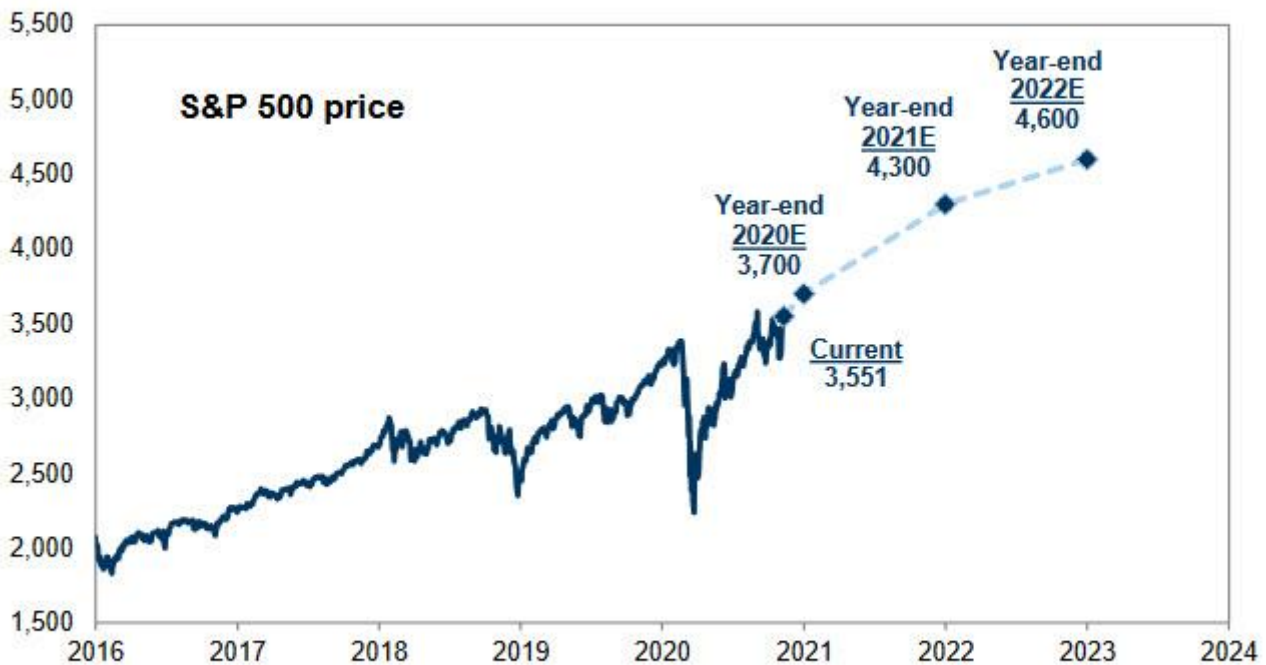


#MacroView: Earnings Growth Will Disappoint In 2021

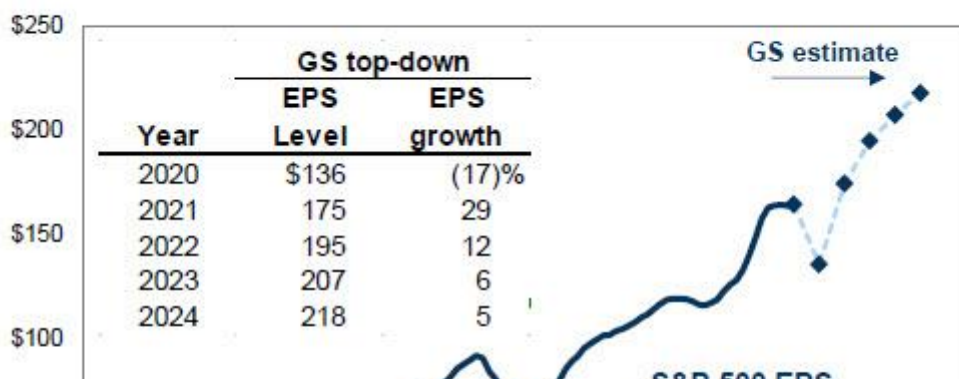
It's that time of year when Wall Street analysts started trotting out the predictions for earnings growth and stock market targets for the coming year. Unfortunately, each year these overly optimistic estimates are ground down as the year progresses. Next year will be no different as earnings growth will disappoint in 2021.

Exhibit 1: Path of the S&P 500 through 2022
As of November 9, 2020



Source: Goldman Sachs Global Investment Research

Exhibit 3: GS top-down S&P 500 EPS estimates
as of November 12, 2020




expensive valuations
y to \$175 in EPS for
arnings Before Reality)
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Goldman Sachs is correct, **such would put valuations on the S&P 500 of 24.57x operating earnings in 2021 and 23.59x in 2022.** Such levels remain extremely expensive by any historical measure.



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The Problem With Estimates

For many years, I have counseled individuals to disregard mainstream analysts, Wall Street recommendations, and even [MorningStar ratings](#) due to the inherent conflict of interest between the firms and their particular client?le. Here is the point:

- **YOU are NOT Wall Street?s client.**
- **YOU are the CONSUMER of the products sold FOR Wall Street?s clients.**

Wall Street is a "big" business. I mean a massive industry of \$715 Billion a year in revenue. The table below shows the annual sales of 22 of the largest financial firms in the S&P 500.

