

Politics and markets are inextricably linked and markets do matter



Neil Birrell, Premier Miton's Chief Investment Officer and lead manager of the Premier Miton Diversified fund range, has a look at events at home and abroad, as politics takes centre stage.

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A quick look back in time

I regularly get calls and WhatsApp messages from journalists, often the market reporters for national newspapers, who are looking for views, thoughts and quotes from financial market participants and commentators on what is going on in the various asset classes including equities, bonds, currencies or commodities, such as gold. Alternatively, the topic could be relating to a statement from the Bank of England regarding interest rates, or the impact of an announcement from one of the giant US technology companies detailing their profits or just how much they are spending on Artificial Intelligence (AI) infrastructure.

However, recently it has all been about politics. It's hard not to express some sort of political view when it's the topic and the questions relate to it, but the key point we are looking at is its impact on financial markets.

Currently, it's all about the leadership of the Labour party and therefore the country. This has been triggered by the local council elections, which reminded me of the period post the global financial crisis (GFC) of 2008 / 2009.

Most will remember how the GFC triggered deep recessions, rising unemployment and bank bail-outs across Europe. While governments initially stabilised the system, the outcome was weaker growth and much higher government debt. This evolved into the Euro-area sovereign debt crisis, exposing structural flaws in the single currency and forcing economic austerity in several countries.

The social costs of this prolonged adjustment prompted many voters to seek change, turning away from established parties. On the left, anti-austerity movements such as Syriza in Greece and Podemos in Spain gained support; on the right, nationalist and populist parties such as Italy's Five Star Movement, France's National Rally and Germany's AfD gained significant traction.

For markets, this increased political risk led to episodes of sharp currency volatility, big falls in equity markets, higher government borrowing costs and greater sensitivity to elections and policy

announcements. We were reminded that, for markets, political stability and confidence matter as much as economic conditions.

The chart below shows the MSCI Europe Index, which includes the UK, from the end of 2006 to the end of 2014. You can clearly see the impact of the GFC in the early part of the period, but there is subsequent volatility as well. The fall in 2011 from its highest point on 18 February, to the lowest point on 26 September, was some 25%, and it took until early 2013 to recover the loss. It was driven by further political and economic policy concerns centring on the debt levels in Spain and Italy and a Euro that fell into crisis. The problems became embedded in economies and societies and cemented the rise in populism. Incumbent governments across Europe were voted out and parties with more extreme policies, to both the left and right, became more influential.

There is no getting away from the relationship between political policy and the markets and therefore, personal and corporate welfare.

MSCI Europe Index 31.12.2006 – 31.12.2014



Source: Bloomberg. The performance information presented on this page relates to the past. Past performance is not a reliable indicator of future returns.

What is happening today in the UK?

So, why the recap on history? As I mentioned, I can see similarities to current events in the UK.

Two years ago, we were heading for a general election that was hopefully going to bring a period of political stability. The incumbent Conservative government had been through leadership and policy turmoil that had rocked financial markets; the “Liz Truss” budget had a seismic impact. The Labour government in waiting promised fiscal prudence, middle-of-the road economic and social policies and a restoration of high political ethical standards.

Unfortunately, those hopes have been disappointed. Even though we have been through two very tough budgets from the Chancellor, it is fair to say she has met her fiscal rules, but the overall level of debt is very high, economic growth is stagnant at best, inflation is still a problem, the cost of government borrowing has risen and tougher fiscal policies are likely to be forthcoming.

It was therefore unsurprising that the Labour party did so badly in the local elections on 7 May. However, the big winners were not the established Conservative or Lib Dems, but the newer Green and Reform parties, much more at the left and right of the political spectrum. This looks like a vote for change or a rejection of the incumbent government, very similar to the post GFC period. In the UK that was followed by Brexit, and let's not forget that Reform was born out of UKIP.

Of course there are many differences between the two periods. There has been no financial system stress, which means political change is creating uncertainty rather than immediate market instability and it is a domestic issue rather than wider one.

However, there has been a meaningful impact on markets and, as a result, a fall-out for all of us. It does appear, as I write this, there will be a challenge to Kier Starmer's position as Prime Minister, possibly from two or three people, although it is a complex situation and trying to predict what will transpire and what the conclusion will be, is nothing other than guess work. That is a problem for financial markets. It is also likely to be out of date by the time you read this.

You will have seen and heard enough about the jump in government borrowing costs, which has significant ramifications.

- The government has to raise money elsewhere or cut spending
- Mortgage rates will be affected
- The cost of borrowing for companies is impacted
- It is very likely to reduce economic activity and therefore growth

A more left leaning government would be seen to be bad by bond markets as it would have to borrow more. Political policy and market behaviour are correlated, whether the politicians like it or not. Financial markets don't vote, but they do set the price of government borrowing.

Markets really matter; indeed they can cause a change in government, examples include Liz Truss's short premiership in 2022 and the Greek and Italian governments falling in 2010 / 2011 during the Euro crisis. Many less developed countries' (emerging markets) governments have suffered similar fates, Argentina in 2001, for example.

As we move through the current situation, markets will be unsettled, companies and consumers are likely to defer spending until there is some clarity, meaning economic growth would suffer and international investors are very likely to look less favourably on the UK. UK economic growth was good in the first 3 months of the year, but the war in the Gulf will have dampened it, as will the current turmoil and the forecasts for the rest of the year already suggest that 2026 will be not far off stagnant. Economic growth impacts company profits and therefore employment and wages. It's circular.

It's clear that politics and policy matter for markets, there's no point in suggesting markets are not relevant.

Investment opportunities; health and space

We are always thinking about long term trends that are taking place in the economy and society, particularly looking out for investment opportunities they might provide, here.

A non political mega trend: the GLP 1 revolution

A major theme developing beyond markets and politics is the rapid rise of GLP 1 medicines, drugs that were first used for diabetes, such as Ozempic and Mounjaro, but are increasingly used for weight management. What makes this more than a healthcare story is the potential spillover into the wider

economy. If treatment becomes more accessible (including through newer oral options), it could influence everything from healthcare spending to consumer behaviour, with knock on effects for sectors like pharmaceuticals, insurers and even parts of food and drinks industry. The opportunity is real, but so are the uncertainties: who pays, how persistent usage is in the real world, and which companies ultimately win as competition intensifies.

Space: from frontier to infrastructure

Space is no longer just about rockets and exploration. Increasingly, it underpins everyday activity on Earth, from communications and navigation to climate monitoring, mapping and logistics. Falling satellite and launch costs have brought forward a wider range of commercial applications.

For investors, the opportunity lies less in individual “moonshot” projects and more in the broader areas of satellites, software and services that sit behind them. That does not remove risk: specialist space investments can be volatile, portfolios may be concentrated and the sector still depends on technological execution and regulation. As a result, space related investments probably should form just a small part of any portfolio, reflecting the potential risk it carries, but it is an exciting and growing opportunity.

As ever, there is plenty to keep us busy!

Neil Birrell
Chief Investment Officer

Glossary

Bonds (or fixed income)

Types of investments that allow investors to loan money to governments and companies, usually in return for a regular fixed level of interest until the bond's maturity date, plus the return of the original value of the bond at the maturity date. The price of bonds will vary, and the investment terms of bonds will also vary.

Risks

Forecasts are not reliable indicators of future returns.

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