MacroResearchBoard
mrb partners
Independent Investment Strategy

U.S. EQUITIES

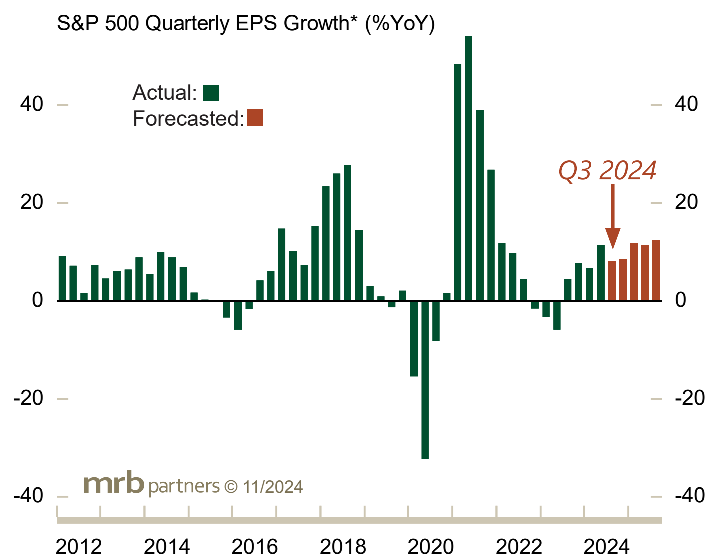
November 21, 2024

Q3 2024 Earnings Review And Outlook: Continued Expansion

- S&P 500 companies delivered solid earnings in the third quarter, with a healthy number of index members beating top- and bottom-line estimates.
- Corporate profits were supported by sturdy revenue growth of more than 5%, reflecting the ongoing strength of the economy.
- Communication services and technology topped the list of sectors with the best earnings growth, while the energy, materials, and industrial sectors saw their profits contract.
- Our constructive economic stance implies that the overall earnings outlook remains positive.
- However, consensus profit expectations for 2025 are aggressive and earnings estimates are likely to adjust to more reasonable levels, especially if the U.S. dollar strengthens further, and uncertainty about the policy priorities of the incoming Trump Administration persists.

The U.S. third-quarter (Q3) earnings season is winding down, with only a small number of companies left to report results. Corporate profits in the third quarter were underpinned by the ongoing economic expansion. While overall earnings growth moderated from the previous quarter, it remained healthy. Moreover, corporate commentary and guidance were sufficiently positive to support equity prices and reinforce the notion of continued earnings expansion (**chart 1**).

Chart 1 Q3 Marked The Fifth Consecutive Quarter Of Profit Growth



* Forecasted growth is based on consensus estimates; truncated above 50%; source: LSEG I/B/E/S

Nearly 95% of S&P 500 companies have reported Q3 2024 results. According to LSEG I/B/E/S, year-over-year (YoY) earnings growth for the quarter is tracking at just under 9%, on revenue growth of more than 5%. Excluding the energy sector, earnings growth is pacing at more than 11% YoY. Earnings growth moderated

Table 1 **S&P 500 Q3 2024 Earnings And Revenues Versus Consensus Forecasts**

	Earnings				Revenues		
Sector	Beat (%)	Met (%)	Missed (%)	Surprise Factor (%)	Beat (%)	Missed (%)	Surprise Factor (%)
Consumer Discretionary	61.4	2.3	36.4	10.4	47.7	52.3	1.7
Consumer Staples	79.3	3.4	17.2	3.4	57.1	42.9	0.4
Energy	68.2	0.0	31.8	5.0	50.0	50.0	0.7
Financials	83.1	2.8	14.1	8.7	66.2	33.8	3.7
Health Care	88.1	3.4	8.5	9.5	79.7	20.3	3.5
Industrials	75.3	2.7	21.9	8.4	47.9	52.1	-0.3
Materials	53.6	3.6	42.9	-6.9	35.7	64.3	-0.6
Real Estate	61.3	19.4	19.4	-1.3	71.0	29.0	0.5
Technology	88.9	7.4	3.7	5.6	87.0	13.0	1.1
Communication Services	94.7	5.3	0.0	11.6	57.9	42.1	0.8
Utilities	66.7	3.3	30.0	12.8	36.7	63.3	-2.5
S&P 500	76.3	4.6	19.1	7.7	60.6	39.4	1.6

