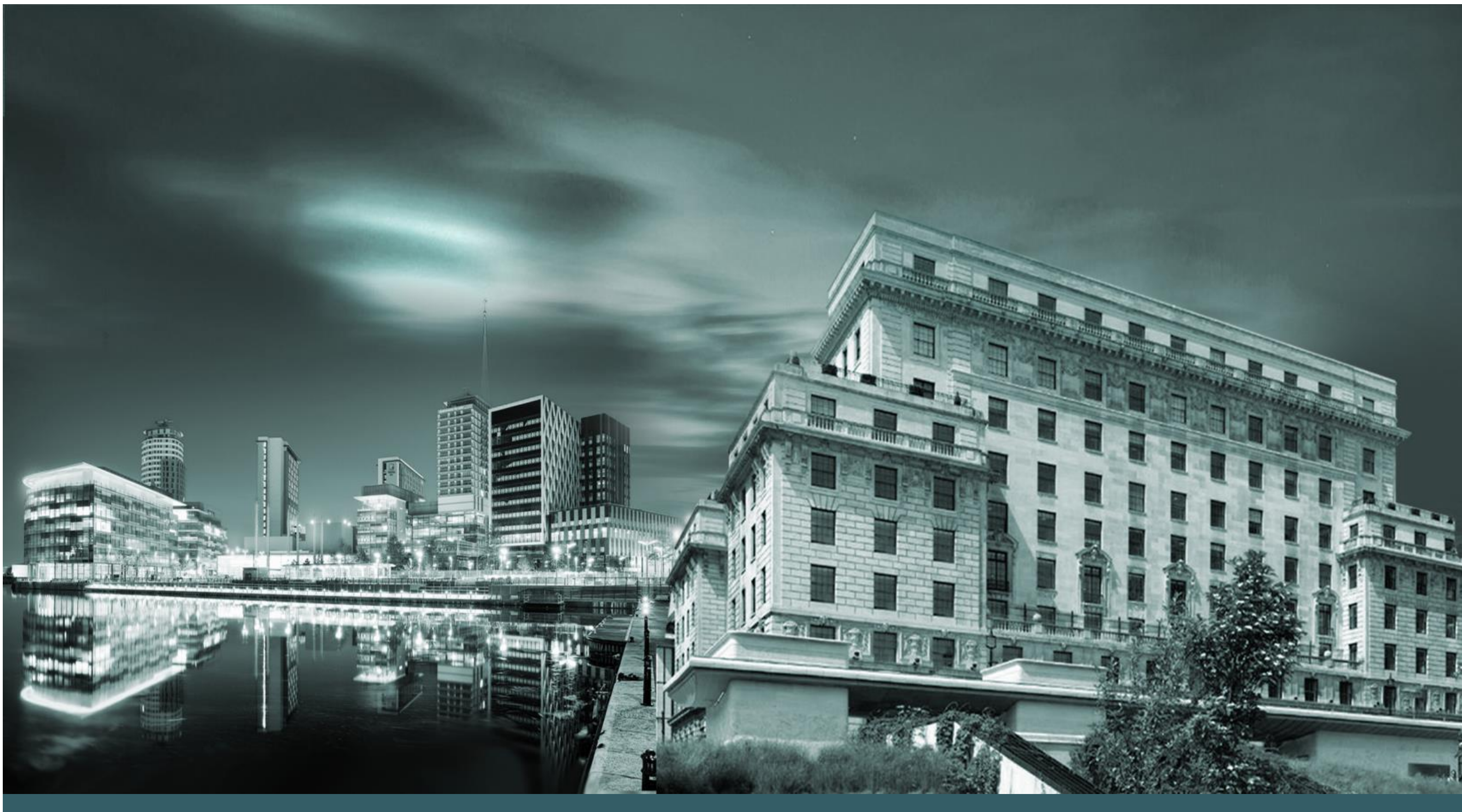
ARTORIUS WEALTH

INVESTMENT OUTLOOK

Artorius Wealth

May 2015



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Election response

The outcome of the General Election has brought about a more robust outcome than most commentators would have expected. The Conservatives maintained their improvement in polling with the 'normal' surge in shy Tories getting them into government.

A Tory majority

Whilst this may be 'best' in terms of economic policy, those with memories back to post-92 may remember that a small majority means that the 'rogue' element will have power, if the likes of Jacob Rees-Mogg would ever fit the description of a rogue. I am thinking of the issues such as Heathrow which the west London Tories will try and block the runway and political spite from the other parties may join them in blocking what most think is necessary for the country. Less necessary (in my opinion) is HS2 which may also be threatened if Central England Tory MPs have to be listened to. Putting aside the impact of local MPs on national projects, the economic outlook is clearer.

There is apparently a huge amount of money to be extracted through a clampdown on tax avoidance (mysteriously missed by all previous clampdowns). There is yet more money to be extracted from those on very high incomes saving in a private pension. The main rates of income tax, National Insurance contributions (NICs) and VAT will not be increased. The 'triple lock' on indexation of the basic state pension will remain and most pensioner benefits will be protected. There is a lack of any attempt to paint a coherent strategy for tax reform, by the Conservatives but is a critic of all major parties.

On cutting welfare benefit costs, the Conservatives have spent two years promising substantial additional benefit cuts of £12 billion a year whilst failing to come up with more than 10% of that figure in actual cuts.

The Conservatives are promising significant income tax cuts through further increases in the personal allowance and an increase in the point at which higher-rate tax becomes payable. Only 57% of adults now pay income tax, down from 61% in 2010---11, and of course further increases in the personal allowance will not help the 43% who pay no income tax.

