

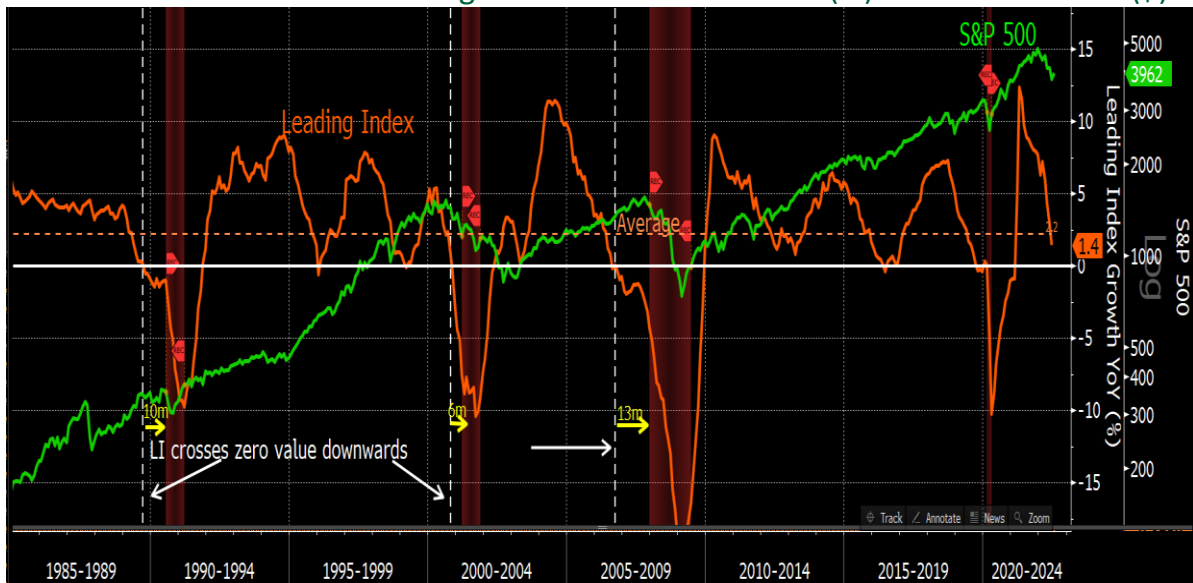
“Let’s not look back in anger, nor forward in fear, but around in awareness.”

James Grover Thurber

1. US ECONOMIC OUTLOOK

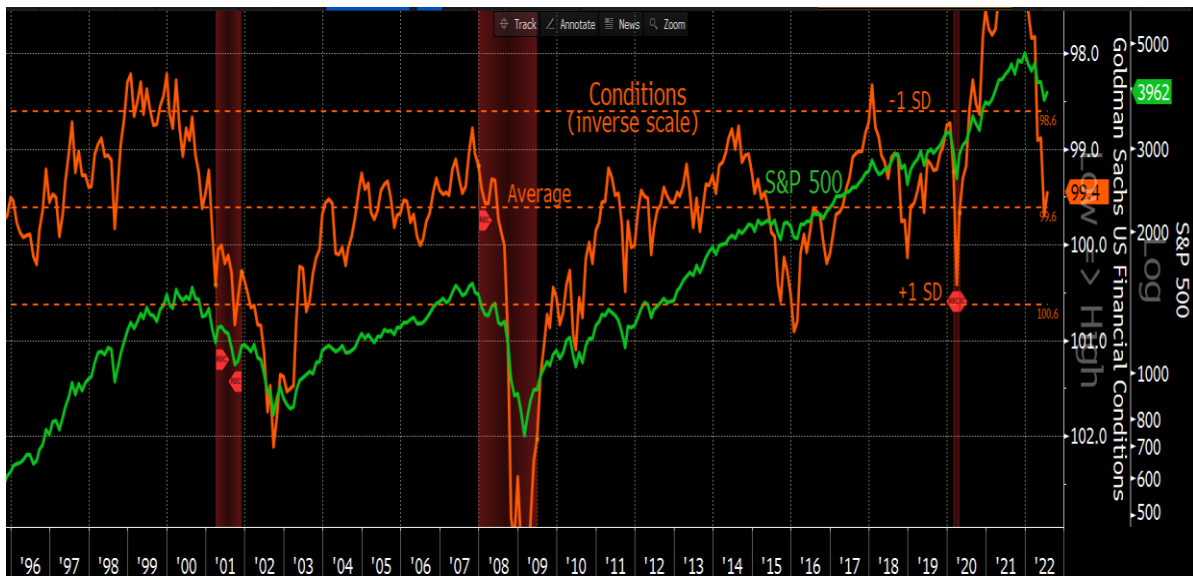
With large parts of the Chinese economy in lockdown until recently, global investors are most dependent on the health of the US economy:

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



The above authoritative Leading Economic Index’s growth has dropped materially, but is still in positive territory. Its direction of travel is clearly negative, but it does not reflect an imminent collapse of the US economy. Chances are growing for a mild US recession.

Goldman Sachs US Financial Conditions Index vs S&P 500 Index

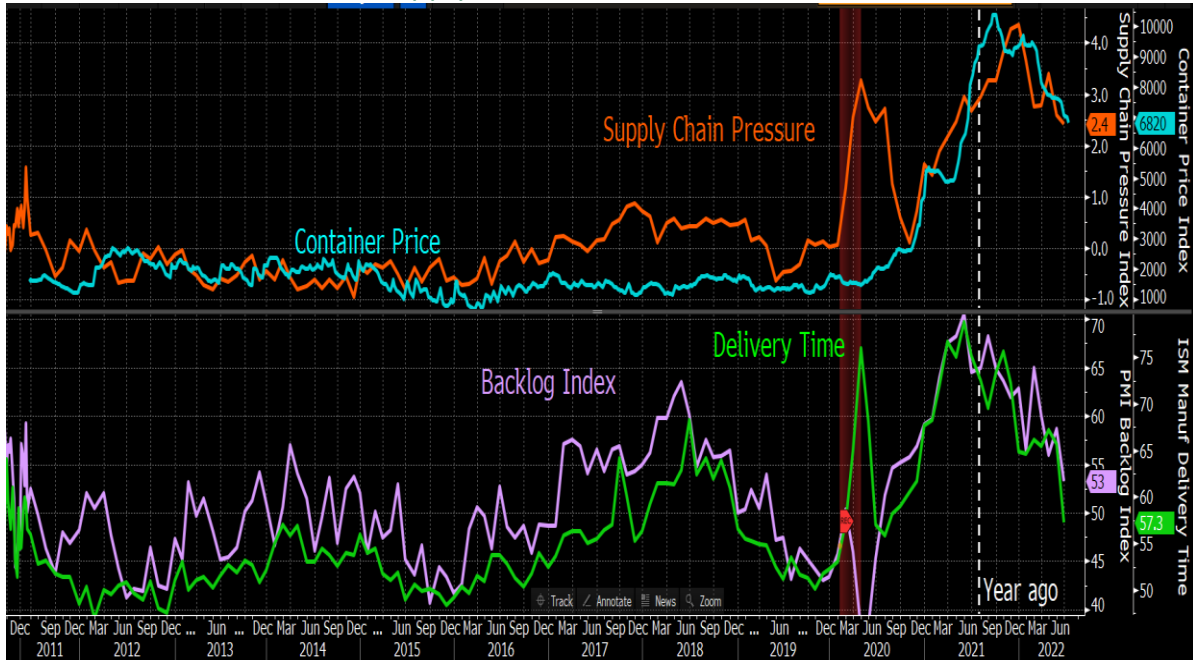


The above Financial Conditions Index is close to its average level. This reflects a relatively normal financial conditions environment without severe financial constraints threatening the US economy.

2. US INFLATION

Whilst Core Inflation and PCE (Personal Consumption Expenditure) have both recently dropped three months in a row, Headline Inflation keeps rising relentlessly, and is now at 9.1%¹. Investors remain concerned about headline inflation.

Supply Chain Causes of Inflation



The original Pandemic-inflicted causes of inflation seem to now be well under control. We indicate with the white vertical line the levels of the above indices a year ago. All of them are currently well below those levels. Whilst some are still at elevated levels, they clearly are now already contributing to lower inflation.

Commodity Price Indices – Indexed to Respective Levels a Year Ago



Many commodity prices are currently dropping. Both copper and iron-ore are currently at meaningfully lower prices than a year ago. The overall CRB Commodity Price Index is still marginally higher than a year ago, but is in a sharply dropping trend. The gold price reflects a similar picture, indicating less fears for financial stresses than before, including Inflation. These indices indicate to us some fears of a weaker economic outlook and, along with that less risk of inflation remaining the dominant risk many currently perceive it to be.

