HYMANS ROBERTSON
INVESTMENT SERVICES

Hymans Robertson Investment Services (HRIS)

Supporting your clients through a UK recession

March 2024

- The UK economy entered recession last year. However, we do not believe this should be a major concern for investors, in particular given other economic data indicates the recession will be shallow.
- The prospect of the UK falling into recession has been well trailed and should be largely reflected in market pricing. Markets tend to act as a forward-looking indicator, this is one of the reasons that, when you look at history, investors have often been better off investing through a recession instead of waiting for it to end.
- HRIS portfolios take a diversified approach to global markets with the aim of giving greater predictability of future returns and ultimately enhancing customer outcomes.

On 15 February, the Office for National Statistics (ONS) confirmed that the UK economy had contracted for a second consecutive quarter in Q4 2023 – the technical definition of a recession. Hearing the news may have led to concerns from equity investors, but we believe there are plenty of reasons why this should not necessarily be the case.

Yes, the UK is in a recession but other economic metrics look more positive

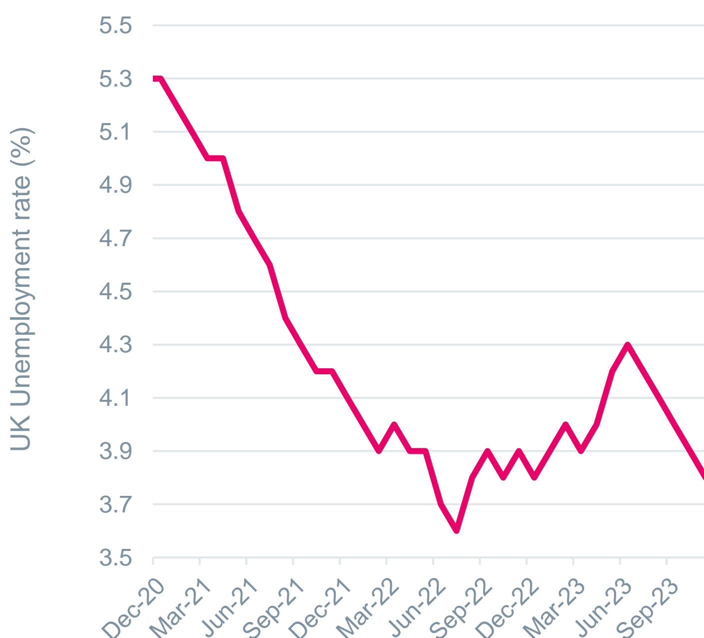
The definition of a technical recession normally used in the UK is two consecutive quarters of negative economic growth. Other countries like the US use a much broader definition which looks at a larger range of metrics. In comparison, the UK definition is quite narrow and isn't always the best indicator of a full economic downturn.

The UK economy has had little growth for over 18 months. Whether the economy shrinks by 0.1% or grows by 0.1% doesn't change the economic landscape much. In addition:

- Unemployment in the UK remains historically low (see chart 1).
- Wages are still rising at a decent pace and have been above inflation for several months now.

In our view, a better term for what the UK economy is currently experiencing is stagnation rather than downturn. With interest rate cuts on the horizon, the hope is that the recession will be shallow. Recent, more timely, economic indicators already suggest this and point towards a potential turning point in early 2024.

Chart 1: Unemployment continued to fall towards the end of last year



Source: ONS

In summary, even though the UK is technically in recession this does not necessarily mean it is bad news for investors, as we discuss on the following page.

The UK Recession has been well trailed and should be reflected in market pricing

Investors have been aware of slow UK economic growth and the prospect of the UK falling into recession for a while now and this should be largely reflected in market pricing. Indeed, markets tend to act as a forward-looking indicator, which is one of the reasons that, when you look at history, markets start to recover up to nine months before a recession ends, rather than waiting for the recession to formally come to an end.

