Earnings Watch:
A Synchronized Recovery in Global Earnings

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Notes from the Global Growth Equity Desk

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"The most recently completed earnings season marked the fourth consecutive quarter of companies exceeding analysts' expectations."

Key Takeaways

- Earnings growth continues to improve, even in regions that lockdowns continue to still affect.
- Pent-up demand, healthy corporate and consumer balance sheets, and monetary and fiscal policy are fueling revenue and profit growth.
- Inflation is top of mind for CEOs, but most believe the trends are transitory. So far, stronger sales have helped businesses absorb higher costs.
- Strong results underpin confidence in a broader earnings recovery.
- Markets rose in anticipation of the profit recovery, but we believe actual results will determine whether the advance can be sustained.

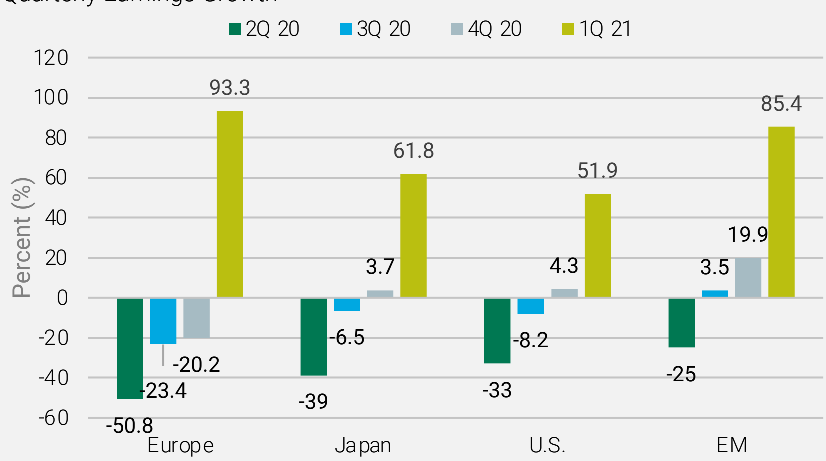
Companies Continue to Beat Earnings Estimates

The most recently completed earnings season marked the fourth consecutive quarter of companies exceeding analysts' expectations. This set a record for consecutive quarters of earnings beats dating to the 1990s. The results are especially impressive considering analysts have been raising earnings targets steadily since hitting pandemic lows a year ago. It's also notable that the results came with portions of Europe, Japan and emerging markets still experiencing lockdowns and reduced levels of economic activity due to uneven global vaccine availability.

While cost-cutting helped lift profits in recent quarters, sales growth in all regions accelerated and turned positive in the first quarter of this year, as shown in **Figure 1b**. Revenue growth outside the U.S. rose at the fastest pace in 10 years. Growth drivers include pent-up demand as the world emerges from pandemic lockdowns, record amounts of fiscal stimulus, continued accommodative monetary policy, especially in Europe and Japan, accelerating capital spending, and high levels of cash on hand for corporations and consumers.

Figure 1a | Earnings Growth Accelerated in All Regions

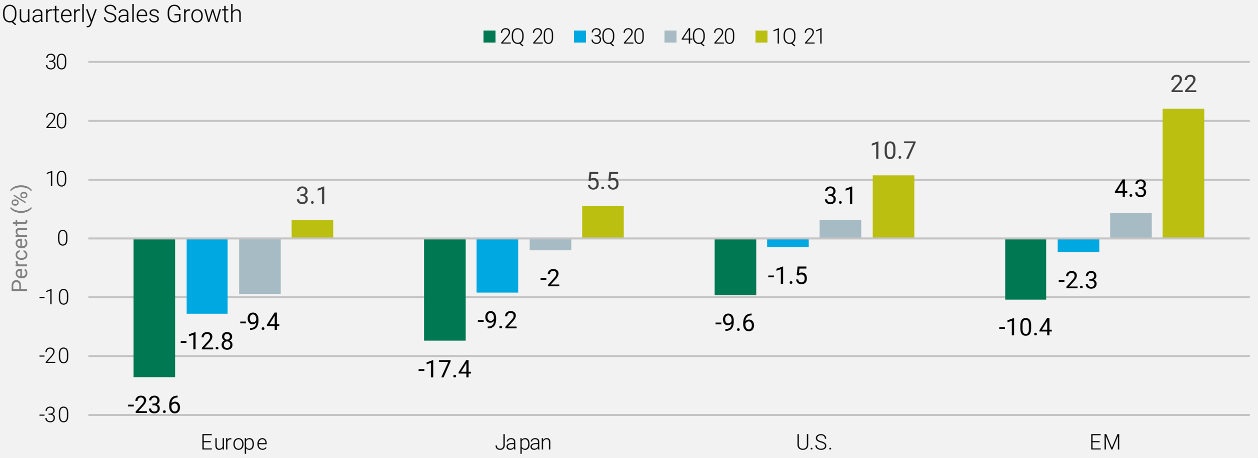
Quarterly Earnings Growth



Data as of 3/31/2021. Sources: Refintiv, FactSet.

