STONEHAGE FLEMING

GLOBAL EQUITY PERSPECTIVES 27 MAY 2019

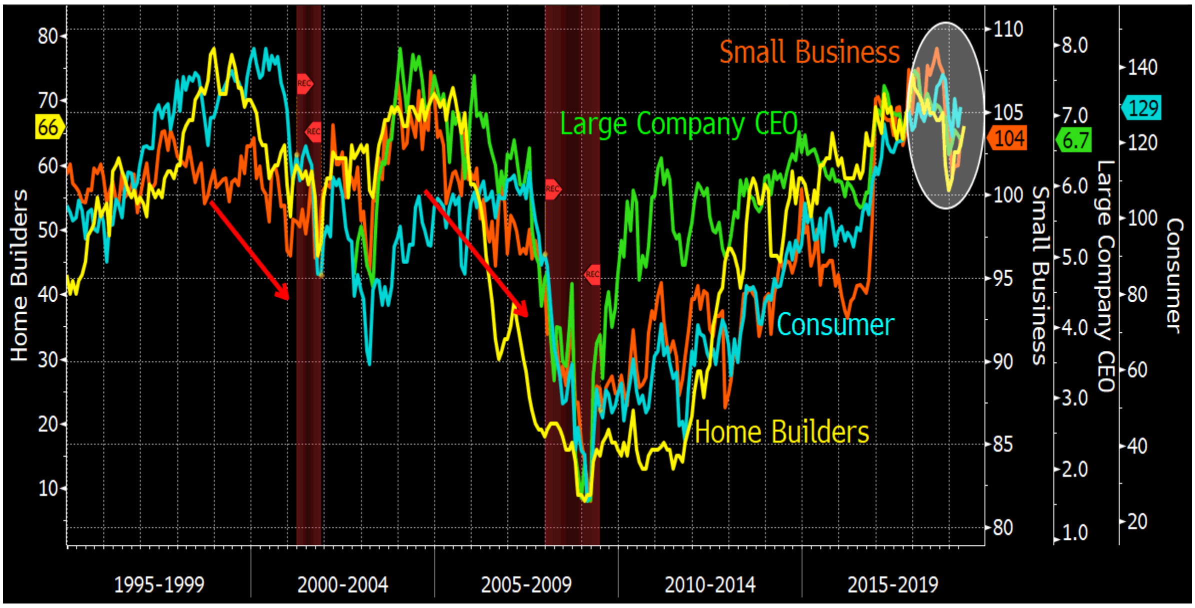
"Life can only be understood backwards; but it must be lived forwards."

Søren Kierkegaard

1. BIG PICTURE

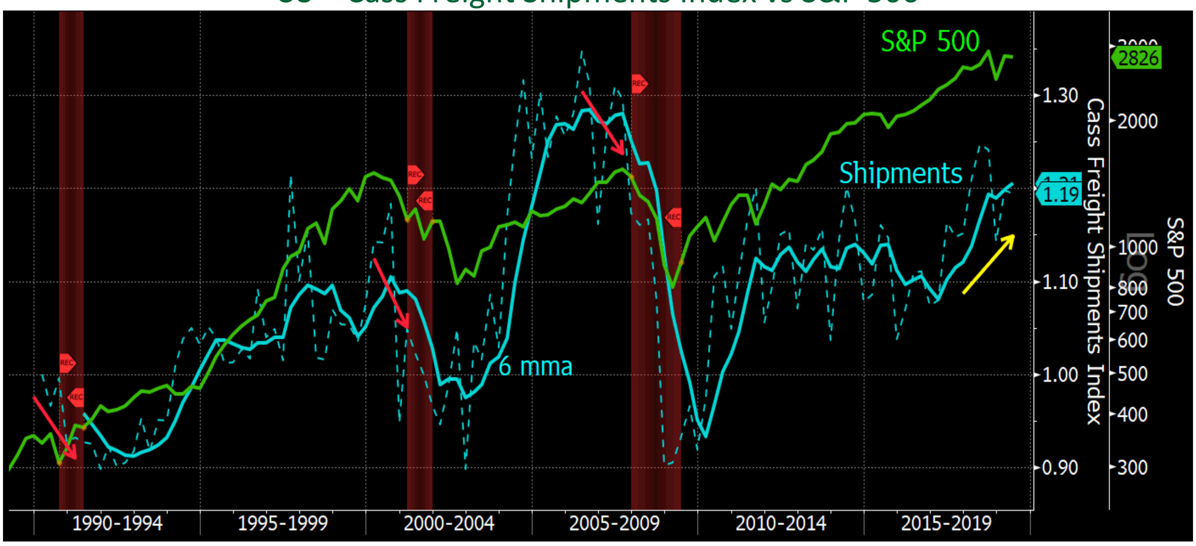
We follow various US sentiment indices to better understand the outlook for economic activity. These indices do not reflect real economic data, but are useful to consider 'the economic mood of the nation'.

