

INVESTMENT TEAM

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Maybe it's because I'm a Londoner

Soon after the Brexit referendum, a joke became popular which went along these lines. "Roy Hodgson should become Prime Minister, because he has a proven record of leaving Europe swiftly". Well the irony could not be stronger, with all Continental European soccer teams now out of the Europa League, two London rivals, Chelsea and Arsenal will battle it out to become European Champions on the 29th of this month, less than a week after the European Parliamentary elections. So, while it is assured that a UK football team will sit atop all other European competitors this year, results of the imminent European Parliamentary elections will deliver far less joy to UK politicians. Sterling is trading at its weakest since January, very close to our "fair value" but it may fall further as European protest votes are lodged against the main parties. This increasingly bitter and unattractive UK political impasse over BREXIT now seems to have finally claimed the Prime Ministers scalp, ultimately making a remain (or remain-like) outcome increasingly likely. If we are right, that will eventually send Sterling soaring.

On Thursday last week Prime Minister May was effectively forced out, briefing senior colleagues that she would confirm details of her departure in June. She wants one more attempt to get her deal through parliament, but the arithmetic really has not changed. BREXIT talks with the official opposition also broke down last week, so she can expect no support there, with senior Labour figures saying the party will oppose Mays Brexit deal in Parliament. The usual suspects have already started to circle their wagons, and Boris Johnson remains the favourite to win a leadership election. In many ways it is a side show, and the task of toppling an embattled Prime Minister from within, is likely to prove much easier than solving the conundrum that is BREXIT.

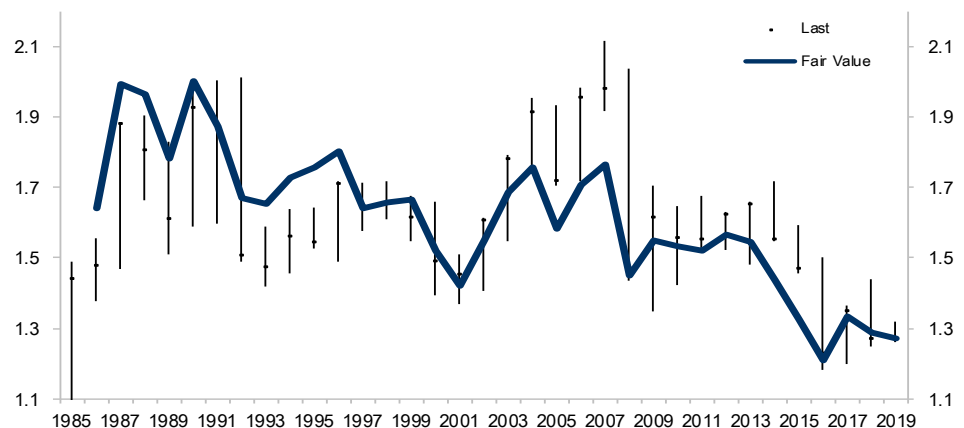
Whoever wins the top job will face the same parliamentary arithmetic on BREXIT. Parliament will not allow a no-deal Brexit, no matter how attractive Boris might make that sound to his grass roots support, but the time frame remains fixed. If no progress is made by the EU deadline of October 31st, then a second referendum, or revoking Article 50, may become the only way out. Of course, Boris wants to renegotiate with the EU, and he will make much of that in his campaign, but what if they say no? Interesting how vocal the EU has become more recently about the last referendum admitting they were wrong to have remained silent about bogus anti EU claims. These views are likely to harden and become more freely expressed in a world where Boris is Prime Minister. Donald Tusk recently suggested there was a 30% chance BREXIT would be cancelled. We think it is higher than that.

That said, the path to cancelling BREXIT is by no means clear, but Article 50 could yet be revoked against a hard EU deadline about which no orderly exit proved possible (October 31st being the current deadline). The UK may find itself in that position through negotiating incompetence, unchanging parliamentary arithmetic, an increasingly tactical negotiating position from the EU seeking a remain outcome, or indeed a second referendum. Parliaments inability to deliver an acceptable BREXIT ultimately makes remain the most likely outcome in our view.

Unfortunately, it seems unlikely that a prospective Conservative leadership contender would endorse a second referendum at the moment. It is not a vote winner for the top job. To be fair, Mr Corbyn has also remained resistant to the idea of a second referendum in the face of some considerable pressure from senior colleagues within the Labour Party. The European Parliamentary elections might just change minds if Labour voters desert their party with protest “remain” votes propelling the Liberal Democrats further along their political comeback. If Conservatives were also seen to lose more than expected to a remain protest vote, then the new leader might also consider a referendum pivot. Interestingly, Boris has already proved to be most agile with his political convictions. That really would be ironic if the man many see as having been the principal architect of the BREXIT problem, lending credibility to the leave campaign, were to become part of the solution.

The path of Sterling has been towards further weakness this month as the prospect of breaking the Brexit impasse receded. Against the US dollar, Sterling is now trading close to our “fair value” estimates, which leaves some considerable downside should we leave without a deal – possibly below parity. The more likely outcome, however, is that we remain. Indeed, the most likely outcomes now seem to have polarised around the opposite extremes. With so many European politicians and bureaucrats having developed an active dislike of Boris, if he wins the leadership election, he may find that he is quickly cornered into a choice between a no-deal hard exit or revoking Article 50. We think remain is the most likely outcome, taking Sterling back above \$1.50.

Figure 1: UK Sterling versus US Dollar and “fair value”



Source: Bloomberg, Canaccord Genuity Wealth Management

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