INVESTMENT STRATEGY INSIGHTS

Debt, Dollar, and (Earnings) Depreciation

October 3rd, 2022

Don't Give Up on Bonds

- Bonds are beginning to look like a more competitive option for portfolios for the longer-term

Dollar Dominance

- The strong dollar remains a near-term headwind to both foreign investments and domestic stocks with foreign revenues

(Earnings) Depreciation

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

© 2022 Glenmede. All rights reserved. Please see important disclosures at the end of this presentation

GLENMEDE

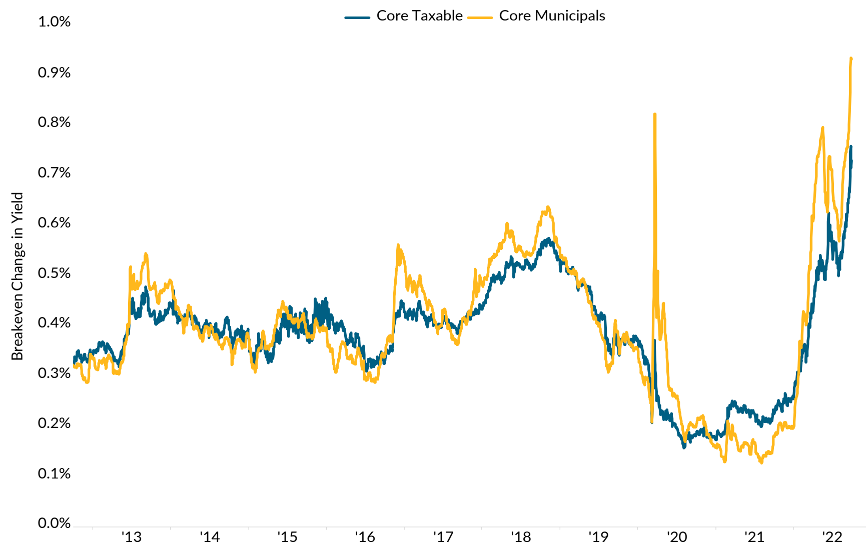
Debt, Dollar, and (Earnings) Depreciation

Don't Give Up on Bonds

- **Diversification Fizzles.** Stocks and bonds have so far had a rough 2022. Based on data going back as far as 1926, this year is shaping up to be the first in U.S. history when large cap stocks and core investment-grade bonds both post negative annual total returns. This has been driven by the Fed seeking to bring inflation under control with aggressive monetary tightening and an associated rise in bond yields, which has upended the typically inverse relationship between stock and bond returns.
- **Building a Margin of Safety.** Now that yields have risen, bonds are beginning to sport more attractive yields, which should offer fixed income investors a larger margin of safety going forward. For example, with investment-grade municipal bond yields at their level in mid-2021, core munis would only have been able to withstand a 0.2% general rise in interest rates before wiping out their yield and dipping total returns negative on an annual basis. The outlook now is quite different, as an investor in those same securities could withstand an almost full-percent upward yield shock before experiencing negative 12-month returns.
- **Investing in a Rising Yield Era.** In the short-run, interest rates continue to climb higher, which warrants an underweight to duration within bond allocations, since shorter-term fixed income securities tend to exhibit less interest rate sensitivity. With that said, bonds overall are beginning to look like a more competitive option in portfolios. For example, the yield on 10-year Treasuries is at its largest premium to the dividend yield on the S&P 500 Index since the Great Financial Crisis.

Bonds are beginning to look like a more competitive option for portfolios for the longer-term

Chart of the Week:



Source: Glenmede, FactSet — Data through 9/30/2022
Data shown quantifies how high interest rates would need to rise to result in a price decrease that wipes out one year's worth of interest income at each point over the last 10 years. Core Taxable is represented by the Bloomberg Barclays U.S. Aggregate Index. Core Municipals is represented by the Bloomberg Barclays U.S. Municipal 1-10 Index. One cannot invest directly in an index.

Debt, Dollar, and (Earnings) Depreciation

Dollar Dominance

- **Dollar on the Rise.** The U.S. dollar has risen sharply off its May 2021 low, as it now stands near its highest level in decades versus major currencies like the euro, the British pound and Japanese yen. Since the beginning of the year, the U.S. Dollar Index, which measures the value of the U.S. dollar against a broad basket of global currencies, has soared nearly 17% this year, en route to a fresh 20-year high last week.
- **Currency Catalysts.** The dollar's march to record highs this year is largely driven by an aggressive tightening from the Fed as higher interest rates continue to boost yields and attract foreign capital. With other central banks seen as lagging the Fed's commitment to taming inflation, the widening gap in interest rate differentials between the U.S. and other nations is currently providing support for a stronger dollar. However, the Fed may be the first central bank to slow its rate hikes, and this interest rate differential could begin to close as other central banks catch up with the U.S. and may eventually reduce the upward pressure on the dollar.
- **Direct and Indirect Impact.** When the dollar appreciates, overseas investments for Americans become less valuable when converted back into the home currency, impacting both foreign equities and bonds. However, domestic stocks are not fully insulated given that roughly 40% of the average S&P 500 company's revenues are derived from overseas; those company's products and services will be less competitive abroad as the dollar's strength increases their price. Only the more domestic-focused sectors, such as real estate and utilities, are less exposed to these effects.

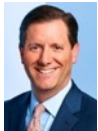
The strong dollar remains a near-term headwind to both foreign investments and domestic stocks with foreign revenues

(Earnings) Depreciation

- **Q3 Earnings Season Preview.** With the third quarter in the rearview mirror, investors are eagerly awaiting the first glimpses at profit trends into the second half of 2022. Consensus estimates project 3.2% year-over-year earnings growth for the S&P 500 in Q3, a swift drop from the estimated growth rate of 9.8% just three months ago and a deceleration from Q2's 6.2% annual growth pace. The driving forces for growth are likely to remain inflation sensitive sectors such as energy, industrials, materials and real estate.
- **2023 Growth Revisions.** Although headline earnings consensus has remained relatively resilient, the 2023 earnings per share estimate for the S&P 500 dipped lower last month and now sits just below $242 down from the $250 estimate as of the beginning of Q2 earnings season. Notably, tech remains the largest contributor to overall earnings, representing ~30% of the profit base for the broader index. Barring an improvement in the sector, downward revisions are likely to ramp up in the face of a more challenging macroeconomic environment.
- **Earnings at Risk.** 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 currently sits at $225, only marginally lower than its all-time high of $230. However, Glenmede's Economic Indicator, which tends to directionally inform on the path of corporate profits on a forward 6-month basis, has dipped into negative territory, suggesting there may be downside risk to earnings as the odds of recession rise.

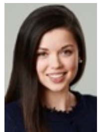
If earnings begin to turn over, there may be further downside to this bear market, justifying an underweight to risk

Debt, Dollar, and (Earnings) Depreciation



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

This presentation is intended to be a review of matters of possible interest to Glenmede Trust Company's clients and friends and is not intended as personalized investment advice. Advice is provided in light of a client's applicable circumstances and may differ substantially from this presentation. Opinions or projections herein are based on information available at the time of publication and may change thereafter. Information obtained from third-party sources is assumed to be reliable, but accuracy is not guaranteed. Outcomes (including performance) may differ materially from expectations and projections noted herein due to various risks and uncertainties. Any reference to risk management or risk control does not imply that risk can be eliminated. All investments have risk. Clients are encouraged to discuss the applicability of any matter discussed herein with their Glenmede representative.