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Brexit Q&A

Posted by [lplresearch](#)

LPL Research thought it would be helpful to share top questions that our advisors have had today in light of the surprising Brexit vote and significant market reaction. The Brexit vote was a referendum on whether the U.K. would remain part of the EU or leave, and the vote was to leave.

LPL Outlook

To what degree, if any, does this event change LPL's outlook for the remainder of the year? Are you still comfortable with the mid-single-digit total return forecast for the S&P 500 in 2016?

Tighter financial conditions (via a stronger dollar) and increased uncertainty may have a modest impact on the U.S. economy in the second half of 2016. Although the odds of a recession have moved up as a result of the Brexit vote, we don't expect the Brexit to cause a recession in the U.S. this year. Our stock market forecast remains unchanged: We continue to expect mid-single-digit total returns for the S&P 500 in 2016.* Consistent with planned communication in the upcoming *Midyear Outlook* publication and following the Brexit vote, we are raising our 2016 bond market forecast, based on the Barclays Aggregate Bond Index, to a low- to mid-single-digit total return.

Market Response

Some have described this as being like 2008. Will the Brexit spark a full-blown financial crisis?

While the Brexit was unexpected and is likely to cause some near-term and perhaps even some longer-lasting financial market volatility, we do

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not believe the Brexit will turn into another Lehman Brothers-type event. The U.S. economy, banking system, and consumers are in far better shape today than in 2008, and policymakers (fiscal and monetary) are much more adept at dealing with these events today than they were in 2008 and 2009. Furthermore, bank liquidity backstops and lending facilities remain in place to provide emergency funding if needed.

Does economic uncertainty in the U.K. and EU make the stability of U.S. markets even more attractive?

Perhaps the better way to describe it is that the U.K. and EU have become somewhat less attractive, making the U.S. more attractive by comparison. But there may be some negative impacts for the U.S. as well, from a stronger dollar and tighter global financial conditions, for example.

How impactful might the appreciation of the dollar be on corporate profits due to this event?

We are still looking for earnings to potentially ramp up in the second half of the year. Right now the dollar is a tailwind for earnings in the second quarter of 2016. But a stronger dollar could be one way in which the Brexit negatively impacts the U.S. Nevertheless, we believe this negative impact may be manageable. We will begin to get second quarter 2016 results and guidance from corporate America in the second week of July.

From a market reaction standpoint, would this be comparable to the U.S. debt downgrade in 2011?

The U.K. leaving the EU, like the debt downgrade, is a powerful symbol and increases the sense of uncertainty. Without minimizing the Brexit impact, the debt downgrade was a more powerful shock to the financial system and also took place at a more fragile stage of the recovery.

What are the new/additional “uncertainties” facing corporate America resulting from this vote?

In the short term, there are few direct uncertainties. The immediate concern is the indirect impact on financial conditions and uncertainty around currencies and commodities that make business planning difficult. There are long-term uncertainties about potential changes in

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doing business with the U.K. and EU. These issues may be most important for financial firms doing business across Europe; they may no longer be able to use London as their European headquarters. Given the relatively small contribution of the U.K. to global economic growth (approximately 4%), the impact is likely to be concentrated on the U.K. and Europe, with the U.S. and emerging market countries less impacted from a trade perspective.

Trading/Transition Impact

Might global markets be volatile for two years as the U.K. and the EU sort through the terms of separation and trade agreements?

The two-year limit is somewhat of a soft deadline. We envision that all parties will be eager to make this process as swift as possible, although the road map to complete the exit is far from clear. Before these negotiations begin, the leadership within the U.K. needs to be determined in the wake of the resignation of Prime Minister David Cameron. It will be several weeks or likely months before negotiations can begin in earnest. Since markets are forward looking, participants will be watching closely how these agreements progress and will likely be pricing in the cost of the transition well before it reaches its actual conclusion.

What do we think about airlines and other global trade-oriented areas?

Most U.S. airlines have little direct exposure to the U.K. and may benefit from lower oil prices as a result of the Brexit decision. We expect minimal potential impact on global trade or travel, although U.K.-focused airlines may experience some resulting weakness. More broadly, U.S. exporters, concentrated in the industrials sector, may offer an attractive opportunity should the sell-off become more pronounced, as that sector's direct exposure to the U.K. is relatively limited.

Voting Concerns

Does the vote raise concern about anti-EU sentiment growing in other countries, not to mention nationalist and separatist movements?

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Yes, there are movements in many EU countries to foster a more insular stance amid budding nationalism. Some of these nationalist parties are fringe elements, while others have become more mainstream. The British vote to leave the EU will likely embolden some of these movements, including a revitalization of the Scottish and Catalan independence movements. But the U.K. has always had a particularly complicated relationship with continental Europe that won't be directly replicated elsewhere. In general, financial markets would prefer that centrist parties continue to win elections and govern in other EU nations and beyond.

Sectors/S&P

How might Brexit impact opportunities in the energy sector?

We expect only a minimal possible drag on global oil demand from Brexit, suggesting a potential opportunity in energy on a dip. The oil market has moved closer to equilibrium supply and demand following U.S. production cuts of roughly 1 million barrels/day from the peak. Still, U.S. dollar strength may weigh on oil prices in the short term and economic weakness in the U.K. and Europe will have some impact on oil demand, suggesting some patience is warranted.

Does the Brexit vote mean stock performance is likely to be sluggish in the next few months?

It is difficult to develop a view for such a short time period, but given our year-end outlook, the slow seasonal period, and potential continued uncertainty around U.S. elections, stocks may continue the pattern of the last year or more and remain relatively sluggish with continued periods of volatility. A potentially strong earnings season—set to begin in mid-July—positive surprises from economic data, and a controlled inflation backdrop that helps keep the Federal Reserve on the sidelines are some factors that could be supportive of stocks.

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*Historically since WWII, the average annual gain on stocks has been 7-9%. Thus, our forecast is in-line with average stock market growth. We forecast a mid-single digit gain, including dividends, for U.S. stocks in 2016 as measured by the S&P 500. This gain is derived from earnings per share (EPS) for S&P 500 companies assuming mid-to-high-single-digit earnings gains, and a largely stable price-to-earnings ratio. Earnings gains are supported by our expectation of improved global economic growth and stable profit margins in 2016.

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Tomorrow is the last day of the month. Be aware, this day has been historically weak the past few years. Up 3 times the past 19 months.

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The S&P 500 was down 1.63% last week. It is up 1.63% this week. [#Brexit](#)

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