DWS

Chart of the week

Once again the majority of U.S. companies beat earnings forecasts. And this quarter more than ever, the markets are showing what they make of this game.

While the U.S. president continues with his efforts to make America great again, America's companies are already one step ahead. They are great, their sales are great and their profits are great. So great that the analyst community is constantly surprised at how the companies can deliver such great results, as seen in their quarterly figures. The current reporting season has now been running for almost three weeks, and behold, U.S. companies have again managed to beat the numbers that most analysts predicted. But the analysts must slowly be realizing that U.S. companies always deliver. And even over deliver. And isn't that what investors should like more than anything: forecasts that are surpassed? This joy should be reflected in share prices, which should rise sharply with every reporting season. The data going back to 1998 shows that more than half of U.S. companies always surprise the markets – every quarter, whether the economy is in an upswing or a recession.

But stock prices reflect nothing of the sort, as our "Chart of the Week" shows. More precisely, it shows three things:

1) Over the past three years, 73% of U.S. companies have on average exceeded their forecasts (we show the deviation from the average here).

2) The reaction of the S&P 500 in the first four weeks after the start of the reporting season during the past five years, of which we only show three years, has been largely detached from the beat ratio (the ratio of firms that were able to beat the forecasts). The correlation of both data series is close to zero.

3) In the current quarter, the discrepancy is particularly striking: a record 80% of U.S. companies were able to beat the forecasts, but, after Wednesday’s selloff, the S&P 500 is down by 8%.

We draw three conclusions from these observations:

1) Neither as an indicator for the market reaction nor as an indicator for the quality of the quarterly figures is the "beat ratio" of much use.

2) This is primarily due to the fact that companies are very successful at expectations management and guide analysts down just ahead of quarterly reporting.

3) An independent, quantitative and qualitative analysis of the quarterly figures is therefore mandatory.

In our opinion, given the high expectations, the quarterly results have so far been somewhat more mixed than expected, but overall

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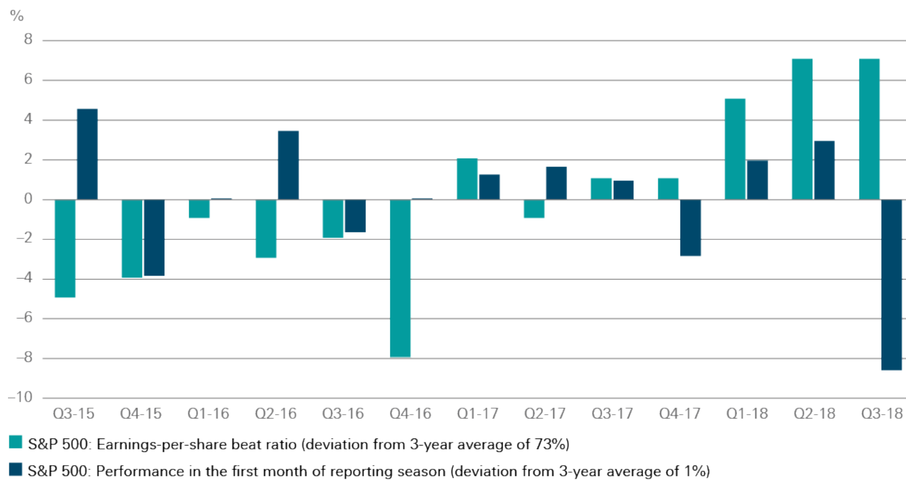
remain at a pleasingly high level. We are therefore sticking to our forecast for the S&P 500 (3,000 points by September 2019) and consider the market correction to be overdone given the still quite good economic environment, as we explain in our CIO Flash (see CIO Flash: U.S. equities under pressure). At the same time, we believe that the market will remain nervous in the context of the U.S. midterm elections (see The Trump effect 2.0).



Sources: FactSet Research Systems Inc., DWS Investment GmbH as of 10/25/18

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Glossary

Correlation

Correlation is a measure of how closely two variables move together over time.

S&P 500

The **S&P 500** is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

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