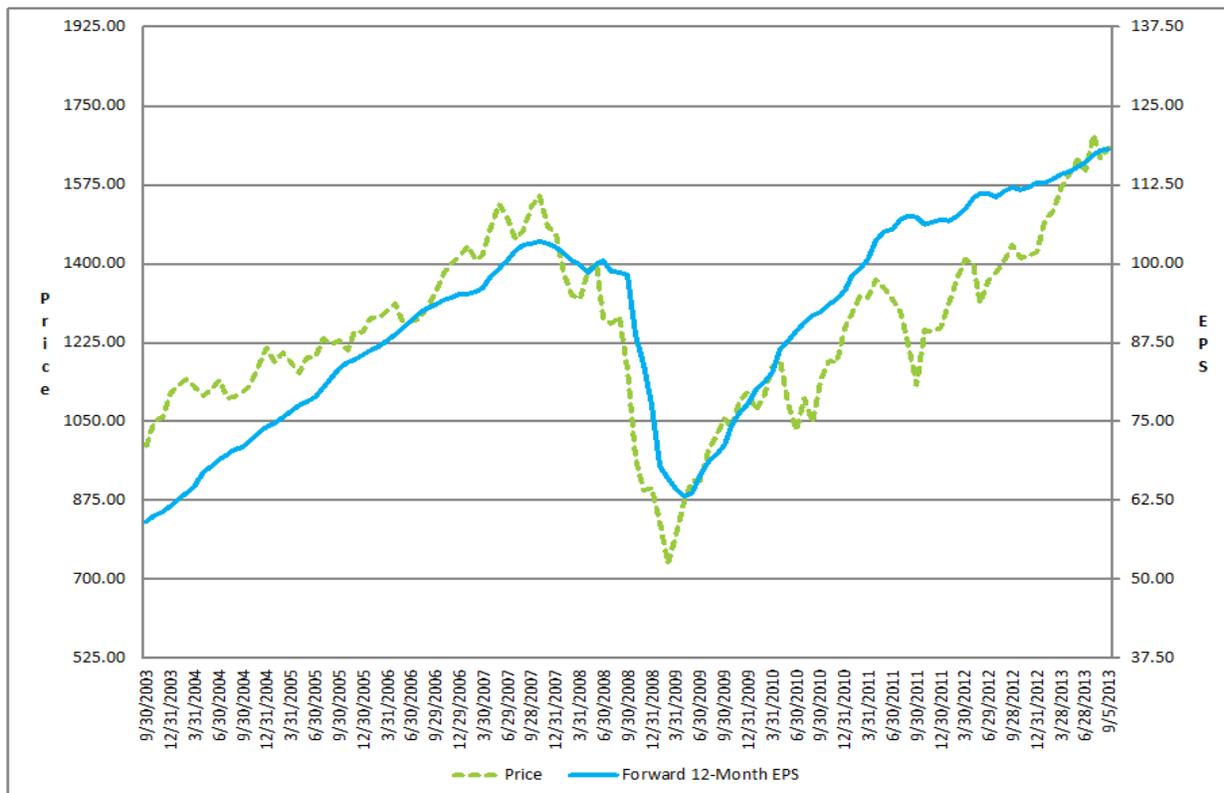


### Key Metrics

- + **Earnings Growth:** The estimated earnings growth rate for Q3 2013 is 3.6%. The Financials sector is predicted to report the highest earnings growth for the quarter, while the Health Care sector is predicted to report the lowest earnings growth for the quarter.
- + **Earnings Revisions:** On June 30, the earnings growth rate for Q3 2013 was 6.5%. Eight of the ten sectors have recorded a decline in expected earnings growth over this time frame, led by the Materials sector.
- + **Earnings Guidance:** For Q3 2013, 85 companies have issued negative EPS guidance and 19 companies have issued positive EPS guidance.
- + **Valuation:** The current 12-month forward P/E ratio is 14.0. This P/E ratio is based on Thursday's closing price (1655.08) and forward 12-month EPS estimate (\$118.12).
- + **Earnings Scorecard:** Of the 496 companies that have reported earnings to date for Q2 2013, 72% have reported earnings above the mean estimate and 53% have reported revenues above the mean estimate.

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



## Topic of the Week

### Energy Sector Earnings Growth for Q3: A Tale of Two Oil Companies

For the third quarter, the Energy sector is projected to report the second lowest earnings growth of all ten sectors at -0.6%. Two companies within the sector that are competitors are having significant and opposite influences on the earnings growth rate for the sector: Exxon Mobil and Chevron.

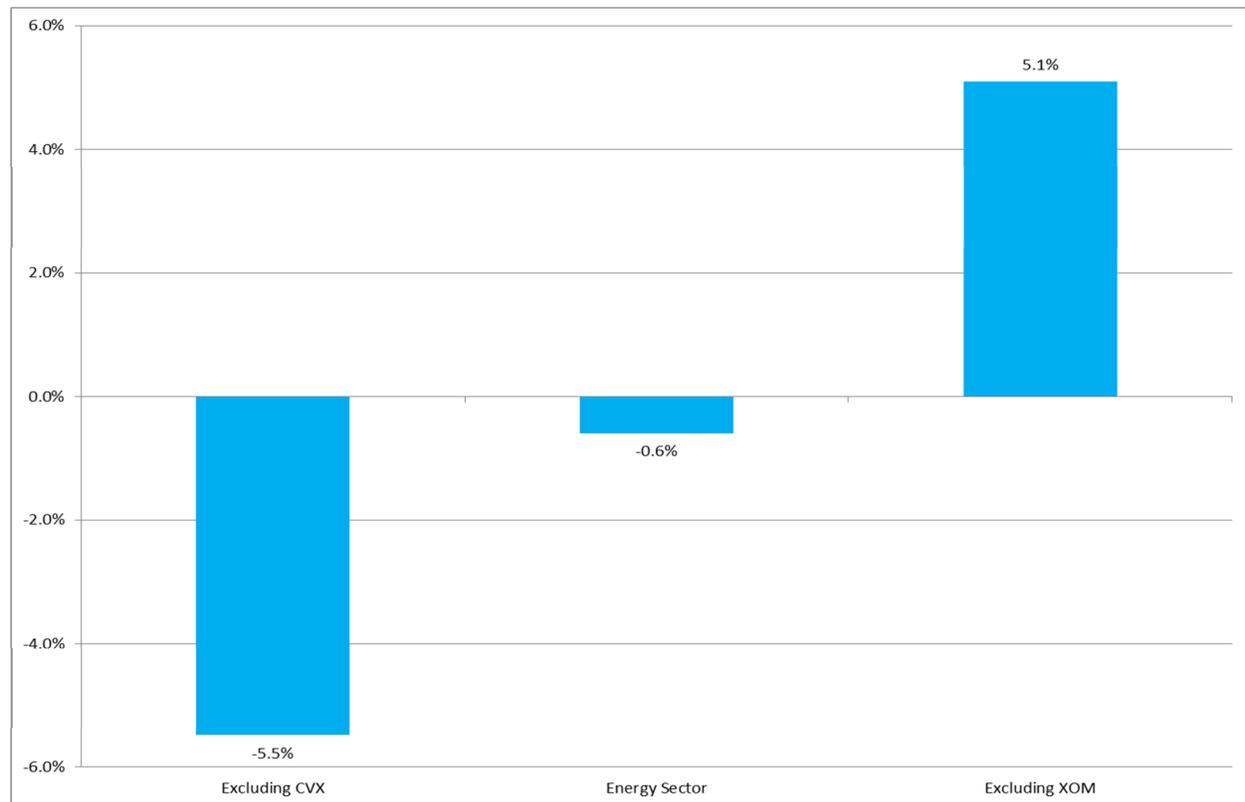
Exxon Mobil is expected to be the largest detractor to earnings growth for the sector in the third quarter, as the company is projected to report a 9% year-over-year decline in EPS. The mean EPS estimate for Exxon Mobil is \$1.91, relative to year-ago actual EPS of \$2.09. If Exxon Mobil is excluded, the estimated earnings growth rate for the sector would improve to 5.1%.

Chevron is expected to be the largest contributor to earnings growth for the sector in the third quarter, as the company is projected to report a 29% year-over-year increase in EPS. The mean EPS estimate for Chevron is \$3.06, relative to year-ago actual EPS of \$2.38. If Chevron is excluded, the estimated earnings growth rate for the sector would fall to -5.5%.

It is interesting to note that despite the contrast in expected earnings growth for the two companies in Q3, analysts foresee relatively similar earnings growth rates for both companies in 2014. The estimated EPS growth rate for Exxon Mobil in 2014 is 5%, while the estimated EPS growth rate for Chevron in 2014 is 2%.

However, analysts have differing opinions on the two companies in terms of their ratings. For Exxon Mobil, just 25% (6 out of 24) of the analysts covering the company have a "Buy" rating on the stock. For Chevron, 57% (13 out of 23) of the analysts covering the company have a "Buy" rating on the stock.

S&P 500 Energy Sector: Estimated Earnings Growth for Q3



## Q3 2013 Earnings Season: Overview

### No Change in Earnings Growth This Week, But Has Been Cut Almost in Half since June 30

#### Earnings Growth Rate Unchanged This Week

The estimated earnings growth rate for the third quarter is 3.6% this week, equal to the estimated growth rate of 3.6% last week.

#### Materials Sector Has Seen Largest Cuts to Earnings Estimates since June 30

The estimated earnings growth rate for Q3 2013 of 3.6% is below the estimate of 6.5% at the start of the quarter (June 30). Eight of the ten sectors have recorded a decline in expected earnings growth during this time frame, led by the Materials sector. Other sectors that have witnessed decreases in predicted earnings growth since June 30 include the Information Technology, Consumer Discretionary, Consumer Staples, and Energy sectors.

The Materials sector has seen the largest drop in expected earnings growth (to 2.8% from 15.3%) since the start of the quarter. Companies in the Metals & Mining industry have witnessed the largest cuts to estimates during this time, including U.S. Steel (to -\$0.45 from -\$0.18), Allegheny Technologies (to \$0.01 from \$0.29), Newmont Mining (to \$0.29 from \$0.60), and Alcoa (to \$0.06 from \$0.10).

The Information Technology sector has witnessed the second largest decrease in expected earnings growth (to 1.0% from 5.4%) since June 30. Companies in the Software and Semiconductors & Semiconductor Equipment industries have recorded substantial reductions in EPS estimates, including Intuit (to -\$0.09 from -\$0.02), Teradyne (to \$0.44 from \$0.60), KLA-Tencor (to \$0.67 from \$0.86), and Autodesk (to \$0.40 from \$0.51).

The Consumer Discretionary sector has recorded the third largest decline in expected earnings growth (to 6.2% from 10.5%) since the beginning of the quarter. Companies in retail industries have seen the largest cuts to estimates during this time, including Amazon.com (to -\$0.10 from \$0.07), J.C. Penney (to -\$1.61 from -\$0.75), Abercrombie & Fitch (to \$0.46 from \$1.08), and Target (to \$0.64 from \$0.91).

The Consumer Staples sector has seen the fourth largest drop in expected earnings growth (to 3.5% from 7.4%) since the start of the quarter. Companies that have recorded substantial cuts to estimates during this time include Safeway (to \$0.18 from \$0.45), Archer-Daniels-Midland Company (to \$0.46 from \$0.62), Avon Products (to \$0.19 from \$0.25), and Estee Lauder Companies (to \$0.73 from \$0.91).

The Energy sector has recorded the fifth largest decrease in expected earnings growth (to -0.6% from 3.3%) since the beginning of the quarter. Companies that have seen significant reductions in EPS estimates include CONSOL Energy (to \$0.08 from \$0.21), Marathon Petroleum (to \$1.92 from \$2.92), Tesoro (to \$1.45 from \$2.17), and WPX Energy (to -\$0.15 from -\$0.12).

#### EPS Guidance: Negative for Q3

At this point in time, 104 companies in the index have issued EPS guidance for the third quarter. Of these 104 companies, 85 have issued negative EPS guidance and 19 have issued positive EPS guidance. As a result, 82% (85 out of 104) of the companies that have issued EPS guidance for the third quarter have issued negative EPS guidance. This percentage is consistent with the percentage recorded in the previous quarter at this time (81%), but well above the 5-year average of 62%.

At the sector level, the Industrials sector has the highest percentage (91%) of companies issuing negative EPS guidance for the third quarter (with a minimum of five companies issuing EPS guidance). Ten of the eleven companies in this sector that have issued EPS guidance have issued negative EPS guidance.

**Estimated Earnings Growth: 3.6%**

The estimated earnings growth rate for Q3 2013 is 3.6%. Eight of the ten sectors are expected to report higher earnings relative to a year ago, led by the Financials and Consumer Discretionary sectors. On the other hand, the Health Care and Energy sectors are the only two sectors predicted to report a year-over-year decrease in earnings for the quarter.

**Financials: Bank of America and Morgan Stanley Lead Growth**

The Financials sector is projected to have the highest earnings growth rate (11.5%) of any sector for the third consecutive quarter. It is also expected to be the largest contributor to earnings growth for the entire index. If the Financials sector is excluded, the earnings growth rate for the S&P 500 falls to 1.9%.

Four of the eight industries in the sector are predicted to report earnings growth for the quarter, led by the Capital Markets (64%) industry. Four of the eight industries are expected to report a year-over-year decline in earnings, led by the Thrift & Mortgage Finance (-11%) industry.

At the company level, Bank of America and Morgan Stanley are the key drivers of growth in the sector, due in part to comparisons to weak earnings in the third quarter of 2012. The mean EPS estimate for Bank of America is \$0.21, relative to year-ago EPS of \$0.00. The mean EPS estimate for Morgan Stanley is \$0.49, compared to year-ago EPS of -\$0.55. If both of these companies are excluded, the growth rate for the sector would fall to 1.2%.

