



# Market Update

07 Jul 2016

## What is next after Brexit is the trillion dollar question?

The tides of globalization are being pushed back. Brexit is just another example of the desire for some to move away and encapsulate themselves. So what does Britain do from here? Well there is no going back. The EU has made that very clear. Big banks and insurance companies are making arrangements to move their banking agents to Frankfurt and Berlin. How Britain plans to come out of this ahead of the pack is unclear. Scotland will leave the United Kingdom as it looks to remain in the EU. So what happens to the United Kingdom? Germany and France have kept the marching drums sounding for Britain to trigger Article 50 and leave which is why we keep seeing the British pound get decimated in value. Britain unpegged its currency from the American dollar in 1971 to float freely. The value went from \$2.43 to \$1.28 in 1985.

Let's examine some general facts about Britain and the Pound.

Overview: The official currency of the United Kingdom is the British Pound (GBP), which is used in Great Britain, British Overseas Territories, the South Sandwich Islands, and the British Antarctic Territory, as well as Tristan de Cunha. The Pound is divided into 100 pence. Another name used for the Pound is Sterling. The symbol for the Pound is £.

Economy: The United Kingdom is rated as the sixth-largest economy in the world. The main industries range from aerospace



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to financial services. Export products are beverages, tobacco, fuels, manufactured goods, chemicals, and food. Import products are foodstuffs, fuels, machinery, and manufactured goods. Unemployment is estimated at 7.6%.

History: It is difficult to estimate when the Pound originated; but sources indicate that the Pound was already in circulation during the Anglo-Saxon period. During the medieval period the Tealby penny was circulated and was the standard unit used until the 20th century. In 1552, silver coinage was introduced made of sterling silver .In 1663, gold coinage was introduced. The silver coinage remained and was used for importing goods; gold was used for exporting goods. This made Britain a gold standard country. The first paper money was issued in 1694, after the Bank of England was established. In 1861, the gold standard was adopted again. In 1914, after the outbreak of World War I, the gold standard was abandoned and treasury notes became legal tender. In 1940, the Pound was pegged to the US Dollar and later became part of the Brent Woods system. In 1971, the Pound was changed to a free-floating currency. In 1976, the country had a Sterling crisis. In 1988, the UK Treasury instituted a policy whereby movements of the British Pound "shadowed" those of the German Mark. In 1990, the UK became part of the European Exchange rate mechanism, but withdrew in 1992. The UK had the option to adopt the Euro in 1999, but declined.

The British pound does have a long history with humanity as a currency. However, after the Second World War it required to be propped up. Government leadership flirts with the notion but never established firm commitments. So why would a nation which relies on financial services so heavily kill the goose which lays golden eggs. Britain is not new to currency crisis. It has had many remarkable ones as noted above and even made George Soros a billionaire household name. The 1992 black Wednesday currency crisis is how George Soros became a billionaire by short selling \$10 billion worth of pounds. For this Mr. Soros is known as the man who broke the bank.

Brexit is a symptom of Britain loosening grip on global economics

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and trade. Once the master, but no more. However it is still a very relevant player as the 6th largest economy. Plenty economic noise and headwinds will continue to bellow and blow as a result of Brexit. It is however just noise of a global economy shift fiscal priorities.

When writing my weekly update I focus on the key economic and fiscal elements which share behavior and general sentiment. This week after all the political uncertainty ruling markets last week greener pastures are present in North America. Private sector jobs grew by 172,000, while economists polled by Reuters forecast a gain of 159,000. The May number was revised down to 168,000 from 173,000. Small businesses, those with fewer than 50 employees, accounted for 95,000 of those jobs, up from 84,000 in May. Medium sized businesses, those with an employee count between 50 and 499, added 52,000 jobs, down from 60,000 in May, while large businesses accounted for an extra 25,000. Chair Janet Yellen will be watching closely to determine what is next with interest rates. Unemployment in America is at 4.7%. Wages in the United States increased 4.6 percent in May of 2016 over the same month in the previous year. Annualized GDP for May came in at 2.1%. Global headwinds from Asian, EM nations, China and most recently Britian have plagued the great American economic recovery. The culminations of these events have not stalled the world's mightiest economic machine only prolonged the recovery time. Regardless of who will lead America's next administration, the American Federal Reserve has managed to preserve the monetary momentum gained under Chair Ben Bernake and continues to make strides under extremes.

For the EU and the larger European trading partners, Britain's announced exit only under scores the club's disfunctionality. Let's examine Euro area: GPD is at 1.7%. Unemployment is 10.7%. Inflation is 0.1%. Interest rates are zero. Actually government 10 year bonds are at -0.39%. Europe has some fantastic corporations with in its borders just like Japan does but the monetary and fiscal policy needed is not being implemented by Brussels leadership.

The Chinese government's call to the nation to build an innovation

driven economy from the top down has sparked a rush by local governments to construct new buildings in the name of supporting creativity. Innovation centers have been popping up around the country and are set to more than double to nearly 5,000 in the next five years. The only problem for local governments; entrepreneurs are not moving in. Many centers are in small Chinese cities or towns, not ideal locations for attracting startups. There is no local market for their product, no local ecosystem of suppliers and fellow entrepreneurs and centers generally provide only basic amenities, such as a desk and a telephone. They lack the financial, technical or marketing expertise that many startups need. Most incubators have occupancy rates of no more than 40 percent. The result will be similar to steel mills, theme parks and housing before them. The country now faces a glut of innovation centers as another top down policy backfires to leave white elephant projects and a further buildup of debt. How many failed top town schemes can the Chinese leadership continue to fund till the Dragon nation goes broke. China's Ministry of Industry and IT declined to comment and the state planning agency, the National Development and

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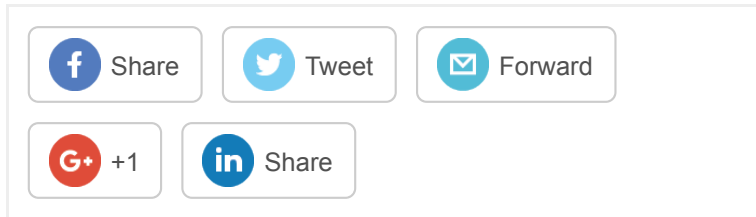
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Beijing argues the development model that focuses on heavy infrastructure and real estate, powering the country through the global financial crisis, can build successful, high-tech startups. With slogans such as "mass entrepreneurship" and "internet plus", Beijing has called for innovation centers to be built all over the country, hoping to lay the groundwork for the next Jack Ma. It has encouraged college students and even migrant workers to try their hand at starting their own businesses to transform China into a high-tech economy less reliant on basic manufacturing. Almost 80 percent of the capital investment for the innovation centers springing up around the country is coming from the government or universities, which are state backed in China.

Canada's annualized GDP is at 2.4% with unemployment down at 6.9%. The rally in gold and oil prices have pushed the TSX higher. As fears of Brexit dissipate so will the need for gold as a safe haven. In times of uncertainty in governmental leadership, monetary policy and currency crisis gold is the favorite stand by. For Canada to make continued progress it must have more than

just infrastructure or fiscal spending it needs more trade. The ratification of the CETA (Comprehensive Economic and Trade Agreement) between the EU and Canada is a critical piece in driving overall trade higher for Canada. Brexit and the dazed faces of Europe's leadership many mean CETA take a back seat till the dust settles.



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