GLOBAL EQUITY PERSPECTIVES 16 AUGUST 2021

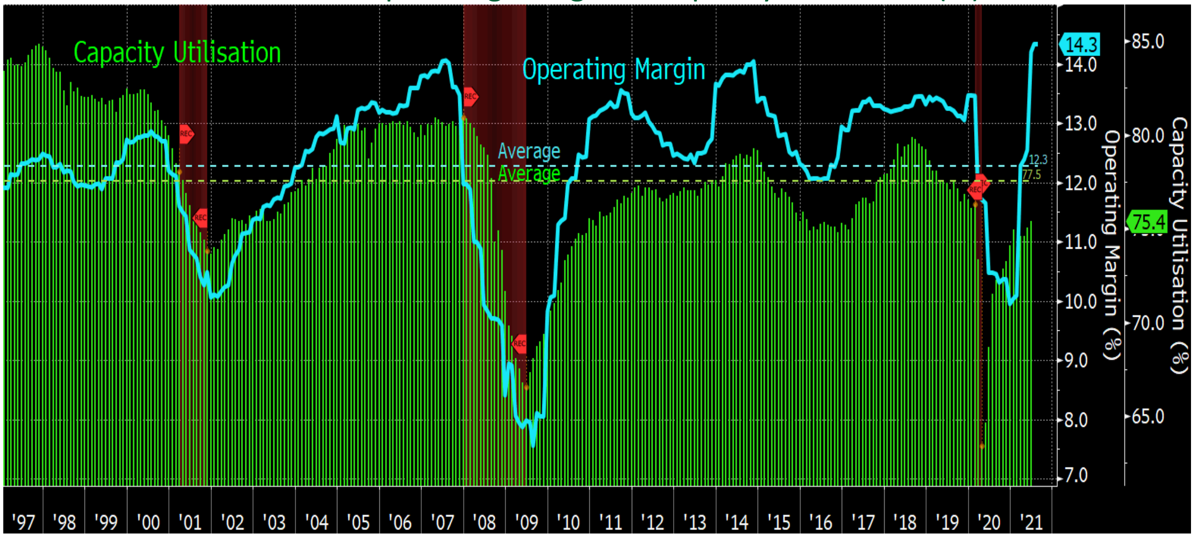
"To see things in the seed, that is genius."

Lao Tzu

1. MARGIN RECOVERY

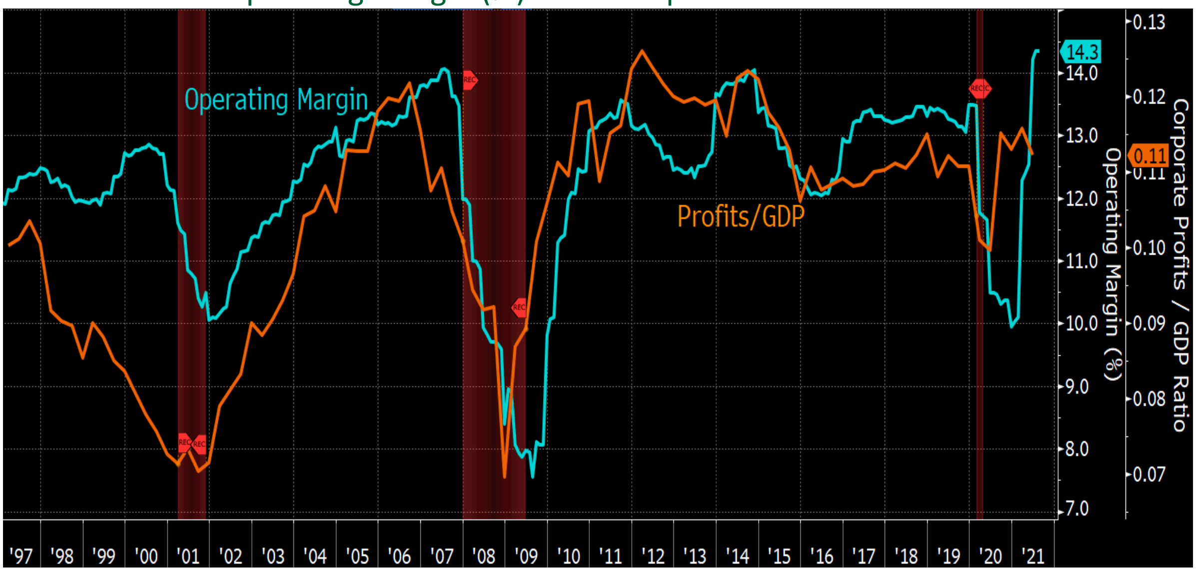
The current strong US earnings season has delivered a striking feature – the strong margin recovery. The Operating Margin has already recovered to a record level. This implies that top-line recovery has compensated well for cost rises. The fact that record profitability has been reached may be a surprise to many.

