GLOBAL EQUITY PERSPECTIVES 1 NOVEMBER 2021

"Wonder is the beginning of wisdom."

Socrates

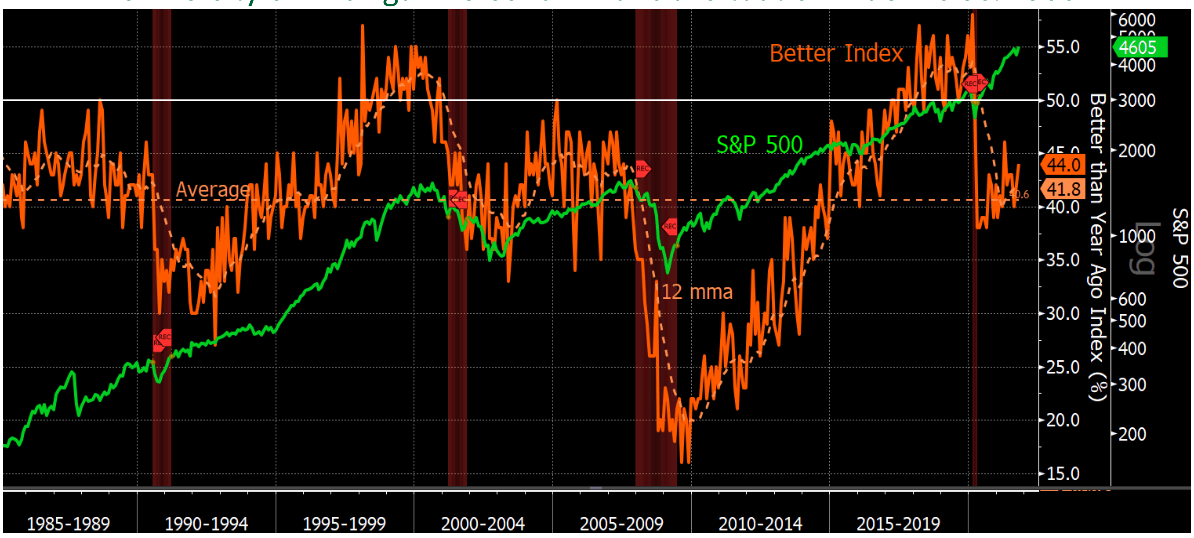
1. US OUTLOOK

World capital markets remain dependent on the US business outlook, which in turn structurally is very dependent on domestic consumption.

Philadelphia Fed Business Outlook Index vs S&P 500

The above US Business Outlook Index remains on a constructive course after a recent setback. The current reading is on an elevated level, indicating continued economic expansion. It is also well above the 7.5 level which has historically coincided with the cyclical peaks in share prices (indicated on the chart). On this basis, the outlook for share prices seems constructive.

