

Liquid Insight

2Q EPS was all about margins, demand now in focus

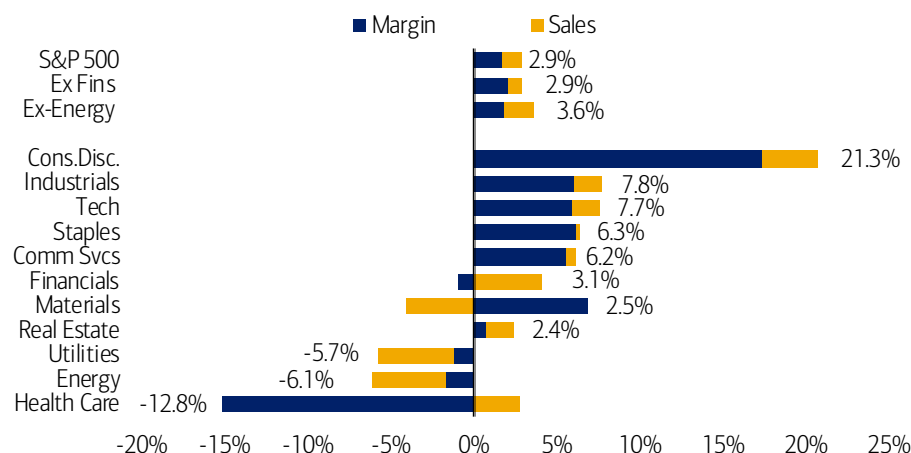
Key takeaways

- Beat & raise quarter but it was all margins. 2Q likely trough quarter unless demand deteriorates.
- Reactions to beats/raises were muted, indicating crowded positioning after 2Q AI "FOMO" chase. Growth v. value crowded again.
- Cyclical still unloved despite capex surprising to the upside, consumption still okay, and productivity inflecting higher.

By Savita Subramanian, Jill Hall & Tori Roloff

Exhibit 1: Margins did the work in 1Q

S&P 500 2Q23 earnings beat by sector, decomposed into sales vs. margin beat



Source: FactSet, BofA Us Equity & Quant Strategy

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Margins drove the 2Q beat; demand now on watch

The US 2Q23 earnings season is all but done: 98% of S&P 500 earnings are in and beat by 3% (5% ex- Merck acq). YoY growth of -5% is likely a trough absent a demand collapse. Margins drove the beat across most sectors (chart above, see our [Earnings Tracker note](#)). 71% of S&P 500 companies beat on EPS, well above the average 58%. Consumer Discretionary saw the biggest beat, but credit delinquencies, student loan headlines and weakening jobs data have investors concerned and on the sidelines – more underweight Discretionary (and cyclicals overall) than ever – see our [Ownership note](#). We moved Cons. Discretionary two notches to overweight for 10 reasons including overblown headline risks (see our [ARMS note](#)). But the recent FOMO chase in growth stocks resulted in muted reactions to beats, and our positioning work suggests that Tech/Growth/Magnificent 7 are crowded.

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Exhibit 2: S&P 500 2Q23 earnings -4% YoY

S&P 500 consensus growth forecast by sector using current constituents

Sector	Earnings		Sales	
	YoY%	QoQ%	YoY%	QoQ%
Consumer Disc.	53.7%	38.2%	9.8%	9.5%
Consumer Staples	6.6%	7.3%	3.2%	1.4%
Energy	(51.5%)	(24.1%)	(28.8%)	(3.4%)
Financials	6.9%	(2.8%)	11.3%	1.6%
Health Care	(27.4%)	(16.5%)	5.4%	2.6%
Industrials	13.4%	26.7%	4.2%	5.5%
Technology	3.4%	4.3%	0.2%	(0.2%)
Materials	(29.2%)	8.6%	(12.7%)	2.5%
Real Estate	9.2%	6.6%	4.8%	3.3%
Communication Services	18.6%	58.9%	3.3%	3.5%
Utilities	0.1%	(4.7%)	(3.8%)	(19.3%)
S&P 500	(4.2%)	6.4%	0.8%	2.1%
ex. Financials	(6.3%)	8.6%	(0.5%)	2.1%
ex. Energy	2.8%	9.3%	4.5%	2.6%
ex. Fins & Energy	1.8%	12.6%	3.6%	2.7%

Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 3: Proportion of companies beating consensus on EPS/sales

