



Weekly Market Commentary



April 11, 2011

Earnings Season Preview

Jeffrey Kleintop, CFA

Chief Market Strategist
LPL Financial

Highlights

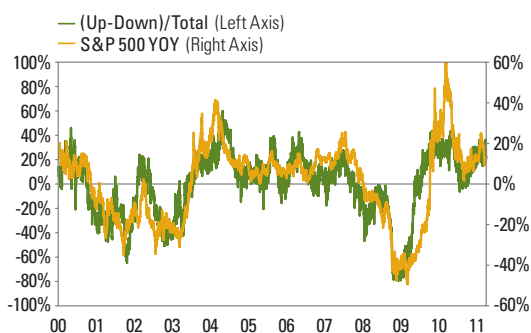
The S&P 500 earnings per share (EPS) for the first quarter of 2011 may set a record as the highest first quarter EPS in history.

However, corporate profits have slowed as businesses have stepped up spending on materials, capital, and labor.

During this earnings season, we are paying special attention to business spending, the impact of high and rising commodity prices, and guidance from business leaders on the EPS outlook for coming quarters along with the impact from the events in Japan, North Africa, and the Middle East.

1 S&P 500 Performance and Earnings Outlook Closely Linked

S&P 500 Year-Over-Year Performance and Number of Upward EPS Revisions to S&P 500 Companies Less Number of Downward Revisions Divided by the Total Revisions Over Past Three Months for S&P 500 Companies



Source: LPL Financial, Factset Research Systems 04/08/11

The S&P 500 is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

The 2011 first quarter earnings reporting season kicks off this week. Four times a year investors focus on the most fundamental driver of investment performance: earnings. As you can see in [Chart 1](#), the performance of the S&P 500 and analysts' revisions to their earnings per share (EPS) estimates are closely linked.

For the S&P 500 companies as a whole, the consensus of analysts' estimates points to average earnings per share growth in the first quarter of 2011 of 13% from one year ago, not much above the 8% growth rate of sales, as the rise in profit margins has slowed as businesses have stepped up spending on materials, capital, and labor.

Likely to come in near \$23, the S&P 500 EPS for the first quarter of 2011 may set a record as the highest first quarter EPS in history, and the second highest quarterly result overall, behind only the peak in the second quarter of 2007 when earnings totaled \$24.40. Having climbed all the way back to near the prior peak, earnings growth is beginning to slow. We expect closer-to-normal EPS growth of 10% in 2011, well below the 39% EPS gain in 2010.

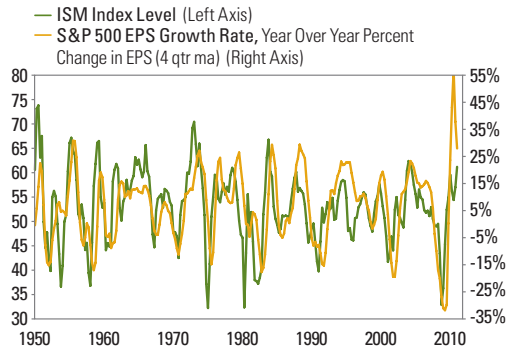
In addition to peaking profit margins, our outlook for 2011 EPS is bound, in part, by continued sluggish revenue growth resulting from modest economic expansion in the developed markets, including the United States.

The first quarter earnings season lasts about four to six weeks starting about two weeks after the close of the quarter. During this particular earnings season, we are paying special attention to business spending, the impact of high and rising commodity prices, and guidance from business leaders on the EPS outlook for coming quarters.

- **Business spending** – While investor attention is often directed on consumer spending as a driver of profits, we will be watching business-spending-driven industries more closely. Business spending and commodity prices are major drivers of S&P 500 profit growth, while discretionary consumer spending has a much smaller impact to S&P 500 earnings. During the first quarter, commodity prices rose and manufacturing was booming, according to the ISM Index (Institute for Supply Management Purchasing Managers Index), likely boosting profits for S&P 500 companies. We will be watching to see how effectively this translated into profits for the Information Technology, Industrial, Energy, and Materials companies for clues as to how rapidly their profit growth may slow in 2011.



2 ISM Suggests Slower S&P 500 Profit Growth
Institute for Supply Management's Purchasing Manager Index and S&P 500 Earnings per Share Growth Rate Year-over-Year Four-Quarter Moving Average



Source: LPL Financial, Thomson Financial, and Bloomberg data 04/08/11

The S&P 500 is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

- **The impact of high and rising commodity prices** – We will be monitoring the impact of higher commodity prices, including energy, on the expectations for consumer-spending-driven businesses. Sluggish income growth combined with rising prices on essentials like food and energy means something has got to give. While discretionary spending has generally remained solid in recent months, it could begin to suffer.
- **Guidance** – We will be listening closely to conference calls and reading press releases to aid in assessing the likely movement in expectations of future earnings. CEO confidence rose during the first quarter to highs not seen since the prior business cycle peak in mid-2007, but it slipped in March as attention turned to Japan's natural disasters and the violent clashes in North Africa and the Middle East. The impact of the earthquake, tsunami, and nuclear accident in Japan may temper the EPS outlook of some companies with operations or supply chains in Japan, including semiconductor companies and retailers.

The earnings reporting season has historically had an impact on stock prices. Although the S&P 500 posted gains for 2010 as a whole, stocks were generally flat-to-down during the four earnings reporting seasons in 2010—continuing a trend that started in 2009. The first quarter of 2011 bucked that trend with a modest gain as earnings from the fourth quarter of 2010 were reported in January and February 2011. Analysts expect a record \$98 in EPS in 2011 for S&P 500 companies, representing about 15% growth versus 2010. We believe 10% growth is more likely for EPS in 2011 and expect downward guidance from business leaders in the coming weeks, potentially leading to downward revisions to 2011 earnings by analysts acting as a headwind for stocks as the earnings season matures.

It is important to keep in mind that the companies that report early in the season are most often not the bellwethers they are commonly thought to be. We will not really know how results are shaping up until just after the end of the month when about half of the S&P 500 companies will have reported.



IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

All Indices are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

The ISM index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

This research material has been prepared by LPL Financial.

The LPL Financial family of affiliated companies includes LPL Financial and UVEST Financial Services Group, Inc., each of which is a member of FINRA/SIPC.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial is not an affiliate of and makes no representation with respect to such entity.

Not FDIC or NCUA/NCUSIF Insured | No Bank or Credit Union Guarantee | May Lose Value | Not Guaranteed by any Government Agency | Not a Bank/Credit Union Deposit