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Investment Strategy Insights

February 1st, 2021

Revenge of the Herds

- Internet Bulls Unleashed in the China Shop
  - Risky retail trading hints at over-confidence, and underlines the value of a robust due diligence process/appropriate risk controls
- Approaching Dawn on Earnings
  - Expectations are rising for an earnings rebound in 2021, predicated on a vaccine-induced return to “normal”
- New Day, Same Fed
  - The Fed remains committed to its accommodative policy stance, priming the U.S. for growth in a post-pandemic world

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Internet Bulls Unleashed in the China Shop

- **Tumultuous Market Behavior.** Last Wednesday marked the largest trading day by volume in U.S. history, eclipsing the days following the collapse of Lehman Brothers. The culprit this time was a standoff between hedge funds with large short positions and retail traders coordinated through Reddit's WallStreetBets online forum. The tug-of-war centered on a few small companies with questionable or borderline fundamentals that were very popular short ideas among hedge funds. GameStop garnered the most attention, as its stock spiked ~5x higher last week due to outsized retail demand.

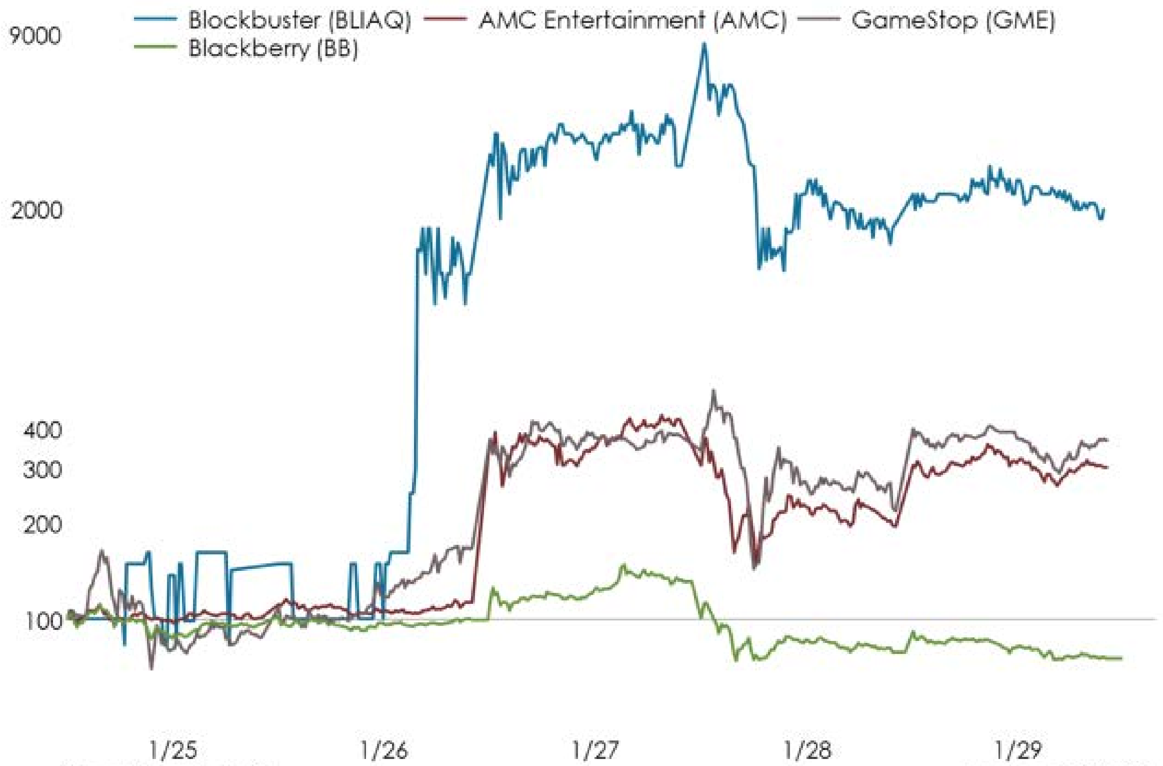
- **How Did This Happen?** A number of factors contributed to the meteoric rise in these stocks. To start, many of them were heavily shorted stocks – in GameStop's case more than 140% of shares had been sold short, so when its price started to rise, hedge funds with bets against the stock were forced to become buyers to close out their positions. In addition, stock option sellers needed to buy shares as well to hedge their exposures as the price continued to rise, further boosting demand. Sprinkle in a little FOMO, and a self-perpetuating rally turned into parabolic gains for a number of these stocks.

