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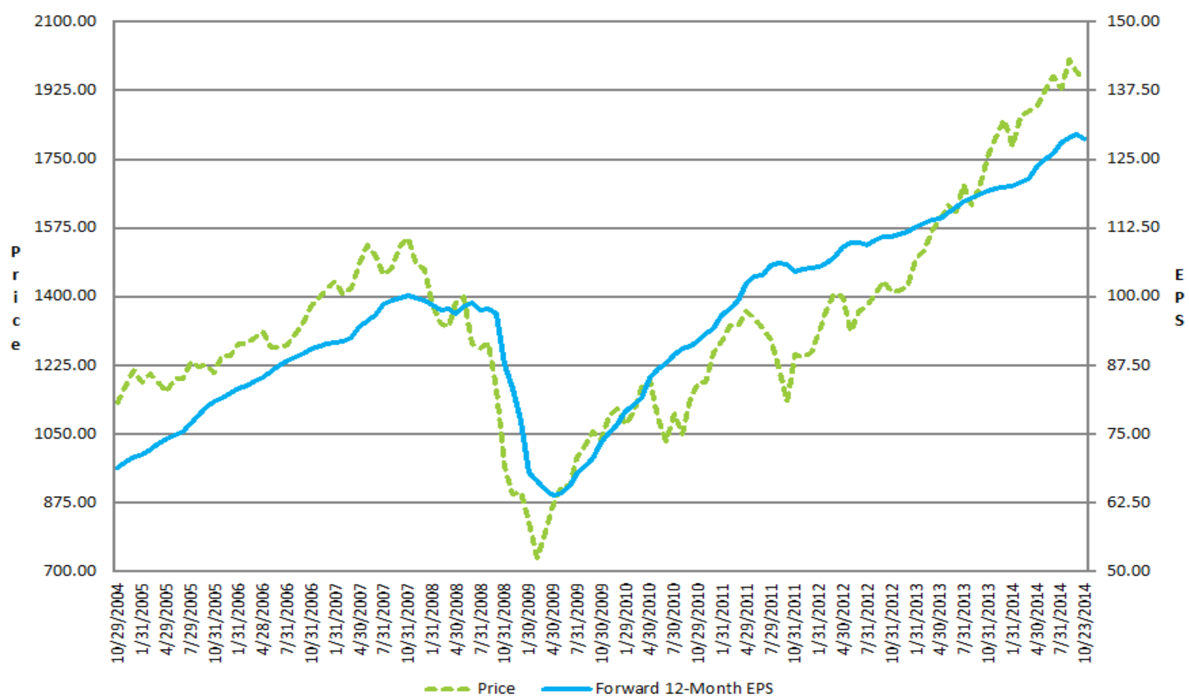
FACTSET EARNINGS INSIGHT

S&P 500 October 24, 2014

Key Metrics

- **Earnings Scorecard:** Of the 208 companies that have reported earnings to date for Q3 2014, 75% have reported earnings above the mean estimate and 60% have reported sales above the mean estimate.
- **Earnings Growth:** The blended earnings growth rate for Q3 2014 is 5.6%. The Telecom Services sector is reporting the highest earnings growth for the quarter, while the Consumer Discretionary and Energy sectors are the only sectors reporting year-over-year declines in earnings.
- **Earnings Revisions:** On September 30, the estimated earnings growth rate for Q3 2014 was 4.6%. Six of the ten sectors have higher growth rates today (compared to September 30) due to upside earnings surprises, led by the Financials sector.
- **Earnings Guidance:** For Q4 2014, 29 companies have issued negative EPS guidance and 8 companies have issued positive EPS guidance.
- **Valuation:** The current 12-month forward P/E ratio is 15.2. This P/E ratio is based on Thursday's closing price (1950.82) and forward 12-month EPS estimate ($128.58).

Change in Forward 12-Month EPS vs. Change in Price: 10 Years
(Source: FactSet)



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Topic of the Week:

Energy Sector Has Seen Largest Decline in Earnings Estimates and Price for Q4 to Date

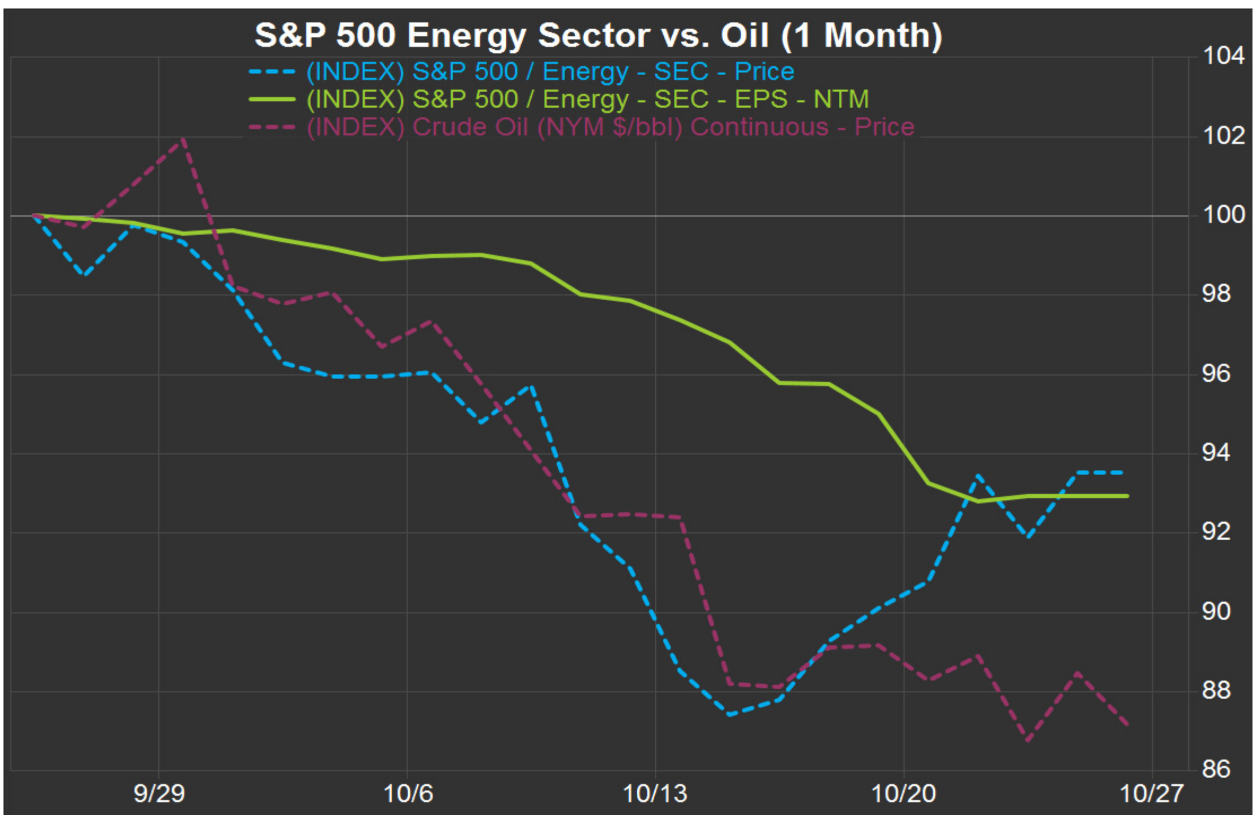
The Energy sector will be a focus sector for the markets next week, as Exxon Mobil, Chevron, and ConocoPhillips are all scheduled to report earnings during the upcoming week. The estimated earnings for all three companies are lower today compared to the start of the third quarter. The mean EPS estimate for Exxon Mobil is $1.72, compared to an estimate of $1.91 on June 30. The mean EPS estimate for Chevron is $2.54, relative to an estimate of $2.79 on June 30. The mean EPS estimate for ConocoPhillips is $1.19 compared to an estimate of $1.48 at the start of the quarter.

During the third quarter, the Energy sector overall recorded the second largest cuts to earnings estimates of all ten sectors, as the price of oil decreased by 13% during the quarter. Given the continued decline in the price of oil to start the fourth quarter, have analysts continued to slash earnings estimates for the Energy sector for the fourth quarter and beyond?

The answer is yes. Since the start of the fourth quarter (September 30), the bottom-up EPS estimate for the Energy sector (which is aggregation of the EPS estimates for all of the companies in the sector) has fallen by 9.9% (to $10.76 from $11.94), which is by far the largest decrease of all ten sectors since the start of the quarter. As a result of these cuts to estimates, the Energy sector has recorded the largest decrease in expected earnings growth (to -4.7% from 7.0%) of all ten sectors during this time.

Analysts have not only lowered earnings estimates for Q4, but have also lowered earnings estimates for future quarters as well. The forward 12-month (bottom-up) EPS estimate for the Energy sector has declined by 6.7% (to $46.58 from $49.94) since September 30. This is also the largest decrease in the forward 12-month EPS estimate for any sector over this period.

Given the drop in the price of oil and the cuts to future earnings estimates over the past few weeks, the price of the S&P 500 Energy sector has fallen by 4.7% since September 30, which is the largest drop in price for all ten sectors during this time frame



Q3 2014 Earnings Season: By the Numbers

Overview

With 41% of the companies in the S&P 500 reporting actual results for Q3 to date, more companies are reporting both actual EPS above estimates (75%) and actual sales above estimates (60%) compared to recent historical averages.

As a result of these upside earnings surprises, the year-over-year blended (combines actual results and estimated results) earnings growth rate for Q3 2014 has improved to 5.6% today relative to an expectation of 4.6% at the end of the quarter (September 30). At the sector level, the Telecom Services, Financials, Materials, and Health Care sectors are reporting the highest earnings growth rates, while the Consumer Discretionary and Energy sectors are the only sectors reporting declines in earnings.

Despite the upside revenue surprises, the year-over-year blended sales growth rate for Q3 2014 of 3.7% is slightly below the estimate of 3.8% at the end of the quarter due in part to downward revisions to revenue estimates for companies in the Energy sector. At the sector level, the Health Care sector is reporting the highest sales growth, while the Energy sector is reporting the largest year-over-year drop in sales.

In their earnings releases and conference calls, a number of companies have cited the negative impact of the stronger dollar on both results for the third quarter and expected results for the fourth quarter. Comments from companies regarding Europe have generally been mixed, while comments regarding China have generally been positive.

Looking at forward estimates, analysts are projecting much higher earnings growth in first half of 2015 compared to Q3 2014 and Q4 2014. However, they are not predicting a substantial improvement in revenue growth, which implies that net margins are expected to increase in future quarters as well.

Companies have begun to lower expectations for the fourth quarter, as 29 companies in the index have issued negative EPS guidance while 8 companies have issued positive EPS guidance.

With the recent uptick in the market this past week, the forward 12-month P/E ratio is now 15.2, which is still above the 5-year and 10-year averages.

The upcoming week marks the third peek week of the Q3 2014 earnings season, as 159 S&P 500 companies are scheduled to report results for the third quarter. Six of these companies are Dow 30 components.

More Companies Beating Estimates than Average

With 41% of the companies in the S&P 500 reporting actual results for Q3 to date, more companies are reporting both actual EPS above estimates and actual sales above estimates compared to recent historical averages.

Percentage of Companies Beating EPS Estimates (75%) is Above Recent Averages

Overall, 208 companies have reported earnings to date for the third quarter. Of these 208 companies, 75% have reported actual EPS above the mean EPS estimate and 25% have reported actual EPS below the mean EPS estimate. The percentage of companies reporting EPS above the mean EPS estimate is above both the 1-year (73%) average and the 5-year (73%) average.

At the sector level, the Industrials (92%) and Health Care (86%) sectors have the highest percentages of companies reporting earnings above estimates, while the Telecom Services (0%) and Utilities (33%) sectors have the lowest percentages of companies reporting earnings above estimates.

Market Rewarding Earnings Beats and Not Punishing Earnings Misses

To date, the market is rewarding upside earnings surprises more than average and not punishing downside earnings surprises more than average. Companies that have reported upside earnings surprises for Q3 2014 have seen an average increase in price of 2.8% from two days before the earnings release through two days after the earnings release. Over the past five years, companies in the S&P 500 that have reported upside earnings surprises have witnessed a 0.9% increase in price on average during this window. Companies in the index that have reported downside earnings surprises for Q3 2014 have seen an average decline in price of 1.2% during this window. Over the past five years, companies in the index that have reported downside earnings surprises have recorded a 2.4% decrease in price on average during this window.

Earnings Surprise Percentage (+3.8%) In-Line with Recent Quarters

In aggregate, companies are reporting earnings that are 3.8% above expectations. This surprise percentage is slightly above the 1-year (+3.6%) average but below the 5-year (+5.9%) average.

Companies in the Materials (+7.8%) and Financials (+7.3%) sectors are reporting the largest upside aggregate differences between actual earnings and estimated earnings. In the Materials sector, Alcoa ($0.31 vs. $0.22) has reported the highest positive earnings surprise. In the Financials sector, Bank of America (-$0.01 vs. -$0.09) and Goldman Sachs ($4.57 vs. $3.21) have reported significant upside earnings surprises.

On the other hand, companies in the Utilities (-1.5%) and Telecom Services (-1.4%) sectors are reporting the largest downside aggregate differences between actual earnings and estimated earnings. In the Utilities sector, CMS Energy ($0.37 vs. $0.40) and DTE Energy ($1.02 vs. $1.05) have reported the largest downside earnings surprises. In the Telecom Services sector, Verizon Communications ($0.89 vs. $0.90) and AT&T ($0.63 vs. $0.64) have reported the highest downside earnings surprises.

Percentage of Companies Beating Revenue Estimates (60%) is Above Recent Averages

In terms of revenues, 60% of companies have reported actual sales above estimated sales and 40% have reported actual sales below estimated sales. The percentage of companies reporting sales above estimates is above both the 1-year (58%) average and the 5-year average (59%).

At the sector level, the Health Care sector (76%) has the highest percentage of companies reporting revenue above estimates, while the Telecom Services (0%) sector has the lowest percentage of companies reporting revenue above estimates.

Revenue Surprise Percentage (+0.5%) Below Recent Averages

In aggregate, companies are reporting sales that are 0.5% above expectations. This surprise percentage is below the 1-year (+0.7%) average and the 5-year (+0.6%) average.

Companies in the Materials (+2.0%) sector are reporting the largest upside aggregate differences between actual sales and estimated sales, while companies in the Telecom Services (-0.4%) sector are reporting the largest downside aggregate differences between actual sales and estimated sales.

Increase in Q3 Earnings Growth This Week Due to Surprises from Technology and Industrials

Increase in Earnings Growth This Week Due to Earnings Surprises from Industrials and Technology

The blended earnings growth rate for the third quarter is 5.6% this week, above the growth rate of 4.7% last week. Upside earnings surprises reported by companies in the Industrials and Information Technology sectors were the largest contributors to the increase in the growth rate for the index for the week.

In the Information Technology sector, upside earnings surprises reported by Apple ($1.42 vs. $1.30), Microsoft ($0.54 vs. $0.49), and Yahoo! ($0.52 vs. $0.32) were the largest contributors to the increase in the earnings growth rate for the index during the week. As a result, the blended earnings growth rate for the Information Technology sector improved to 1.6% from 0.0% over this time frame.

In the Industrials sector, positive earnings surprises reported by Caterpillar ($1.72 vs. $1.34), United Technologies ($2.04 vs. $1.81), and Boeing ($2.14 vs. $1.97) were the largest contributors to the rise in the earnings growth rate for the index during the week. As a result, the blended earnings growth rate for the Industrials sector improved to 8.7% from 5.9% over this time frame.

Financials Sector Has Seen Largest Jump in Earnings Growth since September 30

The blended earnings growth rate for Q3 2014 of 5.6% is above the estimate of 4.6% at the end of the quarter (September 30). Six sectors have seen an increase in earnings growth over this period due to upside earnings surprises, led by the Financials (to 16.1% from 10.3%) sector. Four sectors have recorded a decrease in earnings growth due to a combination of downside earnings surprises and downward revisions to earnings estimates, led by the Energy (to -1.0% from 3.7%) sector.

Blended Earnings Growth: 5.6%

The blended earnings growth rate for Q3 2014 is 5.6%. Eight sectors are reporting higher earnings relative to a year ago. Four of these nine sectors are reporting double-digit earnings growth: Telecom Services, Financials, Materials, and Health Care. On the other hand, the Consumer Discretionary and Energy sectors are the only sectors reporting year-over-year declines in earnings.

Telecom Services: Ex-Verizon, Growth Rate Drops to -7%

The Telecom Services sector is reporting the highest earnings growth rate of all ten sectors at 19.4%. At the company level, Verizon Communications is the only company within the sector reporting growth in EPS for the quarter. The company reported actual EPS of $0.89 for Q3 2014, compared to year-ago EPS of $0.77. If Verizon is excluded, the earnings growth rate for the sector would drop to -7.3%.

Financials: A Tale of Two Companies

The Financials sector is reporting the second highest earnings growth rate at 16.1%. At the company level, two companies are having significant and opposite effects on the earnings growth rate for the sector: JPMorgan Chase and Bank of America.

JPMorgan Chase is the largest contributor to earnings growth for the sector, mainly due to a charge the company reported in the year-ago quarter. The company reported actual EPS of $1.36 for Q3 2014, compared to year-ago EPS of -$0.17 in Q3 2013. The loss reported by JPMorgan Chase in Q3 2013 included a charge of $1.85 for legal expenses and reserves. If JPMorgan Chase is excluded, the earnings growth rate for the sector would drop to 2.5%.

On the other hand, Bank of America is the largest detractor to earnings growth for the sector, mainly due to the settlement with the DOJ announced in August. The company reported actual EPS of -$0.01 for Q3 2014, compared to actual EPS of $0.20 in Q3 2013. The actual loss for Bank of America in Q3 2014 included a negative impact of $0.43 per share due to the settlement with the DOJ. If Bank of America is excluded, the earnings growth rate for the Financials sector would rise to 22.5%.

Materials: Strength in Chemicals Industry

The Materials sector is reporting the third highest earnings growth rate at 13.3%. At the industry level, only three of the five industries are reporting or are expected to report earnings growth, led by the Construction Materials (62%) and Chemicals (22%) industries. However, the Chemicals industry is by far the largest contributor to growth for the Materials sector. If this industry is excluded, the earnings growth rate for the sector would fall to -1.6%.

Health Care: Gilead Sciences Leads Growth

The Health Care sector is reporting the fourth highest earnings growth rate at 12.4%. At the company level, Gilead Sciences is the largest contributor to earnings growth for the sector. The mean EPS estimate for the company for Q3 2014 is $1.92, compared to actual EPS of $0.52 in Q3 2013. If Gilead Sciences is excluded, the earnings growth rate for the sector would drop to 5.7%.

Consumer Discretionary: PulteGroup a Drag on Growth Due to Comparison to High Year-Ago EPS

The Consumer Discretionary sector is reporting the largest year-over-year decline in earnings at -6.6%. At the company level, PulteGroup is the largest contributor to the earnings decline for the sector, mainly due to a gain the company reported in the year-ago quarter. The company reported actual EPS of $0.37 for Q3 2014, compared to year-ago EPS of $5.87. The unusually high EPS reported by PulteGroup in Q3 2013 included a deferred tax asset valuation allowance reversal (gain) of $5.42. If PulteGroup is excluded, the earnings growth rate for the sector would jump to 1.0%.

