

Equity Strategy Insights

Blowout Earnings Raise the Floor; Technical Breakout Raises the Ceiling

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Executive Summary

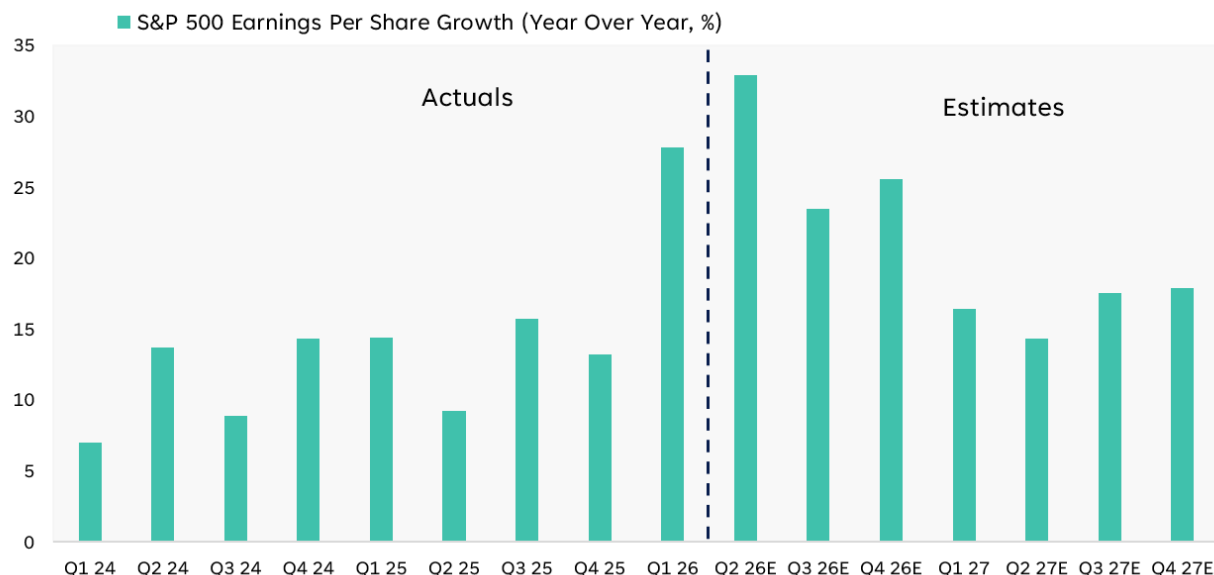
- Second quarter earnings season strengthened the fundamental case for equities, with S&P 500 profit growth exceeding 30% excluding private investment mark-ups and analysts continuing to raise estimates.
- AI-driven investment remains the dominant earnings catalyst, but strong results across other parts of the market suggest the profit expansion is broadening and becoming more durable.
- While policy, geopolitical, and election-related risks may drive volatility in the coming months, improving earnings, expanding margins, and healthy earnings breadth have likely raised the floor for stocks through year-end.
- From a technical analysis perspective, the S&P 500 Index's breakout to new all-time highs may raise the ceiling for this bull market.

Strong Earnings Season Raises the Floor

As we wrote in last month's Equity Strategy Insights publication, earnings have provided a strong foundation for stocks this year. In fact, as earnings expectations have risen, stocks have gotten cheaper. The price-to-earnings ratio (P/E) for the S&P 500, based on consensus earnings per share (EPS) estimates for the next 12 months, has fallen 9% this year even though the index's price has appreciated 14% (through August 14, 2026). In other words, the "E" has risen faster than the "P" in the P/E calculation.

Second quarter earnings results — and it seems fair to call them a blowout — have increased our confidence that the earnings outlook can support stocks over the balance of 2026. Not only has the pace of earnings growth surprised us (we expected a percent increase in the high 20s), but the guidance was good enough for analysts to raise estimates for the second half and for 2027. As shown in "Earnings on Track for Four Straight Quarters of Over 20% Growth," not only have earnings grown at over a 20% pace during each of the last two quarters, but they will likely do so in the third and fourth quarters as well — even without the "other income" from mark-ups on private investment holdings that boosted overall S&P 500 earnings growth to over 50% in the second quarter.

