Market Analysis, Research & Education
A unit of Fidelity Management & Research Company

Q4 2010 U.S. Earnings Update

Revenue Growth Kept Profit Train Rolling

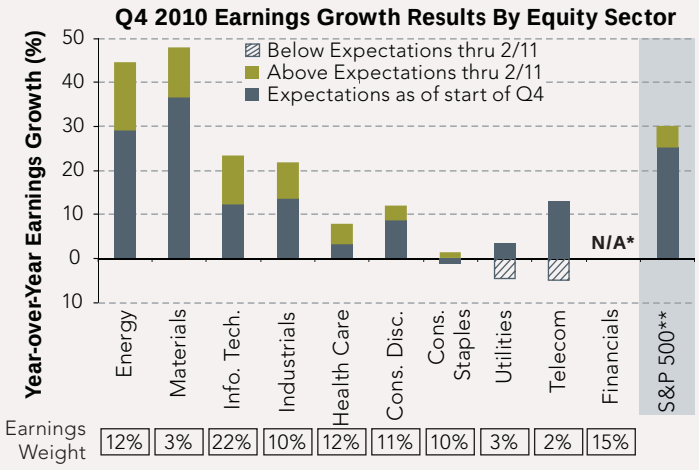
KEY TAKEAWAYS

- **With nearly three-quarters of S&P 500 companies having reported operating profits for Q4 2010, more than 70% of them have exceeded analysts' expectations. Collectively, revenue growth accelerated from the prior quarter and came in well ahead of analysts' consensus expectations, providing a broad boost to profitability.[i]**
- **The rate of earnings growth slowed in Q4 relative to recent quarters, but became more broad-based on a sector-by-sector basis as the economic recovery became more firmly entrenched; seven of 10 sectors beat prior earnings estimates, and eight of 10 sectors posted better-than-expected revenue growth.**
- **Earnings growth rates may continue to moderate going forward as comparisons to prior periods and profit margin expansion become more difficult, but a broadening U.S. economic expansion and strong growth abroad may lend support to continued profit gains.**

U.S. Corporate Earnings Scorecard - Q4 2010[i]

	% Reported (# Cos)	Positive Surprises	Negative Surprises
S&P 500	74% (372/500)	70.4%	23.1%
Consumer Discretionary	60% (48/80)	75.0%	22.9%
Consumer Staples	76% (31/41)	48.4%	35.5%
Energy	63% (25/40)	84.0%	16.0%
Financials	88% (71/81)	64.8%	32.4%
Health Care	82% (42/51)	85.7%	4.8%
Industrials	83% (48/58)	70.8%	20.8%
Information Technology	84% (64/76)	78.1%	14.1%
Materials	83% (25/30)	68.0%	24.0%
Telecommunication Services	33% (3/9)	33.3%	66.7%
Utilities	44% (15/34)	40.0%	53.3%

Earnings shown above represent operating earnings.
Source: FactSet, FMRCo (MARE) as of 2/11/11.

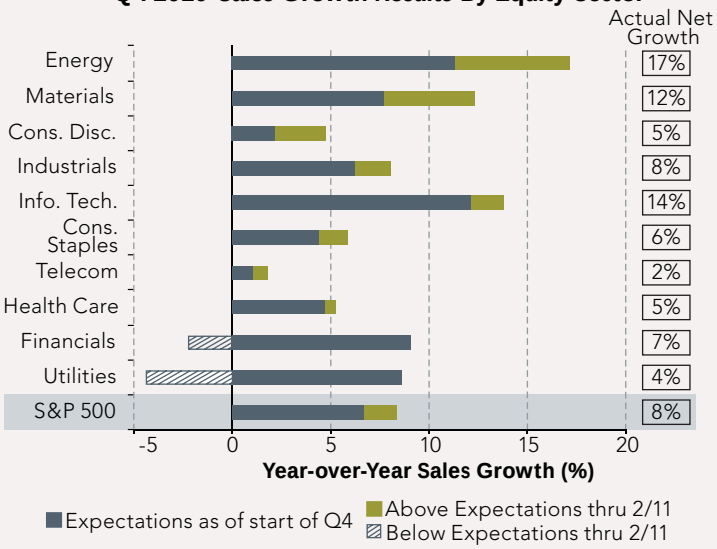


*Financials sector earnings grew by 432% in Q4, missing expectations of 1,122%. These figures were particularly large due to unusually low earnings in Q4 '09 as an after-effect of the financial crisis. Financials growth rates not charted due to scale. Actual growth incorporates estimates for companies that have not yet reported Q4 results. ****AIG projections and results are excluded from S&P 500 results due to significant revisions to prior earnings statements announced Feb. 9, 2011.** Source: FactSet, FMRCo (MARE) as of 2/11/11.

- For the seventh straight quarter, the combined earnings growth rate for S&P 500 companies' exceeded analysts' expectations.** Total Q4 earnings grew 30% year-over-year vs. expectations of 25%.
- The financials sector was the largest contributor to the S&P 500's collective rate of earnings growth (17 percentage points of the 30% overall growth rate), but those results fell short of expectations. The financial sector's 432% year-over-year quarterly growth rate was primarily due to a beneficial year-over-year comparison to Q4 2009, when earnings were depressed due to the after-effects of the financial crisis.
- Outside of financials, energy and materials stocks surpassed expectations by the greatest magnitude, and had the most robust profit growth due largely to rising commodity prices. Information technology and industrials—two sectors that are particularly sensitive to economic growth—grew earnings in excess of 20%, also ahead of expectations. Technology accounted for 22% of the total dollar amount of S&P 500 earnings—the largest sector contribution.

