

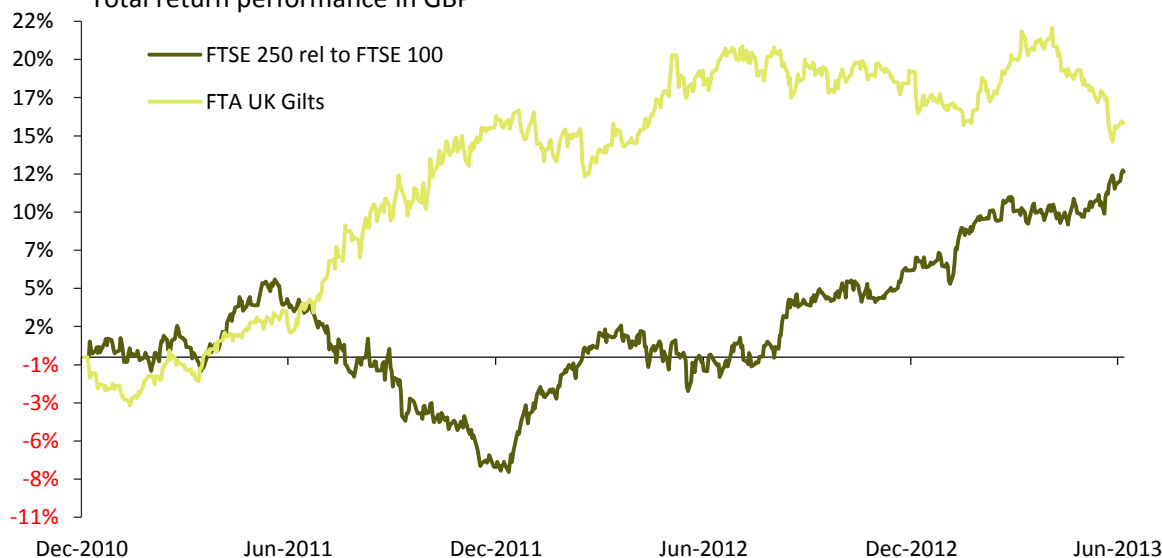
Turn in interest rate cycle bolsters UK Mid-cap

Summary

- Higher and stickier interest rates are a direct result of investors putting their money back to risk assets. It signals investor's confidence in UK growth.
- Domestic and secular growth themes help UK Mid cap stocks gain momentum. The outperformance against UK large cap stocks may continue
- Investors may consider a long leveraged position on UK Mid Cap stocks: buying Boost FTSE 250 2x Leverage Daily ETP (2MCL)

Risk-on! Confidence in UK's growth is driving Mid Cap stocks to outperform Large Caps

Total return performance in GBP



Source: Boost ETP Research, Bloomberg. Data as at 5 July 2013

Early signs of higher and stickier interest rates may reflect sustainable UK growth, giving renewed impetus to domestic secular investment themes. Momentum in the UK's Mid Cap stocks is building on the back of it, driving the FTSE 250 to outperform the FTSE 100 since the fall of 2012. At this turning point in the interest rate cycle, growth may not be fully priced in. As a result, investors wishing to gain long exposure to UK Mid Cap stocks may find the leverage available in the Boost FTSE 250 2x Leveraged Daily ETP (2MCL) interesting.

UK's economic recovery is gaining traction, driving a wedge with Eurozone's stagnant outlook and on course to align itself to the US. Confidence in the UK's recovery is growing as the rise in UK bond yields since May has not fed through into weakening producer

sentiment indicators. Provided a further rise in bond yields is managed gradually by the newly installed BoE Governor, the strengthening of domestic demand may help the economy to absorb higher interest rates further out. At 2.4% (as of 4 July 2013), UK's 10Y bond yields remain below inflation and historic average levels, suggesting potential for significantly higher yields. With the prospect of bond prices falling back to levels where real (positive) bond yields reflect an improving economic growth outlook for the UK, investors' attention will shift to domestic, as opposed to global, growth proxies. As the chart shows, this appears to have started in 2012. As UK interest rates started to climb, investors' risk appetite has steadily risen, helping the FTSE 250 to outperform the FTSE 100. This outperformance may have been the result of the former offering investors much better exposure to growth than the latter.

With the top line geared towards exports and the bottom line subject to generous pay-out policies, the performance of the FTSE 100's multinational heavyweights is essentially a reflection of global macro cycles with a defensive twist. In contrast, the performance of the FTSE 250 is underpinned by the secular, domestic growth themes of UK's Mid Cap stocks, and led by capital returns as opposed to dividend yields.

The following metrics comparison highlights the growth versus value proposition between the FTSE 250 and the FTSE 100. With net debt to EBITDA multiples of 1.3x for the FTSE 250 versus 2.5x for the FTSE 100, UK mid-cap stocks are, on average, significantly less indebted than UK large-cap stocks. With low pay-out policies being adopted by UK Mid Cap stocks, re-invested dividend income has contributed 46% to the total return of the FTSE 250 since July 1998. Hence more than half of the returns are capital gains driven. For the FTSE 100, dividends over the same period contributed close to 70%, freeing up significantly less cash for reinvestment.

In addition, with UK Mid Cap stocks' sales less reliant on overseas markets (2012 exports make up ~43% of total sales for FTSE 250 companies vs. ~62% for FTSE 100), corporate management and business models are focused on core competencies as opposed to business diversification.

The above growth characteristics of UK Mid Cap stocks may benefit the FTSE 250 as the interest rate cycle in the UK is starting to turn. After the BoE's accommodative monetary policy update last week¹ had a negligible impact on the recovery of UK Gilts, investors are more decisively betting against the sustainability of QE and its support for bond markets. If rising interest rates can be absorbed, it could be the early signs of sustainable growth taking hold over the UK economy. The re-rating of midcap stocks suggests the market agrees. Having climbed back to historic average trading ranges of ~18x forward looking P/E multiples, compared to previous peaks which were as high as 21x, valuations of the FTSE 250 do not appear stretched. As a proxy for this renewed interest in mid cap stocks, investors may wish to consider the Boost FTSE 250 2x Leverage ETP (2MCL).

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¹ (maintaining the 50 bps policy rate and GBP 375bn p.a. of QE)

