"Brexit" Investment Update

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Executive Summary

Markets around the globe overnight and today are responding to Britain's decision via referendum to begin the process of exiting the European Union. We discuss this in more detail below, and make the case to maintain a broadly diversified investment approach amid the current volatility. We are not recommending taking immediate action within portfolios.

What happened

Yesterday, Britain voted in a referendum to leave the European Union. Subsequently, David Cameron committed to stay on as prime minister until a new transitional government is formed, but notified that he would ultimately be resigning within the next few months. Prime Minister Cameron had been a vocal proponent of remaining in the EU; his departure is not a surprise with the referendum decision to leave.

Markets had been volatile in the preceding weeks leading up to the vote as polls vacillated between likely outcomes. Earlier this week global markets had been rallying substantially on the expected outcome of Britain remaining in the EU; today's selloff is resetting expectations and nullifying the previous gains.

What it means

Yesterday was simply a referendum and does not start any formal process or have immediate implications for trade, immigration, or markets. Under "Article 50" of the Lisbon Treaty, a country wishing to leave must provide formal notice and is then given two years to negotiate an exit and new trade deals. Britain might not invoke Article 50 until later this fall, when a new regime is implemented, to allow as much time as possible to begin negotiations. To reiterate the point: Britain is still a member of the EU, will still have access to all the same markets, etc., until the formal process is followed over the course of the coming years.

We think it is important to note that while Britain is a member of the European Union, they did not adopt the Euro and become a member of the Eurozone. This should make a withdrawal relatively simpler, although there will likely be much press in the coming weeks and months about this setting the stage for additional referendums and potential departures-potentially even from Eurozone members. It is too early to call that; we believe it is likely policy makers all over the world but especially in Europe will seek to present a unified front, potentially relax some policies, and prevent additional departures.

Has this happened before?

Many times countries leave economic unions and/or trade pacts; however typically they leave because they are joining a new or different union. There have been a couple of previous instances of countries leaving the EU (Algeria left when they became independent from France, and Greenland left under a somewhat similar referendum).

Why are markets reacting so negatively?

Markets do not like uncertainty. Put more eloquently: as we believe markets are generally efficient, they are now going through the adjustment process of taking the "Brexit" decision into account and factoring in potential future ramifications for global trade, the global economy, corporate earnings, and so on.

We believe the overarching risk is simply the uncertainty of what new types of trade agreements and economic ties an independent Britain can forge. Certainly they will remain a trading partner with the EU and the rest of the world, but the uncertainty is that they may not be able to negotiate the same preferential terms and the same easy access to trade partners as they had within the EU. There are several potential models they can follow for renegotiating trade deals, and other countries operate quite successfully within the European Economic Area and are not EU members.

For Britain specifically, the risks are obviously heightened. Many economists have predicted a potential recession should they leave the EU. This again we think is too early to call. Policy makers are likely to attempt to pre-empt large economic effects. We have already seen pledges of monetary support from the Bank of England, and other central banks around the globe are likely to account for this in their respective policies.

Should we alter course on our investment strategy?

No. Markets are making significant moves today, and again that is because they are processing this development. The adjustment process could take days, weeks, months...we don't know, and we don't know what the ultimate effects of an independent Britain will be on the world economy. There is precedence in these types of events for markets to over-react negatively initially, with the reaction then moderating over the course of the coming days.

We believe international equity exposure-including Britain and the EU-is an important diversification element and potential source of return for portfolios. The international markets represent approximately half of the global market cap, and a significant portion of the world's GDP.

Finally, we design each client's bespoke investment plan with events like this in mind. We view the risk to investors is not necessarily the fact that markets decline (market declines are an unavoidable certainty), but rather that the true risk is if clients are forced to sell, or otherwise make suboptimal decisions, during periods of duress. We build in a cash buffer to support expenses during volatile periods such as these, and ensure overall asset allocation is set appropriately for long term success if we adhere to the plan.

Conclusion

These types of market adjustment processes are never comfortable to go through. They do, however, happen with some regularity. We would expect the market effects to moderate and markets to continue to adjust to new information as it becomes available. We do not see cause for immediate concern for investors with a well-defined investment objective and a globally diversified portfolio.

That said, we understand that you may have questions or concerns, and as always we stand ready to discuss these with you and are happy to take your calls or emails. Please do not hesitate to reach out.

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