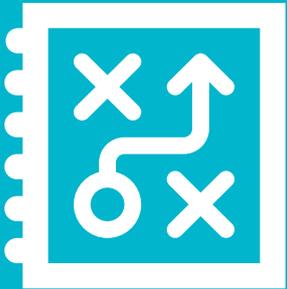




WHITEHELM
ADVISERS

MARCH 2019

**FEATURE ARTICLE:
BREXIT – A SPECIAL PLACE IN HELL**



Introduction

29 March 2019 — Brexit Day — is the day the UK is scheduled to leave the European Union. With just under two weeks to go, what Brexit means is still largely unknown, and this continued uncertainty inflicts its own cost on the UK economy.

British Prime Minister Theresa May negotiated with the EU until the eleventh hour, getting some small final concessions on the Irish Backstop. But these concessions have not yet been enough to convince Brexiteers in her own party to vote for her withdrawal agreement. As we go to print, House of Commons Speaker John Bercow has thrown a spanner in the works, ruling out a third parliamentary vote on the withdrawal agreement unless it has substantially changed.

Chaos reigns in Westminster as polarised MP's struggle to make headway in parliament, some defecting to the parliamentary middle. A request for extension now seems inevitable but to what end – the EU27 have been clear that they will not re-open the withdrawal agreement text, European elections are due to take place in May and French President Emmanuel Macron has stated that France would use its veto power to block an extension unless it was 'justified by new choices from the British.'¹

But one thing is sure – whichever way the UK leaves the EU, the way they interact will be the subject of negotiations for years and maybe decades to come. Brexit is not an event, it is a process, and one that will take a very long time to evolve.

¹ <https://in.reuters.com/article/uk-britain-eu/may-gains-two-weeks-brexit-relieve-from-mps-idINKCN1QG2JW>



This feature article begins by examining the current state of play including a deep dive into the Irish Backstop (a key source of uncertainty in Brexit negotiations). And we detail updated scenarios of what is possible over the next two weeks.

Brexit has short- and long-term implications for investors because of its impacts on both the UK economy and European financial markets. We consider how the UK economy has changed since the Brexit referendum – specifically in terms of GDP, currency, foreign direct investment, inflation and trade – and how these changes impact investors. We also provide an analysis of the global derivatives markets, detailing the agreements we expect will ensure the smooth functioning of derivatives trading over the 29 March 2019 period.

We highlight the importance of an implementation period following the 29 March 2019 deadline and how a soft Brexit will minimise the damage of the divorce.

And we consider longer term implications for financial markets, including for London's role as a global financial centre. We then consider the impact of Brexit on investors in UK-based infrastructure assets.

Finally, we look at the larger geo-political implications of Brexit. Is Brexit just the UK leaving the EU? Or does it signal the beginning of the disintegration of Europe. EU negotiators have been acutely aware that whatever Brexit deal is struck, the UK must be in a less good position outside the EU than it was as a member state, a principle that will presumably sit underneath all future trade negotiations too. But we also consider that a more nimble, unshackled UK may be able to negotiate more favourable trade agreements over the longer term.

Brexit started as a political tactic, a tool by then Conservative Prime Minister David Cameron to placate backbenchers and afford him a mandate to govern unconstrained by the European question. And now, with the clock running down to Brexit Day and still no certainty, the UK finds itself in its own special place in hell.²

² To paraphrase European Council President Donald Tusk
<https://twitter.com/eucopresident/status/1093112742293266435>



Current State of Play

The EU and UK negotiated a withdrawal agreement and it was endorsed by the European Council on 25 November 2018. This agreement (or any withdrawal agreement) cannot come into effect until it has been passed by the UK Parliament. However, when Prime Minister May put the agreement to the UK Parliament on 15 January 2019, it was overwhelmingly defeated (432 votes to 202 - the biggest ever Government defeat on the floor of the House of Commons). Prime Minister May subsequently survived a vote of no-confidence and sought changes from the EU in the hope that her parliamentary colleagues would find a revised version of the withdrawal agreement more palatable.

On the eve of the second parliamentary vote, Prime Minister May left Brexit negotiations in Strasbourg saying she had 'secured legal changes' to the backstop. And, while the text of the withdrawal agreement had not changed, she released three additional documents that detailed these so-called concessions.

However, Attorney General Geoffrey Cox subsequently advised³ that these new documents did not change the legal risk of the UK being bound

indefinitely in a customs union with the EU. This advice sounded the death knell for Prime Minister May's withdrawal agreement, at least in terms of the second vote.

On 12 March 2019, the House of Commons voted on the withdrawal agreement for the second time and it was defeated 391 votes to 242 (as shown in Chart 1). This defeat also goes down in the House of Commons history books as one of the worst for a sitting Government, but importantly it was less bad than the first loss.

So now observers are left wondering if Prime Minister May has lost control of the parliament, forever to be remembered for her doggedness? Or is she executing a genius political strategy that requires her to hold her nerve as Brexit Day approaches to defeat the Brexiteers in her party and deliver the British people a soft Brexit?

