GLOBAL EQUITY PERSPECTIVES 23 APRIL 2018

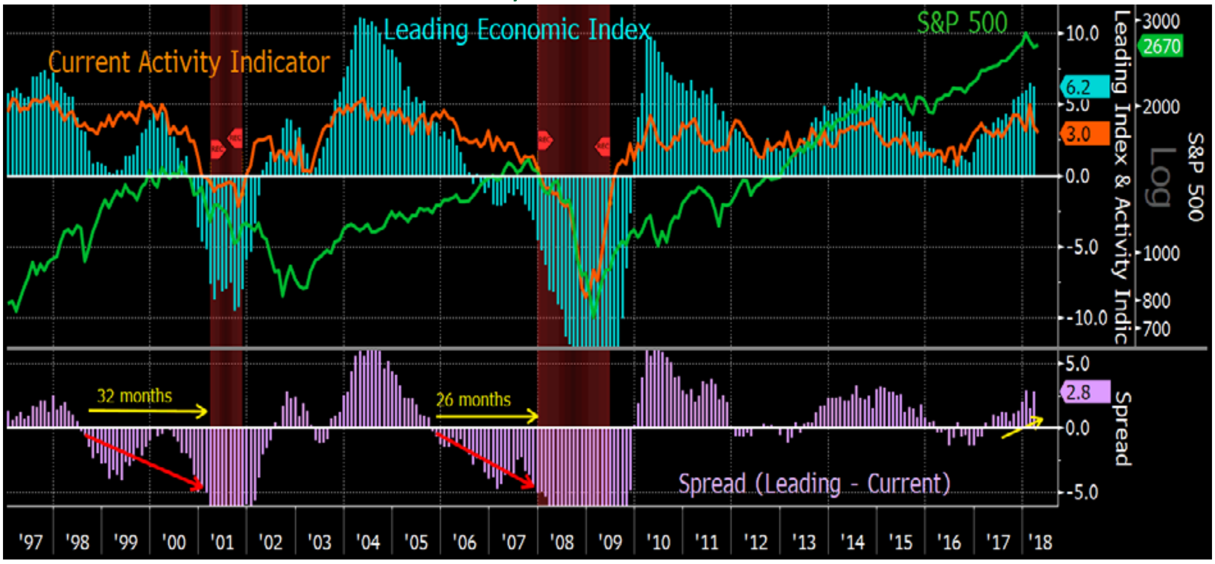
"Twenty years from now you will be more disappointed by the things you didn't do than by the ones you did do."

Mark Twain

1. ECONOMIC SUPPORT

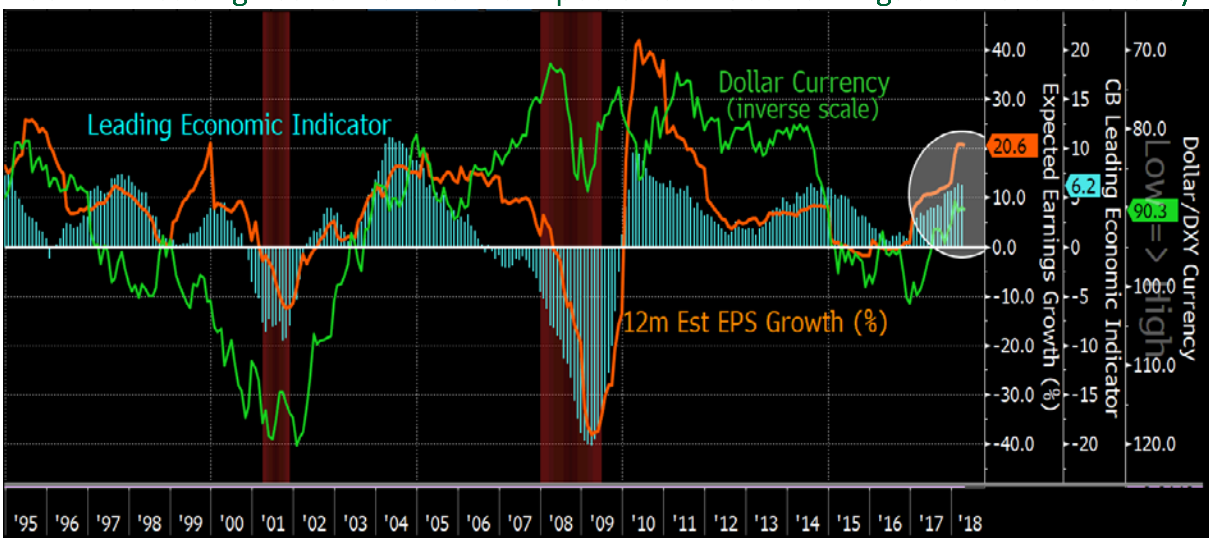
It is useful to constantly follow economic indicators to assess whether the fundamental economic outlook stays constructive.

