HBKS® Wealth Advisors

Despite Fears, The Brexit Should Not Cause You To Alter Your Investment Plan

On June 23, Britain voted to leave the European Union. The final results had 51.9 percent voting to leave the EU versus 48.1 percent voting to stay.

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As Director of Asset Management for HBKS® Wealth Advisors (HBKS®), Brian Sommers oversees the firm's investment management processes for a distinguished group of nearly 30 investment advisory representatives. Mr. Sommers chairs the Investment Policy Committee of the firm and is instrumental in the identification, evaluation and recommendation of the investments that make up HBK's portfolios. He brings HBKS clients the expertise of more than 20 years managing a wide range of portfolios for both high net worth individuals and institutional clients.

Over his career, Mr. Sommers has managed an impressive array of investments, including Taft-Hartley plans and endowments, and plans for foundations, corporations, individuals and public entities. He has held positions in investment consulting and client service for both institutional and high net worth clients.

The U.K. is expected to notify the EU of its withdrawal and start negotiating an agreement to leave, which will cause significant economic and political uncertainty. At this point, while it is very hard to predict what the long-term economic impact will be, an increase in volatility in the near-term is almost certain to occur. Here is a summary of the initial reaction:

1. David Cameron is resigning as Prime Minister of Britain.
2. The S&P 500 Index was down 70 points (3.32 percent) and the Dow Jones Industrial average was down 566 points (3.15 percent) at 3:00 p.m. EDT June 24, 2016.
3. In Europe the FTSE 100 was down 3.2 percent, and Japan's Nikkei dropped 7.9 percent today.
4. The pound dropped below $1.35 for the first time since 1985. The currency fell as much as 11 percent and was on course for its biggest one-day fall ever. It was down against all major world currencies.
5. Bank of England Governor Mark Carney said the central bank could pump up to £250 billion ($345 billion) into the financial system to steer the economy through a "period of uncertainty and adjustment." The Swiss National Bank said it intervened in the foreign-exchange market and would remain active after the franc soared against the euro.

In the near-term, this could cause a disruption in international trade while the implications are sorted out. Also, foreign direct investment from the EU could move from the U.K. to other countries, hurting Britain's banks. In the U.S., the Federal Reserve will now probably defer another rate hike until later this year.

However, we do not believe this is a "Lehman Moment" as many market commentators have suggested. The Brexit will not occur immediately because the EU has in place a two year exit process. So while there is surprise and disappointment at the results, the sell-off has been orderly. There has not been a panic which would cause a crisis in liquidity. In fact, because stock markets had rallied this week leading up to the vote, a drop of around 3 percent would still leave the S&P in slightly positive territory for the year, and substantially higher than it was in mid-February.

While the U.K. could be pushed into a recession this year, the European Union will see a more modest contraction in economic activity. Most importantly, this vote will probably have only a marginal effect on global economic fundamentals, which remain stable but weak. We already are in a slow-growth, low-inflation, low-interest rate environment. A Brexit probably ensures these conditions will persist for some time to come. We do not believe this vote will derail the global economic recovery because longer term some of the changes could actually be positive for growth, offsetting the potential negative implications.

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For example, Britain is now free to make a trade deal with China that may be more favorable to the U.K. Also, the drop in the value of the pound could help to boost exports from the U.K. The British government may also now be able to enact an immigration policy that is more tailored to the needs of the U.K. and moderately reduce the regulatory burden in the U.K.

The main risk which could result from the U.K. referendum is it could set off further political and economic fragmentation in Europe. A voluntary withdrawal from the EU by Britain increases the odds that one of the Euro area's struggling economies will eventually decide to abandon the common currency. This could cause another round of fears concerning the debt of Italy, Greece, Portugal or Spain and might lead to even greater economic disruption than the U.K.'s exit because it would necessitate the need to create a new currency.

But all of this is speculation. No one can predict the future and we believe investors should stay the course through the volatility. Our approach utilizes broad diversification so our clients' portfolios are not overly exposed to any one area. We also believe in utilizing alternative asset classes which have a low correlation to traditional stocks and bonds. This event is a good example as to why we actively manage the risk profile of our clients' portfolios in this manner. Our conservative approach prevents our clients from making hasty decisions to move in and out of investments instead of maintaining a long-term focus on their strategic allocation. □