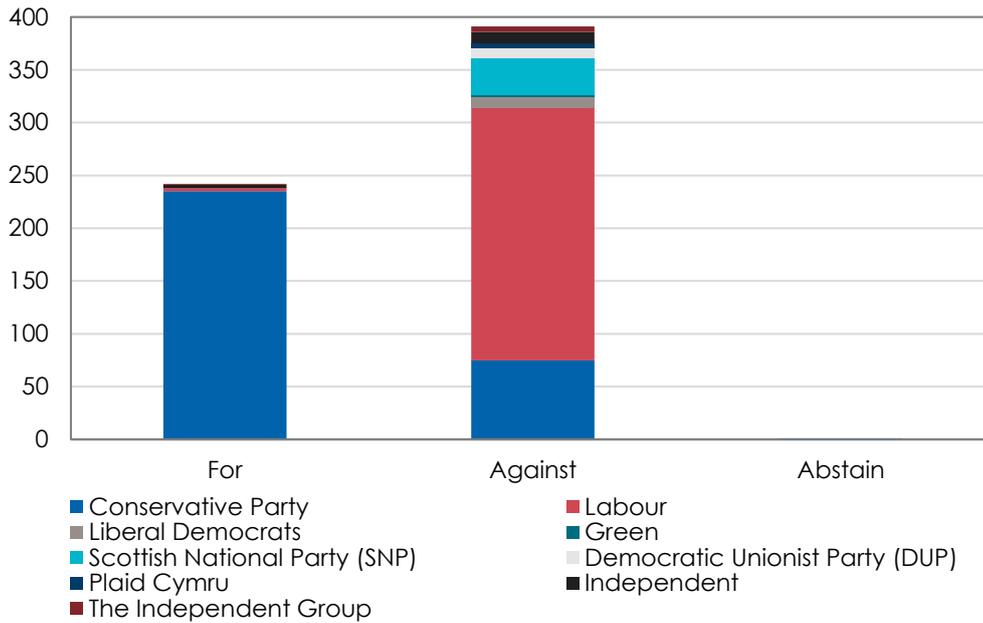
The latest twist – where the House of Commons Speaker John Bercow has ruled out a third vote on the withdrawal agreement in the absence of substantial changes – has changed the odds again.

³ <https://www.gov.uk/government/publications/legal-opinion-on-joint-instrument-and-unilateral-declaration-concerning-the-withdrawal-agreement>

Brexit continues to be opaque, unpredictable, and destructive. But in a scene heavy with symbolism, Prime Minister May argued for her deal with a

barely-there voice, worn down by the weeks (and months and years) of negotiating the latest iteration of her withdrawal agreement.

Chart 1 – Second vote on Brexit withdrawal agreement 12 March 2019 – How the parties voted



Source: FT, Whitehelm Advisers

Where to from here? Good question. Every option is on the table.

If the current withdrawal agreement is ratified by the UK Parliament,⁴ there is a transition period from 30 March 2019 until at least 31 December 2020. During this period, the UK will remain in customs union and most of EU law would continue to apply however the UK could not participate in EU law, making it a law-taker during this period. The UK will also lose access to Free Trade Agreements the EU has with other countries, unless and until each of those third-party countries agree to apply the agreements to the UK.

But this Brexit would be a softer, more managed divorce with an implementation period to ensure a period of adjustment for the British economy. It would reduce the economic cost of withdrawal and

give all affected parties time to adjust to the reality of the UK outside of the EU.

If the parliament does not pass the withdrawal agreement and the EU do not approve an extension, then a hard Brexit happens. The agreement has been voted down twice already and the Prime Minister has said she will schedule a third and final vote this week. If the parliament votes no again and there is no extension agreed, the UK will crash out of the EU on 29 March 2019 with no agreement in place.

A hard Brexit is considered the worst-case scenario and would mean no implementation period.

⁴ It seems safe to assume now that the EU will not allow any further changes to this agreement.



And there are other possibilities too. These include the extension of Article 50, effectively giving the UK and EU more time to negotiate. While this is a real and likely option, an extension requires unanimous approval from all E27 member states and, other than for a technical extension for a few weeks, current European sentiment suggests this would only be forthcoming if the UK has something new and different to offer.

There has also been growing support for a second referendum, but this is akin to opening a can of worms. Firstly, the EU27 would need to agree to an extension. It would then need to be legislated by the parliament. But then the tricky part – what question would a second referendum ask? Would it ask whether Brexit should happen? Or how it should happen? Or a combination of the two? And what are the democratic implications of a second referendum – does this mean the first result was not respected? Should there then be a third referendum so it becomes the best of three? And then if the result was Remain? Or if it was Leave? More complexity for a deeply divided parliament, more uncertainty for an economy being suffocated by opacity, indecision and division.

Then there is the possibility of cancelling Brexit; on 10 December 2018 the European Court of Justice ruled that the UK could unilaterally cancel Brexit provided they followed a ‘democratic process’. But this is an unlikely option that would require the UK Parliament to vote for it and would probably only happen if a new referendum voted to Remain.

And there is the prospect of a general election. Prime Minister Theresa May has said she will not stand at the next election. Labour leader Jeremy Corbyn is a divisive politician with a polarising agenda, including a plan to nationalise national utilities and railways. A general election would not just be a referendum on Brexit but would include a broader policy agenda. So, a general election would arguably add complexity and prolong Brexit uncertainty.

All these Brexit scenarios exist in a deeply divided British population and parliament. Nor do they exist in isolation, likely overlapping and occurring in tandem depending on what path Brexit ultimately takes.

We consider a soft Brexit, underwritten by Prime Minister Mays withdrawal agreement, to be the most favourable outcome now. It is coming down to the wire, but the agreement is not yet ‘dead, buried and cremated’ with this week’s vote (if it happens) giving the UK a final chance to contain the uncertainty. It is looking likely that this path would require an extension of the Brexit deadline, if only to get the necessary authorities passed through the parliament. But it would let the UK leave this damaging deadlock behind it and to begin negotiations on its post-Brexit place in the global economy.

It would not be the end of Brexit. It would not even be the beginning of the end. But it would, perhaps, be the end of the beginning.⁵

5 With due apologies to the late Sir Winston Churchill.



What is the Irish backstop?

The key sticking point is the much talked about Irish backstop. During the almost 30-year conflict in Northern Ireland known as ‘The Troubles’, the border between Northern Ireland and the Republic of Ireland was heavily militarised. The Good Friday Agreement, signed on 10 April 1998, formally ended The Troubles with one of the key tenets being an open Irish border. And this has been the reality — today the only discernible indicator of the Irish border is the change in colour of the road markings from white to yellow. In deference to the EU principle of freedom of movement, people and cars now cross this border unimpeded. Products do not need to pass through a customs and standards inspection because of the EU’s single market and customs union.

However, Brexit means the Irish border will also become a border between the EU and the UK. If Northern Ireland and the Republic of Ireland have different customs regimes, products travelling between the two countries may become subject to customs inspections at the border, for which physical infrastructure would be required —in effect, a hard border. There are fears that a return to a hard Irish border may jeopardise the Good Friday Agreement, endangering the cooperation and peace that has characterised the two Irelands since it was signed.

