GLOBAL EQUITY PERSPECTIVES 20 APRIL 2020

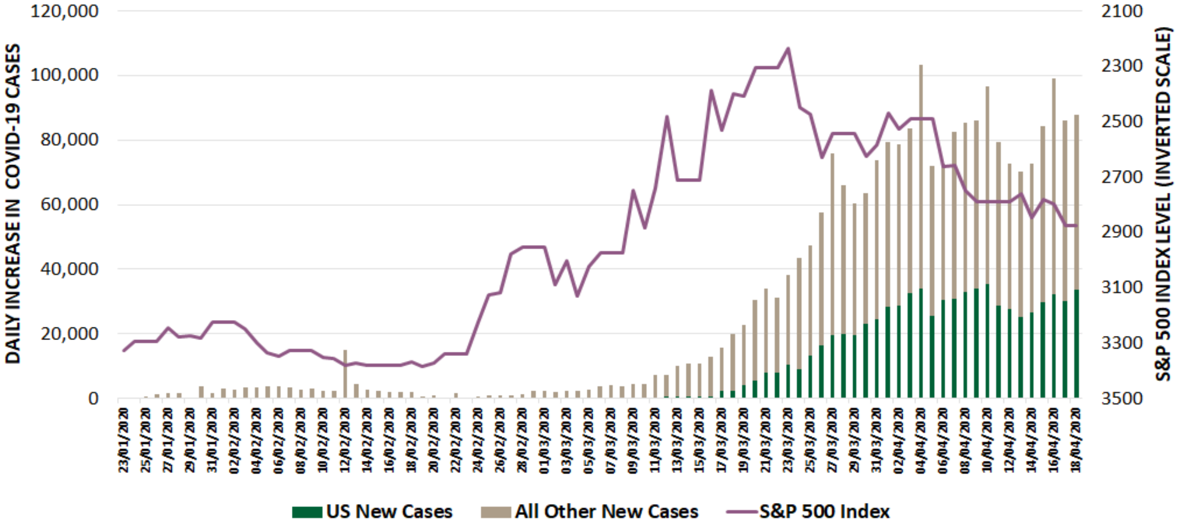
"Well bought is half sold."

Howard Marks

1. THE RECESSION

The level of total new COVID-19 infections obviously plays a significant role in investor sentiment:

Global Daily New COVID-19 Cases vs S&P 500



Despite some recent spikes in infection numbers (some from the inclusion of care home data), it seems the trend is in process of rolling over. The S&P 500 index is following a similar trend (presented in an inverted scale in the above chart).

Whilst all recessions have different causes (and effects), many wonder whether this one can be a repeat of the 1929 Depression or the 2008 Credit Crisis examples. We do not share those fears because of the huge differences in fundamental causes now and then. We summarise the main issues at that time in the following table:

1929 DEPRESSION COMPARISON

THEN	EFFECT	NOW
Raised FedFund rate through recession	Contractionary Monetary Policies	Fed totally on board
Gold Standard	Dollar collapse	Strong Dollar
Fed raised interest rates to protect Dollar	More bankruptcies	Fed cut rates
Fed did not increase Money Supply	More Monetary contraction	M2 = +7%
Banking panic	Fed ignored	Sector Repaired after GFC
Decreased international lending	Less trade	Manufacturing weak
Smoot-Haley Tariff Act 1930	Less trade	Trump tariffs
Federal Reserve = Huge Problem		Federal Reserve = Major Solution

2008 FINANCIAL CRISIS RECESSION COMPARISON

THEN	EFFECT	NOW
Liquidity crisis	Threatened Financial system	Incredible central bank and government responses (it is about human health and life)
Banking sector the problem		Banking sector part of solution

