1952 – 2022: A PLATINUM ERA?

As Her Majesty the Queen approaches the 70th anniversary of her coronation we look back at some of the defining moments under her reign and how the world of investing has evolved since 1952.

Franklin Templeton, through their subsidiary Martin Currie, manage the Omnis UK All Companies Fund and the Omnis UK Smaller Companies Fund.

Ben Russon

Portfolio Manager
& Research Analyst

Jo Rands

Portfolio Manager
& Research Analyst

Richard Bullas

Portfolio Manager
& Research Analyst

Dan Green

Portfolio Manager
& Research Analyst

Summary

- The UK has navigated significant political, social and technological reform since the Queen ascended the throne in February 1952.
- Negotiating many business cycles, inflation has averaged 5% per annum since 1952[1] with the 1970s suffering a crippling period of stagflation and record interest rates.
- Assets have appreciated over the long term. Small and mid-cap companies have outperformed their large-cap counterparts and house prices have increased some 13,000% since 1952.[2]
- Conversely, the value of the pound has fallen by 55% relative to the US dollar.[3] Although the rate was pegged until the 1970s, subsequent de-ratings have been a consequence of major economic events.
- Surging inflation and rapidly rising interest rates are dominating today's market where the prospect of a policy mistake is increasingly discussed.
- Positive underlying factors are supporting the UK economy, including robust employment data.
- The UK is suffering a cost-of-living crisis which is weighing on consumer-sensitive companies.
- The UK Equity Team are optimistic about the outlook for the UK, supported by structural growth trends and the observed long-term outperformance of small and mid-cap companies, as well as the opportunity to exploit pricing anomalies.
- Exposure to inflation-resistant sectors provides the manager with access to investable companies with the headroom to grow, alongside attractive valuation metrics and the tailwinds earned from sterling weakness relative to the US dollar.

[1]Source: ONS as at 30 April 2022.

[2]Source: Elroy Dimson, Scott Evans and Paul Marsh, Numis, as at 31 December 2021, and Nationwide Building Society, as at 30 April 2022.

[3]Source: FX Top, as at 30 April 2022.

How has the market evolved under the Queen's reign?

A lot can happen in 70 years. Queen Elizabeth II ascended the British throne in February 1952 and the UK has since navigated significant political, social and technological reform. The contrast to today is stark from a year where just 14%[4] of households owned a television set, tea remained rationed, Sir Winston Churchill was re-elected UK Prime Minister and London was subjected to the tragedies of the Great Smog. Elsewhere, the contrast is not so evident as 2022 UK inflation averages 9%, proportionate to levels seen in 1952.[5] Until very recently inflation figures have remained well below the average 5% since the Queen ascended the throne, boosting returns albeit at the expense of the pound. In fact, assuming a return on investment commensurate to observed nominal GDP growth over the period of 7.4%[5], £100 invested in 1952 would today be worth nearly £15,000.

In 1952, the prominent index in the UK was the FT 30 which was comprised of 30 stocks in the industrial and commercial sectors. In a world of post-war austerity, waning investor optimism was felt in the FT 30 which at times struggled when encumbered with high taxes and unexpected interest rate rises. At the time, British industry was heavily dependent on manufacturing with investors seeking returns from popular sectors such as chemicals, shipping and rubber manufacturing. In the 1950s, we didn't see much by way of mergers, however, 1952 did deliver one of the period's few major mergers when Austin and Morris combined to form British Motor Corporation, the largest British car company of its day.

Lethargic equity markets were relatively short-lived under the queen's reign, culminating in the "Cult of Equity" in the mid-late 1950s which saw institutional investors herd into shares for income and inflation protection at the expense of bonds. By 1959 the market yield had retreated beneath the gilt yield for the first time ever, a trend that persisted for multiple decades. This was a seismic shift in the way investors approach income and indeed high yield investing.

