

WEEKLY STRATEGY Perspectives



Private Wealth

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Q3 Earnings Watch: Scaling the Wall of Worry

"Hope is not a strategy. Luck is not a factor. Fear is not an option."

– James Cameron, filmmaker and explorer

The Through Line: Stock market indexes in the U.S. and Canada remain near all-time highs despite an abundance of thorny issues. They've accomplished this feat by building solid fundamentals – not through *hope* or *luck*. For company leaders, moving *fearlessly* forward in an uncertain environment has paid off with toned muscle memory for how to survive repeated challenges and thrive on the other side. The bar is set high for more of the same when Q3 earnings are released in coming weeks. We discuss whether we agree – or not – and what the focus of our attention should be.

Q3 expectations: the bar moves up *again*

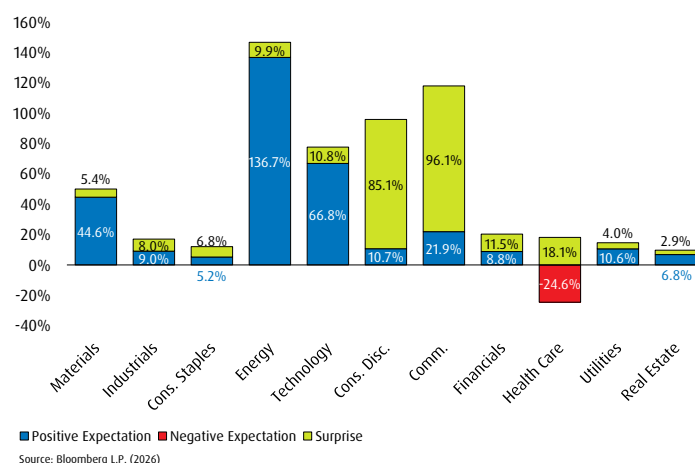
At first blush, it seems almost incomprehensible that stocks are at all-time highs, given the litany of concerns investors have confronted over the past nine months: triple-digit oil prices; 10 year U.S. Treasuries at 5.3%; two ongoing hot wars; obstinate, above-target inflation prompting the U.S. Federal Reserve to resume hiking its policy rate; and a trade war in full bloom. Yet, here we are.

Upon further examination, though, stocks are climbing that wall of worry for ample fundamental reasons. Case in point: earnings growth that is well above expectations. The S&P 500 Composite Index, for example, grew Q2 earnings at a 54% clip (or over 32% after backing out one-time gains from tech IPOs owned by some of the index's weightiest constituents) versus the 25% that consensus had projected at the start of the period. Revenues advanced 16% in total. **Such strength on both the top (revenue) and bottom (earnings) lines would be more indicative of an economy just emerging from recession – not coming after multiple years of fundamental progress already under its belt.**

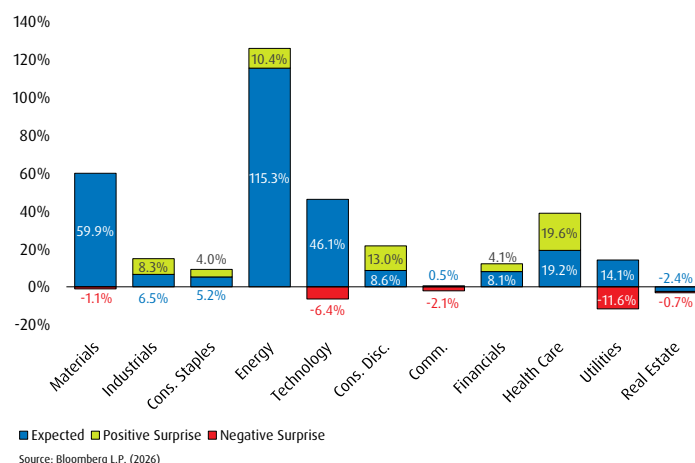
Contrary to popular opinion (which assumes vibrancy is primarily coming from tech), the strength was broad based: five sectors reported double-digit earnings growth; three posted *triple-digit rises* (energy, consumer discretionary and communications).

Not to be left out of the fun, Canada's S&P/TSX Composite Index likewise produced remarkably strong numbers: aggregate bottom-line growth of 35% on a revenue advance of 20%. Six sectors showed double-digit earnings gains – and one sporting a triple-digit uptick. The largest upturns came from energy, materials, technology and healthcare.

