

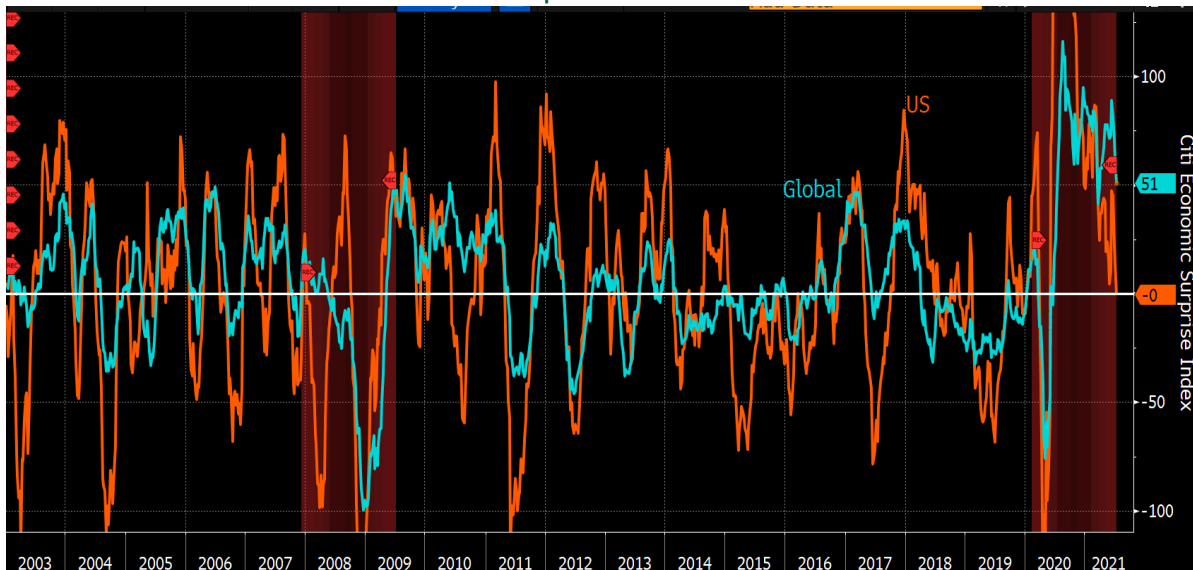
*"I've failed over and over again in my life. And that is why I succeed."*

*Michael Jordan*

## 1. ECONOMIC CYCLE PROGRESS

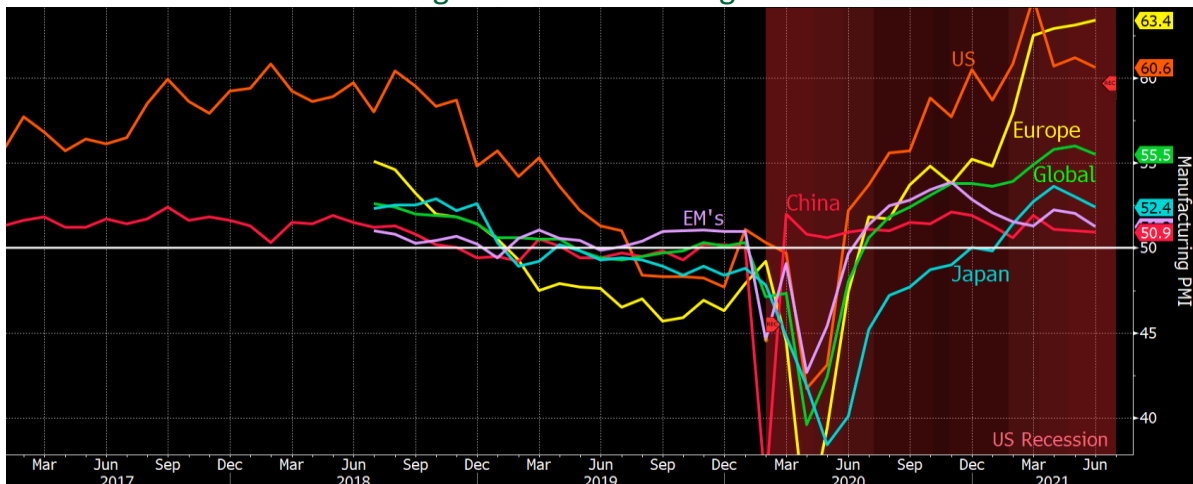
The rapid economic recovery in many economies has already become general investor perception. The US GDP has most probably already reached its pre-pandemic peak level. The investor issue now is more whether incremental news on the economic front will exceed already high expectations.

