Week in review and ahead (vol.18)

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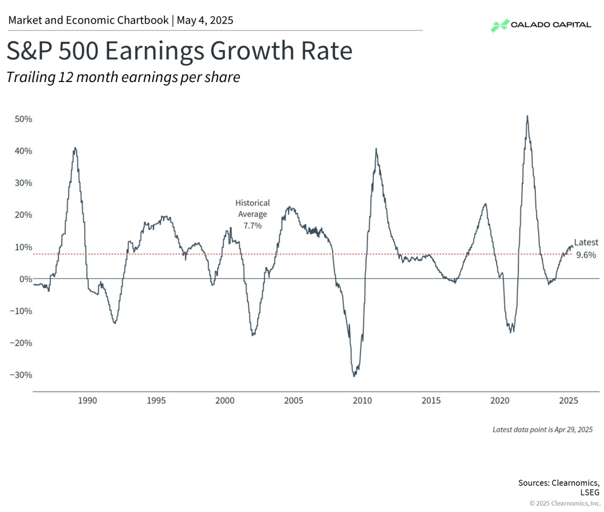
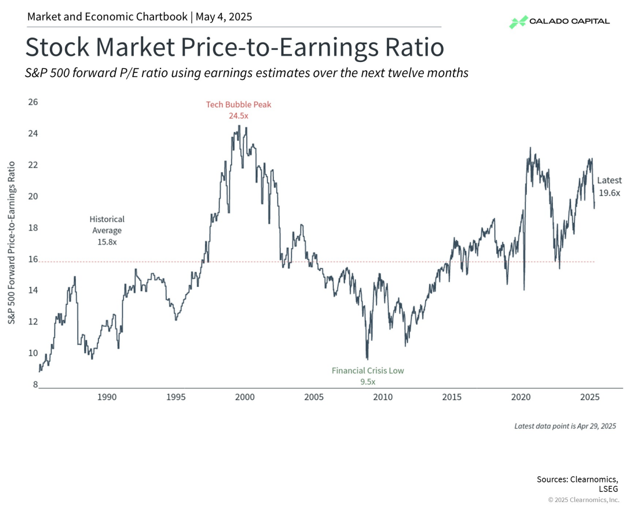
Equity markets in the US closed higher for the week after a slew of mixed macroeconomic data and generally better than anticipated corporate earnings scorecard. To date, about 72% of the Companies included in the S&P500 have reported quarterly results, out of which about 76% have reported better than expected earnings thus far. Given the elevated number of Companies (in the S&P500) reporting better than expected earnings last week, lifting overall market sentiment that has been risk-off for a while, earnings growth rate edged higher for the week, to 12.8% on a year-over-year (YoY) from a 10.1%-YoY level just last week.



Should earnings report continue to come in at these levels, this would mark the second consecutive quarter of double-digit growth in earnings YoY, and the seventh (7th) quarter of YoY earnings growth, and elevate or reflect a forward 12 month P/E ratio on the S&P500 of 20.2x (vs 19.6x previously).

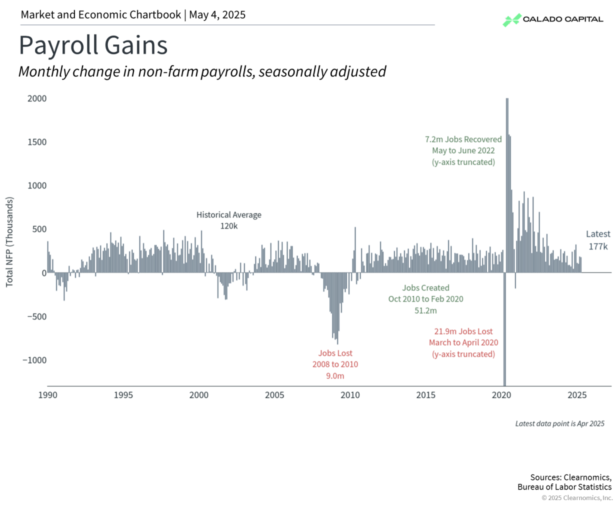
The S&P closed higher on Friday and for the week, setting a nine-day win streak for the first time since November 2024. For the week, the major index closed higher by nearly 3%, while the tech heavy Nasdaq and Dow Jones Industrial ended higher by 3.4% and 3%, respectively. Despite a disappointing first read of US GDP for the first quarter 2025, showing it contracted by 0.3% vs expectations of marginal growth of 0.4%, but surprisingly better job growth than feared in March created somewhat of a relief rally on Friday which helped both indexes, the S&P500 and Nasdaq, to edge above the April 2nd levels. The Dow Jones remains below, however, is now within 2.3% of the April 2nd close (when POTUS announced reciprocal tariffs on the world).

