A Second Quarter of Double-Digit Earnings Growth

Since earnings per share (EPS) is considered the single best way to assess a company's financial health, it follows that analyzing corporate earnings reports is a good way to gauge the overall health of domestic equity markets. For dividend-paying firms, earnings reports 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 currently earning and is likely expected to earn in the future. A company's reported quarterly results either matching, missing or exceeding analysts' consensus estimates can often drive investor perceptions of the company's ability to deliver future earnings and thus, impact share prices.

With the quarterly earnings season now over 90% complete, results from S&P 500 reporting companies now point to a 10.7% year-over-year increase in second quarter (Q2) EPS, according to S&P Global Market Intelligence. The near 11% increase widely exceeds the 6.2% consensus analysts' forecast at the beginning of the quarter. And while Q2 earnings growth trails the 15.5% EPS growth during the first quarter of this year, it will mark the second-highest earnings growth rate since the fourth quarter of 2011, and the first occasion of two consecutive quarters of double-digit profit growth since the third quarter of 2011.

A Look at Sector Profit Growth and Sector Earnings Above Forecasts
Through August 11, a total of 78% of all S&P 500 companies had reported Q2 quarter results that topped analysts' consensus earnings estimates, and that exceeds the historic average of 66%. As for revenues, 62% have exceeded analysts' projections. Moreover, as Chart 1 shows, all 11 major sector groups are now poised to finish with positive quarterly earnings growth, led by Energy (+314%), Financials (+28.9%) and Technology (+20.3%). The weakest growth sectors include Industrials (+0.8%), Consumer Discretionary (+0.6%) and Real Estate (+0.03%). Looking forward, bottom line EPS growth in Q3 and Q4 is now estimated at 6.6% and 11.9%, respectively, and is seen rising by 11.1% for all of 2017, followed by a 10.6% increase expected for full year 2018.

Chart 1 – Sector-based Earnings Results and Forecasts

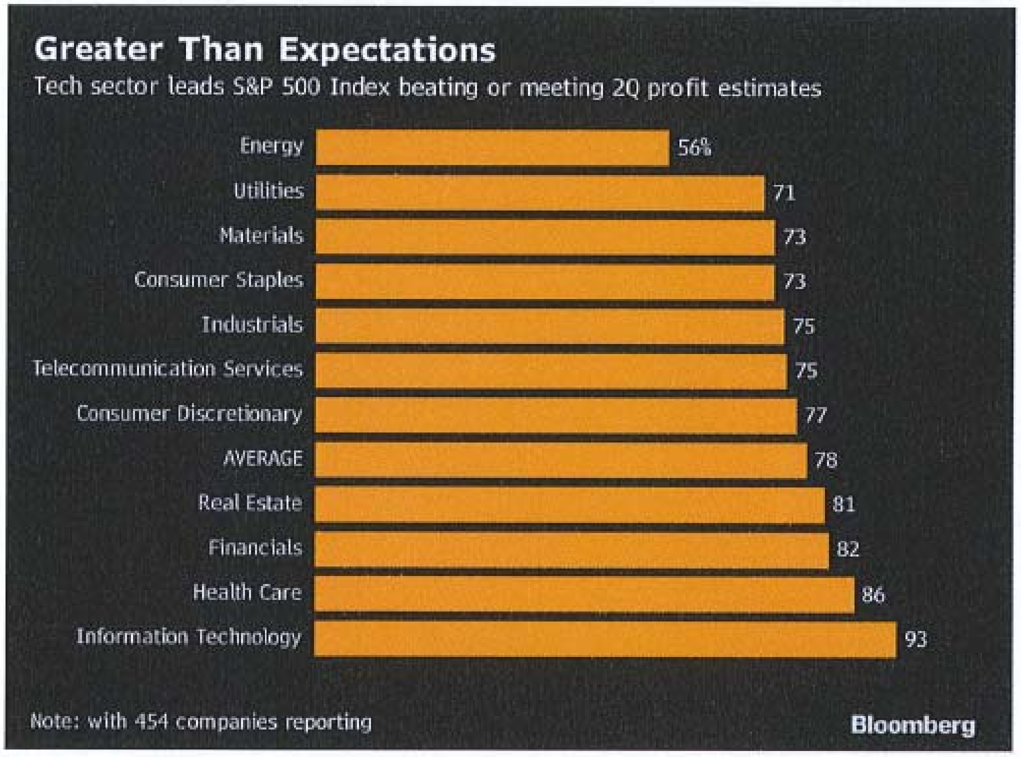
	EPS Growth %			
S&P 500 Sector	Q2 2017	Q3 2017e	2017e	2018e
Cons Disc	0.6	(1.0)	4.9	10.6
Cons Staples	6.1	4.6	6.0	8.1
Energy	313.7	127.3	250.1	43.6
Financials	28.9	4.5	12.3	11.4
Health Care	5.8	2.4	4.4	8.6
Industrials	0.8	8.2	6.6	11.0
Info Tech	20.3	10.5	15.7	9.7
Materials	5.8	2.6	11.0	13.2
Real Estate	0.0	6.7	3.8	3.9
Telecom Svcs	5.4	(0.1)	(0.2)	2.0
Utilities	2.4	(1.0)	(0.5)	4.7
S&P 500	10.7	6.6	11.1	10.6

