GLOBAL EQUITY PERSPECTIVES 10 FEBRUARY 2020

"Wonder is the beginning of wisdom."

Socrates

1. CHINA FUNDAMENTALS

The total number of coronavirus related deaths now exceeds the total number of SARS infected deaths. Our heartfelt sympathies to all who are affected directly or indirectly.

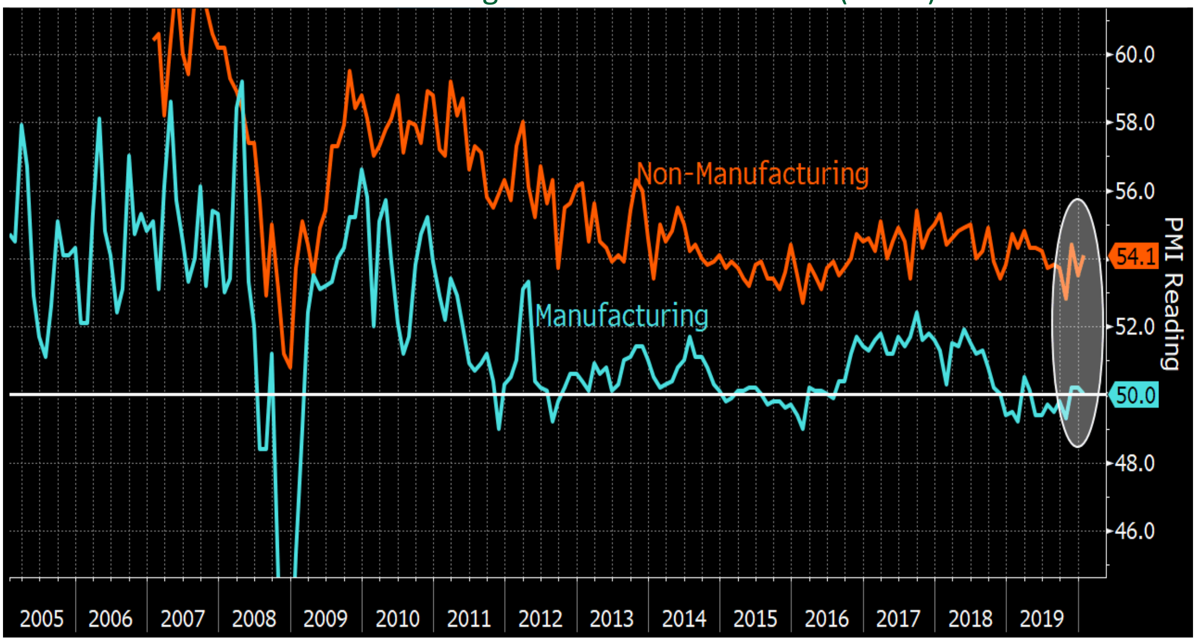
The potential economic effects of the virus are currently impossible to assess. Comparisons with the SARS experience are not very relevant for two main reasons:

- The Chinese government this time is effectively shutting down the economy in the worst impacted areas to contain the virus. This can affect global supply chains more than at the time of SARS.
- The Chinese economy is currently much larger and more open. The potential negative effects from the virus on the global capital markets therefore may be more profound.

Potential effects from the fact that many transport systems are running at low capacity utilisation can also be profound, like impacting the supply of critical supplies to humans and livestock. One can paint a very gloomy picture in the worst affected areas.

The other side of this coin is that scientists hopefully develop a solution and that everything can return to normal relatively soon. It has happened every time before. We take full cognisance of the logical negative short-term tactical economic effects from the virus and present our note more in context the strategic, longer-term fundamental considerations.

