STONEHAGE FLEMING

GLOBAL EQUITY PERSPECTIVES 27 JULY 2020

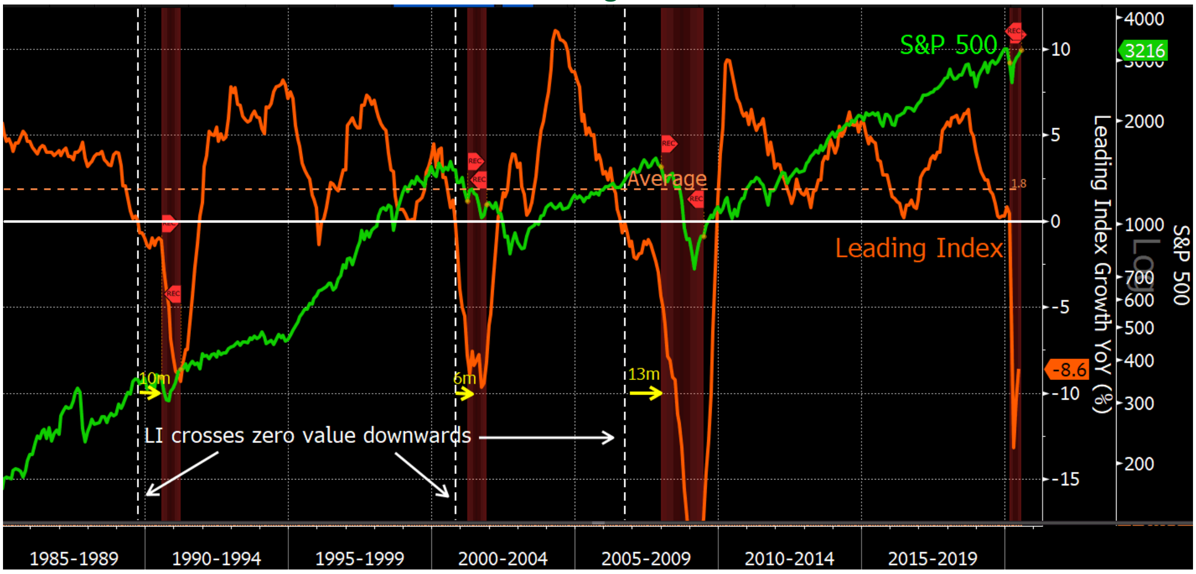
"You are lost the instant you know what the result will be."

Juan Gris

1. ECONOMIC OUTLOOK

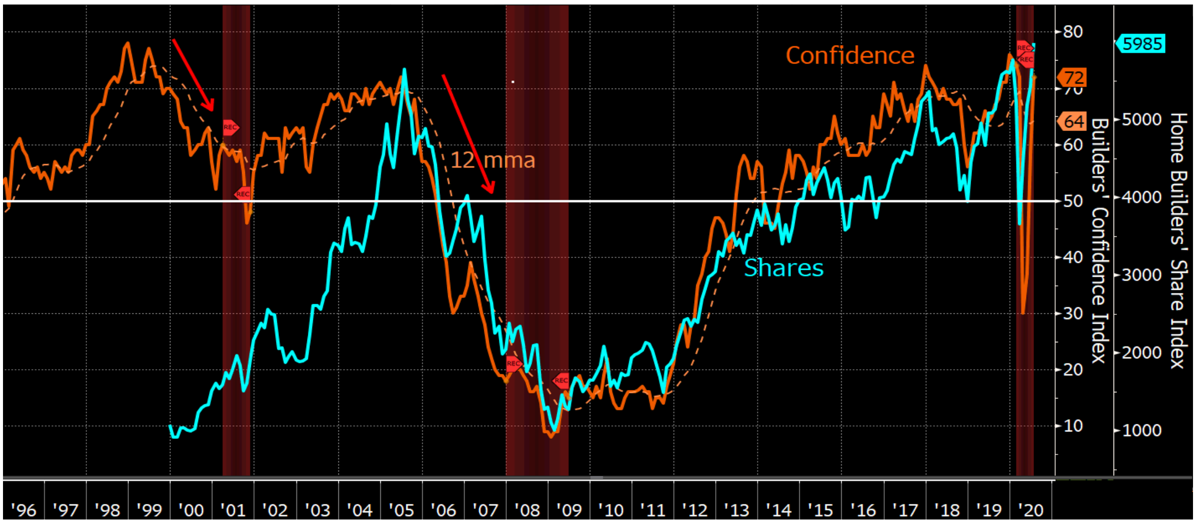
The chart of the Leading Economic Index below is our 'desert island' chart to form an impression of the overall capital market outlook:

US - Conference Board Leading Economic Index vs S&P 500



The index consists of ten underlying leading indices. It continues to recover off its recent low base. Whilst the current level is still in negative territory, its direction of travel seems constructive. Historically, such a recovery process was followed by a positively performing stock market, as reflected by the S&P 500 index in the chart.

US – National Association of Home Builders' Confidence Index vs Homebuilders' Share Index



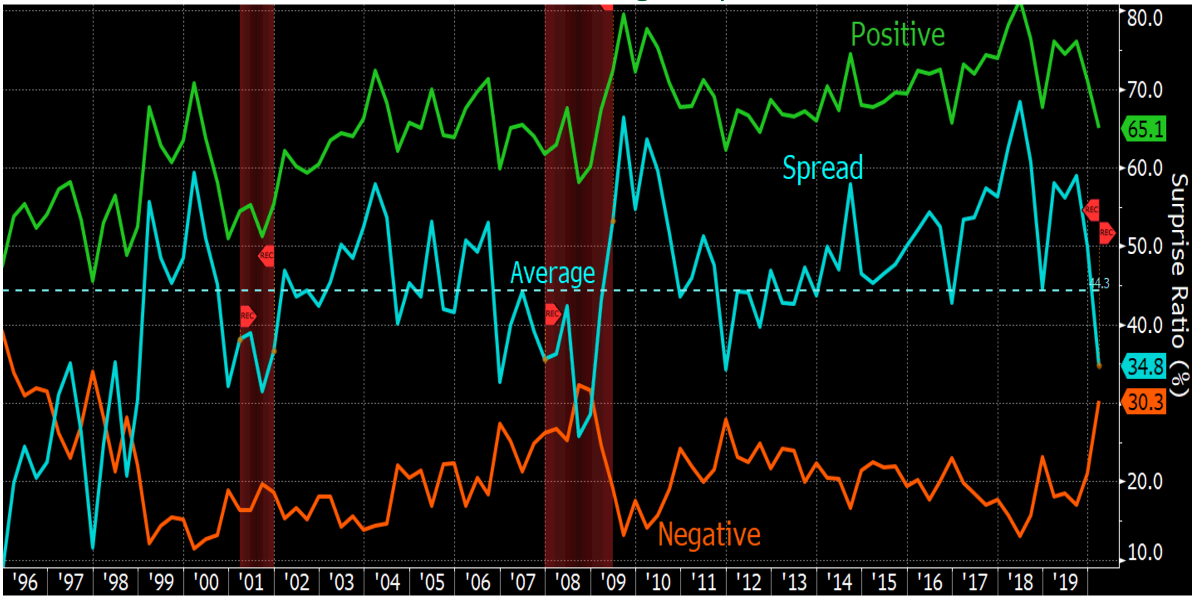
The above Home Builders Confidence Index has a solid record of foreseeing economic deterioration. It has bounced back close to its recent peak levels. Home builders' share prices have recovered to record levels. This economically sensitive industry seems to recover well from the Virus Crisis shocks.

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

2. EARNINGS SEASON

The second quarter earnings season has started. As investors are very aware, apart from the absolute results, the level of surprise against analyst expectations is also important.

