

June 24, 2016 03:52 AM GMT

# Cross-Asset Strategy

## What Leave Means

We see GBP moving to 1.25-1.30 and 15-20% downside to European equities relative to Thursday's levels. Corporate and sovereign credit present the best opportunities to buy on weakness.

**Economic implications:** The UK faces a prolonged period of uncertainty which should lead both investment and consumption to wane. Longer term, a less open economy could lower the UK's rate of potential growth. Risks to the economy will likely lead the Bank of England to keep an easing bias – **staying on hold through 2017-18, or a rate cut to 10bp with further QE depending on exit negotiations.**

**What has furthest to fall:** Negative implications extend beyond the UK. We see the most downside in GBP and EU equities, and would also be sellers of AUDJPY (target 70), USDJPY (90) and EURCHF (1.02) on a flight to safety. Gilt yields could rally 30-35bp to all-time lows, but breakeven inflation could ultimately rise, given weaker GBP. In EM FX and local rates, sell Poland and South Africa.

**Where to be brave:** ECB support, both potential and existing, argues for buying corporate and sovereign credit into weakness. We discuss levels and our expected central bank response.

**FX:** Poor fundamentals could support 10%+ downside in GBP. Higher global volatility favours JPY and CHF. Increased concerns over eurozone vulnerabilities make PLN the best short in EM.

**European equities:** We expect significant downside for European stocks - SX5E at 2400-2550 and FTSE 100 at 5000-5300. Financials and Consumer Discretionary will likely lead the market lower, while Staples and Healthcare should outperform.

**Credit:** We expect a strong response from the ECB – we'd add risk in CSPP-eligible assets and 'A'-rated ineligible non-fins on initial weakness. We'd also add bank credit selectively on what we expect will be materially lower prices today – UK banks' LT2 and AT1s have best asymmetric returns.

**European rates:** We reiterate our long duration recommendations and believe UK yields could rally 30-35bp. GBP depreciation should be a dominant force on inflationary pressures over the next two years – long Nov-18 UKTi breakevens. The decline in global yields could see 30y UK real yields return to all-time lows; we reiterate long Mar-46 UKTi real yield. BTP spreads moving more than 25bp would represent value to 'buy on weakness', in our view.

**EM fixed income:** We expect risk-aversion to widen the impact beyond countries with direct UK links. We see Poland and South Africa most exposed in rates and FX, and South Africa and Turkey most exposed within EM credit.

For the economics view, see [EU Referendum: Out into the Unknown](#).

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### Summary of key six-month target levels (mid)

	As of 23 Jun, 5pm	6m Target	6m Return
<b>FX</b>			
GBPUSD	1.48	1.28	-14.0%
EURUSD	1.14	1.05	-7.5%
EURGBP	0.77	0.83	7.7%
<b>Equities</b>			
MSCI Europe	1336	1105	-13.6%
Stoxx 50	3038	2475	-14.5%
FTSE100	6338	5150	-14.3%
<b>CDS Indices (bp)</b>			
iTraxx Main	75	100	-0.5%
iTraxx Crossover	322	438	-4.5%
iTraxx Senior Fin	96	115	-0.7%

Source: Bloomberg, Morgan Stanley Research forecasts

Andrew Sheets, Hans Redeker, Sheena Shah, Anton Heese, Srikanth Sankaran and Jackie Ineke are fixed income strategists and are not opining on equity securities. Their views are clearly delineated.

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## Cross-asset implications: Bracing for volatility

Andrew Sheets

It looks likely that the UK has voted to leave the EU. This result will come as a surprise to markets, based on Thursday's pricing, and creates material political and economic uncertainty in Europe. Both are negative for risk premiums, and the question over the next several days is not whether prices fall, but by how much, and whether central banks respond.

**What level of sell-off is warranted?** A great deal of uncertainty hovers around all of our estimates in this scenario. Generally speaking, **we see the most downside in European FX and equities**. We think both European corporate and sovereign credit will be better insulated, given central bank support.

Specifically, we think GBPUSD could trade down to 1.25-1.30, as valuations need to adjust sharply before the currency is 'cheap', in our view. EURUSD could fall to 1.05 over the next six months as its correlation with risk flips, reverting back to the pattern seen in 2011-12, when EUR served as a proxy for European cohesion. JPY and CHF, in contrast, should be well-supported. We think European equities could sell off by 15-20%, on a ~5% hit to earnings and de-rating the P/E back to near historical averages. Within equities, we prefer to be defensive, favouring Staples and Healthcare, and our 'Weaker EUR beneficiaries' basket (MSSTWKEU).

While spreads should also widen, we think **corporate and sovereign credit stand to outperform FX and equities significantly**, given the ECB's outstanding purchase programmes for both. We expect CDS to materially underperform cash, with XOver moving out towards 450bp.

**What to watch for?** All eyes are now on the ECB, and how aggressively it decides to intervene in order to protect its member states and deflect downside risks to inflation that could result from increased economic uncertainty. In the very short term, we think the ECB could reassure markets about liquidity provision (including via FX swap lines and emergency liquidity assistance) today. We would also watch MS GRDI\* (STGRDI <Index>), our preferred sentiment measure, dropping below -3, for assessing if the sell-off has run its course.

**We see US assets across the spectrum - stocks, FX, credit and government bonds - becoming relative safe havens:** We reinforce our preference for US versus ROW in equities. We think EM equities are more vulnerable to contagion risks from Europe than US equities.

\*Global Risk Demand Index – US Pat. No. 7,617,143

**Exhibit 1:** Most assets are at YTD highs

Asset Class	Asset Prices			14-Jun	YTD	YTD
	Low	High	Spot		Low	High
Equities						
S&P 500	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	2,105	2,075	1,829	2,119
Euro Stoxx 50	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	3,038	2,797	2,680	3,178
FTSE 100	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	6,338	5,924	5,537	6,410
Rates						
UST 10Y	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	1.73	1.61	1.57	2.27
DBR 10Y	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	0.09	0.00	-0.02	0.63
UKT 10Y	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	1.37	1.14	1.11	1.96
FX						
EURUSD	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	1.14	1.12	1.07	1.15
GBPUSD	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	1.48	1.41	1.39	1.48
USDJPY	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	106	106	104	121
Credit						
iTraxx Main	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	78	87	69	123
iTraxx XOver	<div><div></div><div></div><div></div></div>	<div><div></div><div></div><div></div></div>	339	369	293	484

Source: Bloomberg, Morgan Stanley Research. Note: Dot represents spot levels while line represents levels on June 14, 2016.

**Exhibit 2:** Summary of key six-month target levels (mid)

	As of 23 Jun, 5pm	6m Target	6m Return
<b>FX</b>			
GBPUSD	1.48	1.28	-14.0%
EURUSD	1.14	1.05	-7.5%
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Source: Bloomberg, Morgan Stanley Research forecasts.

***Statements and actions by central bankers***

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Elga Bartsch and Chetan Ahya, our global economists, think that in the immediate aftermath of a vote to leave key global central banks will make statements that they stand ready to support markets by providing liquidity and by reopening existing FX swap lines. Such statements could well be coordinated across the G7. Central banks with active QE programmes could make operational adjustments to their asset purchase programmes, if needed. Beyond these emergency measures, however, they do not expect changes in the monetary policy stance in the immediate aftermath of a vote to leave.

## UK & European equity strategy: Significant and sustained uncertainty = significant downside

Graham Secker

### Equities to fall to 2400-2550 for SX5E and 5000-5300 for FTSE100 in our base case

In our prior research (e.g., [European Economics & Strategy: What Brexit Would Mean for Europe, 7 Mar 2016](#)), we argued that European equities could fall 15-20% in the event of a vote to leave, comprising a 15% drop in the N12M P/E (back to the long-run median reading) and a 5-10% drop in EPS. Applying this assumption to the average index levels observed over the last three months (rather than spot) implies a fall in the STOXX50 to 2400-2550 and a decline in FTSE100 to 5000-5300 post the UK's decision to leave the EU.

The vote to leave ushers in a significant and sustained period of uncertainty for economic and earnings growth and political risk. The magnitude and duration of equity price declines over the coming weeks and months will likely be determined by a range of issues including the expected response from policy-makers (what, when and how much), political newsflow in the UK (e.g., a possible change of senior leadership in the government) and across the eurozone and moves in FX markets. [Exhibit 3](#) provides a short description of potential bull, base and bear scenarios and related implied index levels.

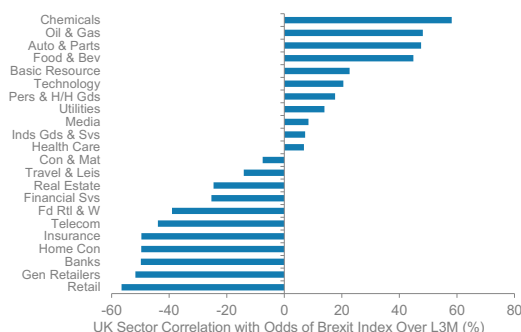
**Exhibit 3:** Our scenario framework with the UK voting to leave

	SCENARIO	MARKET LEVELS
BULL	A quick and aggressive policy response from politicians and central bankers successfully reduces investor fears about a spreading of geopolitical and economic contagion risk into the rest of Europe. Both UK and European politicians sound constructive in their intention to work together.	Equities see a small PE de-rating but no EPS decline. SX5E troughs between 2700- 2850 and FTSE100 troughs between 5600-5900.
BASE	Moderate slowdown in economic activity and earnings as per our economists 'medium stress scenario'. European policymakers have moderate success in limiting downside to markets and preventing significant political contagion spreading into the rest of Europe. Investors take a pragmatic approach rather than assuming Brexit implies the start of the end of the European project.	Europe's N12M PE falls back to its long-run average and we see a moderate drag on corporate EPS. SX5E falls to between 2400-2550 and FTSE100 drops to 5000-5300.
BEAR	More significant slowdown in economic activity and earnings as per our economists' 'severe stress scenario'. Policymakers fail to respond aggressively enough to satisfy investors who start to assume a significant degree of economic and political contagion from the UK into the rest of Europe. Politicians from other countries in Europe start to talk openly about the possibility of holding referendums in their own countries, raising the risk of further disintegration.	Europe's N12M PE falls 20-25% with the prospect of an additional 15-20% drop in EPS under our economists' 'severe stress' scenario which sees both the UK and EMU fall into recession. SX5E falls down towards 2000 while FTSE100 approaches 4000.

