Macro-Strategy Key Issue

It's 'Leave' - Implications for UK, Europe & markets

Economics

Europe including UK

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UK votes to leave the European Union

For the UK we believe this means sharply lower growth, a large drop in the pound and further easing from the Bank of England. For the Fed the increased global risks means we remove our call for a September rate hike. For equities we see relatively big downside potential for the market, with UK mid-caps falling further.

For the UK economy this is a significant negative uncertainty shock

For the UK the immediate consequence is a significant rise in economic uncertainty, especially as the future of trading relationships between the UK & the EU is expected to remain unclear for some time. As a result we expect a further deceleration in growth, to around zero for a number of quarters. For the Bank of England we think the sharp loss of momentum will trump short-term inflationary impacts from any potential decline in sterling. We expect the MPC will cut policy rates to zero and make further asset purchases, in the first instance of GBP 50-75bn, not later than February 2017.

UK rates and sterling

Anticipation of further QE, intense domestic safe haven demand, & lower nominal growth expectations are likely to compress Gilt yields, more than offsetting any upward pressure on yields from possible negative ratings action, higher Government borrowing, & a drop in overseas' investor demand. Sterling has already fallen in response to the Leave vote, we have estimated previously that in the near-term it could trade to the 0.84-0.89 range. From a longer term perspective, we think sterling could head towards parity against the Euro and 1.20 against the US dollar.

Impact on the EU: quality of negotiations crucial; somewhat more dovish ECB

We think the impact on the EU will depend on whether negotiations will be amicable or confrontational, and whether, over time, the EU moves towards closer integration or disintegration. We consider it important that EU leaders present a Plan B quickly, perhaps at the EU summit on 28/29 June. These uncertainties imply a somewhat more dovish ECB: we believe the Bank will stand ready to inject extra-liquidity in the coming weeks. And if it becomes clear that Brexit slows down the Eurozone recovery, it might skew the ECB towards an extension in asset purchases beyond March 2017.

European Rates and broader FX

We expect wider peripheral spreads, particularly in Ireland and Spain. In the short-term, we expect 10yr Italy-Germany spreads to widen to around 185bp, Spain-Germany to 195bp and Ireland-Germany to above 110bp. 10yr German yields are likely to fall to around -0.15%. We expect European credit spreads to gap wider with the move focussed in financials, real estate and retailers. Amidst the risk-off move we expect EURCHF to move lower, which may require the SNB to ease policy if substantial intervention is required by the SNB to keep EURCHF above 1.05-07.

We remove our September Fed hike call

Market volatility means we no longer think the FOMC will raise rates at the September meeting; we maintain our call for a December hike.

Equities

The vote should support more buying of Quality, Growth & Defensives across Europe. But choose carefully; most, except Switzerland, look more expensive today than at the peak of the euro crisis in July 2012. For the UK, we see the FTSE100 falling to c. 5,500; the PE de-rating to 12x, but the fall being mitigated by an FX boost to earnings. We prefer large over mid-caps. FTSE100 is nearly 40% cheaper than the FTSE250 (biggest gap for a decade) and three-quarters of its sales are international (ex-UK).

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Figure 1: Key expected LEAVE developments in months to come

	Development	Indicative timing
Economics	Sharply slower UK growth	2016 H2 onwards
	Bank of England cuts policy rate by 50bps (likely August/November)	August and November
	Bank of England re-starts 'QE'	Not later than February 2017
	Federal Reserve does not hike rates in September, as previously forecast	
	Downside risks for the Eurozone. ECB ready to react, with liquidity and longer QE	
Currency	EURGBP trades 0.84-0.89	Near-term
	EURGBP moves towards parity, should market force narrowing of UK current account	Following quarters
Rates	Long term Gilt yields lower on QE and slower nominal growth, by up to 50bps	End 2016
	Front end fully prices in cut in Bank Rate to 0.25%, high probability of cut to 0.0%	Within a month
	Tighter yield spreads between 10yr US-Germany, and 30yr UK–Germany.	end 2016
	Peripheral spreads to widen at first but tightening could follow if signs of further integration among remaining countries emerges	end 2016
Credit	Issuance to remain muted, especially in HY and GBP, flight to quality for IG Credit, favour CSPP eligible bonds	2016 H2 onwards
Equities	UK market de-rates but within it prefer large caps. Wider Europe: quality defensives and Switzerland.	

Source: UBS estimates

It's Leave: Key Issues

What are the immediate next steps?

UK Prime Minister Cameron has previously said he would invoke Article 50 of the EU Treaty quickly, which would start a two year countdown to a UK exit. Doubts persist though, as some on the 'Leave' side advocate a delay in invoking the Article. In any case, the post-leave trading arrangements between the UK and EU could easily extend beyond two years.

How will this impact the UK economy in the short-run?

We anticipate a short-run uncertainty shock taking GDP growth to zero in the second half of 2016. The longer-run impacts depend on future trading arrangements, such as what kind of access the UK will have to the EU single market. These are uncertain but in our view could lower long-run UK GDP by c3.0% under a scenario in which access is very restricted.

How will the Bank of England respond?

We anticipate two rate cuts over the next six months and the re-engagement of QE.

Where will sterling fall to?

Sterling has already fallen in response to the Leave vote, and we have estimated previously that in the near-term it could trade to the 0.84-0.89 range. From a bigger-picture perspective, we have shown that if markets forced a rapid narrowing of the UK's current account deficit towards equilibrium, EUR/GBP could trade as high as parity.

What is the impact on UK yields?

We expect longer-end yields to move lower as slower nominal growth, the return of asset purchases and flight to safety dominates. We expect the front end to fully price in a cut in Bank Rate to 0.25% and a high chance of a further cut to zero.

What is going to be the impact on the EU?

We think two questions will be crucial: *First*, will the forthcoming negotiations between the EU and the UK proceed in an amicable or a confrontational way? *Second*, will the rest of the EU move towards greater integration or disintegration over time? Further integration is not impossible, but we think big steps forward would likely face significant political obstacles.

What is the impact on wider European fixed income?

We expect much wider peripheral spreads to Germany, particularly in Ireland and Spain. We expect 10yr Italy-Germany spreads to widen to around 185bp in the short-term and Ireland-Germany to above 110bp. In credit there is scope for widening in GBP sterling spreads to overall EUR.

What is the impact on the EUR?

We have long argued that the impact on EUR/USD of a Leave vote would be limited. We have estimated that it could trade into the 1.08-1.12 range in the immediate aftermath of a Leave vote. This is for a number of reasons. First of all, we see ample room for US yields to decline during a risk-off episode. Secondly, we see considerable uncertainty around the impact of the various potential contagion channels to the Eurozone. Macroeconomic and financial vulnerabilities may prove smaller than feared; the case for political contagion is not straightforward; and, finally, policy response by the ECB/European policymakers may also lead to a decline to risk premia.

What is the impact on equities?

A leave vote should support more buying of Quality, Growth & Defensives across Europe. But choose carefully; most, except Switzerland, look more expensive today than at the peak of the euro crisis in July 2012 For the UK, we see the FTSE100 falling to c. 5,500; the PE de-rating to 12x, but the fall being mitigated by an FX boost to earnings. We prefer large over mid-caps. FTSE100 is nearly 40% cheaper than the FTSE250 (biggest gap for a decade) and three-quarters of its sales are international (ex-UK).

What is the impact on European credit?

We expect European spreads to gap wider with the move focussed in financials, real estate and retailers. We estimate iTraxx Main will widen to 130bp and Crossover to 560bp and iBoxx EUR cash IG spread to widen to 210bp. The sterling market is expected to be hit hard and we expect sterling cash spreads to widen to 315bp. Over the medium term we expect a spate of downgrades to outlooks and even ratings and no pick-up in sterling issuance which should act as modest support to spreads.

What are the broader global macro implications?

Trade and financial sector linkages are the prime avenues through which we expect the cross border impact to be felt. On this count, the EU countries are likely to be most affected (to varying degrees depending on their exposure) as well as non-EU countries with large banking sector exposures. Beyond this, the risk of "political contagion" in the Euro-area from a UK exit may be less serious than feared.

What is the impact on US rates?

We believe that Brexit ushers in at least a temporary period of heightened global financial market and economic uncertainty and a likely stronger dollar, which will influence the Federal Reserve System's federal funds rate policy in our view. In this setting, we are withdrawing our forecast for a 25 basis point Federal funds rate tightening move at the September 20-21 FOMC meeting. However, we still foresee a 25 basis point hike at the December 13-14 FOMC meeting.

What is the impact on EM?

We believe risk sentiment swings are likely to affect EM assets. Their impact, however, will likely be much smaller relative to Euro-area and UK assets, given the cushion from lower US yields. More generically, the limited upside in global bond yields means we prefer bonds over currencies and credit in EM.

The outcome

The UK's EU referendum has resulted in a vote to leave the European Union - a truly historic moment for Europe and markets. As we write, the 'Leave' vote appears to be settling at 52% of the total votes cast, compared to 48% for the 'Remain' side. A key observation from the regional breakdowns is that the vote in Scotland was significantly in the opposite direction, with a vote to remain having a clear majority.

What happens from here?

Attention will turn to the uncertain future

Once the impact of the result dissipates attention is going to quickly turn to how the legal and political process will work from here. At this very early stage the way forward is highly uncertain, and will clearly be governed by both the response of the UK government and also that of the EU institutions and the major EU powers.

We expect the UK government to seek to withdraw from the EU under Article 50 of the Treaty of the European Union. Following this approach the Prime Minister would notify the European Council of the UK's intention to leave. The EU would appoint a negotiator, likely the EU Commission. The UK will continue to participate in EU decisions with the exception of those concerning withdrawal.

Article 50 allows for 2-year period. But when will it be triggered?

The stipulated time period for the withdrawal agreement to be negotiated once Article 50 is triggered is two years, though this could be extended if there was unanimous agreement of the European Council. If no agreement is reached, the UK would leave after two years with no agreement in place.

Comments from the Leave camp over the recent campaign have suggested they would not necessarily trigger Article 50 straight-away (see Michael Gove's speech here). The argument is that the UK would be better getting close to a negotiated 'deal' between it and the EU before setting the clock running.

So practically the timeline to UK withdrawal from the EU looks highly uncertain. It is likely to be at least two years, but could conceivably be considerably longer.

Article 50, Treaty on European Union

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.

2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.

3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.

4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it.

A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union.

5. If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure referred to in Article 49.

Source: Official Journal of the European Union, C 115/1, 9 May 2008

Article 50 is about the leaving arrangements not the ex-post arrangements

It is important to note that the Article 50 withdrawal agreement concerns ending the existing relationship between the UK and the European Union. It is not explicitly about the UK's *future* relationship with the EU. So, for example, the future trading relationship with the EU could conceivably be tackled once the UK has left the EU. In practice these negotiations may run alongside the withdrawal negotiation and aim to conclude at the same time. Possible end points could involve the UK leaving the EU and taking up EEA membership (like Norway) on departure, or a bilateral trading arrangements such as Switzerland's, but this is not automatic nor guaranteed.

The negotiations will cover large spheres of UK law where the EU has had some impact. As such the UK government may need to set up a comprehensive negotiating team/department to coordinate all the policy areas. Additionally, many provisions in current UK law are derivations of EU law, and will need to be reviewed.

Political realities will ultimately govern timetables

While some of the formal process is set out, the political realities are far from it. Prime Minister David Cameron has said he would invoke Article 50 relatively soon after the referendum. However domestic politics may prevent that.

The response from other EU governments will also be critical. It is not inconceivable that some early clarity over the future principles that will govern the UK and EU relationship will be sought, even if much of the detail takes far longer. It is also possible that market pressure could bring crisis-response reactions from the EU. Clearly these are possible events, especially given that many countries in the EU have some Eurosceptic parties which could gain from a Leave.

Domestically, the vote to leave the European Union could now lead to the Scottish National Party to call a second independence referendum.

