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SUMMARY

- US earnings estimates appear to us to have bottomed…
- …as corporate efficiencies and pricing power provide support.
- We remain cautiously optimistic on stocks.

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Debt Debate Diminishing…Earnings are the Real Story

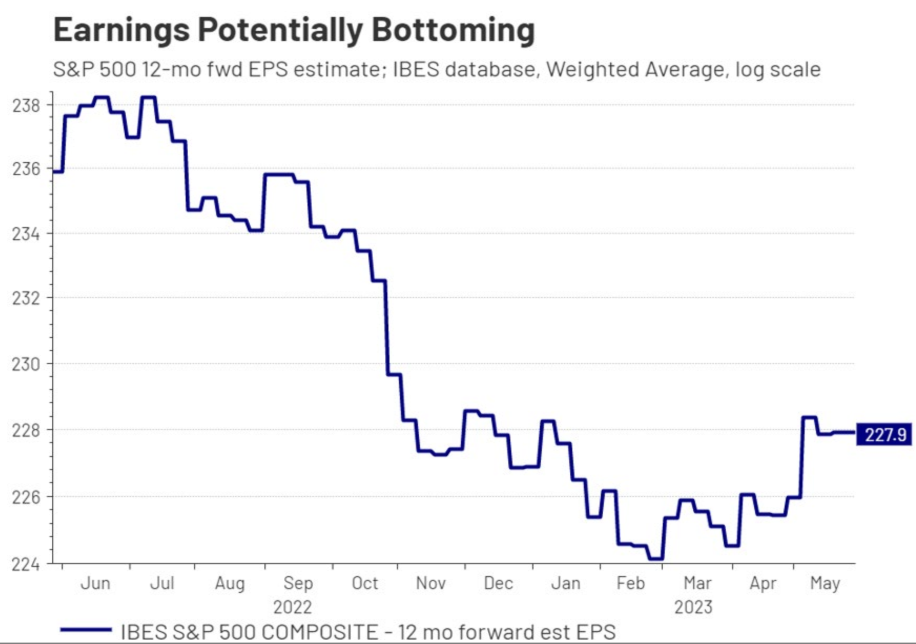
This week we are interrupting your regular scheduled programming - the reality TV show that is the US debt ceiling debate – to talk corporate earnings trends. With a debt ceiling deal agreed to in principle over the weekend by White House negotiators, investors' focus will likely shift to earnings fundamentals…and the news here is improving, in our view. Earnings are less salacious, but in our view are more impactful to stock prices in the longer run.

Q1 Results: Better than Expected, Led by Tech, Cyclical and Consumer Companies

With most of the S&P 500 having now reported first quarter results, we can say with confidence that it was a successful earnings season. Looking through the lens of earnings 'estimates' gives us hope that we've seen the bottom in earnings for this cycle.

Earnings estimates are published by Wall Street analysts for every company in the S&P 500. Analysts derive these estimates by monitoring industry trends, reviewing data, guidance furnished by company management, and through conversations with employees, suppliers, and customers. According to data from Ned David Research (NDR), close to 80% of all S&P 500 companies beat the consensus analyst earnings estimate this quarter, a stronger result than in Q4 or Q3 of 2022. The Technology sector was the standout, in our view, with almost 90% of tech companies beating estimates, by a median rate of roughly 8%. Other sectors such as energy, industrials, materials and consumer cyclicals also had a beat rate above 80%.

