GLOBAL EQUITY PERSPECTIVES 17 DECEMBER 2018

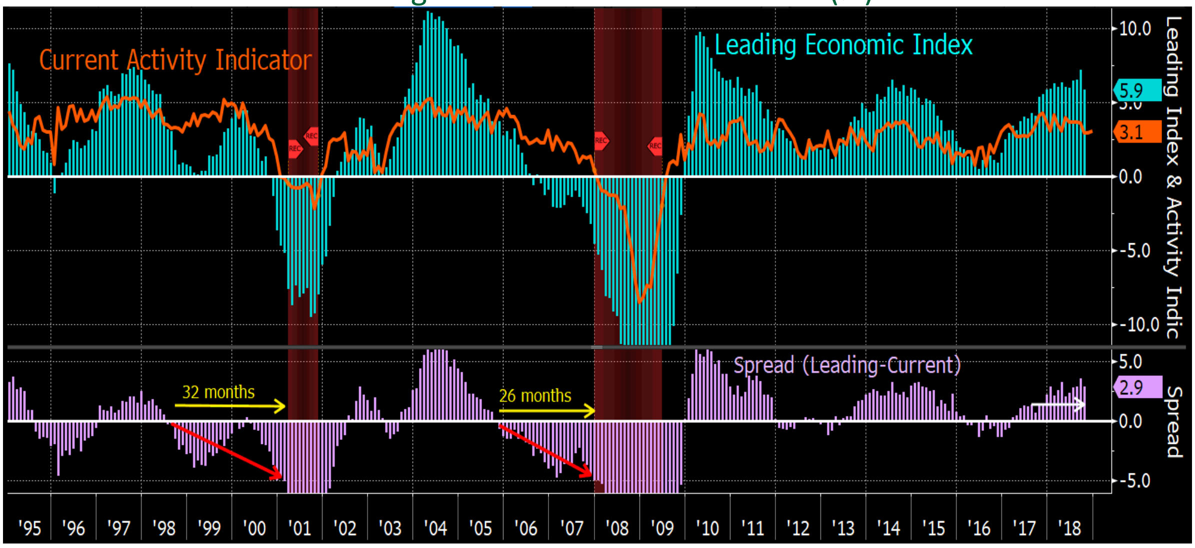
"He who in contented is rich."

Laozi

1. US OUTLOOK

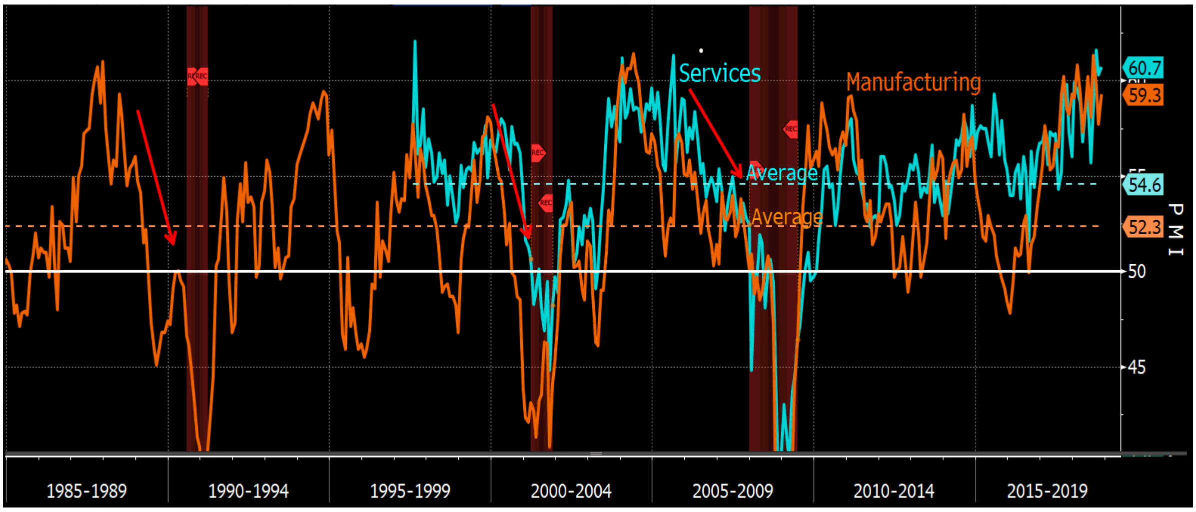
With the volatile US stock market, it is prudent to continue closely monitoring its economic fundamental outlook as this year closes. The following charts are useful in this context:

US – Goldman Sachs Current Economic Activity Indicator vs Conference Board (CB) Leading Economic Indicator Growth (%)



The current economic indicator in the above chart remains stable. The most recent reading of the trusted leading economic index of ten economic indicators has dropped from the previous peak level but is still at an elevated level. The spread between the two series (see the bottom section of the chart) is also at an elevated level. This spread traditionally went negative more than two years before the respective recessions.