US – Conference Board Leading Economic Index vs Goldman Sachs Current Economic Activity Index and S&P 500



The most recent reading of the leading economic index (for March) in the above chart is just fractionally lower than the preceding reading, and is still at an elevated level. This keeps the upwards trend well in place. The current activity reading dropped but is also still at a constructive level. The spread between the two series (the bottom section of the chart) is in a constructive rising trend. This series usually provide a good early warning of more than two years of an upcoming recession (see the red arrows).

US – CB Leading Economic Index vs Expected S&P 500 Earnings and Dollar Currency

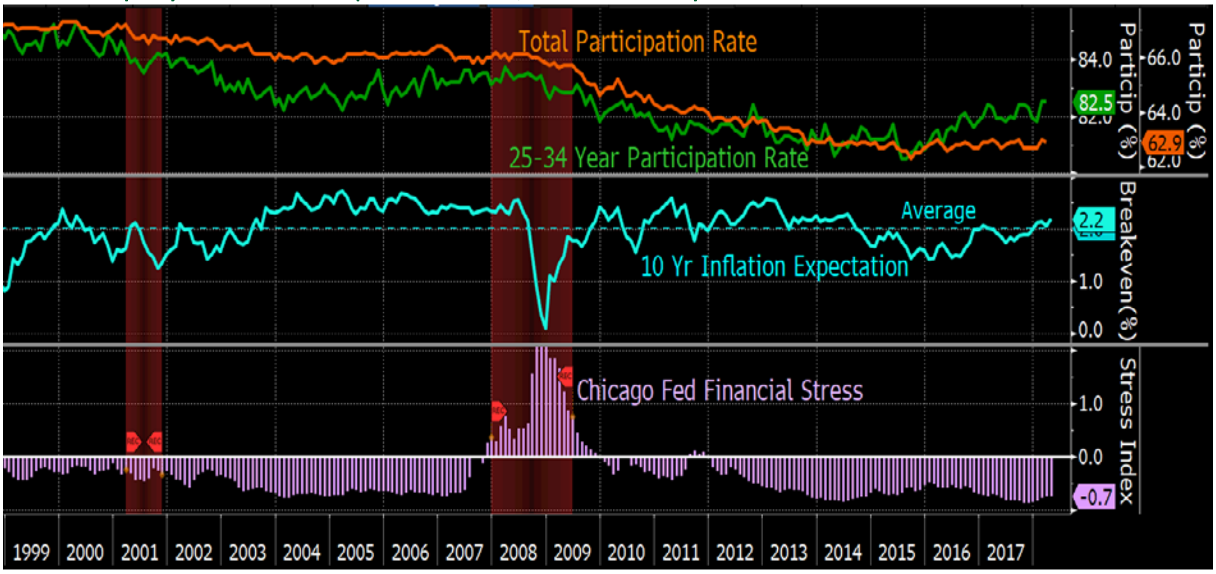


Source: Bloomberg & Stonehage Fleming Investment Management Limited April 2018. Past performance should not be used as a guide to future performance.

The positive economic outlook along with the continuing weak Dollar currency and the tax cuts support company earnings growth well. Expectations in this context for the coming twelve months are close to record levels (apart from levels following the credit crisis). Expectations are high for the current reporting season as well.

