23 October 2009

Equity Strategy
Global

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US Q3 results: feel the beat

- **With a third of the S&P 500's market cap having now reported, we find that the season is coming in significantly ahead of analysts' expectations**
- **78% of companies have beaten on the bottom line, many by a wide margin; moreover, we are now seeing more top-line surprises emerging with beats here outnumbering misses by a factor of two-to-one**
- **The positive news is broad-based, but technology is the standout sector, with a hugely impressive 90% of companies beating on the EPS line and 95% beating on the sales line**

The US Q3 results season has so far significantly exceeded market expectations. With 35% of the S&P 500's market cap having now reported (through Wednesday 21 October), our analysis shows that 78% of the constituent companies have provided a positive EPS surprise in the third quarter and only 12% have missed (remember on average 60% beat expectations and 20% miss).

However, it's not just the number of companies beating expectations that has impressed, but also the magnitude of the beat – we estimate a positive EPS surprise of 21% for the S&P 500 index. And even if we exclude the volatile financials sector (where the EPS surprise stands at a huge +224%) we still get an impressive EPS surprise +12%.

If we combine the figures from the companies that have reported with the consensus forecasts of those still to report, we arrive at a 'blended' growth rate of -23%. Note, Q3 will be the ninth consecutive quarter where EPS growth has been negative, but it is almost certain to be the last in the current cycle, with the rate set to turn sharply positive in Q4.

So what about sales? Isn't aggressive cost-cutting the only reason companies are beating? No, is the short answer. Our analysis shows that 59% of companies have also beaten sales expectations and these have outnumbered the number missing by a factor of two-to-one.

The fact that we are now getting more upside surprises coming through at the top line is reassuringly positive for the earnings outlook and we see no reason to change our view (recently set out in *Equity Insights Quarterly: upgrade cycle to continue,* 6 October 2009) that the earnings upgrade cycle has further to run and that consensus expectations for 2010 earnings are too low.

We are maintaining our pro-market view and we stay pro-beta at both the regional and sector levels.

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HSBC strategy recommendations

Global market calls

Market	HSBC call	Weight: MSCI AC World (%)	Weight: HSBC (%)	Weight: Difference (% pts)	Blue-chip index	Current level	Target: End-2009 level	Target: Chg vs current	Target: End-2010 level	Target: Chg vs End-09
US	Under	41.2	35.0	-6.2	S&P 500	1,081	1,100	2%	1,225	11%
Pan-Europe	Over	29.7	35.2	5.5	FTSE Eurofirst 300	1,026	1,050	2%	1,250	19%
Eurozone	Over	14.4	19.5	5.1	EUROSTOXX 50	2,937	3,030	3%	3,700	22%
Japan	Neutral	8.6	8.9	0.3	TOPIX	914	950	4%	1,100	16%
UK	Under	8.9	5.6	-3.3	FTSE 100	5,258	5,300	1%	5,900	11%
France	Neutral	4.7	4.6	-0.1	CAC 40	3,873	4,000	3%	4,600	15%
Germany	Over	3.5	8.0	4.5	DAX 30	5,833	6,200	6%	7,500	21%
China	Over	2.3	2.9	0.6	MSCI China	64	66	2%	75	14%
Brazil	Neutral	2.0	1.9	-0.1	Bovespa	65,485	64,000	-2%	74,000	16%
India	Under	0.9	0.0	-0.9	SENSEX	17,009	16,000	-6%	18,000	13%
Russia	Over	0.9	4.0	3.1	RTS	1,447	1,400	-3%	1,850	32%

Note: figures do not add because some countries excluded
Source: HSBC, Thomson Financial Datastream, MSCI

Global sector calls (benchmark: MSCI AC World index)

Market	HSBC call	Weight: MSCI AC World (%)	Weight: HSBC (%)	Weight: Difference (% pts)	Preferred industries within sector
Energy	Neutral	12.0	11.4	-0.6	Energy Equipment and Services
Materials	Neutral	8.3	7.9	-0.4	Construction Materials
Industrials	Over	10.0	13.5	3.5	Machinery, Electrical Equipment, Industrial Conglomerates
Consumer Discretionary	Neutral	8.7	8.8	0.1	Household Durables, Media
Consumer Staples	Under	9.5	5.0	-4.5	
Health Care	Under	8.7	5.0	-3.7	
Financials	Over	21.9	28.0	6.1	Commercial Banks, Diversified Financial Services, Insurance
IT	Over	11.6	15.5	3.9	IT Services, Internet Software & Services
Telecom Services	Under	5.0	2.9	-2.1	
Utilities	Under	4.4	2.0	-2.4	

