Q4 Earnings Continue to Beat Expectations and Provide Investors with Hope

U.S. corporate earnings continue to roll in beating expectations on both the revenue and sales side. The S&P 500 earnings growth rate remains at 8% annually, while year over year fourth quarter earnings saw an increase of 0.7% (according to FactSet). This is the first positive YOY quarterly growth in the S&P 500 since 2018. The growth rate has dropped in recent quarters but was still positive overall. Earnings drive current and future price. As such, it is to be expected that Q4 2019 reports would be strong given the run up in stock prices over the past six months.

With impeachment no longer a distraction and the coronavirus becoming old news, investors can now turn their attention to the prospect of continued growth. The S&P 500 aggregate forward P/E ratio is 20 and significantly above long-term averages. This implies that earnings growth will have to accelerate to justify current price as well as price gains going forward. Whether this can happen is of course anyone's guess, but the collective wisdom of the world's equity investors seems to think it is possible. I wrote a commentary several weeks ago suggesting that investors seemed to find conditions for growth just right. This "Goldilocks" scenario occurs when interest rates are low, inflation is contained, and companies can efficiently borrow to invest in their own products and services, thereby growing their earnings.

The one noticeable current concern for me is the flat yield curve (recently inverted). When short term rates are the same or lower than long term rates, banks cannot make money loaning money and access to capital dries up. If the growth story were as strong as the stock market seems to think it is, we would expect the bond market to have higher long-term rates. After all, who would loan their money out for ten years in return for a 1.55% return when they could invest it in a company like Apple or Amazon or even the S&P500 as a whole and experience a much better return. This bit of common-sense analysis suggests that the bond market is not as enthused about future growth as the stock markets would otherwise indicate. We will continue to keep a close eye on this important part of the picture.

Key Terms:

The **S&P 500 PE Ratio** is the price to earnings ratio of the constituents of the S&P 500.

Last week's commentary can be found here.

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