THIS MONTH'S TOPIC

In the wake of first-quarter reporting season, the consensus is probably still too optimistic

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At -12% for the S&P 500 in the US and -35% for the Stoxx 600 in Europe, first-quarter results were hit hard by the pandemic, even though it had hardly begun by the end of the quarter. It is therefore a safe bet that results will be even worse in the second quarter but also that they will bottom out for the year. Even so, the consensus still looks far off the mark for both second-quarter results and for 2020-2021. Consequently, the positive impact from reopening the economy already appears to be priced in by far.

The broken momentum of 2020

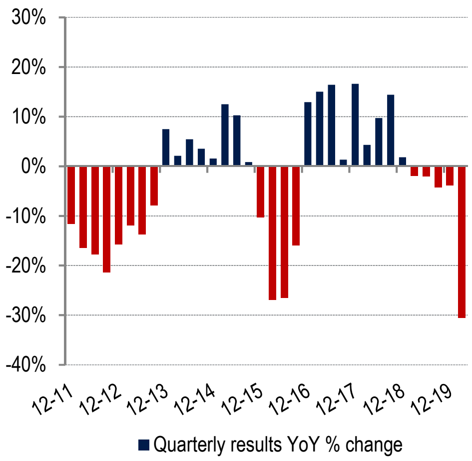
A reporting season already hit hard by the pandemic

Now that first-quarter reporting season is almost over, it's time for an initial assessment. Although the pandemic was still far from peaking in the first quarter, it still hit numbers hard. For the first time since 2015, quarterly results dropped significantly, including **by 12% by the S&P 500** in the US **and by 35% for the Stoxx 600** in Europe.

This is even more striking, as **the pandemic was only beginning** during the first quarter. According to the World Health Organisation (WHO), as of 31 March there were just 0.75 million reported cases worldwide when, as of 12 May, there were more than 4 million. The number of deaths has also skyrocketed, from fewer than 40,000 to almost 300,000.

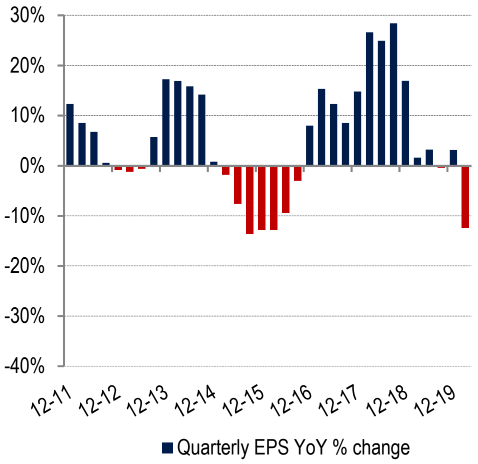
Earnings fell sharply in both the US and Europe, but far more in Europe, as it was hit earlier by the epidemic and resulting lockdowns. As of 31 March, Europe had three times more cases than in the US (0.42m vs. 0.14m) and five times more victims (11,591 vs. 2398). These proportions are likely to rebalance in the second quarter, as the US became the new epicentre of the pandemic from April.

1/ Stoxx 600 Quarterly results



Source: IBES, Amundi Research

2/ S&P 500 Quarterly results



Source: IBES, Amundi Research

A major sectoral split

Two-track results, depending on sector

Another thing that jumps out from first-quarter numbers is the clear separation between two types of sectors, in both Europe and the US.

The most resilient sectors in Europe included Healthcare, Utilities, Telecoms and, to a lesser extent, Technologies, which, one way or another, managed to keep their numbers steady or even to improve them in the first quarter. **At the opposite end of the spectrum**, Industrials, Financials, Energy and Consumer Cyclicals suffered drops of between -45% and -60%; there was little difference in this breakdown in the US.