Source: HSBC, Thomson Financial Datastream, MSCI

Global Super Ten

Code	Company	Country	Industry	Analyst	*Price (local) 21-Oct-09	Target price	Currency	Potential return (%)	HSBC rating	Market cap (USDmn)
2409.TW	AU Optronics	Taiwan	Electronic Eqpt Inst & Components	Su, Frank	32.05	59.00	(TWD)	84	Overweight (V)	8,679
3988.HK	Bank Of China Ltd	China	Commercial Banks	Dunivant, Todd	4.57	5.60	(HKD)	23	Overweight (V)	44,827
LLOY.L	Lloyds Banking Group	UK	Commercial Banks	Toeman, Peter	0.92	1.50	(GBP)	64	Overweight (V)	41,310
ROSN.RTS	Rosneft OAO	Russia	Oil, Gas & Consumable Fuels	Redman, Anisa	8.37	9.50	(USD)	14	Overweight (V)	90,263
PERP.PA	Pernod Ricard	France	Beverages	Rambourg, Erwan	56.00	68.00	(EUR)	21	Overweight (V)	21,720
005930.KS	Samsung Electronics	Korea	Semiconductors & Semiconductor Eq	Park, Nam	735,000	1,021,000	(KRW)	39	Overweight (V)	91,797
SAND.ST	Sandvik	Sweden	Machinery	Gibson, Colin	79.50	100.00	(SEK)	26	Overweight (V)	13,776
SAN.MC	Santander	Spain	Commercial Banks	Digrandi, Carlo	11.66	13.20	(EUR)	13	Overweight (V)	142,637
TEF.MC	Telefonica	Spain	Diversified Telecom Services	Minerva, Luigi	19.04	21.50	(EUR)	13	Overweight	134,370
VWS.CO	Vestas Wind	Denmark	Electrical Equipment	Clover, Robert	340.50	500.00	(DKK)	47	Overweight (V)	13,978

Source: HSBC, Thomson Financial Datastream, MSCI. *At close.

US Q3 results season EPS and Sales analysis (through 21st October): S&P 500 index and sectors

