STONEHAGE FLEMING

GLOBAL EQUITY PERSPECTIVES 25 NOVEMBER 2019

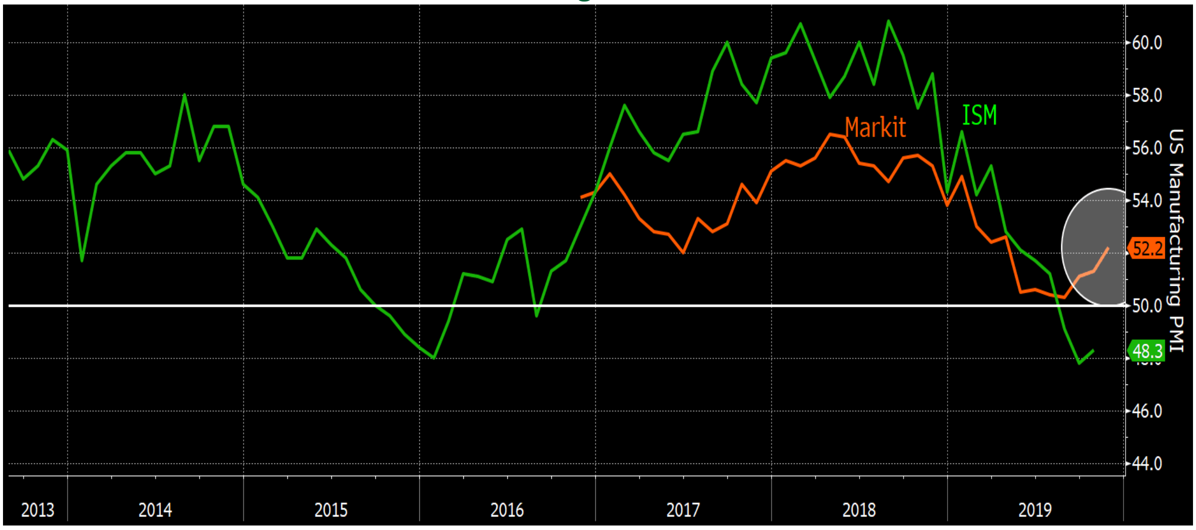
"Man is affected not by events, but by the view he takes of them."

Seneca the Younger

1. STAYING CONSTRUCTIVE

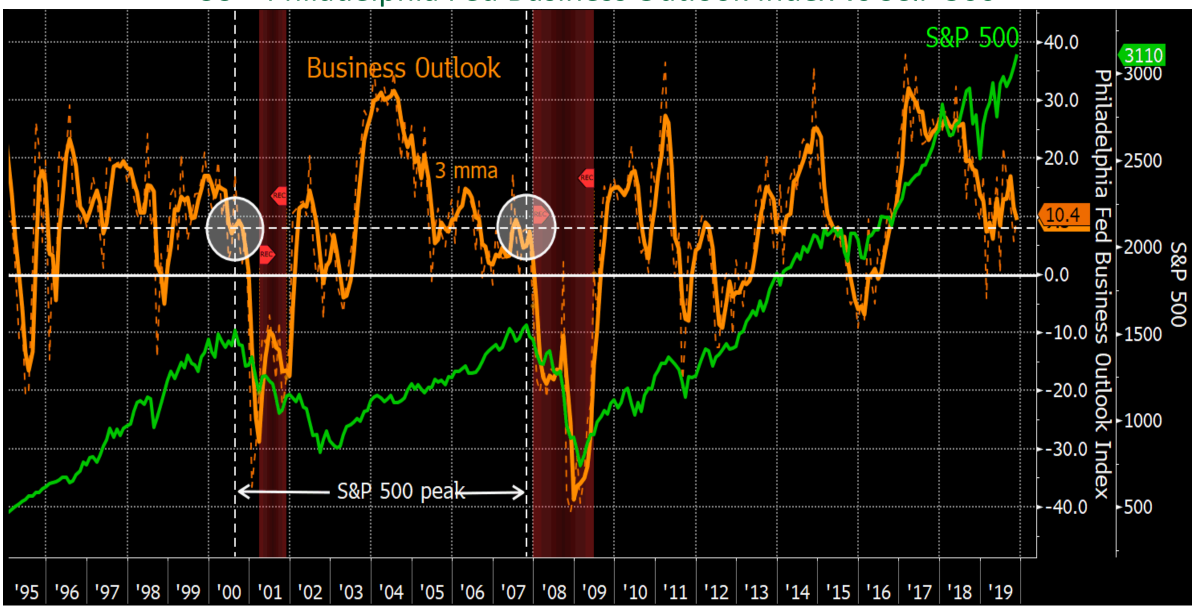
Investors have been following the PMI data closely because of its recent weaker readings. The next official US Manufacturing data will be announced on 2 December. In the interim, the Markit flash data provides an indication of private sector perspectives:

US – Manufacturing PMI – ISM vs Markit



The Markit Manufacturing PMI readings this year have stayed marginally above the critical 50 level and are now in a rising trend. This is clearly a positive development and we won't be surprised if the official data may follow suit.

US – Philadelphia Fed Business Outlook Index vs S&P 500



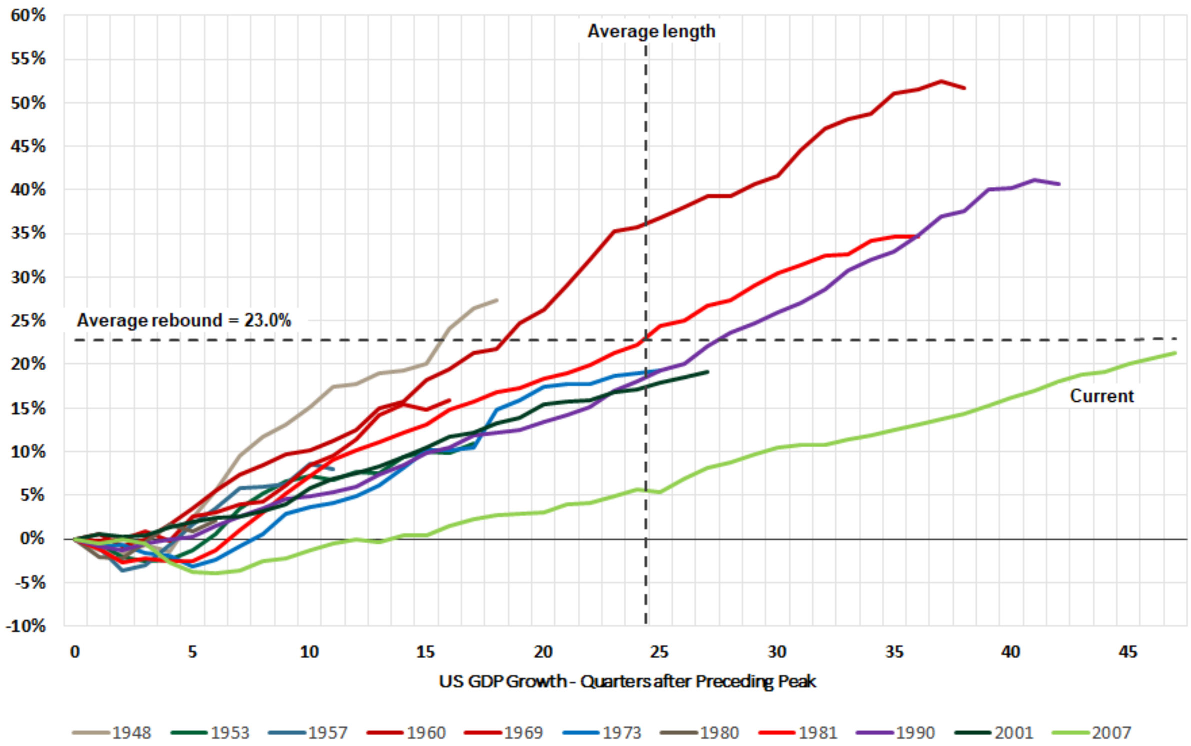
We indicate in the above chart the historic S&P 500 peaks preceding two recessions (the vertical dotted lines). These coincide with Philadelphia Fed business outlook index readings of 7.5. The current reading is marginally above this level. Should the PMI data follow through as we touch on above, we expect the above business outlook data to remain constructive.

