



Gill Lakin
Chief investment officer

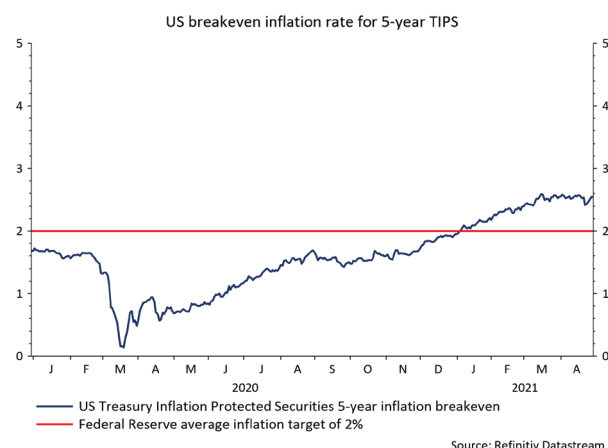
Quarterly review

for the three months to 31 March 2021

In March, the Federal Reserve increased its forecast for 2021 gross domestic product (GDP) growth from 4.2% to 6.5% as the recovery gathered steam. Fed optimism was confirmed in April, when the initial estimate of first-quarter GDP growth showed the US economy expanded 6.4% on an annualised basis and was just 1% below its pre-pandemic level. A world-leading vaccination programme and large-scale fiscal stimulus hastened recovery. President Biden enacted his \$1.9 trillion American Rescue Plan to distribute cash to households and unveiled his American Jobs Plan, a longer-term \$2.3 trillion infrastructure spending programme spread over eight years and funded by increased corporate taxes over 15 years.

Economic data for March revealed the recovery's strength. Institute of Supply Management leading indicators for manufacturing and services activity, which imply economic expansion at readings above 50, reached historic highs of 64.7 and 63.7 respectively. Unemployment fell to 6%, well below the 14.7% high reached in April 2020. This was still, however, 2.5 percentage points above the pre-pandemic level of February 2020 and labour market participation has fallen during the pandemic. US consumer confidence rose and retail sales increased 9.8% month-on-month.

A strong recovery combined with pent-up consumer demand, materials shortages and disrupted supply chains fuelled inflation. Oil and copper prices increased 21.13% and 12.29% in sterling respectively over the quarter. US headline inflation rose 2.6% year-on-year in March. Longer-term inflation expectations also rose significantly above the Fed's average inflation target of 2%, as the chart below shows.



The Fed chairman, Jerome Powell, told investors higher

inflation would be “transitory” as the product of temporary factors such as supply shortages. The Fed’s remit is to maintain full employment alongside price stability and may be reluctant to tighten monetary policy to combat higher inflation until the US nears full employment. There was no change to Fed guidance on interest rates, which are expected to remain pegged until late 2023. Longer-dated bonds may be vulnerable to an earlier withdrawal of stimulus should inflation and jobs data prove stronger than expected.

Inflation may prove more persistent than central bankers expect because governments’ decarbonisation plans will increase demand for some industrial commodities. The US has re-joined the Paris climate change agreement and is the latest large country to set out an ambitious green agenda, aiming to have a clean-energy economy with net-zero emissions no later than 2050.

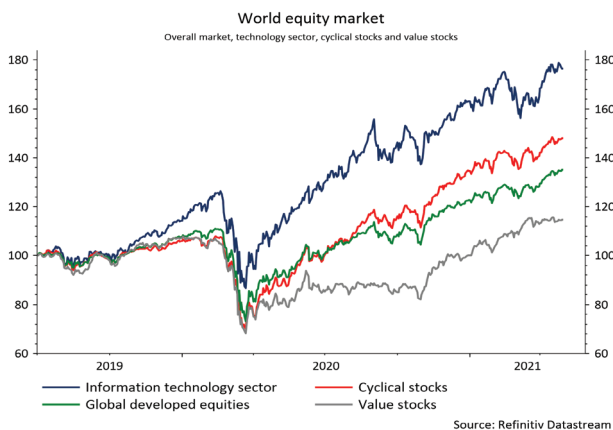
Inflationary pressure may also come from demographics, with workers demanding higher wages as ageing populations reduce the relative size of the workforce. Companies may retreat from globalisation policies that involve reliance for key components on distant, low-cost suppliers. They may, instead, prefer to increase their costs by diversifying their sources of supply and adding to their stocks of raw materials and components.

