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Richard joined RLAM in 2016 as part of the Income team and manages the RL UK Equity Income Fund and RL UK Dividend Growth Fund. He previously worked at AXA Investment Managers for 19 years where he ran a wide range of UK Equity and multi-asset class portfolios, most notably AXA's Distribution Fund franchise. Prior to working in the City, Richard had an engineering background, having served an apprenticeship with British Aerospace. He holds a Mechanical Engineering Degree from Sheffield University and a PhD in Aerodynamics from Oxford University.

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Searching for dividends in UK equities

Richard Marwood, Senior Fund Manager at Royal London Asset Management, discusses the prospects for UK equities in 2022, reflects on an eventful 2021 and shares his longer-term views on dividends.

What important lessons did you learn from 2021?

Each year the markets teach us something new and while this equips us for the future to some extent, every year finds something entirely unique to throw at us. It very much feels like 'known unknowns' and then 'unknown unknowns'.

One theme I would take from this year is about just how interconnected the global economy has become and how small glitches in one area can give rise to unexpected impacts. For example, car production in Europe is suffering because of production issues surrounding semiconductors in the Far East, while people were sitting in long queues outside UK petrol stations, not because there was a shortage of petrol, but because there was a lack of lorry drivers to get that fuel to the right places.

In what way will 2022 be different from 2021?

As ever, that is very difficult to predict. One potentially profound difference could be if inflationary forces persist and we find ourselves in a world where monetary policy needs to tighten. While this is not a given, it is not beyond the realms of possibility. There are many investors out

there who have only ever seen inflation being well behaved and the cost of money get ever cheaper. Such a shift would be a strong test for businesses, to see who can exhibit cost control and pricing power and which companies are not dependent on the oxygen of cheap money to support themselves.

What is your view on UK equities?

In my opinion, the UK market does remain an interesting place to invest. It has many strong companies and a good mix of sector exposures. Furthermore, it is attractively priced on a relative basis to other markets and offers a good dividend yield. There are good reasons why the UK may have struggled to keep pace with other markets, not least of which are the uncertainties of Brexit and the lower weighting that the UK market now has in global indices. Additionally, the UK market was arguably less well placed for the 2020 lockdowns, having a lower exposure to technology stocks and a greater exposure to sectors reliant on mobility and physical activity (e.g. oil and leisure) but as the world now hopefully normalises, that allows greater prospects for recovery.

As valuations languished, the attraction of UK companies was well illustrated in 2021 by the number of UK companies that found themselves on the receiving end of takeover bids from either private equity firms or industrial buyers. It would be unsurprising if we continued to see similar takeover activity into 2022.

What are your expectations for inflation and interest rates next year?

Personally, I am in the camp that sees the current inflationary forces as being less transitory than some might hope. The issues of higher commodity prices, supply chain constraints and lack of labour in certain areas will take time to be resolved, even if some of the pent-up demand that we saw unleashed after the Covid-19 lockdown eases back. A more structural issue is around climate change. Action to tackle climate change is a necessity, but we should be under no illusions that this action will be cost free. The vast amount of investment required

will have to be funded from somewhere and at least some of that is likely to be seen in higher energy or transport costs for consumers.

What areas of UK equities do you expect to perform well next year?

As ever, I think that stock picking will be a crucial driver of returns. Some well-run stocks in apparently tough sectors will thrive, while other stocks will fare poorly, despite being in what appear to be attractive industries. Businesses able to deal with inflationary pressures, be it through pricing power, cost cutting or better harnessing data and technology to drive revenue or manage costs, should be at an advantage. A great example of this is Dunelm, who operate in the tough retail sector, specifically in homewares. Despite their stores being shut during some of the lockdown period, the company did well as they were still able to satisfy strong consumer demand through their multi-channel business

that they have built up (stores, online click and collect, and home delivery). This was something many of Dunelm's smaller competitors could not do. They have also seen an improvement in their competitive position as some of the department stores have left the market.

What does the landscape for UK equity dividends look like?

After a torrid 2020, when dividends collapsed, we have already seen a fair degree of recovery in 2021, although we are still not back at the levels we were at in 2019. Dividends are back at more sustainable levels and we should see many companies able to grow dividends rather than reducing them. The yield on the UK market is currently around 3.5%, even with dividends still behind 2019 levels. This seems an attractive level given the relatively low yields available in bonds and near zero yields available on cash.



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