

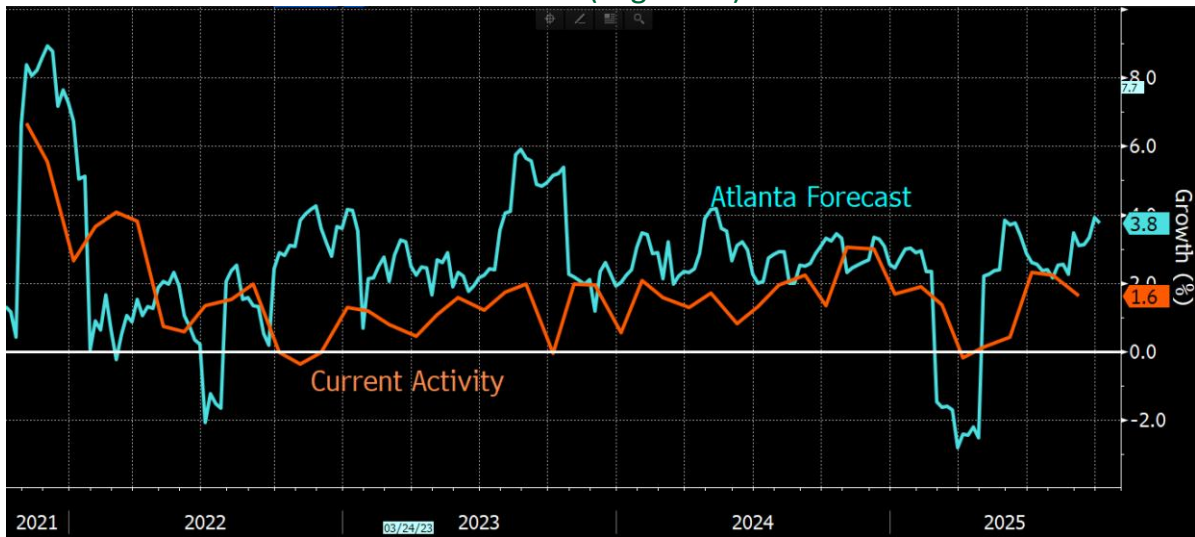
"To know what you know and what you do not know, that is true knowledge."

Confucius

1. US ECONOMY

With the US government shutdown, important economic data is not released. We are aware of generally soft new employment data, but otherwise we do not detect immediate material threats.

US – Goldman Sachs Economic Activity Index vs Atlanta Fed GDPNow Quarter Forecast (% growth)



According to Goldman Sachs current economic activity stays on course, whilst the Atlanta Fed's estimate for the quarter has been rising. This continues to paint a constructive picture.