Earnings on Track for Four Straight Quarters of Over 20% Growth



Source: LPL Research, Bloomberg, 08/13/26

Disclosures: All indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results. Estimates may not materialize as predicted and are subject to change. Earnings exclude investment mark-ups from Alphabet (GOOG/L) and Amazon (AMZN).

That higher potential floor for earnings and stock prices doesn't mean we don't have to watch out for volatility. however. Geopolitics, the midterm elections, and the Federal Reserve may cause swings in stock prices this fall. Questions about overspending on artificial intelligence (AI) capabilities will probably be with us well beyond 2026. But the spectacular second quarter results from corporate America probably raises the floor for stocks through year end. At the same time, the technical breakout in the S&P 500 to new highs this month likely raises the ceiling as well (more on that below).

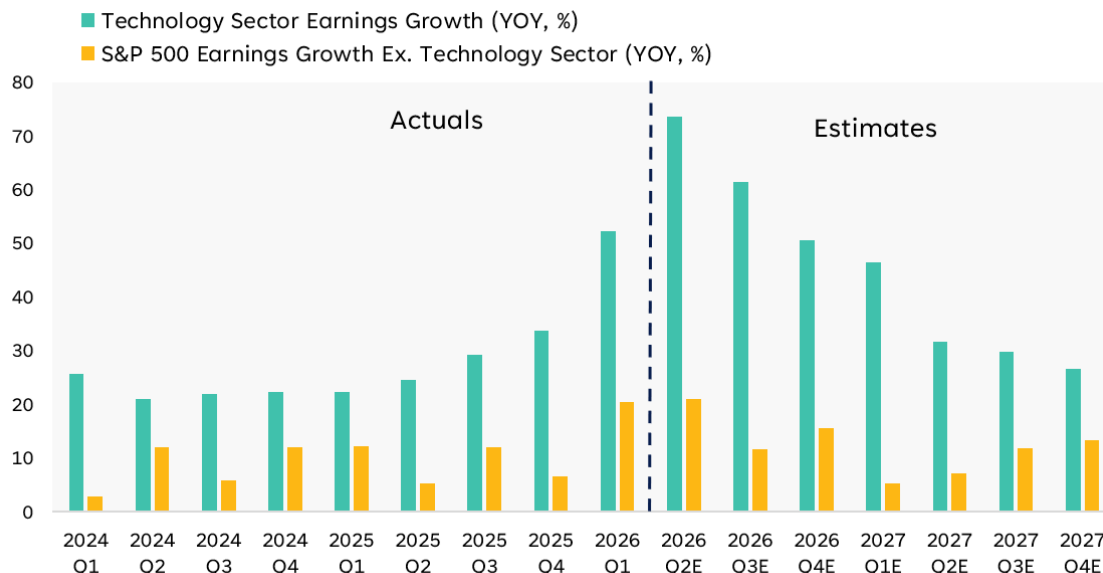
Earnings Season Highlights Must Start With AI

The primary driver of the strong earnings growth will not surprise you — it's technology and the massive AI investment. We estimate that about three-quarters of the headline S&P 500 EPS growth number near 50% was AI driven. That includes some tech companies not classified as tech, such as Alphabet (GOOG/L) and Amazon (AMZN), and valuation mark-ups of private AI holdings.

If instead we isolate just the technology sector, the contribution to S&P 500 earnings in the second quarter is more like 35%. But that doesn't mean the sector's earnings aren't booming. The "Technology Remains by Far the Most Powerful Earnings Driver" chart illustrates just how strong the sector's earnings growth has been — over 50% in the first quarter and over 70% in the second.

