Markets in a Minute:
Earnings Season

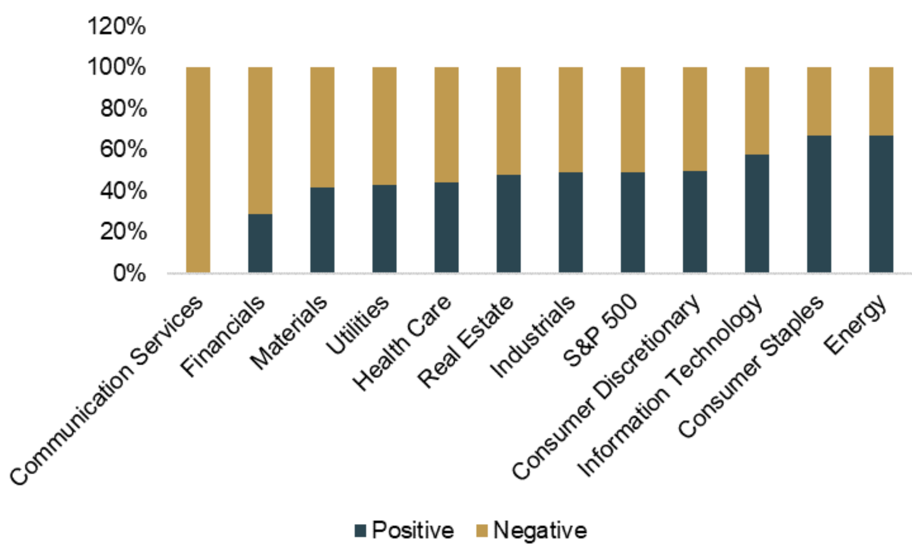
With the Federal Reserve slowing its interest rate increases and inflation slowing to a tolerable level, the question remains: What can companies earn in this softer economic environment? Now that we are halfway through companies reporting their earnings for the fourth quarter of 2022, we can affirm that it's not going great. Read on to see why that's actually a good thing.

How's it going?

So far, about 70% of companies have reported earnings that were better than analysts' expectations and, on average, those earnings have been 0.6% higher than estimates. That performance, as good as it may sound on first blush, is well below historical averages. For instance, over the last 5 years 77% of companies have beat expectations and they've done so by over 8%. This below-average performance tells us that economic momentum is clearly slowing.

The weaker results are fairly widespread with 7 of 11 sectors reporting lower earnings compared to a year ago. A majority of companies that have offered guidance on earnings for this year have said that they anticipate earnings to be lower than current estimates.

S&P 500 Constituents with FY Positive and Negative Guidance

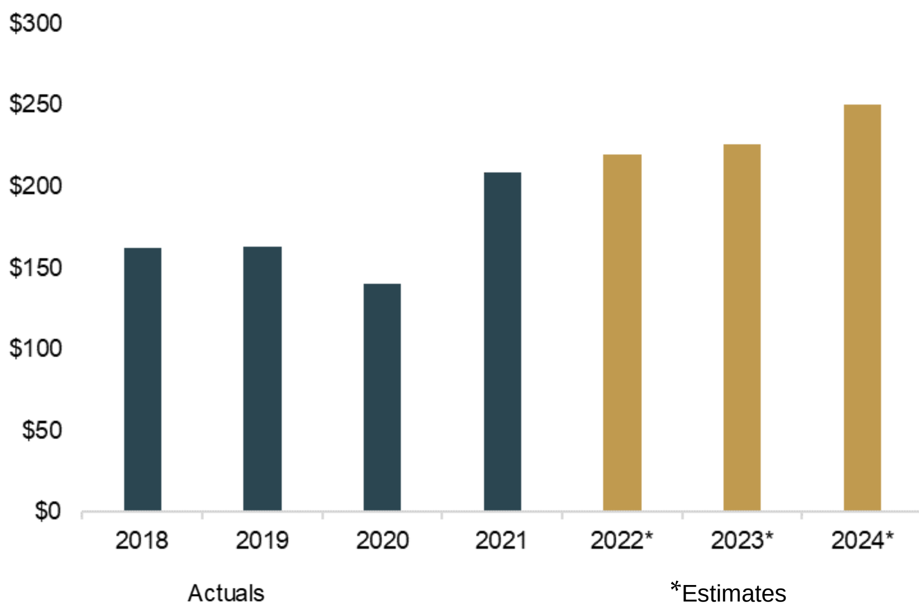


Source: Kestra Investment Management with data from FactSet. Index proxies: S&P 500 Index. Data as of January 26, 2023.