US – Philadelphia Fed Six Month Business Outlook Index vs S&P 500

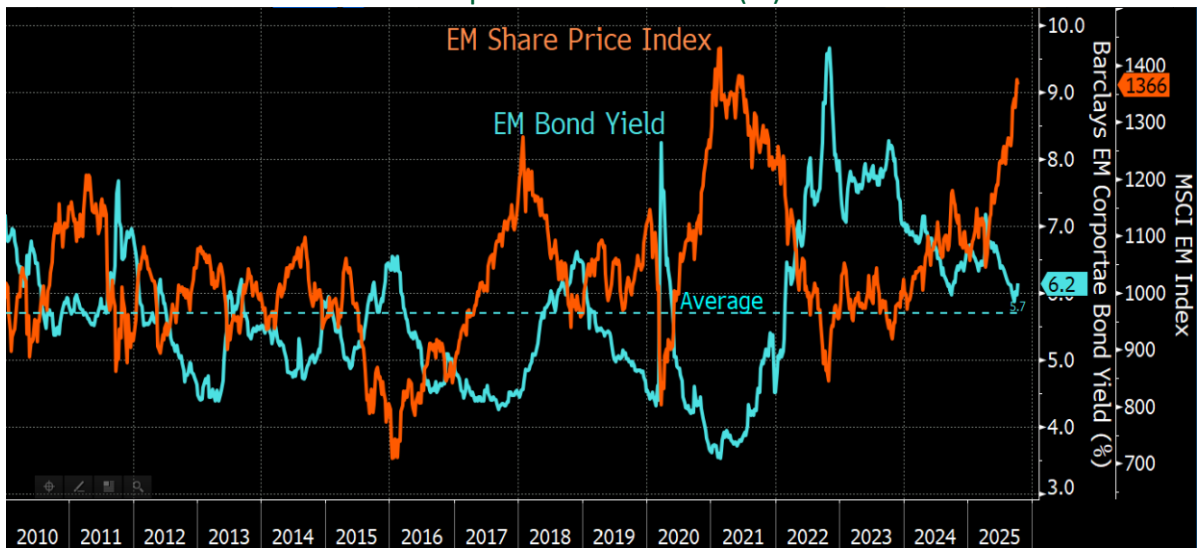


The above Business Outlook Index is in positive territory, in a rising trend, and currently on its long-term average level. This provides a similarly constructive picture. US corporate profits (before taxes) on a consolidated basis are also rising, currently at +3.6% (graph not shown). Historically its growth rate has started dropping well before negative economic growth emerged. It therefore seems to us that US economic growth currently remains on course.

2. EMERGING MARKETS

In conjunction with the weaker Dollar, Emerging Markets have performed strongly this year:

MSCI Emerging Market (EM) Share Price Index (\$) vs Barclays Emerging Market Corporate Bond Index (%)



Despite the strong EM share price index, its current level has not yet reached its 2020 peak. Similarly, the EM Corporate Bond yield has dropped from its previous peak and is currently close to the average 5.7%, reflecting good value.

Forward P/E Ratios – MSCI Developed vs Emerging Markets



As in Developed Markets (the blue line), stock market valuations in Emerging Markets (the orange line) have risen from below average levels to historic peak levels (barring the Pandemic levels). On a relative basis (compared to Developed Markets, the green line) it is still below average.

There are two main arguments around Emerging Markets to consider:

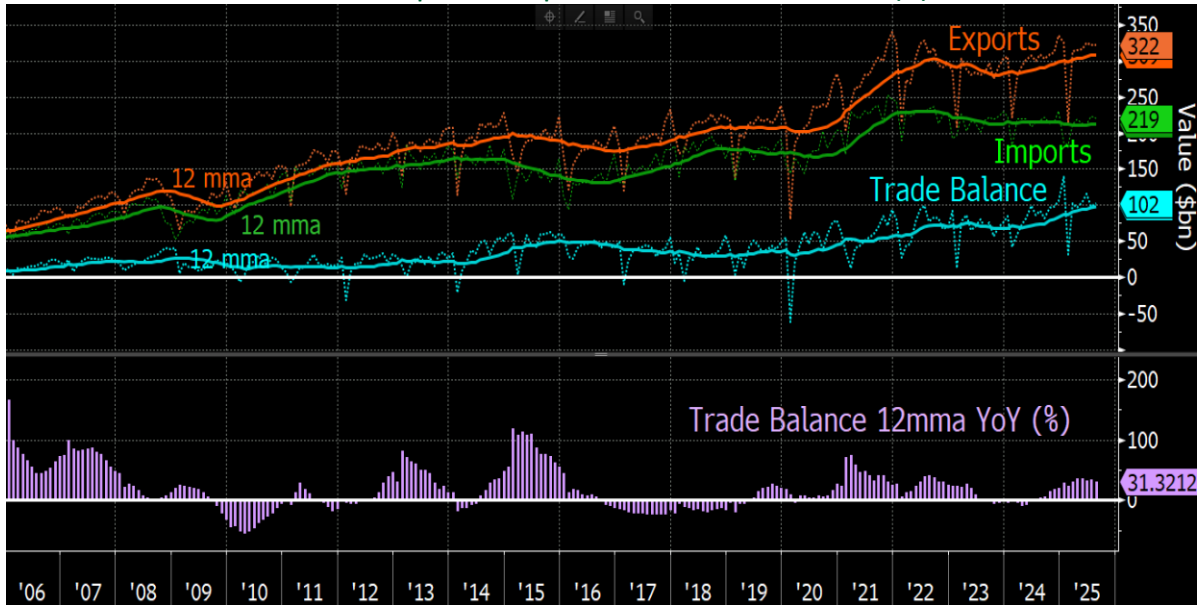
- A view must be taken on the Dollar. Against a trading partner basket, it has stabilized over the past three months and is currently close to its 10-year average. It may well be that most of its depreciation is done with.
- Global investors are structurally diversifying their portfolios. Also with good earnings results, Emerging Markets are a contender for some of those investment flows.