US – Sentiment Indices



All the above indices peaked at elevated levels towards the end of last year and now seem to be in a downwards trend. Importantly, though, all of them are still at quite high levels in historic context and (apart from the large company CEO index) have recently picked up again. This implies a continuing healthy economy, but most probably with a moderating outlook.

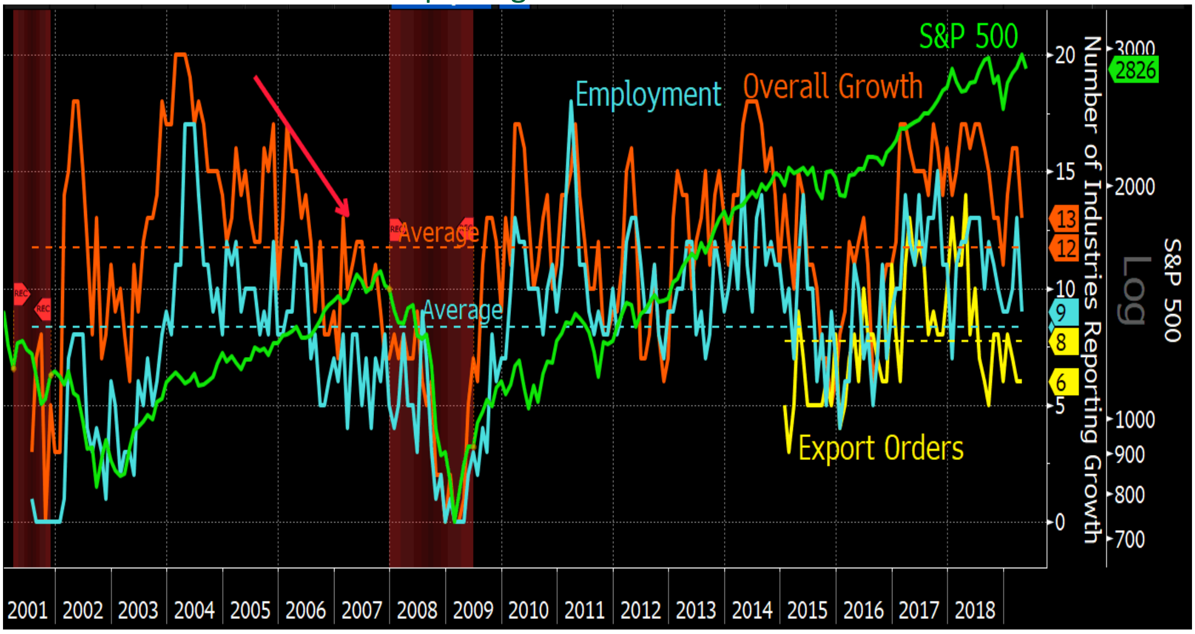
US – Cass Freight Shipments Index vs S&P 500



The Cass Freight Shipments index measures North American freight volumes. It currently remains in a rising trend reflecting good economic activity. Our chart of truck tonnage transported presents a similar scenario. The current US economic backdrop therefore still seems to be constructive despite uncertainties around trade tariffs and manufacturing.

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

US – Institute of Supply Management (ISM) Survey of Number of Industries Reporting Growth vs S&P 500

