STONEHAGE FLEMING

GLOBAL EQUITY PERSPECTIVES 29 JULY 2019

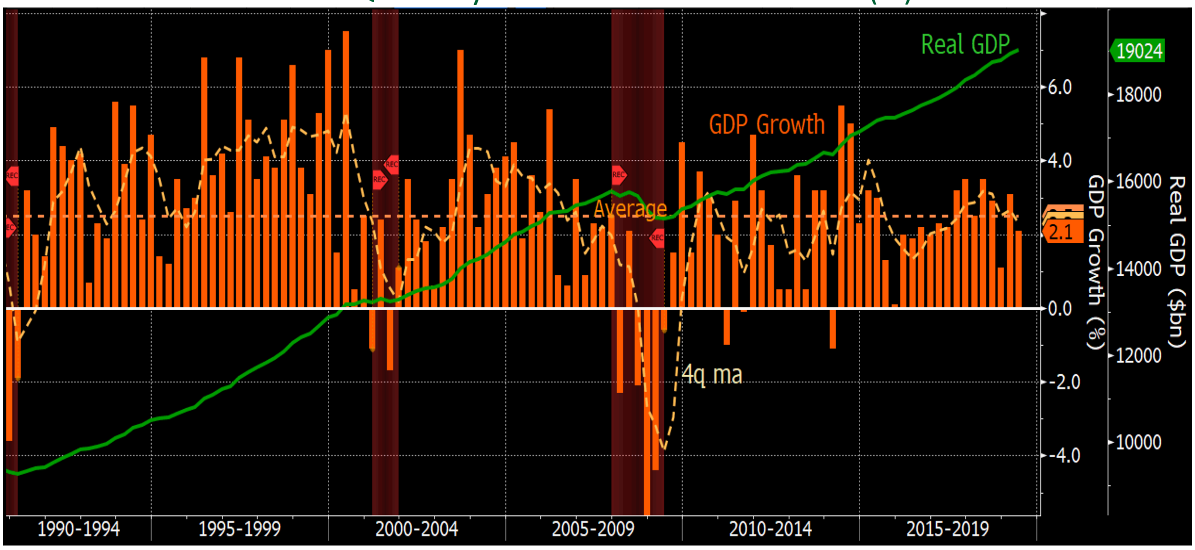
"The truth is more important than the facts."

Frank Lloyd Wright

1. MARGINAL MODERATION

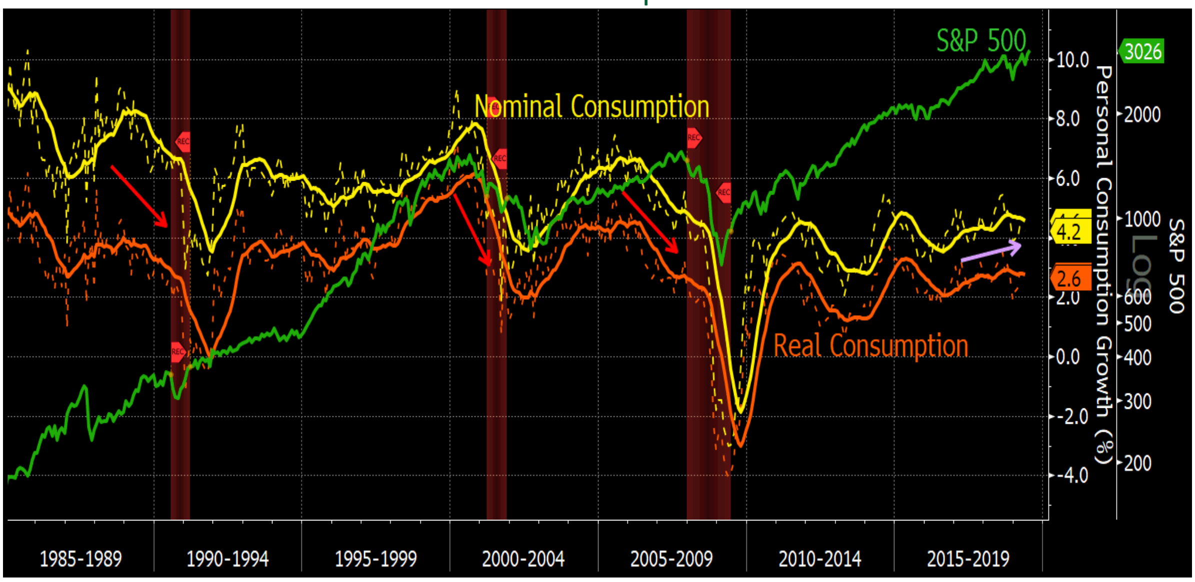
US economic data for the second quarter has just been released. The growth of +2.1% is marginally better than consensus expectations:

US – Quarterly GDP Year-on-Year Growth (%)



Rolling annual GDP growth remains at the long-term average despite the second quarter moderation. Contrary to the run-up to previous recessions, the quarterly growth numbers are currently less volatile. This is rather constructive towards capital market stability.

US – Nominal and Real Consumption Growth vs S&P 500



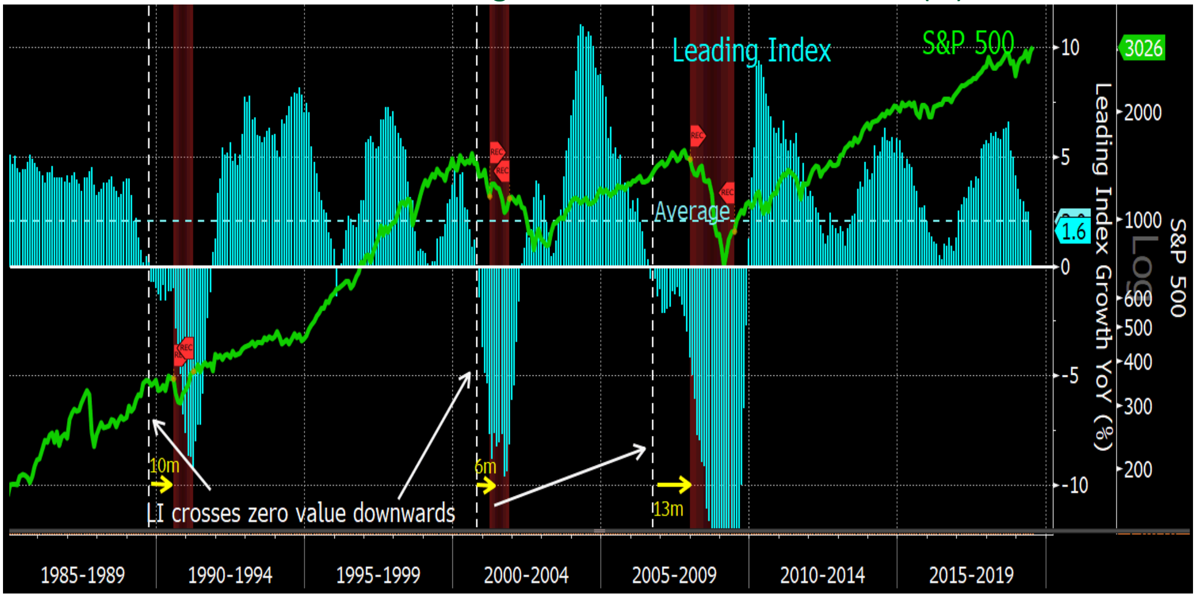
Nominal consumption picked up moderately to +4.2%, with real consumption growing at +2.6%. The trend in both these series remains on a constructive trajectory, in contrast to trends in the run-ups to earlier recessions. It is clear the US consumer remains the backbone of the US economy and with their current solid financial positions, investors can continue to rely on this pillar of the US economy.