Note: The Surprise Factor denotes the percent upside/downside for actual earnings and revenues versus consensus forecasts
Source: LSEG I/B/E/S

from 13% in the prior quarter and was roughly in line with the rate of growth expected at the start of Q3, as well as at the beginning of the year. The third quarter marked the fifth consecutive quarter of positive earnings growth and the second consecutive quarter in which revenues expanded by more than 5%.

Over 75% of reporting companies exceeded earnings forecasts, while roughly 60% beat revenue estimates

Over 75% of reporting companies exceeded earnings forecasts, while roughly 60% beat revenue estimates. The beat-rate for earnings was modestly above the long-run average, while it was slightly below the historic average for revenues. The surprise factor (i.e. the magnitude by which actual results exceeded analysts' forecasts) was above the long-term average for both earnings and revenues. However, in the months leading into the reporting season, analysts lowered estimates by more than in recent quarters, thus lowering the bar for positive surprises.

At the sector level, communication services, technology, health care, and financials had the widest breadth of companies reporting positive earnings surprises (**table 1**). Conversely, the materials, consumer discretionary, energy, and utilities sectors had the largest share of companies negatively missing earnings estimates. The tech and health care sectors produced the highest beat-rates for revenues, while materials and utilities had the largest share of companies underperforming top-line estimates.

Eight out of the 11 sectors reported positive YoY earnings growth, led by communication services, tech, utilities, and health care (**table 2**). Financials also produced respectable earnings growth thanks to upside profit surprises from banks and property & casualty (P&C) insurers. Energy, materials, and industrials were the three sectors that recorded negative earnings growth. The wide dispersion in earnings growth across sectors underscores that while the overall profit cycle continues to show strength, the gains have not yet fully broadened out.

Table 2 **S&P 500 Quarterly Earnings Growth**

	Earnings Growth (%YoY)		
Sector	**Q3-2024**	**Q2-2024**	**Q3-2023**
Consumer Discretionary	11.0	14.8	42.7
Consumer Staples	3.9	3.4	6.9
Energy	-25.4	1.3	-33.0
Financials	8.5	20.7	23.5
Health Care	14.6	20.5	-17.3
Industrials	-5.7	1.7	16.4
Materials	-6.8	-5.8	-18.0
Real Estate	1.3	-0.4	-5.4
Technology	17.4	21.2	15.3
Communication Services	25.7	7.4	46.5
Utilities	15.5	15.5	10.3
S&P 500	8.8	13.2	7.5

Source: LSEG I/B/E/S

mrb partners © 11/2024

Key Sector Level Highlights

- After narrowing in Q2, the earnings growth gap between the growth sectors (i.e. technology, communication services, and consumer discretionary) and the rest of the equity market widened anew in Q3. However, the re-widening of the earnings growth differential was partly driven by one-time or special factors. Large accounting charges taken by Boeing and Eli Lilly lowered the aggregate earnings of the industrial and health care sectors, respectively, thereby suppressing the earnings of non-growth sectors in the quarter. Earnings have been unusually noisy in recent years. Hence, we would not read too much into these developments. With the profit momentum of growth sectors set to moderate in the year ahead, it is still reasonable to expect a more balanced earnings growth environment to eventually unfold, but quarter-to-quarter volatility will make the transition bumpy.

It is still reasonable to expect a more balanced earnings growth environment to eventually unfold

- The communication services sector produced the strongest earnings growth at 26%, led by the entertainment and interactive media & services sub-groups where several incumbent companies reported positive earnings surprises. The social media and internet search platforms that dominate the interactive media & services sub-group continued to benefit from strong digital advertising trends and substantially contributed to the sector's overall profit momentum. A blitz in political ads in the lead-up to the U.S. election earlier this month is expected to keep earnings growth buoyant in the current quarter. However, payback from this strong demand beginning in early-2025 should cause the earnings growth of the sector to meaningfully decelerate next year.

