GLOBAL EQUITY PERSPECTIVES 1 APRIL 2019

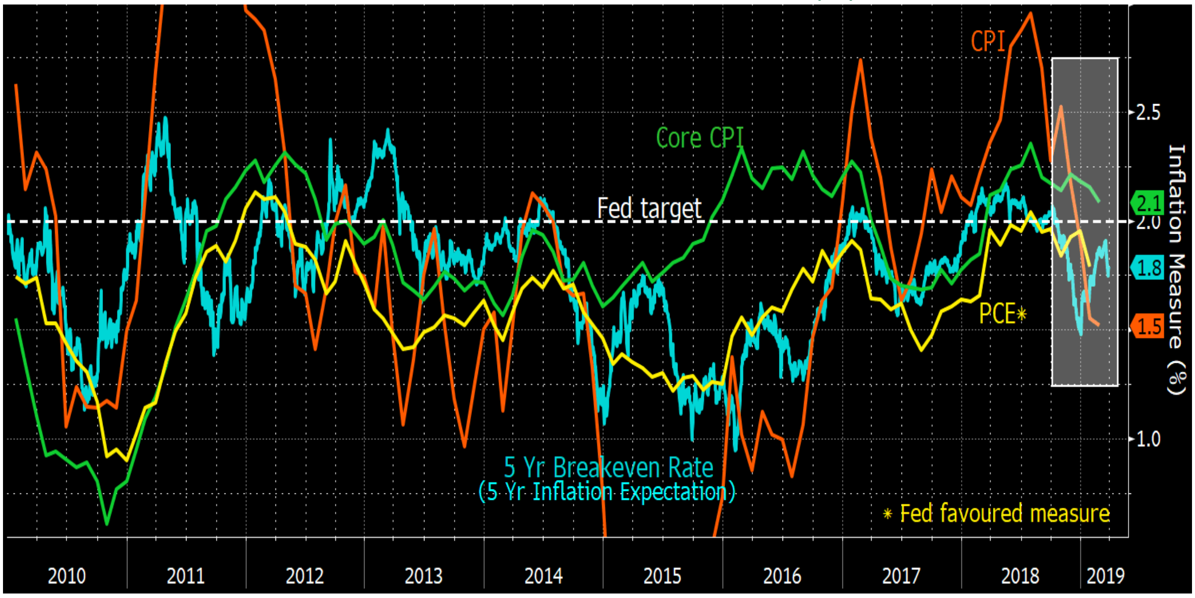
"Only the mediocre are always at their best."

Jean Giraudoux

1. INFLATION FEARS

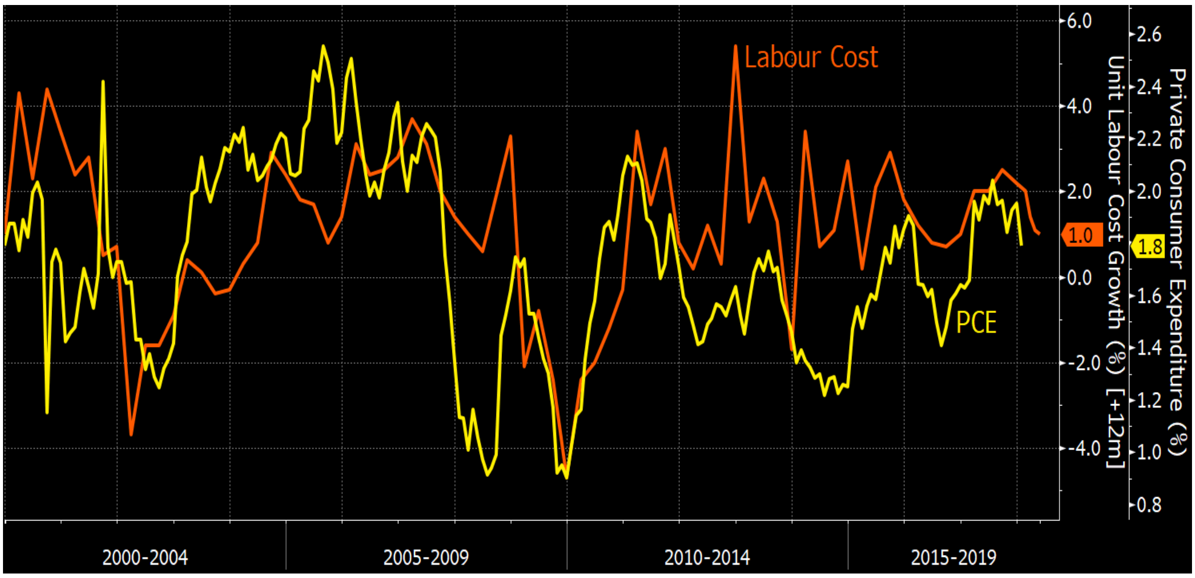
Equity markets have been spooked a few times in the recent past by fears for potentially sharper rising inflation levels in the US. These fears are mainly based on high employment and rising wages. These fears though have not yet come to fruition, as reflected in the following chart:

US – Different Inflation Measures (%)



Despite wages growing at +3.5% currently (well above the long-term average of +2.9%) all the above inflation measures are trending lower. This is also the case for Consumer Expenditure, the most critical measure for the Federal Reserve's considerations.

US – Unit Labour Cost Growth vs Private Consumer Expenditure Inflation (%)

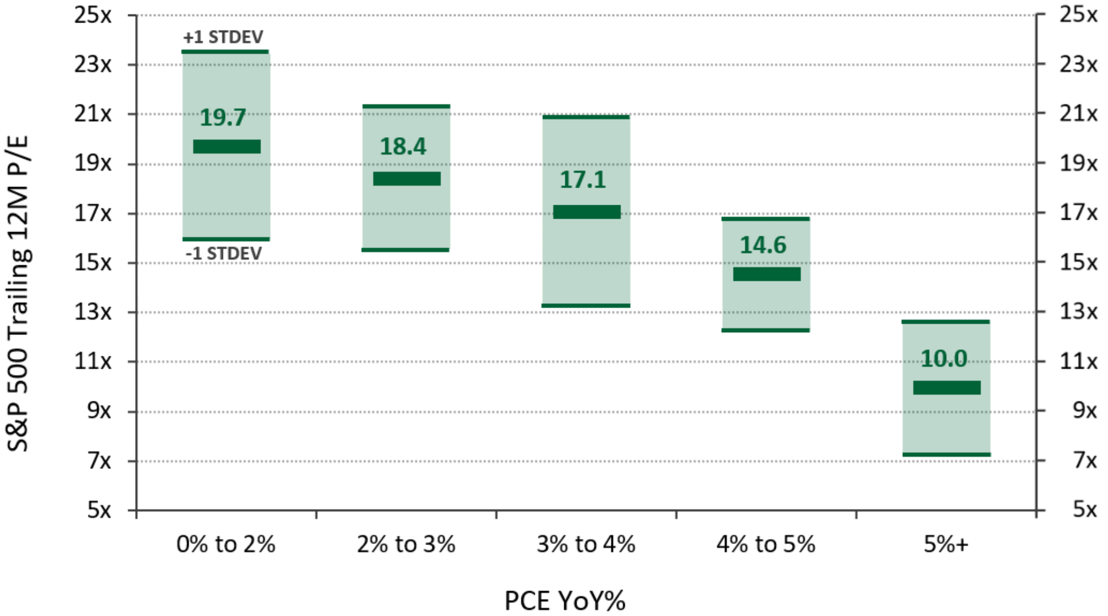


Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2019. Past performance should not be used as a guide to future performance.

As reflected in the preceding chart, unit labour cost growth is actually receding, leading PCE inflation lower. Labour productivity therefore seems to be a more stabilising factor in the US economy than generally perceived.

The historic relationship between inflation and equity valuations reflect in the following chart:

S&P 500 P/E vs PCE (%)
Data since 1960



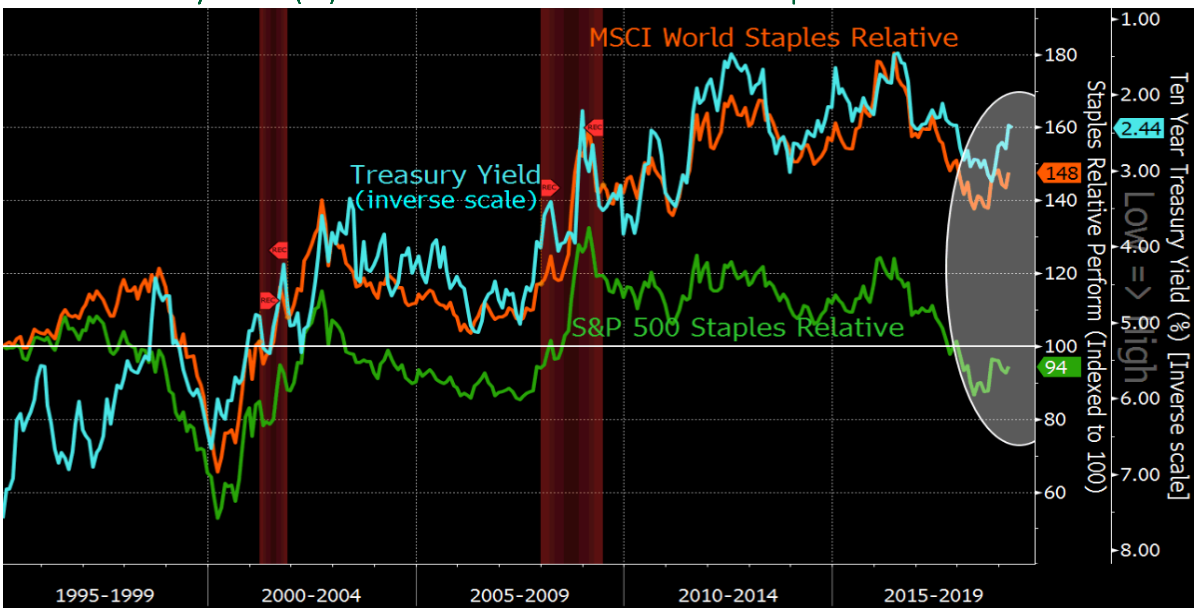
There were many perceptions that inflation may have moved to the 2% to 3% bracket in our chart above. Such a rate would not be a major issue in terms of equity rating expectations. Despite this comfort, chances may be that the first bracket is becoming more relevant again, offering even more support to equity valuations.

We won't be surprised to again hear voices about potential deflation. We think wage growth clearly argues against such risks.

2. STAPLES

The lower inflation and interest rates may further support the staples sector, considering their historic inverse relationship:

US Treasury Yield (%) vs S&P 500 and MSCI World Staples Relative Performance

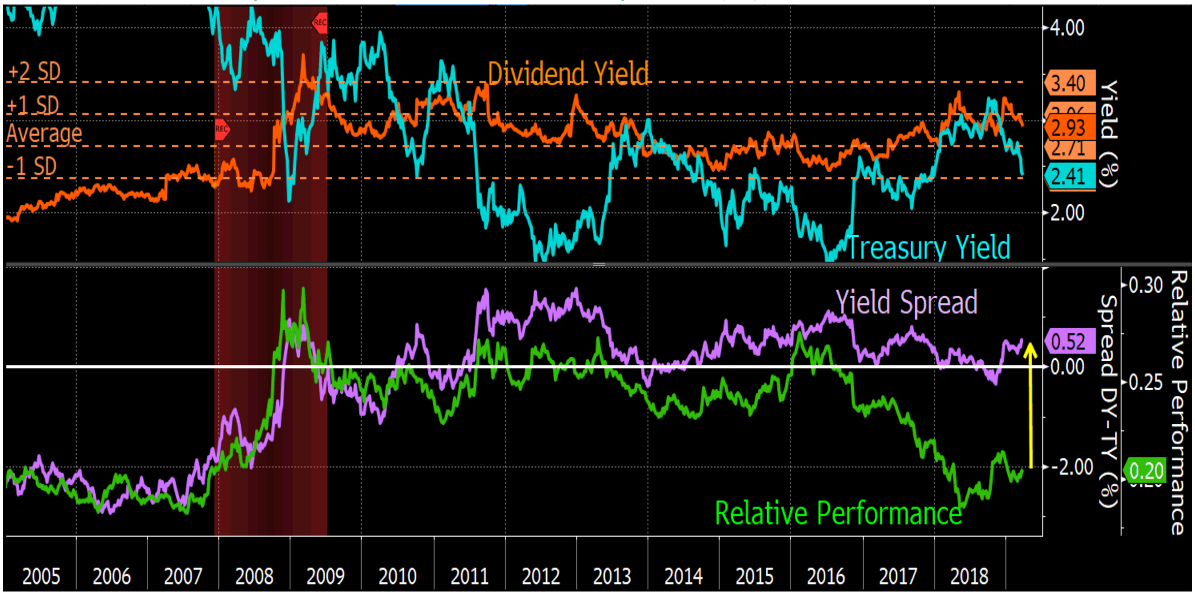


Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2019. Past performance should not be used as a guide to future performance.