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

2. LEADING ECONOMIC INDICATORS

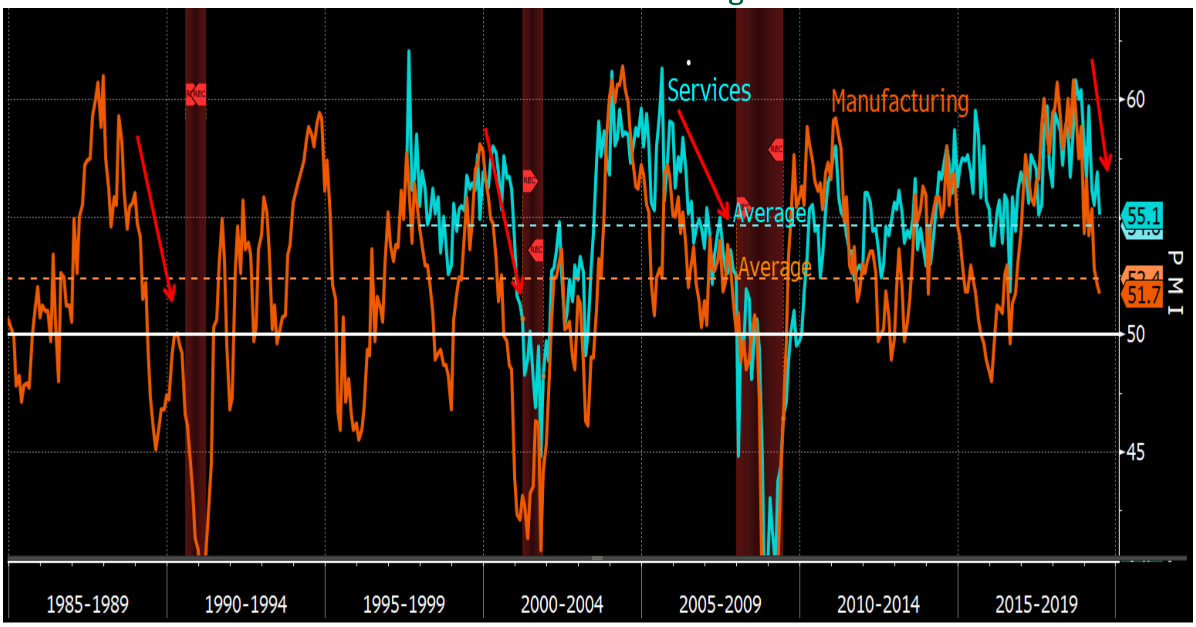
We follow numerous different leading economic indicators. One must be careful not to be overly reliant on one specific series, but we believe the following two charts provide a reasonable indication of recessionary risks in the US economy, and therefore to what extent we may face an imminent equity bear market:

US – Conference Board Leading Economic Index Growth YoY (%) vs S&P 500



The leading economic index in the above chart has a good record of forecasting the structural peaks in share prices and subsequent recessions when its growth level stagnates and then recedes. The current growth level of +1.6% is marginally lower than its long-term average of +2.0% and continues to provide a constructive message.

US – Services and Manufacturing PMI Indices



The PMI indices in the above chart provide constructive economic growth messages when their readings are above a neutral 50 level, and the reverse when below. The Services reading at 55.1 is currently marginally above its long-term average while the Manufacturing reading at 51.7 is marginally below its long-term average. Whilst both series are in a downwards trend, their current readings remain on the side of equity investors.

