

## Reading Between the Lines in Earnings Calls: 6 Things to Watch as the Q3'23 Earnings Season Unfolds

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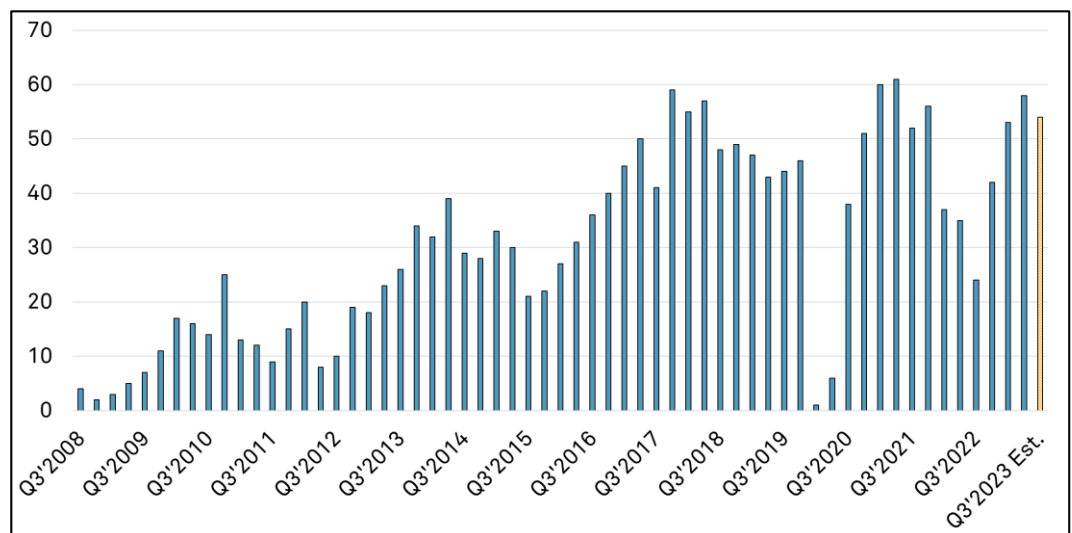
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*For the first time, natural language processing algorithms get to tell the earnings call story. This recurring series reviews an earnings season exclusively using texts from call transcripts.*

- **Watch for Q3'23 sentiment to be near 5-year highs, despite a quarter-on-quarter decline.** Sentiment for Q3'23 is estimated to decline by 5% compared to last quarter; but remains on track to be the 7<sup>th</sup> most positive of the last 60 quarters.
- **Watch for Q3'23 focus on 'supply chain' to hit a 3-year low.** Q3'23 is estimated to be the first quarter in 3-years that focus on supply chain returns to pre-pandemic levels.
- **Watch for renewed interest in 'interest rates' in Q3'23, for the first time in the last 4 quarters.** Talk of interest rates and monetary policy is expected to rise in Q3, quarter-on-quarter, for the first time in the last 4 quarters. If estimates prove correct, mentions will be at their highest for the 2023 fiscal year to-date.
- **Watch for 'inflation' worries to hit the lowest level in the last 10 quarters in Q3'23.** Mentions of 'inflation' are on a steady decline since peaking in Q1'22 and are set to hit the lowest level in Q3'23 in the trailing 10 quarters.
- **The term 'banking crisis', a hot topic in Q1'23, all but vanished in the second quarter and is not estimated to be a focus in Q3'23.**
- **Another hot topic, 'artificial intelligence' is expected to continue to appear in earnings calls at fever pitch.**

Figure 1: Earnings Call Sentiment Rank, S&P 500 Index



Source: S&P Global Market Intelligence Quantamental Research. Data as at 10/25/2023.

**Figure 2: Select Topic Mentions, S&P 500 Index**



Source: S&P Global Market Intelligence Quantamental Research. Data as at 10/25/2023.

## 1. Sentiment Steps Back, Still Near Highs

**Watch for Q3'23 sentiment near 5-year highs, despite a quarter-on-quarter decline.**

Sentiment for Q3'23 is estimated to decline by 5% compared to last quarter; but remains on track to be the 7<sup>th</sup> most positive of the last 60 quarters. What a difference three quarters can make! As ranked by the sentiment of language on earnings calls, Q3'22 was one of the worst quarters of the last 5 years. Just 3 quarters later, Q2'23 sentiment improved 24% to make the season the 4<sup>th</sup> most positive over the period. Major drivers of positivity include abating supply chain disruption, declining inflation, and hope for a more dovish U.S. Federal Reserve roadmap.

