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GLENMEDE

Market Insights

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Balancing Recovery and Risk in the Pandemic's "Reopen" Phase

- Lockdowns across the U.S. have helped to slow the spread of COVID-19, but in turn, have had a significant impact on the economy and profits.
- Economies and corporate profits are rebounding as the U.S. reopens, but remain at risk to viral surges and further shutdowns until a treatment or cure is widely available.
- Equity markets have recovered faster than economies or profits, largely due to the Federal Reserve's massive liquidity injection.
- Investors should maintain neutral equity and risk allocations, while monitoring the pandemic's trajectory and corresponding market valuations.

"Reopen" is the second of three phases in the COVID-19 pandemic

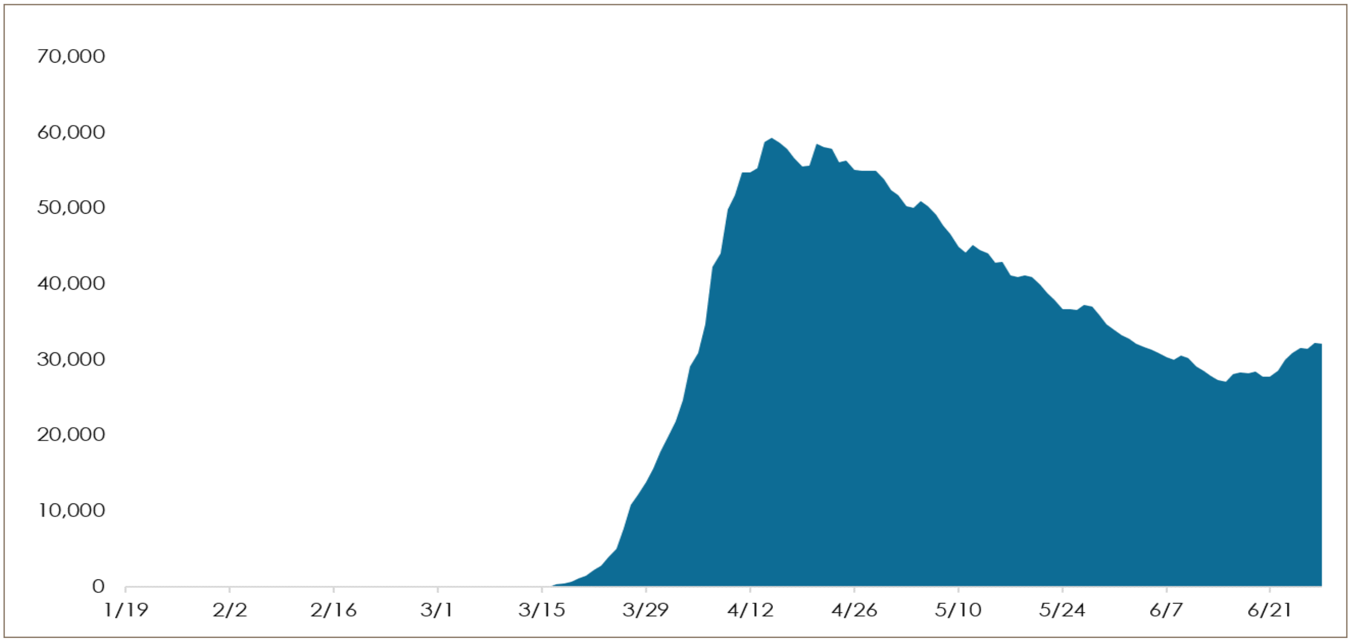
Pandemic response can be distilled into three key phases. **React** — flatten the infection curve via social distancing and economic shutdown. **Reopen** — gradually restart the economy while being careful to manage new COVID-19 surges. **Recover** — return to more normal economic activity only after an effective treatment/cure becomes widely available. The U.S. is currently in the "reopen" phase, which began in May after state-issued lockdowns helped to contain the virus.

