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Scotland rejects independence

Flash note from Multi Asset Solutions | 19 September 2014

SUMMARY

- **Majority votes against independence**
- **MAS TAA was positioned for this outcome**
- **No reason now for the Bank of England to defer rate hikes**

It had long been off the radar screen for most investors, but when the Yes camp closed in on the No camp in the opinion polls ahead of the Scottish referendum on independence, financial markets became jittery. This had ramifications not just in UK markets, but also elsewhere, most notably in Spain where bonds and equities sold off over worries about the impact of a Scottish exit from the UK on Cataluña's ambitions for independence.

However, on Thursday, Scotland voted in favour of staying in the 307-year-old union. With a high turnout – more than 85% of the Scottish electorate took part – a majority of 55% supported continued membership of the UK, while 45% voted for independence. This was a larger victory for the No camp than most polls had foreseen.

Predictably, markets were relieved. The British pound rose against the euro and the US dollar, UK equity futures rose, as did UK bond yields. Outside the UK, spreads on 'peripheral' eurozone member states' government bonds fell, particularly in Spain, Italy and Portugal.

At the MAS TAA team, we had positioned ourselves for Scotland rejecting independence. We had closed our long eurozone equities versus the UK position since we expected UK equities to outperform eurozone equities in a relief rally after a no to independence. The investment rationale for that position had already been undermined by the weakening of the economic outlook for the eurozone.

We believed the negative outlook for sterling had become too strong, especially given the alignment with the US rates cycle. Additionally, investors had bought protection against a yes vote and a sharp fall in British pound. We had took advantage of our view being different to the market and sold protection on the British pound versus the US dollar. This position performs well as the pound appreciates after the referendum.

In our view the issue of Scottish independence is now settled. Of course there will be debates about more autonomy for Scotland within the union, but that should not be an issue for financial markets. Perhaps the most direct impact is on expectations for interest-rate hikes in the UK. In the case of a majority for independence, the Bank of England would likely have deferred tightening official interest rates. With independence off the agenda a hike late this year or early next year looks likely. Hence the increase in UK government bond yields.

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Many other semi-autonomous regions in Europe had been watching Scotland's referendum with keen interest, however we believe the temperature of the independence movement across Europe will have cooled for now.

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