OBSERVATIONS

- U.S. headline inflation (CPI) hit 8.5% year-over-year (YoY) in March, which was the highest YoY increase since December-1981. Similarly, core-CPI (excluding energy and food prices) increased to 6.5% YoY—the highest reading for core-CPI since August-1982.[1]
- Producer prices—prices paid by companies for raw materials and inputs—have also surged to 11.2% YoY—the highest level in more than a decade.[2]
- In part due to the eye-popping inflation figures as well as a bevy of Fed speakers last week, the U.S. yield curve steepened from its flatter profile earlier in the month and the U.S. 10-year breached 2.8% last week.[3]
- Retail sales, unadjusted for inflation, increased by 6.9% YoY in March largely in line with analysts' expectations. Retail sales for Q1-2022 were up 11.9% YoY compared to Q1-2021.[3]
- Initial unemployment claims remain muted, with weekly claims coming in at 185,000 and the four-week average moved up slightly to 172,250 which is near 50-year lows.[3]
- Small business optimism decreased in March to 93.2—the third consecutive month where the index has been below the 48-year average of 98. Inflation has replaced labor quality as the number one problem, with 31% of business owners saying it is a problem—a record high since early 1981.[4]

EXPECTATIONS

- The early days of earnings season have largely been characterized by negative developments. Approximately 2/3 of reporting firms have reported negative impacts of labor costs on earnings, meanwhile the largest banks have increased provisions for losses due to the fallout from the Russia-Ukraine war as well as volatile global markets that typically act as a drag on investment banking activities.[5]
- Russia completed its troop withdrawal from the northern portion of Ukraine and is actively refitting these troops and moving them to southeastern Ukraine. Analysts widely view these activities as a prelude to a new offensive in the southeast region to secure additional territorial gains in the Donbas region of the country as well as area north of the port city Mariupol.[6]
- China is grappling with one its largest COVID outbreaks since the early days of 2020. China has 23 cities—including Shanghai and Jilin—in either full or partial lockdown effecting over 193 million people and about 22% of the Chinese economy.[7]

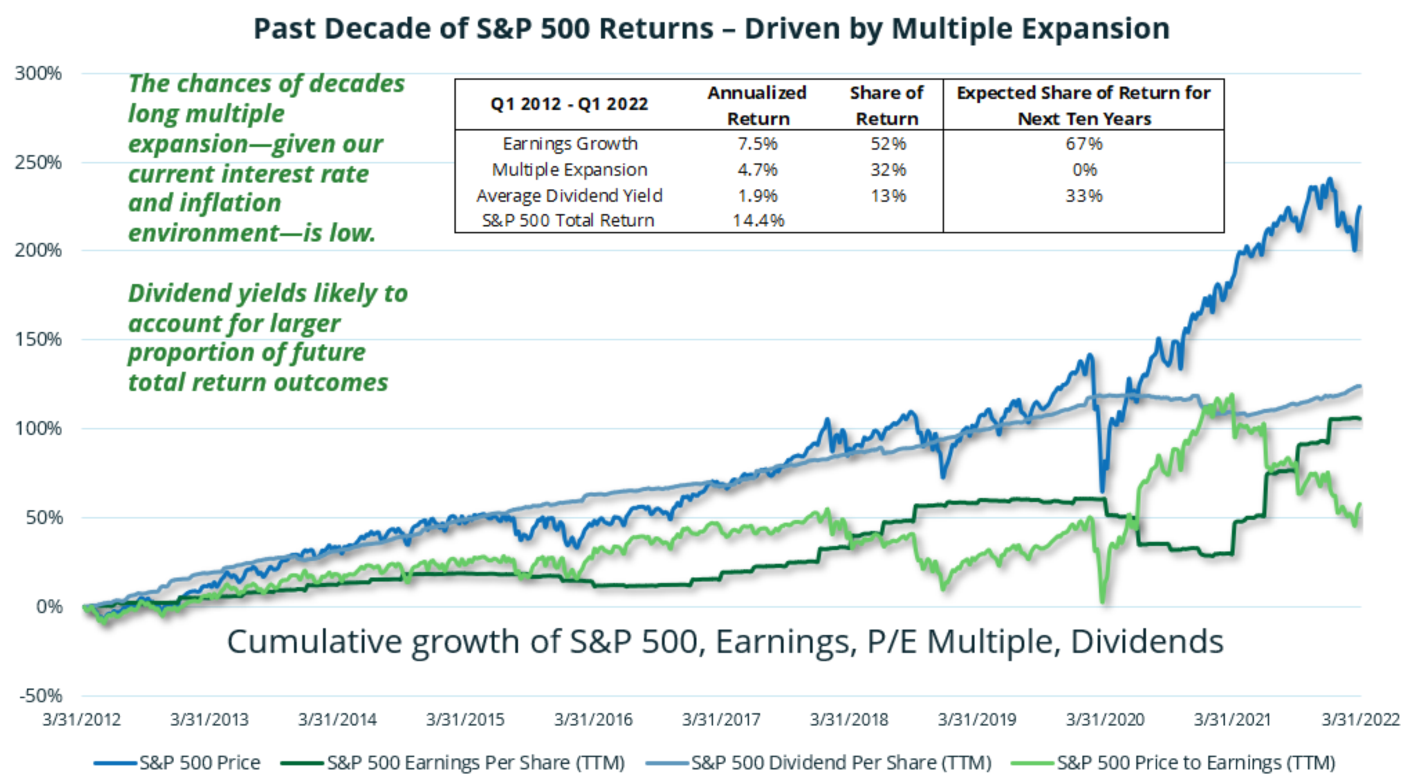
ONE MORE THOUGHT[8]: *Equity Prices Follow Earnings Growth*

