GIAM Macro & Market Research - Market Commentary

January 25, 2021

US Q4 earnings season starts better than Q3 one. Expect good earnings momentum to linger, supporting positive total returns this year.

- **The Q4 2020 reporting season started and more than 60 US firms reported quite upbeat quarterly results. Surprises are very positive especially for earnings (27%). They are better than Q3 ones (16%) and the last 9 quarters' average (10%).**
- **In particular, financials, industrials, discretionary and tech did better than the sector average.**
- **Sales surprise is lower but still positive at 3.3% and better than in Q3 (2.8%) and the last 2 years' average (1.2%).**
- **Yearly growth, for both earnings and sales, is flat (but higher than in Q3), and well in positive territory for materials, discretionary, staples and financials.**
- **Q4 earnings revisions are bottoming out (US better than EU in yoy terms) and Q1 ones outright increasing. 12-m forward earnings revisions are coming back from a cyclical peak but remain in positive territory.**
- **Macro recovery, USD weakness and higher oil prices are helping the S&P 500 momentum while EA suffers more from weaker GDP revisions and stronger euro. On the other hand, the good Chinese momentum bodes well for export-oriented economies, EU included.**
- **US fiscal stimulus will continue to add to GDP and earnings revision, benefiting indirectly also other indices like EMU or Japan. Upside pressure on US yields will bode well for a continuing rotation into Value and to a lesser extent Cyclicals, especially outside the US, where valuations are cheaper.**
- **Overall we continue to see total returns in the range of 5-9% in 12 months (US 5%, EMU 6.8% and EM 9%).**

The Q4 reporting season has just started. **For the US**, expectations are for a yearly earnings growth of -7.8% after -6.5% in Q3: **a positive yearly growth will start to be visible from Q1 2021 (+16.7%).**

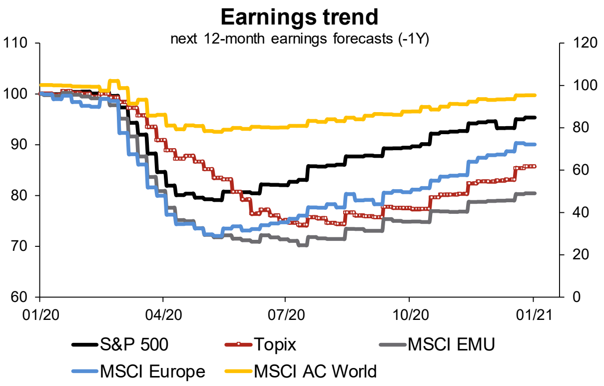
After 64 firms reported, results look quite solid vs expectations, both for earnings and sales.

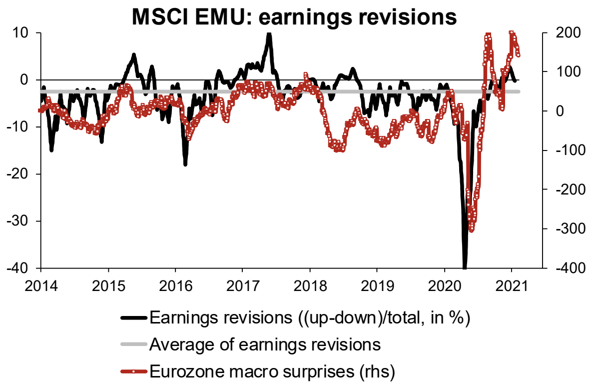
Surprises are largely and broadly positive especially for earnings (27%). They are better than Q3 ones (16%) and the last 9 quarters' average (10%). In particular, financials, industrials, discretionary and tech, did better than the sector average.

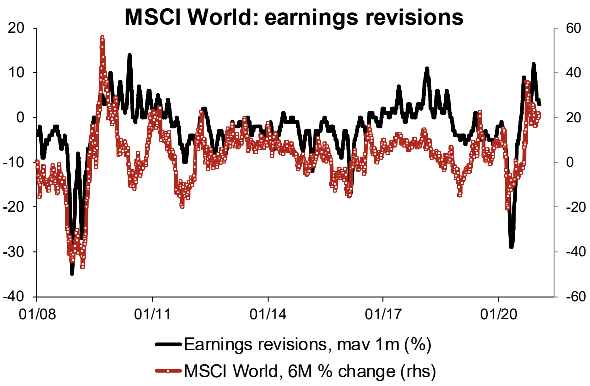
Sales surprise is lower but still positive at 3.3% and better than in Q3 (2.8%) and the last 2 years (1.2%).

