

INSIDE THE BUY-SIDE®

FOURTH QUARTER | ISSUE DATE: OCTOBER 8, 2013

Equity markets continued strong 2013 performance through the third quarter, logging impressive gains in spite of ongoing speculation about monetary policy and the end-of-quarter standoff over Obamacare and a government shutdown. Through it all, the Dow and S&P 500 again hit all-time highs and ended up 1.5% and 4.7%, respectively, while the NASDAQ posted a sparkling gain of 10.8%.

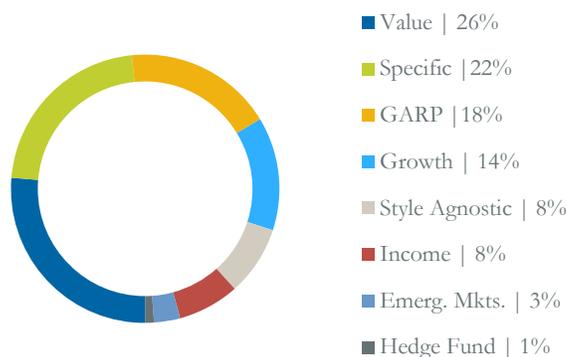
In our ongoing effort to track investor sentiment and expectations, we surveyed 50 financial professionals globally and across multiple industry segments and investment styles. In total, participating institutions manage upwards of \$2 trillion in equity assets.

September marked the five-year anniversary of the 2008 financial meltdown. Fast forward to today and surveyed investors report they are “cautiously optimistic” to positive though management sentiment remains constrained.

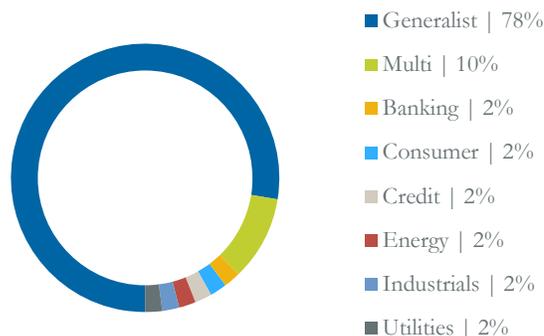
To be sure, the world remains on uncertain footing. Interest rates rose all summer in anticipation of the Federal Reserve tapering that never materialized. The budget battle threatening a government shutdown trimmed some of the market gains in the last week of the quarter. Complex geopolitical events, in particular the Syrian civil war, remain ever-present. Yet equities rise, the U.S. economic recovery continues slow and steady and even Europe seems to have climbed out sheepishly from the ruins of its debt crisis, at least for the moment.

Contributing investors expect a solid if unspectacular earnings season for 3Q13, after a second quarter that the majority describe as either in line or better than expected.

Investment Style¹



Sector



Geography



¹ Specific comprises ROIC-based, Combination, Sector Specific and Special Situation

