

*Marble Harbor Investment Counsel, LLC
Excerpt from
Second Quarter, 2016 Letter*

We are pleased to send an excerpt from our second quarter client letter that discusses our current thinking. We welcome your thoughts.

Sincerely,

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Dear Client:

On Sunday June 20, we were lucky enough to watch LeBron James and Steph Curry, two of the best basketball players in history, battle in Game 7 of the NBA Championship title. The advantage oscillated from Golden State to Cleveland and back again. The score was close all the way through to the end, so much so that no one could predict the outcome with certainty.

Less than a week later, we watched in disbelief as the UK voted to leave the European Union. This competition, too, had wild swings with “Leave” ahead, and then the tragic death of Jo Cox pushing “Remain” into the lead. Even as the polls were closing, the vote was too close to call.

There is a word for guessing about sports events. Gambling. But so often when people talk about geopolitical events, they justify trading around those events by calling it investing. Let’s be clear: No one knew what the result of the Brexit vote would be any more than they knew who would prevail in Game 7, and consequently trades based on the vote’s outcome were outright gambling.

We don’t speculate with your money. We invest in businesses with recurring revenues that will persist whether or not the UK is part of the EU. Even if Brexit produces a recession, people will continue to use baby formula and diapers, put fuel in their cars, talk on their mobile phones, or take their medications.

So, what does the Brexit vote mean for your investments? The UK accounts for only about 3 percent of the revenue from S&P 500 companies. We could certainly see weakness in this 3%, but even if sales in the UK decreased by a third (a very extreme and unlikely scenario) this would cut only one percent out of growth.

More than the actual economic weakness, ambiguity about the road ahead may be the most damaging part of Brexit. We don’t know when the UK will start negotiating for its exit, and we don’t know how long it will be until the new government gives its two-year notice to leave the EU. This will be a long, complicated process, and there is no true precedent (other than Greenland in 1982, a country of 50,000).

It’s not clear that the British knew what they were voting for. One of the most popular Google searches in the UK following the vote was “What is the EU?” Some, such as former Prime



Minister Tony Blair, argue that once the public begins to see how detrimental this divorce will be to the UK, they may push for a reversal of course. The referendum was non-binding and had no coherent plan for execution. It will be up to new Prime Minister Theresa May's government to draw up a strategy for moving forward. In addition, Scotland looks set for another secession vote from the UK, so that they might stay in the EU, potentially triggering a constitutional crisis and an existential moment for the United Kingdom. All of this will lead to more uncertainty for the UK and the EU, which will mean more volatility in the markets.

Globalization and free trade have pulled hundreds of millions of people in emerging markets out of poverty. They have also been of great benefit to many of your companies, offering access to low-priced, skilled labor and opening new markets to billions of consumers. These new markets and labor pools have helped your businesses to earn higher profits. However, a core constituency in the UK, largely older and less affluent, feels that the advantages of globalization have passed them by and left them with a raw deal. Brexit is their attempt to renegotiate that deal. If there is one thing that the history of the 1930s teaches us, it's that protectionism combined with anti-immigration laws doesn't end well. We can only hope that the new leadership in the UK can do a better job of explaining the virtues of globalization to its constituents and, most importantly, come up with policies that share its many benefits.

Your companies can weather economic and political uncertainty by design. They have largely done better than the market as volatility has returned. Regardless of whether the UK stays in the EU or not, your companies' businesses will continue to perform. One bright side to this renewed volatility: We may have some select buying opportunities. That makes us smile, almost as much as Game 7.

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