MAGNUS FINANCIAL GROUP

INSIGHT & PERSPECTIVE

Earnings Revisions Should Set a Careful Tone

January 30, 2019

Analysts have been busy reducing their earnings estimates for 2019 and earnings season commentary from key U.S. companies has been somewhat cautionary so far.

An easing of broad economic conditions, slowing activity in China, trade issues, and the U.S. government shutdown have all been raised as potential drags on corporate earnings growth.

Consensus S&P 500 Earnings Estimates Coming Down

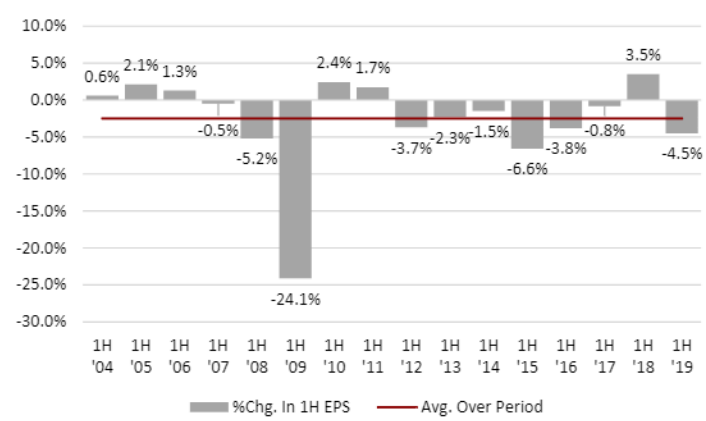
Early 2019 earnings news has been highlighted by a few key companies guiding their earnings targets lower for the year. Investors have stepped somewhat cautiously around names such as Caterpillar, 3M, Intel, and Apple after management guided revenue and/or earnings estimates down. Most have cited broader economic or China-specific uncertainties for their more cautious approach to their forecasts. While the names we mentioned certainly capture headlines, what may be flying a bit under the radar for most is that earnings estimates for S&P 500 Index companies broadly have been falling materially.

According to FactSet Research Systems (an aggregator of earnings estimate data), cuts to projected earnings estimates for the first half of 2019 have been the most pronounced in four years. On Jan. 18, FactSet indicated the combined earnings growth estimate for Q1 and Q2 2019 had fallen by 4.5%; the steepest drop since the first half of 2015. Over the last fifteen years, only estimate revisions in 1H (first half) 2015, 1H 2008, and 1H 2009 have proven worse than we have seen so far in 2019.

On Jan. 25, FactSet updated the consensus S&P 500 earnings growth estimates to read +0.7% year-over-year for Q1 2019, +2.4% for Q2, +3.1% for Q3, and a bullish +11.1% for Q4. For 2019 in total, FactSet indicated consensus earnings growth now stands at +6.3%, down materially from

Figure 1: First Half Consensus EPS Estimate Revisions for S&P 500

Source: FactSet Note: Estimate revisions measured Oct 15 to Jan 15 EPS = earnings per share

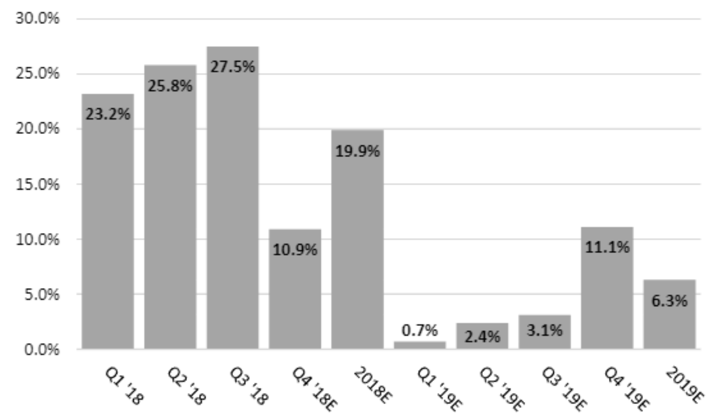


previous estimates. We are giving due attention to earnings developments as they will likely impact how investors view market conditions this year.

Figure 2: Year-over-Year EPS Growth - S&P 500 Index

Source: Thomson Reuters; FactSet E = consensus estimates as measured by FactSet

In our view, the material downshift in EPS growth expected this year is a key reason to be well-disciplined when it comes to choosing the proper equity exposure for 2019.



Earnings Estimates May Be Revised Lower Still

While 2019 earnings estimates have been materially curtailed over the last few months, economic data we monitor may indicate that analysts could have more work to do to bring down forecasts. For starters, estimates for Q4 2019 seem a bit out of line, which can be typical as analysts hold out hope for a late-year earnings recovery amid the paring of expectations. Eventually, in our view, those Q4 forecasts could fall as well. However, more important than the behavioral aspect of earnings forecasting, what we have witnessed in recent Institute for Supply Management (ISM) New Orders data may point to further reductions in earnings estimates still to come.

