

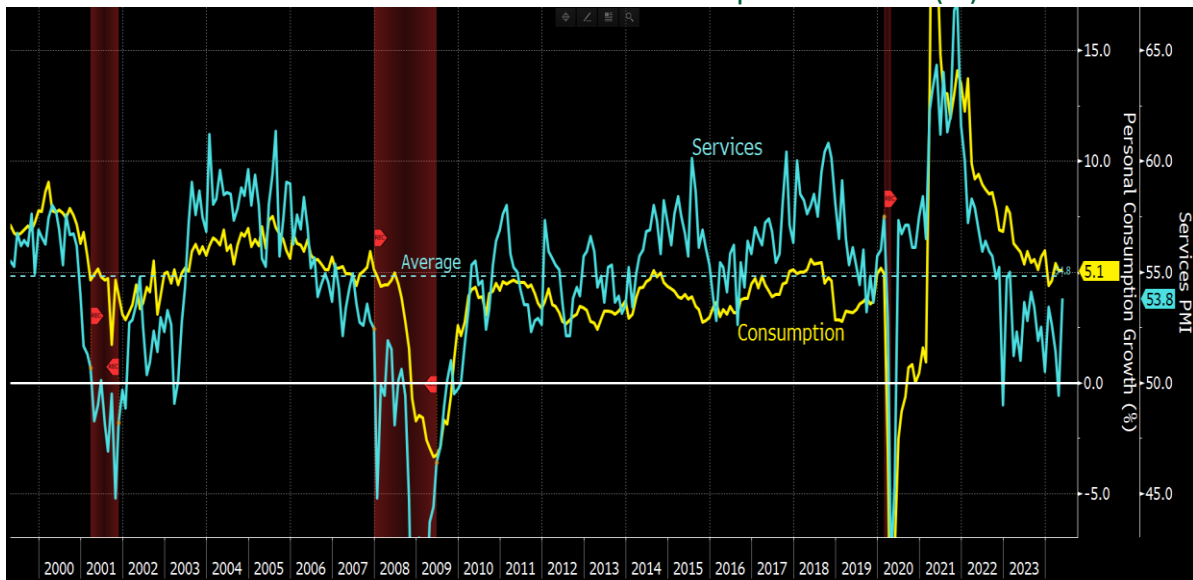
"The more I see the less I know for sure."

John Lennon

1. US CONSUMER

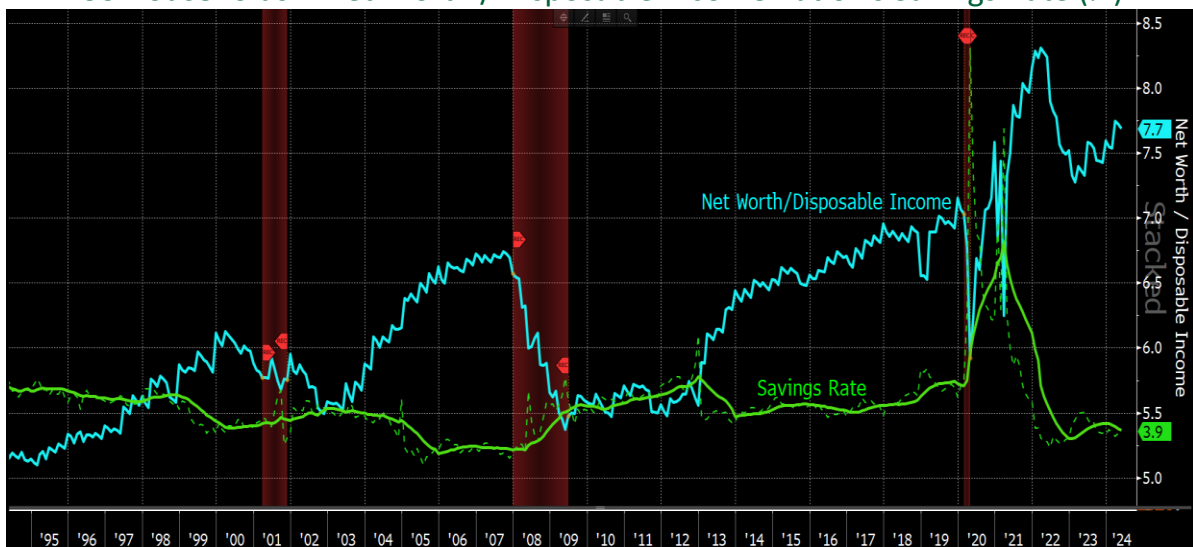
Some important US employment data is indicating the risk of a slowing economy, and with most of the Pandemic savings depleted, fears of a potential recession are building up. We consider further important information in this context.

