

Brexit: Is it a Turning Point on the Road to Globalization? Or a Bump in the Road?

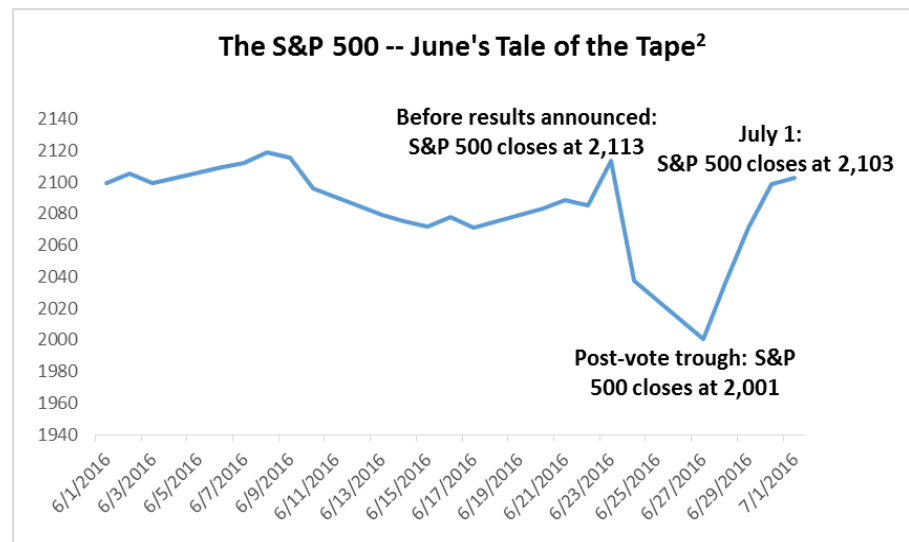
Britons' vote to withdraw from the European Union had roiled financial markets and politics in Europe. But its immediate impact on U.S.-based investors has been muted.

The S&P 500, for example, slid about 5.3% over a two-day span. But this abrupt aftershock proved short-lived and within days, the index regained what it had lost.

Citizens in the United Kingdom have voted to ask their government to withdraw their country from the European Union. When the votes were tallied, 37% favored leaving the EU, 35% favored remaining in it, and 28% did not vote for either position.¹ The vote immediately shook trading on financial markets, but there is still little consensus over its implications for investors. Here is a summary of the factors that could affect your portfolios.

For U.S. Investors, Stock Prices Quickly Take a Glancing Blow

When news of the British vote results broke on the U.S. stock market, share prices immediately went into a broad decline. The S&P 500, for example, slid about 5.3% over a two-day span. But this abrupt aftershock proved short-lived. The next four trading days brought the benchmark back to within a small fraction of its pre-vote value, and back to positive territory for the year.²

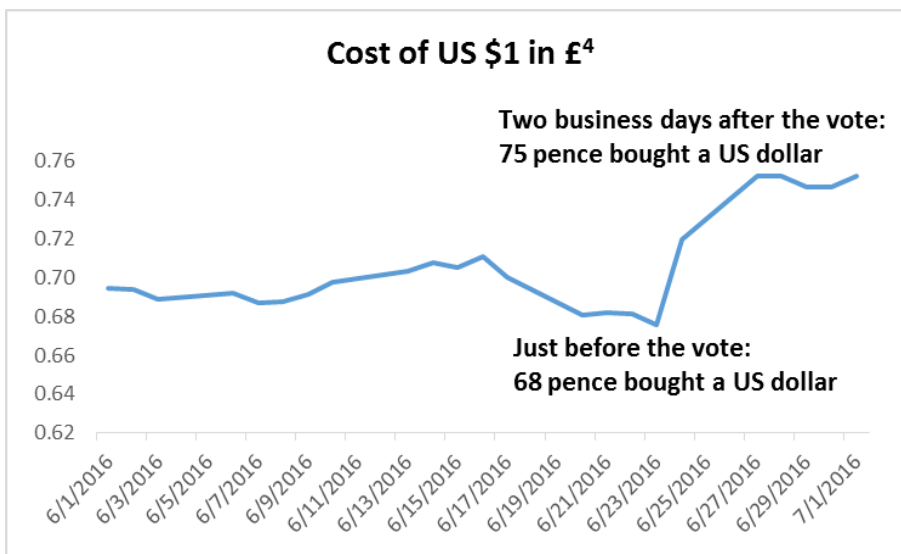


Keep in mind that even though stock markets in the United States are considered

domestic, the business activities of the companies whose shares are traded in the U.S. are often global. In fact, Standard & Poor's estimates that in 2014 foreign business activity accounted for nearly 48% of total revenue for the companies covered by the index, and that rate has been edging higher for at least two years.³ As a result, foreign financial news can have a significant and potentially enduring impact even for those who have no "foreign" stock market holdings.