	Percentage to have reported by		Actuals (reported)										Estimates (yet to report)				Blended (actuals and estimates)			
			Earnings	EPS				Sales					Earnings	EPS	Sales		Earnings	EPS	Sales	
	# %	Mkt cap %	Value USDbn	YoY %	Beat %	Miss %	Perc surp*	Value USDbn	YoY %	Beat %	Miss %	Perc surp*	Value USDbn	YoY %	Value USDbn	YoY %	Value USDbn	YoY %	Value USDbn	YoY %
Energy (40)	**10**	**5**	**0.5**	**-65**	**75**	**25**	**28**	**6**	**-29**	**50**	**50**	**5.7**	**15.6**	**-64**	**259**	**-43**	**16.0**	**-64**	**266**	**-43**
Materials (30)	**27**	**45**	**1.8**	**-15**	**88**	**13**	**46**	**23**	**-23**	**38**	**50**	**3.9**	**1.2**	**-74**	**45**	**-29**	**3.0**	**-56**	**68**	**-27**
Industrials (59)	**31**	**46**	**5.0**	**-56**	**83**	**11**	**22**	**116**	**-14**	**33**	**50**	**-3.3**	**7.4**	**-34**	**117**	**-14**	**12.4**	**-45**	**233**	**-14**
Capital Goods (37)	35	57	4.5	-57	77	15	24	108	-14	38	54	-3.6	4.6	-32	73	-14	9.1	-48	181	-14
Commercial Servs & Supplies (12)	17	11	0.1	-44	100	0	7	1	-28	0	50	-0.9	0.9	-26	13	-2	1.0	-28	14	-5
Transportation (10)	30	18	0.4	-24	100	0	6	7	-15	33	33	1.2	1.9	-39	31	-19	2.4	-37	38	-19
Consumer Discretionary (78)	**14**	**10**	**1.5**	**-16**	**73**	**9**	**7**	**21**	**-10**	**45**	**36**	**-0.3**	**9.1**	**26**	**255**	**-7**	**10.6**	**17**	**276**	**-8**
Automobiles & Components (4)	25	13	0.0	-85	0	100	-48	1	-21	100	0	1.9	-0.1	97	40	-14	-0.1	98	41	-14
Consumer Durables & Appl (17)	18	23	0.5	1	67	0	5	4	-4	67	33	-0.5	0.5		23	-17	1.0		27	-16
Hotels, Rests & Leisure (13)	15	15	0.4	-3	100	0	20	5	-10	50	0	1.1	1.8	-12	19	-4	2.2	-10	24	-6
Media (16)	13	6	0.3	-32	50	0	3	4	-16	0	100	-1.9	3.7	-19	54	-9	4.0	-20	59	-9
Retailing (28)	11	5	0.3	-4	100	0	8	6	-7	33	33	-0.5	3.2	-10	118	-2	3.5	-9	125	-3
Consumer Staples (41)	**17**	**26**	**5.4**	**-2**	**86**	**0**	**4**	**70**	**-1**	**43**	**43**	**1.4**	**15.6**	**-2**	**285**	**-1**	**20.9**	**-2**	**355**	**-1**
Food & Staples Retailing (9)	33	13	0.6	-20	100	0	9	41	-5	33	33	-0.3	5.0	6	169	3	5.6	2	211	2
Food Beverage & Tobacco (26)	15	45	4.8	1	75	0	3	29	5	50	50	4.0	6.3	-9	81	-6	11.1	-5	110	-3
Household & Person Prod (6)	0	0	0.0					0					4.3	-1	34	-7	4.3	-1	34	-7
Health Care (53)	**32**	**58**	**15.1**	**3**	**76**	**18**	**8**	**81**	**2**	**65**	**12**	**0.7**	**9.4**	**-0**	**170**	**4**	**24.4**	**1**	**251**	**3**
Health Care Equip & Servs (30)	27	34	2.7	15	75	13	6	32	6	50	13	0.6	4.6	-5	145	4	7.3	1	177	5
Pharmaceuticals & Biotech (23)	39	68	12.4	0	78	22	8	49	-1	78	11	0.8	4.7	5	25	3	17.1	1	74	0
Financials (78)	**32**	**60**	**5.1**	**166**	**65**	**19**	**224**	**143**	**71**	**64**	**24**	**4.6**	**7.4**		**122**	**38**	**12.5**		**265**	**54**
Banks (16)	75	85	2.3	-38	67	25	55	35	62	75	8	4.0	-0.4	-156	8	25	1.9	-58	44	53
Diversified Financials (26)	42	76	2.6		58	17	999	104	80	45	45	4.9	1.6	-30	18	-3	4.2	999	121	61
Insurance (21)	5	4	0.2	16	100	0	9	4	1	100	0	0.0	5.8		90	58	6.0		94	54
Real Estate (15)	7	6	-0.1	-190	100	0	31	1	-22	100	0	2.8	0.5	-70	6	-10	0.4	-74	7	-12
Information Technology (76)	**26**	**41**	**10.1**	**10**	**90**	**0**	**14**	**62**	**-3**	**95**	**5**	**3.8**	**15.1**	**-17**	**127**	**-12**	**25.2**	**-8**	**189**	**-10**
Software & Services (31)	19	30	2.5	9	83	0	10	10	2	83	17	3.2	7.1	-16	38	-8	9.6	-11	48	-6
Tech Hardware & Equip (27)	26	42	5.2	30	100	0	11	36	0	100	0	3.5	7.6	-16	82	-14	12.7	-2	118	-10
Semiconductors & Equip (18)	39	69	2.4	-16	86	0	25	15	-12	100	0	4.8	0.4	-32	7	-19	2.9	-19	22	-14
Telecommincation Servs (9)	**0**	**0**	**0.0**					**0**					**4.8**	**-25**	**74**	**3**	**4.8**	**-25**	**74**	**3**
Utilities (35)	**0**	**0**	**0.0**					**0**					**8.4**	**-5**	**90**	**-7**	**8.4**	**-5**	**90**	**-7**
S&P 500	**22**	**35**	**44.4**	**-17**	**78**	**12**	**21**	**523**	**5**	**59**	**28**	**1.4**	**93.9**	**-24**	**1,544**	**-13**	**138.3**	**-23**	**2,067**	**-9**
S&P 500 ex-Financials	**20**	**30**	**39.3**	**-14**	**82**	**9**	**12**	**380**	**-8**	**58**	**29**	**0.3**	**86.5**	**-31**	**1,422**	**-16**	**125.8**	**-27**	**1,802**	**-15**
S&P 500 ex-Energy	**23**	**39**	**43.9**	**-16**	**79**	**11**	**21**	**517**	**6**	**59**	**27**	**1.4**	**78.4**	**-2**	**1,157**	**-2**	**122.3**	**-7**	**1,801**	**-1**

