

## Value is in the Eye of the Beholder

## Global Matters Weekly

9 August 2021

– Mark Wright

In her 19th century novel, ‘Molly Bawn’, Irish novelist, Margaret Wolfe Hungerford, is credited with paraphrasing a statement made about beauty by Athenian philosopher and founder of the first institution of higher learning in the Western world, Plato.

“Beauty is in the eyes of the beholder” is a phrase I’ve often found myself replying in retort – we are sadly not all blessed with looks that appeal to the masses! The concept of beauty has been a topic for debate preceding Christ and almost certainly precedes value investing, but I would suggest that it is not just beauty that is in the eyes of the beholder, but also value.

Chinese philosopher, Confucius, stated that “everything has beauty, but not everyone sees it”. The UK equity market certainly has value, but it appears to only be corporates and private equity investors, rather than traditional investors in the UK public equity market that presently see it.

The first half of 2021 has seen 124 takeovers and purchases of minority stakes in UK companies by private companies, totalling some £41.5bn. This is the highest value recorded by Dealogic since the company started tracking deals in 2005. London listed companies have comprised 21 of that 124, with an equity value of £24.4bn.

Four of those 21 London listed companies were, or still are, held in the direct UK equity portfolio we manage for our clients. A pleasingly high hit rate in what is a relatively concentrated portfolio of 24 holdings; we do not believe in diluting conviction with an unwarranted proliferation of holdings.

The first investment to be subject to takeover was Marston’s in January when it was revealed that private equity outfit, Lone Star, had tabled an all cash offer at 105p per share; a 40% premium to the closing price on 28th January and a whopping 373% premium to the level at which the shares were trading in the depths of the market sell off last year. That said, it only valued the pub operator and brewer at £665m, a 10% discount to the company’s net asset value prior to the pandemic. The Board dutifully rejected the offer.

Quickly following on from Marston’s, the second was Arrow Global in early February when private equity group, TDR Capital, made a revised offer of 307.5p per share for the debt investor and fund management business. The premium was a healthy 33% to the prior day’s closing price and a huge 406% premium to share price lows witnessed less than 12 months earlier.

The two most recent examples within the direct UK equity portfolio

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are within the Aerospace and Defence sector, namely Senior and Ultra Electronics. Senior ultimately rejected a final offer at 200p per share from the same private equity group that bid for Marston’s, despite it being an appealing 69% premium to the undisturbed share price before Lone Star first made an offer in May and a massive 367% premium to the share price low in 2020.

Jim Henson, creator of The Muppets characters, comically said “Beauty is in the eye of the beholder and it may be necessary from time to time to give a stupid or misinformed beholder a black eye”. Lone Star have certainly found themselves with a black eye or two!

Ultra Electronics has been bid for by Cobham at 3,516p per share, equivalent to a 42% premium to the prior day’s closing share price. Cobham itself was victim to takeover less than two years ago when the public market failed to see the value in its equity, post the completion of a turnaround project of some magnitude by CEO, David Lockwood. We now expect Mr Lockwood to achieve similar results at Babcock International (one of our other 24 high conviction holdings). Babcock International is an engineering group that services the entire British fleet of nuclear submarines, as well as the majority of its naval fleet.

At times, the public equity market is very poor at seeing value and this is evidently the case with respect to the UK equity market currently. The UK’s headline indices trade at substantial discounts to other international indices in both absolute terms and relative to each index’s own history. We believe the direct UK equity portfolio we manage remains even more undervalued.

Why is it right now that the private equity industry can see value in the UK public equity market, but traditional equity investors cannot? Perhaps it has something to do with patience... whilst the average holding period of UK equity investments has declined from as long as 10 years in 1980 to just 8 months now, holding periods within the private equity industry have been increasing recently to over 5 years.

We do not assume any M&A will help generate returns when investing in what we perceive as materially undervalued UK equities, but similar to Russian mathematician, Ivan Panin, who is quoted as saying “For every beauty there is an eye somewhere to see it”, we do believe that “For every value opportunity, there is a potential acquirer somewhere to see it”.

## The Marketplace

- Global equities rose 1.0% last week
- Chancellor Sunak confirmed that the government has no plans to extend furlough
- Brent crude fell -7.4% over the week to \$70.7 a barrel
- Gold fell -2.8% to \$1763 per ounce

## Market Focus

### US

- US equities rose 1.0% last week
- US jobs report showed US payrolls rose by 943k (vs 870k expected) in July, the largest one-month rise in jobs since last August
- Initial jobless claims for the week through July 31st were at 385k vs 383k expected. Continuing claims for the week through July 24th fell to 2.93m from 3.269m the previous week, the largest weekly decline since late November 2020
- The July ADP employment report printed well below expectations at 330k compared with the consensus of 690k, its lowest since February
- The manufacturing PMI came in at 63.4 revised up 0.3pts from the flash reading
- July's ISM services report was positive with the headline very strong at 64.1, up 4pts from June and the strongest on record
- July's ISM manufacturing report came in at 59.5, the lowest reading since January and below expectations of 61.0
- The employment component of the ISM services for July came in at 53.8, up 4.5pts from June and back in expansionary territory
- June factory orders rose slightly more than expected (1.5% vs 1%)

### UK

- UK equities rose 1.4% last week
- The final manufacturing PMI declined to 60.4 in July from 63.9 in June, the second consecutive monthly decline, though it remains firmly in expansionary territory
- The UK is set to deliver booster shots to 32m people starting from September

