STRATEGY NOTES: US corporate earnings were up by 27% y/y in 4Q 2021. Upside surprises back to normal: above the historical average, but the smallest observed since the onset of the pandemic.

15h February 2022

The 4Q 2021 earnings reporting is close to completion in the US, and mid-way through in Europe. Earnings were higher by 27% and 44% respectively in the USA and in Europe.
Upside surprises were still above the historical average but fell well short of the exceptional rates observed over the five quarters that followed the pandemic-induced crash (1Q 2020), to which analysts responded with strong upside earnings revisions. In the US, the normalisation of the size of upside surprises was followed by the typical (albeit limited) downside revision of forecasts for the following quarter.

4Q 2021 CORPORATE EARNINGS

The earnings reporting season is close to its completion in the USA, and mid-way through in Europe. **Earnings are still recovering, albeit at a progressively more normal pace after the acceleration seen in the opening half of 2021.**

At the start of the reporting season, analysts were forecasting 21% y/y earnings growth for US companies, as opposed to negative quarterly growth (-4%).

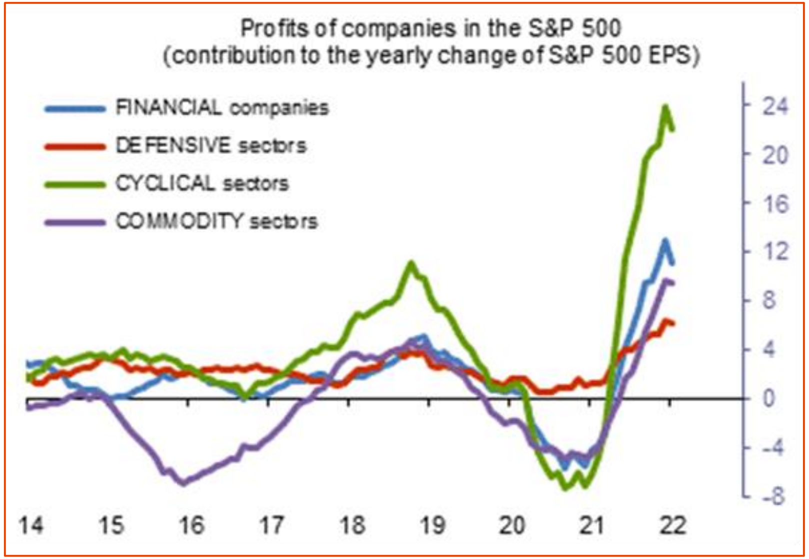
Earnings were up by 27% and, most importantly, growth was positive in quarterly terms, consistent with a strengthening of the macro picture in the closing quarter of last year.

Upside surprises (6%) beat the historical average (del 5%), but fell short of the exceptional rates (14-20%) observed over the five quarters that followed the pandemic-induced crash (post-1Q 2020). The top performers belong to the industrials and basic materials sectors, whereas cyclical sectors reported stronger results than defensive ones overall.

Seventy-six per cent of US companies beat. Positive earnings surprises were driven by the technology and pharmaceutical sectors.

In Europe, the earnings reporting season is proving more favourable than in the United States. In year-on-year terms, earnings growth amounted to 44% y/y. The share of companies that beat earnings expectations (67%) was larger than in the previous quarter, and most importantly, the percentage of businesses that beat revenues forecast was higher than in the previous reporting seasons. As a result, forecasts are being revised upwards.

4Q 2021 CORPORATE EARNINGS



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GUIDANCE, REVISIONS AND PROFIT MARGINS