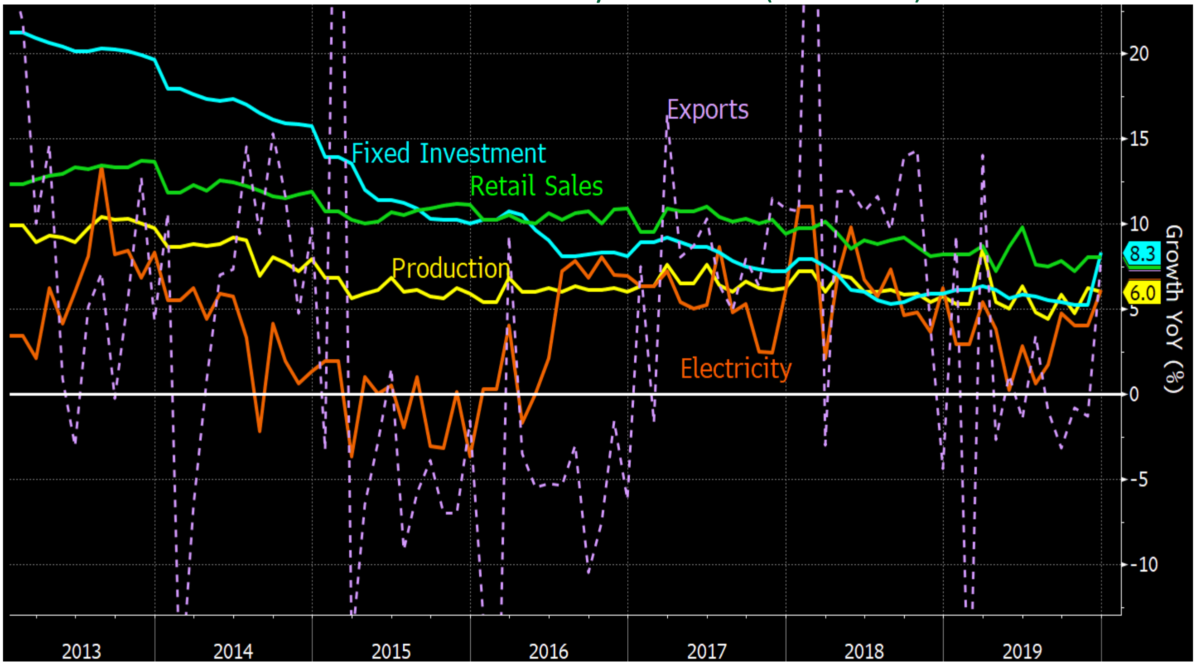
China Purchasing Manufacturers' Indices (PMI's)



China's manufacturing PMI had a neutral reading at the end of January, while the non-manufacturing PMI remained stable in constructive territory. Seeing that this already reflects some of the effects of coronavirus, we perceive these readings as neutral.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. February 2020. ***Past performance should not be used as a guide to future performance.***

China Economic Activity Indicators (Growth %)



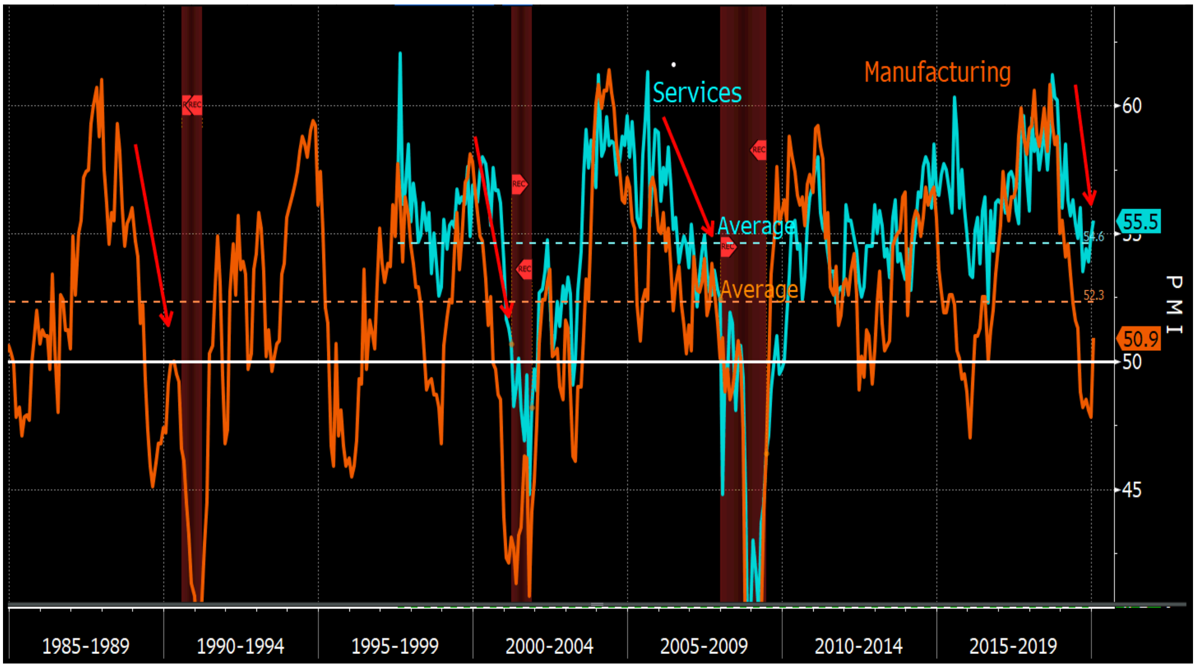
The above chart reflects economic activity readings at the end of December 2019. All of Fixed Investment, Production, Retail Sales, Electricity Consumption and Exports showed positive growth trends.

