

Convexity Maven

A Commentary by Harley Bassman

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"Family Feud"



While I cannot claim to be an expert on marriage, after all, I only have a sample size of one, I do think I can make some proper summary comments after 28 years, four children, two dogs and one rat (please don't ask).

Families have fights, sometimes a bit rough; and words are sometimes said that are regrettable in the cold light of day. But most times it's "kiss and make up" instead of a trip to the divorce court as cooler heads prevail after good night's sleep.

As such, despite the volatile gyrations in most financial risk vectors I would suggest that it is quite possible the recent Brexit vote makes a trip down the memory hole in the not too distant future; quite similar to my last family tussle (which frankly I cannot recall).

Protestations by the Brexiters to the contrary, the United Kingdom and Europe are a family by almost any measure. The Spanish Philip II was concurrently the King of England, Ireland and Spain as a consequence of his marriage to Queen Mary I in the 1556. Most recently, the current Queen Elizabeth II linked Britain to Europe via matrimony in 1947 upon her union with Philip Mountbatten, who was required to renounce his ties to the Royal Families of Denmark and Greece.

If the IRS had a global reach, it might deny a tax deduction to the EU as Britain certainly has a significant degree of economic dependency. Over the past few years nearly half of all UK trade crosses an EU border.

Despite garnering a slight majority, it is unclear that there is actually an overwhelming appetite to separate. While the overall turnout was high at 72%, a “leave” vote of barely 52% implies that only 37% of registered voters had the motivation to vote for a separation. And this ignores the rabbit hole of how it came to pass that only a one time simple majority was required for such a consequential decision; the US requires a 67% approval of the legislature and 75% majority of the states to amend the constitution.

On the political front, nearly every MP has their hands in their pockets as no one seems eager to execute Article 50 to officially commence the process of separation. To this end, it may not have been a coincidence that this plebiscite was non-binding since it now seems clear that no one in the political class was actually in favor of a Brexit. (Does “The Wall” sound familiar?)

With the price of both petrol and Carling now 13% higher than last week, it is likely that some of the Brexit voters are having second thoughts, especially since the cost of beer at the pub is real while the fear of immigration is more theoretical. At a higher level, despite the insinuation that the EU might want to punish the UK, this is all puffery. Britain has a significant trade deficit with the EU, consequently it is in their interest to keep the UK economy healthy and well-linked to the EU.

As I am fond of saying, it is never different this time and hubris is still a prevailing human frailty; so don’t expect the pundits of Brexit to jump in front of a camera to reverse their previous statements. But I think it’s better than a coin-flip that under the umbrella of fervid online petitions and various accounts of regret in the heartland, the political class will unify behind a strategy to create a hurdle steeper than a single referendum before Article 50 is engaged.

Needed: Stiff Upper Lip

Friday’s washout in global markets cost investors dearly, but also created bargains.

Country	Friday Close	Friday Change	Weekly Change	YTD Change	Market P/E 2016	Dividend Yield	Domestic Exposure
U.S. (S&P 500)	2037.30	-3.6%	-1.6%	-0.3%	17.3	2.2%	70.0%
Euro Stoxx 50	2776.09	-8.6	-2.6	-15.0	12.9	4.4	49.0
U.K. (FTSE)	6138.69	-3.2	2.0	-1.7	16.7	4.5	35.5
Germany (DAX)	9557.16	-6.8	-0.8	-11.0	12.1	3.2	27.6
Japan (TOPIX)	1204.48	-7.3	-3.7	-22.2	12.2	2.4	58.0

Sources: Bloomberg; Morgan Stanley

Families fight, that is the nature of a strong emotional bond; but what is now Britain has been part of Europe since the Anglo-Saxons migrated across the channel in the 5th Century. It is doubtful that this successful family will permanently rupture.

Investment Implications: I still like diversified EU Equities and high-quality risk assets (despite being dead wrong to date).

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