STONEHAGE FLEMING

GLOBAL EQUITY PERSPECTIVES 1 JULY 2019

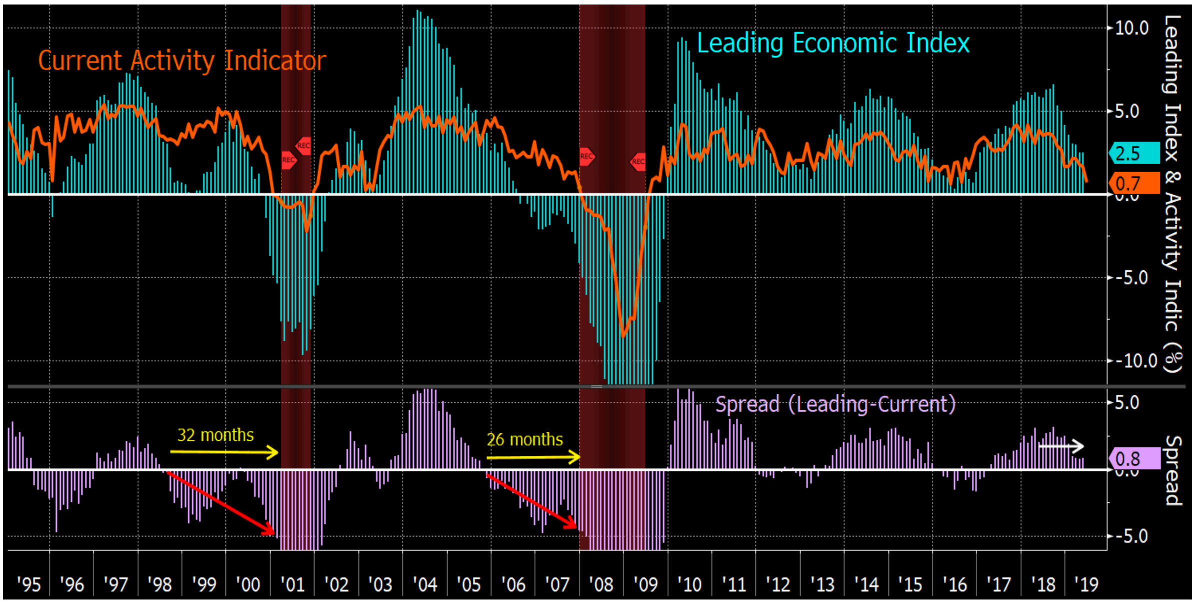
"Too often we enjoy the comfort of opinion without the discomfort of thought."

John F. Kennedy

1. US ECONOMY

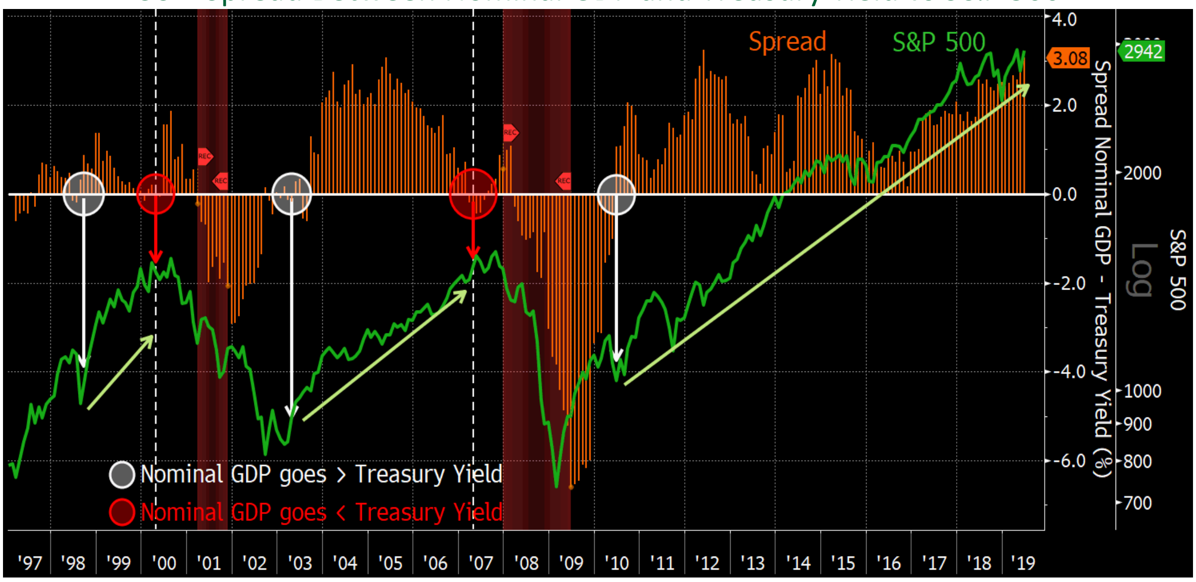
We intentionally start our note considering again the state of the US economy, and we continue to rely on our 'workhorse' chart of the leading economic index:

US – Growth in Conference Board Leading Economic Index vs Goldman Sachs Current Economic Activity Index (%)



The leading index's growth continues at the previous month's constructive level of +2.5% (on its long-term average). Against this, the growth in the current activity index in the chart continues its moderating trend. Importantly, the spread between the two series (the bottom section in the above chart) continues in positive territory. This spread has historically provided a very early warning against recession risks, but currently seems far from doing so.

US – Spread Between Nominal GDP and Treasury Yield vs S&P 500



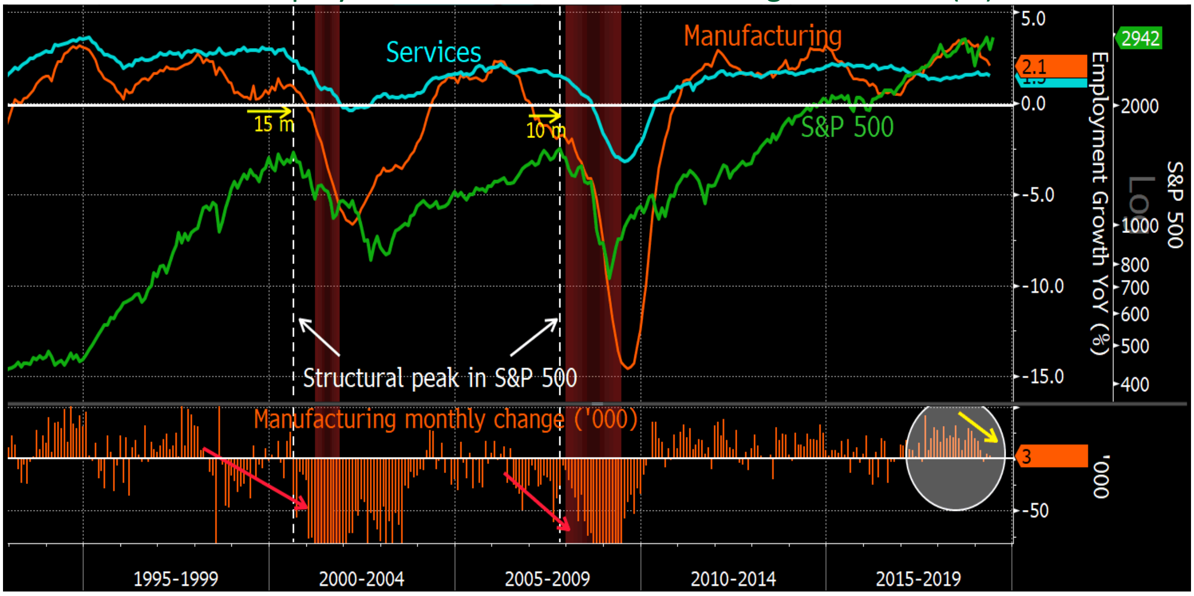
Source: Bloomberg & Stonehage Fleming Investment Management Limited. June 2019. ***Past performance should not be used as a guide to future performance.***

The economy is currently well supported by low interest rates. The preceding chart shows that the spread between the nominal GDP and interest rates is currently at a record level. Historically, this spread indicated potential peaks in share prices when it shrank to zero (see the red circles). On this basis, therefore, it seems that the constructive equity market is still intact.

