EAGLE GLOBAL ADVISORS

Global Equity - Earnings Review Q3 2020

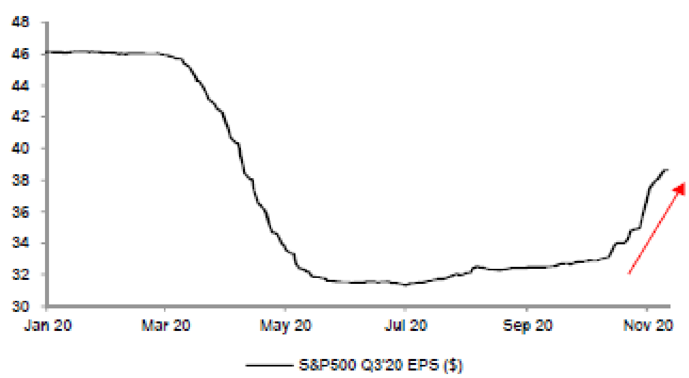
Encouraging Results, But Investors Have Their Eye On 2021

Third quarter earnings results around the globe again exceeded expectations as fears of another COVID-19 wave created a low bar for companies to positively surprise. In the short-term, investors will have to contend with the fear of an uptick in virus cases during the holidays versus the excitement about the potential high efficacy rates from Pfizer and Moderna's vaccine treatments.

S&P 500

Q3 2020 earnings results for the S&P 500 were better than initial consensus estimates with EPS surprises of +17%, despite an approximate (-7.1%) decline in YOY EPS growth. Sectors most affected by COVID-19 (Energy, Consumer Services, Transports) account for 121% of the drop and mask a return to growth across most sectors. As shown in Figure 2 below, the blended S&P 500 Q3 EPS (combines actual results for companies that have reported and estimated results for companies that have yet to report) continues to inflect higher, while the proportion of U.S. companies beating EPS estimates remains elevated. Improving manufacturing data and a very low hurdle rate contributed to the strong earnings beats. As of October 30th, the CY 2020 bottom-up EPS estimate for the S&P 500 has increased by 8.2% ($126.86 to $137.30*) from the June 2020 trough. *Source: Factset Insights

Figure 2: S&P500 blended Q3 '20e EPS



Source: Thomson Reuters.

Stock price response to earnings was varied this quarter. Through November 2nd, ~80% of S&P 500 companies beat earnings estimates, yet the median stock fell 0.3%, according to Morgan Stanley data. The early October rally coupled with companies withholding forward guidance in response to the Fall surge in COVID-19 cases were the likely culprits. By early November, the average gain in the two days after earnings were announced was 4.5% due to company specific results versus macro influences.

The Health Care sector was the clear winner for the quarter with 93% of companies beating profit estimates and the leader among all sectors with a 15% YOY EPS growth rate. However, growth trends continued to show a wide YOY gap between Life Sciences (+46%), Biotech (+19%) and Pharma (+10%) offsetting negative growth from Providers & Services (-3%). The Technology sector also delivered strong results with EPS expected to grow 7% due to strength in Software and Semiconductors. Cloud computing and Software as a Service continue to drive momentum in the space. The Communication Services sector generated a strong earnings surprise led by Media (+81%) and Internet related companies (+28%) with YOY EPS expected to rise by (+8%).

The consumer related sectors were a mixed bag. The Staples sector had strong results with 91% of companies beating EPS estimates and with YOY EPS expected to rise (+4%) led by robust demand for personal, food, health & hygiene products. On the flip side, Consumer Discretionary delivered weak results with YOY EPS projected to decline (-6%) led by weakness in Gaming, Lodging & Leisure (-212%), despite a robust earnings surprise in all other sub-sectors. Internet retail, led by AMZN, had the strongest forecasted revenue growth (+25%) among all the sub-groups.

