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Investment Strategy Insights

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Galloping Along the Pandemic Recovery

- Ponying Up on Capital Gains
  - Investors should consider accelerating capital gains realizations now, and increase their preference for tax efficiency later

- A Furlong to Full Employment
  - Labor market dislocation is notable, but may prove to be near-term noise in a longer-term recovery

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Ponying Up on Capital Gains

- **Capital Gains in the Crosshairs.** The Biden administration released its American Families Plan a few weeks ago, which proposes additional federal spending on initiatives such as extended child tax credits, universal pre-K, paid family/medical leave and free community college. To offset that $2 trillion cost, one of the revenue raising provisions calls for higher capital gains tax rates for households with income greater than $1 million, from 20% currently to the proposed top marginal income rate of 43.4%.*

- **Broader Market Impact?** In theory, higher capital gains tax rates are an incremental barrier to the efficient allocation of capital within the marketplace, since investors may be less likely to update their views by selling one security to buy another. However, the market has historically shown little sensitivity to either rising or falling capital gains rates in aggregate. More specifically, the performance of the S&P 500 and changes in U.S. statutory capital gains rates have not empirically demonstrated a relationship of statistical significance.

- **Importance of Tax Aware Wealth Management.** The consideration of tax impacts will continue to be one of the cornerstones of effective wealth management. From capital gains planning, investment vehicle selection, tax aware asset allocation and evaluation of the tax efficiency of individual strategies, taxes can have multiple, interdependent effects on portfolios. More so than ever, the threat of higher capital gains taxes makes it more important to take an approach that's thoughtful, holistic and tax aware.

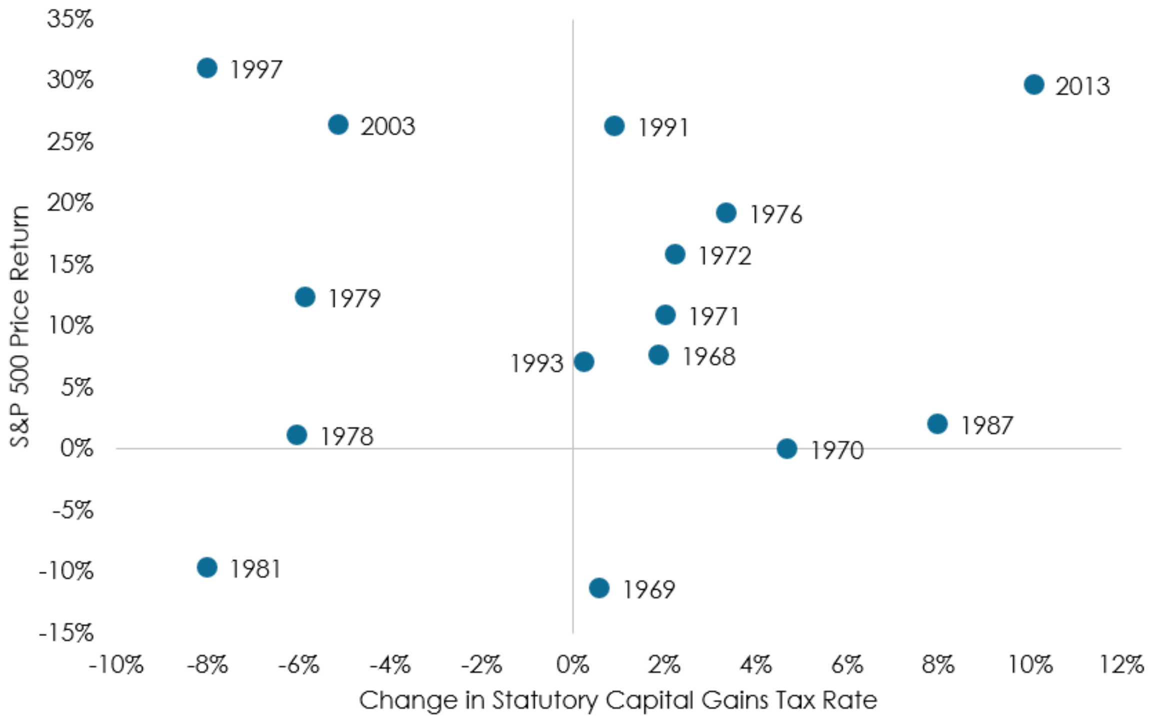
Investors should consider accelerating capital gains realizations now, and increase their preference for tax efficiency later

