

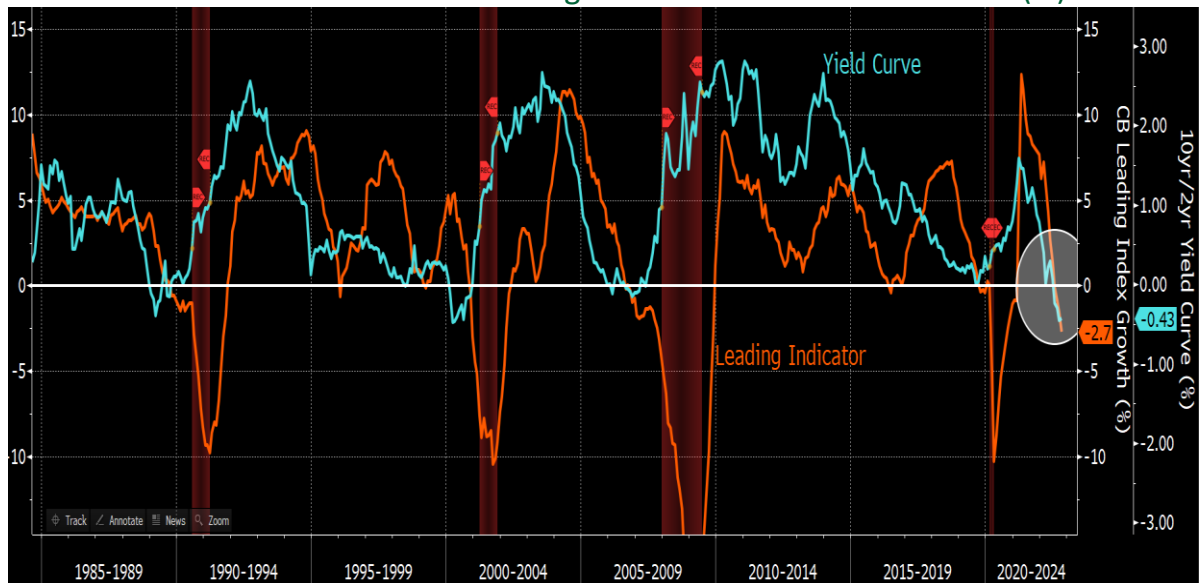
"There will come a time when you think everything is finished; that will be the beginning."

Louis L'Amour

1. US RECESSION

Whilst US personal consumption and retail sales are currently both growing at an elevated level of 8%, and unemployment remains low at 3.6%, we are cognisant of leading indicators warning of a potential recession:

US – Conference Board Leading Economic Index vs Yield Curve (%)



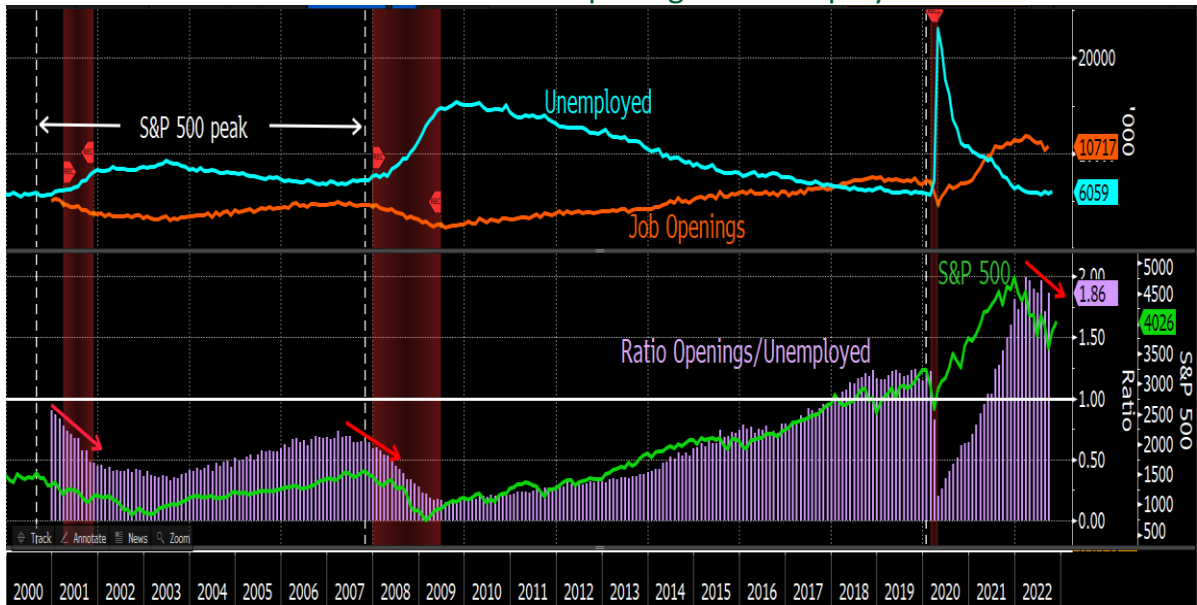
Both the Leading Economic Index and Yield Curve in the above chart are in economic-contracting territory currently. This is a relatively rare occasion and therefore should be carefully considered.

