

Focus on valuation offers attractive opportunities beyond the short term

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The UK market remains very volatile as the economic news flow in the US and the UK continues to deteriorate. The US Federal Reserve has been particularly aggressive in cutting interest rates in order to reflate the US economy, whilst the Bank of England has taken a more measured approach given the constraints of its inflation remit.

Generally, investors have tended to avoid those cyclical and consumer exposed stocks and chosen to invest in areas deemed to be relatively defensive, with valuations becoming less relevant. The de-rating of some cyclicals has been swift and has been exaggerated by hedge funds aggressively "shorting" these stocks and in many cases share prices are now already discounting a recession scenario. For those willing to focus on valuation and look through some of the short term negative news flow, I believe there are some compelling opportunities, particularly in some of the US exposed stocks, such as Carnival Cruise Line and Ashtead, the US rental group.

Carnival has managed to grow earnings despite having the dual headwinds of its US consumer exposure and the impact of rising fuel costs. It is trading on a Price Earnings ratio of 12x, which significantly undervalues the structural growth drivers and the duopoly nature of the cruise market. Ashtead trades on a PE of 4x, as the market chooses to focus on the debt levels and ignore the company's ability to divest of assets and reduce capital expenditure in order to improve the balance sheet.

Many commentators have speculated that the Federal Reserve has cut rates for the final time and it is encouraging to note that in previous US rate cutting cycles, the final rate cut has been followed by a significant outperformance of cyclical stocks.

In the UK, the banks have been the focus of much attention. Whilst, it is encouraging that balance sheets are being repaired through rights issues, earnings will continue to be under significant pressure from the deteriorating UK economy and increased regulation.

Within the financial sectors, I believe that the real opportunity lies in companies such as Intermediate Capital Group and Cattles. These are the real beneficiaries of the "credit crunch", yet they are being valued like banks. Competition is exiting both of their markets and both have the pricing power that allows them to maintain margins by passing on increased funding costs. Whilst both companies have recently had rights issues, it is important to make the distinction that these were done in order to fund growth by taking advantage of improving market conditions rather than to repair balance sheets damaged by asset write downs.

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