STONEHAGE FLEMING

GLOBAL EQUITY PERSPECTIVES 27 AUGUST 2018

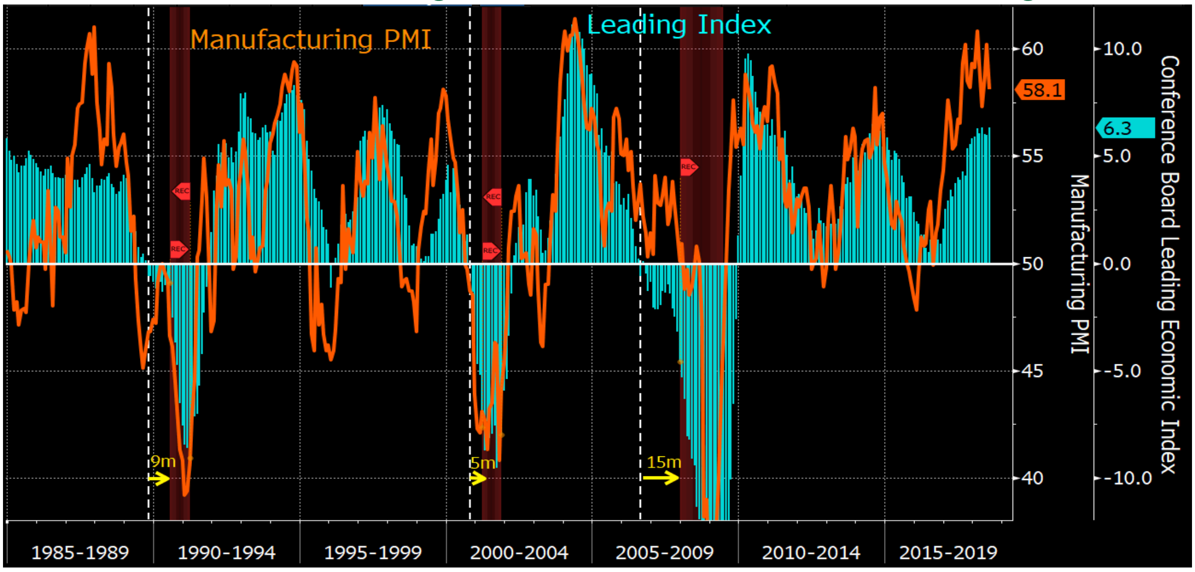
"Tomorrow belongs to those who can hear it coming."

David Bowie

1. US ECONOMY

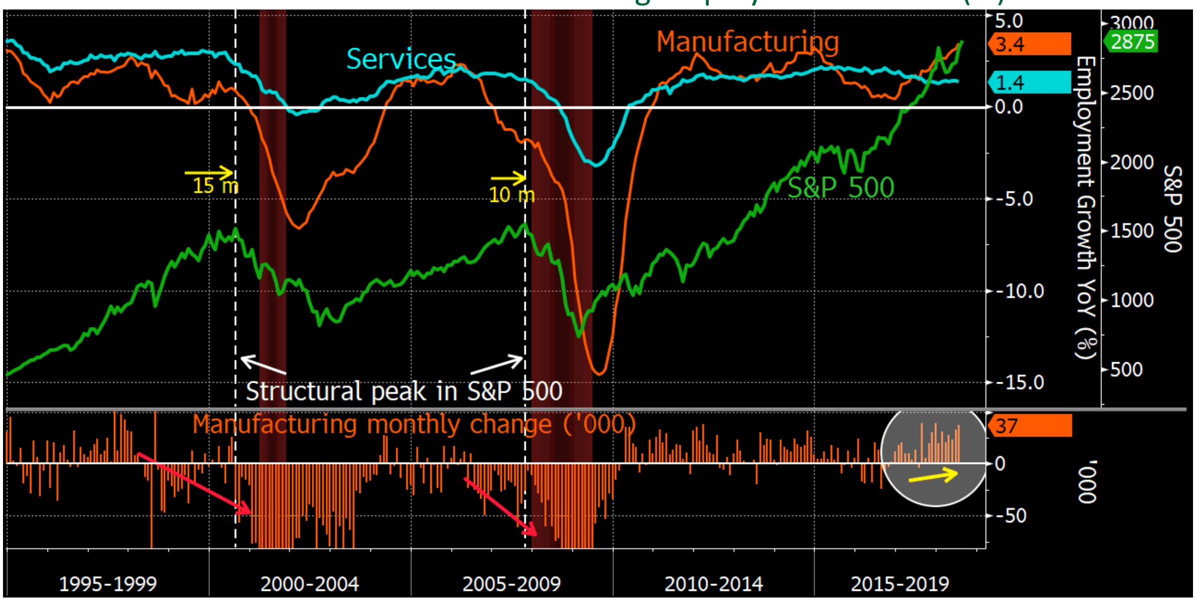
We combine the two most important leading indicators for the US economic outlook in the following chart:

US – Conference Board Leading Economic Indicator & ISM Manufacturing PMI Index



Somewhat surprisingly the end July reading for the leading economic indicator ticked up again. Whilst the PMI index dropped a notch, it is still at elevated levels. The combination of these two reading provides continued confidence in the US economy.

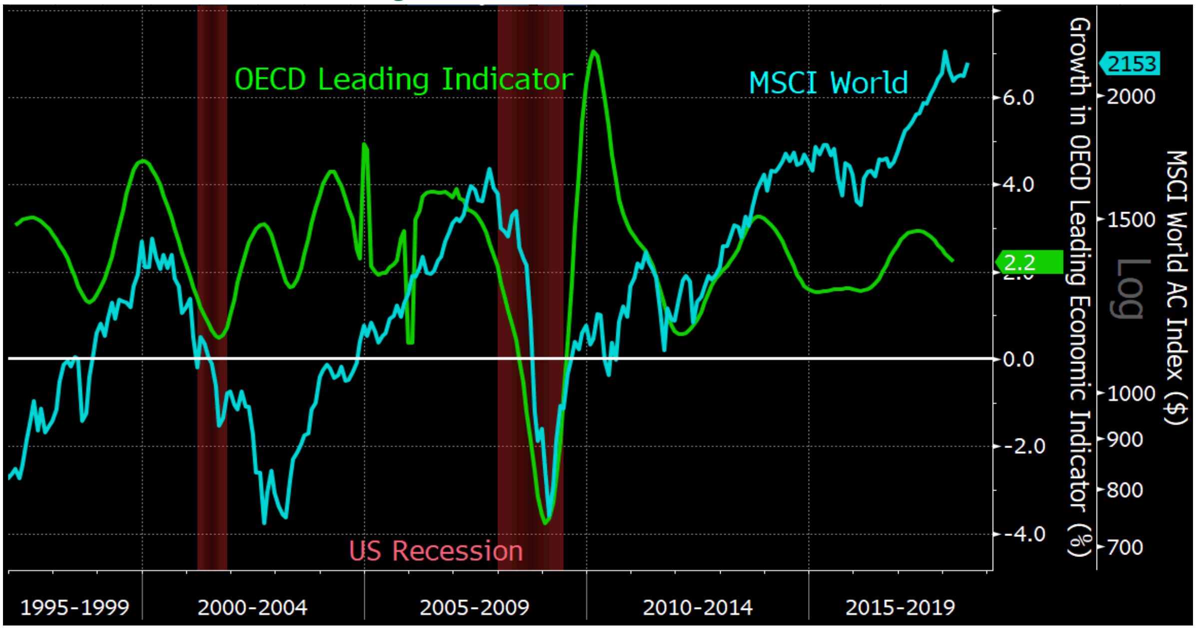
US – Services and Manufacturing Employment Growth (%)



Manufacturing employment itself serves as a valuable leading indicator. We indicate in the above chart the leading periods from when its growth levels stagnate to the subsequent peaks in share prices (the yellow arrows) and the subsequent respective recessions. This employment growth is currently accelerating at +3.4%, a record level in over 25 years.

