ADVISER INVESTMENTS

SPECIAL REPORT

JULY 2016

Brexit and the Global Economy

INVESTMENT UNCERTAINTY AND OPPORTUNITIES

The U.K.'s vote to leave the European Union (the "Brexit") on June 23, 2016, led to an immediate global stock market rout. But as panic gave way to reason, the global markets bounced back. The post-Brexit relief rally was the result of the dawning awareness that, as with a contested divorce, separating the U.K. from the E.U. will take years to sort out. In the meantime, long-term investors (and shell-shocked traders) are asking what the Brexit means for their portfolios.

While there are legions of talking heads and self-proclaimed experts offering myriad theories about what will happen next, the reality is that no one (including our research team at Adviser Investments) has a crystal ball. Questions regarding the political and economic health of the European Union will remain a persistent market concern for years to come, periodically impacting short-term stock and bond market performance.

We wanted to share some thoughts on the Brexit and its likely impact on investors' portfolios and our investment strategy. But first, a bit of background.

A Contentious History

Currently comprised of 28 member states, the European Union is an economic and political union that emerged out of World War II with six countries forging an alliance to promote peace through trade and economic collaboration. If countries could become more prosperous through trade, create more opportunity for themselves and their citizens as a collective rather than as separate entities, they'd have an incentive not only to maintain peace but also to present a new model for global commerce and comity.

Led by France and Germany, the first treaty was signed in Italy in 1957. The "Treaty of Rome" established the six founding members of the European Economic Community (E.E.C.), the precursor to the E.U.: Belgium, France, Italy, Luxembourg, the Netherlands and West Germany.

Britain withdrew from initial discussions and then saw its application vetoed by French President Charles de Gaulle when it tried to join the union in 1963. Ten years later, the United Kingdom successfully gained membership.

With the ink barely dry on its 1973 admission, it took only two years before the U.K. government, led by the Labour Party, held a referendum over its E.E.C. membership. In contrast to the recent vote, British citizens decided to remain in the E.E.C. by a two-thirds majority.

In 1984, then-Prime Minister Margaret Thatcher threatened that the U.K. would halt contributions to the E.E.C. due to Britain receiving much smaller agricultural subsidies than it was paying into the union. She won the argument and received a rebate from the Europeans.

Britain officially declined to adopt the euro currency in 1997, which future Prime Minister Gordon Brown declared unfit (he was the Chancellor of the Exchequer at the time). Since then, the U.K. and the E.U. (established in its current form by a 1993 treaty) have both been buffeted by fair and ill economic and market winds.

The road to the Brexit vote began in 2011, as Prime Minister David Cameron argued with the E.U. over planned sanctions against London's financial sector. As tensions rose, Cameron appeased British voters by promising an "In-Out" referendum for 2017. He was later pressured to move the date up after making concessions while negotiating a "new E.U." deal earlier this year.

Brexit Aftermath

The June 23 vote is final, but it is not binding; the means by which global commerce is conducted hasn't changed—yet. The U.K. Parliament must decide to repeal the law that legally

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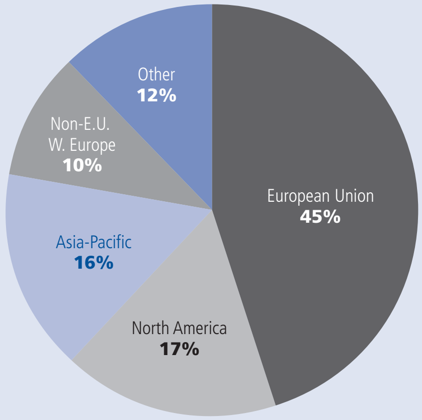
U.K. Exports by Region (2015)



Source: U.K. Office of National Statistics.

joins the country with the E.U. and then invoke Article 50 of the Treaty of Lisbon, which gives the country two years to negotiate a new agreement with E.U. leaders. These negotiations will be front and center on new Prime Minister Theresa May's desk for months to come. In the meantime, the U.K.'s current laws and trade agreements remain in place.

The primary economic benefit of the E.U. has been the reduction of trade barriers, which make imported goods and services cheaper for U.K. consumers, and allow for greater exports by U.K. businesses. In 2015, exports accounted for almost 27.4% of the U.K.'s national output, and as the ninth-largest export economy in the world, any slowdown in trade from the U.K. will have a noticeable global impact. With so much at stake, we think that it's likely (but far from certain) that the U.K. will be able to renegotiate its policies to continue to promote free trade.