## 2. Supply Chain Troubles Abate

**Watch for Q3'23 focus on 'supply chain' to hit a 3-year low.** Q3'23 is estimated to be the first quarter in 3-years that focus on supply chain returns to pre-pandemic levels. Supply chain became a central focus as the world emerged from the COVID lockdown era.<sup>1</sup> Mentions of supply chain had almost doubled, year-on-year, in Q3'21 and the tri-gram, 'supply chain disruption' appeared 6.7 times more often in S&P 500 earnings calls. The topic has received diminishing spotlight for 7 consecutive quarters. Declining mentions are expected to continue in Q3'23. 'Supply chain disruption' has only been said 4 times as of the date of analysis.

## 3. Fed Fears

**Watch for renewed interest in 'interest rates' in Q3'23, for the first time in the last 4 quarters.** Talk of interest rates and monetary policy is expected to rise in Q3, quarter-on-quarter, for the first time in 4 quarters. After a 60% year-on-year increase in Q3'22, earnings call discussions of interest rates took a back seat to talk of a 'banking crisis' (section 5) and 'artificial intelligence' (section 6). However, after 3 consecutive quarters of declines, interest rate discussion is estimated to pick up by more than 16% in Q3'23. If estimates prove correct, mentions will be at their highest for the 2023 fiscal year to-date.

## 4. Inflation Risks

**Watch for 'inflation' worries to hit lowest level in last 10 quarters in Q3'23.** Mentions of 'inflation' are on a steady decline since peaking in Q1'22 and are set to hit the lowest level in 10 quarters in Q3'23. According to the most recent fed meeting<sup>2</sup>, "[the] Committee remains highly attentive to inflation risks." Since the fed began its tightening cycle in Q1'22, talk of inflation has steadily declined. The 12-month percentage change in CPI<sup>3</sup> was 3.7% for September 2023, down substantially from the 9.1% high in June 2022, suggesting that central bank policy has had the desired effect.

<sup>1</sup> <https://www.cnn.com/2021/10/18/supply-chain-chaos-is-hitting-global-growth-and-could-get-worse.html>

<sup>2</sup> <https://www.federalreserve.gov/monetarypolicy/files/monetary20230920a1.pdf>

<sup>3</sup> <https://www.bls.gov/charts/consumer-price-index/consumer-price-index-by-category-line-chart.html>

## 5. What 'Banking Crisis'?

**A hot topic in Q1'23, talk of a 'banking crisis' all but vanished in the second quarter and is not estimated to be a focus in Q3'23.** While projected for a slight elevation to 1,600 mentions in Q3, 'banking' mentions in general are significantly below the 2,337 mentions in Q1'23. 'Banking' terms in general popped in Q1'23 as firms grappled with the Silicon Valley Bank fallout in mid-March. However, Q2'23 saw a return to normal levels as the sector stabilized. The bi-gram 'banking crisis' appeared 55 times in Q1, 7 times in Q2, and only twice, as of the date of this analysis, in Q3. Prior to 2023, the term hadn't appeared in an earnings call since 2016 when RTX Corporation referenced the 'banking crisis ... in Italy'.<sup>4</sup>

## 6. And 'Artificial Intelligence'

**Watch for talk of 'AI' to continue at fever pitch in Q3'23.** Terms related to 'AI' were mentioned nearly 10 times more often than usual in Q2'23. Among firms in the S&P 500, 'artificial intelligence' and related terms were mentioned a total of 311 times in the Q2'22 season; compared to 2,721 mentions in Q2'23. Our estimate of 2,500 mentions for Q3'23 indicates we may be passed the peak of inflated expectations, but not quite at the plateau of productivity.

## 7. Methodology and Data

### Textual Data Analytics (TDA)

TDA was launched in October 2019 and is productized from Quantamental Research's previous publications with an advanced suite of analytics and metrics added in May 2022. It is an off-the-shelf NLP solution that tailors to our Machine-Readable Transcripts and outputs 800+ predictive and descriptive analytics for equity investing and various data science workflows. The analytics could be accessed via SQL, Snowflake or (DataBricks) Workbench.

