GLOBAL EQUITY PERSPECTIVES 4 MARCH 2019

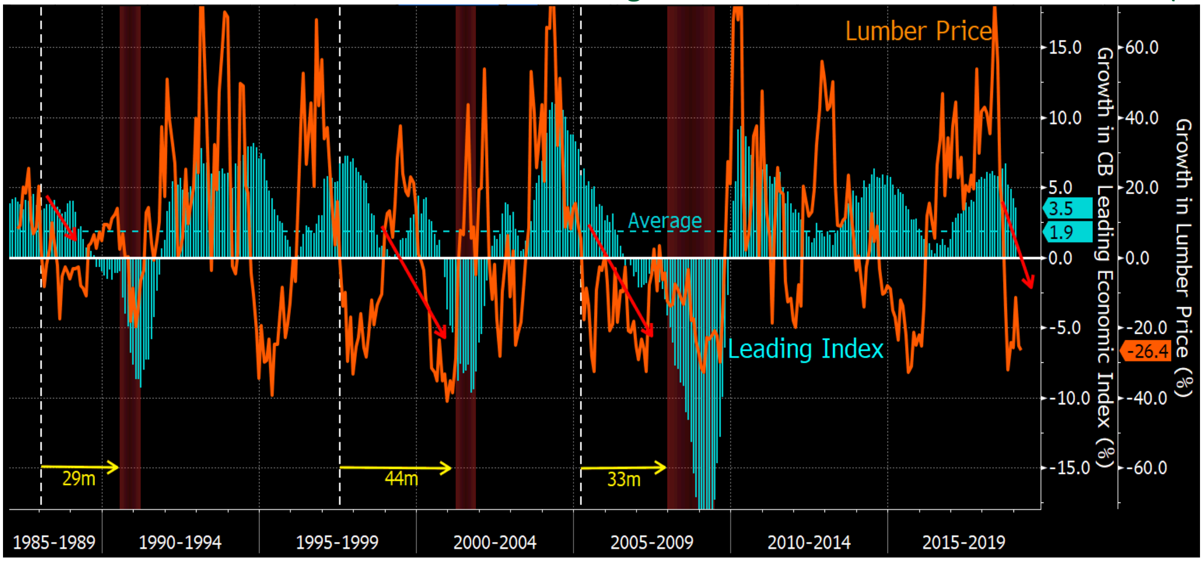
"It's not the mountain that we conquer but ourselves."

Sir Edmund Percival Hillary

1. LEADING INDICATORS

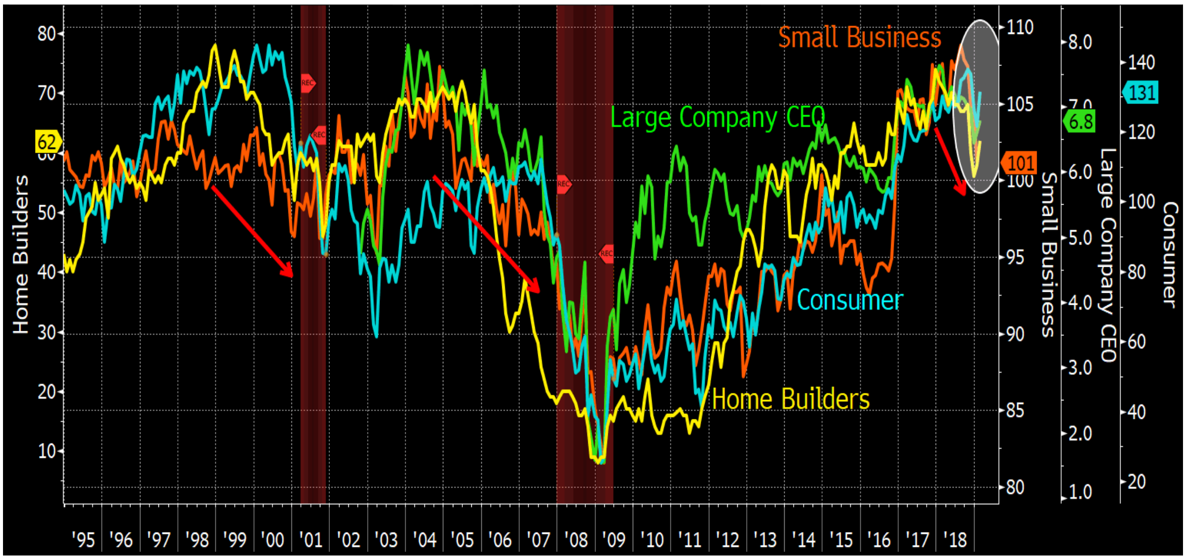
We often start our note with a chart of a leading economic indicator to understand the risk of an imminent recession in the US. The following chart is useful in this context:

US – Growth in the Conference Board Leading Economic Index vs the Lumber Price (%)



The US lumber price serves as a very early indicator to the leading economic index. Its growth stagnated in August last year. Based on historic patterns this indicates the next US recession may start sometime in 2021. Whilst the leading economic index follows lumber's downward trend it is still almost double its historic average and does not yet provide recession warnings.

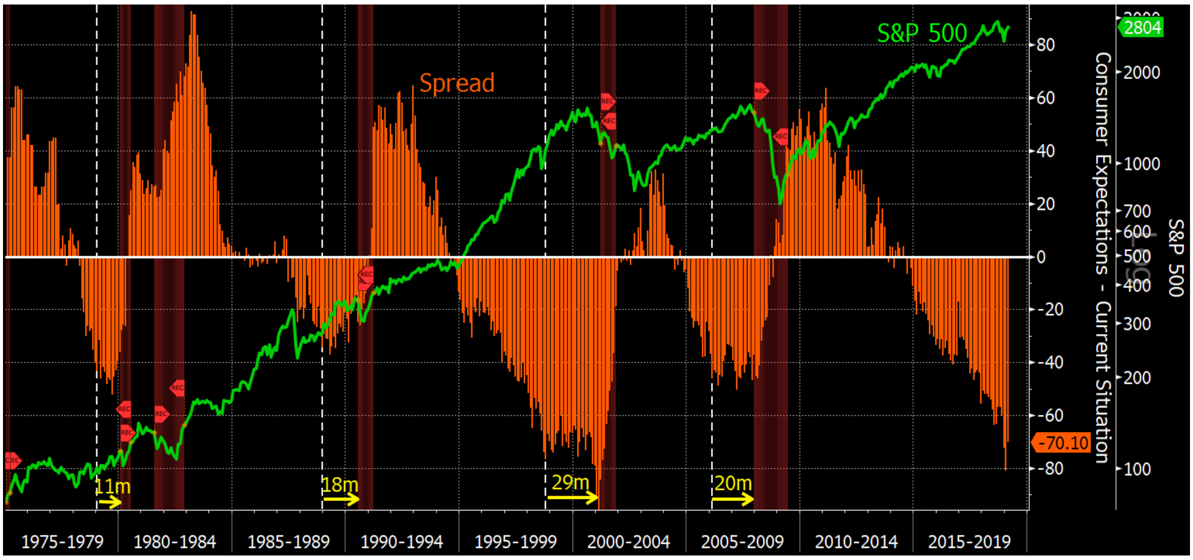
US – Confidence Indices



All of the Home Builder, Consumer, Large Company CEO and Small Business confidence indices seem to be in a new downward trend, though still at elevated levels. Apart from the latter index, all the others' most recent readings have bounced back. These indices all remain constructive and do not reflect imminent risk of an US recession.