**Consumer Discretionary: Broad-Based Growth across Sector**

The Consumer Discretionary sector is expected to have the second highest earnings growth rate at 6.2%. Growth is predicted to be broad-based across the sector. Eight of the twelve industries in the sector are projected to see earnings growth, led by the Internet & Catalog Retail (82%), Auto Components (16%), and Household Durables (15%) industries. At the other end of the spectrum, the Multiline Retail (-21%) and Automobiles (-7%) industries are expected to have the lowest earnings growth rates for the quarter.

**Health Care: Lowest Growth Expected**

The Health Care sector is predicted to have the lowest earnings growth rate of all ten sectors at -1.4%. Four of the six industries in the sector are expected to report a year-over-year decrease in earnings, led by the Health Care Equipment & Supplies (-4%) and Pharmaceuticals (-2%) industries.

**Energy: Chevron vs. Exxon Mobil**

The Energy sector is expected to have the second lowest earnings growth of any sector at -0.6%. However, only two of the seven sub-industries in this sector are expected to report a decline in earnings: Coal & Consumable Fuels (-92%) and Oil & Gas Refining & Marketing (-41%). On the other end of the spectrum, the Oil & Gas Storage & Transportation (47%) and Oil & Gas Exploration & Production (18%) sub-industries have the highest earnings growth rates.

At the company level, Chevron is the largest contributor to earnings growth for the sector, while Exxon Mobil is the largest detractor to earnings growth. The mean EPS estimate for Chevron is \$3.06, relative to year-ago actual EPS of \$2.38. If Chevron is excluded, the growth rate for the sector would drop to -5.5%. On the other hand, the mean EPS estimate for Exxon Mobil is \$1.91, compared to year-ago EPS of \$2.09. If Exxon Mobil is excluded, the growth rate for the Energy sector would improve to 5.1%. Please see page 2 for more details.

**Estimated Revenue Growth: 2.8%**

The estimated revenue growth rate for Q2 2013 is 2.8%, slightly below the growth rate of 3.0% estimated at the end of the second quarter (June 30). Nine of the ten sectors are predicted to report revenue growth for the quarter, led by the Utilities and Consumer Discretionary sectors. The Energy sector is the only sector expected to report a year-over-year decline in sales in the quarter.

The Utilities sector is expected to report the highest revenue growth at 6.9%. While all four industries are predicted to report growth, the Independent Power Producers & Energy Traders (34%) and Gas Utilities (19%) have the highest expected sales growth rates in the sector.

The Consumer Discretionary sector has the second highest revenue growth rate at 5.3%. Growth is predicted to be broad-based across the sector. At the industry level, eleven of the twelve industries in the sector are expected to report earnings growth, led by the Internet & Catalog Retail (22%), Distributors (12%), and Household Durables (11%) industries.

The Energy sector has the lowest revenue growth rate of all ten sectors at -0.4%. At the sub-industry level, only two of the seven sub-industries are predicted to report a decrease in revenues: Coal & Consumable Fuels (-7%) and Integrated Oil & Gas (-6%). At the company level, Hess Corporation and Exxon Mobil are the largest detractors to growth in the sector. The mean sales estimate for Hess Corporation is \$2.4 billion, compared to sales of \$9.6 billion in the year-ago quarter. The mean sales estimate for Exxon Mobil is \$109.1 billion, relative to sales of \$115.7 billion in the year-ago quarter. Excluding these two companies, the revenue growth rate for the Energy sector improves to 4.6%.

## Global Concerns: F/X Rates, Europe and China

### Less Favorable F/X Rates

The U.S. dollar has strengthened relative to the Japanese yen and other foreign currencies over the past year. In the year-ago quarter (Q3 2012), one dollar was equal to about \$78.62 yen on average. For Q3 2013 to date, one dollar has been equal to about \$98.82 yen on average. A number of companies commented on the negative impact of F/X rates on revenues and earnings for the second quarter. Will this trend continue in Q3?

*“Currency also had a negative 1% impact on our top line, as the dollar strengthened against most currencies, particularly the Japanese yen.” –DuPont (Jul.23)*

*“Without the impact of the US dollar strengthening compared to foreign currencies, Oracle’s reported Q3 GAAP earnings per share would have been \$0.01 higher at \$0.53, up 8%, and Q3 non-GAAP earnings per share would have been approximately \$0.01 higher.” –Oracle (Jun. 20)*

### Europe

Europe has been reporting a decline in economic growth relative to last year. According to FactSet Economics, the European Union recorded a decrease in GDP of 0.2% in Q2 2013, which marked the sixth consecutive quarter of year-over-year declines in GDP. A number of companies stated that economic conditions were still weak in Europe in the second quarter. However, some companies stated that conditions may have reached a bottom or improved slightly. Will companies see any improvement in Europe in the third quarter?

*“It’s still pretty weak in Europe. But it just seems to have – net/net, in the GE world anyhow – stabilized in Q2.” –General Electric (Jul. 19)*

*“In Europe, the picture is not that pretty. We expect a production decline and we’ve upwardly adjusted it but the upward adjustments still comes up with a negative number...” –Alcoa (Jul. 8)*

### Emerging Markets

Economic growth for some countries in emerging markets regions has also been decreasing over the past year. According to FactSet Economics, two of the four “BRIC” countries recorded slower GDP growth in the most recent quarter. For Q2 2012, China and India recorded GDP growth of 7.6% and 3.4%, respectively. By Q2 2013, GDP growth rates for China and India had fallen to 7.5% and 2.4%.

On the other hand, Brazil has recorded an increase in GDP growth over the past year. For Q2 2013, Brazil reported GDP growth of 3.3%, above the 0.5% recorded in Q1 2012.

As a result, comments on business conditions in China and emerging markets continued to be mixed for Q2. Some companies (such as IBM, Coca-Cola, and NIKE) reported weak conditions, while others (such as Ford Motor, Johnson & Johnson, and McCormick & Co.) saw strength. Will this trend continue in the third quarter?

*“The areas that we had more difficulty in our growth markets frankly, can be, I think, best attributed to kind of three large countries, China, Australia and Russia, and they account for about 40% of the GMU base of business. Without those three countries, GMU frankly would have been up 7%.” –IBM (Jul. 17)*

*“As is well-publicized, China's economy has been slowing as this is now being felt in consumer spending. China's first-half retail sales were the slowest in 10 years, while much of the growth in the nonalcoholic ready-to-drink beverage industry in the second quarter came from the value-orientated water category. As a result, our volume performance in China remains soft and was even for the quarter, cycling 7% growth from prior year.” –Coca-Cola (Jul. 16)*

*“Revenues for NIKE, Inc. increased 7 percent to \$6.7 billion, or up 9 percent on a currency neutral basis. Excluding the impact of changes in foreign currency, NIKE Brand revenues rose 8 percent with growth across each product type and in every geography except Western Europe and Greater China.” –NIKE (Jun. 27)*

*“Asia Pacific Africa's second quarter market share was 3.6 percent, one percentage point higher than a year ago and a quarterly record. The 38 percent improvement was driven by China, where Ford's market share improved 1.5 percentage points to a quarterly record of 4.3 percent, reflecting mainly strong sales of the new Focus, Kuga and EcoSport.” –Ford Motor (Jul. 24)*

*“Larry, we're not splitting it out specifically for all emerging markets but if we take a look at our BRIC markets – Brazil, Russia, India, China – what we're seeing is about 19% growth. “ –Johnson & Johnson (Jul. 16)*

*“Second quarter sales in the Asia/Pacific region grew 2%, and in local currency the increase was 4%. China was the largest contributor to this increase with 11% sales growth in local currency, driven by strong sales execution at retail, revitalized packaging and expanded advertising.” –McCormick & Co. (Jun. 27)*

### **Earnings Growth Rebound Still Projected for Q413, But Little Revenue Growth**

Although analysts have reduced earnings growth expectations for Q4 2013 (to 10.3% from 11.7%) since June 30, they still expect a significant improvement in earnings growth in the fourth quarter of 2013 relative to recent quarters. For Q4 2013, five of the ten sectors are predicted to see double-digit earnings growth: Financials (27.6%), Industrials (17.5%), Materials (16.1%), Telecom Services (15.4%), and Consumer Discretionary (12.2%).

The estimated revenue growth rate for Q4 2013 of 0.8% is expected to be well below estimated earnings growth rates. However, Prudential (PRU) reported an unusually large revenue number (\$46.1B) in Q4 2012 due to pension risk transfer transactions during the quarter. Because of this unusually large, one-time boost to premiums in Q4 2012, Prudential is expecting a substantial decline in year-over-year revenues for Q4 2013. As a result, this company is the largest detractor to estimate revenue growth for the entire S&P 500. If Prudential is excluded, the revenue growth rate improves to 2.1%

### **Valuation: Forward P/E Ratio is 14.0, even with the 10-Year Average (14.0)**

The current forward 12-month P/E ratio for the index is 14.0. This P/E ratio is based on Thursday's closing price of 1655.08 and forward 12-month EPS estimate of \$118.12.

At the sector level, the Consumer Discretionary (16.9) and Consumer Staples (16.1) sectors have the highest forward 12-month P/E ratios, while the Financials (11.8) and Energy (12.2) sectors have the lowest forward 12-month P/E ratios.

The P/E ratio of 14.0 for the index as a whole is well above the prior 5-year average forward 12-month P/E ratio of 12.9, but equal to the prior 10-year average forward 12-month P/E ratio of 14.0.

However, it is below the forward 12-month P/E ratio of 14.6 recorded one month ago. During the past month, the price of the index fell by 3.0%, while the forward 12-month EPS estimate increased by 0.8%.

At the sector level, the Telecom Services (to 13.8 from 14.9) and Utilities (to 14.6 from 15.8) sectors saw the largest decreases in the forward 12-month P/E ratio over the past month. No sector recorded an increase in the forward 12-month P/E ratio during this time.

### **Companies Reporting Next Week: 2**

The “peak” weeks the Q2 2013 earnings season are now finished. During the upcoming week, two S&P 500 companies are scheduled to report earnings for the second quarter.

