

U.S. Economics

Corporate Profits:

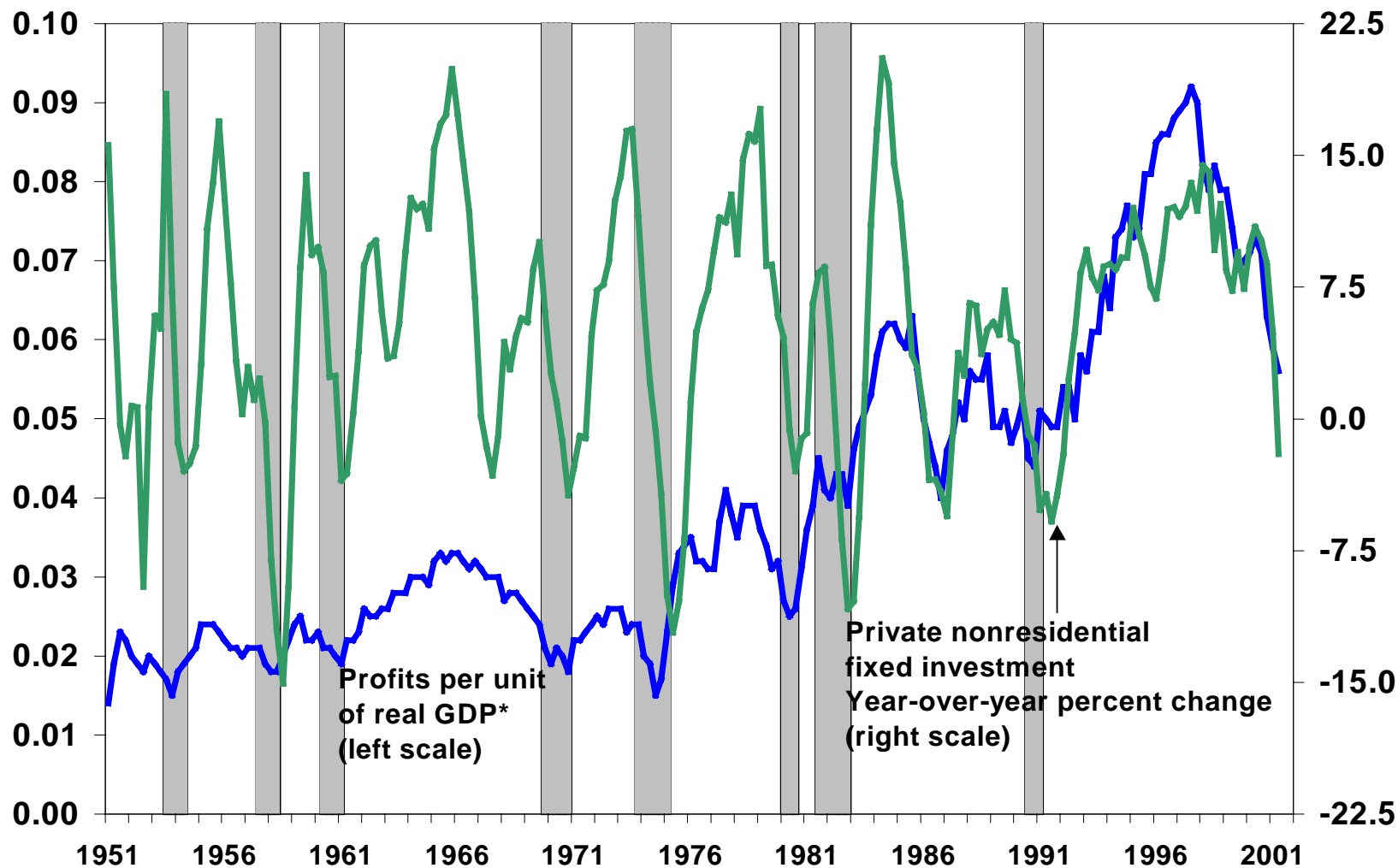
CRITICAL FOR BUSINESS ANALYSIS

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Key Points

- **Profits analysis neglected**
- **Three reasons to analyze**
- **Interplay between operating leverage and capacity shapes margins**
- **Earnings obfuscation; measurement lacking**

