

CORNERSTONE MACRO

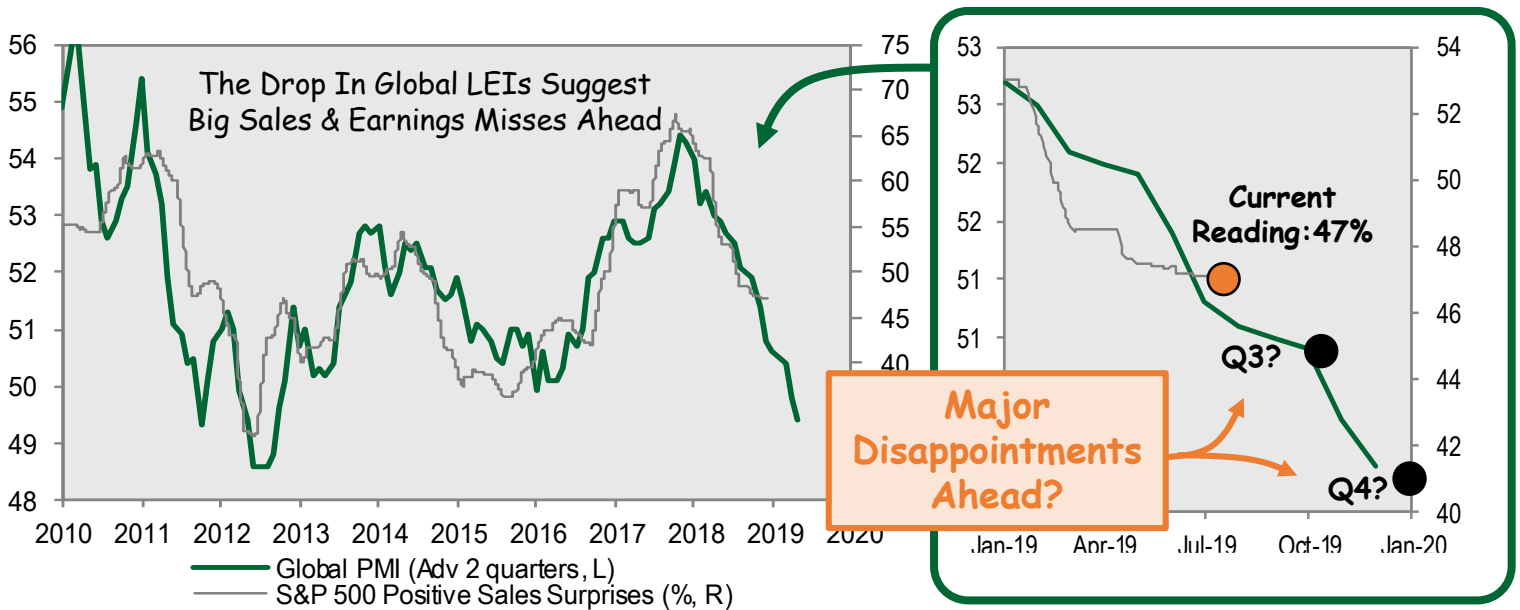
Economics, Policy, Strategy & Technicals

Portfolio Strategy

WHO'S AT RISK OF MISSING 2Q EARNINGS?

We've seen a tremendous amount of P/E expansion in 2019 as hope has returned to financial markets. 95% of the S&P 500's return this year has come from higher P/Es while the forward earnings estimate has only added 91 basis points of the markets 20% YTD return. With earnings season now upon us, can markets continue to make new highs? All signs we see point to an increasing level of negative surprises in the coming earning season(s).

Are We Destined For A Rough Earnings Season? ... Leading Indicators Say YES!



2Q19 Earnings Risk Stock Screen:

See Which Stocks Are Most At Risk In The Current Economic Backdrop



Screen For Stocks That

- Have The Highest Growth Expectations And
- Significant Variance In Estimates And
- Are Most Economically Sensitive

&

Turn Back The Clock And Look At Past Earnings Seasons ('15 to Today)



See What Stock Estimates & Uncertainty Looked Like In Past Earnings Seasons. Plus What The Price Impact To Earnings Was.

See Our 2Q19 Earnings Season Risk Screener (For A Copy Email Quant@cornacteam.com)

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GLOBAL BUSINESS OUTLOOK “GLOOMIEST SINCE 2009” ACCORDING TO RECENT SURVEY

The below content is from IHS Markit’s recently published (today) **Global Business Outlook**. According to the survey, worldwide business optimism relating to future output and profits is at the lowest reading of the current 11-year expansion. Will this show up in company EPS guidance?

