Earnings Season Begins with Low Expectations; Will it Be a Catalyst?

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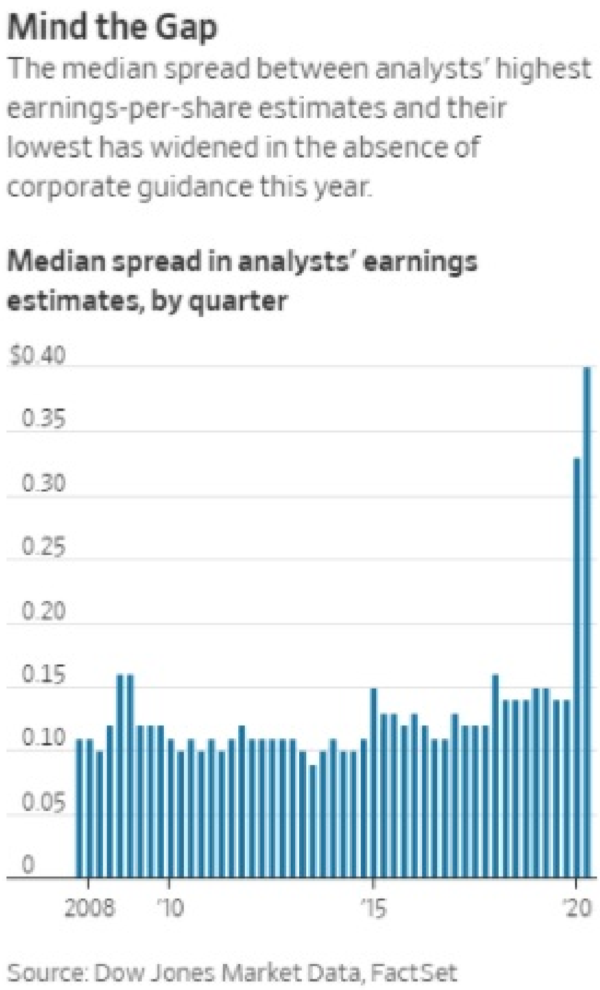
Key Points

- Earnings Season Starts with Estimates Widely Dispersed
- Treasuries Remain Well-Bid Despite Equity Strength
- Commodities Move Higher as Inflation May be Increasing…
- ...Emerging Markets Turn Bullish
- Growth Over Value is Now Stretched to the Upside

Action Plan

This week we will begin to hear earnings reports with the big banks kicking off the season as they always do. It is safe to say that expectations are low as the bottom up consensus for the S&P 500 calls for a year over year earnings decline of about 45% in the 2Q. This would be the largest year over year decline since 2008. But that is well understood at this point. There is no one who does not know that the quarter is going to be bad in absolute terms. The key will be the surprise. And based on the spread in consensus estimates, there is a strong possibility that there will be plenty of surprises. As we can see in this chart, in the absence of guidance, analysts have a wide dispersion of estimates.

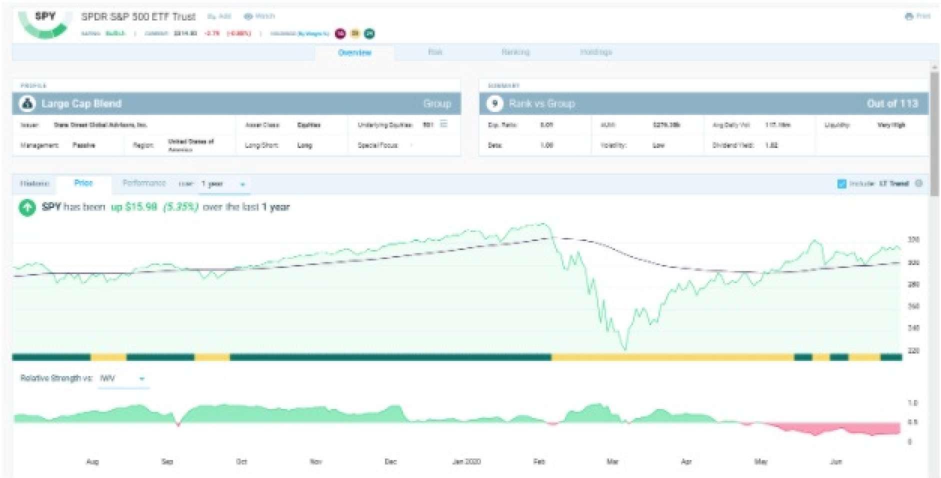


The question now is will the earnings seasons be a catalyst to change the trends currently playing out in the asset markets. Will the pendulum swing toward value? Perhaps in the near-term this could be the case as our bullish view on growth is now stretched to the upside. Will there be a shift from treasuries? Right now it is hard to make that case as last week's 10 and 30-year auctions saw strong demand and record low yields. For the time being, our views remain largely unchanged. The biggest new theme on our radar is the potential for rising inflation. We note that commodities are working higher and that Emerging Markets are beginning to show signs of leadership.

Commentary

Equities

The SPDR S&P 500 ETF has a Bullish Chaikin Power Gauge ETF Rating and is overbought. The fund is above the rising long-term trend line which is near the upper end of the zone that we have been highlighting with $300 - $310 as support and $315 - $325 as resistance. SPY tried to push through the top end of the zone yesterday but a late-day sell off postponed a breakout for at least one other day.



Our view on the equity market remains as it has been for the past few weeks. A break from the consolidation will determine the best course of action. Despite consolidating for a month, the bulls remain in control until $300 is broken to the downside.

We have written at length and have largely been correct on our view that investors should favor growth over value, we do note that this view has now become consensus and crowded. In fact, when we drill down on the relationship between growth and value, we can see that the growth's outperformance has become parabolic in the near-term and the ratio is stretched from the 200-day moving average. We can see just how stretched at the bottom of the chart, which shows us that the Growth / Value Ratio is more than 20% above its 200-day moving average, which is the highest that it has been in the past five years. With this in mind, we do not think that chasing the growth factor is a prudent strategy at this time.

Fixed Income

The iShare 7 - 10 Year Treasury Bond ETF (IEF) has a Bullish Chaikin Power Gauge ETF Rating and is lagging the SPY. IEF is trading at the rising long-term trend line.

Despite the strong rally in the equity market over the past few months, the treasury investors do not seem to be fully convinced of the “economic rebound” thesis. Last week the 10-year and 30-year auctions were well bid with the bonds being sold at / near record low yields. If you believed that there were going to be solid opportunities for growth, would you settle for a mere 63 basis points on your money for the next 10 years? But that remains the case for now and we are sticking with a view that owning treasuries is a good way to diversify equity risk in the portfolio.

Commodities

In these pages and in other venues, we have begun to open up to the idea of rising inflation and believe that this is a theme (and potential concern) that is now at an inflection point. It can best be seen in the recent strength in commodities as an asset class. The Invesco DB Commodity Index Tracking Fund (DBC) is not rated. The fund has been lagging the SPY for more than a year but the intensity of underperformance has been waning of late. Support is near $11.50 while resistance is just overhead at $12.75.

We have been and remain bullish on gold. We also note that mining stocks in the precious metals space continue to perform well. The VanEck Vectors Gold Miners ETF (GDX) and the Global X Silver Miners ETF (SIL) both have Very Bullish ETF Ratings while seeing the intensity of their relative outperformance (vs SPY) increase of late.

Global Equities

Should commodities continue to work higher, we would expect to see Emerging Markets move to the upside as well. We have recently become more constructive on equities outside the US with bullish comments on EFG. Last week we began to highlight EEM and we note that this week the fund has seen its rating turn bullish (the fund is highly exposed to China).

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