Earnings Tracker

# 3Q preview: 2Q was trough. It gets better from here.

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United States

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## Better micro despite macro drama

S&P 500 3Q EPS was unchanged over the past three months (+0.1%) vs. a typical 4% cut into earnings (first no cut since 4Q21). Despite negative headlines (rate shock, oil shock, now geopolitics) macro data continued to beat expectations (Exhibit 11) and the jump in rates and oil suggests improving, not deteriorating, growth. Our Corporate Misery Indicator, a macro gauge of profits, improved for the first time since 3Q22 (Exhibit 19). China is a key risk but shows some positive trends – see positive Industrial profit growth & China data deep dive reports. Consensus expects flat EPS in 3Q y/y (vs.-6% in 2Q), the first quarter of recovery. We forecast a sizeable 4% beat (vs. a typical 2% beat), or $58 (+4% y/y). We nudge up our 2023 EPS to $222 from $218.

## AI is long-term; Infrastructure spend is now

AI is real, potentially boosting S&P operating margins by 250bps over the next 5 years (see AI primer). But any meaningful contribution may be some quarters away. A bigger near-term contributor will be fiscal stimulus via IIJA, then IRA. Incremental $550B over the next 5 years from the IIJA ($110B/yr run rate, 10% of non-res construction) will be a significant boost in the near-term. While citing it as a tailwind, companies were hesitant to put numbers around it in 2Q. But we may start to hear more clarity this quarter.

## De-stocking in rearview. Goods > services

Earnings lagged GDP growth for the fifth straight quarter (historically, quarterly earnings outpaced GDP by 1.5ppt on avg. since 1950). The lag was partly due to the shift from goods (50% of earnings vs. 30% of economy) to services, which we believe is now over. Despite still muted signs of re-stocking (see Trucking report), at least the de-stocking cycle is now over (Exhibit 24). Manufacturing PMI also started to catch up to Services PMI, which has historically been a tailwind to earnings vs. GDP (Exhibit 25).

## Risk: scant & weak guidance, analyst caution

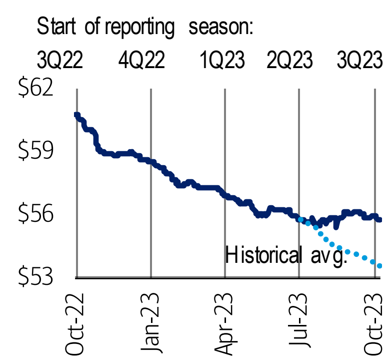
A small sample size (15 instances) and seasonality drove weakness in the 1-mo. guidance ratio which fell to just 0.2x, the lowest level since June 2019 (Exhibit 26). Our 1-mo. earnings revision ratio also fell to 0.8x, but is in line with a typical Sept ratio. Our analysts' caution speaks to worries of a weakening macro environment – see Heard on the 16th floor. But a pause after strong recent revisions (2024 cons. EPS up 1% since 2Q end, bucking seasonal patterns of -2%) is to be expected.

## FX tailwind today, headwind tomorrow. Oil can be positive

FX flipped to a tailwind for the first time since 3Q21, but recent USD strength presents a headwind in 1Q24. Higher oil prices have historically helped S&P earnings (Exhibit 30). Oil represents only ~3% of total costs and a consumption 'shock' is unlikely absent another spike in oil (Exhibit 31), where US energy independence could soften the blow. Easing wage pressure (40% of total costs) should more than offset the impact from oil.

**Also see analysis on productivity, expected volatility, rate impact (pg. 12-14).**

**Exhibit 1: 3Q EPS unchanged since 2Q**
Revision to consensus S&P 500 3Q EPS




**Source:** FactSet, BofA US Equity & Quant Strategy
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**Exhibit 2: S&P 500 qtrly EPS forecasts**
Bottom-up consensus vs. our estimates

| | Btm-up analysts | YoY | BofA Strategy | YoY |
|---|---|---|---|---|
| 1Q23 | 53.08 | -3% | 53.08 | -3% |
| 2Q23 | 54.29 | -6% | 54.29 | -6% |
| 3Q23E | 55.91 | 0% | 58.00 | 4% |
| 4Q23E | 57.98 | 9% | 57.00 | 7% |
| 2023E | $221 | 1% | $222 | 2% |
| 1Q24E | 57.51 | 8% | 56.00 | 5% |
| 2Q24E | 60.89 | 12% | 60.00 | 11% |
| 3Q24E | 62.99 | 13% | 59.00 | 2% |
| 4Q24E | 65.55 | 13% | 60.00 | 5% |
| 2024E | $247 | 12% | $235 | 6% |

**Source:** FactSet, BofA US Equity & Quant Strategy
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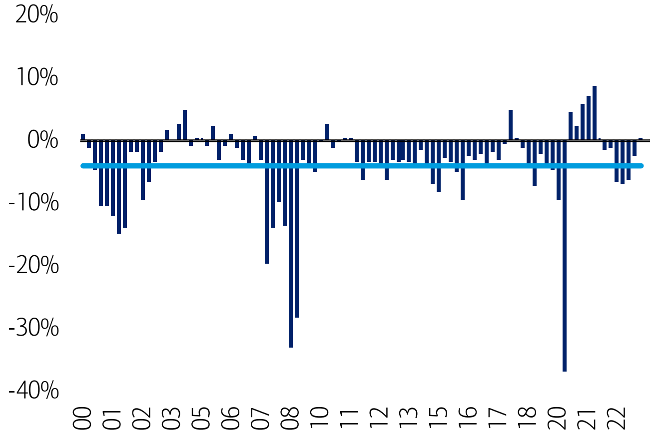
AI = Artificial Intelligence
IIJA = Infrastructure Investment and Jobs Act
IRA = Inflation Reduction Act

# 3Q23 Earnings Preview

S&P 500 3Q consensus EPS was largely flat (+0.1%) since June, well above the typical pre-season 4% cut. This marks the first time since 4Q21 when earnings were not cut into earnings. Macro data and other indicators that we track generally point to a beat. Consensus expects flat EPS y/y growth in 3Q (vs.-6% in 2Q), the first quarter of recovery, and excluding Energy (-38%), earnings are expected to be up 5% y/y (vs. +3% y/y in 2Q). We see more green shoots than red flags and forecast a sizeable 4% beat (vs. historical avg: +2%), or $58 (+4% y/y).

**Exhibit 3: 3Q EPS flat over the last 3mos vs. 4% average**
Bottom-up S&P 500 EPS revision by quarter in 3mos. before reporting season, 2000-3Q23




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

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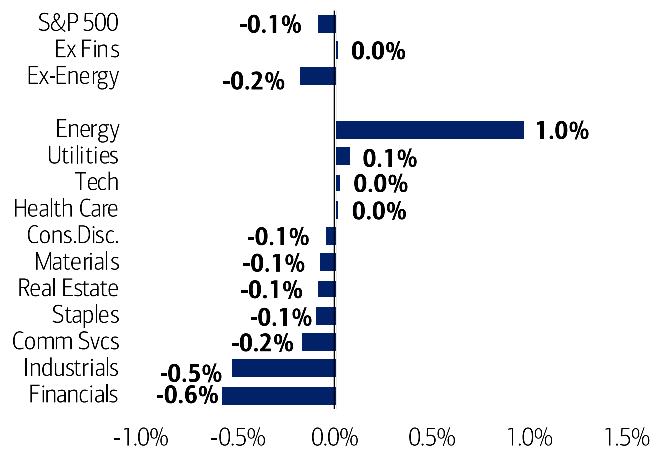
**Exhibit 4: Upward revisions in Energy largely offset downward revisions in Financials and Industrials**
Revision to consensus 3Q23 earnings estimates over the last 3 months




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

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**Exhibit 5: Consensus expects flat earnings YoY in 3Q**
S&P 500 consensus earnings and sales growth expectations by sector based on current constituents

| | Earnings | | Sales | |
|---|---|---|---|---|
| **Sector** | **YoY%** | **QoQ%** | **YoY%** | **QoQ%** |
| Consumer Disc. | 22.6% | (0.2%) | 7.0% | 1.1% |
| Consumer Staples | (0.2%) | (2.0%) | 4.5% | 4.8% |
| Energy | (37.6%) | 19.1% | (18.6%) | 7.3% |
| Financials | 8.8% | (2.4%) | 4.6% | (2.2%) |
| Health Care | (11.5%) | 17.1% | 4.6% | (0.5%) |
| Industrials | 3.2% | (14.0%) | 1.9% | (1.7%) |
| Technology | 5.1% | 2.4% | 1.5% | 2.3% |
| Materials | (22.2%) | (21.3%) | (10.1%) | (5.0%) |
| Real Estate | 0.1% | (6.4%) | 6.3% | 0.3% |
| Communication Services | 32.2% | 42.2% | 5.3% | 1.2% |
| Utilities | 12.1% | 48.5% | 4.5% | 25.5% |
| **S&P 500** | **0.1%** | **6.4%** | **1.5%** | **1.6%** |
| **ex. Financials** | **(1.6%)** | **8.4%** | **1.1%** | **2.1%** |
| **ex. Energy** | **5.2%** | **5.5%** | **3.8%** | **1.1%** |
| **ex. Fins & Energy** | **4.4%** | **7.5%** | **3.7%** | **1.6%** |

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

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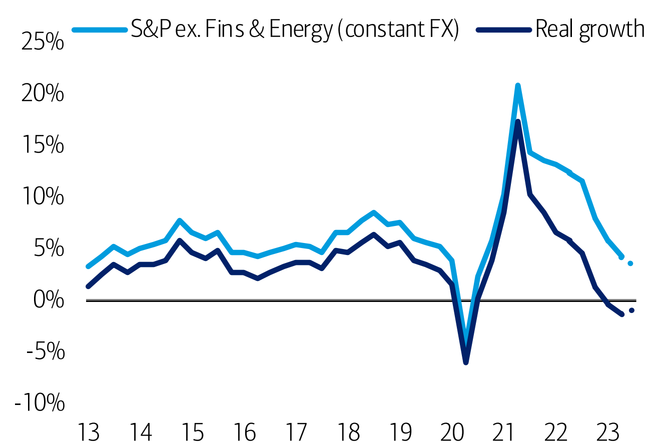
**Exhibit 6: Real sales growth (ex. Fins & Energy) expected to bottom out in 3Q**
S&P 500 sales growth ex. Fins & Energy (constant FX) and real growth (constant FX ex. Fins & Energy) – 2013-3Q23E




**Source:** FactSet, BofA US Equity & Quant Strategy; dotted line = forecast

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**Exhibit 7: Six of 11 sectors are expected to see earnings growth improving this quarter vs. 2Q**
S&P 500 sectors' quarterly earnings growth YoY

| | 4Q21 | 1Q22 | 2Q22 | 3Q22 | 4Q22 | 1Q23 | 2Q23 | 3Q23E | Direction q/q |
|---|---|---|---|---|---|---|---|---|---|
| Comm. Svcs. | 42% | 23% | 6% | (8%) | (19%) | (21%) | (19%) | 32% | ▲ |
| Cons. Disc. | 74% | 41% | 4% | 1% | 4% | 10% | 20% | 23% | ▲ |
| Staples | 11% | 7% | 2% | 0% | (2%) | (2%) | 0% | (0%) | ▼ |
| Energy | 2370% | 3219% | 550% | 273% | 165% | 92% | 12% | (38%) | ▼ |
| Financials | 56% | 23% | (1%) | (9%) | (12%) | (8%) | (3%) | 9% | ▲ |
| Health Care | 26% | 24% | 19% | 11% | 6% | (5%) | (13%) | (11%) | ▲ |
| Industrials | 65% | 83% | 41% | 27% | 26% | 25% | 21% | 3% | ▼ |
| Tech | 38% | 29% | 18% | 7% | (2%) | (6%) | (7%) | 5% | ▲ |
| Materials | 82% | 73% | 42% | 19% | 4% | (11%) | (23%) | (22%) | ▲ |
| Real Estate | 6% | 6% | 7% | 6% | 6% | 4% | 3% | 0% | ▼ |
| Utilities | 9% | 11% | 7% | 2% | 1% | (10%) | (10%) | 12% | ▲ |
| **S&P 500** | **27%** | **12%** | **10%** | **4%** | **(1%)** | **(3%)** | **(6%)** | **0%** | ▲ |

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

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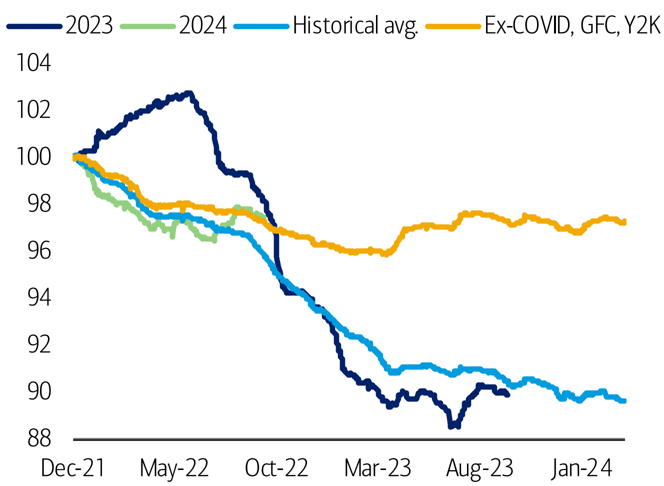
**Exhibit 8: Both 2023-24 consensus EPS have stabilized**
S&P 500 historical FY2 EPS revisions vs. 2023-24 consensus EPS (2023-24 as of 10/8/23)




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

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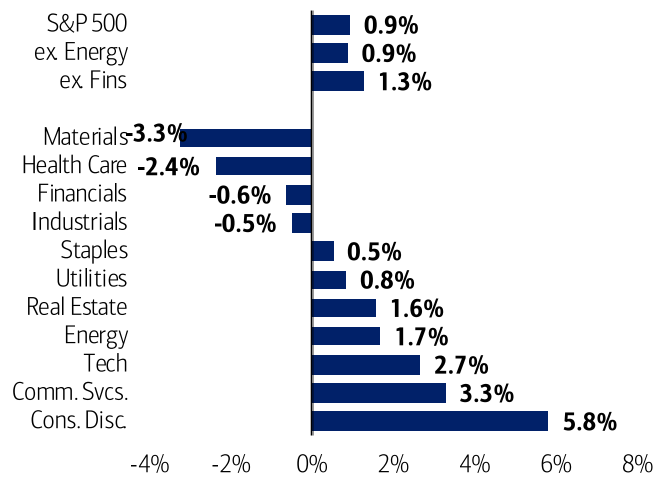
**Exhibit 9: Consensus 2024 EPS is up 1% since 2Q, led by Growth sectors**
S&P 500 consensus 2024 EPS revision since 6/30/23 (as of 10/8/23)




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

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## 3Q: Macro data inflected higher

The macro environment generally improved q/q in 3Q. Macro data continued to surprise to the upside (Exhibit 11), both manufacturing and services PMI improved on a YoY basis, and early reporters largely beat consensus expectations.

So far, 21 companies (primarily "early reporters" with February quarter-end) have reported 3Q results. Early reporters are concentrated in Consumer, Tech and Industrials, but can often give a read on the full quarter's results: since we began tracking in 2012, we've found a 70% correlation (49% $R^2$) between the proportion of early reporter beats on EPS and sales and the proportion of full-quarter beats on EPS and sales.

76% of early reporters have beaten on EPS, 67% on sales and 57% on both, better than the historical average beat of 70%/64%/49% and last quarter's 78%/61%/44%. The median EPS beat so far has been 2% (vs. last quarter's 3% and the historical average of 4%).

