Heartwood
Investment Management

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Investment Insight

A message from the Investment Team

The UK election - our key takeaways so far

- Despite the political headlines, markets are taking the news of a hung parliament reasonably well and there has been no major knee-jerk reaction so far this morning. Sterling fell on the announcement of the exit poll, but the currency has since stabilised as parliamentary results have been confirmed.

- **We cannot discount the risk of a second General Election,** although Theresa May's Government will try and muddle through, propped up by the Democratic Unionist Party (DUP).

- Clearly this is an uncertain political environment, but **this election result does not fundamentally change the UK outlook in the shorter term.** From the market's perspective, a worst case scenario outcome has been avoided of a high tax and high spend economic programme, which would create an unfriendly environment for UK-based corporates. While markets are less fearful of this scenario, it remains a very fluid situation.

- **Brexit is now the primary focus.** The key date coming up is the 19th June when negotiations formally begin. It is not yet clear what stance the Government will take. The talks are timetabled to last 15 months. The first six months are expected to focus on settling the issues of citizens' rights, the UK's divorce bill (some estimate at around £100 billion) and the border with Ireland. Assuming the EU 27 believes sufficient progress has been made on these issues, the next nine months will be spent on negotiating the future trade deal. Transitional arrangements will be discussed for the period the UK leaves the single market and the customs union in March 2019. Any EU-UK trade deal is expected to be finalised and ratified some years after. All of this has been placed under great uncertainty. Before this election, the UK was on course for a 'hard but smooth' Brexit. However, we may now be on course for a 'hard but rough' landing.

- Under a Conservative government in alliance with the DUP, **the fiscal rules set out in the autumn 2016 Budget are unlikely to shift too much** and we expect fiscal continuity. The Conservative government had already announced a slower pace of deficit reduction and fiscal austerity in the autumn budget and this is something that the DUP would support, based on its opposition to the Winter Fuel Allowance and Triple Lock pensions commitment. The current aim is to balance the budget by 2025.

- **The election outcome is unlikely to have much impact on Bank of England policy in the shorter term,** which remains accommodative to support overall economic activity. Policymakers are concerned about downside risks to growth as consumers feel the squeeze of falling real incomes. However, the Bank has also expressed its limited tolerance level for above-target inflation and has signalled that policy can move in either direction. That being said, we expect that the recent fall in oil prices and stabilisation in sterling should relieve some inflationary pressures and, therefore, ease the real income squeeze on consumers.

- From a longer term economic policy perspective, **there has been a notable policy shift across a number of developed economies to find ways to improve productivity growth,** which has weakened due to the impacts of ageing demographics and new technologies on the labour force. There are wide ideological differences between the two major UK parties on how these economic challenges are tackled, but after years of austerity and with the rise of populism there is a consensus that more investment is needed in infrastructure, research and development and up-skilling the workforce.

Clear Thinking

Contact

To find out more about the Heartwood strategies, visit our website or contact your local representative.

- **We are taking no immediate actions in portfolios and remain underweight in UK assets.** We have an underweight allocation to UK equities, as we believe that other developed markets hold more attractive value. Within the UK equity market, our bias is towards larger companies, which have performed well over the last year and have benefited from the depreciation of sterling. The scale of the imbalances of the UK economy – large current account and budget deficits – keeps us underweight in both sterling and UK government bonds on a duration basis. We also have an underweight position in UK commercial property, where we hold preference for areas of the market that are less sensitive to Brexit risk, such as regional UK cities.

- **While the focus is on the UK, it is worth remembering that the other 92% of global GDP is largely unaffected by this news.** Based on our assessment of global growth drivers and inflation dynamics, not to mention policy tailwinds, we retain a modestly optimistic stance on global risk assets. We continue to think that the fundamental backdrop remains constructive for financial markets and corporate earnings globally.

- Events are fluid and we are monitoring political, economic and market developments closely.

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