# Weekly Market Flash

## Tempest in a (British) Teapot

***June 17, 2016***

One week from today we will (probably) know the answer to the Big Question: Are they in or are they out? Britain votes on the future of its relationship with the European Union on June 23, deciding whether it wants to continue to be part of an organization it joined in 1973. While the vote is technically a referendum, not a binding obligation with legal force, a Leave vote would likely require the government to set the wheels in motion for a proposed exit within a two-year time frame. What the terms of any actual deal would look like remains unclear, despite the impression created by much handwringing this week that the economic pain of a Brexit is precisely quantifiable.

Most of the conversations we have had with clients over the past several weeks have, understandably, homed in on the practical implications of Brexit for their portfolios. From our standpoint, the playbook ahead of June 23 is very much in line with our usual advice about event-driven market movements, which is to say do nothing. Make no mistake, if the Leave vote prevails next week there is a very good chance of an immediate volatility spike in asset markets. Much of that volatility would likely be concentrated in ground zero exposures like the FTSE 100 stock index and the British pound, which could see double digit declines, but risk asset markets worldwide would be vulnerable.

The reason we advise our clients to do nothing in situations like this is that, far more often than not, the tempest surrounding the actual event blows over rather quickly. The volatility is driven mostly by short-term money positioned one way or another before the event and algorithms wired to react immediately upon the outcome being known. That flurry of activity will settle down as the winners lock in their gains and the losers bite the bullet on pain trades to cut their losses. Markets will then adjust over time as investors assess the practical implications of Britain outside the EU for the future cash flow generation potential of the companies in which they invest.

Here is one practical example of what we mean by separating the short-term tempest from the longer term market adjustment to new information. Much has been made this week of the spike in volatility for the pound sterling, with commentators noting that the risk spike is higher than anything seen since the 2008 market crash. But an excellent article in Bloomberg carefully points out what other pieces have glossed over: the volatility spike relates only to what traders expect in the next 30 days. In other words, while 30-day futures for the pound sterling are more volatile than those for the Russian rouble or Hungarian forint, one-year sterling futures are virtually unchanged. The market for sterling futures today is a textbook definition of an event tempest: rough seas today, calmness further ahead.

None of this is to say that Britain's leaving the EU would be unimportant, or have no implications down the line. We are of the opinion that the Leave arguments are largely misguided and shaped more by emotion and fear than by real facts. To that end, our longer-term concern is less about how Britain finds its economic footing outside the EU, and more about how Brexit is part and parcel of a larger global trend – a backlash against trade and globalization in general that seeks refuge in – depending on where in the world one happens to be – appeals to nationalism, authoritarianism and populism. Such sentiments swirl about in locations from Peoria to Paris to the Philippines.

But trying to put a specific price on anything as vague and variable as anti-globalism is a fool's errand. In a very practical sense we are not prepared to adjust our strategic allocation targets to various asset classes on the basis of events that may or may not transpire. Sometime in the future economic historians may look back at June 2016 as an important milestone towards a new world of less trade and weaker economies. Alternatively, they may write that the populist anger of this age finally forced global elites to wake up and meaningfully address key imbalances and inequalities feeding that anger. Either way, we will follow the same approach as always: evaluate the data as they come in and let the data, not ill-defined emotions, drive our ongoing portfolio decisions.

***Masood Vojdani***
*President & CEO*

***Katrina Lamb, CFA***
*Head of Investment Strategy & Research*

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