

Equity Strategy Insights

The Bar is High for Corporate America This Earnings Season

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Executive Summary

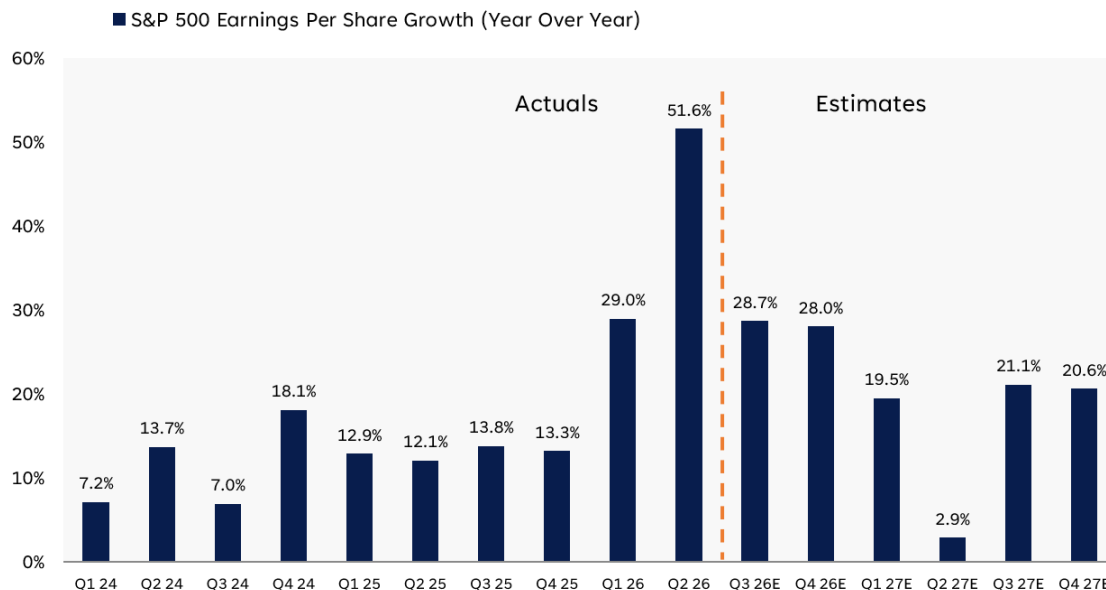
- Third quarter earnings face a high bar. We expect S&P 500 earnings growth in the high 30% to 40% range, although initial upside surprises have been modest.
- Earnings growth is broadening beyond artificial intelligence (AI) and technology. Six of the 10 non-technology sectors are expected to deliver double-digit earnings gains, strengthening the market's fundamental foundation.
- Margin expansion could continue gradually as AI boosts productivity, but input and financing costs remain headwinds. Historically, strong guidance has supported subsequent stock returns despite elevated expectations.
- For 2027, we forecast S&P 500 earnings of \$390 per share, up 11%. Continued AI investment offers upside potential, while macroeconomic uncertainty and margin pressures warrant caution.
- In our latest Equity Strategy Insights, we preview third quarter earnings season by answering four key questions that investors have been asking about corporate America's bottom line.

Big Numbers but High Expectations

We are about a week into third quarter earnings season, and so far, we would characterize the results as mixed against a high bar. While nearly half of the 79 S&P 500 companies that have reported so far have been banks and capital markets businesses — which have faced an increasingly challenging interest rate environment — the non-financials reports have not been particularly impressive as a group, leaving the average upside earnings surprise below recent trends at 4.8%.

The growth delivered by companies that have reported thus far has been outstanding at nearly 40%, and once all the numbers are in, our expectation is third quarter S&P 500 earnings per share (EPS) growth will be in the high 30% to 40% range despite the slow start. That could also change over the next few weeks as the big technology companies report results. That's where the growth will be — and possibly the upside relative to expectations.

Another Quarter of Over 30% Earnings Growth Expected



Source: LPL Research, FactSet, 10/19/26

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.

Question #1: Is All of the Earnings Growth Coming from Technology?

The simple answer to this question is no. In fact, one of the more encouraging fundamental developments this year has been the broadening of profit growth beyond AI infrastructure and leading sellers of cloud computing services. Technology clearly remains the dominant driver, as is illustrated in “AI is the Key Earnings Driver but Earnings from the Rest of the Market are Solid,” healthy economic growth is increasingly translating into very respectable earnings gains for the rest of corporate America.

