GLOBAL EQUITY PERSPECTIVES 25 JANUARY 2021

"It's what you learn after you know it all that counts."

Earl Weaver

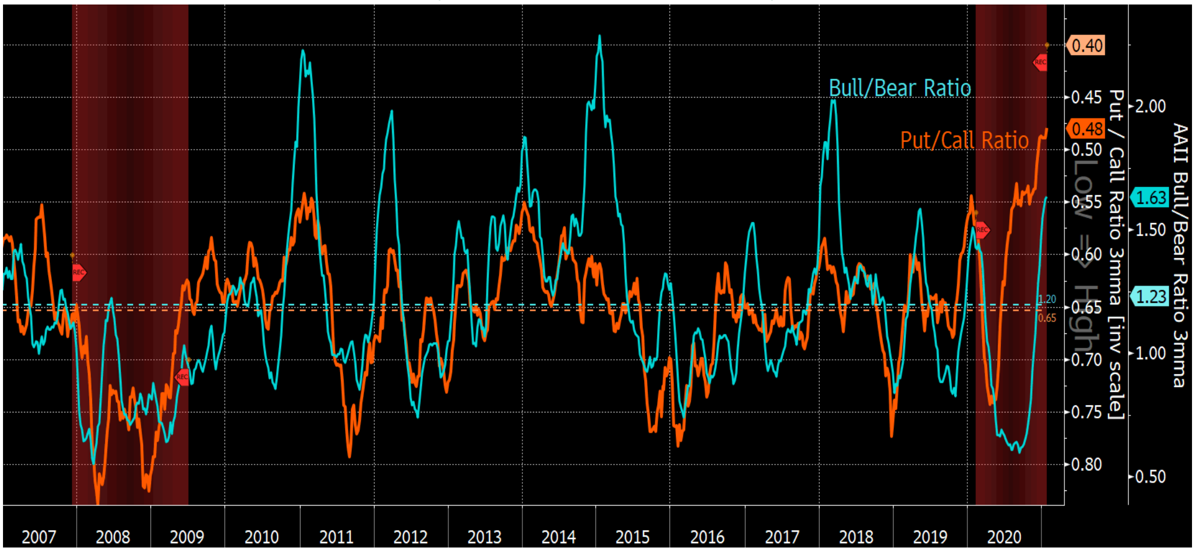
1. STRONG MARKET

Equity markets have continued to build on the support they got from third quarter US earnings season, the surprisingly close US election outcome and then the excellent news of three successful vaccines. Investors are looking well beyond the current economic lockdown conditions.

S&P 500 Index with Positive Technical Indicators

The S&P remains in an uptrend with all six of the positive technical indicators in place (the yellow arrows). It does not currently show signs of any technical downturn.

S&P 500 Put/Call Ratio and AAII Bull/Bear Ratio



The S&P 500 Put/Call ratio is currently at a two standard deviation extreme (the orange line), reflecting strong institutional interest in equities. The American Institute of Institutional Investors' Bull/Bear ratio is also at an elevated level (the blue line), but not at an extreme one. This clearly indicates strong optimism about this year's outlook.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2021. ***Past performance is not a guide to future returns.***

2. SNAPSHOT

S&P 500 vs Virus Fear Index

Despite the strong market, we continue to be cognizant of the risks around the current frail economic environment. Our Virus Fear index (S&P Food Retail Index / S&P Travel Index) is slowly rising again, reflecting some risk for potential tactical weakness.

In this context, it is interesting how the current stock market recovery compares to the Financial Crisis experience. We have indexed the S&P 500 to a value of 100 at the cycle low during both crises in the chart below.