3. CHINA

The Chinese economy continues growing at +5%. Their retail sales in 2020 caught up with the US's in monetary value, but the strong US consumer brought a discrepancy of +31% in favour of the US currently. China's retail sales currently grow (on a 12-month moving average basis) at +3.9% against the US's +4.1%. Whilst there seems to be eagerly awaited catch-up potential, the rest of the Chinese economy also offers potential:

China – Exports, Imports and Trade Balance (\$)



Despite the US trade tariffs, China's exports (the orange line) are growing strongly (now 44% of retail sales), while imports (the green line) remain flat. Their trade balance is currently growing at +31% (the purple bars). This can assist to support their currency.

China Foreigner's Equity 'Risk Premium' – MSCI China less S&P 500 Forward Earnings Yield (%)



We compare earnings valuations with those of the US in the above chart. This form of relative 'Risk Premium' is currently on a long-term average level. Seeing the dominance of technology related stocks in the S&P 500 Index with high valuations, a more favourable argument can be made for investing in China on this basis.

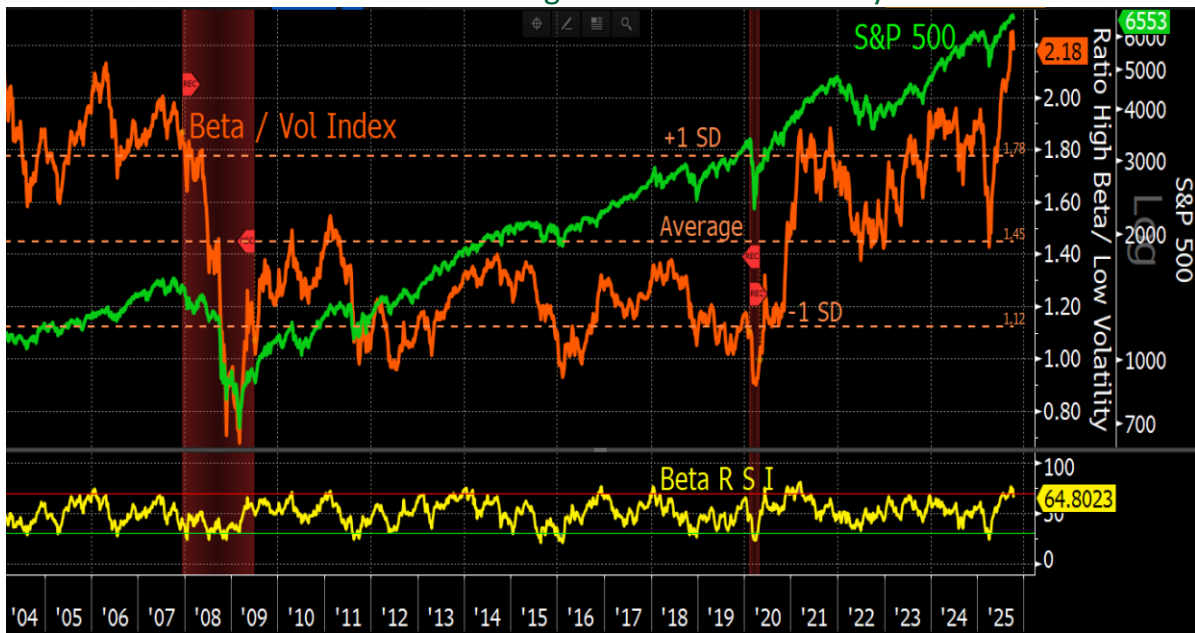
China has an opportunity to again attract foreign investors.