Citi Economic Surprise Index – US vs Global



According to the Citi Economic Surprise indices in the above chart, news on a global basis continues to be meaningfully positive, but in the US it now simply meets expectations (a zero reading). Chances for disappointment are therefore growing in the US.

Markit Regional Manufacturing PMI Indices



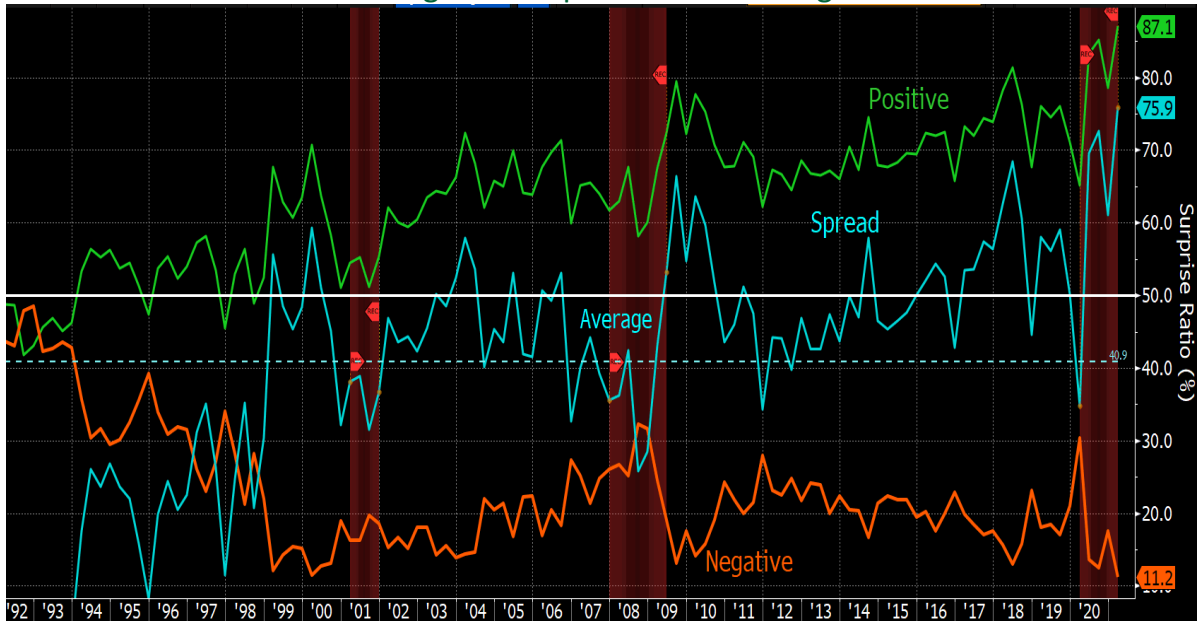
Most of the Manufacturing PMI indices in the above chart have recovered to levels indicating good economic expansion. Strikingly, though, apart from Europe, their June readings have receded and illustrate that the economic recovery cycle may be close to maturing and that we are entering a normal expansionary phase. The China index is surprisingly low - just marginally at an expansionary level.

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

## 2. EARNINGS CYCLE

The earnings recovery cycle is well on track, with many positive surprises for shareholders.

### US – S&P 500 Positive vs Negative Surprises as Percentage of All Announcements



The Earnings Surprise Index (the green line in the above chart) is at a record level after completion of the first quarter results. The spread between the positive and negative surprises is also at a record level. This is clearly supportive of share prices.

### MSCI World Index vs Earnings Upgrade Index



Considering the MSCI World Index constituents in the above chart (the green line), the number of earnings upgrades is currently close to record levels (the yellow arrow). It is over two standard deviations away above its average level. This reflects strong fundamental support to share prices globally.