Also impressive is the pace of earnings growth excluding technology, which is tracking to 21% in the second quarter. Excluding AI stocks, as defined by Bloomberg, the earnings growth rate is an even more impressive 23.9%. And excluding the Magnificent Seven, which means the memory stocks with their surging earnings are included, earnings are growing 31%. Bottom line, while tech and AI are leading the charge, the stock market would not be where it is if it wasn't for help from the rest of the market.

Technology Remains by Far the Most Powerful Earnings Driver



Source: LPL Research, Bloomberg 08/13/26

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What Did We Learn About the Hyperscalers' Ability to Monetize Capital Investment Plans?

Our biggest question coming into earnings season was not so much about capital investment guidance from the hyperscalers; it was widely anticipated that those numbers would go higher. The top five are likely to spend nearly \$800 billion this year and well over \$1 trillion next year. Our biggest question was whether the hyperscalers would be able to monetize that massive investment. (Tom Shipp and Tucker Beale discussed this topic in their latest [Beyond the Numbers](#) report on July 22.)

Alphabet, Amazon, and Microsoft provided solid responses to that question, growing cloud computing revenue strongly. Let's take them one by one before we get to the nuanced story around Meta:

- Alphabet grew its cloud/AI revenue 82% in the quarter, the fastest in the group. Add to that a backlog of \$514 billion, and it looks like the company is monetizing its investment at a reasonable level. However, negative free cash flow in the quarter and the need for outside funding to add compute capacity, via both debt and equity issuance, caused investors to sell the news after second quarter results.
- For Amazon, revenue jumped 37% to \$42.2 billion at Amazon Web Services (AWS), the fastest pace of growth since the fourth quarter of 2021. AWS generates about a fifth of the company's revenue and most of its profits. Profit margins held up but capital investment drained all of the company's free cash flow, similar to the Alphabet story.
- Microsoft was the cleanest story. Revenue for Microsoft's cloud offering, Azure, accelerated to 43%. Perhaps more impressive, \$19.6 billion of free cash flow was generated in the quarter, best of this select group, and operating margins held steady. The software giant also told Wall Street that compute capacity added to the backlog was monetized quickly during the quarter and that they expect positive free cash flow in 2027.

Turning to Meta, where its AI investment to date is being used internally and not to support an external cloud business, the story is complicated. Meta was one of the earliest winners in the race to show improved results in its core business by implementing AI in its advertising business. Ad revenue grew a solid 27% in the second quarter, suggesting that trend continued.

But Meta does not have cloud revenue to justify its capital investment, leading to worries among some analysts that this cycle will be a repeat of the metaverse debacle back in 2022, when the stock fell 26.4% in a single trading session on February 3, 2022, on fears of wasteful spending. Another similar 24.6% one-day drop on October 27, 2022, sent the stock below \$100 for the first time since 2016.

Meta's capital expenditures guidance this quarter was too open ended for the market's liking, and progress toward monetization has lagged its hyperscaler peers, even though founder and CEO Mark Zuckerberg has indicated that selling excess computing capacity is being considered.

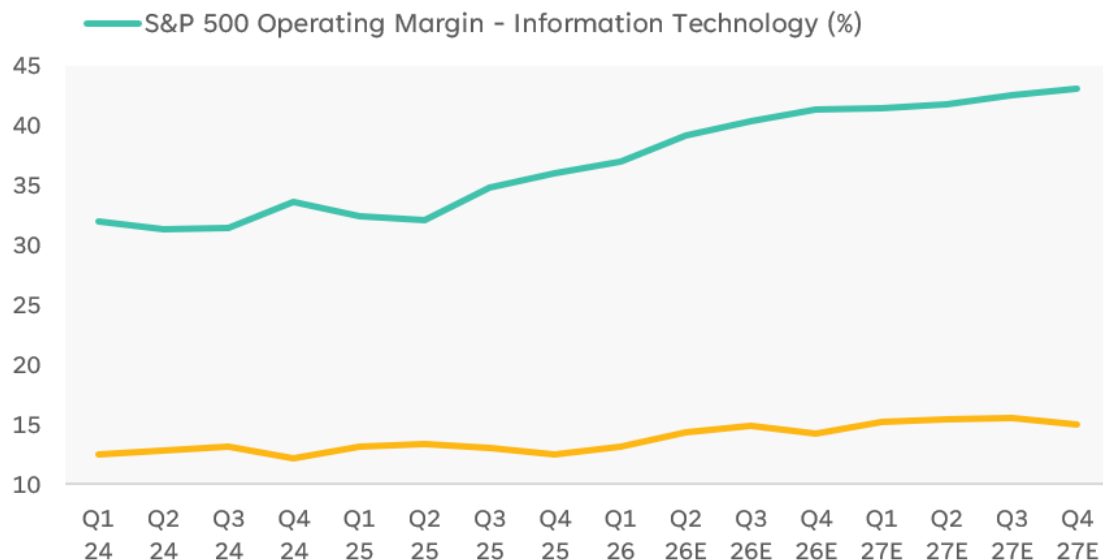
Bottom line, as a group, the hyperscalers have made progress convincing markets that the massive investment in AI compute will pay off. Total order backlog has surpassed \$2.5 trillion after increasing 18% quarter over quarter (source: Bloomberg). At the company level, Alphabet, Amazon, and Microsoft made some good strides, Amazon's and Microsoft's cloud revenue were particularly impressive, while Meta, on the other hand, still has some convincing to do.

Other Earnings Takeaways

Moving beyond mega cap technology, here are some other takeaways from earnings season that suggest the floor for stocks has likely been raised.

- **Margins remain on the upswing.** Profit margins for the S&P 500 are at record highs and are expected to go higher — with or without the technology sector — despite high oil prices and rising borrowing costs. The AI adoption productivity story is still in its early stages, but we're already seeing earnings growth (30% plus, excluding one-time mark-ups of investments) much faster than revenue (+15%). Much of the operating margin expansion in the quarters ahead is expected to come from the technology sector, as highlighted in the "Technology Margins Have Inflected Higher" chart, but non-technology operating margins have reached record highs and are expected to inch higher over the next few quarters.

