

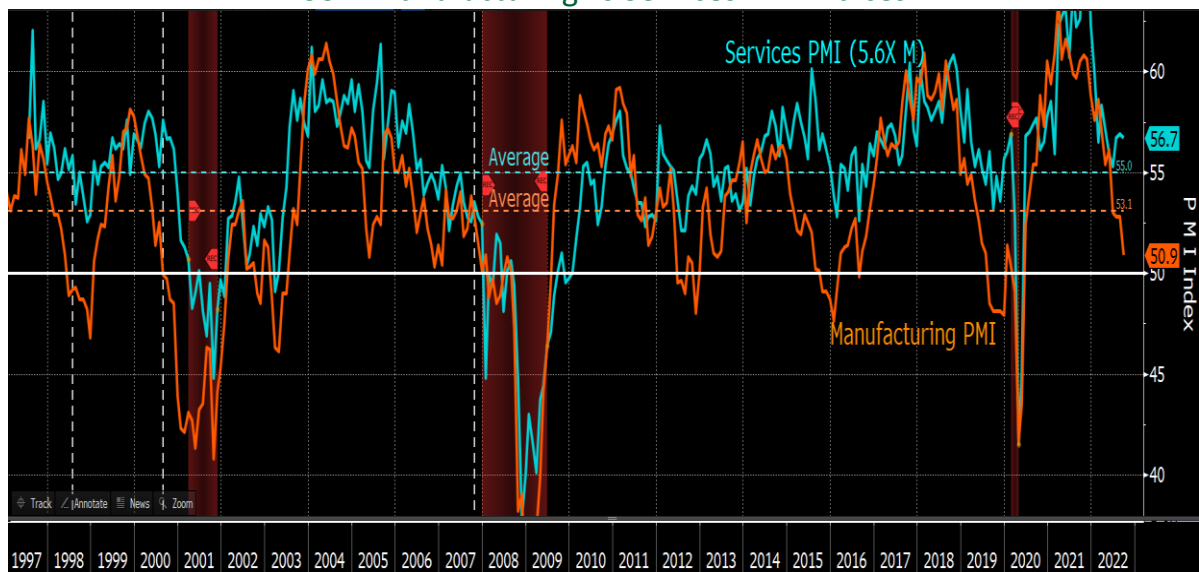
*“When it is dark enough you can see the stars.”*

*Ralph Waldo Emerson*

## 1. US ECONOMY

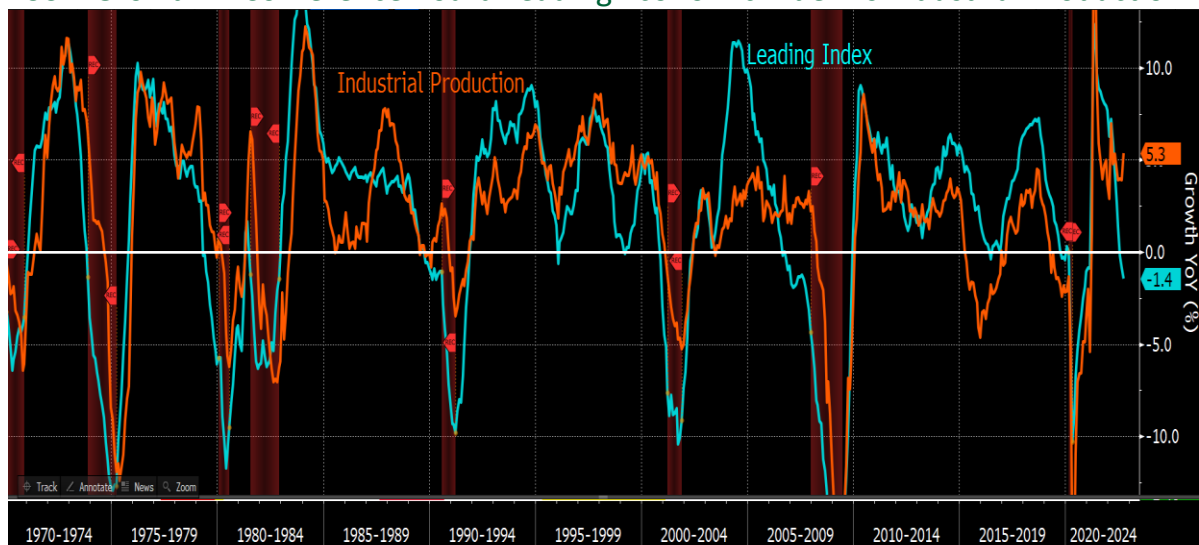
One of the major investor fears is that the Federal Reserve (Fed) may trigger a US recession with its determination in ‘breaking the back’ of inflation. We consider the current strength of the economy in this context:

US – Manufacturing vs Services PMI Indices



Whilst the Manufacturing PMI (the orange line) is approaching contraction territory, the Services PMI (the blue line) remains well above its average. With the latter part of the economy over five times as large as the former, this indicates a still-healthy US economy.

US – Growth in Conference Board Leading Economic Index vs Industrial Production



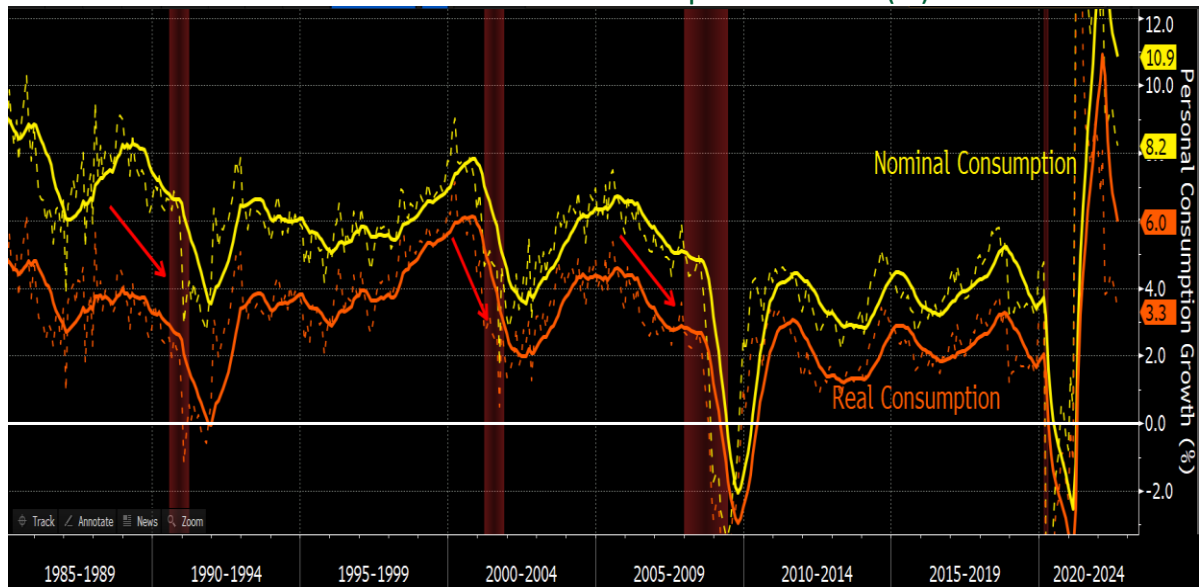
Whilst the leading economic index (blue line) provides a very early indication of an upcoming recession, industrial production (orange line) is still growing at an elevated level. The latter usually also provides an early recession warning. On this basis, we believe the US economy is currently still on a relatively healthy footing.