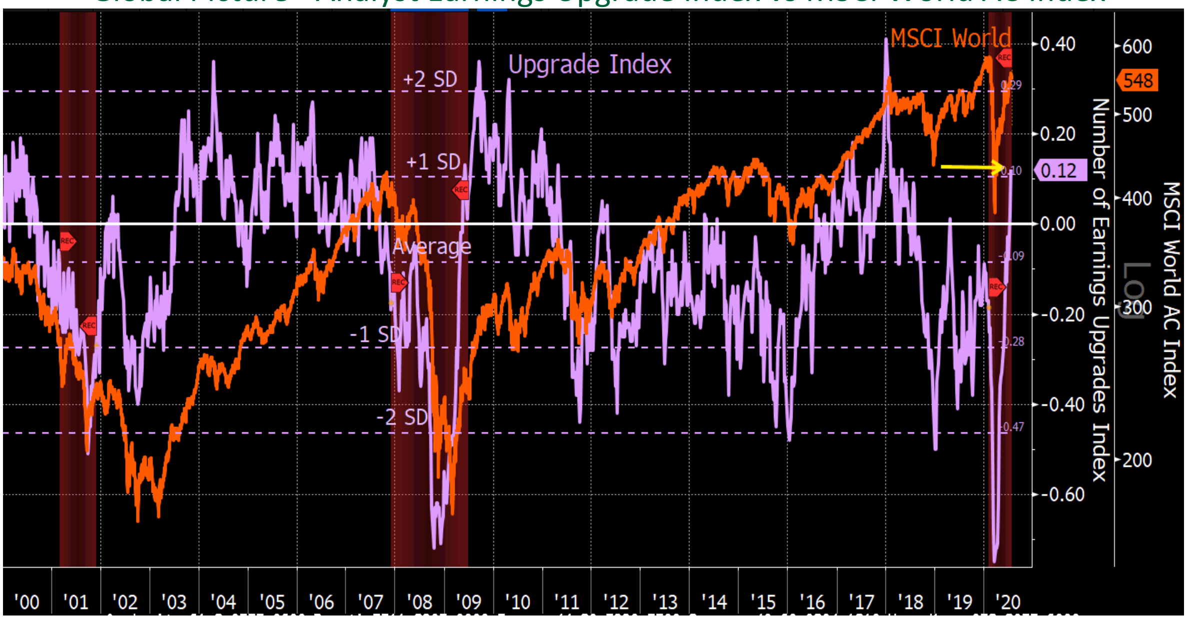
S&P 500 – Earnings Surprises



Logically the first quarter absolute results were very disappointing. However, almost two-thirds of those were positive surprises and less than one-third were negative surprises compared to expectations. Still, the spread between the two series was at a post Credit Crisis low (the blue line in the chart), further lowering the expectations for the current season.

We have updated our chart of earnings upgrades by analysts:

Global Picture - Analyst Earnings Upgrade Index vs MSCI World AC Index



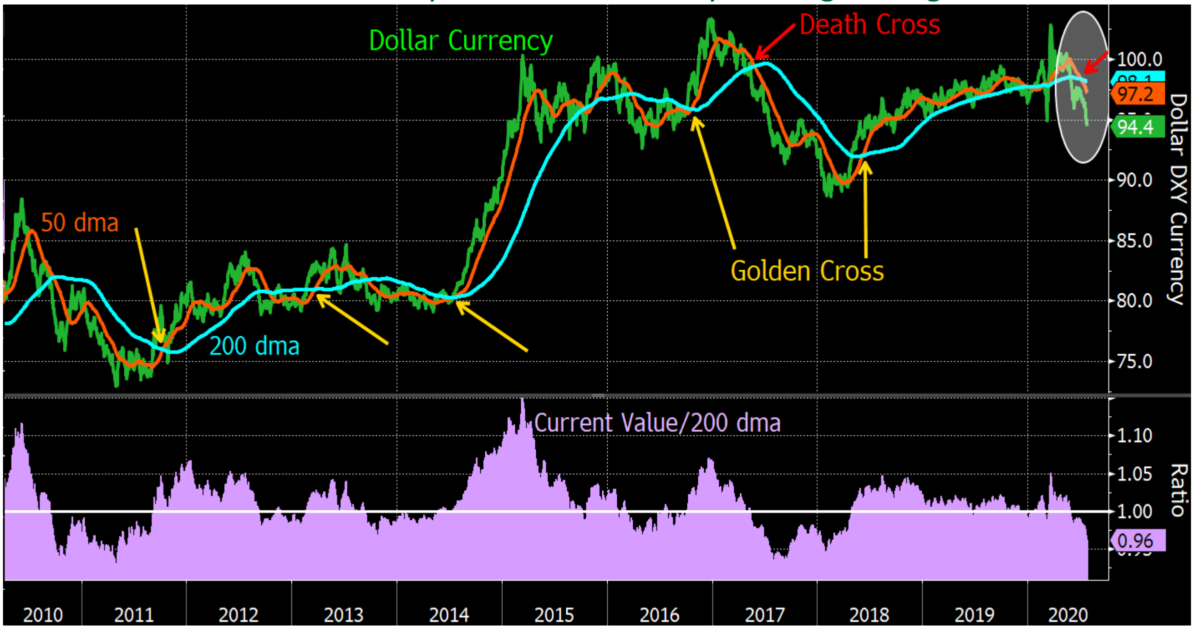
The upgrade index is recovering strongly. It is currently at a +1 standard deviation level already. It seems expectations may have been trimmed too aggressively when the Virus Crisis struck, with the first quarter results offering a positive surprise (as shown in the top chart). This recovery in expectations clearly supports share prices (the orange line). A quarter of S&P 500 companies have already reported their second quarter results, with two-thirds delivering positive sales surprises and over eighty percent delivering positive earnings surprises. This is constructive information for those who are invested in the right businesses.

