GLOBAL EQUITY PERSPECTIVES 9 DECEMBER 2019

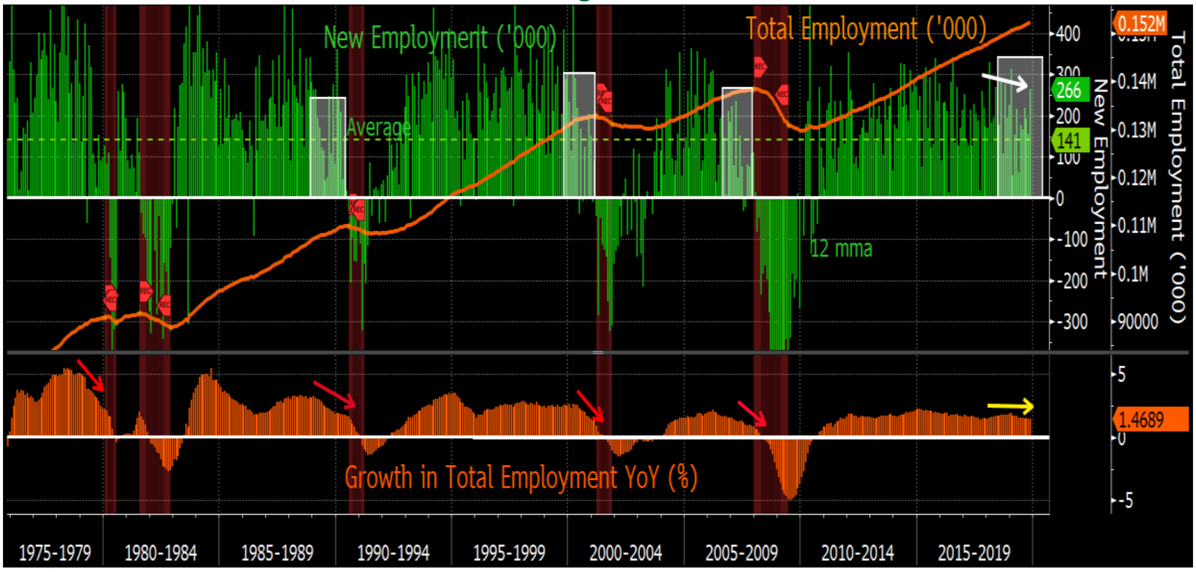
"To attain knowledge, add things every day. To attain wisdom, remove things every day."

Laozi

1. EMPLOYMENT SURPRISE

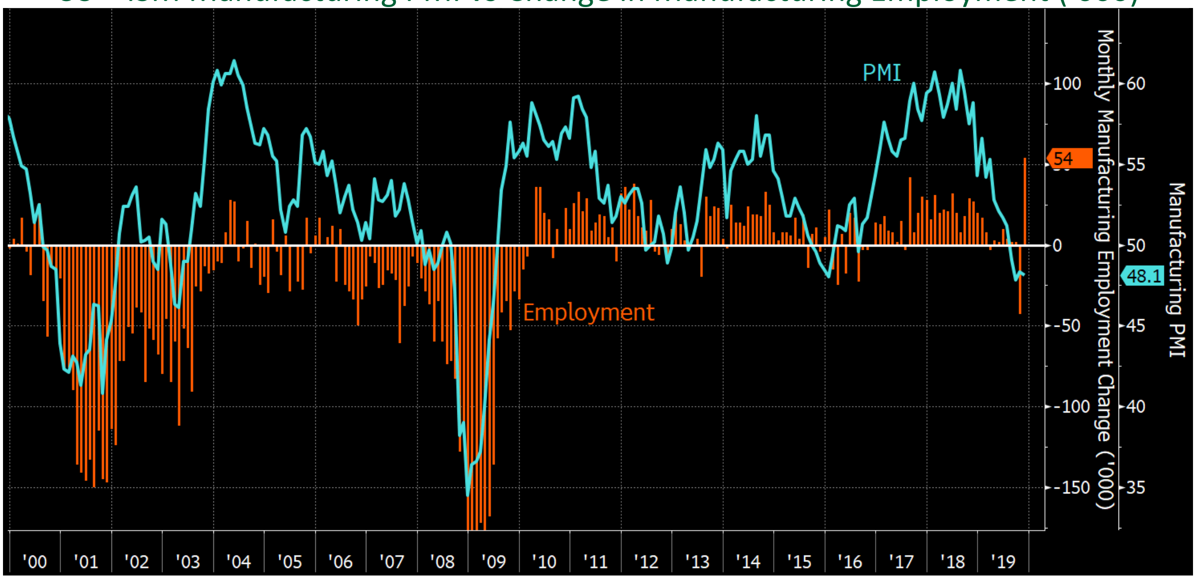
The new US employment number of 266,000 for November was over a third higher than general expectations:

US – Manufacturing PMI – ISM vs Markit



Total employment now amounts to 152m, growing at +1.5% over the past year. Monthly new employment data remains more solid than usually with run-ups to recessions (see the highlighted areas in the chart). This leaves the impression of a continuing healthy US economy.

