Zacks Earning Trends

Sheraz Mian SMian@Zacks.com

What's Wrong with the Earnings Picture?

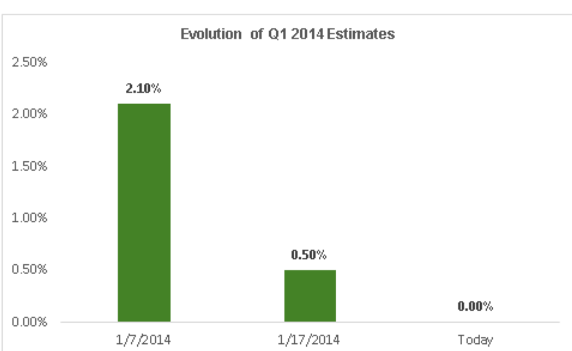
There is actually nothing wrong with earnings picture; they are about as good or as bad any of the other recent quarters. Total earnings for the S&P 500 are on track to reach a new all-time quarterly record and even the earnings growth for the quarter in on track to be the highest in 2013 (thanks to easy comparisons). The beat ratios started off a bit weak, but even those appear to be catching up fast with historical norms.

But if Q4 results are no different, by and large, from other recent quarters, then why all the angst and handwringing in the market about earnings? My sense is that investors have finally started paying attention to the earnings picture. The picture is definitely not terrible, but it's not consistent with a stock market sitting close to all time highs either.

Companies have been guiding lower quarter after quarter, prompting earnings estimates to keep moving for almost two years now in only one direction – down. The market didn't care much about this, with an ever helpful Fed keeping hopes of an eventual earnings ramp-up alive. But the Fed has started to get out of the QE business just as the economic picture has started looking up. Not many people are worried about Europe anymore and few would bet a hard landing for China despite today's softish PMI readings.

All in all, the economic backdrop had raise hopes that we may finally start seeing positive and reassuring commentary from management teams on the Q4 earnings calls, which will produce greater confidence in estimates for 2014 Q1 and beyond. But barring a few exceptions, we are not seeing that, as the overall tone of management guidance still remains negative. It's still relatively early in the reporting cycle, but what we have seen thus far doesn't inspire much confidence about the rest of this earnings season.

The chart below shows what is going on with 2014 Q1 estimates



And that's perhaps the reason for the earnings anxiety in the market. We have been singing this tune for a very long time, but finally folks have started paying attention to it. Better late than never, I guess.

The 2013 Q4 Scorecard

With respect to the Scorecard for 2013 Q4, we have seen results from 102 S&P 500 members accounting for 27.3% of the index's total market capitalization. Total earnings for these 102 companies are up +22.8% from the same period last year, with 65.7% beating earnings expectations with a median surprise of +2.0%. Total revenues for these companies are up +3.6%, with 54.9% beating revenue expectations with a median surprise of +0.8%.

The +22.8% 'headline' total earnings growth rate definitely looks fairly robust, particularly when compared to the growth rate for this same group of 102 companies in the last few quarters. Before we get too excited about this growth pace and start extrapolating it into the coming quarters, we should keep in mind that the bulk of this growth is due to easy comparisons for just three companies – Bank of America (BAC), Verizon (VZ), and Travelers (TRV) Exclude these three and total earnings growth for the S&P 500 companies that have reported drops to +8.3% from +22.8%, which is about where growth has been in recent quarters.

The composite picture for Q4 – combining the results for the 102 companies that have reported already with the 398 still to come – is for earnings growth of +7.6% on +1.7% higher revenues and 52 basis points higher margins. The actual Q4 growth rally will most likely be higher than this, a function of management's well refined expectations management skills.

More important than what happened in Q4 is the question of whether management guidance for the coming period(s) will get any better from what we have become accustomed to in recent quarters. My sense is that the preponderance of guidance will remain negative, as has been the case for more than a year now. This will keep downward pressure on estimates for the coming quarters.

Trends on the estimate revision front have been negative for a while, but we could afford to overlook such details in the Fed-inspired rally. It will be interesting to see if investors will continue shrug estimate cuts in the post-Taper world.

Key Points

- Total earnings for the 102 S&P 500 companies that have reported results are up +22.8%, with 65.7% beating earnings expectations. Revenues for these companies are up +3.6%, with a revenue 'beat ratio' of 54.9%.

- Easy comparisons for Bank of America, Verizon and Travelers accounts for most of the growth thus far. Excluding these three companies, the earnings growth rate drops to +8.3%, which is comparable to what this same group of companies have achieved in recent quarters. The beat ratios started out weak and are still a tad bit weak relative to recent quarters, but have caught up quite a bit lately.

- Total Q4 earnings for all S&P 500 companies, combing the 102 that have reported with the 398 still to come, are expected to be up +7.6%, which reflects +1.7% revenue growth and modest gains in margins. This compares to +5.1% earnings growth in Q3.

- Total earnings in Q4 are on track to reach a new all-time quarterly record, surpassing the record reached just the preceding quarter.

- Easy comparisons, particularly for the Finance sector, account for a big part of the Q4 growth. Total earnings for the Finance sector are expected to be up +25.5%. Outside of Finance, total earnings growth drops to +3.92%.

- Technology sector earnings are expected to be relatively flat from the year-earlier period, while earnings in the Energy, Medical, and Staples sectors are expected to be below the year-earlier level.

- Earnings growth is expected to accelerate this year, with full-year 2014 earnings expected to be up +9.1% after the expected +4.8% growth in 2013. Total earnings are expected to increase a further +10.8% in 2015.

- Guidance has overwhelmingly been negative in recent quarters and the trend from pre-announcements in the run up to the Q4 reporting season doesn't appear to be much different either. It will be interesting to see if the recently quarterly trend of negative guidance will remain in place this quarter as well.

Into the Heart of Q4 Earnings Season

The 2013 Q4 earnings season has gotten underway, with results from 102 S&P 500 companies accounting for 27.3% of the index's total market capitalization already out.

As is typically the case each reporting cycle, the early going has been dominated by the Finance sector, with 53.9% of the sector's total market cap already out with Q4 results. Outside of Finance, the only other sectors that have reported enough Q4 results already out include Transportation (63% of the sector's total market cap has released results) and Conglomerates (60%).

Total earnings for the 102 S&P 500 companies that have reported results, as of Thursday, January 23th, are up +22.8% from the same period last year, with 65.7% beating earnings expectations with a median surprise of +2.0%. Total revenues for these companies are up +3.6%, with 54.9% beating revenue expectations with a median surprise of +0.8%.