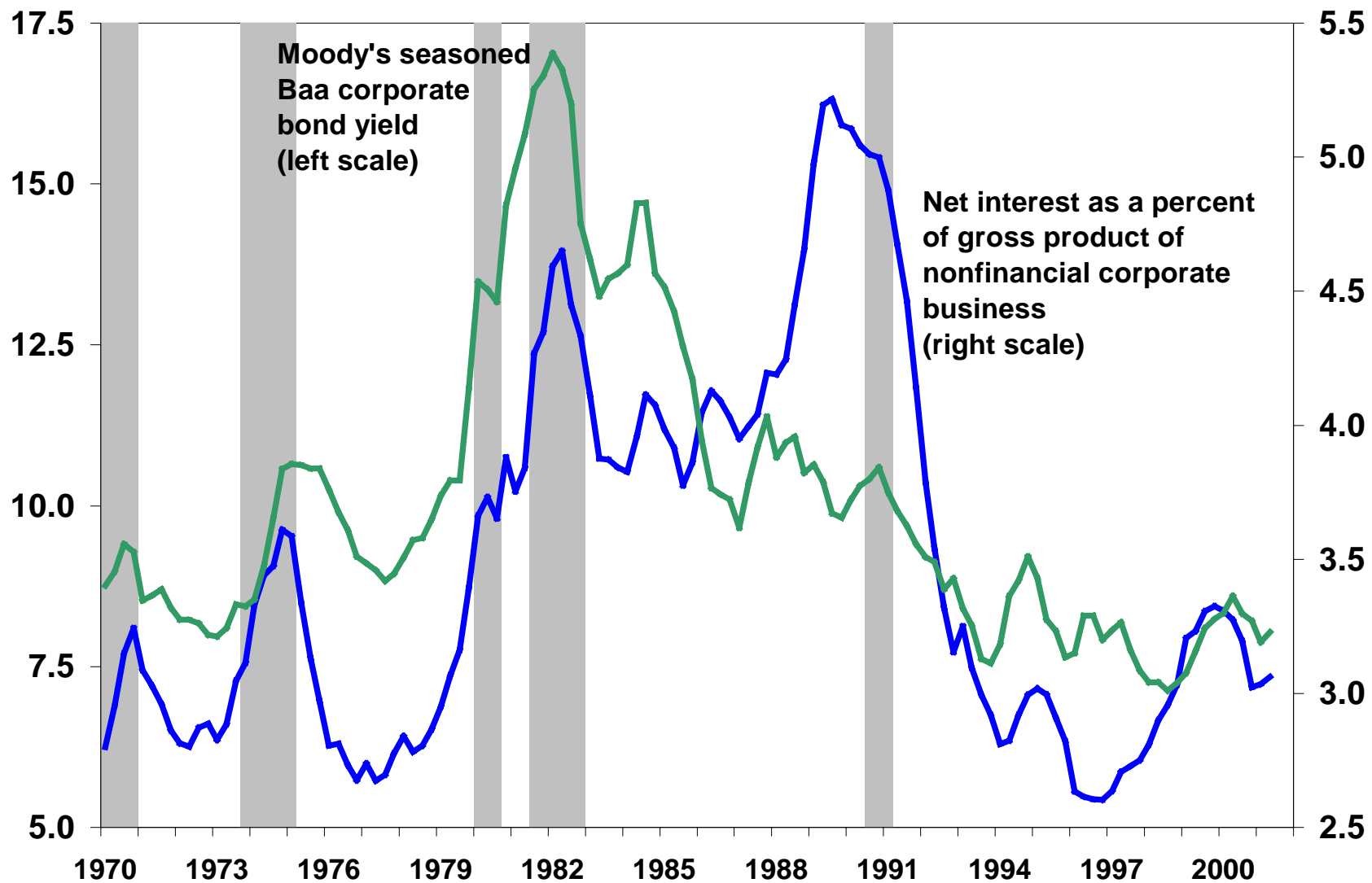
The Profit Squeeze: A Leading Indicator?



**Note: Corporate profits after-tax with inventory valuation and capital consumption adjustments per unit of real GDP of nonfinancial corporate business.*

