Active is: Navigating geopolitics

UK: still no reason for optimism?

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Summary

"Under-owned, cheap and unloved" – those words sum up how many investors view the UK today. Some see a fresh start in the arrival of a new prime minister eager to change the narrative. But it's difficult at this stage to look beyond Brexit to make a convincing short-term investment case for UK assets, despite a number of enduring positive fundamentals.

Key takeaways

- It's tempting to see the Boris Johnson premiership as a fresh start for the UK – but Brexit-related uncertainty remains a major obstacle for investors
- While the UK boasts some positive fundamental qualities, it's difficult to see beyond Brexit in the short term
- Any future reassessment of the UK relies on Mr Johnson doing two things: achieving a satisfactory Brexit resolution and creating a compelling, forward-looking and positive narrative

This week, the UK announced its new prime minister. Boris Johnson stepped into Downing Street as the new Conservative Party leader and replacement for Theresa May, whose premiership foundered on her failure to deliver Brexit.

Meanwhile, the UK markets remain in the doldrums even though the economy has been surprisingly resilient and stocks of internationally focused UK companies have done relatively well, at least in sterling terms. Indeed, the "valuation gap" between internationally focused stocks and their more domestic counterparts is among the most extreme in recent times.

We are not surprised investors have been underweight the UK; it is a difficult market to navigate. Not only is overall sentiment pessimistic, but UK equity and bond markets are pointing in different directions.

Brexit is, of course, a large part of the reason why the UK is struggling, and Mr Johnson takes office with the clock ticking on a 31 October deadline – the end date for the current Brexit extension granted by the European Union. In the face of this major challenge, the new prime minister will be eager to change the narrative and inject optimism.

Yet we think that any positive rhetoric from Mr Johnson will be insufficient for changing investors' view of the UK fundamentally. He must first resolve Brexit – and until he does, it will always get in the way.

The first important days

One of the challenges facing the incoming prime minister is that his party holds only a small majority in the UK parliament. Unless and until Mr Johnson calls a general election, and his Conservative Party gain a sizeable majority, the parliamentary maths remain forbidding – on Brexit and any other issues that require primary legislation. That doesn't give him much support for a radical new fiscal programme. Nor would Mr Johnson have much room for manoeuvre if he were to find the votes: the current-account budget deficit may be down, but the UK faces a late-cycle environment with a mountain of debt.

So what can the new prime minister do from a fiscal perspective to set the tone for his premiership while positioning his government – and the country at large – for an uncertain Brexit outcome or even a general election?

In his first speech as prime minister, Mr Johnson said that those people "who bet against Britain are going to lose their shirts" and spoke of an economic package in the autumn to boost the country's competitiveness. Given his lack of a meaningful parliamentary majority, he may need to focus initially on measures that require no primary legislation. These could include housing-market stimulus such as a reduction in stamp duty, cuts to value-added tax (VAT) or a vehicle-scrappage scheme that encourages use of more environmentally friendly cars.

Short-term stimulus aside, there is no avoiding the Brexit question. We're not going to speculate on the likely outcome, but the new prime minister has been bullish on Brexit, even if that means a hard, no-deal departure. At the same time, he will be cognisant of the existential threat posed by the Brexit Party, which made major inroads into the Conservative vote in the European elections with its uncompromising approach to Brexit.

What this means for investors

From our perspective, a lot of "ifs" remain. If Mr Johnson is able to pull off a satisfactory resolution to Brexit – no mean feat – and if he creates a compelling, positive narrative, we could see a reassessment of the UK's prospects:

- The British pound sterling has struggled since the Brexit referendum in 2016, and we continue to be nervous about the currency in the short term – despite it being undervalued on just about every measure. Sterling would be among the first beneficiaries of an improved outlook for the UK.
- The UK may turn out to be the value trade it has promised to be. For example, real estate and utilities have been discounted, in part because of Brexit-induced economic and political uncertainty. A positive resolution of Brexit that reduces near-term economic and political risks could mean a move upward as these risks are priced out.
- From an environmental, social and governance (ESG) perspective, the UK has some of the highest corporate governance and stewardship standards. We believe this may become more important over time as ESG risks come to play a greater role in separating the long-term winners from the losers.
- The UK economy has many long-term attractions, such as a well-educated workforce, a commitment to liberal values and the protection of property rights. In a world where markets are driven by energy and conviction, a shift in direction could be the boost people need to look past the negative noise and see the positive fundamentals.

Still, despite Mr Johnson's victory, nothing significant has changed overnight, and it may be too soon for investors who are underweight the UK to take a new tack.

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Active is: Anticipating what's ahead

A major about-turn for the Fed

by Franck Dixmier | 25/07/2019

Summary

In the face of slowing global economic growth, continued trade tensions and the prospect of a "hard Brexit", the FOMC seems set to announce a reduction in interest rates at its next meeting. We expect a 50-basis-point cut that will start a new rate-cut cycle, and we think the markets should react favourably.

Key takeaways

- The FOMC meeting on 30-31 July seems likely to mark a major turning point in monetary policy for the Fed
- The Fed appears set to enter a rate-cut cycle; we expect the FOMC to announce a decrease of 50 basis points
- Given a weakening global economy and persistent trade tensions, the Fed likely wishes to act pre-emptively as an exercise in risk management
- Markets might be surprised at the news, but will likely react positively given the historically favourable impact of rate cuts on equity markets

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