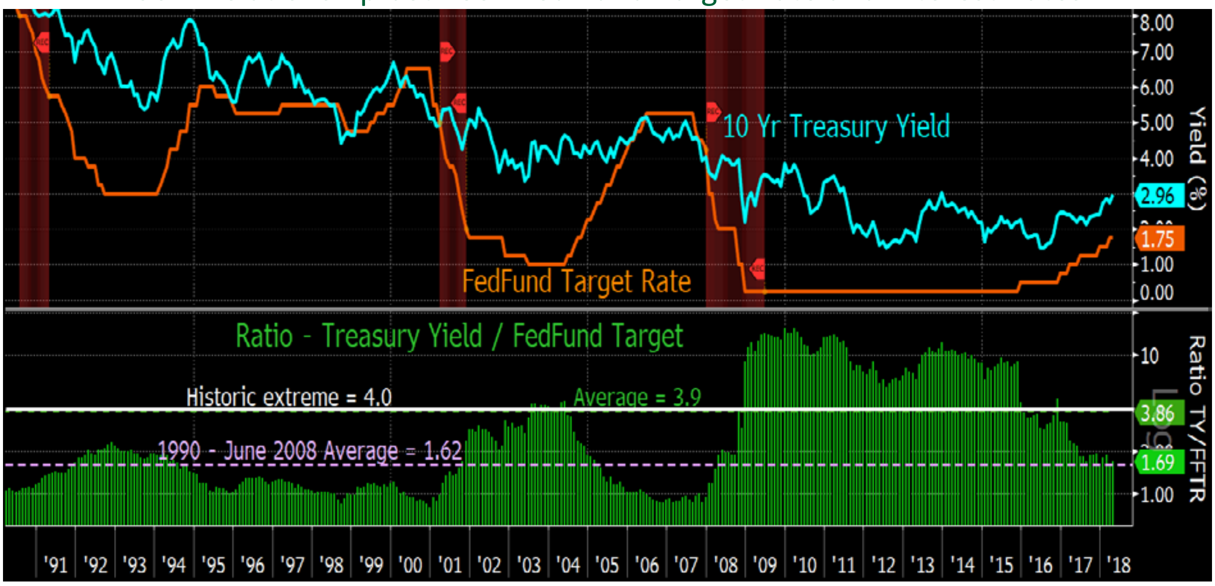
2. FED TO TIGHTEN

US – Employment Participation Rate, Inflation Expectations and Financial Stress Index



The underlying forces in the US economy in the context of the Federal Reserve's considerations for further tightening currently seem to be benign. Whilst the overall employment participation rate has been low for long, it is noticeable that the rate for young people is picking up. Inflation expectations (as reflected through the breakeven rate) are picking up and are now marginally above the long-term average. Stresses in the financial system are also relatively low (bottom section of the chart).

US – Relationship between Fed Fund Target Rate and Interest Rates



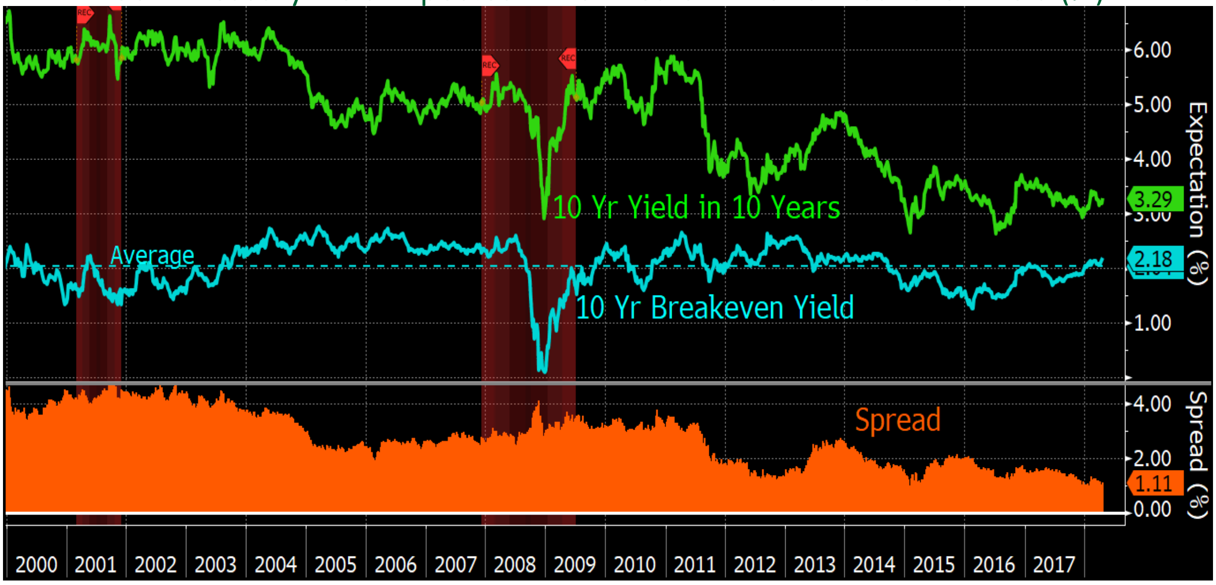
It is striking to notice that the historic relationship between the Fed Fund target rate and US interest rates has been restored should we perceive the average ratio between the target rate and the ten-year yield before the credit crisis as a fair norm (see the bottom section of the above chart). On this basis we can expect interest rates to rise further when the Fed tightens. It is also important to mention that we perceive this possibility in a positive light because it rather reflects economic normalization to a real target rate rather than fears for high inflation.

