Weekly Market Commentary

September 21, 2026

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What's Holding Up Record Margins?

Profit margins have historically been cyclical, but the recent performance of S&P 500 companies has many investors questioning whether this rule still stands. Structural changes in the composition of the index, and the higher margin profile that results from that change, suggest that a higher baseline margin is justified. However, we argue that some portions of current and future profit margins are either cyclical or temporary, yet are being capitalized as permanent in current analyst forecasts. Here, we analyze the historical trajectory of S&P 500 margins, estimate how much of the recent margin expansion is structural vs. cyclical/temporary, and provide tangible examples with industry case studies.

Margins are Mean-Reverting. Right?

For decades, operating margins (earnings before interest and taxes, or EBIT, divided by sales) behaved like a cyclical series. When margins rose well above trend, the forces of competition, input costs, capacity additions, and customer pushback eventually compressed profitability. As Jeremy Grantham, investor and co-founder of asset manager GMO, famously said, *"Profit margins are probably the most mean-reverting series in finance, and if profit margins do not mean-revert, then something has gone badly wrong with capitalism."*

This has been a less reliable rule since the Global Financial Crisis (GFC), as S&P 500 operating margins did not revert to their historical average, but remained remarkably steady in what appeared to be a stepped-up new range from 2010 to 2019. The post-COVID-19 period has seen yet another step-change higher, and recent figures show an upward trend rather than a range. The current trailing-12-month operating margin is at a record high of approximately 16.5%, a level that several strategists thought to be a secular peak. Forward-looking bottom-up estimates sourced from Bloomberg suggest calendar year records will continue to be made in 2026 (19.8%), 2027 (22.1%), and 2028 (23.6%). While these out-year estimates may ultimately prove too optimistic and likely reflect "adjusted" rather than GAAP figures, analysts are clearly not anticipating a reversion to long-term or more recent averages. To put it mildly, current and forecasted margins appear stretched.

However, the simple chart glosses over the fact that the index has structurally changed over time. The S&P 500 has migrated away from capital-intensive cyclical businesses and toward companies with predictable recurring revenue and high incremental margins. So, has something gone badly wrong with capitalism? Or, does the mean-reversion argument need to be refined? We lean toward the latter and therefore do not expect today's S&P 500 operating margin to revert all the way back to the pre-2010 average without a significant change in the composition of the S&P 500. The risk is that investors mistake a higher baseline for a permanently rising one.

Technology Sector Mix: Is Intellectual Capital Still Capital-Light?

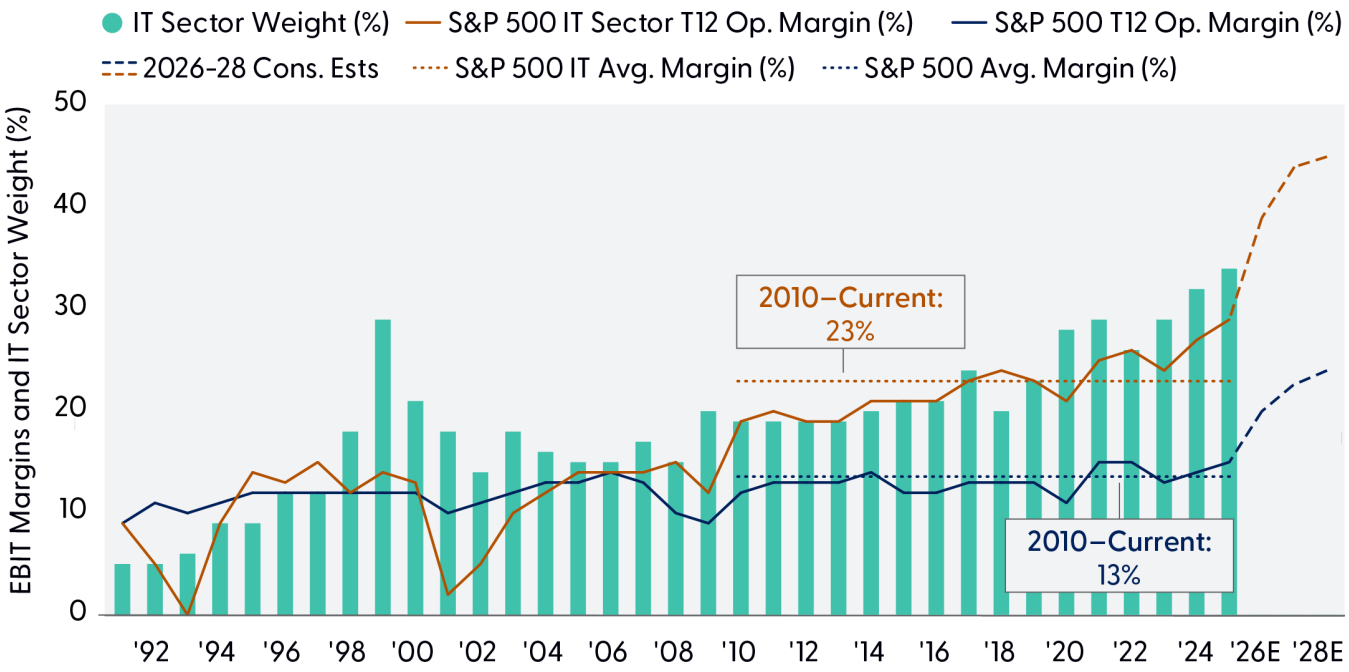
The biggest reason margins have defied historical gravity is the rising weight of the information technology (IT) sector and technology-adjacent businesses. IT now represents roughly 37% of the S&P 500. Add Alphabet Inc. (GOOG/L) and Meta Platforms (META) within communication services, plus Amazon.com (AMZN) within consumer discretionary, and the technology-linked index's weighting is roughly 48%.