US – ISM Purchasing Manager's Indices (PMI's)



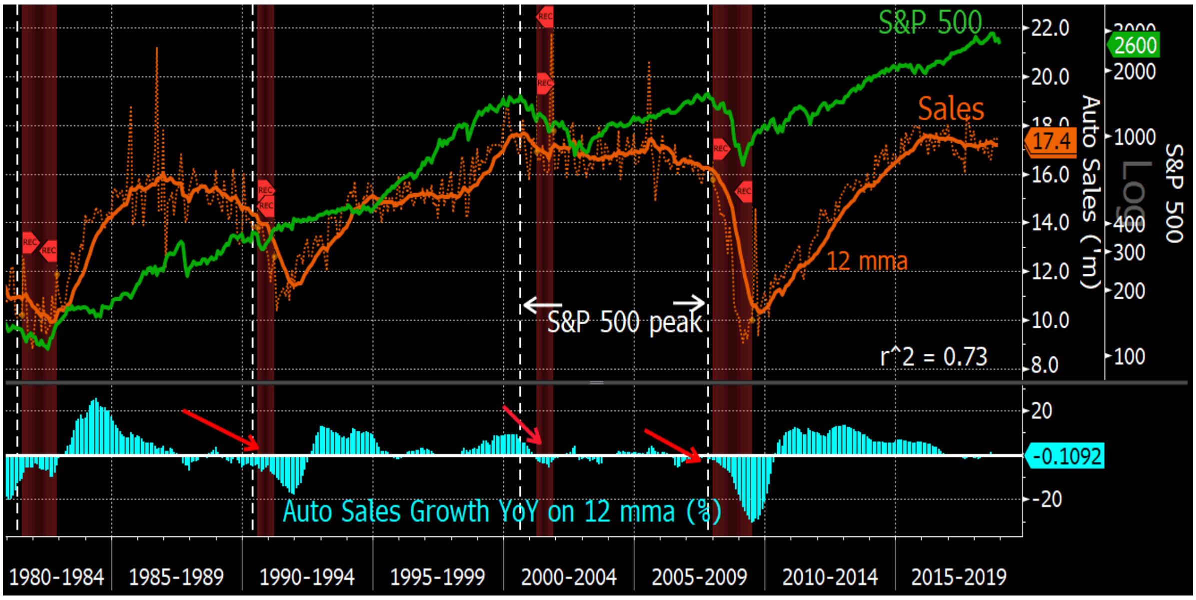
Both the Services and Manufacturing PMI's have been at elevated levels for a while. Both of their November readings increased from their respective October readings. While we can expect the readings to start drifting lower, they have historically taken more than a year to reach the neutral 50 levels. All-in-all, these fundamental charts provide little information to form a negative view on the US economy.

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

2. NEGATIVE INDICATORS

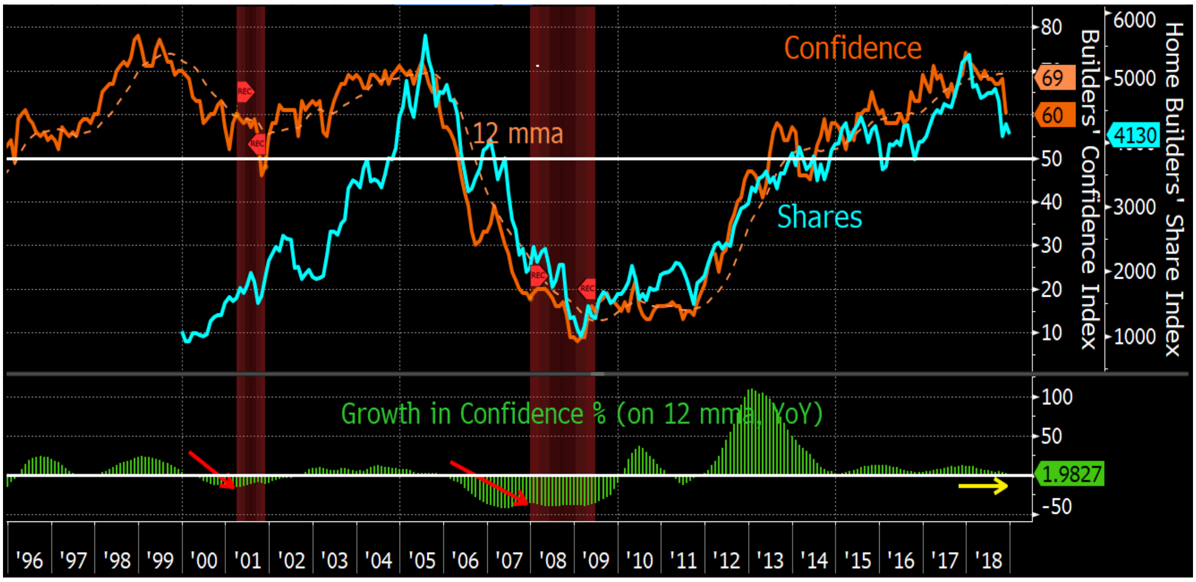
It is important to consider the negative signals we may get from the marketplace:

US Auto Sales vs S&P 500



US auto sales have been flat for two years already, long before the increase in interest rates. They have historically dropped well before the respective recessions (see the bottom section of the above chart). Along with the fundamental changes in this sector, we do not yet find enough reason for economic concerns based on this information.