By the end of the 1950s confidence had returned and living standards were back on the rise, summed up by Harold Macmillan's 'you've never had it so good' speech. Increased production in major industries such as steel, coal and motor cars led to a rise in wages, export earnings and investment. However, this prosperity was short-lived when the Conservative government applied a wage freeze in the early 1960s to combat inflation which had risen to around 5%.[5]

Intended to serve as a reliable 'standard portfolio' of UK shares, the FT-Actuaries All-Share index was launched in 1962, later to become known as the FTSE All Share index. Spanning 594 companies, today it represents around 99% of investable UK universe.[6]

Strong growth and employment continued through the 1960s alongside technological innovation, allowing Barclays bank to open the first 'Hole in the Wall' ATM in 1967.

The information provided should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the securities discussed here were, or will prove to be, profitable.

[4]Source: BBC, as at 30 April 2022.

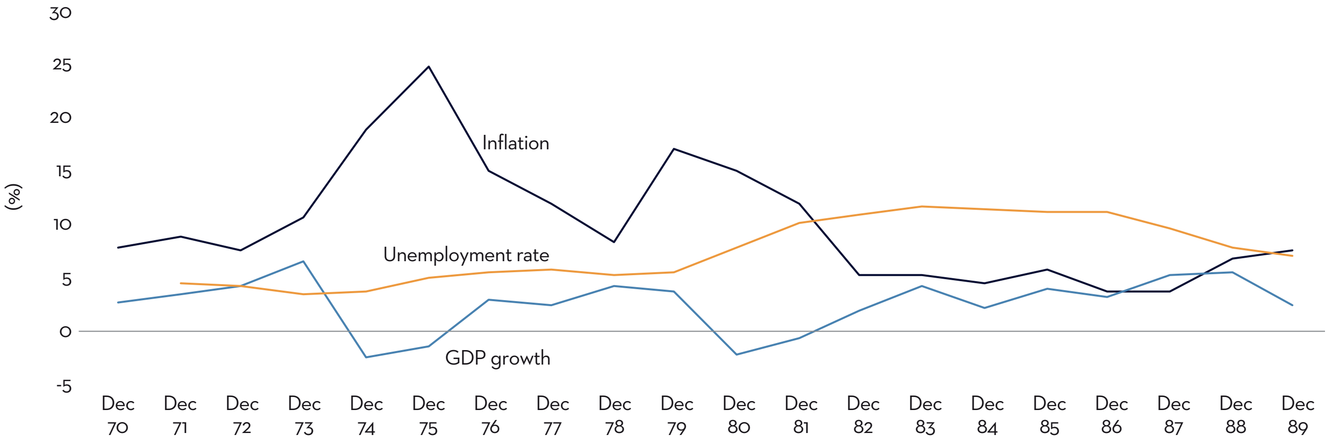
[5]Source: Statista and Office for National Statistics (UK), May 2022. Consumer price inflation tables, table 37, ID CZBH.

[6]Source: As measured by market capitalisation. FTSE Russell, as at 30 April 2022.

Strong growth and employment continued through the 1960s alongside technological innovation, allowing Barclays bank to open the first 'Hole in the Wall' ATM in 1967.

By the 1970s inflation had risen to 25%[7] driven by the three-fold rise in the price of oil, the growth of credit and consumer spending and rising wages. The UK succumbed to a wage-inflationary spiral as the powerful unions of the time bargained for higher wages to keep pace with the rising cost of living. Stagflation and mass unemployment had become a reality. The government attempted to implement wage and price controls which proved largely unsuccessful in combating inflation.

UK Inflation, GDP Growth and Unemployment, 1970-1989



Source: Office for National Statistics, 30 April 2022.

Margaret Thatcher's government succeeded in moderating spiralling inflation at the expense of a deep recession in 1981 where unemployment reached levels not seen since the Great Depression. Supply-side reform such as privatisation, reduced income tax, the reduced power of trade unions and the de-regulation of financial markets aided the UK's recovery.

