

Uncertainty – what markets hate most

By Tom Stevenson , 07 May 2010

Investors seek safe havens as sovereign debt fears in Europe and an indecisive UK election see a collapse in risk appetite

Financial markets hate uncertainty more than anything and investors face it in spades on Friday morning. The UK looks certain to be headed towards a hung parliament – in which no party can claim an overall majority of seats – after a tense night of counting set against a backdrop of a computer-trading driven plunge in the US stock market.



During a spectacular half hour period on Wall Street on Thursday, the Dow Jones index fell by almost 1,000 points after genuine selling on the back of European sovereign debt fears was apparently compounded by technical automatic trading reminiscent of the computer-fuelled market crash in 1987.

"Investors had hoped for decisive action along the lines of the measures previously adopted in the US and UK."
Tom Stevenson

The US market bounced back quickly but still ended the session more than 3% lower with follow on losses in Asia on Friday morning setting the stage for another difficult day on European bourses.

The sell-off was triggered by seemingly complacent comments from the European Central Bank president Jean-Claude Trichet who said at Thursday's ECB press conference that he was not even discussing the possibility of buying up government bonds in a bid to stem the spread of the sovereign debt crisis from Greece to other peripheral European countries.

Investors had hoped for decisive action along the lines of the measures previously adopted in the US and UK.

If UK investors hoped that the British election would provide some clarity they looked like being disappointed at the end of a night in which an early exit poll predicting a hung parliament looked ominously prescient.

With only a handful of seats still to declare during the day on Friday it looks increasingly likely that the 2010 election will be lost by the incumbent Labour government but not won by the opposition Conservatives.

Rarely tested constitutional convention means that the failure of the Conservatives to achieve at least 326 seats (half the total) leaves the existing government in pole position to attempt to forge an alliance with the Liberal Democrats, who despite a disappointing performance hold the balance of power.

Although the Conservatives will win the largest number of seats, they may not get to form the next government if Labour can create a workable pact with the Lib Dems.

For investors, the election result is just about the worst outcome because it opens up the possibility of an extended period of back-room horse-trading with all the uncertainty and inaction that implies.

Early trading on Friday morning confirmed the market's negative reaction. The FTSE 100 index lost around 1%, completing a dismal week for the UK's equity benchmark. At 9am, the market was 49 points lower at 5,212.

Benchmark bonds were also lower, with 10-year gilt yields 5 basis points (hundredths of a per cent) higher at 3.85%. Sterling took a battering on the foreign exchanges, falling to \$1.47, a year low. The euro rose against the pound by almost a penny to 86.6p.

With investors looking for swift and decisive action to cut the UK's deficit – the largest in Europe – the hung parliament is a poor outcome that will further unsettle market sentiment.

Markets have been relatively patient during the pre-election period, accepting that in the run up to a tight vote none of the main parties were likely to give too much away about the scale of the fiscal consolidation that all tacitly accept is inevitable. They are likely to be less forgiving in the days and weeks ahead.

Having seen the market fall by close on 10% since the recent peak in the middle of April, investors will hope that much of the uncertainty is already priced in. But this is not a time for heroic bets. A well-diversified portfolio, both geographically and between asset classes, will provide the greatest reassurance in the difficult days ahead.

Note the value of an investment and the income from it can go down as well as up, so you may get less than you invested. The ideas and conclusions in this column are the author's own and do not necessarily reflect the views of Fidelity's portfolio managers. They are for general interest only and should not be taken as investment advice or as an invitation to purchase or sell any specific security. Past performance is not a guide to what may happen in the future. Investments in small and emerging markets can be more volatile than more established markets. For funds that invest in overseas markets, changes in currency exchange rates may affect the value of your investment.