Sheraz Mian SMian@Zacks.com

Is the Earnings Picture Good Enough?

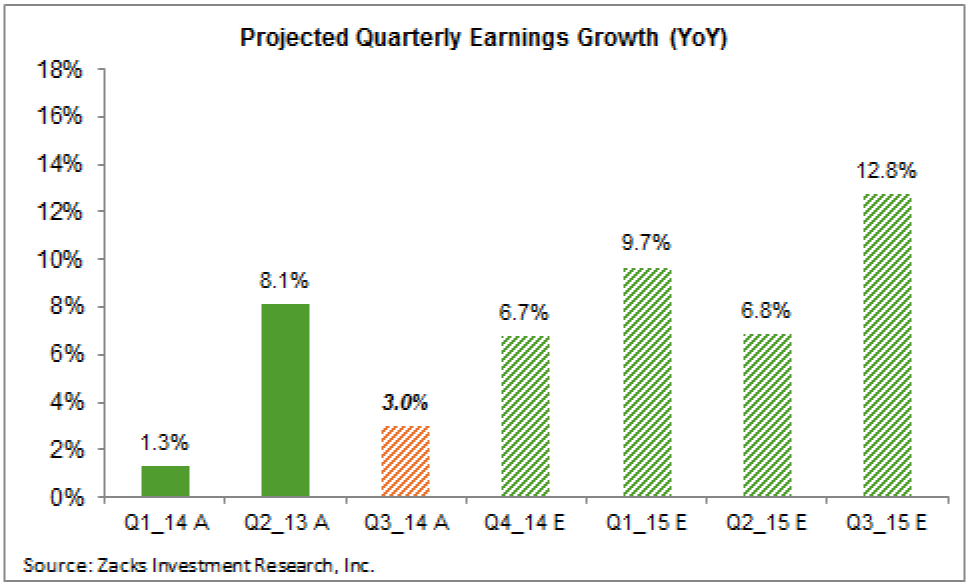
The 2014 Q3 earnings season has gotten off to a good-enough start, though the small sample of reports at this stage is heavily weighted towards the Finance sector. We will know more in the coming days as companies from outside of Finance post numbers, but it wouldn't be wrong to say that the reports thus far don't corroborate the all-around fear and anxiety weighing on the market lately.

We know that the market's anxiety is not because of earnings. Europe centered growth and deflation fears, the market's major source of anxiety lately, is for real and will eventually have a bearing on the earnings picture as well. But we aren't seeing anything unusually weak in the admittedly small number of Q3 earnings reports that we have seen thus far.

All of this could change in the coming days, but the results thus far aren't materially different from what we have been accustomed to seeing in other recent quarters. Earnings have been great for quite some time and they are no by means in that category this time either. But they aren't terrible either. If investors were broadly satisfied with other recent earnings seasons, then we don't see any reason why they should be so much on edge this time around.

Perhaps they are finally realizing that they shouldn't have pushed stocks into record territory in the face of an earnings backdrop that at best could be described as decent. You would recall that stocks have been moving higher even as earnings estimates have been coming down over the past two years. But is it reasonable to stay bullish on stocks if earnings estimates keep coming down.

The chart below shows current consensus earnings growth estimates for the coming quarters

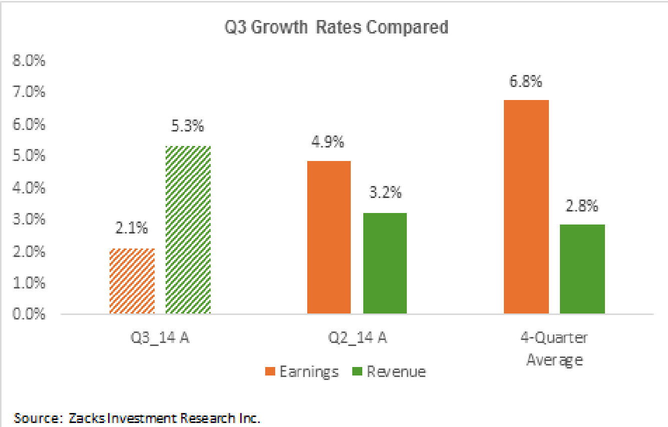


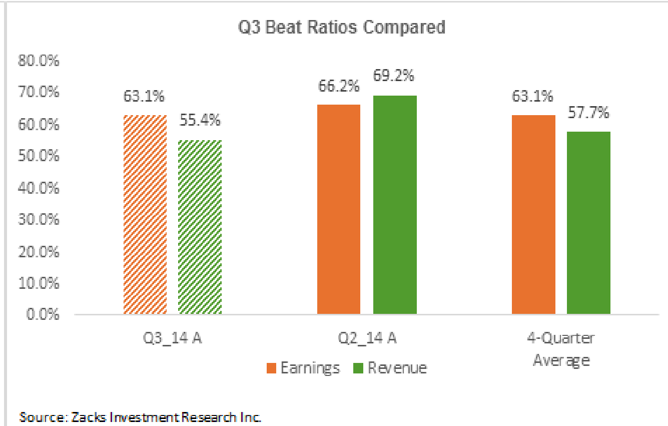
If the global growth picture is as bad as currently reflected in the market, then we better brace ourselves for a major negative revisions trend in earnings estimates for the current and coming quarters.

Q3 Earnings Scorecard (*as of October 16th, 2014*)

Including this morning's earnings announcements, we now have Q3 results from 65 S&P 500 members that combined account for 18.8% of the index's total market capitalization. Total earnings for these 65 companies are up +2.1% from the same period last year on +5.3% higher revenues, with 63.1% beating EPS estimates and 55.4% coming out with positive revenue surprises.

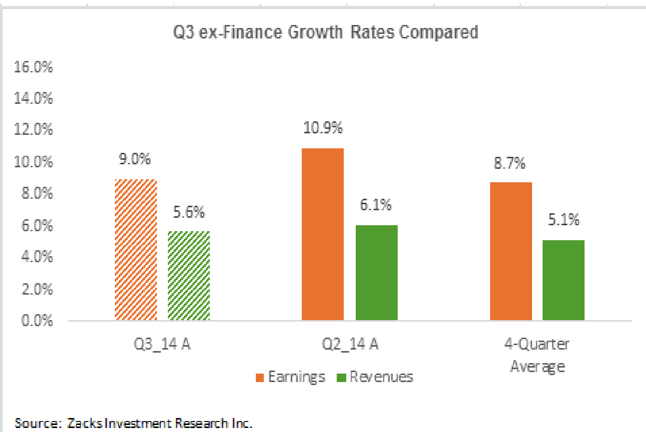
The two charts below compare the Q3 growth rates and beat ratios for these 65 companies with what these same companies reported in 2014 Q2 and the 4-quarter average (through Q2).