S&P 500 Indexed to 100 at Cycle Low – Virus vs Financial Crisis

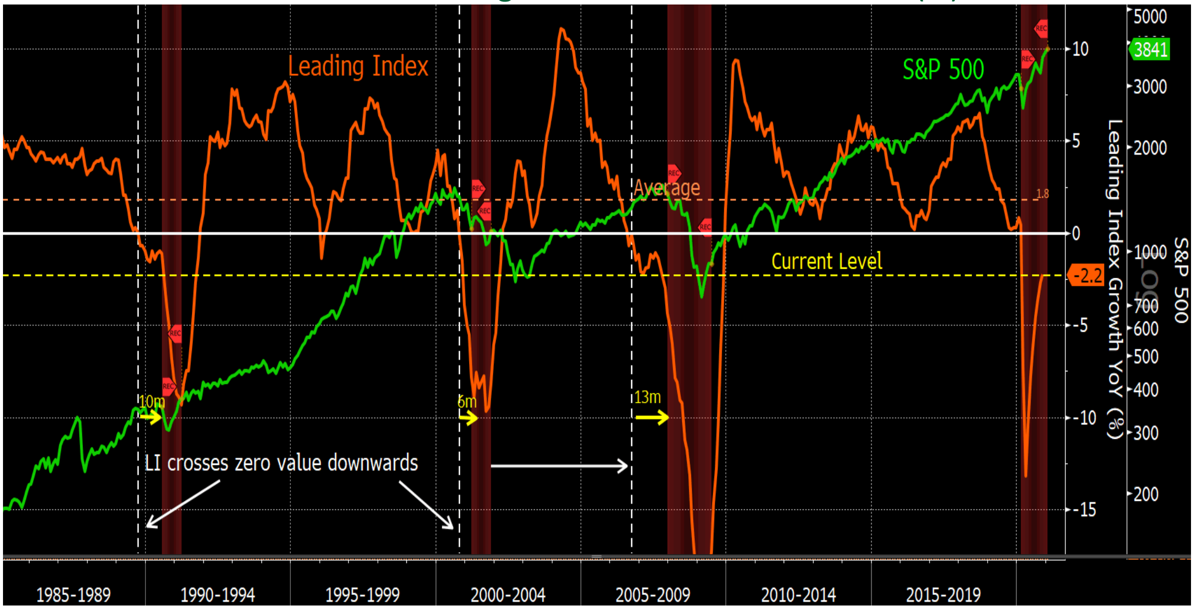
The current stock market recovery follows the recovery track after the Financial Crisis surprisingly closely. This negates general comments that the current recovery is ignorant of the current negative economic environment. Seeing the small correction at this time that the stock market experienced following the Financial Crisis, we should not be overly surprised to see a pullback at some time in the not-too-distant future – it may well be a normal tactical behaviour pattern.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2021. ***Past performance is not a guide to future returns.***

3. STRATEGIC CONSIDERATIONS

The following chart is our well-trusted 'desert island' strategic investment tool:

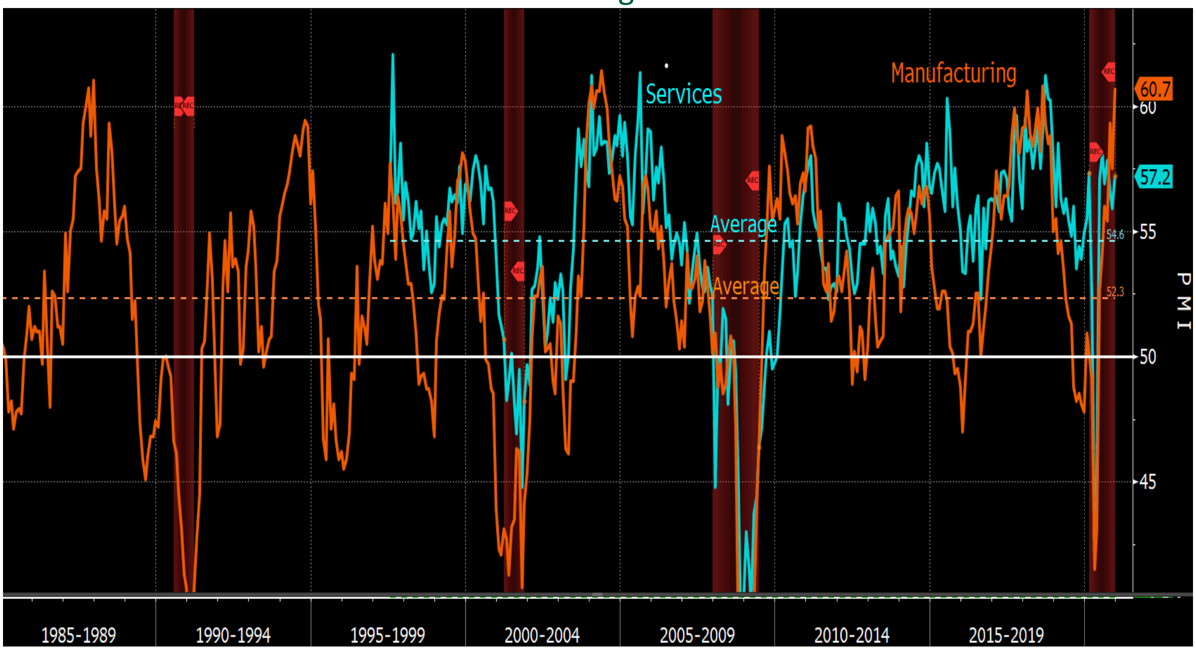
US – Conference Board Leading Economic Indicator Growth (%) vs S&P 500