Company	Ticker	12 Mo Sales (\$ Mil)	Company	Ticker	12 Mo Sales (\$ Mil)
Bank Of Amer Cp	BAC	\$99,581	Wells Fargo-New	WFC	\$85,438
Bank Of Ny Mell	BK	\$18,652	Ameriprise Finl	AMP	\$12,003
Citigroup Inc	C	\$94,702	Blackrock Inc	BLK	\$15,704
Comerica Inc	CMA	\$3,265	Franklin Resour	BEN	\$5,644
Fifth Third Bk	FITB	\$8,894	Goldman Sachs	GS	\$54,006
Jpmorgan Chase	JPM	\$133,138	Invesco Ltd	IVZ	\$6,258
Northern Trust	NTRS	\$6,464	Morgan Stanley	MS	\$51,409
Pnc Finl Svc Cp	PNC	\$19,538	Principal Finl	PFG	\$15,024
State St Corp	STT	\$12,465	Raymond Jas Fin	RJF	\$8,168
Truist Finl Cp	TFC	\$22,741	Schwab(Chas)	SCHW	\$10,121
Us Bancorp	USB	\$25,903	T Rowe Price	TROW	\$5,943

Total Revenue For Top 22 Investment Banks In S&P 500 \$ 715,061,000,000.00

Like all businesses, these companies are driven by increasing corporate profitability annually, regardless of market conditions. In a previous [study](#) by Lawrence Brown, Andrew Call, Michael Clement, and Nathan Sharp, **you are not a Wall Street analyst's priority.**

?Countless studies have shown that the forecasts and stock recommendations of sell-side analysts are of questionable value to investors. As it turns out, Wall Street sell-side analysts aren?t primarily interested in making accurate stock picks and earnings forecasts. Despite the attention lavished on their forecasts and recommendations, predictive accuracy just isn?t their main job.?

Table 5 Survey responses to the question:

How important are the following to your compensation?

Responses	% of respondents who answered		
	Very Important (5 or 6)	Not Important (0 or 1)	Avg. Rating
(1) Your industry knowledg	72.18	1.93	4.95***

Table 4 Survey responses to the question:

How important are the following clients to your employer?

Responses	% of respondents who answered		
	Very Important	Not Important	Avg. Rating

Where are you in order of importance, **at the bottom of the list**. Such is because accuracy isn't essential - it's only "broker votes" that matter.

"A ?broker vote? **is an internal process** whereby clients of the sell-side analysts? firms assess the value of their research and decide which firms? services they wish to buy. This process is crucial to analysts **because good broker votes result in revenue for their firm**. One analyst noted that broker votes **?directly impact my compensation and directly impact the compensation of my firm.?'?**



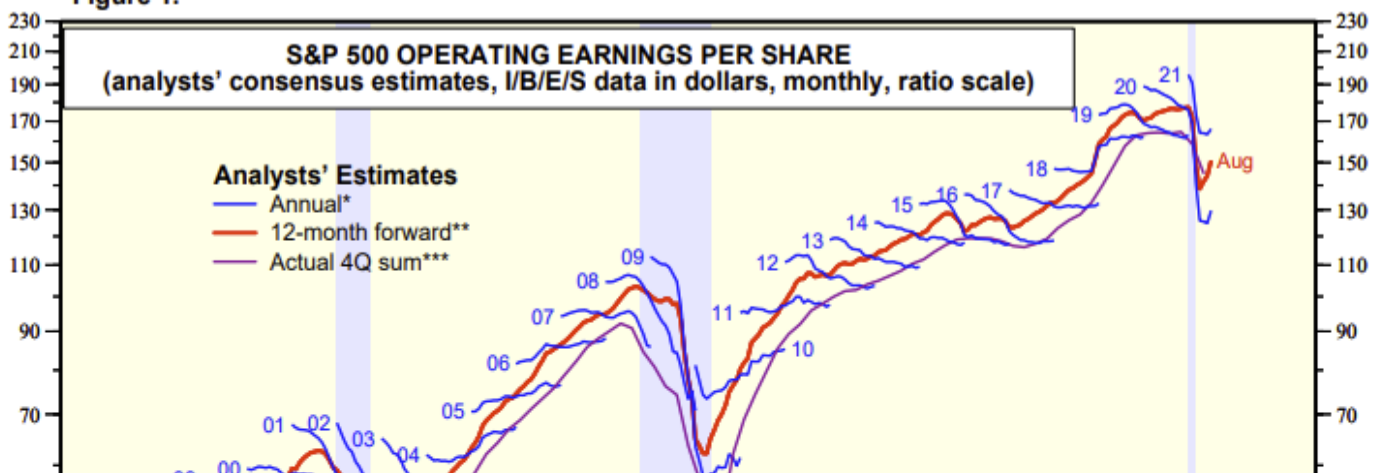
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S&P 500 Annual Reported Earnings Estimates					
Year	Initial Estimate For The Year		Actual Year-End EPS	Difference	% Miss
2013	\$	112.23	\$ 100.20	\$ (12.03)	-12.01%
2014	\$	119.70	\$ 102.31	\$ (17.39)	-17.00%
2015	\$	147.50	\$ 86.53	\$ (60.97)	-70.46%
2016	\$	123.70	\$ 94.55	\$ (29.15)	-30.83%
2017	\$	126.81	\$ 115.44	\$ (11.37)	-9.85%
2018	\$	136.75	\$ 132.39	\$ (4.36)	-3.29%
2019	\$	156.28	\$ 139.47	\$ (16.81)	-12.05%
2020	\$	161.87	\$ 93.51	\$ (68.36)	-73.10%
2021	\$	176.20	\$ 143.27	\$ (32.93)	-22.98%
Average Miss:				\$ (28.15)	-27.95%

have stated previously that [analysts consistently overestimate earnings by as much as 30%](#). However, this isn't just a recent event, as the two charts from Yardeni Research show below.

Figure 1.



Of course, the problem is that investors take these estimates from analysts at "face value" and "pay up" for earnings that fail to materialize in the future. **Such works out great for Wall Street who makes their investment banking clients happy. However, not so much for their retail clients to whom they are offloading overpriced shares. (IPO's, secondary offerings, etc.)**

