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Supplement
Brexit Observation

The consequences of the Brexit vote will be worked out over many years, and no one yet can confidently profess a clear understanding of all of its impacts on the international economy. In a way though, for us as *investor-manager-advisors*, responding to Brexit is just "business as usual": we are always in the business of considering how developments in the economy (regional, national, international) are likely to impact our collective fortunes in the near, medium and long term.

As advisors and asset allocators for client accounts, our focus is typically on the medium- to long-term horizon. We are prepared to act more immediately, in view of extraordinary circumstances, but we are very mindful of the risk that emotions rather than facts drive short-term market fluctuations. (That certainly seems to be the case with the precipitous drop and partial rebound following the Brexit vote.) Wearing our client advisory and account manager hats, therefore, the questions we are asking ourselves in the wake of Brexit (and consider afresh on a daily basis) revolve around whether this vote is likely to lead to long-term, secular changes in the global economy that challenge our bedrock assumptions about the advantages of broad diversification in client portfolios, and our belief that, over any reasonable period of time, the value of a diversified portfolio of equities will trend upward as the economy expands (and/or as inflation kicks in).

As for the various funds into which much of our and our clients' wealth has been allocated, it is safe to assume more immediate steps are being taken to respond to Brexit. If we are considering the appropriateness of our overall asset allocations on a daily basis, "business as usual" for fund managers means managing through this volatility on an hourly basis. And while information about the specific buys and sells of the fund managers to whom we allocate (ourselves among them) is confidential until it is reported publicly (usually quarterly), our history and that of our various active managers shows that we can be nimble and opportunistic, working to take advantage of the openings offered by market turbulence (and to side-step the more obvious risks).

While we are not yet convinced that the Brexit vote justifies fundamental course corrections, we can draw some conclusions that will inform our investment decisions going forward. For one thing, world GDP projections are almost certainly going to be adjusted downward in the weeks to come. For another thing, it is already clear that the Brexit vote has accelerated the long-term trend (evident for a couple of years now) of a "flight to safety." Steady income-generating securities (for example, government bonds, dividend-generating equities like utilities and telecoms) were looking expensive before the Brexit vote. Now these "safe havens" are looking positively frothy, with prices (in the case of the utilities and telecoms) generally well beyond what their low or negative earnings growth should reasonably support. To the extent the debt markets were developing something of a "bubble," the reaction to Brexit has made things worse. At the same time, assets that have been cheap (i.e., down) in recent months (international equities and some value stocks) are looking cheaper still and may offer even more attractive buying opportunities as a result of Brexit.

So "business as usual" means watching these developments and weighing appropriate actions carefully and having some degree of confidence that markets, over time, tend to work through shocks like this and revert to long-term means.

All of that having been said, there has certainly been no end of lively debate here concerning the broader economic and political implications of the Brexit vote. So I will share with you my personal - perhaps idiosyncratic - take on Brexit. Enjoy.

Any "authoritative pronunciamentos" (including, perhaps, Prime Minister Cameron's recent declaration that there will be no second U.K. referendum on E.U. membership) are bound to be misleading at best and partisan cant at worst. While I cannot speak authoritatively about what will happen in the coming months in the U.K., I feel reasonably comfortable speaking about what I think should happen. What should happen is that there should be a second referendum and that the "Remain" side should prevail.

Consider the following:

1. In the first week following the vote, some of the most ardent supporters of "Leave" have pulled back from their more extreme campaign promises/arguments. This is symptomatic, it seems to me, of a dawning realization on the part of many Leavers that, in their enthusiasm for a "Leave" vote, they (or those speaking for them) discounted and/or misrepresented the costs of "Leave." My view is that the costs of Brexit are and will be huge and painful to the U.K. And I remind you that the perceived "benefits" ("recovery of national sovereignty" and "immigration control" chief among them) are highly emotional issues which lend themselves to short-term sloganeering, while the "costs" have not been all that easy to quantify and communicate clearly and are, in any event, much longer term in their impacts.

2. It became immediately clear after the votes were counted that an inter-generational conflict has arisen over this issue. 75% of voters between 18 and 24 said "Remain." These folks are not inclined to Leave quietly. There is a developing movement among the Anti-Brexit young, the sense of which might be paraphrased as follows: "We are not inclined to allow a bunch of old fogies to dictate to us how we are to live our lives, particularly when what the fogies are supporting is so clearly against the national interest as well as our own."

3. Scotland has strong economic ties to the E.U. This was evidenced by 62% of Scotland voters who said "no" to Brexit. When the issue of Scottish independence was recently argued (and settled), one of the assurances the Scots relied on was that Britain would stay in the E.U. No doubt the promise was made in good faith, but it is now null and void. The Scots are a strong-minded people. A majority of them feel that they have been twice betrayed. So expect a resurgence of nationalist activism (will Wales and Northern Ireland be far behind?) and expect some deep soul-searching within the English electorate as they contemplate the possible breakup of the U.K. as a Brexit consequence.

4. The complexities associated with the execution of Brexit are mind numbing (the "good" news: thousands of lawyers and bureaucrats will be kept busy and well paid for a decade). As a new non-E.U. member, the U.K. will, among a multitude of other tasks, be faced with negotiating trade deals with more than fifty other nations including the U.S. and China. And it seems unlikely that these deals will be as favorable as those negotiated by the E.U. Why should they be? General Electric can buy furniture cheaper than CWC can. E.U. members can buy cheaper (and sell dearer) by virtue of scale than would be the case of any stand-alone country. (Well, maybe not the U.S. but certainly Albania and a non-E.U. England.)

5. There is no question that E.U. governance can be, to put it mildly, clunky. But the Brexit movement bypassed obvious avenues of reform and proceeded to amputate the foot to cure an ingrown toenail. The vote will, I believe, refocus all parties (even some of the Leavers) on serious reform opportunities (particularly in the areas of immigration and over-regulation) as an alternative to a concluded Brexit.

I could go on but you get the point. In a rational world (a world characterized by prudence, common sense, economic reality, competent governance), a second referendum would be a no-brainer. (Of course, in a rational world, Brexit would never have arisen.) I think there is a strong and obvious case for a second referendum and, while I have no knowledge of what will happen, I am comfortable, as I noted above, with my claim of what should happen.

Brexit is one of many crises that impact the markets through which CWC and other investment managers must navigate. There will certainly be volatility for some time, presenting some risk analysis challenges and investment opportunities. But we continue to believe that quality equity securities - domestic, international and global - are a vital component for total return in an investment portfolio over the long term.

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