Technology Margins Have Inflected Higher

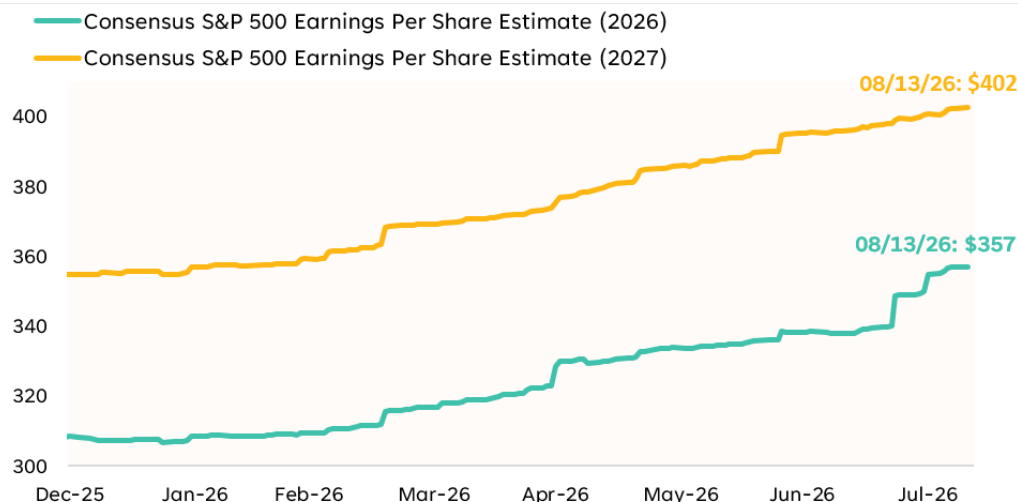


Source: LPL Research, Bloomberg 08/13/26

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- Estimates have risen.** Broadly speaking, one of the best ways to judge earnings season is by analyzing guidance to assess how confident management teams are about the future. We can do this by calculating the change in consensus estimates for S&P 500 EPS in 2026 and, especially, 2027, where the story is great and getting better. The “Earnings Estimates Continue to March Higher” chart illustrates this powerful trend. Actual earnings usually fall short of where estimates stood at the start of that year, but this year they have risen steadily. The consensus S&P 500 EPS estimate for 2026, based on aggregating company-by-company estimates, has risen 15% year to date, while the estimate for 2027 is up 13%. During the earnings reporting period over the past six weeks, estimates for 2026 and 2027 have increased by 5.6% and 1.8%, respectively, suggesting the earnings momentum has not slowed down. Positive earnings revisions like this typically only occur during recoveries from recessions, making this period highly unusual.

Earnings Estimates Continue to March Higher

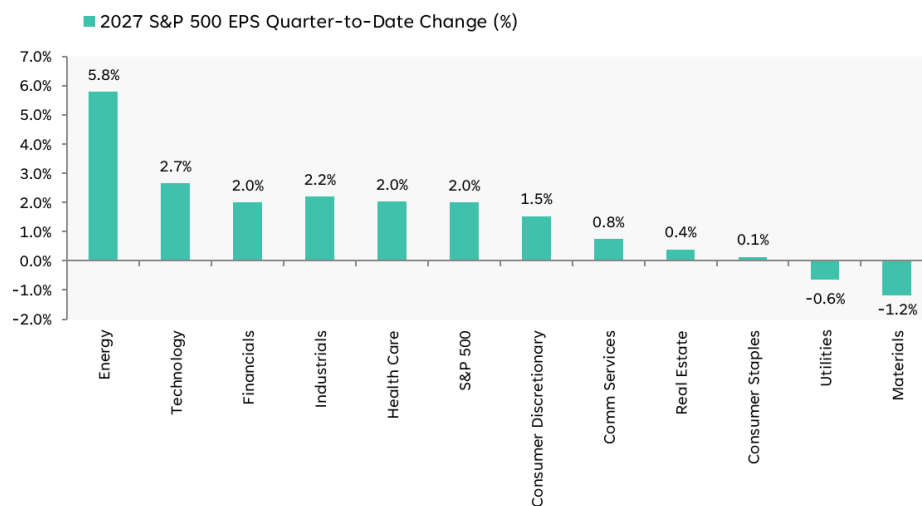


Source: LPL Research, Bloomberg 08/13/26

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- Impressive breadth of earnings momentum.** An overview of earnings season, of course, starts with AI and technology. But, as noted above, S&P 500 companies grew earnings over 20% excluding AI-levered companies. If one-time charges for Gilead (GILD) and Merck (MRK) are excluded, all 11 S&P sectors grew earnings by at least 8% in the second quarter (healthcare earnings excluding one-time items rose 18%, per FactSet). So, it wasn't just AI. Perhaps even more impressive is that 2027 estimates have increased for nine of 11 sectors since quarter-end, as shown in "2027 Earnings Estimates Lifted for Nine of 11 Sectors."

