

## Theresa May dodges the bullet... This time

Theresa May has clung on to power in the United Kingdom, having won a leadership challenge within her own party. But her position is precarious. And the developments of the last two days have increased the chances of a Hard (or no-deal) Brexit.



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David Zahn, Franklin Templeton Fixed Income Group's head of European Fixed Income, warns May's troubles are not over yet. He predicts further volatility ahead for financial markets, but argues there may be opportunities for shrewd active managers.

Financial markets are likely to react to that development. We'd expect gilts likely to rally, yields to decline and the pound to continue to weaken.

### Further hurdles ahead

May's main challenge continues to be securing support from members of parliament (MPs) for the withdrawal agreement she has negotiated with the European Union (EU). Her leadership victory doesn't fix the problem that parliament doesn't like her deal.

She has already postponed a parliamentary vote on the deal once, because of lack of support. We think she will need to

obtain some further concessions from the EU if she is to get it past MPs.

The relatively small margin of May's victory in the leadership challenge has significantly dented her mandate to negotiate the Brexit deal terms with Brussels.

Meanwhile, opposition parties in the House of Commons have threatened to table a vote of no confidence in her government. The narrowness of her leadership victory suggests she might struggle to win a confidence vote in parliament and that could lead to a general election early in the New Year.

We think Theresa May remaining as prime minister currently represents the best chance of the United Kingdom securing a Soft Brexit, in other words, leaving the EU with a negotiated settlement.

## **No time for a fresh deal**

There would simply be no time for May's successor to renegotiate a fresh deal with Brussels, so if she were to step down or be ousted we would expect the United Kingdom to leave the EU without a deal.

So in our view, May's departure would likely have extremely negative consequences for markets.

Amid this uncertainty, markets will likely be quite skittish for some time, as investors wait for a potential challenge to May's government and the possibility of a fresh general election and any last-ditch attempt at securing a deal.

## **A role for active management?**

Against such a background, we reiterate our view that it makes sense to be active in the management of fixed income portfolios.

Investors will likely have to react to news flow coming out from Westminster and Brussels.

It may well be difficult to read through the noise, but for those investors who can, we think there may be an opportunity to add value to their portfolios.

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