MORNING BRIEFING
December 13, 2023

Earnings: Yesterday, Today & Tomorrow

Check out the accompanying chart collection.

Executive Summary: S&P 500 companies collectively outperformed industry analysts' Q3 expectations, posting record-high revenues and earnings per share. The profit margin was the highest in four quarters, suggesting that the cost-push inflation pressures that had weighed on margins are easing. … Analysts' consensus estimates for 2024 and 2025 suggest accelerating growth for both revenues and earnings and rising profit margins. … The earnings outlook together with our projected valuation ranges result in our price targets for the S&P 500 of 4600 by the end of this year, 5400 by the end of next, and 6000 by year-end 2025.

Earnings I: The Past. The Q3 earnings season is over, and the final numbers for S&P 500 companies are in. The results in aggregate were better than analysts had expected, which isn't surprising when the economy is growing. Worse-than-expected results tend to occur when the economy is falling into a recession. Widespread concerns earlier this year that the economy would fall into a recession—which was not our outlook, as you know—have been largely alleviated.

Today, let's do some time traveling. We'll review the recent past—i.e., the Q3 results—then go back to the future by revisiting our forecasts for S&P 500 revenues per share, earnings per share, and the profit margin for 2023, 2024, and 2025. Then let's conclude with a discussion of the outlook for the S&P 500's forward earnings per share, forward P/E, and stock price index—including our newly announced S&P 500 target of 6000 for year-end 2025.

Here we go:

(1) *Revenues.* S&P 500 companies' collective revenues per share rose to a record high for a second straight quarter in Q3 after dipping in Q1 from Q4-2022's record, but the y/y gain slowed to an 11-quarter low of 5.0% from 7.1% in Q2 (*Fig. 1* and *Fig. 2*). Inflation continued to boost the growth rate, but less so than in Q2—as the GDP price deflator rose only 1.7% in Q3 compared to 3.5% in Q2—but the inflation-adjusted revenues increase was still a solid gain.

(2) *Earnings.* S&P 500 earnings per share also rose to a record high in Q3, for the first time since Q2-2022, and its 4.6% y/y increase was its first y/y gain in four quarters (*Fig. 3* and *Fig. 4*).

(3) *Profit margin.* We can calculate the S&P 500's profit margin by dividing the index's earnings by revenues (*Fig. 5* and *Fig. 6*). The margin rose 0.8ppts q/q to a four-quarter high of 12.5%, which is up from 11.5% during Q4-2020. But it was still down from the record high of 13.7% during Q2-2021.

The just-ended earnings recession was very mild, with three back-to-back quarters of modest single-digit percentage declines on a y/y basis. There was no revenues recession. The earnings weakness of recent quarters has been entirely attributable to the decline in the profit margin due to cost-push inflation, and productivity has been weak because of unusually high turnover in the labor market, with record-high quits and job openings earlier in the year. However, the improvement in the profit margin during Q3 suggests those pressures are abating now.

Earnings II: The Present. The S&P 500 companies' actual Q3 earnings per share turned out to be up 4.6% y/y, which was better than the 0.2% decline expected by industry analysts collectively at the start of the earnings season (*Fig. 7*).

Currently (as of the December 7 week), industry analysts project that S&P 500 earnings will be up 3.5% y/y during Q4, followed by quarterly gains in 2024 of 7.0% (Q1), 11.2% (Q2), 9.3% (Q3), and 17.8% (Q4) (*Fig. 8*). At the start of Q4, analysts had been expecting a 9.4% gain in Q4-2023 earnings. Since then, expectations were mostly cut at the drugmakers, auto manufacturers, and commodity-related industries in the S&P 500 Materials sector.

Like the economy, revenues and earnings have been experiencing a soft landing so far, and industry analysts as a group have not been slashing their forecasts. Currently, the analysts' consensus estimates imply the following y/y revenues and earnings growth rates: for 2023 (2.1%, 0.7%), for 2024 (4.9%,11.2%), and for 2025 (5.4%, 12.4%) (*Fig. 9* and *Fig. 10*).