Figure 1b | Sales Growth Turned Positive

Quarterly Sales Growth



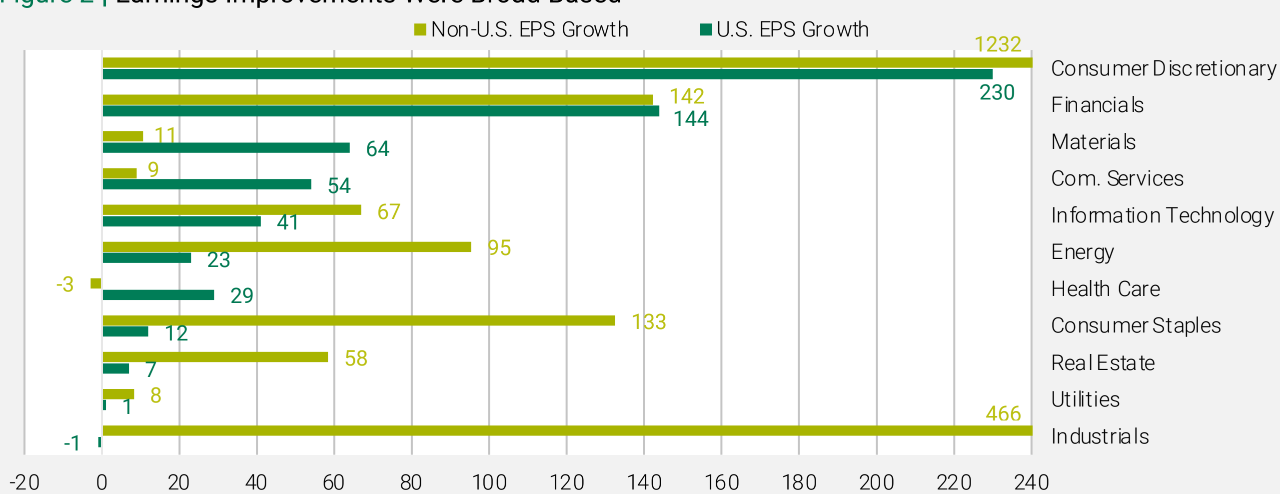
Data as of 3/31/2021. Sources: Refintiv, FactSet.

Cyclical Growth Trends Are Proving to Be Durable

In recent quarters, we noted a rebound in cyclical growth sectors and first quarter results highlight the durability of those trends. Overall, as shown in **Figure 2**, the earnings improvements were broad-based.

- Consumer discretionary posted some of the strongest earnings gains as the economy reopened. Consumer savings rates rose throughout the pandemic. Coupled with pent-up demand, this led to big upside surprises and strong earnings growth for many companies that had struggled in prior quarters. This includes LVMH, the owner of luxury brands such as Louis Vuitton, Dior and newly acquired Tiffany and Tapestry, owner of the Coach and Kate Spade brands. We also saw continued strength from areas that were early beneficiaries of economic recovery, including businesses associated with e-commerce, home improvement and auto manufacturing.
- Financials, especially banks, posted stronger earnings due to rising rates and improving credit trends in the U.S. Wells Fargo is an example. Its revenues were higher than expected due to stronger fee income from mortgages, trusts and investments. It also benefited from a large reserve release and good credit quality trends. Financials in Europe and Japan are seeing a similar cyclical recovery, though a decline in provision costs was the key improvement driver. Negative short rates still pressure non-U.S. banks' net interest margins.
- A resurgence in capital spending led to high demand for materials. Global investments in green energy solutions and the transition away from combustion vehicles is fueling increased copper demand. Electric and plug-in hybrid vehicles contain up to four times more copper than traditional cars and trucks. Beneficiaries include Freeport McMoRan and First Quantum. Other materials companies reporting strong results included Mosaic, which mines potash and phosphate used as fertilizers, and Mexican cement company Cemex.

