GLOBAL EQUITY PERSPECTIVES 28 JANUARY 2019

*"The more I live, the more I regret how little I know."*

*Claude Monet*

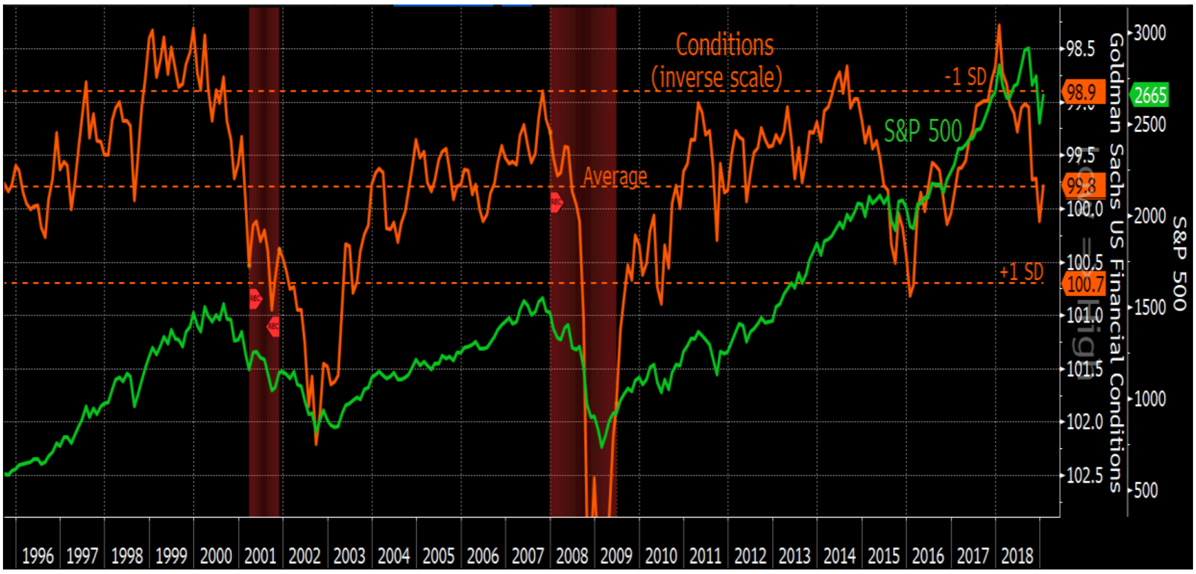
## 1. MARKET CONDITIONS

We monitor several indices reflecting general capital market conditions. Each one considers the sponsor's perceptions of the capital market environment, including stresses in the financial system.

Bloomberg US Financial Conditions+ Index vs S&P 500


The above index considers overall stresses in the overall money, bond and equity markets, along with indications of asset bubbles to assess financial market conditions. It also serves as a leading stock market indicator. We notice that it did not overreact with the recent stock market volatility, with the most recent readings turning upwards.

Goldman Sachs US Financial Market Conditions vs S&P 500




Goldman Sachs's financial markets conditions index also serves as a leading indicator at its peaks and troughs and portrays a similar environment. It has recently moved beyond its average reading, but has since recovered.

*Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2019. Past performance should not be used as a guide to future performance.*

BofA Merrill Lynch Global Financial Stress Index vs MSCI World AC Index


Merrill Lynch's global financial stress index has been portraying a less constructive picture for most of last year. It has recovered well recently and is currently on a neutral level with no clear guidance.

