ICR® 2nd Quarter Newsletter – July 2016

Financial markets were relatively calm for most of the second quarter until the final week, when the people of Great Britain voted to leave the European Union – commonly referred to as "Brexit." The decision sent shockwaves through the global financial system and briefly sent markets tumbling with the S&P 500 and FTSE 100 (a British stock index) losing more than 5% over the next two days. Despite the turbulence in June, the S&P 500 still managed a 1.9% gain for the quarter. Foreign markets didn't fare as well, with the MSCI EAFE index losing 2.6%.

Early in the second quarter, interest rates began to rise slightly as investors priced in a higher probability of the Federal Reserve raising rates at their June meeting. However, a very weak jobs report in early June led most to believe that the Fed was unlikely to take action in the near future which sent rates lower. That thinking, combined with a flight to safety in the wake of the Brexit vote, sent the U.S. ten-year treasury yield to 1.49% from 1.79% at the beginning of the quarter. In fact, the rate briefly hit an all-time low of 1.34% in early July.

Some of the biggest swings took place in currency markets, where the fallout from the Brexit vote were most acutely felt. In the weeks leading up to the vote, the British Pound rallied to about 1.49 versus the U.S. dollar as odds makers and market pundits saw the prospect of Great Britain leaving the EU as increasingly unlikely. That overconfidence in an outcome that was uncertain made the voters' unexpected decision all the more jarring for financial markets. In the two days following the vote, the Pound tumbled over 11% versus the U.S. Dollar, reaching a 30-year low of 1.32.

Above all, do no harm!

We have all heard the variations on the age-old advice, "First, do no harm." (e.g. "Be careful what you wish for" - "Look before you leap" - "Think it through") And, in past quarterlies we have discussed the unintended consequences of various policies, like artificially low and negative interest rates and banking deregulation. Time will tell, but it appears that the Brexit vote may turn out to be another example of voters and policymakers failing to heed this prudent advice. However, that doesn't mean that the vote by Britain to leave the EU was anything other than a rational decision.

Brexit is part of a growing trend to push back on the local effects of globalization. Most European countries, as well as the U.S., have a populist movement that believes certain aspects of globalization threaten their cultural and economic stability. They believe that immigration, trade and offshoring are out of control and that the political and financial elites have conspired to ensure that any net gains from globalization are not fairly distributed. These beliefs are based upon the firsthand experience of middle class workers whose wages have stagnated due to automation, offshoring, and immigrant labor. Therefore, to vote in favor of Brexit as a way to limit these destabilizing effects of globalization seemed perfectly reasonable. Equally rational is the ever-increasing flow of migrants and refugees from regions of instability and chaos to regions of order and stability – from Central and South America to North America and from the Middle East and Africa to Europe. Rational people (and investment capital) prefer order to chaos.

The rub comes when well-intended populist actions have unforeseen and unintended negative consequences. Brexit, for example, may end up causing more uncertainty and instability than before. For example, there may be greater polarization between Great Britain and the rest of Europe. Other countries may decide to exit the EU. Scotland or Northern Ireland may wish to remain in the EU and therefore consider leaving the U.K. Meanwhile, businesses postpone making investments that would create jobs, until things become more certain. And, the U.K. risks going into recession.

Hopefully, these potentially negative consequences of Brexit will serve as a wakeup call to both the populists and the institutions that have failed them. The root causes of the problems that populism seeks to address – growing disparity of income, culture, and opportunity, failed leadership of institutions that have not kept pace with changing geopolitical and socioeconomic challenges, and terrorism – are global in nature. They are the problems of a connected and interdependent world. Real solutions exist, but they must also be global in nature, requiring greater collaboration and partnership among nations, not less.

Investment Implications

We see the current investment environment as one of radical uncertainty with voters, politicians, and policymakers all too willing to enter the world of unintended consequences by ignoring the precautionary principle – "First, do no harm." This level of uncertainty will probably result in continued market volatility and cause capital to flow in the direction of stability and order. As we've said before, at ICR we understand that the future is **always** uncertain and we invest accordingly. Our efforts are focused on managing the risks from radical uncertainty with the flexibility to profit from volatility along the way.

Thank you for your continued confidence and support as we work to protect and grow your wealth in a particularly uncertain world. Please call if you have questions or concerns.

Sincerely,

James A. Heine　　　　James L. Cobb

Market Report (as of 6/30/16)

Index	2016 YTD (%)	3-Year Annualized (%)	5-Year Annualized (%)
S&P 500	2.68	9.32	9.70
Dow Jones Industrial Average	1.49	6.34	7.63
U.S. Aggregate Bond Index	5.31	2.89	3.76
MSCI EAFE (Foreign Index)	-6.28	-0.62	-1.19