Results from S&P 500 companies that have reported 2Q earnings

Sector	Total companies	Number Reported	% with		% EPS & Sales beat
			EPS beat	Sales beat	
Cons. Disc.	53	53	85%	64%	57%
Cons. Staples	37	32	84%	53%	50%
Energy	23	23	35%	26%	9%
Financials	72	72	58%	63%	42%
Health Care	65	64	83%	83%	75%
Industrials	75	74	74%	66%	58%
Tech	65	61	87%	70%	67%
Materials	29	29	59%	17%	14%
Real Estate	31	31	65%	68%	42%
Comm. Svcs.	20	20	70%	40%	40%
Utilities	30	30	37%	37%	17%
S&P 500	500	489	71%	60%	49%
ex. Financials	428	417	73%	59%	50%

Source: FactSet, BofA US Equity & Quant Strategy

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2Q likely the trough in profits growth

S&P 500 2Q EPS was in-line with our forecast, 3% above consensus. 2023 expectations have stabilized, revisions turned positive and the global revision ratio is at levels that argue for risk-on, not risk-off. Macro data is still strong, favorable seasonal trends suggest limited downside risk to 2023 EPS, but FY2 (2024) estimates usually fall from here. BofA Predictive Analytics earnings transcripts analysis shows a big jump in sentiment (+6ppt YoY, the biggest YoY jump since 2Q21.) Absent a collapse in demand, 2Q likely marks the trough in earnings.

Exhibit 4: We expect 2Q was trough in growth

S&P 500 quarterly y/y EPS growth 2023-2024E

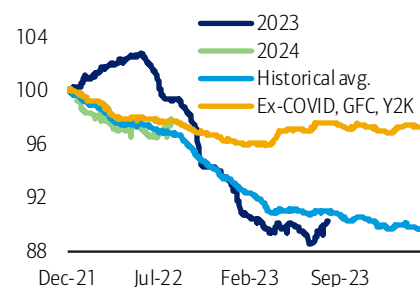
	Btm-up analysts	YoY	BofA Strategy	YoY
1Q23	53.08	-3%	53.08	-3%
2Q23E	54.53	-5%	54.50	-5%
3Q23E	56.15	0%	55.00	-2%
4Q23E	58.25	10%	55.00	3%
2023E	\$222	2%	\$218	0%
1Q24E	57.97	9%	56.00	5%
2Q24E	61.30	12%	60.00	10%
3Q24E	63.29	13%	59.00	7%
4Q24E	65.68	13%	60.00	9%
2024E	\$248	12%	\$235	8%

Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 5: 2023 expectations stabilize

S&P 500 historical FY2 EPS revisions vs. 2023-24 consensus EPS (2023 as of 8/29/23)

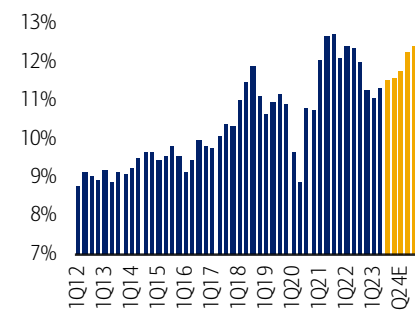


Source: BofA US Equity & Quant Strategy, FactSet; Note: historical average based on 2001-2022

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Exhibit 6: Analysts expect margins troughed

S&P 500 quarterly net margins ex-Financials (2012-4Q24E)

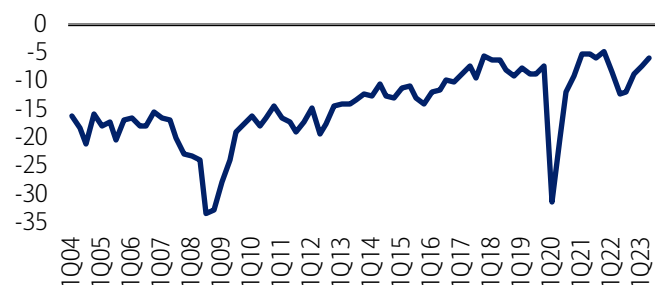


Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 7: Corporate sentiment well off 2022 lows

Avg. negative sentiment score for S&P 500 companies (2004-8/28/23)

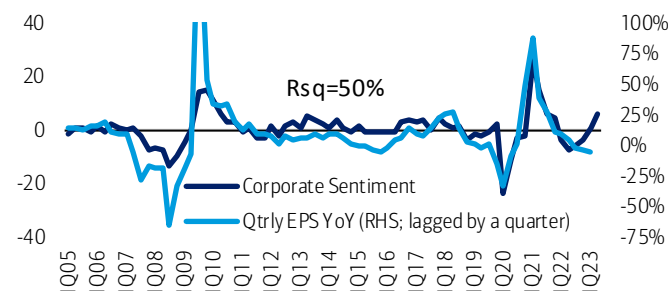


Source: BofA Global Research, FactSet

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Exhibit 8: Sentiment score points to earnings recovery

