# GLOBAL EQUITY PERSPECTIVES 25 MAY 2020

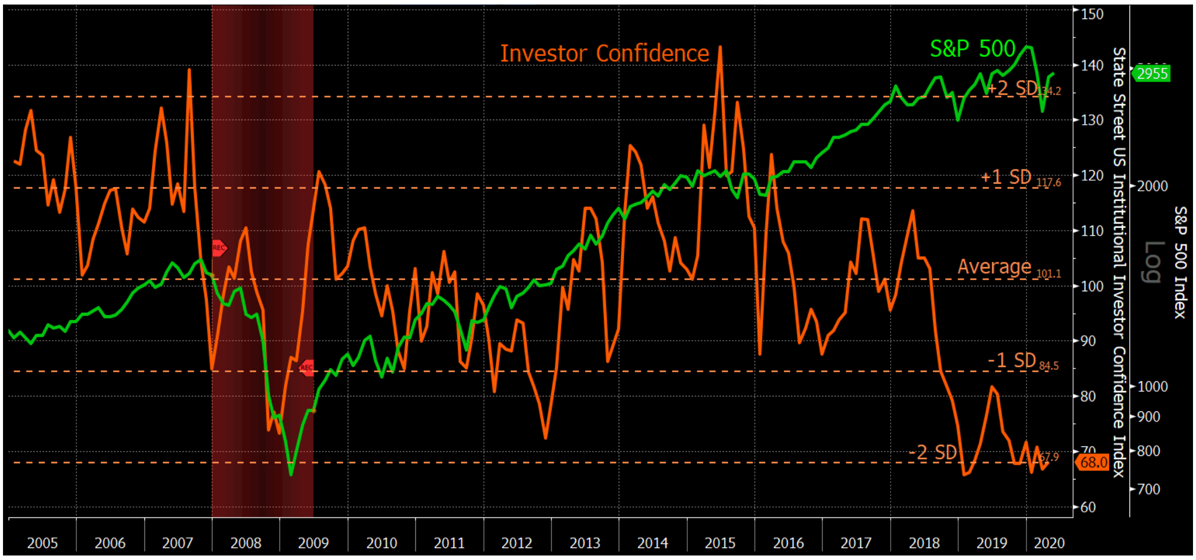
*"Wonder is the beginning of wisdom."*

*Socrates*

## 1. INVESTOR CONFIDENCE

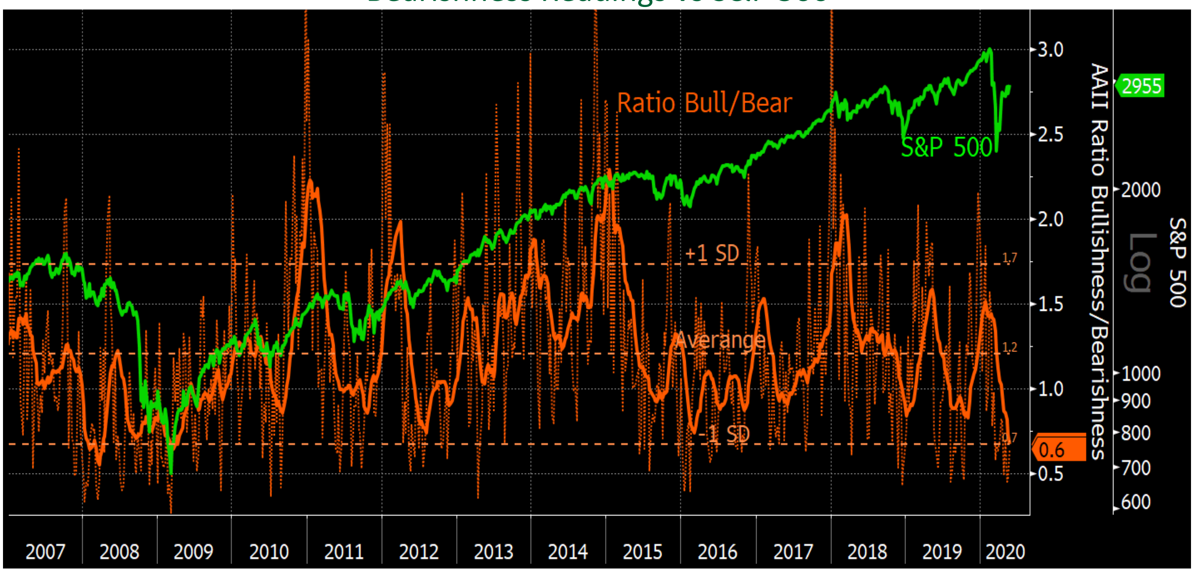
Investor confidence remains weak as reflected in the following two charts:

### US Institutional Investor Confidence Index vs S&P 500




US institutional investor confidence is currently at historic low levels, two standard deviations away from the average. Potential positive economic news may have quite some effect. As reflected in the chart, trough levels in investor sentiment have historically been associated with positive turns in share prices.

### American Association of Individual Investors (AAII) – Ratio of Bullishness to Bearishness Readings vs S&P 500




The conclusions are similar regarding the US individual investor market. The ratio of the AAII bullishness to bearishness index is currently close to historic low levels, again with a historic correlation with share prices. Both these charts reflect very little froth in equity markets.

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

## 2. RECOVERY GONE TOO FAR?

The S&P 500 index is currently -13% since its peak level on 19 February. It has recovered a healthy +21% after its trough level of -34% on 23 March 2020 (or +31% for those who bought at that trough level). Some reckon this recovery is overdone and that the market is now due another steep correction.

S&P 500 Sectors – Prices Indexed to 100 on date of S&P 500 Peak


Technically anything is possible. On the geopolitical front, China's intentions to pass a security bill on Hong Kong is clearly worrisome. The stock market has attracted many new speculators that cannot bet on their horses or sporting outcomes for the moment. We are currently in the traditionally slower "Sell in May" season when some short-term traders opt for the side-lines. They have healthy profits to bank.

Despite the recent recovery, the current -13% for the S&P 500 still is a steep correction. Seeing that the stock market discounts troughs in economic activity well in advance, it clearly implies a continuing dire global economic outlook for quite some time by projecting another steep correction from this level.

Too many investors, in our view, attempt to project the overall market (e.g. the S&P 500 index) rather than considering those businesses making up the index or the so-called market. We believe COVID-19 has damaged some businesses for a very long time to come, while others are less severely affected and some may even benefit from the "new normal" economic environment many of us believe we are now facing.

All the different sectors are in negative stock market territory. Strikingly though, four sectors are down less than 10% while four sectors are down more than 20% since 19 February (Health Care, Technology, Discretionary and Communication in the first group, against Energy, Financials, Industrials and Real Estate in the second group). Investors have worked out that the focus on Health Care is not going to fade, that many Technology services are going to be in even higher demand (especially as more employees than before will work more from home), that the boost to eCommerce is going to last, that streaming services will stay popular, etc. There are many more investors hoping for lower prices to buy these types of businesses than those willing to sell them at current prices with confidence that they will be able to buy them back at materially lower prices.

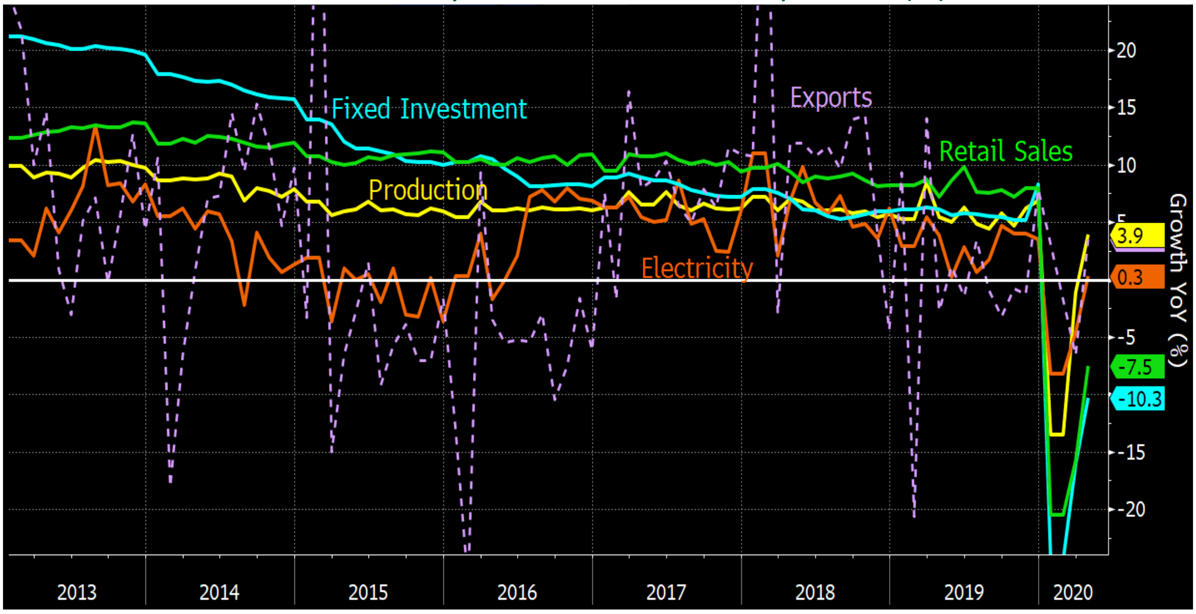
Against this, COVID-19 has clearly postponed good economic growth for long. The demand for energy is going to remain low for long. Interest rates are also expected to remain low for long. The financial sector struggles to grow under these circumstances. General manufacturing capacity will be underutilised for longer than previously thought. Real estate is not going to deliver at income levels investors have become used to.

