

# 8.24%

The total return of UK equities over the last decade

See pages 20-35

For full fund and trust performance statistics

15

## Chris Rush Multi-asset manager



In our opinion, UK equities remain an area of substantial opportunity relative to wider equity markets. The UK equity debate has many parallels and crossovers with the ongoing value versus growth discussion. It is probably fair to say that while UK equities remain extremely unpopular, the opinion that they could offer significant upside from here is more widely accepted – though just as importantly not widely adopted.

### Being unpopular is never easy

We have seen a raft of fund manager departures within the value space, some high profile and some less so. However, while many value funds have been removed from prominence, the effect on UK equity funds has been much broader in nature, as UK assets have suffered significant outflows across multiple strategies. Concerningly, the major outflows from the IA UK equity sectors (UK All Companies and UK Equity Income) occurred in earnest from June of this year, shedding circa £100bn worth of assets – more than was lost in the coronavirus drawdown.

As mentioned previously, the idea that UK equities could be an area of opportunity from here does not seem too contentious; we have a relatively strong government at least by European standards, our own currency and some world beating companies. However, as with all investing, timing is everything and those multi-asset propositions which have heavily favoured UK assets have suffered a difficult period of performance. The MSCI United Kingdom index has underperformed the MSCI World in nine of the last ten discrete calendar years and by 75% in the last five years. Much like the underperformance of value investing over the last decade, attempting to time when to go long UK equities has been close to a

widow maker trade.

### The wrong kind of companies?

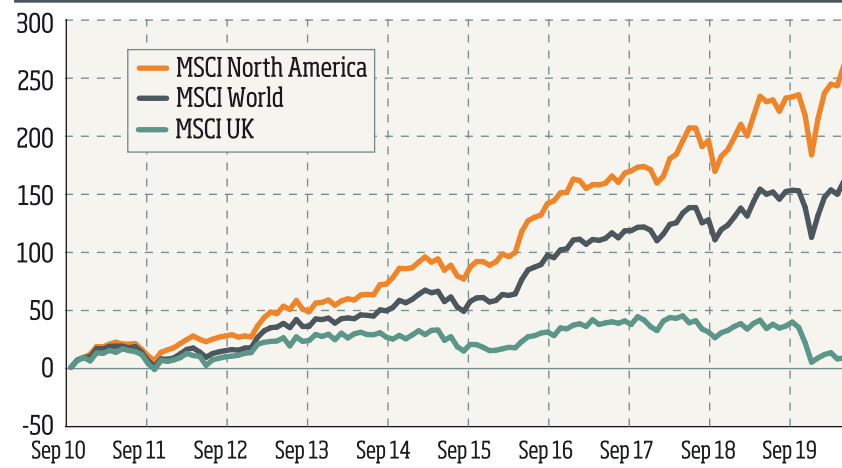
The reasons why UK equity stocks have been so unpopular are relatively easy to identify. The average UK index is heavily weighted to areas of the market that have become increasingly less popular including oil, tobacco, and finance. These areas have fallen out of favour for multiple reasons – ESG factors, Brexit uncertainties and value versus growth to name a few. While I believe all of these points are pertinent, I do think that they are perhaps the symptoms rather than the cause, and would hazard a guess that the biggest reason for the UK's unpopularity is less to do with what the FTSE contains but rather what it is lacking.

We need only look at the most popular stocks and areas in the world currently and over the last five years to identify that technology companies have been driving returns for almost all areas and across portfolios. The US FAANGs (and Tesla) are some of the most discussed stocks having accounted for a huge proportion of US returns over the last five years and in the recent market bounce back. The UK, in keeping with wider Europe is, for the most part, bereft of the companies necessary to benefit from this major tech based trend and has therefore struggled because of it on a relative basis. In short, we maybe just don't have enough of the 'right' kind of companies.

A small portion of the UK has benefited from the outperformance of technology firms. In fact, many of the best-performing UK funds have large exposures to technology companies that sit within AIM. This sub-area of the market has seen stellar returns that have been almost comparable to the aforementioned US technology companies.

Though the lack of major tech

### 10-yr performance UK equities, global equities and US equities (%)



Source: FE fundinfo

players has limited the upside potential of the UK over recent years, it is worth considering that the different shape of the UK equity market could be a positive for those constructing multi-asset portfolios. We would argue that the UK is one of the few geographies that provides real diversification away from the concentrated style risk many other areas of the market have so far benefitted from but which also makes them vulnerable to a tech-based pullback. Anybody who doesn't think this will ever happen is in our opinion being potentially naïve.

### Currency

Another factor that needs to be considered is currency. Until recently the dollar had strengthened almost uninterrupted from 2014 against pound sterling, acting as a significant tailwind to all international assets. We have begun to see the reversal of this long-term trend and the tailwind has quickly turned into a currency headwind. This headwind has so far been offset by phenomenal gains in US assets, but if the dollar were to weaken (or the pound were to strengthen through for example, a better Brexit outcome) at the same time as US equity markets struggled then it would be domestic UK assets that provide much needed diversification.

### Valuation

Not only do UK assets deliver

diversification in a world where diversifying assets are much harder to come by, but UK assets look very cheap on many traditional valuation metrics, trading back at levels last seen almost a decade ago. This valuation opportunity can even be observed over the short term as the UK has failed to recoup all the losses of the coronavirus period.

Within our UK holdings we are looking to identify a range of UK managers with the track record and ability to take advantage of these valuation opportunities.

This means selecting managers who can capitalise on the volatility and negativity surrounding UK assets in what could be a once-in-a-lifetime opportunity. Some managers we favour include Ed Legget, manager of Artemis UK Select; George Godber, manager of Polar Capital Value Opportunities; Margaret Lawson, manager of SVM UK Growth; and Henry Dixon, manager of Man GLG UK Income.

We would, however, caution that in multi-asset investing diversification is key, and while we are positive on the potential of UK assets from here, the trends that have dominated recent history could continue for some time longer.

*Chris Rush is senior investment manager at IBOSS*

### Discrete calendar performance

	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
<b>MSCI UK</b>	16.32	-8.82	11.71	19.16	-2.21	0.5	18.43	10.19	-1.84	12.27
<b>MSCI World</b>	22.74	-3.04	11.80	28.24	4.87	11.46	24.32	10.74	-4.84	15.28

Source: FE fundinfo

14 September 2020

[investmentweek.co.uk](http://investmentweek.co.uk)