

UK Equities

Ed Legget explains why a combination of historically attractive valuations, share buybacks and M&A should commend UK equities to investors in 2025.



2025 OUTLOOK



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Why are you still positive on the outlook for the UK?

Looking into 2025, we remain optimistic on the outlook for the UK stockmarket. And that principally comes back to **valuation**. In the Artemis Funds (Lux) UK Select, we very much focus on **free cashflows** as, fundamentally, we believe that free cashflow is what we will get over time as long-term holders of UK equities. Today, the UK equity market trades on just over 11 times earnings – **a discount to its own history and a significant discount to its global peers**.

What parts of the UK market are looking most attractive?

The parts of the market that we think are most interesting are some of the sectors which have been most out of favour over the last decade. In particular, these are sectors like **financials** and some **consumer cyclicals**, where valuations are at discounts to a UK market which is itself trading at a significant discount to its own long-term history. At the same time, we think the prospects for those sectors have become materially better.

In the case of financials, the interest-rate cycle has turned. And that makes a big difference to the earnings power of banks and insurance companies. In the case of consumer cyclicals, we actually think the UK consumer is in a relatively good position. Balance sheets are strong, real incomes are rising and, when you look in those sectors that were hit particularly hard by Covid, we've seen a big polarization where the winners – the larger companies – are getting stronger. Those are the ones that we own in the fund.

What will be the catalyst for narrowing the valuation gap between UK equities and their global peers?

The catalyst for narrowing the valuation gap initially is something we've already seen a lot of in the last 12-to-18 months, which is **M&A**. Companies are saying, well, actually I can buy one of my peers at a big discount to my own company's valuation. And so you're seeing that discount being arbitrated away in that way.

You're also seeing companies buying back their own equity at big discounts. **NatWest** would be a prime example in our fund. It has bought back over 35% of its equity in the last three-and-a-half years. And we've seen some companies decide to move their listings into other markets. Flutter is an example in the portfolio; it has done just that and we've seen a significant valuation uplift as it moved to the US market.

So I think the arbitrage is being unwound in real time before our eyes. If you look forwards, that is driving performance for the stocks that are doing that. And, eventually, performance drives investor interest, which in turn drives flows – and it is flows that have been the real problem for the UK equity market over the last 10 years.

Have the policy priorities of the Labour government materially changed the outlook for any sectors of the UK market?

Post the election, we have more political stability than we've had over the last 10 years. At a corporate level, we're clearly going to get different policies and different taxes and we saw that in the Budget. If we think about the sectors which have potentially benefited from

the change in government, the prime one to think about are the utility companies, where the current government's desire to **decarbonize the electricity grid** in the UK will drive a significant uptick in investment and an improvement in returns for the likes of **National Grid** and **SSE**.

If you look elsewhere, the focus on the Budget has been around the rise in the National Living Wage and the rise in National Insurance. Both of those are headwinds for companies that employ a significant number of people, particularly at the lower end of the wage spectrum. Those stocks have generally been quite weak. What we anticipate happening is that the companies that are the strongest in those

sectors will seek to pass on those increased costs through pricing. And, on the flip side, you'll see more pressure on some of the weaker players in those sectors and capacity exiting the market. So, overall, we see the strong getting stronger in the consumer sector. **The thing we're watching and the thing which I think will have a big impact on the economic outlook for the UK is whether corporates stop hiring.** Will we see a rise in unemployment? It's going to take some time to see that. And in the near term, companies will pull the **pricing lever** to offset those higher costs.

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The fund's objective is to grow capital over a five year period. The fund is actively managed.

Market volatility risk: The value of the fund and any income from it can fall or rise because of movements in stockmarkets, currencies and interest rates, each of which can move irrationally and be affected unpredictably by diverse factors, including political and economic events.

Currency risk: The fund's assets may be priced in currencies other than the fund base currency. Changes in currency exchange rates can therefore affect the fund's value.

Derivatives risk: The fund may invest in derivatives with the aim of profiting from falling ('shorting') as well as rising prices. Should the asset's value vary in an unexpected way, the fund value will reduce.

Concentration risk: The fund may have investments concentrated in a limited number of holdings. This can be more risky than holding a wider range of investments.

Charges from capital risk: Where charges are taken wholly or partly out of a fund's capital, distributable income may be increased at the expense of capital, which may constrain or erode capital growth.

Leverage risk: The fund may operate with a significant amount of leverage. Leverage occurs when the economic exposure created by the use of derivatives is greater than the amount invested. A leveraged portfolio may result in large fluctuations in its value and therefore entails a high degree of risk including the risk that losses may be substantial.

Investment in a fund concerns the acquisition of units/shares in the fund and not in the underlying assets of the fund.

Reference to specific shares or companies should not be taken as advice or a recommendation to invest in them.

For information on sustainability-related aspects of a fund, visit www.artemisfunds.com.

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