Estimates

It is earnings season in the United States and earnings can spark serious volatility in markets. The earnings season is the time when most publicly traded companies report quarterly or annual earnings. This period is associated with more volatility at the individual share level because of expectations. Recently, the Goldman Sachs share price slumped 7% on reporting a larger-than-expected drop in quarterly profit. In October last year, META (Facebook) plunged 20% on a weak growth outlook.

What are Earnings Estimates and why are they Important?

An earnings estimate is an analyst's estimate for a company's future quarterly or annual earnings (net profit) per share. Future earnings estimates are an important input when analysts attempt to value businesses. As such, earnings estimates are useful for investors in determining target buy or sell prices for shares.

Inflation Forecast

Recently, the inflation forecast has proved to be another key estimate. Last year, the monthly inflation release, particularly in the United States came with large market moves. The inflation print has implications for central bank policy (interest rates) and economic growth, and thus can influence market moves. The inflation forecast is economists' projection of the changes in prices of a basket of goods and services typically purchased by households.

The Reality

Market volatility emanating from (missed) estimates reflect importance of estimates. We commonly see headlines like "Company XYZ earnings miss estimates" or "inflation missed forecasts." However, this is inaccurate, and the reality is:

Earnings do not miss estimates, but estimates miss earnings.

Inflation does not miss forecasts, but forecasts miss inflation.

Analysts/economists calculate estimates using data, guidance, and assumptions, but judging by history, it is difficult to get it right (accurate). As no one really knows what is going to happen, estimates contain false precision, and it is the preciseness of estimates that investors like. Because things change, assumptions of the future are fragile.

It is likely better to focus on expectations through understanding enduring themes of history rather than the irresistible promise of forecasts. Focusing on fundamentals and the long-term story is key rather than getting sucked into short-term noise.

In a short space of time, we've had no inflation to rising inflation dubbed transitory, which then became higher for longer, and is now likely rolling over. Such is the complexity of getting sucked into ever-changing themes. Fundamentals are key and it is important for investors to be invested in the right products for their risk profiles and follow a consistent investment strategy.

Surprises like Covid occur and the correct lesson to learn from surprises is that the world is surprising. Though tempting to think experiencing a surprise improves the ability to forecast, what we gain mostly is confidence in false precision.

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