Hayek Kallen
Investment Management, LLC

President's Letter – July 2016

Investors around the world were treated to a significant dose of volatility in June when, despite predictions and expectations to the contrary, the UK voted to leave the European Union. The vote sent shockwaves across the globe as the markets faced their two least favorite emotions: surprise and uncertainty. Despite the public rhetoric, the markets rallied strongly once the dust settled, suggesting that the Brexit crisis will be less severe than many had feared—at least for those of us outside of the UK and the EU. The full impact, or for that matter even the immediate impact, of the UK's decision on Europe is not clear. Speculation abounds about what the Brexit will ultimately mean, but for now, we are all going to have to wait and see how this plays out. The markets have weighed in and have—despite an initial sell-off (the S&P declined almost 6% from its high reached the night before the vote)—corrected to pre-vote levels when the consensus was that the EU would remain intact.

While we wait for the details of the UK's exit from the EU, we can focus on the things that seem to be impacting the markets and the economy. From our perspective, here are the issues that warrant the most attention:

Rates are low, really low. One of the biggest issues that savers face today is the fact that any instrument that offers safety and security provides little to no return. With this most recent bout of volatility the yield on the US 10 year Treasury Bond dropped to 1.3%. With economic headwinds from the Brexit vote, the Fed seems even less likely to raise rates this year, despite indicating the intent to do so two months ago. The path to higher rates continues to be deterred by a sluggish economy and low inflation. Despite these low rates, bonds continue to play an important role in our portfolios. In addition to the income that they generate, bonds can provide stability, which is vital today given all of the uncertainty facing the markets and global economy.

**Data source: The Federal Reserve*

The US economy continues to show gains, albeit modest ones. Pretty much across the board our economy continues to make progress. With unemployment under 5%, we are rapidly approaching full employment, and with a tightening labor market we are finally starting to see wage growth, which until recently has been absent. Coupled with better housing data, low rates, and increasing consumer confidence, we hope to find an environment that will support increased levels of consumer spending and business investment—which have been slow to appear. In a market that is starved for growth, these factors present a welcome sign. And remember that sluggish economic growth, accompanied by low interest rates and low inflation, is not necessarily an unfavorable backdrop for the stock market over the long term.

The global economic picture is not as bright. Outside of the U.S., prospects aren't as bright. Europe and the UK will now be dealing with a significant "distraction," a likely impediment to economic growth as they sort through the mess caused by the Brexit vote. China is facing a rocky road as officials attempt to refocus their economy more on the consumer and less on infrastructure and investment. The energy markets appear to be stabilizing, which is a welcome relief to many countries who are dependent on energy, but we still remain well below the levels that we saw even two years ago.

Volatility is likely to be elevated for the near term due to political and economic uncertainties. There are a lot of moving pieces for the markets to digest right now. Our country is in the midst of a highly contentious election, the outcome of which is unlikely to appease anyone as we choose between two of the least popular candidates in history. The Fed continues to react to financial conditions as it sets out to continue its program of monetary tightening, but the timing of the next move is unclear. Add the recent Brexit vote and you can see why investors remain a little tender and skittish.

Despite these challenges, the economy and the markets remain positioned for continued advancement. The challenge facing investors today is to remain patient. Market returns over the last couple of years have been muted, and the yields on high quality bonds continue to remain well below historical levels. Investor frustration can be as dangerous as the other more commonly discussed investor sentiments (fear and euphoria). Buying good companies, supplementing income from high quality bonds with dividends and share buybacks, and crafting portfolios with the ability to weather the volatility and ultimately advance with market gains has proven to be a very effective long-term strategy for investors.

On a personal note, we are very sad to report that our founder and former president Fred Hayek passed away on June 27th after a four and a half year battle with cancer. Fred's passion for investing and his love of the business, which he founded more than 30 years ago, serve as both inspiration and motivation for all of us here at Hayek Kallen. Fred cared deeply for all of you, and his commitment to our clients and this firm never wavered. Fred was a mentor and a friend, and he will be greatly missed.

As always please do not hesitate to call or email with any questions or concerns either about Fred, or your enclosed portfolio statements.

Eric

Eric O. Kallen
President, Hayek Kallen Investment Management