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

2. ECONOMIC CYCLE

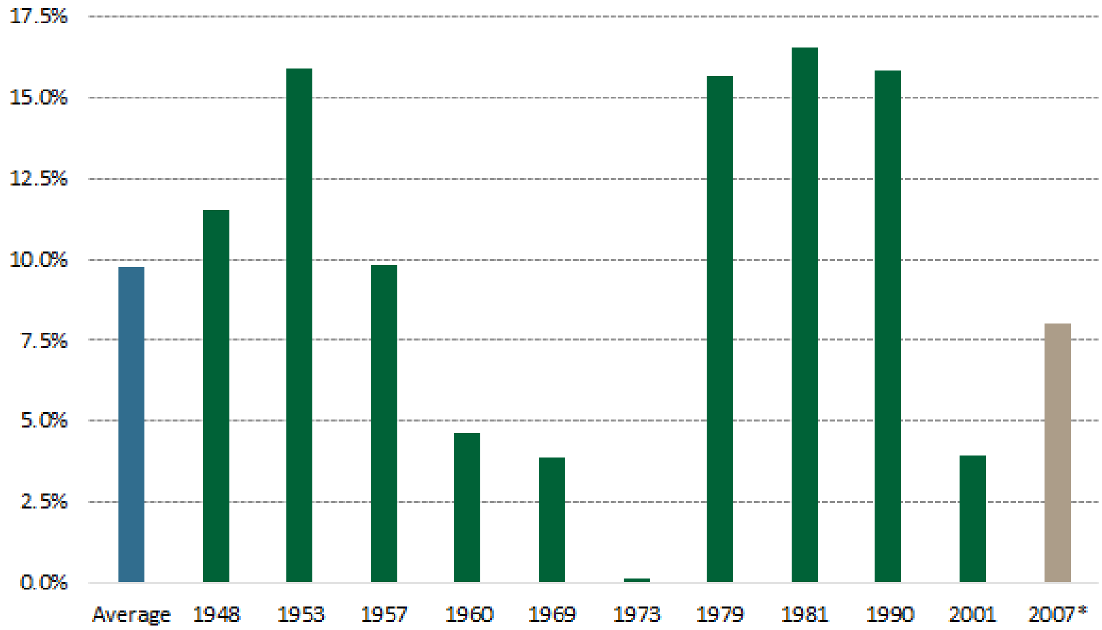
We have updated our chart of the level and duration of US economic recovery cycles. As a reminder, we consider data following the preceding cycle peak for the sake of fair comparisons (not to be subject to the level of the depth of the respective recessions).

Level & Duration of US GDP Recovery after Preceding Cycle Peak (%)



The current cycle is the longest since 1948 and is double the average length. Despite this extended length, the level of recovery has not yet reached the average level of preceding recovery cycles. In our view the latter point has more significance in considering the risk of the recovery cycle running out of steam.

S&P 500 – Annualised Total Return Over Economic Recovery Cycles (%)

