GLENMEDE

Investment Strategy Insights

September 20th, 2021

Game, Set, Match

- Inflation on the Backspin
  - Confidence in the transitory nature of inflation allows the Fed to unwind monetary stimulus in a gradual and orderly manner

- Serving Up a Monetary Policy Update
  - Expect the Fed to begin tapering its balance sheet within the coming months, which should not be disruptive for markets

- The Opening Volley on Fiscal Policy
  - Expect the volume/noise out of Washington regarding the $3.5 trillion fiscal plan to rise, potentially causing volatility for markets

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Inflation on the Backspin

- **Encouraging Signs in CPI.** Inflation appears to be showing initial traces of deceleration after running well above average for much of the summer. Last week's Consumer Price Index (CPI) print for August was right in-line with consensus on a year-over-year basis at 5.3%, the lowest it's been since May. Inflation has become problematic in the past when both the sticky and flexible components move higher in tandem, as they did in the 1970s. As it stands now, sticky CPI has merely recovered to pre-pandemic levels, suggesting that a persistent inflation cycle has not yet set in.

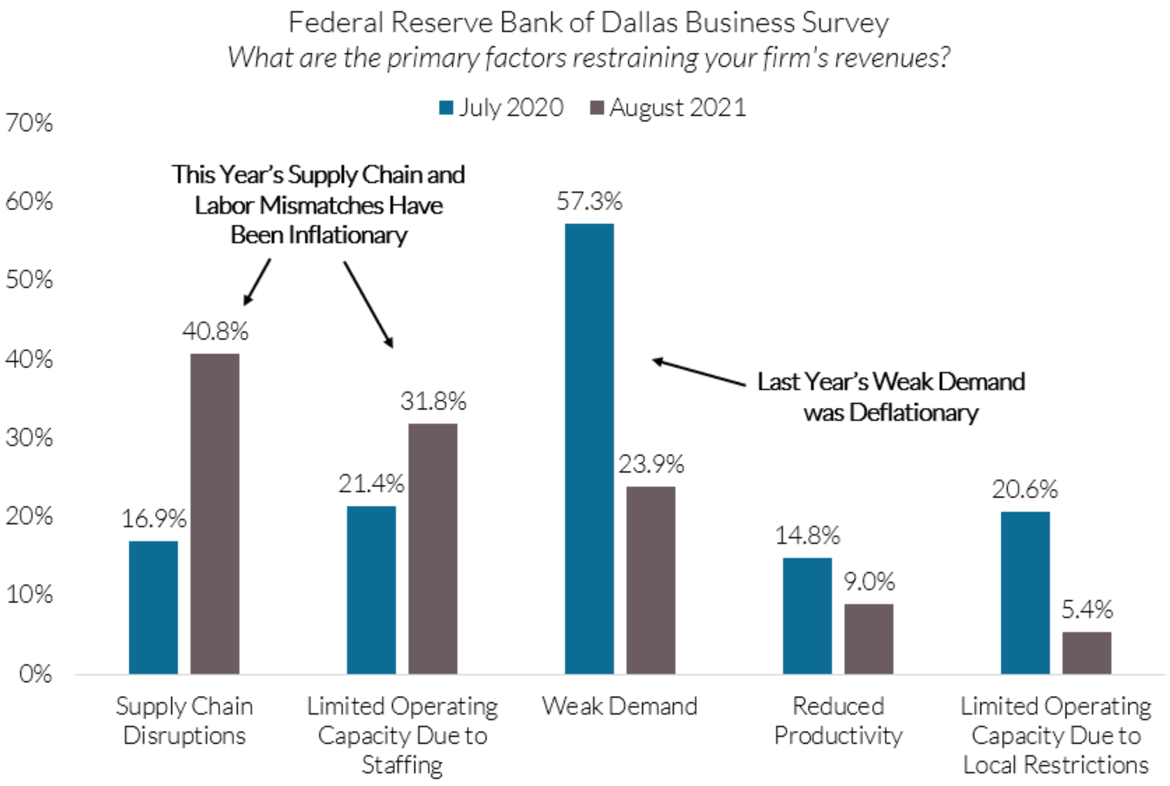
- **Lingering Inflation Concerns.** The base effects of year-ago deflation should begin to wear off heading into the fall, but it appears that supply chain disruptions and staffing shortfalls could keep inflation higher than normal in the short-run. The Dallas Fed's Business Survey found that weak demand was the primary concern of business executives last summer (which was, all else equal, deflationary). At the end of August this year, supply chain and staffing issues ranked among the most reported factor restraining revenues.

