



Insigneo Weekly Dispatch

Quarterly Earnings: Half Time Report

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Quarterly Earnings: Half Time Report

As of yesterday evening, approximately one half of the companies in the S&P 500 had reported second quarter earnings, so we thought it could be useful to evaluate where we stand at half-time. Going into earnings season, overall earnings growth was expected to end in negative territory. In fact, Wall Street consensus expects earnings to contract by 8% for the quarter. However, the second quarter is expected to be the trough of the earnings cycle, as the market sees earnings turning positive again by the end of this year. It might still prove true that earnings will be down for the quarter, but as of this writing, earnings growth is actually showing an increase of approximately 3.7%. Granted, the numbers could be skewed by the companies that have reported, so let's delve into the individual sectors, particularly those that have seen a large number of their constituents report.

With 76% of its constituents having already reported earnings for the quarter, the Financials sector has seen the highest number of companies report so far on a percentage basis. Generally speaking, this sector has posted a healthy 7.4% increase in earnings. However, the sector has also seen a battle between the haves and the have-nots. The large financial institutions like J.P. Morgan, Bank of America, and Wells Fargo have experienced sales and earnings growth as their deposit bases swelled with inflows, helping offset higher deposit costs as interest rates continued to rise. The forward guidance given by these banks for

the rest of the year also appears to be stable. On the other hand, some regional banks such as Key Corp and Zions saw meaningfully lower earnings for the quarter, as many of these banks have not been able to successfully offset higher deposit costs. Some management teams appeared optimistic in their forward guidance, stating that the worst might be behind them, but this remains to be seen. A notable laggard in the large cap financial institutions space was Goldman Sachs, as the company posted meaningfully lower earnings growth driven by several portfolio write-downs as the company continued to transition its business model.

Another sector that has seen most of its constituents report is the Industrials sector. Like the Financials sector above, Industrials has also seen overall earnings growth of 7.4% for the quarter. However, this sector has been somewhat of a mixed bag, as some companies reported stellar numbers while others did not but gave much improved forward outlooks. For example, within the airline industry, legacy carriers like United, Delta, and American Airlines, posted some of their best quarters ever, driven by increased travel demand, particularly in the premium and international travel categories. On the other hand, the discount airlines continued to struggle, as many lack exposure to the premium and international travel markets. We wrote about the potential for the legacy carriers to outperform their discount peers based on this premise earlier this year ([see report here](#)). Since then, we have seen the legacy carrier stocks outperform their smaller peers by close to 15%, and we believe that this trend is likely to continue. This quarter, we have also seen aerospace and defense companies post lower earnings; however,

companies like Boeing and General Electric gave better than expected guidance for future quarters, which resulted in meaningful price moves for their respective stocks.

Consumer Discretionary is another sector that has seen most of its constituency report, with very interesting results. In general, this sector is currently reporting a very promising 22% increase in earnings. However, looks can be deceiving. If we look under the surface, we can see that most of these gains are concentrated in the Leisure and Entertainment industry. Hotels, cruise lines, and entertainment venues have seen a large move higher in earnings. However, let's remember that a year ago, the world was still emerging from the Covid-19 pandemic, so although it is true that this industry is posting seemingly high earnings numbers, it is doing so off a very low base. However, it is nonetheless encouraging to see companies such as Carnival Cruise Lines provide future earnings guidance that could portend sustainable revenue recoveries. Keeping things in perspective though, we can see that other industries in this sector, particularly retail, housing, autos, and e-commerce have so far proven weaker than expected. For example, Tesla and Ford saw their stocks pressured after they reported lower price points for their electric vehicle offerings. Companies in many of these industries could prove to be important bell weathers in keeping a pulse on the health of the consumer.

Seeing an increase of approximately 14.5% earnings growth, the Communications sector is one that has seen exactly half of its companies report quarterly earnings. But unlike the Consumer Discretionary

sector above, earnings growth has proven to be evenly distributed between its largest industries, mainly Media and Communications. Alphabet posted solid earnings numbers and gave a positive outlook, as its cloud services are likely to see increasing focus on and integration of generative AI. At the same time, YouTube subscriptions continued to rise. Meta also posted good numbers, boosted by services such as WhatsApp, while its Llama generative AI product also promised future earnings growth. Even Netflix posted solid numbers as it saw its user growth meaningfully increase. However, a cautious outlook going forward, coupled with Wall Street's very high expectations, pressured the stock lower after the announcement. More traditional companies such as AT&T and Verizon also posted relatively strong numbers and cash flow projections, although the Street likely expected higher metrics.

A sector that goes hand in hand with the Communications sector above is Technology, and although less than half of its constituents have reported earnings so far this quarter, it is one that is worth touching on. Microsoft's report headlined the sector, delivering respectable numbers, but a slowdown in growth of its Azure cloud platform spooked Wall Street. Keeping things in perspective, Azure still grew by nearly 30% over the previous year. Even though a slowdown in consumption for the company's cloud business is possible in the near term, its use and implementation of AI are likely to drive growth higher over the long term. More concerning than the software side of the sector was its hardware industry. Semiconductor companies Intel and Texas Instruments both posted numbers below what could have been high

expectations set by Wall Street, at the same time giving less than positive outlooks driven by lower-than-expected demand, as well as lingering supply chain issues. This same dynamic was echoed by Taiwan Semiconductors, which although not a member of the S&P 500, also cited that AI is a long-term driver, not a near-term one. This is important for other semiconductor companies such as Nvidia, whose exposure to the AI revolution might have led to lofty expectations for the quarter. On the positive side though, Technology Service providers such as Visa and Mastercard posted strong numbers for the current quarter and provided positive outlooks for the year. Generally speaking, the Technology sector has so far seen a decline in earnings in the range of -2%.

Another sector that has only seen a handful of companies report but could prove to be a good barometer for inflation, is the Consumer Staples sector. Food and beverage companies like Pepsico, Coca Cola, Mondelez, and Hershey, as well as household product maker Kimberly Clark, have all posted strong earnings growth boosted by higher prices as well as higher demand. However, many of these companies could begin to see demand erosion if prices remain too high for too long. So far, this sector is seeing earnings growth in the 7% range, but again, the number of companies reporting is not yet meaningful.

Other sectors such as Energy, Materials, Healthcare, Utilities and Real Estate have not yet seen a meaningful number of its constituents report earnings for the quarter, but nonetheless, these sectors bear watching closely.

Although we are only halfway through the earnings season, a few trends are beginning to emerge. An important one revolves around technology companies, as expectations for many of these names might have been set too high by Wall Street and are at risk of not being met. This creates downside risk for some of these stocks, as we are already beginning to see. Another trend that also involves tech companies revolves around AI. Many management teams, in an apparent attempt to manage expectations, are indicating that although AI is a potential game changer for their businesses, it will take time to fully develop. We are in complete agreement with these statements, as we too share the view that AI's impact, although revolutionary, will take more time to be fully realized than what Wall Street appears to be expecting. Consumer consumption and inflation trends are also worth watching, as they could prove to be useful indicators regarding the possibility of a recession. We will see what the second half of earnings season brings, but as of now, the market is defying Wall Street's prediction of a meaningful earnings contraction.



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