What does this mean for the UK economy?

We no longer can realistically expect the UK to bounce back

Our central case for the UK economy, predicated on a rebound in UK activity in the second half of 2016, is considered no longer valid. The continuation and likely increase in economic uncertainty likely means the UK economy will do significantly worse that our previous forecast.

Growth likely to fall to zero, perhaps negative

Our forecast is now that UK output growth will slow to around zero in the second half of 2016 and into early 2017, while uncertainty is at a peak. Thereafter, contingent on some reduction in uncertainty, we are likely to see a gradual recovery in growth, though we think it could well remain weak for most of 2017.

What is the likely monetary policy response to this outturn? We wrote in a recent note that under a weak growth scenario the Bank of England would likely cut policy rates to zero and thereafter re-engage Quantitative Easing (QE). This now becomes our central case: we now expect 25bps Bank Rate cuts at the August and November Monetary Policy Committee (MPC) meetings.

Expect Bank Rate cuts and more QE

Further, we expect the MPC to re-engage asset purchases. These may come from around the February meeting, though earlier is certainly possible. We would envisage the MPC initially buying between GBP 50 to 75bn of conventional gilts over a three month window. As in previous QE from the Bank of England, the MPC would review the effectiveness of the policy every three months. Further extensions in purchases are considered likely.

Of course at this early stage there are very large uncertainties. For one, how far will the exchange rate fall before some floor is reached? And could the rise in import prices that sterling's decline would provoke potentially mean the MPC choose not to loosen policy as aggressively as we suggest?

We think the MPC reaction will ultimately prioritise stabilising the growth outlook, so as not to threaten the medium term inflation target, so any fall in the exchange rate and subsequent rise in inflation above target will be 'looked through' so long as inflation expectations are not threatened to the upside. But with this vote UK domestic policy-makers may view it as important to display their credibility. So we feel initially that the MPC may be reluctant to sound too dovish, even if ex post that is where they end up.

Longer run impact depends on nature of new trading arrangements

In our view the longer-run impacts on UK GDP from an EU exit will ultimately depend on what form of relationship with the EU the UK manages to negotiate.

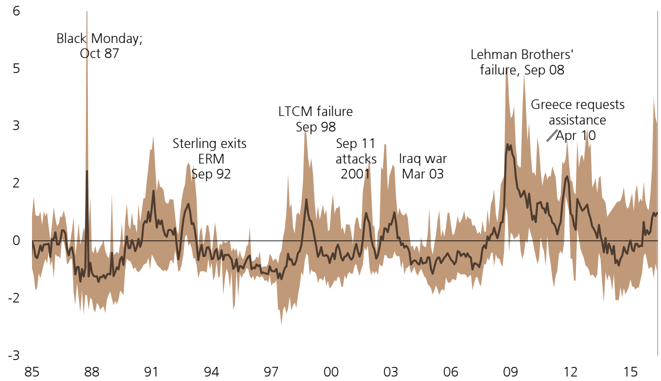
We have previously written that under a 'soft' BREXIT in which the UK continues to enjoy many of the access rights to the EU's single market the long-run impact on UK GDP could be around a permanent recurring hit of 0.5% of GDP.

Under a ‘hard’ BREXIT in which many of the access rights to the single market are lost (with the UK effectively falling back on WTO rules) the impact could be around a permanent recurring hit of 3.0% of GDP. We believe these estimates remain plausible, with wide uncertainty around them.

For the market, the form of the post-BREXIT relationship and whether it is 'soft' or 'hard' between the UK and EU may take some time to become clear. This only adds to short-term uncertainty, and in our view means the cyclical reaction to the referendum will largely be driven by a response to this uncertainty. The main channel will likely come in the first instance through lower investment, though consumer spending will also likely slow as a result of the expected higher inflation and slowing employment growth that will erode real income.

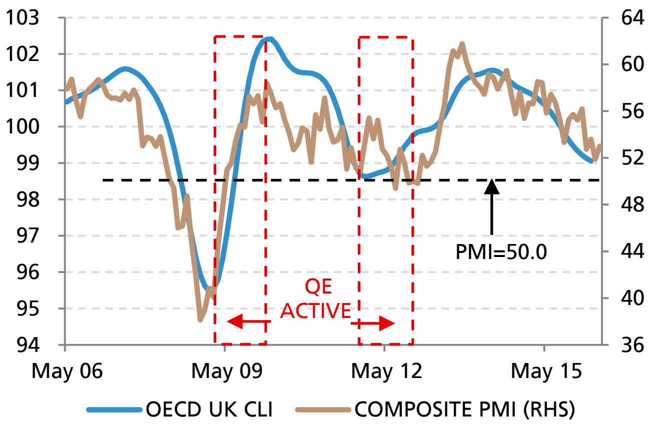
Overriding uncertainty to drive the cyclical response

Figure 2: Economic uncertainty expected to rise further



Source: UBS

Figure 3: Bank of England to ease policy



Source: Haver Analytics, UBS

What does this mean for the EU?

On 14 April 2016, we published our report "Brexit - Impact on the EU". Following the UK's vote to leave the EU the analysis and conclusions of that report remain fully valid, in our view.

Going forward the economic impact of Brexit on the EU – rather than the UK – will depend crucially on two questions, we think:

Two crucial questions

First, will the forthcoming negotiations between the EU and the UK proceed in an amicable or a confrontational way?

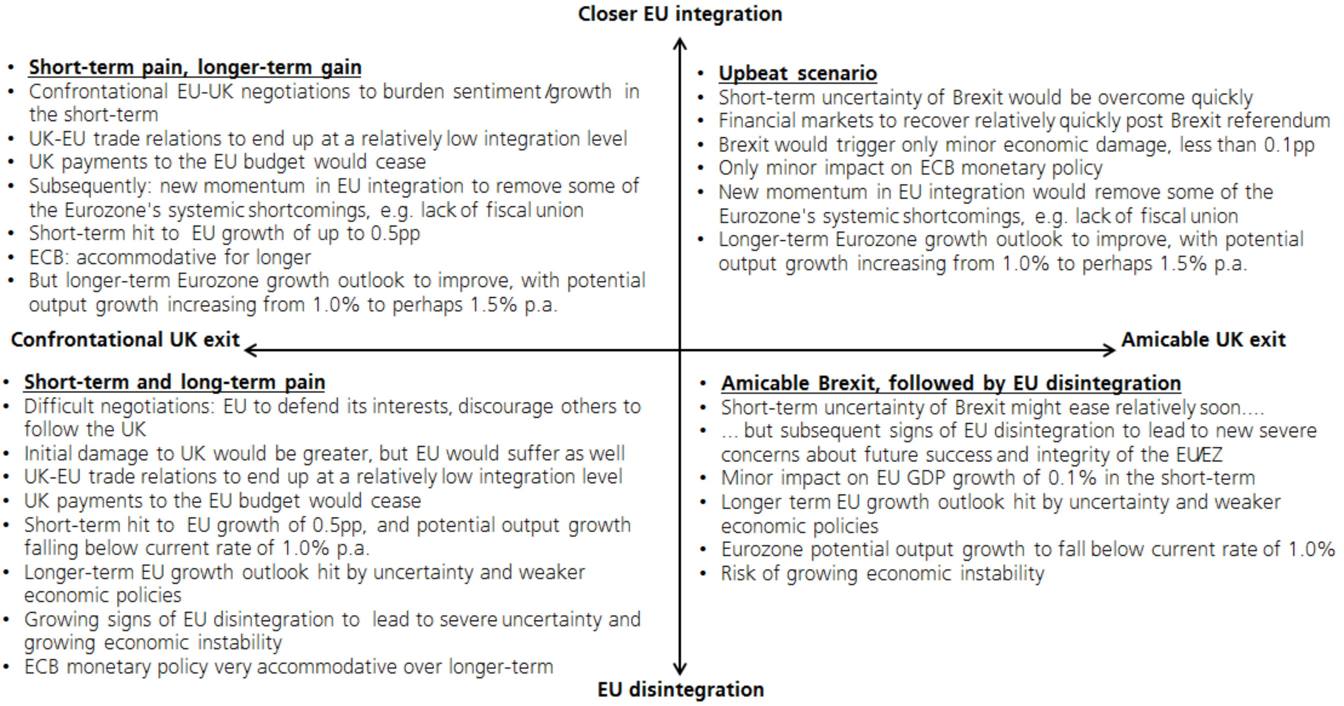
Second, will the rest of the EU move towards greater integration or disintegration over time?

To alleviate uncertainty about these two questions, we consider it very important that EU leaders or the EU Commission present a **Plan B** very soon. This could potentially happen at the EU summit on 28/29 June, where the outcome of the UK referendum will be on the agenda. In the absence of such a Plan B, it might take at least weeks or months until a clearer picture evolves regarding the character of the exit negotiations (constructive/confrontational), while it might take years until the future path of the EU (integration/disintegration) becomes clearer.

Will EU leaders present a Plan B quickly?

Defining the two key questions mentioned above as "axes of uncertainty", we established a four-quadrant scheme that renders various shades of benign and challenging outcomes, which allowed us to make a nuanced assessment of potential economic and financial market outcomes over time (Figure 4).

Figure 4: The EU after Brexit – four key scenarios



Source: UBS, ''Brexit – Impact on the EU', R.Cluse, 14th April 2016.

What are the costs, shorter and longer term?

Type of UK exit (amicable/ confrontational) affects the short-term costs; the question of EU (dis)integration is more relevant for the longer term

In our view, the question about the **type of Brexit** (horizontal axis – amicable vs. confrontational) will influence the **short- and medium-term** costs that the EU faces: a period of uncertainty, perhaps lasting 1-2 years, will be followed by a period of adaptation to the "new normal". In contrast, the question regarding the **degree of EU (dis)integration** (vertical axis) is more about **long-term** costs or benefits for the EU.

The upbeat outcome (upper right quadrant) would combine minimised short-term costs with long-term benefits. We estimate amicable negotiations between the EU and the UK would imply a short-term loss in GDP for the EU-ex-UK of just 0.1pp, while the medium-term trend growth rate (potential output growth) could well rise substantially above the current rate of 1.0% p.a., to perhaps 1.5% p.a., if the EU were to move towards greater integration.

By contrast, we believe the scenario of a confrontational exit and EU disintegration (lower left quadrant) would combine setbacks in EU-UK economic relations and potentially much more severe economic and political challenges for the EU over the longer term. We estimate that the short-term loss in EU-ex UK GDP growth in this case could be up to 0.5pp. This scenario implies downside risk to our current base case scenario (see Eurozone: Upgrading Germany, France, Spain 2016 forecasts after Q1 GDP details, 18 May 2016). However, we think the long-term damage caused by EU disintegration could be much more severe. While the EU and the Eurozone are two different institutional arrangements, we think the linkages between the two are such that major disintegration forces affecting the EU would probably spill over into the monetary union as well.

Within the grand scheme of things, the question of EU integration/disintegration would ultimately be much more important than whether the UK's exit from the EU is amicable or confrontational. If the EU moves towards disintegration over time, the question of whether Brexit negotiations have been amicable or confrontational will, in the aftermath, have largely paled into insignificance. However, the markets would likely get clarity about the type of Brexit (amicable/confrontational) much faster than about the future state of the EU (integration/disintegration).

Presentation of a Plan B would help to alleviate uncertainty

To repeat, it would therefore be crucial in our view that EU leaders or the EU Commission present a **Plan B** very soon, thus alleviating uncertainty about the negotiations and the future path of the EU.

Adverse spill overs to Switzerland

Any adverse impact on EU growth would also spill over to neighbouring countries, including Switzerland, as exports to the EU account for more than half of total Swiss exports. In addition, ongoing discussions between Switzerland and the EU about changes to the free movement of labour between both countries (following the Swiss referendum on immigration in 2014) are likely to become more complicated now, and may not be finalised by February 2017 as originally planned. This may add to the level of uncertainty and weigh on Swiss growth going forward.

