



GWM USA

The week in review

Earnings Through the Looking Glass

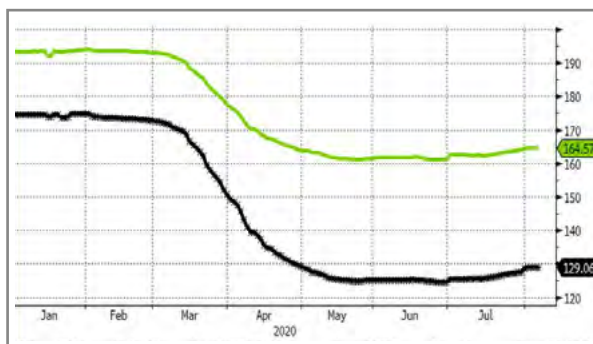
LATEST

This week equity markets are strongly up, government bond yields remain exceptionally low and gold has been hitting new all-time highs.

We spoke about gold coming out-of-the-closet a couple of weeks ago, when it was still just below its all-time high. So, with the S&P 500 index closing last night just below its all-time high, let's take a look at the current quarterly earnings season, as it draws to a close. Factset (who analyse US earnings in detail) report that 84% of US companies beat consensus expectations ("positive surprises") in the last quarter. This is the highest level since at least 2008. Companies beat expectations by 21.8% on average, the highest amount also since at least 2008.

S&P 500 Earnings Estimates 2020 & 2021

We ourselves are closely monitoring earnings estimates for both 2020 and 2021 – these are starting to increase for the first time since the Covid crisis.



Source: Bloomberg, 07/08/2020



Earnings estimates for both 2020 and 2021

US fiscal stimulus deadline

Who gets the money?

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In fact, with estimates now on a modest uptrend, we think the market could discount earnings of \$170 for 2021 by the end of this year, compared with current expectations around \$165. Nevertheless, even at \$170 for earnings, with the S&P 500 at 3349 (last night's close), the market is still on a Price / Earnings multiple of 19.7 times. This is certainly not cheap.

So why is it that we don't think the market is wildly overvalued on a 19.7x multiple, even though this is high by historic standards? With interest rates practically zero, money is likely to remain essentially free (at least for the government) until the economy has fully recovered. To the extent that government spending supported by the central bank creates new money, no matter who the stimulus actually goes to, as that money gets spent in the economy it creates income and profits for businesses. So fiscal stimulus is strongly positive for equities.

US fiscal stimulus deadline

With interest rates so low, the market can discount future profits at the same value as if they were achieved today - whether it takes another year, two years or even longer. So, we think the market can look through to the profit recovery whenever that occurs as if it were today. Of course, there will be many risks and bumps along the way. The most immediate of which is the self-imposed deadline today for the US to agree a further \$1trn fiscal stimulus. Despite talk of a "fiscal cliff", markets remain sanguine since all sides seem to want a deal. We expect negotiations to be resolved in the near term, if not today.

Who gets the money?

The main question seems to be a political one - who actually gets the money. But no matter who that is, any stimulus should filter through to the US corporate bottom line as additional profit. Until the virus is beaten, continued stimulus will likely remain critical to the US corporate profit recovery and we would expect calls for yet further stimulus if the recovery slows down at all.

Fiscal stimulus is likely to be one of the most important factors to monitor for equities in the months ahead.



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