MARKET SIGHTLINES

Second-Quarter Earnings: A High Bar Cleared – Mostly

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August 17, 2026

We recently highlighted the **lofty expectations** for second quarter earnings: earnings projected to grow by about 23% year over year, revenue approaching 12%, and analysts raising estimates during the quarter rather than lowering them. With the reporting season now close to complete, companies did more than meet that elevated bar. Reviewing those companies reporting, 86% exceeded earnings expectations, blended earnings growth reached 50.4%, and revenue growth accelerated to 15.0%. Alphabet and Amazon results have amplified both the growth rate and the size of the aggregate surprise, and much of the momentum remained concentrated in technology, energy, and businesses tied to the artificial intelligence (AI) buildout. In this Sight|Lines, we revisit the expectations we set in July, assess where results stand, and consider what the quarter tells us – and does not yet tell us – about the return on AI investment.

THE TAKEAWAY: COMPANIES CLEARED A HIGH BAR, WITH AI STILL DRIVING RESULTS

Second quarter results were stronger than the already-high expectations, but results were concentrated. In summary:

- The reporting companies have cleared a high bar – 86% beat earnings estimates, and blended earnings growth reached 50.4%, more than double the 23.1% expected at the end of June.
- Excluding Alphabet and Amazon, however, earnings growth falls to 32.0% and aggregate earnings surprises decline meaningfully.
- Revenue grew 15.0%, the fastest since late 2021, and all 11 sectors reported year-over-year growth.
- Technology and energy were the largest revenue contributors, while healthcare earnings fell.
- AI demand continues to influence results, but investors still await evidence of a return on that investment.
- Analysts raised third quarter estimates through July, and full-year 2026 estimates also moved higher.
- These strong results support a market trading at elevated levels, but any disappointment in the future runs the risk of triggering a market pullback.

IN-DEPTH: RESULTS WERE EVEN STRONGER THAN THE ALREADY OPTIMISTIC EXPECTATIONS

The quarter validated much of the positive setup we discussed in July, while also showing why the largest headline numbers require some normalization. Going deeper:

- Company results cleared the previous, lofty expectations by a wide margin:
  - Blended earnings growth reached 50.4%, up from the 23.1% expected on June 30 and the strongest rate since the second quarter of 2021.
  - Ten of the 11 sectors reported earnings growth, including eight with double-digit growth.
- However, a meaningful portion of the overall results came from items that will not repeat:
  - Alphabet's second quarter earnings included a $98 billion other-income gain, primarily from unrealized gains on equity securities, while Amazon recorded a $53.4 billion gain primarily related to its Anthropic investment.
  - Excluding these two companies, S&P 500 earnings growth would have been 32.0%, and the aggregate earnings surprise would have been 10.9% rather than 29.2% – still strong results.
  - Separately, some companies have also cited tariff refunds tied to the Supreme Court's tariff ruling as a modest, non-recurring boost to results this quarter.
- Revenue growth reinforced the strength of the quarter's results:
  - Blended revenue growth reached 15.0%, up from 12.2% expected at the end of June and 9.5% expected in March.
  - All 11 sectors reported year-over-year revenue growth, with five achieving double-digit gains.
  - The blended net profit margin reached 15.7%, the highest since FactSet began tracking the metric in 2009, and 14.4% excluding Alphabet.
- The expansion was broad, but technology and energy were dominant sectors:
  - Information technology revenue grew 35.9%, led by 77% growth in semiconductors and semiconductor equipment, while energy revenue grew 42.5% as average oil prices were 45% higher than a year earlier.
  - Healthcare was the only sector reporting a year-over-year earnings decline.
- The quarter provides strong evidence of AI-buildout demand, but the return on investment question remains open:
  - Semiconductor revenue growth and hyperscaler spending show continued demand for chips, data centers, cloud capacity, and related infrastructure.
- As Warsh implements an approach with less forward guidance, he emphasizes the need to monitor market signals instead:
  - For example, Warsh highlighted the increase in longer-term Treasury yields during his press conference.
  - Pressure on the long end drew in the Treasury Department recently, as Secretary Bessent asked the Fed to expand a lending facility so Japan could defend the yen without selling its $1.14 trillion in Treasury holdings.
- Analysts have raised third quarter estimates during July, and full-year 2026 estimates also moved higher:
  - Analysts currently expect earnings growth of 27.4% in the third quarter and 25.2% in the fourth, although revenue growth is expected to moderate some to 11.3% and 10.9%, respectively.
- These strong results support positive equity returns, but signs of disappointment can trigger a pullback.

WHAT WE THINK

Second quarter earnings are coming in even better than expected when **we published in July**. Companies cleared the high bar we described, revenue growth accelerated, earnings strength extended across most sectors, and analysts raised forward estimates as well. We believe those are meaningful positives. At the same time, Alphabet and Amazon earnings lifted the index result substantially, and technology and energy accounted for an outsized share of revenue growth. The quarter provides again strong evidence that the AI infrastructure buildout continues, but spending and capacity growth are not the same as broad, durable returns for the companies adopting AI. With valuations elevated, we're mindful that any signs of disappointment – results below these still lofty expectations – are often associated with a market pullback.

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