MAY 2022

US Equity Perspectives

Volatile earnings season buffeted by multiple cross currents

Summary

- The past weeks had been a wild ride for markets with the S&P 500 Index and Nasdaq Composite Index falling 8.8% and 13.3% respectively in April 2022, before posting a rebound in early May.
- As the US market headed into the 1Q22 reporting season, investors had much less visibility compared to previous quarters given multiple cross currents including geopolitical impact, food and energy cost spikes in 1Q22, supply chain issues and fears of a sharper macro deceleration.
- Although 1Q22 earnings was a slight beat, forward guidance was weak, leading to FY22-23 earnings per share (EPS) estimates being trimmed. Volatility has been extremely high, with companies that missed expectations severely punished.

US tech megacap earnings not immune to market headwinds, Covid beneficiaries struggle

- Streaming was weighed down by uneven/weak net subscriber adds, as well as concerns around increased market saturation and competition.
- Digital advertising trends were healthy, but continued to be impacted by privacy policy changes, the shift to short video formats with lower monetisation, and competition from emerging platforms.
- Ecommerce faced headwinds from difficult compares and inflationary pressures, as fuel and transportation costs spiked in 1Q22.
- Enterprise software and public cloud seemed to be the only standout segment with little sign of slowdown.
- Despite near-term challenges faced by the tech megacaps, we note that overall valuation is not demanding, with many trading at multi-year low valuations despite secular thesis being intact. In the near term, our preference stays with the enterprise software segment.

US bank earnings beat estimates but expect more volatility ahead

- The largest US banks mostly beat estimates on both earnings and revenue lines for 1Q22. Key trends included weaker investment banking revenue, an encouraging loan growth and net interest income (NII) picture, and manageable Russia exposure, though credit provisioning ticked higher.
- Looking past 1Q22, loan growth started off solidly in 2Q22, while NII will be supported as more rate hikes are expected. Fee income is likely to remain weak. Credit quality is holding up, but one needs to keep an eye on signs of softness given expected macro deceleration.
- Fears of a hard landing may keep banks volatile, but valuation is starting to look attractive. Within our coverage, we prefer banks leveraged to the rate hike cycle, with higher rate sensitivity coupled with a lower credit risk profile.

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Volatile 1Q22 earnings season buffeted by multiple cross currents

The past weeks had been a wild ride for the markets with the S&P 500 Index and Nasdaq Composite Index falling 8.8% and 13.3% respectively in April 2022, before posting a rebound in early May.

As the US market headed into the 1Q22 reporting season, consensus was expecting a sharp deceleration in earnings growth (+5% year-on-year) compared to 2021 when growth ranged from 28-92%. This was due partly to a high base effect, as well as margin compression due to inflationary pressures.

Investors also had much less visibility heading into reports compared to previous quarters given multiple cross currents including geopolitical impact, food and energy cost spikes in 1Q22, supply chain issues and fears of a sharper macro deceleration.

As the 1Q22 earnings season progressed, consensus 1Q22 EPS had risen slightly since 1 April 2022 (see Chart 1), pointing to earnings growth of 6%. Around 50% of companies beat consensus on both revenue and EPS, though forward guidance remained weak, leading to FY22-23 EPS estimates being trimmed. Volatility has been extremely high, with companies that missed expectations severely punished.

April 2022 was also marked by the sharp underperformance of Growth stocks against the broader market, impacted not just by sentiment around rising rates, but also weakening fundamentals.

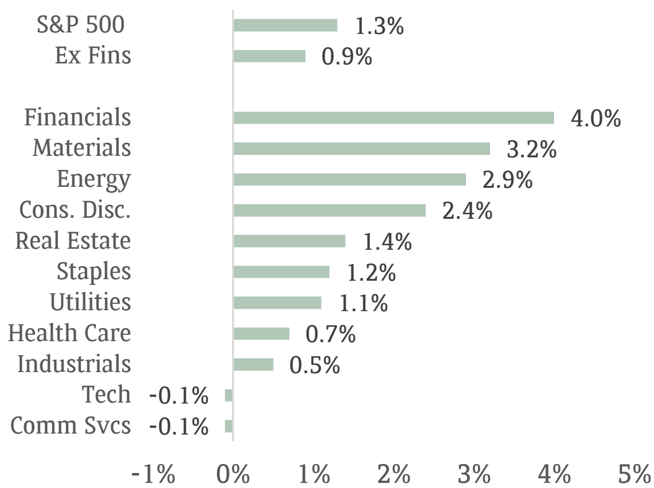
US tech megacaps not immune to headwinds

The major US tech megacaps have reported their quarterly earnings. As with the rest of the market, Covid beneficiaries saw difficult compares and pull forward of demand which had impacted results negatively.