RIA Pro

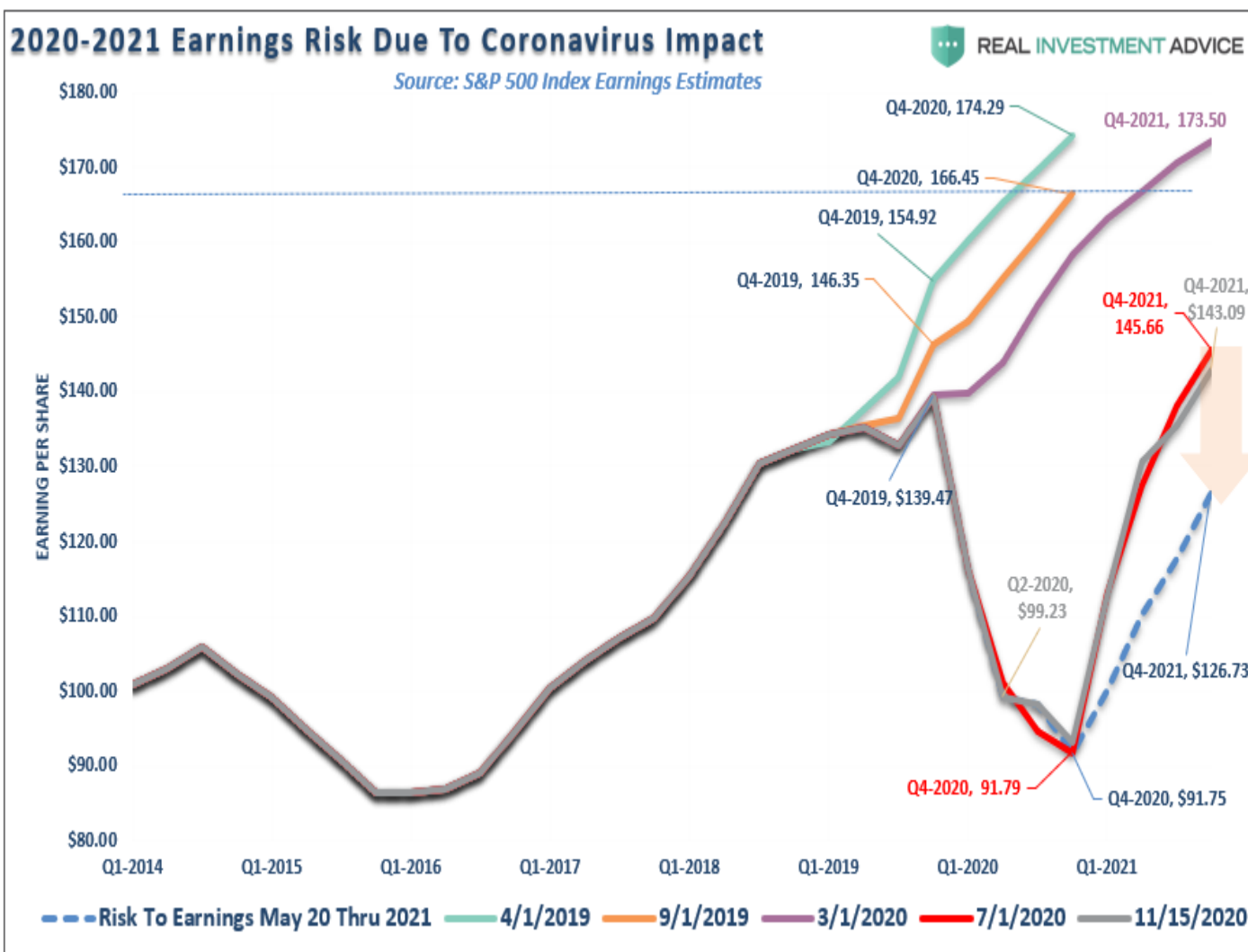
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2021 Likely To Be Disappointing Once Again

While analysts are rushing to set the highest target price possible and overestimating earnings to "justify" them, the next 12-months will see those targets sharply reduced. Such was a point we made in April of this year as the pandemic's reality set in. [To wit:](#)

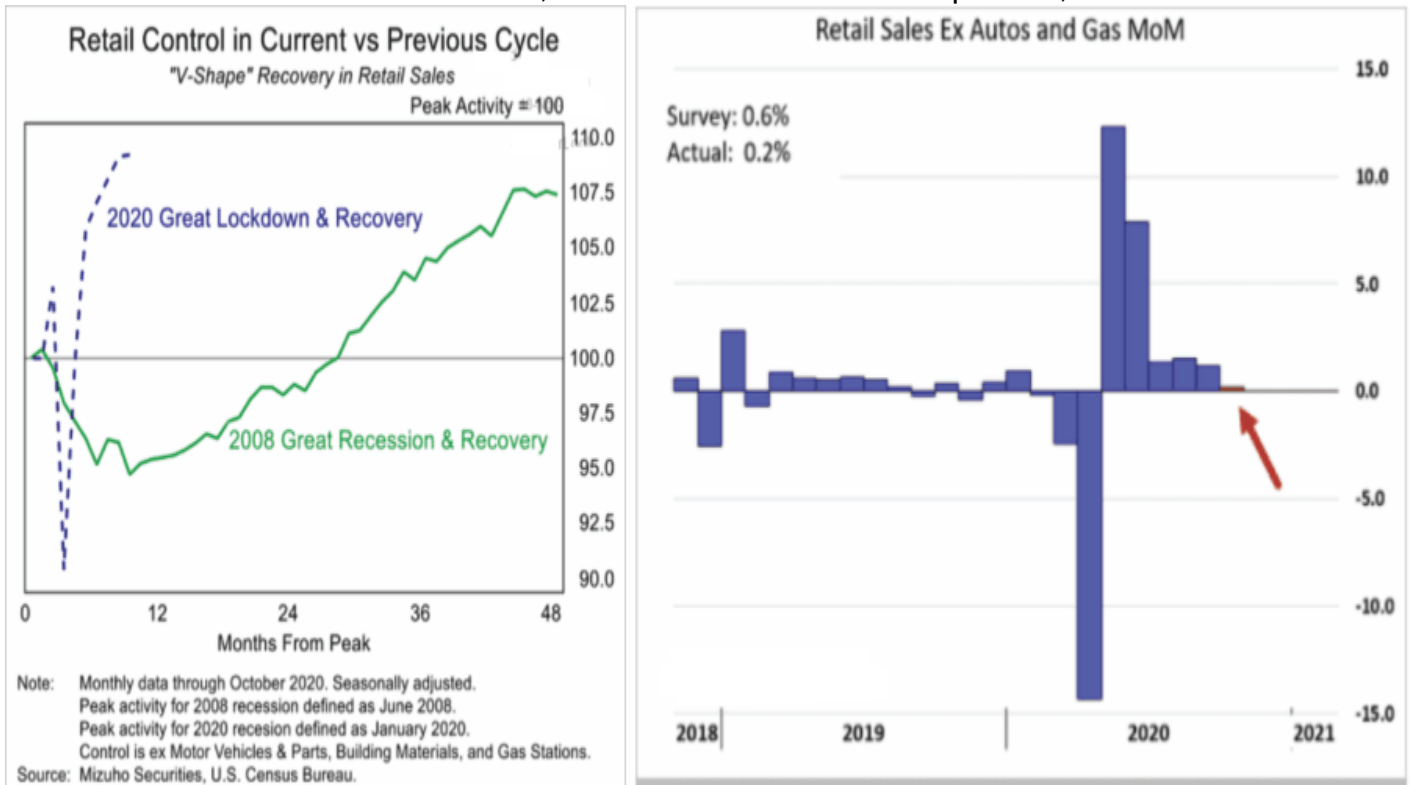
*"This analysis is based on the presumption, that despite the fact the major buyer of stocks, namely corporate share repurchases, will be missing that **earnings will recover sharply once the 'economy opens back up for business.'** To analyze the reality of these expectations, we need to review the history of the estimates for the S&P 500 from when 2021 estimates were first published by Standard & Poors in April 2019. The chart shows the progression in estimates April to September 2019, and March, July and November of 2020. (The dotted blue line is my original, unrevised estimate of the impact to earnings in May of this year.)"*



