GLOBAL EQUITY PERSPECTIVES 3 JUNE 2024

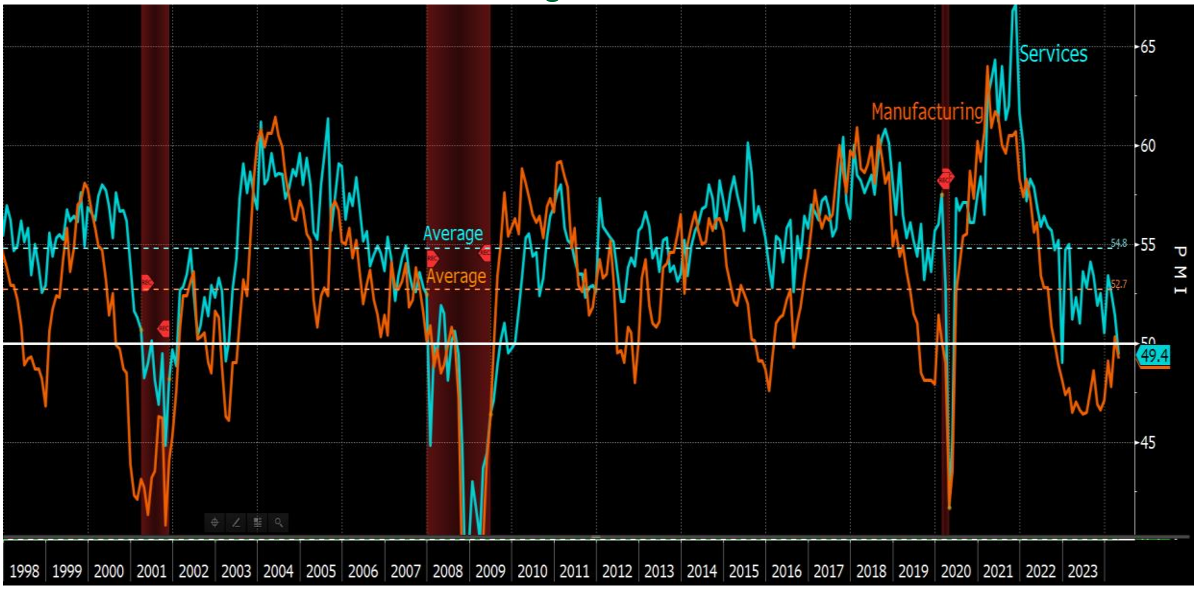
"To see things in the seed, that is genius."

Lao Tzu

1. US 'NO LANDING' ECONOMY

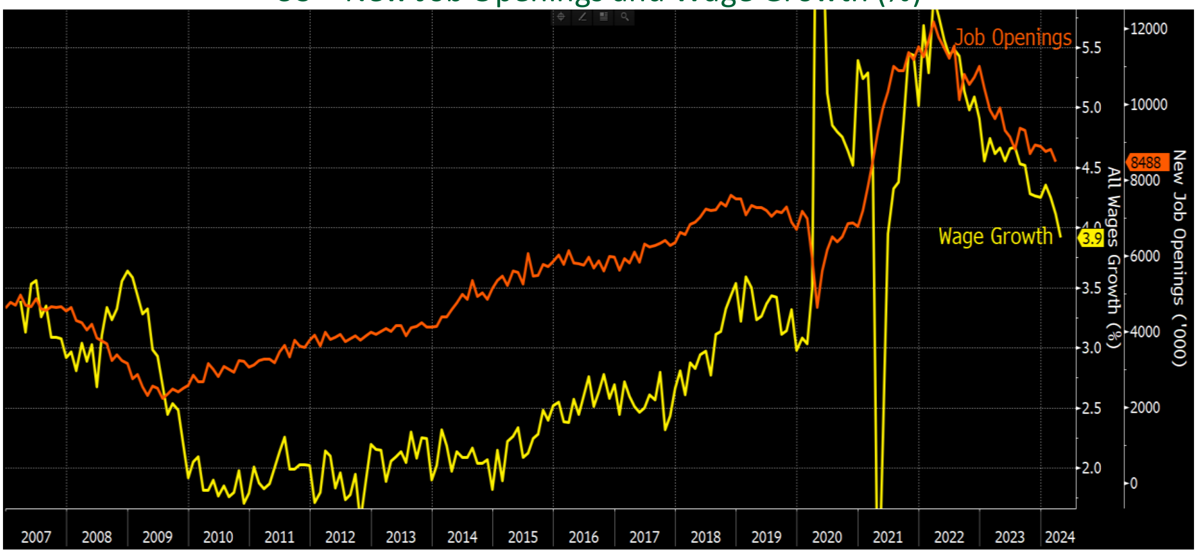
Considering some strong cyclical sector performances this year, it seems many investors have an optimistic view of a 'no landing' US economy.

