MARKET MINUTE
WITH McGAREL

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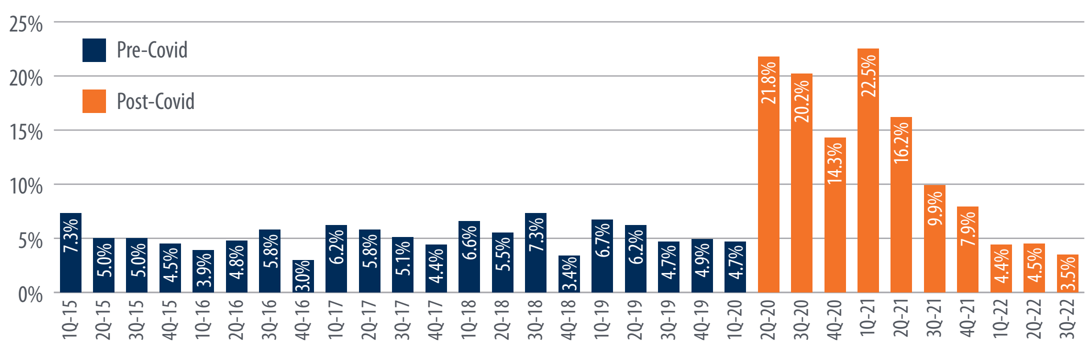
It's well known that companies underpromise and overdeliver on earnings. They set the bar low and analysts follow along with their estimates and a modest earnings outperformance is almost always the result once earnings are reported. Just look at the average earnings surprise for the S&P 500 Index each quarter from 2015 through 2019 [Chart 1]. "Surprises" averaged 5.3% over those 20 quarters. Surprises were always pleasant and positive. In truth, the market wasn't really surprised during those quarters. It expected modest outperformance over the consensus. Everyone knows how it works. But starting in the second quarter of 2020, the earnings outperformance actually did surprise the market. For the last three quarters of 2020 and for all 4 quarters of 2021, earnings surprises averaged 16.1%. It's a significant reason we saw such big stock market gains in the last three quarters of 2020 (the S&P 500 Index was up 47% for those final 9 months) and 2021 (29% for the year). We can see, however, that the first 3 three quarters of this year are back to being more normal "surprises." Our expectation going forward is that we are back to normal when it comes to outsized earnings beats. The market won't reward average surprises with high returns.

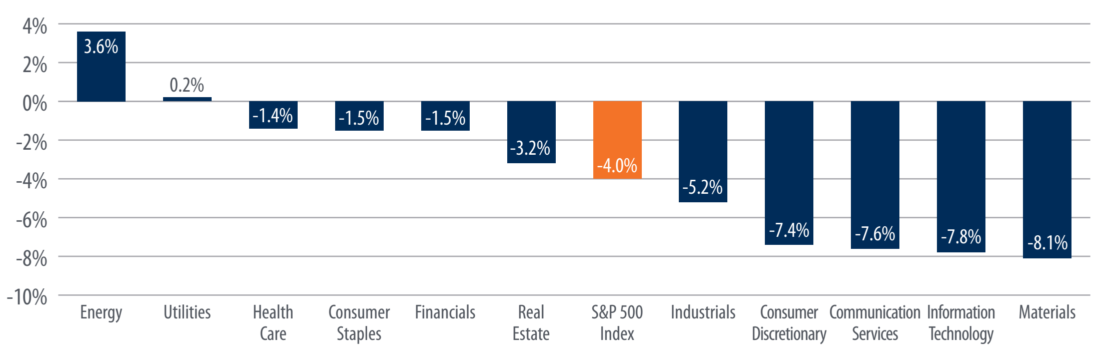
Analysts do try to get earnings forecasts correct over time and continually revise earnings up or down based on the broader economic environment. In the last three months, analysts have lowered earnings estimates and are forecasting downward revisions in 2023 for every sector except energy and utilities. It makes sense. Higher interest rates will certainly slow economic growth and the fiscal stimulus of the past several years is fading. In our opinion, these revisions are what's important as we look at the opportunity ahead in the equity markets. The second chart shows us that a harsh recession is not yet forecast as cyclicals (financials, industrials) are being revised downward at a slower pace than the growth sectors (information technology, consumer discretionary). Yet there still exists a larger than normal spread in valuations between growth and value stocks which is one of the main reasons we still favor an overweight to value.

Chart 1: S&P 500 Index Earnings Surprise | Expected vs. Actual Earnings



Source: Bloomberg. Data from 1Q-15 – 3Q-22. Earnings estimates rates are based on aggregate sell-side estimates.

Chart 2: S&P 500 Index Earnings Revisions By Sector | 3-Month % Change in 2023 Estimated EPS



Source: Capital IQ. As of 10/31/22. Earnings estimates rates are based on aggregate sell-side estimates.

Past performance is no guarantee of future results.

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The **S&P 500 Index** is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. **Earnings per share (EPS)** is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability. There is no assurance any forecasts will be achieved.