Q2 2013: Scorecard

Q2 2013 Earnings: Above, In-Line, Below Estimates

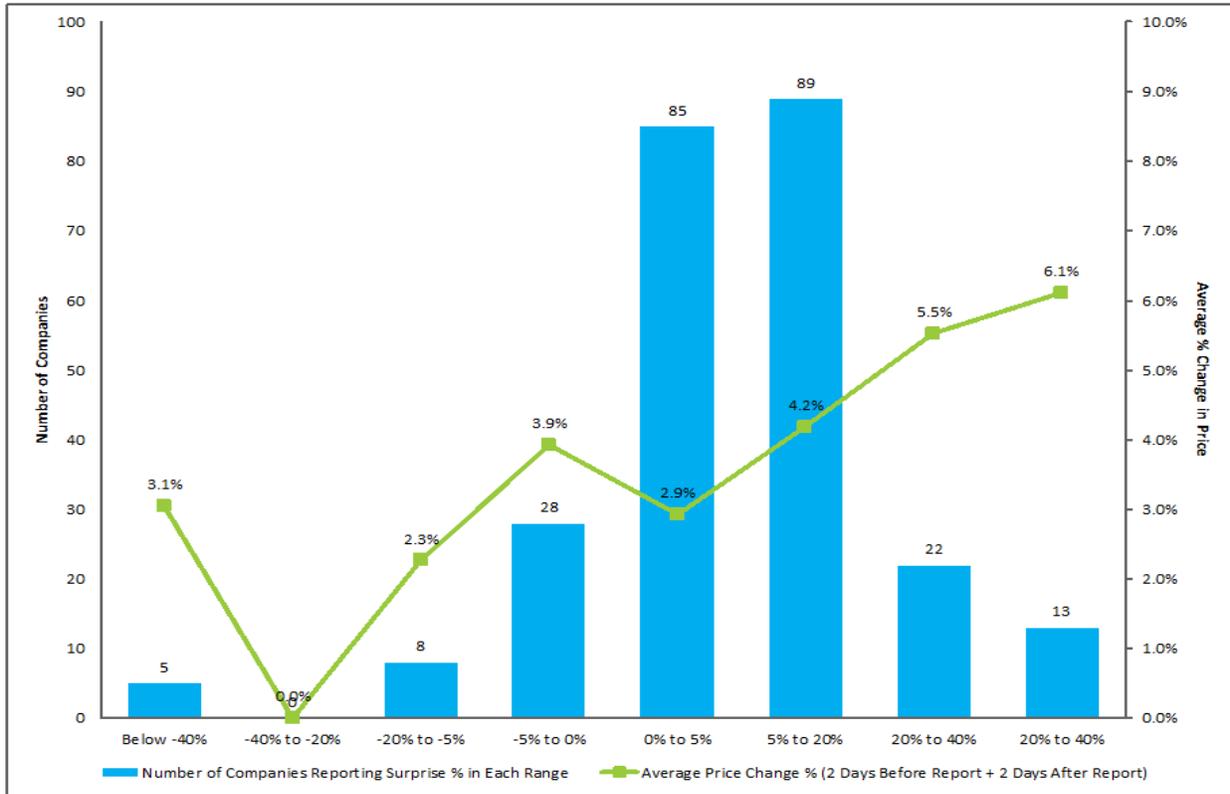


Q2 2013 Revenues: Above, In-Line, Below Estimates

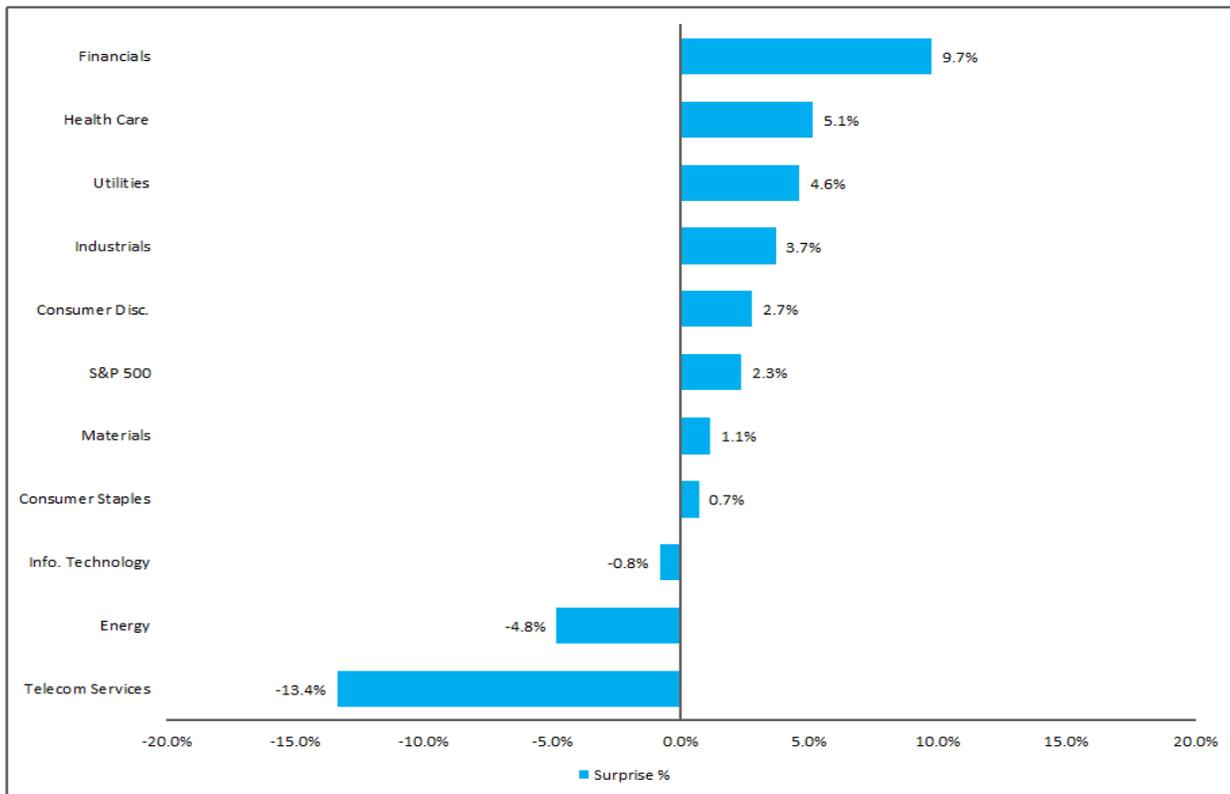


Q2 2013: Scorecard

Q2 2013: Surprise % vs. Average Price Change %

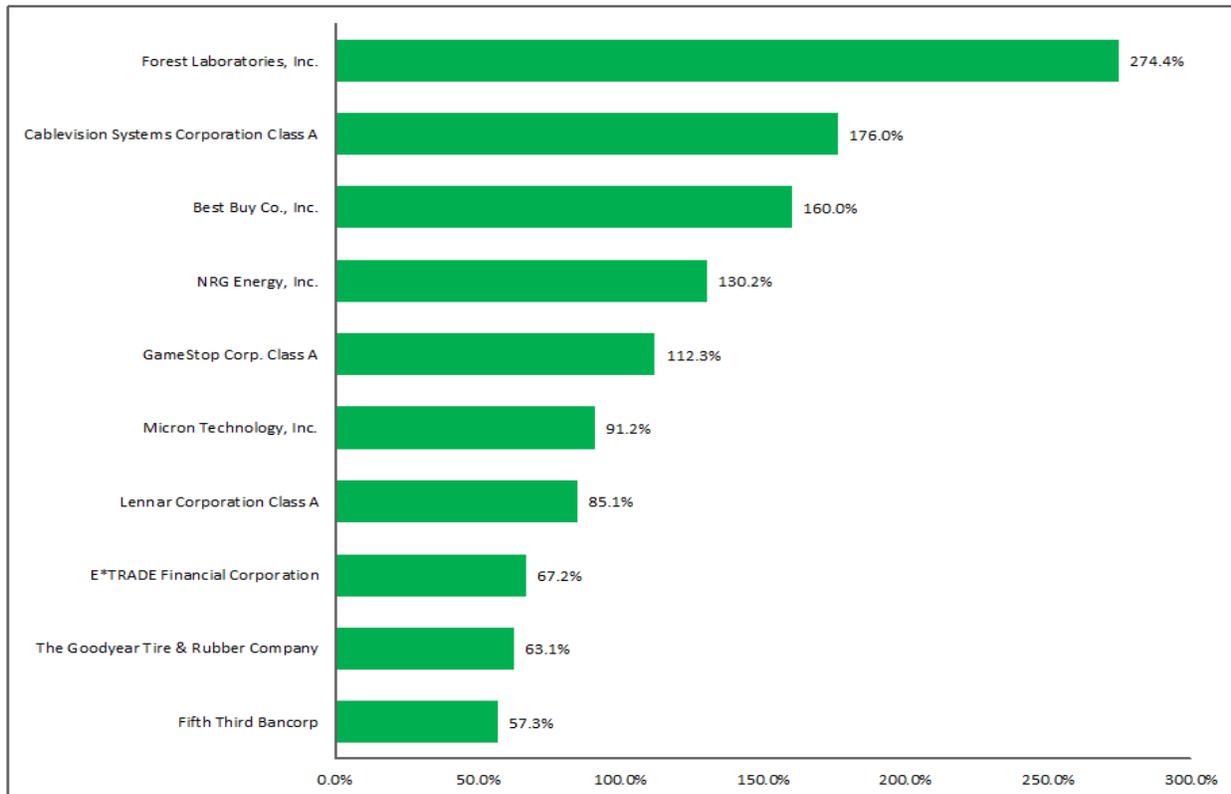


Q2 2013: Sector Level Surprise %

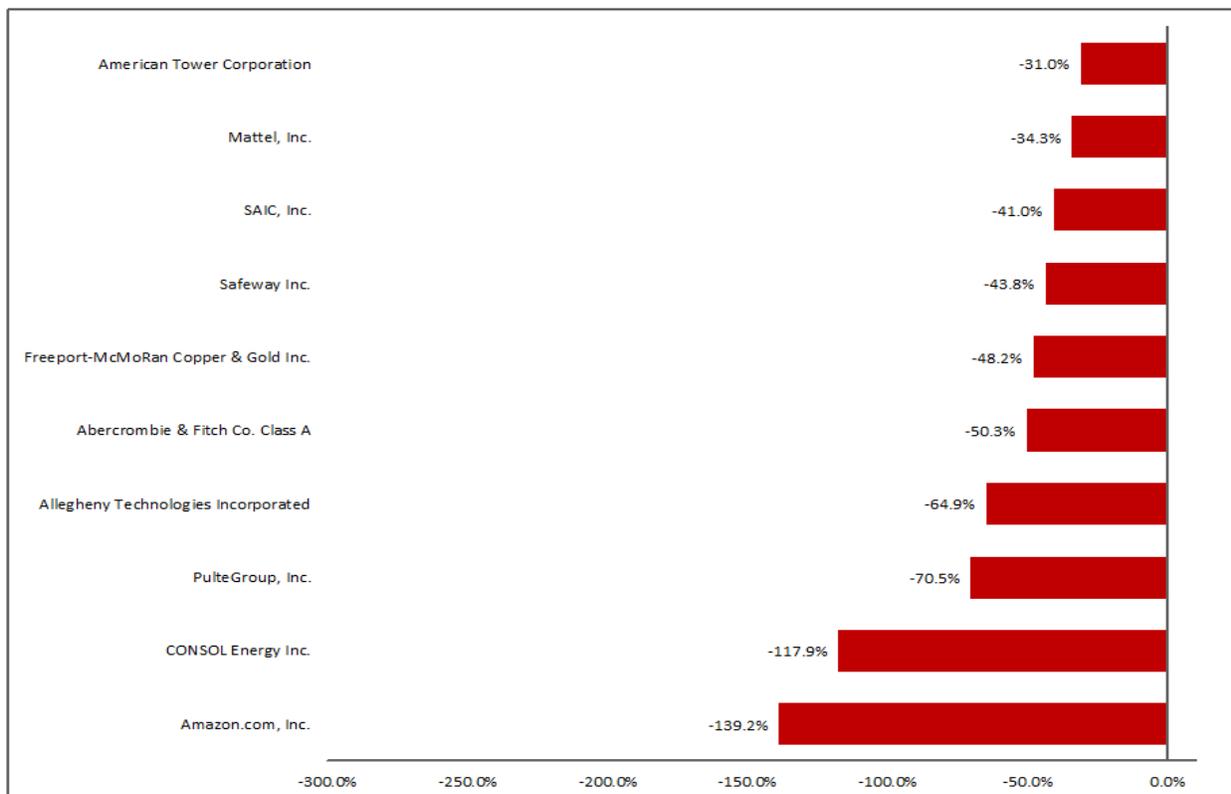


Q2 2013: Scorecard

EPS Surprise %: Top 10 Companies



EPS Surprise %: Bottom 10 Companies

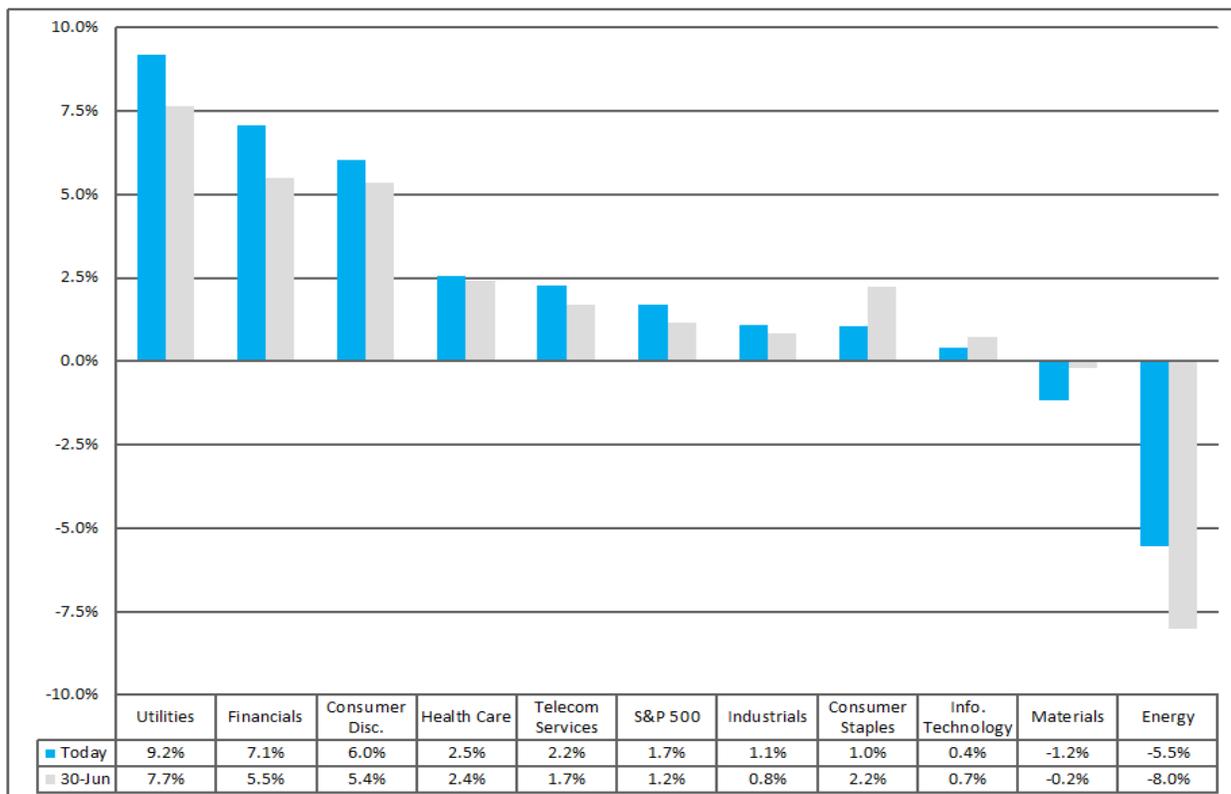


Q2 2013: Growth

Q2 2013 Earnings Growth

