GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

January 26, 2023

A cool and cloudy earnings season

Kelly Bogdanova – San Francisco

Amid economic uncertainties on many fronts, Q4 2022 U.S. corporate earnings are tracking lower thus far. We look at potential downside risks going forward, and what the market may already have priced in.

With uncertainty about the U.S. economy's fate hanging in the air, market participants are paying close attention to Q4 2022 earnings reports and the prospects for earnings and revenue growth in 2023.

The consensus forecast is for quarterly earnings to ebb moderately in Q4 2022 and hold steady in Q1 2023, with growth picking up thereafter, as the chart illustrates. If the U.S. economy does indeed succumb to recession, we think this forecast would be too optimistic.

The main question for investors is to what degree any additional earnings retrenchment has already been factored into the market.

Underwhelming, but could be worse

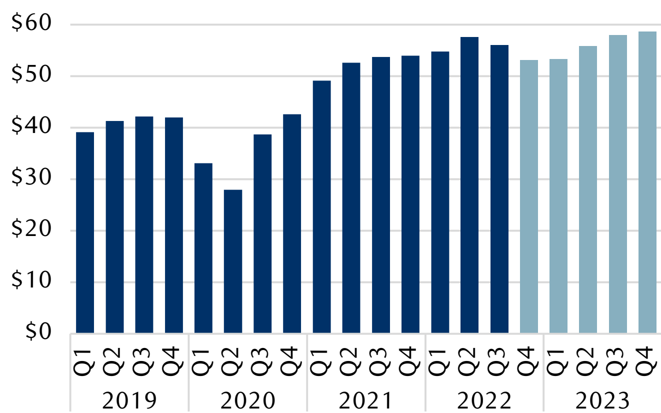
The U.S. Q4 earnings season is off to a decent start given the challenging economic conditions.

With 25 percent of companies having reported thus far, S&P 500 earnings are on pace to decline 2.7 percent year over year. That would represent the lowest growth rate since Q3 2020, the tail end of the most acute phase of the COVID-19 crisis.

The biggest driver of the decline in overall earnings is pressure on technology-oriented companies within various sectors (a.k.a. Tech+). Excluding this segment, Q4 results are much more favorable, with earnings growth pacing 4.7 percent year over year.

U.S. profits seem set to ebb over the near term

S&P 500 quarterly earnings per share: actual in dark blue, consensus estimates in light blue



Source - RBC Wealth Management, Refinitiv I/B/E/S; data as of 1/25/23

Relative to consensus expectations, the magnitude of earnings and revenue beats are uninspiring at 2.0 percent and 0.5 percent, respectively. But at least these rates are not negative, as they would likely be if results across a broad range of sectors were hitting a wall.

If the earnings beat rate holds steady for the remainder of the reporting season, our national research correspondent estimates the final tally for Q4 S&P 500 earnings growth would be only slightly negative

For perspectives on the week from our regional analysts, please see pages 3–4.

For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

at -0.7 percent year over year instead of the current -2.7 percent consensus estimate.

Additional Q4 takeaways:

- Growth stocks are exceeding value stocks in earnings and revenue growth, and the growth category has stronger earnings beats.
- Domestically focused companies are delivering higher earnings growth than more globally oriented firms.
- Profit margins are weak overall, pacing around -8.9 percent year over year—not surprising, given that margins peaked at record levels previously and the economy is soft. Weak margins could usher in another round of corporate cost cutting.
- Margin retrenchment is not just a Tech+ story; it is also impacting Materials, Financials, Health Care, and Consumer Staples.
- Some companies are still facing challenges with supply chain disruptions and/or labor shortages, but the proportion is lower than in previous quarters.
- More companies have announced layoffs, mostly in the Tech+ group.
- Some of the largest companies in the Consumer Staples and Industrials sectors are signaling they still have pricing power; they continue to benefit from inflation.
- Banks have generally reported strong loan growth as well as higher net interest income growth and larger net interest margins. But firms with capital markets businesses have seen weakness in that area.

