

# RESEARCH INSIGHTS



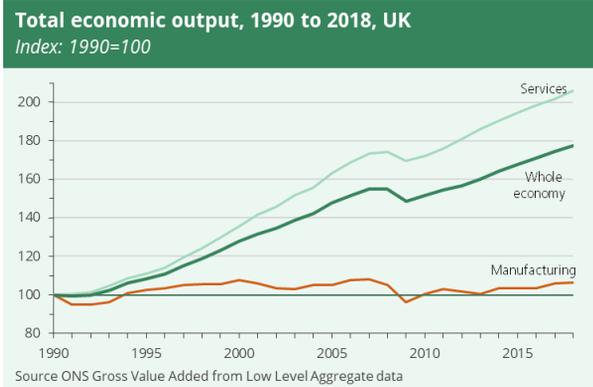
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## Fishing for a Bargain On British Economy & Markets

Amidst historic turns of events, we take a closer look into the workings of the United Kingdom's economy in a bid to answer a curiosity; one where satisfaction comes with a possible reward.

### At a Glance

The United Kingdom (UK) has been no stranger to shifting tides and shaky grounds the past few years, in no small part, due to the looming issues of BREXIT and the world-changing black swan we all know as the COVID-19. In these unprecedented times, we examine what turns the gears of the markets, and what will continue to be the driving force as the world looks forward towards a post-pandemic world past the incoming mass vaccinations.



Source: UK Parliament, House of Common Library

As of the most recent forecast, the final tally for economic contraction in 2020 is estimated at 11%. Given that they had 0% GDP growth in Q4-2019 compiled with experiencing the deepest plunge in GDP across the next two quarters (Q1-2020 & Q2-2020), the Kingdom has seen better days.

As shown above, the UK GDP in recent years has seen increasingly strong output from the Services Industry. This is doubly reflected in how the economy sways in tracking the line of that industry.

Manufacturing, while still a major contributor towards production, remains stable given the strong engineering and science presence that balances out against dipping sectors such as fishing and agriculture.

Together, both the Services and Manufacturing Industries account for about 93% of the UK economy, while Construction, Agriculture etc accounts for the remaining 7%. The focus here will, however, be on the 2 major industries.

### The Waters

As constant as change can be, the markets continue to shift at breakneck speeds to reflect forward enthusiasm in the new normal.

While manufacturing, as of 2021, has found temporary footing, the Services Industry continues to trail behind.

### Services Business Activity Index

sa, >50 = growth since previous month



### Manufacturing PMI

sa, >50 = improvement since previous month



Source: IHS Markit, CIPS

***“Customers, especially those based in the EU, brought forward purchases, boosting sales temporarily. It seems likely that this boost will reverse in the opening months of 2021, making for a weak start to the year.”***

- Rob Dobson, Director at IHS Markit

On first look, it appears that forward expectations for manufacturing are that there will be expansions in many of its sectors. However, that may not be the case.

Given the third lockdown in the UK that recently kicked in due to the new strain of coronavirus as well as companies stockpiling inventories to take advantage of existing trade agreements before the BREXIT agreement goes through, this has thus resulted in a sharp upshoot in the Manufacturing's Purchasing Manager's Index (PMI).

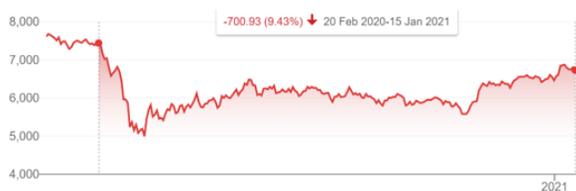
On the other hand, the Services Industry is tracking lower than equilibrium (< 50) on the Services PMI, at around 49.4, since December 2020. In light of the slightly negative sentiment, a lot of it can once again be attributed to the ongoing pandemic and uncertainties spilling over from the BREXIT deal.

Some very important things to note are that huge contributors to the makeup of the Services Industry are derived from the Financial, Retail and Tourism Sector. This is compiled by the fact that much of the expenditure towards them also comes from household spending, of which much has also slowed down to reflect current circumstances.

