



INTERNATIONAL DEMAND TO DRIVE EARNINGS

U.S. exporters expected to fare better during second half of 2008 than companies with a domestic focus.

BY JAMES D. McDONALD

U.S. companies generally are well positioned financially heading into the second half of 2008. As a result, we would expect earnings to improve, although U.S. exporters should see stronger earnings growth than companies with a domestic focus.

For the first quarter of 2008 (the most recent period available as of this writing), S&P 500 companies, excluding the financial sector, saw revenue growth of 11%. Companies benefited from strong renewal growth, low unit labor cost growth and high free cash flow. Total earnings for S&P 500 companies declined 18% from a year earlier, with the earnings of two sectors — financials, down 88%, and consumer discretionary, down 11% — offsetting growth in other areas.

Strong Overseas Demand

Companies with a significant international component to their businesses posted strong earnings growth during the first quarter. For example, the energy sector grew 26% from the year earlier period, technology was up 11% and materials 9%.

The U.S. dollar's decline during the past five years has made U.S. exports significantly more competitive in overseas markets. In addition, economic growth outside the United States has been considerably stronger than within. Many global economies did not get as leveraged as the United States did, so they're not feeling the same pain from de-leveraging.

These developments should ease concerns about the U.S. current account deficit, which has forced the country to borrow from foreign governments such as Japan and China. To continue to reduce the deficit, the United States needs to increase exports and reduce consumption of foreign goods, both of which are already under way.

The Domestic Picture

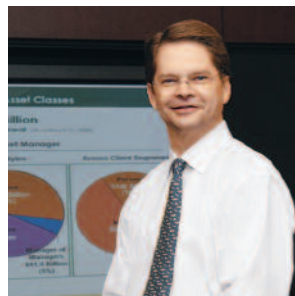
Earnings for U.S. corporations focused on the domestic market likely will not be as strong as those for global companies.

U.S. banks and brokerage firms are still feeling the impact of the slumping residential real estate market and credit crunch. Write-offs from subprime mortgage portfolios and other credit products are likely to continue into the second half. In addition, three trends — falling home values, increasing energy costs and the need to rebuild savings — are expected to hold down discretionary spending by U.S. consumers.

On a more positive note, the impact of rising commodities prices on earnings should be somewhat offset by low unit labor costs, which currently are increasing by less than 1%.

The Road Ahead

We expect U.S. exporters to continue to perform well, and the trends hampering financial companies' earnings should start to diminish as the year progresses. S&P 500 companies could see overall earnings growth return to positive territory in the third quarter, with stronger gains possible in the fourth quarter. ♦



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