3 Reasons Stocks Sometimes Sell Off After Posting Strong Earnings

Description

One thing you'll notice when you start investing is that often stocks will perform opposite to how you'd expect after a significant piece of news, such as a strong earnings report.

There can be times when a stock seemingly posts positive results. It could post strong growth in revenue and income. It could also beat the expectations that analysts had set for it — usually a significant factor in how the stock reacts.

However, even when all these metrics are positive, there are times when stocks still sell off after posting strong earnings. Conversely, there are times when the numbers may not be very strong, but the stock reacts positively.

So, here are three reasons why stocks might sell off after posting strong earnings.

Are the stocks selling off after strong earnings due to an industry development?

One of the most common reasons that stocks sometimes sell off after posting strong earnings is due to recent developments that impact the industries they're in. Conversely, after posting poor earnings, a stock could rise if a positive industry development came to light.

This could be anything from interest rates changing, new government legislation being introduced, or any other significant development the market deems to have a meaningful impact on the stock's outlook.

Take **Air Canada** stock, for example. Last week, the stock, which has been one of the most impacted stocks of the pandemic, finally began to post strong and positive earnings. Initially, it rallied as a result. However, this week, it's losing value due to the conflict in Ukraine, as these types of conflicts typically impact airline stocks.

So, any time a stock may be performing differently to how you'd expect after posting strong earnings, look for any industry developments.

Operational guidance can play a significant role in the stock's price

It's also crucial to know that earnings reports aren't all about the numbers that the company achieved in the past. Often guidance going forward can have a significant impact on how much investors want to value the stock at.

Factors such as the company taking on a new strategy, looking for different avenues of growth, or projecting different future sales or margins than expected can all have a much bigger impact on the stock's price than the actual results it's reporting.

For example, look at **Shopify's** (TSX:SHOP)(NYSE:SHOP) earnings report earlier this month. If you're just looking at its numbers from the last quarter, it was one of the top Canadian stocks with strong earnings. Its revenue in the fourth quarter was up 41% year over year, and the number came in above expectations.

Yet it was Shopify's outlook for growth going forward coupled with its decision to invest a tonne of capex in the coming years on building a new distribution network, which really impacted the stock.

Is the financial guidance negative after these stocks reported strong earnings?

Lastly, financial guidance is another huge factor in how stocks perform after posting positive or negative earnings. For example, if the company has a tonne of cash and decides to buy back shares, increase the dividend, or both, the stock price could have a positive result.

Conversely, if a company has debt getting out of control and is forced to trim its dividend to pay down that debt, the stock will understandably sell off.

So, even when stocks post strong numbers in their earnings reports, there are times when the financial guidance going forward may create a different reaction in the share price.

Bottom line

Earnings reports are some of the most important times to get updated information on the stocks you own and those you are watching. But when looking at the earnings reports for stocks, it's crucial to read all the information, as sometimes, strong numbers can be overshadowed by guidance that the market deems to be less than ideal.

So, if you want to gain as much information as possible, it's crucial to read the full earnings reports and even listen to management's conference calls. This way, you can understand why the stock is moving how it is in the short run.

And by knowing why stocks are moving in the direction they are in the short run while keeping a long-term mindset, you'll be able to make the best investing decisions possible.

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