Yardeni Research

MORNING BRIEFING
April 5, 2023

All About Earnings

Check out the accompanying chart collection.

Executive Summary: Today, we analyze the analysts, specifically industry analysts' recent earnings and revenue estimate revision behavior. Their collective earnings estimate shaving doesn't suggest recession jitters, in our view, even though flattish y/y revenues expectations may indicate concern about unit sales. Forward earnings remains consistent with a soft landing. … And: Analysts typically do lower their quarterly estimates as a quarter progresses, often setting the stage for a positive earnings surprise. Joe highlights the takeaways from data on earnings estimate revisions that occur in the runup to reporting seasons, including what the data say about Q1-2023.

Earnings I: Analysts Shaving. Industry analysts following S&P 500 companies continue to lower their outlook for 2023 and 2024 earnings per share (*Fig. 1*). Yet S&P 500 forward earnings has stabilized around $227 per share over the past seven weeks. That's because 2024's consensus estimate remains higher than 2023's consensus estimate. As time passes, the former's weight in the calculation of forward earnings increases as the latter's decreases (since forward earnings is the time-weighted average of analysts' consensus estimates for this year and next).

Let's have a closer look:

(1) *Revenues.* S&P 500 revenues estimates have been holding up quite well. During the week of March 16, industry analysts collectively predicted revenues of $1,801 per share this year and $1,888 next year (*Fig. 2*). Those estimates have been relatively steady since H2-2022. Analysts tend to be too optimistic when the economy is expanding, causing them to lower their projections as the actual results become available during earnings reporting seasons (*Fig. 3*).

During 2021 and 2022, however, analysts weren't being overly optimistic when higher-than-expected inflation led them to raise their revenues outlook; they were right to do so. Given that inflation remains relatively high, the recent flatness in the 2023 and 2024 revenues estimates might reflect concern about the prospects for unit sales (*Fig. 4*).

S&P 500 forward revenues per share is a great high-frequency (weekly) indicator of actual quarterly revenues (*Fig. 5*).

(2) *Earnings.* Industry analysts also tend to be too optimistic about earnings during economic expansions, causing them to lower their annual estimates as earnings are released (*Fig. 6*). That's making it hard to discern whether the downward trend in the 2023 and 2024 consensus estimates reflects any mounting concern about an imminent recession. Forward earnings is a more reliable economic indicator than its annual components (*Fig. 7*). It is currently consistent with a soft-landing economic scenario rather than a hard one, in our opinion.

As of the March 30 week, industry analysts projected S&P 500 earnings per share of $220.45 this year and $247.57 next year. So earnings are expected to be up just 0.3% this year and 12.0% next year (*Fig. 8*).

Also, S&P 500 forward earnings is a great high-frequency (weekly) indicator of actual quarterly earnings (*Fig. 9*). It is showing a softer landing than is the forward revenues series, for now.

(3) *Margins.* If there is a recession in all these numbers, it's clearly a profit margin recession. We can calculate weekly profit margin estimates simply by dividing weekly earnings estimates by weekly revenues estimates. Since the start of this year through the March 16 week, the analysts' consensus expected S&P 500 profit margin for 2023 fell from 12.5% to 12.1% (*Fig. 10*). The margin estimate for 2024 fell from 13.3% to 12.9% over the same period.

These are still relatively high, but similar declines occurred during the pre-pandemic economic expansion years from 2011 through 2019. Joe and I attribute the current margin squeeze to rising labor costs, which we expect will ease as the hot labor market cools off in a soft-landing scenario. We also expect that productivity growth will make a comeback later this year.

In any event, the actual quarterly operating profit margin for the S&P 500 fell to 11.6% during Q4-2022, down from a record high of 13.7% during Q2-2021 (*Fig. 11*). The weekly forward profit margin, which we calculate using forward earnings and forward revenues, was down to 12.3% during the March 16 week from a record-high 13.4% during the June 9, 2022 week.

So maybe there isn't much more downside for the profit margin. Obviously, if the hardlanders are right, there will be lots more downside for revenues, earnings, margins, valuations, and the stock market. That's not our story, but rather the risk to it.

(4) *S&P 500, M-PMI, NRRI & NERI.* On Monday, we learned that the M-PMI was down to 46.3, the lowest reading since May 2020 (*Fig. 12*). That's somewhat unsettling because the yearly percent change in the S&P 500 is highly correlated with it. Then again, the S&P 500 fell to a low of -16.5% y/y during October and rose to -9.6% during March, suggesting that the worst may soon be over for the M-PMI.

