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CIO BLOG

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Laboured Breathing

UK PRIME MINISTERS SINCE 1900	YEARS IN OFFICE	TOTAL REAL RETURN ON UK EQUITIES (%)	AVERAGE OF GDP GROWTH
Conservative	**65**	**7.9**	**2.6**
Alec Douglas Home (1964)	1	-9.3	5.6
Andrew Bonnar Law (1922 - 1923)	2	20.6	4.2
Anthony Eden (1956 - 1957)	2	-8.0	1.8
Arthur James Balfour (1903 - 1905)	3	5.8	1.2
David Cameron (2011 - 2016)	6	5.1	2.1
Edward Heath (1971 - 1974)	4	-11.3	2.9
Harold Macmillan (1958 - 1963)	6	18.2	3.4
John Major (1991 - 1997)	7	13.9	1.9
Margaret Thatcher (1980 - 1990)	11	12.3	2.5
Marquess of Salisbury (1900 - 1902)	3	3.7	1.3
Neville Chamberlain (1938 - 1940)	3	-9.9	5.1
Stanley Baldwin (1925 – 1929; 1936 - 1937)	7	5.7	2.9
Theresa May (2017)	1	9.1	1.8
Winston Churchill (1941 - 1945; 1952 - 1955)	9	14.0	2.1
Labour	**37**	**7.7**	**2.1**
Clement Attlee (1946 - 1951)	6	-0.2	1.7
Gordon Brown (2008 - 2010)	3	1.6	-0.9
Harold Wilson (1965 - 1970; 1975-1976)	8	15.7	2.3
James Callaghan (1977 - 1979)	3	8.5	3.4
Ramsay MacDonald (1924; 1930 - 1935)	7	13.0	1.8
Tony Blair (1998 - 2007)	10	4.2	2.9
Liberal	**16**	**-0.7**	**0.1**
David Lloyd George (1917 - 1921)	5	0.7	-4.4
Henry Campbell-Bannerman (1906 - 1908)	3	3.9	0.4
HH Asquith (1909 - 1916)	8	-3.3	2.9
GRAND TOTAL	**118**	**6.7**	**2.1**

Not in living memory have local elections in the UK – coming in May – been beset by such fervour. Local councils aside, this will also be the most thorough litmus test of the national mood since last year's snap election. Conclusions will be drawn about the state of the parties nationally, most notably the potential for a Labour government at the next parliamentary elections. Judging purely by the headlines, the Conservative party is headed for a rout; and for some, this has raised the spectre of a future Jeremy Corbyn-led Labour government sharply raising tax rates, and even going as far as placing controls on capital.

An immediate observation – an obvious one when it comes to elections – is to not place undue faith in headlines (we feel even more vociferously about negative financial headlines, but that's another story). Prior to the general election in 2015, the one near certainty being touted by pundits was that neither the Conservative party, nor the Labour party, would win outright. They were wrong: David Cameron led the Tories to a reasonable, albeit small, majority.

Following his victory, he kept a promise to hold a national referendum on the "Brexit" question. Of course, guided by a battery of pundits, Mr. Cameron was convinced about

the near certainty of a "Remain" vote, on which his political future hinged. He lost, thus setting alight the political fortunes of Theresa May, the current Prime Minister.

The following year, in 2017, convinced her stars were finally aligned, Ms. May was lured into calling a new general election she had no need to call. Nonetheless, the near certainty of bolstering the slim Tory lead – and winning a mandate in her own name – appeared a no brainer. But her seeming masterstroke was made to a look like a reckless gamble; she lost face as her party lost seats. She has managed to stay on by cobbling a confidence and supply agreement with a tiny Northern Irish party which took its pound of flesh, but she is a far diminished figure.

Such tremendous miscalculations occur often and everywhere. It is not surprising: politics is ultimately dependent on human behaviour, therefore political outcomes are subject to as many vagaries as the human spirit. Moreover, this underlines an important lesson: the experts are often wrong, and near certainties can be anything but.