Energy: Weakness in Multiple Sub-Industries

The Energy sector is reporting the second largest year-over-year decrease in earnings at -1.0%. At the sub-industry level, four of the seven sub-industries are reporting earnings declines, led by the Oil & Gas Exploration & Production (-18%) and the Oil & Gas Drilling (-17%) sub-industries (62%). On the other hand the Oil & Gas Refining & Marketing (+147%) sub-industry is projected to report the highest earnings growth within the sector.

Blended Revenue Growth: 3.7%

The blended revenue growth rate for Q3 2014 is 3.7%, which is slightly below the estimated growth rate of 3.8% at the end of the quarter (September 30). A combination of downward revisions to revenue estimates and downside earnings surprises reported for companies in the Energy and Consumer Discretionary sectors, partially offset by upside revenue surprises for companies in the Financials and Information Technology sectors, has accounted for most of the drop in the revenue growth rate for the index since the end of the quarter.

Overall, eight sectors are reporting revenue growth for the quarter, led by the Health Care sector. The Energy sector is reporting the largest year-over-year decline in revenues.

The Health Care sector is reporting the highest revenue growth of all ten sectors at 10.2%. All six industries in the sector are reporting sales growth for the quarter. Four of the six industries are reporting double-digit sales growth, led by the Biotechnology (38%) industry.

On the other hand, the Energy (-3.5%) sector is reporting the largest year-over-year decrease in sales for the quarter. Five of the seven sub-industries in the sector are predicted to report a decrease in revenue, led by the Coal & Consumable Fuels (-28%) sub-industry.

Q3 2014 Earnings Season: Themes

"As we finished out 2014, we're very mindful of the challenging macroenvironment, geopolitical tensions, uneven growth and concerns over the timing of interest rate increases have increased volatility while the economy in the U.S. seems to be slowly gaining strength, the Eurozone is not yet in growth mode and emerging market growth has slowed." –Citigroup (Oct. 14)

Economic Themes: U.S., Europe, and China

United States

On a quarter-over-quarter basis (SAAR), U.S. economic growth has been inconsistent in recent quarters. In Q4 2013, Q1 2014, and Q2 2014, quarter-over-quarter (SAAR) GDP growth rates for the U.S. were 3.5%, -2.1%, and 4.6%. According to FactSet Economic estimates, quarter-over-quarter (SAAR) GDP growth for the third quarter is estimated to be 3.0%. Despite the inconsistency, a number of companies to date have reported strong results from the U.S. and North America in their third quarter earnings releases and conference calls, or see continued strength going forward.

"Scott, just to give you a view of the world, and again, there's certainly a lot going on, but I would say the U.S. is probably the best we've seen it since the financial crisis. When you look at rail loadings and things like that, you've got a decent and healthy U.S. market." –General Electric (Oct. 17)

"While challenges remain in the global economic recovery, the U.S. economy is an exception, showing signs of steady improvement. Corporate America is in good shape with strong balance sheets and employment trends continue to be positive." –JPMorgan Chase (Oct. 14)

"But at the same time, I mean, keep in mind that IMF just came out yesterday with the new projections for this year and next year. And interestingly, I mean, they've upped the U.S. – and U.S. is a very important market for us and very important for the strong end markets…" –Alcoa (Oct. 9)

"And finally, North America continues to be a growth driver for the company, with Q1 revenues up 12%." –NIKE (Sep. 25)

However, other companies have reported weak results in the U.S. or have expressed reservations about future economic growth.

"When we introduced our fiscal 2015 guidance in July, we indicated that we were still looking for more consistency in the U.S. economy. We continue to see inconsistent employment figures resulting in no real change to our customers' hiring patterns, and we see heightened global uncertainty that may affect U.S. businesses. We are updating our fiscal 2015 guidance based on our first quarter results…but also based on our views of the U.S. economic situation" –Cintas (Sep. 29)

Europe:

On a quarter-over-quarter basis, economic growth in Europe has been weak in recent quarters. In Q4 2013, Q1 2014, and Q2 2014, quarter-over-quarter GDP growth rates in the Eurozone were 0.3%, 0.2%, and 0.0%. According to FactSet Economic estimates, economic growth in the Eurozone is expected to remain weak, as quarter-over-quarter GDP growth in the Eurozone is estimated to rise 0.2% for the third quarter. Companies have generally provided mixed comments regarding Europe. Some companies have commented on deteriorating conditions in Europe.

"With that said, there's no question that we need to improve our execution in many markets, especially our consumer marketing and commercial strategies. Although we could point to various markets, this was most prominent in Europe where we saw a continued challenging macroeconomic environment and also aggressive competitive pricing." –Coca-Cola (Oct. 21)

"In terms of Europe, specifically. I mean, Europe was a surprise. The weakness in Europe was – we had growth in Europe in the first half and then it declined in the third quarter. So that's a note of caution in terms of what we're looking at." –Pentair (Oct. 21)

"Europe is slower, for sure. But I think most companies, industrial companies haven't counted on Europe and Japan for much incremental growth." –General Electric (Oct. 17)

"I would say Europe, clearly, Western Europe clearly is the softest area globally, and I think to a large degree, that is directly correlated with the general economic condition, Glenn. So we see less – we see less robust demand in Europe, for example, than we would – than we do in the United States. And I would project that given the broader macroeconomic environment, that's likely to continue." –Baxter International (Oct. 16)

"Earnings declined for our Other Businesses due to start-up costs for our single channel business in Europe and softer results from Fabory, tied to a weaker economy in Europe." –W.W. Grainger (Oct. 16)

"I think you're all very familiar with the fact that Europe is in fact slowing down, and we're seeing that across our businesses as well." –Johnson & Johnson (Oct. 14)

"Well, you've seen in detail our projection on what we think is going to happen in the end market. And on Europe there is already I think a slowdown scenario for Europe in the second half of the year built into it." -Alcoa (Oct. 9)

But, other companies have been more positive in their comments regarding conditions in Europe.

"Yeah, sure. And so, again, we can comment on what we're seeing in our businesses. We had, obviously, a good quarter in Europe and a good September. And we haven't seen signs of a slowdown in Europe. I mean we were encouraged to see Automotive up 9%, really continue to build on strong penetration gains in that business. Test & Measurement and Electronics, that's had a good year all around, and we're up in Europe. We just talked about Food Equipment up 6%. And then Welding, Polymers & Fluids, and Construction, you're probably seeing a little bit more product line simplification initiatives in those businesses. But, overall, Europe for us up 3%, we're pleased. And we have not seen a slowdown in Europe." –Illinois Tool Works (Oct. 21)

"Well, I'll ask Gene to handle some more color, but I think it's interesting that in Europe, you'll hear us talk about broad based throughout this discussion. But clearly it was broad based in Europe. I mean, almost every geography in Europe delivered good results this quarter. So it wasn't just a U.K. initiative or a German initiative, it was kind of throughout Europe we saw this kind of response." –Waters Corp. (Oct. 21)

"First, Western Europe, where our incredible business momentum continued into the first quarter, with revenues up 25%; our revenue growth was broad-based with every key category and territory reporting double-digit growth. There is tremendous energy around the brand in Europe, with innovative products that are resonating with consumers. We saw strong results from both performance footwear and apparel, as well as in sportswear." –NIKE (Sep. 25)

"In Europe, despite an economic environment that continues to be difficult, we are performing very well in many of our largest countries, including France, Italy, Germany, and the United Kingdom." –Accenture (Sep. 24)

"Our continental European operations also enjoyed strong yield and profit improvement in the quarter, reflecting continued progress for the Costa brand." –Carnival Corp. (Sep. 23)

China

On a year-over-year basis, economic growth in China has been declining in recent quarters. In Q3 2013, Q4 2013, and Q1 2014, year-over-year growth GDP growth rates in China were 7.8%, 7.7%, and 7.4%. In Q2 2014, there was a slight uptick in GDP growth to 7.5%. However, year-over-year GDP growth in China dipped back to 7.3% for the third quarter. Despite the slowing growth, most companies have been positive in their comments regarding China in their third quarter earnings releases and conference calls.

"China, again, 25% growth in the quarter, that's on a 45% comp last year, so very strong growth. We're in 100 cities now. That was our goal, to be in 100 cities by the end of the year. So we've picked up distribution, which is part of it. We've done well in e-commerce, which is the fastest growing segment in China." -Kimberly-Clark (Oct. 21)

"And so when I look at China, I see an enormous market where there are more people graduating into the middle class than any nation on earth in history, and just an incredible market where people want the latest technology and products that we're providing. And so we're investing like crazy in the market. We're more than doubling our stores. We've got 15 stores in Greater China today. We're going to be close to 40 stores in the next couple of years. We've expanded our online store to cover now 315 cities in China. The revenue results for Q4 were more than double the previous year. The App Store is growing. Chinese developers have now created 150,000 apps on the App Store. And so I see lots of very, very positive vectors there, and I couldn't be more excited." –Apple (Oct. 20)

"In Asia, Vans revenue grew nearly 40% with China increasing more than 40%, so strength across the board." –V.F. Corporation (Oct. 20)

"*China continues to be a strong market for us both on the short and long cycle sides of the portfolio and we saw double-digit increases this quarter in both the Middle East and India, reinforcing that our focus on high-growth regions is paying off." –Honeywell (Oct. 17)*

"And frankly, I mean, China, Asia, they might be a little slower but still going very, very strong." –Alcoa (Oct. 9)

"In Greater China, we continue to see strength in the NIKE Brand and positive near-term results from our actions to sharpen our product assortments and reset the marketplace. Revenues grew 20% in the quarter, led by 30% comp store growth in our own DTC doors." NIKE (Sep. 25)

However, some companies have reported weak results from China to date. Food quality and supply concerns were a common theme for some of these companies, rather than broader economic factors.

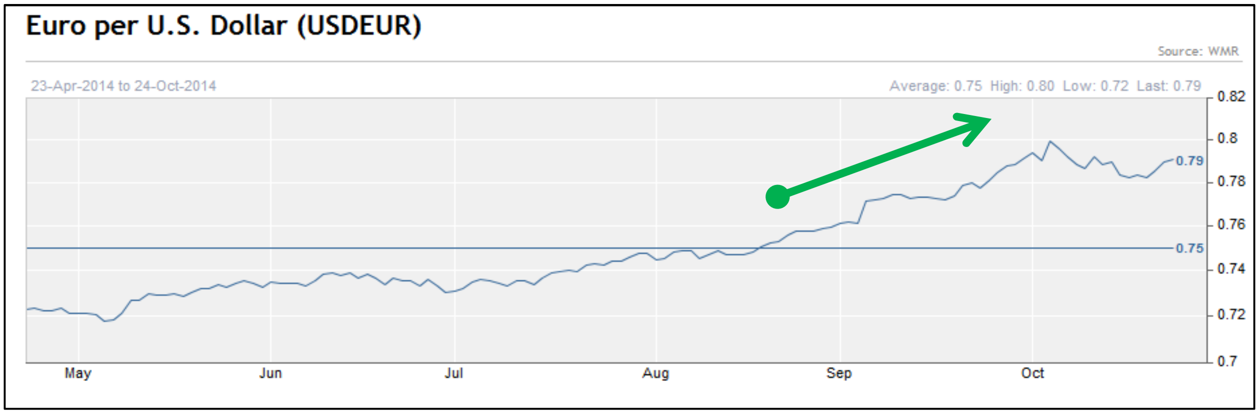
"The second most significant factor impacting third quarter results was the China supplier issue. In early September, we estimated the total impact from lost sales, expenses associated with our customer recovery efforts and the tax effect of these items to be in the range of $0.15 to $0.20 per share. The actual impact was approximately $0.15 per share and the impact was felt in virtually every line of our P&L. The markets most affected by this include China, Japan and Hong Kong, which collectively represent about 10% of global system-wide sales and about 5% of global operating income." –McDonald's (Oct. 21)

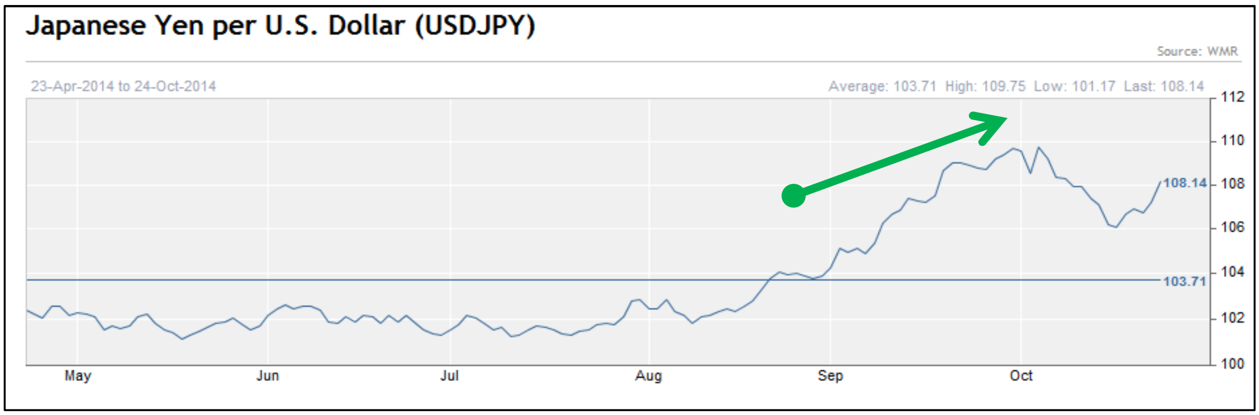
"I'm absolutely confident in Yum! Brands' ability to deliver strong, sustainable growth in the years ahead despite the recent supplier incident in China, which has significantly impacted China sales, leading us to reduce our full-year EPS outlook." –YUM! Brands (Oct. 8)

"Our quick service restaurant customers in the Asia/Pacific region are currently being impacted by well-publicized supply issues. This is affecting our sales results in the region, and has us cautious in our near-term outlook, as reflected in our latest guidance." –McCormick & Co. (Oct. 2)

"On the international front for Lamb Weston, some of our customers are facing the impact of adverse food quality news in China. This will give us some short-term headwinds…" –ConAgra (Sep. 18)

Currency Themes: Stronger U.S. Dollar





During the course of the third quarter, the dollar strengthened relative to other foreign currencies, including the yen and the euro. A number of companies have not only discussed the negative impact of the stronger dollar in Q3, but have also highlighted the negative impact of the stronger dollar in their sales and earnings guidance for Q4 and beyond.

"The impact of currency was a three-point headwind on this quarter's comparable operating income results. Comparable EPS was even in the third quarter, including a currency headwind of six points. Although the currency headwind and operating income was in line with the outlook we provided last quarter, foreign currency unfavorably impacted EPS by six points due to additional currency headwinds related to re-measurement gains and losses recorded in the line item other income." –Coca-Cola (Oct. 21)

"Currency is the biggest driver. It's about $50 million year-over-year of headwind. I think, again, the pricing pressure that we talked about in Europe earlier continues to be a bit of a headwind, but it's not the big driver. It really is primarily FX. Again, I would say Otis is recovering. The Florence factory is doing much, much better; still some room to go there, but there's no big operational misses here, it's really just pricing in Europe, I would say, and FX." –United Technologies (Oct. 21)

"Foreign currency translation negatively impacted third quarter EPS by $0.01. At current exchange rates, which reflect a stronger U.S. dollar, we expect a negative impact on fourth quarter EPS of $0.05 to $0.06 with a full-year negative impact of $0.09 to $0.10. As usual, take this as directional guidance only because rates will change as we move toward the end of the year." –McDonald's (Oct. 21)

"Finally, I want to spend a minute on the impact of currency. The dollar appreciated dramatically in the last several weeks of the quarter. And as you know, when the dollar appreciates broadly against other currency, it impacts our revenue and earnings. What is unusual about this is not just the sharp move, but the movements were nearly all in an unfavorable direction for our business profile." –IBM (Oct. 17)

"We're not predicting the impact of currency movements, but to give you an idea of the potential impact on sales, if currency exchange rates were to remain where they were as of last week for the balance of the year then our sales growth rate would decrease by nearly 1.5%, reflecting the recent weakening of the euro and other currencies against the U.S. dollar." –Johnson & Johnson (Oct. 14)

"Our current outlook for reported revenue growth is 1 point to 2 points lower, reflecting the stronger dollar." –NIKE (Sep. 25)

Commodity Themes: Oil Prices Down

During the course of the third quarter, prices for both WTI and Brent oil declined in price. A few companies have commented on the benefits of lower oil and gas prices to date.

"We've probably been on a little longer run of good gas profitability the last several months. Generally speaking, when gas prices are, year-over-year, are flat or declining, as they are now, that's good news. We save the customer more, and we make more… And so we've been blessed by having a positive run here for several months." –Costco (Oct. 8)

"Our non-GAAP EPS for the third quarter was $1.58. I'm excited to report that this was $0.17 above the midpoint of our June guidance, driven essentially by three things…And third, lower fuel prices worth $0.02. –Carnival Corp. (Sep. 23)

However, some companies believe the low price of oil will not continue.

Now, before I close, I have to recognize that there is currently a concern about the recent decline in commodity prices. I'm not going to predict what the oil price is going to be, but on a longer term, we believe industry fundamentals suggest that these lower prices are not sustainable. While we might be in a slight oversupply situation right now, remember, demand is still growing. Therefore, considering North America and OPEC production expectations, the continued tightness in global spare production capacity and potential geopolitical impacts on non-OPEC production, we believe that supply and demand will essentially be back in balance, in a relatively short period of time. –Halliburton (Oct. 20)

Geopolitical Themes: Russia/Ukraine and the Middle East

During the third quarter, tensions between Russia and Ukraine continued and military action in the Middle East region escalated. However, these events have not had a significant impact on the sales and earnings reported by most S&P 500 companies for the third quarter, given the limited aggregate revenue exposure S&P 500 companies have in these two regions. According to FactSet Geographic Revenue Exposure, S&P 500 companies in aggregate only generate 2% of sales from the Middle East region and 2% of sales from the non-European Union region (which includes Russia and Ukraine). However, some companies have discussed the negative impact of geopolitical issues on third quarter results.

"The fourth most significant impact on our third quarter earnings was a decline in Europe's company-operated margins, driven by Russia and Ukraine, due to the economic slowdown, decline in consumer sentiment, store closures and weakening currencies in these markets. In fact, these two countries accounted for substantially all of Europe's third quarter company-operated margin decline." – McDonald's (Oct. 21)

"The seasonal recovery in Russia was negatively affected by the recent sanctions, and growth in this market is expected to be a challenge for the foreseeable future, since we'll be prohibited from tendering projects that fall under the sanctions restrictions. We expect our Russia business will continue to face headwinds next year, including the possibility of additional sanctions. But we're hopeful that full-year 2015 could come in at similar levels to this year." -Halliburton (Oct. 20)

"In Central and Eastern Europe, currency-neutral revenues rose 9%, with growth across all key categories except action sports, and all territories except Russia and Israel. We continue to closely monitor the situation in these markets and remain focused on the things we control, building strong consumer connections, leading with innovative products, and managing a healthy marketplace." –NIKE (Sep. 25)

However, other companies have not seen a negative impact in these regions or do not anticipate a negative impact in these areas due to geopolitical events.

