The UK equity market ended 2018 at a two-year low. This volatility was driven by macroeconomic factors that all investors, even those primarily focussed on stock selection, were obliged to navigate. Entering the new year, perceived risks surrounding a slowdown in global economic growth, US interest rate policy, Sino-US trade wars and the rise of populism in Europe continue to dominate debate. At home, we stand at a political crossroads. Despite months of negotiations, fierce rhetoric and political pageantry, the nature of Britain's exit from the European Union remains in doubt.

Despite such negativity, data suggests that the UK's economic outlook is moderately robust. Economic indicators point to continued steady, if unspectacular, economic growth in the UK. We have seen a recovery in real wage growth over the past year; wage growth is faster than inflation. Meanwhile the number of people in work increased by 350,000 in 2018, more than three times the increase in the size of the working age population. This near-record low unemployment is set against a backdrop of 850,000 job vacancies – a record high. Consequentially it feels sensible to expect employment growth to remain robust.

In 2019 we are also likely to see further economic stimulus from an uptick in government spending. Growth in real government spending (adjusted for inflation) has been minimal since the recession. Now that the budget deficit[1] has fallen to less than two per cent of gross domestic product (GDP)[2] and the current budget has moved into surplus, the government intends to step up its spending plans, as announced in the Chancellor's Autumn statement.

The combination of continued employment growth and growth in real wages should help to strengthen consumption growth. Meanwhile, consumption growth, coupled with an increase in government spending, should lead to continued real GDP growth.

OPTIMISTIC INVESTING
in a challenging market

Against this backdrop the UK equity investor must move cautiously. However, I remain optimistic of the UK's prospects and I have positioned the portfolios under my management accordingly[3]. As investors have moved away from domestically exposed businesses, largely due to Brexit fears, I have steadily increased my exposure to UK companies that source the majority of their revenues from the UK. Under a cloud of persistent negativity, the market's indiscriminate approach has created opportunities to buy shares in many companies with attractive fundamentals that are trading on share prices that are, to my mind, below the companies' intrinsic value. The most obvious opportunities, to my mind, lie within retail and real estate.

> "I have also sought to diversify the portfolio by emphasizing exposure to businesses which are not typically reliant on the growth in our economy to stimulate growth."

As well as the tilt towards domestic value opportunities, my portfolios remain well balanced with significant exposure to the international earners of the FTSE All-Share index, and sectors such as oil and tobacco are prominent. In the integrated oil sector, companies are using technology, standardisation and simplification to reduce costs. Management teams have succeeded to such an extent that it is cheaper to mine one barrel of oil today than it was in 2013 when the oil price was over US$140 per barrel. To my mind this superior cash discipline will enhance the industry's ability to pay shareholders income through dividends. Meanwhile, in tobacco, increasing regulation and the rise of industry disruptors, such as US vaping firm JUUL, have spooked investors over the past eighteen months. However, to my mind the pessimistic consensus fails to appreciate the ability of the tobacco sector to remain agile and cash generative within an evolving industry and which includes a tighter regulatory framework.

Meanwhile, I have also sought to diversify the portfolio by emphasizing exposure to businesses which are not typically reliant on the growth in our economy to stimulate growth. This includes catastrophe insurers, alternative lenders (non-banks) and other non-core financials such as litigation financing.

As we move through 2019 macroeconomic factors both at home and abroad will no doubt continue to influence the performance of the UK equity market. However, as I anticipate a revision to more rational pricing, I remain confident that my portfolios remain well diversified, with a range of income generating companies, which trading at attractive valuations offer opportunity for income and capital growth. Catalysts for any reassessment of the UK equity market's prospects must surely include a better-than-expected outcome for Brexit. To my mind, a positive outcome for the UK equity market rests on an end to the political no-man's land which has perturbed investors for the past two years. ■

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When making an investment in an investment trust you are buying shares in a company that is listed on a stock exchange. The price of the shares will be determined by supply and demand. Consequently, the share price of an investment trust may be higher or lower than the underlying net asset value of the investments in its portfolio and there can be no certainty that there will be liquidity in the shares.

The use of borrowings may increase the volatility of the NAV and may reduce returns when asset values fall.

The Edinburgh Investment Trust Plc uses derivatives for efficient portfolio management which may result in increased volatility in the NAV.

Perpetual Income and Growth Investment Trust Plc may use derivatives for efficient portfolio management which could result in increased volatility in the NAV.

1. A budget surplus or deficit refers to the value of a government's spending versus its income. If spending exceeds income then the budget is in deficit. If spending is below income, the budget is in surplus.

2. A measure of the size of an economy. GDP measures the monetary value of (a measure of the market value of all the final goods and services produced within an economy)

3. Mark is named manager of the Edinburgh Investment Trust Plc and Perpetual Income and Growth Investment Trust Plc.

Important information: Where individuals or the business have expressed opinions, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice.

For more information on our products, please refer to the relevant Key Information Document (KID), Alternative Investment Fund Managers Directive document (AIFMD), and the latest Annual or Half-Yearly Financial Reports. This information is available using the contact details shown.

Invesco

Mark Barnett

Head of UK Equities

Invesco

Mark is responsible for the management of a number of UK equity portfolios, with a focus on the management of open and closed ended vehicles.

Mark began his investment career with Mercury Asset Management in 1992 and joined our company in 1996. Since then, he has become one of the team's most experienced fund managers, specialising in UK equity income investing.

He graduated in French and Politics from Reading University in 1992 and has passed the associate examinations of the Association for Investment Management and Research (AIMR).