EARNINGS

GOVERNMENT POLICY

INVESTING

INTEREST RATES

MARKETS

ECONOMY

INVESTMENT STRATEGY INSIGHTS

Drama in the Market Playground

July 11th, 2022

Inflation Tug-of-War

- Inflation and the Fed's actions are the key factors to watch to determine how the economic/market environment unfolds

Fed Playing Recession Dodgeball

- The Fed is likely to maintain a firm tightening path in order to re-establish its credibility in fighting inflation

Energy: King of the (Earnings) Hill

- If earnings begin to turn over, there may be further downside in this bear market, justifying an underweight to risk

GLENMEDE

Drama in the Market Playground

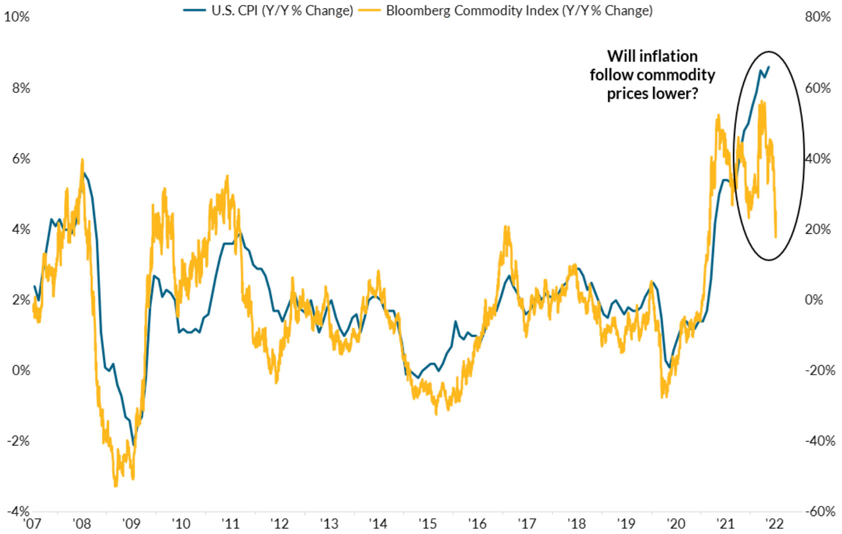
Inflation Tug-of-War

- **June CPI Preview.** The June print of the U.S. Consumer Price Index (CPI) will be released this Wednesday, with consensus expectations calling for an 8.8% annual pace of inflation. The Cleveland Fed's Inflation Nowcast shows June's month-over-month CPI reading is tracking at 0.5%, a level that is still well above the Fed's target range of 0.0 - 0.3%. Inflation expectations have begun to show signs of easing, with 5-year inflation, as implied by TIPS and inflation swaps, hitting 2.5% at the end of last week, and 10-year inflation sitting at 2.3%, both down from their April peaks of 3.5% and 3.0%, respectively.
- **Sticky Situation.** The Atlanta Fed's Sticky-Price Index sorts CPI components into either flexible or sticky categories based on the frequency of their price adjustment. The sticky CPI, pertaining to goods and services that change price relatively slowly, is up to a 5.2% annualized rate, a 40-year high. A contributing factor has been a pickup in rent and owner's equivalent rent, which accounts for roughly 30% of the CPI market basket. This momentum in sticky CPI suggests that inflation may not fade easily.
- **Commodities Abating.** Given the waning contribution from base effects, it's possible that CPI in the U.S. may see a near-term peak over the next few months when measured on a year-over-year basis. Prices in raw materials are showing signs of cooling, with the Bloomberg Commodity Index declining ~15% since reaching an all-time high in early June. Since consumer inflation historically tends to follow commodity prices, this could be a sign that inflation may be poised to cool into the back half of the year. The speed and magnitude of a decline in inflation will be an important determinant of the Fed's reaction function.

Inflation and the Fed's actions are the key factors to watch to determine how the economic/market environment unfolds

Chart of the Week:

Consumer inflation tends to follow commodity prices



Source: Glenmede, FactSet, U.S. Bureau of Labor Statistics Data through 7/8/2022
Shown is the year-over-year percent change in the U.S. Consumer Price Index in blue and the Bloomberg Commodity Index in yellow. Past performance may not be indicative of future results. One cannot invest directly in an index.