Both the S&P 500 and the MSCI World staples sectors are currently outperforming their respective overall indices, countering the lower US interest rates.

These comments are further supported by relative valuation levels:

S&P 500 Staples Dividend and Treasury Yield (%) vs Relative Performance

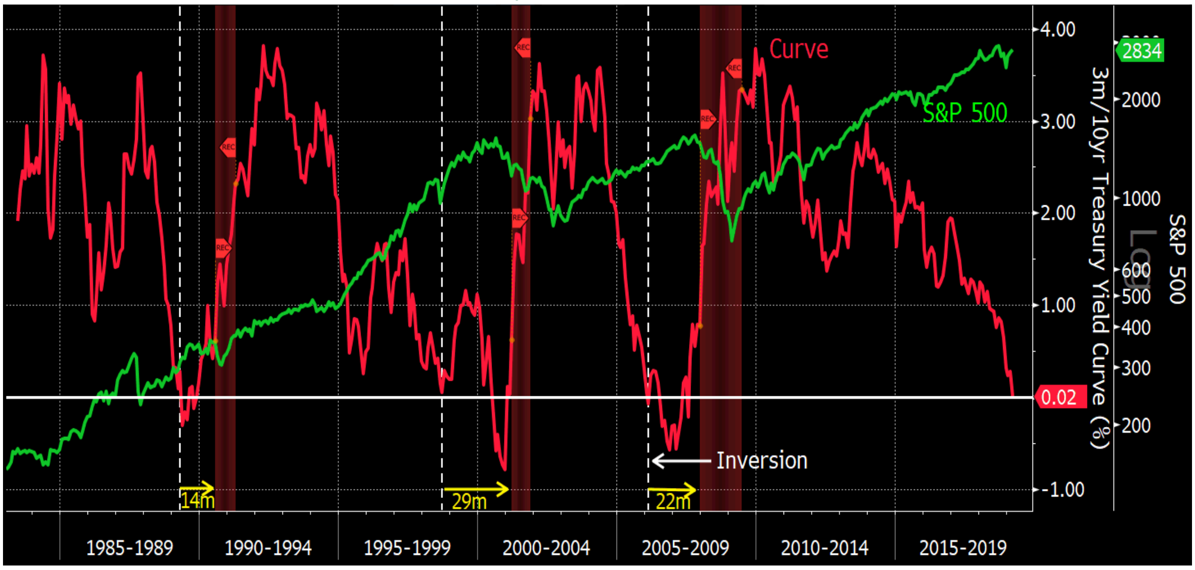


The staples' sector dividend yield (the orange line) is currently one standard deviation above its average and over 50 basis points in excess of the treasury yield. There has been a strong historic relationship between this spread (purple line) and the sector's relative perfromance (green line). Odds in this context seem to favour the staples sector.

3. YIELD CURVE INVERSION

We feel oblidged to comment on all the headline comments around yield curve inversion.

