The Weekly Market Update – 1/30/23: 4Q22 GDP Growth Not as Strong as it Appears

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,070.56	2.47%	6.02%	6.02%	-14.59%	4,796.56	17.8%
Dow Jones Industrial Average	33,978.08	1.81%	2.51%	2.51%	-6.50%	36,799.65	8.3%
NASDAQ Composite	11,621.71	4.32%	11.04%	11.04%	-25.72%	16,057.44	38.2%
Russell 2000	1,911.46	2.36%	8.53%	8.53%	-14.87%	2,442.74	27.8%
MSCI EAFE (USD)	2,109.29	1.39%	8.51%	8.51%	-9.71%	2,398.71	13.7%
MSCI Emerging Markets (USD)	1,051.19	1.44%	9.91%	9.91%	-14.68%	1,444.93	37.5%
Bloomberg Commodity Index	111.61	-0.46%	-1.06%	-1.06%	12.55%	237.95	113.2%
Barclays U.S. Aggregate Bond	91.45	0.04%	2.89%	2.89%	-12.68%	112.07	22.6%

Source: FactSet

On the surface, the U.S. economy posted solid growth in the fourth quarter of 2022 (4Q22), but key underlying trends weakened. U.S. real gross domestic product, or GDP, (the value of inflation-adjusted goods and services produced) as reported by the Bureau of Economic Analysis (BEA) increased 2.9% in 4Q22. This exceeded the 2.3% FactSet consensus (from Wall Street economists) and was a modest deceleration from 3Q22 GDP of 3.2%. The major categories of GDP include consumer spending, business investment, housing investment, and government expenditures. Final numbers are then adjusted for inventories and net trade (exports add to GDP, while imports subtract). In 4Q, consumer spending grew at 2.1% (seasonally adjusted annual rate from the prior quarter), which was slightly below 2.3% in 3Q22. Spending on goods increased, the first quarterly increase in 2022, but was mostly attributed to a surge in motor vehicles and parts. Spending on services increased at a healthy pace, but at the lowest growth rate since 1Q22. We believe that consumer spending, while still positive, eroded through the fourth quarter, creating lost momentum entering 2023. Business investment was considerably weaker in 4Q22, growing just 0.7% after a 6.2% increase in 3Q22, and housing investment dropped 26.7%, its fourth consecutive quarterly annualized decline. Also in 4Q22, government spending grew 3.7%, contributing positively to GDP. But the 2.9% growth in real GDP was helped by a 1.46% contribution (50% of the GDP gain) from inventory as companies replenished stock following two quarters of inventory subtracting from GDP. Once companies bring inventories inline, production levels should level out to match demand. In addition, net trade contributed 0.46% to 4Q22 GDP as imports declined from 3Q, an indication of weaker demand. Looking at consumer spending, business investment and housing investment (three major components of the private economy), 4Q22 growth was just 0.2%. This compares to 0.9% in 3Q22 and was the lowest quarterly growth for those three combined segments since 2Q20 (during the COVID shutdown). This suggests that the U.S. economy was slowing entering the new year and we continue to see the potential for a mild recession to take hold in 2023.

We expect the U.S. Federal Reserve Bank (Fed) to implement a 0.25% increase to its overnight bank lending fed funds interest rate target this week. The Fed will conclude its first 2023 Federal Open Market Committee meeting (FOMC) on 2/1/23 to address its dual mandate to support maximum employment and stable prices. With the labor market at full-employment (unemployment rate of 3.5% in December), the Fed has prioritized fighting inflation by raising interest rates to slow economic growth. With recent reports pointing to slowing economic growth (including 4Q22 GDP), the Fed, in our view, is moving closer to pausing further hikes. A 0.25% increase would take the fed funds target to 4.50% to 4.75%, with perhaps one more 0.25% increase still to come. Despite the near-pause, we expect the Fed's commentary to remain relatively hawkish, as we believe that they are concerned that some inflation pressures remain entrenched.

Earnings reports will occupy the bulk of market headlines this week, leading up to Friday's employment report. Through early Monday, 1/30/23, about 29% of the S&P 500 constituents had reported 4Q22 results. Earnings growth so far reflects a decline of 1%, but the full quarter FactSet consensus estimate remains down 5%. This week, 107 index companies are scheduled to report. Friday's January jobs report reflects an estimated nonfarm payrolls increase of 188 thousand, a modest deceleration from December.

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