The Weekly Market Update – 10/31/22: Exports Drive GDP Upside but Consumer Weakens

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	3,901.06	3.95%	8.80%	-18.15%	-9.44%	4,796.56	23.0%
Dow Jones Industrial Average	32,861.80	5.72%	14.40%	-9.57%	-2.90%	36,799.65	12.0%
NASDAQ Composite	11,102.45	2.24%	4.98%	-29.04%	-23.16%	16,057.44	44.6%
Russell 2000	1,846.92	6.01%	10.95%	-17.74%	-16.22%	2,442.74	32.3%
MSCI EAFE (USD)	1,748.92	4.12%	5.26%	-25.13%	-23.34%	2,398.71	37.2%
MSCI Emerging Markets (USD)	845.58	-2.25%	-3.45%	-31.37%	-32.52%	1,444.93	70.9%
Bloomberg Commodity Index	111.76	0.44%	0.24%	12.69%	10.92%	237.95	112.9%
Barclays U.S. Aggregate Bond	86.77	1.64%	-1.07%	-17.15%	-17.75%	112.07	29.2%

Source: FactSet

The U.S. economy returned to growth in the third quarter of 2022 (3Q22), but the underlying data revealed areas of weakness. The U.S. Bureau of Economic Analysis (BEA) reported that 3Q22 U.S. real gross domestic product, or GDP (the value of inflation-adjusted goods and services produced during the quarter), increased 2.6%. This exceeded the 2.3% FactSet consensus estimate (from Wall Street economists), and was a reversal from negative GDP growth the prior two quarters (1Q22 and 2Q22) of -1.6% and -0.6%, respectively. Growth in GDP was attributed to higher exports, consumer spending, business investment, and government expenditures, offset by declines in housing and an inventory adjustment. U.S. exports increased in 3Q22, while imports decreased (from the prior quarter) driving a large 2.8% contribution to the 2.6% GDP increase (excluding the trade adjustment, GDP was down 0.2%). In addition, U.S. housing investment dropped 26.4% annualized from 2Q22, removing 1.4% from GDP. Among core GDP contributors, consumer spending contributed 1.0% to GDP, which was below 1.4% in 2Q, indicating a slowing trend; business investment rebounded from a flat 2Q to add 0.5% to GDP in 3Q22; and government spending, mostly driven by a recovery from state and local entities (along with Federal defense spending), contributed 0.4% to 3Q22, the first positive contribution in four quarters. The total of consumer spending, business, and housing investment contributed just 0.1% to 3Q22 GDP, the lowest in nine quarters, and compared to larger gains in the first two quarters of this year, when overall GDP was negative. The difference was the strong exports market, representing goods and services produced in the U.S. and then purchased abroad. Exports of both goods and services increased in the quarter with particular strength (according to the BEA) attributed to petroleum exports and travel (airlines). Our takeaways from the report were that, while the relatively strong GDP print of 2.6% tapers some near-term recession discussion (Is the U.S. in a recession?), slowing consumer spending growth and outright decline in housing investment suggests weakness, and likely reflects some impact from restrictive (higher interest rates) Federal Reserve Bank (Fed) policy this year. Given that interest rate hikes take time to slow economic trends (higher rates increase the cost of capital, limiting investment and borrowing), and that the Fed is expected to continue hiking short-term rates at upcoming meetings, the U.S. economy faces numerous headwinds as we approach 2023.

We expect the Fed to increase its overnight fed funds interest rate target by 0.75% this week, taking the target range to 3.75% to 4.00%. The Fed concludes its seventh open market committee meeting of 2022 on 11/3/22 (Wednesday), and is widely expected to raise the overnight bank lending rate target by 0.75% for the fourth consecutive meeting. A target rate of 3.75% would be the highest since January 2008, as the Fed attempts to reduce inflation pressure by limiting economic growth. Although the fed funds rate target is an overnight rate (very short-term), we believe the U.S. 2-year Treasury yield is a barometer of where bond investors believe the fed funds target rate might go to over the near-term. As of 10/31/22, the U.S. 2-year Treasury yield was 4.48%, suggesting 1.50% of additional Federal Reserve rate hikes.

As investors await Federal Reserve policy action on Wednesday, the 3Q22 earnings reporting season remains highly active. Among S&P 500 constituents, 167 are scheduled to report quarterly financial results this week. Through early Monday, 10/31/22, 54% of companies had reported 3Q22 results with reported revenue growth of 11% (above plan) and earnings growth of 1% (below plan).

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