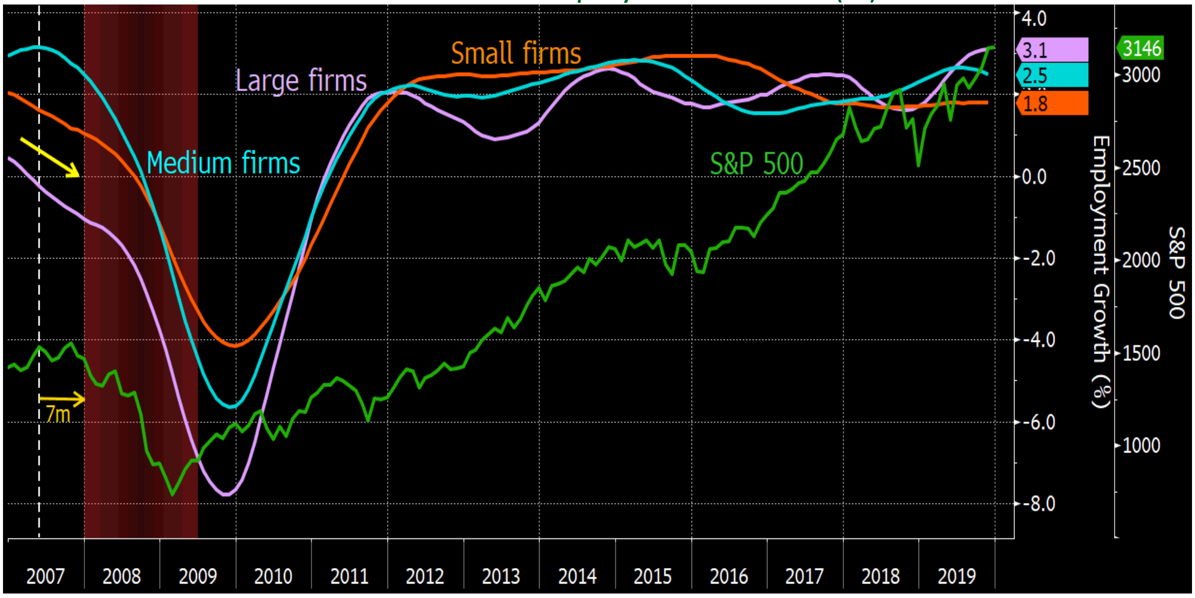
US – ISM Manufacturing PMI vs Change in Manufacturing Employment ('000)



The monthly change in manufacturing employment historically follows the manufacturing PMI index well, but had a huge swing with 54,000 new appointments in November, more than balancing out the weak October. This reflects an interesting situation of hard data being more constructive than soft PMI data and supports some views of manufacturing data potentially bottoming out.

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

US – ADP Total Employment Growth (%)

