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Market Commentary

WEEKLY PERSPECTIVE ON CURRENT MARKET SENTIMENT

Fourth-Quarter Earnings Comparisons Likely Not Pretty

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Last Week's S&P 500 Index:
+0.9%

Key takeaways

» *We believe investors have long been expecting poor earnings comparisons for the fourth quarter of last year.*

» *We believe the market is looking forward and expecting a modest growth/modest inflation environment in 2020.*

The title of this week's piece was meant to get your attention. Now that we have likely achieved that goal, let's discuss further. The good news is the market has known for a long, long, long (emphasis on long) time that earnings comparisons in the last quarter of 2019 were not likely going to be very good. After all, given the nearly 24% rise in S&P 500 earnings in calendar-year 2018, we knew it would be tough to generate above-average growth rates last year. The first three quarters of 2019 were compared to the prior-year period of virtually 25% growth rates. The upcoming earnings reporting season that kicks off in earnest this week will be stacked up against a relatively "easy" 13% growth rate in the final quarter of 2018; a 13% growth rate would rarely be considered an easy comparison.

For last year as a whole, based on current FactSet data, earnings growth after all is said and done will likely come in just under 1%. This would be slightly under our expectation for approximately 2% growth. If we look at just the fourth quarter of last year, once again using our FactSet database, earnings are likely to come in around flat. Given that in any typical quarter 65% to 70% of companies beat the consensus "Street" estimate, we think it is safe to say that fourth-quarter final results will be slightly positive. So all in all, in terms of earnings growth, 2019 won't be one for the record books. But, again, this is not a surprise in any way, shape, or form to the market.

What we believe the stock market has been focused on is the future. Earnings results in 2020 will be gauged against nearly nonexistent (give or take a touch) growth rates in each of last year's quarters and for the year as a whole. We believe stocks continue to anticipate a modest-growth/modest-inflation environment where the Federal Reserve doesn't make a mistake and the probability of a recession is low. That syncs well with our forward outlook. As a result, we see earnings growth for the S&P 500 Index in the 5% to 6% range this year. It is worth noting that Street consensus is more optimistic than we are and currently calls for 9.6% growth this year. We think that estimate is likely too high. Investors appear to be pricing in these easier earnings comparisons as the S&P 500 has notched another all-time record high as this piece is being written. In addition, as we have pointed out in previous issues of this report, stocks have been helped in recent months by a perceived easing of trade tensions as well as some market chasing by those who are sitting on cash and underexposed to equities.

As this expansion rolls on, our interest continues to lean toward those sectors sensitive to the ebb and flow of the economy. We favor the Information Technology, Consumer Discretionary, and Financials sectors. The stock market saw robust gains in 2019. The financial media will be spending a lot of time reporting fourth-quarter results in coming weeks. Those results won't likely be pretty, but we believe the market has been looking beyond 2019 earnings results for quite some time.

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Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players; reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment.

Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector.

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