EARNINGS PULLBACK? NOT THIS QUARTER

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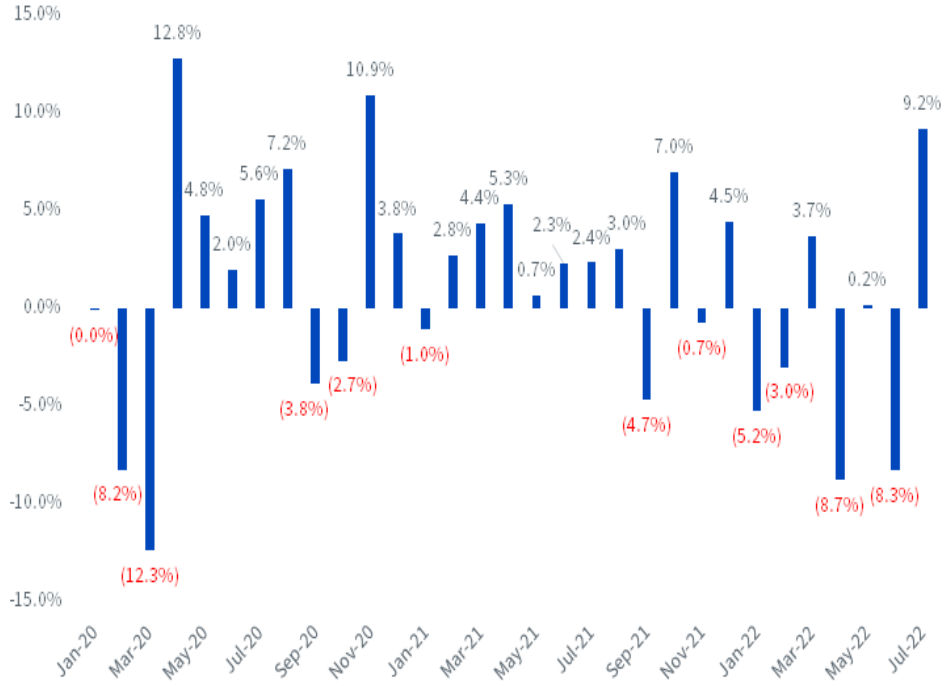
Did this year's falling market get too far ahead of underlying earnings?

After plunging more than 22% from the start of the year through mid-June, U.S. equities in July had their biggest rally since November 2020 amid earnings reports that were generally stronger than forecasted.

S&P 500 2Q earnings per share (EPS) are on track to beat analyst estimates by 3%.[1]

Monthly S&P 500 Total Returns



Sources: WisdomTree, S&P, 12/31/19—7/29/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

Several major factors drove the sell-off in equities to start the year.

As we recently learned, gross domestic product (GDP) growth was negative for the second straight quarter, confirming for many what had been suspected about the economy—growth was moderating, if not in outright recession.

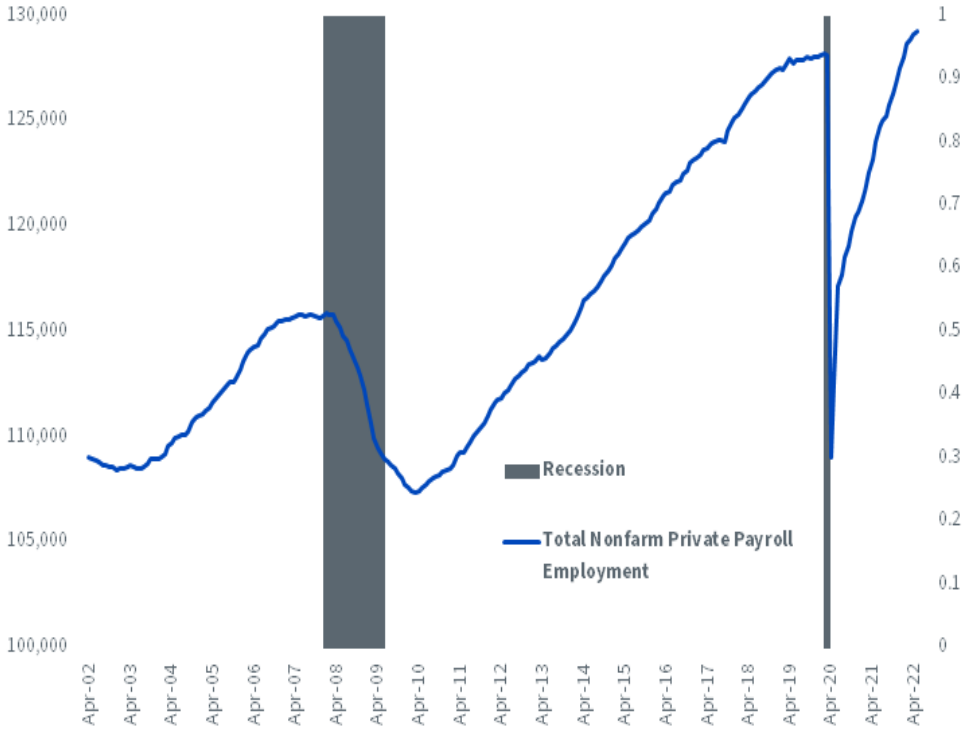
A slowdown in economic activity coupled with a hawkish Federal Reserve and inflation at multi-decade highs created the perfect conditions for a bear market.

