



**BROMPTON**  
ASSET MANAGEMENT

## Quarterly review

for the three months to 31 March 2015



**Gill Lakin**  
Fund manager

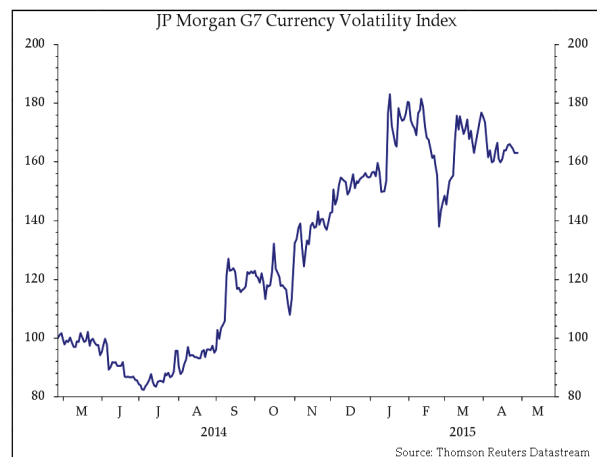
Currency volatility dominated investment returns during the first quarter of 2015. Global equities gained 7.59% in sterling terms but most of the gain for UK investors came from exchange rate movements. The dollar, the yen and the Chinese yuan all rose by more than 5% against sterling over the quarter. Sterling weakness partly reflected UK political uncertainty because no single political party was expected to be mandated to govern alone after May's general election. Overseas investors were particularly concerned about the consequences for the UK's membership of the European Union.

Beyond the UK, currency moves have become an increasingly important investment consideration since central banks embarked on policies of money-printing in response to the 2007-08 credit crisis and subsequent global recession. In January, the European Central Bank confounded sceptics who thought eurozone political divisions precluded a major programme of quantitative easing when it announced €1.1 trillion of bond purchases. The euro fell 6.78% against sterling during the first quarter, taking its loss for the year to 31 March to 12.49%. Over the same period the dollar rose 12.30% against sterling.

The scale of these moves is unusual for developed economy currencies and highlights the importance of considering carefully the currency implications of asset allocation decisions. Clients of Brompton Asset Management benefited from a significant investment in Europe ex-UK equity funds during the quarter as regional equity markets rose 11.01% in local currency terms. At the same time, the decision to invest in the sterling-hedged share classes of some preferred funds also protected these gains from the euro's decline.

Investment returns were also buoyed by a relatively high overall allocation to the dollar on the grounds that the Federal Reserve is expected in the middle of 2015 to raise interest rates for the first time in many years subject to sufficiently robust employment and inflation data. This would put the US on a different path of monetary policy compared to many other central banks, which are still introducing easing measures. I have, however, been cautious on the outlook for US equities relative to Europe ex-UK, Japan and selective emerging economy equity markets because the withdrawal of monetary stimulus and the attendant dollar strength may prove a headwind for Wall Street.

Although client returns benefited from Brompton's currency calls over the quarter, this is an unsatisfactory state of affairs for a fundamental investor. Foreign exchange movements are notoriously unpredictable. Yet, unlike with most other asset classes, currency investors do not receive a "risk premium" or a return in excess of a "risk-free" return such as the yield on US treasury bonds or UK gilts. The higher yields currently paid to investors for holding riskier assets such as corporate bonds or equities can be viewed as the increased return investors demand for assuming a higher level of risk but currencies offer no such compensation. The heightened currency volatility impacting investment returns today could be viewed as a deliberate central bank policy to use competitive currency debasement as a means to stimulate economic growth now that interest rates in many developed economies are close to zero and minimal additional economic benefit can be derived from further reducing the cost of capital.



By contrast, the central banks of some developing economies still have the leeway to cut interest rates and both China and India cut interest rates twice during the quarter to foster growth. This contributed to equity market gains of 13.56% and 10.70% respectively in sterling. Brompton Asset Management has for some time adopted a highly-selective approach to investing in emerging economy equity markets given the risks to some of these economies from a stronger dollar and weaker commodity prices. Hermes Asia ex Japan was selected because of its relatively high Chinese equity holdings. Its manager has said access to this fund will be restricted from May onwards although it will still be

## Quarterly review (continued)

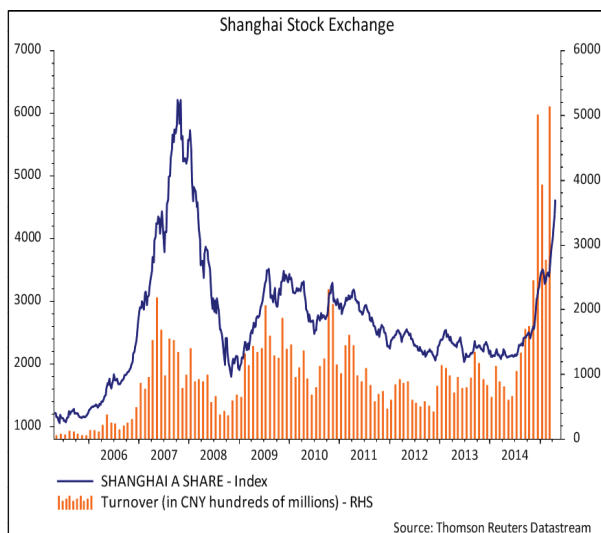
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possible for existing investors such as Brompton to gain access on behalf of clients.

Chinese equities were also buoyed by the recent lifting of restrictions governing both market access for foreign investors and rules limiting domestic investors' ability to invest in the Hong Kong stockmarket. Falling interest rates and the poor returns delivered by some Chinese fixed income mutual funds have also increased local equity market investment, giving rise to fears that a bubble might be developing. The Chinese authorities seem relatively complacent although some measures have been introduced to curb speculative investment. Brompton clients, however, ended the quarter invested in funds with significant Chinese equity holdings because valuations were relatively undemanding and policy support was increasing. After the quarter end, restrictions limiting the amount of bank lending were relaxed, indicating that Chinese policy-makers were prepared to ease monetary policy in addition to introducing targeted measures to assist certain sectors of the economy such as property.

Eurozone quantitative easing further reduced regional sovereign bond yields, creating significant problems for some eurozone financial institutions required to invest in fixed income assets to match future liabilities. Consumer prices data continued to be weak, with eurozone prices declining by an annualised 0.1% in March. This environment should support eurozone convertible bonds, which benefit from falling bond yields and rising equity markets. In response, clients' investments in this asset class were increased, particularly in lower-risk strategies.

Despite the generally-benign global monetary conditions, I modestly reduced the level of risk in the client portfolios in March and April by trimming their equity holdings and/or increasing cash. The increase in large-scale takeover activity including Royal Dutch Shell's agreed bid for BG Group and the proposed mergers of Heinz and Kraft and Nokia and Lucent-Alcatel indicate that company boards are sufficiently confident to make major investment decisions. The impact, however, of the approaching turn upwards in the US interest rate cycle is difficult to predict following such a prolonged period of ultra-low interest rates.



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