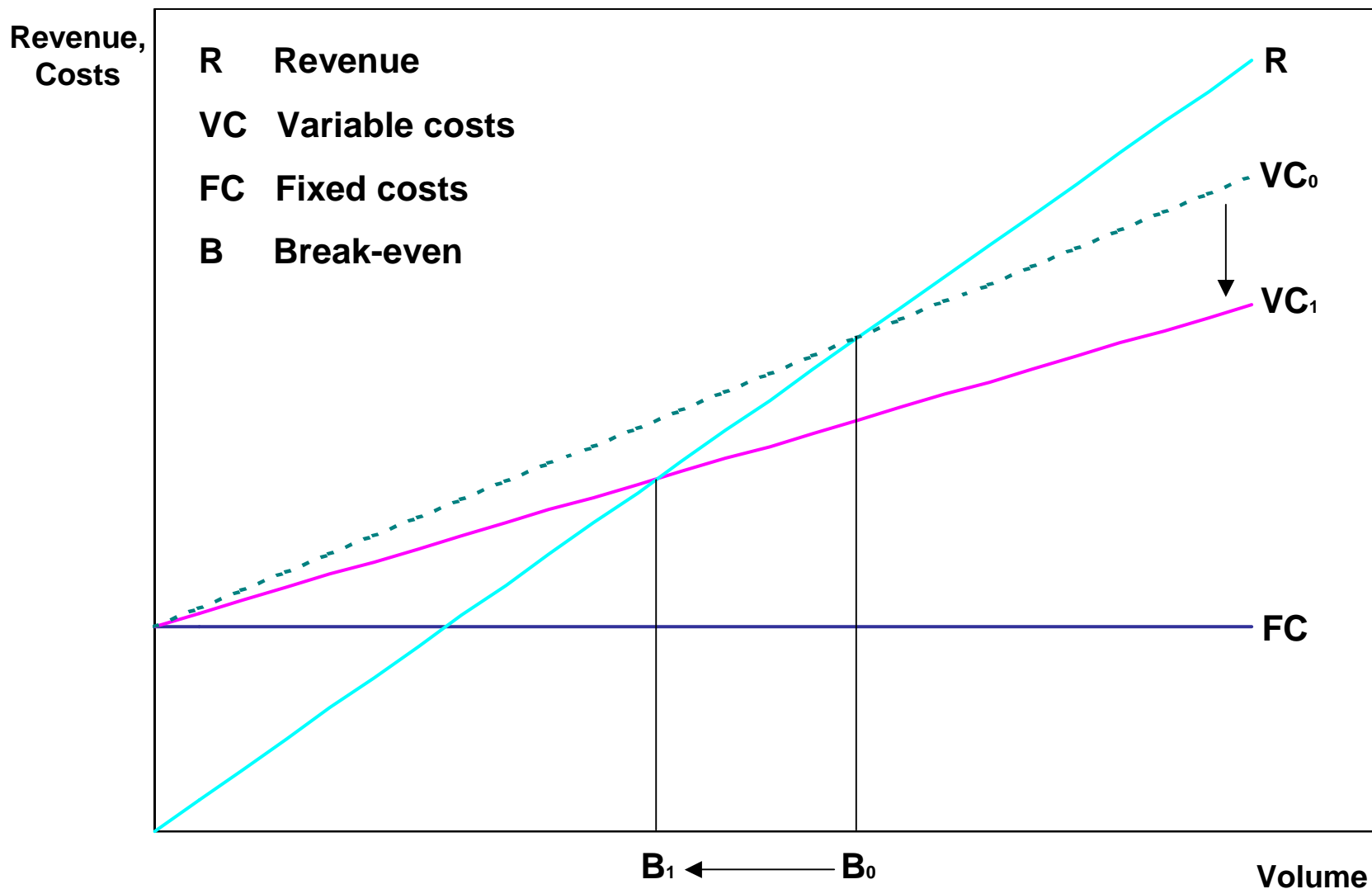
Source: Bureau of Economic Analysis

Rising Corporate Financial Leverage

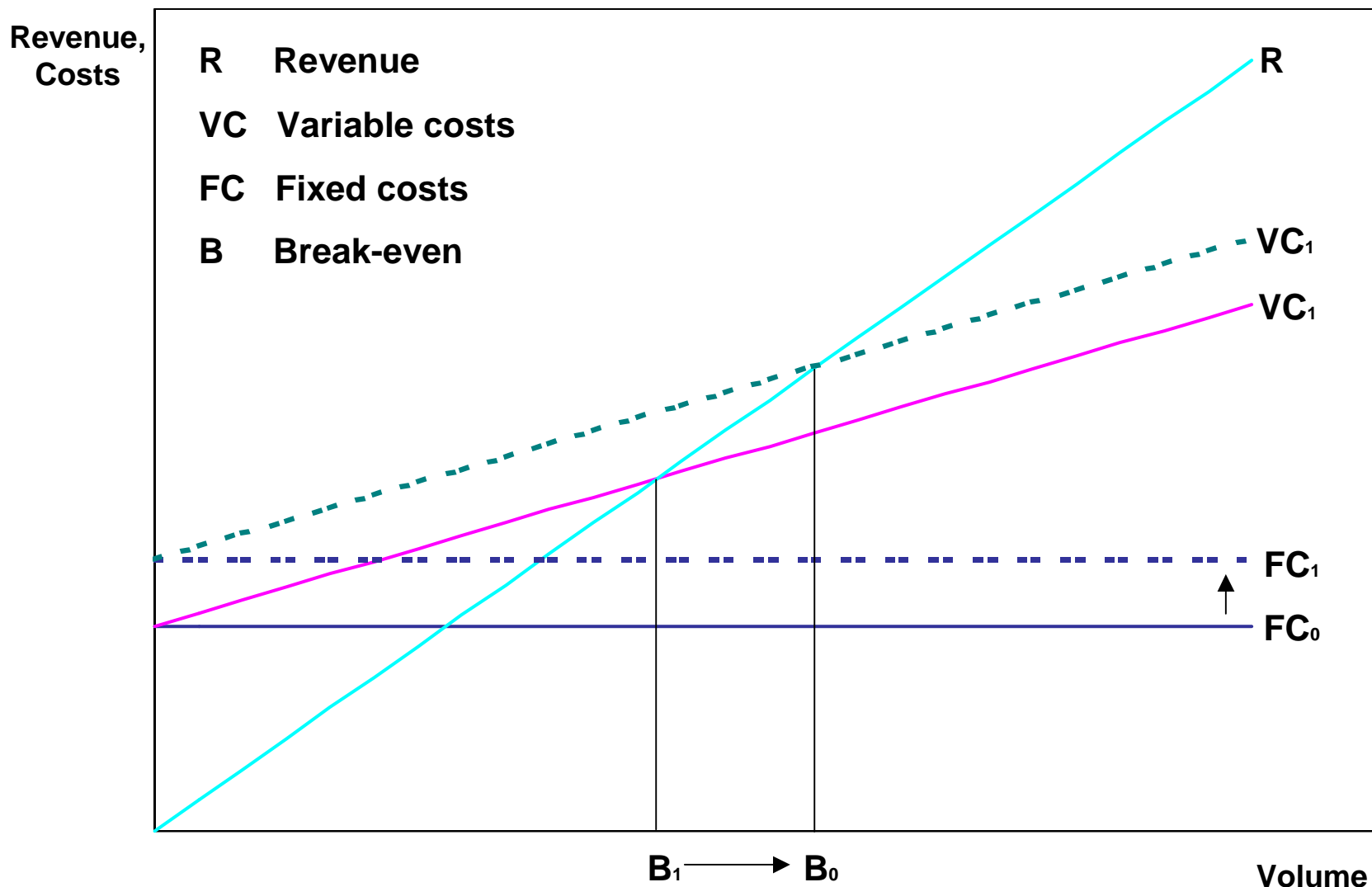


