

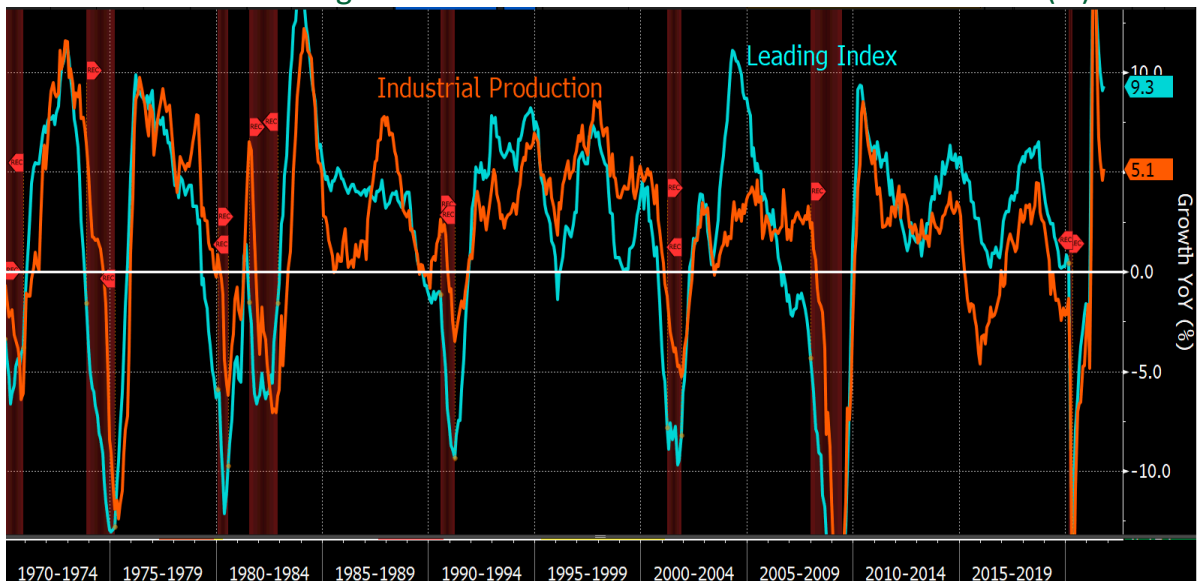
"The noblest pleasure is the joy of understanding."

Leonardo da Vinci

1. US 2022 OUTLOOK

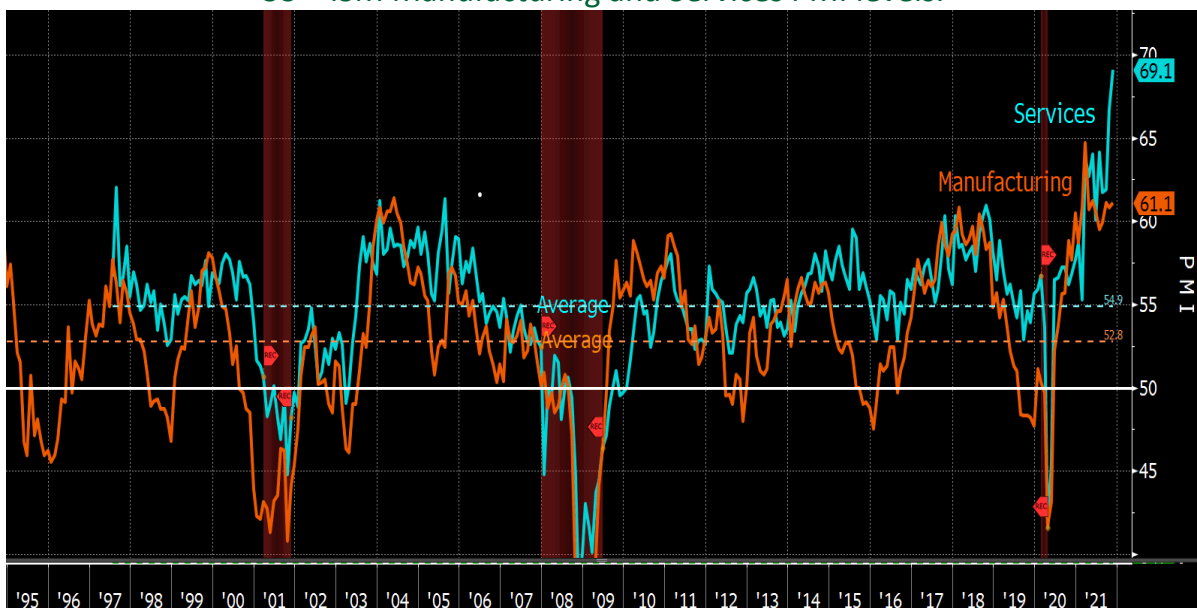
The following two charts are a good combination to form an impression of the economic outlook for next year:

US – ISM Leading Economic Index vs Industrial Production Growth (%)



Both indices in the above chart are currently growing at elevated levels. The absolute value of the Leading Economic Index is at a record level, with Industrial Production in excess of the absolute value immediately preceding the Pandemic. These are positive indications for the economic outlook.

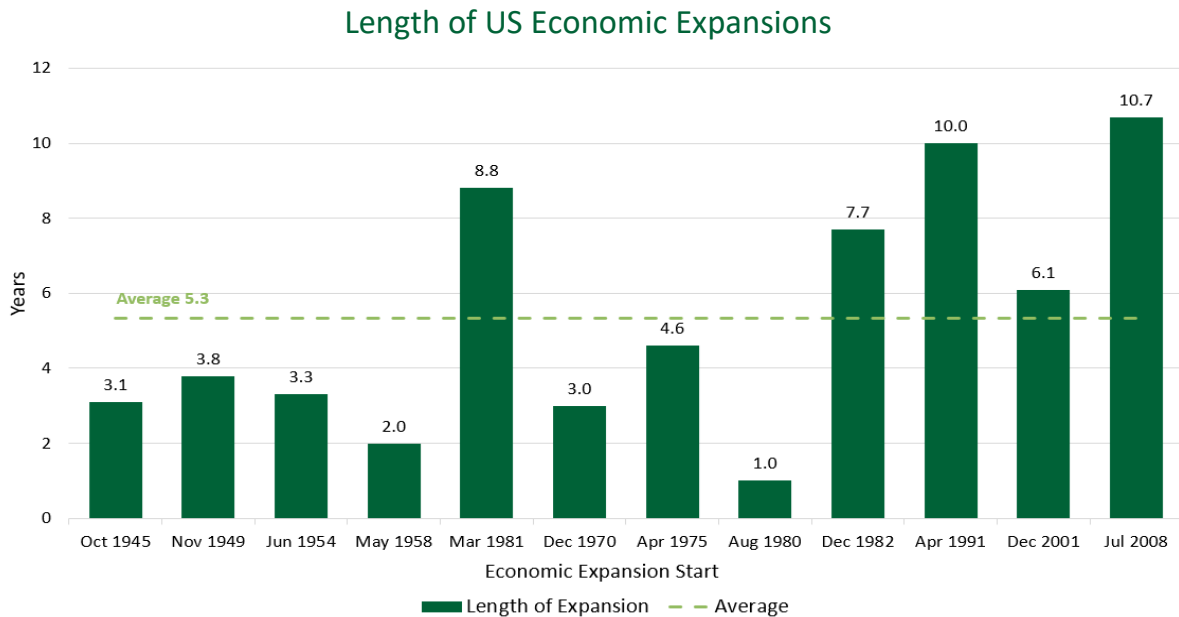
US – ISM Manufacturing and Services PMI levels.



The Manufacturing PMI is currently at a pre-Pandemic record level, with the Services PMI at an all-time record level. This leaves little doubt about continued US economic expansion.

2. STAGE OF EXPANSION

The Pandemic US recession was the shortest on record – two months against an 80-year average of 10.2 months, and the previous shortest of six months in 1980. With the current economic expansionary phase already 19 months old, the question is where are we currently in a typical expansionary cycle.



