June 3, 2024

Morning Briefing

Earnings Tales

Check out the accompanying chart collection.

Executive Summary: Our economic and S&P 500 forecasts are underpinned by our forecasts for corporate revenues, earnings, and profit margins. We often compare them to industry analysts' consensus estimates for S&P 500 companies in aggregate and how they change over time in response to earnings reports. Today, we illustrate this process by showing how data from Q1's earnings season have fed into our own annual and forward EPS estimates, which multiplied by target forward P/Es produces our S&P 500 targets for year-end 2024, 2025, and 2026 of 5400, 6000, and 6500. Notably, Q1's reported revenues and earnings edged down from their recent record highs, but analysts' estimates for the future rose, showing that the quarter's results were much better than expected. … Also: Dr. Ed reviews "Manhunt" (+ +).

YRI Weekly Webcast. Join Dr. Ed's live webcast with Q&A on Mondays at 11 a.m. EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

Earnings I: Expecting Record Highs Ahead. Joe reports that the S&P 500 Q1 earnings reporting season is now 98% complete, with 490 companies having issued their results. The 10 companies left to report are: Lululemon Athletica, Bath & Body Works, Brown-Forman, Campbell Soup, J M Smucker, Dollar Tree, Kroger, Autodesk, Broadcom, and Hewlett Packard Enterprise Co. Whatever those 10 firms report shouldn't significantly change the aggregate results of the 500 companies in the index once the analysts' consensus estimates are replaced by their actual results. Let's have a look at the latest Q1 results:

(1) *Growth rates.* The S&P 500 companies' collective earnings per share and revenues per share edged down during Q1 from their recent record highs during Q3-2023 and Q4-2023, respectively (*Fig. 1*). Their y/y growth rates were 4.5% and 6.7% (*Fig. 2* and *Fig. 3*).

(2) *Forward guidance.* Despite Q1's small decline in earnings per share from its record high at the end of last year, most company managements' forward guidance provided on Q1 earnings conference calls has been positive. We can see that in the analysts' consensus

earnings-per-share estimates for 2024, 2025, and 2026 (*Fig. 4*). All three rose as the earnings reporting season progressed, with the latter two rising to new record highs.

(3) *Annual estimates*. Here are the index's annual earnings-per-share estimates as of the May 30 week: 2024 ($244.68), 2025 ($279.67), and 2026 ($314.81). Here are our forecasts: 2024 ($250), 2025 ($270), and 2026 ($300) (*Fig. 5*).

(4) *Our price target*s. When we calculate our S&P 500 price targets for the end of each year, we project S&P 500 forward earnings per share for the end of each year and multiply it by a forward P/E range of 16 to 20. We are still forecasting the following forward earnings at the end of each year: 2024 ($270), 2025 ($300), and 2026 ($325) (*Fig. 6*). (FYI: "Forward" earnings and revenues are the time-weighted average of industry analysts' consensus estimates for the current and following year.)

That gives us the following year-end target ranges for the S&P 500 stock price index: 2024 (4320-5400), 2025 (4800-6000), and 2026 (5200-6500) (*Fig. 7*). In our Roaring 2020s scenario, we are picking the tops of these three ranges as our point estimates: 2024 (5400), 2025 (6000), and 2026 (6500). By the end of the decade, we expect to see the S&P 500 at 8000, with forward earnings at $400 and the forward P/E at 20.

(5) *Record highs in forward revenues & earnings.* Meanwhile, S&P 500 forward revenues per share and forward earnings per share both rose to record highs in late May, suggesting that actual quarterly S&P 500 revenues per share and earnings per share are heading to new record highs despite the small setback during Q1 (*Fig. 8* and *Fig. 9*).

(6) *Profit margin*. We can calculate the S&P 500 forward profit margin (on a weekly basis) and the actual profit margin (on a quarterly basis) by dividing the comparable earnings data by the revenues data (*Fig. 10*). When we do so, we find that the S&P 500 profit margin ticked up to 12.0% during Q1, while the forward profit margin rose to 13.3% during the May 30 week.