**Proposed top marginal income rate (39.6%) plus the Net Investment Income Tax (3.8%)*

Chart of the Week:

Markets Not Very Sensitive to Capital Gain Tax Rate Changes

Equity Market Returns During Years of Capital Gains Tax Increases



Source: Glenmede, FactSet, U.S. Department of Treasury *Data as of 05/09/2021*

Each dot represents a year in which the top capital gains tax rate was changed, with position along the x-axis representing the change in the statutory capital gains tax rate and position along the y-axis the S&P 500 Index's price return during the same year. Past performance may not be indicative of future results. One cannot invest directly in an index.

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A Furlong to Full Employment

- **Lackluster Jobs Report.** Last Friday's jobs report was overall underwhelming. Nonfarm payrolls for April came in at +266k, which was well below consensus expectations of +975k, and the net revision to prior months was -78k. The unemployment rate ticked a notch higher to 6.1% from March's 6.0%, though this was partially a reflection of more people entering the labor force. Especially since business surveys continue to cite trouble filling open positions, trends in the labor force participation rate will be a key indicator to watch amid the ongoing employment recovery.

- **Transitory Tightness.** There may be a number of reasons why workers are returning to the labor market more slowly than expected. The U.S. Census Bureau's Household Pulse Survey in late March found that 4.1 million Americans out of and not actively seeking work were "concerned about getting or spreading the coronavirus," 2.6 million were sick with or taking care of someone with COVID symptoms and 6.3 million were caring for children not in school, making seeking employment difficult. These factors could be a meaningful, but short-lived headwind to the ongoing labor market recovery.

- **Taking the Broader View.** Nonfarm payrolls and the unemployment rate are but two pieces in a mosaic of labor market data that is generally moving in a positive direction, which includes jobless claims and the employment component of PMIs.** Nevertheless, the disappointing jobs report probably pushes back the Fed's timeline for adjusting its stance on monetary policy, since it's clear the labor market still faces COVID disruptions.

Labor market dislocation is notable, but may prove to be near-term noise in a longer-term recovery

Earnings Season Down the Home Stretch

- **Blowout Earnings Results.** Q1 earnings season is now entering the final stretch, with 89% of S&P 500 companies already reported and an impressive 87% of those firms reporting better earnings than expected. The blended year-over-over growth estimate for the S&P 500, which combines actual results with consensus estimates for firms that have yet to report, currently sits at ~49%. Q1 is shaping up to be the best quarter for year-over-year earnings growth since the economy began emerging from the depths of the Great Financial Crisis in early 2010.

- **New Cycle Growing Pains.** The eye-popping growth observed in earnings so far can be attributed, at least in part, to the progress the U.S. economy is making in stepping out of the pandemic's shadow. However, it does appear that this nascent profit cycle is not without its growing pains. For example, a sizable portion of companies are citing raw material shortages during earnings calls. For industries exposed to those shortages and limited ability to pass-through rising costs to consumers, this could have an incremental impact on profit margins.

- **Eyes on the Horizon.** Looking forward, Glenmede estimates that the S&P 500 is on pace to exceed the earnings run rate implied by pre-pandemic consensus. The ongoing recovery may not be entirely smooth sailing, due to outstanding headwinds from raw material shortages and the specter of higher corporate taxes. With that said, these do not appear to be material enough to knock profit trends off their course of recovery.

The robust earnings recovery appears resilient in the face of supply chain and tax headwinds

***Purchasing Managers' Indexes*

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