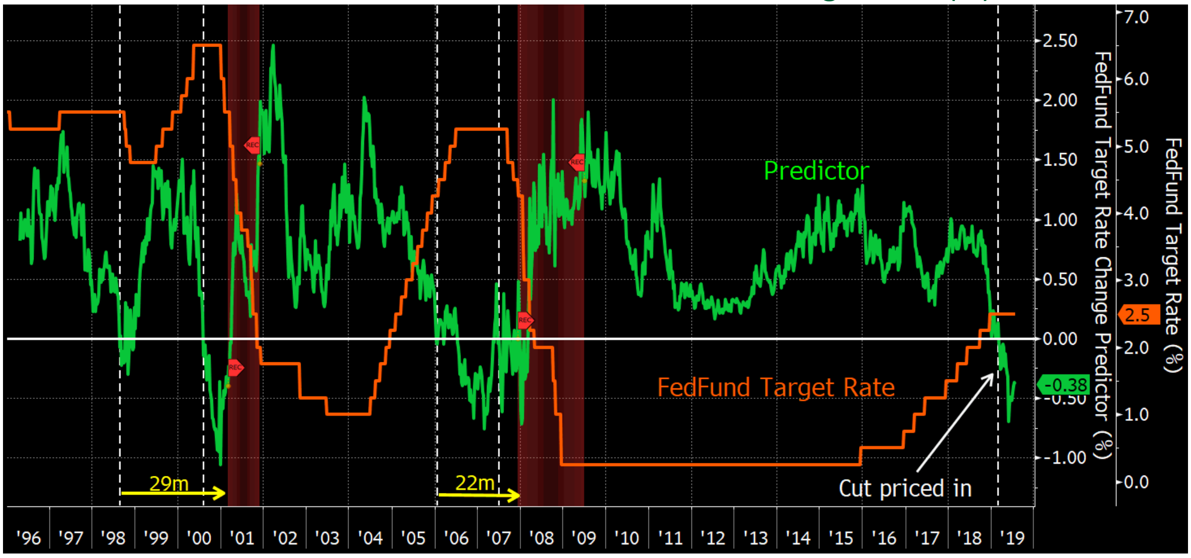
Source: Bloomberg & Stonehage Fleming Investment Management Limited. July 2019. ***Past performance should not be used as a guide to future performance.***

3. FED RATE CUT

Many investors fear the potential first cut in the Federal Reserve target rate during this US economic expansion period. There are perceptions that it may reflect a dire economic outlook and that it should therefore be detrimental to equity markets.

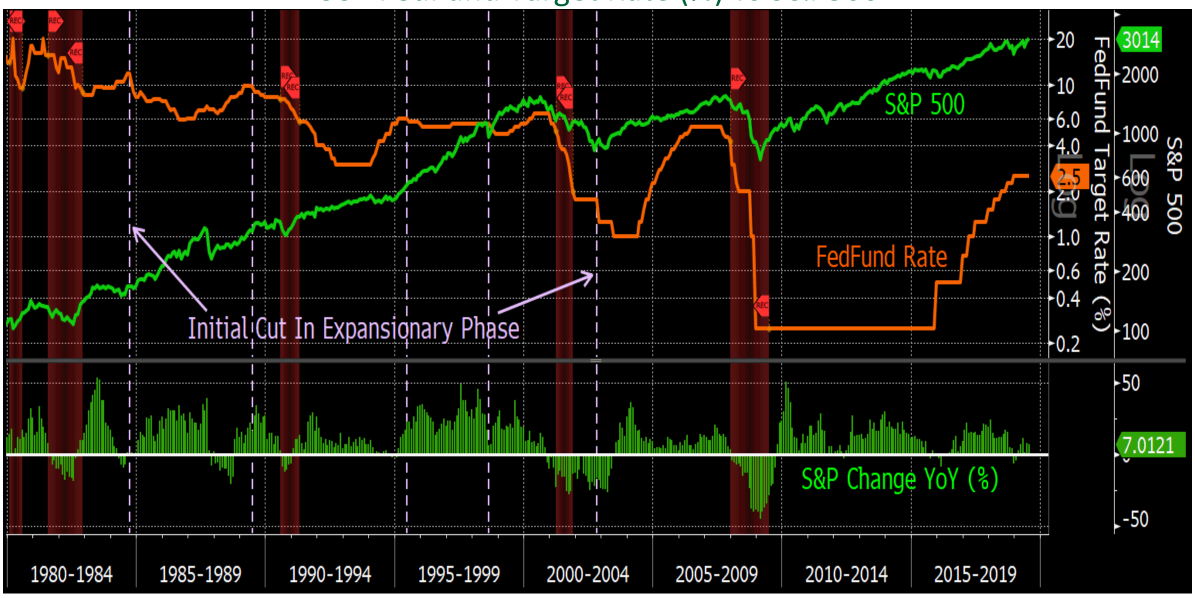
The following charts reflect on the theme of target rate cuts:

US – FedFund Rate Predictor vs FedFund Target Rate (%)



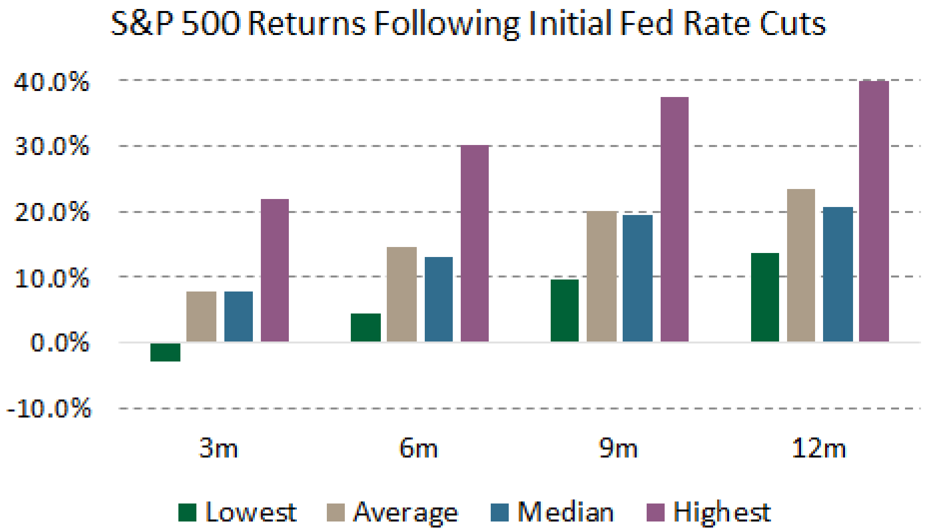
The FedFund predictor rate in the above chart is derived from its forward rates. Although it has been somewhat early (as in 2006) in predicting a rate cut (the vertical lines), it has a good record in this context. It historically warned about an upcoming recession around two years in advance. It has made such a call towards the end of the first quarter this year. Strikingly also, whilst earlier on calling for more than a 50bps cut, its current trend calls for a smaller cut.

US –FedFund Target Rate (%) vs S&P500



We consider in the above chart the S&P 500's reaction following the initial FedFund rate cuts during the preceding economic expansionary periods (we do not include experiences immediately preceding the subsequent recessions). We have not yet had any such cuts during the current economic upswing and do not foresee an imminent recession. We therefore put value to these earlier experiences and present those results in the following chart to consider:

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



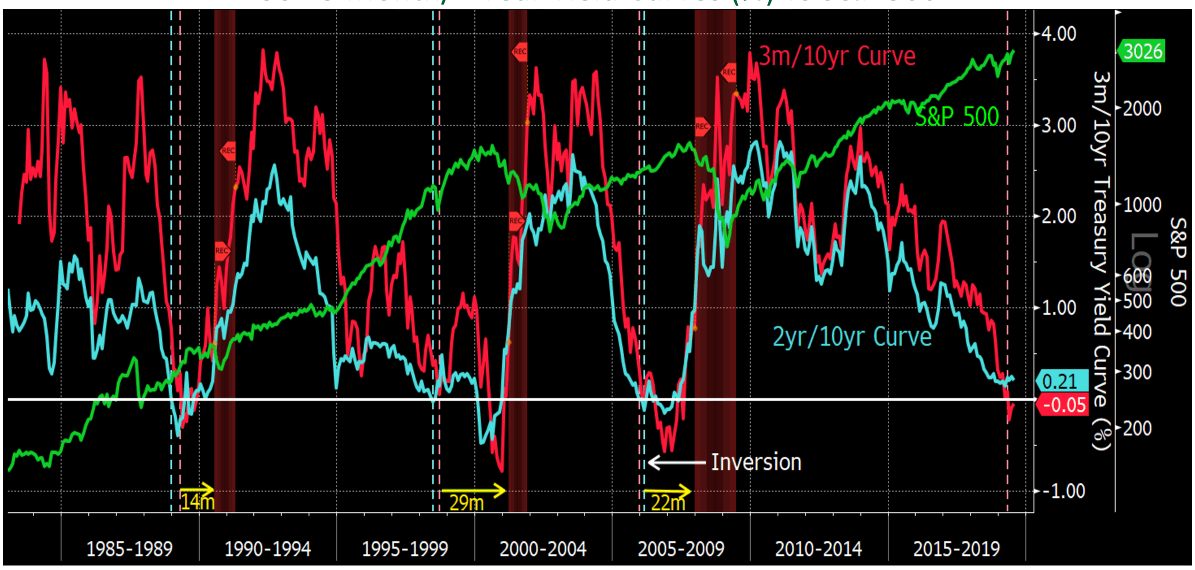
The chart shows the lowest, average, medium and highest returns over the three-, six-, nine- and twelve-month periods following the cuts indicated in the preceding chart. The results have been overwhelmingly positive, and actually at attractive levels on average.

The main argument against the above conclusion remains that we currently may face an imminent US recession. We do not currently share such a view.

4. YIELD CURVE (YET AGAIN)

We have in an earlier note offered our arguments against relying on too short-term rates (which may be more prone to potential manipulation) to judge the messages of certain yield curves. Nevertheless, for the benefit of those 'wearing belt and braces with a rope' we publish both this curve (3m/10yr) and the one we value more (2yr/10yr) in the following chart:

US - 3 Month/2 Year Yield Curves (%) vs S&P 500

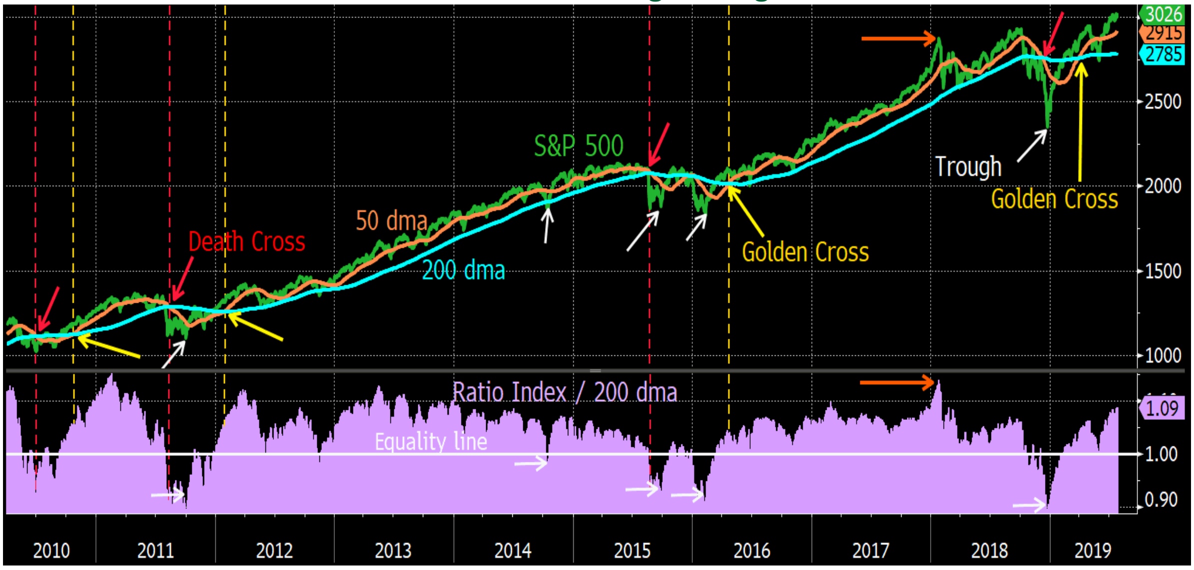


Our preferred curve has not yet inverted, and in fact is in process of bottoming out in steepening territory (above the zero line). Whilst the 3-month curve has inverted marginally earlier, it also is in process of picking up and is currently only 5bps in reverting territory. We won't hang our hat on such a marginal indicator for strategic decision making. Even so, historically, these inverting events preceded the respective recessions by almost two years and clearly does not yet call for moving to the proverbial side-lines.

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

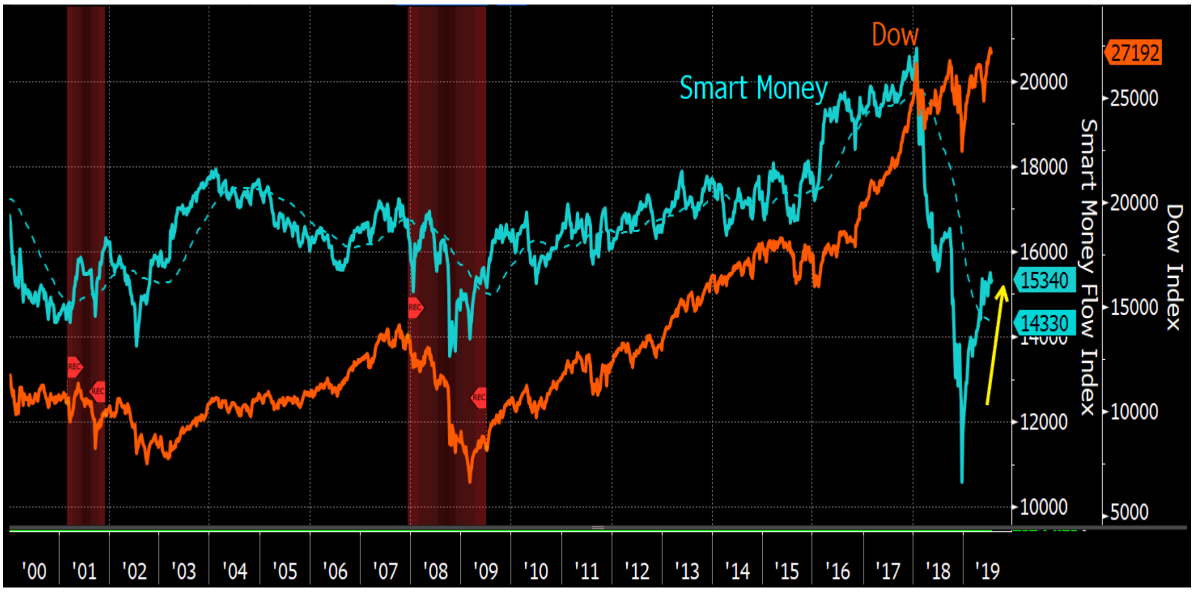
5. TECHNICAL INDICATORS

S&P 500 vs Moving Averages



The S&P 500 technical 'golden cross' made a good call earlier this year. The overall technical picture is healthy with no apparent stresses.

Dow Smart Money Flow Index vs Dow Jones Index



The Smart Money Flow index is currently in a positive trend, having broken its moving average upwards (and the moving average bottoming out). This reflects a positive stance by professional heavy-hitting operators.

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

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