Cases and hospitalizations rise again as states reopen

The initial COVID-19 surge has subsided as economic shutdowns effectively slowed the spread of the disease. Importantly, the number of COVID-19 patients in U.S. hospitals has declined significantly since April's peak (Exhibit 1), lessening the strain on the nation's medical system and allowing the transition to the reopen phase. However, until a widely distributable treatment or vaccine becomes available, continuing vigilance is needed. As various states reopen their economies, new cases are rising in areas previously less affected. Hospitalizations, too, have begun to increase, albeit at a slower rate than during the initial wave, possibly due to a greater proportion of patients who may be younger and less severely impacted by the disease.

In the interest of avoiding a resurgence as significant as the initial wave and the associated strain on the medical system, state governments are slowing their reopening efforts. The reopen phase of the pandemic is likely to be marked by states and regions attempting to strike a balance between the speed of reopening and the risk of a viral resurgence.

EXHIBIT 1: Hospitalizations in the U.S. related to COVID-19

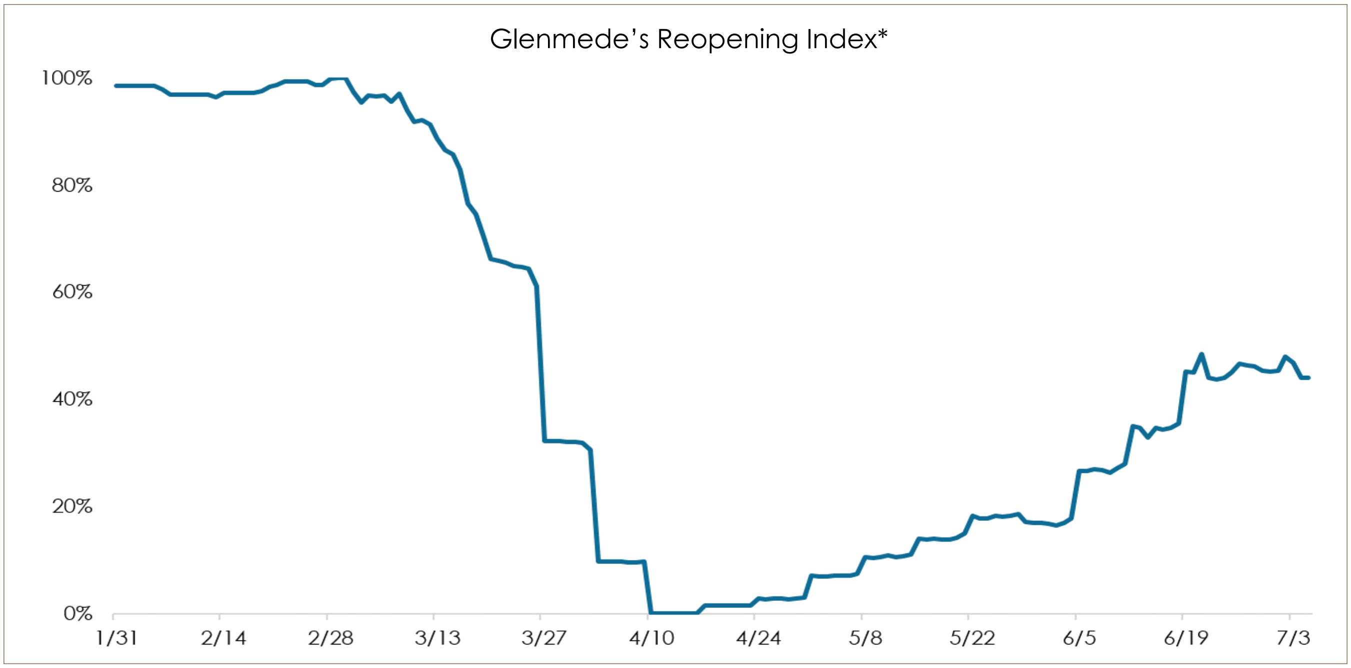


Source: Glenmede, The COVID Tracking Project *Data through 6/28/2020*
Data shows current COVID-19 hospitalizations in the U.S.

