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WEEKLY DIGEST | 12 March 2024

Heat, Not Light

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Last week saw two big political set pieces take place, one on each side of the Atlantic. In the UK we had the ritual of the Spring Budget, while in the US there was Super Tuesday, the day on which 15 state primaries are held and which tend to go a long way towards determining the candidates for November's Presidential election. A lot of column inches and airtime are given to such political theatre, but it's not clear that the outcome ends up making much difference to investors in the grand scheme of things. Additionally, there was

President Biden's State of the Union address, which garnered fewer headlines, probably because it was boringly competent and delivered no shocks.

The considered opinion on Jeremy Hunt's performance is that he delivered a politically astute Budget in that he played up the positive headlines (such as the 2p cut in the National Insurance rate) while deftly hiding the negatives (including, for example, the continuing freeze in personal allowances at a time when inflation remains elevated). Our initial take on the proceedings can be found here. He also managed to inconvenience the Labour Party by appropriating two of their key policies, namely by squeezing non-doms and extending windfall taxes imposed upon North Sea energy producers.

This will leave Labour scrambling for other sources of income to commit to their own spending pledges. Labour's Rachel Reeves is expected to be the next Chancellor of the Exchequer, and she is already emphasising the difficulty of the task in front of her. I remember saying in 2010 that that year's election would not be a bad one to lose given the fiscal constraints in place following the Global Financial Crisis, and the forthcoming election might fall into the same category. The fiscal headroom now afforded to the government by the Office of Budget Responsibility is a mere £8.9bn, which, while it might sound like a lot of money, is next to nothing (about 0.4%) in the context of a £2.3 trillion economy. On average, in the last decade or so, Chancellors have had more like £30bn of fiscal headroom. There really is very little margin for error at the moment.

It is notable that Labour Party leader Sir Keir Starmer continues to play his cards close to his chest in terms of major policy initiatives. Indeed, the most eye-catching move so far has been to make a massive cut in the originally proposed £28bn per annum spend on the green transition. Fiscal responsibility made its impact there, underlining the fact that even the best-intentioned policies need to be backed up with funding for fear of agitating the bond vigilantes. Starmer's predecessor, in contrast, flashed his hand to everyone at the table, allowing fears of more extreme left-wing policy outcomes to be used as a weapon against him.

On the current evidence, there is not a lot to choose between the main opposing parties. Both are focusing on the centre ground to attract swing voters, although the Conservatives probably have the harder job in trying to stop support leaking away to Reform UK on the right. The steady performance of the pound, usually a bellwether of financial market sentiment leading up to elections, tells us that big policy shifts or surprises are improbable.

Meanwhile in the US, Super Tuesday progressed as expected. President Biden is running pretty much unopposed as the Democratic candidate, which tends to be the convention in the case of incumbent Presidents, while Donald Trump finally saw off the threat of Nikki Haley in the Republican race. It's clear that there is a much bigger potential difference between the two US candidates than between those in the UK, but there are also potentially going to be more constraints on the eventual winner. One of those is that it looks as though Congress will remain divided, meaning that it will be very difficult for any President to get policies through the system (which is where we are now).

Even so, the polarised nature of US party politics today suggests that the election campaign is going to be ugly and that there is a high probability of incendiary comments being made with the capacity to upset both voters and markets, at least in the short term. Volatility futures are currently pricing in a 3.5% move in the S&P 500 Index for the day following election day.

But does it matter who wins? We came across a study recently suggesting that all is not what it seems when it comes to Presidential influence on the economy. Only two Presidents in the post-war period have presided over negative annual average returns from the stock market. The fact that they are both Republicans is probably immaterial – Richard Nixon's term took in the first

OPEC-led oil price shock and the bursting of the Nifty Fifty bubble, while George Bush Jr's two terms were bookended by the end of the TMT boom and the Global Financial Crisis.

The author of the paper, an academic from the University of Colorado, then tried to apply a "skill factor" to the stock market returns of all the Presidents from Harry Truman onwards, controlling for factors such as market valuation at the beginning, independent central bank interest rate policy, credit spreads and the yield curve. Controlling for randomness by only taking results more than one standard deviation from the average, he concluded that only Jimmy Carter added any value to markets and that the biggest destroyer of value was Ronald Reagan, which might come as a surprise to free market enthusiasts. But given Reagan's starting point of ridiculously cheap equity valuations and sky-high interest rates and bond yields, he really should have done a lot better. The depressing conclusion of the work is that US Presidents are usually more of a hindrance than a help.

