

"I am always doing what I cannot do yet, in order to learn how to do it."

Vincent Van Gogh

1. WHAT WE GET

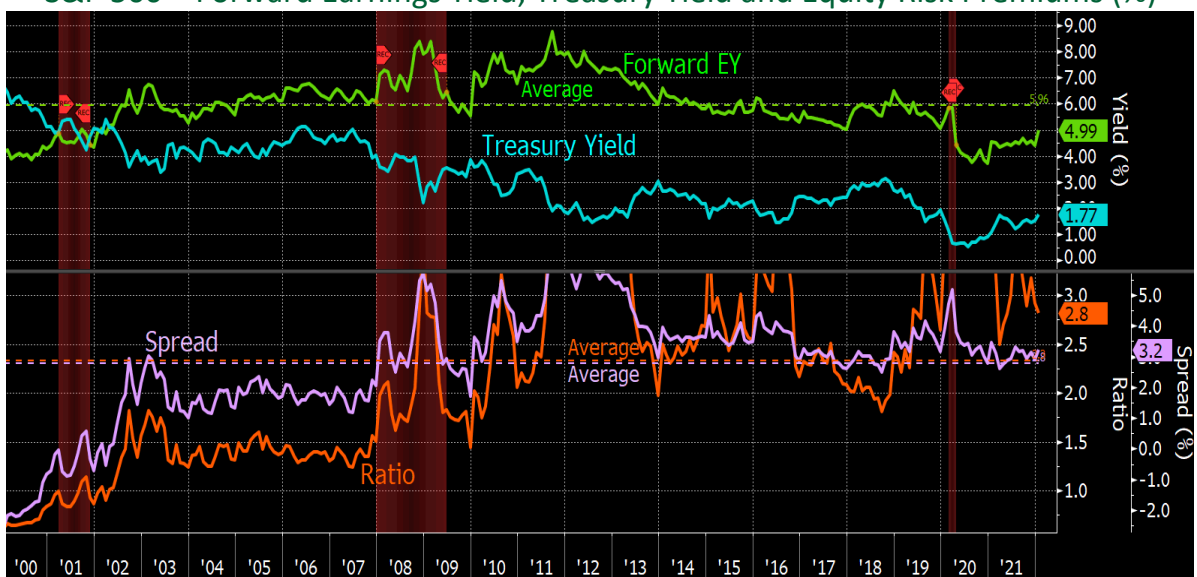
With the volatile stock market start in the new year, it is worth considering the fundamental backdrop:

S&P 500 – Capacity Utilisation vs Operating Margin (%)



As can be expected a year and a half following the recession, capacity utilization is well in process of recovering, but is still below average. Supply chain bottlenecks clearly are a restraint, but can be expected to continue easing. Against this, operating margins have taken another step up, and are currently at a record level. The combination of these two issues bodes well for equity investing.

S&P 500 – Forward Earnings Yield, Treasury Yield and Equity Risk Premiums (%)



With the forward earnings yield at 5.0%, both Equity Risk Premiums (the spread and the ratio) with the Treasury Yield are on their respective averages (the bottom section of the chart), despite rising rates. Seeing the fundamental support touched on above, and not expecting an imminent recession, we perceive the US stock market as fundamentally healthier than what January's volatility implies.

