



Market Update

Looming Brexit vote and the U.S. election spoof the markets!

Is this the most divisive U.S. political election since 1912?

By Bruce VonCannon

May 31, 2016

The Voice for Reason

Comments and Views for the Individual Investor

(May 31, 2016)- The great American author and humorist, Mark Twain, was once quoted as saying “History doesn’t repeat itself, but it does rhyme.”

Evidence that his logic is not entirely wrong seems obvious as we approach two key events this year that will have significant impact on the world economy for years to come. Looming ahead of us in the coming month is the Brexit vote. On June 23rd the citizens of the United Kingdom will vote on whether or not to remain in the European Union. The outcome of this vote will have significant impact not only on Europe but perhaps on the global economy.

The arguments for the U.K. “staying in” or for opting to “withdraw” have been cleverly presented by politicians on both sides of the issue. Current opinion polls on the outcome of the British vote give a slight advantage to those who favor staying in the European Union.

However, should the vote outcome result in the U.K.’s voluntary withdrawal from the European Union, then investors should expect the possibility of noticeable impact in the FX markets. Many analysts think a withdrawal would force the British Sterling lower on currency markets. Also U.K. companies who currently export to Europe and enjoy favorable EU tariff treatment, particularly automobile companies, might face significant blowback if they withdraw from the EU. London is today one of the three most significant global financial centers along with New York and Hong Kong. A withdrawal from the EU, however, might affect how European companies feel about doing business in London. Frankfurt, Amsterdam, Paris, and London all have their own stock

markets and domestic financial centers to fall back upon if they decide to play a more continental European card in the future.

Clearly the out-of-control flow of immigrants from war torn Middle Eastern countries into continental Europe and into the U.K. has had a significant impact on how voters in Great Britain are feeling about the EU membership today. "Europe sans Frontieres (Europe without Borders), which seemed so fashionable 25 years ago after the fall of the Berlin Wall, now seems to be a liability that allows the influx of unwanted immigrants, poses enhance risk to terrorism, and results in added pressures on educational and social services in country.

The second event this year that is looming and has potential for significant impact on the world economy is the U.S. election which will be held in November. This year is a general election year and the office of president, re-election of 33 of 100 U.S. Senate seats, and all 435 House of Representative seats in U.S. Congress will be contested along with the offices of Governor of most of the 50 U.S. states and their respective state assemblies. The presidential election will likely pit anti-establishment Republican nominee, Donald Trump, against the Democratic Party's presumption nominee, Hilary Clinton. While both candidates have their loyal supporters, both candidates have very high unfavorable ratings in political opinion polls, too. An socialist leaning candidate, Bernie Sanders, is running 2nd place to Hilary Clinton in her party primary and has also had a notable impact on the tone of the election. The election outcome will most likely be decided by a growing number of independent and unaffiliated voters in the middle.

More significant than the outcome of the presidential election will be how the races for U.S. Congress (Senate and House of Representatives) turn out. They approve the laws that govern the United States. At present, the Republican party enjoys a slight majority in the Senate (by 8 votes) and a more significant majority (by 59 votes) in the House of Representatives. A victory by Hilary Clinton will likely reverse the Republican majority in the U.S. Senate and could possibly reverse the Republican majority the U.S. House. The U.S. system of government, which prescribes a separation of powers between executive, legislative, and judicial wings of government also must address re-appointment of the judicial wing's Supreme Court judges when they die. Appointment of

these supreme court judges in the U.S. (an executive power) has impact on social issues in the U.S. in recent years such as abortion, gun control, and gay rights.

