

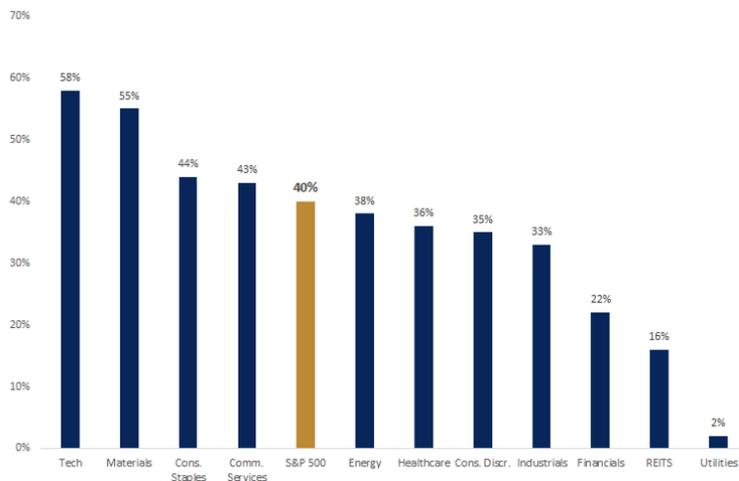
## Weekly Market Commentary October 31st, 2022

### Why Did Big Tech Take A Big Dump?

Investors were paying close attention to corporate earnings last week, as 164 of the S&P 500 companies, or almost 50% of the index market cap, reported results. While still only about halfway into the earnings season, several high-profile misses revealed cracks in the theme of earnings resilience that has prevailed so far this year. The spotlight was on mega-cap technology companies, which exert an outsized influence on the markets. Alphabet, Microsoft, Meta, Apple, and Amazon together account for 20% of the index, and, on average, their stocks declined 9% on the day of their earnings release. But the tone of the earnings updates was not one-sided. Several companies that rely broadly on consumer spending reported solid trends. Here are some key themes to watch in big tech:

1. Online advertising spending continues to slow, as companies are adjusting their marketing budgets in response to the economic uncertainty, and this is weighing on the results of tech and other communications companies. The strength of the U.S. dollar is also trimming earnings for U.S. companies that derive a meaningful portion of their revenue in foreign currencies. Among the 11 S&P 500 sectors, tech is the most affected by currency swings, deriving almost 60% of revenue from abroad.
2. The U.S. consumer is still spending, but less so on goods and more on services. Upbeat earnings from Visa and American Express underscore the resilience of consumer spending despite high inflation and rising interest rates. However, trends appear to vary by income level, with lower-income consumers tightening their discretionary spending. Consistent with the shift in consumer spending patterns, companies that are tied to the reopening of the economy (restaurants, airlines, etc.) are noticing strong demand, with more spending on travel and leisure and less on e-commerce.
3. Strong pricing power is helping support corporate profits. One example is Caterpillar, the industrial bellwether, which noted that it expects price hikes to more than offset rising costs. As supply chains continue to normalize and material and shipping costs fall, some of the headwinds to profits will gradually start to ease.

Percentage of foreign revenue by S&P 500 sector



Source: FactSet, the S&P 500 is an unmanaged index and cannot be invested in directly. Past performance is not a guarantee of future results.

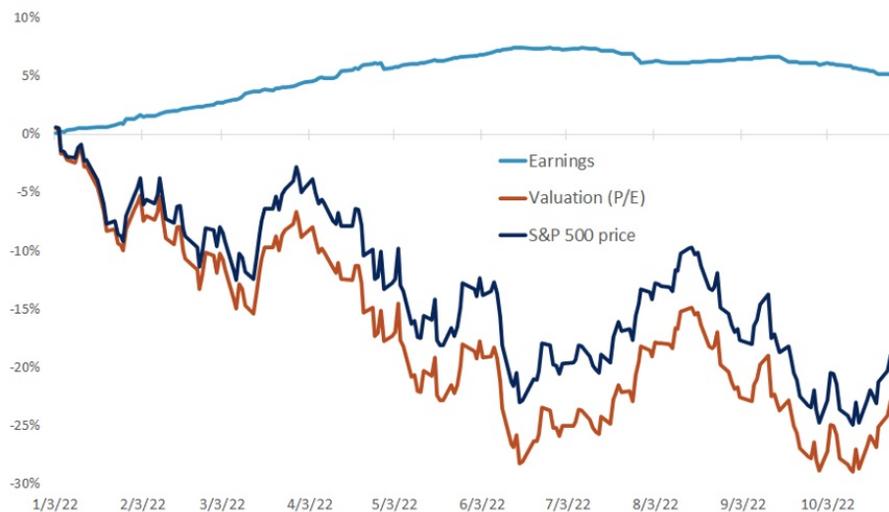
The graph shows the foreign revenue exposure for the different S&P 500 sectors. Technology derives almost 60% of its revenue from abroad.