US Services PMI vs Personal Consumption Growth (%)



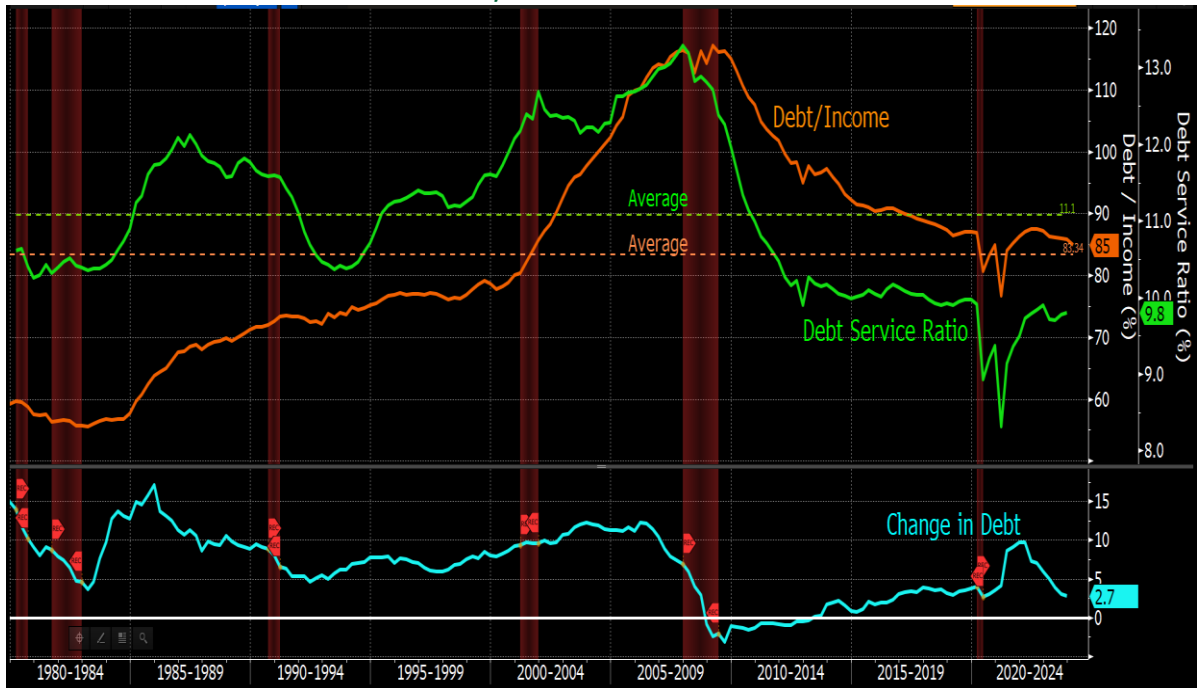
The Services PMI Index (the blue line in the above chart) generally remains in constructive territory, while growth in Personal Consumption is still at a solid +5% level.

US Households – Net Worth / Disposable Income Ratio vs Savings Rate (%)



Whilst the Households Savings Rate is approaching uncomfortably low levels (the green line), their Net Worth as a ratio of Disposable Income remains in a rising trend (the blue line), and is close to record levels. This wealth factor provides some comfort to US households.