- The tech sector's earnings growth rate of 17% was the second-highest among sectors. As has been the case in recent quarters, earnings growth was bolstered by strength in the semiconductor sub-group, which in turn reflected strong growth at NVIDIA and a small handful of other chip stocks linked to the buildout of A.I. infrastructure. Other tech sub-groups such as software and hardware recorded more pedestrian earnings growth. Consensus forecasts for the tech sector's earnings in the coming quarters remain very high. However, with A.I. investments siphoning money from IT budgets, and uncertainties about the timing and magnitude of returns from the massive spending on A.I., we remain concerned that growth expectations for the sector may be too optimistic.

Consensus forecasts for the tech sector's earnings in the coming quarters remain very high

- Utilities reported another quarter of double-digit earnings growth and had the largest positive difference between actual and estimated earnings. However, the sector's low beat-rate for earnings indicates that the breadth of positive earnings surprises was narrowly-based. Earnings growth is expected to slow to more normal levels next year as the sector will face tougher YoY comparisons. While there is considerable optimism that growing electricity demand from data centers and the electrification of transportation will boost the earnings of the sector, utilities must first expand energy infrastructure to meet this demand. The latter will require state regulators to approve investment plans and customer rates, which could take time, implying that it will likely be several years before the sector fully reaps the upside from the data center buildout.

Robust top-line performance gives us confidence that the health care sector's earnings growth will continue to recover

- Despite a significant downward revision to the earnings of Eli Lilly due to a large accounting charge, the health care sector posted earnings growth of nearly 15%. Rebounds in the profit growth of the pharmaceutical and biotechnology sub-groups, more than offset earnings contractions in health insurers and life science stocks. While the earnings growth of pharmaceutical and biotech stocks was flattered by easy YoY comparisons, revenue revision trends for these sub-groups as well as others within the sector remain positive. This robust top-line performance gives us confidence that the health care sector's underlying earnings growth will continue to recover in the year ahead as drug company profits further improve and health insurers raise premiums to offset higher medical costs.

- The 11% earnings growth recorded by the consumer discretionary sector was less impressive than it looked. Aggregate earnings for the sector came in much better than expected, thanks to positive surprises from sub-groups such as automobiles and broadline retail. However, Amazon substantially contributed to the bulk of the sector's earnings growth. We anticipate that the earnings growth for the overall sector will moderate in the coming quarters due to less favorable base effects for Amazon and a normalization in the earnings momentum of companies linked to the post-COVID boom in services spending.

- Financial stocks generated solid earnings growth of almost 9%, which was considerably higher than the slight contraction in earnings that was forecasted by analysts before the reporting season. Upside surprises from money-center and custody banks, as well as broker-dealers and P&C insurers, drove the better-than-expected earnings growth. Fed easing weighing on the net interest income expectations of banks and moderating earnings growth for P&C insurers could restrain the broad sector's earnings momentum in the near term. However, markets should look through these short-term headwinds and focus on longer-term prospects for upgrades to earnings based on firming loan demand, lower funding costs, and improving noninterest revenues.

Financials generated solid earnings growth of almost 9%

- The contraction in the earnings of the industrial sector was driven by profit declines in the aerospace & defense, machinery, and airline sub-groups, which more than offset growth in other component areas such as ground transportation. The decline in the earnings of the aerospace & defense sub-group was especially large and reflected big losses incurred by Boeing due to accounting charges taken by the company for production delays and cost overruns in its commercial and defense businesses. Excluding the impact of Boeing's losses, the earnings of the industrial sector would have grown modestly in the quarter.

