DELTA
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Delta Insights
a weekly commentary on investing

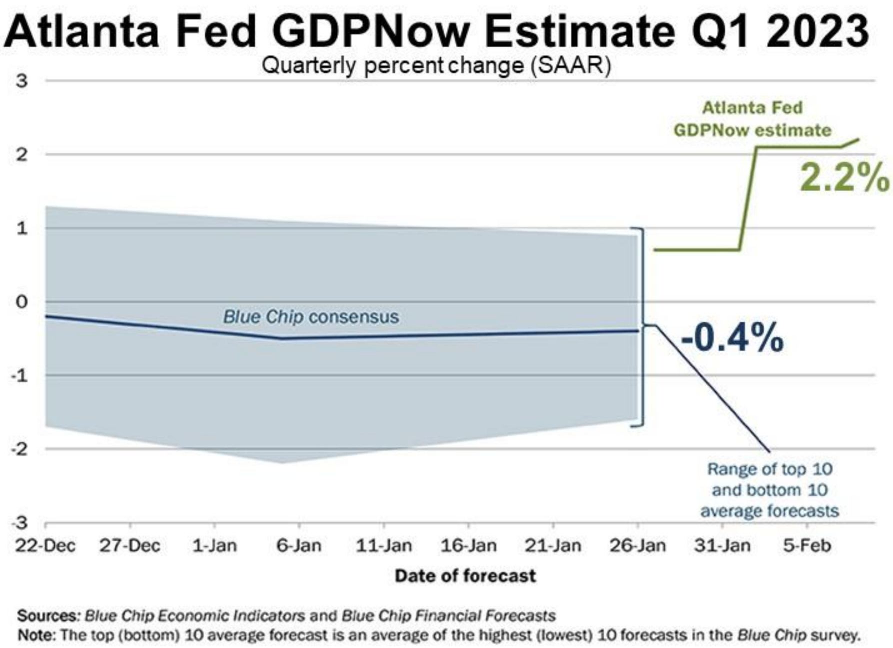
February 10, 2023

Looking at Upside

An investor might think that a contracting economy over a period of two successive quarters is a recession. To recede, the root verb of recession, is to pull back. Shrinking GDP output in real terms, by definition, is a receding economy. We learned in 2022 that in certain circumstances, when not all the data fits the official recession profile according to the National Bureau of Economic Research (NBER), two consecutive quarters of declining GDP (first and second quarter 2022) is not classified as a receding economy.

This raises a question; can we have a recession when GDP is expanding? What if GDP were to expand while the labor market and corporate earnings were to contract? Because the idea that there could be a recession with GDP expansion seems oxymoronic and has never happened before, we will assume we are not about to learn a new lesson about recessions in 2023 from the NBER. It also suggests the risk of recession near term has fallen materially.

Real GDP increased at an annual rate of 2.9% in the fourth quarter of 2022. For the first quarter of 2023, the Atlanta Fed GDPNow model shows an estimate of 2.2% annualized GDP growth, up from 0.7% on February 1. The consensus average forecast for GDP growth in the first quarter is roughly negative 0.4%. For the past two years, the Atlanta Fed has been much more accurate in forecasting GDP growth than consensus.

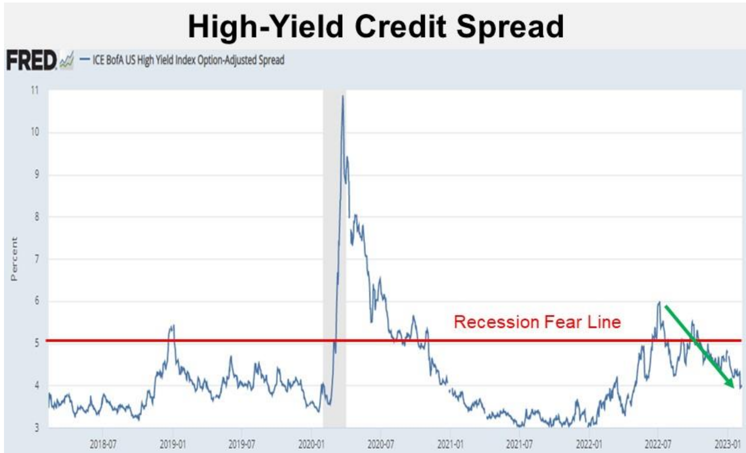


If the Atlanta Fed continues to be the more accurate estimate, first quarter 2023 earnings could surprise to the upside.

With the majority of S&P 500 companies having reported fourth quarter earnings, the FactSet consensus S&P earnings estimates for 2023 and 2024 are $225 and $250, respectively. Coming into 2023 when recession was considered the base case, the earnings outlook had a downward bias. In an expanding economy, upward earnings revision become more likely.

If we assume the 2024 S&P 500 earnings estimate of $250 (no change from current expected level) is what actually happens and we apply a P/E multiple of 17.2x (the 10-year average), it implies an S&P 500 index valuation of 4300, up by about 4.6% from current levels. If GDP continues to expand (no recession) and earnings are 10% better than expected in 2024, the implied S&P 500 index level at a 17.2x P/E would be roughly 4730 by this time next year, a 15% advance.

Not only is the Atlanta Fed forecasting expanding GDP – i.e., no recession and the possibility of earnings upside – so are the credit markets. The high-yield credit spread which measures the differential between the risk-free rate and the non-investment grade credit risk rate has shrunk from a high of 5.9% last year to 3.9% in early 2023. Below 5% suggests healthy credit and stock markets and no recession.



Many of the most heavily sold securities in the stock market from 2022 are showing the largest gains year-to-date in 2023. The ARK Innovation ETF (ARKK) is up 33% this year. Tesla (TSLA) is up nearly 100% from lows. This suggests that some of the stock market strength is coming from short covering. Buybacks have picked up substantially in the wake of earnings reports. It is possible that the positive stock market performance so far in 2023 is a technical rather than a fundamental trade. On the other hand, there is emerging evidence that the economic environment is expanding rather than receding.

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We have unique and sophisticated investment methods that seek to capture the stock market's gains while minimizing drawdowns in bear markets. If you would like to learn more about how we manage money, we invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com.

"Have you given any thought to what you're going to do with your life after the Super Bowl?"

Delta Stock Market Dashboard

MARKET SENTIMENT IS

BULLISH

THIS WEEK'S NUMBER IS

75.3

Our technical indicator decreased from 81.4 to 75.3 this week

INDICATOR STATISTICS

Consecutive Bullish Weeks:	13
Cycle Inception Date:	11/17/2022
Range:	61.6 – 81.4
Mean:	73.5
Bullish Weeks YTD:	6
Bearish Weeks YTD:	0
*S&P 500	5.5%
*DJIA	1.3%
*NASDAQ	8.6%

** Percentage change during current cycle*