THE START OF THE BREXIT GOODBYE

31st January 2020

After three and a half years, two general elections and several postponed deadlines, the UK formally leaves the EU at 11pm tonight. Very little will change in terms of the trading relationship in the immediate aftermath as we enter a transition period which is due to last until 31st December 2020. We do not expect much of a reaction from the UK markets over the next few days, but how they behave in the coming months largely depends on what kind of Brexit we are facing.

THE BREXIT EFFECT SO FAR

UK shares have generally split into two groups since the referendum. One group, consisting of companies with substantial international exposure, benefited from sterling's weakness against major currencies. The other group, made up of domestically focused companies, has struggled as political uncertainty weighed on the UK economy.

After the general election in December, shares of domestically focused companies rallied in response to the greater clarity provided by the Conservative Party's victory. However, by insisting that he will not request an extension to the transition period, the Prime Minister has set himself the difficult task of negotiating a free trade deal in eleven months and left the prospect of a 'no deal' Brexit on the table. The most likely outcome at this stage is the two sides reach a limited agreement covering goods but not services. This would be a relatively 'hard' Brexit.

LOOKING AHEAD

We expect the pound to continue acting as a useful barometer. Over the last few years, it has strengthened against the US dollar when a soft Brexit looked more probable and weakened when the chances of a hard Brexit increased.

The UK equity market has been largely shunned by investors since the 2016 referendum. As a result, UK shares have fallen to historic lows. While domestically focused shares would benefit more from a softer Brexit, we believe valuations are attractive enough to provide some support to the market in all but the very hardest of Brexits.

The Bank of England (BoE) will be closely monitoring negotiations. It left interest rates unchanged at its meeting yesterday, but a hard Brexit could lead to a slowdown in UK economic growth, leaving the BoE little choice but to cut rates later in the year. UK government bonds should rise in value under this scenario.

YOUR PORTFOLIO

The message to investors remains the same try not to let short-term distractions like Brexit negotiations influence the management of your portfolio. After all, it is designed to deliver returns over a period of at least seven years, and we expect the UK and EU to conclude at a minimum a limited free trade deal by the end of 2020.

For further peace of mind, your portfolio is diversified which means the holdings are spread across different types of investments and regions. If UK shares underperform during the upcoming negotiations, overseas shares could make up for them.

Toni Meadows, Omnis Investments Chief Investment Officer

This update reflects Omnis' view at the time of writing and is subject to change.

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