BROMPTON ASSET MANAGEMENT

Quarterly review

for the three months to 30 September 2022

Gill Lakin
Chief investment officer

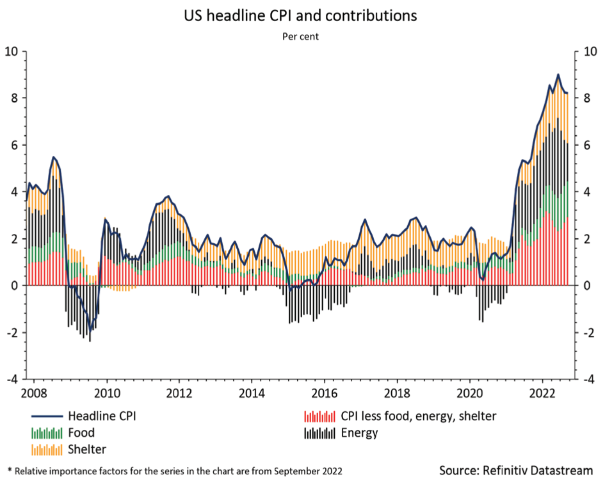
Global equities and global bonds fell 6.71% and 6.94% respectively in dollar terms over the quarter. They did, however, rise 1.49% and 1.24% respectively in sterling as a result of the pound's 8.08% fall against the dollar, a fall that took its decline to 17.58% since New Year.

The Federal Reserve increased its policy interest rate by three-quarters of a percentage point in July and in September, taking it to 3-3.25%, while the Bank of England raised Bank Rate by half a point in August and in September, lifting it to 2.25%. Sterling fell because the interest rate differential between shorter-dated US and UK government bond yields widened and UK economic prospects deteriorated. UK government bonds, investment-grade sterling corporate bonds and sterling high-yield bonds fell 13.95%, 11.48% and 4.86% respectively over the quarter. The fall in gilts took their losses to 26.63% since New Year. Clients of Brompton Asset Management have had no investments in funds dedicated to gilts during 2022.

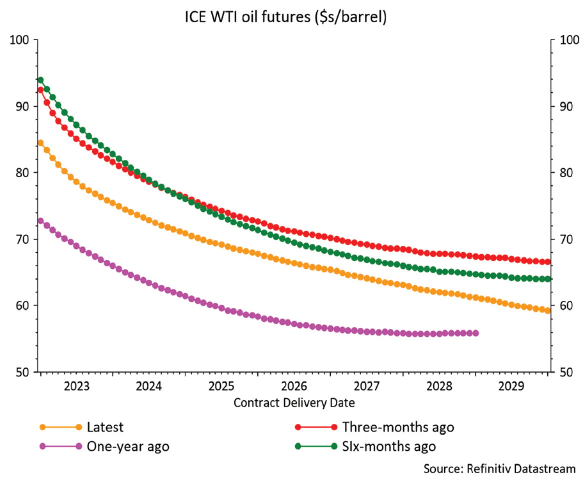
The UK government's September announcement of unfunded tax cuts hurt sterling, which briefly fell to a $1.03 historic low, and attracted criticism from the International Monetary Fund. Some pension funds became forced sellers of gilts as they sought to increase cash buffers against further falls, thus driving down bond prices and engendering further waves of selling. The BoE responded by halting plans to reduce the size of its balance sheet over time through sales of £80 billion of gilts and unveiling bond purchases of up to £65 billion to ensure financial stability. Kwasi Kwarteng, the chancellor, resigned over the fallout and Jeremy Hunt, his replacement, sought to restore calm by watering down or reversing many of his predecessor's planned tax cuts. In particular, the energy price guarantee, the government's flagship policy to shield consumers from higher gas prices, will no longer last until October 2024 but will instead end in April 2023.

