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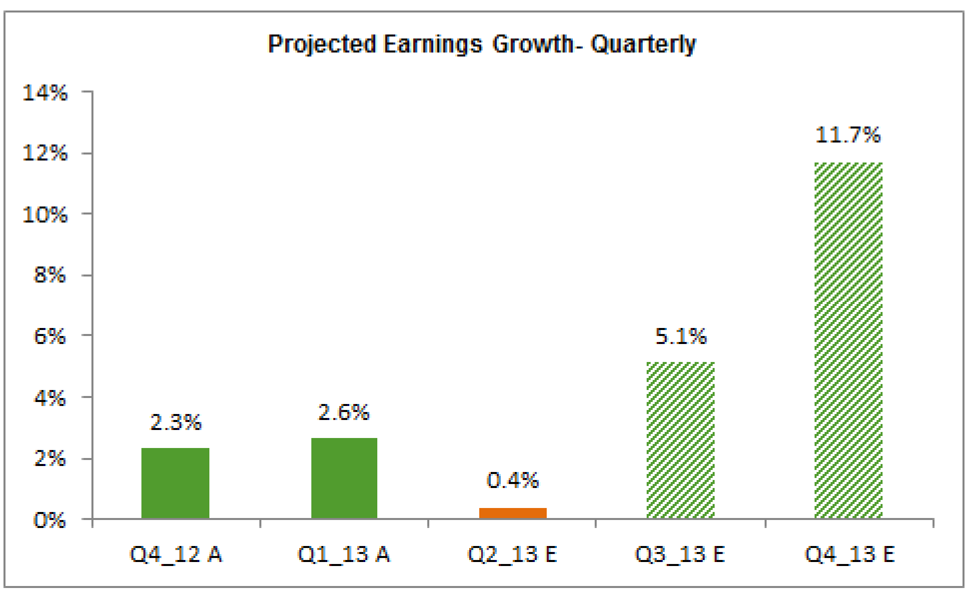
Will Earnings Growth Bottom in Q2?

The June jobs report has put the spotlight back on the Fed and what it will do to the QE program in the coming months. But hopefully the Q2 earnings season will provide enough of a distraction to not let the Fed become a full-time fixation for the market.

Given how low expectations have come down over the last few months, the Q2 reporting season may not carry many surprises. In fact, it may be reasonable to expect this earnings season to be no different from what we have become accustomed to seeing over the last few quarters. But two aspects of this coming earnings season need paying special attention to – revenues and guidance.

Management teams are typically very good at under-promising and over-delivering. That's why roughly two-thirds of the companies end up beating earnings expectations. But an unusually big proportion of the companies came short of revenue expectations in the previous quarter. The situation has not been much different from the 23 S&P 500 companies that have reported results already, which includes companies like Oracle (ORCL), FedEx (FDX), Walgreen (WAG) and others. As such, more than earnings surprises, it will be interesting to keep an eye on revenue surprises.

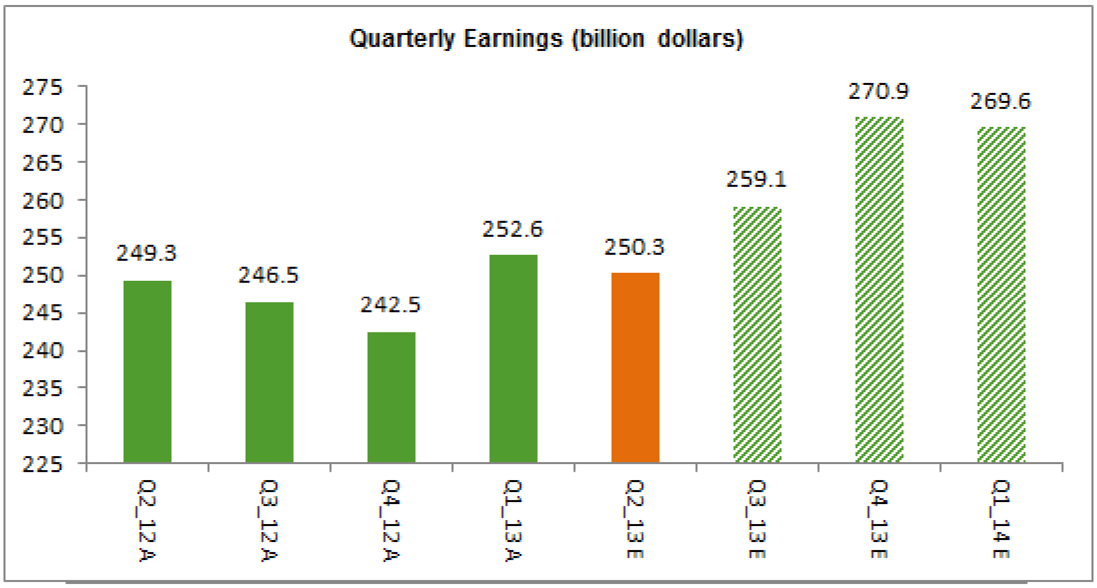
But even more significant than growth rates and surprises will be guidance. Guidance is always important, but it has assumed even more significance this time around given the elevated expectations for the second half of the year, as the chart below shows.



Source: Zacks Data

We may not see much earnings growth in the first half of 2013, but consensus expectations are for a material growth ramp up in the back half of the year – from +2.7% in the first half to +9.2% in the second half.

Importantly, the growth expectations for the second half of the year are not due to easy comparisons – the level of total earnings expected in 2013 Q3 and Q4 represent new all-time high quarterly records, as shown by the chart below of total bottom-up consensus earnings estimates.



Source: Zacks Data

My sense is that estimates need to come down in a big way. The market hasn't cared much in the recent past about negative revisions as aggregate earnings estimates have been coming down for over a year now. But if we are entering a post-QE world, as I believe we are, then it will likely be difficult to overlook negative earnings estimate revisions going forward. How the market responds to negative guidance over and the resulting negative revisions will tell us a lot about what to expect going forward.

Key Points

» Total earnings for the 23 S&P 500 companies that have reported results already are up +8.1%, with 60.9% of this small sample beating earnings expectations. Revenues for these companies are up +5.3%, with a revenue 'beat ratio' of 43.5%.

» Overall expectations remain low, with total earnings for the S&P companies as a whole expected to be up +0.4% from the same period last year, reflecting -0.8%

lower revenues and modestly higher margins. This follows +2.6% earnings growth in Q1 on -1.3% lower revenues.

» Estimates for Q2 have come down materially since the quarter got underway, with the current +0.4% growth down from +3.9% in early April.

» Finance is the only major sector with a strong growth profile, with total earnings for the sector expected to be up +18.6% in Q2. This follows +7.6% earnings growth in Q1 and many quarters of double-digit gains for the sector. Excluding Finance, total earnings would be down -3.2% in Q2.

» Finance reclaims its leadership role in the S&P 500, contributing more earnings to the index's total than Technology this year for the first time since the 2008 crisis. The sector is expected to account for 19.2% of total S&P 500 earnings in 2013 compared to Technology's 18%.

» Technology earnings were weak in Q1 and they are even weaker this time around, with total earnings for the sector expected to decline -8.3% in Q2 after declining -4.2% in Q1. Weakness in hardware and semi-conductor industries more than offset the modest growth in software earnings. Excluding Technology, total earnings for the S&P 500 would be up +2.4% in Q2.

» Estimate revisions remain in neutral territory at present, though Finance continues to experience strong positive revisions, while revisions for Basic Materials, Industrials, Staples, and Business Services predominantly to the downside (page 17 of the report).

» Estimates for the second half of the year still reflect strong growth, with total earnings in the second half expected to increase by +9.2% after the +2.7% increase in the first half. Total earnings are expected to be up 6.4% in 2013 and +11.5% in 2014.

