EARNINGS GOVERNMENT POLICY INVESTING INTEREST RATES MARKETS ECONOMY

Is Change Afoot?

November 14th, 2022

Making Sense of the Midterms

- The likely outcome of split control in Congress reduces the odds of shifts in legislative policy that meaningfully impact companies

Softer Inflation, Finally?

- October provided the first glimpses of slowing inflation, but one month alone does not constitute a durable trend

Earnings Picture Still Softening

- Earnings growth remains positive in 2022, but 2023 estimates are being revised downward as the new year comes into focus

GLENMEDE

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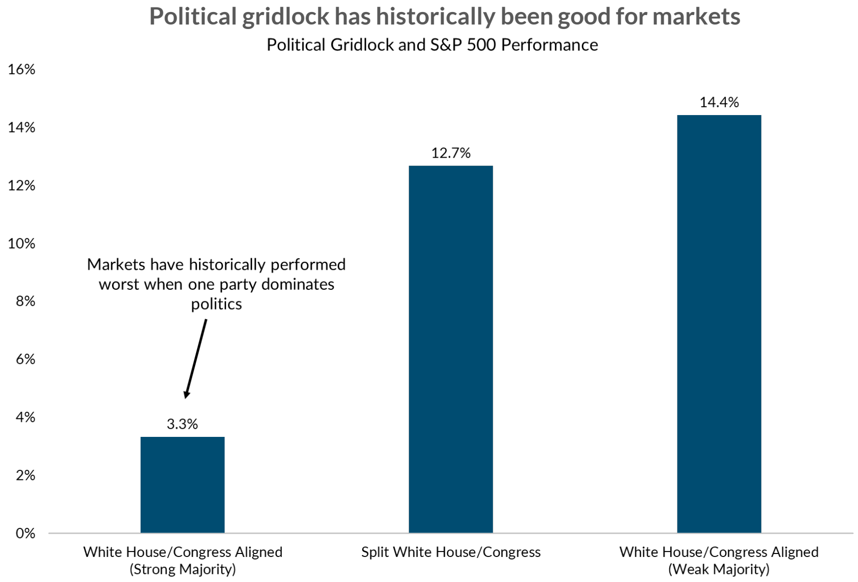
Making Sense of the Midterms

- **Results Are In (Sort of).** A little less than a week after votes have been cast in the midterm elections, it still appears too early to definitively call a majority for Congress. Republicans are favored to flip the House of Representatives, with PredictIt handicapping a 95% chance of such outcome, though with a thinner majority than previously expected. In the Senate, despite the outstanding runoff election in Georgia, it appears that Democrats have at least maintained their narrow majority.
- **Gridlock is Good.** Historically, equity markets have performed worst when one party dominates national politics. For example, the S&P 500 Index has posted 3.3% annualized total returns when the same party controls the White House and strong majorities of more than 60% in Congress. On the flip side, the index has returned 12.7% during periods of split party control of the executive and legislative branches. The reason for this may be the relative certainty that comes with the maintenance of the status quo for businesses.
- **Legislative Outlook.** If the ultimate result of the midterms is split control in the next Congress, that could incentivize the current administration to attempt to pass some legislation now during what would otherwise be a lame duck session. Some possibilities include an extension of research and development expensing for companies, as well as an expansion of the child tax credit. Beyond that, one of the first issues the new Congress may have to confront is the debt ceiling, which could prove challenging under divided control.

> *The likely outcome of split control in Congress reduces the odds of shifts in legislative policy that meaningfully impact companies*

Chart of the Week:



Source: Glenmede, FactSet Data through 11/13/2022

Data shown is the historical average annualized performance of the S&P 500 index on a total return basis during various states of party control in the White House and Congress since 1947. Strong Majority refers to years when the same party controls the White House and both chambers of Congress with majorities greater than 60%. Split White House/Congress refers to years when different parties control the White House, Senate and House of Representatives. Weak Majority refers to years when the same party controls the White House and both chambers of Congress without majorities greater than 60%. Past performance may not be indicative of future results. One cannot invest directly in an index.

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Softer Inflation, Finally?

- **Slowing Inflation?** October's Consumer Price Index (CPI) report provided some glimmers of hope of softening inflation, with the headline index up 0.4% in October and year-over-year inflation easing to 7.7% from 8.2% in September. Meanwhile, core CPI, which strips out the more volatile food and energy components, moderated to a 0.3% month-over-month pace. Importantly, a 0.3% monthly inflation pace equates to roughly 3.6% annualized, which would be a welcome slowdown from the previous pace if sustained.
- **Both Ups and Downs.** The disparity in price changes varied widely this month, a contrast to the more consistent and broad price gains in previous months. Housing, food and gas costs provided most of the increase, with housing inflation even accelerating from 0.7% to 0.8% in October. Meanwhile, used cars and trucks, medical care, apparel and airline fares fell. Of note, medical-care service prices declined 0.6%, helping soften the core inflation numbers.
- **Fed Up with Inflation.** Last week's inflation report is a welcome development and may prompt discussion of an eventual shift by the Fed. However, one month of encouraging data may still not provide a meaningful shift or durable trend, when its goal is to bring inflation back to 2%. After increasing rates swiftly throughout the year, the Fed has adopted a more data-dependent approach to rate hikes moving forward. As a result, this likely leaves the Fed on course to raise rates by only 50 basis points in December and wait for confirmation of this trend in further reports to determine its long-term path.

October provided the first glimpses of slowing inflation, but one month alone does not constitute a durable trend

Earnings Picture Still Softening

- **Third Quarter, Still Positive.** Earnings season is nearing its tail-end, providing some of the earlier glimpses of profit trends for the second half of 2022. The blended year-over-year earnings growth estimate for the S&P 500, which combines actual results with consensus estimates for firms that have yet to report, currently sits at 2.5%. That said, nearly 20% of companies in the consumer discretionary sector have yet to report, with retail activity expected to ramp up this week. These earnings results, alongside October's retail sales report set to come out this week, will be highly anticipated.
- **2022 Growth Drivers.** 2022 earnings growth expectations for the S&P 500 currently sit at 5.3%, a deceleration from its 9.2% estimate as of the end of last quarter. Continued upward revisions in energy alongside positive earnings surprises reported by companies in the health care sector, have been the largest contributions to that share of growth. Notably, 8 of the 11 sectors are expected to report year-over-year growth by the end of 2022, led by energy, real estate and industrials.
- **2023 Estimates Slipping.** The 2023 earnings per share estimate for the S&P 500 dipped lower last month as it now sits just below $233, down from its $250 estimate as of the beginning of Q2 earnings season. While earnings estimates for next year have moved lower in recent weeks, the pace of this decline is beginning to ramp up as companies begin to feel the pressure of an increasingly challenging macroeconomic environment. As such, forward guidance will be an important factor to observe in Q4 earnings season when companies begin to provide further insight to profit trends in 2023.

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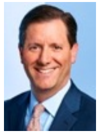

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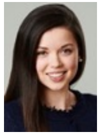

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