The Value of the Dollar Gains Strength

Currency markets reacted quickly to the Brexit vote as the value of the pound Sterling shrank compared with the U.S. dollar. Anything valued in dollars became about 10% more costly to British residents buying with pounds. At the same time, British goods and services became 10% less costly to those buying with dollars. If these values lead to a new market normal range, they could be a benefit for U.S. businesses that purchase components and raw materials from British sources, and U.S. consumers who travel to Britain. On the other hand, they could be a disadvantage for businesses who seek to sell their products to British consumers, and those that serve British travelers to the U.S.



The Political Drama Is Not Resolved

What happens next on the path to an actual British Exit from the EU is unclear. The Brexit vote merely advised the British government about the desires of the British people. The vote did not define what kind of relationship the U.K. should have with the rest of Europe (and by extension, the rest of the world) going forward. It did not set any trade or economic policies for the post-exit Britain. And it did not set timetables for any action.

Under the rules Britain agreed to when it signed the EU's charter, the next legal step should be a vote by the British parliament directing the prime minister to start withdrawal proceedings.⁵ The current British PM was a supporter of remaining in the

EU and because his side of the argument lost in the referendum, he decided to resign, effective in October. The current PM has said that it should be up to his replacement to take on the task of handling the exit process.⁶ The negotiations to establish the terms of the withdrawal could take up to two years after the process starts. Discussions to establish the relationships that would replace EU membership could take years more.

Takeaways for Investors

- **Avoid the traps of market timing.** The quick down and up in the U.S. stock market provided an object lesson in the risks of trying to time the market to those who tried it. Many who hurriedly sold even a fraction of a day into the slide could have locked in significant losses between then and when share prices recovered.
- **Manage risk proactively.** With so much of the future business climate uncertain, it may be virtually impossible to plan for any particular outcome down the road. But you can monitor the evolution of the Brexit process, watching for factors that could have clear impacts for you. Then, when necessary, you can adjust your strategy as a specific need becomes evident. And keep in mind that while portfolio diversification alone cannot protect against investment losses, a diversified portfolio can cover many bases and help to reduce overall risk.
- **Watch for structural changes in financial markets.** London became a key center for derivatives trading in the EU, especially for trades that impact interest rates. For example, LIBOR (the London Interbank Offered Rate) is used as the benchmark for many consumer finance products here and around the world. It is not clear what will happen to LIBOR, but many believe that the trading that helps frame it will have to move from London to an EU center.

Increasing globalization has been one of the large themes driving investment performance for the past several decades. How an actual British exit from the EU evolves could help determine whether the trend toward a unified world economy continues, and what direction it might take.

¹Official tally of the [Electoral Commission](#) of the United Kingdom, *retrieved July 5, 2016*.

²*DST Systems, Inc., based on the closing values of the S&P 500 Index from June 1, 2016 through July 1, 2016. Past performance does not guarantee future results. Investors cannot invest directly in any index. Index performance does not reflect the impact of trading costs, commissions, taxes, and other expenses incurred with actual investments.*

³[S&P 500 2014: Global Sales](#), S&P Dow Jones Indices, *Latest available, retrieved July 5, 2016*

⁴*DST Systems, Inc., based on data compiled by the Federal Reserve (6/1/2016 to 6/24/2016) and by OANDA.com (6/27/2016 to 7/1/2016). Past performance does not guarantee future results.*

⁵*Resolution of the heads of state from the 27 EU countries, [EU press statement](#).*

Brexit: Is it a Turning Point on the Road to Globalization? Or a Bump in the Road? (continued)

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⁶Brexit: Tensions emerge over UK-EU trade negotiations, [BBC News](#), July 1, 2016