It seems that the coronavirus is hitting a strengthening rather than a weakening Chinese economy. This is confirmed by an economic tracker index we follow and is clearly an important economic fundamental point to make.

2. US FUNDAMENTALS

Important US economic data was released last week. The January new employment number of 225,000, well above the long-term average of 131,000, surprised many.

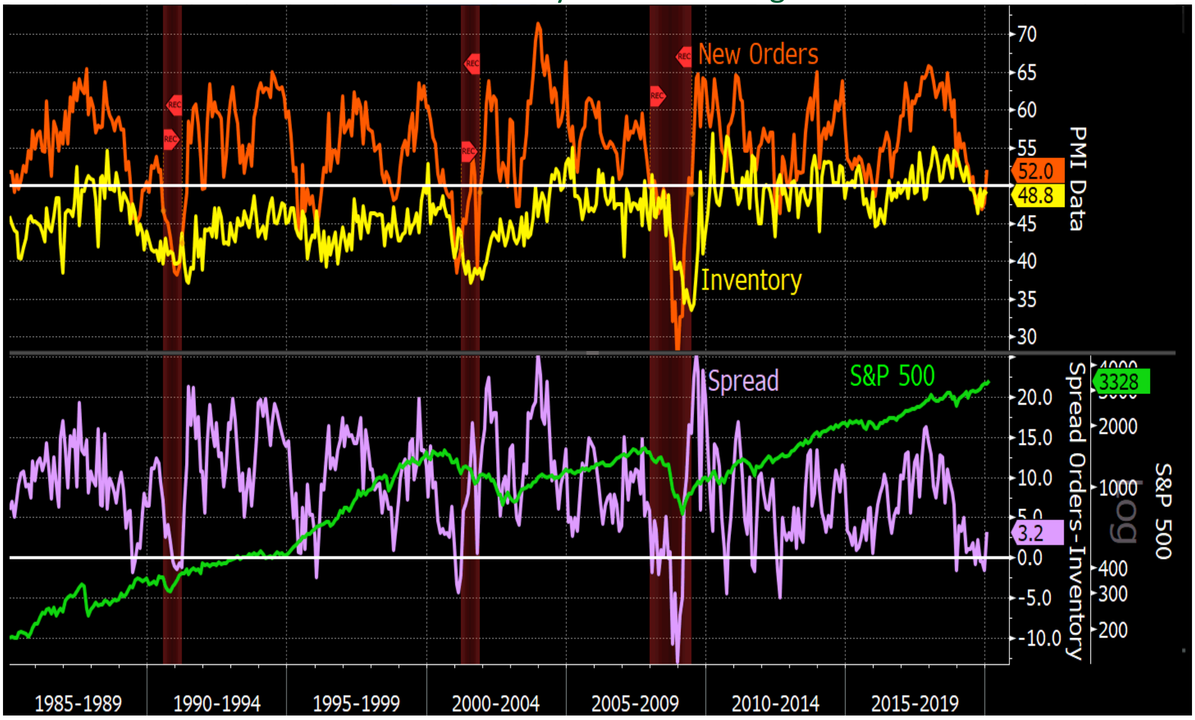
US Purchasing Manufacturers' Indices (PMI's)



The Manufacturing PMI recorded a strong recovery into constructive territory. The Services PMI following suit and rose to an above average level. These indices therefore together counter a perceived negative trend associated with a build-up towards a looming recession. It also seems that the Manufacturing index again had a false alarm after dropping below the critical 50 index reading.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. February 2020. ***Past performance should not be used as a guide to future performance.***