Here is the Scorecard for the 102 S&P 500 companies that have reported already.

Scorecard	% Reported		Q4 Earnings			Q4 Revenue		
Zacks Sectors	Total Companies	Total Market Cap	Growth YoY	Beat Ratio	Median Surp. %	Growth YoY	Beat Ratio	Median Surp. %
Cons. Staples	9.1%	4.7%	9.5%	66.7%	12.7	17.6%	66.7%	1.6
Cons. Discretionary	9.1%	11.8%	-10.5%	33.3%	0.0	4.3%	33.3%	-0.4
Retail/Wholesale	26.2%	23.7%	7.2%	27.3%	-1.5	6.2%	27.3%	-0.2
Medical	17.6%	24.6%	-10.8%	88.9%	1.1	7.6%	44.4%	0.0
Autos	10.0%	13.1%	32.5%	0.0%	0.0	4.7%	0.0%	0.0
Basic Materials	20.8%	24.6%	9.0%	80.0%	4.6	6.2%	60.0%	0.9
Industrial Products	12.0%	14.5%	15.7%	33.3%	-0.8	7.1%	33.3%	0.0
Construction	18.2%	14.3%	15.4%	50.0%	5.7	21.3%	50.0%	1.1
Conglomerates	28.6%	60.0%	18.9%	50.0%	4.6	2.5%	0.0%	-0.9
Technology	29.2%	25.6%	17.2%	84.2%	5.3	2.6%	84.2%	1.4
Aerospace	44.4%	37.3%	29.4%	100.0%	1.4	-1.6%	75.0%	0.7
Oil/Energy	11.1%	13.8%	23.3%	60.0%	0.0	9.8%	60.0%	0.0
Finance	32.9%	53.9%	15.2%	61.5%	2.5	-0.8%	50.0%	0.1
Utilities	2.9%	16.7%	-145%	100.0%	1.5	3.4%	100.0%	0.2
Transportation	54.5%	63.6%	29.4%	66.7%	2.8	5.0%	50.0%	0.2
Business Services	9.5%	12.1%	7.5%	100.0%	3.9	2.1%	100.0%	1.9
S&P 500	**20.4%**	**27.3%**	**22.8%**	**65.7%**	**2.0**	**3.6%**	**54.9%**	**0.8**
ex Finance	18.1%	22.1%	27.8%	67.1%	N/A	5.2%	56.6%	0.0

Source: Zacks Investment Research, Inc.

Data as of: 1/23/14 9:37 AM www.zacks.com

Note: Here are few key points to keep in mind while reading this report.

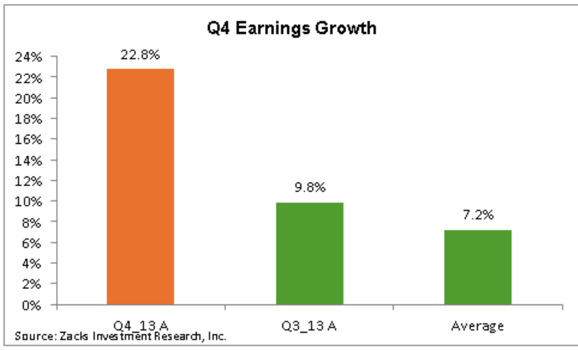
a. *All the earnings analysis in this report pertains to the S&P 500 index, a handy proxy for the entire business world.*

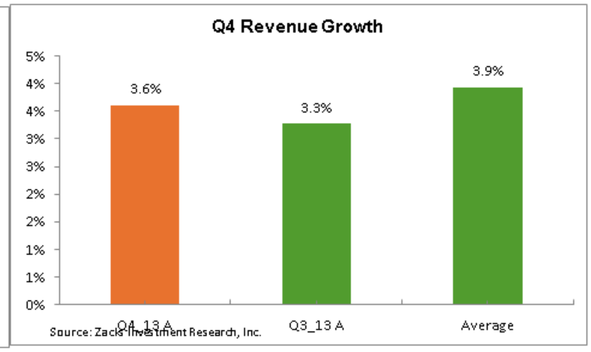
b. *We divide the corporate world into 16 sectors compared to the official S&P 10 GICS. We have stand-alone sectors like Autos, Construction, Conglomerates, Aerospace, Transportation and Business Services that provide for a better understanding of trends in these key areas of the economy.*

c. *All references to 'earnings' mean 'total earnings' and not 'median EPS'.*

d. *We make adjustments to reported GAAP earnings to account for non-recurring or one-time items, but we do consider employee stock options (ESOs) as a legitimate business expense. Unlike Zacks, Wall Street and all other data vendors don't treat ESO's as a recurring business expense.*

The +22.8% 'headline' total earnings growth rate definitely looks fairly robust, particularly when compared to the growth rate for this same group of 102 companies in other recent quarters, as is clear from the chart below. Please note that the 'average' in the chart below represents the average for the 4 quarters through 2013 Q3.





Before we get too excited about earnings growth and start extrapolating into the coming quarters, we should keep in mind that the bulk of this growth is due to easy comparisons for a handful of companies. Three companies in particularly – Bank of America, Verizon, and Travelers – had very easy comparisons that and are big contributors to the overall growth rate for these 102 S&P 500 companies. Exclude these three and total earnings growth for the S&P 500 companies that have reported drops to +8.3% from +22.8%, which is about where growth has been in recent quarters.

At the sector level, only three sectors have meaningful enough samples sizes to warrant discussion at this stage.

Finance has the most representative sample of Q4 results, with 53.9% of the sector's total market cap already out with results. Not too many surprises in the results thus far, though the Bank of America and Morgan Stanley results did stand out for positive reasons.

Total earnings for the Finance sector companies that have reported already up +15.2% on -0.8 lower revenues. The earnings beat ratio is 61.5%, while only 50% of the companies have come out with positive top-line surprises. Bank of America and Travelers account for the bulk of the sector's earnings growth. Exclude these two companies from the Finance sector's tally, and total earnings growth for the sector drops to +2.7% (up +15.2% including the two).

The Finance sector's +15.2% earnings growth thus far compares to +14.0% in Q3 and the 4-quarter average of +24.9% for this same cohort of the sector companies. And the -0.8% revenue drop is about the same as the -0.9% drop in Q3, but materially below the +5.2% 4-quarter average. How could earnings growth when revenues decline? It can't happen in other industries, but banks have been doing a lot of cost cutting and also getting a fair amount of help of reserve releases. Importantly, fewer companies have beat expectations, with the both the earnings and revenue beat ratios for the sector tracking 4-quarter average levels.

