VERMEER
NEWSLETTER

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Brexit Brief

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We have had several requests from clients for our thoughts on Brexit and therefore thought it worthwhile to jot down a few key points. In general, we are not intending to offer dictatorial house views and in the case of Brexit that would be impossible, given that we have no better crystal ball than anyone else. CIOs, economists and market commentators are notorious for sitting on the fence, but on this issue, there is a lack of precedent and too many moving parts for anyone to take a definitive view. What we can do is highlight the following:

Political The range of political outcomes and effects on Brexit are just too numerous to discuss but it seems unlikely that there will be any UK government with a clear mandate and majority in the foreseeable future. That will only be a problem if it continues to stall government day to day decision making which we think is unlikely. The lack of an effective government in the past two years has already caused serious damage.

Economic Activity What is undoubtedly true is that the UK economy has ground to a halt as a result of Brexit uncertainty and an absence of effective government. Official data is only just starting to reflect this, but it has been apparent on the ground for some time. Business investment has ceased, retail spending is being supported by cheap borrowing and the housing market is seizing up. We are now seeing evidence that the latter is being repeated around the globe. A combination of Trump induced trade tensions and Brexit has conspired to put global industrial production into reverse.

UK Opportunity These previous points, do however, in our view present an opportunity. After over two years of no growth there is a pent-up level of demand driven by more normal levels of activity and, in particular, a recovery in investment. Our trading view is that there is a high chance of a short and sharp rally in certain parts of the UK equity market as and when there is a Brexit resolution.

This is not dependent on a hard or soft outcome, just certainty of the outcome. Perversely this may not by evident in the FTSE100 which would suffer from a bounce in Sterling. The “value”/domestic end of the market, however, is characterised by exceptionally low valuations and is only pricing in bad news. It would take very little for a major rally to be ignited in this part of the market. The main risk to our prognosis is a general election resulting in a labour-controlled government which would initially increase uncertainty.

Government Spending This could be further fuelled by a more expansionary fiscal policy from the UK government of any political hue. With no room for meaningful interest rate cuts and the cost of government borrowing so low, we believe that there is a good chance of a loosening of the purse strings in both capital and income expenditure. An anti-austerity / build for the future agenda has appeal across the political spectrum, particularly if the debt to fund it can be locked in on low long-term rates. This would benefit a wide list of stocks.

Corporate Activity – A Brexit resolution of any sort is likely to lead to a sharp upturn in the number of bids for UK quoted companies. Both corporate and private equity have access to enormous amounts of cash and cheap debt and are certainly attracted to the UK. The recent weakness of Sterling has led to some buyers moving early e.g. Entertainment One, Greene King & Cobham.

Conclusion We make no apologies for our even-handed approach to forecasting a Brexit outcome. Even as we write this piece, we are busy reading up on how to spell “prorogue” and the situation changes literally on daily basis. There is no guide book or precedent to the current set of events, but therein lies an opportunity. We continue to seek out high quality companies and fund managers who have the qualities and abilities to ride out the storms and the flexibility to adapt in a fast-changing world.

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