STONEHAGE FLEMING

GLOBAL EQUITY PERSPECTIVES 23 SEPTEMBER 2019

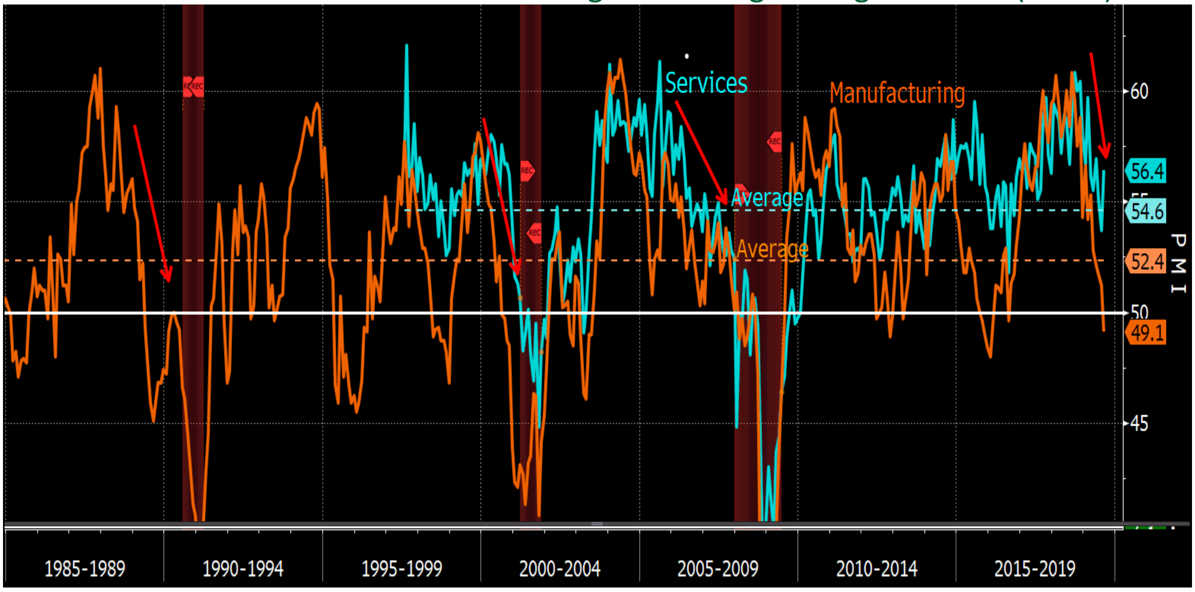
"Integrity is the essence of everything successful."

R Buckminster Fuller

1. ECONOMIC SURPRISE

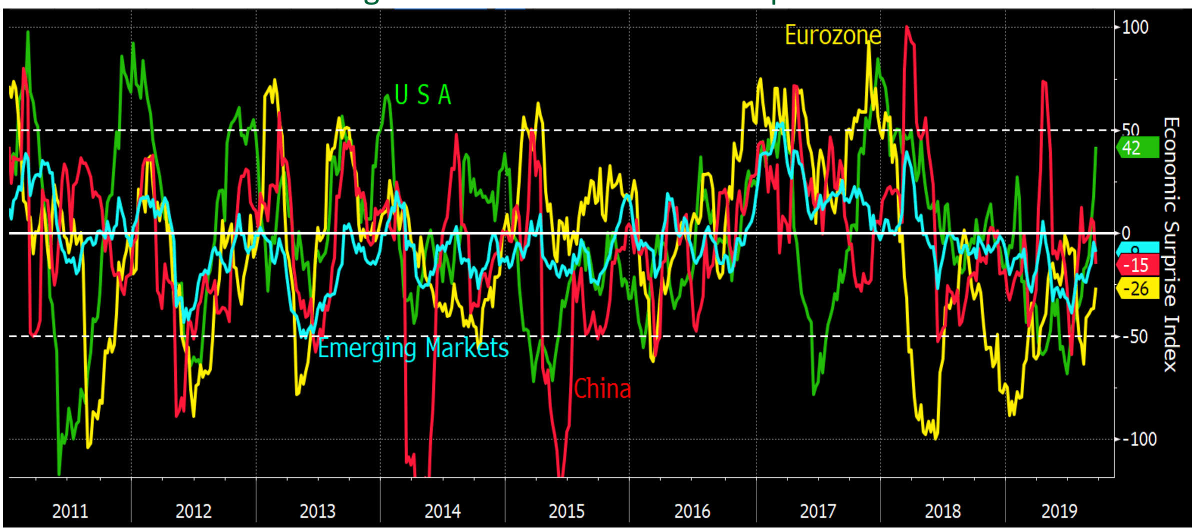
The Institute of Supply Management PMI Indices provide valuable information on US economic activity:

