

And now this...

Brexit Update: The Chaos Continues

Political events in the UK are occurring at a breakneck pace and global markets are watching. We feel it is imperative to try and lay out the current status of the Brexit saga and handicap possible scenarios.

What should investors do now?

We continue to lack certainty on the resolution of this issue. The high stakes brinkmanship we are seeing in geopolitics of late is unwelcome and is impacting volatility in the markets. The 1919 posture is to underweight Developed International equities based on many issues globally. The direct economic impact of a Hard Brexit for the US is considered minor but investors need to be aware of the risk of major European economies like UK and Germany going into recession and what that means for Global demand. UK domestic politics may seem remote and irrelevant but the ripple effects on the market's psyche should not be underestimated.

So what just happened?

The past week has seen several significant events back to back and the battle lines are beginning to form in the fight for the future of the UK. A week ago, all opposition parties met in Labour leader Jeremy Corbyn's office to agree on a broad strategy to put aside differences and unite to pass legislation to prevent Prime Minister Boris Johnson from leading the UK out of the EU without a deal on October 31st. Johnson's response was swift and audacious. He has requested a prorogation (or suspension) of Parliament from

between September 9th and September 12th until October 14th from the Queen. The Queen has approved this request and the calendar to stop Brexit has now been dramatically tightened. There has been understandable outrage in the UK as this is seen as a cynical use of executive authority by the government in order to stymie parliamentary debate and force the hands of those seeking to delay Brexit or call for a second referendum.

On Monday September 2nd, the eve of Parliament returning from the summer recess, Johnson met with his cabinet, then his MPs and finally, delivered a speech to the nation. The message to the public was that he would prefer to avoid an election and press on with his domestic program and negotiate with the EU over Brexit. Apparently the private message was that anyone in the Conservative Party who failed to support his government would immediately lose the whip and be ineligible to run under the party banner at



the next election. When Parliament returned on Tuesday, Conservative backbench MP Philip Lee dramatically crossed the floor to join the Pro-Remain Liberal Democrats and the Government's majority of one instantly became a minority. The Opposition then passed a bill to take control of the parliamentary agenda and has already made progress on a bill requiring Johnson to delay Brexit until January 2020 if he is unable to negotiate on a deal with the EU. Johnson has called for a general election, but it appears the opposition is unwilling to acquiesce. At the time of writing, the opposition parties appear to have the

upper hand, but Johnson and his team likely have some cards left to play. Investors have no reason to believe anything is resolved at this point.

How did we get here?

Our first Brexit paper was published right after Theresa May announced her resignation. Since then, the Conservatives spent much of the summer selecting a new leader and no one was terribly surprised when prominent Brexiteer and evergreen political opportunist Boris Johnson won the leadership contest and was installed as Prime Minister. Johnson's premiership raised many questions which are now being answered. He formed a cabinet comprised of staunch 'Leave' campaigners and elevated infamous Brexit strategist Dominic Cummings as a Special Advisor. He made clear the UK would leave the EU, come what may, by October 31st and the backstop agreement over Northern Ireland was unacceptable. He has openly spoken of being prepared to leave without an agreement and this has obviously spooked markets. The EU has taken an uncompromising stance. They are unwilling to negotiate on the deal already agreed with May and seem determined to protect the interests of Ireland by insisting on the backstop arrangement.

So what is Johnson's Strategy?

The best guess on Johnson's thinking is this: Having seen May fail three times to get her withdrawal agreement through Parliament, Johnson understands that he needs an overall majority. Aside from the math, the political capital and mandate that comes with an election victory are necessary in order to push any new deal through the Commons and leave the EU on time. With the support of the DUP, he had a working majority of one seat prior to parliament resuming this week. If faced with a No-Confidence vote, it is a certainty that he will lose. Under the 2011 Fixed Term Parliaments act, he would have 14 days to either win a new confidence vote and demonstrate to the Queen that he can command a majority, allow an alternative government to be formed, or schedule an election. Downing Street has earlier leaked suggestions that Johnson would schedule the election for after October 31st. So he could potentially take the UK out of the EU without a deal in the role of a caretaker prime minister who has been proven to lack a governable majority. This violates a rule regarding significant events during election campaigns but the legality of this has never before been tested. Opposition politicians and even backbench Conservatives have spoken of imploring the Queen to fire Boris Johnson. The Queen's role is ceremonial and

has always remained above politics. She has never even expressed a clear opinion on recent referenda. Plunging her into this political quagmire would almost certainly damage the brand of the Royal family domestically and the UK would be poorer for it. The UK has no written constitution but it seems a constitutional crisis is not far away right now.

