

THERESA MAY & HER 12 POINT BREXIT PLAN

Prepared by Gilt Edge Investment Consultancy, 30th January 2017



Industry News

Everything is leading to a hard Brexit and massive uncertainty

It seems that politics and political rhetoric have dominated investment markets for the past two weeks. This provides risks and volatility to markets as political risk can rarely be priced in correctly. Politicians have and will continue to shock markets by acting in ways they feel best for their electorate which always sends shocks and reverberations through markets globally.

The following quote from Plato epitomises this point:

‘Those that are too smart to engage in politics are punished by being governed by those that are dumber’

If focus is solely on these events it will eventually cause issues. 2016 highlighted how the unthinkable may happen but may not be as bad as first thought.

This leads onto the fast-moving actions of the UK in the Brexit negotiations and timeline for leaving the EU.

What has happened so far in 2017?

Theresa May has continued to keep markets guessing on whether a hard Brexit will be achieved. Clarity has been shown on how the UK will formalise alliances with global markets and what leaving the EU will entail.

Supreme Court Ruling:

The Supreme Court published its findings into whether the government could enact article 50 without seeking approval from Parliament. The panel of 11 justices confirmed that the December High Court ruling was correct and that Parliament would have to be involved before article 50 can be enacted. This meant that a draft white paper was commission on how the government is looking to evoke article 50 and what type of deal is looking to be made with the EU and other global countries.

The Supreme Court found in favour of the government that separate approval was not required from the three devolved governments of Scotland, Welsh and Northern Ireland. This did not make the Northern Irish and Scottish happy as they are still considering options to leave Britain and thus able to re-join the EU. A majority vote in both Scotland and Northern Ireland of not leaving the EU in last year's referendums.

Davos speech 2017:

Theresa May was invited to speak at the Davos investment forum. This speech was highlighted as a major insight into the Conservatives' plan for Brexit. The speech did not highlight many options for the government regarding negotiating with Europe and other countries to try and get the best deal for the UK. The speech emphasised how May is looking to try and gain unity in the UK by putting its citizens first. She highlighted individualism and globalisations as being key reasons as to why electorates globally are looking for change.

‘But just as we need to act to address the deeply felt sense of economic inequality that has emerged in recent years, so we also need to recognise the way in which a more global and individualistic world can sometimes loosen the ties that bind our society together, leaving some people locked out and left behind’

(Citywire Article – Scottish Mortgage manager attacks Hitler May – 20th January 2017)



Theresa May Brexit Speech:

Before the trip to Davos, Theresa May outlined the twelve point Brexit plan which are the foundations to negotiations globally. The plan set out looks to develop Britain as an individual entity in the global marketplace:

1. Certainty & Clarity – The government believes that this is the most crucial objective. This is something they have not been able to provide and is an objective we do not believe can be achieved in 2017
2. Control of our own laws – The government are looking to control the affairs of Britain meaning that each of the capital cities has the right to make their own laws. Many will see this as a positive and a major benefit to Britain
3. Strengthen the Union – Theresa May's first battle will be to try and unite the leaders of Wales, Scotland, and Northern Ireland. A set of meetings are to be held over the coming weeks to try and extinguish the differences across the nations. This, we believe, will be a fruitless task as Scotland will be trying to evoke another referendum to leave Britain and rejoin the EU
4. Maintain a common travel area with Ireland – Another problematic area that is looking to be addressed quickly. Due to the very close ties with Europe and the US, maintaining a positive border for both countries will be important, especially as the country is still a major haven of large global conglomerates
5. Control of immigration – A very important issue especially for the average voter. Many now agree that immigration was the biggest voice within the referendum vote. This has meant that the governments hands have been tied regarding this. They want to keep the door open for highly skilled workers but want to close the doors to others from Europe who are not contributing enough for what they are given in return. We do not think this is an area that will be easily resolved. Some sort of compromise may have to be made to the detriment of the UK's views primarily
6. The rights of EU and British nationals – A point that has been very opaque. Many people in the services sector have been asking for clarification on this point. This is a point will be completed quickly but called stall from one or two nations holding back. We think some form of policy will be made to allow workers to stay in the UK who are already resident here but with companies looking to relocate away from the city, some workers may look to move anyway as to guarantee personal safety in regards to jobs and benefits. This would be off detriment to the UK economy in the future which has such a large bias towards services and the employment of skilled overseas workers
7. Protection of workers' rights – Another point that follows on from the previous points. European law on human and workers' rights is extremely pivotal and the government wants to expand on this further post the negotiations
8. Free trade with EU Markets – This point has highlighted issues for Theresa May and the Brexiters. Access to free trade with Europe would mean membership of the single market. This has been stipulated as not being possible, so intense negotiations will occur to make this possible. This is a point that is not going to be achieved overnight and in our opinion will not be as rosy as many would hope it is. For this to be positively achieved, a 'have the whole cake and eat it' scenario would have to pay our but there are too many forks on the table for that to occur. A large slice of cake would be beneficial but will mean that the government may lose out on areas which will not be known until the negotiations start
9. Trade agreements with other countries – Having an 'open book' will provide opportunities and risks for the general economy, specific sectors, and specific companies. The US is top of the list to try and gain a positive deal. Theresa May has already sworn allegiance to the new Trump administration and appears to be happy to be in the shadow of the US.

