COMMENTARY

December 8, 2017

Dear clients and colleagues,

Although Brexit continues to hold back growth, the UK economy has proven to somehow be resilient. On Friday, the UK and the EU seem to have finally reached agreement upon three key issues: the EU citizen's right, the divorce bill and the Irish border. As a consequence, the probability to see a hard Brexit scenario has been reduced considerably. But uncertainty remains regarding the trade discussions which will intensify over the next months. Business sentiment and investments should remain sluggish until more progress is achieved in the trade negotiations.

Despite Brexit tensions, the UK economy should grow around 1.5% for 2017 representing a deceleration compared to last year and resulting in its GDP figures being the lowest amongst G7 countries. Although the UK enjoys a substantially low unemployment rate, wage growth is slowing and overall disposable income is trending down.

Higher food and energy prices are putting pressure on UK consumers. The Consumer Price Index accelerated to 3% last September with the main culprits of the hike being: electricity, transports, restaurants, hotels and recreational goods and services.

Currency should remain volatile until a definitive Brexit agreement with the European Union is reached. In an economy in which approximately 40% of all food and non-alcoholic drinks sold are imported, consumers remain vulnerable to currency rate fluctuations. Thanks to fierce competition in the food retail space, consumers have only partially been hit up to now.

With all these headwinds, we find that consumers are gradually seeking better value-for-money deals. We believe that the middle market is being squeezed by value and premium retailers. In order to face this changing environment, retailers are beginning to work out how to respond to structural shifts in the most efficient and cost effective manner. Capex seems to be being diverted away from the traditional brick and mortar to IT upgrades and multi-channel capabilities enhancements. This capex shift is not surprising given that online trends continue to be strong and now represent close to 30% of all non-food and 5% of food shopping.

Greggs, a food-to-go retail shop we own in our portfolios, has been a strong performer year-to-date.
Its stock price has generated a return of 38% while the MSCI UK consumer services index has posted 8% return over the same period. In recent years, Greggs has successfully improved its like-for-like sales growth and revamped its stores network. With a strong value offering for consumers, we believe that Greggs will continue to perform well in the food-to-go market.

The outlook for UK households remains challenging and prices for basics products should continue to rise. The overall retail space could remain under pressure until more clarity emerges from the Brexit negotiations, but up until now, visibility in the UK has been weak.

Have a good weekend.

The Global Alpha Team