

Investors hope for some cheer from earnings

By Masa Serdarevic in New York
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Investors will look to US companies to repeat last quarter's stellar earnings performance when they begin reporting second-quarter results next week.

The earnings season follows sharp losses in the stock market and comes amid growing concerns about the strength of the recovery in the US.

In the three months to the end of June, the S&P 500 index recorded its worst performance since the last three months of 2008, falling almost 12 per cent.

Second-quarter earnings for the companies in the index are expected to be more than 27 per cent higher than in the same period a year ago, according to analysts' forecasts collected by Thomson Reuters.

It would be the third consecutive quarter of earnings growth after profits plunged in the wake of the financial crisis and recession that followed the collapse of Lehman Brothers in 2008.

"The earnings season is likely to be pretty good," said Burt White, chief investment officer at LPL Financial, a network of broker-dealers.

"Companies have had every opportunity to come out and issue warnings recently. They could flush the bad news out with the bad market. But we've actually seen very little of that."

Analysts expect earnings in the materials sector to have grown most with a 94 per cent rise. In total, earnings are expected to improve in eight of the S&P 500's 10 sectors.

The telecoms and utilities sectors are the only two areas expected to report lower earnings than last year, down about 2 per cent and 5 per cent respectively.

One factor that may help reported growth is the fact that earnings were so weak in 2009. Earnings for companies in the S&P 500 fell 27 per cent in the second quarter of last year compared with the same period in 2008 as the US economy fell deeper into recession.

Recently, in spite of the stock market's falls, aggregate earnings forecasts for the S&P 500 companies in the second quarter have increased steadily as the end of June has approached, Thomson Reuters data shows.

Companies should not have trouble meeting their forecasts, said Steve Hagenbuckle, managing partner at investment company TerraCap Partners, but that was largely because they had been successful in revising expectations to lower levels.

“Many set themselves up to overachieve,” Mr Hagenbuckle said. “They should be able to make their numbers through a combination of cost-cutting, living off inventory and efficiency gains.”

Sharp movements in exchange rates, however, may have derailed some companies’ profit targets.

The euro has lost about a tenth of its value against the dollar during the second quarter, with important implications for companies which have a substantial portion of revenues denominated in euros.

“It is going to have some pretty large and unexpected effects,” said Wolfgang Koester, chief executive and chief currency strategist at Fireapps, a provider of foreign currency risk management services.

He cites the example of Priceline.com, an online travel agency, which announced in May that it was likely to miss average analyst estimates for the second quarter, hurt by a weakening euro. The company earns about half its revenues in the eurozone.

Last month Google’s revenue forecasts were cut by James Mitchell at Goldman Sachs and Douglas Anmuth at Barclays Capital, who both cited foreign exchange headwinds as a significant factor.

Last week a group of large-cap banks had their earnings estimates cut at Bank of America-Merrill Lynch. The broker cited “client inactivity” and lower investment banking revenues as risks to earnings.

The biggest downward revision was to Goldman Sachs, whose earnings estimate for the second quarter was cut to \$1.76 per share from \$3.57.

Investors will be watching companies’ outlook for the second half, especially as economists have recently reduced their growth expectations for the year. Alcoa will kick off the results’ season. It posts its earnings on July 12. JPMorgan reports three days later.