

 Earnings bulletin

## 2Q24 Earnings: Bring on the broadening

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### In brief:

- Economic growth may be slowing, but earnings are still growing.
- Only 56% of companies have beat on revenues, compared to an average of 60% over the last four quarters.
- This quarter, for the first time since 2022, the S&P 493 is set to experience positive y/y earnings growth of 5.7%.
- Once again, the Information Technology sector is on track to contribute the majority of y/y EPS growth at 17.5%, though this would represent a -2.3% decline from last quarter.
- As momentum unwinds, investors need to think carefully about how to manage this active bet in their passive exposure.

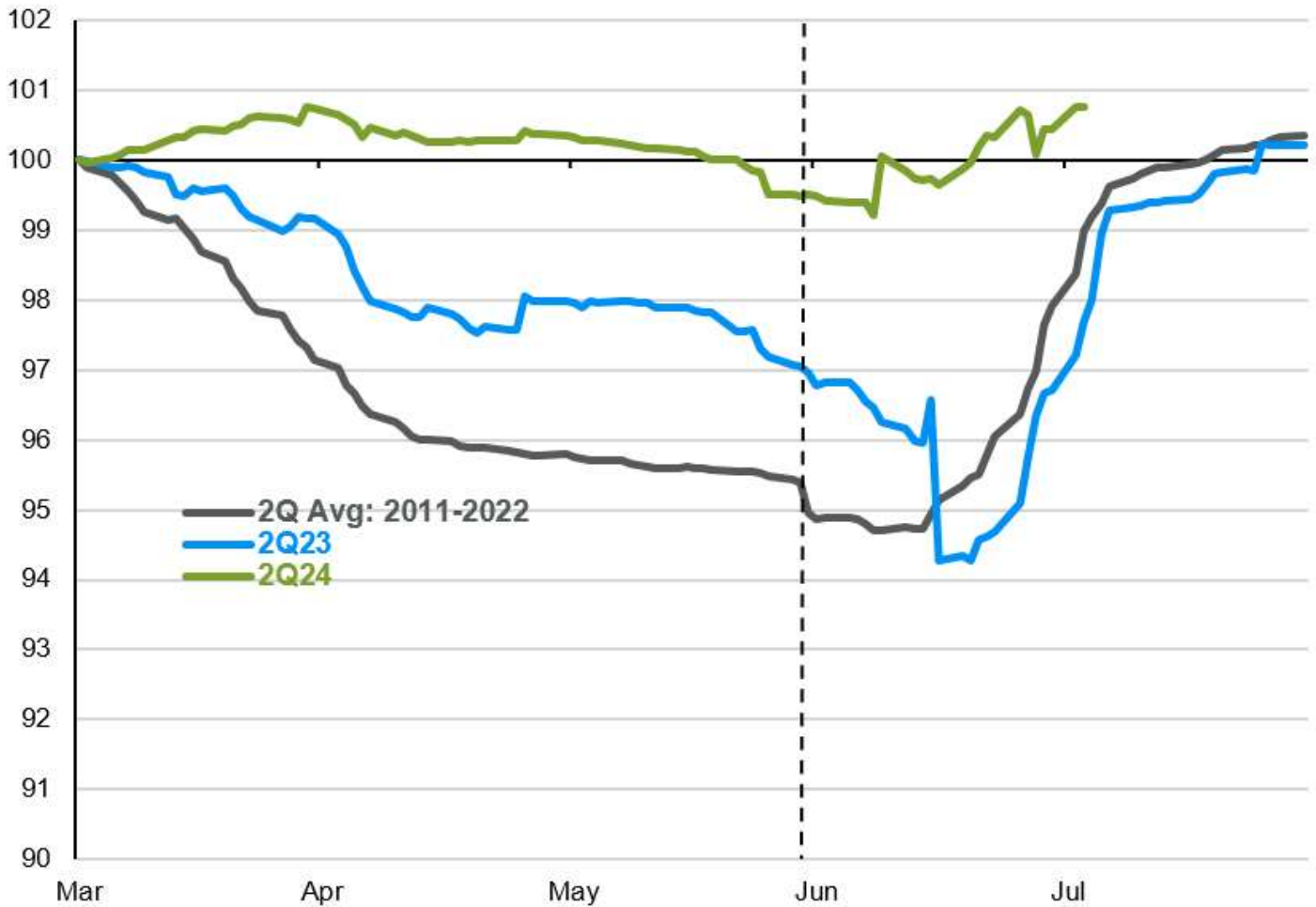
Equity markets are defying gravity. From the beginning of 2023 through the first quarter of 2024, despite widespread calls for a recession, the S&P 500 returned 40% with 6% earnings growth. There's just one problem. If you strip out 7 stocks<sup>1</sup>, the numbers fall to an 19% return with a -2% contraction in earnings.

