GLENMEDE

Investment Strategy Insights

August 2nd, 2021

The Winds (& Anticipation) of Change

- Beijing Flexing a Heavy Hand
  - Higher political risks warrant a valuation discount for emerging markets to compensate investors accordingly
- Taper Talks Underway
  - If the Fed's intentions are telegraphed well in advance, taking the first step toward tightening need not be disruptive for markets
- Hot Summer Earnings Season
  - As peak growth enters the rearview mirror, earnings guidance for the quarters ahead will take on increasing importance

Beijing Flexing a Heavy Hand

- **Chinese Stocks Under Pressure.** Chinese equities have experienced a bout of underperformance, declining -28% since the middle of February, compared to a positive 6% return for the rest of the world.* The weakness has been primarily chalked up to an intensifying regulatory regime, which includes anti-trust action on Alibaba, tightened regulations on micro lending for Ant Group and cybersecurity mandates on Didi Chuxing. The latest was last week's ban on all for-profit K-12 tutoring companies.

- **Regulation Hits Tutors.** These actions do not appear to be a wholesale attack on corporate profits or shareholders, but do offer a reminder that the Chinese Communist Party's agenda does not always put corporate profits above all else. It appears the education-tech industry found itself in the crosshairs as education expenses began to eat into an ever-growing share of disposable income for Chinese consumers. Since 2011, urban Chinese household consumption has increased three-fold, but spending on education has increased more than 7x.

- **Risks & Opportunities in EM Asia.** Despite the recent spate of regulatory intervention, the growth of the emerging Asian consumer remains an important opportunity for investors. This is a thesis that is not confined to China, but also applies to a host of other southeast Asian nations. A repricing of risk assets in the region is perhaps appropriate to properly compensate investors for higher-than-normal regulatory risks, but these risks should be balanced against the likelihood that the emerging Asian consumer will be a force to be reckoned within the coming decades.

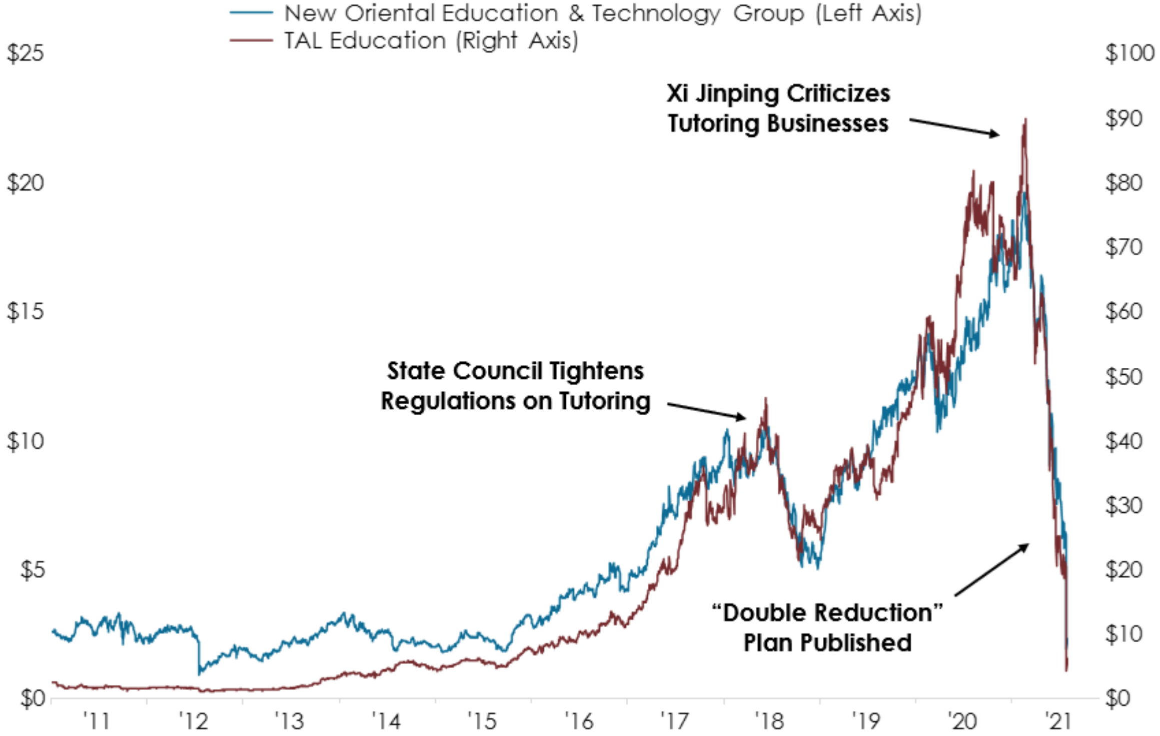
Higher political risks warrant a valuation discount for emerging markets to compensate investors accordingly