Technology companies have historically had fundamentally lean business economics. The AI investment cycle complicates the story, however, as it is much more capital-intensive and "asset-heavy" than the sector's typical research & development focused expenditure. This leads investors to wonder whether the physical capital that is required to fuel the sector's "next big thing" growth bet will make index-level margins less durable.

Bulls argue that the return on investment will be great enough to drive incremental shareholder value. History is littered with successful executives committing ever more capital into exciting and innovative business opportunities,

with only subpar returns to show for it. What we do know is that many of the underlying businesses that drove index level margins to new heights have fundamentally changed.

IT Sector Margins and Index Weight

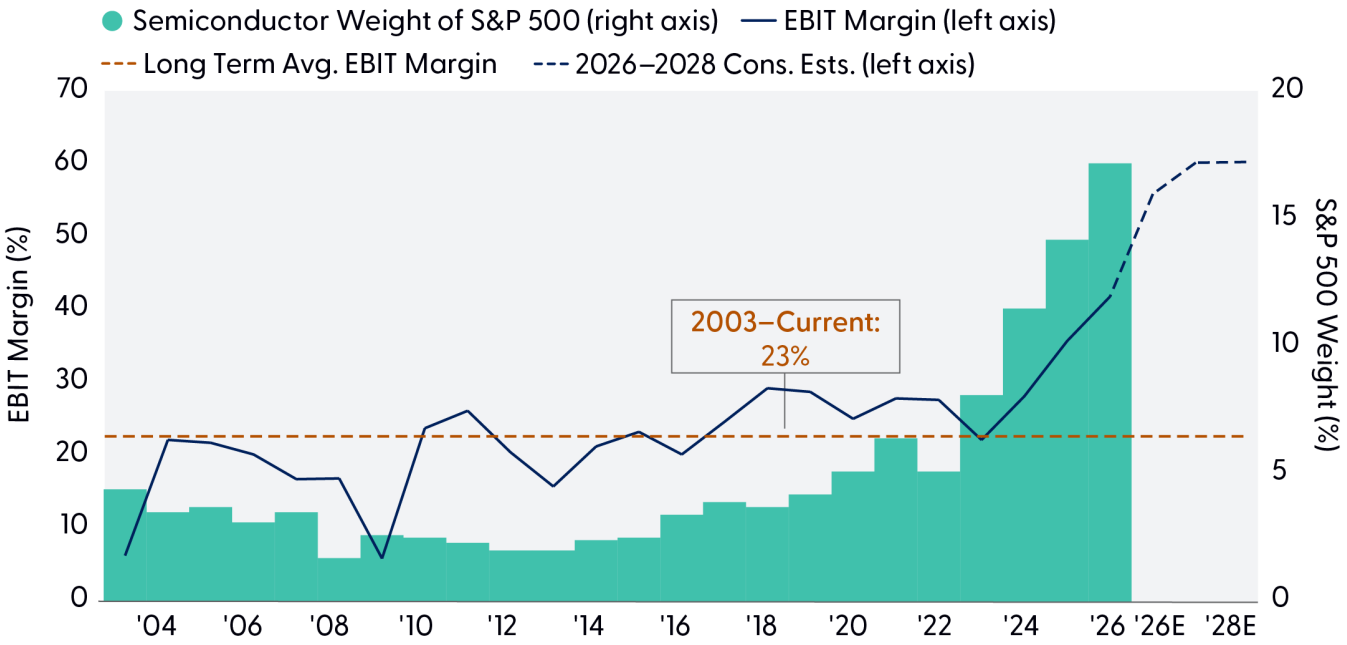


Source: LPL Research, Bloomberg 09/15/26
Disclosures: All indexes are unmanaged an cannot be invested in direectly. Past performance is no guarantee of future results. Estimates may not materialize as predicted and are subject to change.

