

Contrarian fund manager believes UK equities are in good-value territory again

By James Henderson, Divisional Director - UK Investment

Bearish concerns have dominated investors' minds of late but contrarian investors are beginning to ask whether equity valuations are now at low enough levels to represent good value?

By historical measures they would appear to be. The price/earnings ratio on the UK market is prospectively below 12 and the gap between the 10 year gilt yield and equity dividend yield is in very cheap territory for equities. The bears are saying that earnings will not hold up and although this is undoubtedly the case in some areas there are a number of UK companies that will surprise investors by delivering a robust performance during 2008. These companies are heading into an economic slowdown with strong balance sheets and generating good levels of cash profits **which should support dividend payments.**

The UK economy is expected to grow this year at around one and a half per cent and the global economy - fuelled by the strong economic performance of the Middle and Far East - will continue to expand. This gives many of the UK's better companies substantial opportunities. Therefore, for my funds we are buying selective industrials within the smaller companies market which serve these areas. We are also purchasing value opportunities in UK domestic stocks, **including sectors that have been seriously out of favour such as** property companies, builders and banks. There has been an over-reaction to the problems caused by last summer's 'credit crunch' and the better companies in these sectors will come through the current difficult climate. The property companies and builders **can be** purchased on large discounts to asset value while the banks **offer** high and growing dividend yields.

After the sharp falls experienced by the market in the last six months or so, a recovery is expected, although everyone will have their own view on how sustained the recovery will be. The bears will say that it is only a "bear market rally", "a dead cat bounce" or simply hedge fund managers closing out their short positions. However they could be in for a surprise. There is already a high level of corporate activity taking place, and it is the industry buyers coming to the fore as they can see the value that is on offer. This was the case in the early 1990's when the UK left the Exchange Rate Mechanism. At that time valuations were low and interest rates were heading downwards, **making for** a very good period for equity income investors. Falling interest rates and good value in UK corporates suggest that equity income investors could benefit once more. The current yield on the FTSE All-Share is now over four per cent growing faster than inflation, therefore for a buyer at present the attractions of UK equities are considerable as long as dividend growth comes through.

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8 February 2008

This article first appeared in Investors Chronicle