



MORNING BRIEFING

June 5, 2019

Are Analysts Unperturbed or Uninformed?

See the [collection](#) of the individual charts linked below.

(1) Are industry analysts too busy to watch the news? (2) Waiting for guidance. (3) Q2 earnings season is coming. (4) Consensus revenues forecasts remain upbeat in the US and abroad. (5) Q1 revenues and earnings growth rates hit cyclical lows? (6) Falling share count added 2.3ppts to Q1 per-share revenues and earnings growth. (7) Blaming the weather, the dollar, and trade tensions. (8) Macro indicators for revenues remain subdued. (9) Looking like an earnings growth recession during H1. (10) The earnings hook again. (11) Joe finds no significant relationship between buybacks and stock prices.

Revenues I: No Trade Winds in Analysts' Forecasts. Are industry analysts so busy staying informed about their companies that they have no time to follow the news about anything else, even if it might impact their companies? They seem to be totally oblivious to Trump's trade war and the slowing global economy.

In reality, they undoubtedly are aware of these headline news events but simply are waiting for guidance from company managements before making any changes to their Excel spread sheets for revenues and earnings. Some managements are still figuring out the financial impact of tariffs. Some firms are even moving production or sourcing out of China into low-cost nations. Others are banking on their suppliers absorbing the cost of tariffs. It seems that managements' last resort as of now is reducing their full-year forecasts.

We are likely to see more such guidance during Q2's earnings season, beginning in July, but some companies are likely to start managing expectations over the remainder of June. Keep in mind that corporate managements tend to low-ball expectations going into earnings seasons even during good times.

Let's start with the upbeat analysts' consensus expectations for revenues for the S&P 500 as well as the US MSCI and the All-Country World ex-US MSCI stock composites. They are all available through the 5/23 week, yet they don't show any weakness related to the escalating trade war since the start of May:

(1) *S&P 500 revenues* estimates for 2019 and 2020 have been remarkably stable in recent weeks ([Fig. 1](#)). As a result, forward revenues (the time-weighted average of this year and next year) has remained in record-high territory so far in May. Industry analysts expect revenues to grow 4.9% this year and 5.3% next year ([Fig. 2](#)). Those are solid growth rates given the discouraging headlines on global trade and economic growth.

(2) *MSCI revenues*. Just as remarkable is the resilience of forward revenues for both the US MSCI and the All-Country World ex-US MSCI (in local currency). Both remained in record-high territory during the 5/23 week and on solid uptrends ([Fig. 3](#)). The consensus expects revenues outside the US to grow 3.6% this year and 4.5% next year. That's down from 7.4% in 2018 ([Fig. 4](#)).

Revenues II: Q1 Was Stormy. S&P 500 forward revenues is a great weekly coincident indicator of actual quarterly S&P 500 revenues per share ([Fig. 5](#)). So the former remains upbeat on Q2 prospects for the latter. But this indicator is not always on the mark: Q1 revenues was weaker than predicted by forward revenues.

However, the growth rate in actual revenues per share was still solid at 5.0% y/y during Q1 ([Fig. 6](#)). That was down from 5.2% during Q4-2018 and a seven-year high of 11.2% during Q2-2018. Less impressive is that aggregate S&P 500 revenues was up just 2.7% y/y during Q1 ([Fig. 7](#)).

Now consider the following developments that weighed on aggregate revenues growth during Q1:

(1) *Bad weather.* The National Center for Environmental Information reported that February 2019 was the wettest winter on record for the contiguous United States. Lots of retailers in particular noted during their Q1 earnings calls that the weather weighed on their Q1 results. So, for example, UPS cited severe winter weather in the US Northeast and Midwest when reporting disappointing Q1 results, largely due to an \$80 million hit from weather-related disruptions.

(2) *Strong dollar.* The trade-weighted dollar rose 7.1% y/y through the end of March, depressing the value of US multinationals' overseas sales and making goods of exporters more expensive for overseas buyers ([Fig. 8](#)). On Monday, the dollar was still up 4.4% y/y, which will weigh on Q2 revenues and earnings.

(3) *Trade tensions.* During the Q2 earnings season in July, many company managements are bound to blame any disappointing results on Trump's escalating trade war. Since 5/5, analysts have known, thanks to a Trump tweet, that the US would increase the 10% tariff on \$200 billion of imports from China to 25% on 5/10. China retaliated, surprising no one—announcing on 6/1 its intention to increase the tariff rate on some of the \$60 billion of US exports it previously hit during September. Trump also indicated at that time that the US would “shortly” impose 25% tariffs on the rest of US imports from China, as documented in a helpful trade war [timeline](#) compiled by the Peterson Institute for International Economics.

