sentix Global Investor Survey

Special report on Brexit – an analysis in three acts

25 / 2016

Survey statistics

Poll running: **23-June to 25-June-2016**
Survey participants: **1305 investors**
(with institutional background: **316**)

sentix
expertise in behavioral finance

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Brexit – An analysis in three acts

- **Act 1 (prelude):** investors have long neglected the potential perils of a Brexit. As a logical consequence, fear mounted in the run-up to the referendum. The assassination of the British politician Joe Cox, however, ignited peoples status quo bias again. Until election eve, investors remained in denial. Therefore, the market was completely unprepared.
- **Act 2 (Brexit):** the victory of the leave campaign caused investors to enter the behavioural stage of recognition abruptly. Over the next days, sentiment and uniform behavioural pattern dominate markets. Although, these behavioural traits will not leave a lasting impact.
- **Act 3 (outlook):** while irrational exuberances should fade away over the coming days/weeks, the outcome of the Brexit referendum reveals structural interruptions for global markets. Such interruptions often built the basis for new, lasting market trends. It just depends on differentiation, in our opinion, the euro, US equities and German Bunds are to watch.

About the sentix Global Investor Survey

The decision of the British voter to leave the European Union is in its magnitude unprecedented. It is hard to forecast the days and weeks precisely to come. The sentix Global Investor Survey has the objective to measure investors' perception, their motives, sentiment as well as market positions to make that information assessable to the investment community.

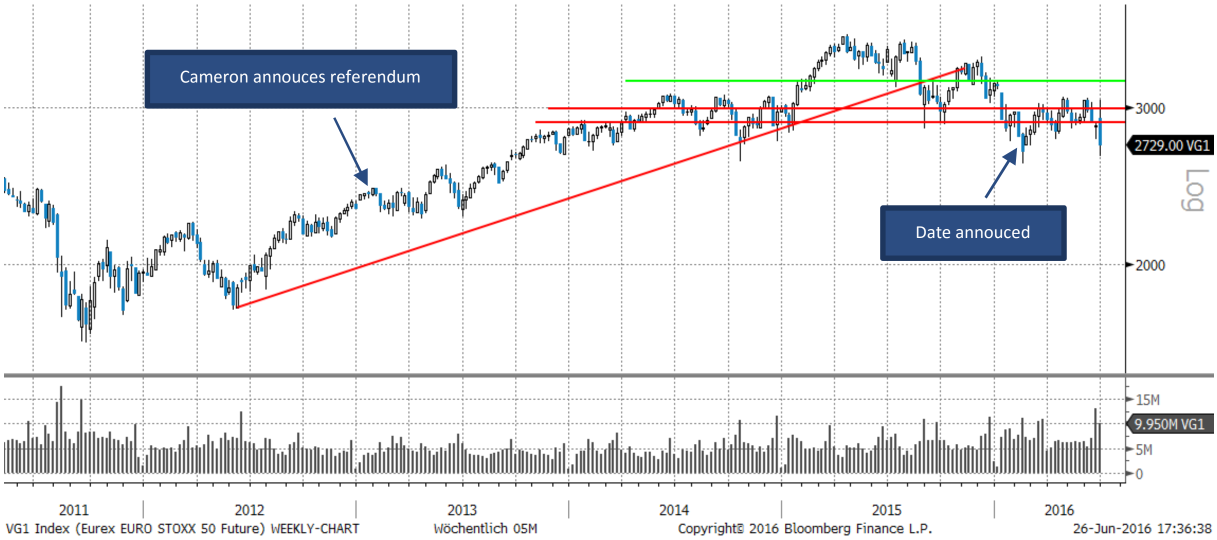
The sentix survey runs each Friday – and we can provide you with first-hand insights what investors think about the Brexit. Where are new trends evolving? How are market participants reacting? Our more than 400 indicators are designed to provide answers. sentix is the only business that can provide such reliable, almost real-time, sentiment data. **sentix – first mover advantage!**

Our pool of investors consists of more than 5,000 registered investors of which more than 1,300 participated in this week's survey – a new participation record.