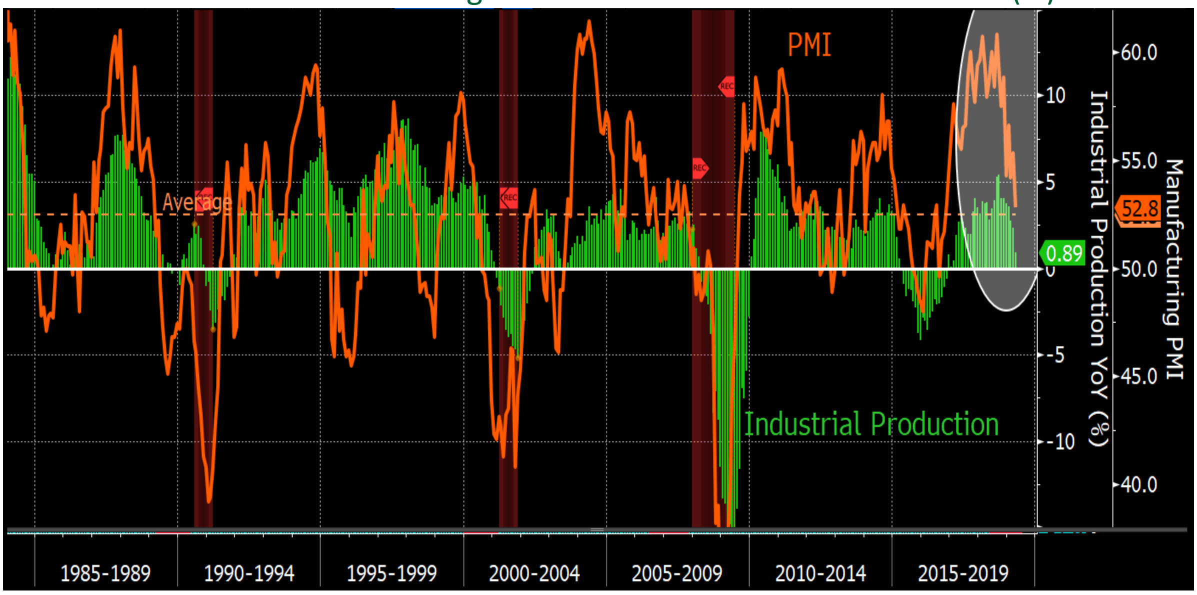


The number of industries reporting growth (see the above chart) confirm our preceding comments. Exports are the exception, suffering from the strong Dollar currency and trade tariff uncertainties.

2. SOFT MANUFACTURING

Industrial production makes up around 15% of the US GDP. Despite this relatively small contribution, it is quite a swing factor in capital market sentiment and should be seriously considered:

US – ISM Manufacturing PMI vs Industrial Production Growth (%)

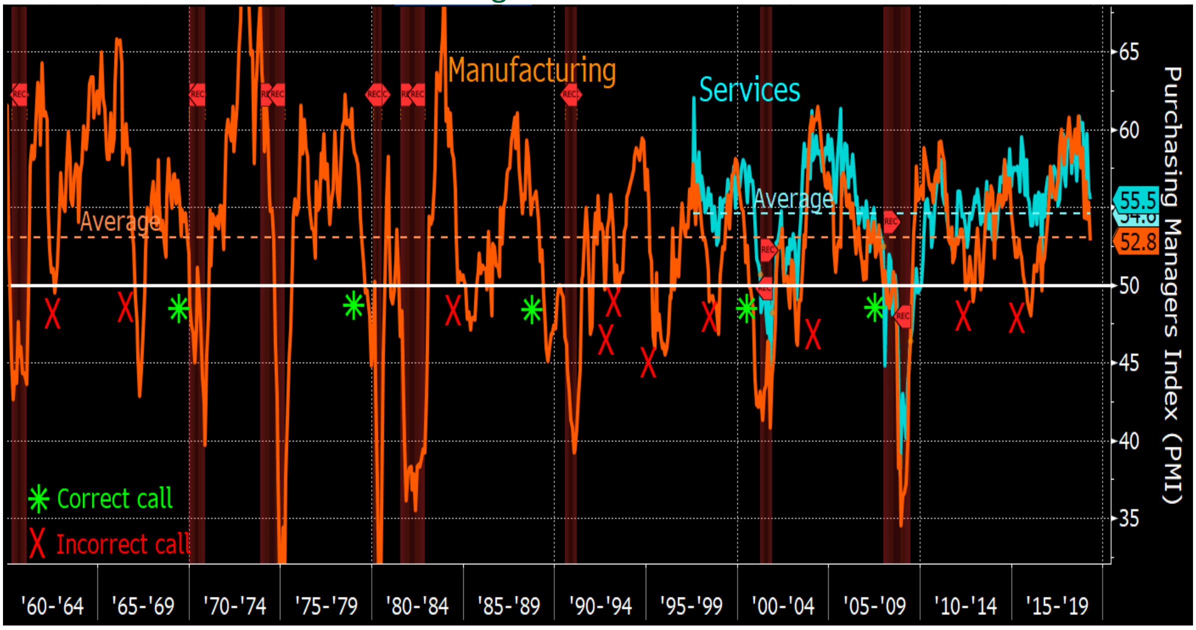


Both the Manufacturing PMI and Industrial Production indices have dropped materially over recent months. The former is currently close to its long-term average, with the latter growing only marginally. This still implies a constructive environment, but the negative trends unsettles some stock market traders.

While the Manufacturing PMI is a better leading economic and stock market indicator than the Services PMI index (with the latter currently being three points higher) we caution against too much pessimism too early on the above chart. The following chart reflects both the correct and the incorrect calls on an imminent recession the index historically provided:

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

US – ISM Manufacturing & Services PMI Indices vs Recessions



The Manufacturing PMI made 15 calls of an imminent recession since 1960. Of those calls ten (two-thirds) were false warnings and would have cost overly cautious investors lots of lost returns. Further to this, the index is currently at its long-term average level.

