

A background image showing a rowing team in a boat, with several oars visible. The oars have yellow and blue handles. The image is slightly blurred and has a dark overlay.

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Inside the
BUY-SIDE[®]

Industrial Sentiment Survey

3Q16 Earnings Primer

Inside The Buy-side® **Industrial Sentiment Survey**

3Q16 Earnings Primer

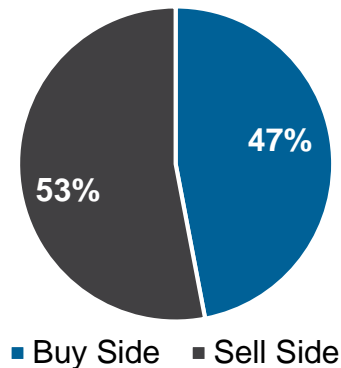
- We survey institutional investors and analysts quarterly to gauge and track sentiment on topics pertaining to the earnings season, business climate, global economy and market drivers
- Survey scope: 30 investors and analysts; buy-side firms manage \$502.1B in assets and have \$49.4B invested in Industrials
- Survey timeframe: September 9 to October 11, 2016

Market Performance

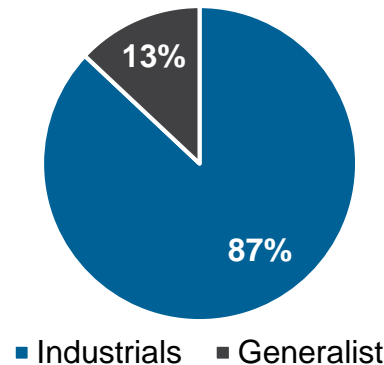
	<u>3Q16</u>	<u>One-Year</u> ¹
S&P 500	3.3%	12.9%
S&P Industrial	3.6%	16.9%

¹ As of 9'30'16

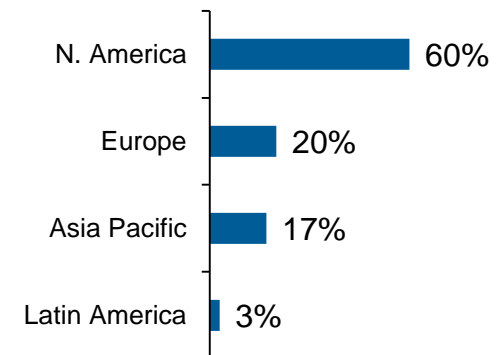
Role



Sector Focus



By Region



Stabilization Largely Expect This Quarter But Fundamental Concerns Loom Large

#1

Neutral Sentiment En Vogue Though Investors Describe Their Stance As More Cautious Relative To What They Are Hearing From Management; Earnings Largely Expected To “Meet”

- Trends in executive tone have warmed somewhat with nearly half of investors and analysts describing management as neutral and fewer as bearish this quarter
- Investor sentiment is tightening – no outright bears or bulls BUT those asserting they are neutral or neutral to bearish have nearly doubled QoQ
- 58% expect this quarter’s earnings to be in line with consensus; fewer are expecting misses
- 3Q KPIs are largely predicted to be in line with 2Q results; notably, those expecting an improvement in revenue ticked up while fewer expect an improvement in margins QoQ

#2

Sentiment On Global Economies Shifting While Mixed Sentiment On China’s Health Makes It A Wildcard

- While views that China’s economy will improve in the near-term increased this quarter, China topped unaided concerns (our separate channel checks suggest Asia-based investors are concerned about a “hard landing”)
- Investors and analysts report being more positive on several emerging market economies while those expecting the Eurozone to worsen declined significantly