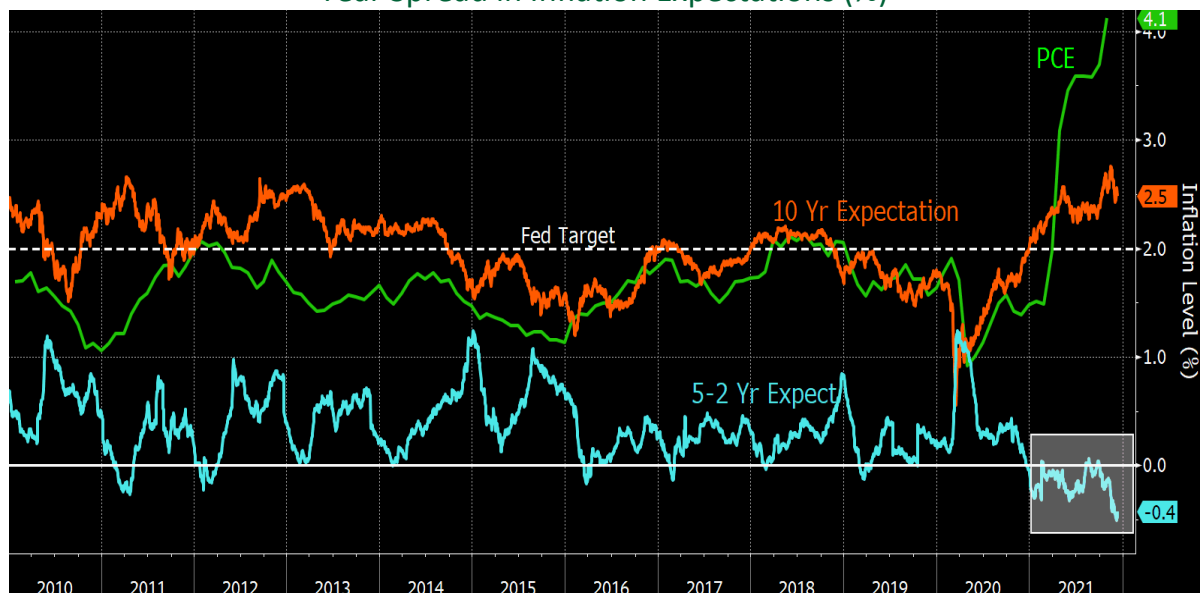
Source: LPL Research. National Bureau of Economic Research. 19 July 2021.

The average length of US economic expansion periods since 1945 is over five years. It has been consistently higher over the past twenty years following the oil shock and excessive inflation era during the seventies and early eighties. On this basis, and with a lack of conflicting information, we believe we may still be in the first half of the current economic cycle and can continue to consider new investment opportunities.

3. INFLATION THREATS

Investor fears for inflation staying structurally at uncomfortably high levels are of the major current concerns. The following charts provide some perspective of market data in this context:

Personal Consumption Expenditure (PCE) vs 10 Year Inflation Expectation and 5-2 Year Spread in Inflation Expectations (%)

