UK EQUITIES

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HISTORY MADE IN DOWNING STREET

Following the collapse of the "Trussenomics" era, Ben Russon and Will Bradwell assess the task ahead for Rishi Sunak and how the UK market may react to the newly appointed prime minister.

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On the 25th October 2022, Rishi Sunak - the new leader of the UK conservative party – met King Charles III at Buckingham Palace where he was formally appointed as prime minister of the United Kingdom.

His predecessor Liz Truss chaired her final cabinet meeting earlier in the day before tendering her resignation, drawing curtains on her 44-day premiership. The United Kingdom's third prime minister in 7 weeks has already made history – the first to be appointed by the first post-imperial monarch is now the first British-Asian to lead the cabinet. But with Liz Truss' chaotic tenure unravelling at rapid speed, Rishi Sunak will need to take decisive action to reassert the market clarity that investors have been longing in recent weeks.

As "Trussenomics" disentangles, we do have some sympathy for the objectives of higher growth, higher rates and lower taxes. However, in our minds the near-disastrous consequences of the mini-budget were clearly exacerbated by the subversion of the OBR and the timing of the policies. With investors already grappling with multi-faceted uncertainty, the extent of debt-funded fiscal loosening announced added a degree of risk perceived insurmountable to market participants. Thus, the appointment of Jeremy Hunt as Chancellor of the Exchequer served as a welcomed return to orthodoxy, assuaging anxiety amongst investors and stabilising UK asset prices as a result.

Following Penny Mordaunt's withdrawal from the conservative leadership race on 24th October 2022, UK Gilts recovered further from the near miss of a systemic collapse driven by the earlier unwinding of widely adopted liability driven investment strategies. As investors priced in a Rishi Sunak-led government, spreads narrowed between the cost of UK and US government debt (figure 1) indicating a reduction in risk premium. Domestic equities were also particularly strong as the prospects of an improving outlook for the UK economy were increasingly considered under the new cabinet. The FTSE All-Share closed 1.25% stronger from its intraday lows.

Figure 1: UK 10 year gilt yield vs US 10 year treasury yield

Source: Bloomberg as at 24/10/2022.

We view the new prime minister as a necessary safe pair of hands as investors seek to curtail risk exposure. Despite the profound economic challenges ahead and the likely adoption of tight fiscal discipline, we believe that this return to orthodoxy represents progress towards reinstating the credibility of the United Kingdom as a preferred investment destination amongst global participants.

Extending our near-term lens, Rishi Sunak has inherited a daunting task to overturn the largest labour poll lead in 25 years, all before the next general election (likely in 2024). However, we are of the opinion that recent events will encourage politicians to consider market forces within their future spending promises. This should enhance the prospects of balancing economic debate on both sides of parliament towards the centre, and indeed mitigate the risk of a recurring crisis within UK markets.

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Important information

Source: Bloomberg as at 24/10/2022 unless otherwise stated.

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