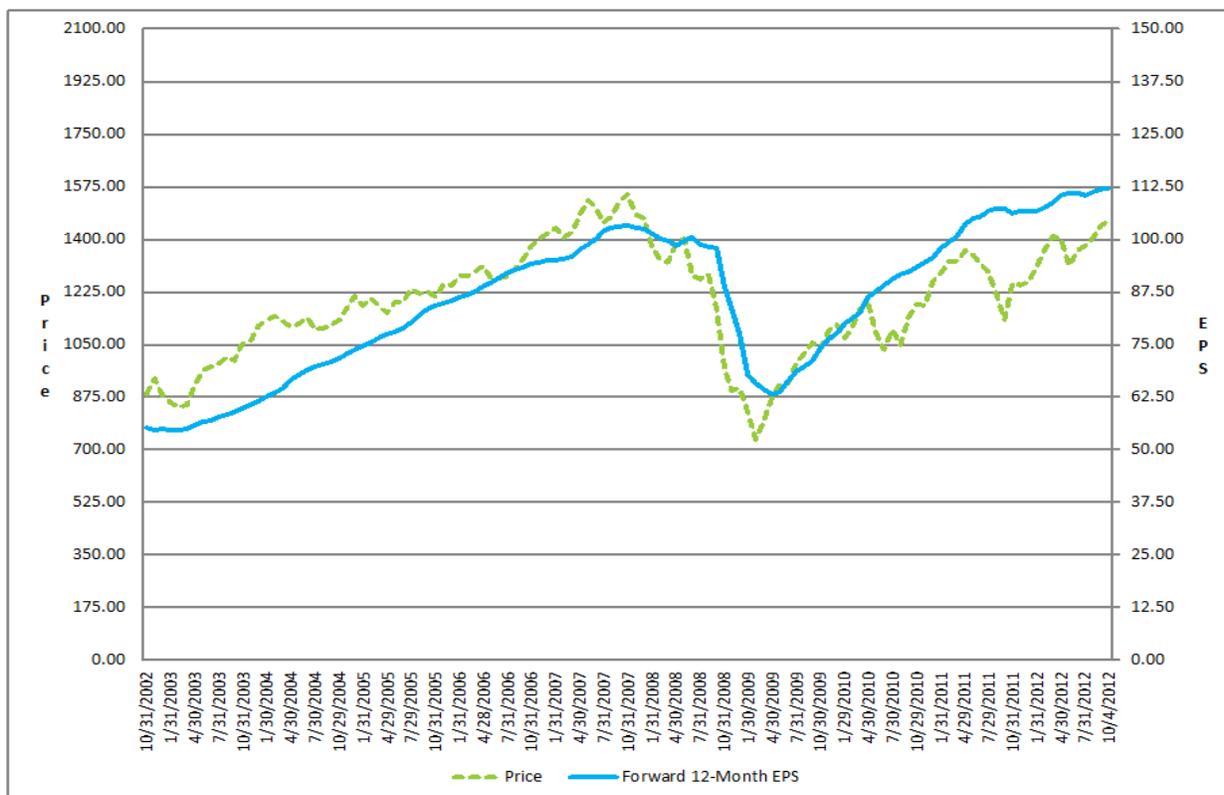


### Key Metrics

- + **Earnings Growth:** The estimated earnings growth rate for Q3 2012 is -2.7%. If -2.7% is the final growth rate for the quarter, it will mark the end of the eleven-quarter streak of earnings growth for the index.
- + **Earnings Revisions:** On June 30, the estimated earnings growth for Q3 2012 was 1.9%. The Materials and Information Technology sectors have witnessed the largest declines in projected earnings growth during this time.
- + **Earnings Guidance:** For Q3 2012, 80 companies have issued negative EPS guidance and 23 companies have issued positive EPS guidance. If 78% (80 out of 103) is the final percentage of companies issuing negative EPS guidance for the quarter, it will be the highest percentage recorded by FactSet.
- + **Valuation:** The current 12-Month forward P/E ratio is 13.0. This P/E ratio is below the average forward 12-Month P/E ratio over the past 10 years (14.3).
- + **Earnings Scorecard:** Of the 26 companies that have reported earnings to date for Q3 2012, 62% have reported earnings above the mean estimate and 54% have reported sales above the mean estimate.

S&P 500 Forward 12-Month EPS vs. Price: 10-Year



All data published in this report is available on FactSet. Please contact media\_request@factset.com or 1-877-FACTSET for more information.

## Topic of the Week:

### Does Alcoa Set The Tone For Earnings Season?

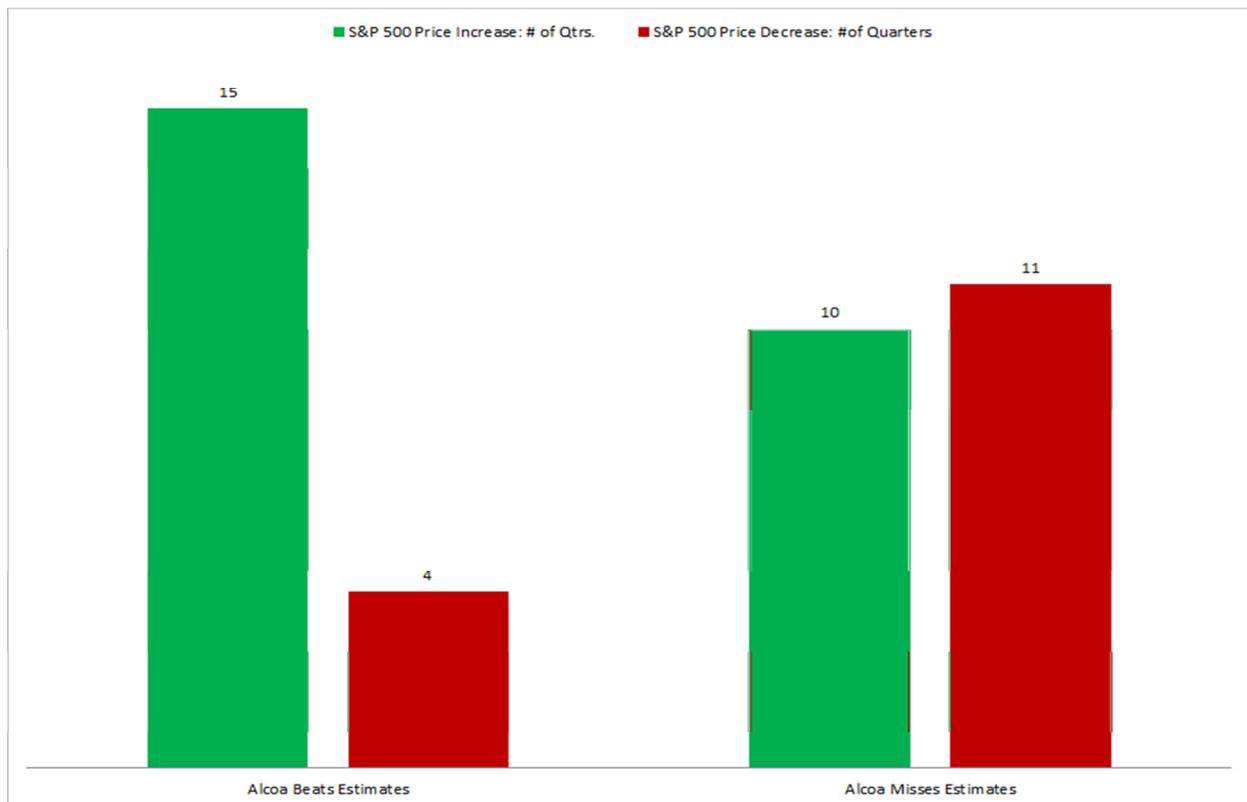
The Q3 2011 earnings season kicks off on Tuesday (October 9), as Alcoa is scheduled to report quarterly earnings on that date. Alcoa is traditionally the first Dow component to report earnings each quarter. Do the results from Alcoa have any predictive value on the rest of the earnings season, either in terms of performance relative to expectations or the price of the index?

Since 2009, Alcoa has reported earnings above the mean EPS estimate 50% of the time (7 out of 14 quarters). In the seven quarters that Alcoa reported actual EPS above the mean EPS estimate, 74.6% of companies in the S&P 500 reported earnings above EPS estimates for the quarter. In the seven quarters that Alcoa reported actual EPS below the mean EPS estimate, 72.4% of companies in the S&P 500 reported actual EPS above the mean EPS estimate for the quarter. So while there is a slight difference in the percentages, it appears that Alcoa's earnings performance relative to estimates has little predictive value in determining the earnings performance of the remaining companies in the index.

Over the past ten years, Alcoa has reported earnings above the mean EPS estimate 47.5% of the time (19 out of 40 quarters). In the 19 quarters that Alcoa reported actual EPS above the mean EPS estimate, the average price change for the S&P 500 from report date to report date (for Alcoa) is 3.9%. The price of the S&P 500 increased in 15 of these 19 quarters (79%). In the 21 quarters that Alcoa reported actual EPS below the mean EPS estimate, the average price change from report date to report date is -0.6%. However, the price of the index decreased in only 11 of these 21 quarters (52%). During the other ten quarters, the price of the index increased over the next three months after Alcoa missed estimates.

Thus, recent history shows that when Alcoa has beat estimates, the price of the index has increased about 80% of the time over the next three months. When Alcoa has missed estimates, the price of the index has actually increased nearly as often as it has decreased over the next three months.

Alcoa Earnings Performance vs. Price Change in S&P 500: Trailing 10 Years



## Q3 2012 Earnings Season: Overview

### No Change in the Growth Rate This Week; Estimates down Overall Since June 30

The estimated earnings growth rate for the third quarter is -2.7% this week, unchanged from last week. Upside estimate revisions to companies in the Energy sector (including Exxon Mobil and Chevron) were offset by small downward estimate revisions to companies in most of the other sectors.

Since the start of the third quarter (June 30), the estimated earnings growth rate for the index has dropped to -2.7% from 1.9%. Nine of the ten sectors have seen a decrease in their earnings growth rates during this time, led by the Materials and Information Technology sectors. The only sector that has witnessed an improvement in projected earnings growth since June 30 is the Financials sector.

### Q3 EPS Guidance: Highest Percentage of Negative Guidance (78%) Tracked by FactSet

Of the 103 companies that have issued EPS guidance for the third quarter, 80 have issued projections below the mean EPS estimate and just 23 have issued projections above the mean EPS estimate.

If 78% (80 out of 103) is the final percentage of companies that issue negative EPS guidance for the quarter, it will mark the highest percentage recorded since FactSet began tracking guidance in Q1 2006. At this time, the Q4 2011 quarter has the record for the quarter that finished with the highest percentage of negative EPS guidance (73%).

The high percentage of negative EPS guidance can be attributed to both the high number (80) of companies that have issued negative EPS guidance and the low number (23) of companies that have issued positive EPS guidance. If 80 is the final number for the quarter, it will mark the fourth highest number of companies issuing negative guidance for a quarter since FactSet began tracking guidance in Q1 2006. At this time, the Q4 2011 quarter has the record for the quarter that finished with the highest number of companies issuing negative guidance at 84. If 23 is the final number for the quarter, it will mark the lowest number of companies issuing positive guidance for a quarter since FactSet began tracking guidance in Q1 2006.

### Projected Earnings Decline (-2.7%) for Q3 2012 Could End 11-Quarter Growth Streak

The estimated earnings growth rate for Q3 2012 is -2.7%. If this is the final growth rate for the quarter, it will mark the end of the streak of eleven consecutive quarters of earnings growth for the index.

Overall, five of the ten sectors are predicted to see a year-over-year decline in earnings for the quarter. Of these five sectors, the Energy and Materials sectors have the lowest earnings growth rates. On the other hand, the Financials sector is expected to have the highest earnings growth rate of all ten sectors.

### Energy & Materials Sectors: Earnings Decreases Expected Despite Rising Commodity Prices

The Materials sector has the lowest earnings growth rate (-21.9%) and the second lowest revenue growth rate (-4.6%) of all ten sectors. Ten of the twelve sub-industries in this sector are projected to see a year-over-year decrease in earnings, led by the Aluminum (-94%), Steel (-64%), and Diversified Metals & Mining (-34%) sub-industries.

The Energy sector has the second lowest earnings growth rate (-20.4%) and the lowest sales growth rate (-16.4%) of all ten sectors. Six of the seven sub-industries in the sector are predicted to see a decline in earnings, led by the Coal & Consumable Fuels (-84%) and Oil & Gas Exploration & Production (-38%) sub-industries. The only sub-industry expected to report earnings growth is the Oil & Gas Drilling sub-industry (2%). The Energy sector is also the largest contributor to the expected decrease in earnings for the index. If the Energy sector is excluded, the growth rate for the index would improve to 0.6%.

