



ARGUS ECONOMIC COMMENTARY

February 19, 2024

How High Is Up?

There is not much you can count on, including the Super Bowl stock-market predictor. The predictor says that if the AFC team wins the Super Bowl, the market goes down; conversely, if the NFC team wins, the stock market goes up. When first proposed by New York Times sportswriter Leonard Koppett in 1978, the indicator had a 100% accuracy rate. However, for the past 20 years, it has been correct only 30% of the time – good news for market bulls and those who don't like the Chiefs.

Fortunately, investors can point to some sturdier and more-tangible supports for the stock market, even as it makes new highs. The past two quarters of GDP growth suggest that the economy is growing faster than its long-term trend. Employment trends continue to exceed expectations long after most economists had forecast a cooler jobs climate. Corporate earnings also continue to surpass expectations, perhaps because fear of a downturn compelled managers to run lean and keep expectations in check.

The Economy: Sneaky Strong?

Fourth-quarter GDP grew at a 3.3% annual rate, as much as a point above consensus expectations. Growth in 4Q23 followed stronger growth of 4.9% in the third quarter. Fourth-quarter GDP growth reflected increases in nearly every category: personal consumption expenditures, residential and non-residential fixed investment, across-the-board government spending, private inventory investment, and exports.

The consumer helped the economy in the back half of 2023, even more so than in the prior nine months. Non-residential fixed investment, the proxy for corporate capital spending, rose nearly 2% in 4Q23 as every data point within this category – structures, equipment, and intellectual property all grew in low single-digit percentages. PCE and

corporate spending make up more than three-quarters of the U.S. economy and both have been trending nicely. Argus looks for U.S. GDP to grow in the 2.0% range for 2024 and 2025.

Nonfarm payrolls shocked with growth of 353,000 jobs for January, nearly doubling the consensus forecast of 180,000. The trailing three-month average was 289,000 – above the 12-month average of 255,000 for all of 2023. Average hourly earnings were up 0.6% month-over-month and 4.5% year-over-year. Annual wage growth is running comfortably ahead of the annual change in PCE core inflation.

Retail Sales rose 0.6% in December, beating the 0.4% consensus forecast, and were up 5.6% from the prior year. Although the consumer continues to “carry” the U.S. economy, businesses are getting in the act too. The ISM Manufacturing purchasing managers index (PMI) for December rose to 49.1%, up from 46.7 for both November and October. While that is not quite above the 50-level signaling expansion, December marks the highest reading in this series since May 2022.

The ISM Services PMI moved up to 53.4% for December from 52.7% for November. The services PMI remains comfortably in expansion mode – important given that the services economy is several times the size of the manufacturing economy. Factory orders rose 0.2%, building on the 2.6% gain for November. Factory orders rose just 0.8% in 2023, after rising more than 12% in 2022. The UAW strike, though limited in scope, played a role. Mainly, though, cautious purchasing managers reflected the general perception that high inflation and high rates would cause the broad economy to falter. Both Industrial Production and Capacity utilization were constrained late in 2023.

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ECONOMIC & MARKET COMMENTARY (CONT.)

The Conference Board's Index of Leading Economic Indicators (LEI) continues to run in negative territory, as it has for over a year. The LEI declined by 2.9% over the six-month period into 2023 year-end, better than the 4.3% contraction indicated for the first six months of the year. The Conference Board's Senior Manager of Business Cycle Indicators reiterated expectations that U.S. GDP growth would turn negative in the middle quarters of 2024 before recovering later in the year. Within the LEI for December 2023, six of 10 components made positive contributions to the index, in a positive trend that belies the Conference Board's own caution.

Inflation is getting closer to the Fed's target range. PCE core inflation, the Fed's favorite metric, increased at a 2.9% annual pace in December. Inflation remains stubbornly high in places. While goods prices for December were up 0.1% in the past year, services prices increased 3.9%, according to PCE price data. Housing inflation (shelter), which represents about one-third of total inflation input, has been sticky, although rent equivalent costs finally show signs of moderating.

Calendar 4Q23 earnings appear to have increased in single digit percentages year-over-year, marking a second consecutive quarter of annual EPS growth after four straight negative quarters. For the fourth-quarter earnings season, with over half of companies having reported as of 2/9/24, 80% have exceeded consensus expectations, versus 70%-75% on average. Moreover, the magnitude of the beat has been at the high end of the 5%-8% historical range.

Three firms that track S&P 500 earnings – Refinitiv, FactSet, and Bloomberg – all have separate calculations of 4Q23 earnings, but all have moved into positive territory. With data as of 2/8/24, FactSet now forecast 3% annual growth. Bloomberg is up to 5%, and Refinitiv is the most aggressive of the bunch with a 9% growth forecast. The Argus forecast is for about 7% growth in 4Q23 EPS against a weak year-earlier comparison. We expect S&P 500 earnings from continuing operation for 2023 to (about) match our \$226 estimate, implying low single-digit growth from 2022.

Our 2024 forecast is still for S&P 500 earnings from continuing operations to be \$247, consistent with high single-digit EPS growth from 2023. Our preliminary forecast for 2025 is for high single-digit EPS growth in the mid-\$260s range.

The Market Rally Widens

While January was good for stocks, February has been very good as of this writing, even though the month is only half-over. After delivering total return of 25.8% in 2023, the S&P 500 is up 5.5% on a total return basis (with dividends) for the year-to-date. Whereas the S&P 500 and

Nasdaq were running neck and neck through January, Nasdaq shows signs of pulling away with a 6.6% year-to-date gain. Wilshire Large Cap Growth is already in double digits for 2024 to date.

The DJIA is up 2.7% year-to-date, not bad for the Blue Chip index this early in the year. Note, though, that DJIA has barely budged in February after ending January up 2.6%.

At the sector level, Communication Services and Technology continue to lead in 2024 as they did in 2023. Both have already posted low double-digit percentage total returns. Consumer Discretionary, however, is lagging in 2024 with a 2% gain, which puts it in the middle of the sector pack.

The two big turnaround stories in 2024 have been Healthcare, with a nearly 6% gain, and Financial Services, up 4%. After a deeply lagging 2023, appreciation in Healthcare stocks reflects the promise of new compounds, drugs and treatments that enhance quality of life for a broadening spectrum of people. Financial Services have benefited from widening in net interest margins, although the bigger factor appears to be recoveries in fee-based businesses, loan growth, and even the mortgage market.

Investors are convinced the Fed will begin cutting rates sometime in 2024, which should bring down market interest rates. The stock market is assumed to be anticipatory, meaning investors should be buying lower rate beneficiaries including Utilities and REITs. That has not happened yet, however. Those sectors deeply lagged the market in 2023, and investors appear fearful of being burned again. Once the Fed does begin to cut, we would expect those areas to take off.

Conclusion

During 2023, we noted that the market was fighting the negatives of high inflation and interest rates with the “Three Es” of earnings, economy, and employment. All three have come in better than expected early in 2024, driving the stock market's advance.

Falling inflation and lower interest rates are good for valuations, and stocks are looking attractive despite a strong 2023 and early-year 2024 strength. Within our modified earnings yield model, the decline in interest rates and the slowing in inflation along with the slight increase in our earnings outlook are increasingly favorable for stock valuations. Given a current yield around 1.5%, along with our forecast for high single to low double-digit EPS growth for 2024 and 2025, the total-return outlook for the S&P 500 is better than it has been since pre-pandemic days.

Accelerating stock gains into year-end 2023 and early 2024 suggest that investors are anticipating the beginning of rate cuts, rather than dreading rate hikes as they had been

ECONOMIC & MARKET COMMENTARY (CONT.)

doing in the prior two years. Our base case outlook for U.S. markets in 2024 calls for a more-normal year of S&P 500

returns, in the 8%-12% range. Our year-end target for the S&P 500 is in the 5,200 range.

Jim Kelleher, CFA,
Director of Research

ECONOMIC TRADING CALENDAR

Release: **Leading Index**

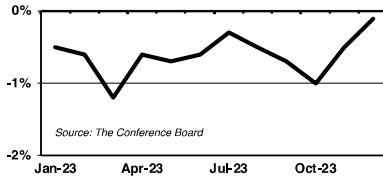
Date: 2/20/2024

Month: January

Previous Report: -0.1%

Argus Estimate: 0.3%

Street Estimate: NA



Release: **Existing Home Sales**

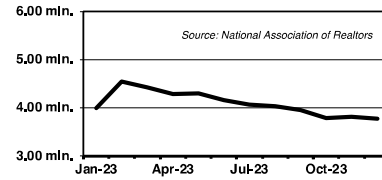
Date: 2/22/2024

Month: January

Previous Report: 3.78 mln.

Argus Estimate: 4.05 mln.

Street Estimate: 4.00 mln.



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
13-Feb	Consumer Price Index	January	3.4%	3.0%	NA	NA
	CPI ex-Food & Energy	January	3.9%	3.8%	NA	NA
15-Feb	Retail Sales	January	5.6%	4.0%	NA	NA
	Retail Sales ex-autos	January	4.5%	3.3%	NA	NA
	Business Inventories	December	0.4%	0.3%	NA	NA
	Import Price Index	January	-1.6%	-1.8%	NA	NA
	Industrial Production	January	1.0%	1.5%	NA	NA
	Capacity Utilization	January	78.6%	78.8%	78.7%	NA
16-Feb	PPI Final Demand	January	1.0%	0.4%	NA	NA
	PPI ex-Food & Energy	January	1.8%	1.8%	NA	NA
	Housing Starts	January	1,460 K	1,480 K	1,450 K	NA
	U. of Michigan Sentiment	February	79.0	82.0	NA	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
26-Feb	New Home Sales	January	664 K	NA	NA	NA
27-Feb	Durable Goods Orders	January	3.7%	NA	NA	NA
	Consumer Confidence	February	114.8	NA	NA	NA
28-Feb	GDP Annualized QoQ	1Q	3.3%	NA	NA	NA
	GDP Price Index	1Q	1.5%	NA	NA	NA
29-Feb	PCE Deflator	January	2.6%	NA	NA	NA
	PCE Core Deflator	January	2.9%	NA	NA	NA
	Personal Income	January	4.7%	NA	NA	NA
	Personal Spending	January	5.9%	NA	NA	NA
1-Mar	ISM Manufacturing	February	49.1	NA	NA	NA
	ISM New Orders	February	52.5	NA	NA	NA
	Construction Spending	January	13.9%	NA	NA	NA

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