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

3. DOLLAR CURRENCY

The Dollar has recently triggered its technical Death-Cross with its 5-day moving average dropping through its 200-day moving average. This is associated with expectations of weakness to persist for a while.

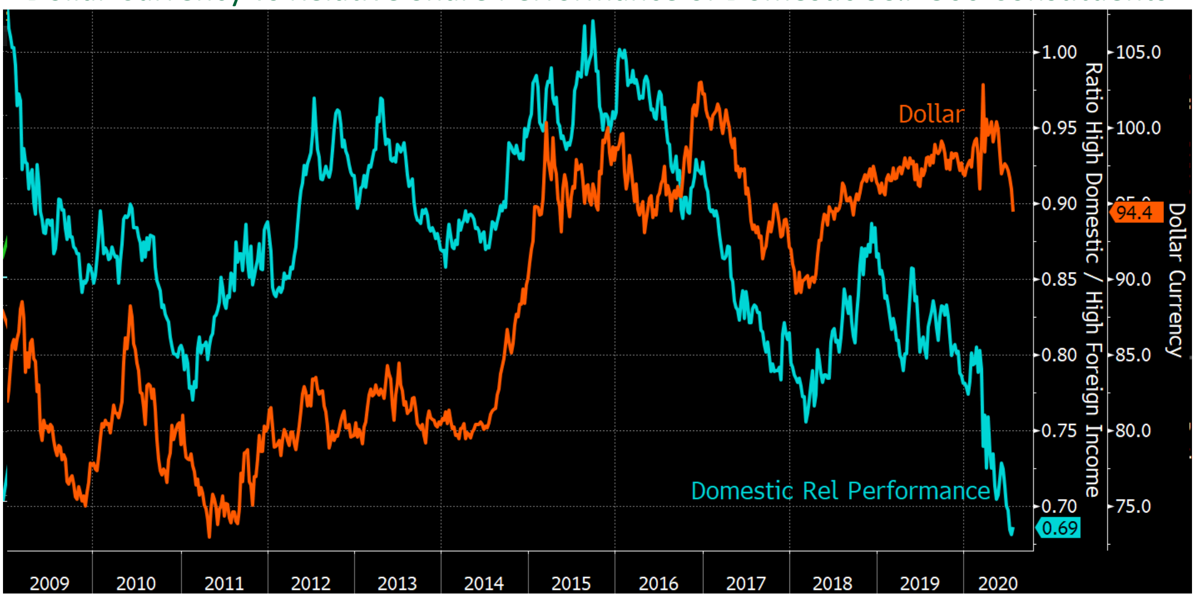
Dollar Currency with 50- & 200-Day Moving Averages



Overall US financial conditions and the record twin (budget and trade) deficit of -16% of GDP argue for continued weakness. Overall net speculative currency positioning in the derivatives market also has turned against the greenback.

This is better news than what may immediately meet some eyes. A weak Dollar 'oils the wheels' of the global economy, encouraging more trade, softening the burden of those with Dollar denominated debt and supporting many commodity prices (and therefore some Emerging Markets). Whilst the US has a negative trade balance, a weaker currency assists exporters who benefit from more global trade.