Global business activity expectations



Key findings:

- Worldwide business optimism relating to future output and profits slides to lowest since 2009
- Global employment and investment spending intentions deteriorate
- US sees sharpest deterioration in business outlook of major developed countries
- Broad worsening outlook for emerging markets, led by weakest China prospects since 2009

Data collected June 12-27

Source: <https://www.markiteconomics.com>

Expectations of profits growth in the year ahead have meanwhile also worsened to a post-crisis low, with the survey net balance down from +15% in February to +7% in June. Profits gauges are down to new survey lows in both manufacturing and services, with the latter indicating especially weak optimism (a net balance of +3% against +9% in services).

“Profit gauges are down to new survey lows in **BOTH** Manufacturing and Services.”

“U.S. profits expectations slide sharply to the lowest since late-2016, accompanied by a similar weakening of hiring intentions.”

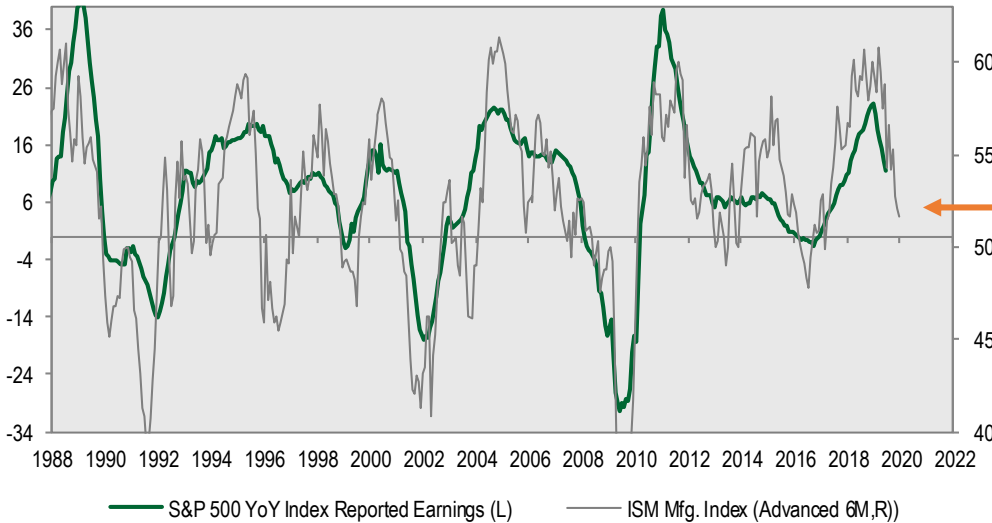
Companies’ concerns are focused on the impact of tariffs and trade wars and the potential for heightened political and economic uncertainty in the lead up to the 2020 elections. Pressure on business performance from high costs and skill shortages are also widely reported.

US profits expectations slide sharply to the lowest since late-2016, accompanied by a similar weakening of hiring intentions. Planned capex growth has improved slightly but remains weaker than a year ago. Despite concerns over tariffs, inflation expectations in relation to both input costs and selling prices has meanwhile moderated further in the US compared to the peaks seen late last year.

WHY DO WE EXPECT EARNINGS TO CONTINUE SLOWING AND WHO IS MOST AT RISK?

It is hard to find a relationship out there between an economic data series and a stock market series that is as highly correlated as PMIs and EPS! Leading indicators give a six-month heads up on where earnings growth trends are headed.