Our data and the analyses results are freely available for survey participants for personal and non-commercial use only. For commercial purposes, please do not hesitate to express your interest and start profiting from assessing one of the world largest sentiment databases. We count numerous reputable institution as our clients such as banks, asset manager, hedge funds as well as public authorities.

First Act – prelude

On the 23rd of January 2013, the British prime minister David Cameron announced that a referendum will be held at the latest by 2017, under the condition that he then still serves office. A referendum addresses the issue whether Britain remains or leaves the European Union. Finally, on February 20th, he announced that the referendum takes place on June 23rd. Financial markets hat time set up precautionary measures, since that day. However, apparently, that did not go well.



Euro STOXX 50 Future since 2011

We are living in extraordinary times characterised by low-interest rates and investment plight. Passive investments have been rewarded over the recent years. On the contrary, deploying risk management strategies have been punished by the markets over the past years. Under the protecting umbrella of the central banks, investors were on the winning track by just remaining invested in risky assets. Being cautious was not a pressing issue on the agenda of many investors. These tempted investors to display an investment attitude "beyond good and evil" and ultimately ousted one of the most important virtues of investing: risk management. It motivated us to choose the headline "risk management is going to be the discipline of the year 2016" for our last year's annual outlook.

By all means, it was foreseeable that over the cause of this year, a Brexit would be a challenge [1]:

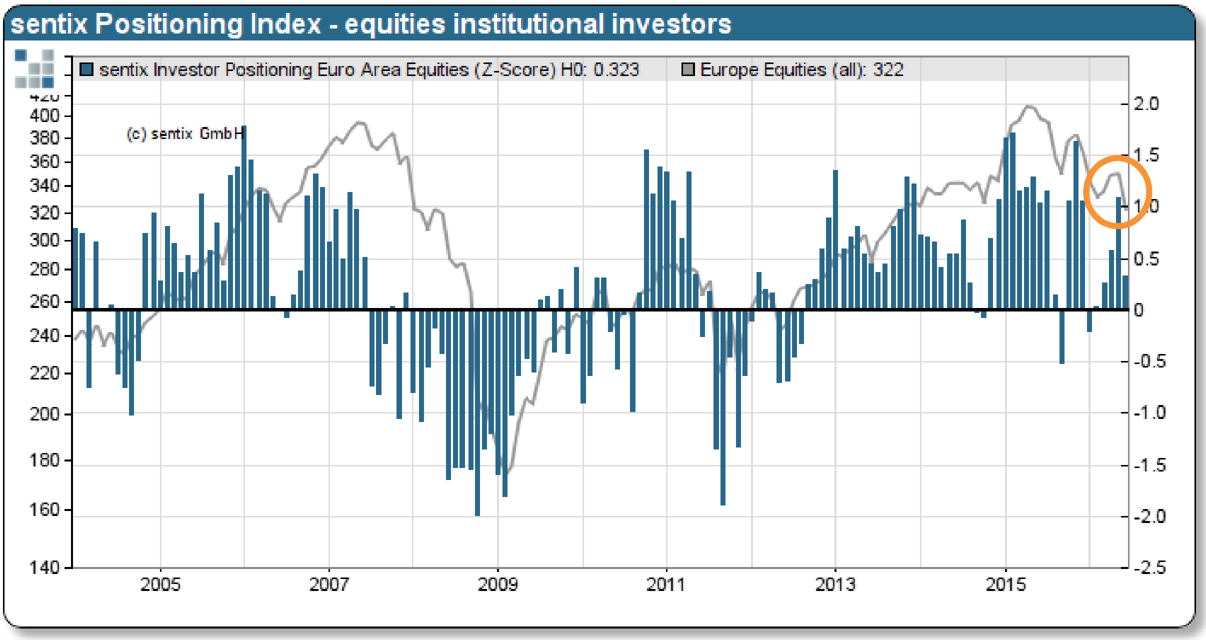
Die drängenden Fragen unserer Zeit überfordern aber nicht nur einzelne Staaten, sondern auch Kunstgebilde wie die EU. „Brexit"[10], „Grexit"[11], „Fixit"[12] – alleine die zunehmende Zahl von Wortschöpfungen, die allesamt auf Auflösungserscheinungen der europäischen Staatengemeinschaft hindeuten, sollte als Warnung verstanden werden.