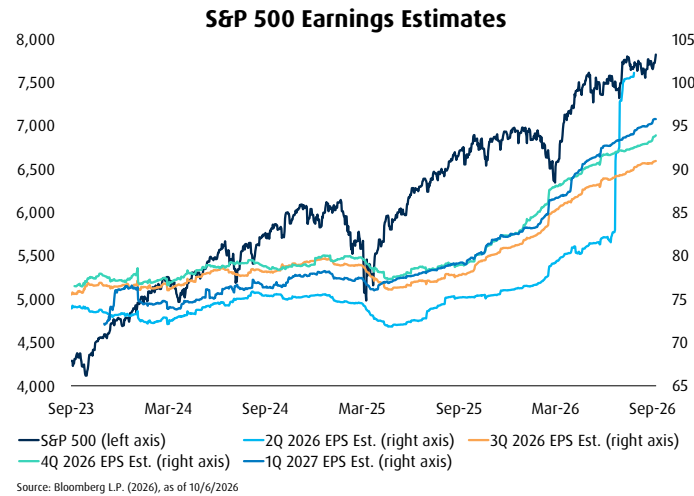
S&P 500 Sector Q2 2026 EPS Growth: Expected & Surprise



S&P/TSX Sector Q2 2026 EPS Growth: Expected & Surprise



Such stellar numbers motivated analysts to nudge third-quarter estimates even higher. **Bloomberg consensus is now looking for combined Q3 S&P 500 earnings growth of 27%; TSX earnings are projected to rise 24%.¹**



The march of stocks to new highs has been grudging rather than exuberant, accompanied by fears that it's long in the tooth and/or any combination of the aforementioned maladies is "sure" to throw it off course. Correspondingly, **we expect this earnings season will receive more intense scrutiny than usual in several areas as investors search for cracks in the good-news story.**

Tug of war: record-high margins vs increasing costs

Even though AI and AI-adjacent issues have dominated the conversation during reporting periods for over a year, we expect to see concerns re how companies are dealing with rising costs take pole position during the current one. *Markets* have handled rising rates and energy costs well; scrutiny will be on how *companies* are dealing. And the math is likely to be complicated considering the many crosscurrents (some constructive, some less helpful).

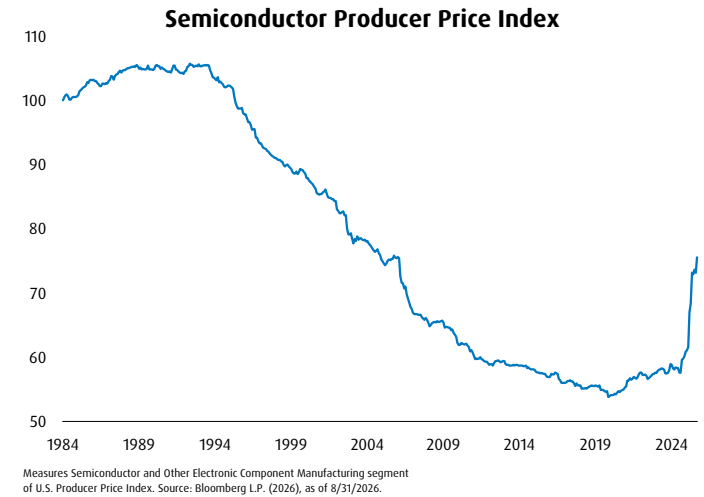
Diesel costs are up over 80% in the last year, touching virtually all corners of the business and consumption environment, including services. Many companies can pass increased prices along more directly (in the form of energy surcharges) than they could tariff costs. Others (e.g., farmers, truckers, services businesses, those who heat with heating oil) must bear the out-of-pocket cost. Central banks, too, must decide if the impacts will be temporary or more widespread and lasting – a task made extra difficult by the extended nature of the Middle East conflict, its spread into other regions (e.g., the Red Sea) and the destruction of physical assets in Ukraine, Russia and the Middle East.

Shipping and transportation costs – including insurance, containership, rail and air freight – have seen upper-double-digit increases to more than triple-digit increases in the last year. Costs swelled thanks to reroutes and lack of container ships not just from war torn areas but also from key corridors like the Panama Canal and the Danube River where dry spells prevented them from functioning properly.

Higher interest rates are impacting those who need to borrow and/or reset (e.g., pandemic-era) loans. They're additionally pressuring an already beleaguered housing market and a commercial real estate market that was just beginning to show green shoots of recovery.

Memory chips will likely stay expensive for years – and deliver knock-on effects for consumers and non-AI/data center buyers. For decades, computer components have been a mighty deflationary force. The sudden extreme ramping of demand brought on by the widespread adoption of AI and other Industrial Revolution 4.0 technologies, however, changed that. Chip makers understand well the cyclical – and capital

intensive – nature of their business. They are demanding binding long-term commitments before adding to capacity (and in the meantime diverting inventory to the highest bidder – hyperscalers – at the expense of all others.



Tariffs and ongoing trade tensions will continue. Although their impact is tough to project and may vacillate from minute to minute, expect investors to listen for/look carefully at how companies are planning for such exigencies.