4. BETA INVESTING

As reflected in the following chart, Beta (higher volatility) investors have done well recently:

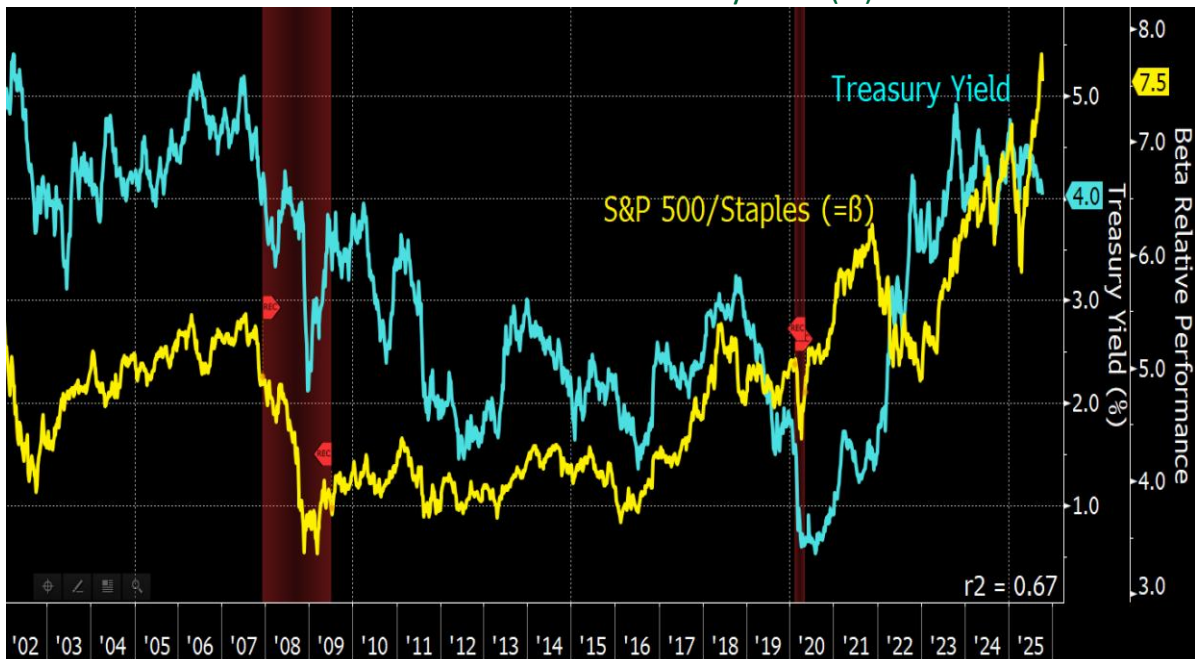
US – Relative Performance of S&P High Beta vs Low Volatility Stocks and S&P 500



The relative performance of Beta stocks is at a record, at about +2 standard deviations from average. This can, to quite an extent, be attributed to the excitement around data centre and AI developments.

This chart has historically also provided good stock market buying signals. It does not currently.

US – 'Beta' Stocks vs Treasury Yield (%)

