

## GIAM Macro & Market Research - Market Commentary

October 7, 2020

### Q3 earnings season starts well. Expect stabilization in revisions momentum but recovery will continue

- Q3 expectations still indicate a gloomy yearly growth, albeit slowly recovering from Q2.
- Analysts' estimates have improved slightly over the last weeks, more significantly in the US.
- The first reported results in the US (19 firms, 4% of total) and Japan (3%) show better growth and surprises when compared to the same number of firms in Q2.
- We observe some fatigue - also due to increasing Covid contagions - in selected economic indicators (i.e. macro surprises in the euro area), with earnings revisions being near a cyclical peak. That said, the recovery triggered by the policy support will remain the dominating theme for investors in the next months.
- In this respect, we notice stabilizing capacity utilization, good Chinese momentum as well as EM exports bouncing back. The ISM and the IFO indicators remain high and overall supportive for the continuation of the earnings recovery although we cannot exclude some weakness in momentum ahead.
- Short term, we maintain a slight OW on equities due to lingering supportive policy action, improving GDP and earnings momentum and expect positive mid-single digit total returns in 12 months. Risks: lower economic momentum, Covid 2nd wave, US elections and geopolitical risks.

The Q3 reporting season has just started. **For the US**, expectations are for a yearly earnings growth of -21% after -31% in Q2.

**As for sectors**, worse growth rates in the US are expected for **energy, industrials and discretionary** while **pharma, utilities, IT and staples** should rank better than the index.

Q4 should see continuing recovery to -13%, while 2021 should see positive growth rates starting with 12% in Q1, then 44% in Q2 and 31% in Q3.

### The US annual earnings growth is expected to turn positive in Q1 2021 (as in Europe):

Exhibit 10. Historical/Current/Future Earnings Growth Rates

Sector	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	2021Q1	2021Q2	2021Q3
Consumer Discretionary	1.8%	2.5%	-52.8%	-64.6%	-34.3%	-26.1%	71.7%	187.9%	50.7%
Consumer Staples	3.7%	2.6%	6.8%	-4.2%	-3.8%	-2.2%	1.4%	10.8%	11.3%
Energy	-37.8%	-41.2%	-30.1%	-168.1%	-113.0%	-86.9%	-50.9%	158.9%	499.7%
Financials	2.6%	10.2%	-37.8%	-46.7%	-20.7%	-20.8%	27.9%	49.5%	12.3%
Health Care	8.8%	10.1%	6.5%	6.8%	-2.1%	4.4%	11.9%	7.0%	22.7%
Industrials	3.4%	-9.3%	-32.8%	-85.3%	-65.5%	-40.2%	3.1%	435.3%	134.0%
Materials	-10.9%	-12.4%	-12.3%	-28.6%	-16.1%	-1.5%	21.7%	48.1%	32.5%
Real Estate	5.9%	7.0%	-3.8%	-15.2%	-14.3%	-12.4%	-2.0%	13.1%	11.6%
Technology	-1.7%	9.2%	7.2%	5.6%	-0.7%	2.9%	11.2%	13.2%	20.3%
Communication Services	-1.4%	8.2%	2.1%	-16.8%	-20.6%	-17.9%	6.5%	29.9%	36.9%
Utilities	6.7%	17.8%	4.3%	6.4%	-3.5%	-1.2%	2.9%	3.0%	5.1%
<b>S&amp;P 500</b>	<b>-0.3%</b>	<b>3.1%</b>	<b>-12.8%</b>	<b>-30.6%</b>	<b>-21.3%</b>	<b>-13.3%</b>	<b>12.0%</b>	<b>44.2%</b>	<b>30.6%</b>
S&P 500 Ex-Energy	2.2%	6.1%	-12.1%	-24.1%	-17.5%	-10.7%	13.8%	35.4%	27.1%

