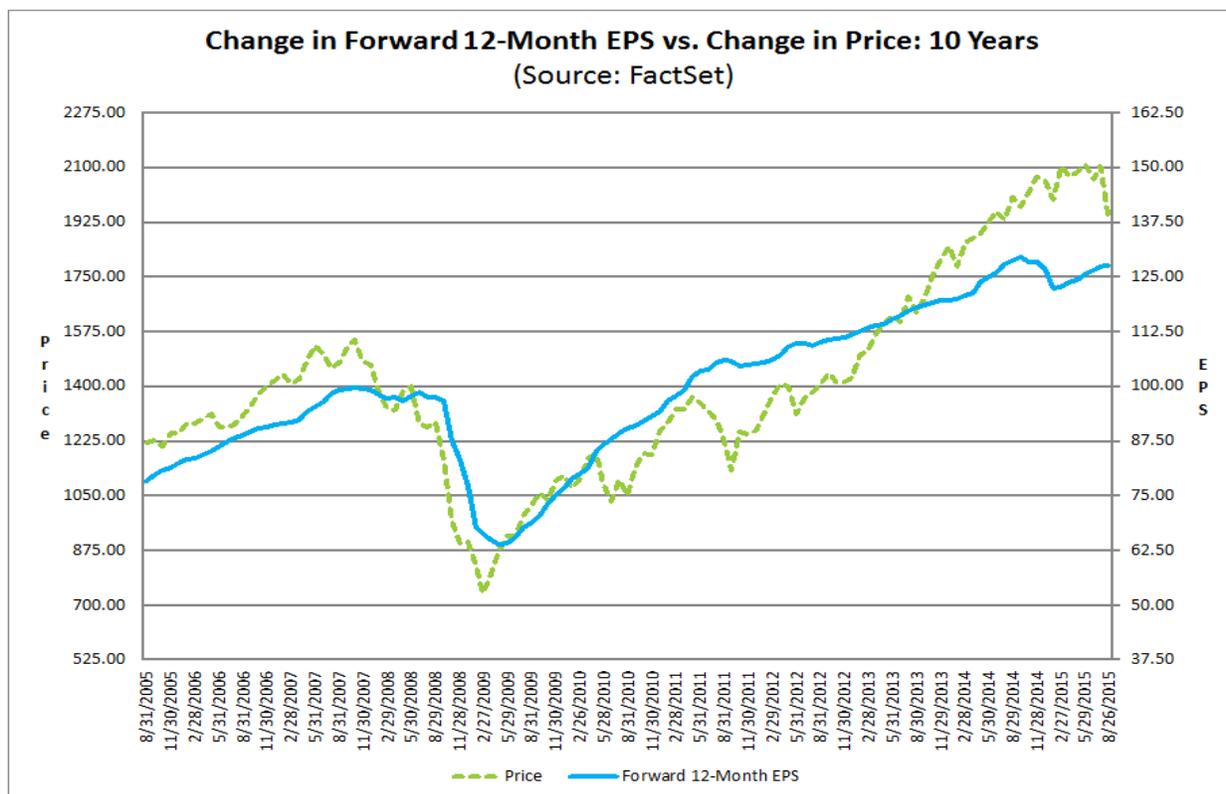


Key Metrics

- + **Earnings Scorecard:** Of the 490 companies that have reported earnings to date for Q2 2015, 74% have reported earnings above the mean estimate and 50% have reported sales above the mean estimate.
- + **Earnings Growth:** For Q2 2015, the blended earnings decline is 0.7%. The last time the index reported a year-over-year decrease in earnings was Q3 2012 (-1.0%).
- + **Earnings Revisions:** On June 30, the estimated earnings decline for Q2 2015 was -4.6%. Nine sectors have higher growth rates today (compared to June 30) due to upward revisions to earnings estimates and upside earnings surprises, led by the Health Care sector.
- + **Earnings Guidance:** For Q3 2015, 76 companies have issued negative EPS guidance and 30 companies have issued positive EPS guidance.
- + **Valuation:** The 12-month forward P/E ratio is 15.2. This P/E ratio is based on Wednesday's closing price (1940.51) and forward 12-month EPS estimate (\$127.70).



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Topic of the Week:

More Dow 30 Companies Reported a Decline in Sales in Europe in Q2

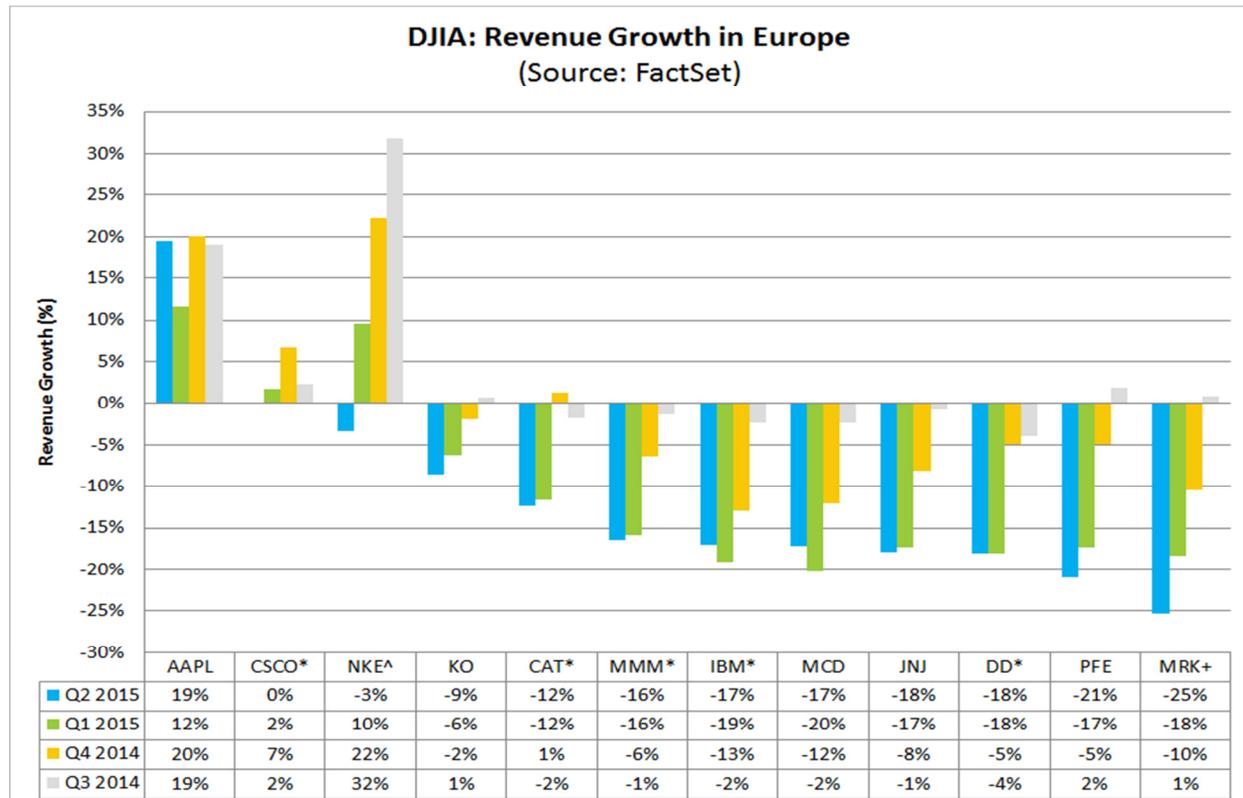
“Foreign exchange impacts reduced sales by 7.3 percentage points in the second quarter. The most notable currencies impacting sales were the euro, yen and Brazilian real, which devalued versus the U.S. dollar by 20%, 17% and 28%, respectively.” –3M (July 23)

Although the volatility in the stock market over the past week has been attributed in part to fears of slower economic growth in China, economic weakness in Europe remains a worry as well. According to FactSet Economic Estimates, real GDP growth in the Eurozone is projected to be 1.5% in 2015.

Coming into the Q2 earnings season, there were concerns in the market regarding the impact of the stronger dollar relative to the euro on U.S. corporate earnings for the second quarter. With the final DJIA components (Home Depot and Wal-Mart Stores) reporting results for Q2 last week, how did companies in the DJIA perform in the second quarter in Europe in terms of sales? How did the revenue numbers for Q2 2015 compare to prior quarters?

Overall, 12 of the 30 companies in the DJIA provided revenue growth numbers for Europe for the second quarter. Of these twelve companies, ten reported a year-over-year decline in revenues. This number was above the number of Dow 30 companies reporting a year-over-year sales decrease in the previous quarter (9). In fact, this was the highest number of Dow 30 companies reporting a year-over-year decline in revenue from Europe since Q3 2012 (also 10).

The stronger dollar was clearly a key factor in the weaker revenue performance in Europe. Of the 12 companies in the DJIA that provided revenue growth numbers for Europe, all 12 cited some negative impact on revenues or EPS (or both) for Q2 due to unfavorable foreign exchange during their earnings conference calls. Six of these 12 companies specifically discussed the weakness of the euro relative to the dollar during these same earnings calls.



*EMEA (Europe, Middle East, & Africa) ^ Western Europe + Pharmaceutical Sales

Q2 2015 Earnings Season: By the Numbers

Overview

With 90% of the companies in the S&P 500 reporting actual results for Q2 to date, the percentage of companies reporting actual EPS above estimates (74%) is above the 5-year average, while the percentage of companies reporting actual sales above estimates (50%) is below the 5-year average. At the sector level, the Health Care sector has the largest percentage of companies reporting both actual EPS above estimates (93%) and actual sales above estimates (69%) of all ten sectors.

Due to companies beating earnings estimates in aggregate, the blended (combines actual results for companies that have reported and estimated results for companies yet to report) earnings decline for Q2 2015 is now -0.7%. This marks the first year-over-year decline in earnings for the S&P 500 since Q3 2012 (-1.0%). At the sector level, the Energy sector reported the largest year over-year decrease in earnings, while the Health Care sector is reporting the highest year-over-year increase in earnings.

Due to companies beating revenue estimates in aggregate, the blended revenue decline for Q2 2015 is now -3.4%. This marks the first time the index has seen two consecutive quarters of year-over-year revenue declines since Q2 2009 and Q3 2009. At the sector level, the Energy sector reported the largest year-over-year decrease in sales. On the other hand, the Health Care sector is reporting the largest year-over-year increase in sales.

Looking at future quarters, analysts are expecting year-over-year declines in earnings to continue through Q315, and year-over-year declines in revenue to continue through Q415. Despite the estimate reductions, analysts are looking for record level EPS to resume in Q4 2015. However, analysts also expect the net profit margins in Q3 2015 and Q4 2015 to be below the profit margin reported for Q2 (based on per-share estimates).

The forward 12-month P/E ratio is 15.2, which is still above the 5-year average and the 10-year average.

During the upcoming week, 5 S&P 500 companies are scheduled to report results for the second quarter.

Fewer Companies Beat Sales Estimates than Average

With 98% of the companies in the S&P 500 reporting actual results for Q2 to date, the percentage of companies reporting actual EPS above estimates (74%) is above the 5-year average, while the percentage of companies reporting actual sales above estimates (50%) is below the 5-year average.

Percentage of Companies Beating EPS Estimates (74%) is Above the 5-Year Average

Overall, 490 companies have reported earnings to date for the second quarter. Of these 490 companies, 74% have reported actual EPS above the mean EPS estimate and 26% have reported actual EPS below the mean EPS estimate. The percentage of companies reporting EPS above the mean EPS estimate is equal to the 1-year (74%) average, but slightly above the 5-year (73%) average.

At the sector level, the Health Care (93%) sector has the highest percentage of companies reporting earnings above estimates, while the Utilities (55%) and Telecom Services (60%) sectors had the lowest percentages of companies reporting earnings above estimates.

Market Not Rewarding Earnings Beats

To date, the market has rewarded upside earnings surprises at less than average levels, but punished downside earnings surprises at average levels.

Companies that have reported upside earnings surprises for Q2 2015 have seen an average price increase of 0.4% two days before the earnings release through two days after the earnings. This percentage is below the 5-year average price increase of 1.0% during this same window for companies reporting upside earnings surprises.

Companies in the index that have reported downside earnings surprises for Q2 2015 have seen an average price decrease of 2.3% two days before the earnings release through two days after the earnings. This percentage decline is equal to the 5-year average price decrease of 2.3% during this same window for companies reporting downside earnings surprises.

Earnings Surprise Percentage (+4.2%) is Below 5-Year Average

In aggregate, companies are reporting earnings that are 4.2% above expectations. This surprise percentage is below the 1-year (+4.5%) average and below the 5-year (+5.0%) average.

Companies in the Health Care (+7.1%) and Consumer Discretionary (+6.1%) sectors are reporting the largest upside aggregate differences between actual earnings and estimated earnings. In the Health Care sector, Tenet Health Care (0.75 vs. 0.45) and Bristol-Myers Squibb (\$0.53 vs. \$0.36) have reported the largest positive upside earnings surprises. In the Consumer Discretionary sector, Amazon (0.19 vs. -0.15), Carnival (\$0.25 vs. \$0.16), and Netflix (\$0.06 vs. \$0.04) have reported actual results above estimates by the widest margins.

On the other hand, companies in the Energy sector (-1.1%) reported the largest downside aggregate differences between actual earnings and estimated earnings. In this sector, CONSOL Energy (-\$0.37 vs. \$0.00), Southwestern Energy (-\$0.02 vs. \$0.05), and Range Resources (\$0.01 vs. \$0.04) have reported the largest downside earnings surprises.

Percentage of Companies Beating Revenue Estimates (50%) is Below 5-Year Average

In terms of revenues, 50% of companies have reported actual sales above estimated sales and 50% have reported actual sales below estimated sales. The percentage of companies reporting sales above estimates is below both the 1-year (57%) average and the 5-year average (57%).

At the sector level, the Health Care (69%) and Financials (65%) sectors have the highest percentages of companies reporting revenue above estimates, while the Telecom Services (20%) sector had the lowest percentages of companies reporting revenue above estimates.

Revenue Surprise Percentage (+0.6%) is Below 5-Year Average

In aggregate, companies are reporting sales that are 0.6% above expectations. This surprise percentage is below the 1-year (+0.9%) average and below the 5-year (+0.7%) average.

Companies in the Energy (+7.4%) sector reported the largest upside aggregate differences between actual sales and estimated sales, while companies in the Utilities (-4.3%) sector reported the largest downside aggregate differences between actual sales and estimated sales.

No Change in Blended Earnings Decline for Q2 This Week

No Change in Blended Earnings Decline for Q2 This Week

The blended earnings decline for the second quarter is -0.7% this week, which is unchanged from the blended earnings decline of -0.7% last week.

Health Care Sector Has Seen Largest Increase in Earnings Growth since June 30

The blended earnings decline for Q2 2015 of -0.7% is smaller than the estimate of -4.6% at the end of the second quarter (June 30). Nine sectors have recorded an increase in earnings growth since the end of the quarter due to upside earnings surprises, led by the Health Care (to 15.4% from 7.6%) sector. The only sector that has recorded a decrease earnings growth during this time due to downside earnings surprises and downward revisions to earnings estimates is the Industrials (to -4.7% from -3.9%) sector.

First Decline in Earnings (-0.7%) Since Q3 2012 (-1.0%)

The blended earnings decline for Q2 2015 is -0.7%. The second quarter marks the first year-over-year decrease in earnings for the index since Q3 2012 (-1.0%). Eight sectors are reporting year-over-year growth in earnings, led by the Health Care sector. Two sectors are reporting year-over-year declines in earnings, led by the Energy sector.

Health Care: Broad-Based Earnings Growth in Sector

The Health Care sector is reporting the highest earnings growth rate at 15.4%. At the industry level, all six industries in the sector are reporting earnings growth. Five of these industries have double-digit earnings growth rates, led by the Health Care Technology (30%) and Biotechnology (23%) industries. At the company level, Allergan PLC and Gilead Sciences are the largest contributors to earnings growth for the sector. Allergan PLC reported actual EPS of \$4.41 for Q2 2015, compared to year-ago EPS of \$3.42 in Q2 2014. Gilead Sciences reported actual EPS of \$3.15 for Q2 2015, compared to year-ago EPS of \$2.36 in Q2 2014. If these two companies are excluded, the blended earnings growth rate for the sector would fall to 10.6%.

Energy: Largest Contributor to Earnings Decline for the Index

The Energy sector reported the largest year-over-year decline in earnings (-55.6%) of all ten sectors. Five of the seven sub-industries reported a year-over-year drop in earnings: Coal & Consumable Fuels (-608%), Oil & Gas Exploration & Production (-94%), Integrated Oil & Gas (-60%), Oil & Gas Equipment & Services (-49%), and Oil & Gas Drilling (-30%). On the other hand, the Oil & Gas Refining & Marketing (45%) and Oil & Gas Storage & Transportation (2%) sub-industries reported earnings growth for the quarter.

This sector was also the largest contributor to the earnings decline for the S&P 500 as a whole for the second quarter. If the Energy sector is excluded, the blended earnings growth rate for the S&P 500 would jump to 5.9% from -0.7%.

First Back-to-Back Declines in Revenue Since Q2 2009 and Q3 2009

The blended revenue decline for Q2 2015 is -3.4%. The second quarter marks the first time the index has seen two consecutive quarters of year-over-year revenue declines since Q2 2009 and Q3 2009. It also marks the largest year over-year decline in revenues since Q3 2009 (-11.5%). Six sectors are reporting year-over-year growth in revenue, led by the Health Care sector. Four sectors are reporting year-over-year declines in revenues, led by the Energy sector.

The Health Care sector is reporting the highest revenue growth of all ten sectors at 8.6%. Five of the six industries in the sector are reporting sales growth for the quarter. Three of these six industries have double-digit sales growth rates: Health Care Technology (32%), Biotechnology (17%), and Health Care Equipment & Supplies (12%).