2. TONNES OF IT

Despite the relatively small contribution of industrial production to overall GDP, we follow changes in this context closely because it can serve as a swing factor in investor sentiment. Interestingly, despite the strong Dollar and trade tariff uncertainties, the most recent growth level has picked up to above +2% and does not currently provide a warning signal. Along with this, US employment growth provides further valuable information:

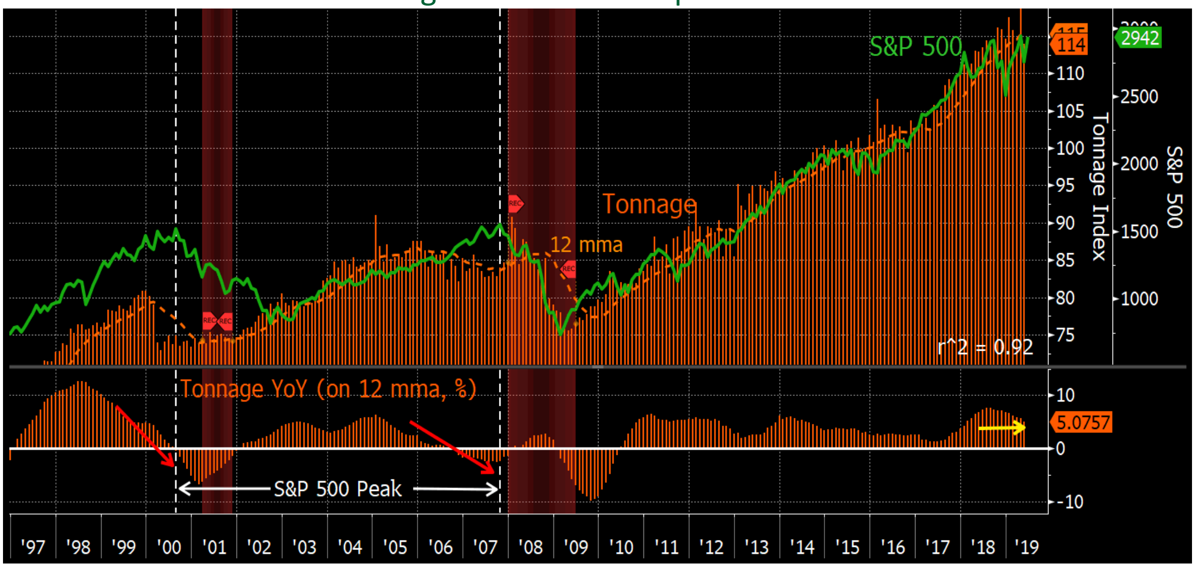
US Employment Growth – Manufacturing vs Services (%)



Although the growth rate is moderating, manufacturing employment continues to grow above +2%. Month-on-month absolute changes remain positive. These are constructive signals for the economy and share prices considering historic trends in this context.

We consider the volume of goods transported in the US a handy economic activity indicator:

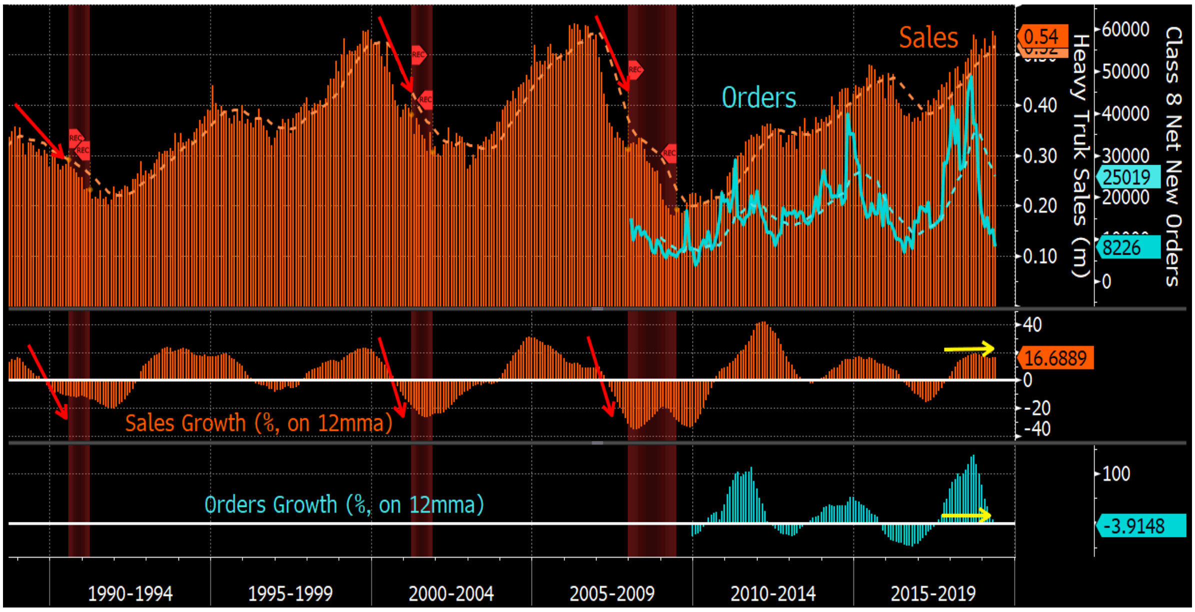
US – Tonnage of Goods Transported vs S&P 500



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

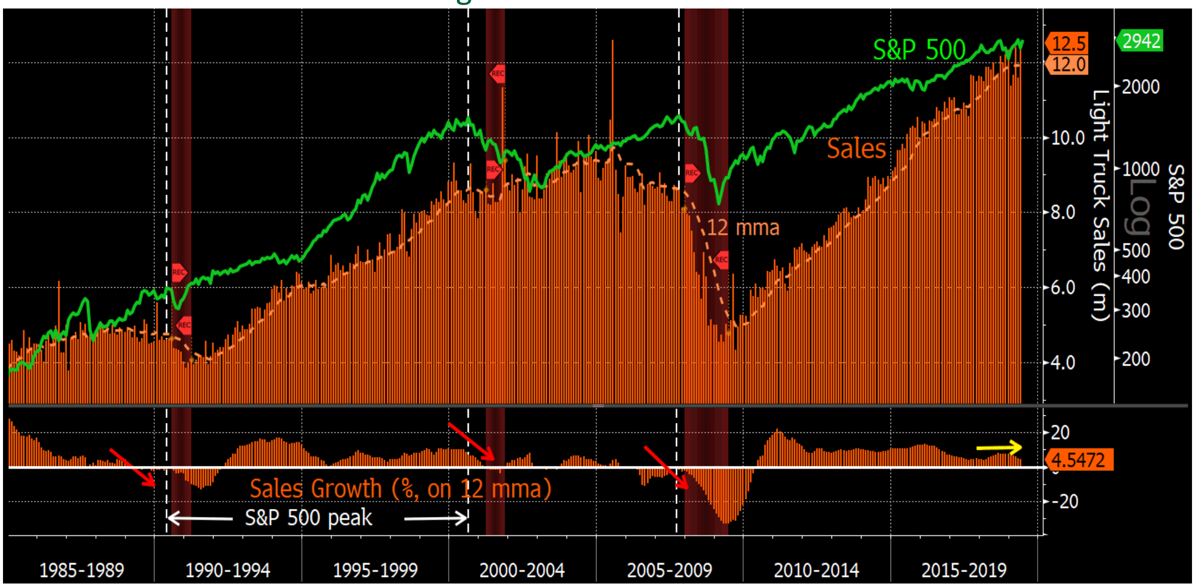
Historically, volumes have stagnated long before structural share price peaks and the upcoming respective recessions. Tonnages are currently at record levels, growing at a healthy +5%. This indicates continuing economic expansion.

