A watershed election

Deon Gouws - CIO, Credo Wealth - 13 December 2019

Hearing investment strategists making the comment that market conditions are not normal – or that they are particularly difficult at present – has been a pet peeve of mine for some time.

What is a "normal" market, after all?

Yes, the financial environment today may be quite different to what most investors have grown used to over the years, what with negative interest rates, the Shiller CAPE ratio for major equity markets remaining far above long-term averages, capital light companies dominating indices, and the increasing role played by high frequency traders and algorithmic participants… but I would suggest that ultimately all of this just boils down to conditions being different to before, not that they are abnormal. After all, as each day passes, markets continue to adapt; in the process, inefficiencies are caused, identified, exploited, and eventually nullified, only for fresh ones to start rearing their heads when and where market participants expect it least.

The same applies to the concept of "difficult" markets: **if there were one thing that I've learnt in more than two decades as a professional investor, it would be that markets only ever appear easy in hindsight.** Commentators love to explain what happened in the past, and why – all with the full benefit of hindsight – as if they had been able to foresee every twist and turn along the way: fitting a convenient story to a bunch of idiosyncratic facts and events. Finance academics refer to this as the narrative fallacy.

When one needs to deal with the vagaries of financial markets on a day to day basis, however, investing is **always** difficult: nothing is certain, news flow is random, benchmarks are notoriously hard to beat, and every other investor in the world is looking to eat your lunch before you get to it yourself.

Ben Carlson, Director of Institutional Asset Management at Ritholtz Wealth Management in the USA, addressed some of these points in a piece for Bloomberg View in 2017. He starts off the article with the famous quote by Sir John Templeton which states that the words 'This time is different' are some of the most costly ones in the annals of investing.

Carlson then unpacks some of the logic behind this quote in the context of market anomalies at the time, and concludes:

"Not only is this time different, but it's different every time. This is why so many investors are able to create market-beating strategies with the benefit of hindsight that go on to underperform in the real world. Markets are constantly evolving based on our updated knowledge of the past."

Which brings me to yesterday's general election in the United Kingdom – the third such event that we've had in just over four years in this country (and that does not even include the infamous 2016 referendum).

At the risk of falling into my own trap as set out in the introduction to this piece, I would argue that this was far from a "normal" election.

Without wanting to express any specific political opinion (and also respecting the fact that clients who read this may of course have very different views compared to my own), let me begin by stating that I'm not exaggerating in the slightest when I say that I have yet to come across anyone who actually voted with full conviction yesterday.

It would appear that a lot of long term party loyalty left by the backdoor around the same time that Brexit differences entered at the front. Add to that the fact that neither of the two biggest parties have leaders who are considered to be remotely as credible as their recent predecessors, and one can understand why people have been so uncertain about how they should vote on this occasion.

Based on this, voters had to fixate on the "least worst" option when they put down their crosses yesterday.

One example: a large number of traditional Tories who don't have much time for the Boris Johnson persona (or identify fully with his Brexit strategy, for that matter) would have held their noses and voted for the Conservative Party regardless – the reason simply being that they wanted to keep Jeremy Corbyn away from the front door of 10 Downing Street (and save themselves a heap of tax in the process).

Other voters – including a sizeable number in the north of the country, who would traditionally support the Labour party, but who are strongly in favour of leaving the European Union – have clearly voted for the Tories for the first (and very possibly also the last) time in their lives. ⏩

At the other end of the spectrum, there were also divergent examples: some people, including a number of traditional Tories who happen to also have strong Europhile inclinations, would have voted against Johnson's Conservative Party simply because they continued to hope beyond hope that Brexit could yet be blocked. Personally, I would never have put too much money on the latter scenario, however: Jeremy Corbyn's pronouncements in this regard had been far too lukewarm; not only that, but many people believe that Corbyn in his heart of hearts is probably a Brexiteer himself, as he would never be able to implement his socialist plans within a European Union framework.

About a month before the election, I was privileged enough to listen to a gentleman named Joe Twyman at an investment conference in London. Twyman is a director at Deltapoll, an organisation that does political polls by means of a number of alternative techniques. As he summarised it that day: nearly half of everyone who voted yesterday would have voted for someone representing a **different** party at least once in the past ten years.

It is based on this type of political cross pollination that I suggest yesterday's election was far from normal.

And yet, this morning, after all the campaigning and polling and speculation, the result of what has certainly been a watershed election has come into full focus:

Boris Johnson has not only won a resounding majority, but the Tories have achieved their best result in more than three decades.

As could be expected, financial markets have reacted quickly and favourably as the full picture emerged overnight, given that the Conservative Party is seen as more business friendly than Labour for a variety of reasons. Most in particular, **the pound strengthened by more than 2% against the US dollar straight after the exit polls were announced last night.**

Understandably, the UK equity market is a bit more of a mixed picture, given that many of the largest companies included in the FTSE 100 are multinational businesses (and their share prices will therefore experience pressure in the opposite direction when the UK currency strengthens). Companies with a domestic UK focus are however likely to benefit somewhat more from this election result.

Whatever one's political stance, the bottom line in our view is that the renewed political certainty should continue to be good for markets as a tumultuous 2019 draws to a close. It is of course likely to be tested once again over the next twelve months as the UK's real challenges of finalising trade terms with the European Union start to emerge... but until then, it feels like markets may experience a more "normal" period after all. ■