The UK stock market is not dependent on a strong UK economy

London's history as a global financial powerhouse means the FTSE 100 is home to several overseas companies, like Swiss miner Glencore. Other larger companies, like Shell and HSBC, may be British, but derive a significant proportion of their revenues from overseas or in foreign currencies. This means that the UK market is less reliant on a strong domestic economy to perform well. The global nature of the UK stock market does mean however it is more sensitive to changes in the value of sterling, but in a counterintuitive way. The FTSE tends to perform *better* when the pound weakens because a company's foreign currency earnings are worth more in pound terms. A weaker UK economy tends to lead to a weaker pound. This mechanism helps mitigate the impact any negative shocks to the UK economy has on the UK stock market. On the day the ONS confirmed that the UK had officially entered recession the FTSE 100 rose by 0.65%.

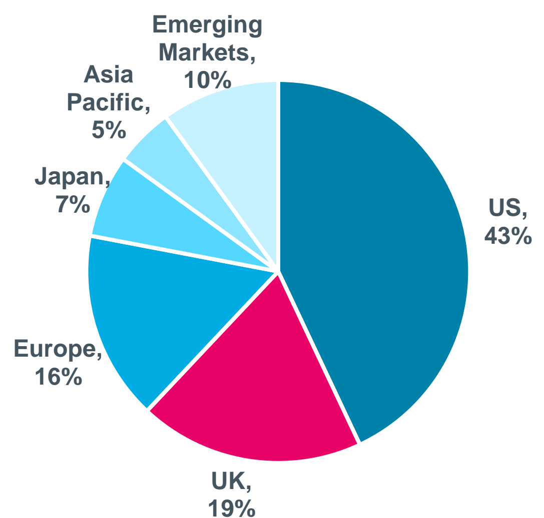
Investors' portfolios should be globally diversified

Even if you are a UK investor, this does not mean that your assets should predominantly be invested in UK markets. In our portfolios we look to hold a range of markets, across regions, and a range of investment styles to support diversification. Our equity holdings allocate less than 20% to the UK stock market (see chart 2). It is this diversification which we believe will enhance client outcomes and the future predictability of investment returns.

Weaker economic growth increases the chances of earlier rate cuts from the Bank of England

A final reason why a UK recession may not be a great concern for investors is related to how the Bank of England (BoE) may react to weaker growth. In a market environment where asset prices are driven more by the actions of central banks than economic fundamentals, good news is bad and bad news is good. Data points indicating weaker economic growth are interpreted by investors as a greater chance of earlier and greater interest rate cuts from the BoE as weaker growth will help to dampen inflation. Lower interest rates support asset prices.

Chart 2: Representative HRIS Portfolio regional equity breakdown



Source: HRIS

Summary

It's natural that many investors would have felt some concern for their portfolios after hearing that the UK had entered a recession. As the above explains though, a shallow recession will have a limited impact on portfolio values, indeed recent equity market performance has been strong. Investors should be diversified globally. Even where there is significant exposure to the UK equity market, the global nature of the companies listed on the London Stock Exchange, and the expected shallowness of any economic contraction, should provide additional comfort.

Jack Richards
Investment Manager

Risk warning

The value of your investments and the income from them may go down as well as up and neither is guaranteed. Investors could get back less than they invested. Past performance is not a reliable indicator of future results. Changes in exchange rates may have an adverse effect on the value of an investment. Changes in interest rates may also impact the value of fixed income investments. The value of your investment may be impacted if the issuers of underlying fixed income holdings default, or market perceptions of their credit risk change. There are additional risks associated with investments in emerging or developing markets. The information in this document does not constitute advice, nor a recommendation, and investment decisions should not be made on the basis of it. The material provided should not be released or otherwise disclosed to any third party without prior consent from HRIS.

Hymans Robertson Investment Services LLP is authorised and regulated by the Financial Conduct Authority. One London Wall, London, EC2Y 5EA, telephone number 020 7082 6000. You can find it on the FCA register at https://register.fca.org.uk/s/ under firm reference number 927111.

Hymans Robertson uses FSC approved paper.