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Press Release

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Election 2010: what will it mean for UK investors?

It has been one of the worst-kept secrets in political history, but today we finally have confirmation that the UK General Election will be held on 6 May, the same day as local elections in England.

In spite of widespread predictions of a hung Parliament, or at the very least the closest election result since 1974, late last week bookmaker Ladbrokes was offering odds of 1-6 on a Conservative victory, with Labour at 7-2 and the Liberal Democrats a 200-1 long shot.

But what does the election augur for markets? Research by F&C Investments looking at market returns (as measured by the FTSE All-Share Index) in the month following an election indicates that an uncertain outcome is likely to be unpopular. In the last election to produce a hung Parliament – February 1974 – the All-Share fell 14.52% in the month following polling day, while the narrow Labour victory in the second election of October that year saw the All-Share rise by 1.67% in the following month. (It is worth remembering, however, that 1974 was an exceptionally bad year for stockmarkets, with the FTSE All-Share ending the year more than 50% below its starting position.)

Interestingly, though the Thatcher years are seen by many as the golden age of free-market capitalism, the FTSE All-Share fell by 7.66% in the month following Margaret Thatcher's victory (with a majority of 43) in 1979, and by 1.55% following her re-election in 1983 with a significantly larger majority of 144. In 1987, however – the post-Big Bang year that culminated in Black Monday – the All-Share rose by 5.95% in the month following Thatcher's third victory, a gain only surpassed in the past 46 years by John Major's election

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win in 1992 with a drastically reduced majority of 21. The month after this arguably surprising victory saw the All-Share rise by 7.08%.

So what are the likely market responses to a range of election outcomes? Ted Scott, director of UK strategy at F&C Investments, has come up with a set of predictions based on the most likely results.

A hung Parliament

Because of the way the electoral boundaries are set it is estimated that the Tories require about a 10% lead in the opinion polls to win a working majority, much more than Labour would need. A YouGov opinion poll on 31 March put the Conservative lead at 6%, on 38% versus Labour's 32%, which would be insufficient to produce a conclusive result.

The initial reaction of both the equity and gilt markets to a hung Parliament would probably be sharply negative. Markets hate uncertainty and if neither party had a workable majority there could be a further hiatus in policy decision making. Because of the dire state of the public finances, action is required sooner rather than later and a hung Parliament would, therefore, be the worst outcome. A second election would probably be called unless the winners could form a minority government in alliance with the Liberal Democrats.

To some extent the markets are already beginning to price in the prospect of a hung Parliament. Equity markets largely traded sideways in the early part of this year following the strong rise in 2009, although more solid gains have been achieved recently. Government bond yields have been increasing, reflecting the growing concerns about the UK's public finances. In addition to signs of distress in the gilt market, sterling has been increasingly weak on the foreign exchange markets.

If a hung Parliament was declared and we still had no clearer policy intentions as to how the public sector deficit was to be reduced, then gilt yields would probably spike higher still and equity markets would fall in sympathy.

A Conservative majority

A sizeable Tory majority would be treated positively by the market, especially as it would be a surprise given the opinion polls. Markets would welcome a change of Government after what has been perceived as several years of economic mismanagement under the current Labour administration. While Labour have committed to bringing the deficit down it is commonly viewed that the Conservatives have both more discipline and the willpower to act and are, therefore, more likely to implement the necessarily austere measures that would retain the UK's AAA credit rating. Indeed, George Osborne has made the preservation of the credit status as one of eight stated benchmarks for the party.

A small majority would hinder the incoming government's ability to govern effectively. The Tories would not have the confidence that comes with a larger majority to implement measures that are unpopular to the electorate for fear of losing the majority in by-elections or not getting the legislation through parliament. It may have to compromise on the austerity of its measures or seek cross-party support from other parties, in particular the Liberal Democrats (see below). That said, following the hung Parliament in May 1974 the incoming Labour government called a second election in October and won a majority of just 3 seats and yet managed to hang on to power until Mrs Thatcher came to power in May 1979.

A Labour majority

A large Labour majority would be even more of a surprise than a Tory one. It would be a vindication of Gordon Brown's stewardship of the economy and underline his authority in a party that has been weakened in recent months as he has been forced to make concessions to other members of the cabinet. These include the Chancellor, Alistair Darling, who is believed to be in favour of being more upfront about what is necessary to improve the public finances. The markets would probably react negatively to such a result but if the Government did respond with an austere emergency Budget, markets should recover much of their losses.

A minority government would be welcome news for the Labour party but from the market's point of view the ensuing uncertainty, just as under the Conservatives, would be unsettling. Although it would be a positive result for Gordon Brown given his personal unpopularity with the electorate, media and even some ranks of his own party, his lack of authority may force a change of leadership ahead of a second General Election. Under a different leadership, Labour would have a much better chance of gaining a workable majority.

A cross-party alliance

During the Labour Government of 1974-79 it struggled to govern effectively for long periods because of the tiny size of its majority. By 1977, after losing some by-elections it had a minority government again and was forced to reach agreements with smaller parties to be able to govern, including the ill-fated Lib-Lab Pact with the Liberal Party under David Steel.