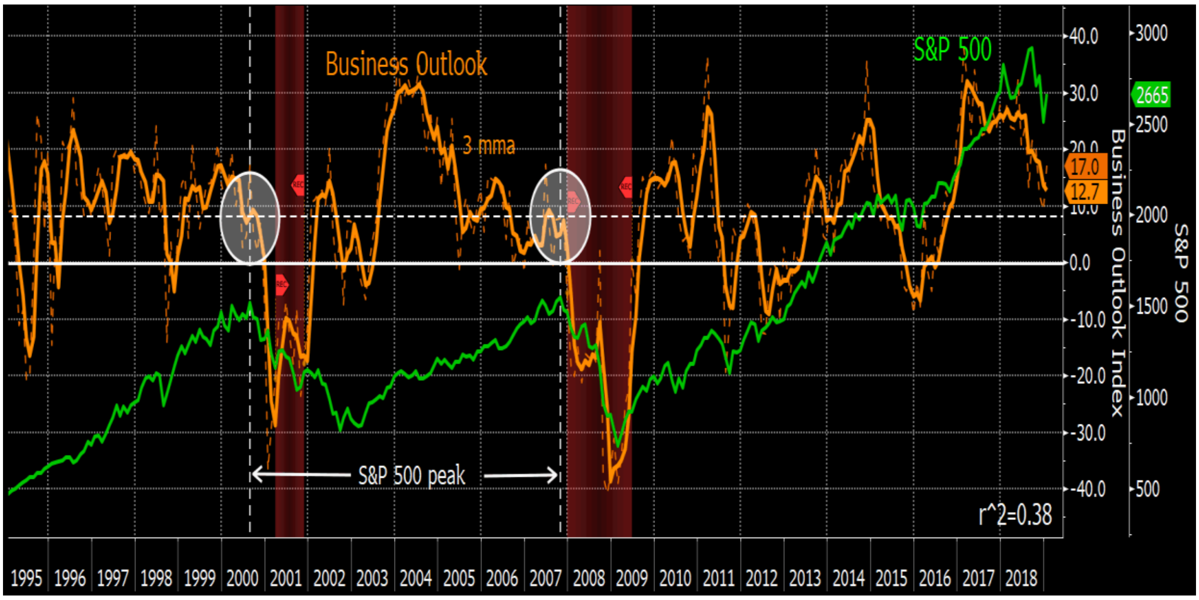
All-in-all, the US financial market conditions seem to remain constructive, and more so than the international markets.

## 2. BUSINESS OUTLOOK

We frequently update our clients with the most important leading economic indices. Their basic message continues to reflect a constructive picture, but with a moderating outlook.

The following chart reflects the general US business outlook:

Philadelphia Federal Reserve US Business Outlook Index vs S&P 500




The Philadelphia Fed's business outlook index is a valuable stock market leading indicator. It has historically provided a clear warning for an upcoming recession. Along with these, it has historically called for a stock market peak when its reading drops to a reading of 8 points (indicated with the dotted lines on the chart).

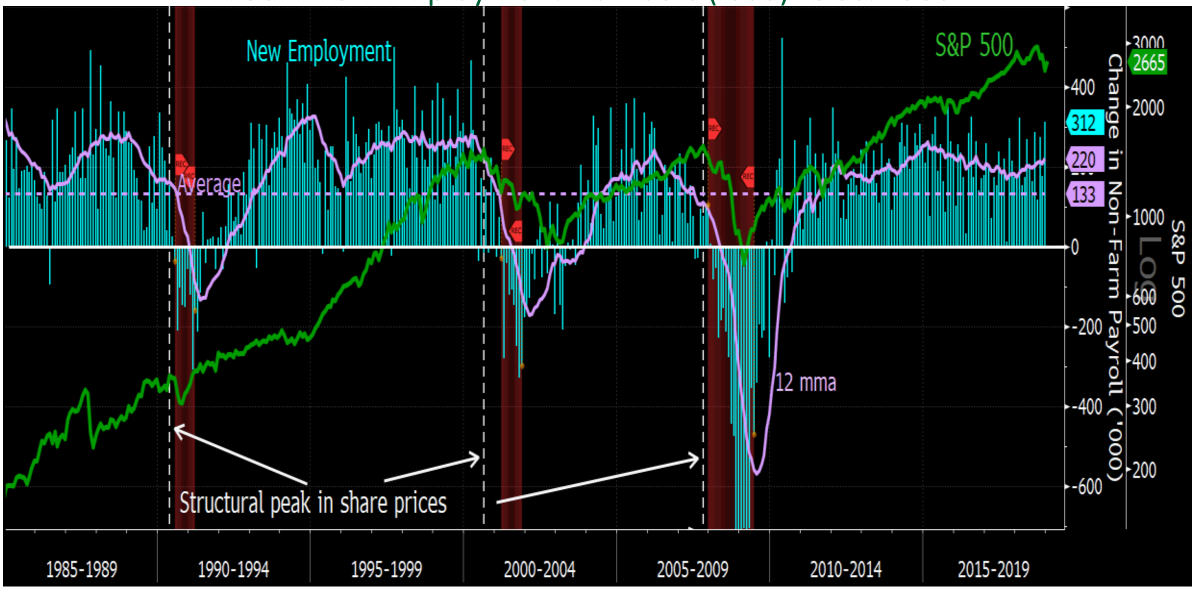
The index has been moderating from elevated levels for most of last year but continues to stay above the 8 reading. The most recent reading rose to a level double this warning level.

*Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2019. Past performance should not be used as a guide to future performance.*

## 3. EMPLOYMENT

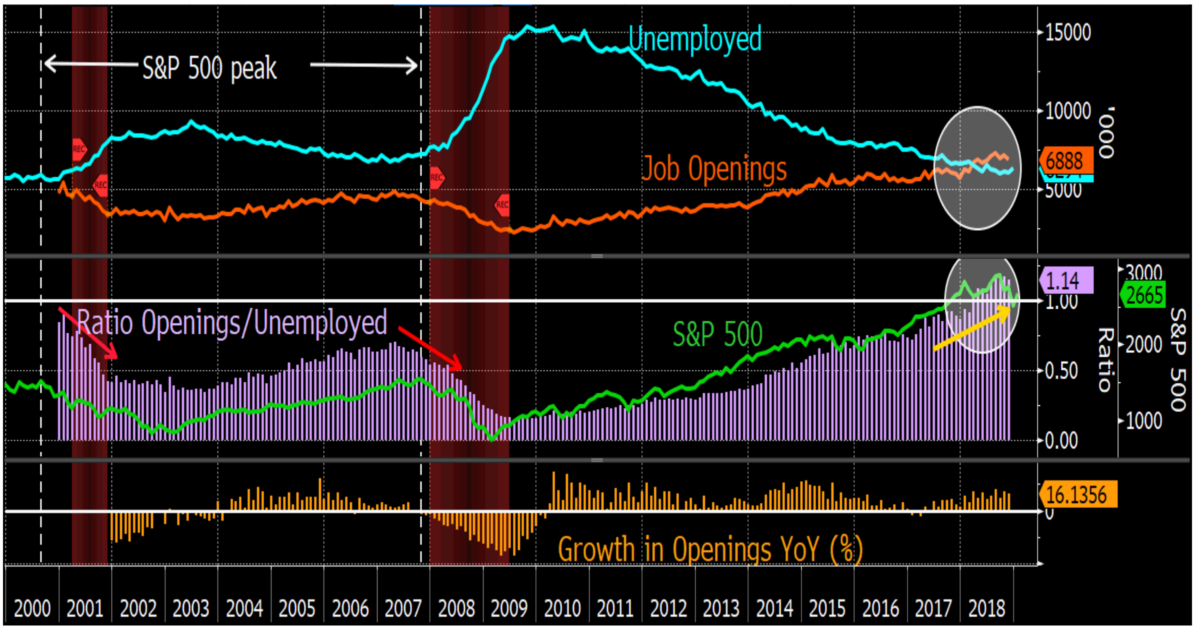
Employment data is critical for most financial market considerations. US employment data remain resilient as reflected in the following chart:

US – New Employment Numbers ('000) vs S&P 500




New employment numbers historically dropped long before the respective recessions kicked in. New employment in December was at a high level 312,000, especially for a December. The current 12-month running level (220,000) is 65% in excess of the long term average of 133,000.

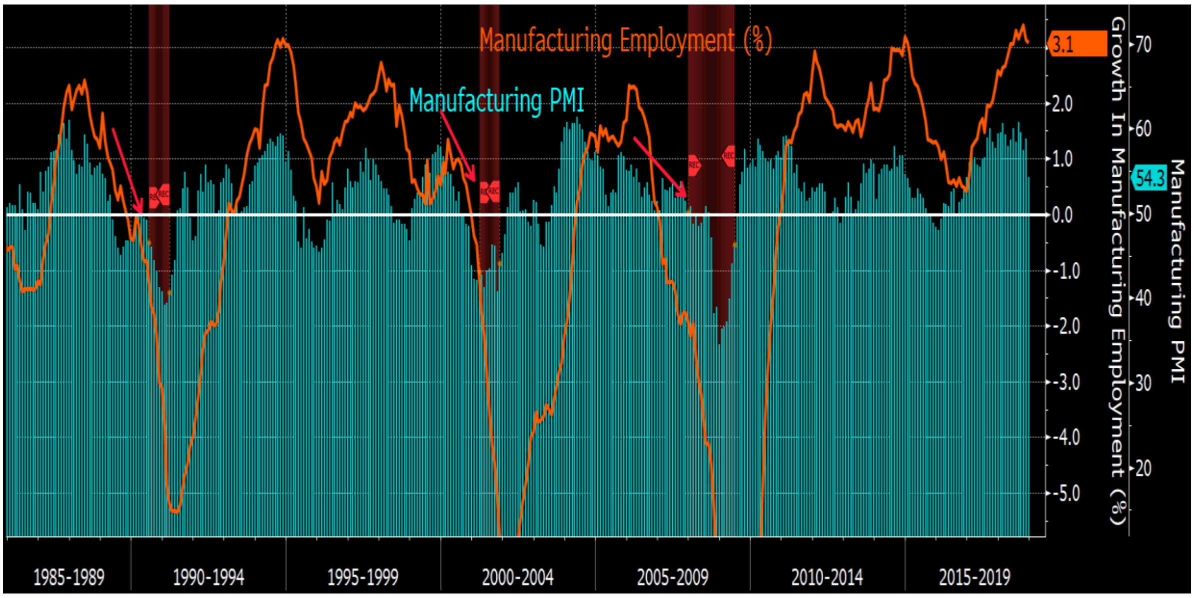
US – New Job Openings vs Unemployed Numbers ('000)




