CUMBERLAND

Britain Votes to Exit the E.U.

On Thursday, the UK, in a surprise vote, decided to exit the European Union.

On Friday, the global stock markets, not surprisingly, decided to discount the worst possible conclusion.

So, what does this mean and why did Britain decide to leave?

Simplistically, this was a case of national identity versus economic consequences. The "leave camp" was simply fed up with regulations being made and imposed on Britain by unelected politicians in Brussels. Meanwhile, the "stay camp" focused on the economic consequences of a departure.

How this all sorts out is still far from certain which traditionally causes investors to anticipate the worst. But before joining that crowd, let's look at what we do know and can anticipate.

The ability of a country to leave the EU is contained in Article 50, a 261 word section of the Lisbon Treaty. As we understand it, this article won't be evoked until Prime Minister Cameron steps down in October. Until then nothing will change. Article 50 states that the Union shall negotiate and conclude an agreement with the state, setting out the arrangement for its withdrawal, taking into account the framework for its future relative to the Union.

It further states that the agreement will cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification unless the European Council, in agreement with the member state concerned, unanimously decides to extend the period.

Germany would like to see an orderly transition that could last beyond two years and could involve negotiations pre the notice.

However, a Brussels Consensus recommends that the UK must be made an example for leaving to discourage others.

Until the departure treaty is signed, which requires assent from Britain and a majority of the remaining 27 states weighted by population. Until then Brits remain EU citizens and business continues as before.

So there is not likely to be any immediate economic fall-out. Consequently, the reaction we're seeing in the market is in anticipation of what is to come and most of those assumptions are broad generalizations.

So what can we assume?

1. This probably takes a Federal Reserve interest rate hike off the table for the balance of the year.
2. Scotland and Ireland now have an issue. Two thirds of Scots wanted to stay in the EU so another separation referendum could be coming.
3. There is the potential for contagion as there are separatist moments already in place in Spain, France, Portugal and Italy.
   On balance this is part of a global move to more protectionism and nationalistic interests not specific to just Europe. Consider Presidential candidate Trump's campaign against immigration.
4. Initially, a weaker Pound and Euro resulting in a strong US dollar and Yen will be negative for those economies. It also hurts S&P 500 earnings due to the large exposure those companies have to foreign markets. Lower earnings in an already highly valued market will be one of the greater consequences for investors.
5. A pause in globalization cannot be good for global GDP, the magnitude of which is yet to be determined.

Conclusion

Over the coming days we will have a clearer understanding of the consequences of Britain leaving the E.U. In the meantime, we know a couple of things from experience.

First, this isn't a financial event. No bank is going broke and we are not facing insolvencies. It is a political event that will have global impact but mostly in Europe. Second, we know that generalized reactions like this usually result in financially unaffected companies being discounted unfairly along with the market.

At the end of the day, there will be winners and losers while right now everyone is discounting the worst. So opportunities will be created.

GRC/amh
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