GLOBAL EQUITY PERSPECTIVES 22 JUNE 2020

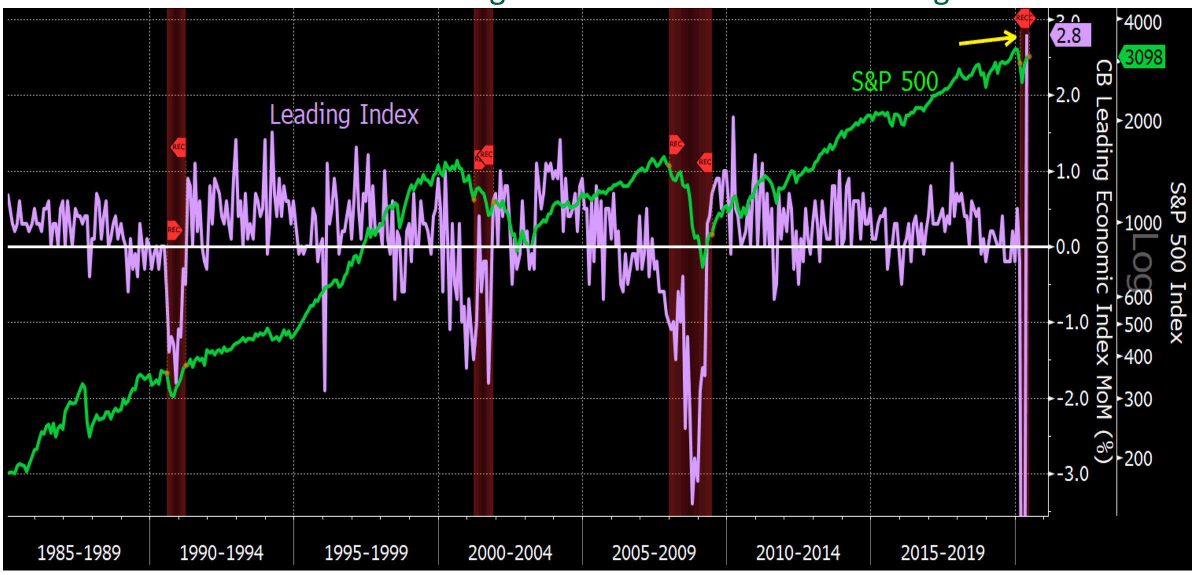
"The noblest pleasure is the joy of understanding."

Leonardo da Vinci

1. ECONOMIC RECOVERY

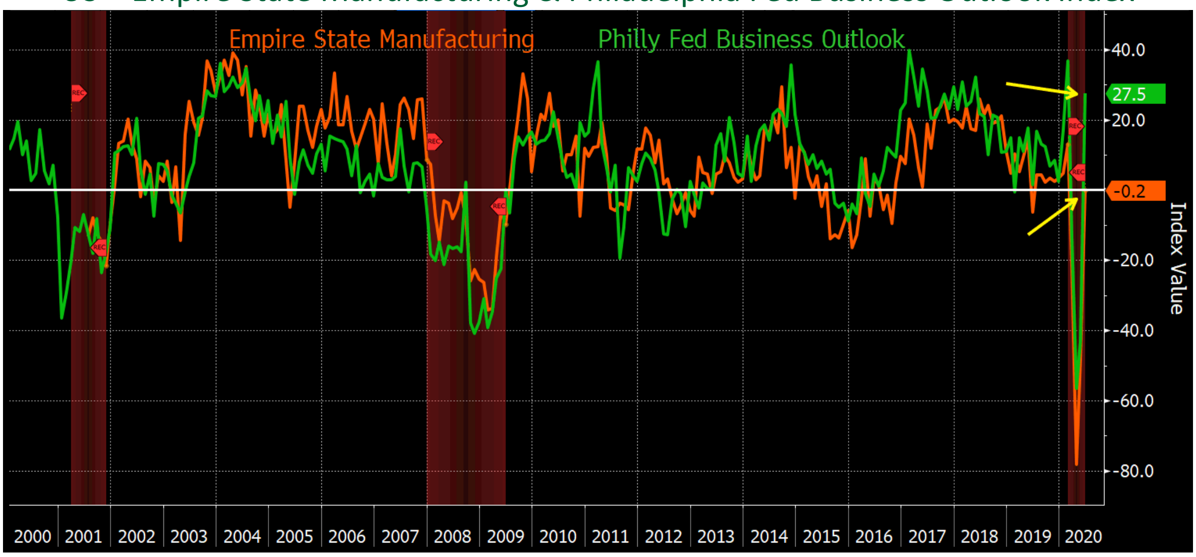
There are clear signs that the US economic outlook is in process of recovering:

