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LEADING THOUGHTS

Seven Crucial Questions this Earnings Season Can Answer

As investors strain to imagine the post-pandemic normal, a blurry vision is already coming into view.

Roughly halfway through this earnings season, markets seem cautiously impressed. Aside from a little chatroom-fueled volatility, risk assets continue to drift higher. While cheerier global economic reports have been accumulating for weeks, they only record past measures of recovery from the pandemic shock. The collected mosaic of corporate stories, however, offers a blurry picture of the future, or at least some tentative answers to crucial investor questions.

1. **Is the end in sight?** Yes. These are the first corporate reports since vaccines arrived and the first that are delivering growth compared to a year ago, before widespread lockdowns. Vaccine rollouts have hit snags and the contagious new virus strains may pose risks, but the trajectory remains unquestionably positive. So far, more than three-quarters of the reports have beat sales and earnings estimates. That's good even in a world of corporate guidance that is gamed to deliver happy surprises. More important, the tone of the conference calls has done little to undermine the broader narrative.

2. **Can stocks go higher? Can spreads get tighter?** Possibly, at least a little. Much of the equities rally last year came from multiple expansions as the world's central banks delivered rock-bottom rates and promised to keep them there. Higher multiples are as hard to imagine as lower rates, as are tighter corporate spreads. This means the hard work of delivering returns will have to come from rising earnings. So far, so good.

3. **Are banks sound?** Yes, whew! There are few thoughts more chilling than a pandemic that might have struck in 2008, shutting down the global economy and taking the undercapitalized financial system with it. Bank earnings have been battered by the past year, but the likes of J.P. Morgan and Citigroup entered the crisis with plenty of capital and are already releasing reserves they had set aside as fears of COVID-triggered defaults recede.

4. **Will we still spend more time at home?** Almost certainly. Amazon, the bellwether for bringing the world to your couch, reported $100 billion in quarterly revenue for the first time, confirming just how much online retailing continues to embed itself in our daily patterns. Pinterest and Snap reported their revenues were roughly two-thirds higher than the same period last year. And for those looking for entertainment while they weren't shopping, Activision Blizzard, designers of the famed Call of Duty video game series, reported 24% revenue gains.

5. **Will technology continue to drive change?** Absolutely. Apple reported a blowout quarter as iPhones continue to find new hands to hold them. Microsoft beat revenue expectations for its Azure public cloud business, while Texas Instruments reported strong demand for its line of personal electronics. Watch for Zoom's numbers this week, but there does not appear to be any let up in the ways new technological tools continue to transform corporate business models and personal habits.

6. **And climate?** Corporate efforts to boost renewable energy and reduce carbon footprints were accelerating before quarantines shut down business travel or a new U.S. administration announced new commitments to address climate change. While missing earnings expectations this time, Tesla predicted 50% average annual growth over the next few years. Ford reported a loss last year but announced a whopping increase in its electric vehicle expansion to $29 billion (higher still than General Motors' $27 billion). Meanwhile, last year's collapse in oil prices and grim outlook for the industry has triggered talk of consolidation.

7. **What about supply chains?** Any shock and recovery even half the scale of last year's puts enormous stress on the world's supply chains, which were already shifting around geopolitical tensions and tariff wars. The unmistakable worry now is the shortage of semiconductors that comes from the cyclical demand for new technology and the secular transformation in many industries—including all those new electric vehicle production lines. International Paper and Peloton reported higher supply chain costs from surging demand. Companies that can't manage these strains will struggle next year.

A good earnings season is hardly a guarantee of a great year ahead. The true scars of the crisis are yet to be fully revealed and the headwinds from long-term secular stagnation remain a challenge. Still, the image coming into view offers a dim outline of what the new "normal" may bring, and it already looks better than we might have expected when winter struck.

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