We calculate that consensus S&P 500 earnings estimates for the next twelve months have increased by +10.3% since just the end of the first quarter to \$191.20. Should this number materialise, it would imply growth of +16.7% over and above the end 2019 (pre-pandemic) expectation (or a compounded growth level of +10.9% p.a. since then). This is clearly strong fundamental data. It also materially raises the bar for further growth levels and along with it, the risk for disappointment increases.

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



### 3. INVESTOR SENTIMENT

Whilst earnings multiples is an important tool to consider the level of investor sentiment, we should also consider further metrics to form a firm view of potential euphoria.

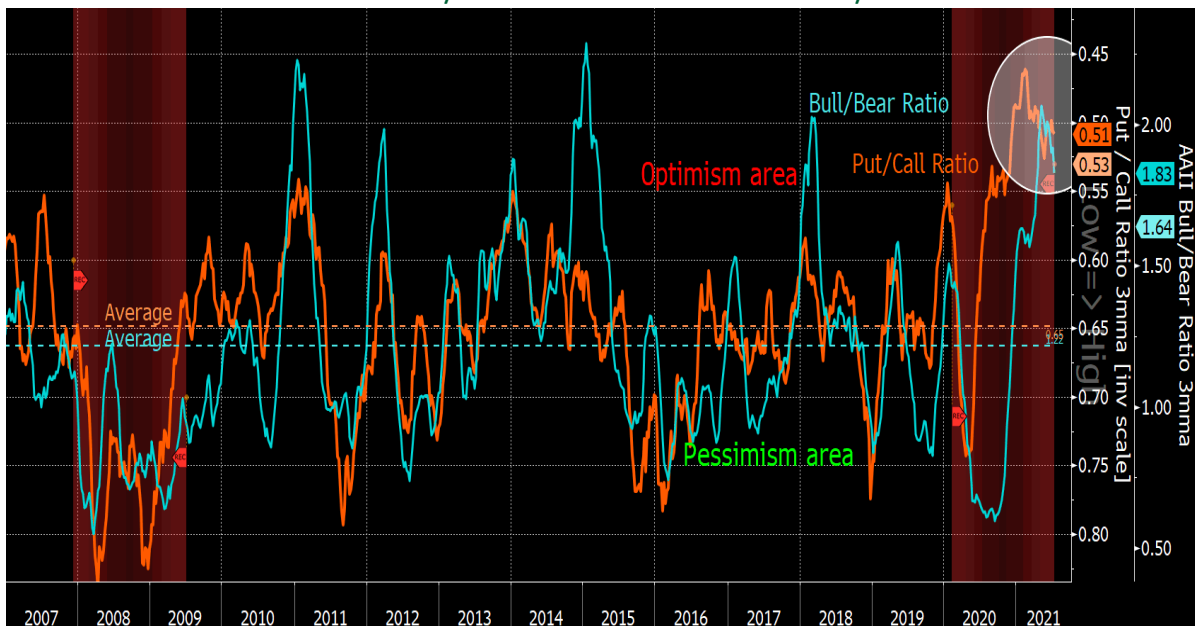
S&P 500 vs Investor Euphoria Index



We calculate an S&P 500 Euphoria Index by adjusting its forward earnings multiple with the market volatility – we use the popular VIX volatility index. This Euphoria Index is reflected in the blue line in the above chart. Its historic levels are categorized from a ‘Mania’ level to an ‘Armageddon’ level at the most positive and most negative extremes, respectively.

This Euphoria Index is currently above average, but still in the ‘Disciplined’ category. We believe this is a constructive level for investing considering where in the economic cycle we are. If market volatility increases it may push the index towards more dangerous ‘Complacency’ territory.

US – S&P 500 Futures Put/Call Ratio vs AAI Bullishness/Bearishness Ratio



The S&P 500 Futures Put/Call ratio reflects the level of optimism in the institutional market, whilst the AAI (Association of American Individual Investors) Bullishness/Bearishness ratio reflects sentiments in the retail market. Both ratios have recently peaked at extreme levels, and have since rolled over – though still at elevated levels. These readings still reflect a high level of optimism and some potential for weaker sentiment should negative surprises materialise.