» While there is not much growth, the overall level of total earnings is quite high. Total earnings were an all-time record at $252.6 billion in Q1 and are expected to total $250.3 billion in Q2 (See Table 4). For the full year, earnings are expected total $1.03 trillion in 2013 and $1.15 trillion in 2014.

» Net margins are expected to be up 20 basis points in Q2 as a whole and stay flat outside of the Finance sector (See Table 8 in the report). But expectations are for net margins to start expanding materially from the third quarter onwards (Table 9). For the full year 2013, net margins are expected to top the 2006 peak and expand even further in 2014.

» The bottom-up 'EPS' for the S&P 500 for 2013 and 2014 currently stands at $109.18

and $121.72, respectively. The top-down 'EPS' estimates for 2013 and 2014 currently stand at $107.83 and $114.80. (Note: All the data in this report is based on bottom-up estimates).

Q2 Earnings Season Gets Underway

The 2013 Q2 earnings season has gotten underway, though we will have to wait a bit longer for the reporting cycle to get into high gear. The initial reports from the likes of Oracle (ORCL), FedEx (FDX), Walgreen (WAG), Darden (DRI) and others don't look very inspiring, though the growth rates and beat ratios are not materially different from what we have been seeing in recent quarters.

Total earnings for the 23 S&P 500 companies that have already reported results are up +8.1% from the same period last year, with 60.9% of the companies beating earnings expectations with a median surprise of +2.7%. Total revenues for these companies are up +5.3%, with 43.5% beating revenue expectations with a median surprise of (negative) -0.4%. This is a shade better than what these same 23 companies reported over the last few quarters, but not materially so.

Here is the Scorecard for these 23 S&P 500 companies

Scorecard	% Reported		Q1 Earnings			Q1 Revenue		
Zacks Sectors	Total Companies	Total Market Cap	Growth YoY	Beat Ratio	Median Surp. %	Growth YoY	Beat Ratio	Median Surp. %
Cons. Staples	11.8%	5.3%	-0.6%	25.0%	-0.9	17.4%	25.0%	-0.5
Cons. Discretionary	9.7%	10.7%	4.3%	100.0%	23.5	-0.1%	33.3%	-1.7
Retail/Wholesale	12.5%	9.4%	22.2%	33.3%	-1.5	7.3%	50.0%	0.2
Medical	0.0%	0.0%	NRPT	NRPT	NM	NRPT	NRPT	NM
Autos	0.0%	0.0%	NRPT	NRPT	NM	NRPT	NRPT	NM
Basic Materials	4.3%	11.4%	2.0%	100.0%	3.8	0.7%	0.0%	-4.0
Industrial Products	0.0%	0.0%	NRPT	NRPT	NM	NRPT	NRPT	NM
Construction	9.1%	6.8%	90.8%	100.0%	30.3	53.3%	100.0%	8.4
Conglomerates	0.0%	0.0%	NRPT	NRPT	NM	NRPT	NRPT	NM
Technology	7.4%	7.6%	4.8%	80.0%	9.1	1.8%	80.0%	0.4
Aerospace	0.0%	0.0%	NRPT	NRPT	NM	NRPT	NRPT	NM
Oil/Energy	0.0%	0.0%	NRPT	NRPT	0.0	NRPT	NRPT	0.0
Finance	0.0%	0.0%	NRPT	NRPT	NM	NRPT	NRPT	NM
Utilities	0.0%	0.0%	NRPT	NRPT	NM	NRPT	NRPT	NM
Transportation	10.0%	11.4%	7.1%	100.0%	8.7	3.9%	0.0%	-0.4
Business Services	10.0%	13.3%	10.6%	50.0%	1.4	-5.0%	0.0%	-1.8
S&P 500	**4.6%**	**4.1%**	**8.1%**	**60.9%**	**2.7**	**5.3%**	**43.5%**	**-0.4**
ex Finance	5.5%	4.9%	8.1%	60.9%	N/A	4.6%	43.5%	0.0

(Note: 'Beat Ratio' is the % of companies reporting positive surprises; NRPT means 'no reports'; NM means not meaningful)

Since the bulk of the earnings season is still ahead of us, it makes more sense to track expectations for all the companies instead of just those that have not yet reported at this stage. Expectations for Q2 earnings remain low, having come down significantly over the last few months. Low expectations mean that easy hurdle rates for companies to jump through. As such, beat ratios and growth rates in Q2 will likely be not much different from what we have become accustomed to recent quarters.

The issue wouldn't be so much companies' ability to beat expectations, but rather how they guide about the coming quarters. Guidance is important in any earnings season, but it is particularly important this time around given the relatively elevated expectations for the second half of the year. Consensus estimates for 2013 Q3 and Q4 have held up quite well, even as expectations for Q2 came down over the last few months.

Total earnings in Q2 are expected to be essentially flat from the same period last year (up +0.4%), on modestly lower revenues and barely higher margins. Estimates have been steadily coming down as the quarter unfolded, with the current flat growth rate down from +3.9% in early April.

The table below provides a summary view of the expectations for Q2.

Zacks Sectors	Year-over-Year Growth					
	Earnings		Revenue		Margins	
	2Q 13E	1Q 13A	2Q 13E	1Q 13A	2Q 13E	1Q 13A
Cons. Staples	-1.0%	1.8%	-7.5%	-0.9%	0.55%	0.75%
Cons. Discretionary	8.9%	13.5%	4.8%	4.4%	-0.10%	0.20%
Retail/Wholesale	5.9%	7.9%	4.5%	1.7%	0.32%	0.02%
Medical	-7.1%	4.2%	2.5%	13.3%	-1.33%	-2.39%
Autos	-4.7%	-20.6%	2.8%	0.3%	-0.58%	-2.11%
Basic Materials	-10.4%	-1.8%	-1.2%	-2.1%	1.21%	-1.77%
Industrial Products	-5.4%	-7.7%	1.0%	-0.5%	-0.09%	-0.11%
Construction	46.7%	105.2%	10.9%	13.9%	0.27%	1.79%
Conglomerates	-2.0%	0.4%	1.2%	0.1%	0.07%	0.11%
Technology	-8.3%	-4.2%	-0.3%	2.9%	0.42%	-1.72%
Aerospace	-1.7%	16.3%	-2.2%	-2.7%	0.01%	-0.35%
Oil/Energy	-5.8%	-1.0%	-9.9%	-13.7%	0.07%	-0.75%
Finance	18.6%	7.6%	-3.6%	-8.7%	2.03%	8.35%
Utilities	3.0%	11.5%	4.3%	3.7%	-1.52%	-1.06%
Transportation	2.4%	3.3%	3.6%	3.1%	0.92%	0.79%
Business Services	9.5%	9.3%	0.5%	3.1%	1.03%	1.87%
S&P 500	**0.4%**	**2.6%**	**-0.8%**	**-1.3%**	**0.20%**	**0.27%**
ex Finance	-3.2%	1.4%	-0.4%	-0.2%	-0.02%	-0.70%

Here are a couple of quick takeaways from looking at the data above.

There is not much earnings growth outside of the Finance sector. Excluding Finance, total earnings are expected to be down -3.2%, with 9 of the 16 Zacks sectors showing negative earnings growth.

Finance earnings are expected to be up an impressive +18.6%, with all the key industries within the sector like major banks, insurance, and brokers/money managers on track to generate strong growth. Next week's results from J. P. Morgan and Wells Fargo will set the stage for the rest of the sector's results, though the broader trend in estimate revisions has consistently remained positive for the group in the recent past. Finance's strong earnings growth in Q2 notwithstanding, total earnings for the sector will remain below Q1's record tally.