Dollar Currency vs Relative Share Performance of Domestic S&P 500 Constituents



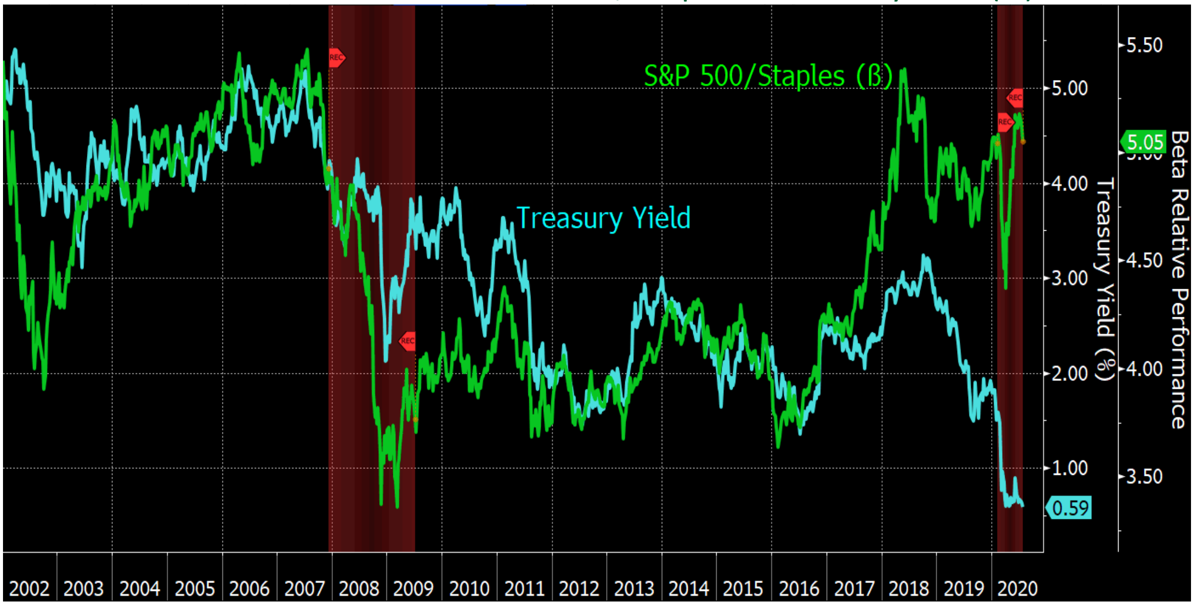
The above chart reflects the relative performance of US businesses that are more domestically orientated. The positive correlation with the currency is clear. Logically, investors have to consider either investing more offshore, or otherwise orientate their portfolios more towards the US franchises that operate globally. With the high-quality offerings also in the latter category, there are good candidates that can directly benefit from a weak Dollar.

Source: US Department of Commerce & Stonehage Fleming Investment Management Limited. July 2020. ***Past performance should not be used as a guide to future performance.***

4. STAPLES

Beta stocks have outperformed Staples materially since the Credit Crisis. This is reflected in the following chart (the green line):

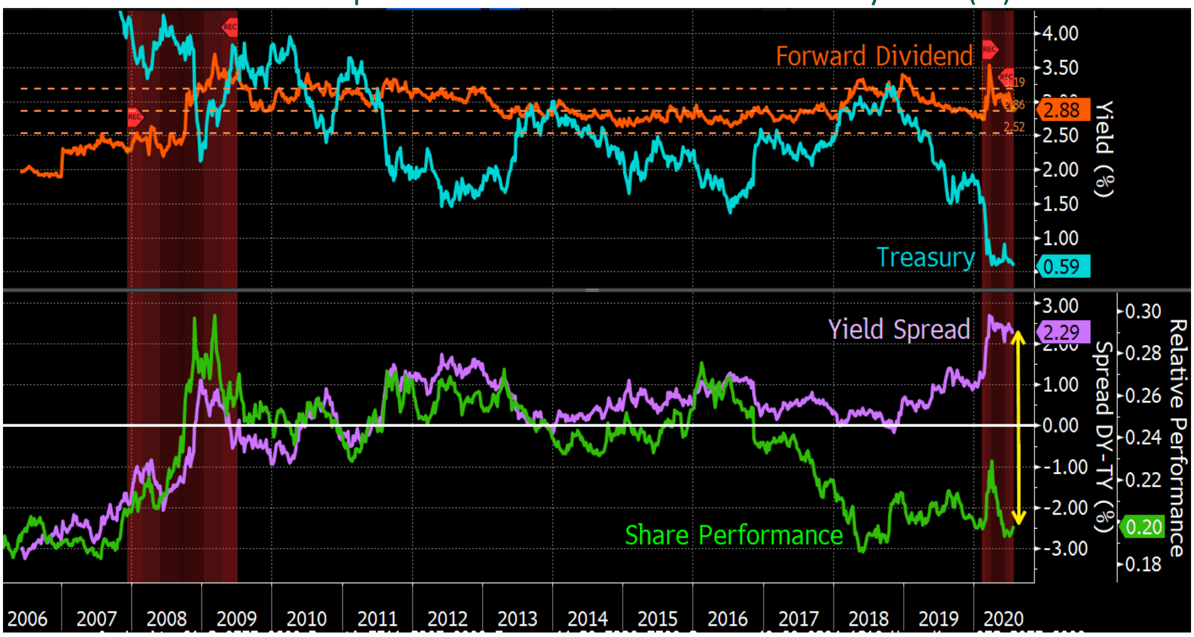
Relative Performance - S&P 500 / Staples vs Treasury Yield (%)