Je mehr die Menschen das Gefühl ereilt, dass die Politik mit der Vielzahl an Herausforderungen nicht mehr zurechtkommt, desto mehr werden sie versuchen, die Dinge in einem regionalen Kontext, der besser überschaubar ist, zu lösen.

Accordingly, we have altered our market outlook already in December 2015 and reviewed the situation on financial markets critically in numerous publications. After the worst start in a trading year ever, the vast majority of investors quickly turned to business as usual. Lead by the US equity exchanges the recovery of asset prices went into full swing. Even in Europe stocks were no alternative for investors.

[1] Excerpt of the sentix annual outlook 2016 (currently only available in German)

Fostered by central banks willingness to deliver more QE, corporate stock buy-backs and rising confidence in stocks, investors played big in the positioning game. Hence, investors' portfolios were loaded with equities by the end of May:



The VSTOXX, which measures the implied volatility of European equities traded in the Euro STOXX 50, plummeted under the 20% mark, in the days before the referendum. It was an opportunity for investors to purchase a relatively inexpensive insurance against a possible Brexit. It is hard to imagine unpleasant market trends during quiet market periods, though.

> But Sentix notes that opinion polls in the UK suggest a higher probability of a Brexit and investors could get a shock if the result goes a different way. The group says:
>
> If indeed a Brexit takes place, the market is likely to panic. As among other things, the only 9% share of institutional investors expecting a "Brexit" highlights the apparent surprise potential.

sentix would not be a first mover if it had not survey investors about their opinion on a possible Brexit. By the end of May, only a mere 9% of institutional investors reckoned that Britain would be in deed to leave the Union. Public opinion polls in contrast already proclaimed a neck on neck race between remain campaign (Bremain) and the leave campaign (Brexit). Hence, the risk awareness of investors was in stark contrast to the general opinion of British voters. Misperception, unfortunately, coincided with highly exposed portfolios. Again, in recent analyses, we highlighted risks associated with such a scenario.

As the Brexit camp first led polls by 46% to 44% financial markets started to panic at the beginning of June. Our strategy played out as investors' demand for hedging increased. As a result, market risk, as well as potential Brexit collateral damage risk, declined. The subsequent market sell-off halted at 2.766 points in the Euro STOXX Future. The market topped just at the moment the British MP Jo Cox was gunned down on June 16th, 2016

sentix ASR Essentials 24-2016

WRITTEN BY PATRICK HUSSY | 19 JUNE 2016
POSTED IN SENTIX WEEKLY

Warming to EZ versus US equities despite near-term uncertainties

A week in which Thursday's UK Brexit vote will likely dominate market sentiment has started in positive fashion, with equity markets bouncing on the back of polls showing 'remain' having a modest lead over 'leave'. However, latest sentix survey suggests investors are becoming more upbeat on eurozone (EZ) equity markets from a medium-term perspective. This has seen the gap between strategic bias readings for the EuroSTOXX and S&P 500 pull sharply back from spring lows. It appears that some investors are seeing value in EZ equities versus US from a strategic perspective (Charts 3-4, p2).

This act of violence caused a shift in public opinion. Especially undecided voters took action and expressed sympathy for the Bremain campaign.

This sympathy pattern is neither unique nor surprising. The last mayoral election in the German city of Cologne was decided by an assassination attempt, hours before polling day. The quick recovery of markets in the aftermath of the killing in Britain proofs the effect the status quo bias which clouded the perception of investors and the media. An analysis of the VSTOXX-index would have provided the intrigued investor with the insight that other investors abandoned their hedges from Thursday afternoon onwards. The data reveals that investors even increased their exposure to risk.

The media echo was dazzling alike: the front pages of prominent (German) magazines and newspapers showed no sign of reverence for the outcome of the referendum. It is rather a ridicule if investors are animated to discount the result of the referendum quickly. The media opined that a Brexit is overestimated and investors could go back to buying equities like nothing is going to happen. Risks were apparently downplayed which anything but responsible.