US – Heavy Truck Sales & New Orders ('m)



Heavy truck sales are close to record levels, growing in double digits. Historically, growth stagnated more than a year before the respective recessions. These are constructive indicators. We take notice of new orders dropping sharply, but also realise that order data is volatile and less reliable.

US – Light Truck Sales vs S&P 500



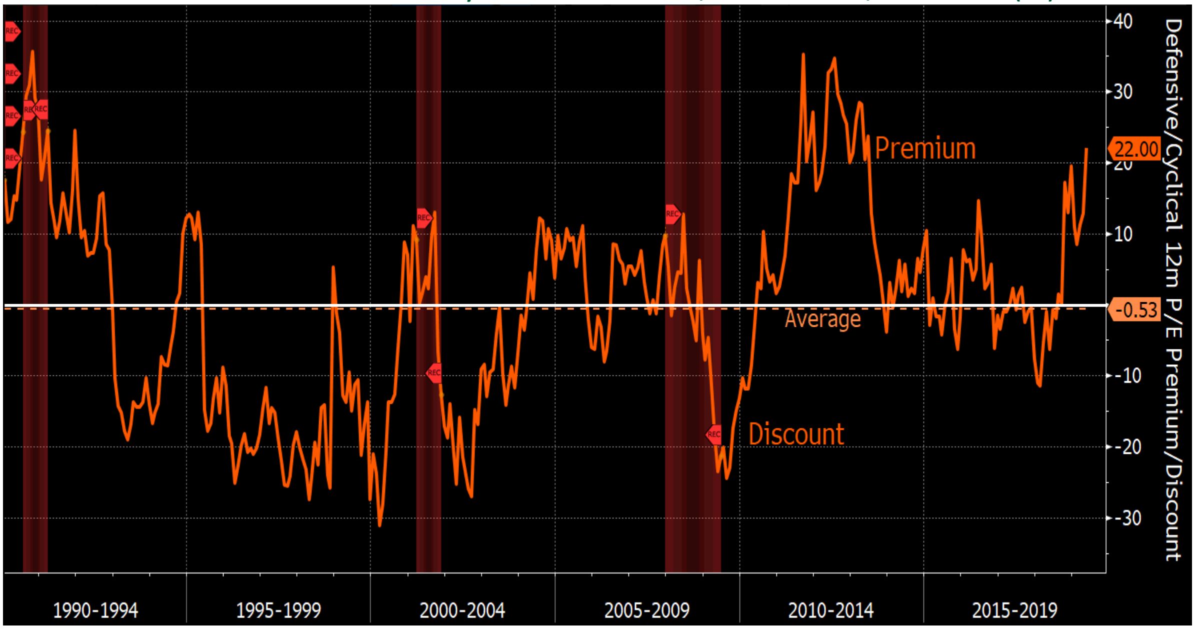
Light truck sales reflect the mood amongst smaller and medium-sized businesses. Sales continue at record levels, a quarter higher than pre-credit crisis levels (in contrast to heavy truck sales, which are still at the same level). Sales are growing at +4%, while they have historically stagnated long before the economy did so.

3. CYCLICAL SHARES

Some investors consider certain investment cycles, amongst others Value vs Growth or Cyclicals vs Defensives. Although it is more about sustainable organic growth for us, we find the following charts of value in considering investment opportunities.

