EMERALD ASSET ADVISORS, LLC

Investment Strategists for
Successful Families

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Thank you for reading GreenThought$. It is our privilege to provide you with our insight on current financial market events and our outlook on topics relevant to you.

Second Quarter 2016: Investment Market Summary

On Friday morning, June 24, 2016, we all woke up to a different Europe. The unthinkable happened, the so-called Brexit became a reality. The citizens of the United Kingdom (UK) voted to leave the European Union (EU), the first country ever to attempt to do so.

The financial markets reacted in a negative way, as surprises and uncertainty never work well with global financial players. Equity markets around the world were down, some of them with double digit percentage losses. The currency markets experienced wild swings with the U.S. dollar being the main beneficiary to the upside, particularly against the British pound, euro, and some of the emerging market currencies. It appears that the Brexit caught many large financial speculators on the wrong side of the trade, and they got out of their positions in a hurry. That activity caused significant selling pressure in many risk assets (such as stocks) while the perceived safe havens (US Treasury bonds and gold, for example) saw large cash inflows.

How should we as long term investors, rather than speculators, respond? For one thing, selling at times of panic is never a good idea, as many high quality assets become mispriced, not reflecting their intrinsic values. These kinds of selloffs may create opportunities for patient, disciplined investors. The Wilshire 5000 index, the broadest measure of the US equity market, is a good example. On Friday June 24th, the day after the Brexit vote, the index dropped 3.7%. On the following morning, it dropped another 2%. On Tuesday, June

28th, traders decided that maybe the world wasn't coming to an end, and bid the Wilshire 5000 up 1.8%. It rose another 1.8% the next day. Investors benefited by not giving in to fear in the days right after the vote.

Does that mean that the storm has passed? Maybe not. The effect of the Brexit vote was relatively muted, in part because even though the UK is a member of the EU, they still use the pound as their currency rather than the euro. Should other EU countries that do use the euro decide to try and leave the EU, the effect could be more disrupting. Looking around the world outside of Europe, there are still risks we need to recognize associated with China, the US economy and upcoming elections, the Federal Reserve, etc.

One asset class we have been using in client portfolios as a way to mitigate some of the risks we see is alternatives, which are investments whose performance is only loosely correlated with the stock and bond markets. Note how some of the more commonly used alternatives have performed during the recession of 2001 and 2008:

	2001 Recession Maximum Drawdown	**2008 Recession Maximum Drawdown**
Stocks	**-14.68%**	**-38.09%**
Long/Short Equity	**-5.91%**	**-23.96%**
Managed Futures	**-3.87%**	**-3.97%**
Global Macro	**0%**	**-4.94%**
Real Estate	**-2.62%**	**-58.31% ***

***large drawdown due to a lack of liquidity, a condition not present at this time**

While these alternatives may seem boring in times when the market is performing well, their value comes through in times of market stress. We want to be careful about drawing many conclusions from just a couple of days, but in the two days of trading after the Brexit vote, when the Wilshire 5000 dropped about 5.5%, our long/short equity fund was up .42%. Our managed futures fund was up 6.3% and the global macro fund was up 1.4%. We use a variety of real estate investments, but the Vanguard REIT index was only down .82%. Of course, there's no guarantee these investments will provide similar protection during the next market downturn, but we're pleased they performed in line with our expectations. In trying to maximize long term portfolio performance, we believe it's more important to minimize drawdowns during bad market periods than it is to maximize upside when the market is doing well.

We have received many calls from you during these past couple of weeks, which we encourage as we know how unsettling it can be when the markets are on a roller coaster and the financial press is telling you the sky is falling. We're here to answer your questions about any market related events, the effect on your portfolio, and what steps we are prepared to take if necessary.

Regards from the Emerald Team

Disclosure
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