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## **How Cheap is Cheap?**

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Many of you will be aware of emerging markets. These are countries that, in aggregate, have a lower GDP per capita, have less liquid markets, higher inflation rates and less stable currencies than developed markets. Some countries currently classed as emerging markets are China, India and Brazil.

There is an entire class of countries that have a lower GDP per capita, even less liquid markets, higher inflation rates and less stable currencies than emerging markets. These are known as frontier markets. As at the end of November 2019, the UK stock market is trading at similar valuations to frontier markets.

Why does this strike us as ever so slightly absurd? If you look at the frontier markets; Kuwait, Vietnam, Morocco and Nigeria account for almost 70% of the market index. Some of these countries are admittedly growing their economies at a faster rate than the UK. However, many of these countries have poor corporate governance and are more corrupt (they rank lower in the corruption perceptions index). This puts a large question mark on their valuations since the earnings "e" in the famous "p/e" ratio is more prone to accounting acrobatics.

What's more, if you buy the UK market, you are going to be disproportionately buying large multinational companies, many of which have direct access to the rapid growth of the middle class and spending power in these frontier markets. By buying the UK market, not only are you less exposed to foreign exchange risks. You are also shielded from poor liquidity and poor corporate governance.

The Referendum in the UK has resulted in mispricing of the UK equity market in our view as investors question the outlook for the UK economy and its role in the globalised economic model. This has reached unsustainable valuation levels in our view and the above comparison is a stark reminder of how market valuations can move away from long term averages and will provide upside when risk premise reduce.

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