By the way, the yearly percent change in the S&P 500 is also highly correlated with the S&P 500's Net Revenues Revisions Index (NRRI) and Net Earnings Revisions Index (NERI) (*Fig. 13* and *Fig. 14*). NRRI was in negative territory from August through January and turned slightly positive during February and March. On the other hand, NERI has been negative since July through March.

(5) *STRG, STEG & LTEG.* Also consistent with soft-landing readings recently have been analysts' consensus Short-Term Revenues Growth (STRG), Short-term Earnings Growth (STEG), and Long-Term Earnings Growth (LTEG) (*Fig. 15*). As of the March 16 week, they were 2.6%, 4.2%, and 9.8%. During the previous two recessions, STEG turned negative.

Earnings II: Looking Ahead to Q1's Earnings Season. Joe has been tracking the S&P 500's quarterly earnings forecasts each week in our *S&P 500 Earnings Squiggles (Annually & Quarterly)* publication since the series started in Q1-1994.

The typical playbook has been for analysts to cut their estimates gradually over the course of a quarter until reality sets in during the final month of the quarter, when some companies warn of weaker results. The combination of reduced forecasts for poorly performing companies and steady forecasts for companies that are quietly keeping good news close to their vests inevitably leads to an earnings hook in the chart, indicating a positive surprise.

The strong recovery following the Great Virus Crisis (GVC) had analysts scrambling to raise their forecasts for six straight quarters from Q2-2020 through Q3-2021—and still not coming close to the actual earnings results. This period saw the S&P 500 record unusually high double-digit-percentage earnings beats for the first time since the aftermath of the Great Financial Crisis (GFC) in 2009-10. The earnings-surprise tide turned in Q1-2022, and this data series has remained weak since Q3-2022.

Joe separates the good news from the bad news. Let's have a closer look:

(1) *Still an uphill run to the finish line, but not getting steeper.* After falling slightly during H1-2022, the pace of analysts' earnings estimate declines made over the course of the quarter accelerated in Q3-2022, when estimates dropped 6.6%. The pace hasn't let up since, but it's not getting substantially worse. The Q4-2022 estimate was down 5.9% during the runup to that quarter's earnings reporting season, and the Q1-2023 estimate is down a nearly similar 6.2%.

This recent trend marks a return to estimate cutting as usual. In the 105 quarters from Q2-1994 to the GVC in Q2-2020, the consensus earnings estimate fell more than 85% of the time (90 quarters) during the runup to earnings season. Of the gains that occurred the rest of the quarters, half were following the GFC, when shell-shocked analysts mistimed the recovery. Post-GVC, the consensus estimate rose for six straight quarters through Q4-2021 before the earnings recovery fizzled during H1-2022. The quarterly estimate now has declined for five straight quarters including Q1-2023.

(2) *More sectors have falling estimates.* Analysts have been too bullish and overestimated the length of the post-GVC boom in earnings. More and more sectors now are seeing their collective Q1-2023 earnings estimates decline during the runup to earnings season.

For perspective, at the peak in Q2-2021, nine of the 11 S&P 500 sectors experienced rising estimates for the quarter over the course of the quarter (*Fig. 16*). By Q1-2022, that was down to five sectors (Energy, Financials, Real Estate, Tech, and Utilities) (*Fig. 17*). That count dwindled to just one sector during Q3-2022 (Energy) and Q4-2022 (Utilities). For Q1-2023, Utilities remains the only sector with an earnings forecast that rose during the quarter (*Fig. 18*).

Prior to the Regional Bank Crisis (RBC) in early March, Financials' estimate had been down just 2% since the start of Q1-2023, which made it the second-best performer of the 11 sectors. It quickly tumbled to -13.2% during the last two weeks of the quarter and now ranks last among the 11 S&P 500 sectors. Financials' decline would have been considerably worse had Signature Bank and Silicon Valley Bank not been removed from the index by S&P.

Here's how much each sector's Q1 estimate changed over the course of the quarter: Utilities (5.1%), Consumer Staples (-2.7), Communication Services (-6.8), Tech (-6.9), Energy (-7.5), Industrials (-7.8), Real Estate (-8.0), Health Care (-8.9), Consumer Discretionary (-10.9), Materials (-12.1), Financials (-13.2).

(3) *More sectors to show y/y growth in Q1.* Four sectors are expected to record positive y/y percentage earnings growth in Q1-2023, up from only two sectors in Q4-2022 (Energy and Industrials). The top three projected double-digit-percentage growers for Q1 are: Consumer Discretionary (36.4%), Industrials (17.9), and Energy (13.7). Surprisingly, Financials comes in at 5.2% growth. Analysts expect the S&P 500's Q1-2023 earnings growth rate to weaken from the Q4-2022 level, to -7.5% y/y from -1.6% on a frozen actual basis and to -5.0% from -3.2% on a pro forma basis.