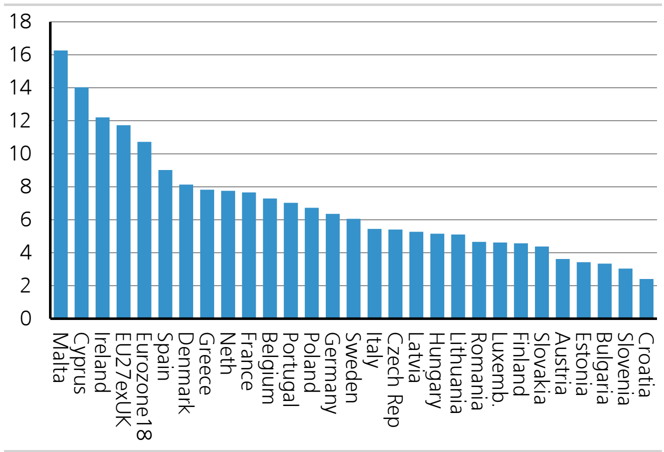
Who in the EU will be most exposed to Brexit?

To answer this question, we look at some of the key transmission mechanisms: trade and financial linkages.

Ireland, Malta, Cyprus, Luxembourg, Denmark, Belgium, Netherlands have closest trade links with the UK

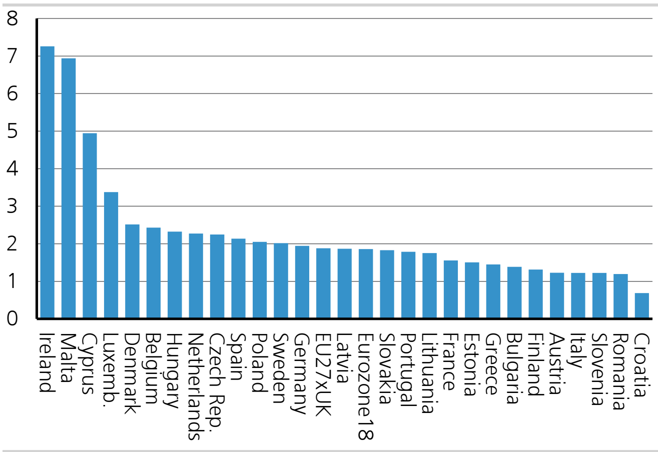
Trade in goods and services would be a key link. According to OECD data, the share of (direct *and* indirect) EU-ex-UK exports of goods and services to the UK (i.e. those that finally end up in the UK even if they pass through third countries) is around 12% of total EU-ex-UK exports (Figure 5). As a proportion of value added (a proxy for GDP), the share is 1.9% (Figure 6). However, these measures mask substantial differences between individual EU member states. As a share of value added, **Ireland, Malta, Cyprus, Luxemburg**, **Denmark, Belgium** and the **Netherlands** have the highest trade integration with the UK – putting these countries most at risk of suffering negative growth effects as a result of Brexit. Amongst the larger European countries, Spain and Germany are most exposed.

Figure 5: Final (i.e. direct and indirect) goods and services exports to the UK, % of total final exports, 2011



Source: OECD Trade in Value Added (TiVA) database, UBS.

Figure 6: Final (i.e. direct and indirect) goods and services exports to the UK, % of total value added, 2011

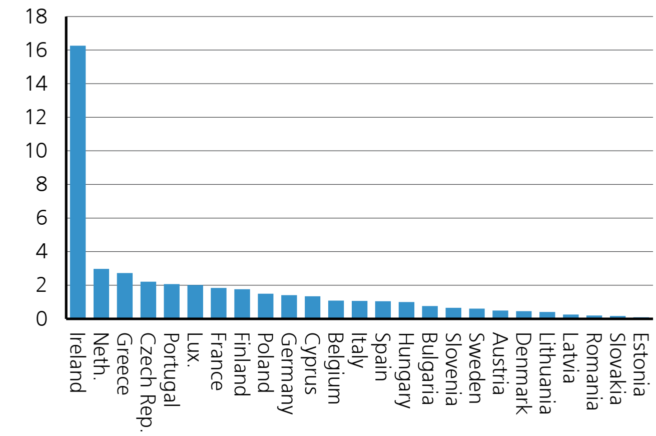


Source: OECD Trade in Value Added (TiVA) database, UBS.

Another channel of spillovers could be **financial linkages**. Should UK banks restrict their activities in the EU, this could negatively affect credit conditions in the EU. This risk seems most relevant for **Ireland**, as claims by UK banks account for 16% of Ireland's total banking assets. For other countries, these linkages are much smaller, however (Figure 7).

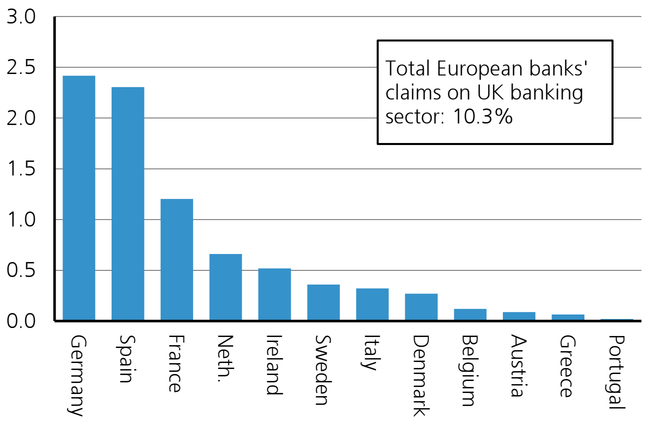
Will UK banks reduce their exposure to the EU?

Figure 7: UK banks' claims on EU's banking sectors, % of total banking sector assets, 2014



Source: BIS, Haver, UBS

Figure 8: EU banks' claims on UK's banking sector, % of total UK banking sector assets, 2014



Source: BIS, Haver, UBS.

Following the Brexit vote, **political uncertainty** could increase in the EU, potentially weighing on private sector confidence. Scotland might end up holding a second independence referendum, perhaps with implications for other regions in Europe. Also, Brexit will mark the first major step backwards after decades of increasing EU integration. All these concerns could weigh on investment plans – in Europe overall and particularly in countries where anti-establishment parties are strong.

How will the ECB react?

Following the easing package from 10 March, the ECB is now in a 'wait and see' mode, and focused on the implementation of previously announcement measures. However, later in 2016, the ECB will have to reassess its QE programme and guide the markets as to how it wants to proceed after March 2017: (1) continue the asset purchases as before, (2) gradually wind them down through "tapering", or (3) stop entirely. We argued that option (3), a hard stop, appears unlikely to us. As we pointed out recently (ECB: Focus on implementation, dovish projections, 2 June) the most likely dates for firmer ECB guidance for QE post March 2017 could be 8 September or – perhaps more so – 8 December, when the ECB will once again issue staff macroeconomic forecasts.

Base case scenario: ECB now focused on previously announced measures. Later in 2016, it will have to give clearer guidance about QE after March 2017

The uncertainties and downside risks triggered by the Brexit decision imply to us that the likelihood of a somewhat more dovish ECB monetary policy has risen. We think the ECB will adopt a wait and see stance for now, but standing ready, if needed, to inject additional liquidity into funding markets over the coming days and weeks. We do not think that the ECB will unleash substantial additional easing in the short term – we believe this would only happen in the event of a major decline in Eurozone sentiment or a significant deterioration in financing conditions, which is not our base case scenario. However, if it became clearer over the coming months that Brexit might slow down the Eurozone recovery, it might well skew the ECB decision further away from a hard QE exit towards an extension in asset purchases beyond March 2017.

Brexit skews probabilities towards more dovish monetary policy: liquidity injections and possibly an extension of QE

What does this mean for the US?

We no longer foresee a Fed hike at September FOMC meeting

We believe that Brexit ushers in an at least a temporary period of heightened global financial market and economic uncertainty, which will influence the Federal Reserve System's federal funds rate policy. While Fed spokespersons likely will reiterate confidence in a continued US economic recovery, they also should state that the Federal Open Market Committee (FOMC) will need time to assess the evolving economic and financial market consequences from the UK Leave vote before making further adjustments in the federal funds rate.

In this setting, we are withdrawing our forecast for a 25 basis point Federal funds rate tightening move at the September 20-21 FOMC meeting. However, we still foresee a 25 basis point at the December 13-14 FOMC meeting. By that time the Fed will have a half year of evidence with which to assess the Brexit impacts on the financial markets and economy.

We maintain our forecasts for US growth

At this juncture, we are maintaining our forecasts for US real GDP growth at an average 2% annual pace in the final three quarters of 2016 and at 2.5% in calendar 2017. While Brexit likely spells a stronger dollar and weaker US exports than otherwise, it also should be associated with even lower longer-term interest rates—a positive for the economy. However, in our view the Leave vote does add some downside risk to these forecasts.

Broader Market Implications

A few days ago we attempted to determine at what level the relevant macro risks would be fully priced in upon a Remain and a Leave scenario across a variety of asset classes.

Our work suggests that the risk-rally of the last few days has left more room for downside pressure across risky assets after yesterday's Leave vote.

More specifically, by asset class, we believe:

- The path of least resistance is for G4 yields to decline substantially. This is especially so in the UK and the US and less so in Europe, where yields already price-in significant pessimism.

- FTSE and Eurostoxx look set to be particularly affected given the downside risks for domestic demand and the macro read-across to the EU. That said, the bond yield/policy cushion, combined with the healthy distance from the macro shock implies less downside for the S&P and EM equities.

- In FX, we believe the GBP is set to come under significant pressure owing to the UK's macro imbalances while safe-haven currencies such as the JPY and the CHF will strengthen. Policy response, however, may limit the degree of strength there. In our view, the impact on EUR/USD is likely to be muted.

- We think Euro-area periphery yields and corporate credit spreads have ample room to widen after the risk rally of the last few sessions. The timing and scale of policy response will again be key in gauging the duration of the sell-off.

- We believe risk sentiment swings are also bound to affect EM assets. Their impact, however, will likely be much smaller relative to Euro-area and UK assets, given the cushion from lower US yields. More generically, the limited upside in global bond yields means we prefer bonds over currencies and credit in EM.

The pages that follow delve into each key asset class in more detail.

UK Rates and Sterling

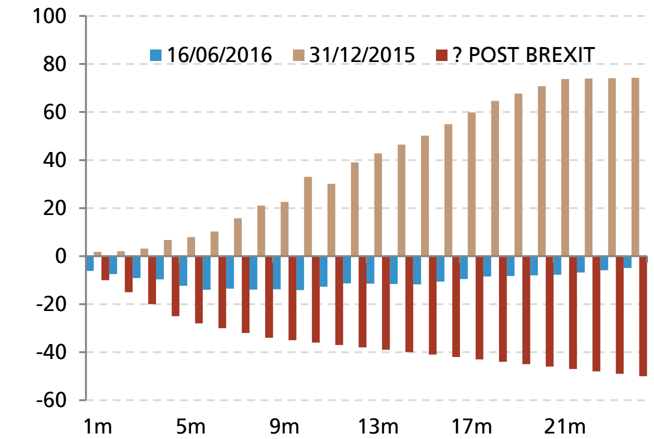
We differentiate between the immediate and short term reaction of UK rates and FX markets, and the expected longer term consequences of yesterday's vote to leave the European Union.

