

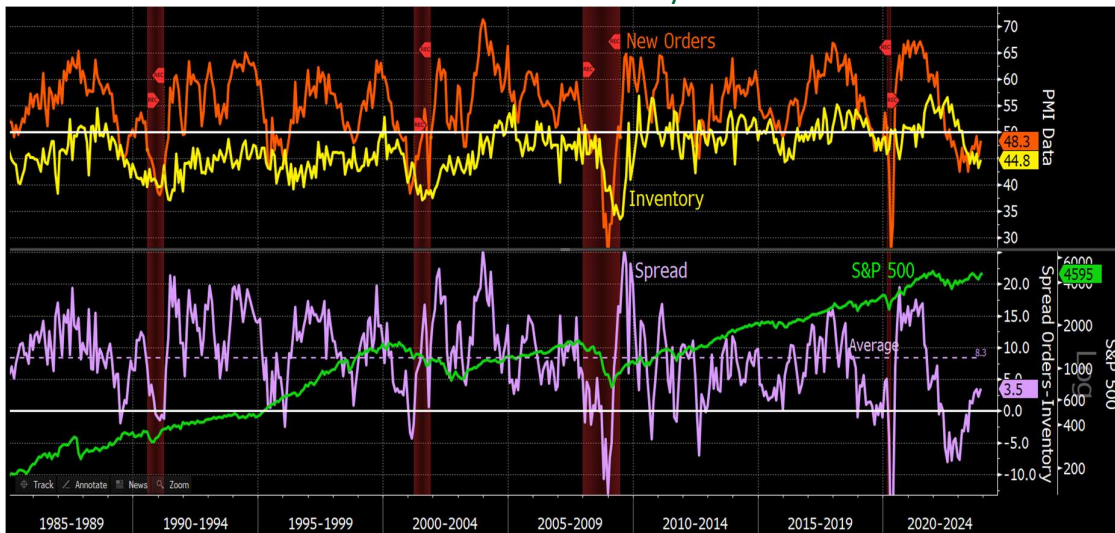
*"People calculate too much and think too little."*

Charlie Munger

## 1. US RECESSION

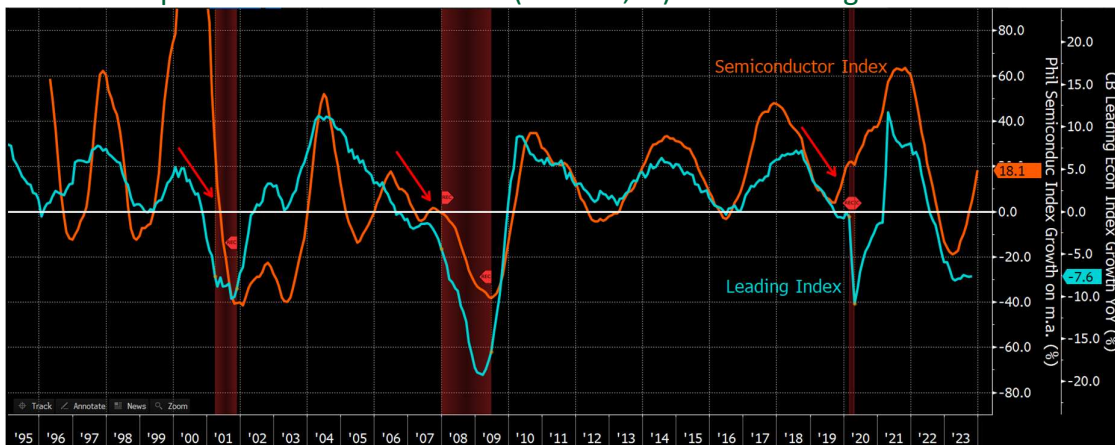
The most ever anticipated US recession has still not arrived yet, despite the Federal Reserve (Fed) aggressively taking their target rate to a two-decade high. There are, though, various indications that interest rates are starting to have an effect, with the economy starting to cool and, amongst others, the employment market getting softer. The question now becomes how deep a potential recession may be.