US – Manufacturing and Services PMI Indices



Contrary to such optimistic views, both the Services and Manufacturing PMI indices are currently marginally in contraction territory.

US – New Job Openings and Wage Growth (%)

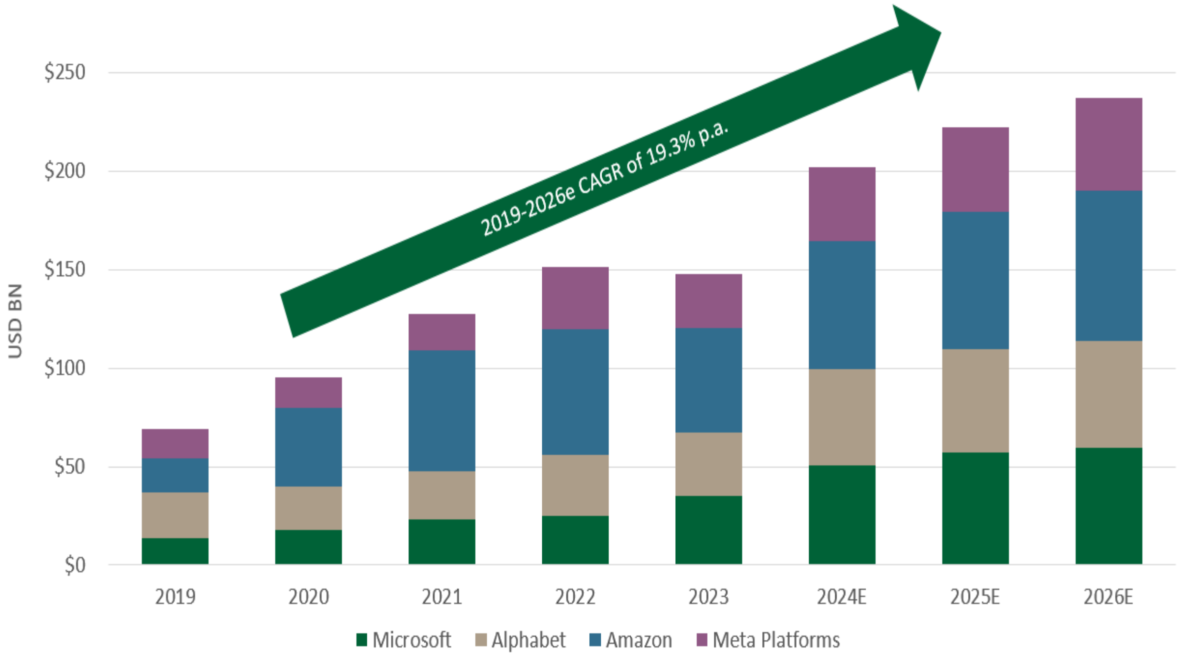


Most employment data series currently have negative signals. New Job Openings have already dropped by almost 30% with Wage Growth following suit, currently just marginally in positive real territory. Credit card delinquencies are at a twelve-year high. We have reservations whether these indicate a 'no landing' economic outlook – we still anticipate a 'soft landing' low growth outcome.