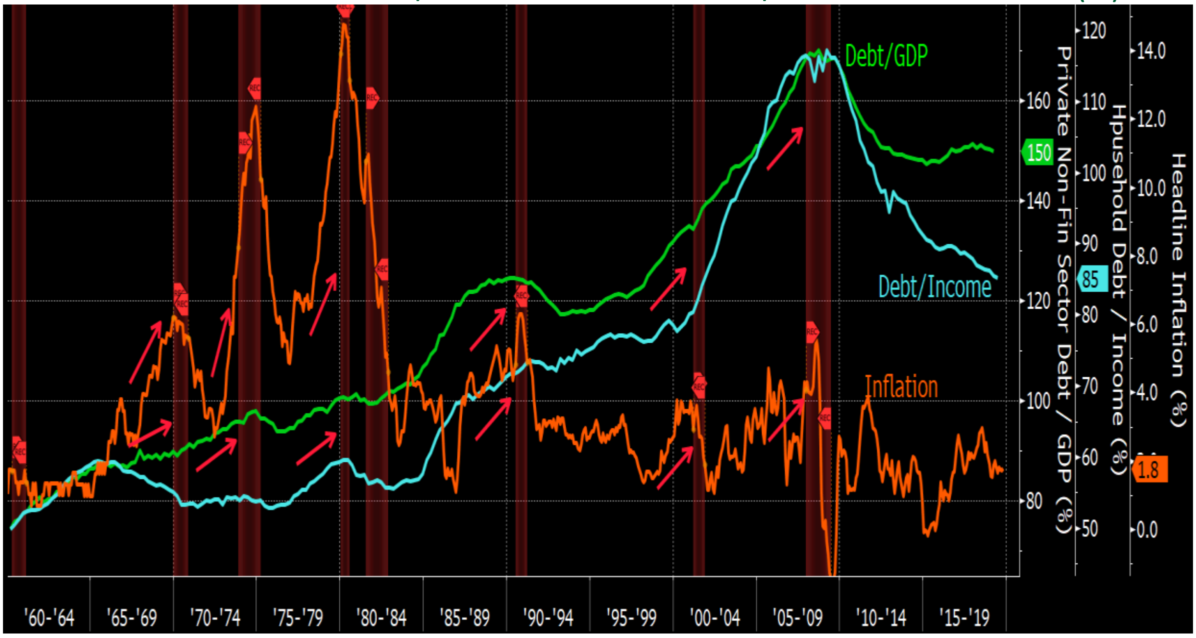


The annualised return over the current cycle thus far is +8.0% p.a. compared to the +9.8% p.a. average over all other cycles - almost a fifth lower. The return since 1927 is +9.4% p.a. We do not perceive the current cycle's data to be out of order.

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

We are of the opinion that the length of the current economic cycle provides no indication of risk for an imminent recession – it is about whether the economy may be overheated and whether there may be particular economic stresses building up. The following chart reflects the main issues in this context:

US – Private Sector Debt/GDP vs Household Debt/Income and Inflation (%)

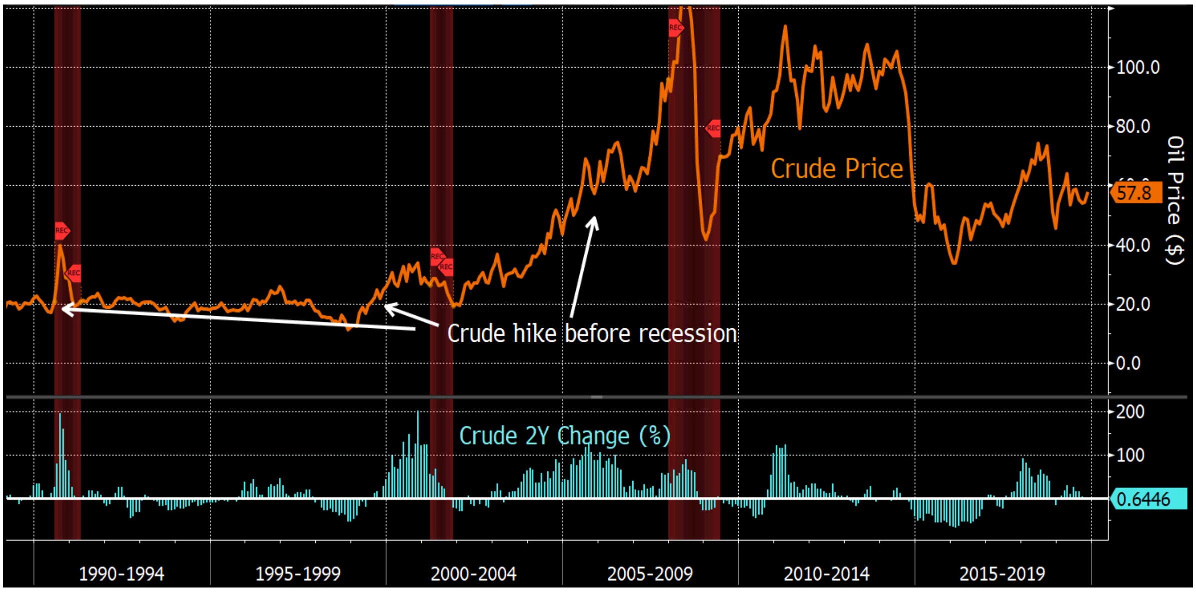


Both the private sector and household debt ratios in the chart are in downwards trends while they all were in rising trends running up to all preceding recessions. A similar constructive comment can be made around inflation. These charts do not currently reflect any material economic stresses in the US economy.