Prime Minister May, whose minority Government is underwritten by an agreement with Northern Ireland’s Democratic Unionist Party (DUP), negotiated a withdrawal agreement with the EU that retains a soft Irish border by keeping the UK in a customs union for the transition period. But the agreement will keep the UK in the customs union beyond the transition period if a new agreement cannot be made and would not allow either the UK or the EU to withdraw unilaterally.

This so-called backstop, designed to avoid ‘under all circumstances’ the return of customs checkpoints between Northern Ireland and the Irish Republic after Brexit, ties the UK to the EU in the short term but also possibly indefinitely. And this is why the backstop has proven so polarising in the British parliament and the minority Conservative Government – on one hand it ensures a soft Irish border but it also potentially creates a border down the Irish Sea (which the unionists of the DUP vehemently oppose) and limits the UK’s ability to pursue an independent trade policy.

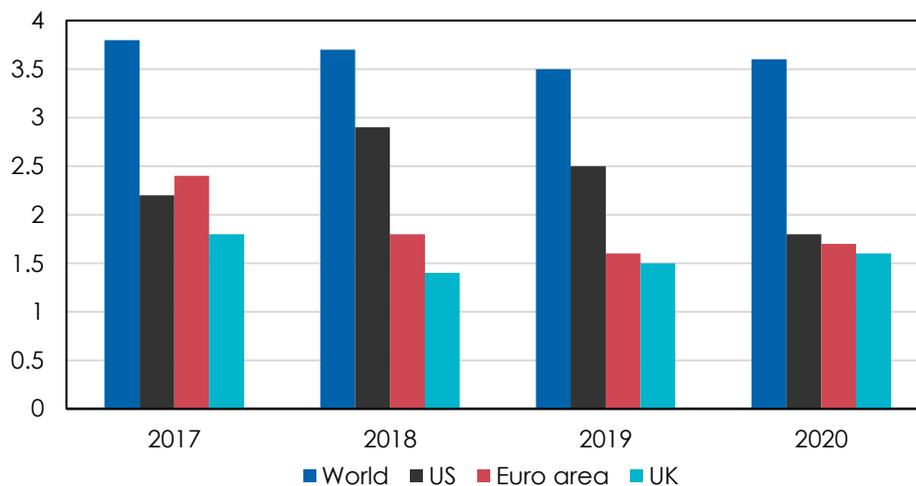


Key UK economic indicators

We consider the implications of Brexit will overwhelmingly be felt by the UK. And while we expect there to be some, smaller impact on the European economy, we believe the global economy will be largely unscathed by Brexit. For this reason, this discussion focusses on the implications of Brexit for the UK economy.

The IMF published updated global growth figures in January (see Chart 2) that forecast UK growth at 1.5% for 2019 and 1.6% in 2020. Though these figures do come with a grain of salt – they assume a Brexit deal is reached in 2019 and that there is an implementation period. A hard Brexit would likely lower these figures.

Chart 2- IMF growth actuals (2017, 2018) and forecasts (2019, 2020)



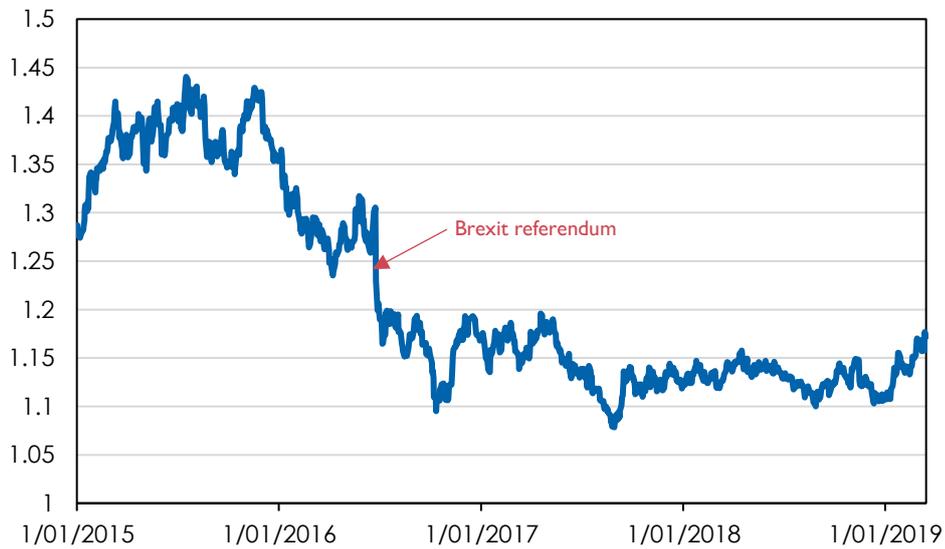
Source: IMF, Whitehelm Advisers



The Brexit result was a surprise for most, including for financial markets, and the British pound fell sharply in response. While the pound has continued to trade at lower levels in the years since the referendum (Chart 3), it is interesting to see its upwards trajectory against the euro since Prime Minister May lost the vote in the House of Commons on 15 January 2019 (Chart 4) – this suggests markets consider a hard Brexit is less likely