2. US CAPITAL EXPENDITURE

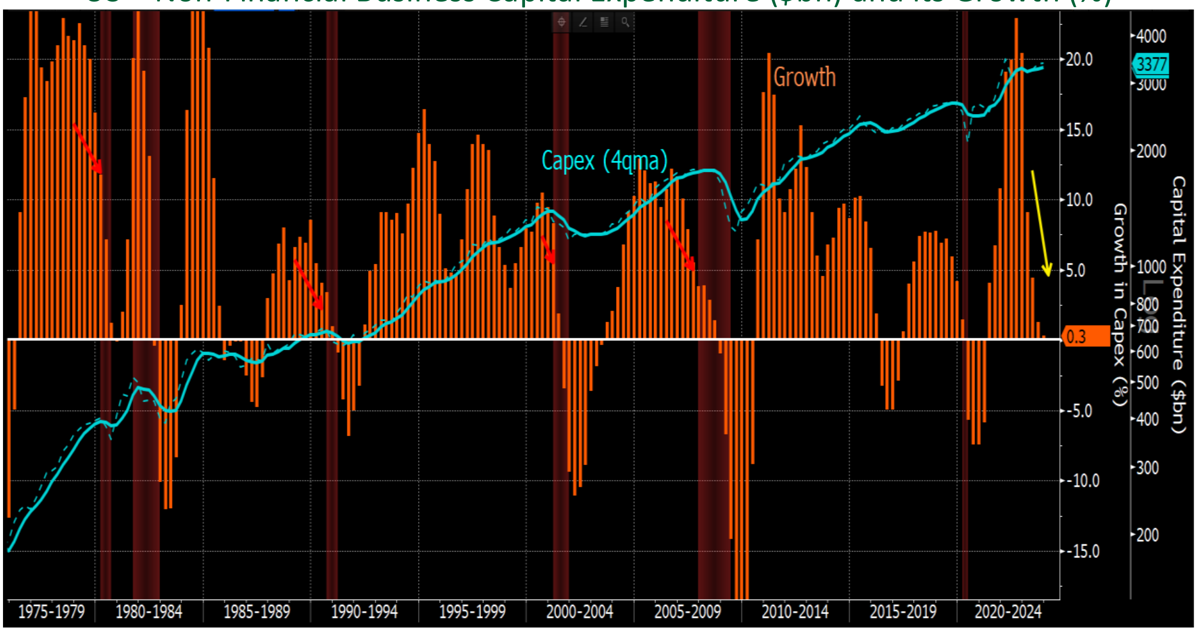
The US Technology sector had a relatively flat capital expenditure budget last year because of many clients optimizing their existing services. Off this low base and major AI needs kicking in, many in the sector are increasing their budgets. The following chart reflects the total capital expenditures for the four major operators:

US – Big Four Technology Capital Expenditures ($bn)



The budgeted increase this year is up over a third to $200bn, with the compounded growth over the above chart's period being almost 20% p.a. The remaining constituents of the S&P 500 Technology Index bring the total to $350bn. This clearly is a good stimulus for the economy.

US – Non-Financial Business Capital Expenditure ($bn) and its Growth (%)

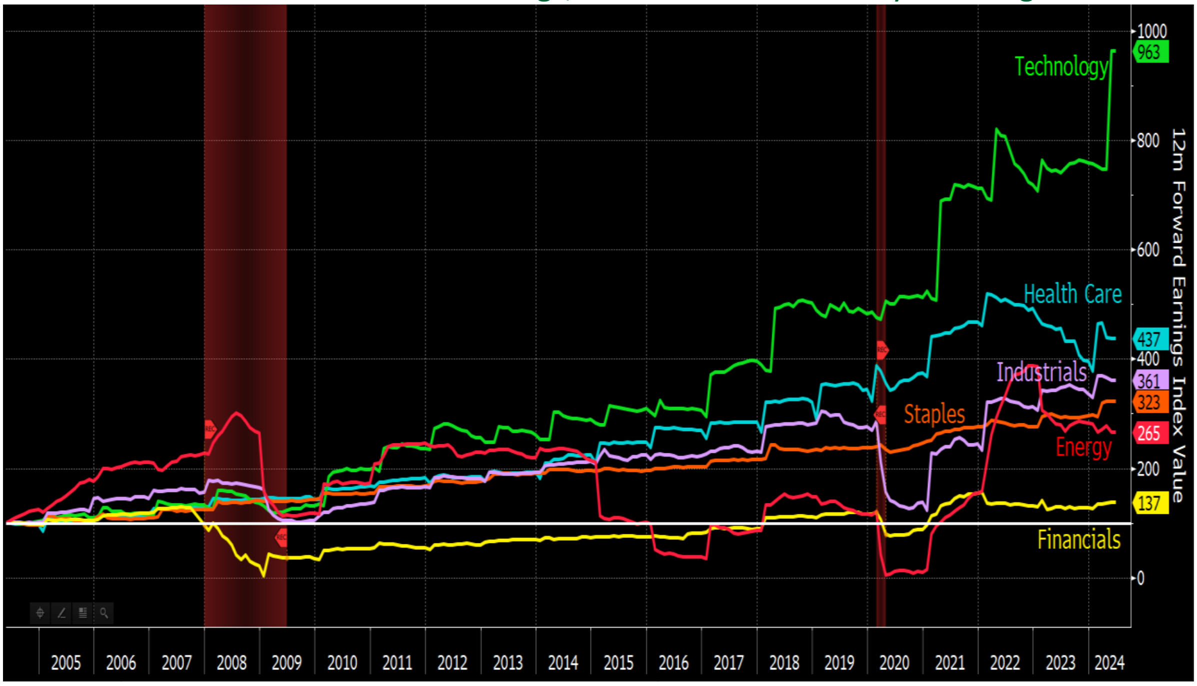


The total US business capital expenditure has worryingly almost flatlined at ~$3.5tn since the end of last year. The increase in Technology's plans in this context is therefore very welcome but makes up only around a 10% direct contribution. Whilst many industrial companies benefit from the infrastructure to be put in place around AI and datacenter developments, we hope overall capital expenditure can also turn the corner and support the US economy.

