

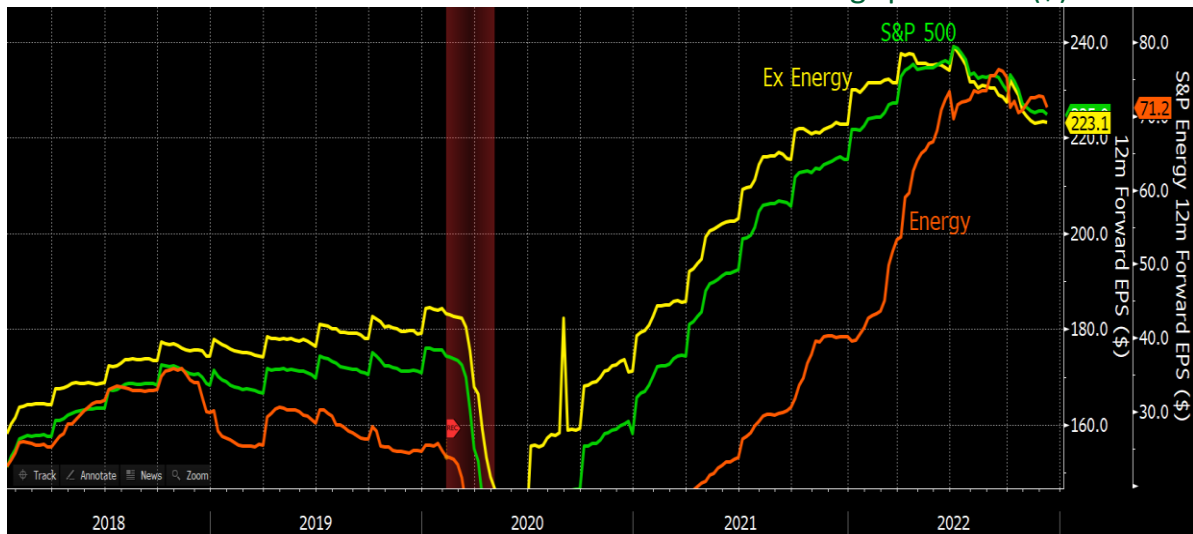
"The measure of who we are is what we do with what we have."

Vince Lombardi

1. EARNINGS EXPECTATIONS

At the end of this volatile year, we consider the earnings outlook for the coming year:

US – Consensus S&P 500 12 Month Forward Earnings per Share (\$)

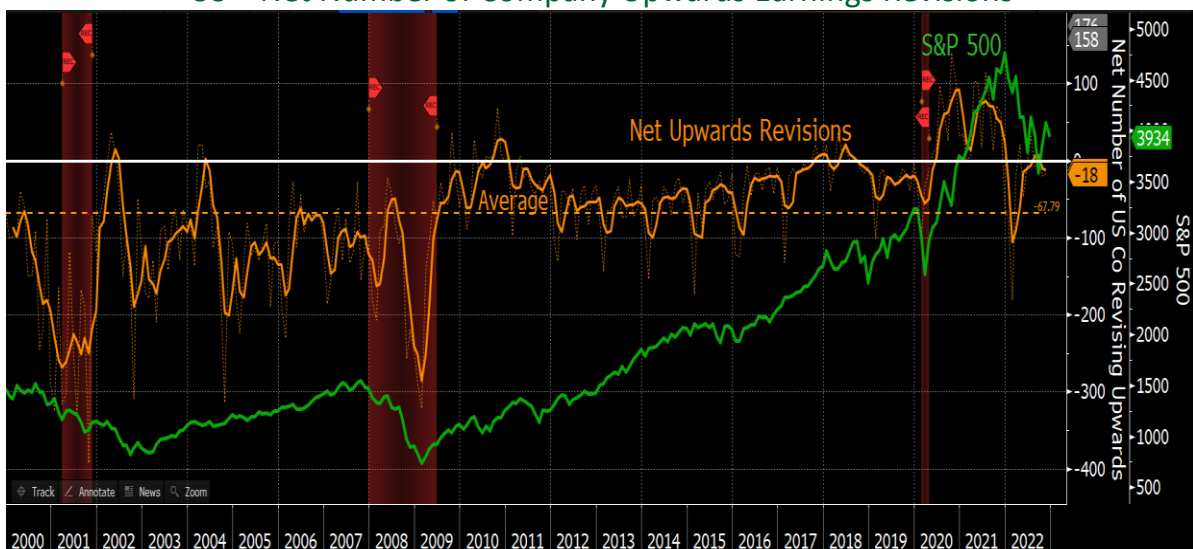


Current overall index earnings expectations started rolling over in July (green line), but still with positive real growth (the table). They were initially strongly supported by Energy, but with the oil price now at a record low for the year, the growth outlook over the next twelve months has started to reverse in favour of non-Energy sectors.

