Will the Ripples from Brexit Reach the California Shore?

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In much the same way that the aftermath of Japan's Fukushima earthquake eventually found its way to the west coast of the United States in the form of flotsam and jetsam, the impact of the United Kingdom's recent "Brexit" vote may very well have ramifications that slowly ripple around the world – even all the way here to the shores of Southern California.

In the run-up to the referendum, the international Organization for Economic Co-operation and Development (OECD) warned Britons that a "leave" vote could have a devastating impact on the global economy –as potentially harmful as a major recession in China.

Nevertheless, two main constituencies came together to propel the anti-European Union faction to victory: economically disenfranchised rural/industrial working-class voters who were spurred on by a nationalistic desire to control immigration and take back power from their appointed EU bureaucrats; and older pensioners fueled by nostalgia for the days of Churchill and a more powerful and sovereign British empire.

The calm before the storm

At first blush, the Brexit decision to leave looks a bit like a tempest in a teapot. Despite an immediate and precipitous post-vote plummet in global markets, three weeks later both the FTSE and DJIA are trading near all-time highs. However, there's truly no historical precedent to help gauge the long-term impact of a British departure from the EU. No developed country has ever left a trading bloc without joining a larger trading bloc. Furthermore, no country has ever left the European Union (the UK has been economically tied to Europe for over 42 years).

With a new Prime Minister, it's expected that at some point over the next two or three months the UK will file Article 50 (the clause in the Treaty of Lisbon that formally announces a member's departure from the EU). That will officially start the clock ticking on a process likely to take the better part of two years to restructure trade agreements and ultimately sever ties. Meanwhile, nothing officially changes, but countless questions abound.

Will London's position as a leading global financial center be severely weakened? Will the more than 3 million EU citizens living in the UK be forced to move back home? Will Scotland (which voted to Remain) leave the UK and rejoin the EU? Might Northern Ireland (also voting to Remain) achieve the same aim by reunifying with Ireland? Will a weaker Pound stimulate the English economy by making exports cheaper, or will it crimp the economy with a massive amount of capital flight? And could this event unleash a domino effect among other nations that irreparably fractures the EU?

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An impact all the way across the pond

It seems very likely that the Brexit vote will at best keep the global economy in its current slow growth, very low interest rate environment. At worst, it could trigger the start of another recessionary period. What we know for certain, however, is that markets generally don't like uncertainty, and this is without question a situation fraught with plenty of uncertainty.

That uncertainty has led to an unprecedented 13% plummet in the value of the British pound compared to the U.S. dollar since the vote to leave.[1] Unfortunately for American businesses, a strengthening dollar also means that U.S. goods become increasingly more expensive overseas, creating pressure on exports and ultimately a drag on corporate profits. According to the Department of Commerce, the U.S. exports more than $100B annually to the UK, with more than a million Americans employed by British companies. Here in California, we export more than $5B annually to the U.K., with 90,000 jobs in the state supported by British investment. From technology, chemicals and machinery to tourism and the film industry, decreased revenues from Great Britain will certainly be felt to some degree across the state.

Is it time to get out of the stock market? The simple answer is no, not if you're investing for the long term. For most investors, following Warren Buffet's advice to "*be greedy when others are fearful*" can be challenging. With no shortage of fear in today's markets, staying invested can be exceedingly difficult—it runs counter to our basic human instinct to flee from any potential threat. Yet although selling may make you feel better in the short term, it's rarely the wise long-term strategy as most money is made when the decision to invest is most difficult. Recall how uncomfortable it was to invest in 2009 after the 2008 Credit Crisis, and look how far the market has climbed. The time to head for the hills is when everything feels perfect, and today is not one of those days.

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[1] As of July 11, 2016

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