**Exhibit 10: % of S&P 500 companies beating consensus expectations on 3Q23 EPS and sales**
Results from early reporters

| Sector | Total companies | Number Reported | % with EPS beat | % with Sales beat | % EPS & Sales beat |
|---|---|---|---|---|---|
| Cons. Disc. | 52 | 6 | 83% | 83% | 67% |
| Cons. Staples | 38 | 6 | 67% | 67% | 50% |
| Energy | 23 | 0 | N.A. | N.A. | N.A. |
| Financials | 72 | 2 | 0% | 0% | 0% |
| Health Care | 65 | 0 | N.A. | N.A. | N.A. |
| Industrials | 76 | 3 | 100% | 67% | 67% |
| Tech | 64 | 4 | 100% | 75% | 75% |
| Materials | 29 | 0 | N.A. | N.A. | N.A. |
| Real Estate | 31 | 0 | N.A. | N.A. | N.A. |
| Comm. Svcs. | 20 | 0 | N.A. | N.A. | N.A. |
| Utilities | 30 | 0 | N.A. | N.A. | N.A. |
| **S&P 500** | **500** | **21** | **76%** | **67%** | **57%** |

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

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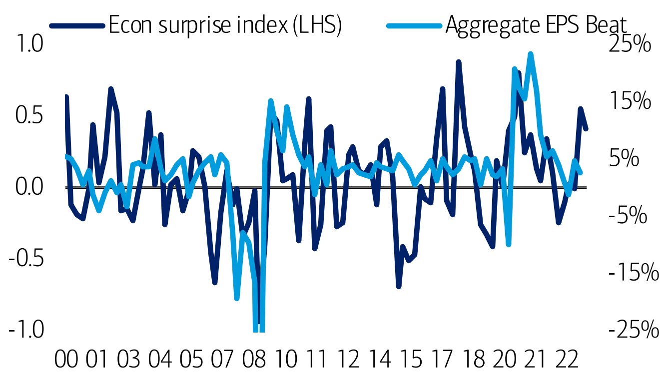
## Macro data generally point to a beat

**Exhibit 11: Economic Surprise Index remains positive, pointing to a 6% EPS beat this quarter based on the historical relationship**
Bloomberg ECO US surprise index vs. S&P 500 EPS beat (2000-present)




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

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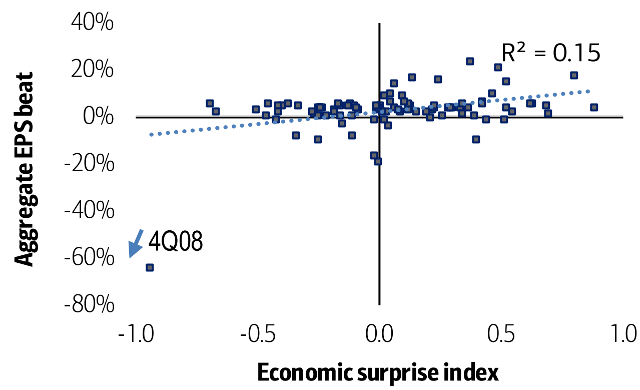
**Exhibit 12: 15% r-sq between Economic Surprise Index vs. aggregate EPS beat**
Bloomberg ECO US surprise index vs. S&P 500 EPS beat (2000-present)




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

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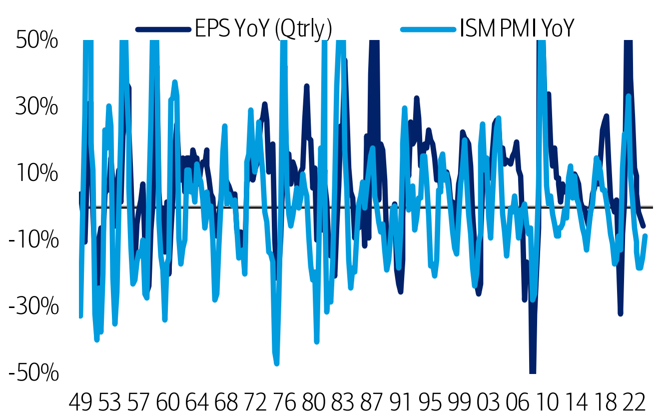
**Exhibit 13: A 9% drop in the ISM manufacturing PMI suggests 3% YoY growth in 3Q EPS (vs. consensus: flat)**
ISM Manufacturing PMI YoY vs. S&P 500 quarterly EPS YoY (1949-present)




**Source:** Bloomberg, FactSet, BofA US Equity & Quant Strategy; dotted = consensus forecast

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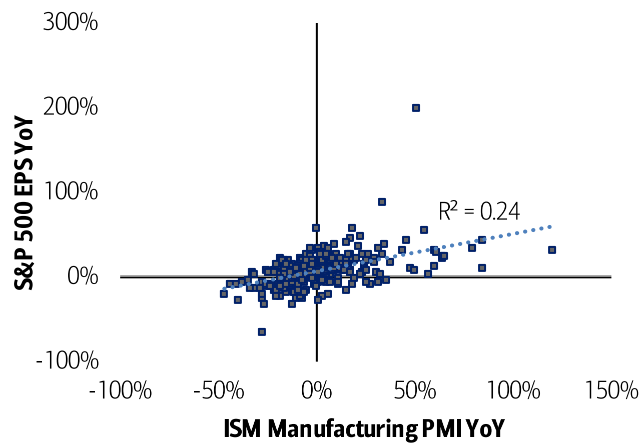
**Exhibit 14: 24% r-sq between ISM Manufacturing PMI YoY vs. S&P 500 quarterly EPS YoY**
ISM Manufacturing PMI YoY vs. S&P 500 quarterly EPS YoY (1949-present)




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

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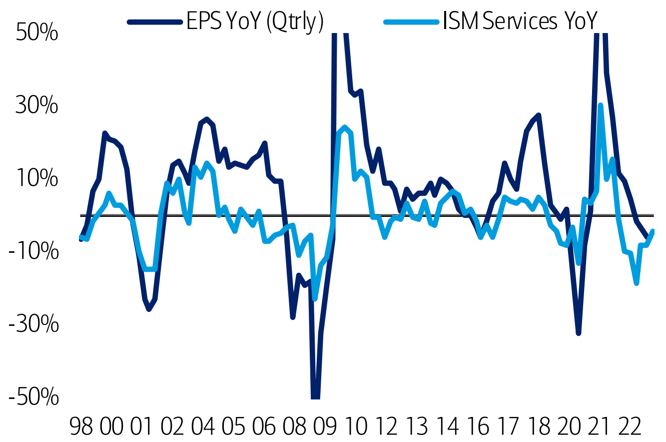
**Exhibit 15: A 5% decline in the ISM Services PMI suggests -1% YoY in 3Q EPS (vs. consensus: flat)**
ISM Services PMI YoY vs. S&P 500 quarterly EPS YoY (1998-present)




**Source:** Bloomberg, FactSet, BofA US Equity & Quant Strategy; dotted = consensus forecast
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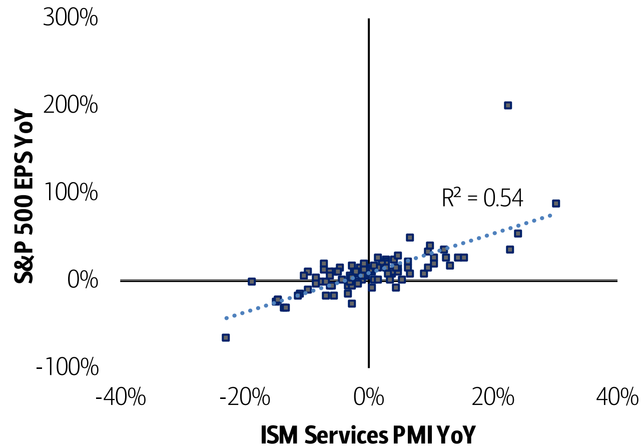
**Exhibit 16: 54% r-sq between ISM Services PMI YoY vs. S&P 500 quarterly EPS YoY**
ISM Services PMI YoY vs. S&P 500 quarterly EPS YoY (1998-present)




**Source:** Bloomberg, FactSet, BofA US Equity & Quant Strategy
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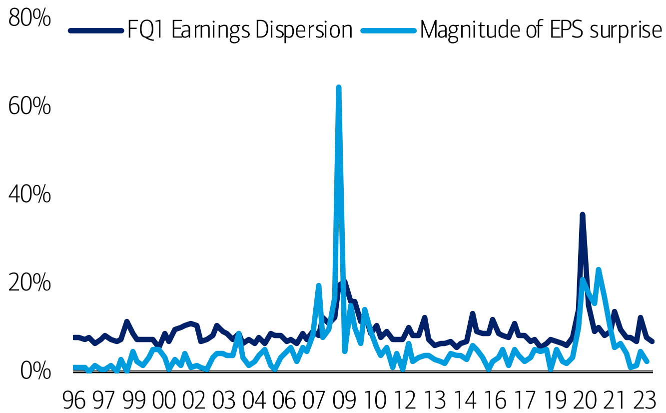
**Exhibit 17: Estimate dispersion narrowed, pointing to a 3% surprise (positive or negative)**
FQ1 earnings dispersion vs. magnitude of EPS surprise (1996-present)




**Source:** FactSet, Bloomberg, BofA US Equity & Quant Strategy
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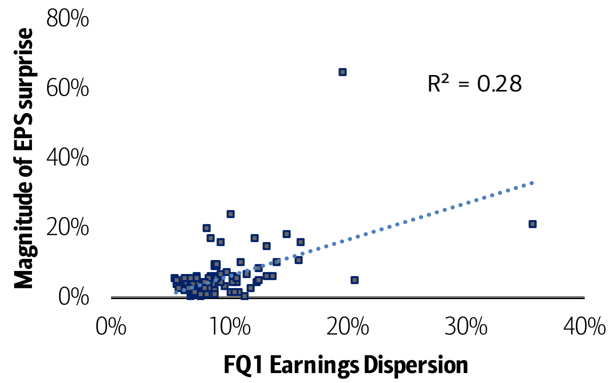
**Exhibit 18: 28% r-sq between FQ1 earnings dispersion vs. magnitude of EPS surprise**
FQ1 earnings dispersion vs. magnitude of EPS surprise (1996-present)




**Source:** FactSet, Bloomberg, BofA US Equity & Quant Strategy
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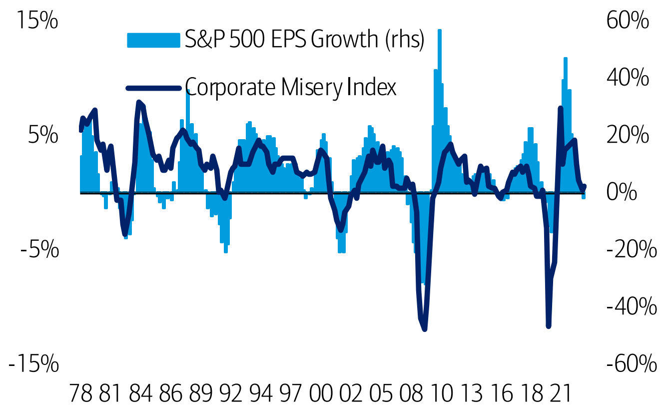
## Corporate Misery Indicator says better environment ahead

Our Corporate Misery Indicator, our macro gauge of profit cycle, ticked up in 3Q for the first time since 3Q22. Re-acceleration in CPI (pricing), combined with moderating cost pressure (slowing wage growth) more than offset lower volume. This is consistent with our profit outlook, expecting a healthy recovery ahead.

**Exhibit 19: Our Corporate Misery Indicator ticked up in 3Q**
BofA Corp. Misery Indicator (lower=more miserable) 4Q78-3Q23 (as of 8/23)




Disclaimer: The indicator identified as BofA Corporate Misery Indicator above is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Global Research. This indicator was not created to act as a benchmark. Note: see Appendix for full details/methodology.
**Source:** BofA US Equity & Quant Strategy, Conference Board, BLS

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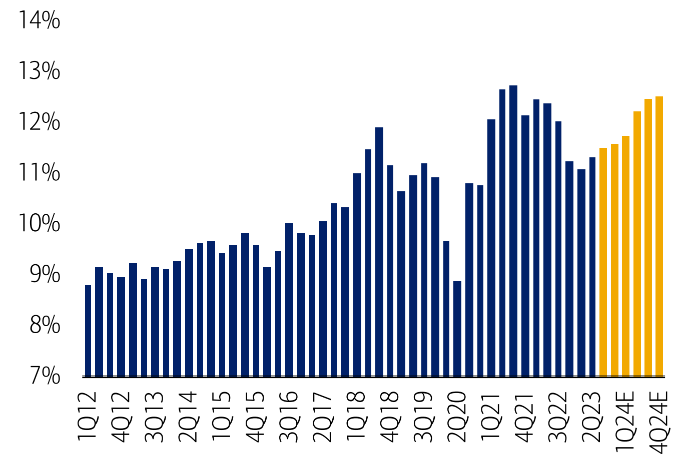
**Exhibit 20: Margins are expected to improve for the second straight quarter in 3Q**
S&P 500 quarterly net margins ex-Financials (2012-4Q24E)




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

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**Exhibit 21: 2024 margin outlook may be too optimistic, especially in Tech**
S&P 500 quarterly net margins by sectors

| Sector | 1Q21 | 2Q21 | 3Q21 | 4Q21 | 1Q22 | 2Q22 | 3Q22 | 4Q22 | 1Q23 | 2Q23 | 3Q23E | 4Q23E | 1Q24E | 2Q24E | 3Q24E | 4Q24E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Consumer Discretionary | 7.8% | 8.0% | 7.4% | 6.2% | 6.5% | 6.3% | 7.0% | 5.7% | 6.8% | 8.6% | 8.6% | 7.2% | 7.4% | 8.7% | 9.4% | 8.1% |
| Consumer Staples | 6.9% | 7.2% | 7.1% | 6.6% | 6.7% | 6.7% | 6.6% | 6.3% | 6.1% | 6.4% | 6.0% | 6.0% | 6.4% | 6.8% | 6.5% | 6.4% |
| Energy | 4.5% | 6.5% | 9.0% | 11.1% | 10.7% | 14.7% | 14.4% | 13.0% | 12.6% | 10.0% | 10.9% | 10.7% | 10.7% | 11.1% | 11.3% | 11.1% |
| Financials | 23.0% | 21.1% | 19.6% | 17.5% | 18.3% | 17.0% | 15.0% | 15.9% | 18.4% | 17.6% | 17.6% | 17.4% | 18.8% | 18.3% | 18.4% | 19.2% |
| Health Care | 11.6% | 11.5% | 11.6% | 11.4% | 11.8% | 11.1% | 10.7% | 9.5% | 9.3% | 7.6% | 9.0% | 9.1% | 9.4% | 9.2% | 9.5% | 9.5% |
| Industrials | 7.0% | 9.4% | 9.4% | 8.2% | 8.1% | 10.3% | 9.6% | 9.8% | 9.5% | 11.4% | 9.8% | 10.2% | 10.0% | 11.5% | 11.4% | 11.3% |
| Information Technology | 25.0% | 25.7% | 25.9% | 24.5% | 25.2% | 23.9% | 24.0% | 24.4% | 22.8% | 24.0% | 24.2% | 25.3% | 24.9% | 25.1% | 25.7% | 27.0% |
| Materials | 11.8% | 14.9% | 13.7% | 13.0% | 13.6% | 14.4% | 11.3% | 10.5% | 11.2% | 11.9% | 9.8% | 9.9% | 10.6% | 12.0% | 11.3% | 11.3% |
| Real Estate | 36.3% | 37.5% | 36.0% | 35.3% | 37.1% | 36.1% | 37.1% | 36.1% | 36.0% | 37.1% | 34.8% | 34.9% | 35.1% | 35.4% | 35.5% | 35.3% |
| Communication Services | 18.7% | 18.8% | 17.8% | 16.2% | 16.8% | 14.3% | 12.9% | 12.1% | 13.9% | 16.1% | 16.4% | 16.7% | 16.8% | 17.9% | 17.7% | 18.1% |
| Utilities | 13.0% | 15.0% | 18.1% | 14.2% | 15.2% | 11.9% | 13.5% | 9.1% | 10.4% | 12.2% | 14.5% | 12.1% | 14.2% | 13.3% | 17.3% | 13.5% |
| **S&P 500 ex. Financials** | **12.1%** | **12.7%** | **12.7%** | **12.1%** | **12.5%** | **12.4%** | **12.0%** | **11.3%** | **11.1%** | **11.3%** | **11.5%** | **11.6%** | **11.7%** | **12.2%** | **12.5%** | **12.5%** |
| **S&P 500** | **13.4%** | **13.7%** | **13.5%** | **12.7%** | **13.1%** | **12.9%** | **12.4%** | **11.8%** | **12.0%** | **12.1%** | **12.3%** | **12.3%** | **12.6%** | **13.0%** | **13.2%** | **13.3%** |
| **ex. Fins & Energy** | **12.7%** | **13.2%** | **13.1%** | **12.2%** | **12.7%** | **12.1%** | **11.7%** | **11.1%** | **10.9%** | **11.5%** | **11.6%** | **11.7%** | **11.9%** | **12.3%** | **12.6%** | **12.7%** |
| **ex. Energy** | **14.0%** | **14.3%** | **13.9%** | **12.9%** | **13.4%** | **12.7%** | **12.1%** | **11.6%** | **12.0%** | **12.3%** | **12.4%** | **12.4%** | **12.8%** | **13.2%** | **13.4%** | **13.5%** |

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

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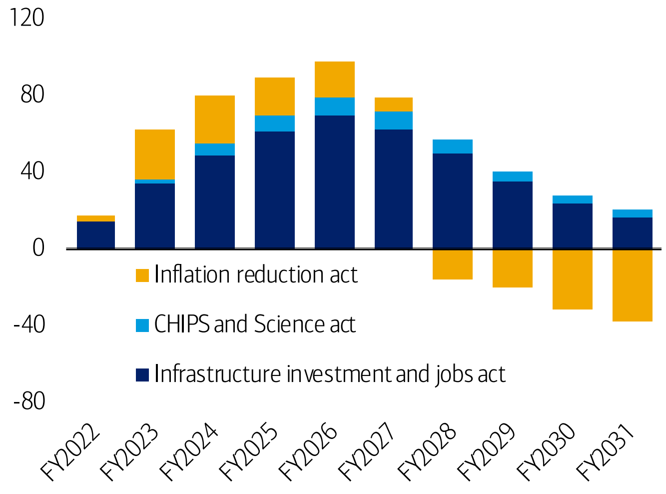
## AI: long-term; Infrastructure: near-term

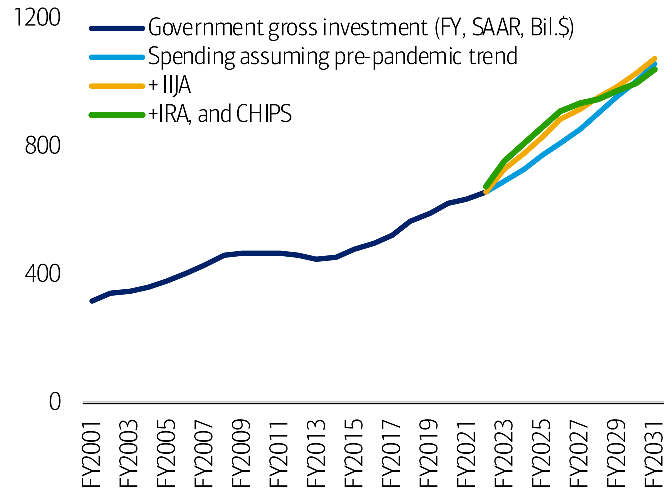
AI is real and will be a big contributor to earnings, potentially boosting S&P operating margins by 250bps over the next 5 years (see AI primer). But any meaningful contribution may be some quarters away. A bigger near-term contributor will be fiscal stimulus via IIJA, then IRA. Incremental spending of $550B over the next five years from the IIJA ($110B/yr run rate, 10% of total non-res construction) will be a significant boost in the near-term. $116B worth of projects have been either announced or awarded so far from the IIJA, and the expected government outlay timeline indicates accelerating pace of investments through FY206. While citing it as a tailwind, many companies were hesitant to put numbers around it in 2Q. But we may start to hear more clarity on benefits this quarter.