Currently, estimates for 2021 sit at \$143.09. **Importantly, with markets presently sitting near all-time highs, 2021 estimates are \$30.41/share lower than was initially estimated.**

Economic Recovery Won't Make Up The Difference.

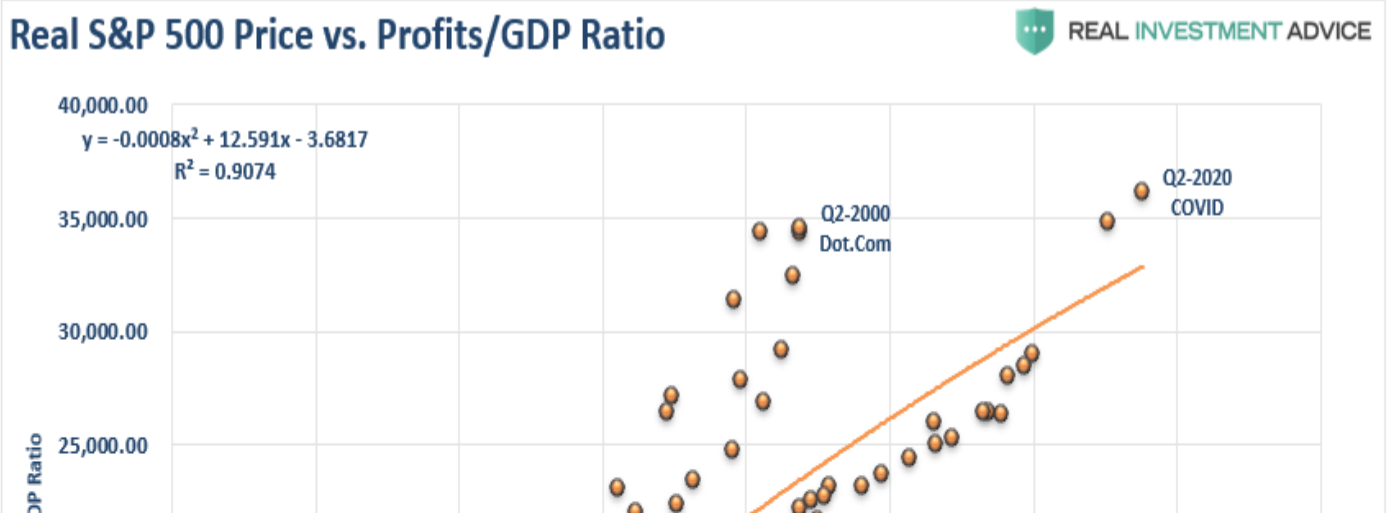
Over the last couple of weeks, we have touched on the various problems with the expected "recovery" even if we get a vaccine in place. **Foremost, the hope that consumers will rush out to spend money due to "pent-up demand" is likely not the case.** Had the Government not acted to send money directly to households that exceeded their previous income streams, I would agree with the argument. However, the flood of stimulus money from direct checks to households and expanded unemployment benefits "pulled forward" future consumption. The comparison between current retail sales and 2008, where the stimulus was not present, is evident.



Secondly, the divergence between the stock market and the economy is unsustainable longer-term. As we discussed in the ["Importance Of Market Cap To GDP:"](#)

*"Since 1947, earnings per share have grown at 6.21% annually, while the economy expanded by 6.47% annually. **That close relationship in growth rates should be logical. Such is particularly the case given the significant role spending has in the GDP equation.**"*

