Brexit!

Global financial markets have been ***roiled*** by the ***"leave"*** vote in the UK's referendum on European Union (EU) membership. While the polls were "too close to call" going into Thursday's vote, it is quite obvious that this result was quite unexpected resulting in increased volatility in financial markets.

The leave side ran a ***brilliant campaign***: Citing the tyranny of unelected bureaucrats in Brussels running roughshod over the poor suffering citizens of the UK (including such silly regulations like those on the curvature of bananas) and playing on their fears of uncontrolled immigration. Despite calls for a new referendum (with over three million new signatures attached to the petition), we believe the damage has already been done.

As a result, Prime Minister David Cameron has ***resigned as leader*** of the Tories with effect from this October and the Tories will have to elect a new leader (who will also presumably become the new Prime Minister). In a smart move, PM Cameron did not invoke ***Article 50 of the EU Treaty*** – which would have set the clock ticking for a two year period within which the UK and the EU would have to negotiate the former's exit.

Many analysts have speculated that the "leave" vote could well ***harden positions*** within the other EU leaders making it difficult for the UK to negotiate a successful exit. In any event, the fact that the UK had always retained the ***Pound Sterling as its currency*** (rather than adopt the Euro at its inception in 1999) ought to make for an easier exit. However, a statement issued by the foreign ministers of the original six founding members of the EU late on Saturday suggests a back-tracking on the project of "European Integration".

The country of ***Scotland*** voted to "remain" by almost 62% in contrast to those in England and it is not inconceivable that Scotland might indeed want to remain part of the EU once all is said and done – especially as the citizens of that country might want to determine their own future. This also increases the likelihood that other countries that have long suffered from the EU's prescription of fiscal austerity like ***Italy, Spain and Greece*** could also seek to exit the EU eventually.

Another issue that seemed to be ***front and center*** for the UK voters was ***immigration.*** The UK has historically been generous in accepting immigrants from all over the world, especially from erstwhile colonies in Asia and Africa. This time however, the angst seems to be directed at immigrants coming in from Eastern Europe and the Middle East – who are moving to the UK in search of a better life for themselves and their families.

From a financial markets' perspective, ***equity indices*** around the world have witnessed ***sizable sell-offs***, with peripheral European equity markets falling 8.0% to 12.0%, on Friday alone. Among currencies, the Pound Sterling fell almost 10% - its biggest daily decline in almost 30 years. Ironically, the FTSE 100 (the UK's widely followed equity index) was only down about 3.8%, due mainly to the belief that a weaker Pound Sterling would help exporters. In addition, interest rates have declined (with the US 10yr now yielding 1.56%) as "flight-to-quality" demand increases.

The "leave" vote and the attendant market volatility also removes the threat of ***Federal Reserve rate hikes*** in July and perhaps even in September. Given that by then the US Presidential campaigns will be in full swing, the FOMC's window has probably closed until their meeting in December. Markets would need to return to calm and the US economy would have to demonstrate significant forward momentum for the FOMC to feel emboldened to move before this fall.

The market sell-off raises the question of whether this is a ***harbinger of things to come***: The Brexit vote, followed by the election results in Spain on Sunday do suggest much angst against the effects of globalization. Indeed, many political pundits have drawn parallels between the Brexit vote and the disenfranchised voters that swayed results in the US primaries. We are of the opinion that the "leave" vote is unlikely by itself to cause a global recession, although we suspect that it could certainly lead to some loss of momentum in economic activity both here in the US and in Europe.

We continue to maintain ***higher than normal cash balances*** in your portfolios with a view to ***preserving capital in these turbulent times*** and will treat these market gyrations as an opportunity to carry out a thoughtful repositioning of existing holdings going forward.

Please do not hesitate to contact us if you would like to discuss this or any other issues in more detail.