Earnings Tracker

# 3Q Preview: get ready for negative EPS growth

Bank of America Merrill Lynch

07 October 2019

## 2Q recap: Buybacks came to the rescue

The S&P 500 once again avoided an EPS decline in 2Q, growing +1% YoY vs. consensus expectations of a 2% decline heading into the quarter. But this was the weakest EPS growth since the 2015-16 earnings recession, and excluding buyback benefits, earnings were -0.6% YoY, marking the first decline since 2Q16. Health Care posted the highest proportion of EPS and sales beats (66%) for the third straight quarter, while only 7% of Materials' earnings topped estimates, the lowest for the sector since 4Q15.

## 3Q19: Third time's the charm – EPS decline in the cards

We forecast $41.75 for 3Q EPS, a 1% beat vs. analysts' $41.29 estimate, and a 2% YoY EPS decline. Analysts expected declines for the past two quarters that failed to materialize, but the further slowdown in macro data could lead to the first EPS decline since the 2015-16 EPS recession. Analysts have trimmed consensus EPS by 4% since July (above the typical 3% pre-season cut), with the biggest cuts in commodity sectors (Energy -17%, Materials -10%). Discretionary (-6%) was hit by softness in recent data, while Industrials (-4%) also saw bigger estimate cuts than the overall S&P 500.

## Brace for weak guidance

4Q-2020 consensus numbers still look too high to us: consensus currently expects +3% YoY EPS growth for 4Q and +10% EPS growth for 2020, which we think are overly optimistic given macro data. Another risk: EPS declines are like cockroaches: rarely a one-quarter event. Consensus expectations imply that 3Q will be the sole YoY EPS decline before bouncing back in 4Q. But this is unlikely: only one quarter in the history of the S&P 500 saw EPS decline without subsequent quarterly declines (4Q 1953).

## …or for no guidance at all

3Q19 saw the fewest instances of 3Q guidance since 2000 (Chart 22). The information vacuum may continue. Historically, 7% of S&P companies have provided FY2 guidance during the 3Q earnings season (Chart 23), but we think that number could be significantly lower as trade and macro uncertainty continues. Companies' lack of visibility into next year, with just three months left in 2019, will likely create more uncertainty among investors and may result in lower 2020 estimates, in our view.

## Business spending is swing factor for EPS: -20% to +7%

Capex has been and is likely to remain anemic (S&P 500 capex grew just +2% YoY in 2Q). Macro surveys imply trailing 12m capex growth could slow to +3% YoY on average over the next 6-12 months from the current rate of +8%. Capex has been a big driver of earnings growth since 2011 (58% R-sq) and matters far more than consumption. If capex decelerates to 2015-16 manufacturing recession levels, 2020 earnings could dip as low as $164 (-10% vs. consensus) based on the historical relationship. If we see an '08-09 decline in capex, '20 earnings could drop as much as 20% vs. consensus. But if we see a capex recovery similar to '18, upside risk is significant: +7% vs. consensus.

## Same story: large, domestic/defensive sectors screen best

Growth / guidance have remained better up the cap spectrum, supporting large over small caps; small caps are already in, and should remain in, an earnings recession. Within the S&P 500, Health Care & Real Estate screen as most likely to beat, while Energy screens weakest, like last quarter. We include screens of stocks most likely to beat/miss, and those neglected / crowded by active funds which could have further room to move.



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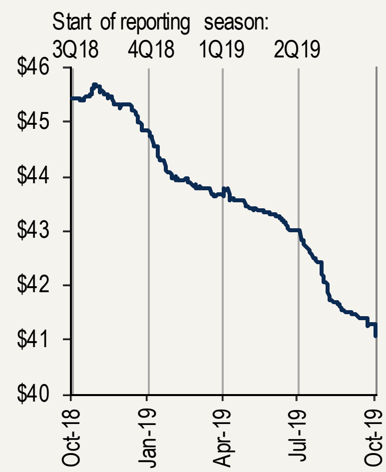
**Chart 1: Revision to bottom-up consensus S&P 500 3Q19 EPS**




Source: FactSet, BofAML US Equity & US Quant Strategy

**Table 1: S&P 500 qtrly EPS forecasts**

| | Btm-up analysts | YoY | BofAML Strategy | YoY |
|---|---|---|---|---|
| 1Q19 | 39.15 | 3% | 39.15 | 3% |
| 2Q19 | 41.31 | 1% | 41.31 | 1% |
| 3Q19E | 41.29 | -3% | 41.75 | -2% |
| 4Q19E | 42.56 | 3% | 41.79 | 1% |
| **2019** | **164.31** | **1%** | **164.00** | **1%** |

Note: Btm-up analysts based on First Call consensus
Source: BofAML US Equity & Quant Strategy, FactSet/First Call

# 2Q19 earnings wrap-up

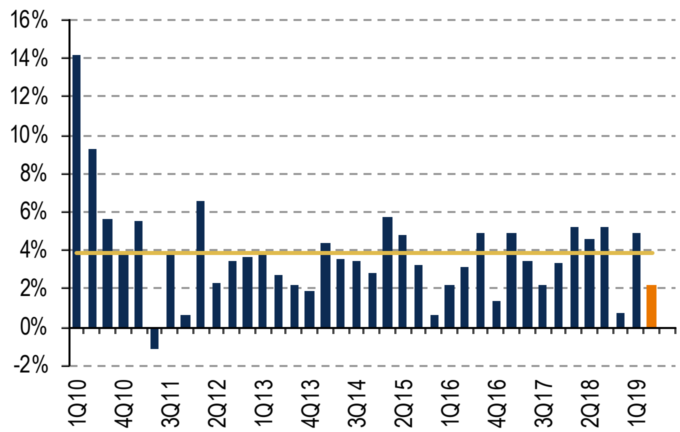
## Boeing dragged, but buybacks came to rescue

S&P 500 2Q19 EPS came in at $41.31, +1% YoY, 2% higher than consensus expectations heading into the earnings season ($40.35) and 1% above our forecast ($41.00). The 1% EPS growth, however, was the slowest growth rate since the 2015-16 EPS recession, and excluding the buyback benefits, earnings were down 0.6% YoY, marking the first decline since 2Q16. Boeing was the biggest negative contributor, with the $5.6B charge it took related to the 737 MAX. Excluding Boeing, S&P 500 earnings would have grown by +0.9% YoY.

The beat vs. consensus expectations was largely driven by mega caps in Communication Services and Tech (Microsoft, Alphabet, Intel, etc.), while Health Care continued to deliver strong results. With slowing global growth, cyclical sectors posted the weakest earnings. Materials and Energy saw the biggest EPS misses where lower oil prices over the course of the quarter were also a negative), while Industrials earnings were dragged by Boeing's charge – excluding the charge, Industrials earnings beat consensus by 2% (Chart 3).

**Chart 2: Better than expected, but a below-average beat in 2Q**

S&P 500 EPS beat vs. consensus expectations at start of the qtr; 1Q10-2Q19




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

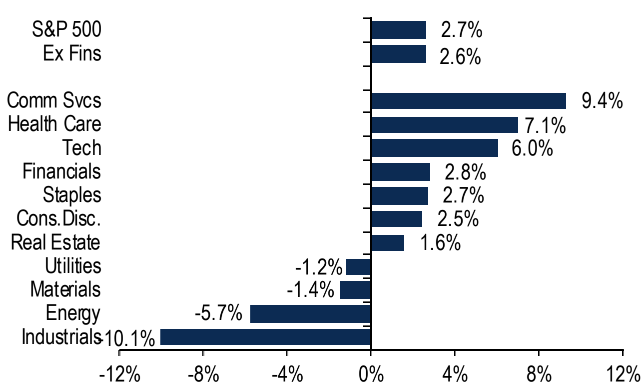
**Table 2: 2Q19 S&P 500 earnings & sales growth by sector**

| | Earnings | | Sales | |
|---|---|---|---|---|
| **Sector** | **YoY%** | **QoQ%** | **YoY%** | **QoQ%** |
| Consumer Disc. | (1.6%) | 10.7% | 4.5% | 6.1% |
| Consumer Staples | (1.1%) | 9.8% | 2.3% | 2.0% |
| Energy | (7.2%) | 46.7% | 0.1% | 10.4% |
| Financials | 0.7% | (0.5%) | 3.3% | (0.2%) |
| Health Care | 8.4% | 6.9% | 13.8% | 3.6% |
| Industrials | (13.1%) | 2.3% | 0.7% | 4.7% |
| Technology | (7.5%) | 0.6% | 0.8% | 2.0% |
| Materials | (10.2%) | 25.3% | (21.4%) | (10.0%) |
| Real Estate | 4.8% | 2.6% | 5.0% | 3.4% |
| Communication Services | 14.1% | 11.2% | 13.0% | 4.3% |
| Utilities | 5.9% | (15.2%) | 0.1% | (12.0%) |
| **S&P 500** | **(0.6%)** | **5.7%** | **3.8%** | **2.9%** |
| **ex. Financials** | **(0.9%)** | **7.2%** | **3.8%** | **3.3%** |
| **ex. Energy** | **(0.3%)** | **4.3%** | **4.1%** | **2.2%** |
| **ex. Fins & Energy** | **(0.5%)** | **5.6%** | **4.2%** | **2.6%** |

Source: FactSet, BofAML US Equity & US Quant Strategy

Note: Industrials impacted by Boeing's charge; excluding the charge, Industrial earnings grew 1.2% YoY and S&P 500 earnings grew 0.9%

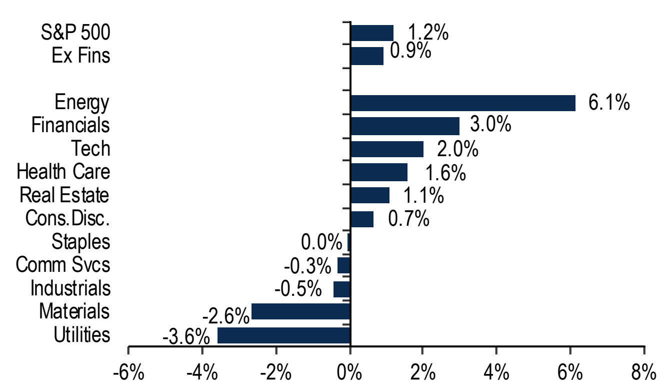
**Chart 3: Revision to 2Q19 cons. earnings by sector since start of Jul**




Source: FactSet, BofAML US Equity & US Quant Strategy

Note: Industrials impacted by Boeing's charge; excluding the charge, Industrial earnings came in 2% above expectations as of July 1or 3.9% for the S&P 500

**Chart 4: Revision to 2Q19 consensus sales by sector since start of Jul**




Source: FactSet, BofAML US Equity & US Quant Strategy

## Healthy proportion of beats; Health Care led again, while Materials lagged

Overall, 62% of companies beat on EPS, 51% beat on sales and 40% beat on both in 2Q (Table 3)—above the long-term average (since 2000) for beats on EPS and on both metrics, but below average for top-line beats (and lowest since 4Q16). Health Care saw the highest proportion of EPS and sales beats (66%) for the third straight quarter. Materials saw the fewest beats (just 7%), the lowest for this sector since 4Q15.