On the other hand, the Energy (-32.2%) sector reported the largest year-over-year decrease in sales for the quarter. All seven sub-industries in the sector reported a decrease in revenue: Oil & Gas Exploration & Production (-40%), Integrated Oil & Gas (-33%), Oil & Gas Refining & Marketing (-32%), Coal & Consumable Fuels (-31%), Oil & Gas Equipment & Services (-26%), Oil & Gas Drilling (-22%), and Oil & Gas Storage & Transportation (-13%).

This sector was also the largest contributor to the revenue decline for the S&P 500 as a whole for the second quarter. If the Energy sector is excluded, the blended revenue growth rate for the S&P 500 would jump to 1.5% from -3.4%.

Q2 2015 Earnings Season: Themes

Overview

Similar to last quarter, companies have been discussing the impact of slower global economic growth, the stronger dollar, and lower oil prices during their earnings conference calls.

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

United States

According to FactSet Economic Estimates, real (year-over-year) GDP growth in the U.S. is projected to be 2.4% in 2015, which would be consistent with GDP growth of the past few years. The U.S. remains the key geographic market for the S&P 500. According to FactSet Geographic Revenue Exposure data (based on the most recent fiscal year data), companies in the S&P 500 in aggregate generate about 70% of sales from North America, almost all of which comes from the U.S.

“Our industry-leading research team under Candace’s leadership in Bank of America Research expects U.S. GDP growth for the second half of the year to be 3% for each of those quarters, and we see that in our statistics. Our company is well positioned to benefit from that continued health in the economy, and we continue to manage this company to deliver for our customers, clients and for you our shareholders.”
–Bank of America (Jul. 15)

“While recent developments in Europe and Asia have implications for the U.S. economy, the ongoing U.S. economic expansion has remained on track and has entered its 7th year, a feat accomplished only four other times in U.S. history....These factors, along with an increase in consumer confidence, makes me optimistic that the economic expansion will sustain momentum into H2, and Wells Fargo should benefit from the increase in economic activity as we remain focused on meeting our customers’ financial needs.”
–Wells Fargo (Jul. 15)

“In the second quarter, PepsiCo was once again the largest contributor to US retail sales growth among all food and beverage manufacturers, with over \$400 million of retail sales growth in all major channels. This was more than two times the next largest contributor to growth, and represented more growth than the next 14 largest manufacturers combined. Notably, North American beverages was the key driver of US retail sales growth within PepsiCo and the largest contributor to US retail sales growth on the standalone basis.” –PepsiCo (Jul. 1)

“Our U.S. Retail segment had a disappointing year. But as you can see on slide eight, trends did improve in H2, most notably for yogurt and cereal....But overall sales trends in many categories were weak, reflecting the impact of changing consumer food preference.” –General Mills (Jul 1)

“North America had a great quarter and another remarkable year. Revenues were up 14% for the quarter and 12% for the year, despite the headwind from the West Coast port congestion. Growth in the quarter was driven by nearly every key category.” –NIKE (Jun. 25)

“In North America, we delivered very strong 12% revenue growth in local currency, driven by continued double-digit growth in the United States, where we are strengthening our position as the market leader.”
–Accenture (Jun. 25)

“All of our North American brands had a strong performance led by the Carnival brand, which achieved a double digit improvement in ticket revenue yield, a testament to the strength of the Carnival Cruise Line product and the brand team’s incredible execution in delivering a vacation experience that truly resonates with our guests.” –Carnival Corp. (Jun. 23)

Europe

According to FactSet Economic Estimates, real (year-over-year) GDP growth in the Eurozone is projected to be 1.5% in 2015, which is a slight improvement relative to 2014. Europe is still an important geographic market for the S&P 500. According to FactSet Geographic Revenue Exposure data (based on the most recent fiscal year data), companies in the S&P 500 in aggregate generate about 13% of sales from Europe (combination of European Union and non-European Union countries).

“The thing I’ll tell you is Europe is a difficult economy between East and the West. There’s some sort of volatility there all the time. I think today, year-to-date, we are the best performing European CPG company, based on all the numbers we’ve looked at. If you combine East and West, or whether you look at them individually, both from the top line and the profit performance, we are performing the best...I think on a year-to-date basis, we are performing at or above our expectations in Europe. And we feel comfortable with what the team is doing and that’s what we intend to keep doing, balance the year.” – PepsiCo (Jul. 9)

“Our International segment generated 6% constant currency net sales growth in 2015. We had a strong year in Europe where constant currency sales rose 5%.” –General Mills (Jul. 1)

“In Europe, Middle East and Africa, EMEA, economic and retail conditions remain challenging in parts of the region. However, in constant currency, we had strong volume-driven sales growth this period particularly in France, Poland and Russia.” –McCormick & Company (Jul. 1)

“Now let’s turn to Western Europe, where we’ve seen broad-based demand with growth of 17% in the quarter and 21% for the year. Growth in the quarter and throughout the year was fueled by our continued efforts to transform the marketplace in line with the Category Offense. We saw strong growth across most key categories, led by Sportswear, Running, Women’s Training, and Basketball, and in the territories, particularly in AGS, that’s Austria, Germany and Switzerland, as well as in the UK and Ireland.” –NIKE (Jun. 25)

“In Europe, I’m very pleased with our growth of 7% in local currency, driven primarily by Spain, the United Kingdom, Germany, and the Netherlands.” –Accenture (Jun. 25)

“As we had said before in the notes, there is a lot of macroeconomic difficulties in Europe. The economy seems to be bouncing along at the bottom. Our Costa brand is doing very well. But as a result of the geopolitical risk and other things, they have had some challenges on the yield side this year.” –Carnival Corp. (Jun 23)

Some companies have commented on the debt crisis situation in Greece as well.

“And just to note, we are monitoring the situation in Greece as the country considers its path forward economically. We do not anticipate any significant negative impact to our sales results for 2015, nor to our earnings for 2015, unless there’s a significant change in the current expected resolution.” –Johnson & Johnson (Jul. 14)

“Given the current situation in Greece, where we fortunately have no business interest, we anticipate a certain level of volatility in the currency markets in the forthcoming months.” –Walgreens Boots Alliance (Jul. 9)

China

According to FactSet Economic Estimates, real (year-over-year) GDP growth in China is projected to be 6.9%, which would be a continuation of the declining growth seen in recent years. China continues to be a vital geographic market for the S&P 500. According to FactSet Geographic Revenue Exposure data (based on the most recent fiscal year data), companies in the S&P 500 in aggregate generate about 9% of sales from the Asia Pacific region, most of which comes from China and Japan.

“So, we have seen in China some slowdown. I wouldn't call it acute. There's some dynamics, of course, of generic competition in China and an overall slower growth in economic growth. So we are seeing that, but I think we're well positioned... So I wouldn't call it acute, but I would say we've seen some slowdown in the overall market growth in China.” –Johnson & Johnson (Jul. 15)

“I think the good news is that sales are recovering. We went from minus 12% to minus 10% despite a more difficult lap of plus 15%. The good news is that the consumer metrics are improving, trending in the right direction. As always, these are never linear, unfortunately, but we do know that when we compare this to previous recoveries, we're going in the right direction, making progress across the board. So I feel good, and we remain obviously bullish on China. We continue to invest in China. And I think as you know, these customer metrics are the harbinger of future sales performance.” –YUM! Brands (Jul. 15)

“And we're experiencing really broad-based growth on both our McCormick brand and on our acquired brands across China. And we recognize that there's been some slowdown in economic growth in China, but our categories continued to do well, and our brands in particular had really broad-based growth in this quarter. And we don't really see any change in that trend.” –McCormick & Company (Jul. 1)

“And finally in China, where Q4 revenue grew 20%, and we posted a full year growth of 19%. Our strong growth in the quarter was driven primarily by Running, Basketball and Sportswear.” –NIKE (Jun. 25)

“With the additional capacity redeployed to China in 2016, we will offer an industry-leading approximately 4 million-passenger cruise days dedicated to the burgeoning China cruise market.” –Carnival Corp. (Jun. 23)

There are also concerns in the market about the impact of the decline in the Chinese stock market on economic growth and consumer spending in China. Some companies have commented on this topic as well.

“Turmoil in China's equity market has reached unprecedented levels, and the impact of intervention is yet to be fully understood by our markets.” –BlackRock (Jul. 15)

“John, we don't see a correlation. We think actually a very small percentage of customers have been impacted by that [decline in the Chinese stock market]. As to whether or not it has impacted broader consumer confidence, we have no reason to believe it at this stage that that is the case.” –YUM! Brands (Jul. 15)

Currency Themes: Stronger U.S. Dollar

The dollar was stronger in Q2 2015 relative to year-ago values for both the euro and the yen. In the year-ago quarter (Q2 2014), one euro was equal to \$1.37 dollars on average. For Q2 2015, one euro was equal to \$1.11 dollars on average. In the year-ago quarter (Q2 2014), one dollar was equal to \$102.10 yen on average. For Q2 2015, one dollar was equal to \$121.42 yen on average.

A number of companies have already commented on the negative impact of the stronger dollar on earnings and sales for Q2, or the expected negative impact of the stronger dollar in future periods.

"Sales volumes in most of our non-domestic businesses were positive. But growth was insufficient to offset the drag from currency devaluation, which was slightly worse than anticipated in the quarter."
- Sherwin-Williams (Jul. 16)

"I do want to point out foreign currency translation remains a strong headwind as we continue to expect this to impact full year EPS by about 5 percentage points." –YUM! Brands (Jul. 15)

"As of last week, the Euro was lower by approximately 17%, as compared to 2014 average levels, and the dollar has strengthened recently versus virtually all major currencies. And though we are not predicting the impact of currency movements, 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, our sales growth rate would decrease by nearly 7%, reflecting the weakening of the Euro and other major currencies against the U.S. dollar." –Johnson & Johnson (Jul. 14)

"Our customers have been hit hard by the strength of the U.S. dollar, most of our businesses in the U.S. and anything that impairs to manufacturing output of this country impacts us and the strong dollar has done some of that. We also sell a fair amount into Canada and that business is all denominated in the Canadian currency, so that's created some headwinds for us." –Fastenal (Jul. 14)

"As you model out the third quarter, I'd ask you to consider the following: Foreign exchange translation should have an approximate 11 point unfavorable impact on the third quarter net revenue growth, and approximate 12 point unfavorable impact on third quarter core EPS growth based on current market consensus rates." –PepsiCo (Jul.9)

"At current exchange rates, we'd estimated \$0.04 headwind to full-year adjusted diluted EPS growth in 2016." –General Mills (Jul. 1)

"We continued to estimate that currency will reduce our sales growth rate by 5 percentage points in 2015." –McCormick & Company (Jul. 1)

"Foreign exchange had a negative impact of \$24mm on net sales, and about \$14mm on operating profit for the [Consumer Foods] segment this fiscal quarter." –ConAgra (Jun.30)

"Specifically, for FY2016, we expect reported revenue growth in a mid-single-digit rate reflecting low double-digit growth on a currency-neutral basis, partially offset by the impact of the stronger dollar." –NIKE (Jun. 26)

"Turning now to revenues, net revenues for the quarter were \$7.8B, slightly positive growth in U.S. dollars and an increase of 10% in local currency, reflecting a negative 10% foreign exchange impact compared to the negative 11% impact provided in our business outlook last quarter." –Accenture (Jun. 25)

"As anticipated, y-over-y Canadian currency fluctuations unfavorably impacted our comparable sales by approximately 30BPS in Q1." –Bed Bath & Beyond (Jun. 24)

"First, let me update you on the impact of foreign currency on Q1 results. As I previewed in Q4, nearly every currency in which we do business weakened significantly against the U.S. dollar when compared against both Q1 last year and last quarter. This significant change in exchange rates impacted not only

our financial statements, but also the statistics we provide on a quarterly basis. For instance, the y-over-y foreign exchange impact on total revenue was 850BPS or \$36mm headwind.” –Red Hat (Jun. 18)

“As you probably remember, I didn’t provide U.S. dollar guidance for Q3, given the unusually high volatility in exchange rates. The currency headwind ended up being 6% for software and cloud revenues as well as total revenue, 7% for total hardware revenue, and \$0.06 per share – and \$0.06 for EPS.” – Oracle (Jun. 17)

“From a q-over-q currency perspective, FX decreased revenue by \$16mm. We had \$22mm in hedge gains in Q2 FY2015 vs. \$24mm in hedge gains in Q1 FY2015. Thus the net sequential currency decreased to revenue considering hedging gains was \$18mm. From a y-over-y currency perspective, FX decreased revenue by \$48mm. Considering the \$22mm in hedge gains in Q2 FY2015 vs. roughly \$2mm in hedge gains in Q2 FY2014, the net y-over-y currency decrease to revenue, considering hedging gains, was \$28mm.” –Adobe Systems (Jun. 16)

“As compared to a year ago in Q3 this year, the foreign currencies where we operate weakened vs. the U.S. dollar, in fact in all countries, but primarily in Canada, Mexico, Korea and Japan, resulting in our foreign earnings in Q3 when converted into U.S. dollars being lower by about \$33mm pre-tax or \$0.06 per share than these earnings would have been had FX rates been flat y-over-y.” – Costco (May 28)

“As with other international companies, the strengthening dollar has negatively impacted our U.S. dollar earnings from these operations recently.” –AutoZone (May 26)

Commodity Themes: Lower Oil & Gas Prices

During the course of the second quarter, the price of crude oil increased by 20.5% (to \$59.47 from \$47.60). However, the average price of oil in Q2 2015 (\$58.02) was still more than 40% lower than the average price in the year-ago quarter (\$102.96).

The impact of oil and gas prices varies by sector, industry, and company. The negative impact of lower oil prices relative to last year has already been seen in the Energy sector, where year-over-year earnings are expected to decline by 54%. What has been the impact of lower oil and gas prices in other sectors of the index? Are companies seeing an increase in consumer spending relative to last year?

“For the remainder of the year, we are approximately 15% hedged against an increase in prices with approximately 85% downside participation to Brent prices of \$40 per barrel. Overall, we continue to expect fuel costs to be an enormous tailwind and provide a net benefit of more than \$2 billion for Delta this year. We are also well positioned to benefit if fuel remains at these levels through 2016.” –Delta Airlines (Jul. 15)

“We’re still seeing a bifurcated consumer with some level of growth in premium, and our gourmet brand is an example of that and niche category, so there is some growth. We’re seeing some recovery in food service with people eating out. So we are seeing some of those lower gas prices find their way in.” – McCormick & Company (Jul. 1)

“We’ve had a lot of discussion around the gas – what we call the gas dividend that’s going back to the consumer. I think there’s a lot of expectation that that was going to stimulate traffic. And what I’ve been saying is we haven’t seen it stimulate traffic, but we have seen it change the consumer behavior once they’re in our building. And they’re not seeking the deals the way they were years ago. We’re seeing consumers buy more add-ons. They’re buying wine, dessert, apps.” –Darden Restaurants (Jun. 23)

“Declining prices at the pump have benefited our customers, especially those most financially stressed. The lower end customer benefits the most from lower gas prices relative to income. This trend is encouraging, but we understand this is just one of many factors that impact our business. While gas prices have increased more recently, prices are still around \$1 a gallon below last year” –AutoZone (May 26)

Looking Ahead: Forward Estimates and Valuation

Revenue Growth Not Expected to Return Until 2016

For Q2 2015, companies reported year-over-year declines in both earnings (-0.7%) and revenues (-3.4%). Analysts do not currently project earnings growth to return until Q4 2015 and revenue growth to return until Q1 2016. In terms of earnings, analysts are currently predicting a decline of 4.1% in Q3 2015, followed by growth of 1.8% in Q4 2015. In terms of revenues, analysts are currently projecting a decline of 2.6% in Q3 2015 and a decline of 0.5% in Q4 2015, followed by growth of 5.3% in Q1 2016.

For all of 2015, analysts are projecting earnings to grow by 1.0%, but revenues to decline by 1.7%.

Guidance: Negative EPS Guidance (72%) for Q3 Slightly Above Average

At this point in time, 106 companies in the index have issued EPS guidance for Q3 2015. Of these 106 companies, 76 have issued negative EPS guidance and 30 have issued positive EPS guidance. Thus, the percentage of companies issuing negative EPS guidance to date for the third quarter is 72% (76 out of 106). This percentage is slightly above the 5-year average of 70%.

Decrease in Profit Margins Projected for 2nd Half of 2015

Analysts are also expecting profit margins for the 2nd half of 2015 to be below the level reported for Q2 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 Q3 2015 and Q4 2015 are 10.1% and 10.4%, respectively. These predictions are below the net profit margin of 10.5% reported for Q2 2015.

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

The forward 12-month P/E ratio is 15.2. This P/E ratio is based on Wednesday's closing price (1940.51) and forward 12-month EPS estimate (\$127.70).

At the sector level, the Energy (21.0) sector has the highest forward 12-month P/E ratio, while the Telecom Services (11.9) sector has the lowest forward 12-month P/E ratio.