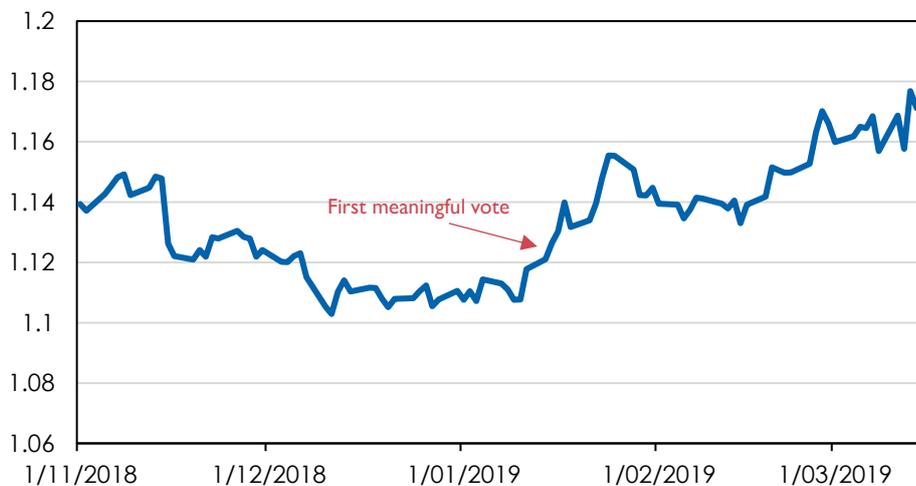
as Brexit Day draws closer. And the reason markets think this is the growing likelihood of an extension, backed by parliamentary posturing to rule out a Hard Brexit (even if the recent vote to this effect was largely symbolic). The reducing margin between the two parliamentary votes on the withdrawal agreement provides some evidence that MP's are now becoming more pragmatic and willing to compromise at the eleventh hour.

Chart 3- GBP/EUR trading levels: 1 Jan 2015-15 March 2019



Source: Bloomberg, Whitehelm Advisers

Chart 4 – GBP/EUR trading levels - 1 Nov 2018-15 March 2019

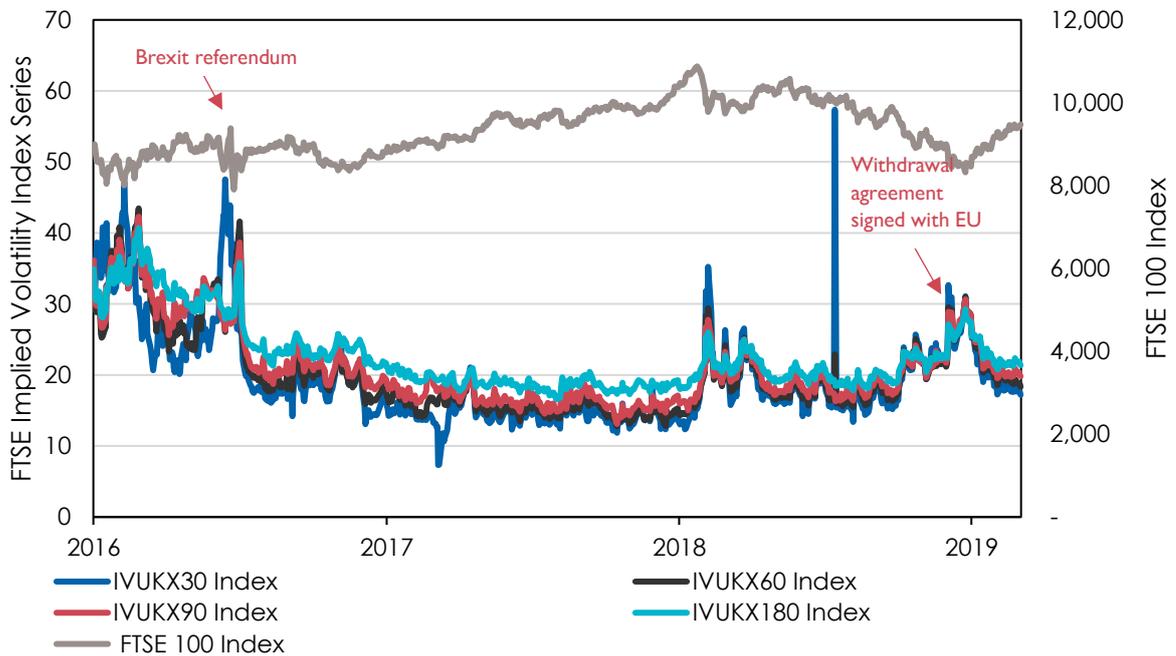


Source: Bloomberg, Whitehelm Advisers

The uncertainty associated with Brexit can be identified by periods of volatility in the UK equities market, as shown in Chart 5. There is an increase in volatility in the lead up to the Brexit referendum, in the immediate aftermath of the Leave result as well as around the time Prime Minister Mays

withdrawal agreement was finalised with the EU. Again, it is interesting to see volatility receding in recent trading sessions, suggesting equity markets are pricing in a lower risk of a hard Brexit at the end of March.

Chart 5 – FTSE 100 Index and FTSE Implied Volatility Index 2016 – 2019

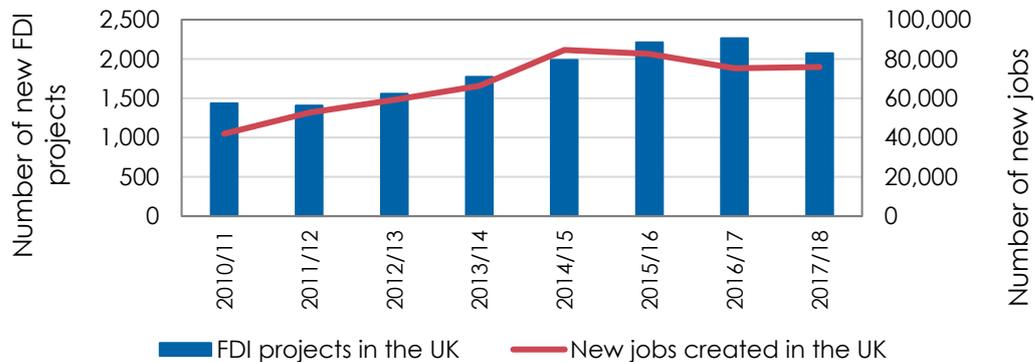


Source: Bloomberg, Whitehelm Advisers.

This prolonged uncertainty has also impacted foreign direct investment (FDI), changing the trajectory of both the number of new FDI projects

and new jobs created in the UK since the referendum, as shown in Chart 6.