US – Homebuilders' Confidence vs Shares Prices



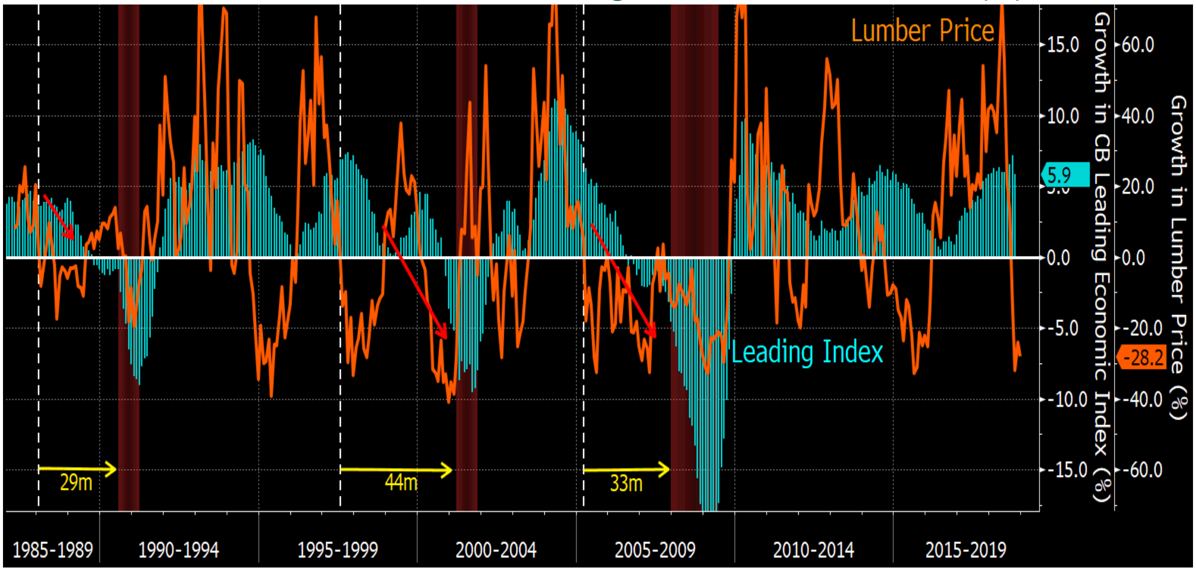
Home builders' sentiment (and shares) historically peaked more than two years before a recession. Whilst the annual growth in confidence historically became negative more than a year before the respective recessions, it has currently been flat and marginally positive for quite some time and does not indicate an imminent recession.

In the above context, we show also on the following page a chart of the growth in the US Lumber Price along with the growth in the Leading Economic index.

It is striking that the Lumber Price leads the Leading Economic Index by around a year. The lumber price has recently dropped sharply and may be fuel on the fire for many sceptics. We notice that the first negative growth number has historically led, on average, to the next recession much more than two years later only (see the yellow arrows in the chart).

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

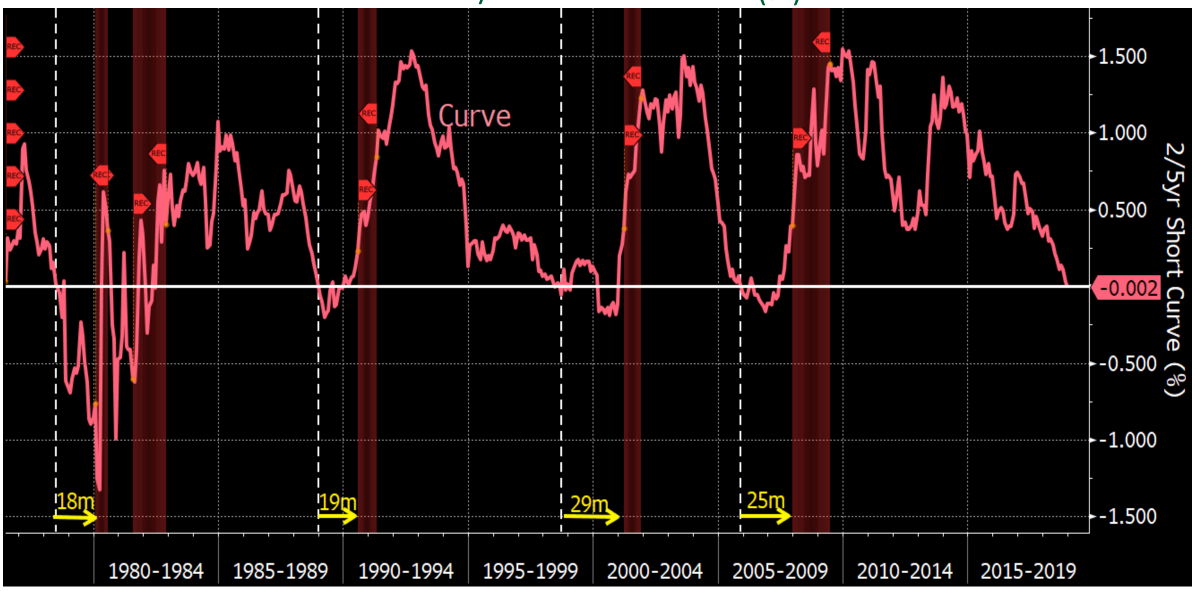
US – Lumber Price vs CB Leading Economic Index Growth (%)



