

Wentz Weekly

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Companies Exceeding Expectations Despite Rising Costs/Supply Chain Issues



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While higher costs and supply chain issues may still be a worry going into the fourth quarter, companies have overcome that concern so far in the third quarter and reported robust results with the third highest profit margins ever. According to FactSet, the net profit margin for S&P 500 companies for Q3 is 12.3%, above the five-year average of 10.9%, and just below the all-time high of 13.1% from the second quarter. Companies are still talking about supply chain disruptions, rising costs, and pressure on margins, but so far they have been able to manage these conditions and post better results than expected, with investors believing these issues will prove to be temporary and driving markets to new highs as a result. With about 56% of the companies in the S&P 500 having reported quarterly results so far, 82% have reported earnings above expectations and 75% have reported sales above expectations, both well above the historical average. Earnings are 36.5% higher than they were a year ago, the third highest y/y growth rate ever, while sales are 17.9% higher than a year ago. Even more, earnings are surprising more to the upside as the margin of the earnings beat is over 14%, while below the 20% beat rate from the second quarter, shows how resilient companies are and how they have been able to overcome issues that have worried investors the second half of 2021.

The highlight of earnings reports so far is the impact of Apple's new privacy setting and its effect on advertising revenues and company's ability to measure the effectiveness of ads. Facebook missed revenue expectations and forecasted lower revenues because of the changes and made a large increase to its capital expenditures as it spends more on its push in the metaverse. Google's parent Alphabet beat expectations on strong revenue growth but had a modest impact from the new privacy change. Apple missed expectations and warned its supply chain issues are worsening and cited a \$6 billion revenue impact due to these issues, which it expects to continue into the fourth quarter. Amazon missed estimates and forecasted Q4 below expectations because of higher input costs from higher wages and freight costs. Out of the big 5, Microsoft was the clear winner, relying less on advertising and its supply chain, beating expectations in all areas with 50% growth in its Azure cloud business. The upward move in the stock made Microsoft the most valuable US company, surpassing Apple.

Democrats are narrowing down their reconciliation spending package in the latest days, now bringing the price tag down to \$1.75 trillion from the initial \$3.5 trillion proposal. President Biden last week laid out the new framework for his social spending plan, deciding to keep a one-year extension to the child tax credit, universal and free preschool, expanded Medicaid benefits, and additional rebates for clean energy. On the revenue generating side, the framework removes the increase in corporate taxes but would implement a minimum corporate tax of 15% on companies with over \$1 billion in profits, in addition to a 1% surcharge on stock buybacks. The plan removes the tax on unrealized gains for billionaires but is replaced by a new surtax of 5% on incomes over \$10 million and an additional 3% on those over \$25 million. Progressives approved the new deal while the original holdouts, including Manchin from West Virginia, still have not publicly committed on the framework. In separate news, The House was expected to vote on the \$1 trillion bipartisan infrastructure bill on Thursday, which Democrats agreed to hold a vote once the reconciliation bill was finalized, but Speaker Pelosi chose to delay the vote after opposition from progressives.

Economic growth in the US slowed to a 2.0% annualized pace in the third quarter, according to the Bureau of Economic Analysis (BEA). This was below expectations and within the range of 0% to 4.8%. Personal consumption (makes up 70% of GDP) rose 1.6%, almost doubling expectations, after a very strong 12% gain in Q2, and contributed 1.1% to GDP. Nonresidential fixed investments rose 1.8%, contributing .2% to GDP, led by an increase in intellectual property (software) that was offset by declines in structures/equipment. Residential investment fell 7.7%, contributing -0.4%, from a slowdown in home builds. The change in inventories contributed +2% to GDP as businesses continue their efforts to restock. Net exports fell 1.1% as the US imported 6.1% more with 2.5% less exports. Government spending rose 0.8%, contributing 0.1% to GDP. Forecasts show GDP growth in the next several quarters should make up for the shortfall from Q3. For the fourth quarter economists expect an annualized growth rate of 5.8% while the Atlanta Fed's GDPNow model sees growth at 6.6%.

Mark Zuckerberg, CEO of Facebook, used the Connect Conference as a chance to announce a new identity of the company he founded. The rebranding comes at a crucial time, one which Facebook is dealing with internal leaks and the threat of being broken up by Congress. Zuckerberg wants Facebook to be known as more than just a social media company, one that now puts the "metaverse" first, hence the new name of the company – Meta. Zuckerberg describes the Metaverse as the new internet and one in which people can interact "in immersive, 3D and shared digital worlds," calling it an "embodied internet." The last company of this size to make a similar move was Google when it renamed and rebranded to Alphabet to better reflect its diversification and show that it is not just a search engine. Facebook will officially be known as Meta and will begin trading under the new ticker symbol MVR5 on December 1. The company said it will see heavy investment in the beginning that might not pay off for 5, 10, or 15+ years.

Company News

- A Bank of America analyst said production will be affected 14% at Apple's manufacturing facilities in China due to the government implementing power shutdowns (because of coal shortages, rising prices of raw materials, and nonstop growing demand for electricity).
- Tesla became just the seventh US company to surpass \$1 trillion in market capitalization. The catalyst for last week's move higher was its deal with Hertz who agreed to purchase 100k Model 3 sedans, worth \$4.2 billion. Also last week, Microsoft passed Apple to be the most valuable US company at \$2.49 trillion.
- Starbucks said it will make a significant investment in employee wages to recognize tenured staff. It said it will increase the pay floor, with average earnings of \$17/hour and a new range of \$15-\$23/hour for baristas starting summer 2022.

The Week Ahead

It is going to be another busy week on the corporate and economic calendars. The corporate calendar is dominated by earnings reports with at least 160 S&P 500 companies reporting quarterly results. Highlights of the week include AMC, Clorox, and McKesson Monday, Pfizer, Under Armour, T-Mobile, Lyft, Activision Blizzard, and BP on Tuesday, CVS, Qualcomm, and Roku on Wednesday, Wayfair, Penn Gaming, Uber, Airbnb, Pinterest, Dropbox, Square, and Expedia on Thursday, and DraftKings on Friday. On the economic calendar, most of the focus will be on the employment report Friday where economist currently expect the Department of Labor to announce 400,000 jobs gains in September. Outside of that, several manufacturing indices are released Monday which should provide more details on supply chain issues, as well as an update on residential and nonresidential investment spending in September. On Thursday we will see an update on the latest weekly jobless claims along with August data on trade. The main event of the week however will be the FOMC announcement which will be followed by Chairman Powell's press conference where Powell is expected to give details on the timing and pace of tapering its quantitative easing program.

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.