Profit revival excites and worries Wall Street

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(Photo: BRYAN R. SMITH, AFP/Getty Images)

After some lean times, Corporate America is again showing Wall Street the money.

The profit pinch that stretched from early 2015 to mid-2016 and gave investors pause appears to be finally giving way to a stretch of stronger results for companies in the Standard & Poor's 500 stock index.

Companies in the S&P 500 are on track for their best quarterly profit growth in more than two years. Fourth-quarter 2016 earnings, which got a big boost late Tuesday when iPhone maker Apple delivered an earnings beat, are on track to grow 7.5%. If that pace holds when earnings season is over it would mark the fastest growth rate since the third quarter of 2014, when profits jumped 10.3%, according to earnings tracker Thomson Reuters I/B/E/S.

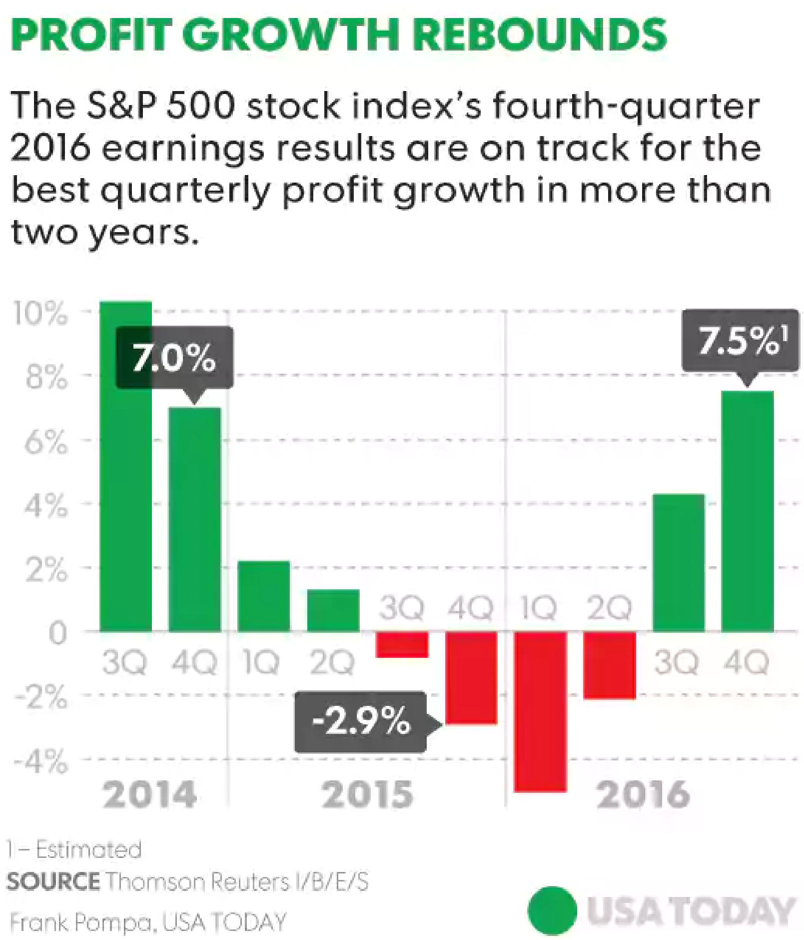
The dangerous side of ETFs (http://www.usatoday.com/story/money/columnist/2017/02/01/dangerous-side-etfs/97308332/)

Still, despite the profit snapback — driven largely by an improving economy and recovering energy sector no longer dragging down the index's overall results — Wall Street is warily watching to see if companies can meet analysts' lofty 2017 earnings projections. Analysts now see S&P 500 profits growing 11.4% this year, up from 1.6% in 2016. Estimates for all four quarters in 2017 were lowered modestly by analysts in the past week.

The general feeling among investors is that companies must deliver on the bottom line if the stock market can continue to move higher and extend the bull market beyond its eighth birthday in early March.

"Stock prices follow earnings," says Randy Warren, chief investment officer at Warren Financial Service.

The latest profit results, along with recent upbeat data on jobs, manufacturing and consumer confidence, point to better days ahead in the U.S. But expectations are high, which means there's a greater chance for companies to disappoint Wall Street.



The outlook for future profits also hinges on the so-called “Trump factor.” Profits could also be hurt if the U.S. dollar strengthens and hurts sales of U.S. multinationals or if the Federal Reserve hikes interest rates more than expected this year, causing growth to slow.

Currently, the double-digit profit growth expected this year, and the earnings jump of nearly 12% forecast for the first three months of 2017, do not include the expected profit-enhancing benefits of President Trump’s plan to slash corporate taxes and reduce costly regulations.

Yet most Wall Street pros say U.S. companies won’t be able to meet or beat the aggressive 2017 profit forecasts without at least some of Trump’s agenda getting passed. A key profit driver, for example, will be a reduction in the corporate tax rate, now 35%, to 15% or 20% as Trump and the Republican-controlled Congress envision. Analysts expect that savings coming from those cuts would flow to companies’ bottom lines.

Fed stands pat on rates, no signal on March hike
(http://www.usatoday.com/story/money/2017/02/01/fed-stands-pat-rates-no-signal-march-hike/97300116/)

“The higher earnings forecast may be attainable if legislation is passed to lower the corporate tax rate,” says Nick Sargen, senior investment adviser at Fort Washington Investment Advisors. “However, both the timing and magnitude (of any changes to the tax code) are uncertain.”

The “main risk” to the stock market and corporate profits, Sargen says, is if Congress can’t reach a deal with the president or the bill Trump submits to lawmakers “gets bogged down in Congress.”

Timing, it turns out, could be the swing factor in whether profits come in as strong as forecast or miss to the downside, warns Warren. The same calculus, he adds, could determine if stocks rise or fall.

“We don’t want the market to get ahead of itself,” says Warren. “The big risk is if the market starts to (go higher) on things that haven’t actually happened yet. The market is cautiously ‘pricing in’ the Trump agenda, realizing it takes more than a tweet to pass a bill through Congress.”

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