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

OECD Leading Economic Indicator vs MSCI World Index



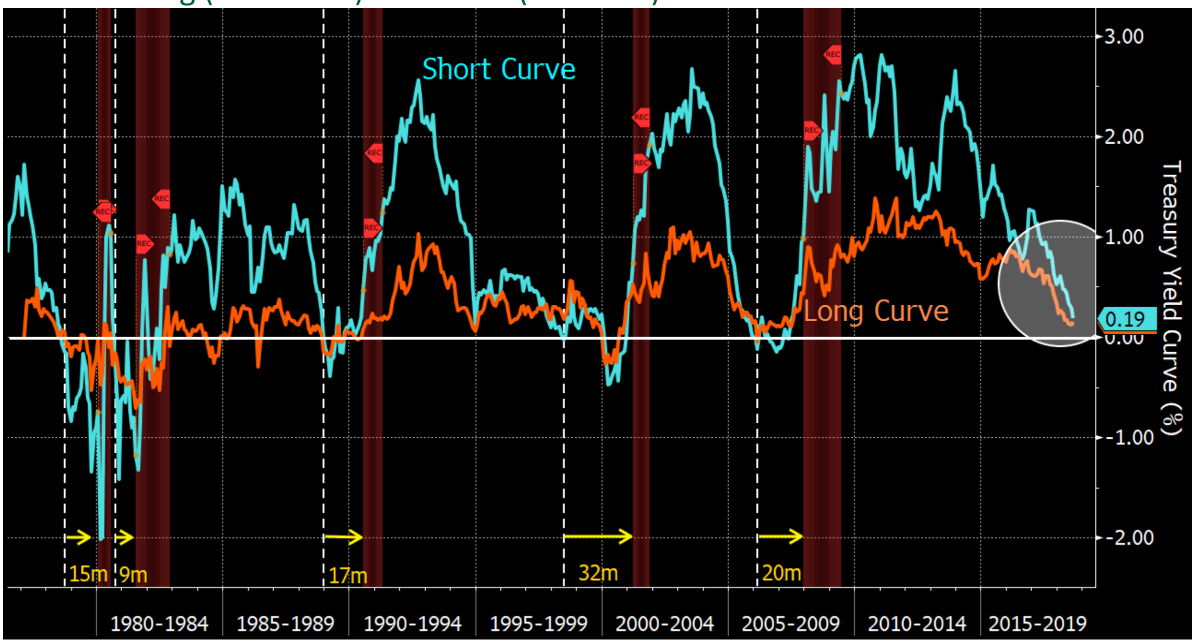
Against the positive US economic backdrop, the global picture seems somewhat less convincingly positive, though still constructive. The OECD leading economic indicator's growth is slowly receding, albeit it from an attractive level for equity investors.

From a fundamental economic perspective, it seems that the US remains to be the investor's first choice from a geographical point of view.

2. RECESSION RISKS

Share prices structurally peak historically a few months before the start of a US economic recession. We spend much effort in assessing the risks for an imminent event in this context. There is a lot of scaremongering about a flat US interest curve going on at the moment.

US – Long (30 – 10 Yr) and Short (10 – 2 Yr) Interest Rate Curve vs Recessions



The first point to make is that the US yield curve has not flattened yet; it is purely in a normal flattening process of over four years since its peak levels. Once it has flattened, it has historically signaled the potential of a recession on average 18 months ahead. On this basis we cannot expect a US recession before 2020 (and peaking share prices a few months before that).

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

We have run historical (weekly) one-year return data for the S&P 500 index from 1979 in this context and present the outcome in the following table:

There were very few (only 8 out of 2015) readings in the -2.5% to -1.5% bracket and we therefore have not considered this data for purposes of this exercise. The meaningful data has been coloured in the table (darkest green as the most attractive, to lightest yellow).