¹ Source: Bloomberg. July 2022.

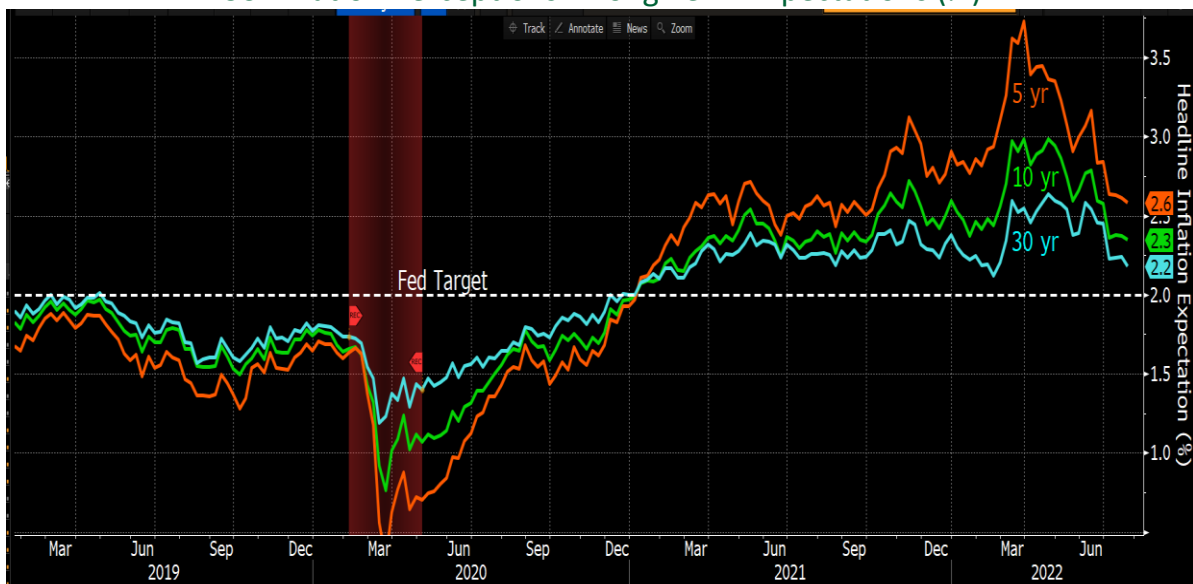


Headline Inflation Effects – Energy & Food



The main issues keeping Headline Inflation high (energy and food) have different drivers currently. We indicate the timings a year ago, and the Ukraine invasion in the above chart. In the top section, energy remains a challenge because of the war. Against that, food prices are dropping quite sharply, with wheat and corn below their respective prices at the start of the war, and also getting close to their levels a year ago, with potential to cause Headline Inflation to drop. It becomes clear that energy may soon be the only main Inflation issue, and that we may be close to peak Headline Inflation.

US Inflation Perceptions – Long Term Expectations (%)



