Weekly Commentary **June 24, 2016**

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Brexit Shock: Implications

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Wow! Did the pollsters – and the markets – get this wrong! Last night before the votes were counted, Ladbrokes was offering between 3 to 1 and 4 to 1 that Britain would "Remain" and the markets hardily agreed. As the polls closed, influential exit pollsters called it a 52-48 Remain vote. Instead it was 52-48 Leave vote. Of interest is that that 4 point swing is the exact margin by which Trump trails Clinton in the US presidential polls. Trump supporters and Brexiters share very similar views: strongly anti-immigrant, anti-establishment, anti-elite, anti-expert, and anti-globalization. If the undercounting of the "antis" in the US follows Britain, we are in a dead heat right now for the Presidency. I still think Clinton will win in November – and win handily – but yesterday's UK vote is food for thought.

Market reaction is as expected: the pound plummeted and the dollar soared except against the "risk-off" yen. Equities and oil swooned and gold rose . Of course, yields on sovereign debt around the world plunged; the markets now say it is unlikely the Fed will raise rates *any* time this year. The Jan 2017 Fed funds rate is trading at 36 bps, less than the midpoint of the current target range. The US ten year dropped to 1.40% in the early morning hours, only 1 bp above its all-time low of 1.39 reached in 2012, before Bernanke's tapering comments convinced traders (wrongly) that low yields were over. I think there is a lot of overreaction here and markets are very likely to reverse many of these moves, but traders will remain cautious, especially ahead of the weekend.

The yen soared overnight, at one point dropping below 100, but there is no way the Japanese policymakers will let it stay there. For long-term investors this is a good entry point for Japanese stocks, but only on a yen-hedged basis. Abe has no hope of meeting his economic goals with the yen so strong and we can expect another round of Japanese QE. The UK equity market is down only 4%, trading above where it was just a week ago while the European markets in France, Germany, and especially Italy have taken much bigger hits. This is because the pound is down 7.7%, about 5% more than the Euro against the dollar, causing dollar investors in UK stocks to be down 11%, on par with continental Europe. I think European are very good values now, selling for an average of 12 times this year's earnings.

The Brexit vote is a revolt against centralization as much as globalization. Voters said I am willing to trade with my neighbors, but I want to control my borders and my destiny. This is not an economic disaster.
