MARKET COMMENTARY

UK – Brexit

26 February 2019

Investing in an 'uninvestable' UK

Ask a handful of global investors about the UK market and the majority will likely tell you that it's uninvestable. However, James Clunie, Head of Strategy, Absolute Return, wouldn't necessarily agree. James argues that while Brexit has caused unarguable confusion and uncertainty, there are still opportunities to be had, both long and short, in a market that has been overshadowed by politics.

The UK is in chaos; uncertainty over Brexit continues to ratchet up and market participants – alongside politicians it seems – have no clear idea what form Brexit will take. Investors, faced with this environment of extreme Brexit-induced uncertainty seem to have come to the general conclusion that in its current state, the UK is 'uninvestable'.

And this sentiment shows. UK stocks valuations relative to Europe have plunged as investors retreat from UK equities, with the FTSE 100's relative valuation versus Europe reaching an eight-year low in late 2018. In a global survey of fund managers, the UK comes out as the most hated region. Many fund managers and investors are simply avoiding the market all together.

While this knee-jerk reaction to extreme Brexit uncertainty is understandable, we have to consider what our job as investment analysts and managers is exactly. For me, the answer is clear: it's to take calculated risks under conditions of uncertainty. If uncertainty is so high that it's terrifying, then actually that's just a slight extension of what is the bread and butter for investment analysts and managers – to take calculated risks when you're not sure what will happen next. So, it should be business as usual, just in a slightly heightened sense.

With this in mind, and while others have taken UK and Brexit-related risk completely off the table, we like to take a different approach to investing in UK equities.

Taking probabilistic decisions

First, we analyse each of the companies we're interested in (either as a long or short position) in its own right – ignoring the geopolitics. We then get an idea of whether we'd want to be long or short of the stock if there wasn't all the Brexit and parliamentary confusion and noise. When that's done, we think about what could go wrong and consider the politics too, and what impact this might have.

This results in a whole set of different scenarios, from benign scenarios to those that don't matter much to ones that would be quite shocking. Effectively, we have to take a probabilistic decision.
We can then look more closely at the stocks we want to own. If we know for a particular stock that there are some scenarios where we'll lose money, but in most scenarios, we'll likely make money in the long-term (3-5 years), then that's a buy. And vice versa with the shorts.

Gently adding to UK domestic stocks on "bad days"

As a result, we are gently adding to UK domestic stocks. There are plenty of "bad days" in the market when we can add at leisure at what we believe are good prices.

An example of this approach is Serco, a company that looks very cheap on our valuation model . It's not going bust, the balance sheet is OK, and they've been winning lots of contracts recently including their largest ever a few weeks ago. Analysts have also been upgrading earning forecasts. Overall, it appears relatively cheap to us with good news and upgrades. Of course, there is potential for headwinds notably around fears it could lose public sector contracts were a change of government to happen, but we are otherwise positive.

Other stock examples include Forterra, the British brick-maker. The company has very positive fundamentals and on a reverse discounted cashflow model the stock looks cheap relative to the market. Factoring in geopolitics, there are potentially negative scenarios to consider, however, regardless of who is in charge of Britain, we will still likely build houses – whether they're private or social housing, it doesn't concern a brickmaker.

Short-selling into sharp rallies

Finally, as well as adding gently to those UK domestics, particularly on 'downdays', we've also been short-selling into sharp rallies. Although not certain, we think we have entered a bear market, with high asset prices and draining liquidity. In these conditions, sharp 'updays', which we have witnessed in the past few months, are not uncommon. These 'up-days' can provide opportunities for short-selling.

James Clunie, Head of Strategy, Absolute Return

James Clunie joined Jupiter in 2013. He is currently Head of Strategy, Absolute Return and manages the Jupiter Global Absolute Return fund (SICAV).

Before joining Jupiter, James worked at Scottish Widows Investment Partnership as an Investment Director of equities, and managed a long/short equity fund and UK long-only funds.

James was a senior lecturer in finance at the University of Edinburgh between 2003 and 2007, prior to which he worked as Head of Global Equities at Aberdeen Asset Management and Director and Head of Asset Allocation at Murray Johnstone International.

James gained a degree and PhD from Edinburgh University and is a CFA® charterholder.

About Jupiter

The listed British investment manager with boutique-like investment approach, located in London and founded in 1985, employs more than 400 employees worldwide (thereof about 35 fund managers). Today Jupiter is one of the UK's most respected asset management groups.

„The Jupiter Global Fund SICAV" (a Luxembourg based UCITS structure) provides clients outside the UK access to the diverse investment capabilities through its 29 sub funds which are registered for distribution in several European countries. Jupiter's total AUMs are GBP 42.7 bn as of 31 December 2018.

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Far from being uninvestable, UK equities can offer plenty of opportunity to the fund manager who continues to employ the same tools they have always used to analyse companies – namely, a rigorous screening process and solid bottom-up fundamental analysis of each potential stock for inclusion in their portfolio. Only then, should the impact of Brexit on the company's fortunes come under scrutiny. In short, Brexit should probably not be the first test of a company's eligibility as a potential investment, rather a secondary consideration once a firm's overall health and prospects have been assessed.

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