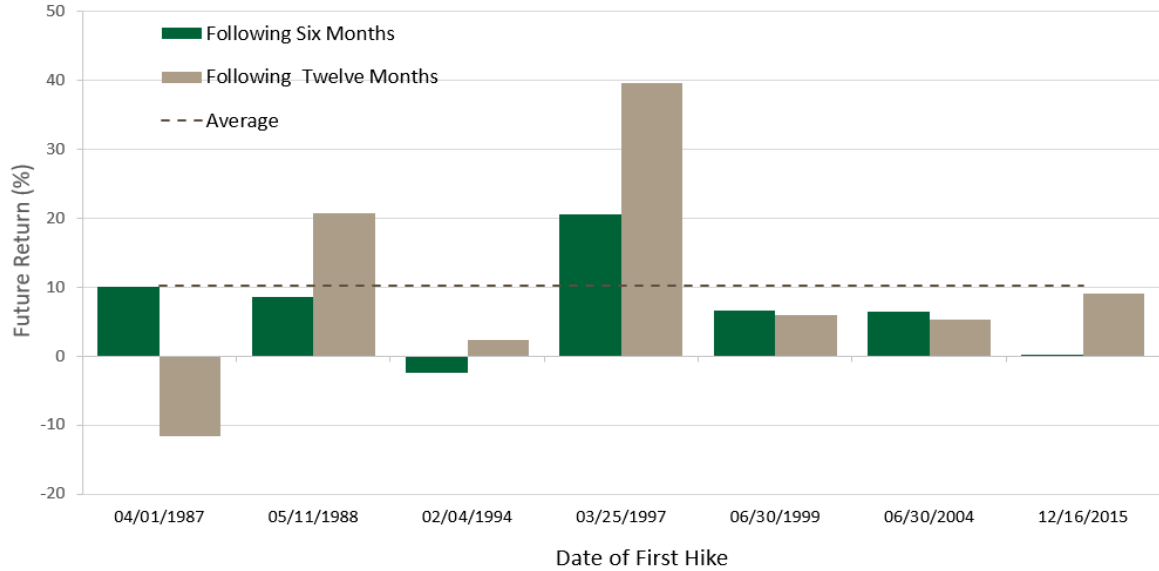
Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2022. **Past performance is not a guide to future performance.**

2. RISING RATES

We have further information on historic stock market behavior following new Federal Reserve tightening cycles:

S&P 500 - Performance Following First Fed Rate Hike

Over last seven hiking cycles

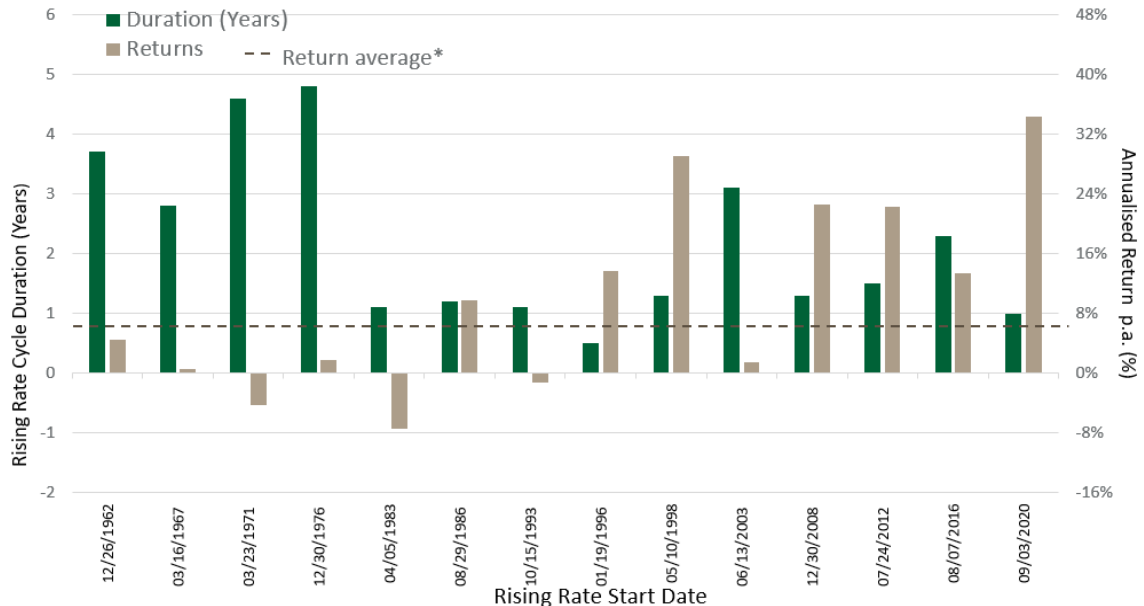


Source: LPL Research, Stonehage Fleming. FactSet 03/03/21

The chart depicts the S&P 500 performance over the following six (green bars) and twelve months (brown bars). The results have predominantly been positive, with an overall +10% average performance over twelve months.

