Election Fever

Latest views from the investment team

Summary

In our January Outlook we highlighted that countries making up over 50% of global GDP are holding elections in 2024. Until this month there has been very little to unnerve global investors. However, the first half of June has proved that politics still matters. There has been volatility across asset markets in Mexico, India, and Europe following elections; there is an update on each below. At first glance, results have not been as sanguine as investors may have liked and with several more elections to come this year, most notably in the UK, in July, and the US, in November, scrutiny has increased.

A key question is whether investors should be concerned? Looking at the historic performance of UK equities under both Labour and Conservative governments and at US equities under both Democrat and Republican governments shows that the governing party has not had a huge impact on returns. In each country, both parties have been in charge in significant up years and down years for equities. Of course, many other factors can have a significant impact – for example, there was a Republican US president during the 2001 US Terrorist attacks and at the onset of the Global Financial Crisis in 2008. Meanwhile, the Democrats gained power in 2009 when stock markets rebounded from the 2008 crisis. Looking at historic data provides a useful reminder that, in most years, stocks tend to rise; since 1929, only three US presidents have overseen negative returns for US stocks during their term. It is difficult not to conclude that investors should, in most circumstances, look through the short-term noise of political turmoil.

Mexico

On Sunday 2nd June, Mexico elected its first female president, Claudia Sheinbaum. She is the protégé of the outgoing President and, therefore, offers a degree of continuity. However, earlier in the year, then President Obrador proposed a package of reforms that included eliminating independent regulators. This raised concerns about there being fewer checks on government decisions however, prior to the election, markets shrugged this off because he lacked the congressional backing to pass the reforms. Ruling party gains in this month's election mean that these fears have returned and intensified. As a result, at the time of writing, the Mexican Peso is down around 10% since the election. In an attempt to reassure investors, Sheinbaum has promised strong relations with the US, Banxico (Mexico's Central Bank) autonomy, fiscal discipline and foreign investment but the reassurances has not supported the currency as yet. Markets will closely watch announcements of cabinet appointments ahead of the new congress gathering in September. Overall, it is important to note that Sheinbaum is pro-industry and Mexico is likely to see continued benefit from the ongoing structural trend of nearshoring.

India

On Tuesday 4th June, the people of India voted for Prime Minister Modi to serve a third term, a rare occurrence in India. However, his BJP party did not achieve a majority. While Modi has presided over a fast-growing economy (with Indian equities outperforming most global markets in recent years), there is a lack of support amongst some cohorts due to high levels of inequality, youth unemployment and Modi's authoritarian style.

The lack of majority initially sparked concerns that it would be more challenging to reach decisions on policy, triggering a sharp decline in the stock market. However, the appointment of coalition partners to key cabinet roles has reassured investors that plans for growth-enhancing economic reforms, such as land acquisition and labour reforms, will remain on track. Additionally, the BJP is likely to exercise restraint regarding more divisive policies, such as implementing a uniform set of personal laws across religious communities, which pertain to areas like marriage, divorce, guardianship, and succession. As a result, confidence amongst investors has been restored quickly. Overall, the long-term growth story in India remains encouraging with its favourable demographics and strong global relations.

Europe

At elections for the European Parliament on Sunday 9th June, far-right parties made significant gains while Green parties suffered heavy losses. The far-right parties have capitalised on unease related to higher prices, immigration and the cost of green energy policies which are viewed as hurting domestic industries. Some gains for the far-right were expected given these parties already lead governments in Italy and Slovakia and are part of ruling coalitions in Finland, Sweden and soon, the Netherlands.

In Italy, Prime Minister Meloni's far-right party won the largest share in European elections with 28% of the vote. In France, Le Pen's hard right National Rally gained 31% of the vote and the extreme-right Alternative for Germany won 16%. This represents a significant uplift in vote share compared with 5 years ago and suggests potential future turbulence in upcoming national elections. However, the majority of seats in the EU parliament remain with centrist parties with the centre-right winning the largest number of seats and making the biggest gains. This means there are not huge concerns regarding the ongoing functioning of the group. Additionally, the far-right parties are not calling for EU break-up, something that has intensified fears in the past. However, subsequent events in France have unnerved investors.

The share of votes won by France's National Rally in the European election was more than double the share achieved by the President's Renaissance party. President Macron already lacks a majority in the French parliament, so this was another blow. In reaction, he has called snap elections for June 30 and July 7 - a risky strategy aimed at reestablishing his authority. In May, Standard and Poor's (the rating agency) downgraded France's credit score, citing a weak budgetary position, because France has a very high level of government debt. France's credit score, at "double A", remains high and is consistent with a very strong capacity to meet its financial obligations and a change in government could make it more difficult to reach agreement, bringing more concerns regarding France's ability to reduce government debt. As investors have relatively fresh memories of the upset caused in the UK in Autumn 2022 when Liz Truss announced sharply higher fiscal spending plans and, also, remember the 2011-12 European sovereign debt crisis, there have been some adverse moves in markets. The EUR currency has depreciated, and French stocks have underperformed the aggregate European index. The magnitude of moves, at the time of writing, has been fairly muted with EURGBP down less than 1% and French stocks approximately just 2% lower relative to the aggregate European index. While concerns are certainly warranted, Le Pen's party have moderated their tone in recent years so adverse historic comparisons may be less relevant than initially feared.

Bottom line

While politics should be considered as a factor in investment decisions, and elections have the potential to trigger sharp moves in asset prices, there are many other influences. Elections are very difficult to predict, and history suggests investors should look through short-term fluctuations and maintain their investment strategy.