The FTSE 100, which tracks the largest 100 (or so) companies listed in the UK, was launched in 1984 and comprised UK-centric, household names such as Boots, Tesco and MFI, deeming it a pure play on the UK economy. Privatisation led to the IPO of British Telecom and British Gas (now subsumed into Shell and Centrica) as well as the UK government disposal of their 30% stake in BP. Although two of the three companies remain present in today's index, the FTSE 100 appears materially distinct in both names and earnings profile when compared to 1984. In 2022, around 70% of FTSE 100 revenue is generated from overseas operations.[8]

> Margaret Thatcher's government succeeded in moderating spiralling inflation at the expense of a deep recession in 1981 where unemployment reached levels not seen since the Great Depression.

The information provided should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the securities discussed here were, or will prove to be, profitable.

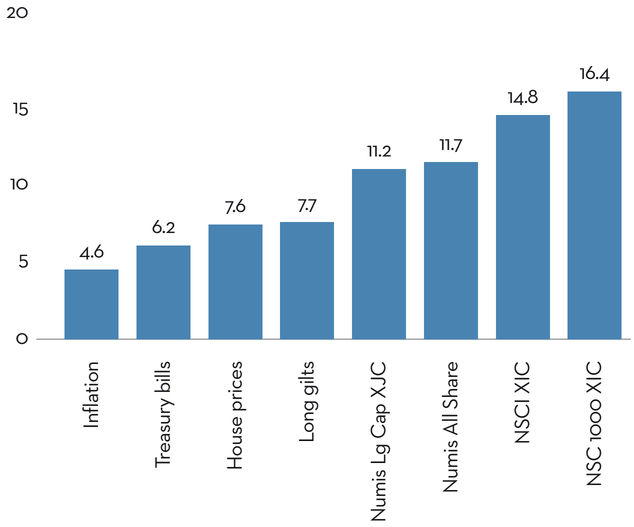
[7]Source: Statista and Office for National Statistics (UK), May 2022. Consumer price inflation tables, table 37, ID CZBH. Inflation reached 25% in December 1975.

[8]Source: FTSE Russell, as at 30 April 2022.

The RBS Hoare Govett Smaller Companies index was first published in 1987. Now known as the Numis Smaller Companies Index (NSCI), it comprises smaller companies available to invest in the main UK equity market, known as "small-caps"[9]. Despite initial publication in 1987, data back-tested to shortly after the Queen's coronation delivers an encouraging long-term story for small-cap UK equities. Over the long term, small-cap UK equities have outpaced their large-cap counterparts despite higher volatility. On a cumulative basis, £1 invested in the NSCI (ex IT) at the start of 1955 would have been worth £10,138 at the start of 2022, compared with £1,658 if the same £1 were invested in the Numis All Share index, which comprises companies of all sizes.

Following a long phase of economic expansion, the UK entered a period of recession in 1991. This recession had a significant impact on the housing market as soaring interest rates meant consumers could simply no longer afford mortgage repayments.

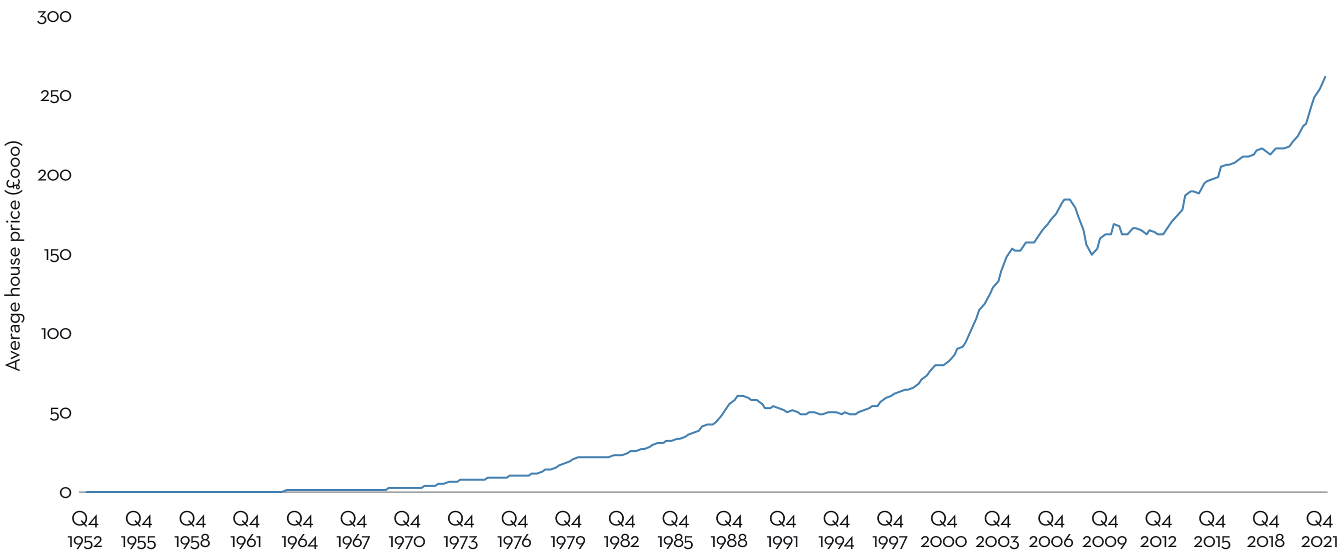
Annualised returns 1955-2021 (%)



