GLOBAL EQUITY PERSPECTIVES 2 SEPTEMBER 2019

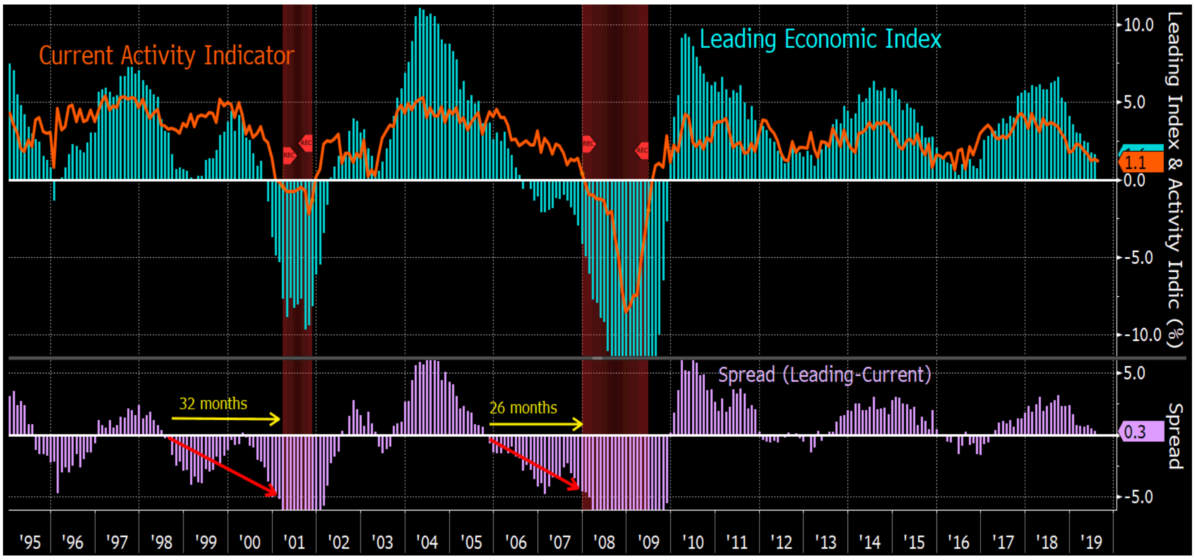
"Do the difficult things while they are easy and do the great things while they are small."

Laozi

1. ECONOMIC ACTIVITY

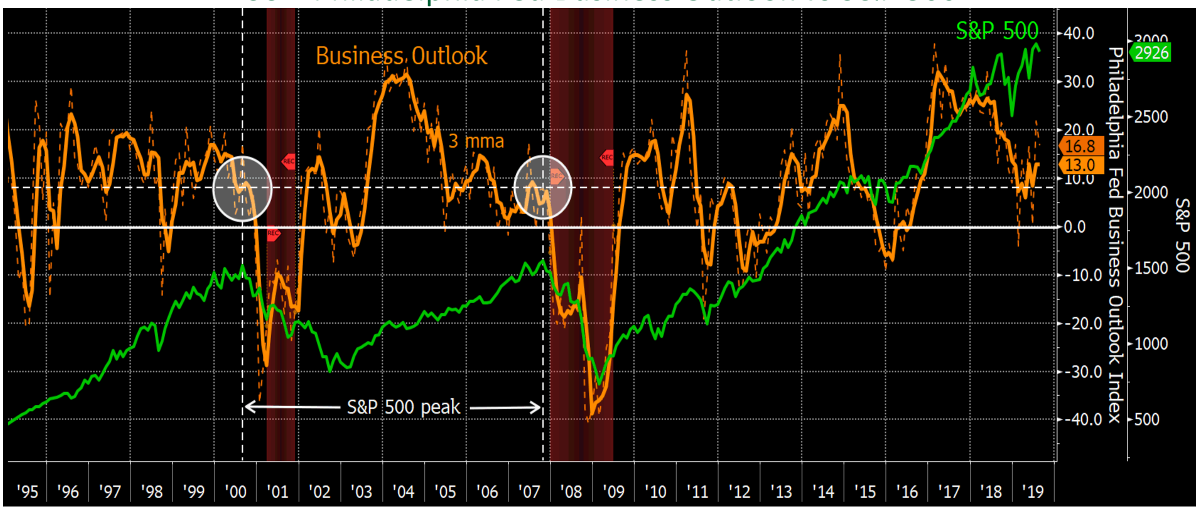
The most important strategic issue for world capital markets remains the strength of the US economy. The following information can shed some light on this subject:

US – Conference Board Leading Economic Index vs Goldman Sachs Current Economic Activity Index Growth (%)



Whilst the growth in both indices in the above chart are in a moderating trend, both remain in positive territory indicating continuing economic expansion. They do not raise immediate alarm. Along with this, though, the spread between the two series (the bottom section in the chart) has narrowed. Historically, such an event indicated the next recession to be some way off still (see the yellow arrows).