Economy steadily improves as activity gradually resumes

The economy has already improved significantly during the reopening phase, following shutdowns and social distancing that devastated Gross Domestic Product (GDP), employment and corporate profits. Glenmede's Reopening Index estimates that about 44% of economic activity lost due to social distancing has so far been regained (Exhibit 2). This index measures the recovery via a combination of high-frequency consumer spending and employment data. Consumer spending appears to be the driving factor, likely due in part to federal stimulus payments. Further, the spending recovery has been quicker in lower-touch segments (e.g., retail, gasoline consumption) than higher-touch segments (e.g., restaurants, travel), reflecting the consumer's desire to spend, but limit personal interactions. This reopen phase is likely to last at least through Q2 2021, with the economy and corporate earnings gradually recovering to a more normal, longer-term trend during the next 12 months.

EXHIBIT 2: U.S. economic reopening is gradually progressing



Source: Glenmede *Data through 7/5/2020*

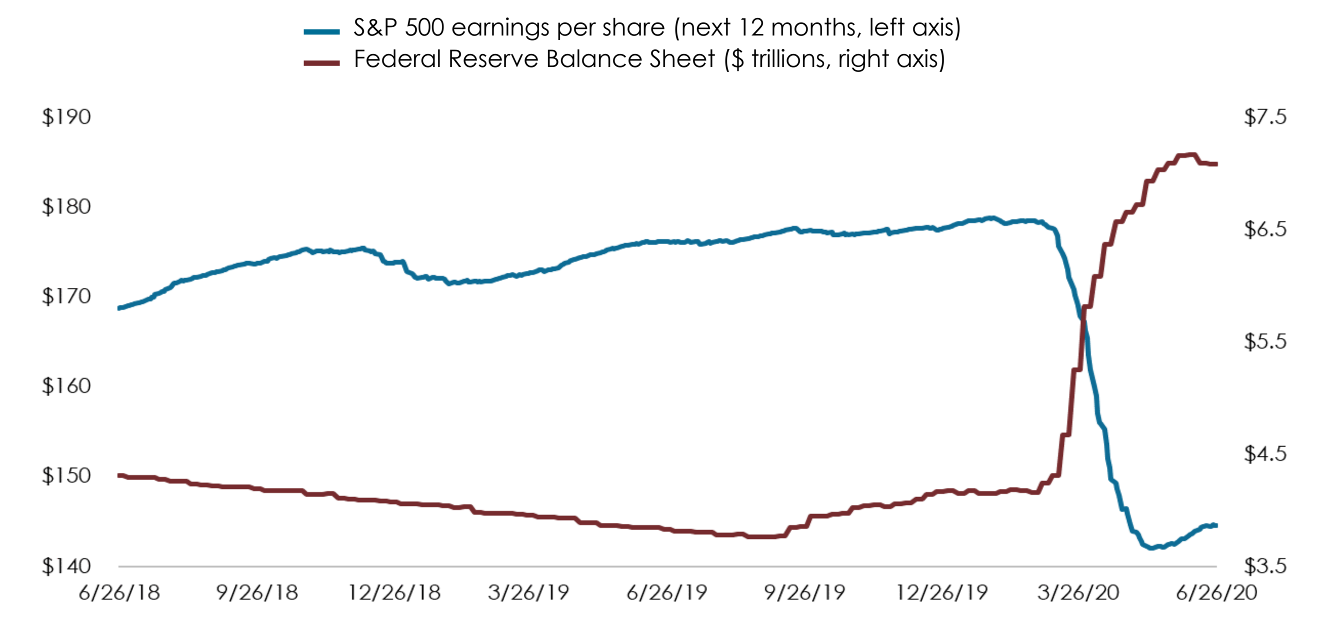
**Glenmede's Reopening Index is a proprietary tool developed by Glenmede. It is a balanced mix of high frequency indicators meant to provide real-time insights into the progress of economic reopening in the U.S. Though created in good faith, there can be no guarantee that these indicators will be accurate.*

