



## One year on from Brexit

Sterling's devaluation in response to the shock UK referendum result has been the most significant market event in recent years. The UK currency was the lightning rod for investor sentiment and has yet to materially recover from its post-referendum low. It remains around 13% weaker on a trade-weighted basis over the past year. Sterling continues to be vulnerable and is likely to maintain a weak trend amid even more political and economic uncertainty, with potentially another election given the current minority Government's fragile mandate.

## Where does this leave Brexit?

For a number of months it appeared that the UK was on course for a 'hard' Brexit. However, this year's General Election result seems to have mollified the UK Government's rhetoric, which has shifted to being more pragmatic and conciliatory. A 'no deal' option looks to be off the table, with the UK government most likely pursuing a transitional arrangement. In other words, the UK would retain access to the Single Market by remaining in the European Economic Area and the Customs Union, in a model similar to the one used by Norway. While this remains speculation, most commentators agree that it will be almost impossible to agree and formulate a new trade agreement between the UK and the European Union (EU) by March 2019.

There is no easy solution since any transitional arrangements which keep access to the Single Market would mean that the UK government broadly adheres to the freedom of movement principle, as well as the legal framework of the European Court of Justice. Inevitably, this would be a difficult sell to the hard-line Brexiters. The alternative is that the UK departs the EU without any transitional arrangements in place and would revert to World Trade Organisation rules, a scenario both costly and damaging to UK business.

## Do better external conditions allow for monetary tightening?

The one consolation for the UK is that these political anxieties are happening at the same time as we are seeing improvements in the global economy. World trade has seen a meaningful pick-up this year and growth appears to have a broader base of support. Unlike in previous years, most countries are contributing to global growth and the majority are seeing above trend growth. There also appears to be a rebalancing towards greater business investment away from consumption. Moreover, outside of the UK, political risks are much reduced in Europe and there are fewer concerns around US foreign policy compared with at the start of the year. Better external conditions have contributed to the UK economy being able to weather the Brexit headwinds thus far.

This more positive assessment of global conditions is allowing Bank of England policymakers, such as the Chief Economist Andrew Haldane, to flirt with the idea of increasing the UK base rate. In a speech this week, Haldane surprised many investors by citing increased risks around the inflation outlook. This came after Governor Carney had reiterated his view that an interest rate rise was not warranted. Haldane has not turned into a fully-fledged 'hawk' but is keen to see the Bank of England tighten at a glacial pace, rather than having to play catch up if upward inflation trends prove not to be transitory. Even with another 25 basis points interest rate hike (reversing last August's cut), UK financial conditions remain very accommodative.





## Contact

To find out more about the Heartwood strategies, visit our website or contact your local representative.

### Maintaining our UK underweight stance

Uncertain politics, economic cloudiness and central bank ambiguities lead us to maintain an underweight allocation to UK assets. We continue to see potential risks around the UK currency, given the scale of the UK budget and current account imbalances. Our long-standing underweight exposure to UK equities is driven by the view that there is better value in other developed markets, which are supported by stronger economic fundamentals. Within the UK equity market, our bias is towards larger companies, which have performed well over the last year as sterling has weakened. We remain underweight in UK government bonds on a duration basis, given our view that interest rates globally are expected to move higher.

**Graham Bishop**  
Investment Director

### Important Information

Heartwood Investment Management is a division of Heartwood Wealth Management Ltd which is authorised and regulated by the Financial Conduct Authority in the conduct of investment business, and is a wholly-owned subsidiary of Svenska Handelsbanken AB (publ). This publication is intended to be Heartwood's commentary on markets and on its own investment strategy. It is not investment research and you should not treat this publication as a recommendation to buy, sell or trade in any of the investments, sectors or asset classes mentioned. The value of any investment and the income from it is not guaranteed and can fall as well as rise, so that you may not get back the amount you originally invested.

Registered Head Office: No.1 Kingsway, London, WC2B 6AN | Registered in England Number: 4132340  
020 7045 2600 | [heartwoodgroup.co.uk](http://heartwoodgroup.co.uk) | Part of the Handelsbanken Group