Source: Morgan Stanley Research

### Financials and Consumer Discretionary to lead the market lower...

Post the UK's decision to leave the EU, we expect all sectors and areas of the market to move materially lower, but Financials and Consumer Discretionary sectors are likely to lead, given that they have higher domestic exposure, have been more highly correlated to moves in Brexit risk over the last three months and have higher exposure to the periphery.

**Exhibit 4: UK sector correlation to Brexit risk\***


Source: Bloomberg, Datastream, Morgan Stanley Research. \*Note: Odds of Brexit index tracks the average implied probability of the event 'UK leaving the EU' based on bookmaker quotes available on the Oddschecker website

### ...while Staples and Healthcare outperform

Against this backdrop, we believe that internationally focused defensives such as Consumer Staples and Healthcare will outperform, given that they are less exposed to potential domestic weakness and are greater beneficiaries of the significant decline in GBP and EUR that our FX strategists predict. Pharmaceuticals in particular tends to perform well in periods of a rising USD. While a backdrop of general risk-aversion and a stronger USD doesn't sound like a good mix for commodity sectors, they have been performing with a relatively low beta to Brexit risk in recent months and may outperform a falling market initially - in this situation we would favour Energy over Materials, given the former's lower-beta characteristics. Ultimately, however, we doubt that commodity sectors could outperform over the longer term if US dollar strength persists and global growth fears rise.

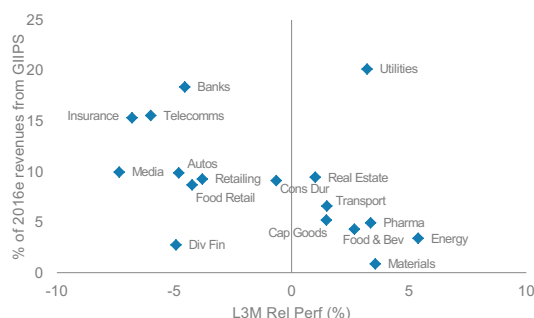
### Peripheral exposure to underperform further

Away from sectors, the UK's vote to leave the EU is likely to put further pressure on the peripheral areas of the market that have already been weak into this event. As illustrated in [Exhibit 5](#), it is noticeable that there has been a close fit at the sector level between higher peripheral exposure and weaker relative performance over the last three months.

### Investors will look for beneficiaries of a weaker GBP and EUR

In contrast, stocks with a relatively high degree of overseas exposure are likely to outperform, given lower gearing to potential UK/European economic weakness and the greater FX boost from any GBP or EUR weakness. With regards to the latter, our 'Weaker EUR beneficiaries' basket (MSSTWKEU) should outperform (see [EU Referendum Playbook](#), June 20, 2016, for constituent details), as should UK companies that report in USD.

European equities have underperformed UK equities in recent weeks as Brexit concerns have risen, likely reflecting fears over greater political contagion spreading across Europe, the potential relative benefits to the UK of a weaker GBP and/or the fact that headline European indices offer a more liquid instrument to trade. Post the vote to leave, we do not expect *significant* divergence in the performance of UK and European indices; however, Europe is likely to continue to exhibit a higher beta than the UK initially.

**Exhibit 5: There has been a clear negative correlation between peripheral exposure and sector performance over the last 3M**


Source: MSCI, Morgan Stanley Research

## FX strategy: JPY and CHF strength

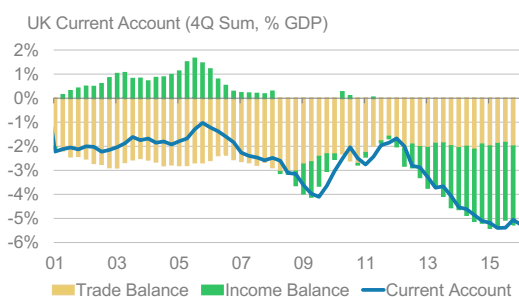
Hans Redeker, Sheena Shah

**Sterling to suffer:** The UK runs a substantial 7% GDP current account deficit caused by its private and public sector running a deficit of 2.4% and 4% of GDP, respectively. Today's vote to leave the common market will not only impact trade and investment flows into the real economy, but the impact on financial flows could be even more disruptive, in our view. Slowing financial inflows suggest the UK increasing its domestic savings in order to deal with its current deficits, suggesting a slower economy. Shifting funds from corporate credit, equity and other risky asset classes into safer assets may allow gilt yields to fall despite capital outflows. Hence, initial GBP weakness is unlikely to be temporary; we expect GBPUSD to fall to 1.25-1.30 before currency valuations start to become attractive enough to steer funds back into sterling. We view any rebound from these lows to be muted, given the Brexit-driven increase in the risk profile of GBP-denominated assets.

**High volatility supports JPY and CHF:** We expect global economic uncertainty to increase, meaning risky assets will have to search for new valuation levels, pushing volatility up. Low-yielding currencies such as JPY and CHF, benefiting from foreign asset positions, should flourish while foreign liability and commodity currencies are likely to come under selling pressure. We like to express this view by selling AUDJPY (target 70), USDJPY (target 95) and EURCHF (target 1.02). The risk to all these trades is a rapid pick-up in risk appetite, potentially driven by aggressive central bank action.

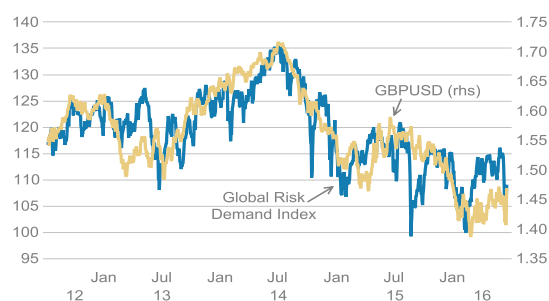
**PLN the best short in EM:** Within G10, initially the bearish EURCHF trade should benefit from a lot of momentum as investors digest increasing vulnerabilities of the eurozone following the vote. However, the longer the time horizon of this trade, the more it may be driven from the CHF side. EMU's banks and insurance companies with weak balance sheets have little appetite to increase foreign asset holdings, suggesting that the outflow of long-term capital may not be sufficient to compensate for the current account surplus-related EUR demand. Hence, we regard PLN as the better short. Poland is the biggest receiver of EU funds while the UK is the second-biggest net contributor. Britain withdrawing from the EU suggests that Poland's net income from the EU would decline.

**Exhibit 6:** UK income balance becoming increasingly negative



Source: Haver Analytics, Morgan Stanley Research

**Exhibit 7:** GBP weakens when risk appetite worsens



Source: Bloomberg, Morgan Stanley Research; Global Risk Demand Index – US Pat. No. 7,617,143



## Credit strategy: Trusting the ECB's backstop

*Srikanth Sankaran*

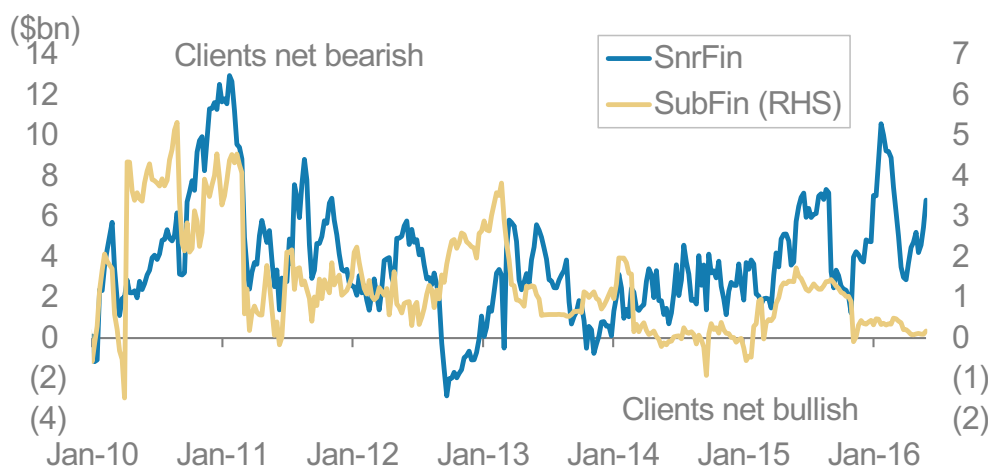
**Bottom line:** Risk-aversion is likely to remain elevated until there is more clarity on the policy response and/or the path of the UK's transition becomes clearer. In the EUR credit markets, we expect a strong response from the ECB via CSPP. This should keep price action in cash markets orderly. Any significant weakness in eligible assets would be an opportunity to add risk here. While financials are likely to remain more volatile, UK banks had already underperformed significantly going into the referendum. We would therefore look for opportunities to add risk here, selectively. Illiquidity premiums in GBP credit, and to a lesser extent EUR HY and corporate hybrids, are likely to remain elevated through the summer.

**Adding in eligible assets...** We recommend adding risk in CSPP-eligible assets and 'A' rated ineligible non-fins during the initial period of volatility. Levels in January-February this year were reflective of the systemic risks that forced the ECB to respond. This time around, the CSPP backstop is already in place. We therefore expect the ECB to skew its asset purchases towards corporates to the extent necessary and prevent a material tightening of credit conditions. Even if the ECB chooses to be measured with its response on the corporate side, we expect eligible spreads to tighten over a 3-6-month horizon.

**...and UK banks, selectively:** Earlier this week, our colleagues in banks credit research recommended adding **UK bank risk in LT2s and AT1s** (see [UK Banks: Brexit - Testing the Downside; Adding Back Risk, June 20, 2016](#)). In general, the ECB's ability to directly influence bank credit spreads is more limited, but we would expect a response if the moves in senior bank spreads were disorderly. However, whether this is sufficient to offset rising political risk premiums is unclear. For the time being, the TLTRO 2.0 remains a credible backstop to keep funding costs in check.

In this context, we expect iTraxx Senior Financials to remain the barometer of systemic risks. They have been for some time now, going by the rising short positioning. Over the very near term, a breach of the 150bp levels seen earlier this year appears extremely likely, but we expect the index to settle in the 110-120bp range after the initial hedging flows clear out. We would therefore take profits on our short Senior Financials vs. Main recommendation from March (see [The ECB's Latest Gambit, March 11, 2016](#)), keeping these target levels in mind.

