

All will come to pass

Brexit is yet another unexpected event with zero long-term impact



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“BREXIT”, the UK vote to exit the European Union (EU), captivated the financial world at the end of June. On the news global equity markets sold off sharply, the pound sterling fell 10 per cent in a single day to a 30-year low and pundits offered innumerable opinions on an inevitable UK recession, how the country had made a huge mistake by reversing three decades of economic progress and how this vote is the precursor to the disintegration of the EU.

This momentous event will have significant ramifications for global trade especially for the UK that will only become clear in years to come. Businesses based in the UK will have to contend with significant uncertainty. But what is the real impact for a global investor?

On the few days around Brexit, investors were inundated by opinions and analyses of the event and its ramifications. Having read and saved every single article on the subject, I stopped once the count topped 200, coming to the conclusion that much of it was speculative nonsense.

I now know in detail the contents of Article 50 of the Treaty of Lisbon, which is actually only 256 words in length. Perhaps EU legislation is not as bureaucratic as we first thought.

While at a dinner event the night after Brexit, I was quizzed by a table of investors about the implications of this event. They were suitably impressed by my knowledge that Article 50 states that a state that has withdrawn from the EU can ask to rejoin, subject to the procedure in Article 49. Article 49 outlines the criteria for entry into the EU, specifically to a set of “values” specified in Article 2. Clicking around the many Articles of the treaty felt like being on a Wikipedia page where you are constantly enticed to more linked articles on related facts.

Clicking around within Wikipedia may broaden one’s knowledge on specific sectors and being able to quote from the Lisbon Treaty may impress new acquaintances over a dinner event. But the more I talked about Brexit, the more I came to the conclusion that I had just wasted a weekend learning about all the possible ramifications for investors. There are far more useful or entertaining things to spend one’s shrinking memory capacity on than EU treaties.

Following all the analyses by the world’s brightest minds, as well as some far less bright commentaries, the conclusions were overwhelmingly bearish for investors. Just two days later equity markets started doing the unthinkable: They rallied and recovered all the Brexit-included losses. Other than a 10 per cent drop in the pound sterling’s value, a week later it is as if nothing happened.

Post-Brexit

So that you can avoid reading any other opinion pieces on the subject and devote your time to more worthwhile endeavours, below is a brief summary of what you need to know.

i) The consensus is extremely bearish for the UK’s outlook, the pound sterling’s exchange rate, as well as global equities. As we know, extreme consensus is usually wrong and investors who aligned themselves with this portfolio positioning post-Brexit are already losing out.

ii) The procedure for the UK to leave the EU is full of uncertainty. We are not even sure if Brexit will actually occur, since the referendum is non-binding and UK politics has been thrown into disarray without a government able to trigger Article 50. Any opinions on what will happen are pure speculation and no basis for making investment decisions. If Brexit should actually proceed, investors are underestimating the benefits that an immediate 10 per cent fall in a country’s currency has on the economy, especially an economy that is primarily export oriented.

iii) As we have written for years, the EU construct is unsustainable in its current form. The year-ago consensus to go long European equities and hedge the euro was wrong, as European equities have underperformed significantly and the currency has not collapsed as expected. The economic stagnation will either lead to a break-up of the EU, or significant reform paving the way to a more sustainable union.

It is interesting now that post-Brexit former European equity bulls are rushing to downgrade the continent’s outlook. Consensus has now shifted to much higher risks for an EU break-up. In reality, the European Central Bank’s (ECB) actions over the last year to effectively monetise and backstop each country’s debt have actually addressed one of the biggest problems to the EU’s longevity, the lack of fiscal union. The last step would be the ECB issuing its own debt, another momentous event that would cement the fiscal union and is far more likely to happen in the near future.

In this respect Brexit may well be the silver lining that kick-starts EU reform, rather than the spark that causes a break-up. We have been eurosceptics for a long time and the markets are finally coming around to this view. However in reality it looks like the risks of an EU break-up are lower today than they were a few years ago.

iv) Other than a number of UK-specific sectors, the longer-term impact of Brexit to global investors is zero. Many investors will find it difficult to accept this now, but just think back to how the Greek default captivated investors five years ago, and how nobody pays attention to continued stress on the Greek economy now. In a few years’ time Brexit will be another “crisis” memory that has passed.

v) My last point is not specifically about Brexit, but about financial and economic shocks in general. While more philosophical in nature, it is probably the most important point in this list.

Every couple of years a crisis event happens somewhere in the world. Some have a limited impact such as the 2014 Ukraine crisis, some have a much bigger global impact such as China’s 2015 yuan devaluation, or the 2008 US sub-prime crisis. All of which will pass and be annexed to the history books. The only certainty investors have is that these crisis events will continue to happen.

The world is inherently unstable and most of these events will be unexpected. Offsetting the volatility from these repeated crisis events are the fantastic advances that are being made. A century’s worth of progress has been made in the last 15 years. Human progress is growing exponentially and another century’s worth of progress will be made in the next 10 years. We will soon get to a point where a century’s worth of progress is made in a single year, instead of 10.

The more an investor researches these advances, especially in technology and biotechnology, the more it becomes difficult to be anything but extremely bullish about the future. Whether Donald Trump becomes the next US president will not affect this pace of progress. All future crisis events will at most only temporarily pause this march forward. Even a big crisis such as an EU break-up that plunges the world into a global recession is calamitous, but one that will also eventually pass.

In an era where most people assume stock market returns will be lower going forward and investors are filled with fear and self-doubt from all this negativity, just consider the possibility that future returns might actually be higher from all the advances we are making. 

AL Wealth Partners is an independent Singapore-based company providing fund management and advisory services to accredited investors

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