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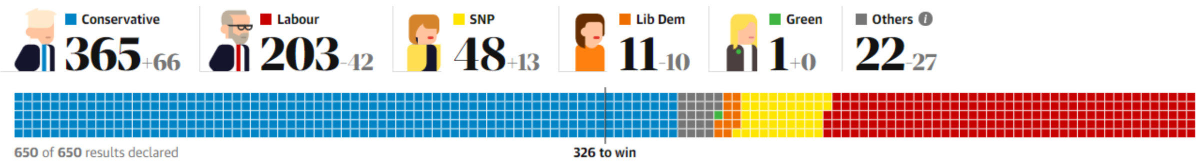
<u>**Market Update: 18th December 2019**</u>

Boris Cashes In on Election Gamble

After a tumultuous six weeks of election campaigning in the UK, markets reacted positively as the Conservatives were returned to power this week with a considerable majority. After months of political uncertainty centred around the all-important Brexit issue, the Prime Minister's resounding election victory carries two important implications for the economy. Firstly, certainty over the Brexit outcome, with an orderly exit in January which should lift some of the weight of Brexit-related uncertainty on activity. Secondly, the role played by previously traditional Labour voters- which adds to the likelihood that the new government will loosen fiscal policy more than its modest manifesto commitments imply. After months of uncertainty and considerably volatility in UK markets, the result provided a welcome degree of clarity to the UK's 2020 economic outlook.

Election Result: What This Means

The last few years haven't been short of political surprises in the UK, and while the polls predicted a Conservative win, the scale of the victory came as a surprise. The Conservatives achieved a majority of 80 seats, its largest majority since 1987.



Investors were elated as the election marked the end to years of Brexit turbulence owing to the government's weak majority following Theresa May's failed election gamble in 2017. The fact that the UK now has a government sitting on solid foundations should deliver an exit from the European Union by the 31st January deadline (albeit with the process of negotiating a trade deal still ahead), reducing the risk of a no-deal exit in January. This is expected to prompt some delayed investment spending into the UK, with investment flows since the election suggestive of a return of investment into UK assets. Additionally, the modest fiscal stimulus laid out in the Conservative manifesto would yield a modest boost to the UK's 2020 growth prospects, however with a Budget due in February, the government may discover a greater appetite for fiscal largesse. This may be particularly true for public sector investment, where there is still sizeable leeway to spend more before the proposed 3% of GDP cap on infrastructure spending is reached. The make up of the conservative's majority may also impact this, with extra public spending in less prosperous parts of the country would seem an obvious part of a Conservative strategy to ensure that Labour's 'Red Wall' remains broken.

UK Economic Outlook

UK GDP is expected to stagnate in Q4 as a result of political and trade uncertainty, which would leave 2019 growth at a decade low of 1.3%. Even after the positive impact that the Conservative victory has had on forecasts, growth next year is expected to run at a softer pace, with expectations of 1% growth over the year. Against that backdrop, it will be interesting to see the impact of a stable government with an optimistic outlook and a fresh strategy may have on economic sentiment over the year. It is clear that the UK economy faces challenges, with falling output and deteriorating PMI data suggesting weakness in activity, while manufacturing and services sectors remain firmly in contractionary territory.

The Bank of England is expected to decide whether to make any changes to UK monetary policy this week. Given that we now have greater clarity on the Brexit outcome, it is likely that policymakers will vote to keep rates on hold, before re-assessing the health of the economy in the New Year based on new data with some Brexit-related uncertainty lifted. A pickup in consumer and business confidence on a Brexit resolution and increased fiscal spending could provide a welcome boost to the economy in 2020, while an improvement in US-China trade relations could also improve global trade conditions.

Brexit Risks: Abating, Not Removed

It is important to note that while the majority secured by the Conservatives clears the path to a Brexit deal being passed by 31st January and fiscal policy being loosened in the February Budget, the resulting boost to the economy is likely to be restrained by the risk that there could be something like a "no deal" exit at the end of the year. The passing of the Brexit deal initiates a status quo transition period until 31st December 2020, however uncertainty still remains on whether a trade deal can be made with the EU before end of next year. Businesses will fear that the UK could end up trading with the EU on WTO terms after 31st Dec 2020, the immediate effects of which would be similar to a "no deal".

By pledging to "Get Brexit Done" by 31st December 2020, the Prime Minister has just 12 months to strike a trade agreement with the EU- a task which has taken others around four years to achieve. Our expectation is that given the agreement in principle already in place, this would be achievable, however it is clear that the passing of the deal to leave on 31st Jan is only the first step towards securing Britain's exit from the EU next year, therefore some uncertainty, albeit reduced, is likely to remain.

Market Reaction

In reaction to the election results, UK equities gained this week, as UK gilts declined in value and sterling strengthened. After initially strengthening to c.$1.34 to £1 against the dollar immediately following the vote, the pound has since fallen back to c.$1.31 to £1 on the back of concerns that a trade deal may not be done before 31st December. This follows our expectations that after a structural appreciation in the lead up to the election, we would see some volatility afterwards as the next stage in the withdrawal process comes into focus. Also as expected, we have observed significant inflows into UK small/mid cap equities coming from professional investors, owing to the improved outlook for UK domestic companies.

Positioning

Following the election results and the agreement of the phase one US-China trade deal, we increased our exposure to UK small/mid cap equities, removing the barbell from the portfolio while also increasing exposure to Global and European small caps. In these areas, we see opportunities to benefit from increased fiscal stimulus and supportive domestic economic conditions, recognising that significant risks remain in large cap equity exposure given high valuations and declining company fundamentals.