In the Financials sector, results were mixed with positive trends for Credit Cards (+7%), Insurance (+8%) and Asset Managers (+3), while Regional Banks declined (-17%). The Industrials and Energy sectors both had challenging results. YOY EPS is likely to contract (-52%) for Industrials with broad based declines across most groups including Transportation (-125%) and Aerospace & Defense (-48%). Finally, Energy revenues and YOY EPS are projected to contract (-35%) and (-109%), respectively due to lower oil prices and falling demand.

MSCI EAFE:

For the third quarter, EAFE EPS growth declined (-22.3%) YOY, a significant improvement from last quarter's nearly (-52%) decline. EAFE still trails the U.S. by ~14% due to the underweight benchmark positions of Technology and Health Care stocks in EAFE versus the S&P 500. While the U.S. outperformed EAFE by the widest spread in Consumer Discretionary, Materials and Staples, EAFE delivered better results in Energy, REITs and Communication Services.

Specific to Europe, 58% of companies beat EPS estimates by 5% or more, while 24% missed resulting in a strong net beat of 34%, an indication consensus expectations were again too low coming into reporting season. Given downgrades to consensus EPS expectations going into this quarter's earnings season were more benign versus prior quarters, one may view this upside surprise as a higher quality outcome. As a result, 12-month forward earnings revisions have improved to their highest level since 2017, led by cyclicals. According to Morgan Stanley, consensus now expects 2020 EPS to see a (-32%) YOY contraction for the full year followed by a (+37%) rebound in 2021.

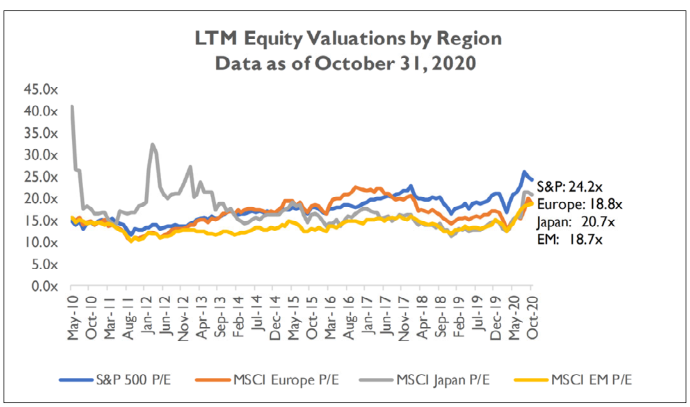
Japanese earnings are on track for a second consecutive quarter of earnings beats with a (+27%) gain. Confidence is on the rise for Japanese equities as more companies are providing guidance for 2021, which has been revised higher by +6.9%. Consumer Discretionary reported the largest earnings beat followed by the Industrials and Financial sectors. The Communication Services and Technology sectors reported a net beat due to work-from-home trends and an improving memory cycle in semiconductors. On the other side of the ledger, Real Estate, Staples and Pharmaceuticals generated the weakest earnings results.

MSCI Emerging Markets:

To date, earnings results have been positive in the Emerging Markets with an (+18%) USD YOY increase YOY. EM Asia earnings, led by North Asia, have come in stronger than consensus estimates and outperforming other EM regions. CEEMEA (Central/Eastern Europe, the Middle East and Africa) is running above consensus estimates, while LATAM is again significantly below estimates with lower commodity prices and currency depreciation taking a toll on 3Q20 results. Among sectors, Information Technology, Consumer Discretionary, Communication Services and Health Care beat consensus by more than 5ppt and surpassed EM YOY EPS growth. Interestingly, no sector has yet produced an earnings miss in excess of 5ppt and underperformed EM. 2020e EPS is currently expected to decline 10-11% in USD in 2020 and materially improve in 2021 with estimates ranging from (+24% - +32% USD) YOY.

Valuation:

Equity market valuations modestly declined in October, yet continue to march higher in November as the market focuses on a 2021 recovery predicated by successful vaccine treatments rather than the recent spike in cases and additional lockdown measures. Valuation is a key hurdle for markets to overcome next year. The vaccine news has many re-evaluating forward earnings estimates, which if justified, could be just what the doctor ordered to ease valuation concerns.



Source: Factset

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