2027 Earnings Estimates Lifted for Nine of 11 Sectors



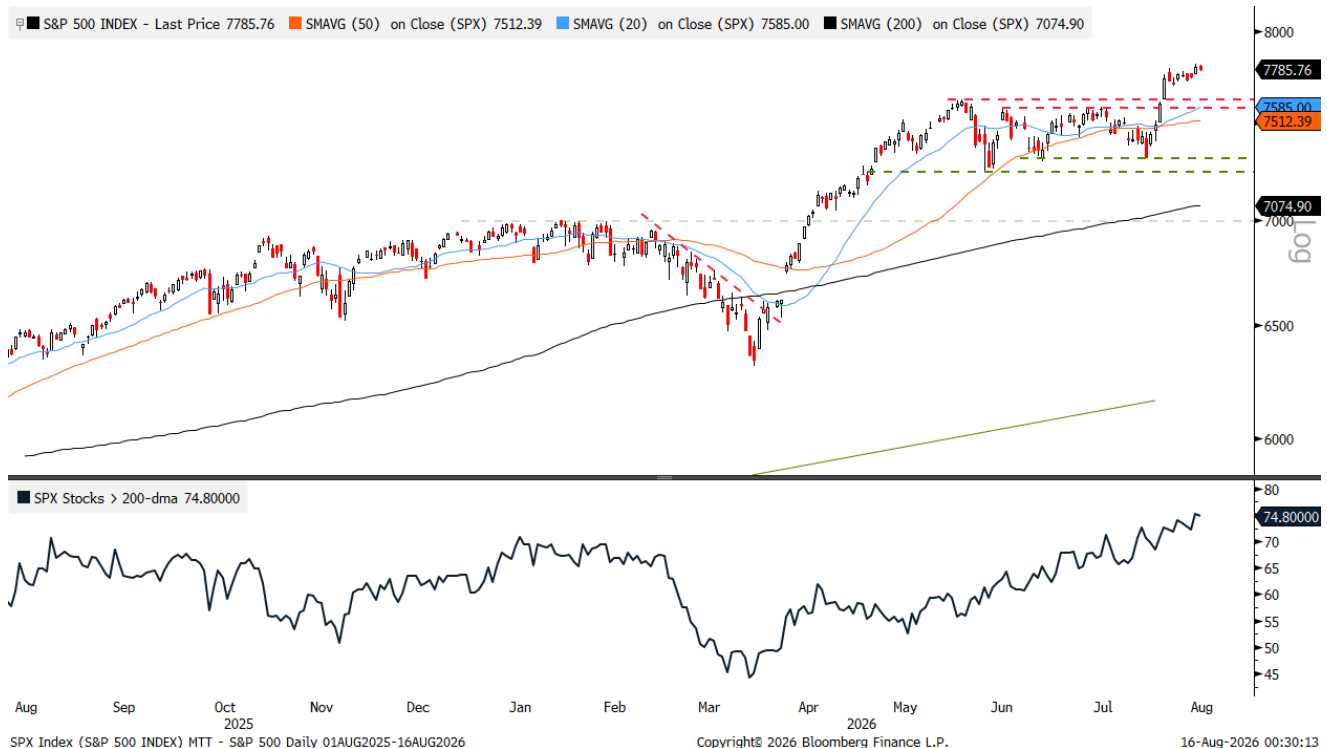
Source: LPL Research, Bloomberg 08/13/26

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Technical Breakout Raises the Ceiling

From a technical perspective, the S&P 500's breakout to new all-time highs in August is an important bullish development. The breakout follows a period of consolidation and has been supported by improving market breadth, with a growing number of stocks participating in the advance rather than a narrow group of mega cap leaders carrying the index higher. The index has held above key moving averages, while leadership from cyclical and growth-oriented sectors points to healthy risk appetite. While overbought conditions and seasonal volatility could create short-term pullbacks, the combination of a successful breakout and broad participation suggests the path of least resistance for stocks remains higher, setting up a minimum technical-based price objective of 7,950.

Textbook Breakout Points to More Potential Upside for the S&P 500



Source: LPL Research, Bloomberg 08/13/26

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Conclusion

Second quarter earnings season reinforced our view that corporate profits remain the most important pillar supporting stocks. While AI investment continues to drive a substantial share of earnings growth, particularly for technology, the breadth of improvement across sectors is also encouraging. Expanding margins, rising earnings estimates, and healthy participation beyond big tech suggest the earnings expansion is widespread and durable. Stronger profits have allowed valuations to become more attractive as stock prices have moved higher. Volatility tied to geopolitics, monetary policy, or the midterm elections may come in the months ahead, but the fundamental backdrop appears increasingly supportive and raises the floor. From a technical analysis perspective, the S&P 500's recent breakout to new all-time highs raises the ceiling.

Important Disclosures

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

The Standard & Poor's 500 Index (S&P500) 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.

The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

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.

All index data from FactSet.

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