"Wherefore do you so ill translate yourself
Out of the speech of peace, that bears such grace,
Into the harsh and boisterous tongue of war(?)"

K Henry IV pt 2

We have been considering what the British In/Out referendum on June 23rd means for financial markets. Sensitivities to the result will diverge wildly among market constituents. Little else is certain. One conclusion, however, is safe. Any fallout from the expected result of the referendum poll will be largely discounted by the time of the actual vote.

As to the result, polls indicate a small majority in favour of **IN**. Pollsters' credibility, however, has been badly holed by results in the general election last May and the 2014 Scottish referendum. Recent big winners, Corbyn and Trump, have been rank outsiders. Disaffection with the political establishment may yet mean that the darker horse prevails in June. As to what follows, the variables are infinite. Breaking the established connection with Europe could open the door to new opportunity or a shapeless muddle. Trying to pinpoint the bottom line in terms of hard cash is an exercise in futility.

Yet the protagonists spend much energy and ink doing just that. They succeed only in whetting an unhealthy appetite for narrow advantage. The vision that dignified the aspirations of Robert Schuman, the EU's founding father, has vanished. A meaner nationalism replaces it. In 1950, five years after Germany signed the treaty of surrender ending the war in Europe, the French Foreign Minister said this: "Cette proposition réalisera les premières assises concrètes d'une Fédération européenne indispensable à la préservation de la paix." Schuman's proposal (for Germany, France and other nations to pool their production of coal and steel) would provide a base from which peace in Europe could be built. The material value of economic co-operation would create a practical incentive to work together towards that much bigger goal. Post-war reconstruction would be the 'collar of necessity' (as our piece in 1993 termed it) to hold the parties together.

So it proved. We have known peace in Europe, more or less, for 70 years, the longest such era since British global hegemony after Waterloo. In 2012 the EU was awarded the Nobel peace prize. But of course the value of peace is not measurable by money. Like other priceless benefits, it is little cherished until lost. Today the need for a coherent European response to violence in its capitals, migration crises in the Middle East and Africa, and the fall-out from over-indebtedness, provide a new and compelling incentive to co-operate. Without that co-operation, there is little chance of stability in Europe.

Popular attention today, regrettably, is focused on the price, not the long-term value, of EU membership. Those who would leave speak the language of freedom fighters. They picture a country struggling to shake off the shackles of a tyranny. Theirs is an emotional appeal. Justifiable complaint about unaccountable diktat and meddlesome bureaucracy lays claim to sovereignty lost and freedoms forfeited. 'Remainers' appeal less to the heart, more to short-term pragmatism. They recite tangible benefits under threat and conjure up unqualified losses in the event of withdrawal. Neither side can demonstrate a convincing net advantage. Analysis produces no credible financial statement, only a catalogue of possibilities.

Certainly freedom lies at the heart of the issue. But it is not a matter of sovereignty foregone or rights forfeited. It is a question of where the limits to state freedom can best be set within a globally inter-dependent community of nations.

Things were different before the communications revolution. National boundaries were real barriers to entry or exit. Fiscal and industrial strategy could be tailored to suit a purely domestic constituency. Monetary policy was devised with little reference to other nations. Only 45 years ago foreign currency

/......

markets were tied into a dollar-based, fixed-rate straitjacket. Central banks looked almost entirely to their domestic requirements. With few exceptions a court's jurisdiction reached only as far as its national border.

Since then, modern communications and unfettered capital and trade flows have nurtured a global market place. In the process they have cropped national freedoms. Nations have grown to accept the inevitable constraints. It has suited popular convenience to suffer the anarchy of the internet. National authorities have little control over its content and application. Cyber-terrorism now poses a critical threat to the world's IT security. No nation is immune to it. Similarly global banking has created an offshore financial sector beyond the reach of any effective jurisdiction or local control. Tax authorities struggle to collect tax from dexterous multinationals. So it goes on. All parties in a global economy are held hostage by global forces. Only the other day the mighty Federal Reserve Board in America cited overseas economic trends as integral to its policy considerations. In today's conditions no nation can hope to exercise its sovereignty in Olympian detachment from its neighbours. Parliament's writ wears the trappings of a rich history. Much of its power has moved elsewhere.

Other strictures apply to our island nation. Status as a leading financial service provider is valuable. For that reason the UK government could not begin to detach this country from the reach of European or American financial regulations. Nor could it entertain a fiscal or monetary policy that ran counter to the expectations of its overseas investors. Roughly 30% of British industry is owned by foreign entities. Overseas companies' capital investment in the UK reached an accumulated total of £1 trillion in 2014. Realpolitik trumps domestic preference. The UK already makes obeisance to economic might wielded by unsavoury regimes overseas. By all means parley to recover what freedoms we can. But check first they still exist.

Since Schuman's declaration, the EU has conferred its own 'freedoms' on members including free movement of capital and labour. The benefits of these have lately been eclipsed by the migration and employment crises. Liberality of spirit is being suffocated by resentment at its perceived abuse. So entry gates to the UK are closed to all but 20,000 (out of today's 4 million) Syrian refugees over the next five years.

In view of current uncertainties, the reaction of the foreign exchange markets has been predictable. When the UK political establishment's position on Europe conflicts, as it does, with a large wedge of grassroots opinion, frustration erupts. The prospect of enduring division at the heart of government is shaking confidence in the long-term health of the UK. Recent falls in the pound reflect that concern. Sterling provides an acid test of investors' confidence.

So far as the UK equity market is concerned, investors' apparent sang-froid may be due to the lack of any discernible net benefit or cost to British business, whatever the referendum result. Company profits in the short-term might even be bolstered by the pound's devaluation. In any case over 75% of the biggest UK companies' revenue derives from overseas. Exit negotiations might well take years. In the meantime big business, contrary to its protestations, will not obviously be crippled either way.

The real risk to markets remains. It is that the UK and other European nations continue to turn in on themselves. Longstanding co-operation gets exchanged for petulant bickering. When national fervour concerns itself with nothing but caricaturing others' failings, it reaps a harvest of bitterness. The precedents and pointers are all too visible. Without some live recollection of what brought us together in the first place, some grasp of a European future beyond the rebates, exemptions, exclusions, razor-wire barricades, the nations of the EU face a miserable and dangerous future. Island though it may be, the UK is confronted with the same issues as other members. Leaders across Europe need to lift their sights. Europe has not been ravaged by war. However, paralysing social and economic problems provide a new and urgent incentive for its nations to work together. Only if they begin to do so can investors be confident, whatever the result on June 23rd, that the stability we have enjoyed in our lifetime may be preserved for Europe's next generation.

11th April 2016

★★★★★★★★★★★★★★★★★★★★★★★★★★

McInroy & Wood Ltd., Easter Alderston, Haddington, East Lothian, EH41 3SF, UK

Tel: +44 (0)1620 825867 Fax: +44 (0)1620 826295 www.mcinroy-wood.co.uk email@mcinroy-wood.co.uk

London Office: 53 Davies Street, London, W1K 5JH, UK Tel: +44 (0)20 3709 7240

Directors: Tim A U Wood, Guido A Bicocchi, J David S Cumming, Simon J Cunningham, Wendy A Ferguson, Antonia H Fraser, John E Marshall, J Campbell McAulay, Lord Francis Seymour, David H Shaw Stewart, Charles T F White, Victor N U Wood

Registered in Scotland No. 100377. Registered Office: Easter Alderston, Haddington, East Lothian, EH41 3SF, UK

AUTHORISED AND REGULATED BY THE FINANCIAL CONDUCT AUTHORITY