Fed stimulus supports markets despite near-term fundamentals

Domestic equity markets have experienced an unpreceded recovery after the quickest peak-to-trough decline in the S&P 500's history, lasting only 16 trading days. This rebound astounded investors all the more, given how dramatically the economic situation had deteriorated. The Federal Reserve came to the rescue with unprecedented monetary support since March, committing to lend or buy trillions of dollars of financial assets and expanding its balance sheet to $7 trillion as a result. This massive expansion of the Fed's assets provided stability just as S&P 500 earnings estimates began their precipitous decline (Exhibit 3). By way of comparison, during the last financial crisis in 2008 — 2009, the Fed added about $3 trillion over the course of multiple years, compared with the $3 trillion addition in only three months this time. And it's not just the Fed: Congress has allocated almost $3 trillion in economic aid, representing more than 13% of U.S. GDP. Additionally, the prospect of economic reopening has driven investor risk appetite higher, particularly with fixed income offering paltry yields.

Although the S&P 500 recovered much of its losses with monetary and fiscal support, much of the gains have been concentrated in a few mega-cap growth stocks that have benefitted from the current upheaval. The five largest companies in the S&P 500 — Amazon, Apple, Microsoft, Facebook and Google — have contributed more to the index's performance since the late-March low than the entire materials, real estate, utilities, communications services and energy sectors combined. The market rebound is betting on monetary and fiscal stimulus to support the economy until recovery in 2021. However, the market is vulnerable to pullbacks caused by pandemic resurgence or subsequent waves.

EXHIBIT 3: Markets favoring Fed stimulus over near-term fundamentals



Source: Glenmede, FactSet *Data through 6/26/2020*

Data shown is the consensus estimate of next 12 months earnings per share for the S&P 500 index over time by the blue line and Federal Reserve's balance sheet by the red line. The S&P 500 is a market capitalization weighted index of large-cap stocks in the U.S. One cannot invest directly in an index. NTM earnings per share are projections, for which there can be no guarantee of accuracy. Actual results may vary considerably from these projections.