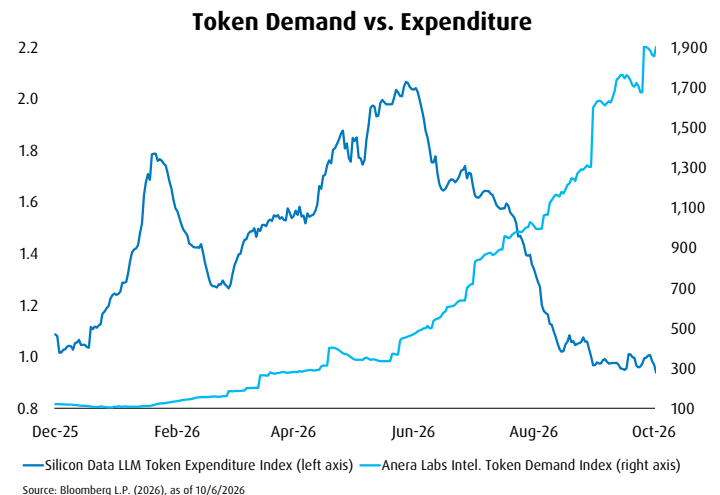
The AI trade continues to evolve

Ah, for the good old days when the only thing we had to worry about was who was spending the most on data center buildout. Investors will be hunting for a variety of clues this quarter:

Use cases – while productivity in services businesses is notoriously hard to measure, recent reports note that 100% of companies are at least dabbling in AI.¹¹ True adoption varies, yet real-life examples – and even some accompanying data – are coming. Expect investors to ask/hunger for more.

Frontier model oversight – will undoubtedly generate questions – and hopefully some answers (or at least outlines).

Spending on AI processing (priced in units called tokens) will be scrutinized. Price/million tokens has come down sharply, which already seems to be sparking a Jevon's paradox of use. (The paradox that as prices come down efficiencies and new uses are discovered which creates even more demand). It's still too early to determine who benefits from this trend – model creators, model users or someone else entirely? Nevertheless, expect investors to be asking plenty of questions.



Data center spend – not just plans for more expenditure, but actual orders, projects underway, projects finished and brought on line. Curious minds will want to know how the spend is financed (stock, public debt, off-balance-sheet and/or vendor financing), what concessions were given/received and if/how it's hooked to a grid or otherwise powered.

Open or closed model – is an ongoing debate that has the potential to impact existing company business models. The leading U.S.-based frontier models are currently “closed” (meaning their coding is proprietary to the companies that create and release them and users are charged monthly fees). China and select other providers are pushing open-weight or open-source models where the underlying code is accessible for free; companies download and then customize it for their specific use.

Status of the “SaaSocalypse” (an AI-driven disruption in Software-as-a-Service business models) – software companies were under pressure early in the year following the release of increasingly sophisticated AI modules that seemed to threaten their viability. Sentiment has since moderated, making room for nuance and a growing suspicion that enterprise software is probably more defensible, especially if it's solidly integrated into a company's routines and legal processes. Likewise, there is a growing realization that companies need someone to blame when things break. We will be monitoring for examples of AI integration into existing enterprise software platforms, plus any pricing shifts caused by the use of AI. We would not be surprised to see enterprise providers at the forefront of security, integration and AI monitoring.

Financing, impact of rates and market volatility

The season starts in earnest in the U.S. next week as per usual: big banks report first. Record M&A, IPO and fixed income issuance – in addition to record volumes of stocks and bonds changing hands – will be analyzed relative to individual company costs to see how much can be converted to bottom lines. The biggest financials also tend to be harbingers of consumer health – and increasingly, adoption of AI and any related impacts on employment levels, productivity and margins. Financial stocks have underperformed recently, though higher rates tend to benefit banks in the short run (increasing lending revenue more quickly than payments on deposits). Trading and deal volumes – have all been at/near record run rates for more than a year, making comparisons with last year's results more challenging, even if absolute volumes increase.

Consumers – consistent yet cranky

Many consumer companies – especially retail – have quarters that end in October, meaning the best read on consumer wherewithal (after the financial services companies) won't come until sometime in November. By then we will also be ramping up for the holiday selling season. This year's consumer will be especially noteworthy (despite continued deterioration in sentiment surveys, spending is still steady overall). Of course, part of the increase (reported in absolute, not inflation-adjusted terms) is driven by higher fuel and housing costs. Nonetheless, market gains and steady employment – especially in the upper income strata – help prop up spending. **We'll be paying more attention to what consumers do rather than what they say.**

Another factor we expect will gain prominence: the exploding presence of AI shopping bots. From a seller's perspective, appealing to algorithms is an entirely different exercise from appealing to consumers. That's because marketing to emotions won't work and must be replaced with pleas to logic and unemotional Mr. Spock-like sensibilities. From a consumer perspective, bots can increase price transparency, eliminate hassle and speed time to purchase. Could it lead to increased overall sales (another iteration of the Jevon's paradox)? Time will tell.

