



Gill Lakin
Fund manager

Quarterly review

for the three months to 30 September 2015

A 2015 US rate rise has been on the cards for months and could still happen but in September the Federal Reserve decided to stick rather than twist, keeping its Fed Funds rate target range at 0%-0.25%. At the time, US employment data looked robust and headline inflation was weak but ultimately it was the global economic outlook that gave the Fed pause for thought. Investors were told officials were “monitoring developments abroad”, concerned that “recent global economic and financial developments may restrain economic activity somewhat”. This was Fed-speak for fears of a Chinese hard landing. Investors took flight at the Fed’s dovish comments and reasoned that if central bankers were concerned about global growth, there must really be something about which to worry and equities fell sharply.

In early October, the US non-farm payroll data revealed a slower pace of job creation, adding to the case against an early rate rise. In the eurozone and Japan, weaker data led to speculation that monetary policy support might be increased. As a result, equities and bonds rallied while the dollar weakened as prospects of a US rate rise receded further.

The extent of the Chinese slowdown is hard to gauge given the lack of confidence in official data. Chinese policymakers cut interest rates and fuelled bank lending earlier this year before unexpectedly allowing the renminbi to fall in August, a development that alarmed investors. In response, global equities fell 5.87% in sterling terms over the third quarter of 2015 and capital flight from Asia accelerated. Fear grew that a sustained renminbi fall could prove deflationary.

Following the devaluation, China used foreign exchange reserves to manage its currency and announced more measures to support its economy on top of the increased infrastructure spending and fiscal and monetary easing already in place.

Chinese year-on-year economic growth slowed to 6.9% in the third quarter, fractionally below the official 7% target, which was achieved in the first half of 2015. Investors greeted the headline figure with scepticism but the underlying data were more illuminating. Industrial activity weakened but this was partially offset by stronger consumer spending. Year-on-year retail sales increased 10.9%, driven by China’s attempts to rebalance its economy away from exports towards

domestic consumption. Further indications of stabilisation or improvement in China’s economy could result in a recovery in share prices given the prevailing negative sentiment.

Emerging markets underperformed during the quarter. Asia Pacific ex-Japan and emerging market equities fell 13.76% and 14.63% respectively in sterling. China remains a concern but, as the chart below shows, Asia ex-Japan equities have rarely been so cheap. Many Asian countries rank among the world’s creditor nations and their economies are in good shape. They should benefit from weak energy prices and the falls in their currencies. Over the longer term, they offer favourable demographics and the potential for higher growth than developed economies.



Source: Thomson Reuters Datastream

I do, however, see the major opportunities for investors in developed markets. Although recent US and UK manufacturing data have been weak, companies with proven business models and strong consumer franchises continue to benefit from prevailing macro-economic trends. Falling prices for oil and other commodities have reduced costs and increased global consumer spending power.

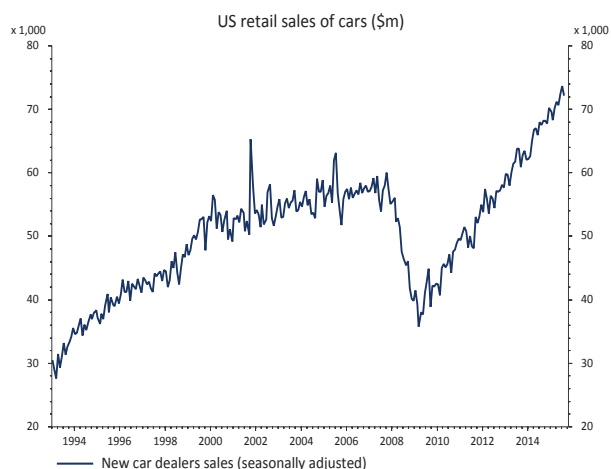
Evidence of this is particularly strong in the US, where consumer confidence rose over the quarter and a willingness to spend was apparent in other data including car sales and construction (see graphs overleaf).

Quarterly review (continued)

for the three months to 30 September 2015



Source: Thomson Reuters Datastream



Source: Thomson Reuters Datastream

In recent months, I have made significant investments in Fundsmith Equity, Artemis Global Equity Income and Newton Global Income, funds that focus on global consumer companies. Similar trends are apparent in the UK, where I have purchased Lindsell Train UK Equity, which also invests in companies likely to benefit from

this trend. These funds proved defensive during weak markets in August and September but should also perform well if the market strength seen in early October continues over the winter. For the second year running, the UK is likely to be the fastest growing Group of Seven economy although this partly reflects weak growth among the other member nations. Domestic economic strength should continue to be reflected in the performance of small and medium-sized UK companies, which typically derive more of their earnings domestically than large companies. Low interest rates and benign economic conditions may also produce an increase in takeover activity, which should benefit funds biased towards these stockmarket tiers. The recent improvement in Britain's current account deficit may also support sterling.

Safe-haven assets such as UK government bonds performed well over the quarter, returning 3.12% as prospects for a base rate rise receded. Sterling corporate bonds rose just 0.49%, however, as investors became more concerned about prospects for credit markets, particularly the high-yield bond market, which fell 0.76%. UK commercial property continued to perform well, rising 3.42% to take returns for the first nine months of 2015 to 10.41%. All investment strategies, with the exception of equity-only, entered 2015's final quarter with substantial property fund holdings because property should continue to provide a good source of diversification and an attractive return compared to many fixed income sectors.

Taking a long-term view, recent stockmarket falls have offered attractive buying opportunities among global equity funds biased towards the consumer companies that will benefit from rising discretionary spending. Asia ex-Japan equities have also appeared undervalued and should recover if the fears about a hard landing in China prove to be overdone.

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