US – New Orders vs Inventory PMI Indices



Some of the more positive aspects are that consumer confidence remains stable, retail sales keep growing well in real terms and businesses have been cautious all along, being prepared and keeping inventories low. As the above chart depicts, demand currently exceeds supply (the spread line).

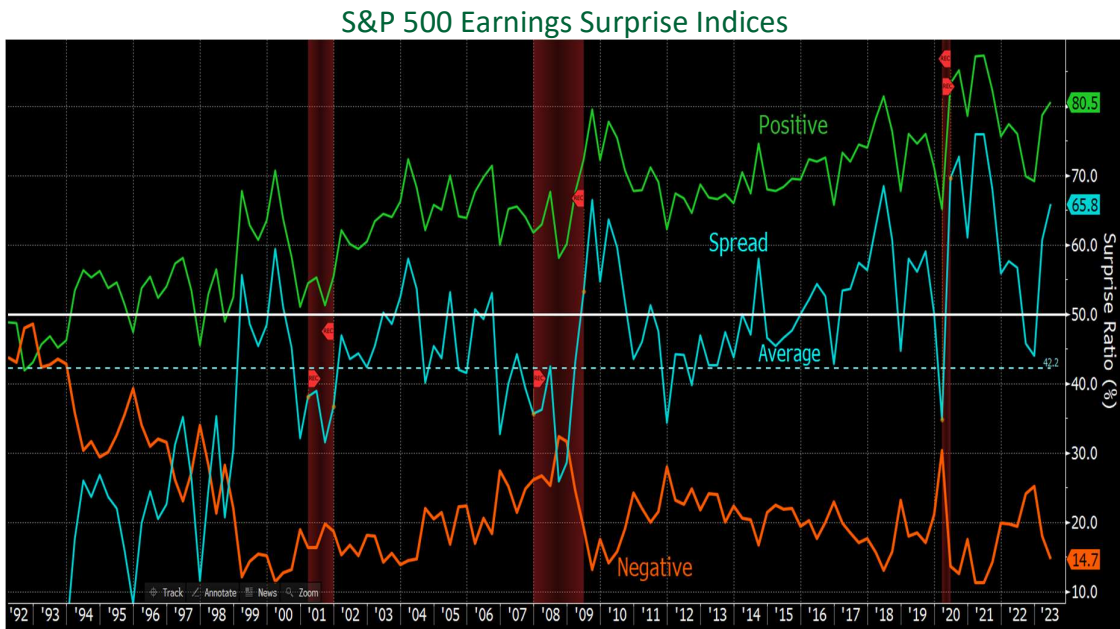
Philadelphia Semiconductor Index (Growth, %) vs CB Leading Economic Index



The above authoritative Leading Economic Index has for long been in negative territory, and seems to be bottoming out, historically closer to the end of a recession. With a strong correlation, the Semiconductor Index has already turned positive. Whilst some of that may be about AI, not much is. With further supporting arguments, we believe we can budget for a 'soft landing' of the US economy.

## 2. COMPANY EARNINGS

With the third quarter earnings season completed, we can consider the overall outcome to assess shareholders' outcome.



Over eighty percent of S&P 500 constituents have delivered better than expected results, with less than fifteen percent disappointing. On balance, two thirds of those companies delivered positive surprises, which is at the high end of historic levels. Shareholders generally have more reason to be cheerful than not.

### S&P 500 – Consensus Earnings Expectations vs South Korea Exports (Growth %)



Consensus expectations are for S&P 500 earnings to grow six percent in the coming year. As the blue line in the chart above depicts, these expectations are in the process of increasing from negative levels recently. Because of the nature of South Korean exports, they are a good indication of international economic conditions. These exports have turned positive recently and seem to support analysts' constructive view on S&P 500 earnings.



### 3. CASH & INTEREST

It is a capital market feature how sharply interest rates dropped in November. The 0.7% drop in the 10-year Treasury yield was the sharpest for a month since 2008. In our view, this reflects a growing perception that the US economy is cooling, and that the Fed's tightening task is done. We also believe capital markets are in process of normalising and that current still higher interest rates are the new norm.