"As you may know, we have nearly 14,000 restaurants in over 110 countries around the world. 91% of which are franchised. We're especially pleased with our continuous strength in emerging markets led by high-growth countries such as South Africa and Russia." –YUM! Brands (Oct. 8)

"And this also ties to the political landscape where we also anticipate some of the turmoil that has been a reality in places like Argentina and the Ukraine will continue, although our 2015 guidance assumes reasonable operating environments in both regions." –Monsanto (Oct. 8)

Looking Ahead

Q4 Earnings Guidance: Negative Guidance (78%) Above Average

At this point in time, 37 companies in the index have issued EPS guidance for the fourth quarter. Of these 37 companies, 29 have issued negative EPS guidance and 8 have issued positive EPS guidance. Thus, the percentage of companies issuing negative EPS guidance to date for the third quarter is 78% (29 out of 37). This percentage is above the 5-year average of 67%.

Higher Net Margins Projected for Q414 – Q215

While the blended earnings growth rate for Q3 2014 is 5.5%, analysts do expect earnings growth for the S&P 500 to be much higher starting in 2015. For Q4 2014, Q1 2015, and Q2 2015, analysts are predicting earnings growth rates of 6.0%, 7.8%, and 9.0%, respectively. For all of 2014, the projected earnings growth rate is 6.1%. For all of 2015, the projected earnings growth rate is 10.5%.

However, revenue growth is not expected to decrease over the next three quarters relative to Q3. The blended revenue growth rate for Q3 2014 is 3.7%. For Q4 2014, Q1 2015, and Q2 2015, analysts are predicting revenue growth rates of 2.8%, 3.5%, and 2.9%. For all of 2014, the projected revenue growth rate is 3.7%. For all of 2015, the projected revenue growth rate is 3.7%.

Given this divergence in expected earnings and revenue growth over the next few quarters, analysts are expecting profit margins to continue to expand into 2015. Using the bottom-up sales-per-share (SPS) and earnings-per-share (EPS) estimates for the S&P 500 as proxies for expected sales and earnings for the index over the next few quarters, profit margin estimates can be calculated by dividing the expected EPS by the expected SPS for each quarter. Using this methodology, the estimated net profit margins for Q4 2014, Q1 2015, and Q2 2015 are 10.3%, 10.4%, and 10.7%. These numbers are above the blended net profit margin for Q3 2014 (9.9%), and are also well above the average net profit margin of 9.3% recorded over the past four years.

Valuation: Forward P/E Ratio is 15.2, above the 10-Year Average (14.1)

The current 12-month forward P/E ratio is 15.2. This P/E ratio is based on Thursday's closing price (1950.82) and forward 12-month EPS estimate ($128.58).

At the sector level, the Consumer Staples (18.0) and Consumer Discretionary (17.4) sectors have the highest forward 12-month P/E ratios, while the Financials (12.9), Telecom Services (13.1), and Energy (13.5) sectors have the lowest forward 12-month P/E ratios.

The P/E ratio of 15.2 for the index as a whole is above the prior 5-year average forward 12-month P/E ratio of 13.5, and above the prior 10-year average forward 12-month P/E ratio of 14.1. However, it is below the forward 12-month P/E ratio of 15.3 recorded at the start of the fourth quarter (September 30). During the fourth quarter, the price of the index has decreased by 1.1%, while the forward 12-month EPS estimate has decreased by 0.7%.

At the sector level, three sectors have recorded an increase in the forward 12-month P/E ratio since the start of the fourth quarter, led by the Utilities (to 16.4 from 15.7) sector. Four sectors have recorded a decrease in the forward 12-month P/E ratio since the start of the fourth quarter, led by the Materials (to 15.8 from 16.4) sector. Three sectors have the same forward 12-month P/E ratio today relative to the start of the quarter: Consumer Discretionary (17.4), Health Care (16.5), and Industrials (15.5).

Companies Reporting Next Week: 159

During the upcoming week, 159 S&P 500 companies are scheduled to report earnings for the third quarter. Of these 159 companies, 6 are in the Dow 30.

Predicted Earnings Surprises: 32

The FactSet Sharp estimate predicts the direction of upside and downside EPS surprises relative to the mean EPS estimate.

Next Week: 12

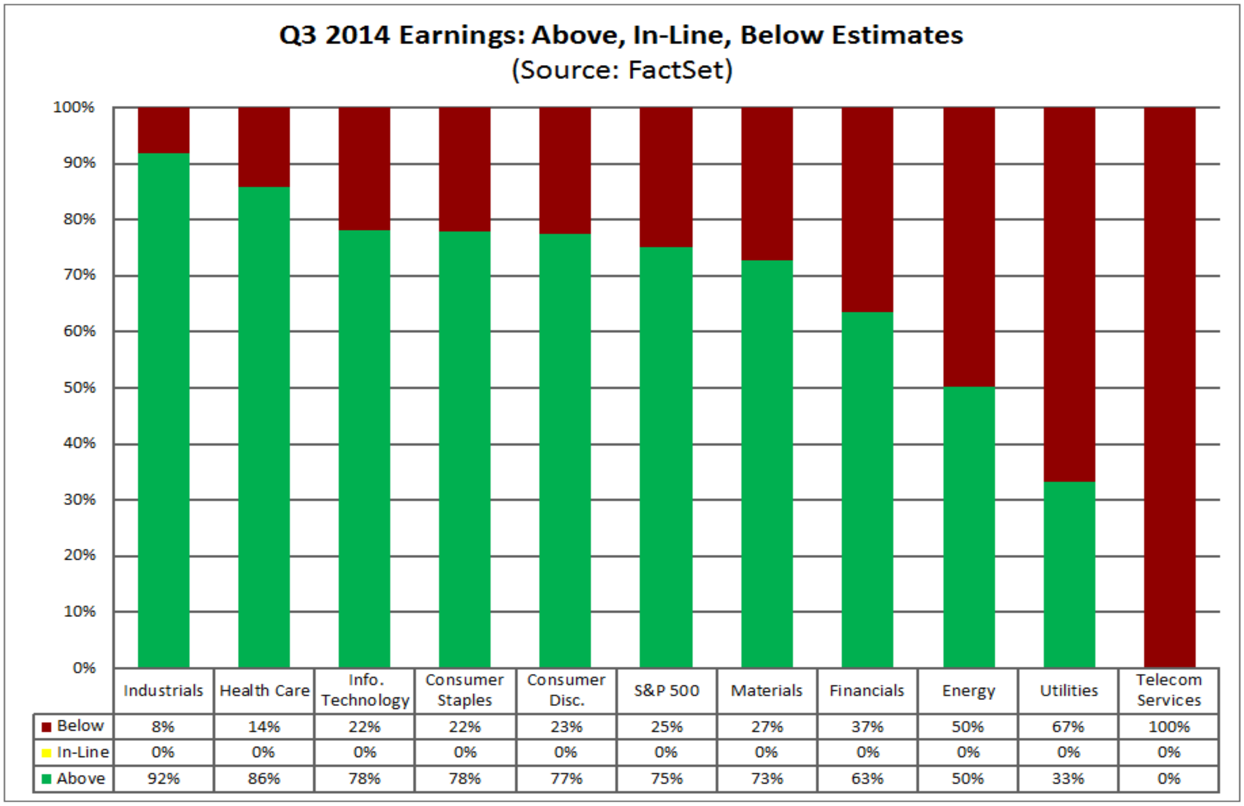
For the upcoming week, 11 companies (including Tenet Health Care, Allergan, and Assurant) have a Sharp EPS estimate above the mean EPS estimate (upside positive surprise indicator) for Q3 and 1 company (CONSOL Energy) have a Sharp EPS estimate below the mean EPS estimate (downside surprise indicator).

Third Quarter: 32

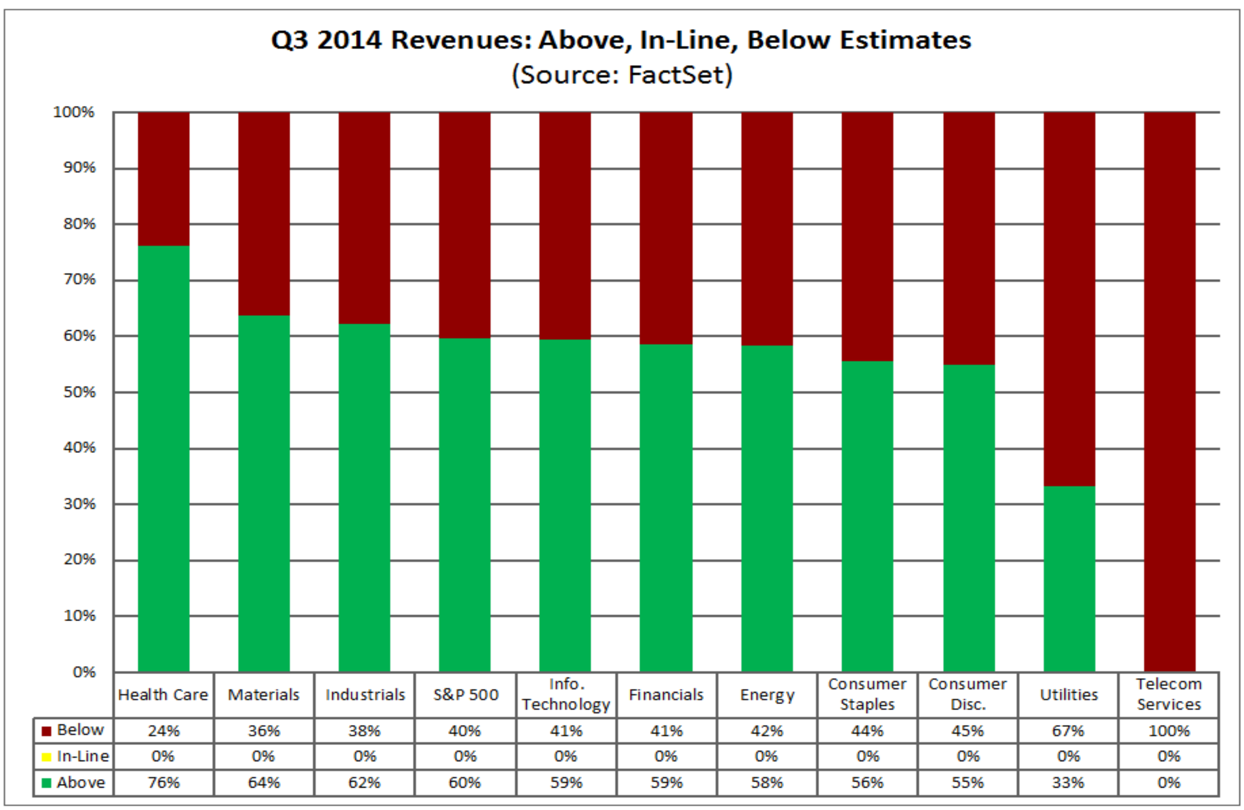
For the S&P 500 overall, 23 companies have a Sharp EPS estimate above the mean EPS estimate (upside surprise indicator) for Q3 and 9 companies have a Sharp EPS estimate below the mean EPS estimate (downside surprise indicator) for Q3. The remaining companies in the index do not have a Sharp estimate at this time for Q3 (no surprise predicted) or have already reported actual EPS for Q3.

At the sector level, the Consumer Discretionary sector currently has the highest number (6) and the third highest percentage (7%) of companies with a Sharp estimate above the mean EPS estimate for the third quarter. The Health Care sector currently has the second highest number (5) and the second highest percentage (9%) of companies with a Sharp estimate above the mean EPS estimate for the third quarter.

Q3 2014: Scorecard

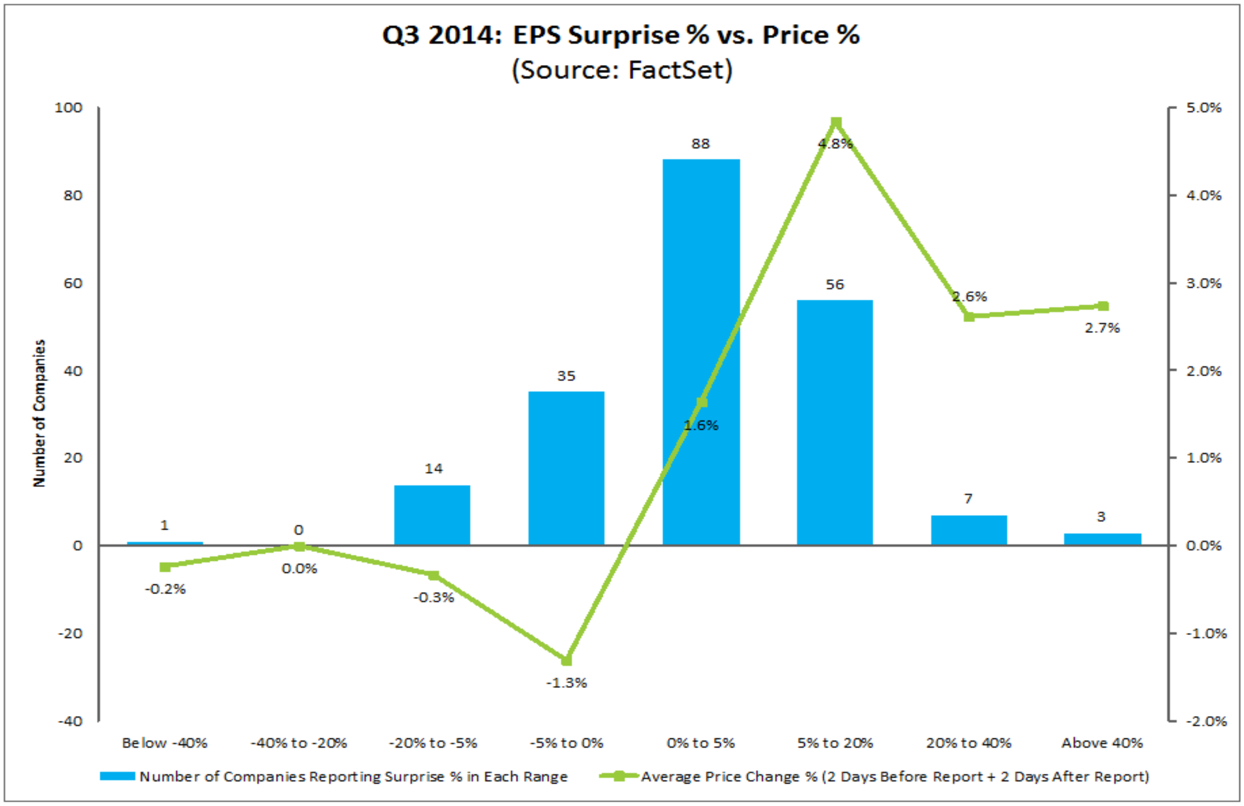


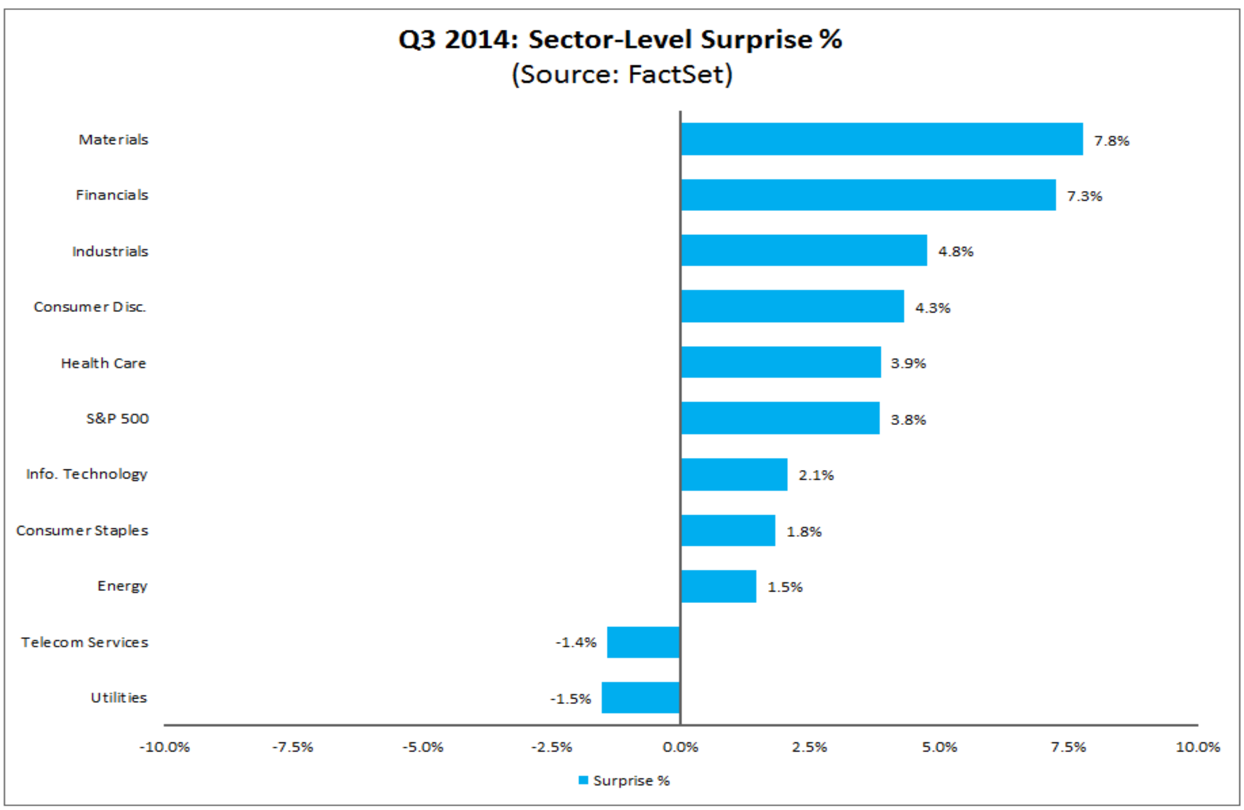
	Industrials	Health Care	Info. Technology	Consumer Staples	Consumer Disc.	S&P 500	Materials	Financials	Energy	Utilities	Telecom Services
Below	8%	14%	22%	22%	23%	25%	27%	37%	50%	67%	100%
In-Line	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Above	92%	86%	78%	78%	77%	75%	73%	63%	50%	33%	0%