### Machine-Readable Transcripts

Transcripts is a global data set that was added to the S&P Global Market Intelligence's Xpressfeed product in September 2017. Among its key features, the data set captures the different segmentations of earnings calls in the follow ways:

- Sections (e.g., prepared remarks, sell-side analyst questions, responses to questions)
- Speaker types (e.g., executives, sell-side analysts, shareholders etc.)
- Professionals (e.g., Tim Cook) where the individual professional identifiers serve as a unique key that connects the transcripts data set with the S&P Global Market Intelligence's Professionals and Sell-side Estimates data sets.

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<sup>4</sup> As based on a string search for 'banking crisis' in S&P Global Machine Readable Transcripts within S&P 500 firms analyzed as of October 25, 2023.

### Current Quarter Projections

The following steps were applied to prepare the raw transcripts for analysis: i) removed all numbers and punctuations; ii) converted all words to lowercase; iii) removed stop words; iv) spelled out contractions.

The Q3'23 values were forecast by multiplying the Q2'23 values by the percentage change among the firms that have already held their earnings call for Q3'23. Specifically,

$$Q3'23\_Estimate_{Index} = Q2'23\_Actual_{Index} \cdot \left( \frac{Q3'23\_Actual}{Q2'23\_Actual} \right)_{Those\_That\_Announced} \quad \text{Eq.1}$$

The analysis was conducted on October 25, at which time 106 firms in the S&P 500 had held an earnings call that was transcribed into the transcripts database.

See Section 3.1 in Zhao<sup>5</sup> (2018) for details on the sentiment 'Net Positivity' score. Select n-grams include {'bank', 'banking', 'banking crisis', 'banks', 'silicon valley bank', 'svb'} for 'Banking'; {'central bank', 'currencies', 'currency', 'fed', 'federal funds rate', 'fiscal policy', 'forex', 'interest rate', 'interest rates', 'monetary policy', 'quantitative easing', 'rate', 'rates', 'tapering', 'treasury rate', 'treasury yield'} for 'Interest Rates'; {'costs', 'hyperinflation', 'inflation', 'inflation rate', 'prices', 'wages'} for 'Inflation'; {'trade', 'supply chain', 'supply chain disruption'} for 'supply chain'; and {'ai', 'chatgpt', 'large language model', 'llm', 'artificial intelligence'} for 'AI'.

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<sup>5</sup> Zhao, F. "Natural Language Processing – Part II: Stock Selection" (September 2018).  
<https://www.spglobal.com/marketintelligence/en/news-insights/research/natural-languageprocessing-part-ii-stock-selection>

## Our Recent Research

### **August 2023: [Breaking Boundaries: Women Poised for Milestone Achievement in Parity Amid Otherwise Bleak Outlook](#)**

While diversity in leadership has received increasing attention, most data show slow, incremental improvements at best. Yet in an otherwise bleak landscape, a bright spot has emerged: An analysis of 86,000 executives from 7,300 US firms over 12 years found that women could reach parity in senior leadership positions between 2030 and 2037, among companies in the Russell 3000.

### **June 2023: [Mixed Financials Diverge from Bullish Sentiment: A Textual Review of the Q1'23 U.S. Earnings Call Season](#)**

A bullish sentiment during the Q1'23 season has taken hold. The excitement surrounding the 'iPhone Moment' of AI, the resiliency in the labor market, the receding likelihood of a banking crisis and the end of the current rate hike cycle have all uplifted the prospects of the U.S. economy. However, the exuded level of sentiment may not be supported by the financials. The breadth of firms citing growth deteriorated on a quarterly and yearly basis. Forecasts for the next season have come down materially from their bullish Q1'23 levels. Ominous clouds are on the horizon as banks' commercial loan portfolios come under scrutiny. Vacancy rates for office buildings have hit all-time highs. For the first time in the past five seasons, banks are prominently discussing their exposures to the commercial real estate market.