University of Michigan Personal Financial Situation Index vs S&P 500



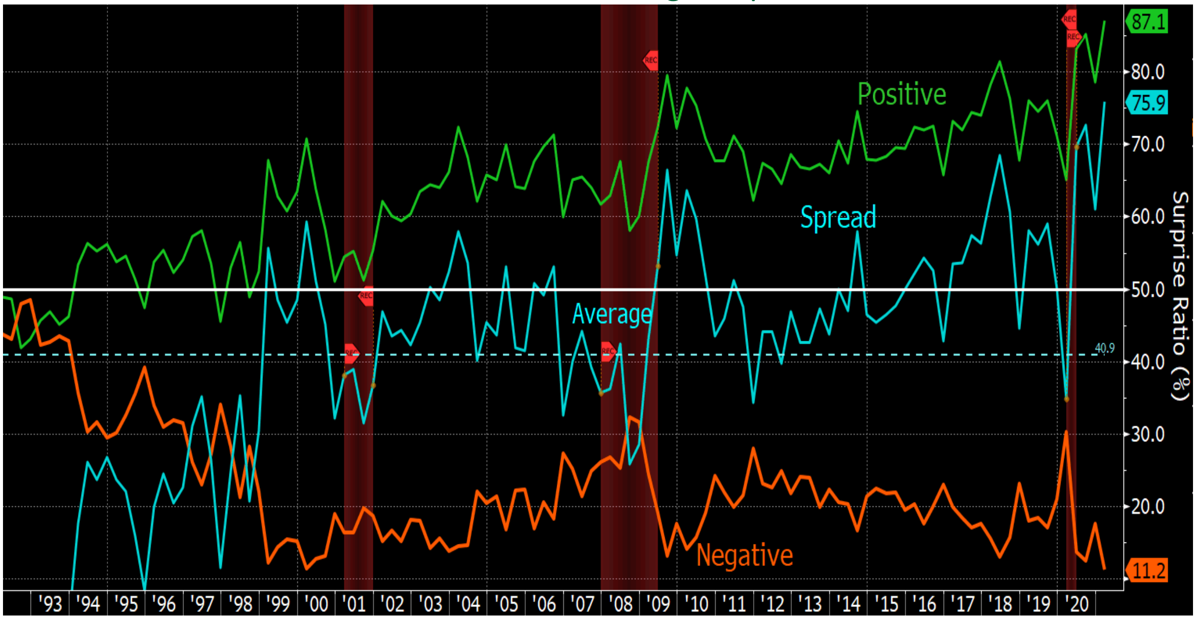
As we have indicated in previous notes, the US consumer is financially in a good state. The above chart reflects their view whether they feel financially in a better position than a year ago, or not. This index's readings are in a rising trend, which reflects solid support for the US economy potentially on its way from this critical source.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. October 2021. ***Past performance is not a guide to future performance.***

2. EARNINGS SEASON

Just over half of both the US's S&P 500 and Europe's BE500 constituents have reported their third quarter results. Before discussing these results, the following chart reflects well the backdrop on which to consider them. It reflects the earnings surprise factors up to the second quarter:

S&P 500 – Consensus Earnings Surprise Factors



Over 87% of the businesses delivered better than expected results in the second quarter. This is a record reading for this positive surprise factor (the green line). The spread between the positive and negative surprises (the net positive surprise factor) has a reading of over 75%, also a new record. Analysts had good indications on which to reconsider their projections.

The table below reflects the results for the third quarter thus far:

	S&P 500 3Q2021 Results (30 Oct 2021)			Bloomberg BE 500 3Q2021 Results (30 Oct 2021)		
	Growth	Surprise Factor	# +ve Surprises	Growth	Surprise Factor	# +ve Surprises
Sales	17.7%	2.0%	66.9%	14.7%	1.0%	61.4%
Earnings per Share	38.9%	9.7%	82.4%	43.7%	8.9%	65.7%

We have the following conclusions from these numbers:

- Sales continue to grow in high double digits in both the US and Europe.
- Two thirds of the US constituents declared better than expected sales, with a high surprise ratio of 61% also in Europe.
- Earnings continue to grow at a high pace in both the US and Europe.
- Expectations for growth have been underestimated meaningfully in both regions (by 10% in the US and 9% in Europe).
- The US's earnings 82% surprise factor is off the preceding record level, but still the second highest reading on record.
- Shareholders have good reason for celebration, and we can see the results thus far as supportive to the stock market.

We would like to highlight the continuing exceptional results from some technology titans (e.g., Alphabet, Microsoft, Accenture) off an already very high base, reflecting their participation in the 'fourth industrial revolution'.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. October 2021. ***Past performance is not a guide to future performance.***