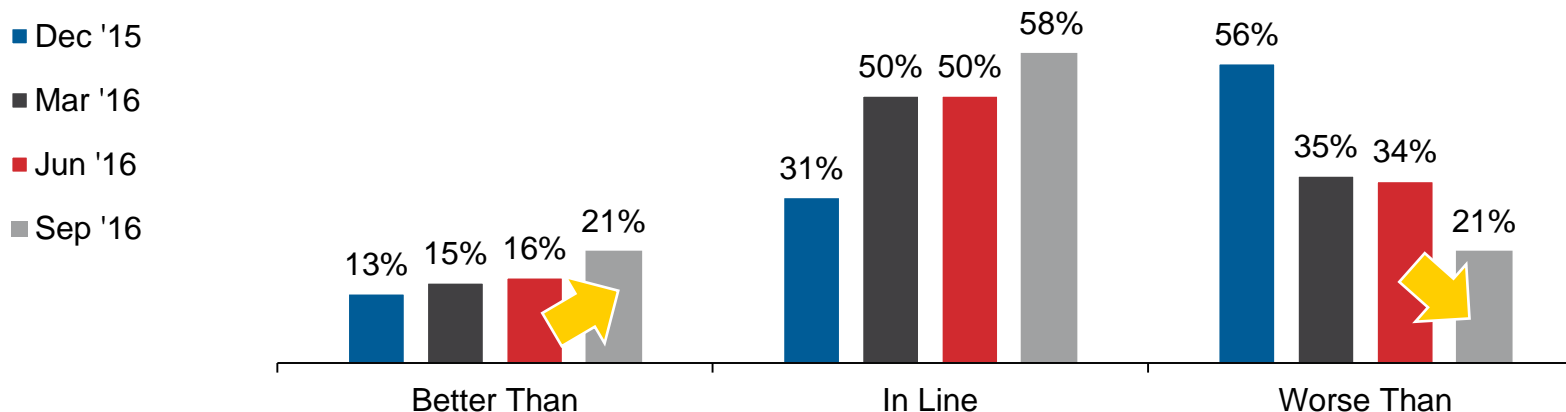
#3

Industrial Valuations Seen As Frothy While Certain Shifts In Subsector Sentiment Are Notable

- 92% believe Industrial valuations are fairly or over valued; those describing their investment activity as “holding” climbed QoQ
- Ag sees largest spike in bearish sentiment while concerns around Non-resi Construction are pronounced, a major erosion in sentiment QoQ, and views on O&G markets deteriorate somewhat

Earnings Expected **To Meet Consensus**; Fewer Misses Predicted In The Post-1Q Reset...“New Normal”

Expectations Regarding 3Q Earnings Performance Relative To Consensus



Better Than

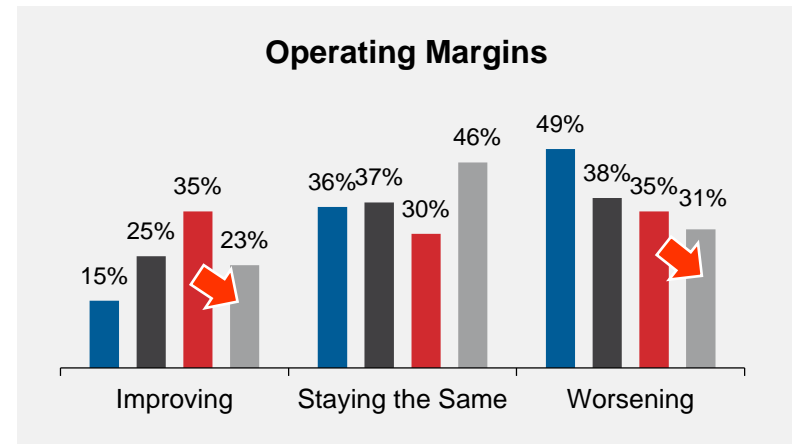
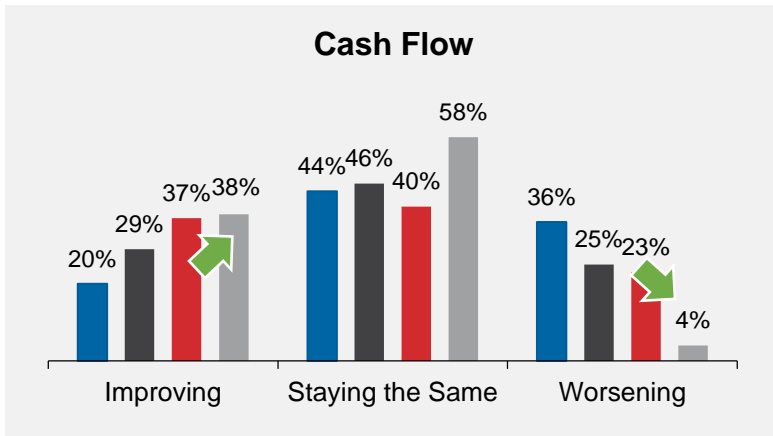
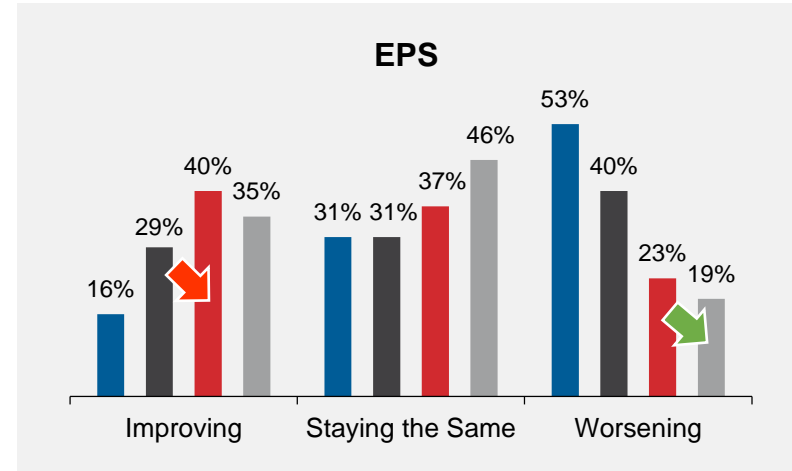
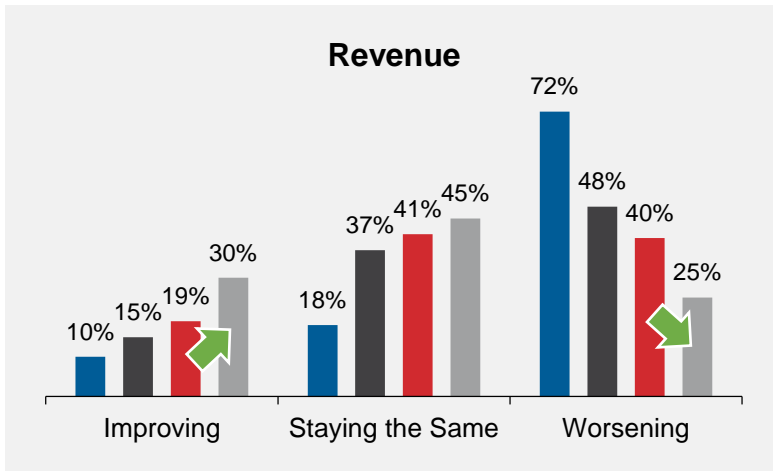
“3Q trends seem in-line with 2Q exit rate across most end markets, with Oil & Gas capex seemingly the only outlier, which continued to decelerate.” **Buy Side, N.A.**