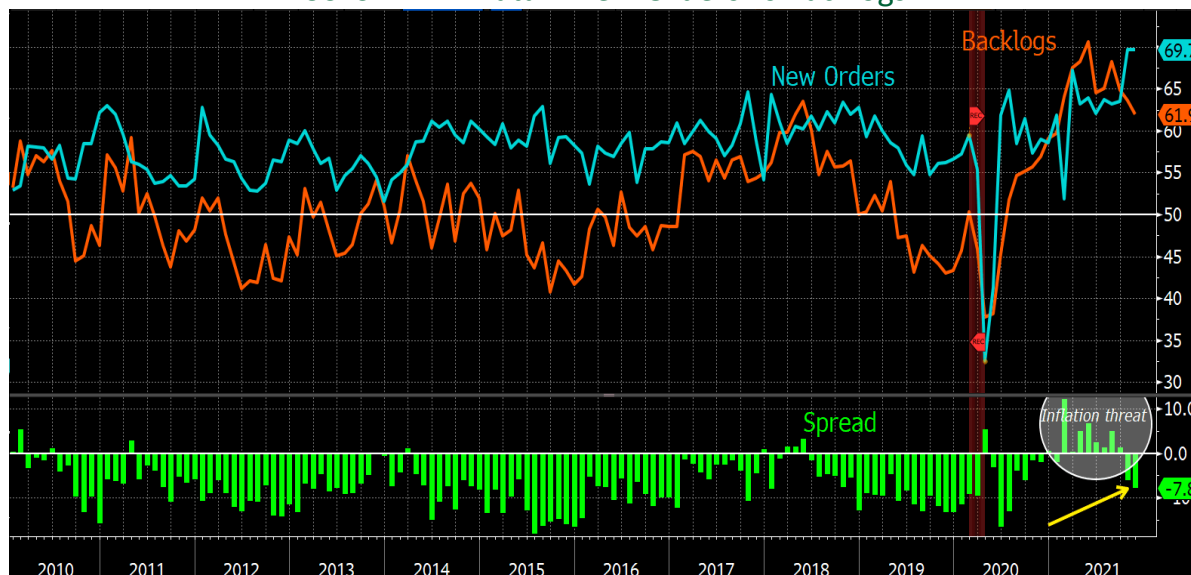


Source: Bloomberg & Stonehage Fleming Investment Management Limited. December 2021. **Past 2 performance is not a guide to future performance.**



Inflation expectations have followed the rising inflation levels during the Pandemic. Whilst inflation levels (PCE in the preceding chart) have risen sharply this year (mainly because of major supply chain constraints), the inflation expectations (currently 2.5%) have not followed through and are currently at the relatively normal levels we've seen in earlier years following the Financial Crisis. Along with this, considering shorter term expectations, the spread between the five- and two-year expectations has stayed in negative territory this year (the shaded area in the chart). This implies expectations of only a temporary period of high inflation.

US ISM PMI Data – New Orders vs Backlogs



The above PMI chart provides valuable information of factory experiences. It shows the data for New Orders and Backlogs since the Financial Crisis (the top section of the chart). The spread between the two series (the green bars in the lower section) has been predominantly in negative territory right through, but turned to positive values for most of this year (the highlighted area). This clearly indicated threats for increasing inflation – which did occur, as we are very aware. The most recent two readings have, though, turned negative. This may indicate lowering pressures on inflation levels.

4. GROWTH INVESTING

We invest for strong structural organic growth, rather than trying to utilise short-term potential mispricing opportunities in the stock market. The following two charts are of value in this context:

Relative S&P Value/Growth Index vs Real Ten-Year Yield (%)



Source: Bloomberg & Stonehage Fleming Investment Management Limited. Decemrerr 2021. **Past performance is not a guide to future performance.**



The preceding chart indicates that Growth generally outperforms under circumstances of lower real interest rates. These rates are currently in negative territory (we apply inflation expectations in the comparison instead of nominal inflation levels). We do not expect real rates to turn strongly upwards into positive territory anytime soon and expect a continuing structural outlook of ‘yearning for growth’ as we’ve seen since the Financial Crisis.

S&P 500 – Average Excess Growth vs Value Return Over Each Economic Cycle (%)



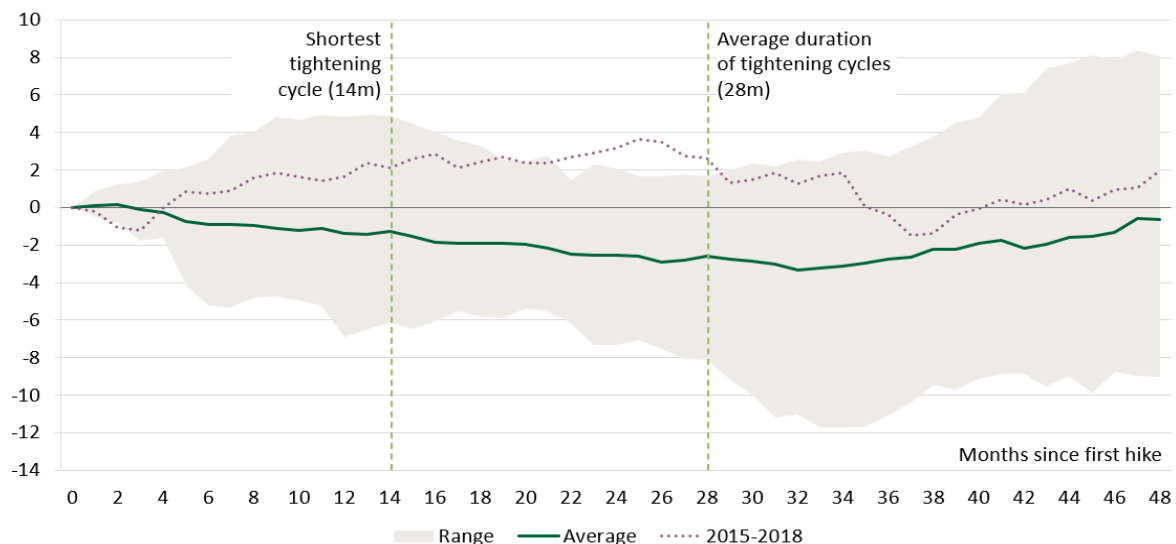
Data since 1950. Source: [TS Lombard](#); Stonehage Fleming Investment Management. October 2021.

