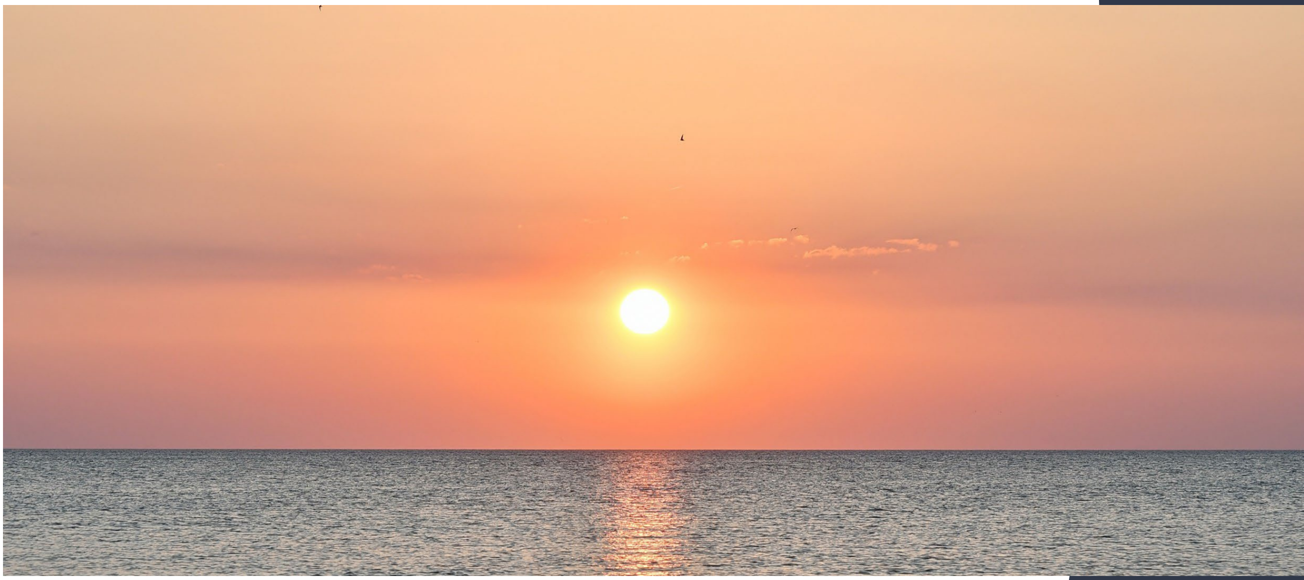
RATHBONES | Incorporating Investec Wealth & Investment (UK)

WEEKLY DIGEST | 24 September 2024

End of the honeymoon



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A few years ago, when I was running a football team, one of my players informed me that he would be unavailable for a while as he was getting married. Fair enough. And so, I was a bit surprised a week or so later when he informed me that he was ready to play again. On further enquiry, it emerged that he and his new wife had found themselves to be incompatible marriage partners even before the champagne had gone flat and decided to pack their bags and call it a day. Top marks for decisiveness, I guess, but a pretty brutal comedown.

The UK electorate seems to be having similar second thoughts about having to spend more time with the new Labour government. Much is made of the "first hundred days" when there is a change of leadership, although there is no science or formality attached to that number. According to an essay published for the Brookings Institute, it all stems back to the beginning of Franklin D. Roosevelt's presidency in 1933 when he wanted to make a clean break with the somewhat disastrous Hoover administration, which had presided over the Wall Street Crash of 1929 and subsequent depression. FDR communicated very well with the population through the still new medium of radio and enacted effective legislation to stem the bleeding in the economy. He also amended the act that had delivered prohibition, which would have been an extremely popular move!

Maybe a new leader needs a proper crisis out of which to lead the way, because, at least in the article's evaluation, only Ronald Reagan has vaguely succeeded in emulating Roosevelt during his first hundred days. That was partly down to lucky timing although it's fair to say that he was also elected with a very strong and popular agenda to shrink government. Interestingly, in the light of recent events, he survived an assassination attempt during his first hundred days too.

Labour's first eighty-odd days have been characterized, as much by their desire to trash the reputation (even more?) of the outgoing Conservatives, as by promoting their own agenda. Much has been made of the legacy of insufficient growth and fiscal mismanagement, with the infamous "£22 billion black hole" in the country's finances being a key part of the campaign. I think it's fair to say that the Tories pushed the fiscal envelope as far as they could get away with without upsetting the bond market, but it's also clear that there were plenty of elements of the black hole that were also well known. These include the unavoidable (and much needed) catch up in public sector wages, which in the last spending review had only been penciled in at a ludicrously low 2%, and the burgeoning spend on accommodating asylum seekers. There were also unrealistic expectations for cost savings within government.

And so, as the Labour Party faithful gather in Liverpool for the annual conference, much of the rest of the country is in a pretty foul mood. Whether the most recent flat monthly UK GDP data can be ascribed to the politics is debatable, but the constant pessimism and the increasing warnings of higher taxes do seem to have had a negative effect on consumer confidence, with the latest measure from GfK falling from -13 to -20. Although this is nothing like the nadir of -49 recorded in September 2022 (yes, that Truss/Kwarteng mini-Budget again!), which was the all-time low in a series dating back to 1981. Other notable troughs include Covid (-34), the Global Financial Crisis (-39), and the early 1990s recession (-35), when the Bank of England raised interest rates to 15% to combat inflation.