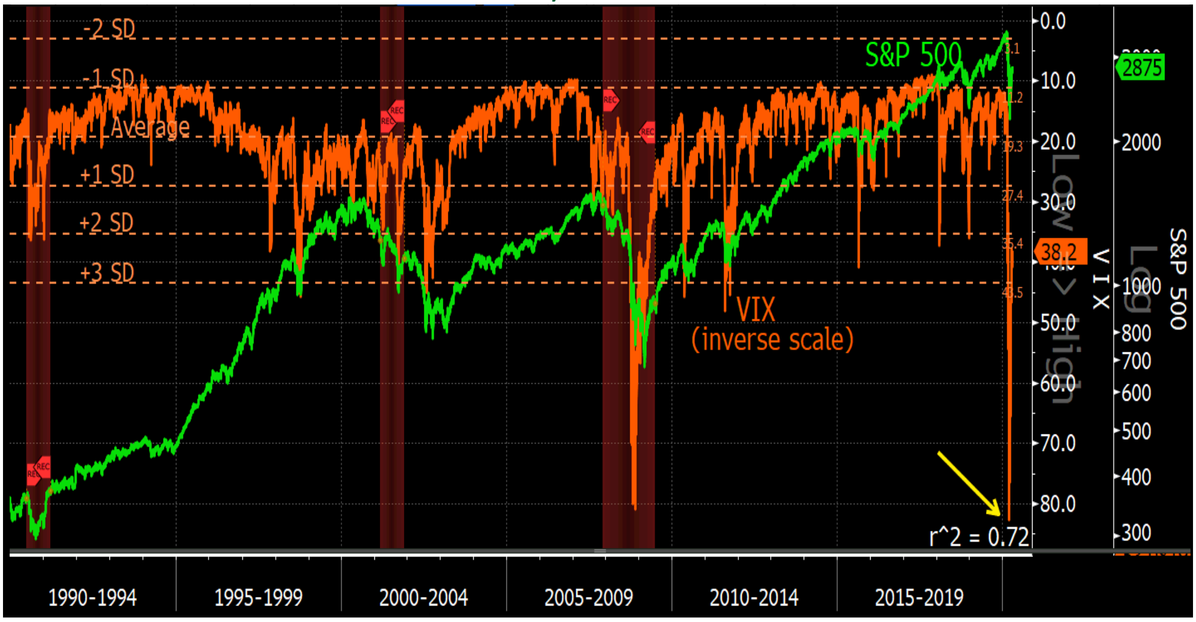
Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2020. ***Past performance should not be used as a guide to future performance.***

The fundamental global economic backdrop preceding the pandemic was constructive with high consumer confidence in both of the world's two largest economies. Of course, the pandemic now has huge fundamental global economic effects and creates a new normal in many aspects, but once it is brought under control, we are not currently facing either the potential collapse of the global financial system or contractionary monetary policies as in the preceding examples.

2. WORST FEARS

The pandemic caught investors unprepared and overnight triggered of the worst fear levels we have seen since the credit crisis. The most apparent example is the VIX volatility index:

VIX Volatility Index vs S&P 500



The VIX spiked to a level of 82.7 points, an all-time record level (presented in an inverted scale in the above chart). This clearly illustrates the extent of investor fears we are witnessing. It has since dropped to a 38.2 reading, which still is over two standard deviations from its long-term average.

We are following a number of Worst Fear indicators to form impression whether the worst is behind us in this context, or not. We present our conclusions in the following table:

Perception of Worst Fear Factors

Bottom Identifier	Score / 5	Mark	Weight	Contribution
Peak COVID-19 Fears	3.5	70%	35%	25%
Peak Volatility	5.0	100%	15%	15%
Peak Volumes	3.0	60%	7.5%	5%
Peak Financial Conditions	3.5	70%	5%	4%
Dollar Strength	4.5	90%	7.5%	7%
Trough Oil	3.5	70%	7.5%	5%
Peak HY Corporate Spreads	4.5	90%	7.5%	7%
Trough Long Term Rates	3.5	70%	5%	4%
Trough Inflation Expectations	4.5	90%	5%	5%
Smart Money Investing	4.0	80%	5%	4%
Total / Average	**4.0**	**79%**	**100%**	**78%**

Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2020. ***Past performance should not be used as a guide to future performance***

We apply our subjective score out of 5 to each fear factor (5 = Peak Fear) and allocate an overall weight and then an overall contribution to each factor. As shown, our perception is that peak volatility has already been reached, that most of the flight to the Dollar is over and that the bottom of long-term inflation expectations has probably already been reached. Against that, despite the very high share volumes currently, they are not exceeding historic panic levels and we apply a relatively reserved score on this item.

The overall contribution comes to 78%. We, therefore, reckon around three quarters of investors' worst fears are already behind us. The remaining quarter may continue causing market volatility, but we believe should not fear the worst in this context still to come.

3. MARKET BOTTOMS

We undertook a study of when markets usually bottom around recessionary periods. The results are presented in the following table:

Historic S&P 500 Bottoms

Date US Recession Started	Date US Recession Ended	Recession Length (months)	S&P 500 Bottom Month	S&P 500 Bottom before Recession Ends (months)	Ratio S&P 500 Bottom Month / Recession Length (in months)
Feb-45	Oct-45	8	Mar-45	7	88%
Nov-48	Oct-49	11	Jun-49	4	36%
Jul-53	May-54	10	Aug-53	9	90%
Aug-57	Apr-58	8	Dec-57	4	50%
Apr-60	Feb-61	10	Oct-60	4	40%
Dec-69	Nov-70	11	Jun-70	5	45%
Nov-73	Mar-75	16	Sep-74	6	38%
Jan-80	Jul-80	6	Mar-80	4	67%
Jul-81	Nov-82	16	Jul-82	4	25%
Jul-90	Mar-91	8	Oct-90	5	63%
Mar-01	Nov-01	8	Sep-02	-10	225%
Dec-07	Jun-09	18	Feb-09	4	22%
Mar-20					
			Average	4	66%
			Ave. ex 2001	5	51%
			Median	4	43%

Source: Bloomberg, National Bureau of Economic Research & Stonehage Fleming Investment Management Limited. April 2020.

