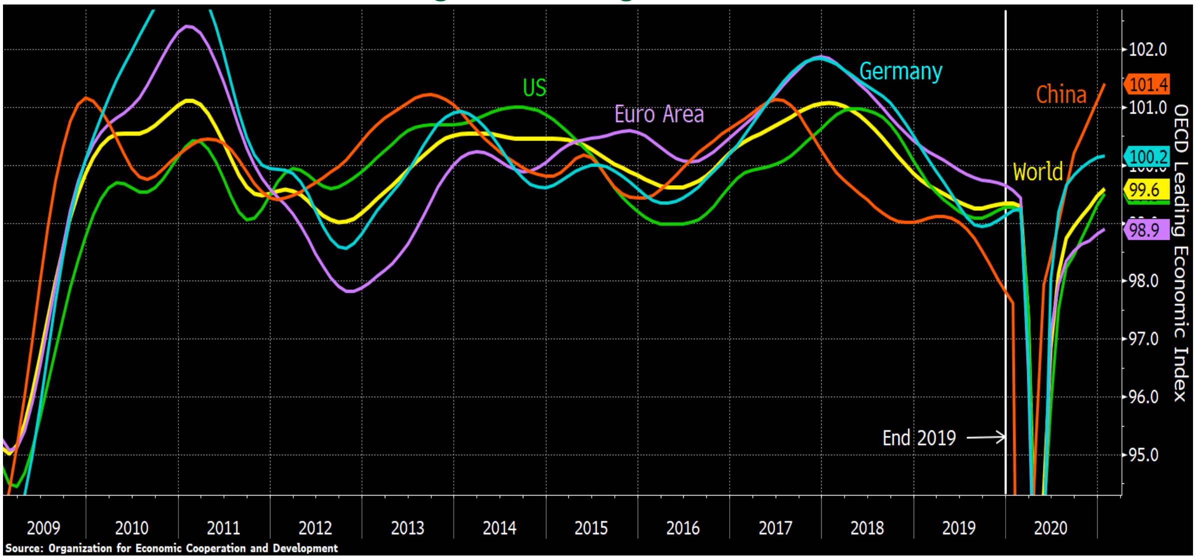
"Great things are done by a series of small things brought together."

Vincent Van Gogh

1. OUTLOOK

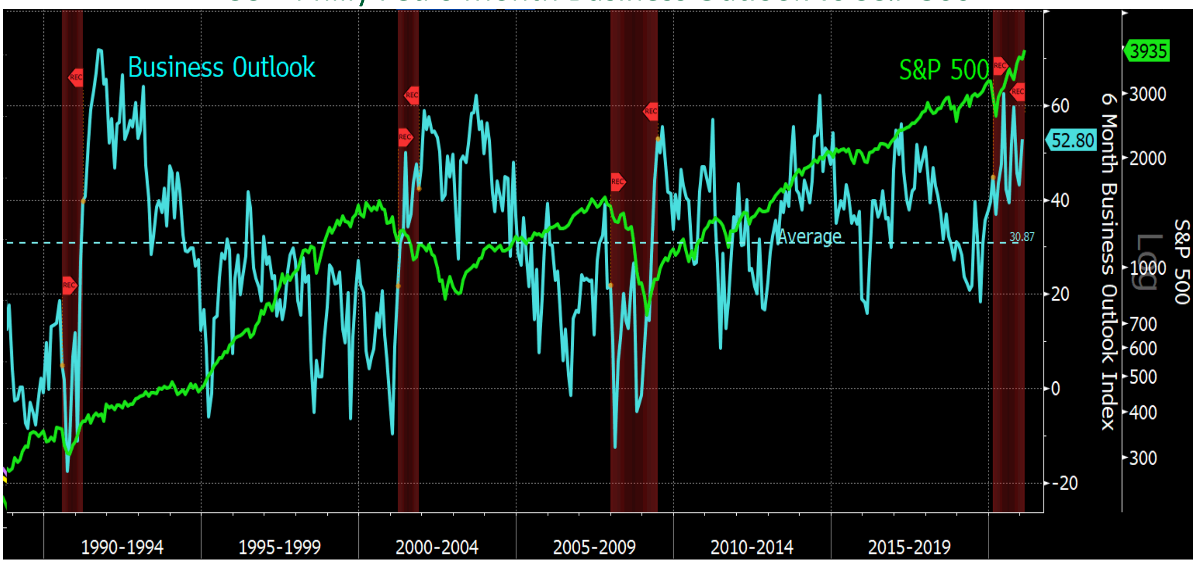
The OECD provide important information on the regional and the global economic outlook:

OECD Regional Leading Economic Indices



We indicate on the above chart the end 2019 levels of the regional indices. It is striking how different current readings are. Europe's index then was at the highest level, with China's the lowest. Current readings are the complete inverse of that, with China's reading currently at a record level, followed by Germany's (who exports a lot to China). Both the US and the World indices have recovered well to readings slightly above their respective end 2019 readings.

US – Philly Fed 6 Month Business Outlook vs S&P 500



The US 6-month business outlook index in the above chart is currently at elevated levels. This bodes well for investor sentiment. We also realise how critical the successful rollout of COVID-19 vaccinations are to continue supporting all this optimism.

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

2. FINANCIAL CONDITIONS

Capital markets are currently deeply dependent on loose fiscal and monetary support. The following charts reflect on the financial conditions in the US capital markets:

Bloomberg US Financial Conditions+ Index vs S&P 500

The above index reflects the overall financial stress in the US money, bond and equity markets, and potential bubbles within those markets. The index is currently at a record level, one standard deviation from average. A similar chart from Goldman Sachs indicates an even more elevated level. Whilst this is supportive of the equity market, with equity prices at record levels it also indicates how critical continuing monetary and fiscal support in this context currently is.

BoA ML Global Financial Stress Index vs MSCI World Index

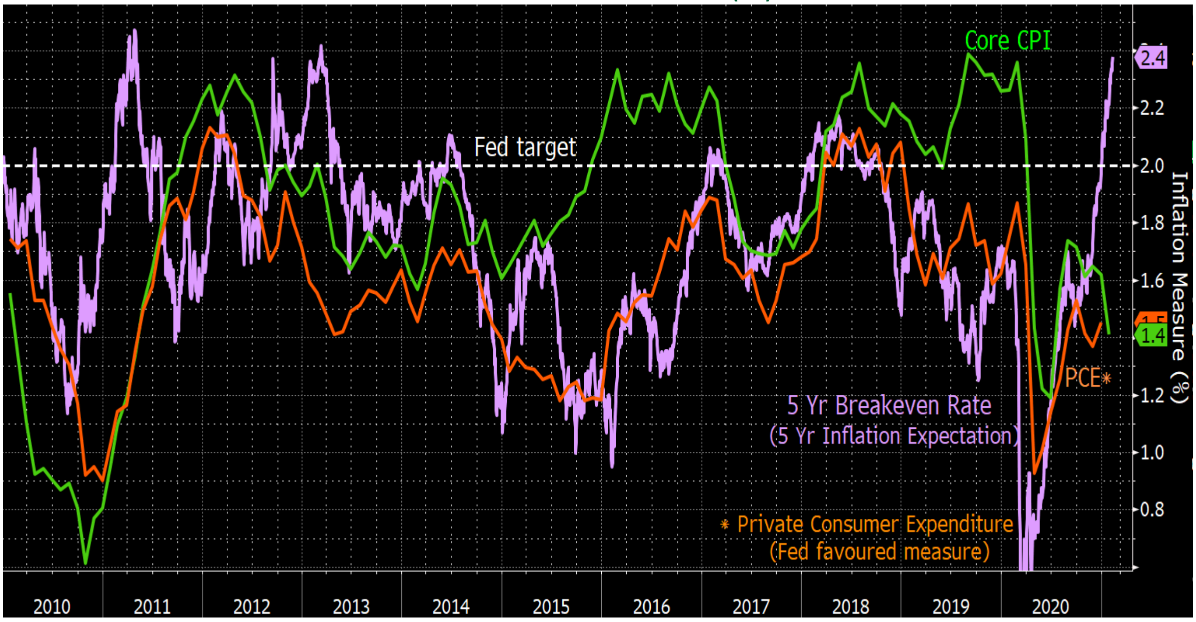
The above global financial stress index is a cross market measure of risk, hedging demand and investor flows in the global financial system, along with the World share price index. It complements the chart above it well. It is currently reflecting little stress in the capital markets, with less risk than in the top chart.

