GLOBAL EQUITY PERSPECTIVES 18 JUNE 2018

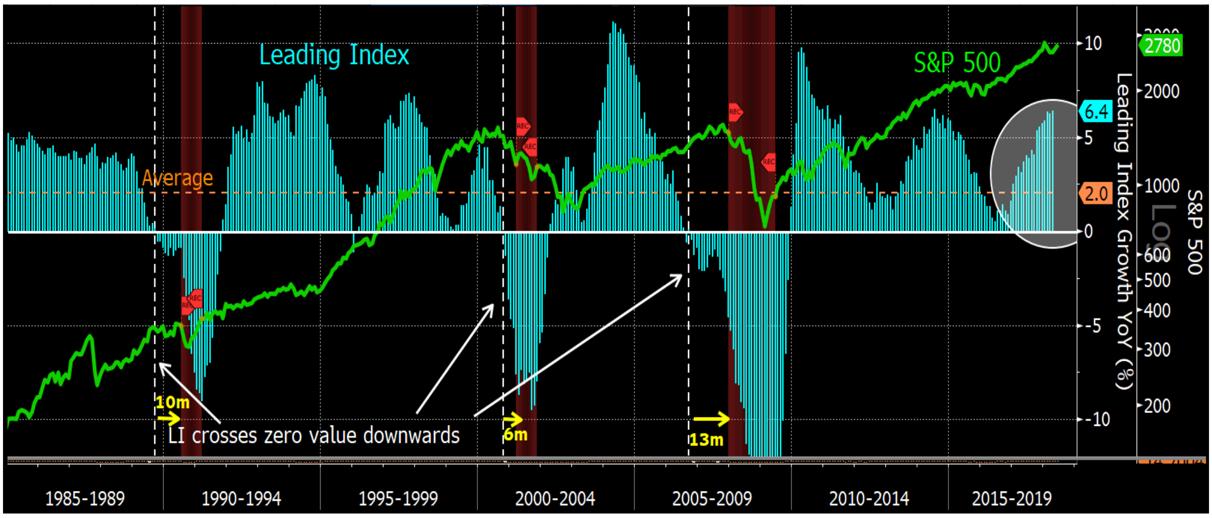
"Uncertainty is an uncomfortable position. But certainty is an absurd one."

Voltaire

1. ECONOMIC FUNDAMENTALS

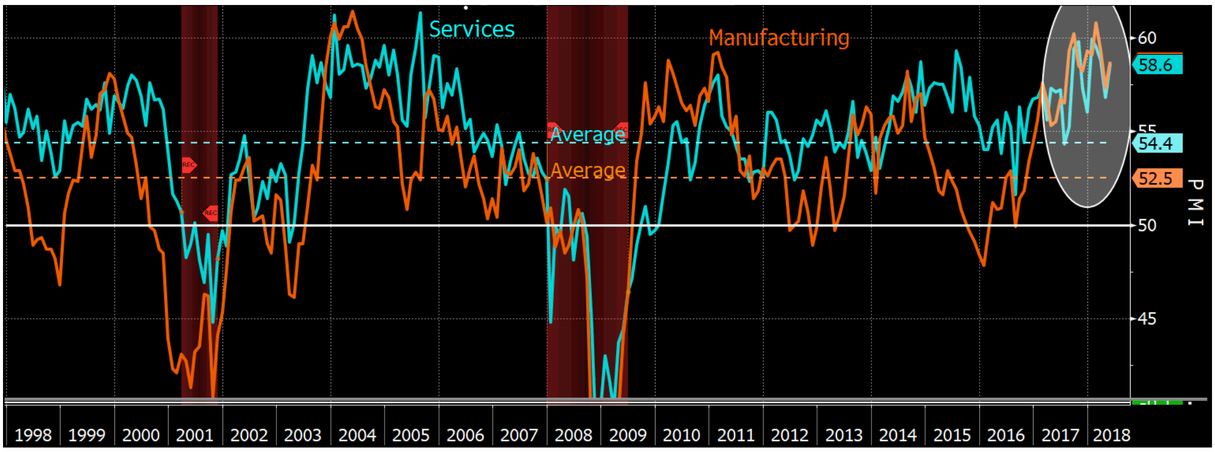
Investors are reflecting on a combination of potent recent geopolitical events. The G7 summit ended in acrimony, the Singapore summit seems to hold promise of more peace in Asia and immediately afterwards more threats of a trade war between the US and China materialised. These are confusing circumstances for decision making, but fortunately investors are better guided by economic fundamental indicators. We have updated our most valued charts in this context:

US – Conference Board (CB) Leading Economic Indicators vs S&P 500



The leading economic index in the above chart remains stable at elevated levels. This series' successful record in providing trusted information about the economic outlook puts our minds to rest that the US economic outlook is constructive and that it should underpin share prices for some time to come.

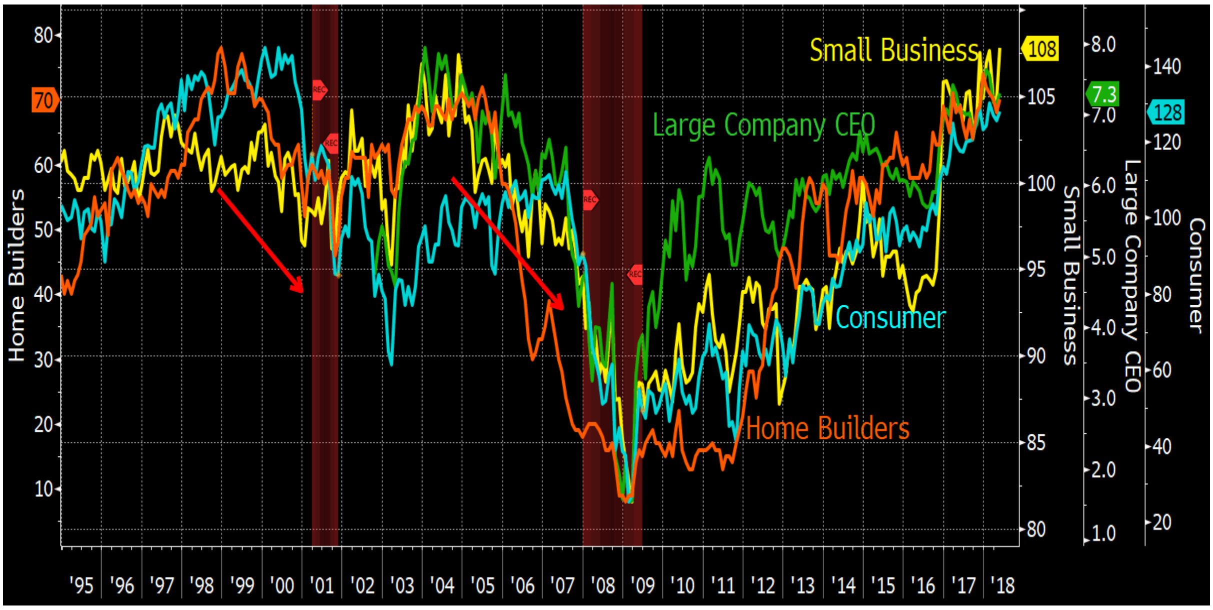
US – Institute for Supply Management PMI Indices (Manufacturing and Services)



Both the manufacturing and services PMI indices are also at elevated levels, well above their respective long-term average levels. This continues to bode well for the US economy.