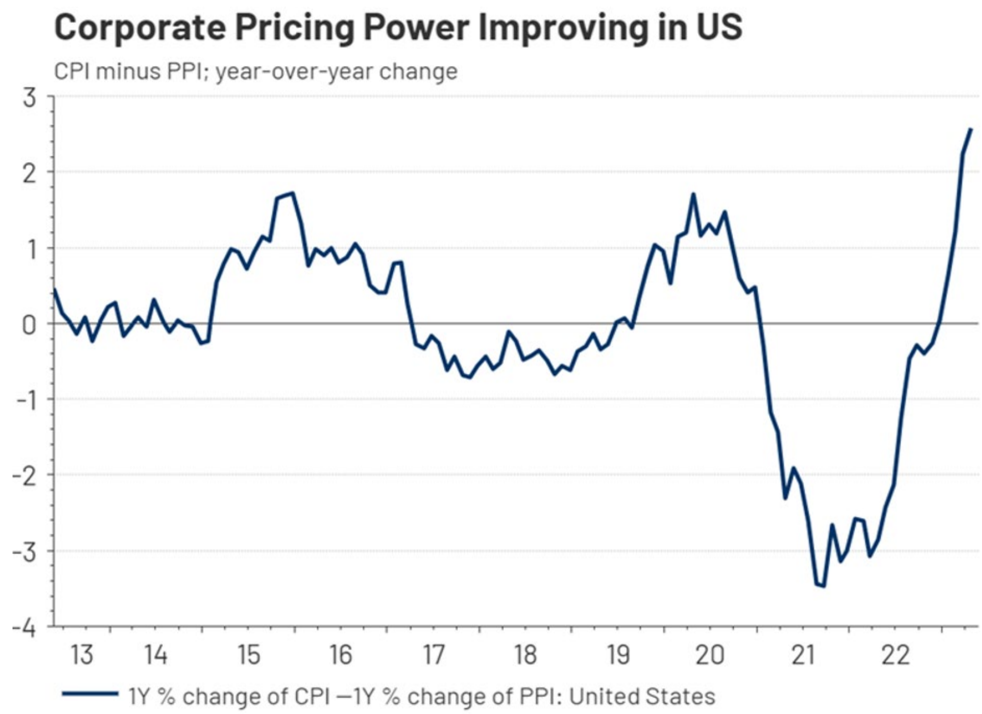
Importantly, this widespread earnings strength seen in Q1 is now starting to pull up 12-month forward earnings estimates for the S&P 500 in general, reversing an almost year-long decline in forward earnings estimates (see chart, below).



Source: Refinitiv Datastream, RiverFront. Data weekly as of May 26, 2023. Chart right shown for illustrative purposes.

Why Earnings are Improving – Pricing Power Still Alive and Well

In our 2023 Outlook, we hypothesized that S&P 500 earnings this year would prove more resilient than many feared. This view was based on our belief that in a higher inflation environment, 'nominal' economic growth (including inflation) was likely to remain positive and supportive of revenue growth. In addition, we anticipated US corporate managers, skilled at managing costs in uncertain environments, would surprise investors with their effective cost-cutting. We believed the relatively robust employment backdrop could keep consumers spending and provide companies 'pricing power', the ability to pass on higher prices to end-users.



Source: Refinitiv Datastream, RiverFront. Data monthly as of April 26, 2023. Chart shown for illustrative purposes.

In this just completed Q1 earnings season, we believe we are seeing this thesis start to play out in the United States. A rough proxy for corporate pricing power can be seen by studying the relationship between inflation rates in consumer prices (as illustrated by the Consumer Price Index, or 'CPI') and inflation rates in input prices for companies (represented by the Producer Price Index, or 'PPI'). Note that, for the first time in roughly 2 years, CPI is higher than PPI…suggesting to us that companies are successfully raising prices on consumers (see chart, above) and protecting profit margins. This differential between CPI and PPI is at its highest point in the last decade, suggesting to us that CPI will remain above PPI for some time.

Conclusion: Stocks' Earnings Fundamentals and Technical Picture Improving

With progress being made over the weekend on the debt ceiling negotiations – President Biden and Speaker of the House McCarthy agreed in principle to a deal - we think investors will start to prioritize company fundamentals over political turmoil. US earnings fundamentals are showing their first signs of stabilizing in roughly a year, a good sign for stocks, in our view. Late last week, the S&P 500 broke above what we view as significant technical resistance around 4200. A lasting breach above would be an incremental positive sign to us that 2023's market rally has staying power. We remain cautiously optimistic on US stocks.

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All charts shown for illustrative purposes only. Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that movements or trends can or will be duplicated in the future.

Technology and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

Index Definitions:
Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

Definitions:

The debt ceiling is the maximum amount of money that the United States can borrow cumulatively by issuing bonds. The debt ceiling was created under the Second Liberty Bond Act of 1917 and is also known as the debt limit or statutory debt limit.

The Consumer Price Index (CPI) measures the monthly change in prices paid by U.S. consumers. The Bureau of Labor Statistics (BLS) calculates the CPI as a weighted average of prices for a basket of goods and services representative of aggregate U.S. consumer spending.

The Producer Price Index (PPI) measures the average change over time in the prices domestic producers receive for their output. It is a measure of inflation at the wholesale level that is compiled from thousands of indexes measuring producer prices by industry and product category. The index is published monthly by the U.S. Bureau of Labor Statistics (BLS). The PPI is different from the consumer price index (CPI), which measures the changes in the price of goods and services paid by consumers.

Interest rate sensitivity is a measure of how much the price of a fixed-income asset will fluctuate as a result of changes in the interest rate environment. Securities that are more sensitive have greater price fluctuations than those with less sensitivity. This type of sensitivity must be taken into account when selecting a bond or other fixed-income instrument the investor may sell in the secondary market. Interest rate sensitivity affects buying as well as selling.

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