Ameriprise Financial

Weekly Market Perspectives

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Investors Look to Fourth Quarter Earnings for a Temperature Check on Corporate America

The S&P 500 Index ended a shortened holiday week lower, finishing down 0.6%. The Dow Jones Industrials Average was also down on the week, ending lower by 2.7%. However, the NASDAQ Composite bucked the weaker stock trends (fueled by gains on Friday) and eked out a slight increase of +0.6% on the week. As a result, the NASDAQ finished higher for the third consecutive week and is up +6.4% in January. Yet, despite Friday's market bounce and the NASDAQ seeing its best day of performance since November 30 on Friday, the overall market sentiment on the week was rather downbeat. Over the year's first two weeks, the S&P 500 had risen over +4.0%, starting last week's trading just shy of the 4,000 level. And while investors have begun to question again soft-landing scenarios and central banker intentions, which last Wednesday contributed to pushing the S&P 500 to its worst day since December 15, the Index ended the week above its 200-day moving average. While psychological and technical conditions aren't exactly a tailwind for the S&P 500 at the moment, a close above the 200-day at the end of the week was a slight positive. Heading into this week, the broad-based U.S. stock barometer is up +3.5% for the year and sits at 3,972. The Dow is higher by +0.7% for the year.

What's Concerning for Investors at the Moment? The Fed, Valuations and the Debt Ceiling

Notably, the soft-landing narrative that helped drive stock prices higher earlier in the month appears to have lost some steam, particularly as economic data and earnings weaken. In addition, fear of a Federal Reserve policy mistake is moving back to a top-of-mind issue for investors as the Fed's first policy decision of 2023 fast approaches. Finally, building skepticism that the recent bounce higher in stock prices is nothing more than a bear market rally, driven by outsized short covering, has also started to creep back into the market narrative. Valuation and technical concerns with some backburner anxiety about the debt ceiling help round out some of the more prominent points for the bears.

Last Thursday, the U.S. federal debt limit was reached, and the U.S. Treasury Department began implementing extraordinary measures, tapping two government-run funds to help avoid a payment default. Some Republicans are demanding spending cuts be a part of the negotiations to raise the debt ceiling later this year. As a result, investors should expect Congress and the White House to continue to arm wrestle over the size and conditions of a debt ceiling deal. But, for now, debt ceiling theatrics will likely be contained in Washington, as the U.S. government has the means to pay its bills for at least the next several months.

On the week, Communication Services (+3.0%), Energy (+0.7%), and Information Technology (+0.7%) helped mitigate losses in the S&P 500, while Industrials (down 3.4%), Utilities (down 2.9%), and Consumer Staples (down 2.9%) acted to drag on performance. U.S. Treasury prices were mostly firmer across the curve, with the 10-year Treasury yield ending last week at 3.48%. The U.S. Dollar Index ended slightly lower last week, and Gold finished mostly flat, ending at $1928.80 per ounce. West Texas Intermediate (WTI) oil finished at $81.40 per barrel.

Inflation Continues to Trend in the Right Direction; European Equities off to a Strong Start

On the U.S. economic front, last week, inflation trends continued to move in the right direction. The December headline Producer Price Index (PPI) came in softer-than-expected, declining by 0.5% month-over-month, and recording its biggest drop since April 2020. On a year-over-year basis, December headline PPI fell to +6.2%, down from +7.3% in November. Ex-food and energy, producer prices also cooled in December, adding more credibility that inflation may have topped out for this cycle. Combined with moderating consumer price inflation in December and benign expectations for future price hikes, inflation anxiety is decreasing. At the same time, concern over an economic downturn is heating up. Retail sales last month fell more than expected, with ten of thirteen categories recording a drop in month-over-month sales. While lower sales across Gas Stations significantly contributed to the overall 1.1% monthly retail sales decline, Furniture, Online, Electronics, Bars/Restaurants, and General Merchandise categories also recorded meaningful sales declines in December. In our view, the broad-based nature of the retail sales decline last month indicates higher prices and higher inflation may finally be taking its toll on consumer strength.

