



A Fall in Earnings Estimates Could Worsen Sell-Off



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KEY INSIGHTS

- Rising recession concerns have exacerbated the stock market sell-off, and major indexes are now in or near bear market territory.
- Given optimistic forward earnings estimates, we believe current stock prices may not have fully baked in a recessionary scenario.



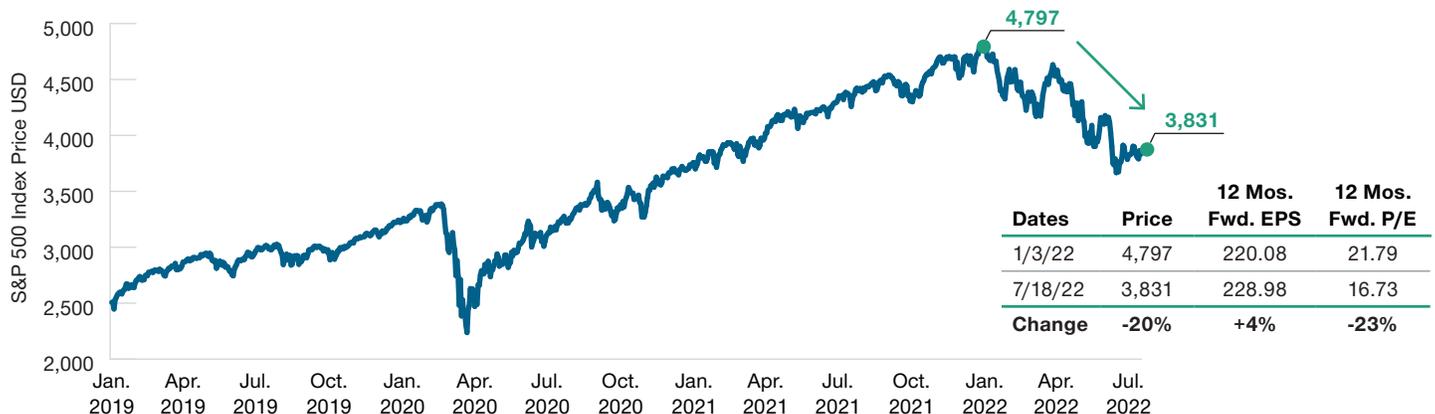
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Deepening recession concerns have caused stocks to sell off precipitously in 2022, and major indexes recently reached bear market territory—meaning that they had fallen at least 20% from their recent highs. An in-depth look at the sell-off reveals that it has primarily been driven by a decrease in price-to-earnings (P/E) multiples (Figure 1).

Although some investors may conclude that stock valuations have now become reasonable, it is important to note that, despite numerous signs of looming economic weakness, earnings estimates have not adjusted downward this year. So far in 2022, the 12-month forward earnings estimates have, in fact, risen by 4%. Therefore, while the current P/E ratio seems attractive, it is based on a very optimistic outlook for company earnings.

Anatomy of the 2022 Sell-Off

(Fig. 1) The price-to-earnings (P/E) ratio of the S&P 500 has declined, but forward earnings estimates remain overly optimistic



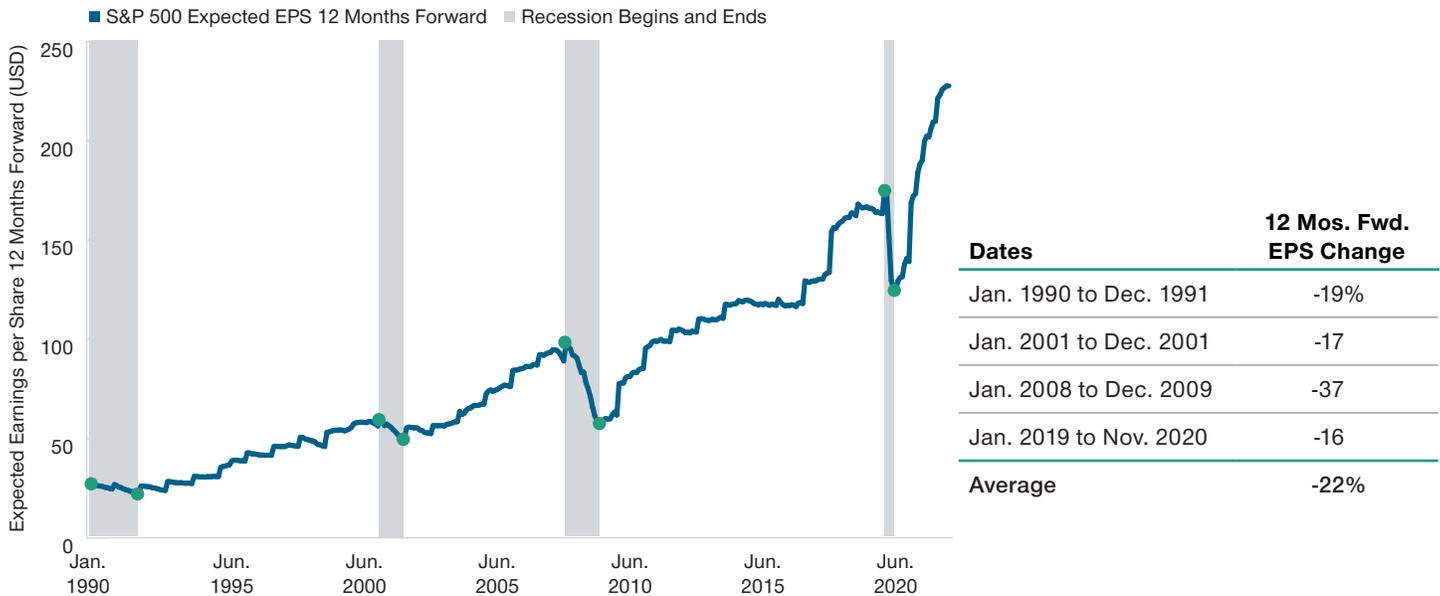
January 1, 2019, to July 18, 2022.

Past performance is not a reliable indicator of future performance.

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How Far Could Earnings Estimates Fall?

(Fig. 2) Earnings estimates have fallen meaningfully during past recessions



January 1990 to June 2022.

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For investors evaluating the current market environment, a review of historical data showing how earnings estimates have behaved during past recessions can be informative. Notably, an analysis of earnings estimates for companies listed on the S&P 500 Index since 1990 shows that during each of the past four recessions, earnings estimates fell sharply, with an average drop of 22% (Figure 2).

Overall, stock prices seem more reasonably priced relative to their peaks early in the year. However, in our view, a recessionary scenario may not be fully baked in to the current share prices because earnings expectations remain too optimistic. As a result, our outlook remains cautious, and our Asset Allocation Committee maintained an underweight allocation to stocks relative to bonds.

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