Growth has outperformed on average 2.1% p.a. over the individual economic cycles since 1950. The worst relative delivery from Growth happened during Recovery phases (bar to the far right), the phase we have just completed in the current cycle. We are currently probably in the Expansionary phase when Growth’s relative performance has historically improved. It is also striking that Growth’s outperformance has increased further as the economic cycles matured.

5. RISING RATES

Many investors fear rising interest rates because of the threat of rising discount rates they apply in their valuations.

S&P 500 – P/E Changes During Previous 9 Tightening Cycles

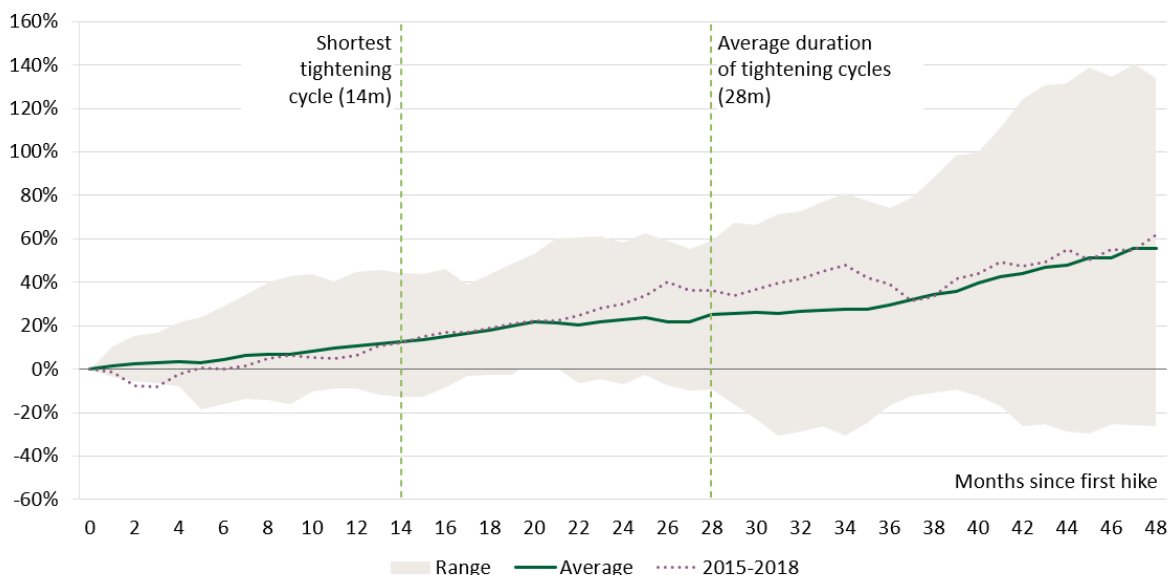


Source: [TS Lombard](#), Stonehage Fleming Investment Management. October 2021. P/E = Price to Earnings Ratio.



The preceding chart reflects the P/E valuation changes during previous tightening cycles, with the averages in the green line and the ranges in the shaded areas. On average, deratings did occur over the tightening cycles, with a -4-derating level as the worst level after two-and-a-half years. The worst absolute derating was a -12-derating level. Interestingly, there were also re-ratings, with the best level at +8-derating level after four years. We may face a derating process again with the tightening cycle lying ahead.

