BlackRock

Healthy high-level earnings mask wide gulf between companies

A Q3 2024 earnings review from BlackRock Fundamental Equities. November 2024


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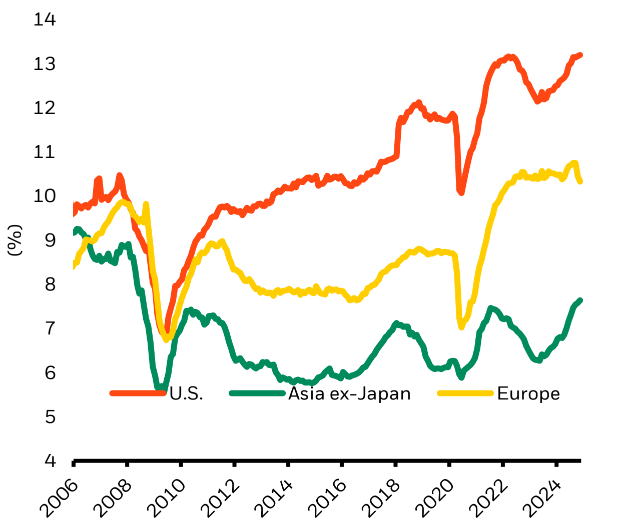
Profit margins have remained robust

Global 12m forward net profit estimates, 2006-2024



Source: BlackRock Investment Institute, November 11, 2024. The chart shows 12 month forward net profit estimates divided by sales estimates for MSCI equity market indexes.

[1] Source for all earnings numbers in this report: Barclays Equity Strategy, October 8, 2024.

[2] All company names in this report are for illustrative purposes only and should not be construed as investment advice or investment recommendation. Companies mentioned as most prominent examples of consumer spending recovery in Europe; Source: Barclays, October 2024.

[3] Hermes mentioned due to greatest Q3 revenue growth among European luxury.

Dispersion both between and within sectors

The Q3 earnings numbers portray a scene of corporate health. Earnings grew around 5% year-on-year in Europe and around 7% in the U.S.[1] In both regions, a majority of companies beat expectations and earnings outgrew sales – a theme of recent earnings season that has translated into rising profit margins since the COVID-19 pandemic. See the chart. Yet beyond the headlines, there were huge differences both between and within sectors. Even where earnings were solid, future outlooks in some areas shifted – with more significant impacts on share prices.

In the U.S., all eyes were on the big technology companies that dominate the S&P 500 index. Some of these names bounced as cloud demand beat expectations, and some slumped due to worries about the durability of artificial intelligence-related revenue. This dispersion, even among names that are often lumped together, was a theme of the earnings season. In Europe, financials and utilities both saw earnings grow about 20%, while energy and consumer discretionary earnings shrunk by 35% and 47% respectively. Yet the intra-sector dispersion is what really caught our eye, and it's this that provides opportunities for stock pickers to generate market-beating returns. Here are three areas of focus within portfolios:

Consumer. Comments from companies across the consumer sector paint a mixed picture. Most European companies that warned on earnings mentioned soft Chinese demand as a reason. Yet in Europe itself, there are signs of economic improvement: German sportswear brand Adidas, and e-commerce names About You and Zalando, all raised their earnings guidance, and in the UK, spending on clothing grew at the fastest pace since July 2022.[2] In the U.S., major payments companies said consumer spending is stable and healthy, although there is also evidence of price sensitivity emerging in areas such as groceries and travel.

The luxury sector has struggled as investors worry about global consumer weakness. But there are large differences between companies – with the high end of the high end outperforming. Hermes revenue, for example, grew 11%, while for some mid-range brands it declined up to 25%.[3] We believe brand heritage, design execution and exclusivity are key in the current environment.

Industrials. European companies exposed to data centres and electrification say business is booming globally. We would expect this to continue as large U.S. tech companies continue to expand spending plans, and believe it's an exciting, relatively cheap way to gain exposure to the AI theme. Another strong area is the aviation after-market, where supply shortages mean positive momentum for engine manufacturers. We see this situation lasting for the rest of the decade. On the other side of the sector, companies more exposed to short-term economic fluctuations continue to struggle, as an industrial destocking cycle that has been going on for more than three years is yet to end. Yet even here there are bright spots, such as cement companies who see long-term demand from data centre construction and for "green" cement.

Semiconductors. Some of the world's largest semiconductor and semiconductor equipment makers posted differing results in the third quarter, with some steaming ahead and some faltering. The dispersion is due to a host of industry-specific shifts and competition between major players. Yet the overall trend remains clear: while some parts of the semiconductor industry, such as those supplying chips for smartphones and PCs, are stuck in the cyclical doldrums, the race to develop more and more powerful AI tools is a significant long-term source of support. Some of the world's leading semi companies are in Europe, and we believe those with dominant market positions and unique products are well placed to outgrow the sector as a whole over the long term.

This earnings season confirmed what we have been saying for some time: dispersion between earnings is likely to increase in this new era of higher-than-zero rates and increased volatility. This provides great opportunities for active managers to outperform.

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