MARKET INSIGHT

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Redmayne Bentley

ISSUE 38 - DECEMBER 2024

2024: The Year in Review

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2024: THE YEAR IN REVIEW

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The time around the festive period offers the opportunity to slow down and reflect on the events of the year. When looking back, we think 2024 will be considered a positive one. All major equity markets produced positive returns, inflation rates trended towards the 2% target rate, and all three major Western central banks begun cutting interest rates.

2024 certainly started well, with strong upward momentum in equity markets. Expectations of aggressive cuts to interest rates were a key contributing factor, along with continued strong performance of key names is US and European markets. As the year progressed, markets continued to adjust their expectations for interest rate cuts, leading to some volatility in global government bond markets. By the early summer, some markets had begun to flatten and slowly drift lower. Continental Europe was a good example, with key names of Novo Nordisk, ASML, and Nestlé seeing their share prices tail off on the back of weight loss drug sales slowdowns, a profit warning, and the overhang of aggressive price increases, respectively. Japanese equities experienced a more volatile period mid-summer as a shift in expectations for interest rate hikes caused the market to decline sharply before quickly rebounding. All major markets experienced a similar move.

The one thing that persisted through 2024 was the intent focus on a small cohort of names at the top of the US market driving the flagship S&P 500 to all new highs. In such a narrow market, performance of the other 493 companies in the index was of seemingly little importance. Instances of investors selling down their UK holdings to increase global weightings continued, almost seemingly forgetting the UK provided some strong performance, albeit on a selective basis. Household names such as Imperial Brands, Marks & Spencer, and Rolls Royce have all posted strong returns for 2024 to date.

The year had always been marked as an important one for politics, with elections being held across the world. As usual, the US took centre stage with the re-election of former President Trump in a clear-cut result, causing a sharp upward move in US equities, partly on the notion of further business friendly policies. At home, the Labour Party returned to power after a long stint in opposition. The party's Autumn Budget was ill received by many, especially by the farming community and heavily labour reliant employers staring down the proposition of a significant rise in their national insurance bills. In the aftermath, gilt yields rose, causing a decline in the more interest rate sensitive sectors of the UK market, namely listed infrastructure funds and the property sector.

In this edition's Insight Article, we reflect on three points of interest in 2024, and within the Stock Focus article, food retailer Sainsbury's comes under review.

2025 also marks the start of Redmayne Bentley's 150th year. We would like to thank clients, readers and listeners as we head towards this milestone. We hope you enjoy this issue of *Market Insight*.

RISK WARNING

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STOCK FOCUS

SAINSBURY'S

RUTH HARRIS | INVESTMENT RESEARCH ANALYST

While Tesco is the comfortable leader of the UK grocery market, Sainsbury's has been gaining market share in recent years through a combination of product innovation and competitive pricing, now holding second position. With companies still digesting the implications of the recent Autumn Budget, investors are keenly watching the execution of Sainsbury's £1bn transformational cost saving initiative.

In February 2024, Sainsbury's presented its Next Level strategy, setting out its operational approach for the next three years. It promised a renewed focus on the grocery business following a spree of shakily executed ventures into other markets, putting food back at the heart of the business. The goal is to offer greater choice of groceries with consistent value, availability, and innovation across stores to attract more customers to shop at Sainsbury's on a regular basis. It is building the range of its premium own label brand Taste the Difference, with product innovations catered to changing consumer tastes. The company launched over 540 new products in the first half of 2024.

Beyond the grocery business, management has emphasised that the company's other products and service should reposition as complementary to the core offering. This includes the clothing line Tu, retail company Argos, and furniture store Habitat.

The renewed focus on food has included selling most of its banking business to NatWest following a failed foray into financial services. It also sold the Argos credit card business to credit provider NewDay Group.

The retail division Argos is well known for its affordable and broad range of products, as well as its traditional high street catalogue stores, though most transactions now occur online. Sainsbury's acquired the company in 2016, and integration has been challenging given the differences in the businesses and target customers. In 2020, Sainsbury's announced that 420 Argos stores would be closed and 3,500 jobs cut, with a shift to outlets and collection counters within the grocery stores. Moving forward, the company is targeting improved service, efficiency, and stock flow at Argos, in addition to modernised, smaller stores offering an improved customer experience. The division has had a difficult 2024 driven in part by poor summer weather, but management is anticipating stronger performance in the second half its financial year.

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On the financial side, Sainsbury's is targeting £1bn in structural cost savings over the next three years to improve margins and drive robust profit delivery. This will partially be accomplished through investment in a strong technology platform and simplified automated processes. The company aims to strengthen its balance sheet, generate retail free cash flow of at least £500m per year and strategically invest in growth projects such as buying some of its store freeholds and developing the electric vehicle (EV) charging network. As the cost of running a Sainsbury's store is largely fixed, increasing the volume of sales should improve margins and returns.