Again, we can expect the Leading Economic Index growth to recede from its current elevated levels. It has historically reached its zero growth levels on average nine months before the next recession.

The media headlines have been littered recently with the 3/5-year yield curve that inverted and therefore the rising risk of an imminent US recession. We have not before been aware of this particular duration curve, but thought of showing it to our clients anyway:

US – 3/5-Year Yield Curve (%)



The curve has inverted only to the third decimal (but, yes, that still means it has inverted). Historically such inversion led to the respective following recessions 22 months later (on average). On this basis, this curve indicates the start of the next US recession in the last quarter of 2020.

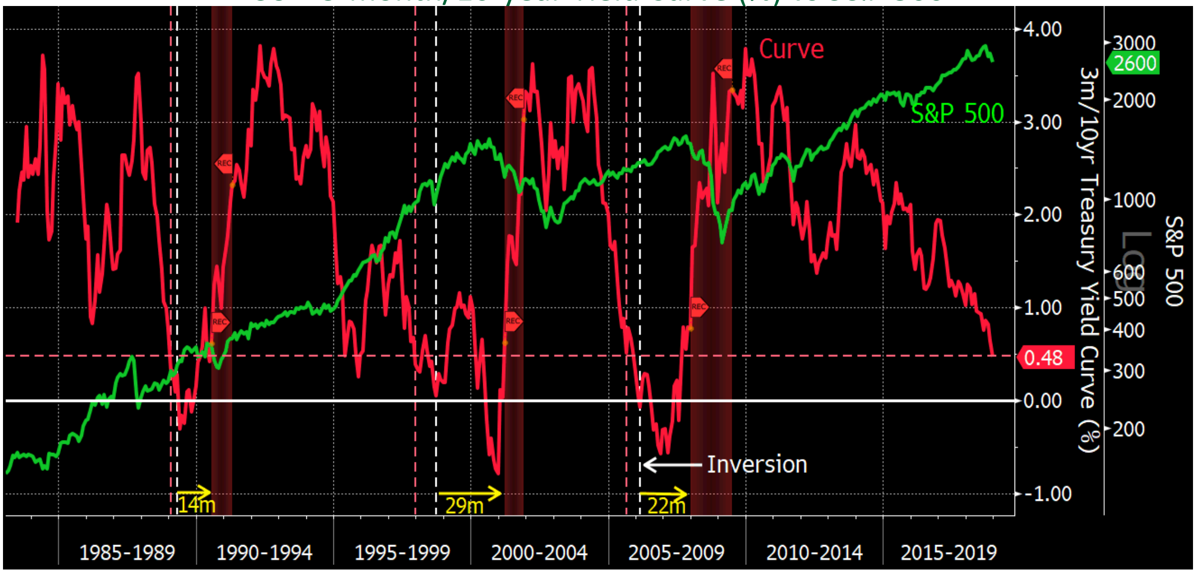
We show on the next page a more popular 3-month/10-year yield curve (along with the S&P 500 index). It also historically indicated a possible recession at 22 months on average after the yield inversion. This curve has not inverted yet.

The curve is currently at +0.48%. We have calculated the price appreciation levels to the respective S&P 500 peaks from this level and from the inversion events, shown in the table. The average appreciation is +30.8%. On this basis it is currently too early to exit the market.

S&P 500 Appreciation to Its Peak Preceding The Respective Recession			
Recession	**1990**	**2001**	**2008**
0.48% Curve	18.8%	56.4%	21.0%
Flat Curve	14.1%	49.2%	25.5%

