



## Brexit: 4 Negative Effects on the Stock Market

### Description

As people feel greater uncertainty in the global economy triggered by the Britain exit (Brexit), the global stock markets have been more volatile than usual. The market's initial reaction is to sell first.

Most notably, money is flowing out of cyclical companies and low-quality companies, and, on a smaller scale, out of banks and energy companies.

#### 1. Cyclical companies traded lower

Cyclical companies are sensitive to business cycles. In times of higher uncertainty, auto parts and equipment companies such as **Magna International Inc.** ([TSX:MG](#))([NYSE:MGA](#)) and **Linamar Corporation** ([TSX:LNR](#)) decline first.

On Friday, they declined 8.2% and 7.5%, respectively. In the recession of 2008, both companies experienced sharp declines in earnings, which were preceded by price declines. However, at that time Linamar showed greater earnings strength than Magna. In 2009 Magna's earnings per share (EPS) were negative and Linamar's were positive (albeit at two pennies per share).

At \$47 per share, Magna is priced at a multiple of 7.5, and it's as if the market is pricing in a recession. Comparatively, in 2008 Magna traded as low as at a multiple of eight.

At \$48.55 per share, Linamar is trading at a multiple of 6.9. Comparatively, in 2008 the company traded as low as a multiple of 3.2.

#### 2. Riskier stocks traded lower

Companies with an S&P credit rating of BBB or higher are investment grade. Low-quality or riskier companies are ones with a rating lower than BBB.

Without the Brexit, the share prices of riskier companies had already experienced above-average volatility. With the Brexit, **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) and **Concordia Healthcare Corp.** (TSX:CXR)(NYSE:CXR) declined 7% and 9%, respectively, in a day.

Valeant has an S&P credit rating of B, a debt-to-cap ratio of 82%, and trades at a multiple of 2.4. Concordia has an S&P credit rating of B, a debt-to-cap ratio of 74%, and trades at a multiple of four.

### 3. Banks were in the red

The Canadian banks closed in the red on Friday with the biggest declines in **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)) and **Canadian Western Bank** ([TSX:CWB](#)). They declined 3.1% and 3.4%, respectively.

The Canadian banks are solid long-term dividend investments. Investors should consider buying more shares at pre-set, desired yields to prevent emotions from clouding their judgment if shares decline further.

In the case of Canada's biggest bank, Royal Bank, it'd be a good starting point to buy some shares at a yield of 4.7%, which translates to a price of just under \$69 per share.

### 4. Energy companies declined slightly

As the U.S. dollar strengthened against the Canadian dollar, oil prices fell. As a result, energy companies fell. They typically declined 2-4%, including **Suncor Energy Inc.** ([TSX:SU](#))([NYSE:SU](#)) and **Canadian Natural Resources Limited** ([TSX:CNQ](#))([NYSE:CNQ](#)), which were down by 1.5% and 3.7%, respectively.

The energy infrastructure companies typically held up better. **TransCanada Corporation** ([TSX:TRP](#))([NYSE:TRP](#)) and **Enbridge Inc.** ([TSX:ENB](#))([NYSE:ENB](#)) were down 0.1% and 1.7%, respectively.

### Conclusion

The initial reaction to the Brexit has been more selling than buying, as the stock market ended up in the red on Friday. Large amounts of money flowed out of cyclical companies and riskier stocks. Some money flowed out of banks and energy companies.

Cyclical stocks and low-quality stocks can deliver above-average returns when the clouds clear. However, they're harder to hold on to because they're likely to fall harder than the rest of the market before they head higher.

Investors should know their risk tolerance and temperament and stick to investments they're comfortable holding in the face of excess volatility.

No one knows the real effects of the Brexit to the economy, and we can only analyze it as it unfolds.

It's good to be cautious and wait for the dust to settle. However, I don't think selling quality companies is the right move, especially if they pay safe dividends and are priced at a discount.

In the meantime, investors should review their watch lists to determine their desired buy price ranges

for the companies they want to own, so they can take a bite when the opportunities arise.

## CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Energy Stocks
4. Investing

## TICKERS GLOBAL

1. NYSE:BHC (Bausch Health Companies Inc.)
2. NYSE:CNQ (Canadian Natural Resources)
3. NYSE:ENB (Enbridge Inc.)
4. NYSE:MGA (Magna International Inc.)
5. NYSE:RY (Royal Bank of Canada)
6. NYSE:SU (Suncor Energy Inc.)
7. NYSE:TRP (Tc Energy)
8. TSX:BHC (Bausch Health Companies Inc.)
9. TSX:CNQ (Canadian Natural Resources Limited)
10. TSX:CWB (Canadian Western Bank)
11. TSX:ENB (Enbridge Inc.)
12. TSX:LNR (Linamar Corporation)
13. TSX:MG (Magna International Inc.)
14. TSX:RY (Royal Bank of Canada)
15. TSX:SU (Suncor Energy Inc.)
16. TSX:TRP (TC Energy Corporation)

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