Wentz Weekly

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Shortages… How Will The Fourth Quarter Be Impacted?

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Two weeks ago we previewed third quarter earnings season and highlighted earnings growth, company's guidance, along with concerns on inflation, supply chain issues, and the related shortages. As we had expected, so far this earnings season companies are mentioning shortages and supply chain issues more than ever. By the second week of October, 160 companies already cited shortages in their quarterly financial reports, a figure about double the amount from two years ago. In attempt to help alleviate the backlog in U.S. ports, the Biden Administration helped reach an agreement between the Port of Los Angeles and its union to operate 24/7, after union workers agreed to work extra shifts, essentially doubling its hours. While this is progress, keep in mind once the containers are off the ships the goods still need to be transported to manufacturers, warehouses, and distribution centers, meaning more rail and truck traffic is required when we are already dealing with labor shortages in those areas. When you hear freight costs are increasing, these are the reasons why.

Despite the known shortages and supply chain issues, stocks have continued to rise reaching new all-time highs last week. Over time, stocks are driven by company's profits and so far this earnings season companies are overcoming supply issues and higher costs and earning more than expected (helped by increasing costs to the consumer!). Analysts now see third quarter earnings growing 32% from a year ago, over double the growth expected when the year began, helping propel the markets higher. Even better, forward looking earnings (fourth quarter) are expected to grow 22.7%, up from the 17% growth rate expected on July 1 when the third quarter began. It is still early in the earnings season though, over half S&P 500 companies left to report quarterly results with almost one-third set to report this week.

During a virtual discussion last Friday, Fed Chair Jerome Powell said inflation is much more robust than expected, which is a small cause for concern but has the tools to deal with it if it becomes out of control. Powell said inflation has been higher and longer lasting than initially expected and if it moves up persistently the Fed would certainly act. Powell went on to say he thinks it is time to reduce the Fed's $120 billion per month in bond purchases as the economy has made progress towards the Fed's goals, but not yet time to raise interest rates noting the five million jobs that are still lost compared to pre-pandemic levels. While that is the case, Powell and the Fed see a growing tension between the Fed's mandates of stable prices and full employment and left the option open of potentially raising rates sooner to prevent inflation from spiraling out of control.

The latest monthly fund manager survey from Bank of America Corp showed fund managers are less optimistic on global growth and earnings expectations, representing the first time the outlook has turned this bearish since April 2020 when the pandemic began. Despite the more gloomy outlook, fund managers are overweight equities after cutting fixed income holdings to a record low. Equities moved to a 16% overweight position, the most since November last year. Bond exposure fell as 38% of respondents see inflation as permanent while 58% see inflation as transitory, a gap that has steadily narrowed. For the same reason, the survey shows allocation to commodities reach a 28% overweight.

In attempt to gather more support for the reconciliation bill, tax increases for individuals and corporations is looking less likely. Opposition from Senator Kirsten Sinema (Democrat from Arizona) has Democrats looking at alternatives and removing the corporate tax increase along with the tax increases on capital gains and the top income tax rate. Less tax revenue from those sources brings down the total spending level. Democrats have discussed cutting free tuition to community colleges, the clean electricity program, shortening the child tax credit extension and the paid family leave program, and other adjustments to Medicare. We believe the removal of the corporate tax increase from the package has helped drive markets to new highs, but the situation is still fluid, and negotiations are ongoing and a lot could still be changed before a final draft emerges.

Company News

- Snapchat parent company Snap Inc reported quarterly results last week that missed expectations. The stock was down over 25% after the company said revenue was impacted from Apple's new iPhone privacy settings, which affect its ability to measure ads effectiveness and target ads, along with lower ad revenue as a result of supply chain issues.
- Former President Trump launched a new media network called Trump Media & Technology Group which will include a social media platform called "TRUTH Social." The company went public last week via a SPAC merger with Digital World Acquisition.
- A report from The Verge last week says Facebook is making moves to rebrand and rename the company. The move to rebrand comes from the recent bad press from the internal document leak, regulatory pressures to breakup the company, and CEO Zuckerberg's desire to be a "metaverse company."

The Week Ahead

This week will be one of the busiest weeks of the quarter for earnings reports and will also include several economic data releases. Highlights on the economic calendar begin with the S&P Case Shiller Home Price Index which has been increasing at the highest pace on record, reflecting the tight housing market. Later in the morning the new home sales report is expected to show an annualized pace of 760,000 new home sales while an index of consumer confidence is expected to show a relatively unchanged level for October. Thursday morning includes the latest on weekly jobless claims and the first estimate of third quarter GDP. Estimates have come down through the quarter with economists now expecting a consensus 2.7% annualized growth rate in the quarter. Finally, the monthly figures on personal consumption and spending are released Friday morning. The earnings calendar this week has almost a third of the S&P 500 companies reporting including the big 5. Notable reports include Facebook and Kimberly-Clark on Monday, UPS, GE, AMD, Twitter, Microsoft, Alphabet, Hasbro, Visa, Robinhood, and AMC on Tuesday, eBay, Ford, GM, McDonald's, Coca-Cola, and Boeing on Wednesday, Amazon, Apple, Mastercard, Anheuser-Busch, Caterpillar, Merck, Comcast, and Starbucks on Thursday, and Exxon Mobil, Chevron, and AbbVie on Friday. In politics, the UN climate change summit will take place in Glasgow after the meeting between G20 nations takes place over the weekend.