BROMPTON
ASSET MANAGEMENT

Quarterly review

for the three months to 31 December 2021

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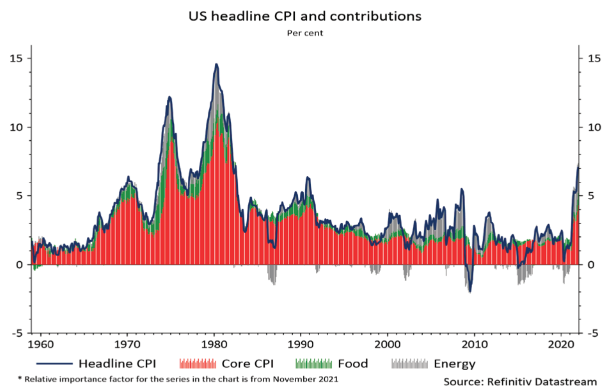
Global equities rose 6.29% in sterling over the final quarter of 2021, ending the year up 20.14%. US stocks outperformed, rising 10.53% in sterling over the quarter, buoyed by US technology stocks, which gained 13.53% as investors braced themselves for more lockdown restrictions in response to the Covid-19 Omicron variant. Early data, however, implied that Omicron's high infectiousness was not matched by its severity and there was a sea change in markets in December as global growth stocks fell 0.48% in sterling and value stocks gained 3.83%. Global bonds fell 1.12% in sterling over the quarter.

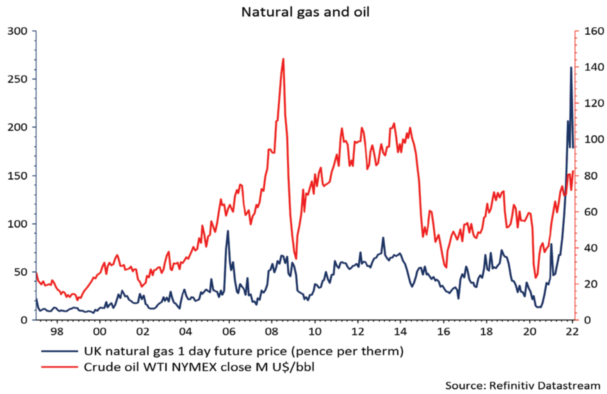
In January 2022, global equities fell as rising inflation and interest rate expectations and an increased risk of a Russian invasion of the Ukraine hurt sentiment and extended the rotation in market leadership from growth to value stocks, with some technology stocks falling sharply.

US gross domestic product (GDP) rose 6.9% annualised over the fourth quarter of 2021 and 5.7% year-on-year in 2021 according to the initial estimate, ending the year above the pre-Covid level reached in 2019. US unemployment fell to 3.9% in December. Heeding the strength of the economy, the Federal Reserve turned more hawkish to fight inflation, hastening the wind-down of bond purchases, which will cease in March 2022, and pencilling in three interest rate increases for 2022 and a median projection for the federal funds interest rate of 0.9% for the end of 2022.

As the chart below shows, US headline inflation reached 7.0% year-on-year in December, the highest rate since 1982.

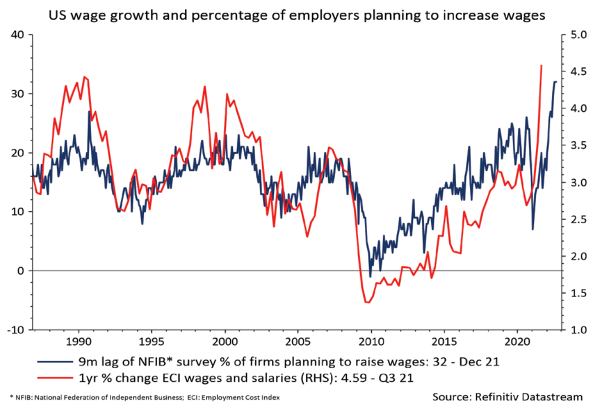


Surging energy prices were largely responsible for higher headline inflation because of increases in oil and gas prices, as shown in the chart opposite.



