Should You Protect Your Portfolio Against an Ugly Brexit?

Description

The United Kingdom is scheduled to leave the European Union on October 31, and there are increasing risks that the divorce will not be a pleasant one.

Brexit, as the UK's exit from the EU is more commonly known, was supposed to occur at the end of March this year, but political differences in the U.K. coupled with the fear of a no-deal exit forced former prime minister Theresa May and the EU to agree to delay the date.

The UK's new prime minister, Boris Johnson, has said the UK will leave this time on the deadline, regardless of whether or not he has reached a reasonable deal with the EU that will make the separation less painful for both EU members and the United Kingdom.

The situation is complicated, ranging from the free movement of people to work in EU member countries to the cost and availability of food and medication. The battle over a border between Ireland and Northern Ireland is also a significant stumbling point.

The biggest concern is that nobody knows exactly how financial markets will react when the UK leaves, and investors are trying to decide how to position their portfolios.

Doomsayers suggest a no-deal Brexit could push global financial markets into chaos. Already delicate situations such as Italy's banking crisis could become too much to handle amid the added turbulence in the European market, setting off a chain reaction across other struggling European banks.

As it stands, Germany is preparing for a potential "deep" recession as the country's economy appears headed for a downturn. Europe's other countries probably won't be able to pick up the slack and the trade dispute between the U.S. and China makes the situation more precarious.

A good chunk of government debt in Europe is now trading at negative yields and interest rates have no room to go lower to stimulate economic growth in the region.

If the worst-case scenario actually unfolds, investors should be prepared by moving some funds tosafe-haven assets.

On the other hand, the result of a no-deal Brexit might be as uneventful as the result of Y2K. Everyone woke up on January 1, 2000 and pretty much continued their lives more or less as they had lived the previous day.

With a no-deal Brexit, there will be people who are working in the UK who will have to jump through a few hoops to stay. The same would likely occur for UK citizens who are working in EU countries.

On trade, the individual countries would have to hammer out new deals with the UK. That could be messy, but it would eventually get sorted out.

London's importance as a global financial hub might be impacted, but companies would have to find somewhere else to move that would be a better fit. There is no obvious answer as to where they should go, or if moving would actually make a long-term difference.

What should Canadian investors do?

One way to shore up the portfolio would be to buy stocks that would be resistant to international financial chaos.

A North American utility stock such as **Fortis** (TSX:FTS)(NYSE:FTS), might be a good choice. Fortis gets most of its revenue from regulated assets located in Canada and the United States.

Companies and businesses need power and natural gas delivered to their premises regardless of what is happening in the financial markets.

The dividend is safe and is expected to grow by at least 6% per year through 2023.

Falling interest rates and lower bond yields should actually be positive for Fortis. The company benefits from reduced borrowing costs to fund growth projects and GICs become less competitive with the stock for yield-seeking investors.

In all likelihood, the Brexit fears are severely overblown, but investors might want to tweak their portfolios a bit, just in case things really do go off the rails.

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