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

3. INFLATION

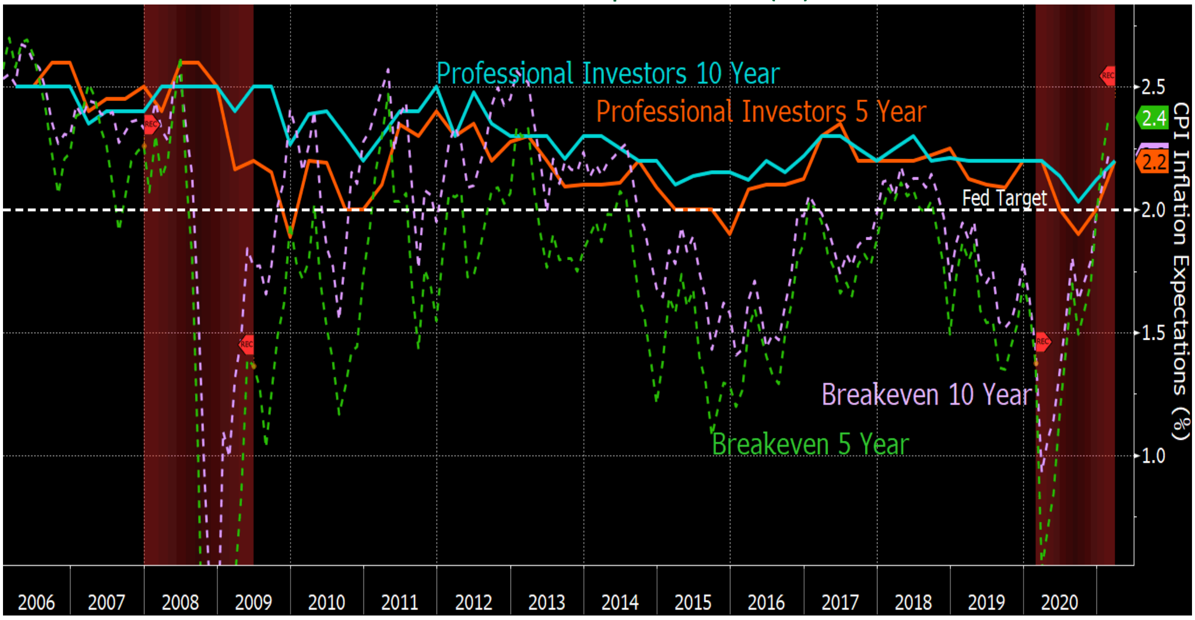
Fears for high inflation seem to keep building.

US – Inflation Factors (%)



Five-year inflation expectations (as reflected by the five-year breakeven rate in the above chart) have risen materially to 2.4%. Those levels were, though, also seen during 2012 – 2013 with similar fears after the Credit Crisis. Against that, Core CPI's (Consumer Price Index) most recent reading has dropped to a mere 1.4%, the same level as the last PCE (Private Consumer Expenditure) reading (the Federal Reserve's favoured inflation measure). We do not yet detect major inflation threats in this data.

US – Inflation Expectations (%)



The above chart reflects different inflation expectations – both five- and ten-year breakeven rates along with the Philadelphia Federal Reserve's survey results of professional investors' expectations for levels five and ten years from now. The latter's expectations have increased from recent lows but are still around 2.2%. This is towards the lower end of their historic expectation levels.

