

And now this...

Brexit: The End of the Beginning

A Hard Brexit is still a possibility

The ongoing saga of the United Kingdom leaving the European Union continues to dominate news headlines in Europe. The recent General Election in the UK provides a path forward but investors would be wise to consider the challenges that lie ahead in 2020. While the UK will almost certainly leave the EU by January 31st 2020, the process does not end there. In fact, this will mark the beginning of a process of ongoing negotiations as the two parties attempt to agree on the terms of their future trading relationship. The insistence of the UK on completing this process by December 31st 2020 does not sit well with their insistence on a clean break from EU rules and regulations. Comprehensive trade agreements generally take many years to complete so the specter of a 'Hard Brexit' looms on the horizon at the end of 2020. The era of cliff-edge deadlines is not necessarily over yet.



Recent Developments

Since our last update on Brexit, Boris Johnson has enjoyed a remarkable turnaround in fortunes. His early days as Prime Minister were troubled by defeated votes, MP defections and a law being passed

preventing him from leaving the EU on October 31st 2019 without a ratified agreement with the EU. He even suffered the humiliation of the UK Supreme Court ruling his prorogation illegal and recalling Parliament. With his options considerably narrowed, Boris Johnson compromised on key promises, made a new deal with the EU, convinced enough members of Parliament to support it and successfully requested a general election.

The New Withdrawal Agreement

Brexit involves withdrawing from the EU on agreed upon terms and then agreeing on the parameters of the future relationship between the UK and the EU. Theresa May was unable to get her withdrawal agreement past Parliament so Boris Johnson's first step was to strike a deal that enough MPs would support. The main sticking point all along has been the treatment of Northern Ireland and the desire to avoid a hard border on the island of Ireland. Theresa May's 'unacceptable' deal would keep all of the UK in an EU customs backstop arrangement designed to cater for these sensitivities without separating Northern Ireland from the rest of the UK. May was relying on the Democratic Unionist Party (DUP) to stay in power in a minority government and acceded to their demand that Northern Ireland not be treated 'differently'. Johnson recognized that DUP support was irrelevant as he needed an election and new parliamentary numbers anyway, so he dropped this demand in favor of a new solution. Under his new agreement, the whole of the UK would come out of the EU Customs Union as a single territory. While Northern Ireland would be a part of future UK trade deals, it would remain an entry point into the EU Customs Union, thereby creating a customs border down the Irish Sea. Johnson's team agreed to this new draft within days of the October 31st deadline and were determined to get it passed by the Commons. While it passed a preliminary vote with support of some Pro-Leave Labour MPs, the government was unable to get the deal ratified in time so a deadline extension until January 31st 2020 was requested in accordance with the Benn Act passed by the opposition just weeks before.

The General Election

From the moment he became leader of the Conservative Party in July, Boris Johnson had desired a general election. The Conservatives enjoyed a 10 point bounce in the polls when he became leader. He believed that if he could capitalize on this popularity and translate it into a parliamentary majority, he would be able to break the stalemate of Brexit. But not even Johnson could have dreamed of achieving the largest Conservative majority since 1987. While he shrewdly focused on voter frustration at the Brexit impasse, he was aided by two external factors. One was the decision by Brexit Party leader Nigel Farage to stand down candidates in traditional Conservative seats and only contest seats held by Labour and the Liberal Democrats. The Brexit Party had topped the poll in the European elections back in the spring and were successfully syphoning voters away from the three main parties. Farage's strategy was to avoid splitting the Leave vote, which could allow a Labour led coalition to take power and hold a second referendum. This benefited Johnson greatly, but the Labour Party itself ended up being Johnson's greatest ally. The leftward march of the Labour Party, under Jeremy Corbyn has ultimately led to their worst result since 1935. While the Labour manifesto may have scared off some voters with its scale and ambition, the main issue appeared to be Corbyn himself. His Brexit stance was to propose negotiating a better withdrawal deal with the EU and then putting that deal to a referendum where the choice was leaving on those terms or revoking Article 50 and remaining in the EU. His refusal to take a side on the key issue of whether or not the UK should leave the EU did not go over well with voters. Neither did his apparent legacy of tolerating antisemitism within the ranks of the national membership. In the end, the Conservatives won many Labour seats, not by meaningfully increasing their vote share, but by many disaffected Labour voters voting for the Brexit Party in protest.