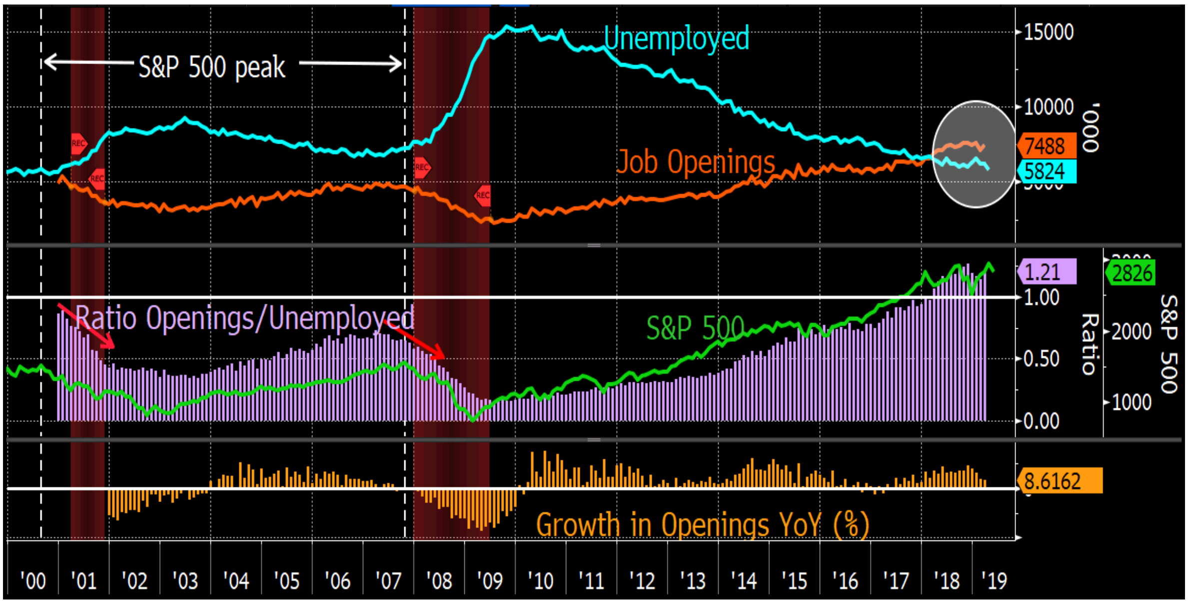
Whilst manufacturing seems to be in process of moderating, it is also important to mention that the overall S&P 500 constituent capital expenditure is currently growing at 12% following the lowering of corporate tax rates. This is an important factor for continuing US economic expansion.

All this information leads us to remain well engaged with our quality business equities.

3. US EMPLOYMENT

Trends in US employment data provide valuable information to investors.

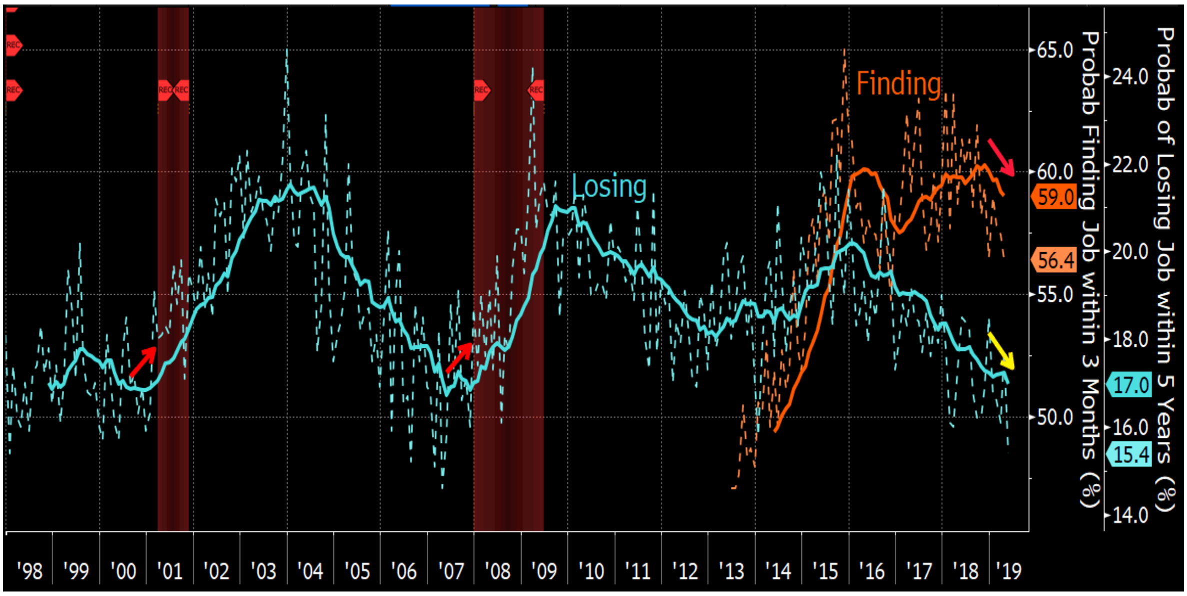
US – Number of Unemployed vs Job Openings & S&P 500



Both the number of unemployed and job openings are relatively stable, with more openings than unemployed. The openings number is growing in excess of 8% (orange bars) and the ratio between the two is at elevated levels (purple bars). Considering historic data in this context, these numbers still reflect a constructive economic environment.