But this earnings season officially welcomes the eagerly-anticipated broadening as earnings growth for the 493 inflects to positive. Economic growth may be slowing, but earnings are still growing. With 344 companies (63% of market capitalization) reporting, our current estimate for 2Q24 S&P 500 pro-forma earnings per share (EPS) is \$59.74. If realized, this would represent year-over-year (y/y) earnings growth of 9.6%, and quarter-over-quarter (q/q) growth of 5.7%.

Not only are earnings growing, they're growing faster than expected. 75% of the companies who have reported so far beat EPS estimates, compared to an average of 74% over the last four quarters. This beat rate is especially impressive given analysts lowered their estimates by less than usual heading into the earnings season.

### EPS estimates were revised down by less than usual

Indexed to 100 on 3/31 of the prior year



Source: Factset, Standard & Poor's, J.P. Morgan Asset Management.

Data are as of July 31, 2024.

Amid slowing headline growth, the revenue story is less supportive. Only 56% of companies have beat on revenues, compared to an average of 60% over the last four quarters. On the bright side, Information Technology has continued to clear sky high expectations with a revenue beat rate of 81%, and the Healthcare sector is coming in much stronger than expected with a revenue beat rate of 80%. Nevertheless, it's getting harder to impress investors. The reward for beating expectations is far less than the punishment for those who have missed.

1-day performance following announcement

# Earnings

		Beat	Miss
Revenue	Beat	0.81%	0.40%
	Miss	-0.42%	-2.47%

Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

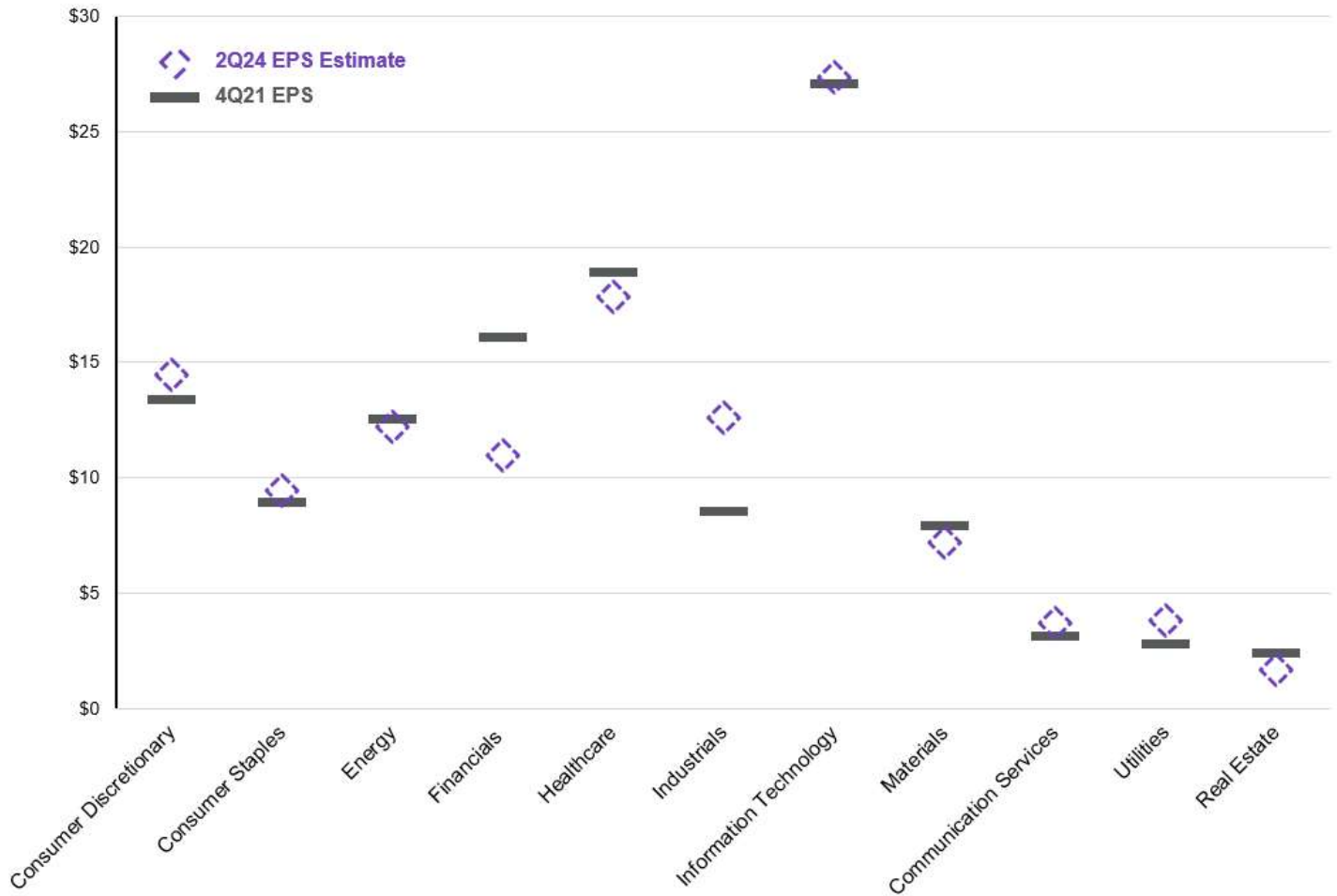
Data are as of July 31, 2024.

