# INSIDE THE BUY-SIDE®

## FOURTH QUARTER | ISSUE DATE: OCTOBER 8, 2015


The summer months were far from a vacation as the third quarter provided a staggering amount of volatility for the global markets. While the Greek sovereign debt crisis was the top story heading into the third quarter, surveyed investors expressed greater concern about China. That sentiment came to fruition on August 24 when the Shanghai Index plunged 8.5% due to fears of slowing growth in the world's second largest economy. The news triggered a domino effect, with losses rippling through virtually all global financial markets, driving the major U.S. indices into correction territory for the first time in four years. In reaction to the extreme volatility, the NYSE invoked little-known "Rule 48" allowing stocks to open without pricing indications. The Dow dropped 1,089 points minutes after the open, surpassing the 2010 "Flash Crash" to mark the biggest point drop in the index's history. Blue chips, such as GE and Pepsi, were down over 20% intraday before rallying. Still, the Dow, which staged a furious comeback midday, ended down 588 points, its largest one-day loss in four years.

The volatility in August weighed heavily on the Federal Reserve, which declined to raise interest rates during its most recent quarterly meeting. The decision rattled investors as fears of a global slowdown, perhaps even spreading to the U.S., unnerved markets. Oil continued to trade at discounted levels but came off August lows, settling at just under $50 a barrel at quarter-end.

For the third quarter, the Dow fell 7.6% while the NASDAQ, S&P 500 and Russell 2000 lost 7.4%, 6.9% and 12.2%, respectively.

In our ongoing effort to track changes in institutional investor sentiment and provide insights heading into earnings season, we surveyed[1] 66 investors globally. Participating institutions manage over $4.0 trillion in total assets.

Survey findings indicate a significant spike in bearish sentiment resulting in a "Wall of Worry", as concerns about growth and an international credit crunch loom. While the bulls came out in droves the first week of the new quarter, the focus this earnings season will be on management tone and outlooks as investors set bets for 2016.

[1] September 16 – 29, 2015


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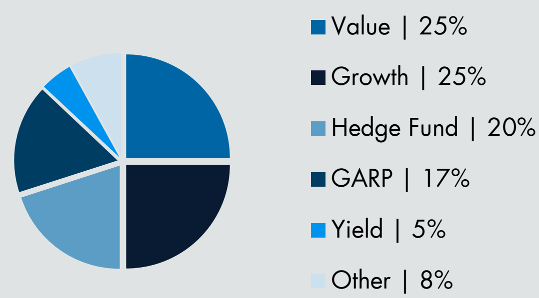
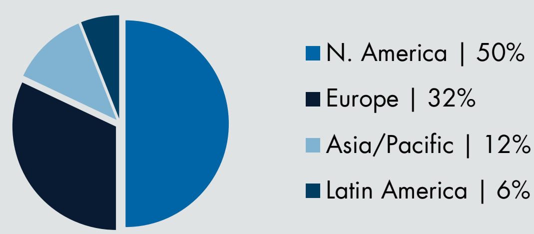
### Market Performance

| | 3Q15 | YTD |
|---|---|---|
| DJIA | (7.6%) | (8.6%) |
| NASDAQ | (7.4%) | (2.4%) |
| S&P 500 | (6.9%) | (6.7%) |
| Russell 2000 | (12.2%) | (8.6%) |

