

March 4, 2024

Confounding the Experts

Heading into 2023, Wall Street economists offered their forecasts on big topics such as GDP growth, inflation, interest rates, and unemployment. The consensus expressed confidence that, by the end of 2023, the Federal Reserve would be able to wrangle inflation back toward (if not quite to) its desired 2% target range. There would be a price to pay, of course. Unemployment was expected to rise above 4%. The broad consensus of economists forecast that GDP growth would slow to a crawl, if not turn negative.

Yet even as inflation was being tamped down in the second half of last year, economic indicators remained solid and even showed signs of acceleration. Although the number of available jobs per unemployed worker ticked down, unemployment remained below 4%. GDP finished 2023 on an upswing, with growth of 4.9% in 3Q23 and 3.3% in 4Q23. Interest rates remain near cycle peaks, and – given broad hints from Fed officials – investors have pushed out expectations for the timing of the first rate cuts in this cycle. Yet the GDPNow forecast from the Atlanta Fed, considered a supple and reliable forecasting tool, was forecasting 1Q24 GDP growth of 2.9% as of mid-February 2024.

Employment is still growing, and economic growth is continuing. Inflation is no longer in rapid retreat, as it was in the middle months of 2023, but it continues to edge lower. The consensus of economists, so skeptical one year ago of a happy outcome in this cycle, now expects the U.S. economy to “stick the landing.”

Will the Employment Economy Cool Off?

The better question might be, when will the employment economy cool off? Timing of any job turnaround has eluded economists and market strategists so far.

Argus Director of Economic Research Chris Graja, CFA, expects February nonfarm payrolls to come in below

200,000, and possibly as low as 180,000. While that would be a big step-down from the 353,000 additions to nonfarm payrolls in January, there may have been some “overhang” in January from massive holiday seasonal hiring. Some workers took on a second job to pay for holiday spending, and those second jobs likely continued rolling off in February.

The trailing 12-month average for nonfarm payrolls is growth of 243,000; the trailing three-month average is higher, in the 290K range. Chris notes that weekly jobless claims have remained low, and that layoffs reported in the JOLTS data are low. Any slowing in net job gains is thus more likely to come from slower hiring than from accelerating layoffs, at least in the near term.

The Federal Reserve has forecast that the unemployment rate could reach 4.1% by the end of 2024. Assuming the labor participation rate holds steady, getting to 4.1% unemployment would require monthly growth in nonfarm payrolls to slip below 100,000 on a sustained basis.

For the near-term, Argus Economics looks for steady-state trends in the overall employment situation. Chris expects the average workweek to tick higher in February from January, based on some edging-up in the labor participation rate for workers aged 25 to 54. He also looks for average hourly wage growth to remain elevated, with a forecast for 4.4% annual growth for February (down slightly from 4.5% for January).

Final 4Q Earnings Wrap

Another key support for stocks, we have noted, has been the improving earnings environment. S&P 500 earnings from continuing operations are on track for high-single-digit percentage EPS growth for 4Q23 compared with the prior-year

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ECONOMIC & MARKET COMMENTARY (CONT.)

period. That is much better than expectations heading into EPS season for a low-single-digit EPS decline. Typically, earnings “surprise” to the upside by four to six percentage points, because companies deliberately low-ball their EPS forecasts to account for a host of negative contingencies that rarely come to fruition. The extent of the beat this time – high-single-digit percentage points, and maybe even low double-digits – is way above average. Nvidia alone, with its latest blowout report on 2/22/24, may have added a point or more to total S&P 500 continuing-operations earnings growth.

FactSet is still calling for 4Q23 EPS growth in the 3%-4% range, while Refinitiv’s latest blended growth forecast exceeds 9%. Bloomberg has some of the most comprehensive quarterly EPS data available, so we will use that data for the following discussion.

With 440 of the 500 constituent companies having reported as of 2/23/24, Bloomberg reports a blended growth rate of 7.7% for continuing-operations earnings for calendar 4Q23. All of the EPS growth is coming from growth stocks. Earnings for S&P 500 companies deemed value stocks are down about 7% in 4Q23, while earnings from growth stocks is up over 40%. Excluding the Technology sector, 4Q23 EPS would have grown a much more modest 4%.

In fact, 4Q23 EPS growth is reliant – some would say uncomfortably so – on the “Magnificent 7” AI stocks. All but Tesla delivered strong double-digit EPS growth. According to the pre-reporting consensus as compiled by FactSet, earnings from the Magnificent 7 less Tesla were forecast to grow 54%, while earnings from the remaining 494 stocks were forecast down 11%. As noted, non-Magnificent 7 companies did not fare so poorly as originally anticipated. That said, markets with this level of concentration rarely end well and often end badly.

At the sector level, some of the best growth has come from growth sectors. Fourth-quarter earnings are up 49% for Communication Services, 27% for Consumer Discretionary, and 23% for Technology. The tiny Utilities sector is posting sharp earnings growth of about 50%, but getting no love from investors given that Utility stock performance is tied to the trend in interest rates.

The weakest sectors are Energy, with earnings down 26%; Basic Materials, down 20%; and Healthcare, down 15%. Energy is on track for a 31% EPS decline for all of 2023, and suffered through several quarters of triple-digit declines.

A range of sectors delivered middling earnings for 4Q23. Sectors with positive EPS growth that nonetheless lagged growth for the overall index include Consumer Staples, Fi-

ancial Services, Real Estate, and Industrials. For 2024, we mainly look for steady-state EPS growth in these sectors.

For the traditional “Big Three” growth sectors, we are modeling 10% EPS growth in 2024 for Consumer Discretionary, down from 32% for 2023; mid-teens growth in Technology earnings, after a high-single-digit decline for all of 2023; and mid-teens growth in Communication Services, consistent with 2023 EPS growth.

Although comps will get easier for commodities-sensitive sectors such as Energy and Basic Materials, we are not looking for strong earnings recovery in 2024. China, the largest market for energy and all sorts of commodities, has struggled to get its economy going again after pandemic lockdowns and may now face demographic restraints on growth. Both sectors appear on track for mid- to high-single-digit EPS declines in 2024.

Healthcare earnings declined about 20% for all of 2023. But, unlike EPS for the commodity sectors, Healthcare earnings appear poised for a strong rebound in 2024. As the pandemic fades from collective memory, office visits with physicians are now approaching pre-pandemic levels. Some of the most significant developments in healthcare relate to therapies that improve the patient’s quality of life. Most notably these include the GLP-1 drugs that address very serious conditions such as diabetes and obesity. Argus looks for low-teens EPS growth for Healthcare in 2024, and we think that forecast may be conservative.

Our forecasts for S&P 500 earnings from continuing operations remain \$247 for 2024 and \$265 for 2025. In coming weeks, after the last earnings stragglers are counted, we will make any needed tweaks to our estimates. We do not anticipate any major changes in our overall EPS forecasts.

Conclusion

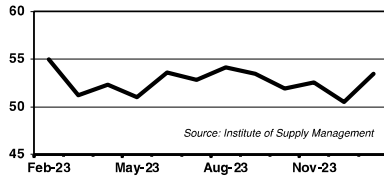
We have noted that stubborn inflation, slower consumer spending, and not-great industrial economy data all represent threats to the soft-landing scenario, or at least could cause a bumpier landing than anticipated. The presidential election is a few weeks away from becoming a two-horse race, and that could have unpredictable effects on consumer and investor sentiment.

We also reiterate expectations that GDP growth will remain positive, earnings growth will increase, and inflation will continue to come down in 2024. Should the Fed begin to cut interest rates after mid-year 2024 as we anticipate, that could be a further tailwind for the stock market this year. We remain confident in our year-end target of 5,200 for the S&P 500.

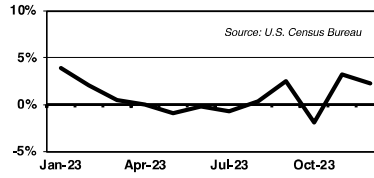
Jim Kelleher, CFA,
Director of Research

ECONOMIC TRADING CALENDAR

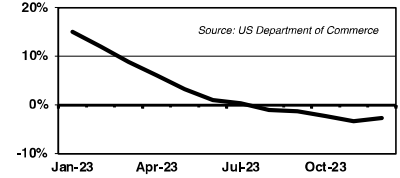
Release: **ISM Services Index**
 Date: 3/5/2024
 Month: February
 Previous Report: 53.4
 Argus Estimate: 53.0
 Street Estimate: 53.0



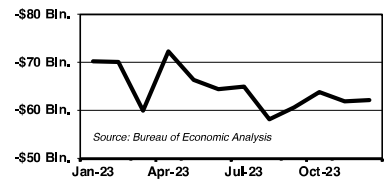
Release: **Factory Orders**
 Date: 3/5/2024
 Month: January
 Previous Report: 2.3%
 Argus Estimate: 0.7%
 Street Estimate: NA