Going forward, it is very likely that we will see a downtrend in both major industries as the UK economy stays largely unproductive amidst sitting through a lockdown in January. OECD forecasts states that the UK economy will remain 6.4% smaller than it was in 2019 Q4 towards the end of 2021. As the new year begins with baggage from the previous, outlook in the short term continues to look dim.

### Rod, Line and Hook

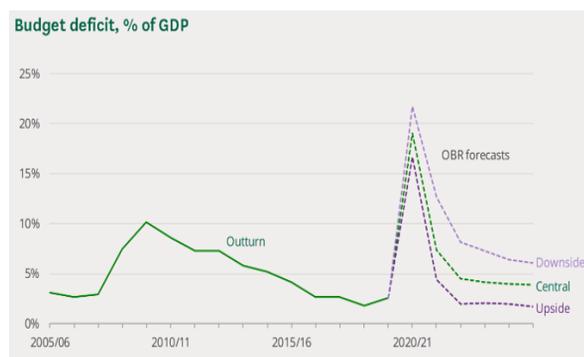
Through the gloom, however, a glimmer of opportunity may just shine through yet. It is of belief that bargains still exist within the UK markets. After the huge market dip back in March 2020, most UK indices, and companies with huge market capitalization are still tracking behind pre-COVID-19 levels. While many show recoveries, albeit the volatility, speed has been slow thus far.



Source: Google, FTSE 100

The UK, as it stands, is currently the first nation to mass vaccinate their citizens. As of January 11th, 2021, as much as 3% (~2.4 million) of the population has been vaccinated. This number, according to the government will be increasingly ramped up and around as much as 25% (~15 million) of the population is expected to be vaccinated by mid-February.

Beyond that, the UK government will be increasing their budget deficit to its highest ever since 2008/9. Numbers forecasted by the UK's Office for Budget Responsibility (OBR) stands minimally at around £353 billion.



Source: UK Parliament, House of Common Library

This flags a huge increase in government expenditure, which is a sign that the UK is looking to include more fiscal policy towards navigating the downturn. While BREXIT remains a huge barrier towards economic growth, the economy is still set to grow regardless.

Meanwhile, the UK continues to be faced with administration challenges regarding changes to border rules with the EU and hashing out a favourable environment for trade. The ironing of details is expected to still take a while; at least for the rest of year.

So, no matter which way the wind blows, we can rest assured that the UK economy will return to productivity eventually and continue to go on expanding past pre-Covid-19 levels. The only question however, being, "when?"

## Writer's Opinions

### The Catch

While uncertainty plagues the UK, recovery trails along slowly, but surely. Given current circumstances, finding gains in the short term may appear to be a fool's endeavor but for those looking to buy and hold on a longer period, there just might be gold where one goes looking for it.

While share prices of large UK companies within the Services and Manufacturing Industries chug along at snail's pace, it is notable that most of them remain profitable, and will continue to foreseeably do so. It is entirely possible that the prices as of now have yet to correctly reflect forward enthusiasm.

Additionally, now that the UK has officially departed from the EU, companies may now be disincentivized from relying on the European market and instead look towards expanding into emerging markets to anchor growth in the coming years. This may bode well as a strategy to diversify their market concentration.

Given the chips we are dealt with, the sectors that any bargain hunters may want to be on the lookout for in either industries would be, for *Manufacturing*, Pharmaceutical, Consumer/Household Goods and Material Science and, for *Services*, Financial Intermediaries, IT & Data Analytics and Healthcare.

These sectors represent some of the more forward-looking parts of their respective industries and/or are largely proven steadfast in times of instability.

Regardless of whether one believes that current markets correctly reflect the outlook, it is undeniable that they've proven to be comprised of value-added companies that will very likely continue to stand the test of time.

All things equal, optimism must still be approached with vigilance for, if anything, the past year has been a cautionary tale in unpreparedness and there is still much yet to be seen in the year(s) to come.

For the brave and undaunted, on the other hand, there could be very well be a big catch lurking below the murky depths, awaiting to be reeled in by whomsoever casts the line first. To the bold I say, may fortune favour you.

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