



Mind Your Ps and Qs

To many, the phrase “Keep Calm and Carry On” elicits one thing: The United Kingdom (U.K.). The now classic phrase started at the onset of World War II and does a fantastic job of embodying the fortitude and psyche at the core of generations of Britons. The biggest takeaway from our most recent research trip to the U.K. hinges on that quintessential sentiment. For those who follow the region closely, it’s clear recent years have been bumpy with no shortage of contentious news. Nonetheless, there is no doubt the U.K. will soldier on. It’s very British, innit?

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Our international research ventures are typically prompted by at least one of two key factors. The first is when a country or region appears to have several viable investment candidates with a macroeconomic backdrop of stability and growth, but because it’s so far “off the beaten path” the information available to us in the U.S. is not robust enough to gain conviction to invest. The second factor that might prompt an international research expedition is when a developed market that we already follow, and typically has a plethora of viable investment candidates, is experiencing a meaningful valuation disconnect from other developed markets around the world. In that instance, a trip to the country or region with a gauntlet of on-site company visits is intended to “check the temperature” of management teams and the local economy, attempting to unearth the underlying reason for the valuation disconnect and measure the outlook of the people most impacted by it. If either of these two factors are present, we pack our bags and head for the airport. Our research trip to London in early October was prompted by the latter, and the burning question Greg Debski and Jim Davis set out to answer was “why are U.K. equity markets so cheap?”

The macroeconomic backdrop underpinning our curiosity in the U.K. is by no means a new development. At least since the “Brexit” referendum vote in 2016, proverbial storm clouds had been forming on the horizon for the long-time global superpower. The uncertainty created by the outcome of that vote for the United Kingdom to exit the European Union (E.U.) sent shockwaves across the European continent and the world. Formal ties to the economic and customs union were severed, and the divorce from the E.U. was completed in January of 2020. Before the ink had a chance to dry on the agreement, the world was hit with the COVID pandemic. Suffice to say, the broader U.K. economy and anything resembling local consumer confidence has endured its share of headwinds in recent history.

In many respects, we in the U.S. continue to share a lot of common ground with our allies across the pond. The U.K., and more specifically London, remains a stable and beautiful place, making it a relatively attractive destination to own property, conduct business, and live. In both countries, long-standing respect for the rule of law, contracts, and property rights sets the stage for a stable currency, makes long-term agreements possible, and allows for a focus on growth versus simply survival. Many recent economic statistics also display similarities between the two global powerhouses. The U.S. and the U.K. have identical unemployment rates (currently 4.1%)¹, similar inflation rates (2.9% in the U.S. versus 2.6% in the U.K. over the past year)¹, similar central bank short term target rates (currently 4.75% in both the U.S. and U.K.)¹, even recent debt-to-GDP levels are in the same ballpark (currently 120% in the U.S. and about 100% in the U.K.)^{2,4}. It’s also nice to not have too much of a language barrier!

However, despite many similarities between our two countries, the differences become stark when comparing U.S. and U.K. economic performance over more recent history. GDP growth rates (a broadly used economic growth metric) haven’t been in the same zip code for years, with the U.S. posting a 5-year average GDP growth rate of about 2.8%, while the



U.K. has been grinding along at a 0.5% growth rate over the same period.³ That stark difference in growth rates is manifesting itself in many ways, but two of the most visible and measurable are per-capita GDP (a broadly used individual “standard of living” metric) and stock market performance. Per-capita GDP differentials stand out with the U.S. at \$86,600 per person (6th in the world) compared to the U.K.’s \$52,420 per person (22nd in the world), a difference that has noticeably widened over the last 5 years.³ Even more pronounced is the difference in stock market performance, with the S&P 500 growing nearly 110% over the past 5 years while the FTSE 100 (the premier large company equity benchmark of the U.K.) grew a total of 32.3% over the same period. One of the most dreaded positions in value investing is something called a “value trap,” or in laypersons’ terms, something that appears to be a great bargain but is in fact simply a poor performer. The sinking feeling that “maybe the U.K. is a value trap” was rooted in the back of our minds initially, at least until we started our string of meetings.

We kept calm and carried on, setting off to “kick some tires” and get some answers by visiting with as many companies as we could schedule to meet with us. The types of businesses visited ran the gamut—from one of the largest liquor brand operators in the world (no free samples unfortunately) to an oil and gas valve actuator manufacturer.

We met with numerous industrial manufacturers, including one of the world’s key aerospace and defense manufacturers, a global conglomerate whose key products include ceramic-inlaid precision industrial seals and gaskets, and one of the world’s top jet engine and turbine manufacturers. We even spent some time with a financial services firm similar in some respects to Naples Global Advisors. As the week progressed, the difference between the perception created by the U.K.’s macro-data and the reality conveyed by management and Investor Relations teams operating “in the trenches” was jarring.

It was fascinating, and at times very exciting to hear a common theme: “Yes, many areas of the U.K. economy and government haven’t been helpful in recent years, but here is how we have adapted to become brutally efficient and to thrive.” The multi-national reach of most of the companies we visited creates a situation where the fortunes of the individual business are more closely tied to the global performance of their chosen line of business, rather than the whims of U.K. politicians and regulators. It’s almost as though the difficulty of the local economy is toughening these businesses, making them even more competitive on a worldwide stage. Granted, a few of the meetings ended with distinct disappointment and a realization that despite a potentially robust operation, unfocused management in conjunction with the U.K. regulatory and tax burden would more than likely lead to lackluster performance. However, a strong majority of our meetings ended in the exact opposite manner—with conviction, excitement, and a reaffirmed belief that “this company is crushing it.”

The debriefing conversations upon our return served to crystalize the key conclusion—U.K. equity markets are a stock-picker’s domain. Local market and government factors remain rife with uncertainty and will more than likely lead to continued mediocre broad-market performance. However, almost as if in spite of that macro-economic cloud, the ingenuity, fortitude, and grit of many of the individual companies with which we met should continue to allow them to rise above the fog, particularly those companies operating on a global scale. Perhaps investing in the U.K. really is just that simple—find and buy into a great company that is executing well and then just keep calm and let them carry on.

¹ “FactSet Economics Standardized Database.” Factset Financial Data & Analytics, Accessed 12 Nov. 2024.

² Department of the Treasury. “Fiscal Data Explains the National Debt.” Understanding the National Debt | U.S. Treasury Fiscal Data, fiscaldata.treasury.gov/americas-finance-guide/national-debt/#:~:text=The%20average%20GDP%20for%20fiscal,difficulty%20in%20repaying%20its%20debt. Accessed 4 Dec. 2024.

³ International Monetary Fund. “GDP per Capita, Current Prices.” IMF, www.imf.org/external/datamapper/NGDPDPC@WEO/OEMDC/ADVEC/WEO/WORLD. Accessed 4 Dec. 2024.

⁴ Public Sector Finance Delivery Team. “Public Sector Finances, UK: August 2024.” Public Sector Finances, UK - Office for National Statistics, Office for National Statistics, 19 Sept. 2024, www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/august2024#:~:text=Public%20sector%20net%20debt%20excluding,seen%20in%20the%20early%201960s.



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