US – New York Federal Reserve Recession Probability Index vs S&P 500



The above Recession Probability Index has recently risen sharply and is currently at an elevated level. We have indicated with the horizontal line the similar historic occasions. These have consistently preceded the recessions (the shaded areas), and the subsequent S&P 500 peaks on average by 17 months, with the shortest period just under a year.

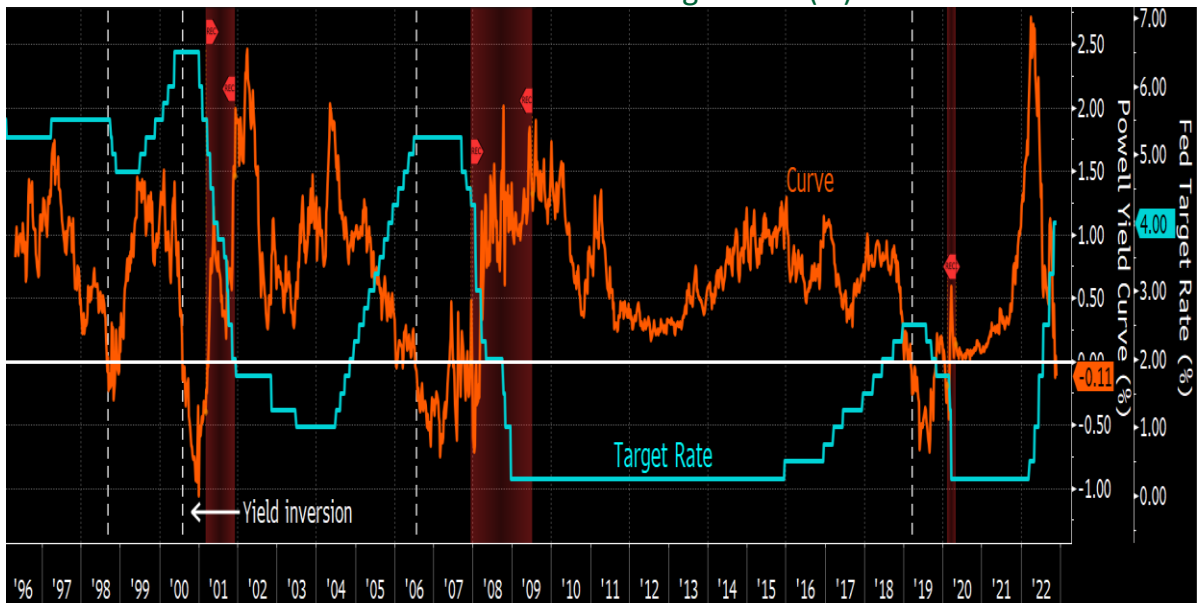
US – Number of Job Openings vs Unemployed



Both US Consumption and Manufacturing currently remain strong. In our view, the depth of the potential recession depends to quite a degree how strong employment can remain (to support consumption). The above chart shows that new job openings are still 1.9 times the number of unemployed (the purple bars). It therefore seems that the economy is not yet overly vulnerable.