Revenues III: Macro Story. The weather was bad enough during the first four months of this year that it might have depressed not only the S&P 500 but also several key US economic indicators. If so, then both should show better growth during the spring and summer months. Here is a short review of the indicators that are most closely related to revenues:

(1) *Business sales.* The growth rates of aggregate S&P 500 revenues and manufacturing and trade sales are remarkably close given that the latter covers only goods but not services ([Fig. 9](#)). Business sales rose 3.4% y/y through March. This growth rate should improve in coming months, in our opinion, assuming, as we do, that Trump will soon be making trade deals with China and Mexico.

(2) *M-PMI.* Aggregate S&P 500 revenues growth is also highly correlated with the M-PMI ([Fig. 10](#)). The latter fell to 52.1 in May from a recent high of 60.8 during August. We can't blame the weather for May's weak M-PMI, which suggests that Q2's revenues growth may be no better than Q1's 2.7% increase.

(3) *New orders and merchandise exports.* It's also hard to blame the weather for the anemic April growth rates of factory orders (1.0% y/y) and merchandise exports (-3.6%). Both are highly correlated with (and highly depressing for) aggregate S&P 500 revenues growth ([Fig. 11](#) and [Fig. 12](#)).

Earnings I: Still Looking Up, a Bit. S&P 500 operating earnings per share (using I/B/E/S data) rose

2.5% y/y. Aggregate operating earnings edged up just 0.2% ([Fig. 13](#)).

S&P 500 operating earnings per share fell 3.0% q/q during Q1, as revenues declined 5.3%, while the profit margin fell from 11.9% at the end of last year to 11.6% during Q1-2019 ([Fig. 14](#) and [Fig. 15](#)).

S&P 500 forward earnings rose for the seventh week in a row during the 5/30 week, signaling that actual earnings should continue to grow over the rest of this year ([Fig. 16](#)).

Earnings II: Hook, Line, and Sinker. The Q1 earnings season displayed a significant hook. At the beginning of the season, during the 4/11 week, industry analysts predicted that S&P 500 operating earnings per share would decline by 2.5% y/y. It actually rose 2.5%, as noted above ([Fig. 17](#) and [Fig. 18](#)).

Meanwhile, the analysts have continued to lower their estimate for Q2 so that it is now 0.8% below the year-ago level. This seems to be par for the course, and not a response to the depressing headline news on global trade and economic activity. Q3 and Q4 estimates are also getting pared, but not enough to suggest a discounting of the headlines.

Buybacks: Do They Boost Stock Prices? In our [Topical Study #84 Stock Buybacks: The True Story](#), Joe and I included a table showing the percentage changes in the basic share count of each of the S&P 500 companies since Q1-2011 through Q4-2018. (See Appendix 3a and 3b.) We observed that, on balance, buybacks reduced the share count of the S&P 500 by only 7.8% over this period, or 1.1% per year. We concluded that the impact of buybacks on earnings per share has been greatly exaggerated. That's because we found that roughly two-thirds of buybacks may be offsetting stocks issued as labor compensation. Rather than boosting earnings per share, most buybacks are aimed at reducing the share-count dilution that results from compensating employees with stock.

I asked Joe to see whether S&P 500 companies with reductions in their basic shares outstanding since Q1-2011 had outperformed the index over the eight-year period. He didn't find a noticeable performance difference between companies that had increased and those that had decreased their share count. But among those companies that had share-count reductions, there was slight outperformance correlating with how much a company's share count was reduced. Here is a summary of his findings:

(1) Joe looked at 452 of the 505 issues in the S&P 500 with price performance data through their calendar Q1-2019. The index has 505 issues, since five companies have more than one share class included. Joe is still waiting for Q1 data for some of the April-reporting companies, mostly retailers, but most of the 53 issues not included in his study went public after Q1-2011.

(2) Joe found that the stock prices of all companies rose an average of 165%. The 172 issues with increased share counts had a slightly higher gain of 167%, while the 278 issues with decreased share counts rose a slightly lower 163%. (Two companies' share counts were unchanged.)

That was a little surprising, but not unexpected. Joe surmises that companies with higher share counts after the past eight years issued additional shares primarily to finance M&A activity. These companies outperformed because the M&A activity presented them with better opportunities for cost reductions and growth of their revenues and earnings.

