GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

November 9, 2023

Earnings update: Questions remain about 2024

Kelly Bogdanova – San Francisco

S&P 500 earnings are on pace to break back into growth territory after three quarters of declines, and the recent equity rally may seem like icing on the cake. But beneath the surface, uncertainty about the future direction of the U.S. economy continues to swirl.

Given the U.S. stock market's strong bounce—the S&P 500 has risen 6.5 percent in the past eight trading sessions—one might assume that the Q3 earnings season is going swimmingly. But that's not quite the case.

Credit for the stock market rally goes to the bond market and the Fed. As the 10-year Treasury yield declined from the nearly 5.0 percent nosebleed level in October to 4.5 percent recently on dovish Fed comments, the S&P 500 regained its footing and bounced.

While major markets around the world will likely remain fixated on Treasury yield movements for the time being, investors should not ignore the mother's milk of equity returns: corporate earnings trends.

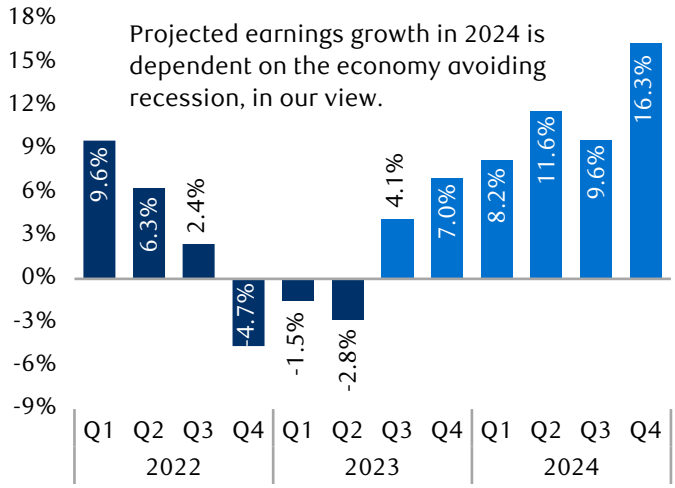
S&P 500 Q3 earnings have been good enough to end the three-quarter-long "earnings recession," as profits are now growing on a year-over-year basis. But management teams' comments and guidance about future quarters have been cautious, reinforcing question marks about profits and the economy in 2024.

Beating estimates, but by how much?

With 90 percent of companies having reported so far, the S&P 500's Q3 earnings and revenue growth rates are pacing at 4.1 percent and 2.0 percent year-over-year, respectively, according to FactSet. These figures are modestly higher than the consensus forecasts at the start of earnings season.

Q3 earnings growth is on pace to break the negative streak of the past three quarters

S&P 500 earnings growth year over year (dark blue are actual data; light blue are consensus estimates)



Source - FactSet, LSEG I/B/E/S, RBC Wealth Management; data through 11/9/23

- 80 percent of companies have beaten the consensus earnings forecast, above the long-term average.
- But the magnitude of earnings beats (the degree to which earnings growth has exceeded the consensus forecast) has lagged the long-term average.

For perspectives on the week from our regional analysts, please see pages 3–4.

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Priced (in USD) as of 11/8/23 market close (unless otherwise stated). Produced: 11/9/23 3:07 pm ET; Disseminated: 11/9/23 3:30 pm ET

- 62 percent of companies have beaten the consensus revenue forecast, roughly in line with the long-term average.
- But the magnitude of revenue beats has also lagged.

Cautious forward guidance

As usual, management teams haven't been very eager to provide specific guidance for future quarters. Among those that have, more executives have lowered Q4 earnings estimates than have raised them.

Overall, management teams have struck a cautious tone about the future.

After reviewing numerous earnings conference call transcripts, RBC Capital Markets, LLC Head of U.S. Equity Strategy Lori Calvasina pointed out the following:

- "The conversations on outlooks, demand, and the general macro [picture] have generally tilted negative. Some companies have emphasized resiliency, stabilization, and normalization, but we are reading a lot more about uncertainty, challenging macro conditions, softening, and caution."
- "Risks and negative impacts from rising rates stand out. This echoes our quantitative work which suggests the recent rise in 10-year Treasury yields has taken the interest rate backdrop to a trouble spot."
- "Inflation and costs are still generally discussed as being problems."

This caution is bleeding into industry analysts' forecasts. While estimates typically come down in the first month of a new quarter, the consensus earnings forecast for Q4 has taken a bigger hit than usual. It declined 3.9 percent in October, much more than the average declines of 1.9 percent and 1.7 percent in the first month of each quarter during the past five years and 20 years, respectively, according to FactSet.

