BROMPTON ASSET MANAGEMENT

Quarterly review

for the three months to 31 December 2019

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Global equities rose 1.46% in sterling over the final quarter of 2019, closing the year up 22.38%. Risky assets recovered from their late-2018 sell-off as the Federal Reserve changed tack, easing monetary policy through three interest rate cuts and a halt to the process of shrinking its balance sheet, which had swelled as it responded to the 2007-09 financial crisis. Fears of adverse developments over US trade policy, Brexit and the UK's parliamentary stalemate moved markets over the year but good news on all these fronts in December spurred equities to new highs.

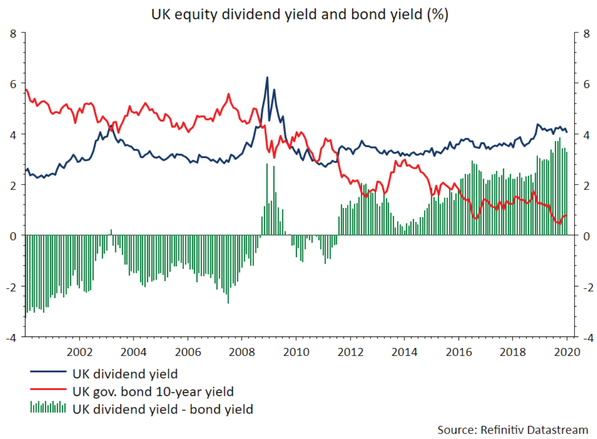
Global bonds returned 0.49% in local currency over the quarter but the pound's rise turned this into a 6.53% fall in sterling terms. Falling US interest rates had encouraged bond purchases but the impact of appreciating pound reduced the full-year return in sterling to 2.71%.

The Tories' general election victory, in which they won an 80-seat majority, averted the threats to Britain's private sector from a radical socialist government and ensured the smooth passage of the Brexit withdrawal bill through the House of Commons. Sterling rose 8.10% and 7.50% respectively against the yen and the dollar over the quarter. It rose above $1.35 briefly after the election but fell back in recognition that the risk of a "no deal" Brexit, although diminished, had not disappeared.

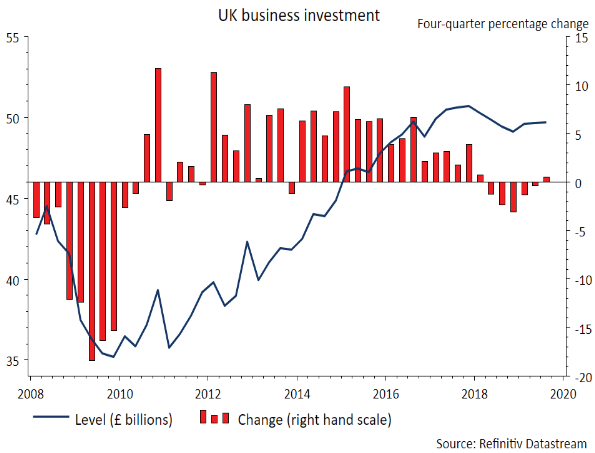
The government used its new-found majority to add a new clause to the bill stating that a UK-European Union trade deal had to be agreed before 31 December 2020. This is a demanding timetable and, without agreement, UK trade will be done on World Trade Organisation terms. UK assets are likely, therefore, to prove sensitive to newsflow surrounding the negotiations.

UK stocks, buoyed by the news, outperformed, rising 2.29% over the quarter. UK smaller companies, which typically are more sensitive to domestic conditions, did even better, rising 13.31%. UK stocks ended the year lowly valued relative to many other markets, with the market yielding more than 4%, a level that is particularly attractive in an environment of low inflation and interest rates, as the first chart opposite shows.

The Bank of England held interest rates in December, keeping investors guessing by saying monetary policy could "respond in either direction" to developments. UK gross domestic product (GDP)



growth languished in 2019. According to the Bank's November monetary policy report, quarterly GDP growth in 2019 is likely to average 0.2%, about half the average of the previous three years and well below the economy's potential rate. Business spending was hit particularly hard, falling in each of the last five quarters, as shown in the chart below.



Business spending in the UK may rise in early 2020 as confidence revives in the wake of the election but overseas business spending may be more sluggish as a result of the residual uncertainties about trade. The reduction in domestic political uncertainty, when combined with signs of some recovery in global economic growth, may generate a rise in UK growth from recent depressed levels. The rise in yields in the UK government bond market over the quarter reflected this view, leaving the negative return from gilts at 4.22%.

Quarterly review (continued)

for the three months to 31 December 2019

Substantive progress in Sino-US trade talks, confirmed when Donald Trump said an interim deal would be signed on 15 January, added to the end-of-year optimism. Equities in emerging markets and Asia excluding Japan outperformed over the quarter, rising 4.11% and 4.04% respectively in sterling while Chinese stocks did even better, gaining 6.71%.

Under the terms of the phase-one trade deal, China will increase purchases of US agricultural products, energy and manufactured goods and improve protection of intellectual property rights. In return, December's planned tariff increases were cancelled and the US said it would partially roll back some existing tariffs. The thornier issues of national security and technological leadership are outside the scope of this phase-one deal and may never be resolved. US blacklisting of some key Chinese technology companies has created a powerful incentive for these businesses to find alternative suppliers of key components such as semiconductors and accelerate the development of rival Chinese technology. President Trump may be wary of the economic impact of trade disruption in an election year but protectionism is likely to prove an ongoing feature of US trade policy.

In December, the Fed held interest rates at 1.5-1.75%, a level it thinks will support sustained non-inflationary economic growth. US inflation remained stubbornly below-target, with inflationary pressures muted. The Fed's preferred inflation measure was 1.5% higher quarter-on-quarter in the third quarter of 2019 against a 2% target, suggesting that interest rates are unlikely to rise for some time. In November, unemployment was historically low at 3.5% and average hourly wages increased by 3.1%. Steady jobs data supported consumer spending but business investment and exports were weak. The Sino-US interim trade agreement may, however, provide a welcome fillip to US exports to China. These have fallen significantly since the opening shots of the trade war in 2018.

US stocks rose in line with global equities over the quarter, rising 1.46% in sterling, with technology stocks, up 6.43%, particularly strong.

The trade dispute dented Chinese GDP growth, which slowed to 6% in the third quarter of 2019. In January 2020, the People's Bank of China eased monetary policy, cutting the reserve requirement ratio, a key policy tool for controlling bank lending, by 0.5 percentage points in the latest of a series of measures aimed at stimulating the economy.

Prospects for equity markets over the coming months appear positive as a result of the supportive monetary policies being adopted by the world's leading central banks and tentative signs of a revival in global economic growth. Policy risks relating to Brexit and trade diminished in late 2019 but investor sentiment is likely to remain sensitive to newsflow surrounding trade negotiations between the UK and EU and between China and the US. In early January 2020, UK stocks looked particularly attractive on valuation grounds and December's convincing Tory election victory may prove a catalyst for gains as investors reassess the market.

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