This is mainly due to a **decoupling between cyclicals and defensives but not just to that**. **Energy** is traditionally deemed defensive, but its results collapsed in Q1, after oil prices plunged on weaker global demand and the inability of OPEC, Russia and US producers to agree to output restrictions. Conversely, **Technologies**, which are cyclical, held up better, driven by the boom in telecommuting and online retailing, increased used of networks, and higher memory prices. Lockdowns, however, hit other sectors especially hard. Hence, some ordinarily highly cyclical sectors, such as **Air Transport**, **Automotive**, and **Hotels, Restaurants & Leisure** have been grounded – literally. And **Financials**, which had begun to accelerate in recent quarters, fell on the provisions they had to set aside for expected weakness of borrowers.

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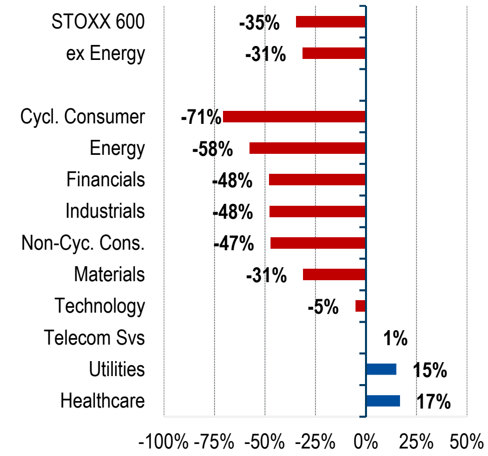
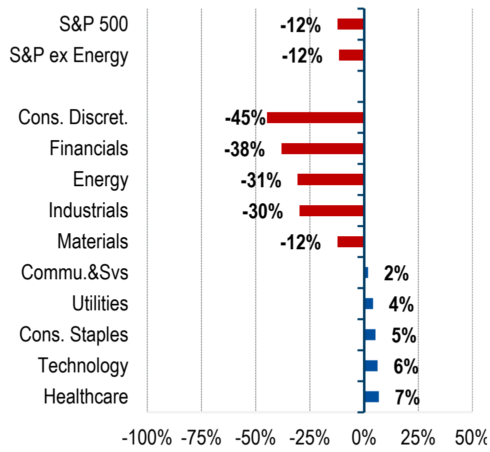
3/ **Stoxx 600: Q1 20 Earnings, (% chge YoY)**



Source: IBES as May 12 2020, Amundi Research

4/ **S&P 500 Q1 20 Earnings (% chge YoY)**



Source: IBES, Amundi Research, as May 12 2020

Earnings revisions have accelerated... but there is still a long way to go

The pace of adjusting the 2020 consensus has picked up...

After a relatively slow start, **downward adjustments in the earnings consensus have accelerated briskly since mid-February**. To take one example, **first-quarter** forecasts for the Stoxx 600 were downgraded successively from **+10%** on 1 January to **+3%** in mid-February, to **-13%** in late March and to **-35%** on 12 May. Symmetrically, **full-year 2020 forecasts** were downgraded from **+8%** on 1 January to **-25%** on 12 May.

This **change in gears** has tracked the various stages of the pandemic. When **the year began,** the market was still shrugging off the virus and was focusing on an easing in the Sino-US trade war.

Thereafter, following the first reports out of Wuhan in **mid-January,** investors believed that the epidemic would be relatively localised and would have only an indirect impact through value chains.

Then, from **mid-February to mid-March**, when the first cases in Europe were reported, particularly in Italy – where the number of confirmed cases rose from 3 to 24,700 and the number of deaths from 0 to 1,800 – the pace of revisions picked up.

