



HOUSE VIEW

EQUITY MARKETS AND TCHAIKOVSKY'S "FIFTH"

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Tchaikovsky's Symphony No. 5, written around this time in summer 1888, is well-known for representing complete resignation before fate, which is not a million miles from what investors have been experiencing since this tortuous year began.

The last few months have been dreadful: equities posted their worst start to any year since 1970 and Treasuries are down 9.2%.

The cycle is forging swiftly ahead and central banks are endeavouring to tighten financing conditions, hiking interest rates at any cost to quash the highest inflation in 40 years. Central bank narratives already accept that this anticipatory action will hamstring growth and that economic recession is looking increasingly likely.

This scenario has triggered a steep downturn in valuations. In the last six months, the S&P 500 12m P/E ratio has dropped 25% to 15.8x earnings, which is a 5.3% discount versus its historic average. In Europe, meanwhile, it is currently 11.7x, down 17.6% versus the long-term average. So is it safe to say that equity markets have bottomed out? Not necessarily.

The latest corporate earnings started to come out in the US on Tuesday and surprisingly, far from a downturn, the consensus is actually expecting stronger earnings growth than earlier this year, before the Ukraine conflict began – see figure 2. In spite of everything, S&P 500 earnings growth is expected to stand at 5.6% for the quarter and 11% for the year. Stripping out the contribution by the energy sector, quarterly growth would stand at -3% rather than 5.6%, but this is still an extremely positive outlook.

In Europe, which is dependent on Russian gas, estimated earnings growth is even stronger: 19.2% for the second quarter and a 15% for full-year 2022. What's more, despite the increase in industrial prices early on this year, 71% of S&P 500 names and 64% of European companies are slated to grow their profit margins versus 2021.

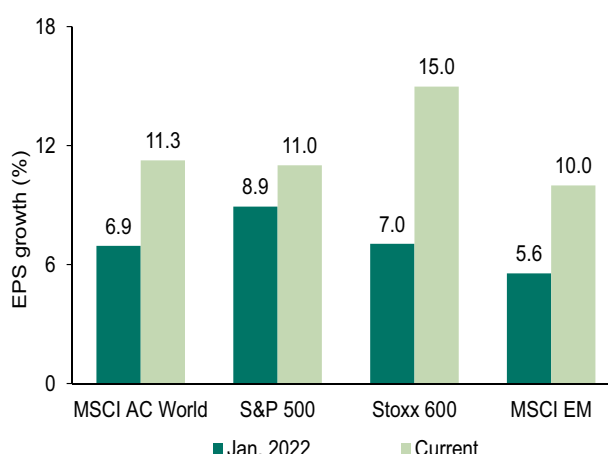
1. 12M P/E RATIO (E) BY REGIONS

Sources: Refinitiv and Banca March



2. ESTIMATED PROFIT GROWTH 2022

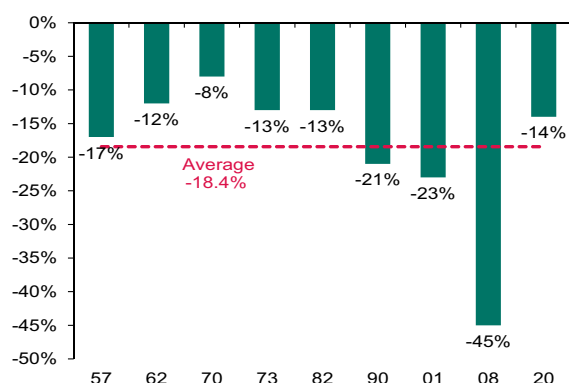
Sources: Refinitiv and Banca March



The markets are now poised to mirror the final diminuendo at the end of the second movement of Symphony No. 5: whilst current household and business situations suggest we are unlikely to see as fierce a recession as in 2000 or 2008, there has not been a single recession in history – however technical it may have been – in which earnings failed to contract; since the 50s, they have fallen by an average of 18.4%.

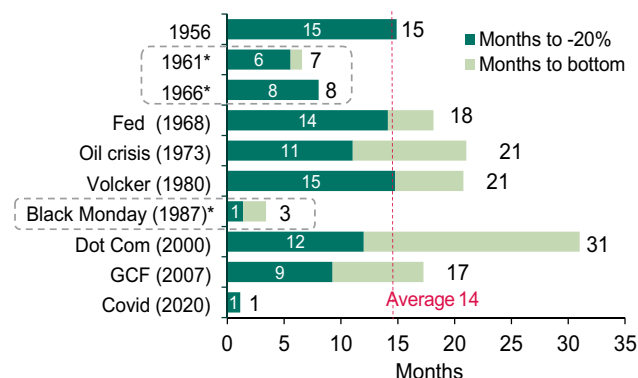
3. RECESSIONS: DROP IN S&P 500 EARNINGS

Sources: Refinitiv, Bloomberg and Banca March



4. BEAR MARKETS. S&P 500 MONTHS TO BOTTOM OUT

Sources: Refinitiv, Bloomberg and Banca March



The market rallies this week sound like the final coda of our symphony, as trumpets, horns and trombones herald the victory of faith and our protagonist triumphs over his fate. This, however, is something of an illusion; Tchaikovsky's Fifth may see the protagonist defy his fate, but the inevitable descent awaits in the subsequent Sixth symphony. Current equity valuations could well be an illusion; bear markets take an average of 14 months to bottom out, so a cautious stance as regards corporate earnings is advisable.

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