Theory and practice show that long-run stock market returns reflect the earnings growth of the stock market. Current stock prices should mostly reflect the collective market's assessment of the future value of all profits (cash flows and dividends) that are expected to accrue to the shareholders of those firms. However, a third component of equity returns is the price multiple (or price-to-earnings ratio "P/E"). Typically, the P/E over long periods of time displays little to no change, yet in the most recent decade has contributed meaningfully to the total returns of the

[1] https://www.bls.gov/news.release/pdf/cpi.pdf
[2] https://www.bls.gov/news.release/ppi.nr0.htm
[3] *Bloomberg LP, 4/14/2022*
[4] *https://www.nfib.com/surveys/small-business-economic-trends/*
[5] *FactSet Earnings Insight Blog, 4/12/2022; WSJ "Stock Futures Edge Down Amid Wave of Bank Reports" 4/14/2022*
[6] *https://www.understandingwar.org/backgrounder/russian-offensive-campaign-assessment-april-14*
[7] *https://www.reuters.com/world/china/shanghai-lockdown-deepens-after-new-surge-asymptomatic-cases-2022-04-05/*
[8] *NBER "Forecasting Stock Market Returns: The Sum of the Parts is More than the Whole" Dec-2008*

S&P 500. The P/E represents how much investors are willing to pay for a dollar of future earnings. The long-run average of the P/E for the S&P 500 is about 16x the estimate of the following year's expected earnings. Over the past decade, however, steadily falling interest rates—in part due to quantitative easing efforts—have allowed the P/E ratio to climb steadily and thus about 1/3 of the past decade's total return of the S&P 500 has been due to growth in the P/E—sometimes referred to as multiple expansion. Going forward, particularly as the inflation and interest rate environment has changed from the pre-Covid era, the likelihood that multiple expansion contributes positively to long-run S&P 500 returns is low—if anything it is more likely that they act as a drag on returns in the coming years. Given this, the expectations of future returns to S&P 500 are likely to be driven predominantly by earnings and dividends, which after all, has been the case for most of the past 100 years of stock returns.

CHART OF THE WEEK



Q1 2012 - Q1 2022	Annualized Return	Share of Return	Expected Share of Return for Next Ten Years
Earnings Growth	7.5%	52%	67%
Multiple Expansion	4.7%	32%	0%
Average Dividend Yield	1.9%	13%	33%
S&P 500 Total Return	14.4%		

Source: Clearstead, Bloomberg LP, as of 31-March-2022, Weekly data, S&P 500 Total return = (1+ Change Earnings Growth) X (1+Change in Multiple) X (1+Average Dividend Yield). "Share of Return" defined as percent of total return attributable to earnings growth, P/E multiple expansion, and average dividend yield. "Expected Share of Return for Next Ten Years" based on a reversion to long run trends. "Multiple Expansion" = change in P/E ratio.

Aneet Deshpande, CFA
Chief Strategist
Clearstead

Dan Meges
Managing Director of Equity
Clearstead