S&P 500 – Operating Margin vs Capacity Utilization (%)



A further striking feature is that this profitability has been reached despite overall capacity utilization still at relatively low levels. As economic expansion continues and capacity utilization rises further, it can probably absorb further cost pressures and support profitability further. All of this bodes well for further earnings growth.

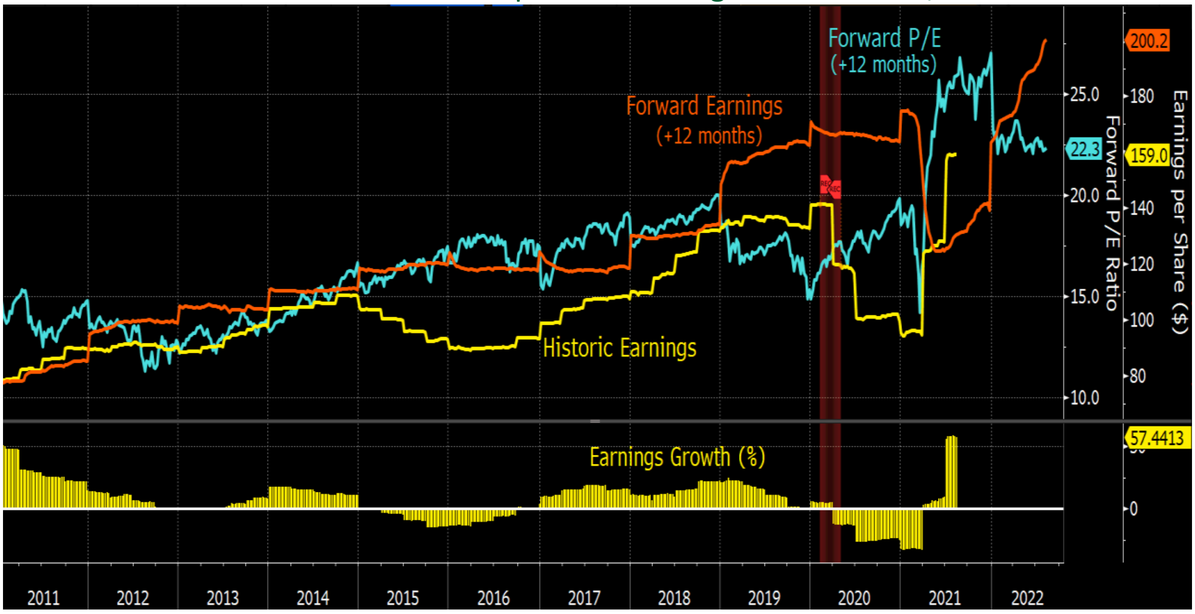
S&P 500 – Operating Margin (%) vs US Corporate Profits as ratio of US GDP



The ratio of US Corporate Profits against the overall GDP logically is correlated with the Operating Margin, as reflected in the above chart. This ratio is currently lagging the Operating Margin, and suggests further room for profit expansion. We believe all this argues in favour of equity investing.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. August2021. ***Past performance is not a guide to future performance.***