PMIs ARE AN ECONOMIC REPRESENTATION OF EARNINGS ESTIMATES

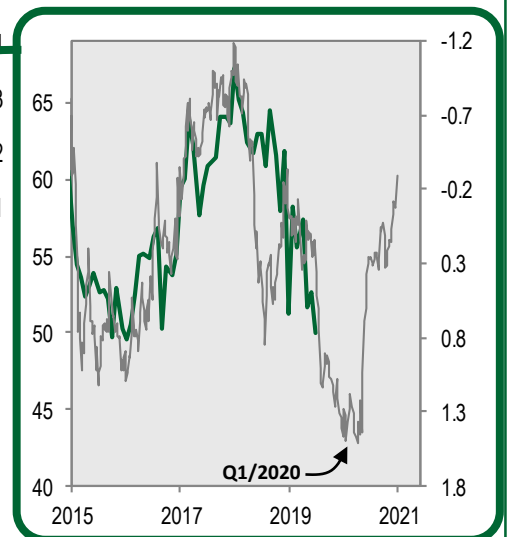
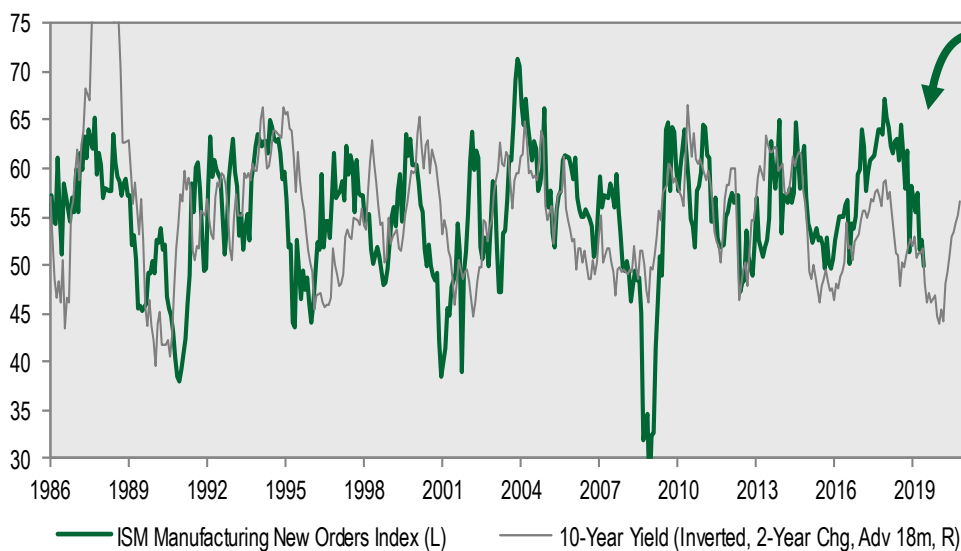


LEIs Lead Earnings Growth By About Six Months ...

... Expect EPS Growth To Continue Decelerating For Several Quarters

Nearly all the indicators that we follow to help forecast PMIs are unanimous in calling for a continued decline until Q1 2020. Given the tight relationship above between EPS and PMIs, we don't expect to see a re-acceleration in EPS growth until mid 2020.

PMIs LIKELY TO KEEP FALLING FOR A FEW MORE QUARTERS



Turn The Page To See Who's Most At Risk

VALUE STOCKS HAVE SEEN THE BIGGEST EPS EXPANSION IN 2019

The impressive rise in the market this year has been almost entirely due to multiple expansion. EPS growth explains only 21 points of the nearly 500-point rise in the S&P 500 YTD. Despite massive underperformance, value stocks have seen an above-average rise in EPS estimates this year. We think these stocks are most at risk as we enter Q2 reporting season.

This year has been all about multiple expansion

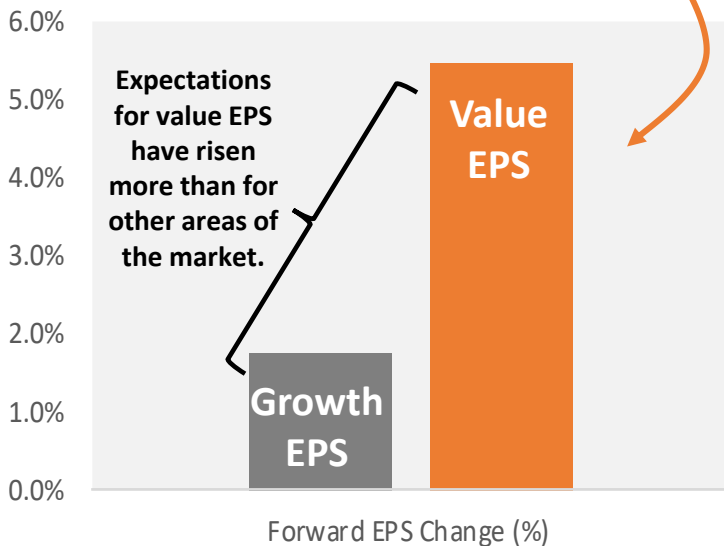
Performance YTD Has Been All About PEs Not EPS

