

Zacks Earning Trends

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Earnings Season in Final Stretch

Our overall verdict on the Q4 earnings season is that it was no better or worse than what we have been seeing in the last few quarters. In some respects, the Q4 earnings season was an improvement over the recent past.

Specifically, total earnings for the S&P 500 reached a new all-time quarterly record and even earnings growth for the quarter was the highest of the year (even after accounting for easy comparisons). Positive surprises started off on the weak side, but even those were running at the best pace of the year.

Where Q4 was no different from other recent reporting cycles was in terms of top-line growth and company guidance. Revenue growth has been a challenge for companies for quite some time and we didn't see any improvement on that front in Q4 either.

Guidance didn't improve either – it has been weak for more than a year now and Q4 was no different. Part of the guidance weakness is likely a function of management's need for expectations management. The need for conservatism aside, one has to be extremely cynical to believe that management teams would guide lower while knowing that their business outlook was stable, if not improving.

The 2013 Q4 Scorecard

The earnings season is almost over, with results from 489 S&P 500 members already out. Total earnings for these companies are up +9.4% from the same period last year, with 64.4% beating earnings expectations with a median surprise of +2.4%. Total revenues for these companies are barely in the positive, up only +0.8%, with 56.4% beating revenue expectations with a median surprise of 0.6%.

The +9.4% 'headline' total earnings growth rate definitely looks fairly strong, particularly when compared to the growth rate for this same group of 489 companies in the last few quarters. Easy comparisons for three companies – Bank of America (BAC), Verizon (VZ), and Travelers (TRV) – account for a big part of the strong Q4 earnings growth. Exclude these three and total earnings growth for the S&P 500 companies that have reported drops by almost half. Performance on the revenue front is notably sub-par relative to recent quarters, dragged down by weakness in the Finance and Energy sectors.

The composite picture for Q4 – combining the results for the 489 companies that have reported already with the 11 still to come – is for earnings growth of +9.2%. This will be the highest quarterly growth pace of 2013, with easy comparisons playing a non-trivial

role propping up the growth rate. But it's not all easy comparisons, as total earnings for the index are on track to reach a new all-time quarterly record.

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 to shrug estimate cuts in the post-QE world.

Key Points

- » Total earnings for the 489 S&P 500 companies that have reported results are up +9.4%, with 64.4% beating earnings expectations. Revenues for these companies are up +0.8%, with a revenue 'beat ratio' of 56.4%.
- » Easy comparisons for Bank of America, Verizon and Travelers account for most of the growth thus far. Excluding these three companies, the earnings growth rate drops to +5.7%, which is comparable to what this same group of companies have achieved in recent quarters.
- » Revenue growth at this stage is lower than what we have seen from this same group of companies in Q3 and other recent quarters, dragged down by weak top-line growth numbers from the Energy and Finance sectors. Excluding these two sectors, the revenue growth picture is still weak, but not so starkly.
- » 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 +22.8%. Excluding Finance, total earnings growth for the S&P 500 drops to +6.5%.
- » Guidance has overwhelmingly been negative in recent quarters and the trend has largely remained in place in the Q4 reporting season as well. As a result, estimates for 2014 Q1 and beyond have been coming down as the earnings season has unfolded.
- » The bottom-up 'EPS' estimate for the S&P 500 for 2014 currently stands at \$117.14, while the top-down estimate for the same is currently at \$117.25. For 2015, the bottom-up estimate remains \$130.38.

Q4 Earnings Season: The Final Phase

We are in the final stretch in the 2013 Q4 earnings season, with results from just 11 S&P 500 members still to come at this stage.

Total earnings for the 489 S&P 500 companies that have reported results (97.8% of the index's total membership that account for 99.3% of its total market cap) are up +9.4% from the same period last year, with 64.4% beating earnings expectations with a median surprise of +2.4%. Total revenues for these companies are barely in the positive column, up only +0.8%, with 56.4% beating revenue expectations with a median surprise of +0.6%.

Here is the Scorecard for the 489 S&P 500 companies that have reported, as of Thursday, March 4th.

Scorecard <u>Zacks Sectors</u>	% Reported		Q4 Earnings			Q4 Revenue		
	Total Companies	Total Market Cap	Growth YoY	Beat Ratio	Median Surp. %	Growth YoY	Beat Ratio	Median Surp. %
Cons. Staples	97.0%	98.6%	2.2%	50.0%	0.4	1.7%	28.1%	-0.2
Cons. Discretionary	93.9%	97.9%	13.6%	51.6%	0.9	3.3%	54.8%	0.2
Retail/Wholesale	83.7%	95.0%	-1.6%	61.1%	1.1	1.9%	25.0%	-0.2
Medical	100.0%	100.0%	1.1%	74.0%	2.1	5.3%	76.0%	1.5
Autos	100.0%	100.0%	17.9%	60.0%	3.7	4.1%	60.0%	1.2
Basic Materials	100.0%	100.0%	20.7%	66.7%	2.4	1.5%	54.2%	0.7
Industrial Products	96.0%	98.7%	12.2%	58.3%	1.6	1.0%	54.2%	0.2
Construction	100.0%	100.0%	13.9%	63.6%	3.1	6.3%	72.7%	1.0
Conglomerates	100.0%	100.0%	11.0%	71.4%	1.0	3.8%	28.6%	-0.1
Technology	100.0%	100.0%	5.0%	76.9%	4.6	4.5%	66.2%	0.9
Aerospace	100.0%	100.0%	20.0%	88.9%	3.1	-0.1%	88.9%	2.1
Oil/Energy	100.0%	100.0%	-10.6%	53.3%	0.0	-3.3%	44.4%	0.0
Finance	100.0%	100.0%	22.8%	72.2%	2.1	-7.1%	64.6%	0.7
Utilities	100.0%	100.0%	NM	67.6%	4.2	2.9%	64.7%	1.8
Transportation	100.0%	100.0%	15.8%	45.5%	0.0	4.5%	54.5%	0.5
Business Services	100.0%	100.0%	10.6%	42.9%	0.0	5.6%	52.4%	0.3
S&P 500	97.8%	99.3%	9.4%	64.4%	2.4	0.8%	56.4%	0.6
ex Finance	97.4%	99.2%	6.7%	62.9%	N/A	2.1%	54.9%	0.0

Source: Zacks Investment Research, Inc.

