



EQUITY

UK Election Result: Grounds for Optimism in the Medium Term?

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As equity markets digest the implications of another surprising UK election outcome, Colin Morton, vice president, portfolio manager, Franklin UK Equity Team, analyzes the immediate aftermath and asks whether the result could offer some grounds for optimism over the medium term.

The UK election result came as a shock to most observers, but early indications suggest financial markets don't view it as an "end of the world" scenario.

And there are indications that some positives could emerge over the medium term—if the result leads the United Kingdom to adopt a softer approach in its Brexit negotiations.

A Predictable Response

So far, the reaction has been largely as we would have predicted in this scenario.

The pound has fallen, but to put that into perspective, it's still stronger against the US dollar than it was when Prime Minister Theresa May called the snap election in April.

From a sector point of view, companies seen as defensive and with international earnings have flourished in the immediate aftermath of the vote.

Most of these companies that earn a significant amount of earnings overseas don't rely on the United Kingdom for earnings. A little bit of weakness in the currency tends to help them.

On the other hand, UK domestic-orientated stocks, including house builders, general retail stocks, real estate and UK-focused banks, have suffered in early trading.

In relation to the UK domestic economy, investors may be concerned that companies could postpone investment decisions and consumers could stop spending until there is greater clarity over the way forward.

Whether that happens, or whether people will respond as they did after the Brexit vote and carry on regardless, remains to be seen.

Rebounding Utilities

One slight surprise has been the rebound among utility stocks.

Many utility and energy stocks had been weak after both major UK parties pledged potential caps on energy bills. Even oil stocks were up in early trading on June 9, despite a falling oil price, because the weak currency helps dividend payments in sterling.

A More Nuanced Brexit?

One potential positive from the result could be a more nuanced approach to Brexit negotiations.

When Theresa May called this election, many observers viewed it as a referendum on her hard-line Brexit approach. One could argue that voters' apparent rejection of May's approach should signal a softer approach to leaving the European Union (EU).

The election outcome could mean that all the tough talking about a potential hard Brexit could ease.

That might be beneficial for sterling over the longer term.

However, the situation remains complicated and there remain many unanswered questions.

From an election point of view, I've never seen a situation where political sentiment seems so starkly divided across the country.

In some areas there was a swing to the Conservatives, in others to Labour and in Scotland there were huge swings away from the Scottish National Party (SNP), which we'd reckon spells the end of talks of a second independence referendum for now.

Youngsters Turnout

The one consistent theme seems to have been the strong turnout from young people. Early indications suggest a turnout of 72% for 18- to 24-year-olds.

The ironic thing is that if young people had turned out to vote in these numbers for the Brexit referendum a year ago, we likely wouldn't be in this situation today.

All the evidence suggests young people were generally in favor of the United Kingdom remaining in the EU. If the "Remain" campaign had prevailed in last year's referendum we probably wouldn't have had this election and David Cameron would have been serving as Prime Minister until 2020.

As it stands, we wouldn't be at all surprised to see another UK general election before the end of the year.

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