ROCHESTER BUSINESS JOURNAL
RBJ
VOLUME 32, NUMBER 16 WWW.RBJDAILY.COM JULY 22, 2016

Potential Brexit impact at least two years away

ON INVESTING
Mark Armbruster

The year 1993 was a pivotal one in the entertainment world. The TV show "Friends" began filming that year and soon became a runaway success. The show launched Jennifer Aniston into mega-celebrity status. Because of her newfound fame, she came into contact with other A-list celebrities, and ultimately she married Brad Pitt.

Their wedding was a pop culture phenomenon: Brad and Jen became known in the media as "Brennifer." Even though their marriage didn't survive, the public's obsession with them continued. Brad continued to hold the spotlight when he found a new romantic life as "Brangelina." While it took Jen longer to find her next spouse, a recent trip through the checkout aisle at the grocery store assured me that she is happily married today.

Just as the filming of "Friends" was the catalyst for numerous subsequent events that would alter the course of peoples' lives, 1993 was also notable for the signing of the Maastricht Treaty, which formed the European Union. This too would set into motion a number of events that many consider important.

The formation of the EU was a polygamous marriage among six original member states that included a common currency, limitations on allowable government debt, inflation targets and free movement across borders. This was a landmark agreement that many hailed as an important step toward globalization and its associated economic benefits. The EU has since grown to include 28 member states.

However, with a recent referendum, the EU is likely to be one member shy in the not-too-distant future. Great Britain's citizenry has decided that any benefits of EU membership are outweighed by a loss of sovereignty and voted to exit the political union, the so-called Brexit.

It may seem a frivolous metaphor to compare Brennifer with the Brexit. After all, a breakup in the EU, we're told, could have calamitous political and economic implications. Indeed, even Alan Greenspan has called the Brexit vote the "worst period I recall since I've been in public service."

However, silly nomenclature aside, I believe Brexit is most similar to Hollywood gossip because the impact is probably inconsequential for the vast majority of us.

British Prime Minister David Cameron has resigned because of the Brexit decision. The actual withdrawal from the EU will be done under the watch of his successor, Theresa May, who will have to decide on when to invoke Article 50 to formally pull out of the EU. Article 50 begins the process of withdrawal, but apparently takes two years to complete. So, even if the new prime minister begins the process immediately upon taking office, an actual British exit from the EU is more than 24 months away.

A lot can happen in a dynamic global economy over the course of 24 months. It may be that Britain goes into a recession for reasons completely unrelated to Brexit. It certainly has plenty of other economic headwinds currently. Conversely, it may be that the recent drop in the British pound that occurred as a result of the Brexit vote makes British exports more competitive, and thus helps boost the economy. Or, it may be that events we can't even begin to imagine will transpire that impact the British economy in unforeseeable ways.

The point is, there is absolutely no way to forecast what will happen, positive or negative; any potential impact will not be felt for over two years. Thus, the impact from the Brexit on my life is quite similar to the impact I felt from Brad and Jen's breakup.

Sure, Brexit did precipitate an unwelcome 900-point drop in the Dow Jones industrial average after the initial announcement, but just four trading days later the market had recouped virtually all of its losses.

In fact, if investors reacted to every supposedly life-changing news story, they would be a lot poorer. Since the end of 1970, the domestic stock market, as measured by the S&P 500 Index, has risen at an annualized rate of 10.4 percent.

Consider that during that period, we've experienced oil price shocks, annual inflation in excess of 13 percent, several wars, a savings and loan crisis, the Asian Contagion, the bursting of the technology bubble, a Y2K scare, terrorist attacks, devastating hurricanes, a huge global recession, and many other negative events.

Each of these has been accompanied by warnings for stock market investors and expert recommendations to sell. However, if you had held onto stocks through that period of great uncertainty and negativity, you would have earned returns that appear quite attractive by historical standards.

Rather than listening to the pundits, a better approach would be to build a long-term, diversified portfolio and ride through the stock market's occasional dips. Indeed, this works even over shorter time periods.

For example, returns from a diversified portfolio (60 percent stocks and 40 percent in bonds) have historically been higher as little as 12 months after significant negative events. This was the case with the stock market crash in 1987, the Asian Contagion of 1998, the Dot Com crash of 2000, and the bankruptcy of Lehman Brothers in 2008. Investment returns were higher three years after the savings and loan crisis of 1989 and the terrorist attacks of 2001.

History has shown that horrific events that have a very large impact on the economy, the capital markets, and even our society at large have not been devastating for long-term investors. It thus seems unlikely that one country leaving a political union, but still desiring to have political and economic ties with the rest of the world, would have a major impact on global affairs.

I might even argue that without a catchy, media-friendly name like Brexit, this whole thing would have passed unnoticed by most of the world.

Mark Armbruster is president of Armbruster Capital Management Inc. He can be reached at (585)381-4180 or marmbruster@armbrustercapital.com.

Reprinted with permission of the Rochester Business Journal.