UK General Election: Investec's Views

9 June 2017

Investec Asset Management portfolio managers give their views on the UK General Election result.

The views expressed in this communication are those of the contributors at the time of publication and do not necessarily reflect those of Investec Asset Management as a whole.

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Read John's views

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Read Michael's views

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Read Simon's views

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Read Alastair's views

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Read Blake's views

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The UK election has heightened uncertainty just as Brexit negotiations begin. Theresa May has failed to get a strong mandate to do a deal on her terms, and indeed she may not survive as Prime Minister. The Conservatives seem likely to form a minority government, and are fairly split between Remain and Leave supporting MPs. Overall, the result probably reduces the risk of a Hard Brexit, but also makes any deal more difficult. The other big takeaway is clear support for more public spending and less austerity.

In terms of the implications of this, uncertainty, scope for messy divorce negotiations with Europe, as well as signs of a weakening economy, are all negatives for Sterling, especially after the pound rallied into the election, but an increased chance of a softer Brexit and more fiscal spending should be supportive. Volatility in a range seems most likely, perhaps with a negative bias. Gilt yields should probably rise a little as well, but economic weakness could limit this. For equities, the result is mostly noise, but Brexit and soft domestic demand are probably still a headwind for FTSE 250 companies, and the FTSE 100 will remain subject to Sterling swings given the dominance of foreign currency earners.

In the Multi-Asset Income portfolios we have bought some options on the pound to benefit from volatility and have a modest short Sterling position, but will look to buy weakness and sell strength. In equities, we hold a modest exposure primarily to UK-listed exporters, with most stock exposure in other jurisdictions. We have almost no UK bond exposure. Having a global opportunity set and no geographic bias, allows the portfolios to exploit potential elsewhere and avoid taking much UK linked exposure in uncertain times, while focusing single-mindedly on our three objectives of a reasonable yield, scope for capital growth and low volatility.

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Michael Spinks

Co-Head of Multi-Asset Growth and Porfolio Manager, Diversified Growth Fund

Theresa May had gambled that Jeremy Corbyn's unpopularity within his own party would be shared by the public and that this would lead to a strong Conservative result and hence a more stable base for Brexit negotiations. She lost this bet and we are now in a situation where the Conservatives are trying to form a minority government with the Democratic Unionist Party (DUP) of Northern Ireland. One of the swing factors seems to have been the Labour Party's ability to mobilise the youth vote. Prior to the election we saw a sharp increase in voter registration by the young; the question was whether those registering would actually vote as we saw a similar dynamic before the Brexit referendum, but they had then failed to turn up. Not this time. Labour made a big push for this cohort while the Conservative party had proposed policies that were deeply unpopular with older voters. The overall turnout rate was also high at 68.6%, up by 2.6% from 2015 and so it is a victory for voter engagement compared to previous years, but leaves us with a great deal of uncertainty.

Action taken:

Investing around political issues is typically best expressed through the currency and bond markets and so this was the focus of our attention. For sterling, we expected that anything other than a majority Conservative government would lead to a decline in its value.

Prior to the election we had reduced our exposure to sterling to 82%. We took further action through the options market, buying a put option which pays out if sterling depreciates relative to the US dollar. This covered a notional 20% of the portfolio, costing 0.06% with a potential maximum payout of 0.42%.

For the bond market the outcome was less clear. We have had a position in 5 year UK gilts on the expectation that rates in the UK will stay low for a protracted period of time with low growth, limited inflation pressures and uncertainty from Brexit negotiations keeping the Bank of England on hold. While we continue to expect this holding to generate positive returns over the medium term, the risk of the election was that greater support for Labour would see a rise in yields at the longer end of the gilt market. This is due to concerns that they would follow a looser fiscal policy, financed partially through increased debt and likely higher inflation. We therefore sold 10 year gilt futures to hedge the risk of our UK 5 year gilt position.

We do not anticipate significant impacts on the rest of the portfolio holdings.

