Ropes Wealth Reminds Us that Expectations are a Privilege, Even for Stocks

There is a new Nike commercial on TV featuring NBA superstar LeBron James. In the advertisement, he sits with his eyes closed, sweat glistening on his brow, talking softly to himself as if in prayer, with his voiceover saying: “Expectations aren’t a burden. They’re a privilege. Because it could be worse. No one could expect anything at all.”

As I sat down to write this week’s missive, LeBron’s words came to my mind as related to the stock market. So far, 76% of S&P 500 Index companies have beaten analysts' earnings estimates with earnings season more than a quarter complete, according to FactSet. However, year-over-year earnings per share (EPS) growth is coming in at just 3.4% for S&P 500 companies this quarter. It is forecast to be 14% next quarter and 15.1% in 2025. With valuations sky-high, that’s a lot of privilege built into those expectations.

Attention shifts next week to mega-cap and big-tech earnings with five of the "magnificent seven" on tap. Tech shares have been volatile amid concerns of slowing long-term growth prospects. But info tech is still seen leading all sectors with year-over-year quarterly EPS growth at 15.6%, though this is down sequentially from a 20% growth rate in the second quarter. AI remains front and center.

With that, a surprisingly strong earnings report from Tesla sparked a rally in the electric-vehicle maker’s shares, leading tech stocks higher. Shares of Tesla closed up 22% yesterday in their best day since 2013 after the company reported a 17% year-over-year increase in net income for the third quarter and CEO Elon Musk signaled high growth in 2025. Market participants also received encouraging earnings news from American Airlines, UPS, Southwest, Lam Research, Whirlpool, and T-Mobile. Shares of many of those, along with Tesla, powered consumer discretionary and info tech sector gains. That said, there were more mixed results from Honeywell, IBM, Dow, Union Pacific, and Northrop Grumman.

Amid the throes of this earnings season, it was notable this week that Goldman Sachs offered a prediction that the S&P 500 Index will return an average of just 3% per year in the next decade, a far cry from the 13% average annual return of the last 10 years. That return would rank in the bottom decile of comparable periods in the last century, and mean it is unlikely stocks will outpace inflation. 10-year forecasts from other Wall Street firms for S&P 500 performance range from a low of 4.4% to a high of 7.4%, with the average being 6%. So why the pessimism? One of the primary causes is the market’s extreme concentration in the Magnificent Seven (Apple, Nvidia, Microsoft, Alphabet, Amazon, Meta, and Tesla), which is near its highest level in 100 years. Concentration of this magnitude makes the performance of the S&P 500 overly reliant on the earnings growth of the index's largest constituents. History shows us that it is extremely difficult to sustain earnings growth at a high clip. In fact, just 11% of S&P 500 companies since 1980 have maintained double-digit sales growth for 10+ years, according to the Goldman analysis. A microscopic share (0.1%) has sustained 50%+ margins for a decade.

It is a good thing that growth is expected to pick up for the other 493, which is why we are encouraging you to embrace diversification within the S&P 500 and elsewhere globally.

The other big news of the week is just how much the yield curve continues to move, with the 10-year U.S. Treasury note now at 4.25%. Over time, higher yields increase borrowing costs for companies and consumers, while dollar strength often clips overseas revenue. This combination can hinder future earnings growth, a concern with major U.S. indexes at historically high valuations and as analysts prognosticate 15% earnings gains next year.

On a final note, we received multiple reports of firm U.S. economic data including jobless claims, new home sales, consumer confidence, and purchasing managers' index readings. It was a break from some of the more uneven readings we have received on inflation and construction and affirms the no recession outlook for 2025. As we dig into the final quarter of this year and are in the countdown to the election, it is time for our discussions to center on expectations, hopes, and goals, and it is our privilege to help you consider those plans today and always.

Thank you for your interest in our weekly investment commentary. If you would like to speak personally with a member of our team at any time, please click **here**.

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Ropes Wealth Advisors
800 Boylston Street Boston, MA 02199-3600