Short term: rate cuts and low growth priced in, GBP likely to fall hard

25bps rate cut likely to become fully priced

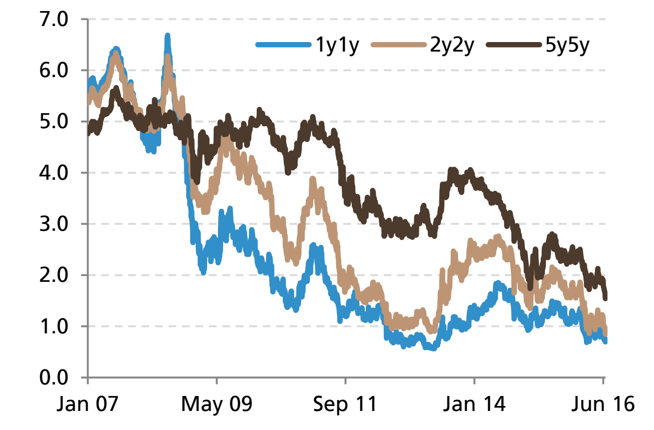
In the run up to the referendum, **the front end** had priced in around a 50% probability of a rate cut over the next six to twelve months. This was already a big change in expectations compared to the profile at the start of the year (Figure 9), but in the wake of today's outcome, there is expected to be a further emphatic shift. A 25bp cut by August is now likely to be fully priced in almost immediately in our view, with a possibility of an additional cut towards zero before the end of the year also anticipated. We doubt the MPC will contemplate cutting rates into negative territory given a series of comments made by senior policymakers over recent months expressing major misgivings about the efficacy of such a policy. Expectations that rates will need to stay ultra-low for a sustained period will likely cause short dated forward rates to drop to new record lows in short order (Figure 10).

Figure 9: Since the start of the year, the prospect of rate hikes has been fully priced out. Now cuts to be priced in (implied cumulative monthly change in Bank Rate, bp)



Source: Bloomberg, UBS

Figure 10: Short and medium dated forward rates likely to fall to new record lows after the vote to leave the EU (%)



Source: Bloomberg, UBS

Longer term yields likely to drop on slower growth and safe haven demand

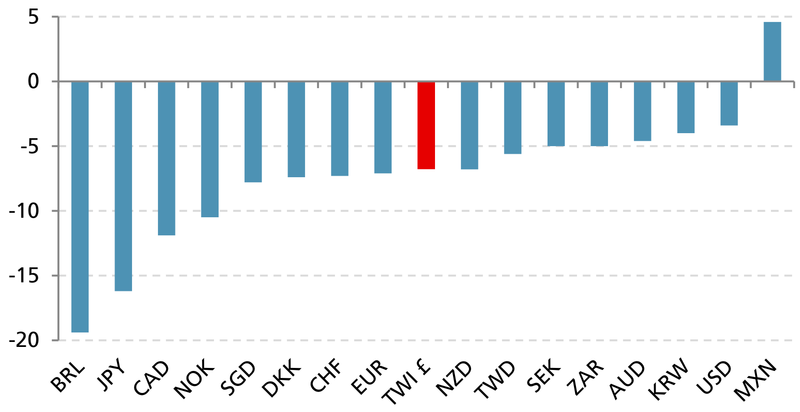
Longer dated yields are also likely to drop quite sharply, with lower nominal growth expectations as a result of the uncertainty that has crystallised with the vote to leave the EU anticipated for a prolonged period to come. In addition, there will be an increase in safe haven demand for sovereign debt, and rising speculation that as well as cutting rates, the MPC may have to reintroduce QE over the coming months as it attempts to counteract the expected economic stagnation. There may be some offsetting impact on Gilt yields from the possibility of a drop in demand from overseas investors, and the higher issuance expectations that would be a consequence of weaker economic growth (and higher Government borrowing) but we see these influences as likely to be overwhelmed by the former factors.

Fall in sterling expected at similar pace to '08 financial crisis

Sterling has already fallen by almost 7% from its highs of November 2015 up to yesterday, and has been a clear barometer of oscillating Brexit expectations. The correlation between the estimated probability of the UK voting to leave the EU and the performance of sterling has been elevated for several months, and increasingly strong as the vote approached. Now that the UK electorate has voted to leave the

EU, we expect a significant depreciation in GBP as a result. Already almost the worst performing major currency over the year-to-date (Figure 11), the likely sharp drop in inflows into the UK from overseas investors now that a period of high uncertainty lies ahead looks sure to mean that underperformance is magnified. We believe the eventual extent of the fall in sterling will depend on how economic data responds to the shock of the outcome of the vote, but for now we expect a steep fall as a result of the Leave vote.

Figure 11: Percentage change in the pound relative to major currencies, 2016 year-to-date (as at 16th June, %)



Source: Bloomberg, UBS

Longer term: rising expectations of more QE to richen conventional Gilts

We expect rate cuts and QE as data slows

We do not expect any near term/knee jerk policy response from the MPC, with the long term liquidity operations being conducted over the period either side of the referendum enough to insulate the banking system. However, when the initial shockwaves recede and economic data begins to reflect the extent to which the economy is likely to slow, we do think lower rates and a resumption of QE will be deemed appropriate.

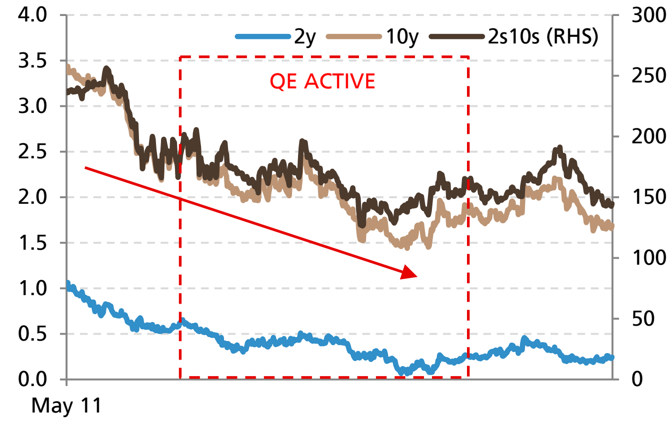
Longer-term gilts to richen

The front end will already have anticipated a cut in Bank Rate towards zero, but we believe **longer Gilts** are likely over time to keep richening as the perceived probability of more Central Bank large scale asset purchases rises. As we showed in a recent note exploring market moves in the run-up to previous QE programmes in the UK, this is likely to mean bull flattening of the conventional Gilt yield curve (Figure 12), lower breakevens (as conventionals outperform non-QE eligible linkers), richening on asset swap (Figure 13), and cross market outperformance (particularly against Bunds in our view).

Sterling to head to $1.20, parity to euro

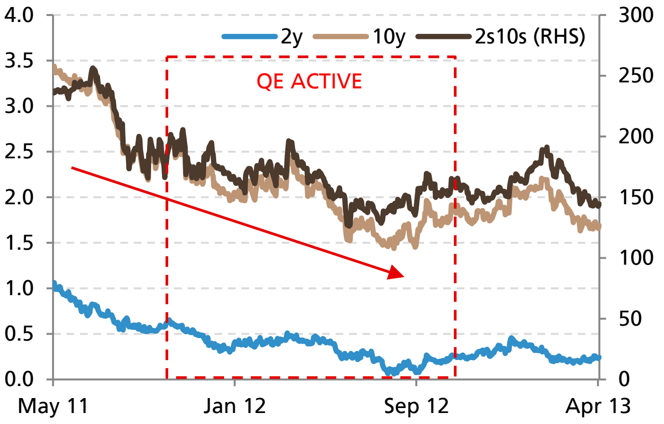
After a significant depreciation, GBP is likely to stabilise, and may start to gently climb again once QE resumes if economic indicators respond positively to a combination of the additional monetary stimulus and the impact of the big drop in the currency in the wake of Brexit (as occurred following the launch of QE1 and QE2 –Figure 14). Such a large decline is likely to push headline inflation higher, but we do not see this as a material deterrent to more QE being sanctioned, as inflation driven by a dramatic currency weakening is unlikely to feed through to medium term expectations as it squeezes real incomes and acts as a material headwind to consumption (as was the case after the drop in the pound triggered by the financial crisis –Figure 15).

Figure 12: 2y and 10y Gilt yields and the 2s10s spread between 6m before the launch of QE2 (October 2011) and 6m after it ended (October 2012)



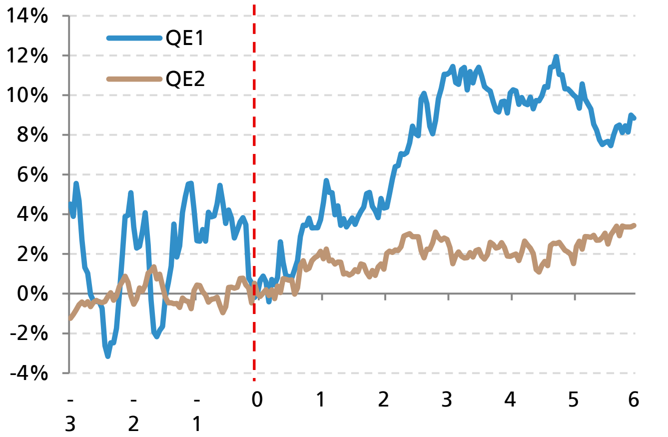
Source: Bloomberg, UBS

Figure 13: Asset swap levels on selected conventional Gilts 6m before and after the start of QE2 (Gilt yield less matched maturity swap rate, bp)



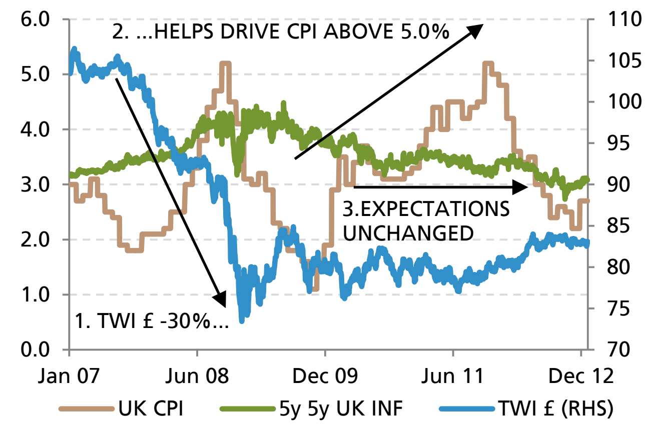
Source: Bloomberg, UBS

Figure 14: Trade weighted sterling, three months before and six months after the start of previous QE programmes in the UK (% change from start of QE)



Source: Bloomberg, UBS

Figure 15: Trade weighted sterling, headline CPI, and 5y forward 5y inflation swap rate in the UK, Jan 2007-Dec 2012



Source: Bloomberg, UBS

European Rates and FX

As previously discussed in our 'Brexit – impact on the EU' (Reinhard Cluse, 14 April 2016) piece we believe the market reaction to the UK deciding to leave the EU will be split into two phases:

Phase 1: - the short term (the initial reaction following yesterday's vote) is likely to involve market participants determining the economic implications for remaining EU members. Our assessment of trade and banking sector exposures to the UK shows that among the larger euro area government bond markets Ireland and Spain have the largest exposures on both metrics.

Following the UK's vote to leave the EU we expect much wider peripheral spreads to Germany, particularly in Ireland and Spain…

Heightened risk aversion in the euro area government bond markets is likely to result in wider peripheral spreads to Germany. We see 10yr Italy-Germany spreads widening to at least 185bp, 10yr Spain-Germany to at least 195bp and 10yr Ireland-Germany spreads widening to at least 110bp. We stress these are the initial spread levels that we anticipate and the longer term outlook in our view will depend on whether the UK's exit results in more or less integration.