The Composite Picture: Reported + Still To Come

Table 1 below provides the composite or blended picture, combining results from the 102 companies that have reported already with the 398 that have still to report numbers.

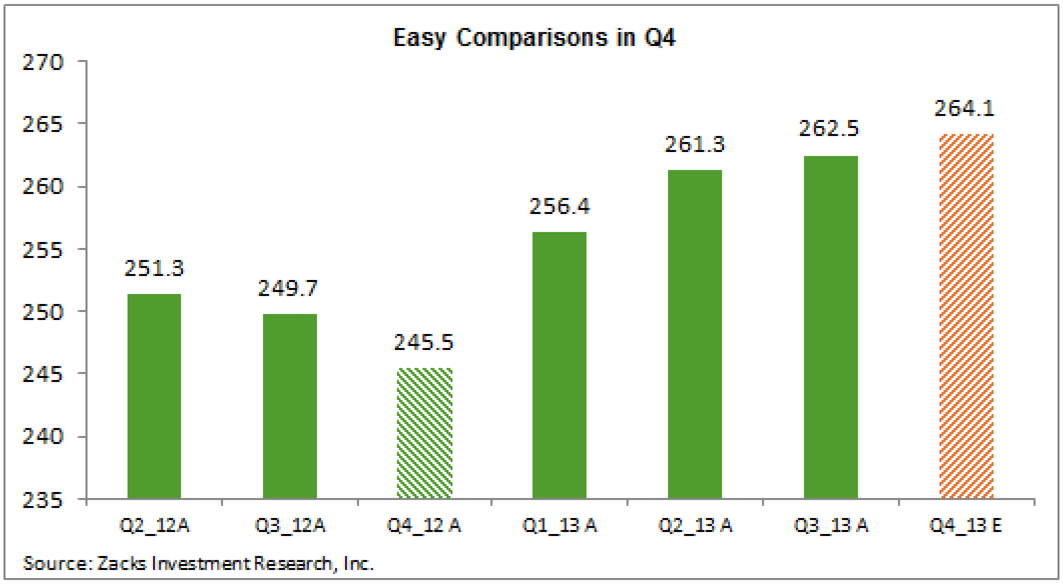
Total earnings in Q4 would be up +7.6% on +1.7% higher revenues and 52 basis points higher margins. This is a much better earnings growth picture at this stage of the reporting cycle than we have seen in recent quarters. In fact, +7.6% growth is the highest quarterly earnings growth rate of 2013.

Zacks Sectors	Year-over-Year Growth					
	Earnings		Revenue		Margins	
	4Q 13E	3Q 13A	4Q 13E	3Q 13A	4Q 13E	3Q 13A
Cons. Staples	-0.3%	2.2%	0.2%	-7.6%	-0.05%	1.17%
Cons. Discretionary	7.1%	11.5%	4.0%	2.3%	0.29%	0.96%
Retail/Wholesale	-0.1%	10.7%	2.2%	3.8%	-0.10%	0.27%
Medical	-2.5%	0.2%	5.6%	7.4%	-0.75%	-0.73%
Autos	15.6%	32.3%	2.6%	7.0%	0.44%	1.17%
Basic Materials	4.6%	2.2%	0.9%	1.1%	0.21%	0.06%
Industrial Products	1.9%	1.3%	-3.4%	-1.2%	0.42%	0.23%
Construction	4.7%	32.1%	7.1%	9.2%	-0.11%	1.01%
Conglomerates	12.4%	3.5%	2.7%	4.1%	1.02%	-0.06%
Technology	2.7%	5.9%	2.2%	3.2%	0.09%	0.44%
Aerospace	10.0%	11.5%	-2.6%	1.2%	0.75%	0.66%
Oil/Energy	-11.5%	-8.4%	1.3%	2.8%	-1.02%	-0.88%
Finance	25.5%	10.5%	-1.7%	-15.7%	3.37%	4.14%
Utilities	132.4%	4.7%	2.0%	2.4%	4.20%	0.24%
Transportation	16.3%	13.2%	4.9%	4.5%	0.82%	0.73%
Business Services	15.2%	8.6%	5.5%	4.3%	1.32%	0.58%
S&P 500	**7.6%**	**5.1%**	**1.7%**	**0.4%**	**0.52%**	**0.45%**
ex Finance	3.9%	3.9%	2.2%	2.9%	0.14%	0.09%

Source: Zacks Investment Research, Inc.

Data as of: 1/23/14 9:37 AM www.zacks.com

The +7.6% earnings growth in 2013 Q4 follows growth rates of +5.1% in Q3, +4% in Q2, and +3% in Q1. We should keep in mind, however, that a big contributor to the stronger-looking growth pace in Q4 is the easy comparisons, as the chart below shows.



As you can see, the 2012 Q4 quarter provides an unusually easy hurdle rate. In fact, 2012 Q4 brought in the lowest quarterly total earnings for the S&P 500 in the last 8 quarters.

The comparisons are particularly easy for the Finance and Utility sectors. We have seen the strong year over year growth for Bank of America already and will see similarly easy comparisons from the insurance industry (Finance sector's second largest industry) in the coming days. Insurers simply wouldn't have to deal with the Sandy-type costs that it suffered in 2012. Easy comparisons for all the major insurers like Chubb, Travelers and others are expected to drive the (medium-level) insurance industry to have +152.8% earnings growth in Q4.

For the Finance sector as a whole, total earnings would be up +25.5% from the same period last year. Excluding the strong growth from the Finance sector, total earnings for the S&P 500 would be a far more modest +3.9% in Q4 vs. the +3.9% ex-Finance growth in Q3.

Other sectors with double-digit earnings growth in Q4 include Utilities (+132.4%), Autos (+15.6%), Transportation (+16.3%), Business Services (+15.2%) and Conglomerates (12.4%). The eye-popping Utility sector growth is primarily a function of easy comparisons for Verizon (we keep the legacy telecom carriers in the utility sector).

Earnings growth for the Technology sector +2.7% – the addition of the fast-growing Facebook was not enough to move the sector's growth needle. Energy (-11.5%), Medical (-2.5%), Consumer Staples (-0.3%), and Retail/Wholesale (-0.1%) are the other laggards. The growth picture for the S&P 500 improves without the Energy sector's drag, with total earnings up for the index up +10.4% outside of the Energy sector.