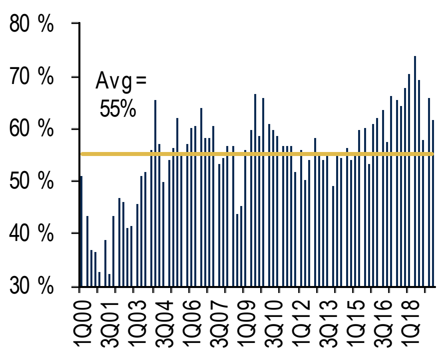
**Table 3: % of S&P 500 companies that beat consensus expectations on 2Q19 EPS, sales and both**

| Sector | Total companies | Number Reported | % with EPS beat | % with Sales beat | % EPS & Sales beat |
|---|---|---|---|---|---|
| Cons. Disc. | 62 | 62 | 58% | 55% | 37% |
| Cons. Staples | 33 | 33 | 67% | 48% | 42% |
| Energy | 28 | 28 | 39% | 46% | 25% |
| Financials | 68 | 68 | 65% | 57% | 44% |
| Health Care | 62 | 62 | 89% | 68% | 66% |
| Industrials | 68 | 68 | 65% | 40% | 32% |
| Tech | 68 | 68 | 71% | 65% | 53% |
| Materials | 28 | 27 | 44% | 14% | 7% |
| Real Estate | 32 | 32 | 44% | 69% | 38% |
| Comm. Svcs. | 23 | 23 | 70% | 48% | 35% |
| Utilities | 28 | 28 | 21% | 18% | 11% |
| **S&P 500** | **500** | **499** | **62%** | **51%** | **40%** |

Source: FactSet, BofAML US Equity & US Quant Strategy

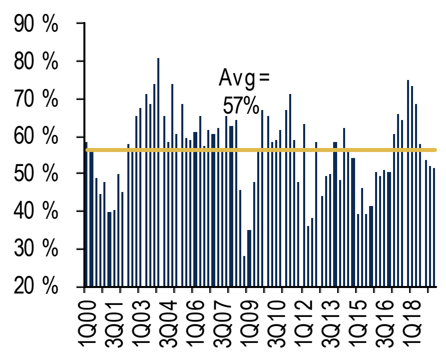
Note: AMCR reports semiannually and is excluded for quarterly comparisons

**Chart 5: % beating on EPS (1Q00-2Q19)**



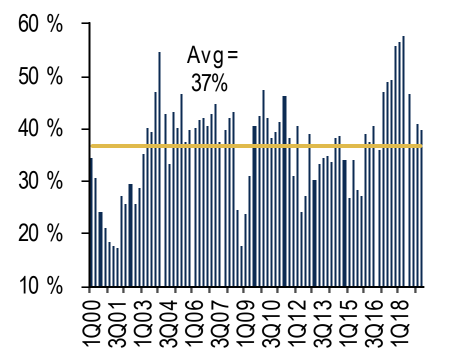

Source: FactSet, BofAML US Equity & US Quant Strategy

**Chart 6: % beating on sales (1Q00-2Q19)**




Source: FactSet, BofAML US Equity & US Quant Strategy

**Chart 7: % beating on both (1Q00-2Q19)**

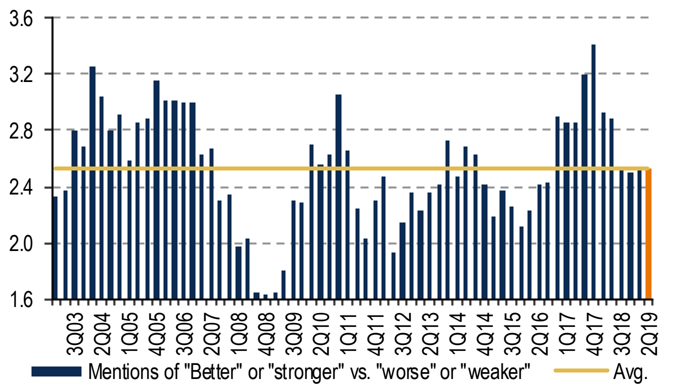



Source: FactSet, BofAML US Equity & US Quant Strategy

## Commentary suggested record low levels optimism

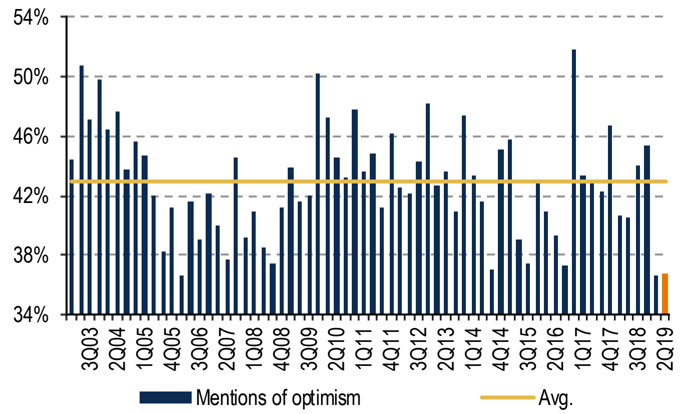
The tenor of conference calls remained cautious, with mentions of "optimism" largely unchanged from 1Q when we saw the lowest level in history since 2Q03 (**Error! Reference source not found.**). Mentions of "better" or "stronger" vs. "worse" or "weaker" were near average (similar to last two quarters, Chart 8).

Chart 8: Mentions of "better" or "stronger" vs. "worse" or "weaker" on earnings calls, 2Q03-2Q19




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

Chart 9: Mentions of optimism on earnings calls, 2Q03-2Q19




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

## Low expectations; reactions skewed to the upside

EPS and sales beats outperformed by 2.3ppt the next day, well above the long-term average of 1.6ppt, while misses were penalized by 1.7ppt, below the historical average underperformance of 2.4ppt. We think low expectations heading into the quarter skewed post-earnings reactions to the upside.

Table 4: Average relative post-reporting performance (vs. S&P 500, in ppt) for companies 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 | 1.4% | 1.4% | 0.8% | 0.7% |
| EPS Miss | -1.9% | -2.4% | -4.6% | -5.0% |
| EPS In-Line | -0.9% | -0.4% | -1.9% | -1.4% |
| Sales Beat | 1.3% | 1.7% | 0.9% | 1.3% |
| Sales Miss | -0.7% | -1.2% | -2.9% | -3.3% |
| Sales In-Line | -0.6% | -1.3% | 0.4% | -0.3% |
| **Both Beat** | **2.3%** | **2.7%** | **2.1%** | **2.5%** |
| **Both Miss** | **-1.7%** | **-2.0%** | **-4.4%** | **-4.7%** |

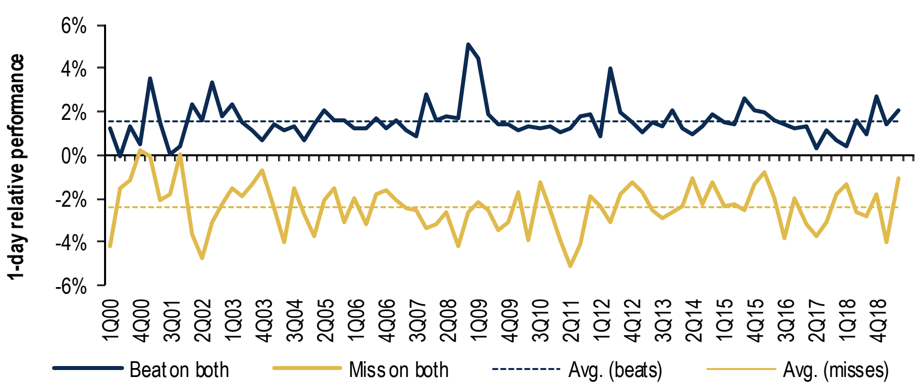
Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

Table 5: Average relative post-reporting performance (vs. S&P 500, in ppt) by sector based on surprise

| | 1 day after reporting | | 5 days after reporting | |
|---|---|---|---|---|
| Sector | Beat on both | Missed on both | Beat on both | Missed on both |
| Consumer Discretionary | 2.9% | -7.3% | 4.4% | -9.5% |
| Consumer Staples | 3.5% | -0.3% | 3.1% | -2.9% |
| Energy | 4.6% | -2.0% | 2.3% | -3.8% |
| Financials | 1.8% | -0.1% | 2.2% | 1.1% |
| Health Care | 2.3% | -5.0% | 2.9% | -4.4% |
| Industrials | 3.1% | -1.7% | 3.9% | -1.2% |
| Information Technology | 0.8% | 1.0% | 0.7% | 0.0% |
| Materials | 5.5% | -2.3% | 3.9% | -4.3% |
| Real Estate | 1.8% | 0.7% | 3.1% | 0.9% |
| Communication Services | 2.6% | -1.6% | 1.4% | -4.6% |
| Utilities | 1.0% | 0.1% | 2.9% | 2.1% |
| **S&P 500** | **2.3%** | **-1.7%** | **2.7%** | **-2.0%** |

Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

Chart 10: Relative one-day post-reporting performance (vs. S&P 500, in ppt)based on EPS and sales surprise (1Q00-2Q19)

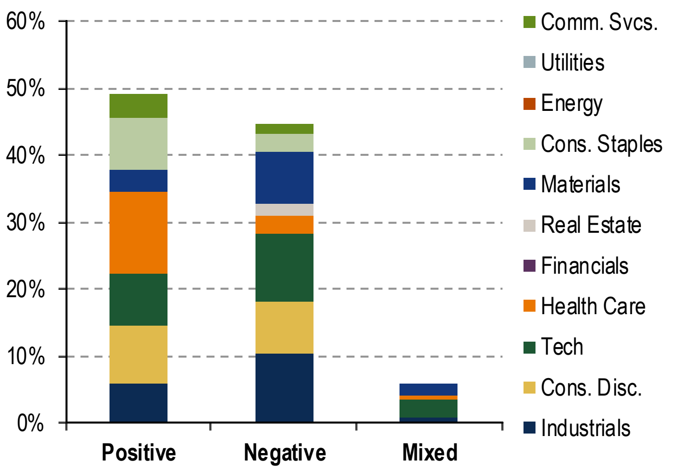



Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

## Trade tracker: more tariffs, more negative impacts

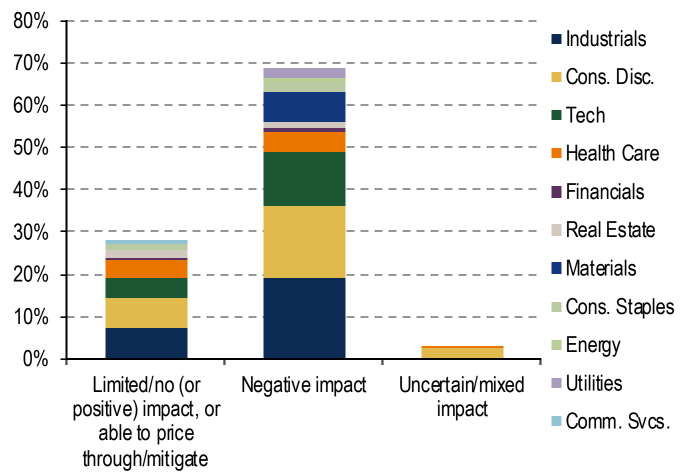
Amid the re-escalation of trade tensions during the 2Q earnings season, nearly 70% of 125 companies that mentioned tariffs saw negative impacts (17% of the S&P 500 overall), compared to about 50% of 83 companies from last quarter (9% of the S&P 500 overall). With the new round of tariffs mainly targeting consumer goods, more Consumer Discretionary companies cited negative impacts from tariffs vs. last quarter (21 companies vs. just 12 in 2Q). Similarly, of the 116 companies that have mentioned China trends on earnings calls, about 45% of 116 companies saw negative trends, compared to 30% of 89 companies from last quarter. With deteriorating macro data we have seen during the quarter, we expect more companies to blame tariffs for the weakness.

**Chart 11: Mentions of trends in China on 2Q earnings calls: our read on impacts**




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 12: Mentions of trade/tariffs on 2Q earnings calls: our read on impacts**

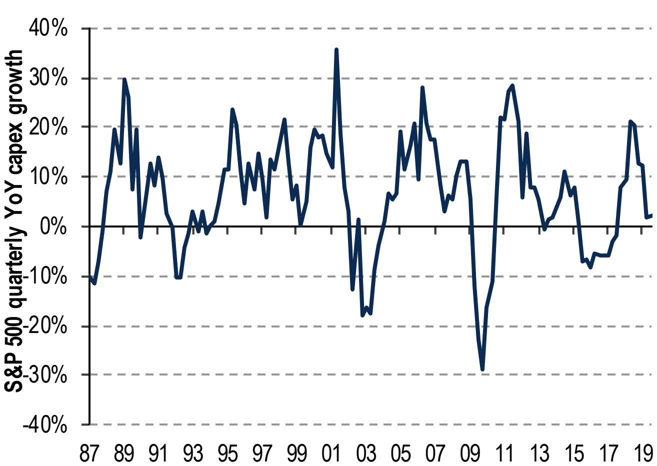



Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

## Capex growth remains anemic on trade uncertainty

Amid uncertainty around trade/tariffs and global growth, S&P 500 capex growth remained anemic at just +2% YoY. By sector, slowing capex spending in Tech and Consumer Discretionary were the biggest drags, while Financials was the biggest capex growth contributor.