The above Leading Economic Index follows its traditional recovery track following recessionary conditions. Whilst the growth level is still in negative territory, its current level (-2.2%) in a rising trend indicates early cycle stock market buying opportunities (the green line). As has historically happened, tactical corrections can also be expected, but there may be more risk in losing out on the following structural growth.

The preceding comment is in our view borne out by the next chart:

US – ISM Manufacturing and Services PMI's



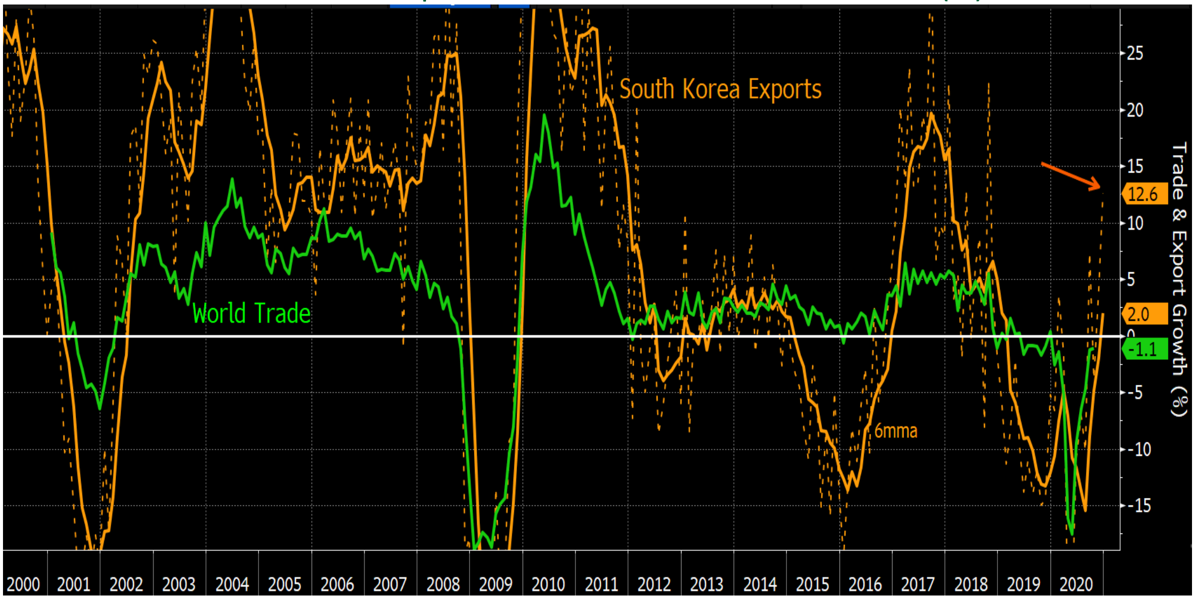
Both the Services and Manufacturing PMI indices have recovered strongly and are at elevated levels already – much higher than levels usually this early after previous recessions. This indicates the possibility of stronger than usual economic recovery in the shorter term.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2021. ***Past performance is not a guide to future returns.***

