BROMPTON
ASSET MANAGEMENT

Quarterly review

for the three months to 31 March 2016

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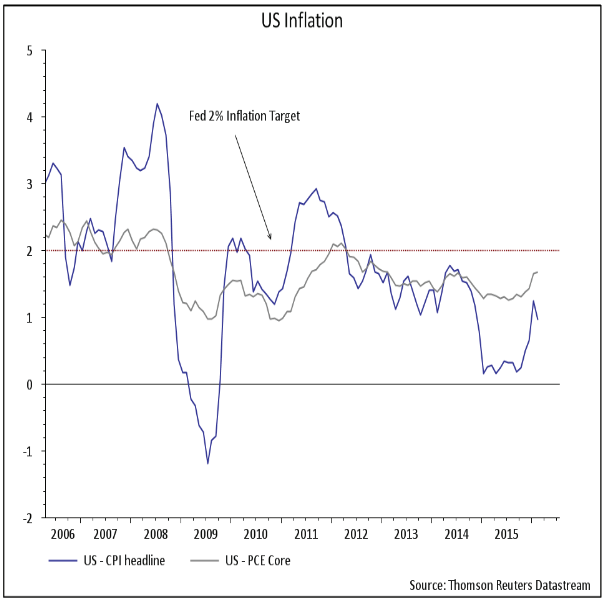
Fund manager

After a rollercoaster start to the year, global equities finished the first quarter up 2.94% in sterling terms. The rising risk of global deflation that led to sharp equity market falls during the early weeks of 2016 moderated later as Chinese policy makers deployed part of the country's considerable currency reserves to support the renminbi and the oil price firmed. Concerns that December's US rate rise might have been a policy error also abated as subsequent US employment data revealed that the economy remained close to full employment and inflation rose. Core inflation was running at 1.7% year on year at the quarter end, significantly closer to the Federal Reserve's 2% target for this measure. Headline inflation rose to 1.0% having dipped close to zero in 2015 (see chart below).

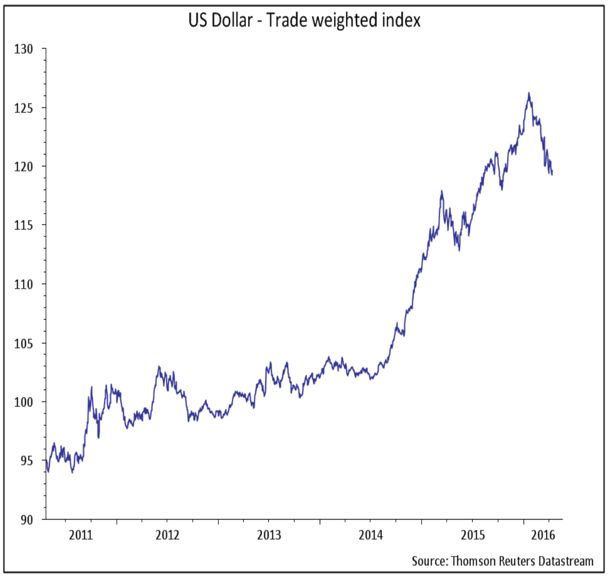


Federal Reserve rhetoric in the early spring remained dovish in tone, however, despite the significant improvement in US inflation data. Janet Yellen said the Fed would "move cautiously" in deciding future interest rate rises and she questioned whether the pick-up in inflation would prove durable.

Some of the improvement in inflation data may result from rising import prices stemming from the recent weakness in the dollar (see chart opposite).

The dollar's weakness also contributed to a bounce in commodity prices. Oil recovered 5.28% in March, reducing the loss for the quarter to 8.45% in sterling. The price continued to move higher after the quarter end. Although Saudi Arabia, other Opec members such as Iran and big non-Opec oil producers such as Russia failed in their mid-April talks to reach an output agreement, supply and demand appeared to be moving closer together. US oil production fell from the middle of 2015 as a result of the price fall and the attendant financial distress of some US shale oil-producers. Burgeoning current account deficits for many Middle Eastern governments may also be putting upwards pressure on the oil price.