Source: I/B/E/S data from Refinitiv

**The Q3 estimate for the US has improved slightly** from -25% yoy in July to current -21%.

Exhibit 3. 2020Q3 Blended (Reported & Estimated) Earnings Growth

Sector	Today	1 Oct	1 Jul	1 Apr	1 Jan	1 Oct
Consumer Discretionary	-34.3%	-34.2%	-50.1%	-6.8%	11.7%	14.6%
Consumer Staples	-3.8%	-3.9%	-5.0%	3.3%	5.9%	8.1%
Energy	-113.0%	-111.3%	-120.4%	-71.0%	30.1%	32.4%
Financials	-20.7%	-21.6%	-31.9%	-3.1%	9.4%	8.6%
Health Care	-2.1%	-2.2%	-3.5%	7.6%	7.5%	12.8%
Industrials	-65.5%	-65.5%	-60.3%	-17.2%	10.0%	15.5%
Materials	-16.1%	-17.0%	-24.9%	-2.3%	15.7%	20.4%
Real Estate	-14.3%	-14.2%	-13.7%	0.2%	4.8%	6.9%
Technology	-0.7%	-0.6%	-3.5%	5.3%	10.2%	15.1%
Communication Services	-20.6%	-20.6%	-20.3%	4.1%	12.7%	12.3%
Utilities	-3.5%	-3.9%	0.2%	2.2%	2.2%	7.4%
<b>S&amp;P 500</b>	<b>-21.3%</b>	<b>-21.4%</b>	<b>-25.0%</b>	<b>-2.7%</b>	<b>10.1%</b>	<b>13.2%</b>

Source: I/B/E/S data from Refinitiv

**US Q4 estimates have instead remained broadly stable:**

Exhibit 16. Estimated Earnings Growth for 2020Q4

Sector	Today	1 Oct	1 Jul	1 Apr	1 Jan
Consumer Discretionary	-26.1%	-25.9%	-23.2%	2.5%	25.2%
Consumer Staples	-2.2%	-2.1%	0.4%	5.1%	8.2%
Energy	-86.9%	-86.7%	-103.0%	-54.2%	15.8%
Financials	-20.8%	-22.1%	-26.8%	-0.3%	12.2%
Health Care	4.4%	4.3%	7.0%	11.2%	14.6%
Industrials	-40.2%	-40.0%	-30.3%	7.3%	19.5%
Materials	-1.5%	-2.1%	-8.9%	5.5%	21.9%
Real Estate	-12.4%	-12.5%	-9.4%	2.5%	10.3%
Technology	2.9%	2.8%	1.3%	6.8%	15.5%
Communication Services	-17.9%	-17.9%	-16.2%	-1.7%	9.2%
Utilities	-1.2%	-2.7%	8.6%	7.6%	8.5%
<b>S&amp;P 500</b>	<b>-13.3%</b>	<b>-13.6%</b>	<b>-13.2%</b>	<b>2.7%</b>	<b>14.5%</b>

Source: I/B/E/S data from Refinitiv

**The consensus sees US earnings to come back to previous peak (Q3 2019, 42.14 eps) in 2 years (3Q 2021, 42.72 eps) similarly to what occurred during the Lehman crisis (Q2 2008-Q1 2010 ).** This is not a crazy forecast given the bold and even bolder policy stimulus pumped during the Covid crisis compared to the 2008-2010 period:

**Quarterly US reported results and growth rates since 2006, incl. consensus for 2020 and 2021**

<b>Year</b>	<b>1Q</b>	<b>2Q</b>	<b>3Q</b>	<b>4Q</b>
2008	19.0	19.8	17.5	5.6
qoq	17.5%	4.3%	-11.6%	-67.9%
2009	12.8	16.0	16.4	16.8
qoq	128.3%	24.9%	2.1%	2.7%
2010	19.7	21.5	21.8	22.6
qoq	17.3%	9.0%	1.3%	3.7%
...				
2019	39.2	41.3	42.1	42.0
qoq	-4.9%	5.5%	2.0%	-0.4%
2020	33.1	28.0	32.9	36.0
qoq	-21.1%	-15.5%	17.5%	9.6%
2021	37.0	40.3	42.7	45.1
qoq	2.7%	8.8%	6.0%	5.6%
<b>Average qoq (2006 -2021)</b>	<b>9.3%</b>	<b>5.8%</b>	<b>1.6%</b>	<b>-4.2%</b>

**In Europe**, the yearly growth is worse than in the US at -36% which will be followed by -24% in Q4 and +49% in Q1 2021. EU will recover previous peak one year later than for the US (2022).

