OCTOBER 2022

Talking Themes: Finding Value in UK Assets

Invest
Ideas to protect & grow your wealth

Key Messages

1. **Prices of UK assets have suffered recently,** a market reaction we consider overdone. We find opportunities in some areas of the UK market.
2. **Short-dated UK government bonds (gilts) offer attractive yields in view of the weak currency.**
3. **The FTSE 100´s valuation is undemanding with a significant foreign revenues + earnings base.**
4. Due to the currency devaluation, UK companies are even cheaper for non-sterling investors, **making them a potentially attractive M&A target.**
5. **The theme is investable via dedicated funds and ETFs, but also single-line bonds and stocks.**

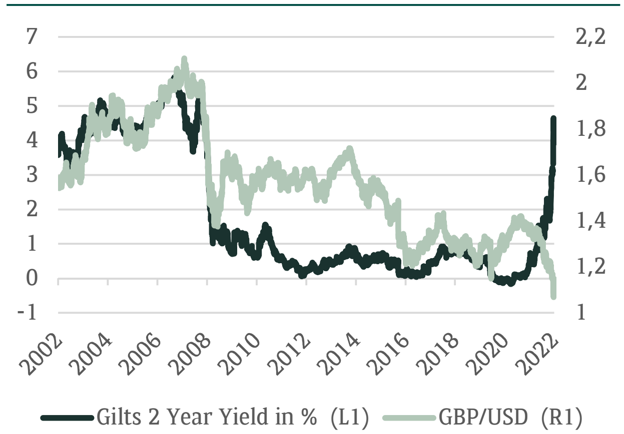
UK asset prices have been dealt a blow by the new government after the latest budget proposal triggered a widespread sell-off in UK assets followed by an intervention by the Bank of England to calm the markets and avoid further damage to the UK pension system. However, in this paper we will not discuss the potential political and economic consequences of the proposed package. We prefer to focus on the impact that the announcement had on asset prices and where investors could find value in UK assets today.

More defensive investors could consider short-dated gilts. Indeed 2-year UK bonds are currently trading at a yield of more than 4%, over double the yield on 2-year German bunds. Clearly, we should not neglect the economic challenges facing the UK. Compared with other regional stock and bond markets, we feel that investors would be well rewarded for taking those risks. Some European government bonds offer only half the yield of gilts despite having substantially higher costs of insuring against default.

Obviously, **non GBP-denominated investors are exposed to currency risk.** As sterling has depreciated against the dollar by roughly 20% since May 2021, USD-investors would buy into a cheap currency. Sterling was more stable against the euro but we do not see material FX risk either. Our 12-month target (0.86/price of 1 euro to the pound) implies only minor changes to the current level.

More risk-tolerant investors may find investing in stocks, e.g. the FTSE 100 Index, an attractive opportunity. While the index is based in the UK, its constituents are truly global companies. The FTSE is home to some of the worlds leading pharmaceutical, telecoms, oil and mining companies. It is thus much more a representation of the global than the UK economy.

2 YEAR UK GILT YIELDS ARE AT DECADE HIGHS WHILE STERLING SUFFERED



Source: BNP Paribas Wealth Management, Bloomberg

Stephan Kemper

Investment Strategist
BNP Paribas Wealth Management, Germany

It is global and it is cheap

A strong US dollar may fuel M&A activity

Close to 75% of FTSE 100 companies' revenues are generated outside the UK. More specifically, the USA and Europe are the main sources of revenue generation for the index constituents, thus making the index heavily dependent on currency moves. If sterling weakens – as it has recently - then foreign revenues, once converted back into sterling, are worth more. Thus, valuations are becoming more attractive which should eventually provide a boost to stock prices.

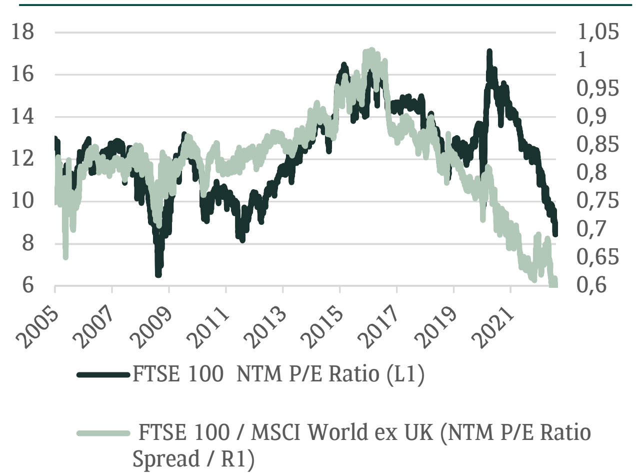
While the FTSE 100 is among the better performing indices in local currency terms over the year-to-date, there are few signs that the market is currently paying attention to the FX-driven revenue tailwind. The index is currently trading at a 12 month forward price/ earnings ratio of 8.8x which is the lowest level since 2011. Compared with the MSCI World ex UK, the valuation disparity looks even more extreme as **the FTSE100 is trading at the biggest discount to global stocks for more than 20 years.**

Equally interesting is the spread between pay-outs. **The FTSE 100 is expected to provide a dividend yield of 4.5% over the next 12 months which is a premium to global peers of more than 200 bps**. This measure stands at a 20-year high as well. While we feel that the combination of currency tailwinds, discounted valuations and above-average pay-outs would already make a compelling investment case for a truly global index, there is another angle to look at: takeovers from foreign companies.