Chart 6- FDI projects and number of new jobs created in the UK 2010/11 – 2017/18

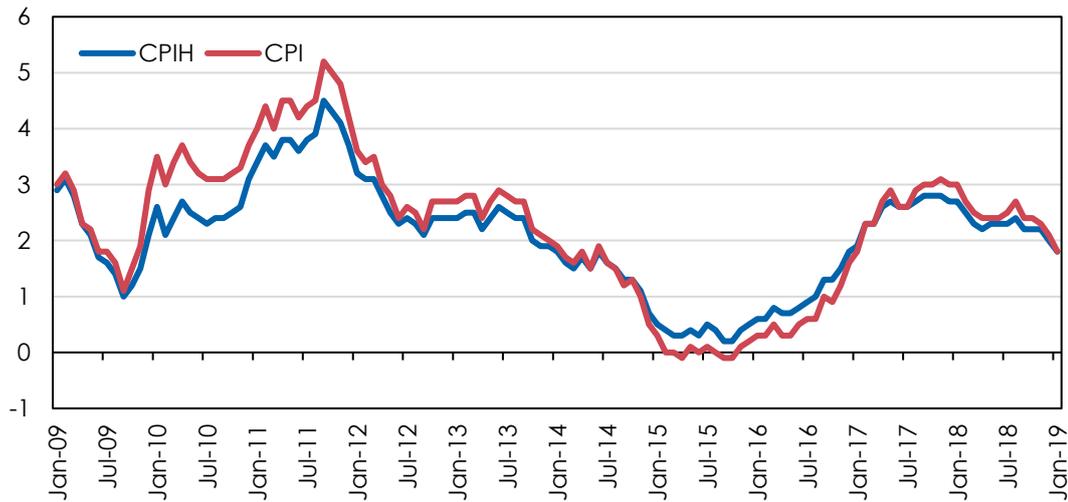


Source: Department for International Trade, Whitehelm Advisers



Inflation increased sharply in the aftermath of the Brexit referendum, peaking around the end of 2017. This was largely driven by the sharp depreciation of the sterling and the higher import prices that followed.

Chart 7- Inflation in the UK

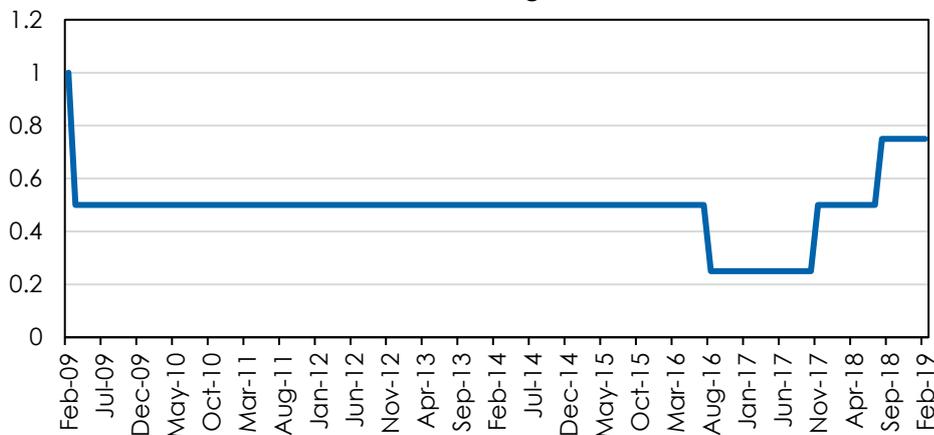


Source: Office for National Statistics, Whitehelm Advisers

The Bank of England did not expect a Leave result and so implemented a range of monetary policy stimulus measures in the second half of 2016, including a 25bp rate cut, taking the Official Bank Rate to a historic low of 0.25%. This was subsequently unwound, with the Official Bank Rate now at 0.75%.

This central bank intervention, combined with the stabilisation of the pound, has resulted in inflation steadily decreasing over the past twelve months and the most recent CPI release in February was 1.8% (close to the Bank of England's 2.0% target).

Chart 8- Official Bank of England Interest Rate

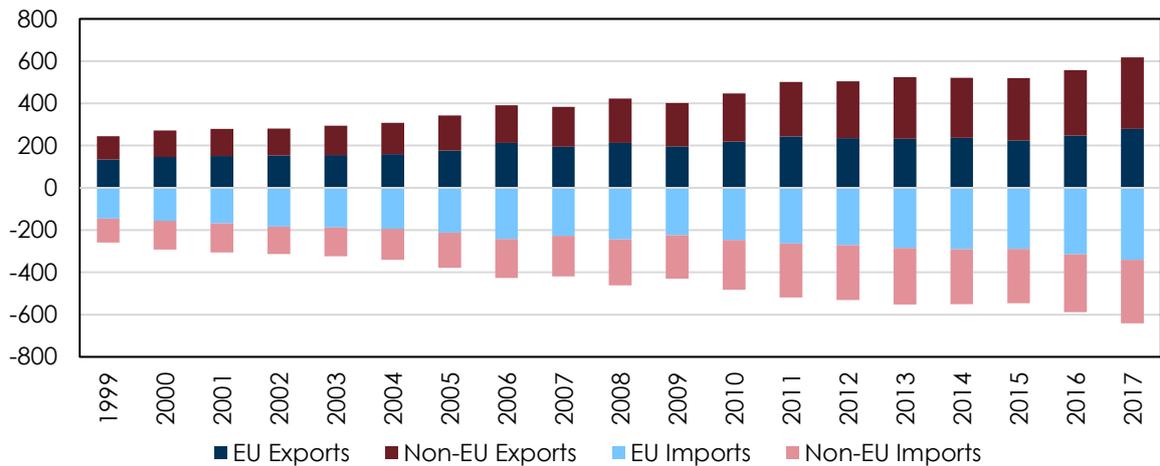


Source: Bank of England, Whitehelm Advisers.

Next, we look at trade.⁶ A quick snapshot - during 2018, the UK exported goods and services to the value of £629 billion. Total imports were £662 billion. Around half the UK's trading flows in 2017

was with EU member states while the UK's top trading partner is the US (accounting for around 14% of total trade).