**Exhibit 22: Investments from IIJA and IRA are expected to accelerate in FY24 (+28% y/y), which began on Oct 1, 2023**
Estimated increase in discretionary spending




**Source:** Congressional Budget Office, Haver Analytics, BofA Global Research
BofA GLOBAL RESEARCH

**Exhibit 23: Investment from fiscal stimulus is expected to accelerate in the near term**
Estimated Government gross investment ($B; SAAR)




**Source:** Congressional Budget Office, Haver Analytics, BofA Global Research
BofA GLOBAL RESEARCH

## De-stocking is over, goods > services

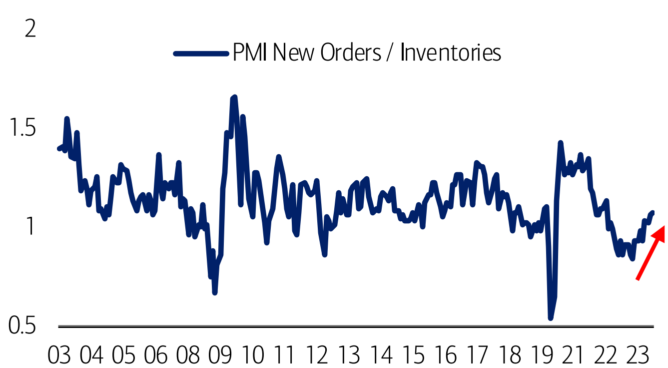
Earnings lagged GDP growth for the fifth straight quarter (historically, quarterly earnings outpaced GDP by 1.5ppt on avg. since 1950). The lag was partly due to the shift from goods (50% of earnings vs. 30% of economy) to services, which we believe is now over. Despite still muted signs of re-stocking (see Trucking report), at least the de-stocking cycle is now over (Exhibit 24). Manufacturing PMI also started to catch up to Services PMI, which has historically been a tailwind to earnings vs. GDP (Exhibit 25).

**De-stocking commentaries from 2Q earnings:**

**J.B. Hunt (JBHT):** "We saw evidence from customers in June that the destocking trend has moderated."

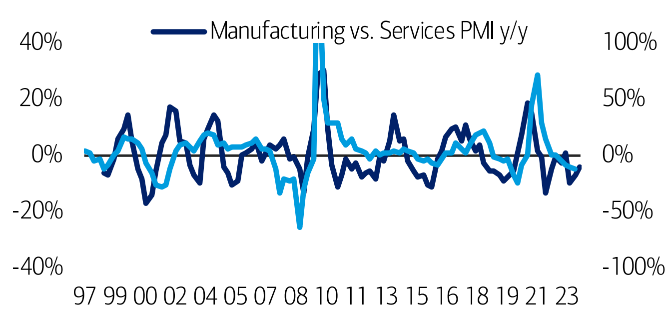
**Knight-Swift Transportation (KNX):** "We believe we're in the final stage of inventory destocking."

**Exhibit 24: De-stocking cycle turn: orders rising, inventories falling**
ISM Manufacturing PMI new orders / inventories (2003-9/23)




**Source:** Bloomberg, BofA US Equity & Quant Strategy
BofA GLOBAL RESEARCH

**Exhibit 25: Manufacturing outpacing services has generally been a tailwind for earnings vs. GDP**
ISM Manufacturing PMI – Services PMI YoY vs. EPS YoY – GDP YoY (1997-9/23)




**Source:** FactSet, Bloomberg, BofA US Equity & Quant Strategy
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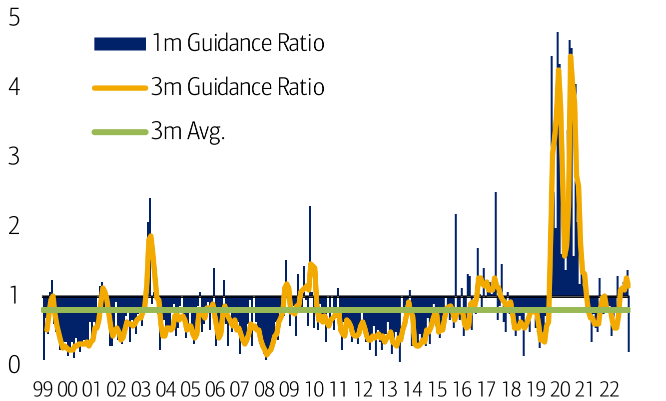
## Risk: guidance started to weaken

One of the most negative indicators heading into this earnings season is recent weakness in company guidance. Our 1-mo. guidance ratio (# of above- vs. below-consensus guides) fell to just 0.2x, the lowest level since June 2019. The good news is that the sample size was very small (15 guides) and September has seasonally been one of the weakest months for guidance, averaging just 0.6x (vs. 0.8x historical average).

Similarly, our 1-mo. Earnings revision ratio fell (but not as much as the guidance ratio) to 0.8x, the lowest level since February 2023. But it was largely in line with a typical seasonal September ratio.

**Exhibit 26: Our 1-mo. guidance ratio plummeted to just 0.2x, the lowest level since June 2019 (sample size: 15)**
S&P 500 management guidance ratio (# above vs. below consensus) – 9/23




**Source:** Bloomberg, BofA US Equity & Quant Strategy
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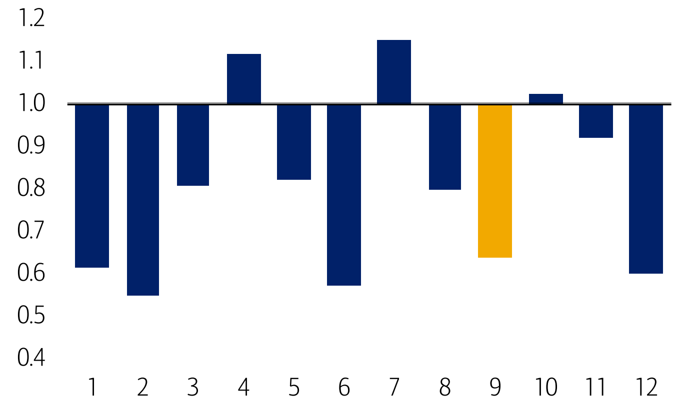
**Exhibit 27: September is seasonally one of the weakest months for guidance**
Avg. 1-mo. guidance ratio by month (1999-9/23)




**Source:** Bloomberg, BofA US Equity & Quant Strategy
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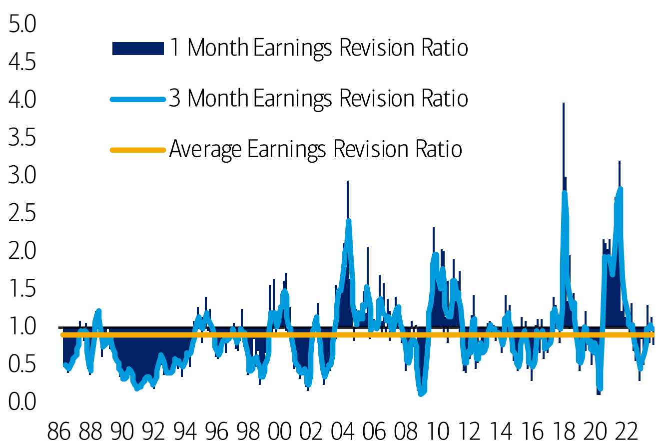
**Exhibit 28: Our 1-mo. earnings revision ratios also fell to 0.8x, the lowest since Feb 2023**
S&P 500 earnings estimate revision ratio, 1/86-9/23




**Source:** BofA US Equity and Quant Strategy, FactSet
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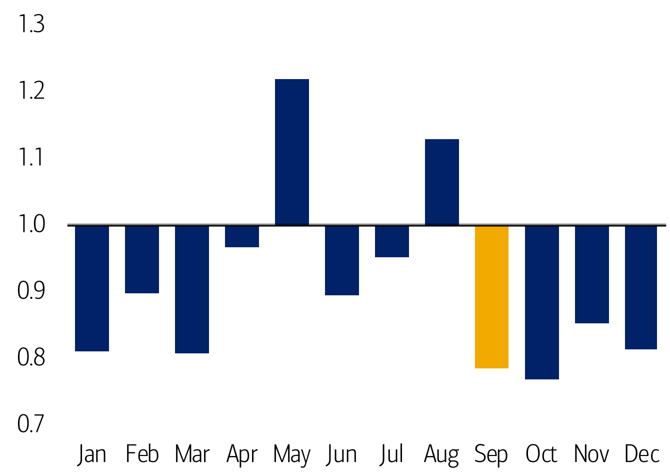
**Exhibit 29: But 0.8x is largely in line with a typical September ratio**
Avg. earnings revision ratio by month (1-86-9/23)




**Source:** BofA US Equity and Quant Strategy, FactSet
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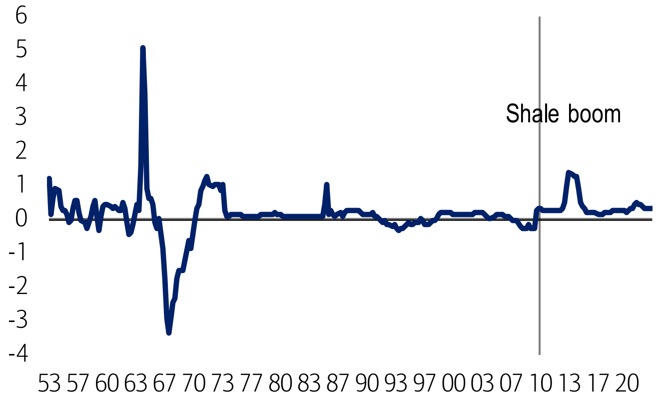
## Higher oil has historically been a tailwind to earnings

While the recent jump in oil concerned some investors, higher oil prices have historically helped S&P earnings (Exhibit 30). Oil represents only ~3% of total costs and a consumption 'shock' is unlikely absent another spike, in our view (Exhibit 31). Easing wage pressure (40% of total costs) should more than offset the impact from oil.

**Exhibit 30: Higher oil prices have historically been a tailwind to earnings, especially after the shale revolution**
WTI 5-yr rolling beta to S&P 500 earnings based on a multivariate regression using WTI and GDP vs. S&P EPS (1953-2Q23)




**Source:** Haver, FactSet, BofA US Equity & Quant Strategy

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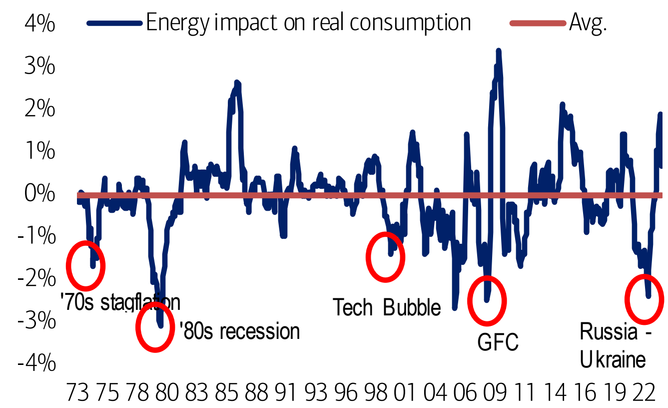
**Exhibit 31: Lower oil added ~70bps to real consumption. A significant jump in oil is needed to have a similar impact as prior shocks**
Spread between CPI ex. Energy and CPI YoY (1973-8/23)




**Source:** BofA US Equity & Quant Strategy, Haver Analytics

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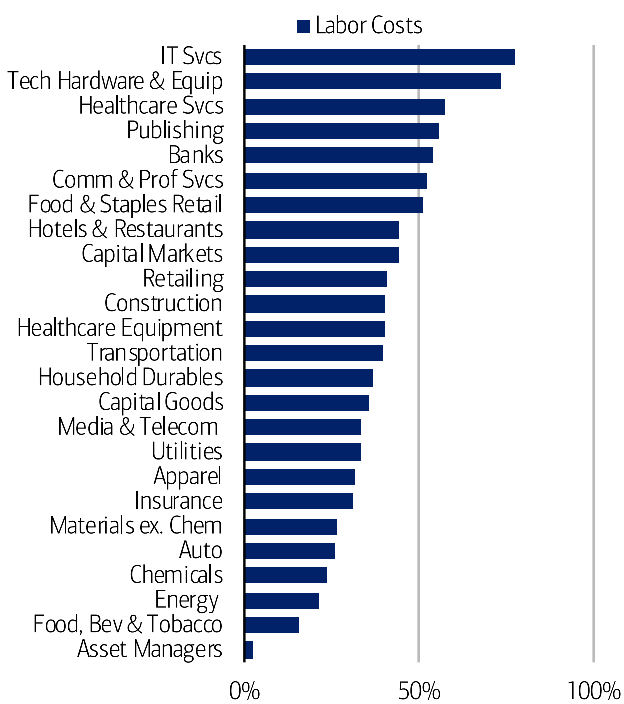
**Exhibit 32: Labor Costs are the biggest cost component for most industries...**
Labor Costs as % of Total Operating Costs by Industry (the use of commodities by industries; as of 2020)




**Source:** BEA, BofA US Equity & Quant Strategy

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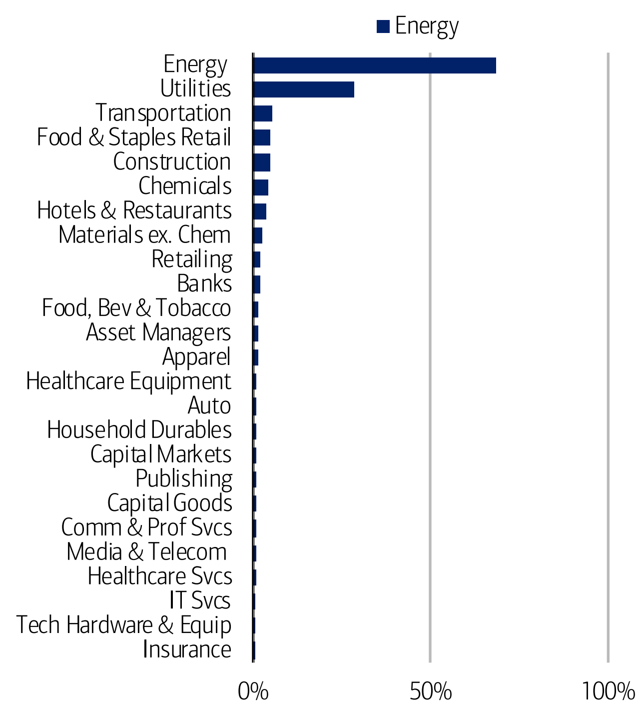
**Exhibit 33: ...whereas Energy costs are insignificant in most industries**
Energy Costs as % of Total Operating Costs by Industry (the use of commodities by industries; as of 2020)




**Source:** BEA, BofA US Equity & Quant Strategy

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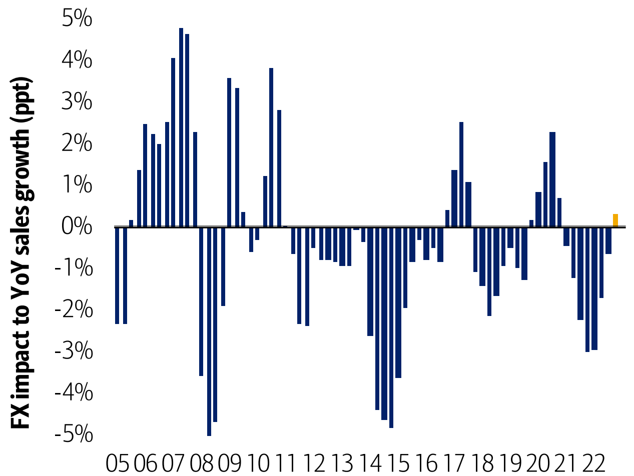
## First tailwind from FX since 3Q21, but not for long

We calculate that FX flipped to a 30bp tailwind in 3Q, marking the first tailwind since 3Q21. But the tailwind may be short-lived with the recent strength in the USD. If the dollar stays where it is today, FX is going to be a much smaller tailwind in 4Q, then will flip back to a headwind in 2H24. In general, we estimate every 10% rise in the USD translates to a 3% hit to EPS, all else equal.

**Exhibit 34: FX flipped to a 30bp tailwind in 3Q, the first tailwind since 3Q21**

Estimated currency impact (in ppt) to S&P 500 quarterly YoY sales growth, 4Q05-3Q23




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

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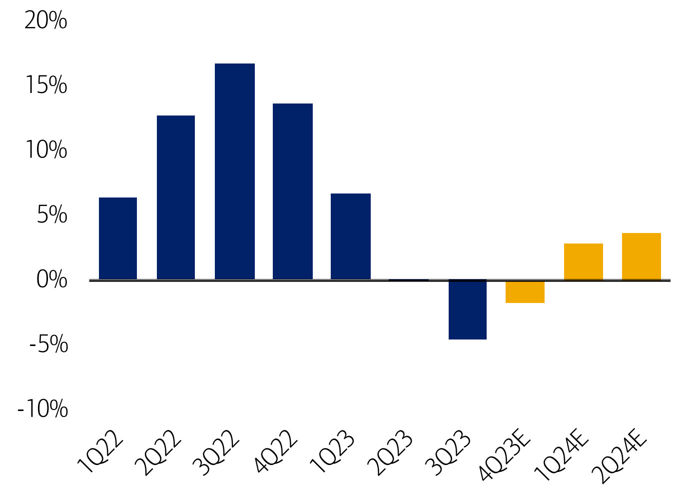
**Exhibit 35: But if the USD stays at the current level, FX will turn to a headwind again in 2H24**

DXY index YoY (1Q22-2Q24E, forecast assuming the current spot price)




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

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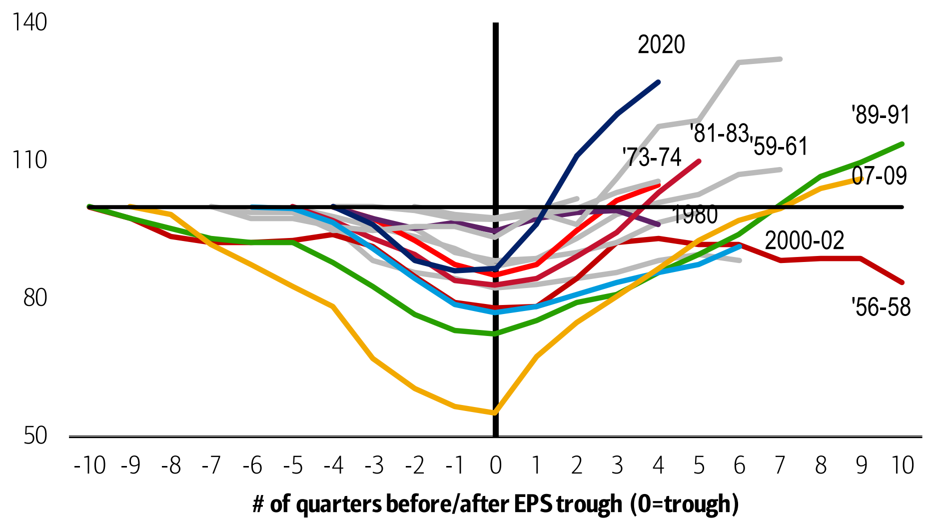
## Earnings recover stronger than they fall

History suggests earnings typically recovery stronger than they fall (Exhibit 36), as downturns usually remove excess capacity, resulting in leaner cost structure and improved margin profiles. On average, S&P 500 TTM EPS exceeded prior peak levels by 5% after the same number of quarters into recovery as those into a downturn. This implies a projected TTM EPS of $233 by mid-2024, compared to our estimate of $235 for the full-year 2024.