3. COST IN THE ECONOMY

Exploring further on the major costs that can cause economic stresses we consider energy costs, wage costs and interest payments:

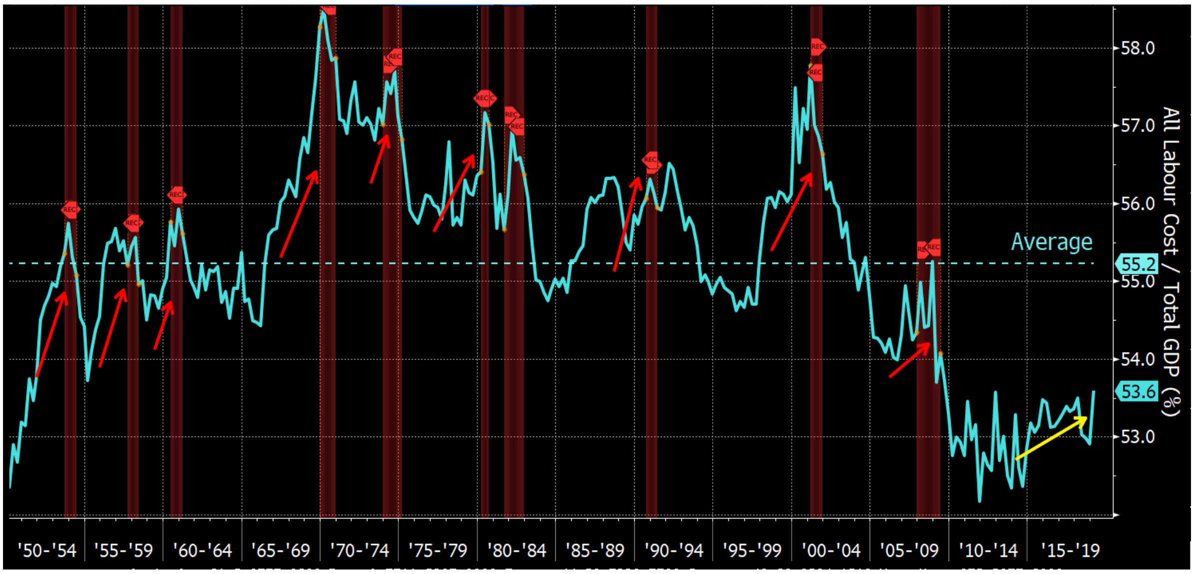
US - Oil Price vs Recessions



Sharp rises in the oil price historically preceded the recessions, contributing to major cost increases in the economy for the same output. This was particularly the case in the preceding two recessions. The current situation is very different – the oil price collapsed in 2014 and has currently in essence been flat for two years.