## Don't count out the 493

This quarter, for the first time since 2022, the S&P 493 is set to experience positive y/y earnings growth of 5.7%. Additionally, 8 out of 11 sectors are expected to contribute positively. Many of these companies are finally seeing margin growth after the earnings recession of 2022 as macro uncertainty, inflation, wage growth and supply chain issues moderate. On the flip side, a cautious consumer and muted manufacturing activity are making revenue growth harder to come by. Looking at the three main sources of EPS growth, revenues, margins and share count are expected to contribute 2.0, 8.2, and -0.6 percentage points respectively to y/y growth. While excitement around AI has fueled sales and margin growth in Tech+ names, outlook in the rest of the sectors is mixed as consumer and industrial activity slow with the broader economy.

## Some sectors are still recovering from the 2022 earnings recession

S&P 500, Quarterly pro-forma EPS, Actuals and estimates



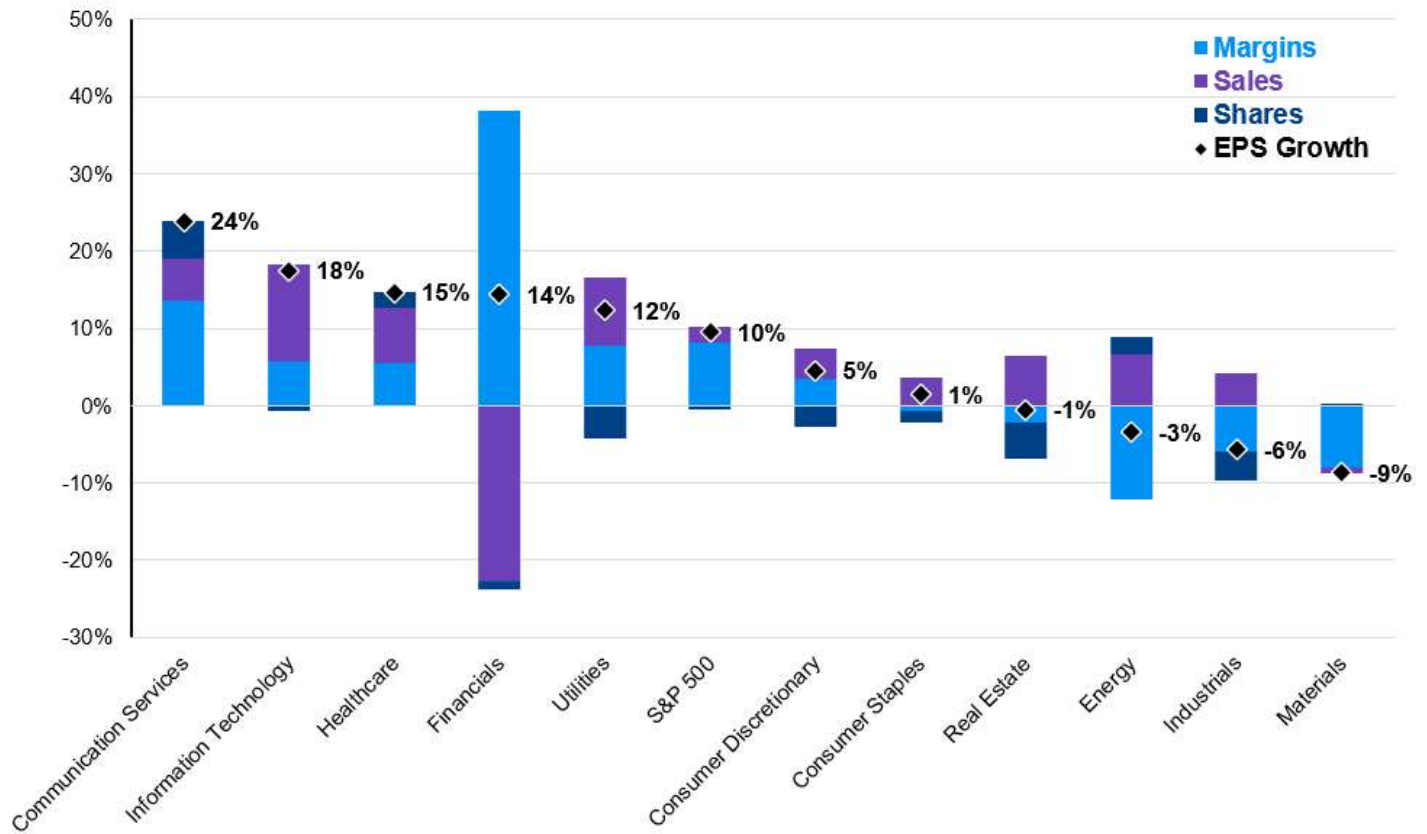
Source: Standard & Poor's, J.P. Morgan Asset Management.

