Global Earnings Season Observations

- Record earnings and peak cycle earnings
- Cost and inflation pressures
- Australian reporting season – more uncertainty

Bruce Apted
Head of Portfolio Management – Australia
Active Quantitative Equities

Record Earnings & Peak Cycle Earnings

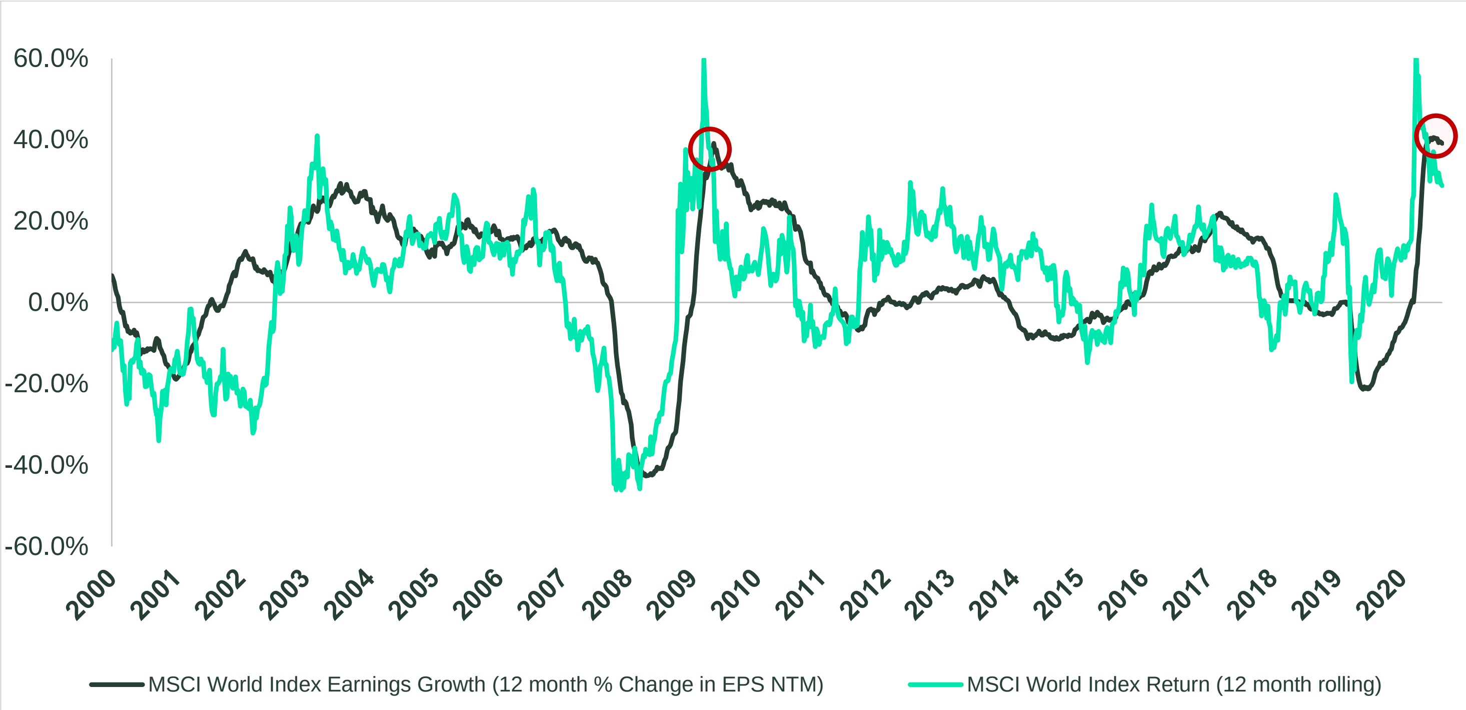
Whilst the Australian reporting season is just getting warmed up the global reporting season is largely complete. In this monthly note we take a look at some of the key take outs from the global corporate landscape and what it may mean for the local market.

