The Brexit Of Champions

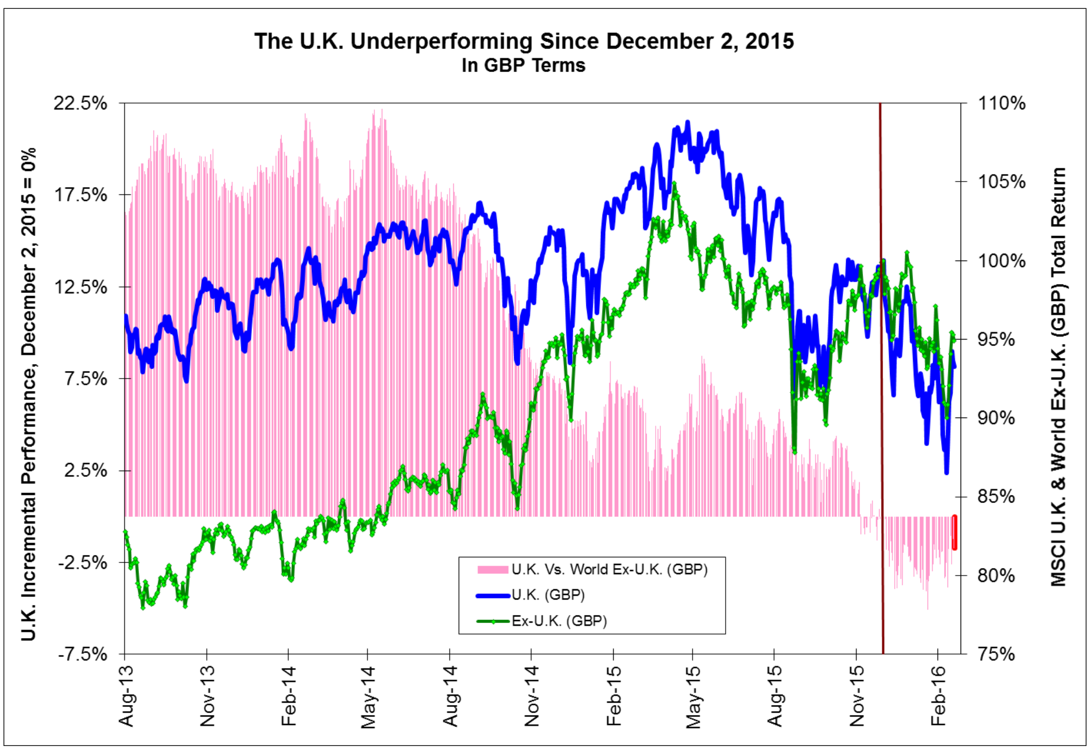
George Meany, the longtime head of the AFL-CIO, once commented, "Economics was the only profession where a person could be considered an expert without having once been right." This certainly has been applicable not only to economists but to all members of the chattering classes with regards to the never-ending farce of European unity. As I never tire of pointing out, a professor of international economics told me more than forty years ago, "Bet against Euro-anything," and in a stunning rebuttal to Meany, he was right.

The presently fashionable worry du jour is the Brexit, or good riddance to the Continent by the residents of Perfidious Albion. I suspect this will go about as far as the Grexit, Quitaly, Spadios and other portmanteaus that allow the speaker to sound knowledgeable without having studied anything more than a tweet. The reason is simple: Europe's elites have pinned everything on the pretense of European unity, and they will do everything in their power to preserve their status. How dissimilar is this to the United States where the present favorite to be the next President is a consummate insider ludicrously trying to be a rebel with a cause?