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

US – Main Confidence Indices



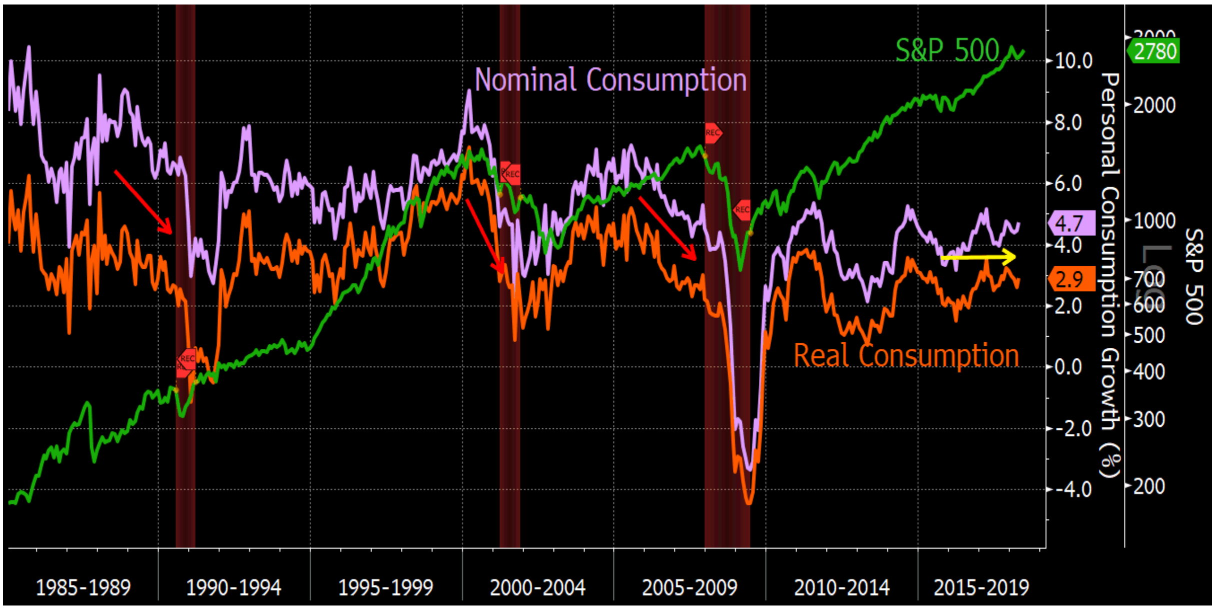
The large company CEO, small company CEO, consumer and builders' confidence indices have all increased with their most recent readings, and all are currently at elevated levels. These levels have historically indicated continued economic expansion for some time to come.

We believe that the current strength of the US economic fundamentals overshadows the geopolitical uncertainties and that equity investors can stay well engaged.

2. ECONOMIC DRIVERS

Personal consumption currently makes up 70% of the US gross domestic product (GDP) and is the primary engine that drives economic growth. The services category performs quite similar to consumption in this context, and together with industrial production, both make about a 15% contribution. Industrial production is often more volatile and acts as an economic swing factor and always needs close scrutiny.

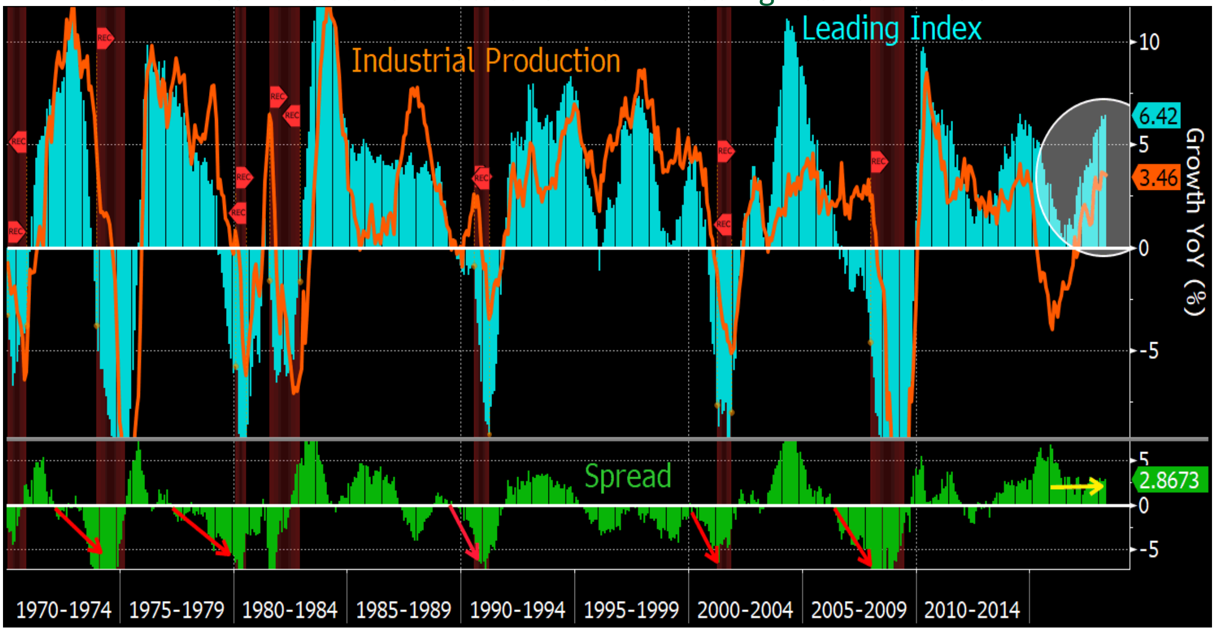
US – Personal Consumption Growth vs S&P 500