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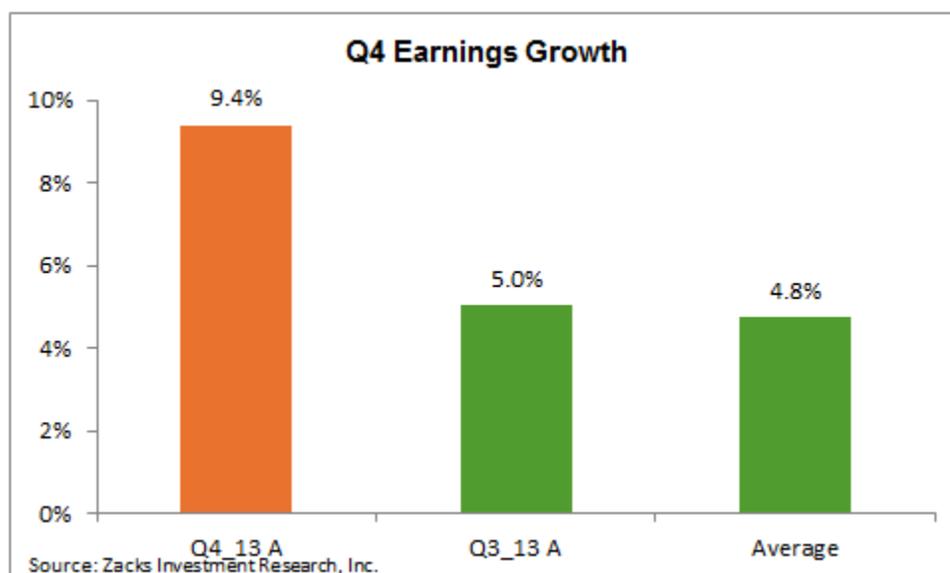
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Note: Here are few key points to keep in mind while reading this report.

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

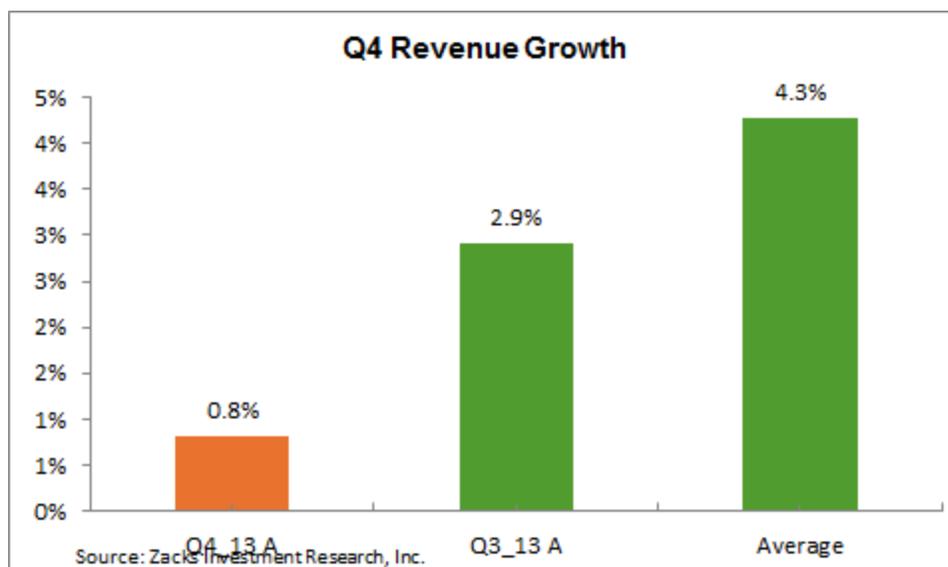
- b. We divide the corporate world into 16 sectors compared to the official S&P 10 GICS. We have stand-alone sectors like Autos, Construction, Conglomerates, Aerospace, Transportation and Business Services that provide for a better understanding of trends in these key areas of the economy.
- c. All references 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 +9.4% 'headline' total earnings growth rate is fairly robust, particularly when compared to the growth rate for this same group of 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.



We should keep in mind, however, that easy comparisons account for a big part of the strong earnings growth. Comparisons are particularly easy for three companies – Bank of America, Verizon, and Travelers. Exclude these three companies and total earnings growth for the S&P 500 companies that have reported drops to +5.7% from +9.4%. This is still better than recent quarters, but a lot less so.

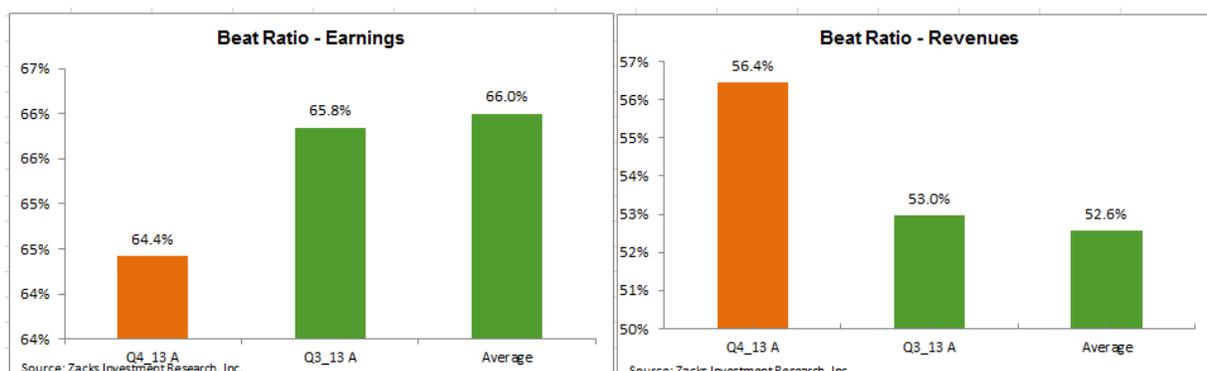
Revenue growth has been problematic for quite some time now, but it is almost non-existent in Q4 at this stage, as you can see in the chart below.



