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An on-line publication by
The Investment Committee

Tracking First Quarter Earnings:

Through the first week of May, 90% of S&P 500 companies have reported their first quarter earnings. Of the 453 companies that have reported, 36% exceeded expectations, 16% were in line with expectations and 48% missed analysts' expectations. Collective earnings per share (EPS) were up just 0.5% versus a year ago, while revenue for the 453 companies declined 3.9%. Does the lack of stellar reports indicate a peak in corporate profits and a sign of an overvalued market or is the data skewed by one-off issues?

Starting with the negatives, the magnitude of lower earnings reports on a year-over-year basis exceeded the scale for those companies that reported higher earnings. For companies that reported lower earnings versus a year ago, the average change was (26%). Companies that reported higher earnings averaged a 19% change versus a year ago. Furthermore, the number of positive earnings surprises is currently tracking lower than the first quarter of 2014, 70.4% versus 67.7%. Negative earnings surprises are on pace to show a 1.6% year-over-year increase to 22.1%.

Despite the negative skew in earnings surprises and in the magnitude of earnings changes, 63% of companies still reported positive earnings growth versus a year ago. Also, a majority of the negative earnings skew can be attributed to a massive decline in energy company earnings, which declined 54.0% versus last year (Table 1). The sector subtracted 3% from the S&P 500 Index's EPS growth.

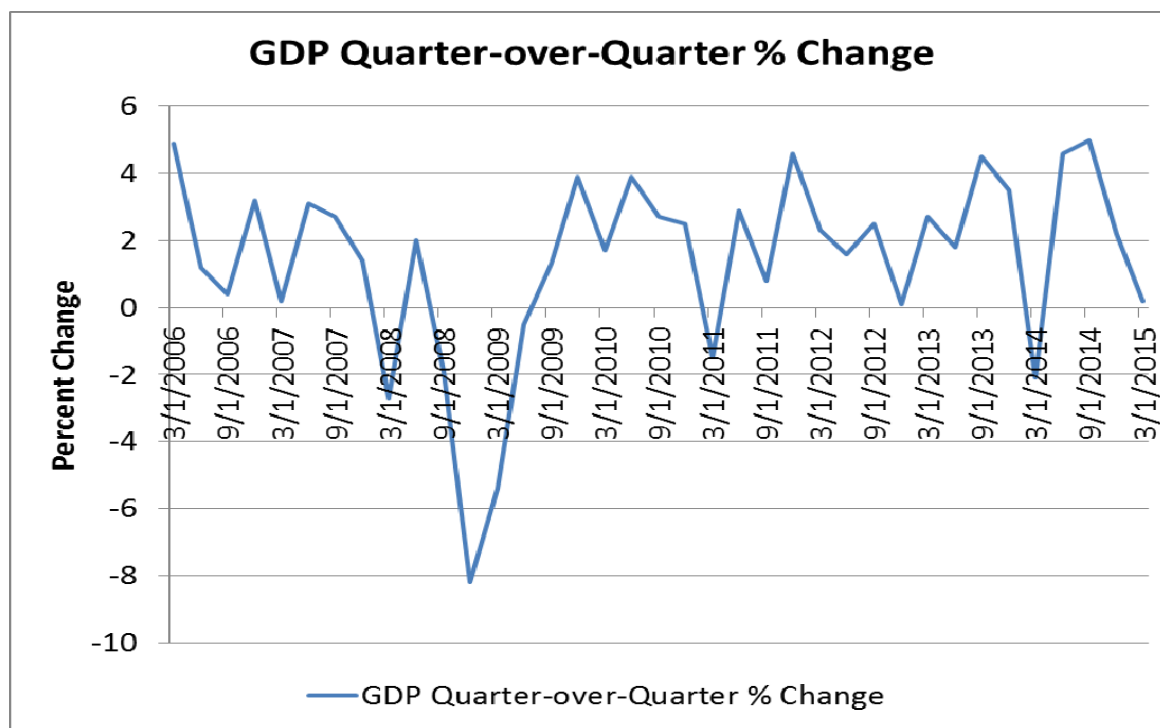
The first quarter results may also be considered fairly positive when considered in the context of how weak the economy was in the first quarter (Chart 1). The weak economic data points may have actually helped lower investor expectations heading into earnings season, as the consensus S&P 500 Index EPS target for the quarter declined from around \$30.00 per share at the start of the year to \$27.00 at the start of April. By lowering the bar, the market was able to discount some of the negative earnings skew in advance and avoid a massive disappointment and subsequent sell-off.

While the lack of first quarter luster may be explained by several one-off issues and the market remains fairly valued, the biggest concern continues to be the ability of corporations to continue to drive earnings growth despite tepid revenue growth. Earnings for the S&P 500 Index are expected to grow 4% in 2015 but revenue is anticipated to decline 0.6%. While this dynamic is nothing new, investors may be more complacent to the risks associated with Corporate America's ability to control costs and execute share repurchase programs as a means to boost earnings versus traditional earnings growth from stronger sales. Any global economic slowdown could reveal the risks to this type of financial engineering and put the market under greater strain to justify the current valuations.

Table 1

| | Reported/Total | Share-Weighted % Change | Positive Earnings Surprise | Negative Earnings Surprise | Sector EPS |
|----------------------------|------------------|-------------------------|----------------------------|----------------------------|----------------|
| Consumer Discretionary | 63 / 84 | 4.7% | 42 | 16 | \$2.71 |
| Consumer Staples | 32 / 38 | 4.7% | 24 | 5 | \$2.31 |
| Energy | 41 / 41 | (54.0%) | 29 | 9 | \$1.56 |
| Financials | 86 / 86 | 7.4% | 55 | 16 | \$6.32 |
| Healthcare | 51 / 55 | 18.5% | 39 | 7 | \$4.29 |
| Industrials | 61 / 65 | 8.5% | 39 | 17 | \$2.82 |
| Information Technology | 55 / 66 | 8.1% | 37 | 12 | \$5.72 |
| Materials | 28 / 29 | (5.3%) | 15 | 12 | \$0.94 |
| Telecommunication Services | 6 / 6 | 14.5% | 4 | 1 | \$0.91 |
| Utilities | 30 / 30 | 4.0% | 21 | 7 | \$1.05 |
| Total | 453 / 500 | 0.5% | 293 | 98 | \$28.63 |

Chart 2



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