What has become more apparent in recent weeks is that two main catalysts may be helping markets find a floor:

- Rapid jobs growth that is at odds with a recession

- Decidedly positive expectations for earnings growth

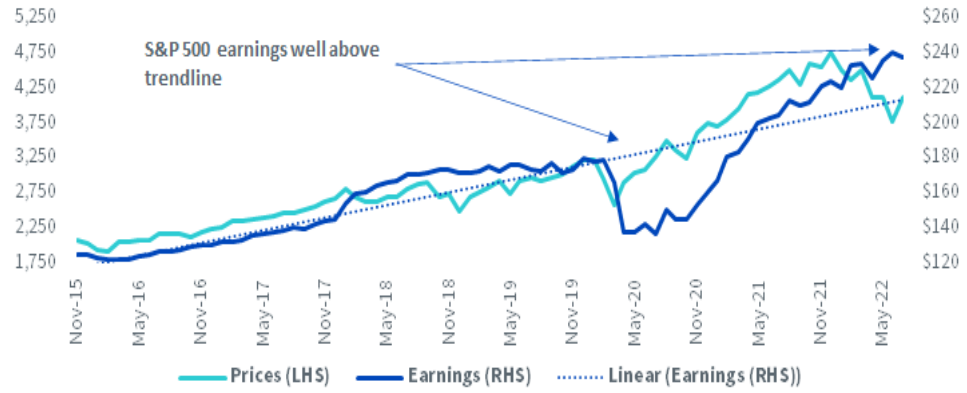
Employment and Recessions



Sources: WisdomTree, FRED, 4/30/02—6/30/22.

Consensus analyst estimates are for earnings to grow 9% in 2022. The forward 12-month EPS has increased more than 6% since the start of the year, continuing to climb in the face of an S&P 500 sell-off.[2]

S&P 500 Index Price Level and Fwd. 12m Earnings per Share, as of 7/29/22



Sources: WisdomTree, FactSet, S&P, 11/30/15—7/29/22. You cannot invest directly in an index. Past performance is not indicative of future returns.

Net negative earnings revisions have started to indicate some moderation in growth estimates—a cautionary but not yet alarming trend.

S&P 500 Net Earnings Revisions Ratio

Sources: WisdomTree, FactSet, S&P as of 7/29/22. Net earnings revisions ratio is a percentage of forward earnings upgrades divided by downgrades.

Growth Sell-Off

At the beginning of the year, the front-and-center market narrative was rising interest rates sending high-growth stocks into a tailspin.

As a result, growth has handily lagged value across large, mid- and small caps.

Russell Style Indexes, as of 8/1/22

	Year-to-Date		
	Value	Blend	Growth
Large	-7.31%	-13.79%	-19.62%
Mid	-9.29%	-13.99%	-22.55%
Small	-9.35%	-15.52%	-21.67%

Sources: WisdomTree, Russell. You cannot invest directly in an index. Past performance is not indicative of future returns. Blend: Characterized by exposure spanning across stocks exhibiting both value and growth attributes. Growth: Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

During the past few weeks, some of the most recognizable growth names have had some or all of their market caps moved from the Russell 1000 Growth Index toward the Russell 1000 Value Index.

In a major turnaround from its outsized stature in the Russell 1000 Growth Index, Meta is now a top-10 holding in the Russell 1000 Value Index.