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

US – 3-month/10-year Yield Curve (%) vs S&P 500

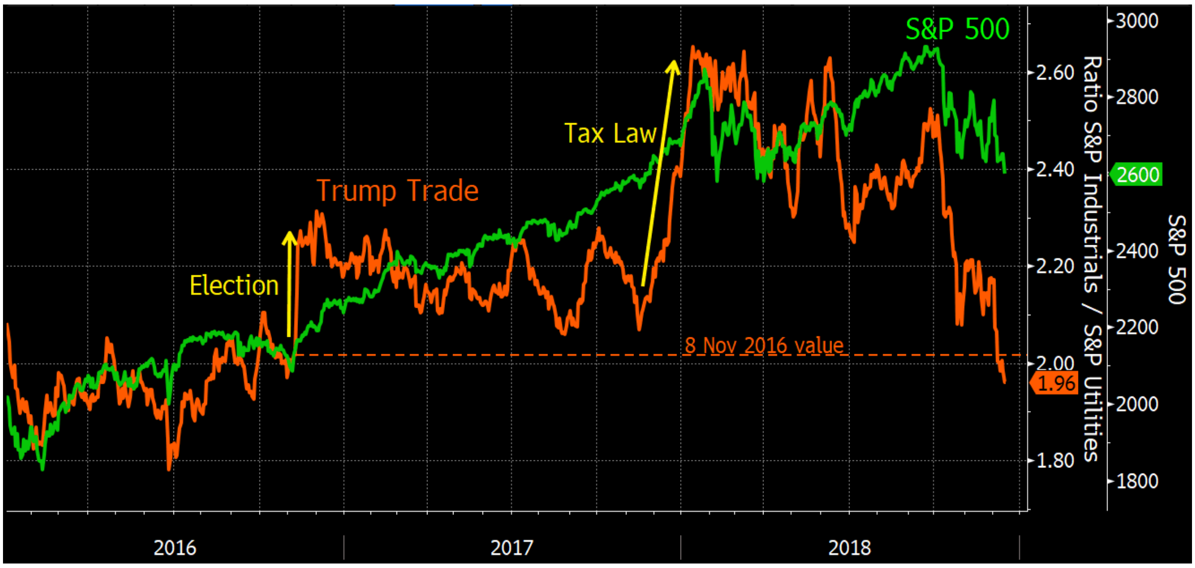


We take cognisance of all the negative signals we get from the market place. At this stage they seem to be rather early warnings than signaling an imminent bear market.

3. TRUMP TRADE

It would be interesting who the media will nominate as their personality of 2018. The S&P 500 index is +22% since the election of Pres. Trump on 8 November 2016.

US – S&P 500 and Ratio of S&P Industrials/Utilities



Some measure Pres. Trump's financial success not necessarily by the overall stock market's appreciation, but also by considering the performance of more cyclical shares against more defensive ones. The measure in the chart above shows that Industrials have lost all of their relative performance against Utilities despite his commitments in this context, and the tax benefits granted (see the orange line in the above chart).

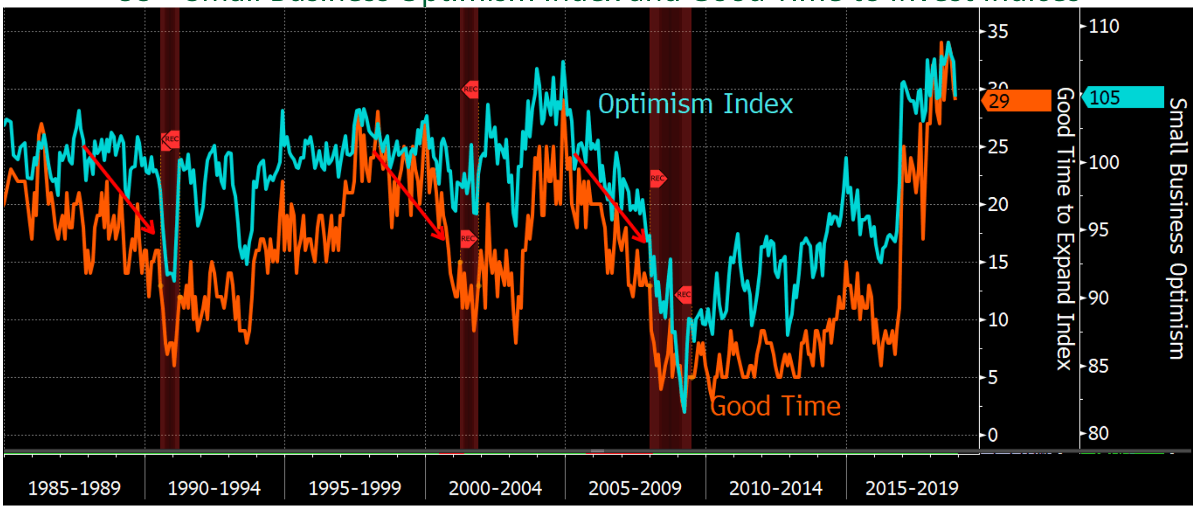
We show another chart in this context on the next page, considering the relative performance of smaller companies. Again, despite Pres. Trump's America First mantra, both the Russell 2000 and S&P 600 small company indices have recently lost all of their outperformance against the S&P 500 since his election in 2016.

This indicates that he needs another stimulus effort – which is difficult to imagine unless he starts with his infrastructure upgrades and finds a solution to the trade tariff wars with the rest of the world.