There is perception that the Federal Reserve (Fed) will continue to be aggressive in raising its target rate to cool the economy and try to increase unemployment. The following chart reflects their preferred yield curve and historic actions:

Powell Curve vs Fed Target Rate (%)



The Fed's preferred yield curve (named Powell's Curve) reflects the difference between the implied yield on 3-month T-bills in eighteen months' time and the current yield of the 3-month T-bill. It has also recently inverted (but still with only a small negative value). We indicate in the chart the previous occasions the curve inverted. The Fed has on none of those occasions further increased their target rate, which may provide some indication of potential caution on their side to not over-kill the economy.

We will continue to follow this chart to form an opinion on how the pressure on the Fed evolves. Logically, the main issue remains the speed at which US inflation drops. Apart from the cost of accommodation rent continuing to increase (currently at +7%), there continues to be some promising signs in this context.



2. REPORTING SEASON

The reporting season is almost done – 97% of the S&P 500 and 92% of the businesses in the S&P 500 and the BE 500 indices have respectively already reported.

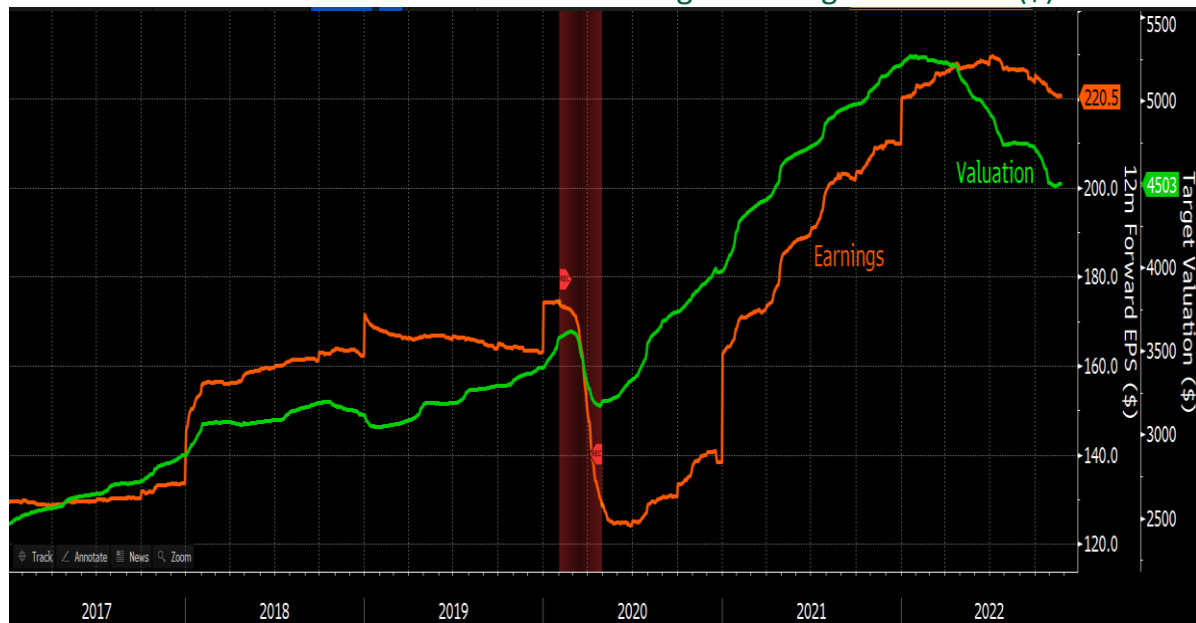
	S&P 500 3Q2022 Results (27 Nov 2022)			Bloomberg BE 500 3Q2022 Results (27 Nov 2022)		
	Growth	Surprise Factor	# +ve Surprises	Growth	Surprise Factor	# +ve Surprises
Sales	11.5%	2.6%	59.4%	26.2%	4.5%	74.4%
Earnings per Share	3.4%	2.9%	69.0%	23.2%	5.5%	54.4%

Source: Bloomberg & Stonehage Fleming Investment Management Limited. November 2022.

We have several observations:

- Overall, top-line organic performance continued on a constructive track. Energy, Discretionary and Industrials did particularly well, while Communications, Health Care and Technology lagged.
- Overall, earnings continued to grow better than expectations. Energy, Discretionary and Industrials did well, while Communications, Financials and Materials earnings dropped in double digits. Technology earnings also dropped, in low single digits.
- Importantly, overall margins started getting eroded (lower earnings than sales growth). Whilst overall expectations were beaten, a new era of lower margins may be on the horizon, and should be borne in mind.
- European results were materially better than US results. The respective reporting currencies clearly had a meaningful impact.
- Outlook statements were generally cautious.

S&P 500 – Consensus Forward Earnings and Target Valuation (\$)



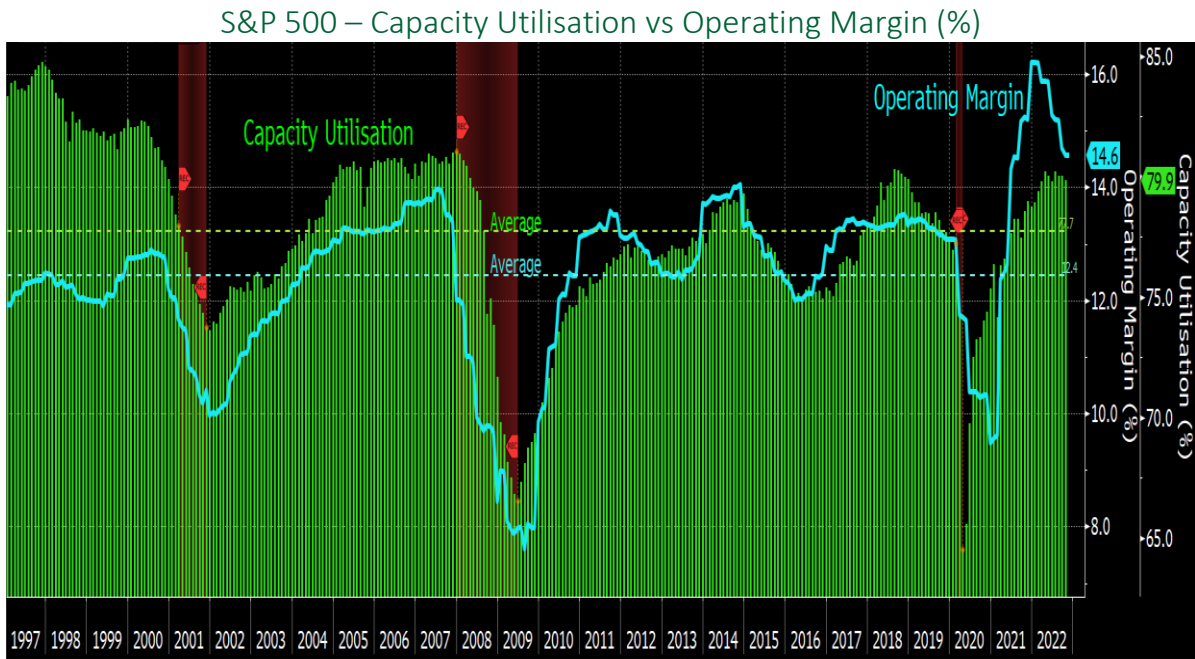
As depicted in the above chart, consensus twelve-month forward earnings projections are beginning to roll over (-4% from its peak level). Consensus company valuations have been trimmed further recently, delivering a material (-15%) drop since the peak at the beginning of the year.

The current S&P 500 target valuation (\$4,503 in the chart) provides for an upside of 12% from its current value. This equals the average consensus upside over the past ten years, and indicates fair potential returns for astute investors.

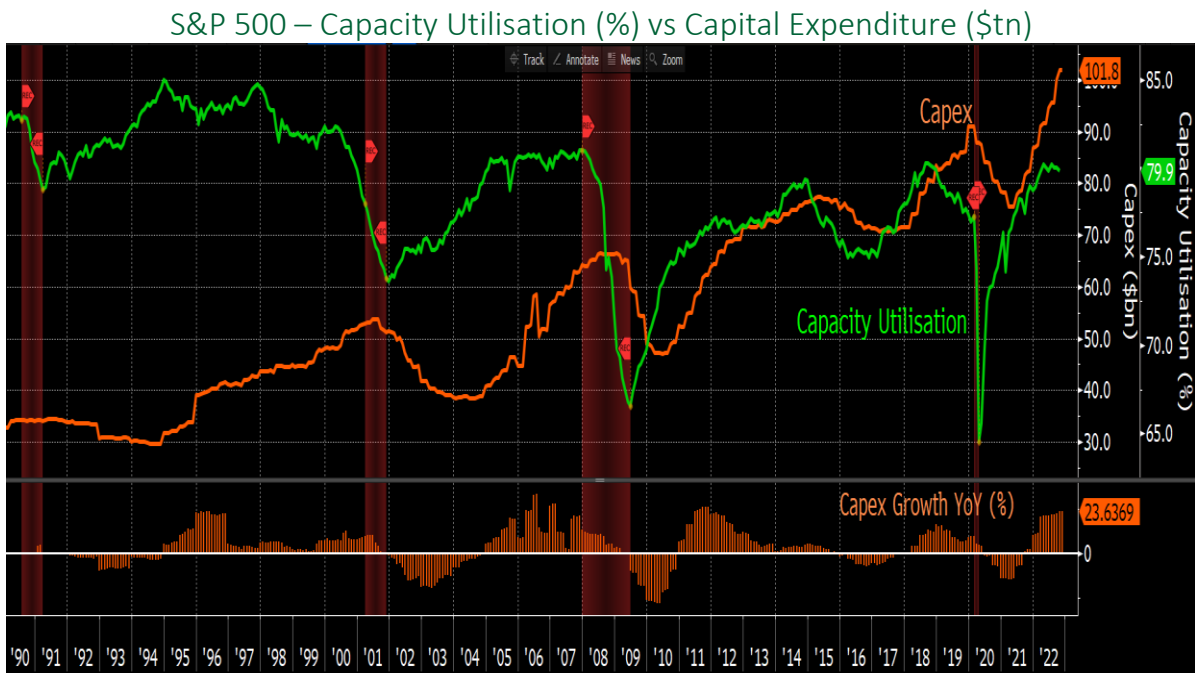


3. US CAPACITY UTILISATION

The consolidated S&P 500 Index companies' capacity utilisation has reached its past ten years' peak level of 80% and seems to be in process of flattening out:



The peak capacity utilisation has been accompanied by historic record profitability as well. The latter, though, has started receding with cost pressures following (predominantly) supply chain restraints. Its toll has now clearly been coming through. We expect this trend to continue for a while, but supply chain pressure indices also indicate that the outlook in this context is slowly turning for the better. We, therefore, would not foresee structurally much lower margins.