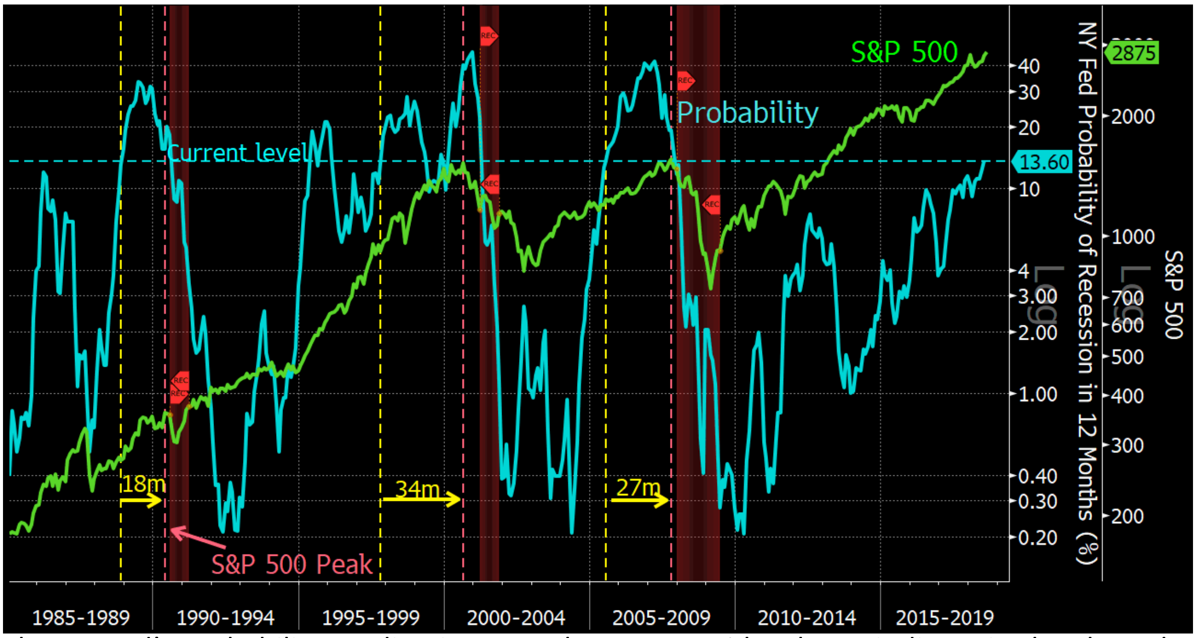
The current curve reading of 19bps falls in the highlighted (in blue) curve bracket of 0% to 0.5%. Interestingly, it historically offers the second-best returns of all the curve brackets, along with still relatively low volatility. In fact, it is the all-green bracket with the best returns (but with higher volatility).

This implies that the current level of the yield curve has historically offered attractive investment opportunities.

Short Curve Bracket	S&P 500 52w Capital Returns		
	Average	Median	Standard Deviation
-2.5% to -2.0%	*25.6%*	*26.3%*	*6.6%*
-2.0% to -1.5%	*5.6%*	*-3.3%*	*19.5%*
-1.5% to - 1.0%	3.6%	-3.1%	19.0%
-1.0% to -0.5%	4.5%	6.3%	15.0%
-0.5% to 0.0%	5.2%	8.2%	19.1%
0% to 0.5%	13.4%	13.5%	14.0%
0.5% to 1.0%	14.0%	16.9%	17.3%
1.0% - 1.5%	9.7%	13.2%	16.7%
1.5% to 2.0%	4.7%	7.0%	18.6%
2.0% to 2.5%	11.8%	10.1%	9.9%
2.5% - 3.0%	9.6%	10.0%	6.4%

The New York Federal Reserve offers an interesting probability index of an imminent US recession. We run both the Y-axes in the chart in log scales to highlight their effects more clearly.

NY Federal Reserve Probability Index of a US Recession within 12 Months vs S&P 500



The NY Fed's probability reading is currently at a 13.6% level. We indicate in the chart the corresponding S&P 500 levels in 1988, 1997 and 2005 preceding the respective recessions, and the respective S&P 500 peaks.

The main conclusions from this historic analysis are as follows:

- The current probability reading has historically preceded the respective S&P 500 peaks by over two years on average, with the shortest period being 18 months.
- The average capital value return to the S&P 500 peak levels has been +38%, with the lowest level being +25%.