US – Conference Board Leading Economic Index MoM % Change vs S&P 500



The above leading economic index dropped to historic lows with the GVC (Great Virus Crisis) and is now in process of recovering to record high levels. Seeing the low base, it can probably stay in positive territory for a while with the real economy also starting to recover. These are positive signals whilst the absolute economic activity levels still have a long way to recover to the pre-GVC levels.

US – Empire State Manufacturing & Philadelphia Fed Business Outlook Index



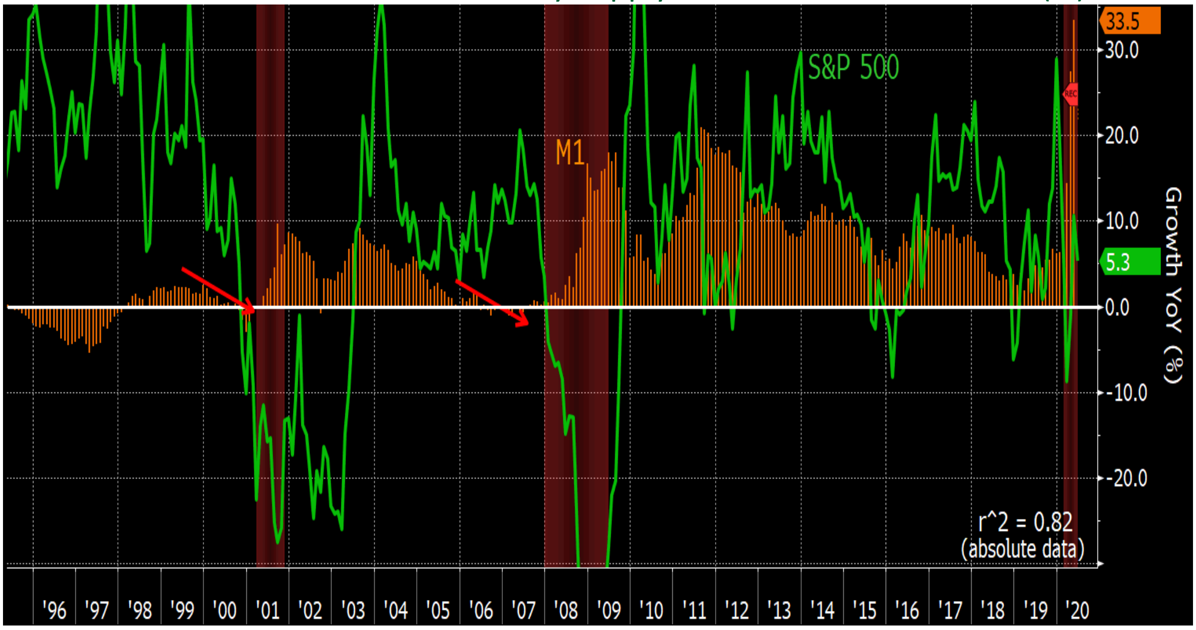
The Philadelphia Federal Reserve Business Outlook index reflects a similarly sharp recovery, itself also off a historic low level. The Empire State Manufacturing Survey has also recovered well, and is almost at a neutral level already. Expectations for economic recovery clearly are high as the US economy opens from the GVC lock-downs.

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

2. MONEY SUPPLY

Governments and central banks have never been so united in providing the necessary liquidity to the global economy.