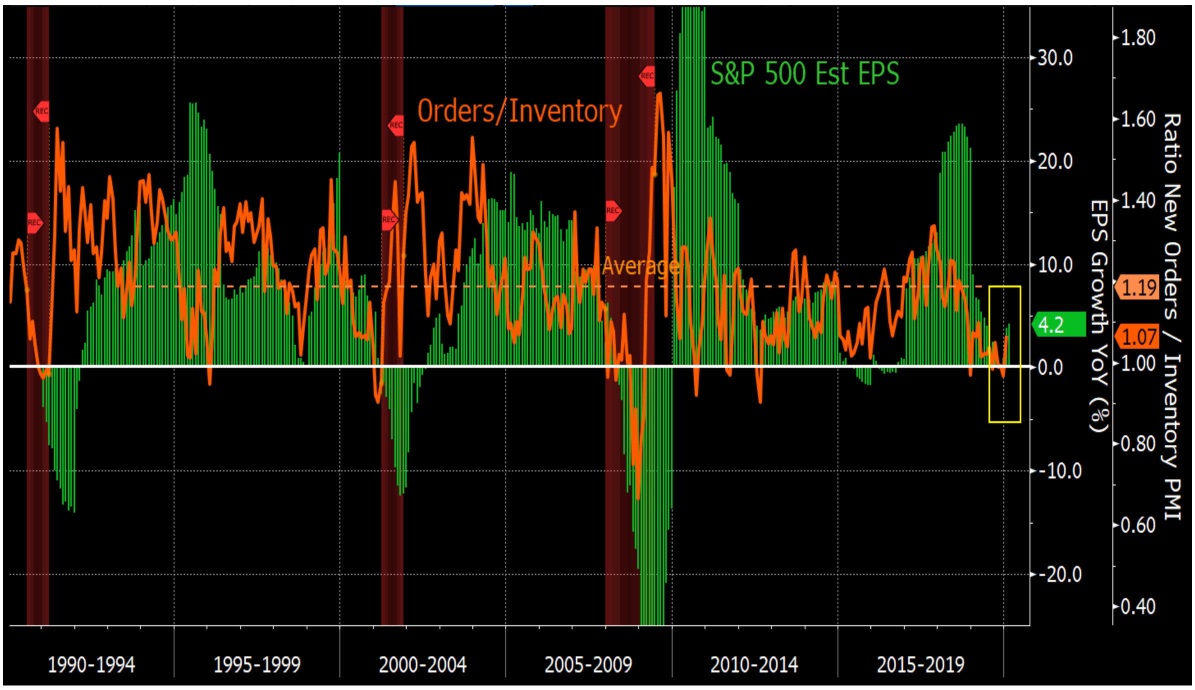
US New Orders & Inventory Manufacturing PMI vs S&P 500



Whilst the Inventory PMI stayed below the 50 level, the New Orders PMI rose to an expansionary level of 52. The spread between the two series (the bottom section of the above chart) recovered well to a +3.2 level. Such recoveries are usually associated with positive stock market effects with demand exceeding depleted inventory levels.

We can furthermore pull these arguments through to the outlook for earnings:

US New Orders vs Inventory Manufacturing PMI vs S&P 500 Extected Earnings Growth (%)