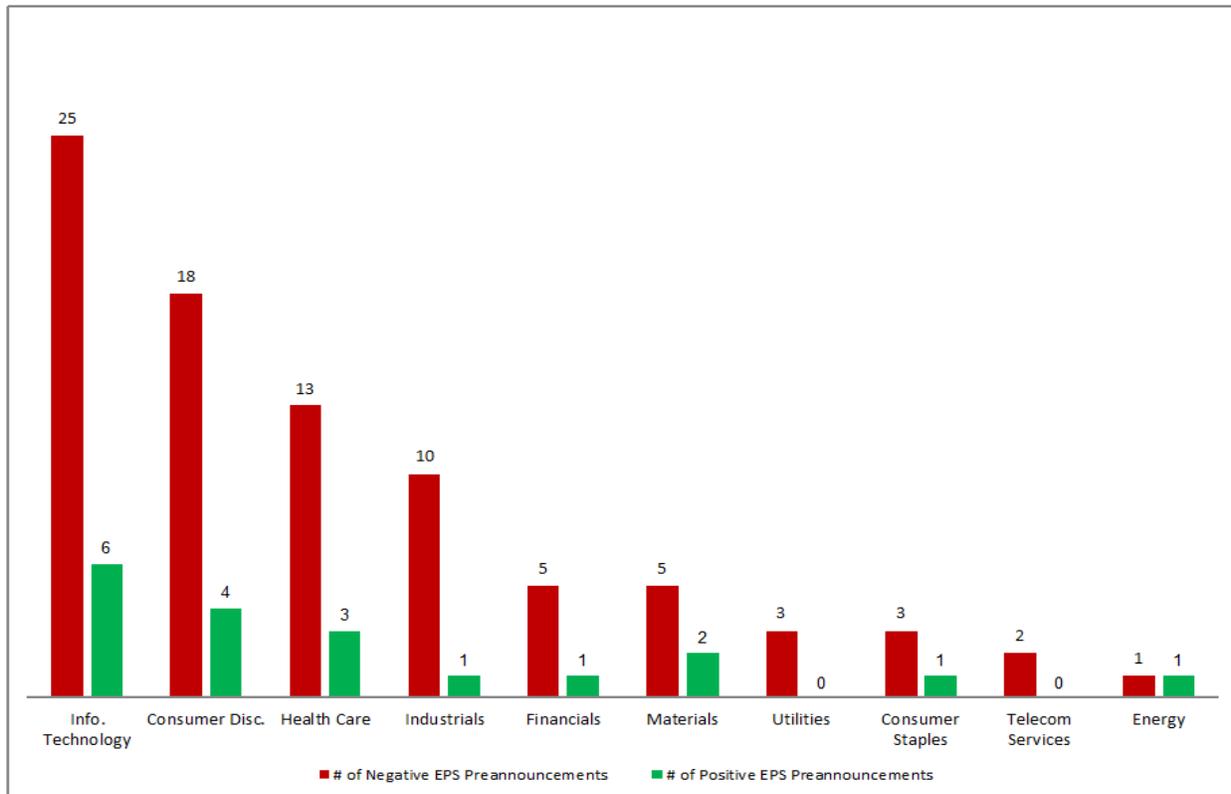


Q2 2013 Revenue Growth

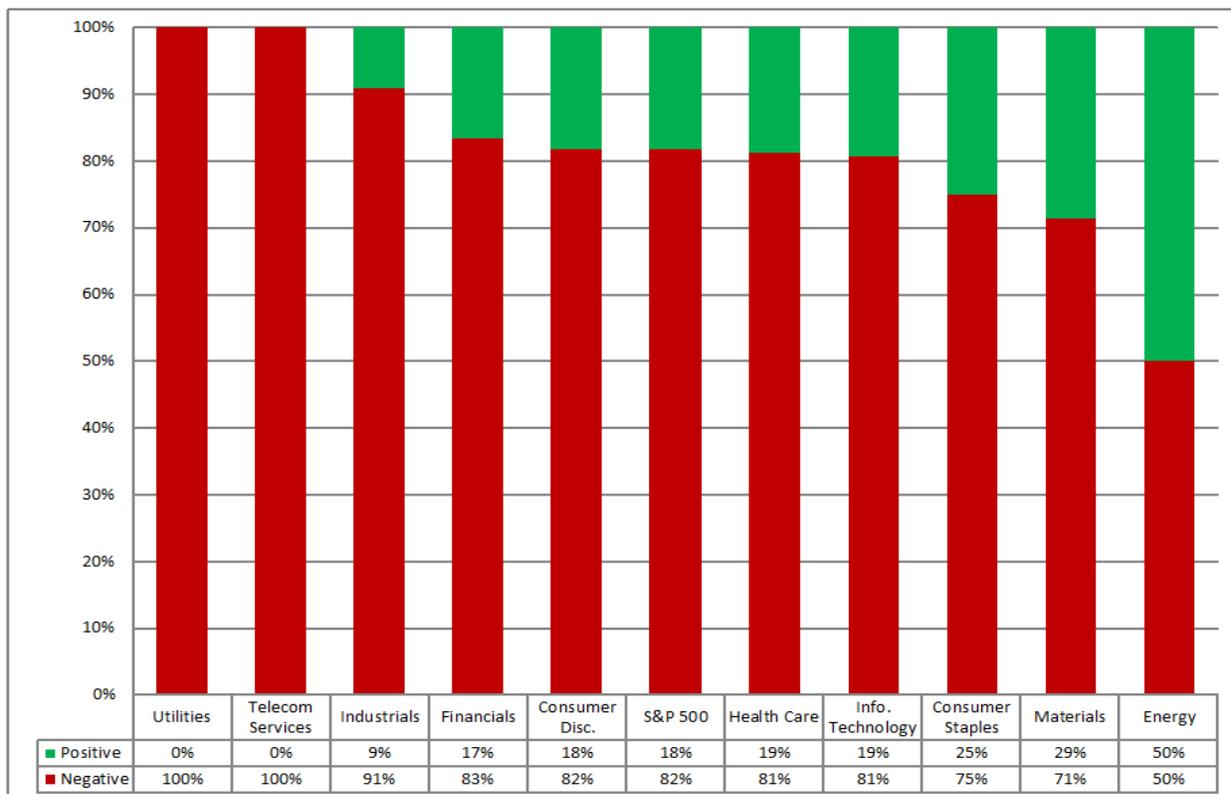


### Q3 2013: Guidance

Number of Positive & Negative EPS Preannouncements: Q3 2013

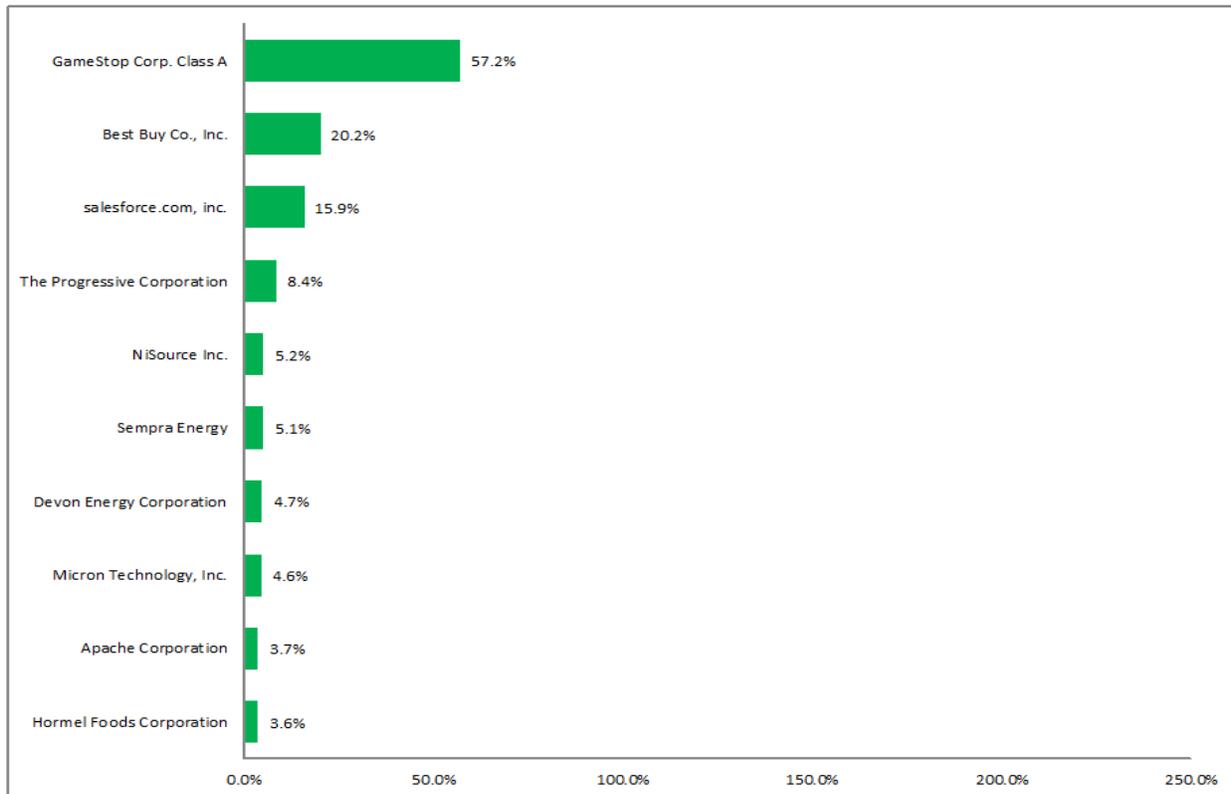


Percentage of Positive & Negative EPS Preannouncements: Q3 2013

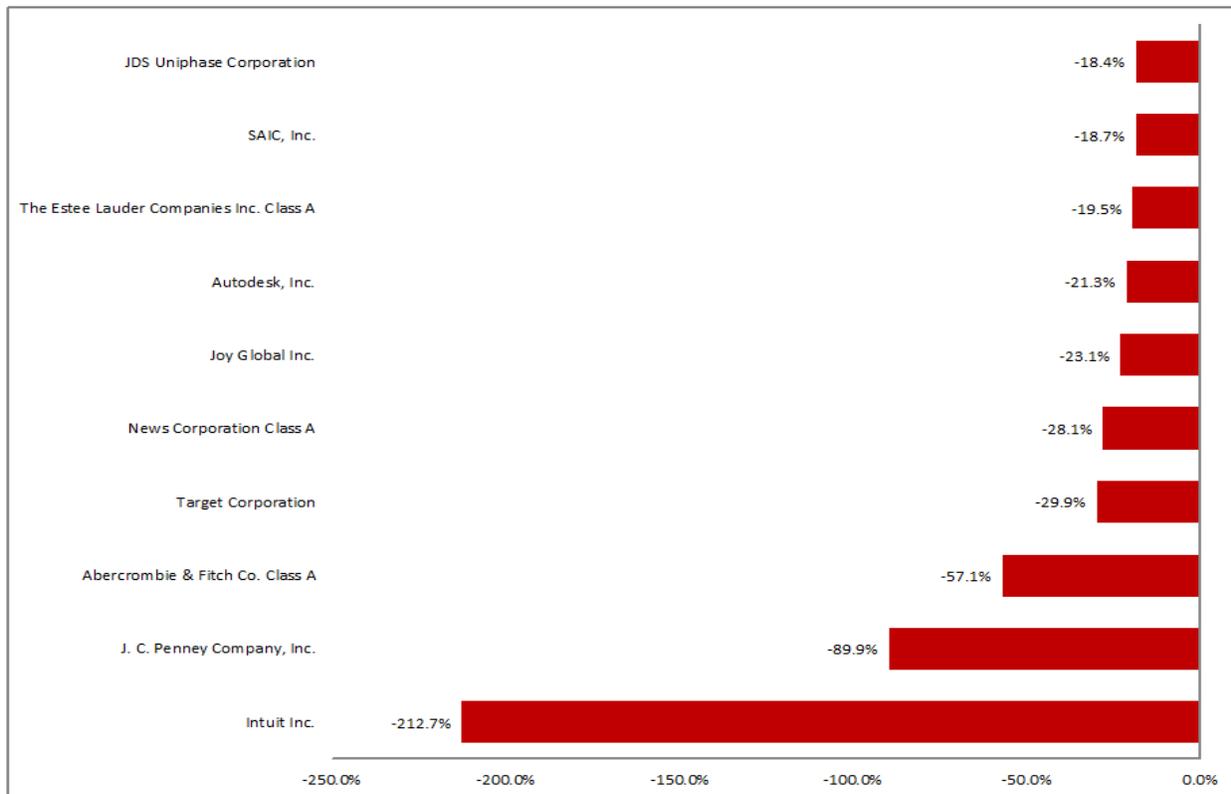


### Q3 2013: EPS Revisions

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

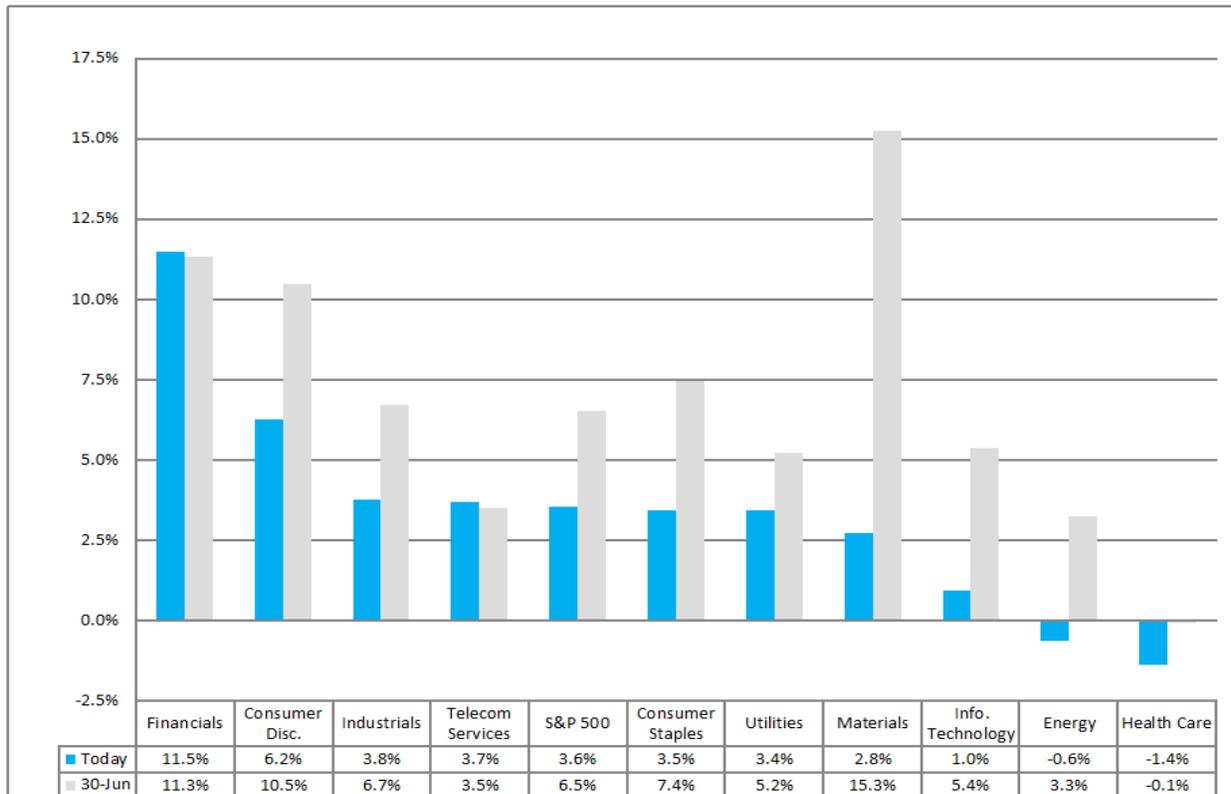


Highest Downward Change (Trailing 4-Weeks) in Mean EPS Estimate: Top 10 Companies

