FINANCE
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Uncertainty, a simple question of patience, perspective and time horizon

Welcome to life after the Brexit vote. "Uncertainty, a simple question of patience, perspective and time horizon" aims at elaborating the UK's options based on some facts after the recent Brexit vote.

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Brexit is not going to happen overnight, it will take time. Lengthy negotiations lie ahead of the British government, business leaders and British people and on one side this is a good thing because it gives time to the government, to business leaders and to the British people to adjust to their new world. One inconvenience of lengthy negotiations is uncertainty, and uncertainty usually does not help investments in businesses and people. The British electorate was unhappy about the growing influence the European Union (EU) was and still is taking on issues concerning everyday life. Immigration into the EU and an unfortunately incoherent immigration policy on a single EU countries level led to fears not only within the British population but also within other EU populations, and this fear was probably not taken seriously enough by EU politicians. Media and politicians tend to exaggerate, and this is what they did on a highly emotional level.

During the entire pre-voting period they were playing far too much with, and even banking on-emotions. Last but not least we should not forget the question why it actually came that far, why was there such a thing as a Brexit vote? I think it is probably fair to say that David Cameron's political strategy which had helped secure his power during the last elections came at a price that turned out to be higher than expected and hit back at him. But then again at the very end of the day, it is a question of perspective and time horizon if staying in or leaving is a good thing or not. The complexity of the current and future relationship between the EU and the UK is most probably widely underestimated. Too many interdependencies on too many different levels make it almost impossible to come up with reliable forecasts as to what will happen after Brexit. Brexit's immediate impact on an EU economy level is probably limited.

TWO MAJOR OPTIONS

On the downside the UK may be hurt during the first years of uncertainties as foreign investments will stall until negotiations show in what direction the political and economic future points. Investors usually seek clarity before committing funds, and clarity can only be achieved over time by negotiating with the EU and/or other (hopefully also new) trade partners. Looking at some facts probably helps understand the magnitude of UK's relationship with the EU and vice versa. The European Single Market is the UK's most important trade partner and accounted for 44.6% of UK exports in 2014. The EU is the world's second largest exporter right after China, with or without the UK. The EU is the world's second largest importer right behind the United States, (US) with or without the UK. This makes the EU an important voice in international trade negotiations, with or without the UK, and since the UK on its own is a much smaller international player than the EU, it will have less bargaining power in international trade negotiations than the EU. The European Single Market is not at stake, with or without the UK. (The Single Market refers to the EU as one territory without any internal borders or other regulatory obstacles to the so called four freedoms which are the free movement of goods, people, services and capital).

"IT IS A QUESTION OF PERSPECTIVE IF BREXIT IS POSITIVE OR NEGATIVE FOR THE BRITISH PEOPLE, AND IT IS MOST PROBABLY ALSO A QUESTION OF INDIVIDUAL TIME HORIZON."

Post Brexit, there are basically only two valid options for the UK to continue participating in the EU single market. Option one, is the European Economic Area (EEA) membership. The EEA was established in 1994, and currently only Norway, Iceland, and Liechtenstein, are EEA members. Option two, is the 'Swiss way' of bilateral agreements. Both options have their pros and cons, and again- it is a question of perspective as to which one will be the better choice for the UK. Option one (the EEA membership) offers access to the European Single Market. However, this access comes at a price, and the price is on one side a monetary one, as EEA members must pay their contribution to be part of the Single Market by contributing to the EU's regional development funds, and on the other hand a political one, as EEA members must accept and implement EU legislation concerning the Single Market in order to gain access to it, including the four freedoms as mentioned before, but also accept and implement further EU rules and regulations without having any say in formulating them.

Option two (the Swiss way of bilateral agreements) would enable the UK to seek trade agreements tailored to the specific interests of UK businesses and consumers, and therefore offers the most flexible possibility of participating in the EU Single Market. As the current negotiations between the EU and Switzerland show, this may be a cumbersome and time consuming exercise, as each agreement needs to be negotiated separately. This is the price one pays for individuality, and either way the key to access the European Single Market lies in the acceptance of the "four freedoms", no matter if Britain will opt for an EEA membership or for bilateral agreements, and this cannot be underestimated as one of the four freedoms- the free movement of people, played a significant role during the entire political pre-Brexit vote debate. This means that the part of the electorate that voted pro Brexit because it was unhappy or even afraid of the "free movement of people" within the EU, will either have to accept it anyway or as a consequence, accept not to be part of the European Single Market, which at least in the beginning – would come at a heavy price.

ALTERNATIVE TRADE PARTNERS

The only country so far that was able to negotiate quotas in respect to the "free movement of people" is the EEA member Liechtenstein, due to its absolute small size of territory and population. Switzerland on the other hand, is trying hard to implement quotas on the "free movement of people" but until now had no negotiation success. Nevertheless, besides the cumbersome negotiations with the EU during the first few years after Brexit, I see potential in the long run. The UK could be forced to find alternative trade partners and diversify its export business, and therefore become more flexible to economic shocks than it currently is as part of the EU. The EU seems to have become a fairly rigid structure and rigid structures react less well to shocks than flexible ones. Furthermore, the UK's financial markets could also take advantage of Brexit. Due to its size and relative global importance, London could become an even more important global financial center if for example, the UK financial markets were to be deregulated in the years to come, which could create a truly competitive advantage versus other EU and/or global financial centers.

BALANCED FISCAL BUDGETS

In my view, one of the biggest risks is that the Bank of England will flood the market with money to offset the effects of an opaque business investment climate that will certainly reign until the negotiations between the UK and the EU bring clarity, and that this flood of money will not only weaken the British currency but will lead to inflation and eventually backfire at British consumers. More than 150 years ago the UK had a Prime Minister called William Gladstone. Prime Minister Gladstone was known for insisting upon balanced fiscal budgets as fiscal deficits had proven to be a prime source of fragility for the economy. This was obviously pre "Keynesian economics", and I only hope for Prime Minister Theresa May to seek balanced fiscal budgets- not by increasing taxes, but by putting a lid on spending which is unpopular vis-a-vis the electorate, but necessary vis-a-vis the millions of young people that will inherit the country's ever increasing debt. As I mentioned before, it is a question of perspective, and even of perception if Brexit is positive or negative for the British people, and it is most probably also a question of individual time horizon. While at the short end the probability of economic and social casualties is high, there is a chance that at the longer end something positive can grow from it. I hope the UK will be disciplined in regard to their fiscal budget and I hope the Bank of England will refrain from excessive money printing and stick to the proclaimed normalizing monetary policy, communicate openly, and direct, because if not, investors may lose trust in the British Central Bank and the currency will weaken even more, and extrapolate the negative side effects that come with it. In an environment of uncertainties diversification in asset allocation makes more sense than ever. A permanent portfolio including precious metals has proven to yield relative stable returns, with relative low volatility over decades. This is no high margin rocket science, just common sense but then again investing also is a simple question of perspective, patience and time horizon. **EG**

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