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The Attractions of the UK Equity Market

The UK Equity Market is Well Placed to Deliver Attractive Returns for Patient Investors

The UK equity market has been out of favour due to events such as Brexit and the perceived lack of cutting-edge technology businesses. Arm Holdings, for example, is now listed on Nasdaq. This compares to the so-called “Magnificent Seven” (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla), which are all listed in the US. In addition, the Truss economic experiment in September 2022 did little to encourage international investors to allocate capital to the UK equity market. Whilst these events have been unhelpful for the owners of UK-listed shares, we think there are grounds for optimism. The UK equity market is home to some high-quality, market-leading businesses trading on attractive valuations. Furthermore, the economic backdrop is improving, boosted by falling inflation and the prospect of falling interest rates. Further support could arrive courtesy of international investors who are considering strategic allocations to attractively valued UK equities. For example, the Novo Nordisk Foundation – which owns 28% of Novo Holdings A/S, the world’s 12th-largest listed business – is looking to increase its investment portfolio in the UK. The CEO recently said the UK remains a “very appealing” investment destination. Interestingly, the Foundation is the largest shareholder in Convatec, a UK-listed medical technology business. Convatec is a core holding in Ocean Equity and recently reported very encouraging preliminary financial results.

Why Do We Like the UK Equity Market?

The UK economy is in reasonable shape. Unemployment is relatively low, at 3.9%, whilst GDP growth is forecast to be 0.8% in 2024 and 1.9% in 2025, according to the Office for Budget Responsibility (OBR). Furthermore, household savings are relatively high, whilst robust corporate balance sheets support confidence and the desire to spend and invest. Importantly, inflation is coming down, with many commentators, as well as the OBR, forecasting it to fall to around the Bank of England’s 2% mandated level during the second quarter of 2024. This backdrop should give the Bank of England the confidence to start cutting interest rates. Current consensus suggests there will be 75bps of interest rate cuts in 2024, taking the headline rate to 4.5%, and a further 75bps of cuts in 2025. The housing market is showing signs of recovery, with modest increases in both house prices and transaction volumes. It should not be underestimated that the UK is an attractive place to do business and ranks second by European countries to attract foreign direct investment (FDI), according to the EY 2023 UK Attractiveness Survey. Whilst France held on to top spot for total project numbers, the UK once again ranked highest in Europe for new projects and continued to deliver more total jobs and jobs per project than France and Germany. Importantly, we think this improving operating environment, combined with very reasonable valuations, bodes well for investors both invested in and considering the UK equity market.

Whilst the UK equity market is attractively valued – the FTSE 100 trades on a forward PE of c.10x – it also has a number of businesses that are world-class. Halma (mission-critical electrical manufacturing technology), Compass (outsourced catering) and Ashtead (rental of industrial equipment) are just three examples. In addition, many of these businesses are managed by experienced teams with outstanding records of guiding companies through turbulent times whilst delivering attractive returns for long-term minded shareholders.

If well managed UK-listed businesses continue to trade at depressed levels we are highly likely to see increasing levels of merger and acquisition (M&A) activity. For example, UK-listed Spirent, which tests 5G telecommunications networks, looks set to be acquired by US-listed Viavi Solutions at a c.60% premium to its depressed share price prior to the bid. The point here is that if fundamentals do not reassert

themselves acquirers are well placed to buy quality assets on the cheap. Whilst we would rather UK-listed businesses remain independent and markets function properly in order to benefit UK plc, others are ready to take advantage. Electrical retailer Currys is currently being bid for, whilst Nationwide has bid for Virgin Money and Pollen Street has bid for Mattioli Woods. In addition, portfolio holding Dechra was purchased in 2023 at an attractive premium.

Following Brexit and the rise of populism since 2016, we think that a new centre-left Labour government could be a positive for the UK equity market. Starmer and Reeves can deliver the much-needed benign political environment that would allow companies a clear pathway for investment. This in turn might provide international investors with another reason to allocate to the UK. We think Labour are likely to be market-friendly and broadly echo the Blair administration of 1997-2010. In fact, many of the Blair hierarchy are firmly behind Starmer and Reeves and are generally fairly pro-business.

In conclusion, we think the UK equity market has been overlooked for too long and is well placed to reward long-term-minded investors, due to a combination of valuation, world-class businesses, an improving economic backdrop and a potentially benign political environment.

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