Source: Elroy Dimson, Scott Evans and Paul Marsh, Numis, as at 31 December 2021.

The housing market was subjected to its own bubble through the 1980s where financial de-regulation allowed banks to compete with building societies for mortgage lending. House prices began to fall in 1990 and continued to decline until 1995, though average UK property prices over the queen's 70-year reign have increased by over 13,000%.

Average UK House Prices, 1952 – 2022



Source: Nationwide Building Society, 31 March 2022.

> House prices began to fall in 1990 and continued to decline until 1995, though average UK property prices over the queen's 70-year reign have increased by over 13,000%.

[9]Covering companies valued in the bottom decile of the main UK Equity market.

The FTSE Mid 250 launched in 1992 which marked the start of a new era for market participants who wanted to benchmark their investments to mid-sized companies – not the very large companies in the FTSE 100, nor the very small ones in the NSCI. Amid doubters who believed that the UK market was dominated by only small and large-cap size factors, the FTSE Mid 250 went on to outperform in its maiden year.

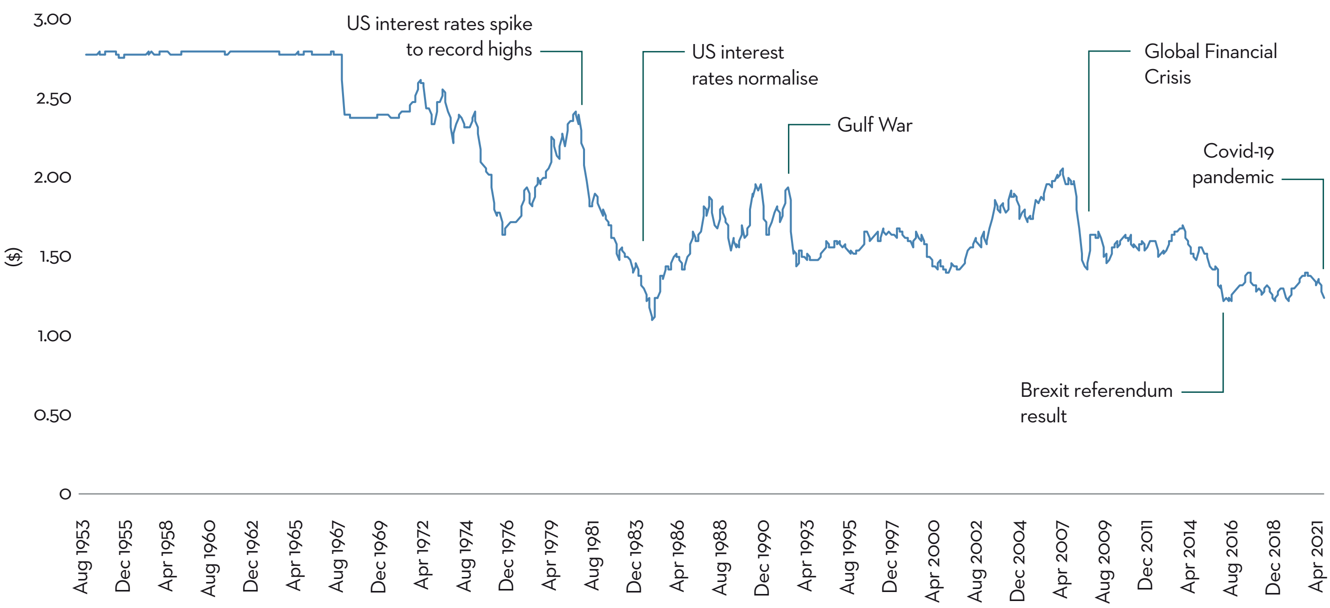
By 1997, the Bank of England was declared independent from the government. Now with complete autonomy over UK monetary policy, this was intended to ensure that any decisions were reached objectively especially in periods of political uncertainty. Technological innovation was further prominent as internet companies became prevalent across markets leading to the Dot Com Bubble. Investor optimism peaked as a period of great stability was expected following an increase of over 300% on the FTSE All Share during the 1990s.[9]