**Exhibit 36: Earnings typically recover stronger than they fall**

S&P 500 TTM EPS before/after earnings troughs (same number of quarters leading to the trough and following the trough; 100=pre-recession peak; 1950-present)




**Source:** BofA US Equity & US Quant Strategy, FactSet, Haver Analytics

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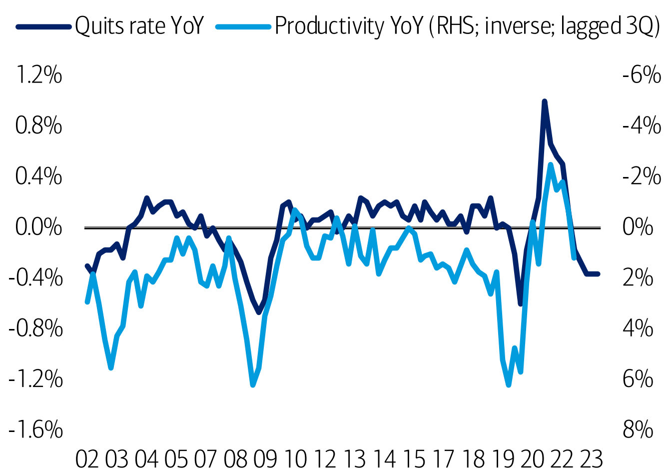
## Early signs of productivity gains

We see encouraging early signs of productivity gains. The falling quits rate suggests better productivity ahead (workers stay longer, becoming more productive; Exhibit 37), and revenue/worker for the S&P 500 is now inching toward its highs from 2008. We expect more productivity gains as the economy upgrades its old equipment (avg. age of equipment at a 60-yr high; Exhibit 40).

**Exhibit 37: Falling quits rate have historically led to productivity gains in the near-term**
JOLTS




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

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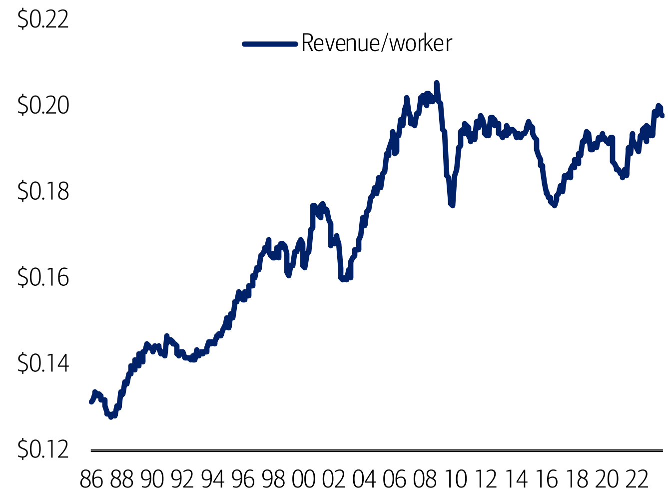
**Exhibit 38: Labor efficiency has been inching toward the record high from 2008**
S&P 500 companies' revenue per worker ($M 1986 dollar)




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

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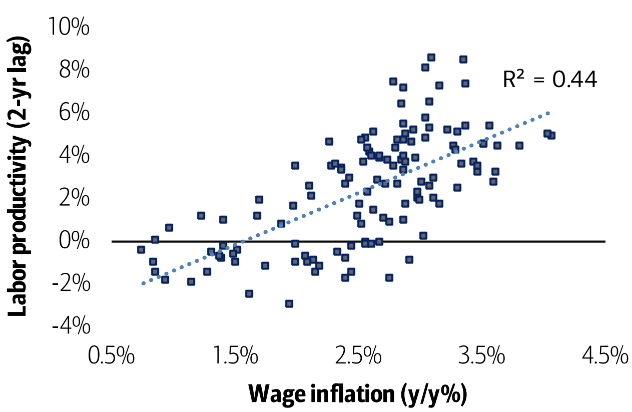
**Exhibit 39: Wage inflation has historically driven labor productivity growth on a lagged basis**
US Manufacturing wage inflation and labor productivity (y/y % changes)




**Source:** Bureau of Labor Statistics, BofA Global Research
**Note:** Quarterly data of US manufacturing labor productivity versus average hourly earnings of production & nonsupervisory employees

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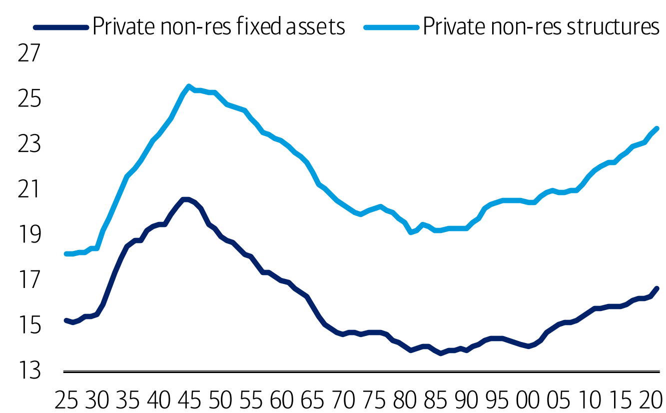
**Exhibit 40: Stuff is old. Productivity should improve as equipment gets upgraded**
Average age of private nonresidential fixed assets and structures (years; 1925-2021)




**Source:** BEA, BofA US Equity & US Quant Strategy

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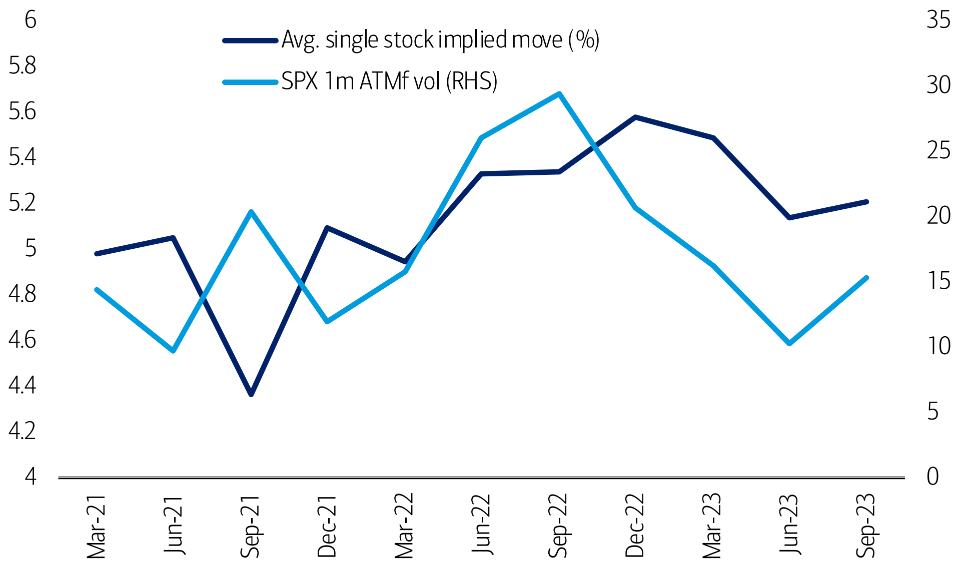
## Does this earnings season matter for equities?

Some may think this earnings season is not as important to the market, with the path of interest rates dictating where the market is headed next. In fact, from a top-down perspective, derivatives markets are expecting relatively low volatility in the S&P during the next month. However, when aggregated from the bottom-up single stock level, options markets are still pricing in relatively large implied moves around the announcements, suggesting this earnings season may indeed matter for the equity market (Exhibit 41).

**Exhibit 41: Does this earnings season matter for equities? Macro says not as much, micro says yes**
S&P 500 1-mo. at-the-money volatility futures vs. avg. implied move of S&P 500 stocks (1Q21-3Q23)




**Source:** Bloomberg, BofA Global Research

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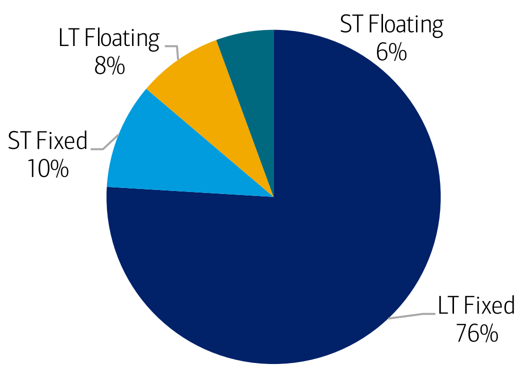
## Some headwinds from higher rates, but manageable

Despite the fastest hiking cycle in 40+ years, we believe the impact to S&P 500 earnings will be manageable, with over 75% of debt being long-term fixed. The debt maturity schedule for the S&P 500 is also more spread out. The real risk is in the Russell 2000, where only 60% is long-term fixed and the debt maturity schedule is much more front-loaded (Exhibit 43).

The effective interest rate for the S&P 500 has started to rise but is only back at pre-COCID levels (Exhibit 44). Also, companies are generating much higher interest income from their cash balance, mitigating the impact of higher interest expense. Even if we assume ~7% cost of debt through 2026, we estimate just -3% cumulative impact to S&P 500 EPS (Exhibit 45).

**Exhibit 42: 75%+ of S&P 500 debt is L/T fixed today vs. just 44% back in 2007**

S&P 500 debt composition (as of March 2023)




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

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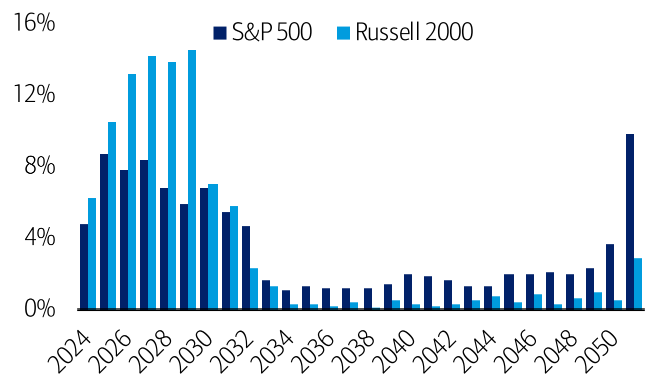
**Exhibit 43: S&P 500 debt maturing in manageable chunks, but not the Russell 2000**

% of LT fixed debt maturing each year for S&P 500 ex. Fins




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

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**Exhibit 44: The effective interest rate is on the rise, but only back to pre-COVID levels**

S&P 500 effective interest rate on debt (1994-9/23)


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

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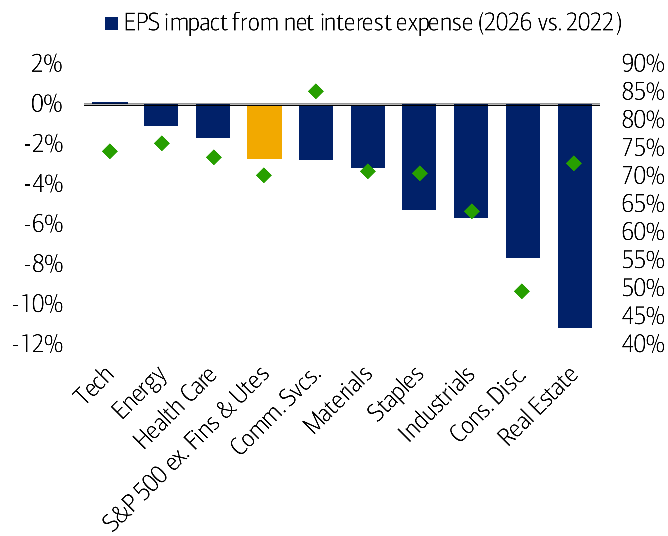
**Exhibit 45: EPS impact will be manageable for the S&P 500 overall, but not for certain sectors**

Cumulative impact to S&P 500 EPS from higher interest rate by 2026, assuming 7% debt cost




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

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## Real Estate and Tech rank best for 3Q earnings

Historically, we have found that sectors with strong EPS/sales revisions and guidance have been more likely to have a greater number of earnings beats than misses in the subsequent earnings season. Also, given that positive surprises tend to persist, sectors with a higher ratio of positive to negative surprises in the prior quarter may be more likely to enjoy similar results in the current quarter. Based on these measures, for this earnings season Real Estate and Tech screen as most likely to surprise to the upside, while Energy and Materials screen weakest.

**Exhibit 46: Sector ranks for 3Q23 earnings season – Real Estate and Tech rank best; Energy and Materials rank worst**
Based on average ranking of EPS & sales revision ratios, guidance ratios and last quarter's surprise results

| Sector | Overall Attractiveness | Guidance 3m Ratio | Estimate Revision 3m Ratio | Sales Revision 3m Ratio | Last Qtr. Surprise Ratio (Beats/Misses) |
|---|---|---|---|---|---|
| Real Estate | 1 | 4.00 | 1.30 | 1.93 | 4.0 |
| Information Technology | 2 | 1.75 | 1.48 | 0.99 | 8.8 |
| Consumer Discretionary | 3 | 1.00 | 1.46 | 1.36 | 3.9 |
| Industrials | 4 | 2.11 | 1.29 | 1.31 | 3.1 |
| Health Care | 5 | 0.63 | 0.77 | 1.43 | 5.1 |
| Consumer Staples | 6 | 1.00 | 0.93 | 0.75 | 2.8 |
| Utilities | 7 | 0.25 | 0.91 | 1.75 | 0.6 |
| Financials | 9 | N/A | 0.74 | 1.06 | 1.6 |
| Communication Services | 9 | N/A | 0.87 | 0.58 | 1.7 |
| Materials | 10 | 0.58 | 0.67 | 0.38 | 1.0 |
| Energy | 11 | N/A | 0.58 | 0.44 | 0.5 |
| **S&P 500** | | **1.15** | **0.99** | **1.07** | **2.3** |

**Source:** FactSet/First Call, BofA US Equity & Quant Strategy
Note: Surprise ratio based on avg of EPS Beat/Miss ratio and Sales Beat/Miss ratio. Guidance ratio is not counted in calculating the average rank if a sector had <10 instances of guidance over the last 3 months.
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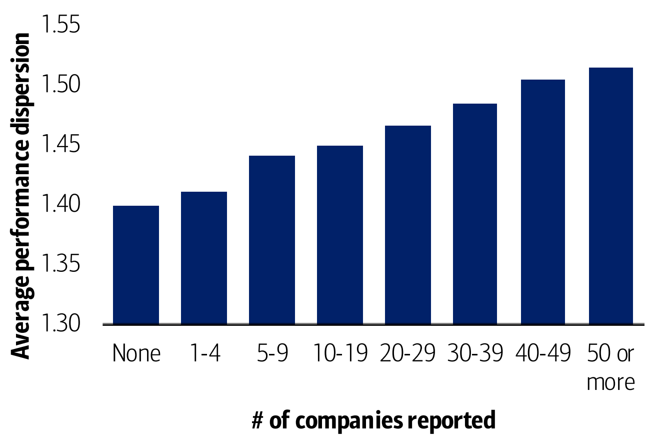
## Earnings season is a good time to be a stock-picker

For short-term investors, stock differentiation is heightened during earnings season, particularly the busiest reporting days. Below we show the average dispersion (standard deviation) of daily stock returns based on the number of companies reporting by day since 2009 (Exhibit 47). This reveals that dispersion is consistently higher for busier reporting days. This quarter, the busiest days fall the week of Oct 23-27 (Exhibit 48).

**Exhibit 47: Wider performance dispersion on busy earnings days**
# of S&P 500 companies reporting daily vs. avg. performance dispersion (standard deviation of daily returns), 2009-present




**Source:** FactSet, BofA US Equity & Quant Strategy
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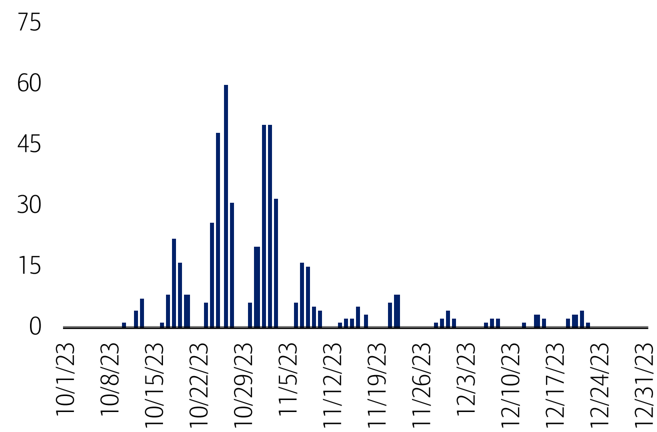
**Exhibit 48: S&P 500 2Q23 reporting frequency by day**
# of companies reporting each day




**Source:** Bloomberg, BofA US Equity & Quant Strategy
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## Screens for top & bottom line beats & misses

We screened the S&P 500 for stocks under BofA coverage that, based on the following screening criteria, are most likely to beat (miss) expectations:

- **BofA vs. Consensus**: BofA EPS and sales above (below) consensus ex-BofA. (Note: Z-score in the tables represents the number of standard deviations that our analyst's estimate is above (below) consensus ex-BofA.)
- **Last quarter's results:** Company beat on both EPS and sales during last quarter's reporting season (for positive surprise screen) or missed on either earnings or sales during last quarter's earnings season (for negative surprise screen).
- **Fundamental Opinion:** We screen for stocks with a BofA rating of Buy (Positive Surprise Screen) or Underperform (Negative Surprise Screen).