The biggest drag on Q4 revenue growth is from the Finance and Energy sectors, revenues in Finance down -7.1% (with results from 100% of the S&P 500's Finance sector results already out) and -3.3% in the Energy sector (100.0% of the sector's total companies have reported). Prudential Financial had an unusually big one-off top-line gain in 2012 Q4, making revenue comparisons for the Finance sector particularly difficult.

Excluding both of those sectors, revenue growth for the S&P 500 companies that have reported results start looking better – up +3.2%, modestly down from 2013 Q3 for the same group of companies (+3.4%) and up from the 4-quarter average of +2.5%. Revenue growth has improved for the Transportation and Technology sectors and somewhat for the Industrials as well.

Unlike the divergence between earnings and revenue growth rates in Q4 thus far, we see a uniformly positive picture on the 'beat ratio', with the ratios of companies coming ahead of earnings and revenue estimates tracking above recent historical trends, as the chart below shows.



The improved beat ratios this quarter likely reflect that estimates had fallen more than they needed to in the run up to the earnings season. We certainly didn't see the improved beat ratios show up in any change on the guidance front, as companies overwhelmingly guided lower.

In terms of standout sectors, the Aerospace sector had an 88.9% earnings beat ratio and 88.9% revenue beat ratio. Other sectors with improved beat ratios include Basic Materials (earnings), Technology (both earnings & revenues) and Finance (both earnings & revenues).

On the negative side, the Retail sector struggled, both in terms of growth as well as surprises. With 83.7% of the sector's companies reporting results, total earnings for the sector are down -1.6% on +1.9% higher revenues, with 61.1% of the companies beating earnings estimates and only 25.0% coming ahead of top-line expectations. In other sectors, fewer Auto sector companies came out with positive earnings surprises and the beat ratios for the Transportation and Consumer Discretionary sectors were also below the levels of the last few quarters.

Among the major sectors, Technology (100.0% of total reported) has much improved earnings and revenue growth rates as well as beat ratios. Total earnings for the sector increased +5.0% on +4.5% higher revenues, with 76.9% beating earnings estimates and 66.2% coming ahead of top-line expectations.

The table below shows the scorecard for the Technology at the medium or M-Industry level (we sub-divide the 16 sectors into 63 M-level industries).

Tech Sector Industries	% Reported of Total		Earnings		Revenues	
	Companies	Market Cap	Growth Rate	Beat Ratio	Growth Rate	Beat Ratio
Computer - Office Equipment	100.0%	100.0%	1.5%	81.8%	0.3%	63.6%
Computer Software - Services	100.0%	100.0%	3.4%	60.0%	10.7%	60.0%
Electronic - Semiconductors	100.0%	100.0%	46.1%	81.8%	12.7%	63.6%
Electronics	100.0%	100.0%	12.0%	85.7%	3.6%	71.4%
Misc. Technology	100.0%	100.0%	64.2%	100.0%	20.9%	83.3%
Telecommunications Equipment	100.0%	100.0%	-6.3%	100.0%	4.1%	71.4%
Telecommunications Services	100.0%	100.0%	-23.8%	33.3%	3.2%	0.0%
<i>Technology Sector</i>	<i>100.0%</i>	<i>100.0%</i>	<i>5.0%</i>	<i>76.9%</i>	<i>4.5%</i>	<i>66.2%</i>

Source: Zacks Investment Research, Inc.

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3/4/14 10:30 AM

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The Table below shows the comparison of Tech sector results thus far with the preceding and 4-quarter average.

Tech Sector Industries	Earnings Growth Compared			Revenues Growth Compared		
	Q0	Q-1	Average	Q0	Q-1	Average
Computer - Office Equipment	1.5%	-3.3%	-6.1%	0.3%	-0.6%	0.9%
Computer Software - Services	3.4%	15.3%	13.4%	10.7%	8.1%	16.1%
Electronic - Semiconductors	46.1%	12.0%	-9.9%	12.7%	4.3%	1.5%
Electronics	12.0%	6.9%	5.9%	3.6%	4.4%	13.5%
Misc. Technology	64.2%	32.7%	-4.5%	20.9%	9.8%	-1.5%
Telecommunications Equipment	-6.3%	13.8%	15.6%	4.1%	12.3%	12.4%
Telecommunications Services	-23.8%	-1.6%	3.6%	3.2%	2.7%	3.7%
<i>Technology Sector (Computer/Tech)</i>	<i>5.0%</i>	<i>5.6%</i>	<i>0.8%</i>	<i>4.5%</i>	<i>3.2%</i>	<i>5.4%</i>

Source: Zacks Investment Research, Inc.

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The Energy sector was been a drag on earnings growth, with total earnings for the sector down -10.6% from the same period last year. While weak, this is a modestly lower decline for the same group of companies in Q3. Excluding the drag from the Energy sector, total earnings for the S&P 500 would be up +12.4%. The strong performance from the Transportation sector, primarily airlines, is partly a result of the Energy sector's travails.

The Composite Picture: Reported + Still To Come

Table 1 below provides the composite or blended picture, combining results from the 489 companies that have reported already with the 11 that have still to report numbers.

Total earnings in Q4 are expected to be up +9.2%, a much better earnings growth than we have seen in recent quarters. In fact, this is the highest quarterly earnings growth rate of 2013.