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

US – University of Michigan Index of Mean Probability of Losing a Job Within 5 Years and of Finding a New Job Within 3 Months.

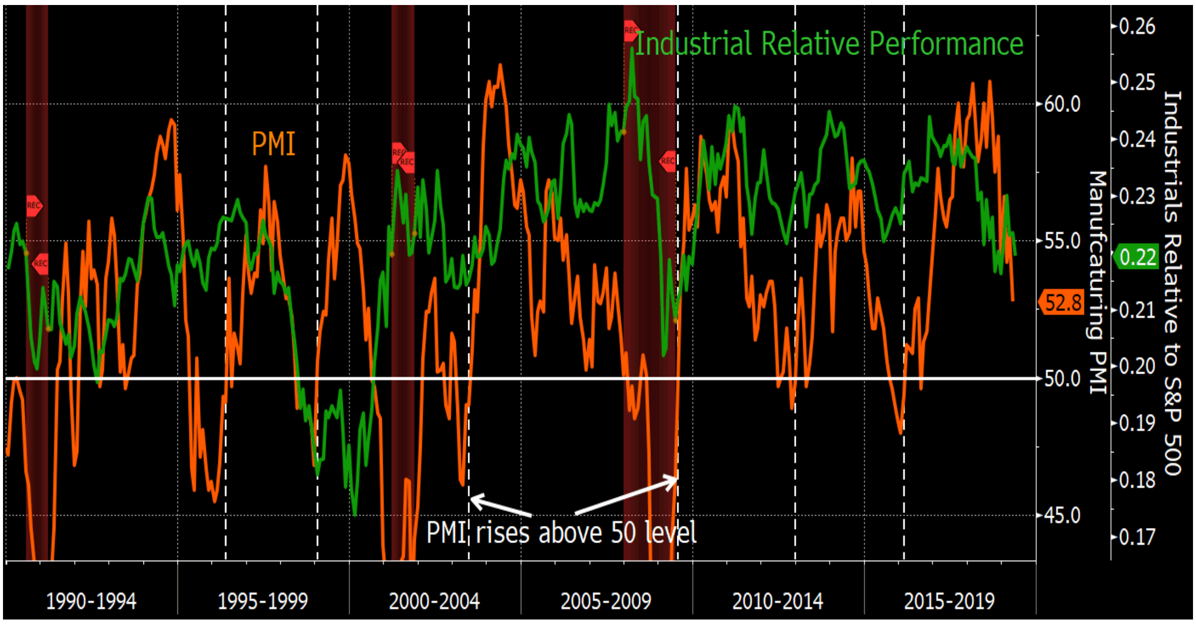


Employees opinion index of losing their job within five years is still in a downward trend. Against this, the probability of finding a new job within three months has started rolling over from an elevated level. Considering the longer-term historic data in this context we do not yet detect meaningful concerns regarding the US economy.

4. RELATIVE PERFORMANCE

We consider some relative performance trends against the backdrop of the preceding information:

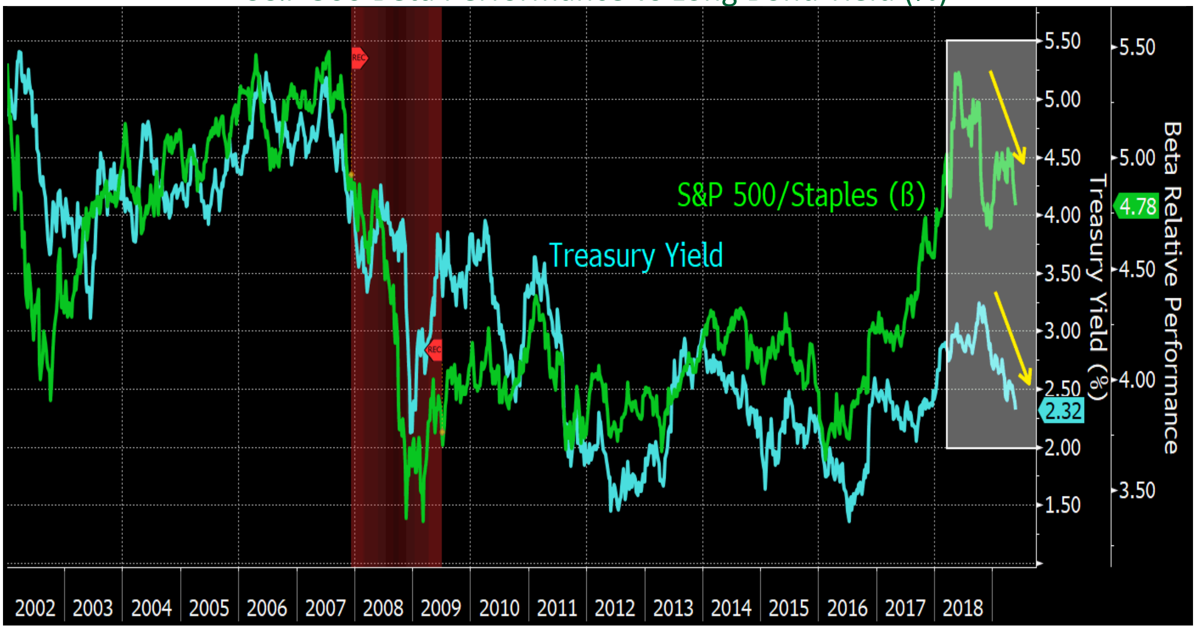
S&P 500 – Industrials Relative Performance vs Manufacturing PMI



The above chart reflects the S&P 500 Industrials index performance relative to the overall S&P 500 index along with the Manufacturing PMI index. There is a clear correlation between the two series. Industrial shares are currently underperforming and may well continue to do so for a while seeing the weakening PMI data.

Interestingly, this sector is quite range bound on a relative basis and has historically ‘found new life’ in the late economic cycles. One must be careful not to throw the proverbial baby out with the bathwater at the wrong time.

S&P 500 Beta Performance vs Long Bond Yield (%)

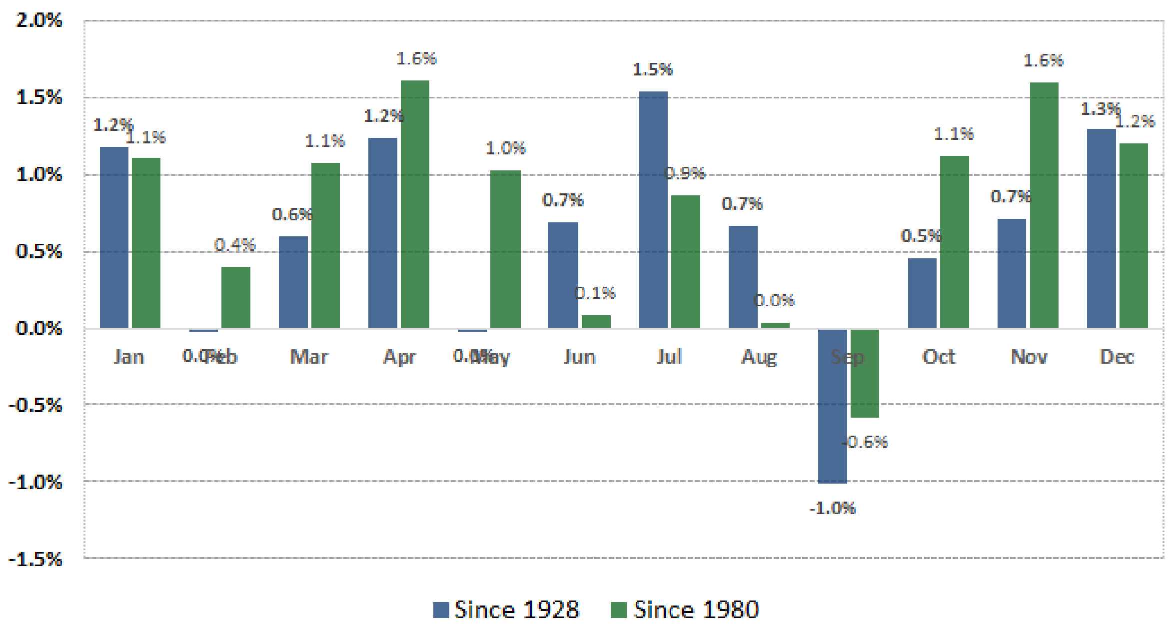


We constructed an S&P 500 beta index by dividing its Staples index into the overall S&P 500 index. It is striking how closely this beta index is correlated to the bond yield. Seeing that we do not foresee an imminent material rise in interest rates, it seems investors can continue to rather back low beta, lower volatility shares.

