



May 18, 2016

Brexit-Bremain: examining the odds

- In most EU referendum polls the Remain and Leave percentages are very close
- The Undecided will define the outcome; polls suggest they lean towards Bremain
- Brexit risk premium is still significant in the currency and equity markets

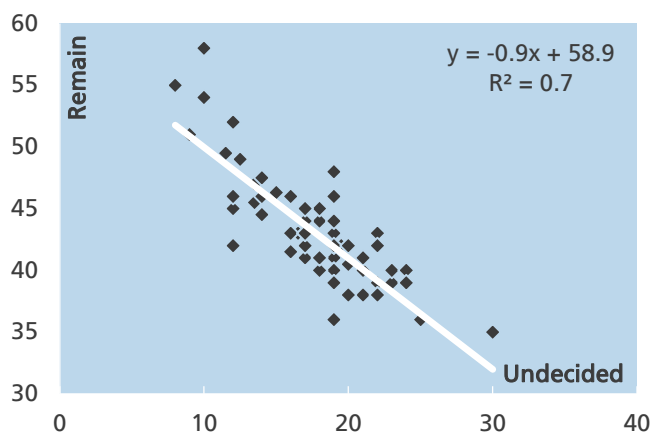
Polls show the Brexit and Bremain camps are neck and neck

Everyone likes a close race, and the media are trying really hard to portray the upcoming referendum on the UK's membership of the EU as one that could go either way. Polls are often used as evidence of this. According to the FT, the average percentage of Leave responses in surveys carried out since 2010 is 40%, vs 42% for Remain. More recent polls since last September show a clearer Remain advantage – 44.0% vs 40.5% – and data collected by Bloomberg over the same period show a similar gap – 43% vs 39.3%. However, even this bigger lead for the Remain camp is fairly small compared to the standard deviation on the responses (four to five percentage points), making it impossible to point to a clear winner with any degree of confidence.

Undecided share very high: they will define the outcome

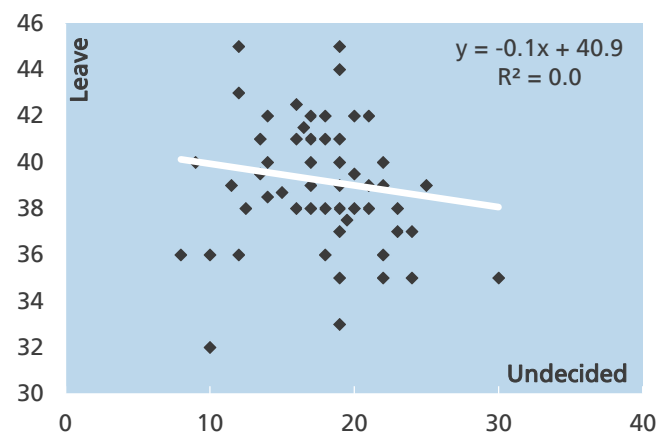
Further analysis of the data, however, provides more insights. In most surveys the percentage of Undecided votes is very high – typically between 15% and 20%. With both Remain and Leave well below 50%, it is clear that it'll be the people who haven't made up their minds yet who will determine the outcome. And it's the analysis of the

Remain share higher when Undecided % lower



Source: Bloomberg composite EU referendum tracker

No obvious Leave / Undecided correlation in polls



Source: Bloomberg composite EU referendum tracker

Undecided voters' inclinations and preferences that provides the most compelling clues that a Brexit is very unlikely.

The fewer the Undecided, the higher the Remain share

The charts on the previous page show that there is a strong negative correlation in the Bloomberg Composite EU Referendum Tracker between Undecided and Remain responses, and virtually no correlation between Undecided and Leave. In other words, at times when more people have expressed a clear in/out preference, there has tended to be a higher percentage of those in favour of the UK remaining part of the EU. A similar pattern is evident in the data collected by the FT, albeit not as clear cut as in the Bloomberg data (Remain R^2 0.6, Leave R^2 0.3). One possible explanation for this data pattern is that when the not-so-sure voters do express a preference, they tilt towards the less uncertain option.

Bremain/Brexit probability roughly 3/4/1/4

As recent elections have shown, one should be careful about relying on opinion-poll data, as they can be remarkably inaccurate. Other sources, however, tend to confirm the results of our analysis. Data compiled by [Number Cruncher Politics](#) put the probability of Bremain/Brexit at 76%/24%. Their probability index is also based on publicly available polls, but it takes into account the likely accuracy of the surveys based on past referendums as well as the historical change in public opinion in the run-up to a vote. Betting odds also seem to agree with a broad 3/4/1/4 probability split (left-hand chart below).

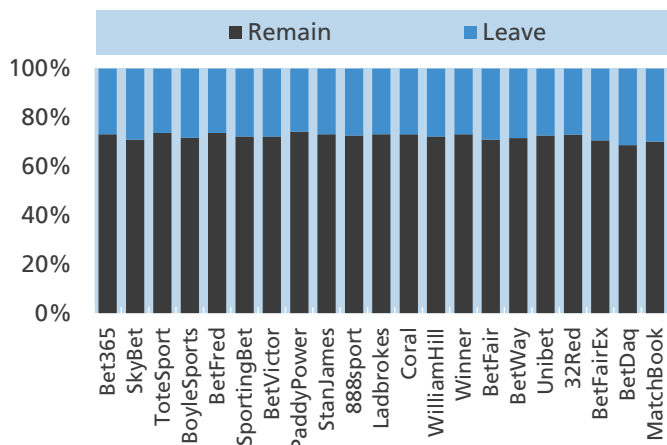
Market still pricing in sizeable Brexit risk, creating opportunities

Despite the race not looking as close as the polls would suggest, financial markets continue to price in a significant risk of the UK leaving the EU. GBP/USD has rebounded sharply in recent weeks, but EUR/GBP is largely unchanged since late February. GBP/USD risk reversals remain at deeply negative levels, indicating a preference by investors for hedging downside risk in cable. And the Bloomberg Brexit equity index (an average of 10 UK stocks exposed to the EU across multiple sectors) has mirrored the moves in the currency. We think that the market may be overestimating the chances of a Brexit vote and that a vote to remain in the EU would see a reversal of some of the recent declines in sterling, UK equities, etc.

Today's *LSR Macro Strategy* will look in more detail at how investors can capture the Brexit risk premium.

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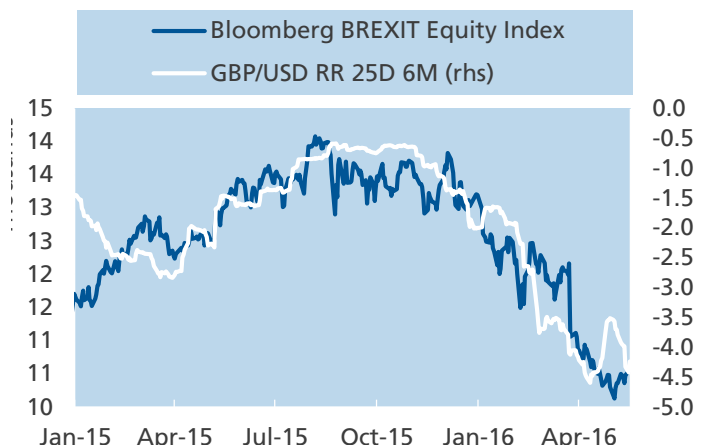
Betting odds for the Brexit referendum outcome



Source: OddsChecker.com

As of 16-May-2016

Markets pricing in significant Brexit risk ⓘ Disclaimer



Source: Bloomberg

