British PM Theresa May’s call for a snap general election in June was designed to help her secure more control ahead of tough Brexit negotiations with the EU. So far, the news has boosted both the pound sterling and hopes of a softer Brexit, but investors should expect more volatility during the run-up to the election.

**Key takeaways**

- The fallout of Mrs May’s surprise announcement will take time to process, and the unpredictable French elections could be a bigger focus for markets in the coming weeks.

- If, as expected, Mrs May’s Conservatives win a bigger majority, she would strengthen her hand at home as she goes into critical Brexit negotiations with the EU – at a time when the UK economy may be slowing down and living standards are set to become more challenging.

- The strong post-announcement rise in sterling was self-fulfilling, as previous short-sellers relinquished their positions; the currency could strengthen further if the Conservatives make gains and policy becomes more predictable.

- The party manifestos should make compelling reading for investors; look for insight into plans for fiscal spending, proposals for reduced austerity measures and sector-investing ideas (such as infrastructure, utilities and defence).
What happened

As UK politicians returned to work after the Easter break, British Prime Minister Theresa May surprised markets – and practically everyone else – by announcing a UK election for 8 June. It is the first snap election in the UK since October 1974.

Mrs May argued that an election was the only way to secure the strong and stable leadership the country needs for Brexit and beyond. She cited a lack of unity in the UK parliament on this issue. The move seems to be a calculated bid to secure more control – in parliament and within her own party – during the Brexit process, amid tough negotiations with the EU and the continued rumblings of her “hard-Brexit” backbenchers.

The day after Mrs May’s announcement, British members of parliament overwhelmingly backed her call for an election by 522 votes to just 13 – significantly more than the two-thirds majority required to trigger a poll.

Although the French elections may be the bigger focus for markets in the coming days and weeks – particularly given their unpredictable outcome – the UK election will be another important focal point.

In the immediate wake of Mrs May’s announcement, the British pound sterling rose to its highest value against the dollar since December. Given that sterling has been heavily shorted recently, its rise became a self-fulfilling event, as speculators relinquished those positions. Sterling’s strength may also be a sign that markets welcome the prospect of a “softer” Brexit than anticipated.

The announcement may also reflect that the UK’s bargaining position with the EU has looked weaker, and Mrs May recognizes the need to secure a strong mandate.

2 The likely outcome of the election is that the Conservatives will win a bigger majority.

Currently hampered by a fragile working majority of just 17, Theresa May’s government could be returned to power with a much more significant majority. This would considerably strengthen her hand. She would gain a mandate, both within the country and her own party, to deliver her version of Brexit – whether this veers more toward a hard Brexit (per the most recent rhetoric) or a more conciliatory approach. The truth is likely to be somewhere in-between. She would have a stronger bargaining position in her negotiations with the EU, while also reducing the influence of the hard-Brexit contingent within her own party.

Brexit will undoubtedly be a key issue during the election campaign – but not the only issue. In a statement, Tim Farron, the Liberal Democrat leader, argued that they are the only party that can “avoid a disastrous hard Brexit”. His centre-ground party scored a notable success in a December 2016 by-election on an anti-Brexit ticket. He may win support from disillusioned Labour voters and Conservatives who fear a hard Brexit.

Voters will, however, want to see the parties’ positions on a broader set of priorities – not just the economy, but also health and education, which are areas of key concern. The main opposition Labour Party, currently languishing in the polls under leader Jeremy Corbyn, will be hoping this is the case. Struggling to establish a clear position on Brexit, they will likely look to campaign on a broader social agenda.

3 The Liberal Democrats may re-emerge as an opposition force.

After forming a coalition government with David Cameron’s Conservatives from 2010-2015, the party was reduced to eight parliamentary seats in the 2015 general election. Recently they have had some success in positioning themselves as the anti-Brexit party – but opinion polls give them only around 10 per cent of the vote nationally. Any resurgence in Liberal Democrat support may do little to dent Theresa May’s majority.

The biggest threat to a Conservative return to power may be tactical voting by people opposed to Brexit. Indeed, the opposition to Brexit could harden as people are asked to vote on Mrs May’s “version of Brexit”. But to be effective, any tactical voting would need to happen on an unprecedented scale.

4 The announcement comes at a time when the UK opposition parties are struggling.

A recent ComRes opinion poll puts Mrs May’s Conservative party more than 20 points ahead of the main opposition Labour Party.

Mrs May has benefited from positive economic news in the UK. However, there are signs of higher inflation and, with the increase in household bills, a steady erosion in UK consumer confidence.
A final question is the impact on the relationship with Scotland, where the ruling Scottish National Party (SNP) has pushed for a second independence referendum. The SNP argues that Scotland, where a majority of people voted to remain in the European Union, should not be subject to a hard Brexit. The election will be a test of the SNP’s dominance in Scotland, where the economy has stalled in recent times. Any meaningful shift in support away from the SNP may make another independence referendum less likely.

**Investment implications**

- Theresa May’s announcement triggered big moves in sterling – and, by extension, the markets – after several weeks of calm. This increased volatility could persist during the weeks running up to the election.

- Markets appear to be reassured by the prospect of a clear Conservative win, giving Mrs May more control – at home, at least – as she negotiates an EU exit.

- Sterling may strengthen if Mrs May increases her majority and policy can become more predictable.

- The party manifestos should make compelling reading for investors. They will contain economic pledges that should provide insight into plans for fiscal policy. The main parties may look to rein in austerity measures, which would be positive for the UK economy as it moves through the Brexit process.

- The manifestos may also reinforce sector-specific stories:
  - Specific plans for infrastructure spending (eg, on schools and hospitals) may be revealed.
  - An emboldened government may take a harder line on utility firms, which have been in the cross-hairs for some time. A government green paper on competition in the retail energy market is due shortly.
  - Defence spending may become a renewed priority given the geopolitical uncertainty.
  - Also look out for any action on corporate governance in the manifestos. When she came to power, Mrs May pledged to put worker representatives on boards, but has since softened her stance.
  - The broader outlook for the UK economy shows that the consumer is going to be worse off this year, and UK retailers are likely to be the first to feel the effects.
  - This could create a dilemma for the Bank of England. While the added certainty of a Theresa May election victory might encourage the BOE to push ahead with interest-rate rises, it may be difficult for consumers to deal with higher rates in the near term. This could affect broader consumer sentiment.
  - Looking ahead, we expect some underperformance in gilts as a larger Conservative majority post-election potentially reduces hard Brexit risks in the short term. In this environment, a firmer sterling would help to lower the risks of higher inflation and, in turn, reduce the prospect of a sharper consumer slowdown this year than has been feared.