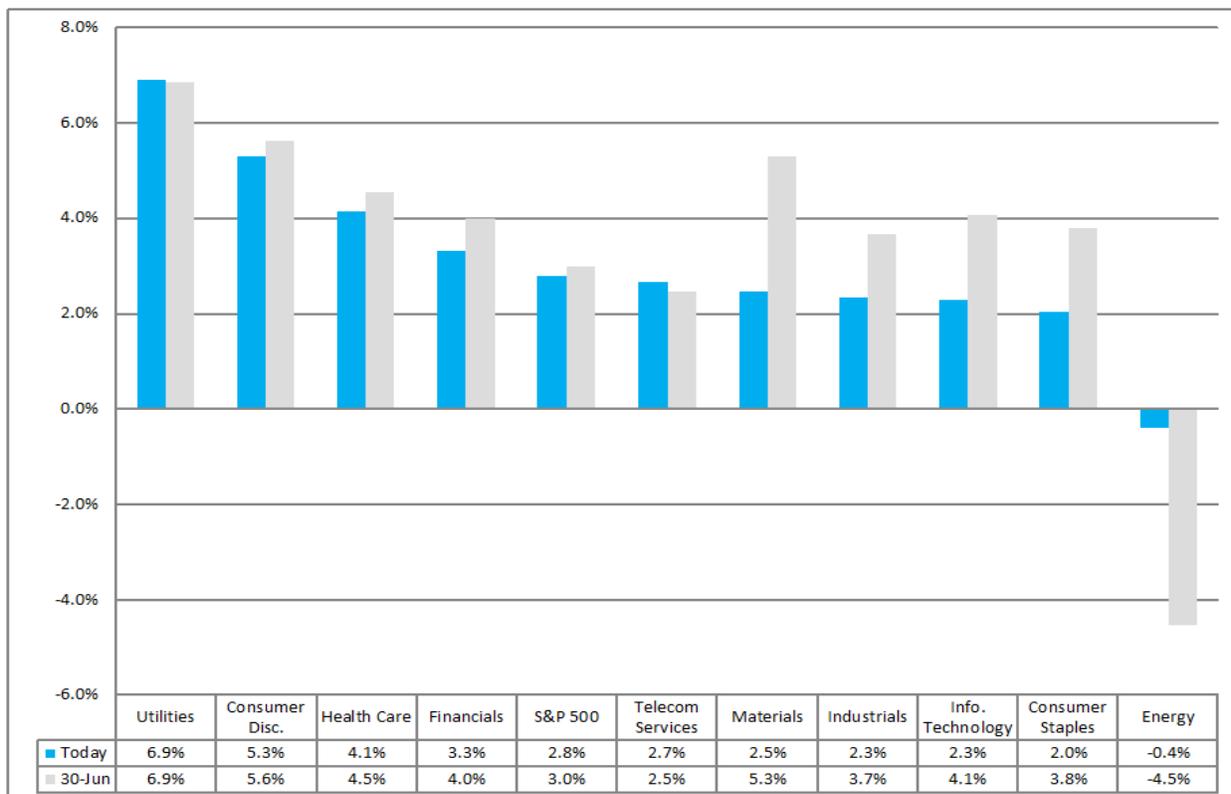


Q3 2013: Growth

Q3 2013 Earnings Growth

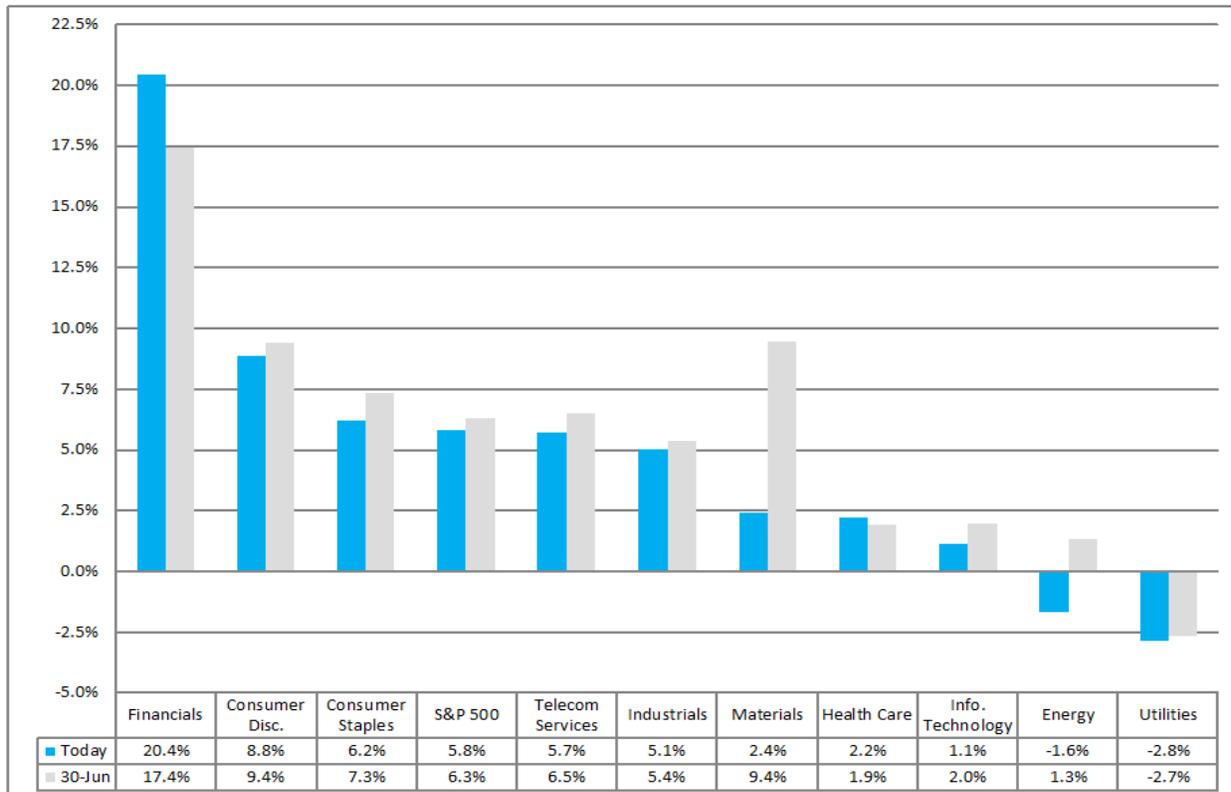


Q3 2013 Revenue Growth

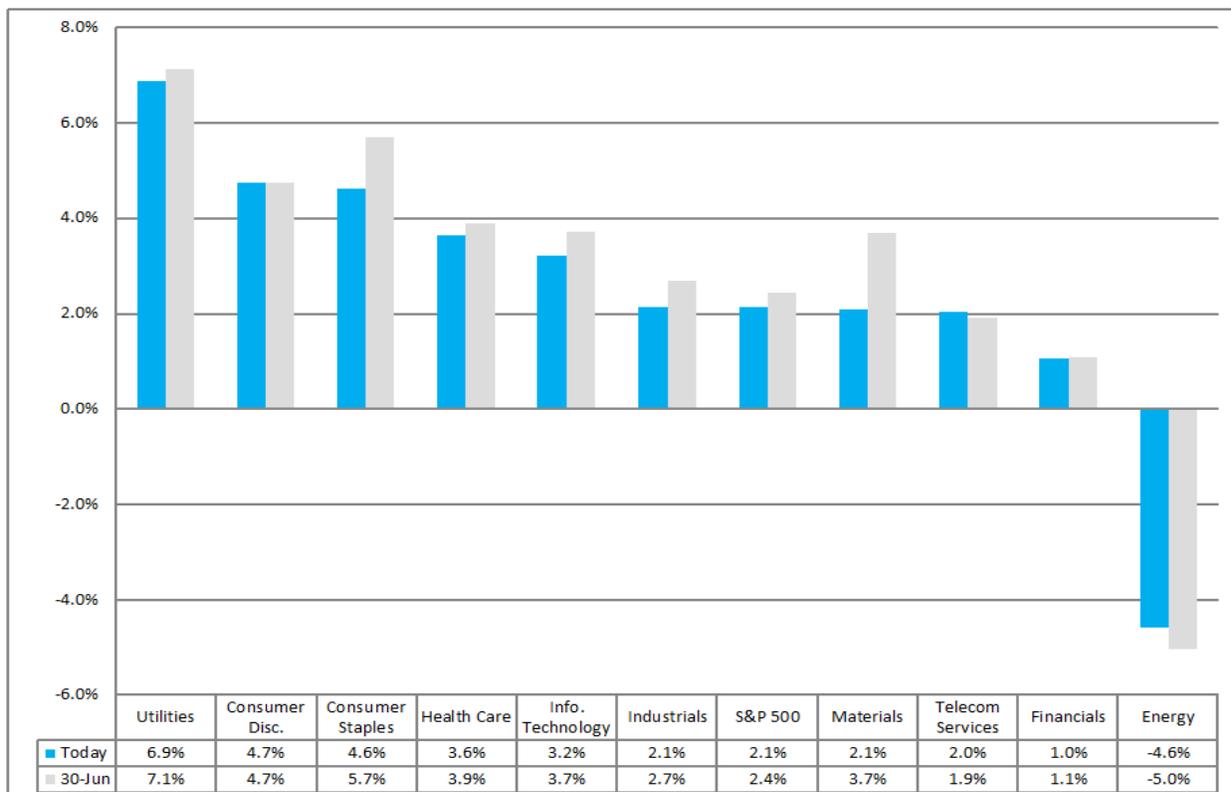


CY 2013: Growth

CY 2013 Earnings Growth

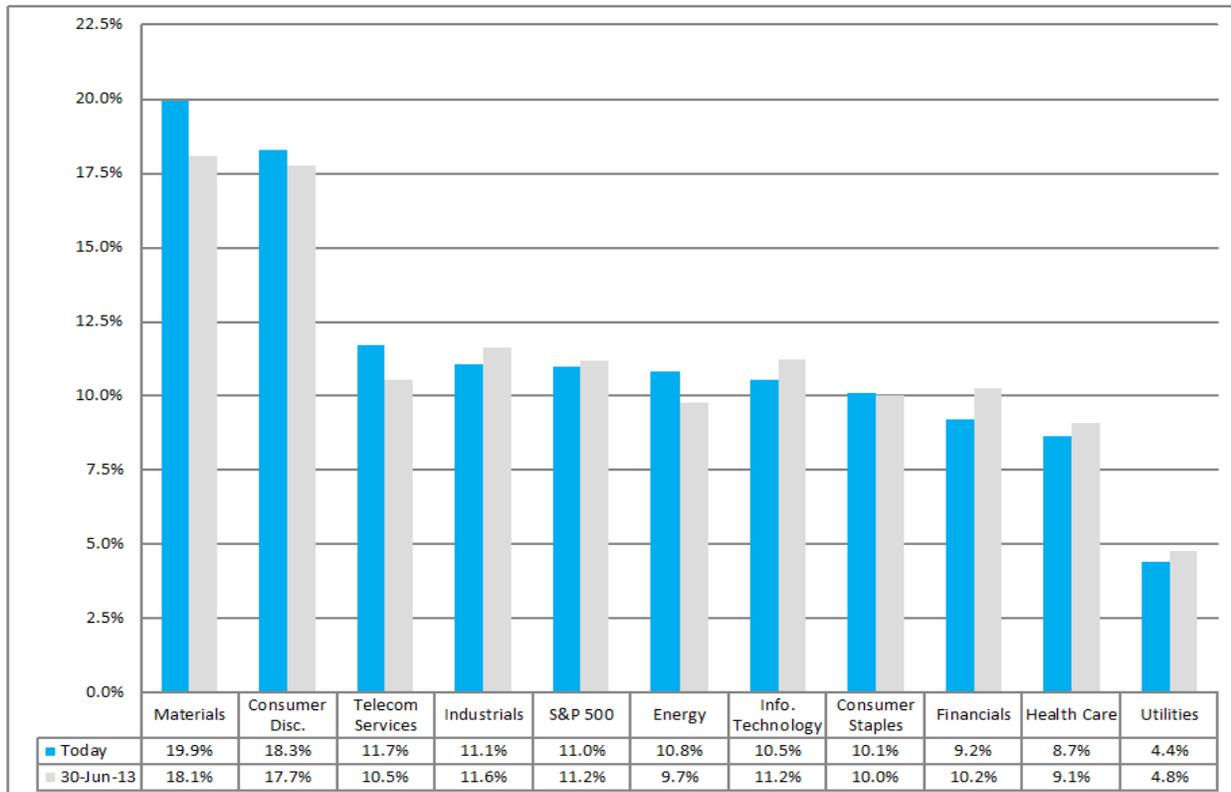


CY 2013 Revenue Growth

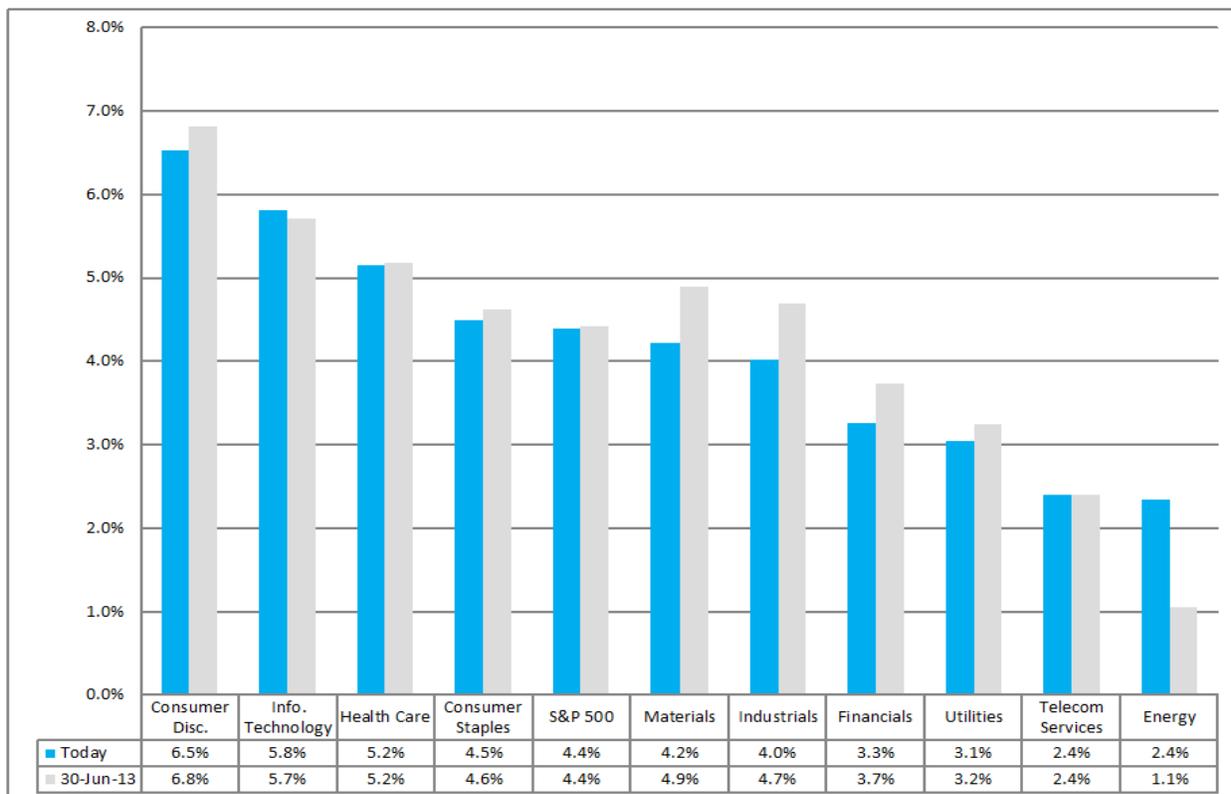