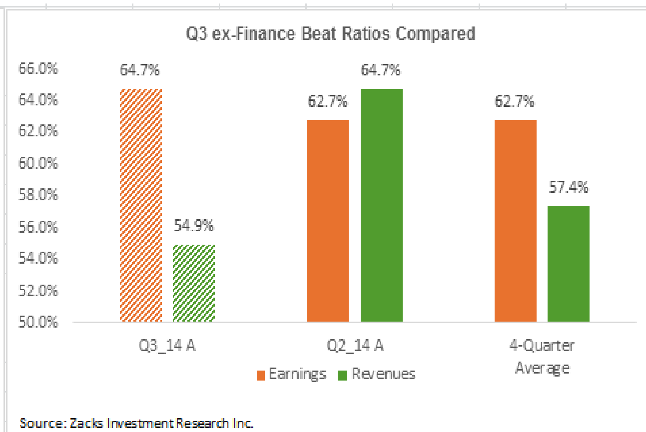




As you can see, the earnings growth performance for these 65 companies (+2.1%) doesn't compare favorably with what we got from these companies, while the revenue growth performance (up +5.3% vs. +3.2% in Q2 and the average of +2.8% over the preceding four quarters) is notably better. With respect to surprises, the earnings and revenue beat ratios are tracking below what we saw from the same group of companies in Q2, but are largely in-line with the 4-quarter average.

The charts below show the same data, but now on an ex-Finance basis.





The reason for looking at these aggregate numbers on an ex-Finance basis is that the Finance sector's results have been unusually held down this quarter by the huge litigation charge at Bank of America (BAC). Total earnings for the Finance sector, with results from 39.9% of the sector's market cap out, are down -6.1% from the same period last year on +4.6% higher revenues. But the sector's growth picture improves to a growth rate of +8.6% once Bank of America is excluded from the numbers.

Looking at Q3 expectations as a whole, combining the actual results from the 65 S&P 500 members that have reported with estimates for the remaining 435, total earnings are expected to be up +3% on +2.7% higher revenues. The composite growth has started going up as more companies report and beat estimates.

Some of the earnings reports from the likes of Pepsi (PEP), Intel (INTC), CSX Corp. (CSX) and others have been fairly reassuring, particularly when seen light of the ongoing growth worries. But we will know more as the earnings season ramps up in the coming days and companies from different sectors share their business outlook with us. Hard to imagine how guidance could become even worse than it has been in recent quarters. But any guidance deterioration will likely accentuate current global growth worries and serve as a fresh headwind for stock prices.

(See next Page)

A decent Start to Q3 Earnings Season

The 2014 Q3 earnings season has gotten underway, with results from 65 S&P 500 companies already out. Total earnings for the these 65 companies are up +2.1% from the same period last year, with 63.1% beating expectations. Total revenues for these companies are up +5.3%, with 55.4% beating revenue expectations.

The table below provides a Scorecard for the 65 companies that have reported results, as of Thursday, October 16th, 2014 (doesn't include after-market reports).

	2014 Q3 SCORECARD							
	% Reported		Earnings			Revenues		
Zacks Sectors	Total Companies	Total Market Cap	Growth YoY	Beat Ratio	Median Surp. %	Growth YoY	Beat Ratio	Median Surp. %
Cons. Staples	17.6%	24.6%	-1.0%	66.7%	5.0	1.5%	50.0%	0.1
Cons. Discretionary	12.1%	13.0%	12.4%	75.0%	9.9	7.5%	50.0%	0.7
Retail/Wholesale	27.9%	20.4%	4.0%	58.3%	0.4	5.6%	66.7%	0.2
Medical	7.7%	17.9%	7.6%	75.0%	3.3	6.5%	25.0%	0.0
Autos	0.0%	0.0%	NRPT	NRPT	NM	NRPT	NRPT	NM
Basic Materials	14.3%	19.4%	180.4%	66.7%	2.2	7.2%	66.7%	7.9
Industrial Products	12.0%	9.2%	-0.9%	100.0%	2.6	-0.3%	33.3%	0.0
Construction	15.4%	14.2%	37.8%	100.0%	11.9	22.1%	100.0%	3.4
Conglomerates	14.3%	8.9%	8.0%	0.0%	0.0	4.3%	0.0%	0.0
Technology	12.3%	17.4%	16.4%	50.0%	0.8	6.5%	50.0%	0.4
Aerospace	0.0%	0.0%	NRPT	NRPT	NM	NRPT	NRPT	NM
Oil/Energy	4.7%	3.9%	20.5%	0.0%	0.0	11.7%	50.0%	0.0
Finance	17.5%	39.9%	-6.1%	57.1%	1.7	4.6%	57.1%	0.5
Utilities	0.0%	0.0%	NRPT	NRPT	NM	NRPT	NRPT	NM
Transportation	27.3%	28.1%	-1.6%	100.0%	7.7	6.4%	66.7%	1.9
Business Services	13.6%	14.6%	6.8%	66.7%	2.2	5.8%	66.7%	1.1
S&P 500	**12.9%**	**18.8%**	**2.1%**	**63.1%**	**2.1**	**5.3%**	**55.4%**	**0.9**
ex Finance	12.1%	14.8%	9.0%	64.7%	N/A	5.6%	54.9%	0.0
Source: Zacks Investment Research, Inc.								
Data as of:	October 16, 2014							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. All S&P 500 data, including history, reflects current membership of the index.

c. 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.

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

e. *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.*

As you can see in the scorecard table, the Finance sector dominates the results thus far, with 39.9% of the sector's market cap reporting Q3 results already. The handful of big money-center banks carry a lot of weight in the sector as a whole, bringing in roughly 40% of the Finance sector's total earnings, and set the stage for what to expect from the other sub-industries.