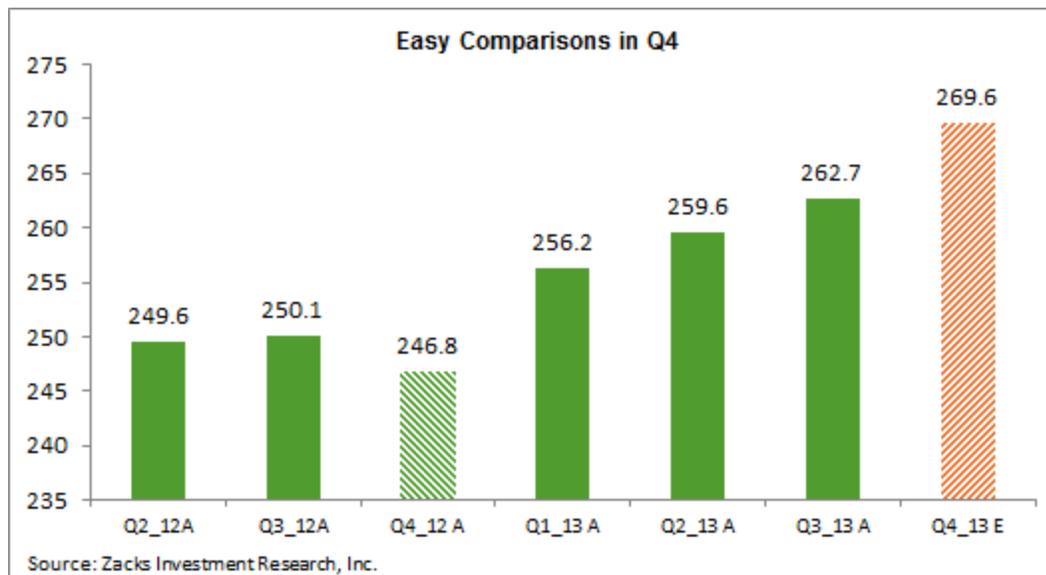
Zacks Sectors	Year-over-Year Growth					
	Earnings		Revenue		Margins	
	4Q 13E	3Q 13A	4Q 13E	3Q 13A	4Q 13E	3Q 13A
Cons. Staples	2.2%	2.3%	1.5%	0.2%	0.07%	0.23%
Cons. Discretionary	13.9%	12.1%	3.7%	3.2%	0.97%	0.92%
Retail/Wholesale	-2.3%	10.3%	1.5%	3.8%	-0.18%	0.25%
Medical	1.1%	0.2%	7.2%	7.5%	-0.55%	-0.73%
Autos	17.9%	32.3%	4.1%	7.0%	0.46%	1.17%
Basic Materials	20.7%	2.2%	1.5%	1.1%	1.08%	0.06%
Industrial Products	10.5%	0.1%	0.5%	-1.2%	0.74%	0.12%
Construction	13.9%	32.1%	6.3%	9.2%	0.35%	1.01%
Conglomerates	11.0%	3.5%	3.8%	4.1%	0.76%	-0.06%
Technology	5.0%	5.6%	4.5%	3.2%	0.08%	0.38%
Aerospace	20.0%	11.5%	-0.1%	1.2%	1.16%	0.66%
Oil/Energy	-10.6%	-8.4%	-2.3%	2.8%	-0.69%	-0.88%
Finance	22.8%	10.5%	-7.5%	0.0%	3.59%	1.42%
Utilities	142.5%	4.7%	2.9%	2.4%	4.46%	0.24%
Transportation	15.8%	13.2%	4.5%	4.5%	0.83%	0.73%
Business Services	10.6%	8.6%	5.6%	4.3%	0.68%	0.58%
S&P 500	9.2%	5.0%	1.0%	3.0%	0.73%	0.19%
ex Finance	6.5%	3.8%	2.4%	3.5%	0.34%	0.03%

Source: Zacks Investment Research, Inc.

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The +9.2% earnings growth in 2013 Q4 follows growth rates of +5.0% 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.

For the Finance sector as a whole, total earnings would be up +22.8% from the same period last year. Excluding the strong growth from the Finance sector, total earnings for the S&P 500 would be up +6.5% in Q4 vs. the +3.8% ex-Finance growth in Q3.

Other sectors with double-digit earnings growth in Q4 include, Transportation (+15.8%), Business Services (+10.6%), Industrial Products (+10.5%), Consumer Discretionary (13.9%), Basic Materials (20.7%), Construction (13.9%), Aerospace (20.0%), Autos (17.9%), and Conglomerates (11.0%). 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 are expected to be up +5.0% for the Technology sector, while Energy (-10.6%), and Retail (-2.3%) are the laggards. The growth picture for the S&P 500 improves without the Energy sector's drag, with total earnings up for the index up +12.2% outside of the Energy sector.

But it's not all easy comparisons, as you can easily see in the chart above. Total earnings have been making new all-time quarterly records in the last two quarters and 2013 Q4 is on track to set a new one.

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	4.4%	2.7%	-1.7%	2.2%	2.3%	-0.8%	4.6%	8.7%
Cons. Discretionary	-3.7%	16.8%	4.3%	13.9%	12.1%	16.3%	12.5%	15.9%
Retail/Wholesale	7.7%	8.7%	2.4%	-2.3%	10.3%	9.8%	10.3%	14.4%
Medical	5.4%	1.8%	-3.0%	1.1%	0.2%	-1.5%	6.9%	15.1%
Autos	-13.4%	2.2%	-10.4%	17.9%	32.3%	18.5%	6.9%	26.3%
Basic Materials	20.5%	1.9%	-6.1%	20.7%	2.2%	-9.9%	11.1%	15.7%
Industrial Products	2.5%	1.4%	-2.6%	10.5%	0.1%	-4.5%	6.2%	12.4%
Construction	18.4%	16.6%	5.3%	13.9%	32.1%	53.6%	12.7%	24.5%
Conglomerates	11.8%	8.2%	-10.9%	11.0%	3.5%	-0.6%	5.8%	9.7%
Technology	9.2%	7.4%	-0.9%	5.0%	5.6%	-7.9%	10.0%	11.0%
Aerospace	4.2%	0.8%	-4.4%	20.0%	11.5%	10.4%	4.3%	9.9%
Oil/Energy	13.4%	12.1%	-6.5%	-10.6%	-8.4%	-11.3%	10.9%	5.9%
Finance	7.3%	0.2%	-2.3%	22.8%	10.5%	31.8%	6.2%	10.7%
Utilities	5.8%	5.6%	5.3%	142.5%	4.7%	0.8%	6.9%	4.4%
Transportation	4.0%	1.3%	19.9%	15.8%	13.2%	8.3%	8.2%	15.2%
Business Services	17.4%	12.2%	13.6%	10.6%	8.6%	9.8%	12.3%	13.7%
S&P 500	7.3%	5.3%	-1.6%	9.2%	5.0%	4.0%	8.3%	11.4%
ex Finance	7.3%	6.7%	-1.4%	6.5%	3.8%	-1.6%	8.8%	11.6%

Source: Zacks Investment Research, Inc.

