Polaris Greystone FINANCIAL GROUP, LLC

Polaris Greystone Educational Series

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What is Brexit? (and why should I care)

On June 23rd the United Kingdom will vote on a referendum to decide whether Britain will leave the European Union (EU). Brexit is simply an abbreviation of "British exit." A new poll conducted by the research firm ORB, who began polling the issue last year, reported that 55% of British citizens believed that Britain should leave the EU.

European Union History

The European Union was established after World War II in the hope that countries that had strong economic ties would not fight wars against each other. There were six founding countries: Belgium, France, Germany, Italy, Luxembourg, and the Netherlands. Today, most of Europe is part of the union, totaling 28 countries in all. The EU has created a single currency, the euro (which the UK never adopted), and has removed trade barriers and border controls so that people and goods can freely move between member countries. According to the International Monetary Fund (IMF), the EU's economy, measured by gross domestic product (GDP), is now the second largest in the world, about ten percent smaller than the United States' economy.

Why is Britain Considering Leaving the EU?

A lot of it comes down to nationalism. The UK pays approximately 8.5 billion pounds each year in membership fees. Many British people don't think that remaining in the EU is worth the cost. The EU controls regulations on European business, immigration laws, trade regulations, and border policies, among many other areas. Many UK citizens feel like their country is being regulated and held back by the rest of Europe.

Immigration is also a key factor in the vote. Since the UK is a wealthy country, many immigrants from poorer EU countries have flocked to Britain in search of work. Since the EU has an open border policy for member countries, no visas are required of these people to live or work in the UK. Some British people are upset that these immigrants are taking jobs from British citizens and drawing from the UK's version of welfare. Others are concerned that criminals and terrorists can more easily enter their country due to the lack of a screening system at their border.

UK Prime Minister David Cameron was elected on a platform that promised to gain more control from the EU. While his negotiations last year provided some compromise, many British people don't think that enough was done.

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What are the Impacts of a British Exit and Which Countries Will be Most Affected?

According to the IMF, Britain's economy is the second biggest economy of EU countries. Only Germany's economy is bigger. The UK's economy represents approximately 17.5% of the EU's GDP. A British departure from the EU would create a lot of "unknowns." No one really knows what the financial impact will be to the British or EU economies. How will it impact employment, trade agreements, cost of goods sold or purchased? There are some that argue that it will be positive. There are others that argue that it will have negative repercussions. The truth is that no one really knows the true impact because a lot will come down to the terms Britain negotiates to leave. What is known is it will take years for Britain to officially leave the EU due to the agreements, regulations, and laws that would have to be detangled and renegotiated.

Besides Britain, Ireland is most at risk economically if Britain leaves the EU. The uncertainty regarding new trade and migratory agreements with Europe could impact the trade of merchandise, services, and human capital between these two neighboring countries.

Malta, Luxembourg, Spain, and Cyprus all follow closely behind Ireland in terms of the potential impact to their economies should Brexit occur. Spain, Malta and Cyprus also benefit from high tourism and large expat populations from the UK to their countries.

How Does a British Exit from the EU Impact Me?

As we've discussed on many occasions, the markets don't like uncertainty. The markets will most certainly become more volatile until the true impact of this change is understood and absorbed by investors.

As we've often discussed, Polaris Greystone is a tactical investment manager. One of our jobs is to assess the risks found in the markets. As risk goes up, we lower the exposure you have to the markets. Our goal is to lower (or remove) exposure to sectors and stocks that we feel are at most risk of decline, while leaving defensive sectors and stocks in the portfolio.

If we see the Brexit vote materially impacting our domestic markets, we will pare our most vulnerable positions. If the risk remains, we will remove more positions. If the risk subsides, we will add back in strong stock positions in an attempt to capture the upside the markets may provide.

As always, I welcome your questions or comments.

Sincerely,

Jeffrey J. Powell
Managing Partner