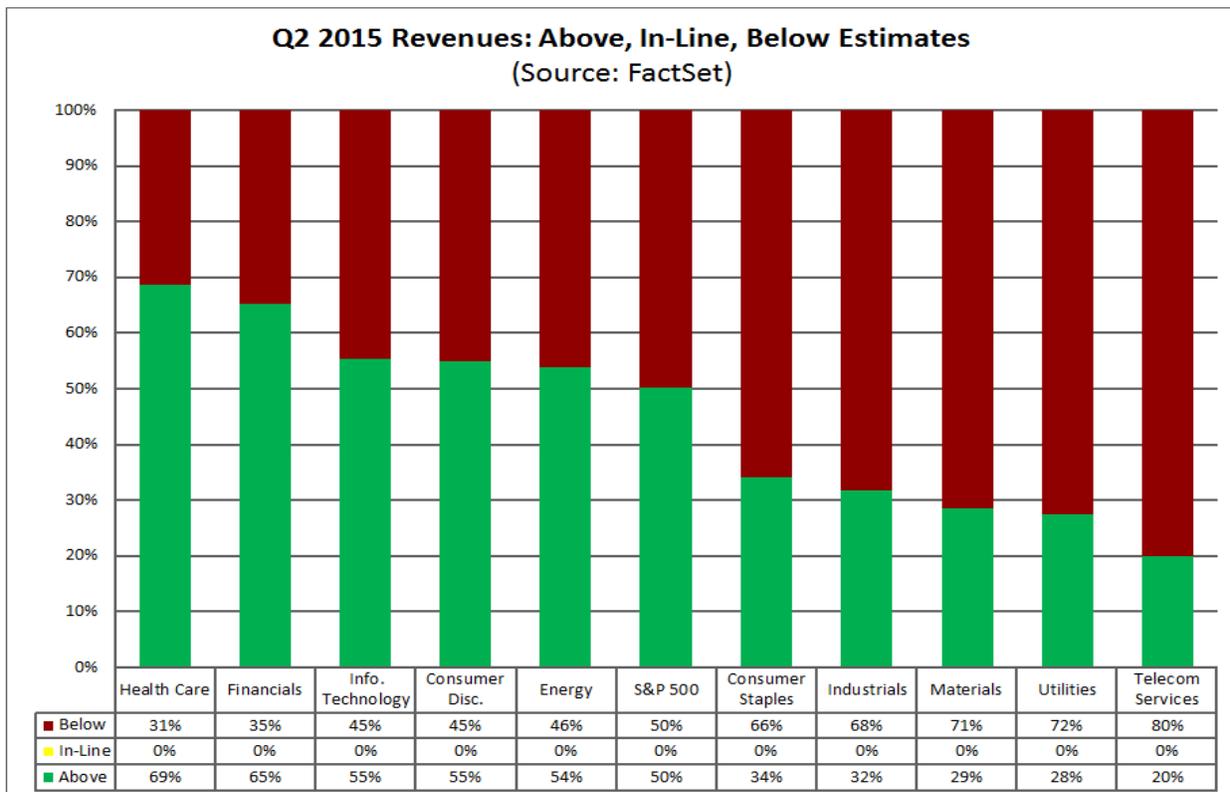
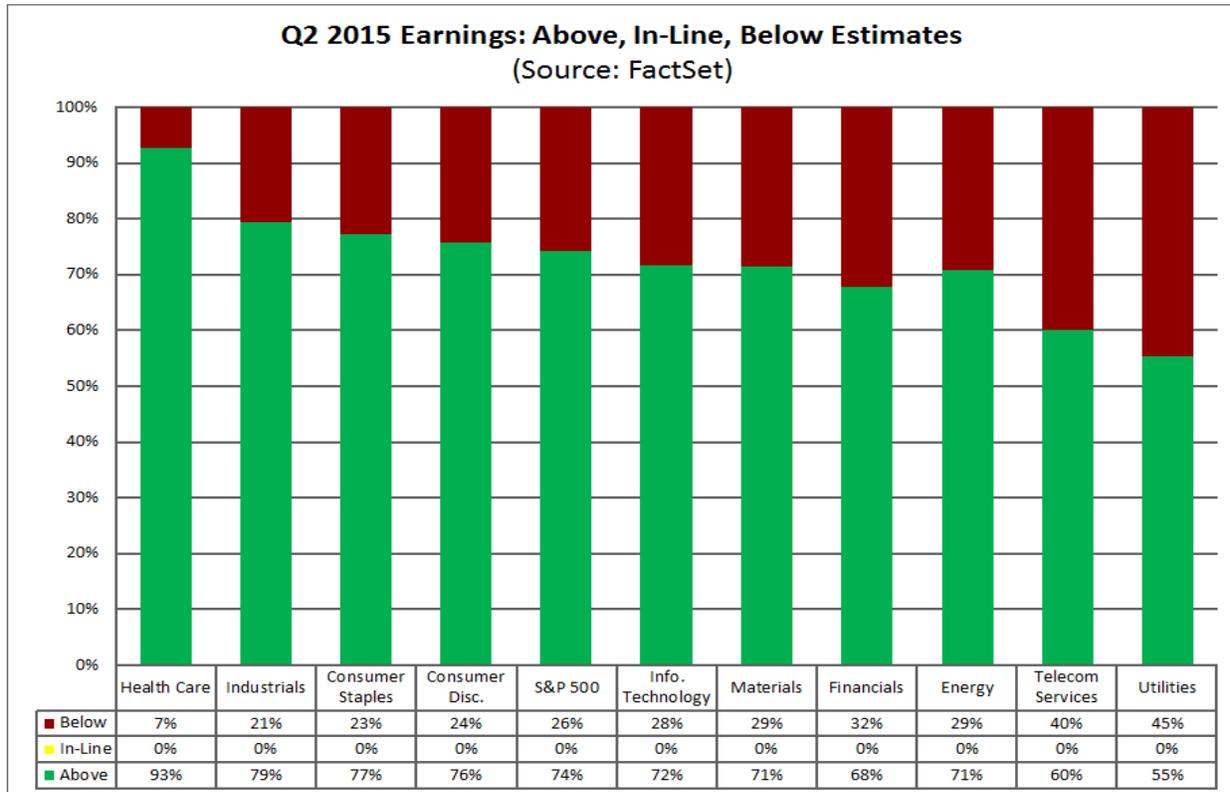
The P/E ratio of 15.2 for the index as a whole is above the prior 5-year average forward 12-month P/E ratio of 14.0, and above the prior 10-year average forward 12-month P/E ratio of 14.1. However, it is below the forward 12-month P/E ratio of 16.4 recorded at the start of the third quarter (June 30). Since the start of the third quarter, the price of the index has decreased by 5.9%, while the forward 12-month EPS estimate has increased by 0.9%.

Six sectors have forward 12-month P/E ratios that are above their 10-year averages, led by the Energy (21.0 vs. 12.7) sector. Four sectors have forward 12-month P/E ratios that are below their 10-year averages, led by the Telecom Services (11.9 vs. 14.8) sector.

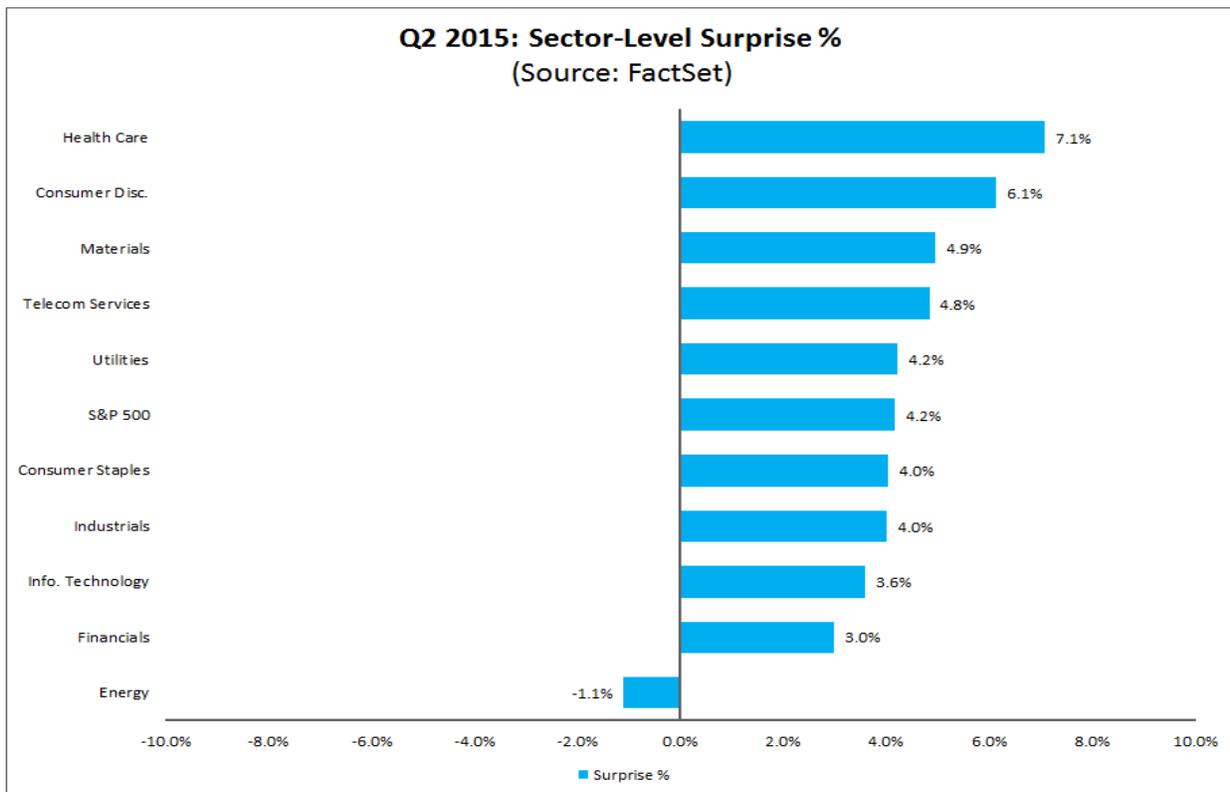
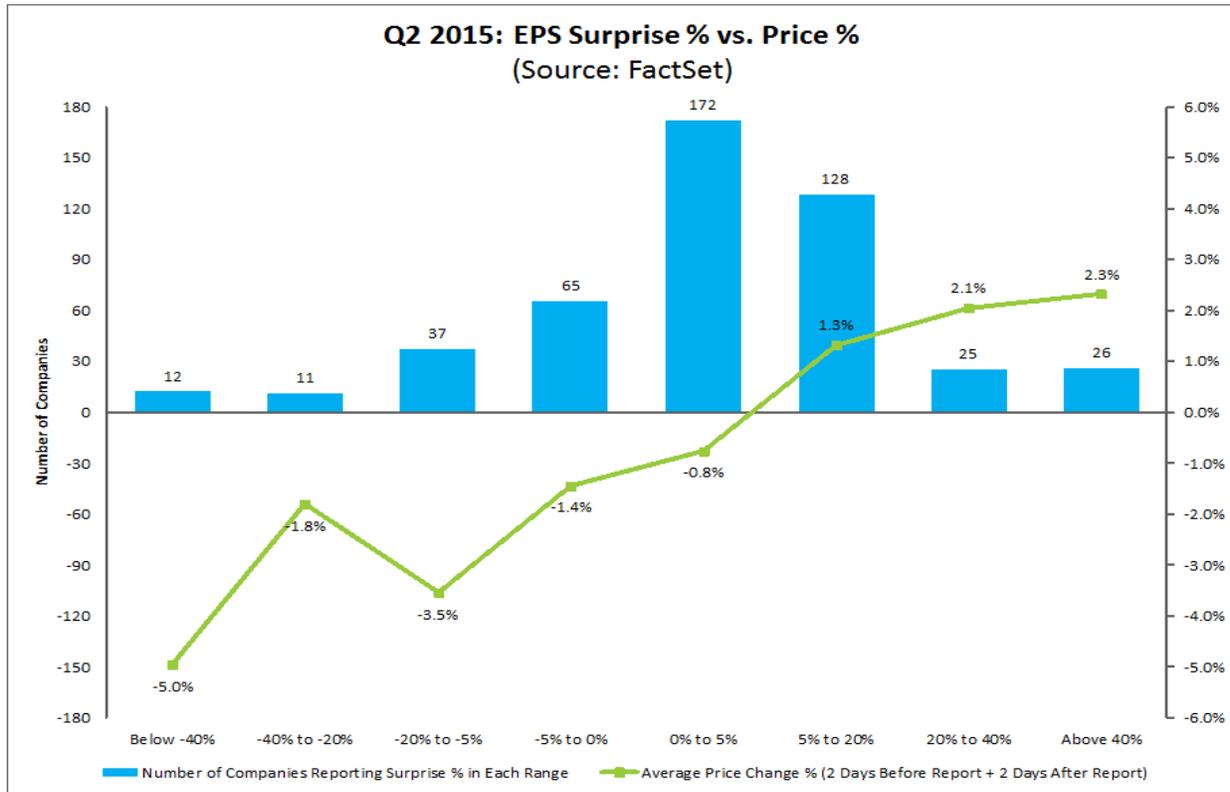
Companies Reporting Next Week: 5

During the upcoming week, 5 S&P 500 companies are scheduled to report results for the second quarter.

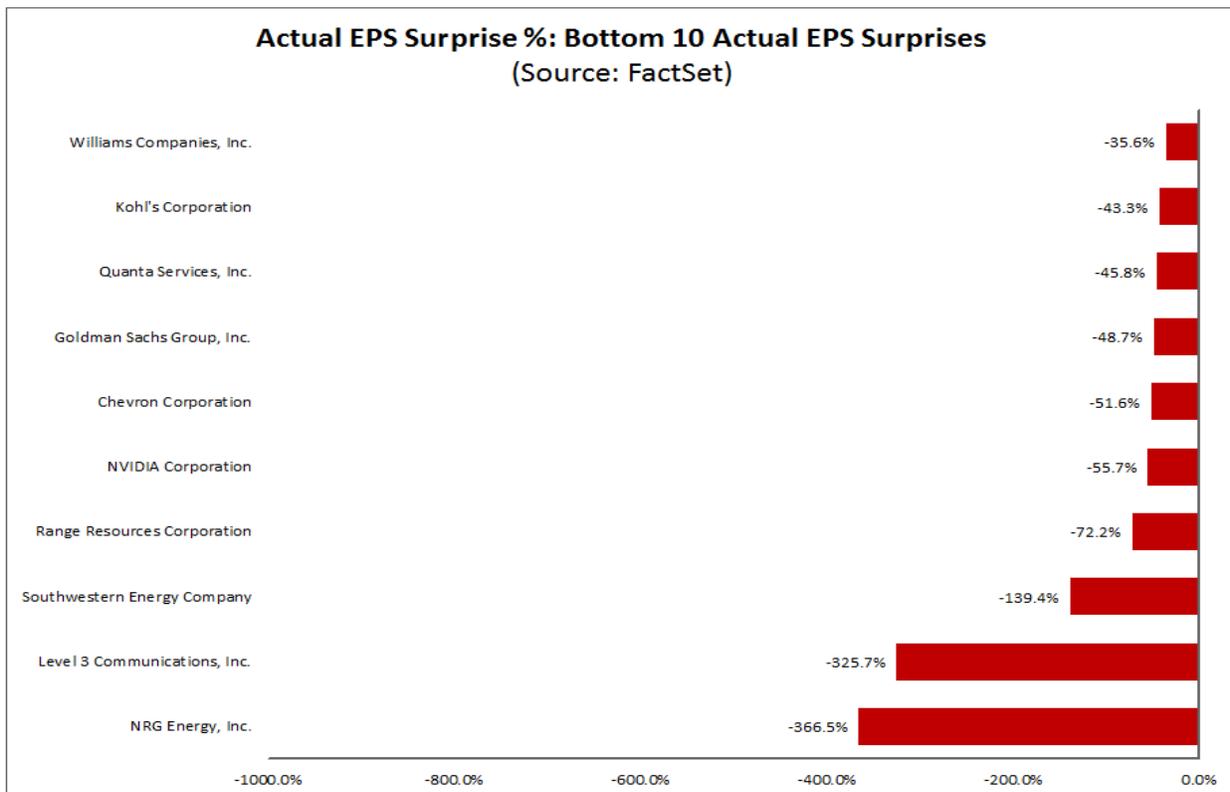
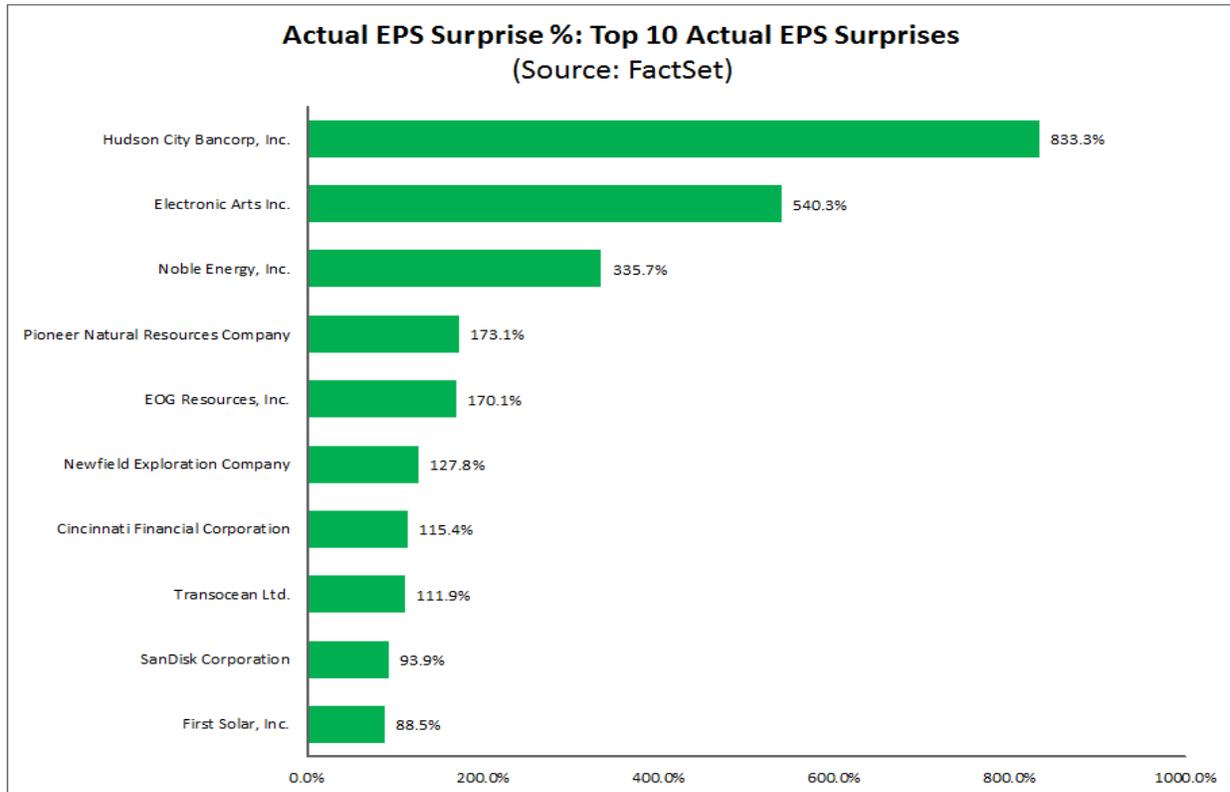
Q2 2015: Scorecard