The Context for Growth Expectations

Let's take a look at how consensus earnings expectations for 2013 Q3 compare to what companies earned in the last few quarters and what they are expected to earn in the coming quarters. Table 2 below presents the year over year earnings growth rates - expectations for Q3 and the following two quarters. 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)							
	3Q 14E	2Q 14E	1Q 14E	*4Q 13E*	3Q 13A	2Q 13A	Annual 2014E	Annual 2015E
Cons. Staples	4.2%	4.9%	4.1%	***-0.3%***	2.2%	-0.7%	7.0%	8.7%
Cons. Discretionary	7.2%	8.5%	6.5%	***7.1%***	11.5%	16.5%	13.6%	16.4%
Retail/Wholesale	20.9%	3.1%	11.1%	***-0.1%***	10.7%	8.7%	9.1%	16.2%
Medical	4.9%	2.4%	-1.6%	***-2.5%***	0.2%	-1.5%	7.5%	13.3%
Autos	-13.8%	0.0%	1.7%	***15.6%***	32.3%	18.5%	12.9%	23.7%
Basic Materials	14.6%	18.5%	8.1%	***4.6%***	2.2%	-9.9%	16.1%	14.6%
Industrial Products	5.5%	5.0%	-5.0%	***1.9%***	1.3%	-4.8%	8.8%	11.9%
Construction	16.5%	12.3%	8.7%	***4.7%***	32.1%	53.6%	-18.5%	21.6%
Conglomerates	11.7%	8.3%	-8.5%	***12.4%***	3.5%	-0.6%	7.5%	9.4%
Technology	7.8%	11.4%	1.1%	***2.7%***	5.9%	-7.8%	9.7%	10.8%
Aerospace	3.3%	2.1%	-0.7%	***10.0%***	11.5%	10.4%	7.7%	9.5%
Oil/Energy	16.2%	15.4%	-4.0%	***-11.5%***	-8.4%	-11.3%	12.0%	3.1%
Finance	-1.0%	-7.4%	-7.3%	***25.5%***	10.5%	31.8%	7.5%	10.2%
Utilities	6.4%	7.1%	5.6%	***132.4%***	4.7%	0.8%	7.8%	5.4%
Transportation	4.5%	4.5%	15.0%	***16.3%***	13.2%	8.3%	8.7%	15.2%
Business Services	17.1%	14.6%	15.1%	***15.2%***	8.6%	9.8%	14.3%	13.8%
S&P 500	**7.0%**	**5.0%**	**0.0%**	***7.6%***	**5.1%**	**4.0%**	**9.1%**	**10.8%**
ex Finance	8.9%	8.3%	1.9%	***3.9%***	3.9%	-1.6%	9.5%	10.9%

Source: Zacks Investment Research, Inc.

Data as of: 1/23/14 9:37 AM www.zacks.com

Table 3 – Revenue Growth Context

Zacks Sectors	Revenue Growth (YoY)							
	3Q 14E	2Q 14E	1Q 14E	4Q 13E	3Q 13A	1Q 13A	Annual 2014E	Annual 2015E
Cons. Staples	1.0%	1.4%	1.4%	*0.2%*	-7.6%	-8.4%	3.7%	3.8%
Cons. Discretionary	6.4%	6.9%	1.6%	*4.0%*	2.3%	5.2%	6.4%	5.5%
Retail/Wholesale	7.4%	5.4%	10.5%	*2.2%*	3.8%	4.4%	4.4%	6.3%
Medical	5.8%	5.7%	5.5%	*5.6%*	7.4%	4.0%	5.4%	5.5%
Autos	1.8%	3.7%	3.3%	*2.6%*	7.0%	4.7%	4.6%	5.8%
Basic Materials	1.9%	2.0%	3.1%	*0.9%*	1.1%	-1.4%	3.7%	4.4%
Industrial Products	1.6%	-0.1%	-5.9%	*-3.4%*	-1.2%	0.6%	0.7%	4.0%
Construction	11.2%	7.5%	6.0%	*7.1%*	9.2%	10.1%	8.5%	9.4%
Conglomerates	2.1%	5.4%	2.9%	*2.7%*	4.1%	0.3%	3.9%	2.3%
Technology	3.8%	5.0%	1.8%	*2.2%*	3.2%	0.9%	4.8%	5.2%
Aerospace	1.8%	0.2%	4.4%	*-2.6%*	1.2%	1.5%	2.4%	-0.3%
Oil/Energy	1.0%	1.1%	2.0%	*1.3%*	2.8%	-4.2%	-1.3%	-4.4%
Finance	15.2%	-5.2%	-4.9%	*-1.7%*	-15.7%	6.7%	-11.5%	4.8%
Utilities	4.5%	1.0%	3.1%	*2.0%*	2.4%	6.9%	2.3%	1.4%
Transportation	5.1%	4.7%	4.9%	*4.9%*	4.5%	2.2%	4.5%	5.3%
Business Services	5.6%	6.3%	4.5%	*5.5%*	4.3%	2.5%	4.8%	6.1%
S&P 500	**5.2%**	**2.5%**	**2.8%**	***1.7%***	**0.4%**	**1.7%**	**1.5%**	**3.5%**
ex Finance	4.0%	3.6%	4.0%	*2.2%*	2.9%	1.0%	3.3%	3.3%

Source: Zacks Investment Research, Inc.

Data as of: 1/23/14 9:37 AM www.zacks.com

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

What this tells us is that while quarterly earnings totals are in record territory, there isn't much growth. But the expectation is for growth to resume in the coming quarters.