Figure 2 | Earnings Improvements Were Broad-Based



Data as of 3/31/2021. Sources: Refintiv, FactSet.

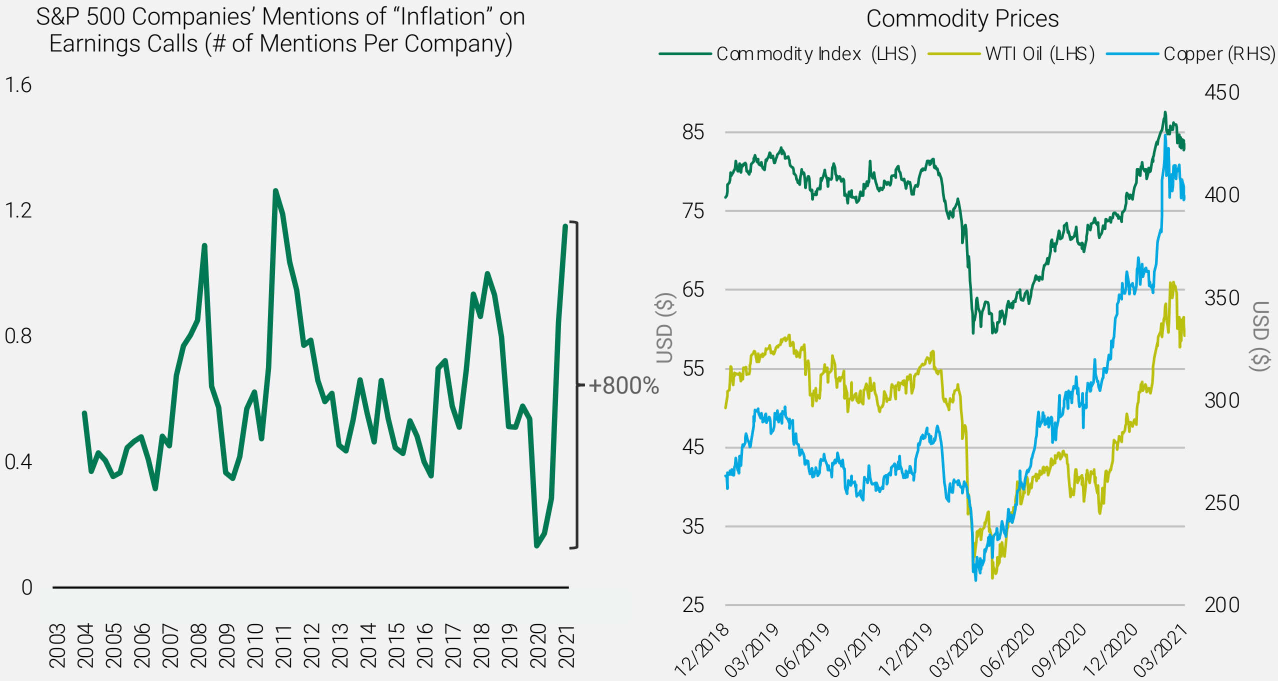
Inflation Risk Is Top of Mind for CEOs

Given the strong results of mining and metals companies, it's not surprising that inflation has captured the attention of management teams as they look ahead. In **Figure 3**, you can see the number of mentions of inflation in S&P 500 earnings calls jumped 800%, rising to levels we've haven't seen in a decade. The increase was especially pronounced among materials, consumer-oriented and industrial companies.

Figure 3 also shows the steady rise in commodity prices. Copper prices, represented by the blue line, have doubled since troughing in March 2020. Mentions of price increases and raw material costs in earnings calls also rose sharply, indicating cost pressures were primarily centered on supply chain issues. So far, higher costs have been manageable with the surge in revenue growth enabling companies to absorb the rising cost pressures without hurting profits.

In Europe and Japan, most management teams at industrial companies indicated they expect cost pressures to peak this summer, as supply chain issues moderate. We may already be seeing some signs that the supply/demand imbalances are beginning to abate as production catches up. Lumber prices, which skyrocketed in prior months, have fallen significantly from their early May peak. This may lend credence to the idea that many recent price surges are indeed transitory.

Figure 3 | Rising Commodity Prices Are Spurring Inflation Concerns



Data from 6/30/2003 - 3/31/2021. Source: BofA Global Research.

