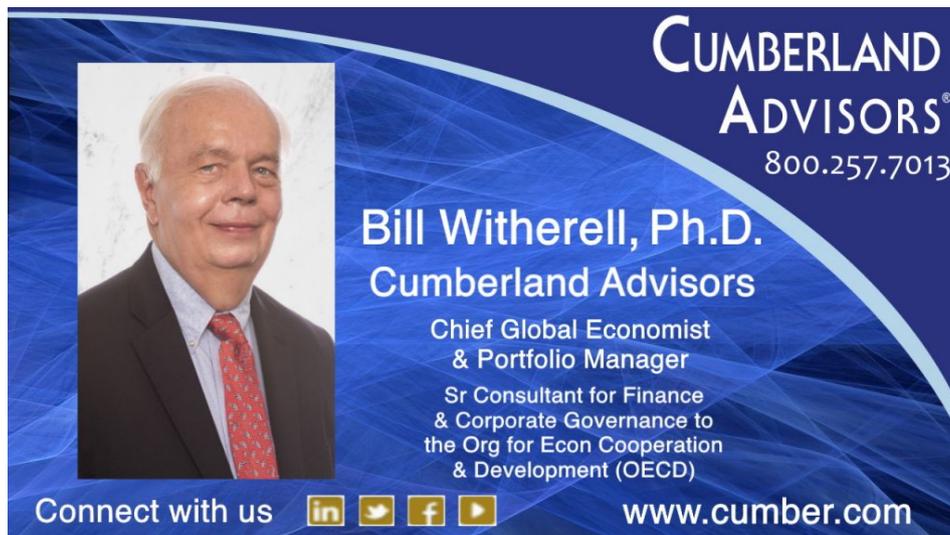


Cumberland Advisors Market Commentary – UK Voters' Dilemma: Johnson or Corbyn?

On December 12th, UK voters will participate in a general election to determine the composition of the next government. The manifestos of both the Conservative Party and the Labor Party contain elements that should concern investors.



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Jeremy Corbyn's hard-left Labor Party intends to convert the UK into a socialist economy through sweeping nationalizations (railways, broadband infrastructure, postal services, energy utilities, and water), large increases in taxes on business and investments, and seizure of 10% of the equity of large corporations, along with a massive increase in government spending and investment. While they had a chance to win voters who have had enough of the years of austerity and slow growth under the Conservatives, Labor instead promises attacks on the private sector and investors which can only reduce prosperity. The Financial Times, pulling no punches, calls the Labor manifesto "a recipe for decline" that "will wreck the UK economy."

The Conservative (Tory) Party, with a sizable lead in the polls, presents a more business- and investor-friendly

election manifesto but with its leader Boris Johnson's populist tilt. Modest spending increases are coupled with a pledge not to increase taxes, a commitment that may prove difficult to fulfill. Investors certainly will not welcome the Conservatives' putting the risk of a no-deal Brexit very much back on the table, nor the unrealistic trade-deal plans they have promised. More on Brexit prospects below.

Neither of the leaders of the two major parties inspires confidence. Corbyn and his close advisers have moved the Labor Party to the far left. His apparent desire for a near-Soviet form of socialist economy is coupled with charges that he has been friendly with terrorist organizations and tolerates anti-Semitism in the party. Johnson's brief, unimpressive period as prime minister, which has included an illegal five-week suspension of Parliament, an instance of lying to the Queen, and the loss of his working majority due to splitting his party, caps a history of purveying populist misinformation and resorting to bluster, including offensive comments about Muslim women, black people, and gay people. Joanne Kate Swinson's centrist Liberal Democrat (Lib Dem) party has little chance of securing a majority, with its 11 percent support in recent polls, but could come to play an important role should neither the Tories nor Labor secure an outright majority.

The issue of Brexit is central to this general election. This is not surprising, as the public is sharply divided, as are the two major parties, on the question as to whether the UK should leave the European Union, and if it leaves, on what terms. The Tory election manifesto is titled "Get Brexit Done, Unleash Britain's Potential." They promise to get the UK out of the EU by the end of January 2020, by passing the Withdrawal Agreement Johnson agreed with the EU. That looks doable if the Tories win a majority. However, Johnson has set December 31, 2020, as the deadline for completing negotiations on the future trade relations of the UK with the EU, ruling out any extension of this period. This timetable looks highly

unrealistic for such a complicated negotiation and raises a new, serious risk of the UK's leaving the EU at the end of 2020 without such an agreement, that is, of there being a highly disruptive no-deal Brexit. Moreover, Johnson promises to have 80 percent of the UK's trade covered by free trade agreements with the other main trading partners within the next three years, another very difficult and probably impossible outcome.

Under a Labor government, Brexit uncertainty would extend for some time as well. Corbyn, faced with a split in the Labor Party on the Brexit issue, is taking a neutral position on Brexit. Labor is calling for a renegotiation of the Withdrawal Agreement, aimed at achieving a "less hard" Brexit and then a referendum on the resulting agreement. This would open the possibility that the public could vote to reject the agreement and remain in the EU.

The Lib Dems have presented a confusing message with respect to Brexit. They started with the promise to have a second referendum to permit the public to again decide whether to exit the EU or to remain. They then replaced that idea with a promise to scrap Brexit by revoking the Article 50 exit process, placing the party fully in the "remain" column.

The polls continue to project a Conservative majority, and such an outcome appears to be priced into the market along with an assumption that a no-deal Brexit will be avoided. Over the last 90 days, covering a period beginning with high Brexit uncertainty and ending with the prospect of a Tory victory in a general election, the iShares MSCI United Kingdom ETF, EWU, has gained 10.13% on a total-return basis, which is above the 9.61% gain of the iShares MSCI Eurozone ETF, EZU.

A Tory victory would likely yield the most positive near-term developments for the UK economy. The Brexit uncertainties have discouraged business investment and contributed to slowing the UK economy almost to a standstill in the current quarter.

Reducing these uncertainties should permit GDP growth in 2020 to pick up to a pace of 1.5%, compared with 1.3% this year and a quarter-to-quarter advance of just 0.2% in the current quarter. However, beyond 2020 the negative effects of the UK's breaking away from the EU and its Common Market with either the relatively "hard Brexit" that Johnson promises or, worse, a "no-deal Brexit" will have a dampening effect on the UK economy. The uncertainties will linger until trade negotiations to establish free trade agreements with the EU, the US, Japan, and others are successfully concluded.

The chances for either Labor or the Lib Dems to win an outright majority appear to be limited. But a hung Parliament with no party's having a working majority could occur. That outcome would lead to a more extended period of Brexit and to economic policy uncertainty. Should the Lib Dem Party become king-maker, the prospects for a softer Brexit or even remaining in the EU would increase. Should Labor play a role in a coalition government, its radical economic plans would likely have to be moderated, and again the prospects would be higher for a softer Brexit or a second referendum, possibly leading to the UK's remaining in the EU. The Scottish National Party could play a role in exchange for support for a second independence referendum. The heightened and extended uncertainty that would follow a hung Parliament would be a significant drag on the economy and the stock market in 2020.

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Sources: Financial Times, Barclays, Goldman Sachs Research, BBC.com, The Economist, cnbc.com.

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