Capital Markets Strategy

Essential inCights for the C-Suite

Chart of the Day

Consensus is building around the notion that **2023 corporate earnings expectations are too high, having been slow to adjust to the formidable headwinds underway**. Downward revisions appear certain; the question remains by how much?

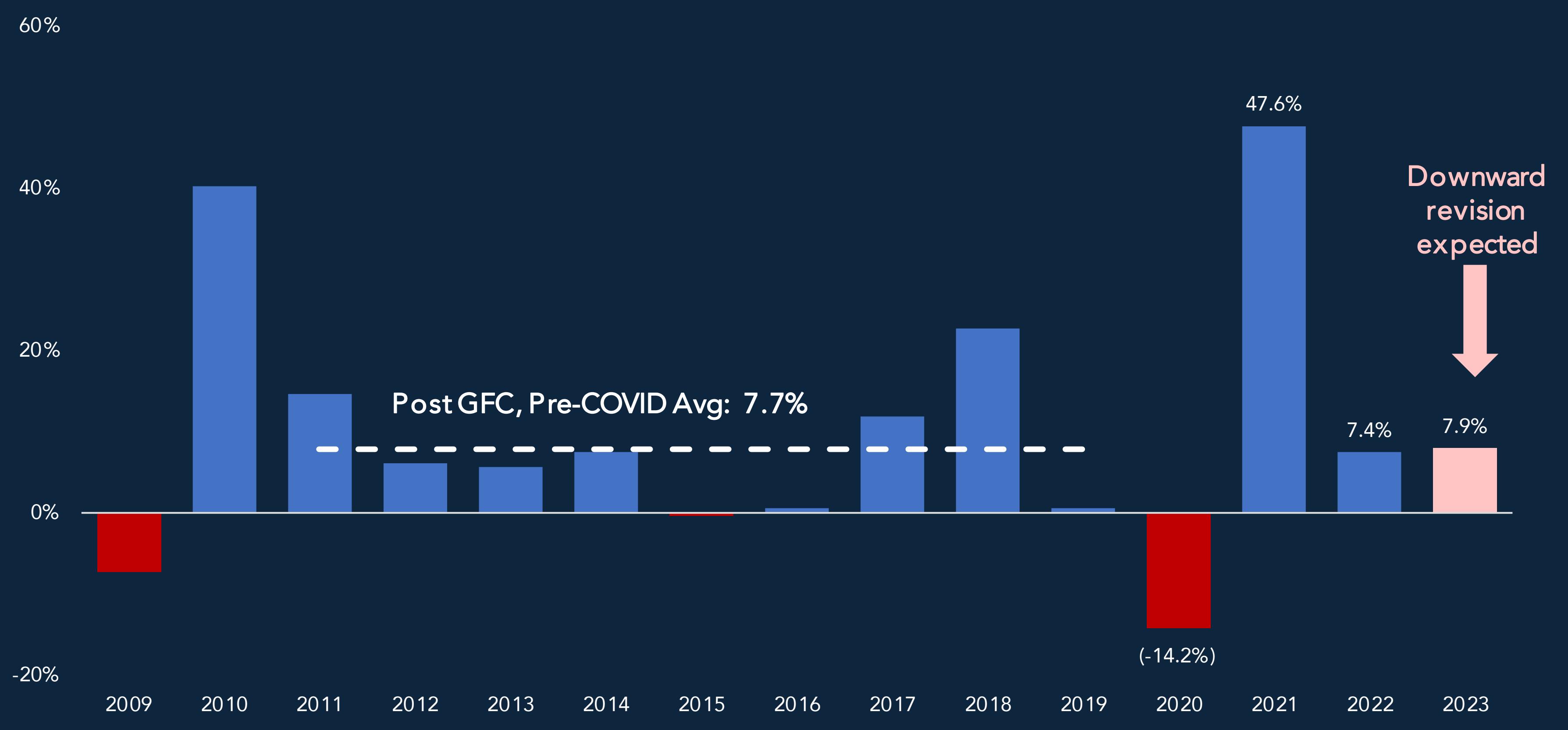
In the months ahead, we believe S&P 500 2023 corporate earnings will face several downward revisions due to: (1) declining nominal GDP growth; **(2)** rising funding costs; **(3)** higher labor and input costs; and **(4)** the impact of US dollar strength.

Taking these one at a time. **First,** corporate earnings are closely correlated with nominal GDP growth, which in turn is decelerating into 2023 as both growth and inflation are slowing. **Secondly,** as Fed tightening progresses and US recession comes closer into view, the contagion in global markets has increasingly spread to previously resilient USD IG credit markets. We expect this to continue.

Third, labor costs and services sector inflation are likely to be “stickier” than anticipated and remain a challenge for corporations even as goods and interest rate sensitive inflation decline next year. **Lastly,** given that nearly 50% of S&P 500 earnings originate overseas, it is generally true that **every 1% rise in the US dollar equates to a 1/2 point decline in S&P 500 earnings growth**. Therefore, with the US dollar up 20% over the last 12 months, dollar strength should shave approximately 10% off corporate earnings growth in the year ahead.

While equities have taken their cue from bond markets for much of 2022, downward corporate earnings revisions may pose the greater challenge for stocks in the months ahead.

S&P 500 annual earnings growth, y/y



Source: 2021 – 2023 earnings data is FactSet Earnings Insight (September 30, 2022). Yardeni Research, “YRI S&P 500 Earnings Forecast” (December 2021).

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“Macro stability isn’t everything, but without it, you have nothing.”