The S&P 500 profit margin forecasts implied by analysts' revenues and earnings estimates for 2023, 2024, and 2025 are stabilizing now after dropping at the start of this year. The latest readings for the three years are at 11.8%, 12.5%, and 13.4%. The bottoming of industry analysts' implied margin estimates suggests they believe that the mini recession in earnings attributable to weakening profit margins is over. They may be right, with margins rising again.

As you know, Joe and I are big fans of weekly S&P 500 forward revenues per share and forward earnings per share as great coincident indicators of the actual quarterly series for S&P 500 revenues per share and earnings per share (*Fig. 11* and *Fig. 12*). (Forward revenues and earnings are the time-weighted average of analysts' estimates for the current year and the coming year.)

During the November 30 week (the latest data available), forward revenues was just 0.2% below its record high, hit during the November 2 week. But forward earnings has been hitting record highs regularly since the September 14 week—the longest string of successive weekly record highs since the June 16, 2022 week. The forward profit margin edged up during the December 7 week to a 13-month high of 12.7% (*Fig. 13*).

Earnings III: The Future*.* Now let's turn to an update of our outlook for the S&P 500 companies' collective revenues, earnings, and profit margin.

Since earnings have had a soft landing so far, rather than a hard one, we are expecting a U-shaped, rather than a V-shaped, earnings recovery. If we are surprised, then it's likely to be because the recovery is more robust than we are projecting. If so, that would be attributable to higher profit margins, boosted by technology-driven productivity gains. Let's think ahead:

(1) *Revenues.* We are projecting that revenues per share will increase 4.0% this year to $1,823, 4.0% in 2024 to $1,896, and 4.0% in 2025 to $1,970 (*Fig. 14*).

(2) *Earnings.* We project earnings per share will be $225 this year, $245 next year, and $270 in 2025 (*Fig. 15*). That's been our forecast since summer 2022. (The final tally for 2022 was $218. We had been projecting $220.) We are now forecasting $300 in 2026.

(3) *Profit margin.* Our projections imply that the profit margin will fall from 12.4% in 2022 to 12.3% in 2023 and rise back to 13.2% in 2024 and 13.7% in 2025 (*Fig. 16*).

(4) *Forward earnings.* We are projecting that S&P 500 forward earnings per share will be $245 at the end of this year (currently $244), $270 at the end of next year and $300 at the end of 2025 (*Fig. 17*). Those are what we expect the analysts' consensus earnings expectations then will be for 2024, 2025, and 2026. (At year-ends, forward earnings match the analysts' projections for the upcoming year.)

(5) *Valuation & S&P 500 ranges.* Now let's apply forward P/E ranges of 16.0-20.0 to our

forward earnings projections to derive target ranges for the S&P 500 (*Fig. 18*). The range for 2024 is 4320-5400, and the range for 2025 is 4800-6000 (*Fig. 19*). Our year-end point estimates are 4600 by the end of this year, 5400 by the end of 2024, and 6000 by year-end 2025.

We acknowledge that our valuation multiple ranges are high historically. However, they reflect our expectations that the MegaCap-8 stocks (i.e., Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, Nvidia, and Tesla) will continue to account for a significant portion of the market cap of the S&P 500, and that they will continue to be highly prized by investors.

We are also seeing more reasons to believe in our Roaring 2020s scenario—the theory that productivity growth will stage a comeback, driven by widely implemented technological solutions to address the US's chronic labor shortages, and rising productivity will propel economic growth to surprising heights.