US – ISM Services and Manufacturing Purchasing Manager Indices (PMI's)



Manufacturing activity is weak currently, for good reason – the strong Dollar and trade tariff uncertainties hamper export activity. Against this, the Services index's most recent reading bounced back from below to well above average. The value of Services activity exceeds manufacturing by a ratio of over six to one and is therefore much more important for continuing economic growth.

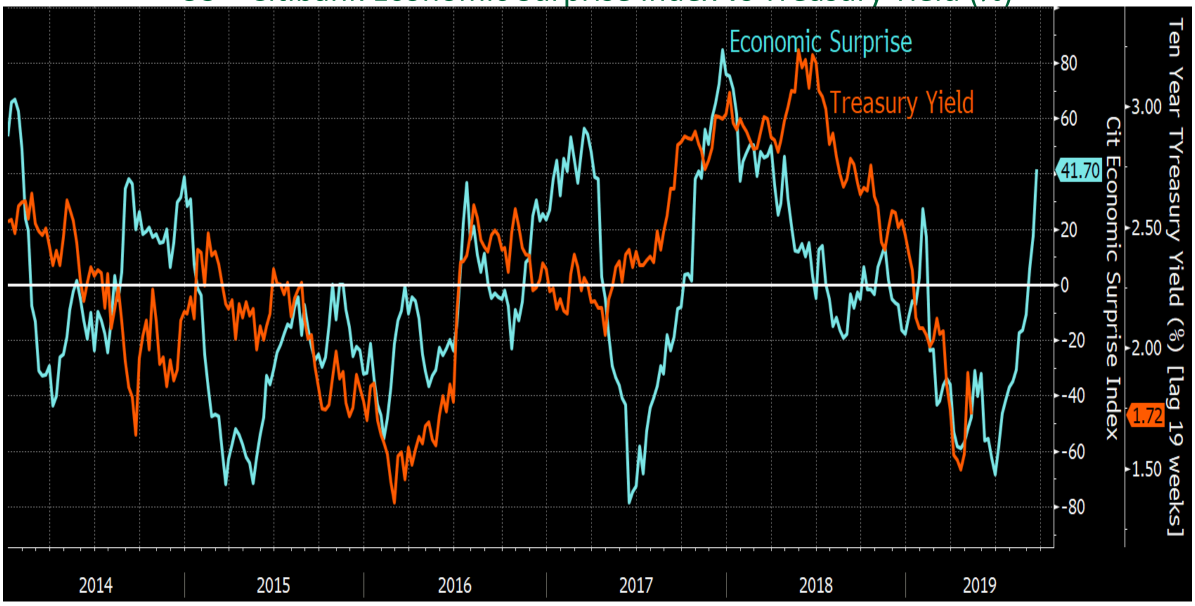
Main Regional Citibank Economic Surprise indices



Apart from China, all the major regional economic surprise indices are currently in process of recovering from quite depressed levels, most notably Emerging Markets and the US. We believe the latter made a good contribution in turning US interest rates upwards from their depressed recent levels, as reflected in the following chart:

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

US – Citibank Economic Surprise Index vs Treasury Yield (%)

