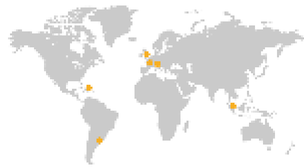

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The pound in your pocket

Former Labour Prime Minister Harold Wilson, following a sterling crisis in 1967, famously said that a devaluation of sterling did not affect the value of the pound in your pocket. He was wrong. The ongoing weakness of sterling since the EU referendum in June 2016 has in fact had a number of knock on effects to UK businesses and consumers.

The winners have, broadly, been major FTSE 100 listed businesses, many of which are in fact global titans, that derive most of their earnings from abroad but just so happen to account in sterling. For them, the effective devaluation was a bonus. Anyone bringing funds into the UK for some reason has also benefitted: for an overseas buyer of prime London residential property, a combination of a weak pound and a weak market have resulted in savings probably close to 50% from the peak. The domestic market of smaller and mid cap sized companies also offers bargains galore to the foreign buyer. There are plenty of companies whose values have suffered against the backdrop of uncertainty surrounding Brexit and sterling.

"The challenge now facing investors is where next for sterling?"

Who are the losers? Us really. Food and imported goods such as cars all cost more, and holidays are more expensive. In the lifetime of the average British adult, this is yet another occasion when one will feel poor travelling to other developed foreign countries.

The challenge now facing investors is where next for sterling? To us, it seems a broadly binary outcome, almost entirely dependent upon what happens with Brexit in the coming months – which will in itself also determine the likelihood or not of a snap election. No deal, or a harder than expected Brexit, is almost certain to result in a further drop in the pound. A combination of no deal and a general election going horribly wrong could easily send sterling to $1.10. However, a soft Brexit, or indeed anything perceived by markets as a ‘good deal’ is likely to result in a rebound, probably to a US dollar exchange rate of up to $1.45 – a 10% uplift from where we are now.

Our crystal ball is currently as foggy as the next person's. However, part of an investment manager's job is to mitigate risk when it seems sensible to do so. It is for this reason that we have shifted tack in our US exposure.

"Our crystal ball is currently as foggy as the next person's."

For several years we have been happy to be fully exposed to the dollar (thus benefitting from sterling weakness). But if the country pulls victory from the Brexit jaws of defeat, sterling will recover sharply. To protect values, we have already started to mitigate this risk by hedging a portion of our US equity exposure, thus removing the currency risk. In the deeply uncertain times we live in, this seems the prudent option.

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