FIXED INCOME

Gilts Under the Microscope as the UK Heads Back to the Polls

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The United Kingdom's political uncertainty is set to continue, with a fresh general election now on the cards. Our Head of European Fixed Income David Zahn discusses the market implications of potential election outcomes.

The United Kingdom is heading back to the polling booths for its second general election since the 2016 referendum at which it voted to leave the European Union (EU).

We expect a rollercoaster ride for UK assets over the next six weeks as investors closely monitor opinion polls for clues as to the outcome.

Gilts are likely to be especially volatile in our view. Whatever the election outcome, we expect a likely general shift higher in UK government bond yields, as the two main candidates to form a government have committed to higher government spending.

In our view, markets would react most positively to a solid majority for the Conservative Party. We think a majority Conservative government would likely push quickly to pass its Brexit Withdrawal Agreement Bill, which should serve to reduce some of the uncertainty hanging over the United Kingdom right now.

That's when the real process of negotiating a Brexit trade deal would start. The negotiations would likely take place during a shorter transition period than originally envisioned because of the latest Brexit extension to January 31.

We consider the chances of the United Kingdom finally crashing out without a deal are much lower in that more accelerated negotiation scenario. While it's likely to prove very difficult to complete a comprehensive trade deal in 11 months, we think current Prime Minister Boris Johnson does now want to leave in an orderly fashion and is likely to push for a trade deal.

The worst outcome for markets, in our view, would be a repeat of the status quo in which no party can command a majority in the House of Commons.

A Jeremy Corbyn-led Labour Party would likely send gilt yields rising and cause sterling to drop dramatically further. However, at least investors could expect some consistency in strategy and policy and would likely be able to adjust their portfolios if need be.

We expect markets to remain very volatile over the six weeks until polling day. We think the ability to actively adjust portfolios quickly to react to changes in the market is likely to be important for investors.

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