S&P 500 – Cumulative Return During Previous 10 Tightening Cycles



Past performance is not a guide of future returns. If the information is not displayed in your base currency, then the return may increase or decrease due to currency fluctuations. Please remember investment involves risk. The value of investments and the income from them can fall as well as rise and investors may not receive back the original amount invested.

Source: TS Lombard, Stonehage Fleming Investment Management. November 2021.

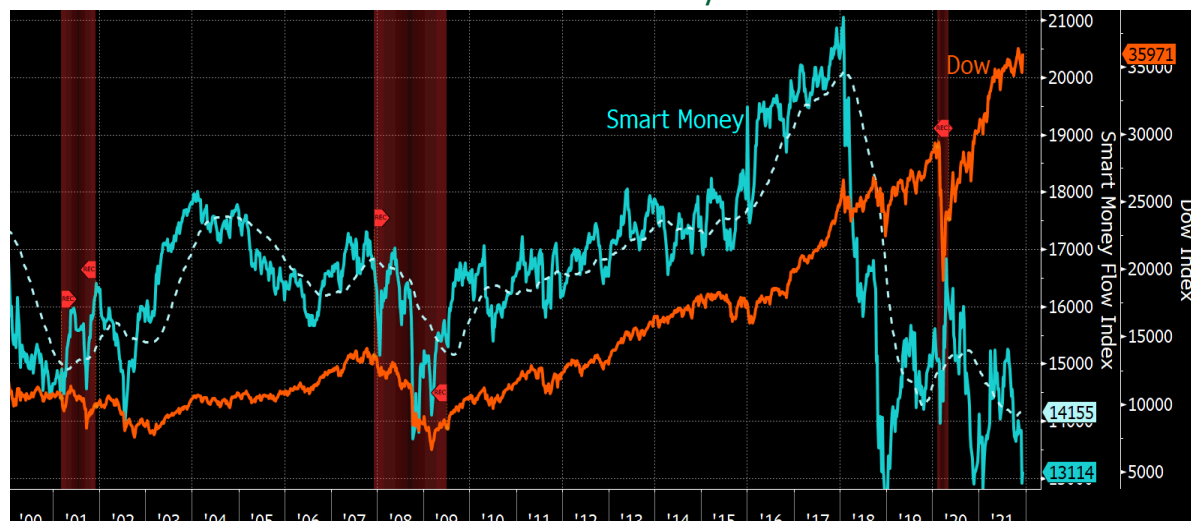
The above chart reflects the cumulative returns over the previous tightening cycles. Despite the valuation deratings in the previous chart, the cumulative returns have largely been positive, to the order of +40% on average after four years of tightening. The worst nominal return has been -20% at that stage, and the best +120%.

The positive economic backdrop underpinning these tightening cycles clearly generated growing company earnings that could generally more than compensate for the lower valuations.

6. TECHNICAL PICTURE

The following three charts provide a good overall summary of the technical picture close to year end:

Dow Index vs Smart Money Flow Index

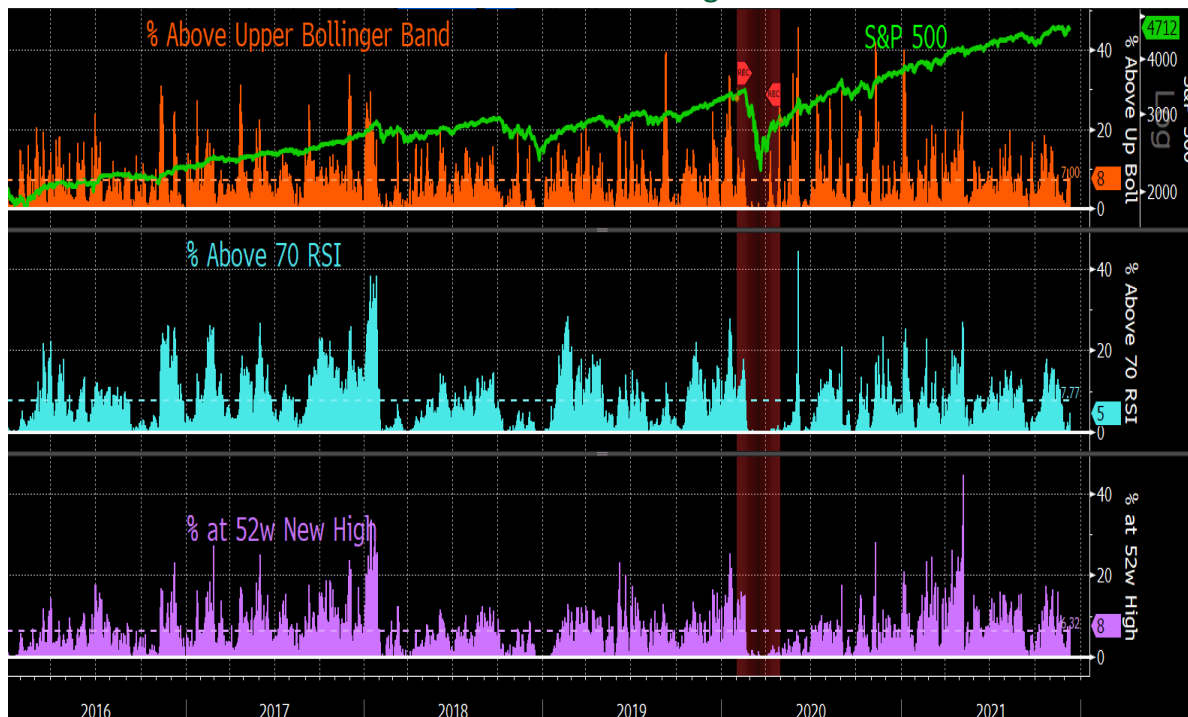


Source: Bloomberg & Stonehage Fleming Investment Management Limited. December 2021. **Past performance is not a guide to future performance.**



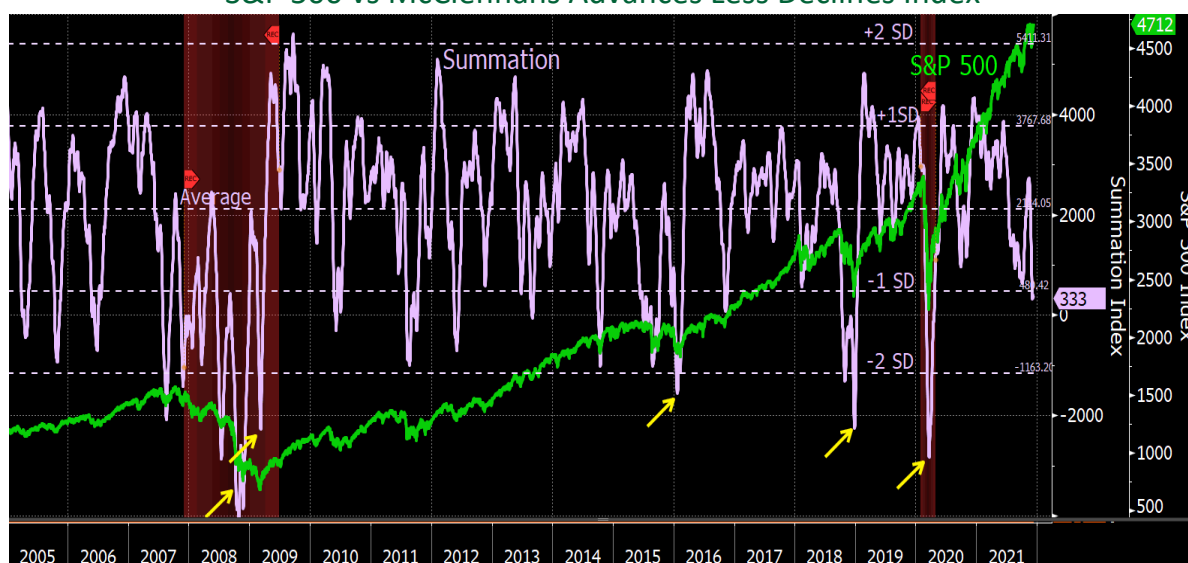
The Smart Money Index reflects trading activity very early and at close of every trading day. It summarises the greed and fear of traders well. The current reading is close to the record low, reflecting a high level of fear. Such low levels have historically indicated good buying opportunities with traders seemingly on the side-lines.

