RESEARCH CORNER

OBSERVATIONS

- US real GDP decelerated to a still healthy 2.9% annualized rate in Q4, down slightly from Q3's 3.2% annualized rate, with the largest drag on growth stemming from a slowdown in housing construction.[1]
- US Natural Gas dropped below $3/MMBtu (million British thermal units) last week, down over -70% from nearly the 15-year highs reached in August 2022, amidst milder weather and increased supplies.[1]
- Earnings, so far, have been weak, but only 30% of the S&P firms have reported. Of the firms that have reported through last Friday, 69% have had a positive earnings surprise, below the 5- (76%) and 10-year (73%) averages.[2]
- Eurozone PMIs (Purchasing Managers' Indices) increased in January and beat market expectations suggesting that Euro economies are adapting to higher energy prices and the war in Ukraine. The services PMI increased to 50.7 in January—any number above 50 indicates sector expansion—from December's 49.8 reading. Similarly, the manufacturing PMI increased to 48.8 in January up from 47.8 in December.[1]
- PMIs for the US improved but continue to suggest contracting economic activity. The January services PMI increased to 46.6 from December's 44.7 figure, while the manufacturing PMI edged up to 46.8 from December's 46.2 report.[1]
- Architectural Billings Index for December—a leading indicator or non-residential construction; where any number above 50 indicates sector expansion—came in at 47.5, a small increase from November's 46.6.[3] Meanwhile, new home sales continued to languish in December and were down -26.6% from new homes in December-2021.[1]
- The central bank pause: The Bank of Canada (BOC) became the first major central bank to say it may pause its interest rate hike cycle after lifting its policy rate by 25bps to 4.5% last week. While still data dependent, the BOC noted that "recent developments reinforced our confidence that inflation is coming down."[4]
- Headline PCE inflation fell to 5.0% year-over-year (YoY) in December from November's 5.5% figure. Core PCE—the Fed's preferred inflation statistic—fell to 4.4%, down from 4.7% YoY in November.[1]

EXPECTATIONS

- The Federal Reserve meets this week (1/31-2/1) and is widely expected to lift the Fed Funds policy rate by 25bps to a target range of 4.50-4.75%, inching closer to the broadly anticipated terminal rate of just above 5.00% which is expected to be reached following another 25bps rate hike at the Fed's March meeting.[1]
- National Association for Business Economics (NABE) survey showed that 20% of respondents expect employment at their respective firms to fall in the months ahead. This marks the first time since 2020 that more respondents expect declining employment as compared to those expecting rising employment.[5]
- The Conference Board's Leading Indicators declined again in December by -1% and has now declined steadily for the past 10 months, "indicating deteriorating conditions for labor markets, manufacturing, housing construction, and financial markets in the months ahead."[6]

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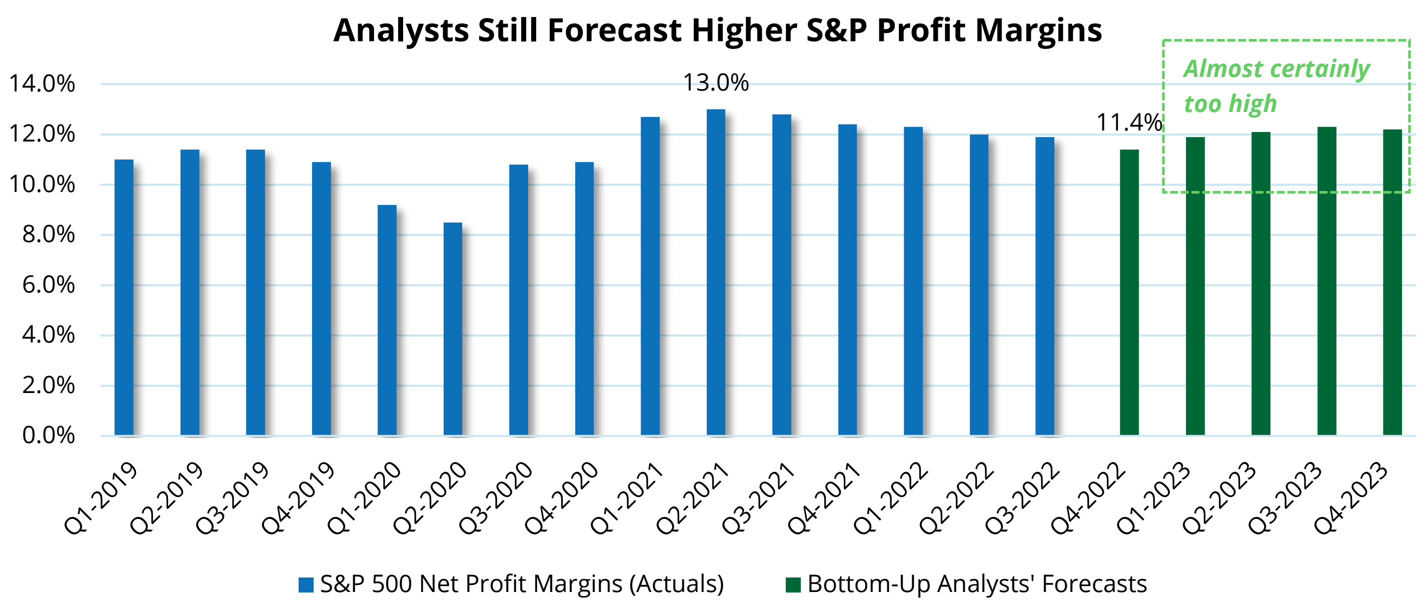
[1] *Bloomberg LP*
[2] *https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_012723A.pdf*
[3] *https://www.aia.org/press-releases/6587504-architecture-billings-continue-to-decline*
[4] *https://www.reuters.com/markets/rates-bonds/bank-canada-hikes-rates-becomes-first-major-central-bank-signal-pause-2023-01-25/*
[5] *Bloomberg LP, https://nabe.com/NABE/Surveys/Business_Conditions_Surveys/January-2023-Business-Conditions-Survey-Summary.aspx*
[6] *https://www.conference-board.org/topics/us-leading-indicators*

<u>ONE MORE THOUGHT</u>: *A rebound in corporate profit margins in 2023 is unlikely*[7]

Despite the fact that over 80% of S&P 500 companies cited inflation as a worry last quarter and the expectation that profit margins will likely slide for a sixth-consecutive quarter down to 11.4% (see Chart of the Week), analysts covering the largest US firms project profit margins will increase steadily in 2023. This seems to directly contradict much of the guidance of S&P 500 reporting firms themselves as well as a host of economic indicators. For instance, Fed action is likely to continue to raise at least short-term interest rates over the first half of 2023, average hourly wages are rising over 4% year-over-year, and China's abandonment of its zero-Covid policy is likely to spur economic activity in the second largest global economy and put upward pressure on energy prices. All of these factors should work to further pressure corporate earnings going forward. Given this, it is no surprise that negative guidance outnumbers positive guidance for next quarter by a factor of 8 to 1. We suspect that in the coming weeks, analysts covering firms within the S&P Index will likely revise their margins expectations lower and with them expectations for 2023's earnings growth.

CHART OF THE WEEK



Source: Clearstead, FactSet Earnings Insight 1/20/2023

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[7] *FactSet Earnings Insight 1/20/2023*