December 6, 2024

MARKET SIGHT LINES

The Shift in Government May Impact Earnings in 2025

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My team and I keep a close eye on company earnings as we try to assess where the market is headed and manage equity portfolios. The quarterly earnings season provides important insights for the stock market as a whole, and the third quarter reports are just about complete. In the wake of the U.S. elections last month, it is also important to begin to assess how policy changes in Washington, D.C. next year may affect earnings going forward. In this Sight|Lines, we review the third quarter earnings season, unpacking the quarter's results so far, and then look forward to the policy implications of the incoming administration.

THE TAKEAWAY: EARNINGS GROWTH WAS POSITIVE AND MAY GET BETTER

A majority of S&P 500 companies beat expectations, and the forecasts for future earnings growth remain positive. Investors will begin focusing on the policy implications of the Trump administration. In summary:

- 98% of the companies in the S&P 500 have reported third quarter results.
- Many companies posted positive earnings surprises, but by smaller-than-average amounts.
- Combined earnings fell short of expectations, and expectations for the fourth quarter have declined some, but remain quite positive.
- Full-year 2024 and 2025 earnings growth expectations also remain positive.
- Most sectors reported earnings growth in the third quarter, with communication services posting the highest growth and energy posting the lowest.
- The incoming administration is focused on deregulation, which for many companies may mean reduced costs, increased profits, and better earnings.
- Consensus estimates for indexes like the S&P 500 are an aggregation of individual analysts' work on individual companies, begging the question: To what degree have analysts already incorporated deregulation effects into their future earnings estimates?

IN-DEPTH: EARNINGS GROWTH WAS POSITIVE IN THE THIRD QUARTER, AND DEREGULATION MAY IMPROVE ALREADY POSITIVE 2025 EARNINGS GROWTH

Earnings results have been positive in 2024 and are expected to remain positive into next year. The policy implications of the next administration are expected to be positive for earnings. Going deeper:

- 98% of the companies in the S&P 500 have reported third quarter results:
  - Third quarter earnings growth is now estimated at 5.9%, down from an expectation of 7.5% at the end of June.
  - Fourth quarter earnings growth is now estimated at 11.6%, down from an expectation of 14.3% at the end of September.
  - These are still very positive growth rates.
- 75% of S&P 500 companies reported a positive EPS surprise:
  - In aggregate, companies are reporting earnings that are 4.5% above expectations.
  - This surprise percentage is below the one-year average of 5.5%, the five-year average of 8.5%, and the 10-year average of 6.8%.
- Full-year 2024 and 2025 earnings growth expectations also remain positive:
  - 2024 earnings growth is now estimated at 9.7%, compared to the estimate of 11.8% as we started the year.
  - 2025 earnings growth is now estimated at 14.8%, compared to the estimate of 12.8% as we started the year.
- Most sectors reported earnings growth in the third quarter:
  - Communication services posted the highest growth rate of 23.2%.
  - Energy posted the lowest growth rate of -24.7%.
- The incoming administration is focused on deregulation, which for many companies may mean reduced costs, increased profits, and stronger earnings. Here are some possible examples:
  - *Energy*: Fewer regulations may drive consolidation in oilfield services, reducing redundancies and improving profit margins.
  - *Manufacturing*: Eased compliance requirements, perhaps related to the environment, may lower operational costs, allowing manufacturers to reallocate resources or improve profits.
  - *Financials*: Fewer restrictions could facilitate mergers and acquisitions, enhancing profitability for financial institutions.
  - *Pharmaceuticals*: More streamlined drug approval processes may lower development costs and/or accelerate time to market, increasing revenue potential.

CONCLUSION

Third quarter 2024 earnings were positive for the S&P 500 and are expected to remain so in 2025. Importantly, the incoming Trump administration is expected to focus on deregulation, which should be a positive for many companies, allowing them to potentially reduce costs and improve earnings further.

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