Source: Bloomberg & Stonehage Fleming Investment Management Limited April 2018. Past performance should not be used as a guide to future performance.

3. STABLE BOND MARKET

Our preceding comment about economic normalization is reflected in the following two charts considering the bond market:

US – Treasury Yield Expected in Ten Years' Time vs Breakeven Yield (%)



Through the zero-coupon market bond investors show us what their expectations for future bond yields are. The green line in the above chart reflects the expectations for yields in ten years' time for the ten-year maturity bond. The chart also shows the ten-year breakeven yield (the expectations for inflation), and the spread between the two series (the orange bars in the bottom section).

We take two important indications from the chart. Firstly, the expectations for long-term yields remain relatively stable, and secondly, the spread with the inflation expectations remains in a downwards trend. The combination of these two reflect a stable bond market in our view, with little anxiety.

US – Treasury Yield Expected in Ten Years' Time vs Current Yield (%)

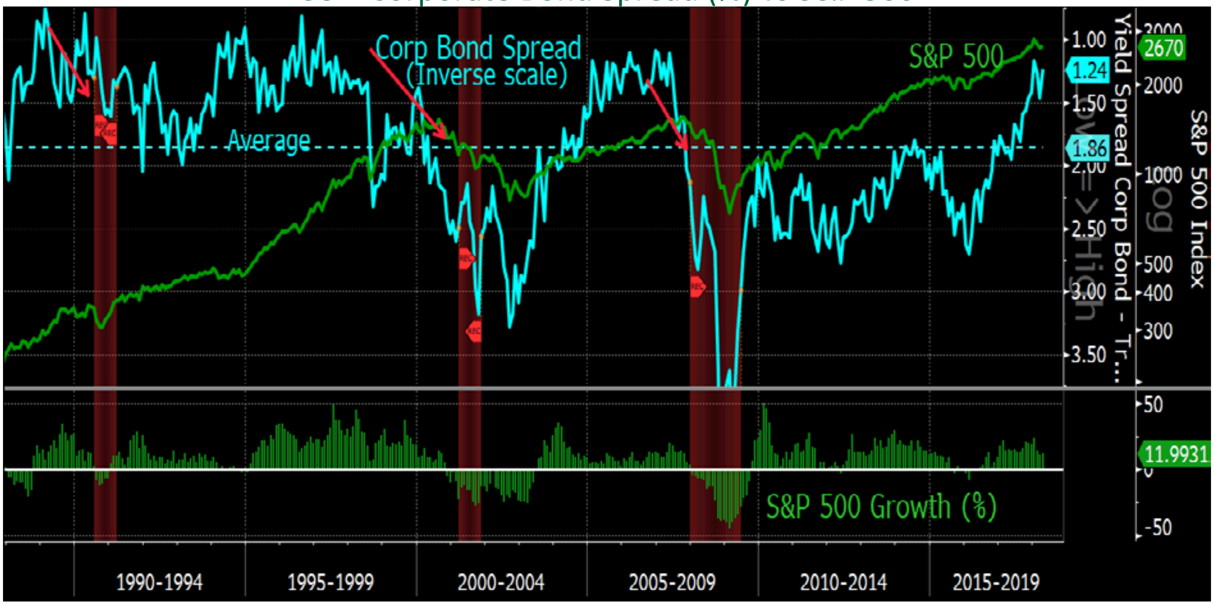
The above chart reflects the same rate expectations, but in this case the spread with the current ten-year yield. Again, the spread is in a downwards trend, not reflecting anxiety. We, therefore, still see rising interest rates in a constructive sense reflecting a normalising economy rather than inflation fears, and therefore being constructive towards equity investing.

Source: Bloomberg & Stonehage Fleming Investment Management Limited April 2018. Past performance should not be used as a guide to future performance.