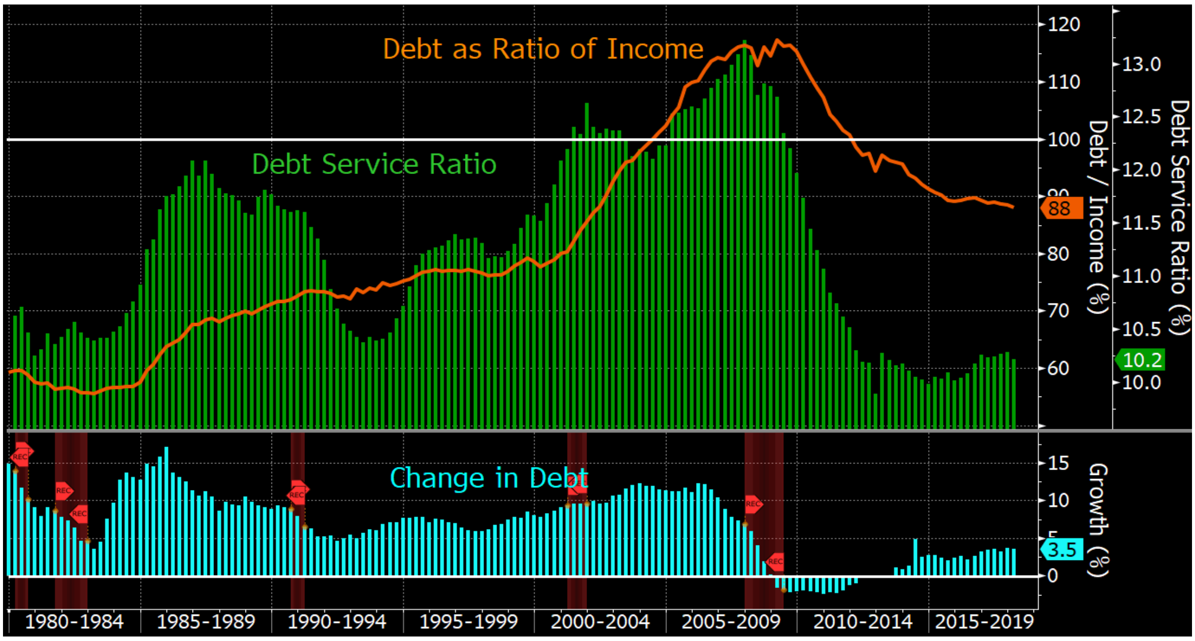
This analysis supports further equity investing in the current US economic cycle.

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

3. US DEBT

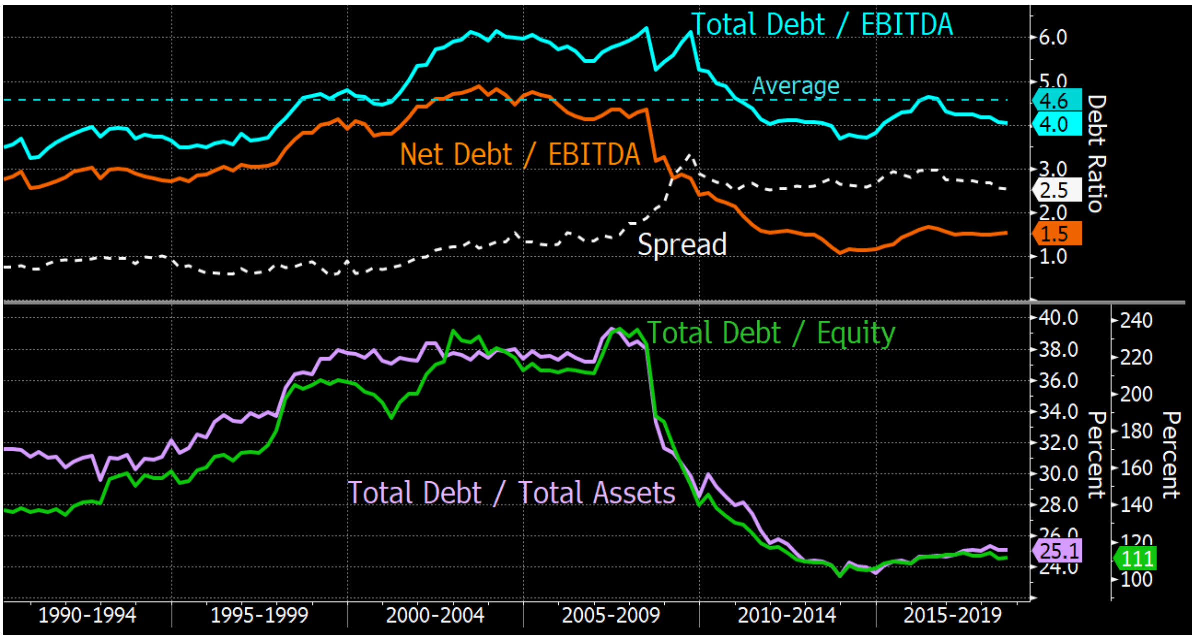
We are often confronted by opinions that the current rising interest rate envornment is very detrimental for both US households and corporates. The following charts elaborate on this theme:

US Households – Debt Data



Household debt as a ratio of annual income continues in a decreasing trend, currently at 2002 levels of 88%. After a cutback in absolute levels during the credit crisis, it is rising slowly at 3.5% - moderate in historic terms. The debt service ratio is almost at a forty year record low level of 10%.