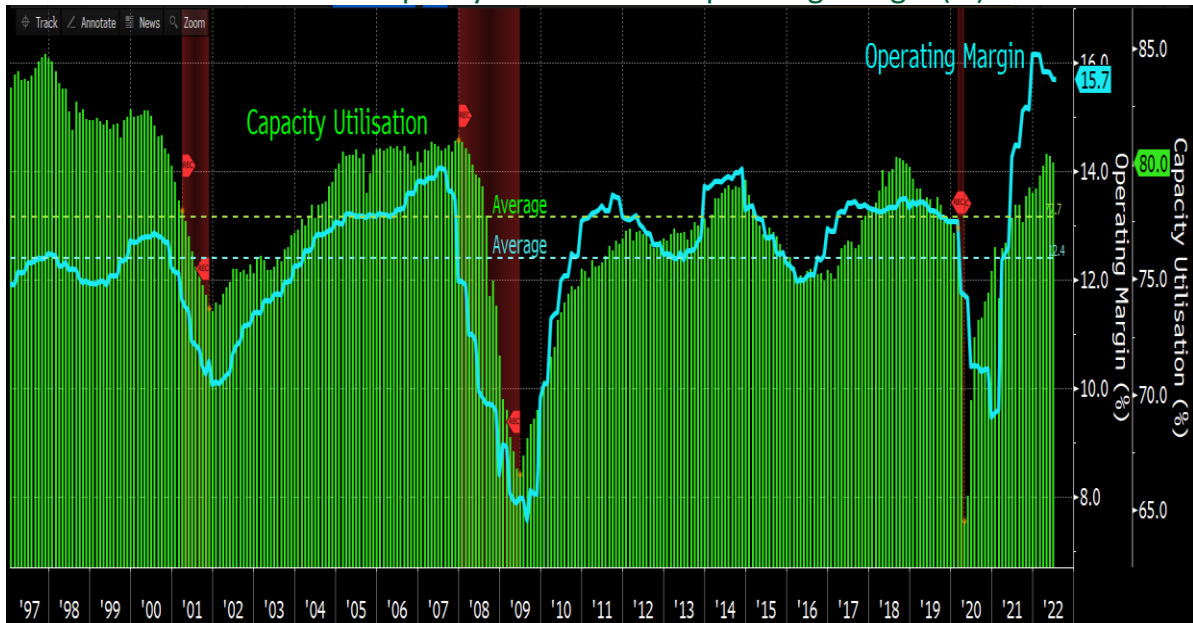
Long-term inflation expectations have recently dropped materially, with 30-year expectations approaching the Federal Reserve target level. This chart indicates to us that public perceptions of inflation have not de-anchored and that longer-term interest rates do not currently risk a meltdown.

3. EARNINGS OUTLOOK

Company earnings have recovered well since the Pandemic. The S&P 500 Index Earnings are over forty percent ahead of the pre-Pandemic peak. Whilst this excellent result deserves huge shareholder appreciation, one should also be cognisant of a more difficult outlook from here.

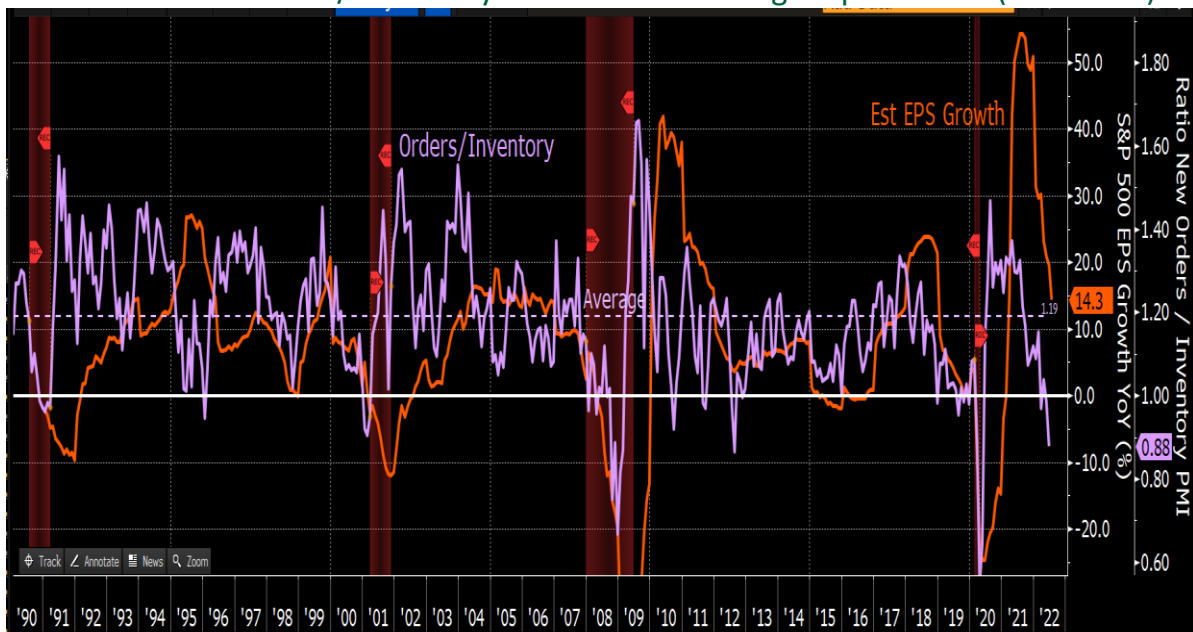


S&P 500 – Capacity Utilisation vs Operating Margin (%)



Capacity utilisation has largely recovered. Whilst we are still experiencing slow supply chain recovery following the Pandemic, there may be some further capacity left to utilise. A potentially weaker economic outlook may, though, argue against that and we will be careful not to expect much higher utilization. This strong recovery has clearly supported the Operating Margin well, with it rising to record levels. Along with our preceding comments, we would also be cautious on projecting any further margin improvements.