Data are as of July 31, 2024.

At the S&P 500 index level, sales increased 4.6% y/y and 2.4% q/q, though growth has been decelerating since the COVID peak. Every sector saw growth, except Materials and Real Estate, which represent a combined 5% of the S&P 500. Margins were down -1.7% y/y, but up 0.8% from last quarter. Profitability in Healthcare, Financials and Consumer Staples is still sitting below historical 10-year averages, indicating room for improvement.

## Margins are the main driver of EPS growth this quarter

Year-over-year pro-forma EPS growth



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Data are as of July 31, 2024.

Healthcare’s prospects are promising. Earnings are still behind their pre-pandemic levels, though the high inflation and labor shortages that plagued profitability in 2023 are abating. Additionally, there are tailwinds for payers from the rapid expansion of higher margin Medicare Advantage plans<sup>2</sup>; for Pharma as clinical trial starts and novel drug approvals are increasing<sup>3</sup>; and for the entire sector as companies leverage technologies like generative AI to streamline paperwork, expand access to care, and increase the pace of drug development.

The bulk of the margin growth this quarter is coming from the Financials sector, where analysts are expecting a 43% expansion y/y. Net interest margins have generally troughed, while increases in fee revenue from Wealth Management and Investment Banking segments, as well as higher trading volumes, have driven growth. Companies are noting an increase in both IPO and M&A activity with healthy pipelines across regions and sectors.

In the consumer sectors, management teams have highlighted a dispersion in spending between income brackets. While it remains robust on the upper-end, lower-end consumers are increasingly value conscious. 2Q Chase credit card data indicates overall spending growth is stable but decelerating slightly for both discretionary and non-discretionary purchases.<sup>4</sup> Weakness in China, however, has weighed on earnings for any company with significant exposure. The Consumer Discretionary sector as a whole saw a -13% y/y contraction in sales to the country.

In both Home and Auto, suppliers, who are suffering from muted demand, might falter, but earnings for makers should be robust. Homebuilders are benefitting from tight excess supply across housing markets, and Automakers are still enjoying pricing power that has barely budged from COVID highs.