The tragic events in New York City in 2001 prompted a sharp downturn across global markets. Financial deregulation continued in the US alongside unprecedented accessibility of credit, leading to increased issuance of structured credit securities and 'sub-prime' mortgages. A wave of loan defaults was triggered in 2006 when the Federal Reserve, the US Central Bank, raised interest rates causing US house prices to fall, as well as the collateral for a significant proportion of the structured credit that had been issued across the globe. Market contagion ensued as global liquidity (how quickly money can be accessed) evaporated culminating in the collapse of the Lehman Brothers in 2008 and the biggest fall in global GDP since the Great Depression. This meltdown led to the nationalisation of Northern Rock and Bradford & Bingley as well as significant cash injections from the UK taxpayer into RBS and Lloyds.

UK interest rates fell to record low levels at the time but by 2010 the UK economy was again growing as Quantitative Easing (QE) was well underway. The Brexit referendum in 2016 caused further headwinds for the UK market in particular as the UK voted to leave the European Union, with many investors consequently reducing allocations to the region. Economic uncertainty clouded the UK, resulting in strong GBP selling pressure in favour of USD, typically considered a safe haven currency. Over the duration of the queen's reign the value of GBP relative to USD has deteriorated by over 55%.

The COVID-19 pandemic in 2020 caused a global recession and the central bank response was unprecedented the world over, unleashing liquidity on a scale that was never-before-seen.

GBP/USD, 1952-2022



Source: FX Top, as at 30 April 2022.

The information provided should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the securities discussed here were, or will prove to be, profitable.

What is dominating the market today?

2022 has investors grappling to price in two powerful forces. Elevated and persistent inflation remains prevalent, which in turn has brought forth monetary tightening in the form of rapidly rising interest rates. The Covid-19 pandemic has been further exacerbated by the geopolitical tensions and humanitarian tragedies witnessed as Russia invaded Ukraine, as oil prices fluctuating around $100 per barrel have suppressed consumer budgets in the UK. Supply chain disruption continues to squeeze consumer spend as major wheat and cooking oil producer Ukraine finds itself unable to export its goods.

Amid soaring inflation the Bank of England is faced with the difficult question of how much inflation will fall of its own accord whilst household finances are being hit hard by the cost of living crisis. Policymakers face the conundrum of how far interest rates need to go in order to moderate inflation without hampering growth. If they dont raise interest rates enough, inflation could continue to spiral, intensifying already compressed consumer budgets. On the other hand, if they raise interest rates too aggressively and over-suppress demand at the expense of a recession, sending growth into reverse. This monetary policy predicament further compounds when you consider that the main drivers of inflation are exogenous forces, particularly energy prices and global goods prices.