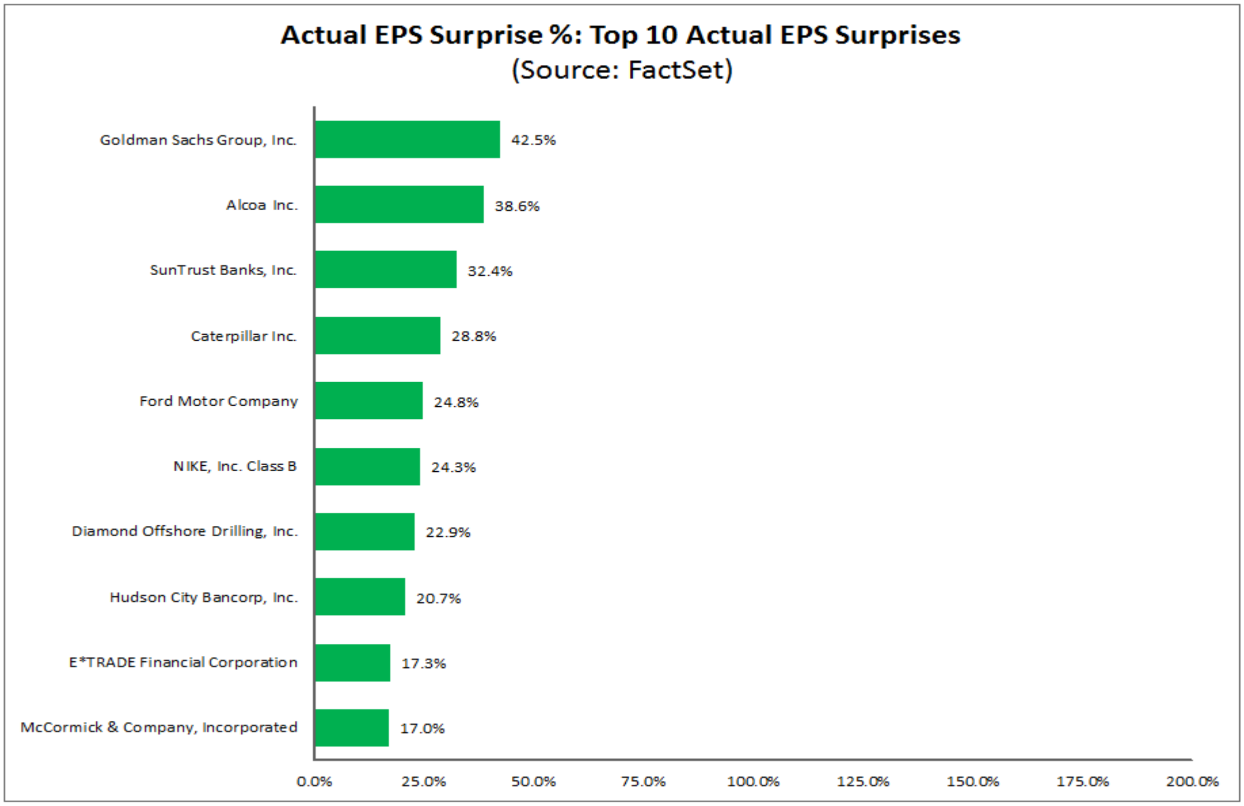
	Health Care	Materials	Industrials	S&P 500	Info. Technology	Financials	Energy	Consumer Staples	Consumer Disc.	Utilities	Telecom Services
Below	24%	36%	38%	40%	41%	41%	42%	44%	45%	67%	100%
In-Line	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Above	76%	64%	62%	60%	59%	59%	58%	56%	55%	33%	0%

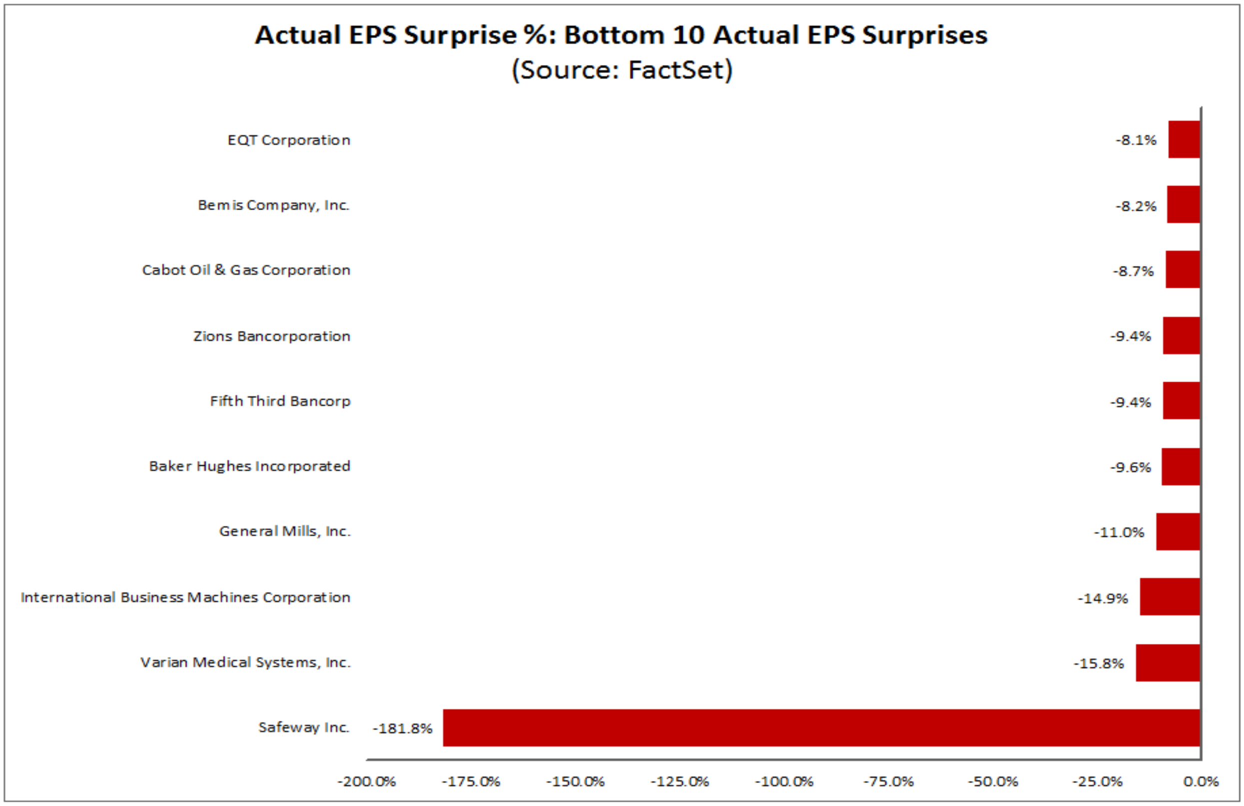
Q3 2014: Scorecard



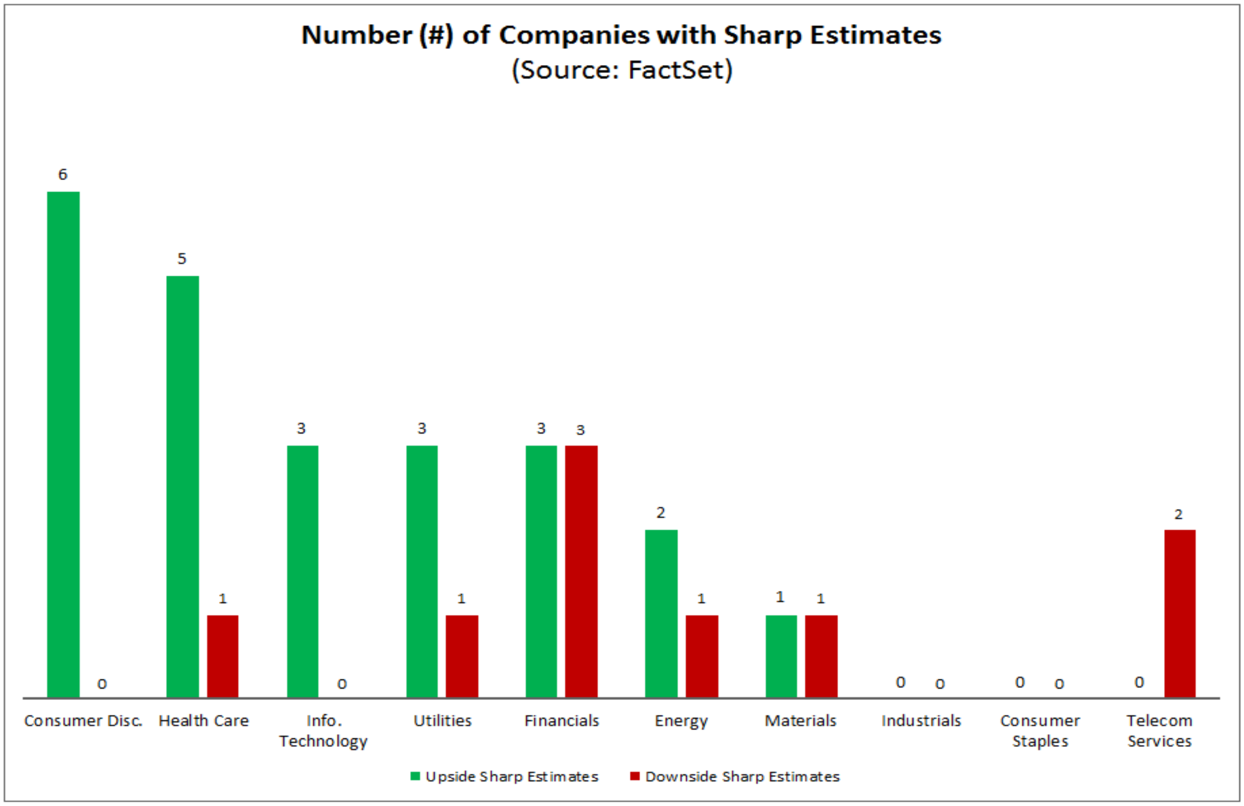


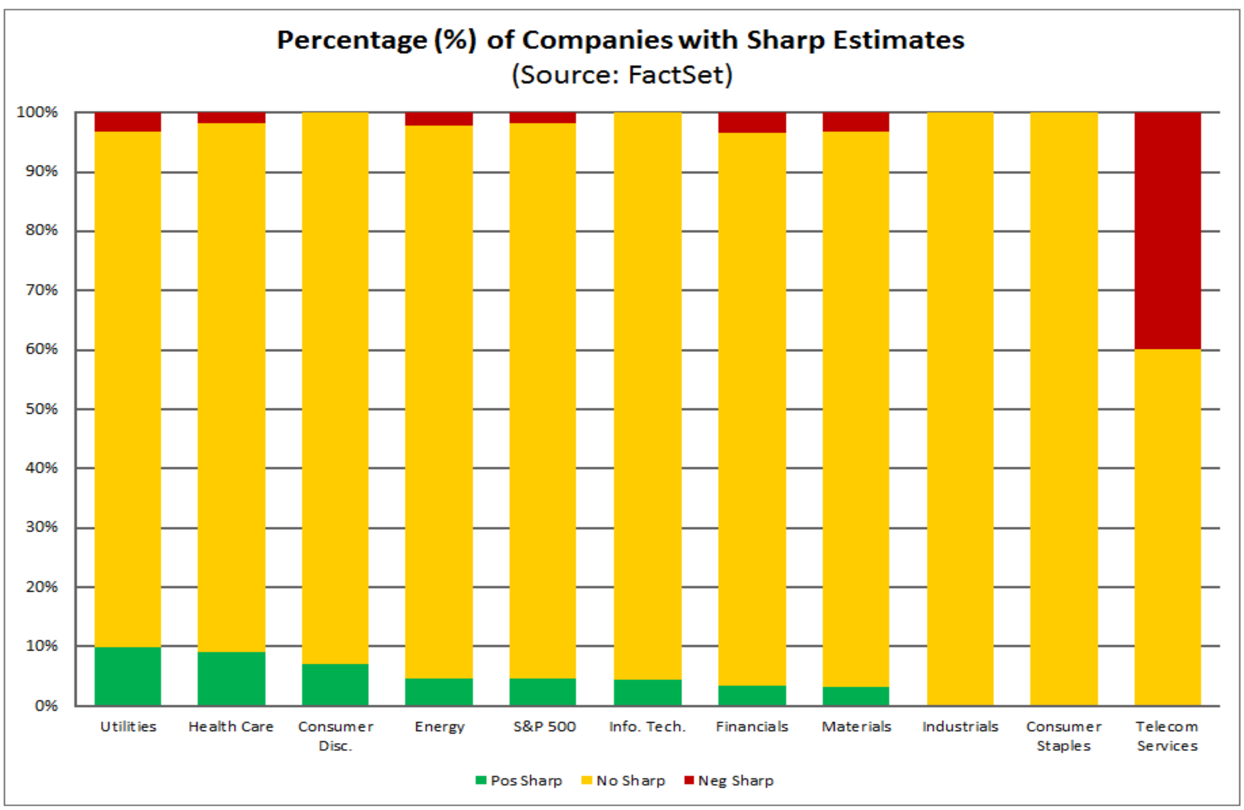
Q3 2014: Scorecard





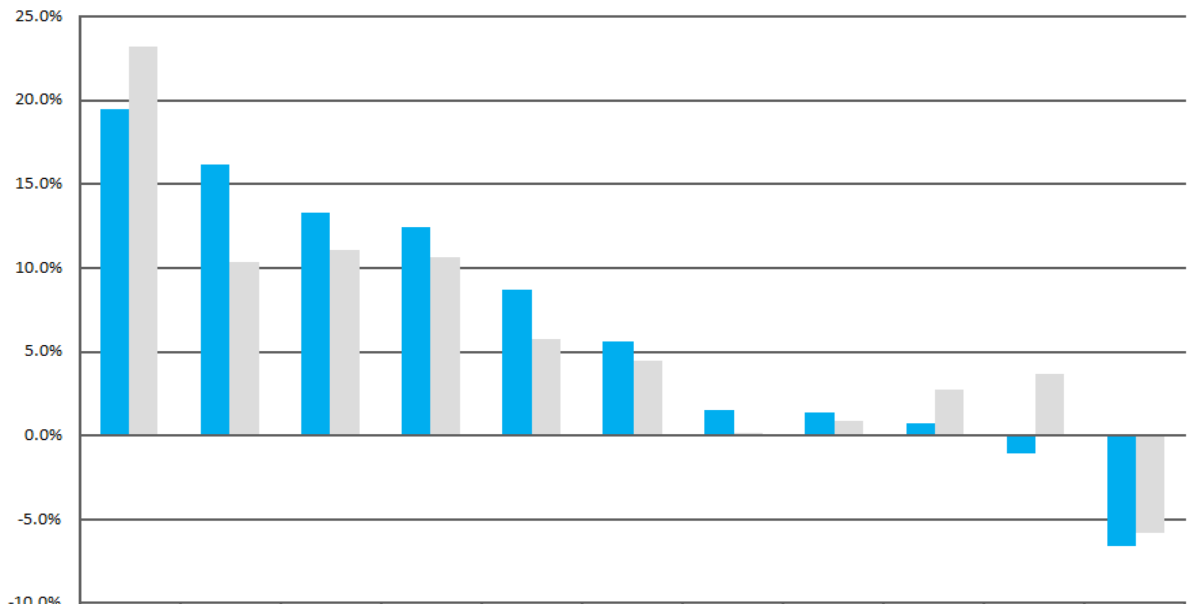
Q3 2014: Projected EPS Surprises (Sharp Estimates)





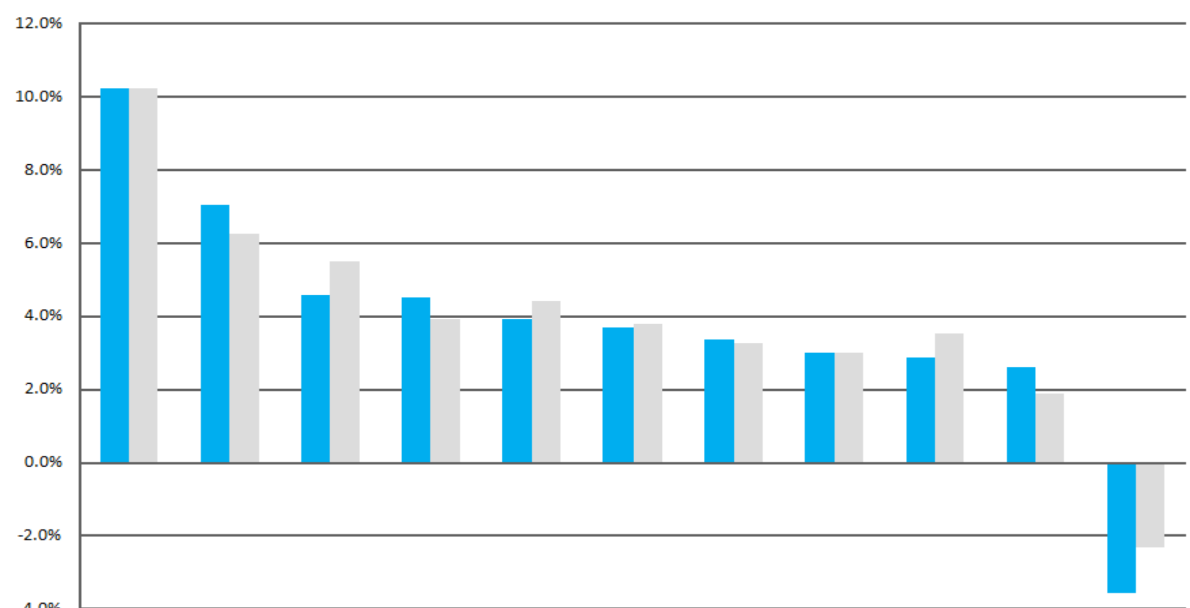
Q3 2014: Growth

Q3 2014 Earnings Growth
(Source: FactSet)



