

What Happens When Corporate Earnings Fall?

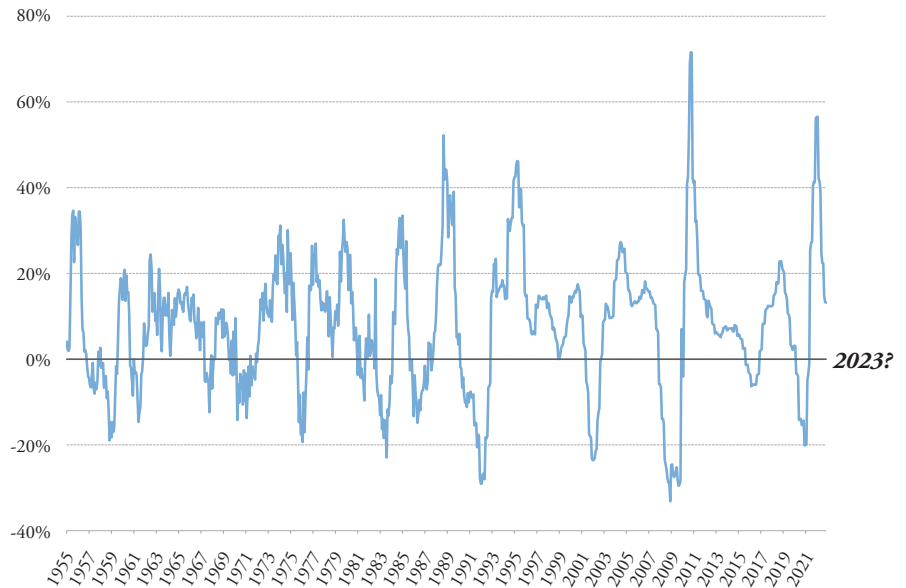
Although they still stand above projected 2022 levels, 2023 estimates for earnings for S&P 500 companies have been trimmed in recent months. Even so, rising interest rates and cost pressures, along with fears of a possible recession, are resulting in some projections of a drop in earnings for 2023. If that happens, what impact would a drop in earnings have on stock prices?

It is important to point out that declines in overall corporate earnings are not unusual. The chart to the upper right illustrates the rolling 12-month change in earnings for the S&P 500 Index from 1955 through the present. In roughly 30% of the periods, earnings have been below the level of 12 months prior.

What happened to stock prices during those past periods when earnings declined? The illustrations, lower right, represent the range of price changes for the S&P 500 during 12-month periods when earnings were declining (left hand image) and when they were rising (right hand image).

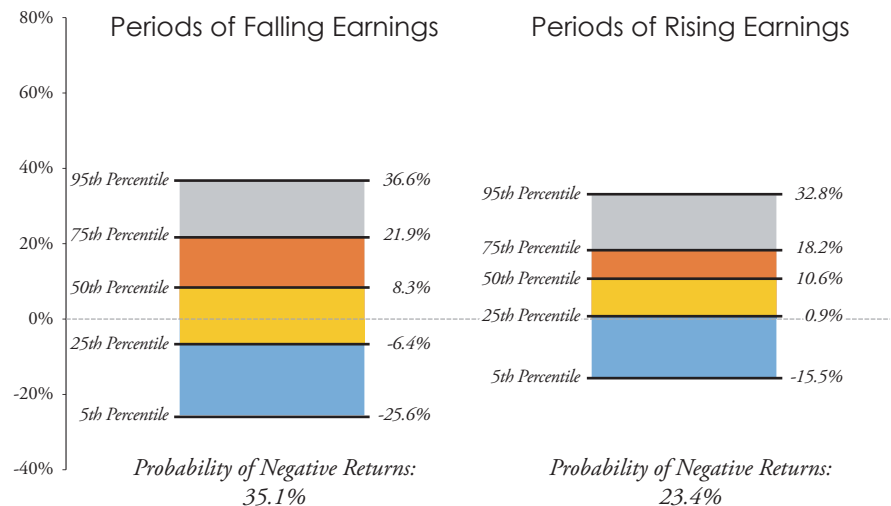
In comparison, stocks do tend to do better when earnings are rising, but not by much. The median return (50th percentile) of S&P 500 price changes during periods of rising earnings was 10.6%, while the median return was 8.3% during periods of declining earnings. Negative returns occurred more frequently during periods of falling earnings than rising earnings (35.1% compared to 23.4%) but, again, the difference was not

S&P 500 Earnings Change Rolling 12-Month Periods



Data from 1/1/1955–11/30/2022
Source: Bloomberg

S&P 500 Price Changes



Data from 1/1/1955–11/30/2022
Source: Bloomberg

tremendously significant (most of the time, stock prices still rose even when earnings were falling).

This is not to say that a decline in S&P 500 earnings next year should

be welcomed by investors, but a long-term look at history suggests that a decline in earnings wouldn't necessarily eliminate the possibility of stock market gains in 2023.

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REFERENCED INDEX

(Indices are unmanaged and are not available for direct investment.)

S&P 500 Index—The S&P 500 Stock Index is a market capitalization weighted index and consists of 500 stocks chosen for market size, liquidity and industry group representation.

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