ARE WE HEADING FOR A PROFIT RECESSION?

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As we enter deeper into first-quarter earnings season, we will likely soon find out whether aggregate earnings growth on the S&P 500 Index is heading for its first back-to-back quarterly contraction since September 2012. What makes the earnings slowdown more of a paradox is that dividend growth on the S&P continues to advance at a double-digit pace.[1] Markets discount a tremendous amount of information, but ultimately, stock markets trade at a multiple of these two essential sources of income. So what are we to conclude when corporate earnings head south yet aggregate dividends continue to head north? The bull case is that, should a profit contraction occur, it's unlikely to be more than a two-quarter affair. This view, which I subscribe to, argues that the frigid weather that sent snowbound consumers into hibernation this winter will soon thaw. The velocity of the foreign exchange hit to U.S. multinationals will moderate, and managements will adjust to a stronger dollar. And while energy companies may have to adapt to oil prices being lower for longer than many expected, this is merely a transfer of wealth from multinational corporations and the Organization of Petroleum Exporting Countries (OPEC) to the American consumer and other sectors of the U.S. economy, where higher savings rates and lower energy costs will become potential drivers of future gross domestic product (GDP) growth. The spring season we have entered is an important one, not just for the direction of corporate profits but for the direction of aggregate corporate dividend growth. Some of the largest dividend-paying companies in the country, including Apple, Exxon, Chevron, Johnson & Johnson and Wells Fargo, typically declare and raise their annual dividend payments by the end of the June quarter[2]. On balance, I believe they will continue to this year, even if some of them have to borrow to do so. Earnings growth, like GDP growth, can be choppy. And although dividend growth should not be viewed as a leading indicator, it at least reflects executive judgments about the cash-generating capacity of these enterprises beyond the next few quarters. What executives say via their dividend policies gives us a window into what they foresee for the rest of the year. On the other hand, come July 1, if it becomes evident that aggregate dividend growth in the U.S. has fallen below the long-term average of 5.5%, that would, I believe, be reason enough to become more cautious about the direction of U.S. stocks.

[1]Source: "Another Quarter, Another Record," Barron's, 3/30/15. [2]As of 3/30/15, the WisdomTree Dividend Index held 3.02% of Apple; 2,75% of Exxon; 2.01% of Chevron; 1.81% of Johnson & Johnson and 1.76% of Wells Fargo.

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S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Dividend growth : The growth in trailing 12-month dividends for the specified universe.

Aggregate dividends : Weighting constituents according to the proportion of cash dividends that they generate compared to the sum total of cash dividends for all constituents within the index.

Bullish : a position that benefits when asset prices rise.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.