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KMI Exclusive Newsletter

24 years of uninterrupted financial advice for the Expatriate Market

Dear Clients and Investors

Just two items in this month's Newsletter. The EU referendum and World debt.

What will happen if Britain leaves the EU?



EU Referendum

Just days to go before the UK votes on this huge referendum and after Thursday's terrible and meaningless murder of MP Jo Cox, it is not surprising that the UK public are stunned into disbelief, hardly able to cope with this terrible event, let alone consider the consequences of the EU vote.

I say the UK, but in fact, much of the civilised world is watching carefully at events unfolding in the UK. There is no doubt that stock markets in Europe

and even the USA where CNBC have been assessing the “Brexit effect” have all suffered as a result of this coming vote.

The initial thought was how will the UK fare outside the EU, however as events have moved on, the more pressing and alarming consideration is "Will the EU break up completely if the UK exits?"

This is now an event that I believe Merkel and Co gave little thought to during Cameron’s so called re-Negotiations, however I suspect they wished that they had done as they ponder the situation today.

It is not the purpose of this newsletter to consider the political rights and wrongs of a Brexit, however I believe it can be summed up simply by misquoting Shakespeare “To Federalise or not to Federalise that is the Question.”

This Newsletter discussion

This is to discuss the effect on your investments should the UK either Brexit or not, the EU.

The two most important considerations for KMI investment clients in regard to the UK leaving the European Union are:

- a) Will stock markets react negatively, in particular the UK FTSE?
- b) Will sterling devalue against the Euro and other major currencies particularly the US\$?

Since we do not know the answers to these questions then we need to see what are the defences we can take to offset any loss.

Regarding Stocks (shares) and Stock related funds

We could actually sell any stocks and funds held with a view to re-buying after the markets have settled. Whilst this seems attractive, it is true that stock markets have already dropped in anticipation of a Brexit. Therefore the potential downside of a Brexit is probably less than had previously been envisaged. In addition Brexit may not happen and if this were the case, the assumption is that stock markets will then jump to regain their previous higher positions (+10%). If we sold now then we would lose this potential re-gain.

For those clients whose assets are in other currencies, US\$ and the Euro for example, then there is not a desire to take action to offset Brexit.

Would a currency “Hedge” Work

A currency hedge could work, for clients that have assets in sterling if we wanted to offset a loss due to a drop in sterling after Brexit against say the Euro & US\$.

Here though, we again meet risks. Quite apart from the cost of the hedge, Brexit may not occur, in which case sterling could jump in value, as hedges can involve selling a currency in anticipation of buying it back at a lower price, the cost of this hedge is not limited so may actually cost more than first anticipated.

We could also purchase say US dollars (or Euros) with our sterling cash holdings in the hope that the US\$ will gain against sterling after Brexit. However, sterling has already lost 10% of its value since the beginning of the year against the Euro and US\$. Again we believe this is in anticipation of a Brexit. If this does not happen, sterling could gain and the purchased US dollars would have proved a very expensive defence, currency trading has always had high risks.

Of course we are making assumptions which in themselves could prove flawed. Sterling and stock markets may not suffer as a result of Brexit. More likely the Euro may well suffer in the face of Brexit and even the US markets may also become volatile. The simple truth is, without some knowledge of what is going to happen, we are unable to make sensible defensive plans. Even going completely into cash, whichever currency that may be, it could prove very expensive.

The likely Result, Polls v Bookmakers

In determining the result on 23rd June we are not helped by the polls. They generally give a lead to Brexit of between 3-7%, which in itself would be a strong guide. However UK Bookmakers give a 2-1 likelihood of a Remain win, which still leaves the result in much doubt. Given recent poll results such as the UK election in 2015, I suspect the bookmakers have the edge in predictions.

Therefore our summary is simply to hold tight to your cash and investments until the 23rd June. We can then review the situation in the light of actual facts.



World debt- A Layman's view on getting the world's debt reduced!

Without doubt 2007/8 was a turning point for the world's economy. If the financial crises had not occurred, I suspect we would not be even discussing the EU referendum above.

Sufficient has been said on why the financial crises occurred, but not nearly enough on how we solve it some nine years on.

Simply put, Europe including the UK at present, USA and most of the western world has been affected by the financial crises, by contagion the rest of the world too. We are still paying interest on the debt and in most cases governments have not even repaid \$1 of it.

It gets worse, since 2009, governments have been pumping tax payers cash into their economies, known as “quantitative easy” (QE) or more honestly “printing money.”

The EU is still involved in QE, and thus more and more of tax payers' money goes down the drain in interest. At a rough count, £1 in every £6 collected in tax in the UK is paid away in interest, the same I suspect in the EU. The effects of this are:

- 1) Interest rates locked around the 0.5% pa
- 2) Money for government services restricted, especially health services, social services and social benefits.
- 3) Wages are pegged as inflation is kept to as near zero as possible.



- 4) Lending for business expansion is difficult without assets to back up loans. This is particularly true of small businesses where loans are needed desperately for expansion and assets are not readily available. The problem is that small business is the engine room for national expansion and wealth creators without which economies cannot grow.
- 5) As there is a government desire to keep inflation down, cheap labour is an important requirement. This has been satisfied by movement of people in the EU, sadly this has added to problems rather than helped them.

The perceived wisdom of zero inflation has almost turned the western world's economies into a depression. The natural result of printing money is actually high inflation, not zero inflation.

Even China, once the worlds answer to global expansion has been adversely affected by the western financial crises, much less demand has caused commodity prices to crash, oil being the best example.

Sooner or later with countries like Greece, Spain & Portugal in the EU and very poor countries elsewhere eventually having public outcry on their streets, the debt bubble will burst.

It is essential for something to be done before we get to a full-blown crises like 2008. We need to let inflation rise and wages rise, this will effectively reduce the value of debt. We cannot repay the debt as has been proven since 2008, therefore we have to deflate it!

As our clients will know KMI are wealth managers. Please contact your normal consultant, or Mike Towning in Prague for investment advice or bespoke details on your particular portfolio if you wish to consider the EU referendum in more detail.

Happy investing and an enjoyable summer to all!

Lee

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