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Commentary

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Brexit: Implications for Investors **6/27/2016**

The U.K.'s decision to leave the European Union sent global markets reeling. The pundits called it "Black Friday" for the United Kingdom and there is no doubt U.S. investors felt the pain of their vote. Much of the commentary following the vote has been a collection of generalizations and unknowns. Quotes such as, "It's early and uncertainty will persist." "Volatility will be prevalent." "The voters' decision might lead to a U.K. recession or global one." It is difficult to project the long term implications of the separation and even harder to determine the ramifications of the vote in the short run. Emotions are running high. Following are a few highlights on the European Union to provide a backdrop on current events.

The European Union goes back to the 1950s, during the post WWII era, but really took shape in 1993 when the association was formed to create European solidarity both politically and economically. The EU has grown over two decades to represent 28 nations and nearly half a billion people from Ireland up through Finland and down to Greece. The EU exercises legal powers and influences everything from social policy to central banking. The Euro is its common currency (although the U.K. never converted the Pound).

There are those who argue the EU was doomed from the start as integrating a true fiscal and political union was not likely possible. In periods of stress, nationalism overcomes sentiment and pushes for defection. Recent stress has come in the form of immigration and terrorism. The open border policies of the EU are heavily questioned by many member nations and certainly by Britain.

What now? Up to a two-year time horizon will decide the process while Article 50 of the Lisbon Treaty is exercised for U.K. departure. As the roadmap is drawn, many worry other member countries will decide the same fate or use this event as leverage to negotiate better member terms. Contagion is potentially the greatest risk and would create weaker confidence and further long term disruption.

Many of the British may not have understood the implications of the votes they were casting. It is predicted by the IMF that a vote to ‘leave’ will have drastic consequences ranging from a major loss in purchasing power, wild currency fluctuations, loss in retirement savings and slower economic growth. While all scenarios are possible, we believe it is safe to assume the EU is not going to turn its back on the U.K. The U.K. is the EU’s largest trading partner and there is strong incentive to maintain friendly terms in future trade agreements.

It is likely near-term growth in both Europe and the U.K. will be reduced due to business and consumer uncertainty. This will also lead to restraint in near-term investment. While the spillover to the U.S. may be modest, many research firms are downgrading their global growth projections for 2017.

Major global equity markets had been up in the weeks prior to the vote in anticipation the UK would vote to ‘remain’ a part of the EU. With the vote to ‘leave’ winning by a slim margin, the Friday one-day sell-off retraced the earlier June gains. Market volatility is very likely in the coming days/weeks. The U.S. Fed is not likely to increase interest rates near-term in part due to the vote. This will be accommodative to the U.S. economy and market. We continue to assess the specific risks and opportunities the markets are presenting. We do recognize the Brexit vote and its ramifications could take years to unfold. However, with U.S. markets down 3-4% on Friday and foreign markets down 5-10%, there are bound to be some investment opportunities in the coming weeks.

We understand that short-term market volatility does not instill comfort for investors. We continue to take the patient, disciplined and long-term approach to investing. Please do not hesitate to contact us with questions, comments and concerns. We welcome your call.

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