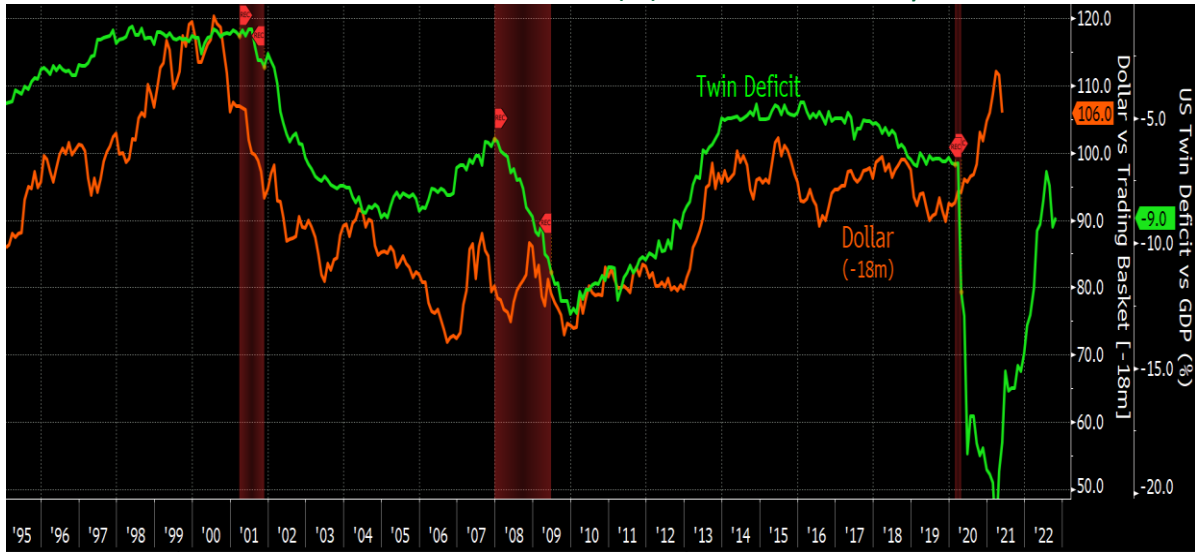
Capital expenditures have early this year recovered to their peak Pandemic levels. It continues to increase, currently growing at a ten-year record rate of +24%. We seek investment opportunities in quality businesses that enjoy good reinvestment opportunities to create further capacity for future growth delivery, and are therefore pleased to see confirmation of the creation of such new capacity in process.



4. US DOLLAR CURRENCY

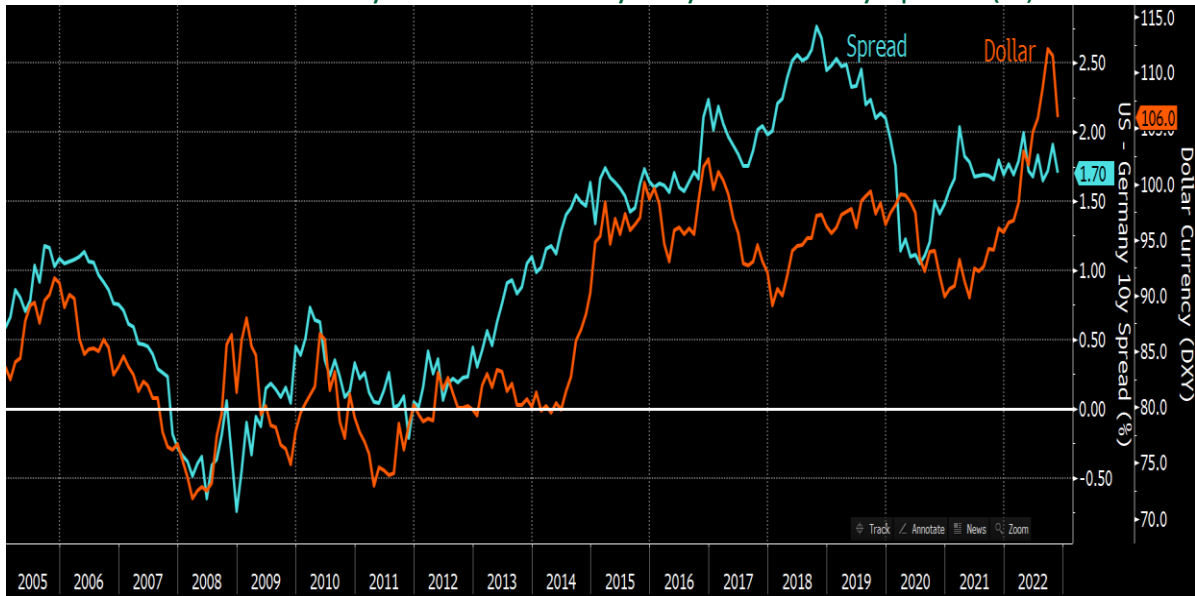
The strong US Dollar has negatively influenced the global economy and, specifically, US corporate earnings this year. Investors are considering the outlook in this context:

US – Twin Deficit / GDP (%) vs Dollar Currency



The twin US deficit has shrunk significantly following the Pandemic, close to its level just prior to the Pandemic. It has since, though, resumed its growing deficit ratio, whilst the currency strengthened materially. The recent weakness in the Dollar ties in with the deficit trend, with odds rather on further (mild) weakness than material further strength.

Dollar Currency vs US – Germany 10-year Treasury Spread (%)



The spread between the US and Germany 10-year Treasury yields has remained stable over the past 18 months, whilst then Dollar has strengthened well beyond earlier comparable levels. Its recent weakness also correlates in this context.

Data on the Goldman Sachs US Financial Conditions Index correlate closely (0.71) with the Dollar currency value. The former has started deteriorating, also indicating odds against further material strengthening of the Dollar.

The following chart shows the net (long – short) number of Dollar contracts. After an eighteen-month period of strong net numbers, they have recently dropped to a neutral position. This confirms a material change in view of the Dollar’s shorter-term outlook.



Dollar – Currency Value vs Net Number of Futures Contracts



The combination of the preceding comments indicate that further Dollar strength is not a material threat to the world economy, and that this headwind of 2022 may turn for the better in 2023.

5. TECHNICAL PICTURE

The S&P 500 has recovered +13% from its recent bottom. Its technical resistance level of ~4,100 is +1.8% above its current level.