Here are the seven sectors expected to report y/y earnings declines in Q1-2023: Materials (-33.5%), Health Care (-18.8), Tech (-14.4), Communication Services (-12.6), Utilities (-9.9), Real Estate (-8.0), and Consumer Staples (-4.8)

(4) *Y/y growth streaks: winners and losers.* The S&P 500 is expected to record its second straight quarter of y/y earnings declines in Q1-2023. However, the Energy and Industrials sectors remain on strong positive earnings growth paths. Energy is expected to record a ninth straight quarter of growth, followed by Industrials at eight quarters. Consumer Discretionary's expected earnings growth rises y/y after falling in Q4-2022, and Financials' rises after dropping for four quarters.

For Communication Services and Utilities, Q1-2023 is expected to mark a fourth straight quarter of y/y earnings declines. For Consumer Staples, Materials, and Tech, the streak would be three quarters long and for Health Care and Real Estate two quarters.

Calendars

US: Wed: ADP Nonfarm Employment 205k; ISM NM-PMI 54.5; S&P Global C-MPI & NM-PMI 53.3/53.8; Trade Balance -$69.0b; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. **Thurs:** Initial & Continuous Jobless Claims 200k/1.699m; Fed's Balance Sheet; Baker-Hughes Rig Count; Natural Gas Storage. (Bloomberg estimates)

Global: Wed: Eurozone, Germany, and France C-PMIs 54.1/52.6/54.0; Eurozone, Germany, and France NM-PMIs 55.6/53.9/55.5; Germany Factory Orders 0.4%; France Industrial Production 0.6%; UK C-PMI & NM-PMI 52.2/52.8; Australia Trade Balance $11.1b; China Caixin M-PMI 51.7; Tenreyro. **Thurs:** Germany Industrial Production 0.1%; UK Halifax Price Index -0.3%; Canada Employment Change 12k & Unemployment Rate 5.1%; Japan Household Spending -0.4%m/m/4.3%y/y. (Bloomberg estimates)

US Economic Indicators

Auto Sales (*link*): Total sales in March dipped for the second month to 14.9mu (saar) after rebounding 2.5mu in January to 16.1mu—which was the highest level since May 2021. *Domestic light-truck sales* slipped to 9.3mu (saar) last month after soaring from 8.0mu in December to 10.0mu in January, which was the highest since April 2021. *Domestic car sales* continues to fluctuate in a volatile flat trend, edging up to 2.2mu (saa) in March after edging down from 2.3mu to 2.1mu in February; it's averaged 2.2mu the past seven months. Sales of *imports* remains in a volatile flat trend in recent months, averaging 3.6mu during both Q1 and Q4, with the former ranging 3.4-3.9mu and the latter 3.4-3.7mu.

JOLTS (*link*): *Job openings* sank to a 21-month low of 9.9 million during February, dropping 1.3 million over the first two months of this year, from 11.2 million at the end of last year. It peaked at a record high 12.0 million last March. Openings reached 10 million during June 2021 for the first time in the history of the series going back to 2000—remaining above that level through January of this year. There were 5.9 million unemployed in February, so there were 1.67 available jobs for each unemployed person that month, the lowest since November 2021 and down from a record high of 2.01 last March. By industry, the *biggest declines* in openings during February occurred in professional & business services (-278,000), health care & social assistance (-150,000), transportation, warehousing & utilities (-145,000), and accommodations & food services (-125,000). Job openings in health care & social assistance have dropped 345,000 the past five months, while openings in accommodations & food services are down 404,000 the past two months. The biggest gains occurred construction (+129,000) and arts, entertainment & recreation (+38,000). *Hirings* fell 164,000 during February to 6.2 million; hirings were at 6.8 million a year ago. Meanwhile, the number of quits remained at a high level in February at 4.0 million, but that's down from the record-high 4.5 million during November 2021.

Manufacturing Orders & Shipments (*link*): Factory orders contracted the first two months of the year, by 0.7% in February and 2.8% over the period, led by 2.8% and 16.4% drops in transportation billings over the comparable periods. *Excluding transportation*, orders fell for the third time in four months, by 0.3% in February and 1.9% over the period. Turning to *core capital goods orders and shipments*, nondefense capital goods orders excluding aircraft (a proxy for future business investment) has been moving sideways since reaching a record high last August, with these orders within 0.4% of August's level. Nondefense capital goods shipments excluding aircraft (used in calculating GDP) ticked down 0.1% in February after rising 0.9% in January to a new record high. On a year-over-year basis, core capital goods orders and shipments are up 4.2% and 5.4%, respectively, slowing from their peak rates of 22.3% and 17.7% during April 2021.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102