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

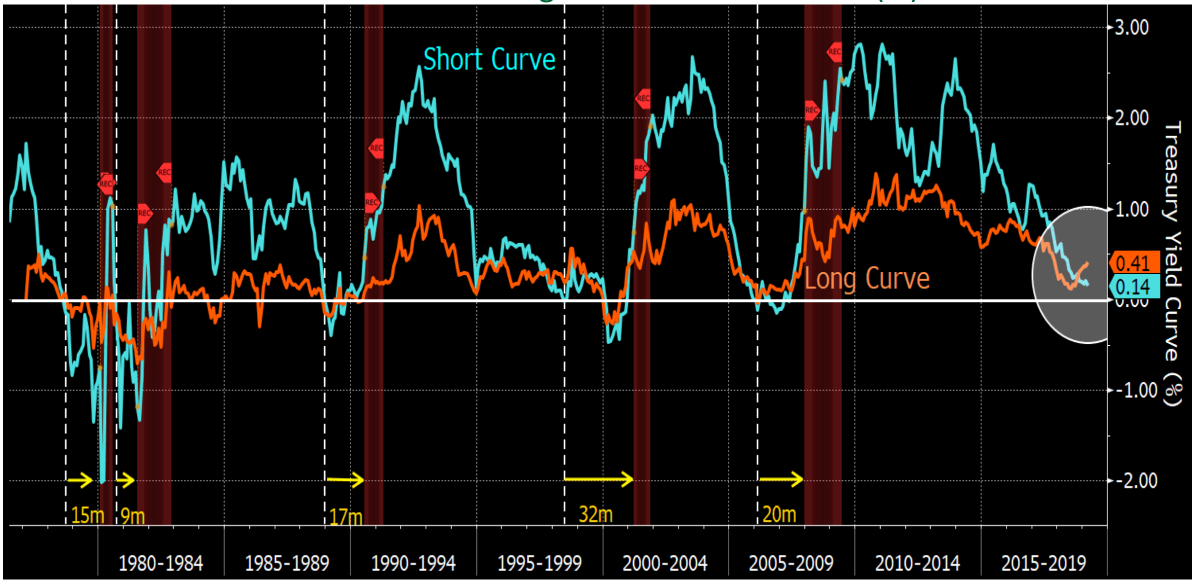


The comments were around the 3-month/10-year curve that inverted. It actually inverted only for a few days and is in a neutral situation again. Apart from this, a 3-month consideration is an unnaturally short maturity to consider in the context of a potential US recession. Further to this, historically this curve provided on average a 22-month early warning. On this basis, if it would invert from here on a sustainable basis (which it does not reflect yet), it predicts a recession in the first quarter of 2021 only. This does not raise immediate alarm bells as the financial press propagates. Interestingly enough, we get exactly the same guidance applying the 3/5-year yield curve.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2019. Past performance should not be used as a guide to future performance.

We show in the following chart the more fundamentally based yield curves – the 2-year/10-year and 10-year/30-year curves.

US – Short and Long Duration Yield Curves (%)



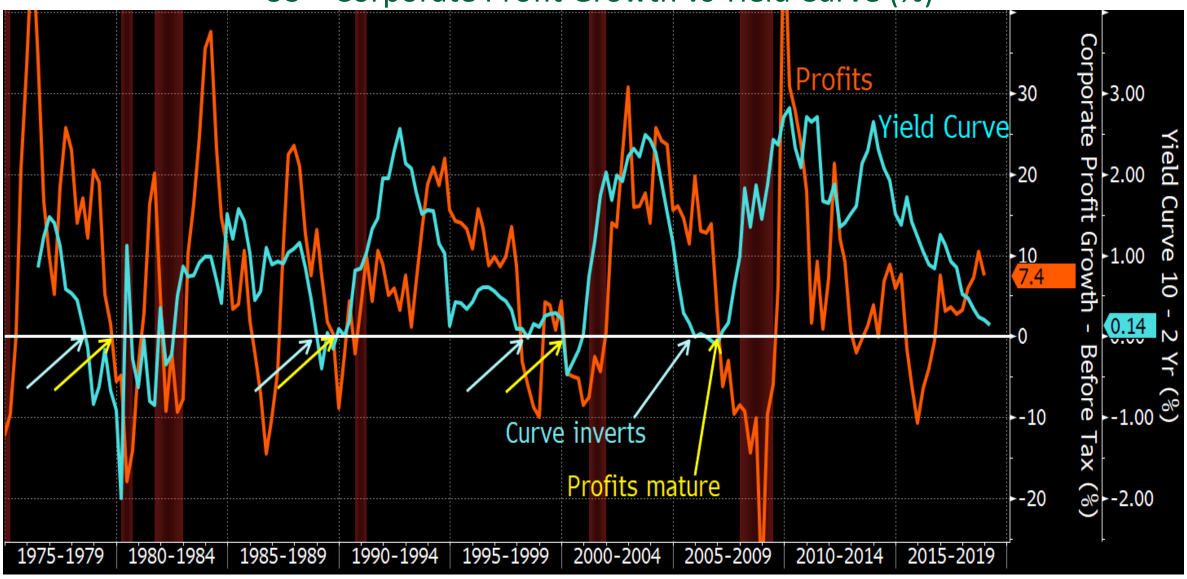
Both these yield curves have not inverted yet. In fact, the longer curve is steepening again. Should they invert, based on historical data, they would project the next US recession on average 18 months following the inversion event. It is therefore, on a fundamental basis, too early to have grave concerns about an imminent US recession.

4. YIELD INVERSION RETURNS

We have applied historical experience to form impressions of potentail stock market returns should the yield curve invert on a sustainable basis.

