

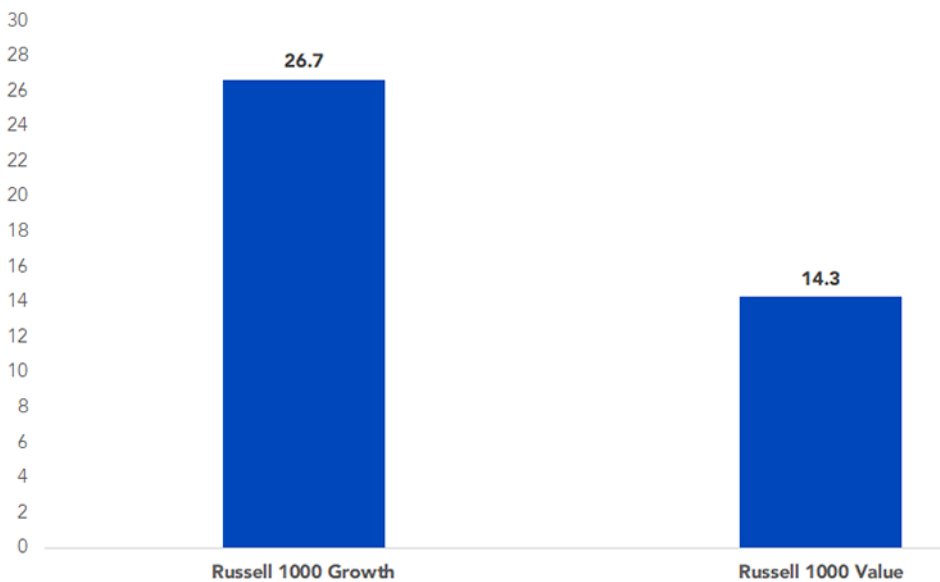
LARGE-CAP GROWTH: BRACE FOR EARNINGS REVISIONS

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So much for crashes bringing [valuations](#) back to Earth.

Here we are in the middle of an economic depression—one that maybe that lasts a few months, or maybe one that goes on for a long while—and yet the Russell 1000 Growth Index is still trading for 27 times [trailing earnings](#) (figure 1).

Figure 1: [Price-Earnings Ratio](#) (Trailing 12 Months)



Sources: WisdomTree, Bloomberg, as of 4/23/20. Past performance is not indicative of future results. You cannot invest directly in an index.

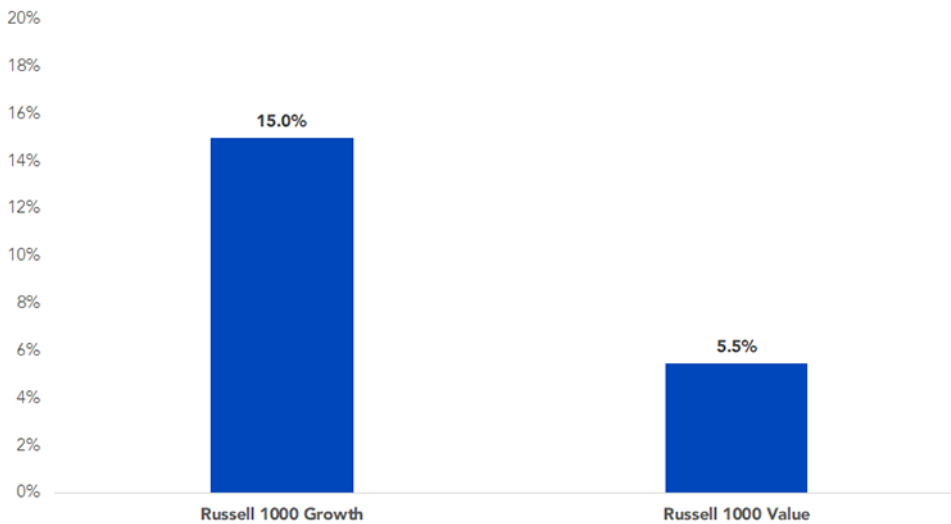
For definitions of the terms in the chart, please visit our [glossary](#).

Why the robust valuations?

Because Wall Street still hasn't gotten around to looking in the mirror when it comes to the beloved U.S. [large-cap](#) growth style investment [box](#), the asset class that could do no wrong for the last decade.

Estimates from Bloomberg for the Russell 1000 Growth Index call for earnings to compound at a double-digit rate for 3 to 5 years—from a starting point of record pre-coronavirus earnings (figure 2).