Overseas, European equities have started the year strong, with the MSCI Europe ex-UK Index higher by +8.5%. Falling natural gas prices and China's reopening have been two major themes that have fueled more optimism in the region early in the year. In addition, a less severe downturn in Europe has also helped improve economic sentiment indicators across Germany and the Eurozone. However, we believe the euphoria around Europe could fade through the quarter as tighter monetary conditions, weakening demand, and an allocation shift back toward domestic equities potentially unfolds. In Asia, the Bank of Japan left interest rate policy unchanged last week, and China's population shrank last year for the first time in six decades.

Earnings Appear Mixed-to-Weaker than Expected; Layoffs in Tech Continue to Make Headlines, but Represent a Fraction of the Overall Jobs Market

On the earnings front, the early story out of corporate America is that fourth quarter results look mixed-to-weaker-than-expected and heading into the heart of the reporting season. With roughly 11% of Q4'22 S&P 500 profit reports complete, blended earnings per share (EPS) growth is lower by 4.6% year-over-year on revenue growth of +3.7%. According to *FactSet*, only 67% of S&P 500 companies have surpassed EPS estimates thus far, which is lower than the five-year average of 77% and the 10-year average of 73%.

But much of the corporate focus last week fell on the continued headcount reductions across some of the S&P 500's largest companies, namely in Big Tech. Goldman Sachs, Microsoft, Amazon, and Alphabet are some of the latest companies to announce layoffs in an effort to right-size their labor force for current conditions. Over the last twelve months, the tech sector has shed more than 200,000 jobs, according to *Layoffs.fyi*. Just four companies (i.e., Alphabet, Amazon, Meta, and Microsoft) accounted for 50,000 of the 200,000 job cuts. But investors have largely cheered the headcount reductions, given that Big Tech went on a hiring frenzy during the pandemic amid a digital transformation boom. Notably, the job reductions across the tech sector have been small overall, with current reductions representing a fraction of the overall job market. **Bottom line: Investors will likely support companies across industries that reduce headcount driven by proactive decisions to adjust the size of their labor force in response to current market/business conditions and penalize companies forced to reduce labor due to poor management, falling profits, or bloat.** Companies that adjust headcount from a position of strength versus weakness, and to protect profit margins, could be a key differentiator in how investors approach future layoff announcements when and if more companies decide to trim their staff.

This week, 93 S&P 500 companies will report fourth quarter earnings results, including 12 Dow 30 components. Microsoft, Visa, MasterCard, General Electric, Johnson & Johnson, AT&T, Lockheed Martin, and McDonald's Corp are just a few of the heavy-hitting reports that will be in focus this week. In addition, the variety of industries reporting results this week and next should provide more detail on how corporate America weathered the fourth quarter and give a better perspective on the outlook at the start of 2023.

In addition to the barrage of earnings reports this week, investors will receive a look at December Leading Indicators (Monday), preliminary January Purchasing Mangers' Index data (Tuesday), a first look at U.S. Q4'22 GDP (Thursday), December Personal Consumption Expenditures (PCE) Index (Friday), and a slew of housing data across the week. Economic activity is expected to show a rebound in January versus December levels but remain in contraction. And the

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rearview mirror look at the fourth quarter should show that U.S. GDP grew by +2.0% quarter-over-quarter based on *FactSet* estimates after increasing by +3.2% in the third quarter.

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The NASDAQ composite index measures all NASDAQ domestic and international based common type stocks listed on the Nasdaq Stock Market.

The **Dow Jones Industrial Average (DJIA)** is an index containing stocks of 30 Large-Cap corporations in the United States. The index is owned and maintained by Dow Jones & Company.

The U.S. Dollar Index (DXY) measures the dollar's value against a trade-weighted basket of six major currencies.

West Texas Intermediate (WTI) is a grade of crude oil commonly used as a benchmark for oil prices. WTI is a light grade with low density and sulfur content.

Producer Price Index (PPI) measures change in the prices paid to U.S. producers of goods and services. It is a measure of inflation at the wholesale level. The index is published monthly by the U.S. Bureau of Labor Statistics (BLS).

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