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



## 4. INTEREST RATES

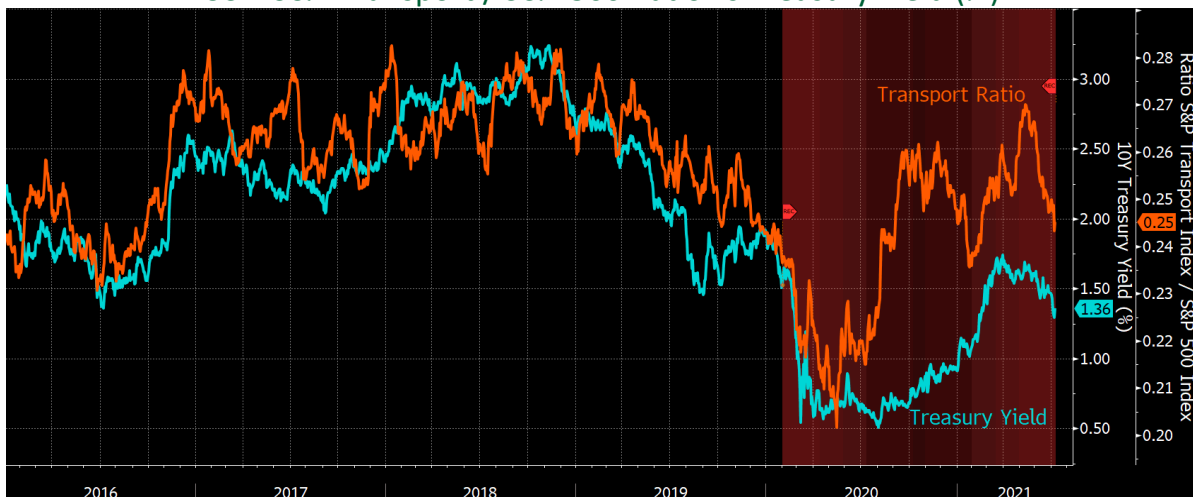
The low level of current US interest rate levels has surprised many. The following charts illustrate how logical it actually is:

### US – Copper/Gold Ratio vs Treasury Yield (%)



The Copper/Gold ratio rolling over was a strong indicator of lower yields on their way.

### US – S&P Transport / S&P 500 Ratio vs Treasury Yield (%)



The underperformance of the S&P Transport index intrinsically argues in favour of lower rates.

### US – Ten Year Inflation Expectations vs Treasury Yield (%)



Against many odds, inflation expectations have matured and started rolling over. This also argues in favour of the current lower rates.

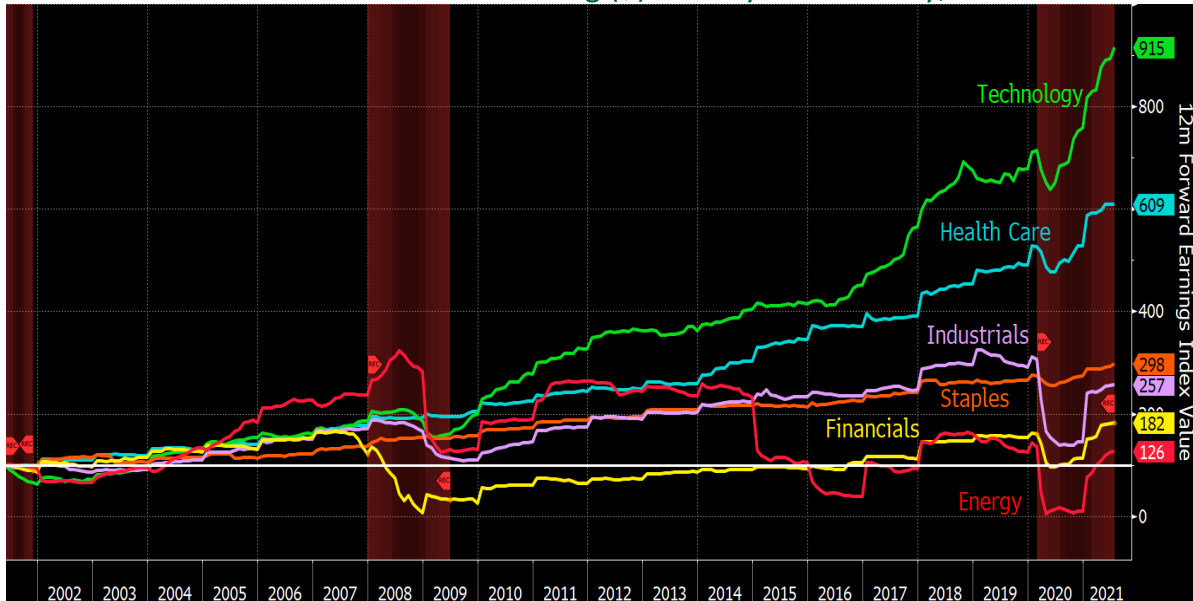
Source: Bloomberg & Stonehage Fleming Investment Management Limited. July 2021. **Past performance is not a guide to future performance.**



