Fourth Quarter Earnings – Not as Bad as Feared

Undoubtedly, you know that stocks are having a difficult and volatile time this year, having their worst ten-day start to a year on record. The S&P 500 fell 8% from New Year's Day through January 15. As of yesterday's close, the S&P 500 is down 5.7% year to date (YTD) and is 9.9% below its May 2015 peak. The primary drivers weighing on equities so far this year are:

- China's growth slowdown and its stock market volatility.
- Weakness in crude oil.
- The uncertainty of how many more interest rate increases the Federal Reserve will impose.
- The direction of corporate earnings.

So now, with the first earnings season of 2016 nearing completion, we want to share some observations on fourth quarter corporate profitability; or in some cases, the lack thereof. After all, what ultimately moves stock prices are a company's revenues and earnings, as well as their perceived ability to deliver future returns.

Fourth quarter year-over-year (YoY) earnings are down 4.9% for the 404 companies within the S&P 500 that have reported their results. Approximately 77% of these reporting companies have exceeded their analysts' consensus forecasts, which compares favorably to the historic "beat-rate" average of 67%. Meanwhile, only about half have beaten their revenue projections. Company forward guidance trends have also been weak. On an overall basis, based on up-to-date results, analysts currently estimate that S&P 500 company earnings will fall 4.5% for the fourth quarter. This figure, too, compares favorably to analysts' mid-January forecast for an even greater 7% earnings slump.

Winners & Losers by Sector

As shown in the chart below, five of the ten major sectors within the S&P 500 are expected to post positive earnings growth for the fourth quarter, with Telecom (+19.9%), Consumer Discretionary (+10.8%) and Healthcare (+10.1%) projected to have the strongest YoY profit growth. Energy sector profits are expected to contract by 75%, followed by Materials (-16.5%) and Financials (-5.7%).

	EPS Growth %			
S&P 500 Sector	Q4 2015	Q1 2016e	2015e	2016e
Consumer Disc.	10.8	12.3	13.6	9.3
Consumer Staples	(2.4)	(2.9)	0.3	2.8
Energy	(75.0)	(98.2)	(61.9)	(51.9)
Financials	(5.7)	5.4	6.3	8.4
Health Care	10.0	4.9	14.6	7.9
Industrials	0.7	(5.8)	3.9	4.1
Info.Technology	0.1	(6.2)	5.0	2.9
Materials	(16.5)	(15.5)	(4.0)	(0.8)
Telecom. Services	19.9	4.4	12.9	1.0
Utilities	(4.7)	1.5	1.9	3.4
S&P 500	(4.8)	(5.2)	(0.5)	3.1

Source: S&P Capital IQ

When subtracting out earnings weakness in energy shares – to illustrate the effects from this year's oil slump – S&P 500 earnings would register a net 1.8% increase. Furthermore, when you also exclude materials and industrial companies, the net profit growth figure improves from 1.8% to 5%. Excluding these energy-related and economically-sensitive sectors reveals that nearly 80% of S&P 500 companies are reporting results that match or beat their earnings forecasts. Weakening oil prices have had a negative effect on global energy companies, and their wider industrials services and infrastructure support industries. Financials—particularly bank stocks—have been hurt as the cost of insuring corporate debt issued to oil and gas companies has climbed to multi-year highs.

On a wider basis, including mid-cap and small-cap stocks, 73% of Russell Mid Cap companies and 64% of Russell 2000 small-caps have surpassed their fourth quarter earnings estimates, while 53% and 52% respectively, have topped their sales projections. These beats are actually up from the third quarter 2015, but are low relative to historical trends.

According to S&P Capital IQ, S&P 500 large-cap company earnings are currently expected to increase by 2.8% for the full-year 2016. This projection is down from their early January outlook for earnings growth of 7.4%.

Looking forward, we feel market direction will continue to depend on China's growth, how further oil prices may fall, the direction of interest rates and the impact on corporate earnings. Regarding earnings, we believe that anticipated profit reacceleration in 2016 is highly dependent on the trajectory of global industrial production and gross domestic product (GDP), where the near-term outlook has weakened somewhat. Because so much uncertainty exists today, we continue to expect market volatility to remain elevated as investors balance the aforementioned concerns with positives that still exist. These positives include low global interest rates, improved manufacturing data, and accommodative central banks. We therefore recommend maintaining allocations to equities based on long-term investment objectives, staying near benchmark on stocks, bonds and cash.