We expect 10yr Italy-Germany spreads to widen to around185bp in the short-term, Spain-Germany to 195bp and Ireland-Germany to above 110bp

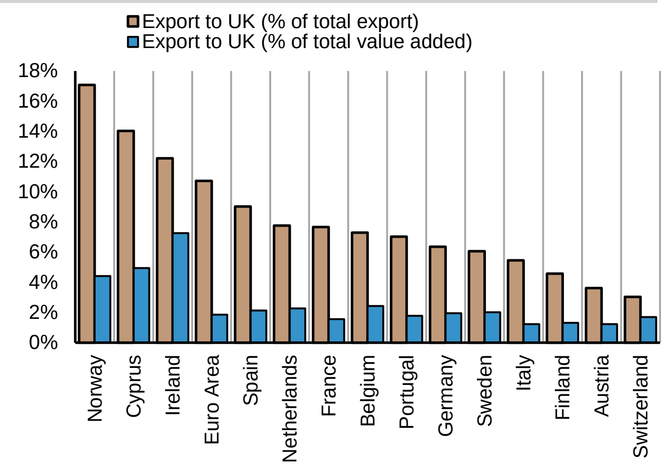
10yr Swiss yields are expected to remain closely correlated with 10yr Germany and we expect yields in both markets to fall and make new record lows. We look for 10yr German yields to initially fall to around -0.15%.

10yr Germany yields are likely to fall to around -0.15%

In addition to the implications of the UK voting to leave the EU, the European rates markets will pay attention to the outcome of Sunday's general election in Spain and how the ECB will react. We believe further peripheral spread widening may emerge if a left-wing coalition is formed in Spain (PSOE/Podemos-IU) or if another round of elections have to take place (Macro Strategy Key Issue: Spain – Just 3 Things). As detailed earlier in this note, Brexit skews the probabilities towards more dovish monetary policy, liquidity injections and an extension of QE beyond March 2017. We do not expect any automatic changes in the purchase of sovereign bonds by the ECB.

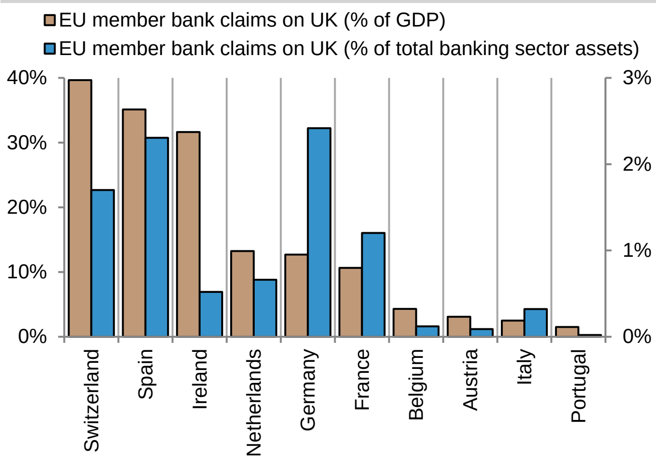
Peripheral markets will pay close attention to the outcome of Sunday's Spanish election in the very near-term

Figure 16: Trade exposures to the UK



Source: UBS, OECD

Figure 17: Banking sector exposures to the UK



Source: UBS, Haver Analytics, BIS

Following the initial market move attention will be paid to the spirit in which Brexit negotiations might be conducted; public remarks by senior EU politicians in the aftermath of yesterday's vote will likely be important. For example, should the European Council indicate a strong sense of goodwill and determination to finish negotiations quickly and in a cooperative fashion, and with the aim of maintaining a high degree of integration with the UK, market concerns might settle down relatively quickly – although this would have to be confirmed once negotiations actually get underway

The SNB are likely to resort to FX interventions as a first line of defence but rate cuts or changes in the exemption thresholds could follow

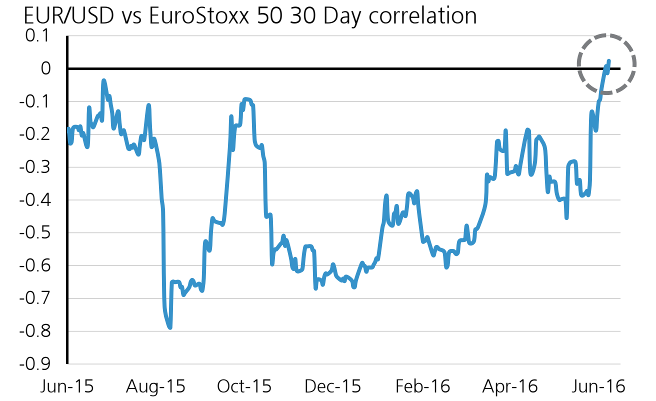
Phase 2: longer-term impact (degree of (dis)integration): Over the *longer term*, the market reaction would likely depend more on signals as to whether the EU will move towards closer integration or disintegration. Closer EU integration would result in higher German yields and tighter peripheral spreads to Germany. Meanwhile, disintegration would be the biggest risk for peripheral Eurozone markets, as the probability of a Eurozone break-up might arguably rise.

In FX, outside GBP we have long argued that the impact on EUR/USD of a Leave vote would be limited. We have estimated that it could trade into the 1.08-1.12 range in the immediate aftermath of a Leave vote. This is for a number of reasons. First of all, there is ample room for US yields to decline during a risk-off episode. Secondly, there is considerable uncertainty around the impact of the various potential contagion channels to the Eurozone. Macroeconomic and financial vulnerabilities may prove smaller than feared; the case for political contagion is not straightforward; and, finally, policy response by the ECB/European policymakers may also lead to a decline to risk premia.

The SNB are likely to resort to FX interventions as a first line of defence but rate cuts or changes in the exemption thresholds could follow

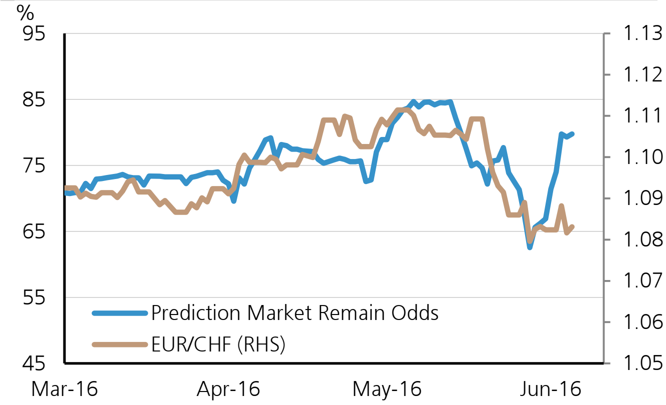
The reduced pricing of a Leave vote in recent days has led the result to be a greater surprise to the market, and so we are likely to see outsized strength in safe haven currencies, such as the JPY and the CHF. Their upside is effectively limited by the market's expectation of a policy response. This can include a cut in the deposit rate facility in both jurisdictions, additional modifications in the exemptions threshold regimes applying to excess reserves, additional asset purchases in Japan and, potentially, even FX intervention. The extent of the currency moves obviously also depends on the policymakers' readiness to react. In our view ranges of 99-103 and 1.03-1.07 are sensible expectations for USD/JPY and EUR/CHF in the short-term respectively, as the lower end of those ranges is consistent with a high probability of intervention.

Figure 18: EURUSD has de-correlated from risk sentiment ahead of the vote…



Source: Bloomberg, UBS

Figure 19: …while safe-haven currencies such as CHF have been tracking betting odds of exit



Source: Bloomberg, UBS

US rates

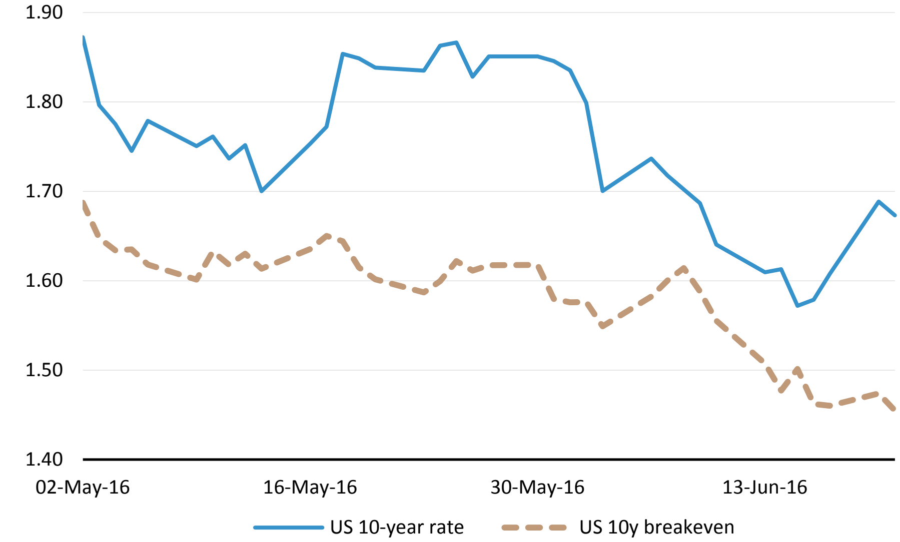
We believe US rate term premium will decline sharply

Following the UK vote to leave the European Union we believe that the US interest rate term premium will decline quite sharply. This is largely because of the increased uncertainty around the US economic outlook. During the June FOMC press conference (see transcript) Fed Chair Yellen highlighted that the risks around the UK's decision on EU membership had been a factor behind the June rate decision. She also noted that the Brexit outcome could have consequences for the US economic outlook and therefore would be a factor in deciding on the appropriate path of policy going forward. This acquires extra significance due to the fact that US yields are already quite high relative to their global counterparts.

Potential 20-50bps rally in UST 10-yr yields

The rates market has already reflected this scenario recently, albeit for a short-while. As the probability of EU exit increased by more than 10 percentage points to c. 40% in early June, 10-year yields declined to as low as 151bp (intra-day) from local highs of 185bp (see Figure 20). This is more than a 30bp decline in less than a month. As a result, recent dynamics suggest that the market may become extremely risk averse yet again following yesterday's Leave vote, potentially leading to a rally in US 10-year yields by 20-50bp. Should our forecast materialise the risk-reward of being long 10yr US Treasuries vs German Bunds is attractive[1].

Figure 21: US rates market likely to resume extreme risk aversion mode



Source: Bloomberg, UBS

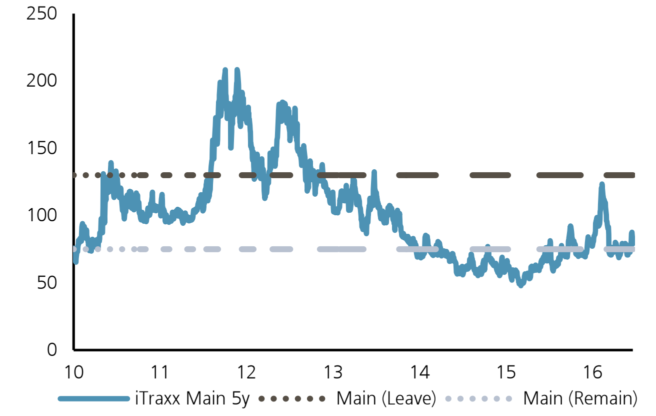
[1] See 'UK Referendum: A roadmap for the "Day After"' and ' Global Rates Strategy: The Global Rates Landscape'

European credit implications of leave decision

Credit spreads to gap wider

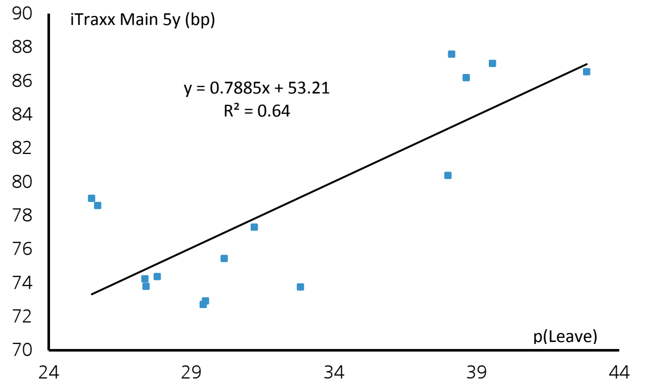
In the short term following the leave vote we expect spreads in European credit to gap wider, first affecting issuers in more exposed sectors of financials, real estate and retailers. Although we expect European credit spreads to widen sharply, the better quality names should be able to withstand this outcome. Based on the strong correlation with the probability of leaving since the beginning of June we would estimate that iTraxx Main will widen to 130bp and Crossover 5y to 560bp (see Figure 22 and Figure 23) and iBoxx EUR cash IG spread will widen to 210bp. This places spread below that observed during the sovereign debt crisis and above the selloff in credit in February this year.