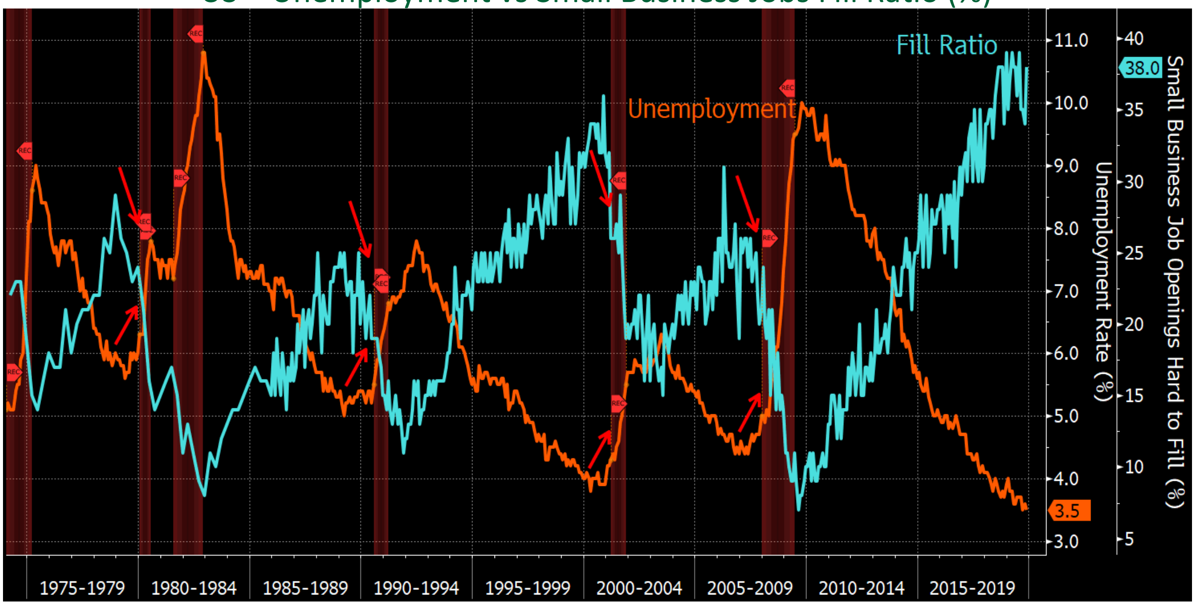


According to ADP data, total employment growth remains constructive for all of the business size categories, with employment in large firms currently accelerating at +3.1%. This also leaves an impression of a rather healthy US economy.

2. US WAGES

US unemployment levels have dropped to a record low 3.5%:

US – Unemployment vs Small Business Jobs Fill Ratio (%)



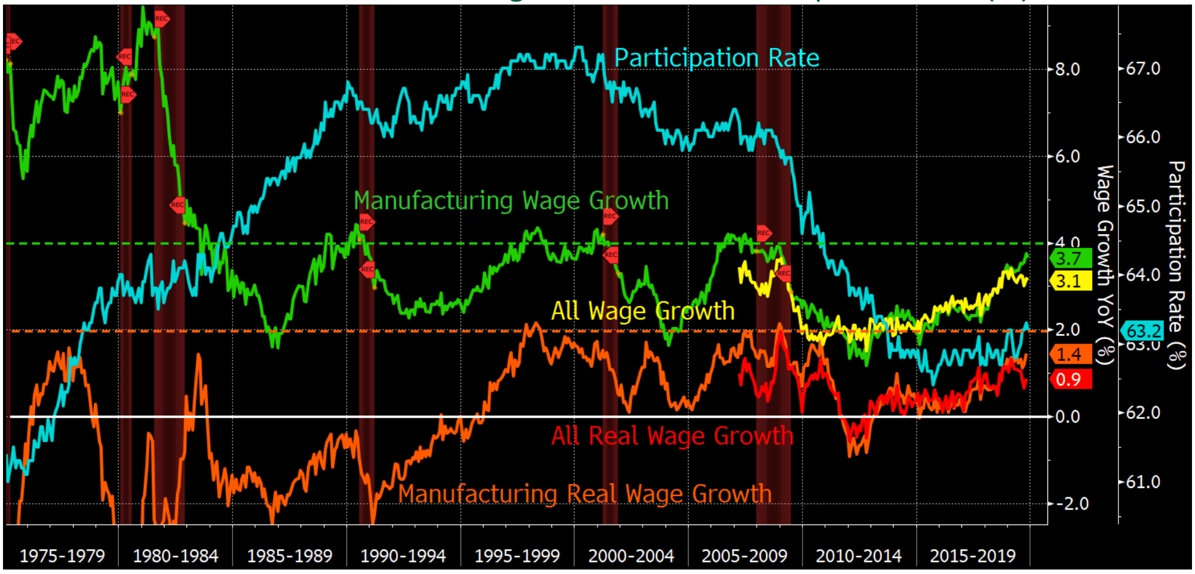
Unemployment levels traditionally start rising well ahead of the respective recessions. Along with the current record low unemployment levels, small businesses are reporting difficulties in filling job openings. Both these issues reflect continuing healthy economic conditions.

The chart on the following page shows the nominal and real wage growth levels in the manufacturing sector and the overall economy. Manufacturing wages are rising at faster rates than the overall economy. This also reflects a healthier manufacturing sector than what some perceptions may be. Despite this, the current level of nominal and real wage growth reflect more favourably towards a continuing healthy consumer market. We believe this more than offsets the building up of cost pressures that may harm economic growth.

The participation rate is also continuing to grow slowly off its low base. This also builds confidence in the US economy.