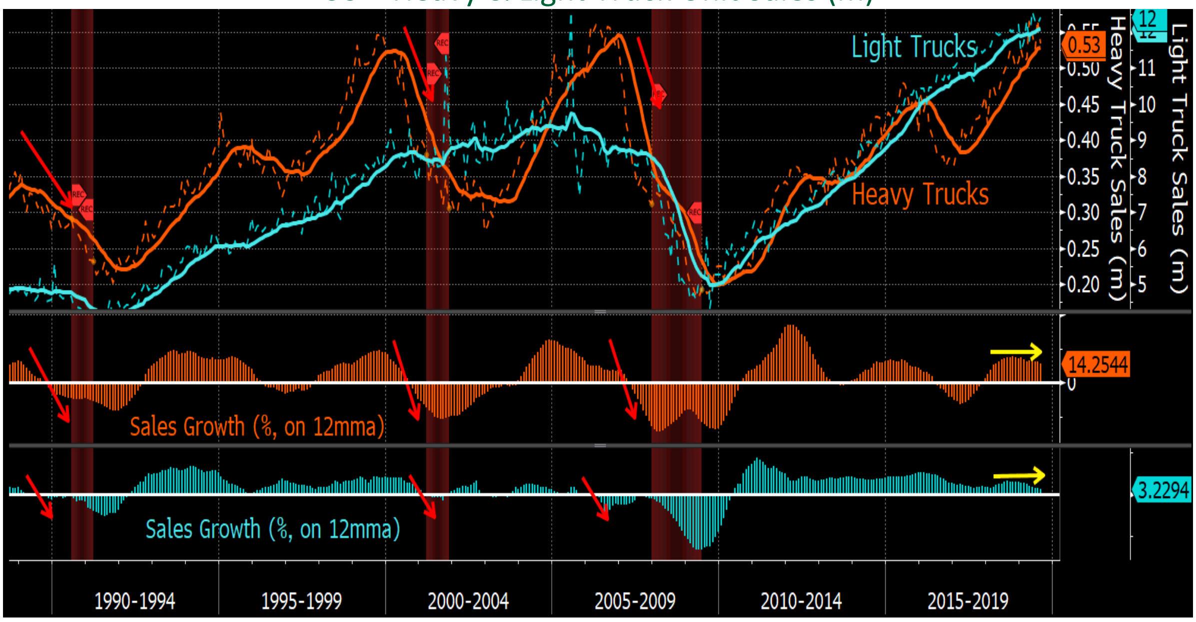


There seems to be a reasonable correlation between the surprise index (the blue line) and interest rates (lagged in the chart). Considering this correlation, we expect interest rates to tread water for a short while, and then to rise again. This may be a relief to some investors.

2. FREIGHT ACTIVITY

Whilst large company CEO and small business confidence indices are moderating from elevated levels, we do not yet detect material concerns from data around freight volumes or truck sales:

US – Heavy & Light Truck Unit Sales (m)