Year	S&P 500			Change During Year			Points Attribution		% Attribution	
	Price	NTM EPS	P/E	Annual Return	Δ EPS (%)	Δ P/E (pts)	EPS PTS	PE Pts	EPS %	PE %
2015	2,044	\$ 125.79	16.2	(0.7%)	(0.1%)	-0.1	-2	-13	(0.1%)	(0.6%)
2016	2,239	\$ 131.02	17.1	9.5%	4.2%	0.8	85	110	4.2%	5.4%
2017	2,674	\$ 144.29	18.5	19.4%	10.1%	1.4	227	208	0.1%	9.3%
2018	2,507	\$ 172.67	14.5	(6.2%)	19.7%	-4.0	526	-693	9.7%	(25.9%)
2019	3,014	\$ 174.08	17.3	20.2%	0.8%	2.8	21	486	0.8%	9.4%

Value has seen the greatest rise in EPS expectations YTD...

...but they've underperformed immensely this year

YTD Earnings Growth



Price Return: Value Rel To Growth



■ S&P 500 Pure Growth ■ S&P 500 Pure Value

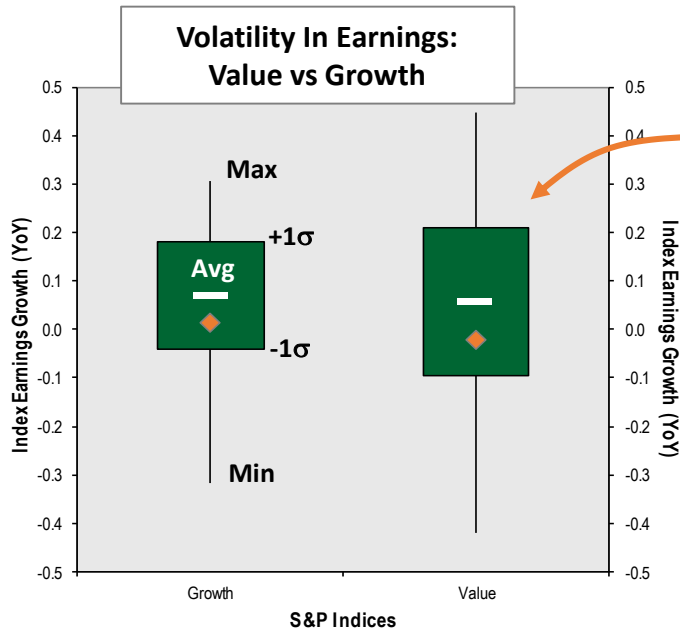
— S&P 500 Value Relative to S&P 500 Growth YTD

value stocks are most at risk this earnings season!

WHY HAVE VALUE EARNINGS FARED SO WELL YTD?

Given the sharp decline in leading indicators of late, how have value earnings estimates been the best performing? Leading data has rolled over, but the coincident data remains elevated, telling us that 1H19 was still a time of relatively strong growth in the US. We expect a “growth scare” to materialize in H2 where both leading and coincident indicators move lower. That’s likely bad news for Value earnings.

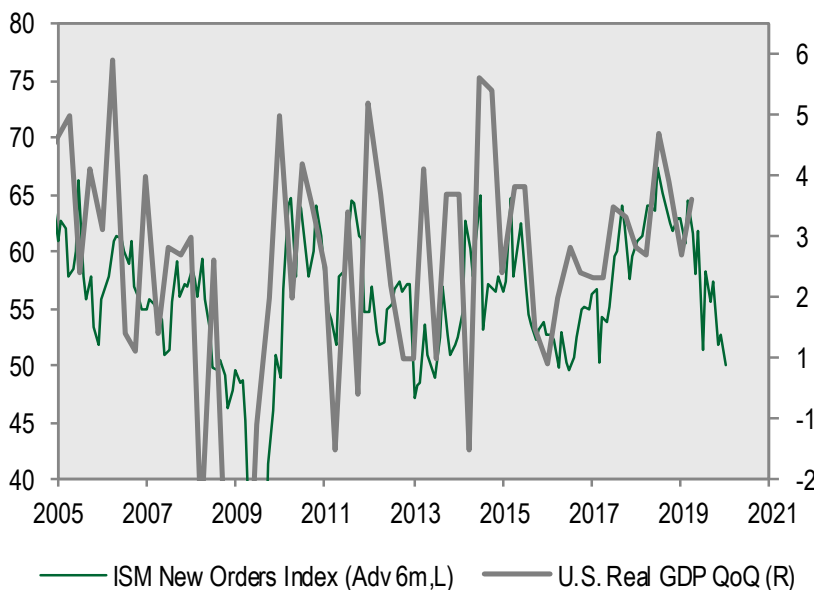
Value Earnings Are Highly Cyclical



Value Stocks' Earnings Are More Cyclical (i.e. Sensitive To Economic Growth)

The Earnings of value stocks tend to be highly sensitive (i.e. elastic) to economic growth. When economic cycles shift, lagging data like earnings and GDP take some time to catch-up. This is a dangerous time as many people extrapolate earnings and growth trends.

