FUND MANAGEMENT DIARY

Meeting held on 17th July 2018

Heading for a 'soft' Brexit?

- The government has put forward new proposals for negotiations with the European Union that would allow continued participation in aspects of the customs union and the single market

- Central to the proposals are a commitment to harmonise rules with the European Union on goods and to collect tariffs on behalf of the bloc in a bid to enable frictionless trade across the border

- But Brussels is likely to see the proposals as an attempt to 'cherry pick' parts of the single market. Unless the European Union softens its stance, the United Kingdom is looking increasing likely to choose to remain in the customs union

The government has put forward new proposals for Brexit negotiations

The European Council summit at the end of June confirmed that little progress has been made in the Brexit negotiations since March, with the major issues of the Northern Ireland backstop solution and the future relationship still outstanding. Part of the reason for slow progress has been a lack of unity in the United Kingdom's cabinet on what that future relationship should look like.

The cabinet did reach agreement on a proposal for the future relationship at Chequers, the Prime Minister's country retreat, on Friday 6 July. This subsequently prompted several high profile resignations, including those of David Davis, the Brexit Secretary, and Boris Johnson, the Foreign Secretary. While these resignations did lead to betting markets assigning a greater probability to an early general election in the United Kingdom, they haven't altered the view in financial markets that there is likely to be a soft Brexit.

And this view is consistent with the government's white paper, published last week, which set out its vision for the post-Brexit relationship with the European Union. The United Kingdom is proposing an "association agreement" that would allow continued participation in aspects of the customs union and the single market. The government hopes that this will unlock the next phase of negotiations with the European Union.

What has the government proposed?

There are several key proposals in the white paper. First, the government has proposed the establishment of a new free trade area for goods, including agricultural produce and food, which would allow cross-border trade in these areas to continue unimpeded. This would require a common rulebook for goods, with the United Kingdom choosing to commit by treaty to ongoing harmonisation with European Union rules on goods, covering those rules necessary for frictionless trade.

Britain would become a rule-taker for goods and would not be able to unilaterally change its product standards in order to accommodate imports from non-European Union countries. This may make it harder to tempt countries such as the United States into signing trade deals with the United Kingdom.

Second, a key goal of the government's proposals is to minimise trading friction at the border by removing the need for customs checks and controls between the two parties, while still keeping the United Kingdom outside of the single market. It is necessary for Britain to leave the single market so that the government can achieve its aim of ending the free movement of people with the European Union. To do this, the white paper proposes that a new facilitated customs arrangement is agreed that takes advantage of new technologies. This would allow the United Kingdom to apply the European Union's tariffs and trade policies for goods intended for the bloc, with domestic tariffs imposed for goods staying for consumption inside the United Kingdom.

Given the complexity of such an arrangement, the white paper recognises that this would need to be phased in and as such probably wouldn't be ready by the end of the proposed transition period in December 2020.

Third, the United Kingdom is seeking active participation in several European Union agencies after Brexit. This includes the European Aviation Safety Agency, the European Chemicals Agency and the European Medicines Agency. The government is proposing that it would participate without voting rights and that it would have to make appropriate financial contributions to them.

Fourth, the government is proposing to have a looser relationship with the European Union for services than it is for goods. It is advocating regulatory flexibility recognising that the United Kingdom and the European Union will not have current levels of access to each other's markets. This includes the loss of 'passporting' rights for financial services, which would be replaced by an enhanced equivalence regime.

Finally, the government still intends to end the free movement of people with the European Union. While full details of a new immigration policy are due to be published in a separate paper later this year, the white paper did say that the future partnership should allow citizens to travel without a visa for tourism and temporary business activity.

What are the next steps?

The government will resume negotiations with Brussels on the basis of its white paper in the hope of agreeing a deal before the European Council meeting in October. If a Withdrawal Agreement can't be agreed by the October meeting, then it will have to be done so by December – the European Union's hard deadline to allow enough time for the European Union parliament to ratify the deal ahead of the United Kingdom leaving the union on 29 March 2019.

However, it is not clear at the moment that, if the compromise proposals were to be agreed with the European Union, that they would command a majority in the British parliament. Members of parliament from both sides of the debate have expressed their dissatisfaction with the proposals. This could present a problem later this year when, assuming that a deal has been agreed, parliament has to give its support for the government to proceed with the Withdrawal Agreement and terms for the future relationship.

Meanwhile, Brussels has so far kept quiet on the United Kingdom government's white paper. However, newspaper reports suggest that European Union diplomats have acknowledged in private that the proposals are at odds to their negotiating position. It is likely that the proposals will still be seen as attempts to "cherry pick" parts of the single market.

The upshot is that many more compromises will need to be made before the United Kingdom and the European Union agree a framework for the future relationship. But the suggestion of aligning British goods regulations with those of the European Union is an important change in government policy. Indeed, it is very difficult to reconcile the government's policies of having no hard border between Ireland and Northern Ireland, no customs checks between Northern Ireland and the rest of the United Kingdom, and the United Kingdom leaving the customs union.

Unless the European Union softens its stance, it is increasingly likely that the United Kingdom will eventually choose to remain in the customs union.

