BROMPTON
ASSET MANAGEMENT

Quarterly review

for the three months to 30 June 2015

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Global equities fell 5.15% in sterling terms over the second quarter of 2015, reversing most of the first quarter's gains and finishing just 2.95% ahead for the six months to June. The positive impact of eurozone quantitative easing was outweighed by fears of Grexit, a Greek exit from the euro, coupled with evidence that US employment and inflation data were robust enough to justify an interest rate rise in 2015.

Europe ex-UK equities fell 5.92% in sterling during a quarter in which gathering unease regarding negotiations on Greek debt refinancing culminated on the last day of June with Greece missing an International Monetary Fund (IMF) payment. In early July, the Greek drama took centre stage as a majority of Greek voters said "no" to austerity and their government said further fiscal tightening had to be linked to debt relief.

The final tableau, staged in Brussels to an audience of eurozone governmental heads, culminated in a compromise that should enable Greece to stay in the euro and enable creditor countries such as Germany to justify a deal to sceptical voters. A negotiated solution always seemed the most likely outcome. The Greeks did not want to abandon the euro although devaluation is an established method to reinvigorate an over-indebted economy. On the other side of the negotiating table, the risks to creditor nations outweighed the cost of another bailout. A Greek departure would have confounded the notion that the euro was irreversible and potentially led to increased borrowing costs for the entire eurozone. The full cost and unintended consequences of Grexit were always unquantifiable. What is clear is that, after days of tortuous talks, the "eureka" moment was finally reached on Monday 13 July. Yet for Greece to receive a bailout package, its parliament will need to pass tough reforms, measures that its prime minister may struggle to force through.

The figure for US unemployment fell more than expected to 5.3% in June, albeit principally as a result of a reduction in those registered as seeking work, and non-farm payroll data continued to register gains. US consumer prices increased by 0.4% month on month in May and the headline annual rate of price changes edged out of negative territory to zero. There were tentative signs of recovering wage inflation. The 11.52% rebound in oil prices in sterling accounted for much of the shift in price trends. The US oil rig count fell sharply as shale producers shut down wells rendered uneconomic by the previously sharp oil price fall.

UK equities were more resilient than global equities, falling only 2.78%, partly as a result of sterling's strength. The pound gained 5.61% against the dollar as political risk diminished following the election of a majority government. Although the Conservatives promised a European Union membership referendum by 2017, the prospect of Britain leaving the EU seemed too remote to depress sterling.

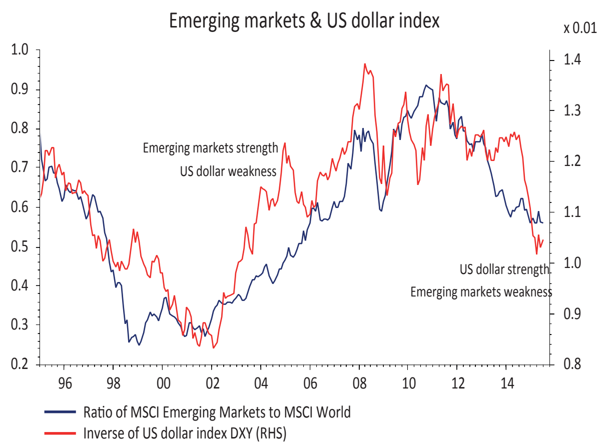
UK data continued to improve after the election. Economic growth was revised up from 2.8% to 3.0% for 2014 and from 0.3% to 0.4% for the first quarter of 2015. Job creation remained healthy and wage growth and retail sales strengthened. The current account deficit remains a concern but the UK could still in 2015 be the fastest growing Group of Seven economy for the second year running.

I generally increased investment in UK equity funds in Brompton strategies once the election removed political uncertainty. The UK market is biased towards natural resources companies, with oil stocks and miners ranking among the largest constituents. These international businesses are less exposed to the strengthening domestic economy and, in consequence, I invested in funds with relatively large holdings in small and medium-sized companies. These bucked the negative trend over the quarter, with small companies excluding investment trusts rising 6.37% and outperforming by 9.15 percentage points.

Asia ex-Japan markets underperformed, falling 6.49% in sterling. Chinese equities had risen 158.81% in sterling over the 11 months to May 2015 as a relaxation in rules governing equity investment for domestic and foreign investors inflated a classic investment "bubble". This burst in June when domestic Chinese equities fell 10.83% in sterling. They fell further in early July, depressed by panic selling as retail investors who borrowed money against their investments had to liquidate to finance margin calls.

The authorities took measures to restore calm including banning short-selling, purchasing shares and allowing companies to suspend their shares. The weaker market could, however, slow the economy as companies put capital spending plans on hold and consumer spending is hit by the negative wealth-effect resulting from stockmarket losses. The Bank of China continued to support the economy, with interest rates cut further in June.

Emerging markets face significant headwinds from a rise in US interest rates and attendant dollar strength. As the chart shows, these markets tend to underperform developed economy peers when the dollar strengthens.

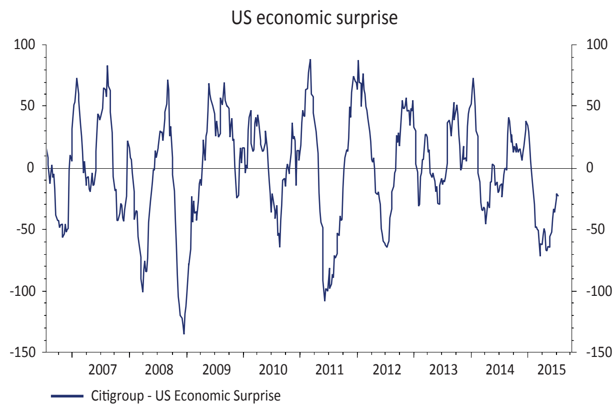


Source: Thomson Reuters Datastream

The Brompton strategies ended the quarter with no, or only modest, investments in emerging market equity funds, depending on the strategy.

Bond markets also fell over the quarter as US economic data improved. The "economic surprise" index illustrates the recent positive trend in data.

Gilts and sterling corporate bonds fell 3.41% and 4.20% respectively over the quarter, reversing first-quarter gains to post losses of 1.29% and 0.92% respectively for the half year to June. The end of the multi-decade bond bull market has been forecast frequently since the credit crisis ushered in quantitative easing, or bond



Source: Thomson Reuters Datastream

buying, by major central banks but, in the absence of a major shock to markets such as Grexit or deteriorating US data, a US rate rise this year seems probable. Brompton strategies ended the quarter with relatively low bond allocations and those bond funds held were relatively insensitive to interest rate rises.

The cash in the Brompton strategies increased during the quarter principally through profit-taking in equity fund investments. This increase provides an element of capital protection and offers flexibility to take advantage of buying opportunities. The impending change in US monetary policy as Federal Reserve members contemplate the first rate rise for many years leaves some asset classes such as bonds and certain regions such as emerging markets and Asia ex-Japan particularly vulnerable. In my view, increased market volatility is likely to give rise to opportunities to reinvest in equity funds, in particular in those focused on Europe excluding the UK, where monetary policy is likely to remain accommodative for much longer, and in the UK, where valuations appear attractive and economic growth is relatively strong.

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