**EU sectors** ranking better and worse in expectations are similar to those in the US with the exception of materials which are among the worst and real estate which looks much better than average.

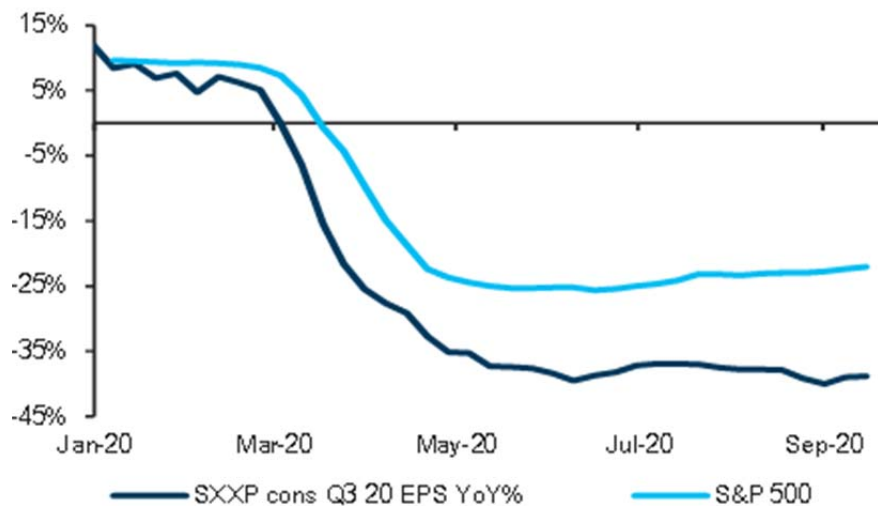
Exhibit 13A. STOXX 600 Eurozone Earnings Growth Rates

<b>Sector</b>	<b>2020Q2</b>	<b>2020Q3</b>	<b>2020Q4</b>	<b>2021Q1</b>	<b>CY2020</b>
Basic Materials	-57.8%	-45.4%	9.8%	52.5%	-33.1%
Cyclical Consumer	-121.0%	-38.9%	-14.8%	1771.8%	-75.2%
Non-Cyclical Consumer	-10.7%	-8.3%	7.9%	0.9%	-13.3%
Energy	-111.4%	-83.4%	-58.6%	3.4%	-69.0%
Financials	-41.1%	-27.0%	-47.0%	320.4%	-52.8%
Healthcare	-6.1%	-11.6%	0.7%	-0.7%	-2.3%
Industrials	-100.6%	-87.5%	-42.3%	337.5%	-60.6%
Technology	-15.2%	-6.9%	-3.7%	52.1%	-7.1%
Real Estate	117.5%	107.9%	-19.7%	104.0%	-12.8%
Utilities	-23.8%	-8.0%	8.4%	13.2%	8.2%
<b>Total</b>	<b>-50.6%</b>	<b>-35.6%</b>	<b>-23.7%</b>	<b>49.1%</b>	<b>-41.2%</b>
Number of constituents with estimates	187	177	182	111	290