### Europe

- European equities rose 1.8% last week
- July final PMIs from Europe were strong overall, with the composite PMI reading coming in at 62.8 against expectations of 62.6
- The Euro Area June PPI print showed prices rose in line with expectations at +1.4% month-on-month and +10.2% year-on-year
- Germany factory orders grew +4.1% month-on-month vs expectations of +2.0%, its highest monthly increase since June 2020
- German June industrial production fell -1.3% month-on-month vs expectations of +0.5%

### Asia/Rest of The World

- The benchmark Global Emerging Markets index returned 1.2% last week
- Japanese equities rose 1.5% over the week
- Chinese equities fell -0.1% last week
- The official Chinese manufacturing PMI fell from 50.9 to 50.4 in July – its lowest reading since February 2020
- China's non-manufacturing reading dipped from 53.5 to 53.3 but was in line with expectations
- China's Caixin services PMI came in at a strong 54.9 (vs 50.5 expected), the highest print since December 2020
- Japan's final Jibun services PMI printed at 47.4 vs 46.4 flash reading
- China has imposed new travel restrictions across the nation to slow the spread of the delta variant

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9 August 2021

Asset Class/Region	Currency	Currency returns			
		Week ending 6 Aug. 2021	Month to date	YTD 2021	12 months
<b>Developed Market Equities</b>					
United States	USD	1.0%	1.0%	18.8%	33.9%
United Kingdom	GBP	1.4%	1.4%	13.2%	22.4%
Continental Europe	EUR	1.8%	1.8%	19.6%	32.8%
Japan	JPY	1.5%	1.5%	8.1%	27.1%
Asia Pacific (ex Japan)	USD	1.5%	1.5%	1.2%	18.8%
Australia	AUD	2.0%	2.0%	16.4%	28.6%
Global	USD	1.0%	1.0%	16.2%	33.2%
<b>Emerging markets equities</b>					
Emerging Europe	USD	0.6%	0.6%	15.4%	28.2%
Emerging Asia	USD	1.5%	1.5%	-1.1%	16.2%
Emerging Latin America	USD	-0.6%	-0.6%	3.8%	25.7%
BRICs	USD	0.5%	0.5%	-4.5%	7.5%
China	USD	-0.1%	-0.1%	-12.3%	-3.7%
MENA countries	USD	1.7%	1.7%	23.6%	40.6%
South Africa	USD	-1.2%	-1.2%	7.3%	29.5%
India	USD	3.2%	3.2%	15.4%	48.2%
Global emerging markets	USD	1.2%	1.2%	1.4%	19.0%
<b>Bonds</b>					
US Treasuries	USD	-0.3%	-0.3%	-1.8%	-3.8%
US Treasuries (inflation protected)	USD	-0.7%	-0.7%	3.7%	5.4%
US Corporate (investment grade)	USD	-0.7%	-0.7%	-0.6%	0.2%
US High Yield	USD	-0.2%	-0.2%	3.8%	9.8%
UK Gilts	GBP	-0.3%	-0.3%	-3.5%	-4.5%
UK Corporate (investment grade)	GBP	-0.2%	-0.2%	-1.4%	2.0%
Euro Government Bonds	EUR	0.2%	0.2%	-1.0%	0.5%
Euro Corporate (investment grade)	EUR	0.0%	0.0%	0.7%	3.1%
Euro High Yield	EUR	0.3%	0.3%	3.8%	9.5%
Japanese Government	JPY	0.0%	0.0%	0.4%	0.2%
Australian Government	AUD	-0.1%	-0.1%	-0.4%	-0.3%
Global Government Bonds	USD	-0.4%	-0.4%	-3.6%	-2.3%
Global Bonds	USD	-0.5%	-0.5%	-2.7%	-0.8%
Global Convertible Bonds	USD	0.0%	0.0%	0.3%	12.9%
Emerging Market Bonds	USD	0.2%	0.2%	-2.3%	0.1%

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Asset Class/Region	Currency	Currency returns			
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<b>Property</b>					
US Property Securities	USD	0.3%	0.3%	27.5%	37.7%
Australian Property Securities	AUD	2.7%	2.7%	10.9%	30.9%
Asia Property Securities	USD	0.0%	0.0%	2.9%	11.6%
Global Property Securities	USD	0.6%	0.6%	17.2%	30.4%
<b>Currencies</b>					
Euro	USD	-0.9%	-0.9%	-3.8%	-1.0%
UK Pound Sterling	USD	-0.2%	-0.2%	1.6%	5.4%
Japanese Yen	USD	-0.4%	-0.4%	-6.3%	-4.3%
Australian Dollar	USD	0.1%	0.1%	-4.4%	1.6%
South African Rand	USD	-0.3%	-0.3%	0.1%	18.9%
Swiss Franc	USD	-1.0%	-1.0%	-3.3%	-0.6%
Chinese Yuan	USD	-0.3%	-0.3%	0.7%	7.3%
<b>Commodities &amp; Alternatives</b>					
Commodities	USD	-2.2%	-2.2%	27.7%	45.1%
Agricultural Commodities	USD	0.8%	0.8%	20.6%	53.1%
Oil	USD	-7.4%	-7.4%	36.5%	56.8%
Gold	USD	-2.8%	-2.8%	-6.9%	-14.4%
Hedge funds	USD	0.2%	0.2%	3.6%	9.3%

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