The Technology sector was weak last quarter and remains on track for an even weaker showing this time around, with total earnings for the sector expected to be down -8.3% on -0.3% lower revenues. Had Technology not been such a drag on growth, total earnings for the S&P 500 would be up +2.4% in Q2 and +4.2% in Q1.

The Technology weakness is broad-based, with modestly positive growth for the software industry (33% of the sector's total earnings) more than offset by weakness for the hardware makers (43% of the sector's total earnings) and semi-conductors (9% of the total). Modestly positive earnings growth at Apple and Cisco are no match for negative comparisons at Dell, Seagate, Salesforce.com and many other industry players.

Among other growth laggards, Industrials (-5.4%) and Basic Materials (-10.4%) are joined by the Medical sector in Q2, with total earnings for the sector expected to be down -7.1%. Within the Medical sector, the weakness is primarily in the pharmaceutical industry which accounts for roughly two-thirds of the sector's total earnings. Total earnings for the pharmaceutical industry are expected to be down -11.3%, while Medical Care earnings are expected to be up +2.9% and Medical Products down -1.8%. Tough comparisons at Pfizer, Merck, Abbot and others tell the pharmaceutical industry's earnings growth challenge.

The Context for Growth Expectations

Let's take a look at how consensus earnings expectations for 2013 Q2 compare to what companies earned in the last few quarters and what they are expected to earn the rest of this year.

Table 2 below presents the year over year earnings growth rates - expectations for Q2 and the final two quarters of the year. It also shows consensus earnings growth expectations for 2013 and 2014. Table 3 presents the same data for revenues.

Table 2 – Earnings Growth Context

Zacks Sectors	Earnings Growth (YoY)							
	1Q 14E	4Q 13E	3Q 13E	*2Q 13E*	1Q 13A	4Q 12A	Annual 2013E	Annual 2014E
Cons. Staples	5.1%	5.2%	3.3%	***-1.0%***	1.8%	4.4%	7.1%	9.4%
Cons. Discretionary	12.3%	15.0%	5.8%	***8.9%***	13.5%	1.8%	13.8%	15.1%
Retail/Wholesale	23.8%	-9.1%	17.6%	***5.9%***	7.9%	6.6%	10.0%	15.1%
Medical	1.0%	2.2%	-3.8%	***-7.1%***	4.2%	2.8%	-0.2%	8.8%
Autos	21.4%	23.0%	-0.7%	***-4.7%***	-20.6%	5.2%	3.3%	21.6%
Basic Materials	15.2%	19.8%	11.0%	***-10.4%***	-1.8%	13.2%	6.6%	18.9%
Industrial Products	11.4%	22.5%	5.3%	***-5.4%***	-7.7%	-8.4%	3.5%	12.3%
Construction	19.9%	7.4%	25.5%	***46.7%***	105.2%	90.7%	41.5%	23.3%
Conglomerates	-2.3%	10.7%	7.3%	***-2.0%***	0.4%	8.6%	5.2%	11.5%
Technology	6.6%	5.2%	3.0%	***-8.3%***	-4.2%	1.9%	2.3%	11.7%
Aerospace	-5.9%	10.4%	0.4%	***-1.7%***	16.3%	-14.2%	7.8%	5.6%
Oil/Energy	3.4%	0.5%	2.6%	***-5.8%***	-1.0%	5.8%	1.0%	9.7%
Finance	1.9%	27.9%	8.1%	***18.6%***	7.6%	10.0%	14.1%	10.1%
Utilities	9.9%	187.3%	6.4%	***3.0%***	11.5%	-58.8%	8.1%	10.3%
Transportation	16.0%	15.1%	13.8%	***2.4%***	3.3%	-0.7%	11.7%	15.9%
Business Services	17.7%	15.8%	11.1%	***9.5%***	9.3%	8.6%	12.2%	13.1%
S&P 500	**6.7%**	**11.7%**	**5.1%**	***0.4%***	**2.6%**	**2.3%**	**6.4%**	**11.5%**
ex Finance	8.0%	8.5%	4.5%	***-3.2%***	1.4%	0.9%	4.8%	11.8%

Estimates for 2013 Q2 came down as the Q1 earnings season progressed, largely reflecting the overall negative tone of company guidance. But estimates for the back half of the year have largely held up.

The +0.4% earnings growth expected in Q2 at present compares to expectations of +3.9% growth in early April. The revisions are particularly pronounced for Technology, Basic Materials, and Consumer Staples. Only two sectors have experienced positive revisions – Construction and Finance. For the full-year 2013, total earnings are now expected to be up +6.4%.

Table 3 – Revenue Growth Context

Zacks Sectors	Revenue Growth (YoY)							
	1Q 14E	4Q 13E	3Q 13E	2Q 13E	1Q 13A	4Q 12A	Annual 2013E	Annual 2014E
Cons. Staples	-6.5%	-6.8%	-10.0%	***-7.5%***	-0.9%	-1.0%	-7.3%	4.1%
Cons. Discretionary	3.9%	5.6%	4.5%	***4.8%***	4.4%	0.0%	4.8%	5.1%
Retail/Wholesale	11.9%	-2.7%	5.5%	***4.5%***	1.7%	5.3%	3.6%	6.7%
Medical	6.0%	2.4%	4.5%	***2.5%***	13.3%	0.0%	4.5%	5.1%
Autos	3.5%	2.4%	4.0%	***2.8%***	0.3%	0.0%	2.1%	5.6%
Basic Materials	4.2%	-0.3%	2.8%	***-1.2%***	-2.1%	0.0%	18.7%	4.4%
Industrial Products	-1.3%	7.2%	3.6%	***1.0%***	-0.5%	0.0%	2.5%	4.2%
Construction	11.8%	11.4%	12.5%	***10.9%***	13.9%	0.0%	12.3%	11.6%
Conglomerates	8.0%	1.7%	1.7%	***1.2%***	0.1%	0.0%	0.5%	4.8%
Technology	3.0%	3.2%	1.3%	***-0.3%***	2.9%	0.0%	2.5%	5.7%
Aerospace	3.0%	-2.2%	0.2%	***-2.2%***	-2.7%	0.0%	3.4%	1.6%
Oil/Energy	3.7%	-9.0%	-3.4%	***-9.9%***	-13.7%	0.0%	-6.7%	2.2%
Finance	9.5%	-14.4%	-6.1%	***-3.6%***	-8.7%	0.0%	-8.1%	3.2%
Utilities	4.0%	3.0%	5.2%	***4.3%***	3.7%	0.0%	4.9%	3.0%
Transportation	6.2%	5.4%	5.3%	***3.6%***	3.1%	0.0%	4.6%	6.2%
Business Services	3.4%	3.2%	1.0%	***0.5%***	3.1%	0.0%	2.5%	5.1%
S&P 500	**5.6%**	**-2.8%**	**0.7%**	***-0.8%***	**-1.3%**	**0.9%**	**0.4%**	**4.6%**
ex Finance	5.1%	-0.9%	1.8%	***-0.4%***	-0.2%	1.0%	1.7%	4.8%

The next two tables present the same data in a different format – instead of year-over-year growth rates, we have the dollar levels of total earnings and revenues for each of these quarters.

What this tells us is that earnings growth has been essentially flat since the second quarter of 2012, a trend that is expected to carry into the first quarter of 2013. But growth is expected to resume from the second quarter onwards, with a significant ramp-up in the back half of the year.