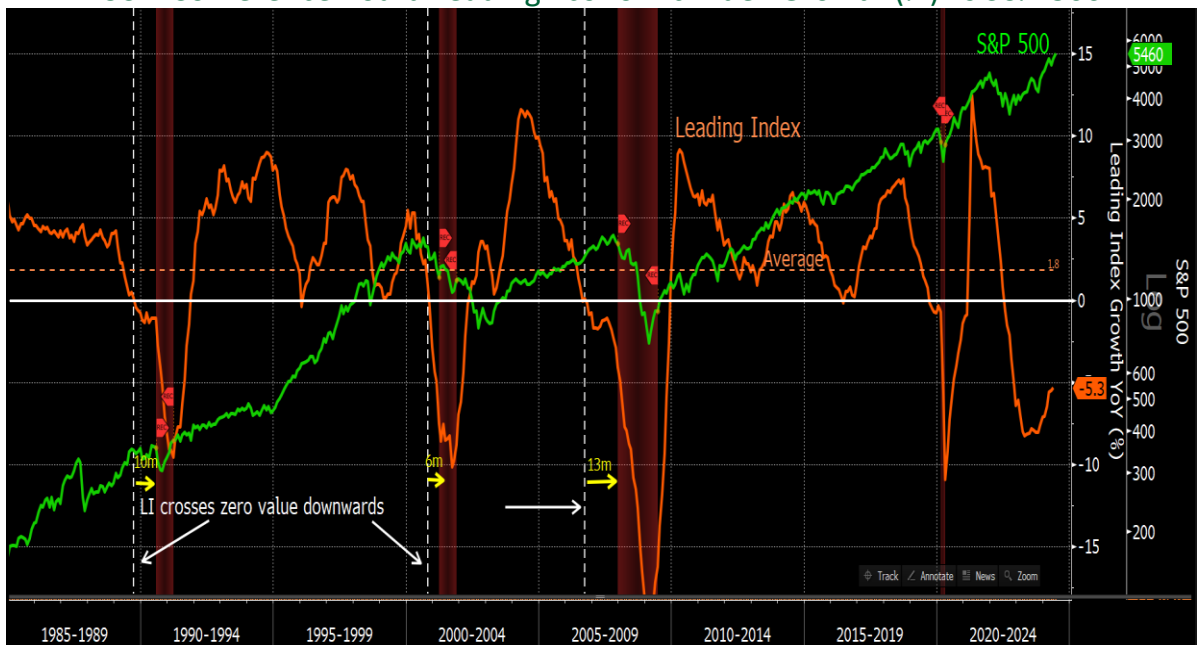
US Households – Debt / Income Ratio and Debt Service Ratio



The Debt / Income Ratio (the orange line in the above chart) is at its long-term average level, while the Debt / Service ratio is at a record low level (excluding the Pandemic period), despite the current high interest rate levels. Barring the Pandemic era, we have not previously experienced a US recession with such a low ratio.

As indicated in the lower part of the above chart, the growth in household debt has been dropping, and is currently at a mere +2.7%. With an outlook for lower interest rates, the Debt Service Ratio may remain low for some time.

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



The above Leading Economic Index is in negative territory but is turning for the better. This level and its trend have historically been associated with the end of a recession and rising share prices.

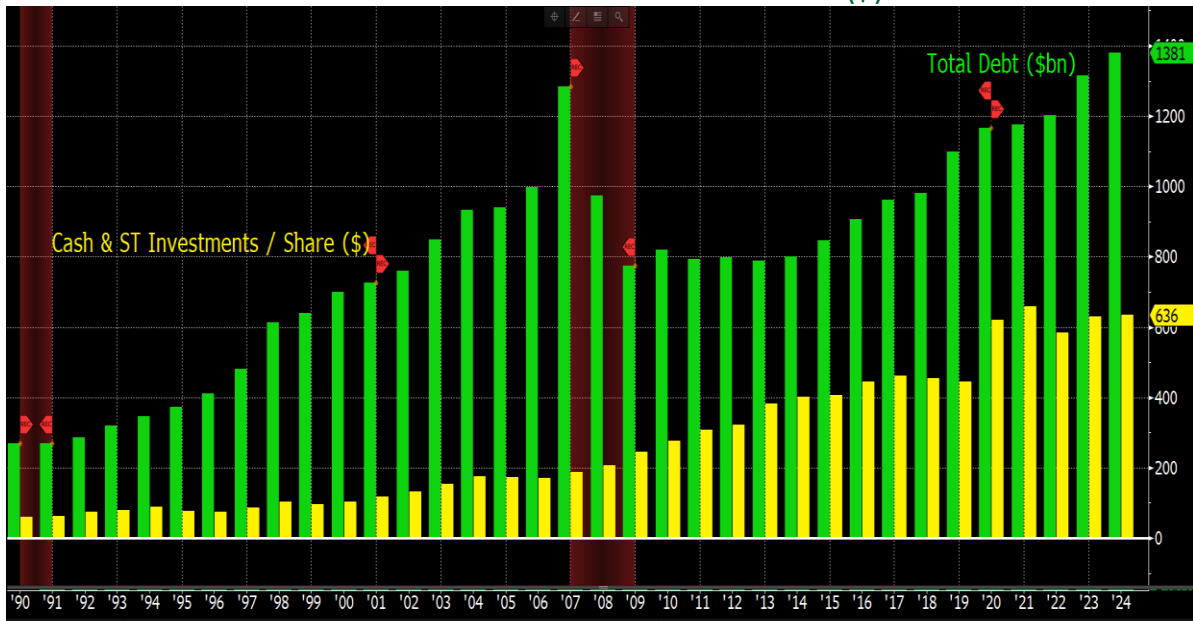
On balance, because of households' strong financial positions, the risk of an imminent deep US recession following the weakening employment data currently seems lower than before. The economy may, though, be more finely balanced than some of the views of overly optimistic investors. We are budgeting for a dull economy and are avoiding overly cyclical exposures.