Shifting weather patterns

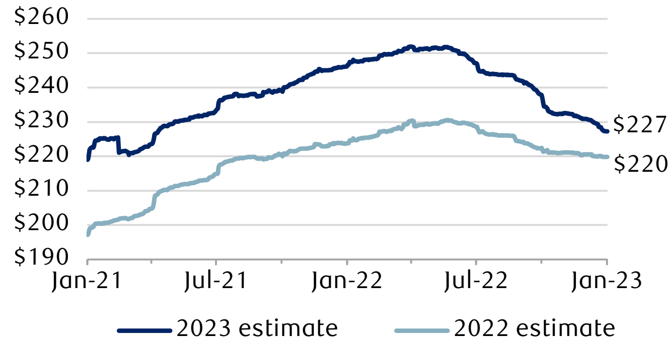
The stock market is almost always more interested in the future than the past, especially where earnings are concerned.

During the Q4 reporting season, management teams generally have been constructive about future quarters. But some have qualified that stance by noting that economic uncertainties make forecasting difficult, and a small proportion have been downright gloomy about the macro situation.

Amid the Fed's aggressive tightening campaign and related expectations of economic weakness, the S&P 500 full-year 2023 consensus estimate has declined notably from about $252 per share last spring and early summer to $227 currently, as the chart at the right shows. The market has already factored this in; it's one of the main reasons the S&P 500 retreated markedly in 2022.

We think many institutional investors (managers of mutual funds, pension funds, and hedge funds) are assuming 2023 earnings could be moderately lower than industry analysts' $227 per share consensus forecast. For example, some institutional investors are factoring in roughly $210 per share for 2023, according to RBC Capital Markets' U.S. Equity Strategy team. We believe the market is already prepared for the $227 per share estimate to tick down five percent or so in the coming weeks and months.

The path of S&P 500 annual consensus earnings-per-share estimates through time in U.S. dollars



Source - RBC Wealth Management, FactSet; daily data through 1/25/23

S&P 500 and sector consensus earnings and revenue growth estimates for 2023

Sector	Earnings	Revenue
S&P 500	**3.2%**	**8.4%**
Communication Services	6.5%	9.7%
Consumer Discretionary	25.5%	11.8%
Consumer Staples	5.7%	10.1%
Energy	-15.5%	-4.0%
Financials	12.1%	12.2%
Health Care	-3.9%	9.2%
Industrials	11.2%	9.4%
Information Technology	3.2%	9.7%
Materials	-12.0%	2.8%
Real Estate	-1.0%	11.7%
Utilities	7.4%	6.7%

Source - RBC Wealth Management, Refinitiv I/B/E/S; data as of 1/25/23

Despite the vulnerabilities we see in 2023 estimates, the earnings outlook seems "less bad" than in previous periods of economic stress. Even if a recession materializes and prompts deeper cuts to the S&P 500 consensus forecast that take it below the $210 level, household spending and employment should be relatively more resilient than in recent economic contractions. Also, S&P 500 earnings have tended to hold up better during inflationary periods of economic stress than during non-inflationary periods. This is because pricing power associated with inflation helps some industries at least partially offset demand weakness.

Importantly, RBC Capital Markets, LLC Head of U.S. Equity Strategy Lori Calvasina points out that the S&P 500 has historically bottomed three to six months before the earnings clouds lifted. The low point in the market has usually come well before the proportion of companies raising their estimates exceeded the proportion of companies lowering them.

Bottom line: There is further downside risk to the S&P 500's 2023 estimate, which could bring forth more volatility and/or downside for the index. But we think a lot of bad news has already been absorbed by the market.

UNITED STATES

Ben Graham, CFA – Minneapolis

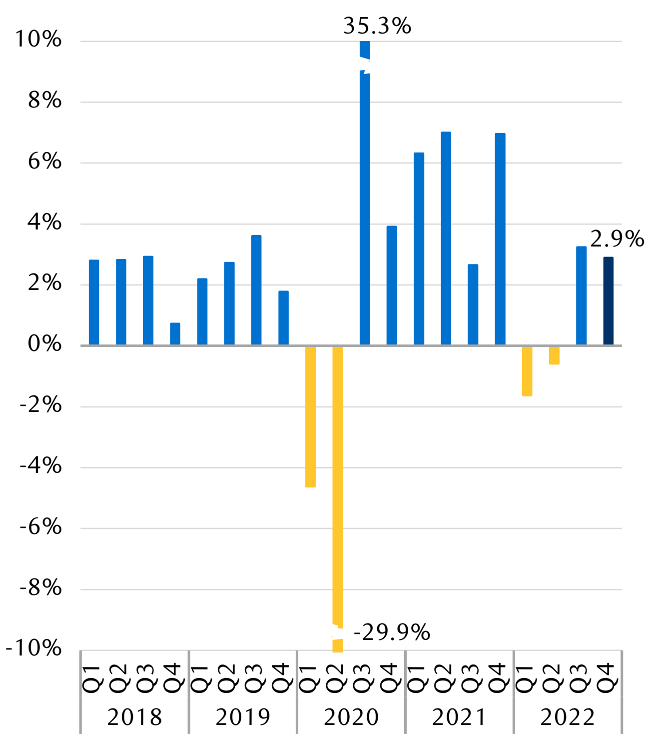
- **U.S. equities are on track for gains this week as earnings season progresses through its busiest two-week stretch**. As of this morning's trading, the S&P 500 had gained 1.4% with the growth-heavy Nasdaq up even more with its 2.2% climb. The Dow Jones Industrial Average is up slightly more than 1% this week and the small-cap Russell 2000 is in a similar position. Sector leadership has been evident in Consumer Discretionary (+3.1% thus far this week) and Information Technology (+2.4%). Sector underperformance can be seen in Utilities and Health Care, which are the only sectors lower on the week.

