

# current PERSPECTIVES

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## Breaking up is hard to do: Brexit Update

A year ago, it seemed likely that debt-ridden Greece would be the first country to exit the 28-country European Union (EU). However, that distinction now looks likely to go to the United Kingdom (UK). In the British leave/remain referendum held on June 23<sup>rd</sup>, voters decided that Britain should leave the EU, marking the beginning of what is being referred to as “Brexit.”

The UK’s withdrawal from the political and economic union is unprecedented, and there is no clear path to the exit as the EU does not have comprehensive terms of departure. This likely means that the UK will remain a member of the EU, subject to all its regulations and budget requirements until it can negotiate a formal separation agreement. Given the complexity of the negotiations, we believe reaching a deal will be a lengthy process — potentially years rather than months.

### Our View

We at TD Asset Management (TDAM) have been cautioning about the potential for increased financial market volatility for some time, and the immediate shock of the “leave” decision will likely cause it to spike, particularly in the UK and European markets. In addition to higher volatility, Brexit may also result in the following near-term effects on investment assets:

- equities are likely to decline, particularly in the UK and Europe,
- the British pound and euro are likely to weaken, and
- safe-haven assets such as the U.S. dollar, Japanese yen, U.S. Treasuries and gold are all likely to strengthen.

Until the terms of the separation agreement are known, it will be difficult to predict the full economic and fiscal effects of Brexit. However, we do expect gross domestic product (GDP) in the UK to weaken amid lower business investment and exports and, potentially, the consequences of Brexit could push the UK into a recession. Politically, Prime Minister David Cameron, who is steadfastly pro EU, has announced his resignation and we expect the Scottish independence movement may well see a surge in support as Scotland is also pro EU. In Europe, Brexit may fuel anti-euro, anti-immigration and anti-austerity feelings and provide support for populist parties, such as Syriza, Podemos and National Front, which could undermine established political parties.

In the longer term, the key issue for investors is whether Brexit marks a turn toward nationalism. In Europe, the UK's departure is not the only challenge facing the EU, and a number of questions remain unanswered (e.g., will the UK exit make it easier for other countries to leave the EU? How will the EU address weak underlying economic conditions and the continuing fiscal and productivity disparities that exist amongst member countries?). In North America, Donald Trump is advocating vigorously for the termination of the North American Free Trade Agreement. Globally, the Trans-Pacific Partnership is facing stiff opposition from a number of quarters. Equity investors particularly have benefitted from globalization over many decades as companies have been able to move production to lower cost jurisdictions and penetrate new markets, providing a significant long-term tailwind to earnings. A move in the other direction would exacerbate the challenges we have been highlighting for some time, including the persistent low growth environment that is firmly in place today.

In the current environment, there is a broad range of potential outcomes, and we believe it is crucial for

investors to retain a long-term perspective and maximize diversification benefits within their portfolios. Within TDAM's investment mandates, our portfolio managers have been carefully monitoring the Brexit situation for some time and have sought to position their portfolios to minimize potential negative impacts while also seeking opportunities to benefit from more attractive valuations and possible market overreactions.

We will continue to monitor and evaluate this situation and to assess conditions with the objectives and best interests of our clients in mind. ■

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To view a video interview of  
Bruce Cooper discussing Brexit,  
please click here.



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