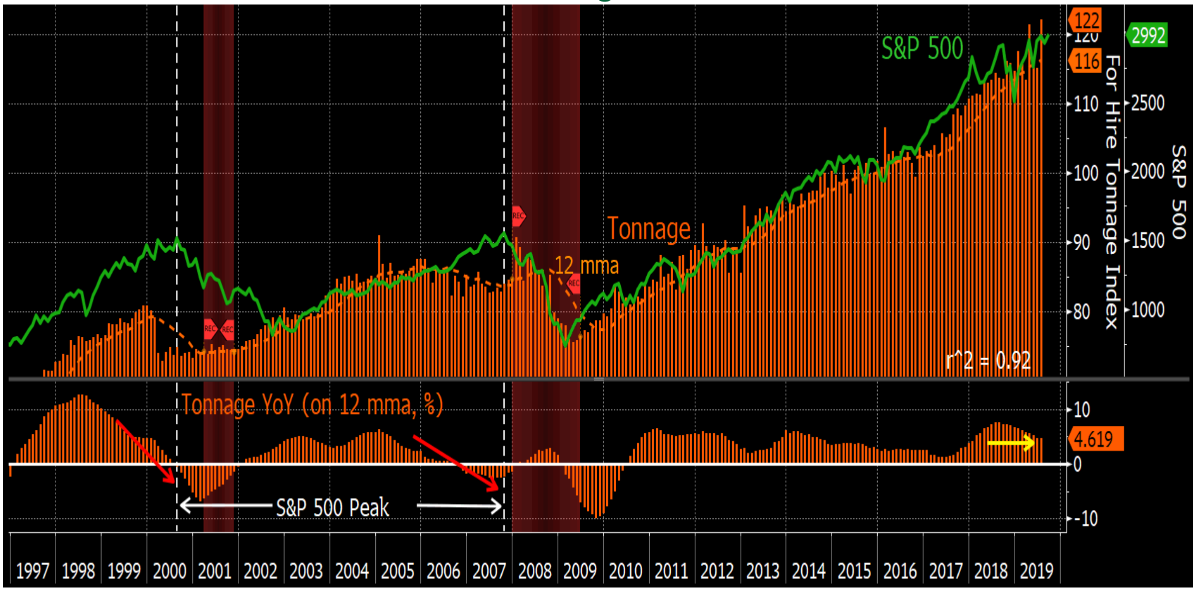


Heavy truck sales are approaching record levels, whilst light truck sales are more than a quarter ahead of their 2006 record levels. The latter is currently growing at +3.2% and the former at a double digit +14.2%. Both series have historically dropped well ahead of the respective upcoming recessions (see the arrows in the bottom sections of the above chart). Current data therefore appear quite constructive in terms of economic activity.

We also consider the tonnage data on goods transported in the US. The following chart reflects data in this context:

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

US – For Hire Tonnage Index vs S&P 500

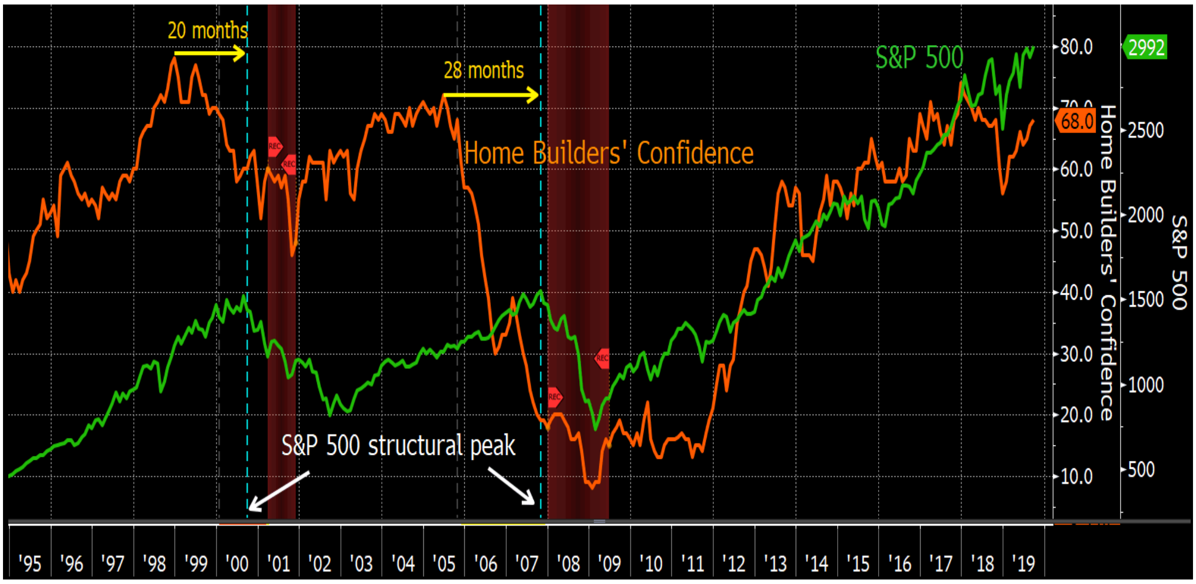


Tonnage is currently growing at +4.6%. Growth historically went negative well before the respective upcoming recessions. It also served as a good indicator for stock market peaks. The current tonnage index is currently at a record level and we do not yet detect material recession concerns.

