Making Sense

Fundamentals Over Headlines: Investing for the Long Term

In this month's market update, we discussed the path of inflation, the outlook for rate cuts, rising fixed income yields, and why investors should focus on equity market fundamentals.

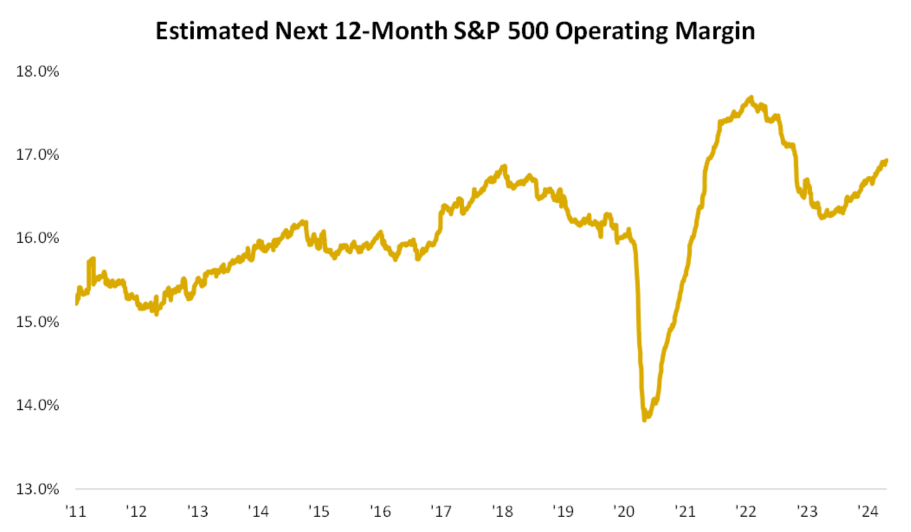
We are often asked how various factors – geopolitics, elections, gas prices, etc. – affect equity market returns. Although markets often react with short term volatility around these themes, longer-term return results depend on market fundamentals. In a recent note, we discussed how market breadth appears to be broadening, which is a good sign for investors concerned by a concentrated rally. With a very positive earnings season turning the corner, we still see reasons to remain optimistic about the US equity market. Two fundamental factors leave us particularly optimistic.

First, analysts' projections of future earnings remain solid. Estimated earnings growth for 2024 is 10.7% (or $243 per share), well above the historical average since 1950 of 7.6%. That growth is expected to increase to 13.8% (or $277 per share) in 2025.[i] Expectations drive equity market returns, and double-digit expected earnings growth is a major reason why equity returns have been so attractive recently. **Even if these estimates are revised down (which often happens), the big picture takeaway is that expectations for future returns remain very positive.**

Second, operating margins—a measure of profits relative to costs—have improved and are expected to widen further. As shown in Figure 1, margins took a dive in 2022 as inflation and expectations for higher rates affected bottom lines. But now strong demand has pushed expected margins for the next 12 months to well above the pre pandemic level.

Although the economic and market outlook appears considerably more complicated compared to Q1, the apparent resilience of the US economy and strength in market fundamentals leaves us constructive on the US equity market this year.

Figure 1: S&P 500 Operating Margins



Source: Strategas

Capital Management Group | First Citizens Bank | 8510 Colonnade Center Drive | Raleigh, NC 27615
First Citizens Bank | 8510 Colonnade Center Drive | Raleigh, NC 27615

Phillip Neuhart | SVP, Director of Market and Economic Research
phillip.neuhart@firstcitizens.com | 919.716.2403

Brent Ciliano, CFA | SVP, Chief Investment Officer
brent.ciliano@firstcitizens.com | 919.716.2650

Blake Taylor | Market & Economic Research Analyst
blake.taylor@firstcitizens.com

[i] Factset, 4/19/2024