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Wall Street's Missed Expectations

By [LIAM DENNING](#)

Wall Street's sell-side analysts are a famously Panglossian tribe. But it turns out that they are actually too pessimistic when it comes to predicting company earnings, particularly in the wake of recession.

With 172 of the S&P 500's members having so far reported quarterly earnings, 143 have beaten their consensus forecast, according to data collated by Thomson Reuters. On average, their numbers came in 21% above the Street's collective wisdom.

Less than 40% of the index's members have reported, so the current score of 83% having beaten forecasts—easily the highest for any quarter since at least 1999—may not stand. But having a high percentage of companies beat the Street isn't unusual. Thomson's data show that, on average, 64% of companies have done so in any given quarter since the start of 1999, compared with 18% that miss. The average earnings "surprise" is 2%, although these data swing erratically.

This is less surprising than it appears. Corporate management, for better or worse, go to great lengths to guide analysts toward the right numbers. After all, the last thing you want to do is deliver a nasty surprise. Just ask [Ingersoll Rand](#), [IR -0.78%](#) which missed the consensus forecast by 11% on Friday and saw its shares plunge 8.5% at one point.

Analysts are also prone to the same greed and fear that fuel the financial markets' gyrations. The most optimistic quarter since 1999, in which only 52% of S&P 500 companies beat the consensus forecast, was the last three months of 2000, just as the tech bubble was turning to bust.

With that in mind, it is little wonder that pessimism has really taken hold recently, with the percentage of companies beating earnings forecasts well above average since the second quarter of 2009. But there could be more to this than mere psychology. So far this quarter, for example, 69% of S&P 500 companies that have reported have beaten revenue estimates, according to Thomson. The implication is that final demand is stronger than anticipated.

Tobias Levkovich of Citigroup points to the importance of labor. Corporate America cut costs rapidly as recession took hold. That helped offset some of the damage inflicted on earnings by falling sales. But the ranks of the unemployed weigh heavily on expectations for a recovery in sales. That leaves scope for surprisingly good revenue numbers, relative to estimates, which in turn provides great operating leverage at the profit line, given earlier cost cutting.

So there is reason to suspect analysts' expectations will continue to be trumped by better results as the current reporting season progresses. But at some point, that unemployment rate has to fall if optimism is to be restored on a sustainable basis.

—Liam Denning