Insights
**Active Quantitative Equity (AQE)**

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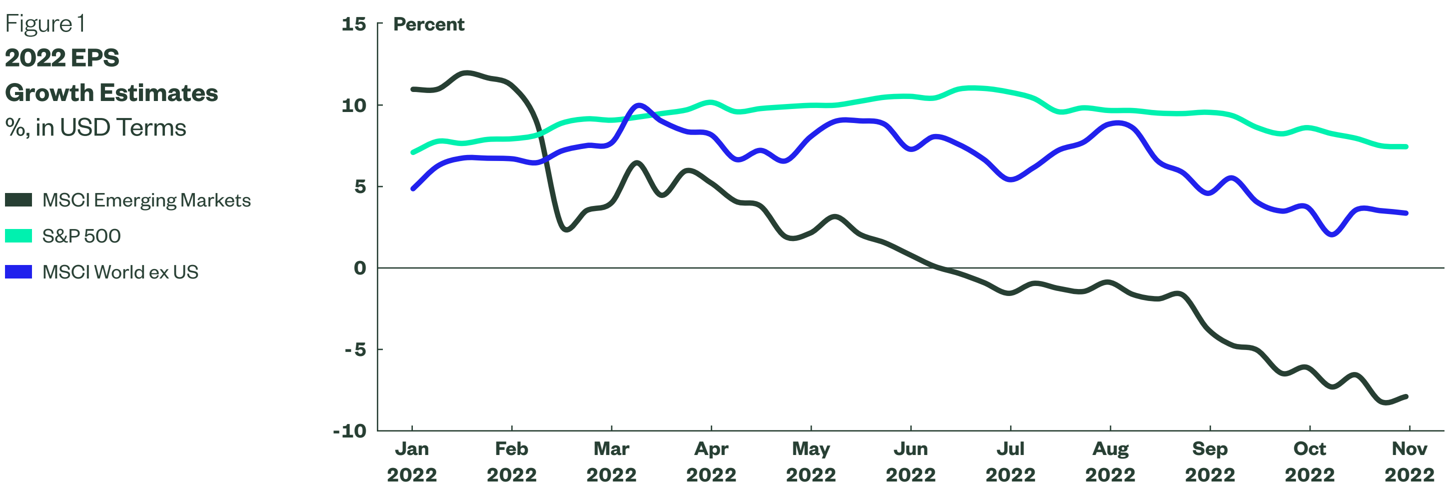
# Earnings Forecast Revisions and the Search for Equity Outperformance


**Olivia Engel, CIO**
Active Quantitative Equity


Though earnings forecasts have weakened in recent months, when selecting stocks it is important to consider these revisions in the context of key Value, Quality, and Sentiment measures.

Earnings growth estimates have been revised downward across the world's public companies for several months, most significantly in Emerging Markets (EM). See Figure 1. Despite this overall earnings weakness, the signal that the Active Quantitative Equity (AQE) team uses to capture earnings forecast revisions has performed well in helping pick market outperformers in the last three months (except in China, where it has not added value). The AQE Earnings and Revenue Trend Indicator complements the signals from our core Value, Quality, and Sentiment themes.

Figure 1
**2022 EPS Growth Estimates**
%, in USD Terms




Source: Bloomberg Finance L.P., as at 31 October 2022.

## Developed Markets Revisions

The strongest revisions to earnings growth estimates right now are Banks in Europe and Australia, Consumer Services, Household Products, and Media stocks in Europe, and Consumer Durables and Retailing stocks in Japan. Japanese Tech Hardware and Pharmaceuticals are also seeing more favorable earnings conditions.

Among segments with strong earnings revisions, we see overall attractiveness in European and Australian Banks, and in Japanese Tech Hardware and Pharmaceuticals (see Figure 2). However, despite some positive revisions relative to other segments, European Household Products are not attractive overall because our Value signal finds them to be very expensive versus other parts of the market. Similarly, Japanese Consumer Durables are not attractive because of weak Quality and Sentiment measures.

Figure 2
**Developed Market Earnings Revisions**

| | Overall View | Value | Quality | Sentiment |
|---|---|---|---|---|
| **Strongest Earnings Revisions** | | | | |
| Europe Banks | Most Preferred | Cheap | Low | Positive |
| Australia Banks | Most Preferred | Cheap | — | Positive |
| Japan Tech Hardware | Most Preferred | Cheap | — | Positive |
| Japan Pharmaceuticals | Most Preferred | Cheap | High | Positive |
| Europe Household Products | Least Preferred | Expensive | — | Positive |
| Japan Consumer Durables | Least Preferred | — | Low | Negative |
| Europe Consumer Services | Neutral | Expensive | — | Positive |
| Europe Media | Neutral | Expensive | Low | Positive |
| Japan Retailing | Neutral | Expensive | Low | Positive |
| **Weakest Earnings Revisions** | | | | |
| US Consumer Durables | Least Preferred | Cheap | Low | Negative |
| US Household Products | Least Preferred | Expensive | High | Negative |
| US Autos | Least Preferred | Expensive | Low | Negative |
| US Materials | Least Preferred | — | Low | Negative |
| US Semiconductors | Neutral | — | High | Positive |
| US Pharmaceuticals | Most Preferred | — | High | Positive |

Source: State Street Global Advisors as at 31 October 2022.

The weakest earnings revision trends are in the US, especially in Consumer stocks (Durables, Household Products, and Autos) as well as Materials, Semiconductors, and Pharmaceuticals. US Household Products are expensive and have weak Sentiment, even though they score well on Quality measures. US Consumer Durables are very cheap, but their Quality and Sentiment measures are weak. US Materials are very weak on Sentiment. US Autos have poor measures across all AQE themes.

We do, however, have a constructive view of US Pharmaceuticals, even though their earnings revisions are weak. Sentiment and Quality metrics are quite strong on average, and US Pharmaceuticals are reasonably priced versus other market segments.

US Semiconductors' earnings revisions are weak (with supply chain issues denting near-term earnings), but measures of Quality and Sentiment remain strong, driven by ongoing demand dynamics.

## Emerging Markets Revisions

In China, Banks have delivered weak earnings revisions and Semiconductor firms have delivered strong earnings revisions. Across the rest of EM, the exact opposite is true, with Banks delivering strong earnings revisions and Semiconductor firms delivering weak earnings revisions. Figure 3 details the more complete picture of why we see overall attractiveness in all EM Banks and Semiconductors.

Figure 3
**EM Banking and Semiconductor Sectors**

| | Earnings Revisions | Overall View | Value | Quality | Sentiment |
|---|---|---|---|---|---|
| China Banks | Weak | Most Preferred | Cheap | Low | — |
| EM Ex-China Banks | Strong | Most Preferred | — | — | Positive |
| China Semiconductors | Strong | Least Preferred | Expensive | Low | Positive |
| EM Ex-China Semiconductors | Weak | Most Preferred | Cheap | High | Negative |

Source: State Street Global Advisors as at 31 October 2022.

## The Bottom Line

Even though earnings forecasts have weakened in recent months, we believe that it is important to pay attention to other attributes when selecting stocks. Value and Quality are important themes to consider, along with key Sentiment measures (e.g., price sentiment, hedge fund positioning, supply-chain linkages, and conference call sentiment).

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* Pensions & Investments Research Center, as of December 31, 2021.
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