Source: S&P Global Market Intelligence

Top line S&P 500 company revenues are expected to grow 6.2% year-over-year in the second quarter and 6.4% for all of 2017. Corresponding to a strong 15.5% first quarter earnings growth, revenues rose 8.4% during the first three months of the year. In terms of valuation, the S&P 500 currently trades at 18.2x the next 12-month operating earnings estimates, which represents a 12% premium to the 16.3x historical average since 2000.

Overseas demand, fueled by a weaker U.S. dollar, is contributing to the best earnings season for the most U.S. companies since 2004, according to Bloomberg. In every sector of the S&P 500, at least half of the companies have met or surpassed analysts' expectations, with most multinationals getting an extra boost from a weaker U.S. dollar. The greenback retreated by 6.4% against a basket of major world currencies during the first half of 2017, making U.S. goods and services more attractive to foreign buyers. As Chart 2 illustrates, Information Technology has been the broadest best-performing sector, with 93% of reporting companies in line with or beating Q2 projections.

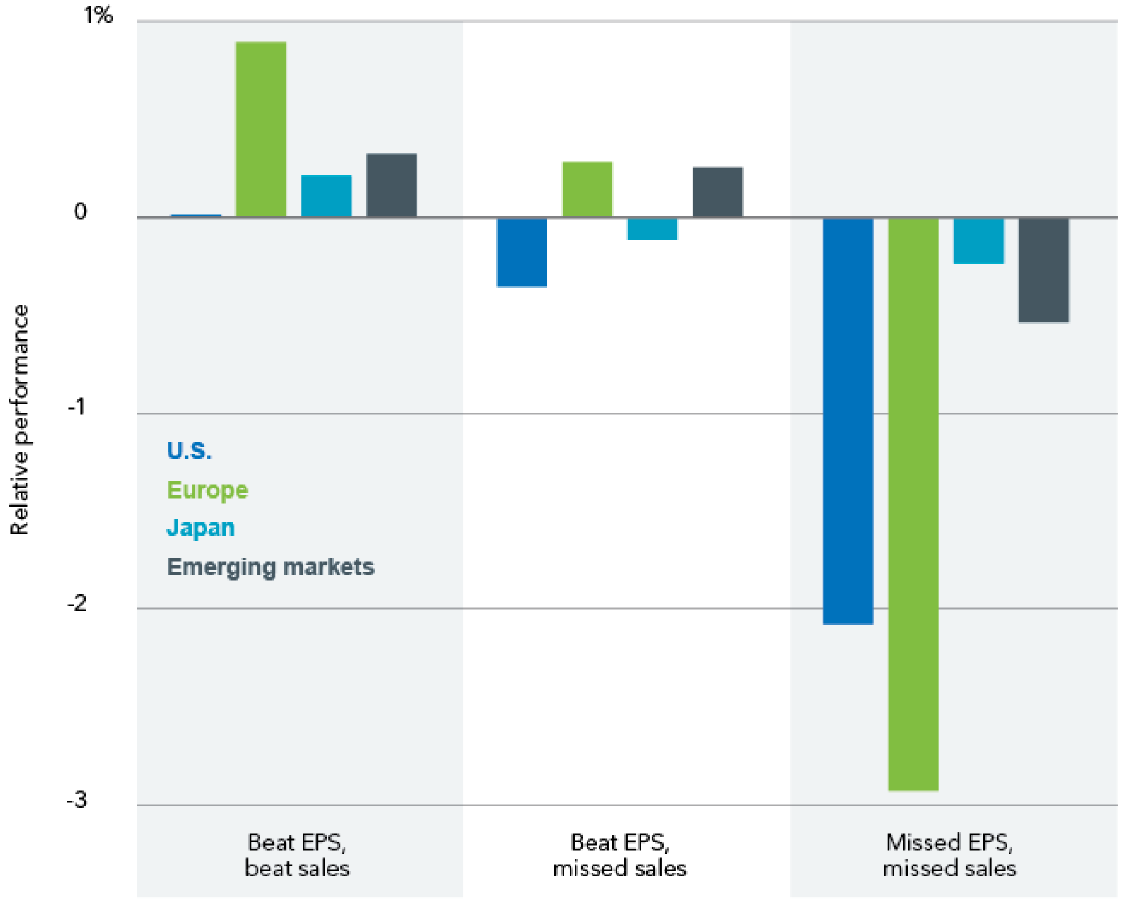
Chart 2 –Sector Companies Reporting Earnings at or Better-than-Forecast



