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September 2019

## *“Brexit or an Orwellian\* world...”*

Dear Investors,

To date, on a national scale, only three referenda have been held in the **United Kingdom of Great Britain and Northern Ireland**. I do find the extended version more appealing for the current topic of this newsletter. First referendum was the 1975 European Communities membership referendum (YES 67%), the 2011 Alternative Vote referendum (NO 67%) and finally the 2016 European Union membership referendum (LEAVE 52%).

I came across a joke I thought I should open this newsletter with, given the comic nature of British politics.

*“ The UK will evolve to be the home of electric airplanes, first in the global battle against climate change. Your mattress will monitor your nightmares, your fridge will beep for more cheese, your front door will open wide when you approach like a silent butler. AI – what will it mean? Helpful robots washing and caring for an ageing population? Or pink-eyed terminators sent back from the future to cull the human race? It is a trope as old as literature, that any scientific advance is punished by the gods. When Prometheus brought fire to mankind, Zeus punished him by chaining him to a Tartarian crag while his liver was pecked out. His liver was pecked out by an eagle, and every time his liver regrew, the eagle came back and pecked it again, and this went on forever... A bit like the experience of Brexit in the UK...”*  
*Prime Minister Boris Johnson, UN speech 25 September 2019.*

The UK is due to leave the European Union (EU) at 23:00 GMT on 31 October 2019. The EU, an economic and political union involving 28 European countries, allows free trade and free movement of people to live and work in whichever country they choose. The UK joined the then European Economic Community in 1973. If the UK leaves as planned on 31 October, it would be the first member state to withdraw from the EU.

On Thursday 23 June 2016, the UK voted whether they should leave or remain. Leave won by 52% to 48%. The referendum turnout was very high at 72%, with more than 30 million people voting - 17.4 million people voted for Brexit. Scottish voters overwhelmingly voted to remain (62%) as did the Northern Irish (56%) whereas Wales (53%) and England (53%) voted to Leave.

The key issues that need to be decided for Brexit are:

- Money, particularly the division of assets and liabilities, and payment of any debt outstanding
- Citizens' rights, both of UK citizens in EU countries and vice-versa
- Border arrangements and customs, particularly along the border between the UK and the Republic of Ireland
- The law, and the mechanisms for resolving disputes, currently vested with the European Court of Justice

Any agreement would also have to set up a 310 mile border across Ireland and Northern Ireland. Without a deal, the trade arrangements set out in the WTO rules will apply; these are a standard set of rules between two countries that have no trade deal.

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“Orwellian” is an adjective describing a situation, idea, or societal condition that George Orwell identified as being destructive to the welfare of a free and open society. It denotes an attitude and a brutal policy of draconian control by propaganda, surveillance, misinformation, denial of truth (doublethink), and manipulation of the past, including the “unperson”—a person whose past existence is expunged from the public record and memory, practised by modern repressive governments.

## ***The State of Affairs***

The UK and the EU agreed a deal in November 2018 but the MPs rejected it three times, first time in Jan 2019 by 230 votes, in March 2019 by 149 votes and third time again in March 2019 by 58 votes. After the third vote, Theresa May resigned, giving way to Boris Johnson, a strong Brexitier.

The latest attempt to suspend the British Parliament was on the 28<sup>th</sup> of August with Boris Johnson asking the Queen to prorogue Parliament until 14 October, effectively seizing the Brexit process out of the hands of the MPs. The last time a similar prorogation of Parliament took place was in 1997 when a controversial report was being discussed regarding bribery of the MPs by the Egyptian owner of Harrods department store, Mohamed Al-Fayed. That eventually led to a general election and a change of government from Conservative to Labour led by Tony Blair.

Parliament returned from the summer break on the 3<sup>rd</sup> of September and decided straight away to table a vote that later became the European Union (Withdrawal) (No. 2) Act passing all its stages in the House of Commons, House of Lords and receiving royal assent on the 9<sup>th</sup> of September despite governmental opposition. The purpose of the aforementioned Act is to prevent the United Kingdom from leaving the European Union without a withdrawal agreement on 31st October.

During September, Boris Johnson lost his working majority in Parliament with the resignation of first 3 MPs including his brother Jo Johnson and later additional members of the Conservative Party following suit. The resulting majority was lost by more than 25 MPs.

Meanwhile the Supreme Court concluded that the Prime Minister's advice to Her Majesty to suspend Parliament was unlawful, void and of no effect. This was the unanimous judgment of all 11 Justices.

Having lost several attempts to push for No Deal Brexit to take place, Boris Johnson then resulted to calling for a general election on 15 October. He needed the support of two-thirds of the MPs - at least 434 - to trigger an early election. The forced general election attempt failed twice with many MPs saying they do not believe Mr. Johnson's assurances of an election that would take place before the 31 October Brexit deadline.

The government remains in place without a majority.



## **What's Next?**

The anti EU withdrawal legislation could have loopholes that would allow Boris Johnson to avoid asking for an extension to Article 50 from Brussels if no deal is agreed until the 31<sup>st</sup> of October.