Table 4 – Total Quarterly earnings

Zacks Sectors	Quarterly Earnings *(billion dollars)*								
	1Q 14E	4Q 13E	3Q 13E	2Q 13E	1Q 13A	4Q 12A	3Q 12A	2Q 12A	1Q 12A
Cons. Staples	16.5	18.5	18.5	***16.9***	15.7	17.6	17.9	17.1	15.4
Cons. Discretionary	10.1	11.8	11.3	***10.6***	9.0	10.3	10.7	9.7	8.0
Retail/Wholesale	23.6	18.7	19.5	***18.6***	19.0	20.5	16.6	17.5	17.6
Medical	28.4	28.0	27.9	***27.4***	28.2	27.4	29.0	29.5	27.0
Autos	5.3	4.6	5.0	***4.7***	4.4	3.7	5.1	5.0	5.5
Basic Materials	10.5	7.6	6.9	***8.1***	9.1	6.3	6.2	9.0	9.3
Industrial Products	6.0	6.7	7.3	***7.0***	5.4	5.4	6.9	7.4	5.9
Construction	1.1	1.2	1.4	***1.2***	0.9	1.1	1.1	0.8	0.4
Conglomerates	8.3	10.1	8.7	***8.4***	8.5	9.1	8.1	8.5	8.4
Technology	47.0	55.6	43.1	***43.5***	44.1	52.8	41.8	47.5	46.1
Aerospace	3.8	3.9	3.7	***3.7***	4.1	3.5	3.7	3.7	3.5
Oil/Energy	31.8	31.6	31.6	***29.6***	30.8	31.5	30.8	31.4	31.1
Finance	53.0	51.3	48.5	***48.7***	52.0	40.1	44.9	41.1	48.3
Utilities	14.2	10.6	15.8	***11.9***	12.9	3.7	14.9	11.6	11.6
Transportation	4.1	4.6	4.4	***4.5***	3.6	4.0	3.8	4.4	3.5
Business Services	5.8	6.1	5.5	***5.4***	5.0	5.3	4.9	4.9	4.5
S&P 500	**269.6**	**270.9**	**259.1**	***250.3***	**252.6**	**242.5**	**246.5**	**249.3**	**246.1**
ex Finance	216.7	219.6	210.6	***201.6***	200.6	202.4	201.6	208.2	197.8

Table 5 – Total Quarterly Revenues

Zacks Sectors	Quarterly Revenues *(billion dollars)*								
	1Q 14E	4Q 13E	3Q 13E	2Q 13E	1Q 13A	4Q 12A	3Q 12A	2Q 12A	1Q 12A
Cons. Staples	132.0	145.9	138.7	***137.9***	141.2	156.5	154.2	149.1	142.5
Cons. Discretionary	101.1	107.1	102.5	***97.8***	97.3	101.4	98.1	93.3	93.2
Retail/Wholesale	538.0	511.6	501.8	***489.4***	480.9	525.8	475.5	468.4	472.7
Medical	221.5	220.4	214.2	***214.1***	209.0	215.2	205.0	208.8	184.5
Autos	109.7	111.4	107.0	***109.0***	106.0	108.9	102.8	106.0	105.7
Basic Materials	119.0	112.7	112.3	***116.7***	114.3	113.1	109.3	118.1	116.7
Industrial Products	72.0	76.6	78.1	***77.5***	73.0	71.4	75.4	76.7	73.4
Construction	24.6	25.3	25.6	***24.3***	22.0	22.7	22.7	21.9	19.3
Conglomerates	84.7	87.6	81.9	***82.4***	78.4	86.2	80.6	81.5	78.3
Technology	284.1	308.3	269.4	***270.3***	275.7	298.7	266.0	271.0	267.9
Aerospace	55.6	59.1	57.1	***56.0***	54.0	60.4	57.0	57.2	55.5
Oil/Energy	361.0	364.3	373.6	***368.6***	348.2	400.5	386.6	409.2	403.7
Finance	333.2	325.6	319.2	***316.8***	304.3	380.6	339.8	328.6	333.4
Utilities	163.1	161.0	167.1	***152.1***	156.8	156.4	158.9	145.8	151.2
Transportation	48.8	49.9	48.1	***48.3***	46.0	47.3	45.7	46.7	44.6
Business Services	38.6	39.6	37.6	***37.6***	37.4	38.4	37.3	37.4	36.3
S&P 500	**2687.3**	**2706.4**	**2634.2**	***2598.7***	**2544.5**	**2783.5**	**2614.8**	**2619.8**	**2578.9**
ex Finance	2354.1	2380.8	2315.0	***2281.9***	2240.2	2402.9	2275.0	2291.2	2245.5

Table 6 – Total Annual Earnings

Zacks Sectors	Annual Earnings (billion dollars)						
	2014 E	2013 E	2012 A	2011 A	2010 A	2009 A	2008 A
Cons. Staples	76.7	***70.1***	65.5	67.8	64.4	56.6	55.6
Cons. Discretionary	49.2	***42.7***	37.5	33.2	28.7	23.4	26.5
Retail/Wholesale	89.4	***77.7***	70.6	68.6	63.3	55.9	54.3
Medical	121.0	***111.2***	111.4	110.6	102.4	90.0	87.3
Autos	22.6	***18.6***	18.0	21.8	18.8	0.8	-2.5
Basic Materials	38.0	***31.9***	30.0	34.3	35.7	14.9	26.4
Industrial Products	29.6	***26.3***	25.4	24.4	18.1	12.5	18.8
Construction	5.8	***4.7***	3.3	2.0	1.9	-0.1	-1.2
Conglomerates	38.9	***34.9***	33.2	31.0	28.5	25.3	32.2
Technology	207.8	***186.1***	181.9	174.8	150.6	103.5	99.6
Aerospace	16.0	***15.2***	14.1	14.8	14.1	12.0	14.6
Oil/Energy	135.7	***123.7***	122.5	137.8	99.0	64.2	148.4
Finance	218.0	***198.1***	173.7	142.2	144.4	88.1	3.4
Utilities	56.2	***50.9***	47.1	48.7	45.7	45.2	52.5
Transportation	19.9	***17.2***	15.4	15.0	12.5	8.4	11.7
Business Services	24.9	***22.0***	19.6	17.8	15.3	13.1	12.6
S&P 500	**1150.6**	**1032.2**	**969.7**	**948.5**	**846.4**	**616.3**	**641.7**
ex Finance	931.7	***833.4***	795.5	806.3	702.0	528.1	638.3

Table 7 – Total Annual Revenues

Zacks Sectors	Annual Revenues *(billion dollars)*						
	2014 E	2013 E	2012 A	2011 A	2010 A	2009 A	2008 A
Cons. Staples	575	***552***	596	604	557	508	514
Cons. Discretionary	427	***406***	387	375	335	282	313
Retail/Wholesale	2138	***2004***	1935	1844	1712	1630	1600
Medical	901	***858***	821	758	717	627	595
Autos	457	***432***	423	424	367	316	403
Basic Materials	481	***461***	388	463	403	326	425
Industrial Products	315	***303***	295	280	235	205	246
Construction	108	***96***	86	75	72	72	86
Conglomerates	340	***324***	323	318	307	304	351
Technology	1187	***1123***	1096	1027	916	785	815
Aerospace	230	***226***	219	221	224	225	211
Oil/Energy	1529	***1496***	1604	1600	1450	1165	1594
Finance	1296	***1255***	1365	1260	1301	1298	1066
Utilities	660	***641***	610	606	586	572	607
Transportation	206	***194***	185	179	160	140	160
Business Services	160	***152***	148	143	131	121	124
S&P 500	**11010**	***10524***	**10482**	**10175**	**9472**	**8575**	**9112**
ex Finance	9714	***9269***	9116	8915	8171	7277	8045

It may be obvious, but it's still useful to explain what we mean by total earnings.

This means the sum total of aggregate earnings for all the companies in the S&P 500. For historical periods through 2013 Q1, we have taken the total earnings (not EPS) for each company in the S&P 500 and added them up to arrive at the sector and index level totals (we do adjust reported GAAP earnings for non-recurring items). For the coming quarters, including Q2, we have taken the Zacks Consensus EPS for each company in the index, multiplied that by the corresponding share count to arrive at the total earnings for each company. And then we aggregated that to the sector and index levels. The lack of accuracy in real-time share count notwithstanding, this gives us a fairly accurate view of the total earnings picture.