4. CORPORATE BONDS VS EQUITIES

The corporate bond market is, like the sovereign bond market, an alternative to investing in equities. Developments in this market is therefore a good barometer also of equity investing.

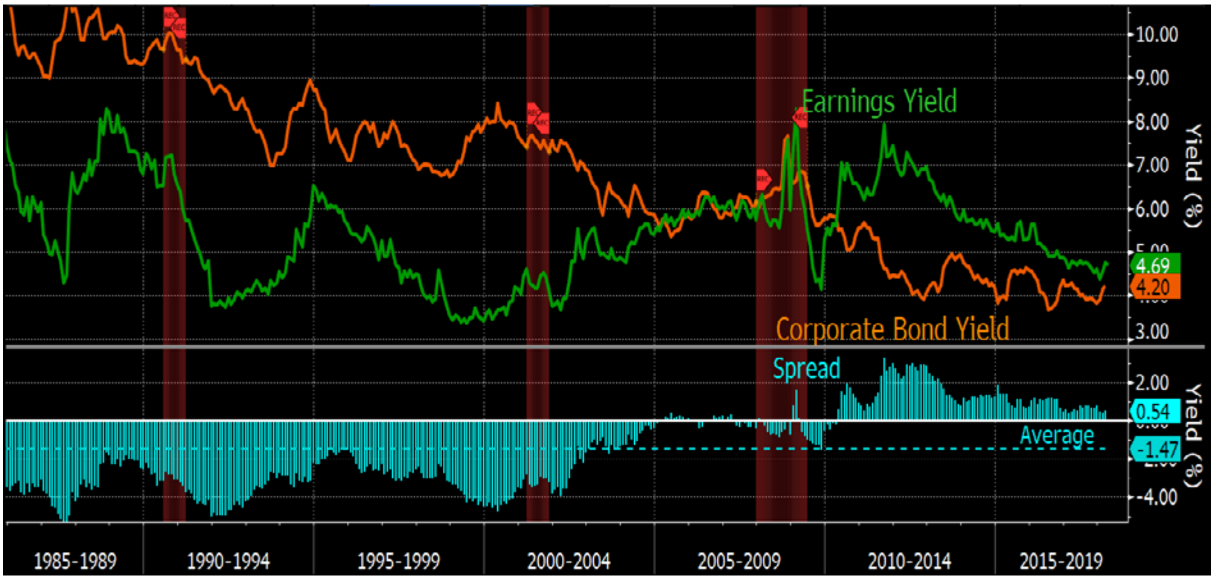
US – Corporate Bond Spread (%) vs S&P 500



The spread between the corporate bond and the ten-year treasury yield is a good indicator in the bond market of changes in fundamental support for investing in business, and therefore equities (presented on an inverted scale in the above chart). The spread shows some correlation with share prices, and periods when the spread remains low delivers a continuing good performing equity market (see the bottom section of the chart).

The current spread is at a low level, reflecting a positive corporate bond market, and a positive equity environment. These relatively low levels of spreads have historically stayed in place for some time.

US – Corporate Bond and S&P 500 Earnings Yield (%)