This bodes well for our expectations of **increasing earnings momentum, which is at the core of our total return targets given that market multiples (PE) have little scope to increase further from current already elevated levels (**albeit justified by policy support, low yields, earnings trough and lower political uncertainty: see our equity focal point).

2021 earnings growth: Our macro-based models back a 2021 earnings growth of **+42% for EMU and +17% for the US**. EU Q4 2020 expectations have been in particular weak (not rebounding yet), incorporating the worsening of Covid new cases and delays to vaccine deliveries. Q1 2021 expectations could also deteriorate but not significantly, as **macro surprises** are still lying around cyclical highs, and **global GDP** is having a positive momentum.







EMU earnings should **recover to 2019 levels** in H2 2022 (24 months would be the norm according to past recoveries after recessions but this time the policy support makes the difference), while those for the US at the end of 2021 (a more resilient index). A lower US weight in energy and financials and a higher one in tech explains a faster recovery in US earnings.

Year 2022 should see an earnings growth of around +10% for both.

GIAM forecast earnings vs IBES consensus

Year	S&P			EA		
	GIAM	IBES	GIE vs IBES	GIAM	IBES	GIE vs IBES
2020	134	133	0.5%	6.9	6.9	0.0%
2021	170	165	3.0%	10.1	10.2	-1.1%
2022	190	193	-1.4%	11.5	12.2	-5.4%

Our US estimates have upside risks as world earnings revisions linger at the top of the cycle and Biden's victory can provide higher GDP growth in 2021. **Democrats' majority at the senate and the next fiscal stimulus under discussion could be at least worth an additional 1.6% GDP growth in 2021 and an earnings growth of 6%,** finally bringing our target towards **4,100** (net of a negative impact from higher 10-year rates by the end of the year of nearly 20 bps).

A better US earnings revision should benefit indirectly also other international firms in EMU or Japan (export volumes, global firms' confidence). The upside pressure on US yields, instead, will **bode well for a continuing rotation into Value and to a lesser extent Cyclicals (they have already outperformed Defensives appreciably), especially outside the US, where valuations are cheaper (EMU, Japan and EM equity indices).**

Overall we continue to see total returns in the range of 5-9% in 12 months (US 5%, EMU 6.8% and EM 9%).

Detailed information

After 64 results, **Q4 growth looks better than Q3 one**: both for earnings and sales with the same number of reporting companies. Negative exceptions are pharma, tech and communication.

The median stock analysis offers the same positive view versus Q3.

Analysis of the median stock: Q4 2020 reporting season

Median stock	Earnings Growth		Sales Growth		availability
	Q3 2020	Q4 2020	Q3 2020	Q4 2020	Q4 2020
S&P	(3.73)%	11.22 %	(1.31)%	1.92 %	12.8%
Topix	0.19 %	9.03 %	(3.87)%	(1.71)%	10.9%

Median stock	Earnings Surpr		Sales Surpr		availability
	Q3 2020	Q4 2020	Q3 2020	Q4 2020	Q4 2020
S&P	10.23 %	14.12 %	1.91 %	2.28 %	12.8%
Topix	13.49 %	27.96 %	0.37 %	0.88 %	11.0%

S&P	*76 reported*	*64 reported*		
Sector	**earnings growth, yoy**		**sales growth, yoy**	
	Q3 2020	Q4 2020	Q3 2020	Q4 2020
Energy	-43.0%	-31.3%	-26.3%	-20.4%
Materials	14.9%	21.4%	-3.1%	2.3%
Industrials	N.M.	-83.8%	-33.2%	-21.2%
Consumer Discretionary	-30.9%	18.6%	-2.4%	4.2%
Consumer Staples	3.3%	15.4%	3.6%	10.5%
Health Care	2.0%	-47.7%	7.7%	2.1%
Financials	-9.6%	18.1%	0.7%	2.0%
Information Technology	6.1%	-12.8%	3.6%	-0.1%
Communication Services	2.4%	-7.7%	-0.7%	21.5%
Utilities	12.7%	-	-14.1%	-
Real Estate	-3.9%	-	1.8%	-
S&P	**-12.8%**	**-0.6%**	**-2.9%**	**0.6%**
Median (all sectors)	2.2%	-7.7%	-0.7%	2.1%
Median, ex. Energy & Materials	2.2%	-7.7%	0.7%	2.1%

