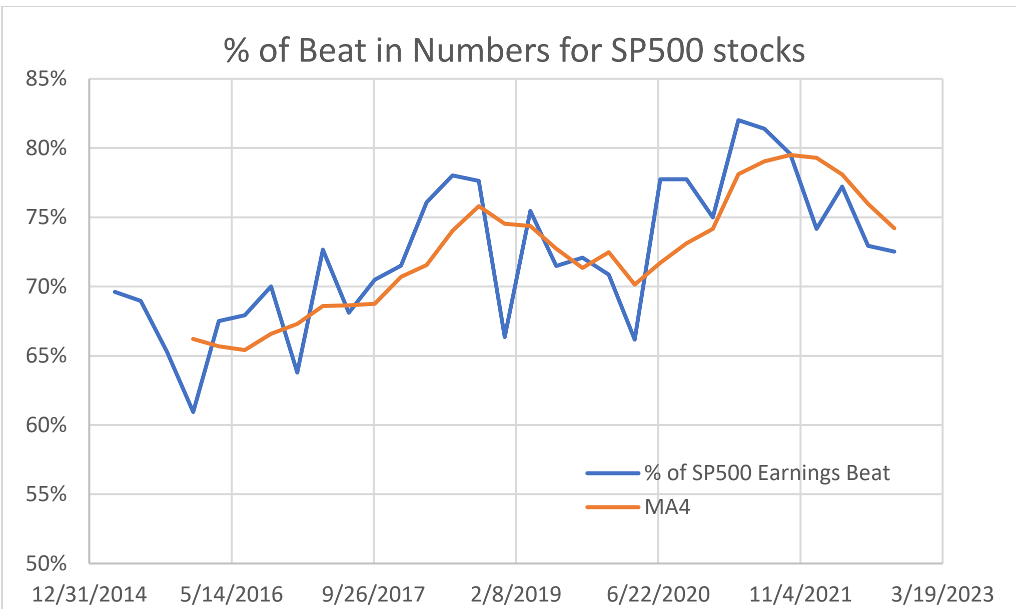
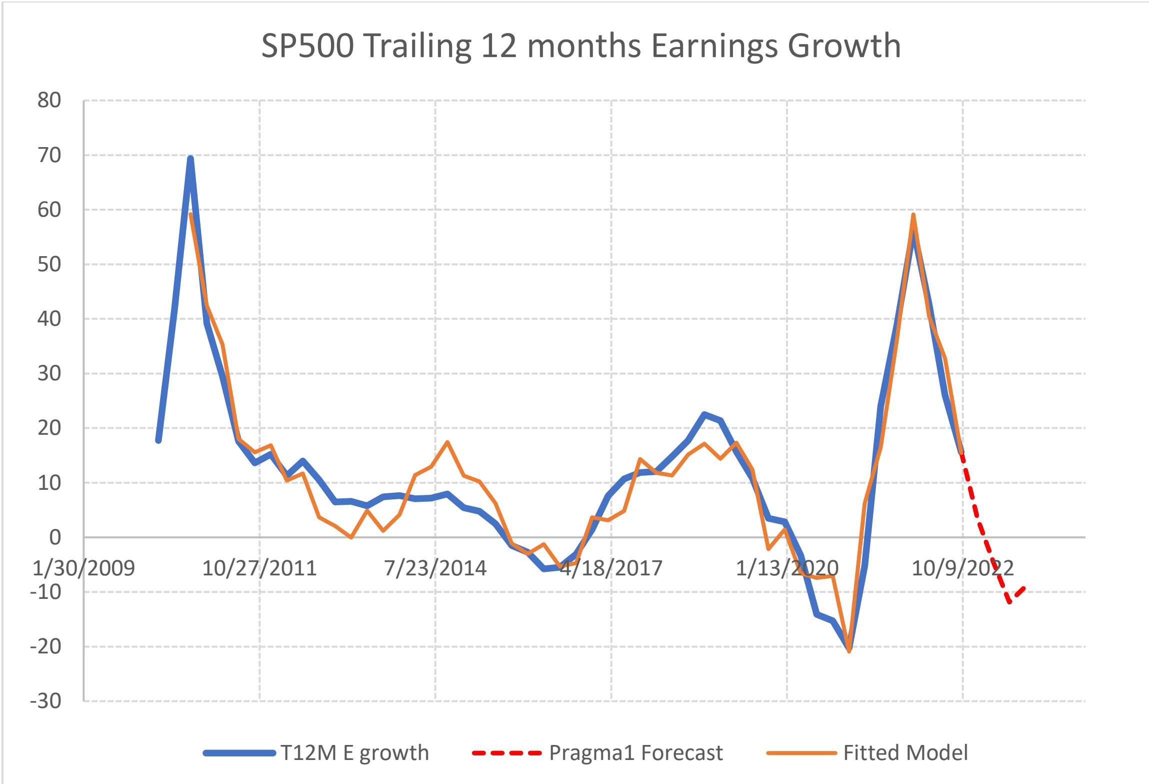
The Earnings Cliff: how deep will it be?

C. Wenzel for PragmaOne.com, November 2022.

The Q3 earnings season is already well advanced, and the positive surprises statistics disappoint: the proportion of positive surprises for US SP500 stocks is close to 72%, and the four-quarter moving average is clearly decreasing (we use the current composition of the SP500). Moreover, FedEx and Amazon, two companies with a strong view of the economy's strength, have launched ominous warnings.



We developed models to forecast the SP500 earnings growth. To avoid overfitting, we limit explanatory variables to a maximum of 3 independent variables selected among macro indicators and sub-components of the PMI report. Then we average out the predictions of our different models to propose the following estimates. Graph1 displays the fit for the period 2010-2021 and the predictions for the forthcoming year until the third quarter of 2023.



We expect the quarter-over-quarter earnings growth to become negative as soon as Q4 2022, with the yearly variation becoming negative in Q1 2023. According to our model, the **trough could be attained in Q2 2023, with an annual earnings growth of -12%.**

Thus, our view is that the current rally will fade when the market finally reprices earnings.

<u>Important Disclaimer</u>