Consumption is currently growing at a stable rate and does not show signs of abating. Retail sales are growing at similar levels. This indicates a solid fundamental foundation for US economic growth.

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

US – Industrial Production vs CB Leading Economic Index

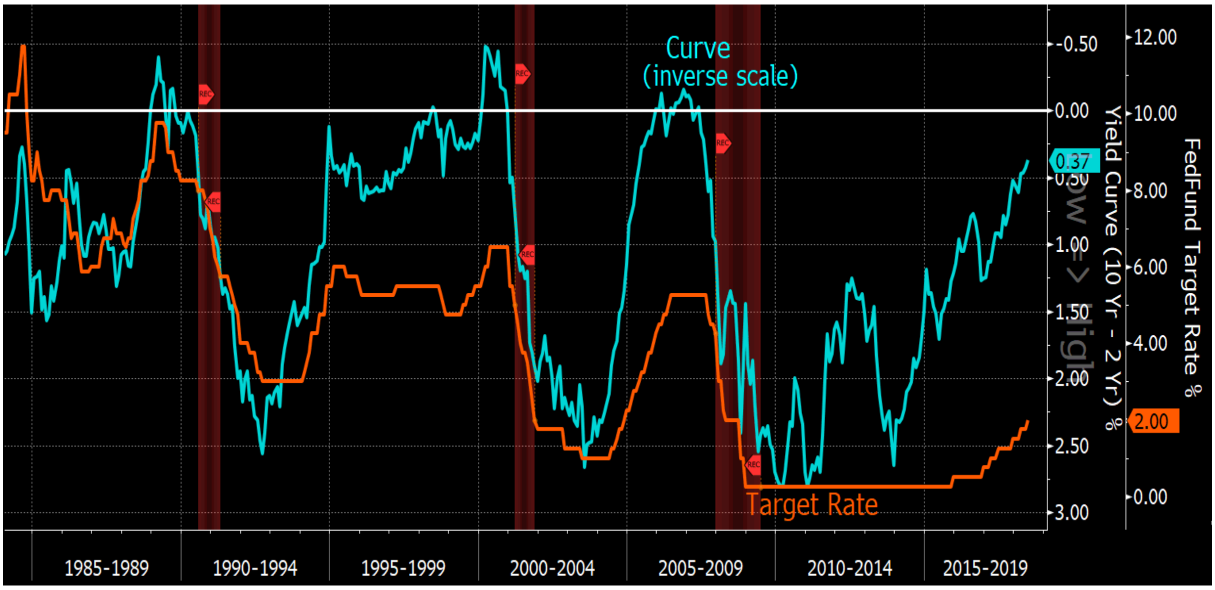


Industrial production growth is currently accelerating along with the leading economic index. This augers well for profit growth in this segment of the economy. Further to this, the spread between these two growth series serve as a handy early warning signal of rising risks for an upcoming recession (see the red arrows in the bottom section of the above chart). It currently indicates continued economic expansion.

3. FED TIGHTENING

The Federal Reserve increased its target rate by another 0.25% to 2.0% under new chair Jerome Powell. In our view, this confirms further confidence in the normalization of the US economy and financial system.