With that in mind, we explore the question of a change in government in the UK in the same way we attempt to unravel the unknowable future of financial markets: what does long-term history tell us?

Breathe again

While this election carries new and unexplored questions for the UK, we have looked back at 118 years for guidance. In that time, Conservative governments tend to deliver significantly better annual GDP growth compared to their Labour counterparts, 2.6% vs. 2.1%, respectively. Clearly, however, Labour governments are far from disastrous, delivering reasonable economic growth. In fact, every single Labour prime minister, barring one, Gordon Brown, saw the economy expand in their tenure. Removing the three "Brown years" – which most unluckily spanned from the pre-financial crisis peak to the post-financial crisis trough – there is even less difference between the two parties.

Moreover, there is no real change to equity performance regardless of whether there is a Conservative or Labour government. In the 37 years since 1900 that began with Labour running the government, UK equities were up 7.7% per year on average in real terms (adjusting for inflation). For the 65 years where the Conservative party held sway, UK equities were up 7.9% annually on average. There is hardly any difference between the two. Indeed, if anything, one might argue Labour has the better record: only one of its six prime ministers, Clement Attlee, presided over negative equity returns. On the other hand, no less than four of 14 Tory heads of government – Alec Douglas Home, Anthony Eden, Edward Heath, and Neville Chamberlain – saw total returns from equities fall in their tenure.

Interestingly, early in the twentieth century, when the now defunct Liberal party - a very different entity to today's Liberal Democrats – was in charge for 16 years, GDP growth and equity returns were both abysmal: 0% and -0.7%, respectively. In sharp contrast, under the stewardship of either Labour or Tory governments, over time, growth tends to be above 2% and risk-assets provide for excellent real returns. If anything, one should hope for a long and glorious reign of the two-party system – the only other party that ran the show did so with terrible results!

Another observation was teased out from the underlying data: there appears to be an impact on equity performance in years of political change. In years where there is no change in Prime Minister, equity performance averages

about 4.8%. However, in years where there is a change in Prime Minister, equity performance is 13.0% in real terms! While it is impossible to explain this, one likely reason is that investors are obsessed with all the things that can go wrong prior to an election, or in periods of political turmoil; arguably, we are in such a period now. Inevitably, when that election or choppy period has come and gone, investors realise that the UK's powerful national institutions remain strong and well-functioning; a sense of relief may well cause markets to rally.

Within that last finding, there is an important inference to be drawn about the value and depth of the UK's institutions. No matter who is in power, or what the pre-election rhetoric has been, a strong system of checks-and-balances exists. This helps temper any leftward or rightward careening of policy, nudging it back towards the moderate, widely palatable centre. In future, a potentially Corbyn-led government may well seek to change the economic model. Chancellor George Osborne certainly tried to fundamentally alter the social contract by making the UK a "lower tax, lower welfare" country under David Cameron's regime; but subsequent elections reversed much of those initiatives.

Moreover, any government would be flattering itself by taking too much credit for growth or investors returns: economies and markets are supremely complex, impacted by far more than just prevailing politics, and even policy. In the end, both major parties recognise the foundational role of market forces in the UK's prosperity, while both uphold that the provision of a welfare state is a basic principle of government. And while each period is always different, over the long arc of history – in respect to continuing growth and conditions conducive to favourable investment returns – the details tend to matter little.

Notes:

1) Total return calculated by taking the cumulative return/loss from capital appreciation AND income (dividends, coupons, etc) using Barclays Equity Gilt Study Data.

2) PM at beginning of year given credit for entire year

3) Real GDP data taken from a Bank of England continuous time series that runs from 1700. (1870–1913 Solomou and Weale (1991) balanced measure of GDP at constant 1900 factor cost;1913–20 Feinstein's Compromise index of GDP at factor cost available in Mitchell; 1920–48 Sefton and Weale (1995) balanced measure of GDP; 1948–2009 ONS GDP at factor cost, chained-volume measure, 2006 reference year prices.)