Stembrook Asset Management

Recent Market Volatility - Brexit

Stembrook Brief – June 2016

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Summary of Events

After a drawn out national campaign, the citizens of the United Kingdom (UK) voted by 51.9% to leave the European Union (EU), after a 43-year membership.

What does that mean?

In all likelihood, Britain will now begin the process of negotiating the terms of their exit under Article 50 of the Treaty on the European Union (also known as the "Lisbon Treaty") which provides procedural requirements for a member state to withdraw from the Union. This will be a multi-year process.

What is the European Union?

The European Union consists of 28 countries across Europe that are aligned economically and politically. The European Economic Community (EEC), which would eventually become the European Union, began in 1958 as a way to improve trade and economic relations post World War II with the signing of the Treaty of Rome in 1957.

The goal of the EU was to establish a single market between the countries involved, allowing for free trade, a single currency and easy access at borders. The premise of the Union is to encourage democratic and voluntary principles among member countries. The union is funded by contributions from its members, import duties on non-EU products and fines for businesses not abiding by EU rules.

How are markets reacting?

As of this writing, most global markets are reacting negatively. Generally speaking, the British Pound and the Euro are down dramatically. Global stocks are reacting negatively, while safe havens, such as U.S. Treasuries and gold are up. The following is an abbreviated account of global markets and their recent movements.

As of 9:40 AM on June 24th, 2016

Equity Markets:
Tokyo TOPIX = -7.26%
Japan NIKKEI 225 = -7.92%
London UK FTSE 100 = -3.68%
Germany DAX = -6.64%
Europe EURO STOXX = -8.42%
Emerging Markets MSCI Emerging Markets = -3.38%
US S&P 500 = -2.62%

Global 10 Year Government Bond Markets:
US Treasury = +1.63%
United Kingdom = +2.58%
France = +0.93%
Germany = +1.60%
Japan = +0.31%
China = +0.40%

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Currencies:

Pound vs Dollar = -7.68%
Euro vs Dollar = -2.94%
Yen vs Dollar = +3.72%

Commodities:

Credit Suisse Commodity Benchmark Index = -2.71%

What are the short-term and long-term implications of the vote?

The vote itself only prompts the UK government to begin a two year negotiation to leave the EU, so nothing happens immediately. That said, markets are surprised by the outcome, which is generally viewed as bad for Britain and bad for the EU. There is also an increase in uncertainty, which financial markets do not like.

The longer-term implications are less clear and are likely less impactful to the UK than the remaining countries in the EU. With a move by Great Britain to leave, momentum behind nationalist movements in other EU countries and an ongoing movement in Scotland to leave the UK, may gain momentum. When the UK negotiates to leave the EU, it will then need to negotiate treaties with EU members to outline the terms of trade with those nations. This will be influenced by the EU's desire to dissuade other countries from doing the same. Said another way, the EU is likely to give the UK a tougher deal on tariffs and trade. This will have negative implications for the UK and the world, if protectionism and nationalism gain traction and hinder global growth. In our opinion, this is the big risk in the long run.

What are the implications for our portfolios?

Our clients' portfolios are robust. They are well diversified and are constructed in a manner that is intended to allow each investor the ability to ride out short-term volatility while seeking to maximize long-term returns. That means that each client has the liquid assets on hand to fund short-term needs while letting the growth oriented holdings do what they do, which includes expected volatility. Our fixed income holdings are based in the U.S. and are conservatively structured. This means that they should experience little volatility, and may be buoyed up in the short run. Fixed income remains an unattractive long-term investment, but is held for just this sort of occasion. Our equity portfolios are global in nature and will experience volatility in both share prices and currency movements in the short-term. Keep in mind that we own equities in an effort to benefit from the earnings of reasonably valued, profit generating companies. This is a long-term proposition with expected volatility along the way. We are monitoring markets carefully and will adjust portfolios as necessary, as events unfold.

If you have any questions or concerns, please don't hesitate to contact either me (201-484-0063) or Tom (201-484-0763) at any time.

As always, I thank you for your trust and appreciate your continued confidence in our investment management and advice.

Sincerely,

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