The Fed and Tokyo: Correction or Contagion

With the British Prime Minister, Rishi Sunak, recently announcing a snap general election taking place on the 4th of July, it is worth taking a look at how TAM think this is going to play out in the market.

As a ‘starter for ten’, the hour after the announcement saw the UK FTSE 100 index move up 0.16%, which isn’t particularly exciting. The fact the announcement prompted a nothing response says a lot in and of itself. In fact, there was more speculation about why the PM was unable to find a brolly for the announcement, which some perceived as a satirical ending to what has been a negative period for the Conservative government.

Much has been made about the potential impact the election is going to have on markets and what this could mean for the nation under a Labour government. It is therefore worth starting on the likelihood of Labour getting into power. At present, the opposition has a fair lead in the polls. That is not to say the Tories can’t turn the tide but if they did, it would go down in history as one of the biggest political turnarounds this nation will have seen. From a financial markets perspective, the FTSE has usually remained flat to slightly down in the six months after a Conservative victory, and has tended to rally around 6% on a Labour victory with the FTSE 250 mid cap market beating the FTSE 100.

We therefore expect Labour’s potential victory to be met with a strengthening market into and out the back of this outcome. Bolt on the potential for interest rate cuts from the Bank of England in Q3 / Q4, which would add further fuel to the rally. As a final addition, the UK remains one of the cheapest developed markets in the circuit, which has started to show real signs of outperformance of late, so there is a greater degree of international cash coming back into the market.

One flash point to watch may be a Labour government attempting to stimulate through borrowing à la Liz Truss, which forced a flash crash in Gilts and effectively ended her premiership. Labour are well aware of the market's view of pushing an already stretched bond market and its disastrous results, and thus will likely opt to steer clear of this, but it's still something the market will be keeping an eye out for.

This is a good segue into talking about what fiscal weaponry remains in the locker after the Conservatives have vacated, which from here looks like the most likely scenario. We have already touched on the point that borrowing to stimulate is largely off the table, so Labour won't be able to pull that lever to any excessive extent. Likewise, with the UK consumer in a weakened state with unemployment rising and consumption and GDP on the fence, the government will have limited headroom to raise taxes on an electorate who have just voted them into power.

Of course, there are Conservative spending pledges which can be re-tasked so expect to see some changing priorities of spending commitments. Although likely not on the 2% of GDP defence pledge, given the heightened state of global conflict we are currently in. There is of course an option to grow UK exports, which would likely involve a thawing of Brexit negotiations. This is something I would certainly not discount, nor would I discount the buoying effect this would have on the pound, the AIM & FTSE 250 markets.

The present iterations of the Labour and Conservative parties are both presenting fairly centrist playbooks so approaches to stimulus and fiscal austerity won't be massively different. A blessing in terms of reducing market volatility.

One final point to mention goes back to the 6% market rally on a post Labour win. The recent state of the UK Conservative party is to sit on one's hands because an election is around the corner, so there is little point in doing anything of substance. From what I read and hear, this state of intransigence has been in place for well over six months. Therefore, a change of the guard for a political party to breathe fresh life and vigour into Whitehall might not make huge waves in political circles. It may however be just the catalyst this UK stock market needs for both international and domestic investors to get off the sidelines and start investing into one of the cheapest UK markets we have seen in recent times. Even a rally back to our view of 'fair value' would present a real opportunity for outperformance, against increasingly US heavy benchmarks.

If you would like to speak with us about anything in this note, or to discuss our discretionary investment management services in general, please get in touch with our UK business development manager David Terry today.

tam ASSET MANAGEMENT

+44(0)207 549 7650 | info@tamassetmanagement.com
City Tower | 40 Basinghall Street | London | EC2V 5DE