Surprises are decisively better than for Q3 and above the average of the last 9 quarters:

S&P	76 reported	64 reported		
Sector	**earnings surprise %** Q3 2020	Q4 2020	**sales surprise %** Q3 2020	Q4 2020
Energy	7.5%	-6.8%	0.5%	1.6%
Materials	5.4%	1.6%	0.9%	5.5%
Industrials	-60.5%	36.7%	2.1%	3.6%
Consumer Discretionary	67.0%	19.0%	6.1%	3.5%
Consumer Staples	10.3%	13.9%	2.3%	2.8%
Health Care	14.8%	-19.1%	3.5%	-4.0%
Financials	22.3%	40.3%	3.6%	6.5%
Information Technology	8.4%	16.8%	3.0%	4.0%
Communication Services	0.7%	-11.4%	0.1%	0.7%
Utilities	2.7%	-	-11.9%	-
Real Estate	-3.6%	-	2.3%	-
S&P	**15.7%**	**27.2%**	**2.8%**	**3.3%**
Median (all sectors)	7.5%	13.9%	2.3%	3.5%
Median, ex. Energy & Materials	8.4%	16.8%	2.3%	3.5%

The **surprise ratio** is also higher than in Q3:

S&P				
Sector	**Eps Surpr. Ratio pos/tot** Q3 2020	Q4 2020	**Sales Sur. Ratio pos/tot** Q3 2020	Q4 2020
Energy	75.0%	66.7%	60.0%	100.0%
Materials	100.0%	100.0%	100.0%	100.0%
Industrials	72.7%	75.0%	66.7%	85.7%
Consumer Discretionary	100.0%	100.0%	100.0%	75.0%
Consumer Staples	100.0%	100.0%	100.0%	100.0%
Health Care	100.0%	50.0%	100.0%	50.0%
Financials	85.2%	100.0%	82.6%	95.0%
Information Technology	100.0%	100.0%	100.0%	87.5%
Communication Services	66.7%	0.0%	100.0%	100.0%
Utilities	100.0%	-	0.0%	-
Real Estate	66.7%	-	66.7%	-
S&P	**86.7%**	**91.5%**	**83.6%**	**90.4%**
Median (all sectors)	100.0%	100.0%	100.0%	95.0%
Median, ex. Energy & Materials	100.0%	100.0%	100.0%	87.5%

Starting from Q1 2021, we should see an increasingly positive yearly growth:

HISTORICAL/CURRENT/FUTURE EARNINGS GROWTH RATES

Exhibit 10. Historical/Current/Future Earnings Growth Rates

Sector	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4	2021Q1	2021Q2	2021Q3	2021Q4
Consumer Discretionary	2.5%	-52.8%	-64.6%	-2.3%	-21.9%	77.1%	217.5%	12.3%	49.8%
Consumer Staples	2.6%	6.8%	-4.2%	6.3%	1.0%	0.4%	9.4%	6.1%	8.2%
Energy	-41.2%	-30.1%	-168.1%	-108.2%	-101.8%	-51.3%	158.7%	870.5%	3944.5%
Financials	10.2%	-37.8%	-46.7%	-2.8%	6.9%	54.1%	68.9%	-0.8%	-4.4%
Health Care	10.1%	6.5%	6.8%	11.8%	4.2%	14.3%	6.8%	7.2%	15.8%
Industrials	-9.3%	-32.8%	-85.3%	-54.7%	-42.3%	-4.5%	483.0%	80.8%	75.2%
Materials	-12.4%	-12.3%	-28.6%	-1.5%	8.9%	33.8%	60.2%	25.2%	17.0%
Real Estate	7.0%	-3.8%	-15.2%	-12.8%	-12.1%	-2.0%	12.9%	10.3%	11.3%
Technology	9.2%	7.2%	5.6%	9.9%	4.1%	13.8%	14.9%	12.2%	16.9%
Communication Services	8.2%	2.1%	-16.8%	3.7%	-12.3%	6.0%	27.2%	11.7%	20.3%
Utilities	17.8%	4.3%	6.4%	0.9%	-3.8%	1.5%	0.6%	1.9%	18.7%
S&P 500	**3.1%**	**-12.8%**	**-30.6%**	**-6.5%**	**-7.8%**	**16.7%**	**46.8%**	**14.9%**	**20.4%**
S&P 500 Ex-Energy	6.1%	-12.1%	-24.1%	-2.3%	-4.4%	18.5%	38.0%	11.9%	17.7%