All of this leaves us skeptical about the 2024 consensus earnings forecast of $246 per share. This figure implies year-over-year growth 11.4 percent above the 2023 consensus forecast.

For this to pan out, we think the economy would need a clear path toward a soft landing, along with prospects for some above-trend GDP growth quarters.

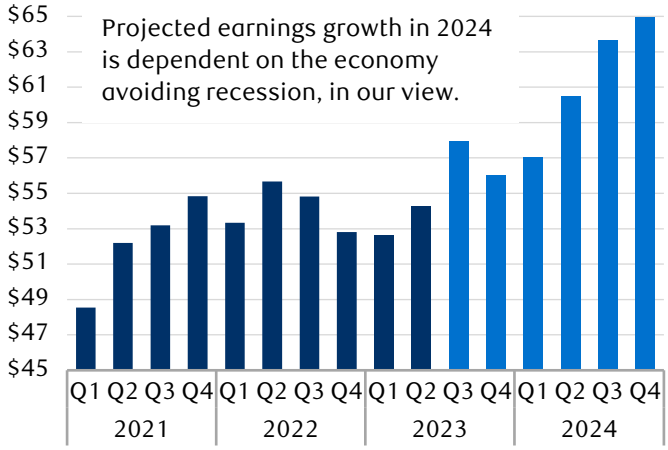
Recession: the elephant in the room

RBC Global Asset Management Inc. Chief Economist Eric Lascelles remains skeptical about the U.S. economy's potential. He thinks high interest rates will ultimately take their toll. Over the next 12 months, Lascelles now sees a 70 percent likelihood of the U.S. entering a recession, up from his previous estimate of 65 percent.

We continue to think earnings growth and the stock market's performance in 2024 will be highly dependent on whether a recession materializes.

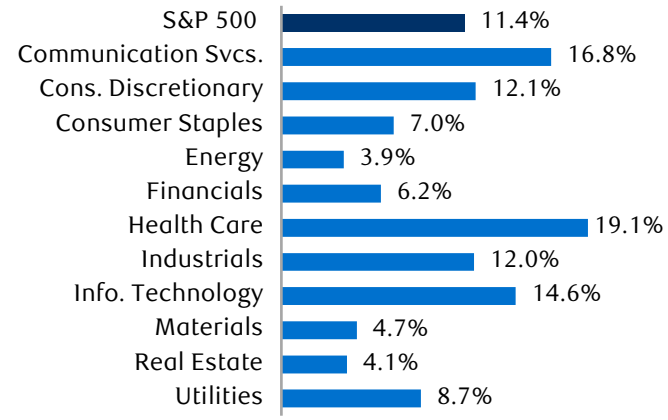
Earnings forecasts seem too lofty

S&P 500 quarterly earnings per share (dark blue are actual data; light blue are consensus estimates)



Source - FactSet, LSEG I/B/E/S, RBC Wealth Management; data as of 11/8/23

S&P 500 and sector consensus earnings growth estimates for 2024



Source - RBC Wealth Management, LSEG I/B/E/S; data as of 11/3/23

As things stand now, the 2024 consensus estimates for the S&P 500 and its sectors look too lofty to us.

Wall Street analysts typically don't firm up their year-ahead forecasts until the early months of the new year as more management teams provide guidance. As this happens, 2024 earnings estimates could be trimmed—especially if there are signs of economic vulnerabilities.

Staying balanced

We think the range of potential economic and earnings outcomes for next year remains rather wide. The rosy scenario of a soft landing and above-trend GDP growth could play out, but it is also possible that the economy could succumb to pressures from high interest rates.

We continue to recommend Market Weight exposure to U.S. equities, a stance intended to balance the risk of a recession against the possibility that one may be averted.

