

Anatomy of Past EPS Corrections

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Earnings Per Share (EPS) Correction Yet to Manifest in Global Markets

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With many economic indicators pointing to a slowdown most investors have been keenly watching emerging earning trends for signs of an earnings slow down or correction. In Australia we are only starting to see results for the August reporting season and it is too early to generalize but globally the majority of corporates have already reported. With the global results largely complete we can report a very minor -0.5% decline in earnings expectations for the next 12 months since 30th June. Indeed since early this year we have only seen a very modest -1.1% decline in earnings expectations for the next 12 months.



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Figure 1: Past EPS Corrections for the MSCI World Index

Past Earnings Corrections	% EPS Correction
Tech Collapse of 2000/02	-23%
Global Financial Crisis of 2008/09	-44%
Global Economic Slowdown of 2015/16	-16%
COVID Lockdown of 2020	-23%
Average	-27%
Inflation & Tightening Recession of 2022/23	?

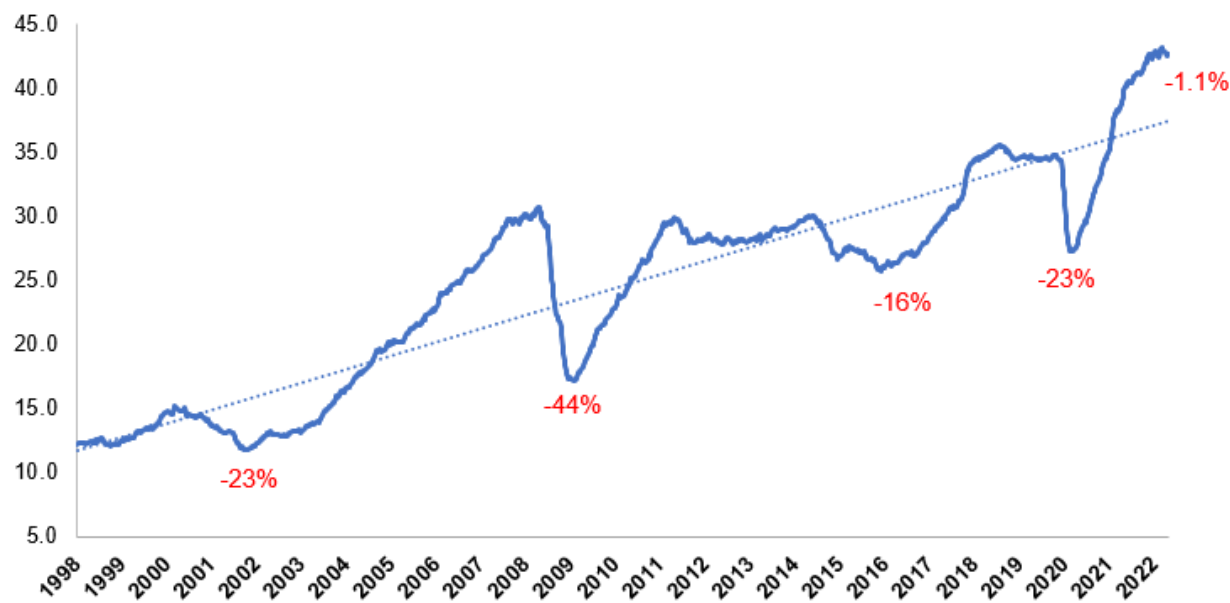
Source: State Street Global Advisors, Factset, as at 5 August 2022. Earnings corrections are defined as corrections of more than 15% corrections in earnings per share estimates for the next 12 months..

As shown in figure 1 above, the average earnings correction in the last 24 years has been a decline of -27 % on average. By historical standards the current EPS correction is either very small or may have more to play out if economic conditions deteriorate.

Figure 2 below shows the long term positive trend in EPS since 1998. The earnings have shown a positive long term trend growing at an annualized rate of 5.3% p.a. on average over the last 24 years. Also shown are the major earnings corrections that have occurred during past economic slowdowns.

Figure 2: Past Earnings Trends and Earnings Corrections

MSCI World Index Earnings per Share Estimates for the next 12 months



Source: State Street Global Advisors, Factset, as at 5 August 2022. MSCI World Index earnings per share for the next 12 months from April 1998 to August 2022. Earnings corrections are defined as corrections of more than 15% corrections in earnings per share estimates for the next 12 months.