U.K. Relative Performance

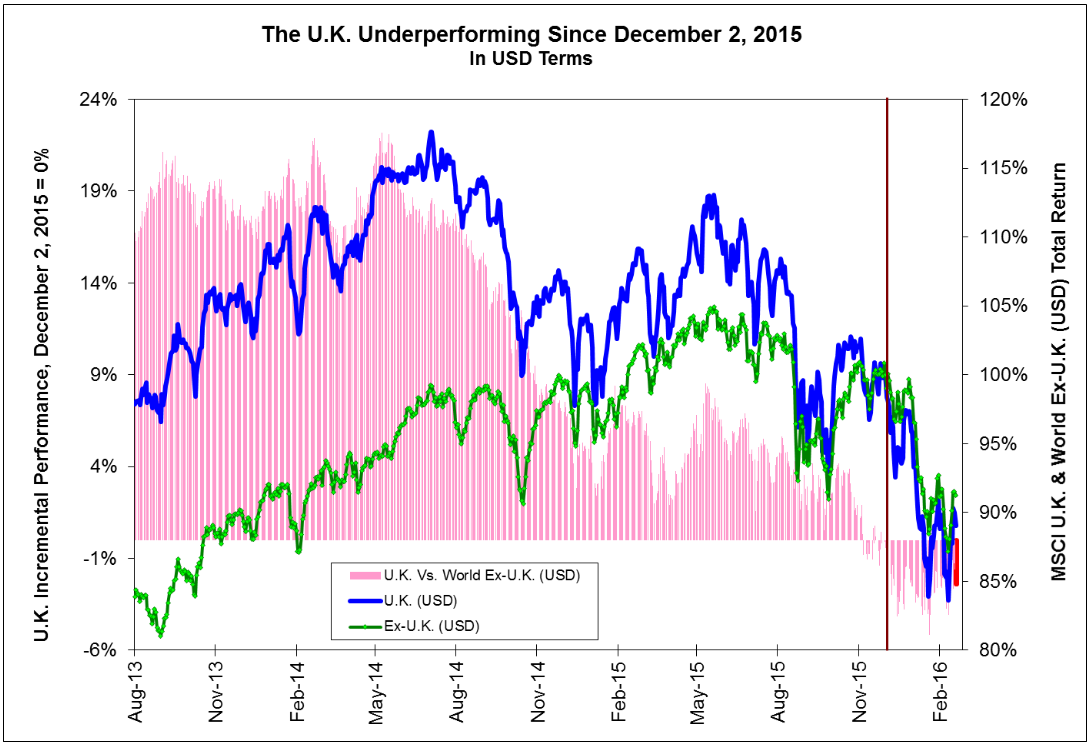
Monday's face-plant by the British pound (GBP) against the euro but especially against the dollar raised the question of whether your money might be safe in British equities, or whether you would be better off finding some negative-yield bond as an alternative. Let's take a look at U.K. relative performance vis-à-vis the rest of world in the period leading up to Monday.

The MSCI U.K. index has underperformed the Ex-U.K. index in GBP terms since the GBP began to weaken on its cross-rate to the EUR in December 2015 (vertical line). Let's compare performance of these indices across two periods separated by this breakpoint. The first extends from a period of a stronger GBP on the cross-rate beginning in August 2013 through the start of December 2015, and the second is the short period afterwards.



Average daily returns for the U.K. index fell from 0.028% to -0.122% in GBP terms; comparable figures for the World Ex-U.K. index are 0.032% and -0.091%. Returns were different at only 53.65% and 57.47% confidence levels for the U.K. and World Ex-U.K. indices, respectively, across the two periods.

The U.K. index has underperformed the World Ex-U.K. index in USD terms as well. Average daily returns for the U.K. index between August 2013 and the start of December 2015 declined from 0.002% to -0.203%; these are different at only a 66.79% confidence interval. Comparable figures for the World Ex-U.K. index in USD terms were average daily returns of 0.025% and -0.161% for the two periods; these are different at an 80.98% confidence level.



While the GBP's 9.68% decline vis-à-vis the EUR since December 2015 has seen U.K. underperformance in both GBP and USD terms, this process had been underway since the EUR's downturn began in earnest in May 2014. We should not expect further weakness in the EURGBP cross-rate by itself to have a materially negative effect on relative U.K. performance even though the Brexit vote will produce higher volatility.