The global reporting season has seen many earnings records broken. The percentage change in earnings and sales are some of the largest percentage changes we have seen. Many sectors, especially the more cyclical sectors that were the most negatively impacted by the Covid-19 pandemic, have generated triple digit earnings growth year on year to 30 June 2021. The percentage changes reflect a comparison of economic activity at its lowest (30 June 2020) to one which is largely back to normal (30 June 2021). The Australian reporting season is producing some very positive improvements in earnings, dividends and capital over the last 12 months. This of course tells us much less about the forward looking environment. Equity markets have in most cases already reflected these improvements and are now digesting a forward looking environment with lower rates of earnings growth and greater uncertainty. Figure 1 provides a 20+ year perspective on changes in expectations for earnings and the corresponding rolling 12 month returns for equities. Figure 1 also highlights the positive relationship between higher rates of earnings growth for equities and higher returns (and vice versa).

As figure 1 below shows the latest growth in EPS is +39% for the MSCI World Index. This is a little below the peak growth of 40.4% achieved on 24 June 2021 (just before the global earnings season kicked off). The 12 month MSCI World Index return over the same period was +28.7%.

The recent pattern in earnings growth and market returns has many similarities to the Global Financial Crisis (GFC) period. During the GFC earnings growth declined by -42.6% to April 2009 and 12 months later peaked at +38% in April of 2010. During the pandemic earnings expectations declined -21.5% to May 2020 and peaked at +40.4% 13 months later. In both cases the equity market lead the changes in earnings by a few months. If earnings growth rates have indeed peaked then it implies lower positive equity returns looking forward.

Figure 1: MSCI World Index 12 Month Returns and 12 Month EPS Growth



Source: State Street Global Advisors, Factset as of 15 August 2021. Data from January 2000 to August 2021. Return is calculated as the rolling 12 month percentage change in the MSCI World Index. The earnings growth is measured by the rolling 12 month percentage change in the expected earnings per share of the MSCI World Index for the next 12 months (NTM).
EPS = Earnings Per Share

Inflation and Cost Pressure Remains a Risk For Equities Looking Forward

Inflation has been a prominent point of discussion of investors this year and for a good reason. As inflation trends higher, the likelihood of tighter monetary conditions increases – adding a “taper tantrum” risk to equity markets. Further, and equally importantly inflation has the ability to erode margins for corporates especially for highly competitive sectors where it is more difficult to pass on cost increases. In the most recent earnings season, cost pressures were a major theme relative to history. Reviewing the global company filings since 30 June 2021 we have seen an above average use of words relating to inflation, cost pressure, labour shortage and labour costs, freight and shipping costs[1]. As these are global issues we would expect this theme to be present in the Australian reporting season as well.

