Cantab
ASSET MANAGEMENT

Investment Outlook after the Mid-Terms and Autumn Statement

22 Nov 2022

In an extraordinary month for politics domestically and across the Atlantic, we provide our outlook for UK and US markets in the updates below.

UK – Autumn Statement

Following a volatile month for UK politics, Chancellor Jeremy Hunt, overseen by Prime Minister Rishi Sunak, delivered an Autumn Statement aimed to reassure domestic and international stakeholders that the UK Government has a plan to repay pandemic and energy-crisis related debts. The tone was in marked contrast to the predecessor's unfunded pro-growth stance which had caused significant concern amongst investors in UK government debt. Instead, Sunak delivered on his leadership campaign objectives to prioritise the control of inflation in the short-term, above ideological desires for a low-tax high-growth economy.

Inflationary pressure is notoriously sticky and highly regressive in its impact on living standards within a population. We welcome the recognition from the government that fiscal and monetary policy tools should be used cooperatively rather than in conflict as policymakers battle to dampen inflation back towards the 2% target level. Mechanically, we are likely to see a significant easing of inflationary pressure in the coming months as we start to hit 'comparators' on a lagging 12-month view. However, we continue to think it likely that inflation will remain elevated on a medium-term view, with moderately higher inflation being a politically palatable way to shrink the national debt burden.

Much coverage is available on the specific measures included in the Autumn Statement, so we will only briefly highlight the main relevant points:

For individuals:

- Personal tax thresholds have been frozen for a further two years, until April 2028. With inflation running in the double digits, this represents a significant increase in real tax payable under a mechanism known as 'fiscal drag'. The 45% additional rate threshold has been lowered from £150,000 to £125,140 from April 2023. Whilst unlikely to raise significant revenue, this adjustment marks the contrast symbolically between the current administration and previous proposals to scrap this tax band entirely
- Inheritance tax and National Insurance thresholds have been frozen until April 2028
- The Pensions Triple Lock has been protected, with pensions increasing in line with inflation at 10.1%. Universal credit will increase by the same amount, but with additional requirements and support for people to increase their economic participation
- The annual Capital Gains Tax exemption will reduce from £12,300 to £6,000 from April 2023 and then to £3,000 in April 2024. The Dividend Tax allowance will be reduced from £2,000 to £1,000 then to £500 over the same timeframe
- From April 2025, electric vehicles will no longer be exempt from Vehicle Excise Duty
- The Energy Price guarantee has been extended in a less generous form for a further 12 months from April 2023

For businesses:

- Properties will be revalued for business rates from April 2023 and the VAT registration threshold will be maintained at £85,000 until April 2026
- The National Living Wage will increase by 9.7% for over 25s, to £10.42 per hour from April 2023
- The Windfall Tax on the profits of Oil & Gas firms will increase from 25% to 35% until March 2028, with a new 45% levy on electricity generators from January 2023 until March 2028

Outside of measures aimed to return national debt and expenditure to more comfortable levels, Hunt committed to an increase in Education spending – a move welcomed by educational leaders. The NHS also received a boost to capital spending, with confirmation that the New Hospital Programme will continue as planned and spending on social care is to be increased with funding from central government contributions and council tax increases.

There are likely to be further challenges for households as we move through this phase of the economic cycle. We anticipate market volatility to persist until signs of recovery are more concrete. However, we note that markets are inherently forward looking and that they often move well ahead of underlying macroeconomic developments. Drawdowns have already been significant, particularly in the small-mid cap section of the market and we are optimistic that on a five-year view, current levels will prove to be an attractive entry point.

US Mid-terms Update

Last week's ongoing battle in the US midterm elections continues to highlight the shift of sentiment in US politics. The midterms, so called given the timing of the vote held at the midpoint of the sitting President's four-year tenure, act as an indicator of the popularity of the incumbent head of state.

Since Joe Biden's inauguration, the Democrats have controlled the Senate and the House of Representatives. This allowed Biden to pass most of his policy through Congress with little disruption. Even though history shows that the party controlling the White House will generally lose seats in the midterms, the Democrats have demonstrated one of the best outcomes in a midterm election in the last 20 years. The Republicans were able to carve out a small majority in the House, but Democrats narrowly retained control of the Senate. The result has created the potential for a two-year period of partisan gridlock where Biden struggles to pass any notable initiatives.

The midterms also revealed a divide within the Republican party. Doubts over Donald Trump's power over the Party have emerged following the underperformance of many of the Trump-endorsed candidates. Ron DeSantis, Governor of Florida, although yet to announce his 2024 presidential candidacy, is the leading Republican alternative to Trump in the polls. DeSantis first rose to prominence when he implemented a controversial early relaxation of Covid-19 restrictions in Florida during the Pandemic. He has since gained popularity following policies on worker pay, property and the environment. However, with the Republican National Convention not for another 18 months, we are still likely to see other candidates emerge.

As for markets, the resulting stillness in economic policy may be reassuring for investors and offer some stability in an otherwise turbulent year. Historic data shows that US stocks perform better under a split Government when a Democrat is in power, therefore the shape of the new Congress could be seen as positive news. Fundamentally speaking however, the economy still has some way to go before we can expect a full recovery. Better than expected inflation data at 7.7% last week saw markets rally in the hopes of a way out, but the Fed continues to raise interest rates and release commentary on the unacceptable levels of inflation. Their modelling shows that rates should in fact be somewhere between 5% and 7%, meaning we are likely to see further hikes and inevitable subsequent volatility in US markets. As much as politics have a say in investor behaviours, economic health is now the focus and we believe that it will be the actions of the Federal Reserve rather than the Federal Government which will drive returns in the short to medium term.

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