In plain language, what Table 4 tells us is that companies in the S&P 500 are on track to earn $250.3 billion in 2013 Q2 vs. $252.6 billion in Q1 and $249.3 billion in 2012 Q2.

Here are a couple of quick takeaways from Table 4.

The overall level of total earnings is very high. In fact, the Q1 total of $252.6 billion is an all-time quarterly high.

There hasn't been much growth in recent quarters, but the expectation is for a trend reversal going forward. Comparing the consensus expectations for the first half of 2013 with the actual results for the same period in 2012, we get a growth rate of 2.8%. But the same year-over-year comparison for the second half of the year shows a growth rate of +9.2%. And as you can see from Table 4, the second-half 2013 growth ramp up is not simply due to easy comparisons – total earnings in each of the last two quarters of the year represent new all-time records. This second-half growth recovery is then expected carry into 2014, resulting in further earnings growth of +11.5%.

Where Is the Growth Coming From?

Driving this optimistic growth outlook is the view that the forces that held down profitability over the last few quarters abate in the second half of the year and are replaced by strong growth.

The U.S. economic outlook has certainly stabilized and GDP growth in the second half of the year should be an improvement over the first half. But it's hard to envision the modest economic growth ramp up in the second half translate into this magnitude of earnings growth.

Expectations for next year's GDP growth remain in the +3% to +3.5% range, even the Fed recently raised its estimate for 2014 GDP. The international economic growth picture looks a lot less impressive. But with almost 60% of total earnings coming from the home market, a material acceleration in U.S. GDP growth along the lines currently expected would provide a major boost to earnings.

The health of corporate earnings is closely tied to the health of the economy. After all, earnings in the aggregate can grow only through two avenues – revenue growth and/or margin expansion. Revenues grow in-line with 'nominal' GDP growth. If 'real' or inflation-adjusted GDP growth next year is expected to grow at +3% rate and inflation is around +2%, then nominal GDP growth next year will be around +5%.

Given these consensus GDP growth expectations, the +4.6% revenue growth expected next year doesn't seem so unreasonable. But in order to reach the expected +11.5% total earnings growth in 2014, we need a fair amount of margin gains to compliment the +4.6% revenue growth.

Margins have come a long way from the 2009 bottom and by some measures have already peaked out. But it may not be so reasonable to expect margins to continue expanding.

The Margins Picture

Net margins are expected to be flat from the same period last year, with 6 of the 16 Zacks sectors showing lower net margins than the same quarter last year. Net margins are down modestly from the preceding quarter's level. Excluding Finance, net margins are down boy sequentially as well as year over year.

Table 8 below shows the year-over-year and quarter-over-quarter changes for the current and preceding quarters, as well as the year-over-year changes for last year, this year, and next year.

Table 8: Change in Net Margins

	2Q13E		1Q13A		2012A	2013E	2014E
Zacks Sectors	YoY	QoQ	YoY	QoQ	YoY	YoY	YoY
Cons. Staples	***0.55%***	0.05%	0.75%	1.13%	-0.23%	***1.70%***	0.65%
Cons. Discretionary	***-0.10%***	0.58%	0.20%	0.77%	0.84%	***0.83%***	1.00%
Retail/Wholesale	***0.32%***	-0.01%	0.02%	0.11%	-0.07%	***0.23%***	0.30%
Medical	***-1.33%***	0.03%	-2.39%	-0.73%	-1.01%	***-0.61%***	0.45%
Autos	***-0.58%***	-0.08%	-2.11%	0.28%	-0.90%	***0.05%***	0.65%
Basic Materials	***1.21%***	-0.14%	-1.77%	-0.89%	0.30%	***-0.79%***	0.96%
Industrial Products	***-0.09%***	0.27%	-0.11%	1.00%	-0.13%	***0.09%***	0.68%
Construction	***0.27%***	0.22%	1.79%	0.81%	1.15%	***1.00%***	0.51%
Conglomerates	***0.07%***	-0.07%	0.11%	-0.59%	0.54%	***0.48%***	0.68%
Technology	***0.42%***	0.30%	-1.72%	-0.24%	-0.43%	***-0.02%***	0.93%
Aerospace	***0.01%***	0.13%	-0.35%	-1.13%	-0.26%	***0.27%***	0.26%
Oil/Energy	***0.07%***	0.11%	-0.75%	-0.91%	-0.98%	***0.63%***	0.61%
Finance	***2.03%***	-2.14%	8.35%	2.75%	1.43%	***3.06%***	1.04%
Utilities	***-1.52%***	0.71%	-1.06%	-1.09%	-0.33%	***0.23%***	0.57%
Transportation	***0.92%***	0.03%	0.79%	1.53%	-0.09%	***0.56%***	0.81%
Business Services	***1.03%***	0.17%	1.87%	0.83%	0.80%	***1.25%***	1.10%
S&P 500	***0.20%***	-0.01%	0.27%	0.01%	-0.07%	***0.56%***	0.64%
ex Finance	***-0.02%***	0.13%	-0.70%	-0.14%	-0.32%	***0.26%***	0.60%

Table 9 below puts the net margin expectations for Q2 in the context of where they have been in the preceding five quarters and where they are expected to go in the coming quarters. As you can see, quarterly net margins are expected dip below the preceding quarter's level in Q2, but the expectation is for a nice jump from Q3 onwards.

