

# Institute Alert

NEWS OR EVENTS THAT MAY AFFECT YOUR INVESTMENTS

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## Brexit Needs Just a Little More Time

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### Key takeaways

- » *The U.K. is scheduled to leave the European Union (EU) this Friday, April 12, yet a plan for its exit has not been finalized. U.K. Prime Minister Theresa May is headed to Brussels this week to seek another short Brexit extension; the EU is likely to offer her more time.*
- » *Markets have not shown great sensitivity to Brexit developments, but we also note that the two sides could still fail to reach an extension agreement. In that case, global market reactions could be negative.*

### What it may mean for investors

- » *We retain a neutral view of Developed Market ex-U.S. Equities. The European economies are slowing, but our base case remains that the two sides will find a way to extend the time for the U.K. to decide its course. A smaller risk remains that the two sides may fail to extend the time—which could lead to even more negative results for global financial markets.*

Market participants have been taking the latest Brexit developments in their stride despite no clear path forward for the U.K. and only a few days to go until the country's scheduled departure from the EU (Brexit Day). Originally scheduled for March 29, the U.K. received a last minute Brexit extension on March 21 from the EU with the hope that U.K. Prime Minister Theresa May's deal (withdrawal agreement and political declaration) would be passed following a third vote, and if not, whether Members of Parliament (MPs) in the House of Commons would finally coalesce around some path forward.

Since the March 21 extension, May's deal was again defeated in a third vote, and U.K. MPs failed to coalesce around a single path forward. Now in a last ditch effort to avoid a no-deal Brexit, the Prime Minister is headed to Brussels this week to ask EU leaders for just a little more time. The reality (and Prime Minister May is likely aware of this) is that another short extension is not on the table. The EU has indicated that it is willing to consider a longer extension—until end-March 2020 has been mentioned—provided that 1) the U.K. can satisfy the European Commission that there are initiatives that may break the U.K.'s political deadlock; and 2) the U.K. agrees to put up candidates and participate in European Parliamentary elections May 23-26.

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The relatively muted response from financial markets to the developments this week suggests that the consensus view is that May will get some sort of extension and the calamitous effects of a no deal likely will be avoided on Friday. One risk to this view could come from resistance among some EU leadership to granting the U.K. government the sought-after extension. Despite ostensibly hardline rhetoric from such EU players as French President Macron, we believe that a long extension to Brexit remains the likeliest near-term outcome. This is because it is the lowest-risk pathway—not just for the U.K., but also for the EU nations that will want to avoid both the appearance of having “pushed out” a member nation and the economic chaos of a “no-deal” Brexit on the eve of the European Parliamentary elections.

### **Investor implications**

Markets have not shown great sensitivity to Brexit developments, but it is important to remember that a chaotic outcome is still possible. Looking into the week ahead, a no-deal Brexit remains a low likelihood event in our view, but this could change if no extension can be negotiated. In that case, the near-term implications for financial markets are likely to be outsized and negative. We would expect a sharp selloff in U.K. risk assets but anticipate a ripple effect of negative market sentiment and heightened market volatility to spread to European and global financial markets in short order.

It is still possible that another extension occurs and that other potential outcomes may arise during the extension period. Assuming she receives a Brexit extension this week, the challenge for the Prime Minister May in the weeks ahead will be whether she can balance diminishing political capital and pragmatism to pull together a deal that a simple majority in Commons can agree upon. If May’s reserve of political capital again proves depleted, and she gives way to pragmatism, then the additional time could be used to explore other options, including remaining in the EU. Whatever the outcome, we recommend investors remain cautious as this week’s extension talks (as with other recent Brexit related developments) will require a wait-and-see approach.

## Risk Considerations

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