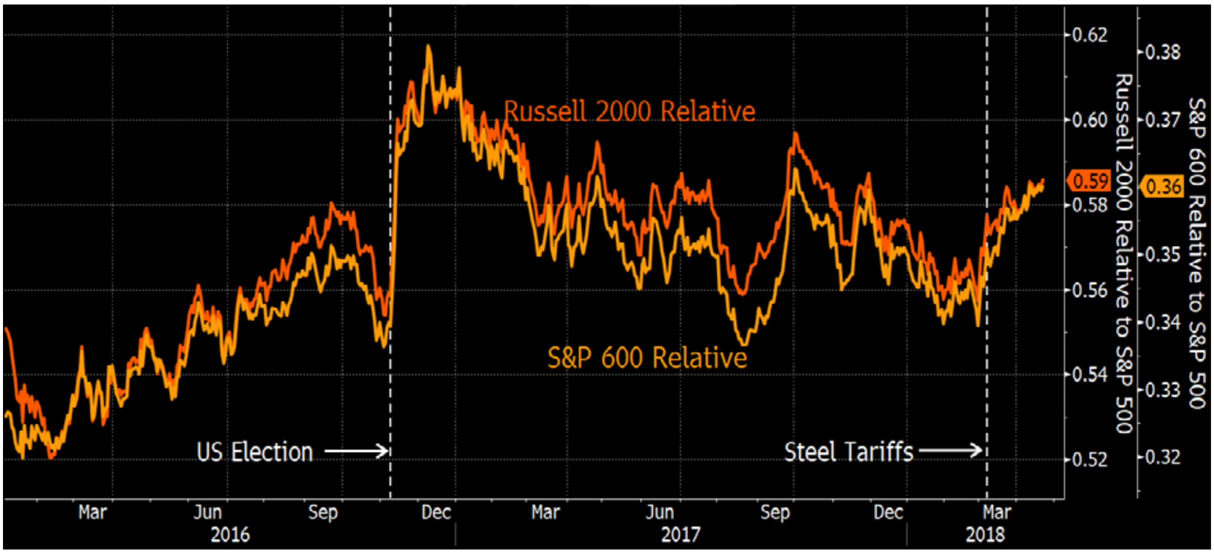
Corporate bond yields have before the credit crisis been higher than earnings yields, clearly because equity investing would offer dividend growth whilst corporate bond payments would stay at the issue level. This discount switched to a premium after the credit crisis in the hunt for yield, but this premium has been shrinking recently (see the bottom section in the chart). This spread should narrow further, arguing in favour of equity investing on this relative basis.

Source: Bloomberg & Stonehage Fleming Investment Management Limited April 2018. Past performance should not be used as a guide to future performance.

5. AMERICA FIRST

The US president's focus on delivering for the domestic economy is apparent in the equity market again:

US – S&P 600 and Russell 2000 Relative to S&P 500



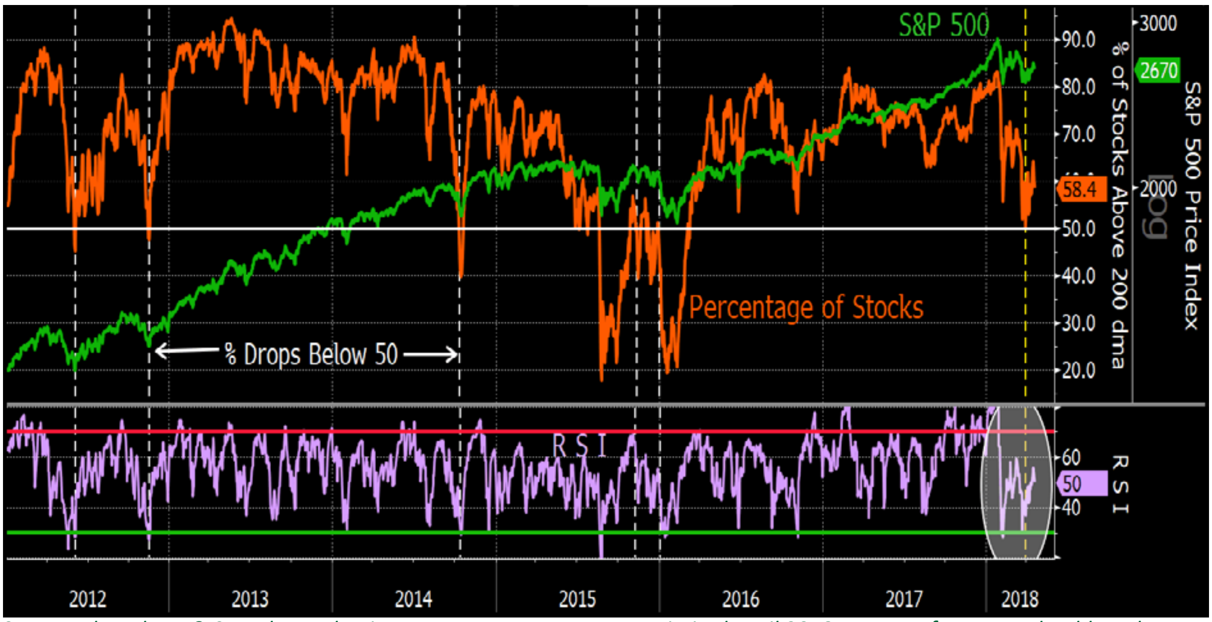
The shares of more domestically focused companies outperformed materially after the election in November 2016 (we use the Russell 2000 and S&P 600 as more representative than the more global businesses in the S&P 500 index). This is happening again since the announcement of the trade tariffs.

