CS INVESTMENT MANAGERS

# VIEW FROM THE SQUARE

July 2024

## Starmer (t)sunami, Sunak stunned – Now time to focus on interest rates

It seems right to concentrate on the UK this month, with Sir Keir Starmer and his Labour party winning the general election with a similar majority to Tony Blair in 1997 and the second largest since 1935. While this was an historic victory, it was one that was largely expected by economists and the markets as election day drew closer, evidenced by the relatively small changes in the currency market after the result was announced.

While the internationally focussed FTSE 100 opened positive, it lost momentum as the day went on, finishing modestly lower. In contrast, the more domestically orientated FTSE 250 and FTSE AIM All-share finished the day higher. Can anything be read into this and does the result of the election indicate a strong period ahead for the UK? Possibly. The incoming Chancellor Rachel Reeves is unlikely to reverse measures introduced by previous Chancellor, Jeremy Hunt, such as the 'Mansion House Reforms' which focused on driving improved outcomes for savers and channelling greater levels of funding into high-growth companies. Reeves has also made it clear that she recognises pension funds are important to a revival in the UK and we think that could make a significant difference.

Last month we touched on the "Magnificent Seven" stocks and how their current premium valuations leave little margin for error on future earnings. They have certainly been the headline grabbing stocks this year so far, both in terms of potential for the future and their performance year to date. But should investors also be looking elsewhere? For example, in the UK within the large cap space, Barclays, NatWest and Rolls-Royce have all risen over 50% on a total return basis this year and similarly, smaller companies such as Reach, Ashtead Technology and Team Internet Group have risen over 40%, meaning that out of the "Magnificent Seven" stocks, only Nvidia has outperformed. What does this tell us? Simply, investors can look outside of the "Magnificent Seven" to make gains and taking an active approach over simply buying the index can make a real difference.

We believe that the stage is now clear for the Bank of England to cut interest rates. This adds urgency to investment allocation as history shows that the inflection point of the first change in trend has a significant impact on equity and bond investment.

The change of government brings an end to recent political uncertainty and while we don't believe that politics is the only driver of investment markets, this also removes one of the risks surrounding UK equities. Indeed, there is talk of substantial capital inflows to the UK. As recent negative net flows reverse, we believe that prices could appreciate considerably, after a long period of weakness relative to overseas peers. It could be argued that the positive movements of smaller companies in the UK on Friday show growing confidence that there will be relative strength in this area, something that was seen under the last Labour government. In our view, particularly in asset classes such as smaller companies, it is important that investors don't allocate capital too late.

We believe that the UK will merit the overweight recommendation of a significant and successful US research house, and that this recommendation chiming with interest rate inflection means that prompt action is of the essence.

To date investors have been validated in a structural underweight to the UK and smaller companies in particular, but with stocks like those noted above providing US tech like returns, on considerably lower ratings, we see this as a potential inflection point. With an improving economy and falling inflation in the UK compared to crowded indices, leading indicators slowing, and stickier inflation in the US mean that the political and economic arguments for avoiding the UK are steadily reducing.

We are optimistic on growth for the UK, and in particular smaller companies, and think that you should be as well.

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