3. SECTOR OPPORTUNITIES

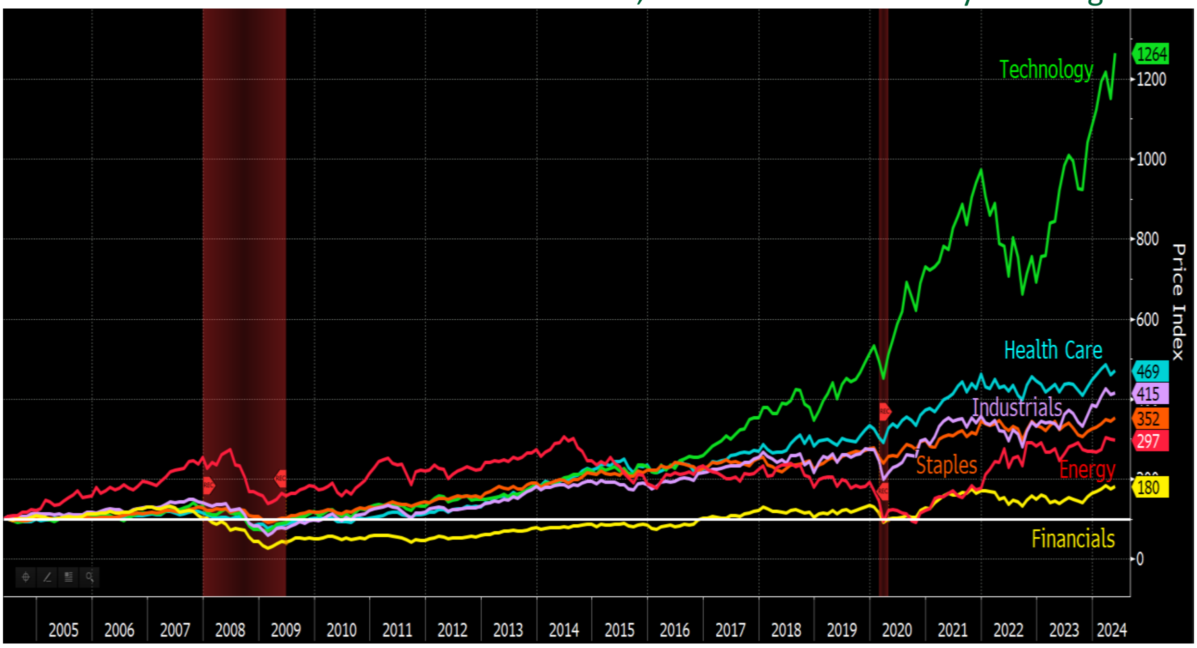
Logically share prices follow earnings over time. We have considered the growth in earnings of the main S&P 500 sectors in the following chart:

Main S&P 500 Sector Earnings, Indexed to 100 Twenty Years Ago



The sequence of earnings growth has been Technology, Health Care, Industrials, Staples, Energy and Financials. Technology delivered almost a tenfold increase, more than double the growth that Health Care did. It is also striking that Industrial earnings growth exceeds those of Staples and Energy. Financials delivered a dismal result, barely exceeding its earnings immediately before the Financial Crisis.