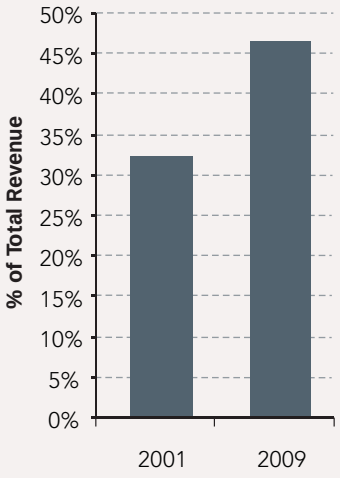
- After a disappointing third quarter, S&P 500 companies' total sales (i.e., revenue) rebounded in Q4, with growth exceeding expectations due to an improved economic backdrop.
- Total S&P 500 companies' sales grew 8% year-over-year, above consensus expectations of 6% growth. Eight of the 10 major sectors posted revenues ahead of expectations—a major reversal from the four of 10 that beat expectations during the prior quarter. All 10 sectors reported positive revenue growth for the first time since Q1 2010.
- Overall, a majority of firms (71%) beat revenue estimates in Q4—the highest surprise percentage in at least three years, and up from the 54% exceeding revenue estimates during the prior quarter.
- Supportive monetary policies and improving U.S. and global economic growth led to better-than-expected sales results for many economically sensitive sectors, such as consumer discretionary, industrials, and technology. Rising interest rates put pressure on revenues in the financials sector, which fell short of analysts' expectations.

Q4 2010 Sales Growth Results By Equity Sector

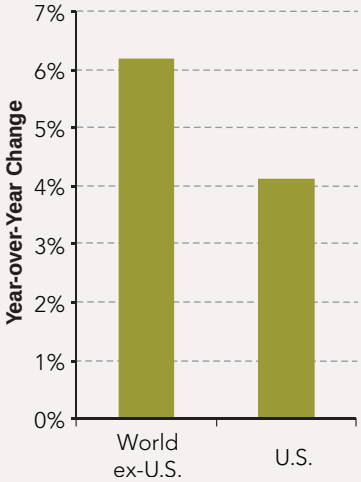


Growth above or below expectations shows total actual growth for sales and includes estimates for companies that have not yet reported Q4 results.
Source: FactSet, FMRCo (MARE) as of 2/11/11.

S&P 500 Foreign Revenues as % of Total



Expected 2011 Nominal GDP Growth



Source [left chart]: Standard and Poor's, FMRCo (MARE) as of 8/10/10.
Source [right chart]: International Monetary Fund (World GDP growth projection), Federal Reserve (U.S. GDP growth projection), FMRCo (MARE) as of 2/7/11.

- With profit margins nearing multi-year highs and the 2010 earnings rebound providing more difficult comparisons, the high pace of earnings growth driven primarily by cost-cutting may be fading. Increased corporate expenditures on equipment and other sources of capital investment, and signs of increased hiring, may mark a transition to a trend featuring more pressure on profit margins.
- However, higher capital expenditures (+17% year-over-year in Q4) may help buoy future top-line revenues by supporting the economic expansion, in turn reinforcing confidence in companies to expand their businesses.[ii]
- Increased exposure to accelerating global growth has helped larger companies boost their revenues and profits in recent quarters. S&P 500 companies derived 47% of all revenues from foreign sources in 2009, up from 32% in 2001.[iii] While recent data has pointed to a broadening U.S. expansion, growth outside the U.S. has been faster during the past year, is expected to continue in 2011, and thus may be a key driver of future U.S. corporate profits.

Investment implications

Better-than-expected corporate sales growth reflected a potential shift in the economic climate. Improving sales trends typically make companies more willing to spend capital to grow their businesses, something they had been reluctant to do until more recently. Increased corporate spending is a vote of confidence in the business outlook and could further reinforce the pick-up in economic activity. However, increases in spending also raise costs for firms and serve as a headwind for profit margins. A continued solid economic backdrop, both in the United States and abroad, will likely be necessary to provide enough revenue growth to offset rising margin pressures. The profit environment remains largely favorable, but a more moderate average rate of earnings growth for large U.S. companies may be expected in 2011. ■

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You cannot invest directly in an index.

Stock values fluctuate in response to the activities of individual companies and general market and economic conditions.

[i] All references to earnings in this article refer to operating earnings, which is net income adjusted for extraordinary items, one time items, etc., and better represents continuing earnings. All year-over-year growth figures are calculated using the S&P 500 Index constituent companies as of 12/31/2010. All sectors represented by S&P 500 Global Industry Classification Standard (GICS)® sectors. Source: FactSet Estimates, FMRCo (MARE) as of 2/11/2011.
[ii] Source: FactSet, FMRCo (MARE) as of 2/11/11.
[iii] Sales data by source are generally reported annually. 2010 results are not yet fully available, so 2009 represents the last available fully-reported year. Source: Standard and Poor's, FMRCo (MARE) as of 8/10/10.

Sales and earnings growth rates show year-over-year operating earnings and sales growth on a bottom-up basis using S&P 500 Index constituent companies as of 12/31/2010. Sectors are defined by GICS.

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