We also flag stocks on the positive surprise screen which are underweight by active funds and stocks on the negative surprise screen which are overweight by active funds.

**Exhibit 49: 3Q23 Positive Surprise Screen (with underowned stocks by fund managers highlighted in blue)**
Stocks that are most likely to beat expectations

| Ticker | Company Name | Sector | Industry | Expected Report Date | BofA vs. Consensus EPS: Z-Score | BofA vs. Consensus Sales: Z-Score | Last Qtr: EPS/Sales Surprise | Price | BofA Rating | Rel. Wgt. (vs. S&P 500) in fund holdings |
|---|---|---|---|---|---|---|---|---|---|---|
| ACGL | Arch Capital Group Ltd. | Financials | Insurance | 10/30/2023 | 0.5 | 3.3 | Beat/Beat | 81.86 | BUY | 0.4 |
| PHM | PulteGroup, Inc. | Consumer Discretionary | Household Durables | 10/24/2023 | 0.3 | 0.5 | Beat/Beat | 73.93 | BUY | 0.6 |
| HD | Home Depot, Inc. | Consumer Discretionary | Specialty Retail | 11/14/2023 | 1.8 | 1.9 | Beat/Beat | 299.22 | BUY | 0.8 |
| BK | Bank of New York Mellon | Financials | Capital Markets | 10/17/2023 | 1.0 | 1.5 | Beat/Beat | 42.30 | BUY | 1.3 |
| AIG | American International Group | Financials | Insurance | 11/1/2023 | 0.7 | 2.9 | Beat/Beat | 61.17 | BUY | 1.7 |
| FSLR | First Solar, Inc. | Information Technology | Semiconductors & Semiconductor Equipment | 10/27/2023 | 2.1 | 0.3 | Beat/Beat | 151.56 | BUY | 1.5 |
| CTAS | Cintas Corporation | Industrials | Commercial Services & Supplies | 12/21/2023 | 2.1 | 2.9 | Beat/Beat | 506.64 | BUY | 0.8 |
| MSI | Motorola Solutions, Inc. | Information Technology | Communications Equipment | 11/3/2023 | 12.7 | 14.7 | Beat/Beat | 285.05 | BUY | 1.6 |
| WDC | Western Digital Corporation | Information Technology | Technology Hardware Storage & Peripherals | 10/27/2023 | 2.9 | 1.9 | Beat/Beat | 45.35 | BUY | 0.1 |
| APTV | Aptiv PLC | Consumer Discretionary | Automobile Components | 11/2/2023 | 1.7 | 0.6 | Beat/Beat | 98.12 | BUY | 1.0 |

**Source:** BofA US Equity & Quant Strategy, FactSet. Note: Closing prices and ratings as of close 10/10/23
This screen is not a recommended list either individually or as a group of stocks. Investors should consider the fundamentals of the companies and their own individual circumstances/objectives before making any investment decision.

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**Exhibit 50: 2Q23 Negative Surprise Screen (with overowned stocks by fund managers highlighted in blue)**
Stocks that are most likely to miss expectations

| Ticker | Company | Sector | Industry | Expected Report Date | BofA vs. Consensus EPS: Z-Score | BofA vs. Consensus Sales: Z-Score | Last Qtr: EPS/Sales Surprise | Price | BofA Rating | Rel. Wgt. (vs. S&P 500) in fund holdings |
|---|---|---|---|---|---|---|---|---|---|---|
| OMC | Omnicom Group Inc | Communication Services | Media | 10/18/2023 | -1.1 | -1.1 | In-line/Miss | 75.28 | UNDERPERFORM | 0.2 |
| ALLE | Allegion Public Limited Company | Industrials | Building Products | 10/31/2023 | -2.0 | -2.2 | Beat/Miss | 105.47 | UNDERPERFORM | 0.1 |
| GNRC | Generac Holdings Inc. | Industrials | Electrical Equipment | 11/2/2023 | -0.3 | -2.7 | Miss/Beat | 107.41 | UNDERPERFORM | 0.5 |
| SCHW | Charles Schwab Corp | Financials | Capital Markets | 10/16/2023 | -1.1 | -0.4 | Beat/Miss | 51.78 | UNDERPERFORM | 1.4 |
| RHI | Robert Half Inc. | Industrials | Professional Services | 10/20/2023 | -2.6 | -2.0 | Miss/Miss | 76.65 | UNDERPERFORM | 1.6 |
| EFX | Equifax Inc. | Industrials | Professional Services | 10/18/2023 | -1.3 | -2.0 | Beat/Miss | 187.26 | UNDERPERFORM | 2.6 |
| WTW | Willis Towers Watson Public Limited Company | Financials | Insurance | 10/27/2023 | -0.4 | -0.7 | Miss/Beat | 208.46 | UNDERPERFORM | 0.3 |
| D | Dominion Energy Inc | Utilities | Multi-Utilities | 11/3/2023 | -0.5 | -1.5 | Miss/Miss | 42.59 | UNDERPERFORM | 0.8 |

**Source:** BofA US Equity & Quant Strategy, FactSet. Note: Closing prices and ratings as of close 10/10/23
This screen is not a recommended list either individually or as a group of stocks. Investors should consider the fundamentals of the companies and their own individual circumstances/objectives before making any investment decision.

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# S&P 500 companies reporting in Week 1-2

Below we list confirmed/tentative dates for S&P 500 companies reporting in the first two weeks of earnings.

**Exhibit 51: S&P 500 companies slated to report 3Q results in Week 1-2 (mega caps highlighted in blue)**
Week 1-2 schedule

| Report Date | Ticker | Company Name | Sector | Market Cap ($B) | Status | Week |
|---|---|---|---|---|---|---|
| 10/10/2023 | PEP | PEPSICO INC | Consumer Staples | 222 | Confirmed | 1 |
| 10/12/2023 | FAST | FASTENAL CO | Industrials | 32 | Confirmed | 1 |
| 10/12/2023 | DAL | DELTA AIR LINES INC | Industrials | 23 | Tentative | 1 |
| 10/12/2023 | WBA | WALGREENS BOOTS ALLIANCE INC | Consumer Staples | 19 | Confirmed | 1 |
| 10/12/2023 | DPZ | DOMINO'S PIZZA INC | Consumer Discretionary | 12 | Confirmed | 1 |
| 10/13/2023 | UNH | UNITEDHEALTH GROUP INC | Health Care | 488 | Confirmed | 1 |
| 10/13/2023 | JPM | JPMORGAN CHASE & CO | Financials | 421 | Confirmed | 1 |
| 10/13/2023 | WFC | WELLS FARGO & CO | Financials | 146 | Confirmed | 1 |
| 10/13/2023 | BLK | BLACKROCK INC | Financials | 97 | Confirmed | 1 |
| 10/13/2023 | PGR | PROGRESSIVE CORP | Financials | 84 | Confirmed | 1 |
| 10/13/2023 | C | CITIGROUP INC | Financials | 78 | Confirmed | 1 |
| 10/13/2023 | PNC | PNC FINANCIAL SERVICES GROUP | Financials | 48 | Confirmed | 1 |
| 10/16/2023 | SCHW | SCHWAB (CHARLES) CORP | Financials | 94 | Tentative | 2 |
| 10/17/2023 | JNJ | JOHNSON & JOHNSON | Health Care | 381 | Confirmed | 2 |
| 10/17/2023 | BAC | BANK OF AMERICA CORP | Financials | 209 | Confirmed | 2 |
| 10/17/2023 | LMT | LOCKHEED MARTIN CORP | Industrials | 110 | Tentative | 2 |
| 10/17/2023 | GS | GOLDMAN SACHS GROUP INC | Financials | 107 | Confirmed | 2 |
| 10/17/2023 | PLD | PROLOGIS INC | Real Estate | 101 | Confirmed | 2 |
| 10/17/2023 | BK | BANK OF NEW YORK MELLON CORP | Financials | 33 | Confirmed | 2 |
| 10/17/2023 | JBHT | HUNT (JB) TRANSPRT SVCS INC | Industrials | 20 | Confirmed | 2 |
| 10/17/2023 | UAL | UNITED AIRLINES HOLDINGS INC | Industrials | 13 | Confirmed | 2 |
| 10/18/2023 | TSLA | TESLA INC | Consumer Discretionary | 824 | Confirmed | 2 |
| 10/18/2023 | PG | PROCTER & GAMBLE CO/THE | Consumer Staples | 338 | Confirmed | 2 |
| 10/18/2023 | NFLX | NETFLIX INC | Communication Services | 171 | Confirmed | 2 |
| 10/18/2023 | ABT | ABBOTT LABORATORIES | Health Care | 168 | Confirmed | 2 |
| 10/18/2023 | MS | MORGAN STANLEY | Financials | 132 | Confirmed | 2 |
| 10/18/2023 | ELV | ELEVANCE HEALTH INC | Health Care | 107 | Confirmed | 2 |
| 10/18/2023 | LRCX | LAM RESEARCH CORP | Information Technology | 83 | Tentative | 2 |
| 10/18/2023 | USB | US BANCORP | Financials | 50 | Confirmed | 2 |
| 10/18/2023 | CCI | CROWN CASTLE INC | Real Estate | 40 | Confirmed | 2 |
| 10/18/2023 | TRV | TRAVELERS COS INC/THE | Financials | 37 | Confirmed | 2 |
| 10/18/2023 | PPG | PPG INDUSTRIES INC | Materials | 30 | Confirmed | 2 |
| 10/18/2023 | NDAQ | NASDAQ INC | Financials | 24 | Confirmed | 2 |
| 10/18/2023 | EFX | EQUIFAX INC | Industrials | 23 | Confirmed | 2 |
| 10/18/2023 | DFS | DISCOVER FINANCIAL SERVICES | Financials | 22 | Confirmed | 2 |
| 10/18/2023 | MTB | M & T BANK CORP | Financials | 21 | Confirmed | 2 |
| 10/18/2023 | STT | STATE STREET CORP | Financials | 21 | Confirmed | 2 |
| 10/18/2023 | STLD | STEEL DYNAMICS INC | Materials | 18 | Confirmed | 2 |
| 10/18/2023 | NTRS | NORTHERN TRUST CORP | Financials | 14 | Tentative | 2 |
| 10/18/2023 | CFG | CITIZENS FINANCIAL GROUP | Financials | 12 | Confirmed | 2 |
| 10/18/2023 | ZION | ZIONS BANCORP NA | Financials | 5 | Tentative | 2 |
| 10/19/2023 | PM | PHILIP MORRIS INTERNATIONAL | Consumer Staples | 143 | Confirmed | 2 |
| 10/19/2023 | UNP | UNION PACIFIC CORP | Industrials | 125 | Confirmed | 2 |
| 10/19/2023 | T | AT&T INC | Communication Services | 105 | Confirmed | 2 |
| 10/19/2023 | ISRG | INTUITIVE SURGICAL INC | Health Care | 103 | Tentative | 2 |
| 10/19/2023 | MMC | MARSH & MCLENNAN COS | Financials | 95 | Confirmed | 2 |
| 10/19/2023 | CSX | CSX CORP | Industrials | 62 | Confirmed | 2 |
| 10/19/2023 | FCX | FREEPORT-MCMORAN INC | Materials | 53 | Confirmed | 2 |
| 10/19/2023 | TFC | TRUIST FINANCIAL CORP | Financials | 37 | Confirmed | 2 |
| 10/19/2023 | GPC | GENUINE PARTS CO | Consumer Discretionary | 21 | Confirmed | 2 |
| 10/19/2023 | FITB | FIFTH THIRD BANCORP | Financials | 17 | Confirmed | 2 |
| 10/19/2023 | SNA | SNAP-ON INC | Industrials | 14 | Confirmed | 2 |
| 10/19/2023 | POOL | POOL CORP | Consumer Discretionary | 13 | Confirmed | 2 |
| 10/19/2023 | KEY | KEYCORP | Financials | 10 | Confirmed | 2 |
| 10/19/2023 | AAL | AMERICAN AIRLINES GROUP INC | Industrials | 8 | Tentative | 2 |
| 10/20/2023 | AXP | AMERICAN EXPRESS CO | Financials | 110 | Confirmed | 2 |
| 10/20/2023 | SLB | SCHLUMBERGER LTD | Energy | 83 | Confirmed | 2 |
| 10/20/2023 | RF | REGIONS FINANCIAL CORP | Financials | 15 | Confirmed | 2 |
| 10/20/2023 | HBAN | HUNTINGTON BANCSHARES INC | Financials | 15 | Confirmed | 2 |
| 10/20/2023 | IPG | INTERPUBLIC GROUP OF COS INC | Communication Services | 11 | Confirmed | 2 |
| 10/20/2023 | CMA | COMERICA INC | Financials | 5 | Tentative | 2 |

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

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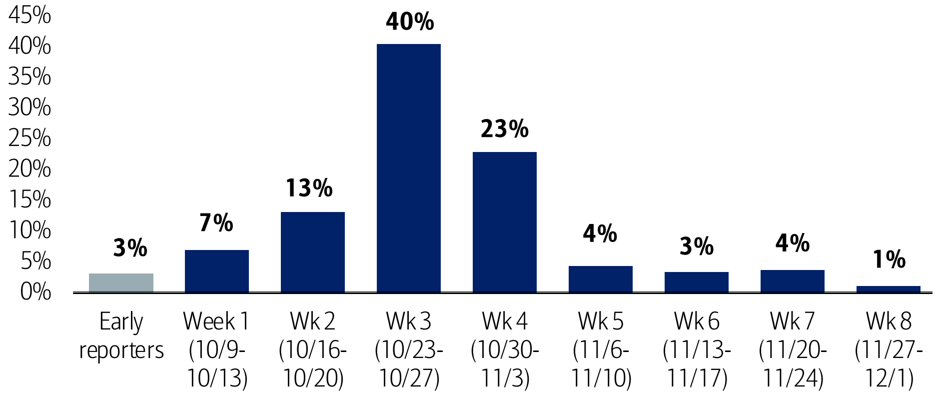
# 3Q23 Reporting by Week

**Exhibit 52: S&P 500 3Q23 Earnings Reporting by Week**
% of earnings by sector




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

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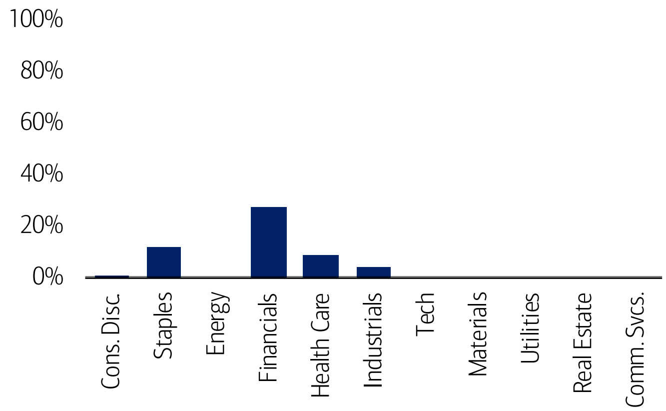
**Exhibit 53: Week 1: % 3Q earnings reported by sector**
% of earnings by sector




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

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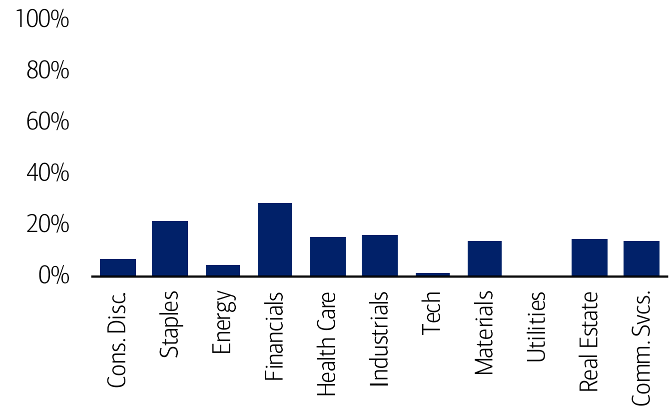
**Exhibit 54: Week 2: % 3Q earnings reported by sector**
% of earnings by sector




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

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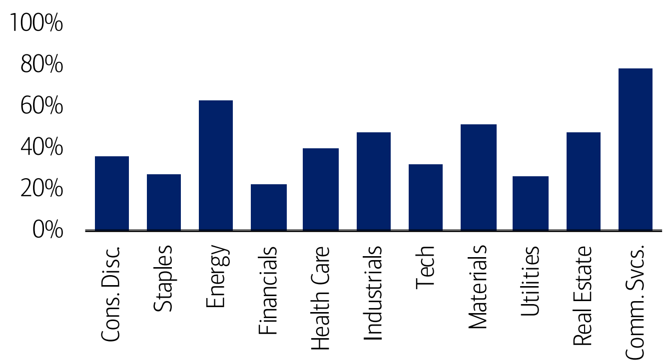
**Exhibit 55: Week 3: % 3Q earnings reported by sector**
% of earnings by sector




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

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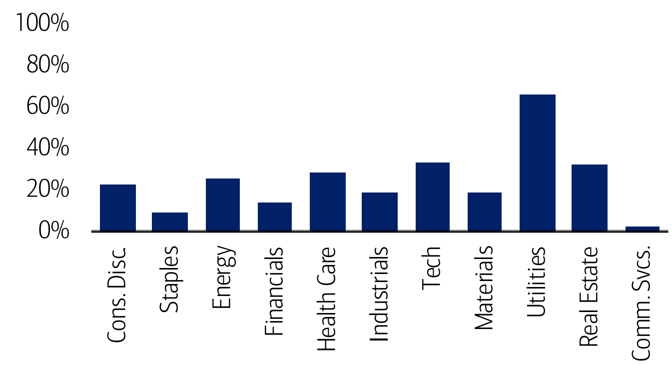
**Exhibit 56: Week 4: % 3Q earnings reported by sector**
% of earnings by sector




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

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# Heard on the 16th floor

## Communication Services

**On watch:** Ad growth, data demand, Hollywood strikes

***Justin Post, Online advertising*** – Comps ease in 3Q vs a difficult ad backdrop in 2022 and we expect as sector growth to accelerate. With consumer data points mixed into 4Q, and US budget uncertainty and International tension, we expect some caution in guidance, which could come in inline with street estimates.