Figure 2: Bloomberg Long-Term Operating Earnings [Growth](#) Estimate

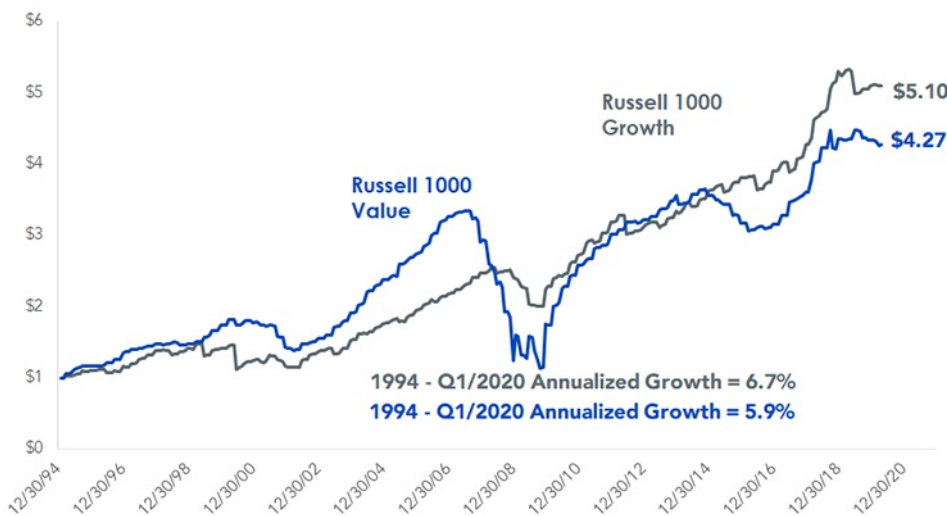


Sources: WisdomTree, Bloomberg, as of 4/23/20. Bloomberg estimated 3–5-year operating earnings growth. Past performance is not indicative of future results. You cannot invest directly in an index.

The thing about forecasted 15% earnings growth from now until 2023, 2024 or 2025, should that somehow come to pass, is that it would blow away historic precedent.

Going back to 1994, Russell 1000 Growth Index earnings increased at a 6.7% annualized clip, only slightly faster than the Russell 1000 Value Index's 5.9% annual growth rate (figure 3). Relative to supposedly stodgy value stocks, the "growth" in growth stocks has largely been an illusion.

Figure 3: Growth of Earnings, U.S. Large Caps (12/30/94 = \$1)

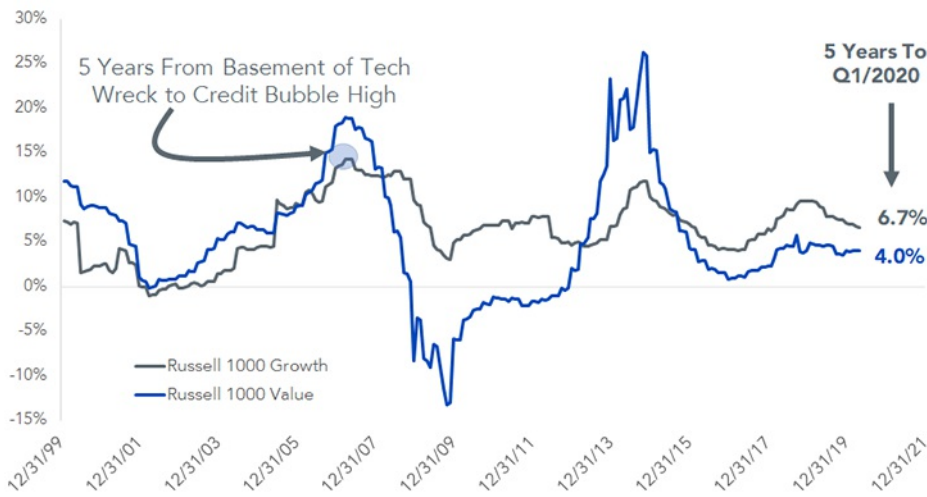


Sources: WisdomTree, Bloomberg, 12/30/1994–3/31/2020. Past performance is not indicative of future results. You cannot invest directly in an index.

Coincidentally, in the five years to the first quarter of 2020—a period of economic expansion, not COVID-19-inspired malaise—the Russell 1000 Growth Index saw earnings increase at exactly the same pace as history: 6.7% annually (figure 4).

To grow 15% for several years from the current starting point is, let's just say, a stretch.

Figure 4: 5-Year Annual Earnings Growth

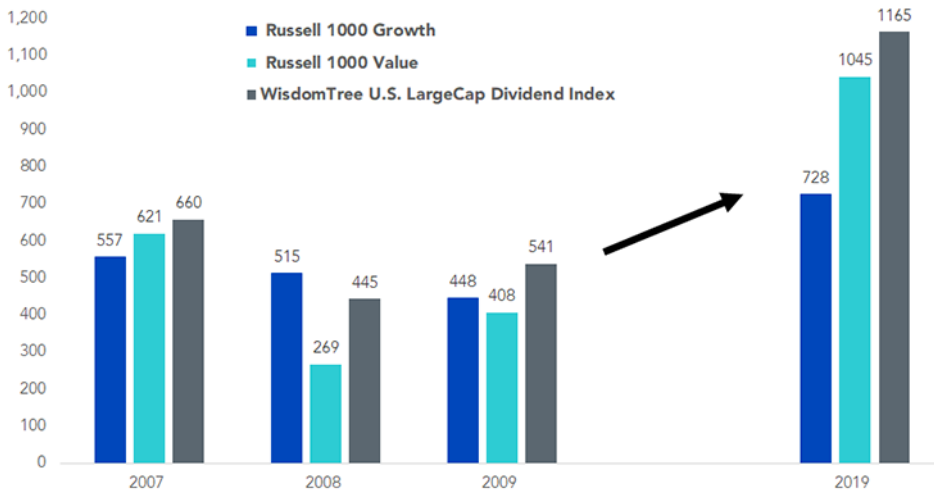


Sources: WisdomTree, Bloomberg, 12/30/1994–3/31/2020. Past performance is not indicative of future results. You cannot invest directly in an index.