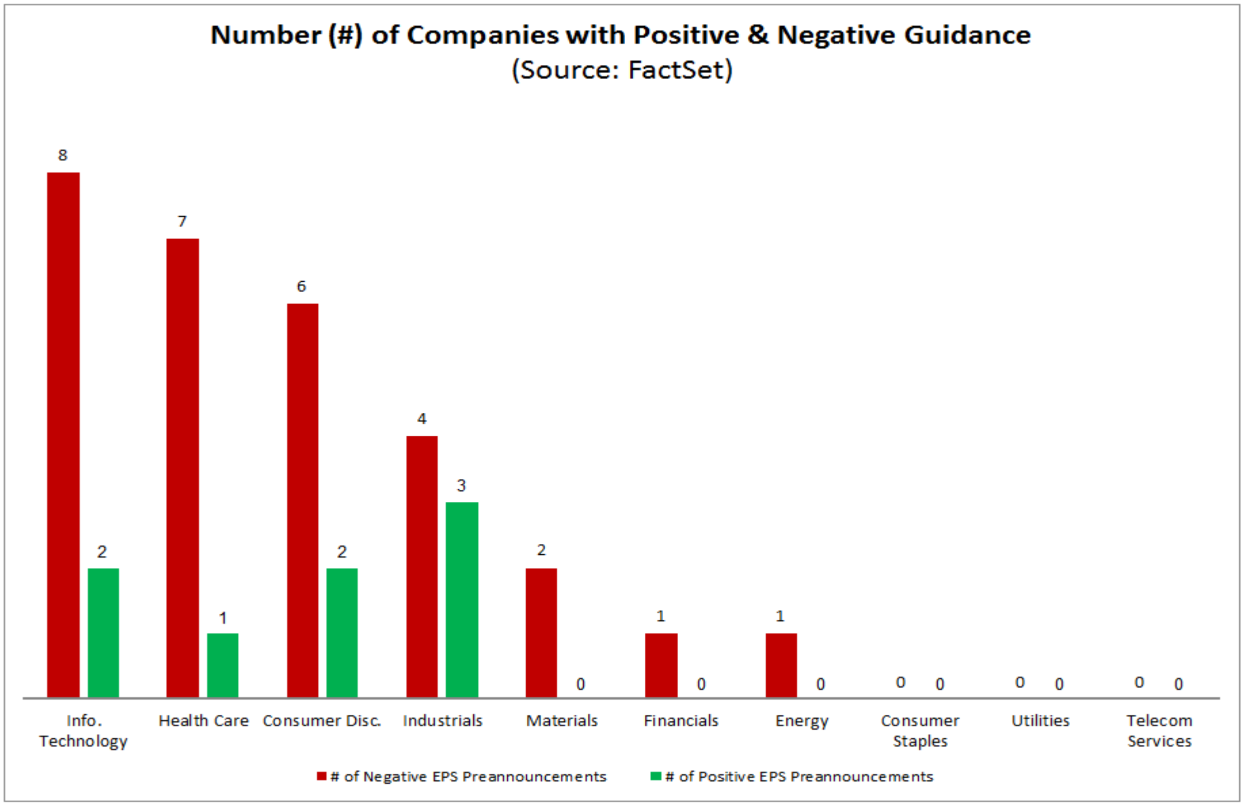
	Telecom Services	Financials	Materials	Health Care	Industrials	S&P 500	Info. Technology	Consumer Staples	Utilities	Energy	Consumer Disc.
Today	19.4%	16.1%	13.3%	12.4%	8.7%	5.6%	1.6%	1.4%	0.7%	-1.0%	-6.6%
30-Sep	23.2%	10.3%	11.1%	10.6%	5.7%	4.5%	0.2%	0.9%	2.8%	3.7%	-5.8%

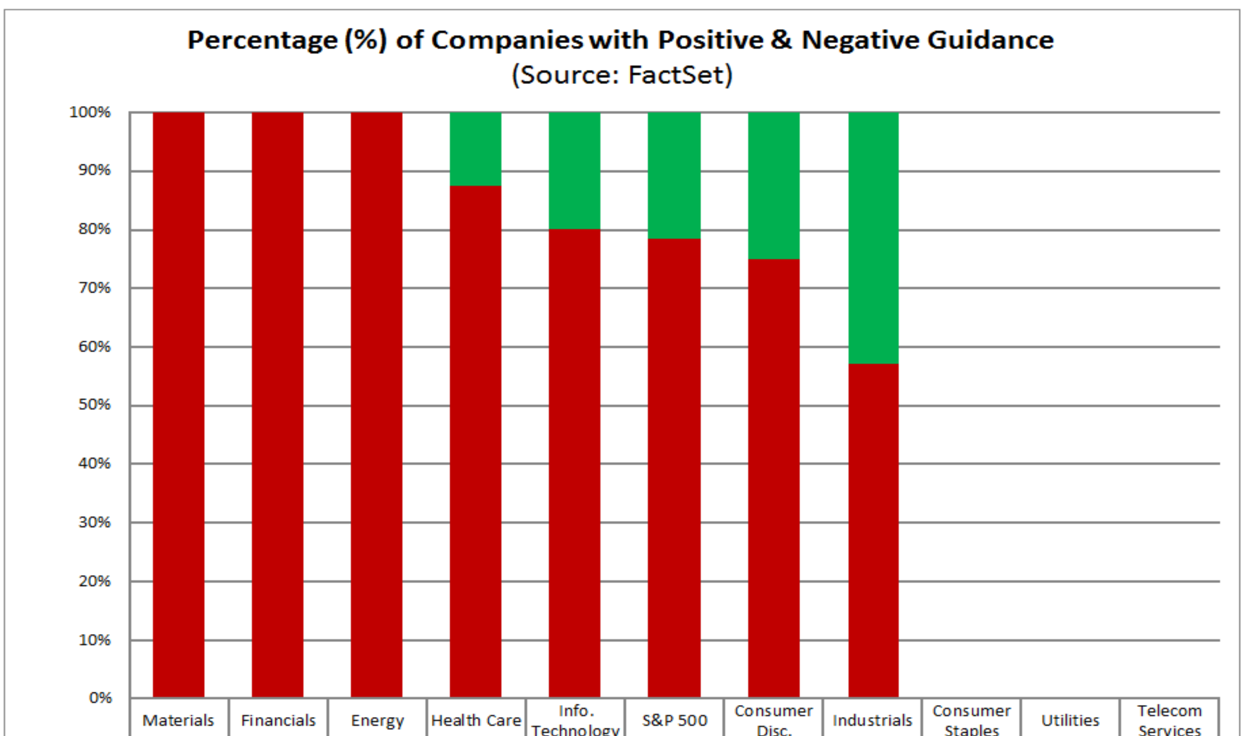
Q3 2014 Revenue Growth
(Source: FactSet)



	Health Care	Info. Technology	Utilities	Financials	Consumer Disc.	S&P 500	Consumer Staples	Industrials	Telecom Services	Materials	Energy
Today	10.2%	7.0%	4.6%	4.5%	3.9%	3.7%	3.4%	3.0%	2.9%	2.6%	-3.5%
30-Sep	10.2%	6.2%	5.5%	3.9%	4.4%	3.8%	3.3%	3.0%	3.5%	1.9%	-2.3%

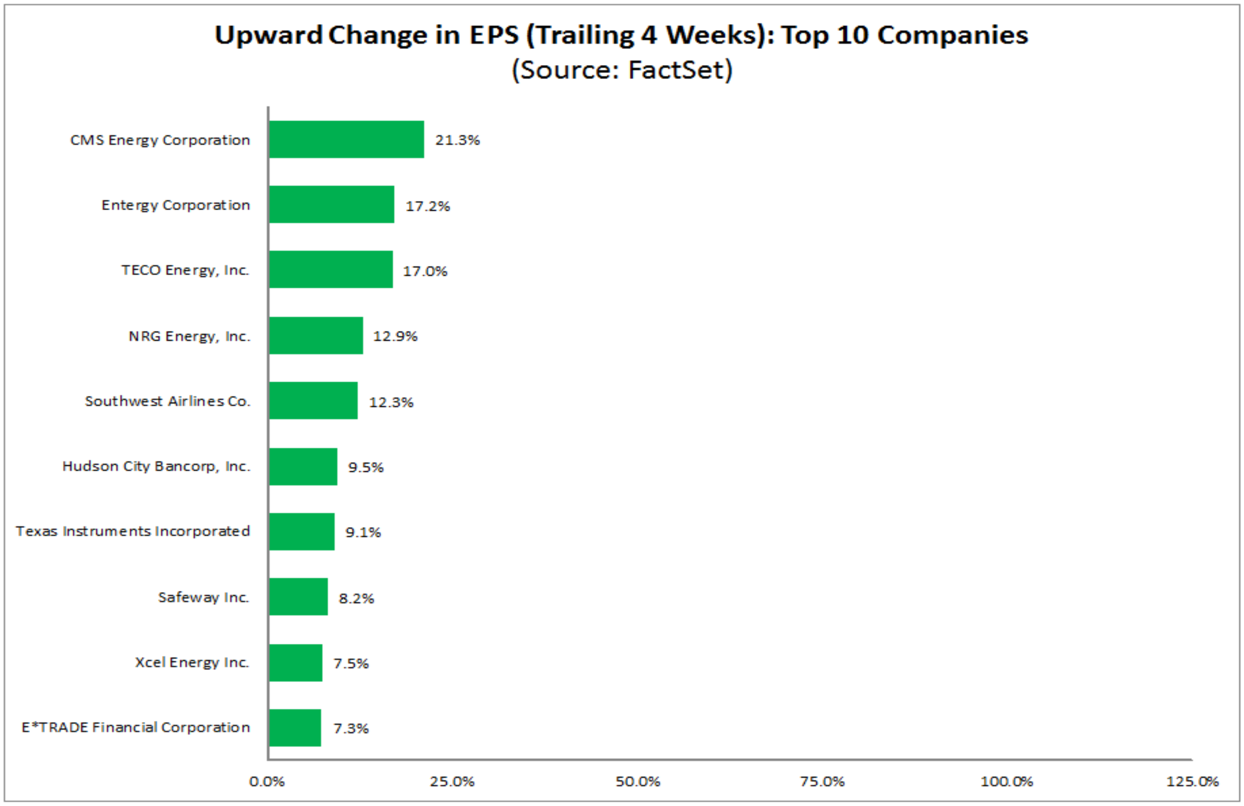
Q4 2014: EPS Guidance

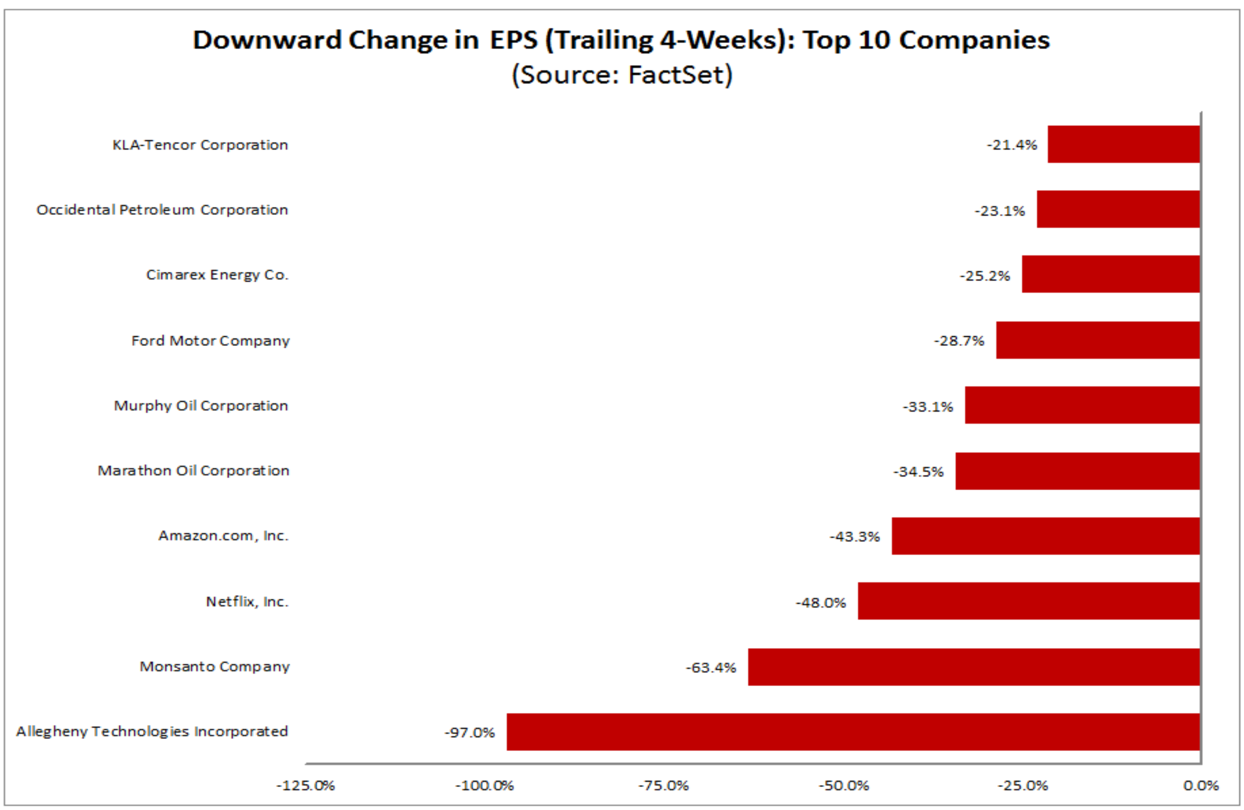




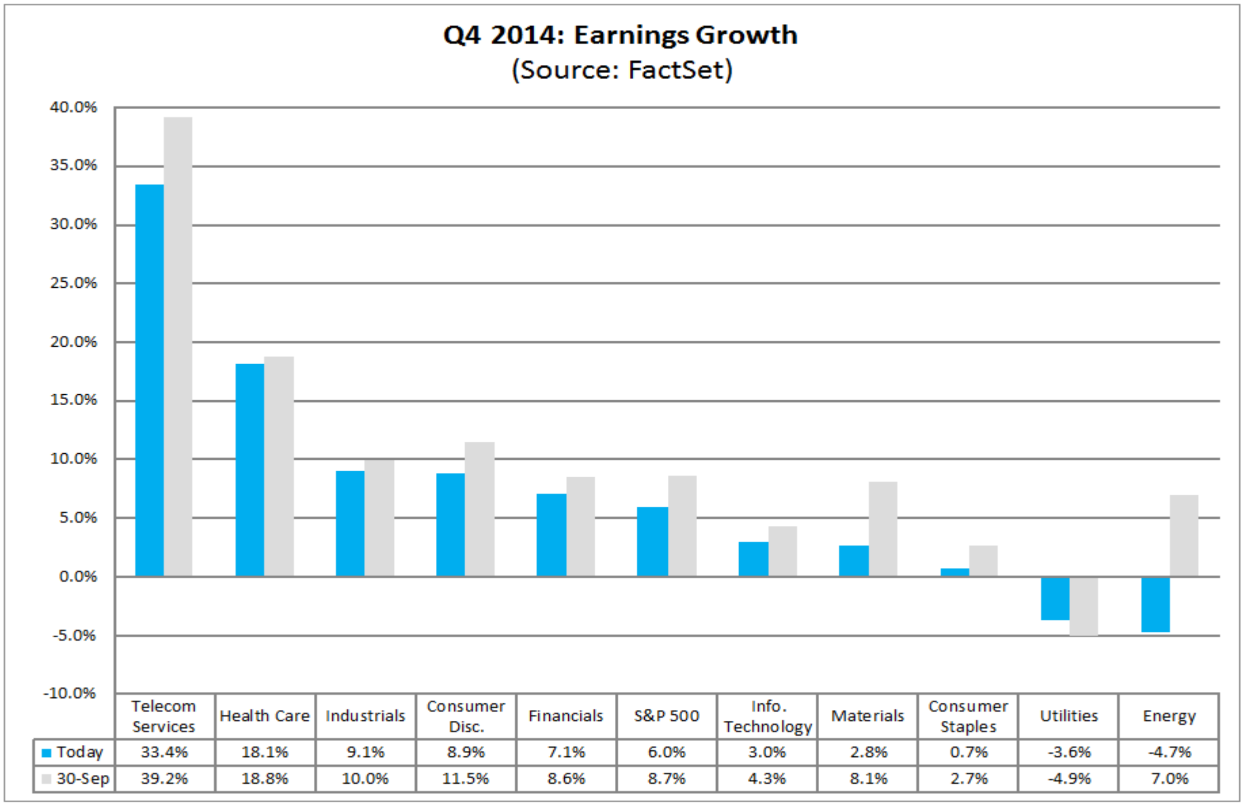
	Materials	Financials	Energy	Health Care	Info. Technology	S&P 500	Consumer Disc.	Industrials	Consumer Staples	Utilities	Telecom Services
Positive	0%	0%	0%	13%	20%	22%	25%	43%	0%	0%	0%
Negative	100%	100%	100%	88%	80%	78%	75%	57%	0%	0%	0%

