



MORNING BRIEFING

March 11, 2020

All About Earnings

Check out the accompanying [chart collection](#) and [podcast](#).

(1) Q4 S&P 500 revenues and earnings are out. (2) Revenues rose 6.8% y/y during Q4 to new record high. (3) Earnings dipped in Q4, rising only 2.0% y/y. (4) Profit margin also dipped, but in record-high territory. (5) Utilities and Financials lead the earnings gainers, while Energy and Materials lead the losers. (6) IT leads in the profit margin derby. (7) Industry analysts cutting their Q1 & Q2 earnings forecasts, which remain too high relative to our forecast. (8) Record dividends.

Earnings I: Yesterday's News. Joe reports that Q4-2019 data are now available for S&P 500 revenues and earnings per share. Let's review:

(1) *Revenues at record high.* S&P 500 revenues per share rose 4.3% quarter over quarter to a new record high; that's the fastest such growth rate since Q2-2018 ([Fig. 1](#)). The year-over-year growth rate accelerated to 6.8%, the fastest such growth since Q3-2018 ([Fig. 2](#)).

Last year's revenues growth rate was weaker than the rates of 2017 and 2018, but better than those from 2012 to 2014 and the energy recession years of 2015 and 2016. Due to Covid-19 and sharply lower oil prices, we expect revenues growth will be weaker in 2020 than last year before strengthening during 2021.

(2) *Earnings dip from Q3.* S&P 500 operating earnings (using Refinitiv data) edged down 0.3% quarter over quarter during Q4 but rose 2.0% year over year. However, the quarterly operating earnings per share is down 1.5% from its record high in Q3-2018 ([Fig. 3](#) and [Fig. 4](#)).

(3) *Profit margin dips too.* Joe and I calculate the S&P 500's operating profit margin using the operating earnings data series compiled by Refinitiv and divide it by S&P's data for S&P 500 revenues ([Fig. 5](#) and [Fig. 6](#)). The quarterly profit margin rose to a then-record high of 10.9% during Q4-2017, which was just before Trump's Tax Cut and Job's Act (TCJA) took effect in Q1-2018. It proceeded to rise over the following quarters, making a new record high of 12.5% during Q3-2018. The following year, during Q4-2019, the quarterly margin fell to a post-TCJA

low of 11.3%, down from 11.9% in Q3-2019—which still is higher than the pre-TCJA record high.

The tax cut provided a “permanent” boost to the profit margin, i.e., permanent as long as the TCJA remains in force. The recent dip in the profit margin may reflect rising cost pressures that cannot be passed through to prices or offset with productivity.

Earnings II: S&P 500 Sector Stories. Now that we covered last year’s slowdown in earnings growth for the S&P 500, let’s slice and dice the data for the 11 sectors of the S&P 500.

To do so, we also prefer to use the I/B/E/S data by Refinitiv for operating earnings. Admittedly, this dataset tends to be less conservative than the one compiled by S&P. That’s because the former mostly reflects the adjusted operating numbers as reported by the companies and as widely followed by industry analysts. S&P prefers to have its own analysts determine what should be considered one-time extraordinary losses and gains. Here goes:

(1) *Q4 to Q4.* Here is the year-over-year-earnings-growth-rate derby, measuring from Q4-2018 to Q4-2019: Utilities (16.5%), Financials (9.2), Health Care (8.9), Communication Services (8.2), Information Technology (8.1), Real Estate (6.7), Consumer Discretionary (3.9), Consumer Staples (2.0), S&P 500 (2.0), Industrials (-9.5), Materials (-24.9), and Energy (-40.1) ([Fig. 7](#)).

(2) *2019 vs 2018.* Here are the full-year growth rates comparing 2019 to 2018: Health Care (8.7%), Financials (6.0), Real Estate (6.0), Information Technology (3.5), Consumer Staples (3.3), Consumer Discretionary (3.2), S&P 500 (1.0), Utilities (0.1), Industrials (-2.6), Utilities (6.7), Materials (-12.1), Communication Services (-28.2), and Energy (-30.1).

It probably makes more sense to analyze the less volatile second set of growth rates, which provides clearer insight into 2019’s slowdown in earnings growth following the surge in 2018 due to the impact of the corporate tax cut.

(3) *Profit margins.* Eight of the 11 S&P 500 sectors saw their profit margins decline year over year in 2019, based on the four-quarter trailing average ([Fig. 8](#)). Utilities’ profit margin rose to a record high in 2019 as Real Estate and Consumer Staples also improved from a year earlier.

Here are the sectors' profit margins at the end of 2019 and 2018 (from highest to lowest last year based on the four-quarter trailing average): Real Estate (28.4%, 28.1%), Information Technology (21.7, 22.8), Financials (15.0, 16.1), Communication Services (15.0, 15.5), Utilities (13.5, 12.3), S&P 500 (11.6, 12.1), Health Care (10.3, 10.8), Industrials (9.4, 9.7), Materials (8.4, 9.2), Consumer Staples (7.4, 7.3), Consumer Discretionary (7.2, 7.5), and Energy (5.3, 7.2).

Earnings III: Tomorrow's Headlines. Company managements are struggling to assess the impact of Covid-19 on their revenues and profits for 2020. Global economic growth is clearly slowing. While the US economy is resilient, it might also be hit by the virus. The good news for many companies that use petroleum products is that oil prices have plunged recently. That's bad news for companies that supply energy products.