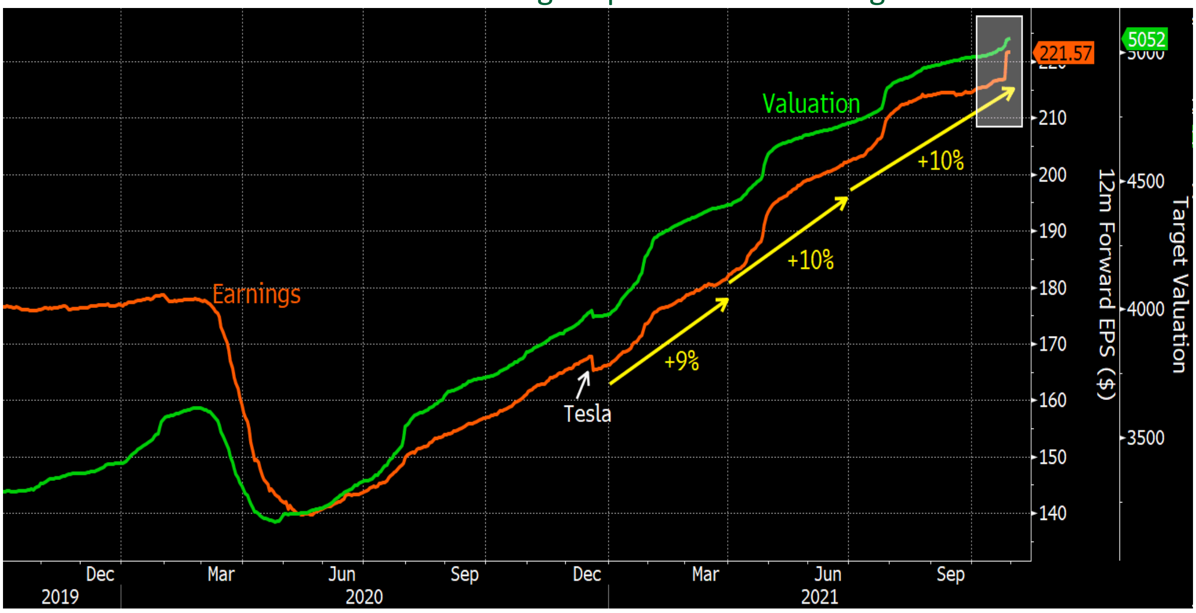
3. EARNINGS OUTLOOK

The following charts reflect changes in consensus earnings expectations:

MSCI World AC Index vs Index of Earnings Upgrades

The earnings upgrade index for the MSCI World AC constituents was recently above a +2 Standard Deviation level. It has since receded to a below +1 SD level (still very elevated), but most recently picked up again to the +1SD level. This reflects further conviction in global earnings expectations.

S&P 500 – Consensus Earnings Expectations and Target Valuation



The orange line in the above chart reflects the twelve-month forward consensus earnings expectations. Whilst it keeps rising, the pace of increases slowed in the third quarter into October. It is striking that it is currently making another step-up (the highlighted box in the chart), clearly following the strong results season thus far. Whilst the fist two quarters saw strong upgrades of +9% and +10% upgrades respectively, we now witness another +10% upgrade since.

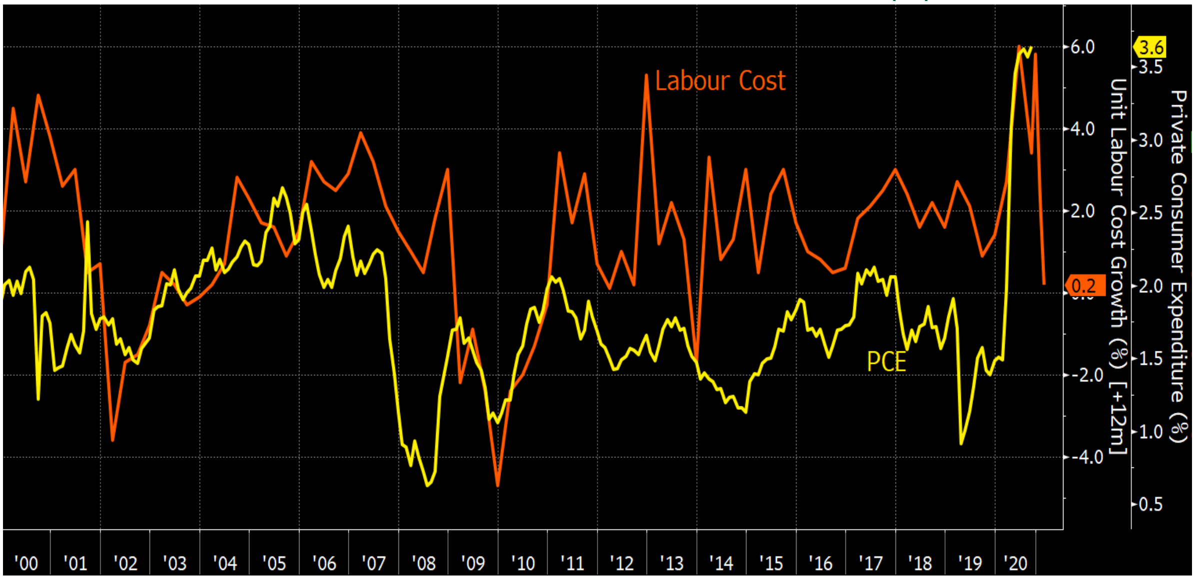
The consensus S&P 500 target valuation is also getting revised upwards. The current target valuation of $5052 reflects a 10% upside on the current price. This upside compares to a +11% average upside over the past ten years. On this basis, we therefore conclude that valuations are generally still in favour of investing in equities.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. October 2021. ***Past performance is not a guide to future performance.***

