6 Lessons learned from the Q1 2017 earnings season

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The earnings season is coming to a close and the time has come to **report back on what we have found**. This is by nature a recurring exercise but, as valuation has normalised, earnings have become an increasingly decisive criterion for the Equity market.

In this respect, the first quarter of 2017 **kept most of its promises.** In terms of business performance, earnings, percent growth, upside surprises and trend depth, Q1 2017 proved to be exceptional for all the developed regions (see table below).

Q1 2017 Results Snapshot

	Europe Stoxx 600	Eurozone Euro Stoxx	USA S&P 500	Japan Topix
% of companies beating Sales	77%	80%	64%	54%
% of companies beating EPS	65%	61%	78%	56%
Sales growth yoy (%)	10%	9%	8%	4%
EPS growth yoy (%)	23%	20%	14%	28%

Source: Bloomberg, JP Morgan, Amundi Research

After a fairly weak showing following mid-2014, **business activity recovered sharply early in the year**. The jump in commodities, the improvement in international trade and the greater pricing power of businesses translated into exceptional topline growth. After zero or even negative results for two years, revenues rose between 4% and 10%, depending on the region. Fuelled by this revival in business activity, **all regions reported double-digit earnings growth**. Furthermore, the outlook for the next two to three quarters is still strong considering the base effects, particularly in Europe and especially in the eurozone.

In Europe, Q1 2017 earnings are more encouraging than they seem

First of all, the **"net balance"** of upside surprises with regard to earnings (% of upside surprises less the % of negative surprises) is at its highest since Q3 2010 (see Graph 1). This is all the more significant as 2010 was atypical: comparisons that year were distorted given the collapse of earnings in 2009, marked by the great financial crisis. Furthermore, compared to the United States, **Europe's relative performance is noteworthy.** On the other side of the Atlantic, the percentage of upside earnings surprises is structurally higher than in Europe due to different communications policies. When comparing the two regions, it's therefore more appropriate to compare deviations from averages rather than relying on absolute figures. Thus, in Q1 2017, the net balance of upside surprises was virtually double the average in Europe (see Graph 1) compared to barely +10% in the United States.

European earnings jumped 23% in Q1 2017. This increase contrasts with the preceding quarters (see Graph 2), and one would need to go back at least six years (Q2 2011) to see another jump like this one.

This rise in earnings is all the more encouraging given that not only is it the result of cost cutting, it has also been accompanied by a **strong economic recovery**. This surge owes a great deal to the energy sector, where, reflecting oil price trends, net sales rose 40%. Putting aside the energy factor, the revenues of European companies still managed to rise 6% after stagnating for years.

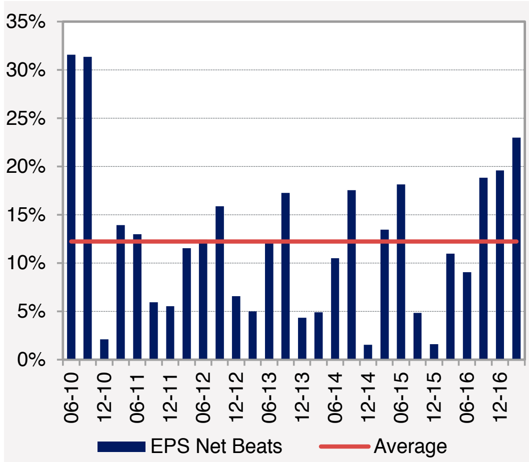
The essential

Results for the first quarter of 2017 came out largely as promised, with double-digit earnings growth for all developed regions and substantial revisions to EPS.

In Europe, earnings figures, up 23%, are even more encouraging on second glance. The net balance of upside surprises is at its highest in seven years. Virtually all sectors took part in this trend. Furthermore, not only is this rise attributable to cost cutting, it has been accompanied by a powerful rebound in economic activity (+4%, excluding energy and foreign exchange effects). Lastly, this earnings rebound is expected to last, with a comparative advantage to Europe and the eurozone in particular.