Note: *Perc surp = percentage surprise, calculated as the percentage difference between the actual and the last estimate for the period
Source: HSBC, Thomson Reuters, I/B/E/S

HSBC

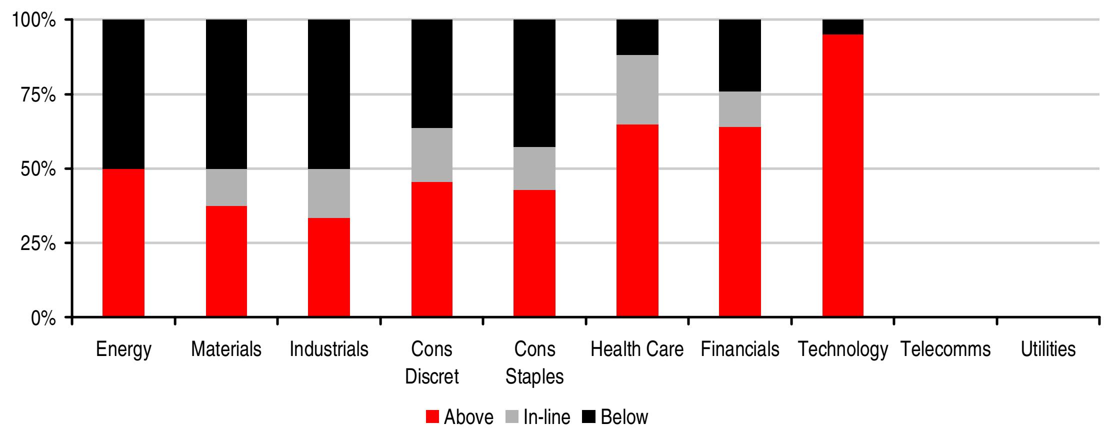
Sales

The sales analysis is summarised in chart form below. In addition, a detailed table showing the underlying sales results alongside the EPS results can be found on page 3.

The key points from our analysis of the top line are:

- Through Wednesday, 21 October, 110 S&P 500 companies (or 22%) had reported Q2 results; this represents 35% of total index market capitalisation.
- Our estimate of the blended sales growth rate (made up of actual results for the companies that have reported and estimates for those that haven't) stands at -9%.
- Excluding energy, the growth rate fall is limited to 1% but excluding Financials the growth rate slips to -15%.
- Focusing on the actual results, relative to expectations we find that S&P 500 sales are coming in 1.4% ahead of expectations.
- In terms of the breakdown, we find: 59% of companies reported sales above expectations; 28% below; and 13% in line (defined as being within 1% of the estimate).
- At the sector level, we see a broad-based improvement but technology is the stand-out performer with a remarkable 95% of companies beating sales expectations (see chart below).
- The financials and healthcare sectors are also having a good season with 64% and 65% of companies beating on the top-line respectively.
- In terms of the size of the beat, the only sector that has disappointed (where we have a meaningful sample of at least 20% of market cap having reported) is industrials with an aggregate 3.3% miss (see top-right chart opposite).
- But even in the case of industrials, we are seeing an impressive number of beats at the bottom-line suggesting very aggressive cost cutting (see next section).