### Estimates may likely fall more, but don't expect a deep earnings recession

Over the last couple of months, it can be argued that earnings estimates will likely be revised lower to reflect the more challenging macroeconomic backdrop, and that as this process happens it could be a catalyst for renewed market swings. The S&P 500's earnings growth forecasts for next year have recently declined to 6.7% from about 10% at the start of the year. In a scenario where the economy enters a mild recession next year, we would expect earnings growth to stagnate or even contract.

Yet, corporate earnings are likely to hold up better compared with the recent bear markets because revenues and profits are expressed in nominal terms, meaning that they are boosted by inflation as companies pass through the price increases to consumers. For example, even though economic growth after adjusting for inflation has stagnated this year, GDP is 6% higher when measured in terms of actual prevailing prices. To this point, the earnings declines during the inflationary periods of the 1970s and 1980s were smaller than the ones experienced in the last four recessions over the past 30 years. And the near 30% decline in equity valuations that has already occurred likely discounts some of the upcoming weakness in earnings and provides some cushion against another major leg lower in stocks.

**Decline in valuations likely discounts some of the upcoming weakness in earnings**  
Change in earnings, valuations and the S&P 500 since the start of the year



Source: FactSet, Edward Jones, the S&P 500 is an unmanaged index and cannot be invested in directly. Past performance is not a guarantee of future results.

The graph shows the change in earnings, valuations, and the S&P 500 since the start of the year. The almost 30% decline in valuations likely discounts some of the upcoming weakness in earnings.

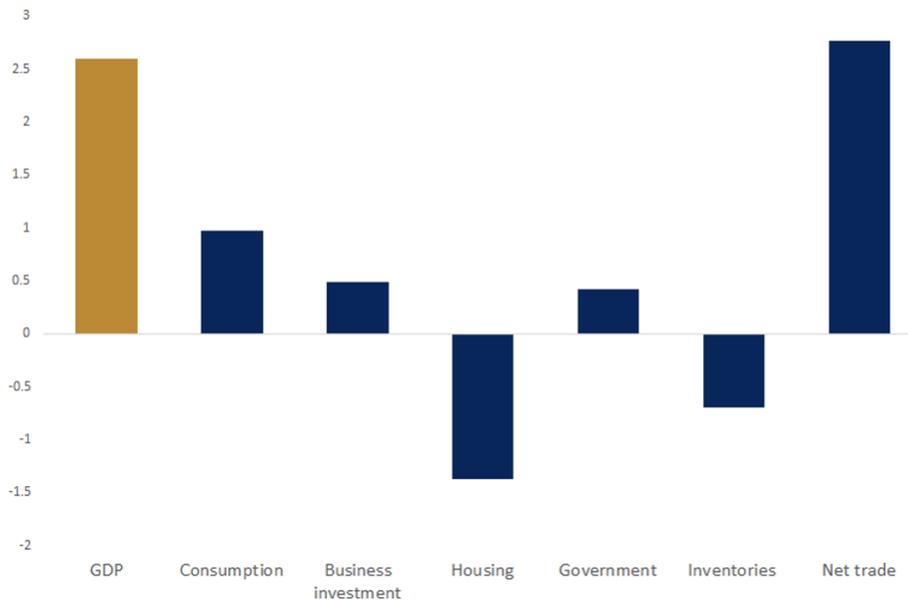
### Third-quarter GDP rebounds, though strength overstated

The initial estimate of third-quarter GDP showed that the economy rebounded nicely, erasing the decline in the first half of the year. On an annual basis, GDP rose 2.6%, slightly above expectations for a 2.4% increase. However, a look under the hood reveals a less rosy picture, as the rebound was mostly due to a boost from net trade, as imports fell, and exports surged. With the global economy weak and the U.S. dollar almost 20% higher from a year ago, the surge in exports will likely fade in the coming quarters. The upshot is that as the first-half GDP data overstated the weakness in the economy, the third-quarter data overstated the strength.