The energy and material sectors remained a drag on overall S&P 500 profits

- The earnings of the energy and material sectors remained a drag on overall S&P 500 profits. The energy sector's earnings contracted 25%, as declines in the profits of refiners, E&P companies, and integrated producers more than offset decent growth in the energy equipment & services and oil & gas storage & transportation sub-groups. While lower YoY oil and natural gas prices weighed on the financial performance of the energy sector, weak refining margins continued to exert the biggest drag on earnings. The earnings of the materials sector contracted by a more modest 7%, led by declines in the containers & packaging and metals & mining sub-groups, with the latter impacted by weak YoY steel prices. The earnings contractions for both sectors should reverse next year if the pessimism about global economic growth that is currently embedded in commodity prices unwinds, as we expect.

The Outlook Is Positive, But Expectations Are Already High

The overall earnings outlook remains positive. While there was an uptick in negative pre-announcements for the current quarter, guidance trends and corporate commentary remained benign. Our forecast that the U.S. economy will expand at an above-trend pace and growth outside the U.S. will firm in the year ahead is consistent with ongoing robust YoY growth in earnings, which should continue to act as support for stock prices.

That said, consensus earnings forecasts are high. As highlighted in **table 3**, annual earnings growth for the S&P 500 is expected to accelerate to more than 14% in 2025 from a projected growth rate of roughly 9% this year. For 2026, analysts are forecasting an additional 13% of earnings growth. Moreover, consensus earnings and sales estimates for 2025 and 2026 imply that profit margins, which are already elevated by historical standards, will further expand by an eye-popping 190 bps by the end of 2026. This is too optimistic, and thus represents a downside risk.

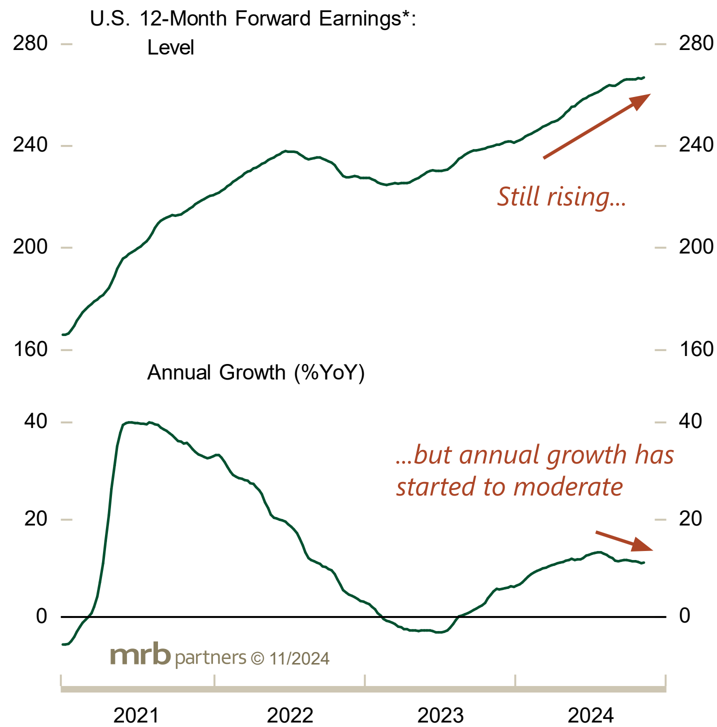
The upside momentum in 12-month forward earnings has moderated as analysts have recently lowered estimates for earnings (**chart 2**). However, the magnitude of the downgrades has been modest. Consensus earnings forecasts for Q4 2024 and Q1 2025 have been lowered by roughly 3% and 1.5%, respectively. The sizes of these downgrades have been within the norms for a typical quarter. Despite the recent downgrades, full-year earnings estimates have remained within the tight ranges that have prevailed in the past 12 months (**chart 3**).

Table 3 Analysts' Forecasts Imply Aggressive Profit Margin Expansion

S&P 500	2023	2024 (Consensus Forecasts)	2025 (Consensus Forecasts)	2026 (Consensus Forecasts)
Earnings/Share	$217	$236	$270	$305
Growth		*8.8%*	*14.4%*	*13.0%*
Sales/Share	$1,812	$1,899	$2,004	$2,128
Growth		*4.8%*	*5.5%*	*6.2%*
Profit Margin	12.0%	12.4%	13.5%	14.3%
Change (bps)		*40*	*110*	*80* !!