Investors have found relative safety in growth stocks in 2020 on account of fears of economic contraction.

Interestingly, both the Russell 1000 Value Index and our main value index, the [WisdomTree U.S. LargeCap Dividend Index](#), which weights stocks by their dividend as a proportion of the total [dividend](#) pie, grew earnings faster than the Russell 1000 Growth Index since the credit bubble (figure 5).

Figure 5: Calendar Year Index Earnings (\$bn)



Sources: WisdomTree, Bloomberg, 12/31/07–12/31/19. Past performance is not indicative of future results. You cannot invest directly in an index. The indexes recently experienced significant negative short-term performance due to market volatility associated with the COVID-19 pandemic.

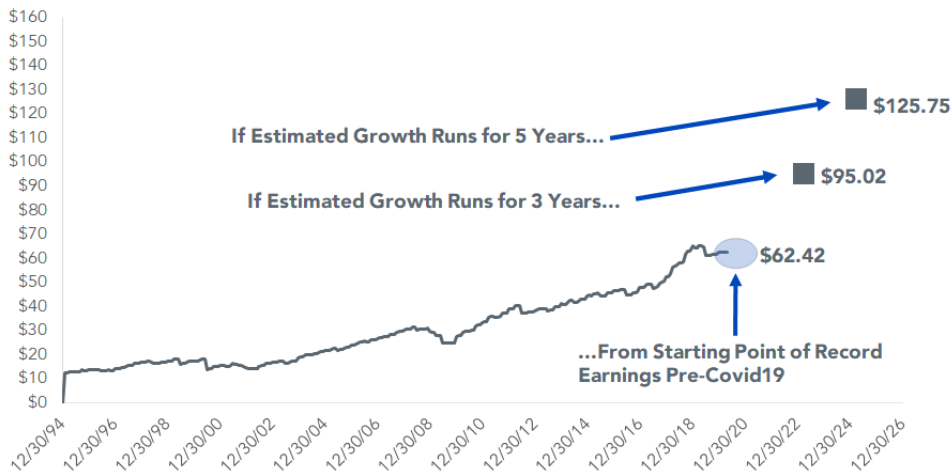
Logic says to brace for downside revisions to the market’s expectations for growth stocks in the coming years.

The Russell 1000 Growth Index is at 1,711¹ and earned \$62.42 in the year through March.

Earnings will decline from the economic shutdown; the question is how much.

But I wouldn’t hold my breath waiting for Russell 1000 Growth earnings of \$95.02 by this time in 2023 or \$125.75 in the first quarter of 2025 (figure 6). Such figures seem fantastical.

Figure 6: Russell 1000 Growth Index [Earnings per Share \(EPS\)](#)



Sources: WisdomTree, Bloomberg, 12/30/1994–3/31/2020.

Figure 7 plots five WisdomTree ETFs on the growth-value spectrum:

[DGRW \(WisdomTree U.S. Quality Dividend Growth Fund\)](#)

[EPS \(WisdomTree U.S. LargeCap Fund\)](#)

[DLN \(WisdomTree U.S. LargeCap Dividend Fund\)](#)

[DHS \(WisdomTree U.S. High Dividend Fund\)](#)

[DTN \(WisdomTree U.S. Dividend ex-Financials Fund\)](#)

Figure 7: WisdomTree Returns Attribution

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Sooner or later, we believe the face of disappointment in this market will be in U.S. large-cap growth.

It will likely not be a one- or two-month problem either. It could be something akin to the seven-year struggle of growth stocks after the dot-com [bubble](#) started to unwind.

Let the spectrum chart in figure 7 be your guide as you engage our strategies.

Unless otherwise stated, data source is Bloomberg, as of 4/23/20.

¹As of April 27, 2020

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For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

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You cannot invest directly in an index.

DEFINITIONS

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Trailing Earnings : The amount of profit that a company produces during prior fiscal year.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Large-Capitalization (Large-Cap) : A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Style : Morningstar defines its style box along two axes—large, mid-cap and small, as well as value, blend and growth. If two strategies are in the same style box, it does not mean that they hold the exact same portfolios, but it means that it might be harder to generate significantly different returns, as compared to strategies in different style boxes.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

Dividend : A portion of corporate profits paid out to shareholders.

Earnings per share : Total earnings divided by the number of shares outstanding. Measured as a percentage change as of the annual Index screening date compared to the prior 12 months. Higher values indicate greater growth orientation.

Bubble : when market participants drive stock prices above their "fair value" in relation to some system of stock valuation.