## 5. STRUCTURAL GROWTH INVESTING

We invest for sustainable growth. The following chart provides clear guidance where the best investment opportunities have been in this context:

S&P 500 Sectors – 12m Forward Earnings (\$) Twenty Year History, Indexed to 100

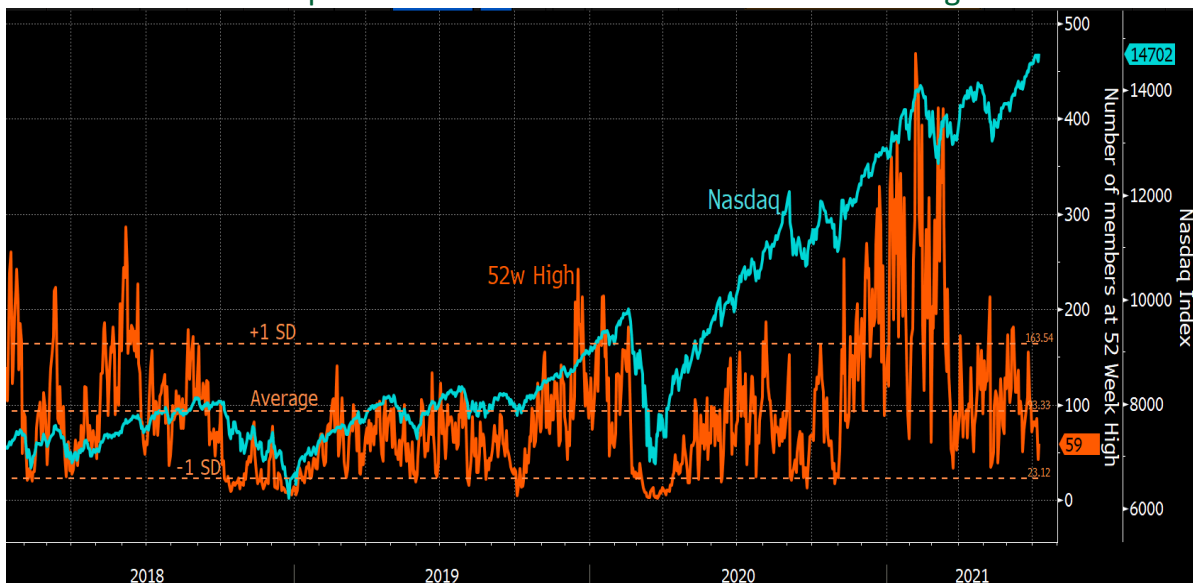


The Technology and Health Care sectors stand out as first choice sectors against all other. The Staples sector follows as the most stable amongst the rest. Energy barely grew over the last decade.

## 6. NASDAQ TECHNICALS

The following charts reflect on the technical perspectives on investor sentiments around the Nasdaq index:

Nasdaq Index vs Number of Members at 52-week Highs

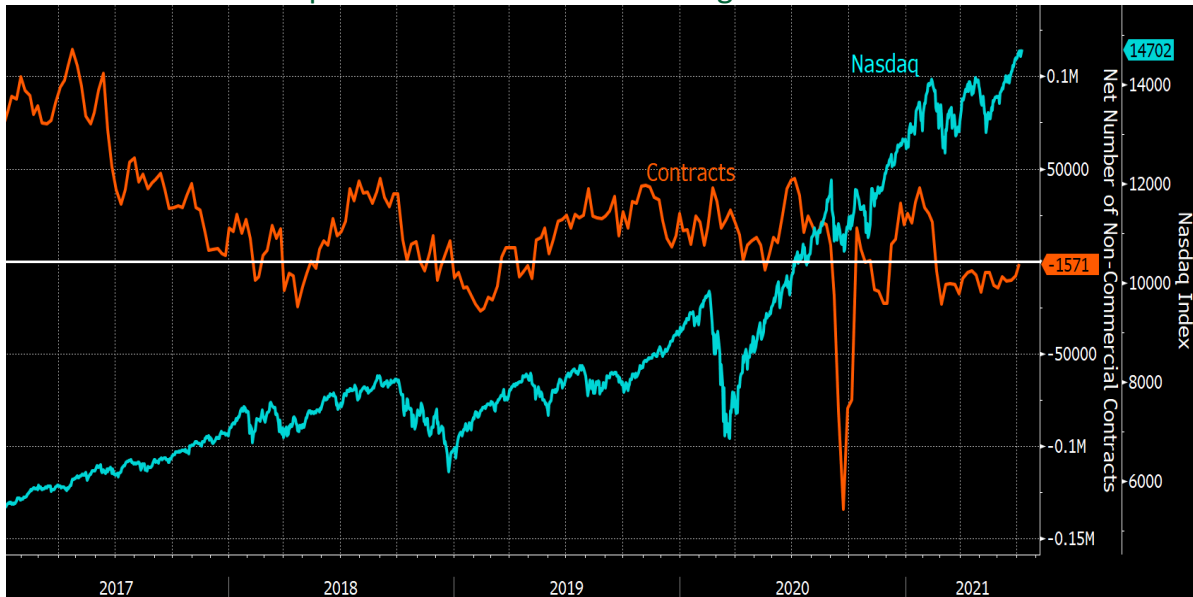


A relatively low number of the index constituents currently trade at their respective 52-week highs. The number is close to the series' -1 standard deviation. This has historically provided technical Buy signals.

