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Market Snapshot
Why UK Stocks are Defying the Odds?

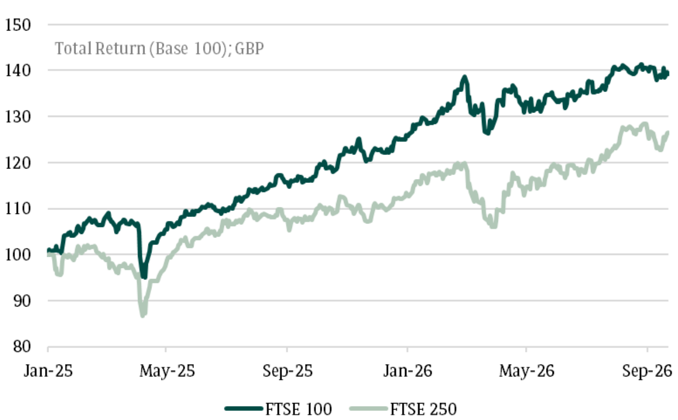
Snapshot

UK equities are currently benefiting from a global rally in earnings expectations, further supported by the global diversification of the FTSE 100 and strong foreign interest in attractively valued mid-caps, which has spurred significant M&A activity.

The UK market presents a compelling investment opportunity, with low valuations relative to US and European peers. Value stocks in banking, energy, and mining offer significant growth potential, supported by favorable long-term rates and high commodity prices. Combined with substantial dividend yields, these assets provide a strong balance of capital appreciation and steady income

Similarly, UK sovereign bonds (gilts) offer a strategic diversification opportunity with highly competitive yields compared to other developed markets. Although fiscal concerns remain, much of the negative sentiment is already priced in, creating an opportunistic window for potential upside in both UK equities and government bonds.

STRONG PERFORMANCE OF UK EQUITIES



Sources: BNP Paribas WM, LSEG Refinitiv

The Drivers Behind the UK's Resilient Stock Performance

The recent strong performance of UK equities should be understood as part of a global trend rather than a uniquely British phenomenon. Across the world, stock markets have benefited from a broad-based rally driven primarily by improving earnings expectations, with companies revising forecasts upward a momentum clearly reflected in UK shares. Within the UK market, two specific forces have further amplified these gains.

First, the composition of the FTSE 100 makes it less sensitive to domestic economic headwinds, as its heavyweight constituents are globally diversified across sectors such as banking, healthcare, oil & gas, and mining. Consequently, large-cap performance is more closely tied to worldwide factors than to the local economy.

Second, there has been a heightened appetite among foreign investors for British-listed companies, particularly within the mid-cap space, such as the FTSE 250. This interest is largely driven by the perception that UK equities remain comparatively cheap and markedly less expensive than their US or continental European peers.

In the FTSE 250 specifically, the prevalence of interesting industrial and technology niches has attracted significant demand. This has led to a surge in merger and acquisition activity, as large overseas industrial players and private equity firms seek to buy out high-quality companies at attractive valuations. This wave of acquisitions has become a primary motor for the index, allowing UK mid-caps to break out to new all-time highs alongside their large-cap counterparts.

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Value and Defensive Trends

The UK market is characterised by a significant concentration of large-cap value stocks and defensive assets, which collectively provide essential stability during periods of economic uncertainty.

Defensive stocks are highly valued for their low beta characteristics, rendering them less sensitive to global fluctuations and enabling them to outperform during sideways markets or corrections. This resilience is underpinned by consistent demand; however, performance varies by sector. While healthcare remains robust, consumer staples specifically the beverages and spirits industry are experiencing structural declines in global demand.

In contrast, value stocks are more cyclical and sensitive to economic shifts. Although they carry higher risk during downturns, they are often more attractively priced and offer substantial growth potential during market upswings.

Current momentum in UK equities is evident across key sectors. In commodities and energy, geopolitical tensions in the Middle East have pushed prices higher, benefiting oil and gas stocks. Similarly, elevated industrial and precious metal prices support the global mining companies heavily represented in the UK index. The financial sector has also performed strongly, with global banks benefiting from strengthened balance sheets, favourable long-term rates, and positive loan demand. Beyond capital appreciation, these value sectors (mining, energy, and banking) remain attractive to investors by offering substantial dividend yields and a steady income stream.

Strategic Opportunities in the UK Market

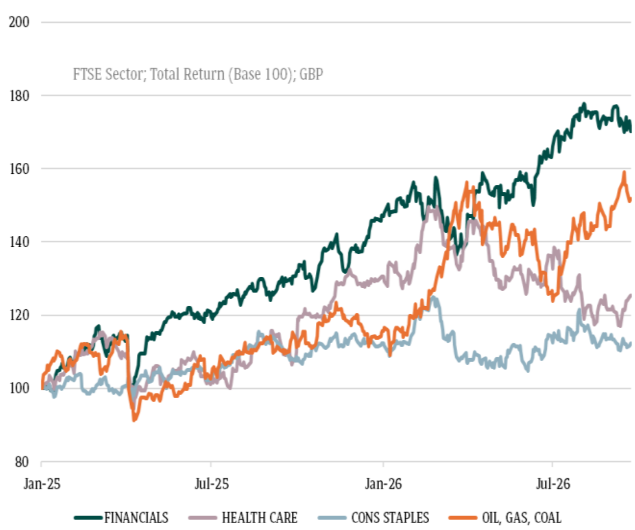
Beyond this fundamental momentum, the UK market remains particularly attractive due to its low relative valuation compared to US and continental European peers. When coupled with the consistent income generated by dividends across both large- and mid-cap equities, there is a compelling case for continued investment. Given the current momentum and favorable valuations, the evidence suggests that market conditions remain more conducive to accumulation than to divestment.

Parallel to equities, UK sovereign bonds offer a strategic opportunity for portfolio diversification. While concerns persist regarding government finances and the necessity for fiscal discipline, the market is focused on the new administration's upcoming budget for indicators of stability, particularly concerning spending reductions and tax adjustments.

From a yield perspective, UK gilts are highly competitive relative to other developed markets; 10-year maturities yielding over 5% provide a higher entry point than averages in the US, the Eurozone, or Japan. Our 10-year gilt 12-month target is 4.4%.

While long-term performance will depend on economic growth and improved budget balances, much of the negative sentiment appears to be priced in. This creates significant potential for an upside surprise, making this an opportunistic window to increase exposure to both UK government bonds and equities.

RELATIVE PERFOMANCE



Sources: BNP Paribas WM, LSEG Refinitiv

UK 10-YEAR NOMINAL YIELD DECOMPOSITION

Sources: BNP Paribas WM, LSEG Refinitiv

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