Internationally, all major indices closed higher for the week as well, with the exception of China following lower than expected Manufacturing PMI (with the NBS Manufacturing falling below 50 indicating contractionary levels). The German DAX once more lead all the major indices, closing higher by 3.8% followed by Japan 3.2%.



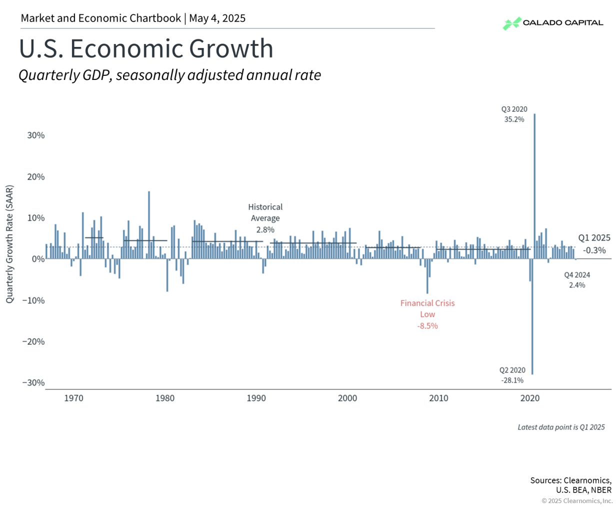
With better than expected earnings lifting sentiment, last week's macroeconomic data was mixed, however, better than expected job growth in March of 177K vs 133K expected, with the unemployment rate in the US remaining at 4.2%, did lift markets also towards the higher close on Friday (and above the April 2nd close). With 44K more non-farm payroll jobs than expected in March, the relief in the market was such that it entirely overshadowed a negative revision of nearly the same amount (of -43K) to February's job growth (from 228K reported to a revised 185K).

Fear of a deteriorating labor market in the US had been preceded by less favorable data points. Last Tuesday's Job Openings and Labor Turnover Survey (JOLTS) report disappointed showing that open jobs had dropped further, to just below 7.2M compared to 7.5M expected and 7.3M surveyed in February, the lowest level since September 2024. On Wednesday, ADP reported private payroll growth of 62K compared to 120K expected. For reference, the ADP report differs from the official Bureau of Labor Statistics (BLS) report that reported, in that BLS's scope expands to include jobs in government. Furthermore, while ADP relies on payroll records, which include both employed and non-employed individuals, the BLS relies on surveys and paid employment only. Finally, weekly initial jobless claims increased to 242K compared to 223K expected and 225K in the prior week. Similarly, continuing claims increase to 1.92M, the highest since November of 2021.



The advance estimate for 1st quarter of 2025 GDP did not surprise in its entirety, even though economic activity appears to have declined by -0.3% compared to the expected marginal increase of 0.4%, given the significant pull forward of imports to avoid tariffs (and which are deducted from consumption, investments and governmental spending), and negative governmental spending growth. US trade deficits have expanded on a monthly basis since November last year, and last week's report for March saw yet another record with a deficit of 162Bln, surpassing January 2025 for the largest deficit of -130.7Bln. It is somewhat expected that net imports will mark sharp declines from May on and in the months ahead as tariffs, particularly with China, began taking effect in March, and subsequently increased by reciprocal tariffs in April, and despite some exceptions that have been put in place. The consumption component (within GDP), however, did show strength at 1.8% growth compared to expectations, even though it was the lowest level of growth since Q2'23 and less than reported with the previous quarter’s GDP. Similarly, investments continued to show strength, growing nearly 4%, not enough, however, to counter imports' impact on real GDP deducting nearly 5%-points.

