London is for sale, buy while stocks last

Going nowhere fast: more than 20 years after the dotcom boom, the UK's flagship index, the FTSE 100, is still hovering around the 7,000 level reached at the end of 1999, while in the US the S&P, Dow Jones and Nasdaq hit new record highs daily.

Why so? At first, Brexit and then Covid-19 deterred buyers, but now with interest rates still at historical lows, there is a bid a day for UK public limited companies by private equity players and trade buyers, who view it as undervalued against other global markets.

Is it a question of ownership? The explanation for the London market's discount lies in the predominance of slow-growth old economy stocks in the FTSE index – banks, oil and gas, mining – and the near-absence of fast-growth digital tech companies. It is also because of the ownership of the market by pension funds and insurance companies who demand progressive dividend policies from established blue-chip companies to meet the long-term liabilities of their customers, the pensioners. So to please their institutional shareholders, these companies over-distribute the cash they generate rather than investing it for future growth and often, instead, make highly-priced acquisitions for equity that are welcomed as long as they are accretive in the first full year of ownership.

As we all know, things largely go wrong after the honeymoon period, but woe betide the management team that makes a dilutive acquisition. So highly-priced accretive acquisitions for quick, short-term gains are preferred to painstaking, long-term investment for organic growth. Why so? Is it to do with the fact that fund managers themselves are judged and evaluated – and importantly, rewarded – on short-term quarterly and annual performance?

The person on the street is no fool: meanwhile, fast-growth, disruptive tech companies do not ordinarily pay dividends and instead reinvest cash to turbo-charge organic growth that is highly prized and highly rated far above dividend-paying stocks. In the US, the market is predominantly owned by retail investors in their 401(k) pension plans who prefer capital gains to income, not least because gains are not taxed until withdrawal at retirement. Similarly, since the Pensions Act 2015, more UK stakeholders have taken their gold-plated defined benefit pensions out of their company pension schemes and placed them into personal self-invested personal pensions (SIPPs) where they, too, are buyers of growth stocks. Needless to say, the lowest interest rates in human history have buoyed all asset prices – bonds, commodities, property, equities – but none more so than fast-growth companies.

The regulator rides to the rescue: in an attempt to bolster the London market and to keep exciting growth companies at home, the UK listings review is looking at changes to the listings rules, including around dual-class share structures and free-float requirements. It is likely that companies with standard listings will ultimately enjoy the same status as the premium listed, including inclusion in the FTSE 100 index, which will encourage UK fund managers to invest in disruptive technologies. This may even revive the FTSE 100 when entrepreneur-led companies such as The Hut Group and S4 Capital become eligible for inclusion in the coveted index.

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If you can't beat 'em, join 'em: the short-termism of the City is perhaps best exemplified by Daily Mail and General Trust's (DMGT's) planned sale of RMS, its insurance risk modelling business, to Moody's, for twice the highest valuation attributed to it by analysts on a sum-of-the-parts basis or on break up – £1.425bn versus £700m. The long road to DMGT's own transformation and take-private began in May 2018 with the sale of Zoopla's parent company to Silver Lake for £2.2bn, followed in March 2019 with the distribution of 49% of Euromoney to its shareholders, which increased the Rothermere family's stake in DMGT from 24% to 36%. It will culminate in the distribution of 610p cash per share from the sale of RMS, along with DMGT's successful US listing of used car business Cazoo and, finally, the company taking its original newspaper and events business private. Who said you can't sell high and buy low at the same time? You just need skin and soul in the game.