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Ros Altmann: Government must up urgency on restoring domestic investor support

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British investors have abandoned UK equity markets. Such neglect has pushed valuations to exceptionally cheap levels, with UK companies undervalued relative to the US and the rest of Europe on just about every measure.

The scale of undervaluation could offer attractive opportunities for long-term investors. In 2015, the UK forward-looking price/earnings ratio was higher than European markets and around 10% lower than the US. Now, UK equities are over 40% cheaper than the US on this measure and more than 20% cheaper than Europe.

pandemic dislocations have played a part, the loss of our once-strong domestic investor support has been a major factor too.

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Private equity and overseas investors are snapping up successful British firms cheaply, share buybacks have increased and companies are listing overseas instead of in London, citing unwarranted undervaluation. This is a loss to our economy and future growth. Restoring domestic investor support must be a government priority.

Office for National Statistics (ONS) figures show the proportion of UK quoted shares owned by British pension funds reached a record low of 1.6% in 2022, continuing a multi-decade downward trend.

In 1991, UK pension funds allocated 75% of their assets to equities – around half in the UK – and 13% in bonds. In 2006, equities were still over 60% and bonds near to 40% but, by 2021, equities were just 19% of assets (with very little in the UK) and 72% in bonds.

> **“This ignored the basic tenets of capitalism, which predict equities will outperform bonds over the long term”**

Regulatory pressures, supposedly designed to reduce risk, cut costs and protect consumers encouraged pension investors to switch from higher expected return equities into supposedly safer bonds.

This ignored the basic tenets of capitalism, which predict equities will outperform bonds over the long term. Rewards for risk are a fundamental element of the capital asset pricing model, so switching from equities to bonds to reduce risk would also reduce expected returns.

After 2009, central bank quantitative easing (QE) policies created new money to artificially support fixed income returns, improving bond market performance. But the 2022 reversal of QE created significant volatility and capital losses in bonds, relative to equities.

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Reviving traditional domestic investor support for British-based companies – which helps create thriving corporate and financial sectors – is important.

Japan, Australia and South Korean pension funds invest 30-50% in their own markets – overweighting by well over 1000% relative to MSCI indices and even US pension funds are 50% overweight. By failing to back their own market, UK investors undermine confidence internationally.

The government wants to re-engage the power of domestic investors to revive our flagging markets and economic performance. The £5,000 extra UK Isa allowance announced in the Budget is a small start but there is room to be much bolder, especially with pensions.

> **"By failing to back their own market, UK investors undermine confidence internationally"**

Directing, say, 25% of all new pension contributions into UK-assets, including listed or unlisted companies, infrastructure and housing projects, would help maximise value from the £70bn a year tax and National Insurance reliefs that go into pensions.

Currently, these huge sums do not need to back Britain and even the Mansion House reforms, encouraging 5% of pension assets into unlisted securities, do not have to invest domestically.

Previous underperformance has deterred purchasers but reviving domestic demand could create a virtuous circle, benefitting us all. Long-term investors should consider this historic undervaluation opportunity seriously and the government should encourage or incentivise support. It is in all our interests for the UK markets to thrive.