WEST BRANCH CAPITAL REPORT

West Branch Capital LLC and its Divisions Singer Potito Associates & Davis Financial Services

Brexit: An Investment Perspective
White Paper

On June 23, 2016, Britain held a special referendum vote to decide whether or not to remain in the European Union. To the surprise of many, Britons voted to leave. “Brexit,” as it had come to be called, was a reality.

The initial market reaction was decisively negative: global equity markets lost over $3 trillion in the ensuing two days, constituting the largest ever two-day loss of global wealth, according to S&P Dow Jones Indices. Yet, many of these equity markets rebounded dramatically over the following two weeks, in some cases actually gaining ground over the period. As investors, how are we to interpret such a market reaction?

To us, this situation highlights one of the main challenges of the current investment paradigm: anticipating monetary policy responses to potential (and actual) economic shocks. In the depths of the global financial crisis of 2008-2009, central banks around the world undertook aggressive measures to improve liquidity and stimulate growth. This included, most notably, lowering interest rates and purchasing massive quantities of government and private-sector securities. The results so far have been relatively positive: most markets have gone up. Whatever opinions one may hold about the longer term effectiveness of monetary policy, it is hard to deny that a new ethos has emerged in the investing world: potential economic adversity begets policy response; policy response supports (or increases) asset prices. In short: bad news is good news.

If we look at the market reactions to Brexit, we see this pattern play out, particularly in the U.K.

Index	% Change: 6/23/16-6/27/16	% Change: 6/23/16-7/11/16
S&P 500	-5.3%	1.9%
FTSE 100 (UK)	-2.6%	5.4%
10-Year U.S. Treasury	1.3%	1.8%
10-Year U.K. Bond	4.1%	6.1%

While it is extremely difficult to anticipate the full economic impact of this historic event for Britain, over the medium term – the horizon for most investors – it is likely to be neutral or negative on balance: trade may suffer and certainly shouldn’t increase while Britain extricates itself from the E.U. The initial market reaction to the news of the vote reflects this asymmetry. That afternoon, the Bank of England announced its response: “As a backstop, and to support

the functioning of markets, the Bank of England stands ready to provide more than £250 billion [$460 billion] of additional funds through its normal facilities." U.K. equities gained more than 11% over the next two weeks. Brexit itself probably wouldn't help the U.K. economy over the next several years, but the Bank of England's willingness to intercede provides support for asset prices. The U.S. market followed a similar, if less dramatic, pattern.

For us, the foregoing suggests a measure of caution. While it is certainly nice to have the Fed and other central banks on our side, so to speak, we cannot ignore the influence they are exerting on asset prices. As disciplined investors accustomed to evaluating companies on their own merits, we find it extremely difficult to put our faith in central bankers.

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