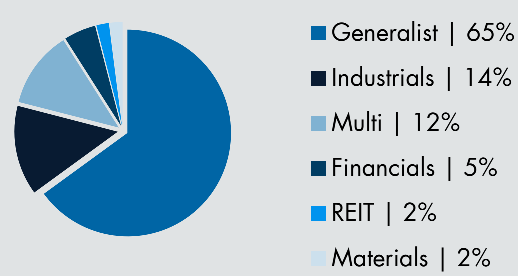
### Investment Style




### Geography




### Sector



## Key Trends

- While sentiment ticked up last quarter, breaking a two-quarter streak of increasingly negative views, the level of bearish sentiment has settled back in due in significant part to China contagion fears and concerns about broad-based slowing growth
  - Investors describing management tone as "more bearish" spiked to 39% from just 11% last quarter
  - Commensurately, self-proclaiming bears rose to 24% from 9% last quarter, while bulls, now at 3%, receded 15% over the period
- Regarding China, Asia-based investors are nearly 2x and 3x more concerned than their U.S. and European counterparts, respectively
- An earnings recession is largely priced in with an unusually high 45% expecting *worse than* consensus results; this could bode well for stocks, as our data indicates outlooks are consistently worse than reality[2]
  - 54% expect downward revisions to 2015 guidance though it is important to note that the 3Q typically sees the greatest number of adjustments
- Investors in aggregate expect key performance indicators, specifically organic growth, free cash flow and earnings, to stay the same or deteriorate
- While the interest rate hike remains a moving target, 57% think it will occur this year while 26% are pegging 1Q16
- From a regional standpoint, the U.S. remains a bright spot, and positive views on the Eurozone remain consistent; meanwhile, sentiment on Japan retrenched significantly from prior survey findings
- In the absence of growth, the bulls continue to revere the Tech sector while positive sentiment on Energy, which had been steadily increasing, whipsawed negatively; notably, Consumer Discretionary witnessed the biggest shift in bullishness as surveyed investors continue to bet on the U.S. consumer
- IR Topic: 41% of investors report that *Say on Pay* is having a material influence on executive compensation

[2] Based on 12 quarters of survey data

## Corbin Perception: Proven Methodology, Proven Results

Corbin Perception assists public companies with systematically understanding and positively influencing critical institutional investor sentiment. We provide senior level executives and IR professionals with company-specific quantitative and qualitative feedback from investors and analysts and then draw upon our firm's considerable expertise to guide management teams in shaping those perceptions and maximizing valuation. Our clients range from mega-caps to micro-caps worldwide across diverse industries. Our quarterly investor research report, Inside The Buy-side®, which tracks changes in global institutional investor sentiment, is covered by news affiliates worldwide and featured regularly on CNBC's *Squawk on the Street*.

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## Slowing Global Growth And China Contagion Sap Market; Investors Unnerved As 4Q Kicks Off

As reported in our last survey issued in early July, concerns about China topped the list despite Greece's potential EU exit dominating headlines. Fast-forward three months and China is broadly and deeply coloring views with 95% of survey contributors indicating they are *moderately* to *very concerned* about the contagion risk of slowing growth in the region. Interestingly, those based in Asia are significantly more concerned about the world's second-largest economy than their overseas counterparts.

Current sentiment witnessed a degradation across all positive descriptors with fewer contributors describing themselves as *bullish* or *cautiously optimistic* quarter-over-quarter. Meanwhile, 68% now characterize themselves as *neutral* to *bearish*, up 20%, with a significant uptick in categorically *bearish*.

Our ongoing research indicates a direct correlation between investor sentiment and management tone, of which the latter is also described as weakening. While nearly 32% maintain that executives with whom they interact remain *cautiously optimistic*, 39% purport that views have become *more negative*.

**Key Drivers of Downbeat Sentiment**

- **75% |** China headwind/contagion
- **42% |** General emerging market growth
- **35% |** Prolonged oil & gas headwinds
- **32% |** Expectations for negative earnings revisions
- **28% |** Expectations for organic growth disappointment

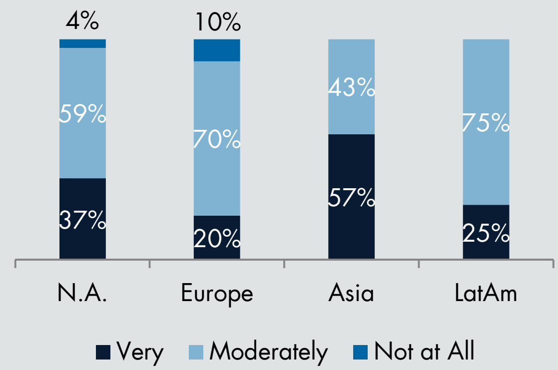
*"Continued weakness in short-cycle indicators, plus uncertainty caused by volatile oil prices, China headlines."* **Core Growth, Industrials | North America**

*"Weaker economic data, slowdown in exports, emerging market weakness."* **GARP, Generalist | North America**

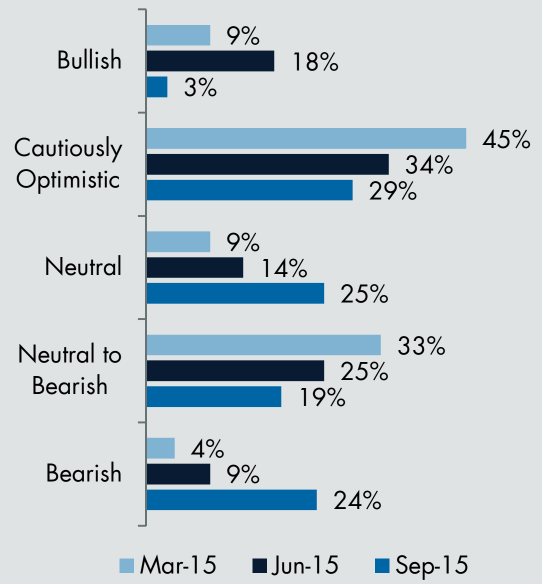
*"Slowing global economy and no real uptick in trade as prices are squeezed."* **Hedge Fund, Generalist | Europe**