Key Trends

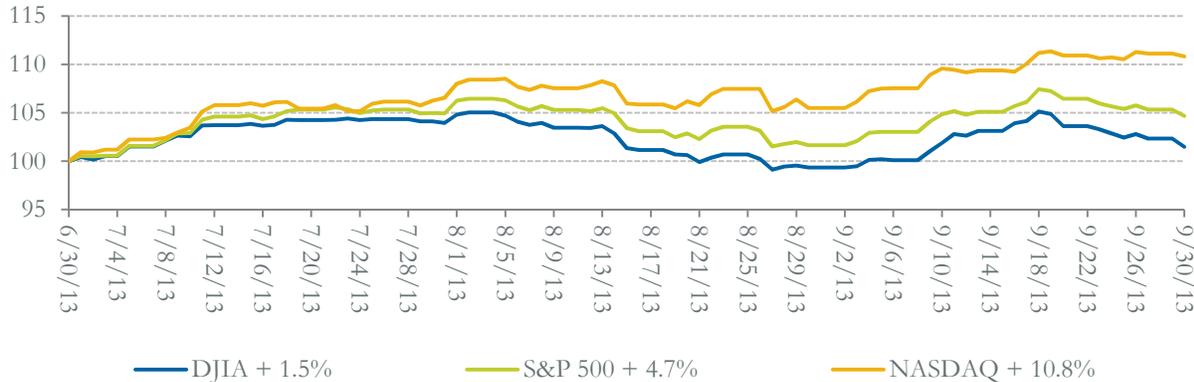
- 56% of surveyed investors indicate that 2Q13 results were in line with expectations, adding there were few “big disappointments”
- Heading into the 3Q13 earnings season, 77% expect results to be in line or better than consensus
- 44% describe management tone as having stayed the same quarter-over-quarter, which they largely describe as “already guarded”, while 25% say it is more negative
- Bullish market sentiment doubled from last quarter, with 20% exhibiting exuberance; still, the majority, or 54%, describe their outlook as “cautiously optimistic” in regard to industry coverage
- Organic growth, capital allocation discipline and valuations are key areas of focus
- Reinvestment topped investors’ preference for use of excess free cash, followed by dividends and sensible M&A
 - Share repurchases, historically a close second to dividends, fell to fourth in the current environment
- Overwhelmingly participants expect the Fed to begin to taper QE by year-end²
 - When the tapering does commence, 43% expect only a slight pullback for stocks
- Geopolitical events, U.S. Fed policy and the economic slowdown in China are cited as top concerns
- 62% assert that the North American non-residential construction rebound is real and sustainable though note that “rate volatility could derail the recovery temporarily”
- 76% maintain the European economy has taken a turn for the better, citing improving PMI surveys in particular
- 78% find Annual Reports valuable sources of information

² Important to note, interviews were conducted prior to the FOMC’s September 18 meeting

Equity Market Mojo Undaunted by Fed Head Fake

As it was in the second quarter, so it was in the third. Equity markets continued to rally and even saw all-time highs for two indices: the Dow and the S&P 500 on September 18. Even better, the NASDAQ's 10.8% gain was more than twice the 4.2% it added last quarter.

3Q13 Market Performance

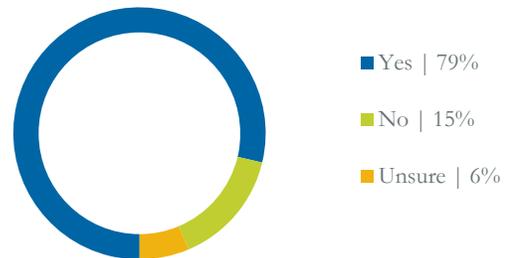


September 18 of course was the date investors were looking towards all summer. Many on the Street were betting that the Fed would announce plans to pull back QE buying at its September 18 meeting but it was not to be. Interest rates rose throughout the quarter and the U.S. 10-year Treasury bond approached 3% in the middle of September before falling back slightly when the Fed announced it would not taper bond purchases but continue its QE measures full steam ahead for at least a while longer.

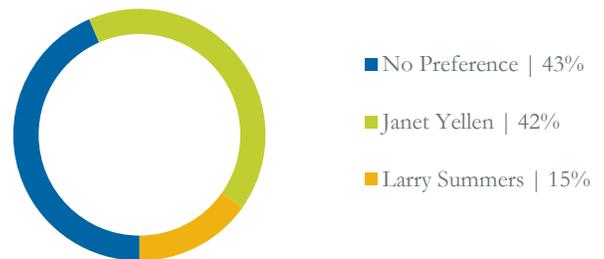
Those surveyed overwhelmingly believe the Fed will begin to taper QE by year-end, though participants were interviewed prior to the September 18 meeting. When the tapering does commence, the majority of participants see only a slight pullback for stocks or assert the effect will be neutral. Indeed, a mere 10% project a full-fledged correction when the tightening begins.

Meanwhile, the search for Bernanke's successor as Fed Chairman was also much discussed during the quarter. Among those surveyed, current Fed Vice-Chairperson Janet Yellen was favored by 42% and former Treasury Secretary Larry Summers just 15%. However a substantial number, 43%, expressed no preference for either, suggesting that investors expect little change in policy from a big change at the top.