The "IT Sector Margins and Index Weight" chart tells the story of the two impacts the IT sector has had on the market writ large. The first impact, sector mix, is structural and argues against operating margins mean-reverting to the pre-2010 average. The second impact is the intra-sector effect of technology margins themselves being at record levels as many of the largest companies are undergoing a capital-intensive business transformation — cyclicality hiding in plain sight.

Beyond the shift in the capital intensity of previously "asset-light" IT platform and software businesses, we also highlight the massive influence the semiconductor industry now has on S&P 500 operating margins as further evidence that investors should not capitalize current margins into perpetuity. The semiconductor industry has long been the cyclical corner of the tech sector, with booms and busts that produce a very different through-cycle earnings trajectory. As the primary beneficiary of the AI investment boom, the semiconductor and semiconductor equipment industry group now makes up ~45% of the technology sector, and ~17% of the entire S&P 500. Additionally, the industry has seen margins expand to record highs in the current cycle, which by our estimates, has driven nearly half of the index-level margin expansion from 2019. **To summarize: The now largest industry group, which has driven nearly half of S&P 500 margin expansion since 2019, is a cyclical industry with a history of capital-cycle booms and busts.**

Semiconductor Margins at All-Time Highs and Have Driven ~48% of S&P 500 Margin Expansion



Source: LPL Research, Bloomberg 09/15/26
Semiconductor index = S&P 500 Semiconductors and Semiconductor Equipment Industry Group GICS 2 Index
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.

Three Sources Driving Excess Margins

Today's record S&P 500 operating margins, when compared to a post-GFC/pre-COVID baseline, reflect the structural index composition effect previously outlined, plus three overlapping forces that we argue remain subject to the laws of gravity and are likely to reverse. We make a best-effort estimate of each factor below and plot their contributions in "Estimated Sources of S&P 500 Margin Growth Since the 2016-2019 Average." This analysis is illustrative of our view of a *normalized* operating margin and is not part of LPL Research's index EPS estimates.

For this analysis, we use the 2016–2019 average S&P 500 index level operating margin of 13.0% as our baseline level and decompose the incremental contributions to the current trailing 12-month operating margin of 16.5%, a total margin expansion of ~3.5%.