CY 2014: Growth

CY 2014 Earnings Growth

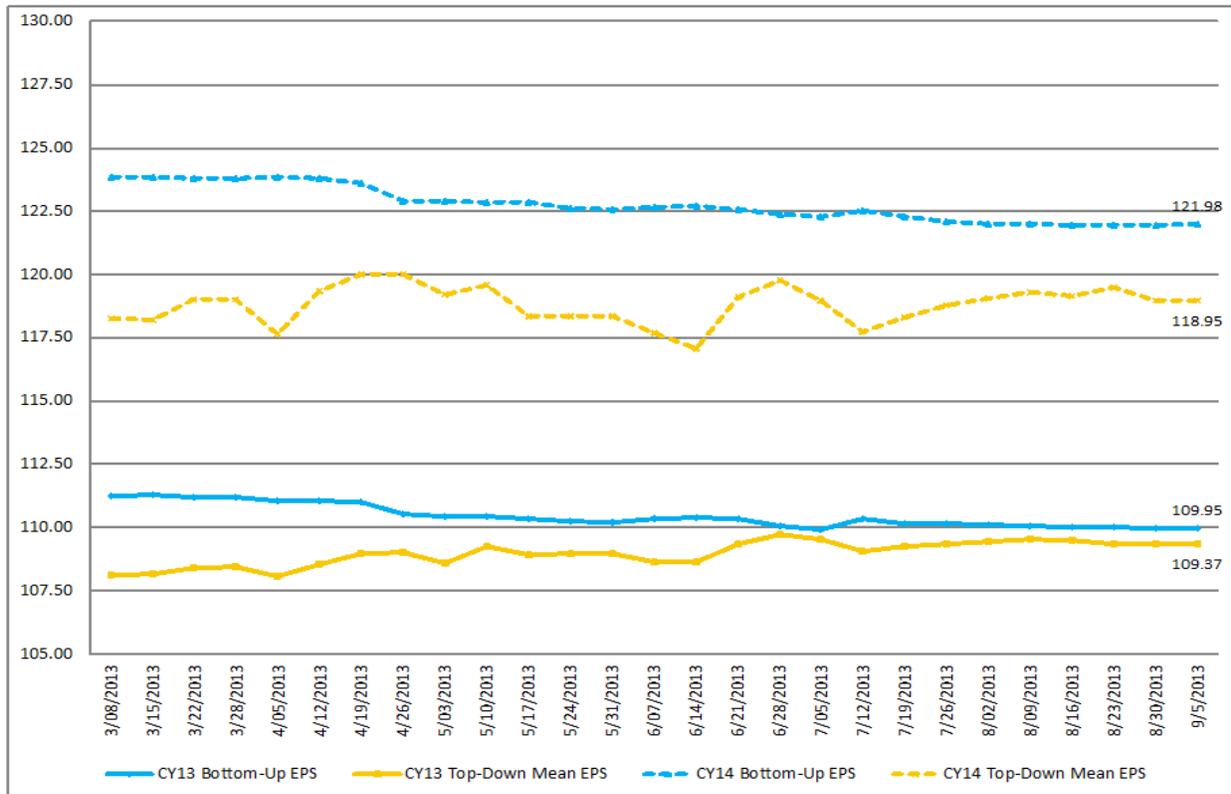


CY 2014 Revenue Growth



## Bottom-up EPS Estimates: Revisions

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

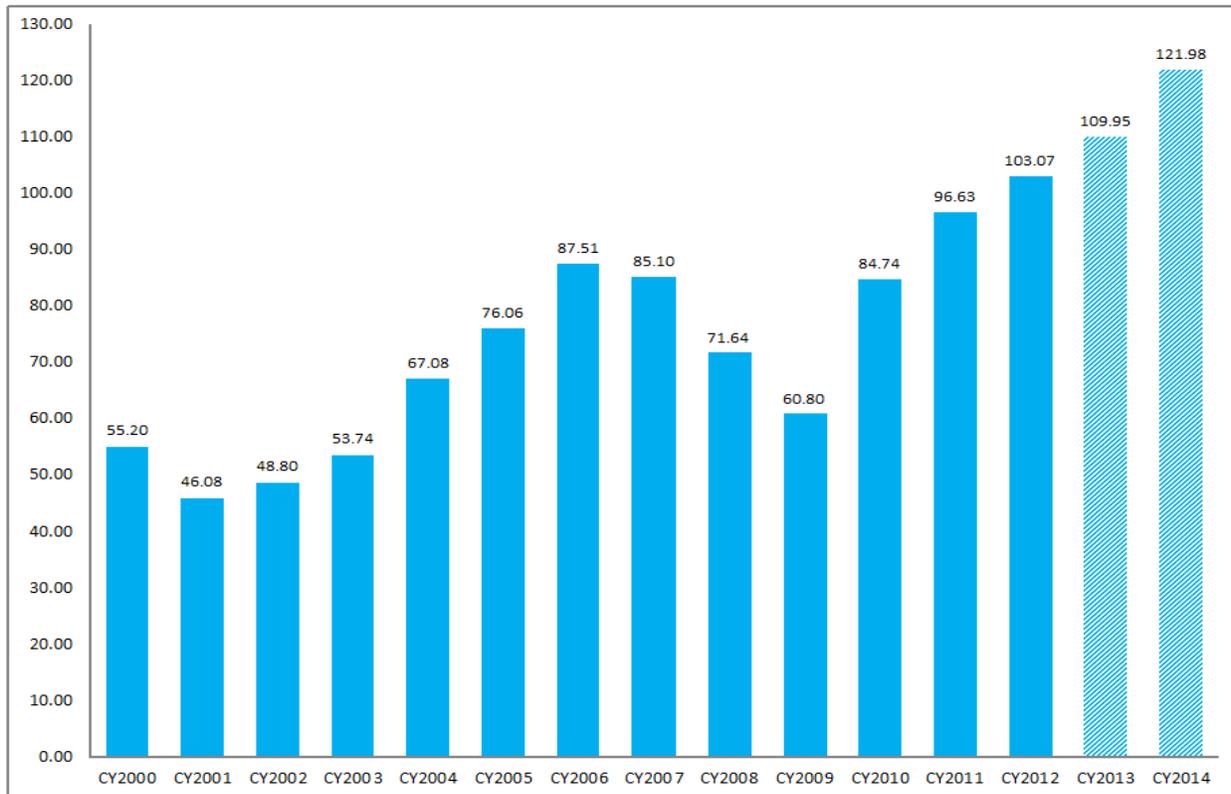


Change in Q213 Bottom-Up EPS vs. Price (Trailing 26-Weeks)