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

The Q4 growth estimate for the US has improved since October from -13.6% yoy to current -7.8%.

Exhibit 3. 2020Q4 Blended (Reported & Estimated) Earnings Growth

Sector	Today	1 Jan	1 Oct	1 Jul	1 Apr	1 Jan
Consumer Discretionary	-21.9%	-22.6%	-25.9%	-23.2%	2.5%	24.7%
Consumer Staples	1.0%	-0.5%	-2.1%	0.4%	5.1%	8.2%
Energy	-101.8%	-98.3%	-86.7%	-103.0%	-54.2%	16.0%
Financials	6.9%	-6.6%	-22.1%	-26.8%	-0.3%	12.3%
Health Care	4.2%	3.4%	4.3%	7.0%	11.2%	14.6%
Industrials	-42.3%	-41.7%	-40.0%	-30.3%	7.3%	19.5%
Materials	8.9%	6.1%	-2.1%	-8.9%	5.5%	21.9%
Real Estate	-12.1%	-11.9%	-12.5%	-9.4%	2.5%	10.3%
Technology	4.1%	3.7%	2.8%	1.3%	6.8%	15.5%
Communication Services	-12.3%	-12.5%	-17.9%	-16.2%	-1.7%	9.2%
Utilities	-3.8%	-3.0%	-2.7%	8.6%	7.6%	8.5%
S&P 500	**-7.8%**	**-10.3%**	**-13.6%**	**-13.2%**	**2.7%**	**14.5%**

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

US Q1 2021 estimates also increased from +11.8% in October to current 16.7%:

Exhibit 16. Estimated Earnings Growth for 2021Q1

Sector	Today	1 Jan	1 Oct	1 Jul	1 Apr
Consumer Discretionary	77.1%	78.5%	72.1%	76.3%	38.3%
Consumer Staples	0.4%	1.0%	1.5%	1.2%	8.2%
Energy	-51.3%	-57.2%	-50.1%	-79.8%	-22.7%
Financials	54.1%	48.7%	26.5%	30.8%	2.6%
Health Care	14.3%	13.9%	11.9%	10.9%	13.6%
Industrials	-4.5%	-0.1%	3.6%	12.9%	34.1%
Materials	33.8%	30.4%	20.8%	14.5%	23.2%
Real Estate	-2.0%	-2.5%	-2.0%	2.2%	5.0%
Technology	13.8%	13.1%	11.1%	10.1%	18.5%
Communication Services	6.0%	6.1%	6.3%	8.6%	14.7%
Utilities	1.5%	2.1%	2.3%	1.9%	4.3%
S&P 500	**16.7%**	**16.0%**	**11.8%**	**12.2%**	**14.0%**

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

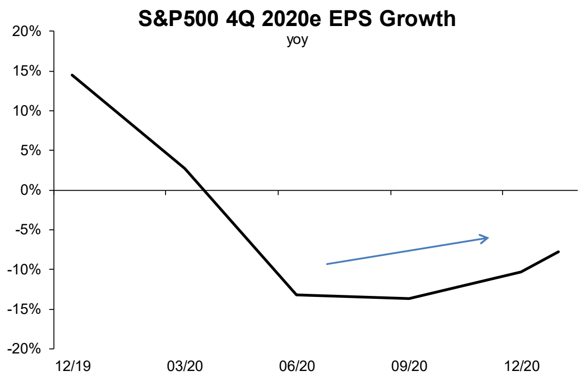
In Europe, the yearly growth will also jump in Q1 this year:

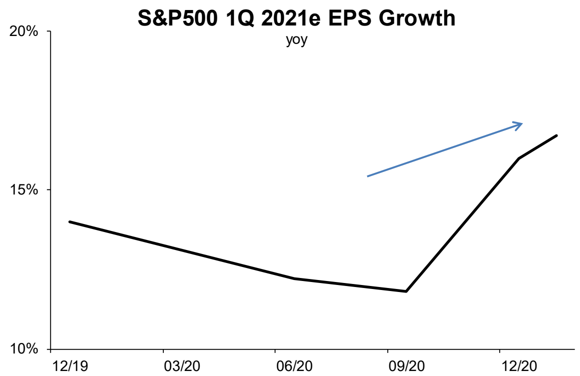
Exhibit 13A. STOXX 600 Eurozone Earnings Growth Rates

Sector	2020Q4	2021Q1	2021Q2	2021Q3	CY2020
Basic Materials	46.7%	51.7%	111.2%	31.4%	-25.3%
Cyclical Consumer	-13.5%	3118.5%	271.0%	-5.4%	-71.4%
Non-Cyclical Consumer	-6.0%	66.5%	11.1%	-30.0%	-18.0%
Energy	-63.2%	24.2%	463.6%	496.2%	-70.6%
Financials	-56.8%	207.4%	29.1%	-5.9%	-46.9%
Healthcare	-3.8%	-8.7%	0.0%	3.6%	-4.2%
Industrials	-63.4%	642.7%	270.0%	39.5%	-61.4%
Technology	-5.0%	44.4%	51.2%	7.4%	-8.9%
Real Estate	-13.8%	84.7%	-55.1%	33.8%	-17.7%
Utilities	3.1%	17.8%	10.7%	20.5%	8.5%
Total	**-28.3%**	**69.2%**	**116.8%**	**12.4%**	**-39.5%**
Number of constituents with estimates	181	138	137	127	288

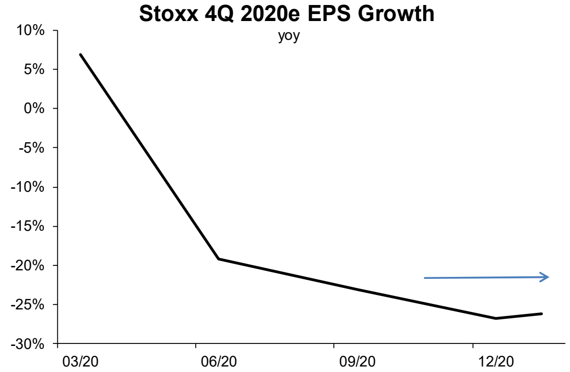
Source: Refinitiv I/B/E/S data
Note: Includes only constituents domiciled in Eurozone.

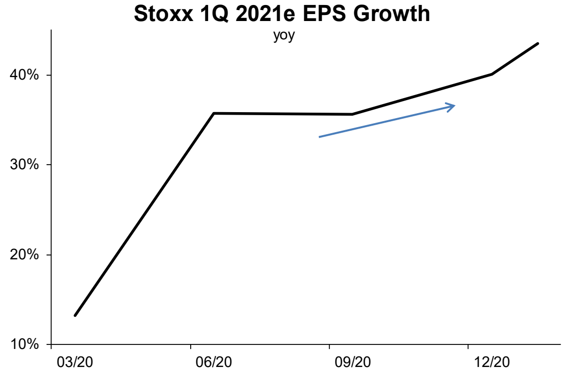
US revisions are looking better:





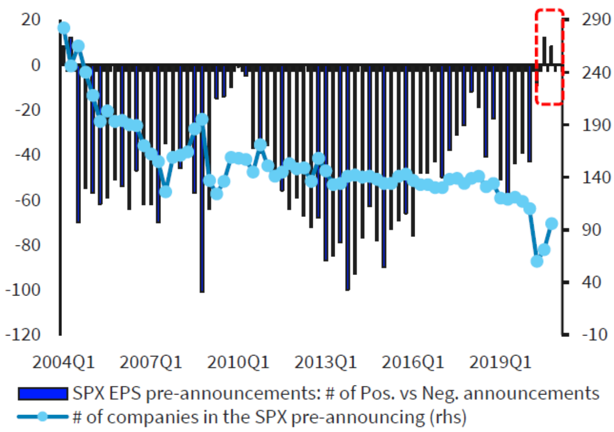
Less so in Europe, especially for Q4 2020, given the worsening pandemic evolution:





