



July 1, 2016

## Is June 23 the New Independence Day?

Dear Clients and Friends,

As many of our clients prepare to enjoy America's independence over a relaxing Fourth of July, we at FBB have been parsing through the June 23 "Brexit" referendum in which UK citizens voted for *their* independence from the European Union. While the dust is still settling, we have been evaluating potential short- and long-term investment implications, while also remaining vigilant for opportunities to own high quality companies at more attractive valuations.

### Is the worst over yet?

While global markets sold off sharply in the two days after the referendum, they rallied back in the subsequent three trading days, recapturing much of their initial losses. The FTSE 100 index, which is the UK's stock index, actually closed higher on June 30 than it was on the eve of the vote—that's right, *higher!* Still, investors should be asking if the worst is over. In the next one to two quarters, while the UK political parties vote for new leadership, we feel there will be a good deal of waiting without much happening. We expect the UK economy to sputter—and certainly its internal growth rate to slow. Eventual terms of the divorce with the EU will dictate how the UK's economy will fare over the long term. The impact on the EU writ large is harder to guesstimate. Potential referendums in other countries who share the common currency could certainly be of more consequence. For now, the only certainty in Europe is uncertainty, and in this environment we continue to maintain an underweight position in European shares.

Looking at the bigger picture to revisit the two most recent market shocks—a China growth scare in August 2015 and a plummeting oil price scare in February 2016— we experienced 10 percent equity market declines in each instance. Relative to these events, the immediate Brexit-related volatility was a more moderate down event (four to five percent), most likely because the UK represents a fairly small part of the global economy relative to China or the energy industry. In thinking through how the Brexit situation will play out, we believe markets will follow a playbook that we have seen play out in the past involving angst and uncertainty at first, a gradual adjustment over days and weeks, and an eventual market reversal to new highs. Our feeling is that investors will focus less on Brexit in the second half of the year and more on upcoming events, such as the U.S. elections and possible Fed rate hikes.

### Playing offense and defense amid the latest volatility

As we think about FBB's investment strategy post-Brexit, we continue to focus on positioning portfolios to play both offense and defense. In terms of offense, we favor some of the global financial exchanges, such as CME Group, which we've discussed in prior letters. These commodity exchanges not only pay attractive dividends with high barriers to entry, but also benefit from the rising volatility stemming from the looming UK / EU divorce.

On the other hand, we also like stocks that are more defensive amid macro-driven volatility—for example, United Health Group, a U.S.-focused health insurer that generates approximately 95 percent of its sales from inside the U.S. The company is in the process of exiting unprofitable state health exchanges and gaining share as its competitors remain distracted with controversial mergers. Additionally, United's non-insurance business

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continues to drive upside as it digitizes health IT, cuts wasteful drug spending, and manages growing doctor networks that offer low cost, high quality care.

Looking beyond individual securities, FBB continues to manage each client's portfolio with a focus on quality, income, and the potential for long-term outperformance. During periods of unexpected market turbulence, when high- and low- quality companies trade at similar valuations, we believe our continued focus on quality will lead us to select companies that enable portfolios to "weather the storm."

While the volatility of the last 12 months seems elevated by recent history standards, as we have written on many occasions, it is in fact much more in line with historic levels. We expect slow global growth and low interest rates to continue to be the investment environment for the next several quarters and we fully expect continued market volatility within that context. Rest assured, we will continue to invest your portfolio in a manner appropriate for your individual needs, goals, and investment time horizon, while keeping a tight leash on the ever-present balance between risk and reward.

With Best Wishes for Summer,

FBB Capital Partners

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The investment committee is pleased to announce several meaningful developments within your team. First, FBB Capital Partners was again named to the Financial Times 300 Top Registered Investment Advisers for the third year in a row. Second, we are delighted to welcome our most recent addition to the FBB team, Payal Vachhani, an investment research analyst. Finally, two additional FBB portfolio managers, Jaime Quiros CFP® and Jane (DeLashmutt) O'Mara CFP®, recently achieved membership as Registered Advisors with the National Association of Personal Financial Advisors, also known as NAPFA.

**NOTE:** Please **SAVE THE DATE** for the following upcoming events. Further details to follow via e-mail.

- On July 7 at 4 pm (EST), FBB will host a conference call with clients to discuss our Investment Outlook. Please send questions in advance of the meeting to [info@fbbcap.com](mailto:info@fbbcap.com). The dial in is: (Local) 301-298-1561 / (Toll-Free) 800-719-7514. The access code is: 707517.
- On July 28 at 2 pm, FBB will co-host the third of four calls this year with our friend Greg Valliere, an expert in political and economic trends who will help enlighten us on potential investment implications of the presidential election. Please stay tuned for an email with dial-in information.

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