



| JUNE 28, 2016

## **BREXITIETY:**

### COMMENTS ON THE BREXIT VOTE AND RECENT MARKET ACTION

Friday was yet another interesting day in an interesting year. As you undoubtedly know by now, the UK electorate voted to leave the European Union sending global markets into a tailspin.

This was the “most pronounced example (yet) of how malaise with the establishment is affecting Western democracies” (Allianz Global Investors). In 2013, David Cameron offered up a vote on the UK remaining in the EU as a political ploy to keep the peace within his own party and to secure his bid to win the 2015 general election. What seemed at the time a low risk gambit turned into a political miscalculation of historic proportions.

#### **SOME FACTS:**

- The UK itself represents less than 3% of the global economy. A recession in the UK would likely have only a modest impact on the global economy.
- This was the first time a member state has elected to leave the EU since the economic bloc was established.
- 66% of Brits who left school at or before age 16 voted to leave. 71% of those with university degrees voted to remain in the EU. (Politico) GoogleTrends reported that the second most searched Internet query in the UK after the vote was “What is the EU?”
- As of Friday, the S&P 500 was still up for the year. Even with Monday’s continued sell-off, the S&P remains well above levels seen in February of this year.

#### **CAUSES FOR CONCERN:**

- The Brexit vote has generated a tremendous amount of uncertainty: who will lead Cameron’s Conservative party now that the Prime Minister has announced his intention to step down; how long it will take the UK to leave the EU; how accommodating will the remaining EU members be in agreeing to terms of exit with the UK; how much of an impact will the decision to leave have on the UK’s economy in the short and long term; will other members of the EU follow the UK and attempt to leave; will Scotland, Northern Ireland or Wales act to leave the UK and remain in the EU; will stock market volatility spill over into consumer confidence and business investment decisions and wreak havoc on the global economy; will the pro-EU parliament even pass the required legislation to start the process to break from the EU? Financial markets tend not to like uncertainty. The Brexit induced sell-off of the last few days is a prime example of that.
- Uneasiness over the health of the economy, immigration policies, income inequality, and frustration with the status quo are leading to populist uprisings around the developed world.

#### **CONCLUSIONS:**

- Experts aren’t always right. At least not often enough to justify the level of certainty that they project when providing their opinions. Most experts, economists, and the financial markets themselves, were confident in a UK vote to remain in the EU through late Thursday evening—despite the fact that it was always expected to be a close call.



- At this point, so long as you don't live in the UK or own substantial assets denominated in pounds, you shouldn't be overly concerned.
- We're doing the "worrying" for you by remaining vigilant and focusing our efforts on building long-term strategies designed to minimize the risk to our clients' portfolios.
- Uncertainty in the UK and the EU, and pullbacks in other asset classes as a result, create opportunities.

**OPPORTUNITIES:**

- Interest rates are likely to be lower for longer. 30-year mortgage rates are back near all-time lows. It's a good time to refinance, if you haven't already. Even if you have, low mortgage rates are a positive for the housing market and the domestic economy.
- Energy prices are also likely to remain low for longer. While this puts some stress on the energy sector, it is ultimately a positive for our consumer-driven economy.
- Lower asset prices today necessarily mean higher returns in the future.
- You may know this about me, but I am a huge fan of soccer and a follower of a London based Premier League team (Arsenal). A trip to London has never been more affordable than it is now with the weakened pound. Perhaps it's time to cheer the Gunners on in person! If you have thoughts of traveling to the UK or Europe it could be a good time.

We don't know what the future holds. That's precisely why we build portfolios the way we do. Risk management is core to our process. We have a number of tactics at our disposal to manage risk ranging from diversifying across asset classes, to employing strategies that seek to minimize volatility, and to a small extent dynamically reducing exposures to risk assets when trends suggest they should be avoided. This is all executed through a disciplined process that emphasizes time-tested, academically supported approaches to managing portfolios. We do not hold a finger to the wind or operate on gut reactions or hunches.

As a final comment, remember that the story of the human race is one of progress. Shocks force people and enterprises to change their ways. But the ambitions of people and companies do not change. Progress lies ahead.

Best wishes for a Happy Fourth of July!

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