

Summary

- Central banks are moving ahead of the policy curve, with the Bank of England seemingly plotting its own path to tackle domestic inflation.
- Despite economic challenges, UK equities have shown strong performance and resilience, offering attractive investment opportunities.
- With more rate cuts likely and a stable political environment, the UK market is poised for positive momentum into 2025.

Reassuringly, central banks in the developed world have started to move ahead of the policy curve, and the Bank of England (BoE) is no exception. However, the UK seemingly has a different rate-setting agenda compared to the United States and Europe, as it grapples with its own unique mix of domestic inflationary pressures.

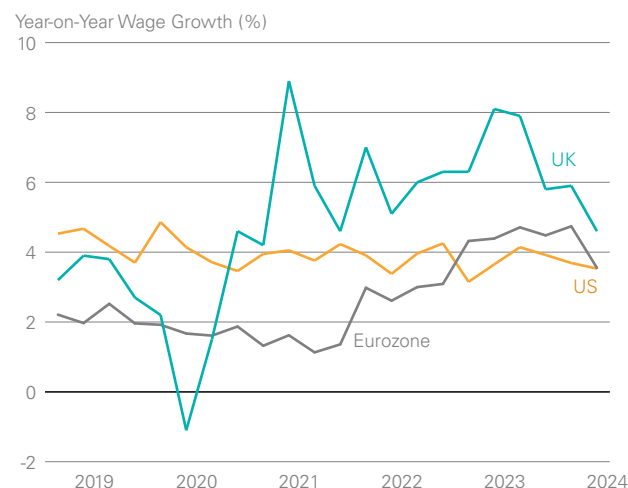
All Eyes on Inflation Trends and Wage Pressures

Inflation has been decisively trending down towards the BoE's 2% target. Despite this progress, the central bank refrained from cutting interest rates at its September meeting—after lowering the benchmark rate to 5% in August—guided by a desire to “squeeze persistent inflationary pressures” out of the UK economy.

Energy prices, a major contributor to inflation, have eased considerably. However, an escalation of tensions in the Middle East could disrupt global oil supply and push up prices. In the United Kingdom specifically, the energy price cap has recently risen by approximately 10%, which should reverse some of the downward

momentum. Meanwhile, wage inflation remains notably stronger in the UK relative to the United States and Europe (Exhibit 1). Above-inflation public sector wage increases have kept wage inflation sticky.

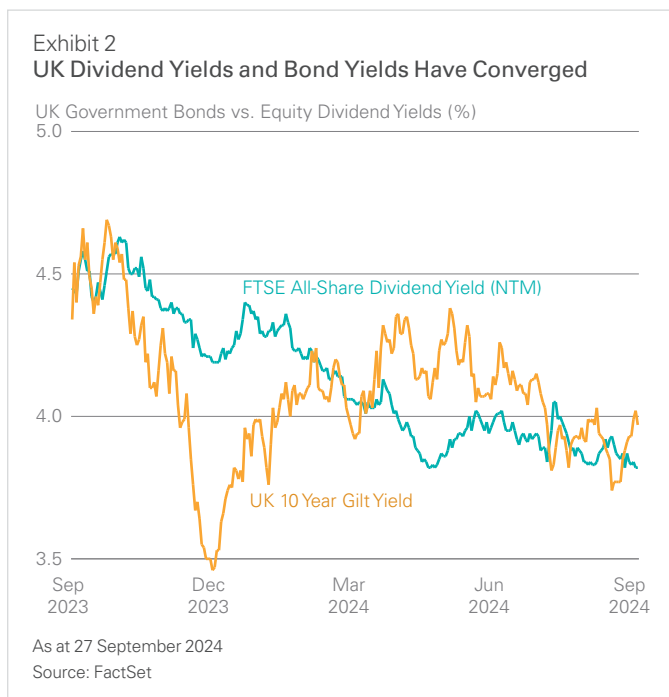
Exhibit 1
UK Wage Growth Is Trending above the United States and Europe



As at 28 June 2024
Source: FactSet

Although the government does not directly control interest rates, it has inadvertently influenced the rate environment through its wage agreements. This complex interplay between government policy and central bank decision-making might garner more international attention in the coming months, particularly as we approach the UK Budget announcement on 30 October.

Whilst the BoE decided to keep rates unchanged at 5% by a vote of 8-1—a seemingly hawkish stance—a sharp fall in the growth of prices for services suggests other domestic price pressures are easing, likely paving the way for further cuts ahead. The UK economy is primed to build on positive momentum quickly as households benefit from positive real income growth and relatively low unemployment. Coupled with high household savings, any further rate cuts could spark meaningful spending growth, boosting consumer-focused stocks. As such, we believe there is scope for interest rates to fall further and faster. Indeed, base interest rates have only dropped by 25 basis points, but medium-term rates—such as those for swaps and bonds—have decreased significantly, whilst there has been a convergence of bond yields and equity dividend yields (Exhibit 2).



Resilient Returns

Normally, a falling rate environment tends to coincide with underperforming equity markets, as investors tend to tie looser monetary policy with a deteriorating economic outlook. However, the converse has played out so far in the United States, Europe,

and the United Kingdom—with the latter proving to be one of the strongest-performing markets this year compared to other regional indices. We view this as a signal that equity market performance has decoupled from economic developments and is instead being driven by idiosyncratic factors, offering ample scope for active managers to identify attractive investment opportunities at compelling valuations.

