1300 NW Briarcliff Pkwy, Ste. 120
Kansas City, MO 64150
913.948.6770
816.399.0787

Is Britain Really Going to Leave the EU?

Weekly Update – June 13, 2016

Before we begin our usual weekly commentary, we wanted to take a moment to honor the victims of Sunday's terrible attack in Orlando. Though details are still scarce, it is the most devastating mass shooting in U.S. history. Our thoughts are with the victims, their families, and with the community that now must cope with the aftermath of the tragedy. As we look for answers, let's also remember to be grateful for the ones we love.

Though stocks reached new 2016 highs last week, they ended the week mixed as investors showed nervousness ahead of Britain's vote on exiting the European Union.[i] For the week, the S&P 500 slipped 0.15%, the Dow gained 0.33%, the NASDAQ fell 0.97%, and the MSCI EAFE lost 1.79%.[ii]

Though fear took over last week, some strategists believe that the S&P 500 could still test new historic highs in the days ahead, indicating that there's still some optimism on Wall Street.

What's going on in Britain?

On June 23, Great Britain will hold a national referendum on whether or not to remain within the EU. The polls had shown that both sides were neck and neck, though the pro-"Brexit" (British exit) side has recently opened a 10-point lead.[iii] Though Britain retains the pound sterling and isn't part of the monetary union, it is a member of the 28-member European Union, which gives it access to the EU's tariff-free single market, accounting for 45% of Britain's export trade. One estimate suggests that Britain's trade with Europe is 55% higher than it would be had it not joined the EU. [iv]

Why would Britain want to leave such a lucrative arrangement?

The debate over whether to stay or go comes down to a few key issues:

Stay Within the EU:	Leave the EU:
Free Trade	
By staying, Britain avoids expensive tariffs and import/export red tape when accessing the EU market. It can also take advantage of the EU's size in negotiating trade terms with other partners.	By leaving, Britain can negotiate new trade terms with EU member countries and develop new trade deals with China, India, and other countries without EU interference.
Regulations	
Regulations are standardized across the EU, avoiding the hassle and expense of negotiating country-by-country standards.	By leaving, Britain will be able to negotiate its own employment, health, and safety standards.
Immigration	
Leaving the EU doesn't guarantee that Britain can stem the tide of immigrants and economic migrants.	Britain can create an immigration system to better suit its economic and social needs.
Diplomacy	
During international diplomatic efforts, Britain benefits by being represented twice: by its own foreign secretary and by the EU high representative.	Britain can reclaim its national interests and influence international policy in its own favor.

Source: The Economist, Britain Stronger in Europe, Vote Leave

What would a Brexit mean for U.S. investors?

Markets would likely react badly if Britons voted to leave the EU. The situation would create serious uncertainty about the future of the EU, and markets hate uncertainty. We don't know exactly how a Brexit would play out; many legal agreements would have to be renegotiated, work situations for EU and British citizens would be left in limbo, and the political climate would drastically change.[v] However, these consequences would play out over several years as both sides negotiate the exit.[vi]

Estimates on the cost of a Brexit vary; one worst-case scenario projects a 6.2% loss of economic growth in Britain by 2030. Another estimate projects a best-case scenario of a 1.6% increase in Gross Domestic Product.[vii] It's very difficult to predict the relative benefits and costs because so much depends on exit negotiations.[viii] However, since Britain and Europe need each other, it's likely that post-Brexit negotiations would be favorable to free trade, making the worst-case scenario unlikely.

Many of the worst-case fears regarding a Brexit are similar to those we faced in 2015 with the "Grexit" or Greek exit. The departure of an important member nation could fracture the EU and cause other countries to consider following suit.

Though it seems unlikely that a Brexit would seriously harm U.S. interests, Federal Reserve Chair Janet Yellen stated that the Fed would consider the potential impact of a Brexit when setting interest rate policy this month.[ix] Most experts don't expect the Fed to raise rates this week, though there's always room for a surprise.

Our view

Is a Brexit the black swan event that could throw a wrench into markets? It's certainly possible, but it's not the most likely scenario. Though a British exit would certainly affect global markets, it's important to keep things in perspective. Headwinds and threats come in all shapes and sizes, and it's important to take them in stride. Some headwinds blow in for a while and then go away; others linger and cause more significant volatility. Being a long-term investor means staying flexible and maintaining focus on your individual goals. If you have any questions about how Britain's vote may affect your portfolio, please give us a call.