Figure 22: iTraxx main 5y spread vs our Remain and Leave estimates.



Source: Bloomberg, UBS

Figure 23: Relationship between iTraxx main 5y spread and probability of Leave since June 1st.

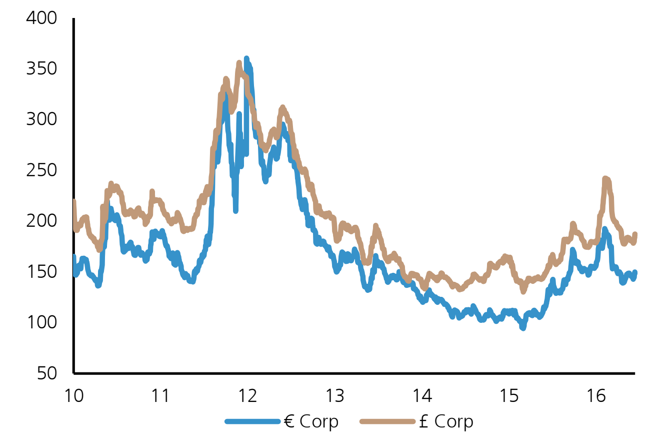


Source: Bloomberg, UBS

Scope for widening in GBP sterling spreads to overall EUR

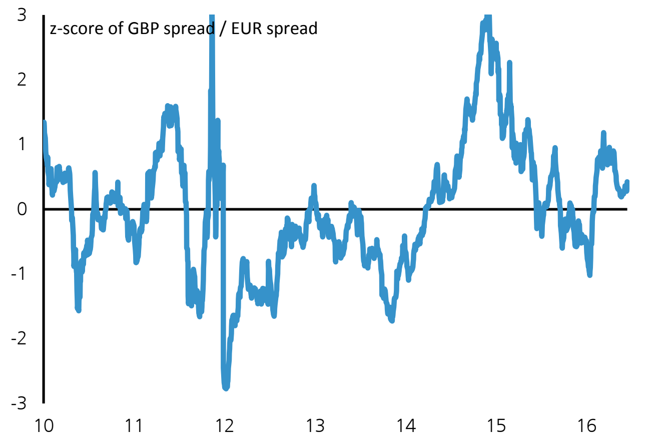
The Sterling corporate bond market has so far been insensitive to the exit risk and as a result of this complacency we expect this market to be seriously impacted. Currently IG GBP spread is at 184bp vs. 146bp for IG EUR spread, and since 2010 sterling spreads have been consistently wider (Figure 24). If we take the ratio of the spread (GBP over EUR) and calculate the z-score we are only just above the average spread ratio with a z-score of just +0.5 (Figure 25). There has been no significant selloff in GBP corporate paper, and so given the vote to leave we expect significant widening relative to EUR spread overall. We expect iBoxx EUR cash IG spread to widen from 146bp currently to 210bp and sterling spreads to be up to 1.5x this spread (as they were at the end of 2014) at 315bp vs 184bp currently.

Figure 24: Spread for IG GBP and EUR bonds.



Source: Markit, UBS

Figure 25: z-score of ratio of IG GBP / IG EUR spread.

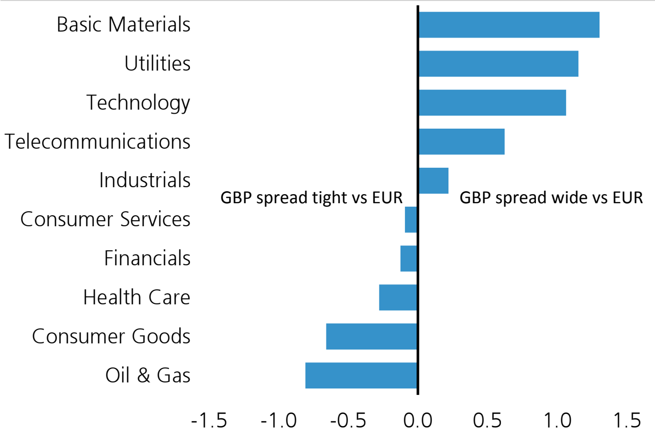


Source: Markit, UBS

Sector variations

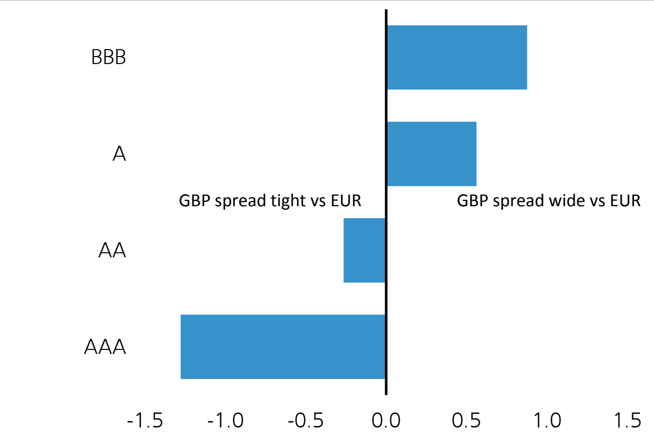
We present a snapshot of the z-scores of the ratio of GBP spread vs the analogous EUR spread by sector (Figure 26) and by rating (Figure 27) to see where sterling paper is trading wide relative to the equivalent euro denominated bonds. Although the overall GBP spread is neutral vs. EUR spread, both sectors and ratings show dispersion. Amongst the sectors, Basic Materials and Utilities show wider GBP spreads than usual whereas Consumer Goods and Oil & Gas are tighter than usual vs their EUR sector counterpart. Lower credit quality (single-A and below) tends to be wider in GBP than equivalent EUR sectors, whereas AA and higher is tighter in GBP than equivalent EUR sectors. We expect the lower credit quality GBP names to widen most following the leave vote.

Figure 26: Ratio of GBP spread / EUR spread by sector, standardized as a z-score (data since 2010).



Source: Markit, UBS

Figure 27: Ratio of GBP spread / EUR spread by rating, standardized as a z-score (data since 2010).



Source: Markit, UBS

Downgrades to outlooks and ratings are possible

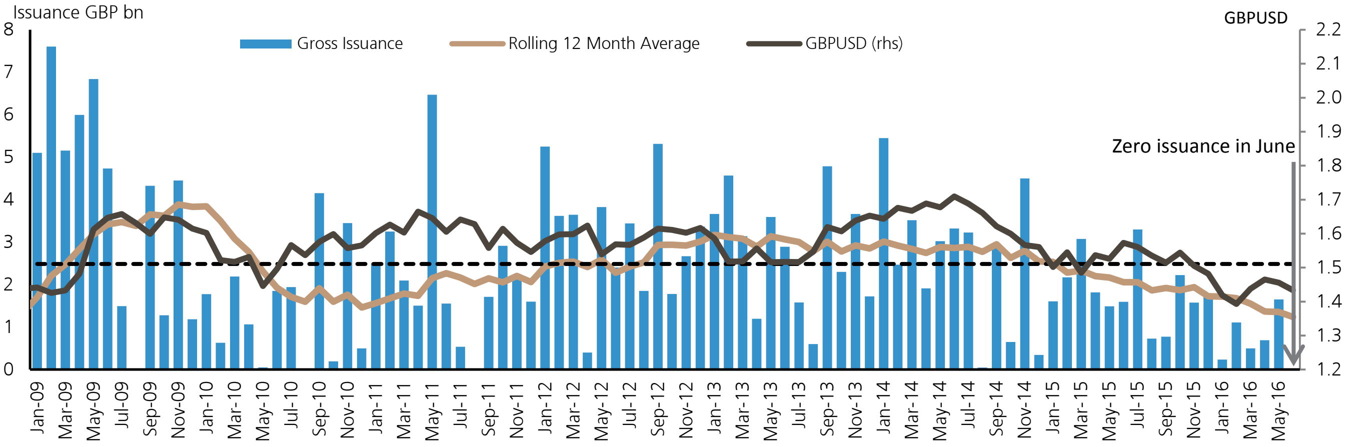
A spate of sovereign and individual corporate issuers' downgrades to outlooks and even ratings is also possible. In turn, this could lead to an increase in an issuer's cost of funding. The uncertainty surrounding the type of Brexit (amicable / confrontational) especially for UK based companies, would also delay investment until terms are agreed.

Net issuance in GBP likely to remain negative, supporting spreads

At a time when markets are looking to increase the reliance on capital markets versus bank lending, we believe the leave vote would also disrupt this growth in the near term. Looking at gross issuance in sterling denominated corporate bonds the average monthly issuance since the GFC has been around £2.5 billion (see

Figure 28). Issuance has been steadily declining alongside GBPUSD since the beginning of 2015. Since summer 2015 monthly issuance has not exceeded the average once, and in June this year we have had no GBP issuance at all. We believe issuers who need to issue in sterling and have held off due to uncertainties around the referendum are now unlikely to issue until there is more clarity over the full repercussions of the leave vote. Net issuance is therefore likely to remain negative and provide some support to spreads.

Figure 28: GBP gross issuance since January 2009.



Source: Dealogic, UBS

UK Equity market – potential downside 13%

On Leave we arrive at a FTSE 100 fair value of 5,500 (ranging from 5,250 to 5,900). This outcome delivers significant uncertainty and we expect the risk-adjusted PE to de-rate by 20%. On the plus side the FX gains offset a material part of the pain. We assume that a leave results in:

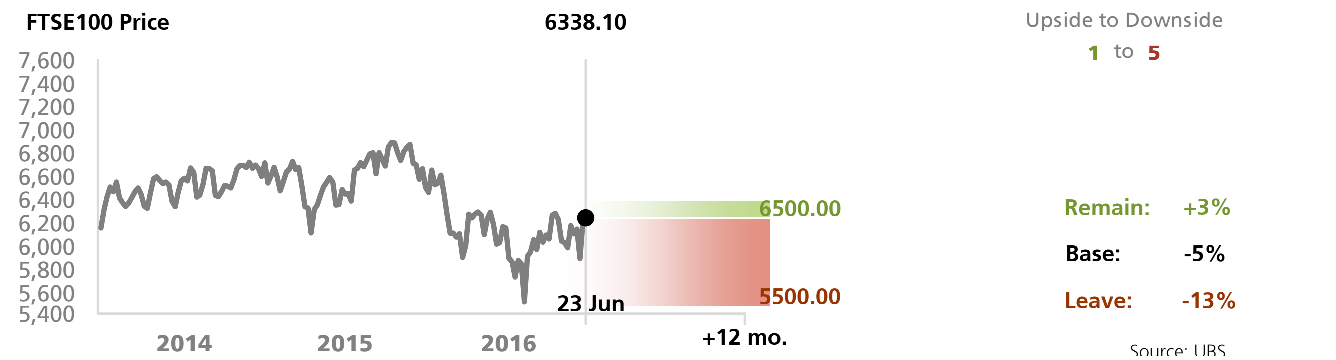
- PE falling by 20% from 15x to 12x; and
- EPS growth of 8% for both 2016 and 2017 (consensus at -5% and 13% respectively), supported by a weaker pound and some commodity catch-up. On the flip-side it is also dragged down by weaker GDP growth and a hit to confidence.