Main S&P 500 Sector Price Performance, Indexed to 100 Twenty Years Ago



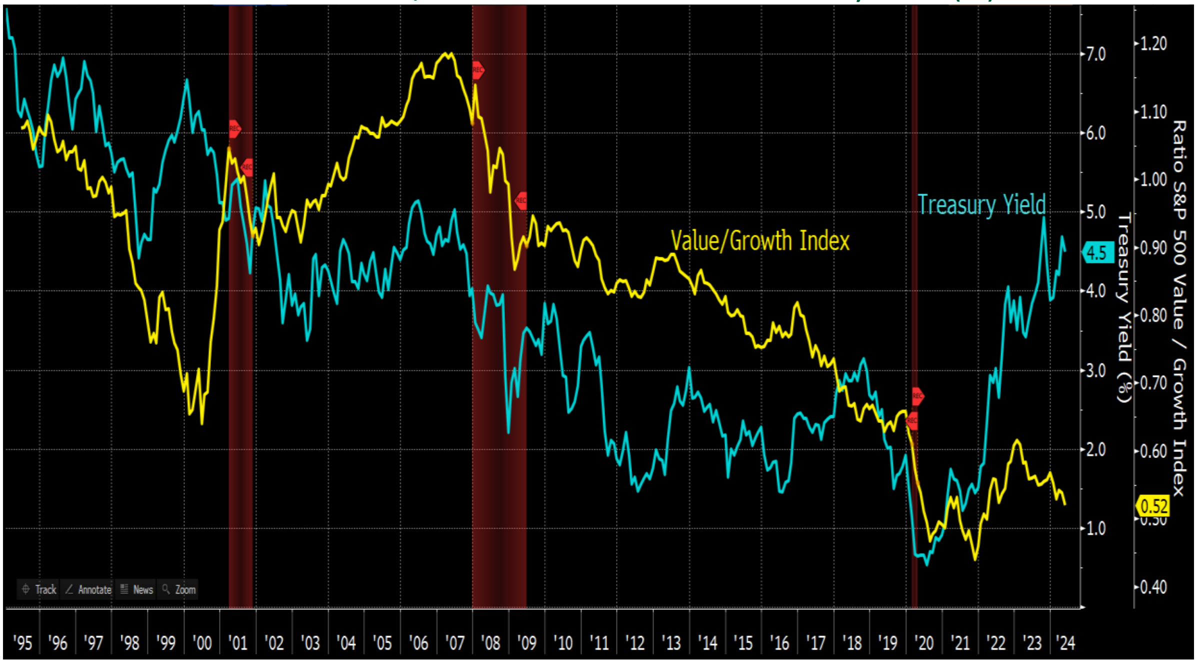
In terms of capital growth, the sequence of delivery has stayed the same, with all sectors delivering better on this front than their earnings – implying re-ratings for all. Technology has done particularly well, with capital growth delivering +13.5% p.a. over the period.

On this basis, we have the correct large exposures in Technology and Health Care, and we can clearly consider increasing our Industrials exposure.

4. GROWTH INVESTING

With a view that we are rather heading for a US 'soft landing' than a 'no landing' economy (the latter of which would result in a structurally accelerating economy), many investors may reconsider their Growth vs Value style of investing.

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



The Value/Growth Index logically correlates to a degree over time with the level of interest rates. It has for the past year, though, dropped despite the rise in interest rates with inflation staying stubbornly high and the Federal Reserve repeatedly warning of them not cutting their target rate anytime soon. Our perception is that investors have formed the view that most of that 'water is under the bridge' and that we have seen the peak in US interest rates. We believe Equity investors are therefore taking a more cautious approach and are investing for Growth.

S&P 500 Quality vs Growth Index

The above chart reflects the relative performance of Quality vs Growth. Quality has outperformed over time, and specifically during lower economic growth periods. We combine Quality and Growth in our investment strategy (not incorporating Growth businesses that have strong topline growth but low profitability), and believe that we are well positioned considering the US economic outlook.

5. VALUATIONS

Equity valuations are undeniably high currently, with the S&P 500 forward P/E ratio at 21.8 compared to its long-term average of 18.0. The following chart puts its valuation also in the context of interest rates over time:

S&P 500 – Forward Equity Risk Premium (%)

The Equity Risk Premium has dropped to almost zero. This implies that Equity investors may expect a combination of structurally strong earnings growth along with a drop in interest rates. We do recognise the fact that the S&P 500 Index has changed materially over time, and that its largest constituents may well provide strong earnings growth for longer than the case was before, but we remain conscious of the fact that there is an Equity Risk Premium gap to the long-term average of about 1.75%. This indicates the importance of US inflation dropping to allow the Federal Reserve to cut its target rate.

S&P 500 – Index vs Consensus Valuation ($)

We put high value to the above chart, reflecting the Index valuation based on the fundamental valuations of all the individual constituents. It is clear how closely the Index followed the Valuation over time, and the excellent opportunity the market was offered in 2022. The upside on this basis is +11% over the coming year, compared to +12% on average since 2010. This is attractive enough to stay invested.

