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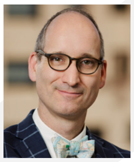


No One Knows What Will Happen with Brexit…But Long-Term Investors Probably Shouldn't Worry Too Much

by J. **William G. Chettle,** Vice President, Loring Ward

Unlike fans of horror movies, markets hate scary surprises.

On June 22, many markets, even betting parlors, were all predicting that British voters would opt to stay in the European Union (the odds went as high as 80% for staying). On June 23, gamblers and markets were proven wrong and stocks fell precipitously around the world, plunging more than 5% in the U.S. in just two days.

Some of the doomsayers from January, when the S&P 500 Index sank more than 10% and then rebounded to positive territory again by the end of the first quarter, came out of the woodwork to predict new Brexit-related disasters. Even European Council President Donald Tusk said, "I fear that Brexit could be the beginning of the destruction of not only the EU but also of western political civilization in its entirety."

But for the most part, after shaking off the initial surprise and processing what Brexit may or may not mean for the global economy, the U.S. markets generally recovered from their losses. By the end of the second quarter, the S&P 500 Index was up 2.5%.

This is not at all unusual. According to Schaeffer's Investment Research, the S&P 500 has fallen more than 5% in consecutive sessions 17 times since 1990. On average, within a week of each of these declines, stocks were up 3%; three months later, they were up 7.1%; and six months later, up a whopping 12%.

This kind of market recovery has been typical with crises around the world. Charles Schwab's chief global investment strategist, Jeffrey Kleintop, looked at how quickly markets came back from three recent, unexpected events:

- Following the earthquake and related nuclear accident in Japan on March 11, 2011, the Nikkei Index fell 16%, but fully recovered those losses by July 8, 2011
- After the U.S. debt ceiling crisis in August 2011, the S&P 500 Index plunged 15% over the next several months on worries about potential economic consequences, hitting a bottom on October 3. The market then soared through the rest of the month, erasing all losses by the end of October
- In March 2012, the European debt crisis worsened as Spain implemented fiscal austerity and the eurozone was hit by a recession. Through the beginning of June, the STOXX Europe 600 Index sank 11%. Two months later, by the end of July, the index had fully recovered[1]

It would be wonderful if we could predict the best and worst days in markets, and invest (or sit on the sidelines) accordingly.

But whenever you try to time the market, you need to be right twice: when you get out and when you get in. This is something almost all professional money managers struggle with (and usually unsuccessfully), in large part because the best and worst days are often right next to each other. For example, following significant losses on the Friday and Monday after the Brexit vote, the Dow then rallied 554 points over the next two days, its strongest performance in nearly a year.

The chart below shows the 30-day moving standard deviation (the ups and downs) of the S&P 500 Index from 1970 to 2015. The 25 best days of the S&P 500 Index are indicated by green dots and the 25 worst days by red dots. Notice how closely clustered the red and green dots are. You can also see that the best and worst days tended to occur when volatility was above average (the black line).

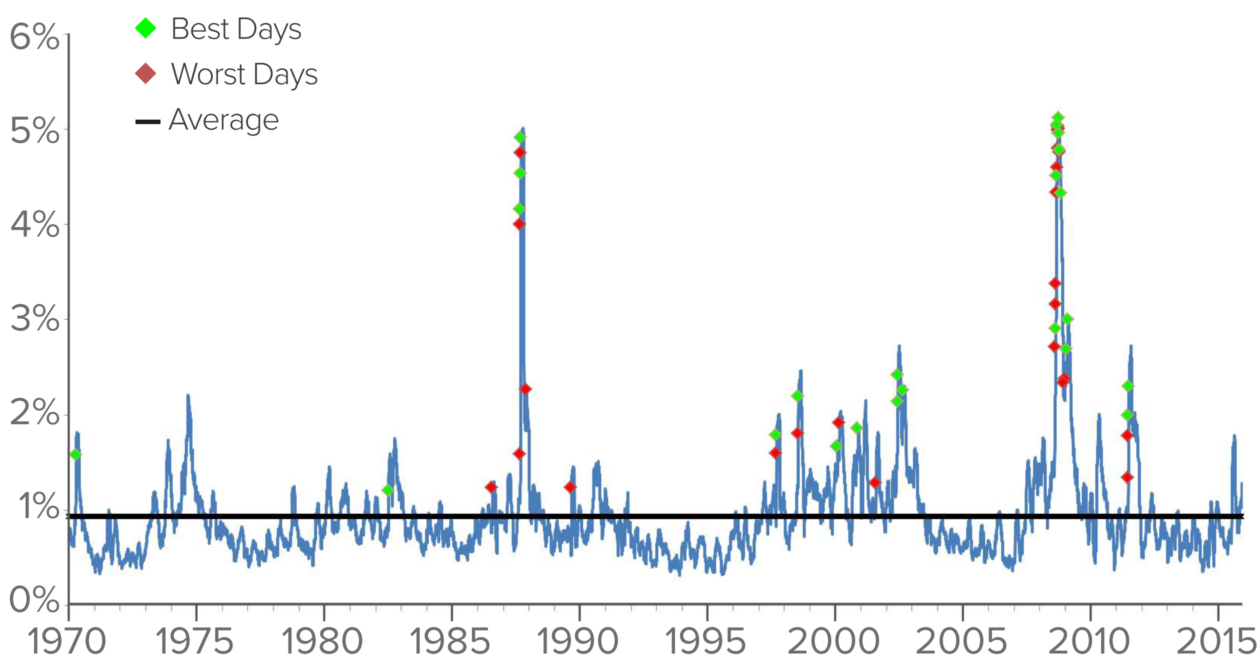
We expect our portfolios to decline during market downturns, crises and panics, but as the chart indicates, it is precisely during these uncertain times that patient investors are often rewarded for staying in the market.

Over the next months, you will hear and read endless speculation in the financial media about what is going to happen with Brexit, what it all means for investors.

Brexit will have numerous, very real consequences for Britain and Europe and possibly other global markets and economies as well. These consequences may be severe, they might even be positive. But anyone who says he or she KNOWS what will happen is being intellectually dishonest. There is just too much uncertainty. And even if you knew with absolute confidence the major policy and political decisions that will occur, their

30-Day Standard Deviation

The Ups and Downs of the S&P 500 from 1970 – 2015



Source: "How missing out on 25 days in the stock market over 45 years costs you dearly" by Michael Batnick, marketwatch.com, Feb. 17, 2016. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. All investments involve risk, including loss of principal.

impact on markets would still be unknowable.

Right now, the recovery of a number of markets, especially in the U.S., suggests that investors believe that the initial Brexit worries were overblown. They may be correct. They could also be wrong.

What we do know with a high degree of confidence is that whatever the impact of Brexit, it probably won't matter much over the long term for globally-diversified investors. It is easy to fixate on headlines and forget the powerful potential of markets to reward patient investors for being and staying invested.

Brexit does not repeal the laws of capitalism, does not stop people from buying and consuming, does not stop companies from innovating. No one likes bad news, especially markets. But over time, Brexit will probably become just a blip, and the news for patient, long-term investors who stick to their plans should be very positive.

Diversification neither assures a profit nor guarantees a loss in a declining market.

[1]"After the Brexit Vote: What Lies Ahead for Markets?" by Jeffrey Kleintop, Charles Schwab, June 27, 2016