Lagging Economic Data (And Expectations) Have Yet To Catch-Up To Leading Indicators



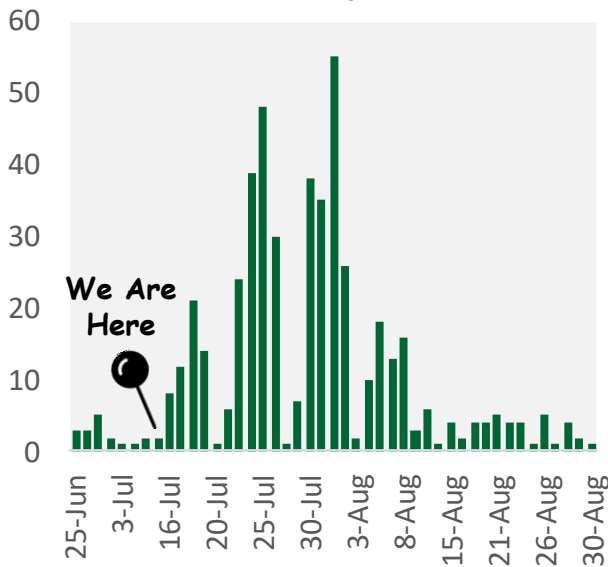
Lagging Economic Data Has Supported Expectations For Value Earnings



WHICH STOCKS ARE MOST AT RISK

When growth is slowing, stocks with high expectations and a history of volatile earnings are at risk of disappointing. This is especially true for stocks with a wide dispersion of eps estimates where there is a lot of uncertainty.

S&P 500 EPS Report Schedule



WHO'S MOST AT RISK OF AN EARNINGS DISAPPOINTMENT WHEN LEIS ARE FALLING

What Stocks Are Most At Risk?

Look Out For Stocks With:

- 1) **Rising Expectations**
Biggest Rise In EPS Growth Expectations
- 2) **EPS Uncertainty**
High EPS Dispersion (Coefficient of Variation of EPS Estimates)
- 3) **EPS Sensitivity To Economic Prospects**
High Fundamental Beta (i.e. Variance in Quarterly Sales)

2Q19 EARNINGS SEASON RISK SCREENER

For The 2Q19 Earnings Season Risk Screener
Please Email quant@cormacteam.com

WHAT STOCKS MEET THE CRITERIA FOR MOST AT RISK OF MISSING EARNINGS

Symbol	Company Name	Earnings Report Date	EPS Growth Est. Chg. - (YoY)	Est. Dispersion	Fundamental Beta	Earnings Sensitivity Rank
CAT	Caterpillar Inc Del	24-Jul	\$0.16 - (5.3%)	0.02	3.6	1
NSC	Norfolk Southern Corp	24-Jul	\$0.29 - (11.7%)	0.02	2.2	1
DE	Deere & Co	16-Aug	\$0.27 - (10.4%)	0.05	2.5	1
APD	Air Prods & Chems Inc	25-Jul	\$0.2 - (10.2%)	0.01	2.0	1
KMI	Kinder Morgan Inc Del	17-Jul	\$0.03 - (12.6%)	0.09	2.7	1
VRTX	Vertex Pharmaceuticals Inc	24-Jul	\$0.13 - (13.8%)	0.07	8.8	1
ADSK	Autodesk Inc	22-Aug	\$0.43 - (224.2%)	0.03	2.1	1
WMB	Williams Cos Inc Del	1-Aug	\$0.05 - (32.2%)	0.12	1.9	1
XLNX	Xilinx Inc	25-Jul	\$0.19 - (25.8%)	0.03	1.6	1
OKE	Oneok Inc New	31-Jul	\$0.04 - (5.6%)	0.04	3.7	1

Included In The Screener...

