Investment Insight
Do elections matter?

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For Financial Advisers to use with their clients

This month's Spring budget reminded us that we are in an election year, both here and in many countries. How much should this matter to investors?

At first glance it might seem to matter a lot. In the UK Labour have been out of power for a long time and remain tight lipped about any major strategic policy changes. In the US, the huge personality of Donald Trump and memories of big shifts in trade, tax and geopolitical alliances evoke expectations of high drama. Elsewhere the major powers are not expected to witness any material change of direction, especially totalitarian regimes in China and Russia.

Navigating politics has been a minefield for investors and often a graveyard when they base their investment strategy on specific political scenarios. Key events confounded expectations: Brexit; Donald Trump elected as US President, Vladimir Putin's invasion of Ukraine. Few correctly forecast these events and the eventual impact on economies and markets.

While all elections do lead to some policy changes, few move the needle in terms of impacting the key drivers of market returns for investors: the path of inflation, interest rates, economic growth and the opportunities for companies to grow profits and ultimately distribute these to investors. Notable changes in the past include taking the US off the gold standard in 1933 and 1971, the drop in corporate tax rates in the 1980s and the introduction of independent central banks with inflation targets in the 1990s. These policies were enacted by incumbent governments and took effect across a wide range of countries at a similar time, akin to a change in fashion for clothing.

Today the differences in policies on offer are not large by historical standards, for the UK and the US. In the UK the current incarnation of the Labour Party is a world apart from the Jeremy Corbyn version, in terms of economic and trade policy. This is evident in responses to the latest UK budget and a long series of policy statements about fiscal discipline. Financial markets have already taken away the option of reckless shifts, because any resulting spike in UK government borrowing costs would eat up yet more of the government revenue and leave less for other spending. Labour are well placed, though not guaranteed to win an election that must be held within the next 10 months, given their lead in the polls and lacklustre economic conditions.

In the US, the picture is more uncertain. Neither candidate is in such a dominant position, as yet. Compared to the 2016 election, Trump's policies are more widely known, and many remain in place including much of the reduction in corporate tax rates and increase in tariffs. Mooted policies include more tariffs, less US support for defence pacts, roll back of pro renewable energy policies and weakening constraints on power. Enacting these will depend on the size of any majority, a constraint that has hobbled the Biden administration. Economic conditions are robust and inflation easing.

So, we continue to follow with interest the prospects for upcoming elections, but see them as outside the scope of what is both knowable and important to investing. We maintain broadly diversified portfolios to deal with a range of potential scenarios, favouring investments where overly cautious pricing today, is creating opportunities for higher gains than usual.

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