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# What is the earnings season telling us about the US economy?

For now, there is a lot of opacity surrounding the outlook for the US economy. On one hand, leading indicators and sentiment trackers have been implying that a contraction is nigh. On the other hand, recent data on employment and consumption is exceedingly strong – albeit heavily influenced by seasonal adjustments and lingering side-effects of the pandemic. The mixed messages are fueling a strong disagreement between bond and equity markets. While the inverted US yield curve has been screaming out "recession", stocks have rallied on the prospects of a soft landing.

For further insights on how the economy is fairing amid one of the Fed's fastest tightening cycles on record, we can look to company earnings for clues.

With the majority of S&P 500 companies having reported their Q4 results, we can say the results are mixed, but not dramatically bad. While revenue growth and earnings are not falling off a cliff, they are surely softening, and margin compression is evident.

For the economy, an important question is where is the margin compression coming from?

Margin pressure might be stemming from higher interest expenses, but given how many companies locked in low rates, it's perhaps more likely that what we are seeing is operating margins shrink.

That is, wage and input costs are beginning to outpace sales. In order to defend their margins, we have already seen companies cutting staff. According to global outplacement firm Challenger, Gray and Christmas, 2023 saw the most jobs cut in the month of January since 2009. Other firms, reluctant to let staff go in the wake of the "Great Resignation", are avidly cutting hours.

Indeed, this might explain why analysts expect earnings growth to decline through the first half and pick up again later in the year. Companies are showing agility in adjusting to slower demand. The key question now is how much the very strong labour market will weaken and how that will affect consumption – especially as pent-up savings start to dwindle while inflation is still more than triple the Fed's 2% target.

Walmart, the world's largest retailer acknowledged that there is heightened uncertainty around these factors during its earnings call. The Chief Executive, Doug McMillon told analysts: "There's just a lot that we don't know… We could tilt into a recession. We don't know what happens to consumer spending. We don't know what happens to lay-offs [and] household income. And so given that we're so early into the year and there's a lot of unknowns right now, we're simply taking a cautious outlook."

While performance varies a lot from sector to sector, taking a bird's eye view of the Q4 earnings season, it does seem like US growth faces some speedbumps in the months to come, and that January's data might be the best it's going to get in the near term. It is very unlikely that the path

towards an inflation rate the Fed is comfortable with will be neither quick nor painless. The good news is that, for now, earnings expectations do not point to an economy falling into a deep abyss, rather a temporary setback.

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