Source: Federal Reserve, Bureau of Economic Analysis

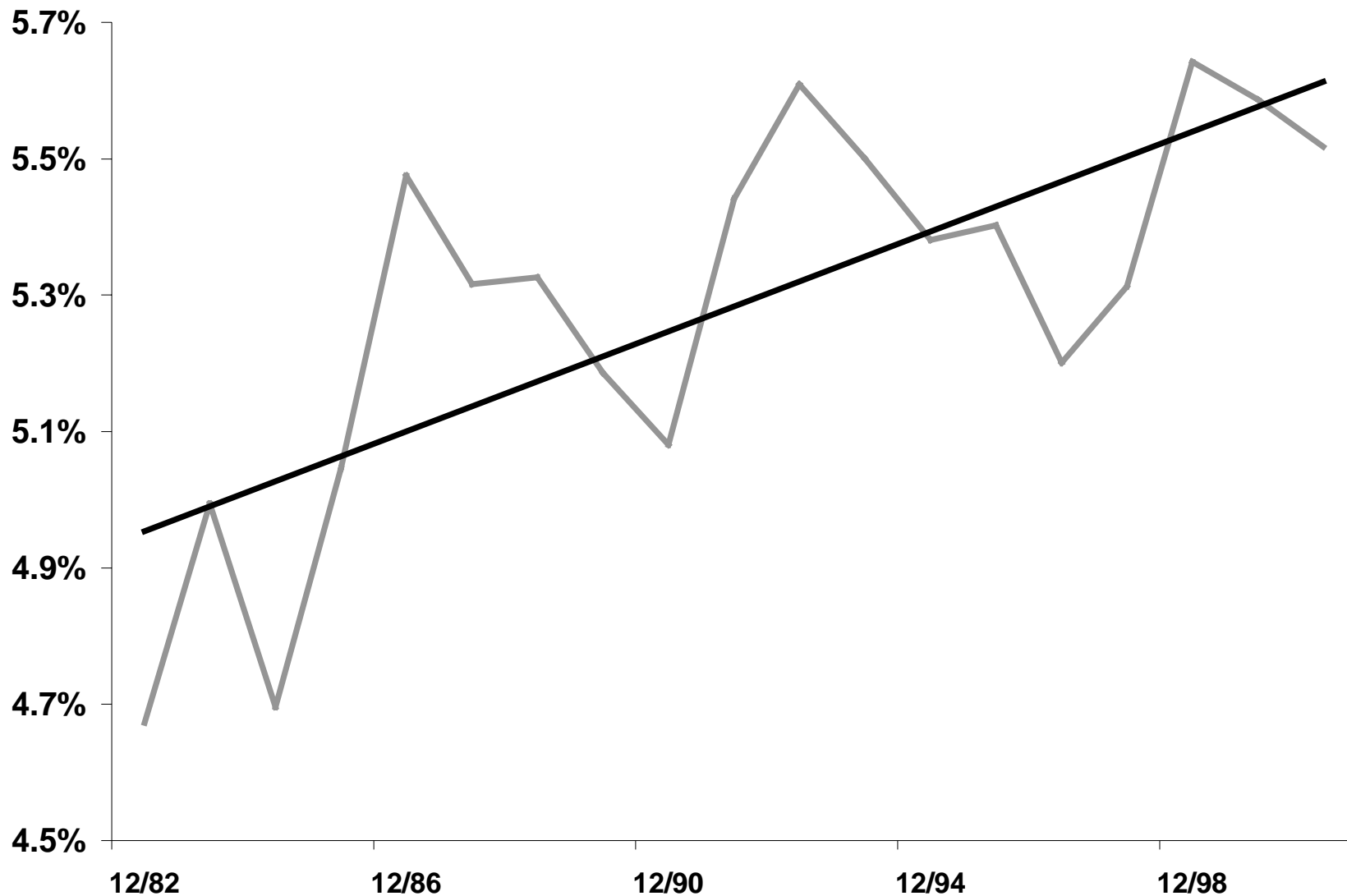
Cutting Variable Costs and ...