The business strategy is supported by a commitment to improved shareholder returns, including introducing a progressive dividend from next year having previously based payouts on 60% of underlying earnings. It is also undertaking a £200m share buyback program in 2025.

In the six months to September 2024, Sainsbury's reported good progress on strategic targets. Market share is increasing, with sales (excluding fuel) increasing by 4.6% with total underlying operating profit before tax up 4.7%. The Taste the Difference range performed particularly strongly, with an 18% increase in sales. Strong execution has driven a shareholder return of 12.7% over the month to 11th December, and an attractive dividend yield of 4.8%.

However, over the longer-term investors remain cautious with year-to-date share price returns of -8.30%. The Autumn Budget will impact operations, especially the hike in National Insurance (NI). The current level of 13.8% on salaries above £9,100 is set to increase to 15% on salaries above £5,000. Given that Sainsbury's has a large base of part-time and minimum wage employees, it is particularly vulnerable to higher labour costs. The company has guided a £140m increase in expenditure from the NI increase alone, not including the impact of a higher minimum wage. Sainsbury's management anticipates that this will feed into higher prices for consumers, especially given that the supermarket industry is notoriously low margin. In the 2024 financial year, Sainsbury's, Tesco, and Morrisons reported an average operating margin of 3.0%, with Asda lagging at 1.7%. The discounters Aldi and Lidl reported even tighter margins, averaging 0.7%. Low margins mean the industry will struggle to absorb the increased labour costs without increasing prices.

This pressure on Sainsbury's was exacerbated in October when its biggest shareholder, the Qatar Investment Authority, sold £306m worth of shares pushing the share price down nearly 5%. However, the business fundamentals remain strong, and the recent improved performance potentially indicates improving investor sentiment. Given the industry pressures moving forward, Sainsbury's transformational cost-cutting strategy and focus on innovation in the core food business seems well-timed. Christmas is a critical time for both groceries and the Argos retail line. Moving into 2025, investors will see if Sainsbury's is able to balance additional wage pressure and intense competition with attractive shareholder returns. ■

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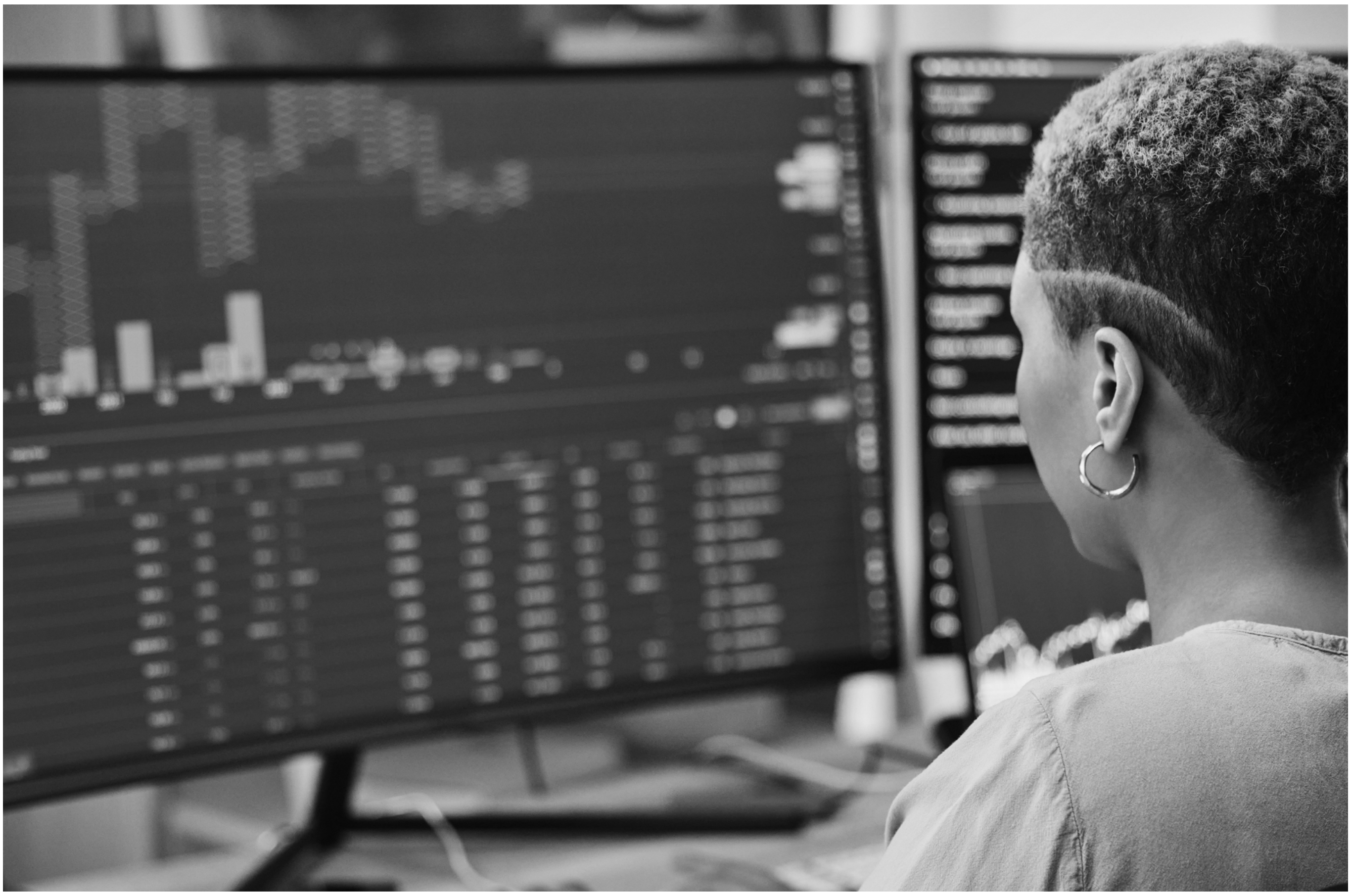
INSIGHT