Many commodities did record a net increase in price during the quarter. Overall, the Thomson Reuters/Jeffries RCB index increased 8.8% (to 309.30 from 284.19) from June 30 to September 30. The

price of Brent Crude (ICE - \$/bbl) improved 14.9% (to 112.39 from 97.80) during this time. The price of the S&P GSCI Industrial Metals index jumped 9.5% (to 397.24 from 362.74).

Despite these increases, the average prices of a number of commodities were also below year-ago levels, which is a contributing factor to the expected earnings declines in these two sectors. For example, the average price of the S&P GSCI Industrial Metals index for Q3 2012 was 366.94, which is 17.2% below the average weekly price of 443.23 recorded in Q3 2011. This year-over-year drop is a contributing factor to the earnings weakness for companies in the Metals & Mining industry in the Materials sector. The average price of natural gas (NYM - \$/btu) for Q3 2012 was 2.90, which is 28.5% below the average price of 4.05 recorded in Q3 2011. This year-over-year decline is a contributing factor to the earnings weakness for a number of companies in the Energy sector, as many have expanded natural gas production in recent years.

However, it is interesting to note that the average prices of both Brent Crude (ICE - \$/bbl) and Crude Oil (NYM - \$/bbl) were almost equal to average year-ago levels. The average price of Brent Crude for Q3 2012 was \$109.34, slightly below the average price of \$111.96 in Q3 2011. The average price of Crude Oil for Q3 2012 was \$92.22, slightly above the average price of \$89.55 in Q3 2011. Based on these numbers, it does not appear that oil prices are a major contributor to the expected earnings and revenue declines for companies in the Energy sector, or analysts have been slow to revise estimates upward to reflect the price changes. There have been some upward revisions to the estimates for companies in this sector in recent weeks.

#### **Financials Sector: Excluding Companies with Unusual Comparisons, Broad-Based Growth in Sector**

The Financials sector has the highest earnings growth rate (10.0%) of all ten sectors. This sector is also the largest contributor to earnings growth for the index. If the Financials sector is excluded, the growth rate for the index falls to -5.0%.

The two companies (AIG and Goldman Sachs) that are the largest contributors to earnings growth for the sector also reported large losses in the year-ago quarter. The mean EPS estimate for AIG is \$0.78, compared to year-ago actual EPS of -\$1.60. The mean EPS estimate for Goldman Sachs is \$2.22, relative to year-ago actual EPS of -0.84. On the other hand, the two companies (Bank of America and Morgan Stanley) that are the largest detractors to earnings growth for the sector reported unusually high EPS in the year-ago quarter. The mean EPS estimate for Bank of America is \$0.08, compared to year-ago actual EPS of \$0.56. The mean EPS estimate for Morgan Stanley is \$0.29, relative to year-ago actual EPS of \$1.14. The year-ago earnings for both Bank of America and Morgan Stanley were boosted by DVA credits and other one-time gains. Excluding these four companies, the growth rate for the sector improves to 13.1%.

Aside from these four companies, analysts project broad-based earnings growth in many areas in the sector. Thirteen of the 19 sub-industries are predicted to report earnings growth. Ten of these thirteen sub-industries are expected to see double-digit earnings growth, led by Regional Banks (44%), Insurance Brokers (39%), Real Estate Services (39%), Specialized REITs (37%), Residential REITs (28%), and Diversified Banks (19%).

#### **Revenue Growth: 0.0%**

In terms of revenues, the estimated growth rate stands at 0.0%, down from an estimate of 1.9% at the start of the quarter. The Materials and Information Technology sectors have witnessed the largest decreases to estimated sales growth rates during the quarter.

Despite the low overall revenue growth rate for the index, eight of the ten sectors are expected to see sales growth for the quarter. The only two sectors that projected to report a decline in sales are the Energy (-16.4%) and Materials (-4.6%) sectors.

The Energy sector is the largest contributor to the decline in sales for the index. If the Energy sector is excluded, the estimated revenue growth rate would improve to 3.3%.

It is interesting to note that the flat growth rate for sales (0.0%) is projected to be higher than the year-over-year decline in earnings (-2.7%) expected for Q3 2012. In fact, nine out of ten sectors in the index are predicted to see higher sales growth than earnings growth for the quarter. The only sector predicted to see higher earnings growth (10.0%) than sales growth (1.6%) is the Financials sector.

### **Global Economic Slowdown: Europe, F/X Rates, and China**

Last quarter, many companies in the index reported lower revenue growth outside of the U.S. relative to recent years due to weak economic growth in Europe, less favorable foreign exchange rates, and slower economic growth in emerging markets (China). These conditions will likely continue to have a negative impact on revenue and earnings growth in Q3 2012 as well.

*“As we announced on September 4, weakness in the global economy constrained revenue growth at FedEx Express during our first quarter and affected our earnings.” –FedEx (Sep 18)*

#### **Europe**

Europe is now reporting a decline in economic growth relative to last year. According to FactSet Economics, the European Union recorded a decline in GDP of 0.3% in Q2 2012, compared to growth of 1.7% in Q2 2011. During the Q2 2012 earnings season, companies commented on the impact of the difficult conditions in Europe on their top and bottom lines. This trend will likely continue in Q3 2012.

For example, Oracle reported a year-over-year decline in overall sales of 2% for Q3 2012. While the Americas (2.3%) and Asia Pacific (2.1%) regions reported slight increases in sales, the combined Europe, Middle East, and Africa region reported a decrease in sales of almost 12%.

#### **Less Favorable F/X Rates**

The continuing weakness in Europe contributed to another factor that will likely have a negative impact on revenue and earnings growth in Q3 2012: less favorable foreign exchange rates. In 2011, many companies recorded a boost to revenues due to the weakness of the U.S. dollar relative to the Euro and other currencies. However, the ongoing weakness in Europe has led to the dollar gaining strength relative to the Euro over the past year. In Q3 2011, one Euro was equal to about \$1.41 U.S. dollars on average. For Q3 2012, one Euro was equal to about \$1.25 U.S. dollars on average. During the Q2 2012 earnings season, companies commented on the negative impact of foreign exchange rates on sales and earnings. This trend will likely continue in Q3 2012.

*“Price realization and mix reduced net sales growth by 2 points, and foreign exchange subtracted 2 points of sales growth.” –General Mills (Sep 19)*

#### **China and Emerging Markets**

Economic growth in countries in emerging markets has also been decreasing over the past year. According to FactSet Economics, three of the four “BRIC” countries recorded slower GDP growth during this time. For Q2 2011, China, India and Brazil recorded GDP growth of 9.5%, 9.0% and 3.3%, respectively. By Q2 2012, GDP growth rates for China, India, and Brazil had fallen to 7.6%, 3.0% and 0.3%. During the Q2 2012 earnings season, companies commented on the negative impact of slowing economic growth in emerging markets on their top and bottom lines. This trend will likely continue in Q3 2012.

*“Intel Corporation today announced that third-quarter revenue is expected to be below the company's previous outlook as a result of weaker than expected demand in a challenging macroeconomic environment...Relative to the prior forecast, the company is seeing customers reducing inventory in the supply chain versus the normal growth in third-quarter inventory; softness in the enterprise PC market segment; and slowing emerging market demand.” –Intel (Sep 7)*

*“The International segment comparable store sales decline of 8.2 percent was driven by the lower growth in consumer spending in China and the continued impact from the expiration of government sponsored programs, which negatively impacted sales in Five Star.” –Best Buy (Aug 21)*

### **Analysts Predict Earnings Growth Rebound to 9.5% in Q4 2012**

Since the start of the third quarter (June 30), analysts have reduced earnings growth expectations for Q4 2012 (to 9.5% from 13.8%), Q1 2013 (to 5.2% from 7.3%), and Q2 2012 (to 9.2% from 14.2%).

Despite the reductions to earnings estimates for Q4 2012, analysts are still calling for near double-digit growth (9.5%) for the quarter. Three of the ten sectors are predicted to report double-digit earnings growth: Financials (28.4%), Materials (24.4%), and Consumer Discretionary (11.1%).

In addition, analysts are calling for slightly higher revenue growth rates in Q4 2012 (2.8%), Q1 2013 (1.3%) and Q2 2013 (3.6%) relative to current expectations for Q3 2012 (0.0%)

### **Valuation: Forward P/E at 13.0, But Still Below 10-Year Average**

The current forward 12-month P/E ratio for the index is 13.0, based on Wednesday's (there is a one day lag in the data) closing price of 1450.99 and forward 12-month EPS estimate of 112.04. This 13.0 P/E ratio is below the prior ten-year average forward 12-month P/E ratio of 14.3, but above the P/E ratio of 12.3 recorded at the start of the third quarter.

The increase in the forward 12-month P/E ratio is mainly due to the improvement in price during this time frame. Since June 30, the price of the index has jumped 7.3%, while the forward 12-month EPS has increased 1.0%.

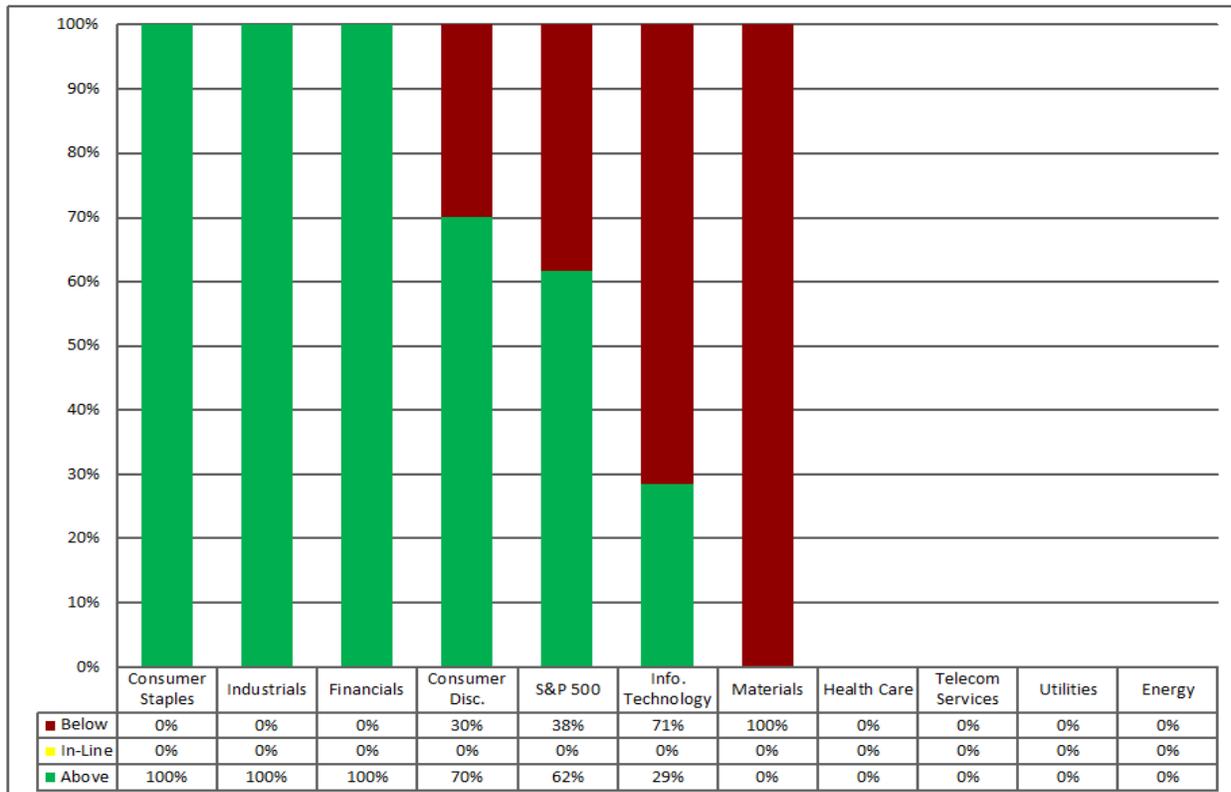
Will there be a return to the 10-year average valuation for the market anytime soon? If there is going to be a return to this average P/E ratio of 14.3, either future estimates will need to decrease, the price of the index will need to increase, or a combination of the two will need to occur.