The number of new job openings exceed the number of unemployed people by 14%, with a growth of +16% in the number of openings. Both the trend of openings growth and the ratio of openings to unemployed in the above chart remain constructive.

Whilst the manufacturing component of the US economy is the smaller portion against services employment, it is more volatile and serves as a valuable indicator of changes to come in the overall economy. We show in the following chart the growth in manufacturing employment with the manufacturing PMI index, both strong leading economic indicators. PMI data is rolling over, but still indicates healthy expansion. The growth in employment is also rolling over, but from a record level of more than 3%. This continues painting a positive economic outlook picture.

US – ISM Manufacturing PMI Index vs Growth in manufacturing Employment (%)

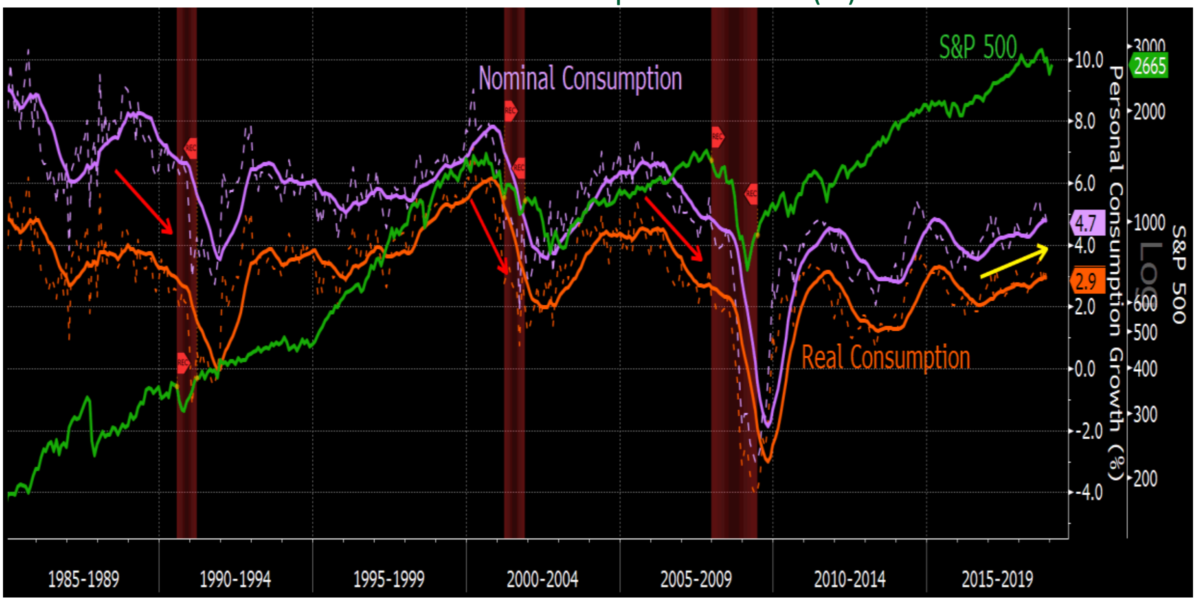



All-in-all, US employment seems healthy, supporting the US economy well.

## 4. CONSUMER MARKET

US Consumption has grown to over 70% of their GDP and the health of the consumer market remains critical for stock market performance.