Source: Refinitiv I/B/E/S Global Aggregates mrb partners © 11/2024

Chart 2 12-Month Forward Earnings Momentum May Have Crested



* Smoothed; source: Refinitiv I/B/E/S Global Aggregates

The strengthening U.S. dollar poses some near-term risk to earnings forecasts. Nearly 40% of S&P 500 earnings are sourced from abroad. As a result, YoY changes in the dollar have tended to be inversely correlated with the earnings revision ratio for the S&P 500 (**chart 4**). While not our base-case forecast, an upside breakout in the dollar would likely spur additional downgrades to earnings estimates in the coming weeks. Uncertainties about the sequencing of President-elect Trump's policies (i.e. the timing of deregulation and tax cuts versus tariffs and immigration curbs) could also lead to some modest scaling back of profit estimates.

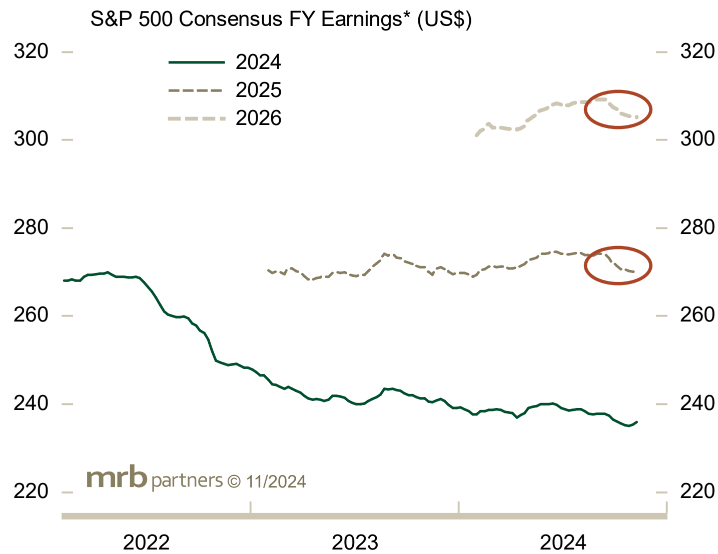
Given the constructive economic backdrop, we expect any "right-sizing" of earnings estimates to be modest and unfold gradually. As such, the equity market should be able to digest these adjustments without too much volatility, provided economic prospects remain favorable.

Final Word: *Third-quarter earnings results for the S&P 500 were solid, with a healthy percentage of companies exceeding earnings and revenue estimates. With the reporting season nearly completed, earnings growth for the index is tracking at roughly 9% year-over-year on sturdy revenue growth of more than 5%. Communication services and technology topped the list of sectors with the best earnings growth, while the energy, materials, and industrial sectors saw their profits contract.*

Our constructive economic stance implies that the earnings outlook will remain positive, but consensus profit expectations for 2025 are aggressive and some adjustment in analysts' estimates to more reasonable levels is likely, especially if the U.S. dollar strengthens further, and policy uncertainty related to the incoming Trump Administration persists. The equity market should be able to take these developments in stride, provided economic prospects remain favorable.

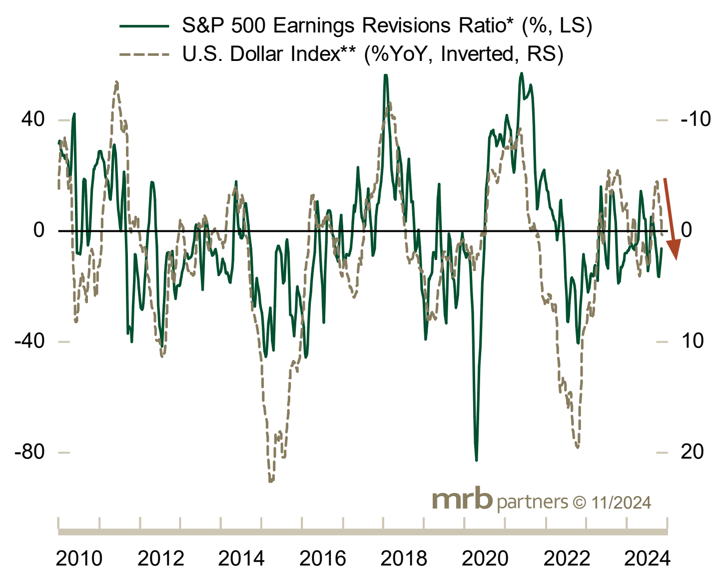
Salvatore Ruscitti | Strategist, U.S. Equities

