

OCTOBER 2022

US Equity Perspectives

Tactical opportunity in defensive plays

FOMC¹ overall tone was hawkish

The Federal Reserve hiked rates by 75bps² in September 2022, with the market expecting another 75bps hike in November, followed by a 50bps hike in December, bringing the target range for federal funds rate to 4.25-4.5% at the end of this year.

The Fed's summary of economic projections (SEP) showed that the FOMC median estimate assumes federal funds rate moving as high as 4.6% this cycle and staying restrictive thereafter. The SEP also showed significant downward revisions to growth in 2022/23, and upward revisions to core PCE³ inflation and unemployment rate. While the magnitude of the September 2022 hike was well expected, markets were spooked by the increasing prospect of a stagflationary scenario while financial conditions remain tight.

In September 2022, US 10-year Treasury yield broke above its previous June 2022 high to touch 4%, while the dollar index continued to rally, reaching the highest level since May 2002. Meanwhile, S&P 500 has fallen marginally below its June 2022 low at point of writing.

What to expect from the upcoming earnings season?

As we head into the 3Q22 earnings season, early results announcements and pre-announcements from large-cap stocks across different industries have not been encouraging. Earnings risk seems to be shifting from cost/inflation pressure to lower demand, and higher inventories/destocking.

A key multinational courier delivery service provider (and bellwether for the US/global economy) reported very weak results, which raised some concerns on global macro activity. A major US automaker reported disappointing results due to supply chain issues, which impacted production. Semiconductor and consumer discretionary companies continued to struggle with weakening demand and rising inventory levels.

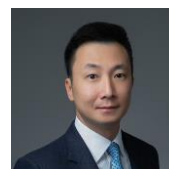
September 2022 PMIs⁴ confirms a sharp slowdown in Europe, with Germany hit the hardest. Our CIO⁵ view is that Europe will likely see a recession over Q3-Q4 2022, which will bring earnings risk to companies with large exposure to the region.

The strong USD will continue to be a significant headwind for companies, especially for companies with large international exposure (see Chart 1). Recent GBP volatility adds to this pressure.

As of end-September 2022, consensus is expecting 3Q22 earnings growth of 2.9% for S&P 500, down from 9.8% on 30 June 2022. This will mark the lowest earnings growth rate reported since 4Q20 (-5.7%). Looking ahead, analysts expect earnings growth of 4% for 4Q22, and in our opinion, a much too optimistic 8% growth for 2023.

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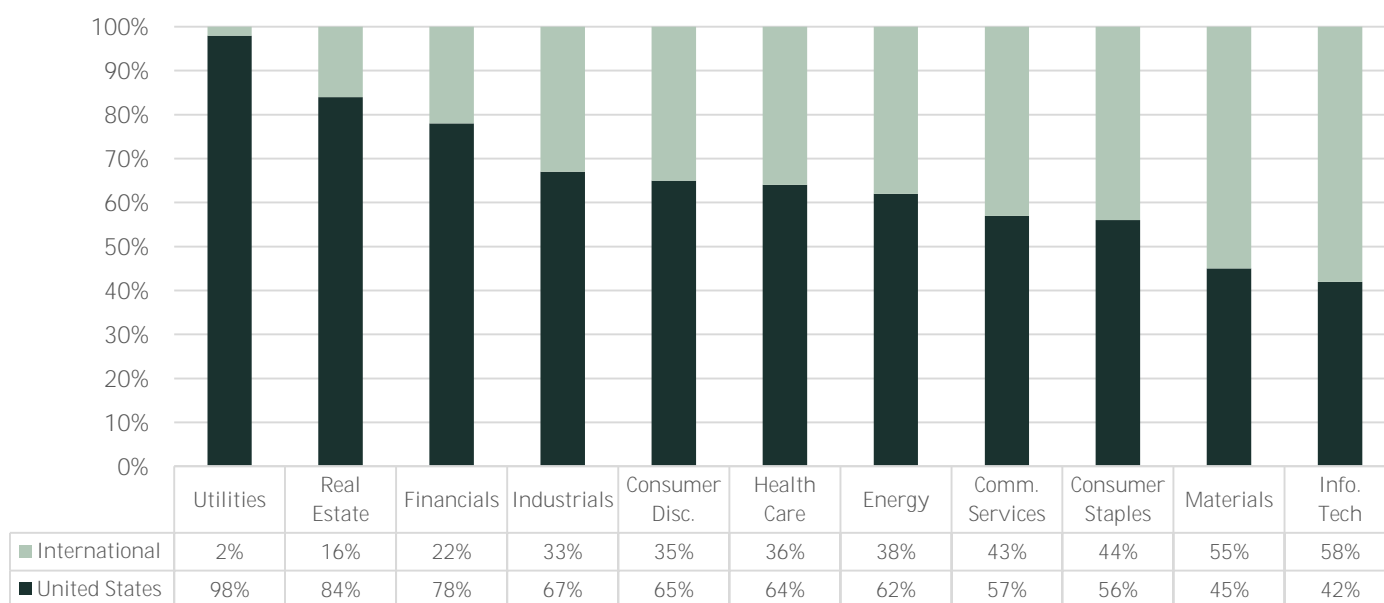
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CHART 1. S&P 500 SECTOR GEOGRAPHIC REVENUE EXPOSURE (%)



Source: Factset, 7 October 2022

Past performance is not indicative of current or future performance.

Recent US macro data mixed

In contrast to a more cautious bottom-up view, recent US macro data releases have been overall rather encouraging, though mixed.

The Conference Board consumer confidence gauge improved in September 2022, bouncing from record lows in July this year. New home sales, housing starts and existing home sales for August 2022 were all better than expected. Labor market data remains resilient.

However, ISM⁶ manufacturing PMI for September 2022 was below expectations at 50.9 (versus consensus 52.0 and prior 52.8), with ISM new orders and employment components falling below the key 50 mark. ISM services index fared better at 56.7 versus expected 56.0 for September 2022.

Where's the actionable opportunity?

While we think there could be a near-term rebound in the overall market given S&P 500 is oversold, approaching the significant support level at ~3600 and more reasonably valued at 16x P/E⁷, future market trajectory heavily hinges on what the 3Q22 earnings season bring upon us, as well as upcoming inflation datapoints.

Should inflation data be in line and earnings better than downplayed expectations for 3Q/4Q22, we could have a tradeable rally into year end, noting that November and December tend to be seasonally positive months for the equity market, especially in the mid-term year of the US presidential election cycle.

Technically speaking, we are looking at an S&P 500 index range of 3600–4200 (as highlighted in our September 2022 edition), with upside capped by headwinds from tightening financial conditions and slowing economic activity.

We prefer to play any potential rebound via defensive sectors (e.g. healthcare, staples, utilities, selected green infrastructure stocks), as they have been sold down indiscriminately together with the broad market. We think these sectors can continue to outperform the broader market in a slowdown given their resilient earnings characteristics, especially as inflationary pressures peak out.

6. ISM: Institute for Supply Management

7. P/E: Price-earnings ratio



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