HANSON

UK General Election 2015

Given the unpredictability of the forthcoming General Election in the UK we thought we would add our two cents worth to the subject. Elections in the UK are changing and gone are the days where one party can command a majority in the House of Commons, which has been typical of the British Parliamentary System. The pollsters have the main two parties as neck and neck, but pollsters are not always right and the beauty of a secret ballot is that you can say one thing, do the exact opposite and no one will know till the votes are counted. A more accurate predictor is probably the Bookmakers, who indicate that the two main parties will receive roughly equal numbers of seats with the Conservatives maybe at a slight advantage.

The likely outcome has been subject to intense debate as more and more parties are edging their way into mainstream politics - even the Greens managed a seat at the last election. Looking at the state of play, the Liberal Democrats are likely to be large losers on the night, while UKIP are expected to poll many votes, but win few seats. Nationalist party Plaid Cymru will impact Labour in Wales and, as widely publicised, the SNP are predicted to do very well in Scotland, largely at the expense of Labour. There is also the UDP from Northern Ireland who could win 8 – 10 seats and would more naturally support the Conservative cause. It is how voters feel about the Conservatives in England that will affect the outcome, especially in marginal seats with undecided voters. As a result it is really too close to call, but how will the markets respond? We have analysed the key markets from the likely perspective of a Conservative or Labour-led government to highlight the key issues.

Sterling

The recent movements have seen Sterling weaken against the US Dollar, but made gains against the Euro. In the event of a minority administration, of whichever party, the currency's value should clearly decline to reflect the risk of extended policy uncertainty.

Conservative-led Government

If the Conservatives can command some kind of majority there will be concerns about a BREXIT from the EU and, therefore, the currency would likely come under pressure. However, if the current coalition is recreated, the Liberal Democrats are unlikely to accept such a referendum, which would support the currency. Further, a marginally sharper pace of austerity could dampen economic sentiment, prompting the BoE to leave interest rates on hold for longer than is currently expected, which would weaken Sterling. However, more broadly Conservative economic policies are seen as good for the economy, which would be supportive of Sterling in the medium term.

Labour-led Government

There will be concerns about overall fiscal credibility and devolution, especially if Labour relies on the SNP for informal support. In addition, certain Labour proposals for increased taxation could lead to capital flight from the UK, which would impact the currency. However, perception of looser fiscal policy, (beyond current spending) in 2016/17 could be countered by a steeper path of interest rate rises, which could offer some support to the currency.

Government Gilts

Conservative-led Government

Reducing net borrowing in line with the projections under the last Budget should see lower issuance (supply) of Gilts, supporting prices. Moreover, any delay to the rate hiking cycle resulting from the earlier target for a balanced budget deficit could also support the market in the short-term. US Government Bond prices have performed well as their government deficit has fallen, but there have been other factors at work.

Labour-led Government

Supply may increase if the deficit reduction path is easier since borrowing levels will remain higher, particularly for infrastructure spending, which could hurt the Gilt market. Additionally, looser fiscal policy may lead the BoE to tighten policy at a faster pace, which could be negative for the front end of the yield curve.

Equities

Conservative-led Government

If Sterling weakens the share prices of FTSE 100 companies are likely to fare better than the FTSE 250, which is more domestically focused with c. 50% of sales occurring in Britain, while the figure is just 25% for the FTSE 100. Historical precedent suggests a favourable reaction to a Conservative-led government, but support would be diluted by a minority position and BREXIT risk.

Labour-led Government

Recent historical precedent would suggest a negative short-term reaction, with international earners outperforming domestics on sterling weakness. Specific sectors of the equity market could be hit if Labour successfully pursues their proposals to increase tax and regulation in various areas, e.g. banks, tobacco and utilities.

Property

Conservative minority Government

It's unlikely that any impact beyond a sigh of relief, in most regions, particularly in London, will be felt. Changes have already been made to Stamp Duty by the Coalition.

Labour minority Government

A mansion tax would likely be negative for the higher end of the residential property market, especially in London as would the removal of tax advantages for those who are Non-Domiciled. The proposal to introduce rent caps on landlords would also create upheaval.

In Conclusion

Neither of the major parties is likely to win a clear victory in the upcoming election. Therefore a minority government for the UK is the most likely outcome. While unusual, this is not unprecedented.

Moreover, there have been many examples both in the UK and abroad where minority governments operate successfully for considerable periods. To be sure, a minority government may not last as long as one which won a landslide victory, but it will be able to operate and pass legislation.

In our view, the greater concern for markets will be who leads a minority government. However, neither choice of leading party presents an ideal outcome for investors, as BREXIT concerns (Conservative) will be countered by worries about the outlook for fiscal policy (Labour). One thing we are certain of is that volatility in UK markets will remain elevated as Election Day approaches and an inconclusive outcome means it will likely persist. However, this will create opportunities, which investors should be ready to take advantage of and dips in the financial markets should be used as buying opportunities.

This piece represents the views of Edward Collins and Jonathan Arthur of Hanson Asset Management.

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