth has bottomed and is even accelerating in the US from the 1st quarter low led by durable goods orders, manufacturing, consumer confidence and credit growth.

Outlook

While Brexit is without doubt negative for global and European growth the impact should not be overestimated. Above all, the UK has created a dramatic domestic political crisis not experienced in generations, which definitely will last for months if not for years. It should immediately create a domestic recession. The ordinary people who voted out will very quickly realize that they have been fooled and betrayed by the “leave” leadership, which belongs to the upper class of the Eaton and Oxford educated establishment. The result of the referendum has depicted that it is all about a large generation conflict. The old generation still holds on to traditional British values and is not ready for change, while the young and better educated generation stands for globalization and for Europe. 75% of the under 25 voted in and 70% of the over 60 voted out. The traditional Labor north voted out while the Tory south voted in. It will be a difficult task and therefore will take time to form a moderate liberal group to establish itself and then possibly form a party that can rule the country. How could a potential Brexiteer prime minister run this country against the UK parliament with 80% of the members being pro Europe and with major protests on the streets looming? Therefore new elections, a possible Scottish and Northern Irish vote about their membership in the UK could happen even before the new prime minister could trigger article 50. He might not do that at all, as he or she will be unlikely to have a majority for that.
As the shock is deep and another crisis is definitely not bearable, this UK created chaos should be the last wakeup call for the EU establishment in Berlin, Paris and Brussels and should therefore have a profound and positive impact on the future of the EU. Its leaders will now be forced more so than ever before to finally implement

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the so long awaited country and EU wide reforms and economic programs. With elections in France and Germany looming the pressure will increase, because the citizens are desperate to see politicians move and they are waiting for change. Otherwise the right wing movements will even get stronger.
Possibly due to Brexit, Spain in its latest elections has strengthened the democratic middle, however, not quite enough to create an outright majority. An European infrastructure program might help here as well, in order to stabilize the democratic process.
In the weeks ahead the US presidential election will enter its final phase with the nomination of the candidates and more importantly with the presentation of their programs. Entertainment will be guaranteed and the capital markets could be volatile up to the Election Day in November.
The emerging economies especially Russia and Brazil seem to slowly improve, not only because of stabilizing commodity and oil prices. Japan still is searching for ways to generate growth and inflation and to stabilize the Yen.

Capital market outlook

Although Brexit has destroyed the short term positive outlook of the equity markets, the US is still in positive territory, while Japan and all European markets are all down for the year. Valuations are more attractive now, especially in relation to bonds. Once markets come to grip with the implications of Brexit the fundamentals will kick in again. The global economic climate should further improve not only due to improving commodity prices and following also corporate earnings. Central banks will stay accommodative for the rest of the year and eventual reforms and additional economic programs should be positive for equity prices. All in, however, investors will be faced with political and volatile markets from now on.
The positive trends in technology, health care and consumer goods should continue and other major themes like infrastructure are still on the table. Gold after its recent consolidation should still be part of a diversified portfolio. Once the recovery gains momentum mining and energy could be huge beneficiaries. A cash position of 10% during these volatile times seems to be appropriate.

On a long term basis we remain bullish on equities, maintaining a maximum overweight allocation. As the global market response to Brexit has been consistent with other crisis events we are watching for a bottoming process and a renewed rally afterwards. This positive outlook is supported by accommodative global monetary policies, a positive supply/demand balance, excessive pessimism, and secular bull tailwinds. US Equities on average have produced double-digit returns per annum since the new secular bull market has started in 2009 and will further lead the other markets as in the past. A key cyclical risk, however, is today's high ceiling of US earnings' multiples, but as global valuations have become more reasonable the likely earnings' growth recovery in 2016 and 2017 will help to overcome this hurdle.

The next report will appear at the beginning of September. Have a wonderful holiday season.

30.06.2016

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