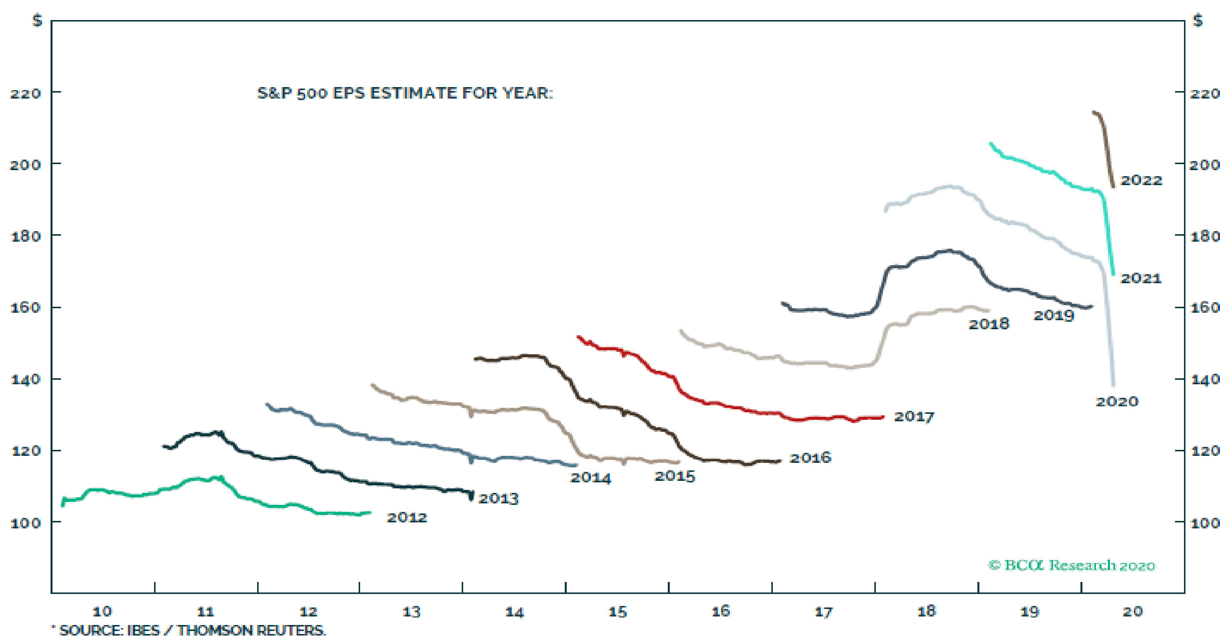
Moving Targets: When do Earnings Estimates Stop Falling?

Earnings estimates have fallen just in time for the current reporting season, thus helping many companies exceed the latest forecasts by the analyst community. It has become common practice that analysts have to downgrade their overly optimistic numbers during the course of the year, but 2020 is a special case given the magnitude and timing, with forecasts for earnings not to recover to pre-pandemic levels until 2022 at the earliest. Whether these forecasts are still optimistic will depend on the length of the lock-downs and if we can avoid a second wave of infections; the gradual re-opening of countries is encouraging but the past history of both the SARS pandemic and the Spanish Flu are not, especially as the second wave proved to be more virulent than the first.



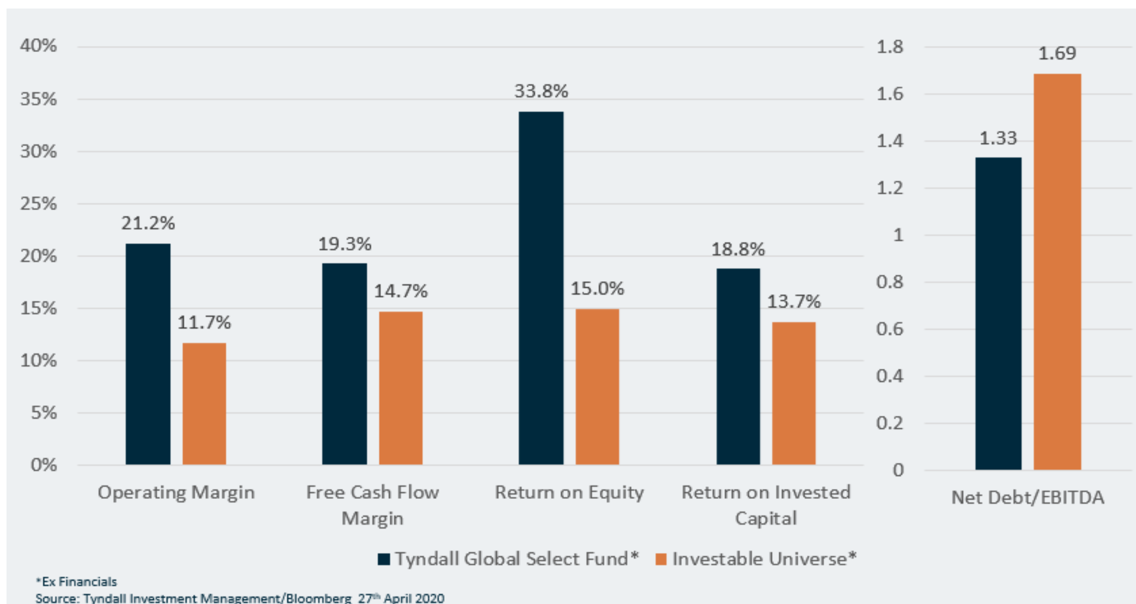
Many companies have fared remarkably well given the economic backdrop of the past few months. There is general acceptance of it being totally reasonable to forgo guidance on the grounds that the pandemic clouds visibility to such an extent that any numbers given may differ materially from reality. All these factors have helped equity markets recover much of the losses incurred in March.

The range of sectors seeing better than expected trading statements has been disperse and selective. As a result, we have seen significant volatility in share prices, as well as those of commodities (including oil!). The quality end of the spectrum has not escaped this phenomenon, as even Unilever and Nestlé produced quite contrasting reports of underlying growth; happily, we hold Nestlé, which saw organic growth of 4.3% compared to Unilever's 0.2%. Similarly Nike (held in the Fund) has weathered the closure of its stores remarkably well given the strength of its on-line offering and remains net cash, meanwhile Adidas has resorted to requesting a $3.3 billion government backed loan and halted dividend payments to ensure it has the ability to withstand the pandemic.

The key to near-term outperformance, however, is identifying when trough earnings are likely to occur, as sustained recovery is unlikely to happen until the market begins to identify that the light at the end of the tunnel is getting brighter. Over the last three 20% market declines earnings revisions have bottomed 19-28 days after the price, and thus if (and it is a big if) March 23rd was the bottom of the market we should be approaching the end of negative earnings revisions soon.

Over the longer term, however, we believe that predictability in cash flow and growth are likely to continue being two of the primary factors of outperformance. Ability to adapt to market conditions and continuing to invest throughout the cycle will drive sustainability, as, in the words of John Donahoe, the CEO of Nike (another of our holdings), 'it is in times like these that strong brands become stronger'. We expect that going forward Return on Invested Capital will be lower than we have seen in recent times, as companies will be incentivised to run larger buffers and spending in contingency planning, so having a portfolio of companies with a significant buffer between ROIC and their cost of capital is a sensible strategy.

VT Tyndall Global Select Fund Metrics: If the Fund was a Business…



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