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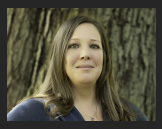
Why Corporate Earnings Matter for Long-Term Investment Success



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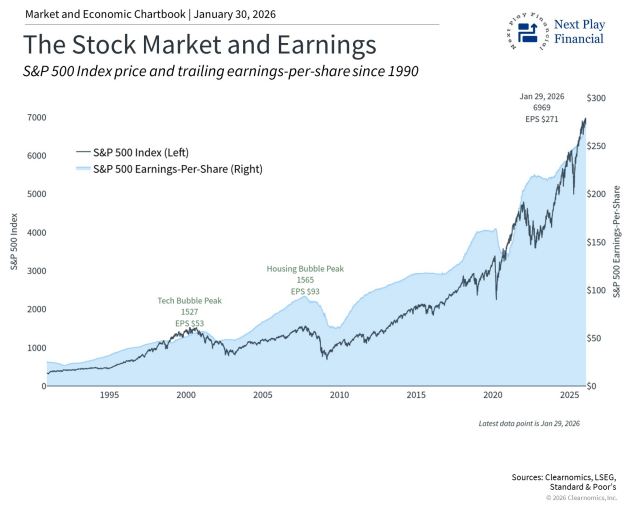
With corporate earnings season in full swing, investor attention is turning from broader geopolitical issues to concrete data about business performance. Given that equity markets are trading near historic peaks, concerns about valuation levels and whether profit margins can be sustained have taken center stage.

Although the reporting period has just begun, analyst projections indicate that corporations concluded 2025 with robust expansion, pushing S&P 500 earnings-per-share to unprecedented levels. These quarterly announcements serve as performance scorecards, revealing how well companies are executing their business plans and whether their approaches are succeeding. Market professionals examine these disclosures carefully because they contain critical metrics used in company valuations, which subsequently influence equity and debt pricing.

For those investing with a long time horizon, expanding profits have historically been the primary engine of equity market appreciation, generating substantial wealth over time. Yet the specific results from any individual corporation are less significant than how broader profitability patterns affect diversified portfolios. The real question centers on what aggregate corporate performance tells us about economic expansion, household consumption, capital expenditures by businesses, and whether current market conditions can persist. Where should investors direct their attention as fresh earnings data emerges?

Expanding profits provide portfolio support



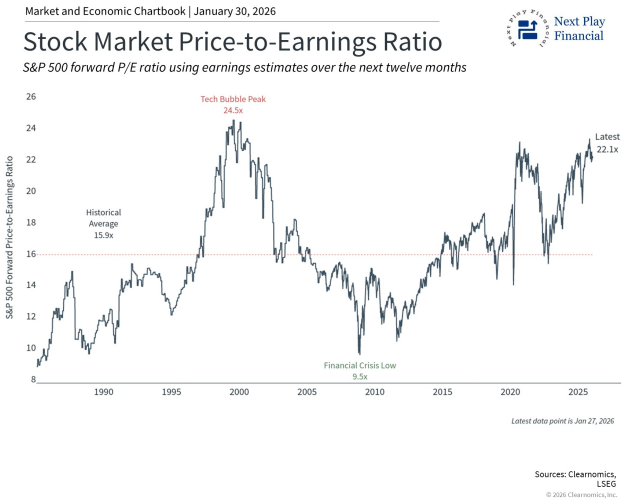
Corporate profitability serves as the bridge linking equity markets to the broader economy and, by extension, to investment portfolios. When economic analysts examine GDP expansion, employment figures, or consumer expenditure patterns, these elements impact investors through their effect on business profits. A thriving economy typically translates into stronger revenue and profit performance for corporations, as we have witnessed in recent years. Because equity ownership represents a claim on company earnings, share values generally rise when profitability expands.

This relationship holds not just for individual company shares, but for equity markets broadly. The chart included here demonstrates that stock market performance has historically tracked earnings trajectories over extended timeframes. The sustained growth and vitality of the U.S. economy stands as perhaps the most compelling explanation for the long-term upward trajectory of equity markets.

During the initial reporting week, approximately 13% of S&P 500 constituents released fourth quarter 2025 results, with 75% surpassing earnings projections, per FactSet data.[1] Analyst consensus suggests earnings-per-share could advance 8.2% across S&P 500 members, marking the tenth straight quarter of profit growth. For the full year 2025, LSEG estimates indicate earnings rose 13%, with projected increases of roughly 15% anticipated for both 2026 and 2027. These figures exceed the historical average expansion rate of 7.7%.

