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Britain's Messy Divorce: How Brexit May Affect U.S. Investors

Weekly Update – June 27, 2016

Stocks fell sharply last week in response to Britain's vote to leave the European Union (EU), putting major indices in the red for 2016. Why did markets react so badly?

The vote to leave was a surprise to most, and markets ***hate*** surprises. It's too soon to know how Britain's exit (Brexit) will play out, but predictions include a British recession, a breakup of the EU as other countries vote to leave, or the introduction of reforms by European leaders who see the writing on the wall. Since the referendum result isn't binding on the government, there's even a very small possibility that the Brexit won't happen at all.[i] It's anyone's guess at this point.

To help you understand how the Brexit may affect you as an investor, here are answers to some key questions:

How will Britain's vote affect markets?

In the short and medium term, we're likely to see a lot of volatility in financial markets around the world as investors grapple with the uncertainty of possible Brexit outcomes. In the long term, it's hard to know what the final tally of the Brexit will be.

If we look at similar events such as the Fiscal Cliff standoff in 2011 and the European debt crisis in 2012, we see that though stocks fell significantly in the days and weeks that followed, prices later rebounded as the uncertainty cleared.[ii]

Is that what will happen this time? Possibly, but we can't predict the future. While political events like this rarely have a long-term effect on markets, we should also keep in mind that 2016 has brought many geopolitical challenges to our door.

How will Britain's vote affect the U.S. economy?

Currently, there's no consensus from economists on what the fallout in the U.S. will be. Trade with Britain accounts for just 0.31% of U.S. Gross Domestic Product (GDP), so British problems with trade won't necessarily affect us.[iii] However, the dollar is often viewed as a safe haven in times of international turmoil, which is pushing the dollar's value up versus other currencies. A stronger dollar may weaken demand for U.S. exports, which isn't good for our economy.[iv]

Globally, Britain accounts for 4.82, of worldwide GDP.[v] We don't yet know how negotiations over trade, labor, and finances will affect Britain's economy. If Britain's exit kicks off a mass exodus of EU member countries, we can certainly expect a greater impact on the global economy. However, it's too soon to know if that will come to pass.

Britain's vote will likely affect Federal Reserve policies this year. Post-Brexit, expectations of a rate increase this year have gone down tremendously. Some experts even suggest that rate cuts may be back on the table if economic growth slows.[vi]

Our View

Though we don't think the Brexit is the end of the world, we want to acknowledge the risks it poses to markets. We believe that bull markets don't die of old age, but we are facing growing headwinds from abroad that may threaten the bulls.

Unfortunately, we can't predict the future. What we can do is focus on long-term financial goals and look for opportunities in the turmoil. ***The emotional reactions of others may create rational opportunities for us.***

We are continually monitoring client portfolios and evaluating economic data and market research as it arrives. We will keep you informed and will contact you personally if we feel changes to your portfolio are necessary.

ECONOMIC CALENDAR:

Monday: International Trade in Goods, Dallas Fed Manufacturing Survey
Tuesday: GDP, S&P Case-Shiller HPI, Consumer Confidence
Wednesday: Personal Income and Outlays, **Janet Yellen Speaks 9:30 AM ET,** Pending Home Sales Index, EIA Petroleum Status Report
Thursday: Jobless Claims, Chicago PMI
Friday: Motor Vehicle Sales, PMI Manufacturing Index, ISM Manufacturing Index, Construction Spending

Data as of 6/24/2016	1-Week	Since 1/1/16	1-Year	5-Year	10-Year
Standard & Poor's 500	-1.63%	-0.32%	-3.38%	12.12%	6.37%
DOW	-1.56%	-0.14%	-3.15%	9.16%	5.83%
NASDAQ	-1.92%	-5.98%	-8.09%	15.49%	12.19%
U.S. Corporate Bond Index	0.20%	6.53%	7.02%	5.44%	7.96%
International	-1.76%	-8.68%	-18.09%	-0.83%	-1.06%
Data as of 6/24/2016	**1 mo.**	**6 mo.**	**1 yr.**	**5 yr.**	**10 yr.**
Treasury Yields (CMT)	0.24%	0.38%	0.48%	1.08%	1.57%

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. Americans were less optimistic about the economy and their financial prospects as concerns over slow economic growth grew. Despite the pessimism, consumers have been opening their wallets, pushing up measures of consumer spending.[vii]

Durable goods fall more than expected. May orders for long-lasting manufactured goods fell a surprising amount, suggesting that restrained business spending may drag on economic growth this quarter.[viii]

New home sales fall from eight-year high. May sales of new residential properties fell 6.0% due to weakness in several regions. However, new home sales are extremely volatile and overall housing trends are still strong.[ix]

Weekly jobless claims drop near 43-year low. Though hiring disappointed in May, weekly claims for new unemployment benefits dropped close to a multi-decade low, indicating that the labor market still has strength.[x]

"To be a successful investor you must divorce yourself from the fears and greed of the people around you."

– Warren Buffett

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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.

Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.

Past performance does not guarantee future results.

You cannot invest directly in an index.

Consult your financial professional before making any investment decision.

Fixed income investments are subject to various risks including changes in interest rates, credit quality, inflation risk, market valuations, prepayments, corporate events, tax ramifications and other factors.

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[i] http://www.vox.com/2016/6/25/12031254/no-brexit-article-50

[ii] http://www.kiplinger.com/article/investing/T038-C008-S003-what-brexit-means-for-u-s-investors.html#dEJKo24ck2r6SyFY.99

[iii] (2014 dollars) http://data.worldbank.org/country/united-states

https://www.census.gov/foreign-trade/balance/c4120.html

[iv] http://money.cnn.com/2016/06/24/investing/brexit-impact-on-american-global-economy/

[v] http://www.tradingeconomics.com/united-kingdom/gdp

[vi] http://www.marketwatch.com/story/post-brexit-odds-are-up-for-fed-interest-rate-cut-2016-06-24?siteid=yhoof2&yptr=yahoo

[vii] http://www.foxbusiness.com/markets/2016/06/24/consumer-sentiment-slips-slightly-in-june.html

[viii] http://www.foxbusiness.com/markets/2016/06/24/may-durable-goods-orders-fall-more-than-expected.html

[ix] http://www.foxbusiness.com/markets/2016/06/23/may-new-home-sales-drop-6.html

[x] http://www.foxbusiness.com/markets/2016/06/23/weekly-jobless-claims-fall-by-18000.html