US – Philadelphia Fed Business Outlook vs S&P 500



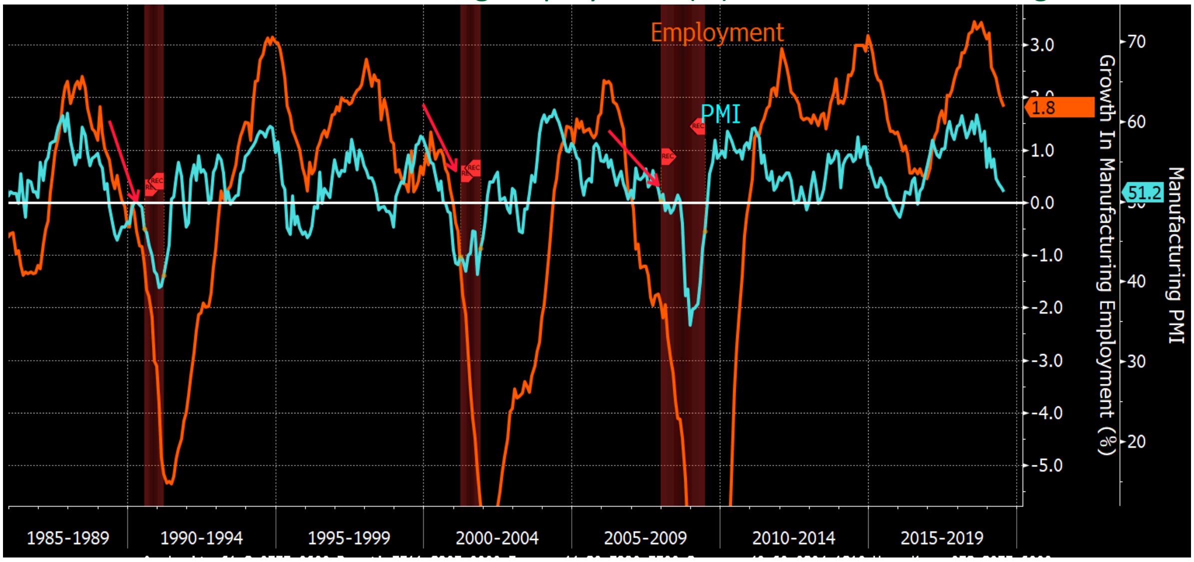
The above business outlook index recently dropped to an important level that historically was associated with stock market peaks shortly before the respective recessions (see the circles in the chart). The index has since increased and does not raise similar alarms anymore.

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

2. US MANUFACTURING

Manufacturing activity makes up only 12% of US GDP, but exceeds the overall size of Canada's economy and is close to the total output of Brazil and of Italy or Korea. It makes up a sizeable 18% of global manufacturing and is an important economic swing factor in the US capital markets. The strong Dollar and trade tariff uncertainties have been restricting issues for some time. The following charts reflect on this subject:

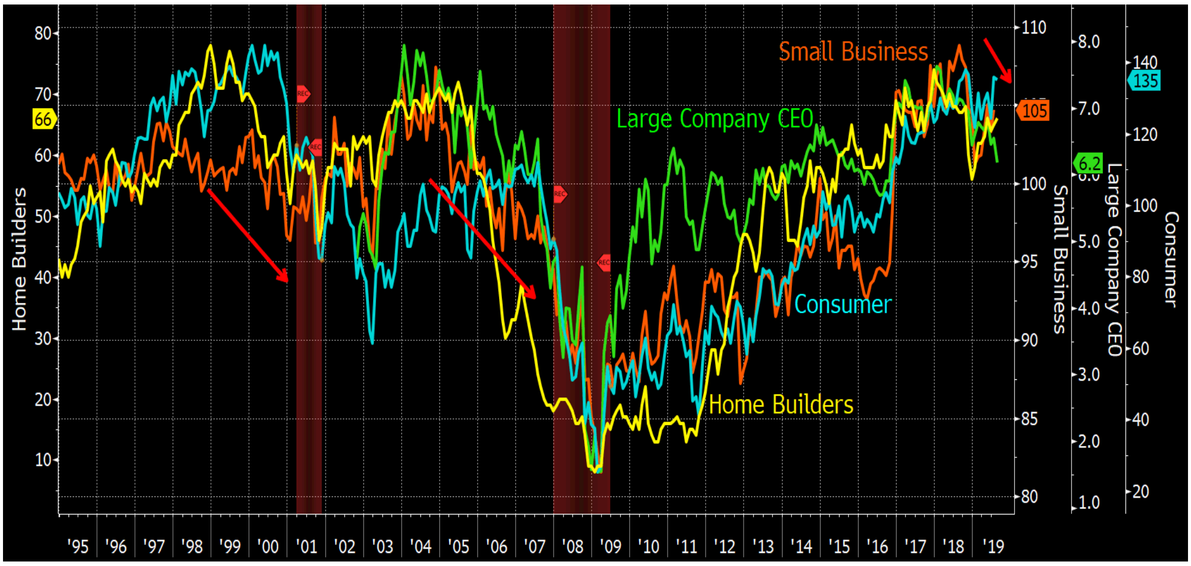
US – Growth in Manufacturing Employment (%) vs PMI Manufacturing Index



Employment growth in the manufacturing sector usually stays positive through economic cycles. It has been particularly strong over the current cycle. The level of growth has receded to +1.8% currently, which still reflects strong manufacturing activity. It does not yet signal a recession alarm.

The Manufacturing PMI index correlates well with the above employment growth chart and acts as quite an affective leading economic indicator. It has recently receded to a level of 51.2, marginally above the neutral index level of 50. Whilst this does not provide particular comfort, we are also cautious to not be alarmed too early. It has historically often dropped through the 50 reading, only to return to constructive levels soon afterwards (since 1960 it delivered twice as many false alarms as true alarms).

US Confidence Indices



Apart from Large Company CEO confidence, all of the Small Business, Consumer and Home Builder confidence indices have recovered from their respective low levels earlier this year. Whilst they all are perceived to be in a structurally weakening trend, their current levels are still elevated in historic context. We perceive this to support Manufacturing to some extent.

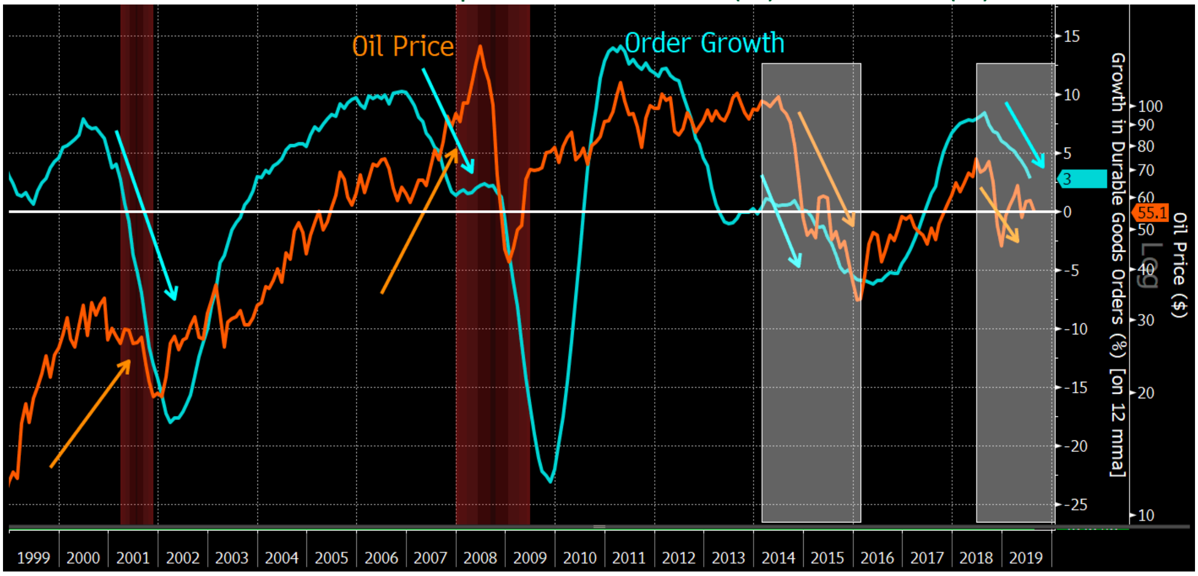
Source: Bloomberg & Stonehage Fleming Investment Management Limited. September 2019. ***Past performance should not be used as a guide to future performance.***

We are very conscious of material uncertainties in the US Manufacturing sector, but the preceding information provide sufficient comfort to not yet take a too negative stance in this context.