Alternatively a vote of no confidence in the government could be tabled by the opposition parties. This would require a simple majority. Opposition parties would negotiate a caretaker government and a new Prime Minister would take over. For the imaginative minds a national unity government can be formed with Labour, Liberal Democrats, Scottish National Party(SNP), Greens and others but has yet to bear fruit as the leader of the Labour party, Mr. Jeremy Corbyn fails to impress. Negotiations are taking place but many issues are expected to arise such as the SNP's push for a second referendum for Scottish Independence and the Lib Dems strategy of revocation of Article 50. If no majority is formed between the parties then early general elections would be called. Parliament would be dissolved 25 working days before an election takes placing yet again the risk of falling through the 31<sup>st</sup> of October deadline. To add to the danger of this outcome the date of an election would be decided by the ruling Prime Minister, Mr. Boris Johnson.

Stretching the imagination even further, the government could table a vote of no confidence in itself triggering the above process which may lead to an early election and theoretically force the UK beyond the 31<sup>st</sup> of October with No Deal.

On the brighter side, if the government complies with the anti EU withdrawal legislation, they would request an extension from the EU, which will be subject to the approval of the EU27. Against popular opinion this will not be easily achieved as Mr. Johnson has lobbied with EU member states to block any extension. Reasons for the previous extension of 31<sup>st</sup> of October have not exactly been abided by making the case even more difficult. If the EU refuses, then No Deal Brexit is back on, but based on the law blocking No Deal Brexit would it no leave a single option of signing the current Brexit Deal the only option? A game of eliminations...

Scotland has rallied for revoking article 50. It is increasingly likely that the ruling party in Scotland may return to voters and ask for independence from the UK with immediate succession to the European Union, creating even more borders. Scotland has voted for independence from the United Kingdom back in 2014 with No (55%) and Yes (45%). The Turnout was at 85%, the highest recorded for an election in the UK. Scotland voted by 62% to remain in the European Union in 2016, something which has been consistently ignored by the UK Government.

## **Market Functioning**

A disorderly UK exit from the EU continues to be a possibility. In order to limit the potential adverse effects associated with a No Deal scenario, important steps have been taken by market participants to reassure markets and limit any operational uncertainties. Market participants have been repeatedly called upon to prepare for the impact that a No Deal Brexit would have on their activities and business operations. Despite the uncertainty surrounding the Brexit outcome, trading conditions in the European financial markets have been orderly over the 3 year period.

"Financial firms are increasingly outsourcing some operational functions to cloud-based systems. However, the use of third-party cloud services may also pose risks related to information security, in addition to risks in areas such as governance and business continuity." *ESMA September report.*

The transition can expect a rise in risk associated with interbank rates, repricing of existing financial products and derivative positions for both banks and counterparties.

## **Political and Event Risk**

With the possibility of disorderly Brexit the transition of the UK out of the EU, remains the most important source of political risk for EU financial markets. Coupled with increasing trade-related risks, political uncertainty and the potential for deteriorating public finances, the risk of a sustainable recovery on the EU markets is reduced. Concerns over the debt sustainability for Sovereign issuers could creep into investors' confidence leading to a retreat of private investment. The GBP/EUR implied volatility metric illustrates the persisting uncertainties related to Brexit negotiations. The risk remains of heightened volatility as the deadline approaches.

## PERSONAL FINANCE

### To Buy or Rent?

When in the middle of paying off debt such as credit cards, car loans etc. one of the biggest discussions is whether rent payments are futile money spent and whether mortgage payments would prove to be the better alternative. In the majority of markets the cost will be similar to rent and pay a mortgage payment for a similar residence but the question should be expanded towards other aspects of life such as behaviour, both financial and personal. Beyond the financial stability aspect such as the necessity of large emergency funds, relatively stable employment status; other things such as long term views on the surrounding area including schooling options and development projects must be considered. More importantly is the aspect of money management and behaviour. Personal behaviour such as travelling should be factored in the equation as renting allows the freedom to “get up and go” whereas a mortgage ties you down to a home for many years. In the above example the individual already has accumulated debt the accumulation of which may have been during a period of approachable credit terms. Fundamentally the behaviour a borrower illustrates is a more important factor than the actual amount of debt. Habits of money management with goals targeting are fundamental toward reducing debt in the long-run as the ultimate propeller of wealth accumulation.

It is well founded that once a mortgage is created the full repayment after X years will be less whereas the property may increase in value over the same period due to inflation. In the current market environment where inflation is close to non-existent, acquiring a house would increase the risk of debt remaining relatively equal if not more due to interest repayments, with the wealth a house could accumulate after full repayment. Adding the unexpectedness of ending built cost and maintenance driving up the mortgage cost the value of a leveraged property diminishes. At the same period expectations for low inflation and low interest rates spiral supply for housing keeping rent in check. A large part of decision should fall on the income side and the ability to create economic savings combined with a debt repayment schedule that minimizes the years to full repayment. Less years of indebtedness provides more flexibility and potentially a competitive advantage for a home owner if inflation eventually picks up.

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