Commentary on Brexit

Now that the U.K. has set a referendum date for voters to weigh in on the country’s continued membership in the European Union, it is inevitable that market pundits will turn their attention to a possible exit, or Brexit. The agreement reached at the February 18-19 EU Leaders meeting in Brussels is almost moot now as we go headfirst into UK politics and the campaigning ahead of the 23 June 2016 referendum. The market reaction has been largely through the currency. Cable (GBP/USD) has fallen to 1.39 from a 1-month high of 1.46, about a 2.6% decline. Equity markets haven’t seen any pressure and 10 YR gilts are yielding 1.35, which has been slightly volatile over the past days. Forex is likely to be the conduit for the bulk of Brexit market influence. There is unlikely to be a significant dent in gilt appeal given the global yield environment and the UK’s less tarnished growth outlook than competing opportunities. There is likely to be more weakness in GBP as we move through the campaign noise and it is likely to be compounded by dollar strength.

5-year Performance of British Pound/ U.S. Dollar from Bloomberg
Prime Minister Cameron has stated that cabinet members could campaign for the referendum as they see fit. There were some widely anticipated moves to the Exit side from Justice Secretary Michael Gove, Iain Duncan Smith, the work and pensions secretary, John Whittingdale, the former Thatcher aide who is now culture secretary, Chris Grayling, the leader of the Commons, Theresa Villiers, the Northern Ireland secretary, and Priti Patel, the employment minister who attended cabinet on the day of the announcement.

Others have slowly emerged as supporting an Exit vote. The Fresh Start group was established in 2011, has about 100 members and is viewed as a new generation of Euroskeptics within the Conservative party. While not all of the Fresh Start members are supporting Brexit at this time, it appears a large chunk are and being joined by other more mainstream colleagues. Eighteen parliamentarians that were judged to be unlikely supporters of the Brexit campaign have declared their support for an Exit vote. It is estimated that almost half of all Conservative parliamentarians now are supporting Brexit.

Boris Johnson’s surprise and early announcement of support for an Exit vote dominated the media on Sunday and Monday. London’s mayor may bring more charisma and good sound bites, but it is yet clear what role he’ll play in the campaign; there are some doubts around his motive. He is clearly a contender for Conservative leadership as well which hangs over his campaigning and may taint his public appeal. Prime Minister Cameron and Johnson have a historic rivalry dating from college a day which adds some much appreciated drama (by the media) to the debate but little substance. Johnson, while still mayor, is also a member of parliament. There will be a mayoral election on 6 May 2016 to name his successor.

It is very early in the campaign process and while polls have been conducted since September 2015, the outcomes have been wildly divergent. The bookie odds have not changed significantly. There is a 2/5 odds for staying in the EU and 7/4 odds for leaving the EU. After the poor showing for the polling ahead of the May general election in 2015, there is a renewed interest in watching the betting odds versus the polls.
Anti-EU sentiment in the UK has been the domain of the extreme left and the extreme right. The rhetoric about lax worker rights from the left and shackles of oppression and constraints on sovereignty from the right have only strengthened those who were already believers. However, with more mainstream Conservative politicians voicing their support for an Exit voice, there may be a normalization of the concept and more ground gained towards moderate voters.

However, the campaign is only beginning and business is only just beginning to voice its concerns about an Exit vote. Similar to voting everywhere, voting intentions mean one thing until personal finances comes into play and then views tend to revert to the status quo.

We will be keeping our eyes on this situation and will have updates as we get closer to the vote.

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