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Market Update Research Note | September 2022

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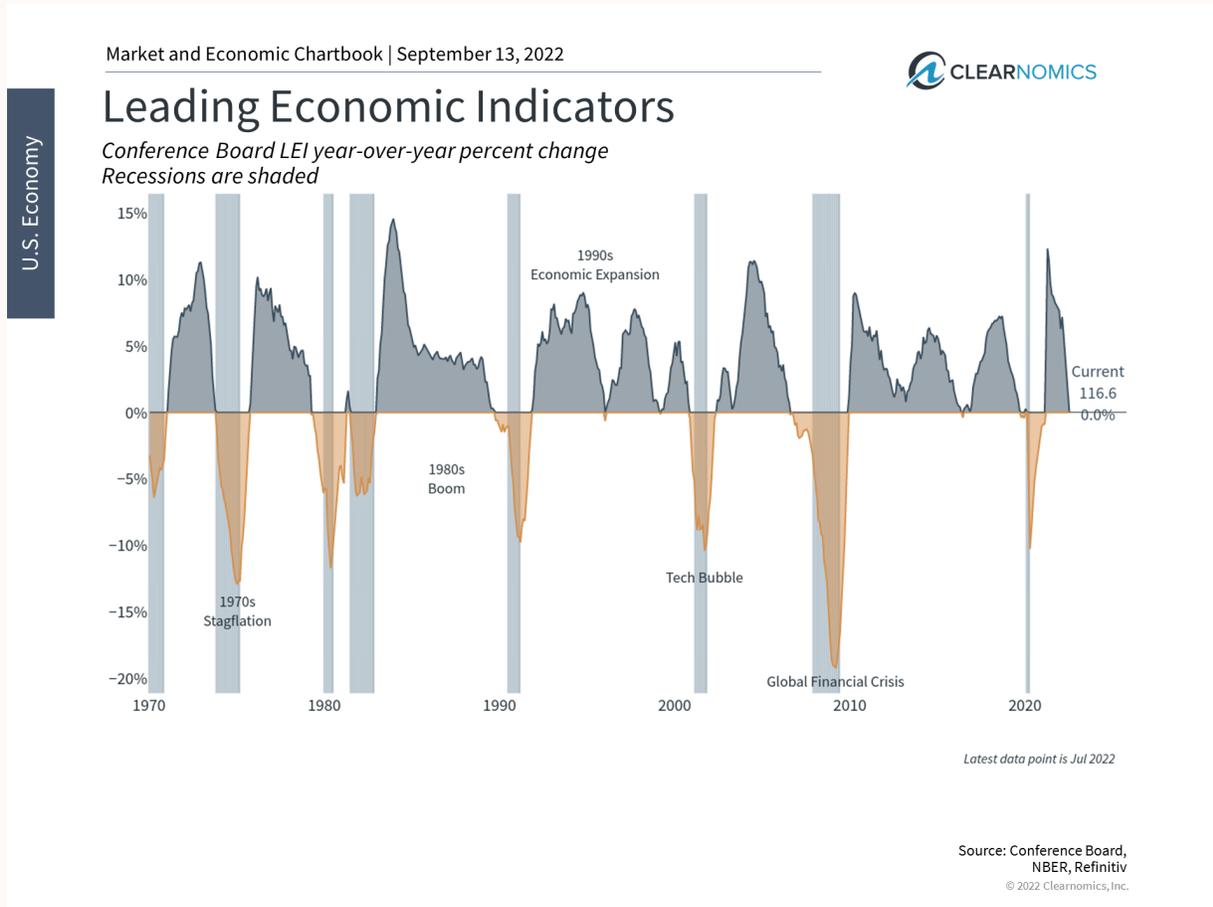
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# Corporate Earnings

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Global markets have fluctuated all year, alternating between pullbacks and recoveries that have lasted months at a time. Most recently, equity markets have faced renewed uncertainty since mid-August when Fed leaders reiterated their plans to keep policy rates higher for longer. The Fed has been forced to walk a fine line between combating inflation, which requires tighter policy to slow demand, and preventing a recession, which would normally require lowering rates.

The latest Consumer Price Index numbers show that prices are still rising, which raises probabilities for Fed tightening through 2023, and could slow the economy further. The following chart of leading economic indicators, a set of ten data points that are highly correlated with economic growth and GDP, shows that year-over-year trends have flatlined in part due to tighter financial conditions. The economy is clearly slowing and could decelerate further as the Fed ratchets up policy rates.