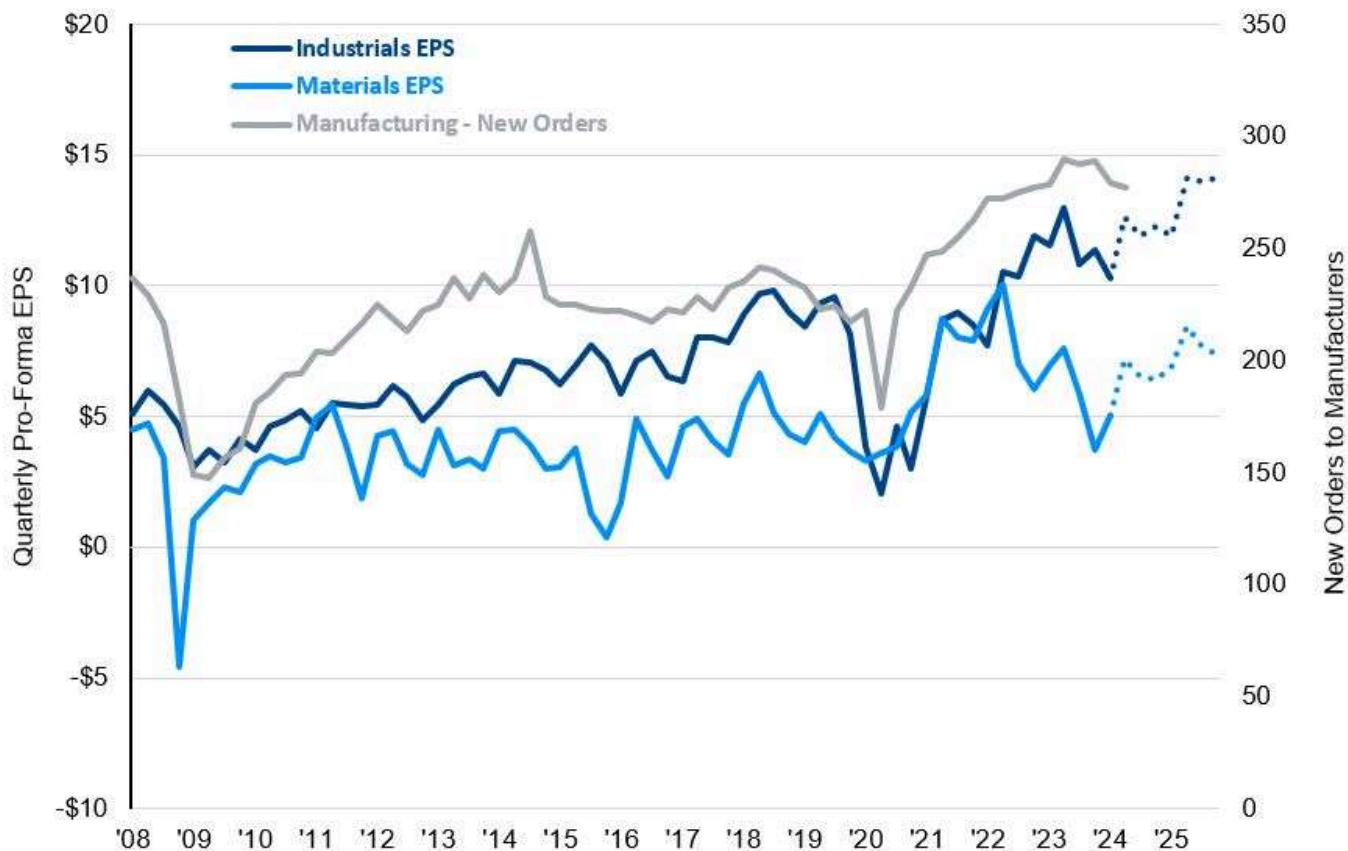
### Not everyone gets to broaden

Only the Industrials, Energy, and Materials sectors should detract from y/y EPS growth this quarter. In each case, margins are to blame. In Industrials, weakness in the Transportation industry is driving the contraction. Freight rates, the price truckers charge to transport cargo, are coming down from their

COVID peak when a massive uptick in consumer spending pinched supply. This normalization, along with stickier inflation, is putting downward pressure on profits. Similarly, petroleum product prices have grown less than the price of the crude oil required to refine them, weighing on margins in the Energy sector. In Materials, demand has been weak as the recovery in China, which makes up a significant portion of global demand, especially for base metals, has not materialized. These unfavorable supply/demand dynamics limit pricing power for the mostly commoditized products. Margins for the sector have contracted y/y in each of the last five quarters. Moreover, while Energy is more unpredictable, Industrials and Materials are highly cyclical, so tepid U.S. manufacturing activity could signal further weakness ahead. On the bright side, secular trends like reshoring and the energy transition could provide a boost.

## Manufacturing activity is slowing, which could signal trouble for cyclicals

S&P 500 pro-forma EPS (actuals and estimates), New durable goods orders, seasonally adjusted, billions



Source: Factset, Standard & Poor's, U.S. Census Bureau, J.P. Morgan Asset Management. A new order is a communication of an intention to buy for immediate or future delivery. Only orders supported by binding legal should be included. Reported data should include all new orders received during the month less cancellations. Dotted lines represent Standard & Poor's estimates for sector EPS from 2Q24 to 4Q25.

Data are as of July 31, 2024.