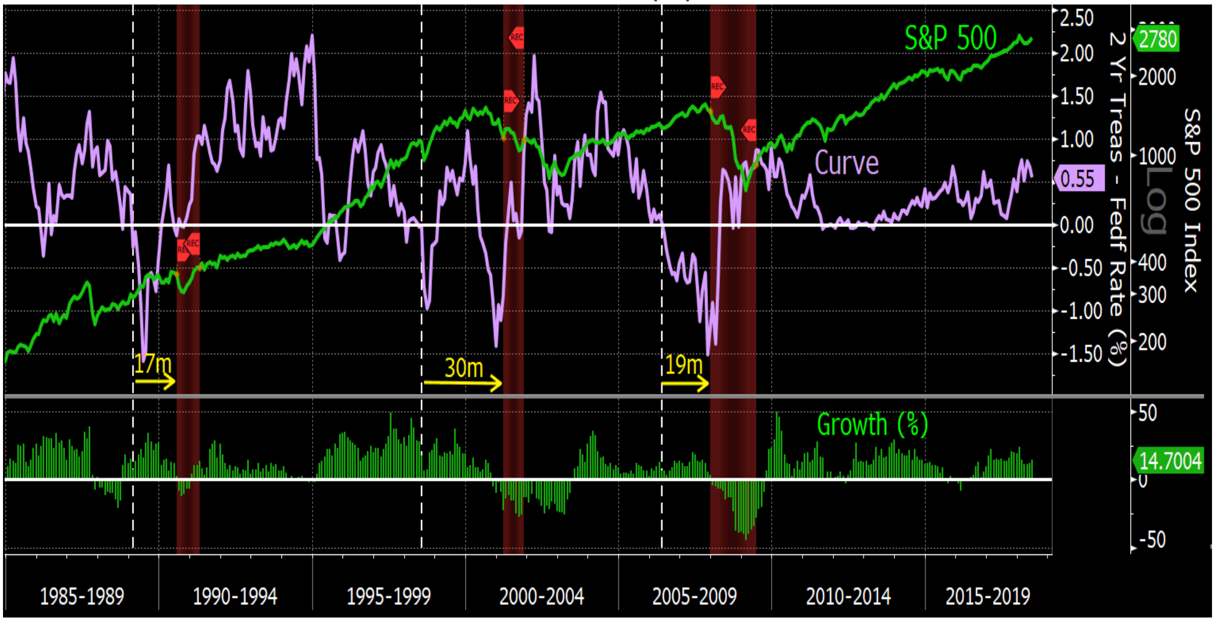
US – Yield Curve vs FedFund Rate (%)



Obviously, there is a fundamental relationship between the target rate and the yield curve. Whilst the curve is in a process of rapidly flattening, it still has some way to go to inverse and effectively indicate growing risk for an upcoming recession. Considering the above chart, it seems that the gap between the curve and the target rate is still too large, and that this may hold back further flattening, or otherwise that the target rate has to increase further.

The latter scenario seems to have some support in the following chart:

US – FedFund Curve (%) vs S&P 500



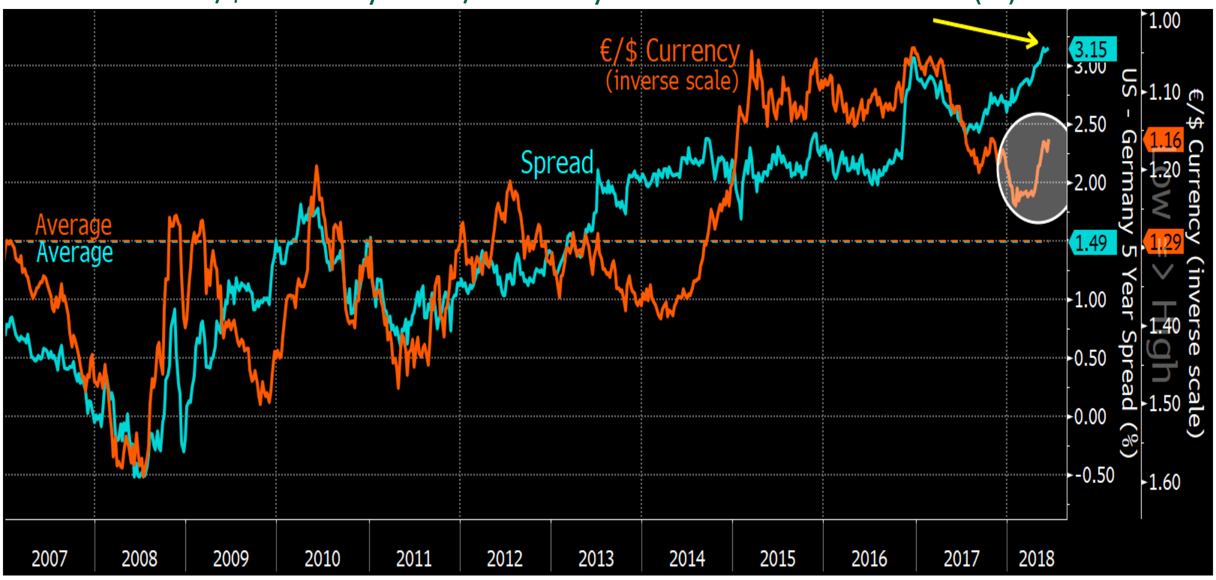
We have created a FedFund curve by applying the two-year treasury yield to the target rate. This curve is not yet flattening and currently needs another two hikes (+0.50%) to get close to that. It seems we can expect a second hike towards the end of this year.

Should this scenario materialise and the above curve start to invert by then, we can, on the basis of the historic experience in the chart, expect the next US recession to start more than a year-and-a-half later on (see the vertical lines). This leaves ample room for equities to continue delivering in the meantime.

4. CURRENCY CHANGES

There are a few important issues to take cognizance of regarding the Dollar/Euro currency:

€/$ Currency vs US/Germany Interest Rate Differential (%)