US – Money Market Fund Values & Estimated Interest Income (\$bn)



The value of US Money Market Funds keeps growing, currently at a new record level of \$5.8 tn. The estimated annual interest income on these funds amounts to over \$300 bn against very little two years ago. Many companies also enjoy this new source of earnings – for example, Alphabet earned \$1.07bn just over the third quarter. This represents 5% of their earnings. Whilst the other side of the proverbial coin is a huge fundamental issue, this also illustrates the new opportunities active stock selectors enjoy. In fact, despite the earlier low interest rates, shares of businesses with strong balance sheets have been outperforming those with weak ones by 30% since the Pandemic.

US – Total Bank Deposits and Money Market Funds (\$bn)

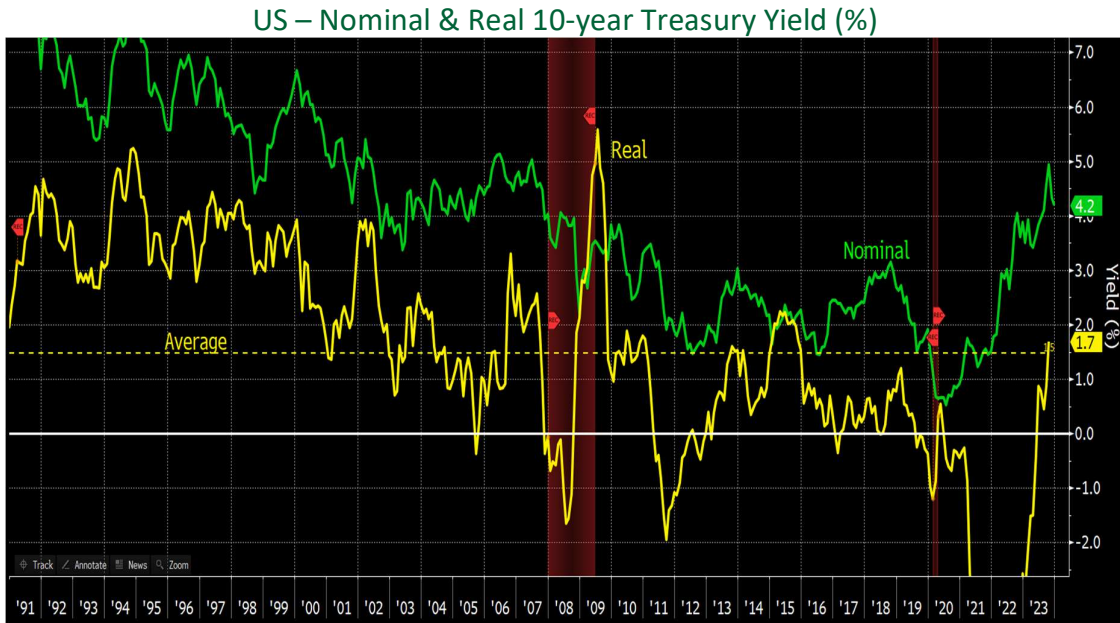


The above chart reflects the total value of all Bank Deposits and Money Market Funds (the green line). After a short period last year of it stabilising, it is again in a rising trend, and currently at a record level of almost \$22tn. This represents over 45% of the total US listed companies' market capitalization. Whilst we would not make a point of this potentially getting invested, it is clear that meaningful liquidity is present in the US capital markets.