Logically, the relative performance historically had a strong (positive) correlation with interest rates. This correlation, though, has broken down recently with a strong Beta performance despite the collapse in interest rates. In this context, with the higher Staples dividend yield, and the sector materially underperforming, it seems the market is currently not yet considering income levels.

The following chart considers these income disparities:

S&P 500 Staples Sector Dividend Yield vs Treasury Yield (%)



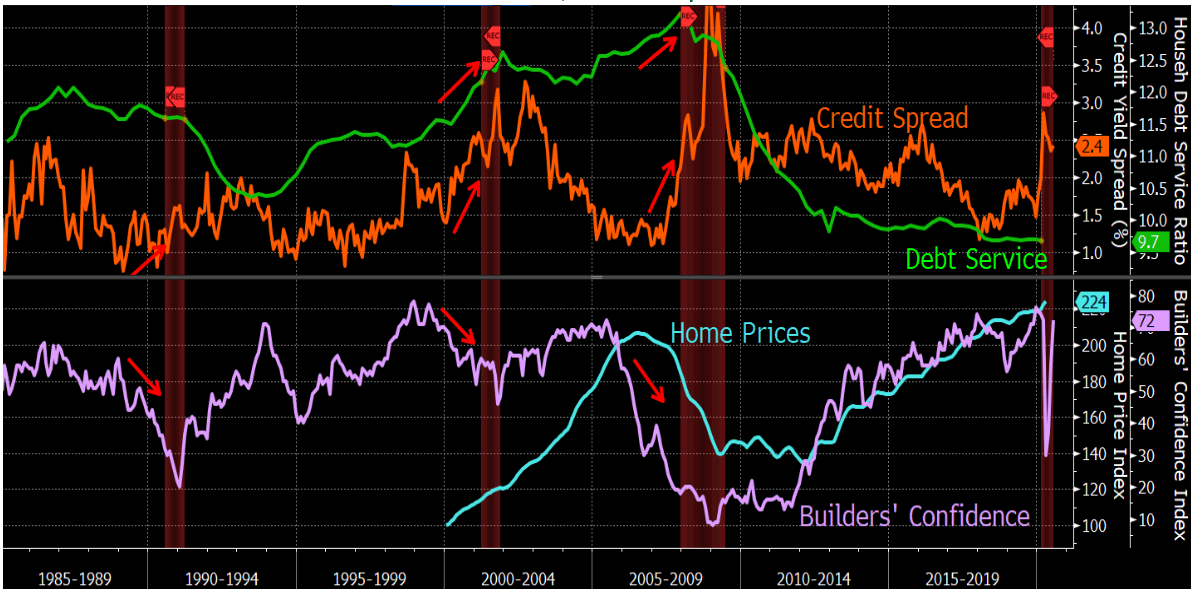
The Staples sector's forward dividend yield is 2.9% (the orange line). This is on the average absolute level (the dotted line). The current treasury yield is at a historic low level of 0.6%. The spread of 2.3% is at record high level (the purple line). This spread has historically had a strong correlation with the relative share price performance (the green line), but the correlation recently has broken down (see the yellow arrow). We believe this offers a long-term opportunity in those Staples shares with good dividend yields where those dividends can continue growing on a sustainable basis.