Hiking Fixed Costs Boosts Operating Leverage

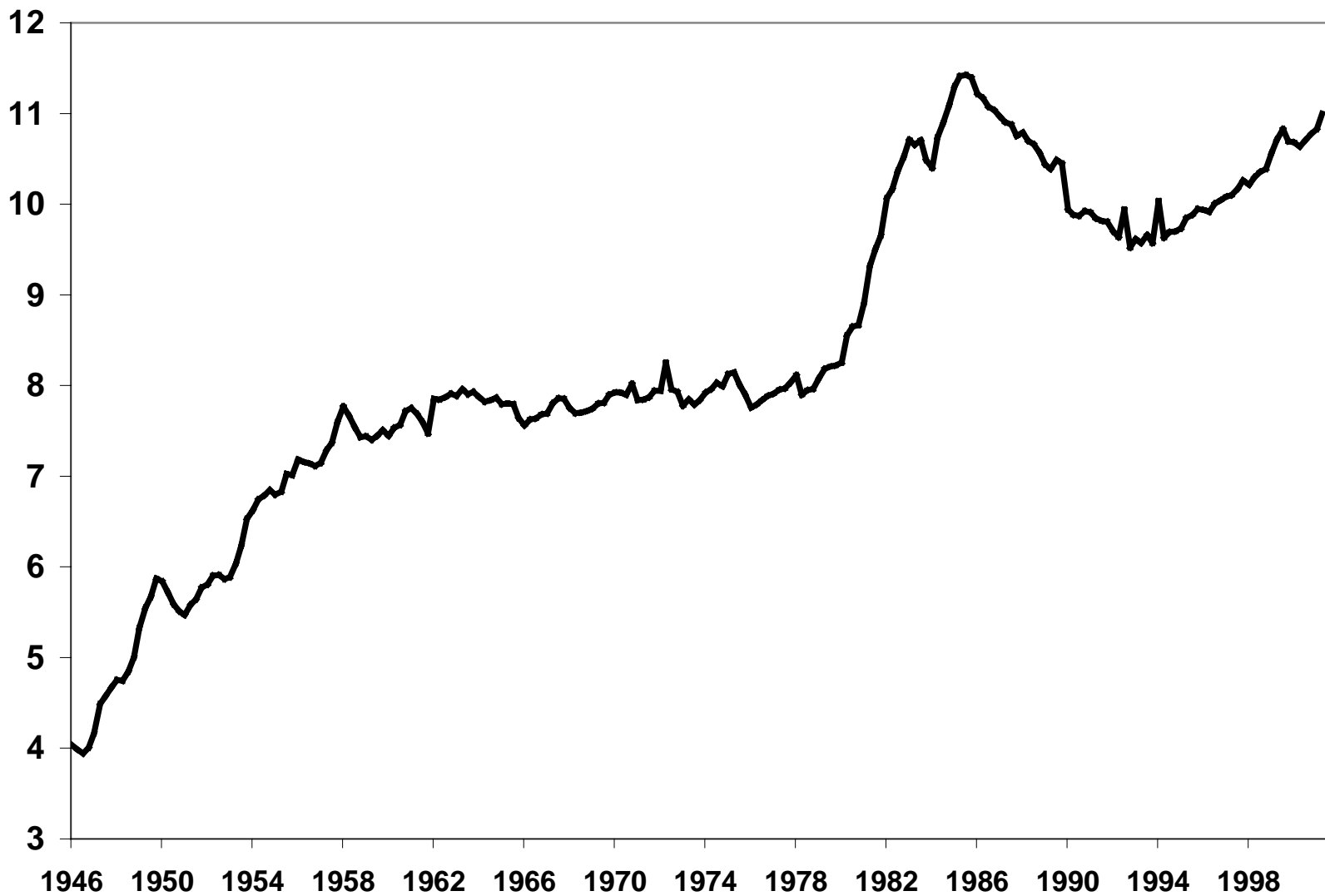


Measuring Leverage: S&P 500



Note: S&P 500 (Ex. Financials) Depreciation % Sales Source: Morgan Stanley Estimates

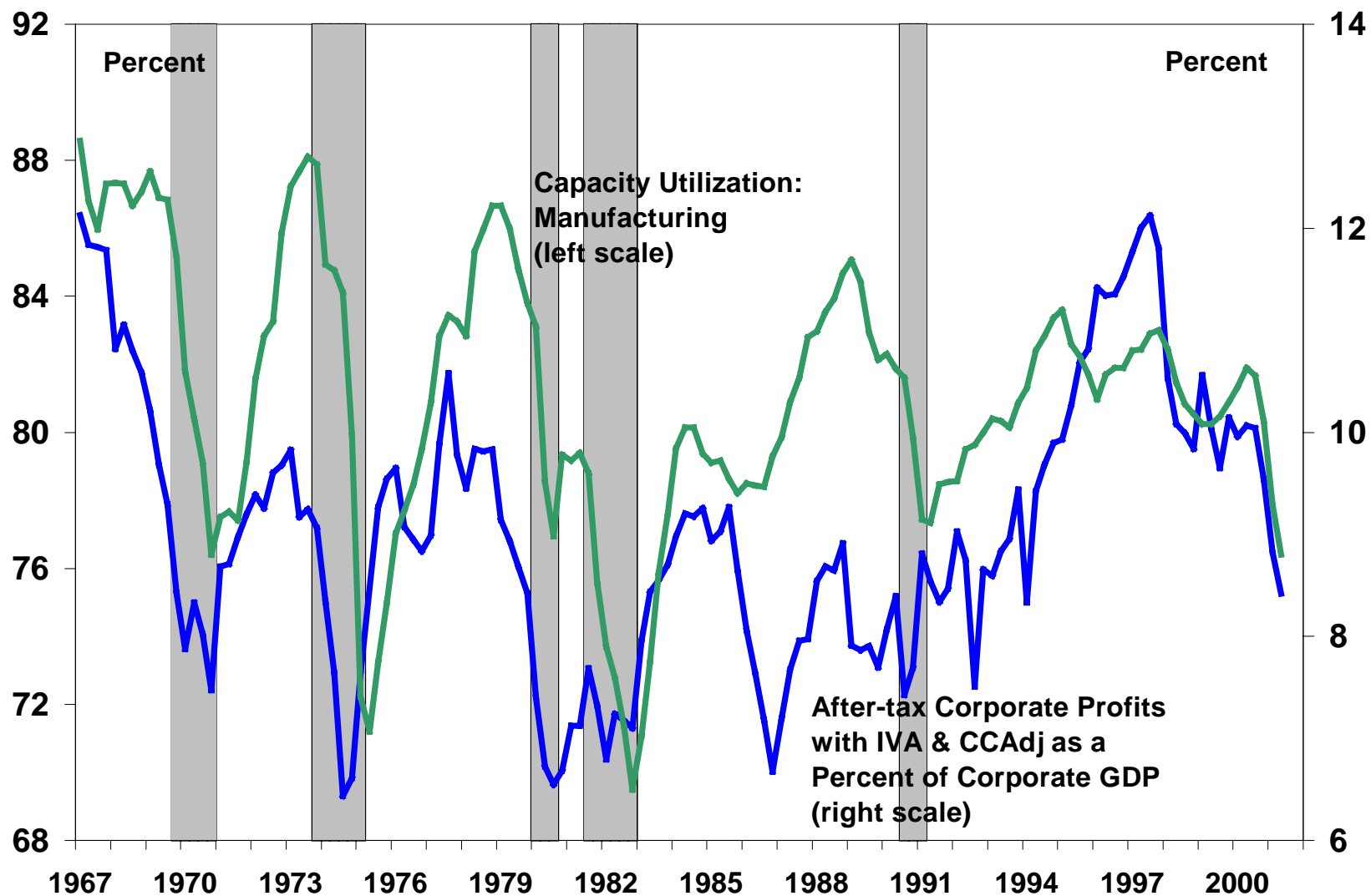
Measuring Leverage: Economy-wide



Note: Private capital consumption allowances as a percentage of nominal GDP.