Mixed Price Responses to Results and Company Guidance

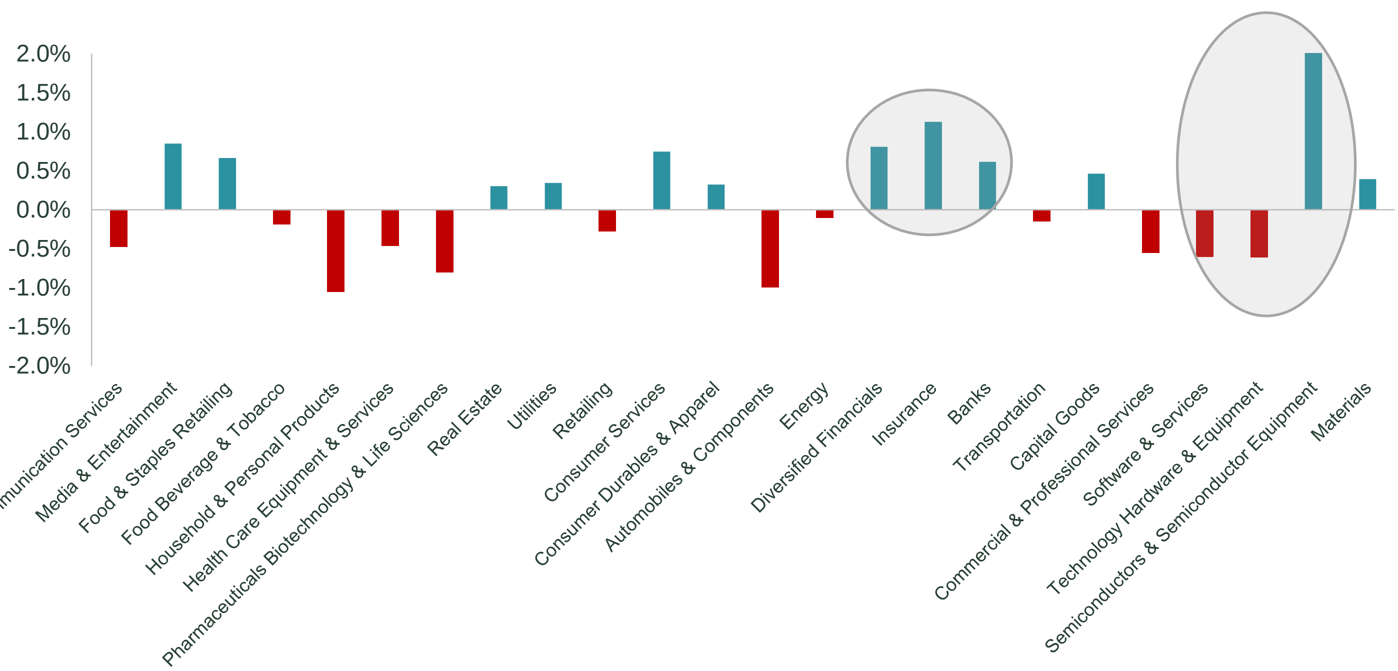
The price reaction on the day of results is an interesting measure of the market’s assessment of the quality of the result and more importantly the companies forward guidance. More important than the company beat or miss is the company outlook and company guidance. Figure 2 below outlines the market reactions across industries, on the day of the company’s results and averages these across the industries.

Globally technology saw some of the greatest dispersion with semiconductors performing the best while software service and hardware and equipment underperformed. Globally market participants liked the results across insurance, diversified financials, and banking. Within Australian financials we have seen strong results from most

[1] Based on word counts of the key words in corporate filings.

insurance companies but less positive response to the banking results. Despite positive earnings, dividends, buybacks and capital positions, the price reactions have been muted suggesting most of the good news was already in the price for the Australian bank stocks. Investors are now looking to the next 12 months and weighing up the impact of the current lockdowns. Many corporates have produced great results to 30 June but looking out to the next 12 months are uncertain about the impact of the lockdowns on sales and earnings and are providing less guidance. This theme is expected to impact investor confidence and result in potentially more volatility in August.

Figure 2: MSCI World Index Price Reactions on the Day of Results (30 June 2021 to 15 August 2021)



Source: State Street Global Advisors, Factset as of 15 August 2021. For all companies within the MSCI World Index as of 30 June 2021. The returns are calculated for stocks on the day they reported their results. The average return is then calculated for the GIC industry group. Holdings and sectors shown are as of the date indicated and are subject to change. This information should not be considered a recommendation to invest in a particular sector. It is not known whether the sectors shown will be profitable in the future.

Thematically the most dominant themes in the market over the reporting period has been the continued out performance of high quality companies, those with lower volatility and those with better valuations[2]. We expect these themes to remain relevant for the rest of August.

The Bottom Line

The record breaking year on year earnings results make for great headlines but somewhat ironically set the market up for disappointment. We have likely seen peak earnings growth which has already been accompanied with above average returns. Looking forward we see positive earnings growth but at lower rates that is likely to be accompanied with lower but still positive rates of return. The Australian reporting season so far has echoed the global reporting season in that much of the positive news is in the price, and looking forward we see greater uncertainty.

[2] Source: State Street Global Advisors, Factset as of 15 August 2021.

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