Again, in our Roaring 2020s scenario, we expect the actual profit margin to rise from 13.2% this year to 13.7% in 2025, and 14.6% in 2026 (*Fig. 11*).

(7) *Latest quarterly result.* In addition to positive forward guidance, industry analysts must have revised their annual earnings estimates higher following a significant beat of their Q1 forecasts by the S&P 500 companies they follow. Near the start of the season, during the week of April 18, they were expecting the quarter's earnings to be up 1.2% y/y. Instead, the

growth rate was 6.7% (*Fig. 12*). That's a very significant earnings "hook" (so called because of the hook-like pattern on the data series line at the point when unexpected actual results replace analysts' estimates).

Earnings II: Forward Revenues & the Economy. Now let's review the relationship of S&P 500 aggregate revenues to various macroeconomic variables. We calculate the former by multiplying S&P 500 revenues per share by the S&P 500 divisor each quarter.

Interestingly, notwithstanding lots of buybacks, the growth rates of revenues per share and aggregate revenues don't differ very much (*Fig. 13*). The average spread since 1993 has been -0.6ppt. During Q1, revenues per share rose 4.5% y/y, while aggregate revenues rose 4.9%.

Shouldn't the growth rate of revenues per share significantly exceed that of aggregate revenues as a result of share buybacks? They certainly do for the companies that are buying back their shares to boost earnings per share. However, many companies are buying back their shares to offset employee stock compensation to avoid diluting their earnings per share. In addition, the spread between the growth rates of earnings per share and in aggregate reflects net stock issuance, i.e., gross equity issuance less gross buybacks.

Now consider the following:

(1) S&P 500 revenues totaled $15.8 trillion at an annual rate during Q1 (*Fig. 14*). This total is derived from the worldwide sales of both goods-producing and services-providing corporations. Nevertheless, its short-term fluctuations are driven by goods-producing companies, which tend to have more cyclical earnings than services-providing companies.

(2) We can see this in the spread between the growth rates of manufacturing & trade sales—which includes just goods producers—and S&P 500 aggregate revenues (*Fig. 15*). The growth rate of business sales of goods started to weaken significantly relative to the growth rate of revenues in late 2022 when the goods economy fell into a rolling recession, while the service economy has remained strong.

Similarly, there is a much closer correlation between the growth rate of S&P 500 aggregate revenues and the growth rate of nominal GDP for goods than the growth rate of nominal GDP for services (*Fig. 16* and *Fig. 17*).

Earnings III: Forward Earnings & the Economy. Debbie and I have found that the S&P 500 forward earnings series is a very good weekly indicator of economic activity. It is currently showing that the economy's growth rate is improving rather than signaling a recession. Debbie and I have previously observed that S&P 500 forward earnings is a coincident rather than a leading indicator of the economy, but it is available weekly (*Fig. 18*). It is currently rising in record-high territory.

The growth rate of S&P 500 forward earnings is also highly correlated with those of the Index of Coincident Economic Indicators and real GDP, all on a y/y basis (*Fig. 19* and *Fig. 20*).

Forward earnings is up 11.7% y/y through the week of May 24. Its growth rate has been increasing since August 2023. That doesn't happen when the economy is slipping into a recession. That's because rising corporate profits cause companies to expand payrolls and capacity.

By the way, the growth rate of forward earnings did turn negative in the mid-1980s, mid-2010s, and during 2023. During those times, the small declines in the growth rate of forward earnings confirmed that the economy was experiencing mid-cycle slowdowns rather than a recession.

Movie. "Manhunt" (+ +) (*link*) is a television miniseries about the hunt for John Wilkes Booth after he assassinated President Abraham Lincoln. Lincoln's Secretary of War and friend, Edwin Stanton leads the investigation. Tobias Menzies plays Edwin Stanton, and Anthony Boyle plays John Wilkes Booth. They both do an admirable job of recreating the protagonist and antagonist in this historical drama about the important events that followed the assassination.

