Corporate Earnings Preview

The third quarter corporate earnings reporting season begins next week. So let's discuss what Wall Street analysts are currently expecting for overall earnings for companies within the S&P 500 and the 11 major sectors that comprise the benchmark index.

Analysts at S&P Global Market Intelligence and S&P Dow Jones Indices have arrived at an aggregate S&P 500 consensus forecast for third quarter operating earnings per share (EPS) of $29.40. This figure represents a 0.8% decline from the $29.64 actual EPS reported for last year's third quarter. This potential decline would represent the first time since 2009 that the S&P 500 posted year-over-year EPS declines in six consecutive quarters.

S&P 500 Y/Y Growth in Operating EPS Estimates

	2016 EPS % Changes				
S&P 500 Sector	**Q1A**	**Q2A**	**Q3E**	**Q4E**	**Year**
Consumer Discretionary	21.3	14.6	2.3	5.3	10.2
Consumer Staples	0.8	(0.8)	4.1	8.8	3.3
Energy	(106.6)	(86.1)	(65.5)	(8.3)	(76.5)
Financials	(15.4)	(7.8)	18.3	26.9	4.4
Health Care	8.0	6.3	4.0	7.5	6.4
Industrials	(3.3)	13.5	(2.4)	0.8	2.2
Information Technology	(4.0)	2.2	3.6	4.6	1.8
Materials	(11.4)	(4.2)	8.6	24.0	2.2
Real Estate*	69.7	12.5	(11.3)	(3.9)	18.7
Telecom. Services	9.1	(2.6)	(2.8)	2.3	1.3
Utilities	(2.5)	11.3	4.5	15.7	6.2
S&P 500	(6.8)	(1.8)	(0.8)	6.3	(0.7)

Source: S&P Global Market Intelligence, * S&P Dow Jones Indices.
Data as of 9/30/16.

Winners and Losers by Sector

As is shown in the table above, seven of the 11 S&P 500 sectors are forecast to post positive third quarter earnings growth. Financials, Materials and Utilities have the strongest prospects for earnings growth. Among the four sectors seen reporting year-over-year profits declines, Energy continues to weigh most negatively on the index. Without this sector, overall S&P 500 earnings would be up 2.5% versus the 0.8% forecasted decline. On the other hand, the forecasted earnings decline in Energy is expected to lessen in the fourth quarter. If this improvement comes to fruition, S&P 500 earnings are seen returning to growth for the first time since Q1 2015.

The biggest sector turnaround story is Financials, with 18.3% forecasted earnings growth following declines of 15.4% and 7.8% during the prior two quarters. Analysts' outlooks include loan growth expectations of nearly 6% for the mega-cap banks, yet little to no change in net interest income. Regional banks are seen posting revenue growth of over 6% with robust loan growth at its core.

To date, ahead of actual earnings reports, around 120 S&P 500 companies have pre-announced forward earnings guidance. Of these, approximately 69% have guided EPS lower. While that's below the five-year average of 74%, these companies are pre-announcing EPS outlooks that are below analysts' expectations by around 15% on average (wider than the five-year average of 9.7%). Overall, while the forecast for third quarter S&P 500 earnings currently remains slightly negative (-0.8%), it is substantially better than the 6.8% and 1.8% declines in the first and second quarters, respectively. Keep in mind that third quarter earnings may even turn positive by the end of the reporting season as actual EPS results have outpaced initial estimates in the past 18 quarters by an average of 3.5%.

Conclusion

The bottom line is that earnings do indeed matter as earnings per share (EPS) is considered the single best measurement of the financial health of a company. For dividend-paying firms, earnings also reflect the ability of the company to pay and grow its cash distributions. Therefore, it is important for investors to know how much a company is earning today and is likely to earn in the future. Current quarter results matching, missing or exceeding consensus estimates often drive investor perceptions of the company's ability to deliver future earnings and can impact share prices.

As earnings season begins next week, we continue to favor domestic equities over international with a slight bias toward value over growth-oriented companies. We, however, recommend retaining global exposures with an emphasis toward emerging market equities. With the growing uncertainties surrounding global central bank effectiveness and the upcoming U.S. elections, we continue to recommend staying fully diversified to limit outsized concentrations in a single asset class.

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