**Chart 13: S&P 500 quarterly YoY capex growth, 1987-2Q19**




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

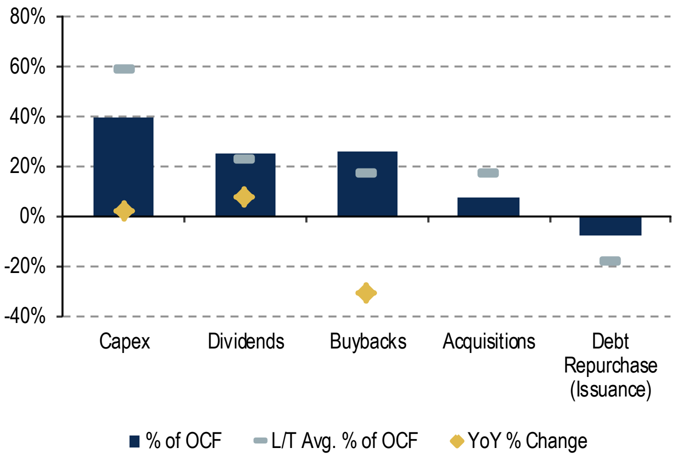
**Table 6: S&P 500 1Q19 YoY capex growth by sector**

| Sector | Aggregate YoY | Median YoY | Contribution to Agg. Growth |
|---|---|---|---|
| Consumer Discretionary | -8.7% | -0.5% | -66% |
| Consumer Staples | 0.6% | -4.0% | 2% |
| Energy | 6.6% | 0.5% | 51% |
| Financials | 25.1% | 20.7% | 79% |
| Health Care | 8.0% | 9.3% | 24% |
| Industrials | 3.1% | 3.8% | 19% |
| Information Technology | -12.1% | 0.8% | -80% |
| Materials | 7.0% | -7.1% | 14% |
| Real Estate | 8.4% | -3.0% | 4% |
| Communication Services | 4.2% | 7.1% | 35% |
| Utilities | 2.6% | 3.6% | 19% |
| **S&P 500** | **1.8%** | **4.3%** | |

Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

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

**Chart 14: 2Q19 use of operating cash flow by S&P 500 companies (% of OCF & YoY chg in spending)**




Note: long-term average % of OCF is since 1986. YoY change in debt repurchase not shown (not meaningful) since year-ago value is negative (debt issuance).
Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

40% of operating cash flow (OCF) was used on **capex** in 2Q, down from 48% the prior quarter and below the long-term average of 59%.

The proportion of cash spent on **net share repurchases** (26% of OCF) was also well below the prior five quarters (38% on average), but remained above the long-term average of 17%.

7% of OCF was spent on **acquisitions**, below the historical average of 17%.

25% of OCF was spent on **dividends**, similar to recent 2Qs.

Despite investors' preference for corporates to de-lever, corporates continued to issue debt for the fourth straight quarter, with 2Q net issuance at 7% of OCF, compared to the historical average of 19%.

## Better results up the cap spectrum

Small cap 1Q19 earnings came in 3% above analysts' expectations at the start of earnings season, a similar beat vs. in large caps, but sales were 1% below expectations (vs. a beat in large caps). And just 31% of small caps beat on EPS and sales, compared to 40% in large caps. Growth was also weaker, where small caps saw their second quarter of negative earnings growth (-10% YoY). **For a complete 2Q19 recap for small and mid caps, see the end of this report.**

# 3Q19 Preview

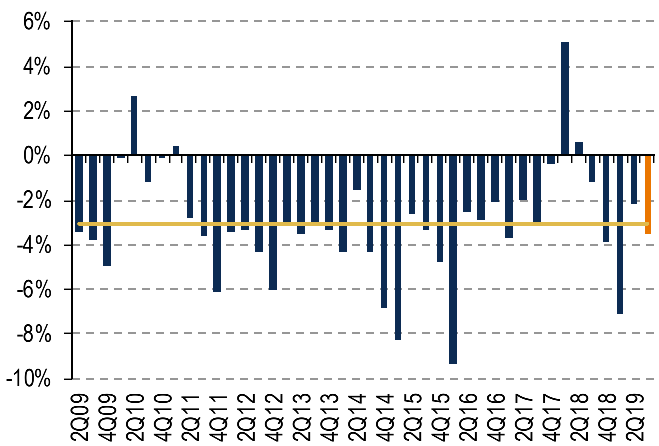
## First EPS decline since '15-16 earnings recession

S&P 500 3Q19 earnings season kicks off this week with DAL and FAST (a lighter-than-usual Week 1, with Banks kicking off in Week 2). Given further slowdown in global macro data and a fresh round of tariffs announced in August, bottom-up consensus EPS has fallen by 4% over the last three months (to $41.29), slightly bigger than the typical pre-EPS season cut of ~3% (Chart 15).

We forecast $41.75 for 3Q EPS, suggesting a 1% beat vs. consensus and a 2% YoY EPS decline. Consensus had expected YoY declines for the past two quarters, which did not materialize, but given the further slowdown in macro data during the quarter, we expect to see the first EPS decline since the 2015-16 EPS recession. Estimates have fallen the most within commodity-driven sectors, Energy (-17%) and Materials (-10%) over the last three months, while Consumer Discretionary (-6%) was hit by the latest round of tariffs which mainly target consumer goods. Industrials (-4%) also saw bigger downward revisions than the overall S&P 500.

**Chart 15: Larger pre-season EPS cut than average**

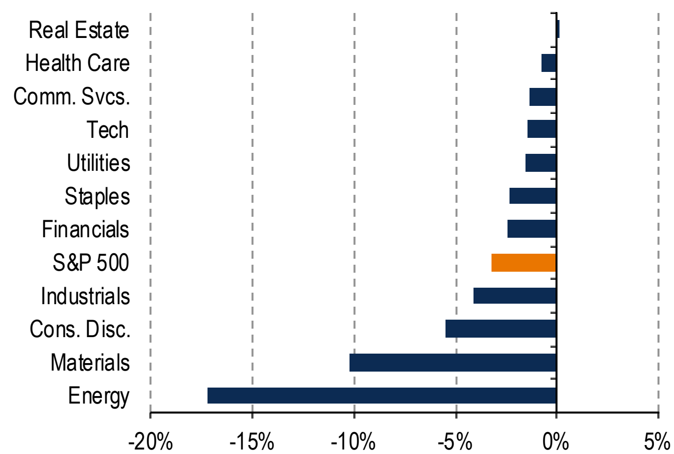
Bottom-up S&P 500 EPS revision by qtr. in the 3mos. ahead of reporting, 2Q09-3Q19




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 16: Downward revisions led by Materials and Industrials**

Revision to consensus 3Q19 earnings estimates over the last 3 months




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

Consensus expects a 5% YoY decline in net income, while sales are expected to rise by 3%. Non-Financials net margins are expected to fall to 10.9% from 11.9% a year ago (unchanged QoQ). Our Corporate Misery Indicator suggests more margin pressure ahead (Chart 28), and we expect full-year non-Financial net margins will fall to 11.2% in '19 from 11.7% in '18. Energy is expected to see the largest YoY decline in 3Q earnings (-30%), while consensus also forecasts Tech earnings -13% YoY on a 1% increase in sales. Utilities are expected to post the best earnings growth (+7%).

**Table 7: S&P 500 consensus 3Q19 expectations for earnings and sales growth by sector**

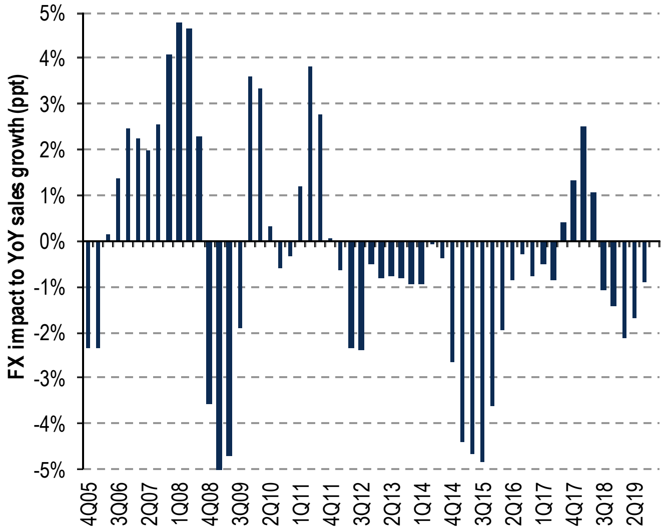
| | Earnings | | Sales | |
|---|---|---|---|---|
| **Sector** | **YoY%** | **QoQ%** | **YoY%** | **QoQ%** |
| Consumer Disc. | (2.6%) | 4.9% | 7.2% | 2.8% |
| Consumer Staples | (2.6%) | 0.0% | 3.2% | 3.2% |
| Energy | (30.3%) | (5.6%) | (5.4%) | (1.0%) |
| Financials | (3.2%) | (5.8%) | (2.2%) | (3.6%) |
| Health Care | 0.9% | (7.2%) | 12.5% | (0.8%) |
| Industrials | (2.2%) | 9.4% | 0.7% | (0.0%) |
| Technology | (13.0%) | (1.0%) | 0.7% | 4.4% |
| Materials | (7.3%) | (11.9%) | (14.1%) | (4.5%) |
| Real Estate | 4.9% | 0.3% | 3.6% | (0.7%) |
| Communication Services | 3.1% | (7.1%) | 9.6% | 1.1% |
| Utilities | 6.8% | 48.0% | 6.6% | 21.7% |
| **S&P 500** | **(4.9%)** | **(1.4%)** | **3.1%** | **0.9%** |
| **ex. Financials** | **(5.3%)** | **(0.3%)** | **3.9%** | **1.6%** |
| **ex. Energy** | **(3.4%)** | **(1.2%)** | **3.9%** | **1.1%** |
| **ex. Fins & Energy** | **(3.4%)** | **(0.0%)** | **5.0%** | **1.9%** |

Source: FactSet, BofAML US Equity & US Quant Strategy

## Sales growth continues to slow

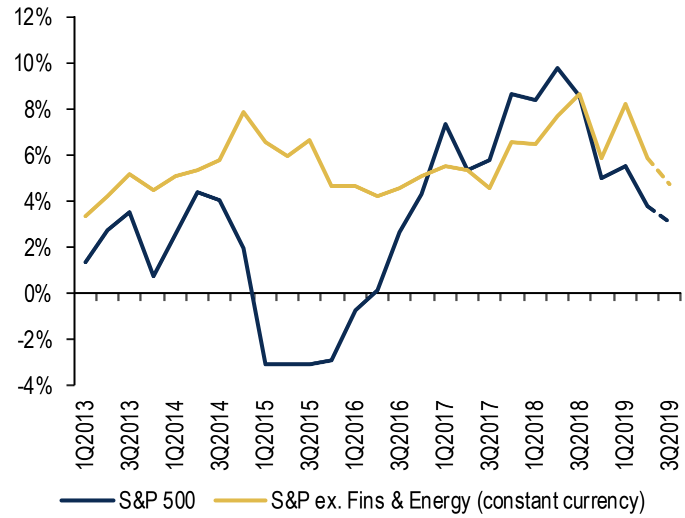
Consensus expects 3Q19 sales growth of +3% YoY, down from +4% last quarter, representing the second consecutive quarter of slowing growth. We estimate FX was a 0.9ppt headwind to YoY growth vs. a 1.7ppt headwind last quarter (Chart 17). Moves in the euro and the yuan relative to the US dollar remained the biggest contributors to the FX drag. Excluding FX/oil impacts, constant-currency sales growth for the S&P 500 ex. Fins. & Energy is expected to decelerate to +5% YoY from +6% YoY last quarter (Chart 18), the slowest pace since 3Q17.

**Chart 17: Currency remains a headwind: estimated currency impact (in ppt) to S&P 500 quarterly YoY sales growth, 4Q05-3Q19**




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 18: Quarterly YoY sales growth: S&P 500 and S&P 500 constant currency (ex-Fins. & Energy), 2013-2Q19 and consensus f'cast for 3Q19**




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

## Solid early results, but macro indicators deteriorate

So far, 22 companies (primarily "early reporters" with August quarter-end) have reported 3Q results. Early reporters are concentrated in the Consumer, Industrials and Tech sectors but can often give a read on the full quarter's results: since we began tracking in 2012, we've found an 82% correlation (68% $R^2$) between the proportion of early reporter beats on EPS and sales and the proportion of full-quarter beats on EPS and sales.

So far, 82% have beaten on EPS, 50% have beaten on sales and 45% have beaten on both – slightly lower than this time last quarter. EPS beats are tracking higher than the average for early reporters since 2012 (67%), but sales and beat on both are tracking below (sales beat avg.: 59%, beat on both avg.: 46%).

**Table 8: Early reporter results: % of S&P 500 companies beating consensus expectations on 3Q19 EPS, sales and both**

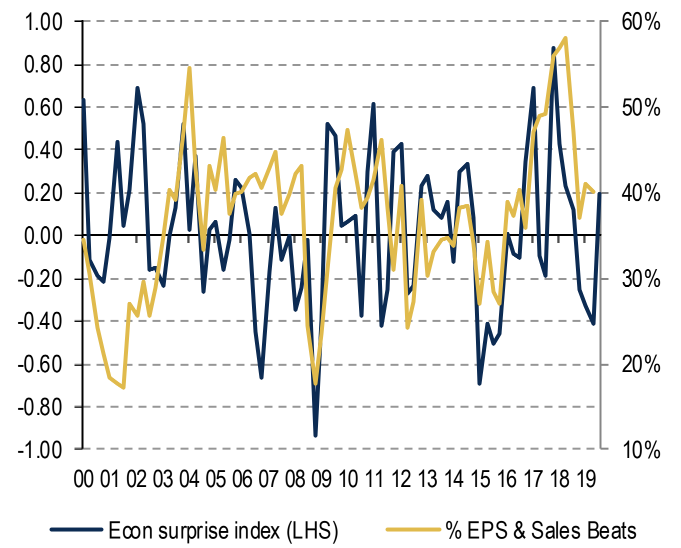
| Sector | Total companies | Number Reported | % with EPS beat | % with Sales beat | % EPS & Sales beat |
|---|---|---|---|---|---|
| Cons. Disc. | 63 | 6 | 100% | 83% | 83% |
| Cons. Staples | 33 | 7 | 86% | 43% | 29% |
| Energy | 28 | 0 | N.A. | N.A. | N.A. |
| Financials | 67 | 0 | N.A. | N.A. | N.A. |
| Health Care | 61 | 0 | N.A. | N.A. | N.A. |
| Industrials | 69 | 4 | 50% | 25% | 25% |
| Tech | 68 | 5 | 80% | 40% | 40% |
| Materials | 28 | 0 | N.A. | N.A. | N.A. |
| Real Estate | 32 | 0 | N.A. | N.A. | N.A. |
| Comm. Svcs. | 23 | 0 | N.A. | N.A. | N.A. |
| Utilities | 28 | 0 | N.A. | N.A. | N.A. |
| **S&P 500** | **500** | **22** | **82%** | **50%** | **45%** |

Source: FactSet, BofAML US Equity & US Quant Strategy

Meanwhile, US economic data surprises—which have also historically been correlated with beats (Chart 19) – bounced back from the recent lows (fuelled by housing data), suggesting a healthy beat is likely.

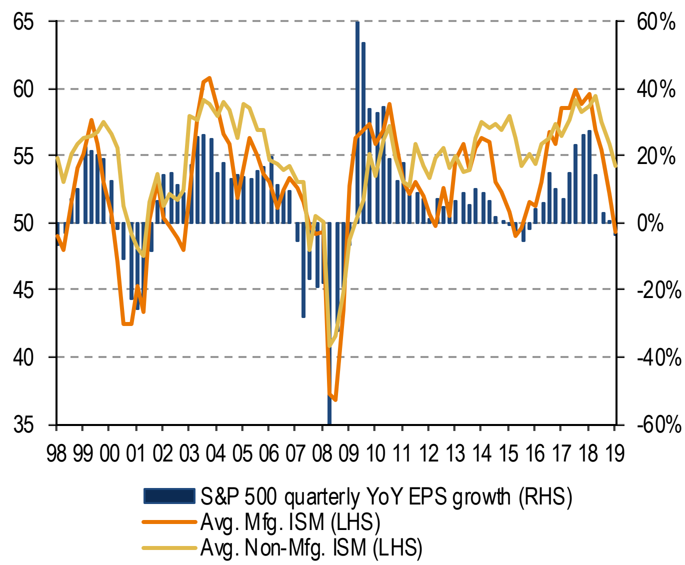
But the ISM manufacturing and non-manufacturing indices—which are one of the most correlated variables with S&P 500 earnings—have signalled weakness. The ISM manufacturing index fell to the lowest level since the financial crisis in September and the non-manufacturing index slipped to a three-year low (Chart 20). Note that the regression-implied 3Q19 EPS growth based on current levels of the manufacturing and non-manufacturing indices (all else equal) is -15% YoY and -11% YoY, respectively, vs. consensus of -3% YoY and our forecast of -2%.

**Chart 19: Bloomberg US economic surprise index (2000-present) vs. % of S&P 500 companies beating on EPS & sales (2000-2Q19)**




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

**Chart 20: Average manufacturing ISM and non-manufacturing ISM by qtr. (1998-3Q19) vs. S&P 500 qtrly. YoY EPS growth (1998-3Q19)**




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

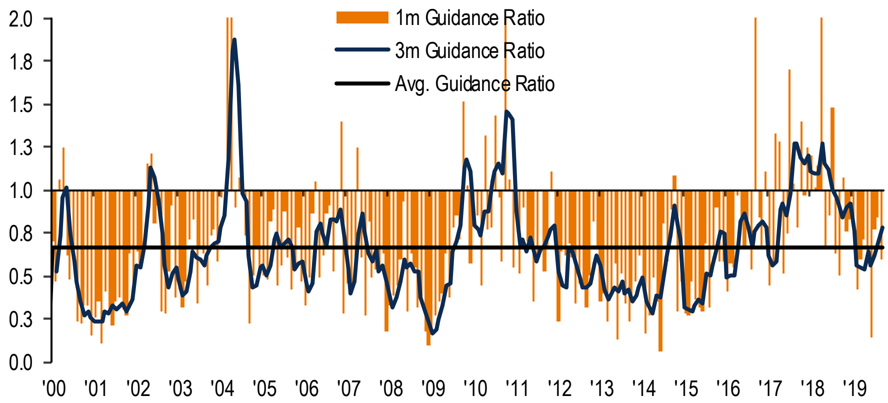
**Expect trends to remain weaker for small caps in 3Q**

Analysts expect small cap earnings to be -9% YoY in 3Q (vs. -7% YoY in 2Q), worse than the expected 5% earnings decline in large caps. The median small company is expected to see earnings decline 4% YoY. Sales are expected to grow +3% YoY, similar to last quarter and comparable to the expected sales growth in large caps. Analysts have continued to cut estimates across the cap spectrum, and guidance has recently been weaker in small caps. **For more details see our SMID cap 3Q preview at the end of this report.**

## Key variable to watch: management guidance

In September, the three-month ratio of above- to below-consensus management guidance on earnings rose to 0.79 from 0.70, above its long-term average of 0.7x. The one-month ratio fell to 0.60 from 0.84, but came in above the typical September of 0.56. We think consensus is too high for 4Q and 2020, and lower guidance vs. consensus could be a key risk for stocks this earnings season.

**Chart 21: S&P 500 Management Guidance Ratio (# Above vs. Below Consensus) – 09/19**

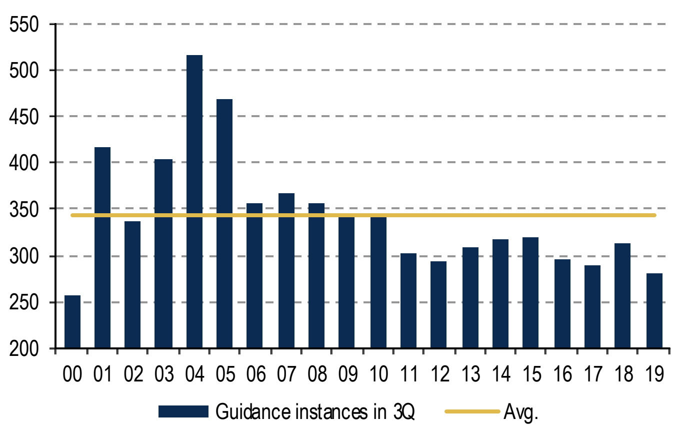



Source: BofA Merrill Lynch US Quantitative Strategy

Amid rising macro uncertainty, 3Q19 marked the fewest guidance instances for historical 3Qs since 2000 (Chart 22). We think the information vacuum will continue this earnings season. Historically, 7% of S&P companies have provided FY2 guidance during the 3Q earnings season (Chart 23), but we think that number could be significantly lower this time as trade and macro uncertainty continue. Companies' lack of visibility into next year, with just three months left in the year, will likely build more uncertainty among investors and likely result in lower 2020 estimates, in our view.

**Chart 22: 3Q19 marked the fewest guidance instances for historical 3Qs since 2000 amid rising macro uncertainty**

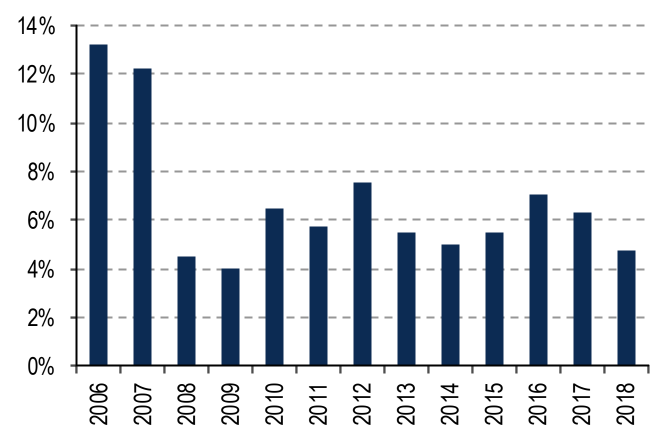
Number of guidance instances in 3Q (2000-19)




Source: Bloomberg, BofA Merrill Lynch US Quantitative Strategy

**Chart 23: Percentage of S&P 500 market cap that issues FY2 guidance during 3Q earnings season**

Based on current constituents & market cap




Source: FactSet, BofA Merrill Lynch US Quantitative Strategy

## Capex guidance improves, but surveys dip further

### Capex guidance ratio rises back above average

The three-month capex guidance ratio rose to 1.6x (vs. the long-term average of 1.4x) from 1.4x in August (Chart 24).

### ...while survey data dip further

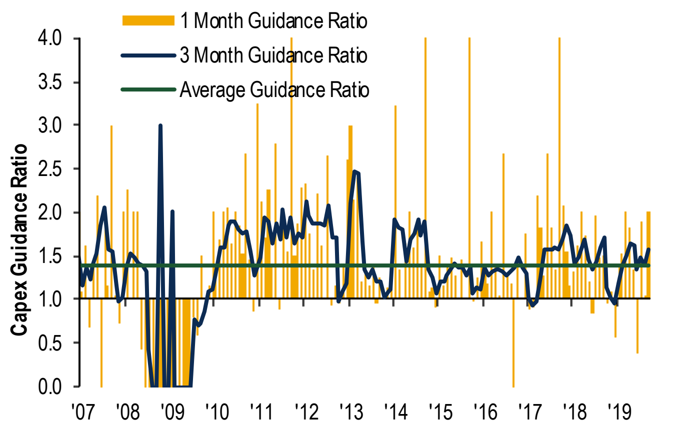
- The Duke/CFO Outlook for expected capex over the next 12 months fell to 1% in 3Q19, down from 3% in 2Q. Based on its historical correlation with actual S&P 500 capex growth (Chart 23), this suggests capex could decline 1% YoY over the next 12 months, vs. +8% over the last 12 months as of 2Q19.

- The Business Roundtable CEO Economic Outlook survey in 3Q suggested that only 36% of respondents expect higher capex over the next six months, down from 48%

in 2Q and at the lowest reading since 4Q16. This measure has been the most correlated with actual S&P 500 capex growth with a six month lead (Chart 24), and all else equal suggests trailing capex growth of +3% YoY six months from now, down from the current rate of +8%.

