Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

The Brexit is Official – Here's What Investors Need to Know!

By Mitch Zacks
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On June 23, 2016, Britain surprised the world with a referendum vote to leave the European Union. Now, some nine months later, it's officially on the books. On March 29, British Prime Minister, Theresa May, sent a letter to the head of the European Council, Donald Tusk, invoking Article 50. This letter effectively begins the two-year process of leaving the European Union.

Not many people know this, but Britain has actually been a member of the European Union for *44 years* now. In the postwar period, Britain benefited from unified security in Europe, and the economic gains across Europe were palpable as trade grew and the global economy took form. The free movement of goods, capital, and labor across Europe were no doubt instrumental to the wealth creation and economic gains of the last few decades for all European nations, including Britain.

But then the 2008 Financial Crisis happened. As the UK grew solidly over the last few years, the rest of Europe faltered. This disconnect coupled with the escalating refugee crisis across Europe has created a rift between Britain and the EU. Their respective goals, economic needs, and stances on immigration were no longer in sync. That's why a slim majority of Britons came to the conclusion that reclaiming sovereignty was the smartest path forward for Britain. Leaving the EU, it was argued, would restore British control over the regulatory and economic environment, as well as its borders. It was time to say goodbye.

This explanation for leaving may make logical sense in theory – but the reality of its implementation is likely to prove much more difficult in practice.

What Happens Now?

The process of negotiating the exit terms is likely to begin in May or June of this year and is expected to last until at least next fall. Among items to negotiate, the most contentious are likely to center on immigration, trade access, and how much Britain owes the bloc to cover future commitments like pensions. Also in question, will be the rights of European Union citizens now living in Britain, and British citizens living amongst the 27 EU countries.

On Trade

What likely matters most to the economics of Europe is the future of trade – and Britain would love nothing more than free access to the single EU market. In Theresa May's letter, she wrote: "*we also propose a bold and ambitious Free Trade Agreement between the United Kingdom and the European Union. This should be of greater scope and ambition than any such agreement before it so that it covers sectors crucial to our linked economies such as financial services and network industries. This will require detailed technical talks, but as the UK is an existing EU member state, both sides have regulatory frameworks and standards that already match. We should therefore prioritize how we manage the evolution of our regulatory frameworks to maintain a fair and open trading environment…*"

It would essentially be a miracle if Britain managed to score those terms. EU-leading countries like Germany and France have repeatedly stated that Britain would not have access to the single market if it did not accept all of the other terms that go with it, like free movement of people. With immigration-reform high on Britain's priority list, this is likely to result in a combative stalemate.

What's more, while the UK is still part of the European Union (for the next two years unless everyone agrees to new terms sooner), it cannot independently negotiate any international trade agreements with non-EU countries without violating EU treaties. That hamstrings Britain from getting a jump-start on molding its future role in the global economy while it settles up with Europe.

Bottom Line for Investors

If no agreement is reached in two years, and no extension is unanimously agreed to, the UK automatically leaves the EU and all existing agreements - including access to the single market – on Friday, March 29, 2019. Expect to see some bitter negotiating between now and then.

-**Mitch**

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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