S&P 500 avg. sentiment YoY vs. 4Q EPS YoY with 1Q lag, 1Q05-8/28/23



Source: BofA Global Research, FactSet

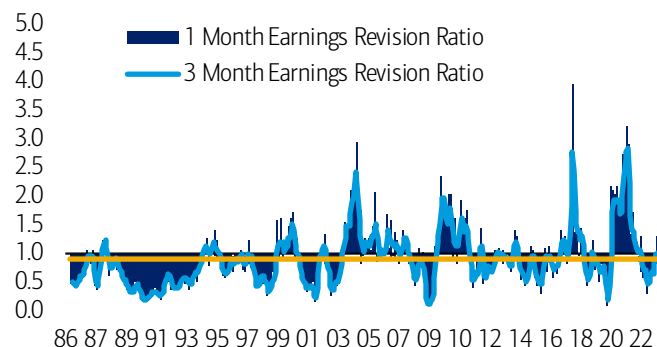
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Guidance strong, revisions strong, why worry?

Our 3-month ratio of above- vs. below-consensus earnings guidance jumped to 1.3x, the highest since 2021 and well above 0.8x (average). Guidance leads revisions, where the US earnings revision ratio is now above 1 and global revisions are near record highs.

Exhibit 9: Our 3-mo. earnings revision ratios improved to 1.04x

S&P 500 earnings estimate revision ratio, 1/86-7/31/23

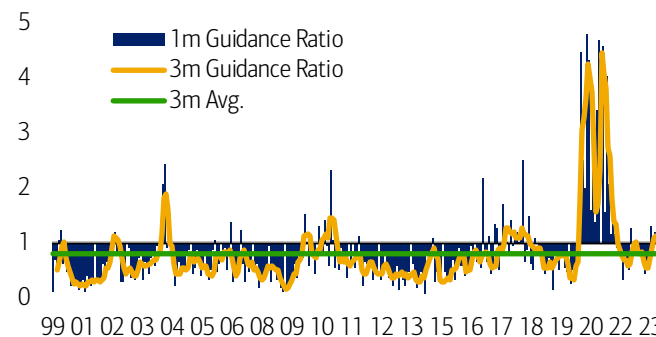


Source: BofA US Equity and Quant. Strategy, I/B/E/S

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Exhibit 10: 3m guidance ratio jumped to highest level since late 2021

S&P 500 EPS guidance ratio (# of above- vs. below-cons. guides), 1999-8/24/23



Source: BofA US Equity & Quant. Strategy, Bloomberg

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Capex strong from underbuild, automation & near-shoring

S&P 500 capex was +9% YoY in 2Q, down from +14% in 1Q but the 9th best quarter. Ex cuts from Amazon (-27% YoY) and Meta (-18%), capex is +13% YoY. Capex guidance remains solid at 1.3x.: 1) >10 years of underinvestment, 2) a tight labor market incentivizing automation (high wage inflation has generally led to efficiency on a lagged basis), and 3) near-shoring amid de-globalization, and 4) fiscal stimulus /tax incentives.

Exhibit 11: Capex remains strong: +9% YoY (+13% ex AMZN/META)

2Q23 capex growth by sector

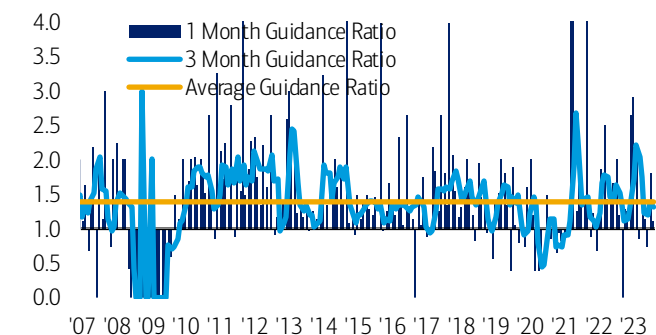
Sector	Aggregate YoY	Contribution to Agg. chg,
Consumer Discretionary	-4%	-7%
Consumer Staples	15%	11%
Energy	35%	35%
Financials	6%	4%
Health Care	9%	6%
Industrials	15%	14%
Information Technology	3%	4%
Materials	20%	8%
Real Estate	8%	1%
Communication Services	-7%	-13%
Utilities	23%	37%
S&P 500	9%	
ex. AMZN & META	13%	