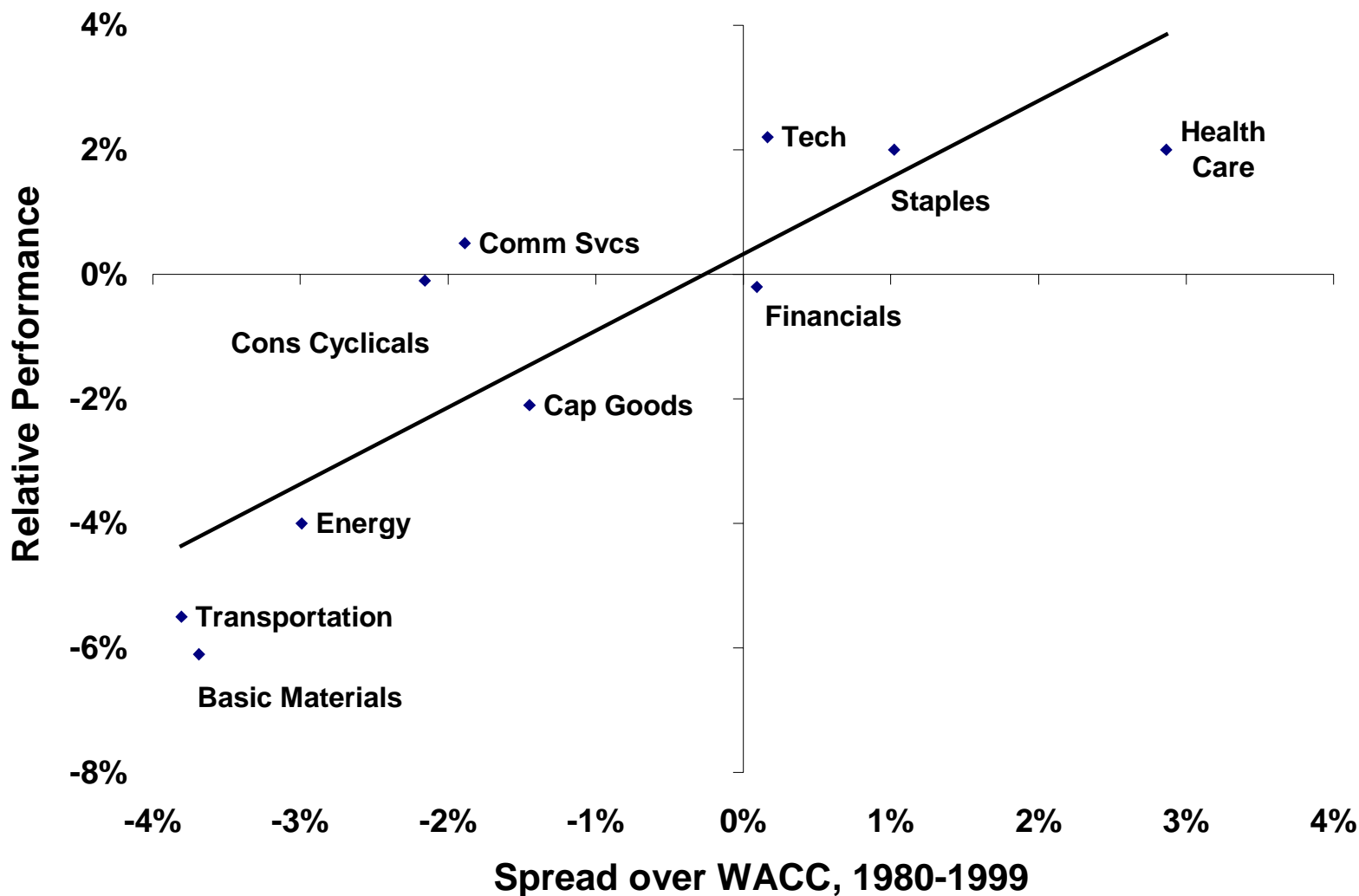
Source: Bureau of Economic Analysis

Capacity/Leverage Interplay Drives Profit Margins



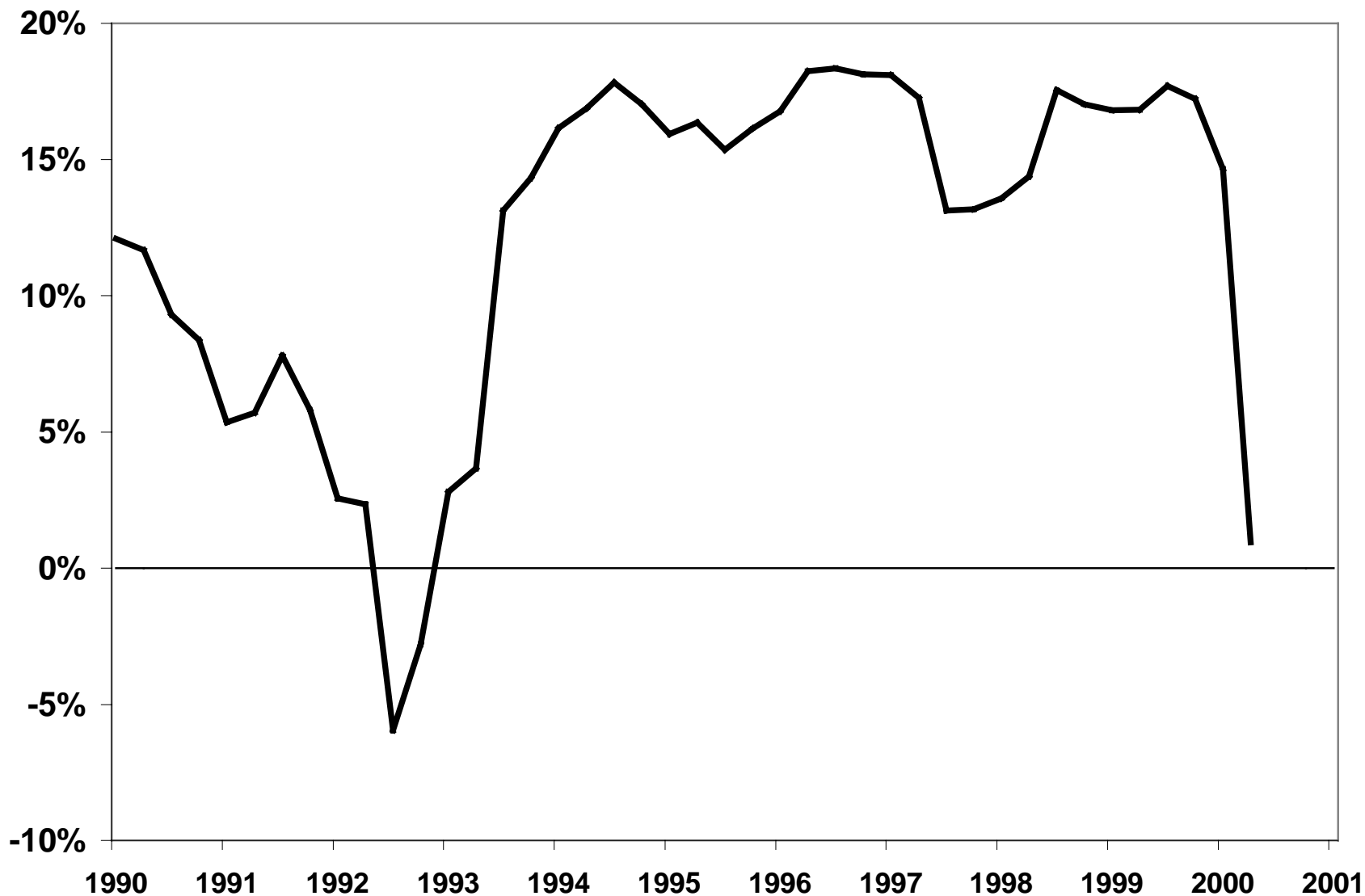
**Note: IVA = Inventory Valuation Adjustment; CCAdj = Capital Consumption Adjustment*
 Source: Federal Reserve, Bureau of Economic Analysis

