

Black Friday – finding value in the UK

November 2023

A Black Friday bargain?

Black Friday has become a much-touted occasion for consumers to 'pick up a bargain' – conveniently timed ahead of forthcoming Christmas celebrations. However, it is often accompanied by suspicions that prices are hastily put up beforehand only to be reduced for the big day.

While finding a bargain is a more difficult thing to quantify when it comes to long term investing, in this article below Liontrust fund managers make the case for the benefits of investing in the UK – a market which has been notably undervalued in recent years.

The government has been examining potential interventions which could help to stimulate investment in the UK stock market, for example, as in the Mansion House Compact of July, as covered below, when the chancellor Jeremy Hunt and some of the largest UK pension funds agreed [an investment target of allocating 5% of pension funds in unlisted UK equities](#) by 2030.

Meanwhile moves to encourage investment in UK equities, including through the establishment of a 'British' ISA in which all investment would be in UK firms, have also been proposed by industry specialists and investor groups. Venture capital investor BGF and investment bank Singer Capital Markets coordinated a letter with 93 signatories – including the broker Panmure Gordon and Liontrust – which called on the chancellor to establish a British Isa to incentivise people to invest their full £20,000 ISA allowance in domestic businesses.

Whether it's small caps or large caps, gilts or investment trusts, a number of our fund managers talk about why they believe there are reasons to be optimistic about the UK.

James Klempster, Fund Manager, Multi-Asset team

While the UK stock market has underperformed the year to date, we believe it could turn versus the other major markets. The UK has significant exposure to the energy and financial sectors and while energy has weakened this year from the highs it saw in 2022, we believe that the financial sector is poised to do well and should benefit from a more forgiving yield curve and higher prevailing yields than we have seen for many years.

It is hard to predict when the UK will turn, but to our mind it will not require a major catalyst. Global investors can avoid the UK but then they would be ignoring an undervalued market. The UK outperformed other developed markets last year but there is still a long way to go, particularly if the value rotation continues.

Small caps

As in the US, smaller companies have suffered amid recent selloffs but longer term, we continue to believe in the small cap premium and the short-term re-rating could represent an opportunity. Overall, smaller companies in the UK should benefit from the same broad themes as the large cap market, with additional sensitivity to domestic economic conditions, whether positive or less so.

Gilts

UK gilt yields are back to the levels seen under Truss-enomics but without the cacophony of panic. While the spike in yields was a symptom of panic then, similar levels seen now seem to have had a relatively muted reception. Yields have drifted up from around 0.7% at the start of December 2021 to well above 4.0% as of 15th November (source: Bloomberg), and these could continue to rise in line with base rates.

We believe that gilts now offer the prospect of delivering real yields over four to five years once the inflationary spike abates. Gilts currently offer their best value in a long time, especially on a longer-term view, but we do not expect they will be a substantial driver of portfolio returns. Overall, we consider gilts to provide a useful function as portfolio insurance in times of market duress but believe they offer little more than a cushion to equities.

Victoria Stevens, Fund Manager, Economic Advantage team

There is a clear level of pessimism still baked into share prices, particularly at the lower end of the market cap scale. Many businesses are clearly experiencing some degree of impact from broader macroeconomic pressures, however, on the whole we feel that our companies in the Economic Advantage funds are trading robustly, with around three quarters of the Fund's holdings announcing in-line results or even upgrading expectations. Despite this show of resilience, a large number of stocks are trading on very low valuation multiples, offering extremely rare levels of longer-term upside opportunity.

While it is easy to wonder whether the extremity of the valuation gap between UK stocks and those listed on other global markets will persist in perpetuity, in the Economic Advantage team we are increasingly optimistic that there are several catalysts which may yet turn the tide strongly in favour of UK equities.

Mergers and acquisitions

One is M&A activity. 14 companies across the Economic Advantage fund range have experienced inbound M&A interest since the start of 2022: five takeovers have completed, six are pending (with several set to complete in the very near term), and three companies have had approaches which have since fallen away. While M&A activity is always a double-edged sword, at the very least it does help to crystallise in investors' minds the level of latent value within share prices at current levels, and provides an influx of capital for recipients to redeploy across other holdings where they see such attractive opportunity.

A government intervention?

Another potentially meaningful catalyst is the possibility of government policy intervention. Much has been written about July's "Mansion House Compact", which saw the chancellor Jeremy Hunt and a number of the country's largest pension funds agree to invest 5% of assets by 2030 in "unlisted equities" – a definition which includes stocks quoted on the Alternative Investment Market (AIM), where over 20% of the Fund's NAV is currently invested. Last week saw an initiative launched by industry which proposed the idea of introducing a 'Great British ISA', where savers benefiting from tax incentives would be required to invest in UK-listed companies within the ISA wrapper.

It seems clear that, in recent weeks, the momentum has accelerated behind calls for the government to recognise the need to stimulate UK equity markets and ensure that our domestic stock market retains its status as a thriving venue for companies to list and prosper for the long term. We cannot help but feel eager to bang that drum.

James de Uphaugh, Fund Manager, Edinburgh Investment Trust

James de Uphaugh takes a look at the potential value offered by UK investment trusts

In the investment trust arena, a good indicator of whether a sub-sector is hot or not is the premium or discount to its net asset value (NAV). The UK equity income sector trades at an average discount of 4% according to JP Morgan – while Edinburgh Investment Trust's discount is wider at about 8%. So rather cool. Many other investment trust discounts are wider still.

There are many factors that drive the UK income trust sector's average discount but most are either fading in impact or in the rear view mirror: Brexit gave international investors the excuse to ignore UK equities that were down to about 4% of their benchmark indices. UK investors were also sellers – both wealth managers and private investors. So were pension schemes. That is the past.

Looking forward, the UK equity market's valuation is low on multiple metrics and is riddled full of companies with strong strategic plans that give them clear blue water in terms of revenue and earnings relative to Covid. We believe domestic investors are yet to appreciate that.

Meanwhile, international corporates are acquiring UK companies – Hotel Chocolat was snapped up last week – and UK companies themselves are big buyers of their own shares. In the case of Edinburgh Investment Trust, our portfolio is focused on 50 holdings, each deeply researched by a team that have produced a strong performance record since appointment.

This is where the value can lie with UK investment trusts. In many, including the Edinburgh Investment Trust, you invest in shares that are cheap in a vehicle that is itself priced at a discount to NAV; the double discount with a respectable yield paid quarterly.

For a comprehensive list of common financial words and terms, see our glossary at:

<https://www.liontrust.co.uk/learning/our-guide-to-financial-words-and-terms>

Key Risks

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The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

Investment in the Fund involves foreign currencies and may be subject to fluctuations in value due to movements in exchange rates. The Fund may invest in emerging markets/soft currencies or in financial derivative instruments, both of which may have the effect of increasing volatility.

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