Inflation data remain elevated although there were signs that data might be close to the highs for this economic cycle. September's figure for UK inflation including housing costs was 8.8%, up from 8.6% in August. The BoE forecast it would peak at less than 11% in October, significantly below the 13% peak forecast in August, because of the energy price guarantee. US and eurozone headline inflation was 8.2% and 9.9% respectively in September, down from 8.3% and up from 9.1% respectively in August.

Higher energy prices have fuelled inflation. Oil prices rose because of increased demand following the synchronised recovery in economies after Covid-19 lockdowns and sanctions following Russia's invasion of Ukraine. The chart below shows the change in US prices and the impact of movements in the prices of energy, food and accommodation, so-called "shelter".



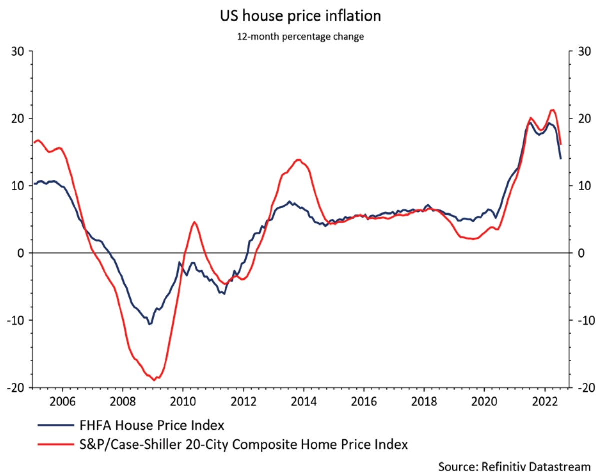
US inflation fell modestly in September in part because of lower oil prices although this was partially offset by increased shelter costs. Oil fell 21.03% in dollars over the quarter and is likely to fall further in the months ahead as indicated by oil futures, as shown in the chart below.



The cost of shelter may also fall as higher interest rates and slower economic growth hurts the housing market, as shown in the chart overleaf.

Quarterly review (continued)

for the three months to 30 September 2022



The Fed has said the strength of jobs data justifies increasing interest rates but this may result in rates rising more than necessary because unemployment is typically a lagging indicator and may be close to historic lows at the onset of a recession. Some leading indicators such as loan officer surveys and the differential between shorter- and longer-dated bond yields indicate recessionary times may lie ahead.

Buoyed by dollar-strength, US stocks outperformed, rising 3.48% in sterling over the quarter. Equities in the UK and Europe excluding the UK fell 3.93% and 1.97% in sterling respectively. UK stocks did not benefit from increased export competitiveness as a result of weaker sterling because of the impact of higher interest rates on growth. UK smaller companies, down 6.35%, fared worse than larger peers because of their greater sensitivity to domestic trends. Dollar-strength proved a headwind for equities in Asia excluding Japan and emerging markets, which fell 6.10% and 3.63% respectively in sterling. Chinese stocks fell 15.62% in sterling as economic shutdowns in response to Beijing's zero-Covid policy and an over-indebted property sector weighed on growth. By contrast, Indian stocks gained 16.14% in sterling as government reforms increased the ease of doing business in India.

Global equities and bonds have fallen in tandem since New Year, increasing the importance of achieving diversification in portfolios through holdings in gold and gold equities and alternative investments such as daily-traded long/short equity funds. Gold rose 0.20% in sterling over the quarter.

It is likely that inflationary pressure from higher oil and shelter costs may subside over the coming months as growth slows. As a result, interest rates may be close to their cyclical peak. US 10-year treasury yields close to 4% provide an opportunity to purchase global longer-dated government bond investments. At the quarter end, prospects for equities overall looked positive, with the most attractive sectors being healthcare, insurance and infrastructure, where there is low substitutability of products and services and businesses can pass on higher costs to customers through higher prices and reward investors with higher dividends. Some income-focused equity strategies may also outperform as dependable, growing dividends provide valuation support for share prices. Asia ex-Japan equity market valuations have fallen significantly but dollar-strength remains a headwind for now. There are, however, reasons to be positive on Japan as a result of the yen's weakness and the Bank of Japan's accommodative monetary policies.

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