Markets will be closely following how negotiations progress. If the U.K. isn't able to find common ground with its trading partners (the country has to renegotiate with all of its partners, not just those within the E.U.), we could see stock prices fall on the negative news. If the country is able to swiftly rewrite its trade agreements, we'll probably see a rally in foreign stock markets.

The challenge today is that companies may curtail spending and investment given this uncertainty—it is hard to play the game when you don't know what the rules will be—impinging growth. In anticipation of weaker growth tomorrow, companies may further scale back their spending plans today, potentially resulting in a self-fulfilling prophecy as lower corporate spending itself could lower global growth.

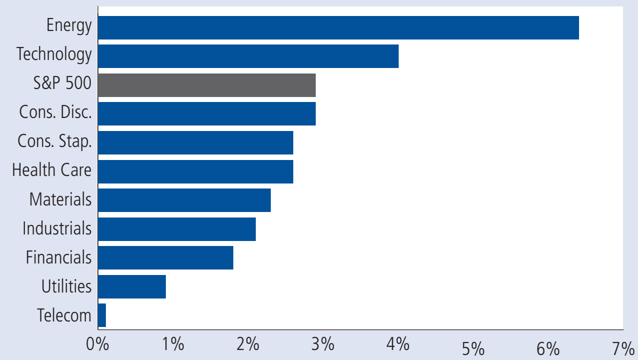
It isn't just trade that is at risk from the Brexit referendum; a potentially bigger risk is that Britain's departure will encourage other member nations to defect, triggering further foreign market sell-offs. But if the E.U. turns the fear from Brexit contagion into constructive action, it has the potential to achieve a stronger and more unified future; a boon for foreign companies and stock markets.

What Does This Mean for U.S. Investors?

U.S. markets seem relatively far removed from the situation in Europe. Companies in the S&P 500 index only generate 2.9% of their revenue from trade with the U.K. Exports to the U.K. account for less than 0.4% of our GDP. As we always remind clients, the bulk of our economy (69%) is consumer-driven, and the American consumer remains in very healthy shape.

With the global economy already struggling with very low growth rates, the Brexit could potentially knock some countries, such as the U.K., into a recession. However, we don't believe the Brexit is the straw that will break the global economy's back, and generally expect the theme of "slow growth, not no growth" to continue both here and abroad.

S&P 500 Sector Exposure to U.K.
(% TOTAL REVENUE)



Note: Data as of 6/17/16.
Source: FactSet.

We don't blame investors for asking whether investing in foreign markets still makes sense—the Brexit is just the latest in a seemingly endless stream of negative headlines coming from overseas. But our conviction is as strong as ever that having some money allocated to foreign assets makes sound investment sense.

U.S. stocks have outpaced international stocks for the past seven years; at some point that tide, as it always has, will turn. Similarly, the U.S. dollar won't appreciate forever. We don't know when those trends will reverse, but when they do, intelligent exposure to foreign markets should reap a handsome reward.

Navigating the Road Ahead

Investment markets are never at a loss for weighty concerns and uncertainties. That's one reason to stick with an investment discipline that doesn't waver in their face. Time in the markets, not market timing, is the longstanding litmus test for our investment results.

Consider this: The movements of the global markets prior to the Brexit referendum highlights the knee-jerk nature of financial markets. In the week leading up to the vote, Britain's stock market, measured by the FTSE 100 index, was up 5.3% in anticipation that the "remain" camp would win. When that didn't happen, the market dropped 5.6% in the two trading days following the vote. But it only

Foreign Markets on Sale

"FOR SALE" SIGNS ARE BEING HUNG across the globe. From Austria to Australia, from Ireland to India, stocks are in bear markets, spelling opportunity.

From the perspective of a U.S. dollar investor—37 of 42 countries we surveyed in the days following the Brexit vote were in bear markets. The exceptions are Denmark, Hong Kong, the Philippines, Switzerland and the U.S. The U.S. dollar has appreciated 30% or so in the last five years (versus a trade-weighted basket of currencies), but even if you remove currencies from the equation, 26 of 42 countries are in bear markets. It may not feel comfortable to invest today, but the world is a screaming buy. You just have to have patience.