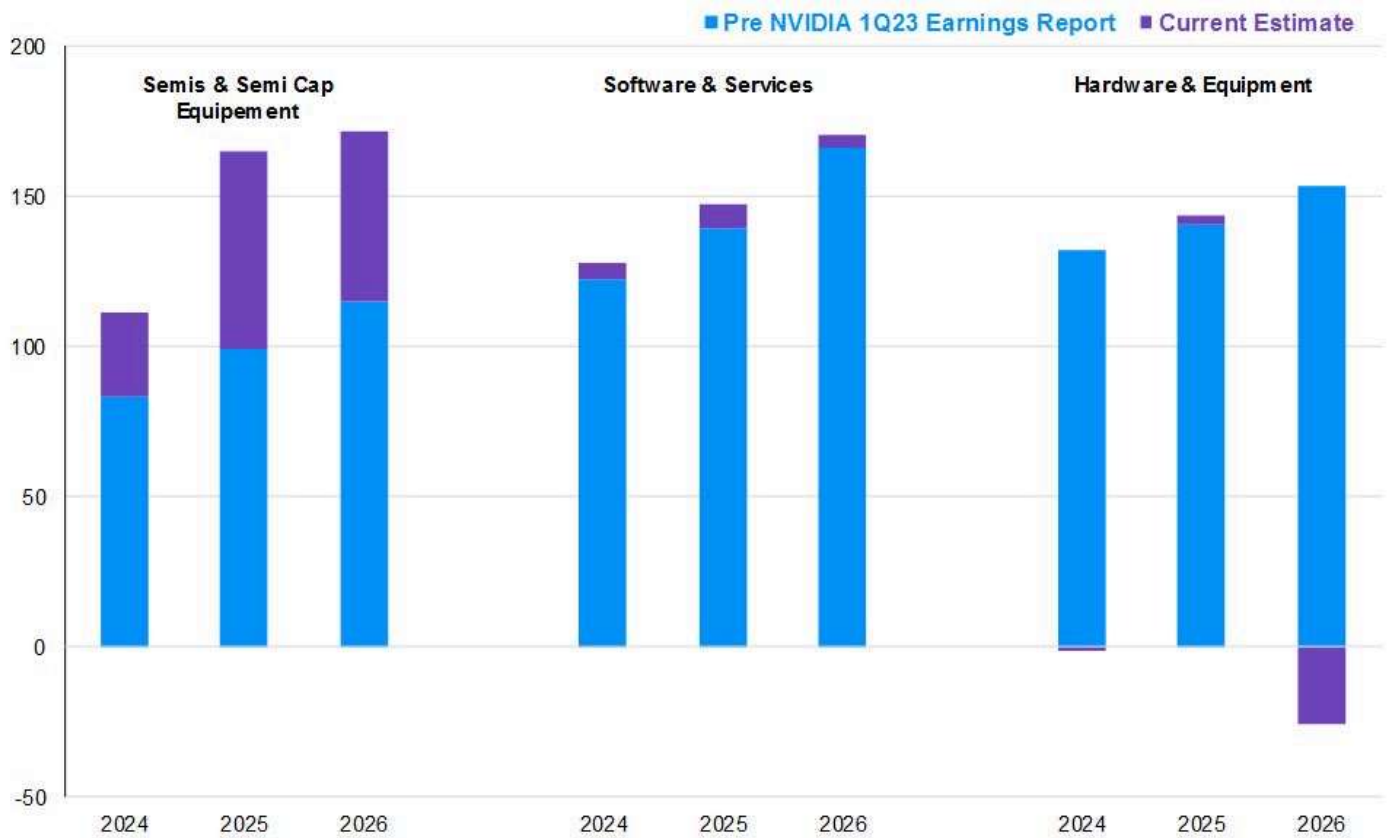
## There's more to Tech

Once again, the Information Technology sector is on track to contribute the majority of y/y EPS growth at 17.5%, though this would represent a -2.3% decline from last quarter. Quarterly earnings growth in Semis over the past year has averaged around 50%, but this is relative to four consecutive quarters of contraction from 3Q22 to 2Q23. Shipments are finally recovering from depressed levels as customers in the industrial, auto, PC, and smartphone end-markets digest bloated inventories. And, of course, there are significant tailwinds as hyperscalers continue to build out AI infrastructure. Semi analysts expect around 20% y/y earnings growth plus positive revisions to last well into 2025. The accelerated compute cycle should also drive a recovery in Semi Cap equipment in the second half of 2024. Similarly, the Hardware industry is still experiencing muted EPS growth as customer spending has yet to rebound from pullbacks amid the cautious macro backdrop of 2022. But, the AI upgrade cycle has pulled demand forward, particularly across servers and phones. Segments of Hardware closely tied to the cloud like Networking and Optics should see a strong recovery at the end of 2024. The Software and Hardware industries house some of Semi's and the cloud's biggest customers as well as companies that supply components needed for datacenters, but

they haven't seen the same upwards revisions to EPS. The ongoing revenue recovery and an expanding understanding of how AI will affect the sector as a whole should support EPS growth well into 2026.

## Not all Tech industries have seen significant revisions to EPS estimates

Full-year pro forma EPS



Source: Bloomberg, Standard & Poor's, J.P. Morgan Asset Management.

Pre NVIDIA Earnings estimates are estimates for 2024, 2025, and 2026 EPS as of May 23, 2023. The next day, May 24, 2023, NVIDIA reported an EPS beat of 18%, causing the stock to rally 24% and generating significant excitement around the AI theme.

Data are as of July 31, 2024.