Mind you, consumer confidence surveys rarely betray any sense of optimism. The highest ever reading for the GfK survey is +10 and that was recorded as long ago as 1985 at the height of the Thatcher boom when Harry Enfield's Loadsamoney character was in the ascendant. The most consistent period of positive readings was between Spring 1997 (welcome, Tony Blair and "Cool Britannia") and the end of 2002 and it was last above zero in January 2016, after which the Brexit referendum result appears to mark the beginning of a new downtrend.

Even so, there is some evidence to suggest that respondents to such surveys generally tend to be more pessimistic about either the countries or everyone else's prospects than their own. Maybe that's the effect of a constant barrage of negative media, a phenomenon I have referred to in the past. And if you think we Brits are miserable, the European Commission Consumer Confidence Index, which has been running since 1985, has never been in positive territory!

The country's deteriorating mood is set to collide with Labour's policies on October 30th, which is Budget Day. The path to higher taxes has rarely been laid out so clearly, and now people are worrying about where they will fall and how big they will be. With around £16bn of spending already committed, that looks like the minimum increase, barring some unforeseen windfall. The option to allow the deficit to increase is unlikely to be exercised owing to the threat to bond market equilibrium. Indeed, the only acceptable path to increasing the deficit would be through some very well thought out investment plan with tangible productivity benefits, but that does not seem probable – well at least not easy. If it was easy, it would, like so many other things, have been done already. The "hair shirt" option would be to raise taxes by more to increase firepower for later in the parliamentary term, but that looks equally dangerous considering the threats by higher earners to head for the exits.

The other problem is that so many red lines have been drawn around the sources of tax that are off limits (VAT, income tax, National Insurance – and a Corporation Tax increase would hardly seem business-friendly) that the burden will fall on just a quarter of the total tax base. Unsurprisingly, a poll taken at the recent Financial Times Weekend Festival highlighted visitors' fears around the potential for higher personal taxes, with capital gains tax, inheritance tax and pension tax relief topping the list of concerns. There are some preemptive moves that investors and asset owners could make, but always with the risk that the policy one is insuring against is not implemented. That's a conversation to have with a Financial Planner.

No doubt there will be a lot of floating (leaking) of ideas over the next few weeks and the final version of the Budget will probably be subject to revisions. Even so, there are a limited number of ways of controlling a big fiscal deficit. The optimal solution is strong productive growth, which, for now at least, falls into the "wishful thinking" category, although who knows what the wider application and adoption of generative artificial intelligence might lead to. Austerity (as Chancellor Rachel Reeves has acknowledged) is not a realistic option – it doesn't seem to work and it's hugely unpopular. Defaulting on one's debt is not a realistic or practical option for any major developed country either. Which leaves the soft option of inflating one's way out of trouble, which, as I keep coming back to, has all sorts of implications for portfolio construction in the longer run, with the emphasis on inflation-proofing.

Economic Commentary

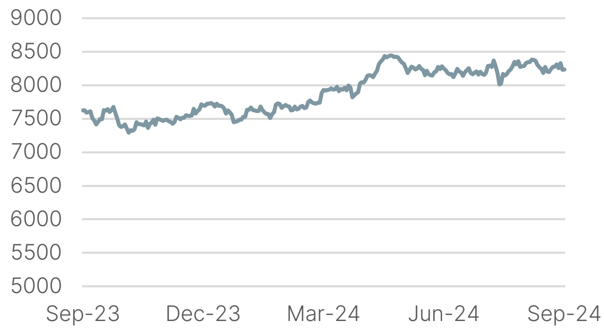
FTSE 100 weekly winners

Kingfisher Plc	13.6%
Ashtead Group plc	6.2%
Smurfit Westrock	5.5%
Rolls-Royce Holdings plc	5.0%
Pershing Square Holdings, Ltd. Public Class USD Accum.Shs	4.6%
International Consolidated Airlines Group SA	4.2%
CRH public limited company	4.2%

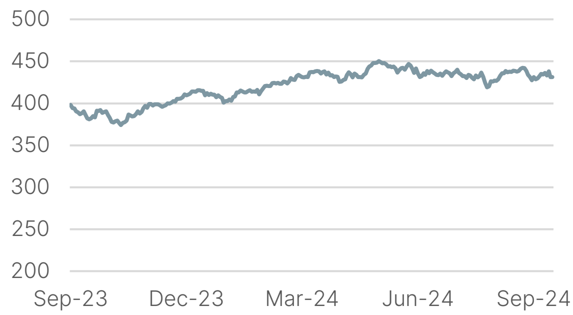
FTSE 100 weekly losers

Johnson Matthey Plc	-8.3%
GSK plc	-6.0%
British American Tobacco p.l.c.	-5.2%
BAE Systems plc	-5.0%
Phoenix Group Holdings plc	-4.8%
Spirax Group plc.	-4.7%
SEGRO plc	-4.3%

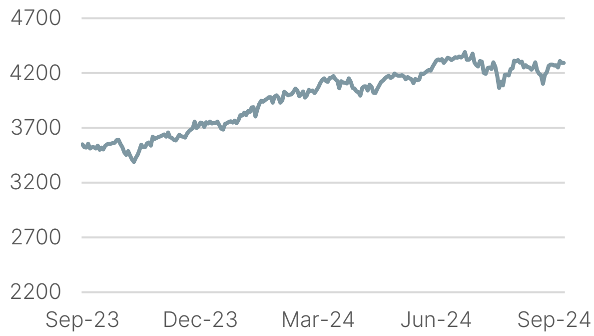
FTSE 100 index, past 12 months



EuroStoxx 600 index, past 12 months



S&P 500 index, past 12 months



All data shown in GBP.

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