***David Barden, Telecom*** – "Major wireless players have largely de-risked the 3Q print, foreshadowing subscriber, ARPU and FCF expectations during the pre-Q conference season. Rates are obviously in focus but we see 3Q setting up the sector for a stronger 2024."

***David Barden, Communication Infrastructure*** – "Results should once again offer proof that a secular imbalance between supply and demand is leading to an emerging period of rising data center pricing power. We foresee this imbalance only growing as AI-related demand unfolds in the coming years. Early tower outlooks for 2024 will likely prove muted."

**Jessica Reif Ehrlich, Media** – "Media earnings in 3Q will be pressured by shorter term factors including cyclical advertising headwinds and the writers/actors strikes (which hurts EBITDA/helps FCF) as well as secular challenges relating to linear subscribers/affiliate fees. Continued strength is likely across live entertainment/theme parks."

**Omar Dessouky, Gaming** – "BAC aggregated US credit and debit card data through August suggest avg. spend per US household on PC/Console Game software is flat-to-up slightly Y/Y. But the bar is low: post Q2, only two of the 36 mobile & PC/Console publishers raised their 2H23 revenue outlooks, despite unusually strong US retail sales data in August and upward revisions to 2023 economic outlooks by both the Federal Reserve and BofA Economists late in the summer. The implied Q4 revenue growth estimates (aggregate of PC/Console games) are flat Y/Y, suggesting the potential for upward revisions if 3Q results meet expectations (+6% Y/Y). Continued strength in consumer spending through the holidays should support at least mid-to-high single digits in Q4, consistent with PC/Console industry trend growth.

See the latest BofA on USA note for an explanation of the methodology, disclaimers and limitations with BAC card data.

## Consumer

**On watch:** consumption trend, easing food inflation, services spend

***Justin Post & Michael McGovern, Online Retail*** – "3Q appears to have started out strong in July, but spending strength may have faded during the quarter leading to results being more inline with outlooks. With mixed consumer data points (strong employment but also high gas prices and inflation), geopolitical uncertainty and a back-end weighted quarter, we would expect some caution in guidance."

***Robby Ohmes, Food and Discount Store Retail –*** "For 3Q23, we see slowing same-stores sales for conventional grocers (incl. KR, ACI and GO), discount stores (WMT, TGT) and warehouse clubs (COST and BJ) as food inflation continues to ease and given continued softness in general merchandise sales for the Broadline retailers. We think shoppers will continue to be hyper focused on value & affordability, which favors greater response to entry level price points (including lower price point, higher-margin private label items) as consumers are still adjusting to grocery prices that are up 25%+ vs. 2019."

***Robby Ohmes & Alex Perry, Leisure Brands & Retailers –*** "Sales trends could be more challenging in 3Q as strength during Back-to-School was likely offset by softening sales in lower volume "shoulder periods" as discretionary spend tightens and demand for high ticket purchases remains pressured."

***Bryan Spillane – Consumer Staples*** – "Overall we expect earnings to be in-line with our modestly ahead of expectations as companies have largely caught up to inflation. Investor focus will shift to the composition of organic sales growth as price increases anniversary and in many instance, volume are still soft. As such, "revenue quality" likely a more meaningful driver than earnings quality in 3Q."

***Liz Suzuki, Retailing-Hardlines –*** "Demand remains under pressure in discretionary categories, and even the more resilient non-discretionary consumer categories now face additional headwinds from higher gas prices and retail price disinflation. Cost mitigation to protect margins will be in focus."

***John Murphy, Autos –*** "Global auto production trended above expectations in 3Q. The UAW strike (which began Sept. 15) will add some small disruption for OEMs and suppliers, but suppliers' guidance for the quarter is likely conservative given the scope of the strike so far. Dealers are not expected to surprise in 3Q23, but auto pricing remains resilient and we expect the same for Dealers' earnings. The UAW and OEMs still have more progress to make in negotiations before a deal is made, and so we expect the impact from the strike will be more meaningful for the Auto sector in 4Q."

***Lorraine Hutchinson, Department Stores and Specialty Softlines –*** "A choppy back-to-school selling season and warmer Fall could mean inventories aren't as clean as expected; holiday outlooks will be the key datapoints for retail earnings this season."

***Sara Senatore, Restaurants –*** "In short order, the macro backdrop has turned materially less favorable for restaurants as "soft landing" gives way to "higher for longer" and stocks have reacted accordingly. Signs of a sharp slowdown in demand in September suggests comps are likely to come in light even as higher rates raise questions about the outlook for unit growth; we think any signs that demand (for both product and new units) is holding up better than feared will be met with a sigh of relief."

***Rafe Jadrosich, Homebuilders & Building Products –*** "New home demand likely trended in-line with normal seasonality in 3Q23 as a spike in mortgage rates pressured sales late in the quarter. Homebuilders continue to offer incentives to buyers, which is supporting demand relative to the resale market. Building product and renovation revenue slowed in 3Q due to weaker consumer spending and higher rates."

## Energy

**On watch:** Commodity prices, cash flow, capex

***Doug Leggate, US Oil & Gas –*** "The impact of 3Q23 earnings has been diminished by subsequent commodity volatility that now points to sequential earnings declines in 4Q and 2024 based on the current forward curve. Stock specific catalysts and rate of change in portfolio mix, including free cash growth from new projects and the continued transfer of value from debt to equity continue to bifurcate stock selection amongst US E&Ps. For refiners, we anticipate continued headwinds from declining earnings expectations albeit after one of the strongest 3Q earnings on record. Amongst sub-sectors we continue to view US natural gas equities with the momentum and line of sight towards changing dynamics of domestic natural gas markets to continue to reset market expectations of value for gas E&Ps.

***Saurabh Pant, Oil Services*** – "Int'l/Offshore with its multi-year growth runway still seems more attractive to us relative to North America (NAM), which is held back by the ample spare capacity (with more coming starting late-'24) in OPEC/Saudi hands and continuing NAM E&P capex discipline. However, increasingly fuller valuations in earlier cycle Int'l service stocks means later cycle Int'l/Offshore capital equipment stocks may have more relative upside over the next 12 months."

***Neel Mitra, Midstream*** – "After a weak 2Q23 for Permian players due to extreme weather and supply chain constraints, 3Q looks to be a repeat of 2Q with flattish hydrocarbon volumes. For now, investors are looking past quarterly weakness, as midstream companies are re-iterating full year guidance with a strong expected 4Q ramp to close out the year. But if 4Q growth fails to materialize, recurring growth forecasts could re-rate down, negatively impacting sector valuation."

## Financials

**On watch:** Funding cost pressure, net interest margin, consumer

***Ebrahim Poonawala, Banks*** **–** "Investors focused on the headwinds from higher for longer interest rates on growth (stalled), capital (rising MTM losses on bond books), net interest margins (continued pressure from rising funding costs) and credit quality deterioration (as customers begin to feel the impact from higher borrowing costs and weakening demand). In the short run, any pullback in UST yields could drive another bear market bounce on inline "better than feared" 3Q results."

***Jason Kupferberg, Payments*** **–** "We expect generally in-line results for 3Q and immaterial changes to '23 guidance, which for most of our companies can accommodate modest softening in consumer spending. September/October volume commentary will be closely watched."

***Craig Siegenthaler, Diversified Financials,*** "We expect mixed results from the diversified financials in 3Q23 given the sharp decline in equity and bond markets in the quarter. We forecast large EPS missed for the Traditional Asset Managers while we expect to see some improvements at the Alternative Asset Managers. Additionally, we believe cash sorting will re-emerge as a headwind at the Brokers while more focus on the future will be on organic growth." See preview reports for Traditional Asset Managers, Brokers and Exchanges.

## Health Care

**On watch:** China, utilization, GLP-1

***Kevin Fischbeck, Managed Care & HC Facilities/Hospitals:*** "MCO sentiment is starting to improve off lows, but trend concerns remain front and center. We expect a stable MLR/trend commentary and initial guidance for 2024 to be a couple of percent below consensus (over the past 12 years, MCOs have initially guided 2% below consensus, then beat that by 5%. We expect similar conservatism this year). With trend stable, and a reasonable, rebased 2024 outlook, MCOs should perform well into year-end as a de-risked sector.

For hospitals, slowing utilization and GLP1 concerns are weighing on the stocks, but we continue to expect EBITDA to move up, setting the stage for a rally."

***Derik De Bruin & Michael Ryskin, Life Sciences & Diagnostic Tools –*** "End-market conditions remain challenging (esp. China demand, de-stocking conditions), and companies will likely use 3Q earnings to talk-down expectations of a major recovery until 2H24."

***Michael Ryskin, Animal Health –*** "Animal Health markets remained sluggish during 3Q, and a lack of company-specific catalysts leaves limited avenues for near-term upside."

**Travis Steed, Medical Supplies & Devices –** "3Q fundamentals likely remain strong with utilization and China coming in at least as expected but there's also nothing to remove any valuation overhangs given GLP-1 uncertainty likely persists along with tough 1H24 comps and FX moving the wrong direction."

***Allen Lutz, Healthcare Technology & Distribution –*** "**Pharma Supply Chain**: Expect steady overall prescription drug volumes to drive in-line/outperformance for the pharma supply chain as a whole with benefits from GLP-1s flowing to drug distributors. **Dental**: Overall mixed results due to macro pressures and some China softness, complimenting slower PPE demand as well but offset by a focus on cost cuts."

## Industrials

**On watch:** New orders, China, de-stocking, fiscal stimulus, fuel costs

***Andrew Obin, Multi-Industrials –*** "We expect the scope of EPS beats to narrow and see limited upside to 2023 guidance ranges. However, orders could start to bottom given what looks like an industrial soft landing (at worse) into 2024." See Multi-Industrials preview report**.**

***Michael Feniger, Machinery, Engineering & Construction –*** "Stable, positive demand is likely in line with Q3 expectations. Management teams likely to remain cautious into 2024 given macro uncertainties (China, higher rates, inflation) and focus on inventory management. Key topic will be the project pipeline into 2024 - if tailwinds from fiscal stimulus and mega projects continue to offset tightening credit conditions."

***Ken Hoexter, Transportation –*** "Transport results for 3Q are expected to be soft given volume weakness lasted longer than expected (rails posted 32 consecutive weeks of negative volumes, truck shipper survey demand indicator remains below prior 4 freight recession levels), fuel costs increased faster than surcharges (though this gap is likely offset/caught up on in 4Q), and rising labor contract rates continue to pressure margins."

***Andrew Didora, Airlines –*** "The key focus points of airline earnings call should be (1) whether any soft industry pricing has crept into the premium leisure business; (2) any changes to capacity growth today given higher fuel costs; and (3) the 2024 unit cost trajectory given continued inflation and higher maintenance costs.)."

## Materials

**On watch:** Supply/demand, cost pressure, de-stocking, fiscal stimulus

***George Staphos, Paper & Packaging*** – "Earnings will remain pressured by oversupply in many paper/forest areas coupled with inventory destocking throughout our coverage. That said, indicators in corrugated box markets and some of our consumer packaging sectors are that sequential volume trends are flat/modestly up into 3Q. Comparisons are getting easier and trade contacts have stated their expectation that destocking is largely done by year-end. Wood/timber markets may face remaining headwinds related to higher interest rates."

***Lawson Winder, Metals & Mining –*** ""The miners (whether industrial or precious metal) are again facing the toxic combination of falling selling prices and upward pressure on input costs: margin commentary should be a focus. For the steel producers, pricing pressure on sheet is likely to be dismissed as they eye a sharp pricing recovery post the auto strike: the blast furnaces have the most auto end-market leverage (CLF and X)."

## Real Estate

**On watch:** Demand, pricing and access to capital markets

***Jeff Spector, Real Estate*** – "With US REITs underperforming the broader market on concerns over higher for longer, expectations for the sector are possibly at a low for the year. Therefore, we ask if REITs can at least meet and maintain this quarter demonstrating stable fundamentals, will that be good enough for the sector to bounce higher. Key topics include are we seeing normalization in demand and pricing power or are there issues emerging in short lease sectors, access to the capital markets and supply through 2024."

## Tech

**On watch:** AI, Order recovery, China, inventory levels

***Brad Sills, Software –*** "While macro pressure is not worsening, it is not easing either in the software channel. Sales cycle remain elongated and deal sizes are smaller than average. We expect the magnitude of topline beats to remain consistent with low recent levels. New AI offerings to launch in Q1 are likely to drive incremental growth as we move through CY24."

***Vivek Arya, Semis –*** "Tricky set-up heading into Q3 earnings as macro remains lukewarm (US slowdown, Europe turmoil, no China stimulus, higher rates), yet positive seasonals keep floor under chip stocks (Q4/Q1 two best quarters to own SOX, historically). We lower 2H23 YoY total/core (ex-memory) industry sales by 400bps to -11%/-8% YoY and now forecast CY24 total/core sales growth of +12%/+7%, lower than +15%/+11% prior."

***Tal Liani***, ***Networking*** – "Most vendors continue to support revenues by backlog drawdowns, yet the spending environment remains week. Service Providers are cutting spending, Cloud Titans absorb historical elevated orders and enterprises remain budget-conscious. Most vendors have implemented some sort of workforce cuts and the outlook might deteriorate in early 2024 if the order trends do not improve once the companies deplete their backlog. We therefore continue to flag risks to the 2024 consensus estimates of the networking sector, and believe this cautious stance is applicable to most equipment vendors in the space."

***Tal Liani, Cybersecurity*** – "Cybersecurity is one of the bright spots for spending in this market. We see stabilization of spending trends with budget scrutiny is slightly easing, supported by on-going cyber risks. We expect most vendors who offer SaaS based solutions to report a solid quarter and improving visibility. On the other hand, we believe vendors who offer appliance-based solutions still need to overcome current strong backlog drawdowns and weak order environment, although we expect the strong underlying demand to help orders recover in the near term."

## Utilities

**On watch:** Interest rates, balance sheet, supply chain, IRA

***Julien Dumoulin-Smith, Utilities, Power, & Clean Energy –*** "We remain cautious on long-term refreshes for the utilities coverage universe after the sharp increase in interest rates. Many companies have long-term guidance based on relatively stale cost of debt/interest rate assumptions which is a headwind. In clean energy, continue supply chain bottlenecks and the similar pressures from higher cost of capital are headwinds too."

# 2Q23 recap: the trough quarter

S&P 500 2Q23 EPS came in at $54.29 (-6% YoY), 2% above consensus EPS heading into the earnings season, in line with the historical average. The beat was led by Consumer Discretionary and Tech, while Health Care saw the biggest miss due to Merck's acquisition-related costs (a 2% beat excluding Merck). Energy and Utilities also missed. 70%/59%/48% beat on sales/EPS/both, better than the historical average of 58%/59%/40%.