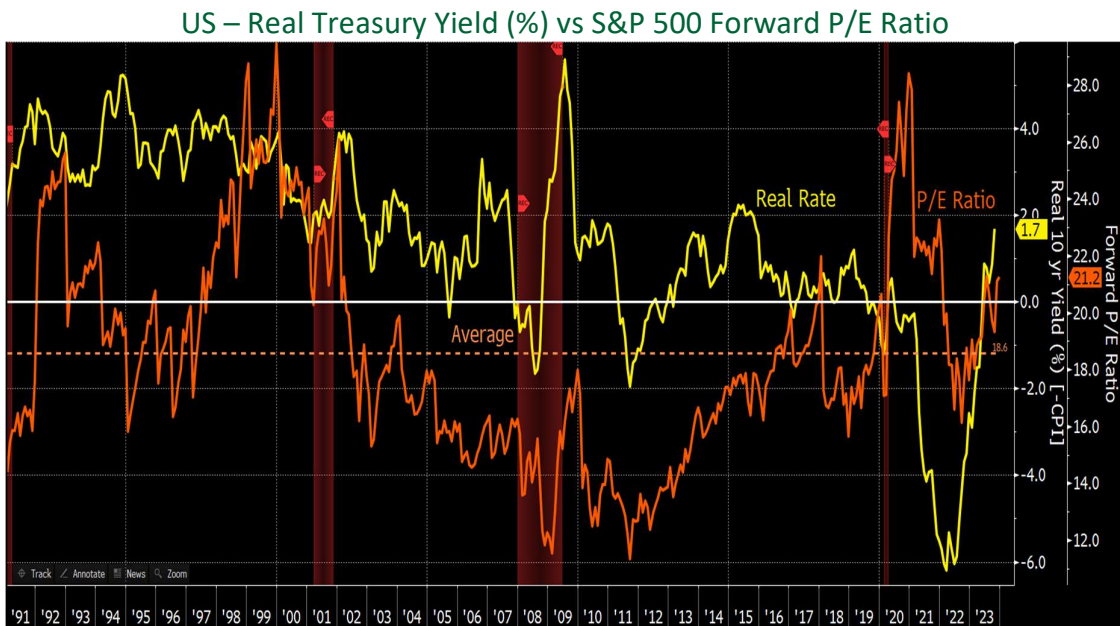


## 4. REAL RATES

Following the turbulent times of the Pandemic and the following aggressive Fed tightening, the US is now back in environment of positive real rates:



As touched on earlier, it seems US nominal rates have peaked (the green line). If so, this is constructive for capital markets. Furthermore, despite US inflation still well above the Fed's target level, their real rate (the yellow line) is currently slightly above its long-term average. Whilst this changes the base for some capital market activities, it is pleasing to observe that the US economy and capital markets have normalised and that investors have fewer destabilising factors to discount.



We have updated our chart above, illustrating the positive correlation between real rates and equity valuations. Whilst some investors fear real interest rates, the normalised economic conditions they reflect are an important determinant of stock market sentiment.



## 5. VALUATIONS

With macroeconomic and capital market environments returning to normality, along with material liquidity in the system, we should expect valuations to be above average:

### S&P 500 – P/E and Forward P/E Ratios



Both the trailing and forward S&P 500 P/E ratios are currently half a standard deviation above average. The risk that implies, or not, is clearly predominantly a function of the potential recession lying ahead. As we have earlier indicated, we believe it can be a relatively shallow recession – should a recession occur.