The anti-establishment sentiment sweeping across the United States this summer should not be underestimated. It has hit mainstream candidates from both radical left and radical right wing factions. Both parties have suffered from divisiveness within their parties, particularly the Republican side who are now faced with Donald Trump being their nominee. Many traditional Republicans outright reject Trump as a presidential candidate and have said they will not vote for him. For the Republicans this promises to be the most divisive election since 1912 when a split occurred in the party and ex-President Teddy Roosevelt ran against incumbent President Taft resulting in a victory by the Democratic nominee, Woodrow Wilson. This year in the U.S. even the tiny Libertarian party, who have chosen the former governors of New Mexico and

Election of 1912

			
William Howard Taft Republican	Woodrow Wilson Democrat	Teddy Roosevelt Progressive	Eugene V. Debs Socialist

The split between the Republicans opened the door for the Democratic candidate – Woodrow Wilson – to win the election.

Massachusetts as their President and Vice-Presidential candidates, is boasting it will come of age this year and emerge as a viable 3rd party alternative to Republican and Democratic candidates.

Where are the areas of biggest impact of these two events?

The potential impact on the global economy from the Brexit vote and the U.S. election appears to be chiefly in two areas: trade policy and immigration policy. This has shades of similarity with the protectionist policies and xenophobic sentiments occurring in several industrialized countries over 100 years ago. Looking back, one can argue forcefully that trade restrictions at that time further exacerbated (not alleviated) global economic imbalances and resulted in worsening economic times. Today the U.K. benefits enormously from the export of its products to continental Europe under the existing EU structure. An estimated 45% of its automobile exports flow into Europe. London also benefits enormously from its solid reputation for financial and accounting services to continental European countries. However, the xenophobic fears in Great Britain over immigrants flowing over into London and other cities from continental Europe has dominated the economic benefits of EU membership.

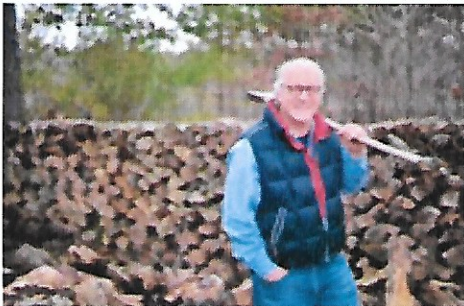
In the U.S. both candidates, Trump and Clinton, are likely to review the recently approved TPP treaty that the U.S. Congress endorsed last year which promotes free trade across Asia Pacific (ex-China). Trump has vowed to re-negotiate it. Clinton will likely be forced from within her own party to conduct a review of the treaty. A Trump presidency could be disastrous for TPP. A Clinton victory will likely see a continuation of TPP. On the immigration issue, Trump has threatened to build a wall between Mexico and the U.S.. Both Republicans and Democrats can fairly be criticized for how in the past they have used the immigration issue for political advantage. There are an estimated 25 million illegal immigrants in the United States. Many are hard working and perform menial jobs that many Americans will not do. The U.S. economy depends

greatly upon immigrant labor, particularly in the agribusiness sectors where seasonal workers pick the harvest. The great failing of the U.S. Congress has been their inability to formulate a comprehensive immigration bill that considers immigration more of an economic necessity rather than a tool for political advantage. Because even U.S. citizens themselves are not required to have a photo I.D., most of the illegal immigrants are not carrying a legitimate form of photo identification. Review of immigration policies that work —————like in Singapore or Hong Kong or Switzerland might be a welcome solution for the United States.

Investors should expect normal market fundamentals to be overshadowed by these two looming macro events in the coming months. Keeping a diverse investment portfolio that is designed for volatility and particularly with positions that have low correlation with the stock markets is advised.

Footnotes:

- i) Photo on cover page is of incoming U.S. President Woodrow Wilson and outgoing President William Howard Taft on Inauguration Day in January 1913 just two months after Taft's presidency had been sabotaged by Teddy Roosevelt's third party candidacy.
- ii) Photo on Page 4 is of the four main candidates who stood for President in the 1912 general election. Roosevelt had actually served as President (1901 to 1909) with Taft as his devoted Secretary of State. Their split in 1911 kept the Republican party out of power until after World War I.



About the author: