Economic Update

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This weekly update provides a snapshot of changes in the economy and markets and their implications for investors.

Growth

1Q22 Real GDP showed the economy contracted at a 1.5% annual rate in 1Q22, a deceleration from the boomy 4Q21. Weakness was primarily led by volatile trade and inventory data. Trade subtracted 3.2% from overall GDP growth as exports fell sharply and imports soared. Real private inventories grew at a solid $158.7Bn annual pace, but came in below its record 4Q21 pace. Weakness was partially offset by strong consumer spending, which grew by 2.7% ann. in the first quarter. At the start of the second quarter, PMIs show U.S. business activity slowed in May as soaring costs for raw materials, fuel and labor pushed input prices to a record high. The composite PMI Index fell to 53.6 from 53.8 in May.

Jobs

May nonfarm payrolls rose by a robust 390K with modest downward revisions of the prior two months. The unemployment rate stayed steady at 3.6% for the third consecutive month, while the labor force participation rate ticked up to 62.3% from 62.3% and wage growth continued at it's moderate pace of 0.3%. Flexibility in labor supply is allowing job gains in areas most in need (construction, leisure and hospitality, and education) while shedding jobs with excess (retail). Investors should take labor market cooling as a positive, as slow and steady growth and lower inflation may suggest the economy can achieve a soft landing, if the Fed has the patience to allow it.

Profits

After a solid 4Q21 earnings season, 1Q 2022 earnings have held up better than expected. With 498 companies having reported (99.7.% of market cap), our current estimate for 1Q 2022 is $49.96 ($41.44 ex-financials). 72% of companies have beaten on earnings expectations and 63% have beaten on revenue expectations. Omicron, higher inflation, disrupted supply chains and a slightly stronger dollar are weighing on profits. However, we expect robust economic growth and a surge in energy prices to continue to provide support for earnings.

Inflation

Inflation has far exceeded the FOMC's 2% target, with the headline PCE price index rising +0.9% m/m and +6.6% y/y in March. The core PCE deflator also rose +0.3% m/m and +5.2% y/y. The May CPI report showed hotter-than-expected inflation despite hopes for a moderation. Headline CPI rose 1.0% m/m and 8.6% y/y, while Core CPI jumped 0.6% m/m and 6.0% y/y. While surges in energy prices led the upside in headline CPI, core inflation continued to accelerate as airfares, new vehicle prices and shelter costs rose solidly.

Rates

Persistent inflationary pressures have pushed the Fed to accelerate its rate hiking scheduling. At its June meeting, the FOMC announced a 0.75% increase in the federal funds target range, the largest increase since 1994, to 1.50%-1.75%. The Fed kept the door open for another 0.75% increase at its July meeting, sending a clear message that the Fed will expeditiously raise rates in order to tame inflation. Revisions to its summary of economy projections recognize persistent inflationary pressures, cooling growth, and the impact higher rates will have on cooling demand for labor. By the end of 2022, the "dot plot" implies a federal funds rate of 3.4%, revised up from 1.9% in March.

Risks

- The Fed could push the economy into recession if it overtightens policy in response to supply-driven inflation.
- Heightened geopolitical tensions with Russia could result in continued energy shortages, low consumer confidence and dampened growth.

Markets may remain depressed and volatile until investors receive clarity on inflation and the Fed.

Investment Themes

- After this year's sell-off, fixed income now offers more protection against a market correction or economic downturn.
- U.S. equity investors may use profits as a guide in a rising rate environment.
- Long-term growth prospects, a falling dollar and wide valuation discounts support international equities.

● Denotes updated information