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Market Commentary

WEEKLY PERSPECTIVE ON CURRENT MARKET SENTIMENT

Thinking About 2019 Earnings Yet? No? Maybe You Should Be

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Last Week's S&P 500 Index:
-0.1%

Key takeaways

- *Equity investors are paying close attention to the forward outlook from corporations during this first quarter earnings reporting season.*
- *But a big question is, when will the market start thinking about earnings growth in 2019? Our guess is sooner rather than later.*

As we move through the first-quarter (2018) earnings reporting season, much attention is being paid to how companies have done over the past three months. That's right, much of the conversation and media coverage is tightly focused on what happened in the very recent past. Every quarter, analysts and investors alike anxiously wait to find out and react to, once again, something that happened in the past. Granted, with the new tax code in place, there is elevated interest in how earnings were affected in the first three months of the year. And of course, there is great attention being paid to the outlook for corporate capital spending, which has sorely lagged historical norms for the bulk of this economic expansion.

But what about the forward outlook for earnings? No, this strategist is not talking about what the results will be for the current quarter, or for the third and fourth quarters of this year for that matter. And yes, we fully understand that expectations are certainly high this year as the lower corporate tax rate along with the ability to fully write off capital expenditures kick in. We know that since we are at least somewhat in uncharted territory in terms of taxes and tax strategies there is a degree of uncertainty as to how corporations will actually behave. But the market is likely to start thinking a little further ahead more quickly than many investors realize.

You might ask why that would happen. After all, we have three quarters of results to project, actually see, and then, post-reporting, analyze. We have a lot of forward outlooks and capital expenditure projections coming from companies over the next nine months or so. Isn't that enough to keep the market occupied over the balance of this year? It might be, but we wouldn't count on it. The potential issue (or problem might be a better term) is very closely tied to what was just discussed: the new tax code.

When the details of the new tax code were fully released and understood, our earnings-growth estimate for this year moved considerably higher. In fact, based on our analysis, without the change in the tax code, earnings for the S&P 500 would have grown 7% this year versus 11.4% in 2017. In other words, as typically occurs in the later third of the cycle, earnings growth would have slowed. But low and behold, with the new tax law in place, our estimate for earnings growth this year jumped to a touch over 16%. The "Street" is even more optimistic, with the consensus calling for just over 19% growth in 2018. But what happens next year (2019) when there will not be a meaningful change in domestic tax law that dramatically affects domestic corporate earnings? Will earnings still grow at a 16% rate?

Sorry to disappoint you, but probably not. The real question is will earnings growth drop down into the 5% to 8% range that would be typical in the later third of a cycle or will the tax benefits for corporations and consumers, along with better global growth, help push earnings ahead at a faster pace?

That is the question the stock market will likely start debating sooner rather than later. If you are not thinking about 2019 earnings yet, maybe you should be.

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