



Ten Reasons Why Brexit Isn't Worrisome

SYNOPSIS

- The media has fixated on the notion that the U.K. vote to leave the European Union will lead to imminent disaster.
- There are several reasons why this vote, for the time being, is simply not that big of a deal.
- The volatility that has ripped through world financial markets has created several opportunities for “discount shopping.”

WAY OVERBLOWN

Contrarian investing is so difficult because it requires one to love what other's hate and to exhibit tremendous patience during volatile times. Success is achieved by looking past the headlines and focusing more on the facts, alternative opinions, and data that expose short-term “mispricings” in markets.

Within this context, here are ten reasons why Brexit should be viewed as an opportunity for a contrarian investor rather than a source of concern:

1. **This Too Shall Pass:** Just as Greece, China, and falling oil prices temporarily impacted the U.S. equity market over the past year, the impact of Brexit will likely also fade over time. For example, Greece is in far worse shape today than a year ago, yet the market no longer cares because it's now old news.
2. **It's not Binding:** The referendum is not even legally binding. It is advisory, not mandatory, so the U.K. government is under no legal obligation to do anything in response to the vote. In fact, they could hold another referendum, and another, and another until the government gets the answer they so desire. They could go so far as to simply ignore the vote altogether.
3. **Timeline:** Even if the U.K. decided to hit the eject button today, the process of leaving the EU would take two years to devise a plan. By the time it's implemented, it could be well past 2020 before the separation is complete (most political leaders do not want to leave so they will likely drag their feet).
4. **Size Matters:** According to the International Monetary Fund, the EU accounts for only 17% of world economic output, which is down from 24% back in 2000. A slowdown here simply won't have enough force to derail the world economy. More specific to the U.S., the U.K. accounts for just 4% of our exports, which is equivalent to about 0.5% of U.S. gross domestic product (GDP).
5. **The Single Life:** Several countries exist in Europe that are not members of the European Union. For example, Switzerland never officially joined, yet they have been able to strike agreements with the EU on trade and immigration.
6. **Talking Their Own Books:** CEOs are against Brexit because they likely do not want to have to spend additional money opening new offices and hiring new staff. President Obama said it would be bad because politicians do not want to spend time and money drafting new trade agreements. Be very careful what you read because many of the big names saying this is disastrous are simply “talking their own books.”

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7. **Currency Impact Overblown:** The media has jumped on the weakness in the British Pound, as it has fallen dramatically against other major currencies. A weakening currency is less of a concern for a country who borrows mostly in its own currency, and a weaker pound could actually help their economy by making their exports more attractive.
8. **Bond Market Reaction:** The U.K.'s 10-year government bond currently yields less than 1 percent, which is incredibly low for a country that faces imminent disaster. For scale, Greece's 10-year bond is over 8 percent, which is more indicative of the bond market expecting a bad outcome.
9. **The Media:** Anytime the media is this fixated and aligned so tightly on a single issue makes me skeptical of their intentions. Their collective opinion is so heavily skewed towards Armageddon that it leads me to believe that they are doing nothing more than creating panic in order to sell more newspapers.
10. **Not Another Crisis:** This is not a "Lehman Brothers event," and this referendum is not enough to ignite another financial crisis. The world economy is in a very different spot today than back in 2008. For example, most banks in the U.S., the U.K., and the EU are overcapitalized today versus severely undercapitalized back then.

IMPLICATIONS FOR INVESTORS

Long-term investors do best when they remain disciplined and wait for prospects to come their way. These events are rare, but when they occur, having "dry powder" available creates a tremendous advantage.

Brexit is one of these unique opportunities, and we have been active in many of the portfolios over the past week. However, buying during volatility spikes can frequently leave one feeling stupid before feeling smart because timing bottoms is impossible.

The good news is that contrarian investors do not need to find bottoms in order to profit over the long run because markets can only remain irrational for so long.

NOTE: *Keep in mind that world equity markets fell over 20% during the first six weeks to start the year, but then they (1) recovered, and (2) never drove the world economy into a recession. Emotions can only weigh on asset prices for so long.*

Eventually, asset prices revert back to being priced on fundamentals, and these have not changed much over the last two weeks. The U.S. economy continues to deliver relatively strong economic data, and the Fed remains committed to supporting future growth.

The bottom line is that although Brexit is wreaking havoc on short-term traders, it is likely an incredibly rare opportunity for long-term investors who can patiently wait for the hysteria to subside.

Sincerely,



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