



Is Brexit Really As Bad As It Sounds?

SYNOPSIS

- The U.K. will vote on June 23rd to decide whether to remain in the European Union.
- Those in favor of staying point to economic benefits, while those opposed cite concerns with immigration.
- Although risks do exist with the outcome of the vote, any material impact to investors is highly unlikely in the near future.

AN UPCOMING VOTE

The European Union (EU) is a political and economic union of 28 countries in Europe that spans areas including trade, security, migration, justice, health, and the environment. It began after World War II and was based on the notion that countries which trade together are more likely to avoid going to war with each other.

The EU has since grown to become a “single market” allowing goods and people to move around as if the member states were one country. Within this respect, it’s somewhat similar to the individual states in the U.S. For example, if I decide to move to California tomorrow, I can simply pack my bags and head west.

The Euro is the currency for the EU, which is used by 19 of the member countries, and it has its own parliament to set rules in a wide range of areas including consumer rights, environmental issues, and even the nitty gritty like mobile phone charges.

Like any club, all countries must pay monthly dues and are subject to its legislation. This centralization of power and capital has frustrated a few countries

over the years, and arguably no member is more upset than the U.K.

A sizeable opposition group in Britain has always made its voice heard. This cohort of “Euroskeptics” prevented the U.K. from adopting the Euro currency and forced the country to maintain its own border control.

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The Euroskeptics have garnered more power over the years due to public opinion surrounding the current state of the EU. These Brits feel that the union has morphed from what was supposed to be a trading zone into a force that has far too much control over British life.

To appease members from within his own political party and assist with his re-election last year, the Prime Minister, David Cameron, agreed to hold a referendum to allow U.K. citizens to vote on whether to remain in the EU or exit. The media has coined this potential outcome as “Brexit,” or Britain’s exit (Br + exit = Brexit) from the EU.

The country will vote on June 23rd, and the polls put the odds of a Brexit much closer than political leaders across the EU would prefer to see. Those in favor of leaving the EU cite three primary reasons:

1. **Immigration:** This issue is by far the most concerning because of the massive inflow of immigrants across its borders. According to



Bloomberg, roughly 500 people every day enter the U.K. and become eligible for employment and subsidies. The populist movement amongst many Brits wants this to come to an end.

2. **Cost:** Britain can stop sending £350 million, equivalent to half of their entire school budget, to Brussels every week. This money could be spent elsewhere.
3. **Control:** Leaving will return control over employment law, healthcare, and safety/security. They could renegotiate trade agreements and have a bigger voice in international affairs.

Those who favor staying in the EU comprise a powerful group. Nearly every major political and business leader has publicly stated that leaving the EU would be a terrible decision for three reasons:

1. **European Trade:** Europe accounts for roughly 45% of all U.K. exports, and any damage to the relationship between Britain and the rest of Europe could dramatically impact their economy.
2. **External Trade:** Membership with the EU has its privileges. For example, the EU has established trade agreements with other countries like the U.S., and all members get access to these trading partners. Leaving would require striking new agreements, and these terms could end up far less favorable.
3. **Fear of The Unknown:** No country has ever left the EU, so it's nearly impossible to predict what will happen if they do leave.

Simply put, the decision comes down to a battle between the economic ramifications of leaving versus the immigration concerns if they stay.

IMPLICATIONS FOR INVESTORS

As much as political leaders may fear the unknown,

markets despise uncertainty far more than any politician ever could. If the Brits do vote to leave, three legitimate risks could eventually impact investors:

1. **Retaliation:** If the U.K. were to leave, other member countries may retaliate by refusing to trade with Britain. Egos are at stake, and logic may get thrown out the window.
2. **Employment:** Jobs could be lost both in the U.K. and in the EU if the Brits choose to close their borders. The instability from further job losses could risk the already fragile economies across southern Europe.
3. **Herd Mentality:** If the divorce ends up working out better for Brits, then other European countries may also leave and ultimately force a collapse of the EU.

But who knows for sure? Maybe exiting the EU and even an ultimate break-up of the union would be a better outcome for Europe. It's hard to say at the moment because it's still far too early to be able to predict possible scenarios.

In regards to any direct exposure to the risks associated with a Brexit, many of the portfolios do have allocations to Europe, but the percentages are small since all are far more heavily weighted to the U.S.

Europe is our largest trading partner, so portfolios that own U.S. companies who sell to Europe do have some exposure to a Brexit. However, the benefits of global diversification far outweigh any risk associated with the potential for trade agreements to be rewritten.

Lastly, even if they do leave the EU, the process will most likely take two or more years, which is

more than enough time to prepare for any negative externalities that could arise along the way.

The bottom line is that the impending Brexit vote carries risk, but any real impact to investors won't be known for quite some time. Therefore, it's best to be patient and resist the urge to make any major changes to an investment strategy until after the outcome is better understood.

Sincerely,



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