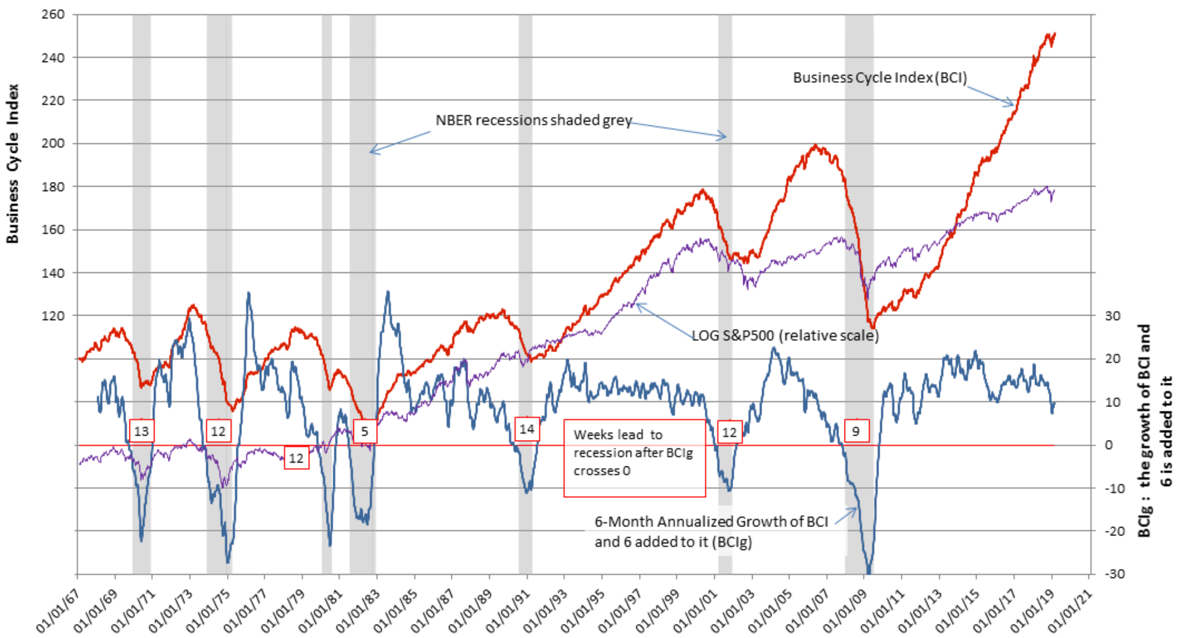
Source: Bloomberg & Stonehage Fleming Investment Management Limited. March 2019. Past performance should not be used as a guide to future performance.

US – Spread Between Consumer Expectations and Current Situation vs S&P 500



Consumer confidence remains one of the most important capital market factors. The above spread between their future expectations and their current situation also serves as a valuable recession warning. Some see the current low reading as a risk factor. We notice that historically the spread first stabilised at a certain (low) level quite some time before the inception of a recession (see the vertical lines, well before the respective S&P 500 peak levels. On this basis the next US recession can be expected in the second half of 2020.

iM Business Cycle Index vs S&P 500



Source: iMarketSignals.

The Business Cycle Index in the above chart is calculated from seven US economic data series. Its growth is reflected in the blue line at the bottom of the chart. It effectively forecasts an upcoming recession well ahead of time when its growth stagnates. The growth level has earlier this year halved to below 10%, but currently is increasing again. This independent source also does not indicate risk of an imminent US recession.

All-in-all, we are conscious of being in the later US economic cycle, but it seems to be more an issue of moderating growth than material risk of negative economic growth. On this basis we expect US company earnings and dividends to continue growing through 2019.

The US reporting season for 4Q2018 is almost complete. Top-line S&P 500 company growth of +6.0% and bottom-line growth of +12.0 (respectively +1.0% and +3.6% against consensus expectations) remains healthy. These growth levels may halve over 2019 but will then still leave forward valuations at fair historic levels on an absolute basis.

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

2. CHINA ECONOMY

There have been many reservations about the outlook for the Chinese economy. Whilst growth levels on a number of fronts have moderated (e.g. retail sales moderating from more than +10% to more than +8%), we are starting to see some encouraging signs of stabilisation.

China – Yield Curve (%) vs Shanghai Composite

The yield curve flattened early last year (with a negative effect on share prices) but steepened since. It has recently spiked, with a corresponding recovery in share prices. This reflects an improving view of the Chinese market.