4. US EMPLOYMENT

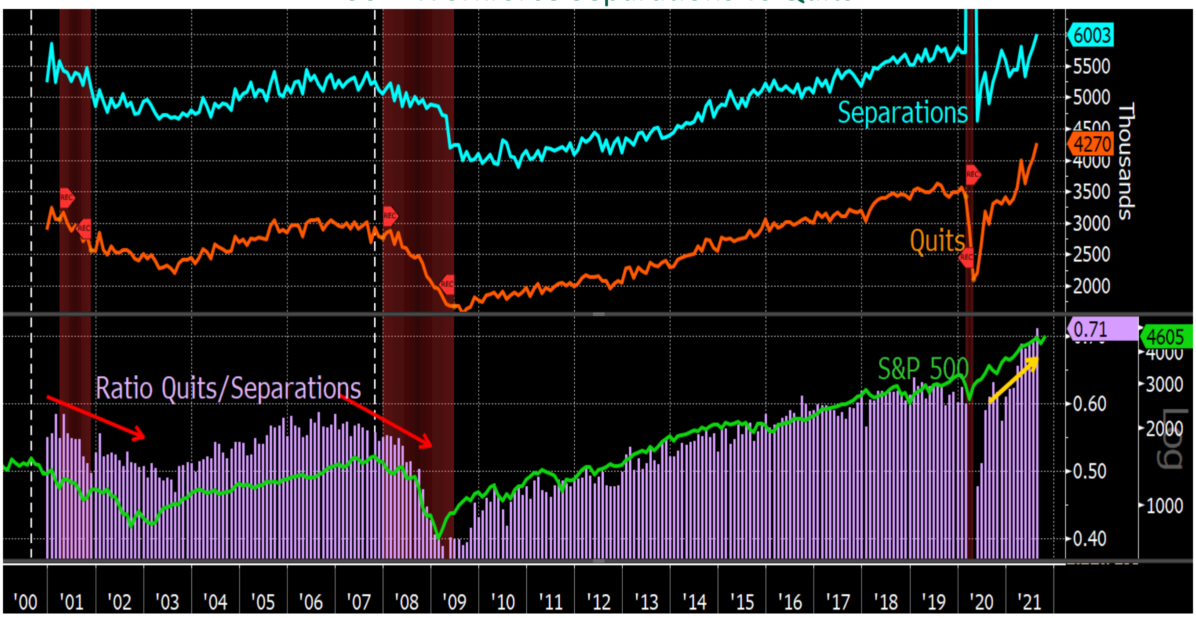
The scarcity of labour capacity at the lower end is well publicized. Wage growth for the low-income category now exceeds the growth in the high-income category for the first time since a brief period in 2010 following the Financial Crisis. The overall US unemployment level of 4.8% is, though, still well above previously perceived full employment levels. It also seems that the pandemic may have had some effects on new employment practices for us to consider.

US – Growth in Unit Labour Cost vs Inflation (%)



The growth in overall Unit Labour cost is, of course, the critical issue for shareholders to consider. We are still awaiting the third quarter data, but it is striking that the growth level has dropped materially following the spike during the pandemic. This may reflect increasing mechanisation of labour, with more productivity in this context. Should the second quarter data persist, it seems we may have less material concerns about the potential effects on business from labour inflation.

