UK Equities

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

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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 arbitraged 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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