On Monday March 2, we cut our 2020 forecast for S&P 500 revenues growth to 2% from 5%, which was slightly faster than the longer-term 4% rate. We also lowered our 2020 earnings growth forecast to zero from our previous estimate of 5.5%. We expect that the annual profit margin will remain flat year over year at 11.5%.

Joe and I have found that the weekly series on forward revenues, earnings, and the profit margin all are great coincident indicators of their respective quarterly series ([Fig. 9](#)). The weekly indicators for earnings and revenues are looking topky after moving to record highs in January and February, but the profit margin has been edging lower since it peaked at a record high of 12.4% in September 2018.

During the March 5 week, industry analysts continued to lower their consensus quarterly expectations for S&P 500 operating earnings for the first half of 2020, while keeping Q3 and Q4 relatively unchanged ([Fig. 10](#)). They now see earnings falling 0.5% year over year during Q1 and rising just 3.9% during Q2 ([Fig. 11](#)). They still expect the sun to shine in the second half of 2020: They estimate 8.7% during Q3 and 11.0% during Q4.

We're expecting worse results: a 5.5% drop in Q1, an 8.0% decline in Q2, and a return to positive growth in Q3 (2.0%) and Q4 (7.1%). We think the analysts have lots of catching up to do (to the downside) and will continue to lower their Q1 and Q2 estimates. Given the rapidly changing situation, however, they're more likely than not to miss the bullseye for both quarters by a wider mark this year.

During the February 27 week, the industry analysts' consensus forecast for S&P 500 annual revenues-per-share growth during 2020 dropped to 4.6% after remaining at 4.8% to 4.9% since the start of this year ([Fig. 12](#) and [Fig. 13](#)). On the other hand, they've been getting more optimistic about next year, raising their consensus forecast from 4.9% to 5.1%.

Analysts' consensus annual earnings growth forecast for this year has been cut from 8.9% to 7.1% during the February 27 week ([Fig. 14](#) and [Fig. 15](#)). They expect growth to improve to 11.7% next year.

The analysts' consensus estimate for the 2020 profit margin has dropped only 0.1 percentage point since early this year to 11.8%, which is still up from 11.5% last year. Next year's forecast is also down 0.1 percentage point but remains (too) high at 12.5%.

Earnings IV: Dividends. Finally, the S&P 500 companies paid a record \$483.6 billion in dividends last year ([Fig. 16](#)). The dividend payout ratio, defined as the four-quarter sum of dividends divided by the four-quarter sum of aggregate operating earnings, rose to 37% in 2019 from 35% a year earlier ([Fig. 17](#)).

CALENDARS

US: Wed: Headline & Core CPI 2.2%/2.3% y/y, Monthly Budget Statement -\$240.8b, MBA Mortgage Applications, DOE Crude Oil Inventories. **Thurs:** Jobless Claims 218k, PPI Final Demand -0.1%/m/m/1.8%/y/y, EIA Natural Gas Storage. (DailyFX estimates)

Global: Wed: UK GDP 0.2%/m/m/0.1%3m/3m, UK Headline & Manufacturing Industrial Production -2.6%/-3.5% y/y, UK Trade Balance - £356m, UK Government Announces 2020 Budget. **Thurs:** Eurozone Industrial Production 1.4%/m/m/-3.1%/y/y, ECB Central Bank Rate 0.00%, ECB Marginal Lending Facility & Deposit Facility Rates 0.25%/-0.50%. (DailyFX estimates)

US ECONOMIC INDICATORS

NFIB Small Business Optimism Index ([link](#)): "February was another historically strong month for the small business economy, but it's worth noting that nearly all of the survey's responses were collected prior to the recent escalation of the coronavirus outbreak and the Federal Reserve rate cut. Business is good, but the coronavirus outbreak remains the big unknown,"

according to William Dunkelberg, NFIB's chief economist. That being said, the Small Business Optimism Index (SBOI) increased 0.2ppt in February, and 1.8ppts so far this year, to 104.5—in the top 10% of all readings in the 46-year history of the survey. Last month, four of the 10 index components rose, while six fell. Reports of better business conditions in the next six months was the biggest positive contributor to February's SBOI, jumping 8ppts to a net 22%. Also contributing positively were expected credit conditions (+3ppts to -1%), along with the employment-related measures of job creation (+2 to 21) and current job openings (+1 to 38)—which both remained around series' highs. Sales expectations (-4 to 19) was the biggest negative contributor to February's SBOI—with the declines among the remaining five components from -1ppt to -2ppts. Finding qualified workers (25%) remained the single biggest problem for small business owners, cited by far more than either taxes (14) or government regulations (13).

GLOBAL ECONOMIC INDICATORS

Eurozone GDP ([link](#)): Real GDP in the Eurozone expanded 0.5% (saar) during the final quarter of 2019, slowing from Q3's 1.2%. Real domestic demand rebounded 3.8% (saar) last quarter after contracting 2.4% during Q3, as real gross fixed capital formation soared 17.9% (saar) after plunging 14.2% the prior quarter. Real household spending edged up 0.5% (saar) during Q4, one-quarter Q3's 2.0% pace, while the increase in real government spending slowed to 1.4% (saar) from 2.2% during Q3. Trade was a drag on Q4 growth as real imports (9.2) rose at a considerably faster pace than exports (1.7). Among the Eurozone economies, Ireland (7.6%, saar) posted the strongest real GDP growth last quarter, while Greece (-2.7) recorded the weakest. Looking at the four largest Eurozone economies, Germany (0.1%, saar), France (-0.2), and Italy (-1.2) were all below the 0.5% (saar) growth for the overall Eurozone, while Spain's (2.1) was above.

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