If economic waters do get a bit choppy then the UK is at least starting the journey from a position of relative strength. Latest ONS data reveals the unemployment rate easing to 3.7% in Q1 2022 taking it to a five-decade low. There are currently more job vacancies than there are job seekers, a scenario that the UK has never encountered before. Furthermore, long-term wage growth is partly counteracting the cost-of-living crisis where nominal wage increases will help consumers keep pace with rapidly rising prices.

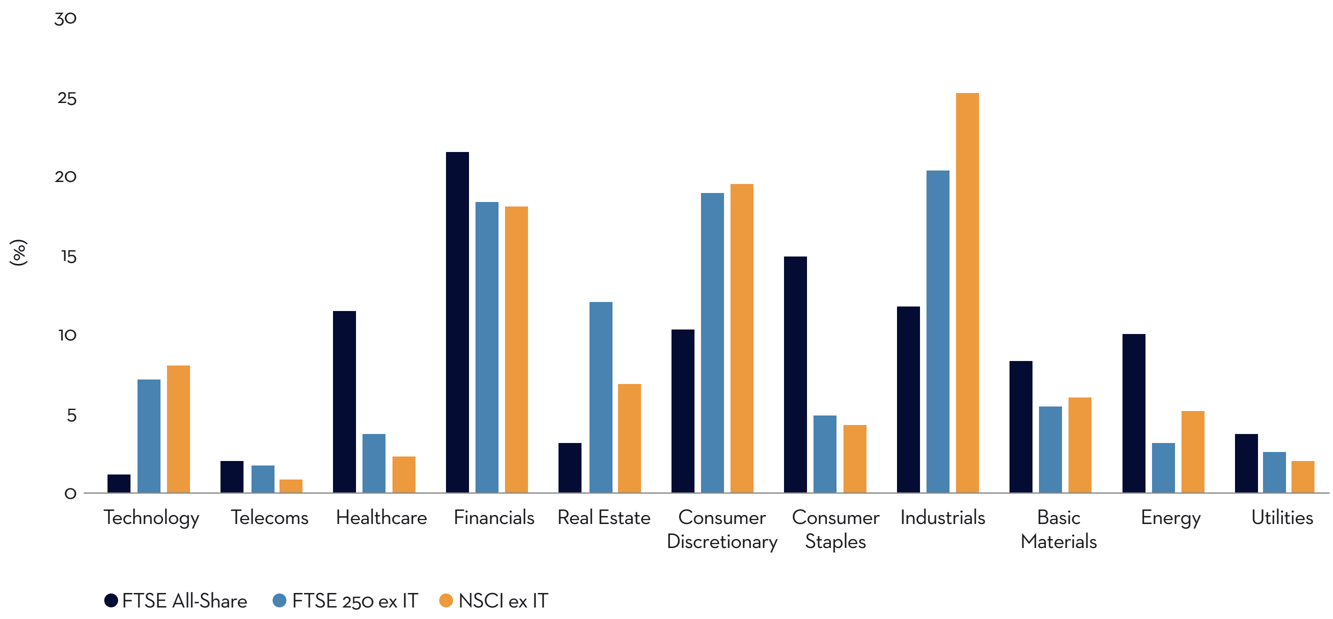
Considering the macroeconomic backdrop of 2022, it is easy to draw comparisons between today and historic periods of surging inflation and rising interest rates. Although each scenario was triggered by a unique set of circumstances, today's investors are beginning to compare the current scenario with the period of UK stagflation suffered in the 1970s. Although history rarely repeats itself, it sometimes rhymes, and we have witnessed a similar sell off as high growth companies and cyclical sectors of the market begin to de-rate at the prospect of prolonged, persistent inflation combined with a slowdown in global growth.

"Considering the macroeconomic backdrop of 2022, it is easy to draw comparisons between today and historic periods of surging inflation and rising interest rates."

How is the market positioned to perform?

UK equity investing is very different to what it was 70 years ago when the FT30 was the recognised proxy for the condition of the UK market. Broad in nature, small and mid-cap companies are positioned to outperform in different environments to those that are supportive of blue-chip companies.

Composition of UK Indices



Source: FTSE Russell, Numis as at 30 April 2022.