**Exhibit 8:** Financials protection bought by clients

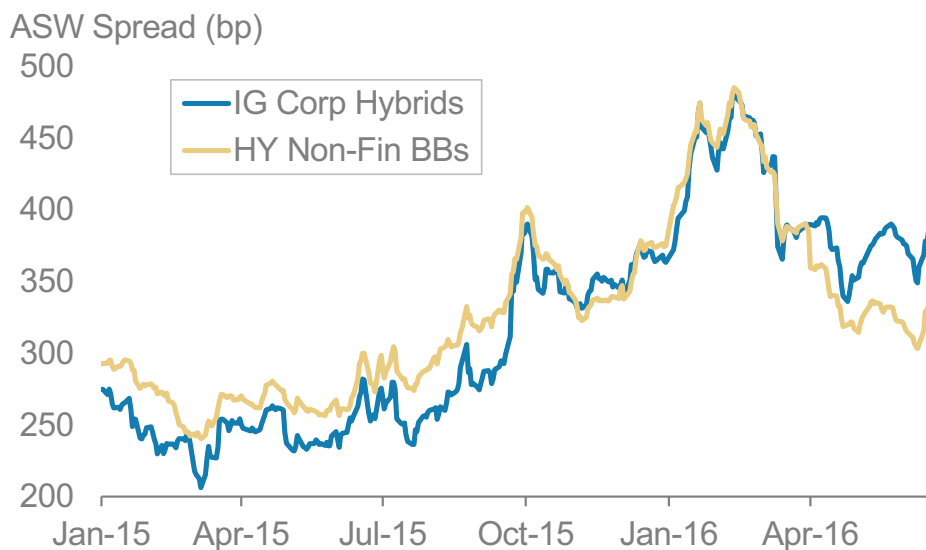


Note: Data as of June 17, 2016

Source: DTCC, Morgan Stanley Research

**No longer constructive on corporate hybrids and BBs:** The behaviour of corporate hybrids and high yield is difficult to predict. While we expected the asset classes to do well in our base case of Remain through late May, we have to account for different market realities now. Both products benefitted significantly from the ECB-inspired rally and were not particularly pricing in Brexit risks. While we expect forced selling to be limited, liquidity in both asset classes is likely to be challenged, resulting in 'gappy' price action. For investors looking to add, we believe that short-call IG instruments from eligible issuers would be the best place to start (see [Corporate Hybrids Playbook, June 20, 2016](#)). Within HY, low-yielding BBs that have rallied sharply since March are likely to be vulnerable. Buying Crossover will clearly be more liquid than trying to sell bonds into the weakness.

**Exhibit 9:** EUR IG corporate hybrids and EUR HY BBs rallied after the CSPP announcement



Source: Markit, Morgan Stanley Research

### Six-month term target levels and UK exposure levels of key indices

In [Exhibit 10](#), we summarise our forecasts for the key cash benchmarks and the iTraxx indices.

**Exhibit 10:** Credit spread forecasts, UK revenue exposures, CSPP eligibility

	Spread (Thu Close)	Target (6 month)	% CSPP Eligible	UK Revenue Exposure**
EUR IG Non-Fin Cash	87	100-105	48%	-
EUR HY Non-Fin Cash	426^	500-550	4%	-
GBP IG Non-Fin Cash	207	250-275	26%*	-
iTraxx Main	75	95-105	48%	15%
iTraxx Crossover	322	425-450	5%	14%
iTraxx Senior Financial	96	110-120	13%	17%

Note: ^HY Cash Spread as of Wed 22 Jun. \*Percentage of issuers with CSPP eligible debt in the EUR index. \*\*Using revenue data for 113 / 125 names in Main, 24 / 75 in XOver, and 27 / 30 in SenFin

Source: ECB, Markit, Bloomberg, Morgan Stanley Research forecasts



## Bank credit: Potentially hardest on eurozone AT1s

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Jackie Ineke

**We expect significant near-term volatility that will go beyond UK names only:** While the UK and Irish banks will likely bear the brunt of the initial move weaker, we expect a significant perception shift across Europe, **with the Dutch and Spanish being most affected**, in our view. While we expect sentiment towards the future of the European project to move more negative, we believe this will be focused on countries most strongly perceived as likely to follow the UK out, as we wrote in [Brace Yourself for the Brexit Campaign](#). To us, the Dutch screen as a likely candidate, with the anti-EU Freedom Party continuing to lead in the polls and a general election due in March, and Dutch bank debt having been robust over recent months. Also, while Spain strikes us as one of the more pro-European nations among the older EU members, we are concerned that the second-round **general elections could again deliver an inconclusive result in just three days' time**.

While the UK banks have underperformed eurozone peers heading into the vote, we believe that credit fundamentals should remain robust, albeit sentiment will of course be initially very weak. As we wrote in [UK Banks: Brexit - Testing the Downside, Adding Back Risk](#), June 20, 2016, even under a 'bear Brexit' stress scenario, no UK bank gets below FL CET1 of 9.5%. Looking out over the remainder of 2016, after initial significant UK bank debt widening, we're more sanguine on the performance over the course of the subsequent months for the UK. While our colleagues in economics expect the UK macro and unemployment outlook to deteriorate, **we see this as a modest risk to UK banks in light of their post-crisis lending standards and solvency levels**. While it would pressure earnings with a tick-up in the cost of risk, we see this as manageable, given the improved level of capital in the system. In addition, [recent statements](#) made by the Bank of England regarding liquidity support in the form of long-term repo operations are helpful. Furthermore, we do not view the potential to lose the right to import financial services (passporting) into the single market as particularly worrying. **With all UK banks being required to split out their UK retail businesses from their international and wholesale operations and place each into separate legal entities by 2019, we believe a loss of 'passporting' rights could be largely mitigated by domiciling the wholesale/international business in the euro area** rather than the UK, leaving UK banks with the similar, but manageable issue that banks such as UBS, CS and other non-EU banking groups face, all of whom have largely domiciled their UK operations in London. As this realisation becomes apparent and the banks' quarterly earnings go on to illustrate a modestly weakened outlook, we'd expect UK banks to unwind some of the immediate, post-vote sell-off over the course of the remainder of 2016.

We maintain our [view](#) of a potential up to 15-point drop (as opposed to an immediate 2-5 point drop for the UK) in a number of eurozone AT1s, linked to our concerns over eurozone break-up fears arising. The largest drop for AT1s will likely mainly apply to front-line core eurozone banks such as the Dutch. To put this in context, we'd note Deutsche's AT1s were 12 points lower than they are today at the worst of February's sell-off, at which point they were 20 points off where they started the year. Furthermore, if we take ING's \$6% or ABN's €5.75% AT1s, an illustrative reduction in price by 20 points would increase the YTP to mid-8s, a similar level to where UK banks closed last night.

## Rates strategy: Lower yields globally

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*Anton Heese*

### **Another reason to be long duration**

We see the vote to leave the EU as a negative risk event which is likely to support the bid for duration. In addition, we think it is likely to lead to the market pricing in a rate cut from the MPC with close to certainty, even though our economists would caution that the MPC will need to see evidence of the economy slowing significantly before easing policy to boost the economy. On Thursday's close, the market was pricing around 6bp of rate cuts over the next six months, but then policy normalisation after that (see [Exhibit 11](#)). We therefore see significant potential for the market to rally on expectations of sustained easing, especially in the 6mth-12mth portion of the curve.

### **FX the conduit for any global contagion**

The significant depreciation our FX strategists expect for both GBP and EUR as a result of the vote to leave should also mean the referendum has an impact on monetary policy globally. In particular, the inverse USD and JPY appreciation are likely to lead to the Fed adopting an even more gradual pace of tightening and increase the chances of more aggressive policy activism from the BoJ. In this manner, we expect a European risk event to push G4 yields lower, not only through term premium compression (due to 'risk off') but also through reducing further the expected path of central bank rate tightening. We would expect 10y USTs and Bunds to rally 15-20bp, and 10y gilt yields to fall 30-35bp.

We therefore reiterate our long duration recommendations, i.e., long 5y USTs and gilts, receive 5y5y EUR and short 10y JGBs on the 2s10s20s. The key risk to this recommendation is a general improvement in the global growth and inflation picture.

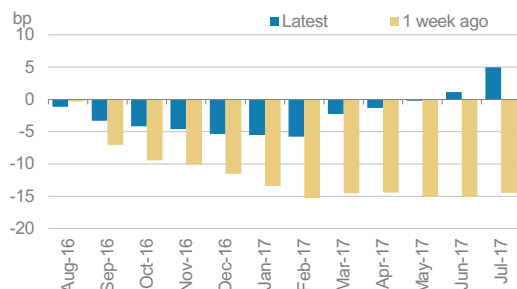
### **What will the UK curve do?**

We find this one tricky to call, as the front end should do well, due to more rate cuts being priced in, and risk-off/term premia compression, which should support longer maturities. But 10y may also benefit from the liquidity of the gilt futures contract. There is also an argument that longer-maturity gilts should trade cheaper (due to increased fiscal risks, worse fiscal dynamics, a higher trend inflation rate and foreign selling of UK assets). We think the safe-haven bid and lower rate expectations will outweigh these potential negatives, but think the curve is still more likely to steepen as more MPC accommodation is priced in. But the better trade is to just be long duration, in our view.

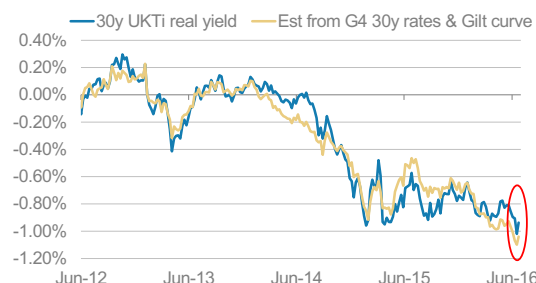
### **How about inflation markets?**

The impact on inflation expectations, especially in shorter maturities, where the negative economic impact should be disinflationary but a substantial FX depreciation should boost inflation, at least in the short term (i.e., 1-2 years). We expect the currency effect to be more dominant over the next two years, and hence continue to recommend being long Nov-18 UKTi breakevens. The key risks to this recommendation are a smaller GBP depreciation than our FX strategists expect and a more disinflationary pass-through from the weaker economy.

Further out the curve, we expect the structural demand from domestic pension funds to reassert itself, although the upcoming Nov-65 UKTi syndication may lead to the market trading heavy (on average there is 6-8bp of concession priced in ahead of a linker syndication on real yield and breakeven). Also, given the decline in yields globally, we would look for 30y UK real yields to return to all-time lows (see [Exhibit 12](#)), and we reiterate our long Mar-46 UKTi real yield recommendation. The key risk to this view is long-end yields globally fall less than we expect.