“Good momentum continuing from 2Q16.” **Sell Side, Europe**

“All forex.” **Sell Side, Europe**

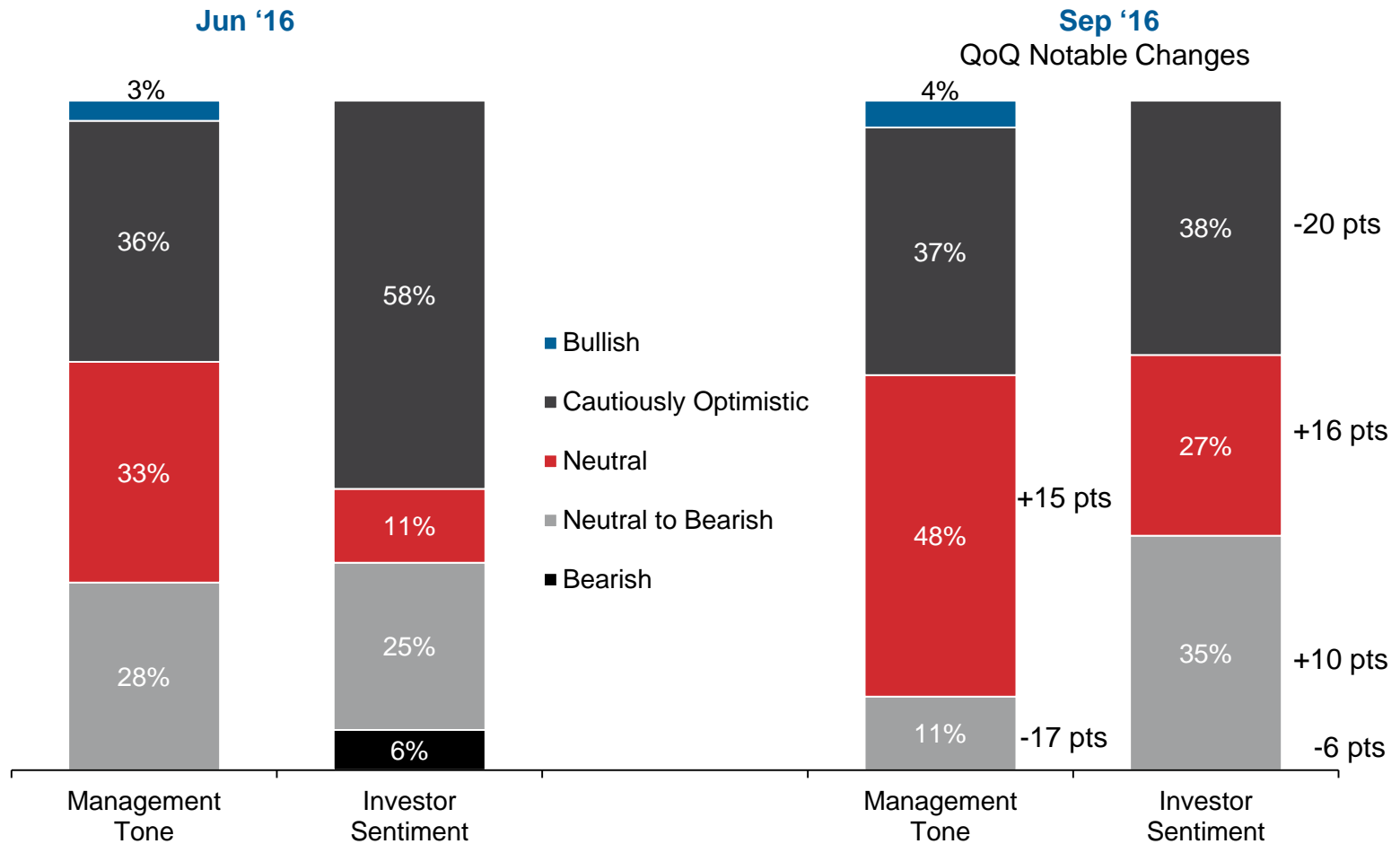
“Ongoing operating leverage of companies will continue to drive results, upside for further price recovery of materials.” **Sell Side, Europe**