3. BUSINESS INVESTMENT

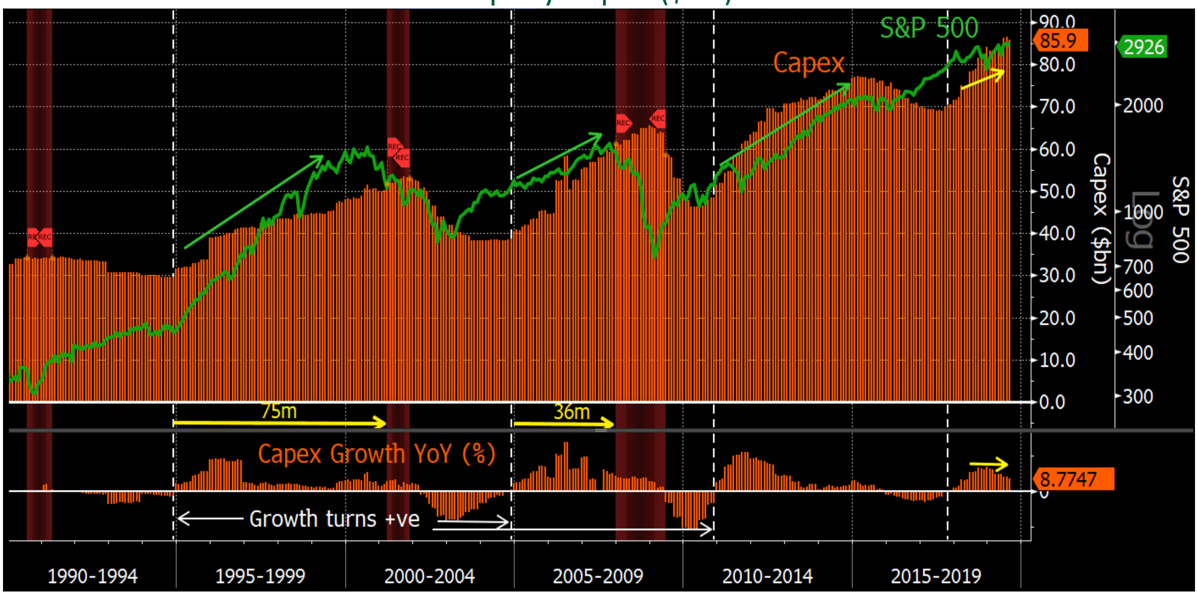
As shown in the preceding chart, large US company CEO confidence is currently slipping (whilst small business confidence remains at elevated levels). This prompted us to look into aspects of business investment.

US – Growth in Capital Goods Orders (%) vs Oil Price (%)



Non-defence capital goods orders (excluding aircraft) are currently growing at a slowing rate of +3%. Against the background that a slowing trend historically was (at times) followed by recessions, these orders are highlighted by some investors as an important capital market risk. We, on the other hand, would caution against too much pessimism too early on the grounds that the oil price has been relatively low since 2015 and that its effect in this context is diluted to some extent.