Total earnings for the sector are down -6.1% from the same period last year on +4.6% higher revenues, with 57.1% beating EPS estimates and a similar ratio coming ahead of top-line estimates. The huge charge at Bank of America is the primary reason for the sector's sub-par growth numbers at this stage. Excluding Bank of America, total earnings for the sector would be up +8.6%.

The table below shows the sector's scorecard at the medium industry level (M-level). As you can see, the Q3 earnings season is almost over for the Major Banks industry, with 81.7% of the industry's market cap having reported results already.

	% Reported of Total		Earnings		Revenues	
Finance Sector Industries	Companies	Market Cap	Growth Rate	Beat Ratio	Growth Rate	Beat Ratio
Banks-Major	53.3%	81.7%	-14.0%	37.5%	1.8%	50.0%
Banks & Thrifts	0.0%	0.0%	NRPT	NRPT	NRPT	NRPT
Finance	12.5%	35.2%	23.3%	100.0%	17.4%	50.0%
Insurance	4.5%	1.8%	27.1%	100.0%	5.3%	100.0%
Invest Bkrs/Mgrs	25.0%	46.6%	39.8%	66.7%	21.0%	66.7%
Real Estate	0.0%	0.0%	NRPT	NRPT	NRPT	NRPT
Finance Sector	*17.5%*	*39.9%*	*-6.1%*	*57.1%*	*4.6%*	*57.1%*

Source: Zacks Investment Research, Inc.

Data as of: 10/16/14 2:39 PM www.zacks.com

Note: NRPT means 'no reports'.

The table below compares the results thus far for Finance sector industries with what we saw from the same industries in the preceding quarter and the 4-quarter average.

Finance Sector Industries	Earnings Growth Compared 3Q 14A	2Q 14A	4-Quarter Average	Revenues Growth Compared 3Q 14A	2Q 14A	4-Quarter Average
Banks-Major	-14.0%	-3.6%	6.4%	1.8%	-4.5%	-2.9%
Banks & Thrifts	NRPT	NRPT	#DIV/0!	NRPT	NRPT	#DIV/0!
Finance	23.3%	11.6%	10.5%	17.4%	0.3%	4.9%
Insurance	27.1%	51.7%	24.1%	5.3%	3.2%	2.4%
Invest Bkrs/Mgrs	39.8%	9.9%	2.1%	21.0%	7.6%	-1.5%
Real Estate	NRPT	NRPT	#DIV/0!	NRPT	NRPT	#DIV/0!
Finance Sector	*-6.1%*	*-1.5%*	*5.4%*	*4.6%*	*-2.8%*	*-2.1%*

Source: Zacks Investment Research, Inc.

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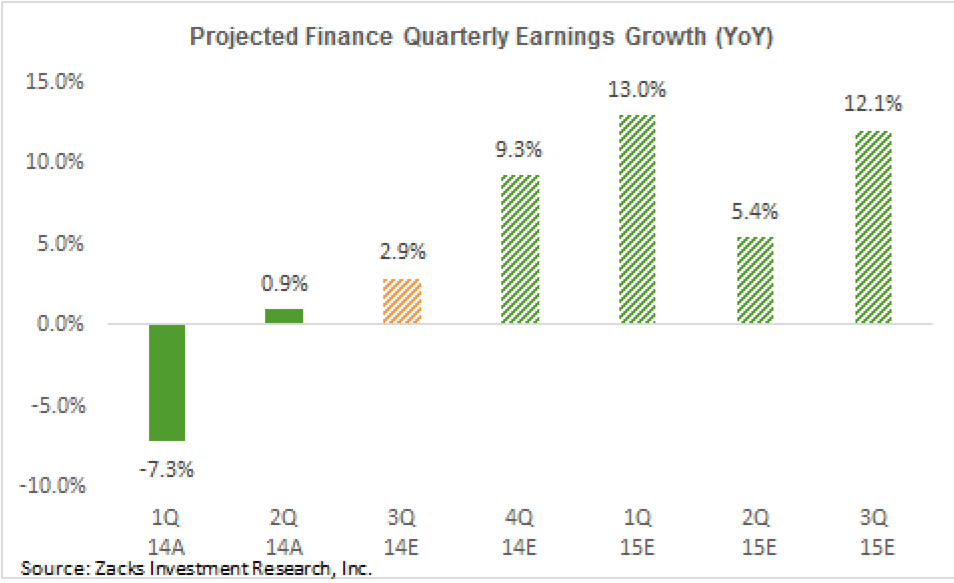
The sector's results outside of the big Bank of America charge are actually better relative to other recent quarters. Core banking results are essentially unchanged from other recent quarters, though trading and investment banking revenues improved modestly in Q3, though the sector's recent stock market performance shows none of the earnings improvement.

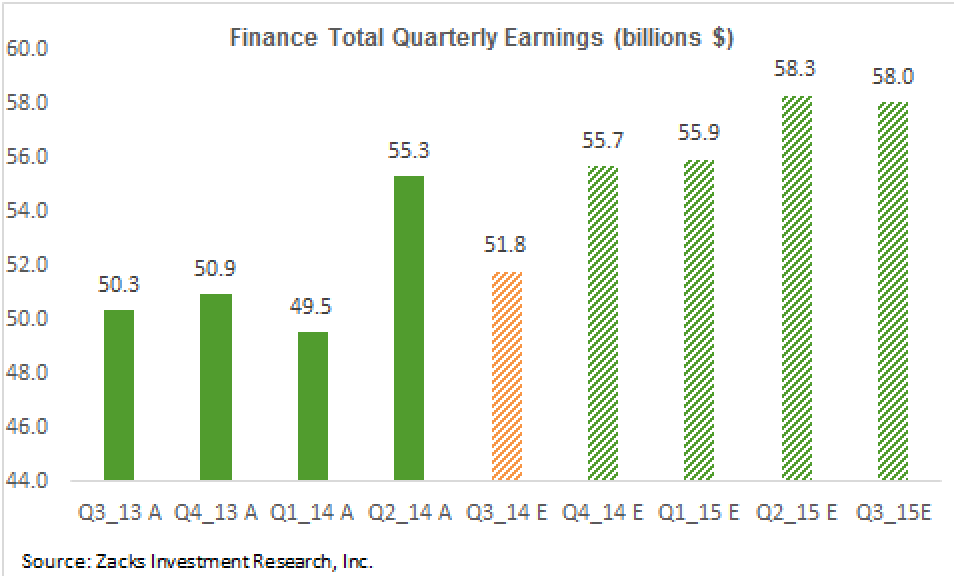
The market's negative response to otherwise better looking banking results likely reflects the recent sharp slide in treasury yields. And that makes perfect sense for the banks given the centrality of interest rates to their core lending business. Low interest rates further squeeze net interest rate margins that forces banks to make their earnings numbers primarily through cost cuts. Consensus estimates for the current and coming quarters reflect steady improvement in the 'core' business.

