Friday, July 8, 2016

DODGING A BULLET

- Following the Brexit vote, global financial conditions tightened and signaled immediate danger to the global economy.
- Since the initial post-Brexit global market reaction, financial conditions have loosened and the US equity market rebounded to pre-Brexit levels. This should limit the economic costs for the US.
- We may have temporarily dodged a bullet because damaged financial conditions improved rapidly, but the stock market is still vulnerable.

Following the Brexit vote of June 23, the global equity markets were meaningfully shaken, and global financial conditions tightened (access to cash, credit availability, transaction liquidity, dollar strength, etc.). It looked bad; bad enough where we quickly reacted and positioned client accounts to a more conservative stance. After all, it is our job to be both proactive and reactive to market concerns so as to best protect your portfolio, which is a means to protect your retirement goals. In regard to our proactive measures, as we wrote in our June 24 missive simply titled "Brexit":

> "We really should have been holding a lot more European assets in all of our clients' accounts. After all, the European Union accounts for about seventeen percent of total global Gross Domestic Product. Traditional investing theory argues that, depending upon your particular goals, you really should have had ten or twenty percent of your BMM investment portfolio in European assets. But you didn't. In 2014 we sold out of that exposure. I actually remember the day, sitting in the second row of a conference hall listening to a lecture given by former Federal Reserve governor Ben Bernanke, that we decided we wanted out. Over the long-term, diversification makes portfolios safer, and it's our job to make sure your portfolio is safe. But we felt that this traditional tool to keep your portfolio safe just wasn't for you. Not in the intermediate-term, at least."

So ***the proactive measure was to avoid European exposure in the first place. The reactive measure was to reduce the remaining risk of client accounts*** (by reducing US equity exposure), until the fallout could be better measured. Financial conditions have loosened and the US equity market rebounded to pre-Brexit levels. This should limit the economic costs for the US.

In the short-term, the US stock market has dodged a bullet. It suffered some losses, but it bounced back strongly on good volume (not to be overly technical, but there were "breadth thrusts" that tend to be clues as to good support of the market as indicated by demand entering back into the market after a sell-off). However, conditions can change quickly. ***We may have temporarily dodged a bullet because damaged financial conditions improved rapidly, but the stock market is still vulnerable*** in the just-a-bit-longer-than-short-term due to increased post-Brexit uncertainty. ***This type of unprecedented uncertainty can cause businesses to reduce hiring and investment, grinding growth and dampening corporate earnings.***

It will take some time to accurately assess how international developments will affect the behavior of US businesses, but it is prudent to expect that it will be a net negative. Combining that net negative with already full equity valuations along with a coming US Presidential election, a modest decrease in risk is appropriate. ***The stock market may continue to go up from here, but our job isn't to capture every percentage point of return of the flavor-of-the-day investment; our job is to make sure you can accomplish all of your goals. And sometimes (most of the times), that involves protecting you, even if it's "just in case". Consider us your retirement insurance.***

All that being said, again***, things have improved dramatically and quickly, post-Brexit***. One of the biggest issues was the immediate possibility of an excessively strong dollar which would be a global monetary shock. The US dollar has a dominant role as a global funding currency as well as invoicing currency in international trade. ***The shock to the US dollar has somewhat reverted and somewhat stabilized. This has taken some of the risk out of the global equity market, and allows us to consider new investments for available cash (even if those investments are more conservative for clients' portfolios than they might normally be).***

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BERKSHIRE MONEY MANAGEMENT

The Knowledge and Experience to Build Your Wealth

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For our affiliates' everyday business purposes— information about your transactions and experiences	NO	WE DO NOT SHARE
For our affiliates' everyday business purposes— information about your creditworthiness	NO	WE DO NOT SHARE
For nonaffiliates to market to you	NO	WE DO NOT SHARE

Questions?	Call 888-232-6072 or go to www.berkshiremm.com

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