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Quarterly Point of View
Brits Boogie

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The second quarter of 2016 ended with a striking event; some have called it one of the most consequential decisions made by a western nation in a half century, and the biggest news event in Europe since the fall of the Berlin Wall. On June 23rd, British voters decided to end their 43-year relationship with the European Union, a so-called 'Brexit', surprising markets that had priced in, as virtual certainty, continuation of that relationship. The British Pound plunged 8% the next morning for its worst single day of trading since 1967, reaching its lowest level relative to the U.S. Dollar since Ronald Reagan's second term as President. Equity markets dropped precipitously, most specifically in the heart of Europe, led down by banking institutions that saw single session losses, on average, equivalent to a fifth of their market value. Meanwhile, fixed income yields dropped, with many sovereign bonds reaching all-time interest rate lows. Gold rose. In addition to the initial surge in volatility across global markets, British Prime Minister David Cameron, who had campaigned for the U.K. to remain in the EU, said he would step aside. This decision is momentous, and may have long term implications for the health of the EU, but in the end is likely to be more of a political than economic event.

From an economic perspective though, this outcome may act as a tax on the global trade system - a bit like throwing sand in the gears of a machine. Growth should slow to some degree as a result, and a period of uncertainty seems plausible as contract re-negotiations with trade partners commence. The vote to exit the EU does not, however, appear to have the capacity to 'systemically' undermine the financial system, but we do believe there are several potential consequences from this decision that are worth addressing.

Firstly, this may mark a tipping point in the globalization debate, representing the highest profile international event yet concerning dissatisfaction with policies relating to immigration, regulation and trade. Legal immigration on an annual basis into the United Kingdom is currently 10 times the rate it was in 1993[1]. European Union immigration to the U.K. averaged roughly 10,000 people a year prior to 2004 on a net basis, the year the EU expanded to include 10 new member states (sometimes referred to as the "A10" countries), adding the likes of Poland and

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Hungary. After the expansion, the UK and a few other nations allowed EU nationals to immigrate immediately under the bloc's freedom of labor laws. This led to a rapid rise in immigration to the British Isles, and by last year alone, 185,000 people from EU countries immigrated legally to the U.K. on a net basis. Many believe this cultural dynamic fed fears of job losses which helped turn the vote to exit.

A similar theme is echoed in politics across the globe today, including here at home. The major candidates for U.S. President espouse policies that would be considered protectionist, even radically so, by measures of the recent past. One in particular recently pledged, if elected, to withdraw the U.S. from global trade alliances, and referred longingly to centuries old economic policy that relied predominantly on tariffs of foreign imports to fund the federal government. In response to the speech in which trade details were outlined, Holman Jenkins Jr., a member of the Wall Street Journal Editorial Board, remarked, not admiringly, that it may go down as "one of the great protectionist speeches in American History" - and this by a candidate in 2016, not 1816.

Secondly, this event could be used by central banks of the world as an 'excuse' to continue experimental monetary policy with renewed fervor. For anyone reading our prior quarterly Point of View letters it won't come as any surprise that we believe central banks need to consider long and hard the efficacy of their policies. A very legitimate worry in our mind is that new rounds of quantitative easing and/or rate cuts would only serve to compound problems in the markets, raising the risk of asset bubble creation and other distorted risks down the line. With nearly $12 trillion[2] in bonds currently trading at negative interest rates around the world, it is no exaggeration whatsoever to say we are in unchartered waters from a monetary policy perspective. Additional fuel to this fire, as a result of Brexit, would be an unwelcome event.

Finally, there is a chance that this will not turn out to be an isolated event for the European Union, but the start of a larger movement against the continuity of the bloc, eventually leading to its disintegration. Concerns are mounting that referendums across the continent will look to capitalize on the result of the Brexit vote. Though the Dutch are founding members of the EU, a 'Nexit', or Netherlands referendum to exit, may be the first to test the post-Brexit waters, as a recent poll suggests the majority favor the chance to vote on membership. In France, Marine Le Pen's National Front Party has called for a vote, and populist parties in Italy, Denmark and Sweden all favor similar referendums. The citizens of the United Kingdom have voted to end their relationship with the European Union, and time will tell if it's only an isolated event.

These relationships necessitate observation, and the above concerns bare watching, but they should not tempt us to deviate from long term investment strategies. To achieve success through many cycles, it's vitally important for investors to act like investors, not market timers or speculators. It's very easy - in fact studies show its human nature[3] - for our minds to 'overweight' negative news many times that of positive news. This affects judgment when it shouldn't. Uncertainty and unexpected outcomes from the recent decision by the Brits to boogie from the EU may actually create positive opportunities for those with a longer term 'investor' mindset. As Brexit is digested, and other chances for 'unexpected outcomes' occur later this year, the likelihood of increased volatility seems like a very reasonable assumption. We will remain attuned to risks as always, but assuredly maintain our long term, investor oriented mindset.

Please feel free to call or email with questions you may have regarding our strategies or Martin Capital Partners in general. You can also find information on our website at www.martincp.com.

It is a sincere privilege serving those that have entrusted us with their capital.

Respectfully,

Cameron K Martin
Chief Investment Officer
Martin Capital Partners, LLC

1. Office for National Statistics UK.
2. Fitch Ratings
3. Kahneman, 2011. *Thinking, Fast and Slow*

Statistical and analytical data provided by Thomson Reuters Datastream, Eikon & Baseline.

If you would like additional information on how Martin Capital Partners, LLC conducts business, we can provide a copy of our SEC Form ADV part II, firm brochure. As always, past performance provides no indication of future results.

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