# We already know

**A gloomy outlook for the UK economy is hardly novel information...**

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Since hitting a high in September 2021, the FTSE 250 has declined by close to 30%. This week has seen a decent rally, most likely as a result of the Bank of England's decision, announced on Thursday, to keep interest rates at their current level.

And yet the BoE's outlook for the UK is poor. Economic growth is likely to be tepid for the remainder of this year, the central bank has argued, and flat in 2024. Other research published by Gavekal this week was also pessimistic, noting that higher interest rates are starting to feed more meaningfully through into mortgages, something that is going to hit consumer spending for both homeowners and renters.

Is any of this actually news to you though? I would hazard a guess and say that it is not. A gloomy outlook for the UK isn't a bad argument to make, but it's hardly a novel one that people have suddenly become cognisant of.

Indeed, the fact that the FTSE 250, which is more domestically-oriented than the UK's large cap index, lost over 30% of its value in just over two years seems like a pretty clear sign that, not only are investors aware of this prospective downturn, they have already priced it in to a large extent.

The question you could ask on the back of this is, assuming the UK economy is going to be sluggish over the near term, is this priced in already to small and mid-cap UK stocks? And if it's not, then how much further does the index have to go?

What the correct answer is to these questions is difficult to say but, as we noted earlier this year, there is some reason to be optimistic about smaller UK companies today, even if the near-term outlook for the economy is poor.

Moreover, the approach active managers take to markets can help to mitigate some of the risks that smaller companies are exposed to, namely difficulty accessing capital to grow and business concentration risk.

For example, when you look at the top holdings in the **BlackRock Smaller Companies (BRSC)** portfolio, you can see the traits that manager Roland Arnold looks for in more tangible terms. Roland looks for a number of characteristics in a company, but the important ones to highlight here are strong cash flows and balance sheets.

4imprint, the trust's largest holding, is a good example of this. The company has good margins, continues to grow earnings, has no debt – and no plans to use any – and a large amount of cash on its balance sheet.

You could argue that the company has not yet been impacted by a downturn. But then it has the traits needed to survive such a scenario and to potentially even benefit if poorer quality companies cannot compete and drop out of the market.

There may indeed be tough times ahead for the UK but markets are ultimately forward looking and it would be hard to argue that a large proportion of small and mid-cap performance has not been driven by this pessimism. Assuming that's the case, then the sorts of companies that trusts like BRSC invest in may – perhaps counterintuitively – be poised to see improved performance moving forward.

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