Russel 2000 and S&P 600 Small Company Indices Relative to S&P 500

The proverbial US 'businessman on the job' (along with the consumer) is still optimistic as reflected in the following chart:

US – Small Business Optimism Index and Good Time to Invest Indices

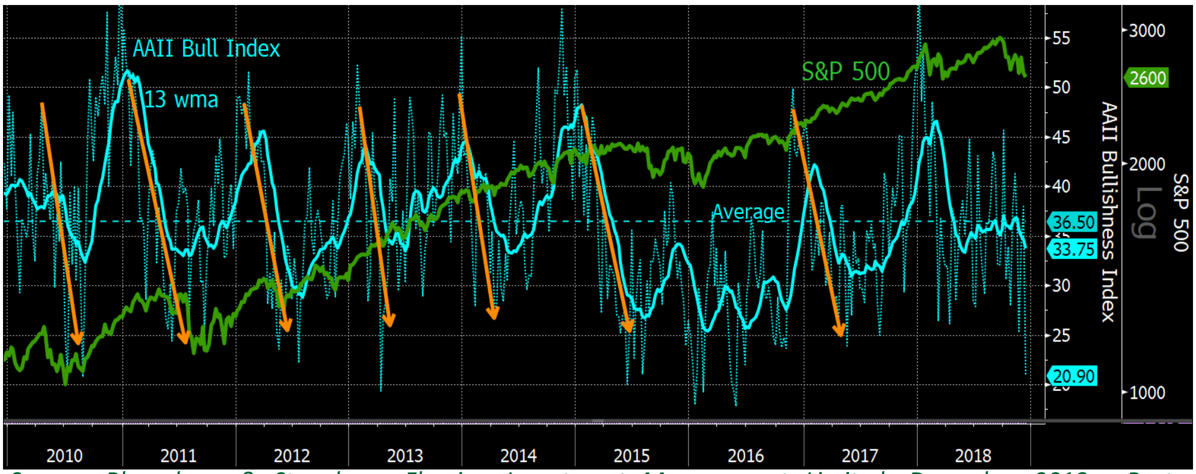


Both the above small business sentiment indices are close to record levels, along with light truck sales still growing at +5%. Considering their respective lead times to recessions, they do not signal imminent economic woes in the US yet.

4. TECHNICAL INDICATORS

Despite being fundamentally driven, we do consider technical indicators for transacting.

American Institute of Individual Investors Bullishness Index vs S&P 500



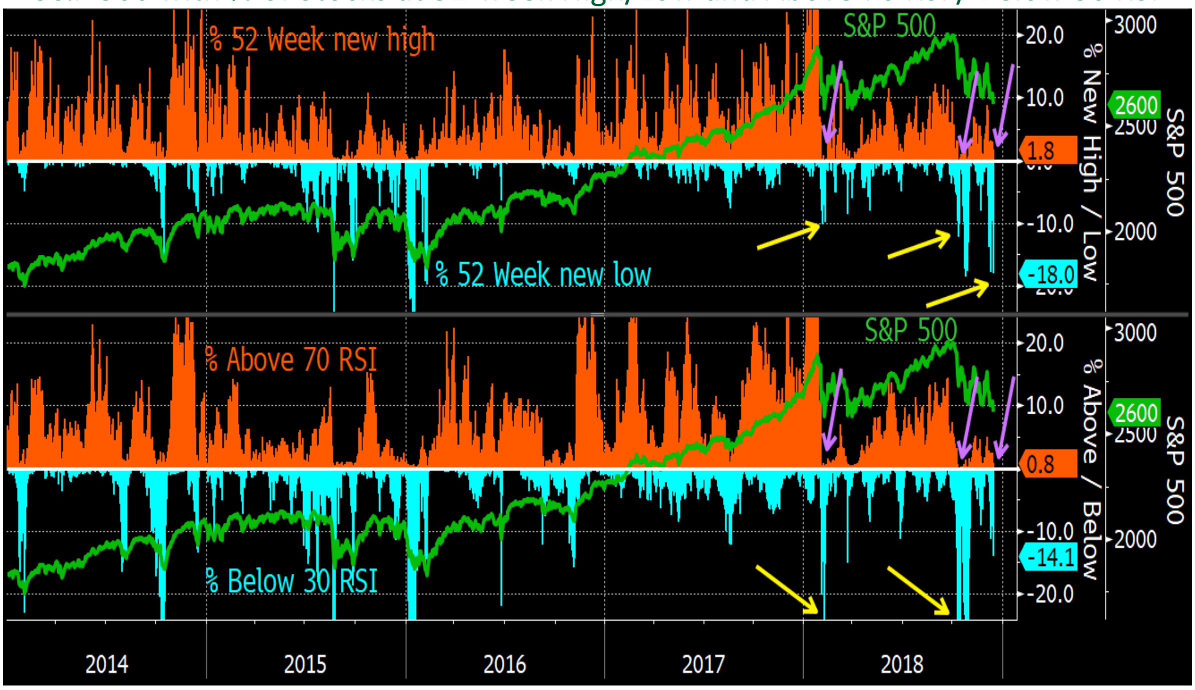
Source: Bloomberg & Stonehage Fleming Investment Management Limited. December 2018. Past performance should not be used as a guide to future performance.