3. BUILDERS' CONFIDENCE

The US homebuilders' confidence index is a surprisingly good stock market leading indicator:

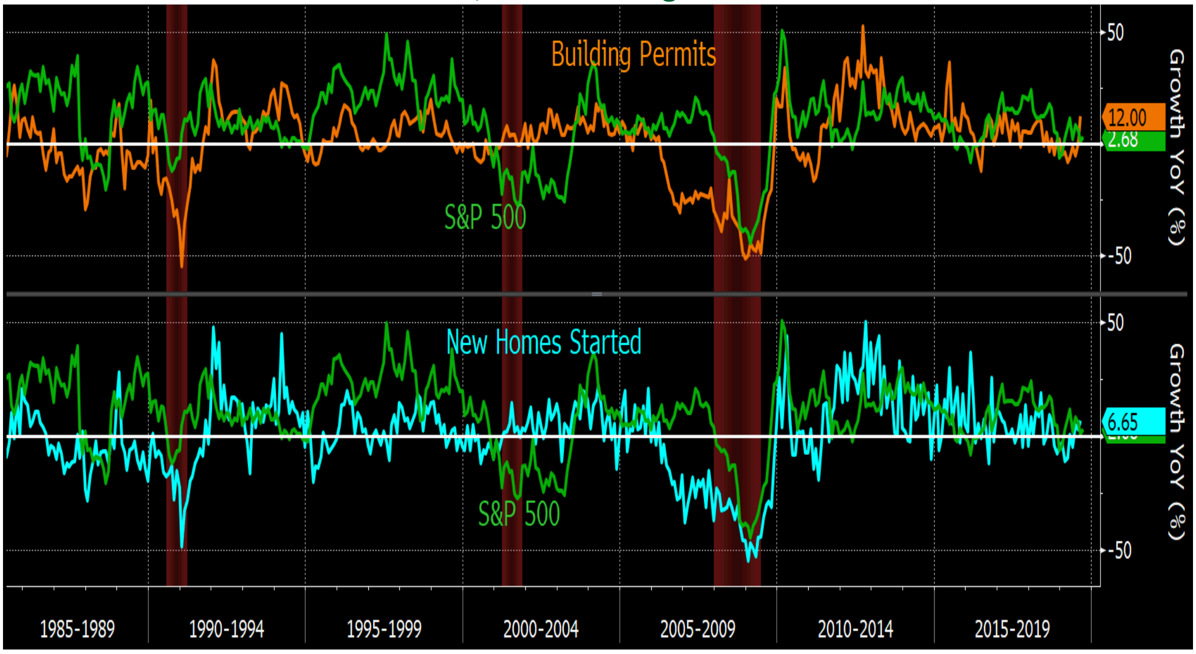
US – Homebuilders' Confidence Index vs S&P 500



The index has on average a two-year lead to stock market peaks. It is striking how well it called both the 2000 and 2007 stock market peaks well ahead of time. The confidence index weakened last year, but is currently making a strong recovery, approaching record levels.

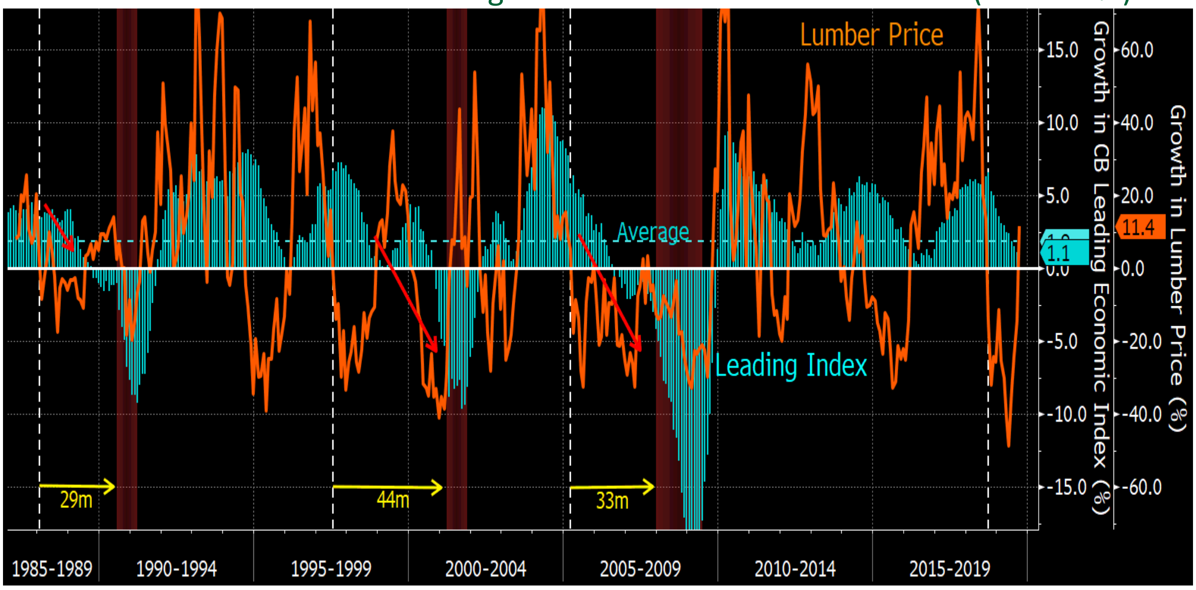
We consider in the following chart the data on new building permits and new homes built along with the S&P 500 index. There seems to be good correlations between the building indices and share prices. New home builds are currently growing at +6.6% whist building permits are growing at +12.0%, both off low bases. It is therefore understandable that builders' confidence is growing again, supporting share prices in this context.