S&P 500 – Annualised Performance Over Rising Rate Cycles

Reference : 10-year Government Bonds



Source: LPL Research, Stonehage Fleming. FactSet 03/03/21

* Calculated from nominal average and duration

The above chart reflects the duration of historic rising rate cycles (left axis) and the annualised performance over each tightening cycle (right axis) since 1962. The performance has predominantly been positive over the respective cycles, with an average annualised performance of almost +8% (the horizontal line).

Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2022. **Past performance is not a guide to future performance.**



3. TECHNOLOGY CORRECTION

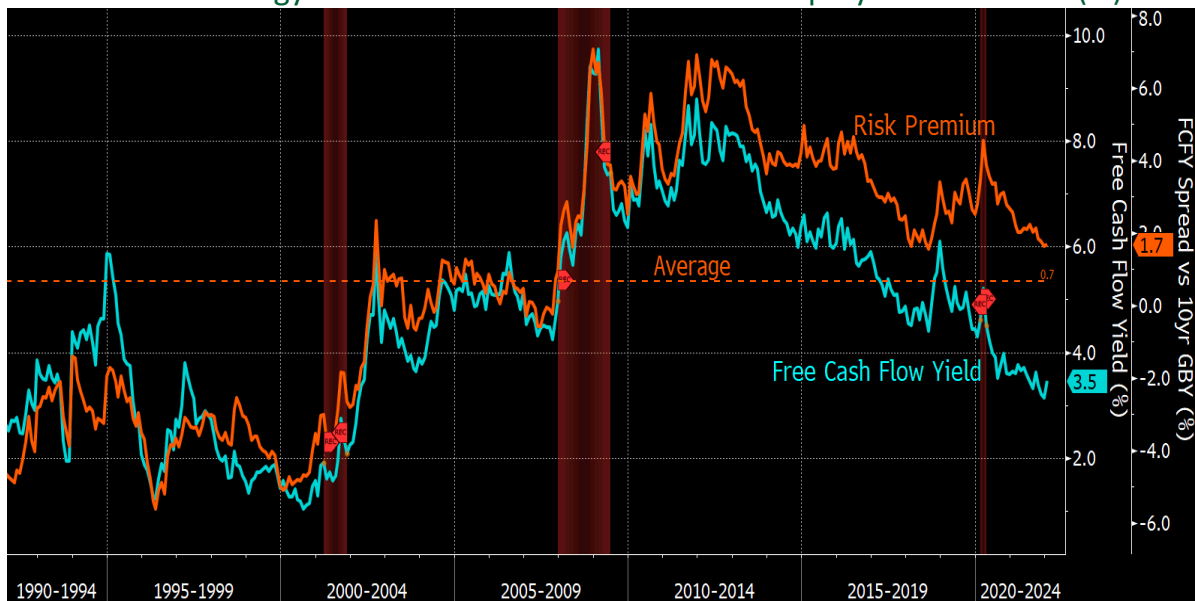
The sharp correction of predominantly Technology shares during the month is uppermost in many investors' minds.

Nasdaq Composite Index vs Maximum Drawdown (%)



The Nasdaq Index corrected quickly, dropping by over -18% since its recent peak level, getting close to the -20% territory. This has been a frightening experience for many. That said, we have seen numerous (about 15) corrections of -10% since the Financial Crisis. Barring the Pandemic Crisis, there have been four correction of the same (or worse) order than the current one since the Financial Crisis. We are therefore not overly surprised about the level of the current correction. For interests' sake, the Pandemic Crisis drawdown recovery took less than six weeks, and delivered a return of +49%.

