INVESTMENT STRATEGY INSIGHTS

Thankful for a Healthy Consumer

November 21st, 2022

‘Tis the Season to Be Spending

- Consumers on the whole are in a relatively healthy position, but some weakness is becoming evident entering the new year

Fed Pivot? Not Yet.

- Markets are prematurely extrapolating slowing inflation data, but one month does not constitute a meaningful trend

Earnings Season Winds Down

- Earnings growth remains positive in 2022, but 2023 estimates are being revised downward as the new year comes into focus

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'Tis the Season to Be Spending

- **All About the Consumer.** Household spending is typically the engine for overall economic growth in the U.S., consistently representing more than 2/3rds of gross domestic product. As a result, keeping a pulse on the health of consumers is a crucial macroeconomic exercise, particularly so heading into the premiere shopping season of the year approaching the holidays.
- **Projections for Holiday Spending.** The National Retail Federation is expecting record levels of holiday spending from households, to the tune of 7% growth from 2021 levels. However, with inflation at multi-decade highs, consumers may have less to show for that higher spending due to rising prices. For example, applying an inflation adjustment to that nominal 7% growth figure yields a real -0.7% drop in spending. So, while households may be shelling out more cash than they ever have on gifts and decorations, that may not yield more stuff than it did just a year ago.
- **Trouble on the Horizon?** U.S. household net worth has taken a sizable hit on an inflation-adjusted basis so far this year, down 7.5% from year ago levels. Such declines have been consistent with recession conditions in the past. With that said, one difference this time is that consumers continue to hold a sizable stockpile of cash, approximately $5 trillion above pre-pandemic trend levels. This suggests that households may have a liquidity cushion to support spending in the near term. However, there are nascent signs of consumer stress showing up in credit delinquencies, as the balances of debt in auto, mortgage and credit card debt transitioning to 30+ days past due have starting to tick higher for the first time this cycle.

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Chart of the Week:

Households may have less to show for record holiday spending due to inflation

Source: Glenmede, FactSet, National Retail Federation Data through 11/21/2022

Shown are the nominal (in blue) and real (inflation-adjusted, in green) growth rates of U.S. holiday retail sales (months of November and December combined) excluding sales from automobile dealers, gasoline stations and restaurants. Projections for 2022 are shown in the hashed bars and are sourced from the National Retail Federation. Actual results may differ materially from projections.

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Fed Pivot? Not Yet.

- **Inflation-Reprieve Rally.** Markets ended last week with the S&P 500 down 0.7% after last week's rally. This modest decline comes against a backdrop of better-than-expected inflation data, with U.S stocks edging lower as investors weighed the recent slew of Fed commentary. Given the prospect of additional tightening from the Fed and the cumulative impact of interest rate hikes this year, recession risks remain elevated and the macroeconomic conditions for a sustainable rally are likely not yet in place.
- **Adding to Softer Inflation.** October's Producer Price Index (PPI) report added steam to the peak-inflation narrative, with the headline index up 0.2% in October and year-over-year prices easing to 8.0% down from 8.4% in September. Meanwhile, core PPI, which strips out the more volatile food and energy components, remained unchanged from the prior month, marking the lowest reading since November 2020. This report comes on the back of last week's softer-than-expected CPI report.
- **Sufficient Restriction.** While recent reports have indicated that the pace of inflation could be slowing, one month of encouraging data does not yet provide a durable trend. St. Louis Fed's Bullard noted last week that "the policy rate is not yet in a zone that may be considered sufficiently restrictive." Bullard's remarks followed statements from other Fed officials expressing the need to keep up the heat against inflation, though several suggested easing the pace of recent increases. As a result, this likely leaves the Fed on course to raise rates by only 50 basis points in December and wait for confirmation of this trend in further reports to determine its long-term path.

Markets are prematurely extrapolating slower inflation data, but one month does not constitute a meaningful trend

Earnings Season Winds Down

- **Wrapping Up Q3 Earnings Season.** Earnings season is nearing its tail-end, providing some of the earlier glimpses of profit trends for the second half of 2022. With more than 94% of companies reporting so far, the blended year-over-year earnings growth estimate for the S&P 500, which combines actual results with consensus estimates for firms that have yet to report, currently sits at 2.2%. Notably, the driving forces of growth remained inflation-sensitive sectors led by energy, industrials, materials and real estate.
- **Retail Giants in the Spotlight.** Last week's earnings reports reinforced the narrative of resiliency in consumer spending. For example, Walmart topped earnings estimates for Q3, echoed by strong reports from Lowe's and Home Depot, both of which raised their full-year outlooks. On the other hand, Target was the odd one out, as it fell short of expectations, given that a larger portion of its sales are derived from discretionary categories. Retail spending trends will remain a piece of the economic puzzle given elevated recession odds heading into 2023.
- **2023 Estimates Slipping.** The 2023 earnings per share estimate for the S&P 500 dipped lower last month as it now sits just below $232, down from its $250 estimate as of the beginning of Q2 earnings season. While earnings estimates for next year have moved lower in recent weeks, the pace of this decline is beginning to ramp up as companies begin to feel the pressure of an increasingly challenging macroeconomic environment. As such, forward guidance will be an important factor to observe in Q4 earnings season when companies begin to provide further insight to profit trends for 2023.

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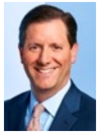
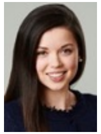


JASON D. PRIDE, CFA
Chief Investment Officer - Private Wealth
Responsible for formulating investment policy and strategy
Serves as a leading member of the Investment Policy Committee
B.S. from Massachusetts Institute of Technology

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®
Vice President, Investment Strategy
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

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