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

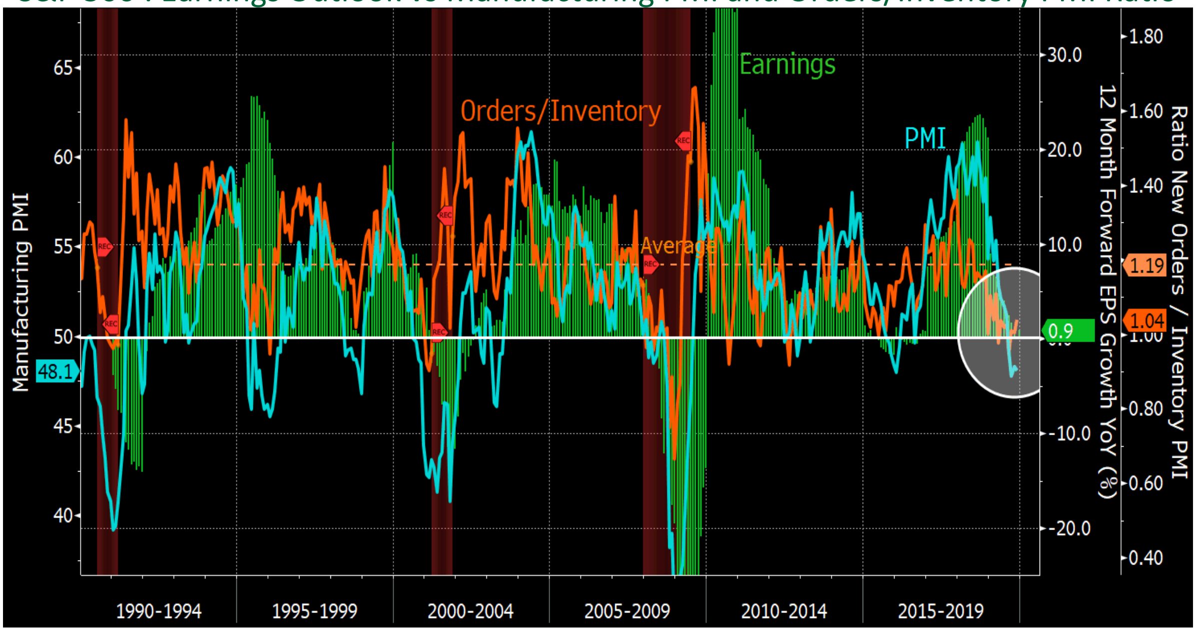
US – Nominal & Real Wage Growth and Participation Rate (%)



3. US EARNINGS

Overall S&P 500 earnings have stagnated, predominantly from weak results in the energy and materials sectors. The earnings outlook is currently on the proverbial knife's edge:

S&P 500 : Earnings Outlook vs Manufacturing PMI and Orders/Inventory PMI Ratio



Stable earnings are expected over the next twelve months (the green bars in the above chart). This series correlates well with the manufacturing PMI and orders/inventory PMI series (respectively the blue and orange charts). If these series may surprise to the upside the earnings outlook may also improve, as happened in 2016.

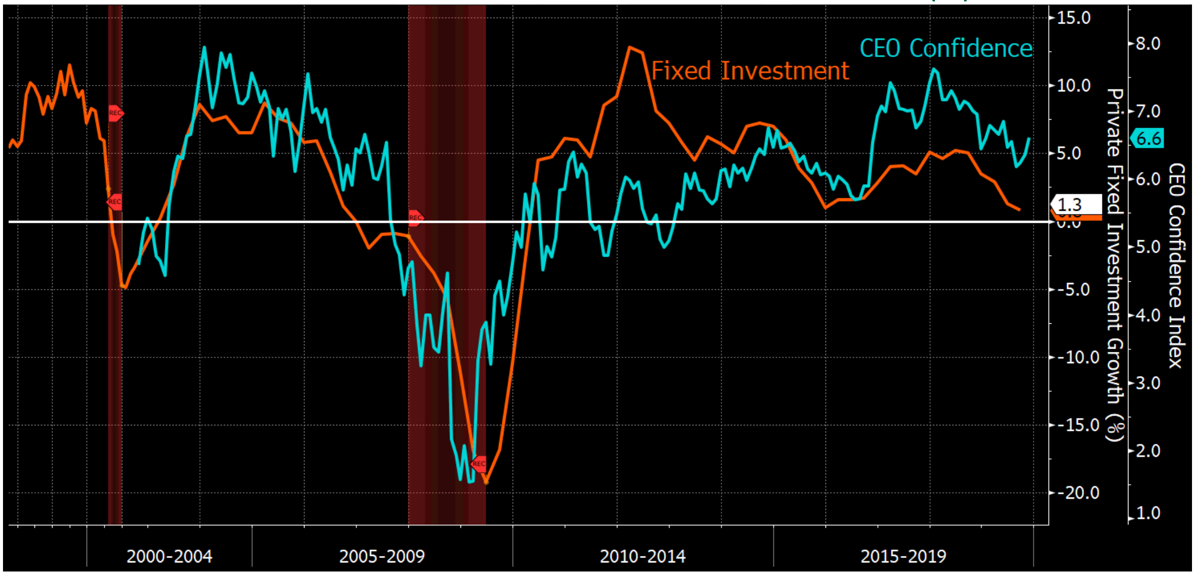
Investors generally practice a wait and see approach, but some form of solution to the US-Sino trade negotiations and the upcoming US election, along monetary easing, may provide some economic support.

