Fourth Quarter Corporate Earnings Scorecard

The 2016 fourth quarter earnings season is nearing the halfway mark with some interesting trends beginning to be revealed. So let's discuss what Wall Street analysts are currently expecting from overall earnings for companies within the S&P 500 and the 11 major sectors in the benchmark index.

To date, the S&P 500 is recording a 5.6% year-over-year increase in earnings growth versus the initial forecast for a 4.2% increase calculated at the beginning of the earnings season. Yet, if long-run trends continue, fourth quarter earnings growth could climb over 9%, as actual results have historically topped initial estimates by an average of 3.6%. As illustrated in Chart 1 below, the sectors in the benchmark index showing the greatest outpacing over their initial January 12th estimates include Real Estate (+14.0 percentage points), Financials (at +4.4 points), Materials (+3.2), Technology (+2.9), and Industrials (+2.5).

The sectors showing the greatest decline in growth expectations are Energy (-12.9 percentage points), Telecom (-3.0 points) and Consumer Discretionary (-1.6 points). Ten of 11 sectors have seen 2017 EPS estimate reductions, led by Materials (-3.6 points) and Real Estate (-3.5 points), followed by Telecom (-2.1 points), and Utilities (-1.3 points). Only Consumer Discretionary has seen no change.

Chart 1

S&P 500 EPS changes as of 02/02/17

	EPS Growth %			
S&P 500 Sector	Q4 2016	Q1 2017e	2016e	2017e
Cons Disc	(1.2)	1.8	9.0	7.8
Cons Staples	5.9	6.5	4.1	6.7
Energy	(20.8)	(1048.7)	(78.3)	350.0
Financials	31.8	36.3	15.2	12.2
Health Care	5.0	4.0	7.1	7.6
Industrials	(2.5)	(3.6)	1.3	4.1
Info Tech	9.6	15.8	3.7	11.6
Materials	9.1	17.2	(0.7)	12.2
Real Estate	0.0	0.0	0.0	3.8
Telecom Svcs	(2.4)	(2.3)	(0.2)	1.3
Utilities	8.1	(0.8)	3.8	0.3
S&P 500	5.6	12.3	(0.1)	11.8

Source: S&P Capital IQ

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Broader Results

So far, 76% of large caps, 76% of midcaps and 68% of small caps have beaten their analysts' earnings expectations, while 51% of large caps, 55% of midcaps and 56% of small caps have beaten consensus sales expectations.

Company-issued forward-guidance trends have improved a bit for large caps over the past week, but still look weak relative to historical trends. Of those that have changed previously announced guidance, just 58% of large caps have raised guidance (vs. 50% as of last week). This is down from last quarter (when 61% had raised guidance) and below its long term average (65%). We are measuring the percent of guidance raised (number of raised announcements over number of raised plus lowered), capturing announcements made between January 1st and February 2nd.

Earnings trends have been a bit better for small caps, so far. Of those that have changed previously-announced guidance, 65% of small caps have raised guidance. This is up slightly from last quarter (when 57% had raised guidance) and above its long term average (62%). At the sector level, we would note that guidance for Technology has been weaker so far this reporting season. Within Technology, we have seen a downtick in the rate of upward guidance across all three industry groups.

Conclusion

The bottom line is that earnings do indeed matter, as earnings per share (EPS) are considered the single best measurement of the financial health of a company. For dividend-paying firms, earnings also reflect the ability of the company to pay and grow its cash distributions. Therefore, it is important for investors to know how much a company is earning today and is likely to earn in the future. Current quarter results matching, missing or exceeding consensus estimates often drive investor perceptions of the company's ability to deliver future earnings and can impact share prices.

As earnings season accelerates into the second half, we continue to favor domestic equities over international, with a slight bias toward growth over value-oriented companies. However, we also recommend retaining global exposures, with an emphasis toward emerging market equities. With the growing uncertainties surrounding actual legislative passage of President Trump's pro-growth policies, we continue to recommend staying fully diversified to limit outsized concentrations in a single asset class.

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***The S&P 500** is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.*

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