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Wall Street's Earnings Forecast: Cloudy With a Chance of Turbulence

Coronavirus uncertainties prompted hundreds of companies to pull their guidance, blinding analysts and investors

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By Michael Wursthorn
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The coming earnings season poses a big test for investors and analysts, who say they are flying blind like never before.

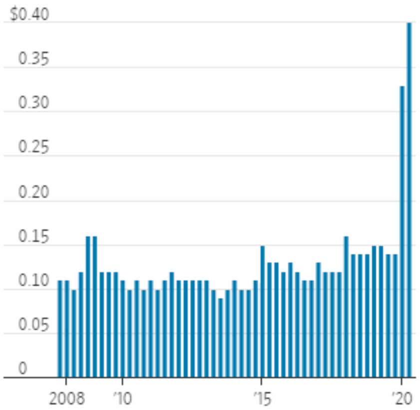
More than 180 companies in the S&P 500 have pulled their earnings guidance in the wake of the economic crisis wrought by the coronavirus pandemic, limiting the visibility of investors. That has led to the widest dispersion in earnings estimates among analysts since at least 2007.

Economists generally agree the recently completed second quarter was likely the trough of the downturn, but the extent of the damage is still unclear. JPMorgan Chase & Co., Goldman Sachs Group Inc. and Netflix Inc. will be among the first companies to open their books, when they unofficially kick off earnings season this week.

Mind the Gap

The median spread between analysts' highest earnings-per-share estimates and their lowest has widened in the absence of corporate guidance this year.

Median spread in analysts' earnings estimates, by quarter



Source: Dow Jones Market Data, FactSet

"I've either been on the phone with folks in the industry or talking to clients nonstop since March," said Jack Atkins, a managing director who focuses on the freight industry at Stephens Inc. "Every day, seven days a week, we have been trying to figure out what's going on. It's been extremely busy and challenging."

The stock market has remained resilient, despite the hazy outlook. The S&P 500 has surged 42% from its March low thanks to high levels of stimulus from the Federal Reserve and Congress. Although the rally has slowed over the past month, the index is off just 1.4% in 2020.

Overall, corporate earnings among companies in the S&P 500 are projected to have fallen nearly 45% in the second quarter from a year earlier, according to analysts polled by FactSet. All 11 sectors of the index are expected to post declines, with energy, consumer-discretionary and industrial companies seeing the biggest drops. Profits are expected to continue falling in the third and fourth quarters, though at more modest levels, before beginning to climb in the first quarter of next year.

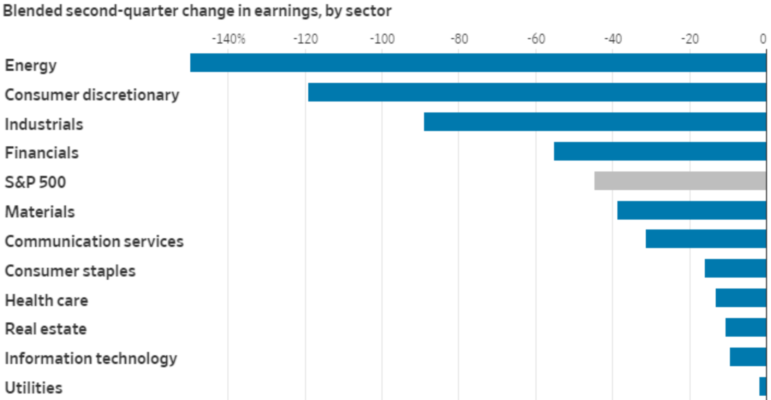
Even before the pandemic, more companies had stopped offering financial guidance. Critics of the practice, including JPMorgan Chief Executive James Dimon and investor Warren Buffett, have argued it promotes a short-term view of corporate success.

Analysts say the guidance is necessary for investors to make knowledgeable decisions and sometimes to keep companies honest. It can also help curb volatility in stocks following the reports.

Profit Ditch

Analysts predict earnings contracted across all 11 S&P 500 sectors in the second quarter, despite a lack of visibility into some companies.

