STONEHAGE FLEMING

9 July 2019

Dear Equity Client

GLOBAL EQUITIES – 2nd Quarter 2019

World equity markets continued their positive trajectory during the second quarter. The MSCI World Index (including Emerging Markets and dividends) appreciated by a further +3.6% on top of the high base of +12.2% during the first quarter. This brought the first half performance to +16.2% (all data in US$ terms).

This positive performance has occured despite further moderation of the US and the global economic outlook. Expectations that the Federal Reserve will cut their target rate at their next meeting at the end of this month grew throughout the quarter. This is expected to support the US economy and cushion the capital markets as the risk of rising inflation and interest rates abate.

There are currently numerous comments in the financial media around the length of the current US economic recovery, with a view that this record implies an imminent recession. We do not believe any particular insights can be gained purely from the length of a recovery cycle in this context, and rather believe we should consider the quality of economic activity. There are currently no material real or financial imbalances in the US economy, while the low inflation and interest rates assist dampening cyclicality. Further to this, the level of economic expansion during the current cycle is still less than half the average of all the previous ten US economic cycles (since 1948), despite its long duration.

We should also consider the level of equity performances over economic cycles. The average S&P 500 performance over the preceding ten economic cycles was +7.5% p.a. (peak-to-peak). The current cycle's performance is +5.4% p.a., well below the average.

It seems that the US economy may be approaching a proverbial 'soft landing', but this time on a 'longer landing strip' because of an environment of moderation in most of the critical issues, as mentioned above. Such an environment lowers business risk and business performance, and is more conducive for equity investing than may immediately meet the eye.

It is important for investor comfort that company earnings continue to grow. The outcome on this front in the later stages of the economic cycle is usually a challenge and a mixed bag, particularly with the high base following the cut of the US corporate tax rate last year. Growth expectations for S&P 500 earnings have moderated meaningfully, but are still expected to be in mid single digits over the next year. Along with this S&P 500 absolute valuations are perceived to be fair on all of the P/E, Dividend Yield and Free Cash Flow Yield bases.

Thank you again for all your support.

With kind regards

Gerrit Smit
Partner – Head of Equity Management

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