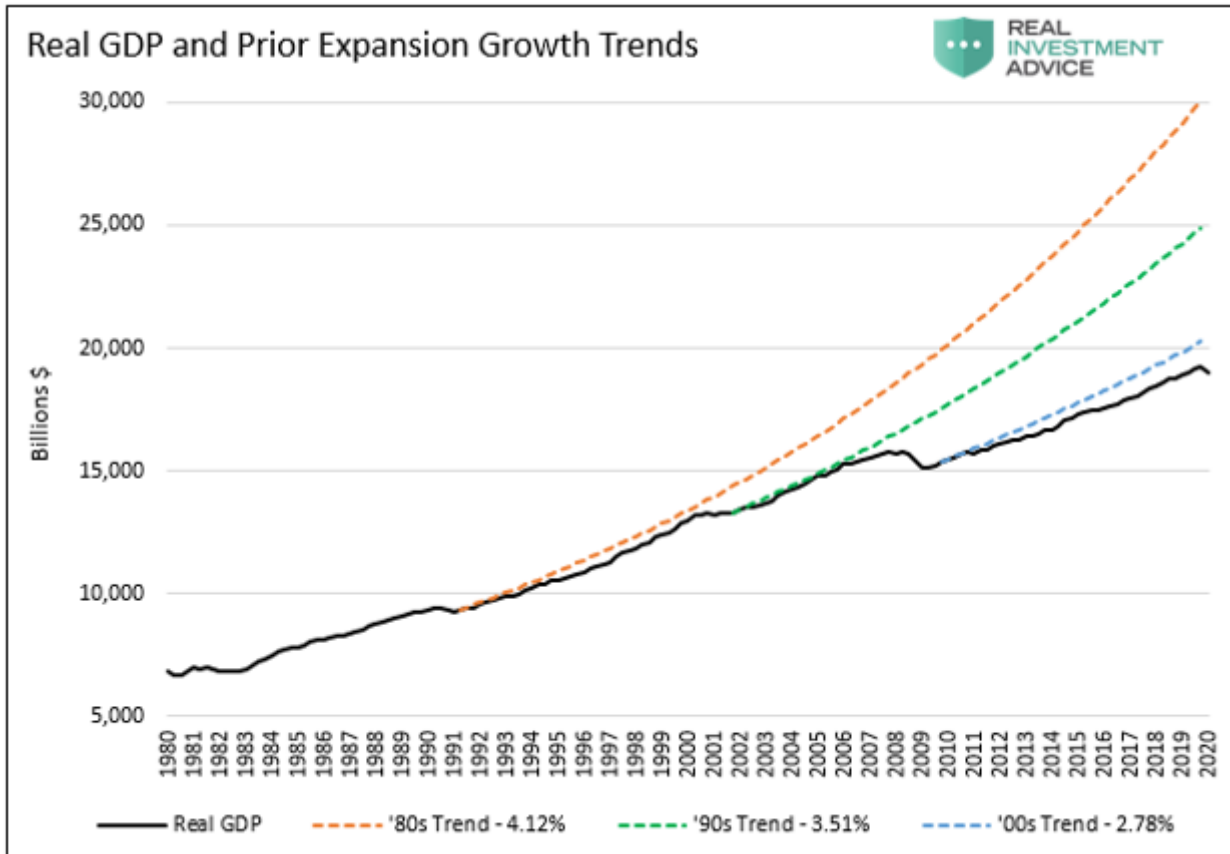
The correlation is more evident when looking at the market versus the ratio of corporate profits to GDP. With a 90% correlation, investors should not dismiss these deviations.



Slower Growth Ahead

Most importantly, economic growth will not recover back to pre-pandemic growth trends, as noted by [Michael Lebowitz recently](#):

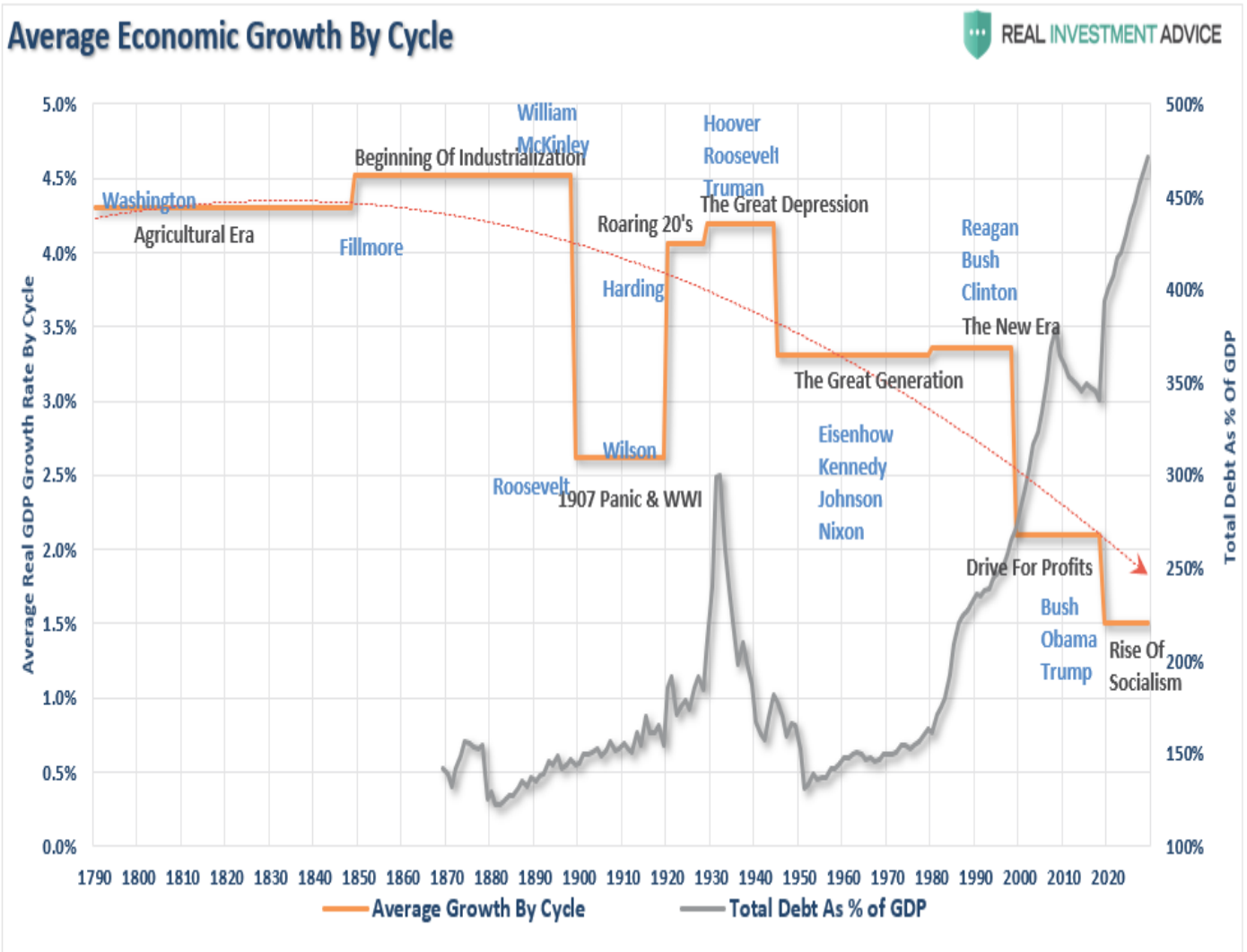
?The new paradigm of weak recoveries is due to the Fed's policy prescription for recessions; debt-fueled consumption. Through lower interest rates they incentivize people, corporations, and the government to borrow. The benefits are here and now as



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The

changes to the economy over the last 40-years has continued to erode economic growth. Had we grown our economy at the rate of the 1980s, **GDP would be over 50% higher than it is currently.** There is no doubt that massive amounts of new federal, municipal, and corporate debt used to weather the COVID storm will have the same economic dampening effect as it has had. **Based solely on the strong relationship between government debt ratio to GDP, we estimate that the coming expansion's real growth rate could be as low as 1.07%.**



Without economic growth, corporate profits will remain elusive.

