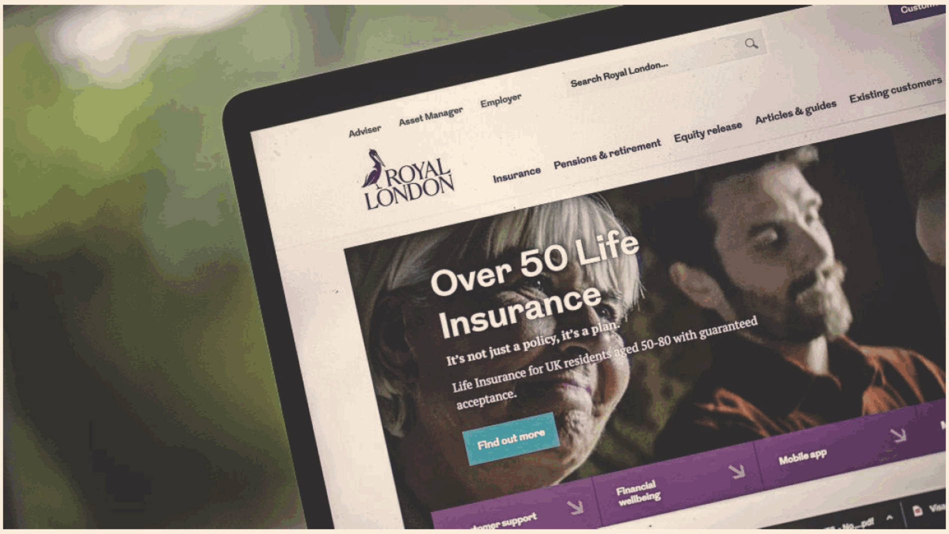
Equities. Portfolios shift

Bargain-hunting traders beat a path to UK bourse



The UK is Royal London's largest regional equity overweight, having ranked bottom of its list as recently as 2020 — Charlie Bibby/FT

Cheap valuations, improved earnings and resilient price action prove strong draws

GEORGE STEER AND NAOMI ROVNICK

UK stocks have widely outperformed global equities so far this year, in a sign that investors are hunting for bargains as they exit higher-growth businesses whose appeal has been tarnished by expectations of interest rate rises.

A broad MSCI index tracking UK companies has added 3.6 per cent in dollar terms since the end of 2021. That gain puts British stocks more than 9 percentage points ahead of the broader MSCI World index, which has fallen almost 6 per cent over the same period.

If current trends were to continue through to December, this would mark the first year since 2011 that UK equities have beaten the rest of the world, according to FactSet data.

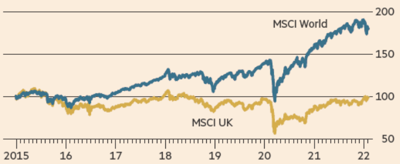
"The UK has shown up increasingly positively over the past year," said Trevor Greetham, head of the multi-asset team at Royal London, which has more than £150bn in assets under management.

Greetham highlighted the cheap valuations of UK companies compared with those in Europe and the US, as well as improving earnings and recent "resilient price action". He said the UK was now Royal London's "largest regional equity overweight", having ranked bottom of its list as recently as 2020.

The MSCI UK trades on a forward price-earnings multiple of 12 times, well below the multiple of about 18 times commanded by the global MSCI gauge.

UK equities have barely budged since 2015

Indices rebased in $ terms



Source: Refinitiv

London's blue-chip benchmark share index, the FTSE 100, has a heavy concentration of industries that have been unpopular investments over the past decade, such as global banks, miners and energy producers from HSBC to oil major BP.

At the same time, the gauge lacks technology companies to rival US heavyweights such as Alphabet, Amazon and Apple, and has trailed other leading equity indices in the years that followed the 2016 Brexit referendum. Last year, for example, Wall Street's S&P 500 index gained 27 per cent, while the FTSE 100 gauge added just 14 per cent.

But those trends have reversed in recent weeks as global investors have begun to unwind positions in riskier assets expected to grow at a rapid clip years into the future in favour of cheaper stocks represented in UK markets.

The change in momentum comes as central banks on either side of the Atlantic weigh up how best to tackle inflation that has proved stickier than many expected. Both the Federal Reserve and Bank of England are expected to increase interest rates in coming months. Higher borrowing costs erode the present value of future cash flows, denting the allure of stocks perceived to be higher risk.