S&P 500 vs % of Constituents above Upper Bollinger Band, above 70 RSI Level, at New 52 Week High



The percentage (8%) of S&P constituents currently above their respective upper Bollinger Bands are close to the long-term average. The same can be said for the percentage (8%) of the constituents above their respective annual record price levels. The percentage (5%) above their respective 70 Relative Strength Indices is below average. These indicators reflect technically a neutral (healthy) stock market, not an overbought one.

S&P 500 vs McClellans Advances Less Declines Index



The above summation index is currently one standard deviation below average. This also reflects a rather healthy stock market that is somewhat more oversold than overbought.

Barring negative news flow into year-end, technical indicators currently seem constructive.

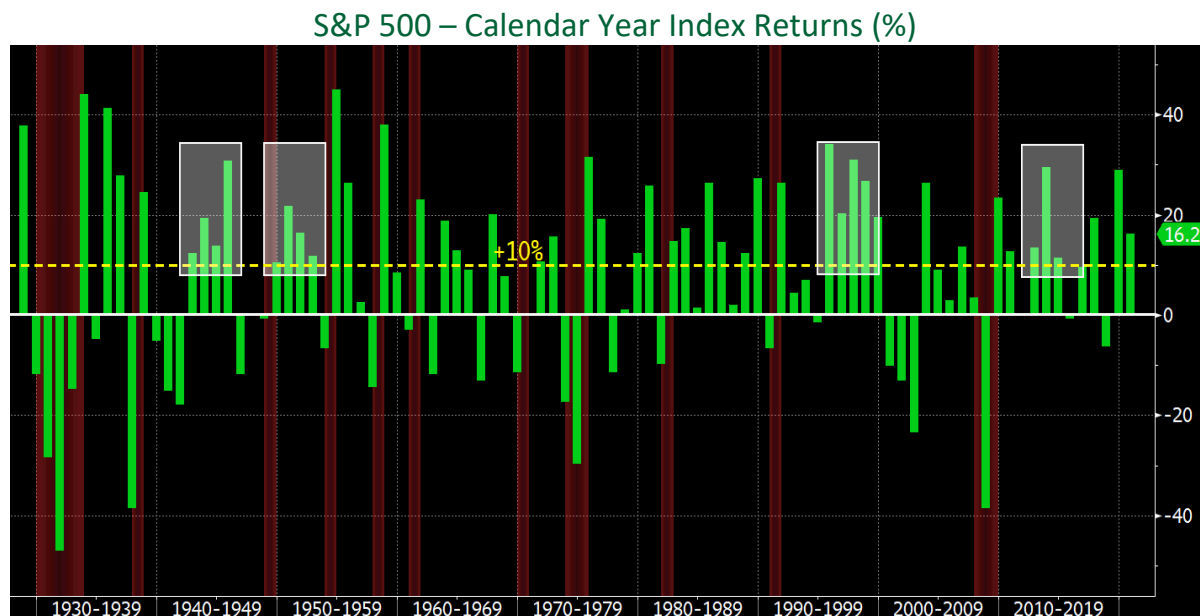
Source: Bloomberg & Stonehage Fleming Investment Management Limited. December 2021. **Past performance is not a guide to future performance.**



7. DOUBLE DIGIT PERFORMANCE

The S&P 500 index is +26% for the year thus far. Barring an imminent collapse, it seems to be on course for a third year in a row of double-digit appreciation.

We have analysed the S&P 500 index returns over calendar years since 1927. The chart below reflects the results:



There have been only four occasions of double digit returns over three consecutive years (highlighted in the chart). Three of those occasions (75%) delivered positive returns in the following (fourth) year. All those fourth years delivered double digit returns, with an average of +17%. The median return overall all four events was +19%. The fourth event delivered a return of -1% only.

On this basis, it seems that the high returns over the past three successive years is not necessarily a threat to 2022.

Our sincere gratitude to our clients for another year of support and friendship through another eventful year. We wish you and yours all the very best for the Festive Season and the New Year.

Gerrit Smit
Partner - Head of Equity Management
Stonehage Fleming Investment Management Limited
15 Suffolk Street
London
SW1Y 4HG

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



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Stonehage Fleming Investment Management Limited
15 Suffolk Street
London
SW1Y 4HG

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