Chart 9- UK Exports and Imports – EU vs non-EU 1999-2017 (GBP billions)



Source: Office for National Statistics, Whitehelm Advisers

An open economy engaging in international trade can expect higher productivity, increased economic output and improved living standards. This finding was detailed recently by the Bank of England⁸ but is supported by mounds of economic research dating back to David Ricardo and his theory of comparative advantage. Brexit, in whatever form it takes, will increase barriers to trade between the UK and EU and so is expected to lead to a decrease in trade volume between the two neighbours (in the absence of any new trade agreement).

In summary, Brexit has resulted in lower GDP growth, a depreciation of the pound, falling FDI, increasing inflation, and decreased trade volumes for

the UK over the short term. In the event of a hard Brexit, these impacts will become more intense, more dramatic.

And this is why we consider an implementation period to be of such importance. A soft Brexit with an implementation period gives authorities and firms enough time to make the necessary adjustments and so materially reduces the economic costs⁹. A hard Brexit fundamentally changes the way firms and countries interact instantaneously, shocking them into the brave new world. Whilst such a thud would end the uncertainty, it would also render significant damage to the UK economy.

⁶https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/781421/190226_UK_Trade_in_Numbers_full_web_version.pdf

⁷ 2018 breakdowns not yet available.

⁸ Bank of England, 2018, 'EU withdrawal scenarios and monetary ad financial stability: A response to the House of Commons Treasury Committee',

⁹ Bank of England, 2018, 'EU withdrawal scenarios and monetary ad financial stability: A response to the House of Commons Treasury Committee',



Impact of Brexit on European financial markets

London is a global hub for financial services¹⁰. International financial services firms have used London as a bridge to Europe, taking advantage of the EU passport to grow the size of their business on the continent. London became even more systemically important when central counterparties (CCPs) were established in the aftermath of the

GFC. So, Brexit in its pure form is a colossal disrupter for the London financial markets, and derivatives markets in particular. And the primary reason for this is that UK entities will lose their EU passport. This means UK financial services firms will no longer be able to operate in EU countries without further authorisation and vice versa.

Central counterparty clearing

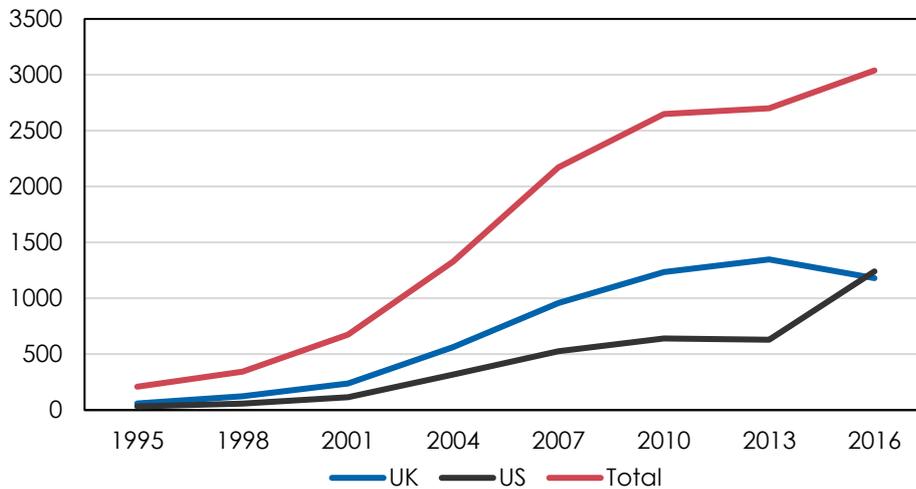
Going back a few steps, the key to European derivatives markets now is to understand at how they have evolved since the Global Financial Crisis (GFC). In September 2009, G20 leaders agreed that all standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms (where appropriate) and cleared through CCPs. CCPs reduce market complexity by placing themselves between a derivative buyer and seller. By doing so, CCPs reduce the number of bilateral trades outstanding as well as the reducing overall counterparty credit risk by netting deals and holding collateral against exposures (known as multilateral netting).

This multilateral netting helps reduce counterparties liquidity requirements by consolidating collateral requirements. CCPs also assist in the so-called orderly distribution of losses in the event of a counterparty default. However, there are risks associated with the CCP model because of their systemic importance and, for this reason, CCPs are regulated by the Bank of England under its financial market infrastructure supervision mandate. There are currently three authorised CCPs – ICE Clear Europe Limited, LCH Limited and LME Clear Limited¹¹.

¹⁰ Ranked in 2nd place by The Global Financial Centres Index, September 2018, https://www.zyen.com/media/documents/GFCI_24_final_Report_7kGxEKS.pdf

¹¹ <https://www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision>

Chart 10 – Turnover of OTC single currency interest rate derivatives 2016 (USD billions)



