clearstead

RESEARCH CORNER

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OBSERVATIONS

- Still reeling from energy prices, which are up nearly +42% on a year-over-year (YoY) basis, preliminary inflation data for the Eurozone showed headline inflation registered +10.7% YoY in October, exceeding the median estimate of 10.3% and the highest ever reading since the Eurozone's formation. [1]
- Amazon joins Tesla and exits the trillion-dollar market capitalization club—Amazon has lost -48% year-to-date. Microsoft, Apple, and Alphabet are now the sole trillion-dollar market cap club members.[1]
- The Bank of England matched the Federal Reserve and European Central Bank by raising its policy interest rate by 75bps to 3.0%. The UK central bank warned the economy could face a two-year recession and expects unemployment to double by 2025—a recession of that magnitude would be its longest on record.[2]
- October ISM (Institute for Supply Management) manufacturing index fell to 50.2—at above 50.0 the manufacturing side of the economy continues to show expansion, albeit slower as compared to September. Prices paid fell for the first time since the pandemic began and supplier delivery times quickened.[1]
- Q3 earnings season is close to wrapping up with 85% of S&P 500 companies having reported Q3 results. As we close in on the final months of the year, blended earnings growth (reported plus estimated) for 2022 is +5.6% on a year-over-year basis (YoY). Excluding the energy sector, earnings growth would fall to +0.5% YoY for 2022. For 2023 earnings are expected to grow by +5.9%, that compares to expectations of +8.1% before this earnings season began—due to negative earnings estimate revisions.[3]

EXPECTATIONS

- The US labor market remains strong as the economy created 261,000 new jobs in October. The unemployment rate increased modestly to 3.7% from 3.5% in September, but other labor market indicators—such as open job postings which increased in the latest September report or initial unemployment claims which fell last week—underscore the fact that US job growth shows little signs of slowing despite the steady increase in interest rates.[4]
- Luiz Inácio Lula da Silva (Lula) was officially declared the winner of Brazil's Presidential run-off vote last week against current President Jair Bolsonaro. While Bolsonaro did not immediately concede he gave a speech a few days after the vote that acknowledged a transfer of power to Lula would occur in January-2023 as proscribed by Brazilian election-law.[5]
- Israel held elections last week and Benjamin (Bibi) Netanyahu's rightwing bloc gained enough votes to form a government that will likely return Bibi to the prime minister (PM) role. Bibi is on trial for corruption charges stemming from his last stint as PM (2009-2021), but his party is widely expected to pass new legislation that would shield him from prosecution while serving as PM.[6] The new government will be the most nationalistic in several years and will likely further strain relations with its Arab neighbors and Iran.

ONE MORE THOUGHT: *Federal Reserve Policy Update*[1]

Once again, the Federal Reserve was back in the spotlight after its decision to raise the Federal Funds Rate by 75bps to a new target range of 3.75%-4.00%. Markets initially reacted positively after the release of the press statement

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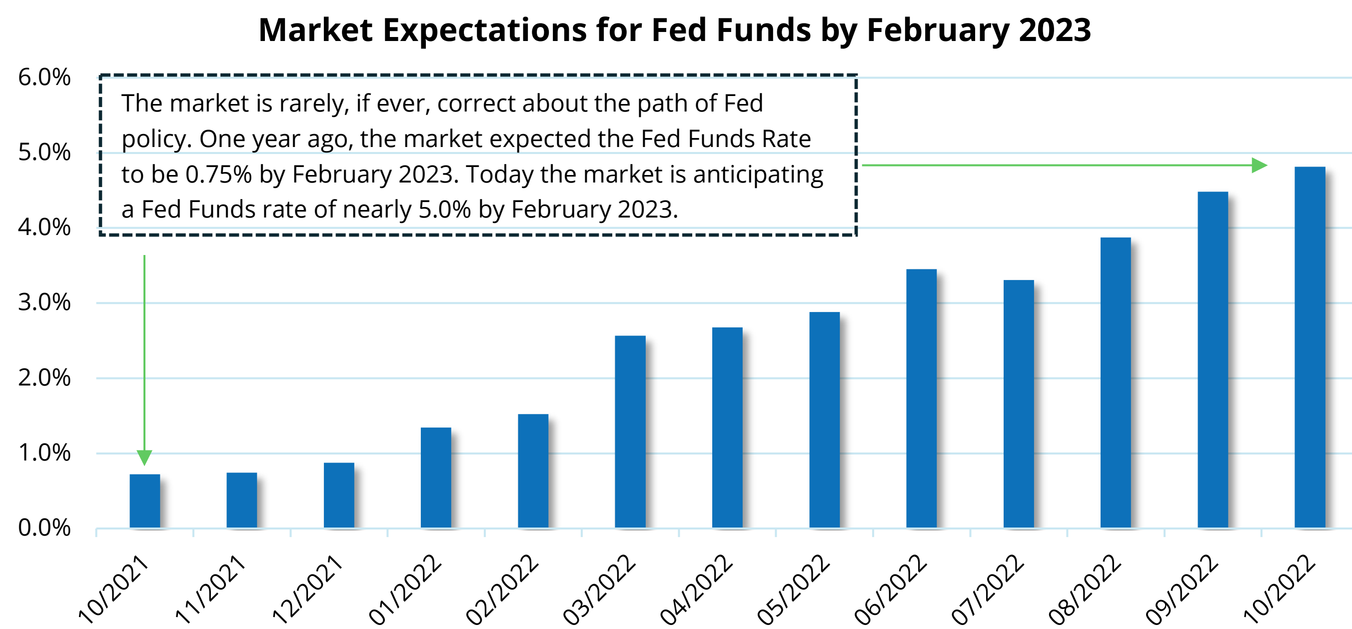
[1] *Bloomberg LP*
[2] *CNBC, BBC*
[3] *Factset Earnings Insight 11/4/2022*
[4] *https://www.bls.gov/news.release/empsit.nr0.htm; https://www.bls.gov/news.release/jolts.nr0.htm*
[5] *https://www.ft.com/content/00201127-baec-47e7-877e-60c18c64fbe5*
[6] *https://www.wsj.com/articles/israel-election-puts-benjamin-netanyahu-on-brink-of-comeback-11667380338?mod=hp_lead_pos3*

which seemed to indicate a greater willingness to slow the pace of rates given the long and variable lags of economic impact. The statement noted that the Fed "will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments." Chair Powell quickly dispelled any notion that an immediate pause was in the works after suggesting that "we still have some ways to go and incoming data since our last meeting suggests that the ultimate level of interest rates will be higher than previously expected." The markets reacted poorly with the S&P 500 experiencing more than a 3% swing in a matter of minutes. We continue to convey that the labor market strength gives the Fed plenty of room (See 24-Oct Research Corner) in its policy making decisions. So long as inflation data remain strong, monetary policy is unlikely to change in the face of a sub 4.0% unemployment rate. We will begin to see the lag effects of monetary policy enter the broad economy likely resulting in tighter financial conditions on balance—some disinflationary pressures are already being observed in certain parts of the economy. Meanwhile, all eyes will be on employment, which as a lagging indicator all but assures the Fed is likely to overshoot.

CHART OF THE WEEK



Source: Clearstead, Bloomberg LP, as of 11/2/2022, Implied Fed Funds rate from Fed Funds futures contracts

Aneet Deshpande, CFA
Chief Strategist
Clearstead

Dan Meges
Managing Director of Equity
Clearstead