Sector and Regional Dispersion in the UK

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Cross-sectional dispersion is an attractive metric in examining the volatility of the market at any one point in time. It is even more useful if total dispersion is decomposed into its beta and non-market components, helping fund managers understand whether there are still investment opportunities, even during financial, economic, and political crises. Using monthly data we calculate total dispersion, bet dispersion, and non-market dispersion for 11 sectors and 15 regions from the MSCI database in the UK, over the period from 2002:4 to 2022:12, we draw a number of conclusions. First, in times of market crisis, there is a sharp increase in cross-sectional dispersion. Second, cross-sectional dispersion has grown considerably following the results of the BREXIT referendum, and especially in the political uncertainty following the resignation of Boris Johnson. Third, beta risk dominates non-market risk, especially in times of market stress, which suggests that fund managers have very few investment opportunities that can outperform the market. Nonetheless, even in periods of market stress sectors display greater levels of non-market risk than regional portfolios, which indicates that fund managers could still have found potentially attractive investment opportunities, even during those periods. As such, sector allocation should be the first level of analysis in constructing real estate portfolios. Fund managers, however, need to carefully examine the size and sources of non-market return dispersion to determine their optimal investment approach at any one point in time.

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