Table 4 – Total Quarterly earnings

Zacks Sectors	Quarterly Earnings *(billion dollars)* 4Q 14E	3Q 14E	2Q 14E	1Q 14E	4Q 13E	3Q 13A	2Q 13A	1Q 13A	4Q 12A	3Q 12A
Cons. Staples	19.5	19.3	18.6	16.4	***17.7***	18.5	17.8	15.8	17.7	18.1
Cons. Discretionary	12.3	12.7	12.0	9.6	***11.0***	11.9	11.1	9.0	10.2	10.6
Retail/Wholesale	19.4	21.0	18.5	20.1	***19.3***	17.4	17.9	18.1	19.3	15.7
Medical	31.7	31.6	30.9	29.0	***27.6***	30.1	30.2	29.5	28.3	30.1
Autos	5.0	5.8	5.9	4.8	***4.3***	6.7	5.9	4.7	3.8	5.1
Basic Materials	8.0	7.5	9.7	10.0	***6.8***	6.6	8.2	9.3	6.5	6.4
Industrial Products	6.4	7.3	7.2	5.6	***5.5***	6.9	6.8	5.8	5.4	6.8
Construction	1.4	1.7	1.5	1.0	***1.2***	1.5	1.3	0.9	1.1	1.1
Conglomerates	10.3	9.2	9.0	7.6	***10.1***	8.3	8.3	8.4	9.0	8.0
Technology	58.6	47.0	47.6	44.3	***53.7***	43.6	42.8	43.8	52.3	41.2
Aerospace	4.6	4.5	4.4	4.2	***4.1***	4.3	4.3	4.2	3.7	3.9
Oil/Energy	32.9	33.5	32.6	30.2	***28.4***	28.9	28.2	31.4	32.1	31.5
Finance	53.1	50.1	50.8	49.5	***52.3***	50.6	54.9	53.4	41.7	45.8
Utilities	11.7	17.2	13.5	14.1	***11.0***	16.2	12.6	13.3	4.7	15.5
Transportation	5.5	5.8	5.6	4.2	***5.0***	5.5	5.4	3.7	4.3	4.9
Business Services	7.1	6.6	6.4	6.0	***6.3***	5.6	5.6	5.2	5.4	5.2
S&P 500	**287.7**	**280.8**	**274.3**	**256.4**	***264.1***	**262.5**	**261.3**	**256.4**	**245.5**	**249.7**
ex Finance	234.6	230.6	223.5	206.9	***211.8***	211.9	206.4	203.0	203.8	203.9

Source: Zacks Investment Research, Inc.

Data as of: 1/23/14 9:37 AM www.zacks.com

Table 5 – Total Quarterly Revenues

Zacks Sectors	Quarterly Revenues (billion dollars) 4Q 14E	3Q 14E	2Q 14E	1Q 14E	4Q 13E	3Q 13A	2Q 13A	1Q 13A	4Q 12A
Cons. Staples	159.6	152.7	151.6	141.1	***153.8***	151.1	149.5	139.1	153.5
Cons. Discretionary	112.7	109.7	107.8	102.1	***108.4***	103.2	100.8	100.5	104.3
Retail/Wholesale	432.6	429.3	413.8	432.0	***441.2***	399.7	392.6	390.8	431.8
Medical	320.1	315.2	311.4	301.8	***305.8***	297.8	294.5	286.1	289.5
Autos	115.2	112.0	115.2	109.5	***111.7***	110.0	111.1	106.0	108.9
Basic Materials	117.6	113.3	119.5	118.6	***114.8***	111.2	117.2	115.0	113.8
Industrial Products	73.4	75.7	77.1	68.7	***69.0***	74.5	77.2	73.0	71.4
Construction	26.9	27.6	25.9	23.3	***24.3***	24.8	24.1	22.0	22.7
Conglomerates	85.6	82.5	83.0	77.8	***85.1***	80.7	78.7	75.6	82.8
Technology	308.0	270.3	271.3	267.0	***291.2***	260.4	258.3	262.4	285.0
Aerospace	63.2	61.8	61.2	59.4	***62.1***	60.7	61.1	56.9	63.8
Oil/Energy	394.0	404.9	394.6	389.1	***402.1***	400.8	390.3	381.7	397.0
Finance	288.9	334.1	333.3	331.4	***336.8***	290.0	351.7	348.5	342.7
Utilities	149.0	157.8	145.0	149.7	***147.4***	151.0	143.5	145.2	144.6
Transportation	61.5	61.0	60.3	57.1	***58.7***	58.1	57.6	54.5	55.9
Business Services	42.2	40.5	40.1	38.8	***40.2***	38.3	37.7	37.1	38.1
S&P 500	**2750.6**	**2748.4**	**2711.1**	**2667.5**	***2752.6***	**2612.3**	**2645.8**	**2594.3**	**2705.9**
ex Finance	2461.6	2414.3	2377.8	2336.1	***2415.8***	2322.4	2294.1	2245.8	2363.2

Source: Zacks Investment Research, Inc.

Data as of: 1/23/14 9:37 AM www.zacks.com

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 Q3, 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, but consider employee stock options as a legitimate business expense).

For the coming quarters, including the bulk of Q4 results still to come, we have taken the Zacks Consensus EPS for each company in the index, multiplied that by the corresponding share count (from the last reported quarter) to arrive at the total earnings for each company. And then we aggregated them to arrive at the totals for each sector and the index as a whole. 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 $264.1 billion in 2013 Q4 vs. $262.5 billion in Q3 and $245.5 billion in 2012 Q4.

The overall level of total earnings is very high. In fact, total earnings are on track to reach a new all-time quarterly record in Q4, surpassing the records reached in each of the preceding two quarters.

The consensus expectation is for a strong growth ramp up later in 2014, starting in Q2. Full-year 2014 earnings for the S&P 500 are expected to be up +9.1% and a further +10.8% the following year. Earnings are on track to have increased +4.8% in 2013.

Where Will the Growth Come From?

There is some truth to the claim that the current record level of corporate profits, whether in absolute dollar terms or as a share of the GDP, does not mean that earnings have to necessarily come down. But earnings don't grow forever either as current consensus expectations of double-digit growth in 2014 and beyond seem to imply.

After all, earnings in the aggregate can grow only through two avenues - revenue growth and/or margin expansion.

Revenue growth is strongly correlated with 'nominal' GDP growth. If the growth outlook for the global economy is positive or improving, then it's reasonable to expect corporate revenues to do better as well. But the global economic growth outlook is at best stable, definitely not improving as the recent estimate cuts by the OECD shows.

The U.S. economic outlook has certainly improved, with GDP growth estimates for Q4 steadily going up in recent weeks. It appears that GDP growth in the second half of 2013 accelerated to a pace roughly double the pace of the first half of the year. Hard to tell how sustainable this growth pace is, but the consensus expectation is for GDP growth accelerating above the +3% pace in 2014 and beyond.

While these growth expectations for the U.S. economy are not outrageous, they nevertheless represent a best-case scenario. The more likely outcome is a continuation of the trend that has been in place in the recent past – a growth pace that is not materially different from the +2% GDP growth rate of the recent past. Please note that even this subdued but realistic U.S. growth picture is better than what other key regions like Europe can achieve. Beyond the developed world, the outlook for the emerging world is a lot less inspiring. India, Brazil, South Africa, Turkey and the other highfliers of recent years are struggling and the recent PMI readings from China indicate that the country may still be losing ground.