*"Europe a plus; USA neutral; Emerging markets declining within a good level."* **Core Value, Generalist | Europe**

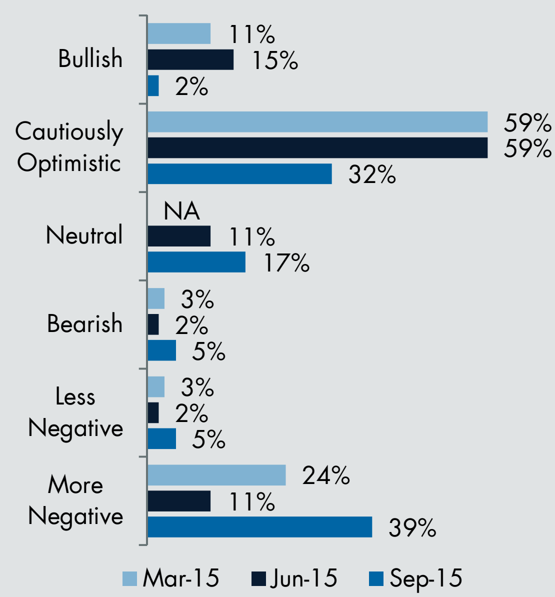
**How Concerned Are You About The China Contagion Risk?**




**How Would You Describe Your Current Sentiment?**




**How Would You Describe Executive Tone?**



## A 3Q Earnings Recession Priced In; Our Research Indicates That Investor Expectations Are Almost Always Worse Than Reality

As the third quarter earnings season gets underway, surveyed investors and analysts are bracing for the worst, with 45% expecting consensus misses versus just 30% last quarter. Still, roughly one-third of participants expect earnings to come in line with analyst expectations.

In looking at the past 12 quarters of survey data on expectations heading into the earnings season versus actual results, our findings conclude that investors and analysts who forecast *worse than* consensus results typically describe their view post earnings as *in line* to *better than* expected. While downbeat views are largely priced in, we underscore the important role that management outlooks for the remainder of 2015 and color provided on 2016 will play in shaping market sentiment. Based on our channel checks, management tone will likely be muted.

Contributors based in North America have the rosiest of expectations, with 44% predicting *in line* results, pointing to the strength of domestic U.S. companies, "pent-up" demand and a "stronger economy than we thought" among the driving forces.

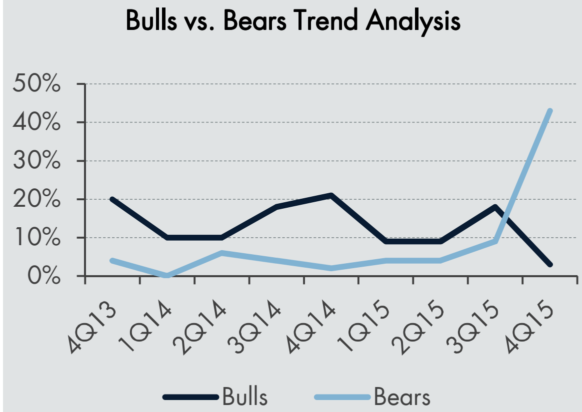
Overseas remains a different story with Europe staging a reversal from last quarter when the entirety of this cohort were bullish heading into earnings season despite the Greek debt crisis. Global growth concern is the leading driver for their negative views that, along with uncertainty regarding the refugee crisis, appears to have thwarted the euphoria for the Eurozone to some extent.

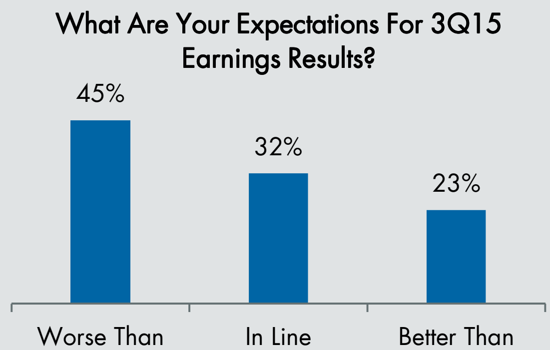
Asia, still new to the slow growth party, sees 76% of contributors invested there expecting *worse than* results as China's deceleration, regional consumer sentiment and general economic conditions weigh on opinion.