Is there method to Johnson's madness?

Observers of Boris Johnson agree that he is a fiercely intelligent man. His unkempt, jovial and buffoonish public persona seems a carefully crafted device to enhance his personal popularity and therefore, his political power.

However, he is considered by many within his own party to lack the necessary character to be prime minister. His rhetoric on Brexit since becoming PM appears to be for the benefit of pro-Brexit British voters. His openness to a hard Brexit has apparently moved the center ground of the debate from no Brexit/second referendum to leaving the EU with a deal. This is likely a tactic to starve of oxygen the hard right Brexit Party of Nigel Farage. It's a tactic used by US politicians in primary contests. Boris is probably playing to the Brexit base in order to galvanize support for himself ahead of a general election. The general election could take place before parliament opens on October 14th. By prorogating parliament for a month, Johnson can focus the opposition's efforts on a Confidence vote instead of a substantive debate on his Brexit policy. He clearly has confidence in his ability to outperform Theresa May on the campaign trail and defeat Corbyn in a straight fight.

What is the Opposition trying to achieve?

Until we see either a confidence vote or a vote on proposed legislation, it is hard to quantify the exact number of MPs opposed to Johnson. He lost his working majority of one with Lee's defection to the Liberal Democrats, but Lee was one of many Conservatives who would not support Johnson's policies anyway. It is reasonable to assume that he has had nowhere near an actual majority of support since his ascent into the role. What remains unknown is how many Labour party members would break ranks with their leadership and support Johnson in order to ensure Brexit is achieved. It doesn't appear as though Johnson is counting on their support. The approach the somewhat unified Opposition is taking is to focus on crafting and passing legislation that would prevent Johnson from leaving the EU without a deal. Recall, the House of Commons voted to leave the EU, per the instruction of the referendum. It then voted three

times against May's withdrawal agreement. Johnson doesn't actually need legislation to just exit the EU, but if the opposition can pass legislation to require a withdrawal agreement, he would obviously be bound by that. The hope is that such legislation would force him to postpone Brexit further. Corbyn's plan is to win a general election, negotiate a new deal with the EU and put this deal to the the public in a referendum.

Why don't more Conservatives defect like Lee?

Brexit is not the only ideology at play here. Many Conservative MPs consider a Corbyn government to be even more unpalatable than a no-deal Brexit. Voting against the government to initiate an election is not the same as supporting a Corbyn led government. Much like the 'Never Trumpers' in the US, these MPs are dismayed by the direction their party is taking, but they are still unwilling to cross party lines.

But what of the EU?

Johnson's exchanges with EU leaders have been insubstantial and unserious thus far. His cabinet have spoken of being open to compromise but have reiterated their red line issue of the Northern Ireland backstop. Having seen the May agreement fail three times, EU leaders quite reasonably wonder why they should bother making any further concessions to a government which appears unable to pass any such deal. Johnson's appears to be gambling not only on his ability to win a general election, but on the EU blinking first in a game of chicken. The EU continues to

advocate for a special status for Northern Ireland based on the Good Friday Agreement of 1998 and the relative peace in that region since. The EU would also suffer economically in a Hard Brexit scenario. Germany has already experienced a quarter of negative growth. Ireland would be forced to erect a customs border with Northern Ireland in order to comply with EU regulations and standards. Johnson must expect a last minute compromise to emerge from the EU. For now, the EU has shown little inclination to address the withdrawal agreement terms.

What would a Hard Brexit mean for the US?

President Trump has been openly supportive of Johnson and warmly embraced a trade deal with the UK once they have left the EU. The reality is not so simple. Any trade agreement between the UK and US would need to be passed by congress. Speaker Pelosi has made it clear that she would be unwilling to support such a deal in the event of a Hard Brexit. She is defending the Good Friday Agreement (brokered by Democrats Bill Clinton and George Mitchell) in order to support the 'Friends of Ireland' caucus on Capitol Hill which is largely Democratic. If her stance is unchanged, then any UK/US deal post Hard Brexit would die in the Ways and Means committee and add another front to Trump's trade concerns. Johnson's team are surely aware of this.

The next 2 months will no doubt continue to fascinate and surprise. We will expect the unexpected and try to navigate the uncertainty.



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