INVESTMENT STRATEGY INSIGHTS

Looking Ahead to 2022

December 13th, 2021

What to expect from policymakers?

- Waning fiscal and monetary stimulus remain a source of anxiety, but should ultimately produce only modest headwinds

Will above average inflation persist?

- Supply chain disruptions may spill over into the new year, but their impact should eventually subside

Where are we in the pandemic recovery?

- Expect ongoing growth in the new year as economies continue to normalize from the pandemic

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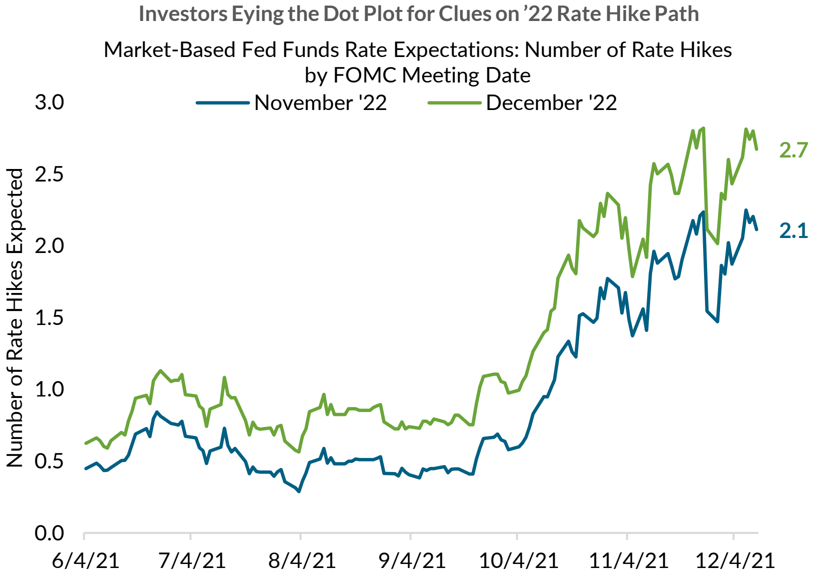
What to expect from policymakers?

- **Monetary Matters.** The Federal Open Market Committee (FOMC) will meet this week in what is likely to be the most anticipated market event through the end of the year. The Committee is expected to announce an acceleration in the pace of tapering its balance sheet purchases, which could put them on a path to complete the process by the end of Q1 rather than Q2. In addition, the FOMC will publish an updated dot plot projection, which when last updated in September showed a Committee split on one rate hike for '22.
- **Charting '22 Course for the Fed.** The process of tapering itself is unlikely to be disruptive for markets – most major asset classes posted positive returns during the Fed's last taper in '13/'14. In addition, the timing of when the Fed decides to complete that process should not have a meaningful effect either. However, the expected order of operations from there likely includes interest rate hikes. Pricing of fed funds futures suggests that by the end of '22, investors are expecting two hikes, with a 70% chance of a third.
- **Fiscal Policy in the New Year.** With the path cleared for raising the debt ceiling, discussions in Congress regarding the Build Back Better bill are likely to continue up to, and perhaps through, the new year. Regardless whether Congress can reach an agreement on the $2T reconciliation package, fiscal policy is likely to be an incremental headwind for growth in '22. This is due to the sheer size of pandemic stimulus over the past two years, which creates higher baselines for annual comparisons, as well as the nature of spending in the bill. The expected outlays are likely to be spread out over multiple years, with some of the costs offset by associated revenue-raising provisions.

Waning fiscal and monetary stimulus remain a source of anxiety, but should ultimately produce only modest headwinds

Chart of the Week:



Source: Glenmede, Bloomberg Data through 12/10/21

Data shown are the progression of expectations through time for the number of rate hikes that investors are predicting by the November 2022 Federal Open Market Committee (FOMC) meeting in blue and the December 2022 FOMC meeting in green. These figures are estimates based on pricing in federal funds futures markets. Actual results may differ materially from expectations.

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Will above-average inflation persist?

- **Inflation Stays Hot.** The U.S. Consumer Price Index (CPI) report for the month of November was released last Friday, headlined by a 6.8% year-over-year inflation figure. This marks the highest annual growth rate for CPI in nearly forty years, as recent price trends have proved resilient over time.
- **Monitoring Supply Chains.** Ongoing supply chain disruptions are one of the culprits behind hotter-than-normal inflation, as the supply of goods has been outstripped by record demand in some industries. There are some initial signs that these impacts may be abating – for example, after rising more than 550% since the beginning of '19, freight shipping rates (as measured by the World Container Composite Index) have started to show nascent signs of a near-term peak. Clearing the backlog of shipments may be key to wrestling inflation under control and boosting inventories. As of now, the percentage of industries in the ISM manufacturing PMI survey with customer inventories that are considered "too low" sits just below all-time highs at 55.3%.
- **Inflation by the Numbers.** U.S. headline CPI is projected to be 5.9% on a year-over-year basis in '21. Although this is materially higher than inflation's longer-term trend of about 2.5%, 1.2% of that difference can be attributed to base effects, with the remaining 2.2% due to the impacts of supply chain disruptions and labor market frictions. Base effects will be gone by '22, but some of the impact from supply chain bottlenecks and labor shortages are likely to spill over into the new year. Nevertheless, inflation should settle down longer-term to near-2.5%, as implied by the market and in line with the Fed's longer-term target.

Supply chain disruptions may spill over into the new year, but their impact should eventually subside

Where are we in the pandemic recovery?

- **An Eye on Omicron.** New studies and observations regarding the omicron variant continued to trickle in last week. A non-peer reviewed study in Japan reported that omicron may be four times more transmissible than its cousin delta. At the epicenter in South Africa, case counts continue to rise, but hospitals do not appear overwhelmed, adding credence to the hypothesis that omicron typically causes mild illness. Also, there are initial signs that vaccine boosters may help neutralize omicron, as Pfizer/BioNTech announced initial studies showing three doses of their vaccine neutralize the new variant.
- **Room to Reach Potential.** As the new year approaches, it's helpful to take stock of where things stand in the ongoing pandemic recovery. At a high level, the economy continues its transition to post-recovery growth. The gap between actual gross domestic product (GDP) and potential GDP in the U.S. has closed significantly over the last year, but there appears to be room for improvement. On the other hand, earnings expectations in most major markets have already eclipsed their pre-pandemic highs, yet a favorable macro backdrop may be the tailwind that pushes earnings ever higher.
- **An Optimistic Outlook.** Glenmede's proprietary Recession Model, which seeks to measure the probability of an economic recession in the U.S. over the next twelve months, currently sits at <1%. Both cyclical variables and measures of economic excess appear to show little sign of economic overheating or vulnerabilities. Historically, this has been a bullish signal for equities – when the Model has projected odds of a recession between 0% and 10%, the S&P 500 has posted an average total return of 15% in the twelve months thereafter.

Expect ongoing growth in the new year as economies continue to normalize from the pandemic

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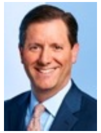

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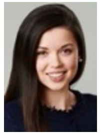

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