Royal London noted in a presentation that while rising real yields — the returns investors in low-risk bonds can expect after accounting for inflation — would hit growth companies whose value was underpinned by expected future earnings, "cheaper, less rate-sensitive stocks" such as those in the UK were likely to do well this year.

Royal London is not the only fund to have warmed to the UK, attracted by its history of hefty dividend payments and the sunken valuations of many of the country's public companies.

A broad MSCI index tracking UK groups has added 3.6% in dollar terms since end 2021

JPMorgan last month upgraded the UK to "overweight", meaning it suggests clients give the country's stocks an outsize weighting in their portfolios.

The bank said the market was trading at a "record discount" compared with other regions. Australia's largest pension fund, meanwhile, has said it expects to more than double its UK assets from £7bn to more than £15bn by 2026, focusing on private markets.

One of Canada's largest pension fund managers last year unveiled its own plans for a C$15bn ($12bn) investment in private assets in the UK and Europe. Caisse de Dépôt et Placement du Québec, the C$400bn investment group, noted that the UK stood out for its "pro-business" stance.

Yet there are reasons to question whether the UK will maintain its outperformance this year. It has consistently ranked towards the bottom of the list of markets popular among global investors, according to Bank of America's closely watched fund manager survey. Retail outflows from UK equity funds reached a record £5.3bn in 2021, topping the previous record of £4.9bn in outflows set in 2016, according to the Investment Association.

Still, the tide may have turned. "The FTSE 100 makes a lot of sense right now," said Leigh Himsworth, lead manager of Fidelity International's UK Opportunities Fund.

"If you want exposure to rising bond yields you play the banks. The oil companies are a play on the oil price. Equally if you think global economies are recovering from Covid-19 then mining stocks are a good way to play that."

Equities

SEC steps up probe into 'block trades' on Wall Street

BROOKE MASTERS AND JOSHUA FRANKLIN — NEW YORK

A slow-burning regulatory probe of big share sales on Wall Street has kicked up a notch as watchdogs examine whether banks and hedge fund traders are improperly profiting at the expense of institutional sellers and retail traders.

The US Securities and Exchange Commission first started asking banks with large equity trading arms about "block trades" during the Trump administration, according to two people with direct knowledge of the probe.

Since then, Morgan Stanley, which is a leading provider of block trade services, has received multiple requests for information. The regulator has also contacted other participants including hedge funds that trade equities.

The SEC probe is looking at whether other traders are getting advance word of these large sales and improperly profiting by shorting the shares in expectation that prices will fall. No enforcement action is imminent, and it not clear that any will result, the people said.

Morgan Stanley, which is a leading provider of block trade services, declined to comment, as did Goldman Sachs. The probe was first reported by the Wall Street Journal.

The SEC is making a push to prevent large traders from unfairly benefiting

The probe is looking at whether other traders are getting advance word of these large sales

from information that is not available to ordinary investors. While much of this comes in the form of new disclosure proposals, the SEC enforcement arm is also part of the drive.

In block trades, a bank is engaged to sell a large slug of shares in a company, either by the company itself or a major investor.

The bank guarantees the seller a discounted price and then aims to sell the shares at a higher price, pocketing the difference. To gauge market appetite, bank traders will speak with potential buyers, often hedge funds, sometimes sharing details of the trade under a non-disclosure agreement and other times using generic terms designed to mask the company involved.

The practice of so-called "wall crossing" to talk with buyers is fraught with risks that other investors will begin to trade on the information, with a block of shares coming to market likely to weigh on a stock price.

Similar allegations have surfaced before on Wall Street: in 2005, brokers at Merrill Lynch and Lehman Brothers were accused of letting day traders eavesdrop on big market moving orders and profit by trading ahead of them.

The convictions in the "squawk box" case were ultimately overturned because the prosecutors withheld evidence, but the revelations contributed to a sense that professionals were stacking the deck against ordinary investors.

See Lex

Cross asset

Cash stockpiles mount amid rising expectations of aggressive tightening

GEORGE STEER

Investors are building their cash stockpiles in a sign that many money managers are bracing themselves for turbulence across global markets.

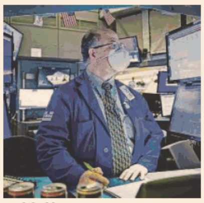
Average cash holdings among investors jumped to 5.3 per cent this month, up from 5 per cent in January, according to a closely watched survey by Bank of America of fund managers with a combined $1tn in assets.