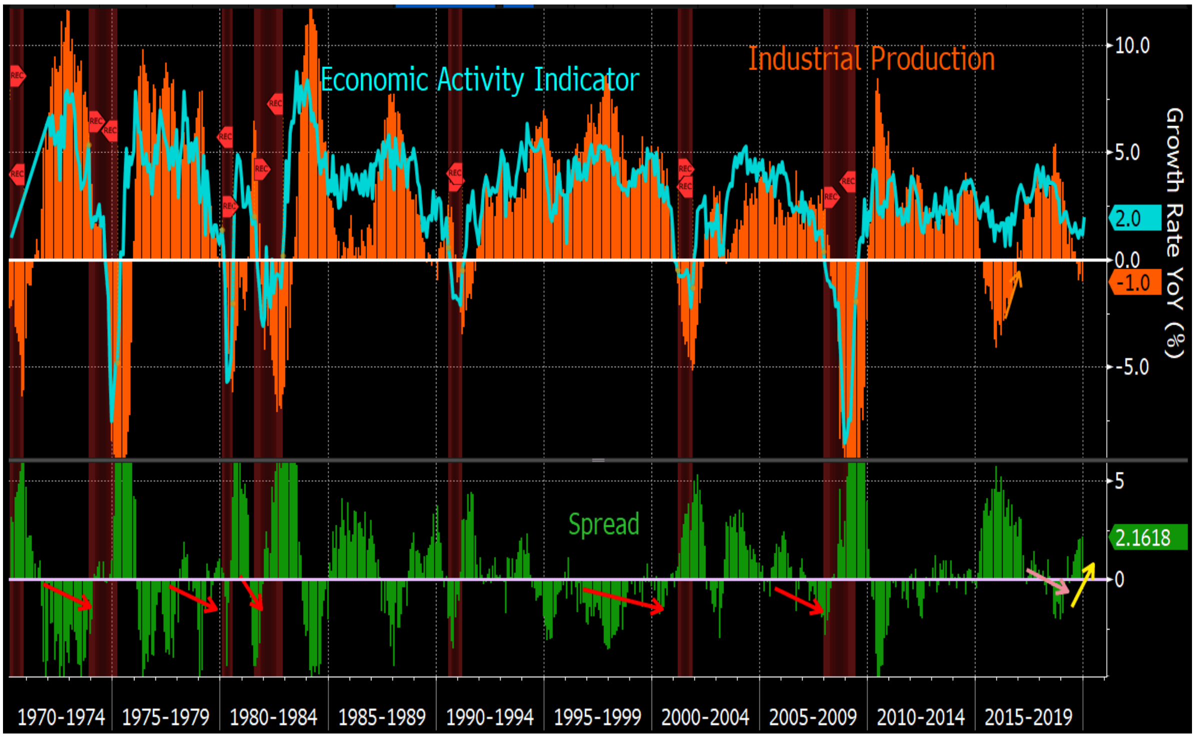


We draw in the above chart the ratio of the PMI New Orders index relative to the Inventory PMI index along with the twelve month forward earnings growth consensus expectations. It is clear how the PMI Orders/Inventory ratio historically has led the earnings growth expectations historically. It currently again leads earnings growth into a new revitalised positive trend. We expect this to support share prices.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2020. ***Past performance should not be used as a guide to future performance.***

Goldman Sachs does good work in building their own economic activity indicator:

US – Goldman Sachs Leading Economic Indicator vs Industrial production



Goldman Sachs's leading economic indicator is also picking up. It has historically led industrial production – which is currently in negative territory (the orange bars in the above chart). The spread between the two series (the green bars) has a constructive trend, contrary to historic trends preceding recessionary periods.

3. AS RELEVANT AS THE YIELD CURVE

The US yield curve unsettled many investors last year. It (the 3-month/10-year curve) has recently inverted again, not really unsettling us (it has steepened since). We are of the opinion that the era of quantitative easing somewhat weakens the relevance of the curve's message and may actually attribute more value to the combination of the following interest related charts:

US – Interest Related Fundamental Messages

Source: Bloomberg & Stonehage Fleming Investment Management Limited. February 2020. ***Past performance should not be used as a guide to future performance.***

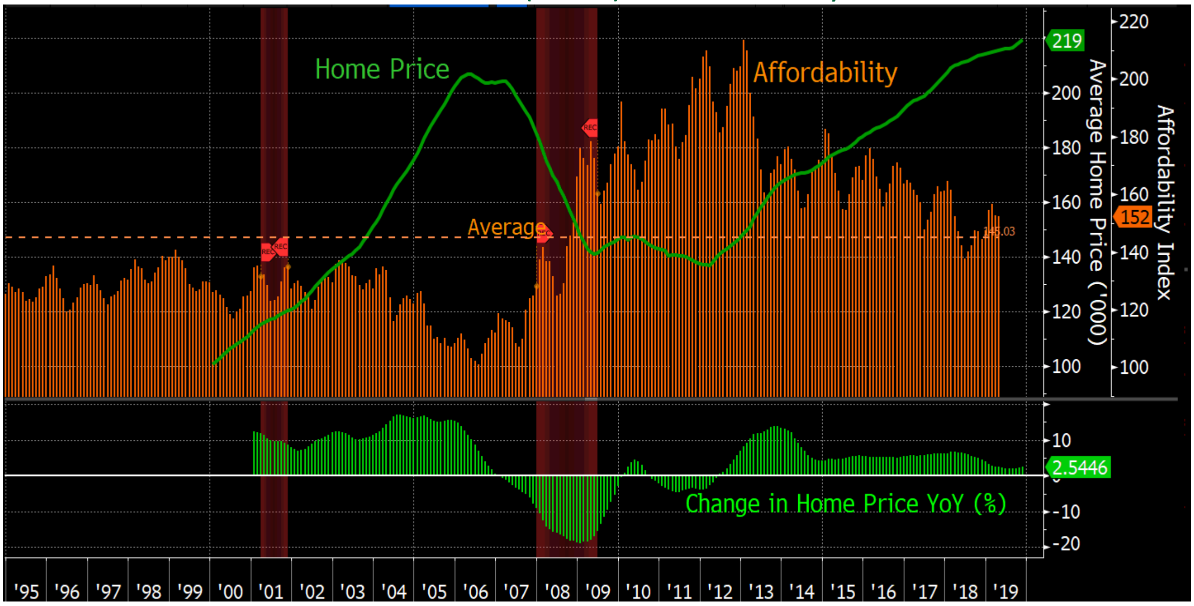
The credit spread has risen somewhat recently with the coronavirus uncertainties, but is not yet in a rising trend. Along with this, the household debt service ratio is at historically low levels. Furthermore, home prices are at record levels, even higher than those preceding the Credit Crisis levels and builders' confidence is back at record high levels.