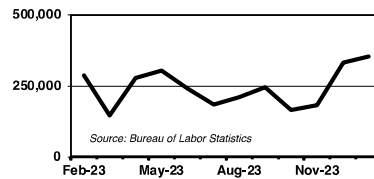
Release: **Wholesale Inventories**
 Date: 3/6/2024
 Month: January
 Previous Report: -2.7%
 Argus Estimate: -2.5%
 Street Estimate: NA



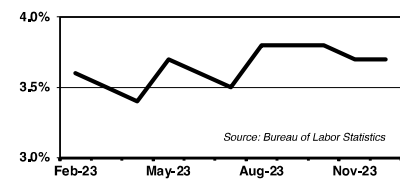
Release: **Trade Balance**
 Date: 3/7/2024
 Month: January
 Previous Report: -\$62.2 Bln.
 Argus Estimate: -\$62.0 Bln.
 Street Estimate: -\$61.5 Bln.



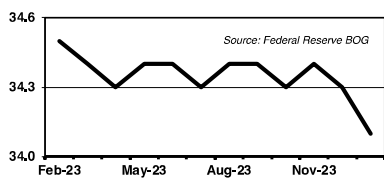
Release: **Nonfarm Payrolls**
 Date: 3/8/2024
 Month: February
 Previous Report: 353000
 Argus Estimate: 185000
 Street Estimate: 190000



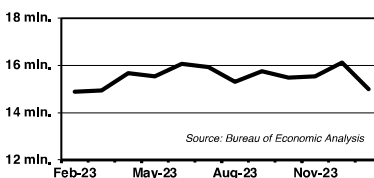
Release: **Unemployment Rate**
 Date: 3/8/2024
 Month: February
 Previous Report: 3.7%
 Argus Estimate: 3.7%
 Street Estimate: 3.7%



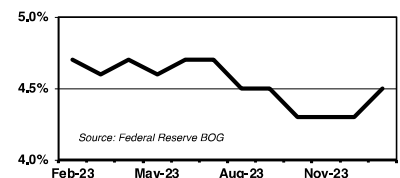
Release: **Average Weekly Hours**
 Date: 3/8/2024
 Month: February
 Previous Report: 34.1
 Argus Estimate: 34.3
 Street Estimate: 34.3



Release: **Total Vehicle Sales**
 Date: 3/8/2024
 Month: February
 Previous Report: 15.00 mln.
 Argus Estimate: 15.10 mln.
 Street Estimate: NA



Release: **Average Hourly Earnings**
 Date: 3/8/2024
 Month: February
 Previous Report: 4.5%
 Argus Estimate: 4.4%
 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
26-Feb	New Home Sales	January	651 K	670 K	NA	661 K
27-Feb	Durable Goods Orders	January	3.5%	1.5%	NA	-0.8%
	Consumer Confidence	February	110.9	114.0	NA	106.7
28-Feb	GDP Annualized QoQ	1Q	3.3%	3.3%	NA	NA
	GDP Price Index	1Q	1.5%	1.5%	NA	NA
29-Feb	PCE Deflator	January	2.6%	2.3%	NA	NA
	PCE Core Deflator	January	2.9%	2.8%	NA	NA
	Personal Income	January	4.7%	4.8%	NA	NA
	Personal Spending	January	5.9%	2.7%	NA	NA
1-Mar	ISM Manufacturing	February	49.1	50.0	NA	NA
	ISM New Orders	February	52.5	51.0	NA	NA
	Construction Spending	January	13.9%	9.0%	NA	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
12-Mar	Consumer Price Index	February	3.1%	NA	NA	NA
	CPI ex-Food & Energy	February	3.9%	NA	NA	NA
14-Mar	PPI Final Demand	February	0.9%	NA	NA	NA
	PPI ex-Food & Energy	February	2.0%	NA	NA	NA
	Retail Sales	February	0.6%	NA	NA	NA
	Retail Sales ex-autos	February	1.2%	NA	NA	NA
	Business Inventories	January	0.4%	NA	NA	NA
15-Mar	Industrial Production	February	0.0%	NA	NA	NA
	Capacity Utilization	February	78.5%	NA	NA	NA
	Import Price Index	February	-1.3%	NA	NA	NA
	U. of Michigan Sentiment	March	79.6	NA	NA	NA

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