



Market Analysis, Research & Education

A unit of Fidelity Management & Research Company

Q1 2011 U.S. Earnings Update

Pace of Growth Moderating But Guidance Firm

KEY TAKEAWAYS

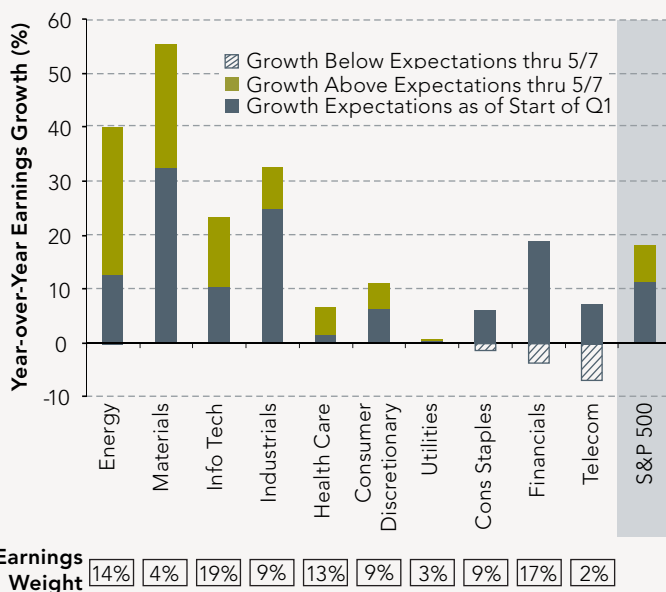
- With most S&P 500 companies having reported operating profits for Q1 2011, roughly 68% of them have exceeded analysts' expectations. The highest rate of upside surprises came from sectors historically associated with the mid-cycle phase of expansion.
- The rate of growth for both profits and sales continued to moderate relative to recent quarters, but remained at healthy levels. Earnings and sales results surpassed expectations across most sectors.
- Earnings guidance has remained firm for the coming year as companies continued to be upbeat about prospects for profitability despite headwinds from higher energy prices and other macro challenges.

U.S. Corporate Earnings Scorecard - Q1 2011ⁱ

	% Reported (# Cos)	Positive Surprises	Negative Surprises
S&P 500	88% (441/500)	68.4%	22.0%
Consumer Discretionary	73% (58/79)	69.0%	20.7%
Consumer Staples	76% (31/41)	54.8%	25.8%
Energy	100% (41/41)	61.0%	31.7%
Financials	100% (81/81)	67.5%	25.0%
Health Care	92% (48/52)	91.7%	6.3%
Industrials	93% (55/59)	70.9%	20.0%
Information Technology	79% (59/75)	72.9%	15.3%
Materials	97% (29/30)	82.8%	13.8%
Telecommunication Services	89% (8/9)	25.0%	25.0%
Utilities	94% (31/33)	41.9%	48.4%

Earnings shown above represent operating earnings.
Source: FactSet, FMRCo (MARE) as of 5/7/11.

Q1 2011 Earnings Growth Results By Equity Sector

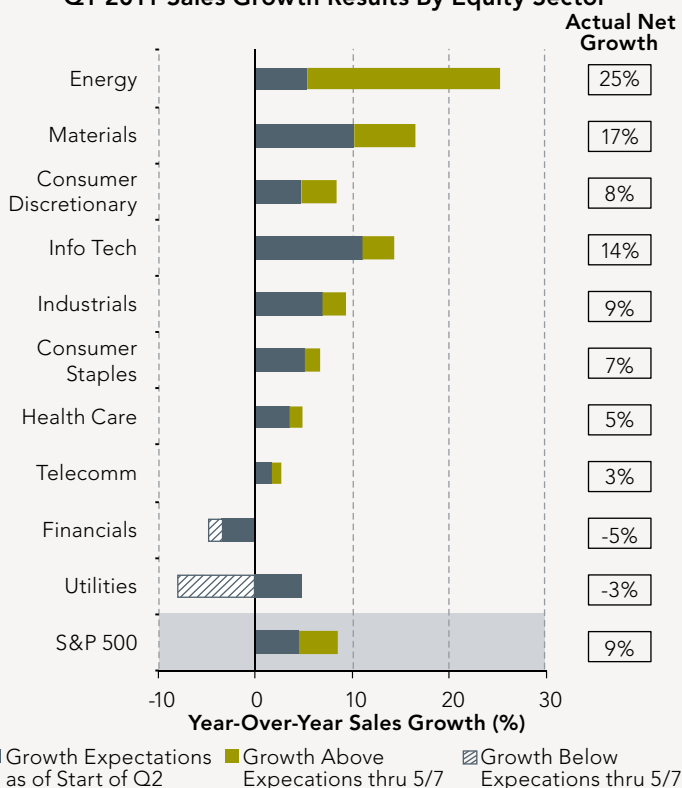


Actual growth incorporates estimates for companies that have not yet reported Q1 results.
Source: FactSet, FMRCo (MARE) as of 5/7/11.

- For the eighth straight quarter, the combined earnings growth rate for S&P 500 companies exceeded analysts' expectations. Total earnings grew 18% on a year-over-year basis during the quarter, compared to analysts' expectations of 11%.
- The energy, materials, industrials, and information technology sectors had the strongest rates of profit growth and exceeded expectations by the largest margins. Historically, these sectors have been associated with leadership during the mid-cycle phase of economic expansion, a period typified by broadening activity yet moderating rates of overall growth. Taken together, these four sectors accounted for more than three-quarters of the market's 18% year-over-year operating earnings growth.
- The financials sector missed profit expectations for the second straight quarter as newly enacted regulatory reforms and weak loan demand combined to create a challenging profit backdrop. Consumer staples sector stocks missed analysts' expectations as high commodity prices and input costs weighed on profit margins. Telecom stocks also underperformed analysts' expectations.

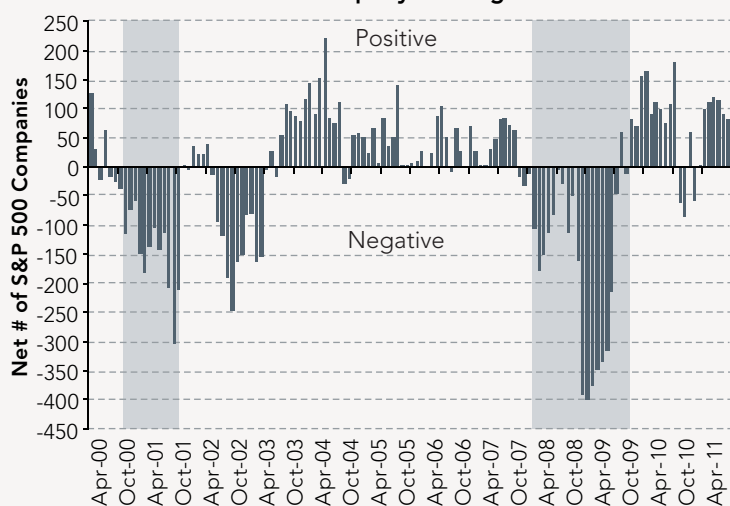
- For the second straight quarter, S&P 500 companies' total sales (i.e., revenue) exceeded previous analyst expectations. Total S&P 500 companies' sales grew 9% on a year-over-year basis, above consensus expectations of 5% growth. This was the largest positive percentage-point difference between results and expectations in at least three years.
- A large majority of companies (67%) beat revenue estimates in Q1, which marked the highest surprise percentage for revenues in three years, and continued the broad-based rate of upside surprises in revenue (66%) seen in Q4 2010.
- Sales growth also generally was strongest in areas associated with mid-cycle leadership on a sector-by-sector basis, and was primarily driven by an improving economic backdrop and rising commodity prices. Eight of the 10 major sectors posted revenues ahead of expectations for the second straight quarter.
- Strong price appreciation for most commodity categories provided a tailwind to revenues for energy and materials sector companies. The energy sector was responsible for more than one-third of the S&P 500's total revenue growth.
- In addition to commodity-related stocks, industrials and information technology sector firms benefited from relatively strong global growth. Gradual but continued repair in labor markets helped buoy U.S. consumers' buying power, driving above-consensus revenues in the consumer discretionary sector.

Q1 2011 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 Q1 results.
Source: FactSet, FMRCo (MARE) as of 5/7/11.

Net S&P 500 Company Earnings Revisions



Shaded areas represent recessions as defined by the National Bureau of Economic Research. Net revisions show number of companies within the S&P 500 Index that revised earnings expectations upward minus the number of companies that revised earnings expectations downward. Source: I/B/E/S, FactSet, FMRCo (MARE) as of 4/30/11.

- Companies have continued to affirm earnings guidance with a slight upward bias for the coming year, despite increased uncertainty over the economic outlook given high energy prices and the impending end of the Fed's second round of quantitative easing (see chart, left).
- In addition, "in-line" guidance affirmations—when company guidance matches Wall Street's consensus view—hit a record high in April.ⁱⁱ An above-average rate of in-line guidance has historically been accompanied by less-volatile, moderate earnings growth.
- This trend is consistent with being in the middle of the business cycle, when companies settle into a steadier phase of growth, leaving behind the early phase of recovery when comparison with past periods of low economic activity made large growth rates easier to obtain.
- In contrast, turning points in the momentum of earnings historically have been preceded by large spikes in either positive or negative guidance revisions. For example, large declines in earnings during 2001 and 2008 were preceded by broad-based reversals in company guidance.

Investment implications

Both earnings and sales data have helped to affirm that U.S. stocks are in the mid-cycle phase of economic expansion. As seen in the Q1 results, this phase of the cycle is accompanied by a slowing rate of profit growth, as easy comparison periods roll off and rapidly expanding productivity and profit margins slow. Improving revenues have been crucial to continued profit expansion in this environment, and it was particularly encouraging to see revenue growth

remain strong even when Q1 GDP growth was disappointing. Despite continued uncertainty surrounding macro conditions from monetary policy to geopolitical turmoil, companies have become increasingly confident in their ability to meet current expectations. With the market anticipating nearly 10% sales growth and 18% profit growth in 2011, fulfilling expectations would provide a solid corporate underpinning for asset markets. ■

The Market Analysis, Research and Education (MARE) group, a unit of Fidelity Management & Research Co. (FMRCo.), provides timely analysis on developments in the financial markets.

[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 3/31/2011. All sectors represented by S&P 500 Global Industry Classification Standard (GICS)® sectors. Source: FactSet Estimates, FMRCo (MARE) as of 5/9/2011.

[ii] Source: Bloomberg, FMRCo (MARE) as of 4/30/2011.

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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.

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 3/31/2011. Sectors are defined by GICS.

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