S&P 500 Company Capex ($bn) vs S&P 500



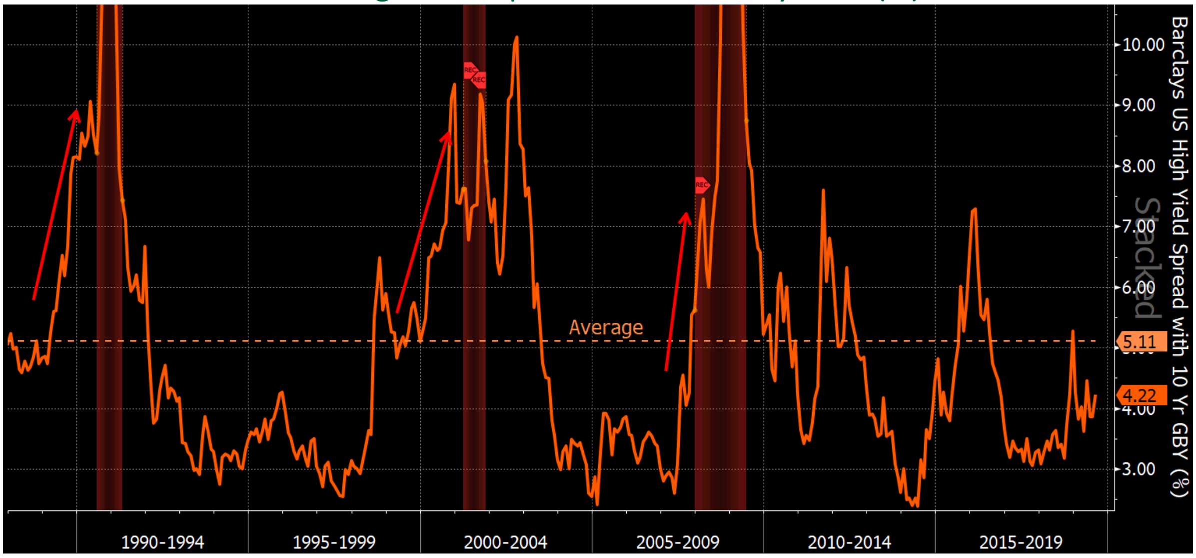
Overall US capital expenditure grew by +15% in the first quarter. Current data for S&P 500 constituent companies shows growth at a still healthy rate of +8.8%. The current cycle of growth is still relatively young (see the vertical dotted lines in the chart). We do not yet detect something to be concerned about.

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

4. HIGH YIELD CURVE

As with the standard Treasury yield curve, spreads in the high yield market also provide good information to assess risks in the capital markets:

US – High Yield Spread with Treasury Yield (%)

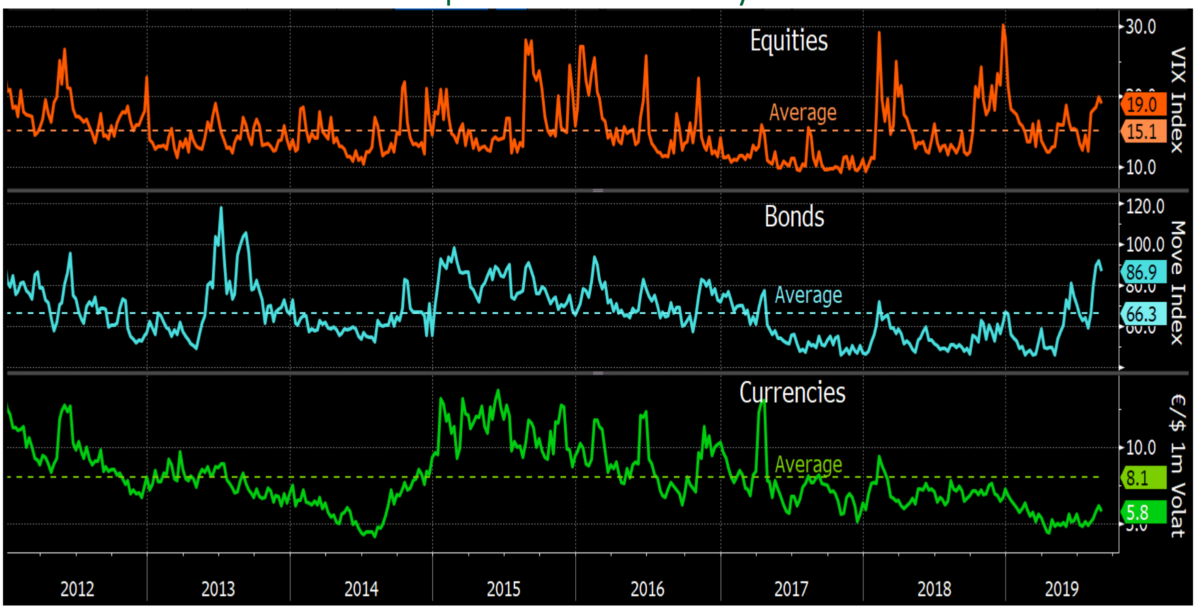


The spread in the above chart is in a process of rising, reflecting growing risk of more difficult economic times to come, but is still below its long-term average. Furthermore, historically it rose for longer and at a faster rate in the run-ups to the respective recessions. This quite volatile market does not yet signal material risk of an imminent US recession.