In the US, earnings preannouncements are also doing decisively better than in the recent history:

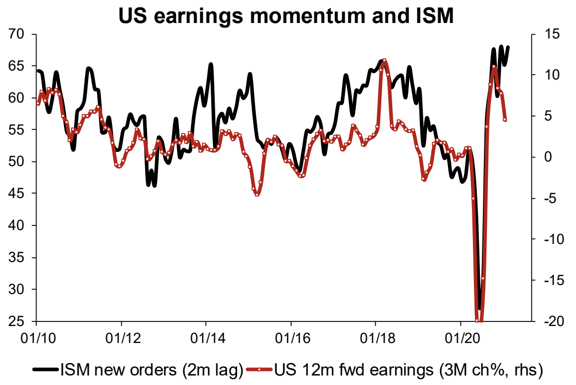
Q4 pre-announcements in the US look pretty good for the second quarter in a row

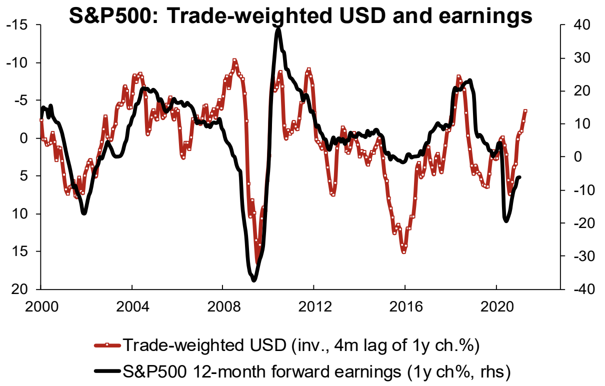


Source: Refinitiv, Barclays Research

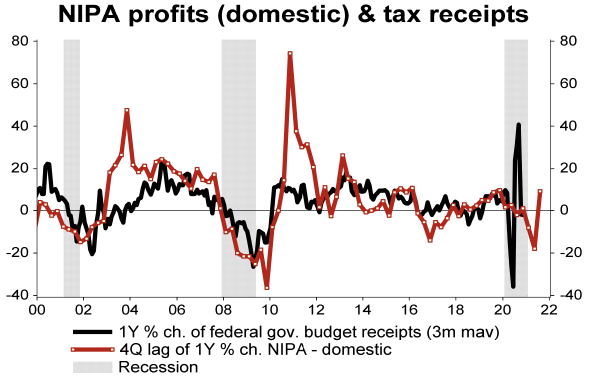
<u>**US macro indicators and earnings momentum**</u>:

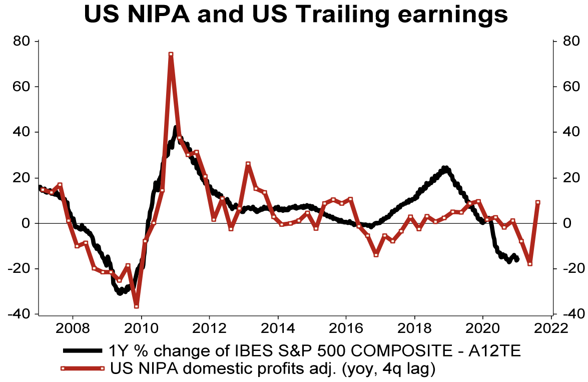
ISM level bodes well for earnings revisions together with the **weaker USD**:



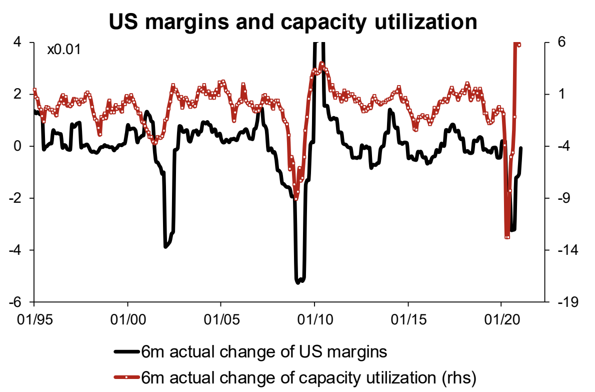


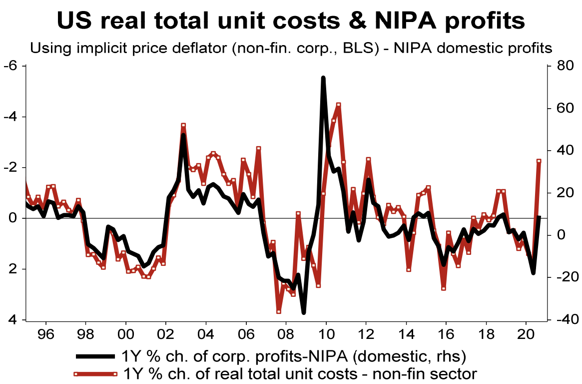
US NIPA domestic profits (all US firms' profits) are bouncing back and historically they tend to lead IBES (S&P 500) ones by 1-2 quarters:

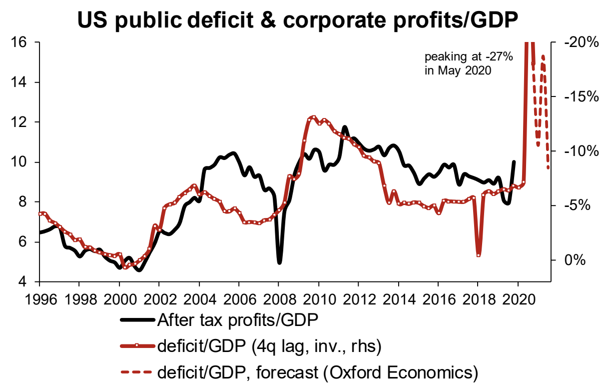




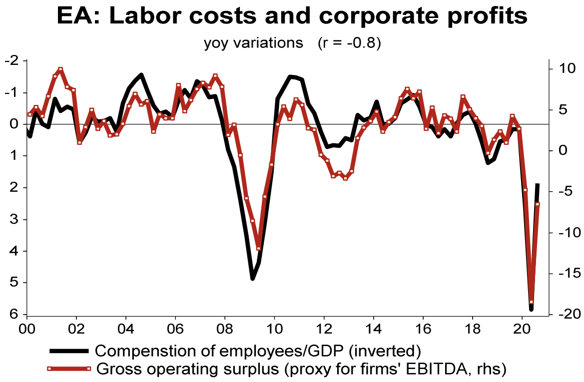
US Margins recovery is supported by increasing **capacity utilization**, weakening **unit-labour costs and increasing deficit spending:**

