To buy or not to buy?

UK stocks are relative to global peers. But is there good reason for that?

Update
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For no particular reason, I've been reading an abnormally large volume of travel writing over the past couple of months. A few books were from the 1980s but others were written in the past couple of decades. In most instances, the authors spent their time wandering around countries in Africa, Latin American, and parts of Southeast Asia.

One of the things that's striking is how often the people they meet along the way are living in such tough circumstances. The legacy of foreign invaders, corruption, moral decay, the environment, and local culture are all put forward as potential culprits. Sadly very little seems to change. In one instance I could compare two authors visiting a set of countries around two decades apart and most of the problems people faced were still there, or arguably even worse than they had been before.

Looking at the UK today, it can feel like a similar dynamic is at play. Everyone has a reason as to why they think investors are so downbeat on the country but, even having identified the problem, it seems that no efforts to fix it have a meaningful impact.

Massive inflation, a seemingly imminent energy crisis, political uncertainty, and Brexit are all put forward as reasons why the pound is performing poorly and the UK stock market has seen anaemic returns over the past few years. And yet the problems just seem to keep coming and the decline keeps going.

The question for investors is whether these problems are indeed terminal and the UK is likely to continue on its downwards trajectory, or if they're simply a temporary phenomenon that the country will ultimately bounce back from.

While recent news concerning the Queen may seem like the final nail in Blighty's coffin, a couple of things suggest that – though things may be rather grim at the moment – the future is not entirely a hopeless cause. Looking at bank forecasts for GBP/USD, almost all the major banks are predicting that the pound will strengthen against the dollar in the next 12 months.

A more salient point is the ongoing acquisition of London-listed companies. Refinitiv data shows that 25 companies had either been taken over or had deals pending by the end of July, compared to 18 deals over the same period in 2021, which was itself a busy period for M&A activity.

It's easy to predict currency rates but acquisitions are more meaningful as they actually involve putting some skin in the game. In other words, it's hard to imagine private equity firms and other corporates engaging in these takeovers if they didn't think they offered good value for money.

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And at least on a superficial level, the UK does continue to trade at substantially lower valuations than its global peers. As noted recently by Schroders analyst Uzo Ekwue, the FTSE 100 was trading at an approximately 35% discount to the MSCI World Index on a price-to-earnings basis at the start of August. Things have not changed significantly in the intervening period.

One can see this spilling over into the investment trust sector as well. In one of our recent strategy notes, our analyst Nicholas Todd noted that discounts have widened significantly in the UK equities space, with trusts trading at one standard deviation below their historical average.

This leaves prospective investors in an interesting position. Either UK equities now offer a bargain opportunity or they're a value trap which will probably end up with you losing money. You'll have to make up your own mind as to which is the more likely outcome.

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