Calendars

US: Mon: ISM M-PMI & Prices 49.8/60.0; Total Vehicle Sales 15.8mu; Construction Spending 0.2%; Atlanta GDPNow (Q2) 2.7%. **Tues:** JOLT Job Openings 8.4m; Factory Orders 0.7%; API Weekly Crude Oil Inventories. (FXStreet estimates)

Global: Mon: Eurozone, Germany, France, Italy, and Spain M-PMIs 47.4/45.4/46.7/47.9/52.5; UK BRC Retail Sales Monitor 1.2%; Australia Retail Sales 0.1%. **Tues:** Germany Unemployment Change 7k; Germany Unemployment Rate 5.9%; Australia

GDP 0.2%q/q/1.2%y/y; China Caixin NM-PMI 52.6; Fernandez-Bollo; Mauderer. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index has posted gains in 22 of the past 33 weeks after trading below its prior (December 27, 2021) record high for 25 months. However, the 0.6% drop last week was the index's second straight decline. The US MSCI finished the week just 1.0% below its May 21 record high. The AC World ex-US index fell 1.0% w/w to 8.2% below its June 15, 2021 record high. It had been at a 28-month high on May 20. EAFE was the best performing region last week, albeit with a decline of 0.1%, followed by Europe (-0.4%), EMU (-0.9), and the AC World ex-US. EMEA was the worst regional performer with a decline of 3.5% last week, followed by EM (-3.1), EM Asia (-3.1), and EM Latin America (-2.9). Among the major selected country markets that we follow, Switzerland performed the best last week with a gain of 1.8%, followed by Spain (0.9), Japan (0.8), Sweden (0.0), and Canada (0.0). The worst country performers last week: South Africa (-6.2), Taiwan (-3.4), Korea (-3.4), Brazil (-3.3), and China (-3.1). During the month of May, the United States rose 4.6%, nearly double the 2.4% gain for the AC World ex-US. Europe was the best performing region with a gain of 4.1%, followed by EAFE (3.3%), EMU (3.3), and the AC World ex-US. The worst performing regions for the month: EM Latin America (-3.9), EMEA (-2.9), EM (0.3), and EM Asia (1.2). Switzerland was the best country performer in May with a gain of 7.8%, followed by Sweden (6.6), Spain (5.7), Taiwan (5.3), and the United States (4.6). Brazil was May's worst performer with a drop of 5.9%, followed by Korea (-3.6), Mexico (-2.8), South Africa (-0.2), and India (0.5). The 10.3% ytd gain for the MSCI United States remains well ahead of the AC World ex-US index (4.3). EMU has moved back ahead of the pack as the leading region ytd with a gain of 7.2%, which puts it ahead of Europe (6.2%), EAFE (5.3), EM Asia (5.2), and the AC World ex-US. The worst performing regions so far in 2024: EM Latin America (-12.2), EMEA (-3.3), and EM (2.5). Looking at the major selected country markets that we follow, Taiwan is far and away the best ytd performer with a gain of 15.3%, followed by the United States (10.3), Spain (9.9), India (8.9), and the United Kingdom (6.6). The worst performing countries so far in 2024: Brazil (-18.0), Korea (-8.3), Hong Kong (-6.7), Mexico (-6.3), and South Africa (-5.8).

