

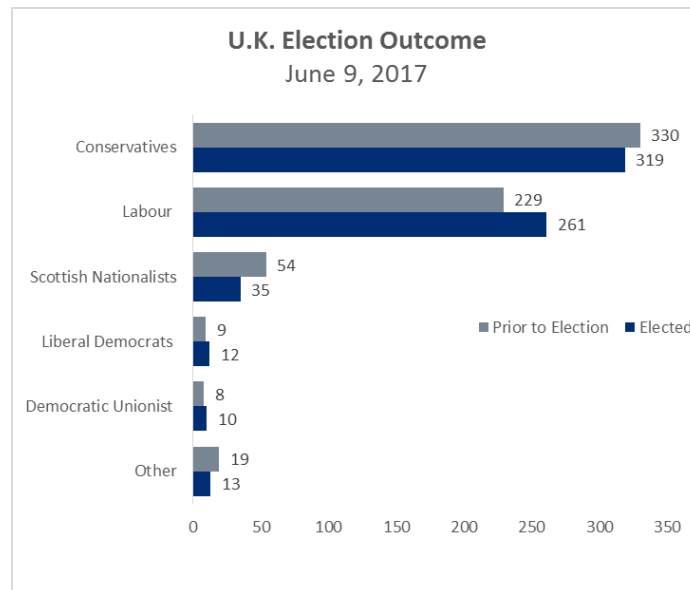


U.K. Election 'May'-hem

Eric Lascelles, Chief Economist, RBC Global Asset Management

In April, U.K. Prime Minister, Theresa May called for a snap election three years ahead of the needed date. At the time, her Conservative party had a 20% lead in the polls and she wanted to consolidate power, grow an already-present majority, and gain an additional few years of potential negotiating time for Brexit. However, in an unfortunate British pattern, yet another Prime Minister has misjudged the public mood, calling for a vote that has ultimately swung badly against them. On the heels of last year's surprise Brexit vote, the election held on Thursday June 8 has failed to deliver the expected majority for May's Conservative party, resulting in a hung parliament.

A hung parliament, another way of saying a minority government, is one in which no party secures the number of seats needed to govern with a majority. With 650 seats up for grabs, 326 seats are required to achieve an absolute majority in the House of Commons. Prior to this election the Conservative party held a slight majority of 330 seats, and they now hold only 319 seats – seven seats short of a majority government. The Labour party, led by Jeremy Corbyn, secured 261 seats, filling 32 seats that they didn't have prior to the vote. The results for the remaining parties are highlighted in the chart below.



Source: RBC GAM

How did the Conservatives lose their majority?

There are two underlying narratives driving why the Conservatives fell short of a majority government. The first narrative is a consolidation of the votes into the two largest parties while the second focuses on the success of the Labour party. For context, the Conservatives garnered the highest share of the vote in thirty years at 42.4%. However, in the past, votes remaining were very fragmented, allowing for larger Conservative wins. Meanwhile, the Labour party ran a clever campaign that de-emphasized a hard Brexit and emphasized economic issues that matter to the average person. Their successful campaign allowed them to capture 40.1% of the vote, their highest in 16 years.

What will the new government look like?

The government that is most likely to form is one in which the Conservatives attempt to govern as a minority with the support of the right-leaning Northern Ireland Democratic Unionists Party (DUP). This will probably not be a formal coalition, more of an issue-by-issue and budget-by-budget approach since the DUP is arguably too small for a formal coalition to work. These coalition-type governments tend to be more fragile and tend to last for a shorter period of time than a majority government.

Another less likely scenario is that the Labour party tries to form a government. This would require the cooperation of five parties to secure more seats than the Conservatives – and it isn't likely that this government would function. Meanwhile, the Labour party and some members of the Conservatives party have called for Prime Minister May to resign. While speculation abounds around whether or not this will indeed occur, we are of the belief that there is a considerable risk of this occurring in the weeks to come – especially given that Brexit negotiations are set to begin in ten days. There is also a possibility of another snap election within two months if this government struggles to govern.

What does this mean for Brexit?

The overall implications favour a somewhat softer Brexit. At the same time, it increases the level of uncertainty around the negotiations and it therefore isn't inconceivable that an even harder Brexit scenario could play out. There are four main scenarios we envision could play out:

1. **No Brexit:** The election results could be viewed as a rebuke of Brexit given the repudiation of Conservatives who called the Brexit referendum, and stronger support for the Labour party who support a softer Brexit. Additionally, the minority government could trigger additional elections in which some parties shift to an anti-Brexit stance and make the election something of a second referendum.
2. **Softer Brexit:** Given that the Labour party, which favours a soft Brexit, did surprisingly well, and that the tentative Conservatives coalition partners favour a soft Brexit with a single market approach, this scenario is more likely than it was before, and perhaps is now the most likely outcome.
3. **Hard Brexit:** The prospect of a Hard Brexit has fallen given that the Conservatives were the main proponents of this and they lost their majority.
4. **Extreme Brexit:** The risk of a scenario where no agreement is reached between the U.K. and the EU has gone up considerably. In this situation, the U.K. would simply tumble out of the EU without a deal given the prospect of a minority government that struggles to negotiate coherently and tries to pass the difficult legislation that will inevitably arrive with Brexit.

While the main global implications of this election outcome are around Brexit, this surprising result indicates that there are still significant anti-establishment forces at work globally, which increases uncertainty in the markets. All in all, the market interpretation has been small and slightly conflicting. The pound is down moderately (2%), yields are currently a bit lower and these both tend to be associated with risk off trade. However, global stocks which prefer the softer Brexit and weaker pound are up. Much remains to be seen in the coming weeks and months.

Publication date: June 9, 2017

This article is not intended to provide individual legal, accounting, tax, investment, financial or other advice and is for informational purposes only. Specific investment strategies should be considered relative to each investor's objectives and risk tolerance. The information contained herein is provided by RBC Global Asset Management Inc. (RBC GAM) and believed to be up-to-date, accurate and reliable. Information obtained from third parties is believed to be reliable but RBC GAM and its affiliates assume no responsibility for any errors or omissions or for any loss or damage suffered. RBC GAM reserves the right at any time and without notice to change, amend or cease publication of the information.

This document may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may", "could", "should", "would", "suspect", "outlook", "believe", "plan", "anticipate", "estimate", "expect", "intend", "forecast", "objective" and similar expressions are intended to identify forward-looking statements. Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risk and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made by the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events. The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

