

# The Key to the UK Stock Market in 2017?

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*"A common mistake people make regarding dining rooms is to buy a matching set of table and chairs, which can be monotonous. I like to mix guest chairs in one style and head chairs in another for a more interesting, dynamic look." Candice Olson*

Putting together an equities portfolio can be remarkably akin to choosing dining room furniture. The temptation is to choose one type of stocks or a single fund product that you are comfortable with. Possibly such a selection feels safe and sometimes, of course, it is hugely successful, but equally at other times it feels un-dynamic and not the most attractive approach.

After a particularly strong second half of 2016, the index of large cap UK equities moved to an all-time high in early January. Additionally, early data for full year 2016 performance has shown that only a small proportion of active equity funds outperformed index tracking equivalents during the year. In short, the most successful strategy for many UK fund managers and allocators would have been to hug underlying indices in passive products. This outperformance in 2016 – and in aggregate over the last three or five years - of many passive products investing in the UK market, has made the pressure to switch away from active equity allocations more acute. Looking at the likely drivers and influences on the UK stock market during the rest of 2017, I feel this would be a mistake.

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	<b>% of active managers beating benchmarks</b>
2016*	21
2015	72
2014	44
*YTD to end Nov	

Source: [www.ft.com](http://www.ft.com)

In hindsight, investors needed to only make one decision in 2016 to probably guarantee outperformance. If halfway through the year they had sold all their defensive investments and allocations in sectors such as consumer staples, utilities and healthcare stocks, and switched them to the more cyclical financials, industrials and commodity-facing sectors, rewards would have benefited materially from the lower value of the Pound and would have been high. Sector rotation was the name of the investment performance game in 2016.

The theoretical "Perfect Hindsight Asset Management" always is a comfortable outperformer of course. The end of June was a challenging time for many investors to switch around their direct equity or fund style allocations because, just a few days beforehand, the surprise of the Brexit referendum vote had occurred. Such switches would have been correct from the context of generating performance last year, but would not have been an easy call to make. Passive funds, with their continuing exposure to the more cyclical areas, typically benefited from this shift, after lagging a little during the first half of the year.



The differentials in sector performance that occurred during the second half did, however, start to bridge the valuation differences that had built up between more defensive and more cyclical shares. In practical terms, it has made sector selection choices less clear-cut and individual choices about shares across all different industry groups more important. In investment parlance terms, greater individual share dispersion has made a more stock selection specific approach the likely key to UK investment success in 2017. With such a backdrop, passive funds are going to have their work cut out to outperform again during the next 12 months. The mix of specific investment choices is going to matter more.

Looking at the overall prospects for the UK market in 2017 it is hard not to conclude that a sideways shift, as individual company prospects wax and wane in the ever-changing Brexit debate/Trump Presidency/global economic growth backdrop, is very plausible. However, within an overall index which moves up or down a handful of percent points over the next 12 months or so, individual companies across a variety of sectors and styles will enjoy their own high or low points, outperformances and underperformances versus market hopes, and collectively offer a much greater share price dispersion experience for the average investor. This suits active and engaged investors.

In 2017, believe in the value of mix... and a more active, fluid approach to UK investment choices. ■

Greater individual share dispersion has made a more stock selection specific approach the likely key to UK investment success in 2017

#### KEY TAKEAWAYS:

- Passive funds typically outperformed in 2016 as many managers did not rotate their portfolios
- 2017 appears different due to the balance of risk and opportunities across all sectors
- Active and engaged investors are set - in our opinion - to outperform in 2017
- Keep flexible and fluid in your investment portfolios!

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