US Stock Indexes (*link*): Investors rotated out of the LargeCap growth-style indexes last week into the SmidCap value-style indexes. Just 22 of the 48 major US stock indexes that we follow rose, but that's up from just 11 rising a week earlier. The Dow Jones 15 Utilities index was the best performer for the week with a gain of 2.2%, followed by Dow Jones 20 Transports (1.0), S&P 600 SmallCap Pure Value (0.9), S&P 600 SmallCap Value (0.9), as well as 0.8% gains for these three indexes: S&P 400 MidCap Value, S&P 400 MidCap Pure Value, and S&P 500 LargeCap Pure Value. The Russell MidCap Growth index was the worst performer with a decline of 2.2%, followed by S&P 500 LargeCap Pure Growth (-1.5), Nasdaq 100 (-1.4), and the 1.2% declines for Russell 1000 Growth, S&P 500 LargeCap Growth, and Russell 3000 Growth. During May, gains were posted by 47 of the 48 indexes that we follow. The Nasdaq Composite was the best performing index in May with a gain of 6.9%, ahead of S&P 500 LargeCap Growth (6.5), Nasdaq 100 (6.3), Dow Jones Utilities (6.0), and the 5.9% gains for the S&P 600 SmallCap Pure Value, Russell 1000 Growth, and Russell 3000 Growth indexes. These indexes were May's worst performers: S&P 500 Transportation (-1.7), Russell MidCap Growth (1.0), and the 2.2% gains for the Nasdaq Industrials, S&P 500 LargeCap Pure Value, and Dow Jones Transportation indexes. Looking at their ytd performances, 41 of the 48 indexes are higher so far, but that's down from 47 at the end of March. The S&P 400 MidCap Pure Growth index is the best performer so far in 2024 with a gain of 19.7%, followed by S&P 500 LargeCap Growth (15.2), S&P 100 MegaCap (12.8), Russell 1000 Growth (12.7), S&P 400 MidCap Growth (12.7), and Russell 3000 Growth (12.3). The worst performing major US stock indexes ytd: Dow Jones 20 Transports (-4.2), S&P 600 SmallCap Value (-3.0), S&P 500 Transportation (-2.8), S&P 600 SmallCap Pure Value (-2.2), and S&P 600 SmallCap Equal Weighted (-1.4).

S&P 500 Sectors Performance (*link*): Six of the 11 S&P 500 sectors rose last week, and seven outperformed the S&P 500's 0.5% decline. That compares to two sectors rising a week earlier when the same two were ahead of the composite index's flat performance. Energy was the best weekly performer with a gain of 2.0%, followed by Real Estate (1.8%), Utilities (1.6), Consumer Staples (0.1), Materials (0.1), Financials (0.1), and Consumer Discretionary (-0.3). The underperformers last week: Information Technology (-1.5), Industrials (-0.8), Communication Services (-0.6), and Health Care (-0.6). During May, 10 of the 11 sectors rose and four outperformed the S&P 500's 4.8%, which was its May performance since 2009. Information Technology was the best performing sector in May with a gain of 10.0%, ahead of Utilities (8.5), Communication Services (6.6), and Real Estate (5.0). These sectors trailed the S&P 500 in May: Energy (-1.0), Consumer Discretionary (0.2), Industrials (1.4), Health Care (2.2), Consumer Staples (2.3), Financials (2.0), and Materials (3.1). The S&P 500 is up 10.6% ytd with 10 of the 11 sectors in positive territory but only three ahead of the index. Several weeks earlier, five sectors were ahead of the index. Communication Services is the best ytd performer, with a gain of 20.4%, ahead of Information Technology (16.9) and Utilities (14.2). These sectors are lagging the S&P 500 so far in 2024: Real Estate (-5.4), Consumer Discretionary (0.4), Health Care (5.1), Materials (6.6), Industrials (8.1), Consumer Staples (8.1), Financials (10.4), and Energy (10.6).

US Economic Indicators

Personal Income & Consumption (*link*): Both income and spending have slowed in recent months, and edged down when adjusted for inflation. Personal income increased 0.3% in April following a 0.5% gain in March and a 1.1% jump at the start of the year. *Personal consumption expenditures* rose only 0.2% in April following gains of 0.7% in each of the prior two months. *Goods* consumption fell 0.2%, with both *durable* (-0.3%) and *nondurable* (-0.1) goods spending slipping during the month after solid gains in March. *Services* consumption climbed 0.4%, slowing steadily from January's 0.9% increase. Adjusted for inflation, *real PCE* slipped 0.1% in April after gains of 0.4% and 0.3% the prior two months, with *goods* consumption falling for the third time in four months, by 0.4% in April and 0.9% over the period, and *services* consumption rising 0.1% and 1.0% over the comparable periods. *Disposable income* increased 0.2% in May, less than half April's 0.5% increase and the smallest increase since last November. Meanwhile, real disposable income ticked down 0.1% in May following a 0.1% gain and a 0.1% loss the prior two months. Consumers continue to dip into savings, with *personal saving* falling for the third month by $111.6 billion (to $744.5 from $856.1 billion in January) and the *saving* rate falling from 4.1% in January to 3.6% in both March and April.

