Brexit: Should We Stay, or Should We Go?

At a glance

- **The Arduous Road to Brexit:** Never expected to be an easy transition, Britain’s exit from the European Union (EU) has involved a series of complex and often contentious negotiations.

- **Possible Conclusions to Brexit:** Leave with a deal, crash out without a deal, or remain following a possible second referendum.

- **Investment Implications:** The TD Wealth Asset Allocation Committee (WAAC) believes there will be minimal direct impact for North American investors, regardless of the Brexit outcome. The WAAC is currently underweight International Equities in its portfolios, due in part to the Brexit overhang.

The arduous road to Brexit

The United Kingdom’s (UK) dissolution drive from the EU remains embroiled in gridlock, despite the British electorate voting to separate from the Union roughly three years ago. In the 2016 Brexit referendum vote, the ‘leave the EU’ side edged out the ‘remain’ camp 51.9% to 48.1%, while exposing deep regional divisions across the UK. In large part, these divisions remain today, and reflect the conflicting views of constituent representatives within the British legislature that have thus far failed to deliver a Brexit resolution.

Never perceived as an easy exodus, the Brexit affair has involved a series of complex and often strained negotiations, that has delivered cringe-worthy political theatre for chagrinned British citizens. Some remain hopeful that a deal will be stuck by the latest October 31, 2019 extension; others are skeptical. While we can’t predict a final outcome, we will explore the events that have led to the current Brexit impasse, and potential investment implications, regardless of how events unfold.
Deadlines old and new

In October 2016, PM Theresa May, who assumed Conservative leadership following David Cameron’s resignation, began the formal process of initiating Britain’s departure from the EU. On March 29, 2017, the two-year countdown to the Britain-EU divorce was set for March 30, 2019.

May successfully negotiated a Withdrawal Agreement with the EU in November 2018 but failed repeatedly to obtain consensus on the deal within her own legislature - a requirement for Brexit to proceed. Legislative disagreement centred on the structure of the UK’s post-Brexit customs and trade arrangements with the eurozone. With no deal in place, EU leaders agreed to extend Brexit to October 31, 2019 – a second extension to avoid a no-deal exit scenario.

On May 24, 2019, following three failed attempts to persuade the House of Commons to back her Brexit package, Theresa May announced her resignation as PM and leader of the Conservative party. As the party works to appoint a new leader, May’s successor will likely face the same daunting task of attempting to maneuver a Brexit agreement through the British legislature while securing Brussel’s support, or face the increasing prospect of a no-deal Brexit on October 31. The new leader is expected to be appointed by the end of July 2019.

Brexit – short for “British exit” a word referring to the United Kingdom’s decision to leave the European Union.

Are we still Brexiting?

Amid political turmoil and public angst arising from the ongoing Brexit affair, many may question whether breaking up is really worth it? Post-referendum public opinion polls indicate that UK citizens are still very much divided, however the ‘remain’ side has garnered broader support compared to 2016. Poll figures indicate that 48% now favour remaining with the EU versus 45% in October 2016. Interestingly, at 44%, Brexit support is virtually unchanged, increasing a mere 1% from 2016.1 (Chart 1)

Chart 1. Poll: Should the United Kingdom remain a member of the European Union, or leave? (Asked after Referendum) As at June 20, 2019

Source: https://whatukthinks.org, BMG Research, Field work dates: 19 October 2016 - 20 June 2019, Data from United Kingdom, Great Britain. Sample size 1546, Age 18+
What the future might hold: Possible conclusions to the Brexit saga

The October 31, 2019 deadline looms large for an exit deal to be finalized; however, a third extension is possible should time run out. Britain still faces several potential outcomes to Brexit, and below is a summary of some key scenarios.

1. **UK Leaves EU - With Deal:** Some form of agreement would need UK parliamentary ratification and Brussels’ stamp of approval to clear way for a more orderly Brexit. Key issues that need to be resolved include the rules that would govern trade with Europe, the status of European workers in the UK, and the treatment of the border between Ireland (a member of EU) and Northern Ireland (part of the UK). Unfortunately, no plan has been able to garner majority support as views remain sharply divided on these issues.

2. **UK Leaves EU - No Deal:** This scenario remains a distinct possibility. If PM May’s successor and legislative colleagues can’t get their house in order by October 31, and no further extensions are granted, the result could be a no deal departure. The risk of this outcome creates significant uncertainty for companies operating in the UK as it remains unclear what rules would govern trade with Europe in this scenario.

3. **UK Does Not Leave - Remains Part of EU:** This outcome would likely occur as a result of a ‘remain’ vote from a second referendum. It is also possible that the UK stays because they can’t agree on the terms of departure, and the result is a stalemate that lasts for years.

Brexit investment implications: WAAC’s view

Despite the UK equity market recovery over recent months, an economic overhang remains over the economy due to Brexit uncertainty. Real estate has experienced a prolonged period of weakness, with values declining approximately 10% over the past few years. The British pound (Chart 2) is at the lower end of its trading range in recent years, while investment in the country and stock valuations remain depressed.

However, in terms of investment implications, we expect minimal direct impact to North American investors regardless of how Brexit unfolds. The UK economy accounts for only 2.2% of global Gross Domestic Product and is a small market for most U.S. and Canadian companies. We are underweight International Equities in our portfolios, due in part to Brexit politics, sluggish growth throughout the Eurozone, and also because the European equity market has lower exposure than the U.S. to sectors driving growth and innovation, like technology. Longer-term, we remain concerned that societal divisions driving the Brexit debate may also become more prominent in other countries, including the U.S., France or Italy. This could create an environment where economic policies become volatile, and in turn, result in lower investment, slower growth and increased market uncertainty.

The next big test may be the 2020 U.S. election, where the range of policies being advocated by Democrats and Republicans is unusually wide. We will be watching with great interest as the drama unfolds.

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Do the polls point to regret over the initial break-up decision or does the steady support for Brexit suggest that many Britainers remain fed-up with the failed process and are eager to leave, deal or no deal?

Without the ability to foretell the future, we will rely on time for answers, but for now, we’ll examine the potential outcomes from a broader lens.

**Brexit uncertainly, has contributed to Eurozone economic instability, and negatively impacted the British pound as shown in the chart.**

**Chart 2. GBP to USD Exchange Rate**

![Chart 2. GBP to USD Exchange Rate](chart2-gbp-to-usd-exchange-rate.png)