Calendars

US: **Wed:** Fed Interest Rate Decision 5.50%; FOMC Economic Projections; Headline & Core PPI 0.1%m/m/1.0%y/ & 0.2%m/m/2.3%y/y; MBA Mortgage Applications; OPEC Monthly Report; Crude Oil Inventories & Gasoline Production. **Thurs:** Retail Sales 0.2%m/m/1.6%y/y; Business Inventories 0.0%; Initial Jobless Claims 221k; Import & Export Prices -0.8%/-1.0%; Atlanta Fed GDPNow; Fed's Balance Sheet; IEA Monthly Report. (FXStreet estimates)

Global: **Wed:** Eurozone Industrial Production -0.3%/m/-4.5%y/y; UK GDP -0.1%m/m/0.6%y/y; UK Headline & Manufacturing Production -0.1%mm/1.1%y/y & 0.0%/m/1.9%y/y; UK NIESR Monthly GDP Tracker; UK RICS House Price Balance -57%; Japan Industrial Production 0.5%; Japan Core Machinery Orders -0.5%m/m/-5.1%y/y; Australia Employment Change10k; Australia Unemployment & Participation Rates 3.8%/66.9%; RBA Bulletin; Jones. **Thurs:** UK Gfk Consumer Confidence -23; Japan M-PMI 48.2; China Industrial Production 5.7%y/y; China Retail Sales 12.5%y/y; China Unemployment Rate 5.0%; ECB Interest Rate Decision & Deposit Facility Rate 4.50%/4.00%; ECB BoE Interest Rate Decision 5.25%; BoE Inflation Letter; EU Leaders Summit; Lagarde. (FXStreet estimates)

US Economic Indicators

Consumer Price Index (*link*): The headline CPI ticked up 0.1% in November, following no change in October, after averaging monthly gains of 0.5% the previous two months. Core prices rose 0.3% last month, an uptick from October's 0.2%; core services prices accelerated 0.5%, more than offsetting the 0.3% drop in core goods prices. On a *yearly basis*, the headline CPI eased for the second month in November to 3.1%, after increasing from a recent low of 3.0% in June (lowest since March 2021) to 3.7% during August and September. November's rate is one-third of last June's 9.1% peak. *Core prices* yearly rate was unchanged at October's 25-month low of 4.0% in November, down from recent peak of 6.6% last September, though remains above the 2.0%-2.5% range pre-Covid. Here's a laundry *list of CPI yearly rates* for November: The rate for *consumer durable goods* fell 1.6% y/y, its 11th negative reading in 12 months, while the rate for *consumer nondurable goods* excluding food (-1.7 y/y) dipped back into negative territory after brief moves above in August (0.6) and September (2.7). The *services rate excluding energy* remained at 5.5% y/y in November after easing the prior eight months from 7.3% in February—which was the highest since summer 1982. *Food* costs (2.9% y/y) eased for the 15th month from last August's 11.4%, which was the fastest pace since April 1979. Within food, the rate for *food at home* (1.7) has slowed steadily from 13.5% last August (the highest since March 1979); the yearly rate for *food away from home* slowed for the eighth month to 5.3% y/y from March's 8.8%—which was the highest since fall 1981. *Energy costs* were below zero for the ninth month. They tumbled from last June's 41.6%—the fastest pace since April 1980—to -16.7% y/y this June; more recently, the decline narrowed to -0.5% in September before widening again to -4.5% in October and November. Within energy, the yearly rate for *fuel oil* plummeted to -36.6% y/y in June, down from last May's record high of 106.7%, though it picked up to -5.1% in September before tumbling again to -24.8% y/y by November. The rate for gasoline prices bottomed at -26.5% in June, climbed to +3.0% in September, and returned to negative territory in October (-5.3) and November (-8.9); it peaked at 59.9% last June (fastest since March 1980). The rate for *natural gas* prices has been dropping y/y: The price fell below the year-ago level in April (-2.1) for the first time since August 2020 and was at -10.4% in November. The y/y rate was 38.4% last June, which was the highest since October 2005. The *electricity* rate (3.4% y/y) moved a bit higher in November after holding around 2.0% the prior three months; it peaked at 15.8% last August—which was the highest since August 1981. Within *consumer durable goods*, the rate for *new cars* rose 1.3% y/y, the lowest rate since February 2021, down from last April's record high of 13.2%, while the rate for *used cars & trucks* was -3.8% y/y last month, up from February's -13.6% bottom—which was the lowest since November 1960. It was as high as 41.2% last February and at a record-high 45.2% during June 2021. The rate for *furniture & bedding* was in negative territory for the seventh month, narrowing to -3.1% in November from September's -5.4% (which was the lowest since mid-2010). It's down dramatically from last February's record high of 17.1%. The rate for *major appliances* fell to -10.6% y/y last month, down from its recent peak of 12.4% last March, and a tick above June's record low of -10.7%. Within *consumer nondurable goods*, the rate for apparel prices was 1.2% y/y, the lowest since April 2021 and down from last March's recent peak of 6.7% (the highest since the end of 1980). Before the recent move down, it fluctuated in a 5.0%-5.5% range from last April through September. Within services, *owners' equivalent rent* eased for the seventh month, to 6.7% y/y, not far from its record high of 8.1% in April, while the rate for rent of *primary residence* dipped to 6.9% y/y, easing from 8.8% y/y during February through April (the highest since fall 1981). These rates compare with recent lows of 1.8%. Meanwhile, the yearly rate for *lodging away from home* slowed for the second month, to 0.9% in November, after accelerating from 3.3% in April to 7.3% y/y in September; it was at a record high of 25.1% in both March and February of 2022. Turning to *medical care*, the yearly rate for *hospitals' services* has been fluctuating in a volatile flat trend in recent months, accelerating 6.4% y/y in November from a recent low of 2.7% in March. The *physicians' services* (-0.7) rate remains below zero for the third successive month. Meanwhile, the yearly rate for *airfares* fell 12.1% y/y, up from June's -18.9%, which was its steepest drop since February 2021; that compares with last October's 42.9%, which wasn't far from the record high of 45.0% in September 1980.

