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Truss confirmed as new PM

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Following the news that Liz Truss will become the next prime minister of the United Kingdom, Guy Foster, our Chief Strategist, looks at what this means for investors.

Despite not being the favoured candidate among Conservative MPs, Liz Truss has been the frontrunner since the contest was put to the party membership as a straight choice between the foreign secretary and the former chancellor, Rishi Sunak.

The two candidates have been campaigning at hustings events for the last five weeks, with the debate frequently becoming fractious between the two.

Both had talked of their ambitions for growth based on lower taxes.

However, there were some clear dividing lines, particularly with their proposed approaches for managing the cost-of-living crisis. Truss has argued for tax cuts immediately while Sunak prioritised curbing inflation first. Both would have needed to adjust their plans in light of the latest increases in gas prices and the prospect of real social unrest this winter.

All incoming prime ministers presumably have a pretty full inbox when they arrive, but this seems particularly the case this time around. As a result, much attention has been focused on the candidates' statements around the financial support they would offer if they became prime minister.

Truss had said she would hold an emergency budget in September, but that has subsequently been relabelled as a fiscal event where she is nonetheless expected to deliver some of her core tax commitments.

Tax cuts?

There have been a number of tax cut proposals floated over the course of the campaign.

Two of the most notable include reversing her rival's increases to national insurance (the health and social care levy) that was introduced in April, and cancelling the planned increase in corporation tax to 25% that had been due to come in from April 2023.

Alongside those, there have also been pledges to cut fuel duty and suspend the green energy levy, as well as less specific plans to support people with energy costs through the winter. These suggestions are all designed to put more money back in people's pockets.

None of these pledges will come cheap; the first two alone are forecast to cost almost £28bn by 2023-24[1].

Truss also considers that the tax system would be fairer if households were treated as a single tax entity; this would reduce the tax burden on those providing unpaid care, but might incentivise people to leave low paying jobs.

Of course, we will have to wait and see what changes the new prime minister chooses to make once she has her feet under the desk – the economic choices that need to be made may seem less palatable than when discussed on the hustings.

The impact on investors

It's important to remember that the performance of the UK economy is usually relatively muted in its impact on investment portfolios. Most large UK companies are not particularly exposed to the UK economy, being more multinational in nature. For the largest companies, their country of listing is almost a historical accident.

However, some companies do have a specific UK focus, particularly supermarkets and some other retailers as well as some financial companies.

[1] Office for Budget Responsibility, https://obr.uk/efo/economic-and-fiscal-outlook-october-2021/

As you move further down the size spectrum, many mid and smaller sized companies will be progressively more exposed to their local market. If investors believe UK consumers will find life hard (as they do) then they will value companies selling to those consumers a little less generously.

And there are additional effects too, as most UK investments will be affected to some extent by the outlook for the pound and interest rates.

In the run up to the result, the pound has been very weak.

That reflects the particular challenge the UK is facing in terms of soaring inflation, most notably from rising energy prices. The most dramatic weakness has been relative to the dollar, but that is a reflection of dollar strength as much as sterling weakness. Recently though, the pound has been underperforming the euro as well and that should be concerning for Truss, because the pound weakened as her likelihood of winning increased.

Similarly, government borrowing costs, which were rising as a result of the steeper trajectory of UK interest rates, seemed to rise faster as a Truss victory became more likely.

The new prime minister has successfully convinced the Conservative membership she is the right person for the job, but delivering on her promises will be difficult.

She has already been accused of designating the presentation of her economic plans as a fiscal event, rather than a budget, because that will avoid the need for the Office for Budget Responsibility (OBR) to scrutinise them. The markets, however, are passing judgement on them already.

The good news is that the pound's weakness has been a benefit for the majority of UK companies who earn their revenue in foreign currencies. It has been a bigger benefit for overseas equities within client portfolios.

It does make holding longer-dated UK government bonds risky if, as Sunak has suggested, the UK were to lose the confidence of the markets. However, the chances of a default on a UK government bond are virtually nil because the central bank can print its own currency.

While shorter-dated government bonds anticipate future increases in interest rates and so are already providing a more attractive yield than is available in bank accounts, a quirk of the pandemic-era issuance means that, for many UK taxpayers, holding short-dated government bonds as a savings instrument is often hugely preferable to keeping cash in deposits.

The importance of the markets

The UK has a history of being unable to follow through on some policies because of the market's reaction. One of the most notable examples was its withdrawal from the exchange rate mechanism, which ended up being economically advantageous for the economy.

Famously James Carville, economic advisor to Bill Clinton, once said: "I used to think that if there was reincarnation, I wanted to come back as the president or the pope or as a .400 baseball hitter. But now I would like to come back as the bond market. You can intimidate everybody."

The new prime minister will need to have a policy agenda which appeals to her MPs, their voters, and eventually the OBR, and is at least tolerable for the markets.

The implications for portfolios are that we could see further weakness in bonds and the pound until the market builds confidence in the new prime minister. We protect against the weak pound by holding overseas securities. Weaker bonds are a more immediate threat and so we are cautious on this part of the market. However, the weaker they become, the higher the yields they will offer for the future.

Guy Foster, Chief Strategist

Guy leads Brewin Dolphin's Investment Solutions team working to align our investment capabilities with the needs of clients. He also provides recommendations on tactical investment strategy to our investment managers and strategic recommendations to the group's Asset Allocation Committee. Guy has a Masters in Finance from London Business School. He is also a CFA charterholder, holds the CISI Diploma, and is a member of the Society of Business Economists. He frequently discusses financial issues with the written and televised media as well as presenting to the staff and clients of Brewin Dolphin.

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