5. SELL IN MAY

The adage of sell in May is uppermost in many minds:

S&P 500 - Average Monthly Performance



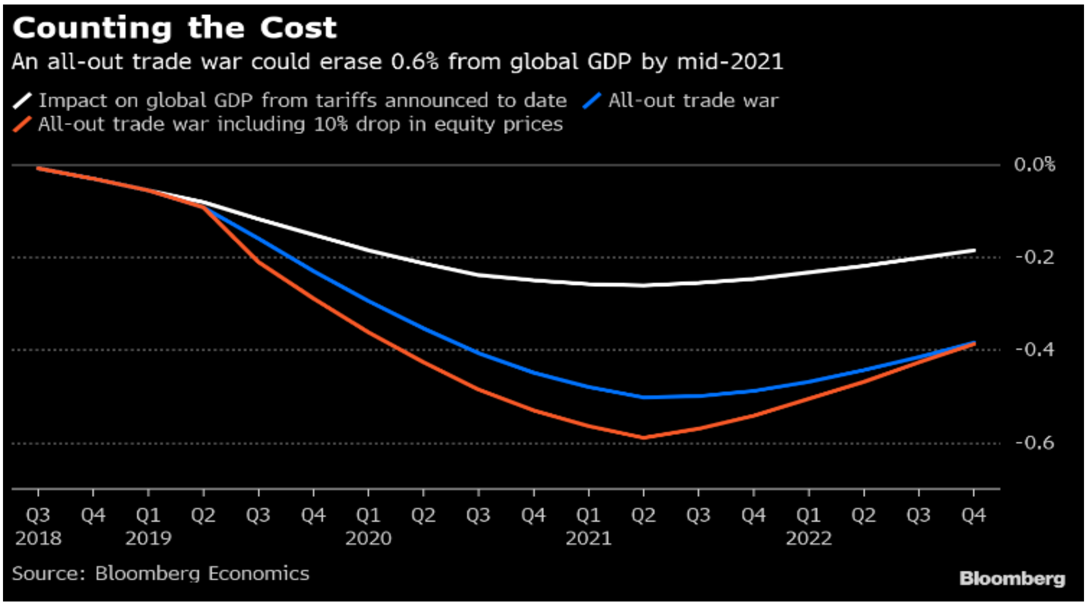
We are cautious not to rely too much on historic average data in the above context, especially because the perceived reason for a slow summer season is not that relevant anymore (it was based on agricultural seasons). The weak stock market performance over the last quarter of last year also went against the above averages.

That having been, said and considering average monthly performance data since 1980, it seems that the upcoming three months may offer some buying opportunities on the condition that the US economy stays on its constructive course.

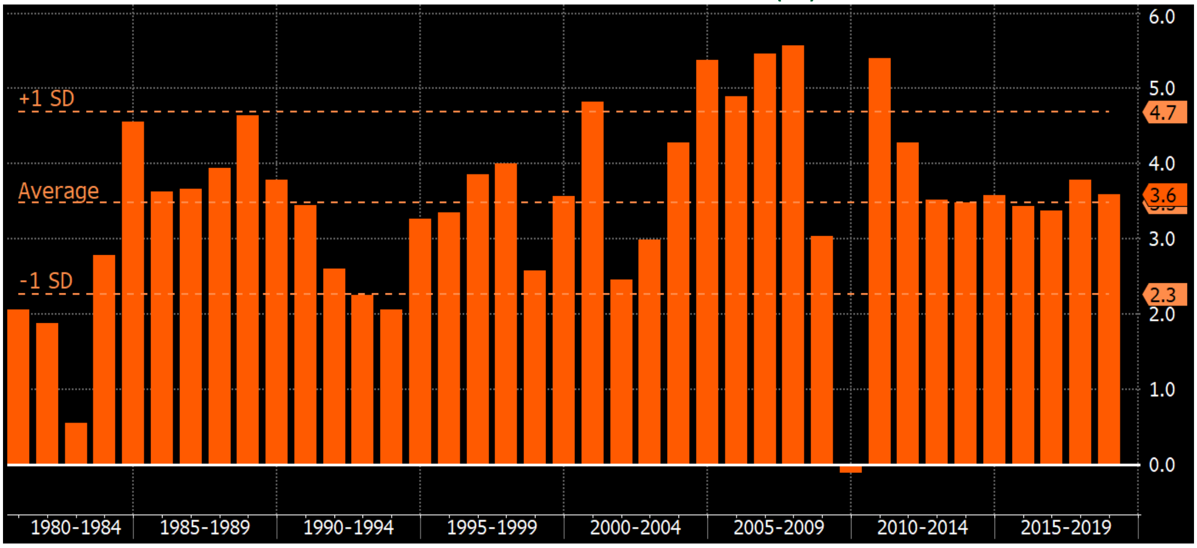
Source: Bloomberg & Stonehage Fleming Investment Management Limited. May 2019. Past performance should not be used as a guide to future performance.

