



Holland Macro Views

Muddy water hides the big fish

We reflect briefly on the events of last week and we lean towards buying the greater opportunities that have resulted rather than waiting for the political muddy water to clear. That said rarely have we witnessed such a self inflicted attempt at economic suicide (Well, not since Greece last year!). Lastly it is worth at least considering if Brexit is a cause, or a symptom of a more widely held view.

[The Political Cycle starts at a new market cycle](#)

We have written before about the three distinct cycles we think investors need to be mindful of. These are:

- The Economic Cycle - All like to commentate on it and many spend much time trying to predict it - with often a poor success rate.
- The Political cycle- This fills our news channels daily but only occasionally has an impact on our investment environment.
- The Stock Market cycle. This being the too-often-overlooked change in mood that takes place between market participants (from Greed to Fear and back again).

The historic events stemming from the UK referendum over the last few days are a very rare example of when the political cycle does play a leading role in driving markets. Arguably now a political cycle has created a new market cycle, but will it create an economic down-cycle too? We think not, but accept there are risks. Like you we have watched and read avidly in the last few days on the many interpretations of Brexit consequences. We would observe the following:

1. That the significant falls in some UK affected company's shares are likely to be incorrect longer term. Once initial uncertainty is out of the way it seems highly unlikely to us that the trajectory of the UK economy should be that different from that otherwise expected. Indeed were the negative effect now discounted to be lasting, it would imply that the UK's EU involvement had in fact been a source of significant domestic growth to the UK (a point not even those campaigning for remain tried to claim). This would seem highly unlikely to have been true not least due to the control we had (and continue to have) over our own Currency and Interest rates. That said shorter term economic activity is all about a sentiment and momentum, both of which right now feel terrible, hence the market now discounting a house price collapse in the UK via various share prices(Lloyds, Foxtons + House Builders)
2. That whilst the danger of a wider EU collapse cannot be completely discounted the UK's vote to leave the EU is very very different to a vote by a Euro denominated country to leave the Euro. The benefits accruing to Euro member states are significant and obvious in lower borrowing costs. This suggests that most Euro member state populations would be highly unlikely to vote for such a move (as we saw with the Greek example last year despite their economic depression). In fact the UK may have done Europe a medium term favour forcing it to more seriously consider the reform that many member states request.

3. The real danger that lies ahead for both the UK and EU economies is, as all observe, uncertainty. Whilst many voters suggested they were prepared to weather such uncertainty for what they saw as a chance for a different future, few likely understand how economies and markets depend on each other. We also observe that Europe's economic prospects were pretty poor before the vote, thus a new period of uncertainty is, to say the least, unhelpful. Many of the actions of central banks in recent years to try to revive the animal spirits in consumers and companies to spend and invest and in banks to lend. All three such parties will now likely see more reason to be cautious for a while. In an ordinary cycle this might not be an issue to be concerned about but with many economies teetering on the edge of deflation it is extremely unhelpful. What is crucial therefore in the UK now is the quick re-election of a confident, decisive Tory leader who will re-assure both consumers and investors quickly whilst making the necessary preliminary decisions with European counterparts. In short to be 'in' or 'out' right now maybe matters less that a long period of uncertainty and the knock on impact it can cause to economies that had some fragility.
4. Additionally at the European level it would be wise to establish an ongoing likely framework relationship between the UK and Europe as soon as possible (as EU leaders have requested) The trouble is that Europe needs a sensible relationship with the UK, but it also needs to send a warning shot across other possible leaver countries bows. Were last Fridays chaos in markets to continue for months in Europe and have a lasting economic impact, Europeans will know where to point the finger of accusation – across the channel. They will have a point.

[In time- normality will return.](#)

In time, hopefully not too long, a new working relationship of how we trade with Europe will be established and in the meantime we would do well to remind ourselves that we control our own interest rates and have an independent currency that just got 10% more competitive in the world. In fact, in a world of competitive currency devaluations we just played our trump card! Equally if no Euro member states try to leave a slightly reformed Euro block it should survive, even prosper.

We observe that high uncertainty is different to high risk - both look similar and are often priced in a similar fashion. Investors looking at some share prices c.15-20% below their last level who see uncertainty as opposed to risk we think should buy such shares. Our favoured UK stocks that fall into this camp would include: **Sport Direct, Ryan Air + Lloyds**. Each has a different risk reward outlook, but all we think offer compelling value. The contagion risk has also offered greater value in US banks and other franchises we favour.

[Just a little reflection-Is 'Brexit' a cause or a symptom?](#)

One of the things that surprised and encouraged us greatly post the credit crunch was the resilience towards the continuing belief in capitalism when arguably it had showed it flaws for all to see during 2009. Whilst there rightly has been greater regulation and litigation there was not a sea change in sentiment toward labour and away from capital. We observed at the time how crucial this was.

A vote now for a more protectionists and isolationist world if repeated elsewhere would be a sign of a step back, not forward in the process of globalisation and co-operation and clearly this would not be good news at the margin for the global economy. However some might claim that the Brexit vote was anti-bureaucracy as much as protectionist, which in theory we should all applaud.

The US elections in October maybe more telling on this point than the UK referendum, as Mr Trump's election would send a similar message of grass roots dissatisfaction. Even if Mr Trump got elected is that the start of a new worrying trend that could threaten economic outlooks or just a period of complaint by voters, only for them to see that problems are not so easily fixed a few years hence. We will see. Our western progressive capitalist system has been resilient thus far, widely supported and aspired-to by many others. It will take more than the occasional protest vote to derail it.

Of greater concern is the upset that such events cause to consumer, industrial and investor confidence at a time when the Global economy is in need of the opposite. It is the addition of uncertainty to the deflation potion that causes us sleepless nights far more than 'In' or 'Out'.

"It is not that we like Bear markets, but we like the prices they bring." Warren Buffett

We wish you luck fishing in muddy waters

With kind regards

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