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Strong profit growth from the "Magnificent 7," a resilient labor market supporting consumer spending, and a near end to the slowdown in the goods segment of the economy are all key drivers of a good earnings season. (UBS)

Moving past the heart of earnings season

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The bulk of the third-quarter earnings season is now behind us. More than 80% of S&P 500 companies have reported and results are coming in fine.

Three-fourths of companies are beating earnings per share estimates while just shy of sixty percent are beating sales estimates. In aggregate, earnings are beating by 5.5% and corporate profits are on pace to grow by 4%—in line with our initial expectation of 3-4% growth. Although the 4Q23 S&P 500 EPS estimate has been revised lower, it hasn't deviated substantially from the historical pattern after accounting for some non-recurring items—lower-than-expected COVID vaccine sales, a big non-cash charge at a pharma company, and lower production at the automakers due to the strike.

It's clear to us that the earnings recession is over as earnings are set to grow for the first time in four quarters. Strong profit growth from the "Magnificent 7" companies, a resilient labor market supporting consumer spending, and a near end to the slowdown in the goods segment of the economy are all key drivers. As a reminder, unlike GDP, S&P 500 profits skew more towards goods rather than services, so a rebound in goods activity should support earnings going forward.

The state of the consumer continues to be a key focus for investors and, in our view, spending remains fine. Credit card companies—a good read on spending as they touch so many consumer segments—suggested growth rates are consistent with earlier this year, and given the cooling but healthy labor market, we believe consumer spending should hold up. Still, at the margin, consumer spending may be slowing due to student loan repayments and higher interest rates. In tech hardware, it's been mostly good news as we continue to see signs that PC and smartphone end markets are bottoming. However, there were some segments this quarter that we had hoped would start to improve after being pretty weak, such as capital markets activity.

Next week, only about 6% of the S&P 500 market cap will report. The later stages of earnings season are historically dominated by the retailers, and we will be focused on any consumer-related insights they provide.

Equity markets performed impressively this week with the S&P 500 posting a 5.9% gain. As we suggested last week, equity valuations had become increasingly attractive after stocks entered correction territory (down more than 10% from the summer high). This week, long-term interest rates plummeted on the heels of Wednesday's FOMC meeting and Friday's job report which increased market conviction that the Fed is done raising rates. This took pressure off the equity market. The market surge seems primarily driven by short covering, with some of the most beaten-down stocks enjoying the biggest gains. In our view, a "soft-ish" landing for the US economy appears achievable and would support our expectations for 9% (USD 240) S&P 500 EPS growth next year. We maintain our June 2024 and December 2024 S&P 500 price targets of 4,500 and 4,700.

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