BlackRock

Record markets, mixed earnings and critical guidance

A Q4 earnings review from BlackRock Fundamental Equities, February 2024

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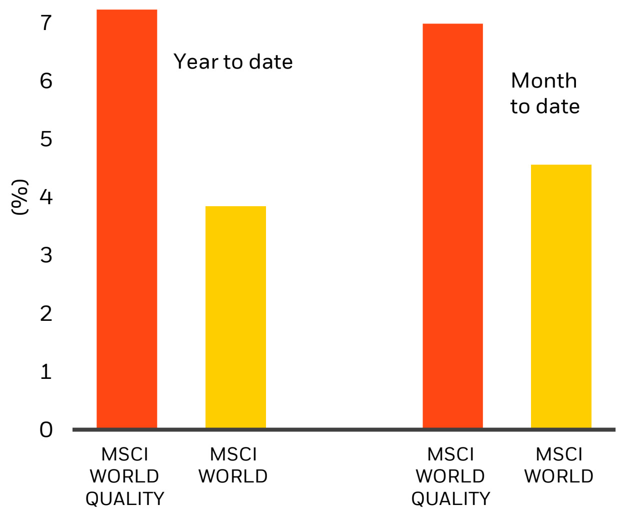
Quality delivered

MSCI quality versus MSCI World, 2024



Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs or expenses. Source: LSEG datastream, BlackRock Investment Institute, Feb. 19, 2023. The chart shows the performance of the MSCI World Quality index versus the MSCI World index. Quality is defined by MSCI as stocks with high return on equity, stable year-over-year earnings growth and low financial leverage.

[1] J.P. Morgan, Bloomberg, Feb. 16, 2023

[2] European Central Bank, Haver Analytics, Goldman Sachs Global Investment Research, 31 December, 2023.

Earnings help stocks reach records

Several global stock market indices have touched record highs in recent weeks, aided by the earnings of some of the world's largest companies in the fourth quarter of 2023. Earnings in Europe have lagged, falling 8% versus growth of 5% in the U.S.[1] Yet if energy stocks are removed from Europe, then earnings rose 4%, while U.S. earnings were propped up by some of the large technology companies. This shows the extent of earnings dispersion across markets, in our view.

Quality delivers

One of our "four themes for 2024" is "quality and capital return," and this has played out so far in Q4 reports. Large, quality growth companies – which have solid earnings and the ability to grow over time – have mostly delivered. Quality companies have outperformed the overall markets globally so far this year, and over the previous month, as the chart shows.

We believe this focus on quality is important in the new era of higher rates, as investors place greater emphasis on profitability today as well as the promise of future growth. Markets cheered the announcements of new dividends at companies that have historically directed cash flows to investment, such as some in the U.S. technology sector.

Star companies across sectors

We find quality companies dotted across sectors. In the U.S., many of these names are linked to the rise of artificial intelligence (AI). The earnings of large payments companies were also notable, especially those with revenues linked to the resilience of affluent consumers.

In Europe, we find quality among healthcare companies with blockbuster obesity products, industrials providing global decarbonization solutions, luxury companies also linked to the resilience of the high-end U.S. consumer or semiconductor equipment companies essential for the manufacture of smaller and smaller chips. Many of these companies are both well positioned for future growth and to return cash to shareholders via dividends and buybacks.

And the valuation gap between U.S. and European stocks has continued to grow this year, so we see opportunities in Europe to pick up quality companies at a reasonable price. This view is shared by the management teams of the companies themselves: buybacks in Europe have surged to historically high levels.[2]

Earnings interesting, guidance critical

This earnings season has confirmed to us the importance of quality characteristics in an uncertain economic environment. The path of inflation and interest rates remains unclear. As stock pickers, our research focuses on how sensitive companies are to the environment – management teams have key insights into their end markets and drivers like wages and inflation. We believe this is an unusual business cycle, with mini cycles playing out across sectors. Our company knowledge helps us understand which businesses may be poised to enter an earnings growth phase, and which may be about to slow down.

What's really important for us is finding those companies that are confident they can deliver strong earnings regardless of what happens with inflation and rates, due to diverse revenue streams and exposure to long-term earnings drivers such as AI, decarbonization and ageing populations. And on the flip side, we might want to avoid those companies whose guidance suggests they are waiting for rate cuts to bring an improvement in business conditions.

We believe a focus on company research and individual stock selection is critical in this tricky period for markets – helping investors to navigate markets regardless of central bank rate decisions.

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