4. CEO CONFIDENCE

Whilst US consumer and builder confidence remain strong, CEO confidence has been harmed by the China trade war uncertainties. This affects fixed investment, an important economic driver:

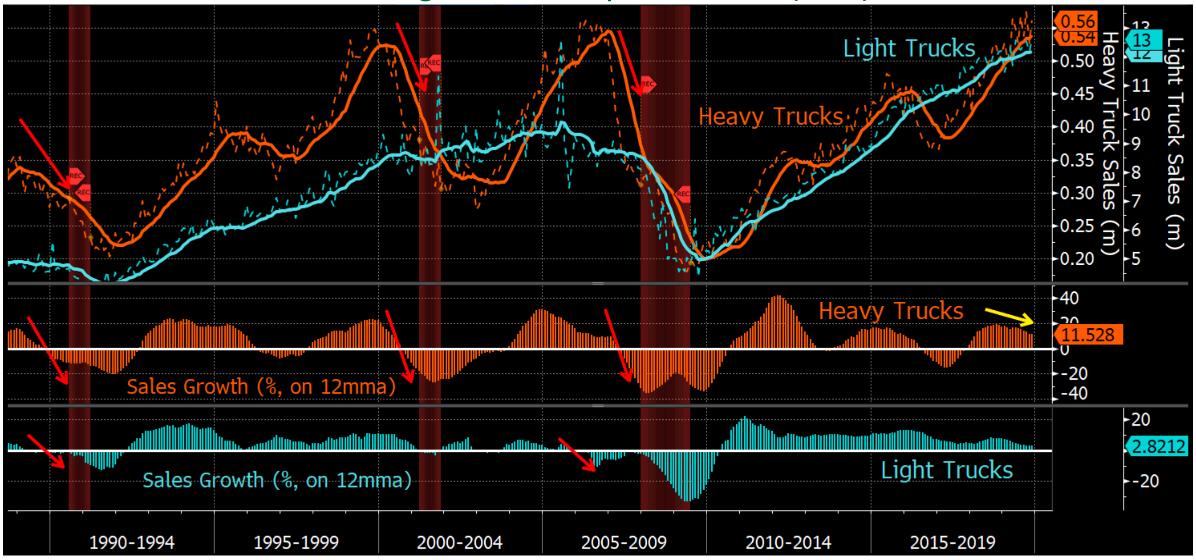
Source: Bloomberg & Stonehage Fleming Investment Management Limited. December 2019. ***Past performance should not be used as a guide to future performance.***

US – CEO Confidence vs Fixed Investment Growth (%)



Fixed investment is currently still growing marginally. Whilst CEO confidence dropped since the beginning of last year, it has recovered to some extent over the last two months.

US – Light and Heavy Truck sales ('000)



Truck sales provide a good reflection of general business confidence. Both light and heavy truck sales continue to grow, with the latter growing in double digits. They have historically dropped well ahead of the respective recessions.

