

## Oh, Flower of Scotland

Leading up to the referendum on Scottish Independence, one trader remarked "there will be blood on the trading floor Friday" if the Scots were to vote "Yes" and chose to break the 307-year-old union with the United Kingdom. That's because money was already flowing back into the assets classes that were negatively affected by the uncertainty surrounding Scottish Independence on the basis that a "No" vote would ensue. Evidently, exit polls were giving traders enough information to bet the outcome. The money illustrated the results in Thursday's referendum as the pound gained approximately 2 per cent from its lows of the week before votes had even been tallied. However, what later resulted was a clear "buy the rumour, sell the news," as the pound gave back most its gains Friday morning.

The theatrics associated with the unknown outcome definitely took a toll on markets as we head into the tail end of the third quarter. But the underlying theme or message is certainly an important one as an astonishing 45 per cent of the population voted for independence in a referendum that saw approximately 85 per cent of their population participate. The message for those invested in financial markets is that populism has the potential to trump pragmatism when it comes to governance and economics.

Any economist leading up to the vote rationally stood on the side for Scotland to remain a part of the UK. The greatest concern, and one that could only be discussed hypothetically thanks to a lack of detail from Alexander Salmond, leader of the Scottish National Party, was what currency to adopt. With over 9 per cent of Scottish GDP coming from their financial services sector, and part of the benefit being that the pound still serves an

important role as an international currency, how would the banks react? Initially Scotland discussed the idea of keeping the pound, an approach known as 'dollarization' where the pound still serves as the nation's currency, but monetary policy and facilities like deposit insurance are not conducted or utilized in Scottish interests. All of these measures that promote stability and longevity in a currency, and thus become a harbour for capital and commerce would be jeopardized.

Other obvious issues surrounded the idea of disruptions to business and a worsening Scottish deficit. Estimates had it that around 60 per cent of Scottish exports are destined for the other three countries in the United Kingdom. There lacked sufficient reasons other than a phoney idea of nationalism to put up a border only to disrupt trade flow and make moving goods harder for businesses. Oil reserves in the North Sea were perhaps the saving grace for Scots, but when transfer payments from Westminster equaled the royalties received from North Sea drilling this year, and projections for North Sea oil are vastly diminishing, financing their 7 per cent deficit looks like a challenge. This compares to EU nations, which outlined by the Maastricht treaty look to maintain a deficit-to-GDP of 3 per cent.

There is the angle that it was the Scots incentive to fear Westminster with an independence vote to benefit more from government or take back more autonomy over more local issues of their economy, and the latter outcome will likely prevail. But the takeaway for investors has got to be the potential for instability in nations were a misguided millennial-inspired movement can have such a significant impact.

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