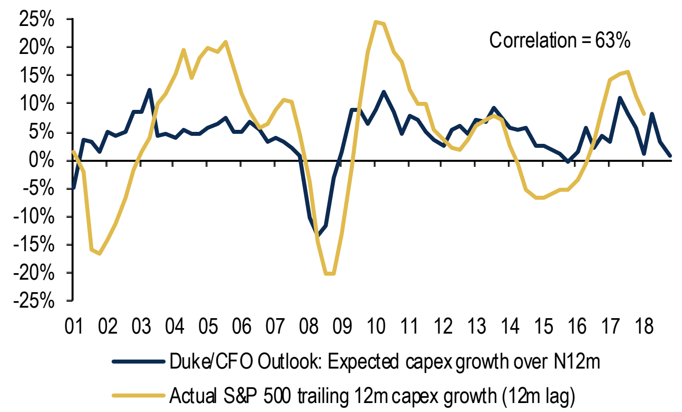
- The Philadelphia Fed Manufacturing Business Outlook Survey's diffusion index for the forecast six-month change in capex slipped to 25.9 in September from 28 in June, but remained above the recent low of 19.5 in 1Q. Based on its historical correlation with S&P 500 capex growth (with a six-month lead), it suggests trailing capex growth of +8% six months from now (in line with the current rate), all else equal (Chart 25).

**Chart 24: S&P 500 capex guidance ratio (2007-9/19)**



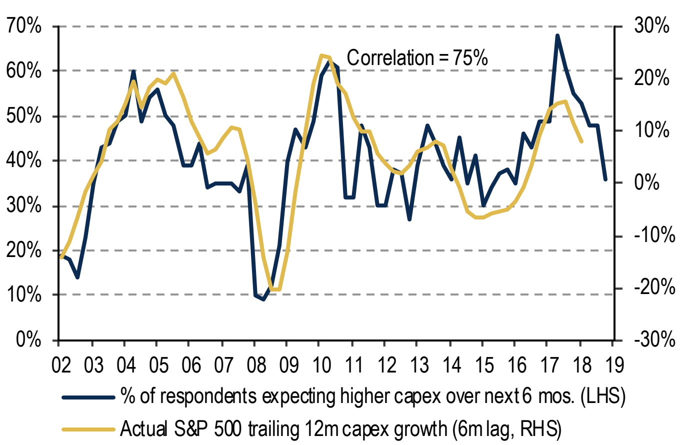

Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 25: Duke/CFO Outlook: Expected Growth in Capital Spending in Next 12 Months (shown with a 12m lead) vs. actual S&P 500 trailing 12m YoY capex growth (4Q02-present)**



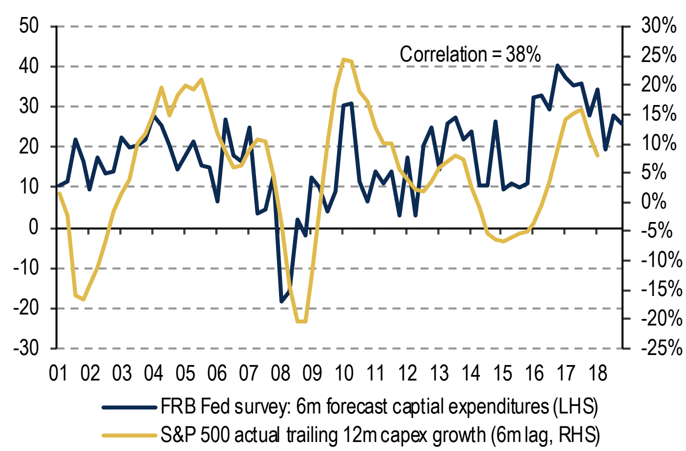

Source: Haver Analytics, FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 26: Business Roundtable CEO Economic Outlook Survey: % expecting higher capital spending over next 6 mos. (shown w/ 6m lead) vs. actual S&P 500 trailing 12m YoY capex growth (4Q02-present)**




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

**Chart 27: FRB Philadelphia Manufacturing Business Outlook: future capital expenditures diffusion index (SA, next 6mos.) vs. S&P 500 actual trailing 12m YoY capex growth (shown w/ 6m lag), 4Q02-present**




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

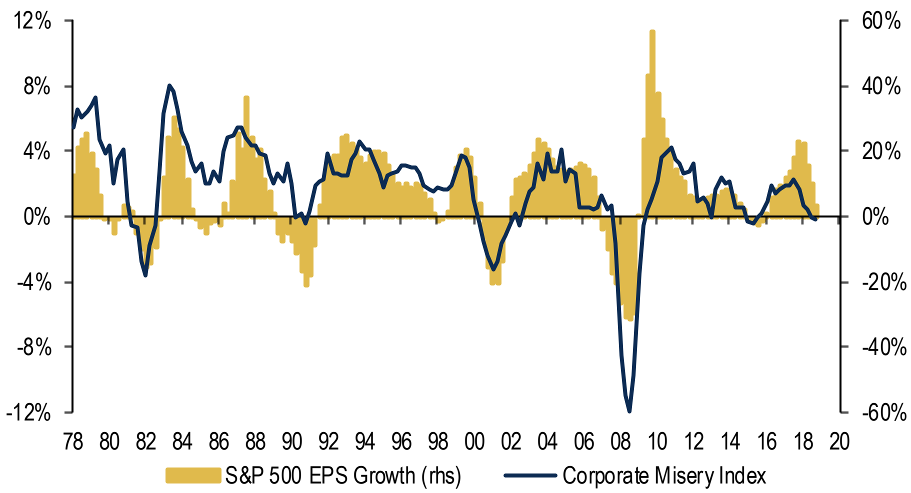
## Margin compression to continue

Analysts expect S&P 500 non-Financial net margins of 10.9% in 3Q, compared to 11.9% in the year-ago quarter. We have been highlighting risk to margins from rising input costs for companies that don't have pricing power, as well as for labor-intensive companies/sectors amid rising wages, and we expect full-year net margins to contract to 11.1% in 2019 ex-Financials from 11.7% in 2018.

**Corporate Misery Indicator continues to head lower – rising risks to profitability**

In addition to company mentions of wage pressures, we're watching our BofAML Corporate Misery Indicator (Chart 28), a macro proxy for profitability, which incorporates unit sales (Conference Board coincident indicators), selling prices (CPI) and input costs (average hourly earnings). This indicator has been strongly correlated with, and sometimes leads, the profits cycle. The indicator has been in a downtrend since 2H18 and fell to negative as of August 2019 for the first time since 1Q16, suggesting a worsening backdrop for corporate profitability.

**Chart 28: BofAML Corporate Misery Indicator (lower=more miserable) 4Q78-3Q19 (as of 8/19)**




Disclaimer: The indicator identified as BofAML 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 Merrill Lynch Global Research. This indicator was not created to act as a benchmark. Note: see Appendix for full details/methodology.

Source: BofA Merrill Lynch US Equity & Quant Strategy, Conference Board, BLS

## Health Care/Real Estate rank best, Utilities/Energy worst

Historically, we have found that sectors with strong EPS revisions, sales revisions and guidance have been more likely to have a greater amount 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 previous quarter may be more likely to enjoy similar results in the current quarter. Each quarter, we have ranked sectors by these measures, and for this earnings season we found Health Care, Real Estate, and Communication Services screen as most likely to surprise to the upside, while Energy, Utilities and Financials screen weakest ahead of earnings.

**Table 9: Sector ranks for 3Q19 earnings season**

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) |
|---|---|---|---|---|---|
| Health Care | 1 | 1.55 | 1.98 | 1.75 | 10.3 |
| Real Estate | 2 | 2.33 | 1.50 | 1.20 | 4.7 |
| Communication Services | 3 | N/A | 0.94 | 0.81 | 2.5 |
| Consumer Staples | 4 | 0.50 | 0.94 | 0.84 | 2.7 |
| Information Technology | 5 | 0.65 | 0.89 | 0.73 | 4.7 |
| Consumer Discretionary | 6 | 0.20 | 0.57 | 0.86 | 2.0 |
| Industrials | 7 | 1.08 | 0.63 | 0.42 | 1.8 |
| Materials | 8 | 0.67 | 0.67 | 0.34 | 0.8 |
| Financials | 9 | N/A | 0.60 | 0.61 | 2.2 |
| Utilities | 10 | N/A | 0.79 | 0.69 | 0.3 |
| Energy | 11 | N/A | 0.33 | 0.31 | 0.8 |
| **S&P 500** | | **0.79** | **0.81** | **0.72** | **2.0** |

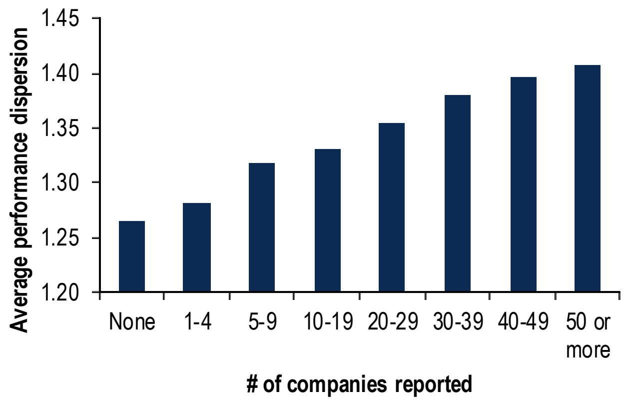
Note: Surprise ratio based on avg of EPS Beat/Miss ratio and Sales Beat/Miss ratio. Guidance ratio is not counted in calculating the average rank if a sector had <10 instances of guidance over the last 3 months.

Source: FactSet/First Call, BofA Merrill Lynch US Equity & US Quant Strategy

## Earnings season is a good time to be a stock-picker

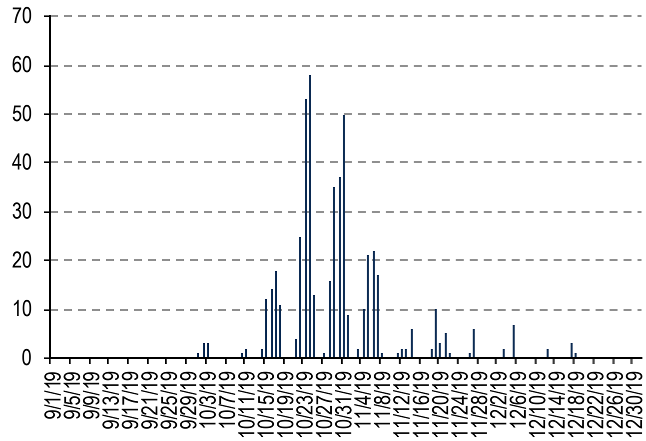
For short-term investors, stock differentiation is heightened during earnings season, particularly the busiest reporting days. Below we show the average dispersion (standard deviation) of daily stock returns based on the number of companies reporting by day since 2009 (Chart 29). This reveals that dispersion is consistently higher for busier reporting days. This earnings season, the busiest days fall the week of 10/21 (Chart 32).

**Chart 29: # of S&P 500 companies reporting daily vs. avg. performance dispersion (standard deviation of daily returns), 2009-3Q19**




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 30: # of S&P 500 companies reporting 3Q19 results by day**



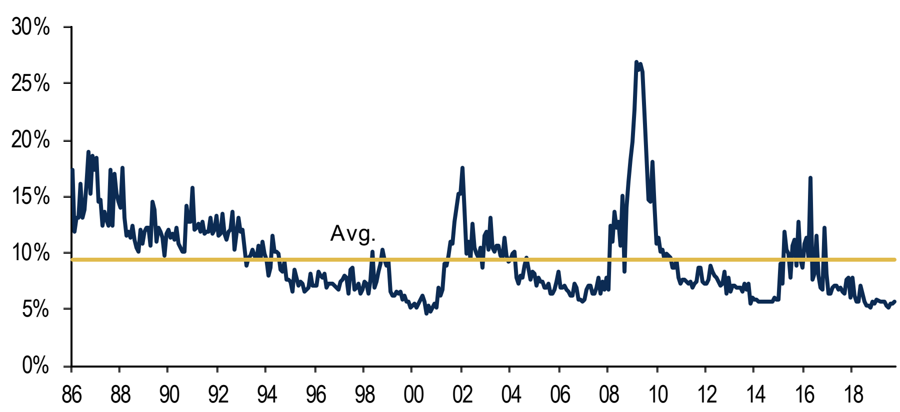

Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

## Analyst estimates: near-record levels of clustering

Amid heightened macro uncertainty, as well as the fact that analysts have been covering more stocks, consensus estimate dispersion has been at record lows. For the S&P 500, dispersion currently sits at 5.7%, up slightly from 5.2% last quarter, which was the 18-year low. It is well below the long-term average of 9.5%. If low dispersion reflects a reluctance to diverge from the pack (which we think is likely), focusing on out-of-consensus earnings calls should be rewarded.