US – Growth in S&P 500 Index, New Building Permits and New Homes Started



The lumber price, logically, is another handy capital market tool in the preceding context. The following chart reflects the growth in this price along with the growth in our popular leading economic index:

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



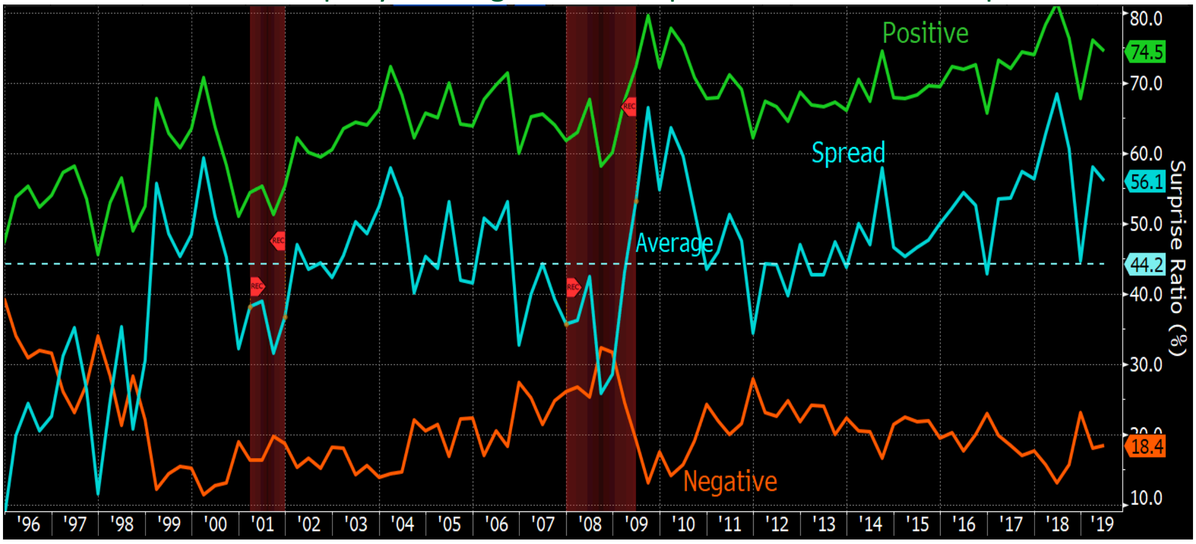
The lumber price historically has had, on average, almost a three-year lead to an upcoming recession when its growth stagnates (see the yellow arrows in the above chart). It is currently growing at +11% after a deep slump last year.

The lumber price is also an early leading indicator to the above leading economic index. Whilst the growth in the latter is in a steep moderating process, it is still close to average. Should the lumber price stay its current course it may later have a positive effect on the leading economic index.

4. COMPANY RESULTS

Company results are often considered against analyst expectations further to the absolute result numbers. The following chart reflects the earnings surprise numbers in this context:

US – S&P 500 Company Earnings Result Surprises vs Consensus Expectations



Despite the current moderate overall growth results, almost three-quarters of the S&P 500 companies provided positive surprises with less than a fifth providing negative surprises. The net positive surprises (56.1%) are well above the average of 44.2% (the spread in the above chart).

