The UK formally leaves the European Union - Sanlam's view

At 11pm on Friday 31 January, the UK will officially leave the EU. We are now entering at least 11 months of transition as policy makers negotiate future trade agreements. Here is our view on what to expect as an investor in the coming months.

Expect some volatility as trade negotiations progress

Already the rhetoric coming out of Europe is conciliatory and optimistic. The UK imports more goods from Europe than it exports, and European countries will be eager to keep these trading opportunities alive. All industries are at their best when they know the rules within which they are operating. But to expect the trade negotiations to be quick and painless is wishful thinking, and investors can expect some volatility in UK and European stocks as negotiations play out, rules are re-written, and businesses across all sectors come to terms with the new landscape.

There will be opportunities in the UK, but caution is still required

As the rules are re-written, there will of course be winners and losers. So far, the biggest benefactors of the certainty brought about by the general election result are housebuilders and utilities companies, meaning investors are confident this deal will bring more jobs, a greater need for housing (supply and demand is already an issue), and increased consumer consumption. It's hard to see who the losers will be at this juncture, so we will be scrutinising the outcome of discussions, and the impact they will have on every sector as they arise.

In the meantime, we will stay true to our investment strategy which is to focus on established UK businesses with strong balance sheets – especially those that trade internationally. We won't shy away from domestic markets as volatility also brings opportunity. We will look for UK companies that are unfairly undervalued due to sector volatility but have a robust business plan and balance sheet to weather the storm.

Europe is not yet out of the woods

In Europe, there are other issues at play. European monetary policy continues to be a source of concern for investors. Negative interest rates have not helped to kick-start the economy, and Europe's manufacturing sectors continue to suffer. We're hopeful that the ECB's proposed strategic review of monetary policy – the first of its kind since 2003 - will bring some better news in 2020. Until then, it's hard to see a compelling reason to invest heavily in Europe.

The threat of inflation

One of the biggest threats to the UK (and global) economy is inflation. Despite Brexit uncertainty, unemployment has remained low. If wage growth continues to increase and consumer spending follows suit, then the Bank of England may be forced to increase interest rates to control inflation. As we saw in the US in 2018, increasing interest rates will expose businesses with excess debt, and will have a negative impact on consumer confidence. We have been mindful of this risk for some time and have invested in companies that can safely increase their prices in line with inflation, as well as other asset classes that protect against an inflationary environment, such as gold.

Changes to legislation

We're not expecting any immediate changes to pension and investment legislation. At the end of this year, EU-influenced regulations under which UK pension and investment schemes operate will need to be adopted or repealed. Given that any changes to legislation have been on hold for the last three years while attentions have been focused on Brexit, we can expect them to find their way back onto Parliament's agenda next year.

By Philip Smeaton, Chief Investment Officer