**Chart 31: Estimate dispersion at 18-year lows**

S&P 500 FY2 EPS Estimate Dispersion (1986-9/30/19)




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

## Screens for top & bottom line beats & misses

We screened the S&P 500 for stocks under BofAML coverage that according to the following criteria suggest which are most likely to beat (miss) expectations:

- **BofAML vs. Consensus**: BofAML 3Q19 EPS and sales had to be above (below) consensus ex-BofAML. (Note: Z-score in the tables represents the number of standard deviations that our analyst's estimate is above (below) consensus ex-BofAML.)
- **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 BofAML 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.

**Table 10: 3Q19 Positive Surprise Screen (with underowned stocks by fund managers highlighted in blue)**

| Ticker | Company Name | Sector | Industry | Expected Report Date | BofAML vs. Consensus EPS: Z-Score | BofAML vs. Consensus Sales: Z-Score | Last Qtr: EPS/Sales Surprise | Price | BofAML Rating | Rel. Wgt. (vs. S&P 500) in fund holdings |
|---|---|---|---|---|---|---|---|---|---|---|
| FB | Facebook, Inc. Class A | Communication Services | Interactive Media & Services | 10/30/2019 | 1.0 | 0.8 | Beat/Beat | 180.45 | BUY | 1.84 |
| TWTR | Twitter, Inc. | Communication Services | Interactive Media & Services | 10/25/2019 | 0.5 | 0.5 | Beat/Beat | 40.36 | BUY | 0.34 |
| EXPE | Expedia Group, Inc. | Consumer Discretionary | Internet & Direct Marketing Retail | 10/24/2019 | 0.5 | 0.2 | Beat/Beat | 133.22 | BUY | 0.31 |
| DG | Dollar General Corporation | Consumer Discretionary | Multiline Retail | 11/27/2019 | 0.2 | 0.7 | Beat/Beat | 160.97 | BUY | 1.55 |
| LOW | Lowe's Companies, Inc. | Consumer Discretionary | Specialty Retail | 11/20/2019 | 2.5 | 1.4 | Beat/Beat | 107.42 | BUY | 1.18 |
| PVH | PVH Corp. | Consumer Discretionary | Textiles Apparel & Luxury Goods | 11/27/2019 | 1.2 | 0.1 | Beat/Beat | 84.48 | BUY | 0.95 |
| CHD | Church & Dwight Co., Inc. | Consumer Staples | Household Products | 10/31/2019 | 1.0 | 1.8 | Beat/Beat | 76.05 | BUY | 0.71 |
| KMB | Kimberly-Clark Corporation | Consumer Staples | Household Products | 10/24/2019 | 0.6 | 1.0 | Beat/Beat | 141.60 | BUY | 0.49 |
| MRO | Marathon Oil Corporation | Energy | Oil Gas & Consumable Fuels | 10/30/2019 | 0.7 | 1.9 | Beat/Beat | 11.56 | BUY | 1.11 |
| AXP | American Express Company | Financials | Consumer Finance | 10/18/2019 | 0.2 | 0.2 | Beat/Beat | 114.41 | BUY | 1.23 |
| ANTM | Anthem, Inc. | Health Care | Health Care Providers & Services | 10/23/2019 | 0.2 | 1.5 | Beat/Beat | 241.79 | BUY | 1.07 |
| CNC | Centene Corporation | Health Care | Health Care Providers & Services | 10/22/2019 | 0.2 | 0.6 | Beat/Beat | 43.57 | BUY | 1.34 |
| CVS | CVS Health Corporation | Health Care | Health Care Providers & Services | 11/6/2019 | 0.5 | 0.0 | Beat/Beat | 62.24 | BUY | 1.04 |
| IQV | IQVIA Holdings Inc | Health Care | Life Sciences Tools & Services | 10/22/2019 | 1.8 | 0.8 | Beat/Beat | 149.30 | BUY | 0.69 |
| MRK | Merck & Co., Inc. | Health Care | Pharmaceuticals | 10/29/2019 | 0.8 | 0.2 | Beat/Beat | 85.00 | BUY | 0.82 |
| MYL | Mylan N.V. | Health Care | Pharmaceuticals | 11/6/2019 | 0.3 | 0.8 | Beat/Beat | 18.91 | BUY | 0.32 |
| UAL | United Airlines Holdings, Inc. | Industrials | Airlines | 10/15/2019 | 1.8 | 0.2 | Beat/Beat | 84.29 | BUY | 1.88 |
| URI | United Rentals, Inc. | Industrials | Trading Companies & Distributors | 10/16/2019 | 0.8 | 0.9 | Beat/Beat | 117.21 | BUY | 0.45 |
| FTNT | Fortinet, Inc. | Information Technology | Software | 10/31/2019 | 2.1 | 0.2 | Beat/Beat | 77.49 | BUY | 0.13 |
| INTU | Intuit Inc. | Information Technology | Software | 11/18/2019 | 2.6 | 1.2 | Beat/Beat | 267.09 | BUY | 1.94 |
| MSFT | Microsoft Corporation | Information Technology | Software | 10/23/2019 | 0.2 | 1.0 | Beat/Beat | 138.12 | BUY | 1.37 |
| AAPL | Apple Inc. | Information Technology | Technology Hardware Storage & Peripherals | 10/30/2019 | 0.9 | 1.9 | Beat/Beat | 227.01 | BUY | 0.44 |
| EQR | Equity Residential | Real Estate | Equity Real Estate Investment Trusts (REITs) | 10/22/2019 | 1.7 | 2.3 | Beat/Beat | 87.47 | BUY | 0.50 |
| ESS | Essex Property Trust, Inc. | Real Estate | Equity Real Estate Investment Trusts (REITs) | 10/23/2019 | 1.0 | 0.9 | Beat/Beat | 330.40 | BUY | 0.15 |
| NEE | NextEra Energy, Inc. | Utilities | Electric Utilities | 10/23/2019 | 0.7 | 0.4 | Beat/Beat | 233.59 | BUY | 0.48 |

Source: BofA Merrill Lynch US Equity & US Quant Strategy, FactSet. Note: Closing prices and ratings as of 10/4/19.
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

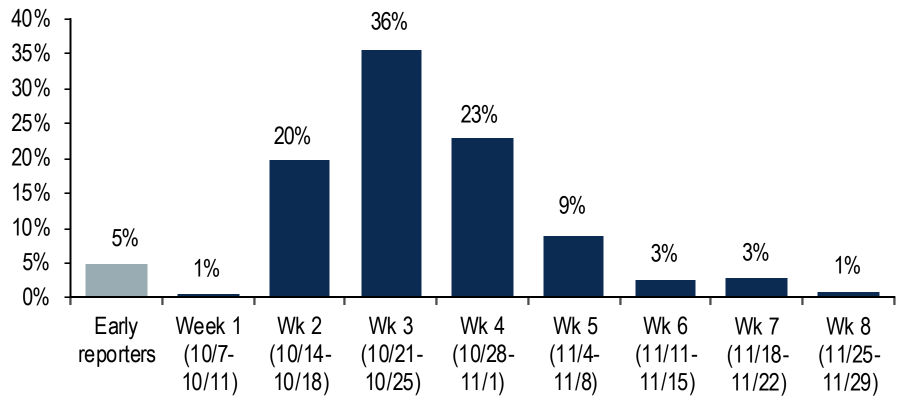
**Table 11: 3Q19 Negative Surprise Screen (with crowded stocks by fund managers highlighted in blue)**

| Ticker | Company | Sector | Industry | Expected Report Date | BofAML vs. Consensus EPS: Z-Score | BofAML vs. Consensus Sales: Z-Score | Last Qtr: EPS/Sales Surprise | Price | BofAML Rating | Rel. Wgt. (vs. S&P 500) in fund holdings |
|---|---|---|---|---|---|---|---|---|---|---|
| TRIP | TripAdvisor, Inc. | Communication Services | Interactive Media & Services | 10/30/2019 | -1.4 | -0.2 | Miss/Miss | 38.98 | UNDERPERFORM | 0.85 |
| M | Macy's Inc | Consumer Discretionary | Multiline Retail | 11/21/2019 | -1.3 | -1.6 | Miss/Miss | 14.96 | UNDERPERFORM | 0.08 |
| JWN | Nordstrom, Inc. | Consumer Discretionary | Multiline Retail | 11/21/2019 | -2.8 | -2.0 | Beat/Miss | 32.49 | UNDERPERFORM | 0.04 |
| GPS | Gap, Inc. | Consumer Discretionary | Specialty Retail | 11/21/2019 | -2.1 | -1.3 | Beat/Miss | 16.23 | UNDERPERFORM | 1.09 |
| TAP | Molson Coors Brewing Co. Class B | Consumer Staples | Beverages | 10/30/2019 | -0.5 | -0.1 | Miss/Miss | 56.63 | UNDERPERFORM | 1.16 |
| MTB | M&T Bank Corporation | Financials | Banks | 10/17/2019 | -0.6 | -0.3 | Miss/Beat | 154.05 | UNDERPERFORM | 0.23 |
| WLTW | Willis Towers Watson Public Ltd. Co. | Financials | Insurance | 10/31/2019 | -1.0 | -0.8 | Beat/Miss | 188.65 | UNDERPERFORM | 1.16 |
| ILMN | Illumina, Inc. | Health Care | Life Sciences Tools & Services | 10/28/2019 | -0.3 | -0.3 | Miss/Miss | 302.34 | UNDERPERFORM | 1.85 |
| WU | Western Union Company | Information Technology | IT Services | 10/31/2019 | -0.1 | -0.4 | In-line/Miss | 23.31 | UNDERPERFORM | 0.97 |
| MXIM | Maxim Integrated Products, Inc. | Information Technology | Semiconductors & Semi Equipment | 10/29/2019 | -0.6 | -0.3 | In-line/Miss | 57.54 | UNDERPERFORM | 1.02 |
| DOW | Dow, Inc. | Materials | Chemicals | 10/24/2019 | -1.0 | -0.5 | Miss/Miss | 45.34 | UNDERPERFORM | 0.17 |
| XEL | Xcel Energy Inc. | Utilities | Electric Utilities | 10/24/2019 | -2.1 | -0.9 | Miss/Miss | 64.63 | UNDERPERFORM | 0.46 |
| DTE | DTE Energy Company | Utilities | Multi-Utilities | 10/23/2019 | -0.4 | -0.6 | Miss/Miss | 132.24 | UNDERPERFORM | 0.64 |

Source: BofA Merrill Lynch US Equity & US Quant Strategy, FactSet. Note: Closing prices and ratings as of 10/4/19.
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

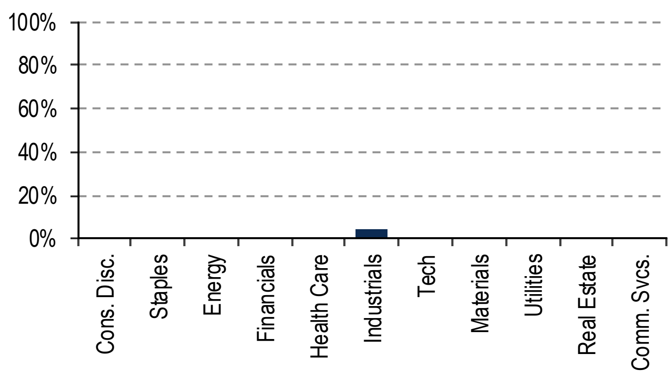
## 3Q19 Reporting by Week

**Chart 32: S&P 500 3Q19 Earnings Reporting by Week**



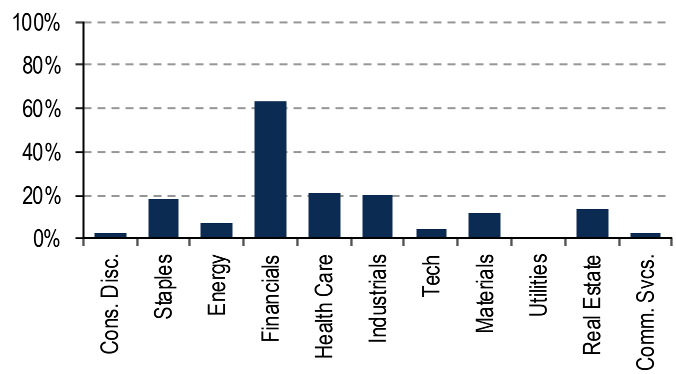

Source: Bloomberg, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 33: Week 1: % 3Q earnings reported by sector**