A similar scenario could occur in the event of a minority government with the forthcoming election. The obvious partner for either the Conservatives or Labour would be the Liberal Democrats under the leadership of Nick Clegg, although the more important person may be viewed as Vince Cable, the Shadow Chancellor. Cable has had a 'good recession' and is credited with some prescience with regard to the credit crunch. While the markets would not welcome the idea of a minority government, a coalition with the Lib Dems may bring some equanimity to equities and bonds. Cable is known to be more hawkish with regard to sorting out the public finances and would, therefore, demand severe policy measures to attack the public sector deficit, something that is likely to be welcomed by both the rating agencies and the markets.

Having said that, as recently as 15 February Clegg said that he would not enter a coalition in the event of a hung Parliament. However, he made clear that he would try to extract support for key reforms and policies that the Lib Dems regard as important in return for working with the new administration. Again, this may help calm the markets as it would mean that the Government would have more authority and the influence of Cable would bring more discipline on public financial policy.

In conclusion, Scott said: “The period up to and shortly after the General Election is vital for the UK both from a political and economic point of view. The election has come at a bad time for the economy and markets because of the lack of key policy decisions ahead of polling date at a time when action is urgently needed. This will only increase the risk of a financial crisis developing that may involve the economy lapsing back into recession. The reaction of the markets following the election depends on the outcome achieved, but even a hung parliament may not be bad news for markets if a working relationship is put together with the Lib Dems that enables decisive government. Ultimately, the bond market vigilantes may force the issue so whatever the election result, significant policy measures will be taken to address the burning issue of the UK’s public sector debt.”

- Ends -

Market performance in the month following a General Election, 1964-2005

Election date	All-Share level	1 month later	All-Share level	Election result	Change
15/10/1964	106.85	13/11/1964	102.71	Lab win, maj 4	-3.87%
01/04/1966	104.82	29/04/1966	105.07	Lab win, maj 96	+0.24%
19/06/1970	127.10	17/07/1970	124.53	Con win, maj 31	-2.02%
01/03/1974	138.40	29/03/1974	118.30	Hung	-14.52%
11/10/1974	75.28	08/11/1974	76.54	Lab win, maj 3	+1.67%
04/05/1979	283.82	01/06/1979	262.09	Con win, maj 43	-7.66%
10/06/1983	443.87	08/07/1983	437.00	Con win, maj 144	-1.55%
11/06/1987	1138.39	10/07/1987	1206.18	Con win, maj 102	+5.95%
10/04/1992	1232.15	08/05/1992	1319.37	Con win, maj 21	+7.08%
02/05/1997	2142.25	30/05/1997	2200.91	Lab win, maj 179	+2.74%
08/06/2001	2881.26	06/07/2001	2649.60	Lab win, maj 167	-8.04%
06/05/2005	2448.06	03/06/2005	2503.35	Lab win, maj 66	+2.26%

Source: Bloomberg/Datastream/F&C Investments

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Notes to Editors

F&C Investments

- F&C Asset Management (F&C) is an independent London Stock Exchange listed asset management group with around 100,000 shareholders.
- F&C traces its origins to 1868 with the launch of Foreign & Colonial Investment Trust, the first ever publicly listed investment fund. Foreign & Colonial Investment Trust remains a client of F&C.
- F&C is an active fund manager with a multi-specialist investment model where individual teams have strong accountability for their products and processes. The group is also an active shareholder with a leading franchise in governance and sustainable investment.
- F&C manages £97.8 billion (€110.2 billion) of assets* for a diverse range of institutional, insurance and retail clients across all major asset classes – equities, bonds, cash and property – as well as alternative and specialist product classes. F&C invests globally and has been a longstanding investor in emerging markets.
- F&C has three pillars to its strategy: *Advisory & Solutions* – the servicing of strategic partners and the provision of investment solutions and overlays such as shareholder engagement programmes, Liability Driven Investments, Asset & Liability Management, Multi-Manager and Fiduciary Management; *Alpha Investing* – active fund management across a diverse range of asset classes and markets but with a focus on UK and European equities and fixed income and Emerging Markets; *Environmental, Social & Governance Investing* – building on its market leading presence in ethical investment with new products.
- F&C REIT Asset Management is the group's global property asset management business. It was formed in 2008 from the merger of F&C's property division and REIT Asset Management. F&C REIT operates from offices in London, Dublin, Munich, Mumbai and Stockholm.
- F&C manages assets principally from three investment centres: London, Amsterdam and Edinburgh. The group has a global office network spanning a dozen countries: China (Hong Kong), France (Paris), Germany (Frankfurt & Munich), India (Mumbai), Ireland (Dublin), The Netherlands (Amsterdam), Portugal (Lisbon), Sweden (Stockholm), Switzerland (Geneva), UK (London, Edinburgh, Dorking) and the United States (Boston).
- In March 2009 F&C signed a Memorandum of Agreement with Hua Xia Bank, one of China's twelve nationwide joint stock commercial banks, to establish a joint venture fund management company in China in which F&C will have a 19.5% interest.

* As at 31 December 2009.

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