Oil prices rose 11.31% in sterling in December, taking their 2021 gain to 63.74% as the synchronised global recovery increased energy demand. Natural gas prices benefited additionally from decarbonisation as some countries, particularly in south-east Asia, switched to natural gas from more-polluting fossil fuels such as coal. Energy prices, particularly European natural gas prices, may also include a premium for political risk as a Russian invasion of the Ukraine would likely result in sanctions against Russia, a key supplier of gas to Europe, and further delay the planned increase in the supply of Russian gas to Germany through the Nord Stream 2 gas pipeline.

US price increases spread to a broader range of goods and services, resulting in higher core inflation, as the first chart shows. Price increases were leading to rising wages, as the chart below shows. Wages were 4.59% higher year-on-year during the third quarter of 2021 and the percentage of firms expecting to increase wages rose to 32% in December 2021. Higher wages coupled with a strong residential property market may mean core inflation proves more persistent than headline inflation.



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Quarterly review (continued)

for the three months to 31 December 2021

UK and eurozone consumer prices showed 5.4% and 5.0% year-on-year rises respectively in December. The Bank of England increased interest rates to 0.25% and said its stock of UK corporate and sovereign bonds would remain constant at £895 billion after asset purchases ceased in December 2021. The Bank of England expects inflation to peak at 6% in April 2022 as higher wholesale gas prices lead to rising utility bills. Risks around inflation are, however, "two-sided" over the medium term. In the eurozone, the European Central Bank responded to higher inflation by slowing the pace of asset purchases, which will cease in March 2022, but interest rates will not rise until expectations for medium-term inflation stabilise at the 2% target rate.

By contrast, the People's Bank of China eased monetary policy, cutting its key reserve requirement ratio, which governs commercial bank lending, by 0.5 percentage points in both July and December 2021. Chinese GDP rose 8.1% year-on-year in 2021 but the official composite leading indicator was 51 in January 2022, a level consistent with slower growth. China's "zero-Covid" policy may result in more lockdowns in 2022, slowing consumer spending and adding to supply-chain disruptions. The over-indebted commercial property sector may also weigh on growth. Chinese equities fell 6.48% in sterling over the quarter, contributing to falls for equities in emerging markets and Asia excluding Japan of 1.69% and 1.63% respectively in sterling.

Higher oil and natural gas prices in January 2022 were evidence of "cost-push" inflation, which may subside as supply catches up with demand, as opposed to more-endemic "demand-led" inflation. Materials shortages and bottlenecks in distribution are likely to be resolved over time as economies re-open following the measures imposed to curb the spread of the Omicron variant. Energy prices may weaken because growth is likely to slow in 2022. Consumer spending may also slow as windfall savings accumulated during lockdowns are run down and consumers are squeezed by higher prices and some tax increases. The Michigan consumer sentiment survey for the US was revised lower in January 2022 to 67.2, the lowest level since 2011.

At the end of January, US 2-year, 5-year and 10-year treasury bond yields were 1.15%, 1.61% and 1.78% respectively. The gently-sloping shape of the yield curve and low absolute level of bond yields implies that investors believe the Fed may move gradually to normalise monetary policy and interest rates may peak at relatively low levels compared to previous interest rate tightening cycles. In December, the Fed's median forecast for US interest rates for the end of 2023 and 2024 and the longer run were 1.6%, 2.1% and 2.5% respectively.

Equities may perform well in an environment of modest inflation and growth stocks may outperform because these businesses typically have higher barriers to entry and more pricing power than value stocks. Companies operating in more cyclical and commoditised sectors typically find it difficult to differentiate their products and services from competitors and may be compelled to compete on price. The rapid growth in technology applications is a deflationary force as trends such as internet retailing, robotics and artificial intelligence lead to lower costs. The current pull-back in the share prices of some growth companies may present longer-term investors with an attractive buying opportunity.

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