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The "Brexit" Vote

Britain Votes To Leave the European Union

June 24, 2016

Yesterday, British citizens voted in favor of exiting the European Union (EU). The referendum passed by a surprisingly wide margin of 51.9% to 48.1% with turnout exceeding 70% of eligible voters. The U.K. is the second largest economy in the E.U., behind Germany, and has been a member of this economic confederation of 23 nations since 1973. Prime Minister David Cameron had pushed hard to remain a member of the union; however, after the stunning defeat he announced yesterday he is stepping down in October.

The decision by the British people sent global markets into turmoil overnight and into Friday. The sharp reaction was compounded by the fact that the vote was expected to go in favor of staying in the Union. Recent polls indicated the results would be close – but, consensus was firmly biased towards the U.K. maintaining its membership. A few key questions are important to consider.

Why would the U.K. people push to exit the E.U.?

Dissatisfaction with Britain's membership in the E.U. has been simmering for several years as a growing number of citizens perceive they are not getting the full benefit of the economic partnership with E.U. members. A growing number of workers and politicians feel they are paying in more to the E.U. than they are getting out in the form of trade, jobs, and investments. More recently, control of U.K. sovereign borders has dominated debate among policymakers. As in the U.S., rising concerns over immigration and security has added nationalistic emotion to the debate. These powerful public forces were underestimated by most observers.

What does Britain's exit from the E.U. mean to markets and the global economy?

As with all unexpected economic shocks there are near term and long term implications. The initial reaction of uncertainty and fear force markets to function with a lack of information. The result is violent volatility as investors grope for direction. Initially, the worst case scenario often drives the market as investors flee risk assets and crowd into safe-haven investments such as U.S. Treasuries, gold, and stable global currencies.

After the initial shock subsides meaningful long-term issues will become the primary focus. On the economic front it could take several years for Britain to fully exit the E.U. The complexities of re-negotiating trade agreements will need to be resolved. There are currently over 50 significant trade pacts that exist between Britain and E.U. members. There's an abundance of regulation, tax, property rights, and employee citizenship issues that will need to be addressed.

Although the U.K. will gain more direct control over its social and economic destiny, the impact of this vote is expected to result in a slowdown in growth, rise in unemployment, currency devaluation, and political wreckage that will need to be rebuilt.

What's our view?

Like the majority of observers, we believed that the people of Britain would choose to remain in the E.U. However, in this environment of unpredictable political and economic events we are not surprised by the outcome. In this initial stage of volatility, with pundits spouting their wisdom through every media outlet, we're avoiding the "herd" temptation to rush to one end of the risk spectrum or the other. Our focus remains on the long term and positioning portfolios to benefit from diversification.

We continue to have a bias towards U.S. equities relative to international stocks . Our global equity emphasis is on developed versus emerging markets. Our approach to the fixed income markets remains focused on quality. Therefore, our risk profile is positioned appropriately in the current environment.

Overall, this is a significant global and political development that warrants attention and will take time to unfold. However, we do not view this event with the same level of concern as the financial crisis of 2008-2010, or the Euro/Greek Debt crisis of 2010-2012. We believe this unsettling time will eventually give way to improved market conditions that will benefit client portfolios.