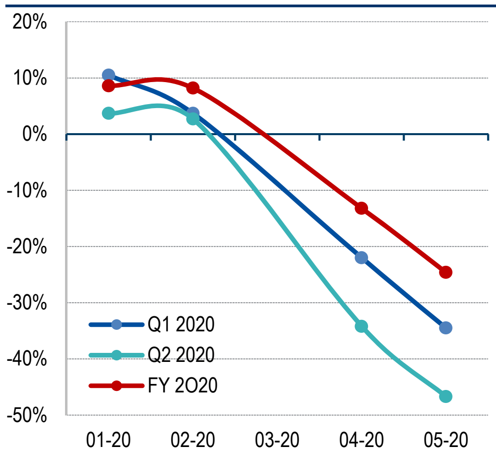
However, not until **the second half of March**, with the imposition of lockdowns, did the consensus truly begin to measure the pandemic's impact and macro- and microeconomic forecasts drop through the floor.

...but not nearly enough

Earnings revisions have picked up their pace, but we still don't think they fully price in the severity of the recession that is now beginning – while there is still some debate over how long it will last, there is no longer any doubt on how intense it will be – and that is shaping up to be the worst since the second world war.

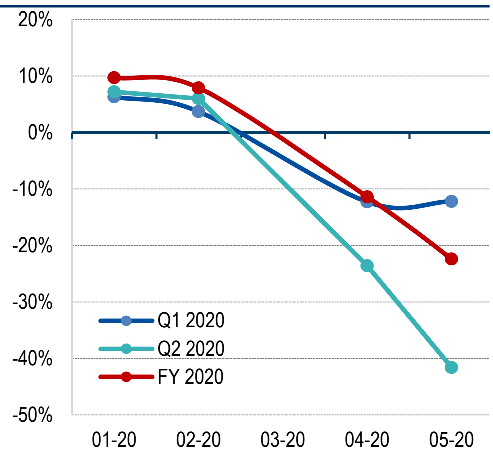
For full-year 2020, the IMF is forecasting a 3.0% contraction in global GDP, including

5/ **Stoxx 600 Earnings estimates over time**



Source: IBES, Refinitiv as May 12 2020

6/ **S&P 500 Earnings estimates over time**



Source: IBES, Refinitiv as May 12, 2020

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-5.9% in the US and -7.5% in the euro zone, compared, respectively, to -0.1%, -2.5% and -4.5% during the Great Financial Crisis of 2009. Amundi economists are just as pessimistic in their forecast ranges, with a core scenario of -2.4% to -3.9% globally, including -4.5% to -6.5% in the US and -7.5% to -10.2% in the euro zone.

Given that earnings per share during the Great Financial Crisis of 2009 dropped by 35% in the US and by 47% in Europe, it's hard to see how S&P 500 and Stoxx 600 earnings would fall, respectively, by just 22% and 25% over the full year this time.

It is even harder to imagine, given that there will be no favourable basis effect to cushion the shock, as there was in 2009. Back then, earnings had already begun to plunge in the fourth quarter of 2008, in the wake of the Lehman bankruptcy, while Covid-19 began to play out in full in Q1 2020.

Exceptional items will further dampen results

While Q1 2020 results have already slumped, the moment of truth will be in Q2. Despite the rush to downgrade, consensus Q2 forecasts (-47% in Europe and -42% in the US) still look overly optimistic. Whereas in Europe, 15 days of lockdown (on average) in Q1 was enough to send profits down by 35%, it's hard to see how 45 days in Q2 would cause a drop of just 47%. In the US, Q2 results should be more resilient than in Europe, given the predominance of disruptive companies better able to operate remotely. Even so, such resiliency should not be overstated, and the -12% Q1 figure is not a very good guide, as lockdowns had not yet begun in the US, whereas in Q2, they are expected to have lasted almost six weeks, as in Europe.

Moving past the quarterlies to a two-year view, there are yet more surprises in store. For example, the Stoxx 600 consensus is for a cumulative decline of just 1.5%, based on an initial drop of 23% in 2020, followed by a 28% rally in 2021**. The same goes for the S&P 500**, where, based on consensus forecasts (-21% in 2020 and +28% in 2021), 2021 results would even be slightly higher than in 2019 (+0.9%). In both cases, all this looks even more **unlikely** as, even with a rebound after 2020, **real GDP** in these two regions is unlikely to return to its **starting point** until 2022 in the US and 2023 in Europe.

