

BRITAIN EXITS. MARKETS RESPOND.

I Fought the Polls and the Polls Won*

Financial markets around the world are reeling from an unexpected “Leave” result in the Brexit vote on June 23. The final result, 52% in favor of the United Kingdom (UK) leaving the European Union (EU) and 48% in favor of remaining, was unexpected given polling figures just before the vote. In the days before the vote, global equity, debt and currency markets largely dismissed the virtually-even polls, pricing in the opposite outcome, but are now singing a modified version of the 1966 pop music hit about the perils of “fighting the law.”

Now the dreaded “U” word is out of the bag. Uncertainty is the enemy of markets that typically crave clarity, and we can expect plenty of uncertainty to drive investor sentiment over the coming days, weeks and months. Not only will the ramifications of the EU’s second largest economy becoming an outsider be digested, but questions about which of the remaining members might be next to leave are likely to follow. Amid the onslaught of headlines and pundits on television proclaiming clarity amidst calamity, let’s begin to size up the situation:

- The referendum is non-binding, but will likely lead the British government to invoke Article 50 of the treaty that established the EU. Article 50 gives a country two years to negotiate a future relationship with the rest of the EU and must be invoked by the British Parliament. Parliament, however, is strongly in favor of remaining in the EU, adding the potential for more uncertainty and delay as the legal and political aspects of separation are worked out.
- Prime Minister David Cameron, a staunch supporter of the ‘Remain’ campaign, has announced his resignation.
- An uncertain future may create recessionary conditions for both the UK and the rest of the EU beginning as early as the third quarter.
- Weakening Euro and Pound Sterling currencies may have offsetting benefits in the form of increased European export demand.
- The UK would be the first country to leave the modern-day EU, and its departure requires new negotiations on trading pacts between it and its EU trading partners. Such negotiations have never occurred before.

At this point, we are comfortable with our current positioning and see no justification for a hasty reaction to the Brexit surprise.



- It is expected that the EU and its trading partners will not offer favorable trading terms to the UK for fear of encouraging similar movements in other member countries, or what is termed the risk of “political contagion.”
- Scotland, which voted in favor of “Remain,” renewed calls for a second referendum on their status as a member of the UK, leaving open the possibility that Scotland might join the EU on their own.
- Central Banks had prepared for this outcome and are ready to act as a liquidity provider as necessary.
- A settlement between the EU and Britain on the open immigration issue (a major force behind the leave vote) could occur before membership is officially withdrawn.

As the “Leave” campaign celebrates its emotional victory of so-called independence, the unfortunate reality is that lawyers are likely to be the big winners as the UK government sorts out what is likely to be a legal mess of historic proportions.

Stepping back from the noise of the moment, investors should remain focused on their long-term goals as financial markets react negatively to the unknowns that lie ahead. Volatility in equities and currencies, fueled by emotions and rhetoric, will likely persist over the near-term as the true implications are sorted out. While not the positive outcome most investors expected, a measured assessment of both the risk and the opportunities resulting from Brexit are required before any definitive action is taken.

We believe in building long-term, durable investment portfolios for our clients that are designed to weather the periodic storms in markets. As we digest the implications for all asset classes, we will be carefully reassessing our outlook to determine if any changes to our asset allocation programs are warranted. At this point, we are comfortable with our current positioning and see no justification for a hasty reaction to the Brexit surprise.

* The Bobby Fuller Four, Sony/ATV Music Publishing LLC.

Perspectives is a publication of HighMark Capital Management, Inc. (HighMark). This publication is for general information only and is not intended to provide specific advice to any individual or institution. Some information provided herein was obtained from third-party sources deemed to be reliable. HighMark and its affiliates make no representations or warranties with respect to the timeliness, accuracy, or completeness of this publication and bear no liability for any loss arising from its use. All forward-looking information and forecasts contained in this publication, unless otherwise noted, are the opinion of HighMark, and future market movements may differ significantly from our expectations. HighMark, an SEC-registered investment adviser, is a wholly owned subsidiary of MUFG Union Bank, N.A. (MUFG Union Bank). HighMark manages institutional separate account portfolios for a wide variety of for-profit and nonprofit organizations, public agencies, public and private retirement plans, and personal trusts of all sizes. It may also serve as sub-adviser for mutual funds, common trust funds, and collective investment funds. MUFG Union Bank, a subsidiary of MUFG Americas Holdings Corporation, provides certain services to HighMark and is compensated for these services. Past performance does not guarantee future results. Individual account management and construction will vary depending on each client’s investment needs and objectives. **Investments employing HighMark strategies are NOT insured by the FDIC or by any other Federal Government Agency, are NOT Bank deposits, are NOT guaranteed by the Bank or any Bank affiliate, and MAY lose value, including possible loss of principal.**