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Strategists Say Stock Rally Needs Bumper US Earnings Season

- **Firms need to show solid beats alongside forecast raise: Citi**
- **Forward 12-month earnings expectations are at record highs**

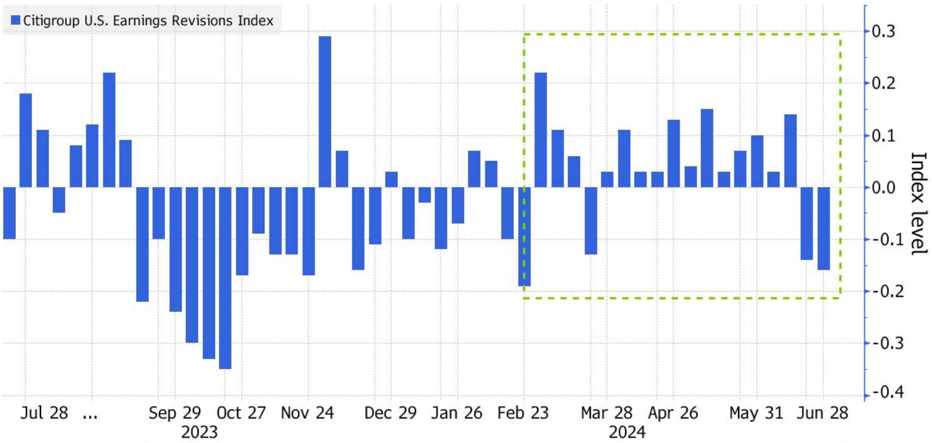
By Sagarika Jaisinghani - 8 July 2024

Corporate America needs to deliver a blowout quarterly earnings season for US stocks to extend a record-breaking rally, according to some Wall Street strategists.

Analysts' upgrades to profit estimates have outnumbered downgrades going into the second-quarter reporting period, according to a Citigroup Inc. index. At the same time, expectations for 12-month forward earnings stand at an all-time high, data compiled by Bloomberg show.

"Given the lofty implied growth expectations, markets likely need to see raises coupled with solid execution-driven beats to sustain recent gains or push higher from here," Citigroup strategist Scott Chronert wrote in a note. "The concern is while fundamental trends are positive and consensus estimates are attainable, valuations suggest the buy-side will demand more."

US Profit Estimates Have Risen Into the Reporting Season
A Citi index showed upgrades are mostly outnumbering downgrades



Source: Citigroup, Bloomberg

The second-quarter season begins in earnest on July 12, when JPMorgan Chase & Co. reports results. It will follow a rally of about 35% in the S&P 500 Index since its October low, with the benchmark notching record highs 34 times this year, fueled by the buzz around artificial intelligence and bets on lower Federal Reserve interest rates.

But that has made valuations more expensive, with the benchmark trading at a price-to-earnings ratio of almost 22 compared with a long-term average of 16. Duilio Ramallo, senior portfolio manager at Boston Partners, said trading in US stocks could turn more choppy given high earnings expectations, although any pullback may not be severe.

“There’s a valuation mis-match between how much those top-tier companies can achieve and the market’s expectations,” Ramallo said in an interview. But since fundamentals remain strong, he sees any declines in the S&P 500 capped at as much as 10% by the end of the year.

First-quarter reports had also received a muted response from investors. Over 80% of S&P 500 firms beat estimates, but the median stock underperformed the index by 12 basis points on results day, according to data compiled by Bloomberg.

Stocks and Profit Expectations Are Both at Record Highs
S&P 500 firms face a high bar this reporting season

Source: Bloomberg Bloomberg

That trend could be repeated in the second quarter, Goldman Sachs Group Inc. strategist David Kostin said in a recent note. Profit growth expectations stand at the highest in almost three years, while investor sentiment is at elevated levels, his team estimated.

“Accordingly, the reward for beats should be smaller than average this quarter, although not as extreme as during the first-quarter season,” Kostin said.

Over at Oppenheimer Asset Management, though, strategist John Stoltzfus said a robust earnings outlook and a resilient economy could support even higher valuations.

Stoltzfus raised his year-end target for the S&P 500 to 5,900 points — the second-highest among strategists tracked by Bloomberg. His projection implies gains of another 6% from current levels.

— With assistance from Farah Elbahrawy