### **Companies Reporting Next Week: Start of Earnings Season on October 9**

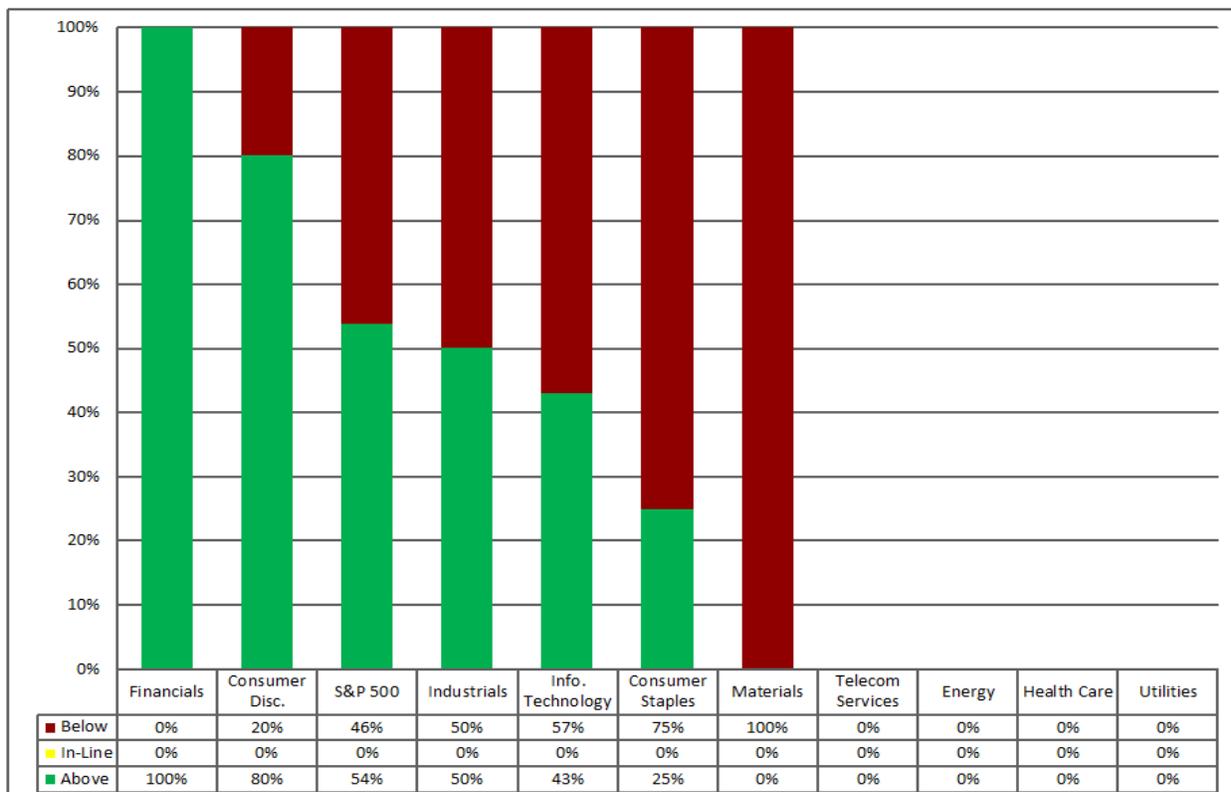
The unofficial start of earnings is October 9, when Alcoa is scheduled to release quarterly earnings results. However, it will be a light week in terms of overall numbers. Aside from Alcoa, only one other Dow component (JPMorgan Chase) and eight other S&P 500 companies are scheduled to announce earnings. The peak weeks of the earnings season will begin the week of October 15.