ECONOMIC CALENDAR:

Tuesday: Retail Sales, Import and Export Prices, Business Inventories
Wednesday: PPI-FD, Empire State Manufacturing Survey, Industrial Production, EIA Petroleum Status Report, FOMC Meeting Announcement, FOMC Forecasts, **Fed Chair Press Conference 2:30 PM ET**, Treasury International Capital
Thursday: Consumer Price Index, Jobless Claims, Philadelphia Fed Business Outlook Survey, Housing Market Index
Friday: Housing Starts

Data as of 6/10/2016	1-Week	Since 1/1/16	1-Year	5-Year	10-Year
Standard & Poor's 500	-0.15%	2.55%	-0.43%	12.98%	6.74%
DOW	0.33%	2.53%	-0.75%	9.90%	6.40%
NASDAQ	-0.97%	-2.25%	-3.59%	17.03%	12.92%
U.S. Corporate Bond Index	0.51%	6.45%	7.44%	5.50%	7.72%
International	-1.79%	-4.39%	-13.30%	-0.27%	-0.63%
Data as of 6/10/2016	**1 mo.**	**6 mo.**	**1 yr.**	**5 yr.**	**10 yr.**
Treasury Yields (CMT)	0.18%	0.42%	0.57%	1.17%	1.64%

Notes: All index returns exclude reinvested dividends, and the 5-year and 10-year returns are annualized. Sources: Yahoo! Finance, S&P Dow Jones Indices, and Treasury.gov. International performance is represented by the MSCI EAFE Index. Corporate bond performance is represented by the SPUSCIG. Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly.

HEADLINES:

Consumer sentiment slips in June. A measure of how Americans are feeling about the economy and their prospects fell slightly even though Americans are feeling the benefit of higher wages.[x]

Jobless claims fall unexpectedly. The number of Americans filing new claims for unemployment benefits fell last week, suggesting strength in the labor market after May's weak hiring.[xi]

Employers announce most job openings in nine months. Though employers are posting record job openings, they are holding back on filling them, suggesting businesses may have concerns about economic growth.[xii]

Oil prices jump on supply disruptions. Though the world is still gripped in an oil-supply slump, supply disruptions in several oil-producing nations gave oil prices a recent boost.[xiii]

"To handle yourself, use your head; to handle others, use your heart."

– Eleanor Roosevelt

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Investing involves risk including the potential loss of principal. No investment strategy can guarantee a profit or protect against loss in periods of declining values.

Diversification does not guarantee profit nor is it guaranteed to protect assets.

The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ. The DJIA was invented by Charles Dow back in 1896.

The Nasdaq Composite is an index of the common stocks and similar securities listed on the NASDAQ stock market and is considered a broad indicator of the performance of stocks of technology companies and growth companies.

The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) that serves as a benchmark of the performance in major international equity markets as represented by 21 major MSCI indexes from Europe, Australia and Southeast Asia.

The Dow Jones Corporate Bond Index is a 96-bond index designed to represent the market performance, on a total-return basis, of investment-grade bonds issued by leading U.S. companies. Bonds are equally weighted by maturity cell, industry sector, and the overall index.

The S&P/Case-Shiller Home Price Indices are the leading measures of U.S. residential real estate prices, tracking changes in the value of residential real estate. The index is made up of measures of real estate prices in 20 cities and weighted to produce the index.

The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.

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Past performance does not guarantee future results.

You cannot invest directly in an index.

Consult your financial professional before making any investment decision.

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[i] http://www.marketwatch.com/story/sp-500-logs-highest-close-of-2016-2016-06-06

[ii] http://finance.yahoo.com/q/hp?s=%5EGSPC&a=05&b=6&c=2016&d=05&e=10&f=2016&g=d

http://finance.yahoo.com/q/hp?a=05&b=6&c=2016&d=05&e=10&f=2016&g=d&s=%5EDJI%2C+&ql=1

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https://www.msci.com/end-of-day-data-search

[iii] http://www.independent.co.uk/news/uk/politics/eu-referendum-poll-brexit-leave-campaign-10-point-lead-remain-boris-johnson-nigel-farage-david-a7075131.html

[iv] http://www.economist.com/blogs/graphicdetail/2016/02/graphics-britain-s-referendum-eu-membership

[v] http://www.ft.com/cms/s/0/43645264-12a7-11e6-839f-2922947098f0.html

[vi] http://news.sky.com/story/1650373/if-uk-quits-eu-answers-to-the-key-questions

[vii] http://www.economist.com/news/latin-america/21697097-leaving-eu-would-come-heavy-cost-treasury-analysis-suggests-costs-brexit-would

[viii] http://news.sky.com/story/1650373/if-uk-quits-eu-answers-to-the-key-questions

[ix] http://www.bbc.com/news/business-36463819

[x] http://www.foxbusiness.com/markets/2016/06/10/consumer-sentiment-slips-slightly-in-june.html

[xi] http://www.foxbusiness.com/markets/2016/06/09/weekly-jobless-claims-fall-by-4000.html

[xii] http://www.foxnews.com/us/2016/06/08/us-job-openings-rise-yet-employers-cut-back-on-filling-them.html

[xiii] http://www.usatoday.com/story/money/columnist/2016/06/12/oil-supply-uncertainty-helps-pump-up-prices/85692674/