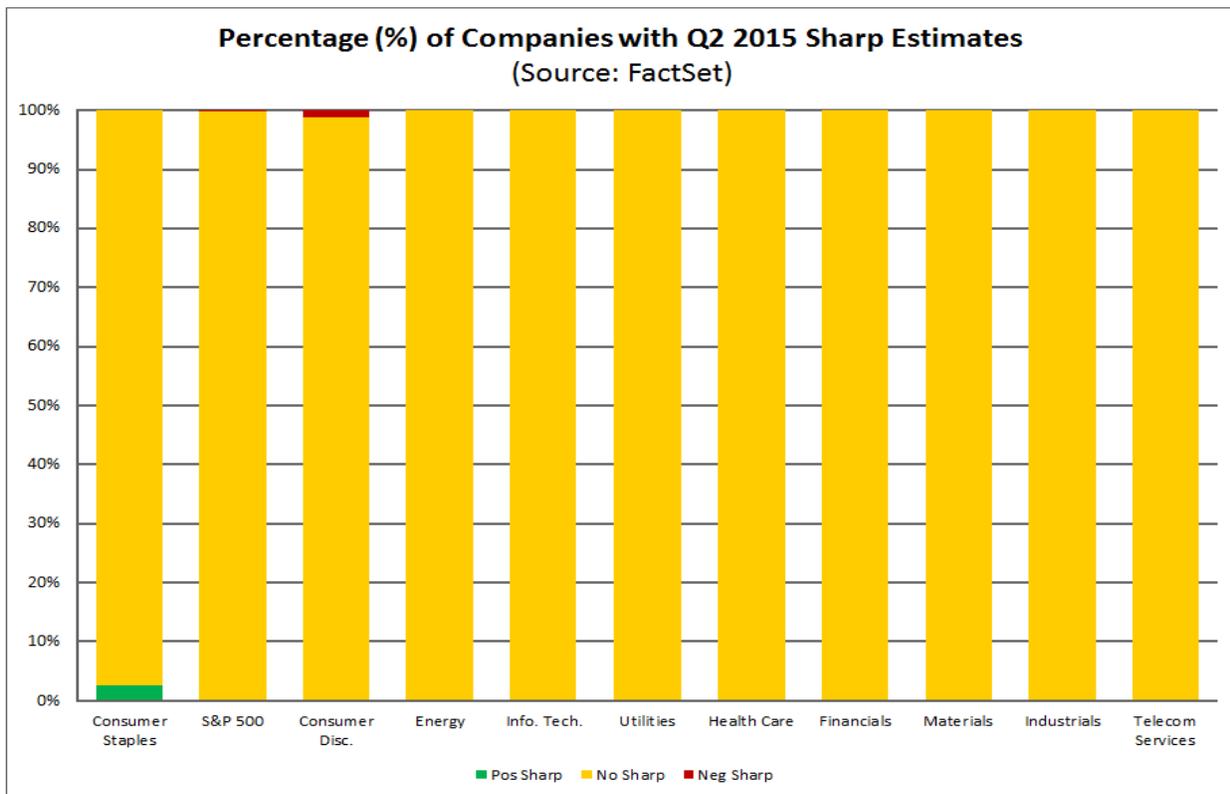
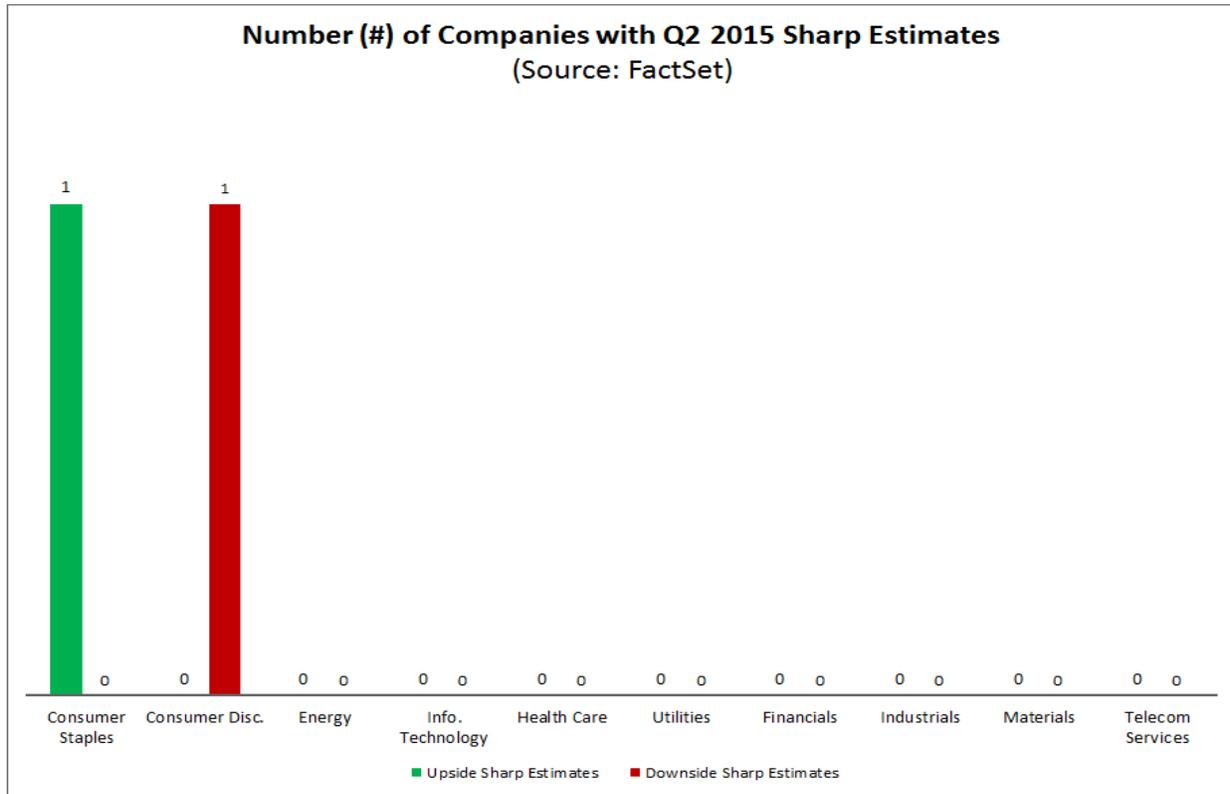
Q2 2015: Scorecard



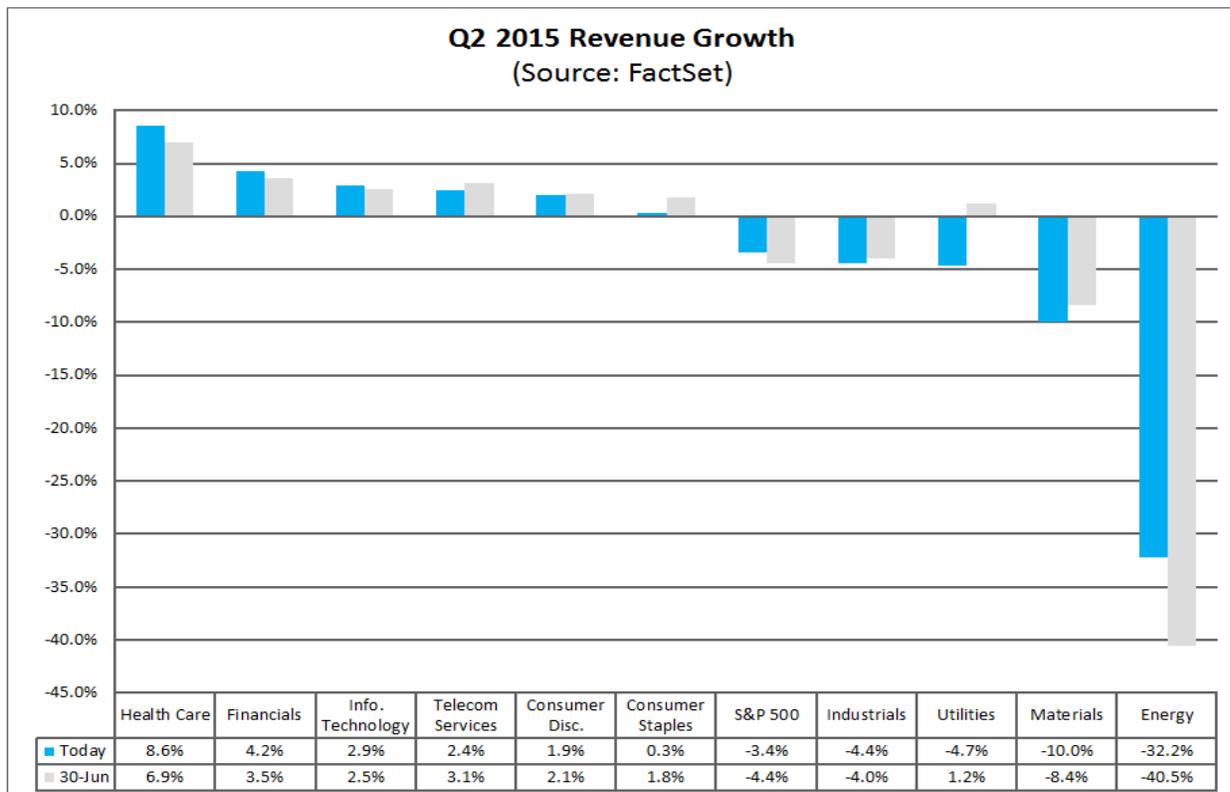
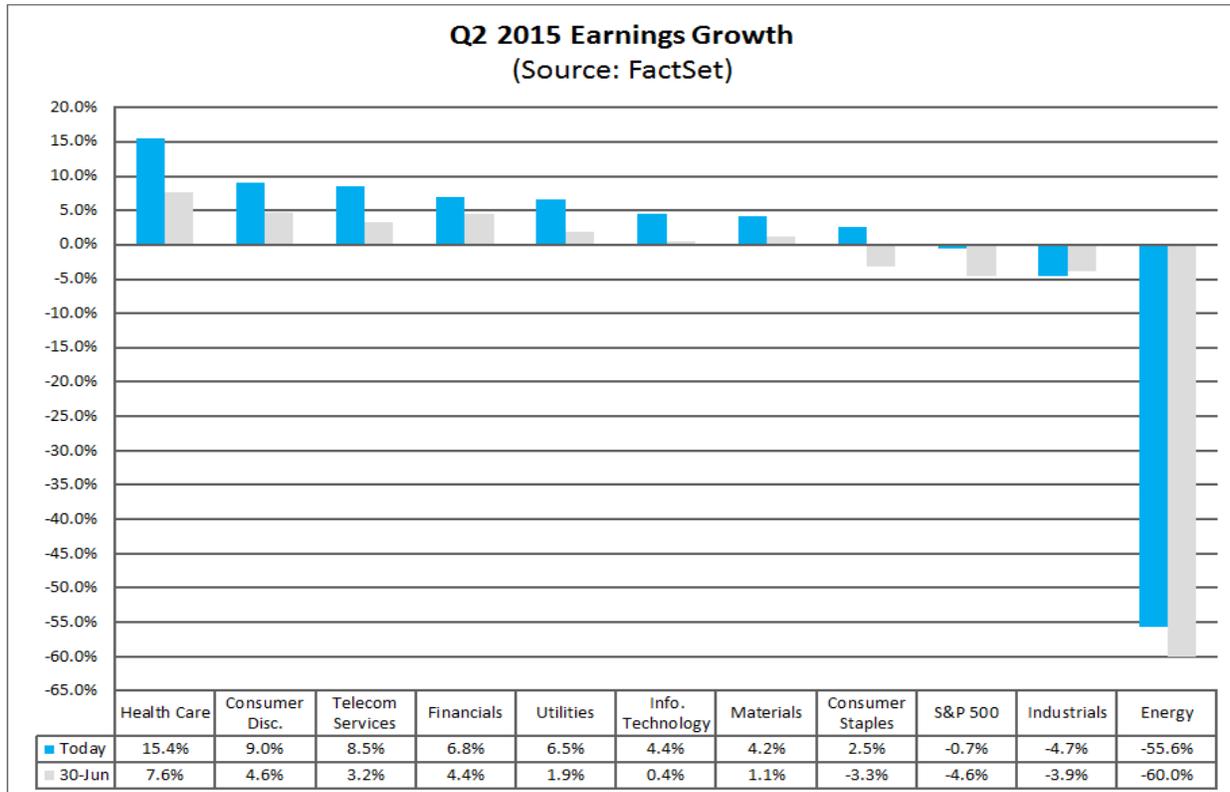
Q2 2015: Scorecard



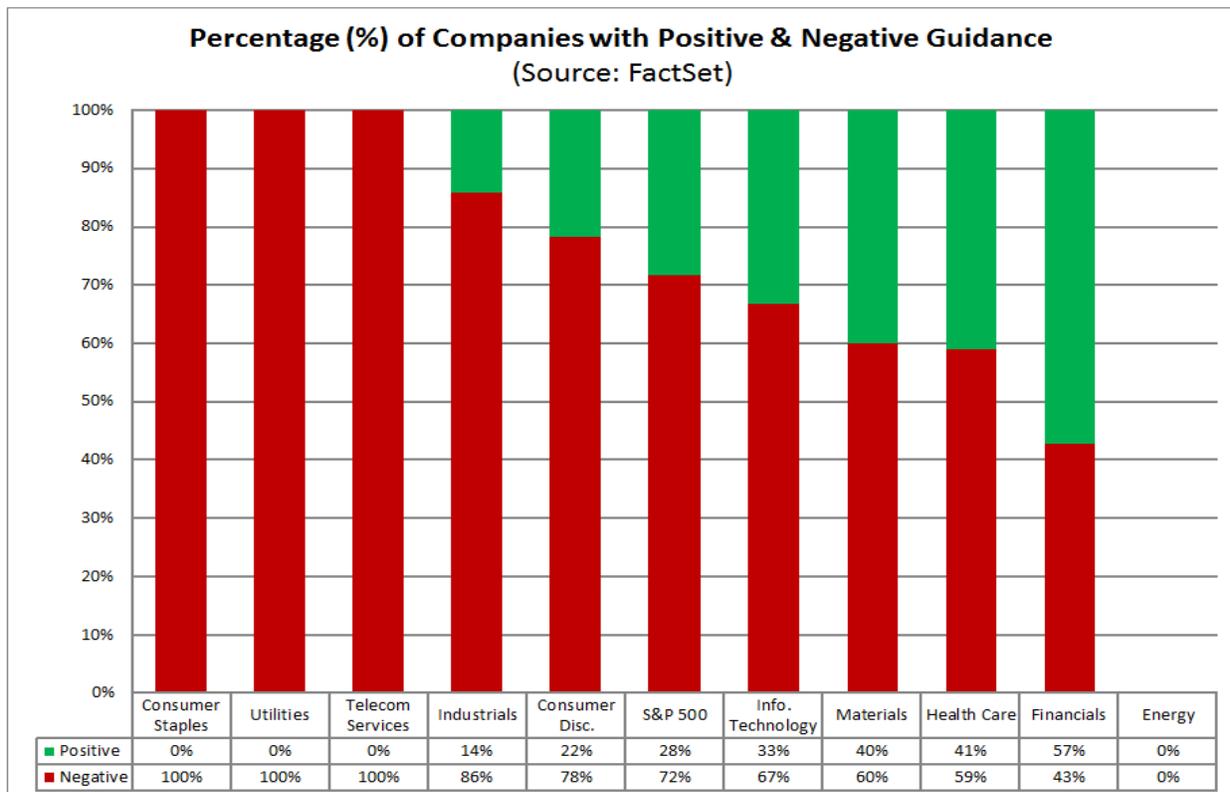
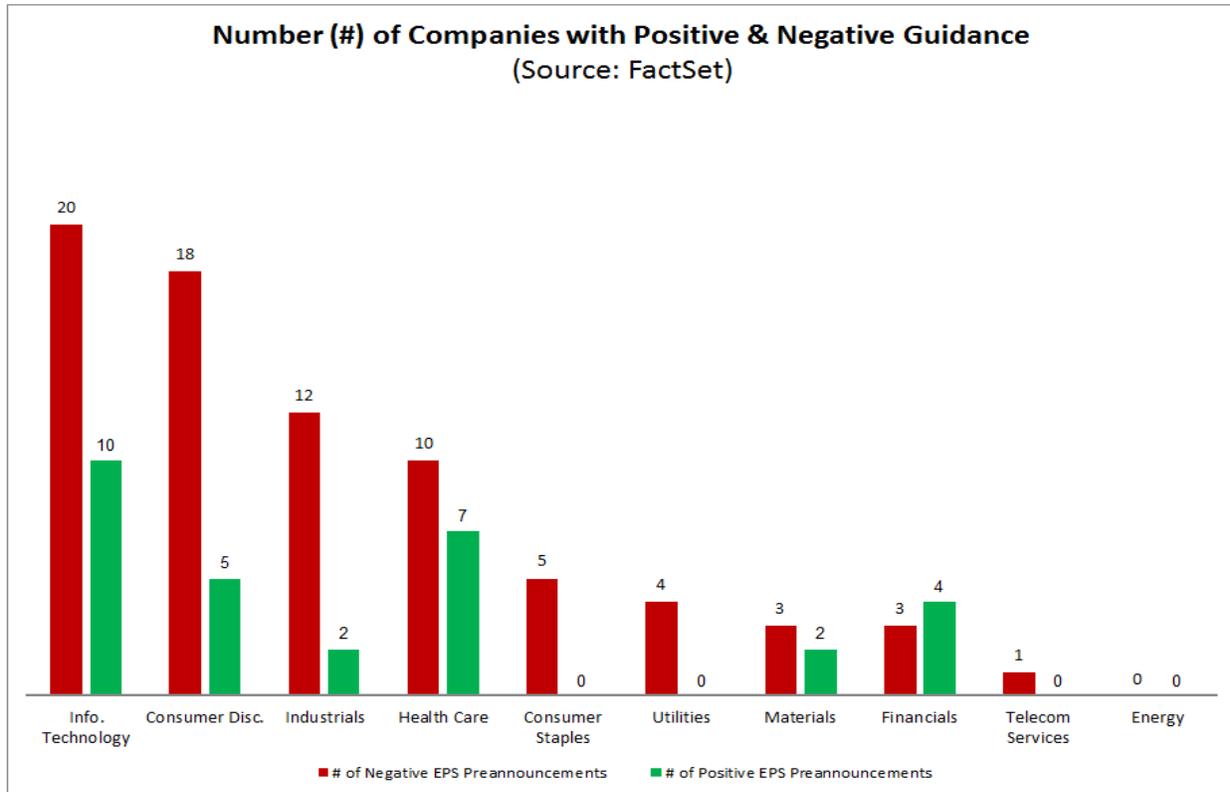
Q2 2015: Projected EPS Surprises (Sharp Estimates)