**Exhibit 57: S&P 500 earnings were -4% y/y**
S&P 500 2Q earnings and sales growth by sector

| | Earnings | | Sales | |
|---|---|---|---|---|
| **Sector** | **YoY%** | **QoQ%** | **YoY%** | **QoQ%** |
| Consumer Disc. | 53.4% | 37.9% | 9.8% | 9.5% |
| Consumer Staples | 6.2% | 6.9% | 3.1% | 1.3% |
| Energy | (51.5%) | (24.1%) | (28.8%) | (3.4%) |
| Financials | 6.9% | (2.8%) | 11.2% | 1.6% |
| Health Care | (27.6%) | (16.8%) | 5.4% | 2.6% |
| Industrials | 13.5% | 26.7% | 4.2% | 5.5% |
| Technology | 3.8% | 4.7% | 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%) | (3.9%) | (19.3%) |
| **S&P 500** | **(4.2%)** | **6.4%** | **0.8%** | **2.1%** |
| **ex. Financials** | **(6.3%)** | **8.6%** | **(0.6%)** | **2.1%** |
| **ex. Energy** | **2.8%** | **9.3%** | **4.5%** | **2.6%** |
| **ex. Fins & Energy** | **1.8%** | **12.6%** | **3.5%** | **2.7%** |

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

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**Exhibit 58: % of S&P 500 companies beating consensus expectations on 2Q23 EPS and sales**
Results from companies that have reported 2Q earnings

| **Sector** | **Total companies** | **Number Reported** | **% with EPS beat** | **% with Sales beat** | **% EPS & Sales beat** |
|---|---|---|---|---|---|
| Cons. Disc. | 53 | 53 | 85% | 64% | 57% |
| Cons. Staples | 37 | 37 | 76% | 46% | 43% |
| Energy | 23 | 23 | 35% | 26% | 9% |
| Financials | 72 | 72 | 58% | 63% | 42% |
| Health Care | 65 | 65 | 80% | 83% | 72% |
| Industrials | 75 | 75 | 73% | 67% | 57% |
| Tech | 65 | 65 | 86% | 71% | 68% |
| Materials | 29 | 29 | 59% | 17% | 14% |
| Real Estate | 31 | 31 | 65% | 68% | 42% |
| Comm. Svcs. | 20 | 20 | 70% | 40% | 40% |
| Utilities | 30 | 30 | 37% | 33% | 17% |
| **S&P 500** | **500** | **500** | **70%** | **59%** | **48%** |
| **ex. Financials** | **428** | **428** | **71%** | **59%** | **50%** |

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

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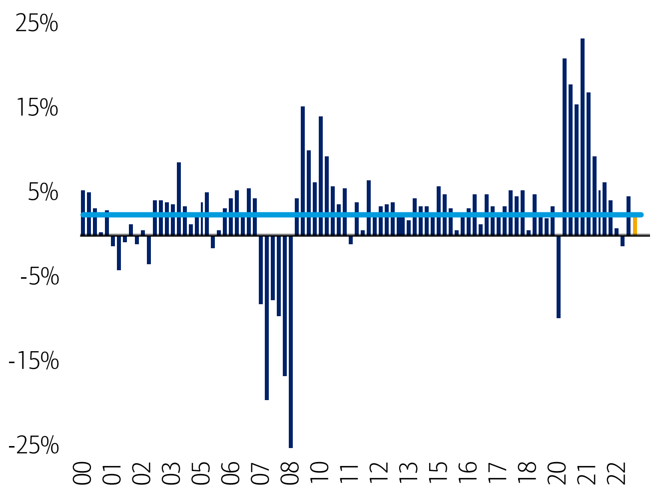
**Exhibit 59: EPS beat by 2%**
S&P 500 EPS beat vs. consensus estimate at start of the qtr., 1Q00-2Q23




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

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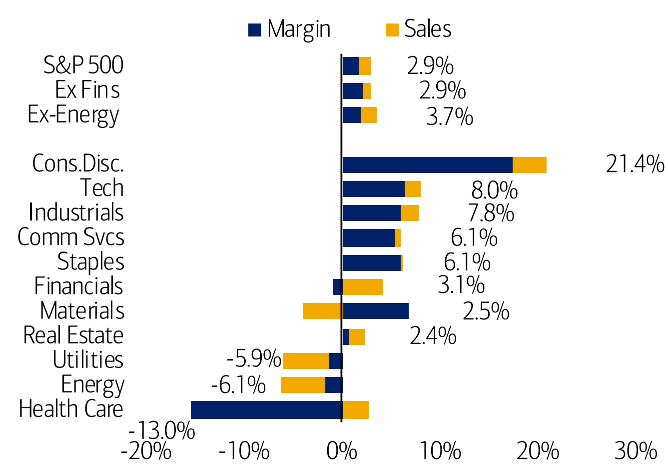
**Exhibit 60: Margins did the work in 1Q**
S&P 500 2Q23 earnings beat by sector, decomposed into sales vs. margin beat




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

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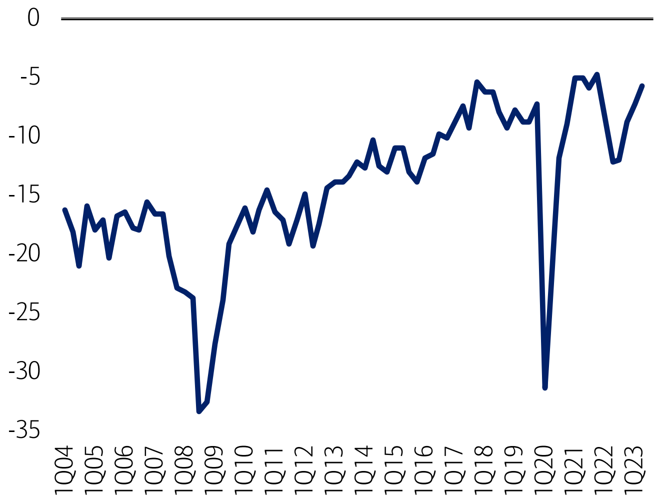
## Corporate sentiment is improving

BofA's Predictive Analytics team helped analyze earnings transcripts using Loughran McDonald's financial dictionary to calculate sentiment scores (see Appendix for full methodology). Corporate sentiment improved again in 2Q for the second straight month. The YoY change in corporate sentiment has been highly correlated with quarterly EPS YoY with a one quarter lead, pointing to a potential earnings recovery ahead.

**Exhibit 61: Corporate sentiment further improved in 2Q...**
Avg. negative sentiment score for S&P 500 companies (2004-2Q23)




**Source:** BofA Global Research, FactSet

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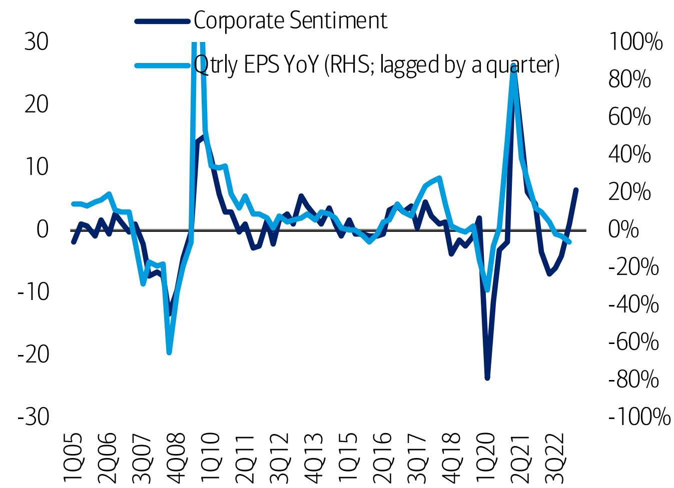
**Exhibit 62: ...pointing to a potential earnings recovery ahead**
S&P 500 avg. negative sentiment score YoY vs. quarterly EPS YoY with a quarter lag (r-sq=50%; 1Q05-2Q23)




**Source:** BofA Global Research, FactSet

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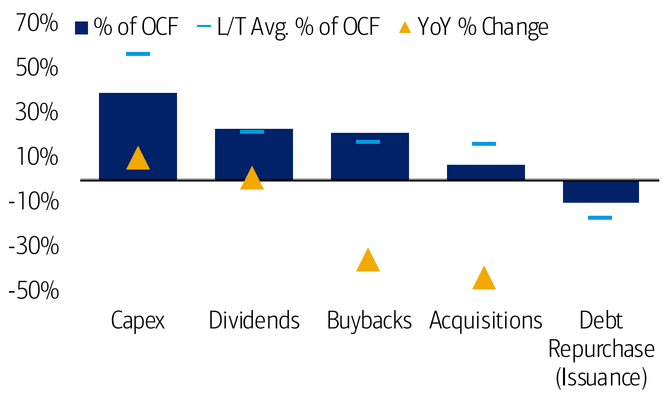
## How did companies spend their cash in 2Q?

**Exhibit 63: Capex increased YoY the most, while buybacks notably slowed**
2Q23 use of OCF vs. long-term avg. and YoY % change




Note: long-term average % of OCF is since 1986; Debt issuance +256% y/y
**Source:** FactSet, BofA US Equity & Quant Strategy

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### Capex rises the most, buybacks fall

Capex rose 9% YoY, the biggest increase of cash use categories. But as % of operating cash flow (OCF), capex remained just 39% vs. the historical average of 57%, indicating there is more room for companies to increase capex.

Buybacks notably slowed again in 2Q, down 35% YoY, marking the third straight quarter of decline (-27% YoY in 1Q). We expect buybacks to slow going forward amid rising financing costs.

## Capex: cyclical headwind vs. secular tailwind

Despite macro uncertainty, capex spending has remained relatively resilient at +9% YoY in 2Q (down from +14% in 4Q), marking the ninth straight quarter of capex growth. The past 10+ years of underinvestment in US manufacturing and accelerating re-shoring efforts are secular bull case for a robust capex cycle. Our capex guidance ratio also remains generally positive at 1.34x (vs. historical average 1.39x) despite macro challenges. However, capex is typically pro-cyclical, and the Business Roundtable CEO Survey on capex outlook, which has led actual capex by six months with a 75% correlation, remains weak suggesting some moderation ahead.

**Exhibit 64: Capex +9% YoY in 2Q**
S&P 500 2Q23 capex growth by sector

| Sector | Aggregate YoY | Contribution to Agg. chg, |
|---|---|---|
| Consumer Discretionary | -4% | -7% |
| Consumer Staples | 14% | 11% |
| Energy | 35% | 35% |
| Financials | 6% | 4% |
| Health Care | 9% | 6% |
| Industrials | 16% | 14% |
| Information Technology | 3% | 4% |
| Materials | 20% | 8% |
| Real Estate | 8% | 1% |
| Communication Services | -7% | -13% |
| Utilities | 23% | 36% |
| S&P 500 | 9% | |

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

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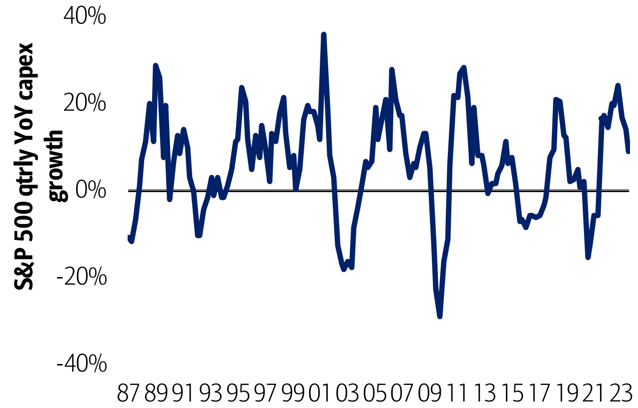
**Exhibit 65: Capex growth moderated, but remains strong**
S&P 500 quarterly YoY capex growth, 1987-2Q23




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

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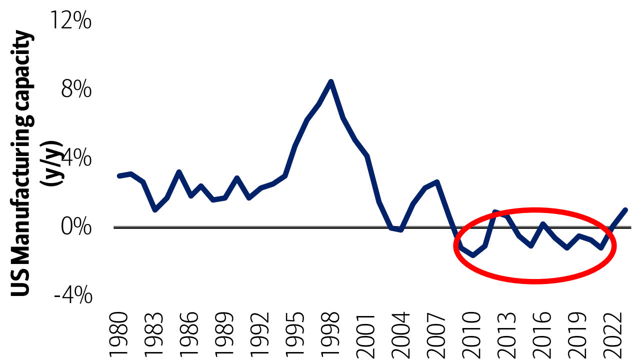
**Exhibit 66: Coming out of 10+ years of underinvestment in US manufacturing**
US manufacturing capacity YoY (1980-8/2023)




**Source:** Federal Reserve, BofA Global Research

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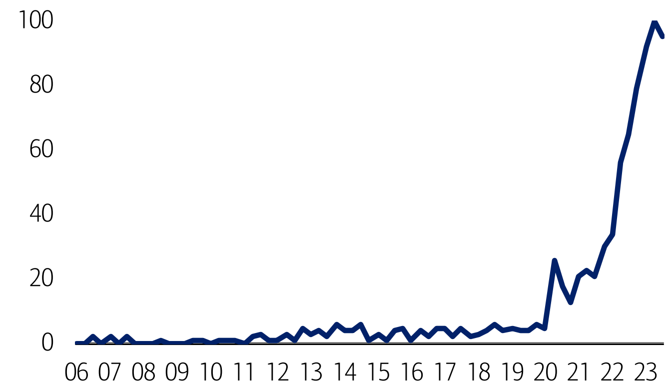
**Exhibit 67: Mentions of re-shoring skyrocketed over past year**
Companies mentions of re-/near-/on-shoring (100=max; 2006-9/23)




**Source:** AlphaSense, BofA Global Research

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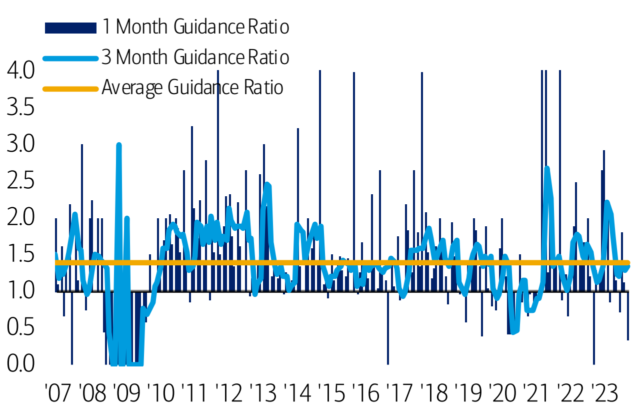
**Exhibit 68: Still more above-consensus capex guides than below**
S&P 500 capex guidance ratio (2007-9/23)




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

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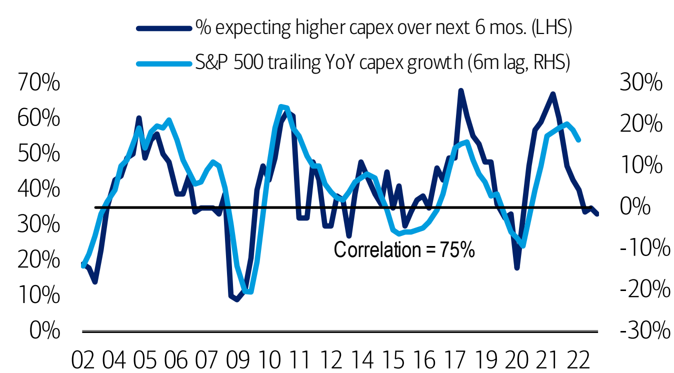
**Exhibit 69: Risk: fewer CEOs expect higher capex over the next six months**
Business Roundtable CEO Survey: % expecting higher capex over the next 6 mos. vs. S&P 500 TTM YoY capex with a 6-mo lag (4Q02-2Q23)




**Source:** Haver Analytics, FactSet, BofA US Equity & Quant Strategy

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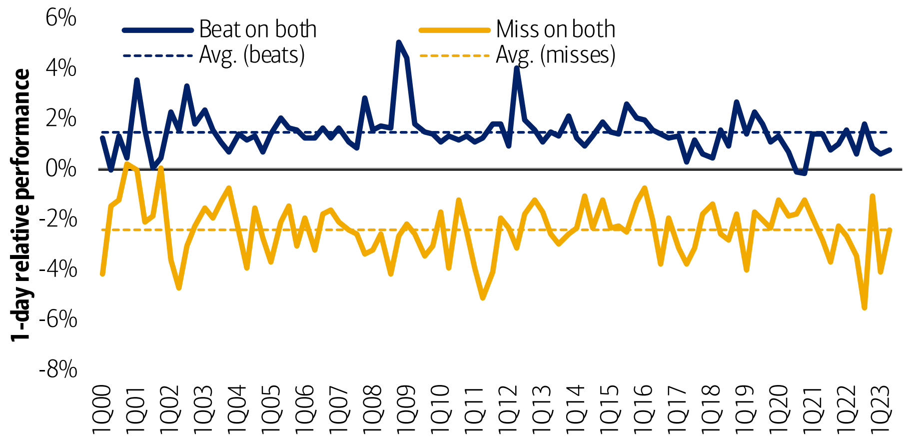
## Stock reactions were skewed to the downside

Post-result reactions were skewed to the downside in 2Q. Companies that beat on both sales and EPS outperformed the S&P 500 by just 80bps the next day (vs. +148bps historical average), while companies that missed underperformed by 238bps (vs. -241bps historical average).

**Exhibit 70: Smaller reaction to beats, but bigger average reactions to misses**
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 71: Relative 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 | -1.9% | -1.4% | -0.3% | 0.3% |
| EPS In-Line | -1.5% | -1.3% | -2.2% | -2.1% |
| Sales Beat | 0.4% | 0.5% | 1.0% | 1.0% |
| Sales Miss | -1.6% | -1.3% | -1.2% | -1.0% |
| Sales In-Line | -2.6% | -1.9% | -3.4% | -2.3% |
| Both Beat | 0.8% | 0.8% | 1.0% | 0.9% |
| Both Miss | -2.4% | -1.8% | -1.5% | -0.8% |

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

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**Exhibit 72: Relative performance by sector vs. S&P 500**
2Q23 earnings reactions based on surprise by sector

| | 1 day after reporting | | 5 days after reporting | |
|---|---|---|---|---|
| Sector | Beat on both | Missed on both | Beat on both | Missed on both |
| Consumer Discretionary | -0.2% | -0.1% | 0.1% | 0.2% |
| Consumer Staples | -0.9% | -4.1% | -1.2% | -5.5% |
| Energy | 1.0% | -0.2% | 4.3% | 2.1% |
| Financials | 1.2% | -1.2% | 1.8% | 0.4% |
| Health Care | 1.6% | -5.6% | 1.0% | -6.9% |
| Industrials | 1.1% | -1.1% | 1.3% | -1.9% |
| Information Technology | 0.4% | -15.6% | 0.6% | -13.9% |
| 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% | -1.1% | 0.3% | -1.1% |
| S&P 500 | 0.8% | -2.4% | 0.8% | -1.8% |

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

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# SMID cap 3Q23 earnings preview

## Small caps

- Analysts expect small cap earnings growth to improve in 3Q to -13% YoY (from -25% YoY last quarter) with ex-Financials earnings -25% YoY (-30% YoY last quarter). The median small cap is slated to see earnings -14% YoY (vs -14% YoY last quarter).
- Comm. Svcs. and Health Care are slated to see the biggest YoY earnings declines.
- Sales are expected to fall 4% YoY but median sales YoY are expected to grow 1%.
- 63% of earlier reporters beat on EPS, 38% on sales and 12% on both, worse than this time last quarter and worse than surprises for large caps so far.