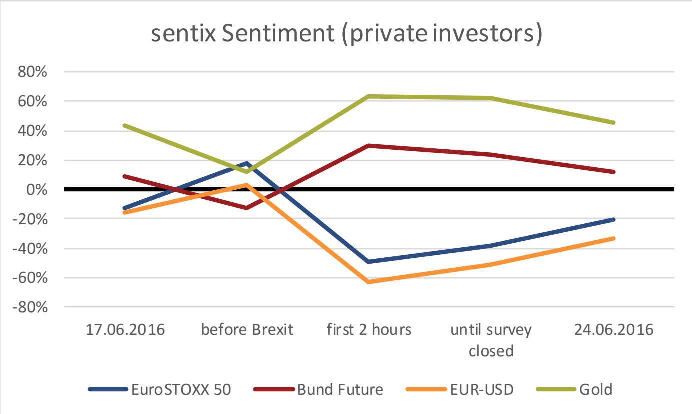
Second Act: The Brexit

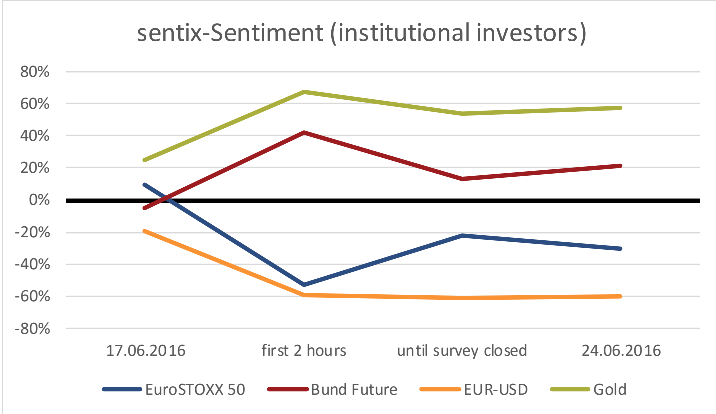
2016 is obviously not an easy year for being a British bookie. At first, they got the odds wrong on this year's premier league champion Leicester City. To make things worse, they got the odds associated with a Brexit wrong. In both cases, the odds were not nearly as close as they should have been. No wonder that the likelihood of a Brexit went off the radar for the financial industry.

The weekly sentix headline indices represent the average of investors' opinion over the voting period. Institutional investors can vote to start from Friday morning until Saturday afternoon. Private investors, however, can submit their views as early as Thursday evening. Consequently, votes cast on Thursday distort the overall voting behaviour as the result of the Brexit referendum became only apparent starting from Friday morning. Without adjustments, the sentix averages would lead to wrong conclusions. Our infrastructure nevertheless allows us to distill the precise time Brexit news impacted investors behaviour. We can subdivide the survey process. In this week's analysis, we, therefore, segment our sentiment data into three phases to illustrate investors emotions. In the following we analyse euro area equities, German Bunds, the EUR/USD FX rate and gold.

- Phase I: the sentiment ahead of the election night ("before Brexit")
- Phase II: the first hours after the opening bell - European exchanges (until 10.30 CEST; "first 2 hours")
- Phase III: the sentiment by survey closing (Friday from 10.30 CEST until Saturday afternoon; "until survey closed")

The following charts illustrate investors sentiment swings:



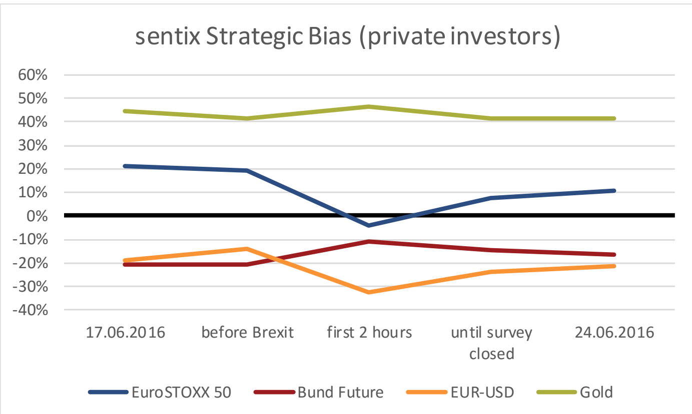


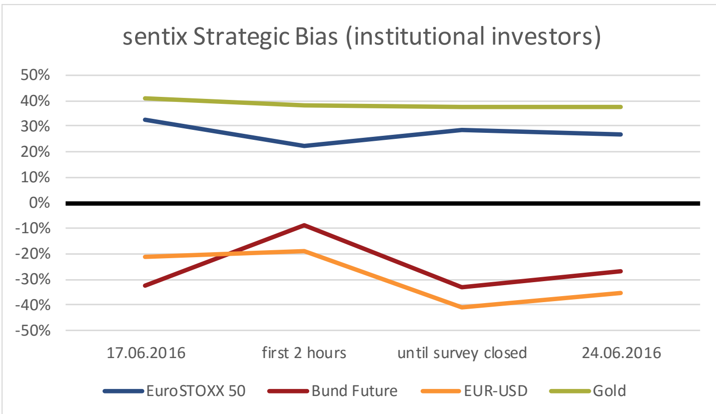
The charts above clearly indicate complacency the night before the Brexit referendum. Sentiment brightened in comparison to last week’s survey data (June 17th). On Friday morning, however, sentiment nose-dived. While investors’ sentiment for stocks and the euro FX collapsed to panic-like levels, gold was sought after based on sentiment readings.

Private and institutional investors showed similar behavioural patterns. Both investor groups' sentiment recovered throughout Friday’s trading session. Nevertheless, two exceptions are striking, especially for institutional investors: the sentiment for the euro FX rate remains depressed, while gold’s sentiment remains on top.

The sudden collapse of investors’ sentiment follows behavioural finance theory. Theory suggests that people react to unanticipated shocks with short-term emotional overreaction (=sudden sentiment collapse). In contrast, investors’ longer lasting motives and convictions evidence underreacting.

Hence, the sentix Strategic Bias should indicate a plausible pattern whether such an under-reaction took place.





The graphs above highlight that investors have indeed adapted their strategic convictions only at the margin. Except institutional investors view on the EUR/USD FX rate, where the Strategic Bias dropped, the Brexit should either turn out to be a non-event or a longer-lasting effect has not managed to alter investors strategic outlook yet.

We are convinced of the latter and conclude that the Brexit represents a chance of structural magnitude. Investors might need to adapt their medium-term expectations in the coming days.

At this point, we would like to remind you kindly that the next sentix Economic Index will be released on 04. July 2016 at 10.30 CEST. Our indicator is the first of its kind to be published after the referendum. No investor should miss out the nest sentix Economic Index as it leads the way for other economic indices (95% correlation to the ZEW and ifo) **sentix – first mover advantage!**

