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CAPITAL INSIGHTS

FLASH UPDATE • JUNE 2016

STIFF UPPER LIP, AND ALL THAT

You'd probably have to have been on a desert island with zero electronic gadgetry to have missed the build up to the "Brexit" vote, as it has been called. Yes, on Thursday, Britain voted to leave the European Union after having been a part for over six decades. The melodrama in the media has been a sight to behold. But what does it really mean and just how will this impact financial markets ahead?

We have witnessed many a financial problem in Europe over the last three to four years. Greece, Italy, Spain, Ireland and France have landed "on the front page" a time or two. The strongest of economies in the European Union have been Germany and England. So England leaving the Union leaves the Union with one less strong man, so to speak. Not good for the longer term strength of the Union. That's a concern.

Although England never adopted the Euro as its currency and continued to use the Pound post the Euro currency rolling out across Europe, England walking away from the European Union causes members of the Euro community to second guess their own inclusion. To ourselves, THIS is the key to the ultimate impact of the Brexit vote. Will other Euro centric countries also decide to leave, ultimately unraveling the Union itself with very negative impact on the Euro currency? We see this as the heart of the issue. By the way, post the Brexit vote, the Netherlands and France suggested a need for their own referendum, as did the Northern League of Italy. That didn't take long.

So what about the financial markets? In overnight futures trading, the S&P fell over 110 points in the post Brexit aftermath, but as the markets opened Friday morning, the S&P was down less than 50. In fact, the level of the S&P on Friday morning was where it stood…..a week and a half ago. The media made it sound as if the world was coming to an end. Not quite.

But what also happened in the post Brexit environment was that the Euro and the Pound as currencies sold off noticeably. You may remember we have been highlighting the importance and impact of currencies in investment outcomes for quite some time now. In light of Britain leaving the Union and the news that other major countries are thinking along the same lines, just what do holders of the Euro itself do? Most likely they act to protect themselves and that involves moving their Euro assets to a stronger global currency for protection. The most logical choice is the US Dollar, as it has been for some time now. So although Britain leaving the Union is not good for the broad European economy, it will spark a movement of global capital from the Euro most likely to the US Dollar. We need to remember that when global capital moves, it will influence asset prices. When global money moves to the US Dollar it has a series of choices. It can buy bonds, real estate and usually blue chip stocks. So as convoluted as this may sound, does the Brexit vote mean more global capital, especially Euro currency centric capital, is coming to the US Dollar and US Dollar assets? Most likely, yes. This will actually act to support the Dollar and US asset prices to some extent.

So before hitting the panic button as per the US media, which we will never do, it makes sense to think through all of the ramifications of the British vote. And one of those impacts is now very positive for the US Dollar. We live in a world of global capital movement, not a US centric world in isolation.

We encourage you to contact us with any questions or comments you may have.

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