

Wentz Weekly

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Second Quarter Earnings Season Preview



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A record number of companies are issuing positive guidance for the third quarter. According to FactSet, 103 S&P 500 companies issued guidance for the quarter with 2/3 of those issuing guidance that was above analysts' consensus expectation, a record high number, and only 1/3 issuing negative guidance. In addition, earnings estimates typically start high and decline as the quarter progresses with data showing over the last ten years earnings estimates have declined an average of 4.0% during a quarter. This past quarter saw estimate do the opposite – estimates increased by 7.3% over the quarter, the highest increase recorded since data began by FactSet. In total, S&P 500 earnings are expected to have increased 64% for the second quarter, the highest earnings growth since 2009. Some companies are conservative in forecasting sales and profits and the economy is recovering much stronger than expected, a couple reasons why we believe second quarter earnings growth will end up being higher than the 64% currently expected. With most of the pandemic behind us, this earnings season we will shift our focus to company's commentary around inflation and how they see it impacting margins. We expect another strong earnings season driven by a strong consumer with support from fiscal and monetary policy but with expectations so high we would not be surprised if stock price reaction is more muted, similar to what was seen last quarter.

Chinese companies listed in the U.S. saw shares fall last week after Chinese regulators intensified its enforcement on companies listed in the U.S., cracking down on some of its largest tech firms. The most recent Chinese company listing in the U.S., Didi Global who is referred to as the "Uber of China," fell over 25% a couple days after its IPO after China ordered the company's app to be removed from app stores. China wants the company, along with several others trading on U.S. exchanges, to stop adding customers until it investigates the company's collection and handling of its users' data. Chinese regulators are stating it is a cybersecurity risk and its rules and supervision needs strengthened, but speculators see regulators doing this because of the company's decision to list and raise funds outside of China. We believe some of the recent U.S. listed Chinese stocks are attractive long-term, but would avoid for now as China's regulatory concerns will likely lead to increased volatility.

President Biden signed an executive order that aims to improve competition in several markets in the US economy and limit the power of large, dominant companies. Democrats have been persistent over the last several years on anticompetitive behavior of some of the largest companies, specifically in the tech space. However, the executive order covers a much broader market, addressing behaviors in not just the tech sector but also the banking, airline, agriculture, transportation, and health care sectors. The order does not have an immediate impact to today's businesses but does encourage agencies to write policies to fight back on business practices that puts consumers, workers, and small businesses at a disadvantage. Two weeks ago, a district court dismissed the FTC's antitrust suit against Facebook for being a monopoly and stifling competition. The order looks to address issues like this going forward, which may mean more scrutiny in mergers and acquisitions.

The minutes to the Fed's most recent Federal Open Market Committee meeting were released last week and showed the Fed appears more divided than what we previously thought. Some Fed members believe the stronger recovery than expected warrants a tightening of monetary policy, while others believe the economy still needs to show "substantial further progress" in reaching the Fed's goals of maximum employment and 2% inflation until any change in policy is necessary. The minutes support our view that the Fed is preparing to announce a plan to taper its asset purchases in one of its upcoming meetings. With the economy recovering much stronger than expected, the labor market tightening, and inflation running above 2%, we think some sort of tightening in monetary policy is warranted, beginning with peeling back its \$120 billion per month in asset purchases.

The labor market is in an interesting spot with a record high number of job openings, hirings that fell for the first time this year, both of these despite still being with 6.8 million fewer jobs than before the pandemic. In May there were 9.2 million job openings, the highest level since tracking of this data began, jumping from 7 million openings two months prior, and compared to the 9.5 million Americans the Bureau of Labor Statistics counted as unemployed. Interestingly, the number of separations, which includes quits, layoffs, and discharges, declined to 5.3 million from 5.8 million the month prior. With so many job openings it would be more typical to see separations rise as people feel more comfortable leaving their job to look for better/higher paying jobs. We think this will be the case going forward which will drive wage growth as employers will be forced to offer a higher wage to attract the skilled worker they need, leading to further inflationary pressures.

Company News

- The Pentagon canceled its \$10 billion JEDI (Joint Enterprise Defense Infrastructure) cloud contract with Microsoft. The Pentagon awarded Microsoft the contract in 2019, but Amazon fought the contract with lawsuits since then alleging Amazon's chances were ruined because of President Trump's sour relationship with then-CEO Jeff Bezos.
- Amazon reportedly approached CVS, who recently acquired Aetna, in effort to join its insurance networks to expand its health care coverage. The report says Amazon is running into disagreements during the conversations, mostly around payment arrangements.
- BigCommerce announced a new integration with Amazon's Multi-Channel Fulfillment that lets merchants use Amazon's fulfillment services whether they sell on Amazon's platform or not.

The Week Ahead

Economic data reports, earnings reports, and several events will make this week much busier than the last several. On the economic calendar, the first major report of the week is inflation data from the consumer price index Tuesday morning. The consensus sees a 0.5% increase in the month and 5.0% increase in the index from a year ago. Then the producer price index is released on Wednesday, which measures prices that producers pay to make the goods/services we consume. On Thursday, weekly jobless claims and two manufacturing surveys, the Philly Fed survey and Empire State Survey, are released. Finally on Friday, the Census Bureau will report on retail sales where a slight decline is expected due to a drop in car sales. Second quarter earnings season will kick off this week as well with some of the largest banks being the first to report for the quarter. JPMorgan, Goldman Sachs, and PepsiCo will kick things off on Tuesday. Other notable reports include Bank of America, Wells Fargo, Citigroup, and Delta on Wednesday, Morgan Stanley, United Health, and Taiwan Semiconductor on Thursday, and Kansas City Southern on Friday. We will also hear from Fed Chairman Powell when he will give his testimony regarding monetary policy to Congress Wednesday and Thursday.

The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market. The Dow Jones Industrial Average (DJIA), commonly known as "The Dow" is an index representing 30 stock of companies maintained and reviewed by the editors of the Wall Street Journal. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index. The NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system. Every investor's situation is unique and you should consider your investment goals, risk tolerance and time horizon before making any investment. Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification. Information contained herein was received from sources believed to be reliable, but accuracy is not guaranteed. Information provided is general in nature and is not a complete statement of all information necessary for making an investment decision and is not a recommendation or a solicitation to buy or sell any security. Investing always involves risk and you may incur a profit or loss. Keep in mind that individuals cannot invest directly in any index. Past performance does not guarantee future results. There is no assurance these trends will continue, or forecasts will occur.