Table 9: Quarterly Net Margins

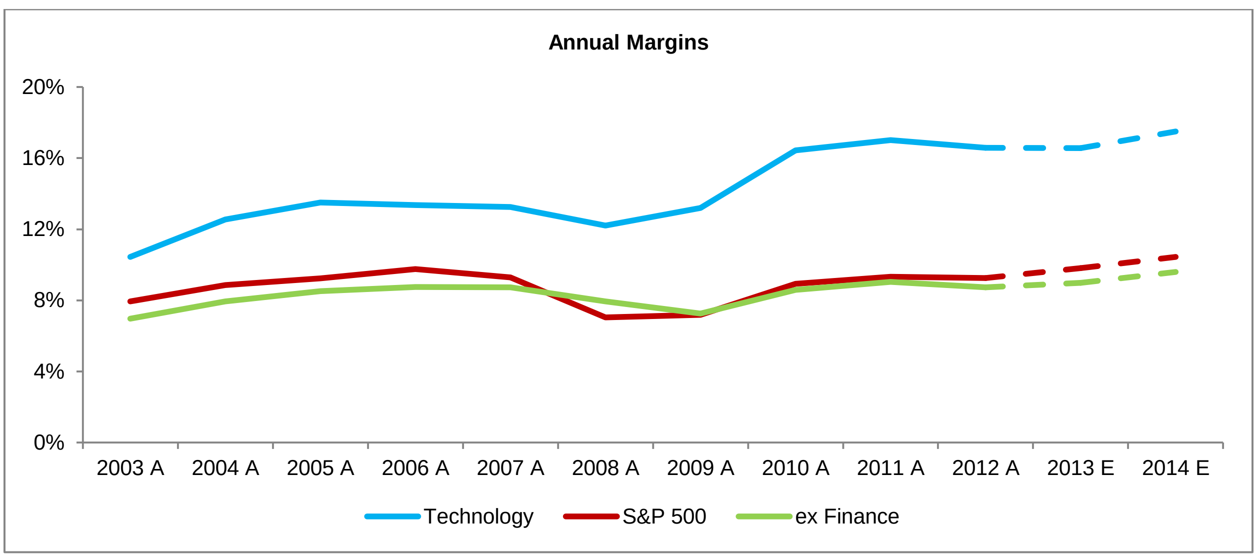
Zacks Sectors	1Q 14E	4Q 13E	3Q 13E	2Q 13E	1Q 13A	4Q 12A	3Q 12A	2Q 12A	1Q 12A
Cons. Staples	12.5%	12.7%	13.3%	***12.2%***	12.2%	11.1%	11.2%	11.7%	11.4%
Cons. Discretionary	10.0%	11.1%	11.0%	***10.8%***	10.2%	9.5%	10.2%	10.9%	10.0%
Retail/Wholesale	4.4%	3.7%	3.9%	***3.8%***	3.8%	3.7%	4.3%	3.5%	3.8%
Medical	12.8%	12.7%	13.0%	***12.8%***	12.8%	13.5%	12.7%	14.1%	15.2%
Autos	4.9%	4.1%	4.7%	***4.4%***	4.4%	4.2%	3.4%	4.9%	6.5%
Basic Materials	8.8%	6.7%	6.2%	***6.9%***	7.1%	8.0%	5.6%	5.7%	8.8%
Industrial Products	8.4%	8.7%	9.3%	***9.1%***	8.8%	7.8%	7.3%	9.2%	8.9%
Construction	4.4%	4.7%	5.4%	***5.1%***	4.9%	4.1%	4.9%	4.8%	3.1%
Conglomerates	9.8%	11.5%	10.6%	***10.1%***	10.2%	10.8%	10.6%	10.1%	10.1%
Technology	16.5%	18.0%	16.0%	***16.1%***	15.8%	16.0%	17.6%	15.7%	17.5%
Aerospace	6.9%	6.6%	6.6%	***6.6%***	6.4%	7.6%	5.8%	6.5%	6.8%
Oil/Energy	8.8%	8.7%	8.5%	***8.0%***	7.9%	8.8%	7.9%	8.0%	8.7%
Finance	15.9%	15.7%	15.2%	***15.4%***	17.5%	14.8%	10.5%	13.3%	9.2%
Utilities	8.7%	6.6%	9.5%	***7.9%***	7.2%	8.2%	2.4%	9.4%	8.2%
Transportation	8.5%	9.3%	9.1%	***9.3%***	9.3%	7.8%	8.5%	8.4%	8.5%
Business Services	15.1%	15.4%	14.6%	***14.3%***	14.1%	13.3%	13.7%	13.3%	12.2%
S&P 500	**10.0%**	**10.0%**	**9.8%**	***9.6%***	**9.6%**	**9.6%**	**8.8%**	**9.4%**	**9.4%**
ex Finance	9.2%	9.2%	9.1%	***8.8%***	8.7%	8.8%	8.6%	8.9%	9.4%

Table 10 below of annual net margins provides the full context for margins since the start of the current earnings cycle in 2009. As you can see, aggregate net margins for the S&P 500 peaked in 2006 and are expected to get past that level in 2013.

Given Finance's relatively flaky margins and the sector's outsized role in the index back then, it is even more instructive to look at the ex-Finance net margins, which are basically the margins for everything else outside of Finance. As you can see, ex-Finance margins are already at peak levels. But consensus earnings expectations reflect even more gains this year and next. It may not be unreasonable to be skeptical of these margin growth expectations.

Table 10: Annual Net Margins

Zacks Sectors	Annual Margins								
	2014 E	2013 E	2012 A	2011 A	2010 A	2009 A	2008 A	2007 A	2006 A
Cons. Staples	13.3%	***12.7%***	11.0%	11.2%	11.6%	11.1%	10.8%	10.6%	11.9%
Cons. Discretionary	11.5%	***10.5%***	9.7%	8.9%	8.6%	8.3%	8.5%	8.3%	8.1%
Retail/Wholesale	4.2%	***3.9%***	3.6%	3.7%	3.7%	3.4%	3.4%	3.7%	3.8%
Medical	13.4%	***13.0%***	13.6%	14.6%	14.3%	14.4%	14.7%	14.5%	15.4%
Autos	4.9%	***4.3%***	4.2%	5.1%	5.1%	0.3%	-0.6%	1.7%	0.9%
Basic Materials	7.9%	***6.9%***	7.7%	7.4%	8.8%	4.6%	6.2%	8.3%	8.1%
Industrial Products	9.4%	***8.7%***	8.6%	8.7%	7.7%	6.1%	7.6%	8.2%	8.0%
Construction	5.4%	***4.8%***	3.8%	2.7%	2.6%	-0.1%	-1.4%	2.0%	5.2%
Conglomerates	11.4%	***10.8%***	10.3%	9.7%	9.3%	8.3%	9.2%	10.8%	10.8%
Technology	17.5%	***16.6%***	16.6%	17.0%	16.4%	13.2%	12.2%	13.2%	13.4%
Aerospace	7.0%	***6.7%***	6.4%	6.7%	6.3%	5.3%	6.9%	6.6%	5.6%
Oil/Energy	8.9%	***8.3%***	7.6%	8.6%	6.8%	5.5%	9.3%	10.2%	10.3%
Finance	16.8%	***15.8%***	12.7%	11.3%	11.1%	6.8%	0.3%	12.3%	15.1%
Utilities	8.5%	***8.0%***	7.7%	8.0%	7.8%	7.9%	8.6%	9.4%	8.7%
Transportation	9.7%	***8.9%***	8.3%	8.4%	7.8%	6.0%	7.3%	8.2%	8.4%
Business Services	15.6%	***14.5%***	13.3%	12.5%	11.7%	10.8%	10.1%	10.1%	8.9%
S&P 500	**10.5%**	**9.8%**	**9.3%**	**9.3%**	**8.9%**	**7.2%**	**7.0%**	**9.3%**	**9.8%**
ex Finance	9.6%	***9.0%***	8.7%	9.0%	8.6%	7.3%	7.9%	8.7%	8.7%



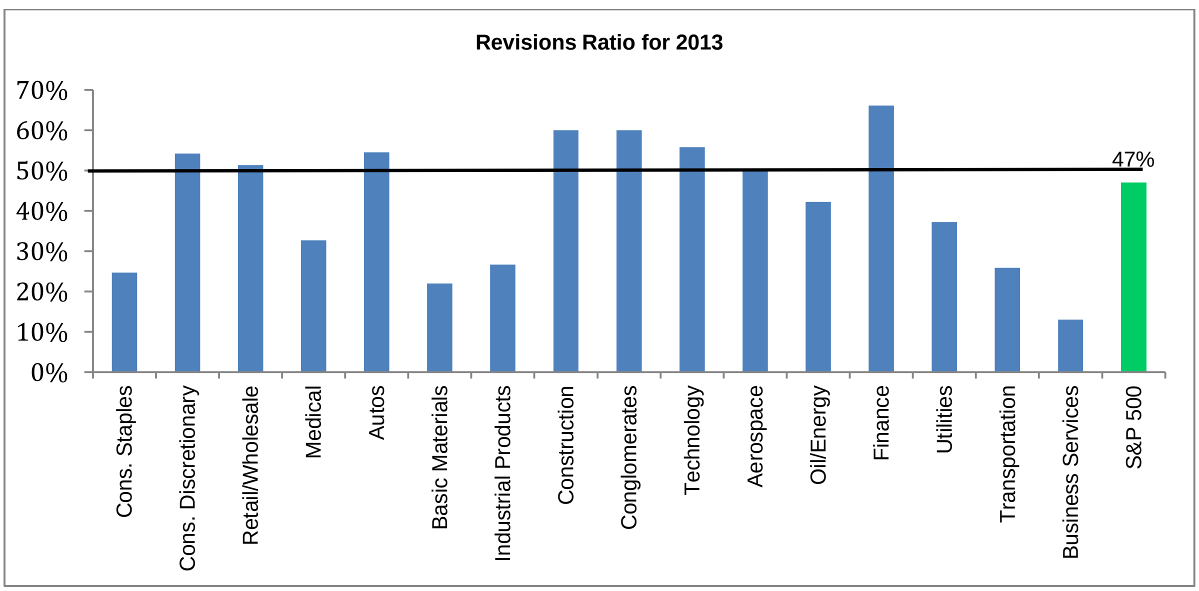
Margins follow a cyclical pattern. They expand as the economy comes out of a recession and companies use existing resources in labor and capital to drive business. But eventually capacity constraints kick in, forcing companies to spend more for incremental business. At that stage, margins start to contract again.

