Brief Market Commentary
June 22, 2016

After a dismal start to the year, risk asset classes rebounded sharply from February's lows with solid gains from U.S. and emerging markets stocks, in addition to credit and energy-related investments. Yet, volatility has picked up again over the last couple of weeks amidst political uncertainty. Markets have moved in tandem with recent polls around the United Kingdom's upcoming referendum as investors weigh the probability of the country voting to leave the European Union (EU). Nervousness about the so-called "Brexit" risk has weighed on sentiment. This is perhaps seen most clearly in the recent strong performance of perceived safe havens such as the Japanese yen and the price of gold.[1] In addition, bond yields in many developed markets have declined to historic lows.

Given the potential for increased headline risk and uncertainty around the referendum, we provide below additional information and share our perspective. We also include a summary of current portfolio strategy.

Brexit or Bremain?
The United Kingdom (UK) government will hold a referendum on Thursday, June 23, 2016 to determine whether or not the country will leave (Brexit) or stay (Bremain) part of the EU. Proponents of leaving claim that the UK would be better off by regaining control of policy around immigration and trade, rather than being bound by the EU regulations. They also complain that the UK pays far more into the EU budget than it receives from the EU in terms of benefits. Supporters of continued EU membership argue that being part of the world's largest single market generates valuable economic gains to Britain, including the free movement of goods, services, and people.

Recent polls suggest that public opinion is divided and the vote will be close, with some giving the edge to leavers. Yet, betting markets indicate greater than 60% odds of staying. Conventional wisdom among financial professionals seems to be that the UK will ultimately remain part of the union. As Guggenheim Investments points out, similar citizen polls over the past couple years (e.g. Scottish referendum) have been well off base, and the thinking goes that when push comes to shove, people tend to speak from their heart but vote with their head.[2]

A few points to highlight in terms of the potential implications:

- Both the long-term costs and the potential benefits of Brexit to the UK economy are probably exaggerated by commentators and campaigners on either side of the argument.
- While the referendum on Brexit is a binary question, the outcome is not. A vote to leave would open up a wide range of possibilities, with varying degrees of impact on the economy and financial markets. Though the potential longer-term consequences are less clear, it seems likely that there would be some near-term negative economic effects due to the impact of uncertainty on sentiment and investment.
- Even if the vote is for Brexit, the UK would probably remain a member of the EU for several years. The nature of the new relationship between the UK and EU would only be decided after a two-year period of negotiations, following a process laid out in the Treaty of Lisbon (2007).[3]
- From an economic standpoint, the most important question is likely whether the UK can retain access to the European Single Market as the EU absorbs over 40% of UK exports.[4] However, if the UK votes to leave, there seems to be little incentive for the EU to act generously in the negotiation period.
- A UK vote for Brexit (or even a narrow majority for Bremain) would likely extend political uncertainty throughout the region with the risk of encouraging EU-sceptics elsewhere in Europe. Other

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governments may not be able to resist pressure for their own referendums, which could be destabilizing for the whole union.[5]

For investors, the possibility of Brexit creates uncertainty—and uncertainty is generally not enjoyed by financial markets. The potential exists for volatility to remain elevated at least until the referendum and possibly afterwards, particularly as the US election looms. Yet, volatility often creates opportunities and, in the long run, politics often has far less influence than short-term market response might suggest.[6]

Broader Portfolio Strategy

In our view, the macro backdrop of continued slow economic growth, low inflation, and ongoing monetary policy accommodation is likely to remain supportive of financial markets and risk assets over the intermediate term. Yet, forward-looking returns are likely constrained by current valuations.

Our portfolio positioning themes include the following:

- *Don't tilt too far away from a thoughtfully-constructed, long-term strategic asset mix as we view most asset classes as being close to fairly valued or slightly overvalued.*
- *Maintain a slight underweight position in fixed income as bond yields are likely to rise longer-term, but remain low by historical standards.*
- *Target a slight underweight positon in equities, while emphasizing large cap/high quality stocks.*
- *Within the real assets space, maintain exposure to energy master limited partnerships. In our view, last year's sell-off far exceeded the change in fundamentals, therefore current valuations reflect an attractive long-term opportunity.*
- *Target an overweight position to certain flexible/alternative (hedge fund) strategies as the opportunity set should continue to improve given global economic/policy divergence and increased market volatility.*

Asset Category Tactical Views	Strong Underweight	Underweight	Neutral	Overweight	Strong Overweight
Fixed Income					
US Government Bonds	■				
Corporate Bonds		■			
Tax-Free Municipal Bonds			■		
High Yield Corporate Bonds		■			
Equities (Public & Private)					
US Large Cap Stocks			■		
US Small Cap Stocks		■			
Non-US Developed Markets Stocks			■		
Emerging Markets Stocks			■		
Private Equity					
US Large Buyout	■				
US Mid-Market Buyout		■			
Real Assets (Public & Private)					
Commodities			■		
Public Real Estate (Core)	■				
Private Real Estate (Opportunistic)		■			
Diversifying Alternatives					
Less-Directional Hedge				■	
Directional Hedge			■		

Note: Based on research and opinion provided by Greycourt & Co. as of March 31, 2016. Tactical views reflect a three-year investment horizon. Suggested asset class weights are influenced by Greycourt's detailed quarterly tactical analysis and are used as a starting point in assessing client portfolio weights against strategic targets which typically reflect a ten-year investing horizon.

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As always, past performance is not necessarily indicative of future results, and the value of investments and the income they might generate can fluctuate. CFO-16-103

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[1] *Julian Jessop, Capital Economics, Global Markets Update: Vote for Brexit May Prove to be a Damp Squib, June 16, 2016.*
[2] *Guggenheim Investments, Weekly Viewpoint: Brexit or Bremain?, June 20, 2016.*
[3] *Laura Somers-Edgar, CFA, Lazard Asset Management, Brexit Basics for Investors, May 26, 2016.*
[4] *Ibid.*
[5] *Julian Jessop, Capital Economics, Global Markets Update: Vote for Brexit May Prove to be a Damp Squib, June 16, 2016.*
[6] *Laura Somers-Edgar, CFA, Lazard Asset Management, Brexit Basics for Investors, May 26, 2016.*

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