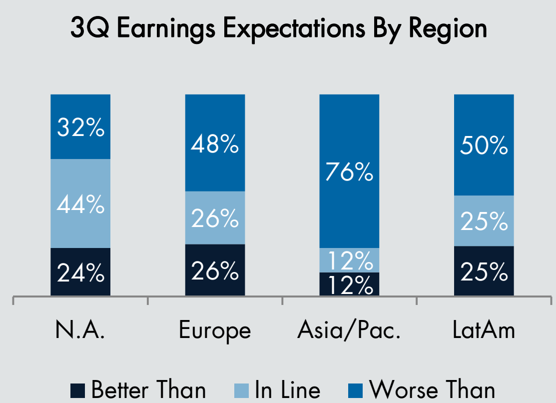
Meanwhile, Latin America views remain a mixed bag with negative growth, debt levels and credit crunch concerns dominating sentiment.

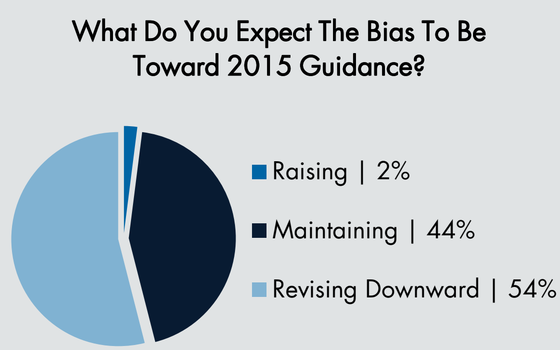
Surveyed participants largely believe around 25% of companies will post *better than* consensus earnings results.

*"We see weaker economic data, slowdown in exports, and emerging market weakness."* **GARP, Generalist | North America**

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*"It's easier to beat consensus with lower revised forecasts for 3Q earnings after disappointing 2Q results."* **Hedge Fund, Generalist | Asia**

*"Global macro forces will dampen earnings growth."* **GARP, Generalist | North America**

*"There is a slowing global economy and we don't see a real uptick in trade as prices are squeezed."* **Hedge Fund, Generalist | Europe**

*"There is deteriorating global growth fundamentals and emerging market growth deceleration."* **Other, Generalist | Latin America**

## Another Healthy Helping Of Downbeat Sentiment Surrounding Key Performance Metrics

Despite the universal view that key performance metrics (i.e., Organic Growth, FCF and EPS) would improve last quarter, our channel check this time around sees outlooks softening and all metrics expected to *stay the same* or *worsen*.

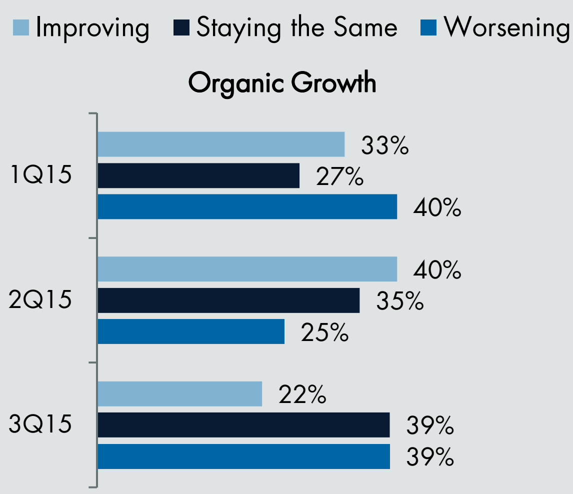
Some interesting trends on organic growth:

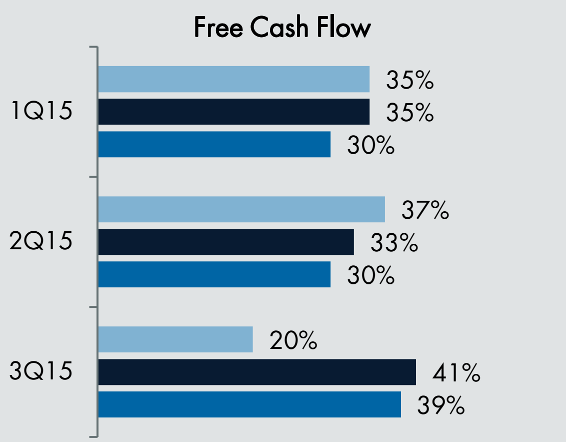
- Those expecting organic growth to improve are bullish on Technology, Financials and Consumer Discretionary
- Conversely, those that expect organic growth to worsen report that management tone has become more negative and are bearish on Energy, Industrials and Materials
- European-based contributors are the most concerned about organic growth, with 50% projecting deterioration