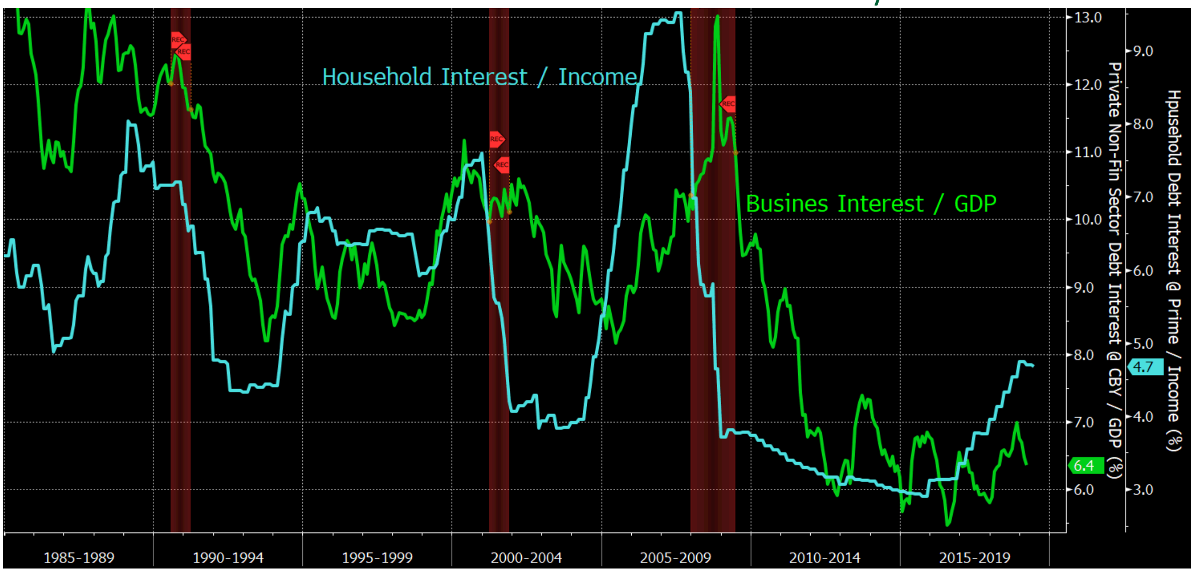
Source: Bloomberg & Stonehage Fleming Investment Management Limited. November 2019. ***Past performance should not be used as a guide to future performance.***

US – All Labour Costs / Total GDP (%)



Labour costs historically rose to levels in excess of 56% of GDP (apart from the most recent recession). This ratio is currently rising, but is still lower than its levels preceding all previous recessions, well below historic average levels despite full employment levels.

US – Household and Private Sector Interest Payments



The above chart reflects our rough estimates of interest payments by households (relative to income) and the private sector (relative to GDP). Despite the recent increase in the prime rate, both groups' interest payment ratios are currently closer to their respective low levels than their average levels.

It does not seem that energy, wage or debt service costs are major threats in the US economy.

4. HOUSEHOLD SAVINGS

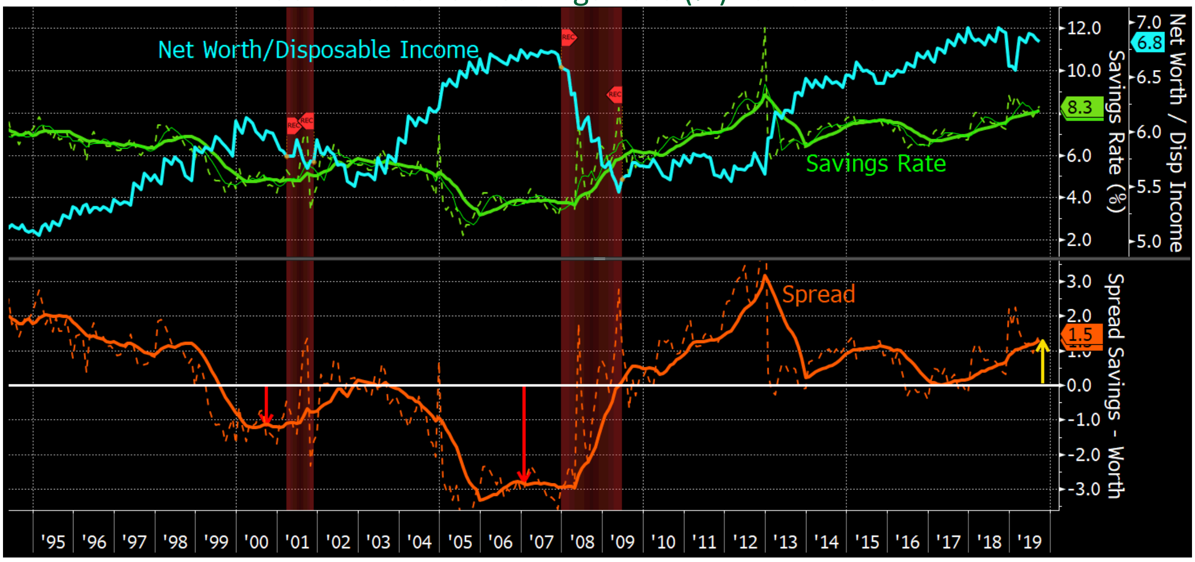
We show in the chart on the following page the US household savings rate along with the ratio of their net worth to disposable income.