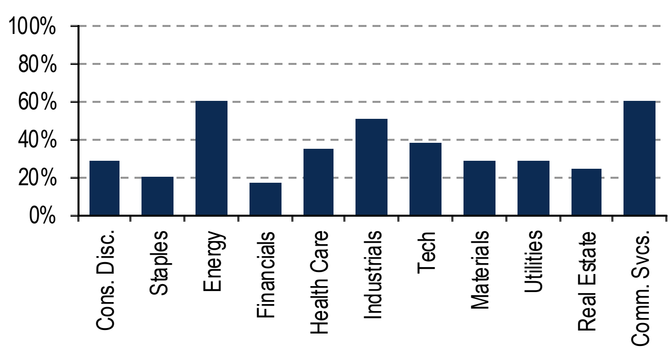

Source: Bloomberg, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 34: Week 2: % 3Q earnings reported by sector**



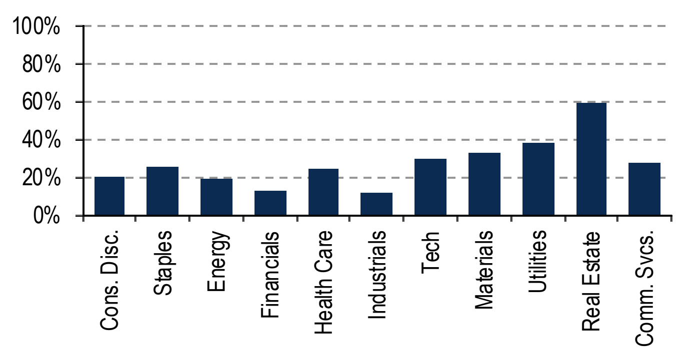

Source: Bloomberg, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 35: Week 3: % 3Q earnings reported by sector**




Source: Bloomberg, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 36: Week 4: % 3Q earnings reported by sector**




Source: Bloomberg, BofA Merrill Lynch US Equity & US Quant Strategy

# Small cap 2Q19 earnings wrap-up

- S&P 600 earnings came in 3% above analyst expectations at the start of earnings season (a similar beat in large caps), while sales were 1% below expectations (compared to 1% above expectations for large caps).

- Earnings beat expectations across most sectors (except Energy and Health Care), led by Comm. Svcs., Technology, and Materials.

- 57% of companies beat on EPS, 44% beat on sales, and 31% beat on both, suggesting fewer beats than in large caps on all three metrics. Tech, Health Care, and Staples saw the most top and bottom line beats.

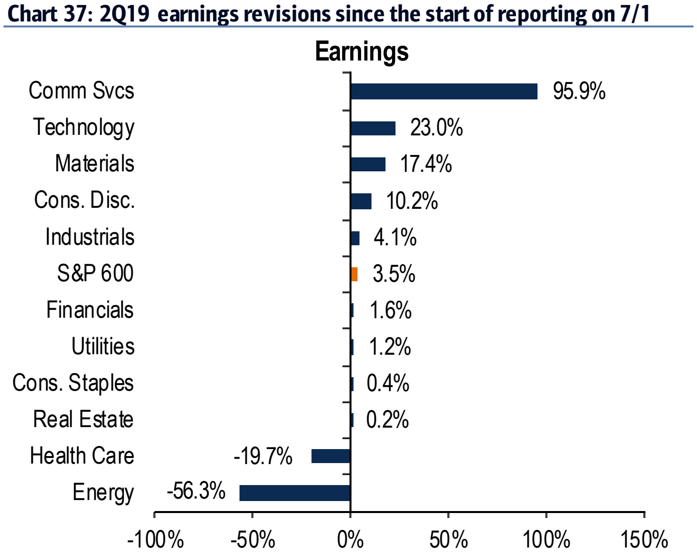
- Earnings fell 10% YoY (flat for the median company) on sales growth of +3% YoY (also +3% for the median company). This is the second consecutive quarter of negative earnings, suggesting small caps are in an earnings recession, and with weaker earnings and sales than in large caps. This marks an acceleration in earnings but similar sales growth from 1Q (-17% YoY earnings growth on +3% sales growth).

**Table 12: S&P 600 consensus 2Q19 earnings and sales growth and % of 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 | 14 | 14 | -31.5% | -32.3% | 5.5% | 6.1% | 67% | 42% | 29% |
| Cons. Disc. | 96 | 94 | -12.3% | 0.5% | -1.1% | 2.0% | 62% | 37% | 31% |
| Cons. Staples | 17 | 17 | 5.5% | 11.4% | 37.1% | 5.9% | 59% | 41% | 35% |
| Energy | 37 | 37 | -66.8% | -21.3% | 5.8% | 2.7% | 31% | 46% | 22% |
| Financials | 91 | 90 | 4.6% | 2.2% | 8.0% | 6.2% | 46% | 33% | 20% |
| Health Care | 69 | 69 | -51.1% | 0.0% | 0.2% | 3.9% | 55% | 62% | 39% |
| Industrials | 95 | 94 | 0.3% | 7.7% | -0.4% | 0.3% | 62% | 38% | 34% |
| Technology | 85 | 83 | -11.0% | 3.0% | 1.4% | 2.3% | 80% | 63% | 55% |
| Materials | 30 | 30 | -15.8% | -20.0% | -5.4% | -4.1% | 60% | 13% | 3% |
| Real Estate | 39 | 38 | -9.3% | -3.6% | 0.0% | 5.1% | 22% | 58% | 18% |
| Utilities | 5 | 5 | -12.7% | -8.5% | 0.9% | 1.4% | 40% | 60% | 20% |
| **S&P 600** | **578** | **571** | **-10.3%** | **0.0%** | **2.9%** | **2.7%** | **57%** | **44%** | **31%** |
| Ex-Financials | 487 | 481 | -14.4% | 0.0% | 2.6% | 2.0% | 59% | 47% | 33% |
| Ex-Energy | 541 | 534 | -8.0% | 0.0% | 2.8% | 2.7% | 58% | 44% | 32% |
| Ex-Energy&Financials | 450 | 444 | -11.7% | 0.0% | 2.4% | 2.0% | 61% | 47% | 34% |

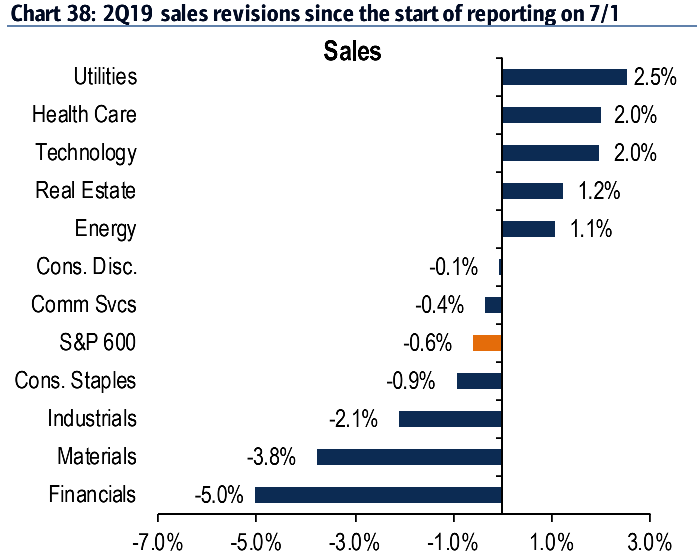
Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 37: 2Q19 earnings revisions since the start of reporting on 7/1**




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 38: 2Q19 sales revisions since the start of reporting on 7/1**




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

# Mid cap 2Q19 earnings wrap-up

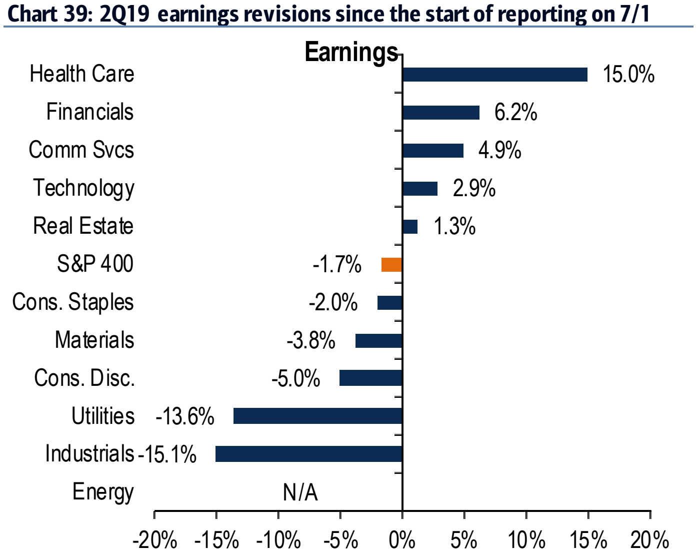
- S&P 400 earnings came in 2% below analyst expectations at the start of earnings season —worse than in small and large caps (which beat). Sales were 1% below expectations, similar to small caps but worse compared to large caps.
- Earnings beat expectations the most within Health Care, Financials, and Comm. Svcs., while Industrials, Utilities, and Discretionary missed the most.
- 79% of companies beat on EPS, 71% beat on sales and 28% beat on both — a higher breath of beats than in small caps on EPS and sales but slightly lower on both sales and EPS beats.
- Earnings fell 7% YoY (+4% for the median company) on sales growth of +2% YoY (+3% for the median company). Both earnings and sales decelerated versus last quarter (-6% YoY earnings growth on +3% sales growth), and suggests mid caps are also seeing an earnings recession.
- Sales growth was lower compared to both small and large caps, while earnings growth was better up the cap spectrum.

**Table 13: S&P 400 consensus 2Q19 earnings and sales growth and % of 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 | 12 | 12 | 15.7% | 11.4% | 4.7% | 2.8% | 100% | 43% | 8% |
| Cons. Disc. | 60 | 60 | -13.5% | 5.7% | 3.1% | 3.2% | 80% | 69% | 30% |
| Cons. Staples | 13 | 13 | 8.8% | 0.0% | -0.1% | 1.5% | 63% | 67% | 8% |
| Energy | 22 | 22 | -126.6% | -55.6% | -3.9% | 0.6% | 70% | 82% | 5% |
| Financials | 59 | 59 | 10.4% | 7.5% | 6.8% | 5.0% | 77% | 72% | 34% |
| Health Care | 36 | 36 | 5.9% | 4.5% | -0.3% | 4.8% | 94% | 64% | 44% |
| Industrials | 59 | 59 | -10.5% | 6.5% | 0.8% | 1.2% | 72% | 68% | 20% |
| Technology | 53 | 53 | -1.3% | 0.0% | 5.3% | 6.6% | 79% | 74% | 40% |
| Materials | 29 | 29 | -25.9% | -8.7% | -2.2% | -0.9% | 88% | 42% | 17% |
| Real Estate | 36 | 36 | -2.2% | 0.7% | -0.2% | 5.1% | 71% | 93% | 42% |
| Utilities | 13 | 13 | -7.9% | -7.0% | -1.4% | -5.8% | 100% | 100% | 8% |
| **S&P 400** | **392** | **392** | **-7.0%** | **3.6%** | **1.7%** | **3.1%** | **79%** | **71%** | **28%** |
| Ex-Financials | 333 | 333 | -11.6% | 1.8% | 1.2% | 2.8% | 80% | 71% | 27% |
| Ex-Energy | 370 | 370 | -3.6% | 4.2% | 2.3% | 3.1% | 80% | 71% | 30% |
| Ex-Energy&Financials | 311 | 311 | -7.4% | 3.4% | 1.8% | 2.8% | 80% | 70% | 29% |

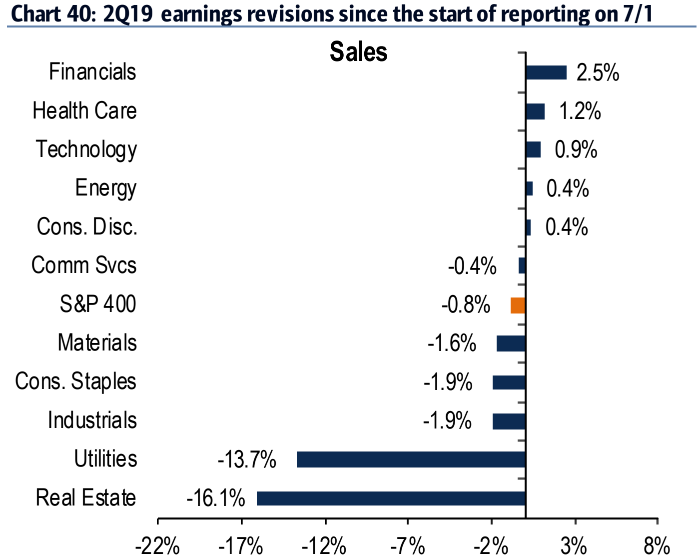
Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 39: 2Q19 earnings revisions since the start of reporting on 7/1**




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

**Chart 40: 2Q19 earnings revisions since the start of reporting on 7/1**




Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

# SMID cap 3Q19 earnings preview

## Small caps

- Analysts are forecasting another quarter of negative earnings growth for small caps in 3Q of -9% YoY (from -7% in 2Q), worse than the 5% decline in large caps.
- Sales are expected to grow +3% YoY — similar to 2Q sales growth and vs. large caps.
- The median company is expected to see earnings fall -4% YoY and sales +3% YoY.