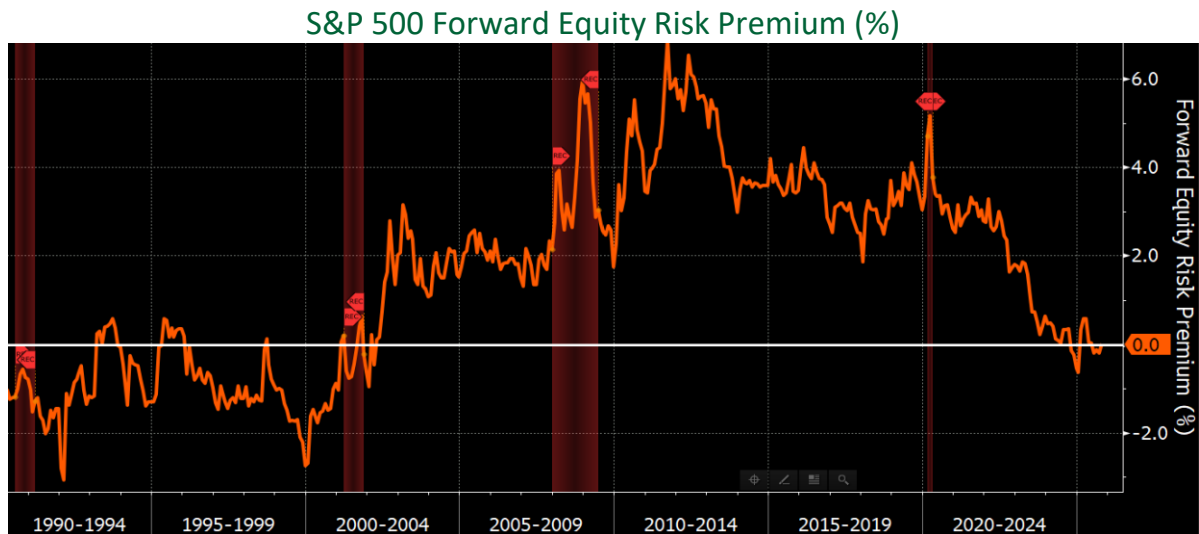


We apply a more moderate version of the Beta index in the above chart (the yellow line). It depicts roughly the same trends as the High Beta relative chart, and is also currently at a record level. It correlates to an extent with the trends in interest rate levels (the blue line). With the Fed now on a new easing cycle, this chart argues in favour of more defensive exposures.



5. EQUITY VALUATIONS

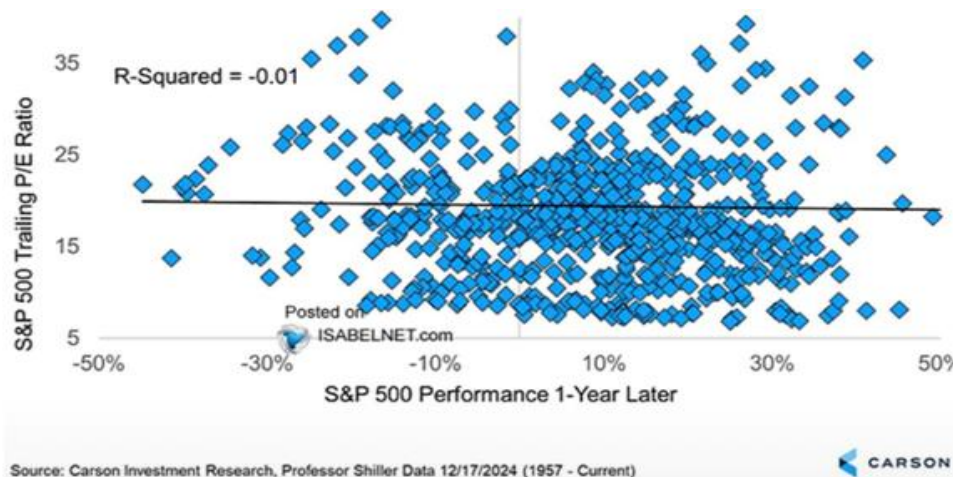
There are no reservations that general equity valuations are currently elevated. For example:



The Equity Risk Premium (forward Earnings Yield less Treasury Yield) is currently at a zero level. This reflects a high valuation and strong conviction about either earnings growth or lower interest rates. In this context, S&P 500 forward earnings revisions are currently in a rising trend, at +11%. Along with this, the Fed is on a new easing cycle (whilst still grappling with inflation risks). Overall valuations have little room for error, and investors need to have conviction in the solid growth outlook of their businesses.

The question is whether high valuations is an immediate sell signal. The following chart assists in this context:

S&P 500 – Trailing P/E Valuation vs Subsequent 1-Year Performance (%)



Over 65 years of data indicate that there is almost no correlation (-0.01) between valuation levels and one-year subsequent return levels. Considering the higher valuations, there are more positive than negative returns in the chart, many in double digits. There are two important considerations:

- Some high-quality growth businesses can maintain their growth levels for longer than initially thought. Astute investors recognise their values.
- Continuing strong fundamentals support risk appetite.