S&P 500 Companies Debt Ratios



Total corporate debt levels (as reflected by S&P 500 data) as ratios of equity and total asset levels are currently close to thirty-year record low levels (the bottom section of the above chart). The net debt to EBITDA ratio is also close to a record low level. This ratio benefits from large amounts of cash levels held by some companies (e.g. Apple, Alphabet), but the total debt to EBITDA ratio of 4.0 is also at the pre-2000 levels which was accompanied by much higher interest rates than currently. Further, most companies have fixed their interest rates at low levels.

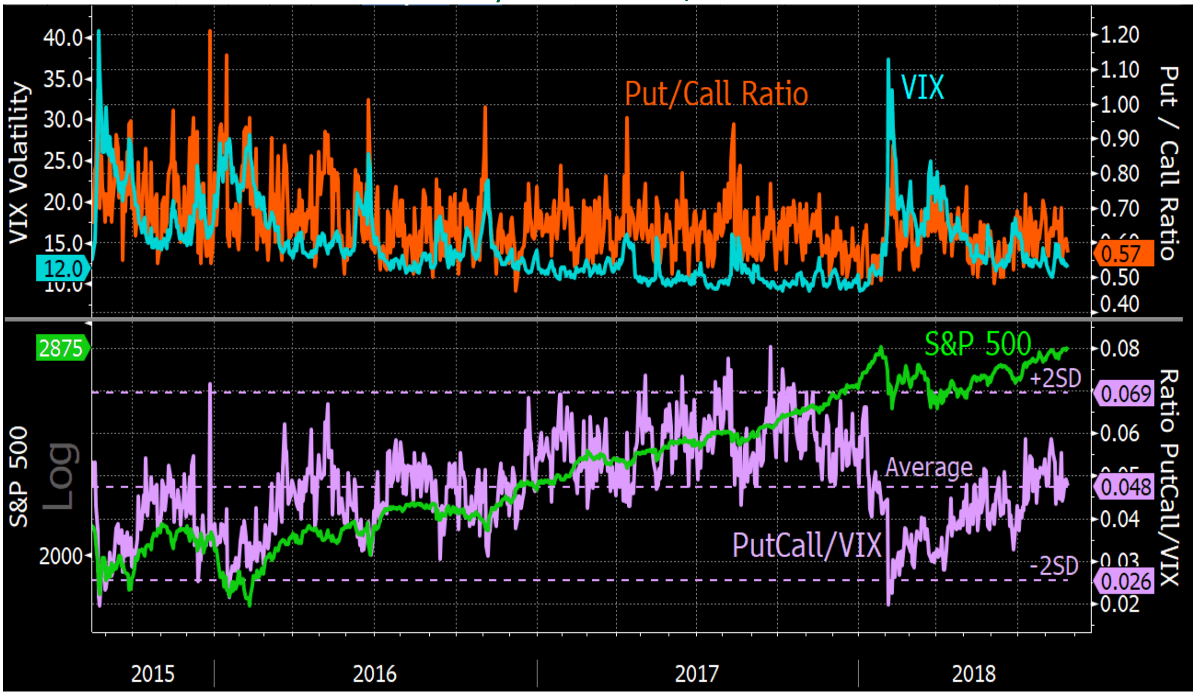
All-in-all, we do not fear debt levels in the context of rising interest rates.

