

OBSERVATIONS AND PERSPECTIVES: RIGHT BACK WHERE WE STARTED FROM

In an emotional vote against crony capitalism, immigration fears and the widening gap between haves and have-nots, the UK voted on Thursday to leave the European Union, shocking pollsters and market makers the world over. The psychological damage on Friday was jarring: the British pound touched a 30-year low, European bank stocks plunged close to 20% and jittery investors rushed into gold and anything U.S., including bonds and the dollar (but not stocks or high yield bonds....yet).

The biggest losers on this historic Friday were, interestingly, not U.K. stocks, but the rest of Europe. Stocks in Greece, Spain and Italy clocked far larger losses than those in the U.K. Winners included our long positions in long-dated U.S. Treasuries and our holdings in municipal bonds, including California. These overweight allocations benefitted our clients substantially.

The slumping global markets on last Friday masked the reality that in the week in which Britain voted to exit the European Union, the blue chip FTSE 100 ended with a gain. Not a loss, but a gain. In fact, a number of broad market benchmarks, while certainly gushing blood this past Friday, really just gave back increases picked up over the past few days, as most were lulled into the complacency that all was well on the British side of the pond. The German DAX lost nearly 7% of value on Friday, but that's where it stood 10 days ago; similarly, the French CAC is down only about 1.3% since mid-June. We would go so far as to say that all the bad news around Brexit is likely out there since, as Maxine Nightingale once belted in her 1975 hit, we are "Right Back Where We Started From."

Being less myopic, the bigger picture is that this vote hammers home the certainty that we live in a world characterized by a lack of cooperation and weak global markets. Italy, China, Spain, Greece, France and Germany are all down 20% and more from highs over the past year or two. The S&P 500 has been dead money for nearly 2 years with two ten+ percent drawdowns along the way. Before and after Brexit, we continue to live in a world where investing should be characterized by capital preservation and making a satisfactory profit, rather than playing the greater fool.

We can say this because the massive moves (up and down) simply do not hold. As we pointed out above, most European markets are just about where they were in mid-June, just before talk of a Breain v. Brexit referendum became big news. The losses in the S&P 500 just set investors back to where they were a few weeks ago. Bonds aren't much different: last Thursday night, the 10-year Treasury yield fell as low as 1.40%, but today sits at 1.58% (it was 1.57% last week).

Looking closely at our strategies, even with last Friday's move there are no clear sells in our holdings of high yield bonds, emerging markets debt, floating rate loans, and, as noted earlier, municipal bonds (including California) and U.S. government bonds. Volatile times highlight for us the potential benefit of having a sell discipline based on dynamic rules established over years that clearly define when it's time to get out, or when it's time to sit on our hands because we are really just *Right Back Where We Started From*.



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A **drawdown** is the peak-to-trough decline during a specific recorded period of an investment, fund or commodity.

The **FTSE 100** is an index composed of the 100 largest companies listed on the London Stock Exchange (LSE). These are often referred to as 'blue chip' companies, and the index is seen traditionally as a good indication of the performance of major companies listed in the UK.

The **DAX** (Deutscher Aktienindex (German stock index)) is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. Prices are taken from the Xetra trading venue.

The **CAC 40** (French: CAC quarante (Cotation Assistée en Continu) is a benchmark French stock market index. The index represents a capitalization-weighted measure of the 40 most significant values among the 100 highest market caps on the Euronext Paris (formerly the Paris Bourse).

The **S&P 500®** is an unmanaged composite of 500 large capitalization companies. This index is widely used by professional investors as a performance benchmark for large-cap stocks.

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