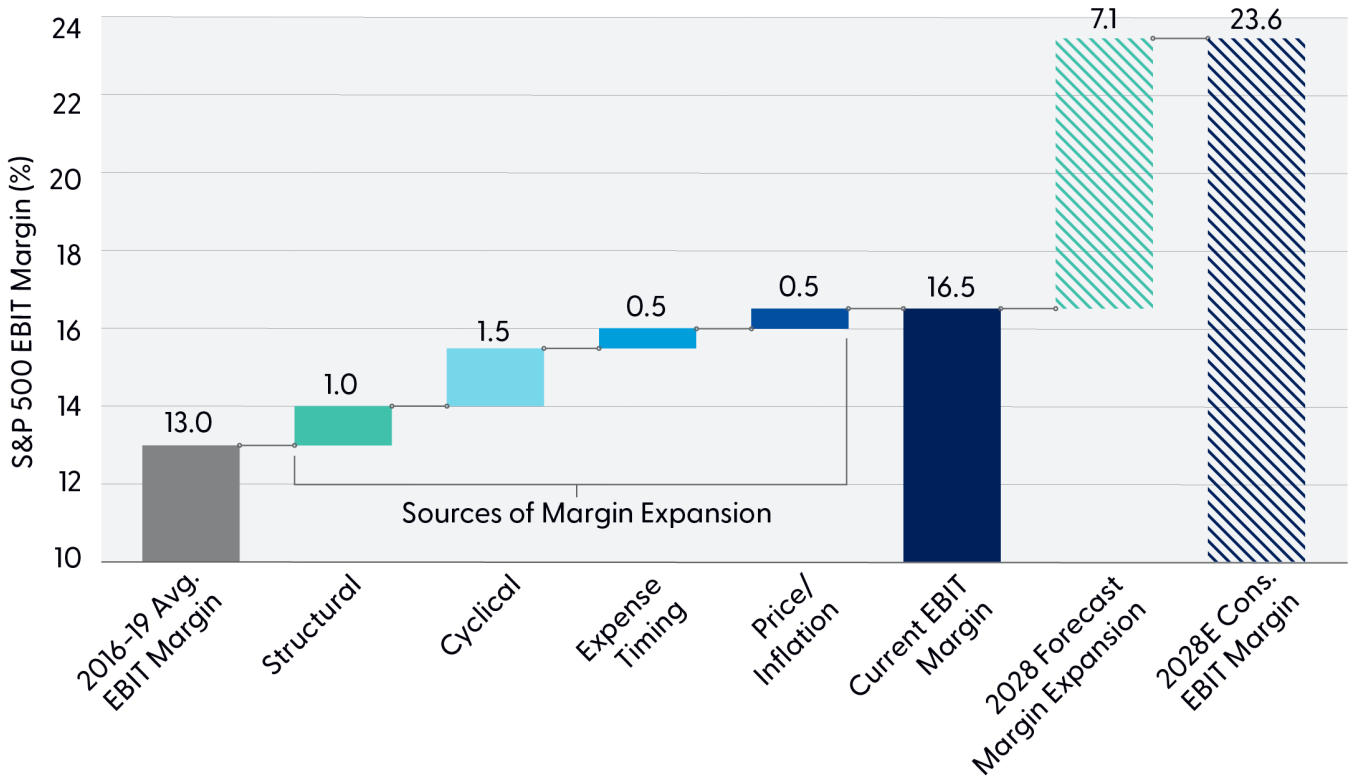
First, the structural effect. Here, we make an estimate of how much of that structural impact persists in a current normalized operating margin range. We estimate ~1% of the ~3.5% margin uplift is attributable to this structural index composition effect.

Second, the cyclical effect. This is primarily driven by the AI trade, as discussed with the semiconductor industry's cyclicality and record margins, and is admittedly the most opaque, and hardest to quantify. Given the record margin contribution driven by scarcity economics in the semiconductor industry, alongside those same scarcity economics driving data center capacity additions from the hyperscalers, we are comfortable applying the lessons from capital cycle theory in our 1.5% margin contribution assumption. Further, when we think about contributors driving forward margin estimates, should they come to pass, we would place most of that potential ~7% expansion from current levels to 2028 into this cyclical bucket.

Third, a temporary, accounting-based impact. The hyperscalers' cash capital expenditures have not yet fully reflected on income statements where GAAP EBIT margins are derived, due to the delayed recognition of depreciation expenses and leases. Simply put, hyperscaler capital spending is running far ahead of current accounting expense recognition, and the size and scale of this investment cycle merit an estimate of the impact. Our estimate works out to ~0.5% contribution, which we believe is fair, given the AI investment cycle beneficiaries' large overall contribution to index-level margins.

Finally, inflationary price-led revenue growth. In the years following the pandemic and inflation shock, many companies were able to raise prices faster than unit volumes declined. The risk is that price-led revenue can look like durable operating leverage when it is really a temporary pricing umbrella. This final margin expansion bucket serves as our plug to get from our baseline estimate to the current margin level, and therefore represents a 0.5% contribution to margin expansion.

Estimated Sources of S&P 500 Margin Growth Since 2016-2019 Average



Source: LPL Research, Bloomberg 09/15/26
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Unpacking Margins Across Select Industries

To stress-test whether today's elevated S&P 500 GAAP EBIT margins are structural or cyclical, we look across four industry case studies that each highlight a different margin mechanism. Taken together, these case studies suggest that the margin story is partially structural, partially cyclical, and partially a timing mismatch between investment and expense recognition.

Consumer Packaged Goods

Consumer packaged goods businesses in the consumer staples sector provide a clean case study in margin quality because the group's organic growth can be separated into price and volume. From 2010–2019, our CPG cohort generated average annual organic growth of 3.5%, with a reasonably balanced contribution from price (+2.0%) and volume (+1.4%), while GAAP EBIT margins averaged 17.1%. Recently, pricing has become the dominant growth driver as companies pushed through inflation-related increases, while volume turned negative. That pricing power helped protect profitability through the cost shock, and margins have remained elevated. **Put simply, CPG margins have not reverted because price did the work volume used to do**.

