L. Roy Papp & Associates, LLP
Investment Counsel

2201 East Camelback Road
Suite 227B
Phoenix, Arizona 85016
(602) 956-0980
FAX: (602) 956-7053

VIEWS FROM CAMELBACK MOUNTAIN

The Impact of Brexit on Our Clients

Last night the world learned that British voters decided to leave the European Union (EU) by a clear majority. While this will take two years or more to fully implement, markets reacted immediately. Almost all financial markets are trading sharply lower based on greater uncertainty and the potential of repercussions of this decision. One reason markets are down is that almost all markets moved up sharply over the last ten days as investors incorrectly concluded that Brexit would fail. The US Market has now given back its gains over the last few weeks.

Here is a list of things that will or may happen as a result of this vote:

<u>Currencies:</u> The pound is down sharply to a thirty year low against the US dollar. The euro is down sharply; the Japanese yen and the US dollar are up sharply. Gold is up moderately. These trends are likely to continue.

<u>Global Economic Growth:</u> Forecasts are coming down across the board based on uncertainty and possible trade disruptions as the UK will have to negotiate new trade agreements with many of their trading partners. This is clearly not a plus for global and economic growth in Europe. The impact may not be significant throughout the rest of the world, particularly here in the United States.

<u>Oil and Commodities</u>: Except for precious metals, oil and commodities are down based on the stronger US dollar and the potential for slower economic growth.

<u>Interest Rates</u>: Interest rates are down sharply based on a panicked flight to quality. During difficult times funds move to the safest location and that would be the US dollar and US treasuries. As money flows into dollars and treasuries, the value of treasuries go up which pushes down interest rates. Our Federal Reserve has not wanted to raise US rates and this gives our "do nothing/zero percent forever" Fed an excuse to keep rates lower for longer.

<u>European Banks:</u> Many banks in France, Italy and elsewhere in the EU were already in serious trouble and these new developments will cause further damage. The mere hint that some other countries might discuss the possibility of joining the "*leave the EU*" movement may cause more stress on their core business. Some European banks could be forced to merge or seek government bail outs. Our US banks are slightly weakened, but remain financially secure.

<u>US Companies with Large UK Exposure:</u> Companies with large, direct exposure to the UK will be impacted. For example, Ford generates significant sales in the UK. The weak pound and uncertainty about the economy will be a challenge for them. Most US companies have much less exposure.

Volatility: Volatility has increased and higher volatility will be with us for many months as the repercussions from Brexit become more apparent. Volatility has also increased due to the fact that the markets were dead wrong in their judgement that Brexit would fail.

London - Leading Global Financial Market Center: The exit from the EU will drive financial service jobs out of London and make business more difficult for these firms. This will be a drag on the UK economy and it cannot be a help for real estate values in London.

Southern Europe: Greece, Italy, Spain and other weak EU countries have been enjoying support from stronger EU countries. The future of financial gifts from the strong countries to the troubled economies is clearly in question. We think investors should avoid exposure to Greece, Italy, Spain and Portugal, particularly banks and poor quality bonds.

Impact on US stocks

- Companies with large direct exposure to UK/EU will see weakness.
- Banks – lower rates for longer plus uncertainty and disruption of UK/European business will cause weakness. Larger banks with more UK/EU exposure will be hurt the most.
- Oil/commodities – slower growth and the stronger US dollar will cause weakness, but there are many other factors that are likely to impact oil and commodity prices over the next few years.
- US multinational companies – The strong dollar is likely to get even stronger, which will cause a drag on reported revenues and earnings at many US multinational companies. This will be a moderate detractor to corporate earnings growth.
- For the most part, we do not own many UK/EU companies or banks and this should limit exposure for our investors. However, we do own several pure US companies or largely domestic US companies and these should enjoy safe haven status.
- Overall, we should be well insulated from these disruptions.

Political Impact: Yesterday, our President stated in a news conference that "Americans are not afraid of immigration". Perhaps he is right, but the British voters **are** concerned about immigration and their actions may become a factor in the upcoming US presidential election. US immigration issues are very different than European immigration issues so it is difficult to tell how this will impact Hillary Clinton and Donald Trump.

What should we do now? We are busy looking for securities that have been put on sale due to this disruption. We are continuing to monitor our existing holdings for any unanticipated exposure that may develop. If we detect anything problematic, we will contact you shortly.

In summary, the markets were expecting Brexit to fail and they moved up sharply in the last ten days. Now that these predictions turned out to be so wrong, these gains have been given up. We do expect increased volatility and some lingering weakness. Overall, our investors' exposure should be fairly limited to what we believe is a short-term phenomenon.

Best regards,

Harry Papp

Harry Papp
Managing Partner
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