Blended second-quarter change in earnings, by sector



Note: Blended growth includes estimates and reported results for 19 companies through Friday.
Source: FactSet

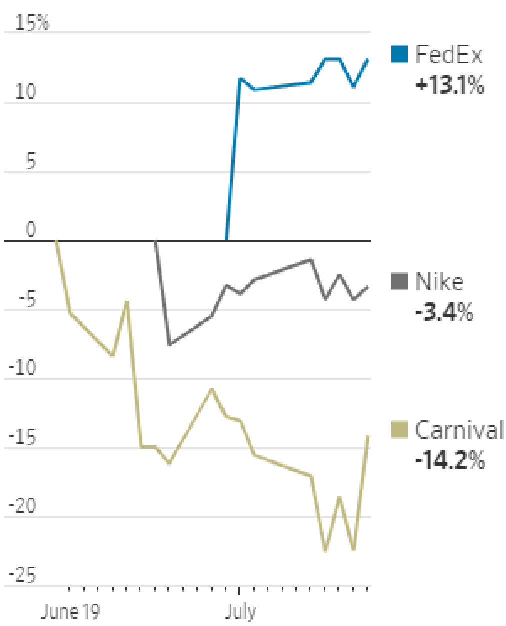
With limited corporate guidance, the median spread on analysts' earnings forecasts for companies in the S&P 500 has jumped to 40 cents for the second quarter from 30 cents in the first, according to Dow Jones Market Data. In comparison, the median spread ranged from 9 cents to 16 cents over the previous 13 years.

The wide gap suggests stocks could be in for a wild ride. That has happened increasingly in recent weeks when Wall Street's predictions were wildly off base.

Take FedEx Corp. After suspending its guidance in March, the global shipping company surprised analysts and investors with profit of $2.53 a share when it reported quarterly results on June 30. That topped the average forecast of $1.58 from 22 analysts. Shares of FedEx tore higher after the report, rising nearly 20% over the next two trading days.

Mr. Atkins was among analysts whose estimate fell short. Without any guidance from the company, he leaned on commentary from rival United Parcel Service Inc., which had said in April that its business mix was shifting away from business-to-business and toward consumers, which tends to be more costly and less profitable.

Share-price performance since reporting quarterly results



Source: FactSet

Mr. Atkins revised his model to assume FedEx would take a similar hit. "What we didn't anticipate was the extraordinary level of volume we saw at FedEx in ground [shipping], which helped mitigate some of the makeshift changes," Mr. Atkins said.

The opposite move played out after Nike Inc. reported results on June 25. The sport-apparel retailer posted a loss of 51 cents a share, well outside the range of analysts who called for a 55-cent profit to a 38-cent loss. Nike shares fell nearly 6% over the following two days.

Analysts aren't just struggling with earnings forecasts. Economic data have also proved difficult to estimate. Unemployment figures for both May and June, for example, came in ahead of expectations, leaving investors and economists scratching their heads.

“We are all in one way, shape or form operating in uncharted waters,” said Harry Curtis, a managing director at Instinet Inc.

Mr. Curtis covers casinos, lodging and cruise lines, three industries hit particularly hard by the coronavirus crisis. Creating new balance-sheet models has been relatively straightforward for those companies, especially the cruise-line operators, because revenue is basically zero or down sharply from a year earlier, he said.

But analysts are missing those marks as well. Carnival Corp., which suspended its guidance for the year in March, reported on June 18 a loss of $3.30 for the three months ended in May. Predictions from the 14 analysts who cover the stock ranged from earnings of 60 cents a share to a loss of $2.50. Mr. Curtis fell in between those, predicting a loss of $1.97. Carnival shares slid 16% over the two subsequent trading sessions.

At a time like this, Mr. Curtis said, analysts better serve their clients by looking further ahead. He said he now focuses on whether a company can survive a prolonged downturn and when investors can hope to see some sort of recovery.

“The job has changed,” Mr. Curtis said. “Stock valuations really are now based on earnings power two years out.”

Before the pandemic, the big banks that will be in focus this week rarely offered financial guidance, said Gerard Cassidy, a managing director and head of U.S. bank equity strategy at RBC Capital Markets.

Analysts usually had some insight into their credit losses, a variable in determining bank profits. That has changed, and data suggesting the U.S. economy is recovering faster than expected has muddied the outlook, Mr. Cassidy said.

There is one bright spot, though. Some analysts hope the fledgling recovery might entice more companies to predict what the future holds.

“There’s still a number of unknown factors out there,” said Mr. Atkins of Stephens. “But we have six months in the bag. To the degree companies feel we’re on an upward trajectory from where we were three months ago, some companies could opt to give guidance.”

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