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SENT VIA EMAIL ONLY TO: CEU.enquiries@hmtreasury.gov.uk
Rt Hon Rachel Reeves
Chancellor of the Exchequer
His Majesty's Treasury
1 Horse Guards Road
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cc: Rt Hon Liz Kendall MP
Secretary of State for Work and Pensions
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18 July 2024

Dear Chancellor

Proposal for Strengthening the UK Stock Market through a Pension Fund Investment Mandate

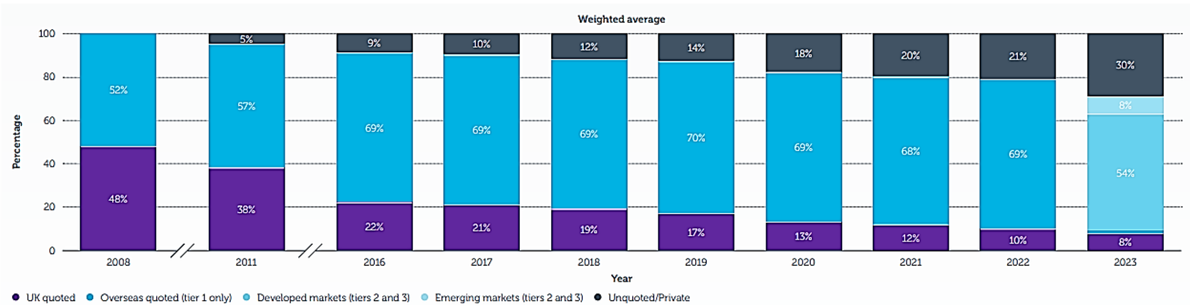
We are writing to propose a cost-effective strategy to bolster the UK stock market by introducing a mandatory investment rule for pension funds. This approach would significantly increase capital inflow into UK listed equities without imposing additional costs on the government.

Detailed below are the key points of the proposal, supported by data and third-party research.

Mandatory Rule for Pension Funds

- Introduce a requirement for pension funds to maintain at least 20% of their equity exposure in UK listed equities to retain their tax-advantaged status. This would simply return pension funds to their UK equity allocation as recently as 2017.

Proportion of pension fund equity exposure invested in UK equities



Source: 2023 Purple Book

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Capital Inflow into UK Equities

- The total market capitalisation of the FTSE 100 is approximately £2.1 trillion.
- The Parliamentary Pension Scheme invests just 2.8% of its overall quoted shareholdings in UK listed companies.
- The weighted average proportion of pension fund equities invested in UK quoted stocks has fallen to 7.6% in 2023 as compared to 48.2% in 2008.
- As of 30 September 2023, the market value of private sector defined benefit and hybrid (DBH) pension schemes was £1,123bn, and the market value of private sector defined contribution (DC) and public sector DBH pension schemes £741bn making £1,864bn overall.
- Therefore, if we apply the asset allocation in the table above to the overall pensions market, it will imply the overall amount invested in UK equities is just £25.5bn.
- An increase to a minimum UK equity exposure of 20% of the overall equity exposure, would direct an estimated £41.6bn into UK equities, equivalent to about 2% of the current FTSE 100 market capitalisation.
- This influx would significantly boost market liquidity and stability.

Reversing Current Trends

- UK equity funds have experienced consistent outflows in recent years, with £13.6bn withdrawn in 2023 alone (in 2022 it was £12bn).
- Our proposal would counteract these negative flows and restore confidence in UK equities.

Enhancing Valuation and IPO Appetite

- Increased investment would likely improve the valuation of UK equities, making them more attractive to both domestic and international investors.
- A March 2024 analysis by SCM Direct found that UK stocks traded at a 25% discount to their global peers.
- A stronger stock market could stimulate greater appetite for Initial Public Offerings (IPOs), encouraging more companies to list in the UK.

Preventing Corporate Relocations

- A more robust UK equity market could reduce the likelihood of companies relocating their headquarters abroad.
- Retaining these companies would help boost UK employment and maintain corporate tax revenues.

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Cost to HMRC

- The cost to HMRC would be minimal, potentially zero, and could lead to increased tax revenues by preventing capital flight and encouraging economic growth.

Flexibility for Pension Funds

- Pension funds would retain autonomy in deciding their overall investment strategy across broad asset classes.
- A mandated rule would simply ensure a minimum allocation to UK listed equities within the overall equity exposure, supporting the domestic market while allowing funds to pursue their preferred investment mix.

Potential for Enhanced Returns

- UK stocks are currently trading at historically low valuations compared to their international peers, presenting a unique opportunity for pension funds.
- The FTSE 100 price-to-earnings (P/E) ratio stands at 11.9x prospective earnings as of July 2024, significantly lower than the S&P 500's 23.2x P/E ratio.
- Reducing exposure to overvalued US equities, particularly the "Magnificent 7" Tech stocks, could mitigate risk and potentially enhance returns. Nvidia currently accounts for 6.6% of the S&P 500 Index and is currently valued at 44x prospective earnings.
- By reallocating funds to undervalued UK stocks, pension funds could capitalise on the potential for value appreciation and higher dividend yields.

Diversification Benefits

- Increasing allocation to UK equities would improve geographical diversification, reducing overreliance on the US market.
- This shift could provide a hedge against potential corrections in overvalued US tech stocks, which have driven much of the recent market gains.

Long-term Value Proposition

- UK equities offer attractive dividend yields, averaging 3.9% at present as compared to just 1.3% for the S&P 500, providing steady income for pension funds.

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- Our proposed mandate would encourage pension funds to take advantage of these undervalued assets, potentially leading to improved long-term returns.

Market Rebalancing

- This strategy could contribute to a more balanced global equity market, reducing the current disparity between UK and global stock market valuations.
- It may also stimulate increased interest in the UK stock market from international investors, further supporting stock prices and market liquidity.

By implementing our proposal, pension funds could not only support the UK stock market but also potentially improve their own returns by capitalising on the current valuation discrepancies between UK and global equities, particularly US equities. This approach also aligns with prudent investment strategies of buying undervalued assets and reducing exposure to potentially overvalued assets.

We urge you to consider this proposal and discuss with relevant stakeholders implementing this strategy. Your support would significantly enhance the resilience and attractiveness of the UK stock market, boost our economy and signal that Labour is a government that is backing Great Britain.

We would be delighted to meet with you or your team to discuss further.

Thank you for your attention to this matter. We look forward to your response.

Yours sincerely,

Alan Miller *Gina Miller*

Alan Miller Gina Miller

Co-Founders
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