Oil was not the only commodity to benefit from the weaker dollar and a more sanguine outlook for Chinese economic growth. During the quarter, copper prices, for example, increased 5.94% in sterling. These gains were too late to prevent mining companies such as BHP Billiton and Rio Tinto recognising the challenging sector environment by abandoning prized progressive dividend policies and cutting payments to shareholders. Gold, meanwhile, rose 19.45% in sterling as falling interest rate expectations and the weak dollar swelled demand for this nil-yielding asset.



The weakening dollar and rising commodity prices provided favourable conditions for a rally in equities in emerging markets and Asia excluding Japan, up 8.45% and 4.40% respectively in sterling. Many emerging markets ended the quarter on big discounts in valuation terms to developed markets and the shift in economic trends provided the catalyst for a share price resurgence. The markets of commodity-exporting nations registered the sharpest gains. Russian and

Quarterly review (continued)

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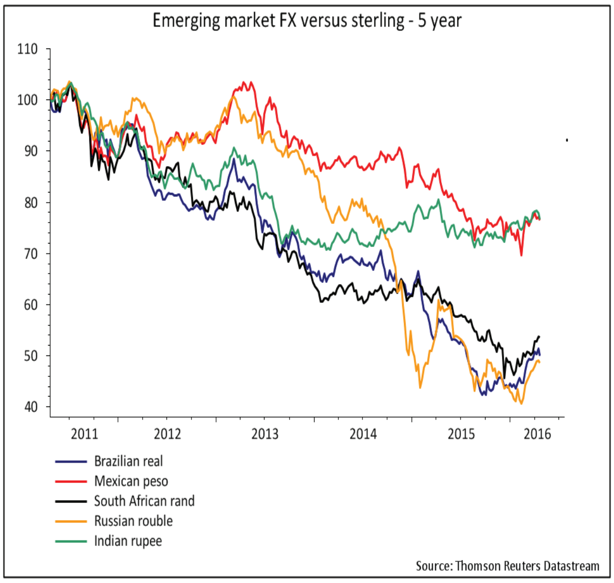
Brazilian equities rose 20.82% and 31.86% respectively in sterling despite the troubled political situations in these countries. I increased clients' emerging market equity investments as appropriate in all investment strategies over the quarter, adding both active and passive funds. I believe the active managers will outperform their indices over the longer term. In the early stages of a trend reversal, however, many stock selectors may fail to keep pace with the rapid rise in their indices because of their focus on more defensive companies during recent years; it will take time for them to reposition portfolios. In higher-risk strategies, clients have significant exposures to Indian equities either through an Indian equity fund or a generalist emerging economy fund with a meaningful investment in the country. Despite recent rises in prices for oil and gold, India should still benefit from their falls from their peaks as well as the reforming polices of her prime minister, Narendra Modi.



Reduced interest rate expectations proved benign for bonds as well as equities over the quarter, with UK gilts and sterling corporate bonds returning 4.92% and 2.94% respectively. After the rises, longer-dated US and UK government bonds appear less attractive than in January given the adjustment in interest rate expectations but emerging market sovereign bonds retain their attractions. Policy makers in countries such as India have capacity to cut interest rates. This should lead to rising bond markets but the recovery in the currencies of many emerging economies may generate even larger gains for investors. As the chart opposite shows, many developing economy currencies are trading at multi-year lows against sterling. In particular, emerging economy local currency bonds could benefit in sterling terms from weakness in the pound ahead of June's Brexit referendum.

Ahead of the referendum, I have aimed to position clients' portfolios to withstand the coming volatility and specific risks attendant on either a "stay" or a "leave" outcome. Where appropriate to the strategy, I have concentrated clients' sterling investments in UK equities because I believe UK equities will benefit from a weaker pound in the run-up to the vote and in the event that Britain elects to leave the European Union. If the "stay" campaign is successful, UK equities should gain from a stronger pound and a relief rally in the stockmarket. I have, however, taken the precaution of ensuring selected UK equity funds have significant holdings in the UK's largest companies, which may be better equipped to deal with the challenges of renegotiating trade terms with the EU.

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