If the economic slowdown does play out and we do see a corresponding earnings correction you can expect vastly different impacts across different sectors of the market. Figure 3 below looks at the major earnings corrections since 1998 and compares the earnings corrections across both defensive and cyclical sectors. The average earnings for the market as a whole was -27% but the correction for cyclical sectors was down on average -42% compared to only -15% for the defensive sectors. It would appear that defensive sectors are true to label with less earnings sensitivity to economic slowdowns.

Figure 3: Defensive Sectors True to Label in Past EPS Corrections

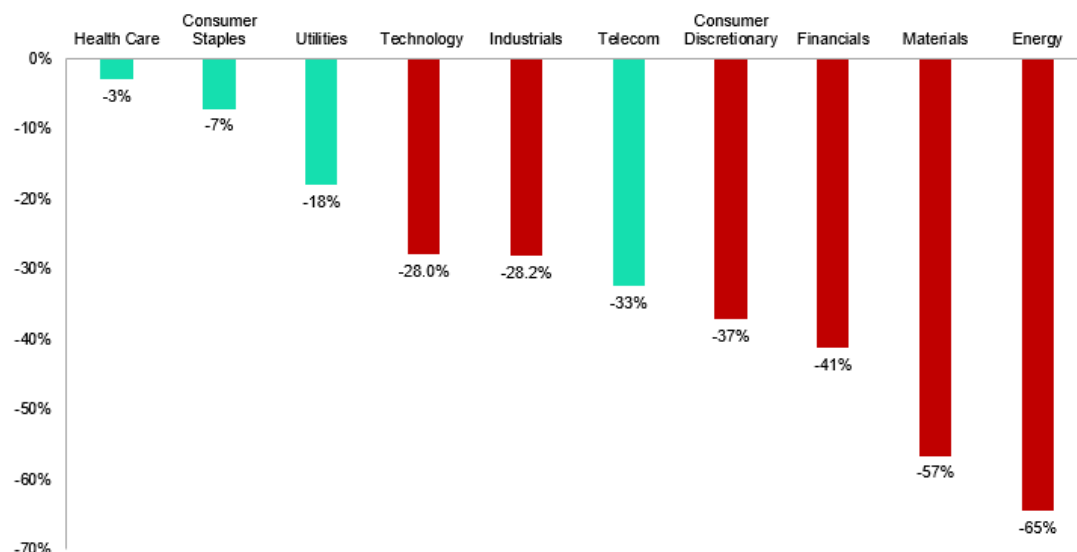
EPS Corrections	MSCI World Index % EPS correction	Defensive Sectors % EPS Correction	Cyclical Sectors % EPS Correction
Tech collapse of 2000/02	-23%	-14%	-31%
Global Financial Crisis of 2008/09	-44%	-14%	-57%
Global Economic Slowdown of 2015/16	-16%	-15%	-34%
COVID Lockdown of 2020	-23%	-17%	-46%
Average	-27%	-15%	-42%
Inflation Tightening Recession 2022/23	?	?	?

Source: State Street Global Advisors, Factset, as at 5 August 2022. Earnings corrections are defined as corrections of more than 15% corrections in earnings per share estimates for the next 12 months. Defensive sectors are Healthcare, Staples, Utilities and Communications. Cyclical sectors are Discretionary, Industrials, Technology, Financials, Materials and Energy.

Breaking the cyclical and defensive classification down even further we can see even greater contrasts. In Figure 4 the green bars represent the defensive sectors and the red bars the cyclical sectors. Healthcare and Consumer Staples are the standouts only correcting -3% and -7% respectively during these past earnings recessions. In contrast Financials (-37%), Materials (-57%) and Energy (-65%) have historically seen the biggest negative percentage declines in earnings expectations during economic slowdowns and earnings corrections. This is especially relevant for the Australian market as these sectors make up a large proportion of main benchmark, the S&P/ASX 300 Index and are widely held.

Figure 4: Past Sector EPS Corrections

Average Earnings Per Share Corrections from Major Corrections in the Last 25 Years



Source: State Street Global Advisors, Factset, as at 5 August 2022. MSCI world earnings per share for the next 12 months from April 1998 to August 2022. Earnings corrections are defined as corrections of more than 15% corrections in earnings per share estimates for the next 12 months.

The Bottom Line

With results in for the majority of global equities the earnings season has proven largely resilient so far. If a recession is really on the cards as many economic indicators are suggesting then we could well see further earnings declines in coming quarters. This is especially true for the more cyclical sectors like Financials, Materials and Energy and is especially relevant for many widely held stocks within the S&P/ASX 300 Index.

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