



## Surprise BREXIT Vote Sparks Reaction

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The long anticipated vote by the citizens of the United Kingdom on whether or not to remain in the European Union (EU) took place on June 23, 2016. Across the financial community, the vote to exit the EU has been referred to as “BREXIT” and a vote to remain in the EU has been referred to as “BREMAIN”.

Coming into the vote, respected polls across the board prognosticated a slight win for BREMAIN. Due primarily to this wide expectation across global markets for a BREMAIN vote, markets gained strongly in the days leading up to yesterday’s vote. Overnight Thursday, as votes began to roll in, it became clear the vote for a BREXIT would win.

### **What is the UK’s relationship to the EU?**

While the UK is a member of the EU, they are not a member of the Euro currency bloc. What this means is that the UK is economically aligned to other EU countries and held to the economic and political commitments of the EU. However, the UK maintains its own currency, the Pound Sterling.

The UK is unique in its position as a member of the EU, while not being a member of the Euro currency bloc. Likewise, the UK maintains one of the strongest independent central banks in the world, the Bank of England. The UK’s access to the Bank of England strengthens significantly its opportunity to provide internal financial support at this time. However, it also complicates the equation for currencies globally. As such, much of the volatility we see today is driven by significant swings in currency values globally.

### **How are Markets Reacting?**

Overnight Thursday, as the BREXIT vote solidified, global futures markets began to drop. Likewise, Asian markets opened lower, to reflect the BREXIT vote. As this piece is being written, markets across the globe have lost ground.

In the short term, markets tend to react significantly to uncertainty and subsequent surprises. As such, the strong reaction to the surprise voting result is not a surprise. The short term reaction to this surprise result was exacerbated by the opposite trend heading into the vote. Much of the negative reaction in markets early Friday is simply a reversal of gains realized over the last few weeks leading into the expected BREMAIN vote.

### **“It will Fluctuate”**

In the early 1900’s, famed banker J.P. Morgan was asked, “What will the market do?” He reportedly reacted by saying “It will fluctuate”. As students of the markets, with nearly 70 years of combined investment experience, our TOPS Portfolio Management Team has the benefits of both market data and market experience. Likewise, the TOPS team utilizes a network of many of the world’s top analysts. This experience and access to information prepares us for these type of market fluctuations.

As J.P. Morgan noted over 100 years ago, “It will fluctuate.” From flash crashes to the 1962 market pullback to the day to day market movements, fluctuations are the expectation and something we prepare for. Risk and return go hand in hand in investing. As such, we often say “Don’t ever mention return without mentioning risk in the same sentence.”

### **What about When the Dust Settles?**

This morning, the TOPS team has already received an analysis from one of the leading analyst firms in London. Jonathan Loynes, Chief European Economist for Capital Economics issued the following statement this morning:

*We have provisionally shaved our forecast for UK GDP growth in 2016 from just above 2% to 1.5%, implying little growth in the second half of the year but no full-blown recession. For now, we expect a similar growth rate next year.*

Overall, the short term reaction to the surprise BREXIT vote is not a surprise. Given the global focus, size of the UKs economy and surprise nature of the result; the short term market reaction is not out of character. Likewise, much of the pullback so far on Friday is simply a reversal of the gains leading up to the expected BREMAIN vote. Instead of focusing on intraday volatility, the short-term market reaction should be looked at in context of the long-term impact of this vote.

As Mr. Loynes noted, this vote could provide a marginal impact to economic growth in the UK. It is our strong feeling the direct economic impact of the vote itself over the long term is not a leading global economic factor. As the dust settles, markets will rationalize the impact of this vote through a clearer lens. For example, the stock value of some leading U.S. banks dropped as much as 7% immediately after the BREXIT vote. A 7% drop in total value of significant banks is a reaction which markedly outweighs the direct impact of this vote. This is an illustration of the amplification effect short term uncertainty can provide.

Central banks across the globe stand ready to provide nearly unlimited stimulus to support liquidity. Unlike the financial crisis, where there was some question regarding whether or not they should intervene, there seems to be little question central banks will step in if needed. Japan, the Bank of England and the EU have already stepped up this morning to pledge support.

### **How does this impact TOPS Portfolios?**

As one of the leading risk-based ETF portfolio managers in the U.S., the TOPS portfolios provide the discipline of diversification. In strategies that are more concentrated and designed to take big bets, there will inevitably be some big losers in times like these. Through the proven TOPS process and discipline provided by the TOPS Portfolio Management team and our partner advisors, TOPS investors stand well positioned for long term results. Likewise, many underlying positions in the TOPS Portfolios may perform well today, such as U.S. Treasury bonds.

The TOPS Portfolio Management Team will continue to monitor market movements and the longer term implications of the BREXIT vote. While not prone to short-term overreaction, this vote may have implications impacting long-term asset allocation in the coming years. Many of the actions resulting from Thursday's surprise vote will take several years to play out.

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Source: Bloomberg for historic price and return references.

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