Will the Fed Taper by Year-end 2013?



Who is Your Preference for Next Fed Chair?



Though President Obama has yet to officially nominate anyone, Yellen now seems likely to get the nod after Summers withdrew his name from consideration on September 15.

“The benefits of QE no longer justify the costs and the Fed seems attuned to that. It will not be, however, because the economy has strengthened sufficiently.” – GARP, Generalist

“Stimulus needs to be withdrawn over a period of time. The U.S. economy is strong enough to withstand it.” – Income, Energy/Technology

“There will be a short term over-reaction followed by a nice buying opportunity.” – GARP, Generalist

3Q13 Earnings Season Expected to Meet or Beat Consensus

Among contributors, just over half indicate that 2Q13 results were in line with expectations. There were few negative surprises, though fundamentals continued to “muddle along” and “sales disappointed but earnings did not”.

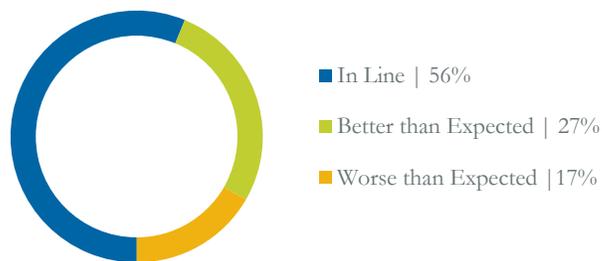
Meanwhile 27% report results were better than expected. This compares to last quarter data, when 78% revealed that 1Q13 results were largely in line with expectations and 22% asserted they were below.

Expectations for the third quarter are positive among contributors, with the majority expecting results to meet or beat consensus numbers. “Expectations have adjusted” they note, while “guidance has come down”. Still, rising interest rates and their effect on the housing market are a concern though the slowly improving economy should boost demand, contributors maintain.

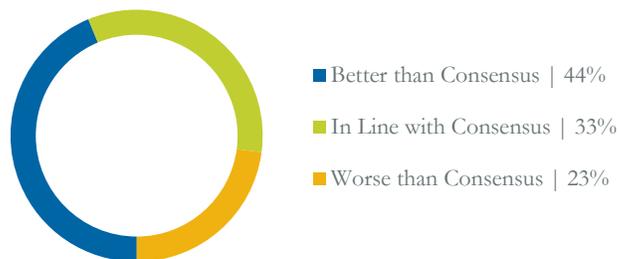
For the quarter, investors report an acute focus on:

- Organic growth
- Disciplined capital allocation
- Valuations
- Macro issues

What Was Your Opinion of 2Q13 Earnings Results?



What Are Your Expectations for 3Q13 Earnings Results?



“I would expect fundamentals to continue to move forward, as long as housing stays relatively strong. If housing dives due to interest rate volatility, all bets are off.”

– GARP, Generalist

“Any further improvement in demand may lead to positive surprises in terms of profitability. My view is that demand will exceed expectations and operational costs will remain under control giving better than expected profit improvements as a result.”