The Government does not seem to want to change the stance on Trump even when the public shows their displeasure to the decisions being made in the US and it affects the UK and other citizens globally. Trade agreements will also be looked to be generated with growing economies in the east and west including China, Brazil, India, and Russia. These should be the fastest growing economies over the next 10-20 years which will provide the best opportunities for the UK economy

10. Growing technology, life sciences & innovation – Theresa May believes that leaving the UK will provide the UK the best opportunities with growing the technology, life sciences and innovation sectors. This is looking to provide some comfort to universities and the life sciences and technology companies attached to these. Many of these have and continue to be worried about funding, employee rights and overseas students. Many of these are run through EU initiatives and have a large bias towards Europe. This may help to reduce the risks partly but will not alleviate the problems
11. Cooperation in the fight against crime and terrorism – Continued cooperation with Europe regarding crime, terrorism, and foreign affairs. Common sense has prevailed as increasingly more resources are required globally to tackle global terrorism and crime
12. Finally, a smooth orderly Brexit – A smooth exit is required and a strong constructive partnership with the European Union and other parties to realise the governments ambition of a stronger, fairer global, Britain. This is a bold statement and the backbone of all the upcoming negotiations. Whether this can be fully negotiated we are unsure like most investors and commentators across the globe

Have we learnt anything new?

What the past two weeks have shown is that Brexit is very real, there are still many unknowns but the government will not budge on issues such as immigration. This may be at a detriment to the opportunities for some of the largest corporations in the world that look for the best workers to create the best services and products. Companies based in services, technology, life sciences and financials have been highlighted as areas to watch. Without free movement of labour these types of companies' will look for bases elsewhere where the restrictions are not draconian. When this occurs, it will have a detrimental effect on the whole economy. It will affect growth, GDP and increase inflation. The whole supply chain will be affected meaning investing in the UK must be very selective.

Gilt Edge believe that investing in the UK should be market cap wide. Large caps may not benefit as they have done as sterling has already priced in such a large devaluation. Investing purely on a currency play will cause risks for investors and we would stipulate that this has more risks than benefits. Small and mid-cap companies may start to come under pressure from higher inflation, falling consumer demand, less spending, and risks in the supply chain. Many commentators have highlighted that domestic stocks will be hit the hardest.

This will make the UK less appealing especially to global investors. However, there are some bright spots which may become brighter in the future. Having a weaker sterling does make exporters more competitive which should continue if sterling remains weaker. Many companies are sat on cash which they are looking to deploy through M&A, dividends, or R&D which the government has highlighted as a big positive for UK companies going forward. The dropping of the tax rates to make the UK more competitive will benefit companies across the whole of the country.

Many companies will continue to operate in the same way they have done for years. Many of the domestic facing companies will continue to make profits, increase earnings and pay out a greater number of dividends and the risks from Brexit will not have a detrimental effect. Having a small nimble fund will be important with an experienced manager. What the past two weeks and 2016 have shown is that the UK should be an integral part of a client's equity portfolio but utilising an

unconstrained manager will be key to not just make the greatest return, but also reduce volatility and losses when markets do react negatively to political risks.

Political risks will always be present; the key is to try and use them positively in determining macro views but not to react to them in the long term. Brexit risks will continue and provide greater volatility we know that these will provide opportunities for small, nimble and unconstrained funds and so we will continue to use these funds to gain returns in a UK market that will be volatile as we go through 2017.

The past few weeks have shown that Theresa May and her Brexit team do have some idea of how they want to play the negotiating game. A trip to the US occurred last week declaring May's loyalty to Trump. A return trip has been penciled in to cement the friendship for the future. This could be at the detriment of Theresa May's long term political career but could be best for the UK. What many might not be happy with now could be best in the future for a post Brexit UK. Having a friendship with the US among other nations might mean putting up with Trump and other less desirable politicians but in the long term may help the UK stabilise and grow. If May puts her career or the EU first this might not get the best outcome.