So where does this leave the Remain campaign?

The campaign to stop Brexit effectively died with this election result. Whatever the criticisms of the 'first past the post' electoral system used in the UK, the party that campaigned on getting Brexit done won a sizeable mandate and any talk of a second referendum on EU membership now seems unrealistic and illogical. While it is true that polls generally show 52% of the UK population in favor of staying in the EU, the make-up of Parliament means Brexit will occur by January 31st. Even Pro-Remain Conservative MPs have been either purged or disciplined by Johnson as he very effectively united the Leave side ahead of the election. The Remain movement will initially shift to a 'No Hard

Brexit' movement and eventually a 'Re-Join' movement.

So Plain Sailing for Boris from here? Not so fast

Johnson does have a sizeable majority and is unlikely to be beholden to any fringe interests within his party in order to pass his agenda. But while the election gives him a path toward delivering Brexit, it does stir up other concerns within the United Kingdom. The Scottish Nationalist Party (SNP) won 48 out of 59 seats contested in Scotland with a platform to demand another referendum on Scottish independence. The 2014 referendum that was defeated was styled as a 'once in a generation' question, but with the fierce Scottish opposition to leaving the EU, the question has resurfaced. While Johnson has no obligation to agree to such a referendum either legally or via parliamentary math, he will face considerable political pressure over the next few years if he fails to recognize the SNP's mandate. In Northern Ireland, there were more nationalist than Unionist MPs elected for the first time ever, but this was somewhat influenced by the election of an Alliance Party MP which does not identify as Unionist or Nationalist, but as 'Other'. A border poll to reunite Northern Ireland with the Republic of Ireland may not be a near term likelihood, but a messy Brexit may impact public sentiment.

An EU Trade Deal is still a long way off

The most immediate issue facing Johnson is the self-imposed deadline of December 31st 2020 to leave the post-Brexit transition period. Upon returning from their resounding election victory, Johnson's government added a new clause to the withdrawal agreement bill ruling out any extension to this period. The EU's chief negotiator Michel Barnier pledged to 'do the maximum' to finalize a trade deal by then, but many in the EU are skeptical that a comprehensive deal can be ironed out within that timeframe. Pressuring adversaries with hard deadlines is a familiar Johnson strategy, but it means markets are likely in for some skittishness if we approach the fourth quarter of 2020 without meaningful progress. The negotiations will be complicated as the EU will be focused on fair competition. Its demands will focus on environmental and labor standards and ensuring the UK doesn't offer products on the EU single market at unfairly low prices. Many industry supply chains in the EU cross borders multiple times for products such as cars and pharmaceuticals and this requires an agreement on exact rules to designate where products come from and whose regulations and taxes apply. The Pro-Leave argument has been that the UK can compete globally if free of the shackles of burdensome EU regulations. Many Conservatives

favor a 'Singapore on the Thames' concept whereby the UK competes as a low tax, low regulation state on the edge of mainland Europe. A strict timetable on the UK side could give the EU the upper hand in the coming negotiations as any piecemeal agreement would likely focus on Products (where the EU had a \$122 billion trade surplus with the UK in 2018) rather than services (where the EU had a \$36 billion trade deficit with the UK in 2018). The new European Commission President Ursula von der Leyen met with

Johnson in January and made it clear that if Goods, Capital and Services are to move freely, then People must also be able to move freely. This is, of course, a key sticking point for Brexiteers. Leaving without any trade deal means reverting to World Trade Organization guidelines and tariffs are likely across the board. It remains to be seen what compromises can be made throughout 2020, but the 'Hard Brexit' concern remains on the horizon.



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