Q4 2014: EPS Revisions

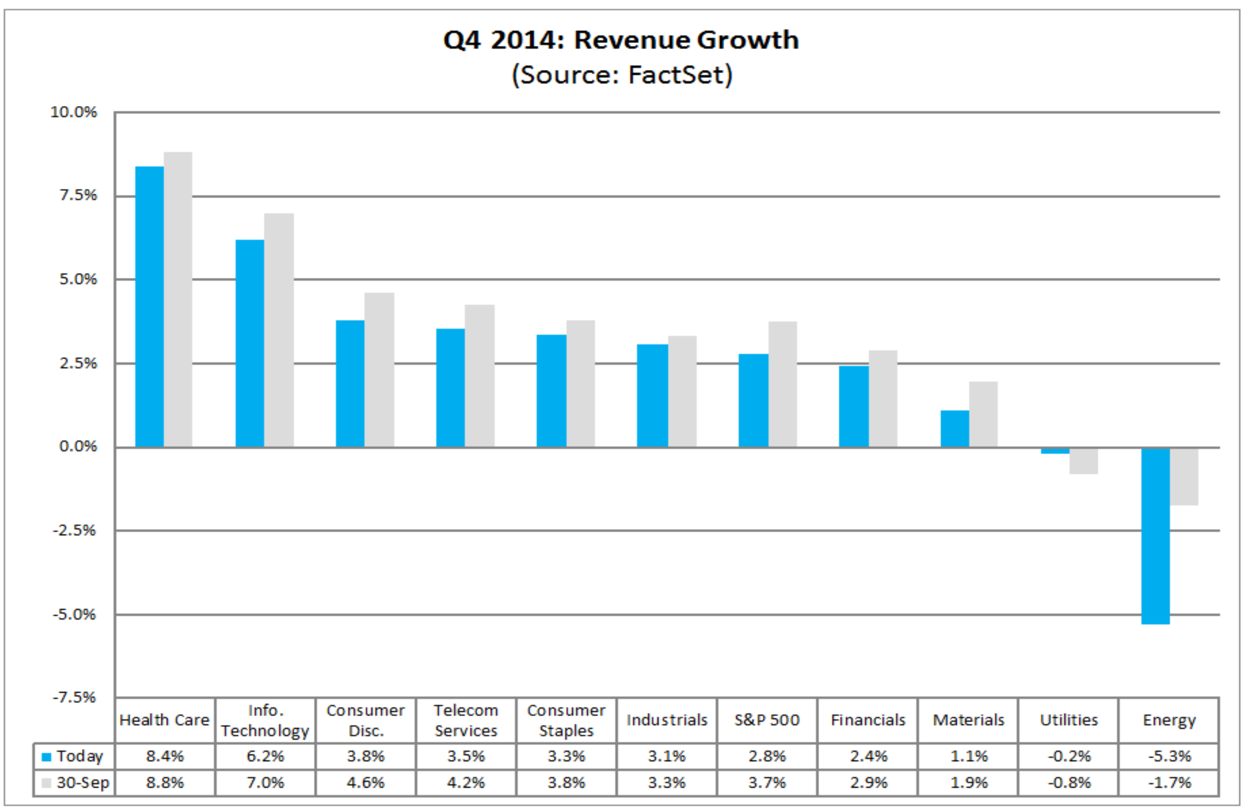




Q4 2014: Growth

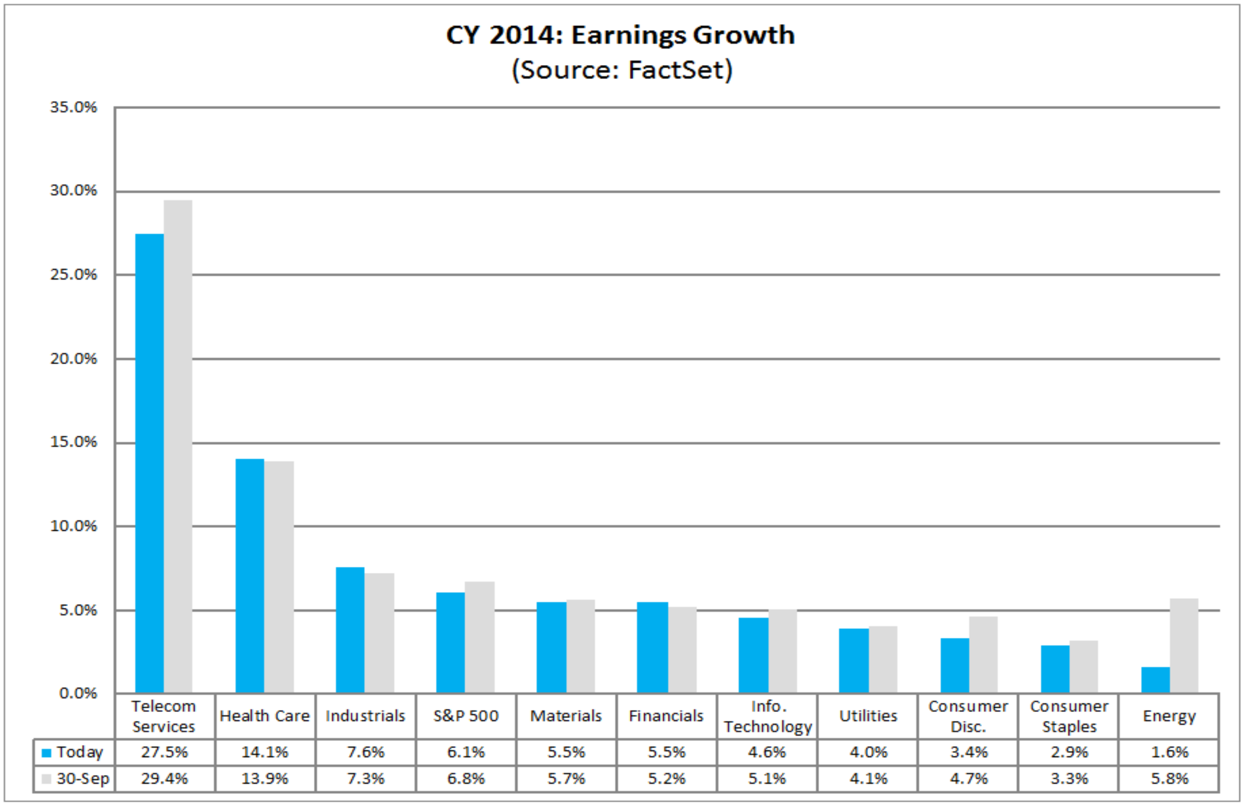


	Telecom Services	Health Care	Industrials	Consumer Disc.	Financials	S&P 500	Info. Technology	Materials	Consumer Staples	Utilities	Energy
Today	33.4%	18.1%	9.1%	8.9%	7.1%	6.0%	3.0%	2.8%	0.7%	-3.6%	-4.7%
30-Sep	39.2%	18.8%	10.0%	11.5%	8.6%	8.7%	4.3%	8.1%	2.7%	-4.9%	7.0%

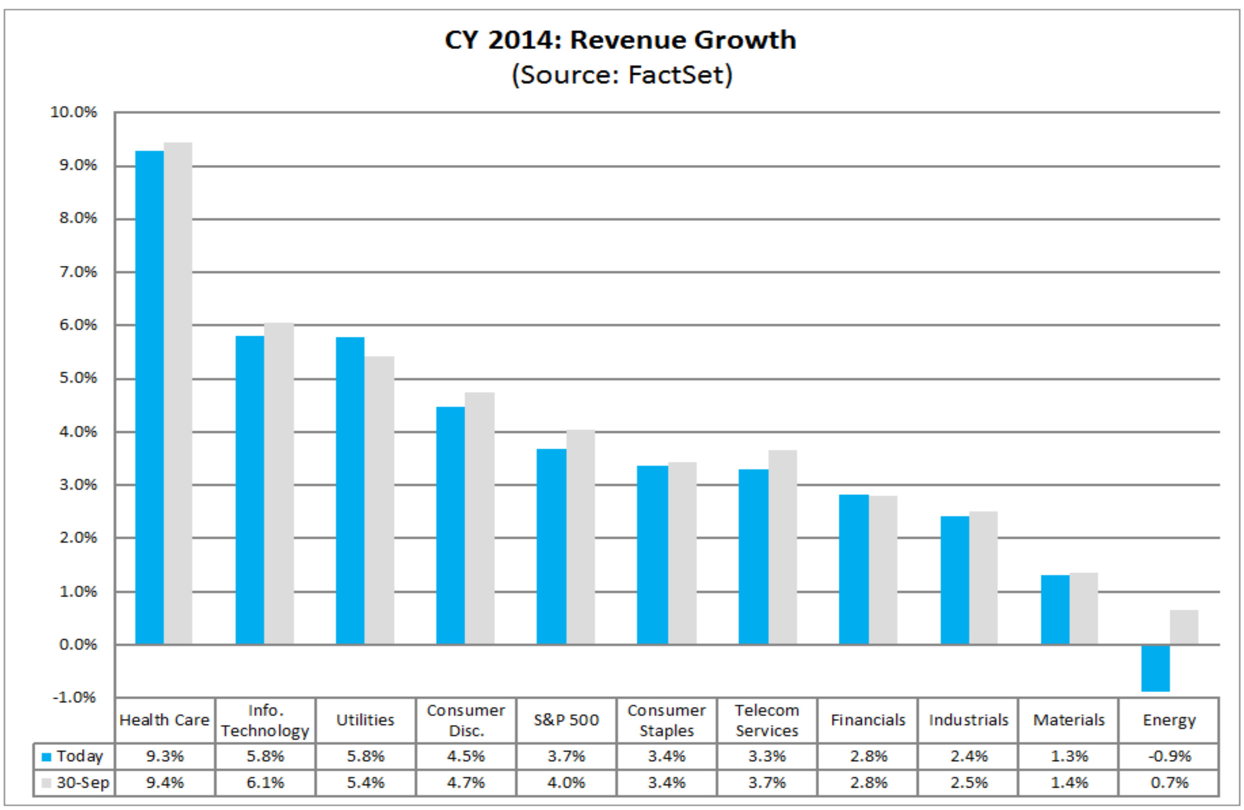


	Health Care	Info. Technology	Consumer Disc.	Telecom Services	Consumer Staples	Industrials	S&P 500	Financials	Materials	Utilities	Energy
Today	8.4%	6.2%	3.8%	3.5%	3.3%	3.1%	2.8%	2.4%	1.1%	-0.2%	-5.3%
30-Sep	8.8%	7.0%	4.6%	4.2%	3.8%	3.3%	3.7%	2.9%	1.9%	-0.8%	-1.7%

CY 2014: Growth

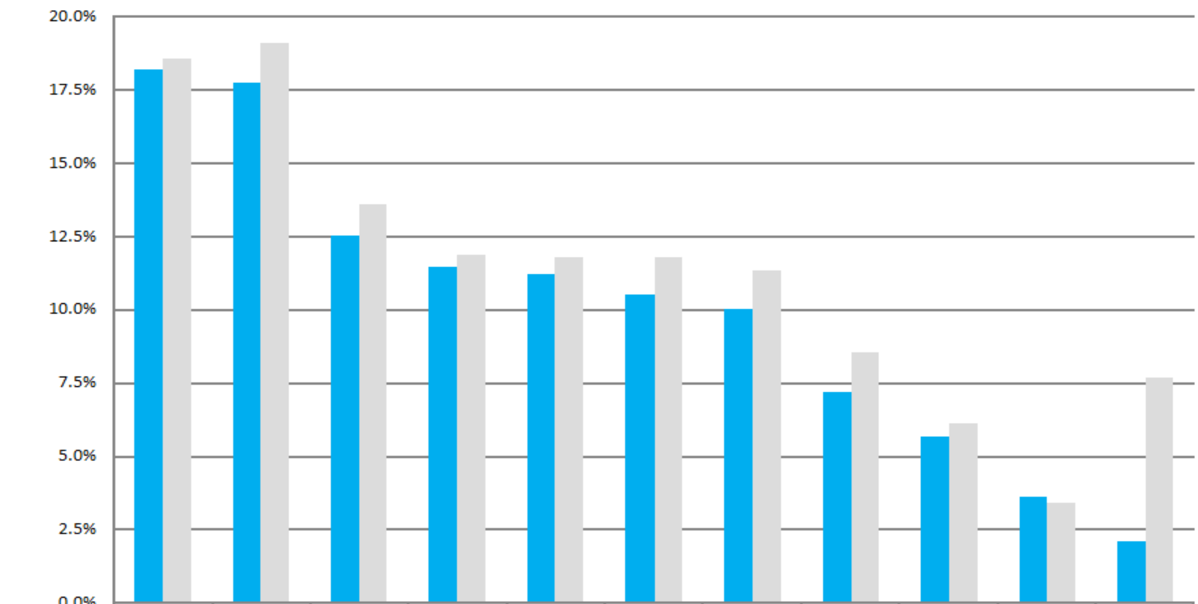


	Telecom Services	Health Care	Industrials	S&P 500	Materials	Financials	Info. Technology	Utilities	Consumer Disc.	Consumer Staples	Energy
Today	27.5%	14.1%	7.6%	6.1%	5.5%	5.5%	4.6%	4.0%	3.4%	2.9%	1.6%
30-Sep	29.4%	13.9%	7.3%	6.8%	5.7%	5.2%	5.1%	4.1%	4.7%	3.3%	5.8%

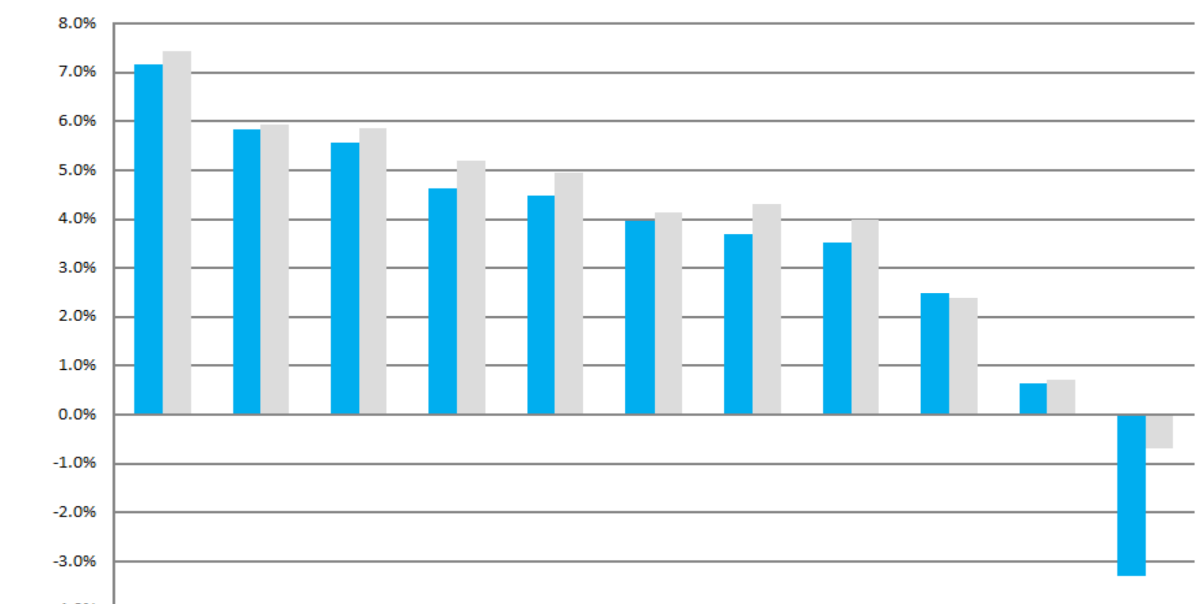


	Health Care	Info. Technology	Utilities	Consumer Disc.	S&P 500	Consumer Staples	Telecom Services	Financials	Industrials	Materials	Energy
Today	9.3%	5.8%	5.8%	4.5%	3.7%	3.4%	3.3%	2.8%	2.4%	1.3%	-0.9%
30-Sep	9.4%	6.1%	5.4%	4.7%	4.0%	3.4%	3.7%	2.8%	2.5%	1.4%	0.7%

CY 2015: Growth

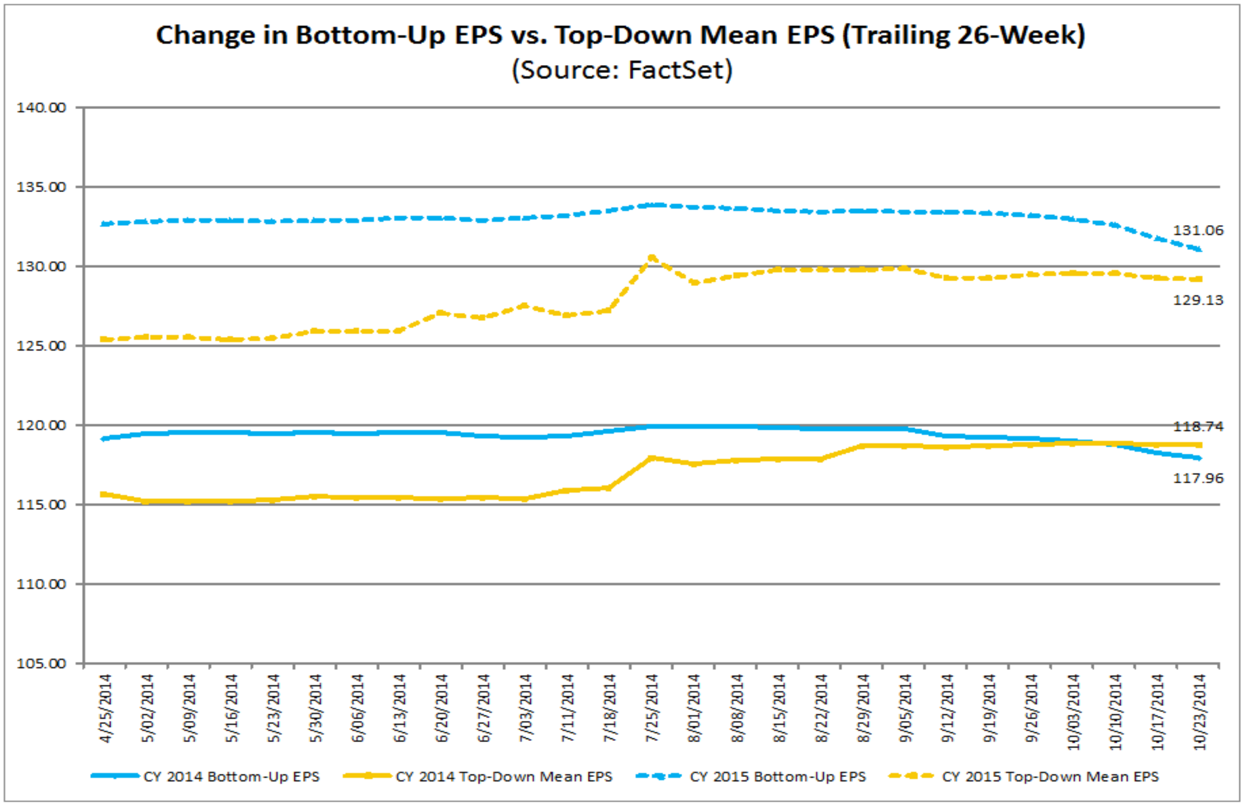


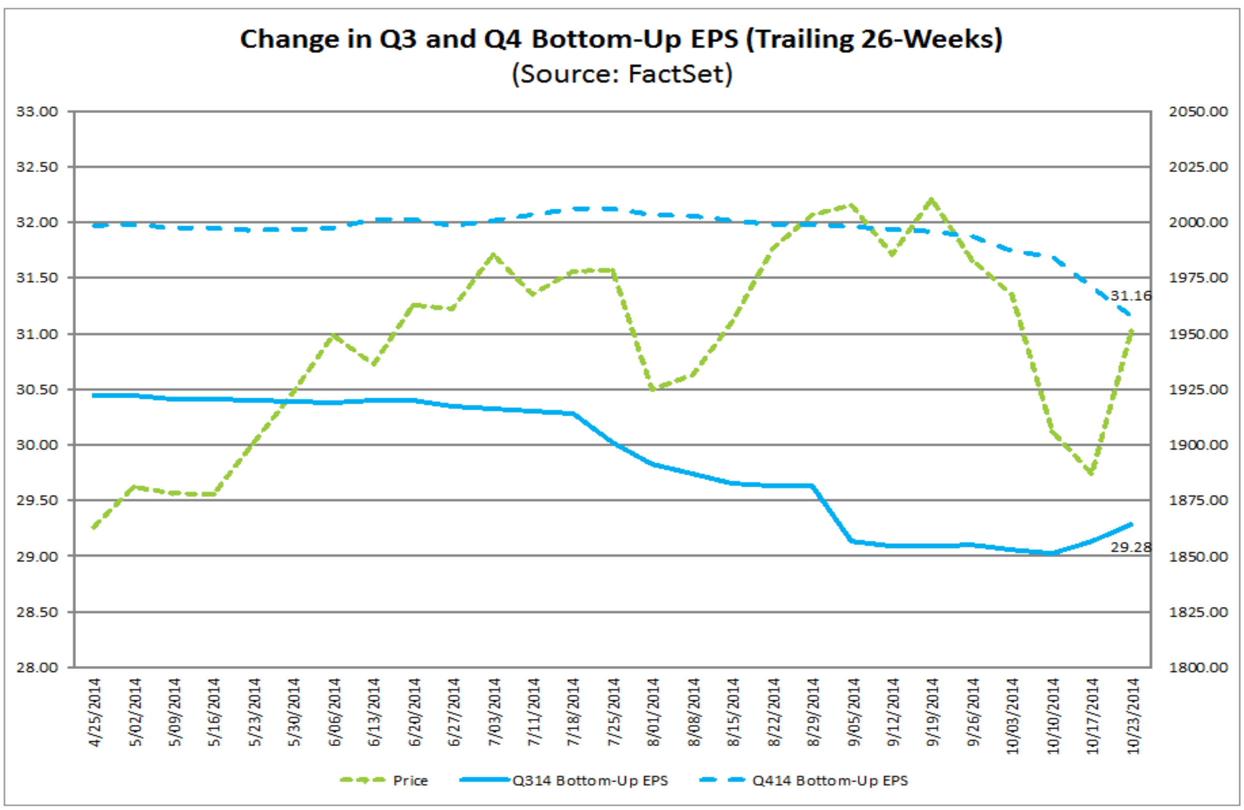
	Consumer Disc.	Materials	Financials	Info. Tech.	Health Care	S&P 500	Industrials	Consumer Staples	Telecom Services	Utilities	Energy
Today	18.2%	17.7%	12.5%	11.5%	11.2%	10.5%	10.0%	7.2%	5.7%	3.6%	2.1%
30-Sep-14	18.5%	19.1%	13.6%	11.8%	11.8%	11.8%	11.3%	8.6%	6.1%	3.4%	7.7%