S&P 500 – Index vs 50- and 200-day Moving Average

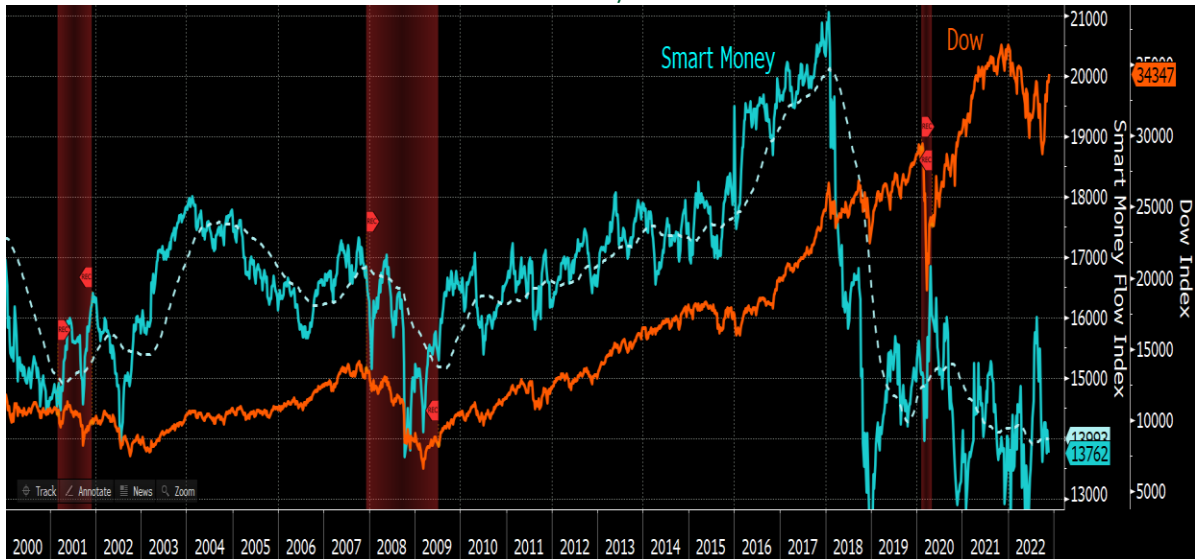


The Index demonstrated normal behaviour by bouncing off its recent oversold level (0.88 times its 200-day moving average, see the purple bars at the bottom of the above chart) and crossing its 50-day moving average (the orange line). It is currently very close to its 200-day moving average (ratio of 0.99 on the purple bars).

The Index has now crossed two important thresholds – crossing the 50-day moving average, and also its golden (Fibonacci) ratio (not shown in the chart). The sequence of further important thresholds are crossing the 200-day moving average (4,057), crossing the technical resistance (4,100) and then, much later, its golden cross (the 50-day crossing the 200-day moving average). We still do not expect a smooth ride, should all this materialise.

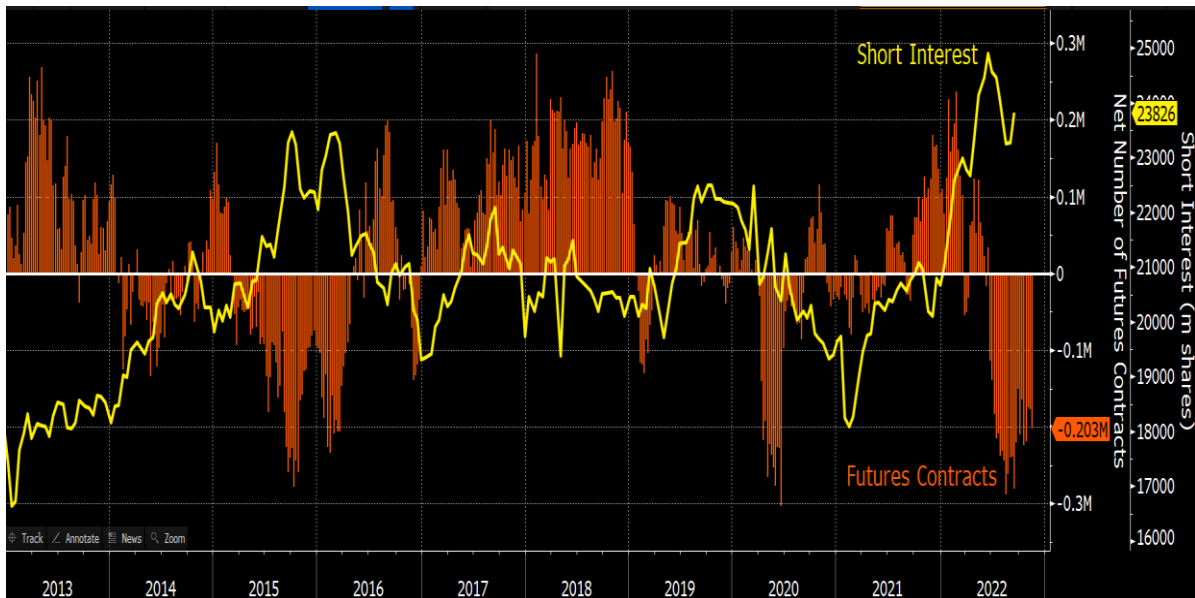


US – Dow Smart Money Index vs Dow Index



The Smart Money read the recent bounce in stock prices well (the spike off the bottom). It seems, though, that they are currently taking a neutral stance again.

S&P 500 – Short Interest vs Net Number of Futures Contracts



This year has been characterized by record Short Interests and the negative number of futures contracts on the S&P 500. Whilst both series still are at elevated historic levels, they have turned for the better. This indicates less pessimism, but still holding a cautious stance, which is typical following extreme market conditions.

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RISK DISCLOSURE

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