S&P 500 – Historic and Expected Earnings vs Forward P/E Ratio



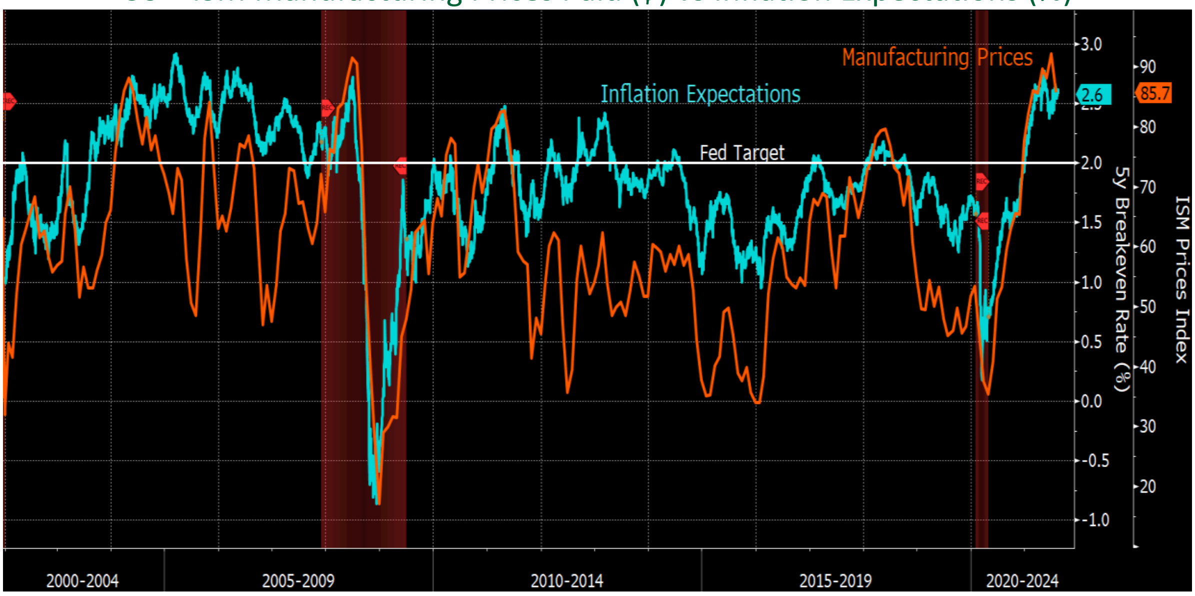
The yellow line in the above chart reflects the historic S&P 500 earnings. Following the recent excellent results season, a full recovery from the pandemic slump has now been achieved. In fact, the current earnings level is already 13% above its earlier peak level.

The orange line reflects the analyst consensus earnings expectations over the coming year. Expectations continue to rise, most recently at an even more rapid rate. The level of $200.2 a year from now reflects further growth of over a quarter. Although this level is half the current growth (+57%, the yellow bars), this is still very strong growth – off an already high base. Despite the rising share prices, the S&P 500 forward P/E ratio is already in a healthy derating process (the blue line).

2. INFLATION FEARS

We share the Federal Reserve's opinion that the current high US inflation levels may rather be transitory than structural. The following charts add further perspectives:

US – ISM Manufacturing Prices Paid ($) vs Inflation Expectations (%)



Inflation expectations (as derived from the five-year breakeven rate) seem to be rolling over from recent elevated levels (the blue line in the chart above). This series correlates with the ISM Manufacturing Prices Paid (the orange line). The latter seems to also be rolling over following its record recent level.

