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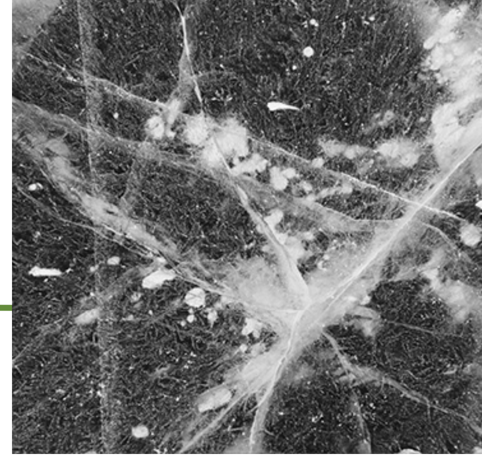
MARKET SIGHT LINES



Strong Q1 Earnings, But Are We Seeing the First Cracks?

By Michael O'Keeffe, *Chief Investment Officer*

The first quarter 2025 earnings season for the S&P 500 demonstrated resilience amid economic uncertainty, exceeding expectations in many ways while also surfacing some headwinds looking forward. In this Sight|Lines, we unpack the details of the earnings results with an eye toward positive surprises, trade uncertainty, and some potential trouble.

THE TAKEAWAY: EARNINGS SURPRISE TO THE UPSIDE, BUT HEADWINDS APPEAR

97% of S&P 500 companies have reported first quarter results, with many positive surprises. In summary:

- Earnings growth grew more robustly than expected in the first quarter.
- Revenue growth also surprised to the upside, but less so.
- A good majority of companies beat their respective earnings per share (EPS) estimates, in line with the five-year average.
- Healthcare, technology, and financials were strong performing sectors.
- Energy, consumer staples, and materials saw earnings decline.
- The Magnificent Seven stocks – Amazon, Apple, Google parent Alphabet, Meta Platforms, Microsoft, NVIDIA, and Tesla – were again dominant sources of earnings for the index.
- Tariff concerns were a recurring theme in earnings calls, with a focus on input costs and supply chain disruptions.
- The index has recovered from its lows in April, now having posted a positive year-to-date return.
- Valuations, as reflected by the current versus historical price-to-earnings (P/E) ratio, are elevated on a cap-weighted basis, but more fairly valued on an equal-weighted basis.

IN-DEPTH: S&P 500 FIRST QUARTER EARNINGS SURPRISE TO THE UPSIDE, BUT SOME HEADWINDS APPEAR

97% of the companies in the S&P 500 have reported their first quarter results, showing positive surprises but some potential headwinds. Going deeper:

- In the first quarter, earnings growth grew more robustly than expected:
    - The blended year-over-year growth rate for the S&P 500 is 12.9%.
    - This is significantly higher than the blended consensus growth rate on March 31, 2025 of 7.1%.
- Revenue growth also surprised to the upside, but in a more muted way:
    - Revenue growth is estimated to be 4.8%, compared to a forecast of 4.4%.
- A good majority of companies beat EPS estimates:
    - About 78% of the companies have beaten EPS estimates so far.
    - This is in line with the five-year average of 77%.
- Positive results were seen in healthcare, technology, and financials, but energy saw earnings decline:
    - Healthcare earnings grew by 43%, influenced by strong demand for weight-loss drugs.
    - Technology earnings increased by 16%, supported by robust AI and cloud computing demand.
    - Higher interest income helped banks, with 88% of financial firms beating EPS estimates.
    - Earnings growth in energy was down 13%, influenced by weaker demand and declining oil prices.
- The Magnificent Seven stocks were again dominant sources of earnings for the index:
    - Combined, these companies' earnings grew 28%, comprising 31% of the index's earnings growth.
- Tariff concerns were a recurring theme in earnings calls:
    - About 89% of companies mentioned tariffs, with some citing potential negative impact due to input costs and supply chain disruptions, and others saying impacts could be limited.
- The index has recovered well since its lows in April, now having posted a positive year-to-date return.
    - The S&P 500 is up 1.1% year-to-date through May 29.
- Valuations, as reflected by the current versus historical price-to-earnings (P/E) ratio, are elevated:
    - The cap-weighted P/E of 25.1 is 15.2% above the 10-year average.
    - The equal-weighted P/E of 20.2 is 0.6% below the 10-year average.

CONCLUSION

The latest quarter showcased the S&P 500's resilience, with earnings and revenue growth exceeding expectations despite persistent uncertainty. Elevated valuations, trade tensions, and sector-specific challenges raise questions about the sustainability of this momentum. The question remains: Can the market's strength continue through the second half of 2025, or will elevated valuations and economic uncertainty weigh on performance?

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