At least we think we know what we will get from a second Biden term – more of the same, but with the possibility of a heavier corporate tax burden. The prospects for a second Trump term, though, are more uncertain, and we know that markets hate uncertainty. Here's a thought experiment. If the primary objective of the first four years of Trump was to maintain the Presidency, what might be the primary objective of a second (assuming that he doesn't try to bend the Constitution to allow him to sit for a third term, or even perpetuity, President Xi-style in China)? Is Trump a "legacy" sort of person, again like Xi or even Vladimir Putin? He might well be remembered for all sorts of things but is he the sort of person who wants to be the subject of hagiographical texts and have statues of himself in all sorts of hallowed places?

Maybe, but I would venture that his desires are more immediate and earthbound. He has shown himself to be motivated by transactions, with the act of achieving a deal today more important than its consequences. If he has to a leave a legacy to his family, it will involve his business empire, not his name on a library – which is a ridiculous thought given that the ghostwriter of Trump's autobiography concluded that Trump had never read a book in his life! Although the doomsday scenario of a Trump presidency sees the world going up in smoke (metaphorically, but, in some people's eyes, literally), that doesn't feel like the sort of world in which people would be flocking to Trump-branded hotels and golf courses.

And so, my current view on the US and UK elections is that they will generate a lot of heat in terms of media coverage and a general sense of outrage aimed at whoever you are not voting for, but limited amounts of light. Markets might well overreact to certain speeches or incidents, and those moments could provide decent trading opportunities. But there are no real grounds to be making big tactical asset allocation decisions based on the forthcoming polls. That might not be the conclusion that many expect or even want, but it might provide some reassurance that we don't have to worry about everything just because the people and organisations that earn a crust from scaring the living daylights out of everyone want us to.

Economic Commentary

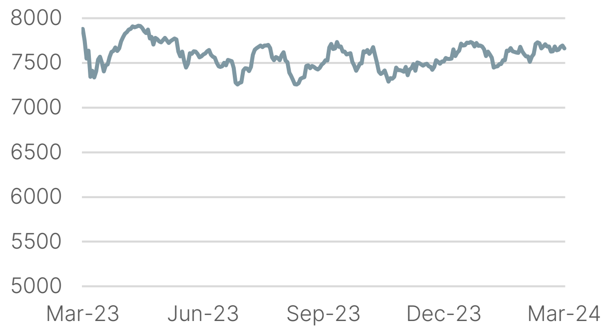
FTSE 100 weekly winners

Rentokil Initial plc	12.1%
ITV PLC	10.3%
Intertek Group plc	8.2%
Johnson Matthey Plc	7.4%
Anglo American plc	5.1%
Aviva plc	5.1%
Glencore plc	4.8%

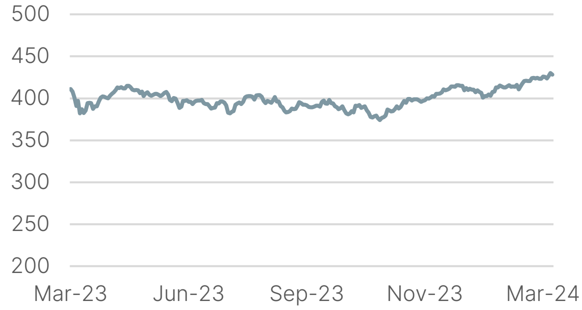
FTSE 100 weekly losers

Entain PLC	-18.5%
Just Eat Takeaway.com N.V.	-12.9%
Ashtead Group plc	-12.1%
St. James's Place Plc	-8.1%
Ferguson Plc	-7.7%
Ocado Group PLC	-5.8%
HSBC Holdings Plc	-5.4%

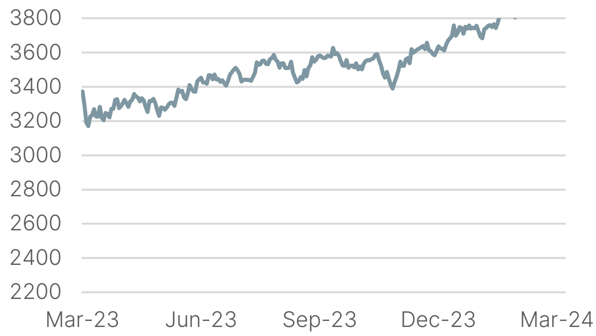
FTSE 100 index, past 12 months



EuroStoxx 600 index, past 12 months



S&P 500 index, past 12 months



All data shown in GBP.

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