S&P Technology Index – Free Cash Flow Yield and Equity Risk Premium (%)



The Free Cash Flow Yield for the Technology Index is currently 3.5%. It seems expensive on an absolute basis, but in terms of a Cash Flow Risk Premium (the orange line in the chart), it is still above average and seems to offer value. With good expected growth, we believe it can probably absorb further interest rate rises.

The chart on the following page shows that a mere 16% of the Nasdaq members still trade above their 50-day moving averages. That level is below two standard deviations from average, and historically has indicated good buying opportunities. We expect astute investors to selectively consider utilising the current Technology sell-off.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2022. **Past performance is not a guide to future performance.**



Nasdaq Index vs % of Members Trading Above 50-Day Moving Average



4. THREATS OF WAR

The Russian military buildup close to the Ukrainian border causes high fears of a potential military invasion. We believe this contributes to the current stock market volatility, as has happened with previous invasions.

S&P 500 & MSCI World AC Index – Performance Around Iraq Invasion



Whilst in the aftermath of the Technology Bubble's burst in 2000, stock markets were weak in the build up to the invasion of Iraq on 20 March 2002. It seems prior to that, markets were ready to recover from the bear market, but were then confronted by the geopolitical issues in Iraq. It is striking that the market did not take much notice of the physical invasion, and experienced a strong recovery afterwards.

We present on the following page a further study of stock market performance in the twelve months following various historical geopolitical events. We present the drawdowns and the subsequent 12-month performances. Whilst each event clearly has its unique circumstances, it is interesting how mild the stock markets reacted on average. The median maximum drawdown was a mere -3%, and the median performance the following 12 months was +10%. The current threat of sanctions on Russia clearly can have wider economic implications.

Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2022. **Past performance is not a guide to future performance.**



S&P 500 – Performance Since Geopolitical Events

| Event | Date | Max Drawdown | 12m Return |
|-------------------------------------|------------|--------------|--------------|
| Iranian General Killed in Airstrike | 03/01/2020 | -0.7% | 16.1% |
| Saudi Aramco Drone Strike | 14/09/2019 | -4.0% | 11.1% |
| North Korea Missile Crisis | 28/07/2017 | -1.5% | 14.0% |
| Bombing of Syria | 07/04/2017 | -1.2% | 10.6% |
| Boston Marathon Bombing | 15/04/2013 | -3.0% | 18.7% |
| London Subway Bombing | 05/07/2005 | 0.0% | 5.5% |
| Madrid Bombing | 11/03/2004 | -2.9% | 8.4% |
| Invasion of Iraq | 19/03/2003 | -3.1% | 27.0% |
| US Terrorist Attacks | 11/09/2001 | -11.6% | -16.8% |
| Iraq's Invasion of Kuwait | 02/08/1990 | -16.9% | 10.2% |
| Reagan Shooting | 30/03/1981 | -0.3% | -16.4% |
| Yom Kippur War | 06/10/1973 | -0.6% | -43.2% |
| Munich Olympics | 05/09/1972 | -4.3% | -5.9% |
| Tet Offensive | 30/01/1968 | -6.0% | 10.4% |
| Six-Day War | 05/06/1967 | -1.5% | 13.5% |
| Gulf of Tinkin Incident | 02/08/1964 | -2.2% | 2.7% |
| Kennedy Assassination | 22/11/1963 | -2.8% | 23.9% |
| Cuban Missile Crisis | 16/10/1962 | -6.6% | 27.8% |
| Suez Crisis | 29/10/1956 | -1.5% | -12.3% |
| Hungarian Uprising | 23/10/1956 | -0.8% | -11.7% |
| N Korea Invades S Korea | 25/06/1950 | -12.9% | 11.2% |
| Pearl Harbour | 07/12/1941 | -19.8% | -0.2% |
| | | Median -2.9% | Median 10.3% |

Source: LPL Research, Stonehage Fleming, Jan 2022

Apart from Russia, the other main geopolitical risk is around China and Taiwan. Particulars fears in this context do not currently reflect in Taiwan's stock exchange performance, but it can turn out very differently in a worst-case scenario.