THREE DEVELOPMENTS YOU MAY HAVE MISSED IN 2024

ALASTAIR POWER | INVESTMENT RESEARCH MANAGER



In sitting down and writing a review of 2024, the path of least resistance would have been a high-level round up of the key events of the year. To avoid a regurgitation of election outcomes, narrow US equity markets, inflation rates, and central bank activity, we instead take a slightly different approach. In this article, we focus on three points of interest throughout 2024 that were of importance but easy to miss.

The UK's domestic equity market has been often overlooked, especially with the tear-away performance of the US's 'Magnificent Seven' and positivity around the potential for Artificial Intelligence (AI). Assets have generally been flowing out of the UK equity market, with Calastone's Fund Flow Index indicating persistent outflows since May 2021. In contrast to fund investor activity, corporate activity has been increasing. In October, investment bank Peel Hunt highlighted a record number of bids for FTSE 350 companies, with nineteen ongoing bids in 2024 compared to just two in the whole of 2023. At the time of writing, forty transactions had been announced with a total equity value of £47bn, mostly from corporate buyers. With the average bid premium to the pre-announcement date share price of 40%, activity could have an important message for investors; the UK equity market is worth keeping an eye on with an apparent public equity discount at play when compared to private market transaction valuations. UK equity specialists Gresham House highlighted another indicator of the undervaluation of UK markets, with companies achieving attractive valuations when selling a subsidiary or business unit through a process known as carve-outs. A key example included Marlowe, which sold its Governance, Risk and Compliance assets for a price greater than the company's market capitalisation despite only accounting for 40% of the group's operating profit. Investors are potentially recognising embedded value is on offer, with the same Calastone index mentioned earlier indicating that November was the first month of positive inflows for UK equities after a forty-one-month stint of net outflows.

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Japan provided a top performing equity market for much of 2024, surpassing the 1989 peak in February before setting yet another multi-decade record in August for the largest single day decline – a fall of 12.4% - since 'Black Monday' in October 1987. Tokyo Stock Exchange's push for corporate reform has reignited foreign investor interest, leading to 6.3 trillion yen flowing into the market in 2023. By the time the Nikkei 225 hit its second all-time high in July 2024, a further 2.5 trillion yen had reportedly flowed into the Japanese market. The August sell-off was triggered by the seemingly minor news of a Bank of Japan interest rate hike combined with disappointing labour market data in the US that resulted in the Japanese yen appreciating sharply against the US dollar. The Japanese market recovered quickly but has traded in a tight range throughout the fourth quarter.

The final point of interest for 2024 comes in the performance of the European high yield bond market. At the time of writing, the Bank of America European High Yield bond index has returned just under 9% for 2024 despite a tough structural backdrop for Europe given political and fiscal uncertainty in both Germany and France that could continue into 2025. Fundamentals reportedly remain strong, with companies' ability to cover interest payments continuing to be healthy and the quality of companies issuing debt into the market remaining high. Technical factors assisted in performance, with a shrinking of the market size by a reported 20% since the start of 2022 being met by a significant increase in demand, as highlighted by the iShares European High Yield Corporate Bond ETF increasing in size by almost 60% over the same period.

For financial markets, 2024 has been fascinating, providing a myriad of interesting events and developments which couldn't all be commented upon. Most importantly, it has been one of positive returns for portfolios with a broad offering of opportunities for those with both short and long-term outlooks. What occurs in 2025 is open for debate and can be expected to be explored within the next edition of our sister publication, *1875*. ■

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