STONEHAGE FLEMING

GLOBAL EQUITY PERSPECTIVES 13 SEPTEMBER 2021

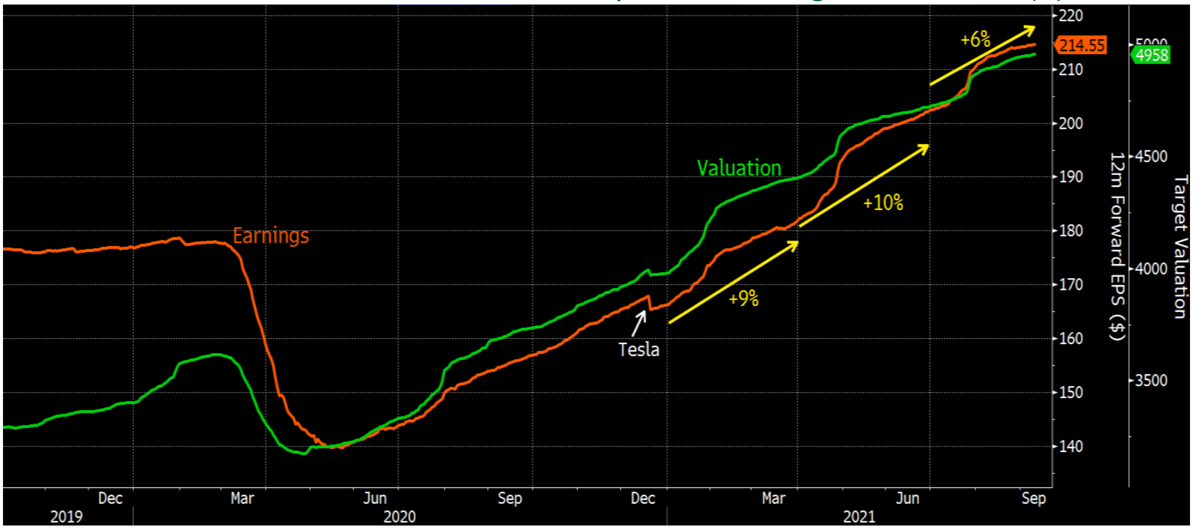
"The art of being wise is knowing what to overlook."

William James

1. VALUATION

Company earnings growth is one of the main determinants of stock market performance over time. We have collated the following information in this context:

S&P 500 – Consensus 12 Month Expected Earnings vs Valuation ($)



Earnings expectations (the orange line in the above chart) are growing at a handsome pace. Those expectations were increased by +9% in the first quarter, and accelerated by another +10% over the second quarter. The third quarter is witnessing another +6% thus far. This is supportive of the stock market. We should, though, also be conscious of the rate of growth probably in process of maturing.

S&P 500 – Price Index vs Bottom-Up Consensus 12 Month Forward Valuation

We have updated the above chart showing the S&P Index along with its bottom-up consensus valuation. It is clear how well the Index follows the valuation over time. Despite the current wide gap between the two series (which may unsettle some nervous investors), the target valuation exceeds the price index by 11%. This premium valuation compares well with an average excess level of 13%. On this basis, investors still enjoy fair valuation.

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

2. US DEBT CEILING

The US administration currently faces a volatile period with material risk of shortly running out of funds to finance their run-of-the-mill activities whilst struggling to get cooperation from the Republicans and even some of their own colleagues to raise the already extended debt ceiling that expired on 31 July 2021. This politically and economically uncomfortable period can cause material capital market uncertainties. In the latter context, we consider experiences during the quite similar politically volatile 2011 and 2013 ceiling events. For interest's sake, the Trump presidency experienced relatively easy ceiling extensions because of their focus on tax cuts over a balanced budget.

US – Treasury Yield Around Debt Ceiling Events (%)

We show in the above chart the Treasury Yield in the 3-month period preceding and the 12-month periods following the respective Debt Ceiling Events. The 2011 experience merits a particular mention seeing the issues around the first ever degrading of US debt at the time.

Yields dropped in the immediate aftermath of both the ceiling events. The rest of the 12-month periods delivered different outcomes (rising vs dropping yields). It rather seems that the trend prior to the events stayed their respective courses.

The following chart considers the stock market experiences around those ceiling events:

S&P 500 – Indexed to 100 at the 2011 and 2013 Debt Ceiling Events

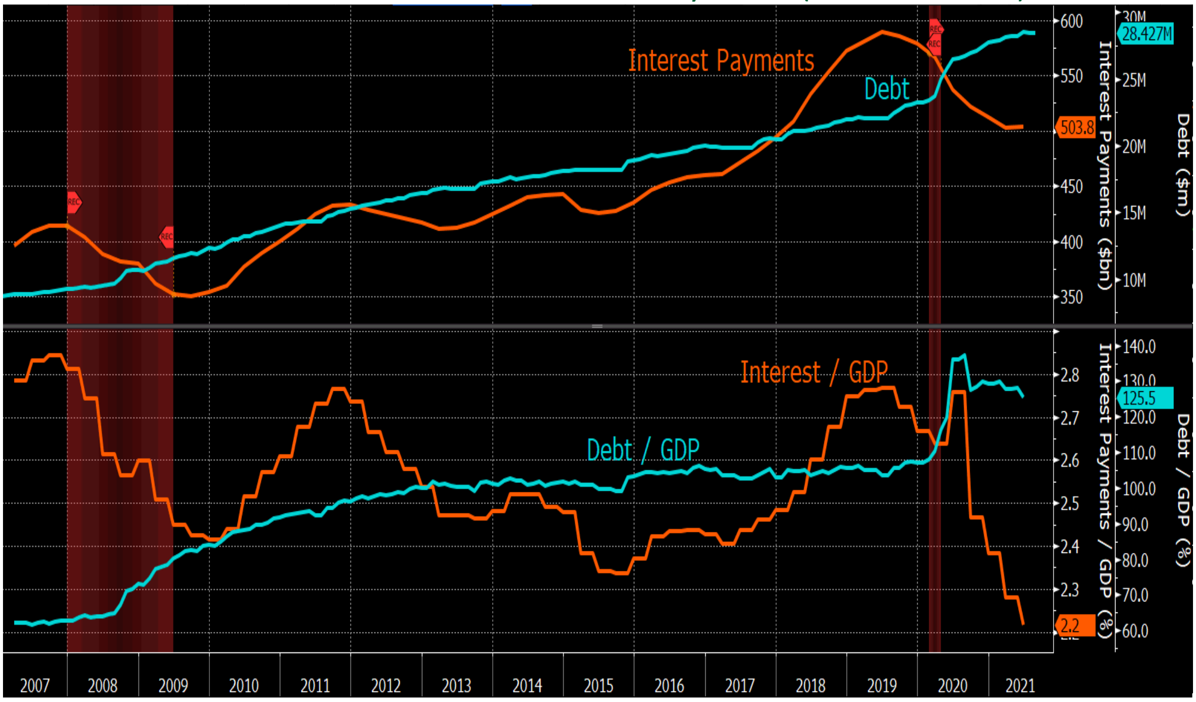
Source: Bloomberg & Stonehage Fleming Investment Management Limited. September 2021. ***Past performance is not a guide to future performance.***

The chart indexes the S&P 500 Index to a 100 reading on the date of the respective ceiling events.

Standards & Poors issued the first ever downgrade in the federal government's credit rating on 5 August 2011, three days following the Debt Ceiling Event. As the chart illustrates, the stock market was at the time already in decline. The debt downgrade caused havoc in the stock market (more so than in the debt market) with a -12% loss since the ceiling event, on top of an already -6% just before that. The market started recovering again after five months. Against this, the 2013 ceiling event was immediately preceded by a strong stock market despite the volatile political backdrop. This strength carried on beyond the ceiling event over the following year.

The big question this time again is whether the administration will succeed in getting Congress support to raise the debt ceiling. We expect firm stances and hard negotiations with Republicans most probably pushing for some sacrifices on the infrastructure and social aid front. Washington can cause material uncertainties to capital markets over the coming weeks in this context. On the point whether more debt can be considered, the following chart is of good value:

US Federal Debt Levels vs Interest Payments ($'s and vs GDP)



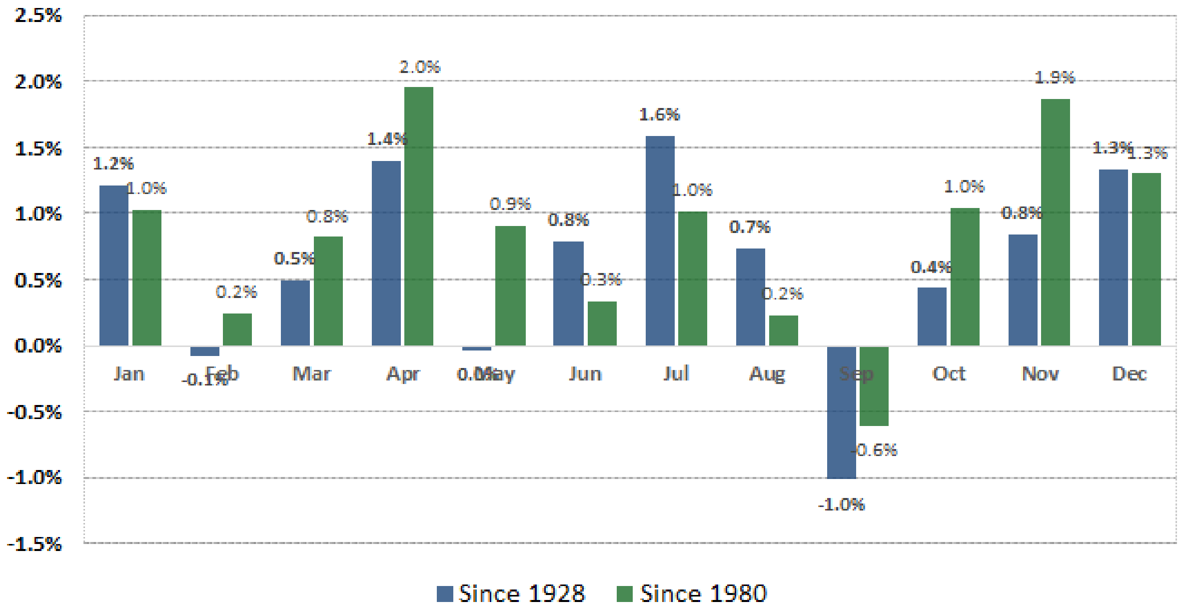
The level of Federal Debt logically is currently at a record absolute level (top section of the above chart). As a ratio of GDP, it is staring to recede as the economy grows, but still is at an elevated historical level (bottom section). Against this, nominal interest payments have dropped since its peak by ~15% (top section), while as a ratio of GDP it is at a record low level (bottom section).