Q3 2012: Scorecard

Q3 2012 Earnings: Above, In-Line, Below Estimates

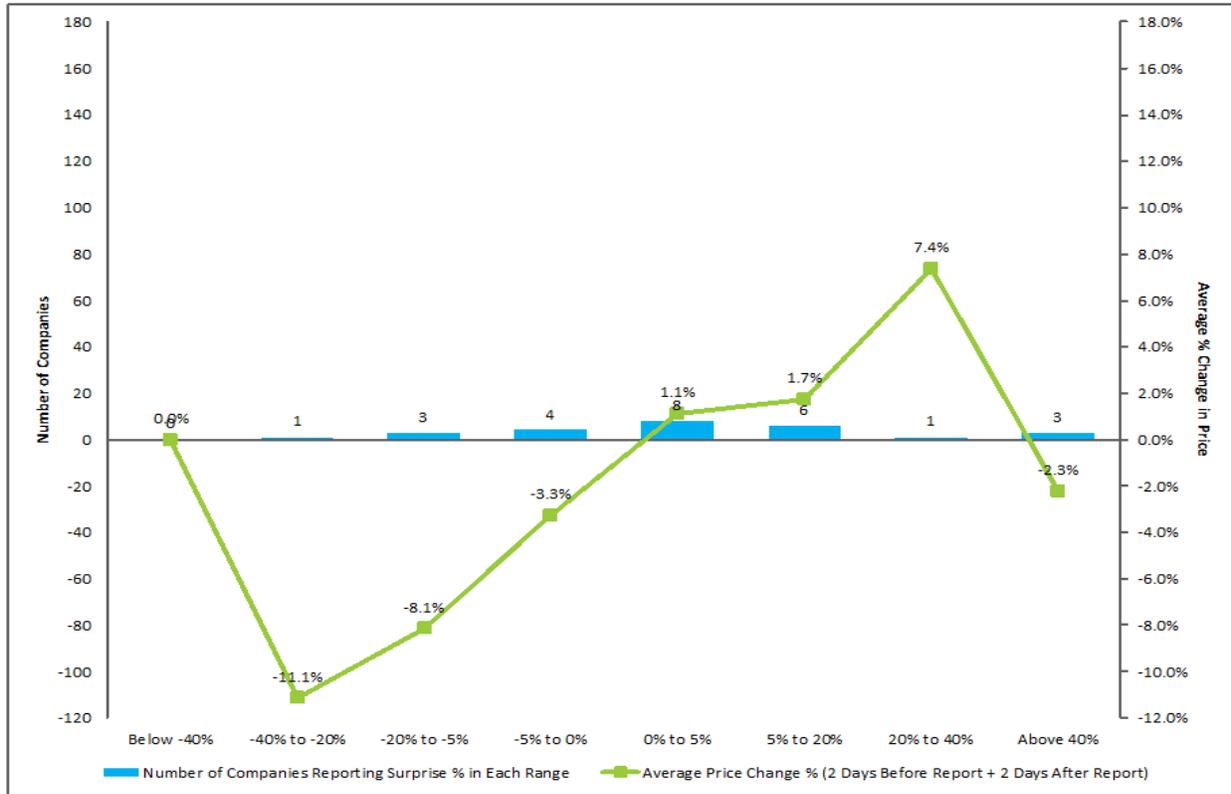


Q3 2012 Revenues: Above, In-Line, Below Estimates

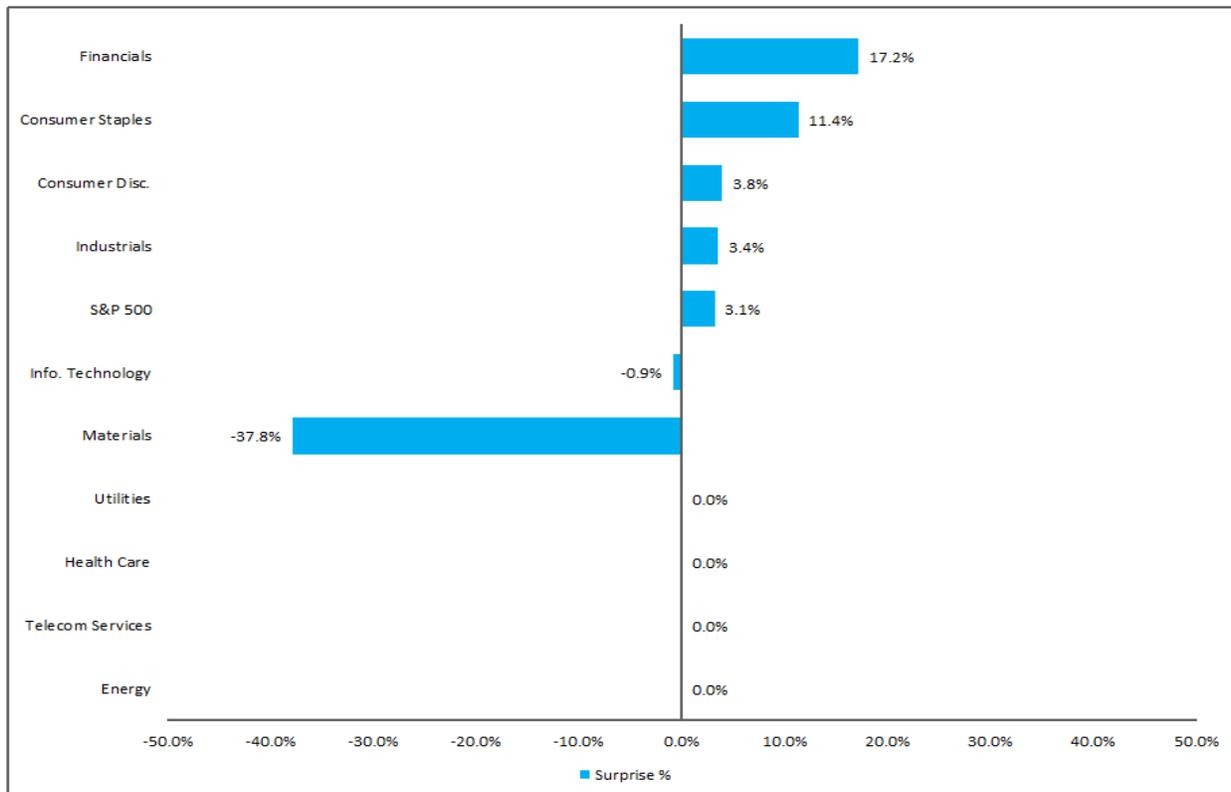


### Q3 2012: Scorecard

Q3 2012: Surprise % vs. Average Price Change %

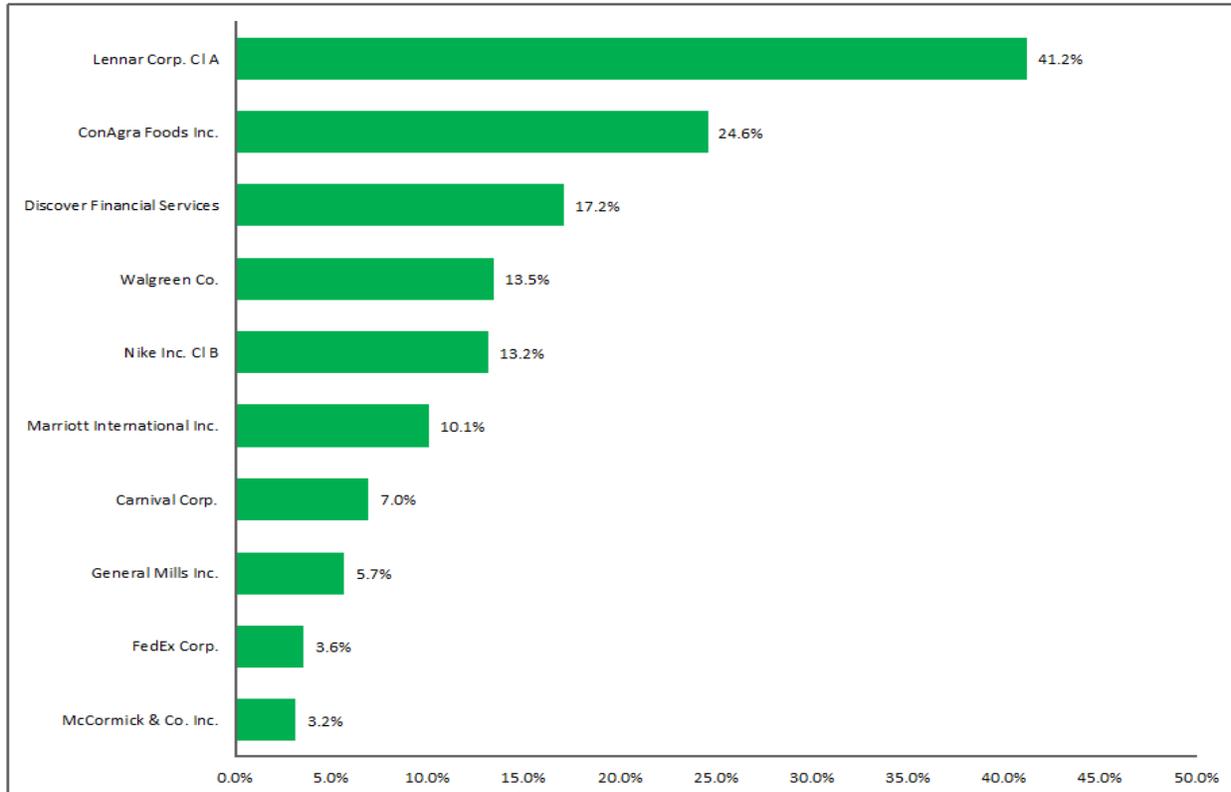


Q3 2012: Sector Level Surprise %

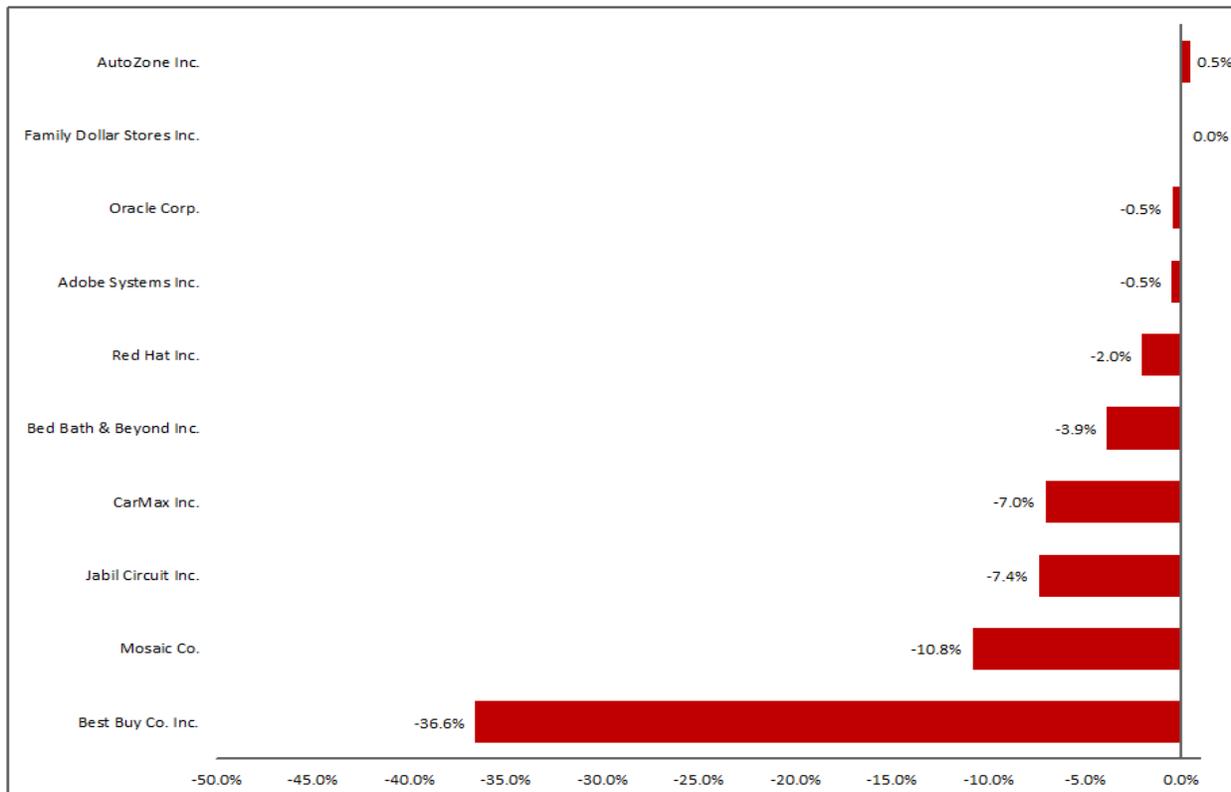


Q3 2012: Scorecard

Surprise %: Top 10 Companies

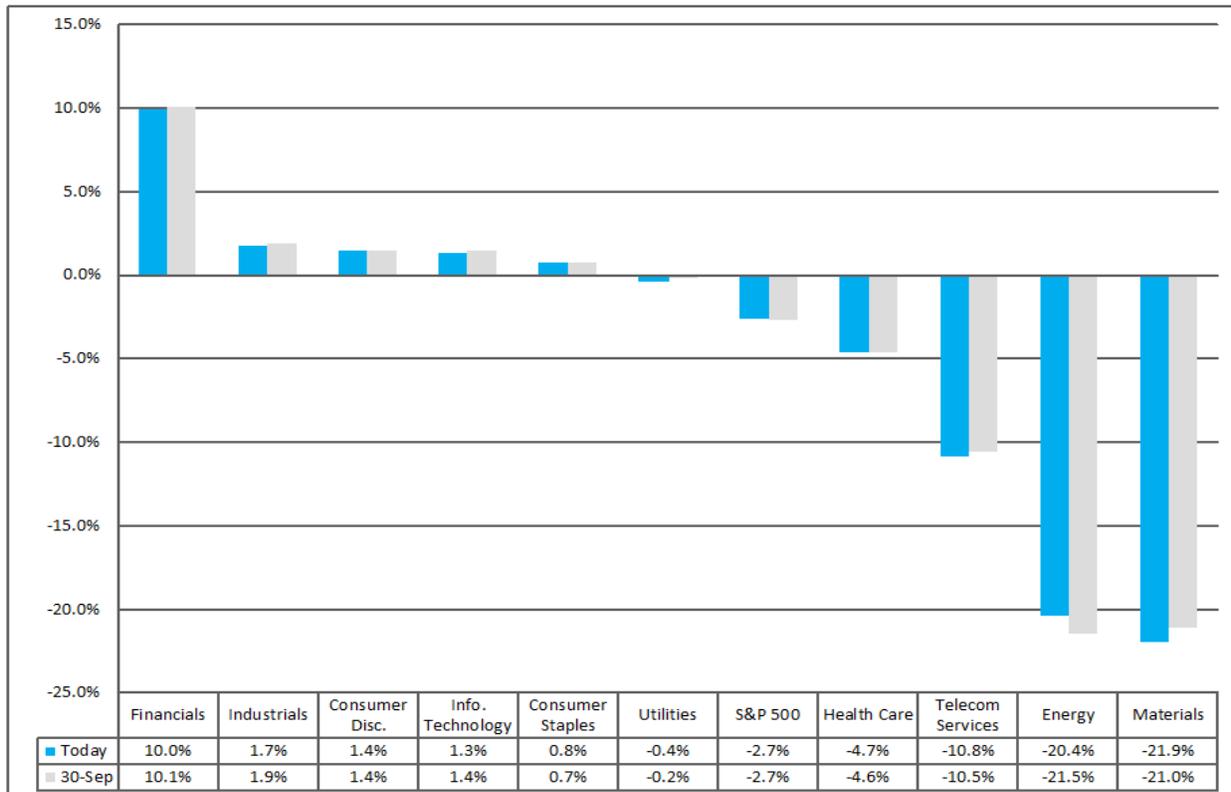


Surprise %: Bottom 10 Companies



Q3 2012: Growth

Q3 2012 Earnings Growth

