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Woodford Outlook 2019

Although the UK stock market has remained preoccupied by the ebbs and flows of the Brexit debate, the UK economy has continued to produce strong data. Towards the end of 2018, we have seen further positive numbers on wage growth and employment, backed up by more good news on inflation. With the lowest unemployment since the 1970s, strong growth in employment and hours worked, combined with the fastest real wage growth since the financial crisis, we enter 2019 with strong economic momentum in the UK.

Meanwhile, the rest of the world economy is gradually looking less robust. China is very visibly slowing, emerging economies continue to struggle with dollar strength and higher dollar borrowing costs, and Europe has slowed significantly. The weak oil price that was evident in the final months of 2018 is, from our perspective a reflection of this backdrop, with much weaker demand growth than the consensus had expected, as well as more robust supply growth. The US economy is still visibly strong but the waning influence of fiscal stimulus, allied to the lagged effects of much tighter monetary policy, are beginning to challenge policymakers and financial markets. Bond investors appear to be pricing in a much more challenging economic environment and the correction that appears to have started in the equity market is another warning of more troubling times ahead.

Our strategy remains focused on avoiding the considerable risks that have built up in equity markets over the last decade of QE-fuelled exuberance, and capturing the opportunity that exists in the few parts of the market that have been left behind.

Over the course of the last two years, we have seen a very attractive investment opportunity emerging in domestically-exposed stocks, which have been increasingly out-of-favour since the UK voted to leave the European Union in June 2016. As the negotiations with Europe have progressed, uncertainty about the path of the UK's future relationship with Europe has increased. The UK has consequently fallen heavily out of favour with global asset allocators and, within the UK stock market, a significant gap has opened up between the performance and valuation of international-facing stocks and domestically-exposed stocks. We have progressively increased the portfolio's exposure to the latter, selectively focusing on stocks which are pricing in a bleak scenario for the UK's future, which stands in stark contrast to the much more positive economic data that we are seeing.

Elsewhere, the portfolio also continues to be positioned to capture an exciting long-term opportunity across a range of earlier-stage businesses exposed to the themes of healthcare innovation and disruptive technology more broadly.

To summarise in one paragraph…

The UK is a rare beacon of growth in a global economy that is clearly slowing. Equity markets have enjoyed a very long bull run which has left many parts of the market very stretched in valuation terms. Our strategy remains focused on avoiding the considerable risks that have built up in equity markets over the last decade of QE-fuelled exuberance, and capturing the opportunity that exists in the few parts of the market that have been left behind. The most attractive opportunities are in UK-focused businesses, which have fallen increasingly out of favour as the Brexit negotiations have progressed. We have increased the portfolio's exposure to this part of the market, selectively focusing on stocks which are pricing in a bleak scenario for the UK's future, which stands in stark contrast to the much more positive economic data that we are seeing. Elsewhere, the portfolio is also positioned to capture an exciting long-term opportunity across a range of earlier-stage businesses exposed to the themes of healthcare innovation and disruptive technology more broadly. We enter 2019 with considerable confidence in the strategy and the long-term returns we can deliver to investors.