4. WORLD TRADE

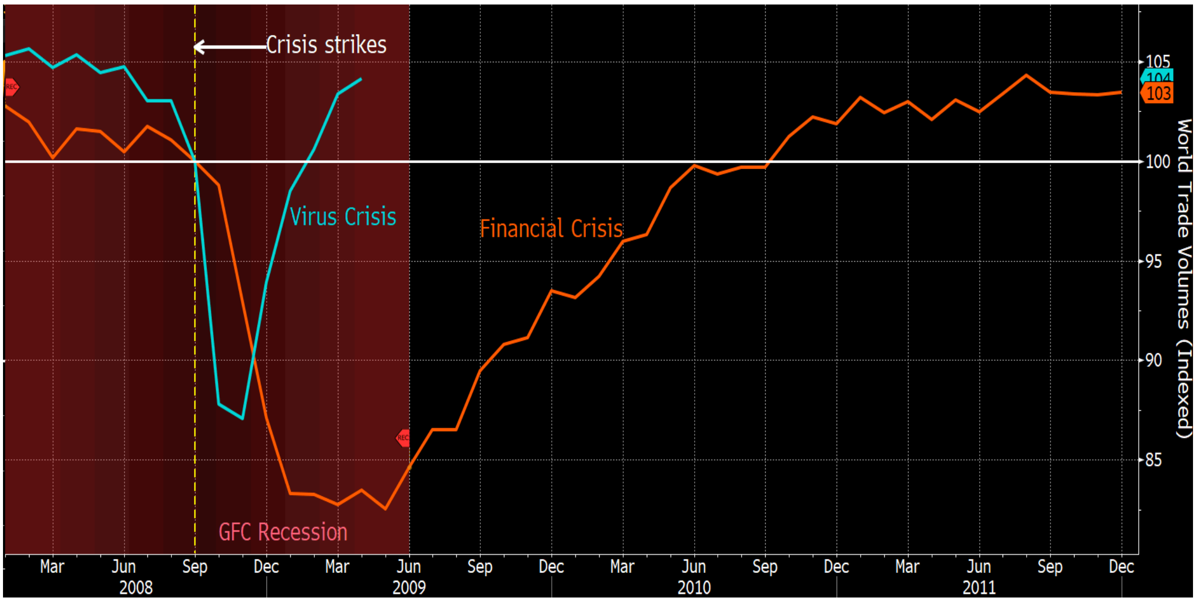
South Korean exports are a good global economic growth indicator. The following chart reflects the growth in both those exports and world trade:

South Korea Export Growth vs World Trade Growth (%)



South Korean exports have recovered well, and are currently growing handsomely. The growth in world trade seems to be recovering sharply in a narrow V-curve and is close to be back in positive territory. This trade recovery is borne out by the Baltic Dry shipping index that is already well above its end 2019 levels.

World Trade Volumes – Indexed to 100 at Time of the Crisis Event for the Virus and Financial Crises



World trade volumes are indexed to 100 at the date of the crisis event for both the Virus and Financial crises. It is striking how much sooner the Virus Crisis induced trade volumes are recovering compared to experiences during the Financial Crisis. The current trade volume index is already at a level it took two year to reach following the Financial Crisis.

It seems that global operators' earnings may already be in a strong recovery mode, much earlier than the Financial Crisis experience. The fact that share prices follow a similar recovery track therefore does not seem to reflect any exuberance on investors' side.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2021. ***Past performance is not a guide to future returns.***

