Mitch on the Markets

What You Can Learn from Brexit

By Mitch Zacks
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On June 23, 2016, voters in the United Kingdom took the bold step of opting to leave the European Union. Yet here we are, over two years later, and there is still no deal for how 'Brexit' will actually occur – in fact, the two sides aren't even close.[1]

The drama reached new heights this week as Britain's chief negotiator in talks with the EU, David Davis, and Britain's foreign secretary and Brexit hardliner, Boris Johnson, both quit their government posts. When British Prime Minister Theresa May won a snap election last year and promised a "strong and stable" U.K., this was clearly not what she was expecting.[2]

In our view, the overarching lesson to draw from the U.K.'s experience is this: *separating and attempting to re-draw markets that are globally intertwined is a near-impossible feat*. The populist wave that has emboldened voters across the world to reject globalization in favor of a more isolationist approach is resulting in outcomes that, in our view, are leaving no one better off. And it's questionable whether that will change moving forward.

Now, the U.K. is inching closer to a deadline of March 29, 2019 to reach a deal with the European Union. But with each iteration of the potential path forward, it appears that the U.K. is conceding more and more.

Just this past week, Prime Minister Theresa May made a notable shift to a "softer" Brexit stance that would continue to abide by the European Union's rules in the industrial and agricultural products space, but that would free Britain from following European rules for services – an approach designed to benefit Britain's lead industries of banking and finance. The new approach would also see Britain reject the European demand for free movement of people across borders, although goods would be allowed to pass freely between Ireland (which will remain part the bloc) and Northern Ireland (which will not). While it may seem like May's government made real progress arriving at consensus, it could be all for naught – the European Union has not agreed to any of these terms, and in our view, rejecting free movement of people is pretty much a non-starter for the EU.[3]

Businesses aren't thrilled about all of the uncertainty. In recent weeks, several major British employers have issued warnings over the economic and investment risks that could result from Brexit. There have been several warnings, but perhaps the most vocal one came from Jaguar Land Rover, which said that a disorderly Brexit could derail more than $100 billion worth of investment plans in Britain and force factory closures. Airbus and BMW have also voiced concerns that a disorderly or "hard" Brexit could result in moving manufacturing facilities out of Britain. Moving factories and reducing investment does not make the U.K. – or its citizens – better off, in our view.[4]

Bottom Line for Investors

The key dates from here will be October 18, 2018, and March 29, 2019. In October, there is an EU summit where both sides will hope to agree on an outline of future relations, which will in turn give time to the UK parliament and EU members to ratify a deal by Brexit day (March 29, 2019). Deal or no deal, Brexit takes place on March 29, 2019 – at which time a sudden, hard exit is possible assuming that the two sides haven't made any agreements on trade, customs or migration. Such an outcome could have profound consequences for both the U.K. and the E.U.[5]

At the end of the day, in our view, Britain's government is learning the hard way that globalization is excruciatingly difficult to stifle, and even more difficult to reverse once corporations have embraced it. We think globalization, like it or not, is here to stay.

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.

[1] BBC, July 7, 2018, https://www.bbc.com/news/uk-politics-32810887

[2] The New York Times, July 9, 2018, https://www.nytimes.com/2018/07/09/world/europe/david-davis-brexit-resign.html?emc=edit_nn_20180709&nl=morning-briefing&nlid=7323247320180709&te=1

[3] The New York Times, July 9, 2018, https://www.nytimes.com/2018/07/09/world/europe/david-davis-brexit-resign.html?emc=edit_nn_20180709&nl=morning-briefing&nlid=7323247320180709&te=1

[4] The New York Times, July 9, 2018, https://www.nytimes.com/2018/07/09/world/europe/david-davis-brexit-resign.html?emc=edit_nn_20180709&nl=morning-briefing&nlid=7323247320180709&te=1

[5] BBC, July 7, 2018, https://www.bbc.com/news/uk-politics-32810887

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