**Exhibit 11:** Implied MPC rate hikes EoD June 23


Source: Morgan Stanley Research, Bloomberg

**Exhibit 12:** 30y UK real yields 10bp higher than we would expect them to be, given global rates


Source: Morgan Stanley Research, Bloomberg

### Euro sovereign spreads wider, but how much?

A vote against the EU project from one of its largest members runs the risk of undermining the credibility of the project as a whole, and hence should lead to an increase in euro area systemic risk, which in turn should lead to wider euro sovereign spreads, even if the path of the deterioration is uncertain. We will look to see if indicators of systemic stress, such as the ECB's CISS index, start picking up.

We expect euro sovereign spreads to widen today, especially 10y BTPs versus Bunds, given that the IK future is likely to be used as a general hedging instrument for euro sovereign credit risk. 10y BTPs may therefore underperform on the curve and versus Bonos, although uncertainty around the Spanish election on Sunday may make investors cautious about being long Spain versus Italy. Our best estimate (not based on any impressive science) is that the initial reaction will be for 10y BTPs to widen 15-25bp versus Bunds.

If they widen beyond that, though, we will start to consider peripheral spread tighteners. This is not only because of the support we expect the ECB to offer the market (through the ongoing PSPP and TLTRO programmes and willingness to implement OMT and other backstops if need be), but also because of the global 'search for yield', which will make it difficult for many investors to ignore any substantial back-up in yields.

### Trade recommendations

Long 5y (Jan-21) gilts @ 0.89%  
 Long 5y USTs @ 1.25%  
 Receive 5y5y EUR @ 1.19%  
 Short 10y JGBs on 2s10s20s @ -12.5bp

Long Nov-18 UKTi breakeven @ 2.21%  
 Long Mar-46 UKTi real yields @ -0.93%

## EM fixed income strategy: Risk spillover beyond Central Europe

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*Gordian Kemen*

**The most obvious impact on EM fixed income and FX should be felt in countries that have direct trade or financial linkages with the UK, i.e., those in CEEMEA, and particularly in CEE. However, we also expect the rest of EM to be affected via higher global risk-aversion:** In fact, the Brexit vote could be one of the triggers for the wider EM risk pull-back we have been looking for (see [Global EM Strategist: The Great Bear Rally Unwind](#), May 22, 2016). Other negative triggers include lower global growth and commodity prices, as well as a likely tightening of financial conditions. The actual impact on EM assets depends on each country's external vulnerability, which we discuss in greater detail in [EM Strategy: Brexit Risks for EM Fixed Income and FX](#), June 20, 2016), as well as their ability to deal with a risk-aversion shock. As we have highlighted, some Brexit risks were already priced into EM asset markets ahead of the vote, but we consider the downside now to be significantly larger than the upside would have been in case of a Remain vote. In terms of asset classes, we see EM FX as most exposed, followed by local rates. External debt will likely be affected to a lesser degree. In terms of regional exposure, high yielders in CEEMEA are most at risk, followed by some of the LatAm countries.

**Local rates** will likely become very sensitive to FX weakness, leaving the front end of many curves vulnerable. However, this does not necessarily imply that curves will flatten, as we expect risk premium in the long end to rise in the context of global risk-aversion. South Africa and Poland stand out as most exposed in CEEMEA. South Africa has a high beta of rates to FX moves, relatively strong direct ties to the UK, and stretched valuations in the front end. In Poland, we expect the curve to steepen. Similarly, flat curves in Colombia and Chile could also be vulnerable to steepening, largely through the risk appetite channel. In Asia, we think safe-haven demand could protect a number of low-beta curves, but are more cautious on high-beta FX countries, namely Indonesia, Malaysia and India, where the front end could be vulnerable.

In **EM FX**, we believe that high-beta currencies are likely to see larger moves initially and consider ZAR as most vulnerable, followed by MXN. For lower-beta CEE, we expect more sustained weakness over time, with EUR/PLN likely to underperform, given its direct ties to the UK and EU, as well as its own domestic concerns (see [PLN: Little Carry and Plenty of Risks](#), June 9, 2016).

In **credit**, we think a vote to leave brings forward the credit spread widening we anticipated over the next few months. Considering different vulnerabilities and policy space to respond, we expect South Africa, Turkey, Colombia and Russia to underperform Indonesia, the Philippines, Peru and Mexico. We think CEE credit spreads will also widen, but to a lesser extent than the high-beta credits, given the CEE credits' YTD underperformance and lower vulnerability to FX and commodity price moves. However, in the high stress scenario as outlined by our economists, CEE spreads are likely to widen by as much as the higher-beta credits, given the significant negative cumulative hit to GDP by end-2017 (1.9%).

**Exhibit 13:** Expected impact in local rates, FX and sovereign spreads over the next 3-6 months

Country	Rates (5-year rates)	FX (Vs. USD or EUR)	Credit (10yr spread)
<b>Countries affected mainly through direct linkages</b>			
Hungary	<b>2.6%.</b> 5yr HGBs to sell off to 2.6%, given the increase in risk premium. NBH could turn more dovish, given the macro impact from Brexit.	<b>330 EUR/HUF.</b> The openness of the economy and exposure to EU trade and financial markets leave HUF exposed to Brexit.	<b>250bp.</b> Directly impacted through trade, but some is already priced in, also less vulnerable to FX and commodity weakness.
Poland	<b>2.8%.</b> 5yr POLGBs to underperform HGBs as the NBP still has a high bar for easing and uncertainty from CHF loan conversion lingers.	<b>4.70 EUR/PLN.</b> Macro/financial spillover risks are high. Other domestic political issues could also be a source of weakness. Intervention may increase.	<b>175bp.</b> Direct trade impact, though mitigated via strong domestic demand, valuations ok, less vulnerable to FX and commodity weakness.
<b>Countries affected mainly through risk-aversion channel</b>			
South Africa	<b>9%.</b> 5yr SAGBs expected to sell off as weakness in ZAR puts pressure on the front end and curve steepens due to increased risk premium.	<b>16.50 USD/ZAR.</b> USD/ZAR beta to USD/EM is tracking at 2.5x. This will be the first driver of ZAR weakness while trade links to the EU are high.	<b>380bp.</b> Vulnerable to FX and commodities; risk of being downgraded to HY in December by S&P. Plus, affected through trade and financial links.
Turkey	<b>9.5%.</b> TURKGBs could bear flatten as the front end still prices in easing. We expect 5yr at 9.5% in 3m.	<b>3.15 USD/TRY.</b> The EU is Turkey's largest export market. CBT easing may also be a source of FX vulnerability in the case of an external shock.	<b>340bp.</b> Impacted through trade/financial links; vulnerable to FX. Political uncertainty an additional risk factor.
Mexico	<b>5.9%.</b> 5yr Mbono yields to trade up to 5.9% on higher risk premium. FX intervention and/or a more dovish Fed could help stem a sell-off.	<b>20.40 USD/MXN.</b> MXN is likely to be used as an EM proxy as risk sells off following the Leave uncertainty. We foresee a 7% move by year-end.	<b>220bp.</b> While spreads should widen, better fundamentals and crossover demand should see Mexico outperform despite the weaker FX.
Indonesia	<b>8.5%.</b> We think risk-aversion will cause bond curve to bear steepen, with 5y IndoGB selling off almost 50bp to 8%.	<b>14,300 USD/IDR.</b> IDR has limited direct linkages with Europe, but the commodity channel and risk-aversion should still lead to FX weakening.	<b>260bp.</b> While spreads should widen, it should outperform on the back of better growth and fiscal spending mix.

Source: Morgan Stanley Research

## Equities

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### Consumer Discretionary / Industrials

#### Aerospace & Defence – Jaime Rowbotham

We see the vote to 'Leave' as most negative for UK A&D and at BAE Systems we think the negative implications most acutely offset FX benefits. The vote to 'Leave' is more neutral for EU A&D and at Airbus we think FX benefits most materially offset any wider negative implications. Fears cited within the industry over Brexit centred on how regulation and tariffs will develop within the EU, risk that Britain could lose influence when it comes to setting global A&D policy and that there could be less scope to claim greater R&D funding from the EU.

If the USD appreciates as our economists expect versus GBP over the next 6 months it could result in a translation benefit to our 2017 EPS for BAE Systems of ~4%. A UK recession would be very negative for BAE Systems, offsetting the FX benefit in our view, given the various risks it would present for defence spending in the UK. Our economics and FX strategy teams have also indicated that the USD may appreciate versus EUR over the next 6 months. Airbus' \$100.6bn hedge book, struck at an average rate of \$/€ 1.27, gives it visibility on transactional FX for the next 4-5 years, beyond that however, unhedged exposures are subject to fluctuations in the spot forward curve. As a result, moves in Airbus' shares have been highly correlated with moves in \$/€ over the last 18 months, as shown in our recent [note](#).

#### Autos & Auto Parts – Harald Hendrikse

Autos are heavily exposed to the UK market, both from an economic perspective and an FX one. The UK market represents almost 20% of the whole European car market at 2.7m units out of approximately 14m. The UK market is also one of the most profitable markets in Europe with a higher proportion of premium branded vehicles, and thus higher ASPs, as a result of the greater level of development of the UK car finance market. As a result, therefore, most European auto OEM fincos also have very substantial receivables and used car residual exposure to the UK market. The UK generates between 8% and 10% of global sales for BMW, Audi, and Mercedes, and also for Peugeot. UK generates 5.5% of VW global sales – but given the size of the group, this is the largest absolute exposure in the European group.

From an FX exposure basis, the UK is mostly an export market for most European OEMs, bar BMW, and hence, the GBP/EUR represents the second largest FX pair for most OEMs. With 550k net exports to the UK, VW is most exposed in absolute terms with exposure in the region of €13bn. Peugeot is second most exposed with almost 200k exports worth over €3.5bn. BMW and Daimler (Mercedes) are also heavily exposed. JLR and Nissan are exporters of cars from UK to Europe, and so would be net beneficiaries if there were a weaker GBP/EUR. Any related EUR/USD weakness beyond the USD1.05 levels reached in early 2015 would provide a boost to export margins for BMW, VW, and Daimler, in that order. [Autos & Auto Parts: Brexit – Risk to European exporters](#) (24 Feb 2016).