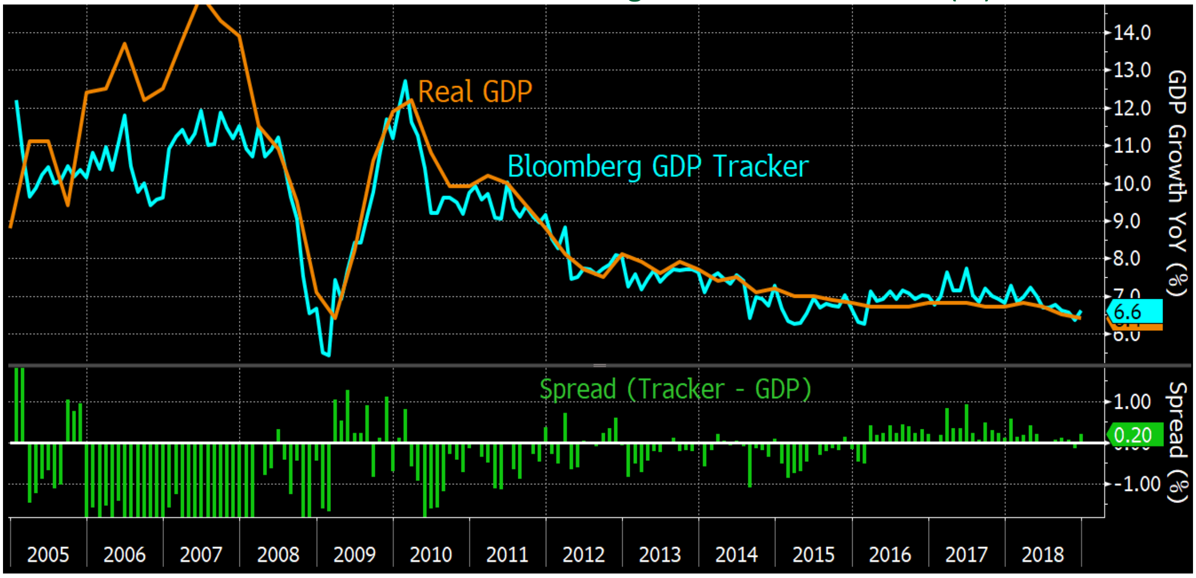
China – Copper Price ($) vs Shanghai Composite

The historic general positive correlation between the copper price and Chinese share prices has grown over the recent past. The copper price is currently picking up, with the corresponding positive effect on share prices.

We show on the next page the real Chinese GDP chart along with Bloomberg's calculation of these economic statistics. Both series moderated through 2018, with the official GDP for the year at +6.4%. Bloomberg's most recent reading is ticking upwards. Electricity consumption growth moderated through 2018 to below +5% but ended the year at above +5%.

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

China – Real GDP vs Bloomberg GDP Tracker Growth (%)

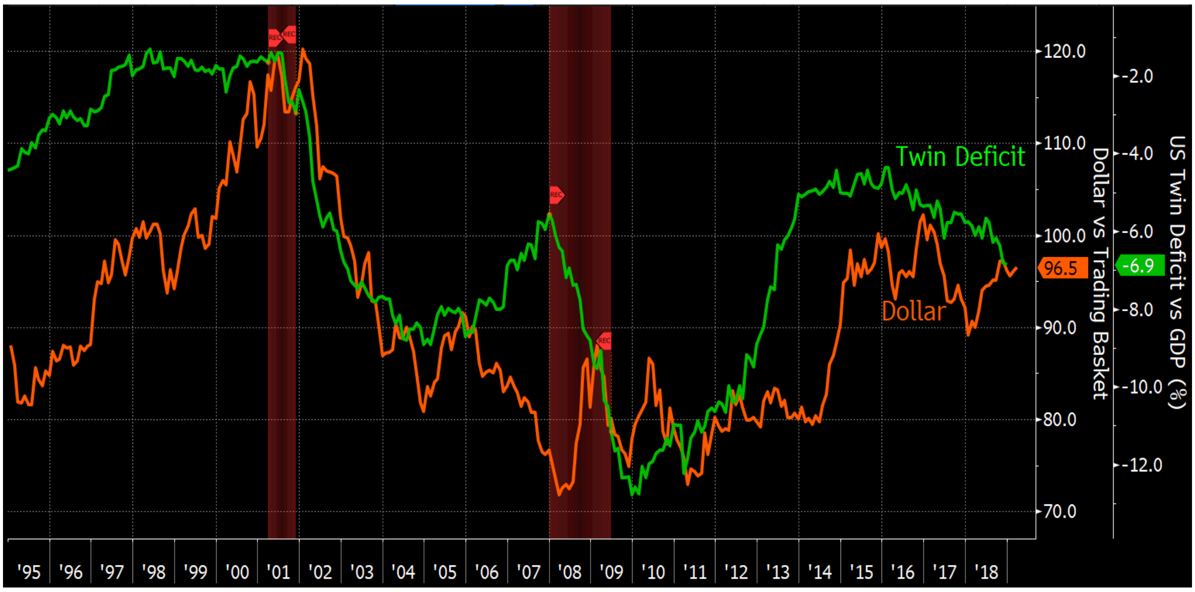


We do not yet find concrete data to be overly confident for increasing Chinese GDP growth, but similarly do not see contrasting negative data. Along with an improving Emerging Market theme we conclude a 'glass half full' approach to China following their weak equity market in 2018.