US – Ratio of Orders / Inventory PMI¹ vs S&P Earnings Expectations (% Growth)



As supply chain restraints lowered and more product could be delivered, it has quickly caught up with new orders, to the extent that the Orders/Inventory ratio in the above chart is currently well below one. A weaker economic outlook may cause further risk in this context. With its strong historic correlation with this ratio, the outlook for earnings growth is clearly also weakening.

Logically, investors will look for businesses with a better chance of growing their earnings in an environment that has an insipid economic outlook. The following chart summarizes the opportunity set well – with inflation getting under control, nominal longer-term interest rates probably having run most of their current course, and real interest rates probably also having run most of their course:

¹ PMI = Purchasing Managers' Index



US – Real Ten-Year Treasury Yield (%) vs S&P Value / Growth Index Ratio

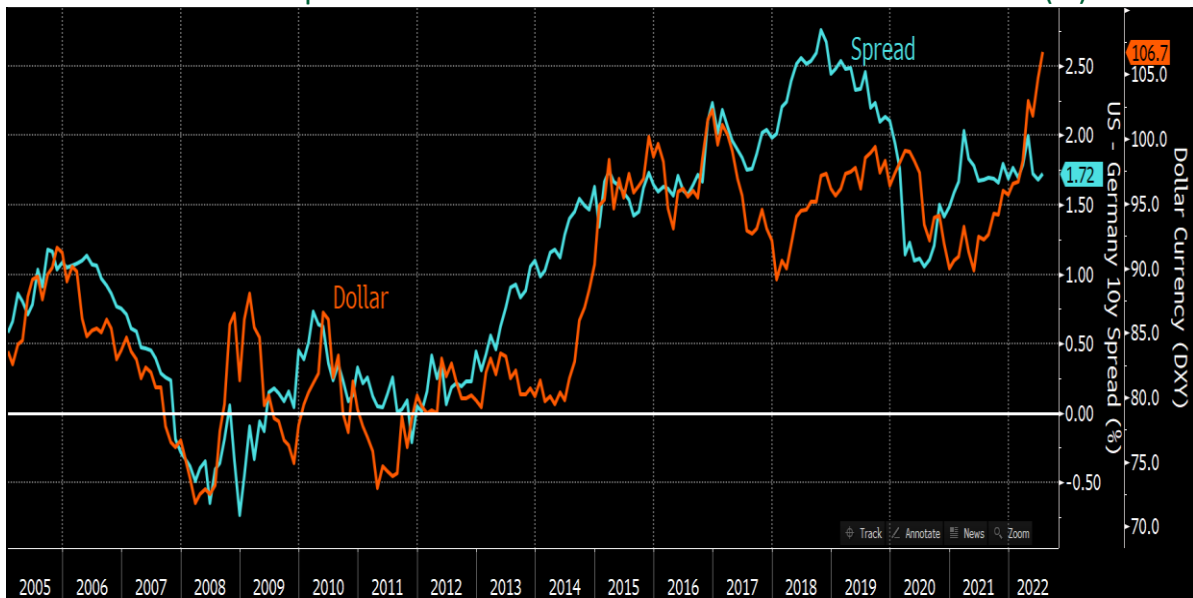


Along with rising real interest rates, Value has outperformed Growth for most of this year thus far. The most recent readings for both series in the chart have turned downwards. This indicates the growing chances for Growth to resume its earlier structural outperformance trend.

4. DOLLAR CURRENCY

The strong Dollar is currently a threat to many US corporations in terms of their global commercial trade and consolidating their offshore earnings.