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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	-6.5%	-8.1%	-7.6%	1.5%	0.2%	-0.6%	-7.0%	3.3%
Cons. Discretionary	3.5%	5.5%	3.5%	3.7%	3.2%	5.4%	4.5%	6.2%
Retail/Wholesale	3.3%	7.6%	4.1%	1.5%	3.8%	4.4%	5.6%	6.1%
Medical	7.0%	7.1%	6.7%	7.2%	7.5%	4.0%	6.1%	6.6%
Autos	0.9%	2.5%	1.4%	4.1%	7.0%	4.7%	1.6%	5.4%
Basic Materials	2.9%	0.9%	1.2%	1.5%	1.1%	-1.4%	2.4%	4.3%
Industrial Products	0.0%	-1.9%	-2.1%	0.5%	-1.2%	0.6%	-0.3%	3.8%
Construction	11.7%	8.8%	6.6%	6.3%	9.2%	10.1%	8.1%	9.8%
Conglomerates	-1.0%	1.4%	-0.9%	3.8%	4.1%	0.3%	0.4%	2.3%
Technology	5.0%	3.3%	2.2%	4.5%	3.2%	0.9%	4.0%	5.2%
Aerospace	1.0%	-1.2%	1.9%	-0.1%	1.2%	1.5%	0.8%	1.3%
Oil/Energy	-3.6%	-0.7%	-0.4%	-2.3%	2.8%	-4.2%	-2.8%	-1.7%
Finance	-1.8%	-4.5%	-4.6%	-7.5%	0.0%	7.1%	-5.3%	-9.9%
Utilities	4.2%	0.6%	1.7%	2.9%	2.4%	6.9%	2.5%	1.1%
Transportation	5.6%	4.4%	4.9%	4.5%	4.5%	2.2%	4.5%	5.1%
Business Services	6.2%	6.3%	5.2%	5.6%	4.3%	2.5%	4.9%	6.1%
S&P 500	1.4%	1.7%	1.0%	1.0%	3.0%	2.3%	1.1%	2.2%
ex Finance	1.9%	2.6%	1.8%	2.4%	3.5%	1.6%	2.1%	3.9%

Source: Zacks Investment Research, Inc.

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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	18.9	19.4	18.2	15.5	18.1	18.6	17.7	15.8	17.7	18.2
Cons. Discretionary	12.5	11.5	12.0	10.2	11.7	12.0	10.2	9.8	10.3	10.7
Retail/Wholesale	23.8	18.6	19.7	16.9	20.7	17.3	18.1	16.5	21.2	15.7
Medical	32.1	31.6	30.5	28.4	28.4	30.0	30.0	29.3	28.1	29.9
Autos	5.0	5.8	6.0	4.2	4.4	6.7	5.9	4.7	3.8	5.1
Basic Materials	9.1	7.9	8.4	8.7	7.8	6.6	8.2	9.3	6.5	6.4
Industrial Products	6.2	7.0	6.9	5.7	5.9	6.8	6.8	5.9	5.3	6.8
Construction	1.4	1.7	1.5	0.9	1.3	1.5	1.3	0.9	1.1	1.1
Conglomerates	10.4	9.2	9.0	7.4	9.9	8.3	8.3	8.4	9.0	8.0
Technology	58.9	47.9	45.0	44.2	54.6	43.9	41.9	44.6	52.0	41.6
Aerospace	4.8	4.5	4.3	4.0	4.4	4.3	4.3	4.2	3.7	3.9
Oil/Energy	32.5	32.7	31.7	29.4	28.7	28.9	28.2	31.4	32.1	31.5
Finance	57.2	54.3	55.0	52.1	51.2	50.6	54.9	53.4	41.7	45.8
Utilities	11.8	17.1	13.4	14.0	11.5	16.2	12.6	13.3	4.7	15.5
Transportation	5.5	5.8	5.5	4.4	4.9	5.5	5.4	3.7	4.3	4.9
Business Services	7.0	6.6	6.3	5.9	6.0	5.6	5.6	5.2	5.4	5.2
S&P 500	297.0	281.7	273.3	252.1	269.6	262.7	259.6	256.2	246.8	250.1
ex Finance	239.9	227.4	218.3	200.0	218.4	212.0	204.7	202.9	205.1	204.3

Source: Zacks Investment Research, Inc.

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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	156.6	153.2	149.1	139.0	168.0	163.8	162.2	150.4	165.5
Cons. Discretionary	114.0	107.8	106.4	103.9	108.2	104.1	100.9	100.4	104.4
Retail/Wholesale	471.2	414.2	423.9	407.9	439.8	400.9	394.0	391.9	433.1
Medical	327.3	317.7	314.4	304.1	309.4	296.8	293.6	285.1	288.5
Autos	113.4	111.0	113.9	107.5	113.3	110.0	111.1	106.0	108.9
Basic Materials	119.5	114.5	118.2	116.4	115.5	111.2	117.2	115.0	113.8
Industrial Products	72.1	74.5	75.8	71.5	71.8	74.5	77.2	73.0	71.4
Construction	25.9	27.7	26.2	23.5	24.1	24.8	24.1	22.0	22.7
Conglomerates	83.6	79.9	79.8	74.9	85.9	80.7	78.7	75.6	82.8
Technology	308.6	273.6	266.8	268.2	297.9	260.5	258.3	262.4	285.0
Aerospace	63.8	61.4	60.4	58.0	63.7	60.7	61.1	56.9	63.8
Oil/Energy	379.3	386.3	387.6	380.1	391.0	400.8	390.3	381.7	400.0
Finance	340.6	334.0	334.1	331.8	351.9	340.2	349.9	347.7	380.7
Utilities	148.5	157.3	144.4	147.7	148.7	151.0	143.5	145.2	144.6
Transportation	61.5	61.3	60.1	57.1	58.4	58.1	57.6	54.5	55.9
Business Services	42.2	40.7	40.1	39.0	40.3	38.3	37.7	37.1	38.1
S&P 500	2828.2	2715.1	2701.4	2630.5	2788.0	2676.6	2657.3	2604.9	2759.2
ex Finance	2487.6	2381.1	2367.2	2298.7	2436.0	2336.4	2307.5	2257.2	2378.5