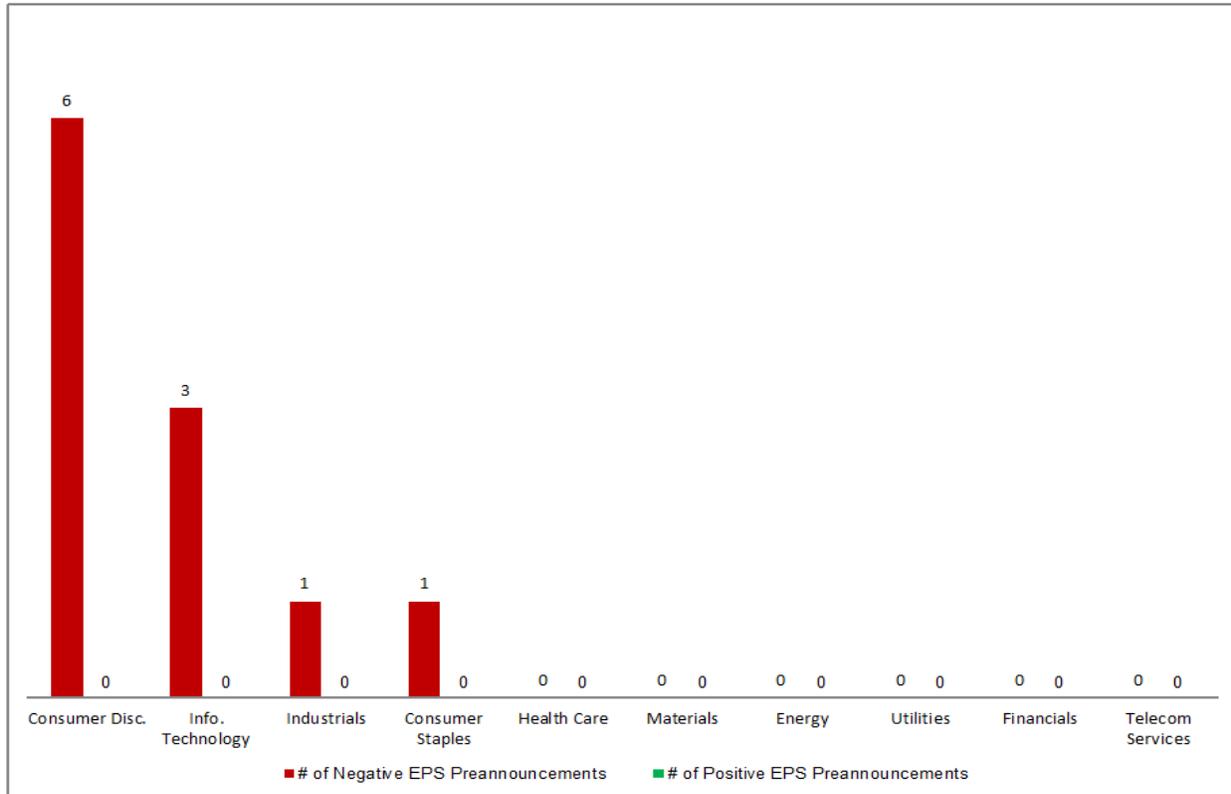


Q3 2012 Revenue Growth

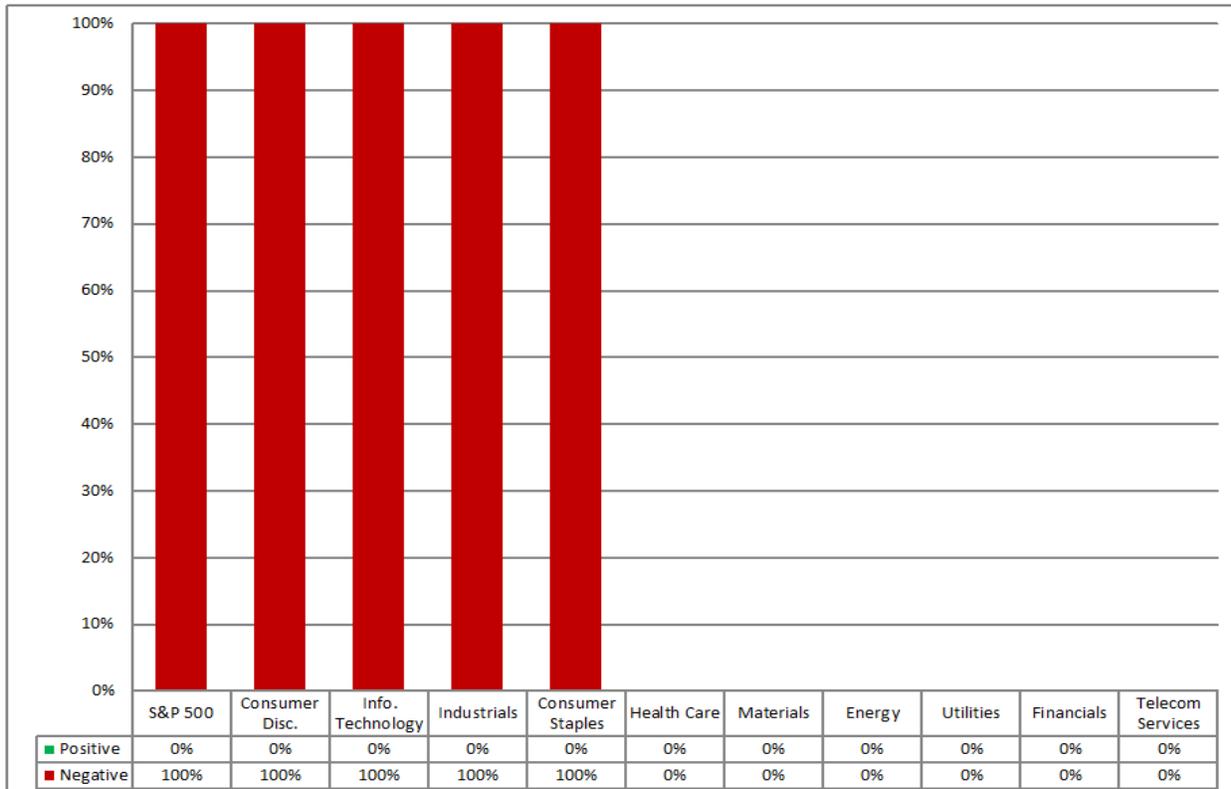


## Q4 2012: Guidance

Number of Positive & Negative EPS Preannouncements: Q4 2012

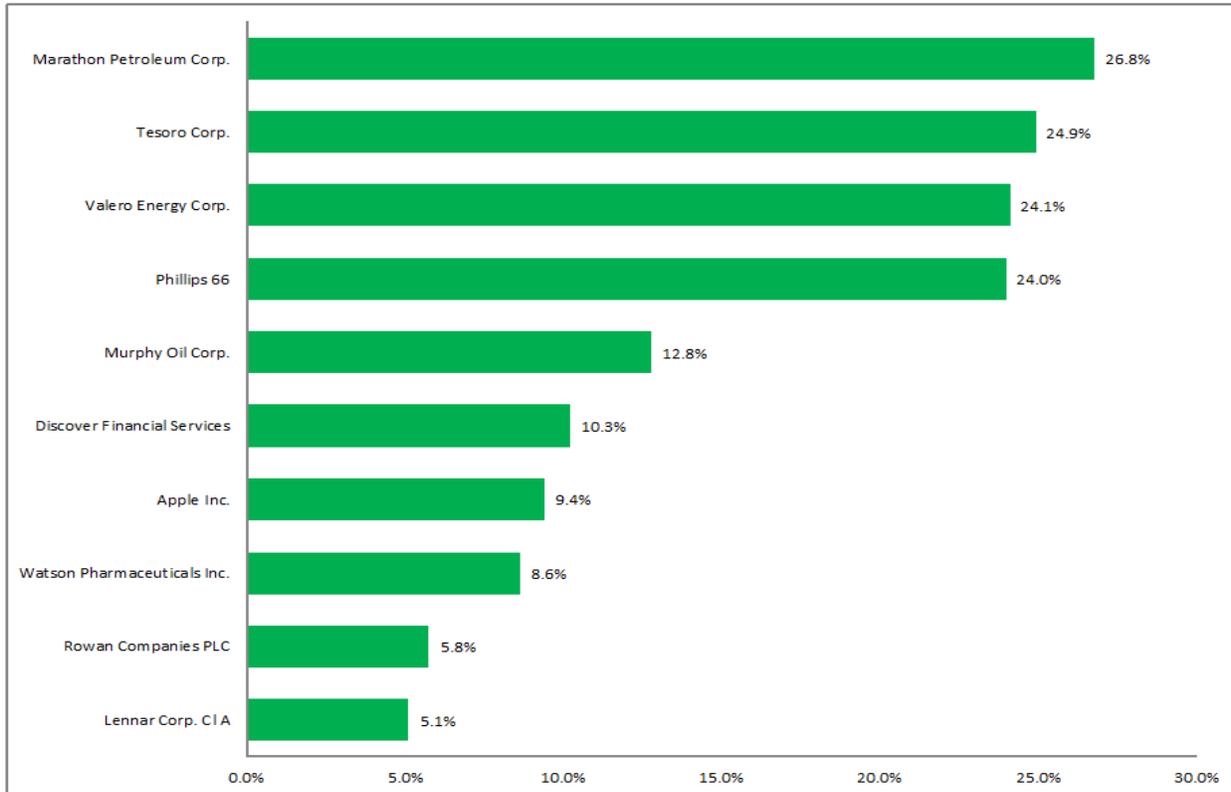


Percentage of Positive & Negative EPS Preannouncements: Q4 2012

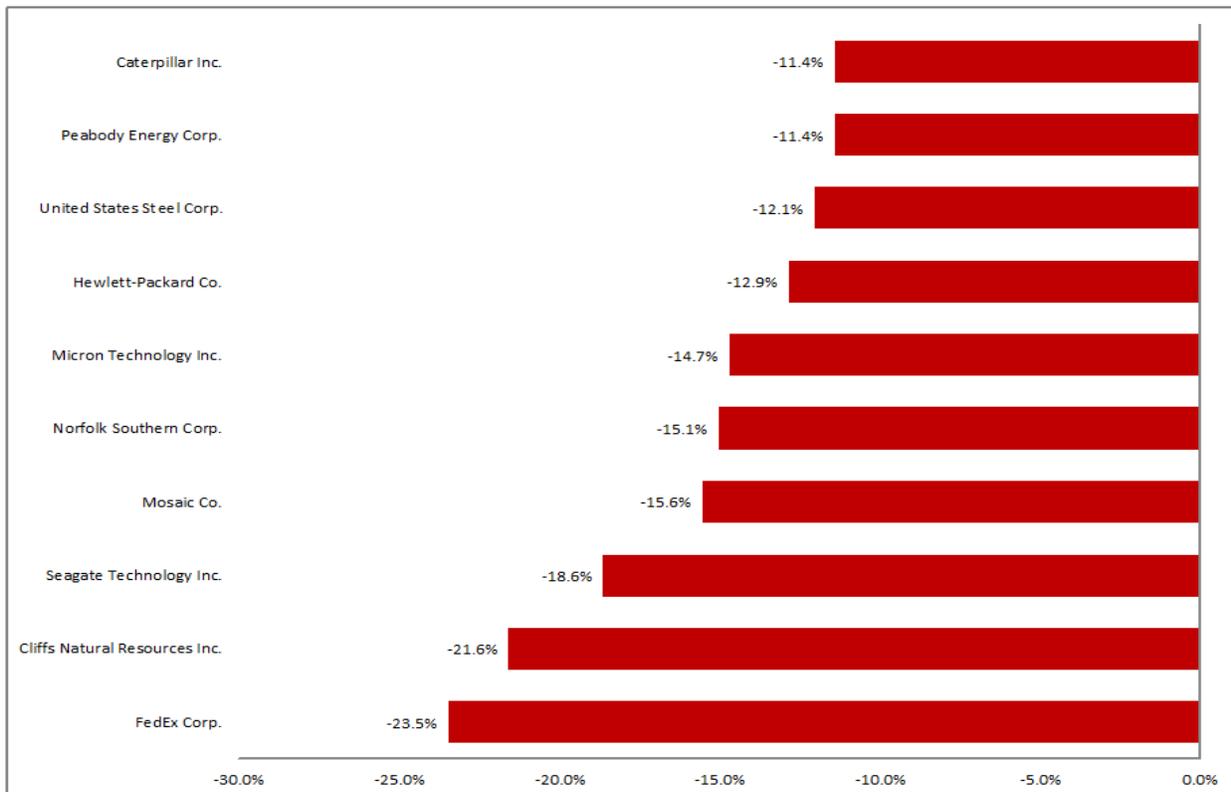


## Q4 2012: EPS Revisions

Highest Upward Change (Trailing 4-Weeks) in Mean EPS Estimate: Top 10 Companies

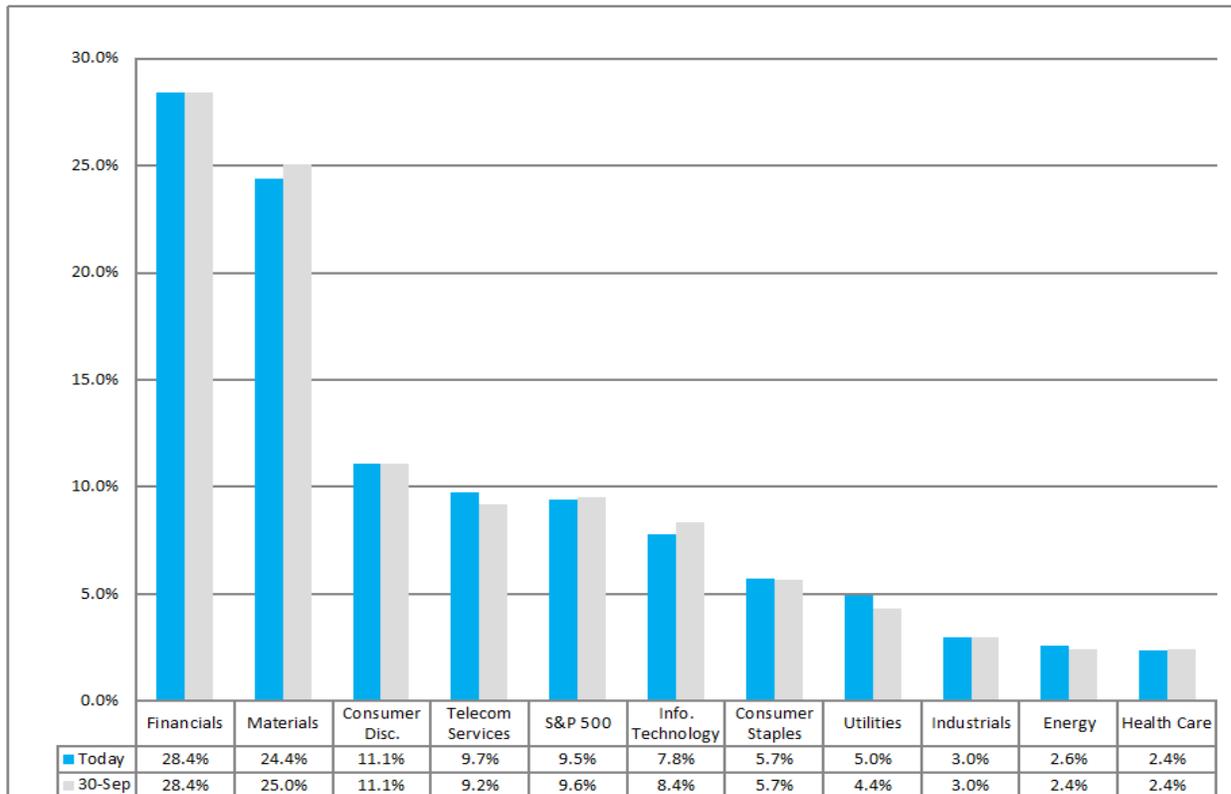


Highest Downward Change (Trailing 4-Weeks) in Mean EPS Estimate: Top 10 Companies