US Dollar vs Spread between US and German Ten-Year Treasuries (%)

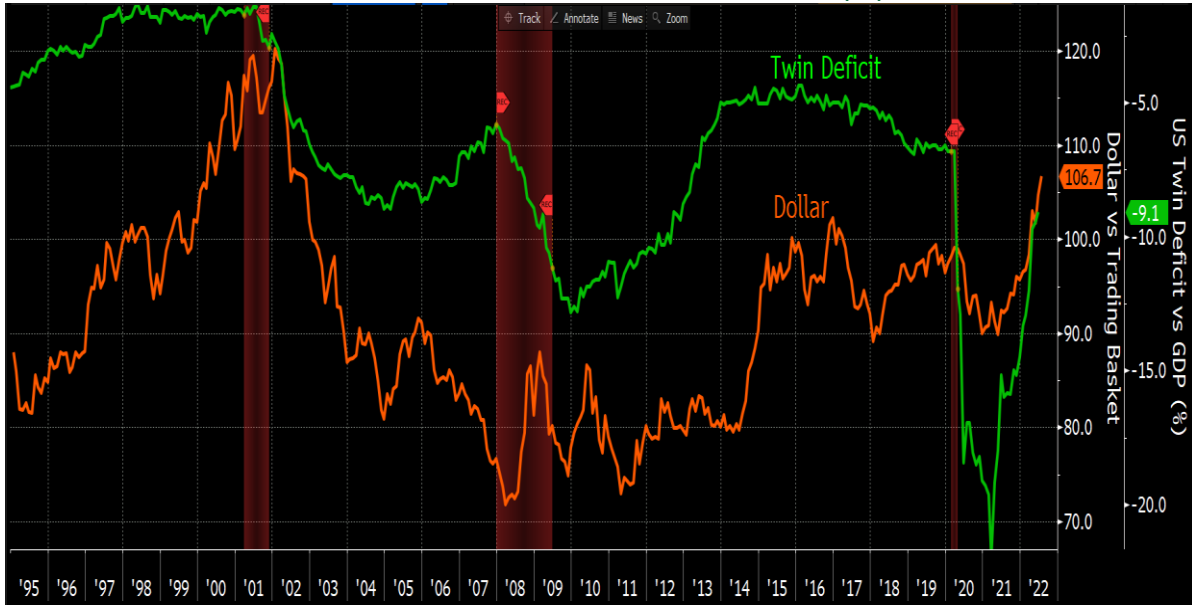


Global investors have been allocating their funds rather to the Dollar rather than to other currencies predominantly because of a better economic outlook. Considering the Treasury Yield differential in the above chart, it seems that the currency has benefitted disproportionately. Other countries' yields have recently been picking up as well - to the extent that interest rates no longer support the Dollar to the same extent that they did previously.

The following chart considers the Dollar against the US twin deficit:



US Dollar and US Twin Deficit vs GDP (%)