The US retail market's bullishness indicator is currently at extreme low levels (at the end 2015/beginning 2016 levels) as reflected in the preceding chart. If we are still in a bull market, this is a positive technical indicator.

S&P 500 with 50 and 200-day Moving Average

The S&P 500 has just experienced a technical 'death cross' (its 50-day moving average crossing its 200-day moving average downwards, see the circle in the above chart) and its discount to its 200-day average (6%) is at the record high levels of end 2015/beginning 2016. Again, if we are still in a bull market, this is a strong buy signal. (Interestingly, this chart provided a strong sell signal at the end of January – see the orange arrows).

S&P 500 with % of Stocks at 52-week High/Low and Above 70 RSI / Below 30 RSI

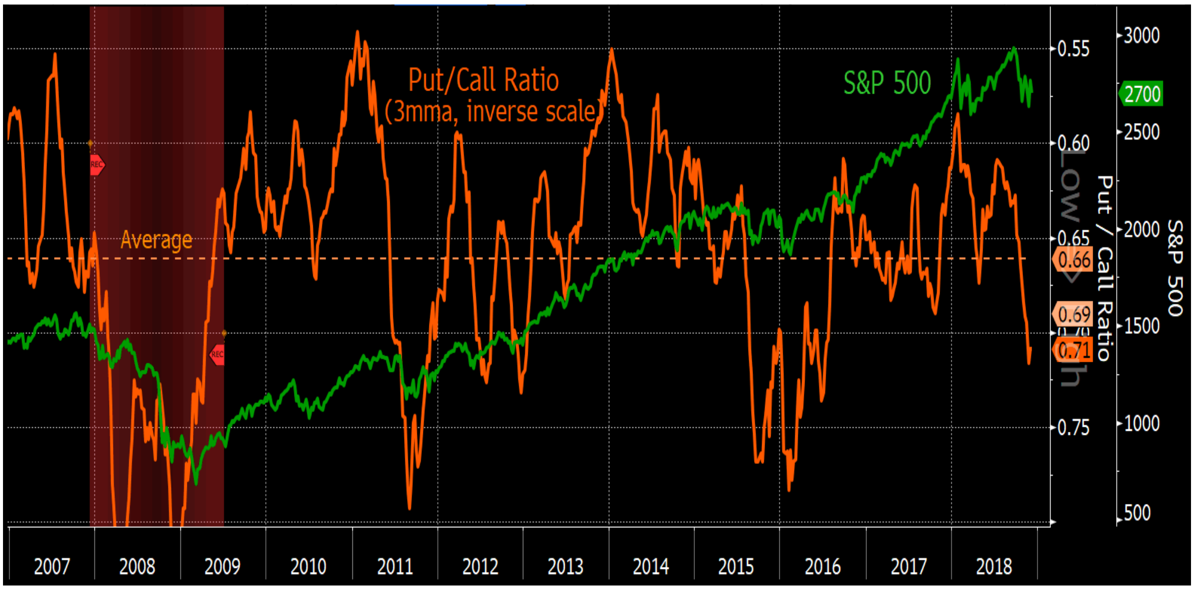


The percentage of S&P 500 stocks above their respective 52-week highs are at a very low level of only 1.8%, and the percentage above their respective 70 RSI levels are at only 0.8%. These provide short term tactical buy signals.

We again show on the next page a chart of the S&P 500 Put/Call ratio. It has turned at quite a high level (on an inverse scale in the chart), reflecting a change in hart of the tactically minded pessimists utilising the derivatives market.