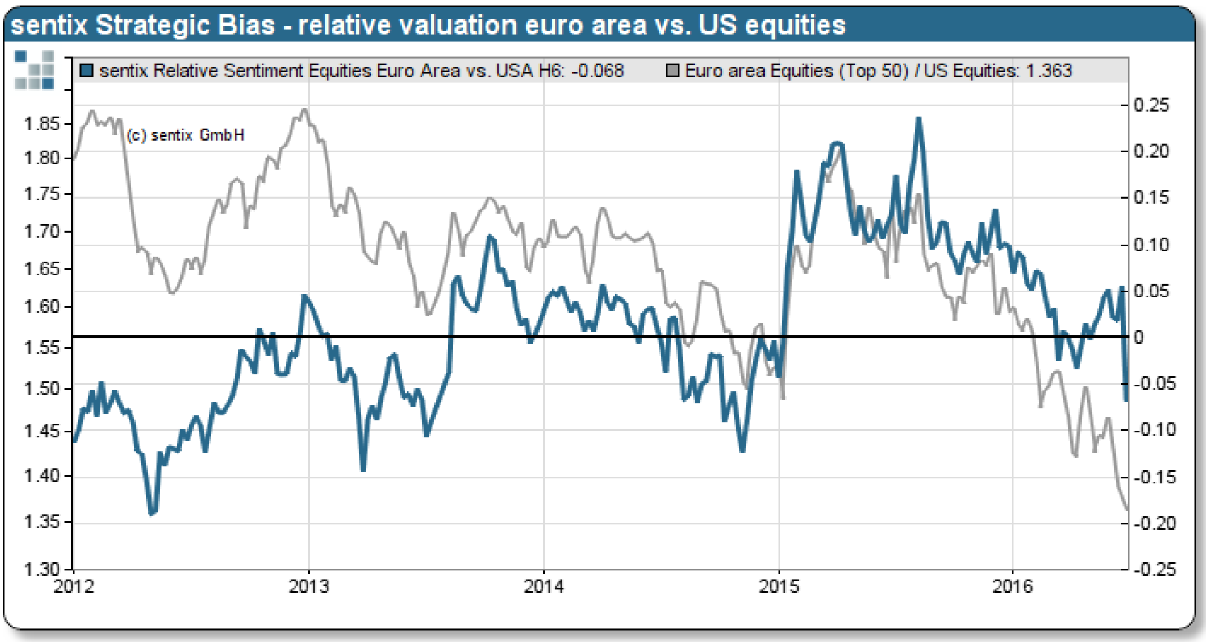
We have to acknowledge that the development in the EUR/USD FX rate has to be put into perspective. The Strategic Bias for institutional investors has already commenced its decline before the referendum. According to our analysis, the euro should face downside pressure in the weeks to come.

The shift in the sentix Strategic Bias for the EUR/USD is related to a change in investors perception on the stability of the euro. Sentix publishes the latest sentix Euro Break-up Index on Tuesday before opening bell to secure the timely delivery of material information. Be the one of the first to know what investors think which country exits the euro first. **sentix – first mover advantage!**

Third act - outlook

According to our opinion, the market currently displays signs of short-term overreaction. In the following trading days, markets should stabilise. However, such a stabilisation should not be misinterpreted as an indication that everything is back to normal. The medium- and long-term consequences for investors are at this stage not clearly visible yet. Only the verdict on the further development of the euro seems unambiguous: the euro should weaken further.

That, in turn, affect the relative relationships between equities. Investors reckon that US equities emerge strengthened of the Brexit skirmish. Although, this could turn out as misinterpretation given a foreseeable euro devaluation.

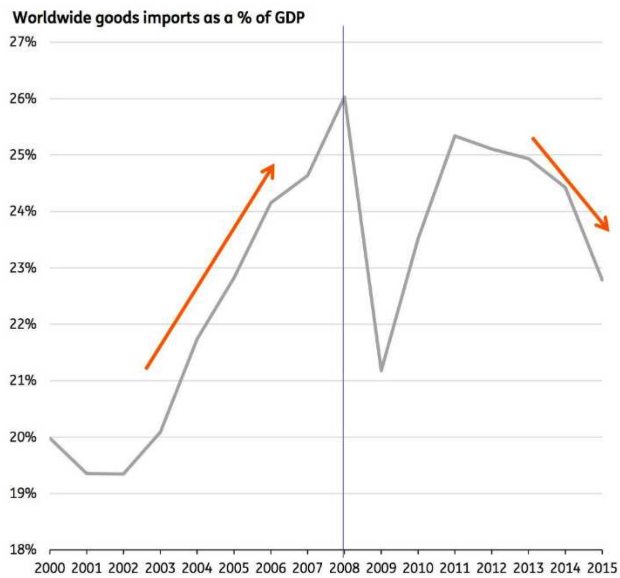


Relative Strategic Bias European equities and US-equities

The analysis of the strategic Bias for German Bunds reveals a second indication for a possible change of investors outlook. Bunds were neither immediately during the panic on opening bell nor the subsequent phases able to strongly benefit from its characteristic as a safe haven asset. We would certainly not be surprised if the Brexit turns out to be a liability for German Bunds.

As we have analysed in **previous outlooks** (please refer to our archive; access for survey participants inclusive) the world economy faces increased pressure due to rising protectionism and regionally limited trade which is a breeding ground for inflation. Since 2011, global import volumes decline (refer to chart on the next page). Therefore, the threat is real that the benefits trough globalisation could evaporate.