Bottom line, it's hard to envision companies overcoming their revenue growth problems in the coming quarters in this economic growth backdrop. But in order to reach the expected +9.1% total earnings growth in 2014, we need a fair amount of expansion in net margins to compliment the revenue growth this year.

The Margins Picture

For the 102 S&P 500 companies that have reported results already, net margins are up 196 basis points year over year and 12 basis points from the preceding quarter.

Composite net margins in Q4, combining the results for the 102 companies that have come out with the 398 still to come, are expected to be up 52 basis points from the same period last year, with ex-Finance margins expected to be up 14 basis points.

Table 6 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 6: Change in Net Margins (Composite)

Zacks Sectors	4Q13E YoY	4Q13E QoQ	3Q13A YoY	3Q13A QoQ	2012A YoY	2013E YoY	2014E YoY
Cons. Staples	*-0.05%*	-0.75%	1.17%	0.36%	0.98%	*0.38%*	0.57%
Cons. Discretionary	*0.29%*	-1.39%	0.96%	0.49%	0.36%	*0.69%*	1.11%
Retail/Wholesale	*-0.10%*	0.03%	0.27%	-0.23%	-0.01%	*0.19%*	0.42%
Medical	*-0.75%*	-1.11%	-0.73%	-0.11%	-0.72%	*0.19%*	0.73%
Autos	*0.44%*	-2.21%	1.17%	0.78%	-0.08%	*0.35%*	0.81%
Basic Materials	*0.21%*	0.01%	0.06%	-1.11%	-0.16%	*0.79%*	0.73%
Industrial Products	*0.42%*	-1.26%	0.23%	0.38%	-0.35%	*0.66%*	0.68%
Construction	*-0.11%*	-1.03%	1.01%	0.46%	3.23%	*-1.77%*	0.59%
Conglomerates	*1.02%*	1.61%	-0.06%	-0.34%	0.47%	*0.38%*	0.79%
Technology	*0.09%*	1.69%	0.44%	0.19%	-1.16%	*0.78%*	0.95%
Aerospace	*0.75%*	-0.59%	0.66%	0.06%	0.23%	*0.35%*	0.70%
Oil/Energy	*-1.02%*	-0.13%	-0.88%	-0.03%	-0.41%	*1.01%*	0.66%
Finance	*3.37%*	-1.93%	4.14%	1.86%	2.79%	*3.36%*	0.97%
Utilities	*4.20%*	-3.24%	0.24%	1.92%	-0.08%	*0.48%*	0.36%
Transportation	*0.82%*	-1.08%	0.73%	0.15%	0.51%	*0.34%*	0.83%
Business Services	*1.32%*	0.95%	0.58%	-0.15%	0.93%	*1.32%*	1.16%
S&P 500	*0.52%*	-0.45%	0.45%	0.17%	0.16%	*0.73%*	0.73%
ex Finance	*0.14%*	-0.35%	0.09%	0.12%	-0.19%	*0.53%*	0.69%

Source: Zacks Investment Research, Inc.

Data as of: 1/23/14 9:37 AM www.zacks.com

Table 7 below puts the (composite) net margin expectations for Q4 in the context of where they have been in the preceding five quarters and where they are expected to go in the coming quarters.

Table 7: Quarterly Net Margins

Zacks Sectors	Quarterly Margins 3Q 14E	2Q 14E	1Q 14E	4Q 13E	3Q 13A	2Q 13A	1Q 13A	4Q 12A
Cons. Staples	12.6%	12.3%	11.6%	*11.5%*	12.2%	11.9%	11.3%	11.5%
Cons. Discretionary	11.6%	11.2%	9.4%	*10.1%*	11.5%	11.0%	9.0%	9.8%
Retail/Wholesale	4.9%	4.5%	4.7%	*4.4%*	4.3%	4.6%	4.6%	4.5%
Medical	10.0%	9.9%	9.6%	*9.0%*	10.1%	10.2%	10.3%	9.8%
Autos	5.2%	5.1%	4.4%	*3.9%*	6.1%	5.3%	4.5%	3.5%
Basic Materials	6.6%	8.1%	8.5%	*5.9%*	5.9%	7.0%	8.1%	5.7%
Industrial Products	9.6%	9.3%	8.1%	*8.0%*	9.2%	8.9%	8.0%	7.6%
Construction	6.1%	5.6%	4.2%	*4.8%*	5.8%	5.4%	4.1%	4.9%
Conglomerates	11.2%	10.8%	9.8%	*11.8%*	10.2%	10.6%	11.1%	10.8%
Technology	17.4%	17.6%	16.6%	*18.4%*	16.8%	16.6%	16.7%	18.4%
Aerospace	7.2%	7.2%	7.0%	*6.5%*	7.1%	7.1%	7.4%	5.8%
Oil/Energy	8.3%	8.3%	7.8%	*7.1%*	7.2%	7.2%	8.2%	8.1%
Finance	15.0%	15.2%	14.9%	*15.5%*	17.5%	15.6%	15.3%	12.2%
Utilities	10.9%	9.3%	9.4%	*7.5%*	10.7%	8.8%	9.2%	3.3%
Transportation	9.5%	9.4%	7.4%	*8.4%*	9.5%	9.4%	6.7%	7.6%
Business Services	16.2%	15.9%	15.4%	*15.6%*	14.6%	14.8%	14.0%	14.3%
S&P 500	**10.2%**	**10.1%**	**9.6%**	**9.6%**	**10.0%**	**9.9%**	**9.9%**	**9.1%**
ex Finance	9.6%	9.4%	8.9%	8.8%	9.1%	9.0%	9.0%	8.6%

Source: Zacks Investment Research, Inc.

Data as of: 1/23/14 9:37 AM www.zacks.com

The table 8 below shows net margins on a trailing four-quarter basis. So, the 9.8% net margin for 2013 Q4 reflects estimates for Q4 and actuals for the preceding three quarters, and so on.