#### Autos: Turkey – Muneeba Kayani

Europe is a key export market for both Tofas and Ford Otosan. Exports represent 64-68% of our 2016e total revenue forecast for Tofas and Ford Otosan. Exports to Europe represented 85% of total export for Tofas and 96% for Ford Otosan in 1Q16. Ford has higher exposure to the UK as the UK represented 7% of total exports for Tofas and 40% for Ford Otosan in 1Q16. Both Tofas and Ford Otosan sell their exports to their respective partners in Europe, and the partners then distribute the vehicles within Europe. A scenario in which the UK levies import taxes on European imports would change the competitive landscape for vehicles produced by Tofas and Ford Otosan (see issues highlighted by Harald Hendrikse in [Brexit – Risk to European exporters](#) published on February 24, 2016).



Ford Otosan: Each 5% lower export volume forecast lowers our 2017e revenue/EBITDA by 3%, and EUR/TL sensitivity is the same. Tofas has take-or-pay agreements for exports, which would limit the negative impact of lower export volumes: Each 5% weaker EUR/TL lowers our 2017e revenue/EBITDA by less than 3%, and export volume sensitivity is lower due to the take-or-pay agreement.

### **Business & Employment Services – Toby Reeks**

In this sector, growth at the European staffing companies looks most impacted by the vote to Leave. Large staffing markets' organic growth and GDP are 45-80% correlated and >70% of revenue is 60-80% correlated.

To reflect the risk here we show our bear case organic growth expectations for group organic growth, which assumes a vote to leave and a recessionary, 'high stress', scenario. FY17e growth for Randstad would fall from our base case of 4.1% to -3.5%, for Adecco the figures are 4.1% to -3.0%, for Hays (UK net fees) 1.2% to -3.4% and Page (UK net fees) 4.0% to -4.2%. We would expect growth and earnings expectations to fall and the market to price in previous recessionary trough multiples. These are 30-40% below current EV/Sales for Adecco and Randstad and 40% below Hays' EV/GP. For Michael Page, currently trading at a 10% discount to 2010-current trough EV/GP and 10% above the 2002-009 and 2004-current troughs, this suggests that a new potential trough would be below previous levels.

Those that should benefit from expected movements in GBP/USD and EUR/USD are the global companies earning revenue in USD and which report in GBP or EUR. The companies in the European Services Sector with the largest exposures in this respect are: Ashtead/Aggreko/Bunzl/Apluss+ and Intertek at 84%/63%/58%/29% and 26% respectively.

### **Capital Goods – Ben Uglow**

Operationally, the biggest negative effect on estimates would come from those companies with the highest European revenue exposure. These include: Zumtobel (82%), Prysmian (63%), Nexans (58%), Rexel (54%) and Legrand (52%).

From FX, we see the translation effects being relatively small – and indeed, the majority of companies may enjoy some benefit from the relative movement of Euro / Dollar. At present, the only companies where we forecast a negative revenue impact on translation are Schindler (-2%) and ABB (-2). Translation and transaction effects on EBIT are more difficult to quantify given hedging strategies and low disclosure on costs. Based on available information, we believe that there may be negative EBIT impacts at Nexans, Weir, Schindler, ABB and Electrolux. The biggest currency beneficiaries would be the UK engineers (especially Weir, Spectris, Bodycote, Rotork) and Euro-exporters like Hexagon, KONE, SKF and Atlas Copco, as laid out in our recent report ([Capital Goods: EU Referendum – Understanding the FX Implications for Capital Goods](#) (20 Jun 2016)).

### **Leisure/Hotels – Jamie Rollo**

The referendum result should have no significant direct impact on the companies in the Travel & Leisure sector, and no significant regulatory or capital issues either. However, the leisure sector is skewed towards midcap companies with a high domestic UK exposure, so will likely be one of the more impacted by any knock-on changes to the GBP, UK GDP, corporate / consumer confidence, and the risk of further exit votes within in the EU. Tour operators might be impacted by a sharp drop in sterling, as this would make overseas holidays more expensive (though hedges protect them for this year) but the predicted EUR weakness should mitigate the effect on holidays to Europe. There would also likely be some disruption to online gambling operators that are licensed in Gibraltar (which would no longer be part of the EU, and so would not enjoy some of the freedom of trade rights that this entails), but we would not expect any significant or permanent issues. Within the broader sector, we see the Foodservice stocks (Compass, Sodexo) as least impacted by the vote (90% of EBIT from outside the UK), and the UK consumer names (e.g. Whitbread, William Hill, Thomas Cook, SSP) as most impacted.

## **Consumer Staples**

**Beverages – Olivier Nicolai**

For the Beverages sector, direct UK exposure is 7% of group EBIT for Heineken, 6% for Diageo, 3% for Carlsberg. Potential economic headwinds from Brexit on the UK consumer are unlikely to have a significant operational impact at group level, in our view.

A sharp GBP/USD depreciation would provide a transactional benefit supporting margins, due to large US and EM exposure. For Diageo, we estimate that 10% GBP/USD weakness would boost EPS by 6%. For Pernod, 10% EUR/USD weakness would boost EPS by 7%. We estimate Scotch accounts for a third of group EBIT at both Diageo and Pernod.

However, Brexit is likely to create uncertainty around Scotch/Gin exports to the EU, which accounts for 25% of Scotch consumption. Trade uncertainty for Scotch could weigh negatively on sales. While higher tax on Scotch is possible, we would flag that the UK is a key market for champagne and wine produced in the EU.

For more detail on product exposure to GBP please see page 25 of our recent note: [Beverages: Input cost inflation and transactional FX: What is the impact on Beverages?](#)

**Food Producers – Eileen Khoo**

We see Brexit as a slightly negative but manageable outcome for the EU Food Producers. We see less potential negative impact from FX (GBP/EUR depreciation) versus overall Euro/UK economic weakness, given (i) all the EU Food companies have highly diversified geographic exposure, with the UK making up 6% of sales for Unilever and Danone and just 3% for Nestle, whilst the Eurozone (ex-UK) is ~30%, ~18% and ~16% of Danone, Nestle and Unilever sales respectively, and (ii) FX translation benefit to reported sales/earnings. Therefore, every 10% depreciation of the GBP against the companies' reporting currency would only adversely impact topline by ~50-60bps for Unilever NV and Danone, by ~20-30bps for Nestle and by +~8% for Unilever plc. Every 10% depreciation of the EUR would be 6-7% positive for Unilever NV and Danone (given they report in EUR), and -2% for Nestle, over the next 12M.

We would highlight Danone as the company likely to be most negatively affected by weaker UK/Eurozone GDP growth, given that it has (i) the biggest Western Europe exposure among its peers, (ii) it does not have production facilities in the UK, but instead exports into the country from Europe, and (iii) its largest product category (fresh dairy) is already under pressure in Europe from private label/local competitors. Unilever plc looks the most positively impacted, simply due to the positive FX translation impact from GBP weakness, and having relatively small exposure to Europe in the event of EUR depreciation.

**Energy / Utilities****Oil & Gas and Oil Services – Martijn Rats and Rob Pulleyn**

The Leave vote may have a large impact on the sector in terms of sentiment, macro moves and oil prices. European oil majors have a meaningful weighting within European and UK indices, with RD Shell and BP representing ~13% of the FTSE 100 and Total ~5% of the EuroStoxx 50. Europe generates ~14% of global oil demand, so the weaker economic outlook could impact oil demand growth and delay the rebalancing of global crude oil markets. In addition, our FX team expects a strengthening US Dollar (vs Euro and Sterling) so we may see downward pressure on oil prices. We see limited operational impact on European majors. The diversification of the Integrates' business model is an important risk mitigator here. As a result, we expect Brexit to be well within the risk boundaries that they typically operate within, and the true international nature of their businesses should help limit the magnitude of any impact from the vote. A depreciation of Sterling and Euro would impact cost bases and denominated debt, but only to a limited extent given the global nature of these businesses. Total and RD Shell's internal sensitivity analyses suggest only a 0.5-3.5% reduction in net assets from 10% moves in these currencies. The impact on capex plans is more difficult to ascertain and depends on how long uncertainty lasts after the vote. However, the low oil price and industry downturn have already created 'rock-bottom' expectations for project sanctions and contract awards for the service industry in the UK and beyond. Therefore, Brexit is unlikely to affect near-term sentiment over oil & gas capex, but may impact the pace of recovery for UK

exposed service names. The most exposed to the UK in revenue and costs are Subsea 7, Wood Group, AMEC and Aker Solutions with 20-35% of revenues in UK.

### **EEMEA Oil – Igor Kuzmin**

Within the EEMEA Energy space, we see PKN Orlen and Tupras as more directly impacted by the Leave vote than Russian O&G names. Weaker economic growth in the region is now forecast, with the impact greatest in CEE, then Turkey and then Russia. PKN's exposure is dual: from its petrochemical operations (a 10% change in petchem margins implies c4% change in 2017 EBITDA, on our estimates) and via oil product demand (a \$1/bbl change in refining margins implies c 12% change in 2017 EBITDA). Tupras' revenues are more reliant on the domestic market. However, the EU is Turkey's biggest export market (47% of total exports), and correlation between EU economic growth and Turkey's exports there is very strong - 94% since 2004. If this leads to an overall economic slow down domestically, we assume domestic fuel consumption is likely to be negatively affected too (a \$1/bbl change in refining margins implies c 19% change in Tupras 2017 EBITDA, on our estimates). For Russian O&G companies the expected effect is lower. Softer oil / gas product demand and weaker oil prices as a result of the Leave vote are clearly negative factors. However, a weaker oil price is normally accompanied by a weaker RUB against the USD, which provides a meaningful offset for Russian companies via opex and capex. For example, Rosneft, which is the most sensitive to these factors, could see a c13% decline in EBITDA if the oil price weakens by 10%. However, if RUB weakens against the USD by 10% at the same time, the net impact would be only 6%.

*Important note regarding economic sanctions: Rosneft is currently the subject of sectoral sanctions programs administered or enforced by the United States, the European Union and/or other countries. Among other things, the sectoral sanctions restrict transacting in, providing financing for, or otherwise dealing in new debt or equity issued by Rosneft. Any references in this note to debt or equity instruments that may be covered by sectoral sanctions are strictly incidental to general coverage of the issuing company as germane to its overall financial outlook, and should not be read as recommending or advising as to any investment activities in relation to such instruments. Users of this report are solely responsible for ensuring that their investment activities in relation to any sanctioned companies are carried out in compliance with applicable sanctions.*

### **Utilities – Timothy Ho, Emmanuel Turpin**

The material impact for European utilities should come from sterling and euro depreciation, particularly against the US dollar. Stocks with earnings in USD will benefit from an FX tailwind, albeit translational, and there will be some offset from USD denominated debt. We would highlight Centrica (22%) and Iberdrola (19%) as two of the stocks with bigger USD exposure in our universe. If the stronger USD drives higher euro and sterling gas and oil prices, then this could also be positive for more commodity exposed names. However, if Brexit is a catalyst for a second Scottish independence referendum then this could have a negative sentiment effect on SSE and to a lesser extent Iberdrola. Risks would be to: (i) renewable subsidies and how these would be remunerated and (ii) the uncertainty around the future currency in Scotland.