The chart below shows consensus earnings growth expectations for the Finance sector as a whole in the coming quarters. Please note that the +2.9% earnings growth expected in Q3 is the composite growth rate for the sector, meaning a blend of the 14 sector companies that have reported results and estimates for the still-to-come 66 companies.



The chart below shows the same the absolute level of sector earnings – actual total earnings for the four quarters through 2014 Q2 and estimates for the following five quarters, including Q3. As you can see, the total level of sector earnings are essentially flat through 2015 Q1 (adjusting 2013 Q3 for the BAC charge), but start growing materially from 2015 Q2 onwards.

Goldman is the least exposed to low interest rates and is likely one of the biggest beneficiaries of the accompanying market turmoil and increased volatility.



If the current downtrend in estimates persists, Finance sector estimates will likely need to come down quite a bit in the coming days.

Expectations for Q3

For the S&P 500 as a whole (combining the results from the 65 companies that have reported with estimates for the remaining 435), total earnings in Q3 are expected to be up +3.0% from the same period last year, on +2.7% higher revenues and modestly lower margins.

Estimates came down as the quarter unfolded, though it has to be acknowledged that the pace of negative estimate revisions for Q3 was tracking lower earlier on relative to other recent quarters. But the pace of negative revisions accelerated towards the end, with the magnitude of negative revisions for Q3 essentially no different from what we have been seeing in other recent periods.

The current +3.0% growth expected in Q3 is down from close +6% growth expected at the start of the quarter in early July. Estimates for 13 of the 16 Zacks sectors came down, with the Medical, Construction and Transportation sectors as the only ones that experienced positive revisions. Negative revisions were particularly pronounced in the Finance, Energy, Retail, Autos, and Conglomerates sectors. We started seeing some improvement on the estimate revisions front towards the middle of the Q2 reporting cycle, with estimates for Q3 not falling as much as in prior periods. But our optimism on that count proved to be premature as the revisions trends eventually gathered pace, pushing Q3 earnings growth estimates to the current +3.0%.

The table below provides a summary view of the expectations for 2014 Q3.

Zacks Sectors	Year-over-Year Growth					
	Earnings		Revenue		Margins	
	3Q 14E	2Q 14A	3Q 14E	2Q 14A	3Q 14E	2Q 14A
Cons. Staples	0.0%	6.5%	-0.1%	1.1%	0.00%	0.52%
Cons. Discretionary	1.6%	11.9%	3.9%	4.1%	-0.26%	0.83%
Retail/Wholesale	0.3%	1.8%	5.3%	5.8%	-0.21%	-0.17%
Medical	8.6%	15.8%	10.1%	12.4%	-0.14%	0.31%
Autos	-28.7%	-7.7%	0.3%	2.9%	-1.76%	-0.55%
Basic Materials	10.2%	8.6%	2.1%	3.4%	0.58%	0.45%
Industrial Products	-2.2%	1.6%	-1.1%	-2.2%	-0.10%	0.35%
Construction	14.1%	16.7%	6.5%	0.5%	0.45%	0.91%
Conglomerates	4.8%	7.8%	0.7%	1.1%	0.42%	0.69%
Technology	3.0%	12.0%	4.8%	6.1%	-0.29%	0.90%
Aerospace	2.1%	10.7%	1.5%	-0.7%	0.04%	0.80%
Oil/Energy	1.7%	12.9%	-2.7%	2.1%	0.33%	0.77%
Finance	2.9%	0.9%	-0.4%	-13.5%	0.49%	2.58%
Utilities	8.2%	12.3%	5.0%	3.1%	0.33%	0.78%
Transportation	8.6%	11.5%	6.2%	6.7%	0.21%	0.42%
Business Services	10.3%	10.0%	5.2%	8.7%	0.72%	0.17%
S&P 500	**3.0%**	**8.1%**	**2.7%**	**2.2%**	**0.02%**	**0.57%**
ex Finance	3.0%	10.0%	3.2%	4.6%	-0.02%	0.46%
Source: Zacks Investment Research, Inc.						
Data as of:	October 16, 2014				www.zacks.com	

We know with a lot of certainty that actual results will be better than these pre-season expectations, a function of management teams' excellent track record of anchoring Wall Street expectations – CEO's know that it pays to under-promise and over-deliver. Roughly two-thirds of the S&P 500 members typically beat earnings expectations every quarter (small-cap stocks in the Russell 2000 and S&P 600 indexes beat at much lower levels). So, more results along those lines would be nothing new and wouldn't tell us much about the health of corporate earnings.

What we haven't seen for a while instead is favorable comments from management teams about business outlook. Corporate guidance has been negative for almost two years now, causing estimates to keep coming down and the long hoped-for earnings growth turnaround getting pushed forward. In a way, this earnings season will be the first 'normal' reporting season of 2014 – Q1 was held down by weather-related issues and Q2 represented a rebound from that. With none of those issues at play now, this reporting season promises to give us a true lay of the land on the earnings front.

Beyond actual guidance, it will be interesting to see management teams' qualitative discussion of -

a. The global growth worries that have dominated market discourse in recent days. The stabilization in the European economy over the past year had started showing up in management commentary on the earnings calls. We will see what effect the recent reversal of that favorable narrative will be on the outlook for the current and coming quarters. Questions about the outlook for Japan and China are similarly important.

b. The strengthening U.S. dollar will likely be a factor as well.

If we see no improvement on the guidance front on the Q3 earnings calls, we will start seeing estimates for Q4 and beyond start to come down in the coming weeks. At present, total earnings are expected to be up +6.7% in 2014 Q4 and an additional +9.7% in 2015 Q1. We will see to what extent those estimates will hold up as the Q3 reporting season ramps up.

The Context for Growth Expectations

Let's take a look at how consensus earnings expectations for 2014 Q3 compare to what companies earned in the last few quarters and what they are expected to earn in the following quarters.

