What Happened?

Citizens throughout England, Scotland, Northern Ireland and Wales voted in favor of the United Kingdom ("U.K.") exiting the European Union ("E.U.") by a narrow margin (52%-48%) last night. The result shocked investors globally, as recent polls and sentiment seemed to be pointing to a victory for the "Remain" camp. While we at Appleton viewed this referendum vote to be anything but certain, Wall Street had been pricing in a victory for the Remain contingent with the U.S. stock market rallying over 2% in the last week alone. This recent strength contributed to the stark reversal we are seeing in markets this morning. Many European equity markets and international markets are down 5-to-10% this morning, with the British pound sterling off 8% and the Euro off 3% against the dollar. In the U.S., the S&P 500 opened down over 3%, but has rallied modestly to trade down slightly over 2% as of this release. In the bond market, the 10-Year Treasury is rallying to a 1.58% yield this morning on a flight to quality.

What Happens Now?

The short and long term impacts of the "Brexit" vote are hard to predict with any certainty, and will be the subject of much debate in the coming months. Much of the negative sentiment and fear this morning is attributable to the fact that there is no clear blueprint for the process of a country leaving the E.U. The future viability of the E.U., the impact on the global currency market, the impact on the U.K.'s trade partners and the contagion risk that other countries will decide to leave the Union are among a number of concerns that investors will face. One certainty is that the process will be drawn out as Article 50 of the Treaty of Lisbon stipulates that the U.K. will have two (2) years to negotiate terms with the E.U. However uncertain, the U.K. is embarking on a multi-year period in which it will negotiate trade agreements with all its partners in what could prove to be a far more orderly exit than what is being speculated today. Another result of the Leave victory, and subsequent market volatility, is that the odds of the Federal Reserve raising interest rates have diminished greatly. The Fed Futures implied odds of an interest rate hike by February of 2017 have fallen to just 11.6%. We believe that the Fed will be hard-pressed to raise rates in the face of the political and economic uncertainty that is sure to follow this unprecedented decision.

The Appleton View

The team at Appleton is confident that our focus on domestic equities is preferential to broader global exposure at this time. Also, to put this drop in the markets into perspective, the S&P 500 is indicated to trade at a similar level to only a week ago, and remains positive on a total return basis for the year. Our allocation to high-quality U.S. bonds in balanced accounts is certainly benefiting from the risk-off trade, and highlights our firm's belief in a balanced approach to portfolio construction. We will continue to monitor the subsequent impacts to the marketplace, and evaluate opportunities as they present themselves.

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