Commentators are divided on the impact of so much monetary and fiscal stimulus on inflation. Longer-dated bond prices are sensitive to changes in inflation expectations and global bonds fell 5.34% in sterling over the quarter while UK government bonds and sterling corporate bonds fell 7.35% and 4.36% respectively as stronger growth and inflation expectations led to higher bond yields. The 10-year US government bond yield rose from 0.91% to 1.75%, leading investors to recall the 2013 “taper tantrum”, when US treasury bonds and equities fell at the prospect of a gradual withdrawal of the Fed’s monetary stimulus. Shorter duration and index-linked bonds may, however, provide some inflation-protection. Sterling high-yield bonds, for example, bucked the negative trend, returning 1.57% over the quarter because of their shorter duration.

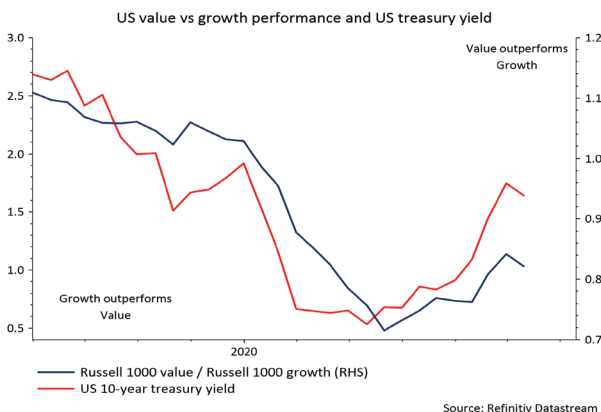
Global equities gained 3.71% in sterling over the quarter, taking their rise from their 16 March 2020 low point to 49.46%, as the chart overleaf shows.

Quarterly review (continued)

for the three months to 31 March 2021



Initially, growth stocks, and technology stocks in particular, performed strongly. In late 2020, however, good news on vaccines offered a path back to normality and led to a change in market leadership in favour of more economically-sensitive value stocks, as the chart below shows.



UK equities benefited from the change in market leadership, rising 5.22% over the quarter. Smaller companies, which are typically more sensitive to domestic trends, gained 11.33%. In March, the Bank of England said Covid-19 restrictions and health concerns would ease as a result of the UK vaccination programme, resulting in an economic recovery during 2021 to pre-Covid levels. Unemployment fell to 4.9% in

February while March's retail sales were up 5.4% on the previous month, exceeding pre-pandemic levels. In April, the economic recovery led the Debt Management Office to announce a £254 billion net financing requirement for 2021-22, £43 billion less than forecast in March's Budget. The Bank expects inflation to rise rapidly to its 2% official target.

The European Central Bank increased the pace at which it purchased bonds to offset the impact of rising bond yields. Equities in Europe excluding the UK lagged, rising 2.67% in sterling as lockdown restrictions tightened in response to rising Covid infections and a slow start to vaccinations. Equities in emerging markets and Asia excluding Japan also lagged, rising 1.40% and 1.80% respectively in sterling as higher US bond yields discouraged capital flows into developing economy assets.

Gold, a traditionally safe-haven asset, and gold producers fell 10.64% and 9.97% in sterling respectively as bullion demand waned, with economic recovery fostering demand for risky assets. Gold typically performs when inflation is higher than interest rates, however, and may provide diversification and some capital protection if equity and bond markets fall.

At the start of the second quarter of 2021, the prospects for equities remained positive because of the strengthening economic recovery and the likelihood of further US fiscal easing. Monetary policy is likely to remain highly supportive overall while there is slack in labour markets. UK equities appeared particularly attractive given progress with vaccinations and low valuations relative to some other markets. Inflation may prove more persistent than central bankers' comments suggest. Brompton has increased clients' equity investments biased towards cyclical companies. Brompton's fixed income investments focus on short-dated and inflation-linked bonds in preference to longer-dated bonds.

Important information

This document is issued by Brompton Asset Management LLP, a partnership authorised and regulated by the Financial Conduct Authority, firm reference number 501651. It is based on the asset management team's opinions at the time of writing supported by publically-available information and other sources Brompton believes reliable. Brompton cannot guarantee the accuracy of information in the document. The opinions expressed may change. The opinions expressed in the document do not constitute investment advice and should not be relied upon as such. It should not be considered a solicitation or recommendation to buy or sell a security. Brompton will not be liable for any direct or indirect losses arising from the use of this document. Past performance is no guarantee of future performance and the value of investments, and the income from them, may fall as well as rise.