Source: FactSet, BofA US Equity & Quant. Strategy

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Exhibit 12: Our 3-mo. capex guidance is tracking at 1.3x, slightly below the historical average of 1.4x

S&P 500 capex guidance ratio (2007-8/25/23)



Source: FactSet, BofA US Equity & Quant. Strategy

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Exhibit 13: Mentions of re-shoring “went vertical” after COVID

Companies mentions of re-/near-/on-shoring (100=max; 2006-8/4/23)

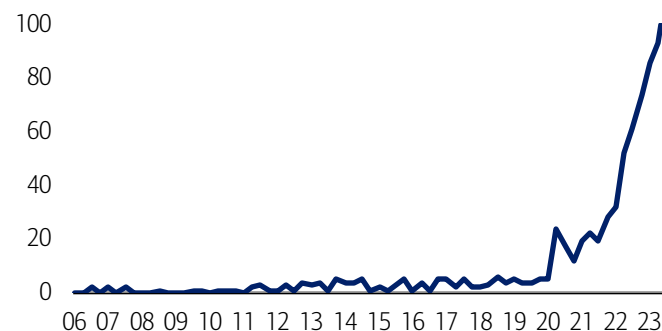
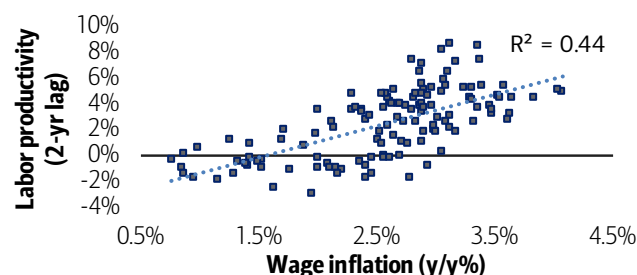


Exhibit 14: Wage inflation drives automation spend and results in productivity growth

US Manufacturing wage inflation and labor productivity (y/y % changes)



Source: AlphaSense, BofA Global Research

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Source: Bureau of Labor Statistics, BofA Global Research. **Note:** Qtrly. data of US manufacturing labor productivity vs avg. hourly earnings of production & nonsupervisory employees
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Buybacks dropping

S&P 500 2Q buybacks are tracking -27% YoY, following -27% in 1Q and -19% in 4Q. Tighter credit, higher hurdle rates, higher financing costs, less relative value between cash (5%) and stocks plus other demands like capex, AI/automation spend are likely culprits - earnings yield vs. bond yield has led buyback activity, and the spread suggests buybacks will wane (Exhibit 16).

Exhibit 15: 2Q buybacks are tracking -30% YoY

2Q23 buybacks by sector (as of 8/30/23)

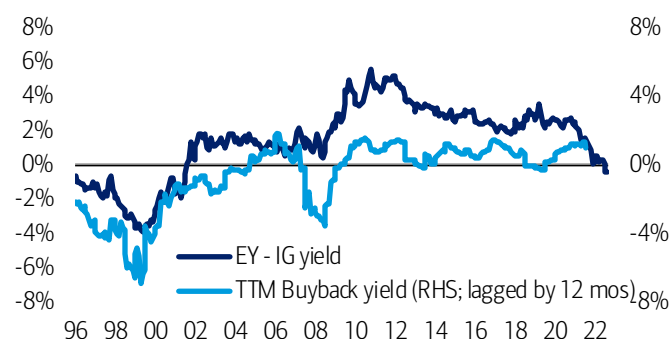
Sector	Aggregate YoY	Contribution to Agg. chg,
Consumer Discretionary	-41%	17%
Consumer Staples	-65%	11%
Energy	10%	-3%
Financials	2%	-1%
Health Care	-50%	13%
Industrials	-37%	12%
Information Technology	-33%	35%
Materials	-67%	11%
Real Estate	6%	0%
Communication Services	-13%	7%
Utilities	-121%	-3%
S&P 500	-27%	

Source: FactSet, BofA US Equity & US Quant Strategy

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Exhibit 16: Higher borrow cost likely to pressure buybacks

S&P 500 EPS yield - IG yield vs. TTM buyback yld with 12-mo lag (1996-7/23)