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Mark Breedon

Co-Head 4Factor Equity

As Britain's voters deliver another surprise relative to expectations of just a few weeks ago, this time, unlike Brexit, the ramifications appear to be a uniquely domestic affair. With a hung Parliament Sterling takes another, albeit minor, hit after its recent rally but global markets are broadly unconcerned about a result that potentially makes the process of Brexit more difficult but if anything likely softens the "Hard Brexit" line being pushed by many in the Tory party as the outcome can broadly be interpreted as a call to soften the Brexit stance and negotiate access to the single European market. This shift in emphasis is more likely if the Conservatives end up governing with the help of Northern Ireland's DUP who want a frictionless border with the Republic of Ireland. The Socialist opposition however will be invigorated by this result and the position of its left wing leader enhanced and some of the more radical elements of their manifesto now likely to become entrenched and any centrist shift is now off the table. The unity of the United Kingdom also appears strengthened with the Scottish Nationalist Party losing ground and although still commanding a majority in Scotland, are likely to face greater resistance to their call for another independence referendum.

Implications for the UK equity market appear relatively benign at this stage as heightened uncertainty around the shape of any new government is offset by relief that a "Hard Brexit" strategy is likely to be watered down. Beneficiaries should again be those companies who generate a large portion of their sales overseas and therefore gain from Sterling weakness while more domestically orientated groups, and particularly those who are sensitive to consumer sentiment, are probably more vulnerable.

So overall despite the extraordinary speed of the turnaround in the UK Conservative party's fortunes global investors are not going to be unsettled by this result. They have bigger things to worry about.

Impact on portfolios:

Global Strategic Equity – Mark Breedon

The Global Strategic Equity portfolio is unlikely to be significantly impacted. We are marginally underweight the UK relative to benchmark and are focused on more globally orientated investments such as Unilever, Shire, Micro Focus and Meggitt whose sterling profits are likely to be enhanced by currency weakness.

Global Equity – Rhynhardt Roodt and Jonathan Parker

Following the current steers of high scoring ideas in the investment universe, Global Equity has a modestly pro-cyclical bias to its portfolio. As such, a hung parliament, which will be seen as a "risk-off" event will likely have a modest negative impact on the portfolio's relative performance, with UK bank Lloyds, UK housebuilder Barratt Developments and UK utility National Grid, likely most exposed to negative sentiment. Looking over the medium to longer term, whilst the effects on the UK political environment and potentially the economy might be profound, the effect at the global level is likely to be more muted.

Global Dynamic Equity – Ian Vose

Following the current steers of high scoring ideas in the investment universe, Global Dynamic Equity did not have a portfolio tilt either way going into the election. The portfolio is underweight the UK with exposure predominantly to multi-nationals British American Tobacco and Rio Tinto, which have little business in the UK. The only UK domestic exposure is to house builders that we expect will continue to benefit from favourable supply-demand dynamics in the sector and limited change to government policy.

UK Smaller Companies – Calum Joglekar

From when markets opened this morning, to 11am, the largest impact of the election result on our Numis Smaller Companies benchmark are housebuilders and related companies, banks, and higher-ticket consumer spending. This reflects expected uncertainty around the willingness of consumers to spend on larger and more discretionary items in an uncertain political environment.

The largest stock relative outperformers in the fund are internationally focussed shares Highland Gold (+10bp), OPG Power (+2bp) and Plus500 (+2bp), the largest negative contributors are domestic consumer and government focussed Aldermore (-4bp), Kainos (-4bp) and Hastings (-4bp).

Strongest sector performance is from Financials (12bp) and Industrial (+12bp), due to overseas exposures in these sectors.

Weakest sectors are Consumer Services (-5bp) and Consumer Goods (-2bps), due to the domestic exposed stocks in these sectors.