12 Month Forward Consensus Earnings per Share Growth

	Compared to Current Earnings	Compared to Expectations a Year Ago	Compared to Recent Peak Expectations
S&P 500	8.7%	4.3%	-5.9%
S&P Ex Energy	10.2%	0.0%	-6.6%
S&P Energy	-3.9%	77.6%	-6.7%

US – Net Number of Company Upwards Earnings Revisions

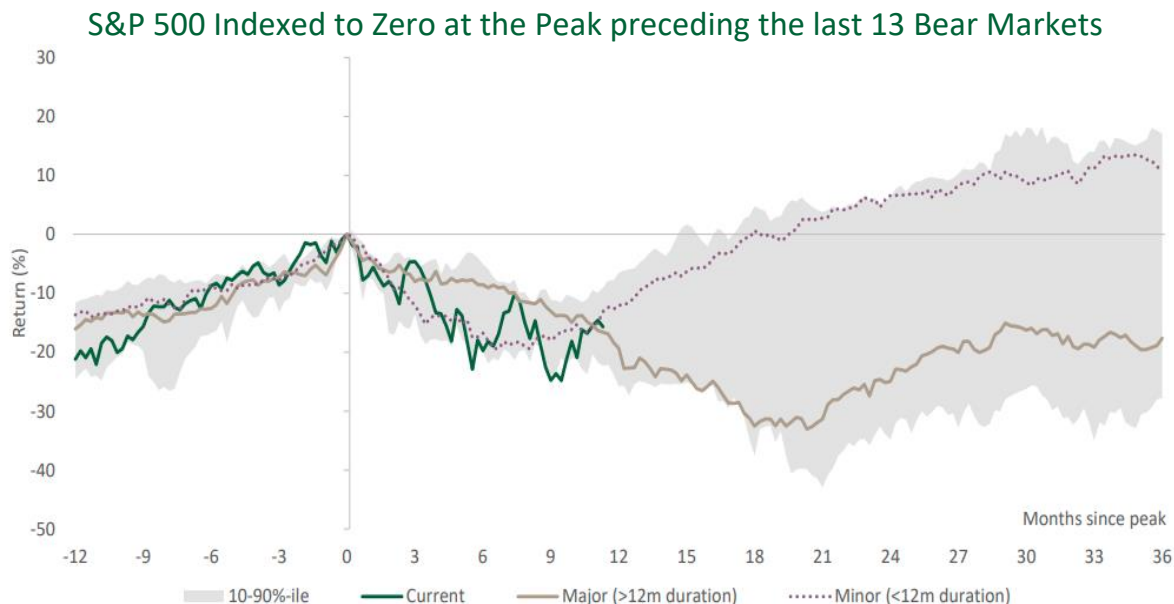


Source: Bloomberg; Stonehage Fleming Investment Management Limited. August 2022. **Past performance is not a guide to future performance.**

The net number of company outlook revisions has returned to almost a neutral level (-18 currently). This is better than the -67 average since the turn of the century. The series has a fair correlation with share prices (the S&P 500 Index in the preceding chart). With share prices substantially down this year, we therefore conclude that the moderation of next year's earnings expectations is already well discounted.

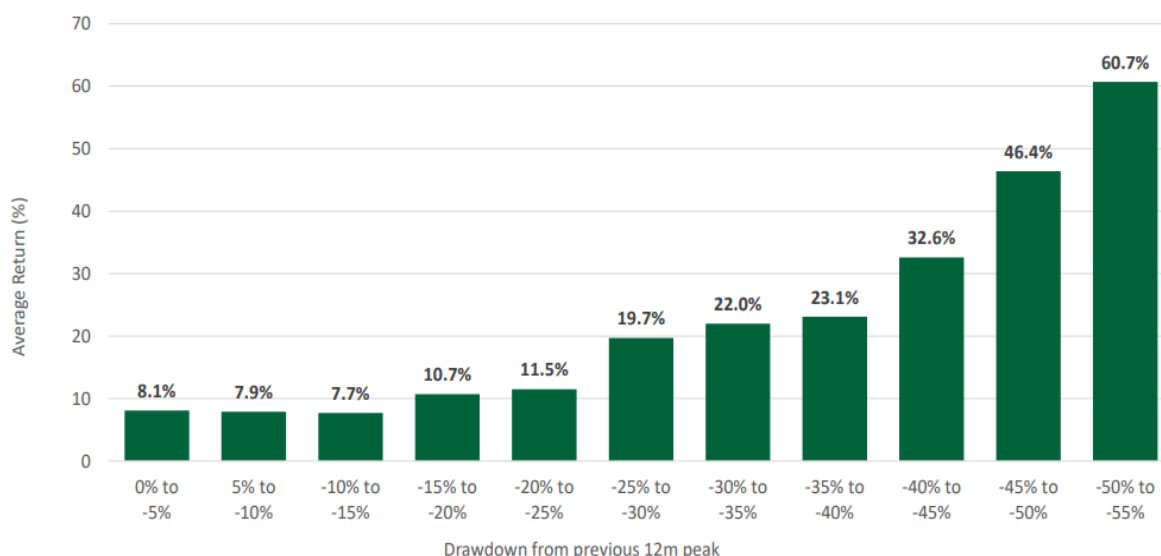
2. BEAR MARKET PICTURE

The following chart reflects how the last 13 US bear markets evolved:



We make a distinction between major (>12 months, brown line) and minor (<12 months, dotted line) bear markets. The current bear market (green line) behaved thus far more akin to a minor bear market. We are currently at a striking juncture of being exactly between a typical major and a minor bear market pattern. Its subsequent pathway may well be predominantly determined by US inflation and the Federal Reserve (Fed)'s further increases of its target rate.

S&P 500 – 12 Month Return Following Various Drawdown Levels



From its most recent peak on 3 January, the S&P dropped by -25.4% to its recent low on 12 October. This puts it in the middle drawdown category in the above chart. It has since recovered by +10.0%, leaving another +9.7% over the coming ten months according to its historic recovery tracks.

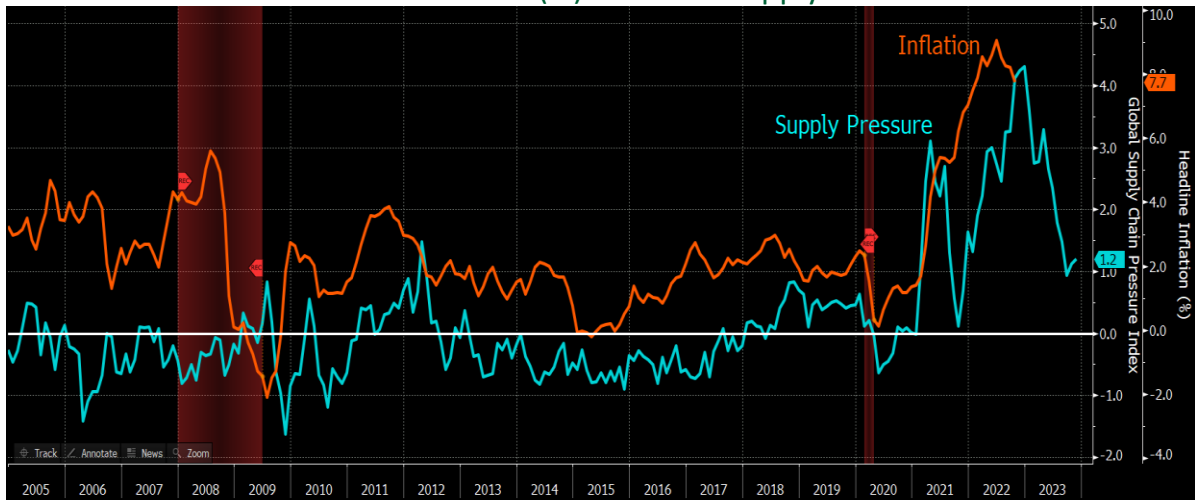
Source: TS Lombard; LPL Research; Factset; Stonehage Fleming Investment Management Limited. August 2022. Past performance is not a guide to future performance.



3. US INFLATION

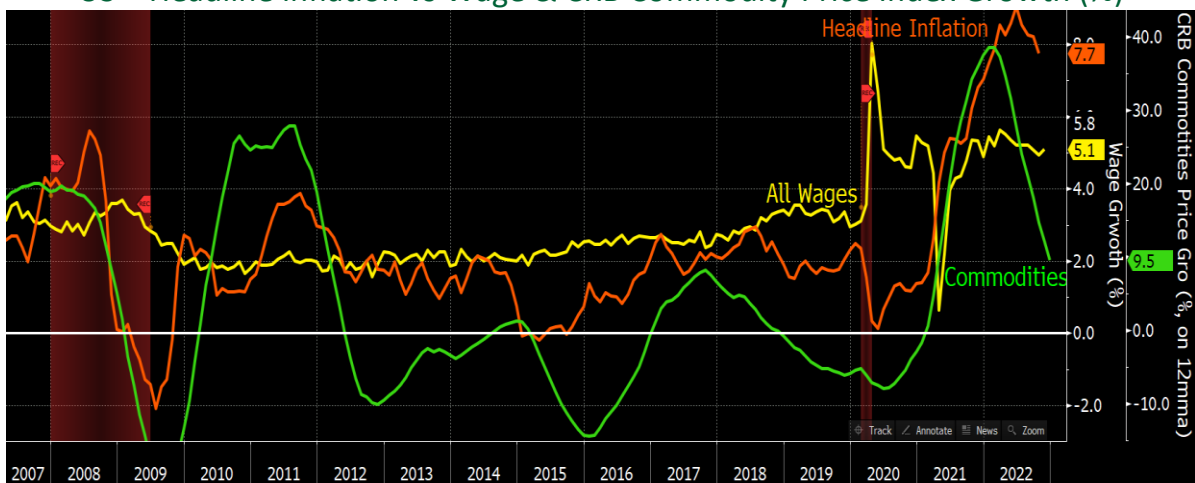
The November US headline inflation number will be announced tomorrow. The consensus expectation is for a drop from 7.7% to 7.3%. We show various charts with background information:

US – Headline Inflation (%) vs Global Supply Chain Index



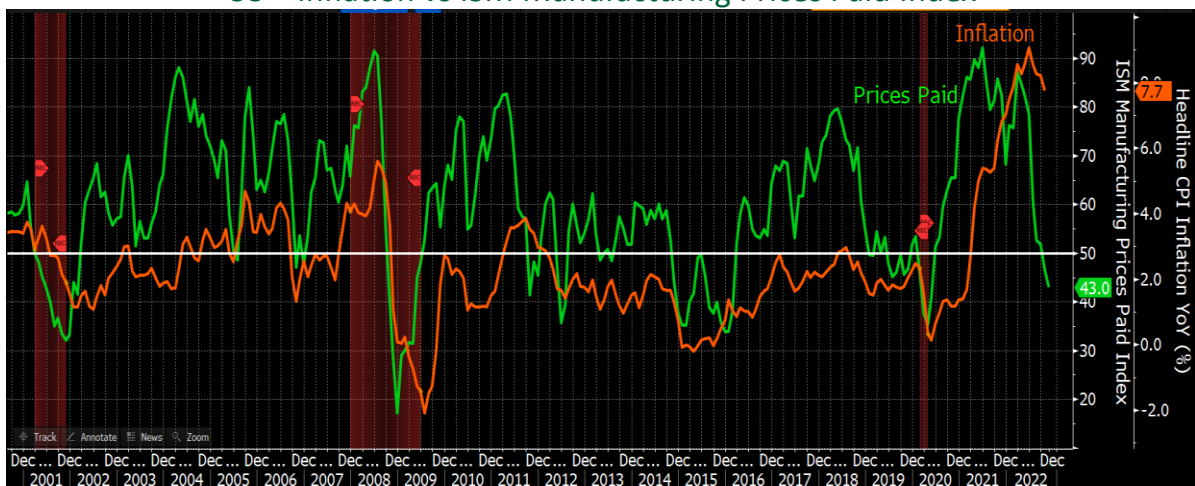
Global supply chain issues seem to be to some extent resolved, considering the Pressure Index in the above chart. As an indication, East-West Container prices has dropped by -76% from a year ago. The index has a strong correlation with Inflation, and leads us to believe Inflation has some way to drop.

US – Headline Inflation vs Wage & CRB Commodity Price Index Growth (%)



Wage growth remains stable, while the growth in the CRM Commodity Index is dropping.

US – Inflation vs ISM Manufacturing Prices Paid Index

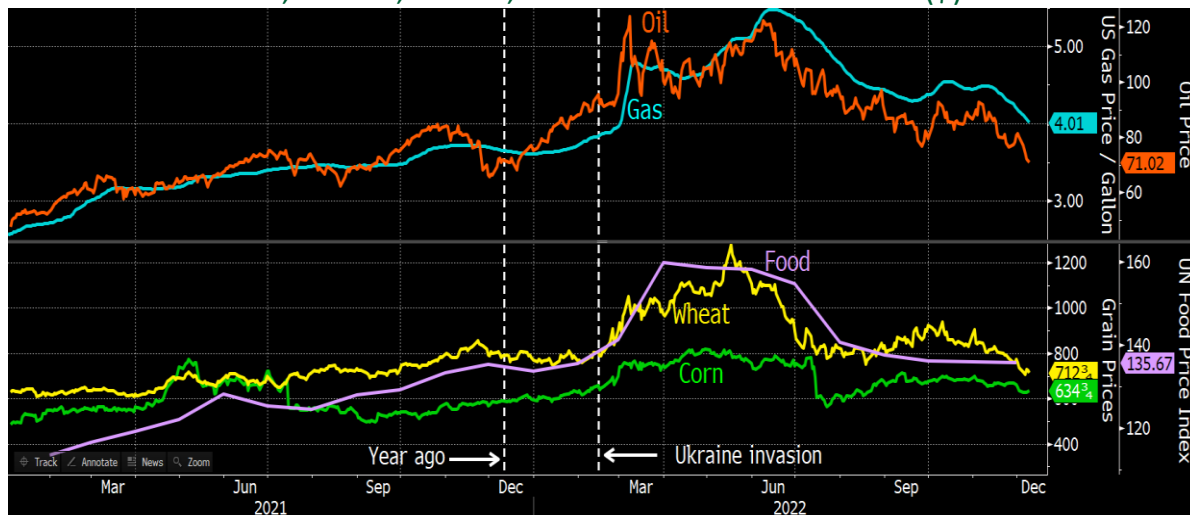


Source: Bloomberg; Stonehage Fleming Investment Management Limited. August 2022. **Past performance is not a guide to future performance.**



