CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

October 2021

Earnings to the Rescue (Again)

After a volatile September, where markets were focused on macro headwinds – slowing growth, Chinese property sector woes, surging inflation and rising bond yields – October has been an altogether more positive affair. And the simple reason – company earnings. Investors were expecting supply chain issues, slowing growth and rising costs to have a material impact on third quarter earnings. However, most companies appear to have navigated these issues relatively unscathed and CEOs have been rather more positive on the outlook than expected. Midway through the earnings season it looks set for another strong set of results from companies across most sectors. The last two months of the year have historically been favourable ones for investors but, after the strong gains seen so far this year and a number of macro headwinds still present, will the allure of equities – from the positive results season – begin to fade into year end?

As October passes, we again find ourselves reporting record highs for global equities. Investors came into the latest earnings season rather more cautious than in recent quarters – global growth had been showing signs of slowing, supply chains were severely disrupted, and inflation was rapidly becoming more entrenched and more elevated than many had anticipated. As a result, forecasts had been managed down for this earnings season, leading to over 80% of companies beating analysts' estimates on earnings at the half-way point. Whilst that sounds like reason for seasonal cheer, "analysts" appear rather poor at gauging company results each quarter as the long-term average of companies *beating* expectations is in the region of 70%, leaving anything below this seemingly weak. A perplexing phenomenon where one would reasonably expect the long-run to be closer to 50%, if markets are efficient and analysts' good at their jobs! Nevertheless, earnings continue to rise and, in recent quarters, supported by more cyclical sectors such as banks and energy, rather than the COVID winners, such as technology, which propelled earnings in 2020. Beneath the surface there were signs that some of the big name technology companies are feeling the supply chain pinch – both Amazon and Apple disappointed in the last week of October. Alongside this, the social media giants had a roller-coaster month following Apple's new privacy changes. SNAP's (Snapchat) 25% share plunge in a day reminded us of the sensitivity of lofty valuations in certain sectors as soon as the mood music turns.

So, where does this leave investors into the year end? With over half of S&P companies having reported, attention may soon turn back to the worrisome macro factors at play. However, climbing these walls of worry has been a hallmark of this long-standing bull market since the financial crisis. And so, as long as there are no credible investment alternatives (to equities) and the bond market doesn't go into all out melt-down (where yields jump higher and prices fall), there is little reason to not remain invested in equities. However, as we have mentioned in previous monthly notes – investors may wish to diversify their risk exposure into alternative real (inflation sensitive) assets, such as property, infrastructure, commodities and gold, giving portfolios more ballast to both (economic) growth and inflation dynamics.

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