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# A Shift in Expectations

**March 21st, 2022**

## The Cost of Geopolitical Conflict

- Despite the fears, earnings expectations remain strong and valuations have become more reasonable

## We Have Liftoff

- The initial tightening cycle should not be disruptive to markets, and may even be favorable to REITs and value stocks

## China's COVID-19 Crackdown

- China's recent outbreaks could cause further disruptions in already strained global supply chains



GLENMEDE

INVESTMENT STRATEGY INSIGHTS

# A Shift in Expectations

## The Cost of Geopolitical Conflict

- **GDP Impact.** The events in Ukraine will continue to make an impact on the global economy, although some regions are likely more insulated than others. So far, real GDP growth estimates across the developed world for 2022 remain intact with U.S. (+3.7%), Japan (+2.6%) and Europe (+3.7%) still positioned for positive low single digit growth. Russian GDP is expected to face a 5% contraction due the toll imposed sanctions will likely inflict on their economy. The impact throughout the rest of the world is likely to be felt through commodities markets and further supply chains constraints.
- **Inflation Impact.** Significant geopolitical conflict has its cost, and Russia, ostracized from the global economy, is bearing the brunt of its own aggressions. Russia's Consumer Price Index (CPI) has whipsawed from 6% to 16% since the invasion. Tangentially, Europe relies on imports of oil, natural gas and other key commodities from Russia, so the region will likely see persistently high prices for such items at best and shortages at worst. The U.S. has also seen a more stubborn increase in prices but remains on the threshold of complete energy independence, so higher oil and other commodity prices are expected to result in a more manageable headwind.
- **Earnings Impact.** Earnings growth expectations have proved resilient, particularly in Asian emerging markets and Japan where growth estimates have increased since the end of January. U.S. large cap, U.S. small cap and broader emerging markets earnings expectations have declined on the margin but are still poised for solid growth in 2022.

> *Despite the fears, earnings expectations remain strong and valuations have become more reasonable*

## Chart of the Week:

**How have earnings per share estimates changed? Not much so far**


Source: Glenmede Data through 3/18/2022
Data shown are 2022 earnings growth expectations for various market indices based on FactSet consensus estimates. Asset classes are represented by the following indices: U.S. Large (S&P 500 Index), U.S. Small (Russell 2000 Index), Europe (MSCI Europe Index), Japan (MSCI Japan Index), EM (MSCI Emerging Markets), EM Asia (MSCI All Country Asia ex-Japan). FactSet's consensus estimates are aggregated from a wide base of contributors and cover over 19,000 active companies across 90+ countries. Past performance may not be indicative of future results. One cannot invest directly in an index.

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## We Have Liftoff

- **FOMC Raises Rates.** The Federal Open Market Committee (FOMC) followed through this week on what was already assumed to be a foregone conclusion, by raising the federal funds rate by a quarter-percent. This is likely only the first step in a larger campaign of policy normalization from the Fed, as it seeks to rein in hotter-than-normal inflation.
- **New Dot Plot Forecast.** The biggest piece of incremental insight for investors is the latest dot plot projection. The median FOMC participant now expects seven rate hikes for 2022, up materially from its forecast for three via the last update in December and in-line with futures market expectations. In addition, the median dot sees the fed funds rate hitting 2.8% by the end of 2023, which is above the Fed's estimate of longer-run neutral. The FOMC press release also teased the idea that it will soon begin winding down the size of its balance sheet.
- **Markets & Tightening.** A tightening Fed may not necessarily prove disruptive for markets. Traditional risk assets have historically held up reasonably well in the early phase of monetary tightening, when policy rates are low but rising. U.S. equities and REITs have posted positive excess total returns net of prevailing yields on 3-month Treasury Bills in those situations. In addition, the value factor as defined by Fama-French has generated 7% annualized returns on average in those environments. However, the return typically become more challenging once monetary policy becomes tight and the Fed keeps tightening, though this scenario is likely a long way off.

*The initial tightening cycle should not be disruptive to markets, and may even be favorable to REITs and value stocks*

## China's COVID-19 Crackdown

- **Cases Rising in China.** Reported new COVID-19 case counts continue to decline in the U.S. to near pandemic lows. On the other hand, China appears to be dealing with a new wave of infections. As a result, China's "zero COVID" policy has prompted Chinese officials to act. The Jilin, Shandong and Guangdong provinces have experienced a jump in cases, and multiple cities are under fresh lockdown orders to stem the spread. The Guangdong province alone accounts for 11% of China's GDP and 23% of its exports.
- **Signs of Economic Disruptions.** China's aggressive approach to COVID-19 containment already appears to be having ancillary economic impacts. In particular, the lockdown in Shenzhen, which is home to one of the world's largest ports, has brought non-essential business to a standstill, leading to temporarily shuttered factories and building freight backlogs. However, Chinese officials appear to be taking an adaptive approach, as restrictions in industrial areas have been eased in recent days.
- **Focus on Supply Chains.** Global supply chain disruptions have been a key driver of higher-than-normal inflation in the U.S. All else equal, COVID-19 related shutdowns could potentially prolong the issue, as the backlog of ships at the ports in Shanghai, Ningbo and Zhoushan grows. Coupled with supply chain issues emanating from the Russia/Ukraine war, further disruptions to global trade linkages run the risk of prolonging inflationary pressures. As a result, Glenmede expects inflation in the U.S. to hit an annual run rate of 4-5% by year-end, which would be a deceleration from it's current ~8% pace but still meaningfully above its longer-term average of 2-2.5%.

*China's recent outbreaks could cause further disruptions in already strained global supply chains*

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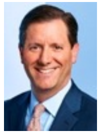

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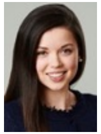

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