We believe the current disparity in sector performances may carry on for quite some time. Against this, should the economic recovery surprise us to the upside, all sectors may well benefit to some extent, but with less disparity than at present.

## 3. CHINA RECOVERING

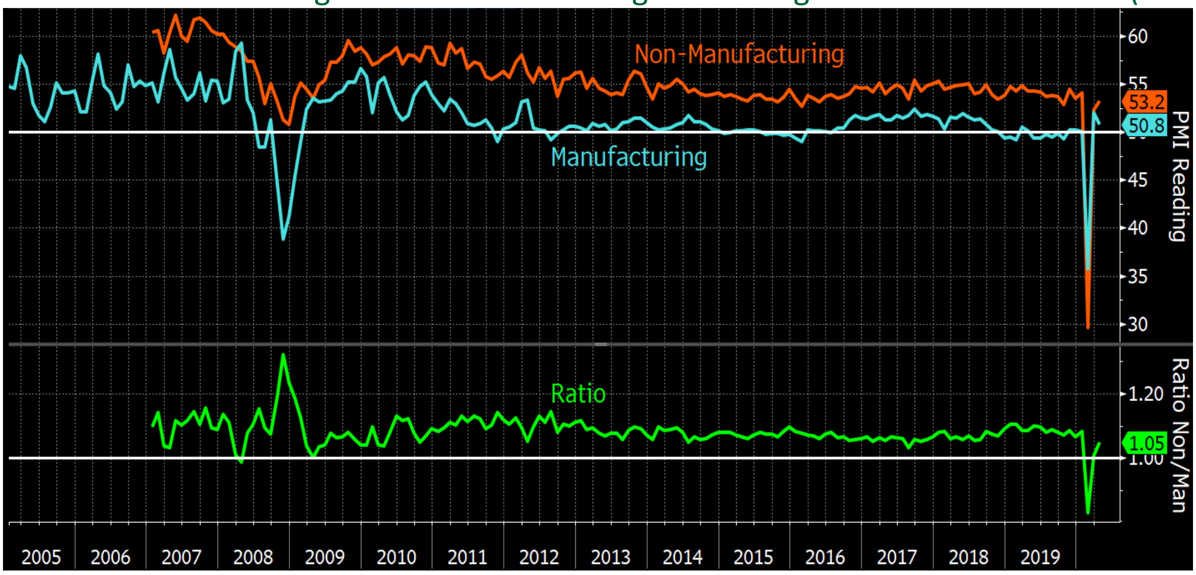
The Chinese economy is showing reasonable signs of recovery:

China Economy – Growth in GDP Components (%)




Whilst retail sales and fixed investment growth is still negative, their trajectories have turned in a positive direction. Against this, growth in electricity consumption, production and exports have already turned positive.