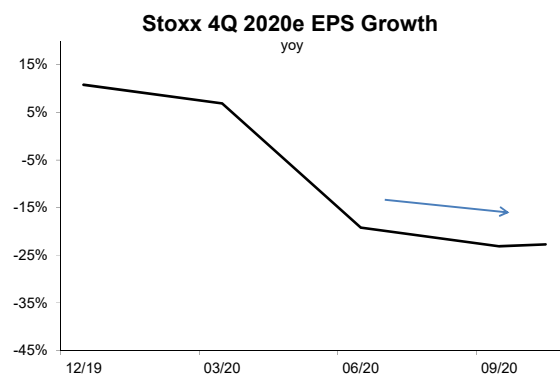
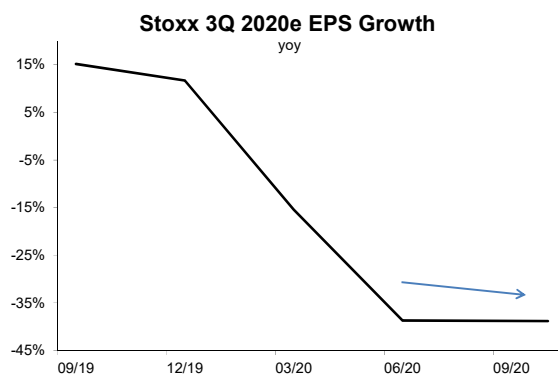
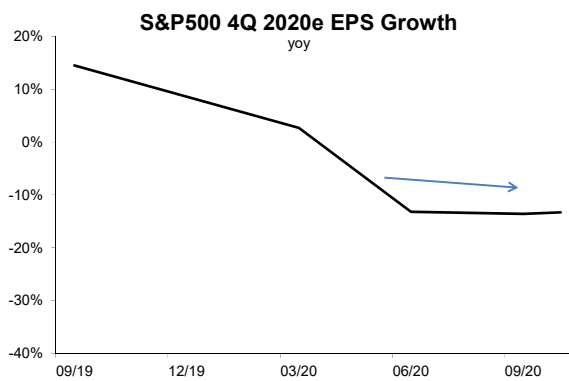
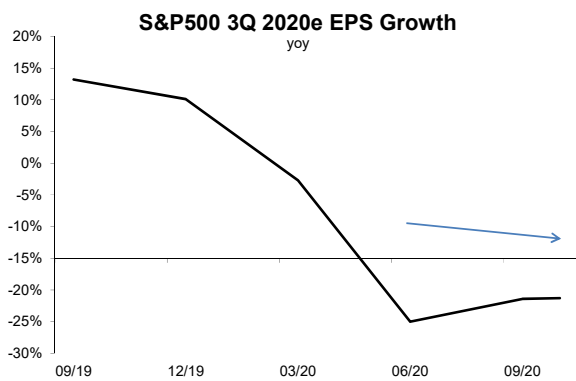
Source: Refinitiv I/B/E/S data

Note: Includes only constituents domiciled in Eurozone.

**Revisions starting to move up in the US, less in EU:**



Source: Barcays



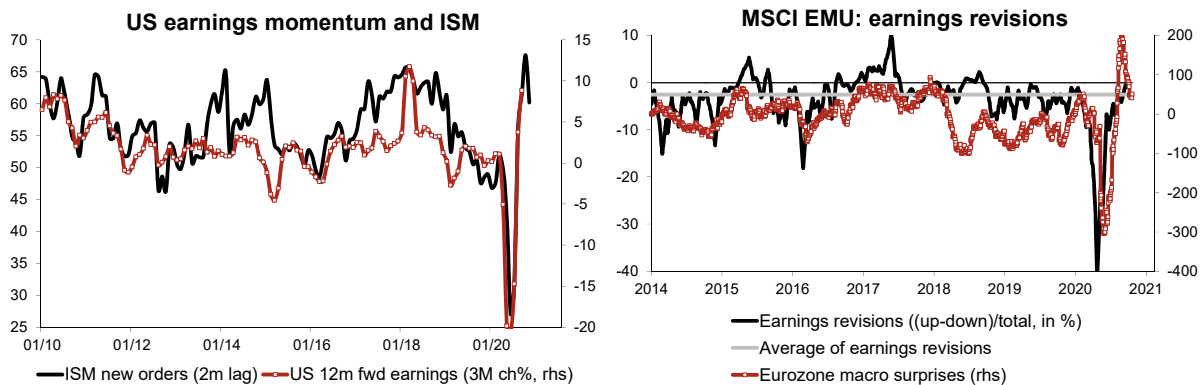
**US and Japanese results so far are encouraging:** earnings and sales **growth** for the **median stock** is higher when compared to the same number of results in Q2. The same is true for the **surprises** vs analysts' expectations:

### Analysis of the median stock: Q3 2020 reporting season

Median stock	Earnings Growth		Sales Growth		availability
	Q2 2020	Q3 2020	Q2 2020	Q3 2020	Q3 2020
S&P	0.95 %	18.01 %	(4.95)%	4.27 %	3.8%
Topix	6.51 %	9.82 %	(2.87)%	2.34 %	3.1%

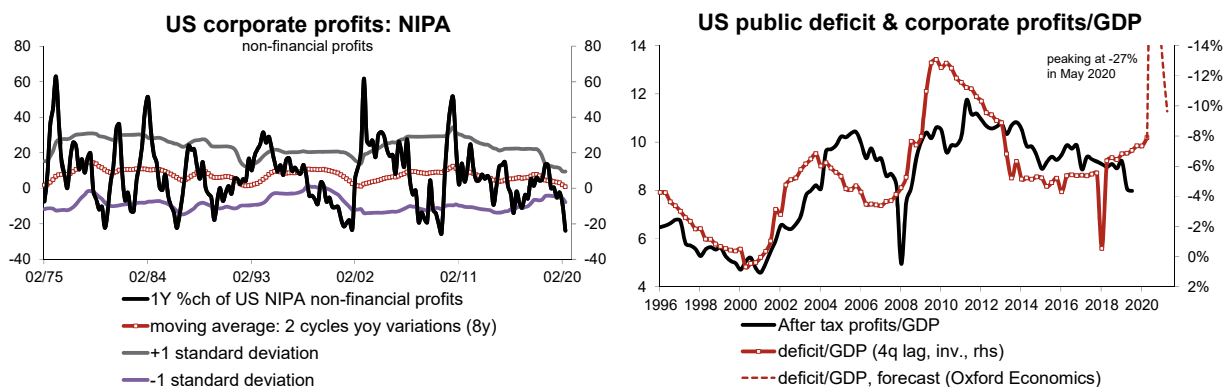
Median stock	Earnings Surpr		Sales Surpr		availability
	Q2 2020	Q3 2020	Q2 2020	Q3 2020	Q3 2020
S&P	5.77 %	15.00 %	1.20 %	3.98 %	3.8%
Topix	13.96 %	66.98 %	0.82 %	1.13 %	3.1%

Mainly due to Covid new contagions, **we observe fatigue in some indicators - ISM new orders component, EA macro surprises and export momentum** – which, by the way, in some cases were around a cyclical peak.



