To reach CIO's upside outcome of 5,300 by the end of 2024, we would need to see further positive signs on inflation, Fed policy, and growth, including from data and earnings releases this week. (UBS)

US profit growth better than forecast

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With each passing week of the US earnings season, the numbers keep getting better. We had originally expected 4–5% earnings growth in the fourth quarter (excluding nonrecurring charges for the banks, mostly related to replenishing the FDIC bailout fund).

With results now in from 80% of the S&P 500 market cap, growth is pacing to be greater than 7%.

And while some mega-cap growth companies are reporting exceptionally strong numbers, even the median company in the S&P 500 should produce growth of about 6%. In terms of breadth, 77% of companies are beating earnings per share estimates, and 65% are beating on revenues. Both are better than average.

This has been supporting a continued rally in US equities, with the S&P 500 hitting another all-time high on Friday to finish above 5,000 for the first time. The index has now gained ground in 14 of the last 15 weeks. We believe the rally has been well-supported by healthy economic fundamentals and profit growth. But we will be looking for further evidence of slowing US inflation and resilient growth before concluding markets should price in a "Goldilocks" scenario, rather than a soft landing.

Inflation data this week could help determine whether market confidence in the health of the US economy should mount further. There is no denying the recent strength of US growth data, from an above-expectations expansion of GDP and rising real disposable income to rapid employment growth. A "Goldilocks" economic outcome, however, will also require inflation to continue falling smoothly. Further guidance on whether this is happening will be delivered this week in the January CPI release. The consensus is for the annual rate of inflation to slow to 2.9%, the first reading below

3% since March 2021. The core rate, which excludes volatile food and energy prices, is expected to decline to 3.8%. By contrast, any interruption in the pace of improvement in inflation has the potential to disappoint investors.

Investors will be looking for signs that Federal Reserve officials will be open to a swift series of rate cuts this year. Our base case remains for 100 basis point of rate reductions from the US central bank over 2024, most likely starting in May. In a "Goldilocks" scenario, however, reassuring inflation data could allow the Fed to trim rates by 150 basis points, even frontloading reductions ahead of the US election in November to avoid any hint of political bias. Recent comments from the Fed have been cautious, in line with the median forecast from top officials for 75 basis points of easing this year. The minutes of the Fed's last meeting stressed they would need “greater confidence that inflation is moving sustainably toward 2%” before it would be appropriate to cut rates. Against this backdrop, investors will be scrutinizing comments from a wide range of Fed speakers this week for any shift in tone.

Continued strength on the consumer side of the economy will be crucial in reinforcing recent optimism. In addition to the inflation data, investors will also be looking to retail sales for January for assurance that American shoppers remain upbeat. The 0.8% monthly rise in December for the control measure—which feeds into the calculation of economic growth—topped expectations. The consensus view remains for a still solid 0.4% gain in January on this measure, based on a Reuters survey. The corporate earnings season will also provide guidance on this front. So far, a number of consumer staples companies are exceeding profit margin expectations as costs continue to improve. Auto manufacturers are alos expecting a solid year of demand. Again, further resilience in consumer-facing companies could highlight the potential that the US is headed for a “Goldilocks” outcome.

So, as the rally has continued, markets are pricing in plenty of good news. The MSCI US is trading on 19.8 times 12-month forward earnings, a 20%premium to the 15-year average. The S&P 500 is now trading close to the 5,000 level where we would expect it to end the year in the event of a soft landing. To reach our upside outcome of 5,300 by the end of 2024, we would need to see further positive signs on inflation, Fed policy, and growth, including from data and earnings releases this week.

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