5. MARKET VOLATILITY

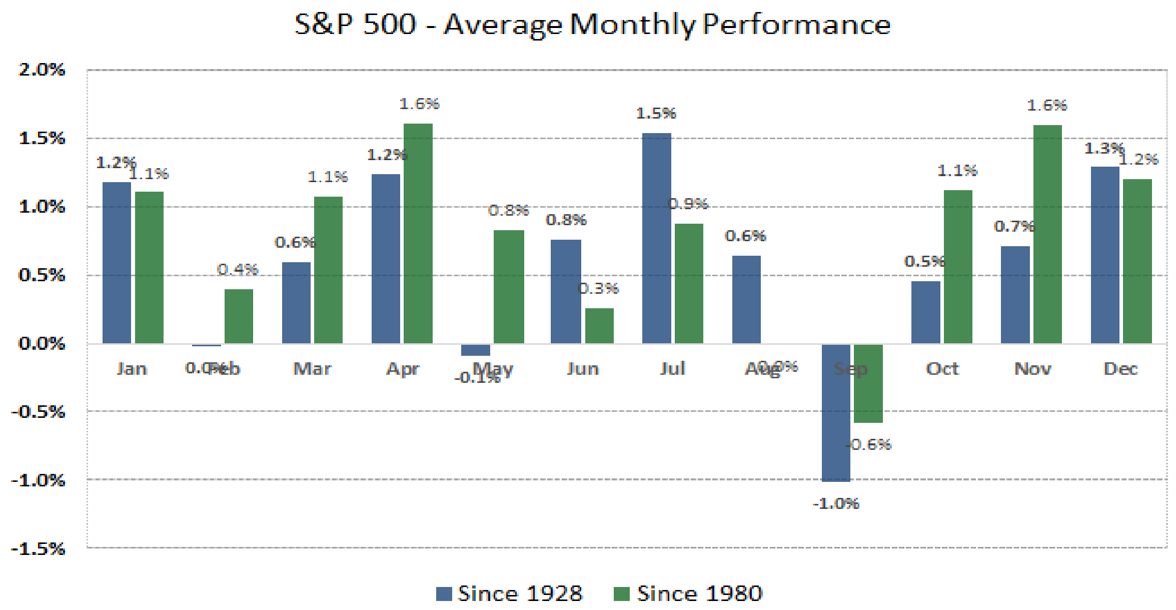
July has been quite a volatile month, mainly because of softer global economic data and material noises in the trade tariff negotiations.

US – Capital Market Volatility Indices



Volatility in both the equity and bond markets increased materially, whilst it is comforting to see volatility remaining muted in the currency market. Being amid the weak summer season, many investors fear the outlook for September.

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

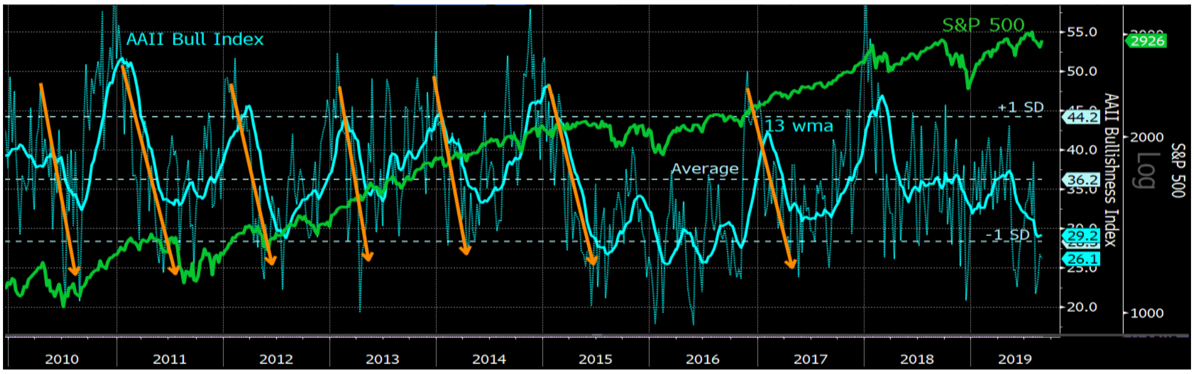


September is traditionally the weakest month of the year in the US equity market. Those investors with a short-term tactical orientation may well, on the grounds of the above chart, either sell now or remain on the proverbial sidelines. Those with a more positive structural orientation may sharpen their pencils for potential good buying opportunities.

S&P 500 with its 50-Day Moving Average and % of Stocks Above Their Own Average

The S&P 500's technical picture remains healthy despite July's volatility, remaining above its rising 200-day moving average (not in the chart) and its 50-day moving average stable. With a relatively low percentage of stocks above their own 50-day average (the white line in the chart), such circumstances have historically usually been followed by higher share prices.