The MSCI China Index and MSCI All Country World Index are used as proxies for Chinese equities and global equities, respectively.

Chart of the Week:

The Education-Tech Sector is the Latest Industry Under Fire

Chinese Private Education Stocks: Share Price



Source: Glenmede, FactSet *Data through 7/29/2021*

Data shown is the price for shares in New Oriental Education & Technology Group, Inc. (graphed on the left y-axis) and TAL Education (graphed on the right y-axis) via American Depository Receipts (ADRs). The company share price information is provided solely for illustrative purposes and does not constitute a recommendation to buy, sell or hold any particular investment. Past performance may not be indicative of future results.

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Taper Talk Underway

- **Monetary Policy Unchanged**. As expected, the FOMC** announced no changes to interest rates or its bond-buying program last week. The statement after the meeting contained new language that hinted the Fed is continuing to discuss tapering, by stating that "the economy has made progress toward (maximum employment and price stability) goals, and the Committee will continue to assess progress in coming meetings." In the press conference following the release, Chair Powell was a bit more explicit, noting that the meeting was the first "deep dive" on the specifics of tapering.

- **Casting Eyes on the Minutes.** The timing, pace and composition of the Fed's tapering plans are likely to be of considerable interest for markets over the next few months. To that end, investors should be circling Aug. 18th on their calendars, when the minutes from last week's FOMC meeting will be released. The minutes will be more important than usual, as they may provide additional color on the specific benchmarks members of the Committee are setting in their respective taper timeline frameworks.

- **Monetary Policy Roadmap.** Investors should expect the Fed to use the next few months to develop and clarify its forward guidance for both bond purchases and rate hikes. From there, the Fed will likely taper its bond purchases through 2022 and perhaps consider a gradual increase of the federal funds rate in the back half of 2023. An orderly and transparent removal of easy monetary policy should not be disruptive, particularly if it's undertaken in reaction to improvements in the underlying economy.

If the Fed's intentions are telegraphed well in advance, taking the first step toward tightening need not be disruptive for markets

Hot Summer Earnings Season

- **A Stellar Quarter for Profits.** With Q2 earnings season now in full swing, the blended year-over-year earnings growth estimate for the S&P 500, which combines actual results with consensus estimates for companies that have yet to report, now sits at a whopping 84.2%. Firms are reporting earnings 17.2% ahead of expectations on average, which is well ahead of the five-year average of 7.8%. If earnings reports continue to unfold as expected, Q2 should mark the largest annual gain in quarterly profits for the S&P 500 since emerging from the depths of the Great Financial Crisis.

- **Tech Reports.** The five largest publicly-traded stocks in the U.S. (Apple, Microsoft, Amazon, Alphabet, Facebook) all reported Q2 earnings results last week that beat analysts' expectations. However, there were some signs of vulnerability in the details. For example, Amazon reported lighter revenues than consensus expectations and Facebook softened its guidance for the remainder of the year. This highlights just how difficult it can be for top companies to maintain their dominance in the marketplace.

- **Peak Growth… So What?** Due to what was, in many respects, an extraordinary year in 2020, earnings results compared to a year ago are posting some eye-popping growth. As such, Q2 2021 may mark peak earnings growth for the unfolding profit cycle, but that in and of itself is not a bad thing. For example, in the 1-, 3- and 5-year periods after reaching peak earnings growth in the last two economic cycles, the S&P 500 has posted cumulative double digit total returns on average. Rather than obsessing over near-term growth peaks, investors would be wise to see the bigger picture.

As peak growth enters the rearview mirror, earnings guidance for the quarters ahead will take on increasing importance

***Federal Open Market Committee*

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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
Vice President, Investment Strategy

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

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