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issue update

Market Correction

June 24, 2016

Yesterday U.K. voters renounced their nearly four-decade participation in the European Union by a margin of 52% to 48%. A close vote was expected, but the result was widely unexpected as recent polling had suggested the "Remain" campaign would prevail. Markets echoed that expectation and risk assets rallied significantly over recent days.

The unexpected result has made future uncertainty a certainty, reflected in markets by their severe initial declines. There will be real and lasting consequences to this decision, but while those consequences are unsettling, we do not believe this to be a "Lehman" type of catalyst event for markets. Additionally, the most significant consequences will only evolve over time --several years-- as the terms of departure are negotiated and put into place. Our view is motivated by several factors:

- Developed markets may be affected in the near term by tightening financial conditions, but the real consequences of this action will fall primarily on the U.K. which represents just under 4% of global GDP and just 7% of global equity market capitalization. The real economic consequences to the U.S. should be fairly limited.

- Markets, operating in relatively poor liquidity conditions, have already made significant adjustments. For example, the European bank stocks index is currently trading below the levels reached during the depths of the financial crisis. This is despite the fact that these banks have dramatically improved capitalization levels since that time period.

- Policy makers have been preparing for the possibility of a Brexit for several months, including coordinated central bank action, expanded financial accommodation, and currency market interventions. In order to prevent their planning from prejudicing the outcome of the referendum, these plans have been kept very private. These measures are likely to be at least moderately risk mitigating for markets.

We view the main near term risk as being the potential economic drag resulting from tightening financial conditions. For this reason, we will be constantly evaluating economic data in order to identify any additional softening.

The bottom line is that we believe investors currently in balance with strategic asset allocation targets should avoid de-risking portfolios into the current illiquid volatile markets. Over the coming days, we will be analyzing policy responses and evolving opportunities in order to identify potential adjustment.

Please contact us with additional comments and questions.

Issue Updates are sent periodically to help our clients make sense of global and national issues affecting the market environment.
If you have any questions, please call or write your Consultant or any of our Research Directors.

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