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

## 2. US CONSUMER MARKET

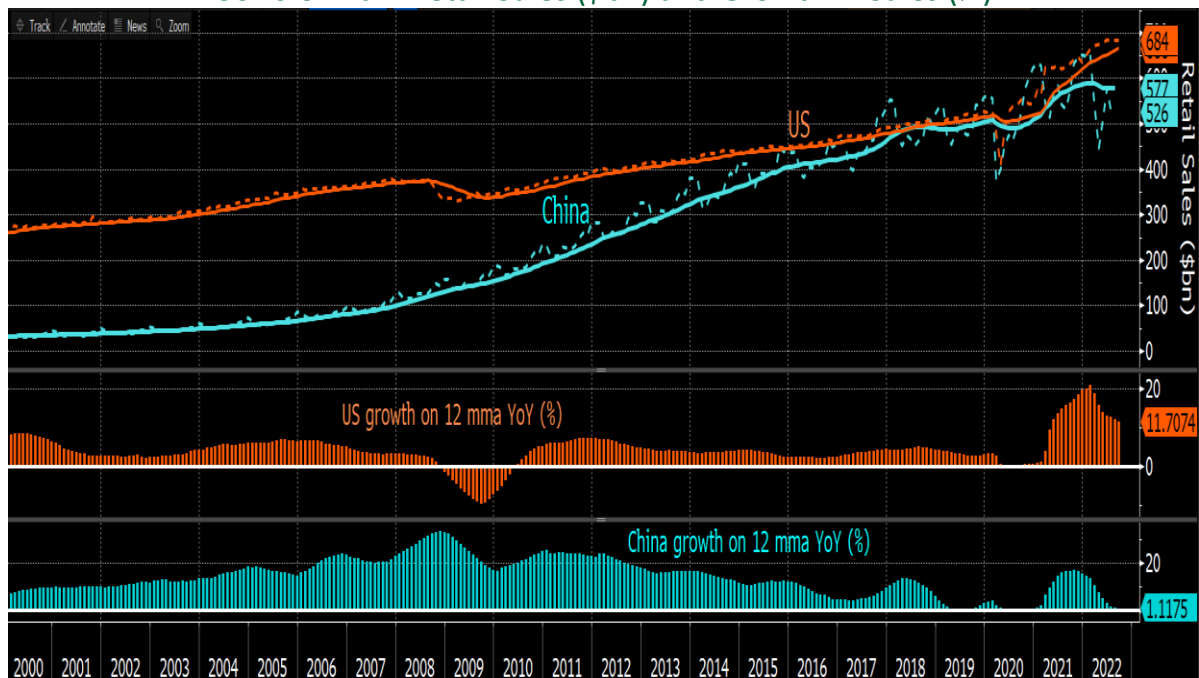
In conjuncture with the strong Services PMI index in the preceding paragraph, we consider the current growth in the US consumer market:

US – Nominal & Real Consumption Growth (%)



Nominal consumption is currently growing strongly on both nominal (yellow line) and real terms (orange line), at elevated historic levels. Consumption is shifting from capital goods to services, despite relatively moderate consumer confidence. Consumer expenditure provides some economic buffer, making up 71%\* of the US economy.

US vs China – Retail Sales (\$bn) and Growth in Sales (%)



US retail sales are currently amounting to \$695bn (12-month running data, the orange line in the top section of the chart above). It has continued recovering strongly after the Pandemic, growing at +11.7% (the orange bars).

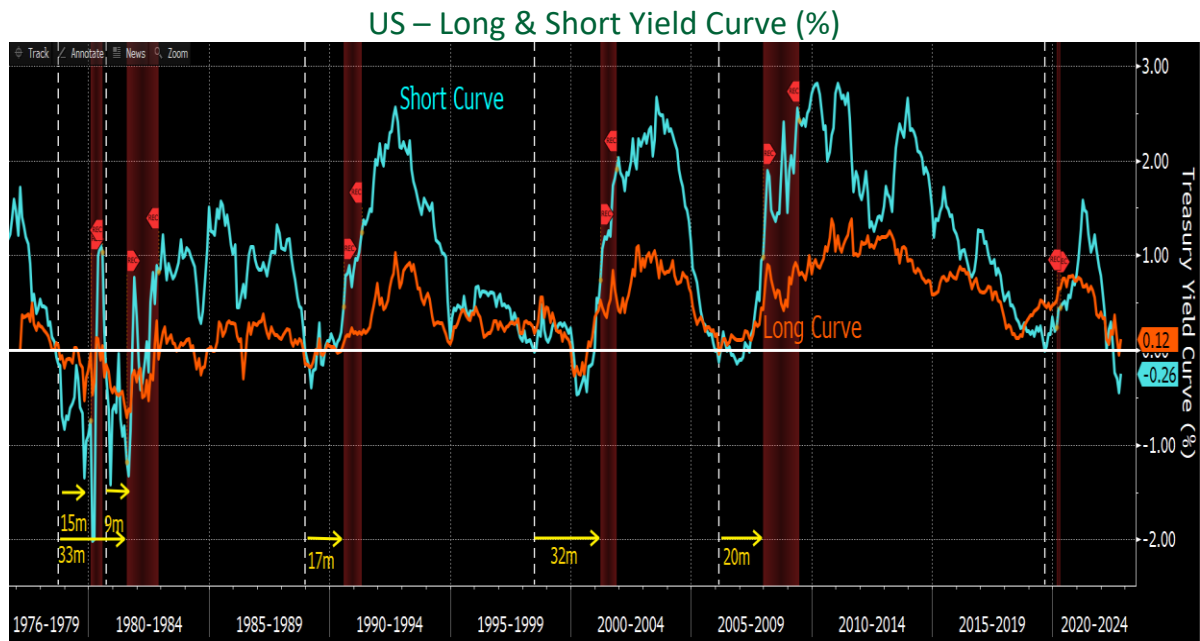
Against this, the Chinese retail sales amount to \$577bn (the blue line), growing a mere +1%, piling against historic levels. While their market equaled the US market in 2018 for a short period, the US currently exceeds them by a fifth. This is a clear indication to what extent their mishandling of the Pandemic is hurting the Chinese economy.