The second-last column to the right shows the number of months that the S&P 500 bottomed before the particular recession ends. The far-right column shows that number as a ratio of the length of the particular recession. The 2001 bear market stands out – the market bottomed after the recession ended. That bear market was saddled with both the 9/11 terrorist attack and a hugely overvalued market that needed time for valuations to normalise. We are not currently saddled with the latter issue.

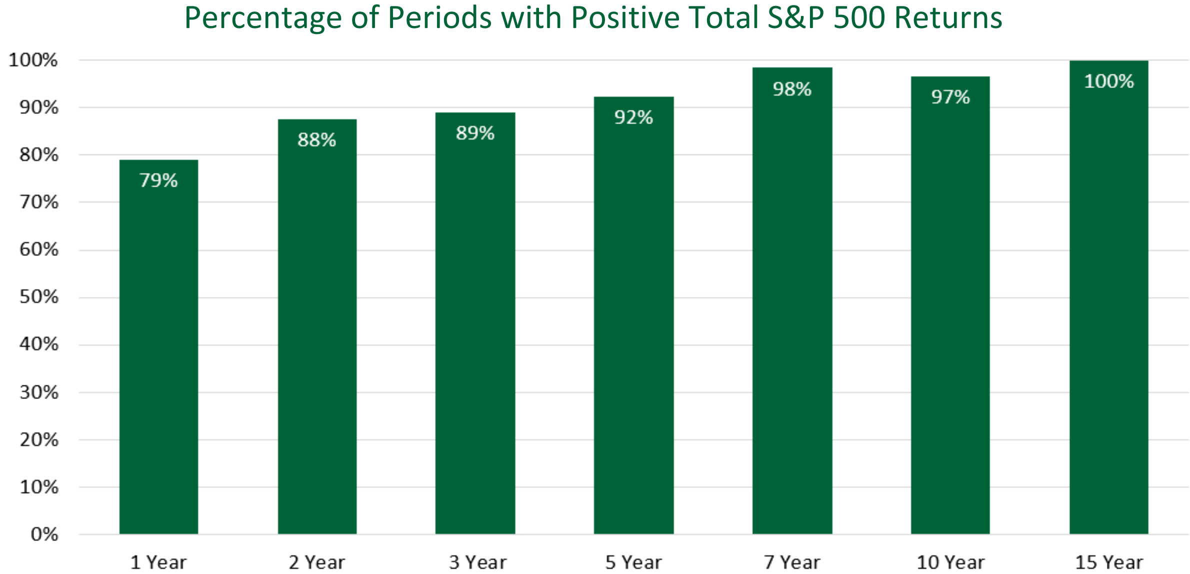
On average, the market bottomed five months before the recession ends (four months if we include the 2001 figure). This is on average halfway through the recession (excluding the 2001 figure).

World economies are clearly undergoing collapses for at least the current and the following quarters. The current central viewpoint is that quarantines are likely to carry on into the middle of the year and prove successful to flatten the infection curves. The lifting of quarantine measures is expected to follow a measured approach as with China/South Korea with gradual economic recovery starting from the third quarter off an exceptionally low base. Growth is expected to pick up by the end of the year with stimulus tailwinds well into 2021. We still face material risks of second (or third) infection waves, but on the other hand we may benefit from better treatments.

No two recessions are the same and history does not always repeat itself, but we conclude that waiting for the end of a recession to invest is most probably a too conservative investment strategy.

4. BEING ON THE SIDELINE

We have done an exercise to understand the option to wait for good news on the COVID-19 front to invest. The following chart depicts the historic frequency of positive S&P 500 returns since 1950. Calculations are done based on investing every month and considering the result after the respective periods.