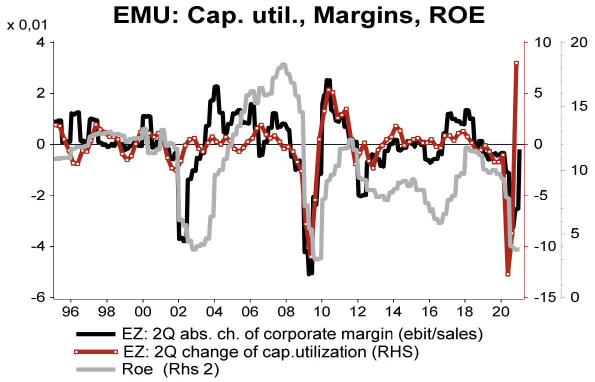


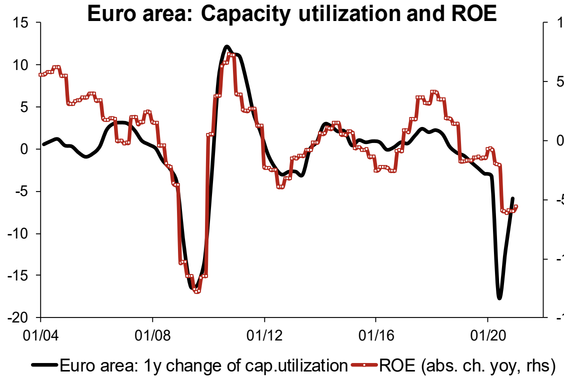


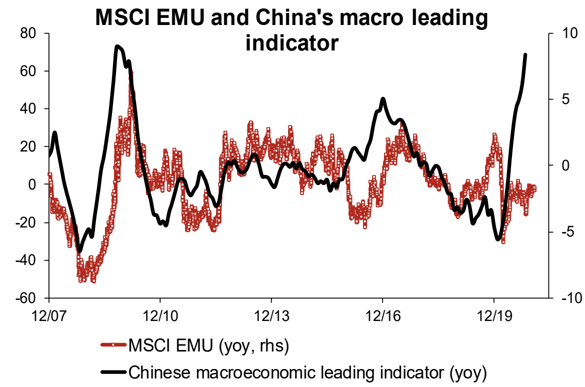


Euro area margins are supported by increasing **capacity utilization, too**, lower pressure from unit-labour costs, improved **exports and IFO expectations index and the China macro momentum**:

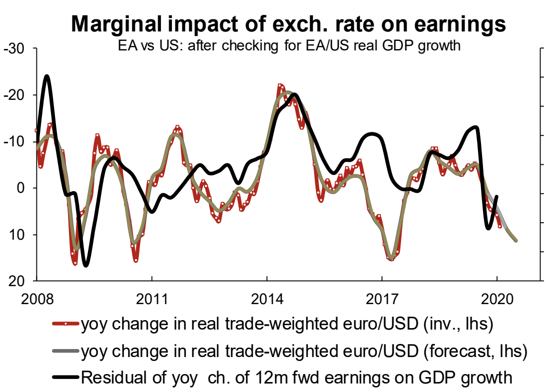


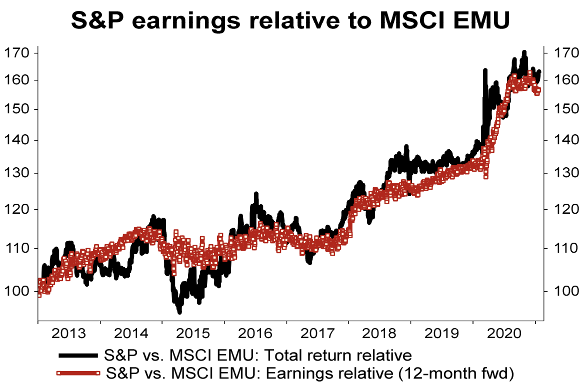




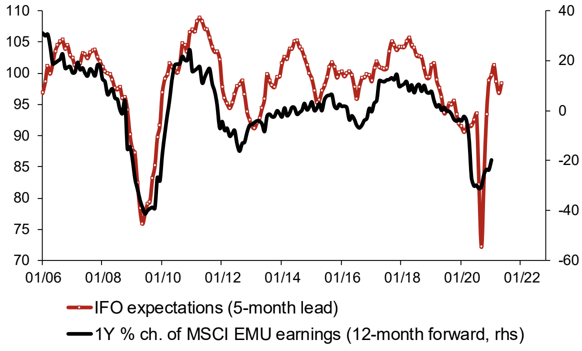


Of course, the stronger euro does not bode well for EA earnings momentum vs the US but current global export acceleration and the higher cyclical nature of EA stocks should compensate for this:





MSCI EMU earnings & IFO expectations



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

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

World Markets: Forecast Earnings Growth (IBES Consensus) 21-Jan-2021				
	A12FE vs 2019	2020/2019	2021/2020	2022/2021
MSCI AC WORLD	10.2%	-15.2%	28.5%	15.7%
MSCI WORLD	6.8%	-17.1%	27.2%	15.6%
S&P 500 COMPOSITE	7.1%	-15.2%	23.6%	16.8%
FTSE-100 INDEX	-12.0%	-42.3%	51.0%	16.3%
TOPIX	24.5%	-10.5%	45.4%	15.8%
SWISS MARKET INDEX	9.2%	-6.1%	15.6%	10.2%
MSCI EUROPE	-3.6%	-31.2%	38.3%	16.1%
MSCI EMU	-4.2%	-36.2%	47.6%	19.0%
STOXX 50 (EURO)	-0.8%	-22.6%	26.7%	14.3%
EURO STOXX 50 E	-4.0%	-29.5%	34.1%	17.7%
MSCI USA IT	26.6%	5.2%	16.2%	13.6%
MSCI EM	30.5%	-4.2%	35.3%	16.1%

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