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

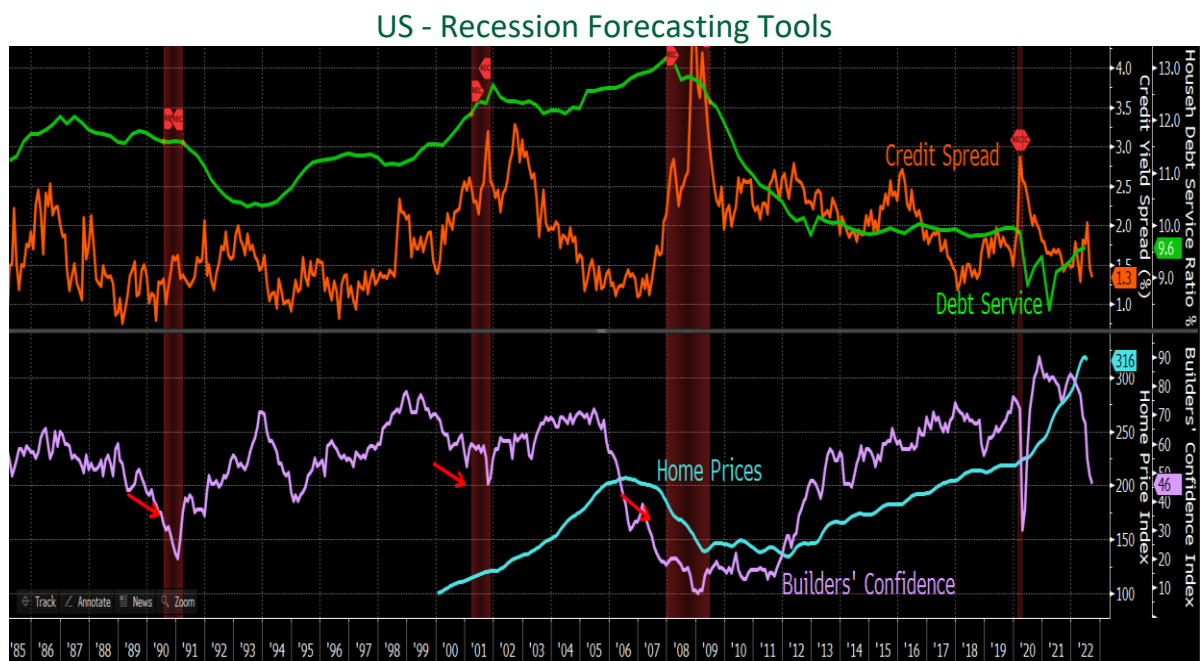


### 3. US RECESSION

The Fed has many tools to assess their risk of triggering a recession. It seems they have a relatively healthy economy on their side, but the following chart is also uppermost in many minds:



The short yield curve has crossed into contraction territory, indicating increasing risk of a recession a year or more away. Whilst the long curve does not provide a clear warning, it seems less reliable in this context. On balance, the chart should not be ignored.



