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Will the Empire Strike Back?

The UK stock market is going from strength to strength.

The Empire Strikes Back starts off with a battered Rebel Alliance (for those who don't know, these are the good guys: think Luke Skywalker, Princess Leia and Han Solo) scattered across the galaxy. They were in retreat having been pushed back by the Galactic Empire (the bad guys: think Darth Vader and the stormtroopers) in the first movie of the franchise.

One could argue that over the past decade or more, the UK stock market has been akin to the Rebel Alliance: forgotten about and trading on depressed valuations amid political uncertainty, a lack of technological innovation and unprecedented levels of selling by domestic investors.

The ensuing structural undervaluation of British companies has led to an almost inevitable wave of inward M&A as overseas buyers have been snapping up UK plc. To try and combat this, UK firms responded by ramping up share buybacks, with London becoming the share buyback capital of the world.

However, we see two key trends taking place within UK markets that point to a more conducive backdrop: the return of outward M&A and the strength Britain brings as a diversifier to US-heavy portfolios – even more so when you consider the fact that the UK's FTSE 100 and the US's S&P 500 have been closely matched in terms of returns over the past five years, in pound sterling terms.

UK plc on the offensive

The first thing we'll highlight here is the new narrative emerging of UK firms striking back. It looks to us as though the pace of share buybacks may have reached a peak, as companies start to look to the future.

Organic growth is often seen as a panacea, but, done well, inorganic growth (acquisitions and the like) can help, too. Certainly, when we're seeing doom-and-gloom headlines about inward M&A, there's a seemingly untold and unappreciated story of UK firms turning the tables and looking to do deals themselves.

Pharmaceuticals giant GSK completed its share buyback programme in June and shortly after announced that it would be buying Nuvalent, a Boston-based creator of oncology therapies, for c. \$10.6bn (£8bn). This was the largest transaction undertaken by the firm in over a decade.

Elsewhere, HSBC completed its \$13.6bn buyout of Hang Seng Bank in January, Shell splashed out \$16.4bn on Canadian natural gas producer ARC Resources in July, while also this year student housing specialist Unite bought Empiric, Standard Life agreed to buy the UK arm of pensions and life insurer Aegon, and Santander completed the purchase of TSB Bank from Sabadell.

Others are focusing on increasing their global growth opportunities. Hollywood Bowl has been expanding into Canada since 2022, when it bought Teaquinn Holdings, which owned five bowling centres in the country. It now runs 16 centres in the country under the Splitsville brand and plans to get to 35 by 2032.

American brewer Molson Coors took a c. 8.5% equity stake in Fever-Tree at the start of 2025, a partnership that has benefitted the tonic water maker by giving it a vastly improved distribution network from which to expand into the US. With UK sales starting to plateau, the US market remains vast and using a similar playbook to how it cracked the UK seems prudent.

So, while some commentators are raising concerns over the health and future of the UK market amid continued inward M&A, a steady drip of companies crossing the Atlantic and low IPO activity, we'd beg to differ. It could be that as a result of this outward M&A that UK plc becomes much stronger and increases its global competitiveness, potentially supporting a further re-rating in many of these companies.

May the force (of diversification) be with you

Of course, the UK has plenty of attractions to recommend it in and of itself. The defensive sectoral make-up of FTSE 100, thanks to its overweight to more traditional industries, means

it can bring diversification benefits to an overall portfolio alongside more tech-heavy indices.

We saw an example of this when the VanEck Semiconductor UCITS ETF, a good proxy for the chipmakers that are powering the AI revolution, crashed into bear market territory in the space of 37 days through June and July. During that time, the Vanguard FTSE 100 UCITS ETF rose c. 5%.

As we’ve mentioned previously, pound sterling total returns from UK and US large caps aren’t as far apart as one might expect. In fact, the MSCI United Kingdom Index, which differs slightly from the FTSE 100, has returned 86.4% in pound sterling terms, higher than the 84.8% return of the MSCI USA Index, which, again, slightly differs from the S&P 500. Despite that, UK blue-chips trade at a c. 40% discount on both a trailing and forward price-to-earnings (PE) basis.

VALUATIONS AND PERFORMANCE				
	Five-year GBP return	Three-year GBP return	Price-to-earnings (PE) ratio	Forward PE ratio
MSCI United Kingdom	86.40%	55.70%	16x	12.6x
MSCI USA	84.80%	69.40%	25.8x	20.1x
MSCI Emerging Markets	59.30%	77.80%	15.2x	10.1x
MSCI Japan	59.10%	60.90%	19.5x	16.4x
MSCI Europe ex UK	52.60%	49.90%	18x	15.6x

Source: FE fundinfo, MSCI. Return data correct to 25/09/2026. Valuation data correct to 31/08/2026.

Past performance is not a reliable indicator of future results

This is evidence of what we’ve long been arguing: that the UK has the potential to play the role of a safe harbour in the eye of any AI storm that comes our way, while retaining a good slug of companies able to benefit from AI as and when the turbulence calms.

Broadening your universe

We think that [Schroder Income Growth \(SCF\)](#) stands out as a good way to get exposure to these trends described above.

GSK, Shell and HSBC all feature in SCF’s top 10 holdings, showing the benefits of manager Sue Noffke’s investment process. Sue looks for companies with strong balance sheets – a prerequisite for doing M&A – sustainable profitability and consistent cash generation, targeting mispriced opportunities across the whole of the UK market.

In addition, Sue benefits from the huge size and scale of Schroders’ UK equities team, enabling them to have ongoing dialogue with some of the largest listed companies in the UK. This ensures that Sue has all the information needed to

assess all potential acquisitions to ensure they are value-accretive and done at the right price.

Given the international outlook the majority of FTSE 100 firms have, SCF’s portfolio is well diversified globally, from a revenue perspective. Overweights to financials and healthcare ought to provide diversifying exposure for shareholders away from the market’s current myopic focus on AI. As an aside, plenty of sectors in the UK, while not direct AI plays, will be beneficiaries of the technology, through productivity and efficiency gains.

The trust has already earned its stripes having benefitted from the ramp up in share buyback activity, while it was also able to secure its 31st consecutive dividend increase, giving it one of the longest track records in the investment trust universe.

This dividend hero status is, to us, the trust’s most compelling characteristic and given the board takes into account all distributable returns (both revenue and capital) when deciding on the dividend, we have confidence its income profile remains on solid footing.

At the end of The Empire Strikes Back, Luke Skywalker returns to finish off his training with Jedi master Yoda in

anticipation of what will be a climactic battle in the final film of the original trilogy, Return of the Jedi.

One could argue that the UK stock market is undergoing a similar journey. It may be down in terms of perception and weightings in both global and domestic investors' portfolios, but it's by no means out when it comes to returns. The unloved UK market looks to us ready to emerge from the

shadows if the AI and tech narrative falters and disappoints those investors that have retreated from our domestic shores.

We think SCF is well placed to take advantage of these factors and provide a compelling re-entry point to returning investors, given its long track record of both outperformance and dividend growth and the attractive c. 8% discount and 4% yield on which the trust trades.

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