2. BUSINESS QUALITY

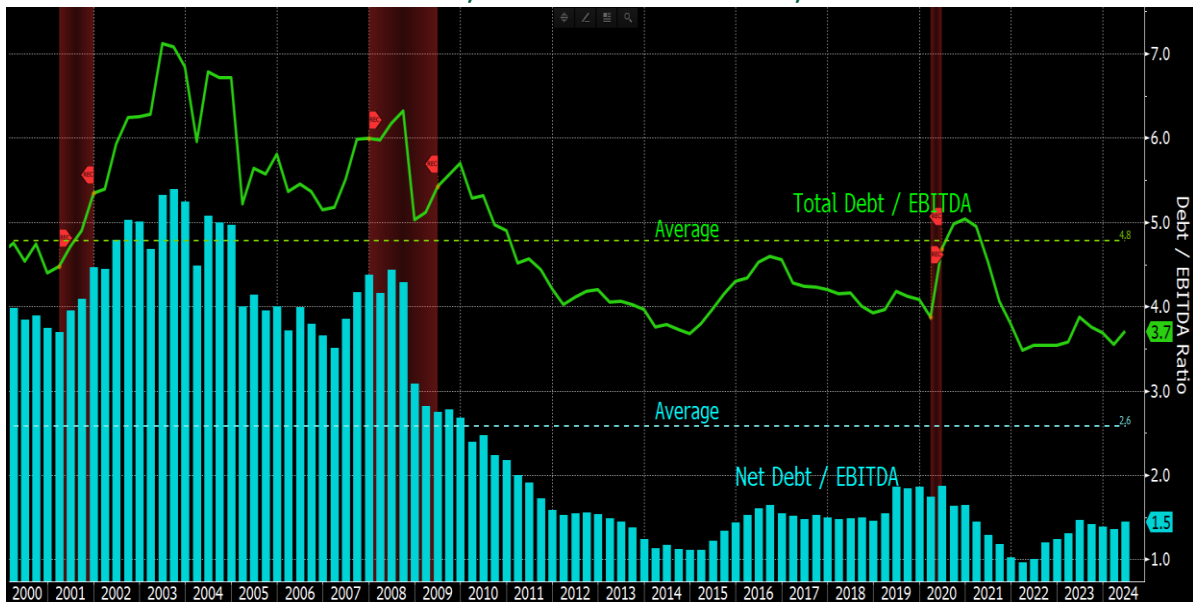
With strong US household balance sheets, we are also interested in the state of listed companies' in this context.

S&P 500 Total Debt vs Cash Positions (\$)



The S&P 500 Total Debt has been steadily increasing in absolute terms (the green bars) but is currently barely higher than what it was immediately prior to the 2008 Financial Crisis, while Cash has also increased. On this basis, the quality of these businesses has increased over time.

S&P 500 Total Debt / EBITDA and Net Debt / EBITDA Ratios



The Total debt / EBITDA ratio (the green line) is currently close to a record low, with a similar picture for the Net Debt / EBITDA Ratio (the blue bars). On this basis, the quality of US corporates has increased materially over time.

The S&P 500 Return on Equity is in a long-term rising trend, and is currently at almost 18%. Furthermore, during the Pandemic, investors learned how resilient and competitive their businesses were, with many thriving following that very testing time. From all this information, a solid case can be made that current valuation multiples for many quality businesses should be higher than their historic averages.



3. VALUATIONS

Expanding on our preceding comment, this is the picture of the S&P 500 valuation:

S&P 500 – Historic and Forward P/E Ratio



Both the historic and forward P/E ratios currently seem elevated - respectively 33% and 16% above their averages since 2000. The latter, of course, is more relevant, and along with the important higher-quality point from the preceding paragraph, it is also important to stress that the index today is more skewed towards the high-quality large capitalization businesses in the booming technology sector. We again make the point of considering each business's valuation multiple on its own merits but, as an overall statement, we are not overly concerned about the 16% premium to average current valuation.