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

Commodity Prices – Indexed to 100 on 7 May 2021

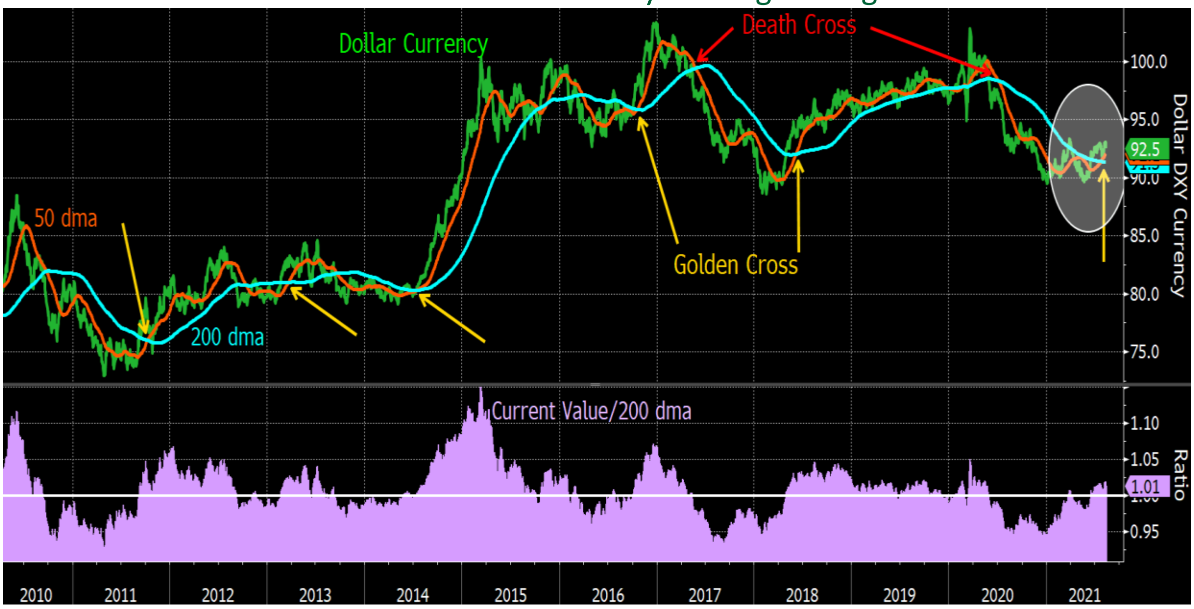
Supply line complications are a major threat to cost issues in the current economic recovery. The US Lumber Price was the first victim in this context as the US economy reopened. The price increased in multiples and then peaked on 7 May.

We have indexed several commodity prices to this date in the above chart, with striking results. Lumber has since dropped by 70%, close to its level immediately prior the pandemic. More importantly, the price of Iron-Ore has fallen by almost a quarter and Copper by almost a tenth. Gold also seems to be easing. Whilst some prices are still rising, these may be early confirmations of inflation in process of maturing.

3. DOLLAR CURRENCY

Many commentators have been concerned about a potentially materially weaker Dollar.

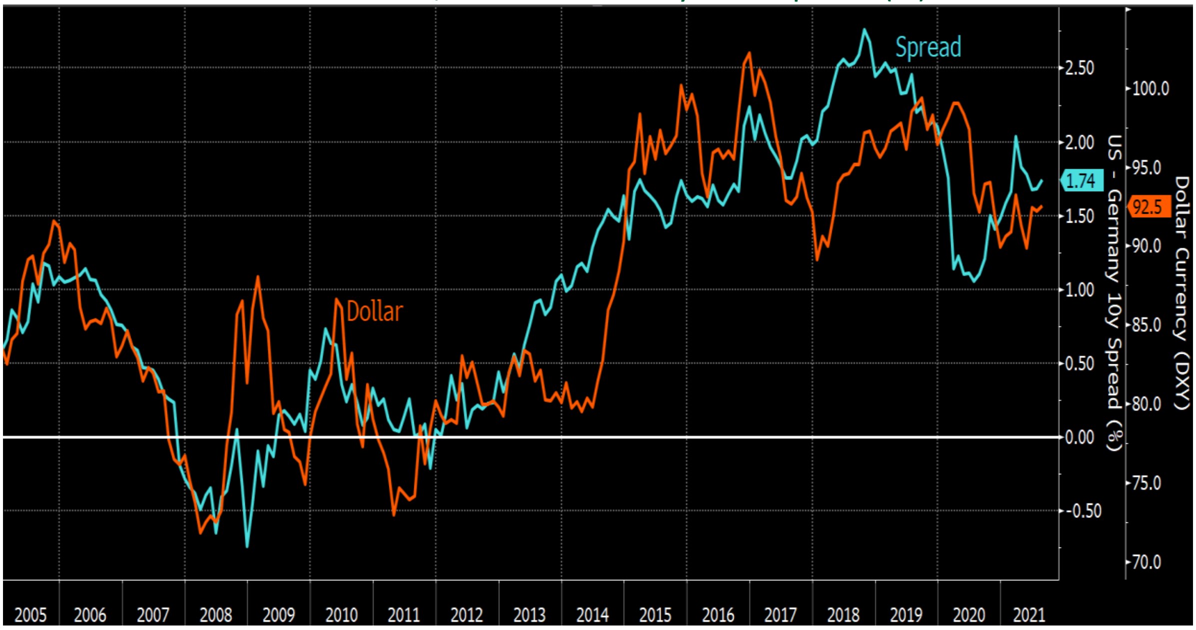
Dollar vs 50- and 200-day Moving Average



Technically the Dollar has recently registered a Golden Cross event – historically an argument to stay on the currency's side. This view is also reflected in the Dollar futures market where the number of long contracts exceed the number of short contracts at an accelerating level since June.