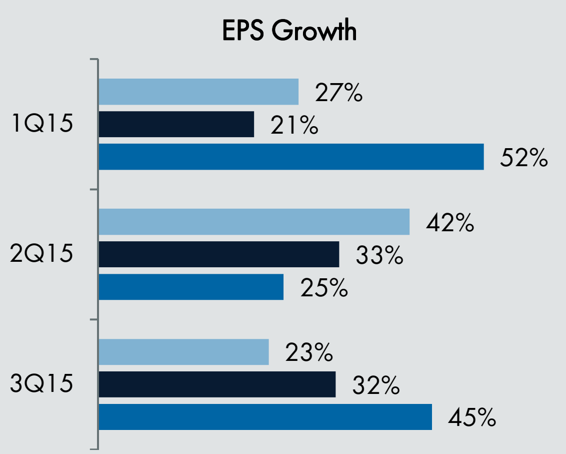
We introduced margin expansion into the mix this quarter; 48% of the group believes current levels will *worsen* given the strengthening U.S. dollar and deflationary pricing pressure while 39% expects it to *stay the same*.

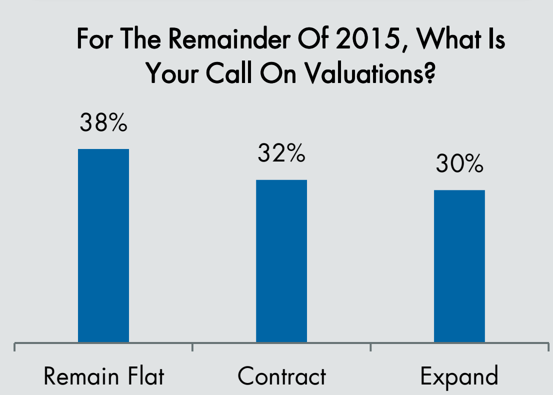
## So What Does This All Mean For The Equity Markets? Heck If We Know BUT…

According to the survey universe, views on valuations through year-end 2015 are mixed with just slightly more calling for valuations to remain flat.



Those expecting stocks to expand are largely positive across the board and, not surprisingly, are most bullish on technology stocks.

Drilling down regionally:

- Respondents from North America are generally mixed with 40% suggesting valuations will trade sideways from here and more, 32%, calling for a contraction rather than expansion
- European counterparts are slightly more bullish with 40% maintaining stocks have room to run
- Asia-based contributors remain the most dour with 50% suggesting valuations will contract further

*"U.S. equity valuations are challenged. The Fed will eventually raise rates and volatility will increase. We are reducing exposure to equities."* **GARP, Generalist | North America**

*"The market is totally at risk of a major meltdown. It won't happen overnight but over the next 12 months or so, we will stop — zero question."* **Core Value, Generalist | North America**

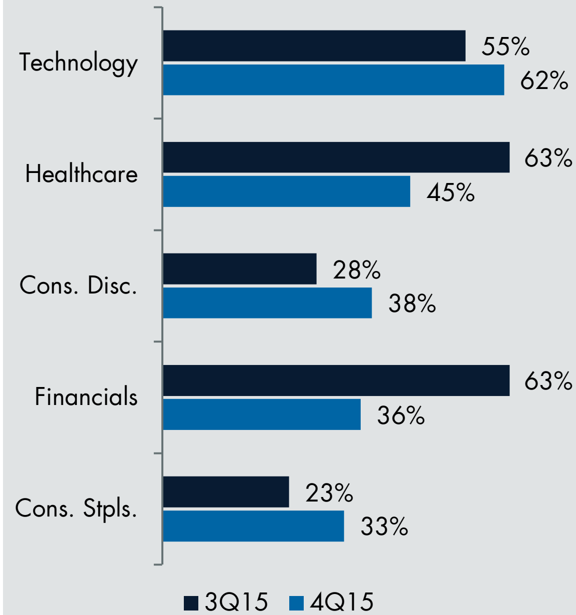
*"I am not worried about the outlook for core Europe, as I believe the growth in this area is moving in the right direction. I have concerns about non-developed markets. Debt levels are high and there is no short-term solution."* **Core Value, Generalist | Europe**