Source: TheCityUK, Bank of International Settlements, Whitehelm Advisers

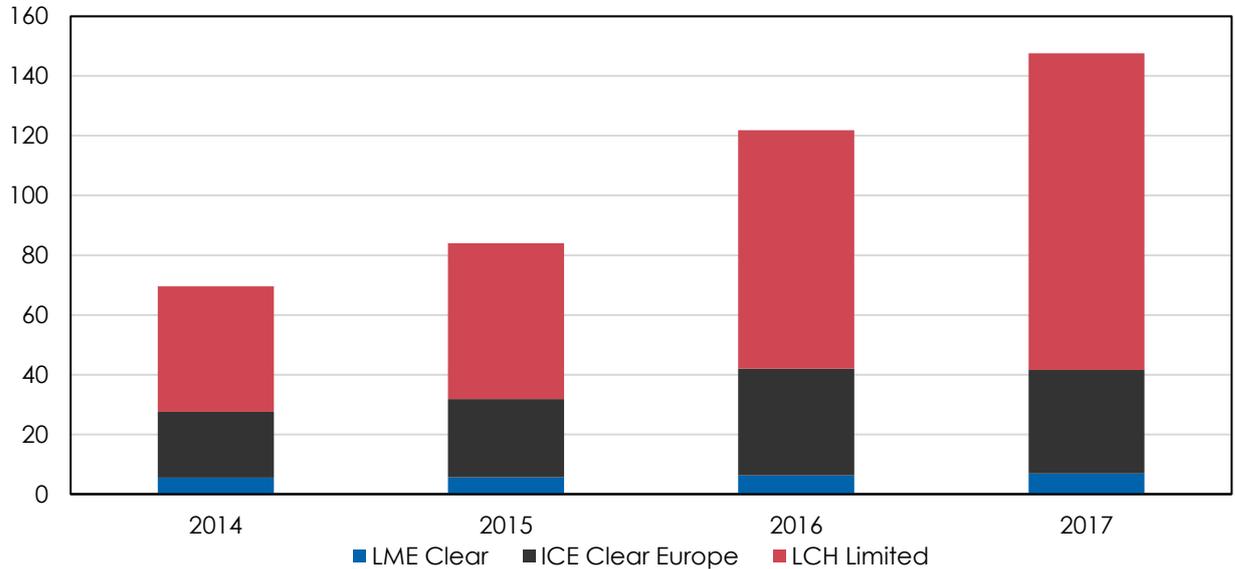
London is the world's second biggest derivatives market, where 39% of all global OTC interest rate derivatives were traded in 2016. It is second only to the US, where 41% of these trades were done (as shown in Chart 10).

And London is the home of global derivatives clearing houses. In fact, LCH clears more than 90% of total global cleared derivatives contracts.¹² Further, the European Central Bank estimates that around 90% of euro denominated interest rates

swaps and 40% of euro-denominated credit default swaps traded by euro-area banks are cleared through London based CCP's.¹³ The three regulated London based CCP's – LCH Limited, ICE Clear Europe and LME Clear – hold an astonishing amount of collateral, as shown in Chart 11, highlighting both their systemic importance as well as London's role as a global derivatives centre.

¹² <https://www.bankofengland.co.uk/-/media/boe/files/annual-report/2018/supervision-of-financial-market-infrastructures-annual-report-2018.pdf?la=en&hash=58A07611A193B1C549E4A443DF3D0E7D19B23A95>

¹³ <https://www.ecb.europa.eu/press/key/date/2017/html/ecb.sp170620.en.html>

Chart 11 –London CCP's: Total initial margin requirement (GBP billions)


Source: Bank of England, Whitehelm Advisers

Under EU law, EU counterparties will not be able to clear derivatives through UK CCP's once they lose their passport, unless the CCP has been separately authorised from the European Securities and Markets Authority (ESMA). EU counterparties currently have OTC derivatives with around £60 trillion gross notional outstanding with UK CCPs and £45 trillion of this matures after Brexit Day¹⁴. So, a hard Brexit with no sideline agreements would mean European counterparties would have to close out or transfer £45 trillion of derivatives transacted with UK CCPs before 29 March 2019.

Similarly, for uncleared OTC derivative contracts, some 'lifecycle' events (including amendments, compressions, rolling of contracts and exercise of some options) would become unlawful in some EU jurisdictions and so would also need to be either closed out or transferred. These scenarios would be hugely costly for counterparties and CCPs as well as creating enormous market disruption.

But financial markets regulators identified these disastrous consequences early and have been

undertaking preparations since the referendum results to ensure that markets would continue to function no matter what happened with the withdrawal process.

Contingency Action Plan

The European Commission's (EC) Contingency Action Plan¹⁵ was implemented in December last year. This plan, which kicks in in the event of a hard Brexit, ensures that UK central counterparties will continue to be recognised by ESMA (on a temporary and conditional basis). It also allows certain OTC derivatives contracts to be novated to an EU27 counterparty, exempting these trades from clearing and margining obligations that otherwise would have been required. Under this contingency umbrella, on 18 February 2019, ESMA granted 1-year licenses¹⁶ to three London based clearing houses – LCH, ICE Clear Europe and LME Clear — so they can continue to clear derivatives trades post Brexit Day in the event of no-deal Brexit.

¹⁴ <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2018/november-2018.pdf>

¹⁵ <https://ec.europa.eu/info/sites/info/files/com-2018-890-final.pdf>

¹⁶ <https://www.esma.europa.eu/press-news/esma-news/esma-recognise-three-uk-ccps-in-event-no-deal-brexit>

So, we consider that financial markets, and derivatives markets in particular, will continue to function over the Brexit period thanks to the planning of regulatory authorities as well as market participants. But this is not to say there will be no disruption. The ties that Brexit unwinds are deep and complex and there must be impacts that have not yet been considered and mitigated against.

What about the longer-term?

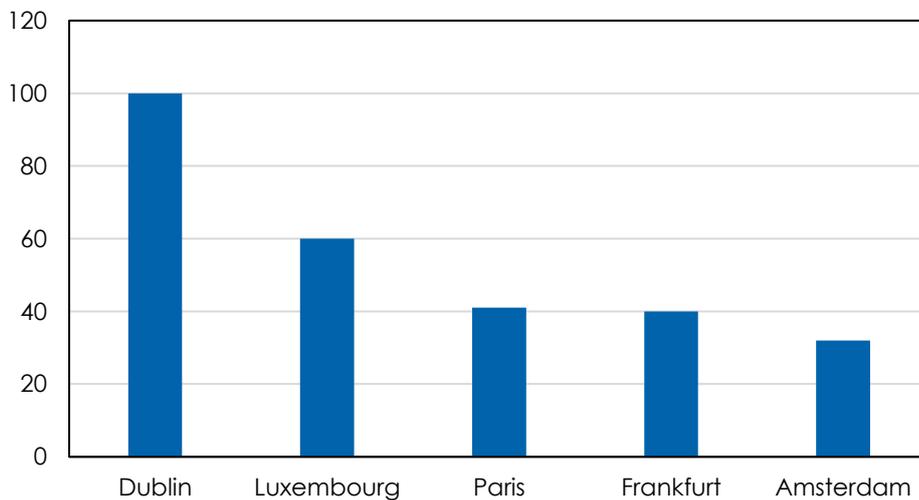
Brexit also has longer-term implications for European financial markets.