Source: FactSet, Bloomberg, BofA US Equity & Quant Strategy

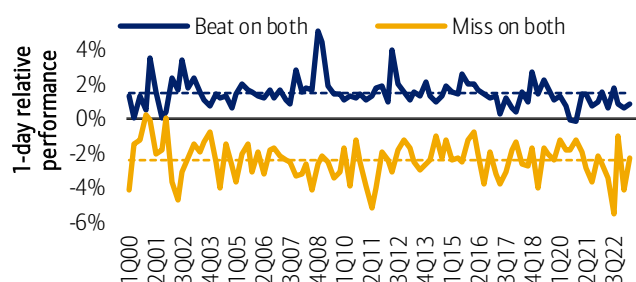
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Earnings reactions skewed negative for growth stocks

Stocks that beat on EPS and sales outperformed the S&P 500 by just 80bp the next day, below the long-term avg. of 150bp. Misses underperformed by 230bp vs. the historical average of 240bp. Reactions to misses were particularly negative for Growth stocks.

Exhibit 17: Earnings reactions were skewed to the downside

Rel. 1-day post-reporting performance (vs. S&P 500) on EPS & sales surprise (1Q00-2Q23)

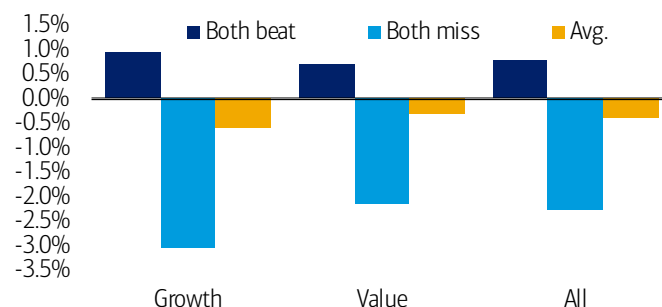


Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 18: Reactions to misses were particularly negative for Growth stocks

Rel. 1-day post-reporting performance (vs. S&P 500) by Russell styles



Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 19: Rel. performance of reported companies vs. S&P 500

2Q23 earnings reactions based on surprise

	1 day	5 day	Start of reporting season to 1 day after reporting	Start of reporting season to 5 days after reporting
EPS Beat	0.2%	0.2%	0.4%	0.4%
EPS Miss	-1.8%	-1.2%	-0.1%	0.6%
EPS In-Line	-1.4%	-1.1%	-1.8%	-1.6%
Sales Beat	0.4%	0.5%	1.0%	1.0%
Sales Miss	-1.5%	-1.2%	-1.0%	-0.6%
Sales In-Line	-2.6%	-1.9%	-3.4%	-2.3%
Both Beat	0.8%	0.8%	1.0%	0.9%
Both Miss	-2.3%	-1.5%	-1.2%	-0.3%

Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 20: Rel. performance by sector vs. S&P 500

2Q23 earnings reactions based on surprise by sector

Sector	1 day after reporting		5 days after reporting	
	Beat on both	Missed on both	Beat on both	Missed on both
Consumer Discretionary	-0.2%	-0.1%	0.3%	0.2%
Consumer Staples	-0.9%	-0.9%	-0.4%	0.9%
Energy	1.0%	-0.2%	4.3%	2.1%
Financials	1.2%	-1.2%	1.8%	0.4%
Health Care	1.5%	-5.6%	0.9%	-6.9%
Industrials	1.1%	-1.1%	1.3%	-1.9%
Information Technology	0.5%	-15.6%	0.3%	-14.0%
Materials	1.1%	-4.1%	0.7%	-3.8%
Real Estate	0.6%	-7.2%	0.5%	-6.2%
Communication Services	2.0%	0.0%	0.6%	2.5%
Utilities	1.2%	-1.4%	0.3%	-1.1%
S&P 500	0.8%	-2.3%	0.8%	-1.5%

Source: FactSet, BofA US Equity & Quant Strategy

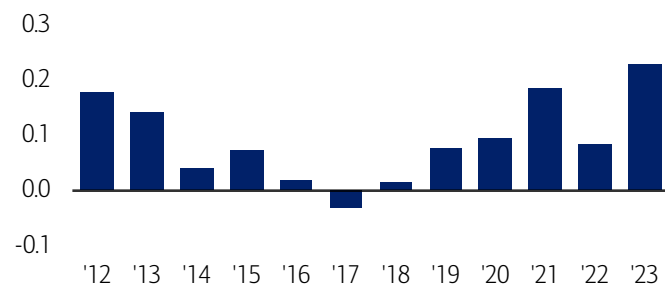
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Holdings suggest 1H perf. chase; 2H inflection could hurt

Evidence of the biggest performance chase since at least 2012 can be seen in the correlation between long only (LO) funds' current relative exposures across stocks to their returns in the first half of 2023 (Exhibit 21). We see risk that a macro inflection in 2H could be painful for active funds whose holdings skew large, growth-y and defensive. Our [US Regime Indicator](#) is on the cusp of shifting from a Downturn to Recovery, the biggest whipsaw across size and style, and a pickup in profits growth could drive a shift from Growth to Value.

