

Weekly Market Insights

January 6, 2020

Happy New Year!

The positive momentum of equity markets was interrupted last week by the U.S. actions in the Middle East. The DOW fell 0.04%, the S&P 500 decreased 0.12%, and the NASDAQ gained 0.18%.

Last week, we started to circle the globe in an effort to get a sense of what may occur in the coming year and decade. We wrote about the United States and China, the two most dominant countries in the world economy. This week, we move to Europe. Rather than treat each country separately, we thought it more interesting to take a close look at the European Union.

Genesis of the EU

In order to have a better understanding of what is happening now, it is instructive to look back in history. The European Coal and Steel Community, the predecessor to the European Union, was formed on the July 23rd, 1952. The first half of the century had proven disastrous. Two devastating world wars separated by the Great Depression had left Europe in tatters both physically and ideologically. Robert Schuman of France, Konrad Adenauer of Germany, Jan van den Brink of Holland and others searched for a solution to enhance the rejuvenation of the European economy. The unifying theme was to bring Germany into the fold, make them economically dependent on a unified Europe and prevent the bellicose behavior of the first half of the century.

The Common Market

On March 25th, 1957, this organization morphed into the Common Market. The leadership of

Europe was still dominated by the specter of two World Wars and the fear of communism. Great sacrifices in national autonomy were made, but it was considered a reasonable price for peace. Interestingly, Charles De Gaulle did not want the U.K. involved and kept them out. One of the reasons is that he did not consider the U.K. to really be European, and, of course, he always felt a great rivalry between the two countries - France and England. Perhaps he was clairvoyant..

History is replete with wars between the United Kingdom and France. It was and remains questionable whether the UK is part of Europe. Besides the intermittent conflicts, the entrances of both countries into the modern age took strikingly different paths. The U.K. was heavily influenced by the Scottish Renaissance, with philosophers and leaders such as David Hume, Adam Smith, Edmund Burke and Samuel Johnson. In France, the intellectual leadership came from Voltaire and Rousseau, and they looked for reform in the French Revolution.

Even today, there are demonstrable differences in thinking on the continent and the U.K. The most important for our thesis is the differences in economic philosophy. Although both were heavily influenced by Adam Smith, David Ricardo and later, Maynard Keynes, the U.K. remained true to a more orthodox version of capitalism, while France and most of the continent had a stronger socialist leaning. This becomes both apparent and important in the next step.

Weekly Market Insights (cont'd)

The European Union

On November 1st, 1993, the Common Market morphed into the European Union. The E.U. created a far stronger bond between the signatories. As time progressed, the obligations to each other and the organization grew exponentially, and it was successful. In fact, it was so successful that on the start of the New Year, January 1999, the members collectively gave up independent currencies and formed a new currency called the EURO. Perhaps prophetically, England demurred. This move dramatically enhanced the authority of Brussels, the capital of the E.U., and conversely tied the members into greater uniformity. These demands began to show splinters in the organization. Countries such as Germany and Holland were vexed by what they considered poor budget management by the South, while the South resented the north.

The Great Recession

Then came the Great Recession, and fractures began to appear. The inability to coordinate monetary and fiscal policies slowed the recovery and remains a problem. It became far more difficult for the rich to subsidize the poor, whether imagined or not. Unfortunately, multiple conflicts blew up in North Africa, which produced a great migration from the Middle East to Europe. Some governments encouraged this, but, in most countries, the citizenry strongly objected.

The stage is set

This long story sets the stage for 2020. It should not be a surprise that much of the U.K. objected to the loss of sovereignty. That they refused to give up the pound sterling and monetary independence should have been telling from the beginning.

As far as the unity of the group is concerned, it is an open question. The leadership that was terrified of another global conflict are all gone. Very few remember, and it is no longer the defining cause of economic and political unity. So, it remains an open question where the EU goes from here. Most any economist can recite the potential gains the European Union provides: enhancement in efficiency, far greater labor mobility and more global clout. On the other hand, these countries suffer a substantial loss of autonomy and national identity. Lastly, the principal organizing factor, fear, appears long forgotten.

What happens from here? No one knows, but it is a reasonable argument that Europe will continue to struggle through 2020. Britain will almost surely leave the E.U. Will she suffer for that momentous decision? Perhaps, but don't bet on rack and ruin. None of this necessarily spells doom. This week's piece is just meant to highlight some problems, and point to legitimate concerns expressed by BREXIT promoters.

A great idea

Now, at the end of a very positive year, it is a great time for investors to take a hard look at their portfolios and rebalance if necessary.

Happy New Year!

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