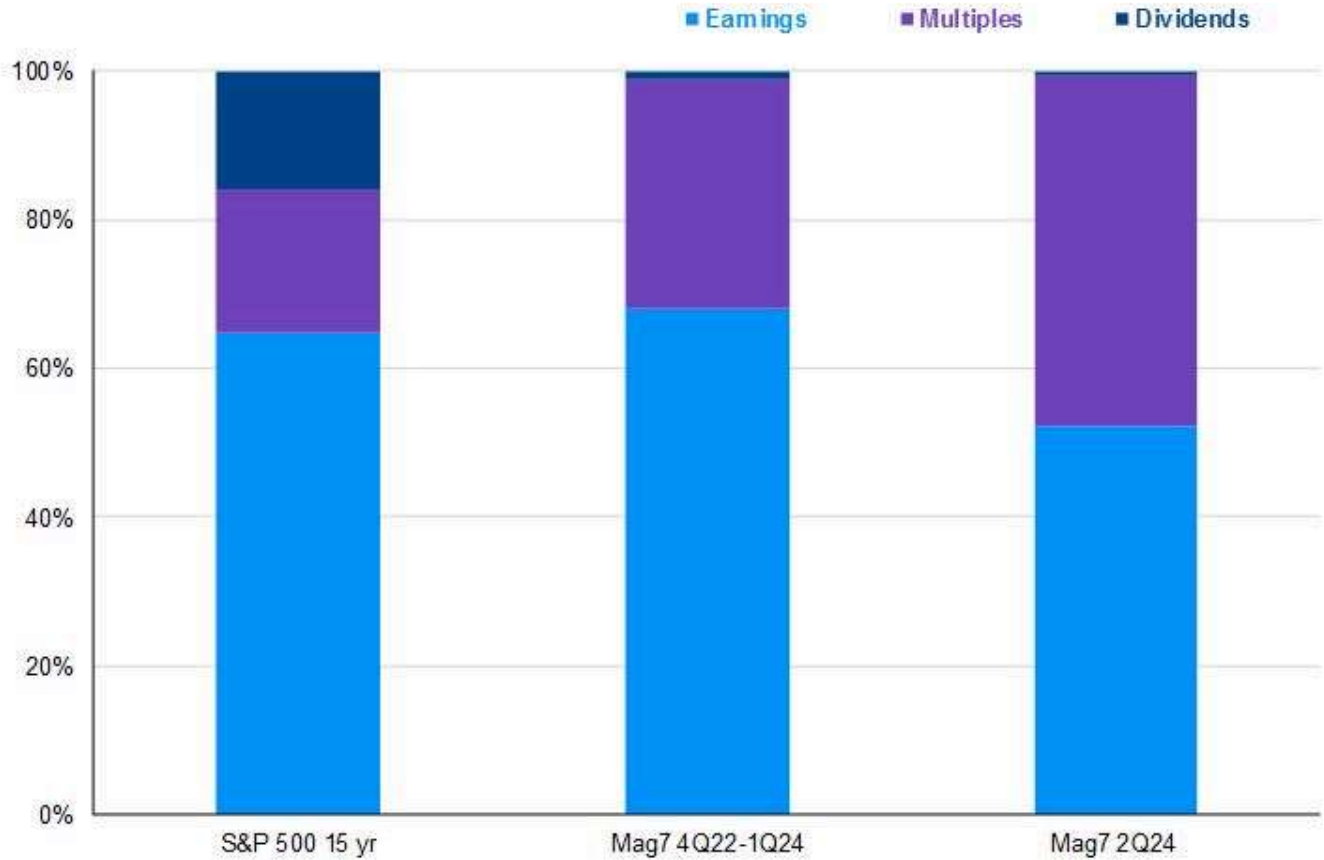
## ...and more Magnificence

On top of the recovery in the rest of Tech, we don't think we've heard the last of the Magnificent 7. They've grown earnings by over 30% y/y for the past 4 quarters and are expected to grow 29% in 2Q24. On a q/q basis, however, this should be the second quarter of contraction before growth reaccelerates in the second half of this year.

Earnings growth has been impressive and is expected to remain so, but a greater portion of returns this quarter were driven by valuation expansion, urging caution. Should earnings estimates be revised downwards, valuations will likely contract as well, making for a steep tumble. Indeed, investors have expected nothing less than perfection from the Mag 7 names that have reported so far. For the broad market, companies that beat on both EPS and revenue have had an average 1-day return of 0.8%. The Mag 7 names that have beat on both EPS and revenue so far have had an average 1-day return of -0.4%. Despite strong results, some companies had higher capital expenditure on AI with little tangible revenue benefit, spooking investors. Nevertheless, Mag 7 valuations are lower now than they were at the start of the year, and their advantages in the AI transformation are compelling.

## Multiple expansion\* contributed more to Mag 7 returns this quarter

% contribution to total return



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

15-years ann. is from 7/31/2009 to 7/31/2024 annualized. All return values are S&P 500 Index data. Multiple expansion is based on the forward P/E ratio and EPS growth outlook is based on NTMA earnings estimates. Chart is for illustrative purposes only. Past performance is not indicative of future results.

Data are as of July 31, 2024.