5. RESULTS SEASON

Seeing the new stock market derating phase we have entered (because of the imminent Fed tightening cycle), company results are particularly important to see investors through. One third of the S&P 500 constituents, but only 15% of the European BE 500 constituents have already reported. It is relatively early for making conclusions, but their consolidated results are as follows:

| | S&P 500 3Q2021 Results (28 Jan 2022) | | | Bloomberg BE 500 3Q2021 Results (28 Jan 2022) | | |
|--------------------|--------------------------------------|-----------------|-----------------|-----------------------------------------------|-----------------|-----------------|
| | Growth | Surprise Factor | # +ve Surprises | Growth | Surprise Factor | # +ve Surprises |
| Sales | 16.1% | 1.8% | 87.5% | 14.8% | 2.0% | 86.3% |
| Earnings per Share | 29.9% | 1.2% | 83.2% | 84.5% | 2.4% | 70.7% |

Seeing the larger pool of US results and the generally low base for European companies, we consider the former of more significance. Investors have little to question in terms of operational performance of their businesses thus far, with top-line growth in strong double digits. The high investor surprise factors indicate that analysts' expectations were comfortably exceeded.

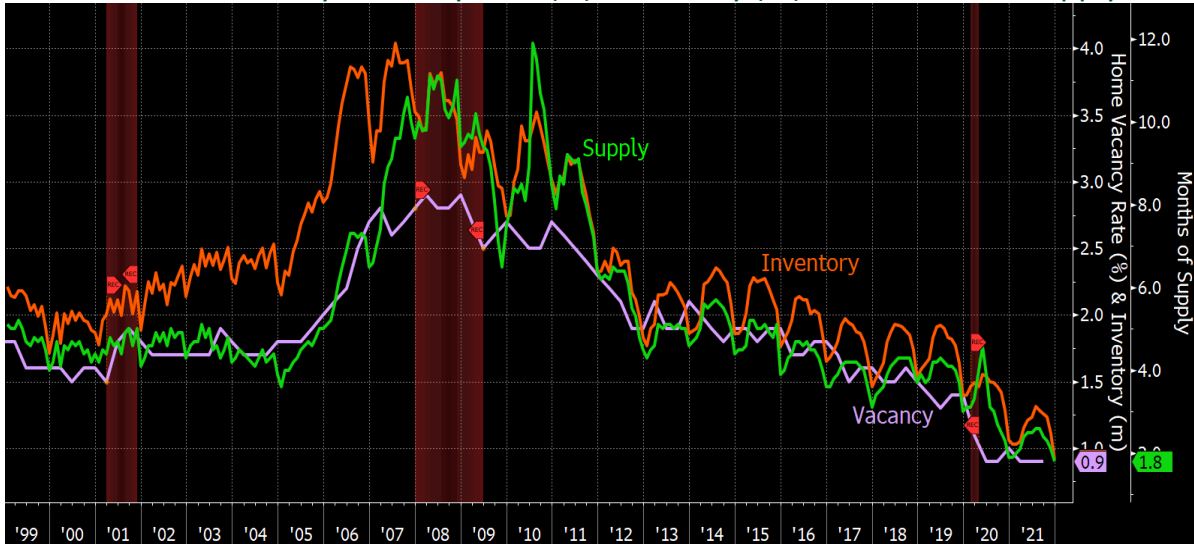
6. US BUILDERS

The US homebuilding sector is an important macro-economic barometer and its status is worth considering by investors. The following three charts provide valuable information to investors in this context:

Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2022. **Past performance is not a guide to future performance.**

