



# Brexitttt!!

(and other Political, Market-moving Nonsense)

John M. Gustafson – 3 July 2016

*I am quite sure now that often, very often, in matters concerning religion and politics a man's reasoning powers are not above the monkey's. – Mark Twain, September 1907*

In just a few weeks (July 20<sup>th</sup> to be exact), we will cross Palmetto Wealth Management's 7<sup>th</sup> anniversary. Also at that time, was the start of my writing career, hammering out these notes on at least a quarterly-basis. The one constant through all those years has been ridiculous political theater causing market-turmoil – well, buckle up my friends, because this one won't be much different.

One positive, tongue-in-cheek sign for the US was best summarized in a headline I saw the day of the Brexit vote, trumpeted by *The New Yorker* magazine. It stated simply, "British Lose Right to Claim that Americans are Dumber." Not since our very own House of Representatives openly contemplated not paying America's bills several summers ago, causing utter chaos across the global markets, have I seen something this ridiculous.

The good news that I pointed out on my quick note the Friday morning after the vote is that it is truly not a binding referendum requiring immediate action, as the Scottish exit vote was last summer. Once everyone was able to catch their breath and realize nothing would change in the very near future, markets recovered just about everything that had been lost in the immediate aftermath over ensuing few days.

There was an immediate public outcry across the UK for a "do-over" but that seems relatively unlikely. And, there really is no guarantee that you would come out with a different result. Every bit of marketing that went into the "remain" campaign focused solely on the economics of being in the EU – and every bit of marketing that went to "leave" campaign focuses on uncontrolled immigration costing jobs and almost guaranteeing further tax increases for British citizens. Sound familiar?

In reality, they are not actually mutually exclusive arguments / discussion – immigration and economics for locals. In fact, *The Washington Post* illustrated perfectly what's occurring in Europe and also right here in America in an article titled, "The World's Losers are Revolting." In

the report they go into great detail demonstrating how globalization helps both the very wealthy and also the very poor, but the people who reap the least benefit and bare most of the economic brunt are those in the middle to upper-middle class.

They encapsulated this theory in a very telling graphic (one I wish I could reproduce here, but I don't want to run afoul of copyright laws) that basically showed the top 1% gain as much as those from the 50<sup>th</sup> percentile and below in terms of improved income and wealth – on a percentage basis. Whereas those from the 75<sup>th</sup> percentile to the 95<sup>th</sup> percentile barely changed at all - in fact, their perceived quality of life had been greatly reduced caused by the ever-growing tax burden and demand for domestic services in their home countries as the lower classes migrated toward opportunity.

It is also why I made the comment in that early Friday note that the staff at high levels in the Clinton campaign should be made quite nervous by the Brexit result. The Brits who voted to leave are the same people in America who like the sound of the slogan “Make America Great Again.” Believe me... ;)

To dig a little deeper in the uniqueness of the British / European Union problems, I'd like to share a few notes from former Prime Minister Tony Blair who spoke on a conference call I was fortunate to listen in on, hosted by J.P. Morgan. PM Blair discussed how the EU was originally formed after World War II to actually keep peace and reduce individual, sovereign power after a bad experience with a couple of very nationalistic countries. Unfortunately, those are all nation-states with their own culture and history, and of course not simply “states” within the same country as we have here in the U.S. Lord knows that the culture of Massachusetts vs Alabama vs Utah vs California are all completely different, but we have all always been “American.” Being “European” is somewhat new culturally and the repressed nationalism is bubbling back to the surface as globalism encroaches. (The Brits aren't the only unhappy lot in the EU.)

The central problem may have been the formation of the Euro, making a central currency and economy on top of a populace and governments that may not have been ready. I'm a little surprised that it is lasted this long, as some of you may recall a facetious eulogy I wrote for the Euro several years ago when Portugal, Italy Greece & Spain (PIGS) were starting to show some signs of wear and bucking against a more Germanic sense of fiscal responsibility imposed upon them from Brussels. This clearly outlined how difficult a central currency without a central economy, or at least control of that central economy, can become. (Too many cooks, so to speak...)

Here is what I wrote in August of 2011 – a fictitious, speculative press release from Brussels:

“We were wrong – we can have special political and business affiliations going forward, but running 17 economies, with vastly different local traditions, policies, and cultures under one currency simply doesn't work. We are beginning today to plan for the slow wind-down of the Euro currency over the next five years and the return of our native monetary systems. Our

political affiliations and cross-border commerce & immigration agreements remain fully supported and in place – but each country will now be allowed to enact policy specific to the economic conditions – and risk / austerity / work appetites appropriate to each sovereign nation’s populace.”