### Investment Implications

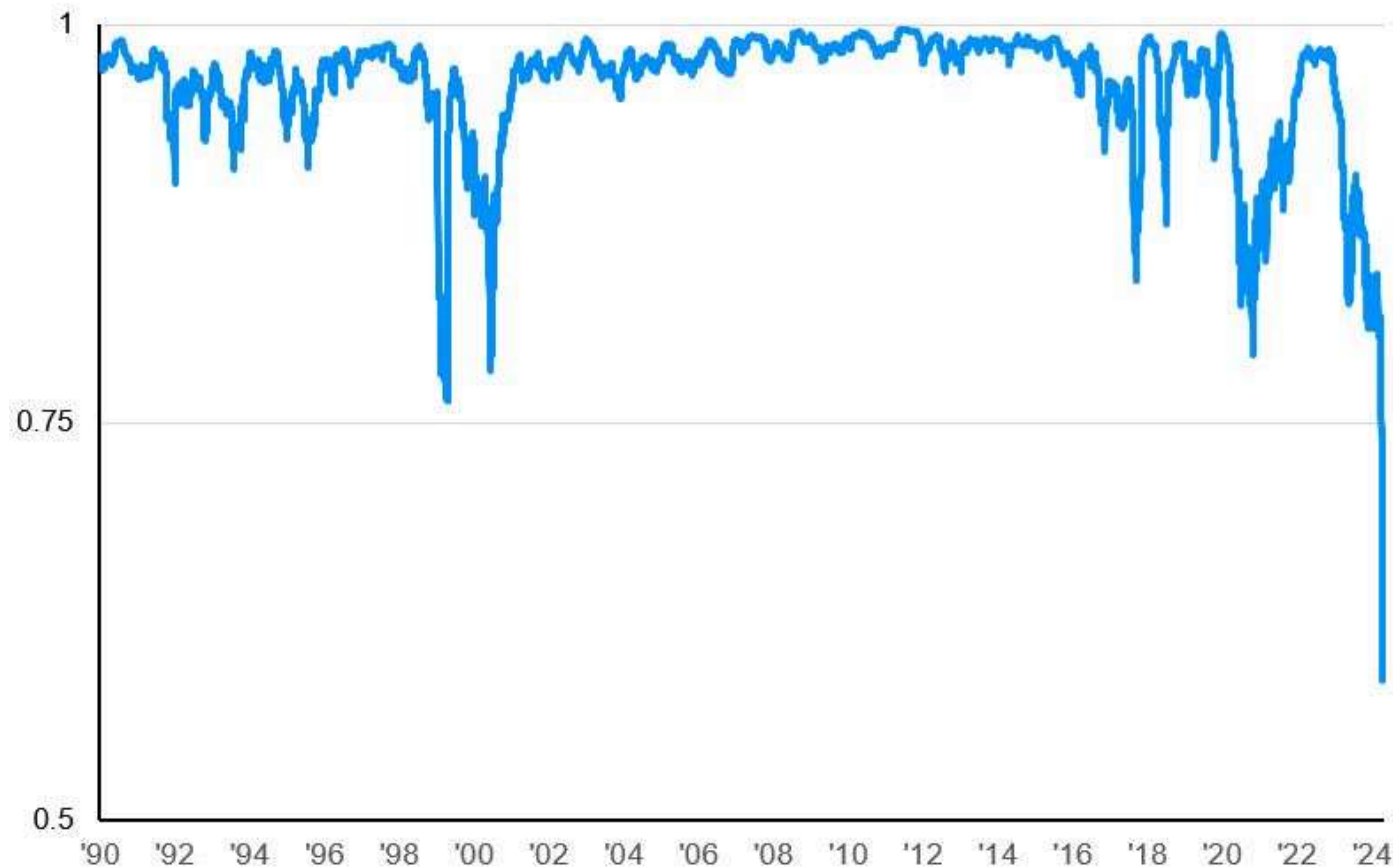
Things look pretty good for earnings. A slowing but growing economy should continue to support growth, and a lot of companies are just getting started as they rebound from the 2022 earnings recession. And though companies driving the AI transition have already seen several quarters of robust earnings growth, we don't think they're going to slow down significantly anytime soon.

As the biggest names keep growing and the rest join in, equity market fundamentals look supportive of robust returns ahead. That doesn't mean there won't be some short-term pain as the market unwinds some of the concentration in Tech in favor of less-appreciated opportunities.

The rotation we've seen this month is a good reminder that though returns and earnings have been broadening, the Mag 7 still constitute 31% of the index, giving them extreme influence.

# Correlation between the market-cap and equal weight S&P 500 is at all-time lows

Rolling 3-month correlation



Source: Bloomberg, Standard & Poor's, J.P. Morgan Asset Management.

Data are as of July 31, 2024.

As momentum unwinds, investors need to think carefully about how to manage this active bet in their passive exposure. Luckily, while the 3-month return correlation between the Mag 7 and the S&P 500 is 95%, correlations between stocks and between sectors are low relative to history, offering opportunities for diversification. And, as this earnings season highlights, some of these sectors are poised for a comeback. Investors shouldn't ignore them as underappreciation is the only way to outperformance.

<sup>1</sup> The Magnificent 7 (Mag 7) includes AAPL, AMZN, GOOG, GOOGL, META, MSFT, NVDA, and TSLA. The S&P 493 (493) refers to the S&P 500 excluding the Mag 7.

<sup>2</sup> McKinsey, "What to expect in US healthcare in 2024 and beyond." January 5, 2024.

<sup>3</sup> J.P. Morgan, "Healthcare Technology & Distribution." July 26, 2024.

<sup>4</sup> J.P. Morgan, "Payments 2Q24 Spending Preview." July 10, 2024.

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