Quarterly review

for the three months to 30 June 2023

Gill Lakin
Chief investment officer

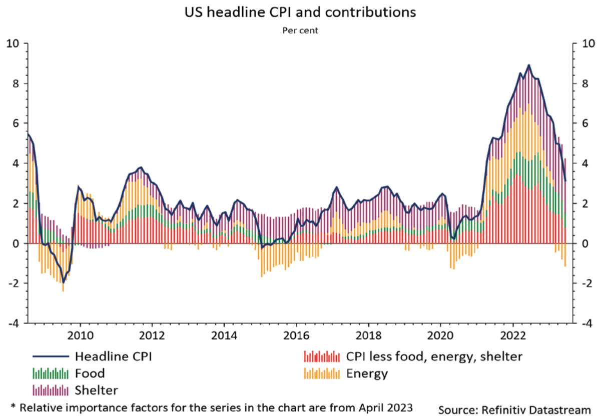
Global equities rose 3.43% in sterling over the second quarter of 2023, with overseas returns muted by the strength of the pound, which rose 2.82% against the dollar. Equities rose because falling US and eurozone inflation suggested the cyclical rise in interest rates was close to peaking.

First-quarter US gross domestic product growth emerged at 2.0% but eurozone and UK growth was more muted at 0.1%.

US equities outperformed, up 5.76% in sterling, with technology stocks particularly strong, up 14.66% as investors sought out growth sectors in anticipation of monetary easing and invested in companies such as Nvidia, a chip supplier to the nascent artificial ligence industry. UK stocks fell 0.72%, however, because core inflation rose, fuelling fears that the Bank of England would maintain tighter monetary policies for longer than some other central banks, precipitating a recession.

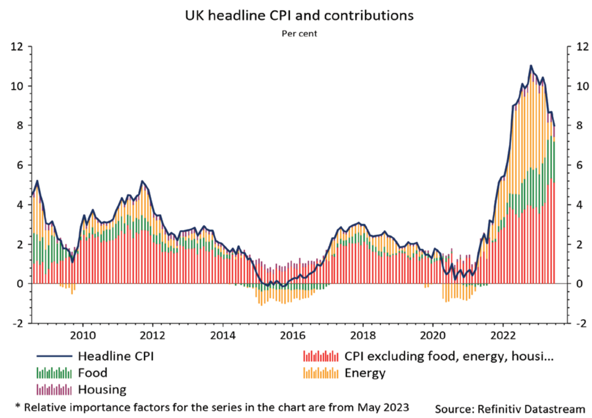
The Federal Reserve increased its official interest rate by a quarter percentage point in May, left it unchanged in June and raised by a further quarter point to 5.25-5.5% in July, a level that may mark the peak for this cycle. As the blue line in the chart opposite shows, US headline inflation has declined in every month since its 9.1% peak in June 2022, falling to 3.0% in June 2023. Energy prices, which rose after Russia's Ukraine invasion in February 2022, are now lower than a year ago, driving inflation lower, as shown by the yellow bars. Oil prices fell 8.06% in sterling over the quarter. By contrast, higher "shelter" costs, the US expression for housing costs, added to inflationary pressures but "shelter" price rises may soon slow due to rising mortgage rates. Meanwhile, food prices will be affected by factors such as weather. The red bars show the fall in inflation excluding energy, shelter and food and imply the Fed may soon ease monetary policy.

UK inflation has declined from October 2022's 11.1% peak as the chart below shows but, unlike in the US, inflation excluding energy, housing and food, indicated by the red bars, has risen and may prove more "sticky". The BoE's inflation target is 2% but headline inflation was 7.3% in June 2023 while core inflation, which excludes energy and food but includes housing, was 6.4%, down only slightly from 6.5% in May. UK inflation may take longer to subside because of higher gas prices caused by the Russo-Ukrainian war,



higher import costs fuelled by sterling's decline and the impact of Brexit on some labour market sectors.

Fears that the BoE will keep interest rates higher for longer contributed to falls for UK government bonds and investment-grade sterling corporate bonds of 6.02% and 3.29% respectively. At the quarter end, Brompton's private clients held no UK government bond funds in their portfolios because the investment team was concerned that stubborn inflation might mean UK interest rates would rise more than expected, leading to further falls for gilts. Sterling-hedged investments in US government bonds appear more attractive. These should rise if US interest rates fall while hedging will protect investors from further gains by the pound against the dollar.



The UK economy proved more resilient than expected in the first quarter but, as the chart below shows, it has not recovered its pre-Covid-19 peak whereas the US and eurozone economies are ahead of pre-Covid levels. UK activity levels may weaken further, with the UK Purchasing Managers Index (PMI), a key leading indicator, falling to a six-month low of 50.7 in June

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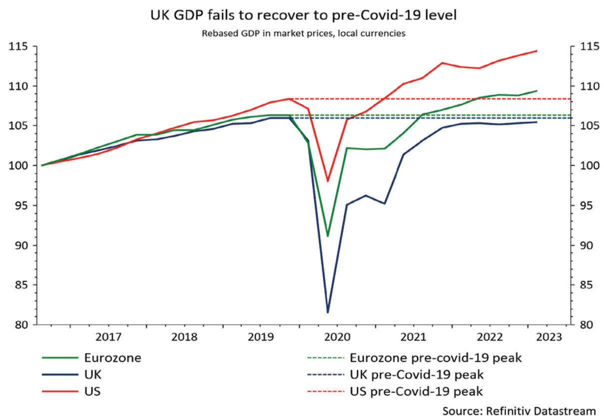
although it remained above the 50 level below which a recession is likely. The Services PMI at 51.5 continued to flag expansion despite a downturn in business confidence but the Manufacturing PMI fell to 45, signalling a contraction, with manufacturers citing lower demand and customers' high inventory levels as concerns.



Japanese stocks gained only 2.49% in sterling, with local returns muted by the yen's 10.45% fall against the pound as the Bank of Japan pursued easy money policies to counter years of deflation. Japanese headline inflation was 3.2% in the year to March 2023 but is forecast to fall below 2% in 2023-24. First-quarter economic growth was surprisingly strong at 0.7%, driven by increased corporate capital spending and household spending.

Equities in Asia excluding Japan and emerging markets fell 3.86% and 1.74% respectively in sterling, dragged lower by Chinese equities, which fell 12.13%. There were fears that China's economic boost from the end of zero-Covid-19 policies would prove short-lived as consumers opted to keep, not spend, the savings amassed during lockdown but Beijing has recently announced measures to stimulate consumption and reassure investors after waves of regulatory tightening. Indian equities, however, rose 9.28% in sterling in response to strong economic growth, lower inflation and business-friendly government reforms.

Prospects for equities overall appear positive because falling US inflation should lead to monetary easing. US growth stocks, particularly technology stocks, are likely to be buoyed by lower interest rates while sterling-hedged investments in US government bonds may also perform strongly. Dollar weakness may benefit emerging market equities, which ended the quarter cheaply valued relative to history, and Japanese stocks also have attractions for their relatively-low valuations compared with other developed markets and the potential gains from improved corporate governance, increased shareholder activism and pro-business policies inherited from the Abe era. There are grounds, however, to be more cautious about the UK because growth is already weaker than in some other developed economies while sticky inflation may lead to tighter monetary policy, stronger sterling and a recession.

Brompton Asset Management Limited, 1 Knightsbridge Green, London, SW1X 7QA