Our first point is that the yield curve inverts long before profit growth matures. The following chart illustrates this point:

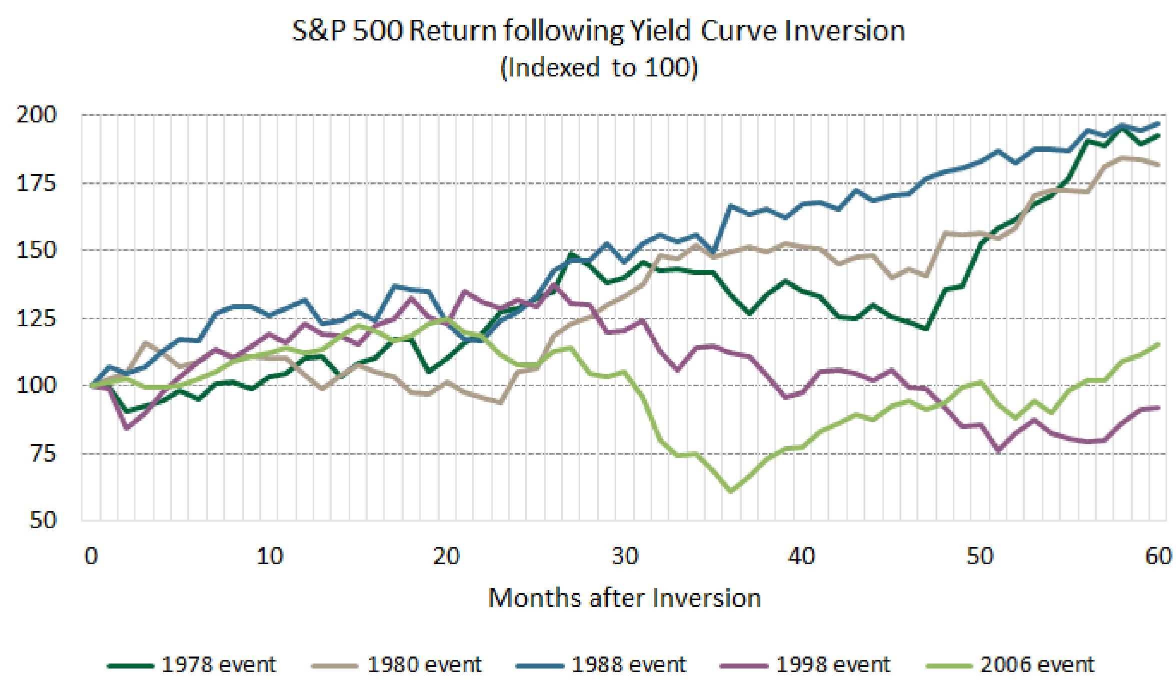
US – Corporate Profit Growth vs Yield Curve (%)



Both the curve and profit growth metrics continue to be in constructive territories and do not yet raise alarms.

We have calculated S&P 500 returns for the five years following historical invertion events. The results are presented in the following chart, presented in an indexed form (the values indexed to 100 at the inversion event):

Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2019. Past performance should not be used as a guide to future performance.



It is striking from the chart that most of the inversion events were followed by positive returns for quite some. The ones that later on led to negative returns were related to the 2000 Technology bubble and the Credit Crisis (the 1998 and 2006 events respectively). These were more exceptional cases and not 'normal' recession cases.