The above practical recession forecasting tools can also add value. Builders' Confidence (purple line) is a very early indicator, and has recently taken a sharp downturn. Home prices (blue line), though, remain elevated with no clear indication of a contraction yet. The individuals' Debt Service Ratio (green line) has risen off a record low but remains on a pre-Pandemic record low. Similarly, the corporate credit spread (with Treasuries, orange line) remains low, indicating little stress in that market.

The Fed may conclude from these that they still have some leeway to rise their target rate without seriously damaging the economy. This also argues rather for a shallow than a deep recession, should one lie ahead.

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



## 4. US EMPLOYMENT & INFLATION

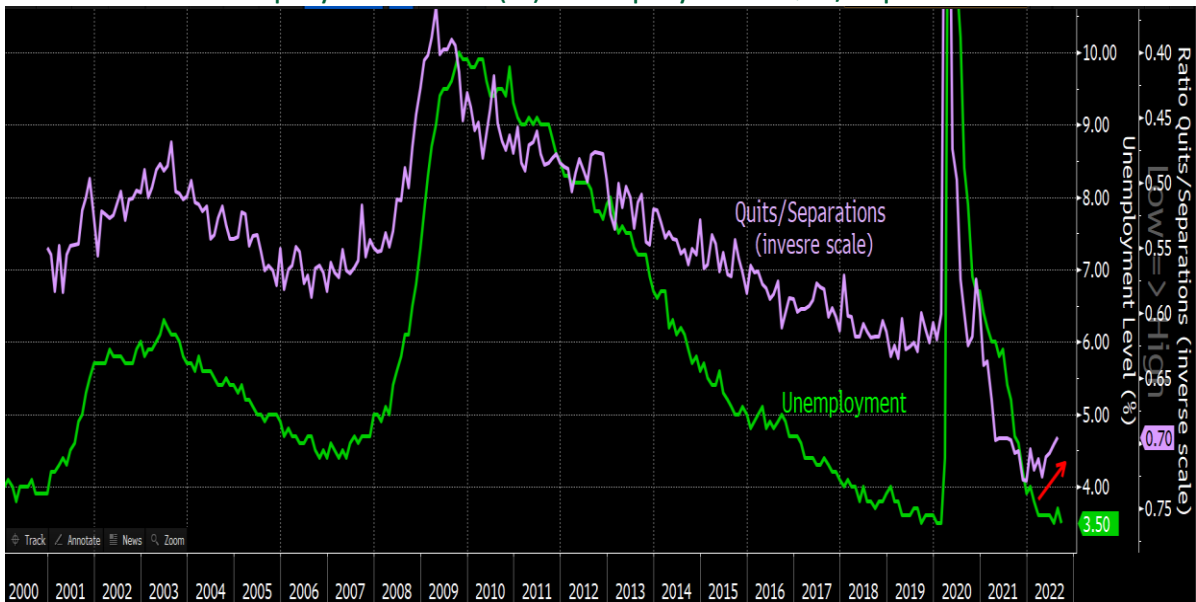
We have shown in previous notes that the initial Pandemic-inflicted causes of inflation are largely becoming 'water under the bridge'. Inflation challenges are now more related to the Ukraine war and high employment issues, i.e. in energy, food, wages and rent.

US – Unemployment Level (%) and Claims (\$'000)



US unemployment (the green line) is currently at a half century record low level of 3.5%, with a similar picture of extremely low unemployment claims. The participation level of 62.3%\* remains below pre-Pandemic levels. This is clearly putting pressure on remuneration costs, with the Fed now determined to increase unemployment and lower inflation risks.

