

October 23, 2023

## Market Outlook for 2023

After a rough two-month stretch in which the stock market gave up about one-third of its year-to-date gain, the S&P 500 has recovered 1.5% so far in October. Stocks have rallied despite cracks in the narrative that “the Fed is done.”

Big jobs gain in September and robust revisions to non-farm payrolls for the prior two months, along with slightly disappointing CPI and PPI data, have raised the possibility that the Fed could hike rates one more time, potentially in December. The developing war in the Middle East risks widening into an international conflagration, with attendant risks to global GDP (down) and energy prices (up).

### Outlook for the Remainder of 2023

While the stock market in 2022 opened to a wide range of challenges, the stock market in 2023 opened to a sense that the most pressing of these challenges – inflation, the Fed’s rate-hiking campaign, and the supply-chain crisis – were on the down-slope of the mountain. Past challenges have persisted, however, while new challenges have emerged, causing the stock market in 3Q23 to give back a portion of first-half gains.

The geopolitical environment appeared to have cooled before the war in the Middle East erupted. The conflict in Eastern Europe is again bogged down as Ukraine’s counter-offensive shows signs of sputtering. The end of China’s zero-tolerance pandemic lockdown has failed to trigger hoped-for economic recovery, contributing to concerns about potential Chinese recession. Globally, COVID-19 is in the rear view, although new strains have kindled fears of wintertime re-emergence. Russia and Saudi Arabia, the largest producers in OPEC Plus, have announced plans to extend their production cuts at least into year-end 2023 and potentially well into 2024.

Following the mid-September FOMC meeting, the Fed’s dot plot signaled the potential for at least one more rate hike and seemed to suggest that any cuts in interest rates in 2024 will occur late next year. Spiking energy prices and a still-restrictive Fed have sent interest rates to 16-year highs and (prior to October recovery) had shaved about one-third off the stock market’s year-to-date gains.

Despite existing and new challenges, the economic, employment, and earnings environment remain positive as the market enters its final quarter of the year. Measures of the commercial and industrial economy – including PMIs, durable goods orders, industrial production, and small-business confidence – have moderated from high readings in the pandemic-recovery phase while remaining at levels consistent with low-level growth. The NFIB Small Business Optimism dipped half a point in September after rising 1.9 percentage points in August. Survey respondents cited inflation and labor quality as their chief concerns.

Supply chains continue to normalize, although that partly reflects slackening in demand related to inflation re-prioritizing consumer and business spending. In response to moderating activity, companies are being frugal, mixing targeted layoffs with across-the-board spending reductions and executive pay cuts.

The consumer economy appears slightly stronger than the industrial economy, even as benefits to consumer balance sheets from pandemic stimulus have melted away. Consumer spending remains positive year-over-year, while slipping to low-single-digit growth from a high- to mid-single-digit annual pace into year-end 2022. Consumer demand shifted from discretionary goods to necessities as inflation intensified. Recovery in discretionary spending has been muted and uneven.

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## ECONOMIC & MARKET COMMENTARY (CONT.)

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At the nine-month mark for 2023, the jobs economy appears sound if somewhat more tempered. According to the JOLTS report, national job openings accelerated to 9.61 million in August from July's 8.92 million. September non-farm payrolls stunned with a 336,000 gain. Unemployment is low and, due to demographic and immigration trends, may remain so for an extended period. Rising wages, now approximately tracking inflation, have helped consumers stay afloat amid higher costs for everything.

Earnings growth for S&P 500 constituent companies is at risk of being negative for 2023, depending on earnings trends for the third and fourth quarters. After slightly lower 1Q23 and 2Q23 EPS, we look for slightly positive EPS growth in 3Q23 and low-double-digit EPS growth in 4Q23.

Our 2023 forecast of S&P 500 continuing-operations earnings is \$226, which implies 2% annual growth from \$222 for 2022. Our 2024 forecast for S&P 500 continuing-operations earnings is \$245, which implies 8% growth from 2023. Our 2024 EPS growth forecast assumes earnings will begin to normalize once inflation is back to acceptable levels and the Fed is finished its rate-hiking cycle.

The S&P 500 two-year forward P/E on our 2023 and 2024 EPS forecasts is 18.3-times, or about 7% below the prior five-year (2018-22) average of 19.6-times. Reflecting the current high level of inflation and interest rates, our adjusted earnings-yield model continues to signal modest overvaluation in stocks.

Argus expects U.S. economic growth at a 4.0% annualized rate in 3Q23, following roughly 2.0% growth in 1H23 and 1.9% growth for all of 2022. We then look for about 1% GDP growth in the fourth quarter of 2023. For all of 2023, Argus is modeling 2.3% GDP growth, after forecasting 1.5% GDP growth at mid-year and less than 1% growth entering 2023. Additionally, Argus is forecasting GDP growth of 2.2% for 2024, also revised higher from our initial forecast. The Fed has sought to use ever-higher interest rates to cool inflation. The risk as 2023 progresses is that softening demand will transition into a deeper downturn as a result of stubborn inflation and the lagged effect of past rate hikes.

Argus believes the U.S. can avoid recession in 2023 and 2024. Even if the U.S. avoids a "textbook" recession, however, below-trend economic growth could persist into 2024. The Argus base-case scenario for the economy and stock market in 2023 assumes that the Fed 2023 has largely (or fully) finished its rate-hiking campaign; that core CPI stays below 5% as of year-end; and that GDP grows at least 1%-2% in 2023. In June 2023, the S&P 500 at 4,293 entered a new bull market, having risen 20% from its October 2022 low of 3,577. Since poking above 4,600 at the end of July, however, the S&P 500 has retreated about 6% to the 4,350

level as of mid-October. And the index remains 10% below its all-time high set in January 2022.

Investors always expect a continuation of the most recent market cycle. Early in 2023, investors struggled to shake the memory of 2022's selloff. Just when investors had begun to accept the AI-infused 2023 bull market, stocks cratered in August and September. Even with recent profit-taking, year-to-date gains in stocks suggest that investors are preparing for a post-rate-cycle world, rather than dreading the rate hikes ahead as they were doing in 2022. The stock market in 2022 reflected sector rotation into cyclical, defensive, interest-rate-sensitive, and inflation beneficiaries. The market rotated back to growth leadership late in 2022 and across the first half of 2023, before rotating defensively again in 3Q23. Given investors' comfort with formerly out-of-favor sectors along with AI-inflected momentum in growth sectors, investors could benefit from a broadly advancing market in 2023 assuming our economic and stock-market scenarios unfold as expected.

Despite recent weakness, Argus continues to forecast S&P 500 appreciation in the 15%-17% range for 2023, which at midpoint would put the index price around 4,600 by year-end. We now see more downside risk to the high end of our forecast, however, compared with our outlook at mid-year 2023.

### Conclusion

As of mid-October, Congress was unable to move forward without a House Speaker. Partisan rhetoric is intensifying as the 2024 Presidential election cycle heats up. Interest rates and inflation are stubbornly high. These factors along with wars in Europe and now the Middle East cloud the outlook. Yet the U.S. economy continues to chug along.

Consumers are employed and are experiencing wage growth running slightly ahead of inflation. Third-quarter earnings could represent the first season of higher year-over-year earnings since 3Q22. Argus believes the U.S. can avoid recession this year and next, although new factors add to existing risks.

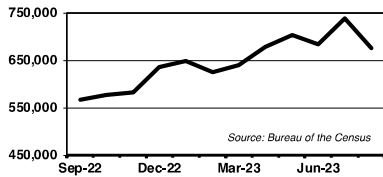
We have long believed that interest rate uncertainty is the biggest challenge to business planning and consumer confidence. Consumers and businesses can move forward once they perceive interest rates to be stable, even when rates are structurally higher.

We now believe that rate stability is at hand or at least approaching. We continue to believe that the Fed has finished its rate-hiking cycle, although timing of any rate relief is now most likely to occur in the second half of 2024. Most notably, the unfolding war in the Middle East has raised the uncertainty quotient into year-end.

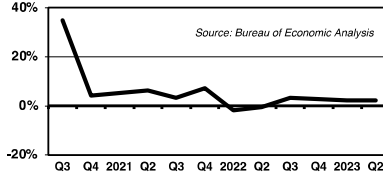
Jim Kelleher, CFA,  
Director of Research

# ECONOMIC TRADING CALENDAR

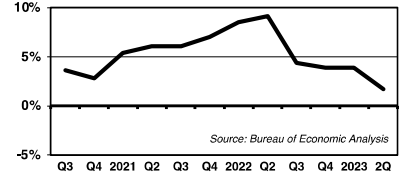
Release: **New Home Sales**  
 Date: 10/25/2023  
 Month: September  
 Previous Report: 675000  
 Argus Estimate: 650000  
 Street Estimate: 685000