- **U.S. economic output, as measured by GDP, expanded in Q4 2022**. The economy grew at an annualized rate of 2.9%, after inflation. This was ahead of consensus expectations despite Q4 growth marking a step down from Q3's growth rate of 3.2%. Importantly, **Q4 growth was reasonably close to normal** at a time in which inflation remains elevated and the Fed is nearing the conclusion of an aggressive rate hiking cycle.

- **Despite layoff headlines** moving beyond Silicon Valley and Wall Street and into harder asset industries such as Industrials and Chemicals companies, **weekly initial jobless claims continued to trend lower**. Initial claims of 186,000 were well below consensus expectations of 205,000 and the result continues to push the 4-week moving average lower. The stability in employment should enable the Fed to stay focused on the inflation outlook at next week's policy meeting. The Fed maintains its dual mandate of managing inflation and employment, and with employment proving to be healthy, as measured by initial claims filings and the country's unemployment rate, **our view is that the central bank will raise the fed funds rate by another 25 basis points next week**.

U.S. GDP expands at 2.9% in Q4 2022

Annualized growth rate (q/q)



Source - RBC Wealth Management, FactSet; data through Q4 2022

CANADA

Sean Killin & Richard Tan, CFA – Toronto

- **The Bank of Canada (BoC) increased its benchmark overnight interest rate by 25 basis points (bps) at this week's policy meeting, bringing the overnight rate to 4.5%**. Overnight index swaps, which act as a proxy for financial market expectations of future interest rates, have interpreted this week's policy action as the last of the cycle, with nearly 50 bps of cuts priced into markets in H2 2023. In recent months, inflationary pressures have been fading in Canada, particularly within goods categories. On the flip side, services inflation, which tends to be stickier, remains elevated. **BoC Governor Tiff Macklem's press conference leaned towards a more dovish posture**, where he noted that nominal economic growth and labour market conditions remained resilient despite some moderation. That being said, there is growing evidence that tighter monetary policy has been slowing the economy, as household consumption and housing market activity have weakened meaningfully.

- The rising rate environment has humbled most asset classes and markets, including Canadian housing. In early 2022, national home prices were up 30% on a year-over-year basis driven in part by ultralow interest rates and hybrid working conditions, which bolstered housing demand. Fast forward to December 2022, and efforts to curb inflation via aggressive monetary policy led to a 7.5% year-over-year decline in average home prices (or approximately 13% below the February 2022 highs). From RBC Economics' perspective, **housing affordability continues to be a key headwind for buyers and, therefore, home prices will likely remain soft until the spring season at the earliest**. However, RBC Economics also acknowledges that home resales have gradually stabilized across most parts of the country and, in turn, signals that we could be close to a cyclical bottom. Overall, we believe the recovery in home prices will be more gradual in nature given the elevated interest rates, but limited supply growth and rising immigration levels may provide downside support.