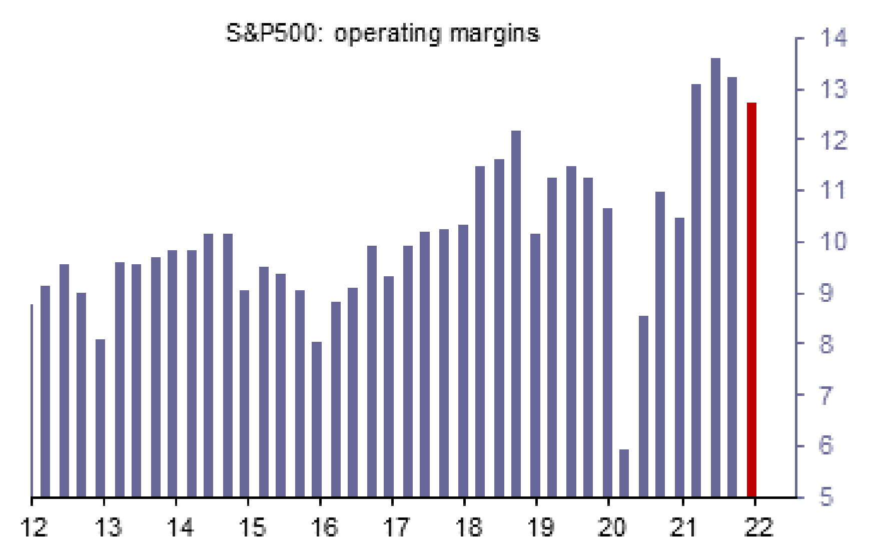
In the United States, 4Q 2021 marked the end of the string of exceptionally stronger than forecast corporate results, and of the resulting rush by analysts to revise earnings forecasts upwards.

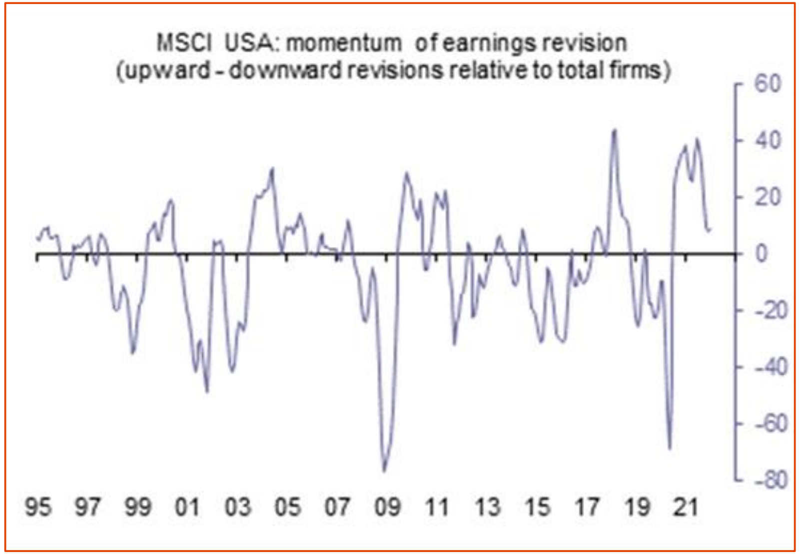
Furthermore, **the guidance provided by US corporates on 1Q were more cautious than in the past**. **Companies are signalling increasing concerns over higher labour costs**. Their negative impact on earnings growth was mentioned more frequently by businesses than other headwinds, such as bottlenecks in the production and distribution chains, commodity price increases, or the Omicron effect.

To date, **profit margins have proven resilient, thanks to the positive trend of revenues** (at 16% in the US, vs. 12% forecast at the start of the reporting season): at 12%, profit margins remain higher than the already elevated values recorded in the pre-Covid period. However, margins dropped from the peak hit in 2Q. **Higher labour costs and the normalisation of the recovery are stepping up pressures on margins.**

In this context, **analysts returned to the more cautious stances** that were typical in the pre-pandemic period. Forecasts for 2022 as a whole remained unchanged, as a opposed to a slight downside revision of estimates for 1Q 2022.

GUIDANCE, REVISIONS AND PROFIT MARGINS





MARKET PERFORMANCES DURING THE REPORTING SEASON

The markets were very volatile in the opening month and an half of the year. The **decline in stock indices and the increase of bond yields** were triggered by the Fed signalling its intention to swiftly remove monetary stimulus, in order to contain inflationary pressures.
The rapid response of US yields affected the US stock market most, and in particular growth sectors (technology at the fore), highly sensitive to the movement of real rates. Contagion spread form the US stock index to the other markets, that nonetheless incurred smaller losses (Eurostoxx -3.7%, Topix -1.5%), whereas the emerging markets proved more resilient, although they had lagged behind heavily in 2021.

The reporting season did not help support performances: the market was strict in punishing names that posted weaker than expected results (Netflix, Facebook, Paypal), whereas stronger performances were acknowledged more cautiously than in the previous seasons.

