BREXIT TORPEDO HITS!

A couple of weeks ago, I mentioned in my last article “What is Happening to Markets this Week?” that the markets were facing a torpedo attack from various sources. I also said that I would keep you informed if one of those torpedoes actually hit. So unless you have been hiding under a rock or marooned on a desert island you will be aware that last week the UK voted to exit the European Union.

This was a direct hit to the market.

Late Thursday of last week, the results of the UK vote slowly came to light. Final results came in the early hours of Friday morning and markets all over the world shouted “Dive, dive, dive”! The Pound Sterling fell to levels not seen since 1985, its biggest one-day drop against the dollar (of over 10%) in 30 years. The Dow Jones fell over 600 points. On Monday, the index fell over 200 more points, making for a two-day decline of about 5%.

The dust has now settled from the explosion and things have started to stabilized, for now. Markets began a rebounded on Tuesday and this continued into Wednesday (I am writing this on Thursday morning 30 June from Hong Kong). The S&P 500 closed up 1.7% and the FTSE100 closed up 3.58% on Wednesday and that’s a full recovery of the UK market pre-Brexit vote. The Pound Sterling has recovered slightly from the lows it hit. Then again a lower currency will be good for UK exporters and potential attract more visitors to UK this summer. I have also just read that many Chinese are buying luxury goods online from the UK as the currency has fallen some 10%.

One of the problems that lead to these wide swings in the markets was that markets had been mistakenly anticipating that the vote would go the other way, to remain in the EU. We are all aware that markets hate uncertainty. The exit vote creates a great deal of uncertainty about how the European economy will respond. As we saw on Friday the initial response was very negative, but short- lived. The real results of the vote will not be felt for some time to come.

Now turning to the biggest economy. The biggest risk to the U.S. market is the global economy. An already sputtering global economy threatens to drag the relatively strong U.S. economy down with it. As I mentioned in my previous article the U.K. vote brings with it the threat of contagion. As you will recall this is the threat that other EU nations will now also opt out of the EU. Another large member exit could rip apart the EU and thrust Europe into recession. And of course the repercussions of which will be felt in the U.S. These elevated risks have lead many investors to seek safety. Money has flooded into the US$, Japanese Yen and gold. This has led to a strengthened US$, which is a negative for U.S. companies that sell products overseas.

Now that the dust is settling, I believe long term, Brexit will be a good thing for all involved.

The EU and the Euro has one great beneficiary, namely Germany. The weakness of the Euro has helped this major export lead economy without doubt. Of course the EU has ensured peace on the continent in the main. The signal market concept is a success enabling smooth trade between its members. The desire of ever-closer political union seems for some to have gone too far for many. A British exit is a rejection of the old ways and a wake-up call for the EU to pursue more pro-growth policies. If those at the top of the EU do not heed the call, the EU is in danger of a break up and seeing individual countries moving towards more pro-growth economic policies on their own and greater job creation.

We still have a long way to go before seeing if Brexit was the right step for all involved. It will be at least 2 years before the EU and the

UK draw up a final agreement. Any meaningful EU reforms will take time and the challenge has to be met for it to survive.

As for the U.S. stock market. This relatively highly priced with more downside risk than upside potential, in the near term. Any negative news could cause prices to plummet. However, as we have seen this past week, stocks have an uncanny ability to rebound as soon as fears wane. This market dynamic will likely remain until it becomes clearer whether the U.S. and global economies see a stronger level of growth or recession first.

To your investing success.

Pedro Robert

means is illegal and punishable by law.