That marks the highest level since the early days of the coronavirus crisis in May 2020, the report released on Tuesday showed.

The shift comes during a tumultuous start to the year for many leading asset classes. The MSCI World index tracking global equities is down almost 6 per cent since the start of 2022, while Bloomberg's multiverse index tracking government and corporate bonds has dropped 3.5 per cent over the same period.

Investor sentiment has been shaken by mounting expectations that central banks such as the US Federal Reserve and the Bank of England will need to aggressively tighten monetary policy to rein in blistering inflation. Some traders are now worried the Fed will need to act so abruptly to cool the intense price growth that it will knock the country's economic recovery off course, something that could weigh on risky assets.

"The start of 2022 has been dominated by an unprecedented hawkish pivot across major developed market central banks," analysts at Goldman Sachs said. The Wall Street bank this week advised clients to give cash an "overweight" position in their portfolios



Cash holdings among investors rose to an average 5.3 per cent this month

as it also reduced its outlook on corporate bonds to "underweight".

Goldman said the move reflected the "more challenging growth and inflation mix [and] also cash becoming more of a competitive asset class of its own".

Investors at present receive almost no returns from the cash they stash in US money market funds, a type of vehicle that typically holds ultra-low risk, short-term assets. These products provided yields of above 2 per cent in 2019, before the Fed slashed interest rates in response to the coronavirus crisis, according to Crane Data.

Many fund managers had been left bruised by recent market gyrations and might have shifted out of "fallen darlings" such as Facebook parent Meta and into cash ahead of the Fed's March meeting, said Tancredi Cordero, founder of Kuros Associates.

He added, however, that the rotation could yet prove shortlived.

"Once we have a clearer understanding of the interest rate path, that will reshuffle the deck," encouraging investors to spend their dry powder snapping up companies which suddenly look underpriced.

Cross asset

Green rush prompts Aviva Investors warning on extreme overvaluation

ADRIENNE KLASA

Green stocks are often overpriced and can offer investors limited scope for making a positive impact on the environment, the chief executive of Aviva Investors has argued.

"I believe that as a general strategy, buying brown and helping it to become green will deliver better investment returns, and it doesn't matter what asset class you're talking about," Mark Versey said.

The investment arm of the UK-based insurer, which has £263bn in assets under management, considers sustainable investment the North Star principle guiding the company, and has been vocal about its intentions to vote against bosses who do not shape up on climate, human rights and biodiversity.

But the rush among asset managers to adopt sustainable investment had created pockets of extreme overvaluation, and was tilted too heavily in favour of stocks over debt, said Versey.

"You can buy some green assets today which are frankly overpriced," he said.

Shares in electric vehicle group Tesla have gained more than 1,500 per cent in the past five years, while electric truckmaker Rivian is valued at $59bn since listing in November, despite producing only about 1,000 vehicles in 2021.

Interest in sustainable investing has exploded over the past few years, with assets in these strategies hitting a record $3.9tn in the third quarter of 2021, according to data from Morningstar.

But opinion is divided over whether it

The unit of the insurer considers sustainable investment its North Star guiding principle

is appropriate for sustainable investors to buy oil stocks, for example. Advocates say it is a meaningful way to push for change. Others warn it is often ineffective and that, ultimately, their business models are unsustainable, while some hedge funds have snapped up fossil fuel stocks on the cheap.

"Defining what might be sensible as an investment definitely depends on the timeline. The longer the timeline, the less it makes sense to be holding truly brown assets [because] these are going to wind up being stranded assets," said James Alexander, chief executive of the UK Sustainable Investment and Finance Association. "What's good for the world is providing capital flows to green and transitioning assets, but what we really need to see is all investors being really active stewards of capital."

Versey said investors should be acting as advocates across all asset classes.

"If you're a bondholder you've got a huge voice — you could argue a louder voice — because corporates are continually refinancing their operations.

"So if the cost of capital changes, it actually hits the bottom line much sooner than the share price. Share price affects the management incentive plan . . . whereas corporate [bonds] affect the borrowing costs."

This month Aviva Investors wrote to 36 finance ministers asking them to adopt global climate disclosure standards. Policymakers including Mark Carney, former Bank of England governor, and François Villeroy de Galhau, France's central bank chief, have said failure to address climate impacts could wipe out $20tn in assets globally.