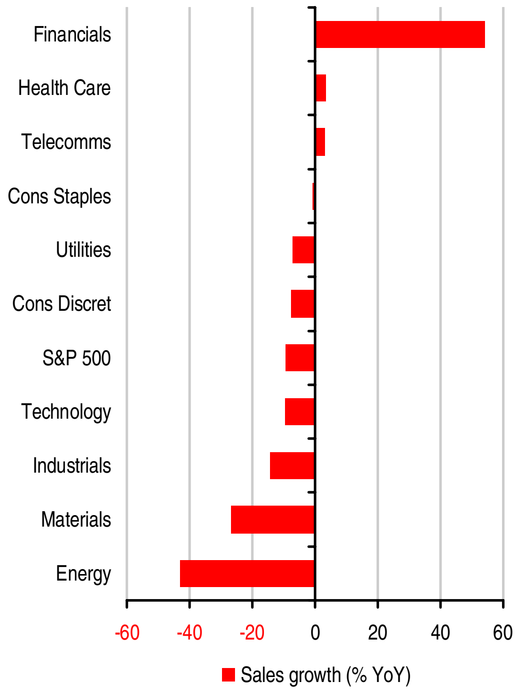
Q3 sales analysis: percentage of companies reporting sales above, in line and below expectations



Source: Source: HSBC, Thomson Reuters

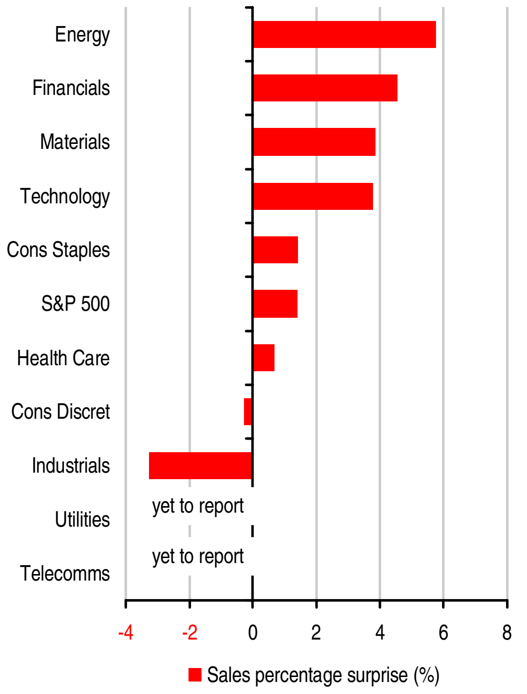
Sales analysis: S&P 500 index and sectors

Q3 sales growth (% YoY)



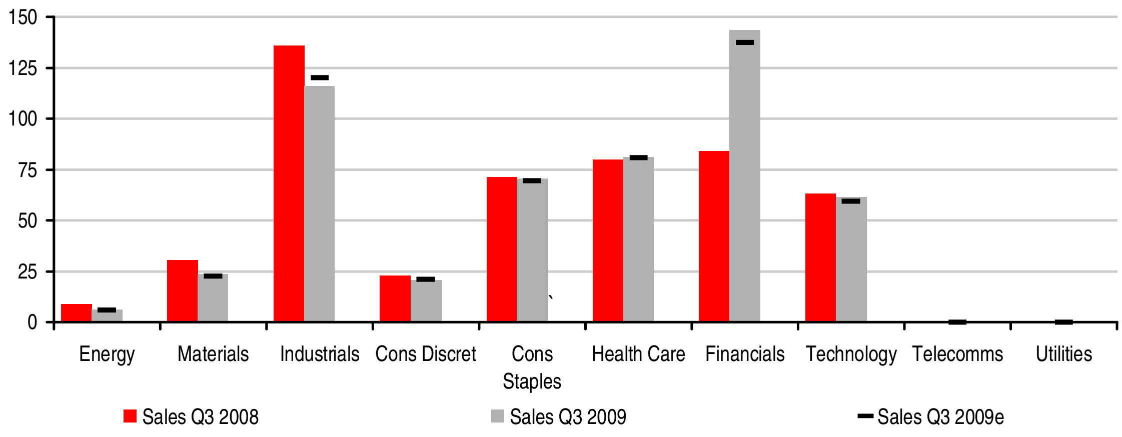
Source: HSBC, Thomson Reuters

Q3 sales percentage surprise* (%)



Source: Note: *Percentage surprise is calculated as the percentage difference between the actual and the last estimate for the period.