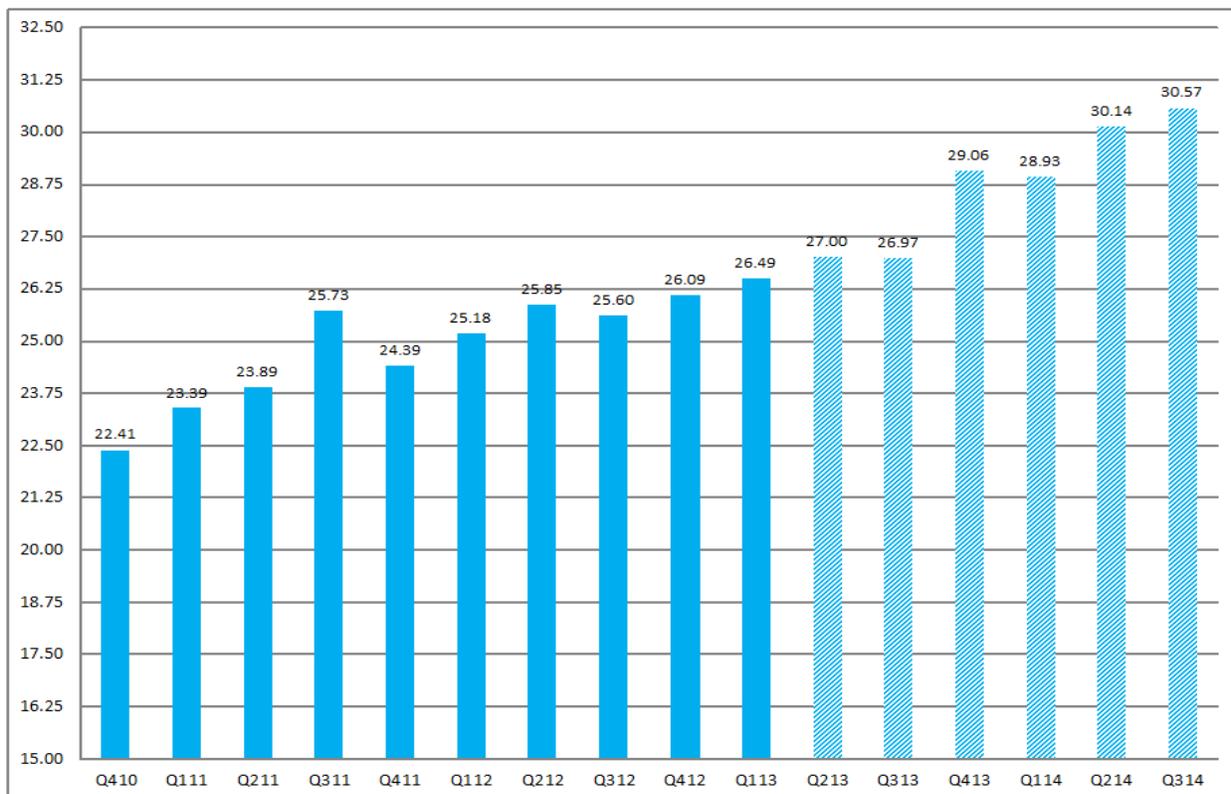


## Bottom-up EPS Estimates: Current & Historical

Calendar Year Bottom-Up EPS Actuals & Estimates

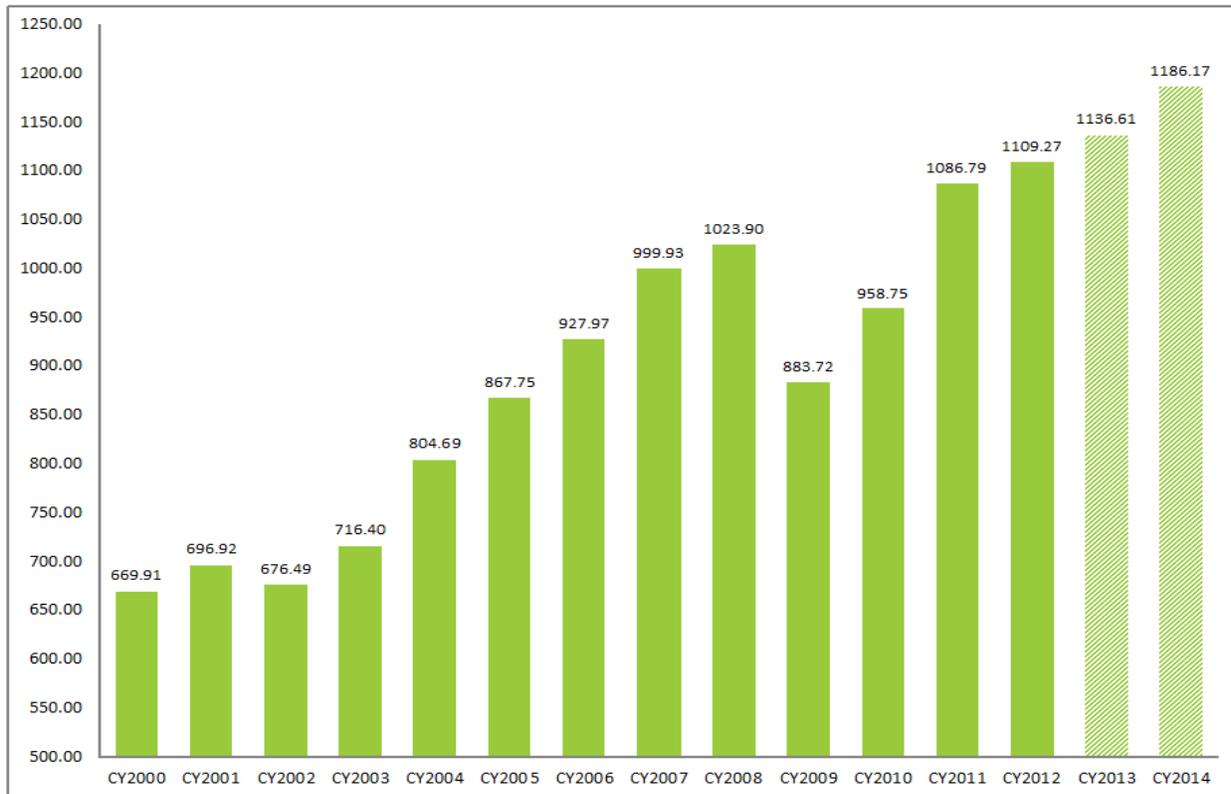


Quarterly Bottom-Up EPS Actuals & Estimates

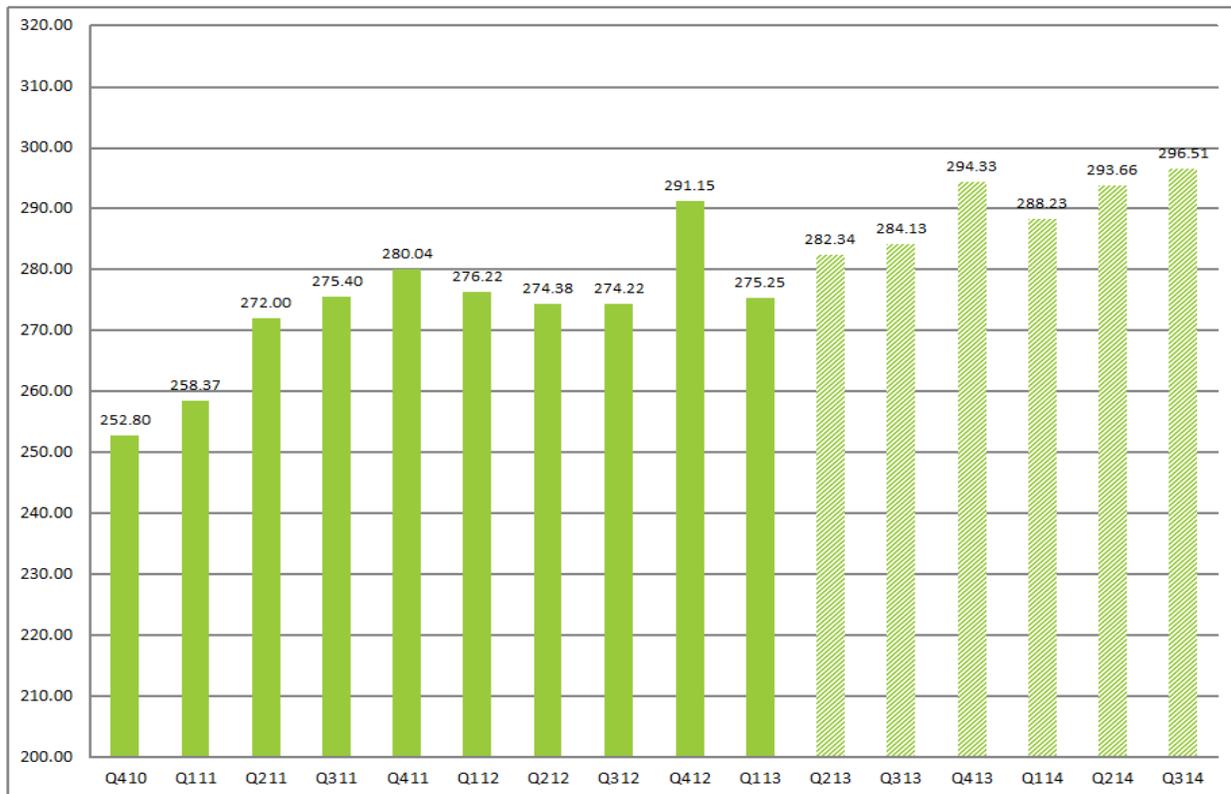


## Bottom-up SPS Estimates: Current & Historical

Calendar Year Bottom-Up SPS Actuals & Estimates

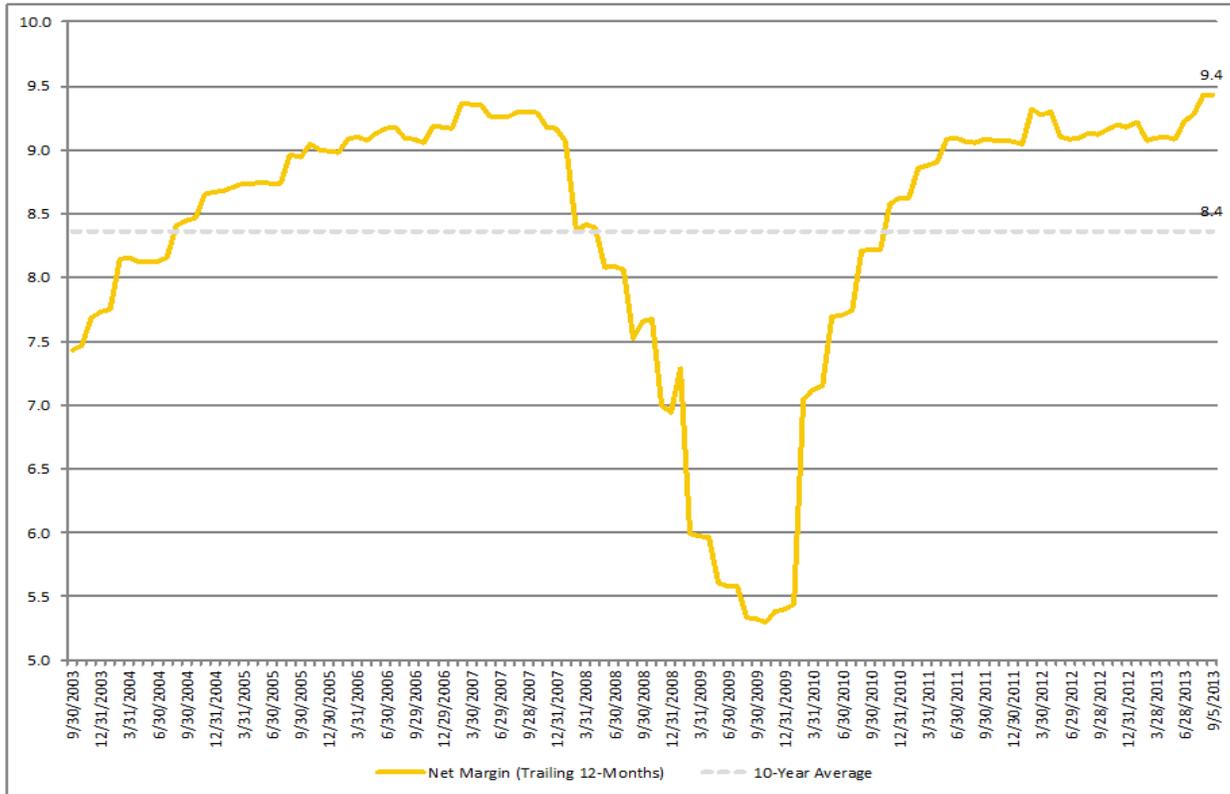


Quarterly Bottom-Up SPS Actuals & Estimates

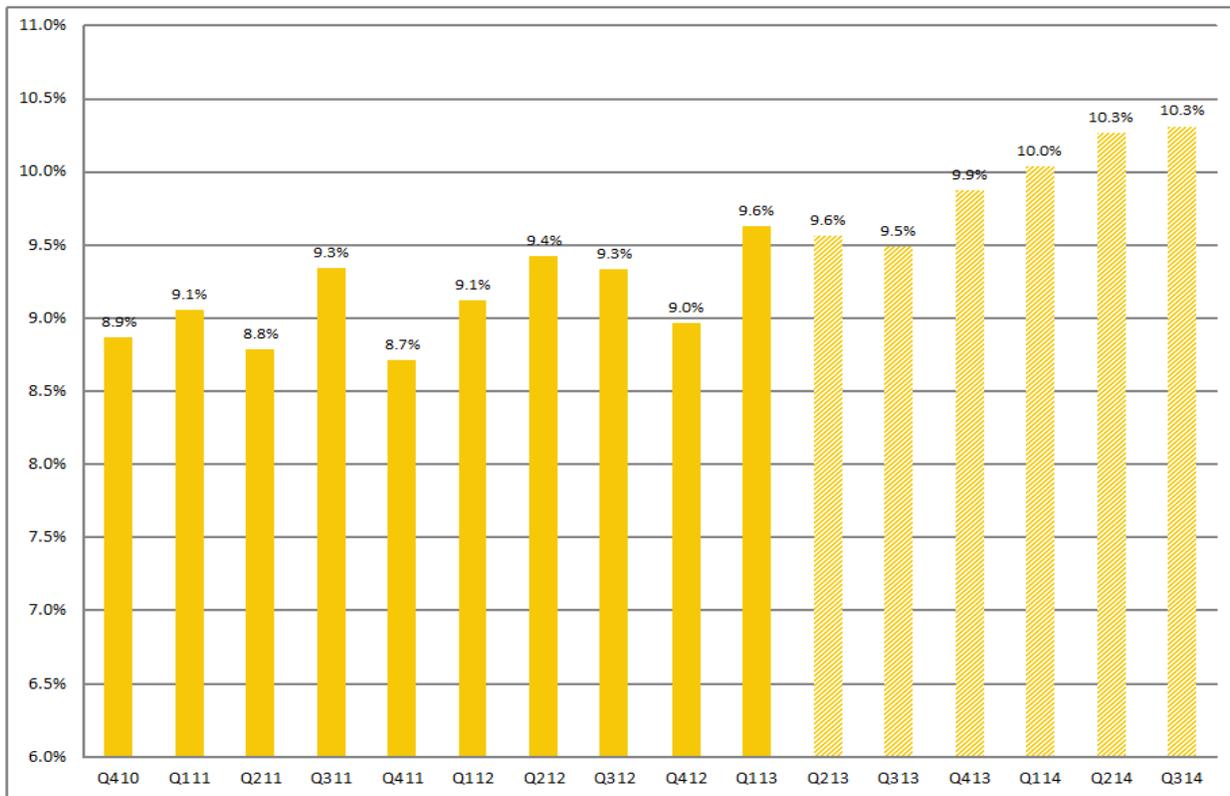


## Net Margins: Current & Historical

Trailing 12M Net Margin: 10 Years

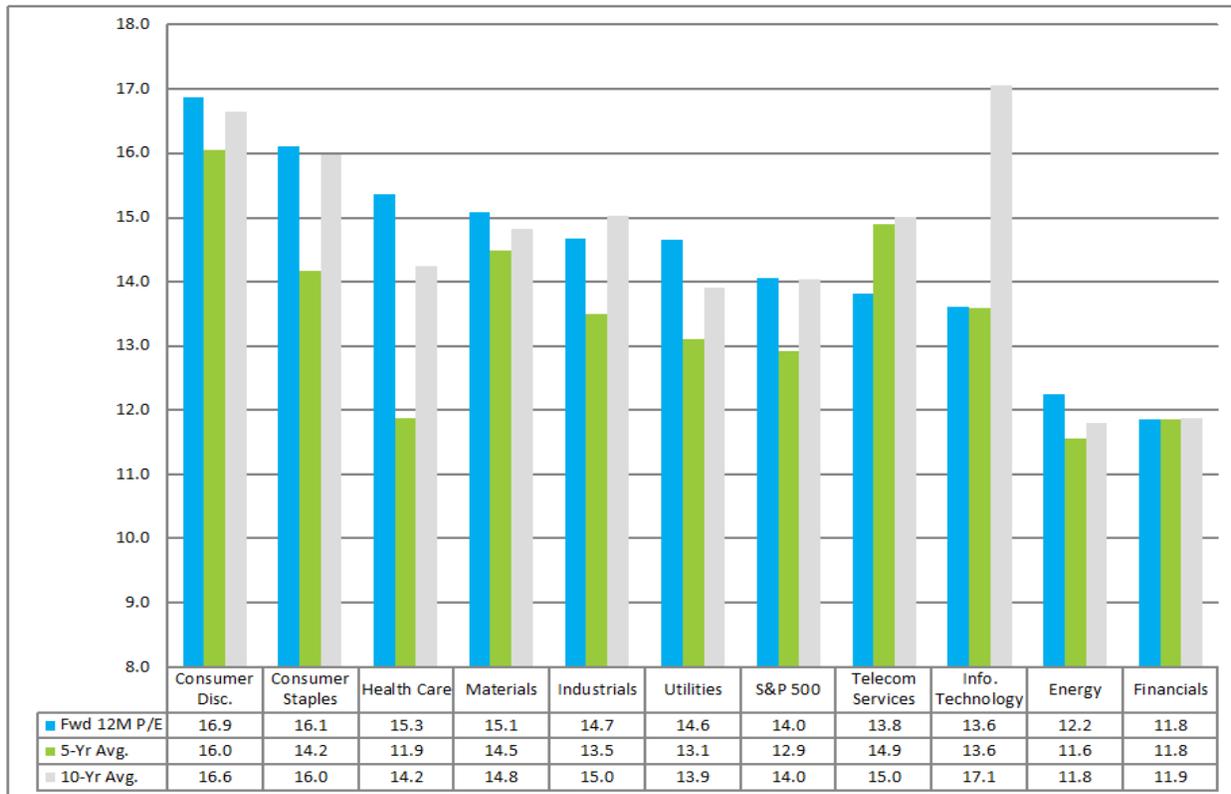


Quarterly Net Margins (Bottom-Up EPS / Bottom-Up SPS)

