AJBell Investcentre

General Election 2017 Special

June 2017

An uninspiring campaign has caught up with Theresa May and the Conservative Party and eroded their Westminster majority, possibly leaving the UK facing the prospect of a coalition Government for the second time in three General Elections. That said, as I sit here, Mrs May is going to see the Queen with the intention of forming the next Government.

Going into the June vote markets had rather lazily been relying upon the opinion polls which continued to point to a Conservative win, so this unexpected development is likely to create some short-term volatility in stock, bond and particularly currency markets.

The markets were able to quickly express a view on the hung Parliament result by trading sterling overnight in Asia. The pound lost around 2% against the dollar, falling to around the $1.27 mark, retracing some of its recent gains.

In some respects, it could have been a lot worse for sterling and that may reflect the electorate's rejection of, or at least failure to wholly embrace, the Prime Minister's so-called 'Hard Brexit' stance.

However, the pound's slide is leading to an action replay of last year's post-EU referendum trading pattern now that markets are open in the UK.

Today's early moves saw the FTSE 100 rise and the more domestically-oriented FTSE 250 fall as stocks took their lead from the currency markets and the big multinationals and dollar earners moved higher.

It is noticeable that defensive names such as the food, drink and pharmaceutical sectors' overseas earnings did best in the opening exchanges today, reflecting the prevailing uncertainty. Gold and silver miners were to the fore as well, as they are also potential beneficiaries of a weaker pound and stronger dollar.

The FTSE 100 laggards were more domestic names like banks, housebuilders and consumer discretionary plays like retailers and media stocks - even if talk of a softer Brexit could play to the financial services companies at some stage, assuming it proves to be more than just talk.

In the very short term, Theresa May's dash to reinstall herself in Number 10 may help calm the markets.

Remember that back in 2010, the FTSE 100 fell 2.6% on the day after the election on 6 May of that year threw up a hung Parliament.

The index then rallied 5.2% on the following Monday, when incumbent Prime Minister Gordon Brown resigned and overall recorded a gain of 2.3% from the day before the ballot to the announcement of the Conservative-Liberal Democrat coalition on 12 May.

In contrast, the UK Government bond (or Gilt) market wobbled a little, as the yield on the benchmark 10-year Gilt rose to 3.78% from 3.74% and prices therefore fell slightly.

Sterling lost between 1.5% and 2.0% against the dollar and euro on 7 May as the hung result became clear but losses came to barely 0.5% on each count by the time David Cameron and Nick Clegg had cobbled together their coalition.

The scope for short-term swings is clear – but note that markets calmed down pretty quickly as economic and company fundamentals reasserted themselves.

Over the 12 months following the 2010 election, the FTSE rose 13.6% while the 10-year Gilt yield fell (so price rose) from 3.74% to 3.40%, helped by the Bank of England's Quantitative Easing bond-buying programme. The pound gained 10% on the dollar and lost 4% against the euro in the 12 months after the poll.

This was as much due to the fundamental backdrop: a recovery from the financial crisis and ultra-loose monetary policy from central banks the world over, in the form of falling (or record-low) interest rates and QE. UK politics, next to that lot, meant relatively little.

Fund managers certainly know that in the long term it is not politics that determine company valuations. Ultimately, it is profit and cash flow that drive share prices so they won't let short term political noise divert them from their investment strategy, at least if they are doing their job properly.

After all, punting around on the basis of which manifesto promises will be kept or jettisoned or compromised as part of any compromises between political parties is a mug's game.

Advisers and clients should bear this in mind. Perhaps the best plan is to stick to the long-term strategies already devised and implemented, since second-guessing what may or may not come out of Westminster and any talks between say the Tory minority and the Democratic Unionist Party is a thankless task.

If nothing else, keeping calm will avoid incurring what could be unnecessary brokerage fees and commissions, as well as other frictional costs such as dealing spreads and potentially Stamp Duty.

As the American economist Robert Solow put it: "Economists are often asked to predict what the economy is going to do – but economic projections require predictions about what politicians are going to do – and nothing is more unpredictable."

Thank you for watching and I look forward to seeing you next time.

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