The European Central Bank (ECB) has been unambiguous in its statements to banks wanting to continue to access an EU passport by seeking a banking license in a E27 country — the ECB will not accept shell companies and all European entities ‘must have adequate local risk management,

sufficient local staff and operational independence’¹⁷. Further the ECB will not accept banks seeking to book all exposures back-to-back with a London entity.

So, Brexit creates a push factor for foreign banks located in London to head across the water to a location that affords them an EU passport. And this movement is underway with Dublin, Luxembourg, Paris, Frankfurt and Amsterdam the key beneficiaries so far. New Financial¹⁸ identified 275 firms that have relocated assets and/or people to the EU27 in response to Brexit and Chart 12 shows where these flows are going. However, it is likely these numbers underestimate the magnitude of the Brexit-related financial services migration and that the outward flow will continue, even when there is more certainty around how Brexit will happen.

Chart 12 Where are financial services firms moving?



Source: New Financial, Whitehelm Advisers

¹⁷ <https://www.ecb.europa.eu/press/key/date/2017/html/sp170322.en.htm>

¹⁸ <https://newfinancial.org/the-impact-of-brexit-on-the-city/>



Euro denominated derivatives market

Another key example of a longer-term impact is the euro-denominated derivatives market — while London will continue to clear these trades for now, there is speculation around whether the ECB would allow this market to stay outside its regulatory jurisdiction over the longer term. But it is also not clear whether this responsibility, if it did move to the EU, would sit centrally with ESMA or would become fragmented between different EU members. Such fragmentation may also have ramifications for the equivalence agreements between the US and the EU.

Brexit will inevitably deal a blow to the UK financial services sector. But banks and other industry participants, including regulators, have been preparing since the referendum result and are arguably one of the most Brexit-ready sectors in the UK. We do not consider London's role as a global financial centre to be in jeopardy. But there is also no doubt that Brexit has reduced its size and will likely change the intricacies of this sector over the longer term.

What does all this mean for investors with exposure to UK infrastructure projects?

Infrastructure investments offer stable returns over the long term and are therefore less likely to be affected by the process of Brexit, in whatever form it takes, than many other asset classes. That said, some infrastructure assets could be affected – some in a positive way.

While it may seem counterintuitive, returns on some infrastructure assets could be boosted, temporarily, by a hard Brexit. In a hard Brexit scenario, we expect the pound to fall significantly, particularly given that markets do not seem to be expecting such an outcome. This would lead to temporarily higher inflation. Infrastructure assets with strong inflation linked revenues (for instance regulated utilities) would be beneficiaries, *ceteris paribus*.

However, the opposite could be true for GDP-linked infrastructure assets, including ports and airports.

As discussed previously, during the process of Brexit, UK GDP growth is likely to be lower than it otherwise would be, particularly in the event of a hard Brexit and this could affect the demand for products and services delivered by some infrastructure assets. UK ports with significant trade flows between the UK and Europe could be materially impacted by the disruption that a hard Brexit would surely bring.

Many UK-based infrastructure assets rely on imports from the EU for inputs into their operations and for capital equipment. Each of the UK infrastructure assets in which Whitehelm is invested has implemented contingency plans to ensure ongoing supplies of such materials and equipment.

A lower value of Sterling would also mean the value of UK based assets in foreign currency terms would fall. A well-considered and implemented currency hedging strategy would protect investors from this risk.



EU disintegration?

There have been rumblings that Brexit could be the beginning of the end for the great European integration project. On a continent struggling to cope with immigration — not just where to settle immigrants but the longer-term question of how to integrate masses of culturally and religiously diverse people — nationalist parties have momentum right now. In the same way Leave campaigners tapped into the anti-immigration zeitgeist in the dying days of their campaign, European populist parties are tending to run on nationalist, xenophobic platforms for the upcoming European parliamentary elections. And these parties tend to not favour the ‘ever closer union.’¹⁹

However, the rhetoric of these parties has fundamentally changed during the period from the Brexit referendum to now. Immediately after the Brexit referendum result, there were fears that countries with a strong Eurosceptic presence, for example the Netherlands, Finland or Denmark, may follow the UK and hold exit referendums. But this sentiment has shifted, with far-right parties now seeking to change the EU from within rather than to break it apart. So, while populist, anti-immigration movements present a significant challenge to the EU – the extent of which will

become clear after the parliamentary elections in May – we do not consider these forces to be an existential threat.

And this goes to the heart of our thesis – the way Brexit has played out since 2016 has created a compelling deterrence effect for other EU member states who have entertained the idea of leaving the union. So, we are not of the view that Brexit means European disintegration. In fact, we consider that Brexit has *strengthened* European integration. And this increased cohesion of member states has been demonstrated throughout the Brexit negotiations, standing in stark contrast to the polarised, chaotic scenes in Westminster.

¹⁹ <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2012:326:FULL:EN:PDF>



Conclusion

Brexit has dominated headlines and the parliamentary agenda for more than three years. It will reduce the size of the UK economy, decrease trading volumes and shrink London's financial centre. The Brexit referendum was by those with strong views but no plan on how the divorce would be implemented. Instead, Brexit implementation fell to Theresa May, a Conservative MP who voted to Remain but whose primary focus since becoming Prime Minister has been to carry out the Leave referendum result.

Investors will be most protected now by a soft Brexit underwritten by Prime Minister May's withdrawal agreement. It would not only end the uncertainty but also reduce the negative economic consequences of the divorce by managing the separation.

In fact, financial markets have largely priced in a soft Brexit. And investors who have implemented a currency hedging strategy can take heart that their short-term returns are protected against the volatility afforded by this Brexit period. Further, counterparties can expect that derivatives markets will continue to function efficiently over the Brexit Day period, although there remains a risk of minor interruption in a no-deal scenario.

But over the longer term, UK infrastructure assets are expected to continue to provide investors with stable, robust returns as the UK economy re-defines its trading relationships and focuses on something other than Brexit.

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