INVESTMENT STRATEGY INSIGHTS

Hawks in the (Jackson) Hole

August 29th, 2022

Fed Hawkishness Confirmed

- The Fed continues to articulate its intent to do what is necessary to bring inflation down, even if there are costs

Slowdown Evidence Growing

- While some conflicting signals exist, a growing collection of data points appear to provide evidence of a slowdown

Defensive Posture Warranted

- Investors should continue to reduce market (equity) risk in light of recessionary trends and still-high valuations

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Fed Hawkishness Confirmed

- **Hawkish Fed.** At the highly anticipated Jackson Hole Symposium last week, Fed Chair Powell highlighted that the Fed will likely require restrictive policy for some time, and that the Fed will "keep at it until the job is done." Walking the line, Powell also reiterated that the size of September's rate increase hinges on the body of available economic data and that it will likely be appropriate to slow the pace of increases at some point, all while signaling the Fed is willing to risk recession to lower inflation. Powell's speech aligns with speeches from other Fed officials, pushing back against the dovish pivot narrative.
- **Recap of the Fed's Path.** July's 75-basis point increase pushed the fed funds rate one step closer to the all-important neutral rate, admittedly making their decision process on further rate hikes more data dependent. With another jobs report and CPI print on the docket ahead of the FOMC's next meeting, both 50bps and 75bps rate hikes remain on the table for September. Recent speeches from Fed officials appear to align with expectations that the fed funds rate will likely rise above 3.5% and stay above neutral further into 2023.
- **Up Next: QT.** Though having taken the backseat to its rapid pace of rate hikes in recent months, the Fed's quantitative tightening (QT) program is also gaining momentum. Heading into September, the Fed plans to ramp up its balance sheet reduction to a maximum of $95 billion per month, which should return the balance sheet to its pre-pandemic size as a share of GDP by year-end 2025. Such actions should withdraw liquidity from the financial system, adding a hard-to-measure impact on top of their already aggressive rate-hiking campaign.

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Slowdown Evidence Growing

- **Broad-Based Slowdown.** The latest Flash U.S. Composite PMI*, a broad survey of business activity, declined from 47.7 to 45 in August, its second consecutive monthly decrease bringing its reading down to levels more consistent with recessions. Though it was broad-based, the services sector appears to have registered a steeper rate of decline, falling from 47.3 to 44.1. Such readings align with recent weakness in Glenmede's U.S. LEI**, which seeks to provide an estimate of expected GDP growth over the next 6–12-months.
- **Looking Ahead Into Earnings.** Though earnings have remained relatively resilient, upward revisions have stalled and analysts have begun lowering earnings estimates. The 2023 earnings per share estimate for the S&P 500 Index accelerated lower last month and now sits just below $244, down from the $252 estimate as of the beginning of the Q2 earnings season. Remarkably, amid rising fears of recession, the financials and consumer discretionary sectors are still expected to rebound, driving a large share of expected earnings growth in 2023.
- **Housing Market Difficulties.** The housing market continues to show signs of softening as sales of newly built homes sharply fell 12.6% in July from June, marking its sixth straight monthly decline. In a market that, for years, has been burdened by too little inventory, builders are now finding themselves with an excess number of homes as buyers begin to pull back. This year's surge in mortgage rates, with the 30-year fixed mortgage rate climbing to 5.1%, has pushed affordability to an extreme. Given that builders may be reluctant to begin new projects amid rising rates, lack of supply due to underbuilding may provide an offset to keep home prices from falling quickly.

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*Purchasing Managers' Index
**Leading Economic Indicator

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Defensive Posture Warranted

- **The Fed's Inflation Fight.** Inflation may have begun to peak but has continued to run at a rate that is higher than the Federal Reserve's target level. Further, inflation has been quite broad, causing prices to rise across a host of items, not just energy and food. In fact, prices for goods and services that the Atlanta Fed identifies as components to its sticky price index, which represents items that change price relatively slowly, grew at an uncomfortably high 5.4% one-month annualized growth rate in the last CPI report. The Fed continues to tighten monetary policy so as to contain inflation and keep it from becoming more engrained and persistent.
- **Rising Recession Risks.** In the wake of an accelerated pace of rate increases, monetary policy is approaching neutral quickly, to a level that should restrain the economy. The fed funds futures market is now pricing in a path that takes rates beyond this neutral level with the curve peaking at 3.6% in February of next year and declining into the latter half of 2023. With consumer sentiment improving, but still sitting near all-time lows and manufacturing surveys coming down from their highs, deteriorating fundamentals continue to point to an elevated chance of an economic downturn.
- **Still-High Valuations.** Having rebounded from the June lows, markets have returned to levels at which they command significant premiums to fair value. According to Glenmede's Expected Returns model, large cap stocks are currently at their 75th percentile level of valuations. This reflects significant optimism that inflation will subside and the Fed will be able to slow its rate hikes, while economic and earnings growth will prove quite resilient.

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Chart of the Week:

Framework for risk allocation indicates a larger underweight is warranted

		Fundamental		
		Mid Cycle	Late Cycle	Recession
Valuation (Equity Percentiles)	Above 75th	Neutral	↓	↓↓
	50th to 75th	↑	Neutral	↓
	Below 50th	↑↑	↑	Neutral

↑ Overweight ↓ Underweight Current Position
Number of arrows represent magnitude

Source: Glenmede Data through 8/29/2022
This table reflects Glenmede's projections, which may change after the date of publication. Actual future developments may differ materially from the opinions and projections noted above.

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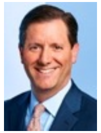

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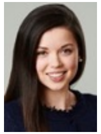

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GLENMEDE CORPORATE FACTS

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