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# Brexit's Ticking Clock—Possible Portfolio Implications

**Peter Donisanu**
*Investment Strategy Analyst*

**Peter Wilson**
*Global Fixed Income Strategist*

**Paul Christopher, CFA**
*Head of Global Market Strategy*

**Key takeaways**

» *Despite the European Union's (EU) latest extension, time remains short to set the terms for the U.K. exit from the EU.*

» *The discussions are ongoing and conditions remain fluid. However, at this point, we anticipate a couple possible outcomes next week.*

**What it may mean for investors**

» *Consequently, we favor a cautious approach to developed equity and fixed income markets. We have a neutral outlook on developed ex-U.S. equity markets and an unfavorable outlook on developed ex-U.S. fixed income markets. We also expect dollar depreciation against other developed-market currencies in 2019.*

Time remains short to set the terms for the U.K. exit from the EU. Until the extension agreed with the EU Thursday, the U.K. Parliament was facing a deadline of March 29 to approve the negotiated Withdrawal Agreement between London and Brussels. U.K. Parliament twice has rejected the Agreement this year, and the speaker of the House of Commons this week declined to schedule a new vote until (and unless) the U.K. government offers material changes. The U.K. government was obliged to turn to other European leaders to extend the deadline.

**Possible outcomes as time runs out**

The discussions are ongoing and conditions remain fluid. However, given the European Council's decision on an extension last night (March 21, 2019), we anticipate the following possible outcomes next week:

- If the U.K. Parliament votes and approves the Withdrawal Agreement, the EU likely will offer a short extension through May 22, 2019, so that U.K. Parliament can pass legislation to legalize the agreement.
- If the U.K. Parliament does not vote or rejects the deal, a no-deal Brexit can be avoided next week, as the EU has given the U.K. until April 12 to decide what to do next. During this time, it may:
    - Hold a vote in the House of Commons indicating the next steps forward for the U.K.

- Decide whether to participate in EU parliamentary elections (late May) so as to request a longer extension from the EU.
- Nothing further happens, and a no-deal (i.e., very hard) Brexit happens on April 12 (the worst case, but not our base case).

The EU's extension does not solve the problem, of course, but it does avoid no-deal chaos on March 29. If a longer extension is seen (subject to the U.K.'s willingness to participate in European Parliamentary elections of course), the hope is that this would provide time for an eventual resolution—perhaps involving a change in the U.K. government or a second referendum. Although it is not our base case, the risk of the no deal (hard) Brexit remains high—as time is still short, and it is not clear yet if the House of Commons can break its impasse. Both the U.K. Parliament and the EU leadership explicitly want to avoid a divorce without an agreement—the so-called "no-deal" hard Brexit that would greatly complicate the movements of goods, people, and investments across the English Channel.

**What we favor doing in portfolios**

So far, global capital markets seem to have focused their attention elsewhere. Weak international trade growth has aggravated a slowdown in global manufacturing that, in turn, has dented sentiment and business spending on manufacturing plants and equipment. The slowdown concerns seemed to peak with the risk aversion of last October to December, and the more accommodative 2019 tone from global central banks has spurred broad rallies in global equity, currency, and bond markets.

Markets appear to be struggling to identify a catalyst to justify a new move higher in equity prices, while at the same time, appear to be anticipating a favorable Brexit outcome. Even though we believe an extension remains most likely, the events over the past week demonstrate how quickly the expected outcome could change. Therefore, this leaves the door open to heightened levels of market volatility if next week the U.K. Parliament either does not vote on the Agreement, or votes but rejects the Agreement.

Consequently, we favor a cautious approach to developed equity and fixed income markets outside the U.S. (including Japan and Europe). We are neutral on developed ex-U.S. equities because we foresee a balance of positives and negatives: upside potential in Japan and easing global trade tensions, with downside risk from the Brexit uncertainties. We also have an unfavorable view of developed-market debt, which could adversely affect returns in dollars and lead the pound sterling to depreciate.

## Risk Considerations

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