American Heritage Financial

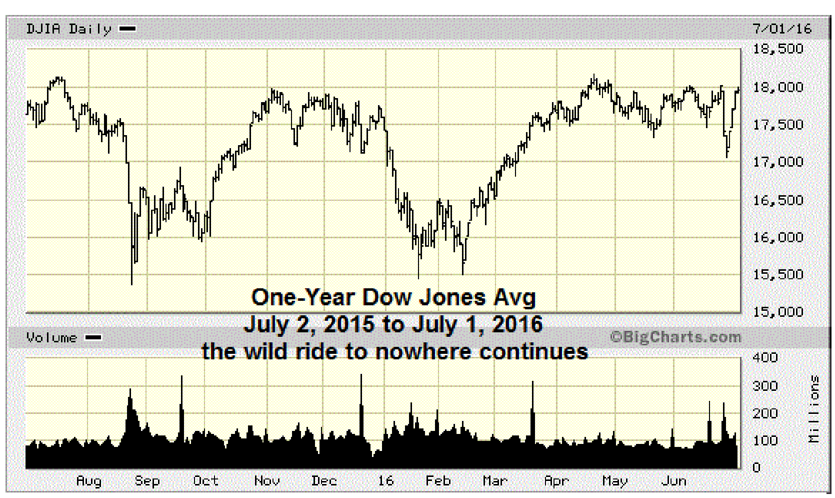
**July Update** **July 1, 2016**

# *Be Careful What You Wish For…*

This ancient proverb is just one of the reactions from Monday morning quarterbacks critiquing the United Kingdom's June 23rd vote to leave the European Union – or ***"Brexit."*** You should already know the basics about Brexit and how it has unsettled world financial markets. (And if you don't, you won't be interested in going farther with this piece—but you should rethink your exposure to current events!)

Brexit is a *political* event, not *economic*, but Britain leaving the EU definitely has significant economic ramifications so it is worth stepping away from our normal focus on the stock market to discuss what drove this decision. We will try to bring some insight to what the Brexit vote means, why it happened, what future implications might be for the global economy and how all of it could affect your portfolio.

First, our title ***Be Careful What You Wish For…,*** was the reaction many had when awaking to the surprising news on June 24. That caution was quickly reinforced by media reports and interviews with British "leave" voters who admitted—after their vote was cast—that they really did not understand the ramifications of Brexit. Some of those voters only focused on job losses resulting from competition from non-British countries and many focused on the flow of immigration into the UK—both valid concerns. However, they did not consider the damage Brexit will do to the British economy or currency (Britain is the only EU member who retains its own currency, the British Pound.) The immediate days after the vote felt like a hangover from a rough night of partying. Many voters apparently voted "NO" as a statement of dissatisfaction and/or their rejection of the status quo and the political "elite." They voted their frustrations without understanding that the Brexit vote will make Great Britain a figurative, as well as literal, island in the global economic market. Many of those—now enlightened—leave voters are now remorseful.




One-Year Dow Jones Avg
July 2, 2015 to July 1, 2016
the wild ride to nowhere continues

Britain has had a long history of strong and vocal anti-EU debate dating to even before they joined the precursor of the European Union in 1973. Just two years after joining, they had a referendum in which 67% voted to remain. Efforts to leave the EU were also mounted in 1983, 1997, 2004 and 2009. Prime Minister David Cameron, a staunch supporter of EU membership has been juggling the issue since 2012 and, on February 22, 2016, Cameron announced that the country would hold an up-or-down vote on the issue on June 23—providing just four months for voters to weigh the issue. The final vote was 51.9% to leave the EU and 48.1% to stay with a turnout of 72.2% of the electorate.

Considering the above and one might also ask ***"What was the leadership thinking?"*** A simple majority vote is a low bar for such a complex and important question. Based on the turnout, the "leave" camp won with only about 37% of eligible voters backing. In the words of **Kenneth Rogoff** at *Project-Syndicate.org, "This isn't democracy; it is Russian roulette for republics. A decision of enormous consequence—far greater even than amending a country's constitution—has been made without any appropriate checks and balances."* There is no question that Great Britain's leadership was reckless in allowing the Brexit issue to be decided by a simple popular (populist?) vote. Of course, the negative vote is reflective of poor leadership in both Britain and the EU for years. Now, there is even further disarray in Britain's leadership with Cameron stepping down, the obvious "leave" leadership backing out and an apparent total breakdown of the dominate Conservative Party. One possible positive result of this mess is reconsideration of the entire Brexit issue. While it would be extremely difficult for the UK to reverse course now and stay in the EU, it would be no stranger than their vote to leave. **This is a crisis (at least for the UK) of proportions that will bring about radical change; perhaps that change will result in a more sensible decision.**

The long-term economic ramifications for Great Britain are expected to be a lower currency, lower trade and a weaker economy. A lower British Pound has some positive impact. It means their exports will be cheaper and may help some manufacturers compete. The downside is that imports will be much more expensive which will lead to inflated prices. Overall, trade will be lower simply because it will be more difficult without the free trade agreements of the European Union. Additionally, global corporations are expected to move employees and offices from the UK because they need to operate in the EU. The bottom line will be a weaker economy and higher unemployment.

The bigger economic problem is **uncertainty.** No one can begin to predict how all this will end. Brexit, as it now stands, means the UK, EU and the global economy face enormous uncertainty for years as the impact on trade and economics is sorted out. This is where there could, eventually, be some impact on investment portfolios. In the near term, the Brexit mess, added to ongoing European and global economy weakness, is actually a positive for the relatively much stronger and more stable U.S. market.

Of course the immediate market reaction to Brexit was a two day rout of global financial markets—many losing 7% or more and the British stock market down 13%. Now, as of July 1, many markets have rebounded back to near pre-Brexit levels and the British FTSE 100 (largest 100 UK stocks) is actually 3% higher than it was the day before the Brexit vote (on hopes Brexit may be reversed). Both the decline and the rebound are likely another example of overreaction by financial markets. Corporations were not suddenly worth 7%-13% less on the days after the vote; but some haircut to stock values is reasonable due to the current and future uncertainty. From an investment strategy standpoint, it is not a time to overreact. Rather, we will continue to watch the issues closely and make adjustments at the margins to portfolios when appropriate.

One last—major—thought relating to Brexit is **the implication for U.S. politics.** It could give populist, change at any cost, politics a boost; or, it could lead to a sobering reassessment of our political values, objectives and expectations for the capabilities of our government. U.S. voters looking to voice concerns over immigration or trade issues need to be sure they have considered all sides of the issues and think hard about what might be their best (or least worst) vote in our upcoming election.

*We hope you are enjoying the Summer!*

*Ted Ingraham*

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**Questions or comments?**
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