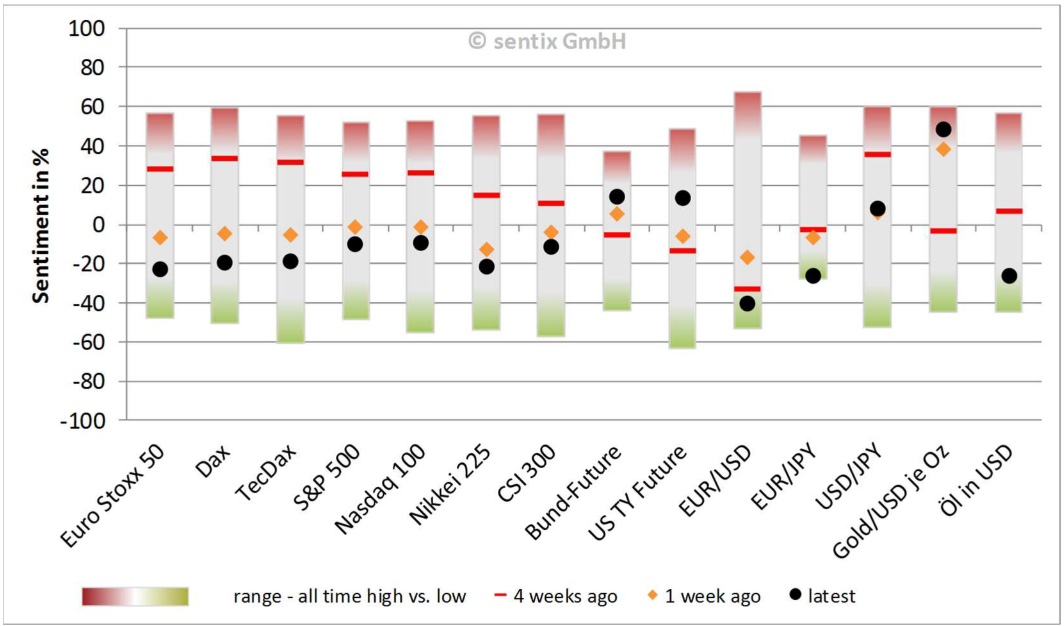
Moreover, investors reckon that Germany has to commit more to keep the European Union together, "whatever it takes". Should further integration be the response to the current crisis, German Bunds might feel the burden. Because medium, as well as long-term consequences, are not visible yet, it is worth paying attention to emerging differentiations. Based on theory, the first phase is characterised by falling and subsequently recovering asset prices. At the moment investors start to realise the full implications of a Brexit for financial markets, they should start to differentiate assets which are expressed through different investment behaviour.



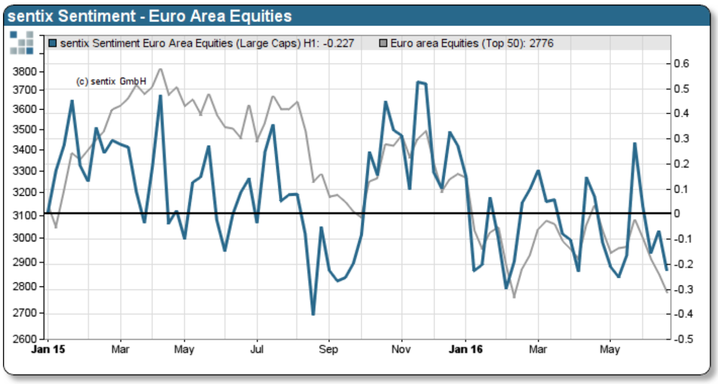
Based on today's data, investors show their wishful thinking that the Brexit remains a one-off shock without far-reaching consequences.