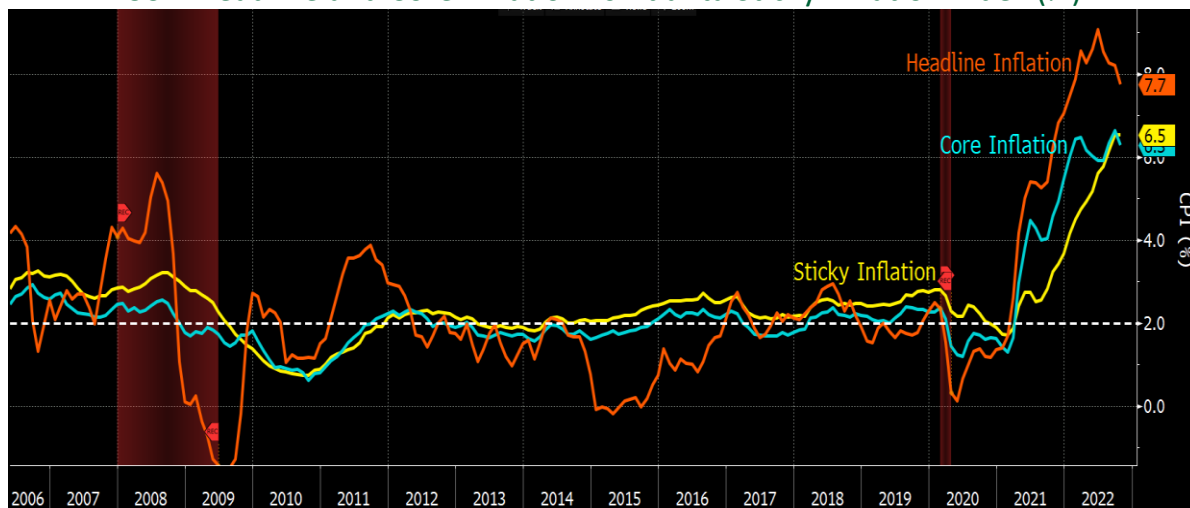
The index of Manufacturers' Prices Paid has dropped into contraction territory. Historically, it has a good correlation with Inflation.

Oil, US Gas, Wheat, Corn & UN Food Price Index (\$)



The oil price is back at its level a year ago. The US gas price is dropping sharply, currently 10% above its level a year ago. The corn and UN food price indices are at their levels a year ago, wheat below its own.

US – Headline and Core Inflation vs Atlanta Sticky Inflation Index (%)



With core inflation hovering between 6% and 6.5%, the Atlanta Fed Sticky Inflation Index has increased to the latter level. Occupational rent is currently at 7.0%. This may support Core Inflation for a while still.

US – Inflation Expectations (%)

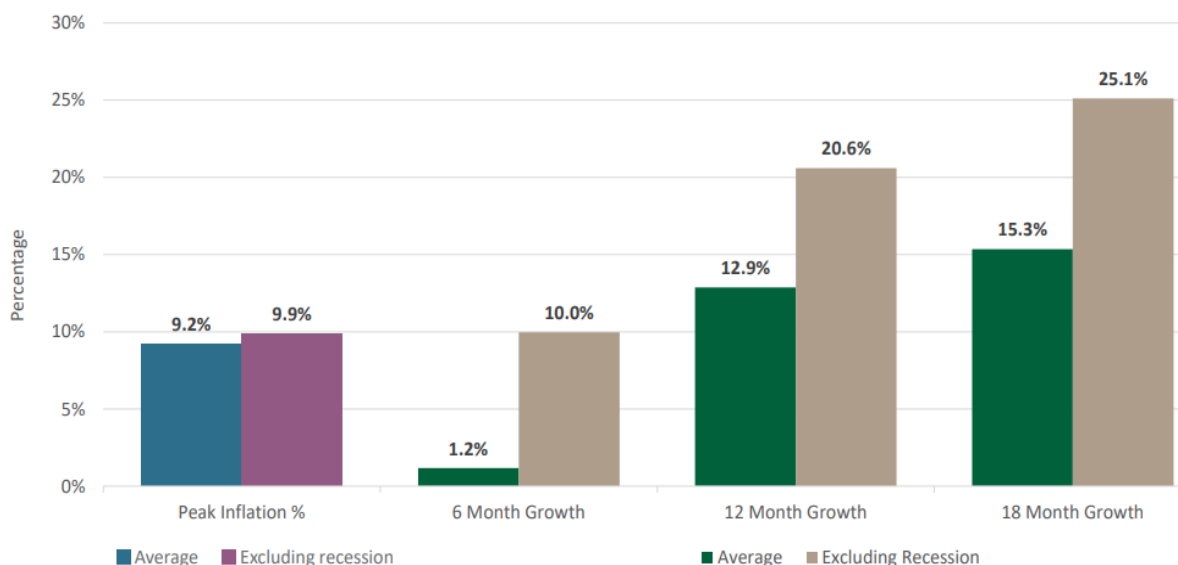


All said, all the above periods' (2 – 30 years) Inflation Expectation levels have moderated to below 2.5%. Should these levels further ingrain in investors' minds, it may lead to further improvement in their confidence levels.