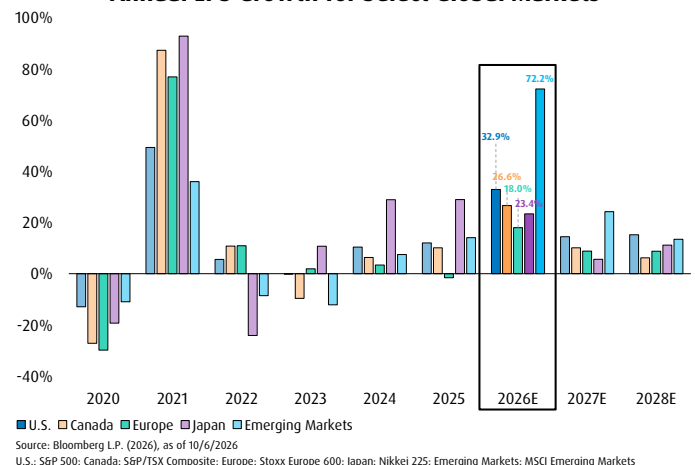
Macro issues we're also watching

Shift to semi-annual earnings releases. The comment period on a proposal from the U.S. Securities & Exchange Commission (SEC) to make quarterly earnings releases optional is moving forward. This is in the face of overwhelming opposition to the plan expressed in several hundred thousand submitted comments. In theory, then, this could be the last set of broad-based Q3 earnings reports investors receive. We suspect at least some companies will continue to provide interim readings; they may not be audited, however, and could be less detailed than the formal report.ⁱⁱⁱ

Investor nerves. While a fourth year of double-digit market gains is lovely, we're frequently and consistently asked whether it gets any better. Yes, markets have moved higher, but we note they've inched their way up the wall of worry. Contrast this to earnings, which have sprinted more quickly. The result: valuations have actually come *down*, theoretically already adjusting for margin pressure, slowing growth, higher interest rates or some combination of all of the above. That said, **we do expect volatility to remain elevated, a reflection of markets' attempts to grapple with a shifting news flow.**

Comparisons get tougher by default. The double-digit, year-over-year earnings gains that began last year will inevitably have to slow (chart), although current projections don't see that happening until sometime next year. Markets, especially those that have not been hit with a broad-based correction in many months, could react poorly when that perception dawns more clearly.

Annual EPS Growth for Select Global Markets



Implications for investors

The next few weeks will provide plenty to digest as earnings season progresses. Expectations are constructive since the tech/infrastructure build remains on track despite all the headlines and election year mud-slinging. **Both the U.S. and Canada have significant infrastructure development in progress, laying the groundwork for enhanced productive capacity for years to come. Consumers are employed and spending strategically regardless of sour moods. All these factors should help corporations continue to execute.** Investors can opt to use the bricks in the wall of worry for footholds to ascend beyond the tensions of this particular market moment.

Next week in North America

U.S. earnings season will launch in the usual fashion; big banks will deliver reports mid-week. More eco data to munch on; expect the U.S. CPI (Wednesday) and PPI (Thursday) reports to be under laser focus for any hints about the timing and pace of continued FOMC rate hikes. Manufacturing data, the Fed's Beige Book and solid reads on sales, inventories and manufacturing activity in both countries round out the week.

Monday 10/12:	U.S. none scheduled. Bond market closed for Columbus Day. Stock exchanges remain open Canada None scheduled
Tuesday 10/13:	U.S. NFIB Small business optimism survey, Federal budget balances, Existing home sales Canada Bloomberg Nanos confidence
Wednesday 10/14:	U.S. CPI, Real average hourly earnings, Fed's Beige Book Canada Building permits
Thursday 10/15:	U.S. Weekly jobless claims, PPI, Retail sales, Philly Fed Manufacturing, Business inventories Canada Manufacturing and Wholesale sales
Friday 10/16:	U.S. Import and Export prices, Industrial Production, Capacity utilization Canada Existing home sales, International Securities transactions



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ⁱ [What does Wall Street expect from the S&P 500 next quarter? 📊 Key sectors to watch | XTB](#)

ⁱⁱ <https://www.mckinsey.com/capabilities/quantumblack/our-insights/the-state-of-ai>

ⁱⁱⁱ [SEC Expected to Change Quarterly Earnings Rule Despite Public Backlash - WSJ](#)