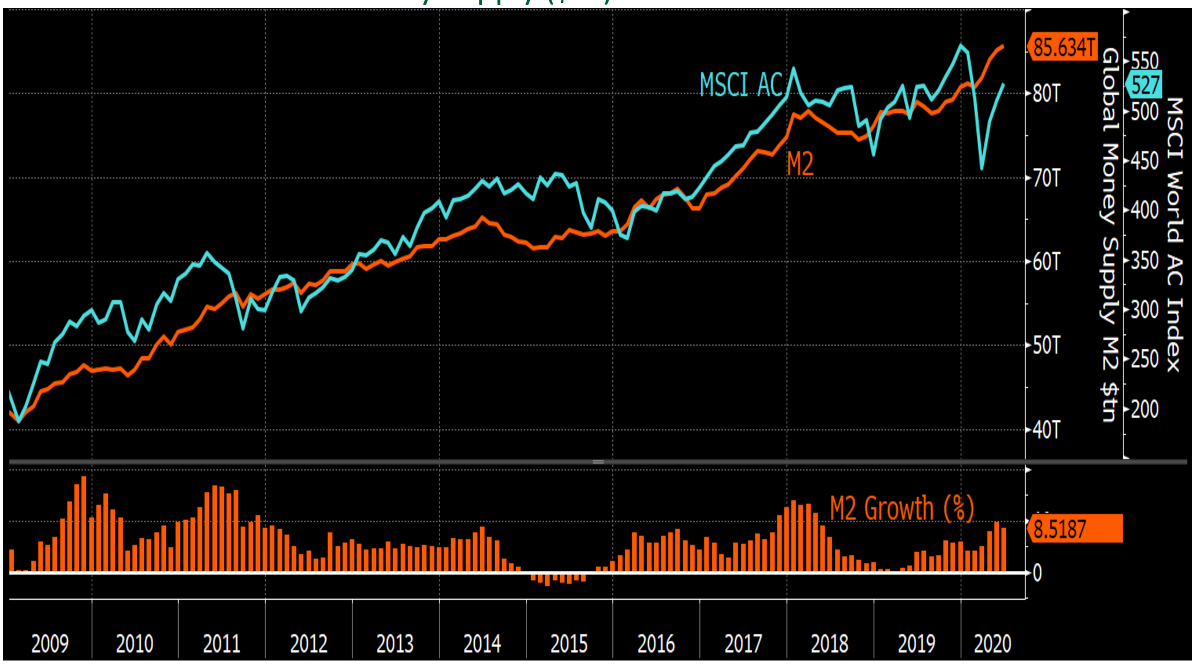
US – Federal Reserve M1 Money Supply vs S&P 500 – Growth YoY (%)



US Money Supply is currently growing at a historic high level of one third. The high correlation between Money Supply and share prices is clear from the above chart. Shareholders currently benefit hugely from this support.

We have obtained this data also in global context:

Global Money Supply ($tn) vs MSCI World AC Index



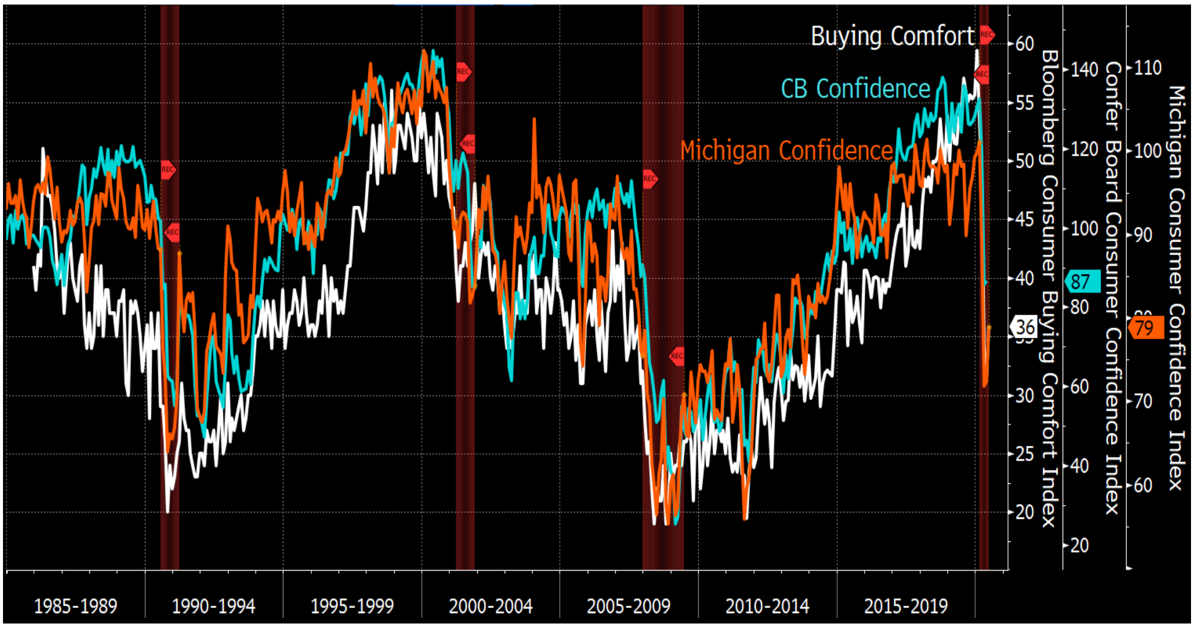
Global Money Supply currently grows steadily at a more moderate +9%. The high correlation with share prices is also clear from the above chart. Strikingly, the share price index currently lags somewhat the Money Supply index. It therefore seems that share prices can enjoy further support should the former stay the course (we have little reservation whether this can continue).

