ECONOMY

Not all is Negative

THINK STRATEGICALLY:

The Mirror of Economic Uncertainty, U.S. Bank Stocks

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Strong Headwinds in U.S. Economic Horizon

We continue to view the U.S. economy positively, at least for the next two quarters, with business and consumer income and spending at robust levels. However, with the combination of economic risks such as high inflation, increasing interest rates, the global supply dislocation and now the Russia-Ukraine war, the scenario for a rising U.S. economy has become quite challenging. For example, the U.S. Consumer Price Index is at 8.54 percent, a 41-year high, and the Producer Price Index rose to 11.18 percent. On the other hand, the U.S. Index of Consumer Sentiment rose to 65.7, up from 59.4 last month, rising 10.61 percent, while U.S. Retail and Food Services Sales is at 0.5 percent, compared with 0.79 percent last month, a significant drop.

We are closely watching two parameters: Auto sales and mortgage loan originations. U.S. Auto and Other Motor Vehicle Sales fell to $123.74 billion, down from $126.35 billion last month and $125.77 billion one year ago, as supply chain issues continue to dampen global auto production. In terms of mortgage loan originations, some banks are reporting reductions as significant as 37 percent due to rising interest rates.

However, not all is negative. We see that U.S. Personal Spending continues to rise, to $16.71 trillion, up from $16.68 trillion last month, higher than a year ago's $14.7 trillion, a 13.7 percent increase over last year.

Banks are the best representation of the broader economy, and their earnings results tell a compelling story. Allow us to review the results so that you may judge for yourself.

Reviewing The Top 5 U.S. Banks facing Economic and Geopolitical Headwinds

Bank stocks are often a mirror image of the U.S. economy, and with so much uncertainty, we review the first quarter (1Q) earnings of the institutions in the Birling Capital U.S. Bank index. They have a collective year-to-date (YTD) return of -10.8 percent as of April 14. These returns are worse than the Dow Jones Industrial Average's -5.19 percen, Birling Puerto Rico Stock Index's -6.53 percent, and the S&P 500's -7.84 percent, but better than the Nasdaq Composite's -14.66 percent.

Let's review the individual banks as of April 14, 2021:

1. Wells Fargo & Co (WFC): reported $17.6 billion in 1Q22 revenue, down 5 percent, and net income of $3.7 billion, down 21 percent. The stock is trading at $46.35 with a YTD return of -3.4 percent and a price target of $61.20.
2. Morgan Stanley (MS): reported $14.8 billion in 1Q22 revenue, down 5.84 percent, and net income of $3.71 billion, down 11 percent. The stock is trading at $84.76, with a YTD return of -13.65 percent and a price target of $107.58.
3. Citigroup (C): reported $19.18 billion, down 2 percent, and net income of $4.64 billion, down 46 percent. The stock is trading at $50.93, has yielded a YTD return of -15.55 percent, and has a price target of $66.72.
4. Goldman Sachs (GS): reported $12.93 billion, down 27 percent, and net income of $3.94 billion, down 42 percent. The stock is trading at $321.64, has a YTD return of -15.92 percent and a price target of $424.81.
5. JPMorgan Chase (JPM): reported $30.72 billion, down 5 percent, and net income of $8.3 billion, down 42 percent. The stock is trading at $125.12, has a YTD return of -20.35 percent, and a price target of $157.73.

The Week in Markets: Concerning Corporate Earnings

The earnings season began with a cautiously optimistic tone. In contrast, most earnings beat expectations. All banks were lower than in the first quarter of 2021, even with healthy loan growth and diminished losses. The banks are concerned with a global economic slowdown with rising rates, including the highest inflation in history and the Russia-Ukraine war.

Our analysis notes that most companies are setting a prudent tone for the upcoming quarters due to the aforementioned variables. The issue to consider is that the forecast for S&P 500 company earnings growth potential is near 9.5 percent for 2022, well below the 2021 results of 45 percent growth.

All these variables may negatively impact some portfolios. Our advice is to perform the necessary asset rotations to prepare for a new reality.

There is a growing list of global central banks raising rates to curb inflation, including the Bank of Canada, which rose by 50 basis points, and the Bank of Korea and New Zealand by 25 basis points, proving our assertion. The table is set for the Fed to raise rates by at least 50 basis points in May.

How should investors align their portfolios in this inflation-driven scenario with slowing GDP growth?

We have concluded that there shall be positive market performance; however, intense volatility and rising risks will be the name of the game.

We do not anticipate a recession in 2022, and while volatility may remain elevated, pullbacks may offer opportunities to diversify or rebalance portfolios.

– Equities headed lower: Following three years of solid growth and with the Dow delivering returns of 30.57 percent, the S&P 500 51.18 percent, the Nasdaq 67.39 percent, and the Birling Puerto Rico Stock Index 43.01 percent, the markets are due for transition, and our advice is to focus on value and defensive stocks to prepare.

– It is an excellent time to look into bonds again: With bond yields headed higher over the next two years, it is an opportune time to rebalance portfolios to add investment-grade bonds. There are fantastic opportunities in higher quality A or higher corporate bonds and government bonds that will substantially buffer rising stock volatility. The yields of these bonds are becoming more alluring.

The Final Word: BEACH Sector Opportunities

As we review our portfolio, we are looking for opportunities in Beach stocks—bookings, entertainment, airlines, cruises and hotels. YTD returns and price targets follow:

– Avis Budget (CAR): a YTD return of 27.99 percent with a price target of $214.67.
– Marriott International (MAR): a YTD return of 9.24 percent with a price target of $174.81.
– Delta Airlines (DAL): a YTD return of 8.39 percent with a price target of $50.98.
– Royal Caribbean (RCL): a YTD return of 7.39 percent with a price target of $89.71.
– American Airlines (AAL): a YTD return of 5.79 percent with a price target of $17.59.
– InterContinental Hotels (IHG): a YTD return of 5.05 percent with a price target of $72.
– United Airlines (UAL): a YTD return of 3.08 percent with a price target of $54.10.
– Hyatt Hotels (H): a YTD return of 1.15 percent with a price target of $101.56.
– Hilton Worldwide (HLT): a YTD return of -0.26 percent with a price target of $152.90.
– Carnival Corp. (CCL): a YTD return of -2.78 percent with a price target of $23.71.
– Wyndham Hotels (WH): a YTD return of -3.31 percent with a price target of $97.20.
– JetBlue Airways (JBLU): a YTD return of -10.25 percent with a price target of $17.40.

The Beach sector is full of potential and upside if you make the correct selections. Recipients are cautioned to seek appropriate professional counsel regarding any of the matters discussed.

Weekly Market Close Comparison	4/14/22	4/8/22	Return	YTD
Dow Jones Industrial Average	34,451.23	34,721.12	-0.78%	-5.19%
Standard & Poor's 500	4,392.50	4,484.28	-2.05%	-7.84%
Nasdaq Composite	13,351.08	13,711.00	-2.63%	-14.66%
Birling Puerto Rico Stock Index	2,691.00	2,663.90	1.02%	-6.53%
U.S. Treasury 10-Year Note	2.70%	2.72%	-0.74%	0.85%
U.S. Treasury 2-Year Note	2.37%	2.53%	-6.32%	0.95%

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