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Five reasons to be positive on UK equities

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The UK stock market has been unloved and undervalued by investors for some time now. Yet we believe it's already reached a turning point and is an attractive environment for active fund managers.

Investment update — 10 December 2020

1 The UK has under-performed the rest of the world in 2020

Global stock markets plunged during the first quarter as the coronavirus pandemic pushed the pause button on large parts of the economy. UK equities dropped by a similar amount to the rest of the world. In local currency, the FTSE All Share Index fell 34% from the February peak to the March trough, while the MSCI World Index lost 25% over the same period.

However, there's been a notable difference in the shape of the recovery. Measured in local currencies, the FTSE All Share has risen 38% from its March low, which is an incredible nine-month return in itself. However, this performance pales in comparison to the MSCI World, which is now 60% higher.

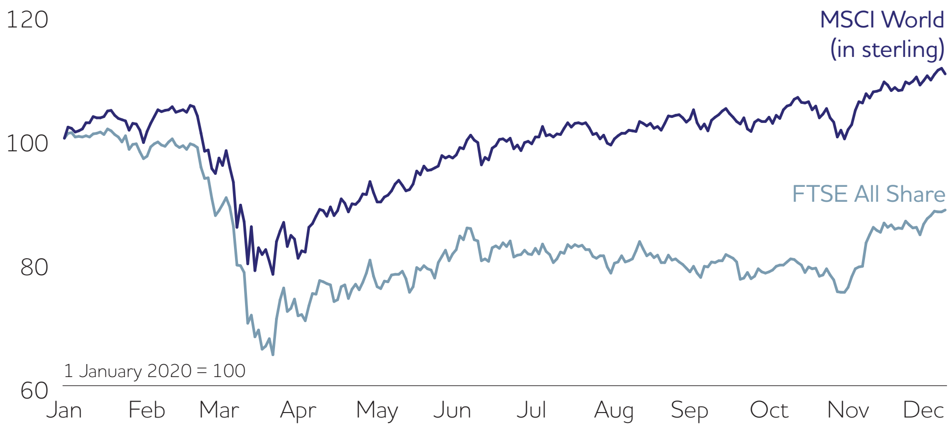
Notably, the pattern shifted during November with the UK stock market outperforming in sterling terms. The MSCI World gained 10%, but the FTSE All Share rose 18%. Although it's only a short period of time, we believe it's indicative of the potential for the UK to catch up.

We don't believe it's a Brexit bounce. Trade talks are ongoing and although there's still the possibility that the UK and European Union will be unable to agree a deal, we're assuming they will reach a meagre one at the last minute. Whatever the eventual details, investors will at last be able to look ahead with more certainty.

Ready for a rebound

After a period of underperformance, UK equity valuations look very attractive

Source: Bloomberg (as at 8/12/2020)



2 The UK economy is set to benefit from a return to a more normal environment

This recession hasn't been like any other that has come before. Typically, the manufacturing sector takes a hit and services stay relatively stable during a downturn. Yet services have taken most of the pain this time, while manufacturing has held up relatively well. It's an important factor because the UK has a large services sector, which makes up about 80% of the economy. This means the UK economy should benefit from the return to a more normal environment.

The UK's track record with vaccinations is strong. In 2018, the country was ranked second globally on influenza vaccination rates (behind Korea), suggesting we are well positioned to recover from this pandemic more rapidly than other badly hit economies.

3 The recovery should benefit some sectors more than others

The UK economy is more heavily weighted to sectors that stand to benefit most from the recovery – including financials, industrials, materials, consumer discretionary and energy – than its global counterparts. Notably, most of these sectors are cheaper in the UK than abroad.

The UK is often seen as an old economy stock market, unlike the US, which is new economy and packed full of innovative technology companies. In this recovery, these old economy stocks are likely to perform better.

4 UK companies are cheaper than similar overseas businesses

UK shares are currently available at a 40% discount to global shares, which is very compelling from an investment perspective. To confirm our valuation case, we analysed three UK companies that we have invested in our funds and compared them with their global competitors:

GlaxoSmithKline's shares are trading at close to half the price of Pfizer's. Although Pfizer has helped to develop an effective Covid-19 vaccine, Glaxo has a similar one in the pipeline. We are currently invested in GlaxoSmithKline in the Omnis UK All Companies and Income & Growth Funds.

Based on the cash flow that BP is generating, its share price suggests it's worth 60% less than the cash that ExxonMobil generates. We are currently invested in BP in the Omnis UK All Companies and Income & Growth Funds.

Over the past 18 months Unilever's share price has been getting cheaper compared with Nestlé's shares. We are currently invested in Unilever in the Omnis UK All Companies Fund.

5 Our active fund managers are finding attractive investment opportunities

In sterling terms, over the past three months the FTSE All Share has beaten the MSCI World. We don't invest in the index passively because we believe in the value of active management. We invest in funds that are able to identify exciting businesses that are positioned to benefit as the UK economy recovers.

For example, the Omnis Income & Growth Fund's largest holding is Kingfisher, which owns B&Q and Screwfix. Its share price fell significantly in March with the rest of the UK market, but performed very well over the rest of 2020 and is poised to continue to do so into 2021. In the Omnis UK Smaller Companies Fund, the fund manager has substantial holdings in industrials and consumer stocks, which are sectors that should do well in the recovery. Both of these funds have outperformed the FTSE All Share and MSCI World indices over the past three months.

Key takeaway

We believe the case for investing in UK assets is compelling. Our economy and stock market should be prime beneficiaries of the vaccine-related recovery and we think our funds are well placed to enjoy the shift as headwinds turn into strong tailwinds.

If you'd like to find out more about our approach to investing or have any other questions about your portfolio then please contact your financial adviser.

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