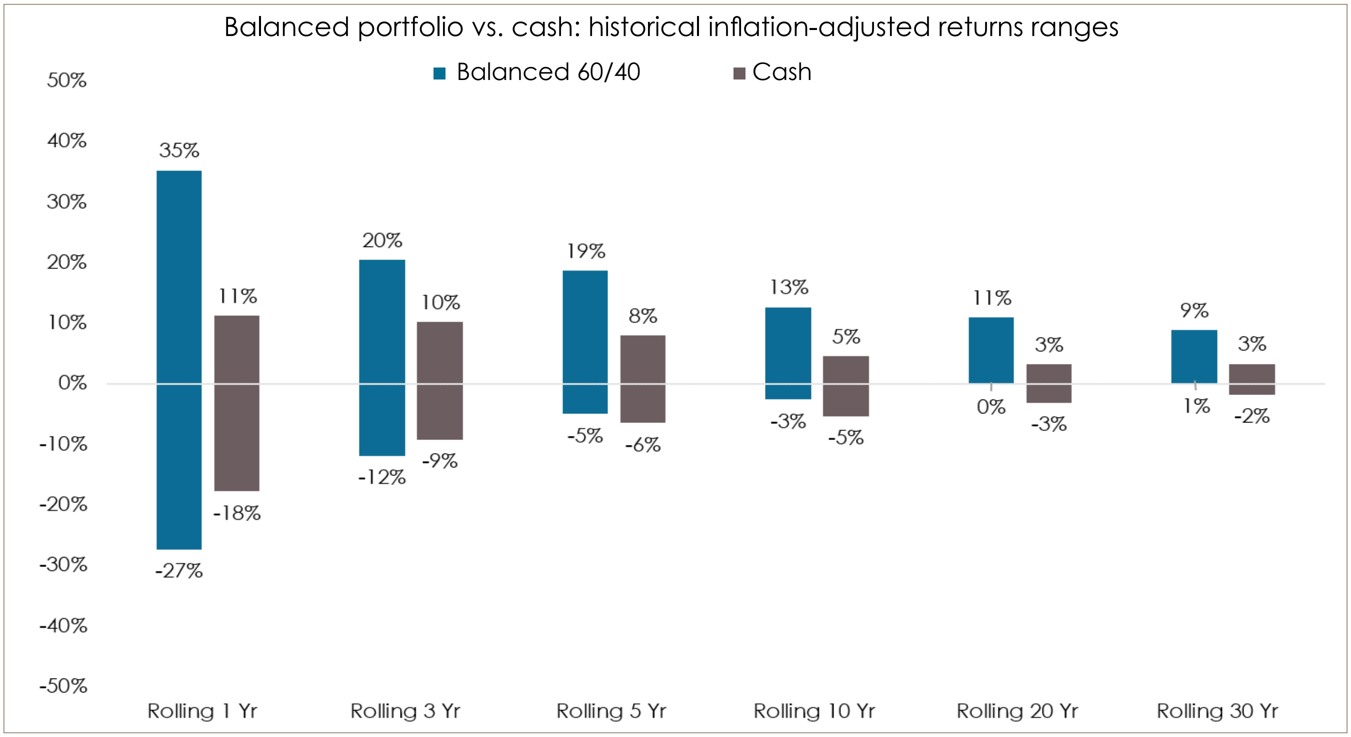
Maintain neutral equity and risk exposure

So, what should investors do? Equity valuations have pushed higher after the dramatic rally in stocks over the past three months, driven by reopening optimism and an absence of attractive alternatives in fixed income and cash. But that does not necessarily mean all opportunities have vanished.

Although Glenmede's proprietary Global Expected Returns model estimates that U.S. large-cap stocks currently are priced above fair value, emerging markets appear near fair value and U.S. small-cap stocks appear below fair value. As a result, there may be attractive opportunities further down the market-cap spectrum, especially outside of high-flying growth stocks that make up a sizable portion of the market's dramatic gains since the late-March low.

Despite uncertainty over the economy and markets, it is crucial for long-term investors to remain invested while facing expected volatility. Historically, in periods of five years or longer, a 60% stock/40% bond portfolio has demonstrated more upside potential and less downside risk than cash on an inflation-adjusted basis (Exhibit 4). Therefore, long-term investors should resist the urge to liquidate into cash and instead continue to follow their longer-term financial and investment plans, rebalancing as appropriate. A goals-based investment approach should anticipate that unexpected twists in the market are inevitable, affording the confidence and ability to ride through market declines and rebounds, staying invested to increase the likelihood of achieving longer-term goals.

EXHIBIT 4: Staying invested is important for pursuing long-term objectives



Source: Glenmede, FactSet *Data through 12/31/2019*

Returns shown are based on calendar year returns from 1927 to 2019, and reflect the historical range of annualized returns from a balanced portfolio (60% stocks and 40% bonds) and cash for different length rolling periods: 1yr, 3yr, 5yr, 10yr, 20yr and 30yr. For example, the highest 5yr return for the balanced portfolio was 19% and the lowest 5yr return for the balanced portfolio was -5%. Stocks are represented by the S&P 500 Index. Bonds are represented by the Bloomberg Barclays U.S. Aggregate Bond Index. Cash is represented by the 3-Month U.S. Treasury Bill. Past performance may not be indicative of future results. One cannot invest directly in an index.