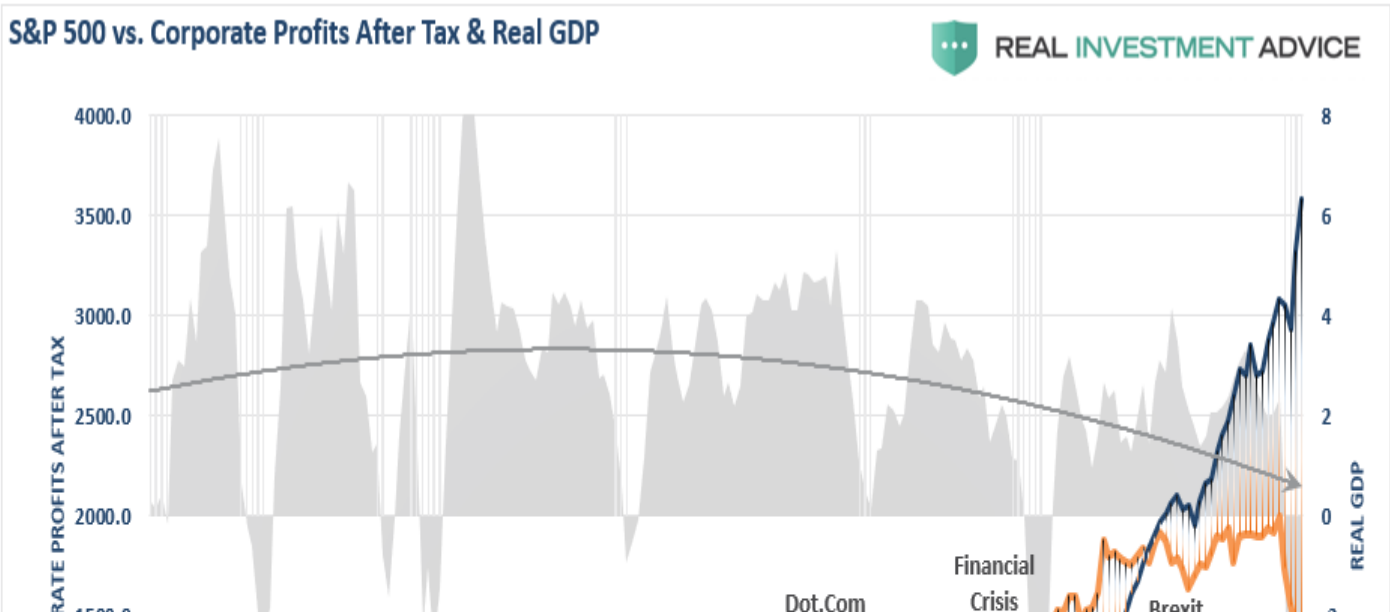
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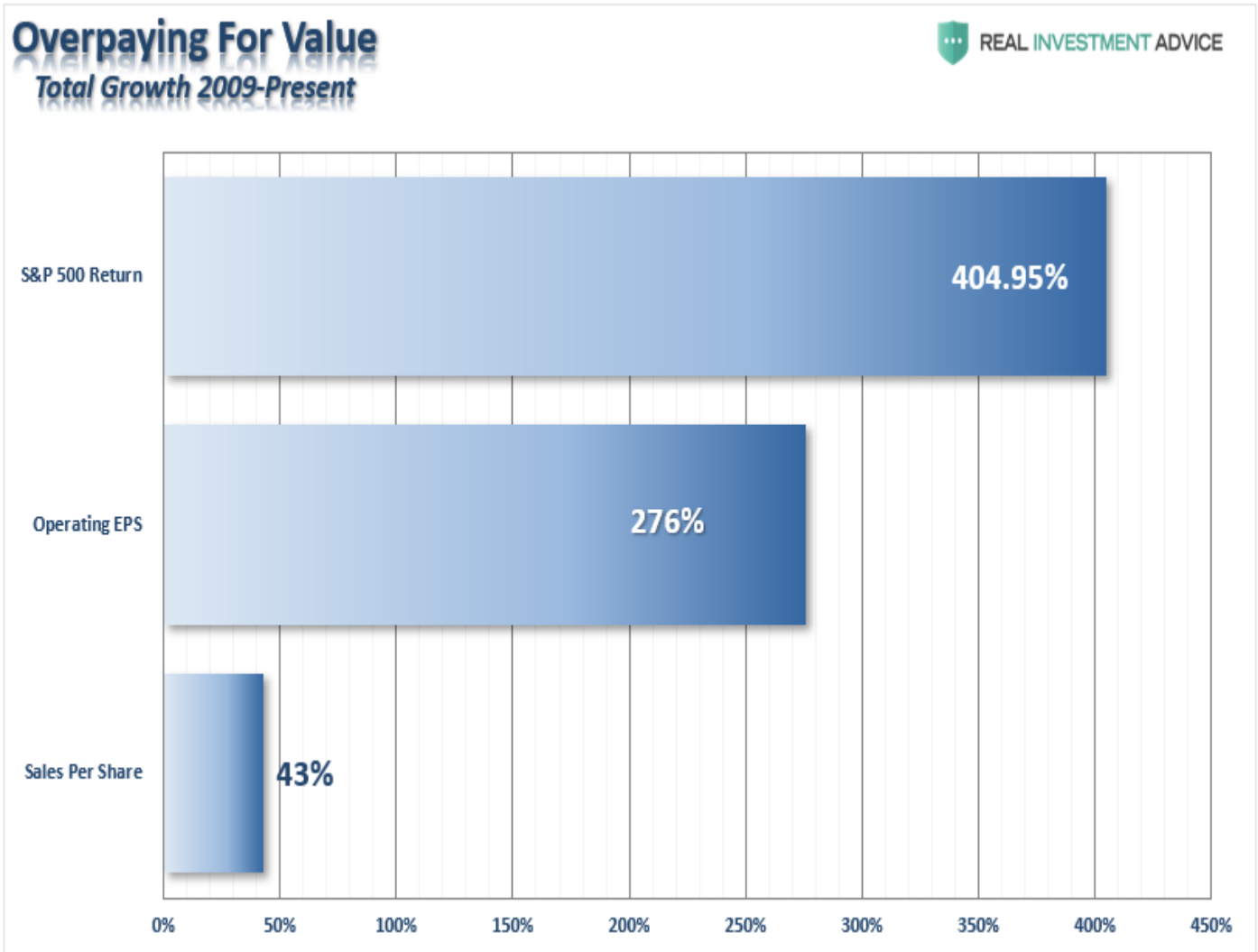
Stock Buybacks Likely Not Coming