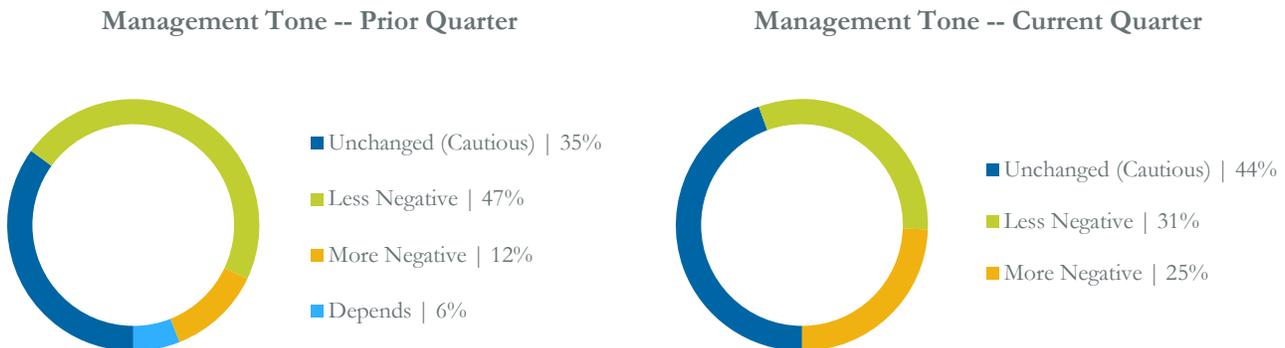
– Value, Generalist

“The underlying economy is a bit better than the consensus perceives and expectations are low.”

– Core Growth, Generalist

Management Tone Turns Pessimistic

Contributing investors report that management teams with whom they interact are expressing increasing concern. The number of respondents reporting a “more negative” tone more than doubled from 12% to 25% quarter-over-quarter while those who maintain executive tone is “less negative” slipped for the first time since 2012.



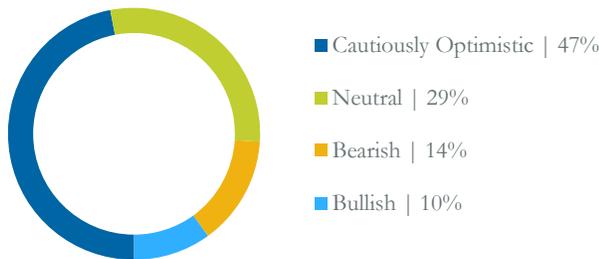
Market Sentiment: Still Fickle But Bulls Growing the Herd

Despite, or perhaps because of equities continuing to rise quarter after quarter, bullish sentiment has gained among those surveyed, who perceive “more tailwinds than headwinds”. Indeed, 20% of investors describe themselves as “bullish” up from just 10% last quarter though still far below the giddy optimism of 1Q13 when 42% of interviewed investors described themselves as such.

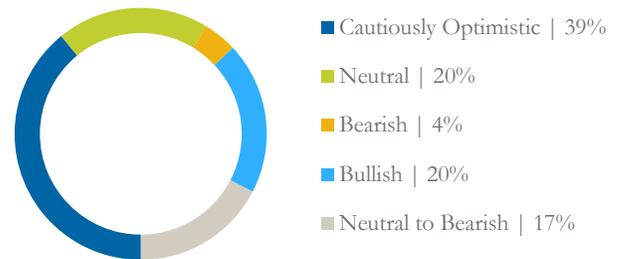
That being said, the majority of participants continue to describe their current market sentiment as “cautiously optimistic” or “neutral” citing rising interest rates, the Syrian conflict and the eventual tapering by the Fed as hedges to their enthusiasm.

Describing their outlook on specific industry coverage, better than half of surveyed professionals say they are “cautiously optimistic” while 30% are neutral to bearish and 15% are emphatically bullish.

Investor Sentiment -- Prior Quarter



Investor Sentiment -- Current Quarter



“The risk is to the upside for U.S. equities. There has certainly been a nice run but when you look on a global scale given our relative GDP strength and the valuations being okay, there is still some room for upside. How much we do not know.”
– Value, Generalist

“Equities win by default but the underlying economics are not strong enough to create deep confidence in valuation levels.” – GARP, Generalist

“In the very near-term, there is a risk for higher volatility tied to Fed moves and exogenous shock. Looking out to the medium-term, the case for fundamentals in the equity market seem fairly strong.” – Value, Generalist

Europe Has Turned the Corner

As in the second quarter, global issues remain of great concern to investors. One theme emerging from our survey is that developed markets are the preferred investment play while emerging markets struggle. More than three quarters of participants believe the European economy has taken a turn for the better. Europe is “getting less bad” they note and there were “positive PMI and GDP surprises”.

