TCM INSIGHTS

# STOCK PRICES FOLLOW EARNINGS

Recent election rhetoric, news of another round of COVID lockdowns, and headlines around successful vaccine trials have distracted investors from the real long-term driver of stocks – corporate earnings. As the Q3 earnings season winds down, there is an important point worth noting – companies are adapting to a COVID world.

**The Numbers**

In Q3, 67% of S&P 500 firms beat consensus EPS (Earnings Per Share) estimates by at least one standard deviation, the highest share since at least 1998. Additionally, just 6% of companies missed consensus estimates, also the lowest share on record. In aggregate terms, analysts had expected S&P 500 EPS to fall by 21% relative to 3Q 2019, but EPS ultimately fell by just 8%.

The reason for the upside surprise in earnings is less about sales and more about margins. At the start of earnings season, it was the consensus expectation that S&P 500 sales would fall by 3%, but company earnings only fell 2%. Furthermore, analysts also forecast S&P 500 net profit margins would decline by 2.2% to 8.7%, but margins actually fell by much less than expected - net margins contracted by just 0.83% to 10.1%. This shows that even though it was a tough environment to grow sales, corporate America found ways to cut costs and improve efficiencies to uphold margins and profitability.

With pent-up consumer demand, it is expected that companies can expect a post-COVID rebound in sales in 2021. The combination of higher sales, coupled with leaner business models, could see earnings growth of almost 30% in 2021 according to some analysts. Add to that the fact that there is currently $4tn of investor cash sitting on the sidelines, if investors decide to allocate some of that cash to stocks, the argument for being invested in the stock market becomes even more compelling.

**Politics**

Turning to the political environment and potential tax consequences of the election, it is generally believed that with a divided House / Senate, sweeping legal changes, including changes to the tax code, will be very difficult to pass for a Biden administration. Additionally, with his top priority right now focused on reigning in COVID-19 and its potential to wreak further havoc on the economy, Biden is expected to wait to propose tax increases, since raising taxes before the economy fully recovers is extremely risky. Furthermore, it would also be difficult to get higher

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taxes approved in a deeply divided Senate. That said, there are a few items which have a good chance of passing early in the Biden administration:

- Another round of stimulus if Democrats and Republicans can't agree on a stimulus bill before year-end under the current administration. A new stimulus package is expected to include an expansion of the employee retention tax credit, another round of Paycheck Protection Program loans, as well as tax breaks for business to help cover the cost of making their premises safe for workers and employees.
- Retirement savings and tax incentives for IRA owners and 401(k) participants, and proposals to encourage more employers to offer workplace retirement plans.

There is always something to worry about as an investor. However, despite a contested election and renewed COVID-related lockdowns around world, the stock market as measured by the S&P 500 is up almost 11% in 2020 and trading near all-time highs. Those investors who are sitting on the sidelines in cash have something else to worry about – after missing the 11% rally this year, they need to try figure out the right time to get back into the market. It's a lot less headache to stay invested through market gyrations than trying to time when to get out and when to get back in.

The old axiom is worth repeating – it's about time in the market, not timing the market.

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