Russell 1000 Value Index Top 10 Holdings

Name	Weight
Berkshire Hathaway	2.8%
Johnson & Johnson	2.4%
ExxonMobil	2.1%
JPMorgan Chase	1.8%
Chevron	1.7%
Meta Platforms	1.5%
Pfizer	1.5%
BofA Corp	1.3%
Thermo Fisher Scientific	1.1%
P&G	1.0%

Sources: WisdomTree, Russell, as of 8/1/22. You cannot invest directly in an index.

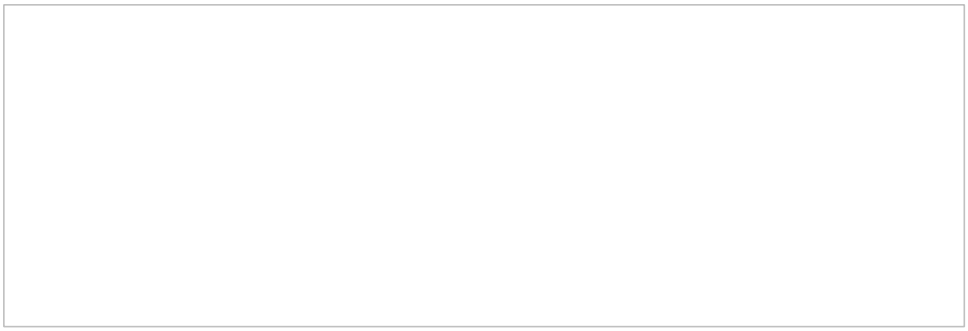
Given the acute drawdowns in select large-cap names—moves that have, to this point, materially outpaced the deterioration (or lack thereof) in underlying earnings—the Index Committee for WisdomTree's core equity indexes decided to rebalance weights of a handful of stocks in the WisdomTree U.S. LargeCap Index to be more in line with earnings weights.

The Index, which uses a modified earnings weighting approach, had an aggregate total of less than 5% weight change to the portfolio.

The weight of Meta was increased from less than 2% to 3%, and the weight of Alphabet increased by about 50 basis points.

Weight was trimmed from Microsoft, AbbVie and Bristol-Myers Squibb to offset these increases.

WisdomTree U.S. LargeCap Index: Top 5 Portfolio Changes



Bottom Line: Rebalance to Earnings Amid Sell-Off

Through June 30, 2022, Meta and Alphabet had declined by 50% and 23%, respectively, since the last screening date for the WisdomTree U.S. LargeCap Index on November 30, 2021.

These market movements had greatly diminished the weight of these securities in the Index. The construction of the Index is meant to tether constituent weights to underlying earnings rather than be heavily dictated by price movements. Therefore, we adjusted our Index intra-year to more appropriately reflect the earnings weights of some of the largest companies.

As a byproduct of the disciplined fundamental rebalance process, the current trailing and forward price-to-earnings ratios on the WisdomTree U.S. LargeCap Index are heavily discounted compared with the S&P 500 Index, and they have valuations in line with the Russell 1000 Value Index.

Index Fundamentals

Metric		WisdomTree U.S. LargeCap	S&P 500	Russell 1000 Value
P/E	Current	15.5x	20.1x	15.5x
	Rank vs. History	59%	68%	45%
	Average	15.3x	18.9x	16.8x
	% Premium/(Discount) vs. Average	2%	6%	-8%
Forward P/E	Current	14.8x	17.9x	14.1x
	Rank vs. History	57%	77%	37%
	Average	14.5x	16.5x	14.8x
	% Premium/(Discount) vs. Average	2%	8%	-5%

Sources: WisdomTree, FactSet, S&P, Russell, 2/28/07—8/1/22. You cannot invest directly in an index.

[1] Source: FactSet, 7/29/22.

[2] Source: FactSet, 7/29/22.

For standardized performance and the most recent month-end performance click here NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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DEFINITIONS

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.

Earnings per share : Total earnings divided by the number of shares outstanding. Measured as a percentage change as of the annual Index screening date compared to the prior 12 months. Higher values indicate greater growth orientation.

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

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

Hawkish : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Inflation : Characterized by rising price levels.

Bear market : A sustained downturn in market prices, increasing the chances of negative portfolio returns.

Value : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over tim.

Large-Capitalization (Large-Cap) : A term used by the investment community to refer to companies with a market capitalization value of more than $10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Mid-Cap : Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

Small caps : new or relatively young companies that typically have a market capitalization between $200 million to $2 billion.

Russell 1000 Value Index : A measure of the large-cap value segment of the U.S. equity universe, selecting from the Russell 1000 Index.

Drawdowns : Periods of sustained negative trends of return.

Basis point : 1/100th of 1 percent.