GLOBAL EQUITY PERSPECTIVES 18 MARCH 2019

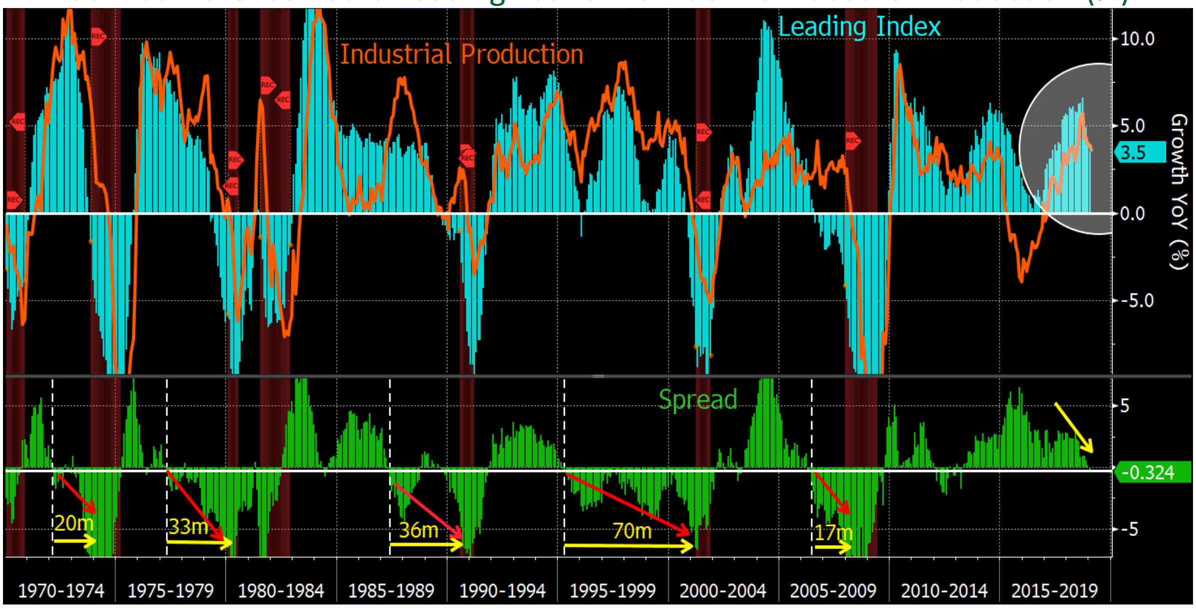
"The stock market is designed to transfer money from the active to the patient."

Warren Buffett

1. LEADING US INDICATORS

The combination of the Conference Board's index of ten leading economic indicators and industrial production serve as a solid barometer of the health of the US economy:

US – Conference Board Leading Economic Index vs Industrial Production (%)



Both these indicators are growing at a more moderate rate currently, but still at an elevated level of +3.5%. This level of growth has historically been structurally constructive towards equity investing. Furthermore, the spread between these two series (the green bars in the above chart) has historically served as an even earlier warning against the risk of an upcoming recession. It has just turned neutral, but on the basis of its long lead-times (see the yellow arrows) we do not yet foresee an imminent US recession.

US – Consumer Confidence Indices

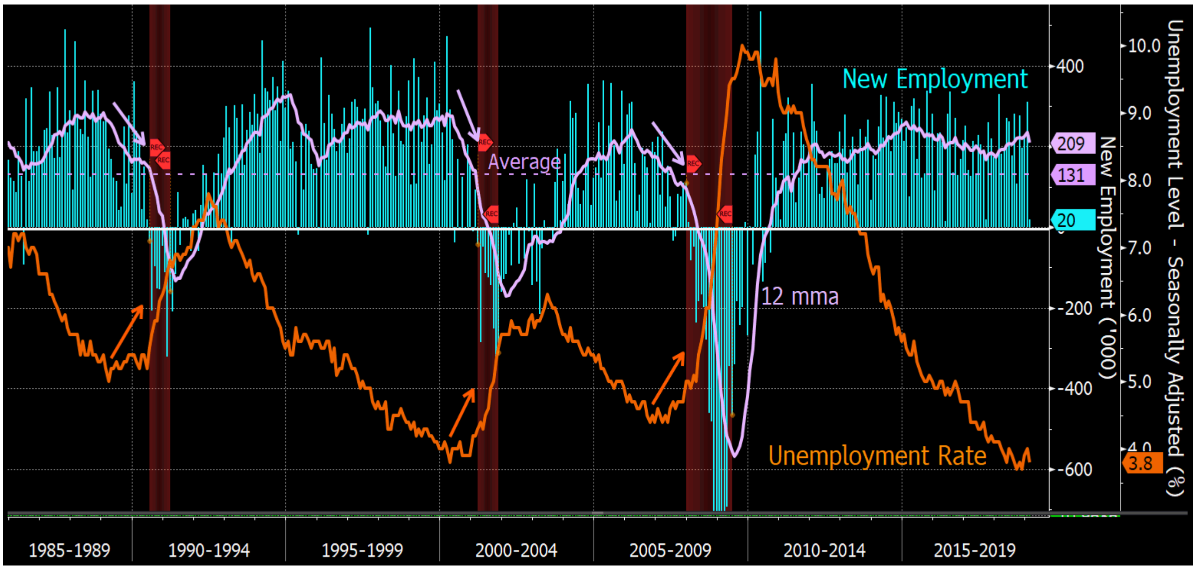
Source: Bloomberg & Stonehage Fleming Investment Management Limited. March 2019. Past performance should not be used as a guide to future performance.

Against the backdrop that personal consumption dominates the US economy, both the Conference Board and University of Michigan consumer confidence indices are still at elevated levels. They seem to be rolling over, but the February readings have increased again and are way beyond their respective average levels. With the former index being more volatile, the spread between the two series also serves as a handy early warning indicator (see the red arrows in the bottom section of the preceding chart). This spread still seems to be in a rising trend and therefore we conclude that we can continue relying on the US consumer to support economic growth and the capital markets.

2. DRIVER OF US GROWTH

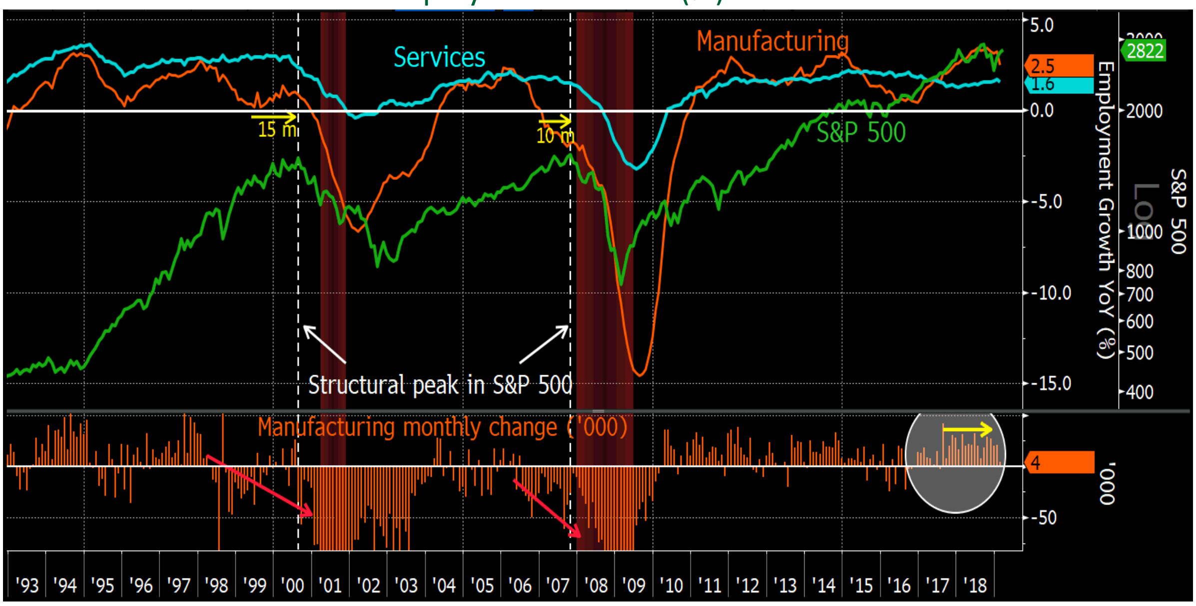
Markets were spooked by a very low new employment number of only 20,000 in February. This followed a very high number of 311,000 in January. We are therefore careful not to make negative conclusions too early in this context. We consider this aspect in the following charts:

US – New Employment ('000) vs Unemployment Rate (%)



The twelve month running average new employment number at 209,000 is still well above the long term average number of 131,000. It is not yet clear that this running average has changed its positive trend – a negative trend has historically been a precondition for a new recession to take effect. Furthermore, the unemployment rate has dropped again, whilst a rising trend preceded an upcoming recession by at least one year. We can therefore see no more than an amber light in current US employment numbers.

US – Employment Growth (%) vs S&P 500

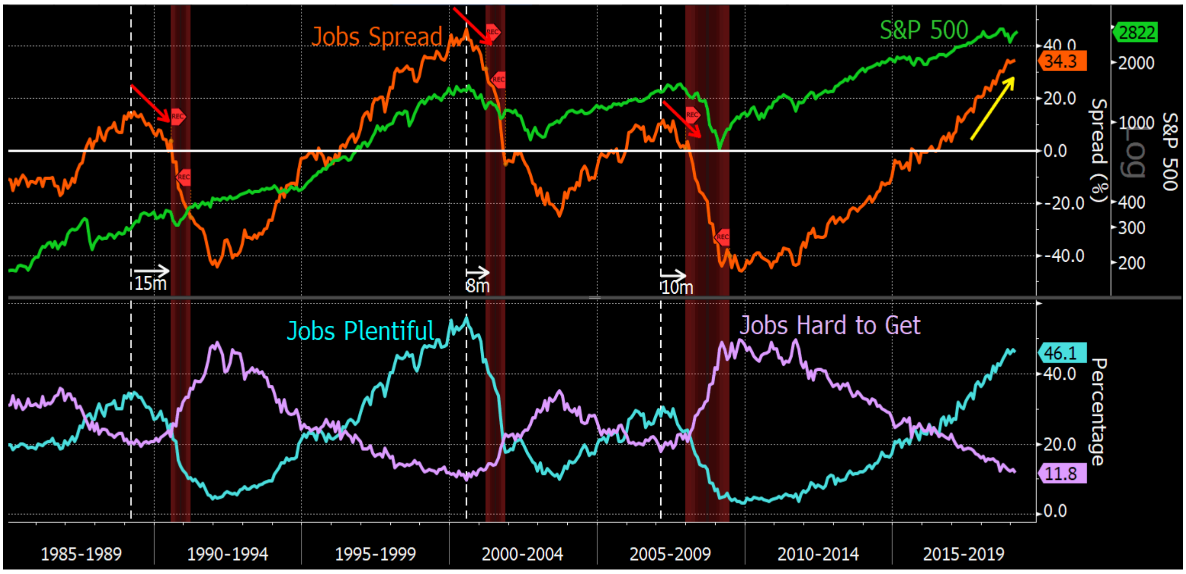


Source: Bloomberg & Stonehage Fleming Investment Management Limited. March 2019. Past performance should not be used as a guide to future performance.

Despite the stable nature of employment in the Services sector, employment in the Manufacturing sector is a critical swing factor in the US econpmy. Stagnation in the latter historically preceded the peaks in subsequent stock market levels by around one year (see the yellow arrows in the preceding chart). Growth seems to be rolling over currently, but is still at a healthy +2.5%, well above the Services sector's +1.6%.

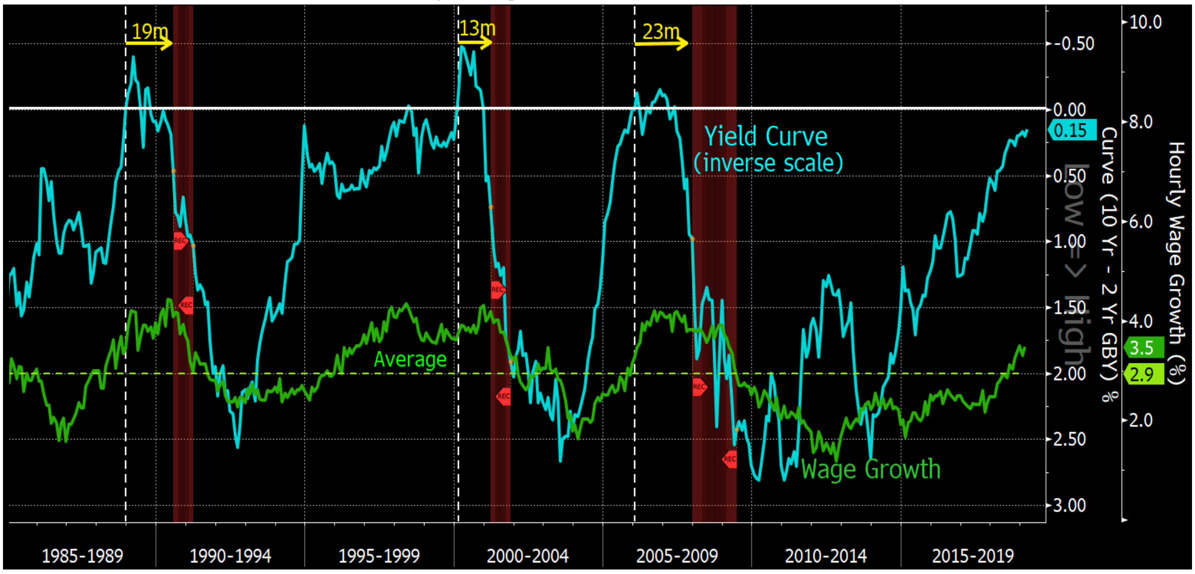
The bottom section of the above chart illustrates long periods of soft Manufacturing new employment numbers preceding the respective recessions. We do not have such an environment currently.

US – Employee Views of Availability of Alternative Jobs (%)



The high confidence of US employees reflect well in the above chart. The spread of the percentage of those feeling there are many jobs available against those with the view it is hard to get one continues in a rising trend, currently at an elevated level of over a third. Until this spread rolls over it is a constructive economic indicator.

US – Hourly Wage Growth vs Yield Curve (%)



Manufacturing wages are growing at a handsome +3.5% currently.This is well above the long-term average of +2.9% and bodes well for general consumption.

The inverse relationship between wage increases and the yield curve also deserves consideration. The main issue in this context is that wage increases may become an economic issue when they rise to +4% or more for a period of more than two years. Along with this, the yield curve has not flattened (or inversed) yet and once that may happen, it historically provided more than a year early warning.