Figure 3 on the next page points to the correlated relationship between S&P 500 forecasted Earnings Before Interest and Taxes (EBIT) and ISM Manufacturing and Non-Manufacturing New Orders survey data. The correlation between the two data sets is .715 over the time horizon presented. If history is any guide, the recent erosion in ISM New Orders (see 3-month moving average) may be a precursor to future estimate reductions. Indeed, the chart seems to indicate that ISM New Orders leads a change in EBIT estimates, which stands to reason.

Granted there are low interest rate and low tax rate benefits to final earnings-per-share (EPS) numbers reported by S&P 500 constituents that are not fully captured in this chart. The correlation between EPS estimates (including interest expense and taxes) over the time horizon presented is .663; indicating a positive relationship. However, the underlying earnings power (EBIT) of S&P 500 companies, perhaps influenced by the directional change in New Orders, is something in which investors may want to take note.

Historically, ISM New Orders have led a change in EBIT estimates or a measure in the underlying earnings power of constituent companies.

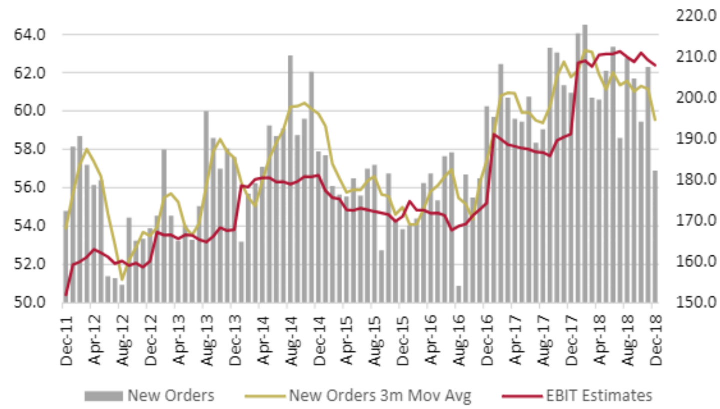
EBIT = Earnings Before Interest and Taxes

The recent drop in New Orders and the potential for further weakening (given slowing economic conditions) may help prompt analysts to further modify their projections.

In terms of Figure 3, the EBIT estimate (red line) could fall to more closely mirror the trajectory of the ISM 3-month moving average (gold line).

Figure 3: ISM Manufacturing & Non-manuf. New Orders vs. S&P 500 EBIT Estimates

Source: Institute for Supply Mgmt (ISM); Bloomberg - EBIT estimates based on Bloomberg consensus



What Does This Mean?

In our view, the inputs from New Orders data and recent downgrades in earnings projections seem to fortify a note of caution for equity markets in 2019. While these numbers alone may not spell a bad year for stocks, they may be foundational in how investors choose to think about risk management in their multi-asset portfolios. Earnings are indeed important to how investors view the likely performance of stocks. As such, the slowing or change in the earnings trajectory may cause investors to take less risk in equity portfolios and hold down their return expectations this year.

Risks

Investors should be aware of the risks associated with all portfolio strategies, and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, and other geopolitical events can have a substantial effect on portfolio performance, our macroeconomic theories, and the effectiveness of strategic and tactical portfolio approaches.

Important Disclosures: ***This commentary was not written by Magnus Financial Group LLC; rather, it was prepared for Magnus Financial Group LLC by Bower Hill Capital Management, a registered investment adviser in the Commonwealth of Pennsylvania.***

This material is for informational purposes only. It is not intended as and should not be used to provide investment advice and is not an offer to sell a security or a recommendation to buy a security. This summary is based exclusively on an analysis of general market conditions and does not speak to the suitability of any specific proposed securities transaction or investment strategy.

Judgment or recommendations found in this report may differ materially from what may be presented in a long-term investment plan and are subject to change at any time. This report's authors will not advise you as to any changes in figures or views found in this report.

Investors should consult with their financial advisor to determine the appropriate investment strategies and investment vehicles. Investment decisions should be made based on the investor's specific financial needs and objectives, goals, time horizon and risk tolerance.

Except for the historical information contained in this report, certain matters are forward-looking statements or projections that are dependent upon risks and uncertainties, including but not limited to factors and considerations such as general market volatility, global economic risk, geopolitical risk, currency risk and other country-specific factors, fiscal and monetary policy, the level of interest rates, security-specific risks, and historical market segment or sector performance relationships as they relate to the business and economic cycle.

Information relating to investment advisory services offered through Magnus Financial Group LLC, an SEC registered investment advisor, can be found at the following address:

MAGNUS FINANCIAL GROUP LLC

280 Park Avenue, 25th Floor West, New York, NY 10017

800-339-1367

www.MagnusFinancial.com