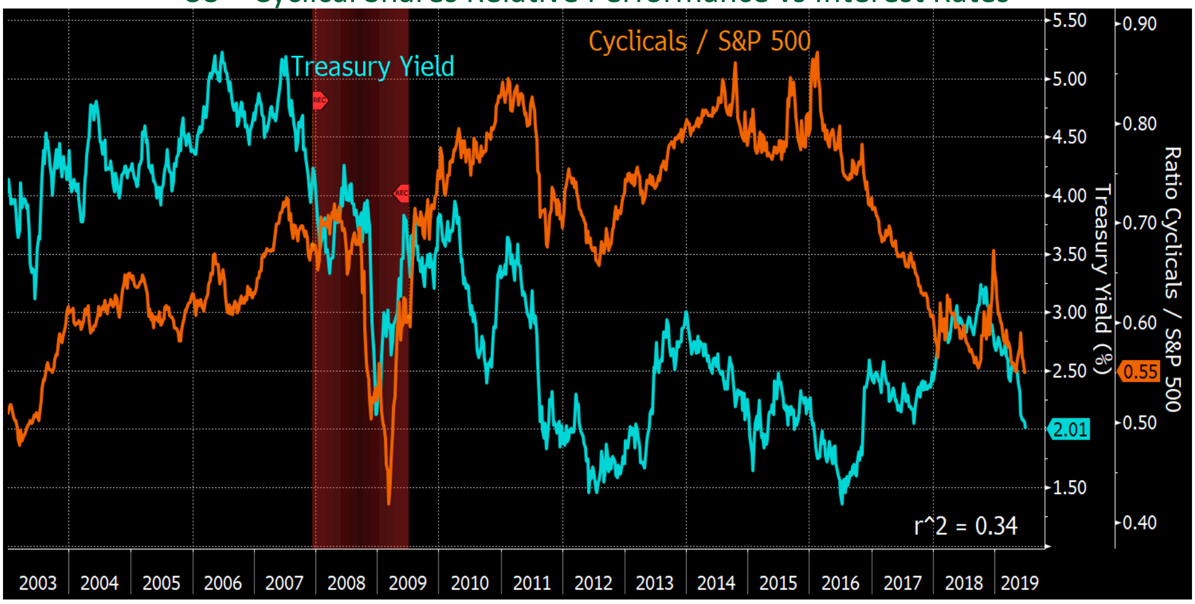
Source: Bloomberg & Stonehage Fleming Investment Management Limited. June 2019. ***Past performance should not be used as a guide to future performance.***

S&P 500 Defensive vs Cyclical Forward P/E Premium/Discount (%)



Defensive shares are currently trading at a high (22%) premium to Cyclical shares. We are cautious to generalise, but on this basis some Utility, Staples and Telecommunication shares may considered to be less attractive than some Industrial, Discretionary and Technology shares.