MARKET PERFORMANCES DURING THE REPORTING SEASON

VALUATIONS AND FUTURE EARNINGS OUTLOOK

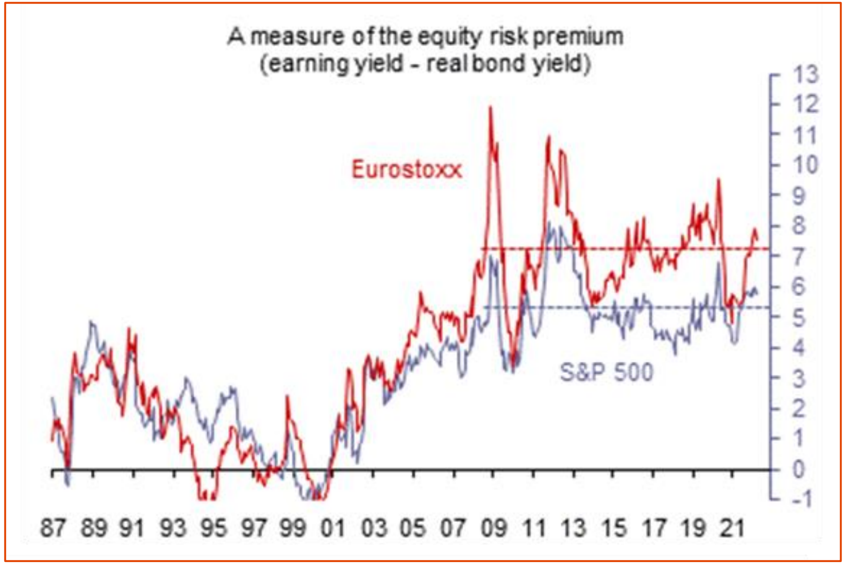
The decline of stock indices at the beginning of the year, in a context of positive (albeit modest) earnings growth, pushed down valuations in absolute terms (price/earnings ratio). Therefore, **the "yield" of corporate earnings compared to bond yields rose back above the 15-year average.**

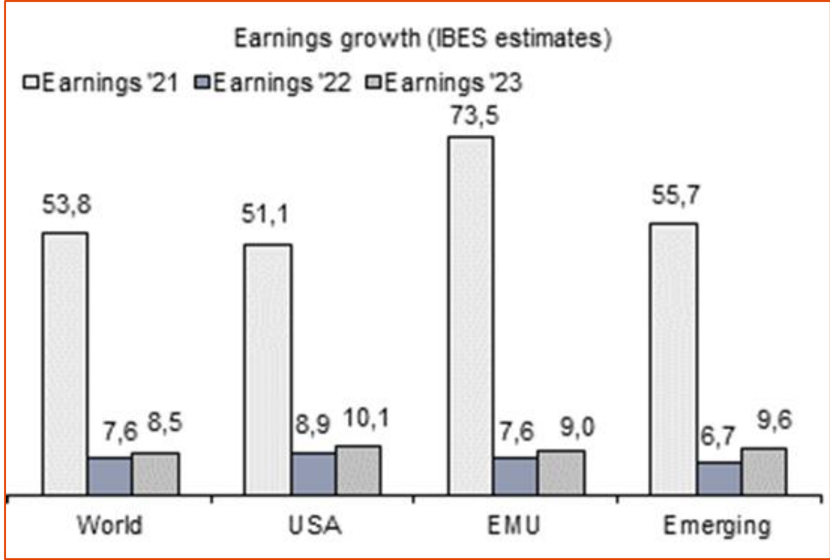
More appealing valuations are a necessary condition to support stock market growth, although not sufficient alone. Earnings growth will be essential. The outlook remains favourable for the stock markets, although forecast return is lower than in 2021, whereas volatility could stay high for some time due to the removal of monetary stimulus.

In 2022, analysts expect solid earnings growth, but back in line with the long-term average (8%-10%), after flaring up 2021. This seems consistent with slower economic growth in 2022 compared to the acceleration of 2021, boosted by reopenings, and marks another step in the return to "normality".

Slightly stronger earnings growth than seen this year is forecast in 2023.

VALUATIONS AND FUTURE EARNINGS OUTLOOK





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