Source: Zacks Investment Research, Inc.

Data as of: 3/4/14 10:30 AM

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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 expected to earn \$269.6 billion in 2013 Q4 vs. \$262.7 billion in Q3 and \$246.8 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 +8.3% and a further +11.4% the following year.

The Margins Picture

For the 489 S&P 500 companies that have reported results already, net margins are up 73 basis points year over year and 59 basis points from the preceding quarter.

Composite net margins in Q4, combining the results for the 489 companies that have come out with the 11 still to come, are expected to be up 73 basis points from the same period last year, with ex-Finance margins expected to be up 34 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)

<u>Zacks Sectors</u>	<u>4Q13E</u>		<u>3Q13A</u>		<u>2012A</u>	<u>2013E</u>	<u>2014E</u>
	YoY	QoQ	YoY	QoQ	YoY	YoY	YoY
Cons. Staples	0.07%	-0.55%	0.23%	0.40%	-0.14%	1.32%	0.63%
Cons. Discretionary	0.97%	-0.71%	0.92%	1.38%	0.19%	0.76%	0.97%
Retail/Wholesale	-0.18%	0.38%	0.25%	-0.28%	0.02%	0.20%	0.36%
Medical	-0.55%	-0.91%	-0.73%	-0.11%	-0.65%	0.08%	0.78%
Autos	0.46%	-2.19%	1.17%	0.78%	-0.02%	0.23%	0.93%
Basic Materials	1.08%	0.88%	0.06%	-1.11%	-0.08%	0.58%	0.80%
Industrial Products	0.74%	-0.91%	0.12%	0.24%	-0.38%	0.53%	0.72%
Construction	0.35%	-0.57%	1.01%	0.46%	1.24%	0.22%	0.71%
Conglomerates	0.76%	1.35%	-0.06%	-0.34%	0.23%	0.58%	0.81%
Technology	0.08%	1.46%	0.38%	0.62%	-1.38%	0.95%	0.96%
Aerospace	1.16%	-0.17%	0.66%	0.06%	0.43%	0.25%	0.61%
Oil/Energy	-0.69%	0.14%	-0.88%	-0.03%	-0.52%	1.04%	0.65%
Finance	3.59%	-0.34%	1.42%	-0.80%	1.70%	1.76%	3.70%
Utilities	4.46%	-2.99%	0.24%	1.92%	0.00%	0.38%	0.30%
Transportation	0.83%	-1.08%	0.73%	0.15%	0.48%	0.29%	0.83%
Business Services	0.68%	0.32%	0.58%	-0.15%	1.00%	1.03%	1.12%
S&P 500	0.73%	-0.14%	0.19%	0.04%	0.00%	0.67%	0.91%
ex Finance	0.34%	-0.11%	0.03%	0.20%	-0.27%	0.57%	0.68%

Source: Zacks Investment Research, Inc.

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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%	12.2%	11.1%	10.8%	11.3%	10.9%	10.5%	10.7%
Cons. Discretionary	10.7%	11.2%	9.8%	10.8%	11.5%	10.1%	9.7%	9.8%
Retail/Wholesale	4.5%	4.6%	4.2%	4.7%	4.3%	4.6%	4.2%	4.9%
Medical	9.9%	9.7%	9.3%	9.2%	10.1%	10.2%	10.3%	9.7%
Autos	5.2%	5.3%	3.9%	3.9%	6.1%	5.3%	4.5%	3.5%
Basic Materials	6.9%	7.1%	7.5%	6.8%	5.9%	7.0%	8.1%	5.7%
Industrial Products	9.3%	9.2%	8.0%	8.2%	9.1%	8.9%	8.1%	7.5%
Construction	6.2%	5.8%	4.0%	5.3%	5.8%	5.4%	4.1%	4.9%
Conglomerates	11.5%	11.3%	9.9%	11.6%	10.2%	10.6%	11.1%	10.8%
Technology	17.5%	16.9%	16.5%	18.3%	16.9%	16.2%	17.0%	18.2%
Aerospace	7.3%	7.2%	6.9%	6.9%	7.1%	7.1%	7.4%	5.8%
Oil/Energy	8.5%	8.2%	7.7%	7.3%	7.2%	7.2%	8.2%	8.0%
Finance	16.3%	16.4%	15.7%	14.5%	14.9%	15.7%	15.3%	11.0%
Utilities	10.9%	9.2%	9.5%	7.7%	10.7%	8.8%	9.2%	3.3%
Transportation	9.4%	9.1%	7.7%	8.4%	9.5%	9.4%	6.7%	7.6%
Business Services	16.2%	15.6%	15.1%	14.9%	14.6%	14.8%	14.0%	14.3%
S&P 500	10.4%	10.1%	9.6%	9.7%	9.8%	9.8%	9.8%	8.9%
ex Finance	9.6%	9.2%	8.7%	9.0%	9.1%	8.9%	9.0%	8.6%

Source: Zacks Investment Research, Inc.

