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Election results: what does it mean for investors?

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On May 7 the UK faced its most uncertain election in a generation where a soothing outcome for markets was hard to imagine.

Today's surprise announcement of a majority Conservative government is an important and encouraging result for the UK economy and its bond and equity markets. Whilst the UK has been relatively stable, both politically and economically, the prospect of an unstable coalition and a second general election could easily have unnerved international and domestic investors. The Conservatives have a reputation for fiscal credibility and international investors as well as International Organisations like the IMF will welcome the announcement of a majority government. However, political uncertainty has not gone away altogether. During his second term, Prime Minister, David Cameron will be at the mercy of the fringe elements in his party although the better than expected general election result should buy him a period of grace.

David Cameron has said he will lead a government for "one nation" and will make "Great Britain greater". Speaking outside 10 Downing Street, he said he believed the country was "on the brink of something special". Mr Cameron said he would reach out to all parts of the UK and strive to "bring the country together". In the wake of the SNP's election landslide in Scotland, where they won 56 out of the 59 seats, if Mr Cameron delivers on these pledges then this will be a great achievement indeed.

The focus will now turn to the long term implications of a strong Tory victory. Markets will now consider the risks that the Conservatives' pledge for an EU referendum in 2017 may pose. Recent polls suggest that the UK's desire to leave the European Union is waning but as the recent election highlighted, opinions can change. The new Government has two years to negotiate changes to the nature of Britain's relationship with Europe. Germany has no wish to see the UK leave the EU, both as a financial contributor and as a free market counterweight to the statist model of France.

The combination of a Conservative government and the SNP's overwhelming victory in Scotland also raises the prospect of a second Scottish referendum and a question mark remains about the viability of our Union.

The initial market reactions to the result of the election were positive. Sterling strengthened as fears over coalition government negotiations disappeared. Equity markets rose led by sectors expected to be squeezed by Labour such as banks. Gilts rallied on the prospect of continued austerity that will put downward pressure on interest rates. Specific areas of the market such as UK smaller companies, where valuations look attractive relative to the broader market, should perform well under a government with a pro-business stance.

The real driver of UK equity markets will continue to be the global economy and Europe will be particularly important as the UK's largest trading partner. This together with the US economic recovery and the prospect for interest rate rises will have the greatest impact. The majority Conservative government does remove much political uncertainty from the markets and their pro-business stance is deemed a positive by the markets. Potential impediments such as the EU Referendum and the continued rise in Scottish Nationalism will remain and are likely to increase during the current term.