RBC BlueBay
Asset Management

Market Commentary

Could the British Tory party place 4th in the coming election?

It's Easter fear – not cheer – for the Conservatives

Key points:

- Financial markets have had a quiet week.
- Credit markets continue to be supported by positive sentiment towards risk assets.
- Geopolitically, the upcoming election may be devastating to the Conservative party in the UK.
- Looking ahead, a majority of investors are expecting rate cuts to commence. Yet, we remain in the camp that robust data may well stand in the way.

28 March 2024 (London): The past week has been a relatively quiet one in financial markets, with major indices and yield levels little changed. Key central bank meetings and data releases have tended to be compressed, making for periods of elevated activity followed by periods of calm. Meanwhile, the Easter holiday period has also contributed to a seasonal lull, which may extend into the coming week.

In the UK, latest opinion polls have seen support for the Conservative party drop as low as 19%. In a first-past-the-post Parliamentary system with a healthy amount of tactical voting, as voters band together to eject Tories even in traditionally safe seats, this outcome could see the party with fewer than 40 seats, down from 376 in the current government.

Although such an outcome seems almost unthinkable, it is certainly possible to imagine the fate of the Conservatives becoming even worse, if the dog days of the end of the Sunak premiership descend into infighting within the party.

Upcoming May local elections in the UK could provide a lightning rod for sentiment if the Tories do as badly as seems likely. It is possible to speculate whether there will be a last-ditch attempt to replace Sunak, or whether calls for greater tax cuts could mount (as well as political pressure on the Bank of England to cut interest rates).

However, another inference is that we are heading towards an outcome that is bad news for the democratic process in the UK. Moreover, with such a large majority, Starmer may struggle to impose discipline in the more extreme elements of the Labour party, and this has the makings of fiscal trouble written large all over it.

Another implication of a Tory decimation could be a split in the party and a more right-wing narrative, mirroring populist movements in vogue across Europe, in the mould of Trump in the US. In that case, the notion of Nigel Farage heading a reconstituted Conservative party and winning the keys to Downing Street in 2029 is no longer a far-fetched reality.

In part, this example from the UK shows the prospect of political volatility ahead of us across the global landscape. In the present age, it seems that polarisation amongst voters is being exacerbated by an addiction to social media. This is a point which seems even more apposite to make in a week when the Spac acquisition of Donald Trump's own social media platform has added paper billions to the past President's fortunes.

In this light, meetings with policymakers and investors in the Middle East over the past week have continued to push the case that benevolent monarchy offers a superior form of government. That's not to say that democracy is dead or in retreat. Yet, as we gear up for the prospect of Trump versus Biden part 2, it is understandable that enthusiasm for the democratic ideal has certainly waned in some parts of the world.

Certainly, as a region, the Middle East continues to boom. Supported by oil revenues and grand infrastructure projects, there is a sense that the future is a bright one (at least away from the ongoing problems in Israel/Palestine). This mood of optimism is something which has been lacking in a region like Europe for a long time, it seems.

It is also encouraging to witness the focus on green technology and sustainability in the region. To this end, it has even been interesting to see how rainfall in the water shortage region is increasing through cloud seeding initiatives, which are influencing the local climate.

Returning to financial markets, the past week has seen an increase in verbal interventions from the MoF in Japan. This has prompted speculation of a desire to stop the yen weakening beyond 152 versus the dollar. However, what continues to be needed is more from the BoJ in terms of policy normalisation. Ueda may want to wait until the next policy meeting in April.

However, the reality is that the BoJ needs to be prepared to speed things up, in order to prevent the risk of losing control over the yen and inflation on the upside.

Credit markets continue to be supported by positive sentiment towards risk assets, as well as positive technicals, which see a contraction in net supply just as government bond issuance continues to balloon. However, amidst the enthusiasm, it is worth highlighting an uptick in credit events in the high yielding space.

In Europe, for example, we see distressed trading and likely restructuring events in names such as Altice, Intrum, Ardagh and Grifols. This again serves as a reminder of the importance of credit selection and proper diversification. For sure, it is never a great outcome when investor attitudes grow too complacent in credit.

Looking ahead

We could have another quiet week to mark the end of the first quarter. As we head into Q2, we would note that a majority of investors are expecting rate cuts to commence. Yet, we remain in the camp that robust data may well stand in the wake of June cuts – certainly in the US and the UK.

There is plenty of scope for volatility to pick up in the coming weeks. Divergent trends in economics and politics can lead to shifts in sentiment amongst investors, and we would juxtapose the current confidence in the narrative around a soft landing and an end to inflation, with the uncertainty of where we will be in 6-12 months from now.

As ever, being disciplined and vigilant is sound advice. As we reflect on the fate of the Tory party, it is also important to remind ourselves to stay connected and relevant, or otherwise risk becoming extinct….

Notes to Editors

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