Economic Update

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This weekly update provides a snapshot of changes in the economy and markets and their implications for investors.

Growth

4Q21 Real GDP showed the economy expanded at a revised 6.9% annual rate in 4Q21, a reacceleration from the 3Q21 slowdown. This brings the 2021 GDP growth rate to a 37-year high of 5.6%. Strength was led by strong consumer spending, nonresidential fixed investment, export growth and strong inventory investment particularly among motor vehicle dealers. These components were partially offset by lower government spending and higher imports, which detracted from GDP. Despite expectations for a slowdown, flash PMIs showed business activity rising to an eight-month high in March. Companies hired workers at the sharpest pace since April 2021 while supply disruptions eased and demand rebounded from Omicron.

Jobs

March nonfarm payrolls rose by a robust 431K with upward revisions of 95K to the prior two months. The unemployment rate dropped to 3.6% from 3.8%, while the labor force participation rate ticked up to 62.4% from 62.3%. Wages grew by 0.4% and upward revisions to February showed the year-over-year gain in wages hit a recovery high of 5.6%. The labor force also grew by 418,000 with women returning to the job market in greater numbers. For investors, signs of a very tight labor market likely mean an even more hawkish Fed and higher interest rates in the months ahead, but they also should inspire some confidence in the economy's ability to absorb those hikes without a recession.

Profits

The 4Q21 earnings season was solid, with 501 companies reporting (99.8% of market cap). 75% of companies have beaten on earnings expectations and 69% have beaten on revenue expectations. Our current estimate for 4Q21 earnings is $56.67, which represents y/y EPS growth of 48% and q/q growth of 8.9% despite Omicron, higher inflation, disrupted supply chains and a slightly stronger dollar weighing on profits. We expect robust economic growth and a surge in energy prices to continue to provide support for earnings.

Inflation

Inflation has far exceeded the FOMC's 2% target, with the headline PCE price index rising +0.6% m/m and +6.1% y/y in January. The core PCE deflator also rose to +0.5% m/m and +5.2% y/y. The February CPI report showed that even before Russia's invasion of Ukraine, consumer prices were rising at their fastest pace in 40 years as gas prices spiked and food and rent prices continued to accelerate. Headline CPI rose 0.8% m/m and 7.9% y/y, while Core CPI rose 0.5% m/m and 6.4% y/y. The Russian invasion will likely pressure gas prices higher and cause further strain to supply chains, postponing the peak on inflation to later this year.

Rates

A rapidly improving labor market and persistent inflationary pressures have pushed the Fed to begin tightening. At its March meeting, the FOMC announced a 0.25% increase in the federal funds target range to 0.25%-0.50% and signaled further increases as it struggles to tame inflation. The Fed delivered hawkish forward guidance by way of its updated summary of economic projections and median "dot" plot. Real GDP was downgraded materially from 4.0% to 2.8% y/y in 4Q22 while PCE inflation was revised markedly higher to 4.3% y/y. Notably, the median FOMC member now expects 7 rate hikes in 2022, a slightly hawkish surprise relative to expectations.

Risks

- Heightened geopolitical tensions with Russia could result in severe energy shortages, worse consumer confidence and dampened growth.
- Inflation could spike further and remain elevated for longer if energy shortages worsen.
- The removal of policy support and stretched valuations could provide a challenging backdrop for equities.

Investment Themes

- U.S. equity investors may use earnings as a guide in a rising rate environment.
- Fixed income investors may want to underweight duration and explore alternative sources of income.
- Long-term growth prospects, a falling dollar and cyclicality support international equities.

Denotes updated information

Data are as of April 11, 2022

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