US – Nominal and Real Consumption Growth (%) vs S&P 500

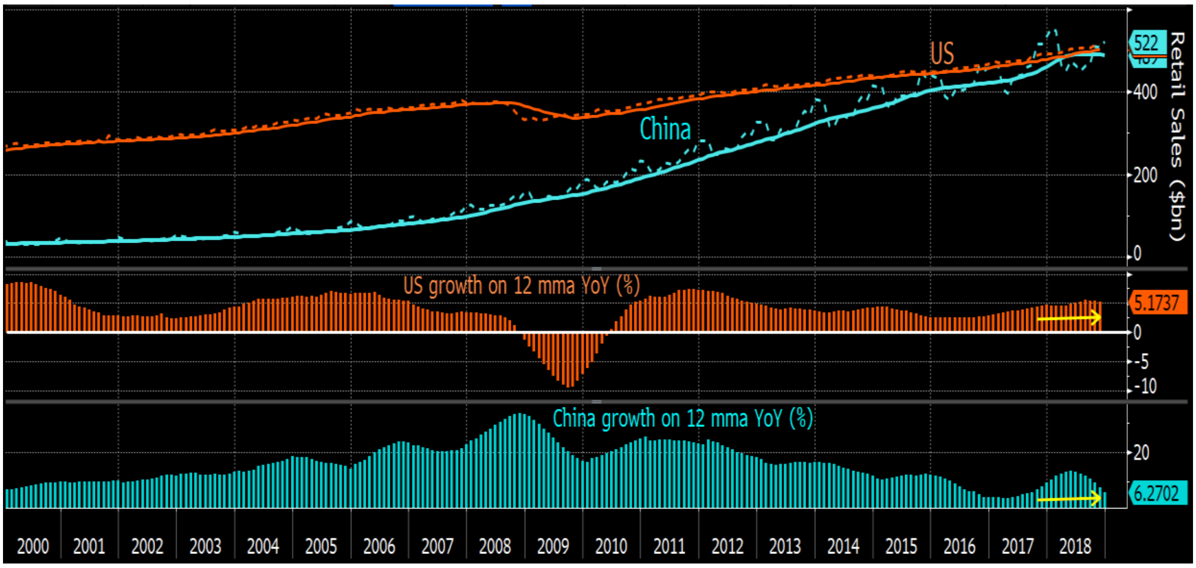



The rate of nominal and real US consumption growth is still accelerating (at +4.7% and +2.9% respectively). Historically these growth rates decelerated in the run-up to the respective upcoming recessions. The current situation therefore seems constructive in this context.

Retail sales clearly are a good barometer of consumption. We show the value and growth of retail sales in the US and in China in the chart following on the next page, both series in US$ terms.

US growth remains steady at +5%, a very solid number reflecting a confident US consumer market. In nominal value terms, Chinese retail sales have caught up with the US retail sales. Strikingly, though, in growth terms their sales have decelerated quite materially (also in Renminbi terms), but at +6% is still exceeding the US growth figure.

US and China Retail Sales ($ terms)




Overall, the US consumer and consumption markets seem to remain strong. There are some reservations about the deceleration in China.

## 5. RECESSION FEARS

We often comment about our perceptions of the risks for an approaching US recession. The following two charts serve as short updates:

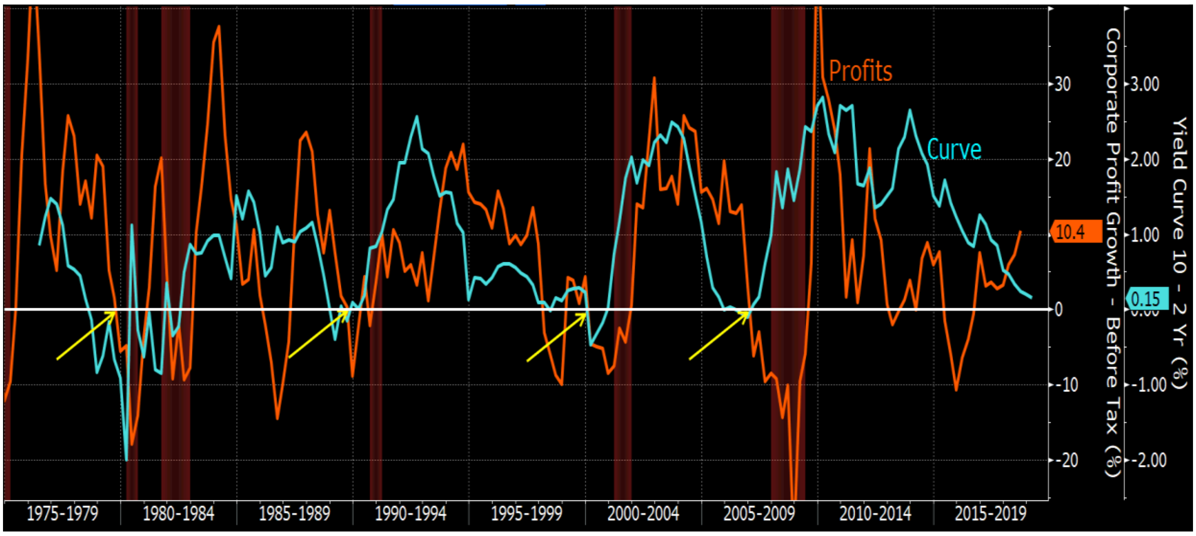
US – Recession Probability vs S&P 500


The above chart shows the NY Fed's recession probability index along with the S&P 500 index. The probability value has been rising materially over the recent months, currently reflecting a 21% probability.

The chart shows the earlier events when the probability index had similar readings (see the yellow dotted lines). It also shows the timings of the stock market peaks following those events (the red dotted lines), and the time periods between the relevant events (the yellow arrows). On this basis, the stock market peaks on average 22 months after a 21% probability reading, and a recession starting even later than that.

The following chart shows the growth in US corporate profits (before tax) along with the yield curve. The main premise is that both profit growth stagnates and that the yield curve inflates some time before recessions kick in.

US – Growth in Corporate Profits Before Tax (%) vs Yield Curve (%)

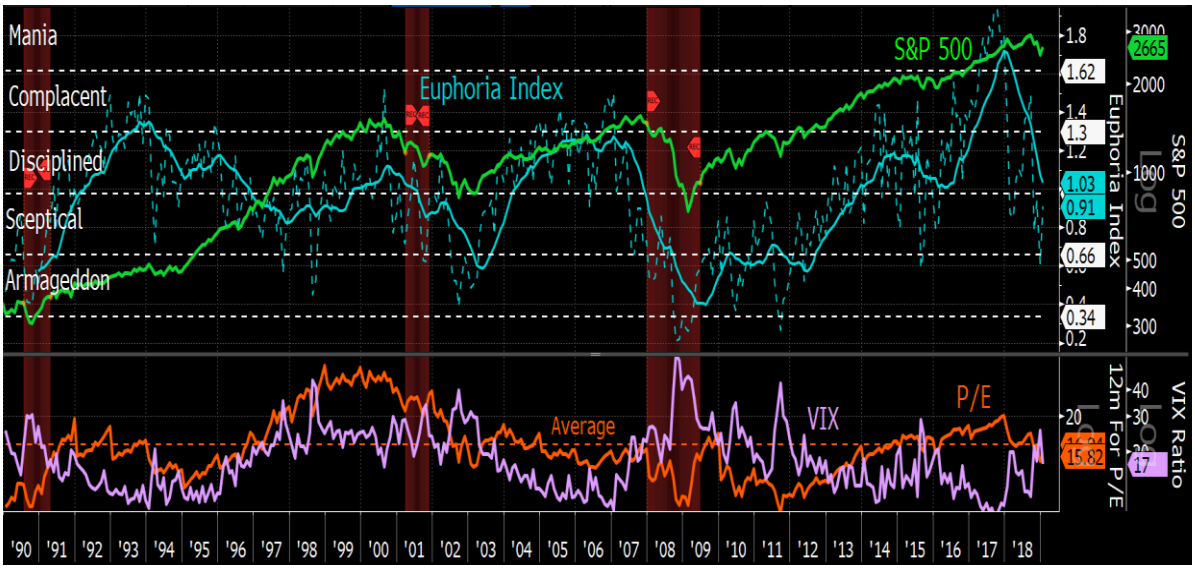



Neither of the said conditions are in place yet. On this basis, we believe we cannot expect an imminent recession.

## 6. EUPHORIA

We measure the level of investor euphoria by adjusting the earnings valuation levels with the stock market volatility and categorising these readings between armageddon (extreme fear) and mania (extreme optimism) categories:

Euphoria Index vs S&P 500




Euphoria readings have recently dropped sharply, touching armageddon levels. They are currently between sceptical and disciplined levels. We perceive this as a healthy investment environment.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*Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2019. Past performance should not be used as a guide to future performance.*

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