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



## Nasdaq Index vs Net Number of Long Futures Contracts

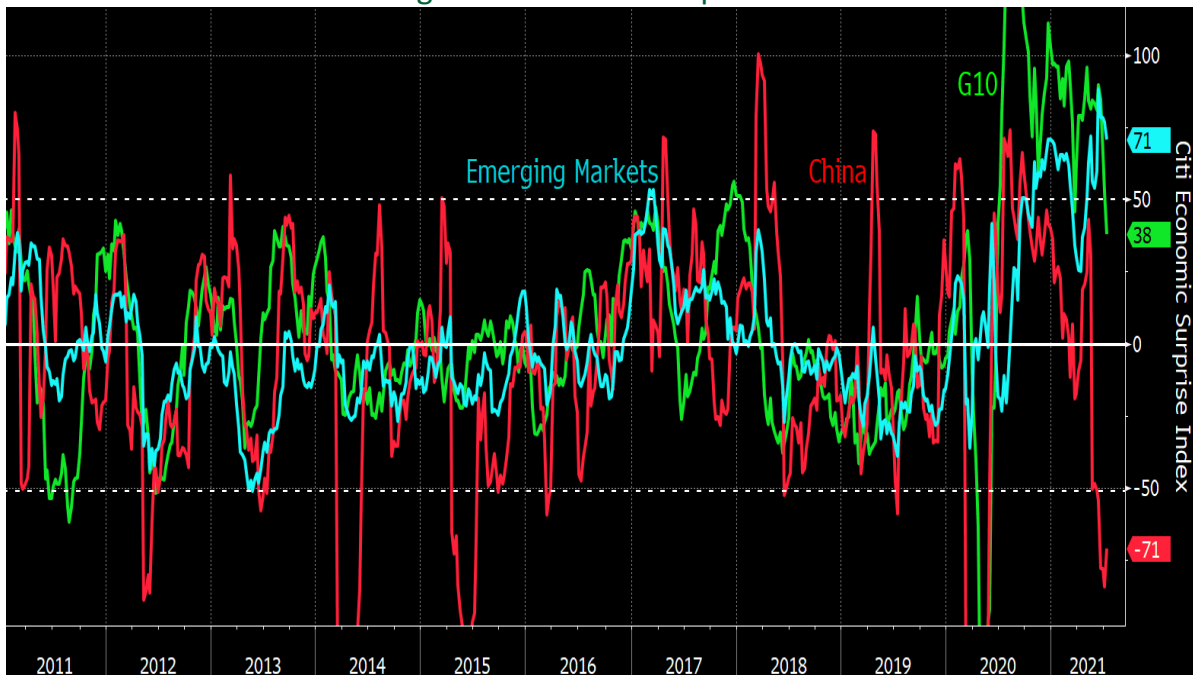


The futures market has had a net Short position on the Nasdaq for all of this year. This has shrunk to only a marginal net position currently. It seems the trend in this net number of contracts position is developing in support of the Nasdaq index.

## 7. CHINA

China as an investment destination has been disappointing on many fronts recently, including the uncertainties around regulation of different industries. The following charts reflect on some of the fundamental economic issues in this context:

### Citi Regional Economic Surprise Indices



China's Economic Surprise Index is currently at an extremely low level – it has been at this level only five times over the past decade. Against this, the aggregate of other Emerging Markets' indices is currently at a record level. This low reading ties in with the low PMI reading on the front page.



## China – Shanghai Index vs Credit Impulse Index Growth (%)



The Chinese government seem to be deliberately dampening credit supply in the economy to control its growth levels following the pandemic and in their housing market. Their inflation is at a mere 1% and does not need tight credit controls anymore.

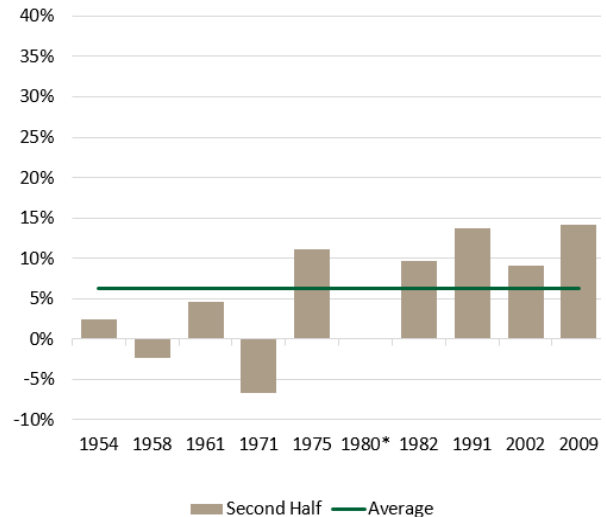
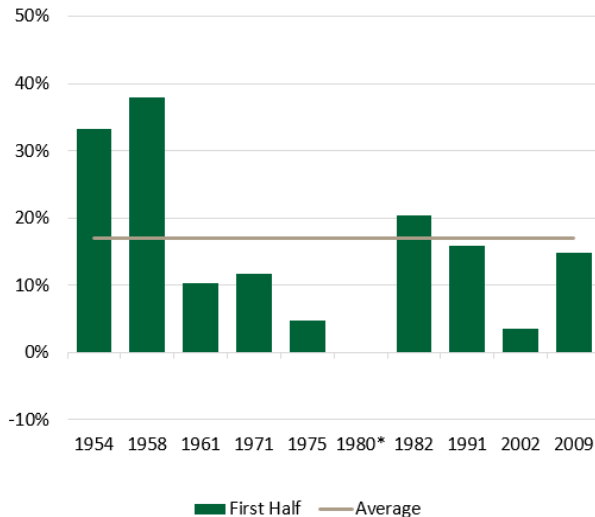
The government has caused major investor uncertainties with the way they have dealt with regulatory issues and foreigners' investments into their IPO's. This may keep investor sentiment weak for a while. Apart from this, they are able to address the weak economy.

## 8. FIRST HALF INVESTING

### S&P 500 – Returns During Economic Upswing Periods

FIRST HALF OF UPSWING

SECOND HALF OF UPSWING



Source: Stonehage Fleming, Bloomberg, May 2021. \*S&P 500 Total Return. \*\*1980: Data omitted (period) <1 year.

The above chart compares the S&P 500 returns over the respective halves during economic upswing periods. The horizontal lines reflect the respective averages over those periods. The average returns have logically been better during the first halves, and to quite some extent.

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



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