Weekly Update

January 30, 2012

Earnings Continued

By the end of last week, about 40% of S&P 500 companies had reported earnings for the quarter, and results continue to be mixed. As we mentioned in last week's missive, this is a relatively new trend. After all, investors had become used to the ease with which most companies had been able to beat Wall Street's earnings estimates.

Quite a few large companies released consensus-beating results last week. Among them was Apple (AAPL) which brought in over $46 billion in revenue in the past quarter alone. (I'll take this moment to remind readers that this is not a recommendation to buy or sell shares in Apple or any other investment mentioned herein). Apple, of course, was an outlier. Most other companies saw growth slowing on both the revenue side as well as in final earnings.

Take for example, financial stocks. They have been the largest drag overall on S&P 500 earnings for the quarter with estimated profits 18% below those of just one quarter prior. On a year-over-year basis, it is estimated that financials will make $2.5 billion less than a year ago.

On a broad sector basis, financials, energy and utilities have had the most difficulty beating consensus analyst earnings estimates. Strength has been found mostly in the technology arena where companies have bested earnings estimates by more that 5% so far. Revenue numbers have trended in a similar direction with the main pocket of weakness coming from financials and the most strength coming from technology.

Earnings growth is slowing. So is revenue growth. So is the economy. We had a major earnings collapse in 2008 and 2009. We had a stellar rebound in 2010 and 2011 with double digit sales and earnings growth that couldn't continue forever. Now we have a more normal, slow-growth environment. We still have growth; it's just slowing. It's part of the business cycle.

As for numbers, the U.S. economy is expected to grow somewhere around 2% this year. Further, S&P 500 companies are expected to grow earnings by about 8-10%. While slow growth may not do much in the way of comforting leery investors who remain fixated on political developments in Europe, it may be just enough to keep the bull market alive in 2012 based on valuations. With most valuation metrics currently hovering below their historical levels, slowing, albeit positive, growth may be enough to keep the rally intact.

Coming Up: Earnings reports remain on tap for this week as diverse names like Amazon (AMZN), Merck (MRK), Viacom (VIAB) and Northrop Grumman (NOC) all release results. On the economic front, the big number will be the jobs number on Friday. Expectations are for the unemployment rate to remain stable at 8.5% with about 135,000 new jobs created in the month. That number will continue to trend of tepid, yet positive, jobs growth.

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