Stock Returns are Linked to ROIC



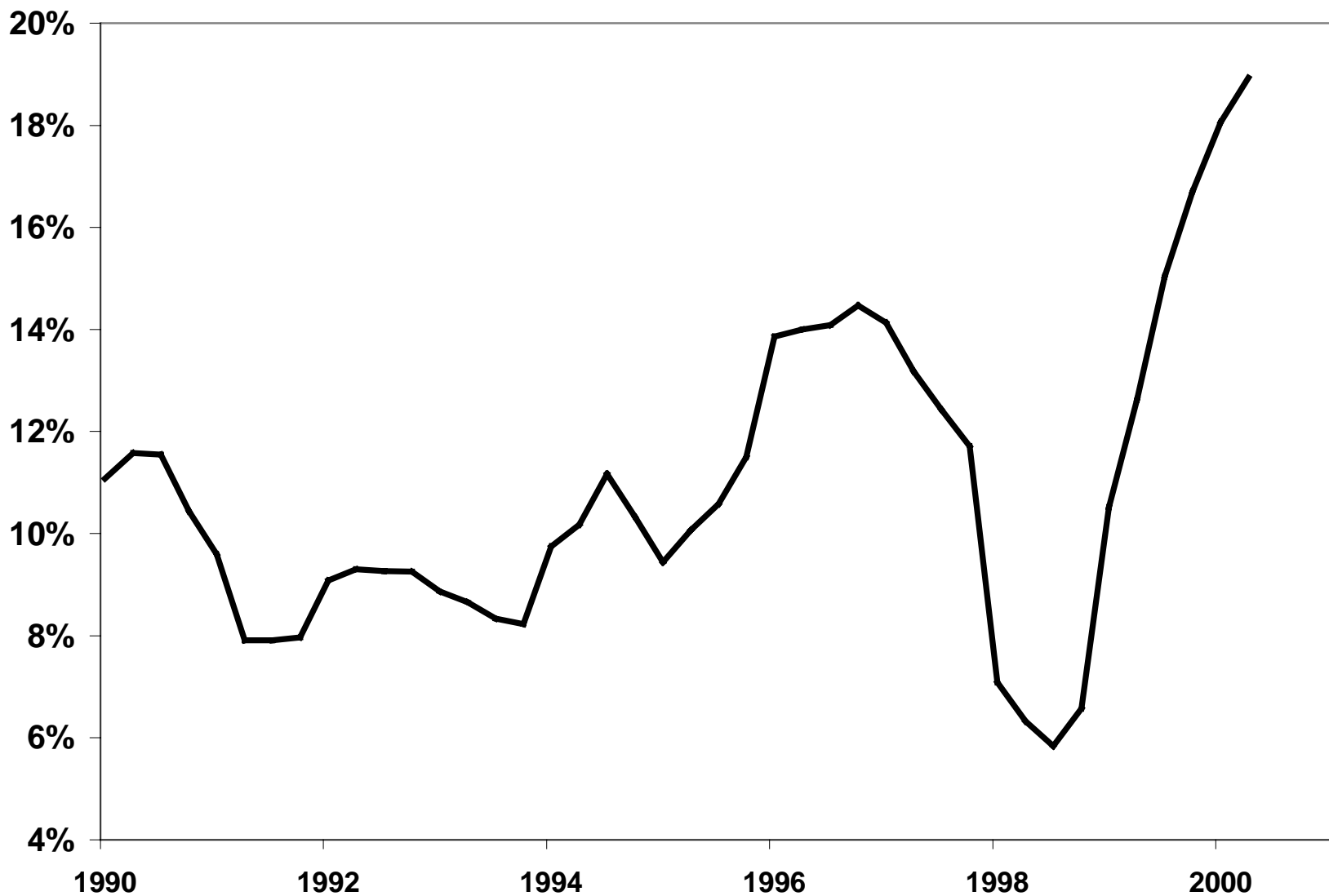
Source: Morgan Stanley Estimates

ROIC, Information Technology



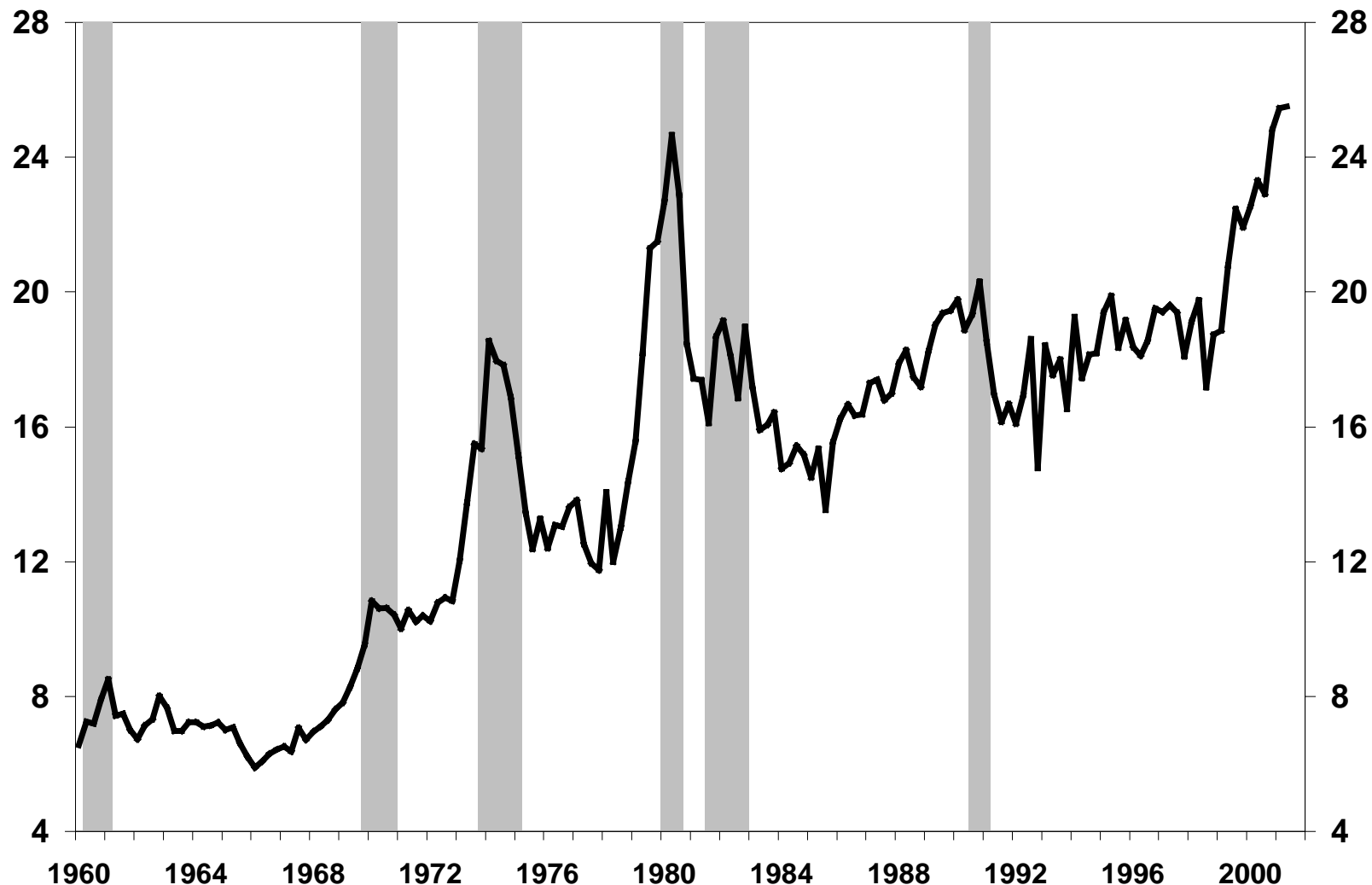
Source: Morgan Stanley Estimates

ROIC, Energy



Source: Morgan Stanley Estimates

Rising Share of Earnings from Abroad



**Note: Receipts from abroad as a percentage of corporate profits including inventory valuation and capital consumption adjustments.*

Source: Bureau of Economic Analysis

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