

INSIGHTS

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Coming Off Economic Life Support

“IT IS BETTER TO BE VAGUELY RIGHT THAN PRECISELY WRONG.” – JOHN MAYNARD KEYNES, 1925

In contrast to the stimulus-driven rebound of 2009, we expect 2010 will be characterized by the transition away from government-sponsored economic life support. The economy should continue to surprise to the upside with above-trend quarterly GDP growth at the start of 2010. However, as monetary and fiscal stimulus is removed and its effects fade, the pace of improvement should slow. The timing and speed of removal will be important to all stakeholders—businesses, employees, and investors.

Near-term economic growth should look substantial on a quarterly basis, but the recovery will likely be sub par when measured against past cycles. Historically, economic recoveries are typically as large and rapid as the preceding collapses were severe. If the economy were to adhere to this pattern, we would have a 7% to 8% rebound in real GDP. Unfortunately, there are exceptions to this rule. Recessions born from financial crisis tend to suffer from larger problems, such as deleveraging and credit market disruption, that result in longer hangover periods.

The current rebound appears to be following this expected subpar pattern with only 3% to 4% annualized GDP growth. The economy continues to struggle against a rather formidable long-term headwind of excess leverage. Nonfinancial debt amounts to approximately 243% of U.S. GDP, nearly twice as high as in the 1960's and over 30% higher than a decade ago. This does not mean the economy is destined to slip into a second recession, but the headwinds will likely restrain economic growth to some degree.

Improvement has even started to show in lagging economic factors such as employment, which we believe could turn a corner and make gradual gains through the first half of the year. Ultimately, employment is the key to sustained economic growth, and increased consumer income is needed

to drive long-term economic growth. Employment is also one of two primary aspects of the economy the Federal Reserve is mandated to control, and improved conditions would weaken the argument for maintaining a zero-fed-funds-rate policy. The Federal Reserve has historically waited for employment to improve materially before retreating from an easy money stance.

The upcoming transition away from stimulus could be the most difficult task faced by the Federal Reserve and other global central banks. The amount of fiscal and monetary stimulus is on the order of what was provided to end the Great Depression. The recent stimulus came in multiple forms, including tax reductions, direct government infrastructure spending, traditional Federal Funds rate reductions, Federal Reserve-funded temporary liquidity facilities, and non-traditional direct government purchases of Treasuries, agencies, and mortgage-backed securities. Following such a huge shift in the use of its balance sheet, the Federal Reserve may now be at its limit. Reductions in government purchases of U.S. Treasuries and other fixed income investments will cause the market to rely more heavily on private purchasers.

The size of both the stimulus and the debt burden facing consumers and the government is relatively unprecedented with the exception of the Great Depression and perhaps the Japanese economy over the last two decades. With limited historical precedents from which to draw a comparison, global central banks are maneuvering with poor to no visibility. Mistakes are possible on both sides of the equation. If governments reduce their stimulus too quickly, the remaining debt problems may overwhelm the economy, stifle the nascent recovery, and revive deflation concerns. On the other hand, if governments do not reduce the stimulus, there is a risk the recent asset inflation (inflation in commodity prices) will accelerate

and roll directly into more painful core inflation (inflation of everyday final goods prices).

Fortunately, excess capacity should keep near-term core inflation in check as employment gradually improves through the first half of 2010. This should provide some latitude for the Federal Reserve to maintain an accommodative monetary policy through this period. However, asset inflation will likely continue in the first half of the year, placing pressure on the world's central banks and leading some to tighten monetary policy in advance of the U.S. We have seen this with the Bank of Australia and the Bank of Norway, both of which recently increased short-term interest rates. We have even seen a hint of such actions from the People's Bank of China, which allowed rates on short-term money to float marginally higher and increased its required reserve ratio for banks.

Although it is difficult to forecast the economy with certainty, we believe the current economic recovery will be rapid at the start but will lose momentum as the effects of stimulus fade. After the initial surge in economic growth in late 2009/early 2010, global economic growth should be subpar for a considerable period. While we are not currently forecasting a double-dip recession, we recognize that significant national and consumer debt places our economy in a precarious position. The U.S. government and other developed nations need to repair their balance sheets and balance their budgets. Consumers within these nations need to repair their own balance sheets and become less addicted to continuously financing their

next purchase. The continuation of a stable economic recovery hinges on a well-executed plan to exit from the fiscal and monetary stimulus that does not accelerate the deleveraging beyond what the economy can withstand.

