This is a big week for earnings in both Canada and the U.S. Here's what to watch out for

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SPECIAL TO THE GLOBE AND MAIL
PUBLISHED 2 HOURS AGO

Investors are scouring second-quarter earnings reports, including a flurry landing in Canada and the U.S. this week, for signs of an economic slowdown and just how bad it could get. The impact of surging inflation and energy prices on profit margins, revenue growth and the outlook for the last half of this year will be some of the tell-tale signs.

Late Monday, Walmart Inc., the world's largest retailer, cut its profit outlook for a second time in two months saying inflation is causing shoppers to spend more on necessities such as food and less on discretionary items like clothing and electronics. The warning has investors fearing similar moves from sectors struggling with the impact of four-decade high inflation on consumer spending.

Some investors believe consensus analyst estimates are too high across most sectors and will be looking to see how potential downward revisions could impact stock prices and broader markets. For example, analysts have been busy slashing expectations for Canadian tech giant Shopify Inc.'s second-quarter financial results amid a global rout for technology stocks. Its results are out Wednesday. Shopify also announced Tuesday that it was laying off 10 per cent of its workforce, or about 1,000 employees.

For the second quarter, total earnings for companies in the S&P 500 Index are currently estimated to rise by 6.1 per cent (or down by 3.3 per cent when excluding energy) year over year, according to Refinitiv data as of July 25. Total earnings for companies in the

S&P/TSX Composite Index are currently estimated to rise by 22.2 per cent (or up 3.9 per cent excluding energy) year over year in the quarter.

Christine Poole, chief executive officer and managing director at GlobeInvest Capital Management Inc., will be following management commentary on demand trends for their companies' products and services to gain more insight into the extent of a slowdown across various sectors.

"Many of the indicators we track to assess the health of the economy are signalling slowing growth and a rising likelihood of a downturn," Ms. Poole says.

She's also interested to hear more details about supply chain bottlenecks and transportation costs to gauge whether inflation pressures show any signs of easing.

"There are a lot of questions as to what companies are seeing and doing," she says, including whether they're pulling back on spending and hiring and if they're able to pass rising costs on to their customers.

Ms. Poole says this earnings season will also reveal just how cautious consumers and companies are in the current economic environment.

"There are a lot of uncertainties out there and sentiment will play an important role in terms of consumer spending, as well as capital expenditures," she says. "It's an important quarter to see how much of that caution is being translated into retrenchment."

Paul Harris, partner and portfolio manager at Harris Douglas Asset Management in Toronto, says analysts are "way too positive" on the economy and believes earnings estimates are "higher than they should be," which could cause markets to fall further in the weeks ahead.

"The risk to the stock market is when analysts realize they have to bring their numbers down," he says, something he expects to start happening soon as a huge swath of companies report earnings this week.

Some of those include big U.S. tech names such as Alphabet Inc., Apple Inc. and Microsoft Corp. as well as General Electric Co., Ford Motor Co. and Visa Inc. The second-quarter earnings season also swings into high gear in Canada this week with reports expected from several large companies such Canadian National Railway Co. and Canadian Pacific Railway Ltd., Canfor Corp., Canadian Utilities Ltd. Cenovus Energy Inc., Teck Resources Ltd. and Cameco Corp.

Mr. Harris says he's looking for opportunities to buy good-quality stocks that drop on missed analyst expectations in the days and weeks ahead.

“I believe that we’re in a profit cycle that’s going down and that’s not represented in the earnings numbers,” he says. “I want to be a little bit ahead of that and buy some of these [overvalued] stocks that I think are great businesses at a cheaper level.”

Mike Archibald, vice-president and portfolio manager at AGF Investments, says he’ll be focused on the corporate outlooks for the second half of the year, following what he expects will be a “decent” second-quarter reporting season. He also expects analysts’ estimates to come down in the next two quarters and for 2023 as many companies lower their guidance.

One example is Canada’s Stelco Holdings Inc., which reduced its second-half earnings guidance on Monday due to falling prices of steel, a widely used commodity that’s considered a key indicator of economic growth.

The two sectors Mr. Archibald believes will provide the best clues for the economic outlook are industrials and consumer discretionary, given their direct connection to consumers.

“It will be important to pay attention to the guidance management provides … because that will give us an understanding of how resilient the consumer may be over the next six to 12 months,” he says.

Mr. Archibald expects the energy sector to continue to prop up the S&P/TSX Composite Index versus the S&P 500 as oil and gas prices remain elevated.

“We are continuing to see the same kind of playbook that we’ve seen for most of 2022, which is the bulk of the positive estimate revisions are coming from energy and to a lesser degree materials,” he says, noting that all of the other sectors in Canada have seen negative earnings revisions.

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