US earnings point to economic slowdown

The aggressive rate hiking by central banks to tackle inflation dominated investors' attention in 2022. However, after a year of rate hikes, central banks are closer to the peak of their tightening cycle, and the focus is increasingly on corporate fundamentals, including their earnings and financial strength.

The US earnings season, seen as a barometer of corporate America – and the world's largest economy – is now in full swing. Heading into it there was much uncertainty related to persistent core inflation, recession fears, geopolitical tensions and how far the Federal Reserve would hike rates.

Companies usually like to manage expectations ahead of their results, leading to the analysts who study stock markets often being pessimistic about upcoming earnings. Surprises to the upside can provide a fillip to share prices.

In the previous quarter – Q4 2022 – S&P 500 companies' earnings were down -5.4% on revenues that were 5.9% higher compared with Q4 2021. Ahead of the current quarter, the consensus was for earnings to be around -10% down on revenues 1.7% higher than they were in Q1 2022.[1]

In practice, the start to the earnings season has been better than expected. The first 53 S&P 500 companies to report stated earnings were up 2.9% on 9.3% higher revenue, with 83% of them beating earnings per share (EPS) estimates and 72% beating revenue estimates.[2]

Financials open season with mixed results

The first industrial sector to report is normally financials. Expectations for the sector were reduced after the crisis sparked by US regional banks in March, most notably involving Silicon Valley Bank (SVB) and results have been mixed.

Several leading names beat market estimates: JPMorgan, for example, was up 52.4% on earnings and raised its outlook, while Bank of America was up 15.5%. Even the regional banks came in better than expected, with most posting a rise in net income on the year, although going forwards, rising costs and heavier regulations will make profits harder to come by for them. Citigroup, another big name, saw its earnings down -8.1% on the year however, while Goldman Sachs posted a US$470 million loss on the partial sale of a loan portfolio and Morgan Stanley reported profits down nearly 20%. The latter did, however, predict a pick-up in mergers and acquisitions, on which it provides advice.

Semiconductor companies warn recovery will take longer

The technology sector had gone into the reporting season following strong performance by growth stocks in Q1, as well as optimism about IT spending and the rise of artificial intelligence (AI). Technology companies have also been slashing staff numbers to prove their financial responsibility.

However, technology giant Tesla said that its gross profit margin fell to its lowest level in 13 quarters, thanks to reduced demand, while semiconductor companies such as global leader Taiwan Semiconductor Manufacturing Company (TSMC) have pushed back expectations for a market recovery. Semiconductor companies have told investors that the industry's sharpest slowdown in over a decade is lasting long than expected amid weak demand and that bulging inventories are taking longer than expected to adjust.

The reporting season is due to continue for a few more weeks and some significant names have yet to announce results, but a key lesson from it so far is that an economic slowdown is occurring, and earnings cannot escape this. The stock market reaction has so far been muted to what have been mixed results. The promising start did show that decent fundamentals still seem to be in place, but also that the full impact of monetary tightening has yet to become clear.

[1]Source: Yahoo! Finance 12 April 2023
[2]Source: Yahoo! Finance 19 April 2023

Key Risks

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