On the inflationary front, core PCE inflation index for March, the closely watch inflation gauge by the Federal Reserve, surprised with no month-over-month change (0.0%), and the YoY-change of 2.6% coming in better than the expected 2.8%, and well off the 3% reported for February.

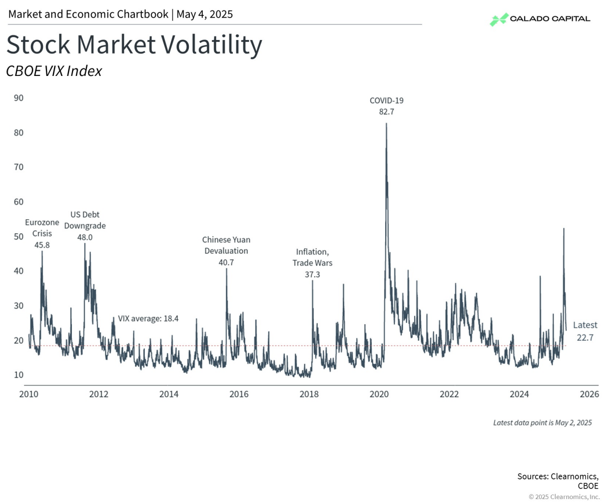


Corporate earnings will continue next week, with 92 S&P500 companies scheduled to report. While last week surprised with 76% of S&P companies reporting having better than expected earnings, guidance for Q2 and the CY'25 have seen downward revisions. Per Factset, other than communication services, which have increased guidance since the last quarter, and the utility sector seeing current guidance for FY'25 at about the same level than during the previous quarter, all other sectors are seeing outlook being cut with the energy sector seeing the largest downward revision for earnings in CY'25. Less changes to EPS have been reported to CY26 earnings growth thus far, when compared to the previous quarter, however, focus to CY'26 will be greater in the coming quarters.

On the macroeconomic front, S&P and ISM will begin with Monday's report on the service sector for

April, with expectations continuing to show expansionary activity with readings of 51.0 and 50.4%, respectively. Markets will turn their attention and await, however, to the FOMC meetings scheduled for Tuesday and Wednesday, with their announcement on rates scheduled for Wednesday at 2pm. While it is widely expected that the Fed will leave the Fed funds rate unchanged, despite pressures by POTUS and recently the Treasury Secretary, markets will look to the press conference to garner any indications of the Fed's stance on future cuts. Given the stronger than expected job growth in March, pressures on the Fed (in general) to cut the Fed fuds rate have eased somewhat, albeit negative growth in US economic activity will have some expect the Fed to act sooner rather than later. Many FOMC members are scheduled to speak on Friday, so markets will garner an understanding of those members' thoughts, beyond the Fed Chair Powell's press conference scheduled for Wednesday after the monetary policy announcement. Given the current strength of the labor market, the Fed likely takes advantage to assert inflationary risks (from tariffs and otherwise), particularly since the core PCE inflation index while better than expected, is still well above its target of 2%.

Besides the FOMC meeting, markets will be keying in on the initial jobless claims (as well as continued claims) on Thursday, to see if the recent spikes are indicative of a trend that the labor market indeed may be weakening. A continuation of the reports from last week should add to market volatility, as measured by CBOE's Volatility Index (VIX) that has been receding throughout last week as news on tariff negotiations and a better job growth report for April.



If you have questions about how this may impact your investments, or how you should be positioned, please do not hesitate to contact us at claudio@caladocapital.com.

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