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# The Bremains of the Day

*"One is not struck by the truth until prompted quite accidentally by some external event."*
― Kazuo Ishiguro, The Remains of the Day

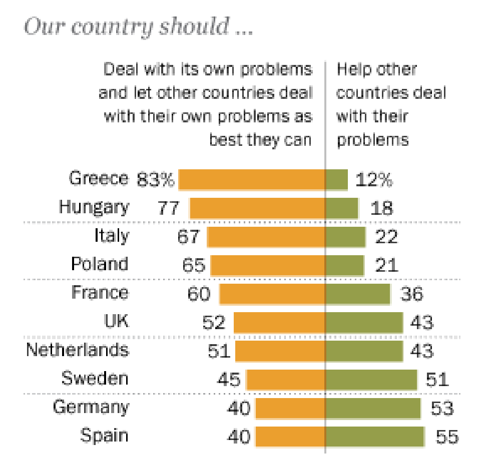
Mr. Ishiguro's novel, published in 1989 chronicles the life of Stevens, an English butler, in the years leading up to and including World War II. For most of his adult life he was in the service of Lord Darlington. Late in life, in the employ of his new master, an American - Mr. Farraday, he reflects on his life of unwavering dedication to Lord Darlington and begins to question the character of the man he served faithfully for so many years. After much reflection he decides that he will live the end of his life focused on the "remains of [his] day", referring to his future service with Mr. Farraday, and what's left of his own life.

Jump cut to Brexit (I do hate that word). It appears that the British people (Stevens) took a look at the leadership in Brussels (Lord Darlington) and decided that their loyalty had been misplaced.

I'll leave it to the pundits to argue about what the vote meant, whether the Brits really understood what they were voting for, and whether this portends a more xenophobic time. All that can be said with certainty about the vote is that with a 72% turnout of eligible voters, the results reflect the fact that a whole lot of people on both sides were passionate about this referendum. As a point of reference, a similar vote was taken in England back in 1975 with a turnout of 64% of the voting public. The vote back then was 67% in favor of staying in the EU.

The vote places the EU in a very uncomfortable position. It needs to trade with Britain, but cannot come off appearing to make this too easy on them for fear of additional defectors. The EU has already begun to play the heavy by indicating that if Britain wants to be included in trade agreements with the EU it will have to continue to accept immigrants right along with the rest of its members.

The European Union began back in 1951 when the European Coal and Steel Community was created by the Paris Treaty. From its humble beginnings of 6 countries, the EU has grown by various treaties to 28 countries with a combined population of over 508 million people. The British are not the only ones unhappy with the growing influence of the EU. In a Pew Research Center Poll published June 13th of this year (10 days before the vote), the following option was presented to survey participants throughout Europe:



What is somewhat surprising is that the percentage of people polled in the UK who indicated that they should "deal with its own problems…" is the same percentage of people voting to leave the European Union. This undoubtedly is sending shivers down the spines of the leaders of Greece, Hungary, Italy, Poland France and the Netherlands; and Sweden, Germany and Spain may be in the "too close to call" category.

Britain has the distinct advantage of having maintained its own currency while a member of the EU. The other countries surrendered theirs as a condition to joining the union. This will certainly make it more difficult for other countries to exit. Since the vote, the Pound Sterling has dropped in value against all major currencies. It has the lowest value against the US dollar in the past 35 years. The move against the Euro has been smaller, with it dropping back to lows made in 2013. This has made exports much cheaper to Great Britain and imports much more expensive. Generally that is good for England, but with the world economy slowing, it remains to be seen if spending on British exports and tourism related activity will overcome the negative effects to the British people of higher prices for imported goods and travel abroad.

Where this ends is anyone's guess. I suspect that England will muddle through given it's relatively large economy. According the the International Monetary Fund, it is the fifth largest economy as measured by Gross Domestic Product, surpassed only by Germany, Japan, China and the US (in ascending order). If it appears that the UK exits with most of its hide intact, I suspect there will be more pressure on some of the remaining countries listed in the above chart to follow.

The markets have been acting rather schizophrenic since the exit. Immediately following the vote international stock markets fell and bonds rallied (yields fell) - a normal reaction to an uncertain outcome. As I write this, however, the US stock market has gained back most of its losses from the early post-exit trading. The bond markets are also making new highs as bond yields fall to historic lows, and gold is rallying. This, my friends is an anomoly. The markets are signaling simultaneous bullish (stocks rising) and bearish (bonds and gold rising) signals.

What has been overshadowed by all the talk about England is the fact that the world economies continue to slow. In the US, the S&P 500 companies have recorded four consecutive quarters of declining earnings, and the quarter ending June 30 is expected to register another quarter of falling earnings (or as analysts say – negative earnings growth – love that one). This hasn't prevented the index from notching a positive return for the year, but has further stretched its valuation. Stock analysts are uniform in predicting that the second half of the year will be better for US earnings and that the current valuations are not excessive. We shall see.

Additionally, about 33% of world government debt now trades at negative interest rates (according to the Bloomberg Global Developed Sovereign Bond Index). You read that right. Currently about one third of current government bond buyers will get back less money at maturity than they pay for a bond bought today. This is one for the record books. Why, you ask, would anyone do this? Because bond buyers believe that any other investment carries too much risk right now, and their demand for safety has driven down the yields on the bonds available. You can thank Central Banker policies for starting us down this path. Our Federal Reserve has steadfastly denies rumors that they too will push our rates into negative territory in yet another attempt to revive our sluggish economy. The current yield on the 10 year Treasury is 1.38%. We ain't got that far to go.

It seems much like the British vote we have two factions loudly making their voices heard. One is betting on continued recovery of the US (and world) markets, and the other is convinced that the US and world economies are headed for tough times ahead. Mr. Ishiguro might have the last word on this one.