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FOCUSED ON WHAT MATTERS MOST.

How Has Brexit Impacted Your Portfolio?

Our apologies up front for using the "B" word in the title of this piece – if you're feeling like we are, you're probably approaching your annoyance threshold with the term that sums up the United Kingdom's decision to leave the European Union (EU). This was a big event. We'll avoid weighing in on how we feel about it, but there's no question that there will be consequences to markets over time as a result - both positive and negative. Some of these consequences can be foreseen, but most probably not. And finally, some of them will play out over the longer term while others will manifest right away as a result of Britain's decision to "leave" the EU. How you were positioned coming into Friday morning on the 24th of June dictated the level of anxiety you felt with respect to your investments and financial future.

Stock markets around the globe were dramatically lower on Friday morning. Some European markets were down as much as 12%, while here in the States, stocks were down roughly 3.5%. If you were invested aggressively, you felt the brunt of this hit. Even a standard 50/50 stock to bond portfolio was down over 2% on Friday alone – a reminder that even broadly diversified portfolios can take good sized hits from time to time.

The U.K.'s exit from the EU is the perfect example of how events can turn markets sour very quickly when they're priced to perfection. If it wasn't this event, it could have been something out of China, a market/technology glitch, or really anything else that investors weren't expecting or that shakes confidence. What investors should take away from the market's reaction to this event is that portfolio risk should be managed based on asset valuations and the overall potential for steep market losses, not individual market events. In other words, moving from an all stock portfolio to an all bond or cash portfolio the day before Britain's vote would have been the equivalent of a coin-toss. Markets could just have easily moved higher had the vote turned out differently. Guessing is not an effective way to manage money over the long term.

As our clients know very well, we've taken on a more conservative approach than usual for quite some time given the markets higher than normal potential for large negative returns. Our diversified portfolios are more conservative than they ordinarily would be while our actively managed strategies (Market Trend and Contrarian) have been very defensively positioned more often than not in recent months. This positioning allowed us to enter the "Brexit" situation with a longer term focus in mind. Regardless of how things turned out, our strategy was focused on minimizing risk and preparing for the likelihood of weak stock market returns over weeks and months, not days. **As a result, Friday was a non-event for our clients.** While some were left contemplating whether to cut their losses or invest more in stocks, our average client likely felt pretty content with her approach. The decision to trim risk or increase stock exposure could be made independently of the stock market route on Friday - emotion being much less of a factor.

As of the time we write this, our actively managed strategies have performed their roles respectably in stabilizing an overall portfolio. Market Trend has experienced somewhere in the neighborhood of a 13% gain this year with roughly 2% of that coming on Friday while Contrarian has returned approximately 4.5% this year with over 2.5% coming on Friday alone. This compares to an S&P 500 return so far this year of less than 1%.

When looked at in combination with a diversified portfolio, most clients actually experienced a **positive** return on Friday, rather than the deeply negative returns that the broad stock indexes did. This highlights the importance of not only being diversified, but of taking a more active approach to portfolio diversification. If the likelihood of large losses is higher than normal based on a host of measures ranging from valuations to the length of the current market cycle, basic diversification may not be enough. In addition, building an investment allocation based on the probable outcome of a particular event is very dangerous. Friday was an important reminder of this.

The recent market turmoil isn't about "Brexit". It's about investment assets being at historically elevated levels and due for a downturn. Whether that downturn continues from here or takes place a bit further down the road isn't important. The point is that it will happen. Events like Britain leaving the EU may just provide the nudge.

The DJIA – The Only Certainty Is Change

The Dow Jones Industrial Average has seen many changes since it first began back in May of 1896 with 12 companies, hitting its all-time low of 28.48 later that summer. As of the writing of this piece, the Dow is currently trading above 17,200. So if we invested in these 12 companies in 1896 and held onto them, what would we own today? Let's take a look.

Of the original 12 companies, only General Electric remains a part of the current index. So who were the 11 other companies and what became of them?

American Cotton Oil Company – formed in 1889 and its DJIA history is a short one. It was dropped from the Dow on April 1, 1901. In 1924 assets were distributed among several subsidiaries making Gold Dust the parent company. In 1931 the company changed its name to Best Foods, Inc. (you may know them as the makers of Hellman's mayonnaise), which was acquired by Unilever in 2000.

American Sugar Company – was dropped from the Dow on July 18, 1930. American Sugar Company was the largest American business unit in the sugar refining industry in the early 1900's with interests in Puerto Rico and other Caribbean locations. One of the best known brands is Domino Sugar and the company is now known as Domino Foods, Inc.

American Tobacco Company – was dropped from the Dow on April 21, 1899. The company was deemed in violation of the Sherman Antitrust Act and ordered to dissolve in 1911 into four companies: American Tobacco Company, R. J. Reynolds, Liggett & Myers, and Lorillard. Through many other buyouts and mergers, two companies remain: R. J. Reynolds and Fortune Brands.

Chicago Gas Company – was bought by Peoples Gas Light in 1897 and was removed from the Dow on October 4, 1916. Today Peoples Gas is the natural gas delivery supplier for 830,000 residential, commercial, and industrial suppliers in the Chicago area.

Distilling & Cattle Feeding Company – changed its name to American Spirits Manufacturing Company and left the Dow on April 21, 1899. American Spirits later became National Distillers, then changing to National Distillers Products Corp with prohibition forcing a change in business focus to industrial alcohol and chemical markets. NDP merged with U.S. Industrial Chemicals in 1951. In 1987, they sold their alcohol business and the name was changed to Quantum Chemicals. Today the company is known as Millennium Chemicals.

Laclede Gas Company – left the Dow on April 21, 1899. It now services over 600,000 residential and commercial, and industrial customers in St. Louis and eastern Missouri and is a wholly-owned subsidiary of The Laclede Group.

National Lead Company – left the Dow on October 4, 1916. It began business in 1772 in the city of Philadelphia. Today it is known as NL Industries, a major producer of inorganic chemicals, especially titanium dioxide, the white pigment found in Twinkies, Oreo fillings, and correction fluid.

North American Company – left the Dow on August 26, 1896, and was the first member to be replaced. U.S. Cordage took its place. The company was formed to finance rail, transit, and utilities ventures in the Midwest. It was broken up in 1946 by the Securities and Exchange Commission.

Tennessee Coal, Iron and Railroad Company – was bought by U.S. Steel in 1907 who stayed in the Dow until it was removed on May 6, 1991. U.S. Steel was removed from the S&P 500 on July 2, 2014 and placed into the S&P MidCap 400 Index because of its declining market capitalization.

U.S. Leather Company – left the Dow on April 1, 1905. The U.S. Leather Company was originally capitalized at $130 million – equivalent to over $3 Billion in today's dollars. The company was liquidated in 1952 and no longer exists.

United States Rubber Company – originally founded in Connecticut in 1892, and left the Dow on October 1, 1928. The company became Uniroyal in 1961 which was then bought by French company Michelin in 1990.

It is safe to say that a lot of change has happened with the original 12 Dow members. Some of the companies grew and are still recognizable brands today (albeit in a completely different industry), while others have disappeared or are no longer household names. What does that mean for us today? Are the Apples of the world going to continue to dominate or will they go the way of Polaroid and Kodak Film? Only time will tell, but having a flexible investment plan that changes along with the times is probably more important than holding onto a picture that may fade in the long run.

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