Over the last several years, the stock market has surged higher as companies beat "earnings estimates" despite the lack of actual profits growth. As shown, corporate profitability, pre-pandemic had not grown since 2014 despite a surge in asset prices.



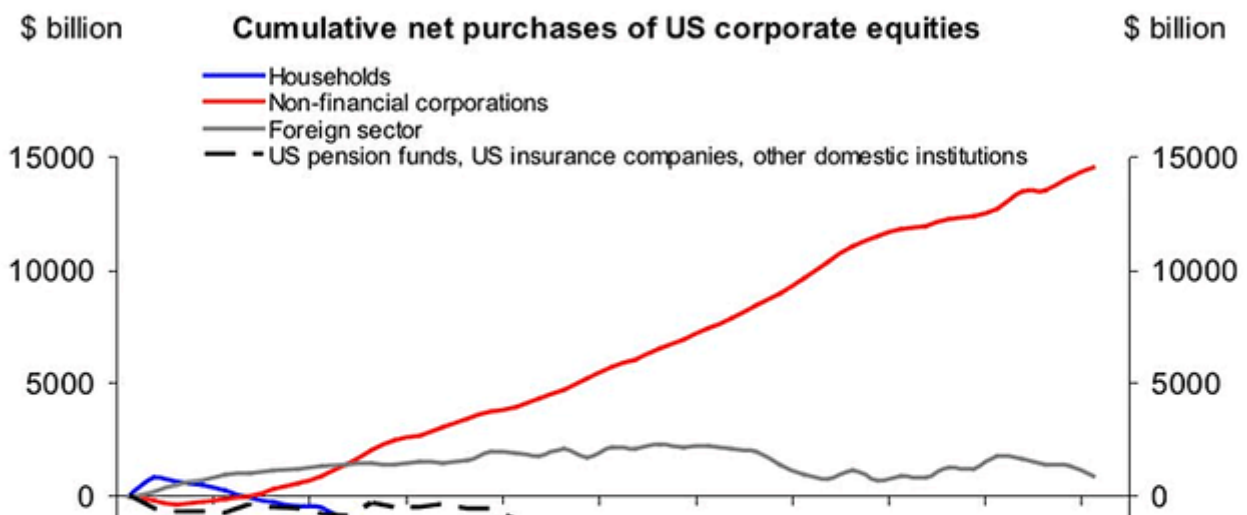
The support for asset prices came from improving bottom-line earnings per share. However, those improvements came not from rising revenue but rather massive indulgences of corporate share buybacks, which provided the illusion of improved profitability. [To wit:](#)

"Since 2009, the operating earnings per share of corporations has risen by 276%. However, the increase in earnings did not come from an increase in revenue. During the period, sales (which is boosted due share reductions) grew by a marginal 43%. However, investors have bid up the market more than 400% from the financial crisis lows of 666."



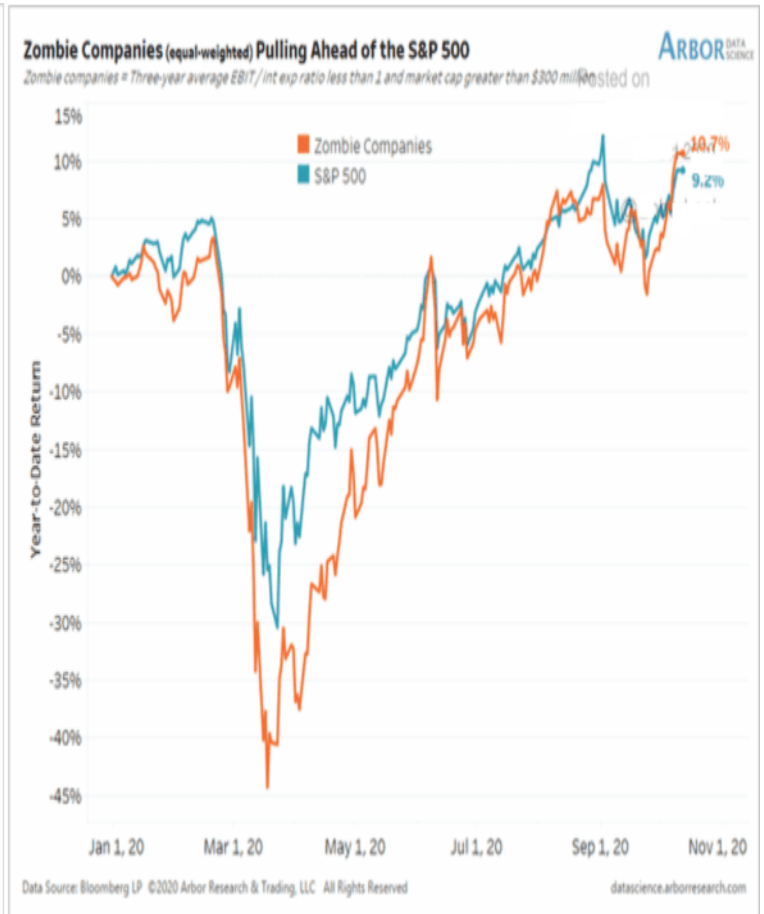
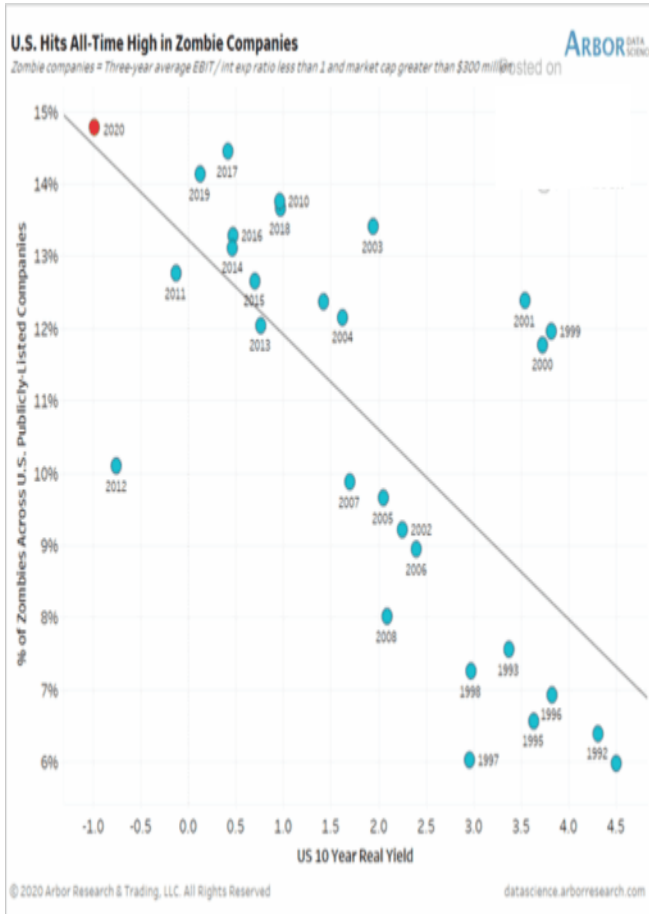
During that period, almost 100% of the net purchases of equities came from corporations.