Leave = 5,500

PE falls to 12x

EPS growth 8% for 16 & 17

Figure 29: What is fair value for FTSE 100? On Leave our base case is 5,500



Source: European equity strategy team

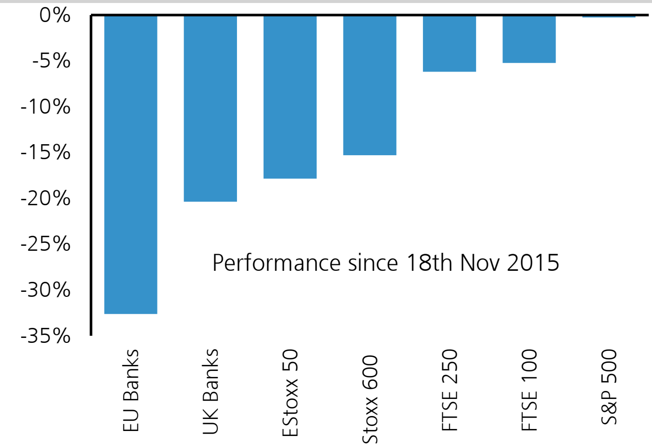
Impact on Equities – story to date

The referendum hit the screens materially around 18th November 2015, when the currency seemingly started to fall away from economic fundamentals. As below, it wasn't just the UK, but Eurozone banks too, that suffered the most. In USD terms the FTSE 100 and FTSE 250 are also down 10%.

EU Banks– risk of more QE

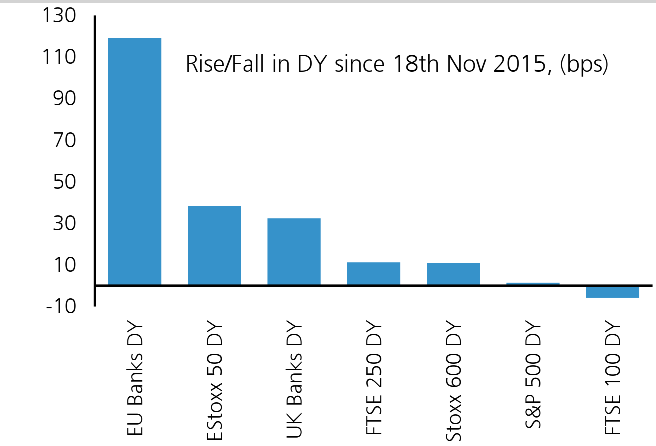
FTSE 100 fell 5% or 10% in USD

Figure 30: Performance of Equities (local curr) Since 18th November (start of Sterling's descend)



Source: Thomson Datastream, UBS European Equity Strategy

Figure 31: Dividend Yields have generally risen – the most in EU Banks – up over 1% since 18 Nov 15



Source: Thomson Datastream, UBS European Equity Strategy

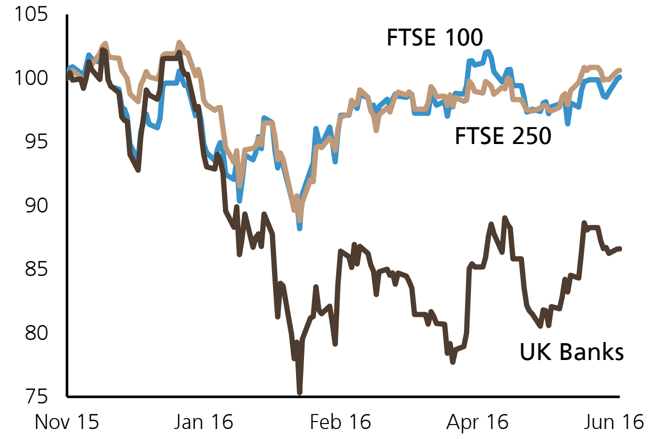
FTSE 100 preferable to FTSE 250 - and c.40% cheaper

We believe a weaker domestic economy and a weak sterling support the large caps relative to smaller domestic stocks. The FTSE 100 is international and barring any immediate trade restrictions it should benefit. As noted in our 13th April report, we are surprised the Large caps have not yet outperformed the mid-caps. This is partly down to the Banks as worries intensify about further QE and yield curve flattening. But of interest: today's valuation gap between the FTSE 100 and FTSE 250 is still near a 12 year high – with large caps c. 40% cheaper on P/Book.

FTSE 100 –c.40% cheaper

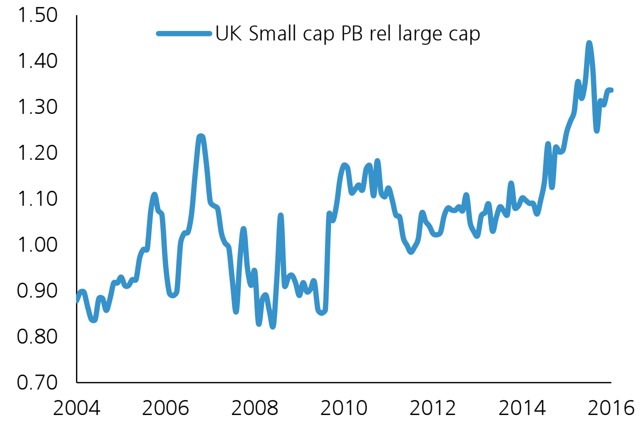
Odd - FTSE 250 not that bothered about domestic risk

Figure 32: FTSE 100 has NOT outperformed the FTSE 250. Banks are a key drag.



Source: Thomson Datastream, UBS European Equity Strategy

Figure 33: Large caps c. 40% cheaper than mid caps – cheapest in close to 12 years (Price to Book)



Source: Thomson Datastream, UBS European Equity Strategy

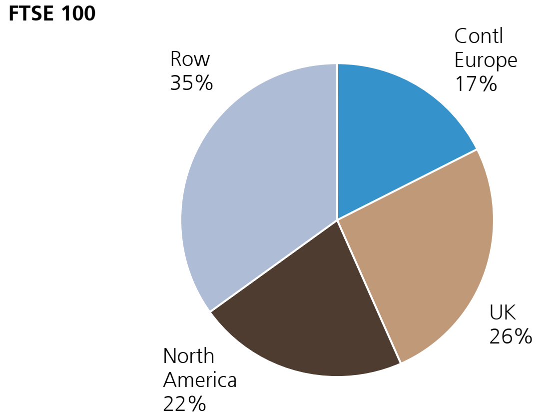
Geographical sales exposure

The fall in the market PE is mitigated by the 75% of sales that leave the UK, boosting profits as they are repatriated. On currency we have the USD/GBP falling to $1.20 and the Euro/Pound falling towards parity, but it becomes more complicated when looking at emerging market currencies like the CNY and any rising USD impact on commodity prices.

75% sales leave the UK

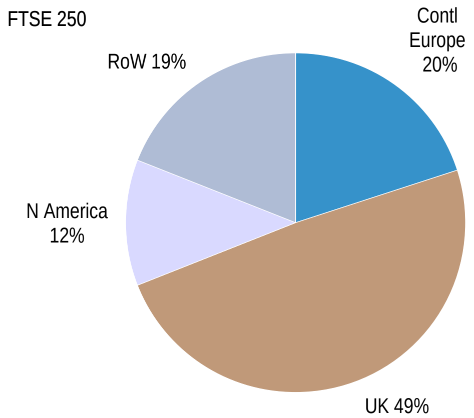
Roughly 10% fall in trade-weighted sterling = c. 5% rise in profits *all else equal*

Figure 34: FTSE 100 - 75% of large cap sales leave the UK and 57% leave Europe



Source: UBS European Equity Strategy

Figure 35: FTSE 250: geographical sales exposure – half of their sales are domestic.



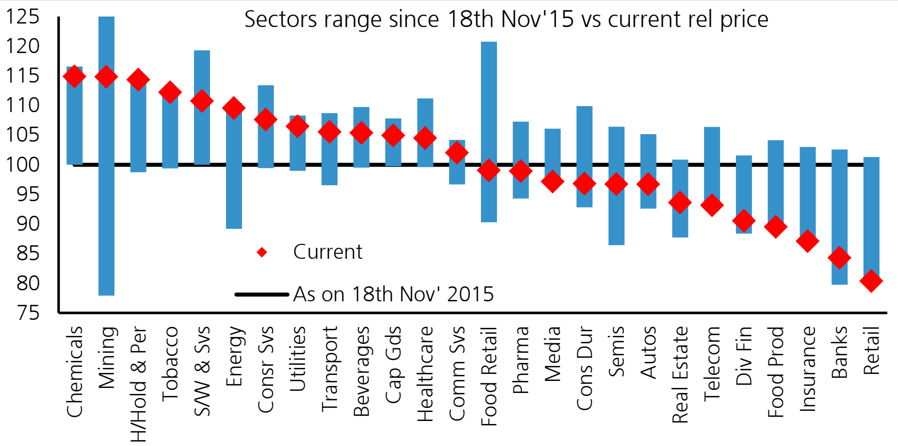
Source: UBS European Equity Strategy

UK Sectors and companies

RANGE of sector performance since 18th Nov

Those sitting on the high end include international defensives like Household, Tobacco and Chemicals and Energy. Real-estate has recovered half of its price fall. But General Retail, Financials and Food Producers are still at their lows.

Figure 36: Sector performance since November 2015 – No let up for Banks unlike the Real-Estate – bounced back to



Source: Thomson Datastream, UBS European Equity Strategy

Top of Range: HH, Tobacco, Chemical and Energy

Middle: Real Estate & Food Retail

BOTTOM of range:

Financials (QE and yield curve worries)

Retail (USD cost base / GDP slowing)

Food Producers odd one out? Are international & defensive

Risk to Europe – what works in a crisis?

There is no precedence of a non-EU member leaving. We look at the escalation of the euro crisis when investors thought the end of the euro was possible between March to July 2012 - before Draghi stepped in to resolve the situation. What worked?

What protection worked in the last euro crisis?

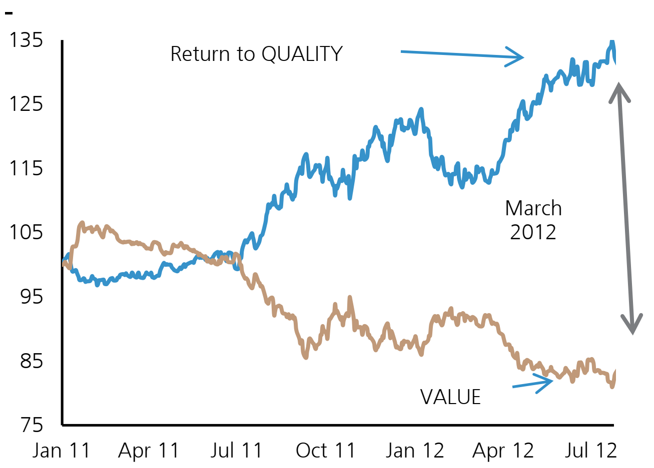
Protection is more expensive than July 12

Is it really worse today?

1. Quality a solid safe haven – but more expensive today

During the euro crisis, Quality was a winner and beat Value by c. 50% from March to July 12 (figure left). Today it is also elevated as shown below. And if we look at the valuation gap between low and high vol stocks, it is 20% higher today than in July 2012 – meaning quality looks expensive. In summary, it is a haven, but in our opinion we would need a pretty bad outcome for Quality to rally further given it already appears to be at crisis levels.

Figure 37: Investors move back into Quality in March 2012 – leaving Value as they go.



Source: UBS Quants and European Equity Strategy

Figure 38: Performance of European High vs Low Quality suggests we are still in a crisis – update.

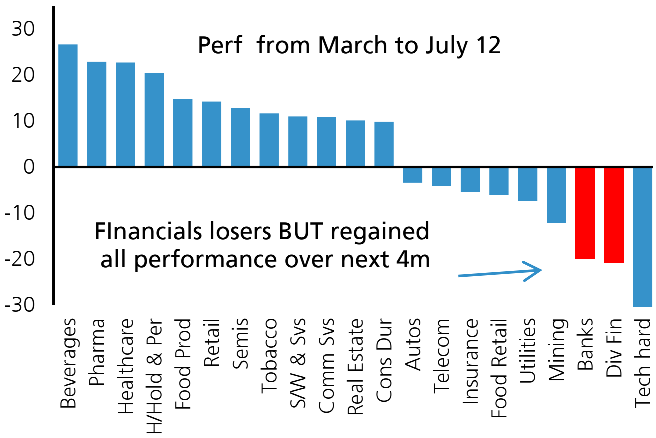
Source: UBS Quants and European Equity Strategy

2. Defensives beat Cyclicals – but more expensive today

Defensives beat from March to July 2012 but are 7% more expensive now. If there is relief and growth is resilient, cyclicals should bounce. Financials hurt most in 2012, but recovered it all. Albeit any resolution in likely to be less straight-forward this time.