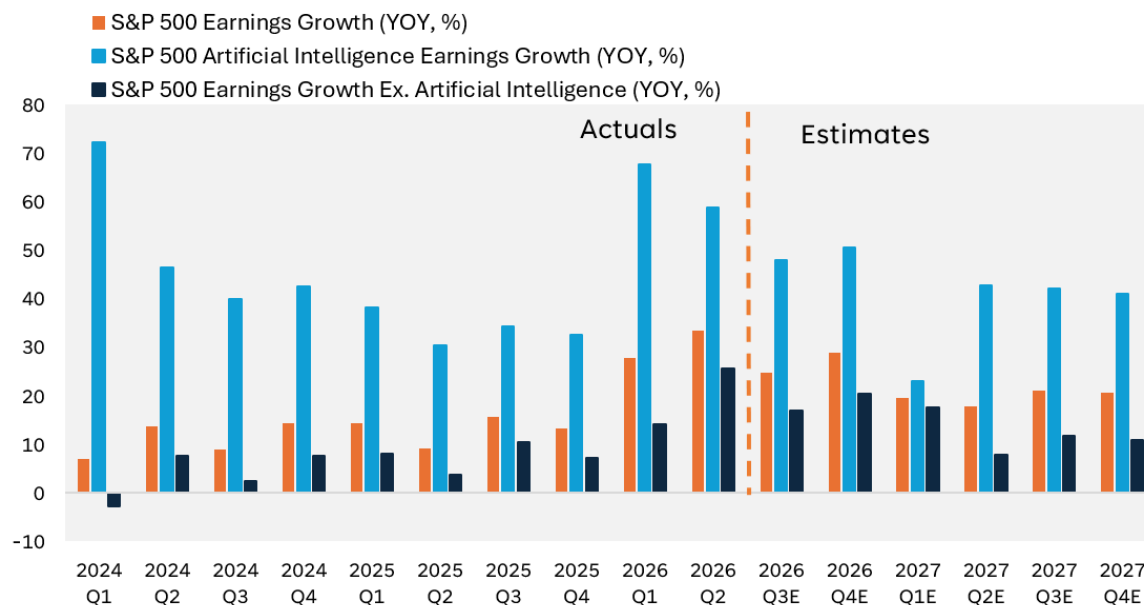
On the economy, despite well-known headwinds (e.g., \$100 oil, high interest rates), consider real GDP growth is expected to approach 3% for the third quarter, up from the consensus forecast of 1.8% three months ago. Add inflation to that to get nominal GDP, which has historically been well correlated to revenue, and you get more than 6%. Look at other economic indicators that tend to track corporate activity, like the ISM Manufacturing Index (mid-50s) and exports out of Korea (+83.5% year over year) and Taiwan (+60.9% year over year), and it’s easy to believe in the earnings power of the S&P 500.

That supportive backdrop is consistent with the numbers. The segment of the S&P 500 that is not directly AI related is expected to grow earnings at a 17% clip in the third quarter — a solid pace even if shy of the roughly 30% consensus growth rate reflected in broad S&P 500 estimates. With the typical upside companies generate, earnings growth over 20% from that segment seems very likely.

Cut another way, non-technology earnings are expected to grow 13% based on current consensus estimates. Add the typical upside and that pace should be in the high teens. Also consider that six of the 10 S&P sectors not named technology are expected to generate double-digit earnings gains.

Bottom line, AI is clearly an earnings accelerator, but it is not the only game in town. A broader mix of industries contributing to profit growth can strengthen the fundamental foundation underpinning this market. As we've seen over the past two weeks, when the AI trade and semiconductors aren't working, it's nice for the broad market averages to have something else to fall back on. Earnings are helping provide that buffer.