Table 2 below presents the year over year earnings growth rates - expectations for Q3 and the following three quarters. It also shows consensus earnings growth expectations for 2014 and 2015. Table 3 presents the same data for revenues.

Table 2 – Earnings Growth Context

Zacks Sectors	Earnings Growth (YoY)							
	2Q 15E	1Q 15E	4Q 14E	*3Q 14E*	2Q 14A	1Q 14A	Annual 2014E	Annual 2015E
Cons. Staples	3.9%	5.5%	0.5%	***0.0%***	6.5%	2.6%	5.1%	7.6%
Cons. Discretionary	2.1%	3.0%	2.7%	***1.6%***	11.9%	14.4%	11.1%	15.7%
Retail/Wholesale	2.9%	21.5%	-11.0%	***0.3%***	1.8%	-0.5%	6.3%	14.5%
Medical	5.6%	9.2%	17.2%	***8.6%***	15.8%	6.5%	13.5%	11.8%
Autos	29.4%	54.2%	8.2%	***-28.7%***	-7.7%	-22.1%	-7.3%	34.4%
Basic Materials	18.0%	15.3%	3.8%	***10.2%***	8.6%	-3.8%	8.7%	18.5%
Industrial Products	4.2%	3.0%	3.4%	***-2.2%***	1.6%	6.8%	8.0%	9.0%
Construction	22.2%	28.7%	11.4%	***14.1%***	16.7%	11.0%	16.1%	23.2%
Conglomerates	4.1%	16.9%	6.3%	***4.8%***	7.8%	-5.0%	5.0%	9.2%
Technology	12.8%	7.6%	6.5%	***3.0%***	12.0%	4.6%	10.2%	13.0%
Aerospace	1.7%	4.2%	7.9%	***2.1%***	10.7%	5.1%	10.5%	7.0%
Oil/Energy	0.2%	-2.3%	3.7%	***1.7%***	12.9%	-1.4%	7.8%	4.8%
Finance	5.4%	13.0%	9.3%	***2.9%***	0.9%	-7.3%	0.0%	15.1%
Utilities	4.9%	5.3%	18.4%	***8.2%***	12.3%	18.0%	8.9%	5.1%
Transportation	13.7%	25.9%	13.3%	***8.6%***	11.5%	6.4%	14.3%	17.1%
Business Services	15.7%	14.7%	14.5%	***10.3%***	10.0%	9.7%	11.4%	13.0%
S&P 500	**6.8%**	**9.7%**	6.7%	**3.0%**	**8.1%**	**1.3%**	**7.2%**	**12.1%**
ex Finance	7.2%	8.9%	6.2%	**3.0%**	10.0%	3.6%	8.9%	11.4%

Source: Zacks Investment Research, Inc.

Data as of: October 16, 2014 www.zacks.com

Table 3 – Revenue Growth Context

Zacks Sectors	Revenue Growth (YoY)							
	2Q 15E	1Q 15E	4Q 14E	3Q 14E	2Q 14A	1Q 14A	Annual 2014E	Annual 2015E
Cons. Staples	-5.8%	-4.8%	-6.2%	**-0.1%**	1.1%	-0.2%	-6.6%	3.1%
Cons. Discretionary	5.2%	-1.1%	2.4%	**3.9%**	4.1%	5.9%	3.4%	6.6%
Retail/Wholesale	4.6%	9.8%	-2.0%	**5.3%**	5.8%	3.8%	6.8%	7.1%
Medical	-2.1%	0.8%	8.5%	**10.1%**	12.4%	7.9%	8.7%	5.1%
Autos	3.1%	3.3%	-0.3%	**0.3%**	2.9%	2.1%	-0.2%	5.3%
Basic Materials	3.5%	5.2%	1.5%	**2.1%**	3.4%	1.2%	2.0%	5.2%
Industrial Products	2.0%	-2.2%	1.9%	**-1.1%**	-2.2%	-2.4%	4.0%	3.0%
Construction	16.7%	13.7%	8.8%	**6.5%**	0.5%	-0.8%	3.6%	11.1%
Conglomerates	4.0%	2.0%	2.8%	**0.7%**	1.1%	0.4%	3.0%	2.7%
Technology	11.7%	12.0%	6.0%	**4.8%**	6.1%	3.1%	5.8%	5.8%
Aerospace	1.4%	2.1%	1.3%	**1.5%**	-0.7%	0.6%	0.7%	1.8%
Oil/Energy	-1.4%	0.9%	-2.8%	**-2.7%**	2.1%	0.8%	-1.3%	-0.6%
Finance	12.5%	-4.7%	-4.4%	**-0.4%**	-13.5%	-0.1%	-6.2%	3.3%
Utilities	1.5%	0.3%	0.4%	**5.0%**	3.1%	11.2%	4.2%	2.4%
Transportation	5.4%	5.9%	5.4%	**6.2%**	6.7%	3.4%	5.6%	5.8%
Business Services	3.2%	4.0%	4.3%	**5.2%**	8.7%	5.0%	4.3%	6.0%
S&P 500	**3.5%**	**2.6%**	0.5%	**2.7%**	**2.2%**	**2.9%**	**2.0%**	**4.2%**
ex Finance	2.3%	3.7%	1.2%	**3.2%**	4.6%	3.4%	3.2%	4.3%

Source: Zacks Investment Research, Inc.

Data as of: October 16, 2014 www.zacks.com

Note: Lack of consensus revenue estimates, particularly for a number of key Finance sector companies such as Berkshire Hathaway, makes consensus projections for the sector less precise. Data for all the other sectors is fairly reliable. As such, we suggest using the ex-Finance growth rate as a proxy for the index as a whole.

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.