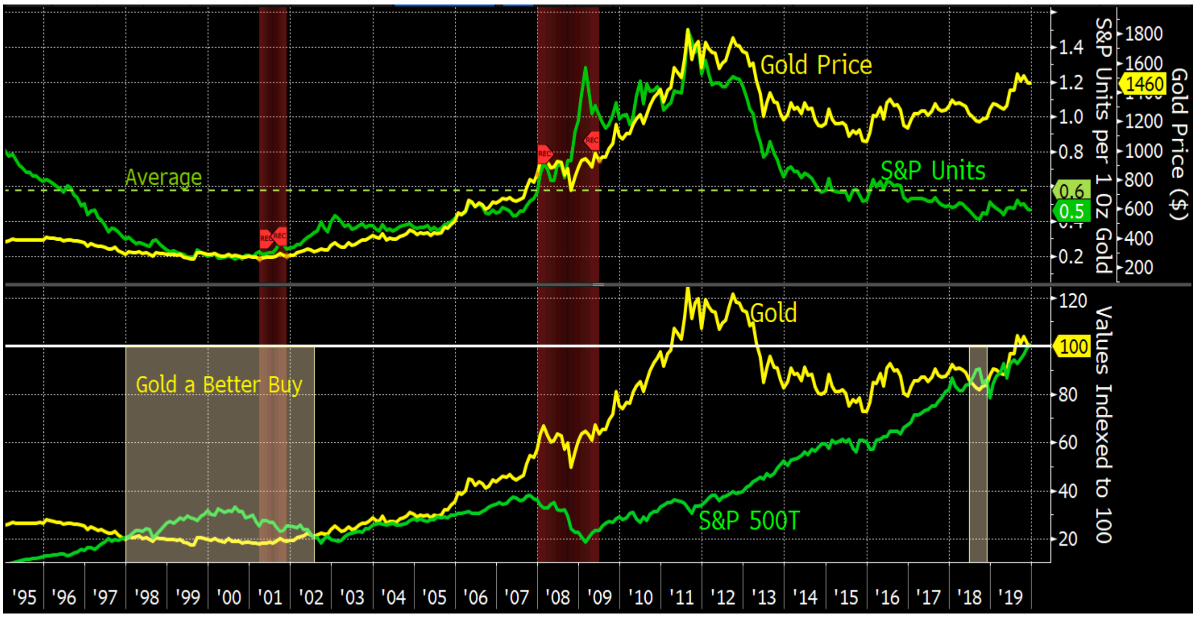
5. GOLD AS AN ALTERNATIVE

Many investors fear the volatilities of the stock market and prefer to hold gold to protect their wealth. We have done a short study to consider the merits of gold against investing in the S&P 500 since 1995. The charts on the following page reflect the result.

The top section of the chart illustrates that an investor currently needs only 0.5 S&P 500 units to buy once ounce of gold, compared to the average of 0.6. On this basis, it may seem a consideration to switch to gold.

The bottom section of the chart indexes both series to a current value of 100. This enables us to consider historically which of gold or shares was the better buy.

Gold vs S&P 500 – Number of S&P Units to Finance 1 Oz of Gold and Values Indexed to 100 on 6 December 2019



The shaded areas represent the periods when gold was the better buy. It was the case in five of the last twenty-five years. On this basis one had 5:1 odds to do better investing in the S&P 500.

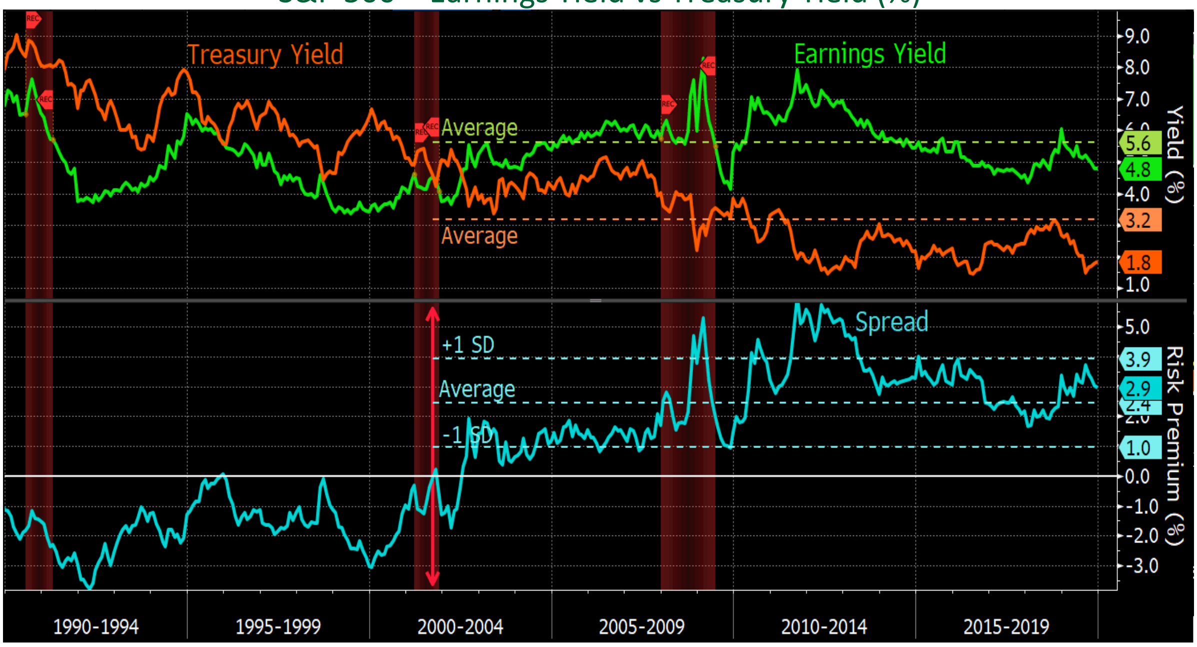
Further to this, the gaps between the two series during those periods were much smaller than during the other twenty years. This was especially the case for the five years post 2009. This implies that, apart from five times more opportunities, one could return materially more in the S&P 500.

6. EQUITY VALUATIONS

The S&P 500 index is somewhat overvalued considering data since 1990. The level of absolute overvaluation is ~13% on earnings, ~11% on dividends and ~25% on free cash flow. Seeing the current depressed results in the energy and materials sectors we reckon these are conservative numbers.

