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### **3 WAYS BREXIT WILL CHANGE THE WORLD**

The recent vote by the United Kingdom to leave the European Union surprised many, including some of the leading proponents of the Leave vote. The nation that was the birthplace of Charles Darwin has opted for devolution. Britain has seen darker days and there will certainly “always be an England” but the vote to leave the EU will have far reaching consequences. Three of the more likely outcomes of the vote are discussed below.

First, Brexit will be the catalyst for the end of the euro and possibly the European Union. I wrote last year that I believed the euro would be replaced within 10 years. My view in 2015 may prove to have been optimistic; the euro may be replaced sooner than I originally thought. It was my belief that the currency/treasury issues of the EU could be addressed while maintaining the trade/social bonds. The departure of one of its stronger members places the whole notion of the EU in peril. Brexit has and will cause Europe to fracture along political, economic and cultural lines.

Second, Brexit will prove to be negative for Britain in several ways. The EU can be expected to be tough on departure negotiations such as trade. Britain can therefore expect poorer trade terms with Europe, by far its largest trading partner, in the future. The City of London stands to lose a significant number of banking and investment related jobs to other cities within the EU. The possibility of Northern Ireland, and more probably Scotland, seeking to remain within the EU may ultimately see the demise of the United Kingdom. England would then geographically resemble the England of Elizabeth I. Brexit will also diminish Britain’s political influence, especially within Europe. Britain’s effort to disengage from Europe flies in the face of its foreign policy of over 500 years. Britain has always sought to form alliances with one or more European powers as a means of exercising influence and preventing the formation of alliances against it. Brexit compromises this strategy.

Third, Brexit will be negative for the global economy. The global economy is already teetering on the brink of recession, with the United States being the only large economy exhibiting a semblance of strength. The uncertainty generated by Brexit will almost certainly contribute to a slowing of the EU economy in particular and the world economy in general. The decline of the pound sterling and euro against the dollar will likely precipitate further competitive devaluations among other currencies. Indeed, the Bank of England is already signalling that it will cut interest rates, putting further downward pressure on sterling. The current environment of rising nationalism, anti-free trade rhetoric and currency devaluations conjure up disturbing echoes of the early 1930s. The US presidential election in November along with elections in Europe in 2017 provide additional potential catalysts to further destabilize the world order.

Brexit has increased the likelihood of two of my major macro themes, the replacement of the euro and US dollar and dollar denominated assets being the preferred asset class for the next 5 years. Brexit, with its effect on the euro and sterling, combined with negative interest rates in much of the world, will drive capital to US denominated assets as a safe haven. The effect of Brexit has been felt primarily within currency markets, with great weakness in pound sterling and lesser weakness in the euro against other major currencies. The initially strong adverse reaction to Brexit by equity markets has been largely recouped and

the volatility index (VIX) has returned to relatively low levels. A level of complacency seems to have returned to the markets, which is surprising given current circumstances.

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