What's the source of the rally in the stock market since 2009? Buybacks



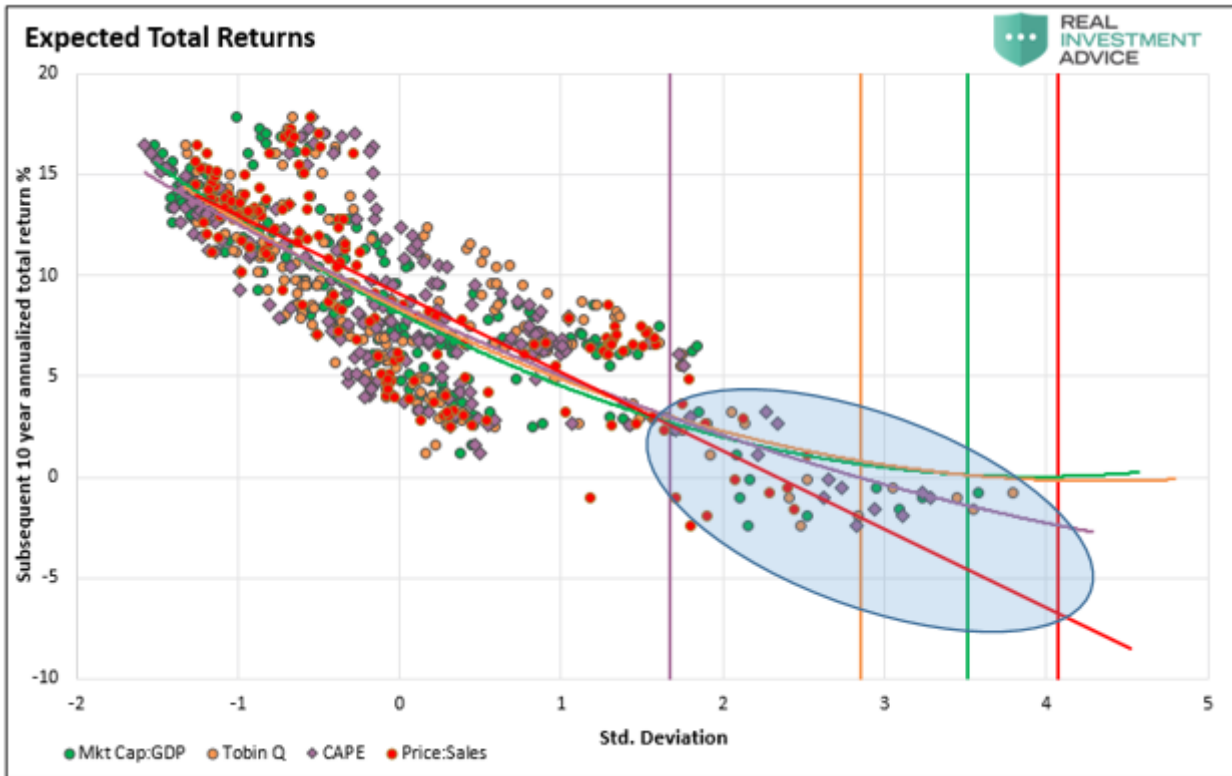
Given that many buybacks used debt issuance for financing, two problems will pose headwinds to manufacturing earnings in the future.

1. Corporations are cutting back on share repurchases due to poor corporate management optics and the need to conserve cash for operations and dividends.
2. With the highest level of "**Zombie Companies**" in the economy on record, the need for debt to remain operational will continue to divert issuance away from repurchases in the future.



The Risk Of Disappointment Is High

By no measure is the market valued at a level that supports current valuations. The average of the 10-year expected returns from four of the most popular measures is **-0.75%**.



While The Fed will continue to supply liquidity, their programs' efficacy has become less with each iteration. While monetary interventions allow market participants to ignore the reality of the economic ties to the market, as we saw in March, such does not preclude hair-raising volatility and large declines. **In 2021, earnings are likely to come in once again substantially lower than Goldman's high estimates.** But such shouldn't be a surprise since they are never accurate historically. More importantly, if the Fed backs off, whether by its design or due to inflation, slower economic growth, or massive debt overhead, rich valuations will matter. The risk of disappointment is high. And so are the costs of being "*wilfully blind*" to the risks.