Source: US Department of Commerce & Stonehage Fleming Investment Management Limited. July 2020. ***Past performance should not be used as a guide to future performance.***

5. US CONSUMERS

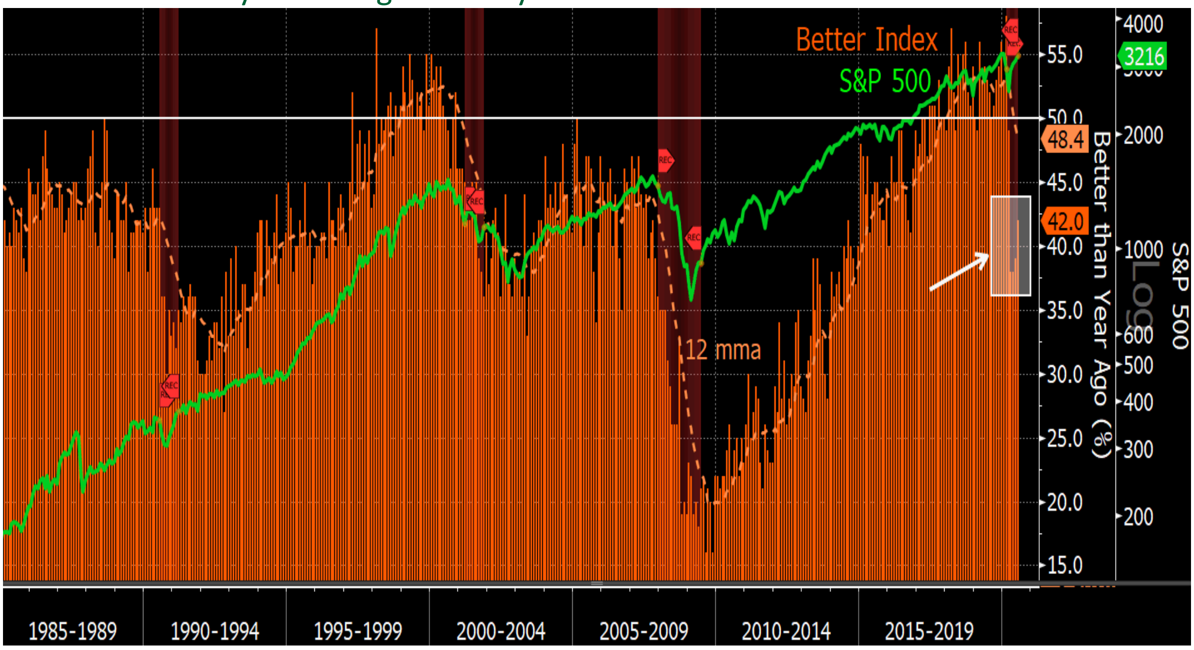
Capital markets are very dependent on the health of the US consumer market. The following charts focus on the main issues in this context.

US – Household Debt Ratio, Credit Spread and Home Prices



The credit yield spread rose sharply with the Virus Crisis, but is in process of recovering. The household debt ratio is currently at a record low level. Home prices are at record levels. Home builders' confidence took a knock with the Virus Crisis, but has already recovered sharply. It is currently close to recent record levels, exceeding levels preceding previous recessions.