We may not be at the contraction stage yet, but we do need to buy into fairly optimistic assumptions about productivity improvements for current consensus margin expansion expectations to pan out.

Estimate Revisions Trends

The charts below show trends in earnings estimate revisions. The key metric in all the charts is the ‘revisions ratio’, which is the ratio of total number of upward revisions over the preceding four weeks to the total number of revisions (positive and negative) over that same period.

We present here the ‘revisions ratio’ for 2013 and 2014 in two ways. For each year one chart shows the current state of this ‘revisions ratio’, while the second chart plots the ratio’s trajectory over the preceding 24 months.

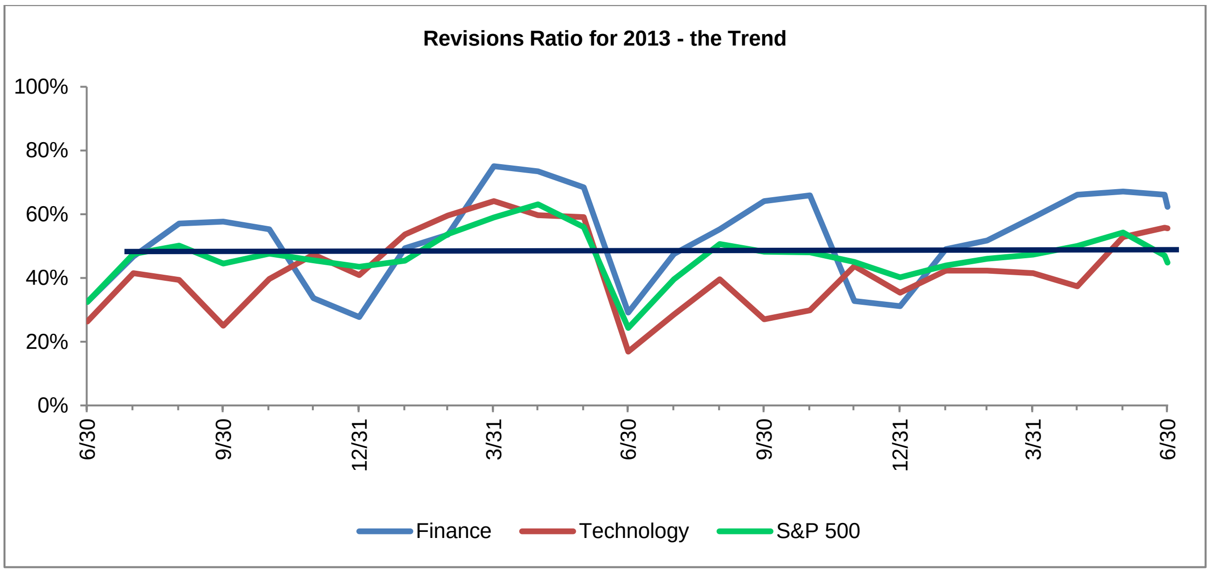


Source: Zacks Data; the number of estimates represent totals for the 4-week period preceding 6/28/13.

The ratio doesn’t tell you the ‘magnitude’ of the revisions, only the direction. The ‘50%’ level is the dividing line between positive and negative trends, with readings above 50% implying more positive than negative revisions. But our analysis shows that readings between 45% and 55% don’t offer material insights into the magnitude of revisions. It is only readings above 55% and below 45% that offer bullish and bearish signals about the magnitude of earnings revisions.

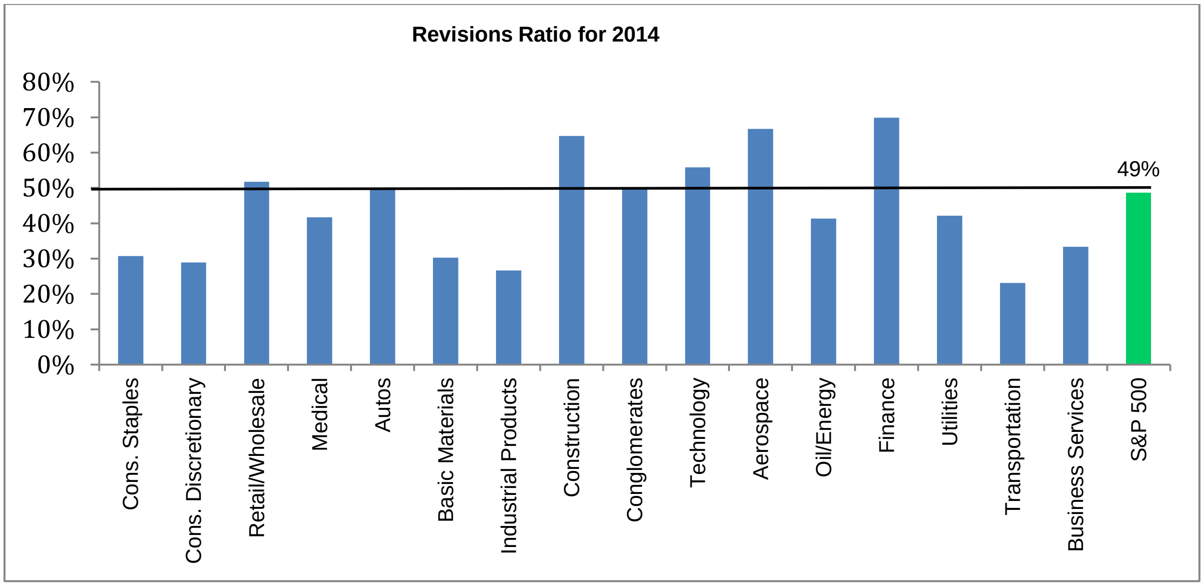
Looked at that way, the aggregate 2013 revisions ratio for the S&P 500 as a whole remains in neutral territory, though a number of sectors like Finance, Construction and Conglomerates stand out. On the negative side, 8 of the 16 sectors have revisions ratios that are in bearish territory, with business services, basic materials, and consumer staples particularly weak.

The chart below shows how the 2013 revisions ratio has evolved over time. We have featured the Technology (red line) and Finance (blue line) sectors to contrast how the picture has evolved for these two key sectors. As you can see, the aggregate ratio has been below or at the 50% line for quite some time.