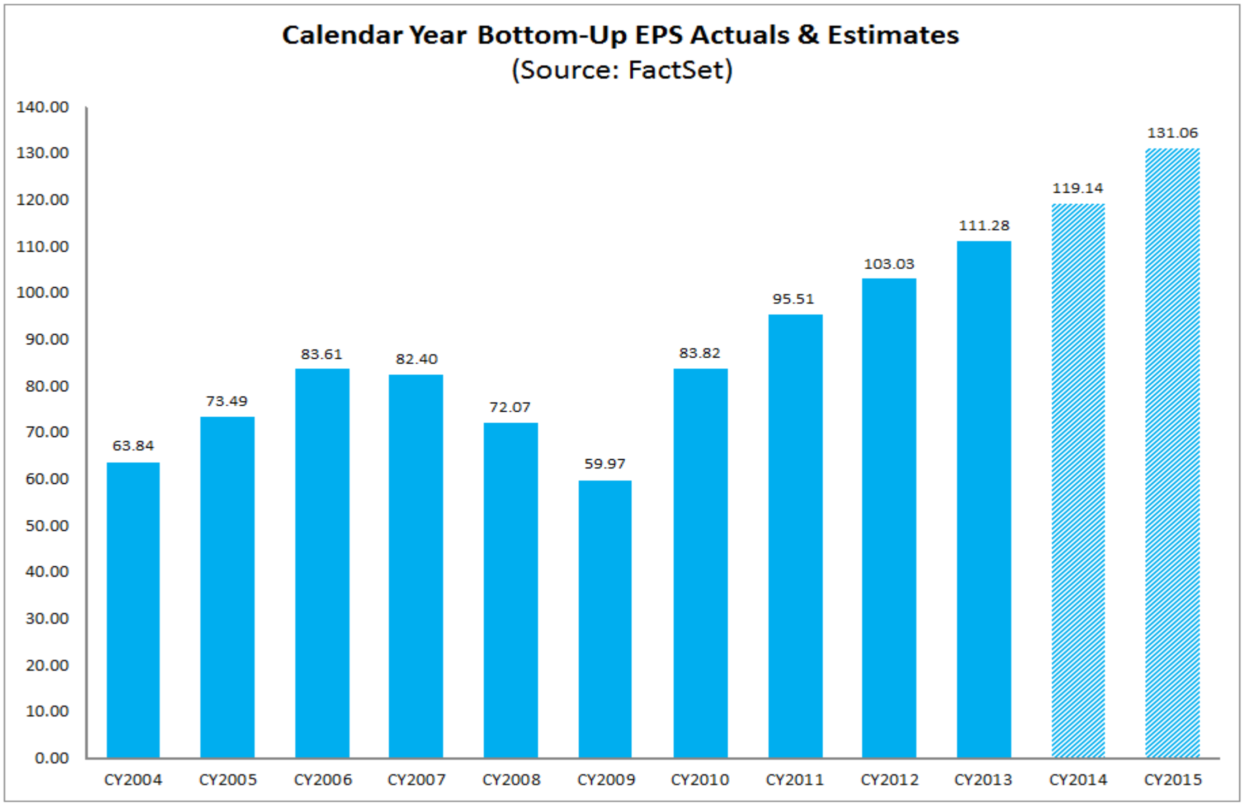
	Info. Technology	Health Care	Consumer Disc.	Consumer Staples	Materials	Financials	S&P 500	Industrials	Telecom Services	Utilities	Energy
Today	7.2%	5.8%	5.6%	4.6%	4.5%	3.9%	3.7%	3.5%	2.5%	0.6%	-3.3%
30-Sep-14	7.4%	5.9%	5.9%	5.2%	4.9%	4.1%	4.3%	4.0%	2.4%	0.7%	-0.7%

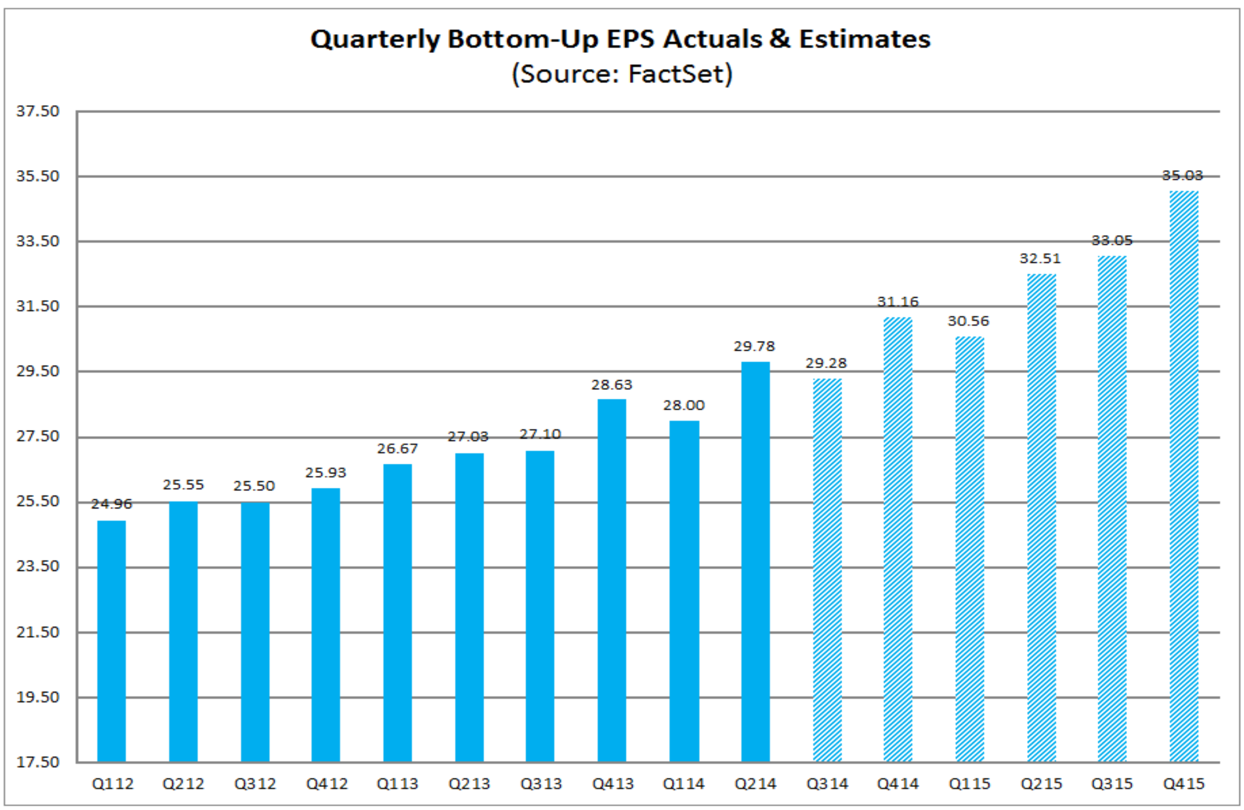
Bottom-up EPS Estimates: Revisions



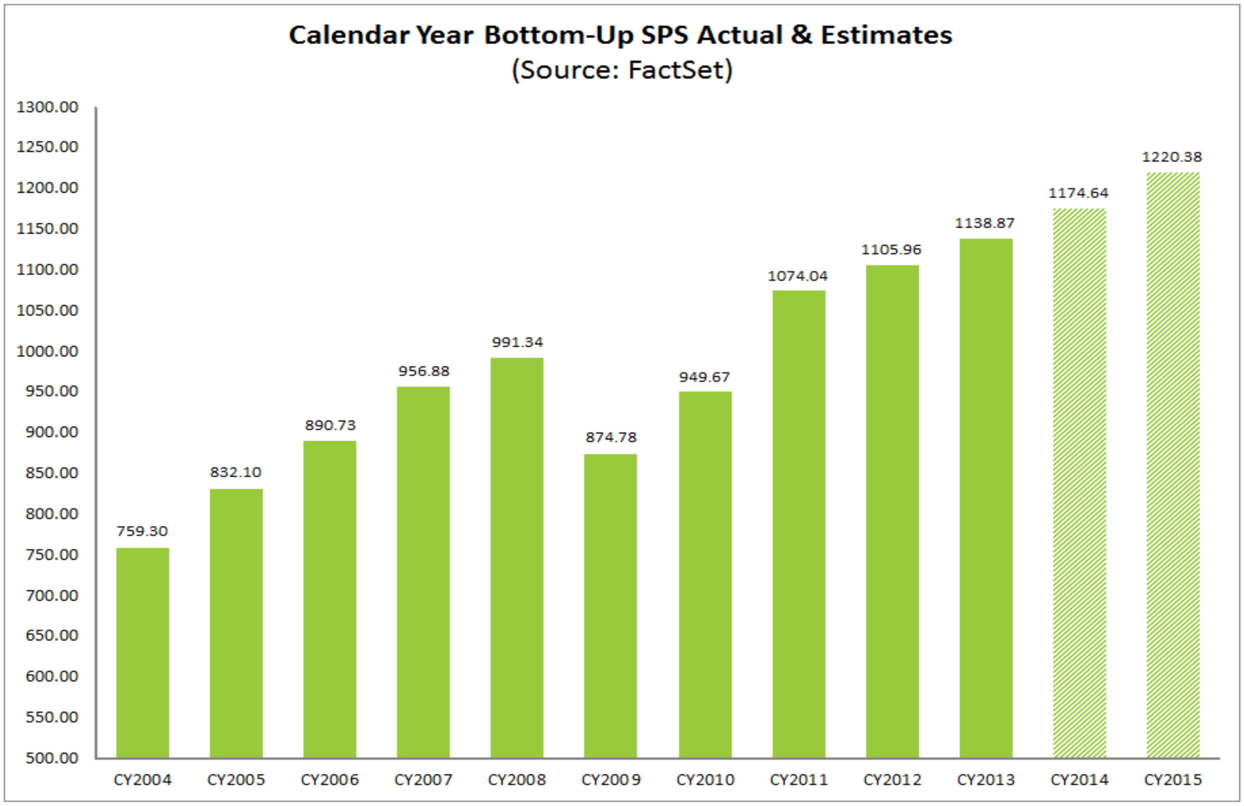


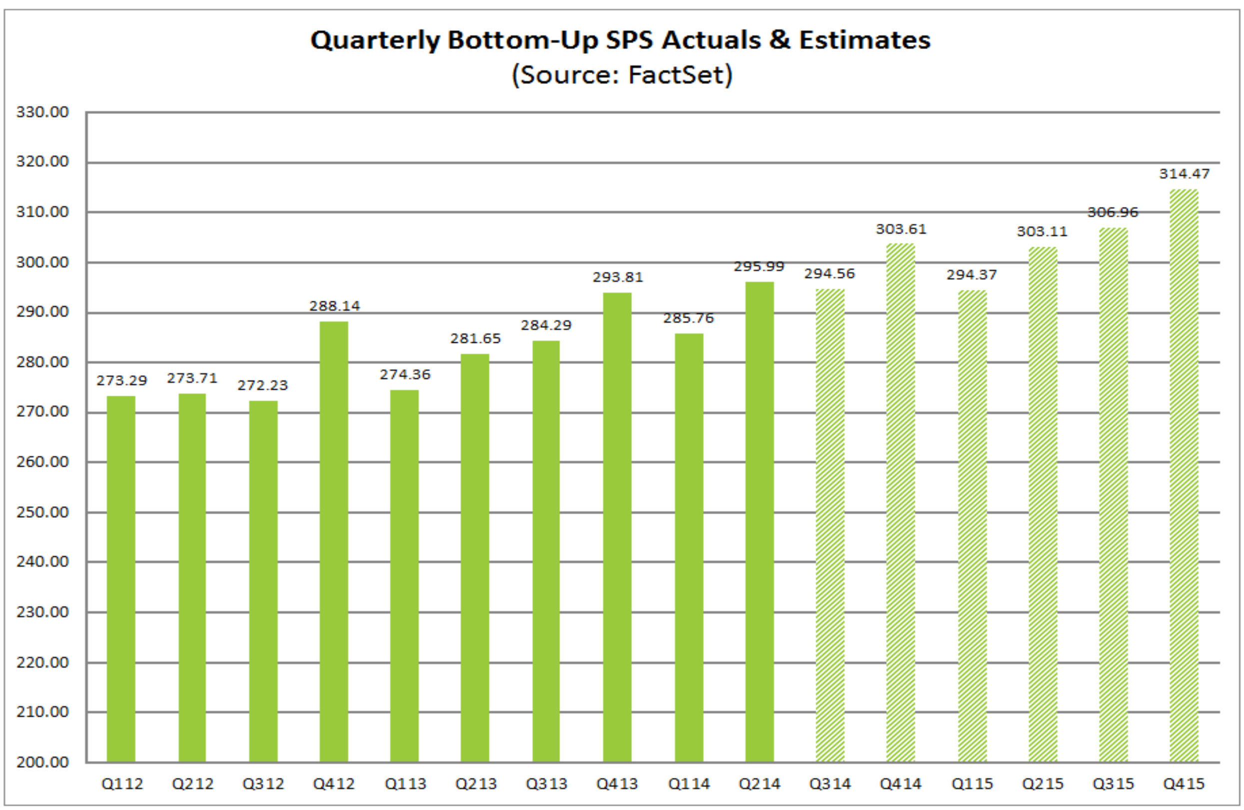
Bottom-up EPS Estimates: Current & Historical



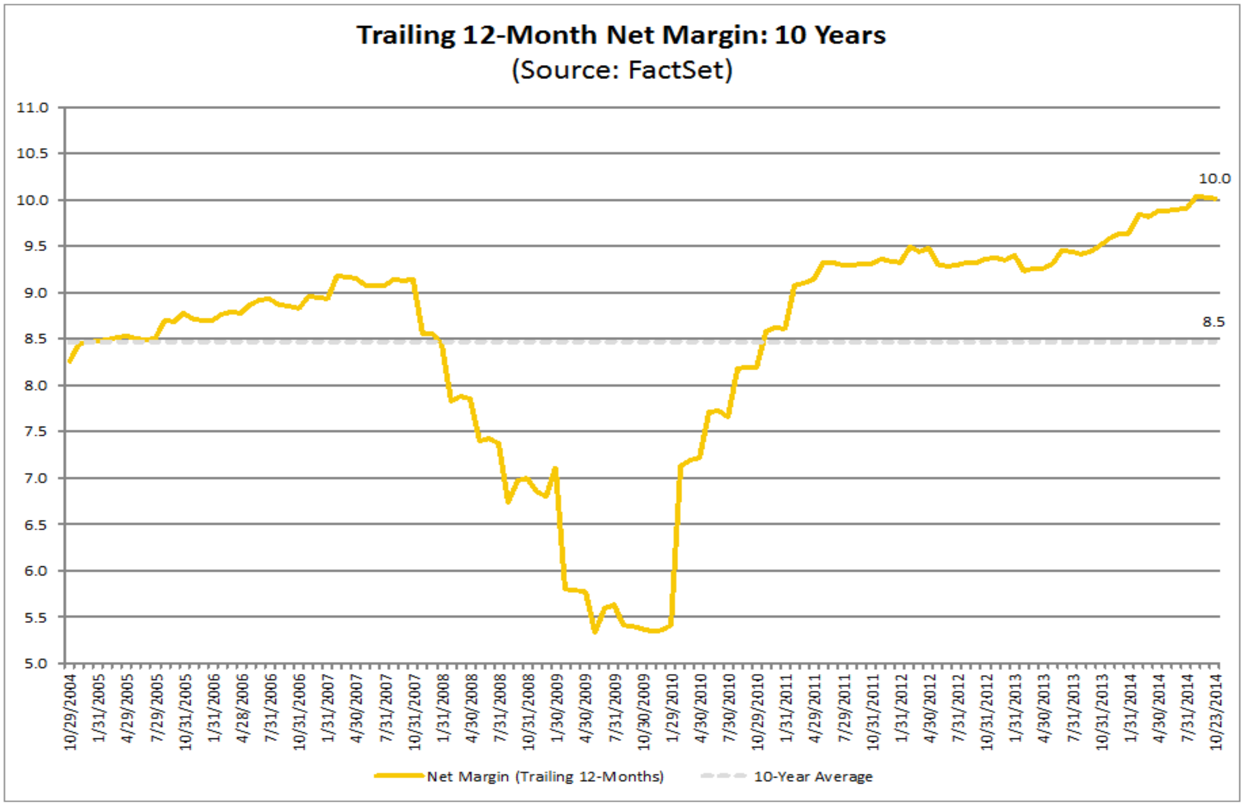


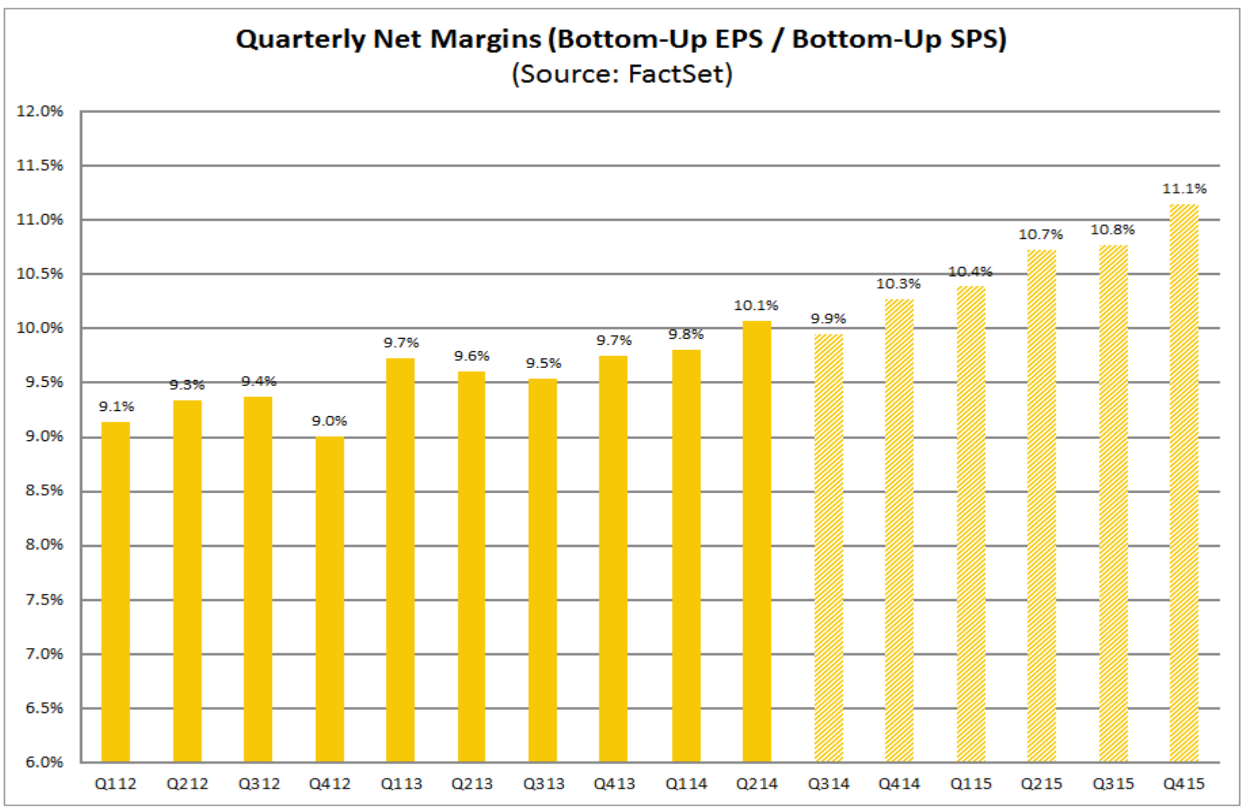
Bottom-up SPS Estimates: Current & Historical