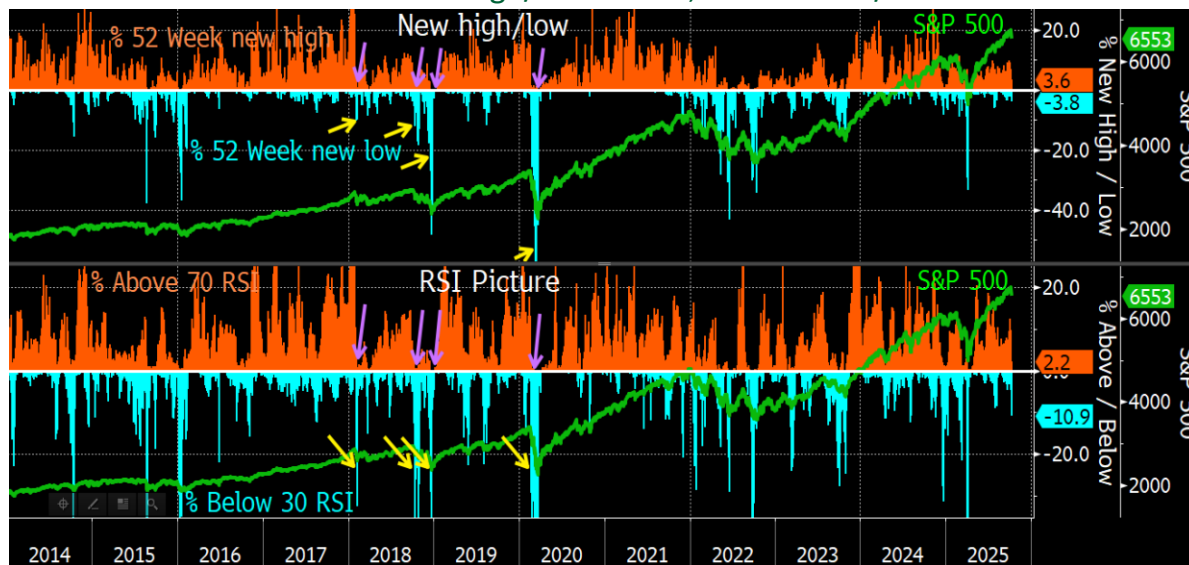
US economic fundamentals are very resilient. With the current high valuations, though, our responsibility is thorough, in-depth research for conviction of growth potential, providing ample room for error in our valuations, having zero complacency, and to sell overvalued businesses.



6. TECHNICAL PICTURE

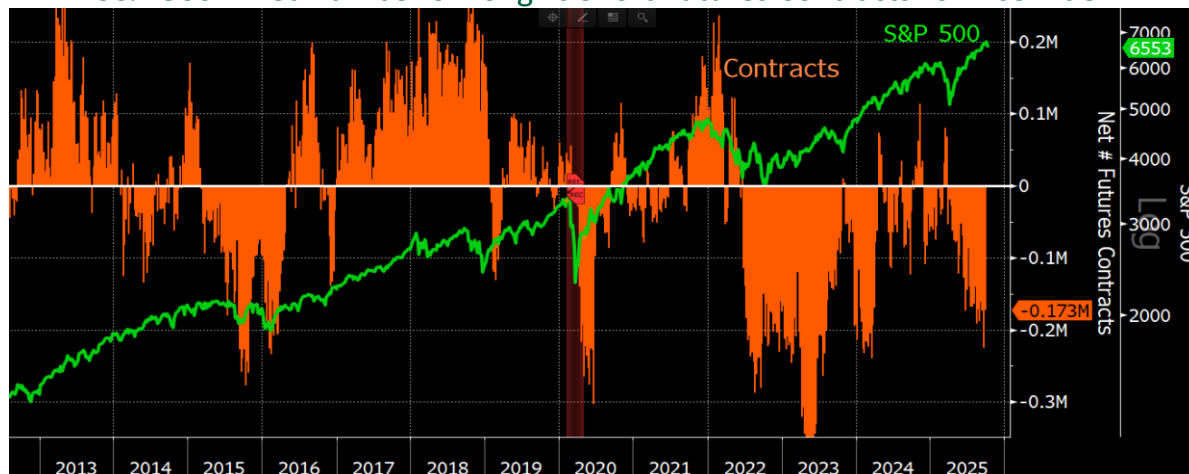
President Trump's new threats of 100% tariffs on China have triggered a sell-off at the end of last week. The S&P 500 index is close to falling through its 50-day moving average, potentially a first negative signal. The question is whether the market has been severely overbought and therefore has material risk of a sharp sell-off.

S&P 500 - % of Shares at New High/ New Lows, % above 70 / below 30 RSI Levels



Currently less than 4% of S&P 500 constituents are at new highs (upper section of the chart) and just over 2% above their respective 70 RSI levels (lower section of the chart). More of the constituents are at new lows or below their 30 RSI levels. This reflects a neutral technical picture.

S&P 500 – Net Number of Long vs Short Futures Contracts vs Price Index



The futures market has been building a net short position since April this year. This implies that the market has been climbing a 'wall of worry' since then, implying little complacency or risk of a severe sell-off – barring new negative information.

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RISK DISCLOSURE

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