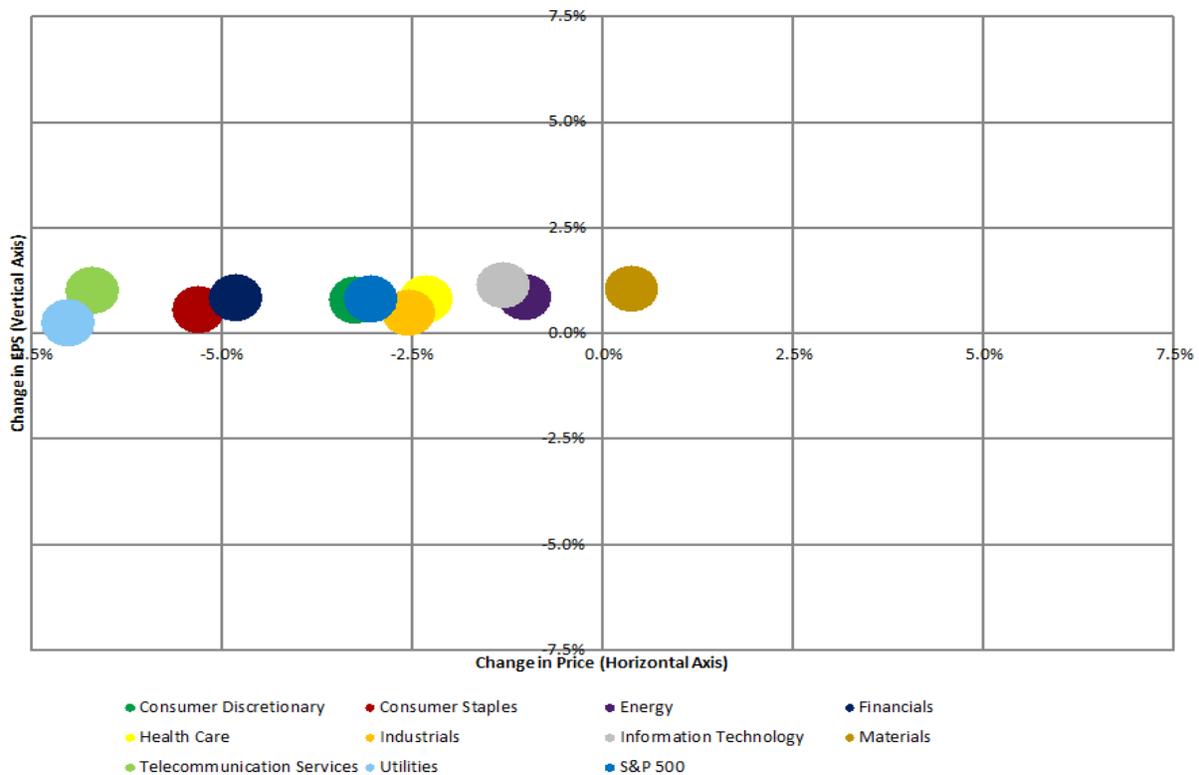


## Forward 12M Price / Earnings Ratio: Sector Level

Sector-Level Forward 12-Month P/E Ratios

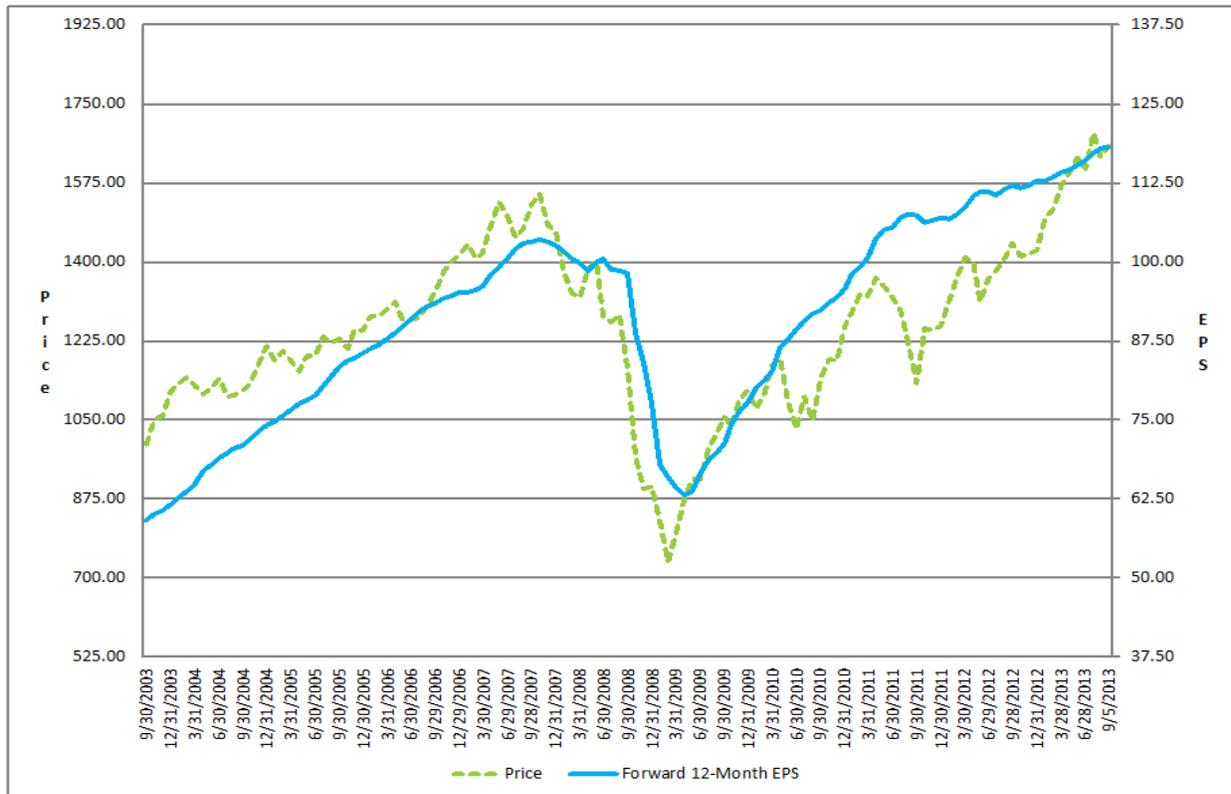


Sector-Level Change in Price vs. Change Forward 12M EPS: 1-Month

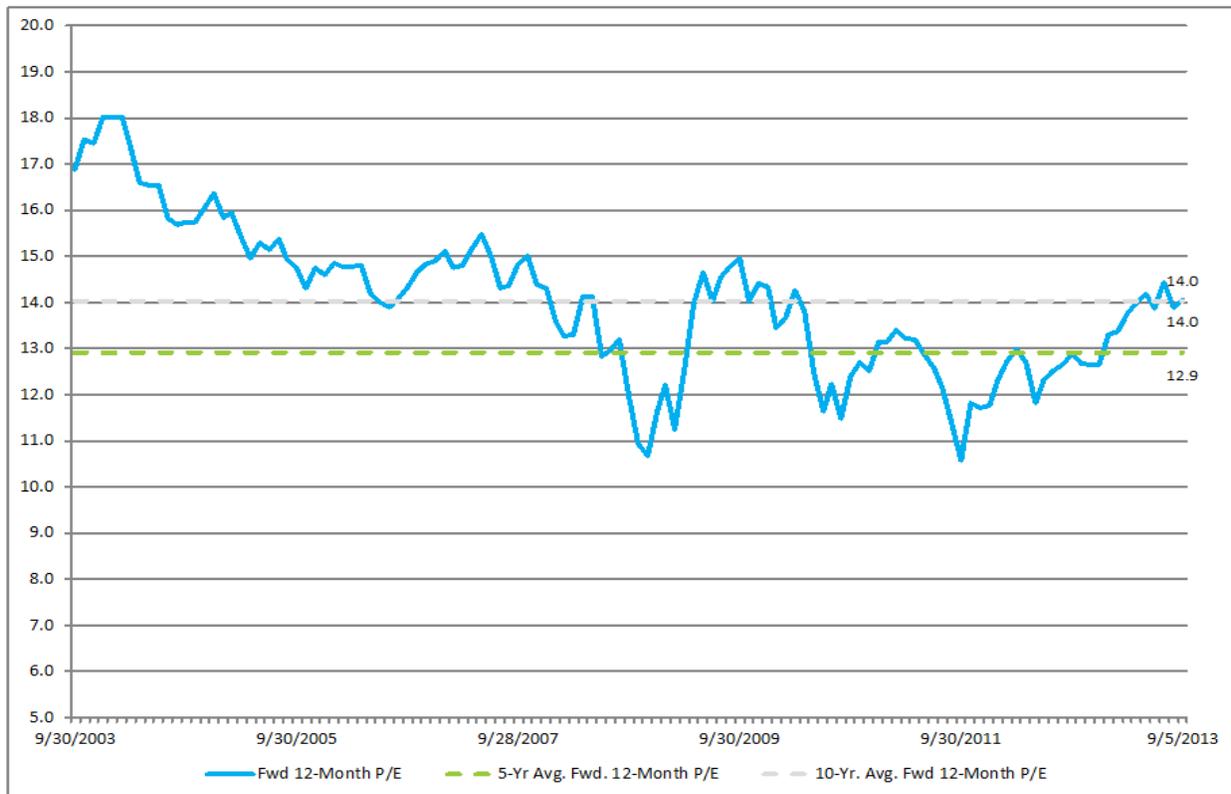


## Forward 12M Price / Earnings Ratio: Long-Term Averages

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

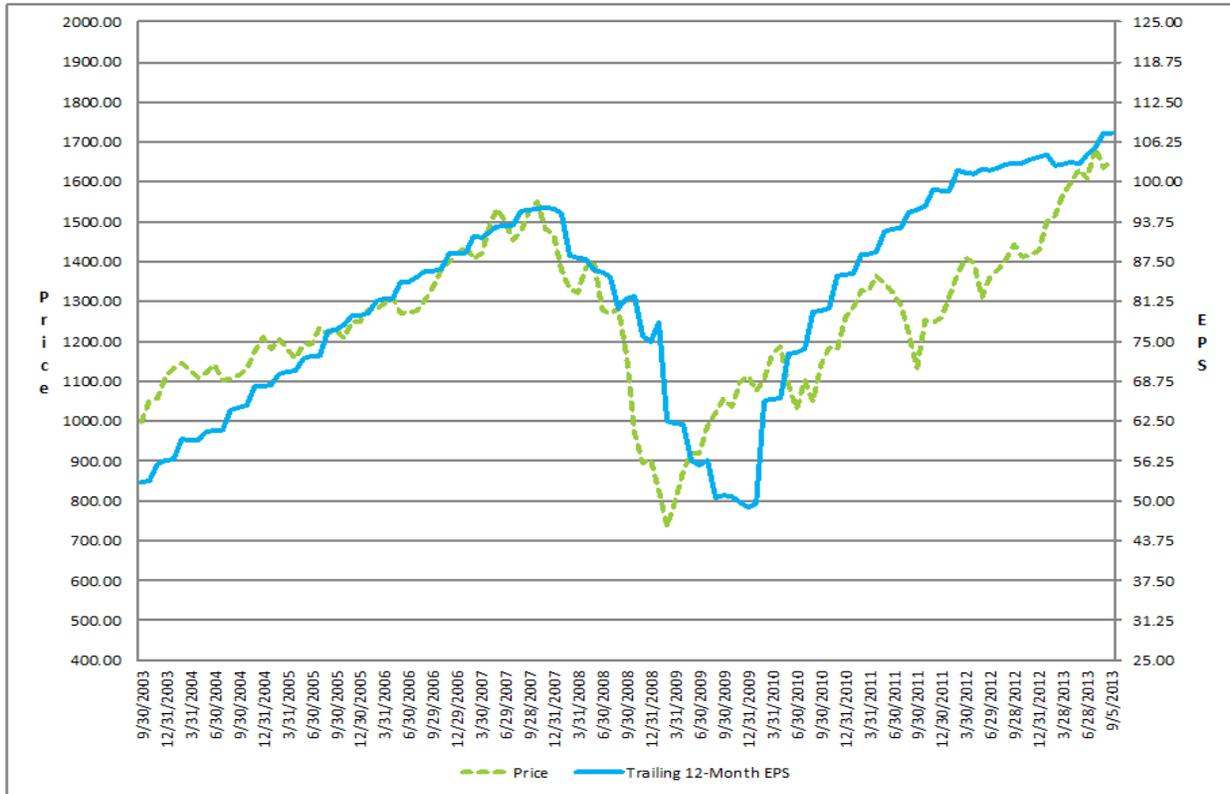


Forward 12M P/E Ratio: 10-Year



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

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



Trailing 12M P/E Ratio: 10-Year



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