LPL Financial

Weekly Market Commentary

Big Numbers, Big Expectations: Three Keys to Earnings Season

Jeffrey Buchbinder, CFA
Chief Equity Strategist

Client Summary

Corporate profits remain strong, with earnings growth expanding beyond artificial intelligence (AI) and technology. However, high expectations, rising costs, and the significant investment required to build AI infrastructure could create volatility along the way.

Positive Factors

- **Earnings strength is broadening.** AI and technology remain important growth drivers, but profit gains are spreading across more industries. Six of the 10 S&P 500 sectors outside technology are expected to generate double-digit earnings growth, giving the market a broader foundation.
- **The economy continues to support corporate profits.** Inflation-adjusted economic growth for the third quarter may exceed 3%, providing a supportive backdrop for company revenues and earnings.
- **AI offers a longer-term productivity opportunity.** Continued AI adoption could help companies become more productive and improve profitability over time. Strong demand for computing power and continued AI infrastructure investment also support the longer-term earnings outlook.

Concerning Factors

- **Expectations are unusually high.** Companies entered earnings season with strong profit expectations already reflected in analyst forecasts, leaving less room for upside surprises. Early results have been mixed relative to this high bar.
- **Profit margins face pressure.** Higher commodity prices, shipping disruptions, and elevated financing costs could make it harder for companies to grow revenue faster than costs.
- **AI investment carries risks.** The AI buildout requires significant spending at a time when borrowing costs are elevated and free cash flow is declining. Uncertain investment payoffs and potential regulatory hurdles for data center construction add to the risks.

LPL Research's Perspective

- **The longer-term earnings outlook remains constructive.** LPL Research expects S&P 500 companies overall to generate double-digit earnings growth in 2027, supported by continued AI investment, broader profit growth, and a resilient economy.
- **High expectations are not necessarily a warning sign.** LPL Research's historical analysis found that stronger corporate earnings guidance has generally been followed by better three-month market returns, although past performance does not guarantee future results.
- **Stay constructive, but recognize the risks.** The resilient U.S. economy and broadening earnings strength support LPL Research's positive stock market outlook, while inflation, financing costs, geopolitical uncertainty, and execution risks surrounding AI investment argue for maintaining a balanced perspective.

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