Source: Bloomberg; Stonehage Fleming Investment Management Limited. August 2022. **Past performance is not a guide to future performance.**



S&P 500 Capital Return Following Peaks in US Inflation (%)

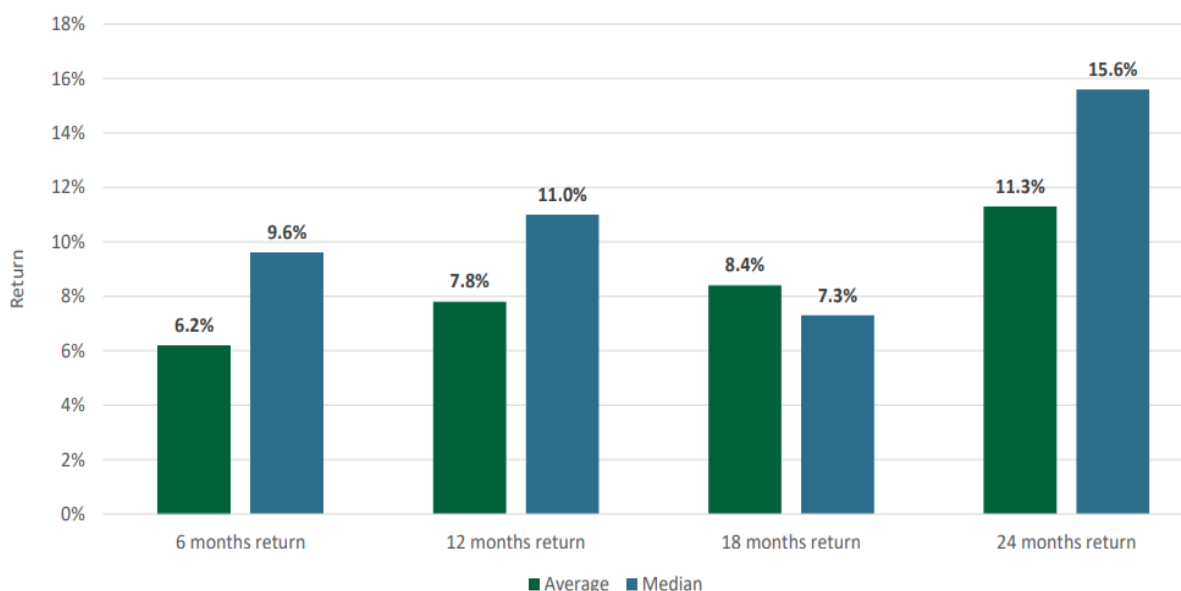


We believe US Inflation has, for this cycle, peaked at 9.1% in June. The above chart of data since 1940 shows that Inflation has, on average, peaked at 9.2% and has since, on average, delivered attractive returns in the following year (the green bars). The returns have been meaningfully higher during non-recessionary periods (the brown bars).

4. RECESSION WARNINGS

We have shown in our previous note that both the US Yield Curve and Leading Economic Indicator are currently warning of a potential US recession. Our view is that it may be a shallow recession (if a recession may materialise), but would warn against too much pessimism on equity performance potential because of that. This view based on the following charts:

S&P 500 Total Return Following US Yield Curve Inversion

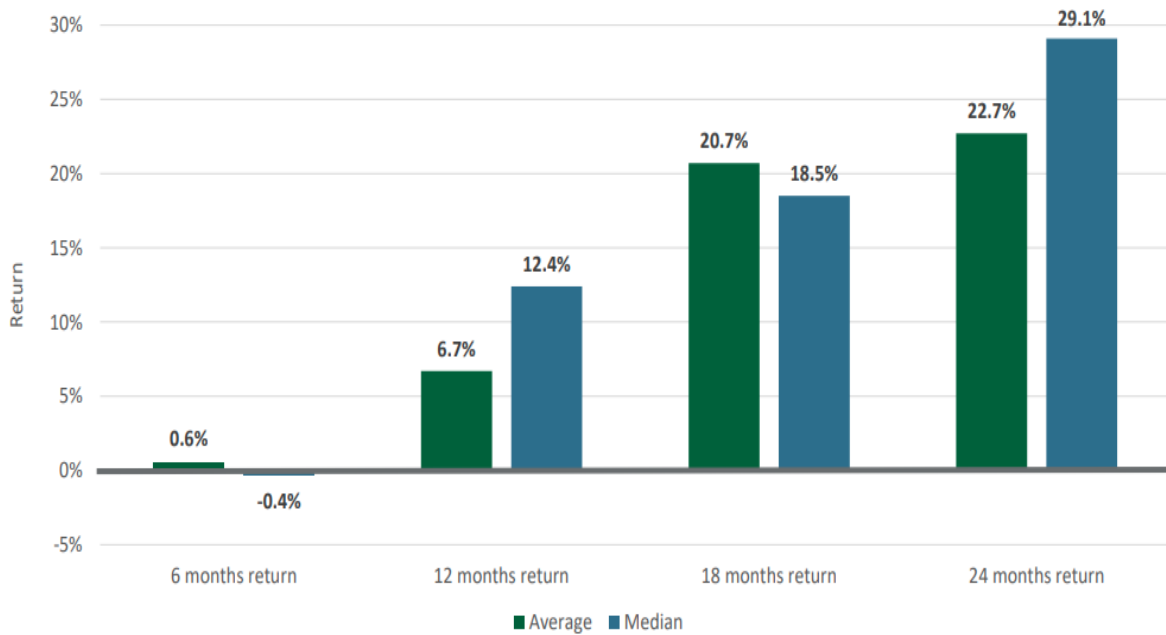


There have been four occasions of US yield curve inversion since 1985. The above chart depicts the S&P 500 returns following the particular inversion dates. On both average and median data, attractive returns were delivered over all of 6-, 12-, 18- and 24-month periods. On this basis, yield curve inversions did not signal selling opportunities but, in fact, warn against absence from the equity market over these periods.

Source: Bloomberg; Stonehage Fleming Investment Management Limited. August 2022. **Past performance is not a guide to future performance.**



S&P 500 Total Return Following a Negative Inflection on The Conference Board Leading Economic Indicator



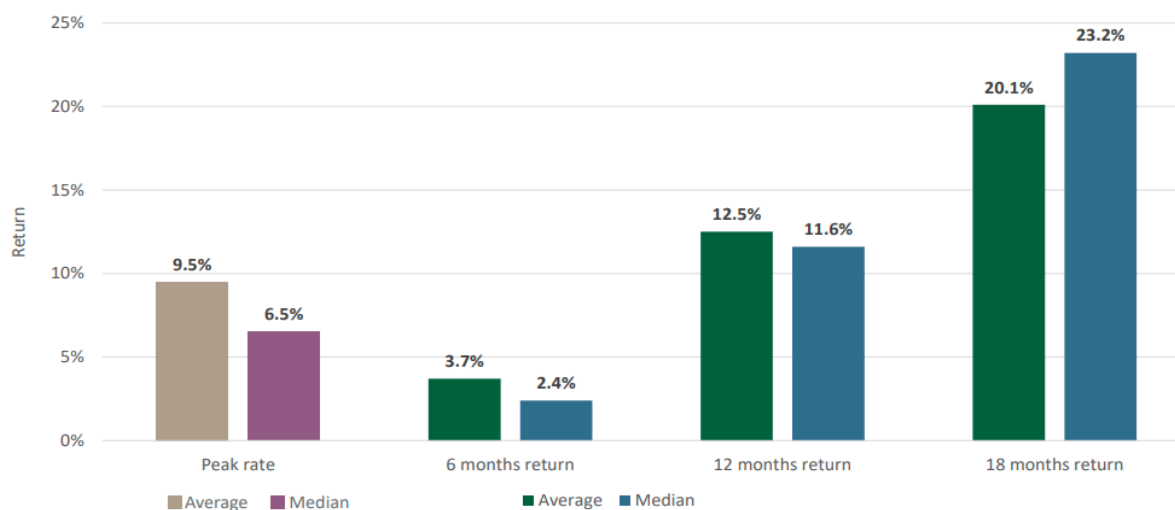
The above chart reflects a similar analysis following the respective dates of the inflection of Leading Economic Indicator data. Whilst the immediate periods did not offer very attractive returns, they were favourable, with attractive returns following that. Again, the conclusion is to rather be invested than absent in the Equity market at those times, and be in the position to be in time to share in attractive returns later on.

