EDINBURGH
INVESTMENT TRUST

The renaissance of the UK stock market

JAMES DE UPHAUGH, MANAGER OF THE EDINBURGH INVESTMENT TRUST

This has been the year that central bankers have had to replace the word “transitory” with “structural” when it came to describing inflation and therefore started raising interest rates in increments not seen for over a decade. The sharp move up in the cost of risk hit returns from most stock markets and asset classes and the classic “plug and play” 60-40 equity bond portfolio had its worst year since the 1930s.

And yet the UK stock market has been resilient to these strong cross currents. This was despite the fact the UK also had to absorb a degree of political uncertainty normally associated with the likes of Italy.

Big chunks of the UK stock market that had previously been written off as “yesteryear” became sought after in 2022:

- international energy companies– it turns out it matters where your energy comes from
- mining – a lot of copper is going to be needed for the energy transition
- deposit rich banks – analysts raced to upgrade profit expectations as deposits made money for the first time since the Global Financial Crisis (GFC) and dividends began to surprise on the upside
- defence companies - became prized for their long duration order books as it became clear that money spent on deterrence was good value for democracies

How will the UK stock market fare in 2023 as we exit 2022 with “Permacrisis” as the Collins word of the year? Three points are worth noting:

- valuation trumps sentiment over the long term
- shares are rarely a bargain when all the news is rosy
- the consensus tends to focus too much on the short term

Given these points, if I was to do a simple Twitter summary of the tomes from strategists in my inbox in 2022 it would be “mind your eye on markets in the first half but get ready for a better second half”. Markets rarely toe the line of consensus, however, particularly when the economic news is getting less bad and there are not huge imbalances in the real economy that could amplify the undoubted near term real economic headwinds the UK and many other economies face.

The US Federal Reserve is determined to reduce the rate of inflation to manageable levels. Earlier in 2022, it looked possible such action could risk a bad outcome for the US and therefore the world via the dollar. Already, however, we are seeing better news on inflation so the risk of a really bad outcome is greatly reduced. The UK and Europe face more of a pig in the python on energy when it comes to inflation but here also the picture is past the worst.

With the chance of bad outcomes dramatically reduced as we enter 2023, we are focusing on how our companies are positioned strategically for the next few years. Here again, there are strong positives that are emerging in the corporate landscape. Multiple “Black Swans” (Brexit, COVID, the supply chain crisis and Ukraine) have engendered corporate fatigue in many small and medium sized companies and the gusher of cash from venture capital ready to unpick profitable incumbent verticals has been turned off.

The result is that the value of incumbency has increased dramatically and therefore Tesco, for example, does not need to worry about “q commerce” in quite the same way it did a year ago. Indeed, the corporate life cycle has become Darwinism on steroids and the Edinburgh Investment Trust is full of examples that are taking advantage of this tough near-term environment to gain market share responsibly at high incremental returns: Centrica, Dunelm, Greggs, Whitbread, Howdens and Ashtead to name but a few. Importantly, we are looking for companies growing responsibly in a way that works for all stakeholders. Greggs was a pioneer of this with its Breakfast Clubs for school kids.

The “Black Swans” of the last few years have also shown the importance of supply chain resilience. Companies now rightly obsess over their single points of failure and, in this vein, are looking to reduce their dependence on China (witness Apple’s move to switch some production to India) and hold more stock in case things don’t go to plan. This gentle deglobalisation is a strong long-term positive current for the likes of RS and Intel.

The UK stock market has had a subdued period since the Brexit vote in 2016, UK equity flows have been persistently negative since and yet in 2022 we saw a stabilisation as quality and low valuation came to the fore. Markets are anticipatory and if we are right that the economic news will become less bad then we are in the foothills of a renaissance of UK equities.

For a comprehensive list of common financial words and terms, see our glossary at: http://www.edinburgh-investment-trust.co.uk/glossary

Key Risks

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested. The issue of units/shares in the Edinburgh Investment Trust 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. The portfolio may invest in smaller companies. These stocks may be less liquid and the price swings greater than those in, for example, larger companies. The Company borrows money to invest in the stock market within prescribed limits with the aim of enhancing returns. The use of borrowings may increase the volatility of the NAV and may reduce returns when asset values fall. The Company may invest in derivatives. The use of derivatives may create leverage or gearing. A relatively small movement in the value of a derivative's underlying investment may have a larger impact, positive or negative, on the value of the company than if the underlying investment was held instead.

Disclaimer

This communication is issued by Liontrust Fund Partners LLP (2 Savoy Court, London WC2R 0EZ), authorised and regulated in the UK by the Financial Conduct Authority (FRN 518165) to undertake regulated investment business. **This is a marketing communication.** Before making an investment, you should read the relevant Articles of Association and the Key Investor Information Document (KIID), which provide full product details including investment charges and risks. These documents can be obtained, free of charge, from www.liontrust.co.uk or direct from Liontrust. Always research your own investments and if you are not a professional investor please consult a regulated financial adviser regarding the suitability of such an investment for you and your personal circumstances.

This should not be construed as advice for investment in any product or security mentioned, an offer to buy or sell units/shares of Funds mentioned, or a solicitation to purchase securities in any company or investment product. Examples of stocks are provided for general information only to demonstrate our investment philosophy. The investment being promoted is for shares in a company, not directly in the underlying assets. It contains information and analysis that is believed to be accurate at the time of publication, but is subject to change without notice. Whilst care has been taken in compiling the content of this document, no representation or warranty, express or implied, is made by Liontrust as to its accuracy or completeness, including for external sources (which may have been used) which have not been verified. It should not be copied, forwarded, reproduced, divulged or otherwise distributed in any form whether by way of fax, email, oral or otherwise, in whole or in part without the express and prior written consent of Liontrust.

[22/965]