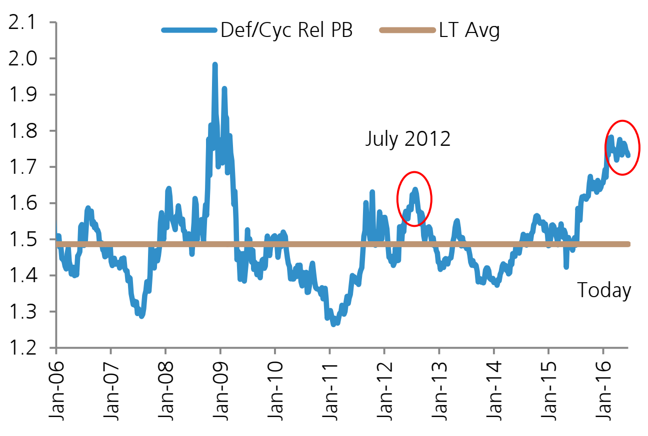
Defensives / Cyclical valuation gap is 7% bigger today on PB

Figure 39: Relative perf 4m before & after Draghi saved the euro



Source: UBS Quants and European Equity Strategy

Figure 40: Defensives vs Cyclicals P/B gap – higher today



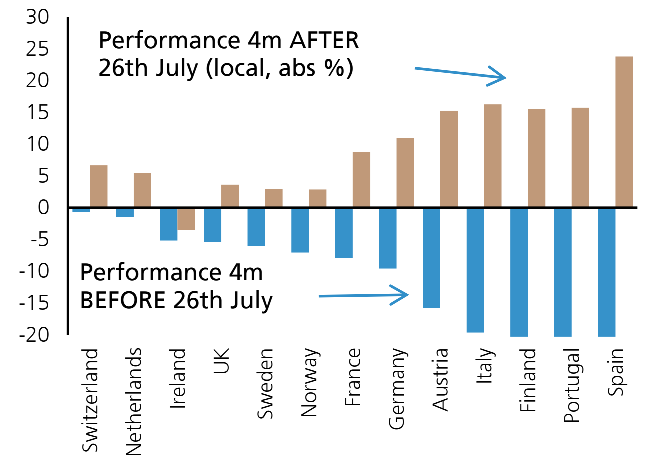
Source: UBS Quants and European Equity Strategy

3. Switzerland best performer – cheaper today

Switzerland was the best performer in March to July 2012 and has started to outperform late April. Switzerland has outperformed the last 1-2 months, but the dividend yield today is at market levels, so it looks cheaper than July 2012. The Swiss market is 50% defensives made up of Food Producers and Pharma (which has recently de-rated).

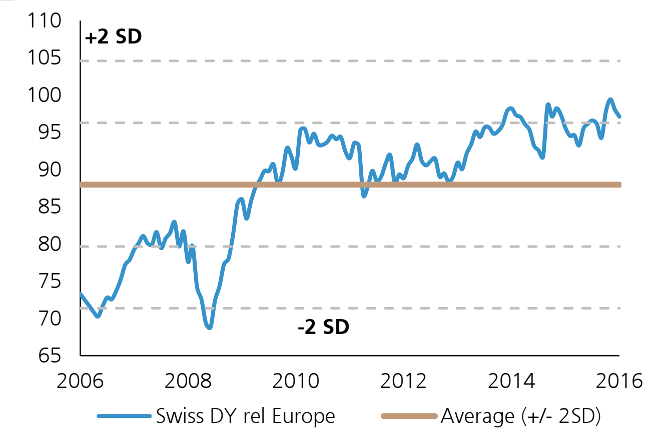
Cheaper today. Swiss dividend yield = 4% in line with Europe

Figure 41: Switzerland is the only country to miss the market sell-off



Source: Thomson Datastream, UBS European Equity Strategy

Figure 42: TODAY: Switzerland looks cheaper: dividend yield relative to Europe near a decade high.



Source: Thomson Datastream, UBS European Equity Strategy

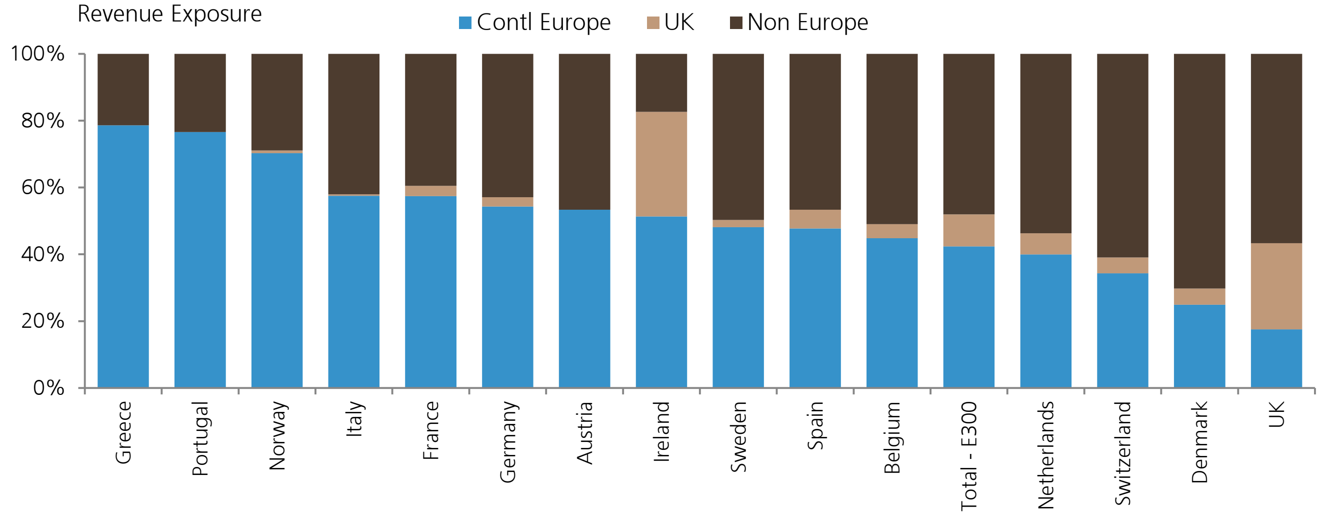
Summary – UK least exposed to UK/Europe

The uncertainty facing the UK (and Europe?) is very hard to measure, but ironically both Switzerland **and the UK** have the LEAST sales exposure to the UK and to Europe. This will offer some support that is not available to most Continental European countries, as below, if Europe as a whole suffers. The UK will likely benefit too if the risk-adjusted PE settles back-up from its initial shock or the 20% de-rating that we expect.

Ironically, the UK sells the least to UK and Europe

In line with Switzerland

Figure 43: Sales exposure by Region – Dark Brown is NON-EUROPE exposure (for European large caps)



Source: UBS European Equity Strategy

Buys on Leave

We provide a list of both UK and European Buys. The UK names are those previously flagged as Brexit winners that have yet to outperform (since sterling started its ascent) but should benefit from lower UK sales exposure and a respective boost to profits on a weaker currency. The European names follow a search for reasonably priced defensives in a backdrop where defensives relative to cyclicals look more expensive today than they were in July 2012 (the peak of the last euro crisis).

(Source: UBS Estimates)

Wire Code	Name	Sector	Performance since Nov 18th 2015 (%)	DY 2016E (%)	UK Exposure (%)	Cont Europe exposure (%)
SOP	Sophos	Software	-37	0.2	13	20
IMG	Imagination Tech	Semis	-22	0.0	9	8
NOTEL	Telenor	Telecoms	-14	5.8	0	44
AZN	AstraZeneca	Pharma	-12	5.0	7	22
PRU	Prudential	Insurance	-12	3.1	18	0
CHHM	Roche	Pharma	-10	3.5	4	28
MDI	Mondi	Paper	-9	3.3	4	57
CHNA	Nestlé	Food Products	-5	3.3	3	21
NLHB	Heineken	Beverages	-5	1.8	6	33
ARM	ARM Holdings	Semis	-4	1.0	1	10
FREF	Essilor	Healthcare	-4	1.0	3	32
VOD	Vodafone Group	Telecoms	-3	5.1	15	51
DGE	Diageo	Beverages	-2	3.2	10	9
CNA	Centrica	Utilities	1	5.7	54	2
MGGT	Meggitt	Capital Goods	2	4.0	10	22

Other markets

The S&P 500 would stand to lose less than other DM stock markets, in our view. First of all, the macroeconomic impact is almost certain to be smaller for the US than the Eurozone or the UK itself due to weaker economic and financial linkages. Secondly and in our opinion more importantly, however, the low level of yields offers an additional cushion that could further soften downside pressures. A cautious Fed has been a key support variable for the equity market. In fact, equity markets have been the best predictors of changes in the Fed's own forecasts of the future path of monetary policy as expressed in the "dot plot". As a result, the expectation of additional policy relief by the Fed in response to the negative shock associated with the Leave vote should help limit S&P downside.

SPX stands to lose less than other DM

Finally, across **EM assets**, we estimate credit stands out as 40-50bps too rich given commodities prices and our balance sheet score. Yesterday's Leave vote could therefore be a catalyst for a further correction there. Correlations to risk will also likely see some damage to EM currencies and stocks as well. However, limited direct exposure to macro risks (outside the CEE) suggest that the effects of sentiment on those assets may not be long lived. Finally, lower G10 yields imply less underperformance for EM bonds vs other EM assets.

Across EM credit stands out as too rich

Valuation Method and Risk Statement

Risks include macroeconomic variables (such as GDP growth rates and inflation), economic slowdown, a weakening currency, global economic events, and government policy changes

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Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2016.
1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
ARM Holdings Plc[4, 5, 7, 14, 16b]	ARM.L	Buy	N/A	1,019p	23 Jun 2016
AstraZeneca[7, 16b]	AZN.L	Buy	N/A	3,899p	23 Jun 2016
Centrica[2, 4, 5, 7, 13, 14]	CNA.L	Buy	N/A	218p	23 Jun 2016
Diageo[4, 5, 6b, 7, 16b]	DGE.L	Buy	N/A	1,833p	23 Jun 2016
Essilor International[7]	ESSI.PA	Buy	N/A	€118.30	23 Jun 2016
Heineken	HEIN.AS	Buy	N/A	€81.27	23 Jun 2016
Imagination Technologies	IMG.L	Buy	N/A	181p	23 Jun 2016
Meggitt	MGGT.L	Neutral	N/A	397p	23 Jun 2016
Mondi[14, 18]	MNDI.L	Buy	N/A	1,363p	23 Jun 2016
Nestlé[4, 5, 7, 22]	NESN.S	Neutral	N/A	CHF72.35	23 Jun 2016
Prudential[2, 4, 5, 6a, 7, 14, 16b]	PRU.L	Buy	N/A	1,359p	23 Jun 2016
Roche[2, 4, 5, 6a, 7, 22]	ROG.S	Buy	N/A	CHF246.50	23 Jun 2016
Sophos Group PLC[2, 4]	SOPH.L	Buy	N/A	179p	23 Jun 2016
Telenor	TEL.OL	Buy	N/A	NKr133.00	23 Jun 2016
Vodafone Group[2, 3, 4, 5, 7, 14, 16b]	VOD.L	Buy	N/A	218p	23 Jun 2016

Source: UBS. All prices as of local market close.
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