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January 2019

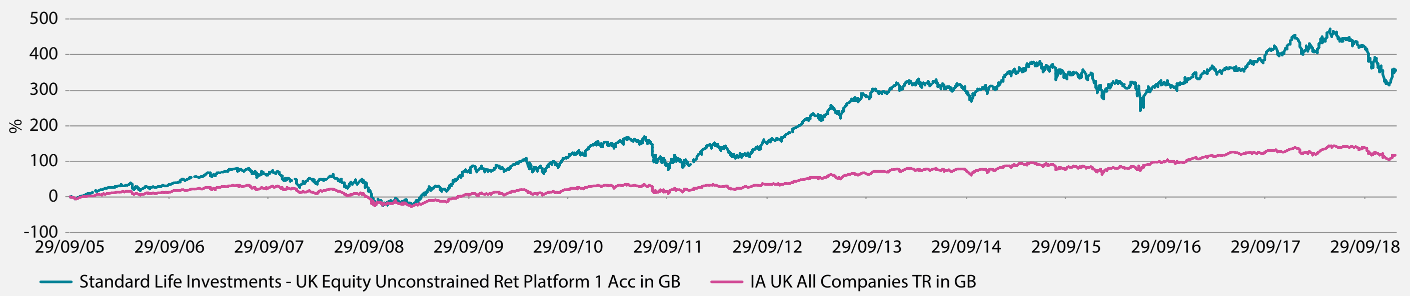
InFocus

Standard Life Investments UK Equity Unconstrained Fund

Key features

An unconstrained approach with a focus on highly selective stock picking	**Style-agnostic and free of market-capitalisation bias**	**Driven by insight generated via full market coverage and close corporate access**

Performance



Source: FE Analytics; 5 year cumulative performance to last month end 23/01/19; Platform 1 Acc share class; TR; GBP

	01/01/2018 31/12/2018	01/01/2017 31/12/2017	01/01/2016 31/12/2016	01/01/2015 31/12/2015	01/01/2014 31/12/2014
Standard Life Investments UK Equity Unconstrained	-21.80%	23.88%	-2.62%	9.01%	0.45%
Sector: IA UK All Companies	-11.19%	13.99%	10.82%	4.86%	0.64%

Source: FE Analytics; discrete annual performance to 31/12/18; Platform 1 Acc net of fees share class TR; GBP

Macro uncertainty creating opportunity

The concluding quarter of 2018 was a difficult one for most capital markets, not least UK equities, which left investors facing three profound challenges to consider in 2019:

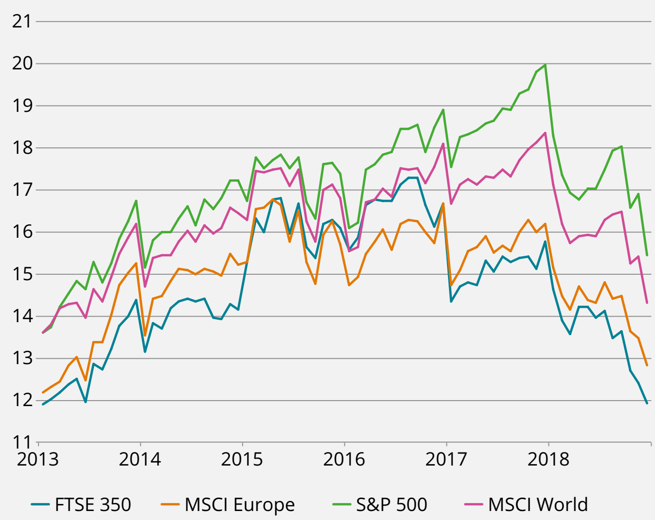
1. Growth rates – is this the end of the cycle both economically and for strong investment returns from risky assets?

2. Geopolitics – how best to navigate the challenges created by populism, such as trade wars and Brexit?

3. Sentiment – what are the prospects for individual securities in the context of strong, top down macro drivers?

As with any investment decision, the point at which you start is key. The good news from here is that the concern surrounding the issues listed above has already permeated deeply into UK equities. So much so that we now have a market that is demonstrably cheap versus its global peers, and one that offers a great deal of opportunity.

Chart 2: Estimated P/E Ratio



Source: Bloomberg, 31 Dec 2018

Digging further, low valuations are particularly abundant where there is the most concern over the outcome of Brexit – domestically exposed stocks. As we recall, the Brexit vote catalysed many allocators and investors into the relative safety of investing in a way that avoided UK exposure. Consequently, the valuation divergence between companies exposed internationally and domestically has reached extreme levels versus recent history with many domestic companies trading at a pronounced discount. However, with Brexit negotiations approaching a resolution and uncertainty on the UK's future path likely to diminish, this valuation gap is set to narrow. Investors are therefore presented with an unusually powerful investment opportunity within the UK market.

Taking an Unconstrained approach

Over the Fund's lifespan, we have often found that periods of high anxiety provide a rich vein of opportunity for outperformance. A good analogy for this is the swing of a pendulum. Markets often shift between exuberance and despondency, greed and fear, driven by sentiment and short termism rather than the underlying fundamentals that inform long run returns. Typically, when markets move to an extreme, most participants cannot foresee how it will ever change. But, like a pendulum, markets don't stay stationary for long, going on to adapt to 'overshoots' in both directions.

When markets feel like this, which we believe they currently do, the key is to challenge consensus, avoid the crowd and look for situations where the thinking is most extreme. Constructing a strong case for a company's medium or long prospects to improve in a way that is not expected provides the bedrock of future outperformance. Whilst acknowledging that market cycles vary, we take comfort from the Fund's track record of performance through previous periods of high anxiety. Indeed, we continue to navigate markets through the same principles of research driven, unconstrained investing in pursuit of meeting our investment objectives.

Exposure to attractive valuations

Starting valuations remain one of the key determinants of future investment performance, with lower valuations strongly linked to higher long term performance. Looking at portfolio valuations versus the past and the prospects for the future, we are particularly pleased to see a strong sense of value emerging in both directions. On average, at the time of writing the shares held in the Fund trade at a circa 47% discount to their five year highs. Putting this in context, the FTSE All Share index is at a circa 12% discount to the five year high it made in 2018. And on a forward looking basis, the portfolio is trading on cheaper multiples than the market on a year 1 and year 2 expected earnings basis.

Driving these characteristics and following on from the points made above, the portfolio is heavily exposed to key UK domestic sectors with the top 10 containing two housebuilders (Bellway and Crest Nicholson), two UK exposed financials (Provident Financial, Barclays) and a solely UK general retailer (Dunelm). In each case, we see significant outperformance potential versus the market. We believe now is a time for allocators who have ignored or avoided the UK to look at how the market stands up globally and then take a step further and look at how much negativity is priced into many parts of the market. We have done just that and believe the starting point of disrupted valuations and expectations allow significant scope for the pendulum away from an extreme.

Wes McCoy
Fund Manager

"We now have a market that is demonstrably cheap versus its global peers, and one that offers a great deal of opportunity "

Important Information

- The value of investments and the income from them can go down as well as up and investors may get back less than the amount invested. Past performance is not a guide to future results.
- More details of the risks applicable to this fund can be found in the Key Investor Information Document (KIID) and Prospectus, both of which are available on request or at our website www.aberdeenstandard.com

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