### S&P 500 – Price Index vs Consensus 12-month Forward Bottom-Up Valuation



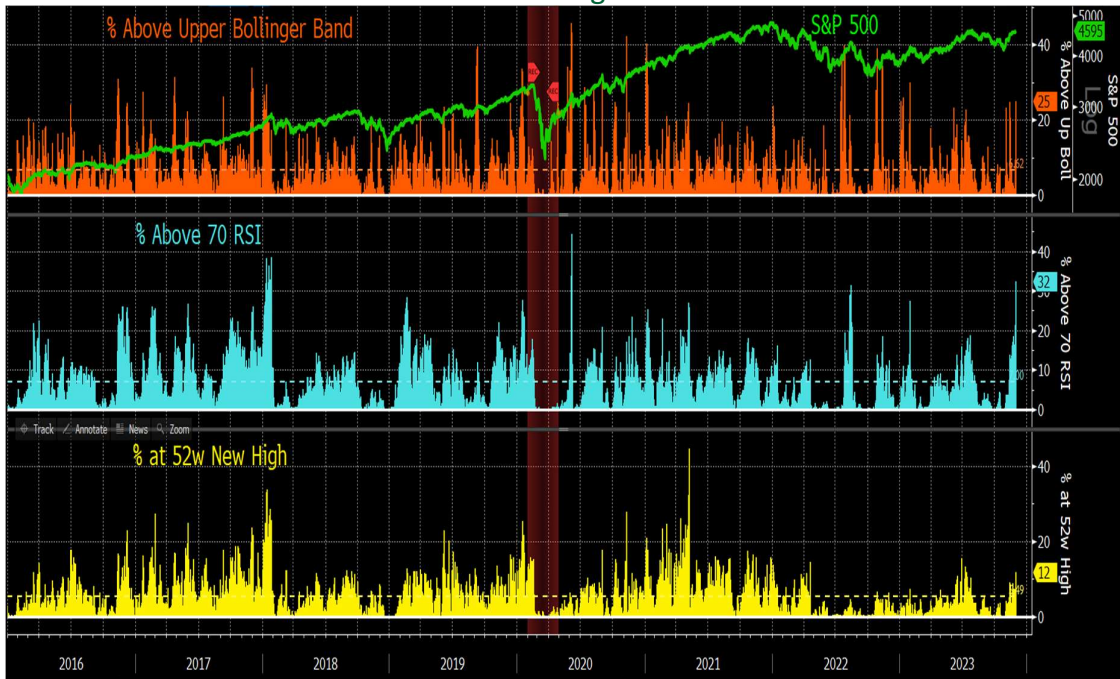
The above chart shows the bottom-up consensus S&P 500 Valuation. It is clear how the Price Index has historically followed the Valuation Index. The discrepancy between the two series currently is +10%, slightly lower than the long-term average discrepancy of +13%. This also indicates that active stock selection is currently necessary to identify the more attractive opportunities.



## 6. TECHNICAL PICTURE

The following chart reflects the percentage of S&P 500 constituents that are above three thresholds:

### S&P 500 vs % of Stocks above Their Upper Bollinger Band, their 70 RSI Levels and at New Highs



The first two thresholds are currently exceeded by quite a margin. Relatively fewer (12%) of stocks are at new highs. This reflects the strong November stock market and argues for a pause sometime.

## 7. 2023 AFTER ALL

This year has delivered a strong recovery from the low base of last year. Equities have proven themselves again to be an asset class of choice. Active stock selection, based on thorough research, delivered well. We could again rely on humankind's intellect, energy and enthusiasm to create and grow their wealth. That will always be the case. It is especially pleasing to see the US economy and capital markets normalising following the Pandemic and the subsequent most aggressive Fed tightening cycle ever. We continue to test equities' real value against Gold. It remains in a positive trend:

### S&P 500 Value vs Gold Price



## 8. 2024 WISH LIST

Investors face a New Year with the risk of a potential US recession and a dull earnings outlook. They can, though, realistically again wish for some proverbial 'swallows for the summer':

- The rent component of US inflation can moderate further and assist to temper headline inflation towards the Fed's 2% target level.
- The Fed's tightening task for this cycle may already be done with them having been successful in getting the target rate to their desired level with no material damage to the economy.
- We may already have seen this cycle's peak US interest rates, with support to equities from this front.
- The Fed may not find it necessary to cut rates in the first half of 2024.
- The US may experience a 'soft economic landing' instead of a normal recession.
- Positive AI and Cloud developments may prove the sceptics of the Magnificent Seven wrong.
- Some of the overly negative stock market reactions on the GLP-1 drug may revert.
- China can hopefully find a way to stimulate their economy more effectively.
- Ukraine/Russia and Israel/Hamas may hopefully find a way to address their tensions.
- The US election may again prove to be of less significance to capital markets.

*Our sincere gratitude to our clients for your continuing support and friendship through another investment year. It is hugely appreciated. We wish you and yours all the very best for the Festive Season and the New Year.*

**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](mailto:gerrit.smit@stonehagefleming.com)  
[www.stonehagefleming.com/gbi](http://www.stonehagefleming.com/gbi)



## RISK DISCLOSURE

Unless otherwise stated, the charts and data used in this document are sourced from Bloomberg, December 2023.

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).

