FINANCIAL PARTNERS

Unloved and ignored but ready for a bounce?

Weekly Digest

9 September 2019

– *Michael Clough*

They have had their time in the sun with periods of success. In the last couple of years though they have underperformed peers with a lacklustre showing. Today, they are largely ignored with not many expecting outperformance in the near term. No, I'm not talking about my beloved Reading Football Club, I'm talking about the similarly overlooked UK equities. In recent years, the UK market has been a classic case of market fundamentals being overshadowed by macroeconomic and political noise. With under two months to go until the October 31st Brexit deadline and with the UK seemingly no closer to resolving negotiations with the EU than immediately after the referendum in 2016, it is no great surprise to see the UK as the chief laggard amongst global equity peers. Going forwards though, should economic and corporate fundamentals remain as resilient as they have proved over the last three years, valuations today potentially provide an attractive buying opportunity for those willing to bear the shorter term risks.

The UK equity market is currently valued at a 23% discount to the global equity market, based on a forward price-earnings (P/E) ratio of 12.8x vs 16.6x for global equities. For instance, the average forward P/E multiple today for the five largest UK house builders is 8.2x, relative to the average US house builder on 11.7x. The five largest UK listed banks are valued at an average of 8.4x, compared to the average US bank valuation at 10.3x. Clearly these businesses have their idiosyncratic differences, but it highlights the clear valuation discount in UK equities.

Other signals portray a similar message. For example, data to July end from the Investment Association (IA) reveal combined net retail sales, or flows, from the three UK equity sectors: IA UK All Companies, IA UK Equity Income, IA UK Smaller Companies have been negative for every month in the last year except one. Elsewhere, a number of investment trusts investing in UK commercial property sit on large discounts today in excess of 10%.

These statistics cast a negative light on the asset class, but certain characteristics should lead us to challenge the consensus anti-UK view. The most widely documented is the extent to which UK companies generate revenue overseas, quoted at around 75% for large caps. Sterling weakness has served to benefit these names. Even for small and mid caps, where there have been concerns around the more domestic nature of the companies, it is estimated at around 50% on average. As such, company fortunes are not as tied to the UK economy and consumer as their UK listings would suggest. Furthermore, companies continue to make healthy profits and deliver earnings growth despite the negative headlines.

So, they are most certainly unloved and ignored but those are traits we are not afraid of at Momentum. We are happy to maintain significant allocations to UK equities in portfolios. Our investment team is meeting this week to discuss the breakdown of our UK equity allocation, our underlying managers and the potential decision to increase smaller companies exposure across portfolios. On today's valuations UK equities look attractive and whilst political uncertainty has led the market to turn its back and might lead to further derating in the short term, once corporate fundamentals return to focus, there is potential for a significant return to form. On a personal note I'm hoping for a similar fate for Reading FC. Perhaps UK equities have more chance of a near term bounce though.

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The **Marketplace**

- Increased confidence abounded in US-China trade talks
- Global equities gained on the week
- Brent crude returned 1.8% for a second week, ending the week at $61.8 per barrel
- Gold fell 0.4% ending the week at $1507.1 an ounce

Market **Focus**

US

- US large cap equities gained 1.8% on the week - within touching distance of their July 26th record. Gains were led by energy and technology stocks. Small cap stocks fared less well
- Factory orders rose 1.4% in July, their strongest gain in a year
- US Jobless claims rose by 1K to 217K versus and estimated drop to 215K. Payrolls rose by 130K versus a forecast of 160K
- US Treasuries fell 0.2% on the week.

Europe

- European equities gained 2.1% in one of their strongest weeks since June, buoyed by hopes of a breakthrough in US/China trade talks
- Italian government bonds rallied pushing yields to record lows as a more EU-friendly coalition government comprising of the Five Star movement and the Democratic Party was formed
- German manufacturing data continued to disappoint as foreign orders fell by 6.7% in July. Industrial production output also fell 4.2% year-on-year
- European government bonds fell 0.3% with their investment-grade counterparts falling 0.4% over the week.

UK

- UK equities gained 1.2% in the week
- Sterling gained 1% versus the US dollar last week as the UK parliament voted to prevent a no-deal Brexit
- UK gilts ended the week flat
- PM Boris Johnson lost a series of votes in parliament aimed at securing a general election, he will today try for a final time get a vote through to hold one before October the 31st. This is expected to fail.

Asia/Rest of The World

- Chinese equities had their strongest week since June increasing 3.9%. The government announced it would bring in new stimulus measures to counteract the effects of US tariffs
- Japanese stocks gained 2.4% on the week as global tensions eased. The continuing stand-off with South Korea may be constraining growth
- Argentinian equities fought back to increase by 11% last week after falling 50% in USD terms during August.

