EARNINGS GOVERNMENT POLICY INVESTING INTEREST RATES MARKETS ECONOMY

INVESTMENT STRATEGY INSIGHTS

Key Questions for 2022

December 20th, 2021

Is the market too expensive?

- Investors should maintain a modestly overweight risk posture, with selective emphasis on small-caps and global real estate

What to expect from policymakers?

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

Where are we in the pandemic recovery?

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

GLENMEDE

Key Questions for 2022

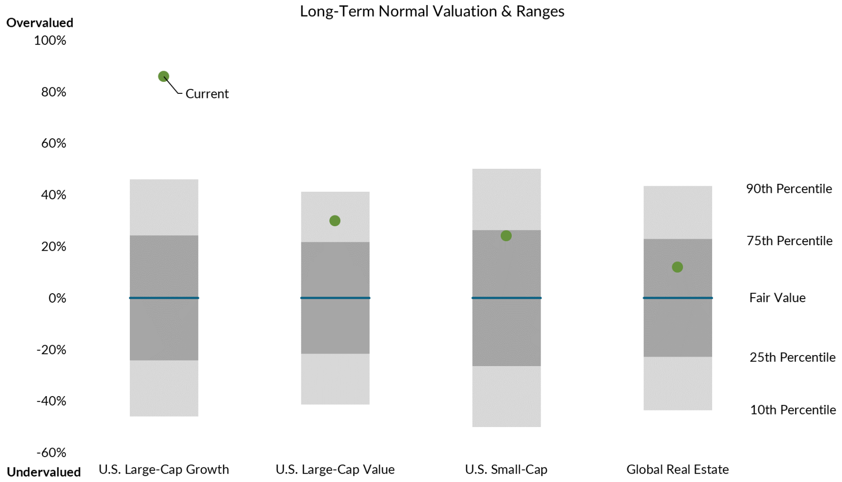
Is the market too expensive?

- **Valuations Matter.** After another year of strong performance in markets, equities on the whole do not appear particularly cheap heading into '22. Glenmede's Global Expected Returns model suggests that an equity portfolio with balanced* geographic and market-cap exposure currently sits at the 81st percentile of longer-term valuations. However, there are meaningful disparities beneath the surface. U.S. large cap growth appears notably extended at the 98th percentile, whereas large cap value and small-cap appear more favorable in comparison, at the 82nd and 73rd percentiles, respectively.
- **Sizing Up Small Cap.** Heading into the new year, investors should consider tilting their equity allocations in favor of small caps. For one, they have a historical record of strong returns in the years after the official end of recessions. Since WWII, U.S. small caps have posted 37.8% and 59.0% cumulative total returns on average in the 2- and 3-year time periods directly following recessions. In addition, small caps have outperformed CPI inflation in every decade since the 1930s, likely reflecting a general ability of smaller companies to be nimbler around shifting price pressures.
- **Real Opportunities in Real Estate.** As far as risk-bearing asset classes go, few seem more attractive than real estate. Real estate investments stand to benefit from a number of macroeconomic crosscurrents: the economy is recovering, which should lead to higher occupancy rates and REITs have historically been among the best performing assets during periods of higher-than-normal inflation. Topping that off with 63rd percentile valuations makes global real estate a compelling solution for diversified portfolios.

Investors should maintain a modestly overweight risk posture, with selective emphasis on small-caps and global real estate

Chart of the Week:

Not All Risk Assets Are Valued Equally



Source: Glenmede, FactSet, MSCI Data through 12/15/21
Glenmede's estimate of long-term fair value for equities is based on normalized earnings, dividend yield and book value using MSCI indexes for equities (MSCI USA Index, MSCI USA Growth, MSCI USA Value, MSCI USA Small-Cap) and FactSet's World Real Estate Investment Trusts industry group for global real estate, which are unmanaged total return indexes with dividends reinvested. Past performance may not be indicative of future results. One cannot invest directly in an index.

*60% U.S. large cap (S&P 500), 10% U.S. small cap (Russell 2000 Index) and 30% international (MSCI All Country World ex-U.S. Index)

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What to expect from policymakers

- **F-O-M-C You in 2022.** The Federal Open Market Committee (FOMC) tied off the bow on 2021 last week by doubling the pace of its balance sheet tapering, which should put the process on a trajectory to complete around March, rather than June. In addition, the dot plot projection now shows the median FOMC participant expecting three rate hikes in 2022, followed by three more in 2023 and two in 2024. This result was relatively consistent with pre-meeting expectations.
- **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.
- **BBB on the Rocks.** Senator Manchin effectively spiked the Build Back Better plan over the weekend, shrouding the near-term outlook for fiscal policy. Even if Democrats somehow find a way to bridge their internal divide 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

Where are we in the pandemic recovery?

- **More Details on Omicron.** A Discovery Health study offering preliminary insights into the attributes of omicron in South Africa has found that a two dose Pfizer/BioNTech regimen was 33% effective against infection from omicron, a notable drop from 80% in prior infection waves. However, those vaccines conferred 70% protection against hospital admission which, while lower than 93% for the delta variant, fits the thesis that omicron may induce more moderate infection than prior iterations of the virus. This study is encouraging, particularly since there are hopes that a booster could provide extra defense.
- **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.

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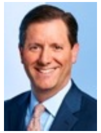

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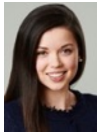

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