Indeed, Europe appeared to move from recession into recovery, as the second quarter GDP rate announced in July turned positive for the first time since 2011. As well, the Stoxx Europe 600 Index surged 8.9% in the third quarter, its largest quarterly gain since the third quarter of 2009. Still, while Europe’s debt crisis is currently a key concern of just 17% of participants, they caution that “long-term there is no solution for the Eurozone in its current state”.

Do You Believe Europe Has Made a Turn for the Better?



Meanwhile, concerns about Japan have ebbed though the economy’s stubborn problems remain. Only a handful of respondents consider Japanese monetary policy a concern while more than half of the study group indicate they are “not concerned” or only “mildly concerned” about Japan. That being said, general geopolitical events, such as civil war in Syria and ensuing diplomatic wrangling, was the leading concern of those surveyed. Further, the slowdown in the growth rate of the Chinese economy and other emerging markets reflect the “risk of growth disappointments” and remain top concerns.

“The PMIs are improving and the fiscal condition is better than the U.S. but unrecognized. They are starting from a lower base with wages having corrected.”
– Style Agnostic, Generalist

“Rich in assets, the key nations in Europe have the balance sheets and eagerness to engineer a turnaround.” – Multi, Generalist

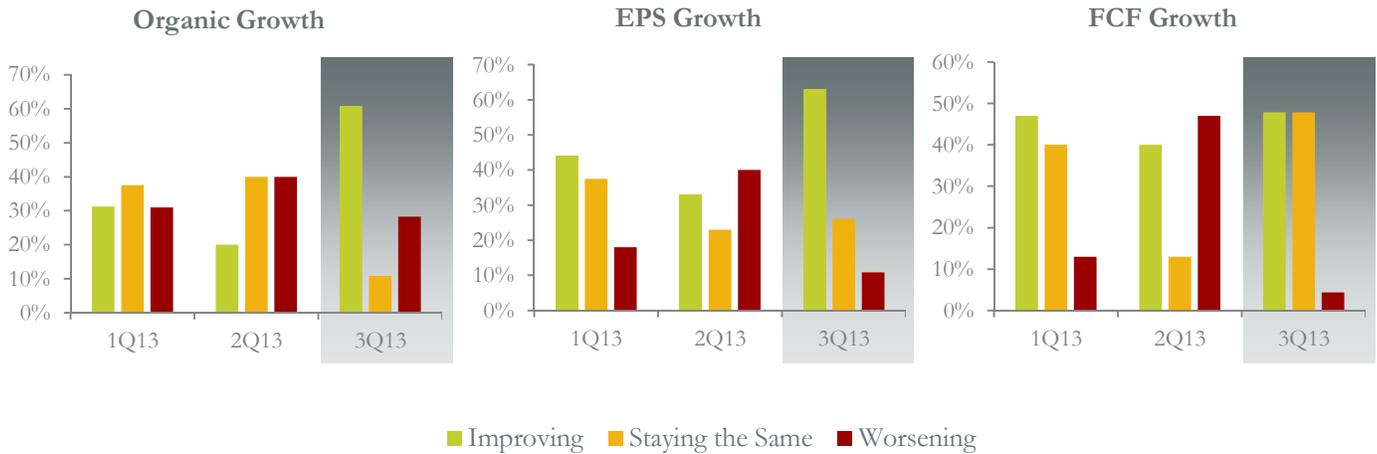
“In the very near-term, yes. Long-term, there is no solution for the EuroZone in its current state.” – Style Agnostic, Generalist