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

3. US CONSUMER

The state of the US consumer is critical for the US (and, by implication, many other) stock markets.

US – Different Consumer Confidence Indices

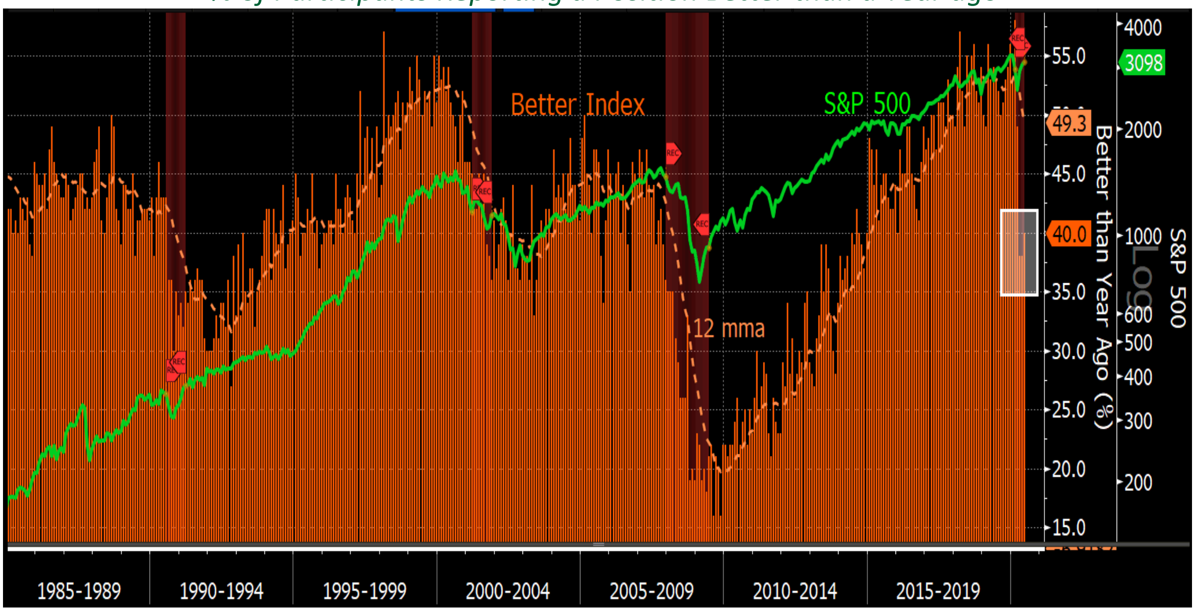


The above chart reflects the Conference Board and Michigan University Consumer Confidence indices, and the Bloomberg Consumer Buying Comfort indices. They have understandably dropped meaningfully, but the most recent readings have recovered somewhat. Another important point is the fact that, although they have all dropped, it is to levels materially higher than with the Great Financial Crisis (GFC).