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Simon Brazier

Co-Head Quality
Portfolio Manager, UK Alpha Fund

In 2012, in Uno pizza restaurant at Chicago O'Hare airport, David Cameron made the decision to hold a referendum on the UK's membership of the EU. The reverberations of that decision continue to be felt. Last night's election, that was meant to provide a clear mandate for Theresa May to negotiate Brexit, has now thrown everything in the air. A hung parliament in the UK is very likely to lead to a minority Conservative government backed by the Democratic Unionist Party. Minority governments are inherently unstable and the electoral maths of this election result means a second election in the next twelve months is a significant possibility. Theresa May will be unlikely to remain as leader of the Conservatives although replacing her may take some time. Under Conservative party rules, unless a single candidate is anointed unchallenged, it will take up to three months for the election of a leader to take place.

The impact on markets will be to provide volatility and uncertainty in the short term. However, the lack of mandate for the Conservatives increases the chance of a softer Brexit (staying in the single market) and this will provide some comfort to many and may steady both the currency, bond and equity markets. Negotiating Brexit on a two year time line was always going to be an uphill task. This election result now makes it even more likely that Brexit negotiations will take longer. The longer it takes, the higher the chance of a second referendum. This should not be discounted.

The largest downside risk, which was a Labour led government, has been averted. The reality for companies is that this is just a continuation of the current uncertainty under which they operate in the UK due to Brexit. Fundamentals for the majority of companies are not changed. At the margin a slightly weaker currency may put pressure on those domestic stocks that have input costs from abroad (mainly retailers), although provides support for those companies that report in US dollars. For the economy, the result further supports our view that UK economic growth will remain weak. Uncertainty delays business investment and the pressure on sterling reduces real incomes for consumers as we import inflation.

In portfolios, we have little to change (unlike after Brexit) and our core focus remains on those companies that have the ability to reinvest cash at high rate of returns. These are the companies that can grow in a low growth world. The next few months will see plenty of political twists and turns, however, CEO's return to their offices today and it will be business as usual. We remain alert to opportunities that may present themselves but owning a diversified portfolio of high quality companies should continue to serve our clients well.

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Alastair Mundy

Portfolio Manager, Cautious Managed Fund and UK Special Situations Fund

Hollywood screenwriter William Goodman noted many years ago that 'nobody knows anything'. Admittedly he was writing about the motion picture business, but many other categories could easily replace it, particularly politics. So virtually, everyone called the wrong outcome of the UK election, but that does not deter us from stepping back into the fray and pontificating further.

So it's jolly nice to see the youth voting, welcoming to see plastic politicians (who have followed the special political advisor route to parliament whilst managing to by-pass the real world) getting poked in the eye and amusing to see a chap looking strangely like Santa Claus being interviewed on the BBC Election coverage, but frankly irrelevant in terms of helping us make money.

From our perspective many domestic exposed UK equities have been weak for some time (even pre-Brexit) and seem to be pricing in a pretty bleak outlook. We would expect to be adding further in this area if we see further share price falls. Overall, for value investors valuation trumps politics every time. Equity valuations remain high (somewhat paradoxical given how often we are told that markets hate uncertainty) and across the funds we are keeping powder dry for cheaper buying opportunities.

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Blake Hutchins

Co-Portfolio Manager, Global Quality Equity Income Fund

It is hard to draw too many firm conclusions at this early stage, given the likely minority Conservative government. However, we do not see this election result as materially negative for UK markets in the short term, given the international nature of the FTSE All-Share. In the meantime, we already expected the UK economy to have a challenging outlook on account of uncertainty over the terms on which the UK will exit the EU. If anything, perhaps the odds of a softer Brexit will improve now, but the process will be even more convoluted.

We expect the election result to have minimal impact on the portfolio or how we position it. Whilst we have around 20% of the portfolio in UK-listed companies, these companies are highly multinational with very limited exposure to UK domestic sales. One should be wary of poor quality businesses whose economics continue to deteriorate, but which might be benefitting in share price terms from weaker sterling. Such returns are overly flattering. Rather, we will continue to focus on quality companies that have strong prospects to grow their cash flows, fund growing dividends from this growing cash flow and reinvest at high rates of return. This compounding of resilient cash flow streams is what drives the performance of our companies in the medium to long term and nothing today will materially impact their ability to do this.

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