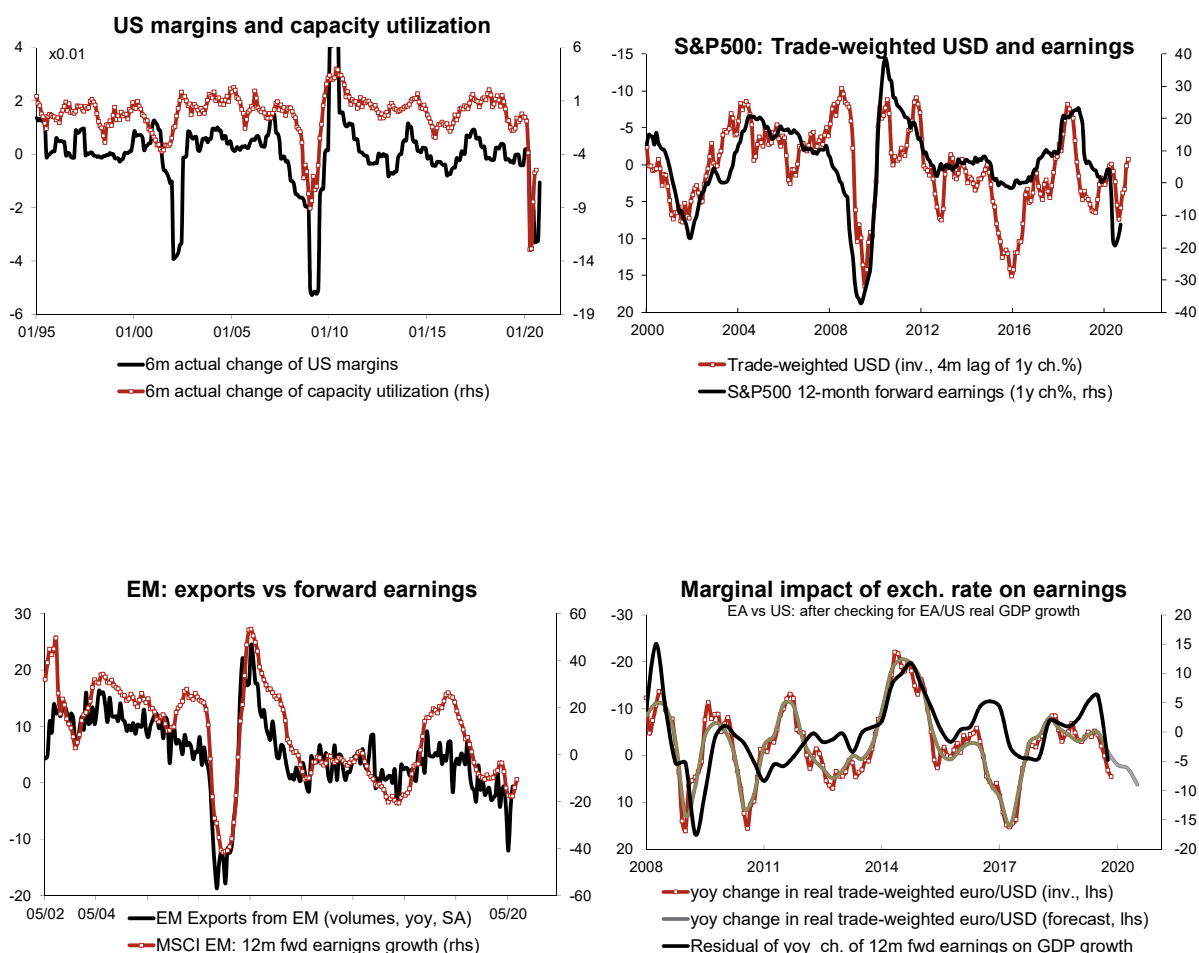
**That said, we think the recovery has still way to go and wil remain, together with the policy support, the dominating theme through the turn of the year.**

As the chart plotting the **NIPA** yearly growth shows, the earnings momentum **has reached a cyclical low** and there is scope to improve thanks to bold policy action (see US fiscal deficit evolution below):