US – Workforce Separations vs Quits



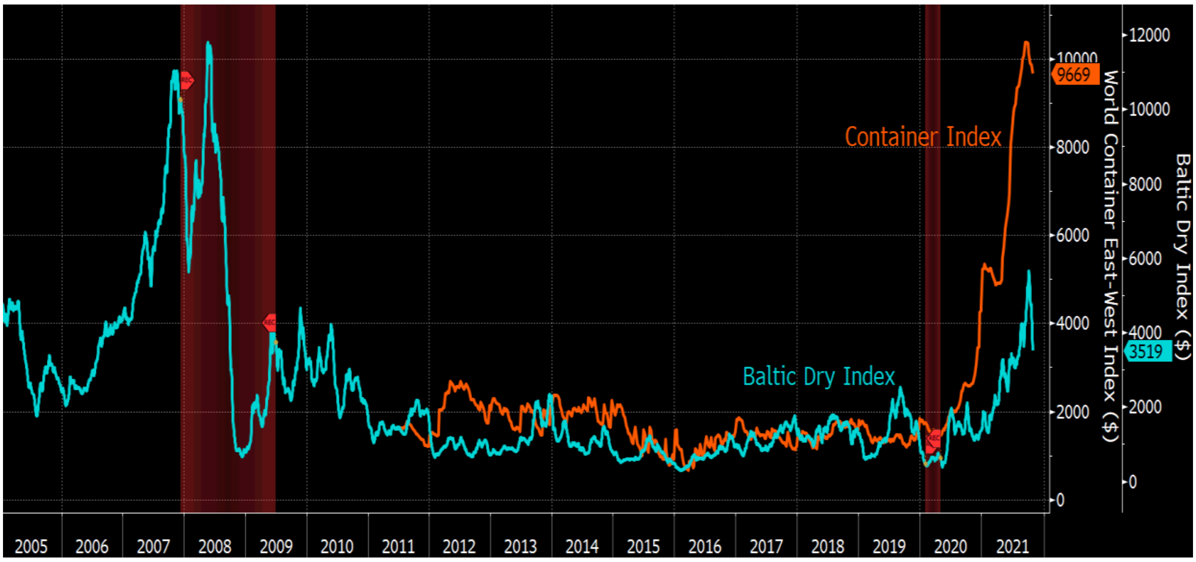
Workforce separations from their employer is already back above pre-pandemic levels (the blue line in the above chart). This reflects a more normal employment environment than many perceptions. It is also striking that the number of quits (the orange line) is currently at a record level and that the ratio between the two series (the bars in the chart) is in a rising trend and at a record level. The trend in the latter historically had a close correlation with share prices, and, on this basis, we as shareholders can conclude a better than feared US employment environment.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. October 2021. ***Past performance is not a guide to future performance.***

5. SUPPLY CHAINS

We have earlier seen improving supply chain issues in the US lumber industry and the global iron-ore industry causing prices to revert to more normal levels for those commodities. There still are major complications in the global shipping and logistics industry, not in terms of capacity, but rather in terms of having the capacity available at the right time at the right place.

Baltic Dry and Container Rent Indices ($)



The said complications have caused the Baltic Dry shipping and Container rent prices to explode following the pandemic – about five-fold for both. As reflected in the above chart, the former has already receded by over a third since its peak, while the latter seems to be in process of rolling over. The correlation of the Baltic Dry index with the Oil price is also to be considered. All these offer hope that normality may be in process of returning in this context.

