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Endless Elections

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Not long after I arrived at Investec in 2013, an investment manager approached me and asked if I would like to talk about the imminent Scottish Independence referendum at a conference. That was the moment when I realised, somewhat belatedly, that my role as Head of Investment Strategy would have to encompass politics. As the years went by, it also ended up requiring a working knowledge of volcanoes and viruses, amongst other things, but elections have been the most persistent distraction from the normal fare of economic and corporate performance and monetary policy.

2024 was billed from the start as a landmark political year, with as much as half of the world's population going to the polls, dominated by India in terms of sheer numbers. That election caused a bit of a stir when Narendra Modi's BJP Party failed to secure the landslide victory that exit polls had predicted, with the Nifty 50 equity index falling 6% in one day. Even so, investors soon calmed down. After all, he remains in charge and the direction of travel for India's economy remains one that looks attractive. Indeed, the Nifty has since more than recovered its losses and gone on to make new all-time highs. One suspects that the big initial downdraft was as much a reflection of over-enthusiastic short-term positioning as of any increased pessimism.

Mexico's Presidential election was another to create a few waves, and these have been somewhat more persistent. The headline MEXBOL index is still at its post-election trough, down around 5% from its immediate pre-poll level. It has actually fallen 11% from February's all-time high, a reflection of the fact that investors were already becoming wary. The landslide victory of Claudia Scheinbaum when combined with control of Congress spooked investors owing to the potential for the ruling left-wing Morena party to pass more radical interventionist policies which might be deemed to be less business friendly and possibly even to change the constitution in its favour.

The Mexican peso also took a big hit, falling from 17 to 18.5 versus the US dollar. Again, this might well reflect unwinding of crowded positions, as the peso had become a popular "carry trade", owing to its premium yield, the country's resilient economy and a relatively stable political situation. Investors had initially been extremely wary of Sheinbaum's predecessor, Andres Manuel Lopez Obrador (who will actually remain in place until October), but his bark turned out to be worse than his bite for most of his period in office, although he was showing increasingly autocratic tendencies towards the end. The overall message from markets appears to be that Ms Sheinbaum will now have to do her own work to win back investors' confidence.

There's a lot to be said for low expectations heading into a political event. In South Africa, the JSE All-Share Index and the Rand rallied in tandem from mid-April until late May as the impending election offered a possible improvement in a domestic political and economic situation that was deemed to be about as bad as it could get (at least from a global investment perspective). Investors appear to be reasonably happy with the resulting coalition government, which will dilute the less attractive elements of the African National Congress Party.

The UK, by contrast, despite being in the middle of a General Election campaign, has suddenly become some sort of political safe haven, with both of the main parties trying to outdo the other in terms of blandness. Whereas in Europe the route to more votes appears to be the promise to adopt more and more radical policies, the tactic in the UK is to appeal to the central swing voter by not breaking anything.

Interestingly, the reality of finding oneself in government in Europe might actually constrain the more extreme instincts of politicians, as we have seen in both Greece and Italy, and one could make the more optimistic case that the National Rally Party (RN) will be equally pragmatic should it gain power in France's lower house.

Some commentators are suggesting that the UK's Labour Party, if elected, could go the other way. Once Sir Keir Starmer is settled in to 10, Downing Street, they claim, he will shed his cloak of middle-of-the-road electability and swing hard to the left. Like a lot of things we have to consider, that is not a zero probability outcome, but it does seem to be an extreme tail risk. It doesn't really make sense to blow one's credibility in such a fashion after so long a period out of power. Even so, we know that whoever wins is going to be faced with a constrained fiscal situation and so we are realistic enough not to expect unicorns and rainbows either.

In some ways, the UK has a bit of South Africa about it – unloved by global investors and ripe for rehabilitation and political stability. Doing nothing stupid and presiding over a period where everyone is not looking over their shoulder for the next mishap might just be good enough. Real progress on supply side reforms would be a bonus. One can see this sense of anticipation reflected in increased levels of merger and acquisition activity so far this year, as bidders take advantage of knockdown prices to purchase attractive assets.

Since I wrote about the situation in France last week, there have been a few new developments. Markets were concerned by an agreement between various parties on the left not to run candidates against each other in certain seats. The conclusion was that this would squeeze President Macron's centrist allies out of a lot of the second round of voting in many places, with some projections suggesting that their tally would fall to as low as 40 seats versus the 246 they gained in 2022 (although that was still short of the majority threshold of 289). Subsequent reports suggested that the left had already fallen out, but the risks are clear.

More positively, RN leader Marine Le Pen told the French press over the weekend that she would be prepared to work with President Macron if RN gained the most seats. Channelling Mandy Rice-Davies, she would say that. Somehow, she has to strike a balance between getting the votes and not scaring the markets.

Which leaves us with The Big One... the US Presidential election in November. It's already playing on the minds of the electorate, reflected by a drop in consumer sentiment attributable to the worsening mood of Democrat voters. In the latest University of Michigan sentiment survey, it looks as though the bump in Donald Trump's popularity following his conviction in New York is making them less optimistic about Joe Biden's re-election prospects.

But so far, at least, you cannot see the slightest hint of concern in the stock market. The S&P 500 made four consecutive new all-time highs last week, bringing the total to 29 this year, the most ever in an election year. As for most of the year so far, it's the big guns at the top of the market that are doing the heavy lifting, with Apple the main contributor last week following its well-received developer conference during which it unveiled planned new services powered by generative artificial intelligence (AI). Its one day increase in market capitalisation was the third largest in history, with AI poster child Nvidia still holding the top two slots.

But something will give eventually, one suspects. Volatility futures are pricing in increased uncertainty as we approach the election, and, indeed, after it, just in case there is a result that one of the candidates is not happy about. That's not necessarily to sound the alarm, more to provide a reminder that it's unusual for equity markets to go up all year with no setbacks. The average worst drawdown for the S&P 500 in all years going back to 1980 is around 14%, which does, admittedly account for some big ones including the 1987 crash (-34%), the Tech Bust (-30% and -34% consecutively), the Global Financial Crisis (-49%) and the Covid plunge (-34%). The key point is that even if there is something of a reversal, it will need a very good reason for it to develop into something more destructive.

Economic Commentary

FTSE 100 weekly winners

Company	Change
Halma plc	15.2%
Rentokil Initial plc	6.1%
BT Group plc	5.7%
3i Group plc	3.9%
InterContinental Hotels Group PLC	3.0%
Severn Trent Plc	2.7%
United Utilities Group PLC	2.6%

FTSE 100 weekly losers

Company	Change
Legal & General Group Plc	-9.8%
Entain PLC	-8.4%
Barclays PLC	-7.0%
Flutter Entertainment Plc	-6.6%
Admiral Group plc	-6.6%
B&M European Value Retail SA	-6.1%
Abrdn plc	-6.0%

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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