All of these argue strongly against fears of an imminent US recession – see the red arrows in the above chart. It seems the yield curve has little choice than to stay in constructive territory (as it has recently done, currently at +0.18%).

4. US HOUSING MARKET

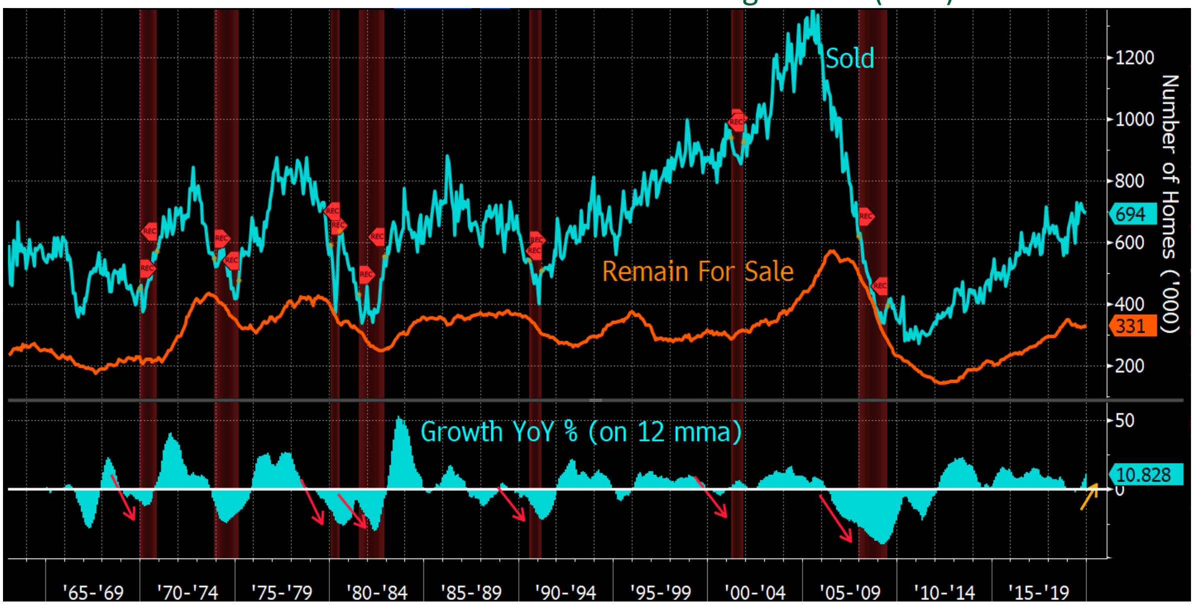
The preceding information triggered us to reconsider the health of the US housing market. The following charts may be of value:

US – Home Prices ($'000) vs Affordability Index



Home prices are in a rising trend, currently at record levels, well in excess of values preceding the Credit Crisis. Home affordability is currently marginally in excess of the long-term average. The combination of these two issues suggests a healthy housing market.