Personal Consumption Deflator (*link*): *Headline* PCED increased 0.3% in April, in line with expectations and matching gains the prior two months, while the *core* PCED rose 0.2%, a tick below the expected 0.3% gain and the smallest monthly increase so far this year. The *yearly rate for the headline* PCED was unchanged at 2.7% in April, up from 2.5% in February, while the yearly rate for *core* prices held at 2.8% again in April, which was the lowest rate since March 2021 and matched gains in March and February. *Goods* prices rose 0.1% y/y in April following gains of 0.1% and 0.5% the prior two months—which followed two months of falling prices—with the durable goods inflation rate at -2.2% and the nondurable goods rate up 1.4% in April. There's deflation in *durable goods* prices: used motor vehicles (-4.9 y/y), furnishings & durable household equipment (-3.1), other durable goods (-2.5), motor vehicles & parts (-1.9), recreational goods vehicles (-1.8), and motor vehicles parts & accessories (-1.3). Within *nondurable goods* prices, rates are down dramatically from recent peaks: recreational items (-2.2% y/y from 7.3% y/y), household supplies (-2.1 from 10.0), magazines, newspapers & stationary (1.3 from 11.5), clothing & footwear (1.5 from 6.9), pharmaceuticals & other medical products (1.9 from 4.5), and personal care (3.0 from 8.1). Within *services*, *housing* costs remain stubbornly high but are down from recent peaks: owners' equivalent rent (to 5.7% from 8.2%), tenant rent (5.4 from 8.8), and housing & utilities (5.6 from 8.3). Looking at *non-housing* services, transportation (3.0 from 15.3) and personal care (7.3 from 10.4) services showed noticeable drops in the rate of inflation, though the latter has moved up in recent months; the communication services (-0.2) rate remains just below zero.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Indexes (ESIs) for the both the EU and Eurozone increased marginally in May, with the *EU's measure* ticking up 0.3 points to 96.5 and the *Eurozone's* edging up 0.4 points to 96.0. There was more strength than weakness in ESIs among the *six largest EU economies* this month, with only Spain (-3.2 points to 101.1) and Poland (-1.5 to 101.7) posting declines; sentiment in France (+1.5 to 97.3) and the Netherlands (+1.1 to 99.4) recorded the largest gains, followed by more moderate increases in Germany (+0.8 to 92.4) and Italy (+0.8 to 100.4). By *sector*, for the overall EU, services (+0.7 points to 6.8) and consumer (+0.5 to -13.2) sentiment improved, while industry (-0.1 to -9.5) confidence was broadly stable. Meanwhile, retail trade (-0.9 to -5.9) and construction (-0.6 to -8.1) confidence declined during the month.

Eurozone CPI Flash Estimate (*link*): The *Eurozone CPI* is expected to be 2.6% y/y in May, according to the flash estimate, up from 2.4% in April, which matched its lowest rate since summer 2021, while the core CPI is expected to tick up to 2.9% in May from to 2.7% in April, which was the lowest since February 2022. Both are down sharpy from their recent peaks of 10.6% in October 2022 and 5.7% in March 2023. Looking at the components, the *services* (4.1% y/y from 3.7% y/y in April) rate is expected to accelerate in May, after falling to its lowest percentage since May 2022 in April, while the rate for *energy* prices is expected move back above zero, to 0.3%, the first positive reading since April 2023. It bottomed recently at -11.5% in November. Meanwhile, the rate for *food, alcohol & tobacco* (2.6% from 2.8%) is expected to ease, matching March's rate, which was the lowest since November 2021. Among the four *largest Eurozone countries*, Germany (2.8% y/y), France (2.7), Italy (0.8), and Spain (3.8), are down from their peaks of 11.6%, 7.3%, 12.6%, and 10.7%, respectively, though the rates for Germany, France, and Spain all accelerated in May.

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