### **April 2023: [Sentiment Rebounds While Regional Banks Tip Their Hand: A Textual Review of the Q4'22 U.S. Earnings Call Season](#)**

The sentiment from S&P 500 firms' latest earnings calls rebounded for the first time in 2022. Earnings continued its recovery after hitting a trough two quarters ago. The headwind surrounding the strong dollar started to recede. Defensive sectors led the way while the cyclicals continued their struggle. The recent implosions of SVB Financial Group and Signature Bank have intensified this divergence. Other regional banks appear susceptible as the sentiment from their latest calls has turned negative, a rare historical occurrence that preceded the demise of the two, now FDIC seized, banks.

### **March 2023: [Singing the \(Banking\) Blues: Navigating the Current Volatility in the Banking Industry](#)**

The collapse of Silicon Valley Bank (SIVB) led to a reassessment of liquidity and contagion risks across the banking industry. Regional banks have borne the brunt of the subsequent market sell-off. Month-to-date, regional bank stocks are down by 28%, versus 0% for the S&P 500. This report introduces a screen to help both equity and fixed income investors navigate the current volatility in the banking industry. The screen identifies regional banks with unfavorable exposures to liquidity, investor sentiment and management sentiment indicators.

### **February 2023: [Watch Your Language: Executives' Remarks on Earnings Calls Impact CDS Spreads](#)**

While company earnings calls are targeted at equity analysts, information relevant to credit investors are discussed on these calls. This report documents that executive remarks have an impact on credit default swap spreads. The percentage change in CDS spreads of companies with the worst executive sentiment reading is larger than that of companies with the best sentiment reading post earnings call. Credit investors should consider using executive sentiment as an additional tool to gauge the direction of future CDS spread movements.

**January 2023: Machines Signal Q4'22 Guidance Not Falling Off a Cliff: An In-Depth Textual Review of Q3'22 Earnings Call Transcripts**

In Q3'22, the sentiment of S&P 500 firms has deteriorated to a level not seen since the IMF Greek Debt Default. Firms' focus has shifted away from pandemic-related concerns to interest rate-related ones. Financial growth is uneven. The breadth of firms citing profitability growth remains a bright spot yet the number of firms citing bottom-line growth has been mired in an "earnings recession" throughout 2022. Guidance for Q4'22 is far from falling off a cliff. This series demonstrates the richness and the intuitiveness of insights that could be surfaced algorithmically from textual data.

**October 2022: Hanging on Every Negative Word: Natural Language Processing Analysis of Credit Rating Action Reports**

Credit ratings are opinions about credit risk. When a credit rating changes, the analyst explains why, in a report. The 'why' is important. For an equity investor, a downgrade due to a rapid decline in a company's sales has a negative implication; whereas, a downgrade due to an increase in leverage arising from a share buyback program may be viewed as positive. This study finds that the relative size of the price impact following a downgrade is dependent on the magnitude of the tone and the topics of focus in the report (Figure 1). Downgrades with strong negative sentiment underperform downgrades with positive sentiment by 2.7% over the following month.

**March 2022: The Sounds of Silence: No Response Speaks Volumes**

No simple remedy for gender discrimination exists. But the first step in solving any problem is collecting the data to understand it. This research shows firms that share their data on diversity, equity, and inclusion (DEI) have taken further steps to address gender equity concerns. The S&P Global Corporate Sustainability Assessment (CSA) is a premier benchmarking survey and litmus test for inclusion in the S&P Dow Jones Sustainability Index. Firms that participated in the CSA survey in 2021 had better DEI outcomes.

**October 2021: Glass Floors and Ceilings: Why Closing the Median Wage Gap Isn't Fair**

The gender wage gap describes the disparity in compensation between women and men doing the same work. Progress on this issue is commonly measured by comparing the median compensation for women to men. This research demonstrates that firms are catering to the focus on median compensation and are paying women in a tighter range around the median, compared to men in equivalent positions. Effectively, women have been given a glass floor as

redress for the still-present glass ceiling. This 'Gender-Based Compensation Management' not only undermines the goal of equitable pay; but because the high end of the compensation range can be much farther from the median than the low end, this paradigm is a net disadvantage for women.