**Table 14: S&P 600 consensus 3Q19 earnings and sales growth and % of 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 | 14 | 1 | N.A. | -25.1% | -0.5% | 5.6% | 100% | 100% | 100% |
| Cons. Disc. | 93 | 0 | -12.6% | 0.6% | 0.1% | 2.0% | N.A. | N.A. | N.A. |
| Cons. Staples | 22 | 1 | 8.6% | -5.5% | 29.7% | 3.6% | 0% | 0% | 0% |
| Energy | 44 | 0 | -136.2% | -31.0% | -2.0% | -1.8% | N.A. | N.A. | N.A. |
| Financials | 90 | 0 | -1.4% | -0.8% | 12.8% | 9.5% | N.A. | N.A. | N.A. |
| Health Care | 72 | 1 | -6.5% | -11.5% | -0.3% | 3.8% | 0% | 0% | 0% |
| Industrials | 90 | 4 | -0.7% | -1.7% | 0.5% | 2.2% | 75% | 50% | 50% |
| Technology | 79 | 2 | -10.3% | -10.9% | 2.2% | 3.2% | 100% | 100% | 100% |
| Materials | 33 | 1 | -27.8% | -5.0% | -2.9% | -2.0% | 0% | 0% | 0% |
| Real Estate | 36 | 0 | -10.0% | -6.0% | 2.3% | 4.6% | N.A. | N.A. | N.A. |
| Utilities | 5 | 0 | -0.4% | 8.5% | -1.7% | 5.3% | N.A. | N.A. | N.A. |
| **S&P 600** | **578** | **10** | **-9.0%** | **-3.9%** | **2.8%** | **3.0%** | **60%** | **50%** | **50%** |
| Ex-Financials | 488 | 10 | -11.3% | -4.9% | 2.3% | 2.4% | 60% | 50% | 50% |
| Ex-Energy | 534 | 10 | -3.6% | -2.8% | 3.3% | 3.4% | 60% | 50% | 50% |
| Ex-Energy&Financials | 444 | 10 | -4.3% | -3.7% | 2.7% | 2.6% | 60% | 50% | 50% |

Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

## Mid caps

- Mid caps earnings are expected to fall -8% YoY in 3Q (versus -7% YoY in 2Q), while sales are expected to grow +1% YoY (versus +2% growth in 2Q). Earnings growth is expected to decline less in large caps, while sales growth expectations are similar to small and large caps.
- The median company is expected to post flat earnings growth (compared to a decline in earnings for small caps) on median sales growth of +3% (similar to in small caps).

**Table 15: S&P 400 consensus 3Q19 earnings and sales growth and % of 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 | 11 | 0 | -10.1% | -21.5% | 4.5% | 4.8% | N.A. | N.A. | N.A. |
| Cons. Disc. | 58 | 2 | -4.5% | 0.8% | 3.6% | 3.8% | 67% | 0% | 0% |
| Cons. Staples | 14 | 0 | 6.8% | -5.1% | 0.4% | 1.9% | N.A. | N.A. | N.A. |
| Energy | 17 | 0 | -97.8% | -46.4% | -10.3% | -4.9% | N.A. | N.A. | N.A. |
| Financials | 61 | 2 | 2.5% | 1.6% | 2.7% | 4.4% | 50% | 0% | 0% |
| Health Care | 36 | 0 | -3.3% | 0.8% | 0.2% | 4.6% | N.A. | N.A. | N.A. |
| Industrials | 62 | 2 | 0.9% | 3.2% | 1.6% | 2.8% | 50% | 50% | 50% |
| Technology | 53 | 2 | -8.6% | -4.4% | 3.8% | 1.9% | 100% | 50% | 50% |
| Materials | 29 | 2 | -35.6% | -2.4% | -5.1% | 0.9% | 50% | 0% | 0% |
| Real Estate | 36 | 0 | -4.8% | -0.8% | 6.0% | 3.6% | N.A. | N.A. | N.A. |
| Utilities | 14 | 0 | 15.4% | 9.2% | 13.3% | 6.0% | N.A. | N.A. | N.A. |
| **S&P 400** | **391** | **10** | **-8.1%** | **0.1%** | **1.1%** | **3.1%** | **64%** | **20%** | **20%** |
| Ex-Financials | 330 | 8 | -10.8% | -1.3% | 1.0% | 2.9% | 67% | 25% | 25% |
| Ex-Energy | 374 | 10 | -4.8% | 0.3% | 2.1% | 3.2% | 64% | 20% | 20% |
| Ex-Energy&Financials | 313 | 8 | -6.8% | -0.6% | 2.0% | 3.0% | 67% | 25% | 25% |

Source: FactSet, BofA Merrill Lynch US Equity & US Quant Strategy

# Appendix

**Table 16: S&P 500 EPS Outlook**

| *All based on current constituents unless specified* | 2014 | 2015 | 2016 | 2017 | Bottom-up Consensus<br>2018 | *y/y* | 2019 | *y/y* | 2020 | *y/y* | BofAML Strategy<br>*2019* | *y/y* | *2020* | *y/y* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **S&P 500 Pro-forma EPS (Historical Index)** | **$118.78** | **$117.46** | **$118.10** | **$132.00** | **$161.93** | | | | | | | | | |
| **S&P 500 Pro-forma EPS (Current Constituents)** | **$117.88** | **$117.58** | **$119.25** | **$132.40** | **$161.44** | ***22%*** | **$164.31** | ***1%*** | **$181.91** | ***11%*** | **$164.00** | ***1%*** | **$174.00** | ***6%*** |
| **Sector ($ billions)** | | | | | | | | | | | | | | |
| Consumer Discretionary | 68.4 | 77.6 | 85.0 | 89.3 | 105.0 | *18%* | 107.8 | *3%* | 118.2 | *10%* | 106.7 | *2%* | 112.4 | *5%* |
| Consumer Staples | 78.3 | 76.0 | 77.7 | 82.0 | 89.3 | *9%* | 89.7 | *0%* | 95.3 | *6%* | 89.6 | *0%* | 95.1 | *6%* |
| Energy | 102.3 | 41.9 | 9.9 | 38.5 | 74.4 | *94%* | 60.4 | *-19%* | 78.3 | *30%* | 57.6 | *-23%* | 70.9 | *23%* |
| Financials | 170.6 | 187.9 | 186.3 | 198.6 | 246.4 | *24%* | 256.4 | *4%* | 260.1 | *1%* | 250.7 | *2%* | 252.9 | *1%* |
| Health Care | 136.4 | 155.6 | 166.9 | 179.2 | 204.2 | *14%* | 218.0 | *7%* | 232.7 | *7%* | 217.4 | *6%* | 230.8 | *6%* |
| Industrials | 111.1 | 111.3 | 107.7 | 109.1 | 130.5 | *20%* | 129.3 | *-1%* | 149.1 | *15%* | 126.2 | *-3%* | 132.1 | *5%* |
| Information Technology | 177.0 | 186.1 | 192.4 | 229.1 | 267.1 | *17%* | 261.6 | *-2%* | 280.9 | *7%* | 261.3 | *-2%* | 278.5 | *7%* |
| Materials | 26.3 | 25.4 | 24.7 | 24.6 | 37.4 | *52%* | 34.9 | *-7%* | 39.6 | *13%* | 33.2 | *-11%* | 34.2 | *3%* |
| Real Estate | 24.1 | 27.1 | 30.1 | 33.4 | 36.2 | *9%* | 37.7 | *4%* | 39.9 | *6%* | 37.2 | *3%* | 39.5 | *6%* |
| Communication Services | 72.5 | 82.3 | 95.1 | 100.4 | 129.4 | *29%* | 134.0 | *4%* | 151.2 | *13%* | 132.1 | *2%* | 146.3 | *11%* |
| Utilities | 30.8 | 31.7 | 33.8 | 35.6 | 39.1 | *10%* | 42.1 | *8%* | 44.6 | *6%* | 40.4 | *3%* | 43.1 | *7%* |
| **S&P 500** | **997.9** | **1,002.8** | **1,009.4** | **1,119.6** | **1,359.0** | ***21%*** | **1,371.9** | ***1%*** | **1,490.1** | ***9%*** | **1,352.4** | ***0%*** | **1,436.0** | ***6%*** |
| S&P 500 ex. Financials | 827.3 | 815.0 | 823.1 | 921.0 | 1,112.6 | *21%* | 1,115.5 | *0%* | 1,230.0 | *10%* | 1,101.7 | *-1%* | 1,183.0 | *7%* |
| S&P 500 ex. Energy and Financials | 725.0 | 773.0 | 813.3 | 882.5 | 1,038.1 | *18%* | 1,055.1 | *2%* | 1,151.7 | *9%* | 1,044.1 | *1%* | 1,112.1 | *7%* |
| S&P 500 ex. Energy | 895.5 | 960.9 | 999.5 | 1,081.1 | 1,284.5 | *19%* | 1,311.5 | *2%* | 1,411.8 | *8%* | 1,294.8 | *1%* | 1,365.0 | *5%* |
| **Energy Sector ($bn)** | **102.3** | **41.9** | **9.9** | **38.5** | **74.4** | ***94%*** | **60.4** | ***-19%*** | **78.3** | ***30%*** | **57.6** | ***-23%*** | **70.9** | ***23%*** |
| *Avg. Oil Price ($/bbl, wtd. blend of Brent & WTI)* | *$97/bbl* | *$51/bbl* | *$43/bbl* | *$59/bbl* | *$69/bbl* | | | | | | *~$62/bbl* | | *~$58/bbl* | |
| **S&P 500 Dividends (Historical Constituents, $/share)** | **$39.44** | **$43.39** | ***$45.70*** | ***$48.92*** | ***$53.74*** | | | | | | **$57.00** | ***6%*** | **$61.00** | ***7%*** |
| **Key Macro Economic Forecasts** | | | | | | | | | | | | | | |
| Global GDP growth (real) | 3.3% | 3.2% | *3.1%* | *3.8%* | *3.8%* | | | | | | 3.1% | | 3.1% | |
| US GDP growth (real) | 2.4% | 2.6% | *1.5%* | *2.3%* | *2.9%* | | | | | | 2.2% | | 1.5% | |
| US Civilian Unemployment Rate | 6.2% | 5.3% | *4.9%* | *4.4%* | *3.9%* | | | | | | 3.7% | | 3.8% | |
| FX Rate: US$/Euro (average) | 1.33 | 1.11 | 1.11 | 1.13 | 1.18 | | | | | | 1.11 | | 1.11 | |

Source: BofA Merrill Lynch US Equity & US Quant Strategy, FactSet/First Call

Note: 2019 EPS growth rate is relative to actual S&P 500 2018 EPS of $161.93

## BofAML 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 year-to-year 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 year-to-year change in the CPI and the year-to-year change in Average Hourly Earnings to approximate margins:

***Corporate Misery Indicator*** *= CPI (y/y) – Average Hourly Earnings (y/y) + Coincident Indicators (y/y)*

When the indicator declines, it implies that profits are being squeezed. This has historically coincided with a decelerating profits cycle.

# 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* |
|---|---|---|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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