Top Investor Concerns



Checking in on Performance Metrics

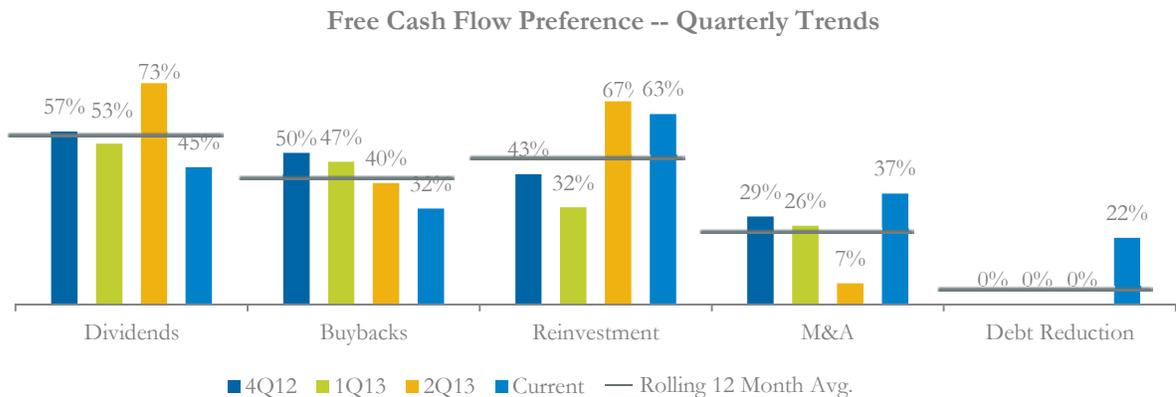
In line with the positive expectations for third quarter results sentiment has shifted to a more positive tone in our latest quarterly channel check on performance metrics. Where last quarter investors expected worsening EPS and FCF growth they now see EPS growth improving and FCF either gaining or holding at current levels. Organic growth, also projected to decline last quarter, is now seen as improving.



Reinvestment States its Case, as Buybacks Lose Appeal

Following six straight quarters in which dividends topped the list of investor preference for uses of excess cash, reinvestment now rules convincingly as the leading choice of contributors. The upturn in sentiment toward reinvestment was noted in 2Q13, when its preference among investors more than doubled from the previous quarter.

Meanwhile dividends remain the preferred method for returning cash to shareholders, far outpacing buybacks. According to the S&P Dow Jones Indices,³ dividend net increases (increases less decreases) rose \$11.9 billion during 3Q13 for U.S. domestic common stock, compared to an \$8.8 billion increase in the third quarter of 2012. Continuing, 475 dividend increases were reported during the quarter, equating to an 8.2% gain over the 439 dividend increases reported the year prior.



³ October 3, 2013

IR Best Practice: Annual Reports – Another Vehicle to Reiterate Strategy

The overwhelming majority of those surveyed, nearly 80%, consider the annual report to be a valuable source of information though some investors describe it as “hype” and “yesterday’s news” and consider the 10K more relevant. Beyond the “critical” financial information contained in the annual report, participants deem the following elements key:

- Outline of long-term objectives
- R&D and new product plans
- Subsidiary activities
- Competitive landscape
- Market segmentation
- Strategic discussion

Are Annual Reports a Valuable Source of Information?



Corbin Perception’s ongoing research finds that many companies do not take advantage of the annual report to reiterate strategy which is “important to critical” to high-quality long-term investors’ decision-making process. Given the buy side’s limited bandwidth, it is imperative that companies reiterate key messaging at every opportunity.

“I would recommend a better shareholder letter. The CEO letter is very important. We rate that as an important aspect of our process because it demonstrates one area in which the management can convey the strategy of the Company to investors and potential investors. If the letter is average, then either they do not care about the investors or they do not have a strategy. Or both.” – GARP, Generalist

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Corbin Perception is an IR research and advisory firm assisting public companies with driving long-term shareholder value. Our advisory services include:

- Perception Studies
- Investor Targeting
- Investor Days
- Investor Presentations
- IR Diagnostic Reviews
- Retainer Consulting

We leverage our broad company and industry experience, ongoing research on the buy side and knowledge of IR best practices to achieve results.

We are passionate about what we do and develop relationships that are collaborative and long lasting.

Our client proposition is based on: 1) insightful, research-driven counsel; 2) a talented and experienced team; 3) an in-depth understanding of best practices and the ability to apply that knowledge to unlock value; and 4) an unparalleled commitment to client service and satisfaction.

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