Zacks Sectors	Net Margins - Trailing 4 Quarters 3Q 14E	2Q 14E	1Q 14E	4Q 13E	3Q 13E	2Q 13A	1Q 13A	4Q 12A	3Q 12A	2Q 12A
Cons. Staples	12.2%	12.0%	11.9%	11.8%	11.7%	11.8%	11.5%	11.2%	11.0%	10.6%
Cons. Discretionary	10.8%	10.6%	10.5%	10.5%	10.4%	10.3%	10.1%	9.8%	9.7%	9.7%
Retail/Wholesale	4.6%	4.6%	4.5%	4.5%	4.5%	4.5%	4.4%	4.4%	4.3%	4.3%
Medical	9.9%	9.6%	9.7%	9.7%	9.9%	10.1%	10.3%	10.4%	10.6%	10.7%
Autos	4.8%	4.6%	4.9%	4.9%	4.9%	4.8%	4.5%	4.4%	4.6%	4.5%
Basic Materials	7.5%	7.3%	7.1%	6.8%	6.7%	6.7%	6.7%	6.8%	6.8%	6.6%
Industrial Products	9.0%	8.8%	8.7%	8.6%	8.5%	8.4%	8.4%	8.5%	8.7%	8.8%
Construction	5.4%	5.2%	5.1%	5.1%	5.1%	5.1%	4.8%	4.4%	4.0%	3.5%
Conglomerates	11.0%	10.9%	10.7%	10.6%	10.9%	10.7%	10.7%	10.7%	10.7%	10.6%
Technology	17.7%	17.5%	17.4%	17.1%	17.1%	17.1%	17.0%	17.4%	17.7%	17.9%
Aerospace	7.2%	7.0%	7.0%	6.9%	7.0%	6.8%	6.6%	6.5%	6.2%	6.5%
Oil/Energy	8.2%	7.8%	7.6%	7.3%	7.4%	7.7%	7.9%	8.0%	8.0%	7.8%
Finance	15.8%	15.2%	15.7%	15.8%	15.9%	15.0%	14.1%	13.4%	13.2%	13.0%
Utilities	9.4%	9.3%	9.2%	9.1%	9.1%	8.0%	8.0%	8.1%	7.9%	8.9%
Transportation	8.8%	8.7%	8.7%	8.7%	8.5%	8.3%	8.1%	8.0%	8.0%	8.1%
Business Services	16.1%	15.8%	15.4%	15.1%	14.8%	14.4%	14.3%	14.0%	13.8%	13.6%
S&P 500	10.1%	9.9%	**9.8%**	**9.8%**	**9.8%**	**9.7%**	**9.6%**	**9.5%**	**9.5%**	**9.5%**
ex Finance	9.3%	9.1%	9.0%	8.9%	9.0%	8.9%	8.9%	9.0%	9.0%	9.0%

Source: Zacks Investment Research, Inc.
Data as of: 1/23/2014 www.zacks.com

Table 9 below of annual net margins provides the full context for margins since the start of the current earnings cycle in 2009. Net margins for the S&P 500 peaked in 2007 and already past that level.

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 9: Annual Net Margins

Zacks Sectors	Annual Margins						
	2015 E	2014 E	2013 E	2012 A	2011 A	2010 A	2009 A
Cons. Staples	12.7%	*12.1%*	11.8%	10.8%	10.9%	11.0%	10.5%
Cons. Discretionary	11.9%	*10.7%*	10.1%	9.7%	9.3%	8.9%	7.4%
Retail/Wholesale	4.9%	*4.5%*	4.3%	4.3%	4.3%	4.1%	3.9%
Medical	10.6%	*9.9%*	9.7%	10.4%	10.8%	10.8%	10.2%
Autos	5.6%	*4.8%*	4.4%	4.5%	5.1%	5.1%	0.3%
Basic Materials	8.1%	*7.4%*	6.6%	6.8%	7.7%	9.3%	4.6%
Industrial Products	9.6%	*8.9%*	8.2%	8.6%	8.6%	7.5%	6.1%
Construction	5.9%	*5.3%*	7.1%	3.9%	2.7%	2.6%	-0.1%
Conglomerates	12.2%	*11.4%*	11.0%	10.5%	10.0%	9.5%	8.6%
Technology	18.4%	*17.5%*	16.7%	17.8%	17.6%	16.9%	13.3%
Aerospace	7.8%	*7.1%*	6.8%	6.5%	6.6%	6.1%	5.1%
Oil/Energy	9.2%	*8.5%*	7.5%	7.9%	8.6%	6.9%	5.8%
Finance	19.9%	*19.0%*	15.6%	12.8%	11.2%	11.0%	6.6%
Utilities	9.7%	*9.3%*	8.9%	8.9%	8.8%	8.8%	8.7%
Transportation	9.5%	*8.7%*	8.4%	7.9%	7.4%	7.3%	4.4%
Business Services	17.1%	*15.9%*	14.6%	13.7%	13.0%	12.0%	11.0%
S&P 500	**11.1%**	**10.4%**	**9.7%**	**9.5%**	**9.4%**	**9.0%**	**7.1%**
ex Finance	10.0%	*9.3%*	8.8%	9.0%	9.1%	8.7%	7.2%

Source: Zacks Investment Research, Inc.