UNITED STATES

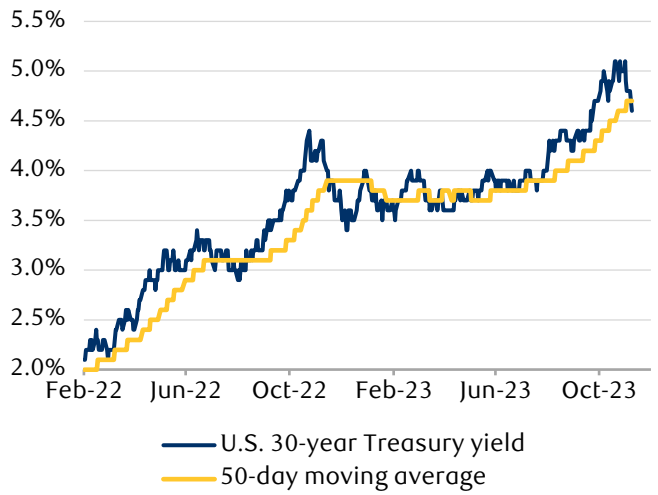
Michael Roedl – Minneapolis

- According to Bloomberg data, **the yield on the 30-year Treasury bond breached its key technical 50-day moving average for the first time since July, an indication that yields potentially have more room to drift lower in the near term**. While Federal Reserve Chair Jerome Powell's comments last week on the potential end to the Fed's rate hike campaign initiated strong appetite for long-dated Treasuries, the Treasury Department's announcement of a smaller-than-expected boost in bond issuance is equally contributing to robust demand. In our view, fixation on Treasury bond auctions will likely continue for as long as the Fed maintains its stance on higher-for-longer rates. Therefore, the market's focus on future rate cuts will likely be pushed to the wayside, in our view, until policymakers see more substantial progress on tempering growth and inflation in the economy.

- **High-yield corporate credit is seeing its best performance of the year** given the strong rally in high-risk assets this month. As of Wednesday's close, the U.S. High Yield Corporate Index is up 7.1% year to date, the best-performing U.S. fixed income asset class this year only behind leveraged loans, which are up 9.5% year to date. The recent pickup in demand has pushed spreads, or the excess yield versus Treasuries, significantly tighter this month. High-yield spreads currently stand at +3.9%, about 30 basis points below the year-to-date average.

- **U.S. mortgage rates tumbled last week by the most in over a year, causing the strongest advance in home purchase applications since early June** as prospective homebuyers finally find some relief in the market. According to the Mortgage Bankers Association, the average contract rate on 30-year fixed mortgages fell 25 basis points to 7.61%, marking the lowest rate since September. Nonetheless, mortgage rates remain uncomfortably high for most Americans and are discouraging households that locked in historically cheap borrowing costs over the past decade from moving. Thus, the situation is maintaining pressure on supply while keeping housing prices elevated in the U.S.

30-year Treasury yield breaches 50-day moving average



Source - RBC Wealth Management, Bloomberg; data through 11/8/23

CANADA

Estefani Ayazo, CFA & Richard Tan, CFA – Toronto

- **Canada's trade surplus more than doubled in September as higher crude oil prices helped boost energy exports**. According to Statistics Canada, the country's trade surplus amounted to CA$2.0 billion compared to a revised surplus of CA$949 million for August. Total exports rose for a third consecutive month in September, with gains observed in seven out of the 11 product sections. Within this, higher exports of crude oil (+13.7% m/m) accounted for most of the monthly gains in September, largely driven by higher crude prices during the summer months. Encouragingly, the increase in Canadian total exports from July to September helped offset the decline in June driven by wildfires and port disruptions in British Columbia. Meanwhile, total imports increased by 1.0% m/m boosted by passenger cars and light trucks despite strike disruptions in the U.S. auto sector. While economic growth has stalled and flirted with falling into a shallow recession in recent months, a widening trade surplus in September could lift economic growth in Q3.

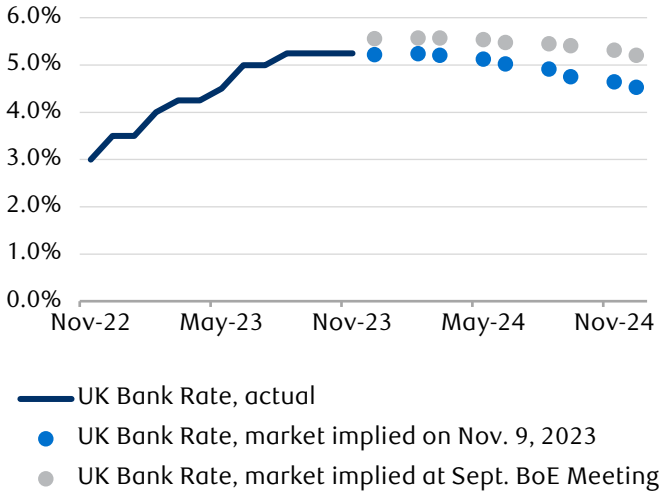
- **While inflation remains above the Bank of Canada's long-term target of 2%, it's clear to us that higher interest rates have weighed on domestic economic growth**. On one side of the ledger, we believe interest rates are likely to remain in a "higher-for-longer" range relative to the low interest rate environment that persisted following the global financial crisis. On the flip side, we believe the likelihood that rates have peaked has also increased given slow economic growth, stretched consumer debt levels, and shrinking disposable incomes. In fact, the Canadian bond market is now baking in rate cuts as early as Q2 2024. **If rates have indeed peaked, we believe this could support certain pockets of the Canadian equity market**, particularly dividend-paying securities and rate-sensitive sectors (e.g., Financials, Utilities, Real Estate, and Communication Services).

