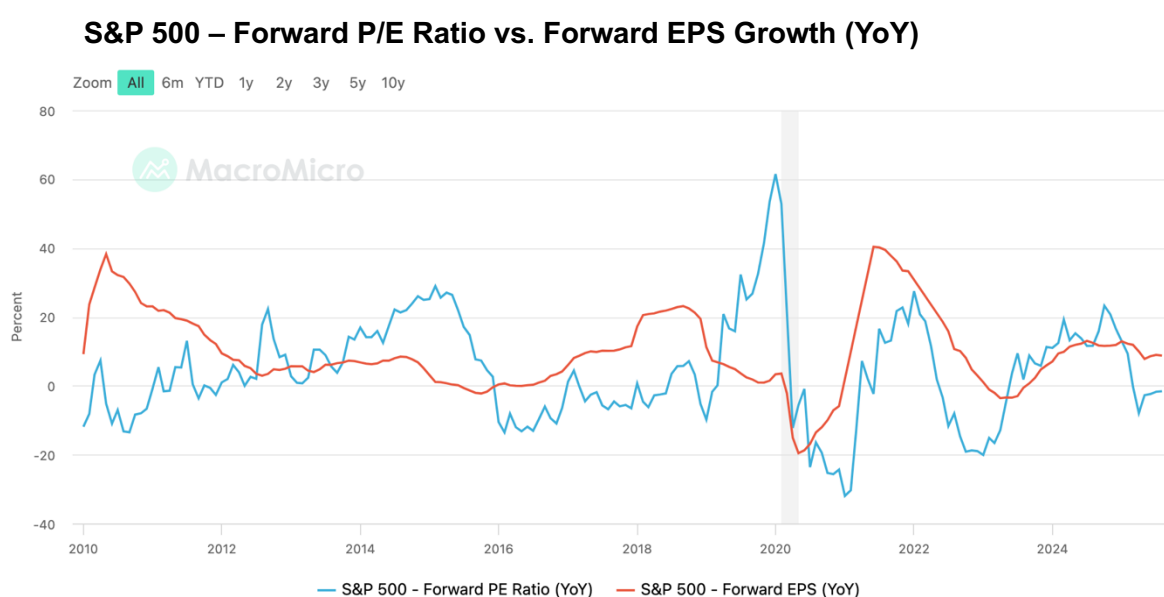


From Euphoria to Earnings: Are Investors Growing More Realistic?

July 30th, 2025

Highlights

Q2 earnings season has delivered better-than-expected results for U.S. equities, particularly among large-cap technology and AI-related names. Yet, the broader equity market valuation started to ease slightly, possibly illustrating the market is right-sizing expectations and being more realistic. This piece explores the divergence between earnings momentum and recent market valuation development, wondering whether investors are growing more realistic versus past growth cycles.



Source: MacroMicro

This chart illustrates the year-over-year change in the S&P 500's forward price-to-earnings (P/E) ratio (blue line) and forward earnings per share (EPS) estimates (red line). While forward EPS continues to rise in 2025, reflecting solid corporate profitability, the forward P/E ratio has declined slightly, highlighting a divergence between earnings momentum and valuation expansion. Potentially suggesting investors are becoming more valuation-sensitive, due to higher real yields or macro uncertainty, despite improving fundamentals.

Earnings Momentum: Solid but Narrow

As of reporting, **66 to 83% of S&P 500 companies** have beaten Q2 EPS and revenue forecasts, surpassing both 5 and 10-year averages.

Year-on-year EPS growth is tracking around **6–10%**, depending on source, well up from 4–5% in early 2025.

However: Much of the beat comes from cost control, share buybacks, and tariff pass-through, not expansive top-line growth. For example:

- Insperity missed EPS expectations by ~37%, hurt by rising healthcare costs, despite revenue up ~3% YoY.
- ON Semi's GAAP margin plunged to ~20% following restructuring, but non-GAAP margins remained ~40%

Valuations: Elevated Relative to History

The S&P 500 forward P/E has settled around **22.2–22.7×**, above both 5-year (~19.9×) and 10-year (~18.5×) averages.