Interesting that the economies mostly recovered but the other agreements are what seem to be pushing everyone apart at this point. There looks to be a standoff right now where the politicians in Brussels want the UK to immediately and officially declare their desire to leave the Union, but having seen the immediate chaos unleashed, the British would like to have some agreements in place prior to leaving. It will be interesting to speculate over the next six months to see who blinks first and also to learn if the French and other countries move forward with their newly-stated desire to leave. If that happens, my obituary for the euro will certainly come true. Right now it appears that Brexit is probably bad for Britain in the near term but not as much of a problem for America. We can negotiate a great trade deal with our close friends in Great Britain and still maintain good relations across the continent. Stay tuned...

Now back to the disastrous Presidential election in the United States and its effect on our markets. I have to admit I’m surprised... Back in January I opined that if folks were tired of negative campaigning and all the ugliness that was going on during the primaries, the two best candidates, who would be forced to actually discuss the issues, would be Trump and Clinton. Well, for those of you who don’t live in a swing state like OH, I can tell you that even though there isn’t much new that the public hasn’t heard with either one of these folks, the ad buyers are certainly trying to test that theory - both sides are engaged in a race to the bottom.

As you can imagine, both have been in the public eye long enough that footage exists of them espousing both sides of an issue years apart. Because remember, nobody in politics is ever allowed to change his or her opinion – even after decades and mounds of new evidence presented to the contrary. Sophisticated, out-of-context editing makes for some pretty ugly ads.

At this point, nothing I’ve seen in the markets appears to be leaning one way or the other in terms of who would be better or worse for the economy. The bullhorn message on both sides of the aisle is that the other will be dangerous. One thing that hasn’t changed in American politics is that both sides seem to be talking about two completely different countries, neither of them good, but both containing a set of problems only “I” can fix for “You.” With very few specifics – and complete disregard as to how difficult anything will be to get through the Senate and the House, regardless of who is in control. Both teams have learned to play on the minority side as obstructionists quite well over the past two decades.

Another flashback from one of these notes is from the summer prior to the 2012 election. The GOP strategy was that Obama was un-American and dangerous – a similar theme to the 2004 Democratic campaign against W; and as I stated back then, it didn’t work in 2004 and it’s not going to work in 2012. I think that may be why there seems to be general dismay in the current

situation, because neither candidate has come out strongly and stated “here’s what we’re going to do and what you can vote *for*.” They’re too busy continuing to throw bombs against their opponent’s past. As previously emphasized, people vote “for” something they like in elections, not “against” things they don’t. In those cases they simply stay home... (Probably a death blow for The Donald, as he needs the populists to be excited and come to the polls.)

Personally, until both candidates officially have the nomination at Convention and have named a running mate I don’t think any of the current polls are worth a tinker’s dam. Even after the conventions, they are probably still worthless until the first face-to-face debate, *that* is when the real race will begin. As Terrell Owens once famously exclaimed, “Getcha popcorn ready!”

Economically speaking, the US continues to grind forward in an ultralow rate environment. And regardless of the Brexit result I do expect the Fed to tighten by one more quarter-point sometime this year. If they don’t do it by September, I wouldn’t expect anything until December, as they truly don’t want to appear political one way or the other. The fact is, near term hardship for the British may actually benefit America. We certainly saw a huge surge in the dollar that hasn’t completely abated and we’re a nation of consumers via cheap imports as sad as that may be.

Over the next few weeks our Core Global Model will be evaluated to look for exposures that may be uncomfortable based on how the negotiations between Great Britain and the EU move forward, as well as what might be poorly affected by our elections. Nothing stands out as dangerous based on the last 10 days of incredible volatility, but nothing looks like a tremendous opportunity at this point either.

It was a good lesson and a reminder of a favorite old Wall Street saying that I’m sure many of you heard me use in the past, “When things get bad, when everything’s in doubt... Run in circles - scream & shout!” In other words, panic never consistently makes anyone money, so go do something else during the worst of it. I’ll keep an eye on things for you.

Finally, since I began with Mr. Clemens and politics, I should like to end with him as well...

*“In religion and politics people’s beliefs and convictions are in almost every case gotten at second-hand, and without examination, from authorities who have not themselves examined the questions at issue but have taken them at second-hand from other non-examiners, whose opinions about them were not worth a brass farthing.” – Mark Twain, July 1908*

Thank you for your business, ping me with questions - here’s to a great and interesting remainder of the year. Cheers!

A handwritten signature in black ink, appearing to read "J.M. Gustaf". The signature is fluid and cursive, with a large initial "J" and "M" and a distinct "Gustaf" at the end.