Will a Brexit Affect Canadian Investors?

Description

The big story dominating business headlines this week is the so-called Brexit, a referendum being held in the United Kingdom to decide whether or not Britain should leave the European Union.

Voters seem to be split almost 50/50 on the issue. Folks leaning towards no point out negatives to membership like high levels of immigration–which critics say take low-end jobs from local workers–as well as Britain not being fully in charge of its own affairs. In other words, if the country stays in the EU, it's forced to play by the same rules as everyone else.

Pro-EU voters like the ability to easily travel throughout Europe as well as the ability to work in any member country without needing a visa or permit. Additionally, U.K. prime minister David Cameron has negotiated special treatment for Britain if it stays in the EU, getting perks like being able to keep its own currency and putting limitations on migrant workers sending money back to their own country. U.K. banks wouldn't be forced to submit to EU guidelines either.

Many North American investors believe the Brexit is nothing but a distraction, which won't affect markets on our side of the pond at all. These investors are wrong. Here's why Canadian and American investors need to be keeping an eye on Thursday's referendum.

Potential fallout

Billionaire investor George Soros knows a thing or two about betting against the U.K. pound. Back in 1992 his Quantum Fund made billions betting against the currency–a date historians refer to as Black Wednesday.

In an article published in *The Guardian* on Monday, Soros warned of dire consequences if electors voted to leave the EU. Without full access to European markets, the average income would fall from £3,000 to £5,000 per household. Additionally, Soros believes the currency would fall between 15% and 25% immediately, which is very bad news for an economy that has to import so much.

It's obvious that such an event would send European shares reeling. It's also quite likely that damage wouldn't just be limited to that side of the ocean. Investors are notoriously fickle, often sending markets cascading lower for no good reason. Imagine the short-term carnage that could happen with a very good reason.

What about specific stocks?

If a Brexit sends the pound reeling, it's only logical that currency investors looking for a safe haven would choose the U.S. dollar as a suitable place to be. The U.S. dollar has been the world's reserve currency for nearly a century now.

This would be bad news for Canadian stocks that are dependent on a lower U.S. dollar. Companies that import merchandise from China would be among the most affected. **Reitmans (Canada) Limited** (TSX:RET.A) and **Dollarama Inc.** (TSX:DOL) import almost all of their products from China, and both stocks have sold off in recent trading sessions.

Strength in the U.S. dollar is also bad news for Canada's oil producers. Since oil is priced in greenbacks, strength in the currency is likely to translate into commodity weakness. Since **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) has become a levered play on the price of oil, it's obvious such a move isn't good news for that company.

The good news for Baytex is the company is well prepared to handle temporary downturns. It has no major debt due until 2021, and its production in Texas is profitable even at prices below $40 per barrel.

More generally, it looks pretty likely stocks will sell off if U.K. voters decide to leave the EU. These types of moves are bad news for traders, but great news for investors looking to hold for decades. If such an event happens, investors should forget about the noise and load up on great companies that are trading for bargain prices.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

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2. TSX:DOL (Dollarama Inc.)

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