China – Manufacturing & Non-Manufacturing Purchasing Manufacturers' Index (PMI)



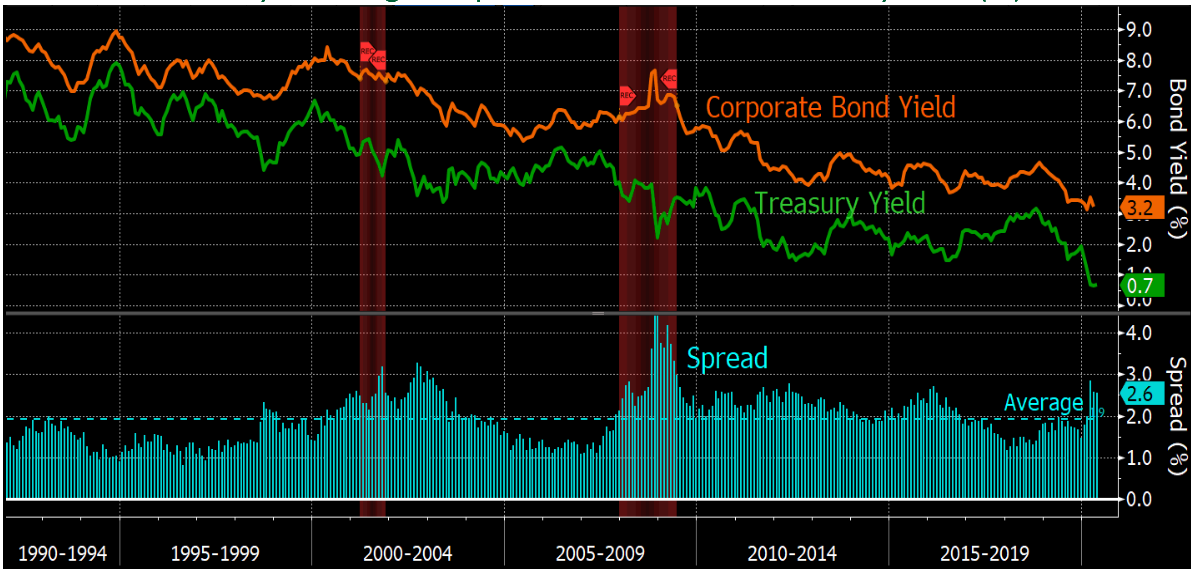

Logically, both the Manufacturing and Non-Manufacturing PMI's dropped to historic low levels with the COVID-19 lock-ups, and were much lower than with the Credit Crisis. It is striking how strong they have since recovered, both currently in constructive territories with readings above the neutral 50-reading.

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

## 4. CORPORATE MARKET

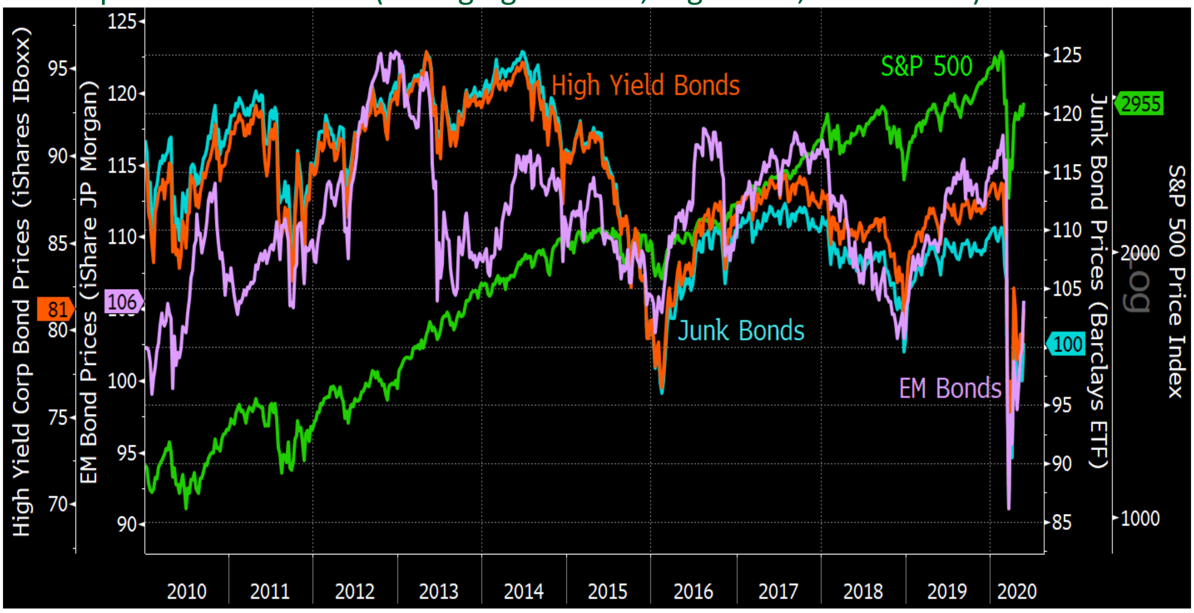
The corporate bond market is a good indicator of the health of the equity market as well.