Data as of: 3/4/14 10:30 AM

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The table 8 below shows net margins on a trailing four-quarter basis. So, the 9.7% 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	12.0%	11.7%	11.4%	11.0%	10.9%	10.9%	10.8%	10.8%	10.8%	10.7%
Cons. Discretionary	10.7%	10.6%	10.8%	10.6%	10.6%	10.3%	10.1%	9.8%	9.7%	9.7%
Retail/Wholesale	4.6%	4.5%	4.5%	4.4%	4.5%	4.5%	4.5%	4.4%	4.4%	4.4%
Medical	9.7%	9.5%	9.6%	9.7%	9.9%	10.1%	10.3%	10.4%	10.6%	10.7%
Autos	4.7%	4.6%	4.8%	4.8%	4.9%	4.8%	4.5%	4.4%	4.6%	4.5%
Basic Materials	7.3%	7.1%	6.8%	6.8%	6.9%	6.7%	6.7%	6.8%	6.8%	6.7%
Industrial Products	8.8%	8.7%	8.6%	8.6%	8.6%	8.4%	8.4%	8.5%	8.7%	8.8%
Construction	5.4%	5.4%	5.3%	5.1%	5.2%	5.1%	4.8%	4.4%	4.0%	3.6%
Conglomerates	11.3%	11.1%	10.8%	10.6%	10.9%	10.7%	10.7%	10.7%	10.7%	10.6%
Technology	17.5%	17.3%	17.2%	17.0%	17.1%	17.1%	17.0%	17.4%	17.7%	17.9%
Aerospace	7.3%	7.1%	7.0%	7.0%	7.1%	6.8%	6.6%	6.5%	6.2%	6.5%
Oil/Energy	8.2%	7.9%	7.6%	7.4%	7.5%	7.7%	7.9%	8.0%	7.9%	7.8%
Finance	16.3%	15.7%	15.4%	15.2%	15.1%	14.1%	13.8%	13.1%	12.9%	13.1%
Utilities	9.4%	9.4%	9.3%	9.2%	9.1%	8.0%	8.0%	8.1%	7.9%	8.9%
Transportation	8.8%	8.7%	8.7%	8.8%	8.5%	8.3%	8.1%	8.0%	8.0%	8.3%
Business Services	15.9%	15.5%	15.1%	14.9%	14.6%	14.4%	14.3%	14.0%	13.8%	13.8%
S&P 500	10.2%	9.9%	9.8%	9.7%	9.8%	9.6%	9.5%	9.5%	9.5%	9.5%
ex Finance	9.3%	9.1%	9.0%	8.9%	9.0%	8.9%	8.9%	8.9%	8.9%	9.0%

Source: Zacks Investment Research, Inc.

Data as of: 3/4/2014

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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	12.6%	11.9%	10.6%	10.8%	10.9%	11.1%	10.5%
Cons. Discretionary	11.6%	10.7%	9.9%	9.7%	9.3%	8.9%	7.4%
Retail/Wholesale	4.9%	4.6%	4.4%	4.4%	4.3%	4.3%	4.0%
Medical	10.6%	9.8%	9.8%	10.4%	10.8%	10.8%	10.2%
Autos	5.7%	4.7%	4.5%	4.5%	5.1%	5.1%	0.3%
Basic Materials	8.1%	7.3%	6.7%	6.8%	7.7%	9.3%	4.6%
Industrial Products	9.4%	8.7%	8.2%	8.6%	8.6%	7.5%	6.1%
Construction	6.0%	5.3%	5.1%	3.9%	2.7%	2.6%	-0.1%
Conglomerates	12.1%	11.3%	10.7%	10.5%	10.0%	9.5%	8.6%
Technology	18.3%	17.4%	16.4%	17.8%	17.6%	17.0%	13.2%
Aerospace	7.8%	7.2%	7.0%	6.5%	6.6%	6.1%	5.1%
Oil/Energy	9.1%	8.4%	7.4%	7.9%	8.6%	6.9%	5.8%
Finance	20.0%	16.3%	14.5%	12.8%	11.2%	11.0%	6.6%
Utilities	9.6%	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	16.8%	15.7%	14.7%	13.7%	13.0%	12.0%	11.0%
S&P 500	11.1%	10.1%	9.5%	9.5%	9.4%	9.0%	7.1%
ex Finance	10.0%	9.3%	8.7%	9.0%	9.1%	8.7%	7.2%

Source: Zacks Investment Research, Inc.