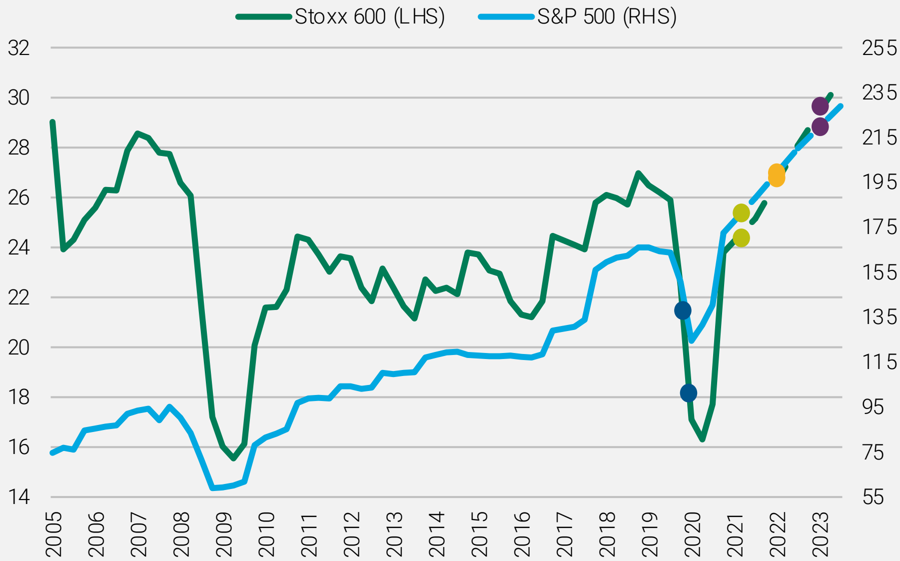
Data from 12/31/2018 - 3/31/2021. Source: Bloomberg.

Earnings Trends Are Positive for Stocks

The broad-based strength in earnings results has led to analysts continuing to revise their earnings estimates higher. This is an important trend to watch as positive earnings revisions are correlated with positive stock price performance. In May, the earnings revision ratio surged to near a record level as upgrades continued to dominate in a strengthening global earnings environment. Revisions were highest in areas that benefit the most from cyclical recovery, including energy, materials, semiconductors and banks. In contrast, the data was weakest for defensive areas such as consumer staples and telecommunications.

May marked the second highest level in the 33 years Bank of America has been monitoring earnings revision data. Each time the three-month revision ratio reached this level, the average gain for the MSCI ACWI index was 12.7% in the subsequent 12 months, with positive returns in all instances.[1]

Figure 4 | The Shape of the Earnings Recovery Is Coming Into Focus



	Stoxx 600	S&P 500
2023	30.71	228.96
2022	28.09	210.2
2021	25.15	188.09
2020	17.71	140.46

Data from 6/30/2005 - 3/31/2021. 2021 forward is estimated. Source: Bloomberg.

Figure 4 shows earnings expectations for both the U.S. and Europe are approaching pre-pandemic levels. Since the beginning of the pandemic, there has been a lot of uncertainty around the shape of the earnings recovery. Improving visibility over the last six months has given companies more confidence in their outlooks. For example, the most recent CEO confidence survey hit an all-time high in the second quarter, catalyzing a new investment cycle that is driving sustained earnings growth.[2]

We expect to see continued growth for the next few years, buoyed by accommodative monetary policy, fiscal stimulus, pent-up consumer demand and a resurgence in capital investment. We believe this is setting us up for a period where the underlying drivers of growth are shifting, and opportunities will lie in a broader range of sectors and industries.

Company Results Will Determine Whether the Rally Endures

The market's recovery off its pandemic lows reflects a great deal of optimism. Since the announcement of vaccines last year, P/E multiple expansion in anticipation of an earnings recovery supported much of the move in stock prices. We believe we are at a turning point now that earnings are accelerating, and actual results should drive future stock price performance.

As always, multiple risks could derail the positive outlook, including inadequate vaccine distribution or vaccine-resistant variants of the virus. Also, it is important to monitor inflation trends, which are rising but remain in check. Spiraling inflation could trigger global central banks to significantly alter monetary policy, which could change the outlook. We'll also closely monitor potential changes in tax policy and the U.S. regulatory environment. Additionally, political unrest in certain regions of the world is reigniting after a short period of stability.

Endnotes

[1] Bank of America Global Research, May 25, 2021.

[2] "CEO Confidence Hits All-Time High in Q2," The Conference Board, May 19, 2021.

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