For high rate taxpayers even under Conservative plans to raise that threshold to £50,000 by 2020-21, it will still be below where it would have been had it simply been uprated with inflation since 2010. Even with that increase, the IFS calculate the number of higher-rate taxpayers would increase from 4.9 million now to 5.3 million in 2020---21.

The Conservatives would like to reduce the annual allowance for those with taxable incomes over £150,000 so that it falls from £40,000 to £10,000 by the time income reaches £210,000. Why someone earning £150,000 should be able to save £40,000 in a pension while someone earning £210,000 should be able to save just £10,000 with tax relief is unclear. Note also that this policy discourages would-be pension savers on high incomes from increasing their incomes over this range, in a similar way to straightforward increases in their marginal rates of income tax.

The Conservatives, in contrast, would like to reduce the effective tax on some owner-occupied homes by effectively increasing the inheritance tax (IHT) threshold to £1 million for married couples whose main residence is worth at least £350,000 and is bequeathed to their children or grandchildren. It is also hard to see the economic or social question to which the Conservatives' proposed additional IHT allowance for housing is the right answer, and it is striking that they are proposing this despite Treasury advice that 'there are not strong economic arguments' for the policy. Offering additional IHT relief for owner-occupied housing can only increase the distortions in the tax system both in favour of owner-occupation and against trading down. Tax incentives that effectively lock older people into bigger and more expensive properties do not look helpful.

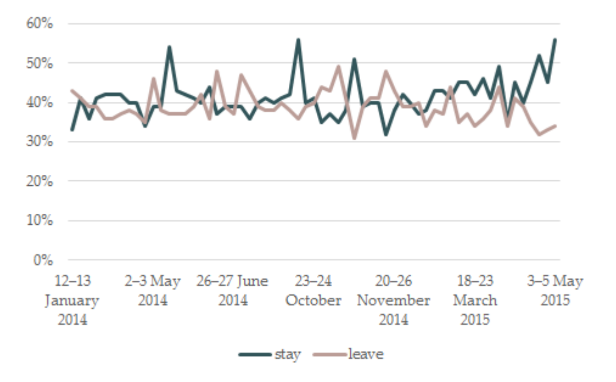
For business and investment the Conservative Party's manifesto included:

- A pledge to set a 'new, significantly higher, permanent level for the Annual Investment Allowance' (the amount of investment a firm can immediately deduct from profits for tax purposes). Having reduced the allowance from £100,000 to £25,000 in April 2012, the coalition subsequently 'temporarily' increased it again, first to £250,000 and then to £500,000, its current level. The level is currently due to fall back to £25,000 in 2016.
- A pledge to retain tax incentives for films, theatre, video games, animation and orchestras.

BREXIT fears overdone?

The Conservatives have promised a referendum on membership of the EU in 2017. Whatever renegotiations take place and concessions won, opinion polling around 'staying' or leaving the current arrangements appear to favour staying. We think that once this is appreciated by investors in coming months, the latent fear over a BREXIT should dissipate. This should support sterling's value.

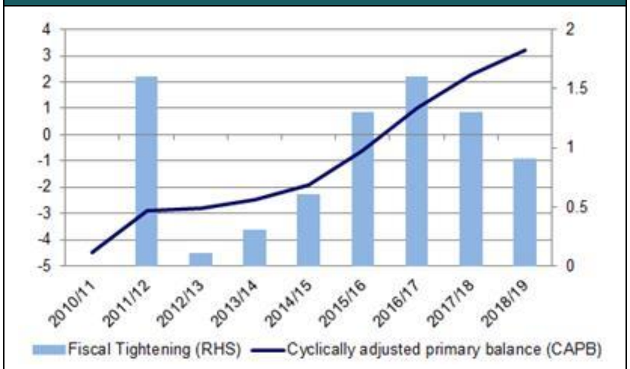
UK opinion polls on leaving the EU



Source: Opinion polls

Against the improving political backdrop economic challenges remain. Fiscal austerity is an economic necessity despite the populist reaction in Scotland.

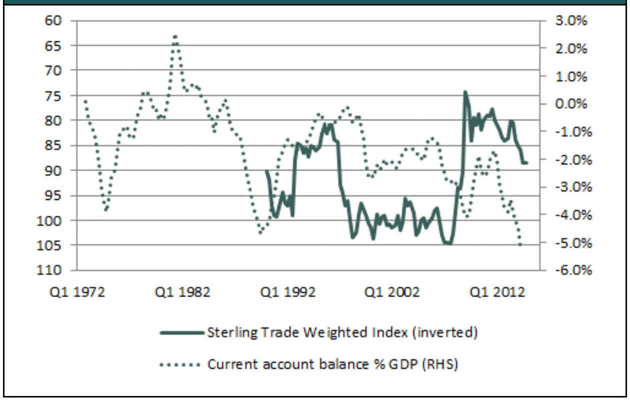
Austerity to return post-election



Source: Artorius Wealth

Fiscal policy is due to tighten markedly in 2016-17 after a period between 2012 and 2014 when policy was relatively loose. Policy proposals from the main political parties vary in degree but the direction of travel, i.e. further tightening either by further spending cuts or tax increases is common. In such an environment we expect the UK economy to slow.
With this this view from the perspective of markets, sterling remains unattractive, especially with the Chief Economist at the Bank of England openly acknowledging the possibility of further monetary policy stimulus, in contrast to market expectations of an interest rate rise.

Large UK current account deficit points to a fall in sterling



Source: Artorius Wealth

Unanswered questions that are raised by the election result include the relationship between Scotland and the rest of the UK and further evidence that the first past the post electoral system is deeply flawed.

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