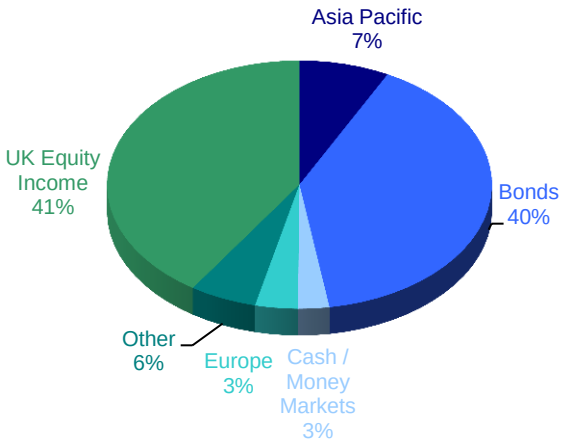
Strategy

The Brexit negotiations are expected to form part of a long process where key areas will be tackled at different stages, with some items being agreed and others being delayed or pushed back. We do not expect this to have a significant negative impact on UK growth, as the long process will allow the economy time to adjust, but are mindful that Brexit headlines can cause temporary market volatility as investors respond to political risk, rather than fundamentals.

We do not feel that any changes need to be made to our strategy at this stage, which currently favours equities. The backdrop of synchronised global growth and rising inflation is expected to support equities going forward. We favour short duration bonds within our fixed income allocation, to reduce our overall sensitivity to interest rate rises.

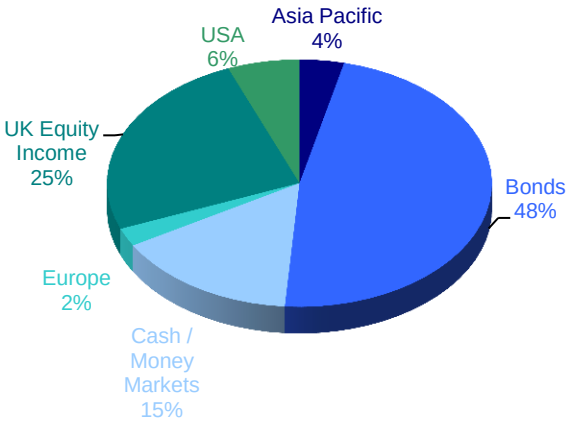
Income

No new changes are currently planned for Future Money Income. The portfolio is in line with target allocations and the fund selection is performing in line with expectations. The movement out of Majedie UK Income and into Man GLG UK Income is ongoing.



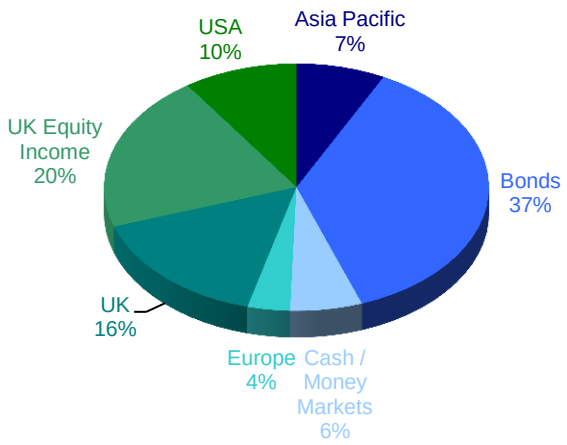
Real Value

No changes are currently planned for Future Money Real Value other than the previously discussed trade away from Majedie UK Income into Man GLG UK Income.



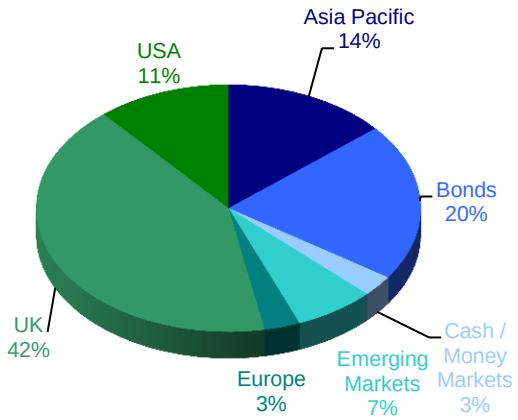
Real Growth

No changes are currently planned for Future Money Real Growth other than the previously discussed trade away from Majedie UK Income into Man GLG UK Income.



Dynamic Growth

No changes will be made for Future Money Dynamic Growth. The portfolio is inline with target allocations and the fund selection is performing as expected.



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Any research is for information only, does not constitute financial advice or necessarily reflect the views of the author and is subject to change.

It remains the responsibility of the financial adviser to verify the accuracy of the information and assess whether the fund is suitable and appropriate for their customer.

Past performance is not a reliable indicator of future performance. The value of investments and the income derived from them can fall as well as rise and investors may get back less than they invested.

Important information about the funds can be found in the Supplementary Information Document and NURS-KII Document which are available on our website or on request.

For any information about the Future Money funds please contact the authorised corporate director, Margetts Fund Management Ltd, on 0121 236 2380, admin@margetts.com or at 1 Sovereign Court, Graham Street, Birmingham B1 3JR. A copy of their Terms of Business which relates to investments into the funds can also be obtained using these contact details.

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