US – Unemployment Level (%) vs Employment Quit/Separation Ratio

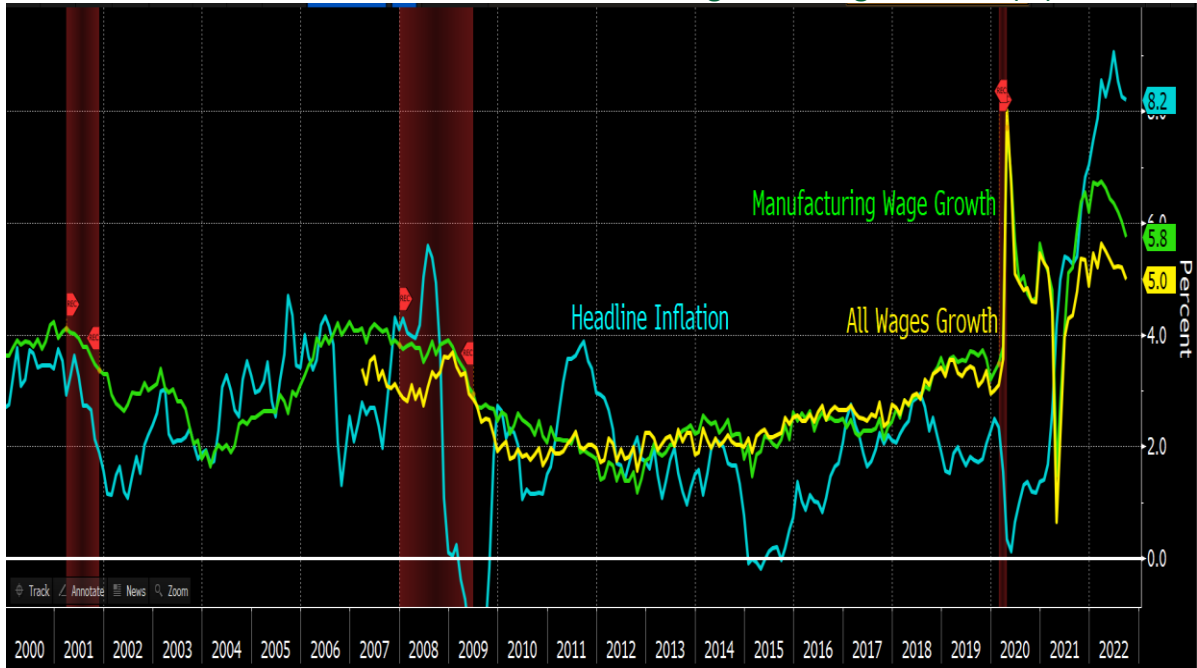


Drilling deeper into employment numbers, and considering the numbers of workers separating from their firms, the purple line above reflects the ratio of workers who quit spontaneously against the total worker separations (presented on an inverse scale). There is a clear correlation between this ratio and the level of unemployment, with the former a leading indicator of the latter. It is striking that the ratio was at a record high early this year but has turned for the worse since. We have a similar chart depicting that employers are now finding it easier to fill new vacancies. These may be early indications of higher unemployment levels that may follow at some point, playing into the Fed's hand of weakening employment.

