Market Message – June 24, 2016

Global financial markets came under enormous pressure as the results of the Brexit referendum caught most investors off-guard. U.S. stocks suffered their largest one-day losses since September. Results overseas were even grimmer, with the British pound falling more than 10% to its lowest level since 1985 and the FTSE 250 falling 7%, its steepest drop since 1988. The drop in sterling helped keep London's export-heavy FTSE 100 somewhat insulated from the turmoil in the U.K. That index fell 3.15%.

With a questionable global economic outlook and a now-muddled political situation, the impact to international trade and the complexity and length of the separation process create a cloud of uncertainty. A period of low corporate investment in the U.K and Europe is expected, with economists calling for a 3%-7% negative long-term impact on U.K. GDP. The question for many is whether this is enough to drive an already tenuous global economy into a recession.

On the surface, the effects are decidedly less severe in the U.S. In terms of U.S. company sales, the aggregate revenue exposure of the S&P 500 to the U.K. is only 2.9%. The sectors whose revenues will be most affected are Energy (6.4% of sales attributed to the U.K.), Technology (4.0%) and Materials (3.7%).

Despite the limited fundamental impact, the effect on investor psyche may be more pronounced. Many investors have been hoping to see a second half profit recovery as the catalyst for higher stocks, and may now worry that this thesis is in jeopardy. Markets are expected to remain volatile in the short term which will also challenge investors' fortitude.

Introducing a calming influence, the Bank of England (BoE) and other major central banks (ECB, Federal Reserve, and Bank of Japan) are expected to provide further liquidity and to backstop markets in an effort to keep the financial system operating smoothly. In the U.S., the Federal Reserve may be on hold for future rate increases. Today, the implied probability of a September rate increase fell from 30% to 0%, and from 56% to 22% for a rate hike in December. Continued lower interest rates will be viewed positively by the stock market. Many investors see this as a silver lining in light of today's events.

As with every significant market event, the message to investors is to try to remain calm and to maintain a long-term perspective. Assuming that today's market reaction is contained, positive cues to look for signifying a healthier market include: accommodative Central Bank policy, stability within the financial system and currency markets, guidance from companies that profits are not comprised, and positive EU and global GDP readings. As with any period of heightened volatility, with panic comes opportunity. Investors should look for signs that the volatility is subsiding and consider buying opportunities.