As interest rates continue to fall, the cost of borrowing for companies should decrease, making it cheaper for them to finance their operations. This improvement in the cost of capital makes previously undervalued stocks more attractive, creating potential investment opportunities among stocks with strong long-term potential but which were previously discounted due to higher borrowing costs.

In a signal of broader strength, UK stocks also held up well against the increased volatility in August following events in Japan, where rising interest rates prompted the unwind of the popular yen carry trade. We believe this resilience is further proof of the growing appeal of UK stocks. Alongside this, we view valuations as attractive—both historically and compared to other regions—Whilst the dividend yield is fully covered, and the political backdrop is more stable despite ongoing political shocks elsewhere.

Currency Considerations

Currency market effects will remain an important feature in the months ahead as central banks continue to adjust rates, and we will watch developments closely. UK equity market performance is more heavily impacted by profits and revenues generated abroad than those generated domestically. If the US dollar depreciates more considerably, it could result in unexpected earnings downgrades. Already weakened sectors, such as the automotive and chemical industries, appear to be more vulnerable to this.

A deterioration in fundamentals would require careful navigation, but equally, we could see attractive value opportunities develop, particularly among cyclicals, into 2025. Cyclicals could receive an additional fillip after China's central bank recently unveiled a broad package of monetary stimulus measures.

Sterling strength tends to have a more positive impact on FTSE 250 companies—potentially setting the stage for a continued rotation that supports FTSE 250 leadership amidst ongoing improvements in domestic activity—as well as domestically focused large-cap stocks, such as retailers and real estate companies.

Whilst investors continue to evaluate the various factors amidst an ongoing adjustment in global central bank policy, we maintain a positive outlook. The resilience of UK equities, combined with attractive valuations and a stable political environment, suggests the balance is tipped towards more positive momentum building into 2025.

This content represents the views of the author(s), and its conclusions may vary from those held elsewhere within Lazard Asset Management. Lazard is committed to giving our investment professionals the autonomy to develop their own investment views, which are informed by a robust exchange of ideas throughout the firm.

Important Information

Published on 14 October 2024.

The performance quoted represents past performance. Past performance does not guarantee future results.

Information and opinions presented have been obtained or derived from sources believed by Lazard Asset Management LLC or its affiliates ("Lazard") to be reliable. Lazard makes no representation as to their accuracy or completeness. All opinions expressed herein are as of the published date and are subject to change.

The indices referenced in this document are included merely to show general trends in the market during the periods indicated and are not intended to imply that investments made pursuant to the strategy are or will be comparable to any index in either composition or element of risk. The strategy is not restricted to securities comprising any index. The strategy may use various investment techniques not reflected in an index. The indices referenced herein are unmanaged and have no fees. One cannot invest directly in an index. There is no guarantee that the strategy's performance will meet or exceed any index.

All rights in the FTSE All-Share Index (the "Index") vest in FTSE International Limited ("FTSE"). "FTSE®" is a trademark of the London Stock Exchange Group companies and is used by FTSE under license. The Index is calculated by FTSE or its agent. FTSE and its licensors are not connected to and do not sponsor, advise, recommend, endorse, or promote the investment product and do not accept any liability whatsoever to any person arising out of (a) the use of, reliance on or, any error in the Index or (b) investment in or operation of the investment product. FTSE makes no claim, prediction, warranty, or representation either as to the results to be obtained from the investment product or the suitability of the Index for the purpose to which it is being used by Lazard Asset Management LLC.

Equity securities will fluctuate in price; the value of your investment will thus fluctuate, and this may result in a loss. Securities in certain non-domestic countries may be less liquid, more volatile, and less subject to governmental supervision than in one's home market. The values of these securities may be affected by changes in currency rates, application of a country's specific tax laws, changes in government administration, and economic and monetary policy.

Certain information contained herein constitutes "forward-looking statements" which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "target," "intent," "continue," or "believe," or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events may differ materially from those reflected or contemplated in such forward-looking statements.

This document reflects the views of Lazard Asset Management LLC or its affiliates ("Lazard") based upon information believed to be reliable as of the publication date. There is no guarantee that any forecast or opinion will be realized. This document is provided by Lazard Asset Management LLC or its affiliates ("Lazard") for informational purposes only. Nothing herein constitutes investment advice or a recommendation relating to any security, commodity, derivative, investment management service or investment product. Investments in securities, derivatives and commodities involve risk, will fluctuate in price, and may result in losses. Certain assets held in Lazard's investment portfolios, in particular alternative investment portfolios, can involve high degrees of risk and volatility when compared to other assets. Similarly, certain assets held in Lazard's investment portfolios may trade in less liquid or efficient markets, which can affect investment performance. Past performance does not guarantee future results. The views expressed herein are subject to change, and may differ from the views of other Lazard investment professionals.

This document is intended only for persons residing in jurisdictions where its distribution or availability is consistent with local laws and Lazard's local regulatory authorizations. Please visit www.lazardassetmanagement.com/globaldisclosure for the specific Lazard entities that have issued this document and the scope of their authorized activities.

This report is being provided for informational purposes only. It is not intended to be, and does not constitute, an offer to enter into any contract or investment agreement with respect to any product offered by Lazard Asset Management, and shall not be considered as an offer or solicitation with respect to any product, security, or service in any jurisdiction or in any circumstances in which such offer or solicitation is unlawful or unauthorized or otherwise restricted or prohibited.