Valuations should not only be considered on absolute bases. The following two charts provide more perspectives:

S&P 500 – Earnings Yield vs Treasury Yield (%)

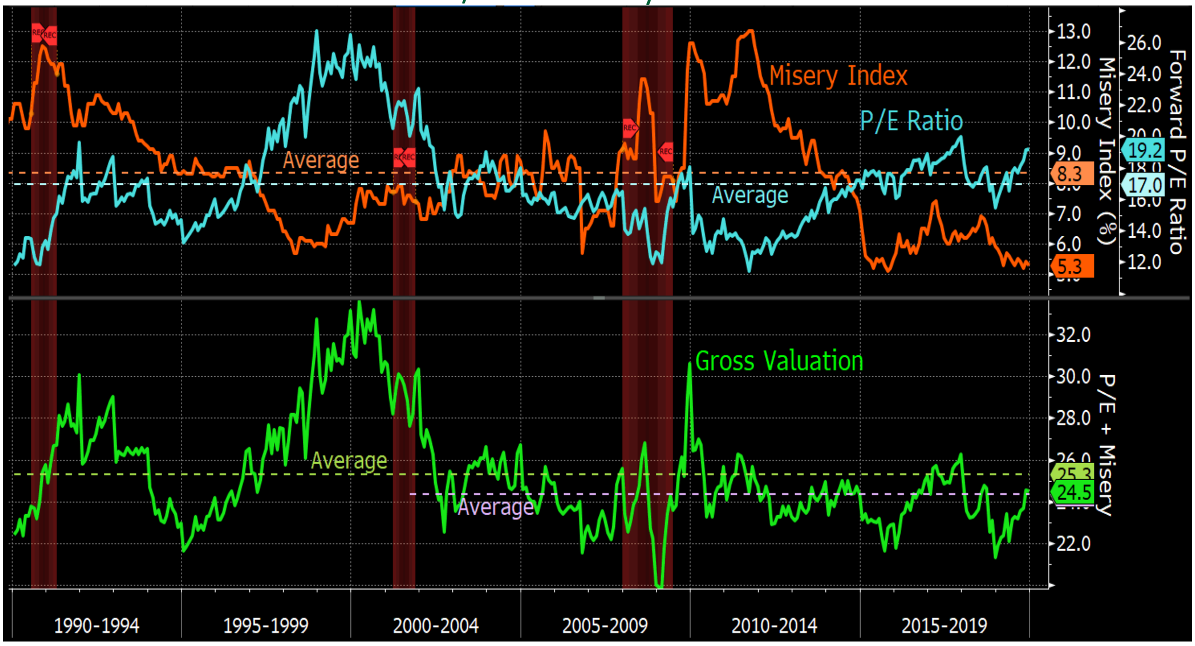


Source: Bloomberg & Stonehage Fleming Investment Management Limited. December 2019. ***Past performance should not be used as a guide to future performance.***

The level of interest rates plays a key role in equity valuations. Prior to the turn of the century earnings yields were typically lower than treasury yields. This situation reversed after the burst of the technology bubble and we now take guidance from the spread between the two series since 2002.

The current spread is 2.9%, compared to an average of 2.4%. On this basis shares are currently undervalued. Should earnings stay constant, the treasury yield can rise to 2.3% and still leave equities fairly valued. Should earnings grow further, that level of growth can also be budgeted for with respect to share performances to still leave equities fairly valued.

