The views expressed in this article are those of the author at the date of publication and not necessarily those of Woodford Investment Management Ltd.

I believe the UK is fast approaching the point at which it has to decide whether it is fully in or fully out of Europe. A Conservative win at this May’s General Election and the promised referendum on Europe, might coalesce the UK’s stance but it is a complex issue the whole of Europe needs to confront.

The eurozone continues to face major economic, social and political challenges. The growing popularity of politicians across Europe with anti-EU or outright separatist agendas is the single most obvious manifestation of disenchantment with the eurozone project. European voters are frustrated by the region’s prolonged poor economic performance and disillusioned by the traditional mantra of ‘more Europe’ peddled by the region’s political elite. Their mandate for pursuing this policy is gradually being diminished.

And yet it is widely acknowledged that, if the single currency is to succeed, it requires closer integration – a fiscal transfer mechanism to sit alongside the monetary union. Although the European electorate is evidently reluctant, Europe must decide whether it wishes to embrace this further integration or accept that it is sub-optimally structured and the euro is at perpetual risk of failure.

Britain is, by choice, on the sidelines of this debate. We are not properly ‘in’ Europe – we haven’t even accepted the monetary union, let alone the fiscal union – nor are we properly ‘out’. As the debate in Europe intensifies, however, this stance seems increasingly unsustainable. As things stand, both the available alternatives have significant shortcomings and risks.

According to Greek mythology, Odysseus was forced to choose which monster to confront while passing through the straits between Scylla and Charybdis – he had no other option. For the UK, going it alone would mean straying too close to Scylla, the mythical six-headed monster, which could have profound economic implications. Would the UK be able to so readily attract inward investment from major global businesses if it were not in the EU? On the other hand, joining the project wholeheartedly (a decision the UK electorate is some distance from accepting) could result in being sucked into the whirlpool of Charybdis. Without fiscal integration, the monetary union does resemble a vortex at the heart of Europe’s troubles. The future, therefore, looks far from plain sailing for the UK economy.

These issues will feature prominently in the General Election and, if the Conservatives win, a referendum on Europe in 2017 is promised. Regardless of the outcome of the election, however, as the debate within Europe intensifies, we will inevitably be confronted by the need to decide.

Rather like Odysseus, we face a significant challenge and a difficult decision. Ultimately, neither option looks obviously right or wrong but, from an economic perspective, I anticipate that this causes more uncertainty and potentially a deterioration in consumer and business confidence.
Indeed, a level of uncertainty already exists with the UK neither properly ‘in’ nor ‘out’ and, increasingly, I worry that businesses may already be less inclined to invest in Britain because of it. To my mind, this is one of several factors that contributes to my level of caution around the UK and eurozone economic outlook in the medium term. In particular, it is going to be very hard for the eurozone economy to confront and conquer its stagnant growth and deflationary demons, while this level of political introspection and uncertainty prevails.

From an investment perspective, these problems provide further vindication for a cautious long-term strategy and a focus on high quality, dependable businesses, many of which have the additional benefit of substantial global diversification. Remarkably, some of the most attractive valuations in the UK stock market are attached to the shares of companies that are best able to cope with these challenges. This leaves me feeling confident about the returns my portfolio can deliver in the long-term, as we navigate through these troubled waters.

This article first appeared in The Daily Mail on 3 January 2015.

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