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

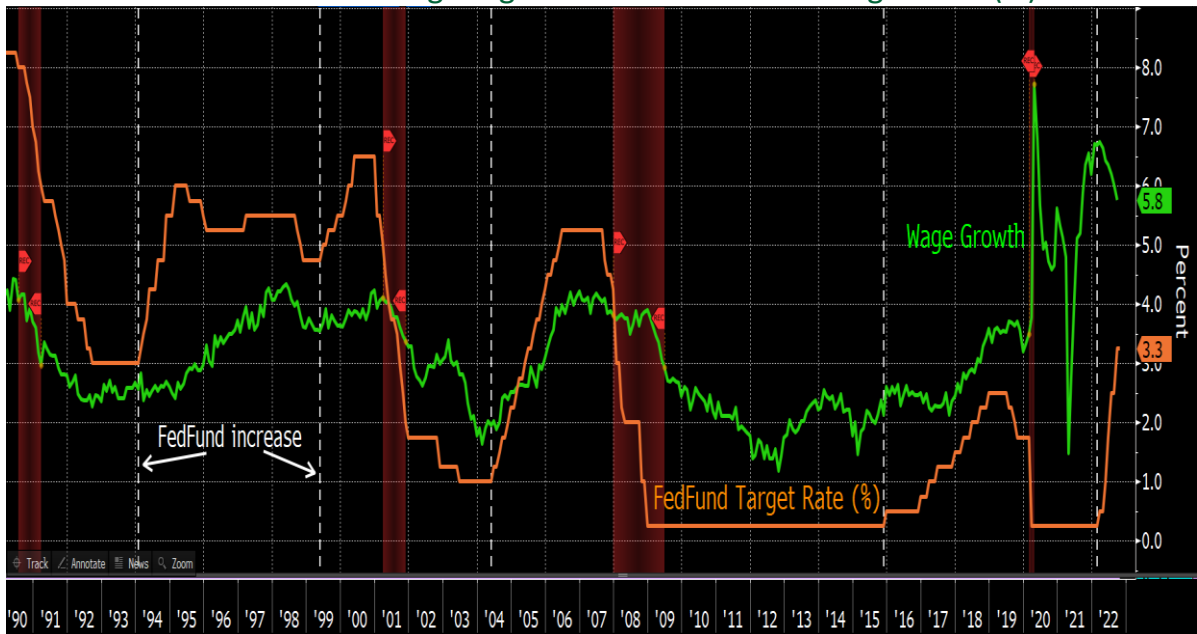


## US – Headline Inflation vs Manufacturing & All Wage Growth (%)



Wage growth has seemingly turned the corner. This seems to be the case for manufacturing jobs (green line) and for all employees (yellow line), correlating with peaking inflation (blue line). Putting this together with our discussion on the preceding page, it seems that odds are growing that the overly strong employment market may become less of a nightmare for the Fed in its task of controlling inflation.

## US – Manufacturing Wage Growth vs FedFund Target Rate (%)



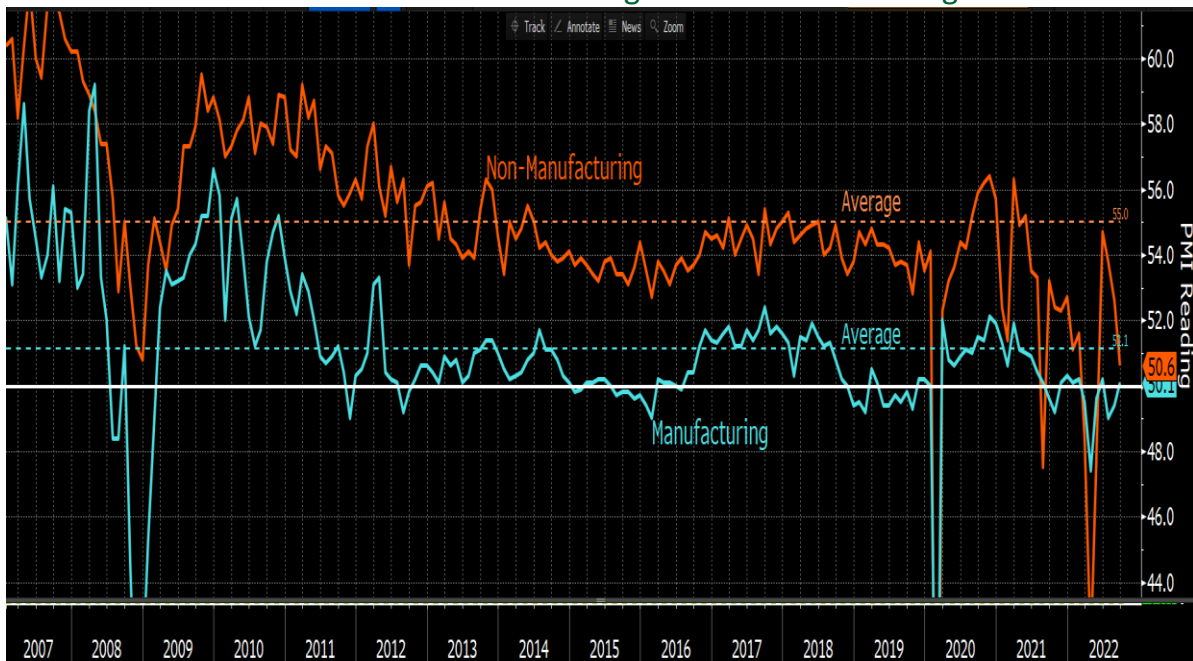
Historically, under the economic environment preceding the Credit Crisis, the FedFund Target Rate exceeded wage growth. Following the 75bps expected rate rise on 2 November, the reverse may still be the case and this issue may keep the Fed weary on this front. Should the preceding scenario of lower wage growth materialise, it seems that a healthier environment in this context may not be too far off.