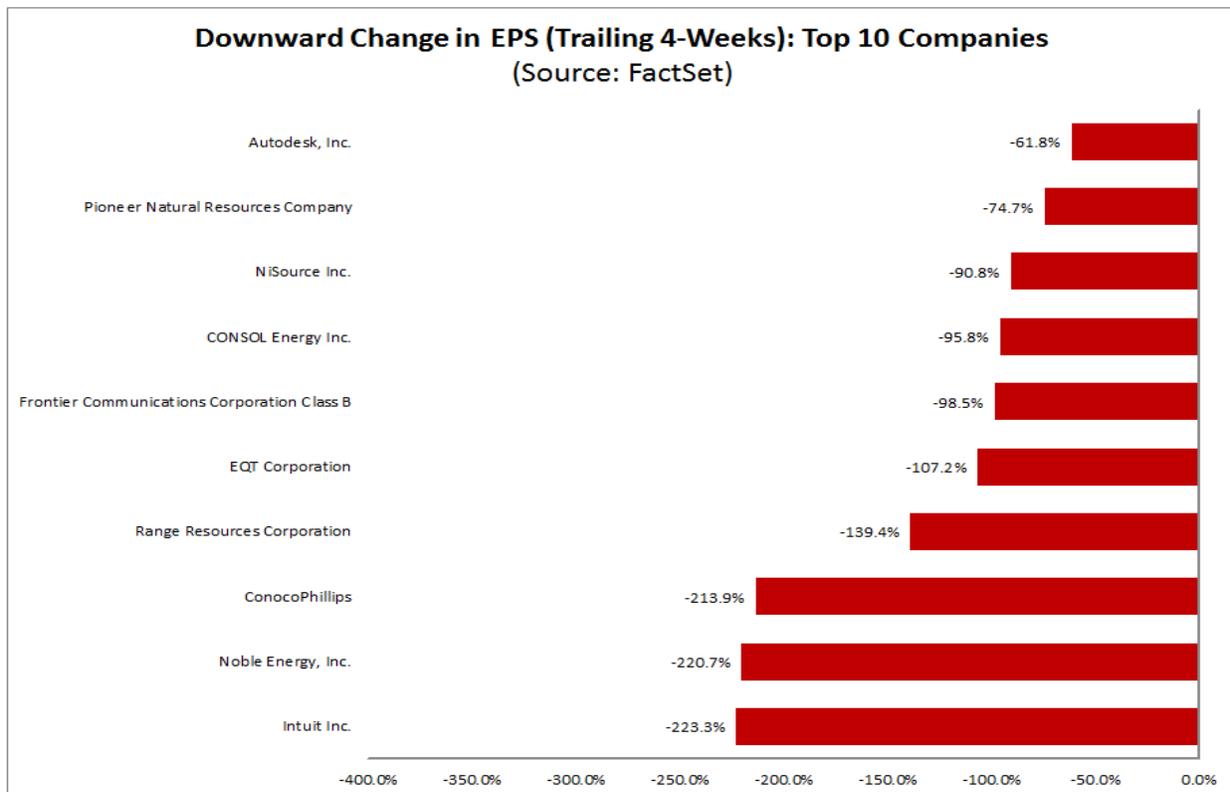
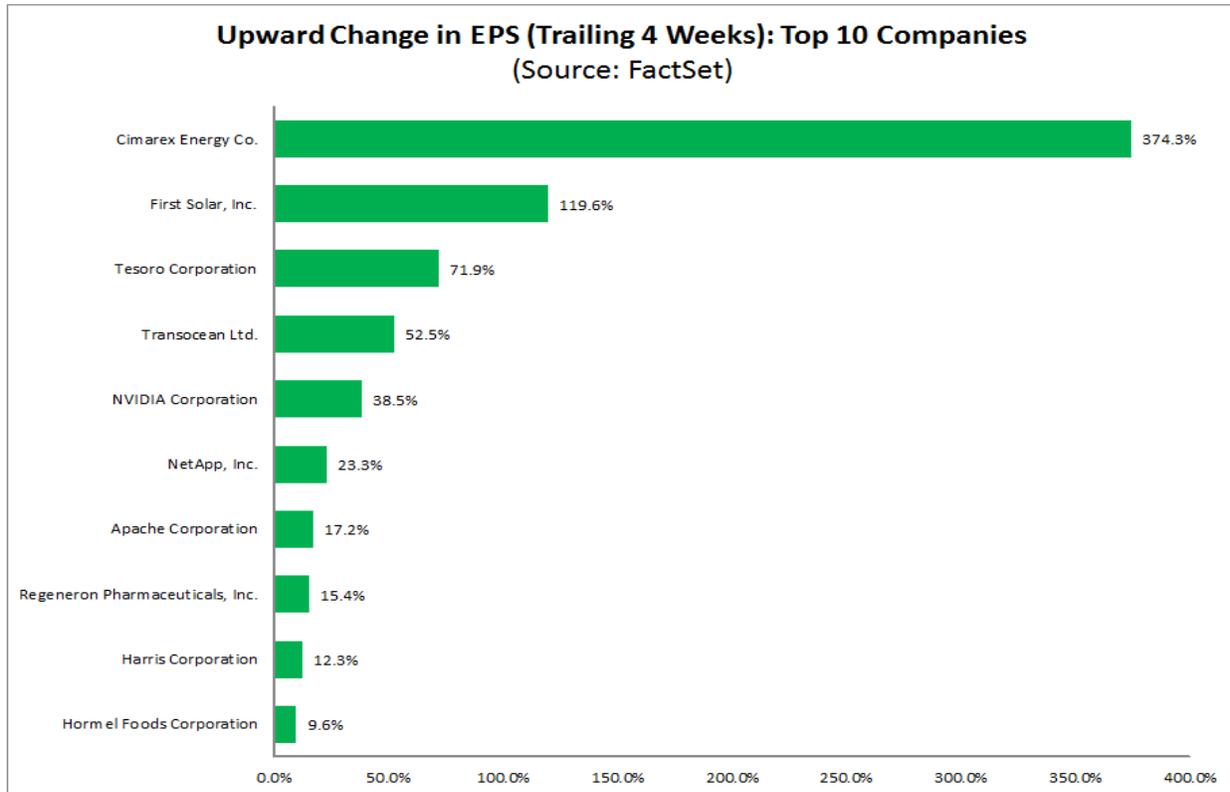
Q2 2015: Growth



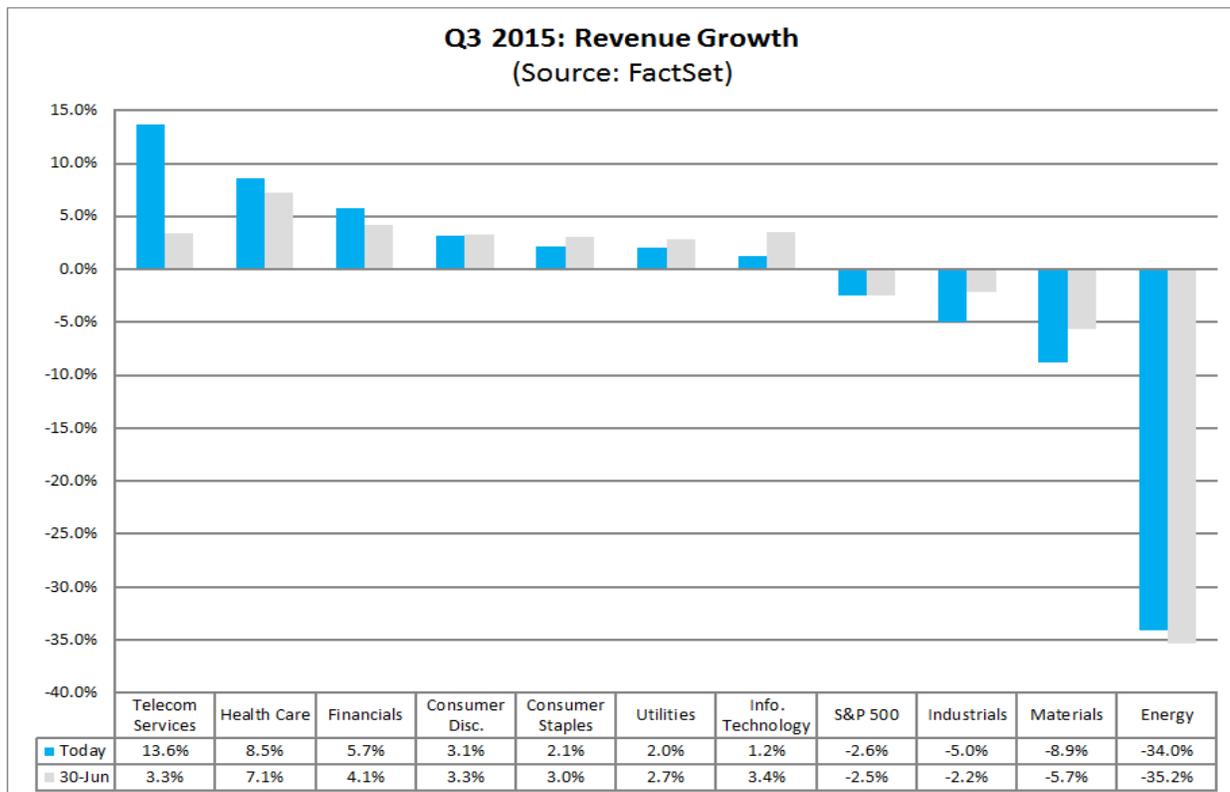
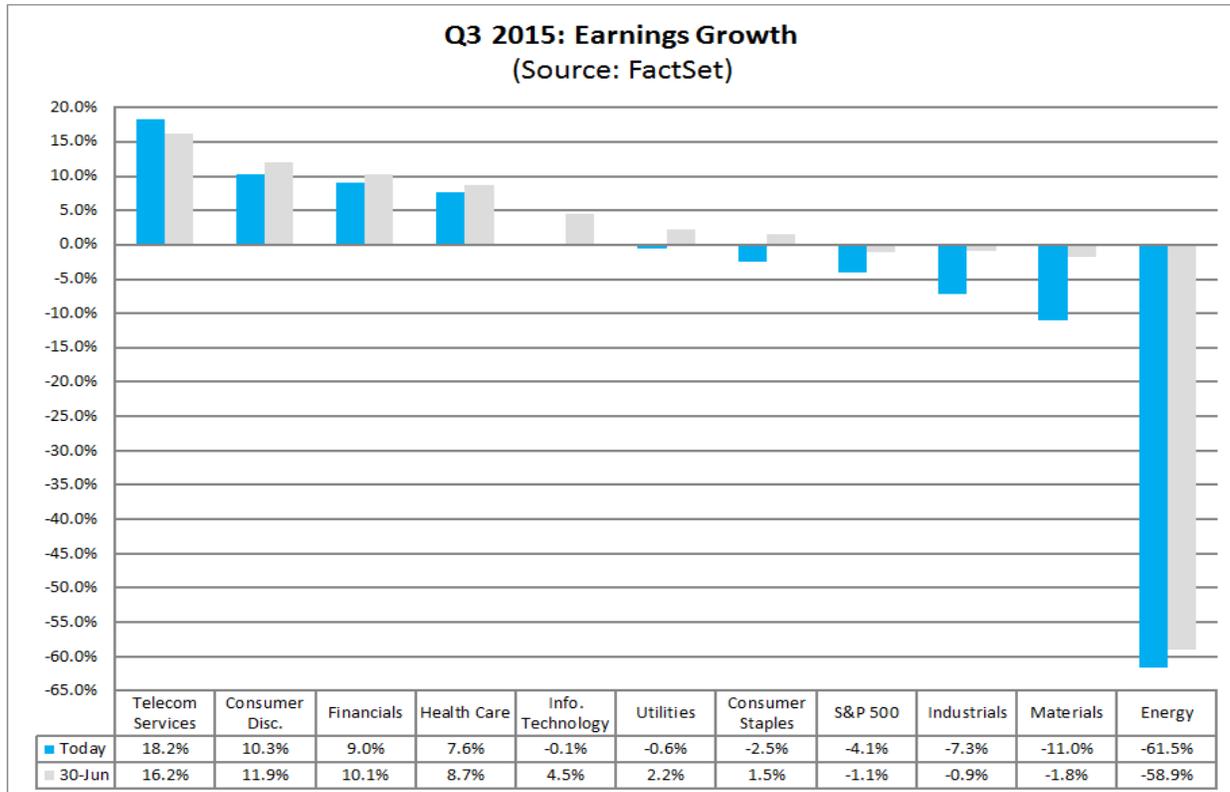
Q3 2015: EPS Guidance