AAII Bullishness Index vs S&P 500



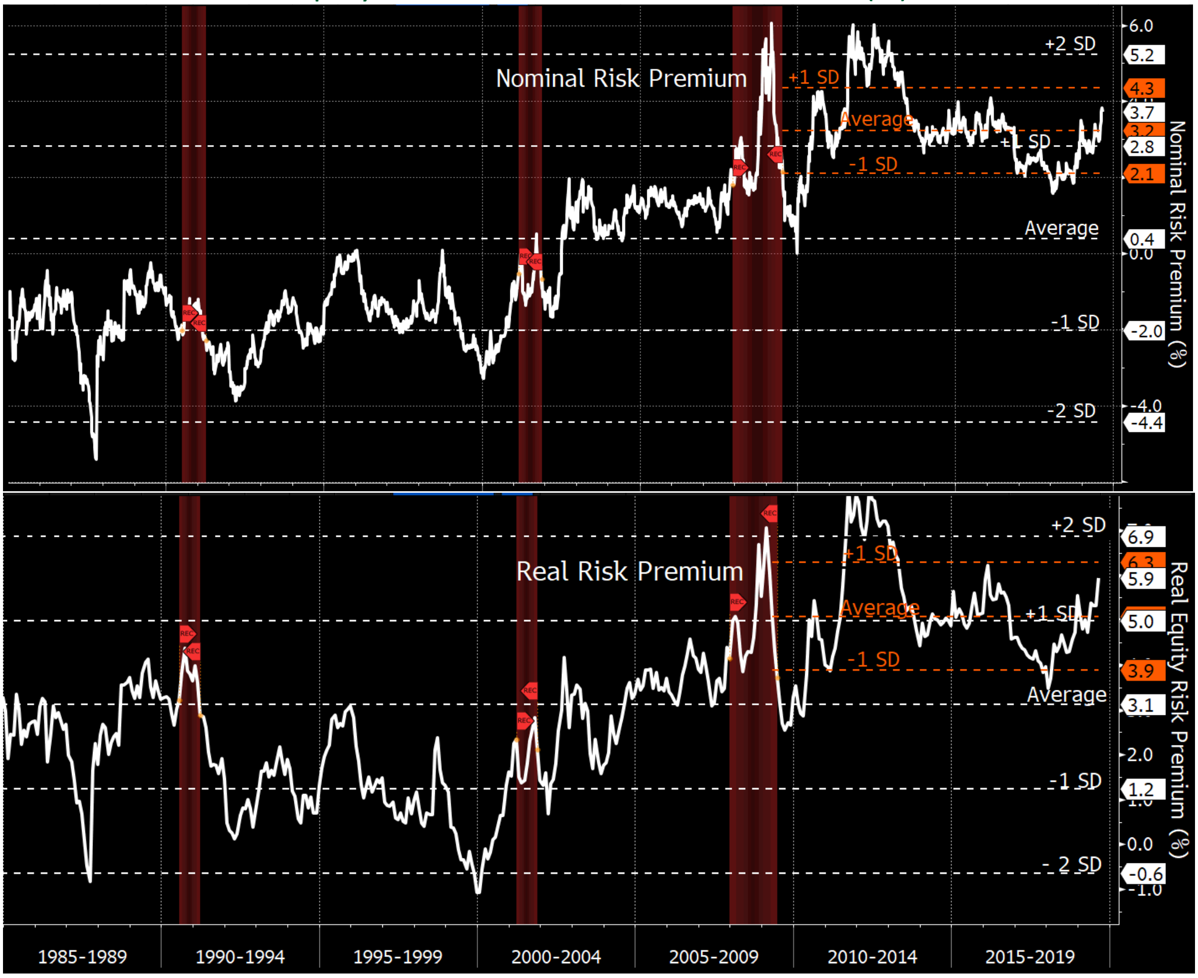
Source: Bloomberg & Stonehage Fleming Investment Management Limited. September 2019. ***Past performance should not be used as a guide to future performance.***

The preceding chart reflects a very low level of bullishness currently amongst retail investors. They have been climbing the proverbial wall of investor worry for a long time. We believe many investors may be underinvested currently, and that such buying pressure is currently absent. Such circumstances can become supportive to share prices should fundamental issues improve.