EUROPE

Thomas McGarrity, CFA & Rufaro Chiriseri, CFA – London

- **The European and UK earnings season has been broadly in line with expectations at the headline level**. Overall earnings per share (EPS) for the STOXX Europe 600 Index in Q3 declined by 13% y/y, with commodity-related sectors a significant drag on overall earnings. Excluding the Energy sector, EPS grew 3% y/y. Notably, however, sales growth has been disappointing, with the proportion of companies beating consensus sales estimates falling sharply in Q3 versus recent quarters. Moreover, the number of profit warnings this quarter has been above average, and the share price reaction to negative surprises has been especially sharp.
- **Consensus earnings estimates for the STOXX Europe 600 Index have been downgraded for 2023, particularly among cyclicals**, and we believe consensus earnings growth expectations for 2024 may be too high at around +7.0%. With Europe's economic outlook continuing to weaken, earnings risks remain tilted to the downside, in our view. Accordingly, we believe an Underweight allocation to European equities remains warranted.
- **The UK bond market reacted positively to the Bank of England's (BoE) Nov. 2 decision to hold rates at 5.25%**, with Gilts rallying across all maturities. Most notable have been 2-year and 30-year Gilts, which rallied by 13 and 15 basis points (bps), respectively.
- **A flurry of mixed messages from the UK's central bankers this week has led to shifts in market expectations**. Prior to the BoE meeting, the market was pricing in around 30 bps of interest rate cuts, and market sentiment was reinforced by comments from BoE Chief Economist Huw Pill on Monday suggesting possible rate reductions. However, Pill seems to have recalibrated his messaging only a few days later and is now taking the same line as BoE Governor Andrew Bailey, who recently pushed back on market expectations by stating that "it is really too early to be talking about cutting rates." Despite the realignment in these two key speakers' messages, markets are still forecasting around 50 bps of policy easing within a year's time.

More rate cuts being priced in by the markets in 2024



Source - RBC Wealth Management, Bloomberg; data as of 11/9/23 6:00 am ET

ASIA PACIFIC

Nicholas Gwee, CFA – Singapore

- **Asia-Pacific equity markets saw mixed trading** during the week, with ASEAN countries such as the Philippines and Vietnam leading and more developed markets such as Japan, Hong Kong, and Singapore lagging.
- **China slid into deflation again in October,** according to the latest data from the National Bureau of Statistics. China's Consumer Price Index fell 0.2% y/y in October after being flat the previous two months; the latest reading was below the median consensus forecast for a 0.1% drop. Meanwhile, the Producer Price Index fell for the 13th consecutive month, dropping 2.6% y/y versus the expectation for a 2.7% decline. Inflation in China has been weak this year due to a confluence of factors spanning Real Estate sector woes, very weak consumer confidence, falling commodity prices, and declining exports. While the People's Bank of China noted in August that prices would rebound from the rough patch in the summer, the latest data suggests to us that the central bank's assessment was overly optimistic. **RBC Global Asset Management believes further policy action is likely**. Twice a decade, China holds its **Third Plenum**—a meeting of senior Communist Party officials that creates a roadmap for reforming the economy and society over the following five years. The next such meeting should take place over the second half of November 2023. Some approaches that we think may be under consideration include: China could announce a greater urbanization push (which could spur productivity and help the housing market), introduce measures to boost consumption and business sentiment, and seek a better balance between state-owned enterprises and the private sector. These measures could be moderately helpful for economic growth, in our view.
- **An unconfirmed Reuters report on Ping An Insurance (Group) Co. of China (2318 HK) being asked to take over distressed developer Country Garden (2007 HK)** sent the share price of the former down more than 5% on Wednesday, wiping out US$3.1 billion from its valuation. Ping An promptly denied the report, saying it has no plans to acquire the Chinese builder.