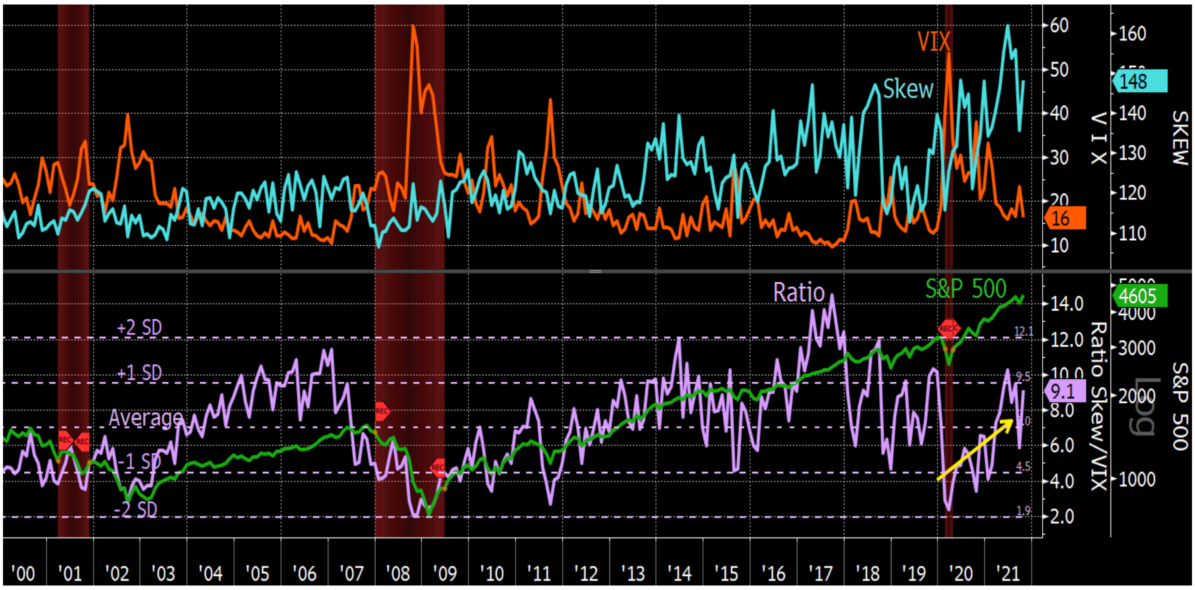
6. TECHNICAL PICTURE

The moving average technical picture for the S&P 500 Index reflects a strong position currently with the Golden Cross on a clear pathway:

S&P 500 vs 50- and 200-day Moving Averages

Source: Bloomberg & Stonehage Fleming Investment Management Limited. October 2021. ***Past performance is not a guide to future performance.***

S&P 500 vs Volatility Indices

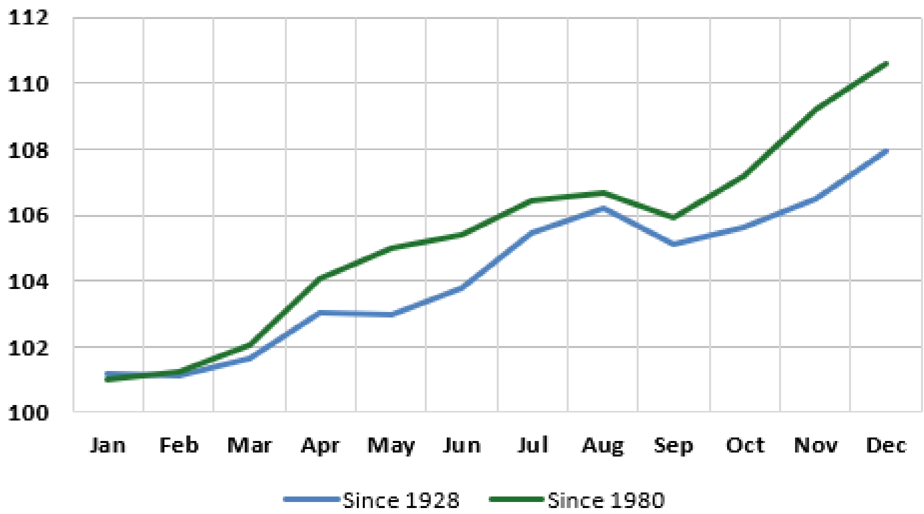


We also consider the historic and expected volatility indices (VIX and SKEW respectively) in a technical context. The ratio between the two indices serves as a stock market indicator (the bottom chart above). It is in a rising trend, but not at an elevated level. This indicates further support for equities.

7. END OF YEAR

The chart below reflects the average S&P performance since 1928 and 1980 up to end October 2021:

S&P 500 – Average Price (indexed to 100 at start)



The trend performance this year has thus far lived up to historic norms, with a weak September and a strong October. November and December have historically on average done well.

Gerrit Smit
Partner - Head of Equity Management
Stonehage Fleming Investment Management Limited
15 Suffolk Street
London
SW1Y 4HG

T +44 20 7087 0000
Email gerrit.smit@stonehagefleming.com
www.stonehagefleming.com/gbi

Source: Bloomberg & Stonehage Fleming Investment Management Limited. October 2021. ***Past performance is not a guide to future performance.***

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Stonehage Fleming Investment Management Limited
15 Suffolk Street
London FP: ID0000789
SW1Y 4HG

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