GLENMEDE

Investment Strategy Insights

October 11th, 2021

Breezy Fall Crosscurrents

- Value Stocks' Second Wind
  - Investors should consider tilting their equity allocations in favor of value stocks, which may benefit from multiple tailwinds

- The Non-Transitory, Transitory Inflation
  - Inflation prints are likely to remain above average well into 2022, but should begin to stabilize as transitory factors normalize

- Q3 Earnings Preview
  - The ongoing earnings recovery appears robust enough to weather short-term inflation and labor market disruptions

Value Stocks' Second Wind

- **Don't Call it a Comeback.** U.S. value stocks began 2021 with a bang, as the Russell 1000 Value Index outperformed its growth counterpart by 10.3% in the first quarter. Since then, growth stocks have fought their way back, capping off an 11.2% (annualized) run of trailing five-year outperformance as of the end of September. Though the longer-term backdrop has recently been a sustained outperformance of growth stocks, value may be poised for a comeback.

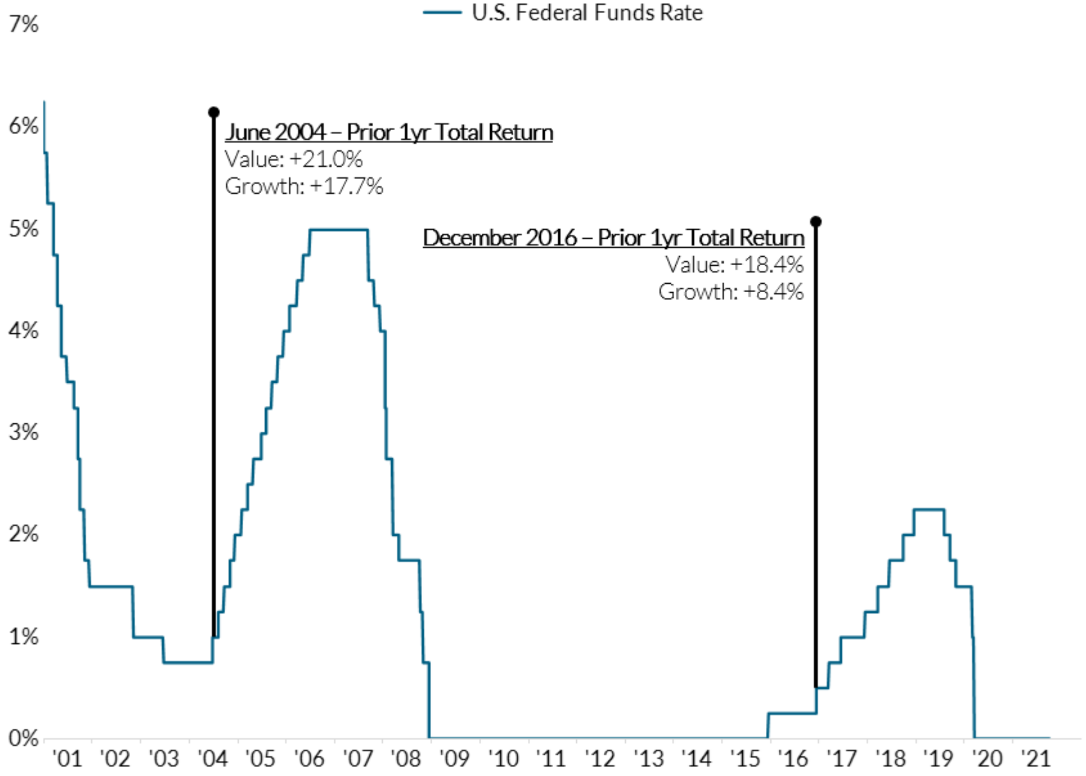
- **Inflation and Rate Hike Sensitivity.** Several macroeconomic factors may be aligning in favor of value stocks over the next year or so. Inflation has stubbornly showed some persistence at higher-than-normal levels, a regime under which value stocks have an empirical track record of significant outperformance. Also, in the year before the Federal Reserve began its last two regimented rate hike cycles (June 2004 and December 2016), value stocks outpaced their growth counterparts by 3.3% and 10.0%, respectively. This is important, given the Fed's latest dot plot projections show the median respondent expecting to begin such a campaign in either late 2022 or early 2023.