Price/Earnings Growth (PEG) Ratios

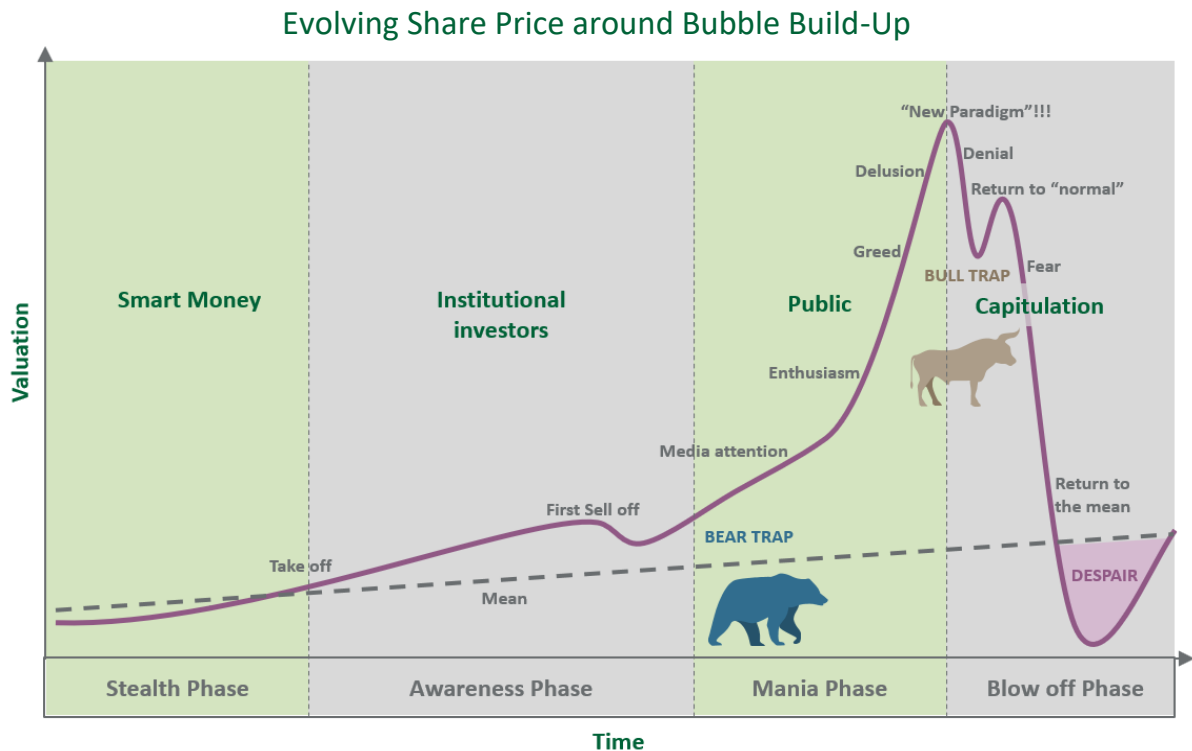
Holding	PE Ratio	3 year expected EPS Growth p.a.	PEG Ratio
Accenture Plc A	23.9	9.1%	2.6
Adobe Systems Inc	40.3	13.3%	3.0
Alphabet Inc C	27.4	14.5%	1.9
Amazon Com Inc	50.3	20.7%	2.4
ASML Holding NV	46.6	22.5%	2.1
Cadence Design Systems Inc	64.0	17.9%	3.6
Microsoft Corp	38.8	14.3%	2.7
Average	40.5	16.3%	2.6
Index	PE Ratio	3 year expected EPS Growth p.a.	PEG Ratio
MSCI World Index	20.3	7.7%	2.6
S&P 500 Index	24.0	9.6%	2.5
MSCI World ex US Index	14.6	4.9%	3.0
MSCI Emerging Markets Index	15.0	14.2%	1.1

We list in green several high-quality growth businesses. Their overall P/E Ratio of 40.5 seems high, but the compounded 16.3% p.a. expected earnings growth puts them on a 2.6 PEG ratio. This valuation is in-line with the World and S&P 500 indices, and lower than the World ex-US index. We are more comfortable holding these businesses at these valuations than the major indices with much lower growth outlooks (shown in purple above).