The US administration surely will make their case for increasing the debt ceiling on the affordability argument, and we guess may succeed. We should not be overly concerned if the process to get there causes market volatility.

3. TIME OF YEAR

The debt ceiling negotiations (with its market implications) this time is happening in the midst of other issues which are also causing uncertainties. Sharply increasing virus infections have raised alarms for a maturing economic recovery cycle (we believe we are already in the early stages of a mid-term economic cycle), China's Regulatory clampdowns has caused material nervousness and uncertain potential economic outcomes around Afghanistan are a few of the strategic issues investors wonder about. In the interim, on a tactical front, we have updated the following chart of average monthly stock market performance over the ultra-long-term and over a working career:

S&P 500 – Average Monthly Performance

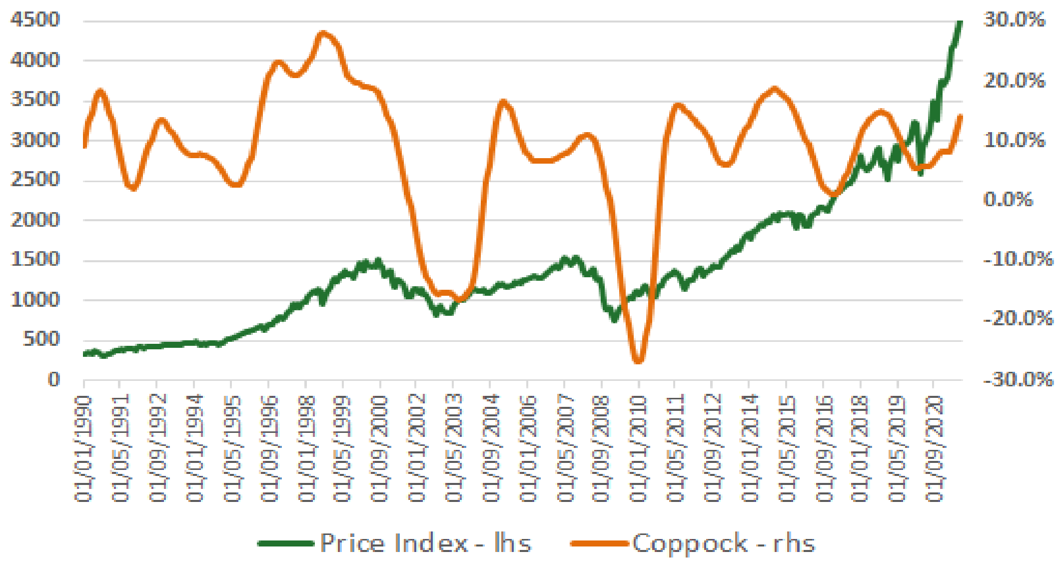


September is historically the weakest month of the year. Those with a strategic buy orientation may sharpen their pencils for upcoming opportunities into the traditional strong last quarter of the year.

4. COPPOCK INVESTING

Coppock is a long-term price momentum indicator. Whilst it is a technical tool, it also serves the more strategic orientated investor well. We have drawn the Coppock charts for both the nominal and the real S&P 500 indices:

Nominal S&P 500 vs Coppock



The Coppock indicator has turned upwards and is in a rising trend. Its current level remains relatively moderate and therefore provides good support for strategic investing. The Coppock of the Real S&P 500 index looks the same (but with lower growth numbers). On this basis, we can therefore make a similar conclusion about strategic investing in the S&P 500.

5. CYCLE INVESTING

We consider the following charts in the context of investing for recovery against being defensive:

S&P 500 vs S&P High Beta/ Low Volatility Index

The High Beta / Low Volatility Index in the above chart seems to be rolling over on an elevated level. On this basis, odds seem to be on the side of investing in lower volatility shares.

US Large Cap Cyclicals / Defensives Index vs ISM Manufacturing PMI

The Cyclicals/Defensives Index in the above chart follows the Manufacturing PMI Index well. It is currently rolling over with the latter, both currently at elevated levels. This chart therefore currently also makes a case in favour of more defensive type of shares.

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

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