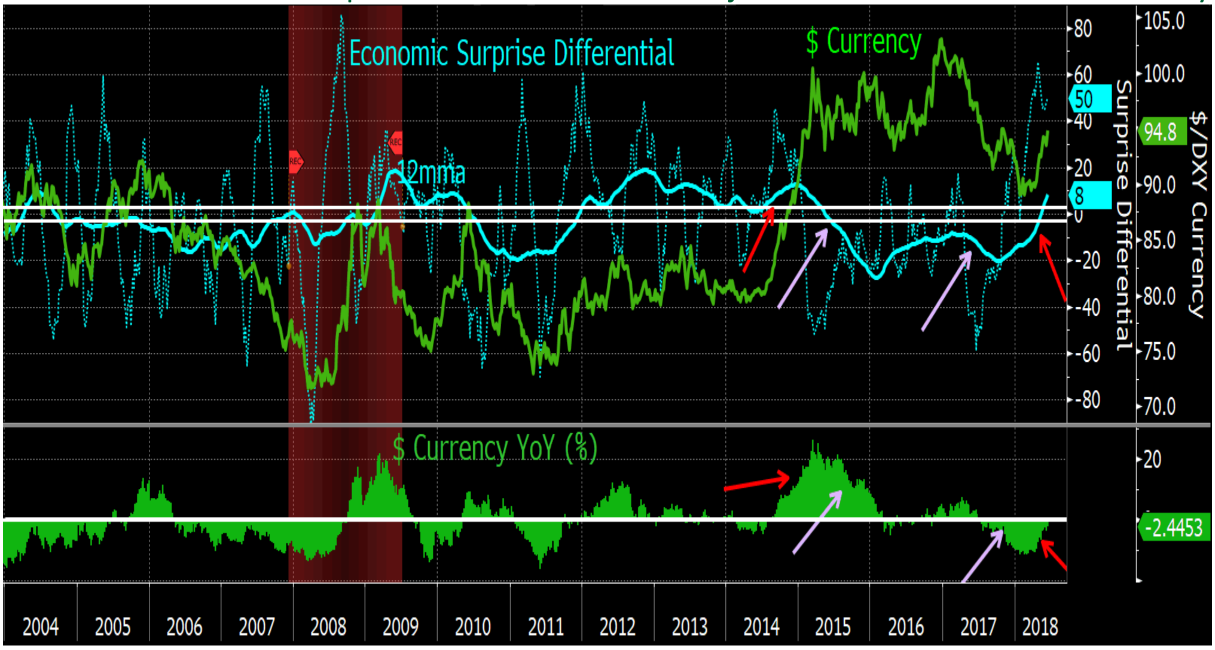


The spread between the US and European interest rates continue to widen. The recent Federal Reserve tightening has potential to further support this process.

The Euro currency struggles to withstand this rising interest differential against the Dollar. The recent weakening of the Euro makes logical sense in this context and more global European companies are already experiencing relief on their Euro based costs.

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

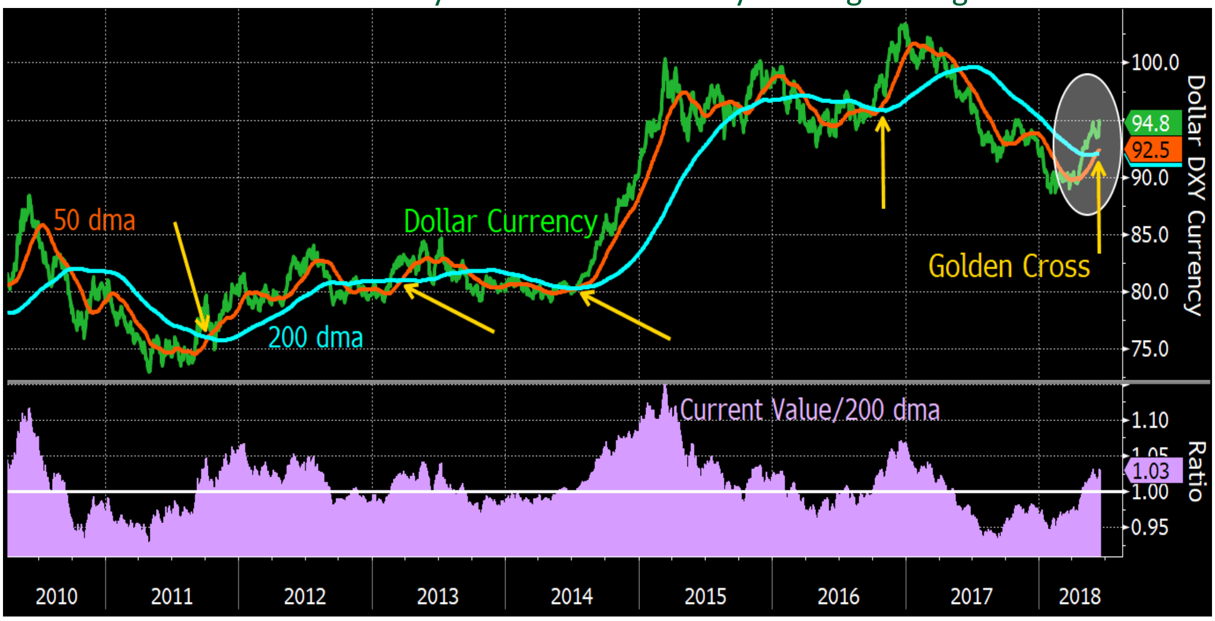
US – Economic News Surprise Differential vs Ten Major Economies and Dollar Currency



The US economic news surprise index turned for the better in April this year compared to the surprise index in the ten major economies (the blue line in the above chart). The Dollar currency historically tends to follow this differential. The current Dollar strength clearly enjoys support in this context.

We also follow data on the speculative positions in the Dollar. Apart from both the number of long and short contracts having been quite stable over the past year, they have also been quite equal in number (very small number of net contracts). It seemed that currency speculators had little directional conviction over this period. This seems to be in process of slowly changing in favour of a higher net long number of contracts.