What does this mean for 2023?

Expectations for corporate earnings in 2023 have been easing since the middle of last year. In June 2022, analysts projected earnings for companies in the S&P 500 to grow in 2023 by 10%. By December, that estimate had declined to just 5%. Four weeks later, the estimate is now for only 3% growth.

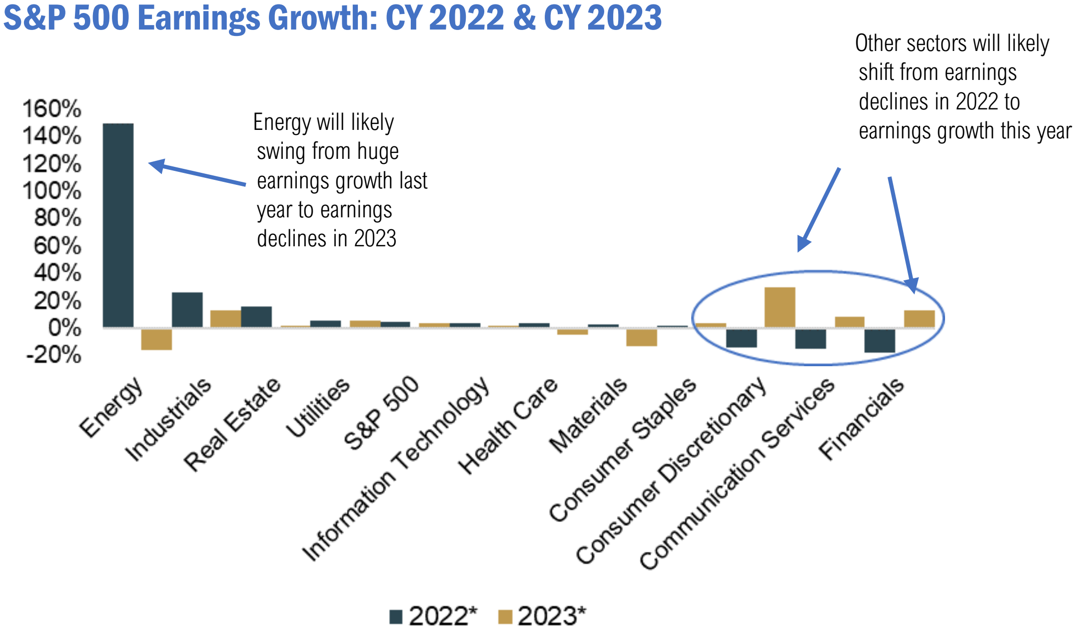
S&P 500 Calendar Year Bottom-Up Earnings Per Share



Forward looking projections may not come to pass. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. Source: Kestra Investment Management with data from FactSet. Index proxies: S&P 500 Index. Data as of January 26, 2023.

In addition to the slowing pace of growth, the drivers of earnings next year are expected to change dramatically. For instance, in 2022, nearly half the growth in S&P 500 earnings came from the Energy sector, where earnings per share soared by about 150% compared to 2021. Next year by contrast, Energy sector earnings are forecast to decline by 15%. Instead, sectors such as Consumer Discretionary, Communication Services and Financials will likely shift from earnings declines last year to earnings growth this year.

S&P 500 Earnings Growth: CY 2022 & CY 2023



*Estimates. Forward looking projections may not come to pass. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. Source: Kestra Investment Management with data from FactSet. Index proxies: S&P 500 Index. Data as of January 26, 2023.

The reduction in earnings expectations is - ironically - healthy for the markets. We've been arguing for some time that with tighter monetary policy and a slowing broad economy, the macro environment has become more challenging for companies to operate in and corporate earnings are likely to suffer as a result. Many analysts on Wall Street are now playing catch up, reducing their estimates of earnings when faced with a clearly decelerating economic momentum.

Once these estimates become more reasonable, which they are now in the process of doing, the market can look forward again to a likely rebound in earnings, which could be positive for stock prices. Recall that the stock market is a discount mechanism, meaning today's prices incorporate and reflect what investors believe will happen in the future. The more conservative those future expectations, the easier it is for stocks to increase in value if actual earnings come in stronger than estimates.

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