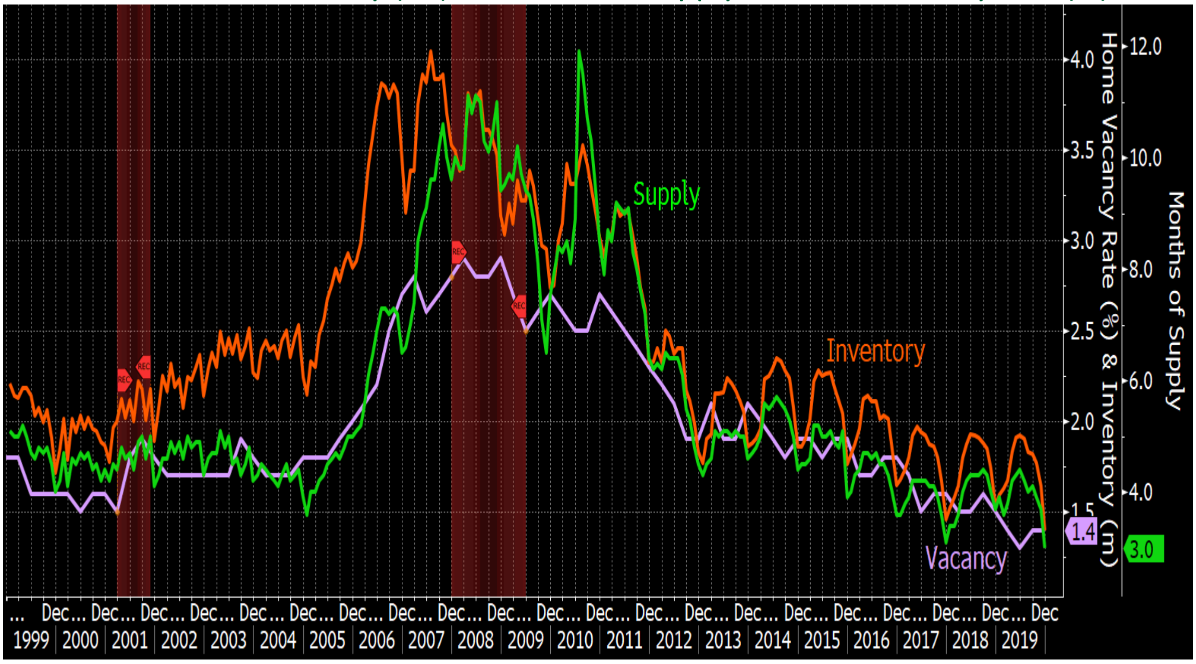
Number of Home Sales vs Remaining Unsold ('000)



Source: Bloomberg & Stonehage Fleming Investment Management Limited. February 2020. ***Past performance should not be used as a guide to future performance.***

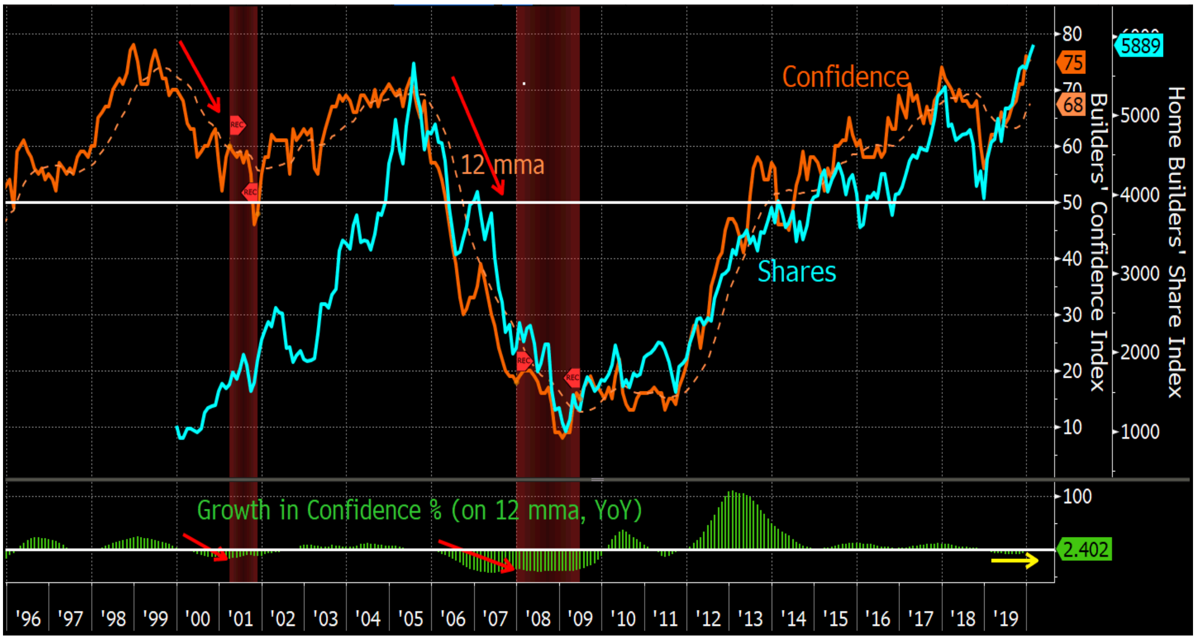
Home sales are in a rising trend, currently growing at +10.8%. Against this, the number of unsold homes is dropping slowly.