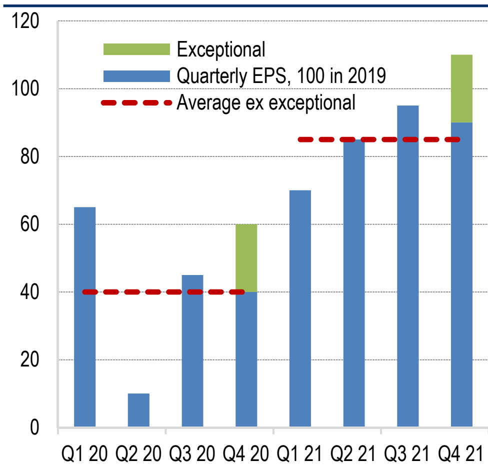
We forecast a deeper initial drop in Stoxx 600 earnings (-60%) followed by a less robust rebound, **which would result in a cumulative, two-year decline of 15%.**

We reached this conclusion based on Stoxx 600 aggregate accounts and on a **comprehensive analysis of leverage**, while taking into account changes in top-line revenues, fixed and variable costs, and likely restructuring. Our reason for doing so is that, during episodes of such severity, it is better to rely on an analytic approach rather than conventional correlations (such as earnings and GDP, etc.), which quickly reach their limits in extreme situations; by definition, these are few in number, but they can skew the quality of the correlation significantly.

The chart below breaks down quarterly forecasts out to the end of 2021. Results are expected to achieve **a sequential increase** after **bottoming out** in Q2 2020. However, both Q4 2020 and Q4 2021 could be hit by heavy **exceptional charges**.

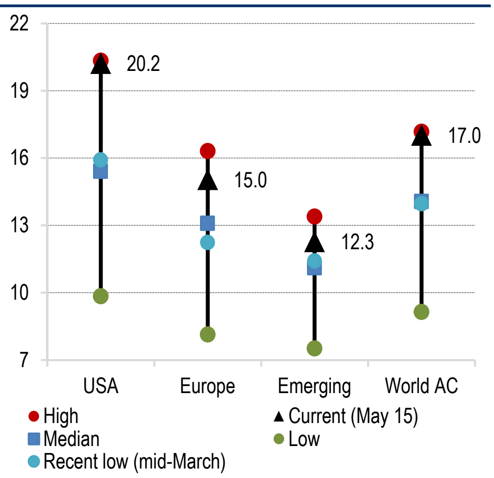
On top of the logistics challenges post lockdowns (transport, return of employees, and reorganising offices and public reception areas, etc.) that should keep them busy until summer, **followed by ramp-ups** this autumn, several companies are expected to announce **productivity plans** late this year in order to adjust to the new environment. Given the time to step back need and the enormity of the challenge at hand, a second round will probably be necessary in late 2021, with measures of a more structural nature.

7/ Stoxx 600 Quarterly EPS forecasts



Source: Amundi Research

8/ 12M Fwd PE over the Cycle (2008-2020)



Source: Datastream, Amundi Research

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Conclusion: the eagerly awaited recovery is already mostly priced in.

We should soon have the confirmation that the European economy indeed hit bottom in April-May and should begin to improve in June, as lockdowns are gradually lifted. Be that as it may, and given how aggressively equity markets have rallied from their mid-March lows, **this eagerly awaited recovery appears to be already priced in by far**.

Even with valuation ratios already high –12M FW P/E on both sides of the Atlantic are at 12-year highs or close to it – **they will only get higher** if, as we expect, forecasts for the coming quarters are revised even further down. So, just in Europe, where our review was more in-depth, the consensus would have to decline by a cumulative 14% by 2021.

This would therefore hinder the upside potential of equity markets and make the path to a sustained rally chaotic and dependent on extensions in support measures and / or sanitary breakthrough.

Finalised on 20/05/2020

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