Economic and Market Insights

October 26, 2015

By Scott Colbert, CFA
Chief Economist, Director of Fixed Income
The Commerce Trust Company

Search upcoming earnings reports for the 'canary in the coal mine'

Look for third-quarter company earnings reports to trickle out over the next few weeks, jostling jumpy markets and making the Federal Reserve's (Fed's) decision on how far out to push a possible interest rate hike just that much harder to predict. So far, initial earnings have been lackluster.

However, markets had gained a respite over the last few weeks from the downward pull of the earlier correction as it became clear the Fed got cold feet about raising rates – once again.

Many observers cautioned against raising interest rates while the U.S. economy seems to be holding inflation at bay and the slowdown of the Chinese economy was contributing to a worldwide pullback in growth. Others, however, want to see at least one rate hike to validate the Fed's mandate and credibility as a long-term inflation fighter.

But how long can a zero-percent interest rate policy last this time, and will third-quarter earnings reports be a potential set of tea leaves to help the Fed move along? A strong earnings season may take away any excuses not to raise interest rates – and, conversely, a weak one will muddy the waters.

Our key takeaways for the investor community:

- Focus on how this earnings season unfolds to gage the underlying strength of the U.S economy. If more companies are hitting or exceeding their earnings estimates, chances are the Fed will be more inclined to raise rates sooner. If companies fall short of their estimates, the Fed's mandate to raise is weakened.
- Also, look for *sales* forecasts in quarterly earnings reports or news releases. If projections are down, growth could stall -- further reason not to raise rates just yet. It's hard to raise rates in an economy treading water.

- If the broad themes of the financial news networks focus on the impact of slower global economic growth due to lower oil and gas prices, a stronger U.S. dollar, and continued low inflation, then the Fed will be hard-pressed to hike rates.
- Watch energy prices in general as the "canary in the coal mine" -- relatively tame or weak gas prices likely point toward lower interest rates remaining longer than most had expected.