The Sky Isn't Falling: Financial Repercussions Of The Brexit Vote

Listening to financial pundits, it's easy to think that the end of the world occurred last Thursday. The United Kingdom voted to leave the European Union in a contentious referendum. While the implications of this decision are many and wide-ranging, there's no need to panic.

What the Brexit does

The referendum in the United Kingdom was to leave the European Common Market. The Market is a network of countries (called the Eurozone) that don't charge each other import or export taxes and simplify the process for citizens of any Eurozone member to get permission to work in any other country. The Brexit vote means that the United Kingdom is leaving that network.

For citizens of the United Kingdom, this decision could have very serious implications. On one hand, the country will get more control over its immigration policy. It is no longer obligated to follow European Union rules on migration or refugee handling. The desire to secure their borders was, in large part, the motivator for those who voted in favor of leaving the European Union.

What most financial experts are concerned about, though, are the trade implications. The United Kingdom will have to negotiate its own trade policies with every other member of the Eurozone. Over the short term, this will be incredibly complicated. For the past 20 years, British trade policy with the rest of Europe has been determined by the Common Market rules. It will take time to reestablish trade policies with the many nations of the Union.

No need to panic

The one thing that drives markets down more than anything else is uncertainty. If no one has reason to believe that trade will occur and profits will be made, there's no motivation to invest. That's the current circumstance. There are no clear trade rules governing Britain's participation in the Common Market, which is driving investors in both European and British markets away. This same fear is also impacting other markets of countries that do business with the United Kingdom. This behavior is driving concerns about a short-term recession.

Ultimately, trade agreements will be mended. The United Kingdom and the rest of Europe are too close, both politically and economically, to remain at odds for long. Business as usual will return sooner rather than later, and short-term losses will rebound.

This is small consolation to those who will lose their jobs due to the economic slowdown, though the most pronounced effects of this loss will be in the United Kingdom. U.S. companies that conduct a great deal of business with Europe and the United Kingdom may have some staff reductions, but job loss should be minimal in the U.S., at
least over the long term.

Normalcy will return

Many doom and gloom economists and pundits predicting mass economic ruin rely on a number of things happening, each of which is unlikely. First, investors must abandon the Pound Sterling, the British currency, en masse. This is unlikely. The British government's ability to pay its bills is still sound, and the currency holds enough value to resist the impulses of speculation.

Second, those who predict financial catastrophe assume a trade war will spark between the United Kingdom and the rest of Europe. Such analysis ignores the likely galvanizing effect that the Brexit vote will have on British moderate voters. As Prime Minister David Cameron has recently resigned, and with opposition leader Jeremy Corbyn likely to do the same, new elections will install a new British government shortly after the British leave the European Union. Those who were opposed to the Brexit referendum, but stayed home because they considered it impossible that the referendum would pass, will heavily influence this new government. These voters will elect moderate leaders capable of returning a degree of normalcy to trade relations, and thus preventing a trade war.

What this means for your portfolio

Over the short term, stocks and foreign currency funds will likely take a significant beating. Resisting the urge to cut and run from these positions will take discipline, but it will reward investors with the courage to ride out the storm. When normalcy returns to international trade, these positions will rebound. This sudden downswing may mean postponing retirement for a few years in order to take advantage of bargain-priced securities in the interim, but investors who sell now may end up regretting the decision.

For those still saving for retirement, it may be prudent to find another place to stash gain-seeking money in the interim. Instead of investing in the typical instruments, consider long-term share accounts. As governments in Europe cut interest rates in an effort to stimulate their economies, traditional safe instruments – such as government bonds – will lose some of their luster. Long-term share accounts will keep current interest rates through the economic trouble and provide a better 3- to 5-year return than many other traditionally safe investments.

The bottom line

The Brexit vote will likely cause some damage to the global economy, but the damage will probably be minimal. After an interruption of trade, everyone will get back to business as usual across Europe. Some companies may cut their staff down for a short time, but they will re-expand once the economic situation returns to normal. Keep calm, and keep saving.

Your Turn:

What do you think of the Brexit vote? Was Great Britain right to want to control their borders at the expense of their economy, or did they act rashly by breaking ties with their biggest trading partners? Let us know!

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