It is also clear that these spurts of outperformance may be of a relatively short-term nature, and we would be careful about a too large exposure to such opportunities. This comment is further relevant in the context of the weak dollar, making offshore exposure attractive also for the US investor.

6. TECHNICAL PICTURE

We showed the chart of the S&P 500 with its 200-day moving average in our previous note. It was trading exactly on the technical support of the moving average, and has since bounced back, now being 2% above the average. This reflects technically a healthy market rather looking for buying than selling opportunities. This comment is supported by the following picture:

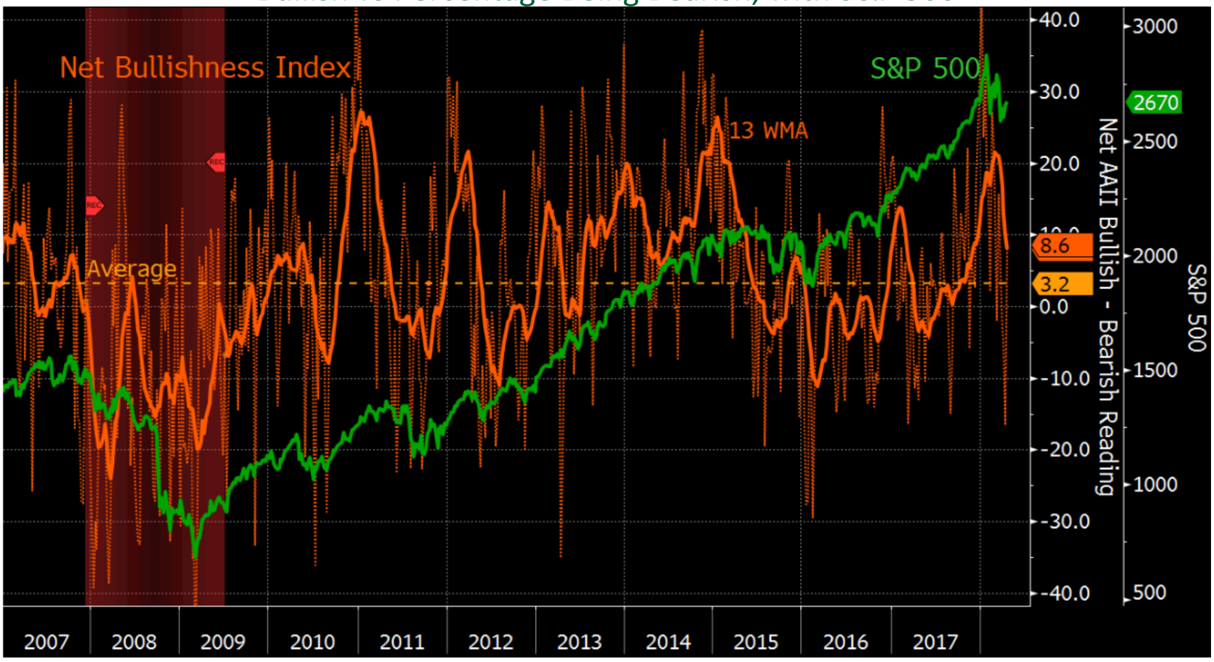
S&P 500 – Percentage of Stocks Above 200 Day Average, and RSI



Source: Bloomberg & Stonehage Fleming Investment Management Limited April 2018. Past performance should not be used as a guide to future performance.

The percentage of stocks dropping through their respective 200-day averages stayed above the critical 50% level despite the fears for a world trade war and seems to be on its way up again. This is technically a positive result. Along with this, the Relative Strength Index dropped to its critical low 30 index level, indicating oversold equity prices. This index bounced back quickly to the average level of 50, reflecting confidence in the equity market.

American Institute of Individual Investors – Spread of Percentage of Members Being Bullish vs Percentage Being Bearish, with S&P 500



It is interesting that, on average, American individual investors are only mildly (3%) bullish on a net basis. The swings in this net bullishness index are quite a contra leading indicator of stock market trends.

The net bullishness level rose to 40% in January with the tax cuts and dropped to a low of -18 with the announcement of trade barriers. It has since bounced back to an above average level. The chart of gross bullishness (not shown) is back on its average of 38%. On balance, these indicators do not reflect exuberance anymore, leaving a healthy environment for equity investing.

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