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

4. SMART MONEY

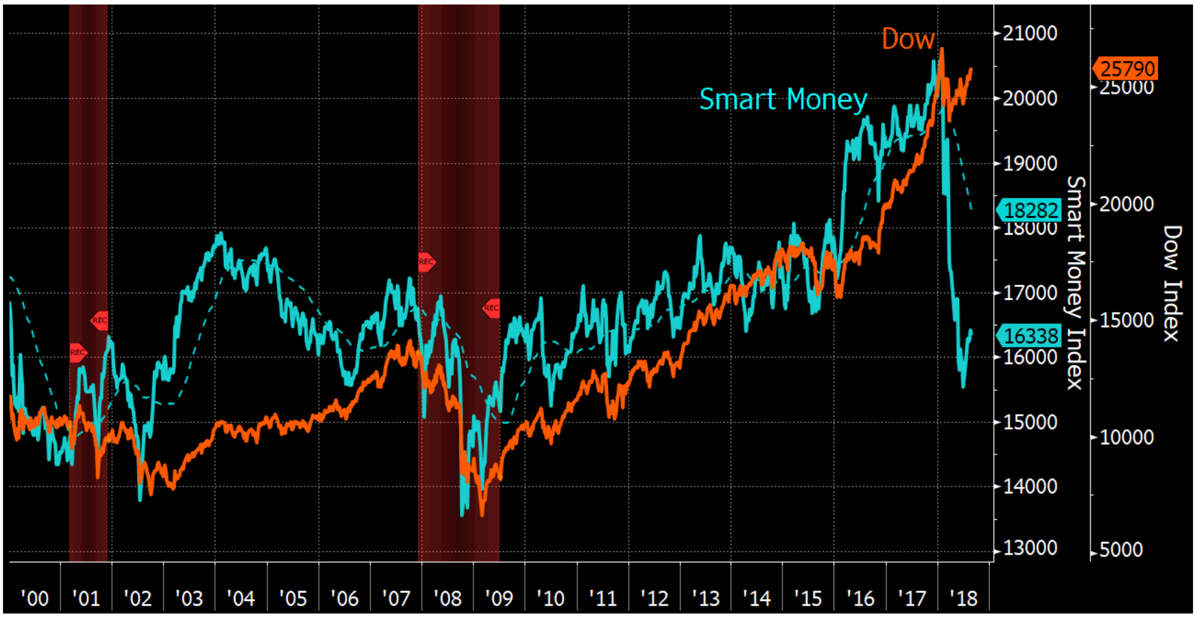
We can make valuable conclusions from the behavior of professional investors in the derivatives market.

S&P 500 – VIX Volatility Index vs Put/Call Ratio and S&P 500



We perceive it to be an environment of undeserved complacency when share volatilities may lag the Put/Call ratio materially. We present these metrics in the top section of the above chart, and the 'complacency' ratio in the bottom section by dividing the volatility index into the Put/Call ratio. This 'complacency' ratio provided a clear sell warning towards the end of last year, and conversely a buy signal early in February this year. It currently is on a neutral level reflecting neither complacency or extreme concerns.

US – Smart Money Index vs Dow Index



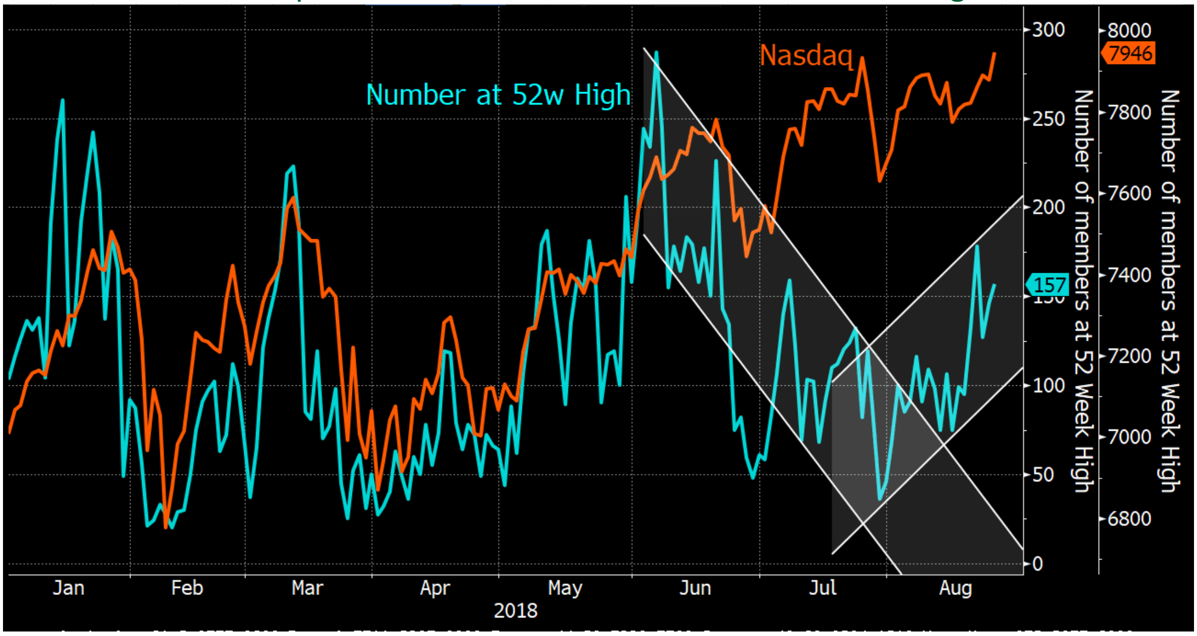
The Smart Money index in the above chart reflects the Dow index adjusted for the actions of more professional investors against those more apt to overreactions. This index historically provided good buy and sell signals. It collapsed early this year, reflecting professional investors leaving the scene. It is currently recovering from its low base, reflecting the return of professional buyers.

