Argent Capital Management LLC

Market Overview – April 2021

Every month *following* a month divisible by three (if you followed all of that) is a busy time for us investment folks. That's because most public companies close their quarterly books in March, June, September and December and report those results the following month. So April is a busy time for us. This April we have noticed something a little odd. Earnings results, for the most part, have been very good. Usually, better-than-expected results drive stock prices up. That's because, off of those better-than-expected results, investors increase their estimates for a company's earnings, and higher earnings generally boost stock prices. That, however, has not been the case for the most part during the first quarter 2021 earnings season.

For a little background, since the early 2000s, 60% of stocks have normally beaten the Wall Street estimates of how they will perform. This on the surface may sound a little strange - over half of the companies report earnings that are better than expected? But part of what companies try to do is "under promise" and "over deliver." Remember, better results generally mean higher stock prices, so companies have a vested interest in keeping expectations low in order to post better results. In fact, up until our most recent bull market, stocks rose on average 1.8% the day they reported better-than-expected results.

This quarter 81% of companies that have reported results so far have exceeded expectations, considerably higher than the 60% average. Naturally then, you would expect these stocks to rise. That, however, has not been the case. Instead of rising on better-than-expected results, those companies, 81% in total, have fallen on average 0.01% the day they released results. Odd outcome indeed.

What explains this situation? There are a few reasons investors have given for the peculiar results we have seen during this earnings season. The first explanation is that the market has had a tremendous run. Remember, from March of last year to March of this year the S&P 500® Index rose over 55%. That's a huge move for mature, U.S.-based stocks, so the explanation goes, a lot of the good news that has been reported this quarter was 'in the stocks.'

Another reason given, somewhat related to the first, is that this is as good as it gets. The second quarter of this year will compare against the nadir of the COVID-driven recession in April of last year. From there, quarterly comparisons against results one year ago will get more difficult, as the recovery began in the second half of 2020. Investors like 'easy comps' and like increasingly better earnings. That trend may slow soon.

A final and likely more pernicious issue is inflation. Throughout earnings calls this quarter companies have called out pockets of inflation. 'Price/cost' is the term they used and that term has been heard a lot so far. Higher costs crimp profit margins, at least in the near term, until a company either can work around those costs or pass them on via a higher price. The Federal Reserve is aware that levels of inflation have risen. The Fed said it believes this bout of inflation is transient, as the economy gets back to operating normally. Investors wonder if the inflation that businesses currently are experiencing is transient and if the Fed may be forced to raise interest rates to guard against an inflationary spiral.

Although the knee-jerk reaction to first quarter results has been slightly negative, the good news is that the vast majority of reports have been better than expected. Rest assured, we at Argent will closely track not only earnings reports as they come in, but also the concerns, real or imagined, investors have as we move through first quarter earnings season.

We are open for business and welcome your interest in Argent Capital. In addition, if you like our market letters, we hope you will pass them on to friends. We have four very successful equity strategies–Large Cap U.S., Small Cap U.S., Dividend Select and Mid Cap U.S.

Sincerely,

Ken Crawford

Ken Crawford, Senior Portfolio Manager

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