Airlines

Airlines are not directly accretive to S&P 500 operating margins in the current cycle. As a group, which we define as the big four domestic operators, Delta (DAL), United (UAL), American (AAL), and Southwest (LUV), operating margins have declined meaningfully from pre-pandemic levels. Importantly, utilization was largely unchanged, so the margin compression was not primarily a utilization problem. Unlike staples, where pricing more than protected margins through the inflation shock, airlines saw higher nominal fares absorbed by structural cost inflation in labor, maintenance, airport costs, and other non-fuel expenses. **The takeaway is that relying on price alone can only go so far.**

Commodity Producers

Commodity producers are the clearest example of why margin mean reversion remains relevant, even in a market where index-level margins may deserve a higher structural baseline. E&P's and miners are currently generating a GAAP EBIT margin well above the full-cycle average and far removed from the 2015–2016 bust. The current profitability is partially the product of a prior capital starvation cycle, and the group's post-bust margin growth was a price story *and* a capital discipline story.

For the S&P 500, this is not the dominant source of record margins as commodity producers represent only about a tenth of the EBIT-weighted margin contribution, but it is one of the more obviously cyclical pieces. **Put simply, commodity producers have not yet repeated the last capex mistake, but the conditions that usually lead to that mistake (high margins, strong FCF, and investor confidence in "new discipline") are increasingly in place.**

The AI Trade

The AI trade is the most important margin story in the market, and it is also the most two-sided. For the hyperscalers, the bull case is that AI demand is real and growing and capital outlays will generate returns to justify the spend. The risk is timing. GAAP EBIT margins today do not yet fully reflect the future depreciation and lease expense associated with the current infrastructure build. The hyperscalers purchased approximately $609 billion of property and equipment in the four quarters through June 2026, against roughly $118 billion of reported depreciation. Capex is an immediate cash cost, while depreciation is a gradual accounting expense. If revenue ramps ahead of depreciation, margins can hold. If revenue lags, EBIT margins face a mechanical headwind. This makes GAAP EBIT an incomplete forward-looking measure. The market is effectively underwriting a future return on AI infrastructure before that return is fully visible in the income statement.

Semiconductors are the other side of the same AI margin coin. The industry is experiencing scarcity economics in leading-edge chips, advanced packaging, high-bandwidth memory, and AI networking. Recently delivered extraordinary margins from the likes of Taiwan Semiconductor (TSM) and NVIDIA (NVDA) attract extraordinary capital. Semiconductor equipment sales are expected to rise sharply in 2026, and the supply response is already underway across leading-edge capacity, packaging, and memory. The historical pattern remains: tight supply drives pricing and utilization; pricing and utilization drive margins; margins attract capex; capex eventually normalizes supply and compresses returns.

Conclusion

If we were to summarize everything in one sentence, it would be that *margins are still mean-reverting, but the mean has moved*. The S&P 500 has earned a higher structural operating margin than it did in prior cycles because the index is more technology-heavy, more intangible-heavy, and more exposed to businesses with high incremental margins.

But accepting a higher structural baseline is not the same as accepting today's record margins as permanent. Price-led revenue in the consumer and industrial sectors may fade as volume matters more. Commodity producers are experiencing strong margins after prior "bust"-led downcycles led to years of underinvestment, and the cycle will eventually attract capital yet again. Semiconductor and AI infrastructure margins reflect scarcity conditions that are already attracting new supply. Hyperscaler GAAP EBIT margins have not yet absorbed the full depreciation and lease burden of the current AI capex cycle.

The right framework for investors is not "margins must revert" versus "margins have permanently broken higher." It is to decompose the margin level into structural, cyclical, and deferred components. The structural component earns a higher multiple, the cyclical component does not, and the deferred component requires scrutiny.

Asset Allocation Insights

LPL's Strategic and Tactical Asset Allocation Committee (STAAC) maintains its recommendation for a tactical equity overweight and fixed income underweight. We believe an improving macro backdrop and sustained AI-driven earnings growth will continue to support the broader equity market through the remainder of 2026. The Committee recently shifted the implementation of the equity overweight from low-volatility strategies to a quality-factor tilt to enable greater upside participation and allow portfolios to diversify between the AI theme and potential rotation beneficiaries. We continue to favor the industrials and energy sectors, providing a modest tilt toward value-style industry groups. Industrial companies offer a lower beta way to benefit from the AI infrastructure buildout, while an energy overweight offers a desirable hedge against potential additional disruptions to global energy production and shipping.

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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 or Bloomberg.

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