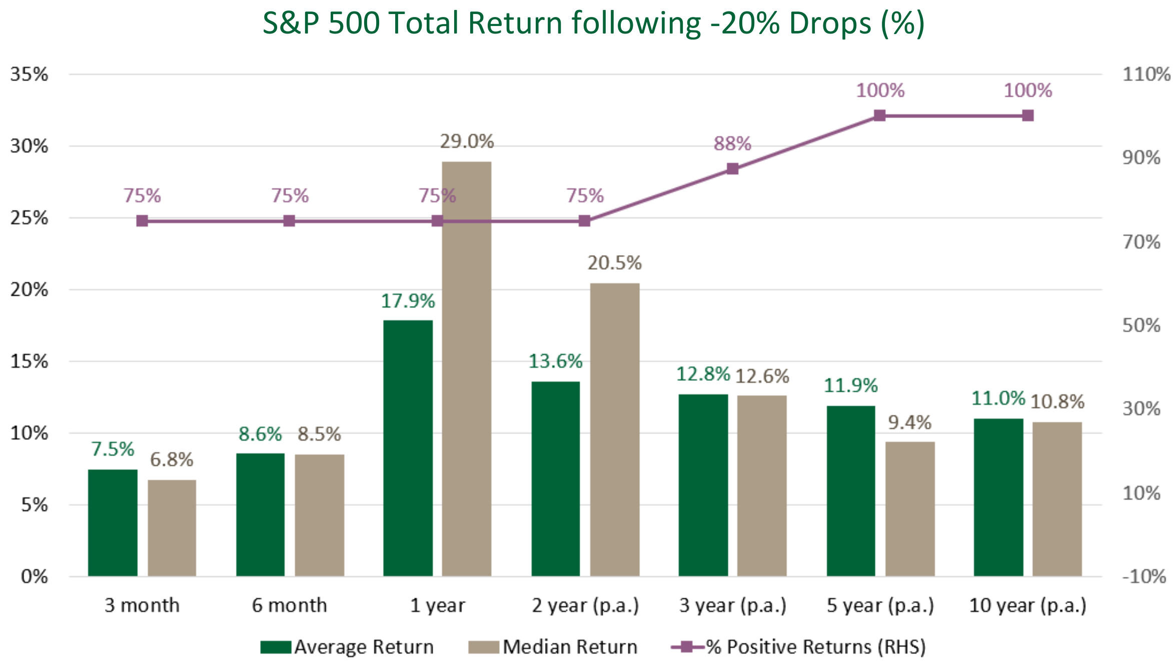


The result may be a surprise to many. Even after such short a period as one year, in more than three quarters of the cases investors were rewarded with positive results. Obviously, this ratio increases with the duration of the investment.

The reverse point to also make is that this chart reflects the risk of not being invested. Clearly those who are successful with market timing can add such value, but most investors have risk of not buying back at the right time even if they may have sold at the right time. They have to make two correct calls, while the one staying invested has the above record in their favour.

5. INVESTING IN A BEAR MARKET

Many investors wonder how long they should wait before investing in a bear market.



Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2020. ***Past performance should not be used as a guide to future performance.***

The general definition of a bear market is one where the market drops -20% from its preceding peak. We present in the preceding chart the average returns since 1950 at all those points of a -20% drop (annualised when more than one year). We also show the median returns, and the ratio of positive returns over all the periods.

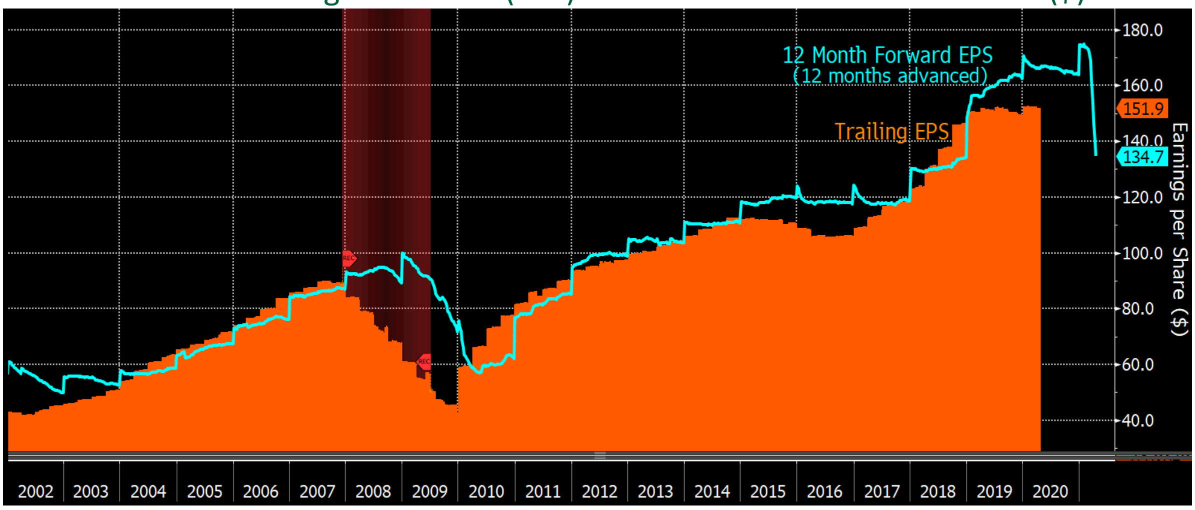
The overall result is rather pleasing. This is also the case over periods shorter than a year. The ratio of positive returns also comes to three-quarters or more. Double digit returns are generally earned after one year or longer.