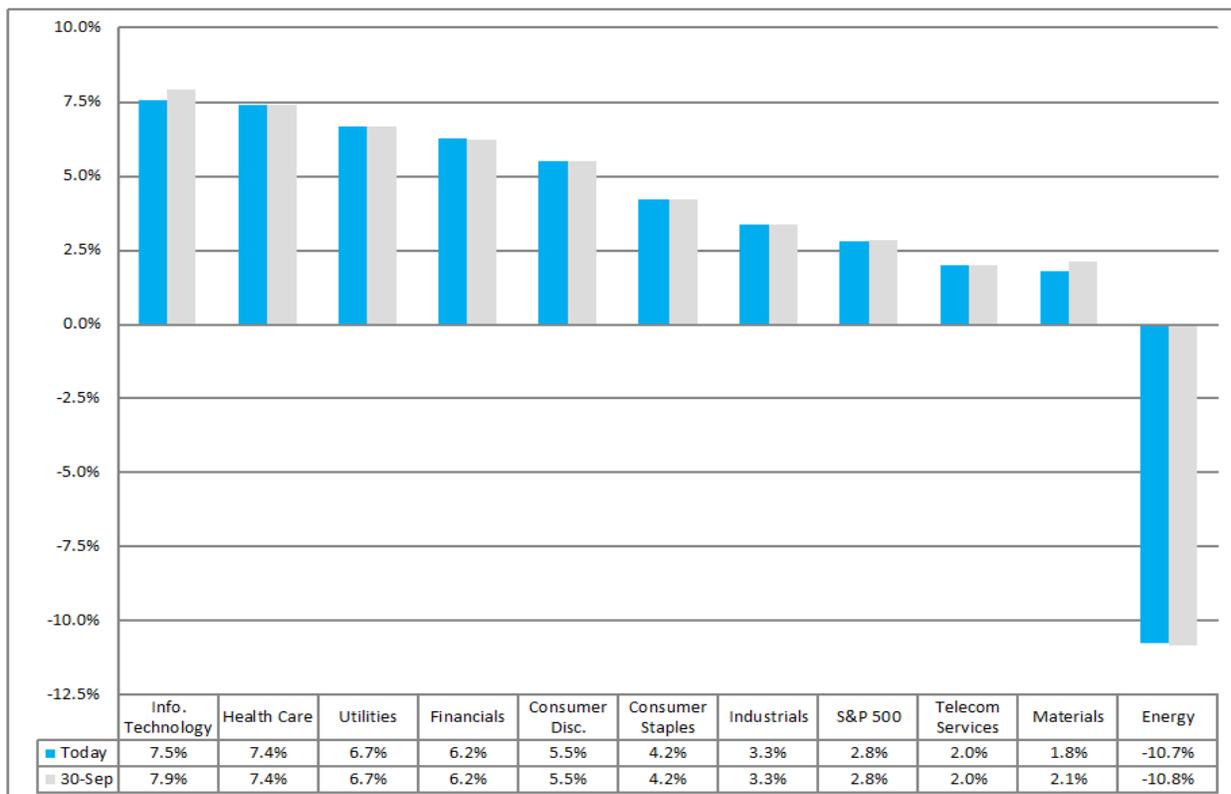


Q4 2012: Growth

Q4 2012 Earnings Growth

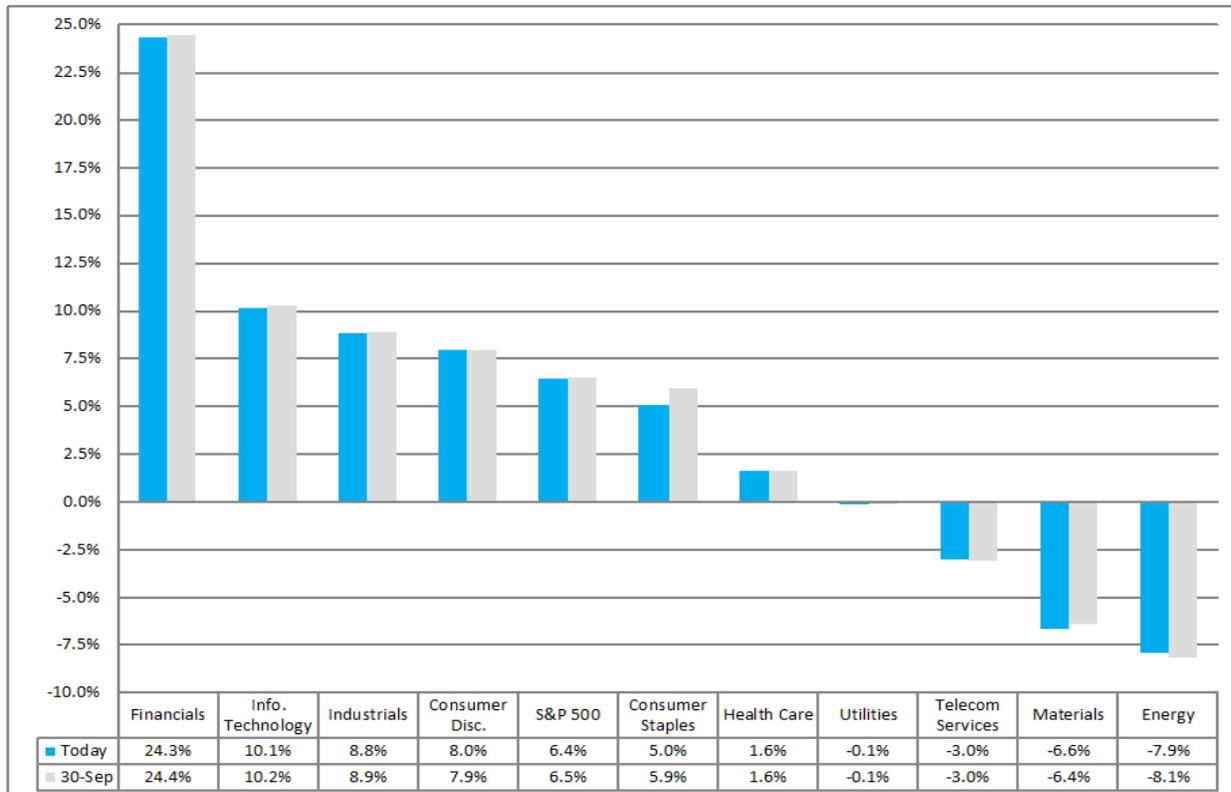


Q4 2012 Revenue Growth

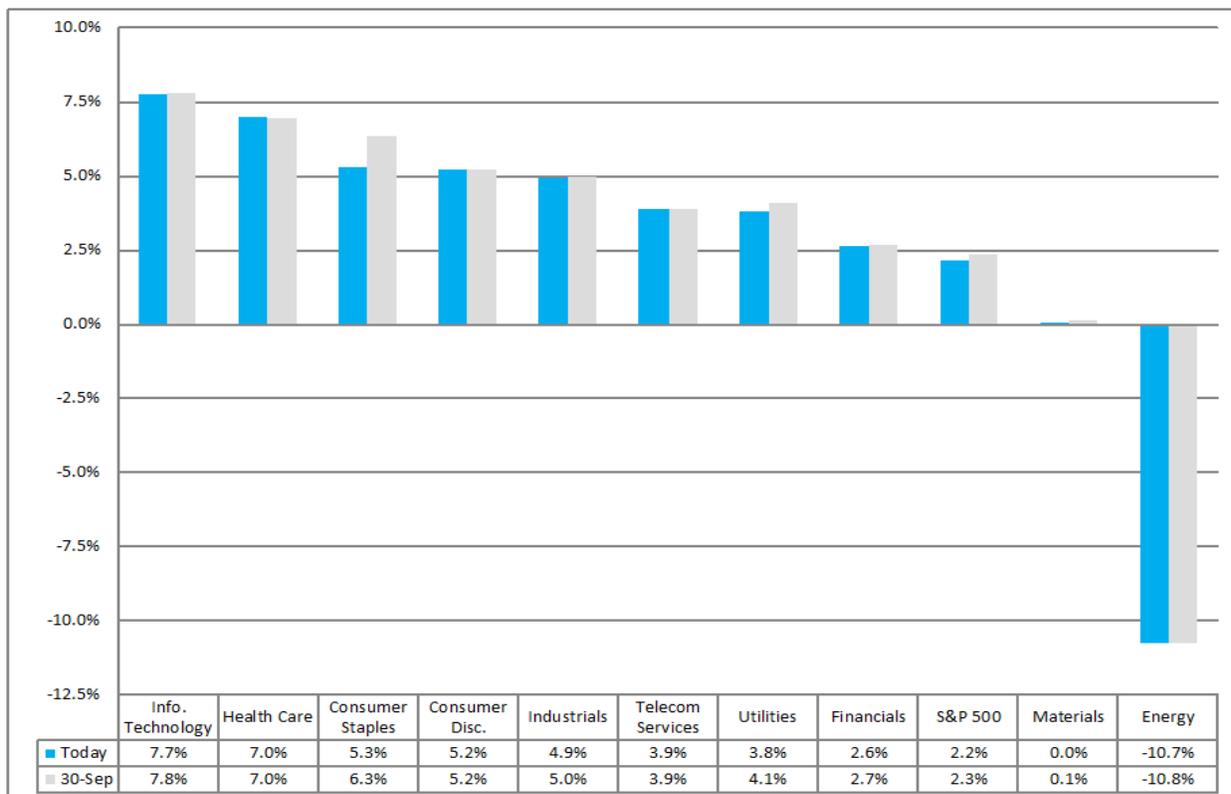


CY 2012: Growth

CY 2012 Earnings Growth

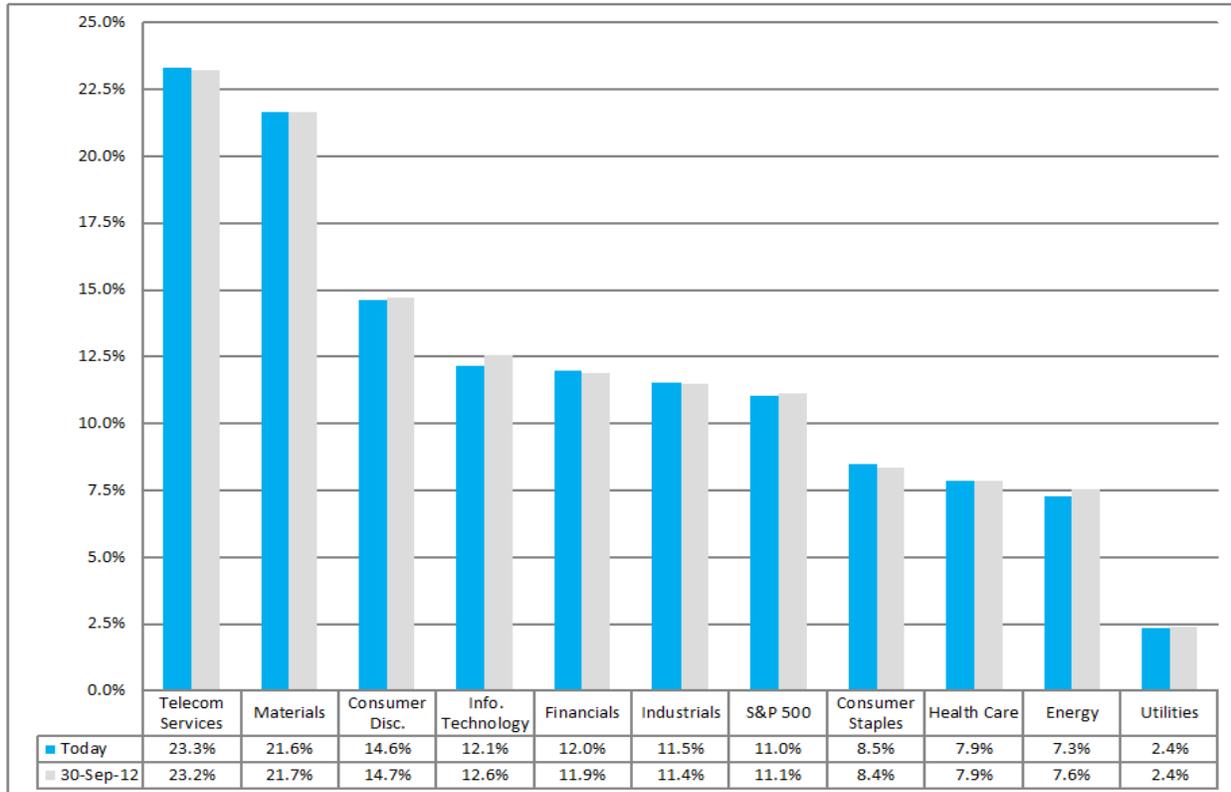


CY 2012 Revenue Growth

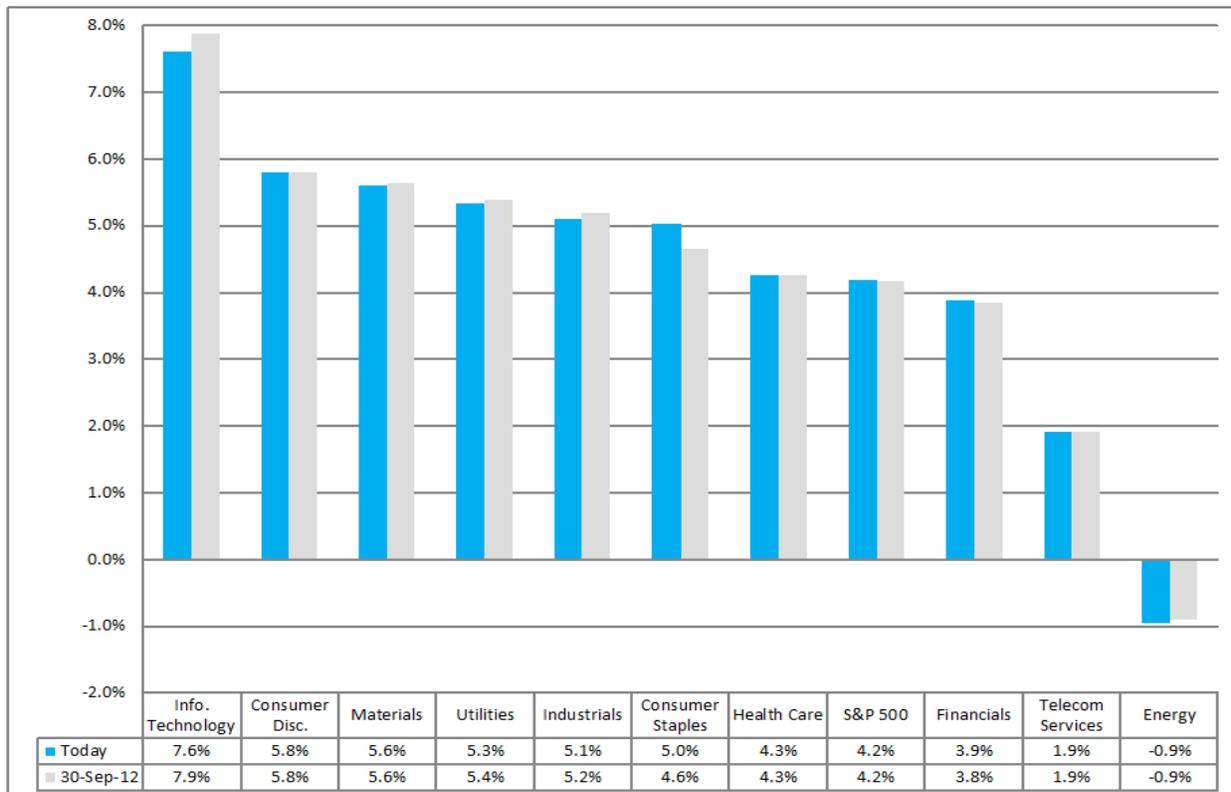


