

UK Election: Will Brexit's dust finally settle?



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Thursday, December 5, 2019

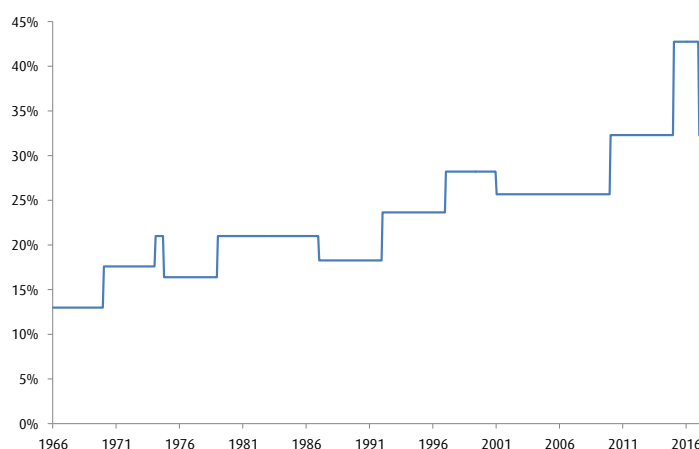
- Brexit is the leading consideration of the December election, shifting traditional voting patterns
- Our expectation is a Conservative majority with a positive initial market reaction
- Longer term, the UK may face headwinds reaching an EU-UK trade agreement

The holidays come early for UK voters this year, as they head to the polls on December 12th for the third general election in five years. As the British economy trudges along, narrowly averting recession in the third quarter, Brexit dominates the discussion. The snap election was triggered by the prolonged impasse on an exit strategy, as Prime Minister Boris Johnson's deal was not approved in time for the original October deadline. Can Johnson secure the majority?

Many signs point to yes.

Since the election was called, the Conservative party has shot up the opinion polls, and maintains the frontrunner position. The Labour party has advanced at a similar rate, but has been unable to close the gap. Labour leader, Jeremy Corbyn is unpopular among the electorate which could lead to poor turnout or swing votes out of his favor. Polls suggest the voting population has become more flexible with regards to their political alignment, as many stand ready to change affiliation (*See Chart 1*). The 2017 election saw a late swing towards the Labour party, presenting an opportunity for the Conservatives to reclaim, especially in pro-Brexit constituencies. A defined Brexit resolution, which does not challenge the result of the 2016 referendum, provides tailwind to the Conservative campaign in those regions.

Chart 1: Percentage of voters who chose a different party than the previous election



Source: Source: WSJ, British Election Study

While we acknowledge the election could ultimately break any number of ways, our base case calls for a Conservative majority to win the day. Britons are incentivized to finalize Brexit after years of debate, and the outcome would be best case scenario for UK assets in the short run. This would result in UK being in a position to leave the EU January 2020 with Johnson's Withdrawal Agreement, reducing immediate political uncertainty. The UK stock market, which remains well below pre-Brexit vote highs, could see a relief rally if long awaited clarity is provided.

However, if the Conservative party falters slightly, the election could yield a hung parliament in which no party forms the majority and no coalition is established. The result produces the highest level of post-election uncertainty, suggesting a myriad of outcomes would

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remain possible. This ranges from approving Johnson's Brexit deal to spurring a second general election or referendum. A hung parliament also bears the greatest probability of a no-deal Brexit, which would be detrimental to the UK economy. However, given the resistance to crashing out of the EU in October, it is unlikely parliament will allow a no deal leave in January. Markets will likely not react favorably to another dose of indefinite political disorder and undefined course of action.

Finally, in the event of no majority and a considerable Conservative miss, the Labour minority could garner support from opposition parties (Liberal Democrats, Scottish National Party) to gain control. Our take is that this development is the least probable outcome. Corbyn's lack of popularity in conjunction with firm opposition party demands hinders his party's potential of acquiring an ally.

Nevertheless, in the reality of a prolonged parliamentary stalemate, anti-Brexiteers may view an allegiance as the best route to a second referendum. The scenario prolongs the Brexit debate and fuels more uncertainty as well.

In the end, a Conservative majority looks to be the path of least resistance to end the Brexit saga with Johnson's Withdrawal Agreement already in play. However, even if the elections result in a Conservative majority, there is still more hill left to climb to reach an EU-UK trade agreement. In any event, the prevailing political uncertainty supports our current underweight position to developed international equities. To be continued...



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