We continue to favor domestic equities over international, especially in small-cap stocks with a bias toward growth over value. As always, we recommend staying fully diversified to limit over concentrations in any one asset class. Lastly, we believe it prudent to retain an allocation to alternative investments that have low correlations to traditional investments.

This report is created by Tower Square Investment Management LLC

About Tower Square Investment Management
Tower Square Investment Management LLC is an SEC registered investment adviser owned by Cetera Financial Group®. It provides investment research, portfolio and model management, and investment advice to its affiliated broker-dealers, dually-registered broker-dealers and registered investment advisers.

About Cetera Financial Group
Cetera Financial Group® is a leading network of independent retail broker-dealers empowering the delivery of objective financial advice to investors across the country through trusted financial advisors and financial institutions. The network is comprised of ten firms: four legacy Cetera-branded firms (Cetera Advisors, Cetera Advisor Networks, Cetera Investment Services, marketed as Cetera Financial Institutions, and Cetera Financial Specialists) along with First Allied Securities, Investors Capital, Legend Equities Corporation, Summit Brokerage, VSR Financial Services and Girard Securities.

Cetera Financial Group is the second-largest independent financial advisor network in the nation by number of advisors, as well as a leading provider of retail services to the investment programs of banks and credit unions. Cetera Financial Group delivers award-winning wealth management and advisory platforms, comprehensive broker-dealer and registered investment adviser services, and innovative technology to approximately 9,500 independent financial professionals and over 500 financial institutions nationwide. Through its distinct firms, Cetera Financial Group offers the benefits of a large, established broker-dealer and registered investment adviser, while serving independent and institutions-based financial advisors in a way that is customized to their needs and aspirations. Cetera Financial Group is committed to helping advisors grow their businesses and strengthen their relationships with clients. For more information, visit www.ceterafinancialgroup.com.

The material contained in this document was authored by and is the property of Tower Square Investment Management LLC. Tower Square Investment Management provides investment management and advisory services to a number of programs sponsored by affiliated and non-affiliated registered investment advisers. Your registered representative or investment adviser representative is not registered with Tower Square Investment Management and did not take part in the creation of this material. He or she may not be able to offer Tower Square Investment Management portfolio management services.

Nothing in this presentation should be construed as offering or disseminating specific investment, tax, or legal advice to any individual without the benefit of direct and specific consultation with an investment adviser representative authorized to offer Tower Square Investment Management services. Information contained herein shall not constitute an offer or a solicitation of any services. Past performance is not a guarantee of future results.

For more information about Tower Square Investment Management strategies and available advisory programs, please reference the Tower Square Investment Management LLC Form ADV disclosure brochure and the disclosure brochure for the registered investment adviser your adviser is registered with. Please consult with your adviser for his or her specific firm registrations and programs available.

No independent analysis has been performed and the material should not be construed as investment advice. Investment decisions should not be based on this material since the information contained here is a singular update, and prudent investment decisions require the analysis of a much broader collection of facts and context. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. The opinions expressed are as of the date published and may change without notice. Any forward-looking statements are based on assumptions, may not materialize, and are subject to revision.

All economic and performance information is historical and not indicative of future results. The market indices discussed are unmanaged. Investors cannot directly invest in unmanaged indices. Please consult your financial advisor for more information.

Additional risks are associated with international investing, such as currency fluctuations, political and economic instability, and differences in accounting standards.

While diversification may help reduce volatility and risk, it does not guarantee future performance.

Investors should consider the investment objectives, risks and charges, and expenses of the fund carefully before investing. The prospectus contains this and other important information about the fund. Contact your registered representative or the issuing company to obtain a prospectus, which should be read carefully before investing or sending money.

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.*

The ***Russell Midcap Index*** *measures the performance of the mid-cap segment of the U.S. equity universe and is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The Russell Midcap represents approximately 31% of the total market capitalization of the Russell 1000 companies.*

The ***Russell 2000 Index*** *measures the performance of the small-cap segment of the U.S. equity universe and is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.*

Tower Square Investment Management LLC
200 N. Sepulveda Blvd., Suite 200, El Segundo, CA 90245