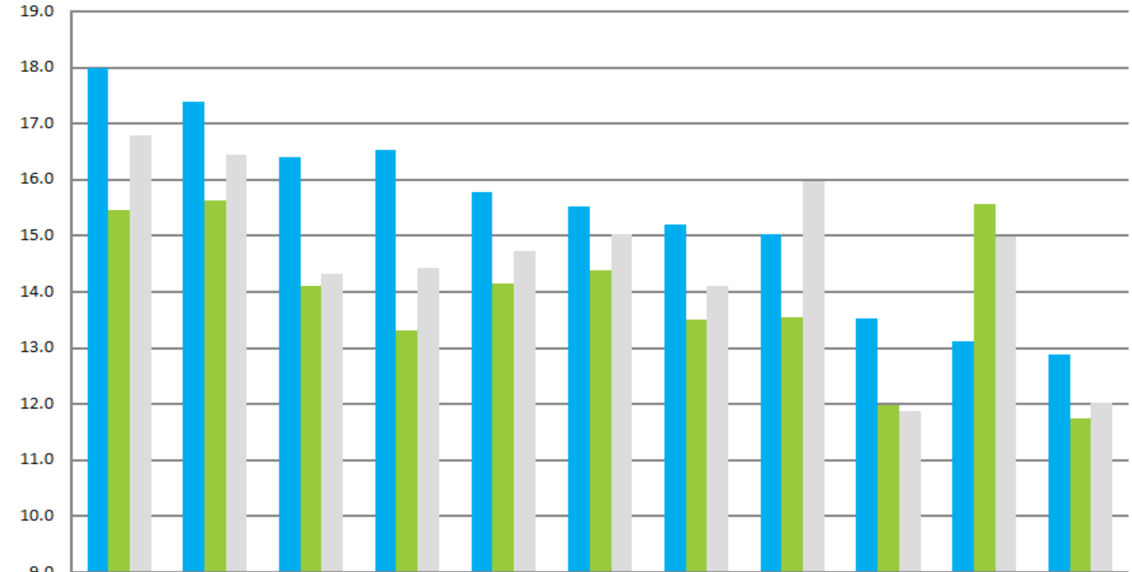
Net Margins: Current & Historical





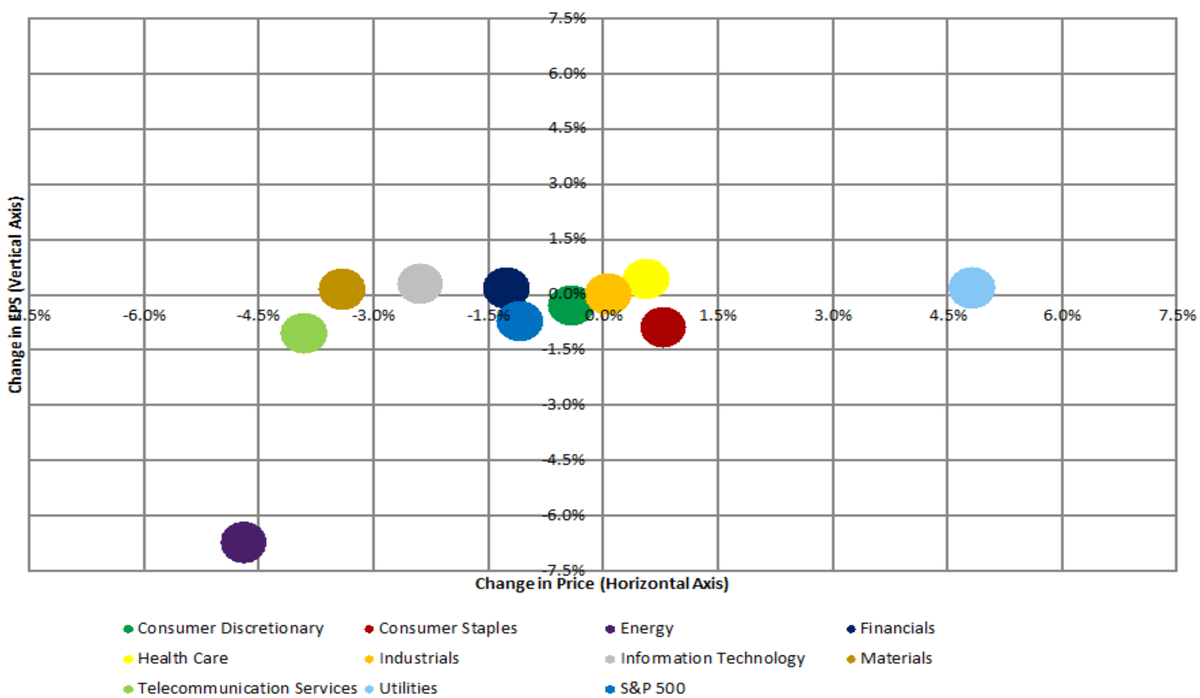
Forward 12M Price / Earnings Ratio: Sector Level

Sector-Level Forward 12-Month P/E Ratios
(Source: FactSet)

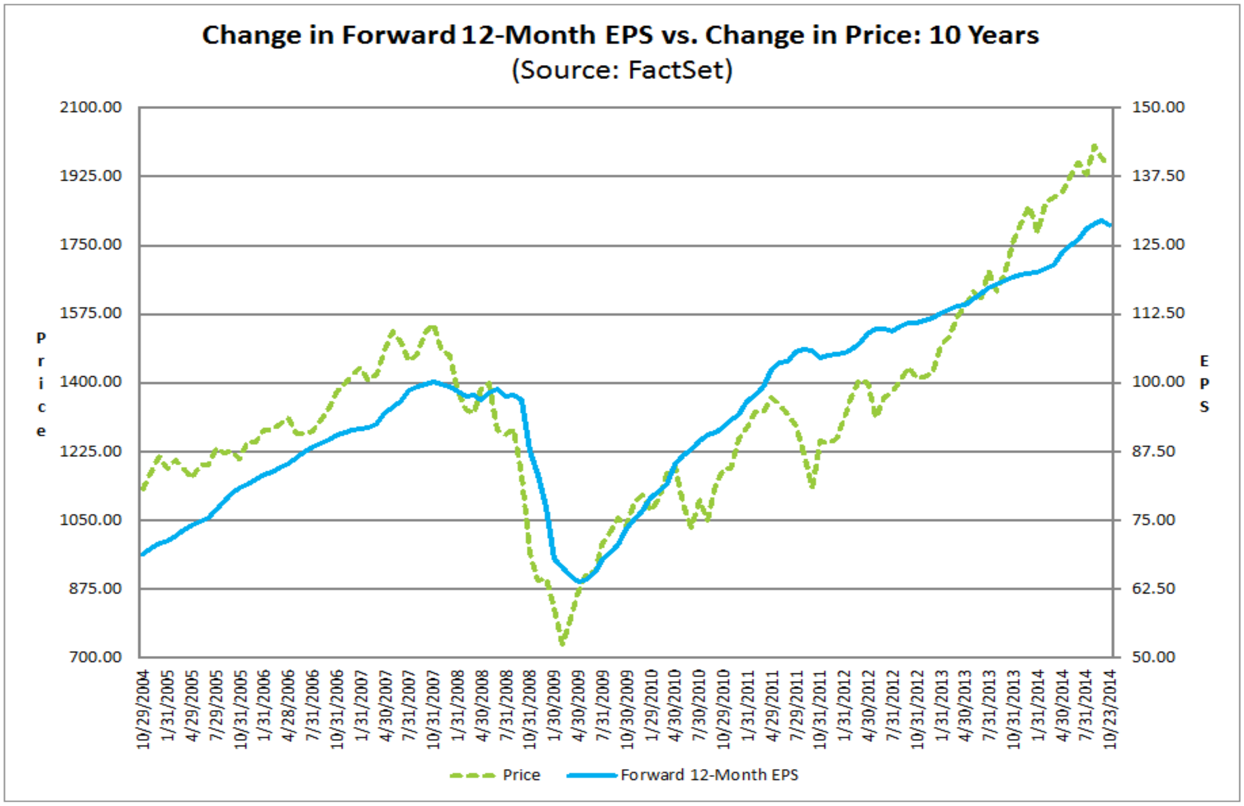


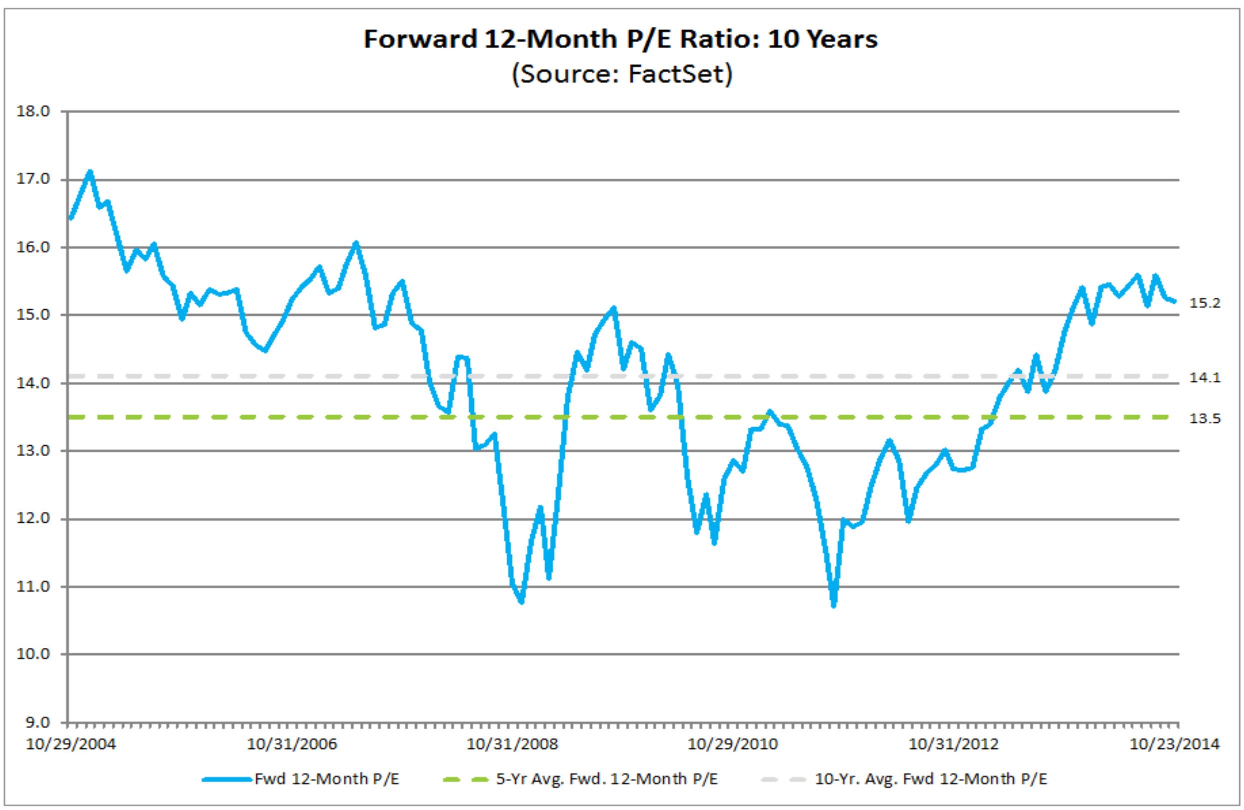
	Consumer Staples	Consumer Disc.	Utilities	Health Care	Materials	Industrials	S&P 500	Info. Technology	Energy	Telecom Services	Financials
Fwd 12M P/E	18.0	17.4	16.4	16.5	15.8	15.5	15.2	15.0	13.5	13.1	12.9
5-Yr Avg.	15.5	15.6	14.1	13.3	14.1	14.4	13.5	13.5	12.0	15.6	11.7
10-Yr Avg.	16.8	16.4	14.3	14.4	14.7	15.0	14.1	16.0	11.9	15.0	12.0

Sector-Level Change in Forward 12-Month EPS vs. Price: Since Sep. 30
(Source: FactSet)

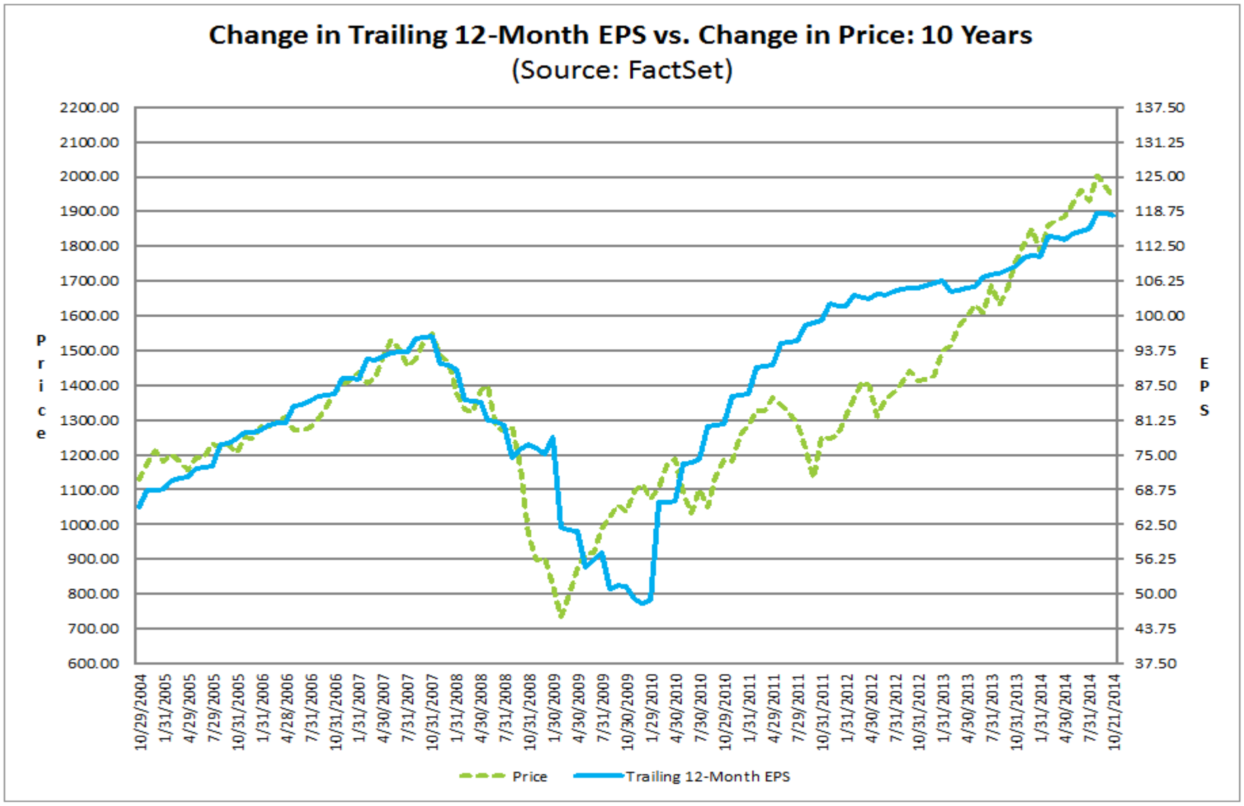


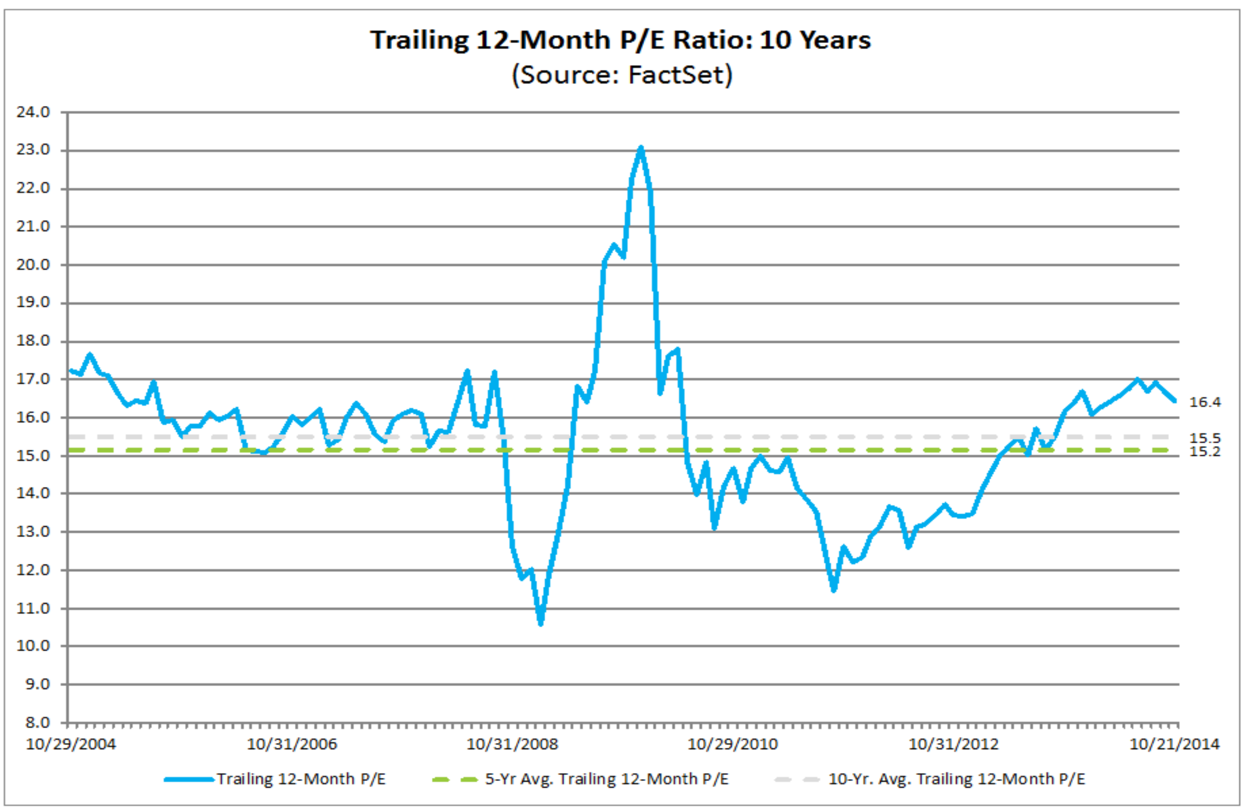
Forward 12M Price / Earnings Ratio: Long-Term Averages





Trailing 12M Price / Earnings Ratio: Long-Term Averages





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