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Investment Strategy Insights

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Transitioning Recovery and Stimulus

- The Aging of the Recovery
  - The recovery is well established and transitioning to ongoing growth, supporting further fundamental-based gains for stocks

- A Lot of Fed Talk, Little Action
  - Expect the Fed's monetary policy shifts to be measured and methodical so as not to disrupt the ongoing recovery

- The ~~$4 Trillion~~ $1 Trillion Plan
  - The combined spending package appears to be less stimulative than previous bills, but also include less tax hikes

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The Aging of the Recovery

- **Economic Recovery Well Underway.** Glenmede's Reopening Index now stands at 100%, suggesting that all the economic activity lost during the recession has been regained. While some further recovery is needed to reestablish the economy's previous growth trend, the economy is beginning to transition to post-recovery growth. Expect this ongoing recovery and transition to be marked by a combination of rolling recoveries in areas of the economy that have lagged, like small business activity and employment, and ongoing but slower growth in areas that have already recovered from or did not decline during the recession.

- **Surprisingly Normal Earnings.** Earnings have also recovered close to their previous trend levels. During the first quarter, over 88% of companies beat earnings expectations, much higher than the historical average of 65%. Earnings growth will likely continue into the back half of the year as the economic rebound progresses, although the magnitude of this growth overall should begin to slow as the base effects from last year's pandemic-impacted earnings drift further away in the rear-view mirror.

- **Not a Surprise for Investors.** Near their 90th percentile of valuations according to Glenmede's proprietary model, U.S. large-cap stocks have largely priced in the unfolding economic and market recovery. The fundamental picture is good, investors know it and markets reflect it. This does not preclude ongoing gains, though, but such gains would likely need to be based mostly on ongoing fundamental growth of the average company than on further appreciation in valuations.

The recovery is well established and transitioning to ongoing growth, supporting further fundamental-based gains for stocks

A Lot of Fed Talk, Little Action

- **The Fed's Dual Mandate.** The recent Federal Reserve Open Market Committee meeting marked a small shift in tone as tapering discussions have begun. Having provided an enormous amount of monetary stimulus through low interest rates and a large bond-buying program, the Fed is finally starting to discuss softening its supportive stance, but likely not due to fears of rampant inflation. The FOMC has remained steadfast that inflation will likely be transitory and that the labor market is still recovering, suggesting little need for a rapid monetary policy response. Instead, these discussions center on a normalizing economy that should not need as much stimulus going forward.

- **Too-Hot (But Transitory) Inflation.** Recent inflation readings have been high relative to historic levels but are showing signs of fading. The Fed's preferred inflation measure (Core PCE*) was in line with consensus of 3.4% Y/Y for May, consistent with an environment of above-3% inflation for most of the summer. However, inflationary pressures should subside as firms increase productivity and meet pent up demand. Overall, inflation readings are indicating slowing momentum as base effects dissipate.

- **Too-Cold (But Also Transitory) Employment.** The labor market's recovery remains lethargic this summer, in contrast to other indications of economic strength. Initial jobless claims on Thursday came in at 411k, below the previous week's report but higher than consensus. While arguably slower than other parts of the economy, employment should improve as pandemic-related factors wane, COVID-relief-related unemployment benefits expire and a greater sense of normalcy returns.

Expect the Fed's monetary policy shifts to be measured and methodical so as not to disrupt the ongoing recovery

**Core Personal Consumption Expenditures Price Index*

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The ~~$4 Trillion~~ $1 Trillion Plan

- **Agreement In Principle.** Last week, President Biden announced his support of a bipartisan infrastructure bill, previously agreed to in principle by about 25 senators. The total package currently includes $1.2 trillion in new spending over the course of 8 years, with about half of that earmarked for infrastructure. However, not all Democrats are on board with this bipartisan agreement by itself and it remains unclear if the passage of the bipartisan deal will be bound to the passage of a supplemental reconciliation bill that would include additional spending and tax hikes.

- **Reconciliation's Road Ahead.** President Biden's endorsement of the bipartisan deal should spur enough momentum to get the bill passed before the August recess. However, if Democrats hold strong with their demands for a reconciliation bill in tandem, the timetable could be pushed back to Q4, as it currently seems there are not yet enough votes on a separate reconciliation bill. With a lot of moving pieces and various stakeholders with different objectives, the shape of the next fiscal package(s) are starting to come into focus, though the path to get there remains uncertain.

- **Less Spending & Less Taxes.** With the current bipartisan deal in motion, the likelihood of tax hikes are decreasing, as Republicans have shot down any broad-based tax increases. It is crucial for investors to understand that this proposed spending is spread out over a large timespan, making it far less stimulative than previous COVID-related bills. However, as Democrats ramp up talks on an additional reconciliation bill, expect tax hikes to act as a headwind for growth in 2022.

The combined spending package appears to be less stimulative than previous bills, but also include less tax hikes

Chart of the Week:

Fiscal Spending: Some Variability Remains In the Final Outcome

Possible Paths Forward on an Infrastructure Deal

Scenario	Total Cost	Tax Implications	Likelihood
Full Biden Agenda	$4 Trillion	28% Corporate Tax Rate 21% GILTI Tax Rate	<1%
Bipartisan Bill + Reconciliation Bill	$2 – 2.5 Trillion	~25% Corporate Tax Rate ~17% GILTI Tax Rate	50%
Reconciliation Bill Only	$2 – $2.5 Trillion	~25% Corporate Tax Rate ~17% GILTI Tax Rate	10%
Bipartisan Bill Only	$1.2 Trillion	No Corporate Tax Rate Hike	30%
No Deal	-	No Corporate Tax Rate Hike	10%

Similar Outcomes, 60% Aggregate Likelihood

Source: Glenmede, Cornerstone Macro
Data shown are subjective estimates of the likelihood of various political outcomes, provided by Glenmede based on information from Cornerstone Macro. GILTI refers to the tax rate applied to global intangible low-taxed income. Actual results may vary materially from these estimates.

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