Consumption, the primary driver of the U.S. economy, was muted and slowed to 1.4% from 2% in the previous quarter, helped by a rise in services spending but partly offset by a decline in goods consumption. Residential investment (housing), which is interest-rate sensitive, declined sharply, as mortgage rates have more than doubled since the start of the year. The silver lining is that the cooling of the housing market in response to the soaring borrowing costs will help lower inflation next year.

### Economic activity rebounded last quarter - but strength will likely fade

Contributions to Q3 GDP growth



The graph shows the contributions to third-quarter U.S. GDP growth, with net trade boosting growth while residential investment declining sharply.

(Source: oXYGen & Jones)

### Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	31,083	4.9%
S&P 500 Index	3,753	4.7%
NASDAQ	10,860	5.2%
MSCI EAFE	1,698	1.7%
10-yr Treasury Yield	4.23%	.2%
Gold	\$1,657	.1%
Bonds	\$93.82	-.9%

### **Earnings Reports For The Week**

**Chevron:** Chevron on Friday reported its second-highest quarterly profit ever, driven by soaring global demand for its oil and gas and rising production from its U.S. oilfields. Chevron posted a third-quarter net profit of \$11.2 billion, or \$5.78 per share well ahead of Wall Street's \$4.86 estimate. Its oil and gas business posted an operating profit that surged 81% to \$9.3 billion, while its oil refining business nearly doubled to \$2.5 billion.

**Pinterest:** Pinterest beat on both revenue and earnings per share. The company bucked the trend in online advertising, which has taken a toll on rivals like Meta and Snap. Pinterest posted a loss of \$65 million.

**Amazon:** Amazon reported third-quarter results on Thursday that missed analysts' estimates. It also gave a disappointing sales forecast for the fourth quarter. The stock sunk in extended trading.

**Apple:** Apple reported fiscal fourth-quarter earnings on Thursday that beat Wall Street expectations on revenue and earnings per share. Apple came up short of revenue expectations in core product categories including the company's iPhone business and services.

**Shopify:** Shopify reported a narrower-than-expected loss and revenue that topped Wall Street estimates. Gross merchandise volume, or the total value of merchandise sold on the platform, rose 11% to \$46.2 billion in the third quarter. The company said the strong U.S. dollar weighed on Q3 revenue.

### **News and Notes:**

#### **What Is The Status Of Student Loan Forgiveness?**

##### **What's the latest on the student loan debt forgiveness program?**

- Many people thought their debt burden was lifted when President Biden announced the debt relief program, but now all their financial plans are in limbo.
- Right now, a federal appeals court officially halted President Biden's student debt forgiveness while it reviews a lawsuit filed by 6 Republican-leaning states.
- The plaintiffs argue debt forgiveness would lead to a loss in tax revenue causing economic harm to the states.

### Will this eventually go through or is it going to take a lawsuit?

- Remember, this was not a 'bill or law' that was passed by Congress, President Biden took executive action.
- 22 million have applied for relief and President Biden said checks will go out within two weeks. They must win the court case.
- The pause on student loans ends on December 31st, so people should plan for their full payments coming January 1.

### Let's shift gears, we are hitting the beginning of November, Thanksgiving is around the corner, and you say it may be hard to get a Turkey??

- Expect a 20% shortage in turkeys. The Avian Flu killed millions of birds since the beginning of 2022.
- In addition, farmers are feeling the effects of inflation and supply chain issues and turkey production will be the lowest in 10 years.
- Frozen turkeys are \$1.99 a pound and that's up 73% from 2021. Your best bet is to shop early and get a frozen turkey or freeze one.

### What about the price of Thanksgiving this year? Is that being hit by inflation?

- 100% - expect a 10% to 20% hike in Thanksgiving dinner.

From the team at J M Brown Financial Partners

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