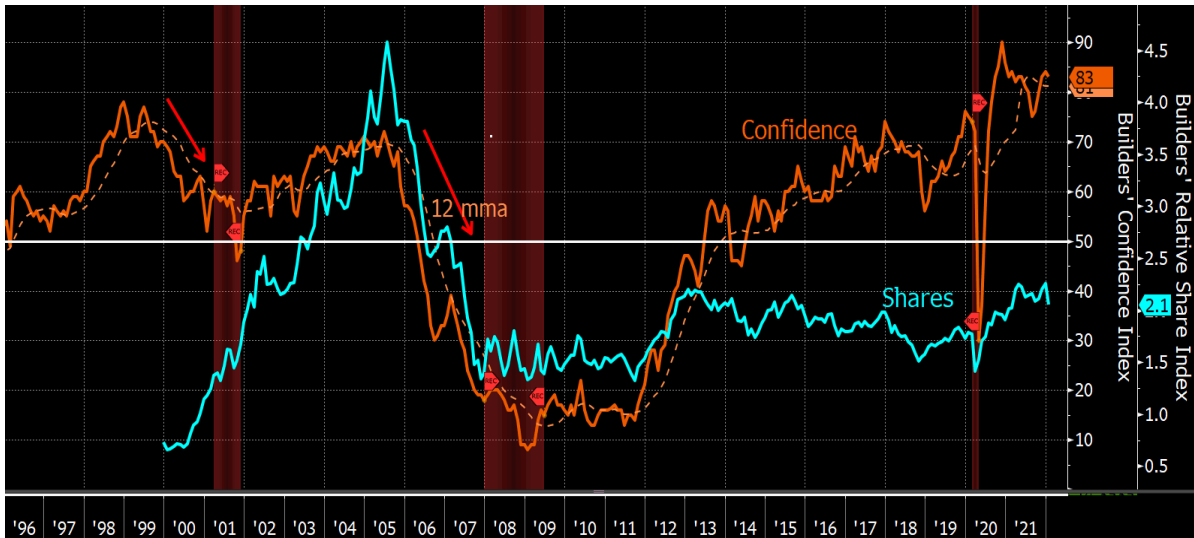


US Home Industry: Vacancy Rate (%), Inventory (m) and Months of Supply



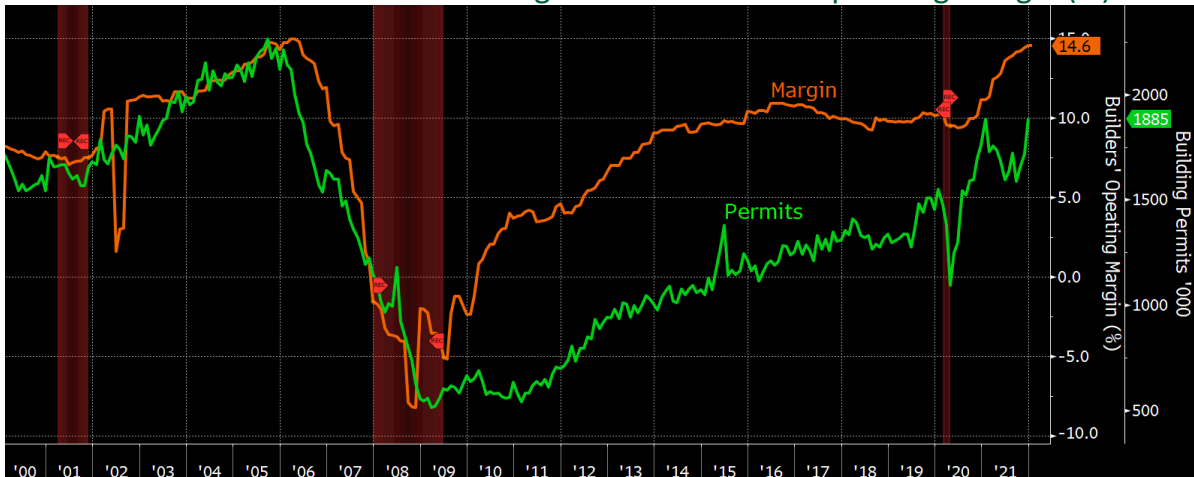
We are at a new chapter for the US home industry. All of Vacancy, Inventory and Months of Supply are currently at record low levels - totally the opposite to the situation preceding the Financial Crisis. There is rather a meaningful shortage in US homes.