Dollar Currency With 50 and 200 Day Moving Average



From a technical perspective, the Dollar has recently crossed both its 50 and 200 day moving averages. Furthermore, the 50-day moving average has just crossed the 200-day moving average, causing the technical golden cross event. Technically minded investors perceive this as the confirmation of a new bull trend.

A strong Dollar has several investment implications. Amongst those, it favours the more US domestically orientated businesses the most and may have some detrimental effects on commodities and emerging markets.

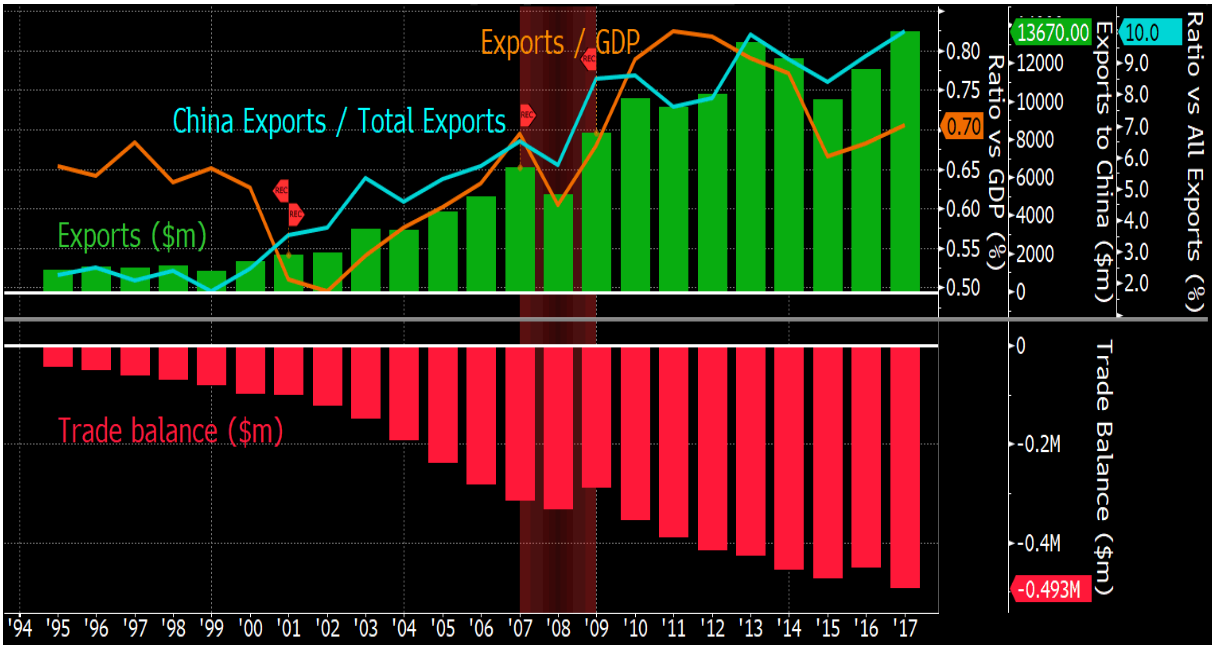
Source: Bloomberg & Stonehage Fleming Investment Management Limited. June 2018. Past performance should not be used as a guide to future performance.

5. US – CHINA TRADE

The threats of a trade war between the US and China concerns most investors. The world capital markets are sensitive to the levels of world trade and experience a setback every time the US president make announcements on new trade tariffs.

The following chart provides some background information in the above context:

US – Data on Trade with China



Exports to China in nominal Dollar terms have grown materially since the turn of the century (the green bars in the above chart), with some volatility year-to-year. In percentage terms it has grown from 2% of total exports to a level of 10%. It is, though, still very small in overall GDP context, being only 0.7%.

The issue of concern to the US is clearly the sharply rising trade deficit (the red bars in the lower section of the chart). The deficit itself is over thirty times the size of the exports currently. The deficit has grown every year in twenty of the past twenty-two years. We should therefore not be too surprised if we hear more political rhetoric in this context.

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Summer in London

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

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