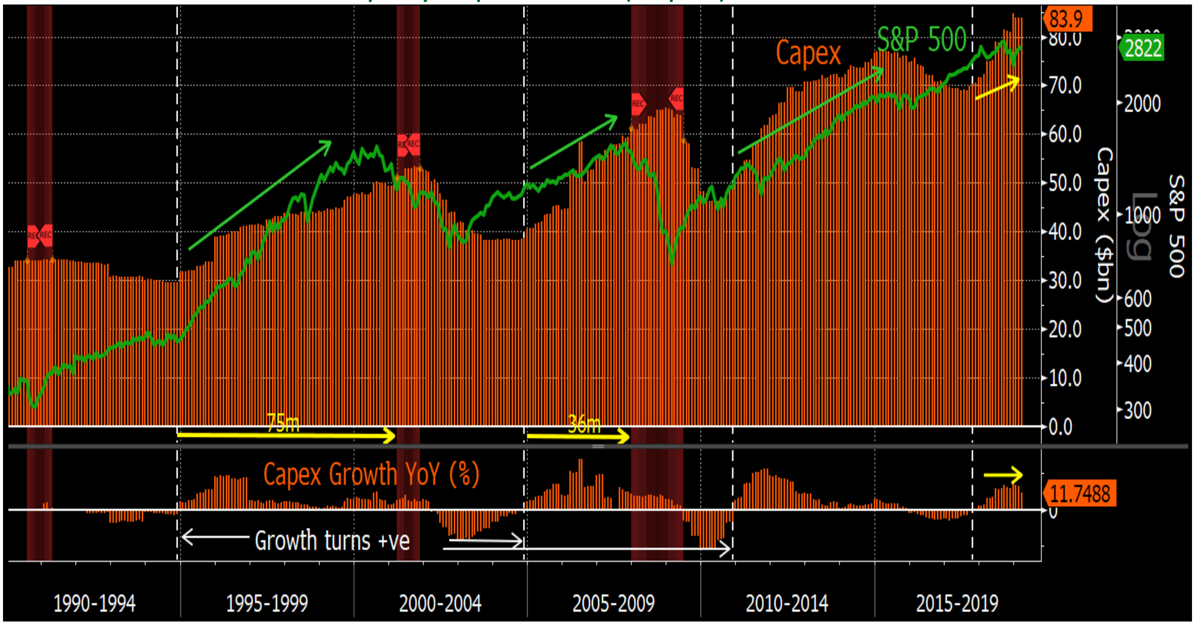
Source: Bloomberg & Stonehage Fleming Investment Management Limited. March 2019. Past performance should not be used as a guide to future performance.

Overall, it seems that US employment and support for consumption remain on a solid course. We can expect this to start moderating, but currently we do not have concrete information to temper our confidence in the US consumer.

3. CAPEX SUPPORT

We have shown in the first chart on page one of this report that industrial production is currently growing at +3.5%. This may be under some threat from a continuing strong Dollar and uncertainties around trade tariffs. Against this, importantly, we remind ourselves that capital expenditure is growing well as reflected in the following chart:

S&P 500 Company Expenditure (Capex) vs Share Price Index



S&P 500 capex started to grow a year ago and is currently growing at a rate of +11.7%. Positively growing capex cycles historically supported the economy and share prices for extended periods (see the respective arrows in the chart). The capex growth number for the overall economy is currently +10% and we won't be surprised if the repatriation of offshore cash is playing some role in this form of economic support.

4. TECHNICAL PICTURE

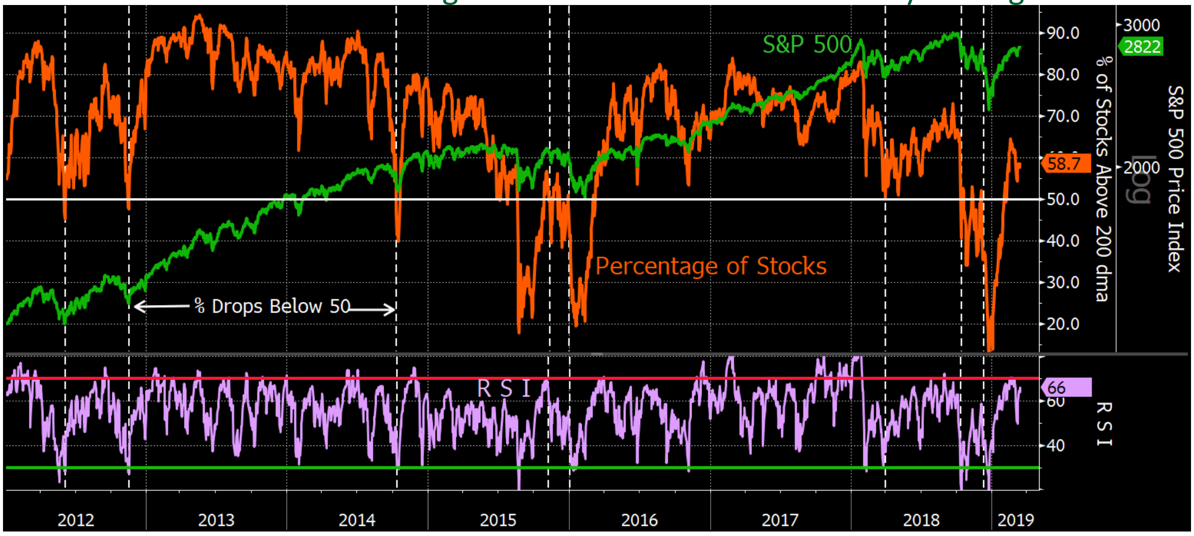
The S&P 500 technical picture continues its process of normailisation after the extreme December volatility:

S&P 500 vs 50 and 200-day Moving Average

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

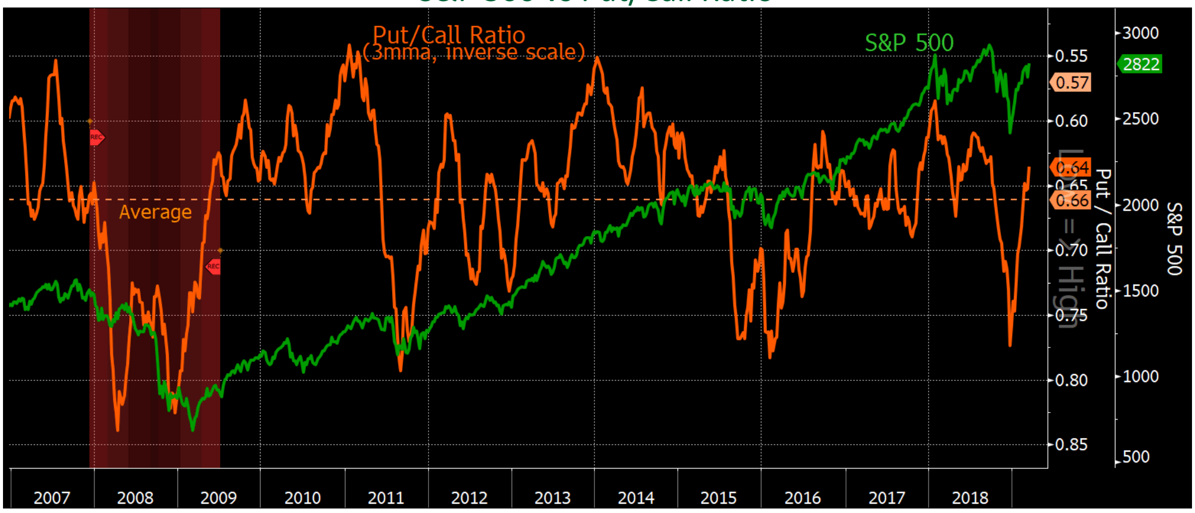
The index has crossed both its 50 and 200-day moving average (see the highlighted circle in the preceding chart). The former is also rising and the question is whether it may form a golden cross soon.

S&P 500 vs Percentage of Constituents Avove 200-Day Average



The above chart assisted us in utilising the outstanding buy opportunity in December. Considering the fact that just over half of constituents currently trade above their respective 200-day averages, it is now more in a hold mode and does not yet raise caution.

S&P 500 vs Put/Call Ratio



The Put/Call ratio is currently in a positive trend and reflects support from the derivatives market despite all the progress since the extreme levels in December.

All-in-all the technical picture seems healthy, along with a backdrop of fundamental economic support. A joker in this pack continues to be the US-Sino trade tariff negotiations.

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