Considering the composition of the NSCI (ex-IT) and the FTSE 250 (ex IT) we observe significant exposures to consumer discretionary and industrial companies. Typically seen as sensitive to the business cycle, consumer discretionary companies have struggled so far this year. Such companies tend to reflect a more representative picture of the UK economy as the majority of earnings are sourced domestically.

Industrial companies have struggled year-to-date as the equity markets have attempted to price-in an economic slowdown. This growth scare has been compounded by supply chain issues being felt across the globe. Supply chains remain under pressure, exacerbated by the Russia/Ukraine conflict and China's zero-Covid policy. These supply chain bottlenecks and shortages are increasing the cost base for many industrial companies, potentially squeezing margins as the prospects of reduced global demand are increasingly considered. Delays and supply shortages are likely to cloud this year's outlook as rerouting, high transportation costs and lower consumer demand all weigh on merchandise trade.

Conversely, certain industrial sub-sectors are benefitting from tailwinds, such as defence stocks, with companies such as QinetiQ reporting a 9% increase in orders,[10] boosted by enhanced military spending. Global military spend has progressed on a positive trajectory for seven years reaching $2.1trn in 2021. The Russia/Ukraine conflict has prompted further investment in defence across the globe meaning this figure is predicted to rise again in 2022.[11]

For mid-sized companies in particular, the sell-off has exceeded other periods of relative underperformance, including the March 2020 Covid-19 volatility, the June 2016 Brexit domestic selloff and even surpassing the drawdown during the Global Financial Crisis of 2007/08. The global uncertainty has led to investors favouring defensive havens that are more prominent in blue-chip indices, at the expense of the growth-oriented, economically-sensitive consumer sectors that we tend to see in the the mid and smaller-sized companies.

The information provided should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the securities discussed here were, or will prove to be, profitable.

[10]Source: QinetiQ Annual report, 31 March 2022.

[11]Source: Sipri, 31 December 2021.

The FTSE 100 is materially distinct to the index that was first launched in 1984. Closer comparisons could be drawn to today's FTSE 250 index given the exposure to domestic and consumer sensitive stocks. Globalisation has accelerated its evolution into an internationally exposed powerhouse sensitive to commodity prices, macroeconomic factors and overseas currencies. The FTSE 100 has returned to favour after many years of headwinds, outperforming markets around the world.

This relative outperformance is easily explained when you consider the composition of the UK's blue-chip index. 70% of revenue generated overseas, during a period of US dollar strength relative to the pound, over 35% exposure to 'defensive' sectors, over 15% exposure to financials, the majority of which will benefit from rising interest rates and over 12.5% to oil-sensitive energy companies.

Real assets, including commodities tend to provide an element of inflation protection. With the price of oil oscillating around $100 per barrel it is no surprise to see both BP and Shell in a relative position of strength in 2022 so far. More broadly, rising industrial minerals have been very supportive for the mining stocks which constitute a large portion of the FTSE 100.

Elsewhere the large-cap index also has a lot of exposure to financials that typically benefit from rising interest rates, albeit this is countered by their economic sensitivity in the face of concerns over slowing global growth. Beyond these sectors we encounter significant exposure to pharmaceuticals, utilities, tobacco and consumer staples stocks. Defensively minded, these sectors could perform well during a period of economic hardship.

Growth-heavy markets such as the US have struggled so far this year, where for example the NASDAQ Composite index has fallen nearly 30% year-to-date. Despite this pullback, the US market still looks more expensive than the UK market offering us as investors some good opportunities to invest in companies in the UK at a reasonable price.

The information provided should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the securities discussed here were, or will prove to be, profitable.

"The FTSE 100 is materially distinct to the index that was first launched in 1984. Closer comparisons could be drawn to today's FTSE 250 index given the exposure to domestic and consumer sensitive stocks."