6. EQUITY RISK PREMIUM

We update our clients frequently with equity valuation levels on different valuation metrics. We have not considered the Equity Risk Premium valuation tool for some time. It is of good value because, apart from earnings, it also considers interest rate and inflation levels:

Equity Risk Premium – Nominal and Real (%)



Both the nominal and real equity risk premiums are currently close to +1.5 SD's (standard deviations) above their respective long-term averages, implying high risks discounted in the equity markets. This makes a case for equity investing.

Many investors have the opinion that the bond market has structurally changed for an indefinite period after the Credit Crisis, and therefore that interest rate levels prior to that are not that relevant anymore. We have, for this reason, also inserted the average data since the end of the Credit Crisis only (the orange lines). On this basis both the nominal and the real equity risk premiums are about +0.5 SD's above their averages, also reflecting attractive valuations in this context.

These arguments may get diluted should interest rates start a new phase of rising levels. We are not sure when such structural bond bear markets may take effect, but for the shorter-term outlook many central banks are rather orientated towards easing than tightening. Our theme of a current 'soft US economic landing on a long landing strip' may also delay the bond bear market.

7. US PRESIDENTIAL ELECTION

The next US presidential election is less than 15 months away. Investors expect, amongst the standard political rhetoric, efforts to keep the economy going in support of more votes.

We present in the following chart the historic S&P 500 returns from 1988 in this context:

US Presidential Elections & S&P 500 Total Return (%)

We have highlighted the annual returns over the twelve months following the respective election events in the chart (the green bars, e.g. the S&P 500 returned +21% a year from the 2016 election). We also show the incumbent presidents and the corresponding forward P/E valuations in the bottom section of the above chart.

We make the following conclusions from the chart:

- Barring the election in 2000 during the tech bubble, all elections delivered handsome returns in the following twelve months.
- Most elections were preceded with attractive returns in the run-up to the respective elections (barring the 2000 election and the one during the Credit Crisis).
- The 2000 election was saddled with an overvalued stock market.
- President Obama delivered good investment returns from low valuations at the time of both of his elections.
- Current absolute valuations are fair, being close to average.

The fact remains that the economic fundamentals and equity valuations are much more important to investors than any political rhetoric, but we'll soon surely be in for interesting times again.

Gerrit Smit
Partner - Head of Equity Management
Stonehage Fleming Investment Management Limited

15 Suffolk Street
London
SW1Y 4HG

T +44 20 7087 0000
Email gerrit.smit@stonehagefleming.com
www.stonehageflemininvestments.com/gbi

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

RISK DISCLOSURE

This communication has been prepared for information only and is not intended for onward distribution. It is neither an offer to sell, nor a solicitation to buy, any investments or services. This communication does not constitute a personal recommendation and does not take into account the individual financial circumstances, needs or objectives of the recipients.

Any information which could be construed as investment research has not been prepared in accordance with legal requirements designed to promote the independence of investment research. Further it is not subject to any prohibition on dealing ahead of the dissemination of investment research

All investments risk the loss of capital.

The value of investments may go down as well as up and, you may not receive back the full value of your initial investment.

Past performance should not be used as a guide to future performance.

Changes in the rates of exchange between currencies may cause the value of investments to go up or down in the reporting currency.

In general, underlying investments denominated in foreign currency are not hedged back into the reporting currency. Among the factors that may influence currency values are trade balances, the levels of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation and political developments. Returns may increase or decrease as a result of currency fluctuations. Values may also be affected by developments relating to controls and restrictions on foreign currency remittance of proceeds of investments in a non-sterling jurisdiction.

Whilst every effort is made to ensure that the information provided to clients is accurate and up to date, some of the information may be rendered inaccurate by changes in applicable laws and regulations. For example, the levels and bases of taxation may change. Any reference to taxation relies upon information currently in force. You should note that the bases and rates of taxation may change at any time. Tax treatment depends upon the individual circumstances of each client and may be subject to change in the future.

In addition to the information provided by Stonehage Fleming Investment Management Limited you may wish to consult an independent professional.

It has been approved for distribution in South Africa and those countries of the EEA where distribution is permitted by:

Stonehage Fleming Investment Management Limited
15 Suffolk Street
London
SW1Y 4HG

Stonehage Fleming Investment Management Limited is authorised and regulated by the Financial Conduct Authority and registered with the Financial Sector Conduct Authority (South Africa) as a Financial Services Provider ("FSP") under the Financial Advisory and Intermediary Services Act, No 37 of 2002 (FSP No: 46194).