NFIB Small Business Optimism Index (*link*): "Job openings on Main Street remain elevated as the economy saw a strong third quarter," said NFIB Chief Economist Bill Dunkelberg. "However, even with the growing economy, small business owners have not seen a strong wave of workers to fill their positions. Inflation also continues to be an issue among small businesses." November's *Small Business Optimism Index* (SBOI) fell for the fourth straight month, slipping 0.1ppt during November and 1.3ppts during the four months through November to 90.6; that's after climbing the prior three months by 2.9ppts to an eight-month high of 91.9. That marks the 23rd consecutive month that the index was below its 49-year average of 98.0, not having exceeded the average since December 2021. In November, five of the 10 components increased, four decreased, while earnings trends was unchanged at -32%. Current inventory (+3ppts to 0%) posted the biggest positive contribution to the SBOI, followed by sales expectations (+2 to -8), now is a good time to expand (+2 to 8), and plans to increase employment (+1 to 18), and expect the economy to improve (+1 to -42). The biggest negative contributions to the SBOI were current job openings (-3 to 40) and plans to increase inventories (-3 to -3), followed by expected credit conditions (-2 to -11) and plans to make capital outlays (-1 to 23). Quality of labor (24%)

and inflation (22) were small business owners' *single biggest business problems*, with taxes (14), government requirements (10), and cost of labor (8) rounding out the top five. The net percentage of owners *raising selling prices* fell back down to July's 29-month low of 25% last month, after climbing 5ppts the prior three months to 30% in October; it was at a near-record-high 66% last March. The net percentage of owners *planning to increase selling prices* continues to trend higher, climbing from a recent low of 21% during April to a 12-month high of 34% in November; it was at a record high of 54% during November 2021. A net 36% of owners reported *raising compensation* in November, where the percentage has been stalled since August and matched June's 25-month low. It was at 46% the first two months of this year and at a record-high 50% at the start of 2022. A net 30% of owners *plan to increase compensation* in the next three months, the highest percentage since last October, up from recent lows of 21% during July and April of this year.

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