

Tortoise QuickTake

Credit Podcast



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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, senior members of Tortoise provide a timely update on trending topics in the market.

Hi, I'm Graham Allen, Senior Portfolio Manager with Tortoise.

Divorces between people are never easy at the best of times; between countries it can be worse. This is especially the case when one party to the divorce has 27 family members who all need to agree on a solution, and the other party cannot even decide on what they want or who will represent them.

As the March 29th 2019 deadline approaches BREXIT is increasingly in the news. Although this is the official deadline, the reality is that there is significantly less time available to reach an agreement because both sides have to have agreed on the details by the March 2019 date. This means that the UK Parliament and the European Parliament need to ratify any agreement by that date. Realistically this means that any agreement blueprint needs to be in place by the end of 2018 at the latest. The issues are so complex that the process is divided into two parts, the terms of the initial departure and then the long-term agreement under which the UK/EU relationship will operate.

Today, the options faced by the UK are essentially three-fold. A hard BREXIT, preferred by the hard line Conservative BREXITEERS, a soft BREXIT and finally the Chequers proposal put forward by PM Theresa May at a recent meeting at the Prime Minister's (PM) summer home of the same name. As far as the hardline members of the Conservative party are concerned, the latter two options are non-starters in their present form. This is relevant because Prime Minister Theresa May would likely need all of their votes to pass any final agreement in Parliament. That means that the recent discussions in Salzburg between PM May and European Union (EU) officials were dead from the start as she was negotiating with a proposal that she could not deliver. In any event, the EU flatly rejected even the Chequers proposal. Since then infighting within the Conservatives has increased. Boris Johnson, the de facto leader of the hard liners has since put forward his own proposal for BREXIT terms which is seen by some as a direct challenge to Theresa May's leadership. If not resolved this could lead to an early general election in November, the outcome of which is far from certain according to the polls. It's worth recalling that the last UK general election was a disaster for the Conservatives, who called a snap election based on polls that indicated they had a huge lead. Although they won the election, they failed to achieve even a clear parliamentary majority severely restricting their ability to push through the BREXIT agenda.

Given that today the polls indicate that the Conservative and Labour would be evenly split in the event of an election, an added complication has now arisen. Jeremy Corbyn, present Leader of the Labour party has now publicly stated that Labour would consider a second referendum to ratify any final agreement, rather than just a Parliamentary vote. To make matters worse he also stated that one option on the table in that event would be the option to vote "REMAIN". In other words, if Labour was elected in a snap election, the UK could effectively be asked to re-vote in another referendum. Corbyn has already made it clear that Labour is likely to vote against any agreement reached by May by March of next year. This policy has doubtless emboldened EU negotiators who probably feel that BREXIT may simply fail under its own gravity without their participation to actively seek a solution

Given this, one would be forgiven for thinking that the well-publicized problems of the UK put the EU in a better position. The truth is that there are also few good options for the EU in any final negotiation. The EU itself potentially faces the beginning of an existential threat if the UK leaves the Union. This is especially the case if any final agreement, if it is achieved, appears to benefit the UK and is workable in the long term. Many countries have expressed a desire to negotiate immediate trade deals with the UK post BREXIT, including most importantly the USA. Potentially, a tidy exit could encourage other countries to leave the Union. This explains the present intransigence of EU negotiators in recent meetings with the UK. It is clear that

from the EU's perspective it still does not want BREXIT to occur in any form, and if it does, it should cause the maximum chaos within the UK to discourage others. With Corbyn's recent U turn, there is now a real prospect, although remote, that a second referendum is possible under a specific set of circumstances.

Given that the UK is the departing member it's easy to understand why the focus has been on the effects of BREXIT on the UK. The reality is that it will likely suffer less than the EU as a whole in the event of a hard departure. Firstly, the EU ran an annual budget surplus with the UK of approximately £67 billion in 2017, so a bad exit will hurt European businesses more. A hard BREXIT would mean the UK would immediately be free to raise tariffs on certain EU industries, most notably the French wine industry and the German car industry, which potentially would suffer the most, if the EU immediately ceases to trade with the UK. Secondly, no agreement would mean that the UK's net contribution to the EU budget may cease, and not be phased out. This amounts to about £9 billion annually. Greece has already said it would be a problem for them if the UK were immediately to withdraw due to the EU's budget reduction. There would also be the issue of the UK's debts, and future obligations, to the EU which would remain unresolved.

Apart from the financial and economic issues there would also be a long list of legal and immigration issues to resolve. The question of what kind of border to have between Northern Ireland and Ireland represents an enormous challenge. Many fear that the re-imposition of a hard border between the two could result in the return of the sectarian war of the last century. The Irish border is the only land border between the EU and the UK – Gibraltar being a British overseas territory.

All of this is critical to the markets as a bad outcome could easily trigger a financial crisis starting in Europe. It's worth recalling that the day after the BREXIT vote, U.S. stocks fell by 3.4%, and the 10-year yield reached its all-time low of 1.36% a short time later reflecting a general flight to quality. Other stock markets fared less well with London's FTSE 100 falling 12.5% and the German DAX down 6.8%.

To paraphrase, the only certainty after BREXIT is uncertainty. This is not likely to change in the immediate future.

Thank you for listening.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseadvisors.com.

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DAX = an index of share prices based on an average of 30 leading stocks quoted on the Frankfurt Stock Exchange.

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