Bargains Abound Abroad

	IN U.S. DOLLAR TERMS		IN LOCAL CURRENCY			IN U.S. DOLLAR TERMS		IN LOCAL CURRENCY	
	Current drawdown	Date of prior high	Current drawdown	Date of prior high		Current drawdown	Date of prior high	Current drawdown	Date of prior high
MSCI Greece	-98%	11/7/07	-98%	1/3/00	MSCI Peru	-37%	11/8/10	-37%	11/8/10
MSCI Austria	-78%	6/4/07	-74%	6/4/07	MSCI India	-34%	1/7/08	-9%	3/3/15
MSCI Portugal	-77%	11/23/07	-70%	7/17/07	MSCI Malaysia	-33%	5/14/13	-14%	5/19/14
MSCI Ireland	-72%	5/23/07	-66%	2/20/07	MSCI Germany	-33%	12/12/07	-25%	4/10/15
MSCI Russia	-71%	5/21/08	-48%	5/21/08	MSCI Taiwan	-33%	2/11/00	-29%	2/11/00
MSCI Italy	-70%	5/18/07	-65%	3/6/00	MSCI Mexico	-32%	4/11/13	-2%	9/8/14
MSCI Poland	-70%	10/29/07	-53%	7/6/07	MSCI Belgium	-32%	5/7/07	-16%	5/23/07
MSCI Brazil	-68%	5/19/08	-39%	5/20/08	MSCI Canada	-31%	11/6/07	-11%	9/3/14
MSCI Finland	-68%	3/6/00	-72%	5/2/00	MSCI Indonesia	-28%	5/20/13	-11%	3/31/15
MSCI Morocco	-64%	4/7/08	-53%	3/13/08	MSCI Singapore	-28%	10/11/07	-34%	10/11/07
MSCI Hungary	-63%	7/23/07	-41%	7/23/07	MSCI Thailand	-27%	5/21/13	-14%	5/21/13
MSCI Spain	-61%	11/8/07	-49%	11/8/07	MSCI Japan	-27%	1/3/00	-35%	2/26/07
MSCI Norway	-61%	5/22/08	-35%	7/19/07	MSCI Sweden	-26%	3/6/14	-22%	4/27/15
MSCI Colombia	-59%	2/1/13	-34%	2/5/13	MSCI Korea	-25%	10/31/07	-16%	5/2/11
MSCI Egypt	-59%	5/5/08	-34%	5/5/08	MSCI Netherlands	-24%	10/11/07	-16%	9/4/00
MSCI Turkey	-51%	10/31/07	-18%	5/22/13	MSCI New Zealand	-22%	7/24/07	-12%	7/25/07
MSCI Chile	-51%	1/3/11	-32%	11/9/10	MSCI Hong Kong	-19%	5/26/15	-50%	2/5/08
MSCI China	-47%	10/30/07	-47%	10/30/07	MSCI Switzerland	-16%	5/21/15	-16%	6/1/07
MSCI France	-40%	10/31/07	-33%	9/4/00	MSCI Philippines	-8%	4/10/15	-3%	4/10/15
MSCI United Kingdom	-39%	10/31/07	-9%	4/27/15	MSCI Denmark	-6%	6/7/16	-8%	8/5/15
MSCI Australia	-38%	11/1/07	-24%	11/1/07	S&P 500	-1%	5/21/15	-1%	5/21/15

Notes: Data as of 6/30/2016. Price returns only. Drawdowns since 1/1/2000.
Source: Morningstar.

took two more days for the FTSE 100 to recoup those initial loses. Market movements are impossible to predict in the short-term. We focus on the long-term.

For more than 20 years, we have been intentionally building diversified portfolios so that our clients' assets aren't left to the mercy of unforeseeable events. During that span of time, we have witnessed far more calamitous political and economic upheaval than this one referendum—and our manager-focused investment discipline has weathered each and every situation reasonably well.

We firmly believe that our focus on finding managers with a track record of successfully navigating challenging markets is the best way to grow and protect our clients' wealth over time. While we don't know for sure how the Brexit referendum will play out over the coming weeks, months or years, we do know that the managers we hire and the investment team at Adviser Investments will continue to manage through turbulent times in order to help our clients secure a solid financial future.