Table 4 – Total Quarterly earnings

Zacks Sectors	Quarterly Earnings (billion dollars) 3Q 15E	2Q 15E	1Q 15E	4Q 14E	3Q 14E	2Q 14A	1Q 14A	4Q 13A	3Q 13A
Cons. Staples	20.0	20.0	17.5	18.9	***18.8***	19.3	16.5	18.8	18.8
Cons. Discretionary	13.8	12.9	10.8	12.3	***12.3***	12.6	10.5	11.9	12.1
Retail/Wholesale	21.8	19.0	21.5	17.6	***17.2***	18.5	17.7	19.8	17.2
Medical	36.9	37.3	34.8	34.0	***33.1***	35.4	31.9	29.0	30.5
Autos	6.5	7.0	5.7	4.8	***4.8***	5.4	3.7	4.4	6.7
Basic Materials	7.8	9.9	9.9	7.2	***6.8***	8.4	8.6	6.9	6.1
Industrial Products	7.4	7.4	6.0	6.3	***6.9***	7.1	5.8	6.1	7.1
Construction	2.4	2.1	1.3	1.6	***1.9***	1.7	1.0	1.5	1.7
Conglomerates	9.4	9.3	9.0	10.7	***8.7***	8.9	7.7	10.0	8.3
Technology	50.8	52.3	49.5	58.4	***44.5***	46.4	46.1	54.8	43.2
Aerospace	4.9	4.9	4.6	4.8	***4.4***	4.8	4.4	4.4	4.3
Oil/Energy	32.8	32.0	30.3	29.9	***29.5***	31.9	31.1	28.8	29.0
Finance	58.0	58.3	55.9	55.7	***51.8***	55.3	49.5	50.9	50.3
Utilities	18.5	14.9	16.6	13.6	***17.5***	14.2	15.7	11.5	16.2
Transportation	6.8	6.9	4.9	5.6	***6.0***	6.0	3.9	4.9	5.5
Business Services	7.5	7.3	6.8	7.1	***6.4***	6.3	5.9	6.2	5.8
S&P 500	**305.3**	**301.5**	**285.0**	**288.4**	**270.7**	**282.2**	**259.9**	**270.1**	**263.0**
ex Finance	247.3	243.2	229.1	232.7	219.0	226.9	210.4	219.2	212.6

Source: Zacks Investment Research, Inc.

Data as of: October 16, 2014 www.zacks.com

Table 5 – Total Quarterly Revenues

Zacks Sectors	Quarterly Revenues (billion dollars)								
	3Q 15E	2Q 15E	1Q 15E	4Q 14E	3Q 14E	2Q 14A	1Q 14A	4Q 13A	3Q 13A
Cons. Staples	162.9	176.3	163.9	181.1	***185.6***	187.1	172.1	193.1	185.7
Cons. Discretionary	114.0	110.9	105.3	111.2	***108.8***	105.4	106.4	108.6	104.6
Retail/Wholesale	455.0	435.8	446.6	430.4	***422.3***	416.8	406.8	439.3	400.9
Medical	325.8	328.4	315.6	341.1	***332.0***	335.3	313.0	314.3	301.5
Autos	116.1	117.8	111.9	113.0	***110.3***	114.3	108.3	113.3	110.0
Basic Materials	90.0	94.9	93.2	86.8	***85.9***	91.7	88.6	85.6	84.2
Industrial Products	76.8	77.5	70.1	73.2	***73.6***	76.0	71.7	71.8	74.5
Construction	32.3	30.4	26.5	28.3	***28.6***	26.0	23.3	26.0	26.8
Conglomerates	80.6	82.6	78.0	88.4	***81.7***	79.4	76.4	86.0	81.1
Technology	301.2	302.4	299.4	312.3	***269.7***	270.7	267.3	294.6	257.4
Aerospace	62.6	61.6	58.4	64.5	***61.6***	60.7	57.2	63.7	60.7
Oil/Energy	397.4	390.4	385.8	377.8	***387.8***	396.0	382.5	388.7	398.6
Finance	337.7	344.6	337.2	336.4	***340.4***	306.2	354.0	351.7	341.9
Utilities	167.4	150.3	162.0	149.4	***159.8***	148.0	161.5	148.7	152.2
Transportation	65.1	64.8	59.7	61.6	***61.7***	61.5	56.4	58.4	58.1
Business Services	44.1	43.9	42.0	43.5	***41.8***	42.5	40.4	41.7	39.7
S&P 500	**2829.0**	**2812.5**	**2755.6**	**2798.9**	**2751.6**	**2717.6**	**2685.8**	**2785.5**	**2677.9**
ex Finance	2491.3	2467.9	2418.3	2462.5	***2411.1***	2411.4	2331.8	2433.8	2336.0

Source: Zacks Investment Research, Inc.

Data as of: October 16, 2014 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 2014 Q2, we have taken the net income or 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, 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 $270.7 billion in 2014 Q3, down from the 2014 Q2 total of $282.2 billion. The overall level of total earnings has been very high in recent quarters. In fact, the 2014 Q2 tally was a new all-time quarterly record, surpassing the record reached in 2013 Q4.

The Margins Picture

Net margins (total earnings/total revenues) are expected to be essentially flat from the year-earlier period, but modestly down from the preceding quarter's level. The table below shows net margin expectations for Q3 in the context of where they have been and where they are expected to go in the coming quarters.

Table 6: Quarterly Net Margins

	Quarterly Margins							
Zacks Sectors	2Q 15E	1Q 15E	4Q 14E	3Q 14E	2Q 14A	1Q 14A	4Q 13A	3Q 13A
Cons. Staples	11.3%	10.6%	10.4%	**10.1%**	10.3%	9.6%	9.7%	10.1%
Cons. Discretionary	11.6%	10.2%	11.0%	**11.3%**	11.9%	9.8%	11.0%	11.6%
Retail/Wholesale	4.4%	4.8%	4.1%	**4.1%**	4.4%	4.3%	4.5%	4.3%
Medical	11.4%	11.0%	10.0%	**10.0%**	10.5%	10.2%	9.2%	10.1%
Autos	6.0%	5.1%	4.2%	**4.3%**	4.8%	3.4%	3.9%	6.1%
Basic Materials	10.5%	10.6%	8.3%	**7.9%**	9.2%	9.7%	8.1%	7.3%
Industrial Products	9.5%	8.6%	8.6%	**9.4%**	9.3%	8.1%	8.4%	9.5%
Construction	6.9%	5.0%	5.8%	**6.8%**	6.5%	4.5%	5.7%	6.3%
Conglomerates	11.2%	11.5%	12.1%	**10.6%**	11.2%	10.1%	11.7%	10.2%
Technology	17.3%	16.5%	18.7%	**16.5%**	17.1%	17.2%	18.6%	16.8%
Aerospace	7.9%	7.9%	7.4%	**7.2%**	7.9%	7.7%	6.9%	7.1%
Oil/Energy	8.2%	7.9%	7.9%	**7.6%**	8.1%	8.1%	7.4%	7.3%
Finance	16.9%	16.6%	16.6%	**15.2%**	18.1%	14.0%	14.5%	14.7%
Utilities	9.9%	10.2%	9.1%	**11.0%**	9.6%	9.7%	7.7%	10.6%
Transportation	10.6%	8.2%	9.1%	**9.7%**	9.8%	6.9%	8.4%	9.5%
Business Services	16.7%	16.2%	16.3%	**15.4%**	14.9%	14.7%	14.9%	14.7%
S&P 500	**10.7%**	**10.3%**	**10.3%**	**9.8%**	**10.4%**	**9.7%**	**9.7%**	**9.8%**
ex Finance	9.9%	9.5%	9.4%	**9.1%**	9.4%	9.0%	9.0%	9.1%

Source: Zacks Investment Research, Inc.