CY 2013: Growth

CY 2013 Earnings Growth

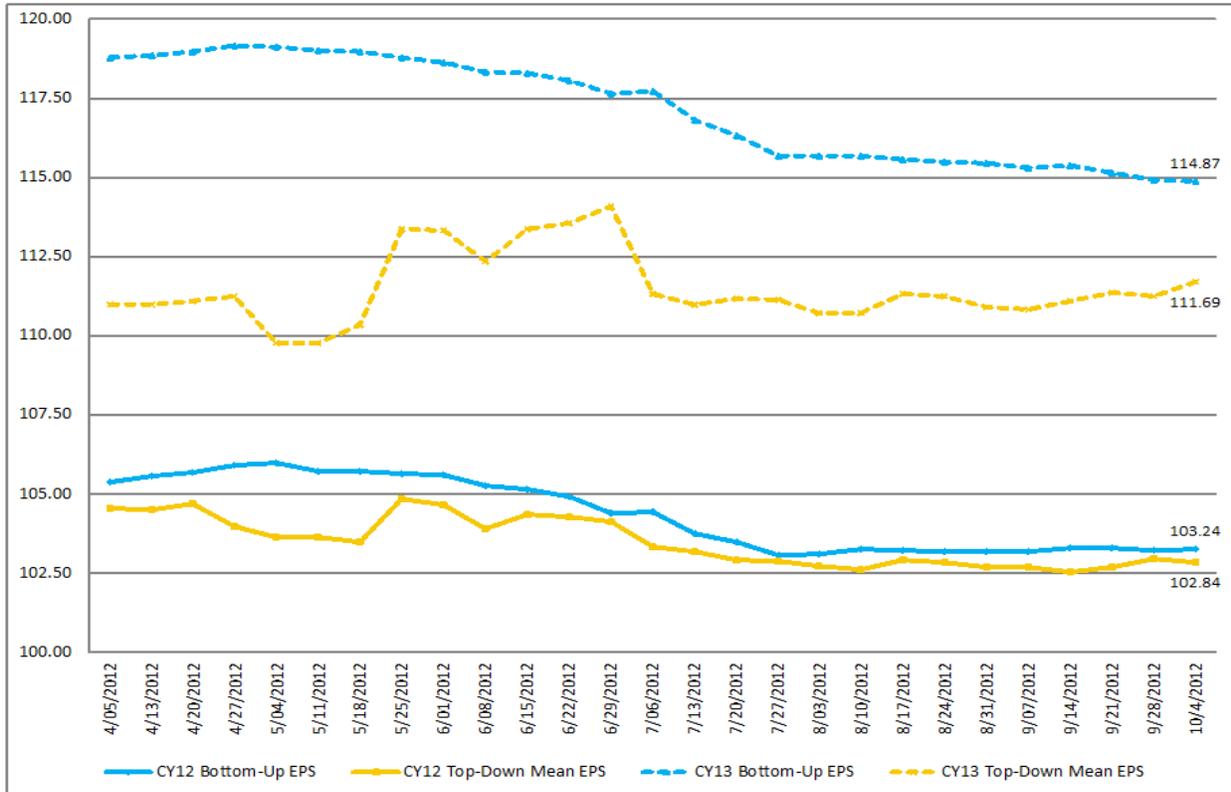


CY 2013 Revenue Growth

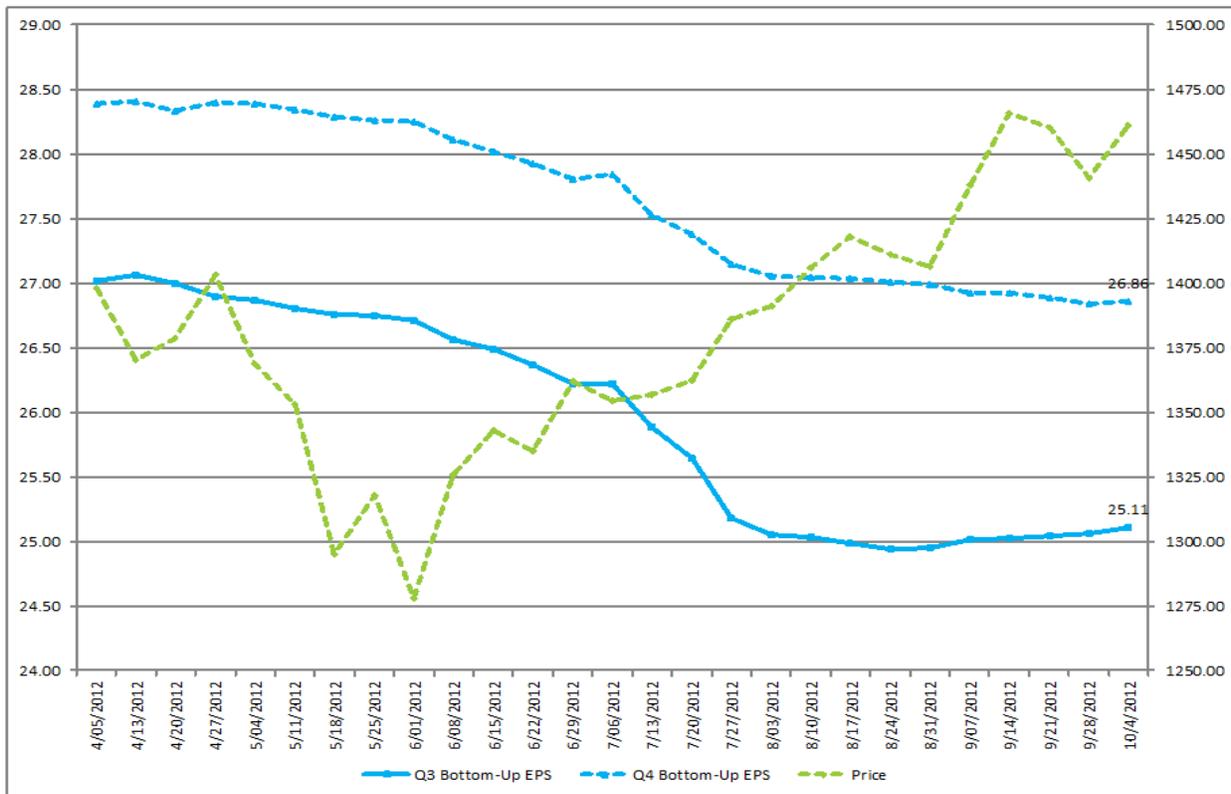


## Bottom-up Estimates: Revisions

CY Bottom-Up EPS vs. Top-Down Mean EPS (Trailing 26-Weeks)

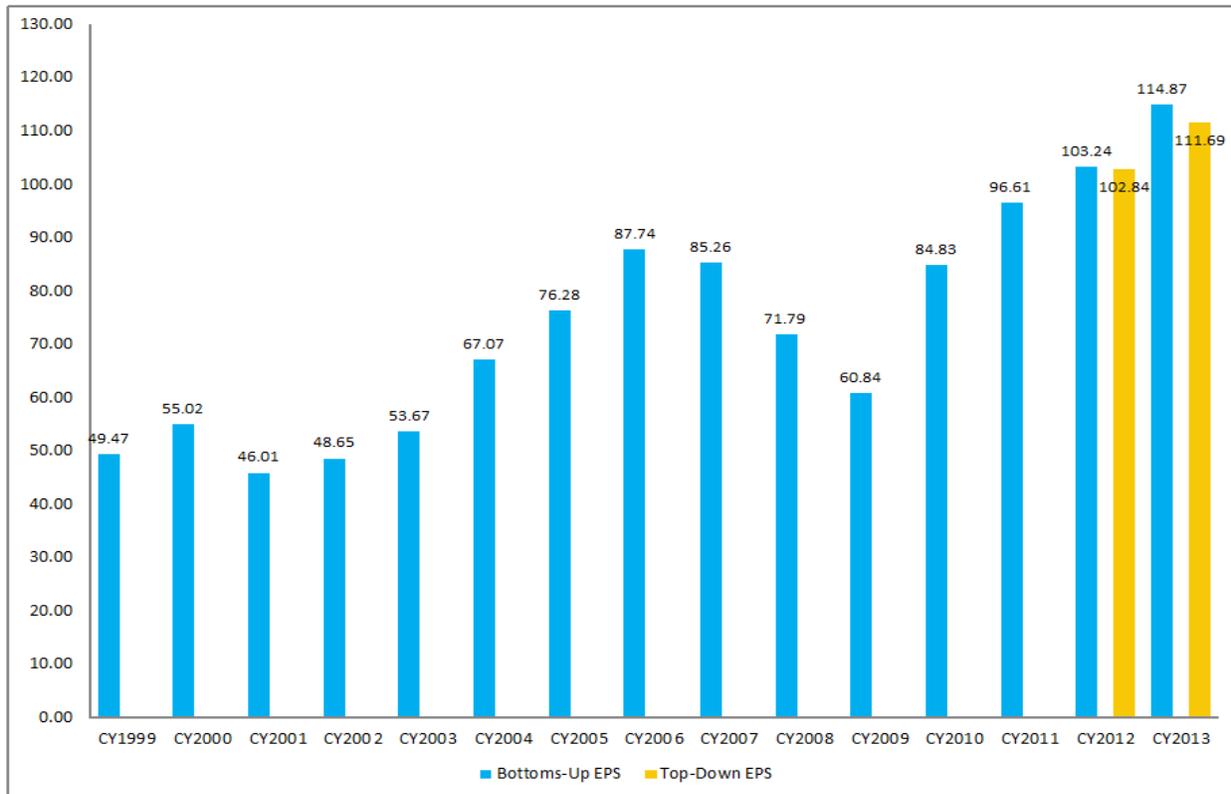


Change in Q312 and Q412 Bottom-Up EPS vs. Price (Trailing 26-Weeks)