**September 2021: The Board Matrix: The (ESG) Value of Well-Connected Directors**

Corporate boards are responsible for shaping and overseeing environmental, social and governance (ESG) policies for their organizations. This report examines the relationship between companies connected through shared board members and ESG performance. It finds that companies with strong board networks (companies with directors who serve on more than one corporate board or are well-connected) have better certain ESG outcomes than firms with weak board networks. Well-connected directors can utilize their network for information on emerging ESG trends/best practices and share this knowledge with their companies. Given their roles on multiple boards, well-connected directors are also better informed about the needs of different stakeholders (governments, communities, ESG activists) than directors with little or no network. This awareness of stakeholder management translates to better ESG performance for companies with well-connected directors.

**August 2021: Technology Momentum: Peer Networks from Patents**

Companies with similar patent portfolios exhibit peer group momentum. A strategy that buys (sells) stocks of focal companies in the Russell 3000 with outperforming (underperforming) technology peers produces an annualized risk-adjusted return of 5.23% in a historical backtest. The strategy returns are more pronounced for smaller companies. In the Russell 2000, the strategy demonstrates more efficacy with annualized long-short return of 7.32%. The strategy is distinct from sector momentum strategies. After controlling for sector momentum, 3.60% excess return in the Russell 3000 can be attributed to technology peer group momentum.

**July 2021: Branching Out: Graph Theory Fundamentals**

Investment analysis has evolved beyond financial data to non-financial, or alternative data. Typically, the focus has been on using alternative datasets that are purely time-series and tabular. Graph networks meanwhile offer investors the ability to gain deeper insights into the connections between economies, industries, and individual corporations.

**May 2021: U.S Filings: No News is Good News**

Company annual filings are a vital but often under-analyzed source of information for investors. Market moving content is buried within an ever-growing body of text that on average is equivalent to a 240-page novel. The filings contain subtle revisions making a computational linguistic approach imperative. Faced with this voluminous amount of text and the minute number of changes, investors have historically overlooked the newly embedded information and the implications of those additions

**March 2021: Hiding in Plain Sight – Risks That Are Overlooked**



This report uses three metrics (Minimum Edit Distance, Jaccard Similarity, and Cosine Similarity) to identify companies that made significant changes to the “Risk Factors” section of their filings. These metrics can serve as alpha signals or be used to quickly identify a pool of companies that require further investigation.

**January 2021: Leadership Change That Matters: A Value and Momentum Story**

**December 2020: Warranted Optimism: Sentiment vs. Supply Chain**

**December 2020: A Dark Winter for REITS: Trouble Brewing**

**October 2020: Sweet Spots in the C-Suite: Executive Best Practices for Shareholder Friendly Firms**

**October 2020: Just the (Build)Fax: Property Intelligence from Building Permit Data**

**August 2020: The Analyst Matrix: Profiting from Sell-Side Analysts' Coverage Networks**

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**May 2020: Finding the Healthy Stocks in Health Care During Lockdown**

**May 2020: No More Walks in the (Office) Park: Tying Foot Traffic Data to REITs**

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**April 2020: Cold Turkey - Navigating Guidance Withdrawal Using Supply Chain Data**

**April 2020: Data North Star - Navigating Through Information Darkness**

**March 2020: Long Road to Recovery: Coronavirus Lessons from Supply Chain and Financial Data**

**February 2020: Ship to Shore: Mapping the Global Supply Chain with Panjiva Shipping Data in Xpressfeed™**

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**December 2019: The “Trucost” of Climate Investing: Managing Climate Risks in Equity Portfolios**

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**November 2018: Forging Stronger Links: Using Supply Chain Data in the Investing Process**

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**September 2018: Natural Language Processing – Part II: Stock Selection: Alpha Unscripted: The Message within the Message in Earnings Calls**

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**April 2017: Banking on Alpha: Uncovering Investing Signals Using SNL Bank Data**

**March 2017: Capital Market Implications of Spinoffs**

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**July 2016: Preparing for a Slide in Oil Prices -- History May Be Your Guide**

**June 2016: Social Media and Stock Returns: Is There Value in Cyberspace?**

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**March 2016: Stock-Level Liquidity – Alpha or Risk? - Stocks with Rising Liquidity Outperform Globally**

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**October 2011: The Banking Industry**

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**September 2011: Research Brief: Return Correlation and Dispersion**

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