3. DOLLAR CURRENCY

The Dollar strengthened recently along with the increase in President Trump's approval rating after his State of the Union address. His rating is back at its peak level of 44%, with probably more room for disappointment from here than for a further increase. Should the currency be linked to the president's approval rating at all, we can therefore rather expect a weakening Dollar from here.

US – Twin Deficit (%) vs Dollar Currency

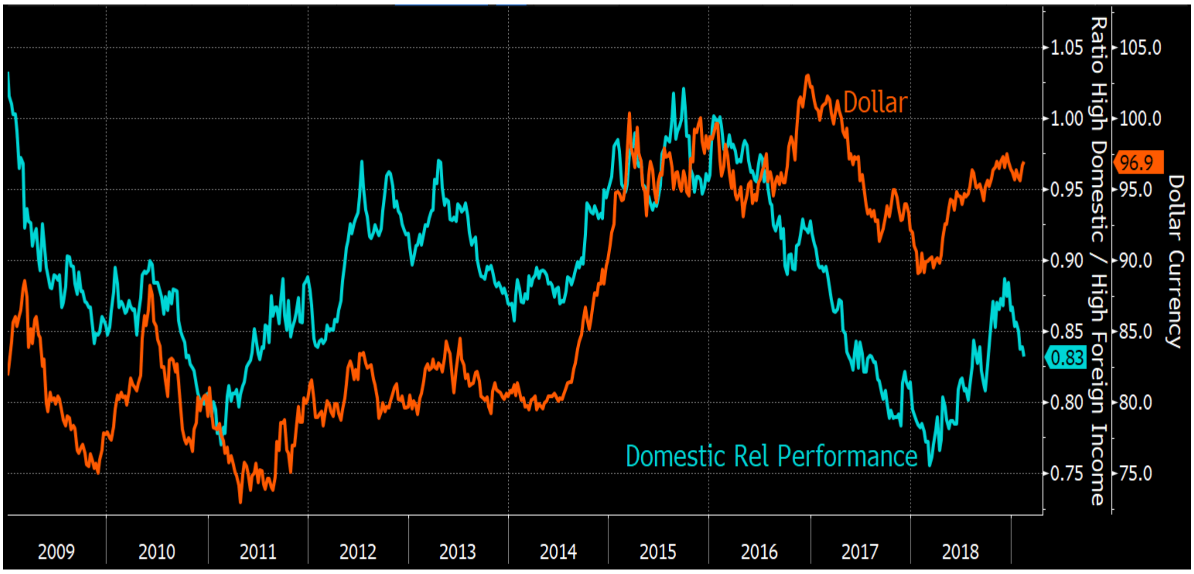


The US's twin deficit keeps growing, currently at -6.9% of GDP. Barring the trade negotiations with China, President Trump's spending plans can most probably stretch the fiscal deficit even further with the corresponding pressure on the Dollar, continuing its current roll-over process. We won't be surprised if the president does not mind 'managing' the currency through spending.

We show in the following chart the relative performance of more domestically orientated shares along with the Dollar.