Data as of: 1/23/14 9:37 AM www.zacks.com

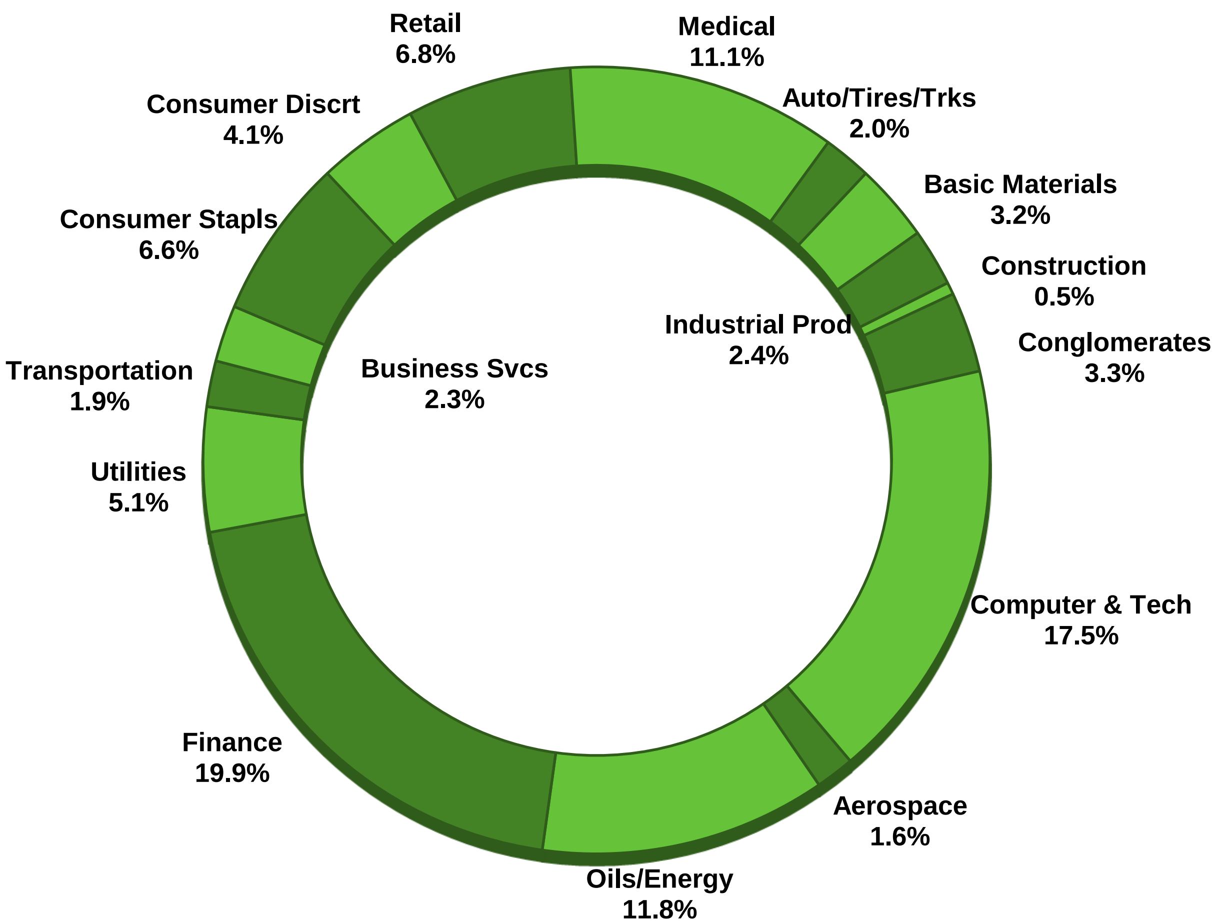
Margins follow a cyclical pattern. They expand as the economy comes out of a recession and companies use existing resources in labor and capital to drive business. But eventually capacity constraints kick in, forcing companies to spend more for incremental business. At that stage, margins start to contract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

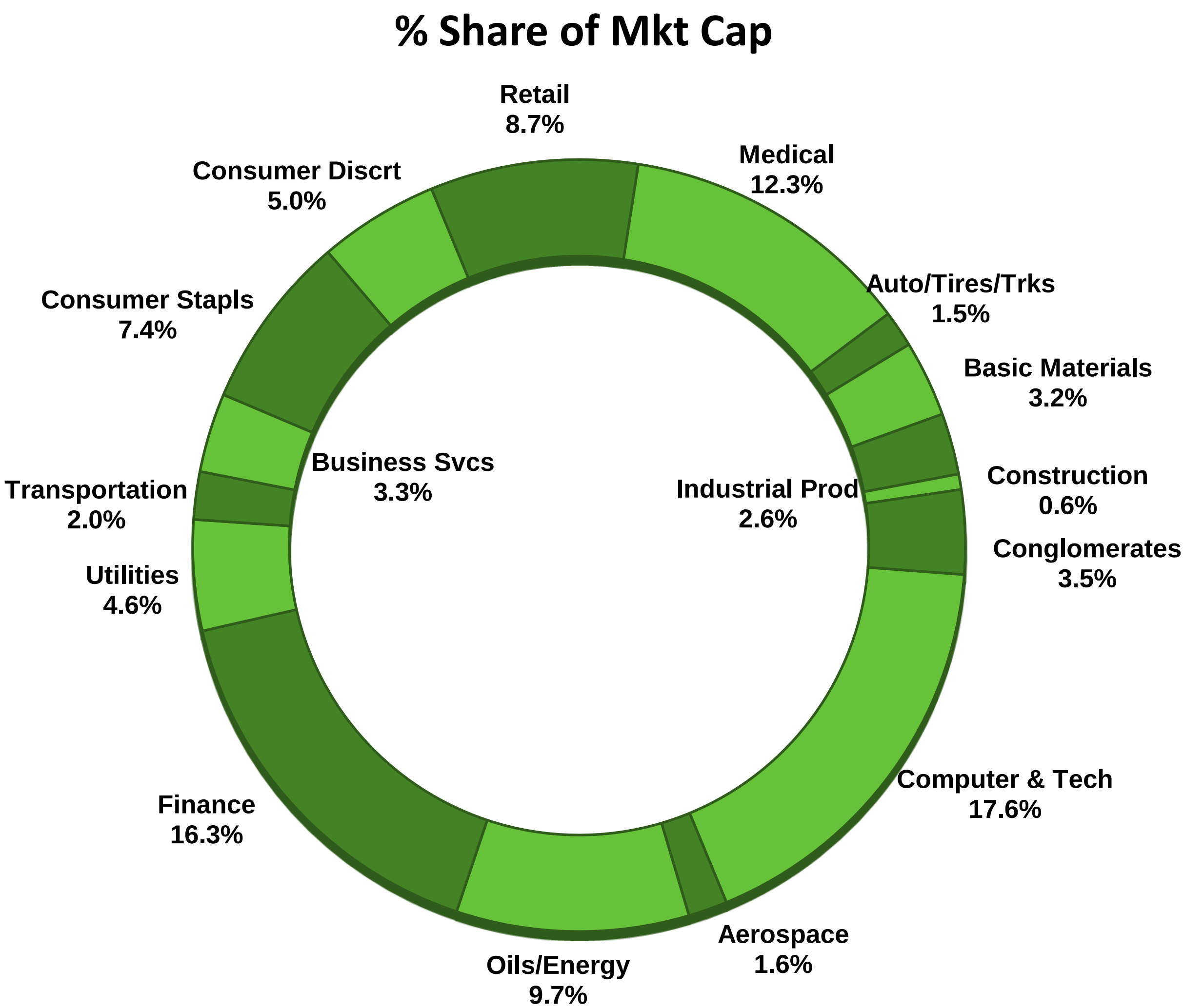
We may not be at the contraction stage yet, but we do need to buy into fairly optimistic assumptions about productivity improvements for current consensus margin expansion expectations to pan out.

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 leadership 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





Want more information about this report or about Zacks Investment Research?

Contact Terry Ruffolo at 312-265-9213 or at truffolo@zacks.com

Visit the Zacks Media Room at zacks.com/media-room