Excluding the 'Magnificent 7', the index trades at ~21.0×, while the magnificent 7 command ~29.5×, driving overall valuation higher.

Analysts at Goldman Sachs and other firms have lifted price targets, Goldman now sees S&P 500 reaching around 6,100 over the next 6 months, amid optimism over falling uncertainty and tariff relief. Oppenheimer's forecasts point to a year-end 2025 level near 7,100 (~11% upside) thanks to trade deal progress and strong earnings realignment.

Key Risks on the Horizon

Multiple Compression: If Fed policy stays restrictive and real yields rise, the current stretched multiples, especially on mega-tech, could contract sharply.

Stranded Growth in Non-Tech: Many sectors face earnings slowdowns and margin wind-downs even as tech stays strong.

Policy Uncertainty: Trade tensions (e.g., Trump-era tariffs with EU, China) remain elevated and could undermine sentiment or supply chains.

Market Drivers Behind the Disconnect

Mega-Cap Dominance & Concentration

- The **top 10 S&P 500 stocks now constitute nearly 40%** of index weight, echoing recent all-time concentration highs.
- While the "Mag-7" still command outsized influence, broader momentum is emerging: equal-weight S&P indices recently hit record highs as financials and industrials rally.

Margins vs. Macro Headwinds

- Barron's notes the S&P's high multiple is underpinned by unusually strong aggregate gross margins (~50%), largely thanks to Big Tech's pricing and scale.
- But many non-tech firms are seeing margin pressure: tariffs, rising labor costs, healthcare inflation and input prices are eroding profitability across sectors.

Volatility & Complacency

The CBOE VIX index, a key measure of implied volatility for the S&P 500, recently averaged **~16–17**, a historically low level implying complacency. Low volatility has reduced risk premia.

Importantly: The current y/y decline in P/E ratios despite rising earnings per share is partly a reflection of elevated valuations from 2023–2024. During that period, investor enthusiasm, particularly around AI and rate cut hopes, pushed prices up ahead of actual earnings delivery. Now that earnings are improving, the market is no longer willing to expand multiples further. Instead, it's letting fundamentals catch up, a rational repricing rather than a reversal.

What This Means for Investors

Focus on Quality

- Look beyond headline EPS beats. Scrutinize whether growth is driven by genuine revenue gains or short-term financial engineering.
- Expect future earnings guidance to carry more weight than past results.

Diversify Smartly

- While mega-cap tech will continue driving index returns, consider selective exposure to financials or industrials, especially where cheaper valuations offer potential upside if macro conditions stabilize.

Manage Duration & Volatility Sensitivity

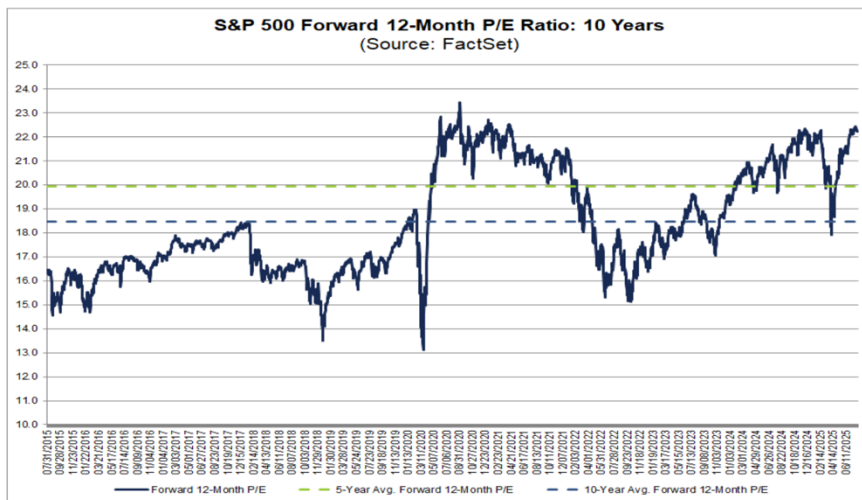
- Elevated equity valuations paired with low VIX readings suggest potential for sudden repricing if volatility returns.
 - Be cautious with long-duration stocks or those priced for 'perfect' outcomes.
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Final Thought

