We think the recent stock tumble is a buying opportunity. Certain areas will be hurt and others helped by the outcome of the referendum. This study will try to explain our thinking and where we see the best prospects.

On Thursday, June 23rd, the United Kingdom voted to leave the European Union causing global market turmoil. On Friday, stock markets declined sharply in countries like Italy (-12.5%), France (-8.0%), Japan (-7.9%), Germany (-6.8%) and the United Kingdom (-3.2%). As a general rule, a crisis often leads to opportunities and this may be occurring for U.S. investors now.

Why the yes vote for “Brexit”? Voters had grown weary of the European Union imposing its will on issues such as immigration, sovereignty, taxes, and regulations. Obviously, these folks thought they would be better off going it alone, as they had for many years prior to the European Union.

The vote to leave does create challenges. The United Kingdom greatly relies on trade. In 2015, it was the 9th largest exporter in the world and had exports to the European Union totaling $196 Billion. Should the European Union decide to take a punitive course as the result of Brexit, the United Kingdom and Europe would both suffer. However, in the short run, very little should change as European Union rules dictate a two-year transition period. Stability, not apocalypse, will likely be the course in the coming months and panic is unwarranted.

Looking at the U.S., we do not expect to see much change in trade. We will continue to do business with both the United Kingdom and the European Union.

While U.S. trade should be unaffected, the investing story may prove different. Investors have been on the sideline. Bank of America Merrill Lynch has noted, “[G]lobal fund managers’ cash levels are at their highest in nearly 15 years…” Given the uncertainty in Europe, this money may move to the relative safety of U.S. markets. This could be especially true given the negative interest rate scenario in much of Europe.

What could benefit? Initially, companies with lower exposure to Europe might make sense. This may be just the trigger smaller cap stocks needed to recover. In addition, stocks that moved excessively lower may make good targets. Those could be stocks that are guilty by association including British or Irish names. We had previously liked gold and it has proven its worth shortly after the vote was tallied. Defensive issues like Utilities also offer some advantages.

Our concerns about valuations and earnings do suggest a cautious approach over the long term. However, our leading intermediate risk indicators have shifted to a more favorable configuration. The volatility created by the Brexit outcome should be considered a buying opportunity for U.S. investors.

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