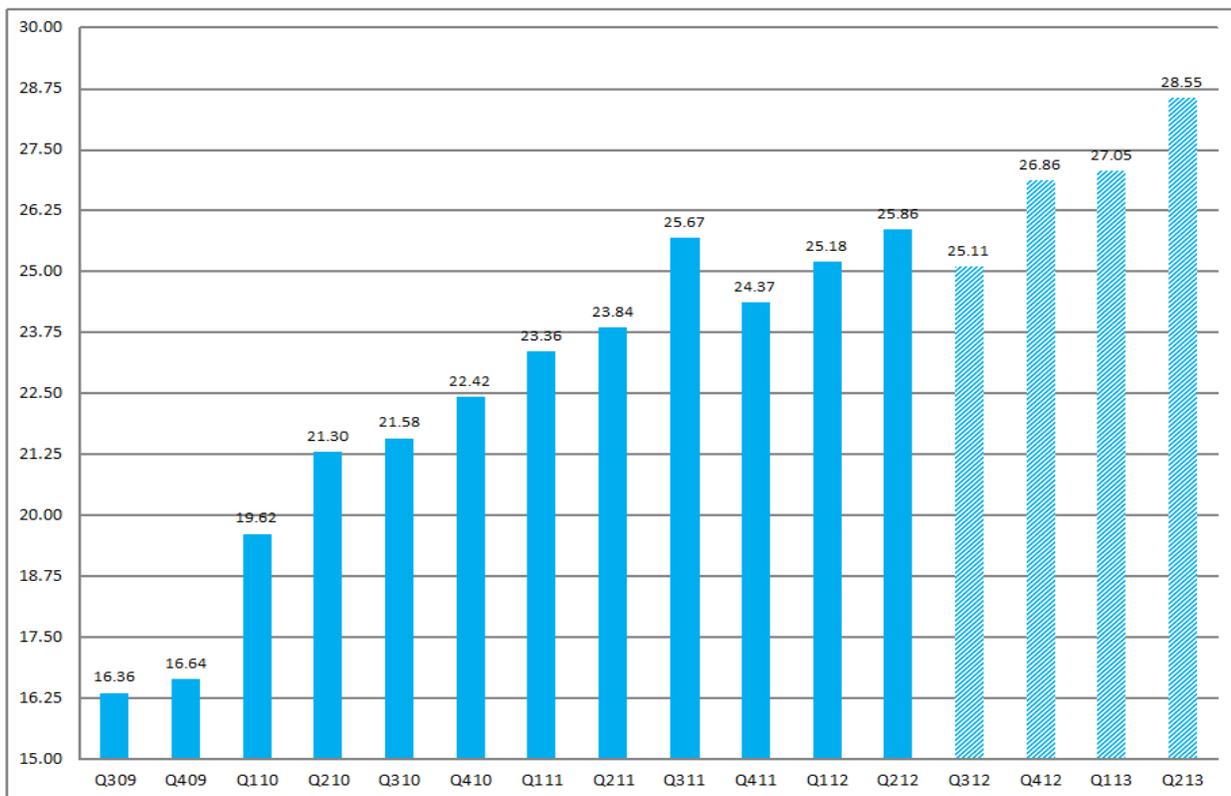


## Bottom-up Estimates: Current & Historical

Calendar Year Bottom-Up EPS Actuals & Estimates

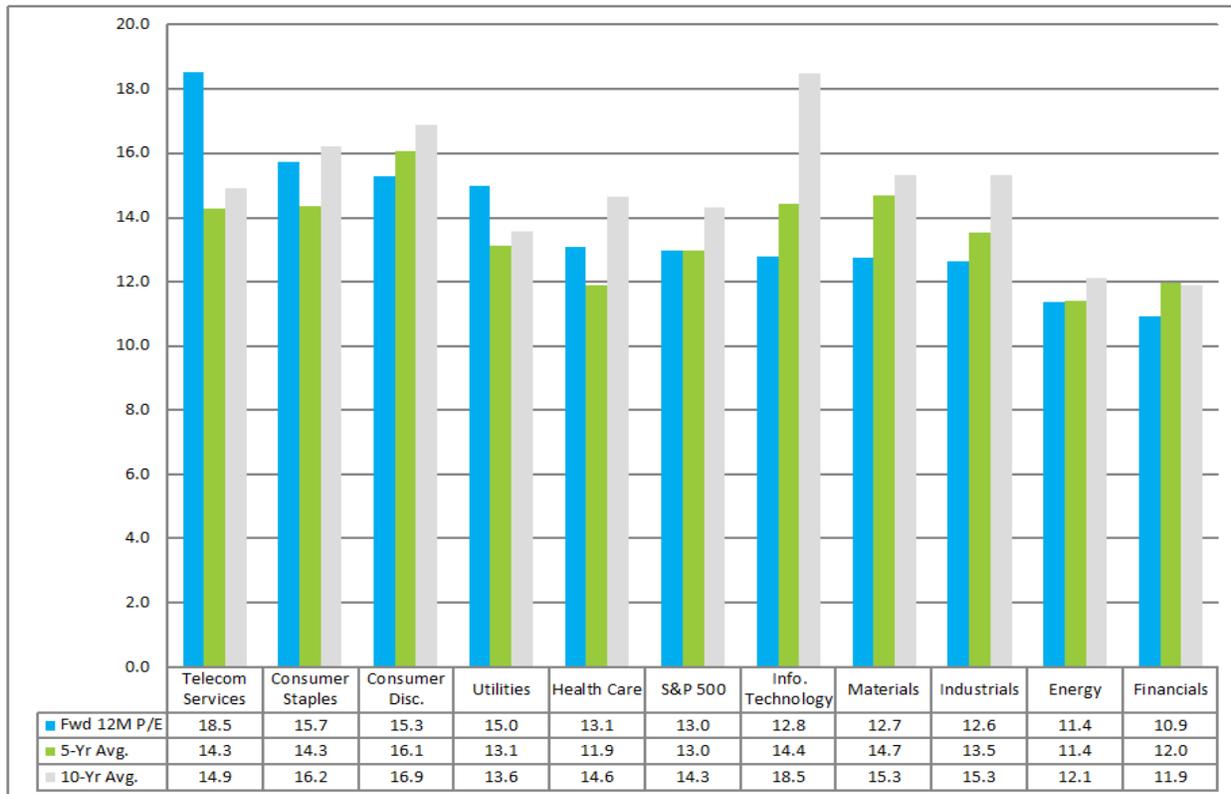


Calendar Year Bottom-Up EPS Actuals & Estimates

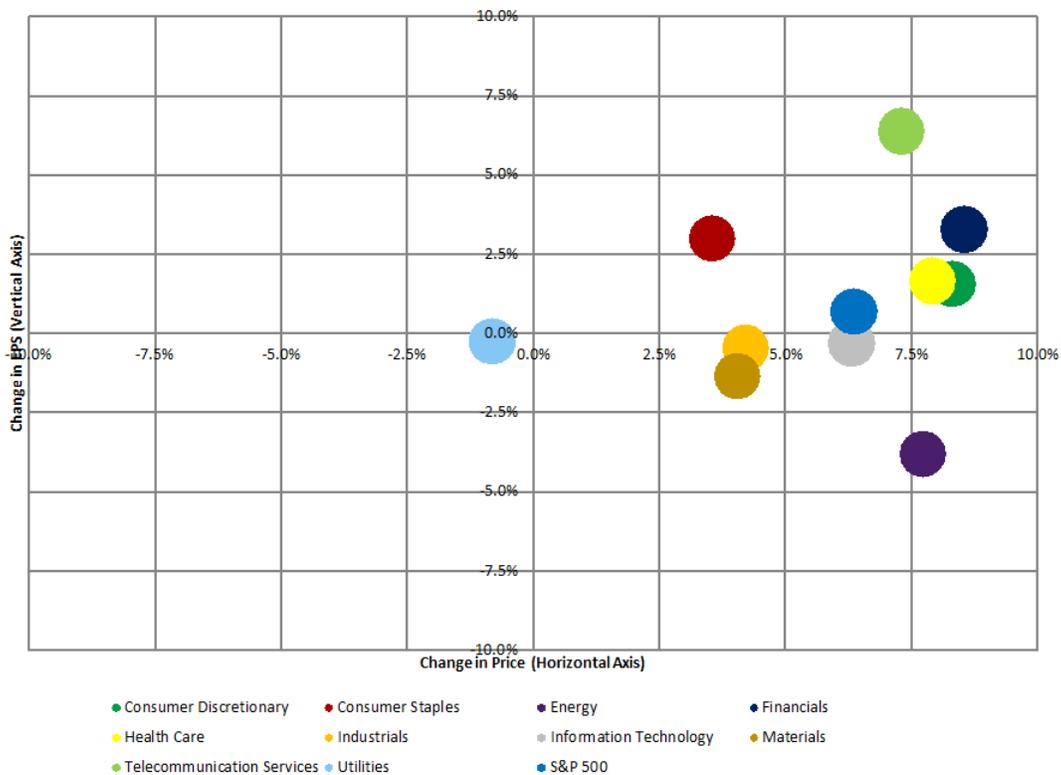


## Price / Earnings Ratio: Sector Level

Sector-Level Forward 12-Month P/E Ratios

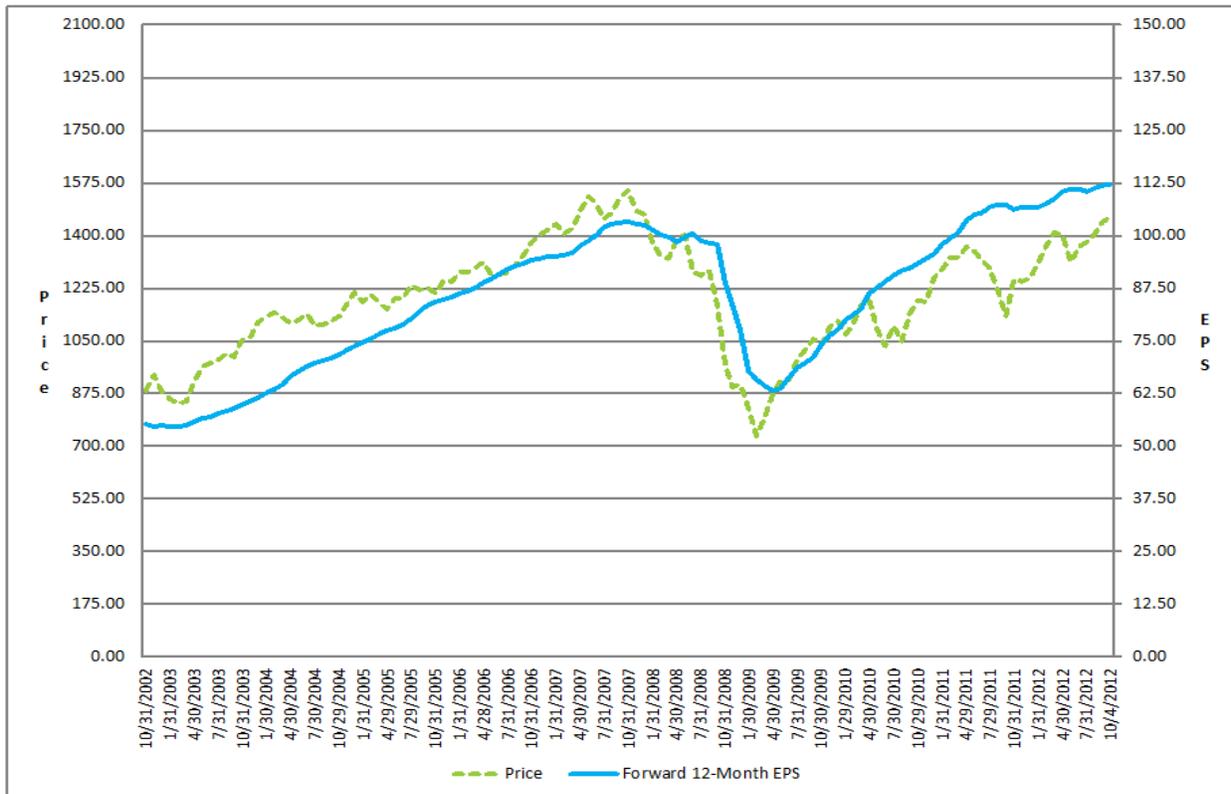


Sector-Level Change in Price vs. Change Forward 12M EPS: 3-Months

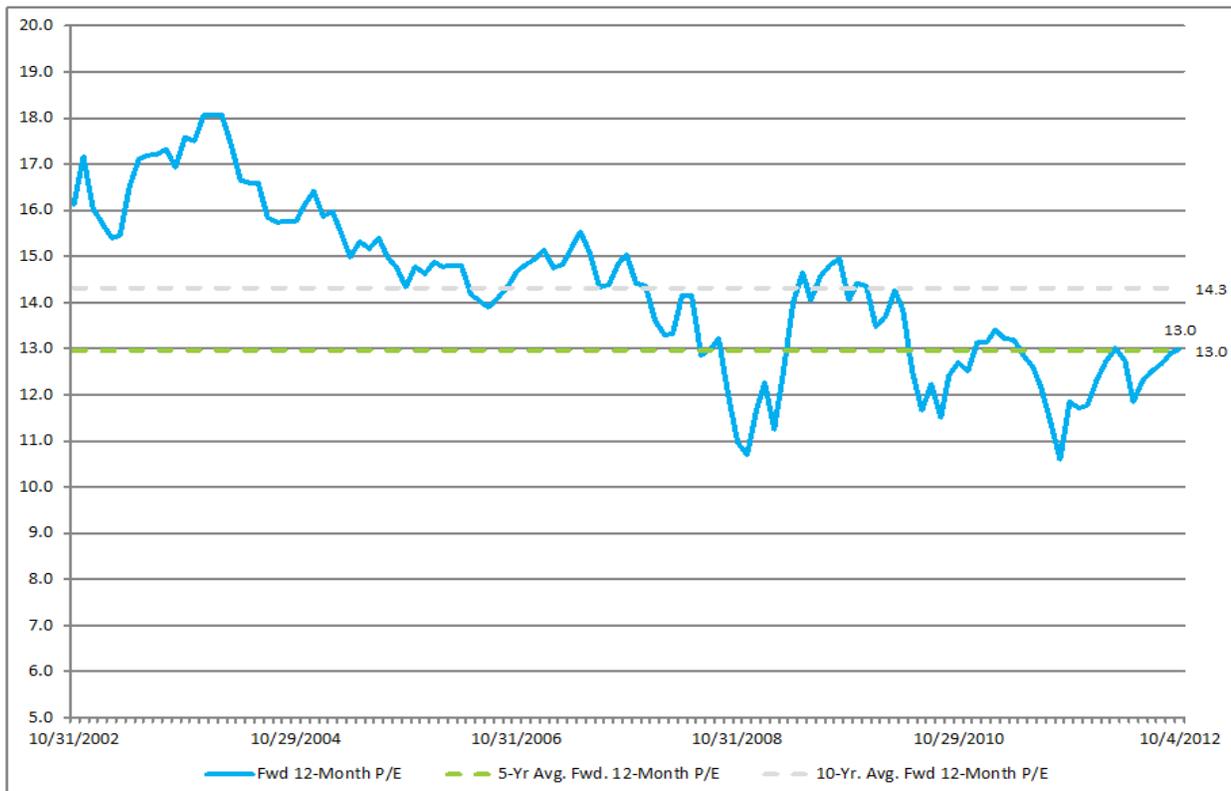


## Price / Earnings Ratio: Long-Term Averages

Change in Price vs. Change in Forward 12M EPS: 10-Year



Forward 12M P/E Ratio: 10-Years



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