# Making **Sense**

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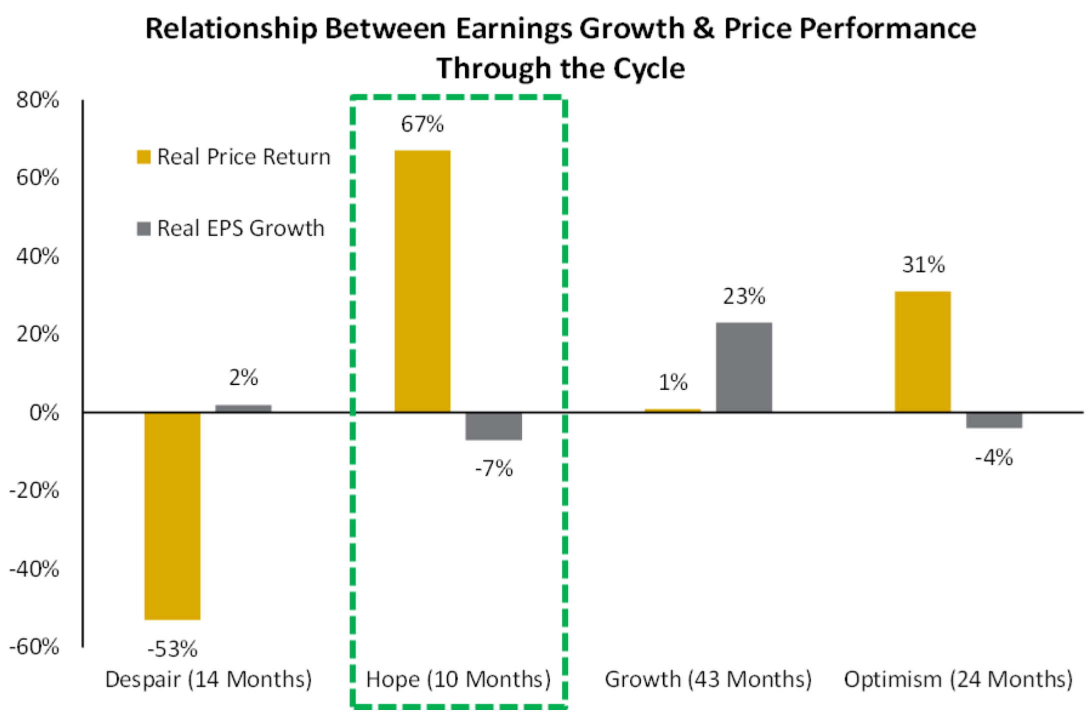
## Is a Potential Earnings Recession Bad for Stock Returns?

As we've said, the potential for a material recession occurring in the next 12-months has increased to a 60% probability, and the potential for an earnings recession has also increased. **But is an earnings recession necessarily a bad thing for stocks?** Consensus expects the S&P 500's full year 2022 earnings to grow 6.7% ($223/share). The estimated growth in earnings for 2023 is currently at 7.3%, but we anticipate that number will fall in coming months. For perspective, average earnings growth since 1950 is 7.6%.[i]

**Let's say we do slip into an earnings recession. What could that mean for investors?** Just because earnings fall, does that mean stocks may also fall? Historically, S&P 500 earnings and returns have not moved in lockstep. Also historically, there have been four phases to the earnings growth cycle: Despair, Hope, Growth, and Optimism. Let's first consider the Despair phase, as that's where we believe we are today. **During the Despair phase**, investors see a severe drawdown in price returns (often into bear market territory), but earnings per share remain positive. Consider this year: stocks have fallen, but earnings have continued to grow. Historically, following Despair is **the Hope phase,** where real price returns rebound dramatically, even as earnings per share start to turn slightly negative. The market is a forward pricing mechanism and quite often begins to look beyond an earnings contraction to better times ahead.

**We believe the earnings growth cycle will likely enter the Hope phase during 2023**—seeing an increase in returns, but potentially experiencing negative earnings growth. Additionally, Wall Street analysts' bottom-up consensus expectation for S&P 500 12-months forward **is 4,604 or ~23% return from close on October 21st's close of 3,752.**[ii]

**Figure 1[iii]:**



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[i] FactSet, 10/21/22
ii FactSet 10/21/22
[iii] Goldman Sachs Research