Chart 3 **The Froth In 2025 & 2026 Earnings Projections May Be Starting To Unwind**



* Source: Refinitiv I/B/E/S Global Aggregates

Chart 4 **Further Strengthening Of The Dollar Is Likely To Spur Earnings Downgrades**



* Upward revisions minus downward revisions divided by total revisions; 4-week moving average; source Refinitiv I/B/E/S Global Aggregates
** Smoothed; source: Bloomberg

MRB U.S. Equity Sector And Industry Sub-Group Recommendations

Sector	– N +	Industry Ratings*: Underweight	Industry Ratings*: Neutral	Industry Ratings*: Overweight
Consumer Discretionary	–	Automobiles Consumer Discretionary Retail Household Durables	Auto Components Hotels, Restaurants & Leisure Textile, Apparel & Luxury Goods	
Communication Services	N		Media & Entertainment Telecom Services	
Consumer Staples	N	Tobacco	Consumer Staples Retail Food Products Household & Personal Products	Beverages
Energy	+			Energy Equipment & Services Oil, Gas & Consumable Fuels
Financials	+		Capital Markets Consumer Finance Financial Services Insurance	Banks
Health Care	+		Health Care Providers & Services	Biotechnology Health Care Equipment & Supplies Pharmaceuticals
Industrials	N	Machinery	Electrical Equipment Ground Transportation Industrial Conglomerates	Aerospace & Defense Air Freight & Logistics
Information Technology	–	IT Services Semiconductor & Semi Equipment Technology Hardware & Equipment	Software	
Materials	N		Chemicals Metals & Mining	
Real Estate	N		Real Estate	
Utilities	N		Utilities	

* 6-12 month horizon; relative to the U.S. equity benchmark
Note: + = overweight, N = neutral, – = underweight

MacroResearchBoard

mrb partners

Independent Investment Strategy

MRB - Macro Research Board is an independent top-down research firm that provides integrated, global, multi-asset investment strategy as well as actionable absolute and relative return ideas. Our views incorporate a long-term outlook based on in-depth thematic research, together with a rigorous set of frameworks and forecasting models/indicators that drive 6-12 month asset market performance. MRB's team of analysts and strategists leverage the firm's robust research engine and their extensive experience to form one cohesive house view and ensure that investment strategy is articulated in a client-friendly manner.

For more information, please contact:
Client Relations
clientrelations@mrbpartners.com

London
24 Old Bond Street, 3rd Floor,
London, W1S 4AP, United Kingdom
Tel (+)44 (0) 20 3523 9618

Montreal
1275 Ave. des Canadiens-de-Montréal, Suite 500
Montreal, Quebec H3B 0G4, Canada
Tel +1 514 558 1515

New York
1345 Avenue of the Americas, FL 2
New York, NY, 10105, United States
Tel +1 212 390 1148

MRB Research Coverage

- **Weekly Macro Strategy**
- **Global Macro & Investment Themes**
- **Global Asset Allocation**
- **Absolute Return Strategy**
- **U.S. & Developed Market Strategy**
- **China & Emerging Market Strategy**
- **Regional Equity Strategy**
- **U.S. Equity Sectors Strategy**
- **Global Fixed Income Strategy**
- **Foreign Exchange Strategy**
- **Commodity Strategy**
- **Webcasts & Live Events**