

HOW CONTAGIOUS ARE EARNINGS ESTIMATES?

Markets seem to have shrugged off the coronavirus. Meanwhile, the earnings outlook continues to be uninspiring. What are investors hoping for?

That was quick. After a few trading days of stock-market panic due to the novel coronavirus, financial markets appear to have shifted back to recovery mode. At least that's what you might think when looking at the S&P 500, which is now¹ roughly back to its pre-crisis level² (in terms of when the outbreak in China began to be widely reported). This is remarkable. Even if the virus were soon to be contained, plenty of economic damage would already have occurred. Moreover, the economic costs are likely to increase daily, probably well beyond the peak in new infections. This also affects U.S. companies, for example those that are dependent on Chinese tourists, on flights to China, on consumers in China or on production facilities in the province of Hubei. The impact is likely to be felt primarily in the first-quarter figures, with corresponding effects on the full-year figures. Similar share prices with lower earnings. This would mean that the S&P would once again benefit from a valuation expansion – the factor that was almost solely responsible for the S&P 500 rally in 2019. That is, if one takes 2019 earnings as a basis, which did not grow compared to 2018. But for now, the market is looking ahead. And for 2020, it (still?)

expects the S&P 500 to post an 8.5% increase in earnings.³

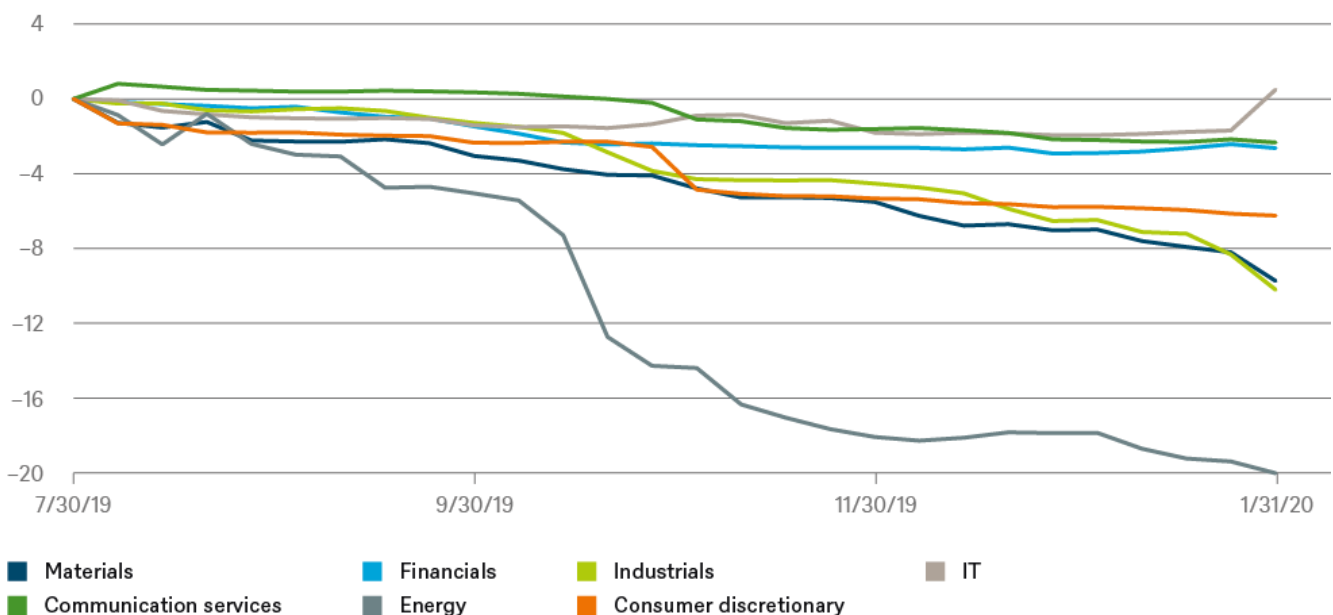
What could move markets more in the medium term are the changes in estimates. As our Chart of the Week shows, things look rather bleak on that front. Since July 2019, the S&P 500 has gained 17%, but earnings estimates for 2020 have fallen by 3.6%. Unsurprisingly, cyclical sectors (see chart) have been responsible for this, while defensive sectors (utilities, health care, real estate and defensive consumption) have done so little that we have not even included them in the chart. The only positive outlier was once again the technology sector, which managed to exceed the high expectations for the fourth quarter of 2019. But on the whole, the impact of the virus is unlikely to be reflected in the consensus estimates yet. So why are investors so nonchalantly pretending to be immune from further health scares? Maybe because they are expecting what they consider to be the right medicine for weak economies and markets: easy money from central banks. The People's Bank of China has already served up the first dose.

¹As of 2/5/20

²As of 1/17/20

³As measured by consensus earnings expectations

Change in consensus earnings estimates for 2020 in %, 7/30/19 = 0



Sources: Refinitiv, DWS Investment GmbH as of 2/5/20

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Source: DWS Investment GmbH

GLOSSARY

A **consensus estimate** is a figure that depicts the average of different analysts' estimates about the performance of a particular asset.

People's bank of China (PBoC) is the central bank of China.

Pro-cyclical sectors are those likely to particularly benefit from an upturn in the economic cycle (i.e. stronger growth).

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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