Correlations Weaken of Improved Earnings to Positive Share Price Changes

Yet despite these impressive second earnings accolades, Wall Street investors have largely reacted with relative indifference. As Chart 3 reveals, U.S. companies that beat both Q2 EPS and sales expectations were greeted with muted share price responses, on average, largely trading nearly unchanged versus its S&P 500 benchmark one day after reporting second quarter results. Meanwhile, global companies that have missed both earnings and sales were hit particularly hard, especially in Europe.

Chart 3 - Relative Performance One Day after Earnings Release



Sources: BlackRock Investment Institute, with data from Bloomberg, August 2017.
Notes: The bars represent the average performance of all reporting stocks versus their respective benchmark one day after reporting second-quarter or first-half earnings. The indexes used are the S&P 500 Index for the U.S., the STOXX Europe 600 Index for Europe, the Tokyo Stock Exchange Price Index for Japan, and the MSCI Emerging Markets Index for emerging markets. Results are divided into three categories based on whether the companies beat or missed earnings-per-share (EPS) and sales expectations.

Beyond a valuation overhang spurred in part because President Trump's economic goals have been stalled, Blackrock observes that it will be more difficult for companies to achieve the same degree of EPS growth in the coming quarters. The earnings recovery in the second half of 2016 will make it harder for companies to surpass recent year-over-year comparisons in Q3 and Q4 of 2017. The energy sector's strong contribution to earnings during the first half will begin waning; its earnings rebound has delivered nearly a quarter of the EPS growth in the U.S. market and half of that in Europe in Q2.

As the Q2 earnings season winds down, from a broad portfolio context, we continue to recommend an allocation to equities, in line with applicable risk tolerances. We also continue to favor U.S. versus foreign equities. While we still see attractive valuations in Europe, Japan, and emerging markets, we are mindful of the impact of currency exchange risks. We also reiterate our small bias toward growth over value-oriented companies. With growing geopolitical risks and the increased level of uncertainty surrounding actual legislative passage of President Trump's pro-growth policies, we continue to recommend staying fully diversified to limit outsized concentrations in any single asset class.

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Glossary

*The **S&P 500** is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.*

*The **STOXX Europe 600 Index** is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 18 countries of the European region: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.*

*The **Tokyo Stock Price Index,** commonly known as TOPIX, is a key measure of free-float-weighted stocks listed on the First Section of the Tokyo Stock Exchange (TSE). The First Section organizes all large firms on the TSE into one group. The TOPIX is considered a major indicator of the state of Japanese investment, and of Japan's economy at large.*

*The **MSCI Emerging Markets** is designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index.*