'BRITIN' OR 'BREXIT'?: POLITICAL RISK FOR UK AND EU UNDERMINE STERLING AND EURO (PART 5)

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We've now analysed implications of both sides of the 'Britin' and 'Brexit' camp – and more importantly, how you may be able to invest, depending on the outcome. Today we round up this series with a final word on the Sterling and Euro.

Brexit creates uncertainty on all fronts: while the terms and conditions to be set on future trade agreements are unknown, it is likely that being outside the block, the UK will have less leverage to negotiate favourable trade terms in the future. At a bilateral trade level, trade agreements both with the EU and outside the EU may become more costly. Adding to the uncertainty is the prolonged timeline until UK is fully disentangled from the EU and a new deal on trade, security and law-making is agreed. Until clarity emerges on what trade agreements need to be put in place, businesses and investors may delay investments into the UK. Under Article 50 which stipulates the process of exiting from the European Union, Britain will have to wait two years to face the new terms and conditions for withdrawing from the block, agreed to by members within the EU and not with UK consultation per se. Until this is clarified, it remains uncertain which trade model the UK is going to emulate.

While the UK will be in control of immigration policy, the economic benefits of reducing immigration remain doubtful and even non-existent (net tax receipts from immigration is likely positive and businesses as well as public services benefit from skilled labour overseas). While exiting the EU membership to reclaim control over immigration means losing access the EU's single market, the greater long-term risk is the fracturing of the UK, with the Scottish National Party ready to call for another referendum on Scotland's independence in an effort to become both an EU and Eurozone member. At risk too is the fragile peace between Northern Ireland and the UK which, through a Brexit instigated border control, may flare up tensions anew. The stark political risks contrasts the doubtful fiscal and labour market gains for the UKBritain. There is also political uncertainty looming within England itself: amongst The Conservatives, the party is largely split, with 6 cabinet ministers alongside half the Conservative MPs going against Cameron's case for remaining in the EU.

The euro is also at risk of succumbing to selling pressure, as fringe parties will seek to exploit "Brexit" by pushing their own national agendas at the expense of a European-wide plan to tackle budget deficits, unemployment and immigration. To ease political pressure, the European Commission is likely going to take a tougher stance on immigration, as well as show more leniency towards members struggling to meet their fiscal targets. This in an attempt to appease fringe parties currently destabilising weak coalition governments in Europe and nurture an increasingly hostile political environment towards the European project.

So what?

Until the EU shows unity in how to deal with unemployment and immigration, the crowded trade in Europe's safest safe havens, including the German Bund, is likely to intensify, driving interest rates deeper into zero and sub-zero territory. The ECB is too likely to provide more support to instil confidence in Eurozone's banks fragile banks. The Brexit scenario is the worst possible outcome for Europe's financial markets. Asset allocators targeting a minimum equity exposure may position defensively in broad diversified high dividend yielding stocks, while currency hedged exposures to European equities could regain appeal if the exposure to Europe's risk asset is sought by foreign investors. The downbeat sentiment in risk assets is expected to also be a boon for gold. Related articles 'Britin' or 'Brexit'?: In a nutshell' "Pre- 23 June Referendum: 2015 Grexit episode suggests to stay hedged until 'B'-Day" 'Britin' or 'Brexit'? : "Britin" seen as confidence boost for European risk assets 'Britin' or 'Brexit'? : "Brexit" is a confidence killer for UK gilts and broad European risk assets

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