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 6 Sept. 2019	Month to date	YTD 2019	12 months
Developed Market Equities					
United States	USD	1.8%	1.8%	20.0%	5.0%
United Kingdom	GBP	1.2%	1.2%	11.9%	4.0%
Continental Europe	EUR	2.1%	2.1%	19.4%	8.0%
Japan	JPY	1.7%	1.7%	4.3%	-7.0%
Asia Pacific (ex Japan)	USD	2.5%	2.5%	8.6%	0.8%
Australia	AUD	1.0%	1.0%	21.6%	12.7%
Global	USD	1.9%	1.9%	17.4%	3.7%
Emerging markets equities					
Emerging Europe	USD	2.6%	2.6%	16.5%	20.4%
Emerging Asia	USD	2.3%	2.3%	6.3%	-1.9%
Emerging Latin America	USD	3.1%	3.1%	6.8%	14.7%
BRICs	USD	2.6%	2.6%	10.2%	7.2%
MENA countries	USD	0.2%	0.2%	4.9%	5.1%
South Africa	USD	4.6%	4.6%	3.1%	6.3%
India	USD	-2.0%	-2.0%	-2.0%	-4.5%
Global emerging markets	USD	2.4%	2.4%	6.4%	1.5%
Bonds					
US Treasuries	USD	-0.2%	-0.2%	8.9%	10.8%
US Treasuries (inflation protected)	USD	-0.4%	-0.4%	9.1%	7.7%
US Corporate (investment grade)	USD	-0.2%	-0.2%	13.7%	13.2%
US High Yield	USD	0.3%	0.3%	11.3%	6.9%
UK Gilts	GBP	0.0%	0.0%	11.5%	12.0%
UK Corporate (investment grade)	GBP	-0.1%	-0.1%	11.0%	9.9%
Euro Government Bonds	EUR	-0.3%	-0.3%	10.1%	11.0%
Euro Corporate (investment grade)	EUR	-0.4%	-0.4%	7.2%	6.4%
Euro High Yield	EUR	0.1%	0.1%	9.6%	6.1%
Japanese Government	JPY	-0.5%	-0.5%	4.3%	5.6%
Australian Government	AUD	-1.4%	-1.4%	9.6%	12.3%
Global Government Bonds	USD	-0.3%	-0.3%	7.7%	8.6%
Global Bonds	USD	-0.2%	-0.2%	7.4%	7.8%
Global Convertible Bonds	USD	0.7%	0.7%	7.0%	2.4%
Emerging Market Bonds	USD	1.4%	1.4%	10.3%	12.4%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
		Week ending 6 Sept. 2019	Month to date	YTD 2019	12 months
Property					
US Property Securities	USD	1.4%	1.4%	24.1%	12.3%
Australian Property Securities	AUD	-2.7%	-2.7%	17.2%	10.9%
Asia Property Securities	USD	2.3%	2.3%	8.2%	11.0%
Global Property Securities	USD	1.3%	1.3%	17.7%	10.6%
Currencies					
Euro	USD	0.4%	0.4%	-3.6%	-5.1%
UK Pound Sterling	USD	1.0%	1.0%	-3.6%	-5.0%
Japanese Yen	USD	-0.4%	-0.4%	2.6%	3.7%
Australian Dollar	USD	1.8%	1.8%	-2.8%	-4.8%
South African Rand	USD	2.8%	2.8%	-2.6%	3.7%
Swiss Franc	USD	0.3%	0.3%	-0.5%	-2.1%
Chinese Yuan	USD	0.6%	0.6%	-3.3%	-3.9%
Commodities & Alternatives					
Commodities	USD	1.7%	1.7%	4.6%	-5.4%
Agricultural Commodities	USD	-1.2%	-1.2%	-11.2%	-13.0%
Oil	USD	1.8%	1.8%	14.4%	-19.6%
Gold	USD	-0.4%	-0.4%	18.4%	26.6%
Hedge funds	USD	0.5%	0.5%	5.8%	0.2%

Source: Bloomberg. Past performance is not indicative of future returns

For more information, please contact your adviser or alternatively contact:

Financial Partners Ltd.
泛柏資產管理有限公司
9th Floor, Centre Mark II
305-313 Queen's Road Central
Sheung Wan, Hong Kong

Tel +852 2827 1199
Fax +852 2827 0270
client.services@f-p.hk
www.f-p.hk

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