Is the General Election Result Good or Bad for the UK Stock Market?

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"Whenever you find yourself on the side of the majority, it is time to pause and reflect" Mark Twain

If a week is a long time in politics, then a couple of months is ample time to irrevocably change a political career. UK Prime Minister Theresa May's decision to hold an early June General Election was lauded by many as a wise step to boost her government's legitimacy – and majority. The resulting Hung Parliament and cobbled together deal with the Democratic Unionist Party to form a thin majority political bloc, is highly likely to be followed by her own quiet resignation before this new Parliament goes full term. History is unlikely to treat her decision as personally astute.

Financial markets, however, jump to a slightly different tune centred around expectations. The morning after the election day before saw the Pound the main financial metric whipping boy for the onset of new unanticipated political uncertainty. There was no huge surprise about this, given the precedent set by the aftermath of the Brexit referendum result, which resulted in the Pound ending 2016 scuttling around with currencies like the Argentine Peso and Turkish Lira, as the worst foreign exchange performer among a group of reasonably sized global economies. The General Election induced fall, however, was not only proportionately considerably smaller, but also – against global peers like the US Dollar or Swiss Franc – was surprisingly short-lived. Post-election currency uncertainties against almost all global currencies, except the resurgent Euro, are even now difficult to spot.

And this causes a problem for the UK stock market. The strongest theme of the last year in UK investing has been the greater value attributed to the non-Sterling earnings of the mining, pharmaceutical, energy and industrial shares that collectively make up the majority of the large cap UK stock market – hence the, at first glance strange, juxtaposition of Brexit referendum uncertainty and a rampant UK equity market. But no generalised Pound weakness brings the potential source of any equity market progress back towards the most domestically-centred financial, retail, building and construction sectors. And discussion of such sectors inevitably leads us back to the practical realities of Brexit.

Conventional market wisdom, at the time the election was called, was that the bigger majority the May government looked to be on the cusp of attaining, judging by early opinion polls, would allow a more expansive Brexit negotiation strategy, not beholden to any of her fellow Conservative MPs who wanted to 'get out of Europe at any cost'. A softer, more conciliatory Brexit which, via the use of transitional arrangements on tricky areas of trade legislation, would allow any material negative impacts on the UK economy to be largely avoided – just the type of economic reality which would provide comfort to the more domestically-centred sectors. Unsurprisingly, in the immediate aftermath of the General Election result, these areas of the UK market generally struggled.

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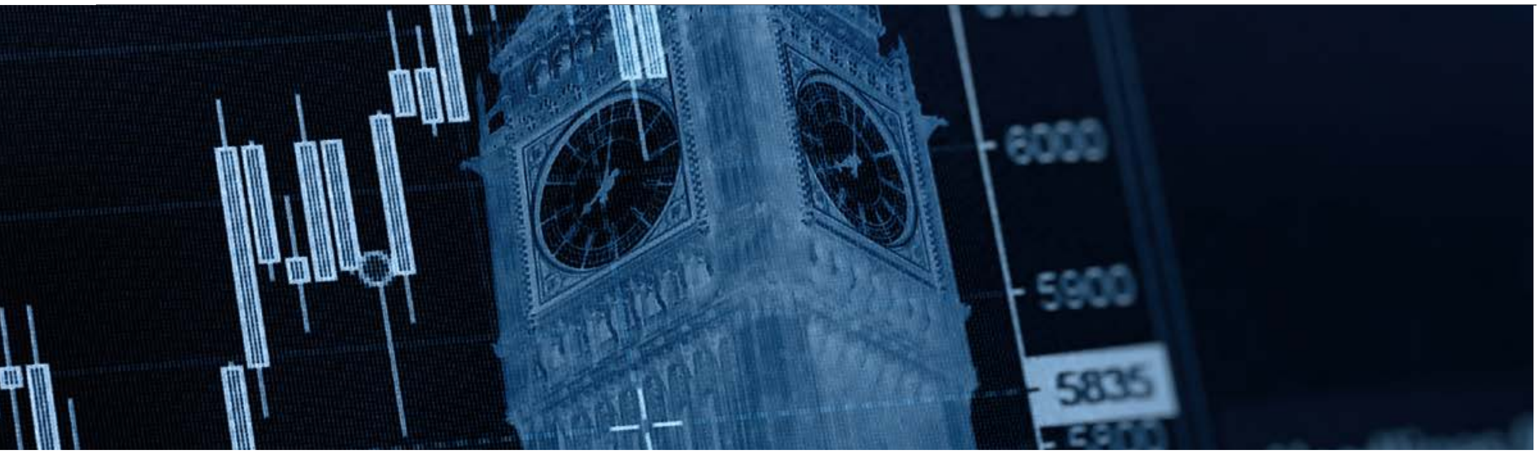

ANNUALISED UK MARKET RETURN SINCE 1970

CONSERVATIVE	16%
LABOUR	9%
COALITION	9%

Sources: HL, Bloomberg

Trends, however, are rarely straightforward in the equity markets, and in a move strangely reminiscent of a previous pro-Brexit campaign negotiation assertion of a 'policy on cake is pro having it and pro eating it', the weakened UK government position galvanised a nascent belief that there is little practical alternative but to compromise in Brexit negotiations – hence the aforementioned recovery in the value of the Pound – and a new focus again on the more domestic centred sectors.

The casual market observer is probably scratching their heads at the shifting sands of rationalisation, which all seem to lead towards higher stock market valuations and positive investment vibes. However, more seasoned observers will note the potential for disappointment in the still-fragile political arrangements, and the leap of faith that Brexit negotiations will be simple and straightforward. Conventional value criteria favour both the more domestic sectors and a higher value of the Pound, but a safer outcome is to expect an inevitable waxing and waning over both this Parliamentary term and Brexit negotiation epoch. The winning strategy for UK market investors is unlikely to be a simple pro-exporter or pro domestic sector strategy, but a realisation that the cross-currents of political and economic newsflow with individual company performances will become more important.

In short, the real value is knowing what you are investing in and why – and probably not being afraid to accept that the views of market participants will change and evolve.

The General Election has made adopting a more active approach to the UK a key stylistic call to make.

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KEY TAKEAWAYS:

- A political gamble did not pay off and the General Election led to more uncertainty
- The Pound has, over the course of the last month, been less negatively impacted than most expected
- A compromise-centred Brexit policy favours more domestic sectors
- Adopting a more flexible and active approach towards the UK market appears sensible

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