Actual sales value USDbn (reported): Q3 2009 versus Q3 2008 and estimates for Q3 2009



Source: HSBC, Thomson Reuters

EPS

The EPS analysis is summarised in chart form below. Also, refer to the table on page 3 mentioned above, showing the underlying EPS results alongside the sales results.

The key points from our updated analysis of the EPS line are:

- Our estimate of the EPS growth rate stands at -23%; excluding energy, the growth rate fall is limited to 7%, but excluding Financials the growth rate slips to -27%.
- Relative to expectations we find: a very healthy 78% beat; 12% missed; and 10% hit (on average the split is 60/20/20).
- This has triggered a positive upside surprise in EPS of 21% (for those that have reported); excluding financials this slips to +12% and excluding energy it stays unchanged at 21%.
- At the sector level, we find that the positive news is across the board with all six of the sectors where we have a decent sample (at least 20% of market cap has reported) providing a positive EPS surprise.
- Technology is leading the way by percentage number of beats (90%) and financials in terms of the size of the EPS surprise (+224%).
- Materials, industrials, consumer staples and health care are the other four sector that we have a decent sample and all of these have also beaten expectations by a notable margin.

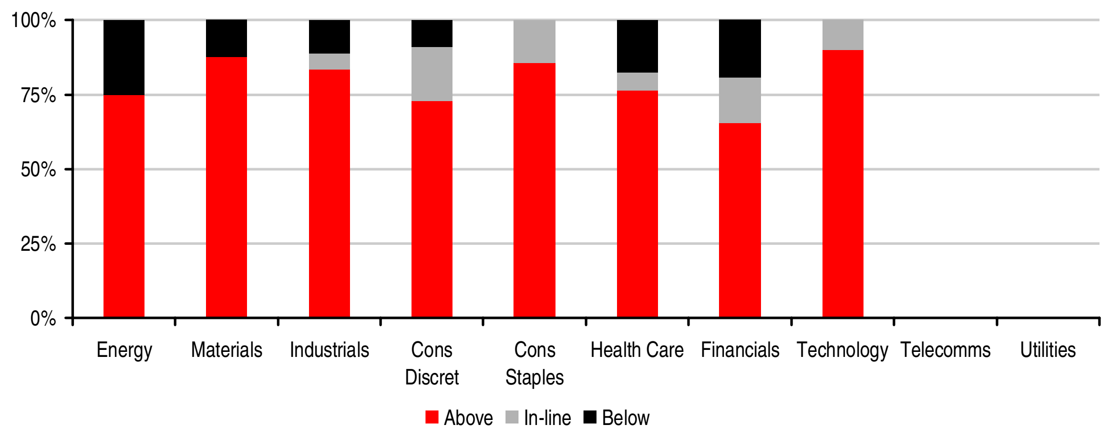
Outlook

Q3 is almost certain to be the last in a run of nine consecutive quarters where the EPS growth rate has been negative. In Q4 we expect the growth rate to turn sharply positive and looking further ahead to 2010 we see consensus earnings expectations as being too low.

Our analysis of previous earnings recessions suggests that it is generally the case that the bigger the fall in earnings, the bigger the initial rebound.

The EPS revision ratio charts on page 8 suggest that this likely upgrading process is already underway but, in our view, it has further to go and should continue to provide a nice tailwind for the equity market over the next few months.

Q3 EPS analysis: percentage of companies reporting earnings above, in-line and below expectations



Source: Source: HSBC, Thomson Reuters

Disclosure appendix

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The following analyst(s), who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Robert Parkes and Garry Evans

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For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

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*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

From 15 November 2004 to 7 June 2005, HSBC carried no ratings and concentrated on long-term thematic reports which identified themes and trends in industries, but did not make a conclusion as to the investment action that potential investors should take.

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As of 22 October 2009, the distribution of all ratings published is as follows:

Overweight (Buy)	38%	(18% of these provided with Investment Banking Services)
Neutral (Hold)	39%	(17% of these provided with Investment Banking Services)
Underweight (Sell)	23%	(15% of these provided with Investment Banking Services)

Analysts are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

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Additional disclosures

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2 All market data included in this report are dated as at close 21 October 2009, unless otherwise indicated in the report.
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