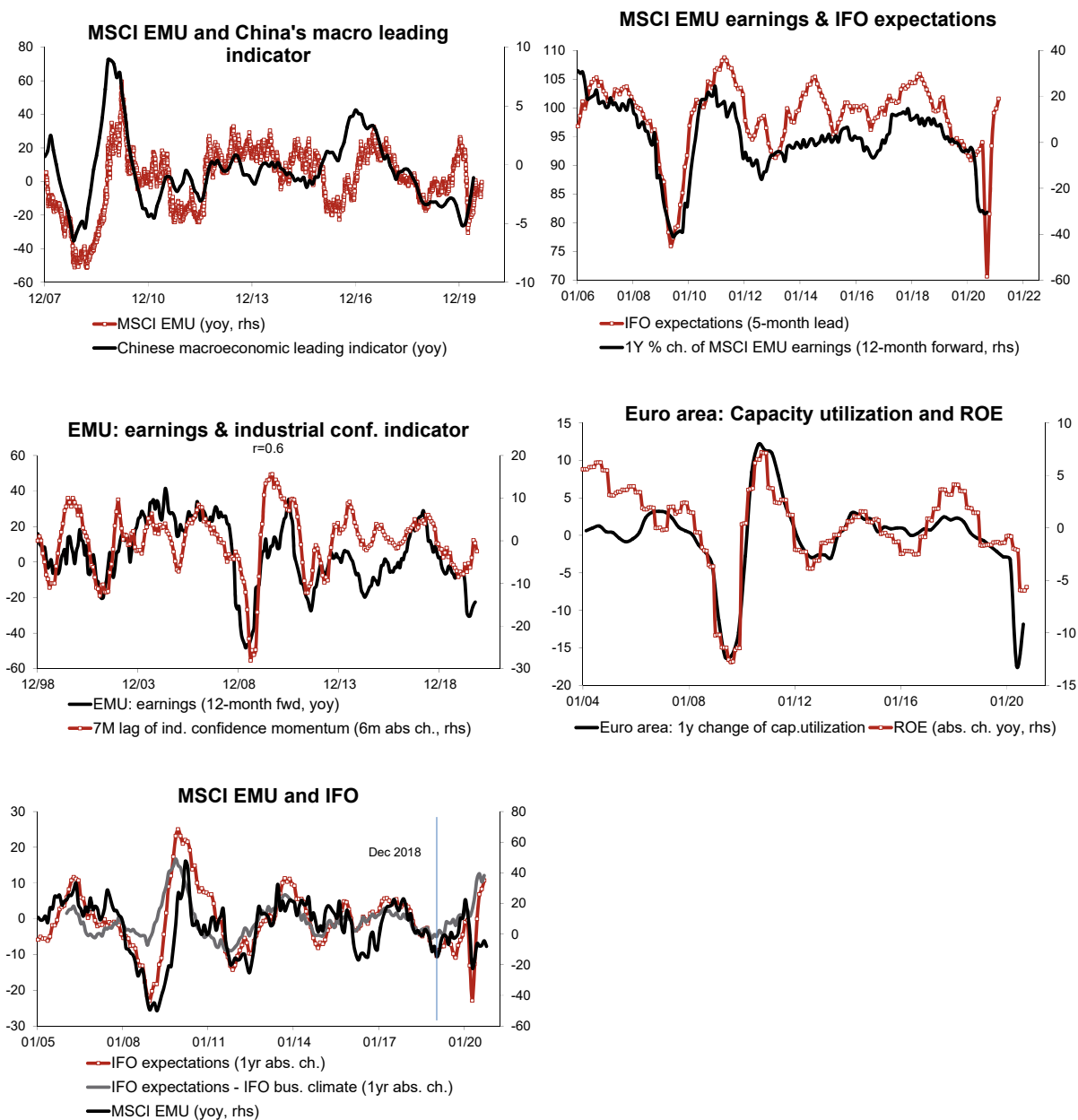
Furthermore, **IFO and ISM levels remain overall high and supportive for the growth continuation, even in case they come off a bit from here.**

In this respect, we notice also the **capacity utilization timidly bouncing back as EM export momentum.** In the **US the trade-weighted dollar is also supportive** while, on the contrary, the **euro appreciation is not helping EMU earnings.**



**As for Europe, the Chinese economic momentum looks increasingly supportive for the EA stocks which earnings are still visibly lagging the meaningful recovery of EU leading indicators (IFO and EU industrial confidence indicators).**

Like for the US, the **capacity utilization looks bottoming, thus supporting the future evolution of the firms' ROE (return on equity):**



In the end we remain cautiously optimistic on equity with a slight overweight position.

Additional charts.

Huge negative revisions year-to-date but stabilization looks coming.



Consensus eps estimates: changes (%) from 31/12/19 to 05/10/20							
IBES		F0: 2019	F1: 2020	F2: 2021	F3: 2022	12M FWD	
1	MSCI WORLD	-2.0	-28.8	-16.0		-13.4	% Change
2	S&P 500	-0.3	-26.2	-15.9		-11.6	% Change
3	MSCI EMU	-6.3	-48.0	-26.4		-26.7	% Change
4	FTSE 100	0.3	-46.8	-27.2		-29.1	% Change
5	SMI	-2.0	-17.3	-11.3		-7.3	% Change
6	TOPIX (F0: 31/03/20)	-25.1	-39.8	-18.5		-23.3	% Change
7	MSCI EM	-10.9	-29.4	-17.8		-12.6	% Change