EUROPE

Frédérique Carrier – London

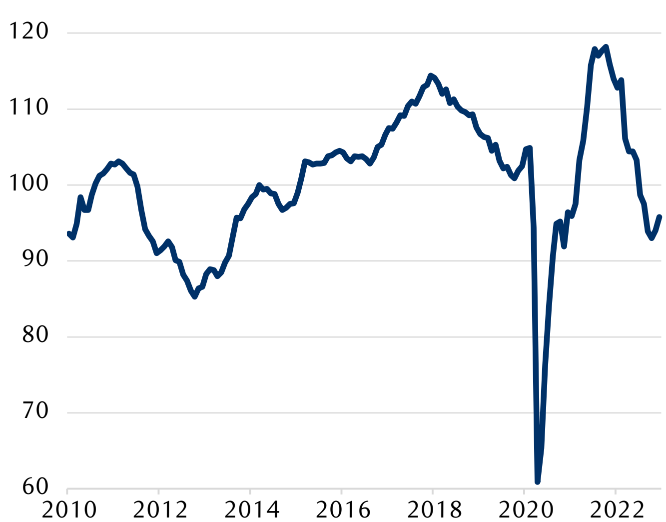
- **Preliminary activity indicators for January suggest the probability of a winter recession in Europe is diminishing**. To be fair, the region was fortunate. Unseasonably warm weather meant gas storage was not reduced much. The sharp fall in wholesale natural gas prices—now below their level of a year ago—led consumer and business sentiment to improve for a third month in a row, though they remain at relatively subdued levels. Nevertheless, the S&P flash eurozone Composite Purchasing Managers' Index (PMI) reached 50.2 in January, up from December's 49.3 and the highest level since June 2022. Consensus 2023 GDP expectations improved marginally, to flat growth compared to the prior 0.1% contraction estimate.

- **The regional economy's resilience likely reinforces the case for a 50 basis point (bps) interest rate increase at the European Central Bank's Feb. 2 meeting**, despite signs of easing price pressures. We think the focus will then turn to whether the central bank leans toward another 50 bps hike or a 25 bps increase at its March 16 meeting. We expect rates to peak at 3.25% this year from the current 2% level.

- **By contrast, the UK Composite PMI declined to 47.8 in January from 49.0 in December**. The country's economy, more exposed to higher interest rates due to the greater importance of the housing market, is also suffering from fiscal policy becoming more austere and the continued fallout from Brexit.

Sentiment improves in the EU

European Commission Economic Sentiment Indicator



Source - RBC Wealth Management, Bloomberg; data through 12/31/22

- **The UK government may well decide to give in to increased calls to extend the energy price freeze beyond April**, a move that would be less costly to the Treasury now that wholesale gas prices have retreated. Energy bills are set to increase by at least 20% when the price freeze expires. Such government action could take some sting out of the cost-of-living crisis and improve consumer sentiment.

- **Weaker growth and the large exposure of the UK economy to the housing market mean the Bank of England may be reluctant to aggressively raise rates at this time**. The consensus peak rate of 4.4% might not be reached. Consequently, higher inflation is likely to linger for longer.

ASIA PACIFIC

Nicholas Gwee, CFA – Singapore

- **Asia Pacific equity markets traded broadly higher during the week, led by Japan**. Most exchanges have a shortened week or are shut entirely for the Lunar New Year holidays. Japanese equities have fully recovered from the Bank of Japan's (BoJ) surprise shift in its yield curve control policy late last year. We believe the market is pricing in a low probability of further tightening moves by the BoJ, at least until the end of Governor Haruhiko Kuroda's term in April.

- **Encouraged by China's Lunar New Year holiday travel and cinema box office data, the Hong Kong stock market rallied** on Thursday as trading resumed after the holiday break with the Hang Seng Index on track to close at its highest level in over 10 months, as investors believe a recovery is gaining traction in the Greater China region. China's Ministry of Transport expects more than two billion people to travel over the 40-day holiday season, almost twice the total for 2022, though still just over 70% of the 2019 figure. Separately, Bloomberg reported that China's holiday box office data has exceeded pre-pandemic levels. Along with the prospects of more pro-growth policies, investor confidence is being boosted.

- **Nidec Corp.** (6594 JP), a leading Japanese manufacturer and distributor of electric motors and the largest manufacturer of the tiny spindle motors that power hard disk drives, **cut its full-year operating profit forecast by nearly half** as it faces pressure from weakening demand for technology goods and a slower-than-expected recovery of the global auto industry. Nidec envisages an impact from rapid inventory adjustments for IT products, and it also expects to report restructuring expenses related to legacy costs for the European automotive business. Notwithstanding these, **Nidec kicked off a campaign to improve profitability, with the goal of achieving a V-shaped recovery in FY2023**, when it celebrates the 50th anniversary of its founding.