**Exhibit 73: Small cap 3Q23 growth expectations and proportion of beats so far**
S&P 600 consensus 3Q23 earnings and sales growth and % positive surprises

| Sector | Total Companies | Number Reported | Earnings YoY% | Median earnings YoY% | Sales YoY% | Median sales YoY% | % With EPS Beat | % With Sales Beat | Both Beat % |
|---|---|---|---|---|---|---|---|---|---|
| Comm Svcs | 23 | 1 | -68.1% | -42.6% | -8.9% | -3.8% | 0% | 0% | 0% |
| Cons. Disc. | 83 | 0 | -23.6% | -18.5% | -2.9% | -1.3% | N.A. | N.A. | N.A. |
| Cons. Staples | 30 | 5 | -20.3% | 13.1% | -1.7% | 1.9% | 0% | 0% | 0% |
| Energy | 28 | 0 | -7.7% | -1.0% | -15.9% | 1.3% | N.A. | N.A. | N.A. |
| Financials | 120 | 4 | 39.7% | -13.9% | 5.0% | 3.7% | N.A. | N.A. | 0% |
| Health Care | 68 | 1 | -58.1% | -19.7% | -1.8% | 3.9% | N.A. | N.A. | 0% |
| Industrials | 95 | 6 | -26.8% | -12.4% | -3.1% | 0.9% | 100% | 50% | 33% |
| Technology | 64 | 1 | -22.2% | -14.8% | -4.6% | -2.2% | 100% | 100% | 100% |
| Materials | 30 | 2 | -16.8% | -7.4% | -3.3% | -3.2% | 0% | 0% | 0% |
| Real Estate | 51 | 6 | -22.7% | -33.6% | -5.1% | -0.8% | N.A. | N.A. | 0% |
| Utilities | 9 | 0 | -3.4% | 13.6% | 0.5% | 6.2% | N.A. | N.A. | N.A. |
| **S&P 600** | **601** | **26** | **-12.6%** | **-13.9%** | **-4.1%** | **0.8%** | **63%** | **38%** | **12%** |
| Ex-Financials | 481 | 22 | -24.9% | -13.9% | -4.9% | 0.5% | 63% | 38% | 14% |
| Ex-Energy | 573 | 26 | -13.1% | -14.4% | -2.6% | 0.8% | 63% | 38% | 12% |
| Ex-Energy&Financials | 453 | 22 | -27.1% | -14.9% | -3.4% | 0.5% | 63% | 38% | 14% |

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

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## Mid caps

- Mid cap earnings are expected to be -15% YoY in 3Q (-5% for the median company), also a continued improvement vs the prior quarter.
- Comm. Svcs. and Energy are slated to see the biggest YoY earnings declines while Staples and Financials are slated to see positive growth.
- Sales are expected to be -3% YoY (+3% for the median company).

**Exhibit 74: Mid cap 3Q23 growth expectations and proportion of beats so far**
S&P 400 consensus 3Q23 earnings and sales growth and % positive surprises

| Sector | Total Companies | Number Reported | Earnings YoY% | Median earnings YoY% | Sales YoY% | Median sales YoY% | % With EPS Beat | % With Sales Beat | Both Beat % |
|---|---|---|---|---|---|---|---|---|---|
| Comm Svcs | 9 | 0 | -47.4% | -3.1% | -1.6% | 0.2% | N.A. | N.A. | N.A. |
| Cons. Disc. | 64 | 3 | -19.7% | -8.6% | -0.6% | 0.5% | 100% | 100% | 67% |
| Cons. Staples | 17 | 1 | 19.2% | 3.0% | 3.5% | 4.9% | N.A. | N.A. | 0% |
| Energy | 20 | 0 | -39.6% | -33.8% | -24.6% | -11.2% | N.A. | N.A. | N.A. |
| Financials | 62 | 3 | 2.9% | -6.4% | 4.8% | 2.1% | 0% | 0% | 0% |
| Health Care | 37 | 0 | -1.2% | -3.2% | 6.9% | 8.5% | N.A. | N.A. | N.A. |
| Industrials | 75 | 2 | -8.6% | 3.7% | -0.5% | 3.4% | 50% | 0% | 0% |
| Technology | 43 | 2 | -27.7% | -10.5% | -7.0% | -2.4% | 100% | 0% | 0% |
| Materials | 28 | 3 | -21.3% | -7.9% | -8.6% | -9.4% | 100% | 50% | 33% |
| Real Estate | 30 | 0 | -26.9% | -20.9% | 34.7% | 4.6% | N.A. | N.A. | N.A. |
| Utilities | 16 | 1 | -0.1% | -1.2% | -1.5% | -0.2% | N.A. | N.A. | 0% |
| **S&P 400** | **401** | **15** | **-14.8%** | **-4.6%** | **-2.5%** | **2.5%** | **78%** | **33%** | **20%** |
| Ex-Financials | 339 | 12 | -18.8% | -4.3% | -3.3% | 2.7% | 88% | 38% | 25% |
| Ex-Energy | 381 | 15 | -11.3% | -4.2% | -0.4% | 2.7% | 78% | 33% | 20% |
| Ex-Energy&Financials | 319 | 12 | -15.1% | -3.1% | -1.0% | 2.9% | 88% | 38% | 25% |

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

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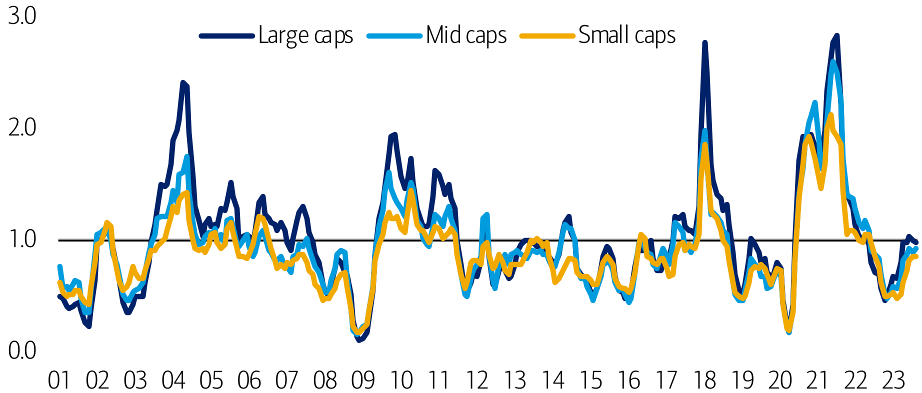
## Guidance improvements in small & large; mid tepid

- Earnings revision trends have improved since June across the board, but the revision ratio is still below 1.0 (more cuts than raises to estimates) in all three size segments (and weakest in small caps).
- For small caps, the 3-month ratio of above- vs. below-consensus guidance improved in June to 1.05 from 0.8 (above the long-term average of 0.9x); it bottomed at 0.4x during COVID and 0.2x during the GFC.
- Mid caps' guidance ratio fell to 0.7x from 0.8x last quarter (below the long-term average of 0.9x); the large cap guidance ratio improved from the last quarter to 1.2x (above the long-term average of 0.8x).

**Exhibit 75: Revision trends improved from lows across the board; trends weakest for small caps**
3m earnings revision ratio (ERR) for S&P small, mid and large cap indices as of 9/30/2023




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

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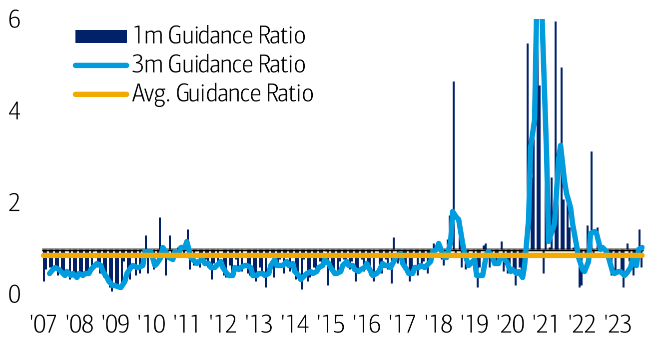
**Exhibit 76: Small cap earnings guidance is above average on a 3m basis**
S&P 600 management guidance ratio (# above- vs. below-consensus) as of 9/30/23




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

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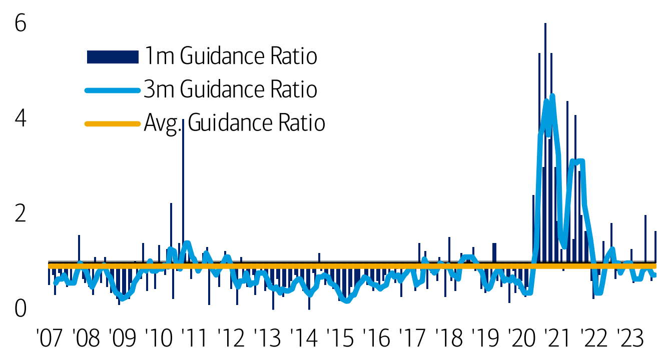
**Exhibit 77: Mid cap earnings guidance is slightly below average on a 3m basis**
S&P 400 management guidance ratio (# above- vs. below-consensus) as of 9/30/23




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

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# SMID caps: 2Q23 recap

- Small cap 2Q earnings were -24% YoY with sales -6% YoY. 34% of co's beat on EPS and sales, led by Tech and Industrials.
- Mid cap earnings were -22% YoY with sales -4% YoY. 38% of companies beat on EPS and sales, with the most beats in Health Care.

**Exhibit 78: Small cap 2Q23 growth expectations and proportion of beats**
S&P 600 consensus 2Q23 earnings and sales growth and % positive surprises

| Sector | Total Companies | Number Reported | Earnings YoY% | Median earnings YoY% | Sales YoY% | Median sales YoY% | % With EPS Beat | % With Sales Beat | Both Beat % |
|---|---|---|---|---|---|---|---|---|---|
| Comm Svcs | 21 | 21 | 45.0% | -17.2% | -10.5% | -2.0% | 76% | 38% | 33% |
| Cons. Disc. | 80 | 80 | -25.9% | -19.6% | -4.0% | -0.6% | 75% | 49% | 44% |
| Cons. Staples | 30 | 30 | 3.4% | 25.9% | 0.8% | 2.3% | 68% | 48% | 27% |
| Energy | 28 | 28 | -27.7% | -15.4% | -25.7% | -1.9% | 25% | 39% | 21% |
| Financials | 115 | 115 | -2.2% | -6.3% | 1.3% | 1.6% | 50% | 29% | 19% |
| Health Care | 74 | 73 | -335.1% | 0.0% | 2.0% | 6.4% | 58% | 61% | 40% |
| Industrials | 92 | 92 | -13.9% | -5.4% | -2.2% | 2.1% | 66% | 56% | 46% |
| Technology | 65 | 65 | -18.9% | -13.0% | -3.5% | -0.9% | 72% | 54% | 48% |
| Materials | 31 | 31 | -35.3% | -19.0% | -5.8% | -1.6% | 70% | 30% | 26% |
| Real Estate | 52 | 52 | -157.8% | -50.0% | -8.5% | 3.5% | 33% | 70% | 21% |
| Utilities | 9 | 9 | 7.1% | -4.9% | 0.9% | 4.6% | 44% | 56% | 33% |
| **S&P 600** | **597** | **596** | **-24.2%** | **-9.7%** | **-5.6%** | **1.9%** | **60%** | **48%** | **34%** |
| Ex-Financials | 482 | 481 | -30.0% | -11.1% | -6.2% | 1.9% | 62% | 52% | 37% |
| Ex-Energy | 408 | 407 | -23.8% | -9.5% | -2.9% | 1.9% | 61% | 48% | 48% |
| Ex-Energy&Financials | 316 | 315 | -30.3% | -11.0% | -3.3% | 1.9% | 64% | 53% | 55% |

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

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**Exhibit 79: Mid cap 2Q23 growth expectations and proportion of beats**
S&P 400 consensus 2Q23 earnings and sales growth and % positive surprises

| Sector | Total Companies | Number Reported | Earnings YoY% | Median earnings YoY% | Sales YoY% | Median sales YoY% | % With EPS Beat | % With Sales Beat | Both Beat % |
|---|---|---|---|---|---|---|---|---|---|
| Comm Svcs | 10 | 10 | -34.2% | -17.7% | 2.8% | 3.0% | 40% | 50% | 20% |
| Cons. Disc. | 64 | 64 | -37.3% | -4.2% | 0.5% | 2.9% | 73% | 62% | 56% |
| Cons. Staples | 18 | 18 | 10.0% | 9.7% | 1.4% | 4.1% | 71% | 35% | 28% |
| Energy | 16 | 16 | -64.3% | -56.3% | -32.7% | -14.6% | 31% | 44% | 13% |
| Financials | 59 | 59 | 2.4% | 0.0% | 9.2% | 7.8% | 52% | 40% | 25% |
| Health Care | 40 | 40 | 15.5% | 11.4% | 8.0% | 11.3% | 78% | 73% | 65% |
| Industrials | 75 | 75 | 2.9% | 9.7% | -0.8% | 4.2% | 73% | 43% | 37% |
| Technology | 42 | 42 | -8.9% | 1.0% | -1.9% | 2.0% | 81% | 69% | 62% |
| Materials | 29 | 29 | -39.7% | -22.9% | -15.0% | -12.4% | 39% | 14% | 10% |
| Real Estate | 29 | 29 | -61.6% | -27.4% | 0.8% | 4.7% | 34% | 62% | 24% |
| Utilities | 16 | 16 | -8.5% | -1.7% | -6.8% | -5.6% | 38% | 38% | 19% |
| **S&P 400** | **398** | **398** | **-21.7%** | **-1.7%** | **-3.5%** | **3.3%** | **62%** | **50%** | **38%** |
| Ex-Financials | 339 | 339 | -26.9% | -2.7% | -4.6% | 2.7% | 64% | 52% | 41% |
| Ex-Energy | 382 | 382 | -16.5% | -1.0% | -0.9% | 3.5% | 63% | 51% | 40% |
| Ex-Energy&Financials | 323 | 323 | -21.2% | -1.8% | -1.9% | 3.0% | 65% | 53% | 42% |

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

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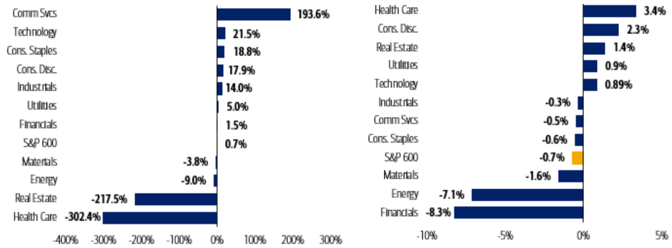
**Exhibit 80: Magnitude of 2Q23 EPS & sales surprise: small caps**
S&P 600 earnings beat (left) and sales beat (right) vs. consensus on 8/1/23




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

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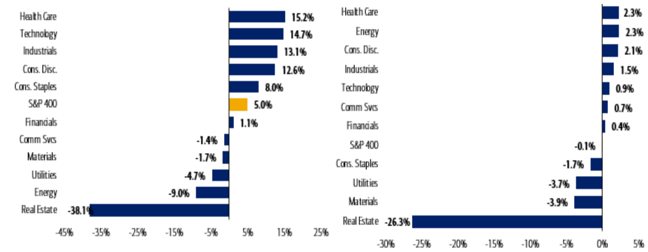
**Exhibit 81: Magnitude of 2Q23 EPS & sales surprise: mid caps**
S&P 400 earnings beat (left) and sales beat (right) vs. consensus on 5/1/23




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

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# Methodology

## Guidance Ratios

**Earnings guidance:** We track the number of instances of above- vs. below-consensus management guidance for earnings over the last three months for S&P 500 companies. If a company issues changes to its outlook more than once in a one-month period, we incorporate all instances of guidance into our aggregate number. The ratio also includes all instances of above- or below-consensus earnings guidance issued by a company (for example, if they issue both quarterly and annual guidance). The one-month and three-month revision ratios are calculated as they are for estimate revision ratios. The data source is Bloomberg. For companies that provide both GAAP and Operating guidance, or for REITs that provide both EPS and FFO guidance, we remove one data point if both data points provide the same guidance direction, otherwise both data points are used.

**Capex guidance:** We track the number of instances of above- vs. below-consensus management guidance for planned capex over the last three months for S&P 500 companies, calculated the same way as above; data source is FactSet.

## Methodology: Earnings Calls Sentiment

With the help of BofA's Predictive Analytics team, we parsed through earnings calls transcripts to calculate sentiment for the S&P500 universe of companies that have reported since 31st March 2020. We use the Loughran McDonald's financial dictionary to calculate sentiment scores as per the definition below.

Sentiment score = No. of Unique positive words – No. of unique negative and uncertainty words

The sentiment score is computed with three different filters: the full transcript, management discussion and answers of CEO/CFO from Q/A section. Calculated scores were then averaged on the Sector level. Loughran-McDonald Sentiment and Uncertainty:

1. **Loughran-McDonald Sentiment:** Examples of positive words include ***accomplish, achieve, outperform, stabilize, strength*** and negative words such as ***abandon, abnormal, downturn, evade, failing, stagnate.*** In total, the lexicon has 2,355 negative words and 354 positive words.

2. **Loughran-McDonald Uncertainty**: Examples of uncertain words include ***almost, ambiguity, hidden, fluctuate, doubts, unclear.*** In total, the lexicon has 297 words.

Note that the charts show the sentiment score multiplied by (- 1) and after applying the natural log to normalize the data on the same scale. Our Predictive Analytics team is currently researching more advance modeling approaches including Deep Learning so please stay tuned for future enhancements.

## BofA Corporate Misery Indicator methodology

The Corporate Misery Indicator is our macro-based predictor of the profits cycle and is based on the CPI, Average Hourly Earnings, and the Coincident Indicators. Our theory is that corporate profits are a function of how many units a company sells and their margin per unit. Implicitly, these factors incorporate productivity because enhanced productivity will result in either better margins or more units sold for the same inputs.

We use the YoY change in the Coincident Indicators as a proxy for units, because the Coincident Indicators are a proxy for Real GDP, a measure of unit growth. We use the spread between the YoY change in the CPI and the YoY change in Average Hourly Earnings to approximate margins. When the indicator declines, it implies that profits are being squeezed. This has historically coincided with a decelerating profits cycle.

***Corporate Misery Indicator*** *= CPI (YoY) – Average Hourly Earnings (YoY) + Coincident Indicators (YoY).*

# Disclosures

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster[R1] |
|---|---|---|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

[R1] Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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