Equity markets and other risk assets should continue their upward march through at least the first half of the year, but will have difficulty maintaining the pace of gains as the rebound matures. Uncertainty over the withdrawal of the stimulus will likely lead to increased volatility. Equity markets must transition from a rebound led by depressed valuations to one driven by improving fundamentals and earnings growth. Similarly, opportunities to realize yield advantage in riskier fixed income instruments are less frequent as credit spreads (the difference between the yield on a non-treasury fixed income investment and its treasury equivalent) have narrowed.

While 2009 rewarded the overweighting of risk assets, this strategy is unlikely to work as well in 2010. Investors should continue to overweight risk assets, but should incorporate a more defensive stance within those risk assets. This can be accomplished by focusing on value opportunities, yield enhancement, long-term secular trends such as growth in emerging Asia, and incorporating an allocation to uncorrelated absolute-value strategies. By following such a strategy, investors will be positioned to benefit from a continuation of economic improvement while realizing greater protection against the uncertainty of the coming year.

GLENMEDE'S MARKET ANALYSIS TEAM



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Mr. Fowler oversees all of the Company's investment activities and is responsible for Glenmede's investment process and policies.

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Economic & Market Outlook

Key Economic and Market Viewpoints

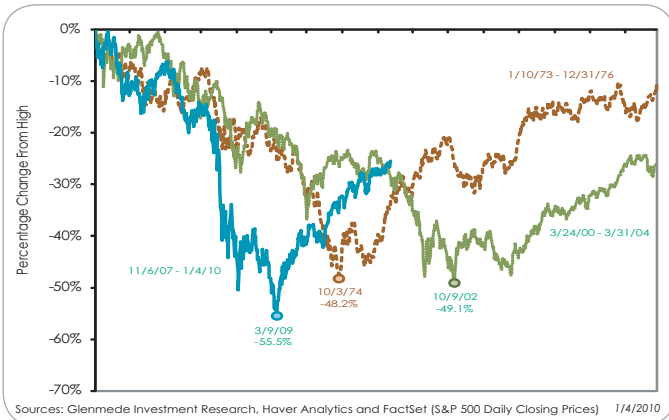
- **The global economy continues to improve** primarily as a result of massive global stimulus. This is evident in most but not all economic and market indications.
- **Global equity markets continue to be supported by upward revisions** in earnings estimates, although the pace of improvement is beginning to slow.
- **The longer term economic outlook, however, is still unsettled.** The debt burden of many of the larger developed economies leaves the global economy open to the adverse impacts of deleveraging.
- **The next 12-18 months will be marked by uncertainty** due to the transition away from significant monetary and fiscal stimulus.
- **Central banks need to withdraw stimulus at just the right pace.** If they tighten too slowly, inflation could be a problem. Tightening too quickly could endanger the fragile economic recovery by accelerating deleveraging and reigniting deflation fears.
- **Emerging Asia (China in particular) has led the global economic recovery**, but has recently begun tightening in order to contain that growth and the resulting inflation.
- In addition, **potential changes in regulatory and fiscal (taxation) policies add to the uncertainty** of corporate management decisions and may affect the capital markets.

Investment Strategy Recommendations

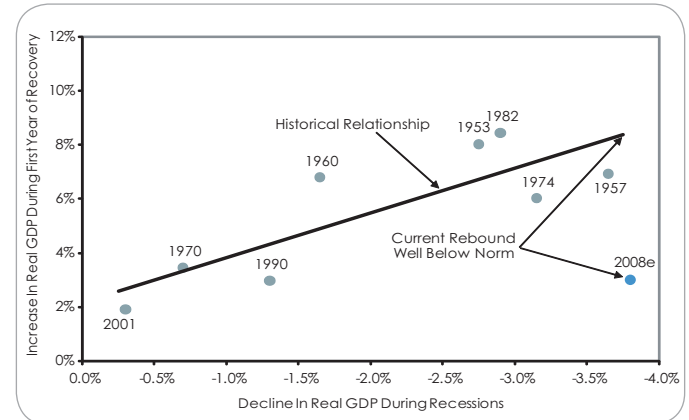
- **Maintain a neutral stance on market-related risk.** Pursue absolute returns through a diversified mix of asset classes and strategies (global equities, high yield bonds, commodities, special strategies, private equity) while remaining underweight low-yielding cash and treasuries.
- **Shift portfolio allocations toward undervalued assets.** We currently see valuation opportunities in U.S. Quality Growth and European Equities.
- **Anticipate appreciation in attractively priced income-producing assets** as retiring baby boomers invest for income. **High yield** debt remains attractive relative to alternatives. Also, **Utility Equities** offer relatively high dividend yields and low beta.
- **Maintain exposure to the most important secular trend: growth in emerging Asia.** While emerging Asian equities look expensive, gain exposure through **multinational equities, Asian real estate, and commodities.**
- **Allocate a portion of the portfolio to absolute value strategies** (absolute long-only managers, hedge funds, buy/write strategies, or regular rebalancing). Absolute value strategies should provide returns that are not as correlated with the public indices, and help reduce the volatility of returns for the total portfolio.