US – Home Inventory ('m) & Months of Supply vs Home Vacancy rate (%)



Home inventory numbers are currently at record low levels, as are the months of supply numbers. Vacancy numbers are also at record low levels (all numbers in the above chart).

US – Home Builders' Confidence Index vs Home Builders' Share Price Index



The home builders' confidence index has an excellent record of foreseeing the good and the bad times. The index is currently at a record level this century (exceeding levels preceding the credit crisis) and is close to all-time record levels. The home builders' share price index is also at a new record level.

All-in-all, the US housing market seems to be in good shape. This installs further confidence in their consumer and capital markets. There is good reason for related businesses to continue performing well.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. February 2020. ***Past performance should not be used as a guide to future performance.***

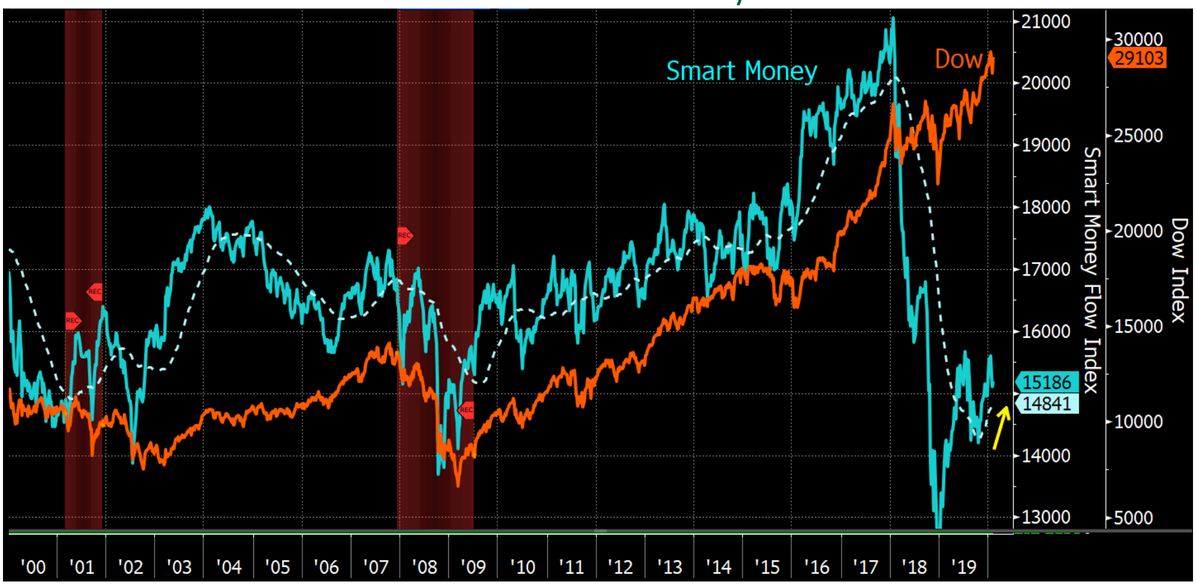
5. TECHNICAL PICTURE

The following charts reflect to some degree the S&P 500 technical picture:

S&P 500 – Technical Picture

The index remains above its 50-day moving average. Just over two-thirds of its members are above their individual moving averages, but not yet at stretched levels. The combination of these two points reflect a technically healthy stock market.

Dow Index vs Smart Money Index



The Dow Smart Money index is in a rising trend. It has historically had good leading characteristics. This reflects confidence amongst the high conviction active stock market traders.

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