Michigan University also produces consumer surveys of how current financial conditions compare with those of a year ago:

University of Michigan Consumer Financial Situation Index* vs S&P 500

**% of Participants Reporting a Position Better than a Year ago*



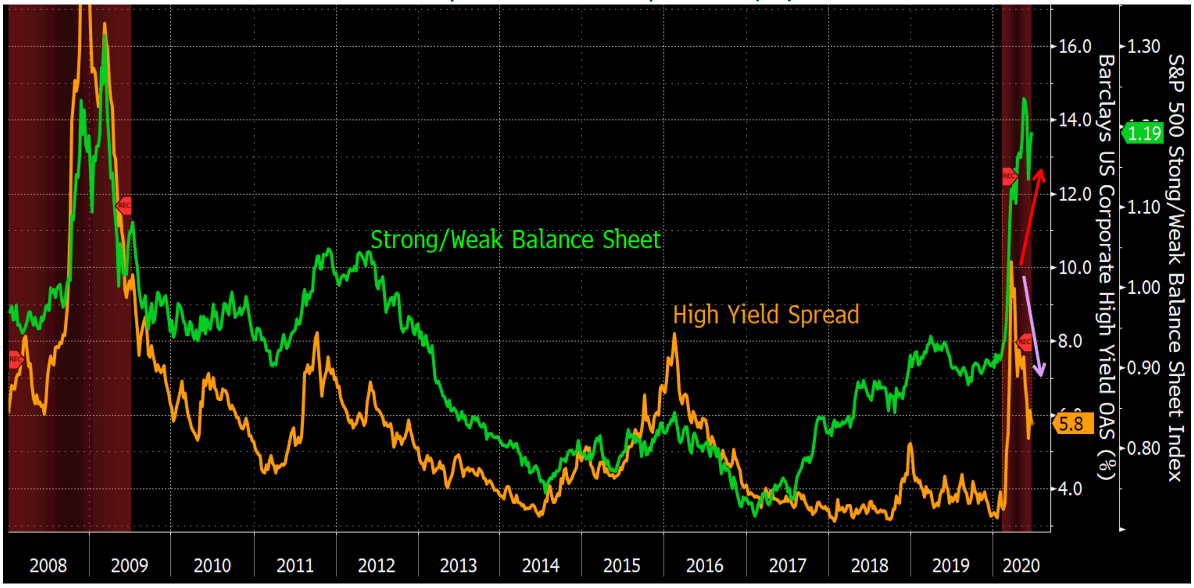
The percentage of participants opining that their financial positions have improved understandably dropped materially. These readings, though, have marginally turned upwards with the latest survey. Strikingly also, the current readings are still double the readings during the GFC. It therefore seems that US consumers are currently much more optimistic than they were during their previous major economic shock.

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

4. STAY STRONG

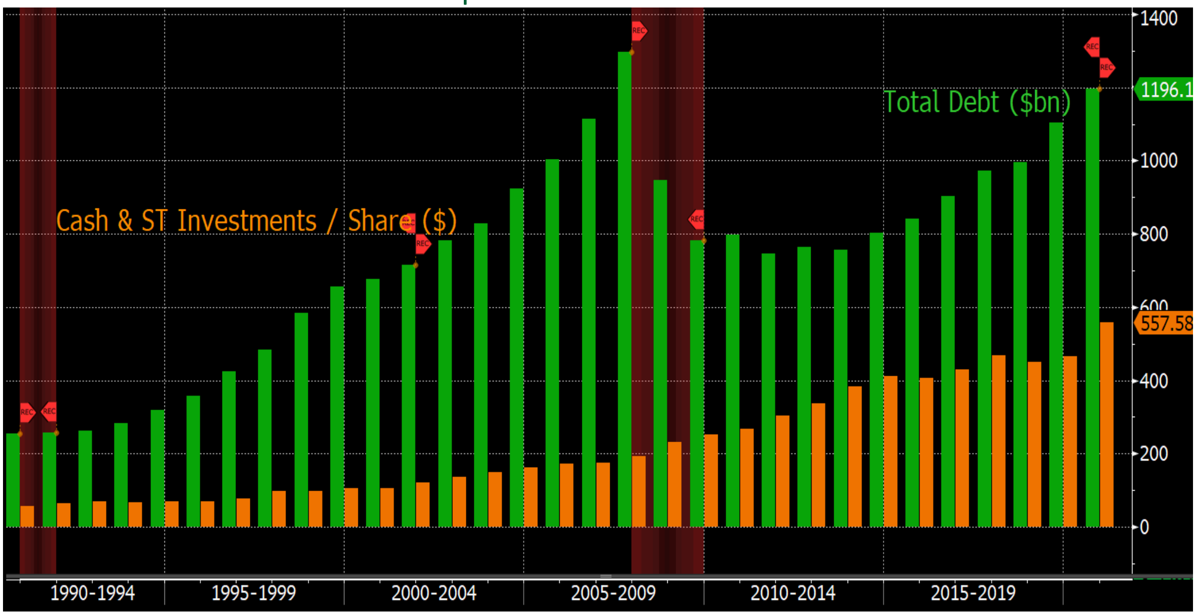
Many companies struggle with very weak cash flow currently. Those with weak balance sheets have it particularly tough.

