GLENMEDE

Investment Strategy Insights

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Peeling Back Market Dynamics

- Anatomy of the Correction
  - Recent market performance has partially corrected the outsized relative gains from growth stocks
- Under the Hood of Value/Growth
  - While growth stocks have delivered idiosyncratic earnings gains, they may carry excess risk due to extended valuations
- Triggers to a Shift in Leadership
  - Persistent value stock performance leadership may be predicated on a return to “normal”

Anatomy of the Correction

- **Equity Market Pullback.** The S&P 500 suffered its second straight week of losses, ending last week 6.7% below its all-time high, but still up 3.4% YTD. An unwinding of speculative positioning in tech stocks was partially to blame, as well as waning prospects for another round of fiscal stimulus before the election. Equity market corrections of this magnitude are common, typically occurring on average 1-2 times per year, often following previous periods of strong gains.

- **Rising Tide Has Not Lifted All Boats.** The market's rally since its late-March lows has been dramatic, with the S&P 500 returning 49.3% since then. However, not all portions of the market have benefitted equally from the rebound. In fact, only 46.9% of companies in the Russell 3000 ended last week above their 200-day moving average. While the FAANMGs (Facebook, Amazon, Apple, Netflix, Microsoft and Alphabet) have posted impressive gains, the consumer discretionary (ex-Amazon), industrials, financials and energy sectors in aggregate have yet to fully recover.

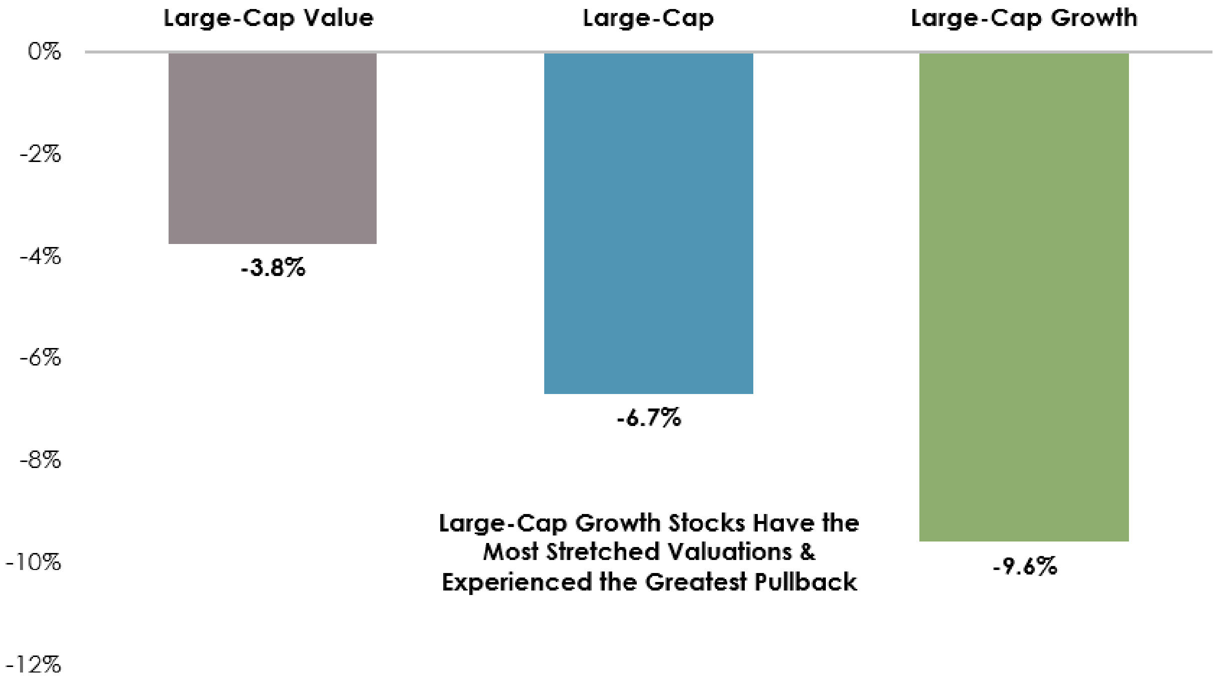
- **Growth vs. Value Divide.** Growth stocks have outpaced their value counterparts considerably since late March, as they became relative beneficiaries of both ultra-accommodative monetary policy and a socially-distanced environment. However, the recent correction has consolidated some of that outperformance. Large-cap growth stocks* fell -9.6% from the all-time high at their recent lows, whereas large-cap value stocks** at -3.8% incurred less than half that loss.