- **Investment Playbook.** Backed up by more fair valuations, Glenmede's proprietary Global Expected Returns Model projects U.S. large-cap value stocks to have twice the return potential for the next 10-years. As a result, investors should consider tilting their equity exposures in favor of value stocks. However, investors should also be careful not to take that tilt to the extreme, as below-the-surface risks can arise from large sector wagers.

Investors should consider tilting their equity allocations in favor of value stocks, which may benefit from multiple tailwinds

Chart of the Week:

Value Typically Outperforms in the Year Preceding Fed Rate Hike Cycles



Source: Glenmede, FactSet | Data through 10/8/2021

Data shown is the lower bound of the Federal Reserve's target range for the federal funds rate. Value and growth stocks are represented by the Russell 1000 Value Index and Russell 1000 Growth Index, respectively. Past performance may not be indicative of future results. One can not invest directly in an index.

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The Non-Transitory, Transitory Inflation

- **September Inflation Preview.** This week brings another round of inflation data in the U.S. The Consumer Price Index (CPI)* is expected to report at a 4.1% year-over-year growth rate, while the Producer Price Index (PPI)** is expected to report a 7.5% annual price gain for September. Both figures exclude food and energy as the two are the most volatile components. Given the recent dramatic rise in natural gas prices, the expectation is for the energy component to rise significantly.

- **Sticky vs. Flexible Inflation.** Historically, inflation has been problematic when both the sticky and flexible components of inflation (via the Federal Reserve Bank of Atlanta) move higher in tandem, as they did in the 1970s. Currently, although Flexible CPI has hit multi-decade highs, Sticky CPI has barely managed to recover to pre-pandemic levels, suggesting that this recent pickup in inflation should prove transitory. Looking ahead, the extent of price-level reversion in the supply-constrained Flexible CPI categories and the pace of wage growth will remain important factors for the '22 inflation outlook.

- **What to Watch.** Lately, due to more persistent supply chain disruptions, in part caused by the spread of the Delta variant in Asia, expectations for higher durable goods prices and stronger wage growth are increasing. Inflation is likely to be higher going forward than the sub-2.0% inflation experienced for much of the past decade, but above-4% inflation is unlikely to persist beyond early '22. A good degree of this inflation should ultimately prove transitory as base effects from year-ago levels normalize and supply shortage concern eases as companies ramp up production.

Inflation prints are likely to remain above average well into 2022, but should begin to stabilize as transitory factors normalize

Q3 Earnings Preview

- **Eagerly Awaiting Earnings Results.** Another earnings season is upon us, with many expecting signs that corporate profitability picked up steam in Q3. With 4% of companies reporting so far, the blended year-over-year earnings growth estimate for the S&P 500, which combines actual results with consensus estimate for firms that have yet to report, currently sits at 27.2%. This would mark the third-highest (year-over-year) earnings growth since '10.

- **Down in the Details.** For Q3, over 20% of companies in the S&P 500 have issued earnings-per-share (EPS) guidance. Of those ~100 companies, 54% of have issued positive EPS guidance, which is well above the 5-year average of 39%. At the sector level, the energy sector is on pace to provide the largest contribution to the S&P 500's earnings growth rate in Q3, after a tremendous recovery in oil/gas prices on a year-over-year basis. Of the eleven traditional sectors in the S&P 500, only utilities are expected to experience negative annual growth.

- **Earnings Reliant on Growth.** In the first half of '21, investors looked forward to a robust reopening with expectations of a vaccine-led recovery following the pandemic. While new COVID cases have recently fallen – a positive for the economy – the Delta variant, supply chain disruptions and labor shortages were all notable headwinds to Q3 activity. The level of surprises this earnings season may, as a result, be more muted, but longer-term earnings growth guidance should remain favorable.

The ongoing earnings recovery appears robust enough to weather short-term inflation and labor market disruptions

**Consumer Price Index (CPI) ex-Food & Energy*
***Producer Price Index (PPI) ex-Food & Energy*
****GDPNow refers to the Atlanta Fed's real-time GDP tracker*

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GLENMEDE CORPORATE FACTS

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