S&P 500 – P/E and Misery Index Valuations

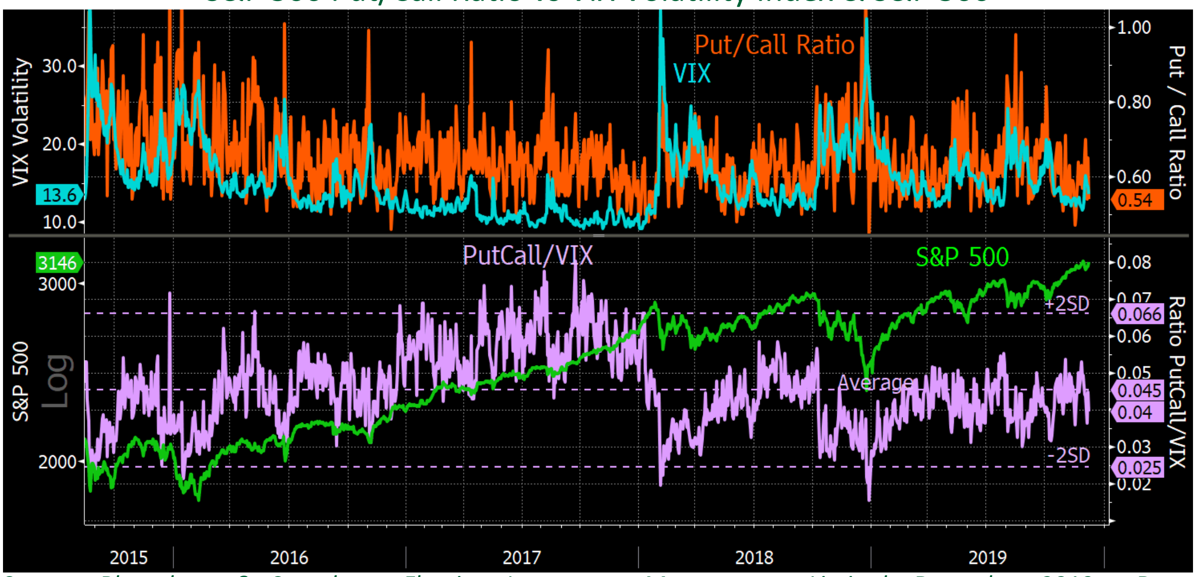


For another perspective we can also consider the level of inflation and unemployment to consider valuation levels. The lower these factors are (together called the *misery index*), the higher the valuations that can be considered. A gross valuation is calculated by adding the misery index to the P/E ratio (the green line in the chart).

The gross valuation is currently marginally below its long-term average. Should we again rather consider data only from 2002, the gross valuation is actually the same as its average. On this basis, we conclude that equities are fairly valued.

7. TECHNICAL PICTURE

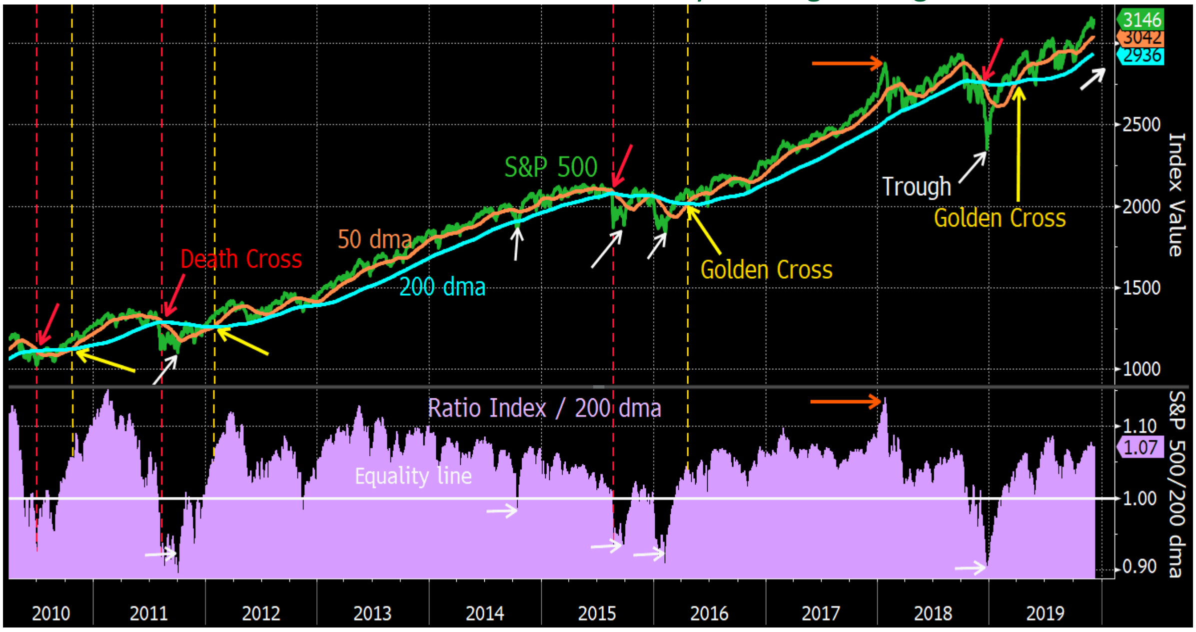
S&P 500 Put/Call Ratio vs VIX Volatility Index & S&P 500



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

We combine the S&P 500 put/call ratio and the VIX volatility index to create a technical overbought/oversold indicator (see the bottom section of the preceding chart). This ratio has historically provided fair buy and sell signals. It is currently marginally below average and reflects a technically healthy stock market.

S&P 500 – Index vs 50- & 200-day Moving Averages



All of the S&P 500 index and its 50- and 200-day moving averages are currently in a rising trend. This is technically a strong picture to hopefully end a successful investing year with. The 7% differential between the index and the 200-day average (see the bottom section of the chart) is at an elevated historical level and needs to be monitored closely.

Our sincere gratitude to our clients for another year of support and friendship, and for sharing fascinating investing thoughts. We wish you and yours all the very best for the Festive Season and a golden New Year.

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