QUARTERLY MARKET COMMENTARY

Our last Market Commentary in June was written just before the UK General Election. Accordingly, although somewhat historic now, it seems relevant to look at what happened, the implications in political terms and what this means for UK Plc, certainly in terms of the current BREXIT negotiations.

Well, what can we say; that certainly wasn't in the script and like most elections of recent times, the polls got it completely wrong. Mrs May's decision to hold a snap General Election in June certainly did not play out the way the Prime Minister and the Conservatives envisaged. A snap General Election was called to increase her majority and improve her standing in future BREXIT and trade discussions; instead Mrs May was left to form a minority government with the backing of the Democratic Unionist Party (DUP) of Northern Ireland. There are probably many reasons why the results turned out this way, including Labour's manifesto pledges, but a significant factor was the sheer increase in the number of young voters who turned out to vote, which some believed were dissenting votes to the UK leaving the European Union (EU).

Mrs May managed to form a government and stay in power as head of the biggest party in the House of Commons. It is worth noting that a 'coalition' Government has not been formed, last seen in 2010 between the Conservatives and Liberal Democrats. A 'coalition' normally means different parties agreeing on a joint programme with ministers representing both parties. The Conservatives and the DUP agreed what is called a 'confidence and supply' agreement. This is where the DUP agree to back the Conservatives in key votes, such as Budgets and confidence motions, but are not tied into supporting Mrs May on other measures.

Mrs May now has 328 votes (including the 10 from the DUP) to take more than half of the 650 seats in the House of Common. But what did the DUP get? As well as the obvious influence and prestige of being involved with the UK Government, an additional £1billion more will be spent on Northern Ireland over the next two years than had previously been planned. The DUP also got agreement on a range of policy priorities, such as keeping the guarantee to increase State Pensions by at least 2.5% a year, to maintain defence spending and to maintain agriculture spending in Northern Ireland at the same level for the rest of the current parliamentary term, which theoretically takes us to June 2022. Some viewed this as a heavy price to pay to one demographic of Great Britain. In some respects, the results were only important in terms of maintaining a level of political stability but, arguably, academic compared to the greater issues emanating from our standpoint in Europe. This was no more clearly evidenced by the less than flattering responses from certain European leaders after the UK General Election results.

It is probably fair to say that Mrs May and her BREXIT negotiation team, led by David Davis, were immediately facing a much more difficult and challenging environment in the BREXIT discussions. Indeed, what we have witnessed over the last few weeks, is that little substantive progress has been made as the EU find themselves negotiating from a position of strength, where economically the region continues to thrive compared to the UK, which is starting to show signs of slowing.

In Europe, the economic recovery is gaining traction, with the region growing economically by 0.6% in Q2 alone, compared to the 0.3% increase in the UK. This is clearly twice the rate of the UK but as the European region collectively is much greater than the UK, the economic expansion is far superior in monetary terms. In Europe, leading indicators and surveys are resolutely upbeat, whilst in the UK there has been a noticeable slowdown in consumer spending.

That said, there are a number of factors that underline these 'headline' figures with inflation rising in the UK (CPI is now 2.6%) as a result of a weaker currency (which can also be beneficial to the UK) and there has been a change in spending patterns by the consumer. The UK unemployment rate now stands at 4.4% (as at June 2017), the lowest level in 42 years and UK finances are now in better shape than 10 years ago, when the UK Budget Deficit was around 10%, compared to less than 1% today.

However, for the EU, the important and key message from the election was that Mrs May was not fully supported by her country. Therefore, it is perhaps not a surprise that recent discussions to agree a financial settlement do not appear to be progressing well. Indeed, the 'UK divorce' bill discussions are centred around the EU looking for £92billion, whilst the UK are starting the discussion at £30billion. Many experts in the BREXIT negotiations have cited that this could easily rise to £50billion, i.e. an additional £20billion, purely as a result of the General Election result. A costly mistake indeed! Whatever amount is agreed, it is likely to be paid in yearly instalments over the next three years but the EU are also demanding that the UK continues to honour its contributions of financing 14% of the EU budget until 2020. No wonder that Michel Barnier, lead of the EU negotiating team, recently stated that 'he sees it as his job to educate the UK about the price it would pay for leaving the EU club'.

What we do know is that these discussions will continue to rumble on for many months and probably years. What is interesting, but not unexpected, is that £ has weakened considerably against the US$ and the Euro but stockmarkets remain somewhat resilient. This is probably a reflection of global earnings by many UK listed companies and the relatively benign environment in which they are operating at the moment.

In the US, the economic backdrop remains supportive for further economic growth as long as President Trump can avoid impeachment, war with North Korea or simply avoid using Twitter for one day!

Japanese and Emerging markets have continued to perform well, highlighted by strong capital inflows. The Emerging Market region especially has benefited in recent months from US $ weakness, which is largely beneficial to commodity biased economies. In Japan, economic and social reforms, together with a stronger framework for corporate governance is providing a backdrop for corporate profitability to rise.

Stockmarket indices have recently hit new all-time highs. That said, despite the good gains made by most stockmarkets in recent years, significant political and economic headwinds prevail. What is interesting to note is that after several years of markedly lower gold prices, the gold price has started to improve and now stands at its highest level in 12 months and is not too far away from the highs it obtained in 2011. Gold is generally viewed and held as a hedge against rising inflation and/or political unrest and economic downturns.

As we have stated time and again, we cannot predict the future and therefore, it is more important than ever for medium to long term investors to maintain a diversified portfolio in order to benefit from market rises when they happen and to dilute volatility in the event stockmarkets fall. It is impossible to predict when markets will fall and rise but, in general terms, a sensible investment strategy involves riding out market volatility.

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