Northern Trust | A Look Beyond the Short-Term Earnings Bumps

[MUSIC PLAYING]

As we sit at market highs and at the beginning of earnings season, it makes sense to take a look at what may drive markets higher going forward. Let's break it down. While we've spent a lot of time focusing on central bank policy, we recognize that ultimately markets will be driven by earnings and changes in valuation. After a challenging first quarter for earnings, analysts are not expecting conditions to improve over the near term.

Whether we look at bottom up or top down analysts' expectations, earnings growth in the US is expected to be at worst negative and at best flat over last year. Further, the S&P is selling at around 17 times forward earnings, above the historical average of 15 times, but reasonable given our view that the Fed will cut rates. Outside the US, the growth trend is the same. European and emerging market earnings growth is expected to be muted at best, with valuations hovering around historical averages. In all cases, a late 2019 earnings rebound is expected with low to mid-single digit growth for the year.

The challenges on the global trade front are having a twofold impact on economic and earnings growth. First, the slowdown in trade activity is having a direct impact, with growth slowing to 2.6%, according to the World Trade Organization. Second, the waning of corporate confidence has hurt global capital expenditures, which had rebounded nicely in 2018. Those sectors most exposed to these two issues-- industrials, materials, and technology-- likely will struggle the most with earnings growth.

For investors, this means taking a longer view. While the challenges are clear right now, the response to those challenges may paint a brighter longer term picture. Global supply chains are being redrawn as we speak in a more flexible form that may buffer the direct impact of future trade skirmishes. Next, it's all relative, as analysts are anticipating a much better 2020 off the weaker base of 2019, with expectations for a high single digit or even double digit earnings growth year for all regions.

Over the past several years, and particularly given the 2018 tax cuts, the earnings growth rate of the US was markedly higher than overseas. Global earnings growth rates are converging, and importantly, expectations are reasonably muted and central banks are assuredly dovish. A 2020 earnings recovery, along with support for current or even higher valuations given low interest rates, presents a constructive case to long-term investors in global risk assets, such as stocks and high yield bonds.

[MUSIC PLAYING]