

Cash Flow and Carey



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A Challenging Situation

Bloomberg Consensus 2023 Earnings Estimates Over Time

	12/31/2021	4/1/2022	6/3/2022	9/30/2022	12/30/2022	2/3/2023
2023 Forecast EPS (\$)	241.8	247.0	247.5	238.6	227.8	221.8

Source: Bloomberg. **Past Performance is no guarantee of future results.**

View from the Observation Deck

As we come to the close of the 2022 earnings season, we thought it would be timely to do a snapshot of the change in earnings estimates for the 2023 calendar year and see what can be gleaned from the data. Today's table shows the Bloomberg consensus 2023 S&P 500 Index earnings estimates on a (roughly) quarterly basis for the 2022 calendar year. We also included the most recent results as of February 3, 2023 for comparison.

Declining earnings could lead to stretched multiples.

As the table shows, 2023 consensus earnings estimates have been declining steadily since June. Assuming price remains stable, a decline in earnings will lead to an increase in the price to earnings (P/E) ratio of an equity. As many investors are aware, P/E ratios are often used as a barometer for how vulnerable a stock could be to price fluctuation in the future. Notably, even though earnings estimates have been trending downward over the past few quarters, the S&P 500 Index ("index") surged to start the 2023 calendar year, leading to increased multiples. As of January 31, 2023, the P/E ratio for the S&P 500 Index stood at 19.31. For comparison, the average P/E ratio for the index was 18.28 for the 20-year period ended in January.

Valuations have trended higher as the long end of the yield curve has come down.

Falling yields on the long end of the treasury curve appear to have offset declining earnings estimates. We've mentioned that the recent price recovery in fixed income has been a welcome sight for those who hold bonds, but believe that equity investors would be well-served to pay close attention to it as well. If the Federal Reserve ("Fed") continues along the path of tighter monetary policy, the likely increase in the 10-year Treasury note (T-note) could result in a substantial decline in equity valuations.

Takeaway

The S&P 500 Index started the year off on a high note, posting a total return of 6.28% through January. Notably, January's surge in equity prices came on the heels of nearly six months of declining earnings estimates. With equity prices climbing and earnings falling, valuations have moved upwards. Adding ballast to already increasing valuations, the yield on the 10-year T-note plummeted by 13.32% over the 3-month period ended in January 2023. With the P/E ratio of the S&P 500 Index hovering above its 20-year average and the possibility of the Fed enacting further rate hikes, equity investors may want to take note: we could be heading into a challenging situation.

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions and other expenses incurred when investing. Investors cannot invest directly in an index. The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance.

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