- Streaming was weighed down by uneven/weak net subscriber adds, as well as concerns over increased market saturation and competition. Meanwhile, spending on content is expected to remain high.
- Digital advertising trends were healthy, but continued to be impacted by privacy policy changes, the shift to short video formats with lower monetisation, and competition from emerging platforms. There have been fears of decelerating trends going forward as advertising revenues tend to be highly correlated with economic activities.
- Ecommerce faced headwinds from difficult compares and inflationary pressures, as fuel and transportation costs spiked in 1Q22. The ongoing unionisation drive may result in higher wage costs down the road.
- Enterprise software and public cloud seemed to be the only standout segment with little sign of slowdown. This is indicative of the fact that digital transformation remains a high priority within corporates.

Despite near-term challenges faced by the tech megacaps, we note that overall valuation is not demanding, with many trading at multi-year low valuations despite secular thesis being intact in our view. In the near term, our preference stays with the enterprise software segment.

CHART 1. REVISIONS TO CONSENSUS 1Q22 EARNINGS SINCE START OF APRIL 2022



Source: BOAML, as of 25 April 2022
Past performance is not indicative of current or future performance.

Spotlight on US banks

Earnings beat but expect more volatility ahead

The largest US banks' 1Q22 results beat consensus on both earnings and revenue lines. Here, we highlight a few broad themes that we have gleaned from the earnings season:

- Mixed capital market business performances. Increased market volatility proved positive for trading businesses, notably Fixed Income, Currencies and Commodities (FICC), but negative for investment banking, given the lower appetite for deal making. Investment banking revenue fell sharply across all the major US banks due to a slowdown in initial public offering (IPO) and special purpose acquisition company (SPAC) listings, a key source of business last year. But M&A advising fees was a bright spot, supported by deals announced last year.

- The NII picture was encouraging. The banks provided improved guidance for NII, given expectations for a higher number of rate hikes. Deposit betas (the responsiveness of banks to deposit repricing to reflect changes in market rates) are expected to rise more slowly than prior rate-rising cycles given unprecedented levels of liquidity on banks' balance sheets.

- Loan growth picked up more broadly with robust credit card spending. Mortgage lending came under pressure on rising rate concerns.

- Russia exposure manageable – Banks provided more clarity on their exposure, with no big negative surprises. While exposure was generally viewed as manageable, the banks did express concerns about the potential spillover effects.

- Provisioning for bad credit has returned, notably for those names with Russia-related exposure.

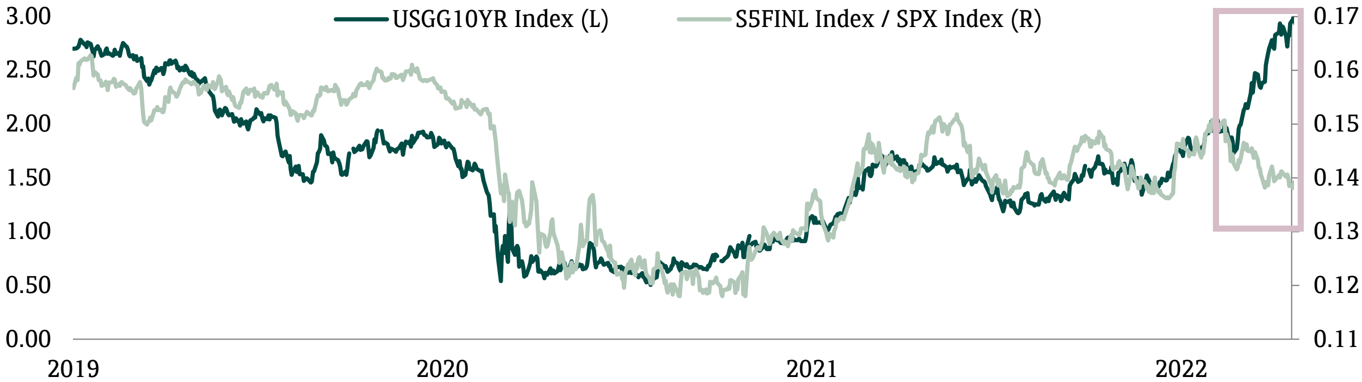
Our thoughts

Russia-related losses reported were small relative to sector earnings, reinforcing the view that direct exposure amongst the big names has been limited. However, second-order volatility in the marketplace remains difficult to predict. As a major bank CEO commented, "the Russian invasion has further complicated the geopolitical landscape and created an additional level of uncertainty that I expect will outlast the war itself."

Looking past 1Q22, loan growth started off solidly in 2Q22, while NII will be supported as more rate hikes are expected. Fee income is likely to remain weak. Credit quality is holding up, but one needs to keep an eye on signs of softness given expected macro deceleration.

Fears of a hard landing may keep banks volatile, but valuation is starting to look attractive (see Chart 2). Within our coverage, we prefer banks leveraged to the rate hike cycle, with higher rate sensitivity and a lower credit risk profile.

CHART 2. FINANCIAL SECTOR NAMES LAGGING THE BROAD MARKET DESPITE RISING YIELDS



Source: Bloomberg, as of 5 May 2022
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