US Homebuilders Confidence vs Relative Performance of Homebuilders' Shares



Homebuilders' confidence is currently at elevated levels - well above those levels during the best of times before the Financial Crisis. Strikingly, though, their shares have not followed though and delivered only a flat relative performance over the past ten years. This may be partly because of the case of too little building activity.

US Homebuilders – New Building Permits Issued vs Operating Margin (%)



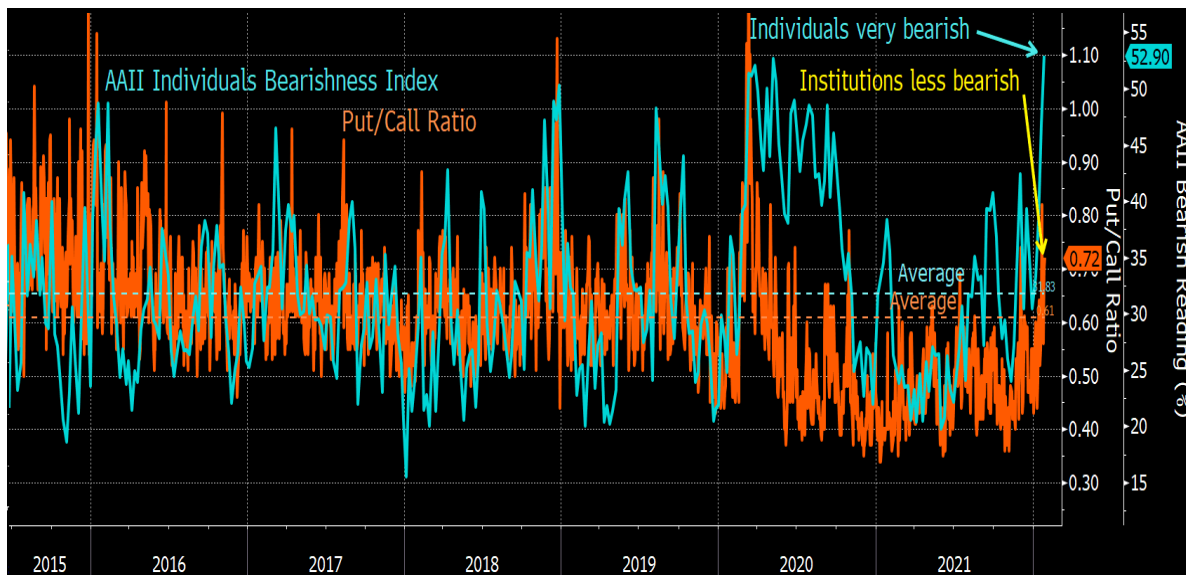
Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2022. **Past performance is not a guide to future performance.**



The issuing of building permits is picking up steam. With the large shortage of homes and prices currently increasing at 18% annually, we can expect a continued increase in permit issuances. Further to this, critically, operating margins have already been restored to the record levels that were obtained before the Financial Crisis. Clearly the sustainability of the margins is currently much better, and we will not be surprised to see profitability in this sector continuing to grow for some time.

