BROMPTON PRIVATE CLIENTS

Quarterly review for the three months to 31st December 2011

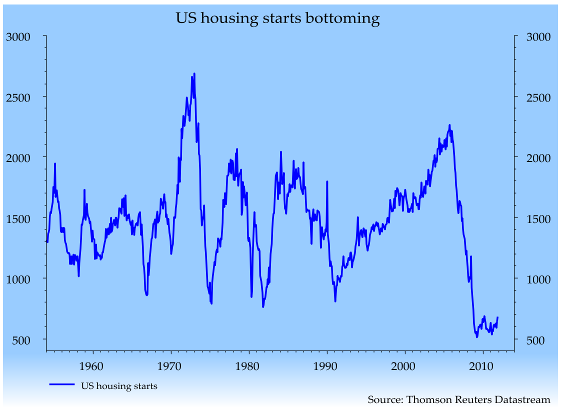
The modest 5.0% fall in the global equity market over 2011 belies the dramatic events witnessed during the year. Equity markets largely recovered following the Japanese earthquake at the start of the year but investors lost confidence in August in the face of a policy vacuum in the eurozone and the potentially disastrous consequences of political brinkmanship in the US. These issues were played out against a backdrop of deteriorating economic growth. The market rallied in October as conviction spread that eurozone leaders would act to resolve the uncertainty and agreement was reached at the eleventh hour to raise the US debt ceiling. A subsequent series of crisis summits did, however, fail to deal decisively with the eurozone sovereign debt issue. Some progress may have been made in establishing greater fiscal discipline, by agreeing measures that arguably should have preceded the original introduction of the single currency, but which do not by themselves constitute a solution. The European Central Bank, with the support of chancellor Merkel, insisted that it was not part of its mandate to act as lender of last resort but nevertheless it did take significant steps to strengthen the banking system in the event of a sovereign default.

The year also brought significant political uncertainty too with the "Arab spring" resulting in regime change in Egypt and Libya as well as growing instability elsewhere in the region. The eurozone crisis resulted in a change of political leadership in Greece and Italy and the rise of so-called "technocrat" politicians regarded as supportive of the eurozone and focused on implementing austerity budgets. In December, Asian markets considered the consequences of dynastic change in North Korea and, in the coming year, a decennial leadership change in China will result in a new cabinet formally taking over in March. In the face of so much bad news and uncertainty it is astonishing that markets remained so sanguine overall although regional equity market returns diverged significantly. The US equity market produced one of the best returns, gaining 2.0% in dollar terms, while equities in Europe excluding the UK and most emerging markets fell sharply.

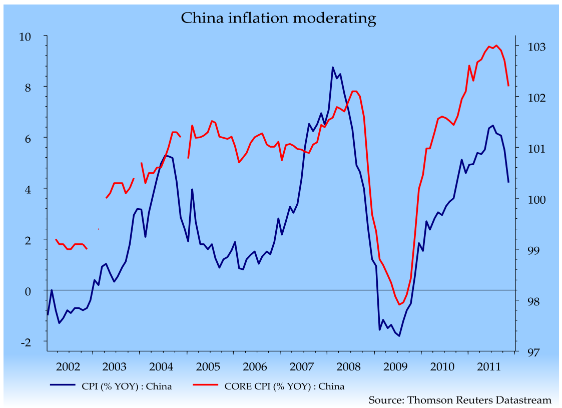
Many of the changes made to asset allocation for Brompton clients over the year proved beneficial as we reduced emerging market exposure and increased investment in US equities. The portfolios continue to have no direct investment in eurozone equity markets and exposure to the euro is minimal, with some forecasters anticipating a recession in the region. In the face of so much negative sentiment, traditional "safe haven" assets such as US and UK government bonds performed strongly. Yields on 10-year gilts fell to an historic low of 2%, offering investors a negative real return with UK inflation at 4.8%. The assumption of high debt levels by developed economy governments should make investors think carefully about the risk and reward on offer from some traditional "risk free" assets such as government bonds. The massive policy action by central banks has resulted in potentially huge distortions in the pricing of risk in bond markets.

The release of poor second quarter gross domestic product figures was a contributory factor as investors became less complacent that the eurozone nations would "muddle through" their problems. Growth in the quarter slowed to just 0.1% in the core German economy and stalled altogether in France. In the UK, growth was just 0.2%. The lower-than-expected growth makes it less likely that a private sector recovery will offset austerity measures imposed on the public sector in the region.

On a positive note, recent US economic data releases have proved encouraging, with manufacturing and employment data giving some cause for optimism. In the long term, the rapid development of US shale oil and gas deposits and the anticipated growth in production from the Gulf of Mexico have significant positive implications for US dependence on energy imports and, in time, could contribute significantly to a marked improvement in the US current account deficit. It will be difficult for US economic recovery to proceed independently of other developed economies but perhaps the most encouraging data of all have been the tentative signs of improvement in the US housing market. The US housing starts per household data measure activity in the construction of new homes and constitute an important leading indicator for the housing market as a whole. After falling for the last six years to levels only previously witnessed during the Great Depression and the Second World War, activity appears to have stabilised. The importance of the US housing market was recognised when Ben Bernanke commenced "operation twist", the name commonly given to the current US policy of purchasing longer-dated US treasury bonds to keep mortgage interest rates low and thus support the housing market.



Having reduced our exposure to emerging markets in 2011, valuations have now fallen significantly as a consequence of increased risk aversion. We will look for opportunities to add to investments for our clients during the coming year. In China, growth has slowed but is still expected to remain above 8% and, although concerns have emerged that there has been significant over-investment in certain sectors such as property and construction, the recent fall in inflation coupled with the desire for a smooth handover of power mean that there is both the capacity and the motive for a significant relaxation in economic policy. Indeed, restrictions on bank lending were eased at the end of the year following a long period of successive increases.



2012 is likely to be another volatile year dominated by macro-economic events. We continue to hold a significant amount in cash and short-dated corporate bonds for our clients as the conflict between the political will to retain the single currency and the market expectation of a sovereign default is fought out in the eurozone. Traditional "safe haven" assets such as UK Gilts offer poor expected returns compared to some equity markets, where we retain a US bias and continue to focus on global companies with strong business franchises supported by above-average dividend yields.

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