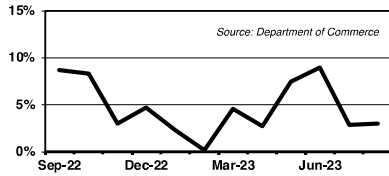
Release: **GDP Annualized QoQ**  
 Date: 10/26/2023  
 Month: 3Q  
 Previous Report: 2.1%  
 Argus Estimate: 4.0%  
 Street Estimate: 4.1%



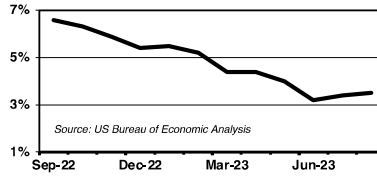
Release: **GDP Price Index**  
 Date: 10/26/2023  
 Month: 3Q  
 Previous Report: 1.7%  
 Argus Estimate: 2.1%  
 Street Estimate: 2.5%



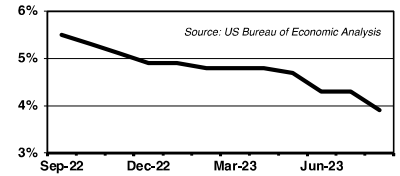
Release: **Durable Goods Orders**  
 Date: 10/26/2023  
 Month: September  
 Previous Report: 3.0%  
 Argus Estimate: 0.9%  
 Street Estimate: NA



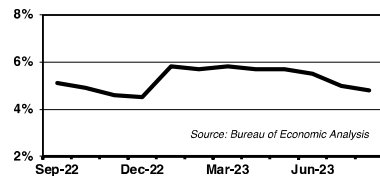
Release: **PCE Deflator**  
 Date: 10/27/2023  
 Month: September  
 Previous Report: 3.5%  
 Argus Estimate: 3.5%  
 Street Estimate: NA



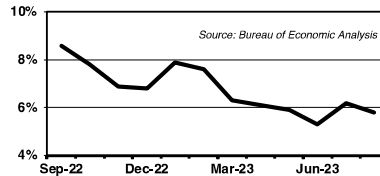
Release: **PCE Core Deflator**  
 Date: 10/27/2023  
 Month: September  
 Previous Report: 3.9%  
 Argus Estimate: 3.7%  
 Street Estimate: NA



Release: **Personal Income**  
 Date: 10/27/2023  
 Month: September  
 Previous Report: 4.8%  
 Argus Estimate: 4.5%  
 Street Estimate: NA



Release: **Personal Spending**  
 Date: 10/27/2023  
 Month: September  
 Previous Report: 5.8%  
 Argus Estimate: 5.4%  
 Street Estimate: NA



*Previous Week's Releases and Next Week's Releases on next page.*

## ECONOMIC TRADING CALENDAR (CONT.)

### Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
17-Oct	Industrial Production	September	0.2%	0.6%	NA	NA
	Capacity Utilization	September	79.7%	79.9%	79.6%	NA
	Retail Sales	September	2.5%	2.2%	NA	NA
	Retail Sales ex-autos	September	2.0%	1.7%	NA	NA
	Business Inventories	August	1.4%	0.4%	NA	NA
18-Oct	Housing Starts	September	1,283 K	1,175 K	1,390 K	NA
19-Oct	Existing Home Sales	September	4.04 Mln.	4.00 Mln.	3.88 Mln.	NA
	Leading Index	September	-0.4%	-0.1%	-0.3%	NA

### Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
31-Oct	Consumer Confidence	October	103.0	NA	NA	NA
1-Nov	ISM Manufacturing	October	49.0	NA	NA	NA
	ISM New Orders	October	49.2	NA	NA	NA
	Construction Spending	September	7.4%	NA	NA	NA
2-Nov	Nonfarm Productivity	3Q	3.5%	NA	NA	NA
	Unit Labor Costs	3Q	2.2%	NA	NA	NA
	Factory Orders	September	0.5%	NA	NA	NA
3-Nov	Nonfarm Payrolls	October	336 K	NA	NA	NA
	Unemployment Rate	October	3.8%	NA	NA	NA
	Average Weekly Hours	October	34.4	NA	NA	NA
	Average Hourly Earnings	October	4.2%	NA	NA	NA
	ISM Services Index	October	53.6	NA	NA	NA
	Total Vehicle Sales	October	15.67 Mil.	NA	NA	NA

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