STONEHAGE FLEMING

19 October 2019

Dear Equity Client

GLOBAL EQUITIES – 3rd Quarter 2019

World equity markets trod water over the third quarter. The MSCI World Index (including Emerging Markets and dividends) held onto the first half performance of +16.2% (US$ terms) over the nine months.

This muted performance should be considered against the backdrop of a traditionally weak third quarter stock market season, further moderation of the global economic outlook, high risk of recession in parts of Europe, unsettling geopolitical risks in the Middle East and Hong Kong and the very strong Dollar currency. The question can be posed as to why the market has not been weaker.

We believe the answer to this question is multi-layered. The first fundamental point to make is that the US economic outlook is currently only moderating – there is no critical leading economic indicator providing a strong negative signal. Investor sentiment has been muted for some time, with no indication of high expectations or exuberance. Institutional equity investors have been trimming positions through the year while the index of the Association of American Individual Investors bullishness has been hovering around a -1 standard deviation for some time now. Investors have been climbing a wall of worry.

The dull economic outlook and low oil price have kept inflation and interest rates at bay, to the extent that the historic dividend yield on the S&P 500 index currently exceeds the US ten year treasury yield. The odds for continuing dividend growth over this period are high. The ratio of 1.1 to 1 between these two yields has been relatively rare, and historically indicated buying rather than selling opportunities.

Since May Investors have been spooked by the inversion of the 3 month / 10 year US yield curve. Whilst we do not place much value on such a short curve, this curve has recently steepened into mildly positive territory with the more relevant 2/10 year curve also steepening off its low base. In our perception the steepening curve reflects an improving investor mood after a few months of excessive bearishness.

The market seems to credit the Federal Reserve's cut of their target rate as an indicator of economic support (with another cut potentially following soon). The US presidential election is a mere year away, and may offer a fair chance of further economic stimulatory actions. US consumer confidence remains at relatively elevated levels and company results generally continue to exceed muted consensus expectations. As we approach the seasonal year-end, conditions seem supportive of the traditional stock market recovery. More positive trade tariff results are a relief. Perceptions have diminished over the risk of an imminent and deep recession and the potential opportunity to buy quality businesses at materially lower prices.

We value all your support.

With kind regards

Gerrit Smit
Partner – Head of Equity Management

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