## **Financials**

### **Banks – Huw van Steenis**

Banks are likely to be lightning rods of concern. Our framework reflects several issues:

- Banks face downgrades due to the impact of an economic slowdown in the UK and EU27 on loan growth, trading and commissions
- Investors may assume that central banks will respond through lower rates and more QE – on the whole we view this as a negative for banks at this stage
- Investors will also fear risk of higher bad debts

Clearly, policy response could have a positive impact – the ECB could look to extend to buy bank debt too, or

there could be a change in fiscal stance. But tail risks may weigh on investors' expectations as the risks of Eurozone break-up will be re-appraised. We have argued for 10-20% downgrades for UK banks – see [UK Economics & Strategy | EU Referendum: Insight: A Close Call](#) (13 Nov 2015) and [UK Economics & Strategy | EU Referendum: After the Vote](#) (05 May 2016). We think international banks such as HSBC and Standard Chartered will be less affected. We also think this event could be discombobulating for Eurozone banks if the market fears tail risk of a eurozone break up. For Continental European banks we see risks to Eurozone GDP and potential further ECB action reinforcing concerns on deflationary pressures on top line and asset quality trends. We expect this to disproportionately impact the periphery (especially in Italy - highest Texas ratios for Monte dei Paschi, Popolare) as well as those with capital gaps in our base case to new regulatory standards by 2019 – Deutsche Bank, Credit Suisse and Unicredit. We expect banks with robust capital positions and superior ROE, better able to withstand growth shocks and still meet distribution expectations, to be relative outperformers (eg KBC and Danske within our most preferred list), but all banks should be under pressure.

### **EEMEA Banks – Magdalena Stoklosa**

Direct links of the EEMEA banks to the UK are very limited, but we expect the usual channels of global macro shocks to manifest themselves through: (1) trade linkages (UK&EU), (2) financial linkages, and (3) risk aversion/external vulnerabilities. Risk aversion looks set to be the main channel of short term reaction in EEMEA, with currencies the first casualties – particularly though proxies – PLN and ZAR. Widening sovereign spreads (20-30bps) and a hike in ERPs across the region should force a sell off in bank equity, as risks of European recession are baked into earnings expectations. We see Polish banks as most exposed on two key fronts – EU induced macro fallout and PLNCHF weakness further complicating CHF mortgage issues. Our cautious South African banks call stems from the double impact of trade and financial linkages and its commodity net exporter position, in addition to ZAR, where our FX strategy team sees high scope for weakness. Admittedly, from an operational perspective the bear steepening expected in Poland and South Africa is not all bad news, and should support margins somewhat, although we think the effect will be dwarfed by increases in COE. We would expect Greek banks to sell off too, as we think the focus on potential Grexit would significantly increase.

### **Diversified Financials – Anil Sharma**

Asset Managers: As outlined in our report [Diversified Financials, Insurance & UK Economics Insight – Brexit: What's the Bear Case for Global Asset Managers?](#), at a minimum, we expect higher operating costs (and associated operational risk charge) and lower operating margins. For retail products, key uncertainties relate to UCITS (~€8trn industry, ~2/3 of all EU retail), and for institutional product key uncertainties relate to managed / segregated accounts offered to EU investors under MiFID. There may be scope to use infrastructure in other EU countries or delegate investment management back to home countries (Platinum Asset Management manages EU products out of Australia). But a bearish outcome (no EU market access) could require separately capitalised and staffed investment entities in the EU. Across our global asset manager coverage, exposure is highest for BTT, Franklin Resources, Henderson, Invesco and Schroders, with 15-40% of AUM held in UCITS format. This could also be a major risk to growth and earnings for insurers' captive asset managers, given their reliance on European inflows in recent years. Standard Life's GARS is in a UCITS structure and represents ~20% of group PBT. Weaker sterling would only be a mild positive and thus modest offset against this backdrop of weaker growth, equity markets and investor appetite for asset management services.

Market Infrastructure: We see inter dealer brokers ICAP, Tullett Prebon and LSE, with significant pan European operations though headquartered in the UK, as most at risk from the uncertainty facing the trade agreement between the UK and the EU. Similar to asset managers, we would expect higher operating costs and lower margins. In a more bearish trade negotiation scenario there are risks that euro denominated products would have to be traded and cleared 'onshore' (i.e. in the Eurozone) and thus force greater structural change on the industry. Weaker sterling would be a short-term positive on earnings.

### **Insurance – Jon Hocking**

After the Leave vote we expect the overall insurance sector to be negatively impacted. Credit spreads are likely to widen at both the corporate and government bond level. Corporate spreads widening should depress asset values and capital levels. Widening government spreads in Europe, in particular at the peripheral countries, will

likely negatively impact Italian, Spanish and, to a lesser extent, French insurers due to pressure on capital given the high gearing to local government bonds. A lower bund yield, on the other hand, given potential 'safe haven' dynamics, could be particularly unhelpful for German and Dutch insurers due to lower reinvestment returns and lower capital generation on the back of greater negative impact from the unwind of the UFR. In terms of FX, a weakening GBP/USD would, on a relative basis, likely be positive for Prudential in particular, given its significant exposure to the US and Asia, which is mostly USD linked. RSA will also likely benefit, with almost half its business in Canada and Scandinavia. A weaker EUR/USD will likely benefit US exposed continental European insurers like Aegon, Axa and Allianz. Zurich would be negatively impacted by a weaker EUR/USD and CHF/USD as it reports in USD; however, the negative impact of the latter should be muted by the positive effect of dividends being paid in CHF. From an operational point of view, lower economic growth across the board in Europe will likely dampen earnings growth in the insurance sector. Operational performance is unlikely to be pressured as most European insurers are locally capitalised. On a relative basis, we expect Prudential to be most positively impacted and Generali to be most negatively impacted.

## Healthcare

### Pharmaceuticals – Vincent Meunier

Overall, we'd expect UK pharmas to react more positively than EUR peers, and Swiss names to react less positively (assuming a weakening of the EUR vs CHF, and no material CHF move vs USD). Also, a weakening of the GBP and EUR versus USD would imply a slight negative impact for US Pharma.

The UK Pharma companies which could theoretically benefit most from Brexit are those with: 1) high US-based revenues and profits, 2) a high GBP/EUR cost base, and 3) shares denominated in GBP. In that context, we estimate that Shire (>70% revs in US, P&L and shares denominated in GBP), Indivior (>90% revs in US, P&L and shares denominated in GBP), AstraZeneca (~40% revs in US, P&L denominated in USD and shares in GBP) could be better positioned. Of note, AZN's dividend paid in USD would be a positive. We think GSK (~35% revs in US, P&L and shares denominated in GBP) could be more impacted by a potential economic deceleration in the UK and EU. It has 5% of its revenues in the UK and ~13k employees in the UK out of ~100k worldwide.

A potential weakening of the EUR vs the USD could be more positive for EUR listed companies generating higher USD profits (like Novo Nordisk, for which DKK is pegged to the EUR), compared to companies making smaller US profits (like Ipsen, Merck KGaA).

## Materials

### Building & Construction – Alejandra Pereda

We believe the main impact of the vote will be through currency translation headwinds, as the direct exposure to the UK in our sector is limited – if UK GDP is weaker construction will most likely slow down. In terms of companies, the most exposed is Ferrovial with ~40% of its attributable EBITDA in the UK, derived from its services operation and airports. For Ferrovial we expect a slowdown in already depressed services activities (10% of group EBITDA) while the potential impact of slowdown in Heathrow traffic likely to be balanced by the regulated return nature of the asset, albeit with a time lag. On the other hand, with sizeable operations in US & Canada too, the FX impact should be partially compensated, as we have written before (see report [here](#)), with the positive balance sheet effect driven by a lower weighting of GBP denominated debt.

In terms of spillover to the rest of the Eurozone in terms of lower economic activity, it would be likely that construction activity would suffer, failing to show the modest recovery we were targeting given construction's correlation with GDP growth. In that sense, St Gobain and Vinci would also be impacted, as both remain overexposed to Europe, with construction ~53% and >95% exposure to Eurozone respectively, the latter mostly in France.

On the positive side, at least relative to the industry, LafargeHolcim has only 4% EBITDA exposure to the UK and 9% to € denominated countries, so should be least affected, and benefit from a positive translational FX impact if SFr (the accounting currency for the group) is also negatively impacted, as our economists assume.

LafargeHolcim obtains 17% of its EBITDA from the US and 5% from Canada, with 65% coming from emerging markets.

### **Chemicals – Paul Walsh**

There are two obvious angles worth considering for the EU chemicals sector on Brexit. The first relates to FX implications, either for those reporting in sterling (i.e. the UK chemical companies), or those European chemical companies with material UK operations. The second has to be those companies that generate above average revenues from the UK as a market. We conclude that Croda is likely the company with the most to gain from Brexit given: (1) it generates just 4% of sales from the UK, but (2) as a sterling reporter it stands to enjoy one of the most favourable benefits from weaker sterling. Most at risk is likely to be Johnson Matthey from an end market perspective, albeit mitigated by some FX tailwinds. However, the UK is not a big end market for European chemicals, and much of the UK sales exposure stems from somewhat defensive end markets, like fine chemicals for pharmaceuticals, paints, adhesives and home and personal care. Akzo Nobel (~7% Group sales from the UK) has risk from its Dulux paint brand, and Linde has ~10% of Group sales from the UK post its 2005 acquisition of BOC.

### **Metals & Mining – Menno Sanderse**

Metals & Mining companies generate the majority of their revenue and cash flows in US\$ and most declare dividends in US\$ too. In contrast, around 40-60% of cost components are in local currencies. However, few mining companies have production in Europe or Euro related currencies. The exceptions are Boliden (Swedish krone), Eramet (Euro), Aurubis (Euro) and Nyrstar (Euro). Those companies could improve their position on the cost curve from potential currency weakness.

The main risk to mining companies is of a hit to global GDP (and by extension industrial production and fixed asset investments) from lower UK and European GDP growth. Supply and demand balance and the commodity price are mainly set by developments in emerging markets. The UK and Europe account for less than 3% and 15% of global demand for most of the mined commodities.

