Further market turbulence appears inevitable as Canadian earnings season commences

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Investors are bracing for a rocky earnings season to roll out in Canada in the weeks ahead as companies continue to absorb the impacts of higher inflation and borrowing costs that have consumer watching their wallets.

Market watchers say the performance of companies both in Canada and the U.S., where earnings season is already in full swing, will provide important clues about the economic health of the consumer and the severity of a recession many now believe is inevitable.

Energy companies are expected to outperform as oil and gas producers continue to benefit from high prices for their commodities, while many corporations in the technology, consumer discretionary and other interest-rate sensitive sectors could disappoint.

The tone has been set in the U.S., where a handful of tech and retail companies have seen their stocks drop on discouraging news. The latest example came Friday when Snap Inc. shares plunged after the social media company reported weaker-than-expected revenue for the third quarter. American Express Co. shares also dropped Friday after the company said it was setting aside more for bad loans, according to Bloomberg estimates.

“I think we’ll see a similar thing [in Canadian earnings] that we’ve been seeing in the U.S., which is a continuation of earnings disappointment coming through and caution on future quarters and earnings,” says Sadiq Adatia, chief investment officer at BMO Global Asset Management.

For the third quarter, total earnings for companies in the S&P 500 index are currently estimated to rise by 3.1 per cent (or fall 3.4 per cent when excluding energy) year over year, according to Refinitiv data as of Oct. 20. Total earnings for companies in the S&P/TSX Composite Index are currently estimated to rise by 18.1 per cent (or up 8.8 per cent excluding energy) year over year in the quarter.

Analysts lowered their earnings estimates more than average for the third quarter for companies in the S&P/TSX Composite, according to FactSet. It said per-share earnings estimates for the third quarter decreased by 6 per cent from June 30 to Sept. 30, a drop that was larger than the five-year average of 0.9 per cent and 10-year-average of 3.1 per cent.

The third-quarter earnings season ramps up in Canada next week with reports expected from a wide swath of companies such as Canadian National Railway Co., and Canadian Pacific Railway Ltd., TMX Group Ltd., Teck Resources Ltd., Cameco Corp., and Air Canada, to name only a few.

Mr. Adatia says sectors to watch in Canada include financials, which should offer clues about how consumers are coping with rising interest rates. The banks are expected to start reporting in late November and early December.

“It should give us a little bit of a tone of where things are heading in the broader market,” he says.

Investors should check into whether the banks’ loan loss provisions are increasing and what executives are saying about their business outlooks in the coming quarters.

"I don't expect to see anything on the dividend side that will be scary by any means; they're not going to be cutting dividends in my opinion. You never know, but balance sheets are still relatively strong," he says of the big banks.

Mr. Adatia expects energy to be one of the outliers this earnings season and largely outperform. Oil and natural gas companies have benefited from rising commodity prices and companies have more cash after years of cutbacks, which could lead to more dividend increases.

"Energy companies are in much better shape than I think people expect and therefore I think it's a good sector to be invested in," Mr. Adatia says.

He says this latest earnings season could present some good buying opportunities for investors across industries, particularly if there is a broader market overreaction to a company or industry-specific issue.

"It could be a good time to dip your toes in solid companies that have good balance sheets that are getting impacted by the economic environment at the moment," he says.

Jason Del Vicario, a portfolio manager with the Hillside Wealth Management team at iA Private Wealth Inc. in Vancouver, says he'll pay attention to inventory levels to indicate whether consumers are pulling back on spending and listening for what executives are saying about the status of supply chain issues.

Major U.S. retailers such as Walmart Inc., Target Corp. and Nike Inc. have already warned investors that they have too much product in their warehouses.

Some consumer stocks have surprised this earnings season, such as Vancouver-based fashion retailer Aritzia Inc., which easily beat analysts' expectations for its third quarter driven by its successful, ongoing expansion across the U.S. In tech, streaming company Netflix Inc. beat third-quarter expectations and reported the addition of 2.41 million net global subscribers, more than doubling its project a quarter ago.

Mr. Del Vicario says earnings from major tech firms such as Facebook parent Meta Platforms Inc. and Google parent Alphabet Inc. will offer insights into advertising spending, another indicator of business investment. Canada's Corus Entertainment Inc. said Friday it saw "meaningfully lower financial results" in its quarter that ended Aug. 31, citing what CEO Doug Murphy described as "an advertising recession" on BNN.

Apple Inc. and Amazon.com Inc. are also expected to report next week, which will be a good gauge of consumer spending habits and may signal what's to come for some Canadian retailers.

Christine Poole, chief executive officer and managing director at GlobeInvest Capital Management Inc., will be paying attention to what executives say about the outlook for their businesses.

"Corporate sentiment is important because that's going to drive how much capital spending they continue to do," she says.

Ms. Poole will also be watching for big moves on some key performance metrics such as revenue and profit growth as well as profit margins, relative to consensus expectations.

If earnings continue to grow, she says it's a positive sign that could support valuations, especially in Canada which is trading at a lower forward 12-month price-to-earnings (P/E) multiple than the U.S. According to FactSet, the P/E ratio for the S&P/TSX Composite is 11.3 times compared to 15.5 times for the S&P 500 companies.

"Coming into this earnings season, with sentiment so low generally speaking, even meeting expectations or having some positive commentary can easily trigger a rebound," she says. "We ended the quarter on such a bad note, that a lot of negative news is baked into the market right now."