## While Technology Continues Its Dominance, Some Major Shifts In Sentiment Take Place

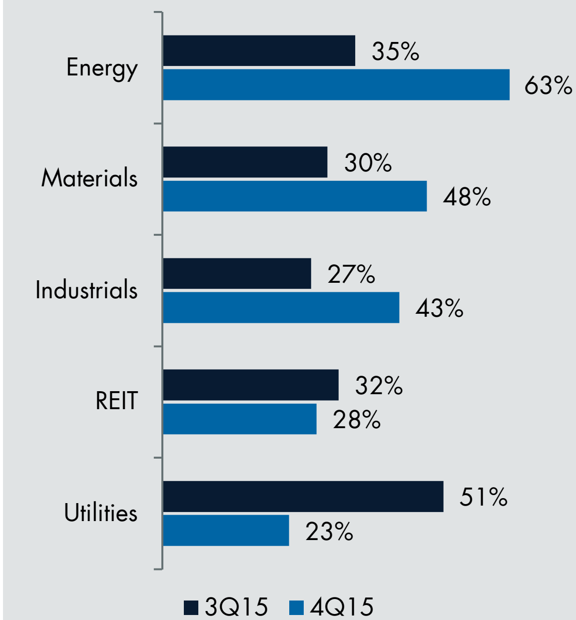
In the absence of broad-based growth, the Tech sector[3] continues to glean the most bullish votes while Healthcare witnessed a sharp decline in bullish sentiment following Hillary Clinton's broadside attack on the pharma industry, initiated in a September 22 tweet.

In another trend break, Consumer Discretionary saw a notable decrease in bears and uptick in bulls this quarter, as investors appear to be doubling down on the U.S. consumer. Of note, 47% of survey respondents believe consumer spending is set to improve, although the pace has been far slower than expected.

**On What Sectors Are You Most Bullish?**




**On What Sectors Are You Most Bearish?**




[3] We will be releasing our latest Tech Sentiment Survey on 10/15, available on CorbinPerception.com/Research-library

The overall trends, however, are down across most industries with Financials garnering its most bearish sentiment in eight quarters. Indeed, views softened considerably, from 63% bullish last quarter to only 36%.

Positve views on Energy, exacerbated by slowing global growth in China and a supply glut expected to last through 2016, hit the skids once again. Sentiment had been improving for two consecutive quarters off 4Q14 lows, reaching an apparent short-lived inflection point last quarter between mounting bulls and declining bears.

Industrial sector sentiment[4], also at an inflection point last quarter, has now seemingly crossed the Rubicon as growth, margin and currency concerns now weigh more heavily on sentiment. Bright spots within the sector include Building Products, Non-resi and Resi Construction and Commercial Aero while Metals & Mining, Ag and Materials remain largely out of favor.

***Bulls***

*"We have price inflation in Healthcare, financial balance sheets are improving and job growth is good."* Core Value, Multi | North America

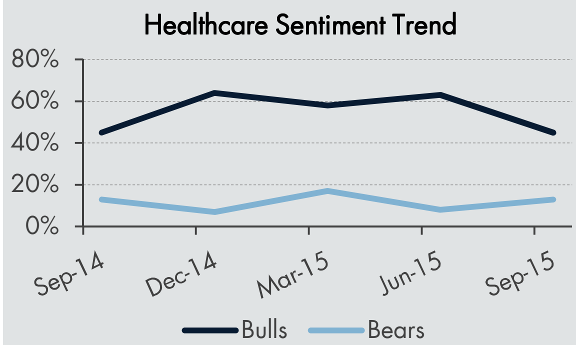
*"U.S housing, U.S. construction spending, Healthcare and parts of Tech are doing well."* Core Growth, Generalist | North America

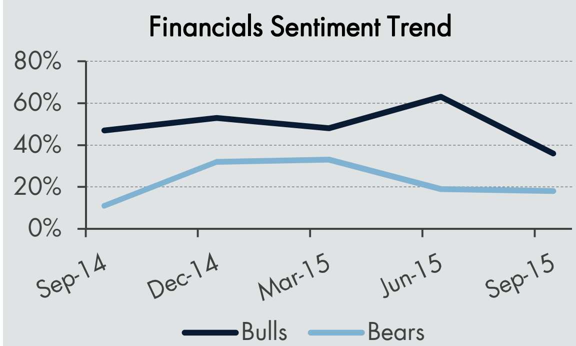
*"Sentiment is dominated by bad performances of cyclical sectors. This provides good entry points for those higher value added industries, like Med Tech & Tech stocks."* Hedge Fund, Generalist | Asia

