



Quarterly Letter July 2016

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THALASSA CAPITAL LLC

"What doesn't kill you, makes you stronger." Friedrich Nietzsche

It doesn't happen too often that writing an investors' quarterly missive coincides with the aftermath of one of the most significant political and diplomatic crises of the post-war era: Brexit.

After months of divisive campaigning, the UK has practically split itself in two and voted with a small but clear majority to leave the European Union.

Just as the UK referendum to leave the EU was instigated by petty internal politics, the ramifications of its surprise result should continue to remain a local European and British issue; however, as global investors, we must consider all possibilities for contagion or opportunities.

The most worrying sign of this incredibly mismanaged process is the confirmation of the rise of populism around the world. Brexit, while supported by a few valid points, was eventually fought over extremely simplistic and populist slogans. Such barrage of populism drown any possibility for a constructive debate to a point where, based on post referendum Google record searches, it seems a significant portion of the electorate didn't even know what the European Union really was.

Unfortunately, the misrepresentations of Nigel Farage, the representative of the UKIP party, and the most vocal Brexit supporter have provided fuel to other fringe, but growing, movements around the world such as the far right in France, Movimento 5 Stelle in Italy and possibly Donald Trump in the US. In this crisis, contagion is not a credit risk or a financial metastasis but a reflexive spreading of unhelpful nationalism which may reverse the trend of globalization that started forty years ago.



To be sure, such outcome is not guaranteed and a proper rebalancing of some of the excesses of unchecked globalization may actually be welcome to ensure that violent and impoverishing reversals may not succeed.

Barring a self-inflicted spreading of negativity and unnecessary nationalism, Brexit remains, as pointed out earlier, a largely local and most likely overblown issue. The road to implementation toward an actual exit of Britain from the Union is a long and winding one and in our opinion a road that may lead to nowhere. In other words, the UK may actually not proceed with it or the exit may be so soft and the changes in benefits and responsibilities so minimal that by the end of the process no-one would notice.

In the interim, however, the UK is experiencing a vacuum of leadership and the risk premium associated with risky asset must go up globally to reflect a higher degree of uncertainty. In this fashion, markets are acting rationally in the short term but they may provide long term opportunities.

Technically speaking, the UK may suffer a minor recession even as soon as by the end of this year and global growth could register a minimal cut. JP Morgan now forecasts global growth to be cut by 0.2% for 2017 for an annualized expected rate of growth of 2.5%.

It is possible that the US Dollar may end up being the winner of this mess and not only in the form of money flowing into US Treasuries but eventually spreading to equities and real estate as well.

Global uncertainty also would seem to keep the Fed in check for longer on the interest rate side, therefore providing continued support for rate sensitive instruments like REITs.

A stronger US Dollar may slowdown the commodity comeback but the disappearing supply-demand imbalance should continue to provide a bid for energy related names.

Among our other strategies, we like the Water portfolio due to the mixed elements of high technology, utilities and dividend stability and geographically diversified exposure. These three components should help insulate the portfolio from the specific uncertainties related to Brexit.

On a short term basis, we would expect volatility to continue as the news flows will only intensify as the process unwinds. We should also expect European stocks in general to remain weak for some time.

Overall, Brexit is clearly not being helpful but it should also not deteriorate into a “Lehman Moment” either. The truth is we continue to find ourselves in a low growth universe where investors should expect generally lower returns amid higher levels of volatility.



As expressed in previous letters, these conditions require diversification, long term horizons and the ability to act on tactical rebalances.

As always, we would like to thank you for the renewed confidence in our work,

Youri Bujko

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