How Brexit Could Cause Catastrophe

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Editor's note: As it's a bank holiday, we have something a little special for you today. This is the article Dan Denning wrote for Friday's Southbank Investment Daily. Usually only paid-up subscribers get the chance to read Southbank Investment Daily, so we hope you enjoy this peak behind the scenes.

If I were a member of the media establishment, I'd begin today's letter with a careful examination of what to expect from Federal Reserve chair Janet Yellen and European Central Bank president Mario Draghi. Neither of them has spoken yet at the central bank shindig in Wyoming. That happens later today.

But markets are so affected by what comes out of the mouths of central bankers that we've gotten in the habit of analysing what they say before they say it, then analysing what they've said, and then analysing the analysis of other analysts. What a giant waste of time.

Here's the abbreviated version: they'll say things are getting better but aren't great. They'll say they'd like to raise interest rates so they can cut them again in the next crisis. They'll say you can never see a bubble coming. And they'll say if any of the economic data changes, they're prepared to cut rates (or take them negative) and roll out another version of quantitative easing.

That's about it. From the British point of view, what comes out of Draghi's mouth will be more important. The pound is down against the dollar around 15% since last year's Brexit vote. But it's the euro strength I showed you yesterday that matters more. Why?

If there's never another problem with European banks, then the euro will likely rise to parity with the pound. Brexit uncertainty will drag on the pound while giving a little tailwind to those UK companies who can increase exports with the help of the cheaper currency. The UK's reputation as a "safe haven" financial centre will slowly crumble like an old castle. Britain will become a dilapidated economic "has been".

Or there *will* be another European crisis at some point. The attempt to create a Federal European Super State by forcing economic and currency integration will generate enough political backlash that the whole thing will lose momentum and fall apart. At that point, Britain's decision to leave the EU and re-engage with the rest of the world will look like a good decision.

Time to go

It's a big bad world out there, though. And just because you have the opportunity to succeed in trading with the rest of the world doesn't mean you will. But I've talked to hundreds of investors and businesspeople in the last two years. The vast majority of them are willing to take their chances that the UK can compete and thrive with the rest of the world (as it always has).

Charlie Morris took that view when he wrote a MoneyWeek story coming out for Brexit in late 2015. The title was "Time to Go". Charlie studied the issue privately for a long time. And then he made the case that economically *and* politically, it would be better for Britain to leave the European Union.

Note I said "leave the European Union" and not "leave Europe". You can't change maps. The British Isles aren't going anywhere (at least not anytime soon, given the pace of plate tectonics). But Charlie reckoned Britain could trade with the EU, the US, China, Africa and all the far-flung places of the world… if it simply made that choice. And so it has.

But that is all in the past. And that brings me back to a point I made yesterday which several readers commented on. Ordinary people – and by ordinary people I mean those outside the echo chamber of social media, the establishment media, the political and financial elite, and academics – have already moved on. They are not terribly fussed about the post-Brexit future (or the Donald Trump present in the US).

Opinion makers and media types have certainly worked themselves into a state. They've managed to convince themselves that Brexit can still be stopped; that Trump will be impeached; and that for their own good, the "great unwashed" who don't understand complicated things can be bullied and workshopped into compliance. Also that elections and/or referendum results don't really matter.

Once you unplug from all the chattering – a move I strongly recommend – life resumes as normal. But just how heated and contentious will things get in the next two years? And given that we're told financial markets hate "uncertainty", how should you invest?

That last question is one where I step aside and leave it to the experts like Charlie. A multi-asset portfolio (like Charlie has set up with Whisky and Soda) gives you a chance to make money from stocks, bonds, commodities, real estate and even bitcoin (if Charlie is right that what's emerging is a new digital asset class).

Another point on what Charlie's done: he's encouraged *The Fleet Street Letter* readers to look outside the UK. In some cases, that means UK companies who derive their earnings from overseas growth. It's an important point because most investors (no matter what country you're looking at) have a home country bias. They tend to be overinvested in stocks and bonds from their own country and miss out on other opportunities as a result.

Charlie's job as investment director is to find the best global opportunities and then find an easy way for you to invest. He told me when we started that his goal was for every single recommendation to be available through an account at Hargreaves Lansdowne. While the strategy may sound complicated (it's professional-level portfolio advice for individual investors) it's not actually hard to implement.

The biggest barrier to putting Charlie's advice work is actually getting it! So I'll remind you one last time this week that as of 31 August, the price of *The Fleet Street Letter* is going up. If you want to lock in the low price, you better do so soon.