Turn Back The Clock And Look At Past Earnings Seasons And How The Stocks Reacted

Earnings Season Data For Every Qtr Since '15

Historical Earnings Data For:

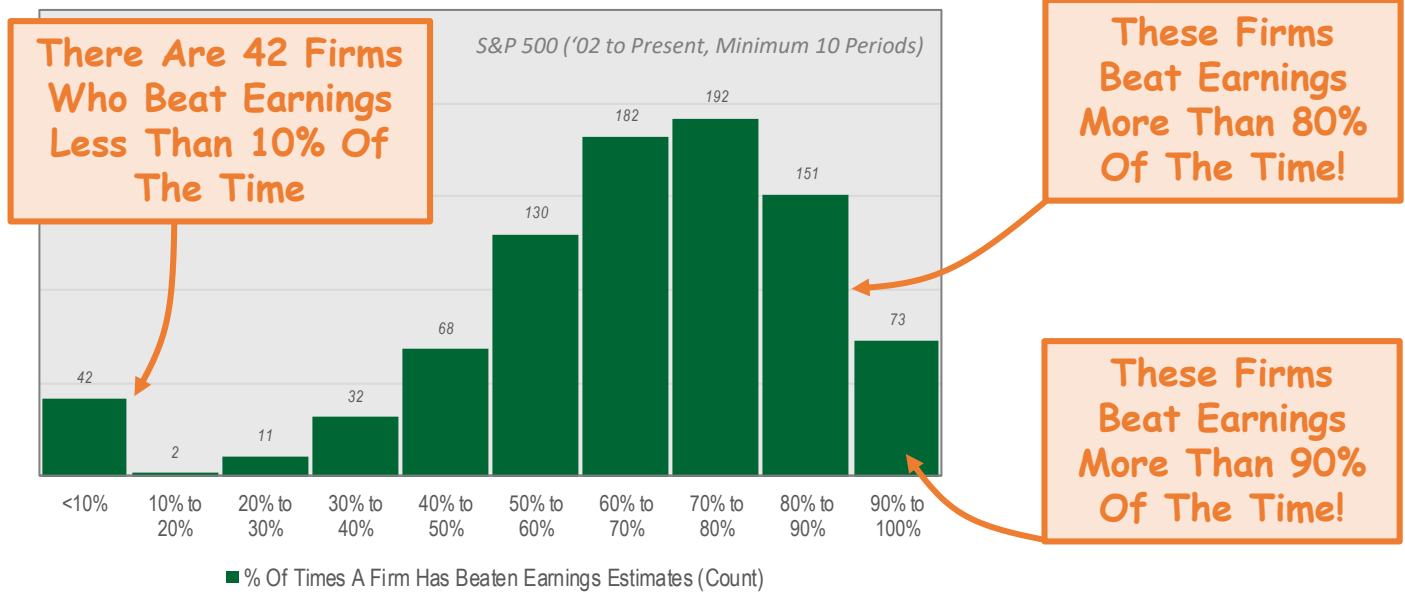
Also See The Price Impact From Earnings Announcements

A FEW EARNINGS SEASON MYTHS

Myth 1: EPS Beats Always Translate Into Outperformance

While earnings surprises are often highlighted and talked about, we looked at the history of firms that surprise and found that they tend to be serial in nature. In other words, firms that beat typically always beat. This in itself takes much of the allure out of the theme.

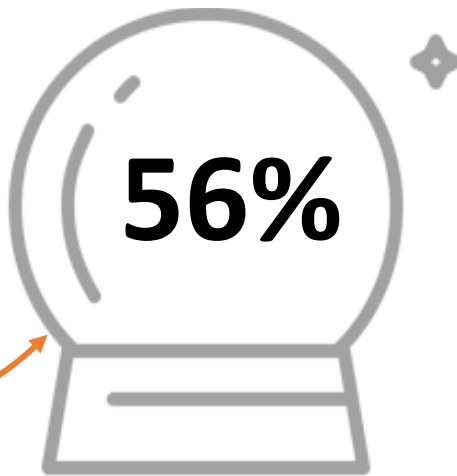
% Of Times A Firm Has Beaten EPS Estimates



Myth 2: High Earnings Growth Guarantees Outperformance

It makes sense that you'd want to own companies that experience earnings growth, and the more the better in that case. However, earnings growth doesn't necessarily mean an increase in share price because **expectations** always take precedence over the earnings themselves. Furthermore, there is a time in the cycle when stability is preferred to strong but volatile earnings growth.

If you had a crystal ball and knew which stocks would have the fastest growth every year, only 56% of them would outperform!



For more on growth traps see our recent report [Click Here To View](#)

% Of Stocks Outperforming Market Top Decile S&P 500 (1990 – Present)