4. EQUITY BUBBLES

The following table succinctly depicts the stages of stock market bubbles:



Source: Dr Jean-Paul Rodrigue, Dept. of Global Studies & Geography, Hofstra University

It is worth studying the information in the chart to understand how a bubble evolves. The different phases broadly attract different type of investors (or speculators).

Cisco – Share Price and Forward Earnings (Indexed to 100 in 1992)



Cisco is a classic example of a share that got carried along within the internet bubble of 2000. Whilst it enjoyed earnings support, investor sentiment got carried away, and its earnings growth was not sustainable. Despite good earnings recovery since the collapse in 2001, the share price has not yet recovered to its 2000 peak. Since 1992 (in its Stealth Phase), it has nevertheless delivered a solid +16% p.a. return to date.

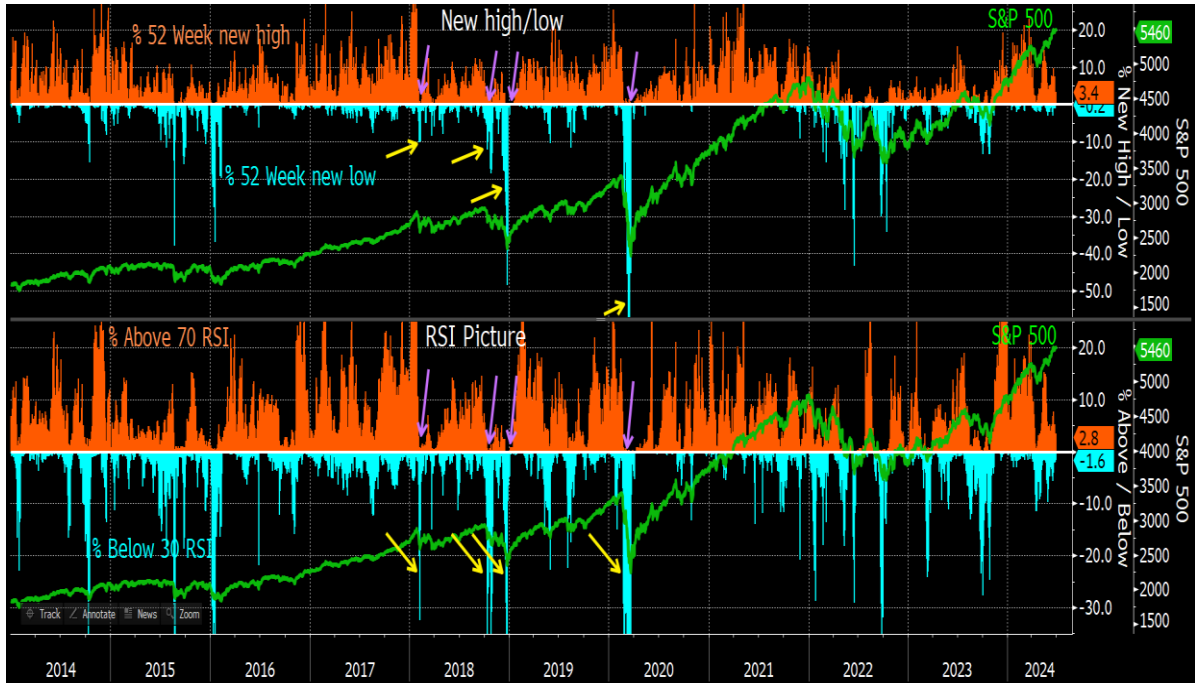
In terms of current market conditions, we do not believe the stock market is in a bubble. Apart from sound overall fundamental conditions, the lack of IPO's and mergers and a generally sceptic retail market indicate that we can continue to utilize good investment opportunities.



5. TECHNICAL PICTURE

The S&P 500 is technically strong – it is trading at record levels, both its 50-day and 200-day moving averages are in rising trends, and it is well above its Fibonacci ratio. The question may rather be whether it is technically overbought.

S&P 500 vs % of Constituents at New Highs/Lows and % above 70/ below 30 RSI Levels



Surprisingly, only 3% of S&P 500 constituents currently trade at new highs, and only 3% of the members trade above its 70 RSI (Relative Strength Index) levels. This does not indicate a technically overbought market.

Gerrit Smit

Partner - Head of Global Equity Management
Stonehage Fleming Investment Management Limited
6 St James's Square
London
SW1Y 4JU

T +44 20 7087 0000
Email gerrit.smit@stonehagefleming.com
www.stonehagefleming.com/gbi



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