KPMG Brexit FTSE indices: 2017 performance and 2018 outlook

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At a glance

- Performance of KPMG UK50 and KPMG non-UK50 indices continued to diverge in 2017, while both indices were out-performed by the world index
- Strong world economic momentum and a possible weaker pound could see further divergence in fortunes for KPMG UK50 and KPMG non-UK50 indices in 2018, highlighting the importance for investors to identify the different drivers of UK-listed stocks

After Brexit vote 18 months ago, KPMG created two indices to measure the impact of the vote on UK stocks and to understand the relative sentiment towards UK-focused companies and their more international peers:

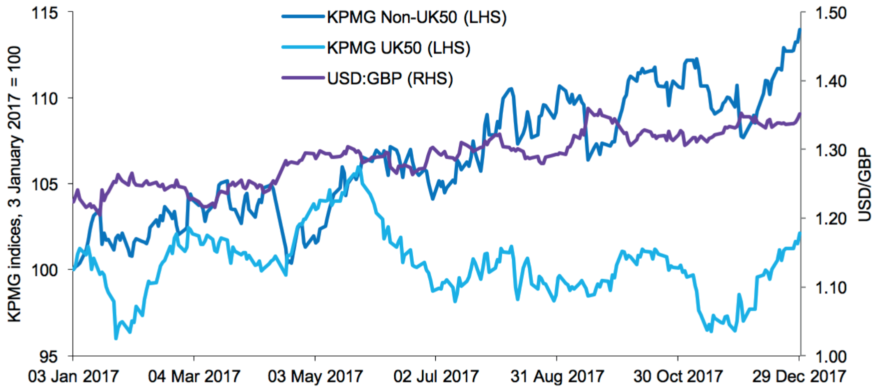
1

The KPMG **Non-UK50** is made up of the UK's largest listed firms from the FTSE 100 and 250 that derive more than 70% of revenues from abroad.

2

The KPMG **UK50** includes the largest listed firms from the FTSE 100 and 250 that derive more than 70% of their revenues from the UK.

KPMG 50 indices in GBP, and USD/GBP exchange rate



Source: Datastream, KPMG analysis

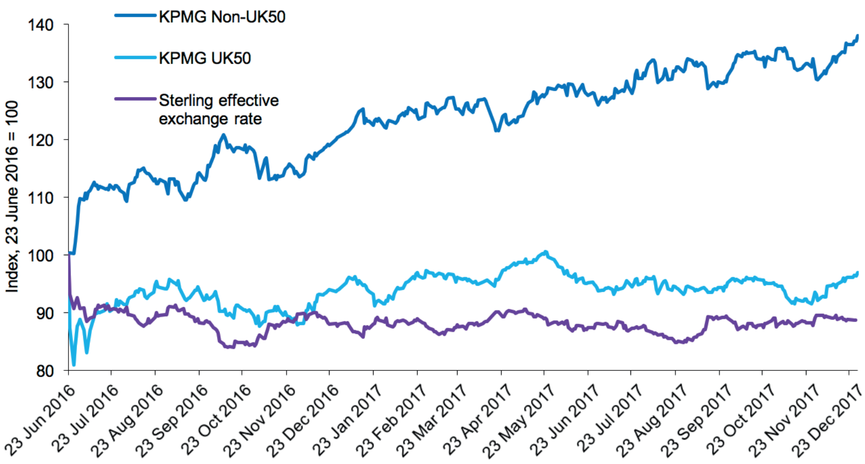
2017 was a year of contrasting fortunes for UK stocks

The last two months of 2017 saw the KPMG Non-UK50 index rise by 3.1% to make it 14% higher overall compared with the start of the year, with the pick-up in commodity prices helping boost the largest constituencies of the index.

By contrast, the KPMG UK50 index saw a more modest 2.3% rise in the last two months, culminating a year of minimal gains for the UK focused index.

According to John Goddard at KPMG Makinson Cowell 2017 was a relatively subdued year for the FTSE All-Share, the leading index for the UK market. Although the benchmark ended the year strongly, closing on an all-time high and increasing 8.5% over the year, in an historical context this increase is comparatively small. Since 1990 the market has posted positive annual gains in 19 out of 28 years, but of those advances only 2007, which saw the start of the bear market, and 2012 were smaller increases, at 2% and 8% respectively. With the $/£ rate closing 2016 16% lower over the year, it provided a tailwind in 2016 to international stocks, whereas sterling strengthened against the dollar over 2017, gaining 10% and acting as a headwind.

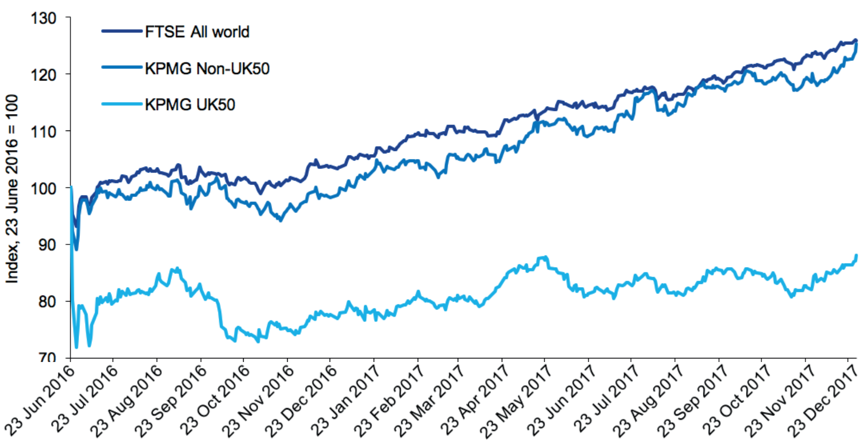
KPMG UK50 and non-UK50 indices since EU referendum in June 2016



Source: Datastream, KPMG analysis

Since the EU referendum in 2016, the difference between the two indices remains stark: a 3% drop for the KPMG UK50 and an increase in the KPMG Non-UK50 of 38%, with the indices generally following the fortunes of the Brexit process and the pound exchange rate.