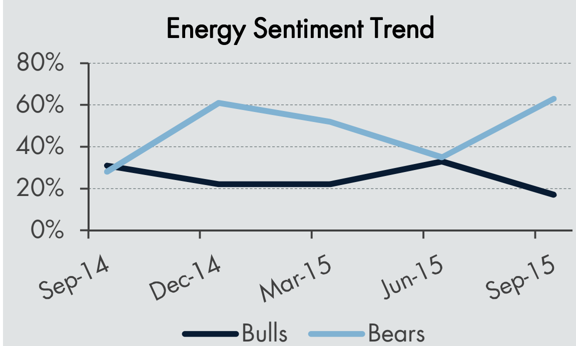
***Bears***

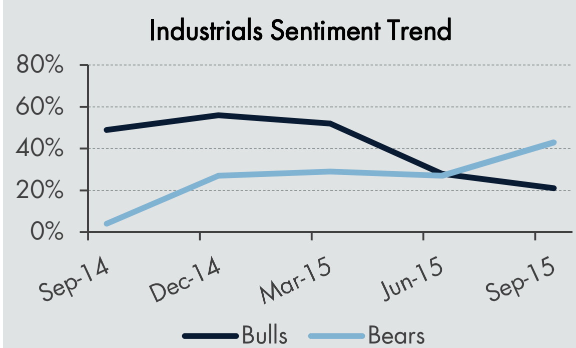
*"Energy is under pressure from capacity and oil producing nations, materials won't pick up until China picks up and Industrials will continue to suffer with materials."* Core Value, Multi | North America

*"Energy and construction will remain in decline for some time."* GARP, Generalist | Latin America




[4] Please refer to our latest Industrial Sentiment Survey released 10/1, available on CorbinPerception.com/Research-library

## In The Absence Of Growth, Invest For Growth

For the sixth consecutive quarter, reinvestment dominates investors' preferences for excess cash, with contributors strongly supporting organic growth initiatives.

Meanwhile, M&A remains the second most popular choice, up from the third spot, as valuations have retreated.

Debt reduction continues to gain favor, largely driven by Europe and Latin America respondents, the latter whom remain acutely fixed on strengthening balance sheets as debt levels, in many cases dollar-denominated, balloon.

Despite the massive sell off likely prompting many issuers to opportunistically repurchase shares, buybacks continue to be in disfavor amongst our survey group. In this regard, share repurchase garnered its lowest level of sentiment of the last eight quarters despite the rationale that the timing is more advantageous.

## IR Topic: Say on Pay

*Say on Pay* remains a controversial Corporate Governance issue for management to address. In an effort to provide insight into constituent thinking, we polled investors on this hot topic:

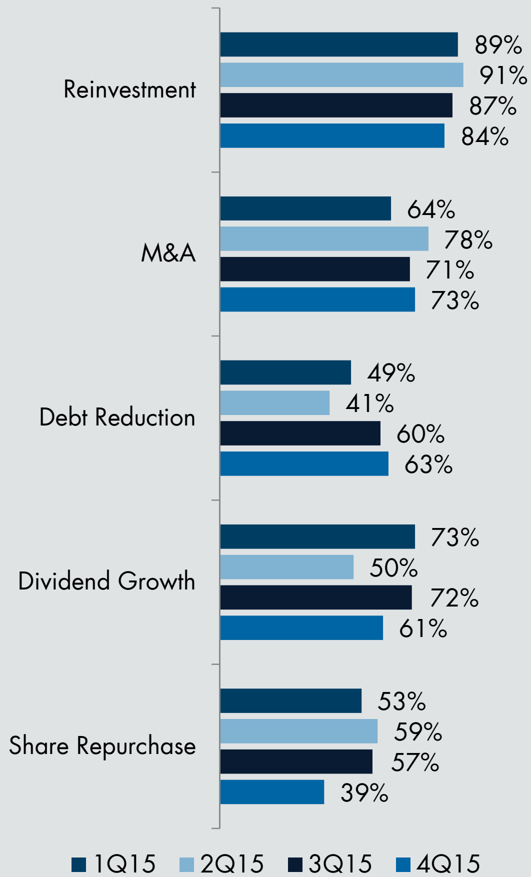
- 41% believe *Say on Pay* is having a material influence on executive compensation
- 33% of survey respondents report that performance can change their view on pay
- 56% report that a vote against management on *Say on Pay* could have an impact on their investment decision but only 21% indicate it would lead them to sell

*"We do vote on pay issues as we feel appropriate."* **Hedge Fund, Generalist | Europe**