AI Is the Key Earnings Driver but Earnings From the Rest of the Market Are Solid



Source: LPL Research, Bloomberg 10/19/26

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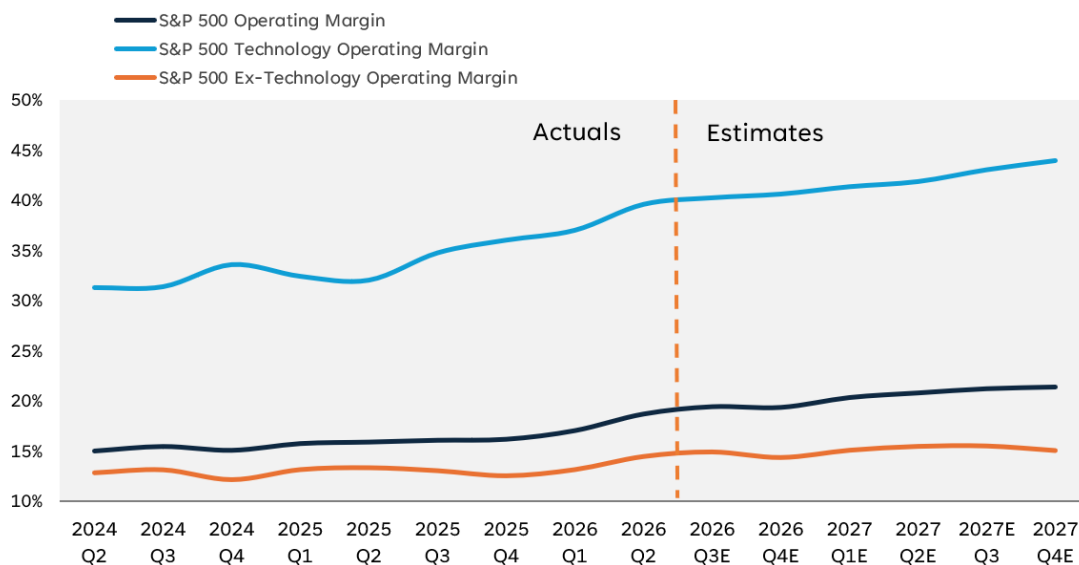
Question #2: Will Margins Continue to Expand?

It's no secret that corporate America is enjoying a boom in profits. Part of that profit boom has been driven by expanding profit margins. Will margin expansion continue? Although expectations through 2027 may be too high based on historical "mean reversion" of profit margins, we expect AI adoption to drive higher productivity, and with that productivity should come higher margins. But realizing that productivity benefit will take time and the ramp up could be slow. In the late 1990s dotcom buildout, the productivity ramp up took about five years — though the AI ramp should be quicker than that.

Inflation will remain a challenge in the near term, as higher commodity prices and transit disruptions will make margin expansion tougher. Meanwhile, higher costs of financing will likely weigh on net margins for the foreseeable future. Bottom line, expectations for margin expansion within the technology sector over the next six quarters may be achieved, but it may be a bit more difficult for the rest of the sectors to keep pace, as illustrated in "Corporate Profit Margins May Continue to Expand, But It Won't Be Easy." Broad market averages have become much more technology-heavy, which has boosted the baseline for profit margins. Keep that in mind when assessing overall margins for the S&P 500 Index.

In our September “[Beyond the Numbers](#)” publication, we estimated that only one point of the roughly 3.5 percentage points of margin expansion since the 2016–2019 average is structural, representing a higher baseline. The rest is either cyclical (primarily semiconductors), driven by pricing power, or resulting from delayed depreciation of capital investment. Bottom line, margins may continue to expand but only gradually, and when the AI capital investment cycle turns lower, expect margins to compress, and potentially by a couple of points or more.

Corporate Profit Margins May Continue To Expand, but It Won’t Be Easy



Source: LPL Research, Bloomberg 10/19/26

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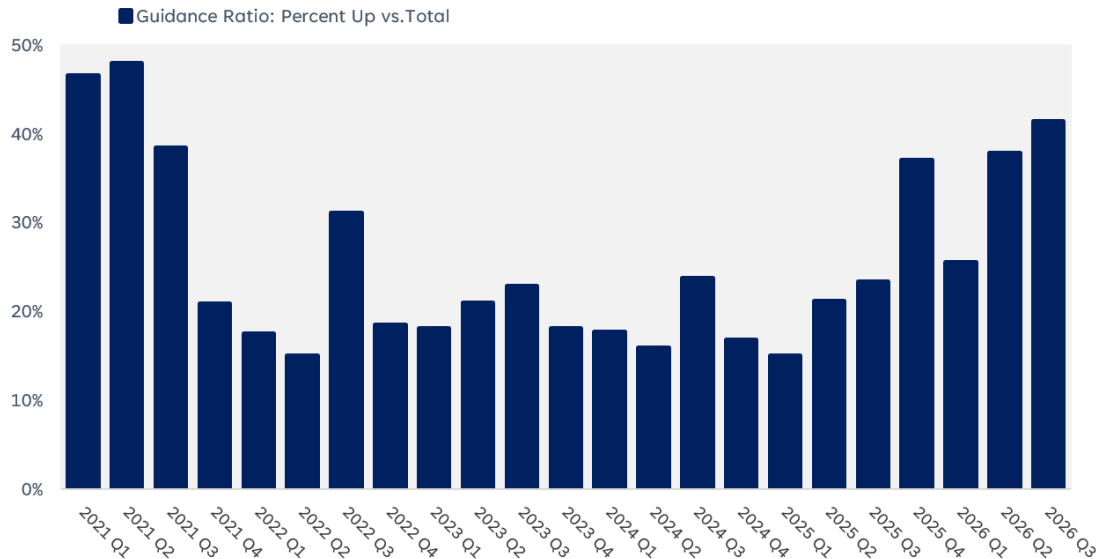
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Question #3: Are Expectations Too High?

