Weekly Market Flash

The Limits of Crazy

September 6, 2019

Anyone can talk the crazy. Actually getting the crazy done, it seems, is a great deal harder. That is the lesson we take away from this week's theater of the absurd unfolding in the United Kingdom, as the Grendel monster that is Brexit consumes all the time and energy of the best minds (and otherwise) that reside in the halls of Westminster.

We have brought up the subject of Brexit before in our commentaries this year (including our putting forth the prediction in our Annual Outlook back in January that it won't ever happen, the probability of which prediction we would argue has trended back above 50/50 after this week's goings-on). We return to the subject this week not just because it is a prominent part of the news cycle, but because it illustrates the limits of turning crazy talk into crazy action. That, in turn, holds a lesson for how to approach portfolio decisions in these odd times.

Three Years and Counting

The Brexit referendum, you will recall, happened three years and three months ago, smack in the middle of the watershed year of 2016. The outcome was narrow – 53 percent in favor of leaving the EU versus 47 percent who wanted to remain. Among those voting to leave were, certainly, loyal subjects of the Queen who genuinely loathed the European project and pined for the old glories of Britannia, ruler of the waves. There were others less avid who bought into some of the arguments (with varying levels of relationship to the truth) about the benefits to leaving outweighing the costs of the same.

Altogether they made up slightly more than half of the citizenry. "The People" – that shopworn rhetorical prop PM Boris Johnson employs in his efforts to justify a quick handing over the exit papers to be done with it – never did speak with anything close to one voice. As the logistical complexities of actually pulling off this feat grew in non-linear fashion, not least from that seemingly implacable deal-killer called the Irish backstop that took down Theresa May's reign as PM, the voice became ever less unitary.

That's why, more than three years after the referendum and even with Leave's most vociferous champion occupying 10 Downing Street, the most likely state of things come October 31 – the deadline for Brexit that superseded the previous April 2019 reckoning that followed the original March '19 deadline mandated by Article 50 – is that Britain will still be in the EU and there will be another "deadline" at some yet-unknown time most likely next year.

How that ultimately gets resolved will depend largely on domestic politics, with a new set of elections in the near term being a highly likely scenario. What is clear from this week's parliamentary maneuverings, though, is that the appetite for a hard crash-out from the EU – which would be the only non-delay outcome since a deal acceptable to all parties appears impossible – is something for which enough parliamentarians both within and without the Tory Party have zero appetite.

For Country and Portfolio

The "Tory rebels" – the 21 members of the ruling Conservative Party who broke ranks this week to legislate against a hard no-deal Brexit – clearly put something ahead of party-first, narrow short-term political considerations this week. That's a noteworthy outcome given how rarely it occurs these days. But if not party first, then what first? It would be nice to imagine something uplifting like a genuine-patriotic belief in country first – a noble attempt to forge a grand coalition in the interests of a genuine (as opposed to Oxford Union-esque soapbox theatrics) respect for the diverse wishes of "the people."

The reality, though, is probably somewhat more basic and grounded. A no-deal Brexit would very likely have very real and lasting consequences, not least on the economic and financial well-being of those 21 Tory rebels and their newfound colleagues in the opposition parties. Scenarios run earlier this year by the Bank of England spell out very tangible potential outcomes taking place from the first days of a hard Brexit, including food shortages, supply chain disruptions and lack of access to medical supplies. Never mind the potential body blows delivered to the pound sterling, UK equities and the like. "Portfolio first" may not be much of an inspirational rallying cry, but it is a perfectly reasonable motivation to stop the crazy from actually happening.

Which brings us to the investment lesson we learn from this week's chapter in Brexit: don't assume that crazy stuff is going to happen just because people (even people with considerable amounts of power!) are talking about crazy stuff. The road from talk to action is long, twisty and paved with obstacles.

This applies to events with a broader global reach than Brexit – like the US – China trade war. Here there is a pattern as well, which has gone through several cycles since the first announcement of new tariffs back in the early weeks of 2018. The rhetoric gets dialed up, with announcements of new rounds of tariffs and other punitive measures. Markets go into a tizzy because billions of dollars are wired into trading algorithms primed to go off when the headlines turn nasty.

Then you get pacifying comments from both sides – yes, we're still talking, no, we're going to hold off on those new tariffs for now, yes, my worthy opponent is a fine man and so on. Those same algorithms digest 240 characters worth of niceties and buy back whatever they sold a couple days earlier. And so it goes, and goes, and goes. Nobody wants to be the one who actually takes the bridges-burned action that sparks a real, lasting global recession and bear market. Portfolio first, and status quo ante. Not particularly noble, but preferable to pushing the crazy beyond the boundaries of conversation.

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