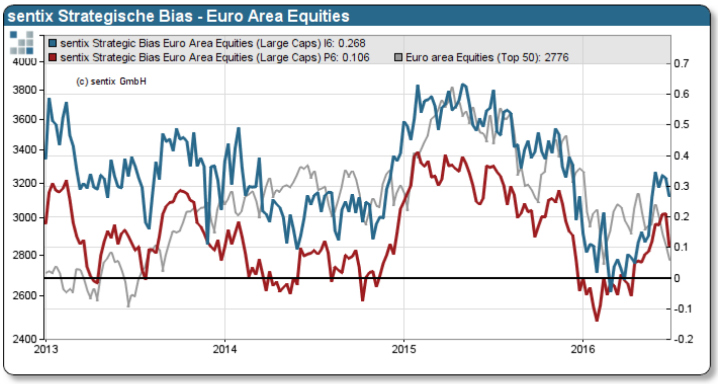
This is understandable based on a psychological point of view. In contrast, the most realistic scenario is that the Brexit represents a profound structural shift causing new trends to emerge. We, therefore pay close attention to the euro (depreciation), US equities (tendency to underperform) as well as German Bunds (trend towards the market top).

Charts and summary of survey results

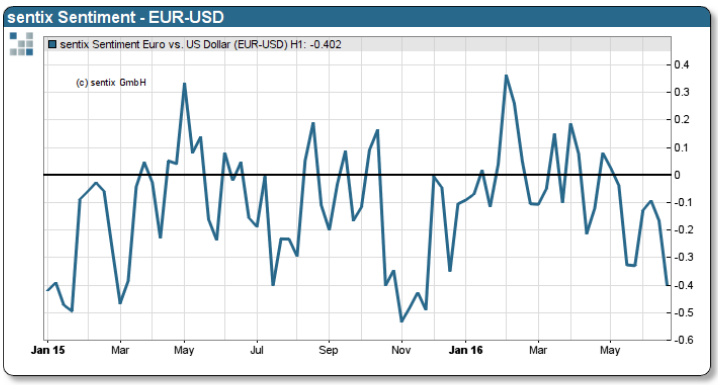


sentix Sentiment





Sentiment (left) and Strategic Bias (right) euro area equities



Sentiment (left) and Strategic Bias (right) EUR-USD

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Background information on the sentix indices

sentix indicators are based on the sentix Global Investor Survey, a weekly survey among more than 5.000 international investors. The survey is carried out on a regular basis since February 2001. For more information on sentix, the participation in the survey and on a detailed description of all indicators, please visit our website under http://www.sentix.co.uk.

sentix indicator	background information
sentix Sentiment (short-term market expectations)	The sentix Sentiment, investors' one-month expectations for a given market, reflects the emotions – between greed and fear – of market participants. Negative sentiment extremes are usually a straight indication for rising prices. High optimism may be a warning signal for an upcoming market consolidation. A sentiment divergence mostly indicates more important turning points.
sentix Strategic Bias (medium-term market expectations)	The sentix Strategic Bias, investors' six-month expectations, reflects the strategic view of market participants as well as their underlying convictions and perceptions of value for a given market. As this indicator represents investors' general willingness to buy or sell it should not be interpreted as a contrarian signal. Rather it is usually leading the market by several weeks. And as the indicator mainly reflects investors' longer-term convictions and perceptions of value it is an indicator coined by the "wisdom of crowds", it bundles the knowledge floating around in a market of various players.
sentix Neutrality-Index	The sentix Neutrality Indices, represent the share of neutral investors in the market. A high percentage of such investors points to irritation and greater volatility shortly. A low reading shows that investors have understood "the market". In the neutral camp, there is always an important part of investors who are not or only marginally invested. Those are important as they are potential future buyers or sellers! For sentix Neutrality Indices, the interpretation of the short-term and the medium-term are most of the time similar. Consequently, the case is strengthened when both time horizons reach extreme readings.
sentix Overconfidence-Index	sentix Overconfidence Index measures the probability for the case that a series of rising or falling prices has led to an augmented complacency among investors. Readings below -7 or beyond +7 are usually a sign that consolidations or corrections are imminent.
sentix Time Differential Index	For a given market, sentix Time Differential Index is calculated as the difference between the short-term sentiment and the (medium-term) perception of value. High readings of the indicator are a sign of a positive sentiment which is not fostered by a medium-term conviction, which is a stress factor for the market. In turn, low readings result when there is fear on a short-term basis but a reliable perception of value for the medium-term that is usually supportive for the market.

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