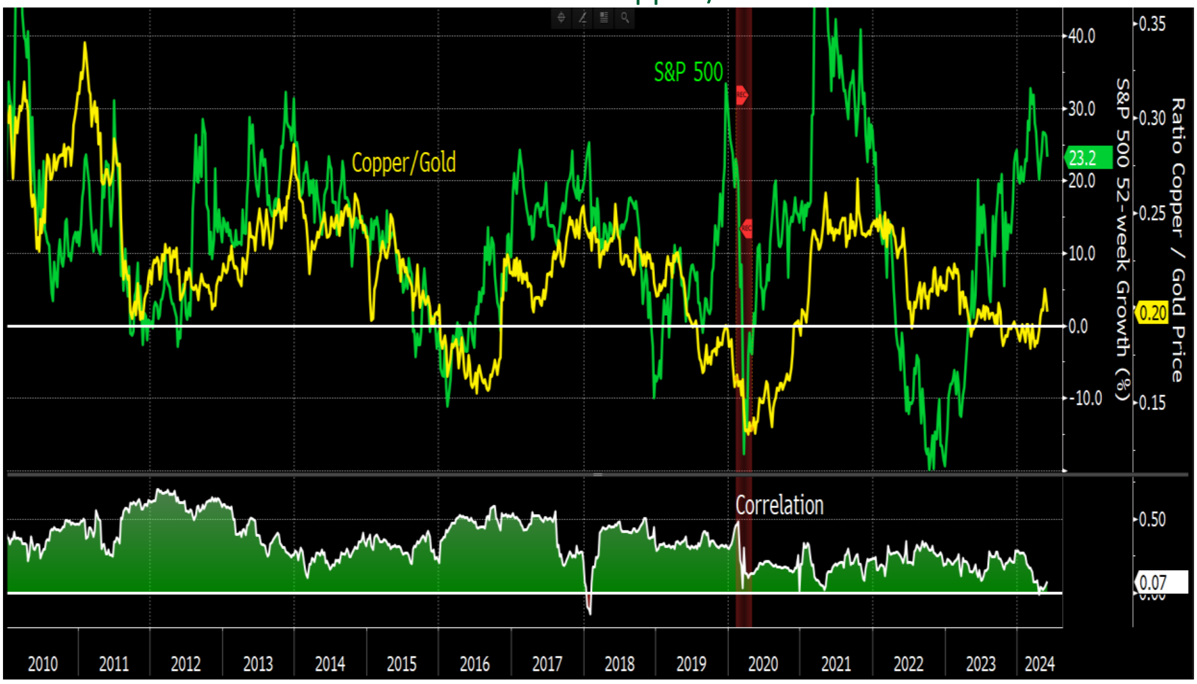
We are very conscious of high stock market valuations and focus specifically on each business's fundamental valuation, allowing room for error.

6. TECHNICAL PICTURE

The overall S&P 500 technical picture currently is relatively mildly overbought, but with no particular alarms.

We find the following chart intriguing:

S&P 500 Growth vs Copper / Gold Ratio



The upper part of the chart shows the growth in the S&P 500 Index along with the Copper / Gold ratio. The bottom section of the chart reflects the correlation between the two series. Whereas there historically was a (logical) positive correlation reflecting constructive economic circumstances against investor uncertainties, it has recently diminished.

Irrespective of economic circumstances, Copper has new attractions in the form of the need for more electricity and green energy, as BHP Billiton's recent bid for Anglo American confirms. Against this, we perceive Gold's current strength being mainly based on insurance needs because of the geopolitical tensions in the world, certain central bank buying and views for US interest rates and the Dollar to drop. Until some of these new influences disappear, we cannot apply the chart's same historic fundamental value anymore.

Gerrit Smit

Partner - Head of Global Equity Management
Stonehage Fleming Investment Management Limited
6 St James's Square
London
SW1Y 4JU

T +44 20 7087 0000
Email gerrit.smit@stonehagefleming.com
www.stonehagefleming.com/gbi

RISK DISCLOSURE

Unless otherwise stated, the charts and data used in this document are sourced from Bloomberg, June 2024.

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.

Opinions expressed here are as of the date of publication and subject to change without notice. Stonehage Fleming Investment Management shall not be responsible for any trading decisions, damages, or other losses resulting from, or related to, the information, data, analyses or opinions contained herein or their use, which do not constitute investment advice, are provided as of the date written, are provided solely for informational purposes and therefore are not an offer to buy or sell a security.

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.

Issued by Stonehage Fleming Investment Management Limited. Authorised and regulated in the UK by the Financial Conduct Authority (FRN No.: 194382) 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).