

## ASK FORSTRONG:

# WHAT'S NEXT FOR BREXIT?

## POSTCARD FROM DUBLIN



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### Speed Read:

- What really matters for Brexit? Eliminating the hard deadline. This will end the threat of a “No Deal” rupture.
- Since last week, Boris Johnson has suffered a series of defeats. Skipping to the bottom line, all of this means a No Deal scenario has quickly become a low probability.
- Depressed sentiment and deep value mean that UK assets are now primed for a tradeable rally. But this situation exists in Europe, Japan and, most clearly, in many emerging markets. Despite widespread calls for a recession, global risks are receding driven by easing monetary policy, lower oil prices and leading economic indicators turning up.

Today's list of world anxieties is seemingly never ending. At the top is trade wars. But there is also Hong Kong protests, Iran tensions, potential policy mistakes and, most conspicuously, bond markets priced for eternal stagnation (not to mention the ambient terror of negative interest rates). We all get it. Global risks are elevated.

Yet if there is one political issue that truly bewilders the macro tourist and investment professional alike, it is Brexit. The media has continued to fumble around for the right narrative, seemingly always out-of-date with their mental maps of the action. You can hardly blame them. Almost daily a rash of new information forces an update to the outlook.

Let's recap the drama. More than 3 years ago, 51.9% of the UK's population (knowingly or unknowingly) voted to leave the European Union. Withdrawal was scheduled to occur on March 31, 2019. That didn't happen. Since then, we have had 2 prime ministers resign, countless cabinet resignations, a conservative majority wiped out, and an unprecedented number of parliamentary defeats. Add in the swaggering Prime Minister Boris Johnson and his now dwindling band of Brexiteers, his family feuding brother Jo and even the Queen approving prorogue. Not an easy plot to follow ... and hard to make this stuff up.

Are most investors staying current on all this? Almost certainly not. Even the British public seem confused, unable to take refuge in their time-honored tradition of humor amid crisis. The message from them is simply: please, make it stop.

A visit to Dublin last week concentrated the mind on all of this. After all, Ireland stands to lose the most should the UK leave the EU. The historically fraught 500 kilometer border between the north (part of the UK) and the Irish Republic to the south (which remains in the EU) will be the only land crossing between the two jurisdictions.



The Brexit deal negotiated by former Prime Minister Theresa May included a controversial provision known as the Irish backstop. It was designed to guarantee that the border remained free and unseen no matter what future trade deal the two sides eventually struck. In exchange, the UK pledged to protect the EU's ability to enforce its customs rules by promising to abide by them until another arrangement was reached. But it was this boundary that sank May's efforts to engineer an orderly exit from the EU.

Clearly, we did not expect the Irish people to be pleased about any of this. They were not.

But, more broadly, where to next for Brexit? To most, the scenario tree ahead extends like a pole with a seemingly endless number of branches. But consider what really matters: eliminating the hard deadline for Brexit. This will end the threat of a "No Deal" rupture.

Recent action has been pivotal in this regard. Last week, Johnson suffered a humbling double defeat. First, MPs backed legislation to stop Brexit without a deal and then blocked the prime minister's attempt to call an emergency election to regain the initiative on Brexit.

Now Mr. Johnson has said he would rather be "dead in a ditch" than seek a further delay to Brexit. But with No Deal taken off the table for now and a snap election blocked, the pressure is on the PM to reach an agreement in Brussels before October. The chance of that is low. Even the EU's chief negotiator, Michel Barnier, said that talks are stuck in "paralysis" after the UK has failed to provide any proposals to break a deadlock over the Irish backstop. Crucially, all of this means a No Deal scenario has quickly become a low probability.

### Investment Implications

Breaking up can be hard to do. And it's taken a toll on the British population. Consumer confidence just hit a six-year low and business optimism is the lowest since 2011. Yet UK asset prices amply reflect that pessimism. British equities remain well below

their long-term average valuations and deeply underweight in fund manager portfolios. Meanwhile, earnings revisions momentum is turning up and the smart money (i.e. commercial hedgers) have been increasing their longs in the British Pound. In other words, UK assets are primed for a tradeable rally.

But a similar situation is evident elsewhere in the world too. Depressed sentiment and deep value exist in Europe, Japan and, most clearly, in many emerging markets. Despite widespread calls for a recession, global risks are receding driven by easing monetary policy, lower oil prices and leading economic indicators turning up. Rather than lurching closer to the proverbial edge of the cliff in recent months, the world has collectively taken a few giant steps back.