Market Analysis in Brief

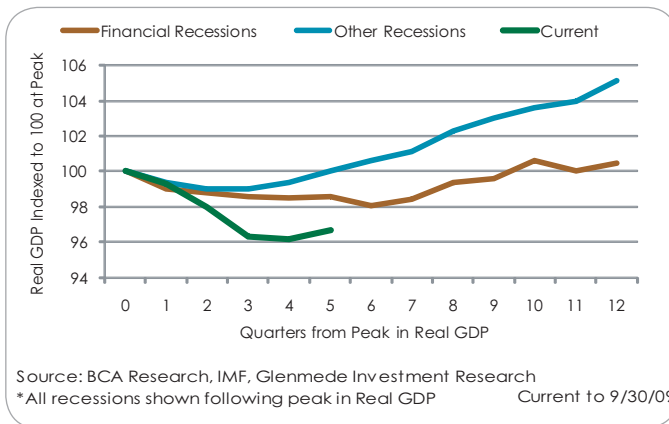
The current rebound is similar to others, but perhaps a little ahead of the norm.



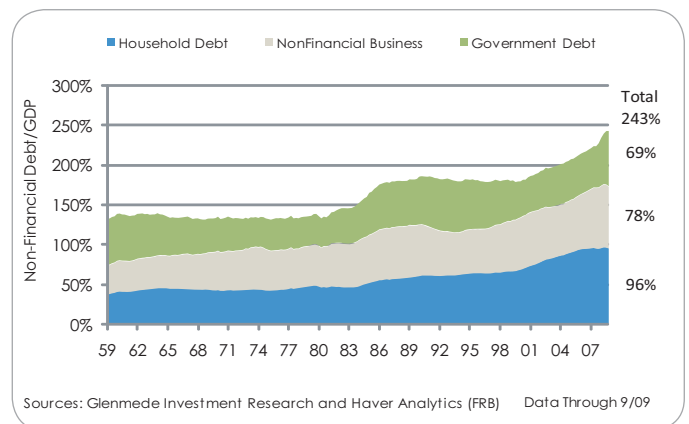
Sharp declines are normally followed by sharp recoveries...



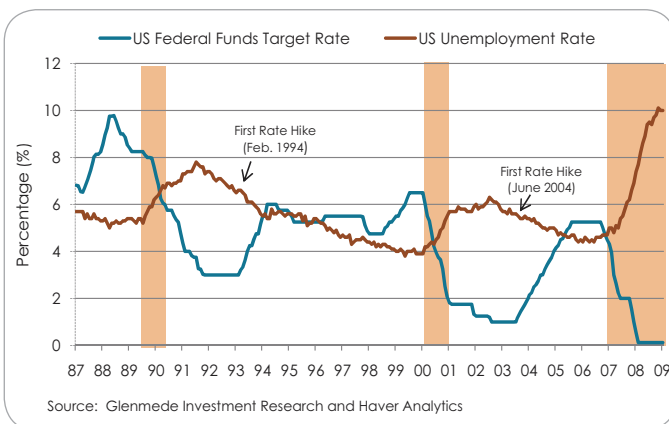
...but slower recoveries often follow financial recessions.*



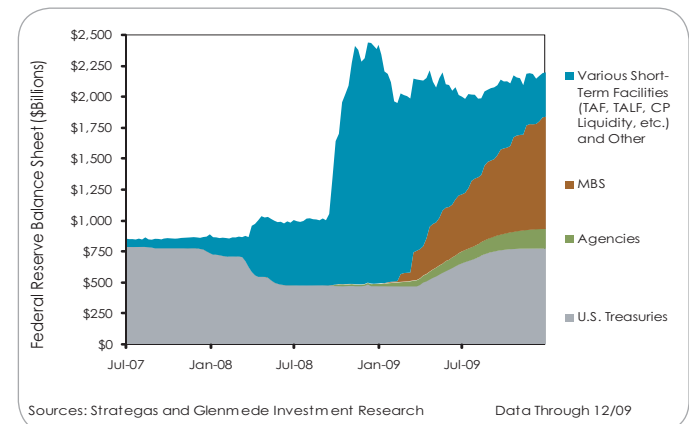
The debt problem remains unresolved.



The Federal Reserve prefers to wait until employment improves materially before raising interest rates.



Balance sheet expansion has halted and mortgage-backed securities purchases are likely to stop.



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