The second-quarter earnings season is about to begin. Here's what Canadian investors should expect

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When compared with the economic carnage caused by the pandemic last spring, this year's second-quarter earnings season is expected to be one big love-in.

Total earnings for companies in the S&P/TSX Composite Index are estimated to rise by 98 per cent year-over-year and 65.4 per cent for those in the S&P 500 index, according to Refinitiv data, driven largely by industrials, energy and consumer stocks.

Still, as earnings reports start to roll out in the weeks ahead, many investors will be watching for what could ruin the recovery celebration, including signs of runaway inflation and supply chain constraints that threaten to curb the comeback enthusiasm.

Starting Tuesday, earnings reports are due from JPMorgan Chase & Co. JPM-K-N +0.30%increase, Goldman Sachs Group Inc. GS-N +1.25%increase, Bank of America Corp. BAC-N +0.60%increase and other big banks, kicking off the quarterly results season. Most big U.S. banks are expected to report a large rebound in quarterly profits even with trading income falling and revenue stalling on low interest rates and weak demand.

More broadly, investors this earnings season will also be looking to see how certain companies that directly benefited from the pandemic lockdowns can maintain their rise in revenues, such as Zoom Video Communications Inc. (now synonymous with the burnout phrase "Zoom fatigue") and many fitness fanatics' favourite brand, Peloton Interactive Inc.

The technology sector will be one to follow, money managers say, to see how it can sustain its supercharged growth, driven by people living, working and working out from their at-home computers.

"The winners and losers will be very company-specific," says Jennifer Radman, portfolio manager and head of investments at Caldwell Investment Management Ltd. in Toronto.

That's unlike last year, when the whole tech sector did well in the April-to-June quarter, which covered the entire initial stage of global COVID-19 lockdowns.

Some technology stocks are still way up, such as Amazon.com Inc. AMZN-Q +0.02%increase and Facebook Inc. FB-Q +0.21%increase , while others have been choppier over the past year, such as Shopify Inc. SHOP-T +0.45%increase and Netflix Inc. NFLX-Q -0.26% decrease. Meantime, Zoom and Peloton PTON-Q -0.89%decrease are both down double-digits from their pandemic-era highs late last year.

"I think in this earnings season, you're going to see a bit more divergence within the sector," Ms. Radman says.

She will also be watching to see how companies are coping with inflationary pressures, everything from skyrocketing prices of raw materials and labour to anything else that's in short supply.

“How companies are going to navigate that environment I think will be a big theme that continues from last quarter,” she says.

Jason Del Vicario, a portfolio manager at Vancouver-based Hillside Wealth Management, a division of iA Private Wealth, says he’ll also be analyzing some of the management comments around inflationary pressures, as well as insights on how global supply chain disruptions might be affecting different companies. An example is discount retailer Dollarama Inc. DOL-T +0.26%increase, which his investment firm owns for clients.

“It’ll be interesting to hear management talk about whether that is normalizing or if it’s a new normal – and whether they’re having to diversify their supply chains,” Mr. Del Vicario says.

Another trend he’s watching is the prospects for acquisition-hungry companies such as Constellation Software Inc. CSU-T -0.34%decrease, Alimentation Couche-Tard Inc. ATD-B-T +0.73%increase and Boyd Group Services Inc. BYD-T -0.70%decrease, all of which his firm owns. Mr. Del Vicario says the pandemic has likely sidelined many potential deals, but the recovery, coupled with stronger balance sheets, could shake loose some transactions.

“It would be interesting to see what those sort of acquisition-driven business models are seeing in terms of owner’s willingness to sell and at what prices,” he says. He’ll also be watching Big Tech bellwether names including Facebook, another stock his company owns, to see how its advertising revenue has been performing in recent months.

“If people are increasing their ad spend, I think that speaks to [business] confidence going forward,” he says. And if some of the Big Tech stocks do beat expectations by a wide margin, as they did in the first quarter, Mr. Del Vicario doesn’t think the stocks will surge, given the already high valuations across much of the sector.

“I don’t think the market, in general, will react too favourably to earnings beats, but it might react quite unfavourably to misses,” he says.

Christine Poole, chief executive officer and managing director at Toronto-based GlobeInvest Capital Management Inc., says there are high expectations for this earnings season, given strengthening markets in recent months.

“I think guidance is going to be very important ... to see if this growth is sustainable,” she says. She says an encouraging sign is the price-earnings multiples for the TSX and S&P are trading at the same levels as in January, at 17.5 times and 22.5 times, respectively.

“That means the growth in the stock market has been driven by earnings growth, instead of valuation multiples expanding,” Ms. Poole explains. She’ll be paying attention to capital spending levels, to see how much of it will resume after the initial pandemic pause.

“Consumers have kind of led [the recovery], and now we need to see the corporate spending kick in,” she says. And while there are concerns about the new Delta variant that have recently pushed markets down, Ms. Poole doesn’t see the economy going back into full lockdown.

“The market has done well, but it will continue to be sensitive to news like that,” she says, adding that any pullbacks could be viewed as a buying opportunity for some investors on certain stocks.

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