We remain positive on the outlook for the broad UK equity market particularly as it's our job to look for good companies who can deliver returns in different market conditions. Within small and mid-cap companies, although we find ourselves in a period of economic and geopolitical uncertainty, the NSCI and the FTSE 250 are less exposed operationally to fluctuating macroeconomic factors such as interest rate movements or commodity volatility. Whilst we are cognisant of the macroeconomic backdrop, our process is underpinned by bottom-up stock selection and provides opportunities to exploit idiosyncrasies through our rigorous fundamental research.

Whilst the market focuses on the macro, we continue to focus on what we call "the micro". Identifying structural growth trends allows us to hone in on those companies that are positioned competitively to succeed over the long term, irrespective of the macroeconomic environment.

We are further encouraged by the observed long-term outperformance of small and mid-cap shares. Offering unique exposure to disruptive industries, we believe that our process of identifying quality companies under strong management teams, trading on reasonable multiples and holding them over a long-term investment horizon will prevail through short-term periods of volatility.

Blue-chip UK stocks have led global markets year-to-date and we believe that there are many encouraging factors that are supportive of the case for FTSE 100 investing from here. The composition of the index is defensive in nature, where prominent sectors such as resources, utilities, pharmaceuticals and tobacco are all well-positioned to weather challenging economic environments and periods of accelerating inflation.

The UK market appears to be cheaper to other markets globally, offering us as investors in the UK, the opportunity to find attractive investments for the fund.

Unless otherwise stated, source of all data is Morningstar as at 30 April 2022.

Important information

This material is intended to be of general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy. It does not constitute legal or tax advice. This material may not be reproduced, distributed or published without prior written permission from Franklin Templeton.

The views expressed are those of the investment manager and the comments, opinions and analyses are rendered as at publication date and may change without notice. The underlying assumptions and these views are subject to change based on market and other conditions and may differ from other portfolio managers or of the firm as a whole. The information provided in this material is not intended as a complete analysis of every material fact regarding any country, region or market. There is no assurance that any prediction, projection or forecast on the economy, stock market, bond market or the economic trends of the markets will be realized. The value of investments and the income from them can go down as well as up and you may not get back the full amount that you invested. **Past performance is not necessarily indicative nor a guarantee of future performance. All investments involve risks, including possible loss of principal.**

Any research and analysis contained in this material has been procured by Franklin Templeton for its own purposes and may be acted upon in that connection and, as such, is provided to you incidentally. Data from third party sources may have been used in the preparation of this material and Franklin Templeton ("FT") has not independently verified, validated or audited such data. Although information has been obtained from sources that Franklin Templeton believes to be reliable, no guarantee can be given as to its accuracy and such information may be incomplete or condensed and may be subject to change at any time without notice. The mention of any individual securities should neither constitute nor be construed as a recommendation to purchase, hold or sell any securities, and the information provided regarding such individual securities (if any) is not a sufficient basis upon which to make an investment decision. FT accepts no liability whatsoever for any loss arising from use of this information and reliance upon the comments, opinions and analyses in the material is at the sole discretion of the user.

Products, services and information may not be available in all jurisdictions and are offered outside the U.S. by other FT affiliates and/or their distributors as local laws and regulation permits. Please consult your own financial professional or Franklin Templeton institutional contact for further information on availability of products and services in your jurisdiction.

UK: Issued by Franklin Templeton Investment Management Limited (FTIML), registered office: Cannon Place, 78 Cannon Street, London EC4N 6HL. Tel: +44 (0)20 7073 8500. Authorized and regulated in the United Kingdom by the Financial Conduct Authority.

FTSE International Limited ("FTSE") © FTSE 2022. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under licence. All rights in the FTSE indices and / or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and / or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent. References to indices are made for comparative purposes only and are provided to represent the investment environment existing during the time periods shown. An index is unmanaged and one cannot invest directly in an index. The performance of the index does not include the deduction of expenses and does not represent the performance of any Franklin Templeton Group fund.

Omnis INVESTMENTS FRANKLIN TEMPLETON MARTIN CURRIE

Franklin Templeton Investment Management Limited (FTIML) Cannon Place, 78 Cannon Street, London EC4N 6HL.
franklintempleton.co.uk

For Professional Investor Use Only. Not for Distribution to Retail Investors.