US – Cyclical Shares Relative Performance vs Interest Rates

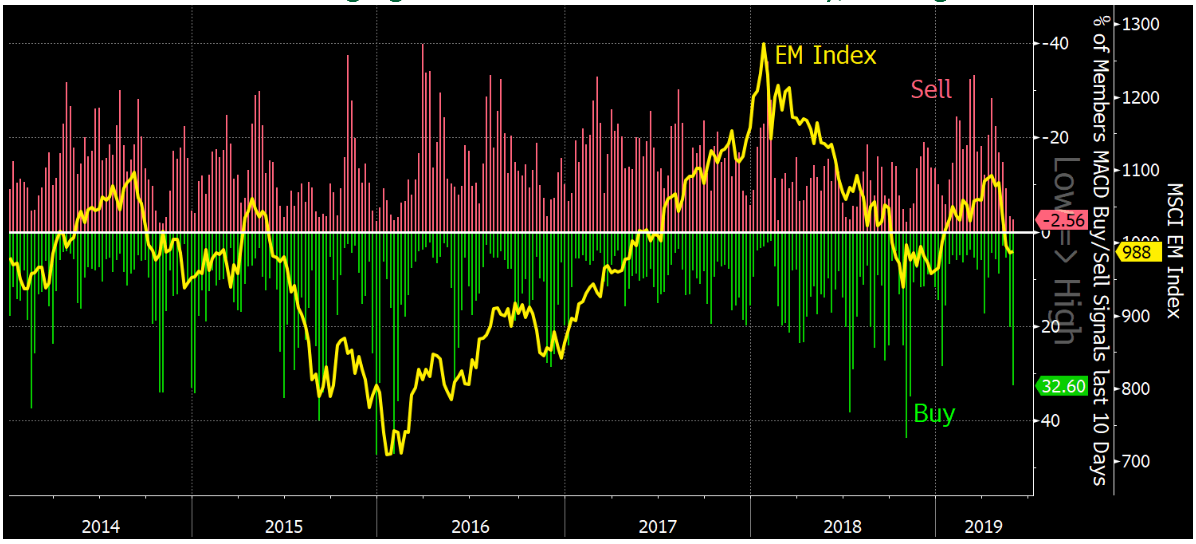


As reflected in the above chart, there seems to be a correlation between the relative performance of cyclical performance of cyclical shares and interest rates. The current low interest rates continue to argue against cyclical shares, and we would caution against 'betting the family farm' on cyclical businesses at this juncture.

4. EMERGING MARKETS

Many emerging market shares have been saddled with headwinds from low commodity prices and the strong Dollar. There are not many indications yet of commodity prices turning for the better, whilst fundamental issues supporting the Dollar do not yet show too many signs of weakness. Emerging Market earnings valuations are at three quarters of the multiple for the Developed World, but on the long-term average ratio. It therefore seems that we do not yet have a clear fundamental reason to call the bottom in this context. As the following chart depicts, though, technically it is starting to look interesting and good fundamental news may see a positive reaction:

MSCI Emerging Market Index vs Technical Buy/Sell Signals

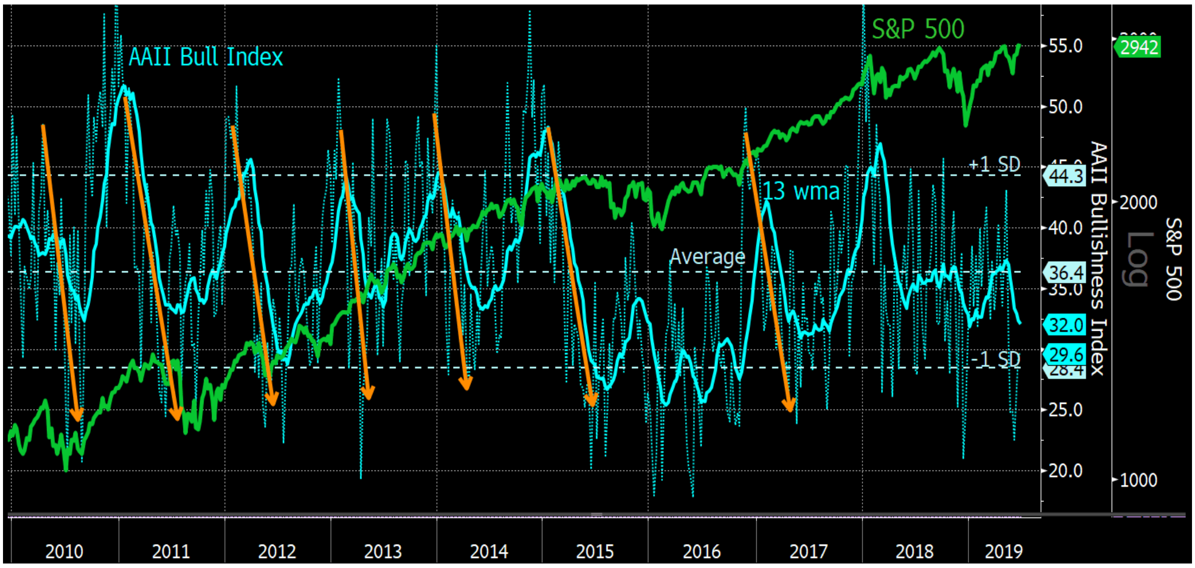


The levels of the current Buy and Sell signals are both of interest.

5. SIDE-LINES

As the following chart implies, we won't be surprised if many individual investors have been on the side-lines for quite some time and may be under-invested:

US – Index of Bullishness of Individual Investors vs S&P 500



The level of bullishness is currently way below average, having been the case for most of the past year. The index serves as a good contra-indicator and supports the view that there is not much exuberance in equity markets.

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

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