European steel producers: Most of their production and sales take place in Europe. Globally, both steel and its raw materials are priced in US\$, so a stronger US\$ would boost gross profit of European steel producers in domestic currencies. Nonetheless, we think the benefit of weaker local currencies versus the US\$ will be offset by the risk to volumes and revenues from lower GDP growth and weaker industrial activity in Europe. As a rule of thumb every 1% reduction in construction activity in Europe reduces steel demand by 0.35%, while every 1% reduction in automotive demand reduces steel demand by 0.2%.

## **Media**

### **Media & Internet – Patrick Wellington**

After the Leave vote, we anticipate three implications for the European Media sector:

(i) We expect incremental weakness in UK operationally focused names, particularly those with advertising exposure. The key UK focused large names in the sector are ITV and Sky. Smaller 100% UK oriented names are Rightmove, Auto Trader and Zoopla. DMGT (print advertising) and Just Eat (UK largest territory) will also be impacted.

(ii) The Media sector as a whole should come under pressure as a European focused and cyclical group. We would expect weakness also in the Continental European advertising names in anticipation of a leakage of economic impact into the core European area. Broadcasters (LIST) are the most GDP-sensitive group. We think global economic slowdown fears are likely to seep into the global ad agency names (Publicis, WPP).

(iii) The relative outperformers in Media should be the clutch of low UK/European exposure, subscription based dollar earners amongst the publishers. There are several big \$ earners in the publishers to take advantage of relative sterling weakness on the Leave vote. Notably, we think UBM (c 20% European/ UK exposure), Pearson



(18%) and RELX (28%) stand out in this regard.

### Internet – Andrea Ferraz

Economic weakness would impact marketplaces including Rightmove, Zoopla, Auto Trader and Just Eat, all of which derive all of their profit from the UK. However, they are still benefiting from structural growth drivers and high margins which protect them on the downside. Zoopla looks worst positioned given its weaker competitive positioning, lower margin and leverage. In ecommerce, Ocado would be impacted by economic weakness in the UK as it generates 100% of profit there and customers might choose to trade down in a weak economic environment. However, in the short term this could be offset by the comeback of food price inflation (on the back of currency depreciation and potential reintroduction of tariff barriers). ASOS could be a beneficiary. While only c.40% of its revenues are generated in Sterling, it continues to source c.85% in Sterling.

## Property

### Property – Bart Gysens

We think a Brexit is profoundly negative for UK property companies in general, and for those exposed to London offices in particular. Property firms are domestic, capital intensive, but also in many cases directly exposed to demand for space from financial services tenants. We expect Britain leaving the EU to reduce demand for London office space, and also significantly affect investment demand, driving a material correction in capital values. We also think the UK's decision to leave the EU could have a materially negative effect on risk premiums for peripheral European property.

## Retail

### Brands/Luxury – Louise Singlehurst

Overall there is relatively limited exposure to the UK for the luxury names. The largest domestic brand, Burberry, has just 10% sales from its home market, we estimate.

The risk of lower GDP could threaten luxury demand. Unsurprisingly luxury demand is fuelled by consumer confidence. We have previously published ([Luxury Goods: Insight: A Broken Pricing Model Set to Disrupt Growth](#) (29 Jan 2015)) our GDP multiplier analysis, which shows an historical rule of luxury growth being ~3x global GDP. On our current estimates this is nearer 1.5x (given our view of less pricing power for the industry) but this would be at risk we believe. On our estimates, Europe/UK consumer base accounts for 20% of brand revenues on average (the majority coming from Asia).

-Impact of currency? The biggest impact would be the potential for the Euro to fall to parity against USD by year end. In this event, we see broad translational benefits across the group. Luxottica has the greatest exposure to the USD (65% sales, although offset by USD cost base) followed by Ferragamo, LVMH, Burberry, Kering, and Boss (average 27%). The European brands have limited sourcing exposure to the USD. We also note Adidas has nearly 30% revenue exposure to the USD but the majority of its sourcing contracts are USD denominated.

-For Swiss Franc denominated names (Swatch) we expect a negative translational impact as our economists expect an initial strengthening of CHF.

-Tourism flows? Depreciation of both the Euro and sterling would attract greater tourism spending in the region. However, as noted above, the overall impact of this depends on the health of consumer confidence in the event of lower global GDP.

-M&A? Potential opportunities for dollar-denominated purchases looking at assets in Euro/GBP.

### Retailing – Geoff Ruddell

Although it has softened slightly in recent months, Consumer Confidence in the UK is currently very high in a

historical context and (unlike the US) the savings rate abnormally low. There is, therefore, a significant risk that uncertainty triggers a sharp fall in consumer spending over the next few months. If sterling weakens to the extent that our FX strategists expect, there will also be significant pressure on retailers' sourcing costs in 2017 (most retailers we follow are hedged for the next 6-9 months). We think investors will be concerned that this will put pressure on gross margins, though we note that most retailers were very effective in pushing price increases through to consumers following sterling depreciating by c25% in Q4 2008. We think it also worth noting that our FX strategists believe that the euro is now likely to fall as much against the US dollar as sterling does, which means Kingfisher may be no less 'Brexit exposed' than more UK focussed retailers such as Next or Marks & Spencer. For reasons we have explained in the past (see [Inditex: Currency Play](#), October 2, 2014), Inditex tends to deliver very strong earnings growth when the euro weakens, whereas, by contrast, a weak euro creates a significant headwind for H&M.

## Technology

### Software & IT Services / Payments – Adam Wood

We believe FX exposures will be the main debate for investors given the sector generally has quite high levels of recurring or transactional revenue. However, we would expect IT Services companies to suffer more from concerns on economic weakness as these companies generally have less visible revenue streams than the software / payments group. On the FX side we look for companies with high USD exposure – Dassault Systèmes and Hexagon are the most heavily USD exposed (41% and 38% respectively). We would find these two – as well as SAP (also USD exposed 33% & strong valuation support in the low €60s) and Amadeus (USD exposed 30% & highly visible transactional revenues) as most attractive on any share price weakness.

## Telecoms

### Telecommunications Services – Emmet Kelly

Around 30% of Telco sector revenues come from the Business segment, which would suffer from lower UK and Eurozone GDP growth and lead to potential cuts in budgets and project delays. Growth in convergence, content and mobile broadband may also see some pressure, given sensitivity to household budgets. Larger companies with higher UK exposure include BT (100% exposure), Vodafone (15% UK, 55% Europe), Deutsche Telekom (75% Europe, including 12% BT stake) and Telefonica (12% UK, c50% Europe). Given assets and costs are in local currency, FX translation risk is relatively small.

## Transportation

### Transport – Penelope Butcher

**Airlines:** FX is our main sensitivity watch-point with regard to near-term earnings impact – the key variance is GBP to EUR and USD. All European airlines are net short the dollar (they have a greater volume of USD-denominated cost than revenue) thus appreciation of USD to GBP / EUR is a net negative for carriers' earnings. Scale of EBIT sensitivity is unclear because of hedging strategies and limited disclosure on the level of currency exposure; however, we expect unit cost inflation to likely impact the carriers' margin profiles. There could be partial offset from improved inbound demand but we would not expect this to be meaningful. USD appreciation would also adversely impact unhedged capex commitment given aircraft acquisition is USD denominated. In the mid-term, consumer behaviour could be impacted by changes in commuting and second home ownership. We estimate ASK capacity exposure between UK and the rest of the EU at 49% for EasyJet, 36% for Ryanair, 11% for IAG and 10% for Norwegian Air Shuttle. Airline traffic rights to and from the UK will require negotiation, albeit as we discussed previously ([see here](#)) there are examples of third countries such as Norway having been granted access to the European aviation single market and the EU-US Open Skies area.

**Airports:** See discussion on 'airlines' for context with regard to airline exposure, flying rights and consumer behaviour. We see most near-term risk at airport names where: i) there is high exposure to airlines with most cash flow risk post a Leave vote as this could impact airline capacity decisions and ii) high exposure to UK

passenger flows. Against this backdrop we see most risk at Aena, where there is high exposure to Ryanair and EasyJet (17% and 5% of Aena traffic respectively, and with Ryanair showing very strong growth at +32% Y/Y in 1Q16) and 15% of passenger flow is to the UK. This implies c33mil passengers on guided 2016 passengers. A 1mil reduction in this UK base (3%) would be €11m reduction in regulated revenue or 1% of consensus 16e PBT. Aena is also exposed through its consolidated 51% stake holding in London Luton of which EasyJet controls 39% summer 2016 seat share. We see more limited impact at other listed names – UK as percentage of summer 2016 seat capacity is as follows: Aena (Spanish network) c12%, Zurich 6%, ADP 5%, Fraport (Frankfurt) 5% and Vienna 5%. Vienna holds 48% of Malta Airport where 13% of seat flow is to the UK.

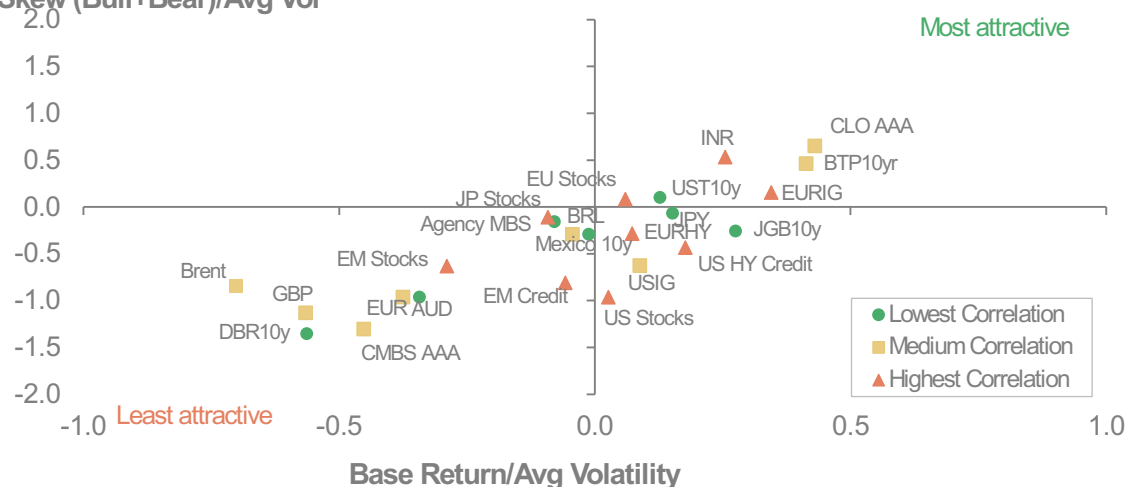
**Freight & Logistics:** The potential reworking of trade agreements across Europe could lead to impacts on freight flows between UK-Europe and potentially with other global economies, depending on changes in finance sources, taxation/duties and regulation. The major freight forwarders, DPDHL and Maersk do not have material specific exposure to the UK-EU trade lane, but could see modest impacts to road, shipping & parcel flows as a result of Brexit. For Eurotunnel, while goods will still need to be transported between the UK and the Continent, changes to trade agreements are unknown at this stage, and, we note that UK GDP growth is a key driver of cross-channel freight volumes. On the passenger car / Eurostar side, UK residents are still likely to travel to the Continent for business and leisure, and as the UK isn't part of Schengen, additional border controls are unlikely to be required.