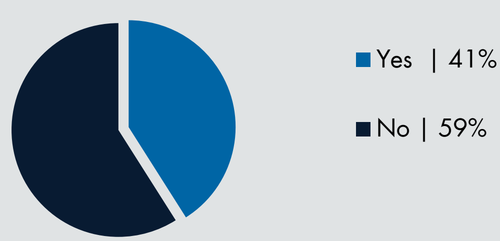
*"There is a structural issue with executive compensation that needs to be addressed."* **Deep Value, Generalist | North America**

*"Consultants run pay and they all have an incentive to pay their clients (management) more and have that published in proxies."* **GARP, Multi | North America**

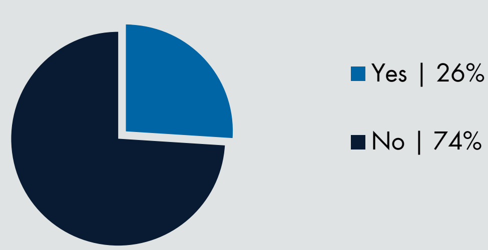
### What Is Your Preferred Use Of Excess Free Cash?




### Is Say On Pay Having A Material Influence On Executive Compensation?




### Do You Anticipate CEO Pay Ratio To Impact Your Investment Decisions In Any Way?

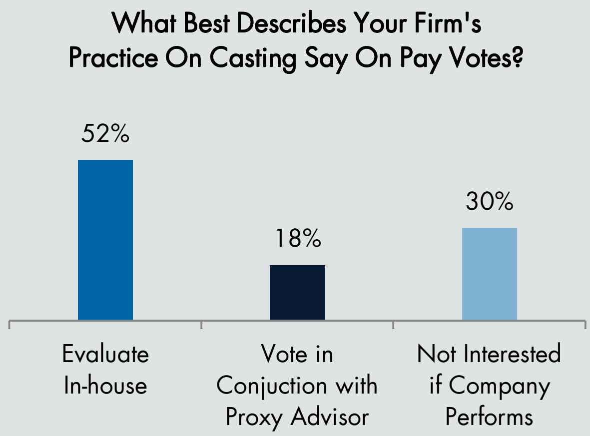


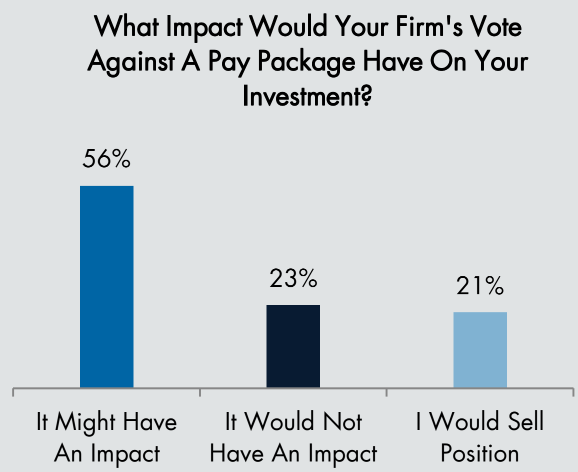
It is increasingly important to proactively identify and address potential concerns regarding executive compensation, including dealing with anomalies in reported pay packages and building relationships with corporate governance offices at top institutional shareholders (both active and passive) ahead of proxy season. Selected best practices include:

- Clearly articulate the correlation between your company's strategy and performance, management compensation and long-term shareholder value creation
- Work with the board to ensure that the proxy CD&A clearly and succinctly summarizes your company's approach to executive compensation and the rationale behind it
- Remember, investor and management interests are aligned over the long-term, however Corporate Governance representatives may be solely focused on metrics not relevant to certain types of investors (e.g., growth versus income)
- If a near-term reporting concern is identified, reach out to proxy advisory firm (e.g., ISS, Glass Lewis) to educate them in advance of their published recommendation

If you do receive a negative *Say on Pay* recommendation, we advise the following:

- Assess your shareholder base's reliance on proxy advisory firms to discern those who are more likely to vote in concert
- Conduct extensive outreach to significant shareholders via the corporate governance offices at the respective firms; involve the security analyst/PM when appropriate
- Ensure a balanced appraisal of performance versus compensation considerations has been conducted and is supported by the Corporate Secretary's office (legal), HR and external advisors, including compensation advisors and proxy solicitors
- Prepare supplemental analysis on how compensation relates to TSR over various time period(s) if relevant
- Contact should be initiated by the IRO with support from those above and, depending on the situation, involvement by Compensation Committee Chair or Lead Director/ Independent Board Chair as the case may be

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