Should these patterns persist, they would constitute robust growth levels that provide portfolio support.

Profit growth can enhance valuation metrics



The reporting season also provides important context regarding equity market valuations. While earnings drive long-term market appreciation, valuations help determine whether share prices appear reasonable or stretched in the near term. Put differently, valuations represent the relationship between market prices and fundamental metrics like profitability. The price-to-earnings ratio, for example, indicates how much investors are prepared to pay for each dollar of corporate profit.

Currently, the S&P 500 trades at a price-to-earnings ratio of 22.2x, significantly above the long-term average of 15.9x and approaching the dot-com bubble peak of

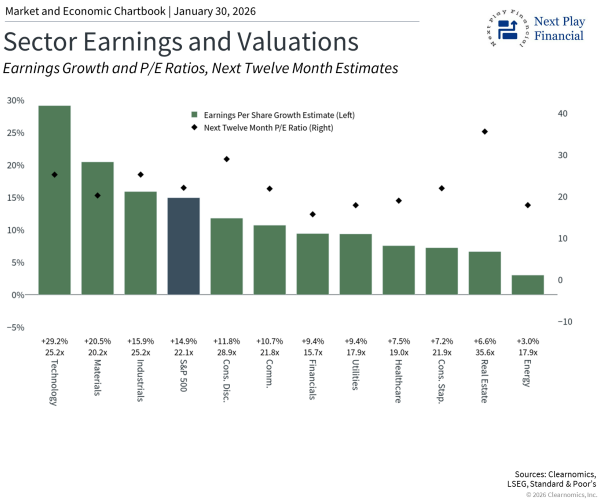
24.5x. Although elevated, this multiple is supported by solid profit expansion, unlike periods such as the dot-com era when investors disregarded profitability fundamentals.

Grasping this relationship helps contextualize near-term market fluctuations. During periods of volatility, earnings forecasts often remain stable while prices and valuations shift. This explains why markets frequently recover quickly from temporary declines when underlying trends stay intact. It also illustrates why maintaining investment positions, or adding to them, during downturns can prove beneficial since valuations become more compelling.

Another approach to analyzing earnings and valuations involves calculating their respective contributions to market performance in 2025. The S&P 500 index advanced 16.4% last year, so if earnings-per-share expanded 13% annually, profitability was clearly the dominant growth driver. Specifically, earnings accounted for approximately 80% of the price appreciation while valuation expansion contributed roughly 20%.

For investors with extended time horizons, this indicates portfolios have benefited primarily from improved corporate performance rather than simply investors paying higher multiples for equities. However, elevated valuations carry important implications even with continued earnings expansion. When share prices embed optimistic assumptions about future profitability, there is typically less room for disappointment, resulting in greater market volatility during uncertain periods. This does not suggest avoiding equities, but rather underscores the importance of appropriate risk management within portfolios.

Artificial intelligence investments continue boosting capital expenditures



While historical earnings results are significant, equity markets price securities based on future expectations. Consequently, forward guidance from corporate management often influences market reactions, particularly regarding major trends like AI-related spending. Corporations are committing substantial resources to build the infrastructure required for AI capabilities, spanning data centers to computing equipment. This extensive capital deployment is transforming not only the technology industry but the entire economy.

For investors, this development presents several considerations. Corporations making these commitments, frequently termed "hyperscalers" given their extensive computing infrastructure, are wagering on persistent growth in AI utilization. Should these investments yield results through rising demand for AI-powered services and solutions, they could generate significant earnings expansion for years ahead. Conversely, if adoption falls short or takes longer than anticipated, corporations may experience margin pressure and diminished returns on invested capital. The chart above illustrates that earnings growth projections differ across industries, with Information Technology sector expectations being the highest.

Although quarterly performance matters, the complete impact of AI on productivity and economic output will unfold over many years. Investors who maintain patience and long-term perspective are

better positioned to capture these opportunities than those who pursue near-term performance or respond excessively to individual quarterly reports.

The bottom line? Robust corporate profitability has provided support for equity markets. Given current uncertainty and elevated valuations, investors should continue emphasizing portfolio balance to manage risk while remaining focused on achieving their financial objectives.

References

1. https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_012326.pdf

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