KPMG UK50 and non-UK 50 in USD and FTSE All World, USD



Source: Datastream, KPMG analysis

Adjusted to remove the effect of the weaker pound, the performance of the KPMG Non-UK50 has been less stellar over that period, however. Comparing both KPMG indices in US dollar terms against the FTSE All World index (also in dollars), investors seem to value prospects of companies listed in the UK slightly less highly, even if the majority of their business is overseas. Since June 2016, the value of FTSE All World has risen by 26%, versus 25% for KPMG Non-UK50 and -12% for KPMG UK50 all in dollar terms.

> "Performance of the two indices is likely to diverge further in 2018. For investors, that means remaining particularly alert to what is driving performance."

Outlook for 2018

Momentum in the world economy remains positive for 2018, and this should support the earnings of companies in our KPMG Non-UK50 index. Commodity prices are also expected to stay firm, benefiting a significant part of the index.
A key conundrum for this year is the exchange rate, which will impact the value of companies' foreign earnings in sterling. The recently approved US tax deal, a more aggressive Fed response, and concerns about Brexit negotiations back home could all put a renewed pressure on the pound versus the dollar, which could boost the index even further.

On the other hand, if changes in US policy are already priced in and Brexit negotiations run smoother than many expect, we may see a further pound rally and that would rein in some potential gains.

Top UK-focused companies captured in our KPMG UK50 index are expected to experience a generally more muted domestic economic environment than elsewhere, with the UK economy expected to grow at similar levels to 2017. This may mean we see a similarly lacklustre performance of the index this year. While banks, the largest constituency of the index, could benefit from a further rise in UK interest rates, real estate and retailers may suffer from investors' jitters, and the index may also be vulnerable to shifts in expectations around the course of a Brexit deal.

All this means performance of the two indices is likely to diverge further in 2018. For investors, that means remaining particularly alert to what is driving the performance of UK-listed companies.

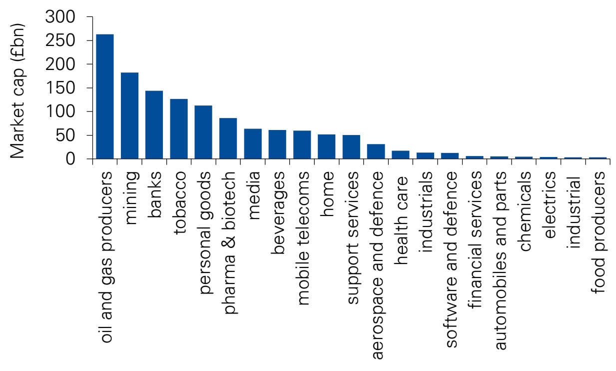
How we created the indices

KPMG analysed the annual accounts of every company in the FTSE 100 and FTSE 250 to calculate the proportion of their revenues originating in and outside the UK. Companies that earned over 70% of their revenues inside Britain were classified as 'UK companies', while those that derived less than 30% were deemed 'non-UK'.

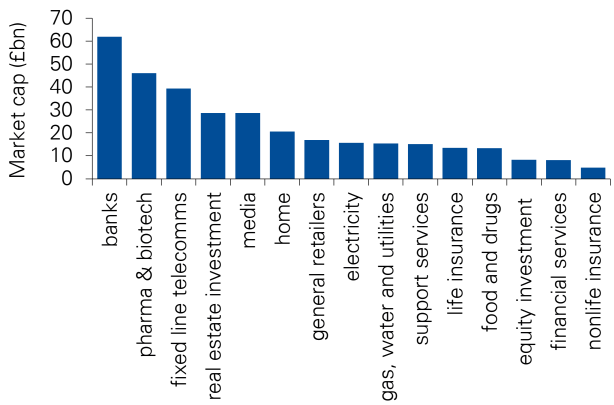
These companies were then ranked by market capitalisation (as of 23 June) and the 50 largest companies included in each index. The indices were weighted by market cap and calculated using the change in market cap of each company over the period from 23 June to 31 October 2016. Both indices were rebaselined to 100 on the date of the referendum, in line with the FTSE 100 calculation methodology.

The number of companies selected for each index took into consideration the range of sectors that are included in each index.

KPMG Non-UK 50 – sector weighting by market cap



KPMG UK 50 – sector weighting by market cap



About KPMG's macroeconomics team

The macroeconomics team at KPMG advises clients on the impact the future economic environment can have on their business, combining economics with data analytics to assist them with their strategy.

With the economic environment expected to remain diverse and unpredictable, risks as well as opportunities for growth across the world are more difficult to identify. At the same time, the rewards for the few who unearth those risks and opportunities are significant.

The macroeconomics team helps clients identify risks and opportunities in their current and future markets.

About KPMG Makinson Cowell

KPMG Makinson Cowell provides clear, precise and independent insight into shareholder perceptions. This specialist investor relations advice helps clients manage and develop interactions with institutional investors and other stakeholders to build positive, long-term relationships that support the clients' strategic goals

The team monitors UK market earnings, dividends and share price/index movements to support its investor relations advisory work.

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