5. FED TIGHTENING

We are relatively relaxed about the Fed's task of reducing their balance sheet during 2023, and in fact do not expect it to affect capital markets to any material extent. On further raising their target rate, we think we may see on this Wednesday the first decrease in the level of their increases (from +75bps to +50bps) taking the upper end of their target rate to 4.5%. If so, this may be the first indication of a slowdown (and later the end) of their current target rate tightening program. We have done an exercise of stock market delivery following such occasions:

S&P 500 Total Return Following the Date of Six Months in Advance of the Last Cycle Target Rate Increase

Since 1970



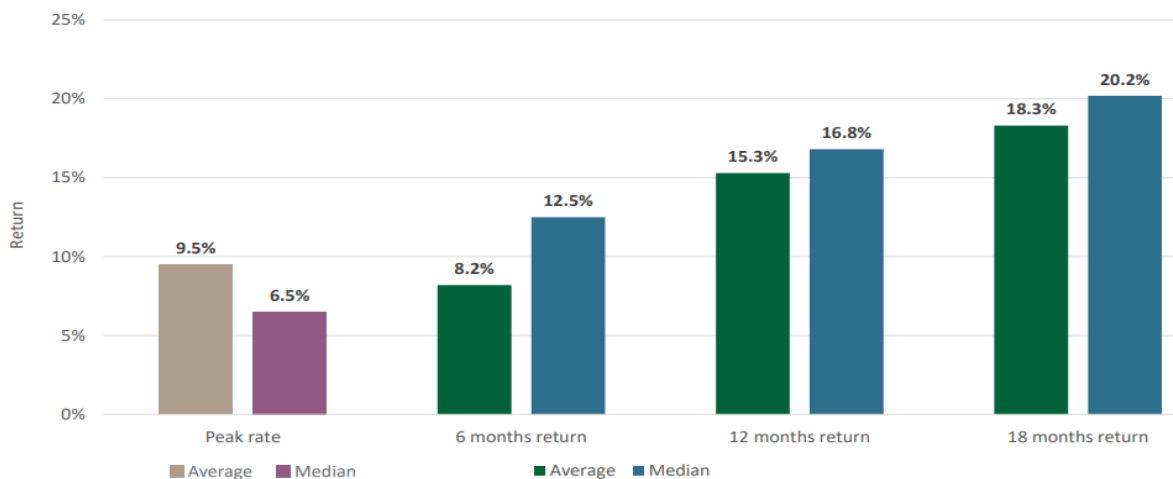
Source: Bloomberg; Stonehage Fleming Investment Management Limited. August 2022. **Past performance is not a guide to future performance.**



As the preceding chart indicates, during the last six months of the tightening process, the stock market returns have been relatively modest. The subsequent six and twelve months have, though, delivered attractive returns in double-digits. This indicates opportune timing for investing during the latter part of the target rate increases.

The following charts depicts a similar exercise, but taken from the date of the last cycle target rate increase:

S&P 500 Total Return Following the Date of the Last Cycle Target Rate Increase Since 1970



Logically, returns further improve under this scenario during the last six months of Fed tightening. The levels of historic returns indicate investing rather earlier than later in this context.

6. 2022 AFTER ALL

This year has been the most testing of all for many investors. As we head for its closure, we can well ask ourselves whether our Equities asset class still has the merits we previously thought it had. For us it is an easy question to answer – it is the main asset class in which its supporters rely on humankind’s intellect, energy and enthusiasm to create and grow. That will always be the case. The choice we have within that is vast – it is up to us to do the necessary work and make intelligent choices. With the collapse of Crypto this year, we continue to test its real value against Gold. Despite this weak year, it remains in a positive trend:

S&P 500 Value vs Gold Price



Source: Bloomberg; Stonehage Fleming Investment Management Limited. August 2022. **Past performance is not a guide to future performance.**



7. 2023 WISH LIST

Investors face a New Year with a dull earnings outlook and further Fed tightening. Apart from our preceding inflation comments, they would, though, not be overly ignorant to realistically wish for some proverbial 'swallows for the summer':

- This has been the first time that the US stock market has experienced a major bear market before the start of a recession (historically it has on average bottomed shortly after halfway through the recession). The S&P 500 this time bottomed on 12 October and has already recovered +10%. It may be that this time, the market may have bottomed before the recession because of the huge inflation scare.
- Hopefully US Inflation and interest rates will get under proper control and the Fed's task will be done.
- Chances are that we may not face an imminent deep US recession. Strong employment and consumption, along with high personal cash holdings, provide some comfort.
- China may start easing their lockdowns with more earnest. If administered correctly, it may then well be a very different country in six months' time, favouring their own economy and overall world trade.
- The world may find a way to calm the Ukraine tensions.
- The rolling over of the Dollar is already a 'small swallow', potentially turning a US earnings headwind into a tailwind. It may be that the persistent Dollar strength has run its course.

Our sincere gratitude to our clients for your continuing support and friendship through a challenging 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 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

This communication has been prepared for information only and is not intended for onward distribution. 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 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.

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.

Stonehage Fleming Investment Management Limited is authorised and regulated by the Financial Conduct Authority (FRN 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). Approved for distribution in Jersey by affiliates of Stonehage Fleming Investment Management that are regulated for the provision of financial services by the Jersey Financial Services Commission (“JFSC”).

FP: ID0001091