Corporate earnings guidance entering the third-quarter reporting season was unusually positive, shown in the “Strong Guidance Ahead of Third Quarter Earnings” chart. According to Bloomberg data, 41% of S&P 500 companies that provided guidance for the third quarter raised estimates. That doesn’t sound like a lot, but it’s the highest positive guidance ratio in over five years and well above the 10-year average of 23.9%.

Another way to assess guidance is by using the change in the consensus S&P 500 earnings estimate for the quarter. On average, the consensus S&P 500 EPS estimate drops about 2% during a quarter. For the third quarter, analysts raised estimates by about 2.5%. The biggest driver of the increase in estimates will come as no surprise to anyone, it was technology.

Strong Guidance Ahead of Third Quarter Earnings



Source: LPL Research, Bloomberg, 10/19/26

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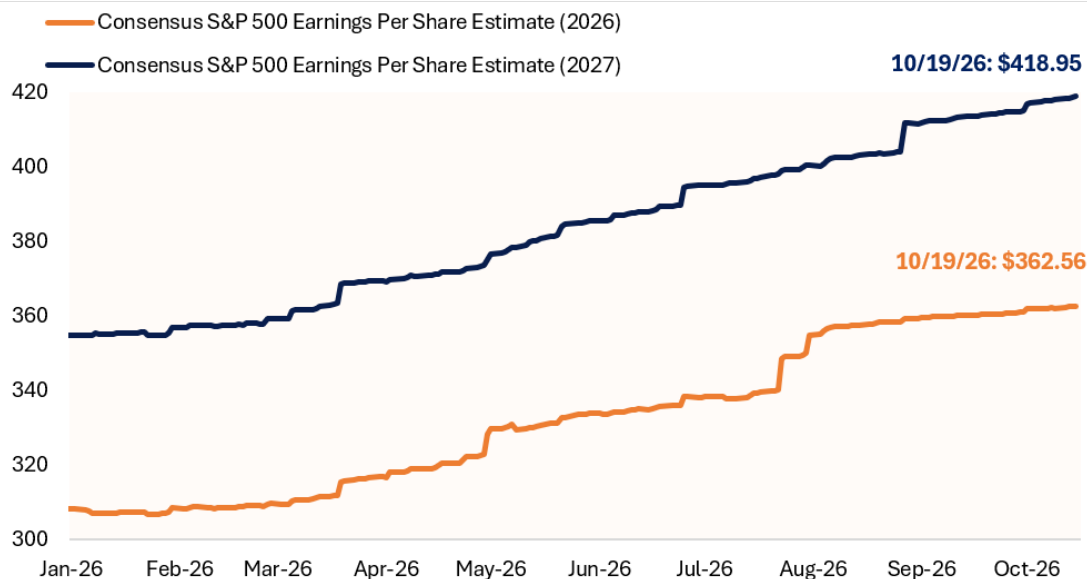
That begs the question of whether strong guidance increases the chance that results fall short of expectations and drags stocks down. To answer that question, we analyzed quarterly guidance ratio data back to 2012, broke the ratios into quintiles, and calculated the average returns by guidance quintiles. What we found was quite the opposite. In fact, the best average quarterly returns (+6.2%) followed quarters with the highest guidance ratios, and the worst average quarterly returns (+0.7%) followed the weakest guidance ratios. In other words, stocks handled the high expectations well and were not rewarded for clearing a low bar. This bodes well for stocks in the fourth quarter coming off a strong third quarter of guidance.

Question #4: Can 2027 Earnings Estimates Continue Rising?

We expect double-digit earnings growth in 2027, supported by continued AI investment, resilient economic growth, and a broadening of earnings gains. Whether corporate America can exceed our latest estimate of \$390 per share, an 11% increase from our \$350 estimate for 2026, will be a function of AI investment, which will likely exceed \$1 trillion next year.