Moody's Average Corporate Bond Yield vs Treasury Yield (%)




The average yield on corporate bonds is stable currently, reflecting a relatively relaxed market. The spread with Treasuries (the blue bars) is above average, leaving ample room for rates to potentially rise and still leaving the corporate market attractive.

Corporate Bond Prices (Emerging Markets, High Yield, Junk Bonds) vs S&P 500




Considering the higher risk sections of the Corporate Bond market (Emerging Markets, High Yield and Junk Bonds), bond prices dropped materially with the COVID-19 issues (-22%, -21%, -22% respectively). As depicted in the above chart, all these prices have since recovered well, also supporting the equity market.

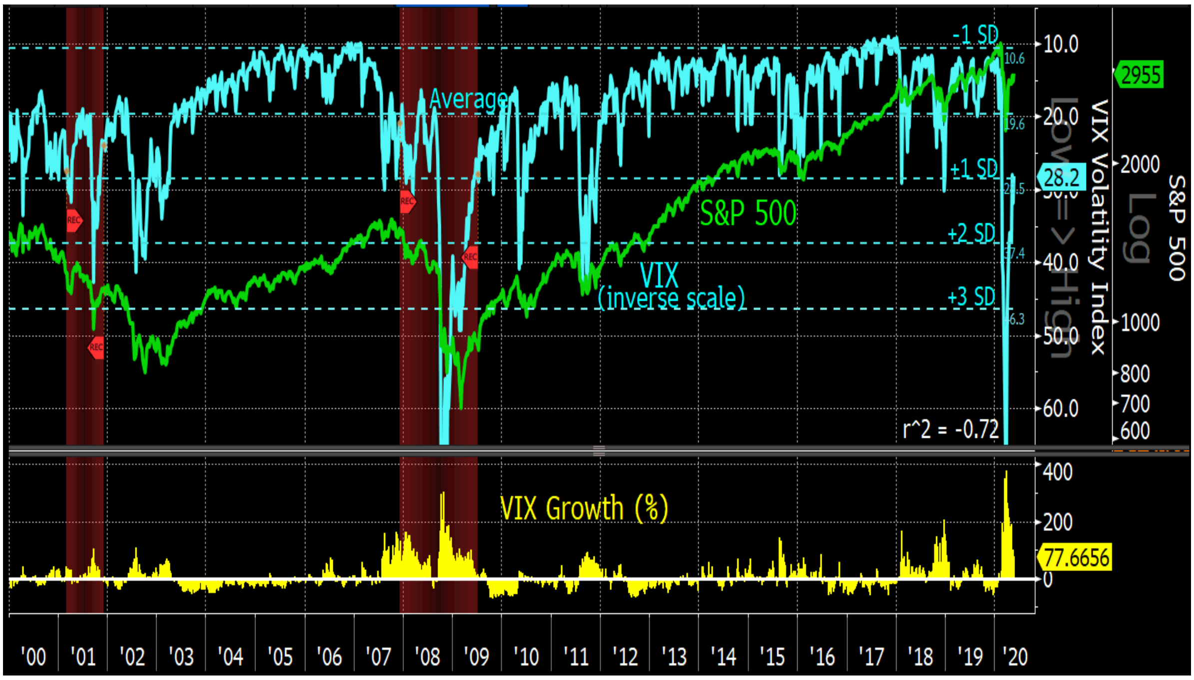
The corporate market currently seems relatively healthy, and in support of the equity market.

## 5. VOLATILITY VS RETURN

We have done another study on data since 1950 around returns following high volatility equity market events.

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

VIX Volatility Index vs S&P 500




As reflected in the above chart, volatility in share prices (considering the VIX volatility index) has a high (negative) correlation with share prices (the VIX index is presented on an inverse scale).