6. TRADE WAR

Investors have been bracing themselves for an amicable solution to the US-Sino trade tariff negotiations. Hopes are for the two heads of state to meet in person at the upcoming G20 summit in Osaka to resolve the issues. The chart below illustrates potential effects on the global economy under different outcomes:



Historic World GDP Growth (%)



The world economy has been growing around its long-term average since 2013. Consensus expectations for the coming three years are already somewhat lower. We show below the potential effects of different tariff outcomes on those expectations:

Consensus World GDP Expectations			
Calendar Year	2019	2020	2021
Current	3.3%	3.3%	3.1%
With Tariffs Already Announced	3.1%	3.0%	2.9%
All-out Trade War	3.0%	2.8%	2.6%
Trade War & 10% Drop in Share Prices	3.0%	2.7%	2.6%

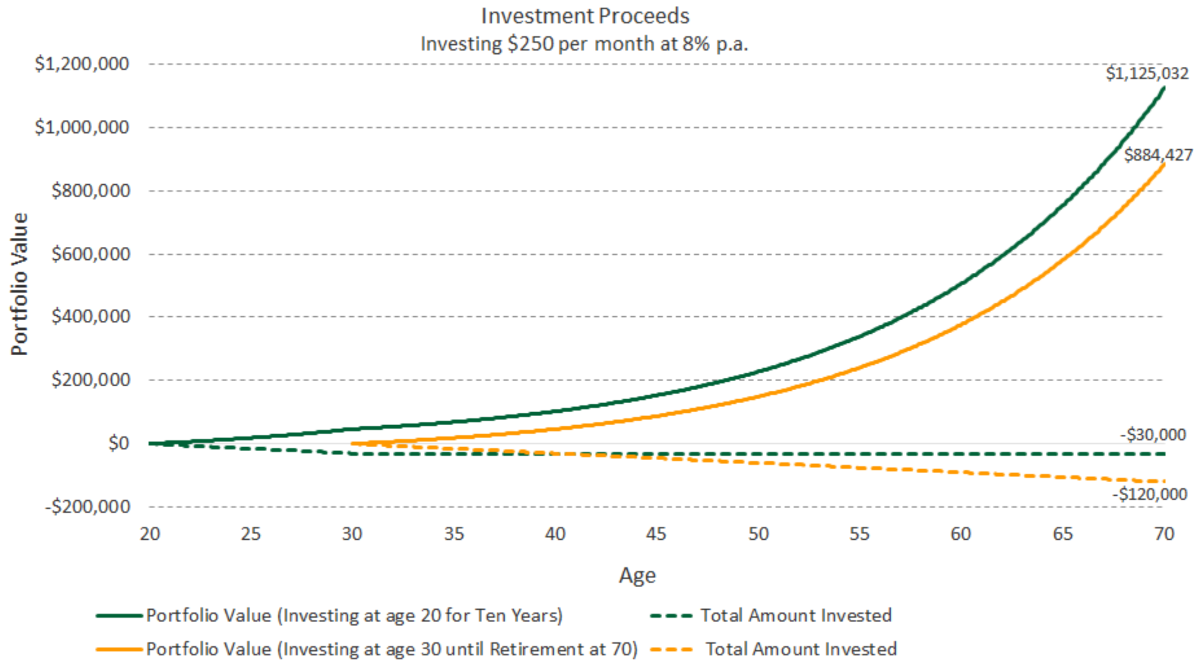
Based on the above numbers the world economy may moderate to levels below its -0.5 standard deviation (GDP growth of +2.9%) from next year with negative tariff negotiation outcomes but stay above its -1 standard deviation of +2.3% and continue expanding. The effects may, of course, be more detrimental on the economies directly involved.

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

7. POWER OF COMPOUNDING

All serious investors buy into the principle of the power of compounding. Many also know of the rule of 72 whereby one can easily calculate how long it will take to double your investment at any given rate by dividing that rate into the number of 72 (e.g. at an 8% rate it will take 9 years to double your investment).

We are strategic investors looking to spend good time in the market – we are not tactical investors attempting to time the market. In this context the following illustration also confirms how important it is to start investing as early as possible:



Source: Stonehage Fleming Investment Management Limited. May 2019.

The example is based on two young people each investing $250 per month. The one starts at the age of 20, investing only for ten years, but leaving the investment untill retirement at age 70. The other one starts at the age of 30, investing for forty years up to retirement age 70. Both earn a rate of 8% p.a.

The first one's total investment of $30,000 accumulated to a final value of $1,125,032 while the second one invested $120,000 which accumulated to a final value of $884,427. Even though the total invested value ratio is only 1:4, the return ratio is more than 1¼: 1.

Case made – start investing early, don't stop, and don't tamper with it.

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