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MARKET SIGHT*LINES*

Third Quarter Earnings Season: Stronger Now, but Weaker Later?

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The U.S. economy has held up well in 2023, with the first estimate of third quarter GDP much stronger than most expected. As equity investors, we are also quite focused on the degree to which this robust economic activity translates to stock earnings, the primary driver of equity performance.

In this Sight|Lines, we share insights from the third quarter earnings season.

THE TAKEAWAY: THIRD QUARTER EARNINGS BEAT, BUT ANALYSTS ARE LESS POSITIVE ON THE FUTURE.

Most companies in the S&P 500 have reported third quarter (Q3) earnings, with many beating expectations. In summary:

- Earnings growth for the third quarter is expected to be much better than thought as the quarter ended.
- This marks the first positive quarter of year-over-year earnings growth since a year ago.
- Most sectors are experiencing earnings growth, but some are reporting declines, including energy.
- Energy's decline, spurred by a drop in oil prices, was a major headwind to a still-positive result.
- Once again, some big tech-oriented companies were large contributors.
- And given worries about an economic slowdown, analysts have revised fourth quarter estimates lower, more than offsetting the positive surprise of the third quarter.
- And full-year growth forecasts for 2023 and 2024 declined slightly.

Current earnings, and views on future earnings, drive stock market performance. While third quarter results appear better than expected, the views on future earnings are less positive.

IN-DEPTH: THIRD QUARTER EARNINGS BEAT EXPECTATIONS, BUT ANALYSTS ARE LESS POSITIVE ON FUTURE EARNINGS, EVEN AS THE VIEW ON 2023 EARNINGS STAYS CONSTRUCTIVE.

Ninety percent of the companies in the S&P 500 have reported third quarter earnings, with results overall better than expected. Going deeper:

- The blended (year-over-year) earnings growth rate for Q3 2023 is 4.1% – better than the -0.3% estimate on September 30:
    - Eighty-two percent reported a positive earnings per share surprise, and 62% reported a positive revenue surprise.
    - This is the first quarter of year-over-year earnings growth reported by the index since Q3 2022.

- Eight of 11 sectors are reporting earnings growth:
  - Results have been led by the communication services, consumer discretionary, and financials sectors.
  - Energy, health care, and materials are reporting declines.
- Energy's decline was driven by a drop in oil prices, year over year:
  - Oil prices averaged 10% lower in the third quarter compared to a year ago.
  - Excluding the energy sector, S&P 500 earnings are estimated to have grown 9.8% year over year, compared to the expected result of 4.1% for the index.
- Once again, some big tech-oriented companies were large contributors:
  - If we exclude results from Meta Platforms (a member of communication services) and Amazon (a member of consumer discretionary), S&P 500 earnings would be estimated to have grown just 1.4%.
- And given worries about an economic slowdown, analysts have revised fourth quarter estimates lower:
  - Interestingly, analysts tend to lower estimates for the current quarter during the first month of that quarter, with the decline averaging -1.9% over the last five years.
  - In the current quarter, this bottom-up analyst forecast has fallen 3.9% for the fourth quarter, so more negative than normal.
- Despite the positive surprises for the third quarter, the full-year growth forecasts for this year and next have declined slightly:
  - The calendar year 2023 S&P 500 earnings growth rate is now forecast to be 0.6%, down from an estimate of 0.8% as of September 30.
  - The calendar year 2024 S&P 500 earnings growth rate is now forecast to be 11.9%, down from an estimate of 12.2% as of September 30.

CONCLUSION

The U.S. economy has been strong in 2023, especially in the third quarter. And, as the third quarter earnings season unfolds, we're seeing better-than-expected results there as well. As we've discussed before, earnings are a driver of stock market performance. So, third quarter results are welcome news. Stock analysts appear worried, though, about the future. Overall earnings growth estimates for 2023 and 2024 have declined slightly in recent weeks. But, importantly, the growth rate for next year is still forecast to be a positive 11.9%, a good result.

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