POLAR CAPITAL

Polar Capital UK Value Opportunities Fund

The UK today: 'A wealth of opportunity in cheap areas'

Q: Gary Corcoran (Head of Corporate Communications & Content): George, why has there been such positive sentiment towards the UK over the past few months? What's changed?

A: George Godber, Fund Manager, Polar Capital UK Value Opportunities Fund: Well, I think a number of things have changed. The first is the UK was a big outlier on inflation, and now I see the inflation rate back at 2% and likely to stay at that level. The second is that the UK experienced a recession, albeit a very mild one. It's now back in economic growth, and that economic growth is looking pretty attractive compared to many other developed markets. Third, and really importantly, is the politics – two quite boring centrist candidates. It looks quite calm, certainly relative to a few other countries, and of course, that's alongside the UK being attractively valued.

If we then focus on the flow environment, that has been very difficult since 2016. A lot of outflows had a lot of media attention, and now we're seeing money coming back in, especially international money. One of the things that perhaps caught American investors' attention – they've been some of the largest net buyers of UK equities – is that now the UK has the highest buyback and total return yield of any of the major indices around the world.

Q: GC: Given that, what are you seeing as the key themes influencing where you are investing?

A: GG: I think the most important theme for us is, if we look below the surface, since 2021 the FTSE 250 is actually down 5%, but the FTSE 100 is up 24%. Even year-to-date, the FTSE 100 has had quite considerable outperformance versus the FTSE 250 although, more recently, that's starting to change. I think that's the biggest area of opportunity as I look at the UK market right now.

Q: GC: And what's driving that?

A: GG: What we saw when we had a rising cost of capital and rates going from zero all the way up to where we find ourselves today, at 5.25%, was a very bad backdrop for investing in small and mid-caps generally. Actually, as we move forward to focusing on rate cuts, with inflation back at a more normal 2% level, it's a far more attractive environment to be looking at that mid-cap part of the UK market.

Q: GC: Let's take it down a level from themes to sectors. What sectors are you particularly interested in right now?

A: GG: The one thing about being a UK fund manager is that there are an awful lot of cheap areas to get excited about. We've got a wealth of opportunities, but if I could highlight a few areas, one is financial services – we have lots of exposure there in terms of holdings like 3i or Hargreaves Lansdown. If we look at some of the sub-sectors, like some of the Lloyd's vehicles, they look extremely good value. Within the REITs space, that's an area we've invested in for the first time ever. You can buy businesses trading below their tangible book value, so below their replacement costs. Every time you can buy a pound coin for 70p, if it's a decent asset base, that's really always worth having a look at.

Infrastructure looks particularly attractive at the moment. There's a lot of spend there, a good end market. We have holdings such as Morgan Sindall or Kier Group or Breedon Group that benefit from government actions in that space. In terms of new ideas, they've come from across the market cap – the whole UK market is attractively valued, in our view. We've been able to add interesting positions in paper and packaging where you've got improving pricing and volume; within ship-broking where there are some really interesting trends happening; in airlines where businesses are trading below all forms of replacement costs. Even within other financials, which I mentioned earlier, there's a highly attractively valued sector with lots of good opportunities. In leisure, there are lots of ways to access improving consumer discretionary income. So, there is a wealth of opportunities, and we're really excited by what we've been able to add this year.

Q: GC: Given that, what are you seeing as the key themes influencing where you are investing?

A: GG: Well, it's interesting because elections create uncertainty. Markets don't like uncertainty, but with this situation, we have some certainty as to what the outcome's going to be; the polls are pretty conclusive. If we take a step back and look at the reaction of the bond market or the FX market since the announcement, it's been very calm. We saw around all of the political shenanigans with Brexit, the FX market is a brutal arbiter of global sentiment and it tells you very clearly what investors think and perceive of an outcome. So, the fact that we've seen calmness there reflects that we've got two relatively boring, dare I say centrist, candidates or centrist policies being put to the electorate. This is a year where half the world's population goes to vote, so there's going to be lots of focus on elections, but with the UK election, I think we know what the outcome is, and we are able to say with some certainty that it's not going to be a huge negative event. In many ways, it could be the unlock event we've been looking for with the UK.

Q: GC: And what's driving that?

A: GG: UK equities have had a long and prolonged period where they've been out of favour. Valuations are now starting to attract attention. We've got record levels of M&A being seen, with $77bn worth of deals announced so far. International corporates have definitely seen the opportunity, and we're seeing international money come back into the UK market. The UK is cheap, at 14x, while the fund's at a discount to that on 12x earnings. We feel that's a good place to be. If we look below the surface, there's great opportunity with the FTSE 250 at this big discount. It is always worth remembering, this is a good index to allocate to. Since its inception, it's compounded at 10% a year. That's what the earnings growth of that index has been since its inception. You can buy businesses generating good consistent profit growth over time at knockdown valuations. That's not a bad starting point. We've got calmer currency, calmer politics, and a much-improved macroeconomic outlook. So overall, the picture feels much more appealing. If we can buy businesses below their intrinsic value, relatively cheaply, with improving returns on invested capital and cash generative, we feel it's a good opportunity to find businesses that can re-rate.

George Godber, Fund Manager

Polar Capital UK Value Opportunities Fund

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