Drama in the Market Playground

Fed Playing Recession Dodgeball

- **Soft Landing in Question.** July's FOMC meeting will likely involve a debate among participants about whether to opt for a 50 or 75 basis point increase to the fed funds rate. In the wake of last week's FOMC minutes release, the Fed continues to emphasize its commitment to bringing prices under control, even if doing so risks an economic downturn. Powell recently acknowledged that recession was "certainly a possibility," as the Fed in coming months will be looking for compelling evidence of slowing price pressures before it begins to put the brakes on rate hikes.
- **Recession Risks Rising.** With the economy now in the late stage of the cycle, some leading indicators in the U.S. continue to show signs of slowing economic growth. Glenmede's U.S. LEI*, which seeks to provide estimates of expected GDP growth over a 6–12-month window, is picking up on signs of economic turbulence ahead, contracting meaningfully into negative territory. Meanwhile Glenmede's Recession Model is projecting a 40% chance of recession within the next twelve months. With that said, the economy may be headed toward a more benign recession given the lack of excesses built up in the system.
- **It's All About the Fed.** With the Fed now well along in its rate hike cycle, monetary policy is approaching neutral and may surpass it by the end of 2022. The recently revised dot plot shows the Fed expects rates will end the year at 3.4%, a level that closely resembles neutral. The fed funds futures market prices in a path that takes rates beyond this neutral level, with the curve peaking at 3.5% in March of next year and declining into the latter half of 2023.

The Fed is likely to maintain a firm tightening path in order to re-establish its credibility in fighting inflation

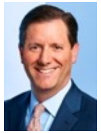
Energy: King of the (Earnings) Hill

- **Sneak Peek into Q2 Earnings Season.** With the second quarter in the rearview mirror, investors are eagerly awaiting the first glimpses at profit trends through the first half of 2022. Consensus estimates project 4.5% year-over-year earnings growth for the S&P 500 in Q2, a deceleration from Q1's 9.2% annual growth pace. The driving forces for growth are likely to be inflation-sensitive sectors such as energy, industrials, materials and real estate.
- **What's Driving Growth?** Getting further down into the details, annual earnings growth for the S&P 500 is expected to be relatively narrowly-driven for the second quarter. In particular, the energy sector is likely to be responsible for the lion's share of profit growth. For example, consensus estimates for earnings growth for the S&P 500 ex-energy sit at -3.7%, which is a sizable contribution from a sector that represents less than 5% of the broader index.
- **Watching For Peak Earnings.** Despite the economic uncertainty surrounding the Fed's campaign to cool inflation, earnings estimates have so far appeared relatively unphased. For example, consensus earnings per share for the S&P 500 in 2022 remains near its all-time high of $230. However, Glenmede's Leading Economic Indicator, which tends to directionally inform the path of corporate profits on a forward 6-month basis, has dipped meaningfully into negative territory, suggesting there may be downside risk to earnings as the odds of recession rise. As the macroeconomic environment becomes more challenging, earnings estimates may face negative revisions.

If earnings begin to turn over, there may be further downside in this bear market, justifying an underweight to risk

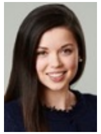
*Glenmede's U.S. Leading Economic Indicator

Drama in the Market Playground



JASON D. PRIDE, CFA
Chief Investment Officer - Private Wealth
Responsible for formulating investment policy and strategy
Serves as a leading member of the Investment Policy Committee
B.S. from Massachusetts Institute of Technology

MICHAEL T. REYNOLDS, CFA
Vice President, Investment Strategy
Responsible for supporting the development of investment strategies, policy and portfolio construction methodologies
Is an active member of the CFA® Society of Philadelphia
B.S. from the Wharton School of the University of Pennsylvania



ILONA V. VOVK, CFP®
Investment Strategy Officer
Responsible for supporting the development of investment strategies, policies and portfolio construction methodologies applied to Private Wealth client portfolios
B.A. and B.S. from Drexel University

GLENMEDE CORPORATE FACTS

Nearly $45 billion in assets under management as of 3/31/2022
Founded in 1956
Serves high net worth individuals, families, family offices, foundations and institutional clients