Data as of: 10/16/14 10:25 AM www.zacks.com

The table 7 below shows net margins on a trailing four-quarter basis. So, the 9.9% net margin for 2014 Q3 reflects estimates for Q3 and actuals for the preceding three quarters, and so on.

Zacks Sectors	Net Margins - Trailing 4 Quarters									
	3Q 15E	2Q 15E	1Q 15E	4Q 14E	3Q 14E	2Q 14A	1Q 14A	4Q 13A	3Q 13A	2Q 13A
Cons. Staples	11.2%	10.6%	10.4%	10.1%	*9.9%*	9.9%	9.8%	9.8%	9.7%	9.6%
Cons. Discretionary	11.3%	11.1%	11.1%	11.0%	*11.0%*	11.1%	10.9%	10.7%	10.5%	10.2%
Retail/Wholesale	4.5%	4.3%	4.4%	4.2%	*4.3%*	4.4%	4.4%	4.5%	4.5%	4.4%
Medical	10.9%	10.6%	10.4%	10.2%	*10.0%*	10.0%	9.9%	10.0%	10.1%	10.2%
Autos	5.2%	4.9%	4.6%	4.2%	*4.1%*	4.5%	4.7%	4.9%	4.8%	4.5%
Basic Materials	9.5%	9.4%	9.0%	8.8%	*8.7%*	8.6%	8.5%	8.6%	8.4%	8.4%
Industrial Products	9.1%	9.0%	9.0%	8.9%	*8.8%*	8.9%	8.8%	8.6%	8.4%	8.3%
Construction	6.3%	6.2%	6.1%	6.0%	*5.9%*	5.8%	5.6%	5.5%	5.3%	5.1%
Conglomerates	11.6%	11.4%	11.4%	11.0%	*10.9%*	10.8%	10.6%	10.8%	10.5%	10.6%
Technology	17.4%	17.3%	17.3%	17.4%	*17.4%*	17.5%	17.3%	17.2%	17.2%	17.1%
Aerospace	7.7%	7.6%	7.6%	7.5%	*7.4%*	7.4%	7.2%	7.1%	6.8%	6.6%
Oil/Energy	8.1%	7.9%	7.9%	7.9%	*7.8%*	7.7%	7.5%	7.6%	7.7%	7.9%
Finance	16.8%	16.3%	16.6%	15.9%	*15.3%*	15.2%	14.7%	14.9%	14.0%	13.6%
Utilities	10.1%	10.1%	10.0%	9.9%	*9.5%*	9.4%	9.3%	9.1%	8.0%	8.0%
Transportation	9.6%	9.4%	9.2%	8.9%	*8.8%*	8.7%	8.6%	8.5%	8.3%	8.1%
Business Services	16.5%	16.2%	15.7%	15.3%	*15.0%*	14.8%	14.7%	14.6%	14.5%	14.4%
S&P 500	10.5%	10.3%	**10.2%**	**10.1%**	***9.9%***	**9.9%**	**9.8%**	**9.8%**	**9.6%**	**9.5%**
ex Finance	9.7%	9.5%	9.4%	9.2%	*9.1%*	9.1%	9.0%	9.0%	8.9%	8.9%
Source: Zacks Investment Research, Inc.										
Data as of:	10/16/2014									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.

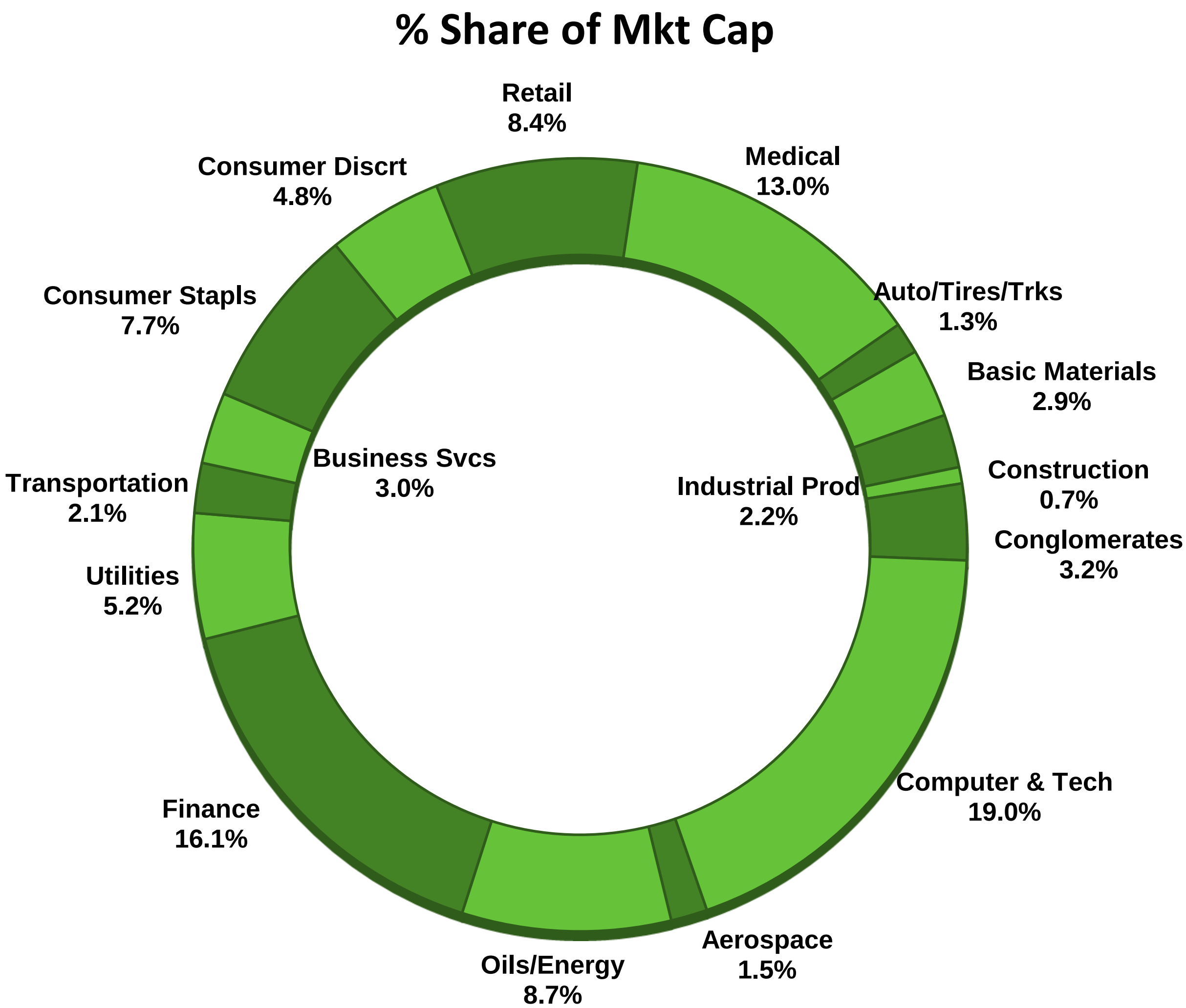
We may not be at the contraction stage yet, but we do need to buy into fairly optimistic assumptions about productivity improvements for current consensus margin expansion expectations to pan out.