Data as of: 3/4/14 10:30 AM

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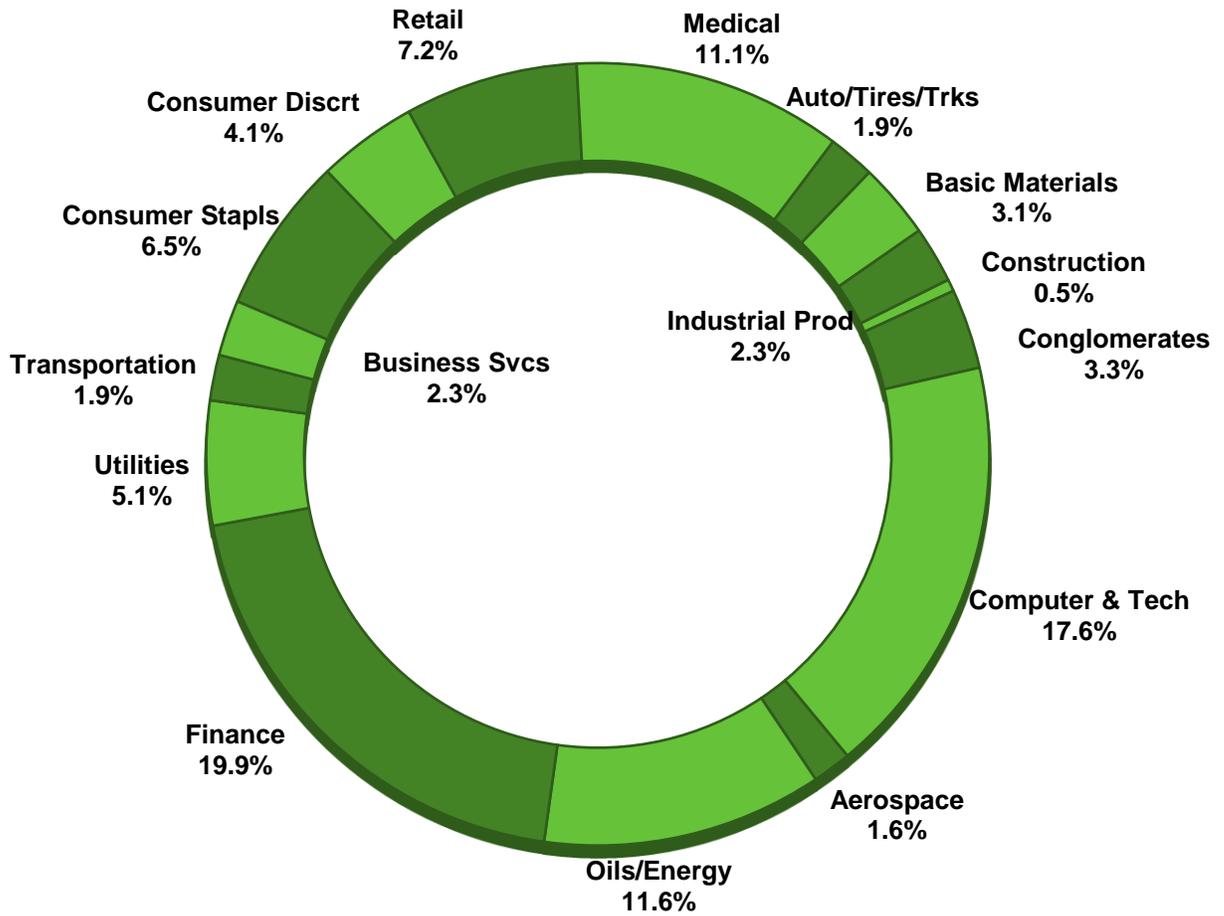
Margins follow a cyclical pattern. They expand as the economy comes out of a recession and companies use existing resources in labor and capital to drive business. But eventually capacity constraints kick in, forcing companies to spend more for incremental business. At that stage, margins start to contract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

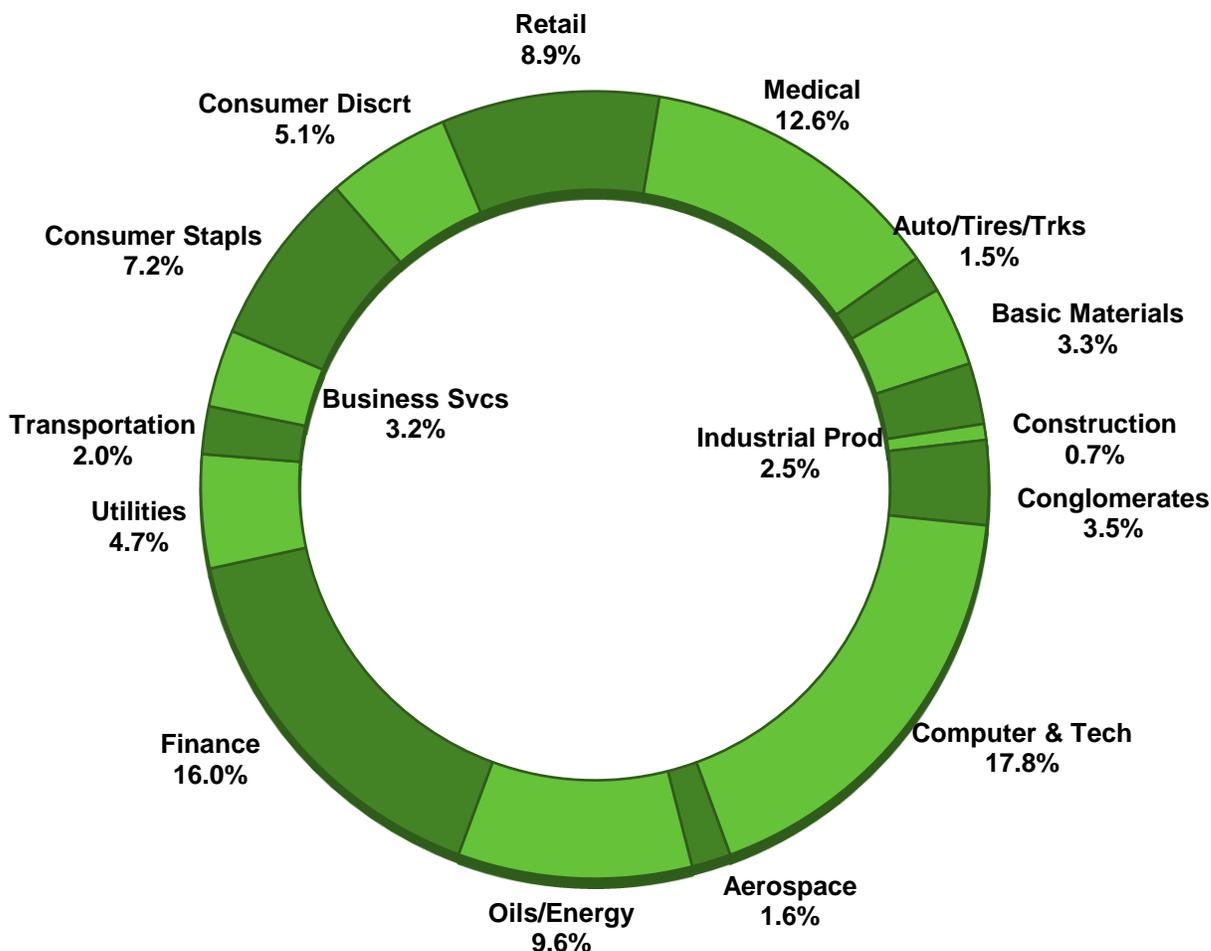
Market Cap vs. Total Earnings

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



% Share of Mkt Cap



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