Accelerating Expansion, Rising Headwinds

Expansion Gaining Momentum

- **US economy pushed ahead by improving manufacturing.** Markit’s preliminary US manufacturing reports indicate the highest growth upturn since early 2015 as November’s 53.9 reading is materially higher than October’s 53.4. We expect to see a continuation in growth in the US manufacturing sector due to the upcoming administration’s support for American based companies.

- **European economic conditions improving significantly amidst broad international growth.** Markit’s preliminary reports place Eurozone manufacturing at a thirty-four month high of 53.7. Japan’s economy is also still demonstrating growth as Markit’s surveys come in at 51.1.

- **U.S. corporate earnings mark first quarter of positive growth since 2015.** As of November 25th, 98% of S&P 500 companies have reported third quarter earnings with 72% beating net income expectations and 54% exceeding revenue expectations. In aggregate, earnings rose 3.2% year-over-year showing a further development of the economic acceleration.

**Our Take:** Economic growth is accelerating again amidst a long, slow economic expansion.

Rising Headwinds

- **Inflation expectations rise.** Inflation is currently rising and appears close to overshooting the Fed’s targets. This rise is coming partly from rising wages, putting pressure on corporate profit margins.

- **Interest rates are poised to rise with inflation expectations.** As we see inflation expectations rise, interest rates should follow suit. Rising inflation will put pressure on the Fed to respond. We expect the Fed to be monitoring this, even beyond its likely rate hike this December.

- **Strong dollar creating a headwind for US.** Higher interest rates, particularly in an environment where other countries’ central banks are holding down interest rates, places upward pressure on the dollar. A strong dollar impacts US corporation’s competitiveness and may show up as a cited headwind in future earnings seasons. The impact of this also shows in precious metals, with gold at a 9-month low.

**Our Take:** Rising inflation, interest rates, and the dollar will be headwinds to the ongoing expansion.

Between a Rock and a Hard Place

- **The prospect of OPEC production cuts is likely to place a floor under oil prices.** Organization of Petroleum Exporting Countries (OPEC) aims to remove ~1.6% of global oil supply via production cuts in an effort to stabilize prices or even nudge them higher.

- **Saudi Arabia’s proposed OPEC production cuts need cooperation of OPEC and non-OPEC members.** In spite of the September agreement to cut production to between 32.5 and 33 million barrels a day, OPEC members have since increased their production. In the proposed production cut range of 600,000 to 1.1 million, OPEC looks to Saudi Arabia to endure the majority of the burden in an effort to balance out for the smaller producers who cannot afford to cut production. OPEC is also requesting non-OPEC countries to pitch in by reducing their production by roughly 500,000 barrels a day.

- **US capacity should present price ceiling in an over $50/bbl world.** Barclays reports that US oil companies account for around 3.3 million barrels a day and could see a production hike of 6% coming into 2017. US production will effectively cap oil prices around $60 per barrel. The likelihood of a US production hike does, however, depend on the upcoming OPEC decision and if oil prices average high enough for US profitability.

**Our Take:** An OPEC production cut would support oil prices, but US production will cap prices at $60 ppb.
**Chart of the Week:**

**Accelerating Expansion Faces Rising Headwinds**

Source: Glenmede, Factset

*5-year, 5-year forward inflation (swaps) are the expected inflation over the five year period that begins five years from today based on swap prices.*

**Dates of interest:**

11/28: Eurozone M3 SA, Japan Job Seekers, Unemployment, Retail Sales, Trade Balance, Real Wages
11/29: US ICSC-Retail Sales, GDP, Consumer Confidence, Eurozone Business Climate, Japan Industrial Production
11/30: US Employment Survey, Core PCE, Chicago PMI, Eurozone CPI, Japan NSA, Markit PMI, China PMI
12/1: US Jobless Claim, Initial Claims, Markit PMI, ISM, Eurozone, Unemployment, Markit PMI
12/2: US Hourly Earnings, Unemployment, Eurozone PPI

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