These concerns about the economy and the Fed have been driving stock market swings throughout the year. Depending on how you count them, the S & P 500 has experienced at least three distinct periods of declines that were interrupted by brief recoveries, with the longest rebound occurring from mid-June to mid-August. Although investors naturally study each data release, what drives markets in the long run is not the economic data on its own, but its impact on corporate profitability. As the following chart shows, the broad market can be volatile over days, weeks and months, but tends to follow the path of earnings over quarters and years.



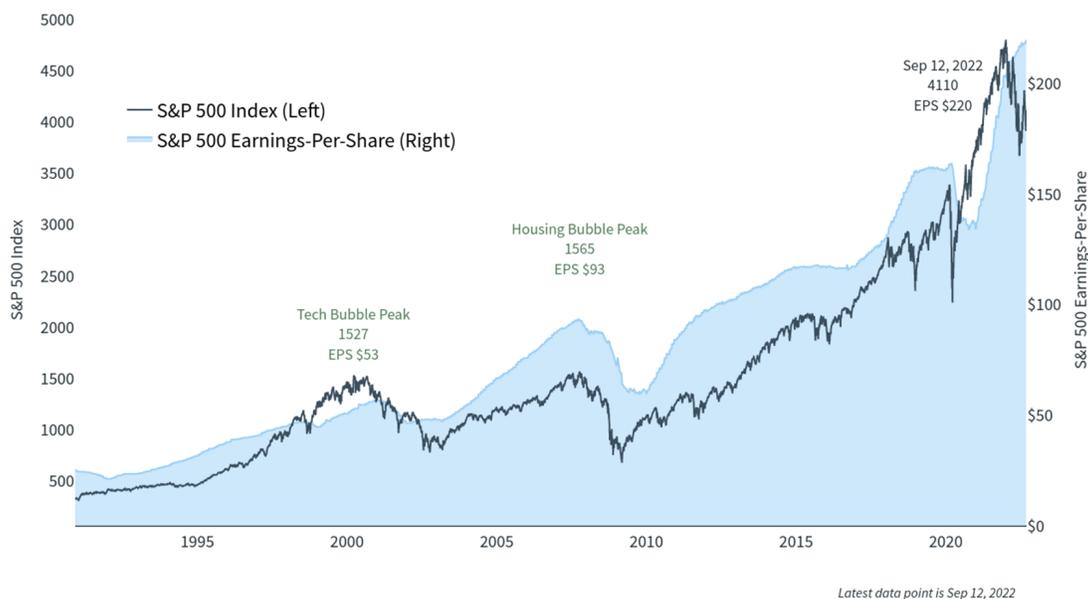
U.S. Stock Market

Market and Economic Chartbook | September 13, 2022



## The Stock Market and Earnings

*S&P 500 Index price and trailing earnings-per-share since 1990*



Source: Refinitiv, Standard & Poor's  
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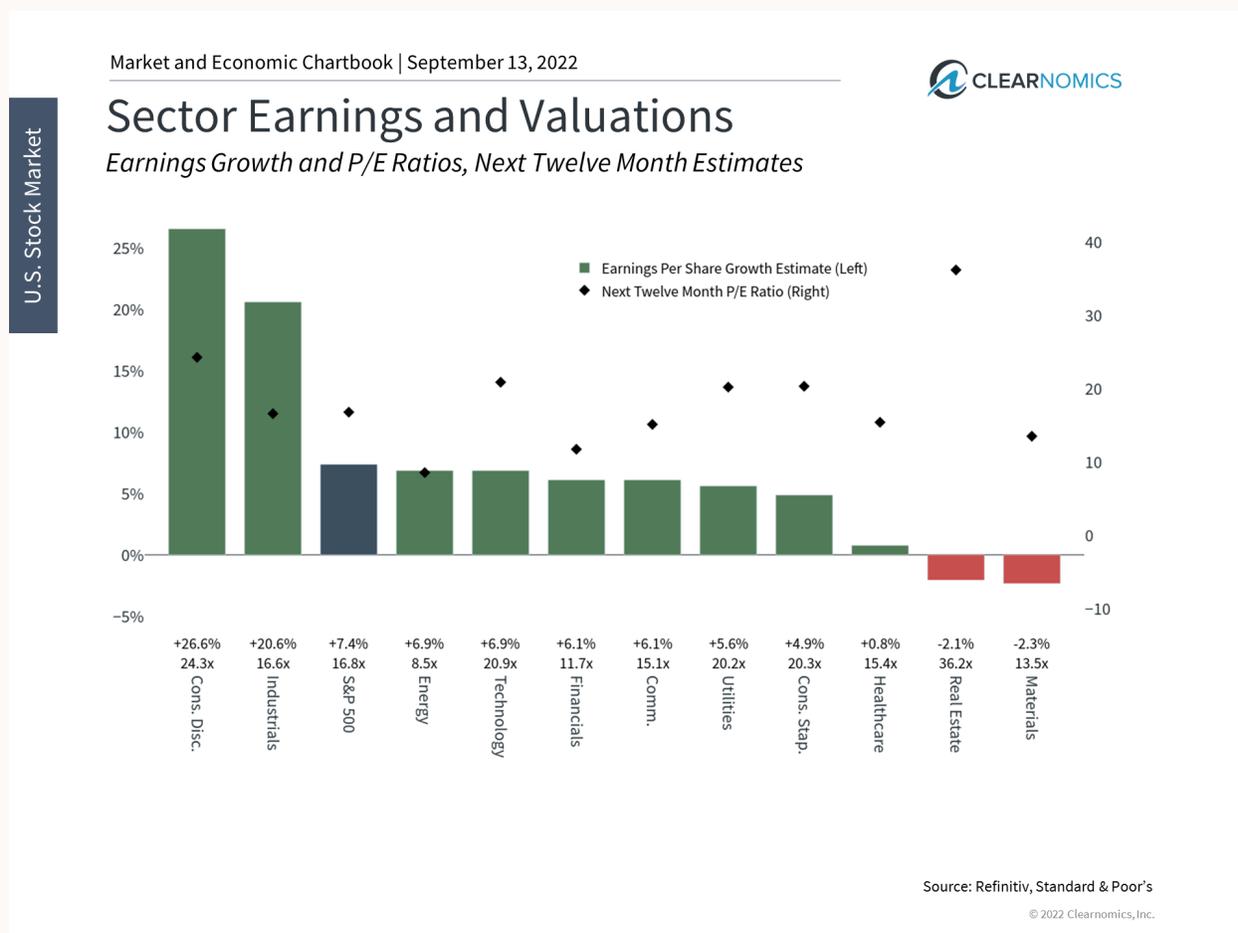
This is because investors don't directly invest in the economy. Instead, when the economy grows, investors benefit as companies earn more — which supports stock prices over time, and vice versa. For this reason, investors closely watch each quarterly earnings season both to understand how individual companies are doing and how the economic landscape is affecting sectors and industries. Macroeconomic factors—such as a difficult hiring market, rising costs, high energy prices and more—have directly driven performance across many parts of the market.

How do the earnings numbers look today? Current Wall Street estimates suggest that S&P 500 earnings-per-share could reach \$222 at the end of the year, representing a 9.6% increase from 2021. This would be a new record level for the overall index, far above the \$164 pre-pandemic peak. These projections also anticipate that earnings could reach \$235 per share one year from now and achieve gains of 7% to 9% in 2023 and 2024. These numbers are all at or above the historical average annual growth rate of 7.8% going back to the mid-1980s.



Thus, expectations are still positive for corporate activity. This is partly because steadily rising inflation can be positive for businesses because those with pricing power can raise prices, boosting their top-line revenue growth. Since prices tend to be “sticky,” these increases aren’t easily reversed. Of course, this is balanced against sharp increases in inflation that prevent companies from passing along costs fully, all at once. For example, while national wages have risen by 6.1% over the past year according to the Bureau of Labor Statistics, this represents a real cost to companies even if it is less than overall inflation.