MARKET Scorecard

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,237.86	1.1%	10.4%	9.9%	-8.1%
Dow Industrials (DJIA)	33,274.58	0.7%	0.4%	1.9%	-7.3%
Nasdaq	13,061.47	1.6%	24.8%	19.9%	-16.3%
Russell 2000	1,669.70	0.4%	-5.2%	-9.8%	-29.2%
S&P/TSX Comp	19,079.00	1.1%	-1.6%	-2.2%	-10.2%
FTSE All-Share	3,967.55	0.3%	-2.6%	1.0%	-4.5%
STOXX Europe 600	436.57	0.7%	2.7%	5.3%	-8.8%
EURO STOXX 50	4,091.71	0.8%	7.9%	12.1%	-4.4%
Hang Seng	17,101.78	-0.1%	-13.5%	10.7%	-32.0%
Shanghai Comp	3,023.08	0.1%	-2.1%	1.8%	-14.7%
Nikkei 225	31,601.65	2.4%	21.1%	14.2%	6.6%
India Sensex	63,591.33	-0.4%	4.5%	4.0%	5.7%
Singapore Straits Times	3,076.77	0.3%	-5.4%	-1.7%	-4.4%
Brazil Ibovespa	115,052.96	1.7%	4.8%	-1.6%	9.0%
Mexican Bolsa IPC	49,787.84	1.5%	2.7%	-2.1%	-3.6%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	4.734%	-19.7	85.9	69.2	317.8
Canada 10-Yr	3.921%	-14.3	62.1	67.4	217.3
UK 10-Yr	4.499%	-1.3	82.7	102.9	343.7
Germany 10-Yr	2.764%	-4.2	19.3	63.3	286.6
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	5.65%	0.0%	-2.8%	0.1%	-15.3%
U.S. Investment-Grade Corp	6.35%	0.0%	-1.9%	2.4%	-17.2%
U.S. High-Yield Corp	9.49%	0.0%	4.6%	6.1%	-6.2%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,982.72	-0.1%	8.7%	20.3%	10.6%
Silver (spot $/oz)	22.95	0.5%	-4.2%	16.9%	-4.6%
Copper ($/metric ton)	8,029.00	0.0%	-4.0%	4.0%	-19.7%
Oil (WTI spot/bbl)	80.44	-0.7%	0.2%	-9.0%	-4.3%
Oil (Brent spot/bbl)	85.02	-2.7%	-1.0%	-10.2%	0.4%
Natural Gas ($/mmBtu)	3.49	-2.3%	-21.9%	-38.9%	-32.6%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	106.6630	0.0%	3.0%	-4.3%	13.6%
CAD/USD	0.7218	0.2%	-2.2%	-1.6%	-10.7%
USD/CAD	1.3854	-0.2%	2.2%	1.6%	12.0%
EUR/USD	1.0569	-0.1%	-1.3%	7.0%	-8.9%
GBP/USD	1.2148	0.0%	0.5%	5.8%	-11.1%
AUD/USD	0.6395	0.9%	-6.1%	0.0%	-15.0%
USD/JPY	150.9300	-0.5%	15.1%	1.8%	32.4%
EUR/JPY	159.5400	-0.5%	13.6%	9.0%	20.6%
EUR/GBP	0.8701	0.0%	-1.7%	1.2%	2.4%
EUR/CHF	0.9590	-0.4%	-3.1%	-2.9%	-9.1%
USD/SGD	1.3683	-0.1%	2.2%	-3.3%	1.5%
USD/CNY	7.3160	0.0%	6.1%	0.5%	14.4%
USD/MXN	17.7710	-1.5%	-8.9%	-10.0%	-14.7%
USD/BRL	4.9555	-1.6%	-6.2%	-3.7%	-12.9%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.72 means 1 Canadian dollar will buy 0.72 U.S. dollar. CAD/USD -2.2% return means the Canadian dollar fell 2.2% vs. the U.S. dollar year to date. USD/JPY 150.93 means 1 U.S. dollar will buy 150.93 yen. USD/JPY 15.1% return means the U.S. dollar rose 15.1% vs. the yen year to date.

Source - Bloomberg; data as of 11/8/23

Authors

Estefani Ayazo, CFA – Toronto, Canada
estefani.ayazo@rbc.com; RBC Dominion Securities Inc.

Kelly Bogdanova – San Francisco, United States
kelly.bogdanova@rbc.com; RBC Capital Markets, LLC

Rufaro Chiriseri, CFA – London, United Kingdom
rufaro.chiriseri@rbc.com; RBC Europe Limited

Nicholas Gwee, CFA – Singapore
nicholas.gwee@rbc.com; Royal Bank of Canada, Singapore Branch

Thomas McGarrity, CFA – London, United Kingdom
thomas.mcgarrity@rbc.com; RBC Europe Limited

Michael Roedl – Minneapolis, United States
michael.roedl@rbc.com; RBC Capital Markets, LLC

Richard Tan, CFA – Toronto, Canada
richard.tan@rbc.com; RBC Dominion Securities Inc.

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As of September 30, 2023

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Sell [Underperform]	55	3.75	5	9.09

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