MARKET
Scorecard

Data as of January 25, 2023

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,016.22	4.6%	4.6%	-7.8%	4.2%
Dow Industrials (DJIA)	33,743.84	1.8%	1.8%	-1.6%	9.0%
Nasdaq	11,313.36	8.1%	8.1%	-16.4%	-17.0%
Russell 2000	1,890.32	7.3%	7.3%	-5.7%	-12.6%
S&P/TSX Comp	20,599.60	6.3%	6.3%	0.0%	15.0%
FTSE All-Share	4,241.85	4.1%	4.1%	2.5%	13.1%
STOXX Europe 600	452.07	6.4%	6.4%	-1.6%	11.6%
EURO STOXX 50	4,148.11	9.3%	9.3%	1.7%	16.7%
Hang Seng	22,044.65	11.4%	11.4%	-9.1%	-26.9%
Shanghai Comp	3,264.81	5.7%	5.7%	-4.9%	-9.9%
Nikkei 225	27,395.01	5.0%	5.0%	1.0%	-5.0%
India Sensex	60,205.06	-1.0%	-1.0%	4.1%	24.5%
Singapore Straits Times	3,352.77	3.1%	3.1%	3.2%	12.7%
Brazil Ibovespa	114,270.07	4.1%	4.1%	3.7%	-2.6%
Mexican Bolsa IPC	54,871.36	13.2%	13.2%	7.4%	21.6%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	3.445%	-43.0	-43.0	167.6	241.6
Canada 10-Yr	2.800%	-50.0	-50.0	99.5	198.8
UK 10-Yr	3.243%	-42.9	-42.9	207.9	298.1
Germany 10-Yr	2.158%	-41.3	-41.3	223.8	270.8
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	4.28%	3.1%	3.1%	-8.5%	-11.2%
U.S. Investment-Grade Corp	4.97%	3.9%	3.9%	-9.8%	-12.6%
U.S. High-Yield Corp	8.15%	3.7%	3.7%	-6.1%	-3.5%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,945.92	6.7%	6.7%	5.3%	4.8%
Silver (spot $/oz)	23.91	-0.2%	-0.2%	0.4%	-5.7%
Copper ($/metric ton)	9,291.01	11.1%	11.1%	-5.5%	16.6%
Oil (WTI spot/bbl)	79.85	-0.5%	-0.5%	-7.7%	51.4%
Oil (Brent spot/bbl)	86.40	0.6%	0.6%	-2.0%	54.6%
Natural Gas ($/mmBtu)	3.01	-32.7%	-32.7%	-25.7%	15.8%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	101.6300	-1.8%	-1.8%	5.9%	12.4%
CAD/USD	0.7469	1.2%	1.2%	-5.6%	-4.8%
USD/CAD	1.3388	-1.2%	-1.2%	6.0%	5.1%
EUR/USD	1.0917	2.0%	2.0%	-3.4%	-10.1%
GBP/USD	1.2401	2.6%	2.6%	-8.1%	-9.3%
AUD/USD	0.7106	4.3%	4.3%	-0.6%	-7.9%
USD/JPY	129.5900	-1.2%	-1.2%	13.8%	24.9%
EUR/JPY	141.4700	0.8%	0.8%	9.9%	12.3%
EUR/GBP	0.8803	-0.6%	-0.6%	5.2%	-0.8%
EUR/CHF	1.0019	1.2%	1.2%	-3.5%	-7.1%
USD/SGD	1.3130	-2.0%	-2.0%	-2.3%	-1.1%
USD/CNY	6.7845	-1.7%	-1.7%	7.2%	4.7%
USD/MXN	18.7940	-3.6%	-3.6%	-8.8%	-6.5%
USD/BRL	5.0767	-3.9%	-3.9%	-6.7%	-7.6%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.74 means 1 Canadian dollar will buy 0.74 U.S. dollar. CAD/USD 1.2% return means the Canadian dollar rose 1.2% vs. the U.S. dollar year to date. USD/JPY 129.59 means 1 U.S. dollar will buy 129.59 yen. USD/JPY -1.2% return means the U.S. dollar fell 1.2% vs. the yen year to date.

Source - Bloomberg; data as of 1/25/23

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As of December 31, 2022

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Rating	Count	Percent	Count	Percent
Buy [Outperform]	839	56.05	225	26.82
Hold [Sector Perform]	603	40.28	151	25.04
Sell [Underperform]	55	3.67	3	5.45

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