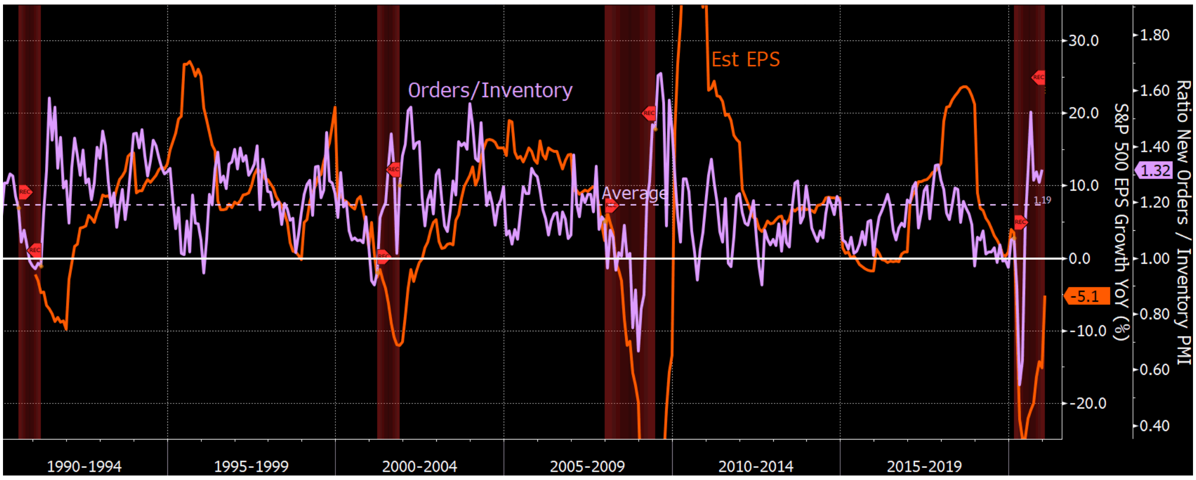
5. COMPANY EARNINGS

It is worth considering how company earnings expectations are evolving:

S&P 500 vs S&P 12m Forward Earnings Expectations

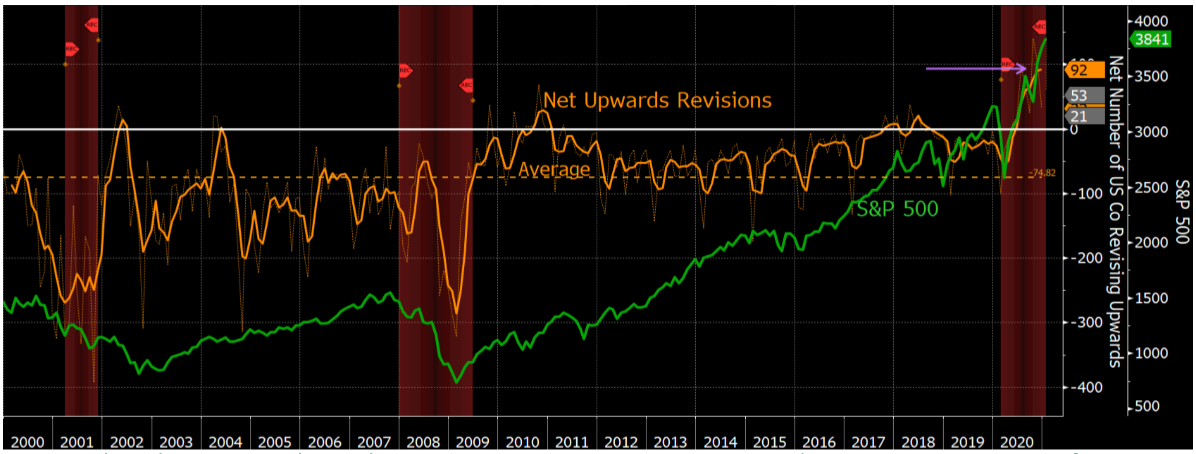
Company earnings expectations continue to recover well and are in process of catching up to the record expected levels before the virus crisis. Furthermore, the recent addition of Tesla to the S&P 500 index has had a logical detrimental effect to the earnings index at the time (shown in the chart). If we add back that loss, the current earnings index is only 3% away from its peak a year ago. This is a stronger recovery than what many may have thought and supports share prices well.

ISM Orders/Inventory PMI Index vs S&P 500 Forward Earnings Growth (%)



The above Orders/Inventory index is currently at elevated levels, well above average. This reflects a well-supported order book. The index has a logical strong correlation with company earnings growth, and we can expect it to 'pull' earnings up well for some time to come.

Net Number of Companies' Own Upwards Earnings Revisions vs S&P 500



Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2021. ***Past performance is not a guide to future returns.***

Company earnings revisions have historically been more downwards than upwards. As reflected in the preceding chart, a record number of US companies are revising their own earnings upwards this time.

All these points on S&P 500 earnings are constructive and can support share prices structurally.

6. BULL MARKET

There are different ways to define equity bull and bear markets. Adjustments to nominal prices are usually made to reflect it in real terms.

Another way to consider this is to express it in Gold price terms. This has merit in the sense that Gold is both a good inflation and a currency hedge. When investors fear these two issues, they may rather opt for Gold than for shares.

S&P 500 in Gold Price Terms

It is striking how regular the cycles in the above chart are and that it has broadly stayed in an upwards channel. The S&P 500 bear markets historically dropped relatively equal percentages (between -85% and -93%) and lasted quite similar periods (11-12 years). The bull markets lasted more than 20 years.

Should this chart continue to build on its historic trends, the current bull market seems to be around halfway completed.

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