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

US – Dollar Currency vs Relative Performance of Domestic Orientated Shares



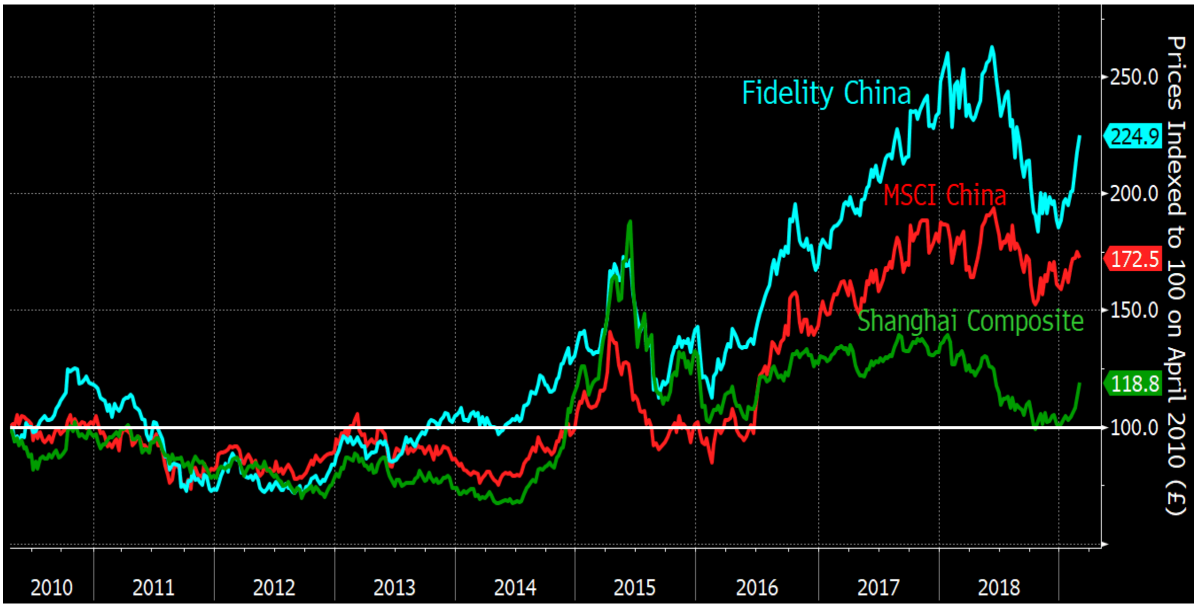
Domestically orientated shares have turned their positive relative performance through 2018 to a negative trend this year thus far despite the recent spike in the Dollar. These equity investors seem to discount a weaker Dollar. We must take cognisance of these new developments.

4. CHINA, INDIA, ESG INVESTING

MSCI announced last week that it is increasing its inclusive factor for Chinese shares in its Emerging Market index, and that it is bringing forward the target date from May 2020 to August 2019. This is expected to support Chinese shares other things being equal.

We believe many of the Emerging Markets offer good stock picking opportunities rather than simply copying the benchmark indices. The following chart of the Fidelity China Fund's performance since its listing in 2010 confirms this:

Fidelity China Performance Indexed to 100 at Listing vs China Indices (£)

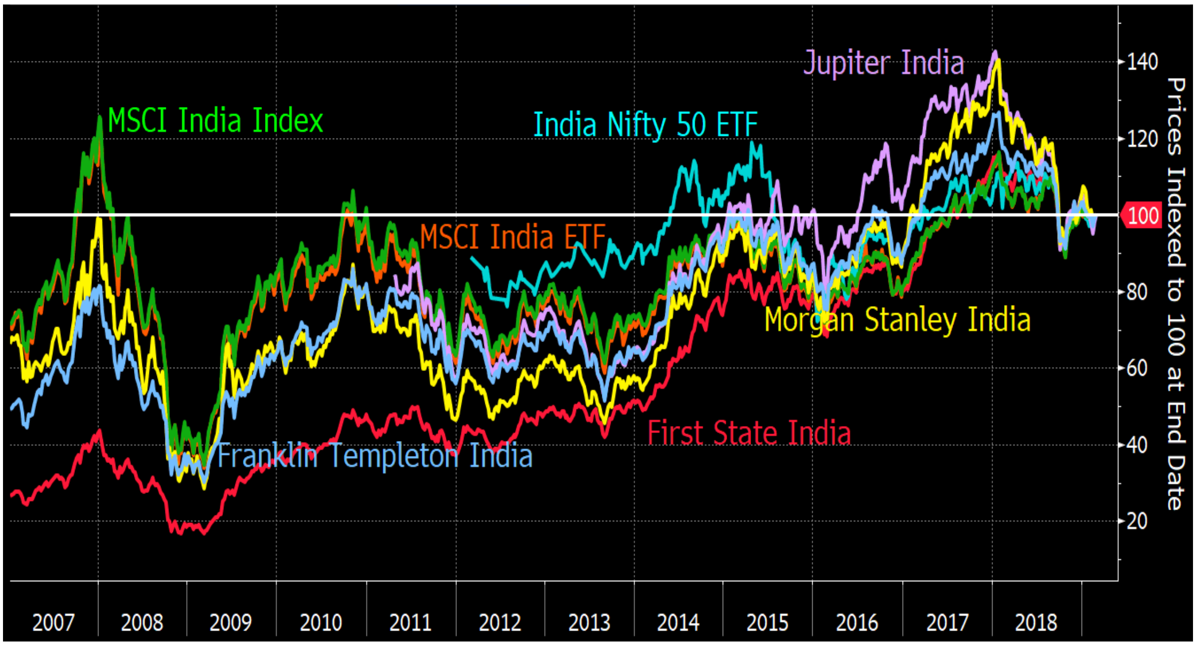


Fidelity China has performed much better than both the MSCI and Shanghai indices since listing on the London stock exchange.

