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Market Commentary

Weekly perspective on current market sentiment July 14, 2021

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Last week's S&P 500 Index: +0.4%

Confirmation

Key takeaways

- Earnings expectations for the second quarter are strong with growth of 60% likely.
- Investors are looking for confirmation that the economy is on track and want forward guidance from companies that shows conviction.

With second-quarter earnings season beginning in earnest this week and the consensus calling for a 60% year-over-year gain in earnings, let's take a closer look at investor expectations and potential impacts on the equity markets.

Investors know that the second quarter is going to be huge in terms of both economic and earnings growth. In fact, in our opinion, the second quarter was likely the high water mark for growth in this cycle. That's because comparisons in the year-ago period were against the pandemic-induced economic trough as much of the U.S. economy was simply shut down due to the virus and more than 20 million workers lost their jobs. In research parlance, second-quarter results are against "easy comps." Investors have been anticipating and building in a lot of good news over the course of the last 12 months or more coming off of the March 2020 bear market bottom. Progress on vaccines, the Federal Reserve's easy money policies, and trillions of dollars in fiscal stimulus have all helped push the recovery ahead at what has been a high rate of speed. While coming quarters are not likely to be as strong as last, we believe the pace should still be well above average and why we continue to prefer stocks over bonds.

Three of our favored equity sectors are expected to post triple-digit earnings gains in the second quarter. We have been favoring sectors sensitive to the ebb-and-flow of the economy (cyclicals) over those that are more defensive, like Utilities and Consumer Staples. We anticipate our favored Industrials (based on the S&P 500 Industrial index) sector is expected to report the largest percentage gain, nearly 330%, relative to the other 10 sectors. The favored Financials and Materials sectors are both expected to produce year-over-year earnings gains slightly in excess of 110% according to S&P Global. Ten of the 11 S&P sectors should post positive earnings growth in the second quarter (Utilities is likely to be down a percent or less).

So as the earnings reporting season financial media frenzy takes hold for the next few weeks, the natural question is "how much of a margin for error is there?" In other words, for the market as a whole, if earnings growth doesn't at least match the lofty consensus expectations, how much downside is there? For this particular reporting season, given the underlying economic and employment assumption priced in and likely to play out over the balance of the year and into 2022, the margin for error is likely higher than most earnings seasons. We expect a beat or miss of 5% versus the consensus call would likely not have a big effect on the major indexes. This time around, investors are looking for confirmation that the economy is on track and want companies to show some conviction that the outlook remains positive.

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