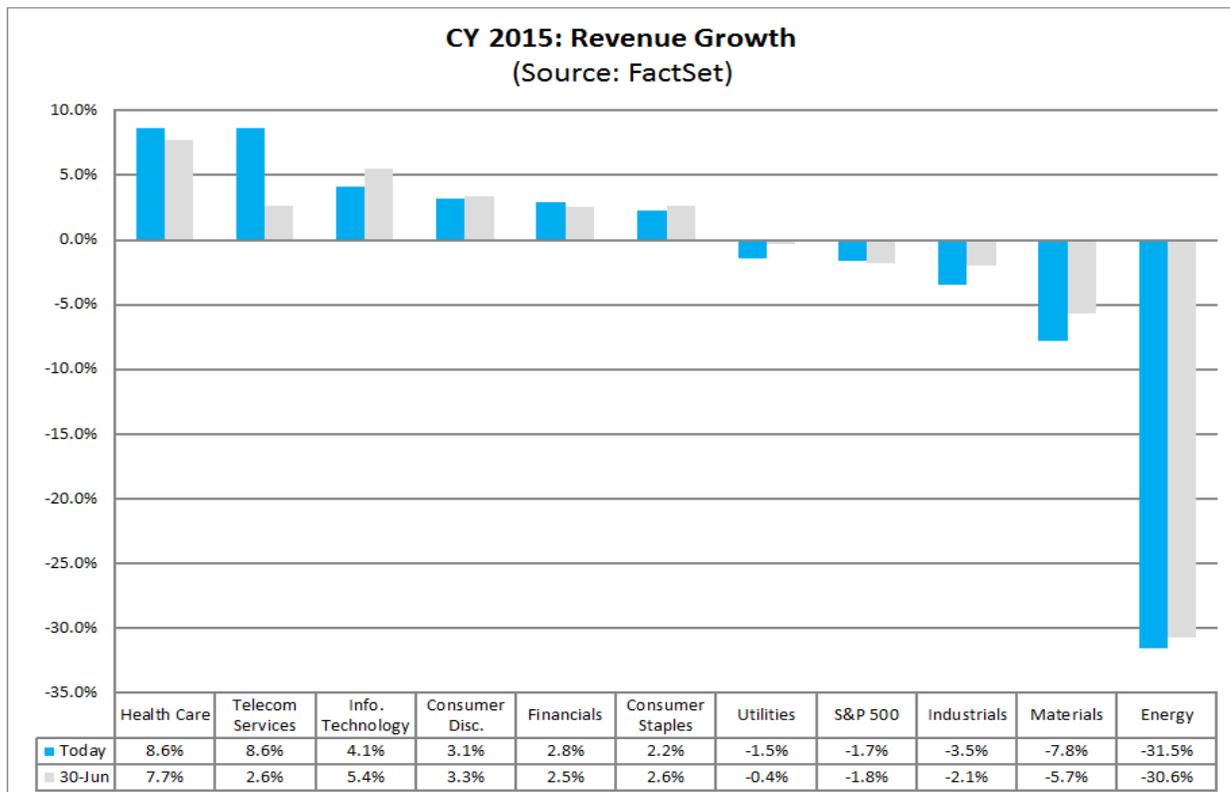
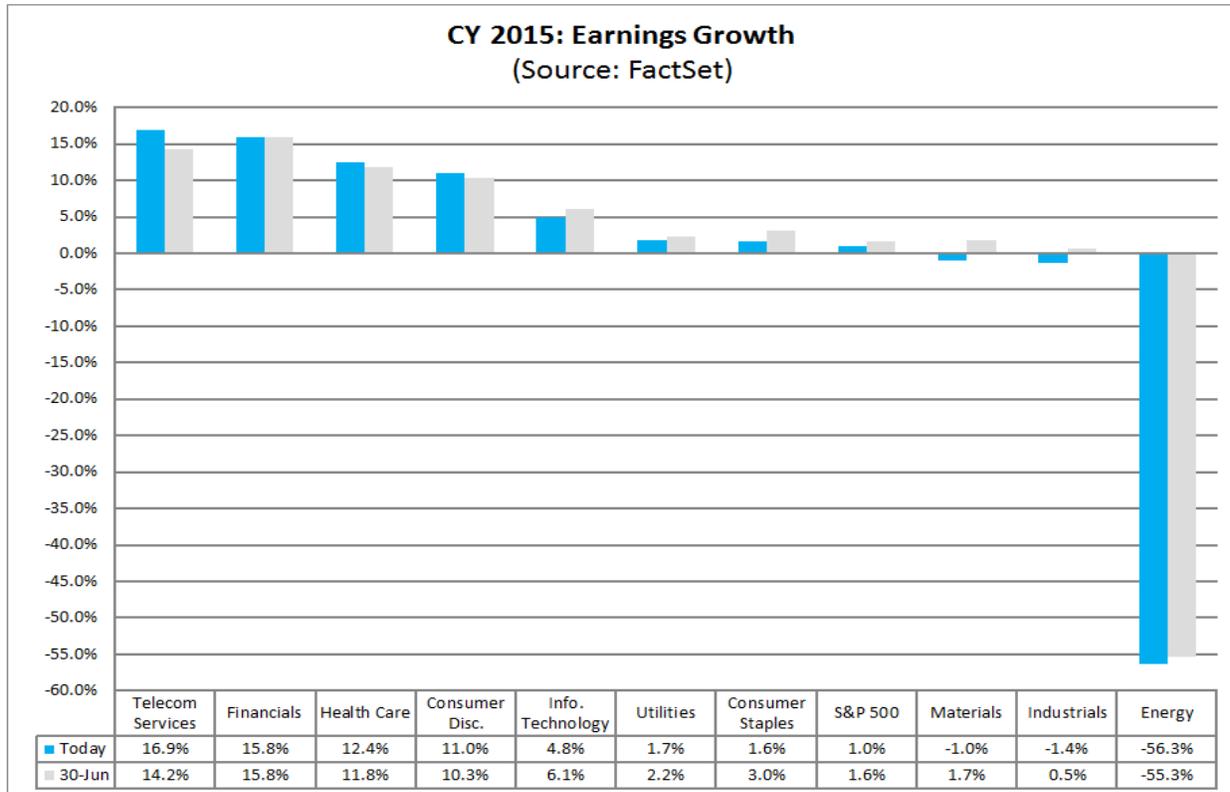
Q3 2015: EPS Revisions



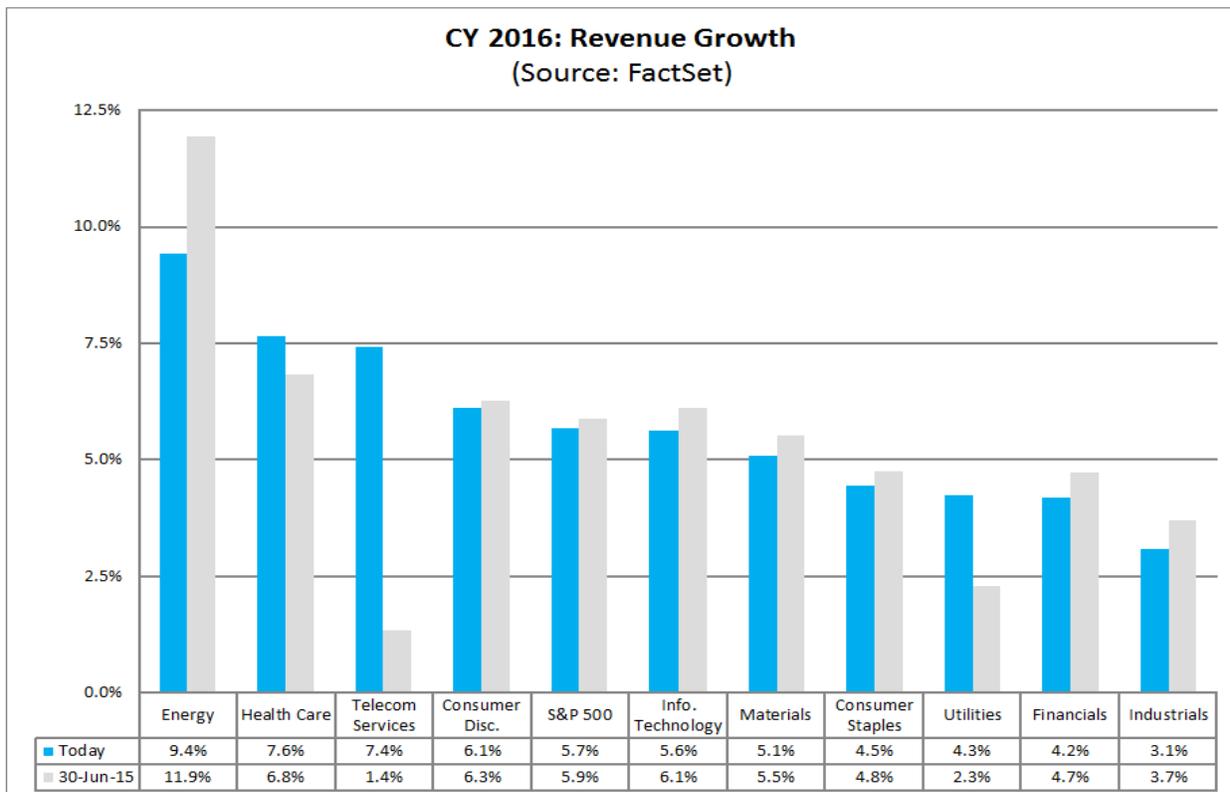
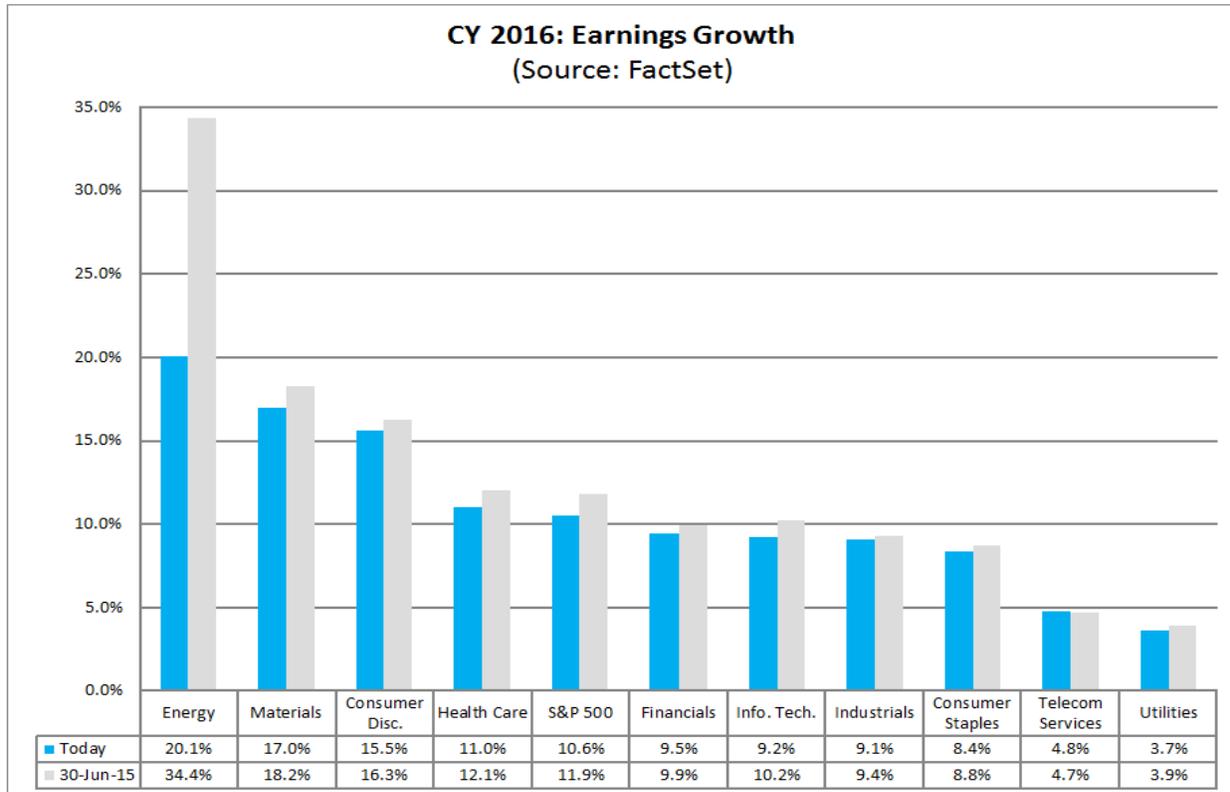
Q3 2015: Growth



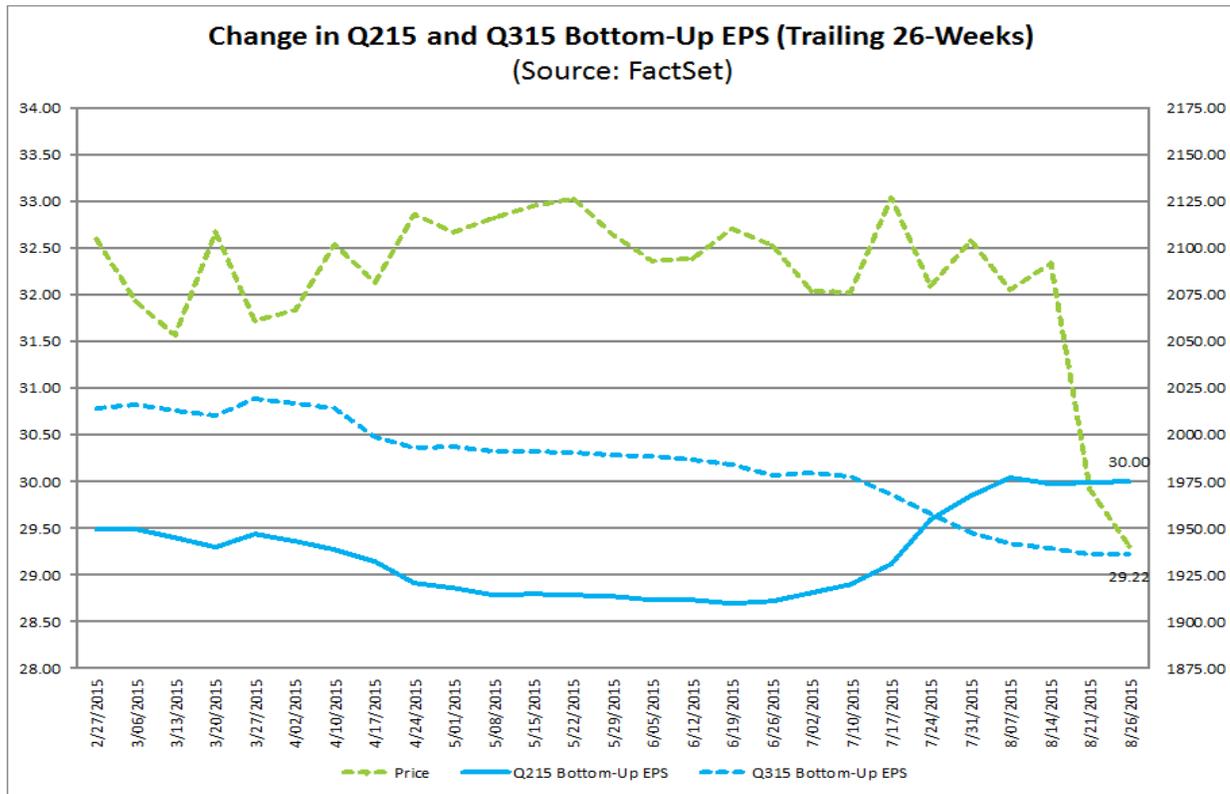
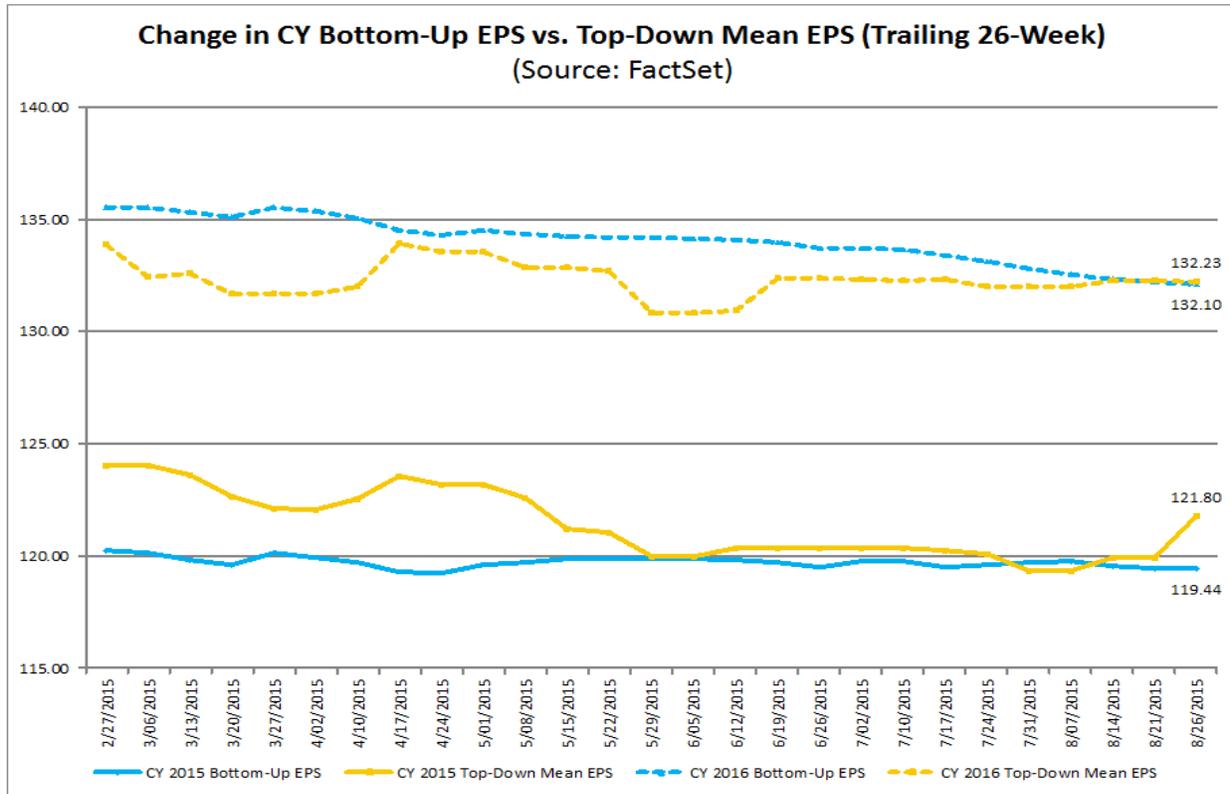
CY 2015: Growth