- **Buying the "Transitory" Narrative.** Investors appear to be coming around to the "transitory inflation" view that the Fed has been pushing. 10-year TIPS* breakeven rates and inflation swaps pricing shows inflation expectations well off their 2020 highs and anchored within the Fed's comfort zone of 2 – 2.5%. This affords the Fed the chance to take a measured and deliberate approach to policy normalization, which need not necessarily be disruptive for markets.

Confidence in the transitory nature of inflation allows the Fed to unwind monetary stimulus in a gradual and orderly manner

Chart of the Week:

Supply Chain Disruptions & Labor Shortages Continue to Play a Role



Source: Glenmede, Federal Reserve Bank of Dallas Data as of 8/30/2021
Data shown are the results of the Federal Reserve Bank of Dallas' Texas Business Outlook Surveys. The survey was conducted between August 17 - 25 and 363 business executives responded to the survey. Respondents were instructed to select up to three factors. Responses of "Other" and "None/not applicable" are omitted from the chart.

*Treasury Inflation-Protected Securities

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Serving Up a Monetary Policy Update

- **FOMC Preview.** The Federal Open Market Committee (FOMC) will convene this week, in what should be an eventful day. Though investors should not expect any direct changes to the stance of monetary policy, the statement release on Wednesday may contain more explicit hints regarding the timing, pace and/or duration of plans to taper its balance sheet. In addition, the FOMC will update its economic forecasts and closely watched "dot plot," which will include projections out to 2024 for the first time.

- **The Specifics on Tapering.** The next action in the order of operations for normalizing U.S. monetary policy appears to be a tapering of the Fed's balance sheet, details of which will be closely anticipated as investors comb through the September FOMC statement. At a higher level, the difference between the Fed starting its taper in late 2021 or early 2022 amounts to a relatively small tweak in the projected path of the balance sheet given the gradual path tapering is likely to follow once initiated.

- **Expecting a Gradual Path on Interest Rates.** Fed Chair Powell has been clear to differentiate a separate decision framework for rate hikes, noting his preference to keep the fed funds rate at the zero lower bound until "the economy reaches conditions consistent with maximum employment." The median respondent in the FOMC's last dot plot published in June expected liftoff on interest rates with two rate hikes in 2023. The addition of 2024 to the dot plot should give investors a better idea of expectations for the pace of rate hikes thereafter.

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The Opening Volley on Fiscal Policy

- **House Dems Show Their Hand.** Last week, the House Ways and Means Committee (HWMC) released its first draft reconciliation proposal, which was headlined by its $3.5 trillion price tag. In order to finance the plan, the Committee has proposed raising the corporate tax rate to 26.5% and increasing the rate applied to global intangible low-tax income (GILTI) to 17.4%. In addition to the corporate proposals, the plan also proposes a top individual tax rate of 39.6% and raises the top capital gains rate to 25%.

- **Nothing Set in Stone.** The HWMC bill is just the opening salvo in what should be a long back and forth in finding a plan that works for all in the Democratic caucus. For a deal to be struck, Democrats will likely need to thread the needle on a compromise that can pass both the House of Representatives, where the Democrats hold a slim majority, and the Senate, where Vice President Harris would likely need to cast a tiebreaking vote. As a result, much of both the spending and revenue-generating provisions of the plan may be subject to change in the consensus-building process.

- **Get Ready for the Noise.** Information around the two bills leaves a lot of room for interpretation and spin. Legislators and commentators will likely selectively quote $3.5 trillion (the total gross spending) or $1.7 trillion (net of tax and other offsets), depending on the point they want to make. The time frame of implementation should also be a key consideration. Investors should keep their eyes on the per-year spending, net of offsets, to better benchmark the economic and budget impacts.

Expect the volume/noise out of Washington regarding the $3.5 trillion fiscal plan to rise, potentially causing volatility for markets

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