FUNDAMENTALS
ROSS WATSON

I cycle to work. So the weather matters. It seems determined to remain indecisive. But until recently stockmarkets, by contrast, were of one, clear mind. Buoyed up by take-overs, real or imagined, oceans of cash and that critical factor called optimism, right around the world the upwards march of equities went on - until the sharp rise in long-term interest rates stopped the show.

Some stocks, though, have been rising less than others. In the UK, small and mid-sized companies have been basking in the sun. But the biggest companies are standing outside in the rain. Glaxo, Vodafone and all the other top ten UK stocks are cold and wet, while their young cousins collect a tan. The top 10 are on a price/earnings ratio of only 11 times - against 15 times for smaller companies and 13 times for the market as a whole.

Why? Mergers and acquisitions (M&A). The so-called "runaway train" of M&A has yet to reach the big-cap station. There have been rumours that a US group may bid for Vodafone, but so far there have been only few words and no action as far as M&A and the big-caps are concerned. The giants aren't devouring each other - yet. They will start doing so, I believe, soon.

So that looks to me, from where I cycle through June's wind and rain, like an opportunity. It means that the top 10 or even 15 UK stocks are very good value at the moment. Because of strong dividend growth they're also all paying a very good yield - and that's sunshine to me as an income and growth manager. The likes of RBS and HSBC, BAE and Xstrata will have their day in the sun. Until then, I am very happy with their dividend alone.

What, meanwhile, of the overall environment for UK equities? It looks pretty sunny to me. The gloomsters point to rising interest rates. I reply by pointing to the fact that two-thirds of the UK's corporate profits come not from the UK, but from overseas. The world's economy is prospering, and set to stay that way. So is the outlook for UK corporate profits.

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Sure, higher UK interest rates will be bad for certain sectors of the market - housebuilders and retail, for example. But they're (relatively) tiny sectors. Vodafone on its own is almost the same size as the whole UK housebuilding and retail sectors combined.

So as I pedal along, I see an encouraging overall environment for equities, and especially attractive opportunities in the UK big-cap space. To cap that (no pun intended), even outside the M&A boom I also find small(er) companies I want to buy. For example Premier Foods has just completed the integration of RHM and has a good record of reducing costs from deals such as this. Abbot Group supplies drilling well engineering and other services to the booming oil industry. Johnston Press has an impressive position in the regional newspaper market.

These are good, well-run companies whose runes read well. So opportunities in the UK stockmarket abound. I think this scenario will be the same for a while - whether the weather is rain or shine.

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