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JEFF'S PERCEPTION

Quarterly Commentary & Portfolio Review **July 2016**

"*The mistake is thinking that there can be an antidote to the uncertainty*" - David Levithan

A European political earthquake that's felt at home

Like many of you, my family and I had a wonderful time celebrating the Fourth of July holiday weekend. When I was growing up, the Fourth seemed mostly about barbeques, friends, family, hanging out at the lake, and fireworks.

Through my adult years, however, I've come to better appreciate what Independence Day really means. We have a degree of freedom in our nation that few today and even fewer throughout recorded history have enjoyed. And that freedom came (and still comes) at a steep price.

We have the freedom to speak our mind, the freedom of religion, the freedom to assemble, and the freedom to question our government.

In addition, we have the freedom to choose our own leaders – from the local city council to the President of the United States.

Some of us are looking forward to the upcoming election and are excited about the prospect that a woman may lead the greatest nation that has ever graced the face of the Earth. Others may be eager to cast their vote for a political newcomer, hoping to shake things up in Washington.

But I am also a realist and am painfully aware that many folks aren't very enthusiastic about the choices that *We the People* have.

It's not always perfect, but if you really reflect on it, we, as a nation, govern ourselves. And this grand experiment in democracy has been exported around the world in many forms.

Political tremors create economic waves

This leads us to Europe--and the United Kingdom in particular. On June 23, the UK voted in a nonbinding referendum to exit the 28-nation economic and political bloc called the European Union. Though "Brexit" was chosen by a narrow margin, the people had spoken.

Given it's a nonbinding referendum, British lawmakers could ignore the results. While there has been some talk that a UK exit will never happen, at this juncture, it doesn't seem likely the referendum will be ignored.

Nonetheless, a victory by the "Leave" camp wasn't supposed to happen. While the vote was expected to be close, pollsters, analysts, and even the bookies who took bets all projected "Remain" would squeak through with a win. In advance of the vote, stocks rallied in anticipation "Leave" would go down to defeat.

Whether good or bad, continuity usually benefits markets because it provides certainty.

Recall from some of my past newsletters that markets hate *heightened* uncertainty. More accurately, short-term traders dislike added uncertainty and are much quicker to hit the sell button than longer term investors, who are more tolerant of disappointments.

Why might this be viewed as heightened uncertainty? Well, we're in uncharted waters. No nation has ever asked to leave the EU.

Could Brexit fuel other separatist movements and create additional economic uncertainty in Europe? Might we see the euro currency, which is shared by 19 nations, begin to unravel?

How might this pressure an already fragile European banking system? And will the dollar begin to strengthen as global investors see the relative safety of the U.S. as a shelter from the stormy global environment?

While these are longer-term concerns, there were a couple of immediate casualties. British Prime Minister David Cameron, who was adamantly opposed to Brexit, quickly resigned, and the British pound fell to its lowest level in over 30 years (Bloomberg).

Meanwhile, expectations of a second rate hike by the Federal Reserve have dimmed considerably. Of course, rate hike sentiment could change again, but for now, prospects for a 2016 rate increase are low (CME Group).

Brexit 101 – what's it all about

In some respects, the vote boiled down to economic uncertainty versus national sovereignty.

You see, the EU is both an economic and political union. Member states enjoy the benefits of free trade, i.e., the free flow of goods and services across borders. Now that the UK appears poised to exit the EU, trade deals and the vast complexities of an exit must be negotiated.

Further, large companies that set up shop in London, using their address as a gateway into the EU, may find other host countries more beneficial. Simply put, layoffs and empty buildings dampen investment and consumer spending, which, at worst, can lead to a recession.

But membership has its costs, and nations in the EU sometimes find themselves burdened by the whims of the European Parliament.

Today, immigration is the biggest concern facing UK voters, and member nations must accept anyone who is a citizen of the EU.

It’s this open-door immigration policy that has rubbed some folks the wrong way. As a colleague who is both a citizen of the UK and the U.S. explained to me, many in his home country dislike EU rules that require British taxpayers to finance welfare benefits to those who immigrate to the UK.

In a nutshell, what voters viewed as onerous regulations and their impact on national sovereignty trumped the economic uncertainty a Brexit might cause.

Let’s not discount the positives at home

Many of the themes that have kept stocks near highs continued to play out over the quarter that just ended. On the plus side, U.S. economic growth appears to have accelerated in Q2 and interest rates remain low. While Brexit may muddy the picture, earnings are forecast to begin rising again in Q3 (Thomson Reuters).

Meanwhile, the increase in oil prices has not only reduced the strong headwinds in the troubled energy sector, but it has reversed the surge in yields among junk bonds. Still, a fill-up at the gas station remains quite reasonable.

Moreover, the dollar’s recent stability reduces the drag on revenues from firms that do a significant amount of business overseas. When U.S. companies sell goods around the globe, they must translate those sales back into stronger dollars.

A rising dollar is a gift for Americans traveling overseas, but it puts a dent in the bottom line of multinationals.

What’s an investor to do?

Control what you can control – the investment plan – and be very careful about making a rash decision based on an emotional selloff. Stocks took a beating in the wake of the Brexit vote but quickly recovered nearly all of their losses by the end of June.

I understand that most investors don't fully understand the impact of what just happened in Europe in relation to their investments. Honestly, many analysts would concede there are unknowns.

My goal, however, is to keep you focused on your financial goals and objectives. Emotionally based decisions rarely work out in your favor.

You may recall that my April letter touched on how markets price stocks.

Whether large or small, whether highly sophisticated or simply a novice, investors price stocks through their collective buy and sell decisions. When new information is disseminated in the marketplace, stocks may react either positively or negatively, depending on how the information is viewed.

By itself, the UK’s economy won’t send the U.S. economy into a recession.

But Brexit creates a new level of uncertainty and risk. However imperfectly, investors attempt to discount the event, pricing in how it may affect the U.S. economy and corporate profits.

If you ever have questions or concerns, or just want to talk, my team and I are always available.

Final thoughts

Democracies can sometimes be messy. What just happened in the UK and the gridlock in Washington are just a couple of examples.

I believe Winston Churchill described it well when he said, “Democracy is the worst form of government, except for all the others.”

While we do not know where the waves of populism that are swelling in the U.S. and Europe may take us, they represent the will of free citizens. Democratic freedoms enable the ordinary to do the extraordinary; to innovate, create wealth and fuel new economic growth. True, free elections aren’t always neat and tidy, but history strongly suggests they are a vital ingredient for long-term economic success.

I hope you’ve found this review to be educational and helpful. As I always emphasize, it is my job to assist you!

Thank you very much for the trust and confidence you’ve place in my team and my firm.