This exercise indicates that investors should guard against waiting for potential bottoms in a bear market or postponing investing for too long.

6. COMPANY EARNINGS

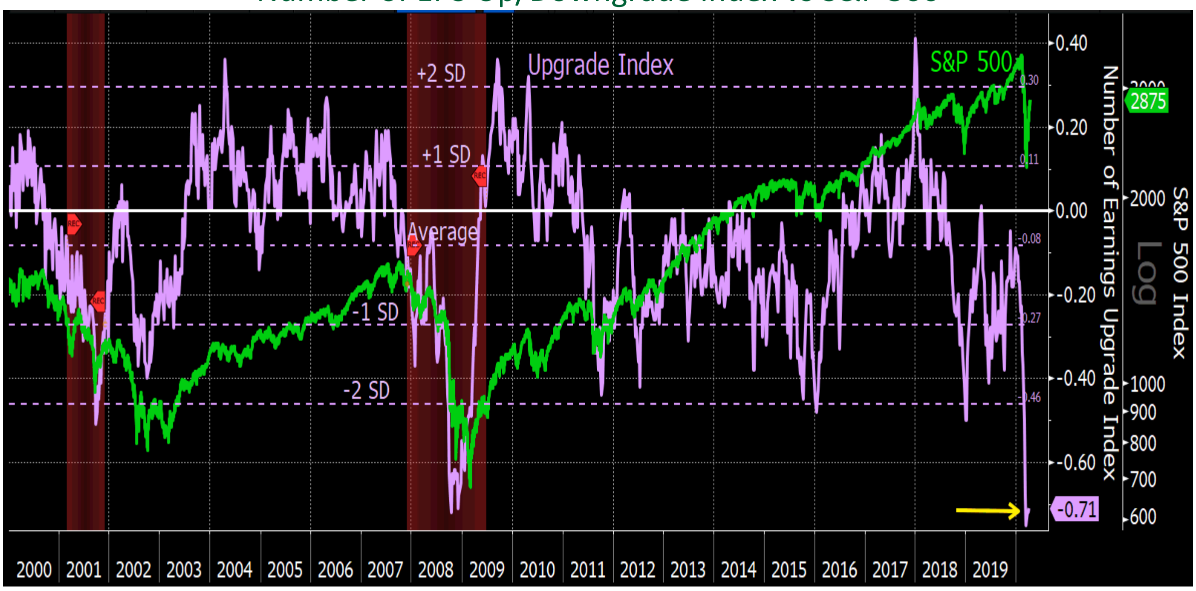
We are about to enter the first quarter reporting season. Investors know they must brace themselves for a dire picture and that there is little value in considering the immediate outlook in this context. Whilst the true value of any business lies in its longer-term performance, investor sentiment fluctuates hugely around short-term issues.

S&P 500 Earnings Per Share (EPS) – Historic and One Year Forward ($)



The historic EPS base is currently at a record level, and will of course now start dropping. The consensus twelve-month forward expectations have also been at a peak, but has already dropped by -23% from $174 to $135.

Number of EPS Up/Downgrade Index vs S&P 500



Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2020. ***Past performance should not be used as a guide to future performance.***

The preceding chart reflects an index of the number of EPS up or downgrades. Strikingly, the index reacted more negatively with COVID-19 than with the Credit Crisis. Also, importantly, the index seems to have stabilised (daily data started rising marginally from 20 March). It historically provided good buy and sell signals, especially so when it is two standard deviations away from average.

7. TECHNICAL PICTURE

The market is currently at a very interesting technical level:

S&P 500 – Price Index vs Moving Averages

We have recently had the (negative) proverbial Death Cross (the 50-day moving average dropped through the 200-day moving average, the red arrow). Against that, it has dropped way beyond the 200-day moving average (the white arrow at the bottom) and has now recovered to a level above the 50-day average). This is of more concern to those being short the market.

Our thoughts are with everyone affected by COVID-19, be it directly or indirectly.

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Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2020. ***Past performance should not be used as a guide to future performance.***

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