*Prices (trading currency) as at 23 June 2016: BT Group plc 439.7, Hexagon AB 320, Kone Oyj 41.3, SKF 149.2, Atlas Copco 224.2, Compass Group 1299, Sodexo SA 96.54, Whitbread 4191, William Hill 300.2, Thomas Cook Group 73.35, SSP Group PLC 320.1, Heineken NV 81.27, Carlsberg A/S 626, Pernod Ricard SA 96.64, Unilever PLC 40.79, Unilever PLC 3186.5, Danone 63.88, Nestle SA 72.35, Royal Dutch Shell 1852, TOTAL 43.69, Subsea 7 82.05, Wood Group 676, AMEC Foster Wheeler Plc 471, Aker Solutions ASA 36.2, PKN Orlen 72.55, Tupras 62.8, Rosneft 5.375, Centrica 217.9, Iberdrola SA 6, SSE 1550, HSBC Holdings 454.45, Standard Chartered Bank 63.8, Standard Chartered Bank 578.2, BAE Systems PLC 504, Airbus Group NV 55.53, BMW 74.25, Daimler 59.99, PSA Peugeot-Citroen 14.31, Volkswagen 126.95, Nissan Motor 1027, Tofas Turk Otomobil Fabrikasi AS 23.74, Ford Otomotiv Sanayi AS 34.2, Randstad Holding NV 46.88, Adecco SA 59.55, Hays PLC 136.9, Page Group PLC 396.9, Ashtead Group Plc 1045, Aggreko Plc 1205, Bunzl PLC 2065, Applus Services SA 8.78, Intertek Group PLC 3215, Zumtobel AG 12.805, Prysmian S.p.A. 21.66, Nexans S.A. 44.75, Rexel S.A. 12.88, Legrand 50.02, Schindler Holding AG 179.4, ABB 20.63, Electrolux AB 234.2, Weir Group PLC 1389, Spectris PLC 1824, Bodycote PLC 612.5, Rotork PLC 203.1, Vodafone Group 217.9, Deutsche Telekom 14.825, Telefonica 9.218, ASOS PLC 3845, Ocado Group plc 253, ITV 219.2, Sky plc 893.5, Rightmove Plc 4225, Zoopla Property Group PLC 312, Auto Trader Group PLC 418, DMGT 647, Just Eat PLC 453.4, Publicis Groupe 63.79, WPP Group Plc 1590, UBM plc 585.5, Pearson 888, RELX PLC 15.17, RELX PLC 1243, BT Investment Management 10.15, Franklin Resources Inc. 33.74, Henderson Group 267.2, Invesco 28.77, Schroders 2711, ICAP 447.2, Tullett Prebon 324, London Stock Exchange 2735, Burberry 1109, Luxottica 46.86, Salvatore Ferragamo SpA 20.08, LVMH Moet Hennessy Louis Vuitton SA 144.6, Kering 153.5, Hugo Boss AG 56.37, Adidas 123.5, Swatch 293.4, Banca Monte dei Paschi di Siena S.p.A. 0.5435, Banco Popolare 3.03, Deutsche Bank 15.565, Credit Suisse Group AG 13.06, UniCredit S.p.A. 2.724, KBC Group NV 52.6, Danske Bank 187.1, Dassault Systemes SA 70.25, SAP SE 71.11, Amadeus IT Holdings S.A. 41.115, Boliden 158.8, Eramet SA, 28.18, Aurubis AG 43.6, Nyrstar NV 8.7, Kingfisher 366.2, Next 5535, Marks & Spencer 366.3, Inditex 31.01, H&M 256.7, Prudential plc 1358.5, RSA 483.6 AEGON 4.344, AXA 21.51, Allianz 141.5, Zurich Insurance 240.7, Generali 13.12, Shire PLC 4048, Indivior Plc 229.5, AstraZeneca 3898.5, GlaxoSmithKline Plc 1429, Novo Nordisk A/S 348.2, Ipsen SA 53.75, Merck KGaA 90.09, Ferrovial SA 18.89, Saint-Gobain 39.99, Vinci SA 64.65, LafargeHolcim 43.48, Johnson Matthey 2993, Akzo Nobel 60.62, Linde 132 Akzo Nobel 60.62 Linde 132.*

## Asset class forecasts and risk/reward

Global asset classes - expected 12-month return vs. risk

Skew (Bull+Bear)/Avg Vol



Source: Morgan Stanley Research. Note: 'Expected returns' based on MS Strategy 12m forecasts and current market prices. Correlation is six-month relative to global equities (MSCI ACWI). Credit returns are excess returns.

### Exhibit 14: Morgan Stanley key market forecasts

	As of Jun 22, 2016	Q1 2017 Forecast		
		Bear	Base	Bull
<b>Equities</b>				
S&P 500	2,085	1,525	2,050	2,200
MSCI Europe	1,336	925	1,300	1,665
Topix	1,285	820	1,230	1,660
MSCI EM	829	515	755	985
<b>FX</b>				
USD/JPY	104.4	95.0	102.0	115.0
EUR/USD	1.13	0.95	1.10	1.22
GBP/USD	1.47	1.22	1.38	1.54
AUD/USD	0.75	0.58	0.70	0.80
USD/INR	67.5	69.0	71.0	73.0
USD/ZAR	14.6	14.0	16.4	18.3
USD/BRL	3.37	3.60	3.80	4.20
<b>Rates (% percent)</b>				
UST 10yr	1.69	2.75	1.85	1.10
DBR 10yr	0.06	1.40	0.60	-0.05
UKT 10yr	1.31	2.75	1.70	1.00
JGB 10yr	-0.14	0.20	-0.18	-0.35
<b>Credit (bps)</b>				
US IG	151	240	168	145
US HY	599	933	668	573
EUR IG	117	170	130	115
EUR HY	426	600	475	425
Italy 10yr	137	210	125	70
EM Sovs	412	625	480	425
US CMBS	116	200	160	150
Agency MBS	12	24	17	7
<b>Commodities</b>				
Brent	53	35	40	55

Source: Markit, MSCI, Bloomberg, The Yield Book, Morgan Stanley Research forecasts

### Exhibit 15: 12m return and risk forecasts

Asset	12m Return			Volatility		Return/Risk
	Bear Case	Base Case	Bull Case	Option Implied	LT Average	Base case Return/Vol
<b>Equities</b>						
S&P 500	-25%	0.5%	8%	17%	18%	0.03
MSCI Europe	-27%	1.2%	29%	22%	18%	0.06
Topix	-34%	-2.0%	31%	23%	21%	-0.09
MSCI EM	-35%	-6.2%	22%	23%	20%	-0.29
<b>FX</b>						
JPY/USD	-10%	1.6%	9%	11.6%	10.1%	0.15
EUR/USD	-17%	-3.3%	7%	9.9%	9.3%	-0.34
GBP/USD	-17%	-5.7%	5%	11.1%	9.0%	-0.57
AUD/USD	-21%	-4.7%	9%	12.0%	12.9%	-0.37
INR/USD	-1%	2.0%	5%	8.4%	7.3%	0.26
ZAR/USD	-12%	-2.8%	13%	20.4%	16.4%	-0.15
BRL/USD	-9%	-0.7%	4%	18.6%	15.3%	-0.04
<b>Rates</b>						
UST 10yr	-6.9%	0.9%	7.6%	7.5%	6.6%	0.13
DBR 10yr	-9.6%	-3.2%	1.9%	6.3%	5.0%	-0.56
UKT 10yr	-9.3%	-1.4%	4.9%	8.2%	5.3%	-0.21
JGB 10yr	-2.6%	0.9%	1.8%	3.1%	3.1%	0.28
<b>Credit (Excess Return)</b>						
US IG	-4.6%	0.4%	1.9%	5.1%	3.5%	0.09
US HY	-8.5%	1.3%	5.3%	8.3%	6.3%	0.18
EUR IG	-1.3%	0.7%	1.6%	2.8%	1.6%	0.35
EUR HY	-4.3%	0.5%	2.4%	8.0%	5.0%	0.07
Italy 10yr	-4.5%	2.4%	7.2%	5.9%	5.8%	0.41
EM Sovs	-9.3%	-0.4%	3.2%	6.7%	8.2%	-0.06
US CMBS	-6.4%	-2.9%	-2.0%	4.8%	8.1%	-0.45
Agency MBS	-1.1%	-0.3%	0.5%	4.4%	3.2%	-0.08
<b>Commodities</b>						
Brent	-33%	-24%	5%	37%	-0.70	

Note: Brent returns are vs. the forward.

Source: Bloomberg, Morgan Stanley Research forecasts

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(as of May 31, 2016)

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STOCK RATING CATEGORY	COVERAGE UNIVERSE		INVESTMENT BANKING CLIENTS (IBC)			OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC)	
	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MISC
<b>Overweight/Buy</b>	<b>1177</b>	<b>35%</b>	<b>283</b>	<b>40%</b>	<b>24%</b>	<b>572</b>	<b>37%</b>
<b>Equal-weight/Hold</b>	<b>1431</b>	<b>43%</b>	<b>337</b>	<b>47%</b>	<b>24%</b>	<b>701</b>	<b>45%</b>
<b>Not-Rated/Hold</b>	<b>78</b>	<b>2%</b>	<b>7</b>	<b>1%</b>	<b>9%</b>	<b>11</b>	<b>1%</b>
<b>Underweight/Sell</b>	<b>663</b>	<b>20%</b>	<b>87</b>	<b>12%</b>	<b>13%</b>	<b>280</b>	<b>18%</b>
<b>TOTAL</b>	<b>3,349</b>		<b>714</b>			<b>1564</b>	



investment banking compensation in the last 12 months.

## Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

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