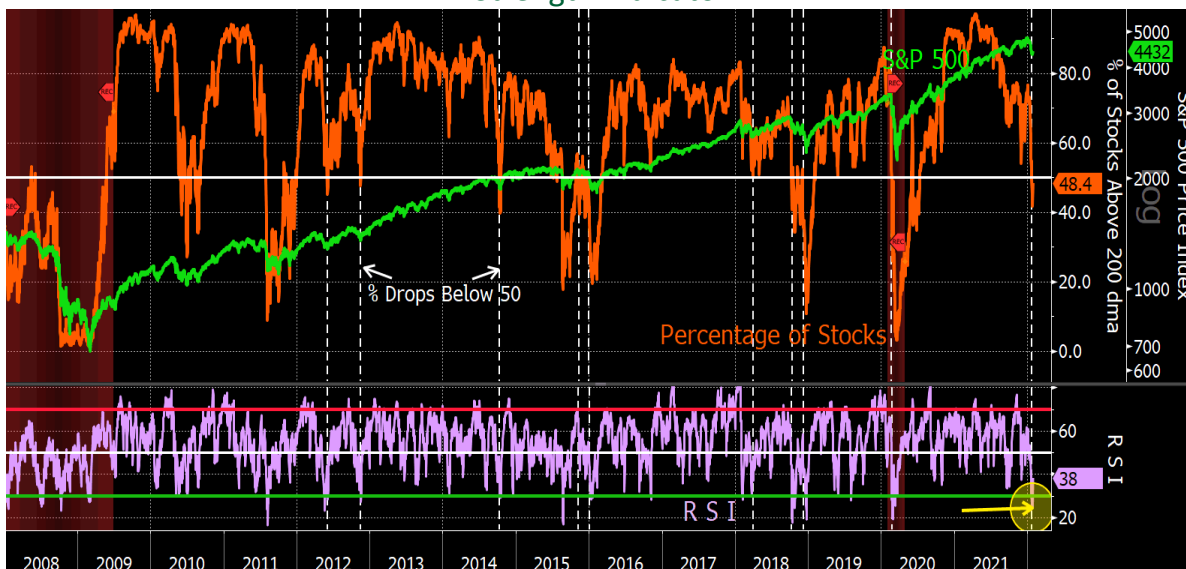
7. TECHNICAL PICTURE

US Investor Bearishness Levels



Considering the Put/Call ratio, institutions are somewhat bearish. Against this, individuals are currently as bearish as they have been at any stage during the Pandemic Crisis. We would not be surprised if many have recently exited the market, putting selling pressure on many share prices.

S&P 500 – Percentage of Stocks Above Their 200-day Moving Average vs RSI Relative Strength Indicator



Both the technical indicators in the above chart reflect technical overreaction levels currently.

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

Source: Bloomberg & Stonehage Fleming Investment Management Limited. January 2022. **Past performance is not a guide to future performance.**



RISK DISCLOSURE

This communication has been prepared for information only and is not intended for onward distribution. It is neither an offer to sell, nor a solicitation to buy, any investments or services. This communication does not constitute a personal recommendation and does not take into account the individual financial circumstances, needs or objectives of the recipients.

Any information which could be construed as investment research has not been prepared in accordance with legal requirements designed to promote the independence of investment research. Further it is not subject to any prohibition on dealing ahead of the dissemination of investment research

All investments risk the loss of capital.

The value of investments may go down as well as up and, you may not receive back the full value of your initial investment.

Past performance should not be used as a guide to future performance.

Changes in the rates of exchange between currencies may cause the value of investments to go up or down in the reporting currency.

In general, underlying investments denominated in foreign currency are not hedged back into the reporting currency. Among the factors that may influence currency values are trade balances, the levels of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation and political developments. Returns may increase or decrease as a result of currency fluctuations. Values may also be affected by developments relating to controls and restrictions on foreign currency remittance of proceeds of investments in a non-sterling jurisdiction.

Whilst every effort is made to ensure that the information provided to clients is accurate and up to date, some of the information may be rendered inaccurate by changes in applicable laws and regulations. For example, the levels and bases of taxation may change. Any reference to taxation relies upon information currently in force. You should note that the bases and rates of taxation may change at any time. Tax treatment depends upon the individual circumstances of each client and may be subject to change in the future.

In addition to the information provided by Stonehage Fleming Investment Management Limited you may wish to consult an independent professional.

It has been approved for distribution in South Africa and those countries of the EEA where distribution is permitted by:

Stonehage Fleming Investment Management Limited
15 Suffolk Street
London
SW1Y 4HG FP:0000853

Stonehage Fleming Investment Management Limited is authorised and regulated by the Financial Conduct Authority and registered with the Financial Sector Conduct Authority (South Africa) as a Financial Services Provider (“FSP”) under the Financial Advisory and Intermediary Services Act, No 37 of 2002 (FSP No: 46194). Approved for distribution in Jersey by affiliates of Stonehage Fleming Investment Management that are regulated for the provision of financial services by the JFSC.