US – University of Michigan Survey of Household Financial Positions vs S&P 500

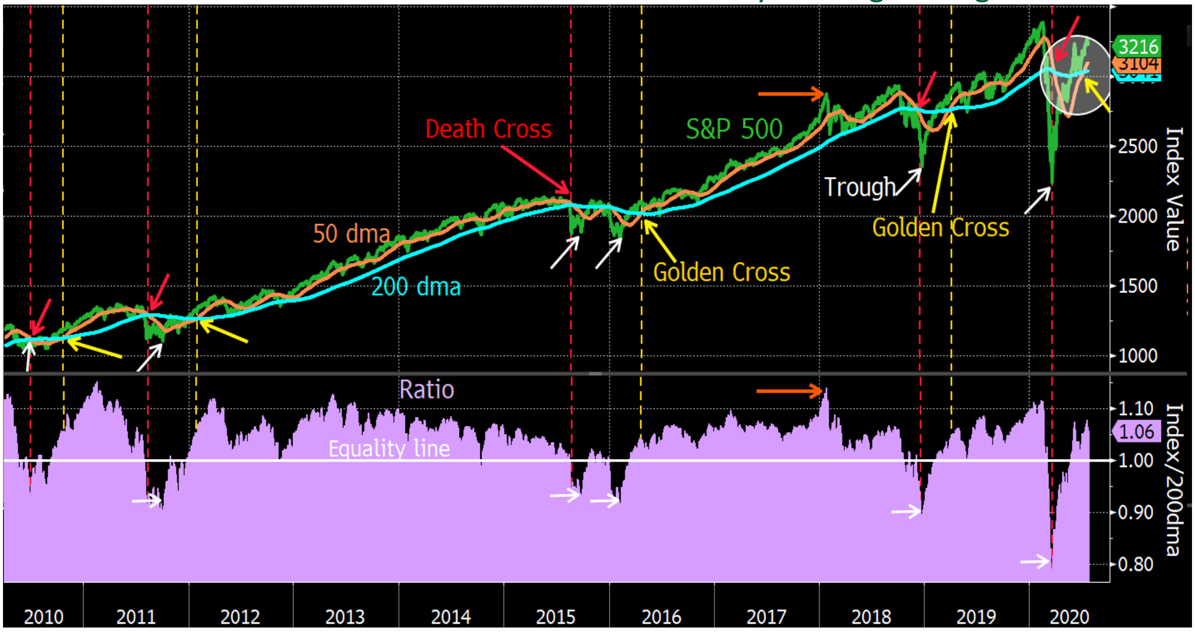


The number of households reporting that their financial positions are better than a year ago dropped from 53% in January to 38% in April. It has since increased to 42%. This level is much higher than during the Credit Crisis, and compares well with constructive levels preceding previous recessions. This implies a rather confident US consumer. The Conference Board Consumer Confidence Index has recovered to a level marginally above its long-term average after a severe setback with the Virus Crisis. This is already a positive level, but clearly will be tested when furlough schemes are phased out. Retail sales have resumed growing again.

Source: US Department of Commerce & Stonehage Fleming Investment Management Limited. July 2020. ***Past performance should not be used as a guide to future performance.***

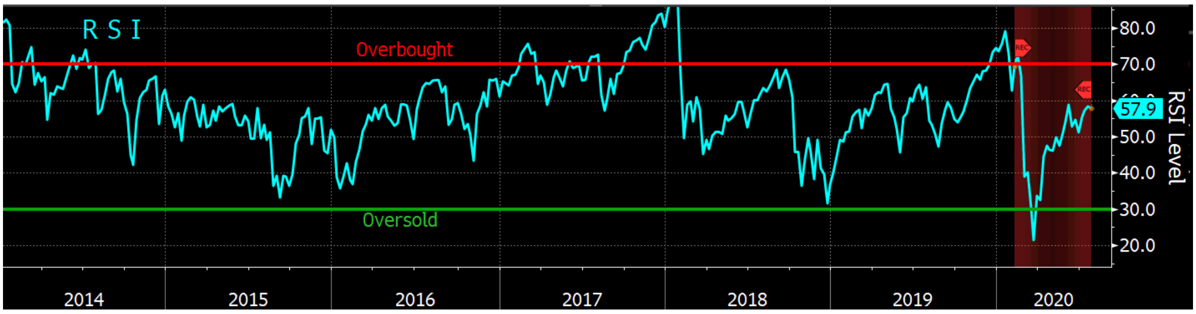
6. TECHNICAL PICTURE

S&P 500 – Price Index with 50- & 200-Day Moving Average



The S&P 500 recently experienced a golden cross technical event (the 50-day moving average crossing the 200-day average upwards). This is interpreted positively by the market.

S&P 500 – Relative Strength Overbought/Oversold Indicator (RSI)



The index's RSI level of 58 points is on a relatively neutral level despite the strong recovery from the March lows. The combination of these two charts reflects a healthy technical picture for the S&P 500 index.

Farewell to a long-standing travel companion

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Source: US Department of Commerce & Stonehage Fleming Investment Management Limited. July 2020. ***Past performance should not be used as a guide to future performance.***

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