For non-GBP based investors, the 20% drop in US dollar terms in UK large-cap stocks presents an excellent opportunity to buy already cheap UK stocks with an even higher discount. Since mid-January, the total market cap of UK stocks has dropped by roughly 17% in local currency. In USD though, UK stocks have lost by more than 30%, making the valuation case even more compelling.

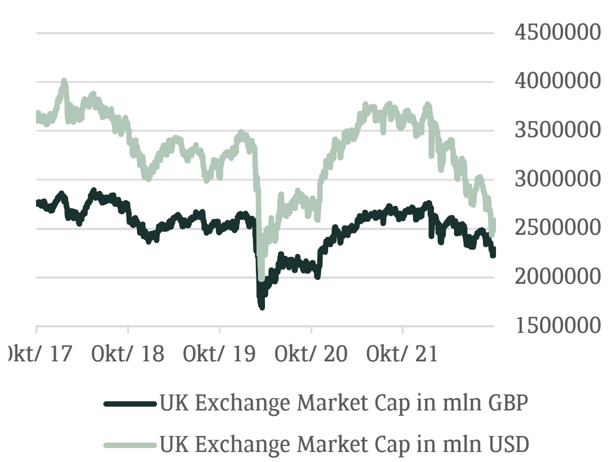
Global financial conditions have became more restrictive over the last couple of months which is usually not a good sign for M&A activity as potential buyers may find it more difficult to secure funding for a deal at a reasonable price. Against this headwind we have seen signs that it still seems hard to resist tempting valuations. For example two British companies (Pendragon & Biffa) have already been taken over by foreign buyers in the last couple of weeks. If this trend goes on, this would be another argument in favour of investors building or increasing allocations in the FTSE 100 index.

FTSE 100 IS TRADING AT DEPRESSED VALUATIONS



Source: BNP Paribas, Bloomberg

UK MARKET CAP HAS SUFFERED DISPROPORTIONALLY IN USD



Source: BNP Paribas, Bloomberg

CONNECT WITH US

wealthmanagement.bnpparibas

DISCLAIMER

This marketing document is communicated by the Wealth Management Métier of BNP Paribas, a French Société Anonyme, Head Office 16 boulevard des Italiens, 75009 Paris, France, registered under number 662 042 449 RCS Paris, registered in France as a bank with the French Autorité de Contrôle Prudentiel et de résolution (ACPR) and regulated by the French Autorité des Marchés Financiers (AMF). As marketing material, it has not been prepared in accordance with legal and regulatory requirements aimed at ensuring the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. It has not been submitted to the AMF or any other market authority.

This document is confidential and intended solely for the use of BNP Paribas SA, BNP Paribas Wealth Management SA or their affiliates ("BNP Paribas") and the persons to whom this document has been delivered. It may not be distributed, published, reproduced or disclosed by any recipient to any other person, nor may it be quoted or referred to in any document, without the prior consent of BNP Paribas.

This document is provided solely for information and shall not constitute an offer or solicitation in any state or jurisdiction in which such an offer or solicitation is not authorized, or to any person to whom it is unlawful to make such offer, solicitation or sale. It is not, and under no circumstances is it to be construed as, a prospectus.

Although the information provided herein may have been obtained from published or unpublished sources considered to be reliable and while all reasonable care has been taken in the preparation of this document, BNP Paribas does not make any representation or warranty, express or implied, as to its accuracy or completeness and does not accept responsibility for any inaccuracy, error or omission. BNP Paribas gives no warranty, guarantee or representation as to the expected or projected success, profitability, return, performance, result, effect, consequence or benefit (either legal, regulatory, tax, financial, accounting or otherwise) of any product or transaction. Investors should not place undue reliance on any theoretical historical information regarding such theoretical historical performance. This document may contain or refer to past performance; past performance is no guarantee for future performance.

The information contained in this document has been drafted without prior knowledge of your personal circumstances, including your financial position, risk profile and investment objectives.

Prior to entering into a transaction each investor should fully understand the financial risks, including any market risk associated with the issuer, the merits and the suitability of investing in any product and consult with his or her own legal, tax, financial and accounting advisors before making his or her investment. Investors should be in a position to fully understand the features of the transaction and, in the absence of any provision to the contrary, be financially able to bear a loss of their investment and willing to accept such risk. Investors should always keep in mind that the value of investments and any income from them may go down as well as up and that past performance should not be seen as an indication of future performance. Any investment in a product described herein is subject to the prior reading and understanding of the legal documentation concerning the product, and in particular the one which describes in details the rights and obligations of investors as well as the risks inherent to an investment in the product. Save as otherwise expressly agreed in writing, BNP Paribas is not acting as financial adviser or fiduciary of the investor in any transaction. The information, opinions and projections expressed herein reflect the opinion of their author at the time of writing; they are not to be relied upon as authoritative or taken in substitution for the exercise of judgment by anyone, and are subject to change without notice. Neither BNP Paribas nor any BNP Paribas Group entity accepts any liability whatsoever for any consequences that may arise from the use of information, opinions or projections contained herein.

As distributor of the products described herein, BNP Paribas may receive distribution fees on which you can obtain more information upon specific request. BNP Paribas, their employees or administrators may hold positions in these products or have dealings with their issuers.

By accepting this document, you agree to be bound by the foregoing limitations.

© BNP Paribas (2022). All rights reserved.

Pictures from Getty Images.

BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world