



Challenges in assessing political risks

While the risks from political events in 2018 flashed attention grabbing headlines, the impact on markets was mostly subdued. Outside of the Brexit issue, which weighed heavily on the Pound and the FTSE, investors mainly looked beyond the political noise to focus on the prevailing fundamentals. The UK's fundamentals deteriorated as the Brexit debate raged on, with consumer confidence falling and industrial production slowing and turning negative in late 2018.

Some recent events suggest that markets are to some degree starting to discount political risks.

Issue: Talks between US and North Korea

Despite the optimistic rhetoric from US President Trump on the prospects for success at the second summit with North Korean leader Kim prior to the meeting, the outcome ended without a deal and revealed significant gaps in position between both countries. The failure of the talks to deliver significant progress is a potential concern on two fronts. The first concern cited is how to set the stage for follow up discussions given the way the talks reportedly broke down, and the immediate rhetoric thereafter. The second is the extent that an unresolved North Korea issue may impact how the US will construct discussions with China over trade.

The lack of success in Hanoi disappointed observers, and markets in Asia fell on the news that the talks ended early.

Issue: Latest India-Pakistan conflict

On February 14, a terrorist from the Pakistani side of Kashmir launched bombing on Indian forces. India forces were mobilised to bomb what they claim was a terrorist training facility on the Pakistani side and the Pakistani military responded, with both sides shooting down aircraft. These current hostilities are now considered to be the most serious since India and Pakistan fought a war in 1971.

Investors in India and Pakistan have been accustomed to border skirmishes. However, stocks across Asia retreated on news that two Indian jets were shot down in Pakistan.

Issue: Brexit

The Brexit issue lingers with the March 29 deadline approaching rapidly. The inability of UK Prime Minister Theresa May to gain support for the previously negotiated Brexit deal with the European Union continues to generate uncertainty for both investors and businesses. While fear of a hard Brexit is declining, and the Pound has recovered some of its losses, an extended period of uncertainty will certainly weigh on confidence and the economy.

Any hope for a concrete Brexit outcome now seems remote.

Issue: Elections

Malaysia's abrupt change of government in 2018 should serve as reminder that change can come unexpectedly. With three Asian elections in the second quarter of 2019, investors will be pricing in the uncertainties. Thailand heads to the ballot box on March 24, Indonesia's turn will come on April 17 and India follows most likely between April and May.

In a nutshell, markets are more likely to fluctuate prior to these election results due to the risk premium involved.

Conclusion

We hold the opinion that the lasting impact on markets is limited with regard to the Trump-Kim talks. And while there were some initial harsh statements from the North Korean side, subsequent comments continue to suggest a desire to continue to engage with the US. Meanwhile, India–Pakistan issues are a more immediate threat which investors hope will de-escalate. Any further escalation would most certainly weigh on Asia markets. Given that chances of a hard Brexit have diminished, the Pound is likely to be range-bound, with potential short term up-side on confirmation that the hard Brexit option has been removed. However, longer-term prospects for the UK economy will influence the path of the currency. As predicting election outcomes remains a risky affair, investors should monitor developments closely. We will be monitoring closely to see if pro-business candidates win mandates in all of the pending elections. With the market increasing its sensitivity to geopolitical shocks we are inclined to moderately reduce risk exposures.

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