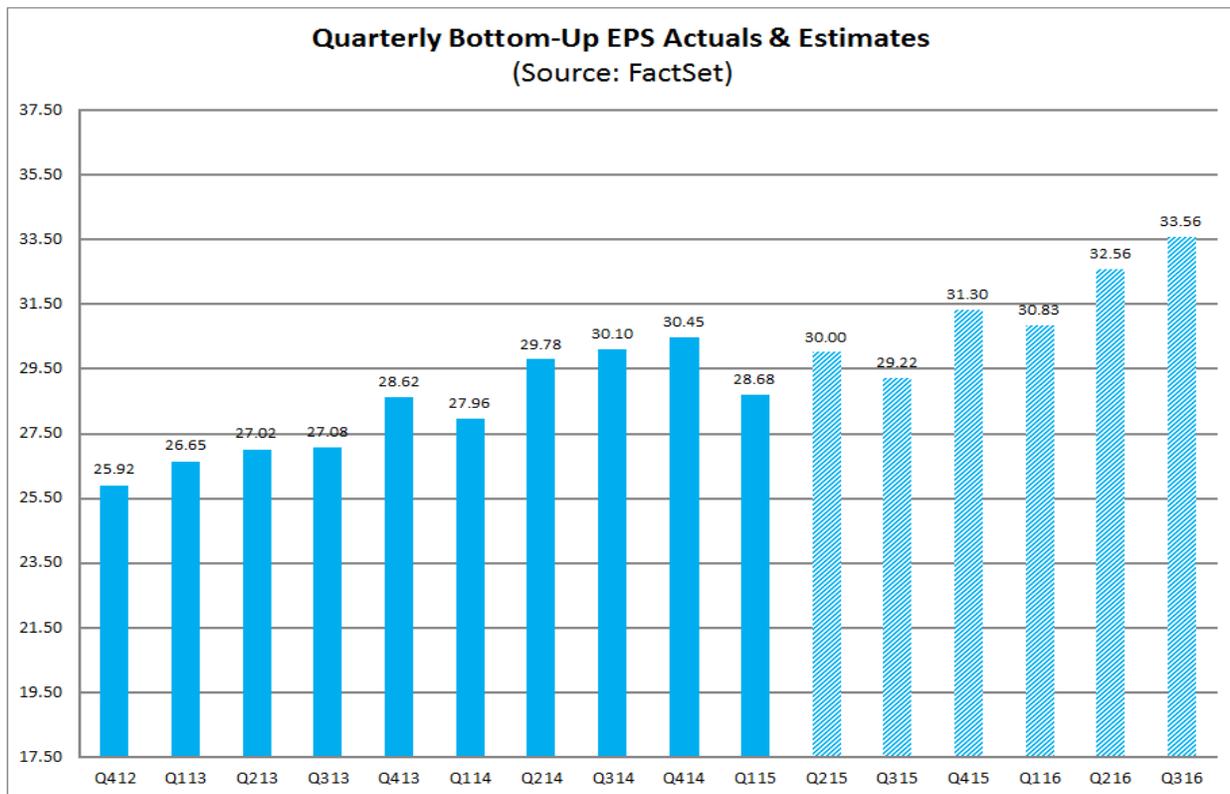
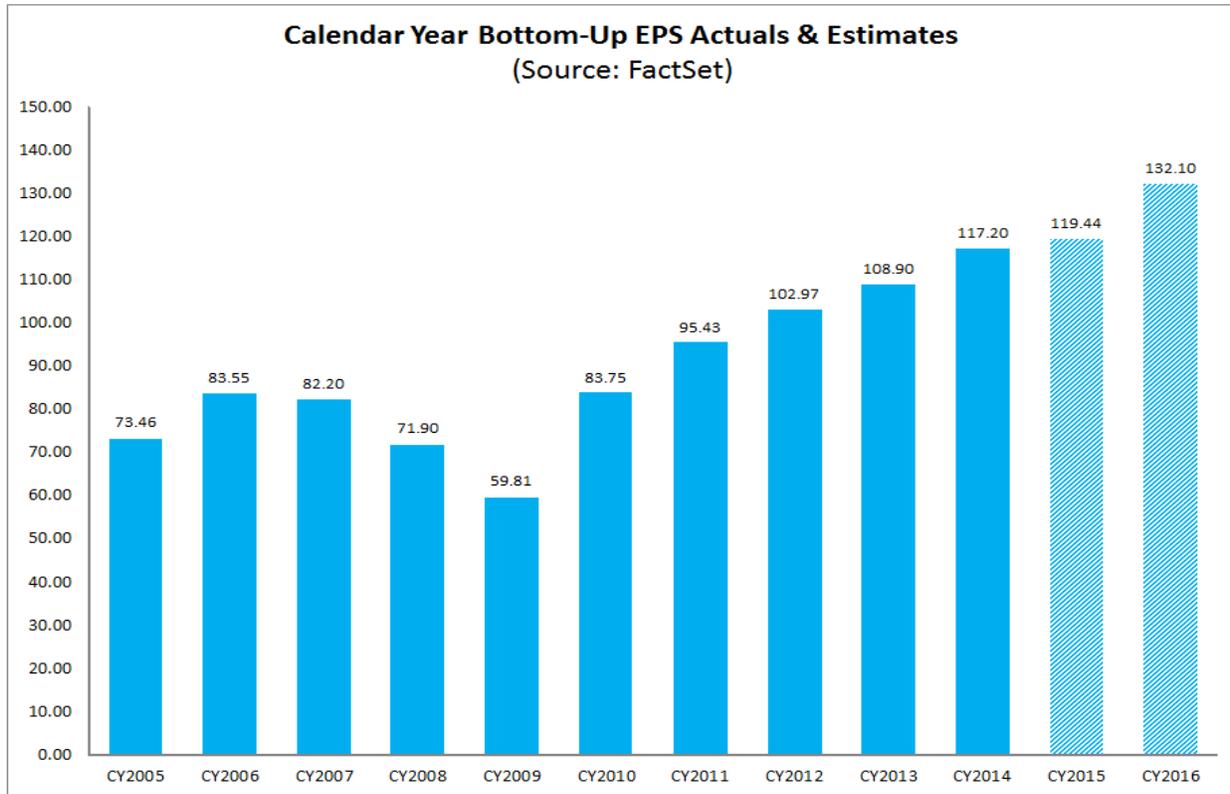
CY 2016: Growth



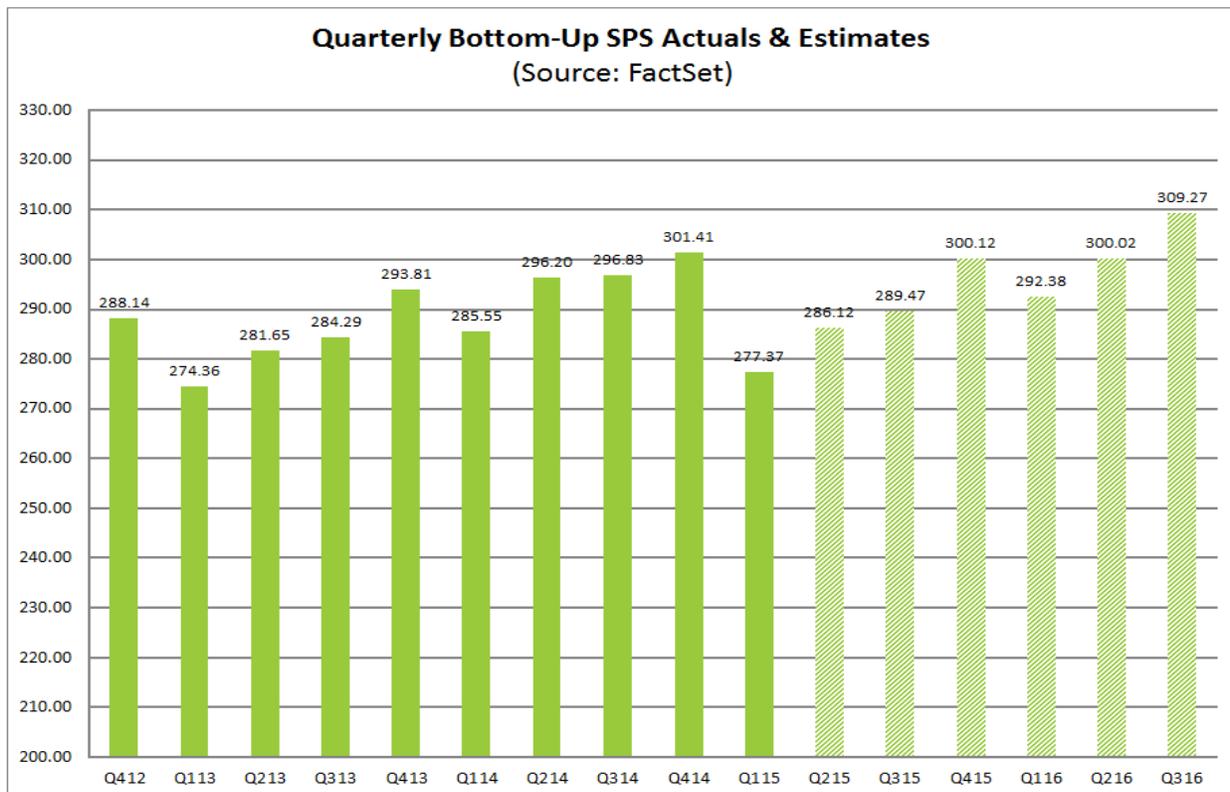
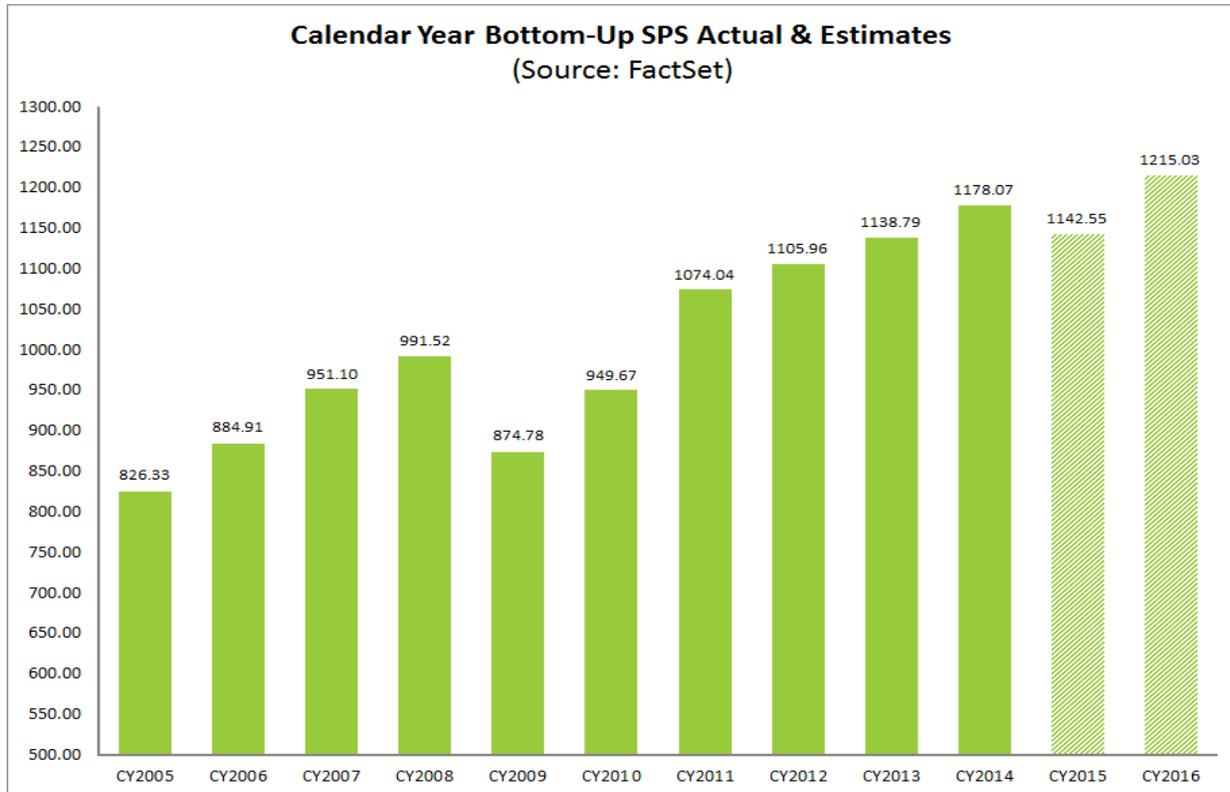
Bottom-up EPS Estimates: Revisions



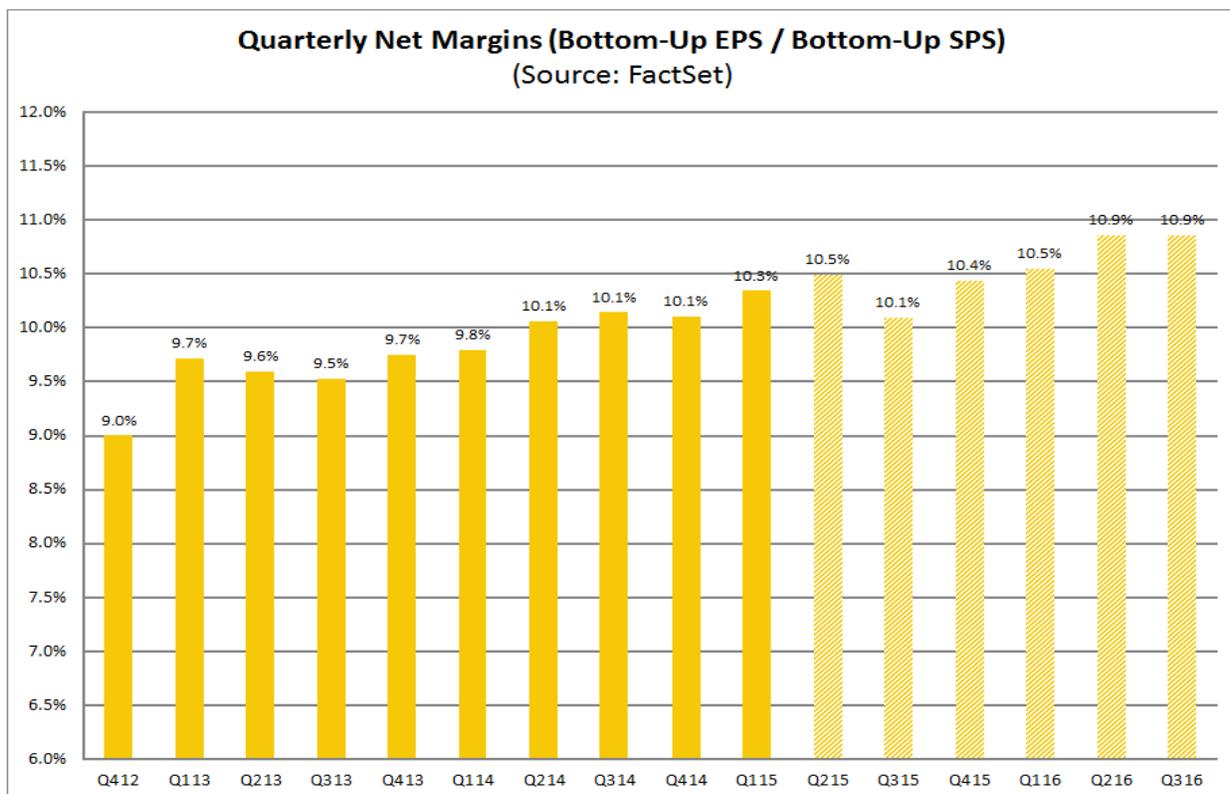
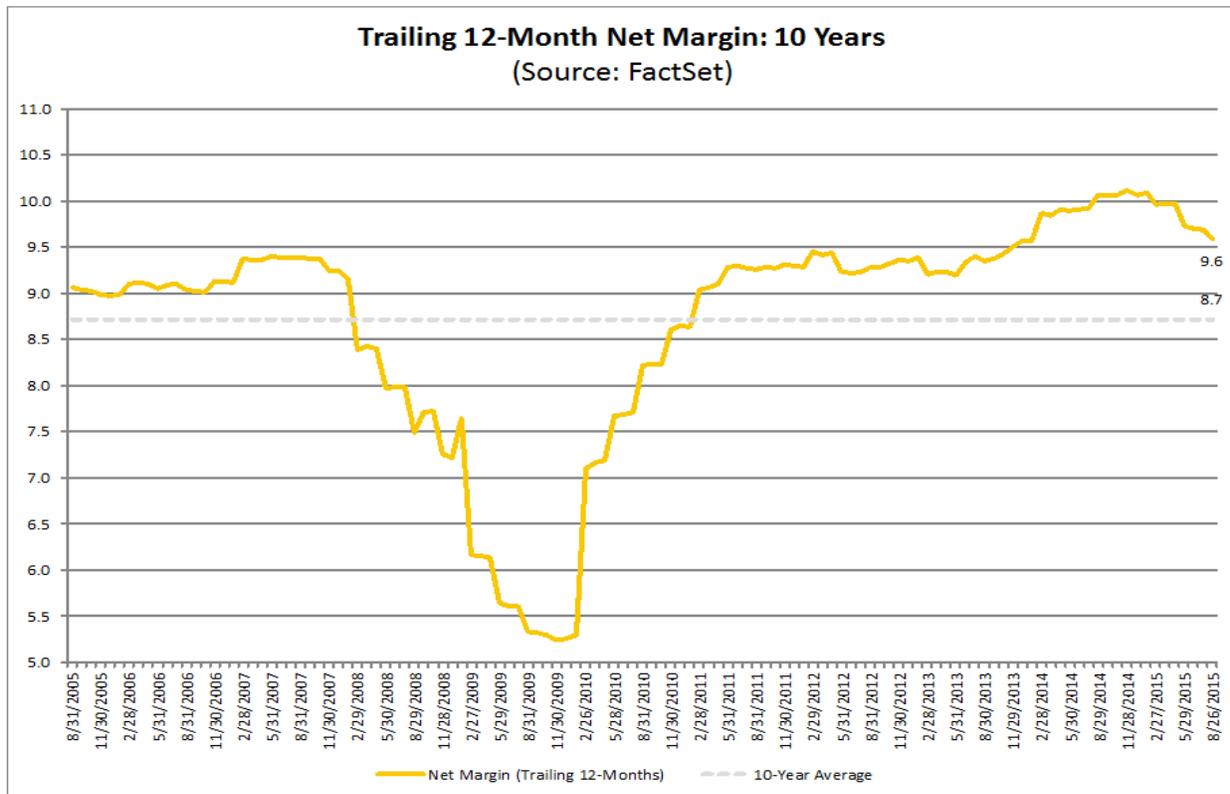
Bottom-up EPS Estimates: Current & Historical