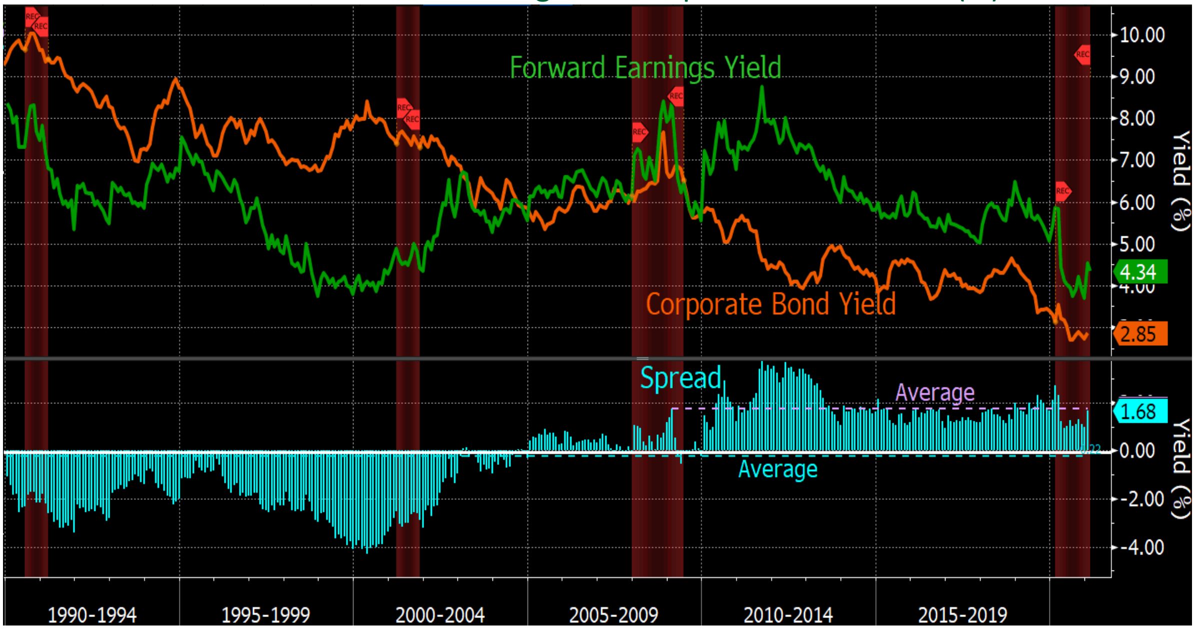
The cyclical economic upswing in commodity and energy prices can certainly support inflation levels, but against this, employment levels may stay muted for some time. We do not yet detect imminent material risks in this context and perceive rising interest rates as constructive data reflecting an improving economic outlook.

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

4. CORPORATE BOND MARKET

Because of its liquidity risks, we monitor the corporate bond market as indicator of equity risks.

S&P 500 Forward Earnings and Corporate Bond Yields (%)



The Corporate Bond yield is currently at a record low, clearly underpinned by strong monetary support, but also reflecting confidence in the corporates themselves. The spread between the S&P 500 Forward Earnings yield and the Corporate Bond yield (the blue bars at the bottom of the chart) is currently on its average since the Credit Crisis, reflecting a well-balanced situation between the two asset classes.

US – Spread Between High Yield Corporate Bond Yield and Ten-Year Treasury Yield (%) vs S&P 500

The High Yield spread in the above chart is currently at a depressed level below its -1-standard deviation (presented in an inverse scale). This reflects a very optimistic high yield market, which supports share prices – well illustrated in the chart.

This level of optimism has historically lasted for quite some time (2013-2014, 2017-2018), supporting share prices then. We would, therefore, be careful to raise an alarm on this, as we are at the beginning of a positive economic cycle countering such risk.