The bottom section of the chart shows the growth in the VIX index. Despite the sharp recent drop in VIX, it is still +78% on its base level. We have based our study on these growth rates to understand the historic returns following such high growth rates.

This table reflects the historic (annualised) returns over different periods following the event of the certain VIX growth level (positive or negative).

The result shows that high volatility historically lead to positive equity returns over both the shorter and the longer term. The best results followed after six months to a year of the volatility event.

| S&P 500 - Average Return p.a. Following High Volatility in VIX Index | | | | |
|---|---|---|---|---|
| Change in VIX | -50% | 50% | 100% | 150% |
| Period following VIX event | | | | |
| 3m | 3.6% | 3.9% | 3.6% | 2.8% |
| 6m | 6.2% | 8.9% | 11.0% | 9.7% |
| 12m | 6.3% | 12.1% | 14.0% | 13.3% |
| 2Y | 7.2% | 9.3% | 9.0% | 6.5% |
| 3Y | 5.4% | 7.4% | 5.9% | 4.1% |
| 5Y | 5.8% | 8.0% | 8.3% | 8.1% |

Whilst high volatility in the stock markets is uncomfortable for most investors, historic data shows that it does not necessarily imply high risk for capital value losses and may rather offer buying opportunities.

## 6. SEMI-CONDUCTORS

The following chart clearly reflects the good performance of the semi-conductor industry (the index has grown +24% over the past year). This clearly has to do with the explosion in data consumption worldwide that may carry on for long. This is another feather in the Technology cap.

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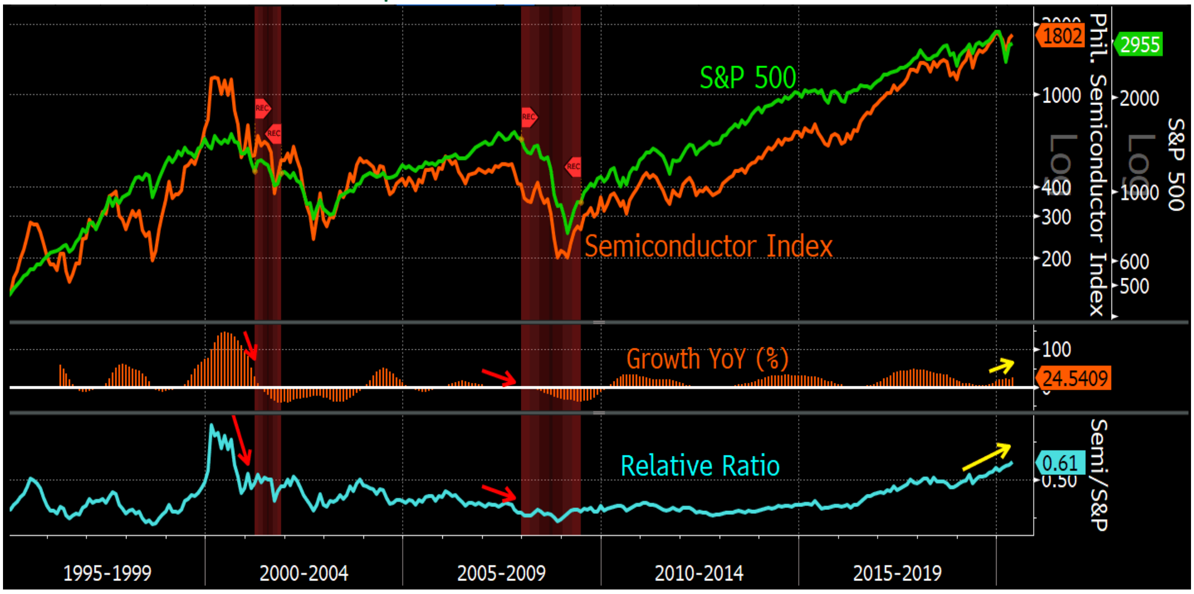
Philadelphia Semi-Conductor Index vs S&P 500




## 7. FEAR & GREED

Fear & Greed Index vs S&P 500


The Fear & Greed index reflects market sentiments in a more technical manner. It has recently rid itself of its worst ever fear readings and moved into positive technical territory. This is a constructive development.

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