These factors make the current and remaining earnings seasons this year important gauges of how companies are adapting to this inflationary environment. So far, companies are still posting positive results, even though consensus forecasts and company guidance are gradually coming down. Whether these numbers decelerate further depends (as discussed above) on how the slowing economy may affect profits.





These patterns also hold true across many sectors. Nine of the eleven sectors are expected to have positive earnings growth over the next year, as shown in the chart above. Sectors such as consumer discretionary and industrials are expected to grow earnings significantly faster than the overall S&P 500. One exception is real estate, which is facing a “housing recession” due to rising mortgage rates and softening demand. Rising earnings have also helped to improve the price-to-earnings ratios across sectors such as energy, financials and communication services.

Thus, the historical perspective in this market update underscores the fact that earnings growth is a primary driver of markets in the long run, and remains positive. Still, these expectations may continue to slow as the Fed tightens rates and the economy decelerates. This can create many investment challenges and highlights why many investors need a trusted advisor who can help them stay diversified through difficult times. This should also prompt investors to consider their portfolio allocations carefully and watch not only the broad economic data, but also its pass-through to earnings.

History-driven simulation provides a principled, systematic way for advisors and investors to quantitatively stress-test their portfolios based on these effects and understand the spectrum of likely outcomes.

Please contact Addepar Research at [research@addepar.com](mailto:research@addepar.com) to model your portfolios through our new stress-testing capabilities. We’ll continue to add new scenarios every month.

**New Scenarios:**

Scenario	Description
Sector Returns	Historical performance of Fama French sectors simulated through economic environments.



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