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

5. TECHNICAL PICTURE

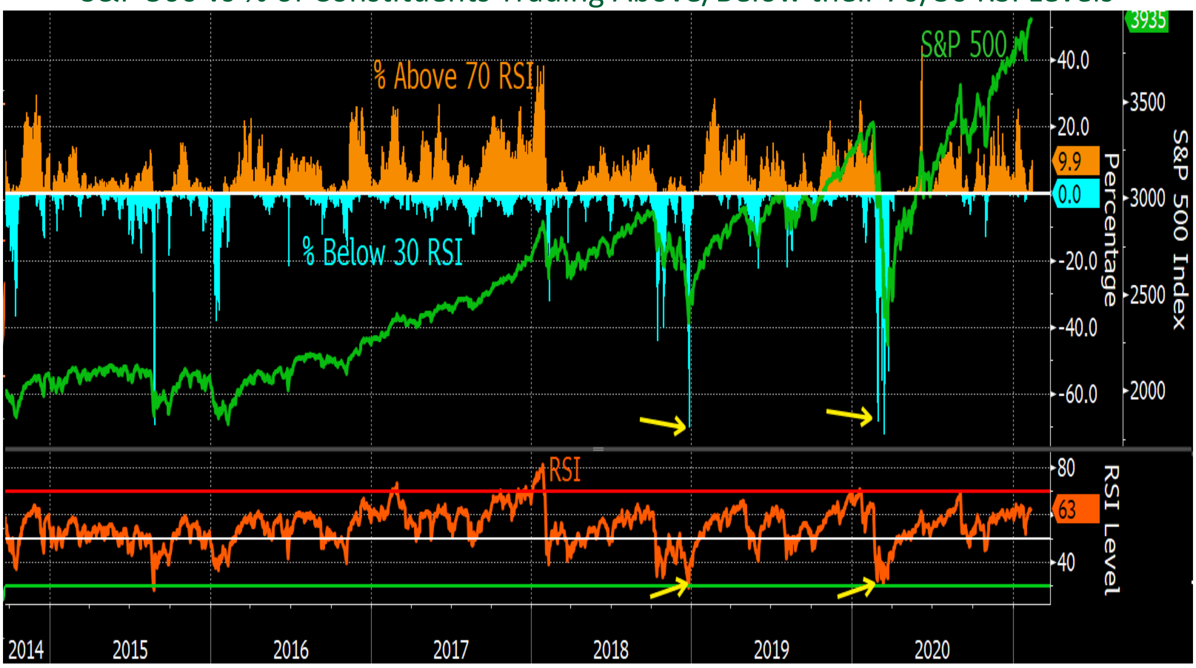
It is worth continuing considering the stock market's technical picture:

S&P 500 vs Moving Averages

The S&P 500 index is technically in a strong position – it has completed its golden cross and the index and its 50-day and 200-day moving averages are all in a rising trend (top right of the chart).

Along with this, the ratio of the S&P 500 index and its 200-day moving average (the bottom section of the chart) is currently at a twenty-year record level of 1.16 (see the orange arrow). This is an alarm signal indicating an overheated market. For more comfort, we would prefer the ratio to be lower.

S&P 500 vs % of Constituents Trading Above/Below their 70/30 RSI Levels



10% of the S&P 500 constituents are trading above their respective 70 RSI (Relative Strength Index) levels (the orange bars in the top section of the chart). This number is relatively low in historic context. This indicates that not many shares are technically overbought. Along with this, the S&P 500 index's RSI current level of 63 is not at an elevated level (the bottom section of the chart).

All in all, the market may need a bit of time or a breather to let moving averages catch up, but it does not seem to raise alarms for an imminent collapse.

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

6. GOLD AS INDICATOR

We showed in our previous note an interesting chart reflecting the S&P 500 in Gold unit terms. Our conclusion was that equities remain in a structural bull market in that context.

The following chart considers Gold in another context to reflect on the potential direction of share prices:

Growth in S&P 500 Index (%) vs Copper/Gold Price Ratio

The growth in share prices seem to have a correlation with the Copper/Gold ratio. The latter has been growing at around 50% over the past six months and remains in a rising trend. The current strong equity market makes sense in this context.

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