S&P 500 – Performance of Strong vs Weak Balance Sheet Companies vs High Yield Corporate Bond Spreads (%)



The relative performance (the green line in the above chart) of shares of those companies with strong balance sheets against those with weak balance sheets logically trended with the high yield corporate bond spread (the yellow line) historically. This correlation seems to have broken down during the GVC – the high yield spread is narrowing as investor confidence recovers, but the relative share performance stays in favour of strong balance sheet businesses. This implies huge reservations around weak franchises, and potential casualties amongst them. Investors will therefore have to be careful in their stock selection.

S&P 500 Companies – Total Debt vs Total Cash



Overall debt levels have increased materially over the last five years (the green bars). Along with this, cash levels also increased, currently at record levels (the yellow bars). The fact is, though, that most of these cash hoards are held by a relatively small number of companies (especially in Technology). Because of investors' focus on these issues, we can expect the rating disparity between strong and weak balance sheet franchises probably to remain (or grow) in favour of the former.

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

5. EARNINGS LOWS

We are bracing ourselves for an extremely weak second quarter earnings season. Whilst this may be an unnerving experience, the much more important issue on this front clearly is rather the outlook for the coming year's earnings.

We consider in the following chart of experiences on this front during the GFC:

Great Financial Crisis – S&P 500 Low vs 12 Month Forward Earnings Low Points.

Both share prices and forward earnings hit their cycle lows during the recession (the red shaded area). The S&P 500 index hit its low 47 days (two months) before the Index earnings hit its low. The S&P 500 maintained a steady recovery rate afterwards, with the earnings expectations increasing strongly off the low base.

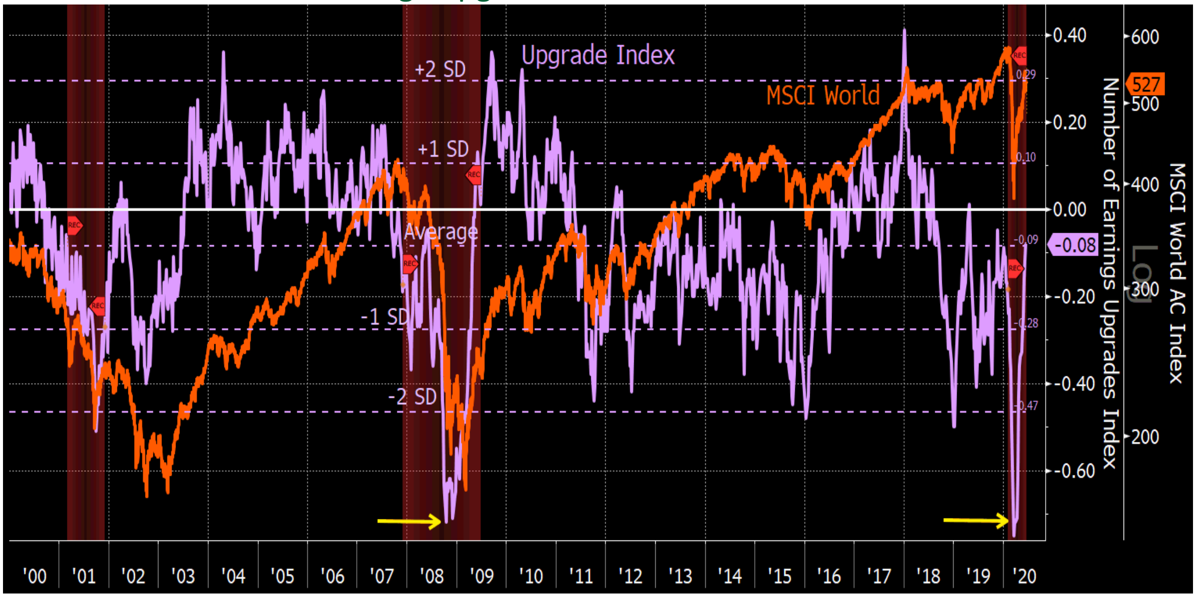
It is interesting to draw a comparison to the GVC currently:

Great Virus Crisis – S&P 500 Low vs 12 Month Forward Earnings Low Points

Earnings expectations started turning for the better on 25 May. Should this be the cycle low for earnings, it ocurred 45 days after the S&P 500 index low (should this also be its cycle low). This timing is very similar to the experience during the GFC. Investors would appreciate some confidence in an improving earnings outlook.

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

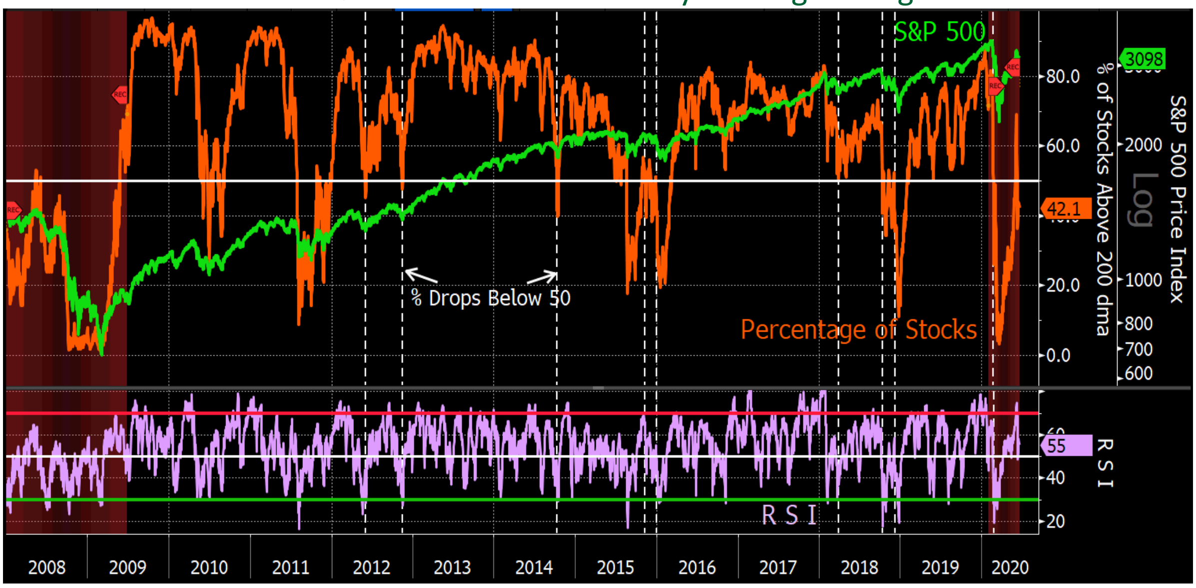
Global Earnings Upgrade Index vs MSCI World AC Index



We have updated the above earnings upgrade index. It has improved further and is already on its long-term average. This bodes well for positive earnings revisions. We would also highlight the outstanding buy signal it gave recently.

6. TECHNICAL PICTURE

S&P 500 vs % of Stocks over 200-Day Moving Average vs RSI



Based on the above chart, the S&P 500 technical picture is currently healthy, moving in favour of buying rather than selling.

Our thoughts are with everyone affected by COVID-19, be it directly or indirectly.

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