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

5. TECHNOLOGY

Technology shares have had a rough ride recently, for various reasons. Some of those reasons are the governance issues in Facebook, weak emerging markets in general (and specifically China), regulatory interference (US and China) and cost overruns. In general top-line revenue performance has been good.

Nasdaq Index vs Number of Members at 52v Week Highs



Many investors became very concerned from June when the chart of the number of Nasdaq shares hitting new highs started lagging the Nasdaq index. That coincided with the Facebook governance issues and the strengthening Dollar negatively affecting the Yuan currency.

It seems that the negative trend in the number of shares hitting new highs has recently turned for the positive and now correlates better with the Nasdaq index. A more stable Dollar can also provide support in this context.

Gerrit Smit

Partner - Head of Equity Management
Stonehage Fleming Investment Management Limited

15 Suffolk Street
London
SW1Y 4HG
T +44 20 7087 0000
Email gerrit.smit@stonehagefleming.com
www.stonehageflemininvestments.com/gbi

RISK DISCLOSURE

This communication has been prepared for information only and is not intended for onward distribution. It is neither an offer to sell, nor a solicitation to buy, any investments or services. This communication does not constitute a personal recommendation and does not take into account the individual financial circumstances, needs or objectives of the recipients.

The advice we provide will all be based on and take into account a majority of product types and not every single equivalent product within a given product category. As such, our advice is restricted (as opposed to independent) as defined by the Financial Conduct Authority.

All investments risk the loss of capital.

The value of investments may go down as well as up and, you may not receive back the full value of your initial investment.

Past performance should not be used as a guide to future performance.

Changes in the rates of exchange between currencies may cause the value of investments to go up or down in the reporting currency.

In general, underlying investments denominated in foreign currency are not hedged back into the reporting currency. Among the factors that may influence currency values are trade balances, the levels of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation and political developments. Returns may increase or decrease as a result of currency fluctuations. Values may also be affected by developments relating to controls and restrictions on foreign currency remittance of proceeds of investments in a non-sterling jurisdiction.

Whilst every effort is made to ensure that the information provided to clients is accurate and up to date, some of the information may be rendered inaccurate by changes in applicable laws and regulations. For example, the levels and bases of taxation may change. Any reference to taxation relies upon information currently in force. You should note that the bases and rates of taxation may change at any time. Tax treatment depends upon the individual circumstances of each client and may be subject to change in the future.

In addition to the information provided by Stonehage Fleming Investment Management Limited you may wish to consult an independent professional.

It has been approved for distribution in South Africa and those countries of the EEA where distribution is permitted by:

Stonehage Fleming Investment Management Limited
15 Suffolk Street
London
SW1Y 4HG

Stonehage Fleming Investment Management Limited is authorised and regulated by the Financial Conduct Authority and registered with the Financial Services Board (South Africa) as a Financial Services Provider ("FSP") under the Financial Advisory and Intermediary Services Act, No 37 of 2002 (FSP No: 46194).