This spread (the blue line) historically dropped below the average well before the respective recessions. We do not yet detect such warning signals.

5. DRONE ATTACKS

The recent drone attack on the Saudi Arabian oil fields unsettled the oil market and many investors, fearing retaliation. Whilst economic circumstances are very different currently, we consider reactions in this context around the invasion of Iraq in early 2003:

Share & Oil Prices around the Invasion of Iraq (Indexed to 100 on Day of Invasion)

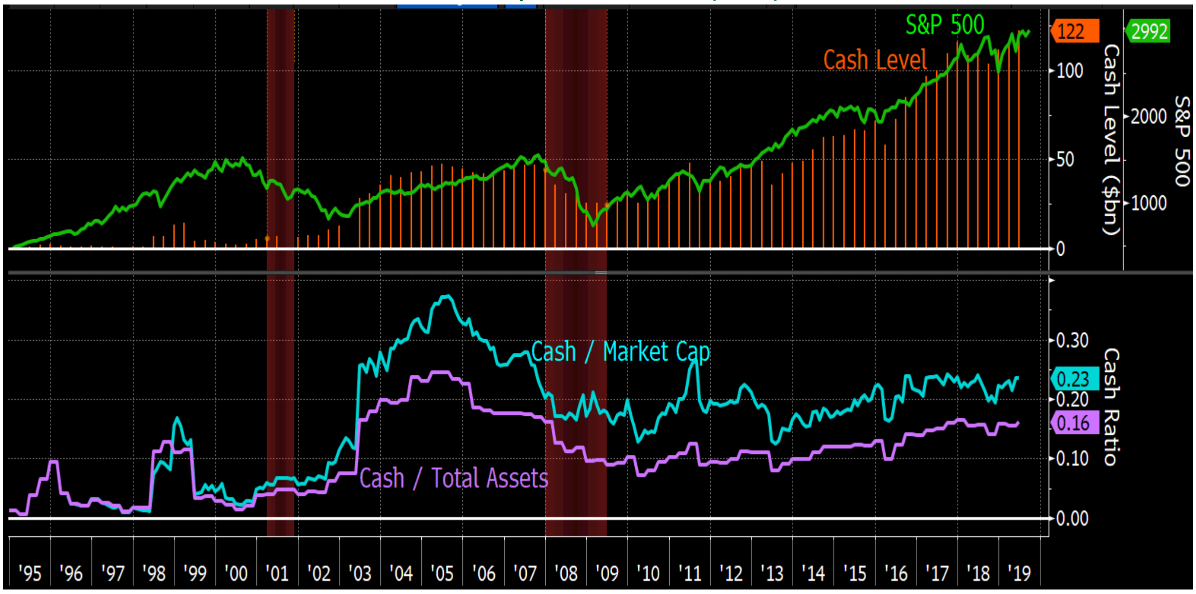
Share prices dropped in the months preceding the invasion on 20 March 2003, with the oil price rising materially. Strikingly, the day after the invasion, share prices started rising for the following months, ending the following year more than a third higher. The oil price treaded water for the remainder of the year. We are certainly not forecasting similar reactions should the current Middle East political situation worsen, but we are also conscious of the structurally diluted demand for oil and the abundance of potential shale supply from the US at higher prices.

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

6. BERKSHIRE CASH

Berkshire Hathaway has built up a cash level of $122bn:

Berkshire Hathaway Cash Levels ($bn) vs S&P 500



This cash level is more than double the level before the Credit Crisis. Many see this as a defensive strategy, but it is also true that relative to Total Assets and to the Market Capitalisation (the bottom section of the above chart) the current cash level is materially lower than the pre-Credit Crisis levels. It is also striking that absolute cash levels were not materially depleted to utilise the excellent buying opportunities during the recession. They have almost consistently increased over the current economic cycle and the point becomes clear that shareholders are missing good investment opportunities and management should consider returning more cash to them in the form of materially more buybacks and starting to pay dividends.

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

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