We present in the following chart the picture on India. We index the current values to 100 to illustrate the best historic buying opportunities.

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

India Funds vs Indices – Current Value = 100



The India funds in the chart have generally done better than the India indices (their historic values are lower than those of the indices most of the time). This implies good stock picking opportunities in that market.

We get a similar picture when we consider stock picking opportunities in Emerging Markets in the context of Environmental, Social & Governance (ESG) issues:

Emerging Market Index Performance vs Emerging Market ESG Index Performance
Indexed to Current Value = 100

The index of ESG Emerging Market companies have outperformed the standard Emerging Market index by far (the green chart above). In terms of offering buying opportunities, the ESG index (orange line) has by far most of the time been below the standard index (blue line). This reflects good stock picking opportunities amongst better governed companies in Emerging Markets.

5. US YIELD CURVE

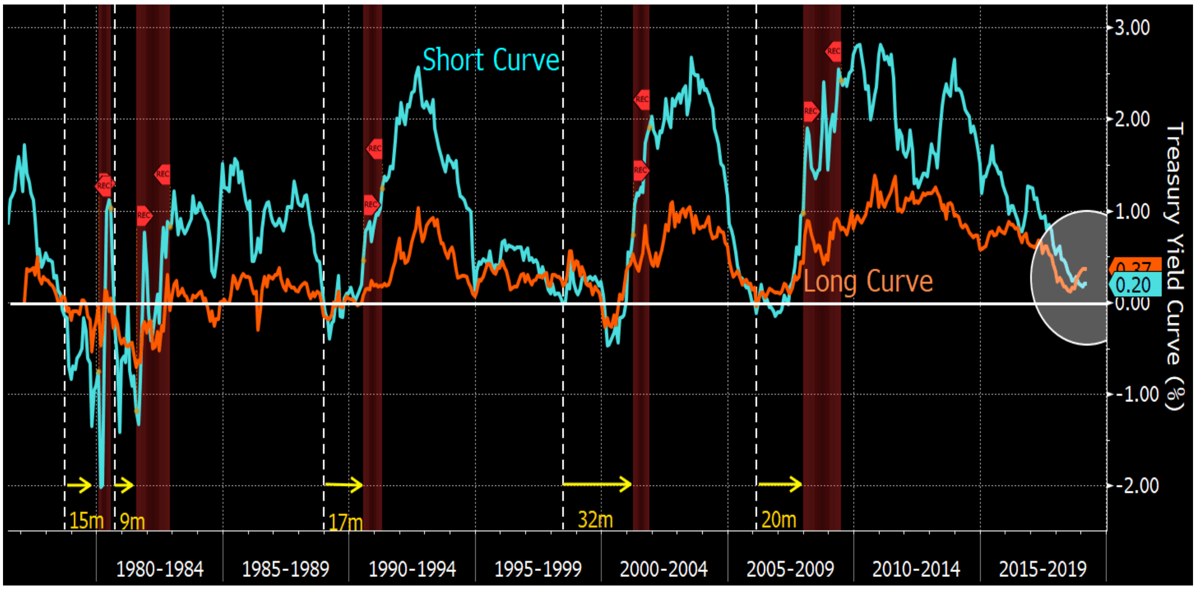
Following the fright markets took last year from the flattening yield curve, we often update clients on the current situation in this context:

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

US – Very Short Yield Curve (%)

The sceptics used the short curve because it was the one that flattened. It is still flat and has not inverted. After it inverts, it historically preceded an upcoming recession by more than a year-and-a-half on average.

US – Standard Yield Curves (%)



The standard yield curves have not flattened yet, with the most recent trend seemingly steepening. This portrays a rather stable economic environment and does not yet raise alarms for an imminent recession.

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