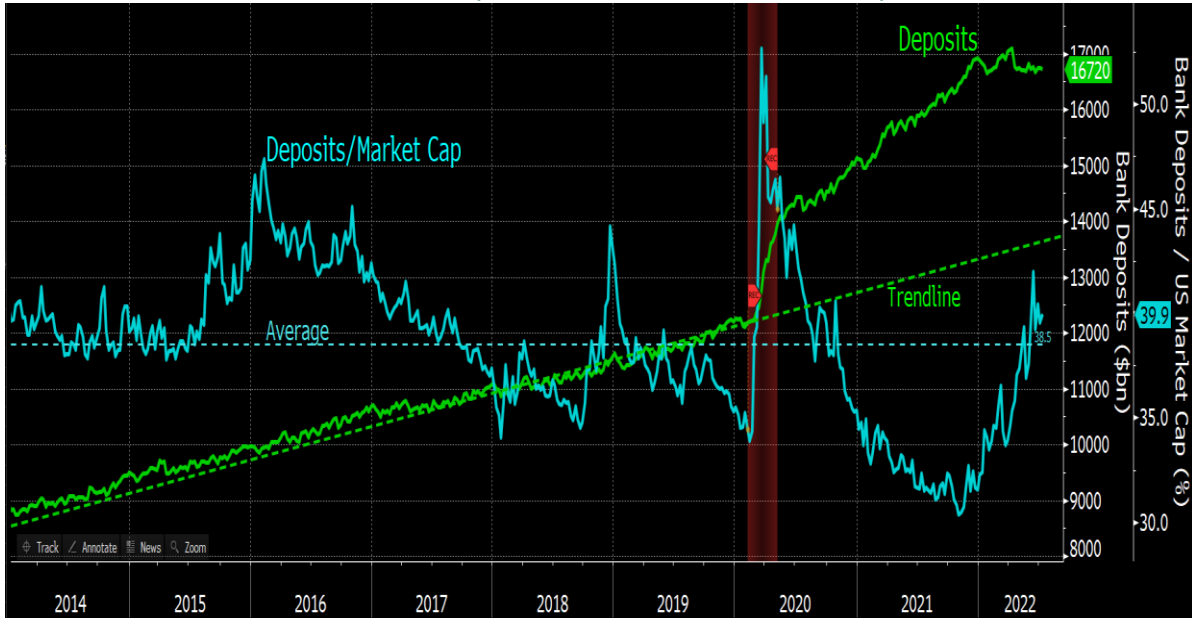


The twin deficit has recovered well. We are, though, skeptical that it can continue recovering at the same pace because of weak economic circumstances of trading partners and the Dollar value itself. On this basis, we also expect less support for the Dollar. A more stable Dollar may be supportive of capital markets.

5. CASH LEVELS

Recent sell-side research work has shown institutional asset management cash levels at historic high levels. We have a similar picture of Commercial Bank deposits:

US – Commercial Bank Deposits (\$bn) vs US Market Capitalization (%)

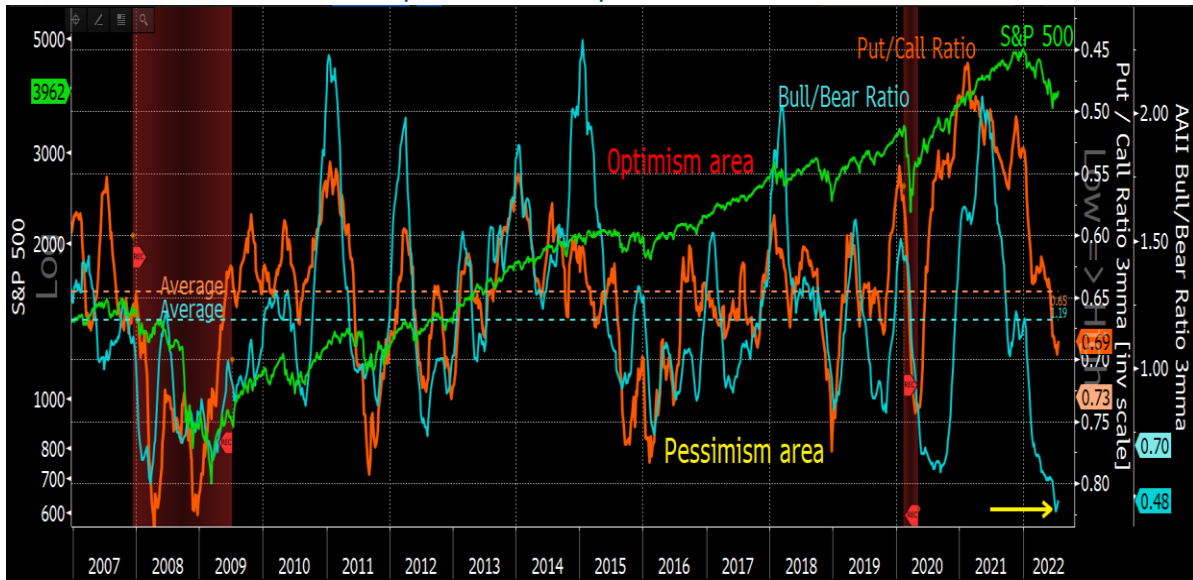


Total deposits are currently almost \$17 trillion. Interestingly, it is double the total Federal Reserve (Fed) balance sheet, more than three times the Bonds they intend reducing, and more than six times the Bonds that will not have matured by the end of next year¹. The current Cash level is well beyond the trendline (see the broken line). This cash level as a ratio of US Market Capitalization is also above its average level. There seems to be more than adequate Cash in the commercial America world to support the Fed's Quantitative Tightening process.

¹ Source: Bloomberg. July 2022.



US – Bull/Bear and Put/Call Ratios vs S&P 500



The Bull/Bear ratio in the above chart is at an extreme negative level, with the Put/Call ratio also well below average. The chart depicts that such negative investor perceptions have historically happened around good buying opportunities.

6. TECHNICAL PICTURE

S&P 500 vs 50- and 200-day Moving Average and Fibonacci Golden Ratio



The S&P 500 Index has recently recovered through its Fibonacci Golden Ratio and its 50-day moving average. These may be early signs of a potential recovery.

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Source: All charts sourced from Bloomberg, July 2022.



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