UK VOTES TO EXIT EU

Last night, citizens of the U.K. voted to leave the European Union (EU) which has sparked a global equity market sell-off. In the past several weeks, the vote appeared to close to call, but most pundits believed that the U.K. would remain within the political and economic union. Today’s sell-off is due to this uncertainty. Markets dislike uncertainty and the decision to leave the EU was unexpected. We now have the difficult task of assessing a multitude of financial, economic, fiscal and political implications and consequences of the decision.

WHAT’S NEXT?

Nobody can predict what impact this decision will have. No country has left the EU before, but there are rules for an exit (Article 50 of the Treaty of Lisbon). EU leadership has demanded that the U.K. quickly enact provisions within Article 50 to exit the EU. They believe that any delay in this process will only prolong the uncertainty. Triggering Article 50 and formally notifying its intention to withdraw from the EU, starts the beginning of a two year period. This likely will not be enacted until October 2016, when a new leader is elected following the resignation of PM David Cameron. After that, the treaties that govern U.K. membership no longer apply. The U.K. will have to negotiate new trading relationships with the 27 members of the EU. On Saturday, the foreign ministers of the founding six member countries– France, Germany, the Netherlands, Luxembourg, Italy and Belgium – will meet to discuss the implications of the vote. Meanwhile, the European Central Bank and Bank of England, along with central bankers around the globe, have stated they are willing and ready to intervene to support the markets.

RISKS

Political leaders fear that the “Brexit” could trigger a domino effect, with membership to the EU becoming less attractive. Nationalist groups across Europe will be watching the impact of the referendum closely. If an independent U.K. proves to be a success, the EU could quickly unravel. We do not view this as a likely scenario, however.

International corporations often invest in the U.K for free trade access to the EU. This could have a negative impact on their profits. The exit will likely disrupt trade and financial flows, curtailing economic growth in a period of uncertainty. The EU, as a whole, is a massive economic power. A slowdown in this region could impact the global economy.

Fed Chair Janet Yellen said earlier this month that a U.K. exit could have consequences for the U.S. economic outlook. According to the European Commission, American direct investment in the EU totaled approximately 1.81 trillion Euros in 2014. Investors have already exited British pounds for the safety of U.S. dollars. This again could negatively impact U.S. multinationals.

WHAT SHOULD YOU DO?

This is not a cause for panic. We reduced our direct exposure to European equities in late May as we understood that an “exit” vote was likely to cause the market to sell-off. If there is one thing the markets dislike, it is uncertainty. This type of market volatility often leads to indiscriminate selling that can present attractive buying opportunities for long-term investors. We’ve seen these sort of market reactions too many times in the past. There was the potential for Greece to exit the Euro, the U.S. “Fiscal Cliff” and the Russian invasion of Ukraine, just to name a few recent instances. As long term investors, we need to understand that these events have occurred in the past, and will continue to occur in the future.

As always, if you have any questions or concerns, please feel free to give us a call.