Reader mail

It's Friday. Shall we hit the mail bag? Let's! Yesterday I mentioned I'm ing to the US for an extended period of time. I asked you whether it was a good time. Or whether the impression of events we get from the media echo chamber is accurate. Here's what you said…

> *Hi Dan,*
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> *Have spent one week of two here. Las Vegas and San Francisco so far. Points to make.*
>
> 1. *Seems to me that there is significant media amplification, made worse by social media, that is distorting the reality.*
> 2. *There is a vocal minority on either side of the argument.*
> 3. *Ordinary people we have spoken with do not appear to be overly concerned.*
> 4. *It may well be that still waters run deep and that there is a hidden resolve. There seems to be much support for Trump's position.*
>
> *Seems to me there is a danger of creating a self-fulfilling prediction driven by vested minority interests.*
>
> *Stephen M.*

Sounds about right to me. What's that saying… the emptiest vessel makes the loudest noise. The noise levels are off the charts right now, politically speaking. But as with investing, pay attention to the signal, not the noise.

> *Dan,*
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> *As with the UK, the USA has developed into a war between makers and takers with the very rich and internationally mobile (Branson, movie stars etc.) taking advantage, as if celebrity status gives you power over hard working tax payers that are weary carrying the weight of public sector workers, criminals, illegal immigrants, career benefit claimants, a myriad of minority groups and socialist lovies, all of which are wreckers when not holding power. This is a war we cannot afford to lose.*
>
> *Bryan W.*

Only really affluent societies can afford to be so wasteful, and only for so long. When you forgot the personal values and habits that produce wealth and opportunity, you are on the road to ruin. We're pretty far down that road. Here's another note…

Dan,

At some future stage, the long-standing Greek debt crisis will explode and probably finish the EU. The euro will then tank and suddenly no-one will want to be long of European equities. As Europe is by far Japan's largest export market, the yen will also be hit and there'll be a flight of capital intro the good old dollar and U.S equities in general. Therefore, the recent trend of dollar weakness and euro strength will be reversed and the seemingly endless bull market in American equities will continue for several more years.

A recent report on global institutional liquidity suggested this to be c$115trn equal to nearly 50% of world GDP – source CrossBorder Capital – and with the likes of Apple, Alphabet, GE, Microsoft and Berkshire Hathaway chipping in a further c$0.5trn via balance sheet cash deposits, there's plenty of ammunition for further upside, especially as, ex energy, earnings growth prospects are looking very positive especially for those companies exposed to A.I, robotics and the IoE (everything).

Greece may, of course, stagger on for longer than everyone expects – Charlie Morris told me recently that its economy had improved somewhat – but for me personally, I wouldn't want to be holding this particular baby when the music does stop. For the medium/longer term, it must still be U.S equities with U.K stocks and those in some other territories like India caught up in the slipstream.

Regards,

Richard T.

That's a good summary. If it's just a question of a fixed amount of liquidity sloshing between preferred and relatively safe asset classes, then the really nasty crises of the past tell you that US and UK government bonds and the dollar and sterling are still the place the rest of the world runs to. Is that changing? Maybe. The other and more neglected scenario is when liquidity disappears and value is destroyed.

Dan,

They (the Americans) need the steadying influence of British Colonial rule, then all will be well.

Kind Regards,

Mick S.

Hmmm. My feelings on this matter are mixed. I'm an American by birth. I became an Australian citizen (and thereby a Commonwealth citizen) after living in Melbourne for nearly ten years. Australia is an interesting mix of both the US and the UK. It has deep cultural ties to the Empire. But in terms of social and economic mobility, it feels a lot more like the US to me. The upside of social mobility is that people can (or believe they can) improve their lives and not face the barriers of birth, class or accent (ahem). The trade-off is the instability of the social order. Britons, at least at the top of the social order, seem to venerate (or at least are desperate to defend) this order by extolling its virtues (it keeps people in their place).

Do not fret, Daniel. The Americans do hysteria better than everyone! Just avoid Detroit and similar others.

Kind regards,

Colin S.

Cheers for that Colin. I'm visiting New York City for a few days and the off to Raleigh, North Carolina (where I have family.) After that I'm going to begin looking for a house to buy in Colorado or somewhere in the four corners area of the US. It's one of the prettiest parts of the country, if you ask me. It has more mountains and fewer people than London. Both are good in their own way, of course.

Until next time!

Dan Denning
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