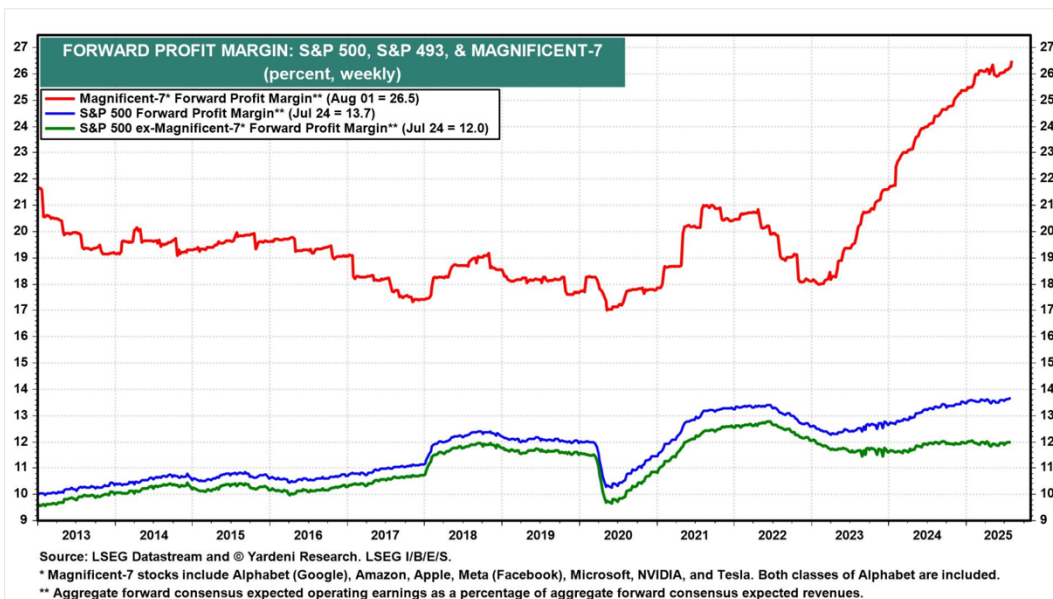
Q2 earnings confirm pockets of corporate strength, but the broader narrative feels top-heavy. The valuation environment is supported by low volatility and ultra-tight margins in mega-cap tech, yet many other segments of the market are quietly under strain. The *earnings mirage* may hold, for now, but investors should keep one eye squarely on fundamentals, not just optimistic headlines.

More Charts:

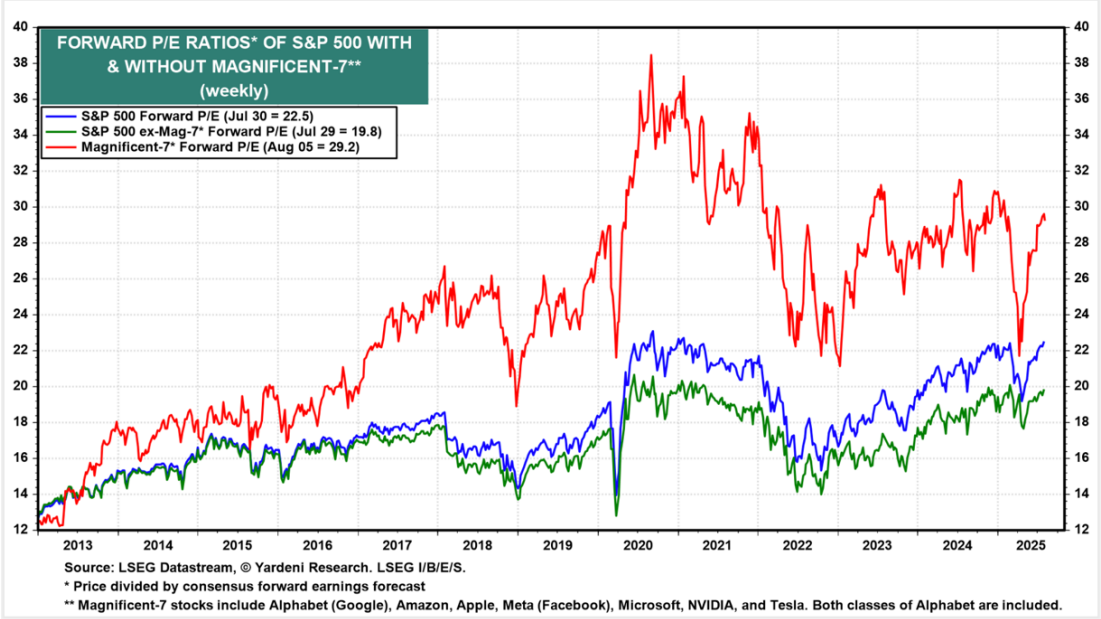
S&P 500 Forward P/E Ratio Nears Historical Highs Amid Elevated Valuations:



Diverging Margins: Magnificent 7 Drive Record Profitability While Broader Market Lags.

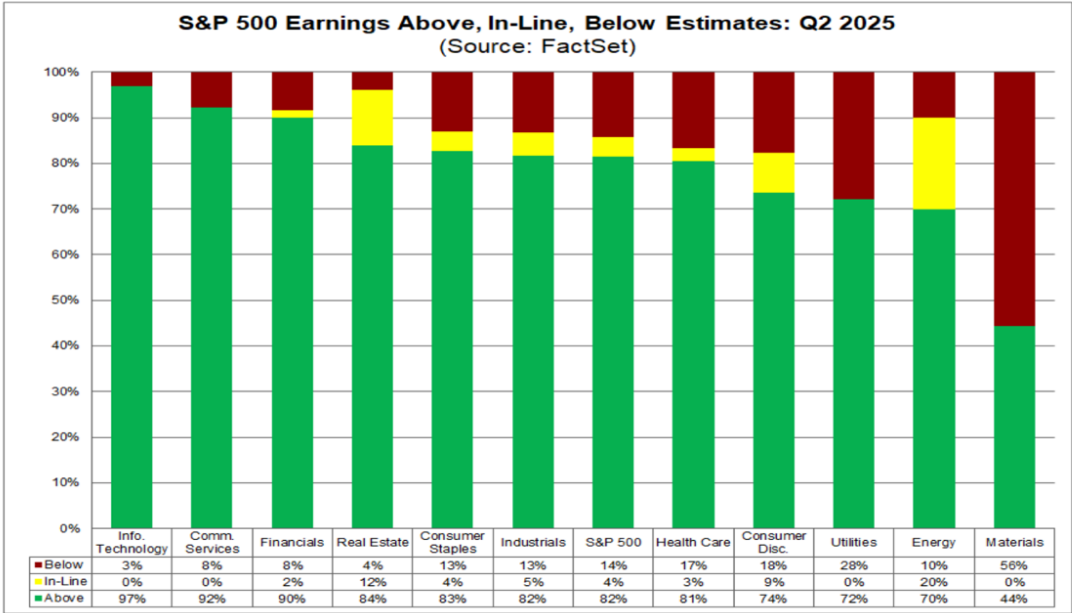


Valuation Gap Widens: Magnificent 7 Trade at a Premium to the Broader S&P 500



Q2 2025 Earnings Scorecard: Tech Leads on Beats, Materials Lag Significantly

Q2 2025: Scorecard



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Used to contextualize historically low implied volatility (~16–17 range), and its relationship to investor complacency and risk premia.

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