**YTD  
CHANGE**

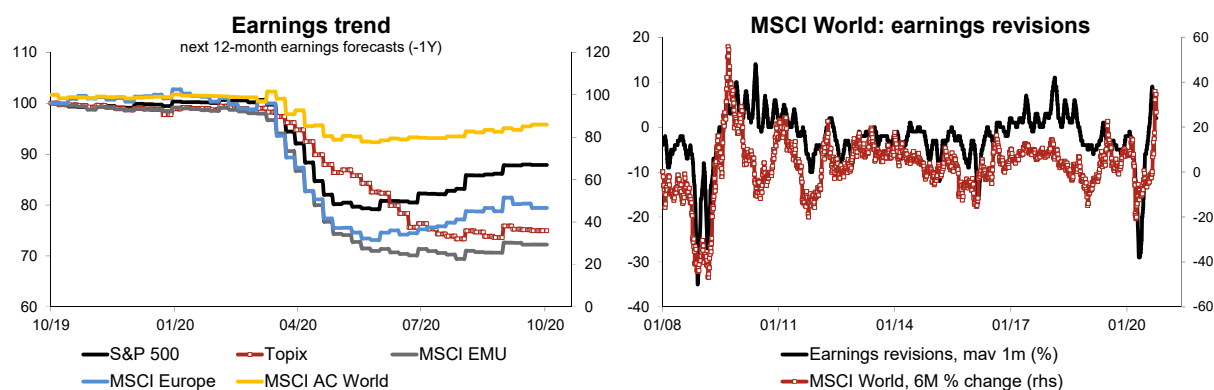
**31/12/2019  
to  
05/10/2020**

Consensus eps estimates: changes (%) from 14/09/20 to 05/10/20							
IBES		F0: 2019	F1: 2020	F2: 2021	F3: 2022	12M FWD	
1	MSCI WORLD	2.9	3.1	3.2	3.2	3.2	% Change
2	S&P 500	0.0	0.0	0.1	0.3	0.1	% Change
3	MSCI EMU	-0.1	-1.5	-0.3	-0.3	-0.5	% Change
4	FTSE 100	1.4	-0.7	1.4	1.1	1.0	% Change
5	SMI	0.0	-0.1	0.0	-0.1	-0.1	% Change
6	TOPIX (F0: 31/03/20)	0.0	-0.8	-0.3	0.2	-0.4	% Change
7	MSCI EM	0.6	1.0	1.2	1.2	1.2	% Change

**PERIOD  
CHANGE**

**14/09/2020  
to  
05/10/2020**

12-month forward earnings forecasts have improved across regions, thus supporting stock markets. Particularly, Emerging Markets have benefitted from rebounding exports.



**Consensus growth shows a big rebound in earnings in 2021.**

**This should come not as a surprise after the big slump in 2020 and the huge monetary and fiscal stimulus:**



World Markets: Forecast Earnings Growth (IBES Consensus)				
05-Oct-2020				
	A12FE vs 2019	2020/2019	2021/2020	2022/2021
MSCI AC WORLD	-1.3%	-19.1%	29.9%	16.1%
MSCI WORLD	-3.5%	-20.8%	29.5%	16.2%
S&P 500 COMPOSITE	-2.8%	-19.3%	26.3%	16.9%
FTSE 100	-24.7%	-43.4%	44.5%	19.1%
TOPIX	10.1%	-11.8%	47.2%	15.0%
SWISS MARKET INDEX	3.7%	-7.4%	16.3%	10.4%
MSCI EUROPE	-13.3%	-33.5%	40.6%	16.8%
MSCI EMU	-13.6%	-38.8%	54.4%	18.3%
STOXX 50 (EURO)	-8.3%	-23.5%	26.4%	14.9%
EURO STOXX 50 E	-10.9%	-32.1%	41.5%	16.5%
MSCI USA IT	18.3%	3.8%	14.7%	13.6%
MSCI EM	12.3%	-8.9%	32.1%	15.9%

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