Market Update

June 30, 2016

Global capital markets ended the second calendar quarter of 2016 in a state of heightened uncertainty as the citizens of the United Kingdom voted to leave the European Union. This political event overshadowed economic and market developments worldwide. However, it already appears that the perceived consequences of the vote weere exaggerated, as capital markets are quickly adapting to this event. Nevertheless, it is useful to review briefly the elements that led up to this surprising occurrence.

The “Brexit” vote in the United Kingdom has now revealed the shortcoming of listening to pundits opine that Britain should remain in the European Union. One of the most closely followed indicators was the betting done on the outcome and reported frequently by Ladbroke’s, the London based firm taking the bets. Only during the very last few days did Ladbroke’s state that while more money had been bet on staying in the European Union, twice as many people had bet on leaving as had bet on staying. That’s when I thought the “Leave” side of the referendum had a better chance of winning than was being reported. After all, who votes contrary to the way they bet? The referendum was not weighted by wealth, it was one person, one vote. And 52% decided it was time to leave.

The “Brexit” vote occurred one week before the end of the second calendar quarter and it was assumed it would have a significant impact on markets worldwide. The same pundits who opined that UK voters would opt to stay in the European Union because it was the “safer” vote, obviously missed the sentiments of actual voters.

The impact was indeed intense, for two days. The British Pound declined by roughly 10%, the Japanese stock market declined by roughly 10% and interest rates in the United States plumbed record depths, as the 10 year U.S. Treasury broke through 1.4%, an all-time record low yield for that Note. The price of gold continued upward and it is now 20% higher than at the beginning of the year.

With European and Japanese Central Banks forcing money market yields into negative territory, gold now provides a positive yield relative to those markets. Perhaps individual savers and investors are withdrawing money from their bank accounts and buying gold. The data from the European banking system support that premise, as bank deposits are down and gold sales are up.

The impact of the “Brexit” vote in the U.S. was much more muted than in other international markets. The S&P 500 was up 2.0% during the quarter while NASDAQ was down 0.6%. Emerging markets were up 0.3% while developed international markets were down 2.3%. This relatively wide spread among returns from different markets reflects the relative merits of individual markets and makes it the equivalent of a “stock pickers” market. Globally well diversified portfolios probably had investment returns near zero for the quarter.

We look for continued slow economic growth in the U.S. and low positive returns from equites for the remainder of the year as corporate earnings sequentially improve.

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