## 5. CHINA

The recent Chinese Communist Party Congress continued the theme of ‘common prosperity’ and wealth distribution in support of the broad population and smaller enterprises. There seems to be a continuing drift away from market principles towards disciplines of state direction and control, with the central deployment of human capital rather than according to the competitive opportunities of the market. Hopefully the economy can regain its strength with a post-Covid potential boom in consumption when their Pandemic issues may get solved, as it did in the rest of the world. In the interim, we consider the current economic backdrop:

### China – Federation Manufacturing & Non-Manufacturing PMI's



Both PMI data series in the chart have been in destructive (below 50) territory earlier in the year, and are currently close to neutral. Their zero-Covid policy continues restraining their economy to a large extent.

### China Gross Domestic Product (GDP) and OECD Leading Economic Index Growth (%)



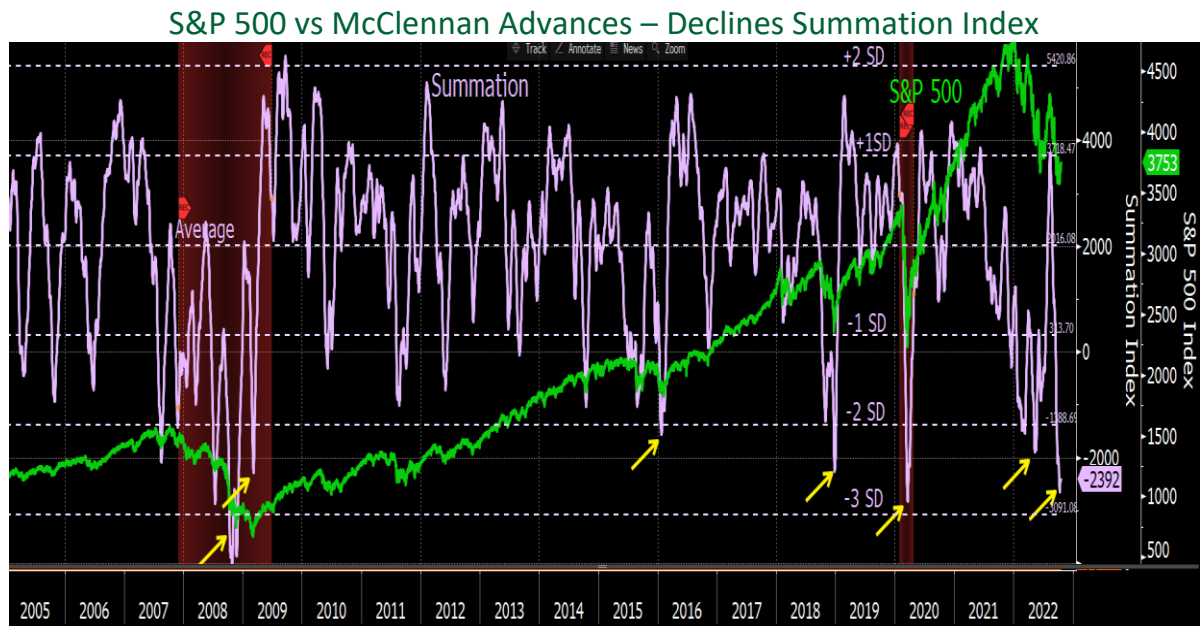
The previous comment is confirmed in the above chart. GDP growth has stalled, while their OECD leading economic index has been in negative territory for most of this year. The Renminbi has dropped to 7.23 to the Dollar, and Dollar exports have stagnated. It is clear that China urgently needs to solve their Pandemic issues and get the economy going again.

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



## 6. TECHNICAL PICTURE

We follow many different technical indicators. Whilst most indicate quite a degree of oversold readings currently, the following one is clearest in its message:



The Summation Index is currently almost three standard deviations below average, on a post-Pandemic record low. The index has a good record of calling stock market tactical lows (see the yellow arrows). The current reading has only been exceeded on the negative side during the Credit Crisis and the Pandemic.

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