BROMPTON
ASSET MANAGEMENT

Quarterly review

for the three months to 31 March 2023

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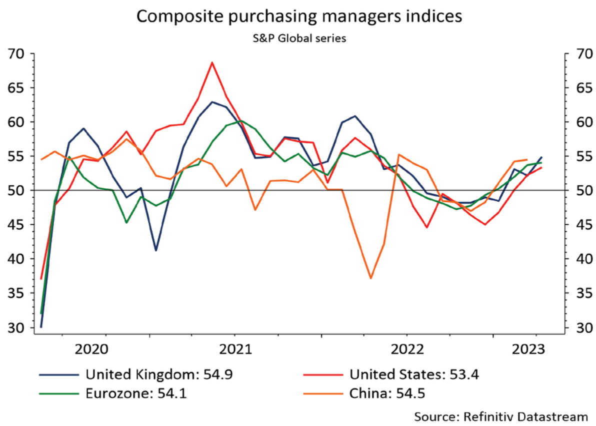
Global economic prospects improved in January and February because of a rebound in China's economy following the end of its zero-Covid-19 policy in December 2022 and stronger-than-anticipated demand in the US and eurozone. Over the quarter as a whole, global equities and global bonds rose 4.53% and 0.21% respectively in sterling.

In March, China's composite Purchasing Managers' Index (PMI) was 54.50, well above the 50-level demarcating likely expansion from contraction. China's services sector PMI was particularly strong at 57.80, up from 55.00 in February because of a rise in orders and stronger employment. Chinese gross domestic product (GDP) growth is expected to be 5.4% this year, driven by higher retail sales as consumers spend savings amassed during three years of Covid-19 restrictions.

US GDP growth was 1.1% annualised over the quarter according to the advance estimate, down from 2.6% the previous quarter but stronger than had been anticipated in late 2022. Eurozone GDP increased 0.1% despite fears of a contraction. UK prospects have also improved. GDP growth was 0.1% in the fourth quarter of 2022. In February 2023, the Bank of England said GDP would fall 0.1% and 0.4% in the first and second quarters respectively of 2023 but in March the BoE predicted marginal growth in the second quarter. The improving prospects stem partly from the March Budget. This increased fiscal support by extending the energy price guarantee for three months and included measures to boost business investment and labour market participation.

The chart opposite shows purchasing managers' indices for some major economies. With the indices having risen above 50, these suggest further expansion is likely.

Leading central banks raised interest rates in response to the stronger-than-anticipated economic data in January and February. The Federal Reserve raised its policy rate by a quarter of a percentage point in February and in March, taking it to 4.75-5%, 4.5 percentage points higher than a year ago. Another quarter point rise came in early May but this may be the last rise for this tightening cycle because of slower inflation and banking sector problems. The BoE raised its rate by a half point in February and a quarter point in March, taking it to 4.25%, while the European Central Bank raised its rate by half a point in March to 3.5% and then a further quarter point to 3.75% in early May.



Inflation eased over the quarter but it remained well above the leading central banks' 2% targets. Having peaked at 9.1% in June 2022, US inflation fell in each subsequent month to reach 5.0% at the quarter end. Increases in housing costs and food prices of 8.2% and 8.5% respectively fuelled inflation in the year to March 2023 but energy prices fell 6.4% as the impact of Russia's February 2022 invasion of Ukraine eased. Eurozone inflation was 6.9% in March, down from a 10.06% peak the previous October. UK inflation was more stubborn, partly because of food price increases. Inflation in March showed only a marginal drop to 10.1%, against 10.4% in February and the 11.1% cyclical peak the previous October.

Recent benign economic data were, however, overshadowed in March by banking sector problems. In the US, Silicon Valley Bank (SVB), Signature Bank and Silvergate faced financial crises. The SVB failure stemmed from losses triggered by rising interest rates and by customers such as technology start-ups withdrawing deposits to fund development. News of SVB's problems triggered a run as customers withdrew deposits. Central banks and regulators responded swiftly to minimise contagion. The parent bank was taken over by the Federal Deposit Insurance Corporation, a fund made up of levies on bank deposits, ensuring no losses for taxpayers. Its UK subsidiary was sold to HSBC for £1 and the BoE told depositors their money would be "safe and secure".

The spotlight then moved to Credit Suisse, a systemically-important bank deemed "too big to fail". Credit Suisse has been a poor performer since the

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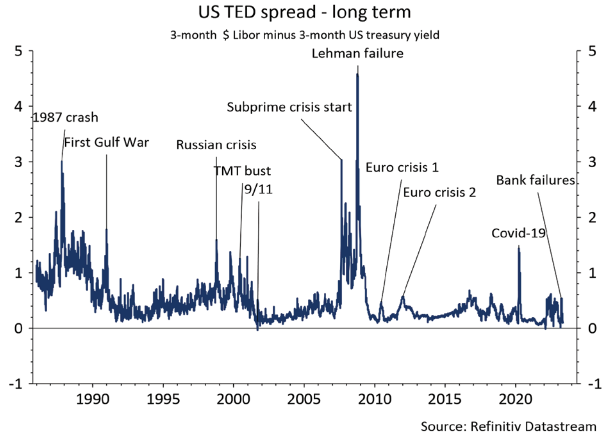
2007-09 global financial crisis, incurring losses from the failures of customers such as Archegos Capital and Greensill Capital and paying fines for assisting US customers to evade taxes. The Swiss National Bank brokered its forced takeover by its larger Swiss rival, UBS, and extended $100 billion of emergency liquidity to the combined company. In early May, First Republic Bank, a larger US bank than SVB, failed as depositors, notably wealthy customers with deposits larger than the federally-insured $250,000, withdrew deposits. The bank was then rescued by JPMorgan Chase.

The bank failures triggered share price falls across financial services sectors but broader equity and bond markets were resilient because investors recognised that tighter regulation meant banks typically had stronger balance sheets and greater management accountability for risk-taking than in 2007-09. As the chart below shows, the TED spread, a measure of commercial banks' willingness to lend to each other, rose modestly but remained well below the levels of 2007-09.



Rising interest rates exposed weaknesses at specific banks and there may be more fallout as the full impact of monetary tightening becomes apparent. As a result, central banks are likely to turn dovish on monetary policy over the coming months. Prospects for equities and longer-dated government bonds appear positive because they should benefit from falling interest rates. At the same time, gold and gold equities , which rose 5.17% and 10.14% respectively in sterling over the quarter, may provide diversification and some protection for capital should inflation prove stronger than expected.

Important information

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