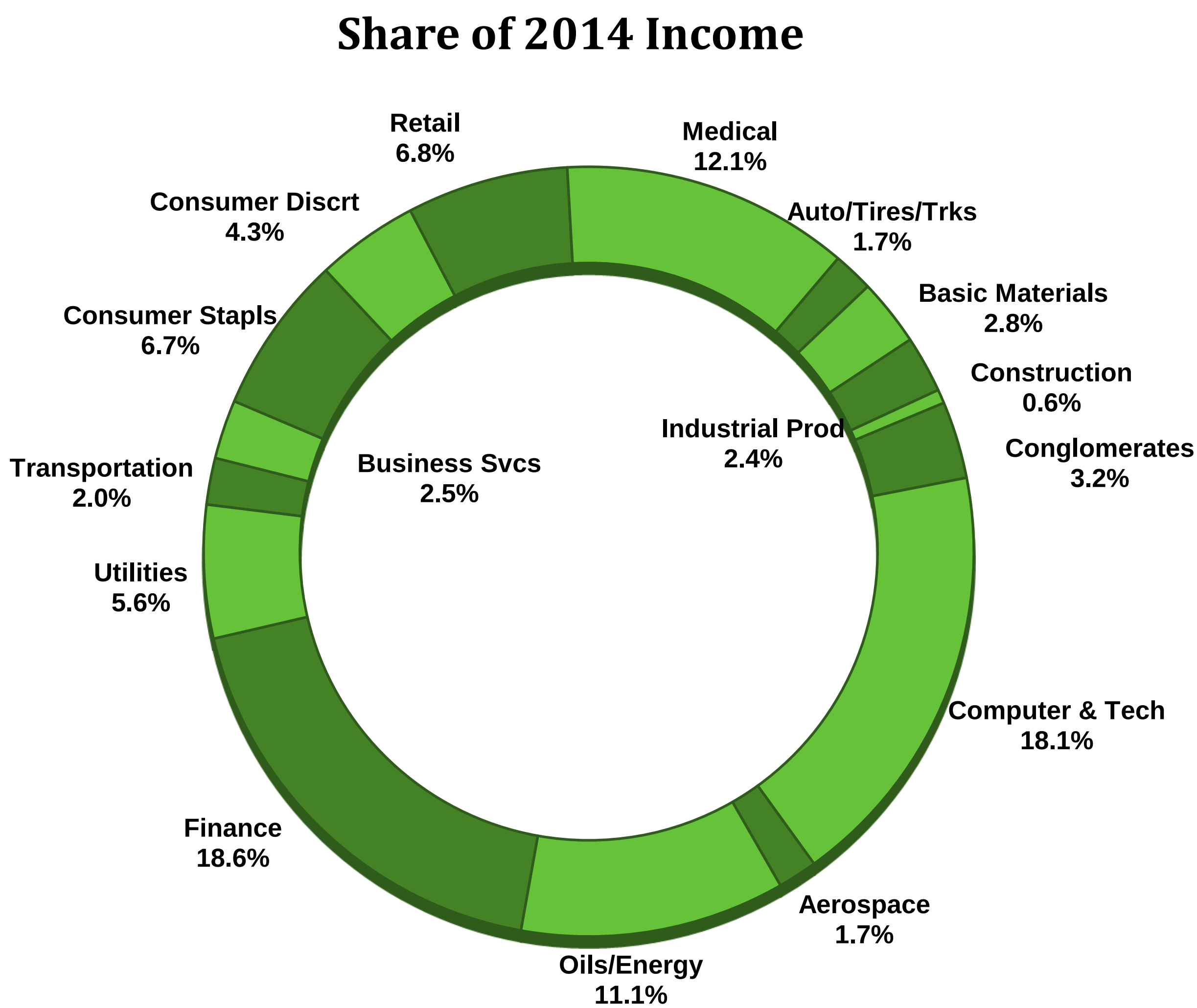
Market Cap vs. Total Earnings

The charts below show the share of total earnings for 2014 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 has regained its leadership position in the index in terms of earnings contribution, though it still remains significantly below its record 27% share of the index earnings in 2007. The sector lost its leadership position to Technology in the wake of the global financial crisis, but got it back in 2013 and remains on track to retain the position this year and next.

The Finance sector is an even bigger contributor to the S&P 600 index, expected to bring in 26.5% of the small-cap index's total earnings in 2014. And unlike the S&P 500 where the Technology sector has the larger market cap, Finance is the biggest market cap contributor to the S&P 600 index.





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

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

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