(3) Looking at the companies with share-count decreases and grouping them in tranches by degree of decrease, Joe noted that their average price change improved the more shares were removed. Among the 148 companies that reduced shares by more than 15%, their average price gain was 166%, slightly

better than the all-company average of 163%. The 97 firms with at least a 20% decrease in their share counts rose 176%; the 40 companies with more than a 30% drop rose 186%; and the 16 companies with at least a 35% decrease rose an average of 185%.

CALENDARS

US. Wed: ADP Employment Change 183k, ISM & IHS Markit NM-PMIs 55.5/50.9, MBA Mortgage Applications, DOE Crude Oil Inventories, Beige Book, Bowman, Clarida. **Thurs:** Nonfarm Productivity & Unit Labor Costs 3.5%/-0.9%, Jobless Claims 215k, Merchandise Trade Balance -\$50.6b, Challenger Job Cuts Reports, EIA Natural Gas Report, Williams, Kaplan. (DailyFX estimates)

Global. Wed: Eurozone Retail Sales -0.5%*m/m*/1.5%*y/y*, Eurozone, Germany, France, and Italy C-PMIs 51.6/52.4/51.3/49.3, Eurozone, Germany, France, and Italy NM-PMIs 52.5/55.0/51.7/49.8, UK C-PMI & NM-PMI 51.0/50.6, China NM-PMI 54.2, Australia GDP 0.4%*q/q*/1.8%*y/y*. **Thurs:** Eurozone GDP 0.4%*q/q*/1.2%*y/y*, Germany Factory Orders 0.0%*m/m*/-5.9%*y/y*, Japan Household Spending 2.7% *y/y*, ECB Rate Decision 0.00%, ECB Marginal Lending Facility & Deposit Facility Rates 0.25%/-0.40%, Draghi, Carney, Kuroda. (DailyFX estimates)

US ECONOMIC INDICATORS

Auto Sales ([link](#)): Motor vehicle sales in May rebounded by 1.0mu as domestic light-truck sales accelerated. Total sales jumped to 17.4mu (saar) from 16.4mu in April—after being below 17.0mu three of the first four months of this year. (The 12-month average has been drifting lower since peaking at 17.7mu during February 2016.) Domestic light-truck sales climbed for the third time in four months, from 9.0mu at the start of this year to 10.0mu (saar) in May—which was the strongest pace since July 2005. Meanwhile, domestic car sales remain in a virtual freefall since peaking at 6.1mu (saar) during August 2014, plunging to 3.5mu in May, the lowest since February 2010. Sales of imports increased for the third time in four months, from 3.7mu in January to 3.9mu (saar) in May—nearing last May’s peak of 4.0mu—which was the strongest pace since August 2009.

Manufacturing Orders & Shipments ([link](#)): The manufacturing sector has lost momentum, facing headwinds from a softening in global demand and trade war between the US and China. Still, both factory orders and shipments remain at relatively high levels. Manufacturing orders edged down 0.8% in April after a 1.3% gain and a 1.0% loss the previous two months; these orders are 3.0% below September’s cyclical high. Nondefense capital goods orders ex aircraft (a proxy for future business investment) slumped 1.0% in April after a three-month gain of 2.1% and is only 1.8% below July’s cyclical high. Meanwhile, factory shipments remain in a volatile flat trend just below October’s record high, with April shipments within 0.8% of the high. Core capital goods shipments (used in calculating GDP) were unchanged in April after dipping 0.6% in March from February’s record high. Looking ahead, May PMIs show manufacturing activity eased further, according to both the ISM and IHS Markit measures, expanding at the slowest rates since October 2016 and September 2009, respectively, last month.

GLOBAL ECONOMIC INDICATORS

Eurozone CPI Flash Estimate ([link](#)): May’s CPI rate remained below 2.0% for the sixth consecutive month, according to the flash estimate, while the core rate moved back below 1.0%. The headline rate eased to a 13-month low of 1.2% *y/y* last month, after accelerating from 1.4% in March to 1.7% in April; it was at a recent peak of 2.2% last October. Looking at the main components, energy (to 3.8% from 5.3% *y/y*) once again is expected to record the highest annual rate in May, though slowing from April’s pace, while services (1.1 from 1.9) inflation also is expected to decelerate. Meanwhile, the rates for

food, alcohol & tobacco (1.6 from 1.5) and non-energy industrial goods (0.3 from 0.2) are both expected to tick higher. The core rate—which excludes energy, food, alcohol, and tobacco—is expected to make a round trip, according to the flash estimate, slowing to 0.8% y/y after accelerating from 0.8% in March to 1.3% in April.

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