

“BREXIT”**BRITAIN EXITS EUROPEAN UNION**

Last night the citizens of the United Kingdom voted to leave the European Union. As with all major market moving events, the most important thing is to remain calm and rational.

The Market Reaction

The result came as a shock to many investors, as evidenced by the market rally on Thursday in anticipation of a vote to remain. Markets don't like surprises! The British Pound has declined almost 9% against the US dollar as of the time of this communication. The UK stock market as measured by the MSCI United Kingdom index is off by over 11% as well. The US stock market sold off to a lesser extent with the S&P 500 being down 3.35%. As expected, safe haven assets such as investment grade fixed income and gold have done quite well in the panic, with a portfolio of 10 year treasuries being up 1.50% and the price of gold increasing by nearly 5%.

What to Expect Going Forward

One thing that we can always count on in these situations is higher volatility for all investments. Fear and uncertainty can lead to very irrational behavior, and we can expect most risk assets (stocks, real estate, high yield bonds, etc.) to have wider than normal fluctuations in price. It is important to understand that what someone is willing to pay today, in a market selloff, seldom reflects the true value of that asset going forward.

It is likely that the market volatility and economic uncertainty that this decision brings will provide continued justification for Federal Reserve to avoid raising rates in the US. The United States Dollar remains the world's safest and most liquid currency and for the time being we could see continued strength relative to the rest of the world's currencies further reducing the likelihood of rising rates.

Reversal Risk

There is a small but notable chance that the UK does not follow through with leaving the European Union. The vote was close and there are anecdotal reports of voter remorse now that citizens see the market impact of their decision. The vote was also not balanced across all parts of the United Kingdom and in order to keep Scotland and Wales in the Kingdom, Parliament may choose to override the will of the people. This could lead to a sharp rebound in the British Pound and world stock markets.

Effect on the US

It is important to note that while the direct economic impact of this decision on the US is likely to be small, it does carry greater implications for the future of the European Union as well as our own upcoming elections. It is important to remember not to accept polling data as gospel and always be ready for uncertainty.

Our Recommendation

We do not see this specific event as the cause for major concern but as we have said for the last several years our concerns about the markets have been based on valuations. When investment prices are high, the risk of decline for any reason increases. We have seen this play out several times over the last 18 months whether it was worries about China's economy last summer or Greece the year before, the market has been quick to react with panic. Whether this is another short selloff followed by a quick rebound or the beginning of a larger market correction, we feel that a defensively positioned and well-diversified portfolio will continue to be the appropriate strategy. An allocation to opportunistic managers will both help buffer the volatility and provide for stronger future returns as this selloff may also present them with the opportunity to invest a portion of their cash. To sum up our recommendation we will quote an old British motto, Keep Calm and Carry On.

Should you need additional information or have any questions, please do not hesitate to call your advisor at Beacon Pointe.