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

Dollar vs US/German Treasury Yield Spread (%)



One of the strong arguments in favour (or against) a currency is obviously the level of domestic interest rates compared to international rates. The above chart reflects the spread between the US and Germany's 10-year Treasury yields. Despite the lower recent US yields, the current spread still argues in favour of the Dollar.

We would be cautious to bet against the Dollar on shorter term considerations.

4. FINANCIAL STRESSES

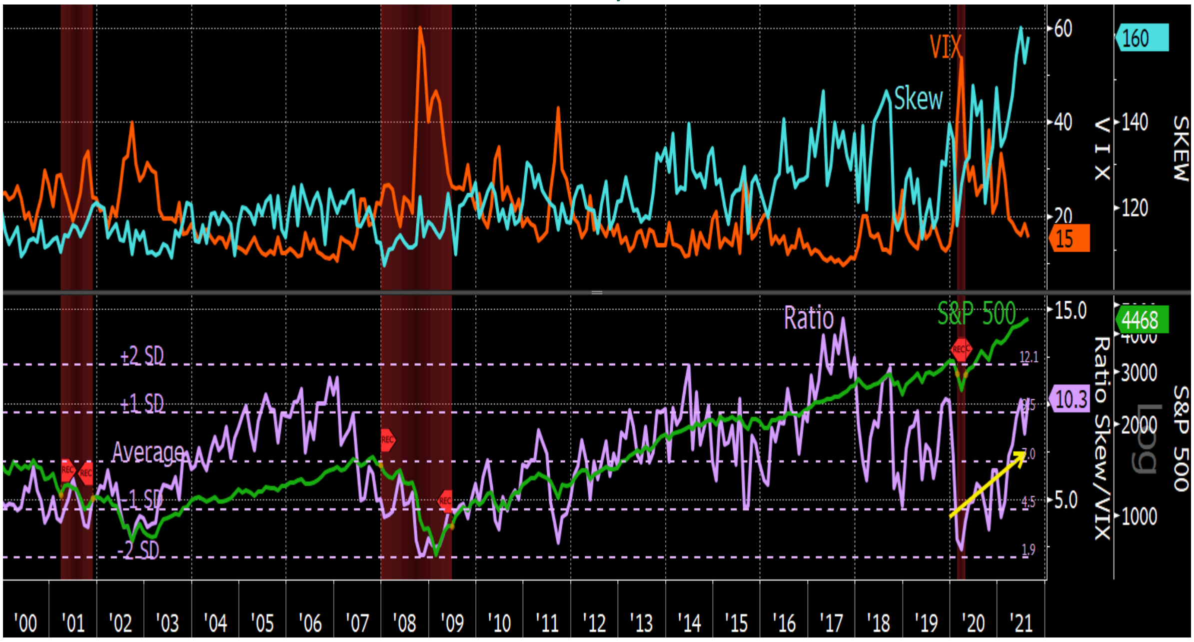
We follow a number of stress indices to asses the risks in the capital markets:

Merrill Lynch Global Financial Stress index vs MSCI World Index

The above stress index reflects a cross market index of risks derived from hedging demands and investment flows. A level below zero reflects below average risk (the chart is presented on an inverse scale). It is currently at a minus half standard deviation away from average, a supporting level for further share price performance.

The following chart considers the VIX equity and SKEW bond market volatility indices. The ratio between the two is a handy stock market risk indicator:

VIX and SKEW Volatility Indices vs S&P 500



The VIX/SKEW ratio (bottom chart) is currently in a rising trend, and at an attractive level. This seems supportive of the S&P 500.

Yuan Currency, US Corporate Bond Spread & Yield Curve and German Bund Yield (%)

Along with the technical indicators, the more fundamental ones in the above chart (Yuan Currency strong, US Corporate Bond Yield low, US Yield Curve at a reasonable level, Bund Yield recently close to zero), seem to reflect the overall capital markets picture to be in fair shape with no clear warning signals.

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

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