Recent market performance has partially corrected the outsized relative gains from growth stocks

Large-cap growth stocks represented by the Russell 1000 Growth Index.
***Large-cap value stocks represented by the Russell 1000 Value Index.*

Chart of the Week:

Growth Stocks Incurred More Than Twice the Loss of Value Stocks



Source: Glenmede, FactSet *Data through 9/11/2020*
Large-Cap Growth is represented by the Russell 1000 Growth Index. Large-Cap is represented by the S&P 500 Index. Large-Cap Value is represented by the Russell 1000 Value Index. The S&P 500 Index is a market capitalization weighted index of U.S. large-cap stocks. The Russell 1000 Growth and Value Indexes are market capitalization weighted indexes of U.S. large-cap stocks, segregated by the portion of the market characterized by growth stocks vs. value stocks. Performance is calculated from the market high on September 2nd, 2020 to the market's recent close on September 11th, 2020. Past performance may not be indicative of future results. One cannot invest directly in an index.

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Under the Hood of Value/Growth

- **FAANMGs Dominate Profit Gains.** The FAANMG stocks (Facebook, Amazon, Apple, Netflix, Microsoft and Alphabet) have maintained their earnings power during the pandemic, with next-twelve-month earnings estimates 13.7% higher than they were at this point last year. However, the sectors at the epicenter of the COVID-19 crisis, including consumer discretionary (ex-Amazon), industrials, financials and energy, combined, are expected to experience a 42% year-over-year earnings decline.

- **Disparity in Valuations.** Glenmede's Global Expected Returns model implies that the expected returns between U.S. large-cap growth and value stocks sit at either end of an unprecedented chasm. The model, which assumes a reversion to fair valuation (derived via a combination of multiple fundamental valuation measures), forecasts an annualized 1.9% return for growth and a 7.6% return for value for the next ten years. Despite growth stocks' ability to maintain earnings power during the pandemic, it appears the prices paid for those earnings have become too far stretched.

- **Evaluate Portfolio Positioning.** Investors with diversified equity exposure may be sitting on comparatively large gains on and oversized allocations to their growth stock holdings, if nothing else, due to the sheer size of their outperformance year-to-date. While growth stocks have delivered differentiated earnings gains in this tough economic environment, the price paid for that growth appears to sit near extreme levels. As a result, it may be prudent for investors to pare back on their growth exposure in favor of more reasonably priced value stocks.

While growth stocks have delivered differentiated earnings gains, they may carry excess risk due to extended valuations

Triggers For a Shift in Leadership

- **Sustained Economic Recovery.** A sustained shift in leadership toward value stocks likely requires a clear sustained economic recovery. Glenmede's Reopening Index, which seeks to measure the reopening of the economy via a combination of high-frequency data from daily and weekly sources, estimates that ~71% of economic activity that was lost due to social distancing has so far been regained. The Reopening Index has slowed over the past few weeks as some states continue to grapple with reopening while managing virus resurgence.

- **The Race Toward a Vaccine Continues.** The race to develop a safe and effective COVID-19 vaccine is well underway. Moderna, Pfizer and AstraZeneca, the three leading candidates for a COVID-19 vaccine, are all in the midst of Phase III trials. Recently, AstraZeneca's suspended its vaccine trial over safety concerns, a reminder that the path of vaccine development is not always quick and linear. The timing of widespread vaccine delivery likely holds the key to a sustainable path toward a return to some semblance of "normal."

- **Watching Inflation.** Higher inflation would also help value stocks narrow the earnings performance gap with growth stocks. Market-implied inflation expectations have risen after bottoming-out in late March, but remain below 2%. The Federal Reserve, however, has recently announced a new framework targeting inflation above 2% for a sustained period to offset the sub-2% inflation we have experienced recently.

Persistent value stock performance leadership may be predicated on a return to "normal"

Investment Strategy Insights

JASON D. PRIDE, CFA
Chief Investment Officer - Private Wealth

Responsible for formulating investment policy and strategy

Serves as a leading member of the Investment Policy Committee

B.S. from Massachusetts Institute of Technology

MICHAEL T. REYNOLDS, CFA
Investment Strategy Officer

Responsible for supporting the development of investment strategies, policy and portfolio construction methodologies

Is an active member of the CFA® Society of Philadelphia

B.S. from the Wharton School of the University of Pennsylvania

ILONA V. VOVK, CFP®
Investment Strategy Officer

Responsible for supporting the development of investment strategies, policies and portfolio construction methodologies applied to Private Wealth client portfolios

B.A. and B.S. from Drexel University

GLENMEDE CORPORATE FACTS

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