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

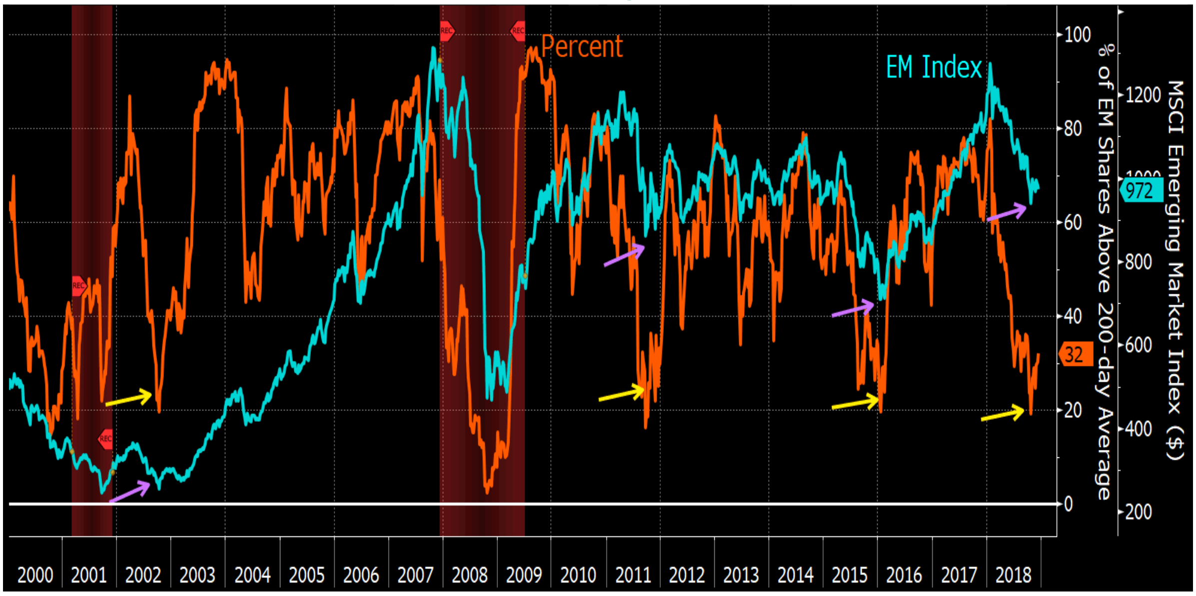
S&P 500 vs Put/Call Ratio



This chart provides the same tactical buy signal as those preceding it.

Lastly in this tactical context, the emerging markets have led the current weakness in the world capital markets. It is appropriate to consider their technical position at this juncture:

MSCI Emerging Markets (EM) Index vs % of EM Shares Above Their 200-day Moving Average



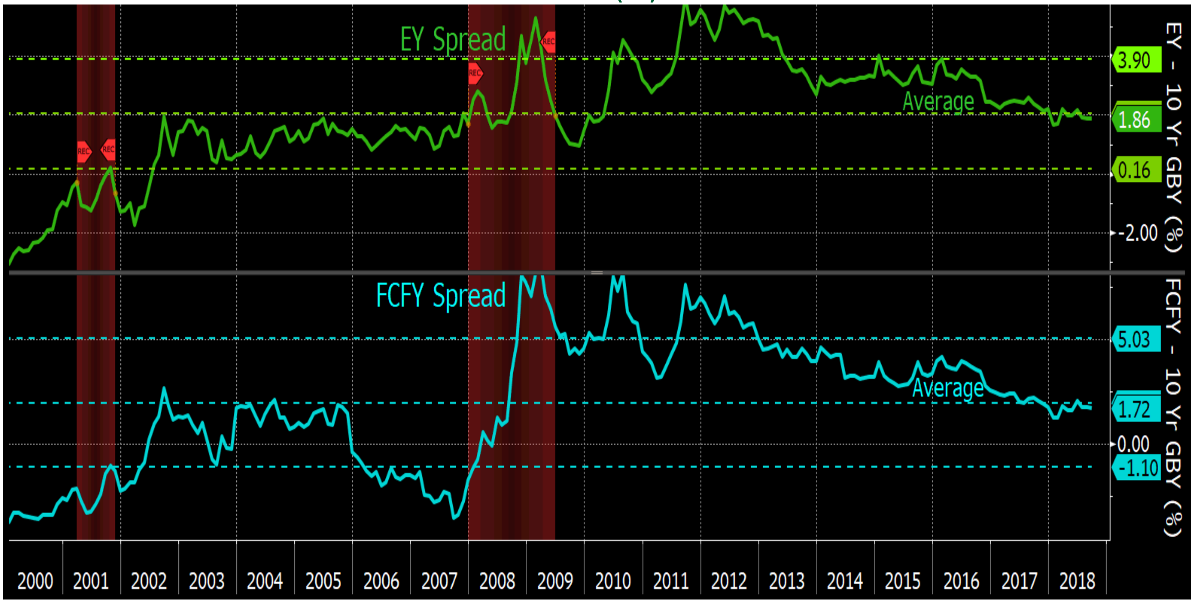
The above 200-day moving average indicator has provided good tactical buy signals this century (see the yellow arrows with the corresponding EM index purple arrows). It has recently provided another positive tactical signal and it seems as if the EM shares have stabalised after a weak performance through 2018.

5. VALUATION

In conclusion of our last equity note for 2018 and all the current uncertainties in the world capital markets, we cannot think of a better quote than Warren Buffett's one of 'Price Is what You Pay, Value is What you Get'. In the end we must ensure we get fair value and that we are not overpaying for the high quality sustainable growing businesses we own.

There are numerous ways to consider valuation. The S&P's current P/E ratio of 17.8 is lower than its 18.8 average (and its Free Cash Flow Yield of 5.4% equals its average) this century. We'll conclude with the following chart of equity yield spreads as best choice:

S&P 500 Earnings and Free Cash Flow Yield Valuation Spread with Ten Year Treasury Yield (%)



We (conservatively) only consider data this century (yield spreads have been much more in favour of equities in the previous century) and it does not reflect the 2019 positive earnings growth expectations.

Both the earnings and free cash flow yield spreads against the ten-year treasury yield are currently at fair value. We can rather talk of the value we get than just the price we pay.

Our sincere gratitude to our clients for another year of support and friendship, and for sharing fascinating investing thoughts. We wish you and yours all the very best for the Festive Season and the New Year.

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RISK DISCLOSURE