> "A net balance of positive earnings surprises at its highest since 2010"

1 % of European companies (Stoxx 600) EPS net beats versus average



Source: Bloomberg, UBS, Amundi Research

Finally, in terms of sectors, the growth in Stoxx 600 earnings was not an isolated event but was achieved on a **broad front**. Among the 11 "level one" sectors, all with the exception of utilities reported **higher earnings** (see Graph 3). Taking into account base effects, it is hardly surprising to see energy (+128%), basic resources (+23%) and financials (+21%) in pole position. On the other hand, the scale of the upturn was broadly underestimated by an average of 9%. Earnings were 21% higher than expected for energy, 13% higher for financials and 6% higher for basic resources. With the exception of real estate and telecommunications, the other sectors delivered results in line with or exceeding expectations.

The recovery in European corporate earnings is expected to continue

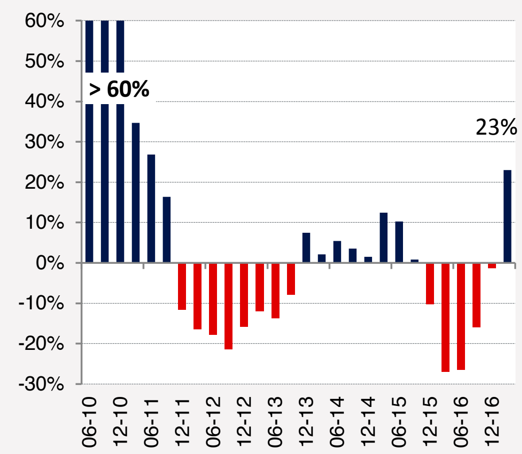
In the short run, a look at the preceding quarters shows that the bases for making comparisons will remain far more favourable in Europe than in the United States. While last year's earnings from Q2 to Q4 continued to fall significantly in Europe (-15% on average from Q2 to Q4: -26% in Q2, -16% in Q3 and -1% in Q4), they began to stabilise in the United States (-2% on average: -9% in Q2, -3% in Q3 and +7% in Q4). Consequently, all things being equal, comparisons in Europe will remain very favourable in Q2 and Q3 2017 and relatively neutral in Q4 (see Graph 2), while in the United States they will begin to become less favourable.

Over the longer term, the earnings of European companies, particularly in the eurozone, still have significant room for catch-up. Although as Brexit approaches (end of March 2019) UK growth may start reversing (+1.3% in 2018 vs +1.5% in 2017), the economic recovery in the eurozone, which has strengthened over the last few quarters, should continue at virtually the same pace (+1.5% vs +1.6% in 2017). In addition, the expected recovery in 2017 earnings cannot eliminate the lag accumulated over the past 10 years. From 2007 to 2016, EPS fell 45% in Europe and up to 50% in the eurozone, while, at the same time, EPS on the S&P 500 jumped nearly 30%.

In conclusion

The Q1 2017 earnings season was exceptional. **After reaching such heights, it will be increasingly difficult to deliver upside surprises.** In any event, between the favourable short-term base effects and the catch-up margins in the longer term, the performance of the eurozone should stand out over the next two years.

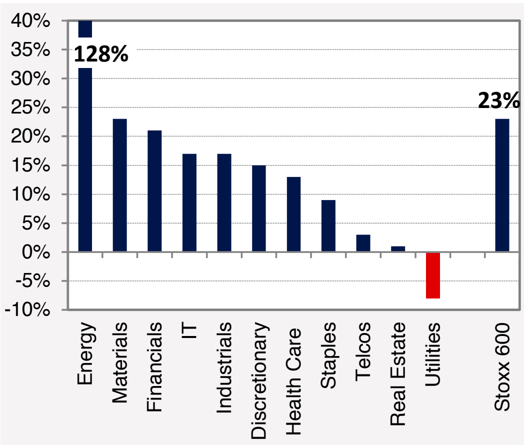
2 **Stoxx Europe 600 Quarterly EPS growth (YoY)**



Source: Bloomberg, UBS, Amundi Research

> Relatively favourable bases for comparison

3 **Stoxx Europe 600, Q1 17 EPS growth by sector**



Source: Bloomberg, JP Morgan, Amundi Research

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