For professional investors only

UK Government and Budget Announcement

September 2022

We wanted to provide some comment on the change of Prime Minister and the cabinet, especially given the emergency (apparently not a) budget which was announced on Friday 23rd September by the new Chancellor Kwasi Kwarteng.

The policy focus of the Truss leadership is still a work in progress given she has taken office during what is a hugely turbulent economic period. The market reaction since then has been incredibly negative. UK stocks have fallen but the larger impact has been felt in the government bond market, with yields on UK 10-year government bonds soaring to levels not seen since 2008 and sterling, which has plunged to multi-decade lows versus the dollar.

Main Policy Announcements

- The basic rate of income tax will be cut by 1p to 19p from April 2023.
- A 1.25% rise in National Insurance to be reversed from 6 November 2022.
- The 45p tax rate for top earners over £150,000 will be abolished, also from April 2023.
- Planned rise on corporation tax from 19% to 25% is scrapped.
- Capping and subsidising domestic and business energy bills, which will cost c.£60bn for the next six months.

On the face of it, the majority of these policies are large in scale, and no doubt will cause debate around the short-term and long-term effects of such expansionary measures. The Treasury are clearly going for 'all-out-growth' in an attempt to both stimulate the economy and provide some cost pressure respite for both households and businesses.

What is of concern to markets is that this will need to be paid for through further debt issuance, potentially as much (or more) as an additional £72bn in the current financial year. As interest rates and bond yields have already increased markedly this year this will need to be done so at more expensive levels. Many are also worried that these policies could add further fuel to the inflationary fire, though the debate here is more mixed. Reversing a recent tax hike and capping energy costs may not prove inflationary, but the government is apparently planning to go further than this next year, which has since muddied the waters. When this is placed alongside a plummeting sterling it places more pressure on the Bank of England to raise base rates even higher than markets were expecting.

We have long been cautious on the UK gilt market and the impact that rising bond yields will have on portfolio values, and have as such been positioned defensively here, which has been a positive. The new government's policies, however, have more than the whiff of a gamble about them. These policies have ramifications for a swathe of asset classes, not just bond and sterling but UK stocks and shares also. The current environment, a weak sterling and worsening UK economic outlook, is more supportive for the UK's largest companies (which generate a significant proportion of revenues from overseas), and not the more domestically focused medium and smaller companies. Yet, the share prices of UK medium and smaller companies have been under pressure for nearly a year now, and are already reflecting a less

than rosy outlook (it could, of course, still get worse before it gets better). Should the government's policies pay off and we see an improving economic growth, sterling stabilise and borrowing costs settle, then this could well translate into better prospects for a swathe of UK companies, many of which are naturally competitive and leaders in their field. Nevertheless, there are clearly many unknowns from here and so we shall continue to monitor events closely, constantly evaluate our fund holdings and remain alert to risks as well as opportunities.

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