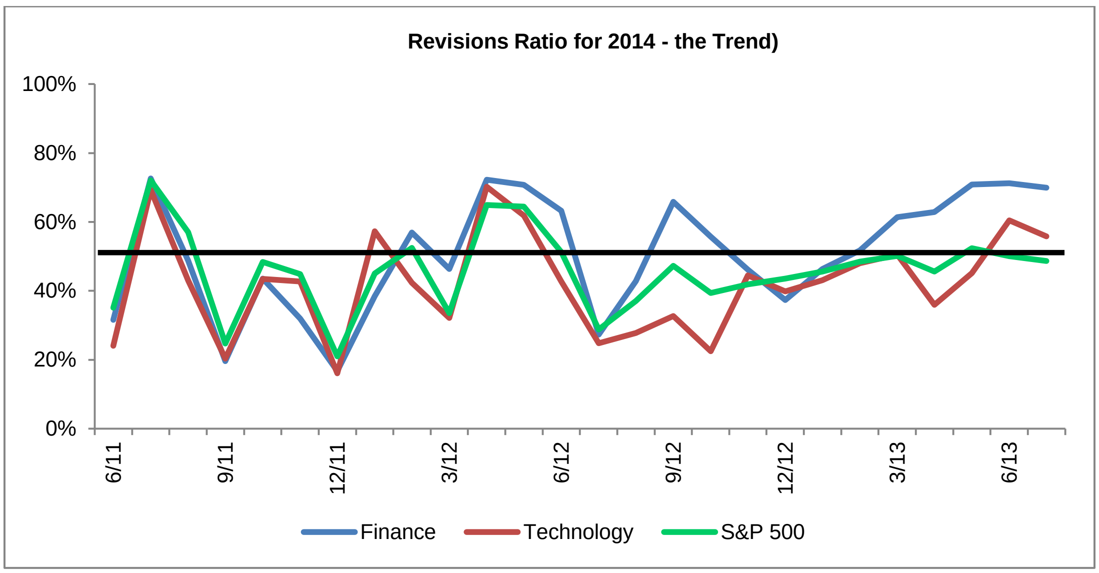


Source: Zacks Data; 4-week estimates totals; the latest period is four- week period preceding 6/28/13

The charts below present the same data for 2014.



Source: Zacks Data; the number of estimates represent totals for the 4-week period preceding 6/28/13.

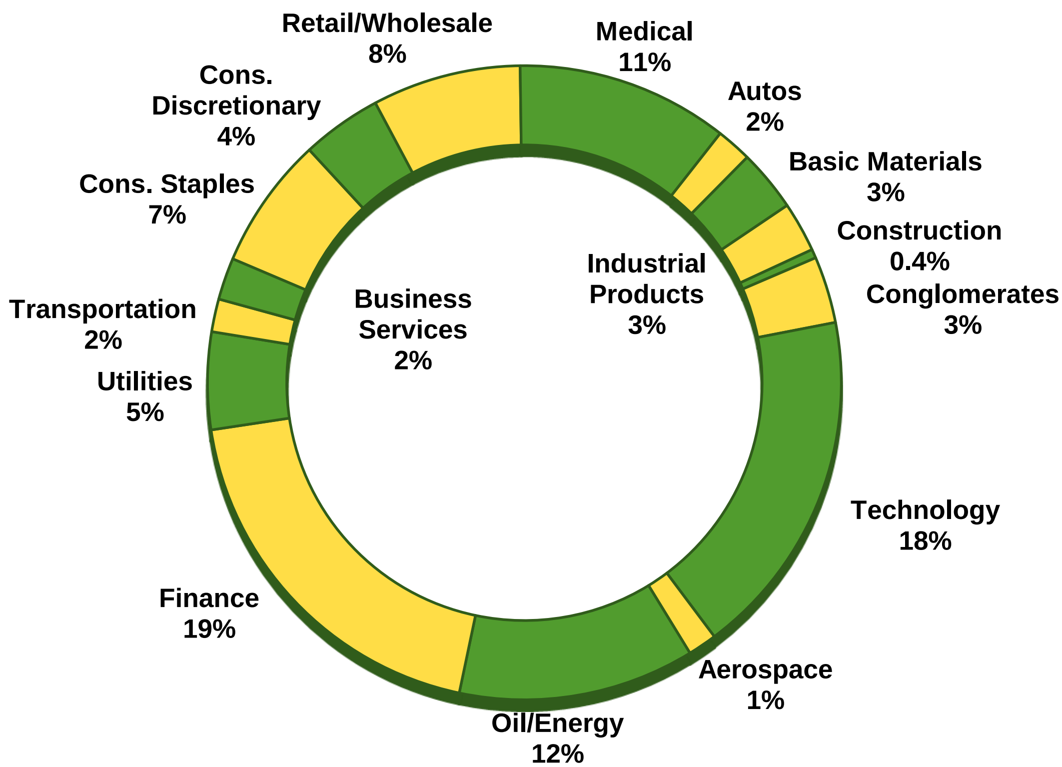


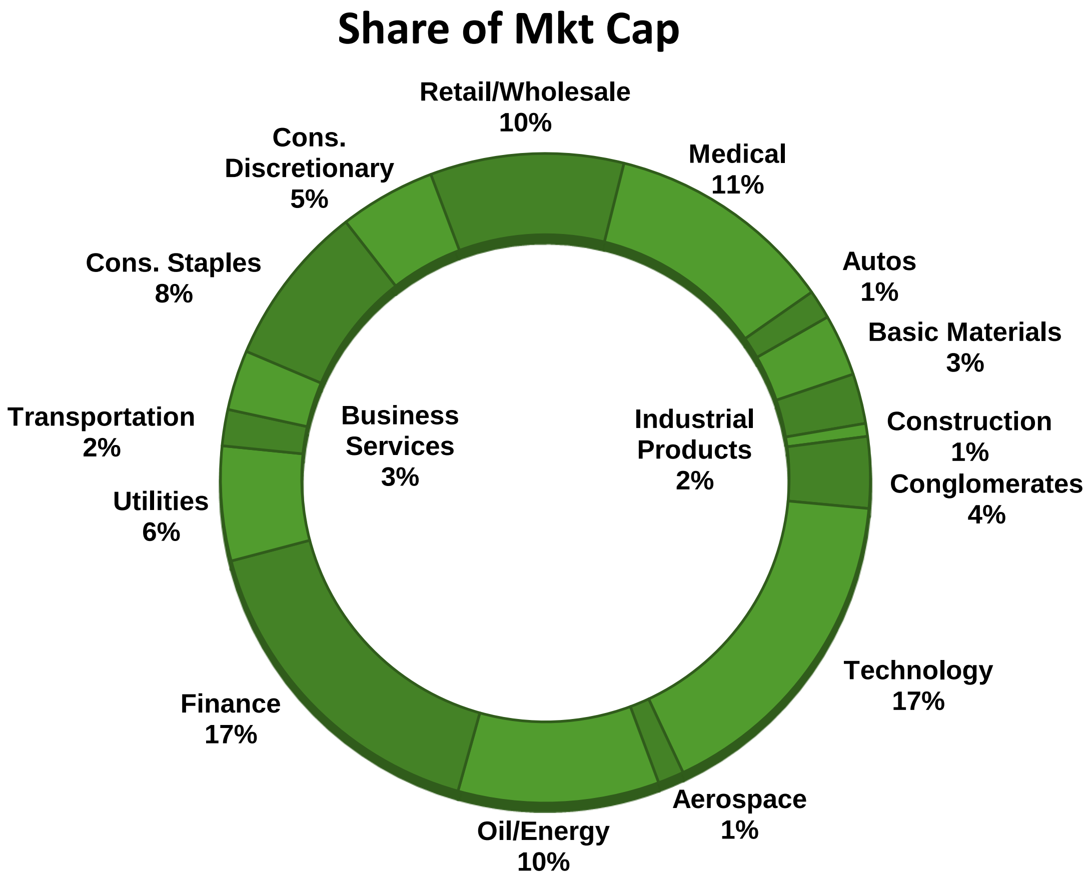
Source: Zacks Data; 4-week estimates totals; the latest period is the four-week period preceding 6/28/13

Market Cap vs. Total Earnings

The charts below show the share of total earnings for 2013 as well as the share of total market capitalization for each of the 16 Zacks sectors. Since the S&P 500 is a market-cap weighted index, each sector's market cap share is also its index weight. Finance is on track to regain its prominent position in the index in terms of earnings contribution this year, though it still remains significantly below its record 27% share of the index earnings in 2007. The sector is expected to edge out Technology as the largest earnings contributor this year.

Share of 2013 Income





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