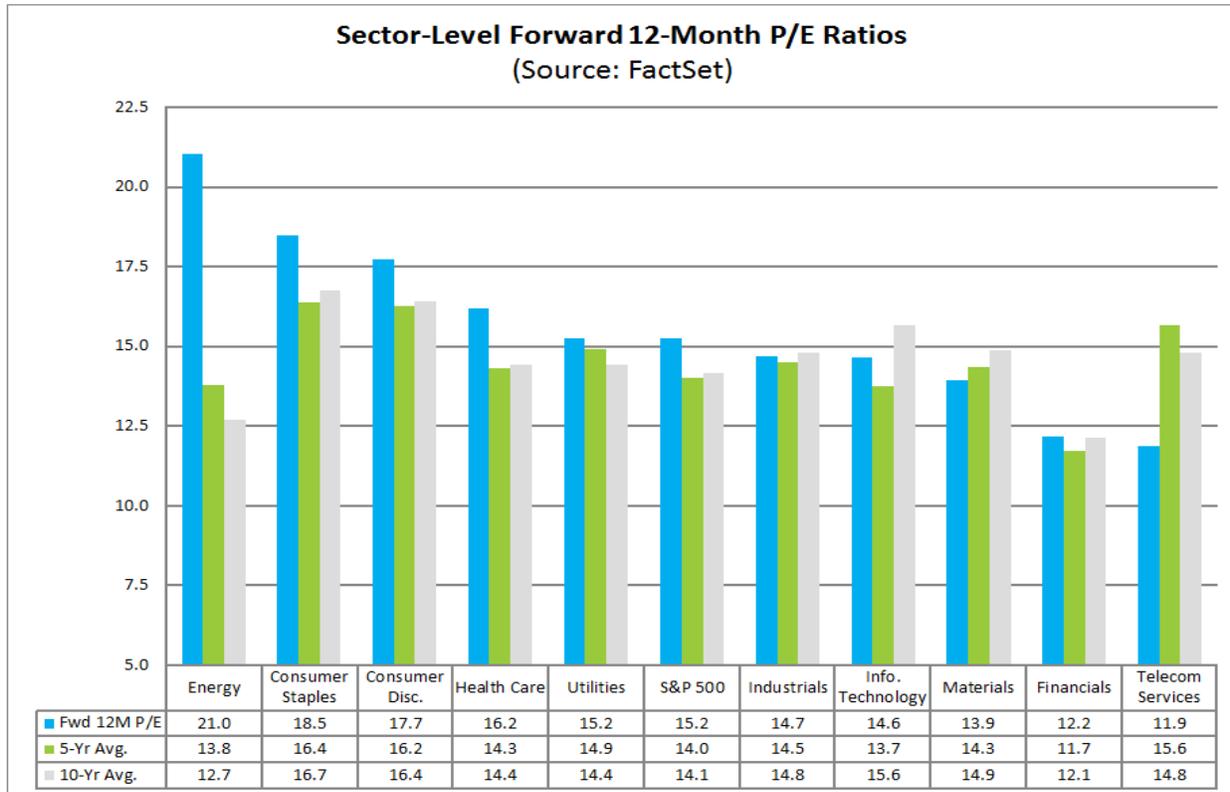
Bottom-up SPS Estimates: Current & Historical



Net Margins: Current & Historical

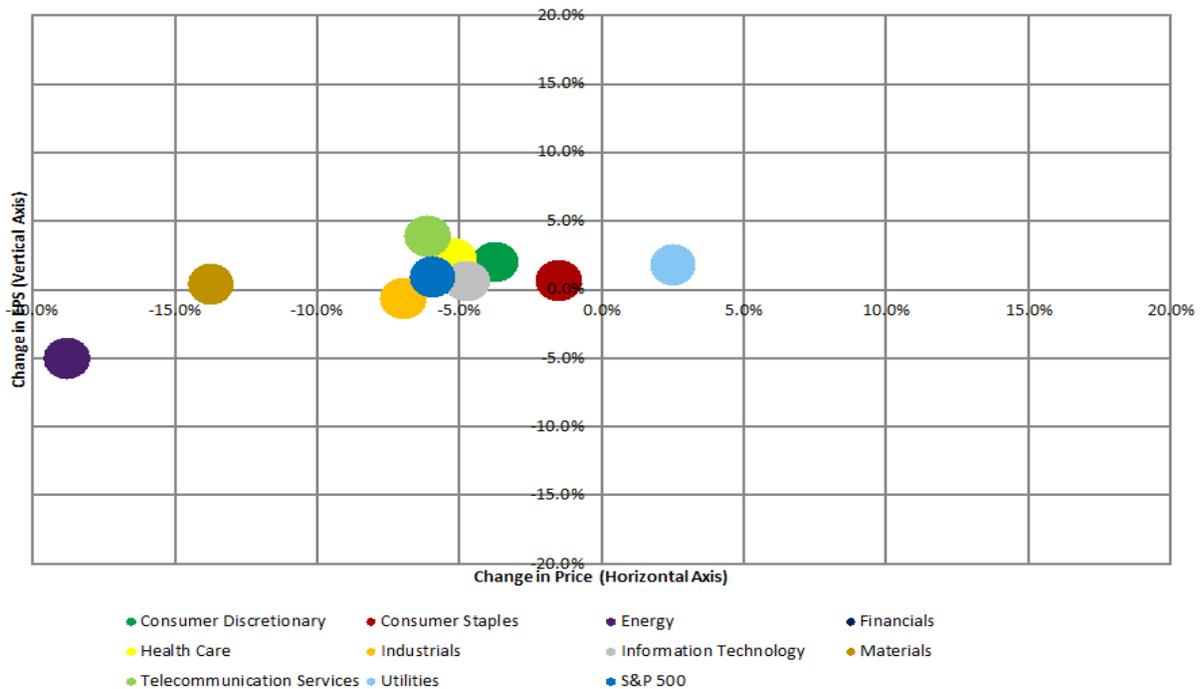


Forward 12M Price / Earnings Ratio: Sector Level

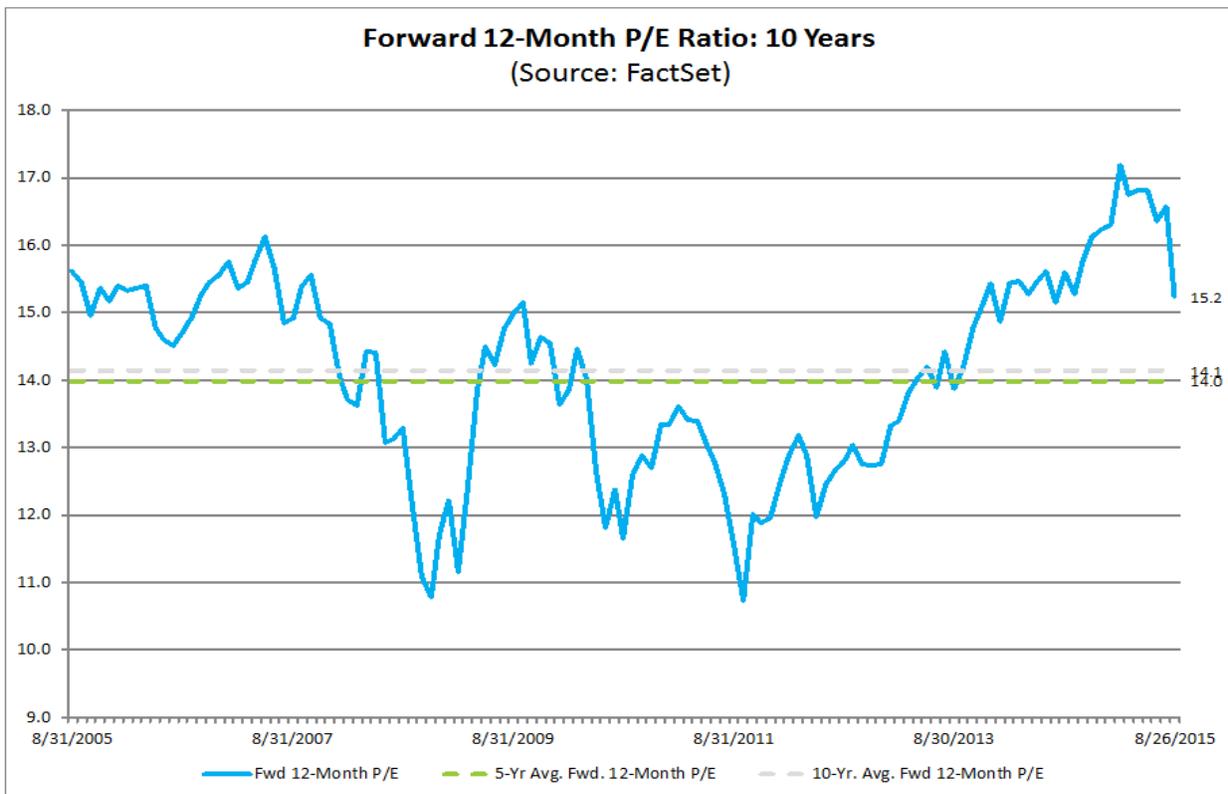
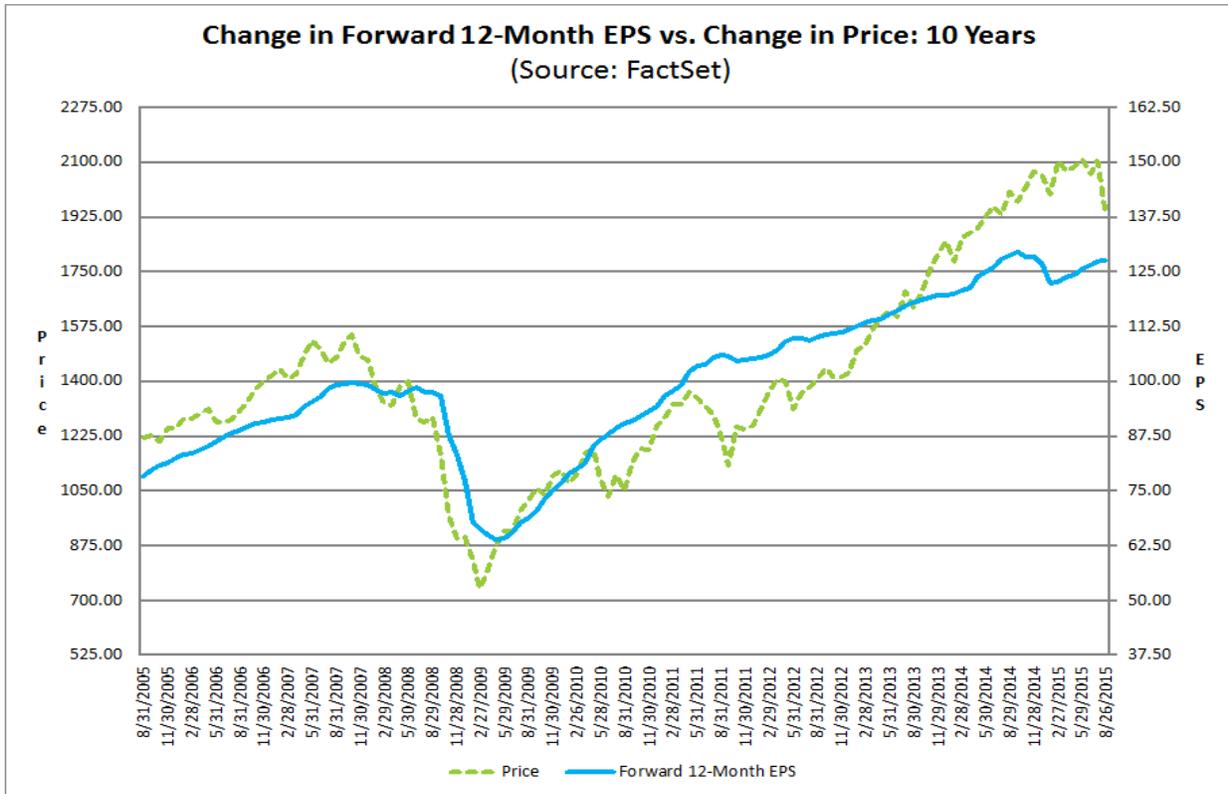


Sector-Level Change in Forward 12-Month EPS vs. Price: Since Jun. 30

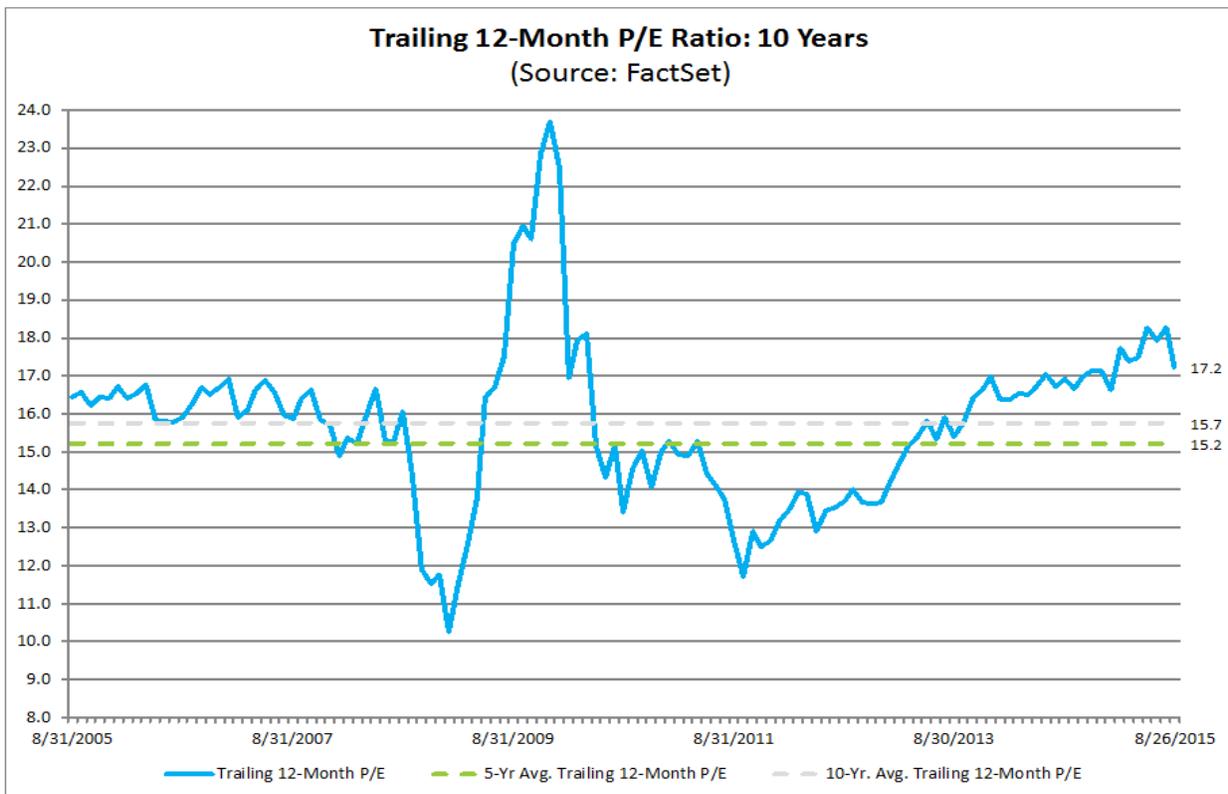
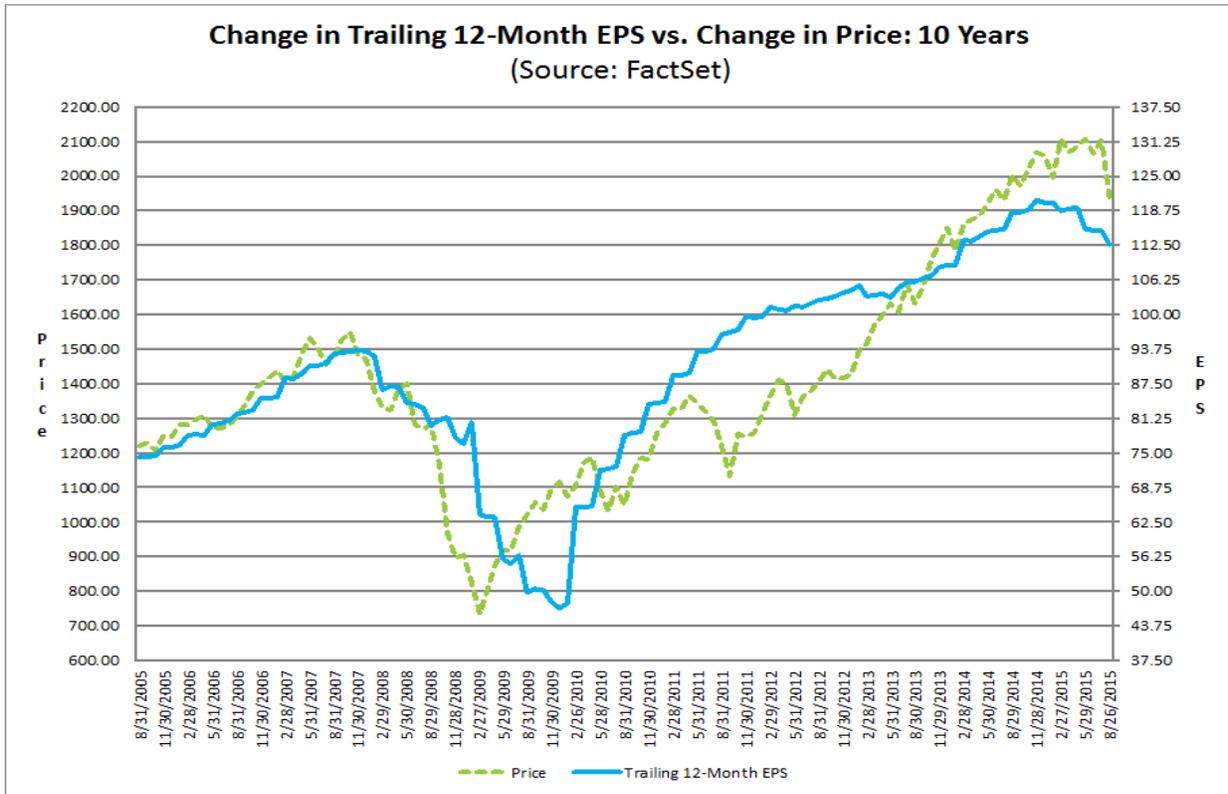
(Source: FactSet)



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



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



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