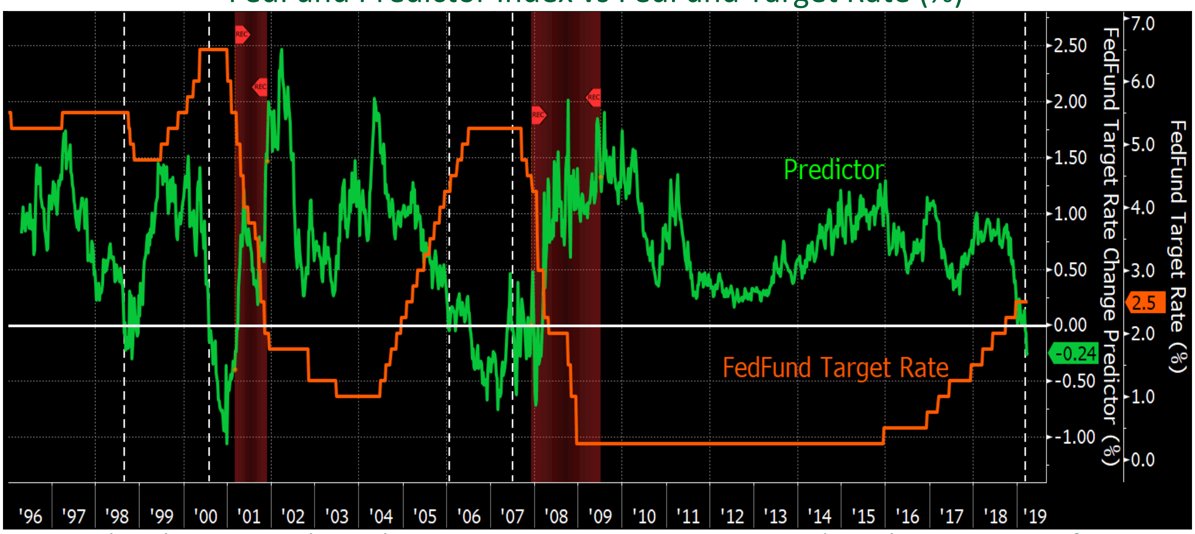
We have also calculated the historic average one-year returns for different yield curve categories, presented in the table. The current category (0% - 0.5%) provided attractive results historically).

Considering historical data we do not have much reason to fear the current yield curve and instead find reason to stay well invested.

Curve Category	S&P 500 52w Returns		
	Average	Median	Standard Deviation
-2.5% to -2.0%	30.4%	31.0%	6.6%
-2.0% to -1.5%	10.8%	1.9%	19.0%
-1.5% to - 1.0%	9.0%	3.0%	18.5%
-1.0% to -0.5%	9.7%	11.8%	14.8%
-0.5% to 0.0%	8.0%	11.8%	19.8%
0% to 0.5%	15.5%	16.0%	14.0%
0.5% to 1.0%	16.0%	18.5%	16.7%
1.0% - 1.5%	12.5%	15.8%	16.8%
1.5% to 2.0%	7.0%	8.9%	18.5%
2.0% to 2.5%	13.9%	12.4%	9.7%
2.5% - 3.0%	11.6%	11.9%	6.4%

5. FEDFUND RATE

FedFund Predictor Index vs FedFund Target Rate (%)



Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2019. Past performance should not be used as a guide to future performance.

Our FedFund predictor index has a fair record of predicting rate cuts ahead of time. This occurs when the index in the preceding chart drops into negative territory. The vertical lines reflect those historic events.

Strikingly, this index dropped sharply towards the end of last year and supports the Fed's hold stance. It has just now crossed into negative territory and we should take notice of a growing probability of a potential cut sometime this year. Also on this basis we do not have much reason to fear risks for sharply rising interest rates.

FedFund Predictor Index vs US Recessions

We can also consider this predictor index to assess risks for the next US recession. On this basis also the next recession is foreseen only towards the end of the first quarter in 2021.

6. GOLD INVESTING

Many consider investing in bullion rather than equities. We have compliled the following chart to consider historic returns in this context:

Total Return Index – Gold vs S&P 500 & MSCI World (Current Value = 100)

Equities have outperformed gold by far over most of the past 30 years (their charts are at lower readings for most of the time). The clear exception in this context was around the technology bubble period). The Credit Crisis era offered an exceptional sell opportunity for bullion holders – they have since lost material capital value.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. April 2019. Past performance should not be used as a guide to future performance.

Of course, some investors may be active traders and utilise short term tactical buy and sell opportunities. We have a quality buy-to-hold philosophy and in this context calculated the total return numbers for equity indices and bullion over different holding periods, as reflected in this table. Gold shares themselves delivered negative returns over most of the periods in the table.

Compounded Total Return (p.a.)			
Period	S&P 500	MSCI World	Gold
1 Year	9.7%	4.1%	-5.2%
3 Years	13.4%	11.0%	3.8%
5 Years	11.0%	6.8%	-3.2%
10 Years	15.3%	11.7%	-3.9%
30 Years	10.0%	6.8%	0.6%

We continue to have high conviction in our philosophy of investing in high quality businesses.

7. COPPER PROMISE

The copper price serves as a leading economic indicator in a number of instances. The following chart reflects a good correlation with the world PMI data:

Copper Futures Price ($) vs World PMI Index

The copper price indicates that we may start to look forward to an improving global economic scenario following a weak first quarter 2019 result. China's PMI index for March has already picked up from its preceding negative reading.

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