The massive upside to capital expenditures guidance this year, which caused strategists including LPL Research to dramatically underestimate earnings, is unlikely to be repeated. However, given 1) the balance sheet strength of the companies doing the investing, 2) favorable pricing power, 3) the expected continued ramp in AI adoption driving productivity, and 4) the seemingly insatiable demand for computing power, we would not be surprised if our estimate ended up being too low again. In terms of risks, financing the AI buildout is a big one given high interest rates and uncertain payoffs. In addition, the macroeconomic and policy environment remains a wildcard, including potential margin pressures from commodity inflation in the event of continued shipping disruptions in the Persian Gulf and regulatory pushback on data center buildouts.

S&P 500 Earnings Estimates Have Risen Steadily All Year

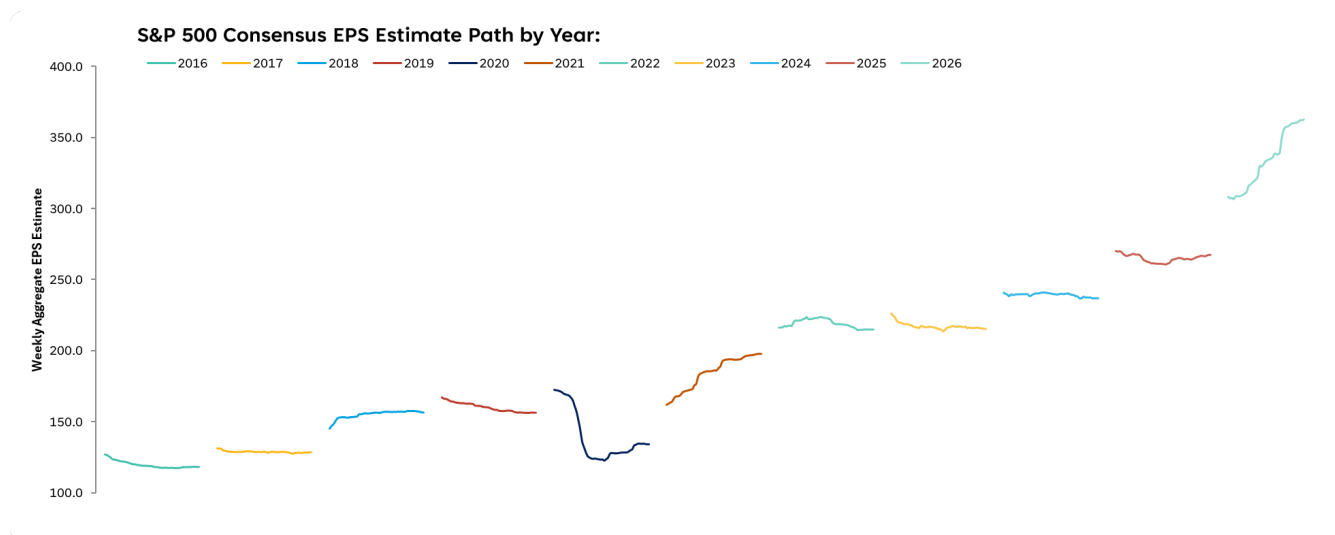


Source: LPL Research, Bloomberg 10/19/26

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To understand how unusual it is for earnings estimates to increase like they have this year, we have charted the path of consensus S&P 500 earnings estimates over the past 10 years. Besides this year, the only year in which earnings estimates increased materially was 2021, and that was coming out of the pandemic when expectations got way too low as the economy was effectively shut down. The increase in estimates in 2018 was driven by corporate tax cuts under Trump 1.0. Otherwise, estimates tend to move lower throughout the year. (Note that if we went back 20 or 30 years or more, the story would be the same.) In other words, 2026 has been a big-time outlier in terms of an earnings surprise, undoubtedly a big reason why stock market has returned about 13% so far this year.

The Jump in Earnings Estimates in 2026 Is Rare



Source: LPL Research, FactSet, 10/19/26

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Conclusion

Corporate America faces a high bar this earnings season, but the underlying profit picture remains encouraging. AI investment continues to power exceptional earnings growth, while improving contributions from other sectors suggest the fundamental foundation for stocks is becoming broader and more durable. Modest early surprises warrant attention, but the largest technology companies have yet to report.

High expectations alone need not derail stocks. Our historical analysis suggests stronger guidance has generally preceded better subsequent quarterly returns. Still, sustaining profit growth will require companies to navigate commodity inflation, ongoing shipping disruptions, and rising financing costs. AI productivity gains offer support, but further margin expansion is unlikely to follow a straight line.

Looking ahead, our 2027 S&P 500 earnings estimate of \$390 per share implies 11% growth, with potential upside from continued AI spending. Overall, broadening earnings strength supports a constructive outlook, balanced against macroeconomic uncertainty and the risk that elevated margin expectations prove difficult to achieve.

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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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