It is striking that historically there was quite an inverse correlation between the two series – as the net worth increased the savings rate dropped, respectively getting to cycle highs and lows in the run-up to the respective recessions. The bottom chart of the spread between the two series illustrate this phenomenon clearly.

The savings rate is currently in a rising trend, causing the spread to be the inverse of the case preceding previous recessions (see the yellow arrow). This reflects a healthy US household financial situation.

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

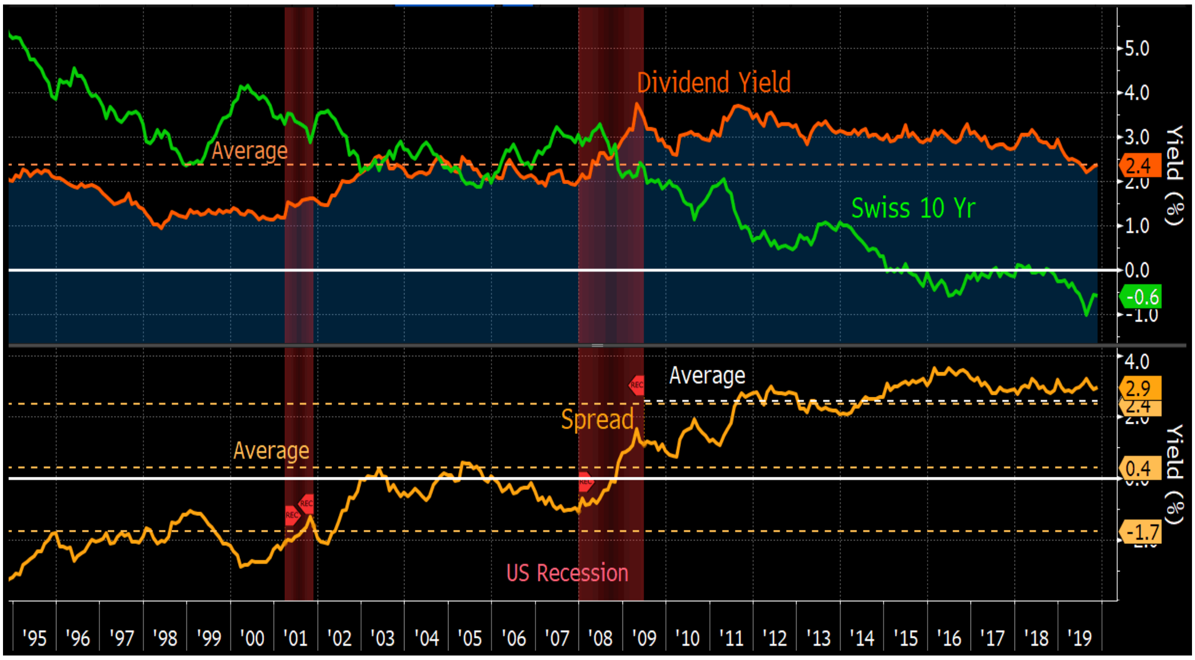
US – Household Savings Rate (%) vs Net Worth



5. NESTLE DIVIDEND

We can understand why Nestlé is popular with Swiss equity investors:

Nestlé Dividend Yield vs Swiss Ten Year Rate (%)



The share is currently trading at a +2.4% dividend yield, compared to the Swiss ten year yield of -0.5%. The spread of +2.9% is +1 standard deviation away from its long-term average, and even marginally above its average during the current economic upswing (the broken white line). This spread seems relatively wide considering our expectations of +4.5% p.a. per share dividend growth over the medium term.

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

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