- **Lessons Learned.** Positions in many of these companies now appear highly speculative. Blackberry's shares traded at higher volumes at points last week than when people were actually still using their phones. But as John Maynard Keynes once said, "Markets can remain irrational longer than you can remain solvent" – a fact that some hedge funds were sorely reminded of last week. This underlines the importance of conducting due diligence and sufficiently understanding the risks prior to making investments.

Risky retail trading hints at over-confidence, and underlines the value of a robust due diligence process/appropriate risk controls

Chart of the Week:

A Handful of Stocks Have Been on a Wild Ride



Source: Glenmede, FactSet Data through 01/29/2021

Data shown is the price of the specified security indexed to 100 on January 25th, 2021 on a log scale over the previous four trading days. Past performance is not indicative of future results. The information shown is solely for illustrative purpose and should not be construed as a recommendation to buy, hold or sell any individual security. Past performance may not be indicative of future results.

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Approaching Dawn on Earnings

- **Earnings Season Chugs Along.** As Q4 earnings season moves forward, investors earnestly await signs of renewed strength in corporate profits. With ~37% of companies reporting so far, the blended year-over-year earnings growth estimate for the S&P 500, which combines actual results with consensus estimates for firms that have yet to report, currently sits at -2.4%. Albeit negative, this is well above the -7.8% growth predicted in the beginning of January.

- **Financials Surprise; Others In-Line with Estimates.** 65% of S&P 500 companies in the financials sector have already reported, posting a blended growth rate of ~14%, notably greater than the prior quarter's bleak -4.4%. Those sectors that have been favored during the pandemic, including materials, tech, staples and healthcare, are all expected to post positive year-over-year earnings gains for Q4. However, results for sectors at the pandemic epicenter are appear less upbeat, particularly for industrials and energy.

- **When to Expect a Full Earnings Recovery?** Glenmede's long term outlook predicts that the S&P 500 should begin to track new highs on its earnings run rate by year-end. Contributing to that thesis includes the prospects of a return to some semblance of "normal" after herd immunity is reached via vaccine delivery. Also, U.S. household savings are roughly $1.5T higher than pre-COVID levels, suggesting that a storm of pent-up consumer demand is possible. Pair that with productivity gains from the work-from-home dynamic, and a number of earnings tailwinds are stacking up for 2021.

Expectations are rising for an earnings rebound in 2021, predicated on a vaccine-induced return to "normal"

New Day, Same Fed

- **Fed's Stance Remains Dovish.** Last week's Federal Open Market Committee (FOMC) meeting was rather routine, considering Chairman Jerome Powell once again echoed the Fed's stance on remaining ultra-accommodative. Mixed signals around quantitative easing over the last few weeks provoked the idea that tapering may begin sooner than expected; this assumption was firmly rejected by the FOMC and Powell, citing remaining risks from the pandemic.

- **Powell Discusses Slowing Recovery.** The FOMC noted that the rate of economic recovery has moderated in recent months, with weakness focused among the sectors most vulnerable to the pandemic, such as services requiring person-to-person contact. For these reasons, Powell has made it clear that vaccinating the population remains the most important undertaking in achieving complete economic recovery.

- **When to Expect Monetary Tightening?** In determining the appropriate timing for the removal of ultra-accommodative policy, the Fed will likely have its eyes closely monitoring inflation. The FOMC reiterated its goal of achieving greater than 2% inflation on a sustained basis before shifting away from its accommodative stance. In some measure, easy monetary policy has been priming the economy for a post-pandemic liftoff. Removing that booster before the U.S. has even come close to reaching herd immunity, would likely be premature and counterproductive.

The Fed remains committed to its accommodative policy stance, priming the U.S. for growth in a post-pandemic world

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