Exhibit 21: Evidence of a record performance chase in 1H

Correlation between 1H perf. and long-only funds' 6-mth chg in relative weights as of June 2023

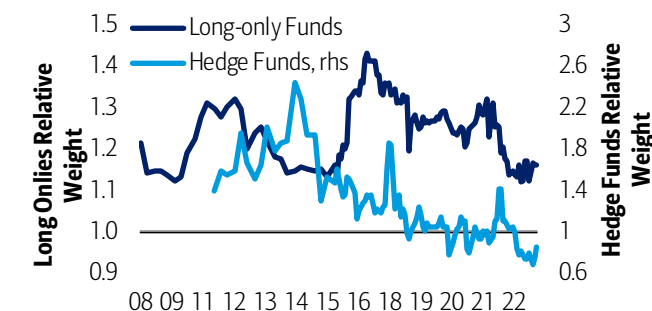


Source: BofA US Equity & Quant Strategy, FactSet Ownership

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Exhibit 22: Defensive vs. cyclical positioning is near record lows

LO & HF relative exposure to cyclical vs. defensive* sectors within S&P 500

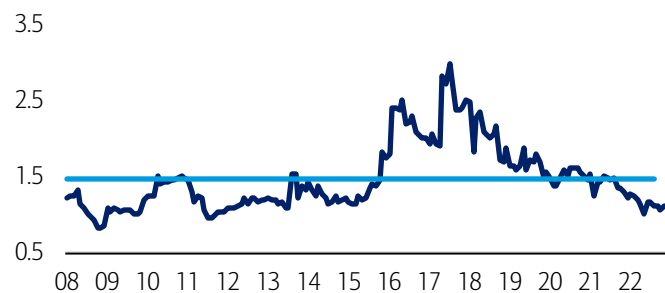


Source: FactSet Ownership, BofA US Equity & US Quant Strategy. *Cyclicals = Discretionary, Materials, Energy, Tech, Industrials; defensives = Staples, Health Care, Utilities

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Exhibit 23: Beta (cyclical bullish) exposure is well below average

LO relative weight in High (top decile S&P 500) vs. Low Beta as of Jul. 2023

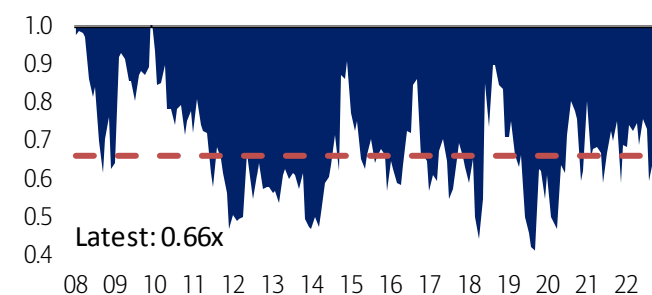


Source: BofA US Equity & US Quant Strategy, FactSet Ownership

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Exhibit 24: Value is 34% underweight vs. Growth

Long only positioning in Value vs Growth proxied by P/E vs Long-Term Growth of S&P 500 (9/2008-present)



Source: BofA US Equity & Quant Strategy, FactSet Ownership

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Notable Rates and FX Research

- **Global Rates, FX & EM Year Ahead 2023 – [Year Ahead 2023: Pivot ≠ Peak](#)**, 20 Nov 2022
- [High rates until 2% at the end of the tunnel](#) **Global FX Weekly**, 18 Aug 2023
- [R*s be our guide](#) **Global Rates Weekly**, 11 Aug 2023
- [Support for USD vs. GBP, CHF, CAD; EM interventions](#), **Liquid Cross Border Flows**, 21 Aug 2023

Rates, FX & EM trades for 2023

For a complete list of our open trade recommendations, as well as our trade recommendations closed over the past 12 months, see the reports below:

[Global FX weekly: High rates until 2% at the end of the tunnel 18 August 2023](#)

[Global Rates Weekly: R*s be our guide 11 August 2023](#)

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