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Five shares worth watching if stock markets catch cold from Omicron

Slow and steady will win the race if the FTSE turns ugly and investors bale out

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By Emma Powell

The emergence of the Omicron strain of Covid-19 caused a stock market sell-off that has led to the FTSE 100 suffering its worst month for more than a year. Share indices have rallied a little in the past few days, but it is clear that investors are in cautious mood. It is too early to tell whether volatility is here to stay, but, if it is, there could be a more pronounced flight to companies perceived as safe havens.

Tighter restrictions on travel or trading hitting retail and leisure companies aren't the only thing that investors have to worry about. Rising inflation has emerged as a bigger threat to stock market valuations, in contrast with what was happening during the depths of the pandemic.

"The most dangerous thing is an overpriced 'defensive' stock," Aidan Donnelly, head of equities at Davy, the broker, said. Shares priced for high earnings growth are at more risk of being sold as high inflation erodes the value of future expected cashflows.

A sensible level of leverage, resilient cashflow and strong pricing power are only some of the attributes to look for in companies that might offer protection in times of volatility. Here are five stocks that might be strongly placed to withstand market volatility.

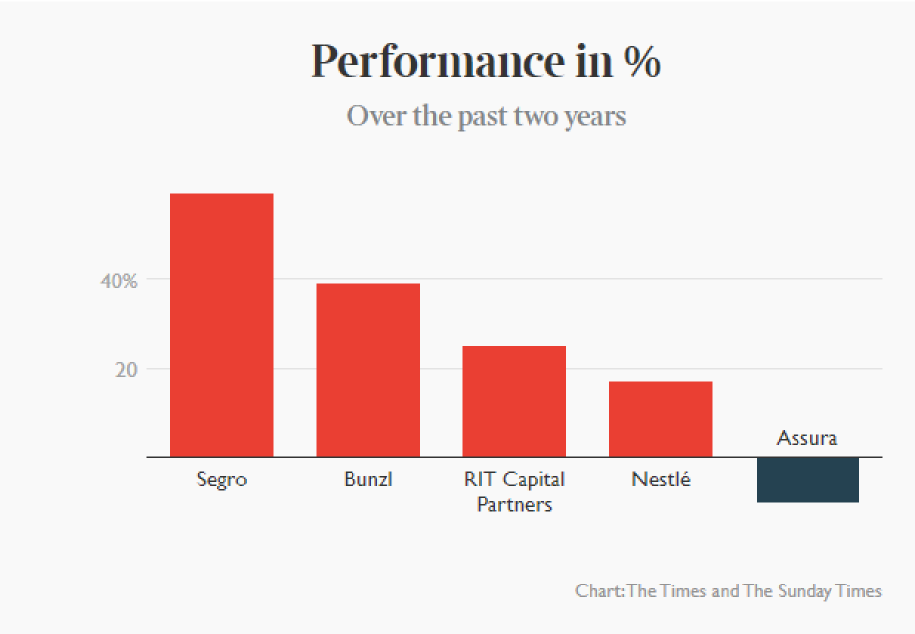
Segro

The warehouse landlord has benefited from twin tailwinds since the start of last year. One is the quickening shift to online shopping at a time of "stay at home" orders, which boosted already frenetic demand for space to service ecommerce. The second, more enduring fillip for asset values and rents is the imbalance in the supply of and demand for distribution space.

In a sign of the times, Segro is now the largest property company listed in London and the shares are still just over 50 per cent higher than they were before last year's market crash. Between July and mid-October, rents secured at review or renewal were an average 13 per cent ahead of previous passing rates and the vacancy rate declined to a mere 3.2 per cent. The balance sheet is in good shape, too, with a loan-to-value ratio of 23 per cent.

Nestlé The KitKat maker might be facing the same rising raw materials and freight costs as other companies in the consumer goods sector, but the strength of its brands means that it has real pricing power and has been able to pass higher input costs to consumers. The shares aren't exactly cheap, priced at 26 times forward earnings, but that's not too far above the range over the five years leading up to the pandemic.

In October the Swiss-based group upgraded its full-year organic revenue growth guidance for the second time, to between 6 per cent and 7 per cent this year, above that expected by Unilever. Over the past three years Nestlé has generated a share price return of almost 51 per cent, versus the just over 1 per cent delivered by its Anglo-Dutch rival. A considerable exposure to higher-growth emerging markets and everyday, repeat purchase items such as pet food and coffee should continue to drive growth in sales volumes.



Bunzl

Mention of the distribution conglomerate in the financial pages is normally preceded by the word "boring", but that's no bad thing when markets are oscillating. Scale is the key to its success. The idea is to be a one-stop-shop supplying companies with everything from first-aid kits to cleaning supplies and coffee cups, sourcing items at a cheaper price than they could themselves. Revenue growth hasn't shot the lights out, typically being at an annual low-single-digit rate, but it is consistent.

Last year it benefited from higher sales volumes and prices for primarily higher-margin, own-brand hygiene products, which offset a decline in sales to businesses affected by lockdowns. That benefit is dissipating, and the group is expected to revert to its historic rate of profit growth over the next three years. But it's also shown an ability to navigate rising inflation and has managed to pass on higher freight costs through price increases.

RIT Capital Partners

The FTSE 250 investment trust's main aim is to preserve shareholders' capital and deliver long-term growth. It invests in a mix of asset classes, listed and private, including global equities, government bonds and property. This year it has delivered a share price total return of just under 29 per cent, versus 17.5 per cent from the MSCI All-Country World Index. Despite impressive gains over the past 12 months, the shares are trading at a 1 per cent discount to NAV.

The drawbacks? If it's plain sailing for markets, the trust can underperform the index. Over the five years to the end of October, the trust delivered a share price total return of 62.5 per cent, versus 82.1 per cent generated by the MSCI World. The charge is also higher than some rival wealth preservation-focused investment trusts at 1.55 per cent of the value of your investment.

Assura

As a landlord to GP surgeries, Assura is a slow-moving real estate story. The FTSE 250 constituent develops and leases surgeries in Britain and has 625 properties serving more than six million patients. Of the £1.6 billion in contracted rent, 82 per cent is paid or reimbursed to tenants by the NHS. The average length of leases is almost 12 years and the vacancy rate was only 1 per cent at the end of September.

A reliable income stream has translated into a steady and growing dividend. This year that payment is forecast to be 2.96p a share, which at the present share price would equate to a potential yield of 4.3 per cent. But that income doesn't come cheap, with the shares trading at a 13 per cent premium to forecast NAV at the end of March next year.