

Election 2019 – Fancy a flutter?

“Horse sense is the thing a horse has which keeps it from betting on people.” – W. C. Fields

The big difference between the current pre-election campaign and the one in 2107 is that this time, as far as the markets are concerned, it really is just about Brexit. In any “normal” election, the cost of huge spending commitments for the NHS, housing and the minimum wage, would be factored into stocks, bonds and the value of Sterling. Broadly speaking, the electorate don’t care about the long-term costs and benefit of these. The extent to which these issues resonate with the electorate now, however, is certainly overshadowed by their views on Brexit. This makes forecasting even more unreliable than normal. In addition, it is noticeable how little pundits are quoting polling data given its dire predictive value in recent elections and even the 2016 referendum itself.



Jupiter Express – Unlikely winner Uttoxeter 1980

There are many ways to gauge voting intentions and one could do worse than looking at bookmakers odds. Today, after a tumultuous first week of campaigning, which saw several candidates fall by the wayside, odds suggest 50/50 for either a Conservative majority or for NO overall majority. A Labour majority is a generous 16/1 and for the Lib Dems and Brexit Party a remarkable 100/1.

A closer look at the pricing indicates that the likelihood of no overall majority is 10% more likely than a Conservative majority. Unfortunately, this does not tell us everything because, as we know, it is neither the job nor aspiration of bookies to predict anything at all. Their objective is to gain financially whatever the result of the elections by balancing their exposures or “books”. The pricing of outcomes is reflected in the amount of money being placed and not the probability.

We saw this demonstrated beautifully in the 2016 Brexit referendum. From the start of the campaigning, and on the day voting started, Remain was priced by bookmakers as a far more likely outcome than Leave. The stock market and Sterling were clearly assuming the same. However, to the punters eye, this only told you that the amount of money betting on Remain was more than Leave. What it didn’t tell you was how many people were betting on each outcome. If you had been one of the bookmakers, it was apparent that the actual number of people betting on Leave significantly outnumbered those backing Remain. The difference was that affluent South Easterners, who were more likely to vote Remain were placing much larger bets than people in the north, more likely to vote to Leave. A profoundly interesting detail which one should bear in mind when looking at something that, on the face of it, appears a closely contested outcome.

If we were to raise our eyes to the more elevated business of currency markets? In the last few months, Sterling has risen from around \$1.20 to the US dollar to over \$1.28 today. Attributing how much of this is due to Brexit or other factors is difficult. The rally started in September when markets took the view that whilst the Federal Reserve U-turn in policy would mean lower interest rates in the US, the Bank of England was

unlikely to follow suit. But by mid-October, when that differential appeared to be priced in as Sterling crept up to \$1.23. The even bigger move higher to \$1.28 started when the prospect of no-deal faded and has stayed there even as a general election was announced amid chaotic scenes in Parliament.

What is clear is that the Brexit deal struck by PM Boris with the EU does, in the eyes of the market at least, have some credibility in that it would bring some clarity to businesses and consumer sentiment. A Conservative majority could well drive Sterling higher and, theoretically, \$1.40 does look within reach.

By then, market commentary and discussions about investment strategy might even be a return to those heady and distant days when there were other things to talk about than Brexit.

We have recently increased our exposure to UK equities with a bias towards more domestic stocks rather than the large international companies that make up the majority of the FTSE 100 Index. Successful though they may be on the international stage, their exposure to fluctuations in Sterling is well known and a period of Sterling strength against the US dollar (and all major currencies) would inevitably impact their international foreign currency profits when repatriated to the UK.

On balance, we believe this increased exposure to UK mid-caps is a relatively safe bet in absolute terms as well as a necessary hedge against a rise in UK stocks being accompanied by Sterling strength.

The more contentious question of what happens in the election is hard to answer. Ask yourself if you fancy a flutter next time you're passing the bookies.

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