3Q KPIs Largely Predicted To **Stabilize** Though Views On EPS And Margin Improvement Reversed Course



■ Mar '16 ■ Jun '16 ■ Sep '16 ■ Dec '16

Things That Make Us Go Hmmm...Management Tone Characterized As “Neutral” And Less Downbeat QoQ



Straight From The Buy / Sell Side

Bullish

“Forex.” **Sell Side, Europe**

“Restructuring during the last few years has prepared companies and increased operating leverage.” **Sell Side, Europe**

“Belief in management.” **Sell Side, Europe**

Neutral

“Slowing GDP worldwide.” **Sell Side, N.A.**

“End market trends.” **Buy Side, N.A.**

“Sector rotation out of defensive dividend stocks into cyclicals.” **Buy Side, N.A.**

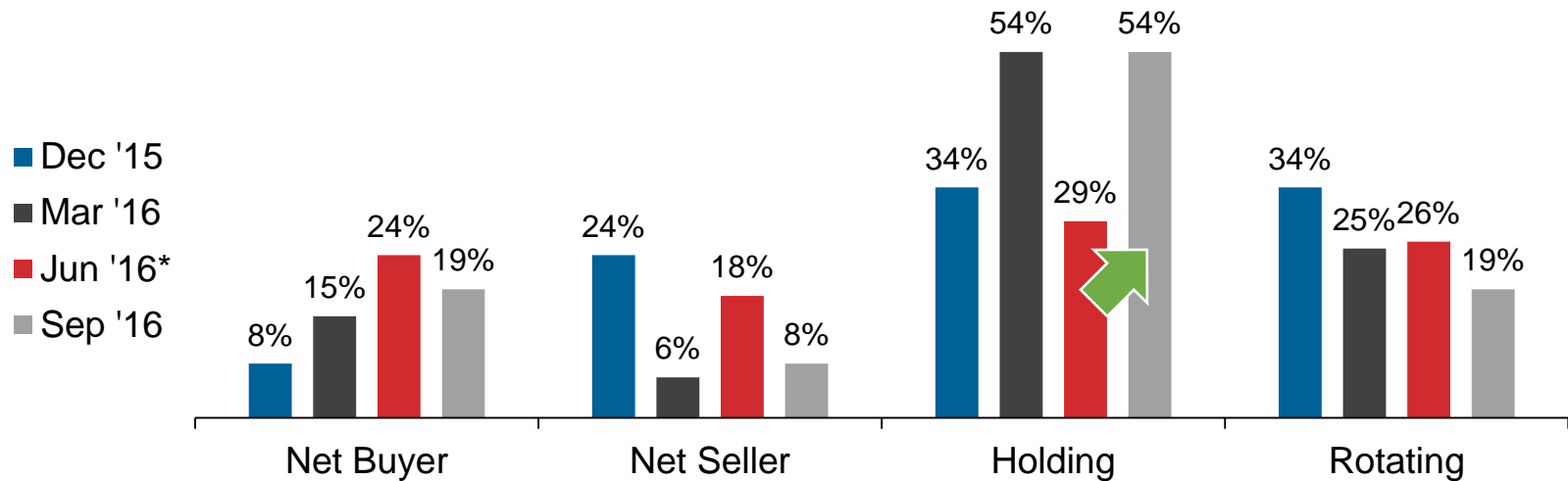
Bearish

“ISM, short cycle orders, and declining plateau in autos.” **Buy Side, N.A.**

“Lack of productivity improvement.” **Buy Side, N.A.**

Investors Revert To **Holding Pattern** After Making Some Moves Last Quarter

How Would You Describe Your Recent Activity In Industrials?



Holding

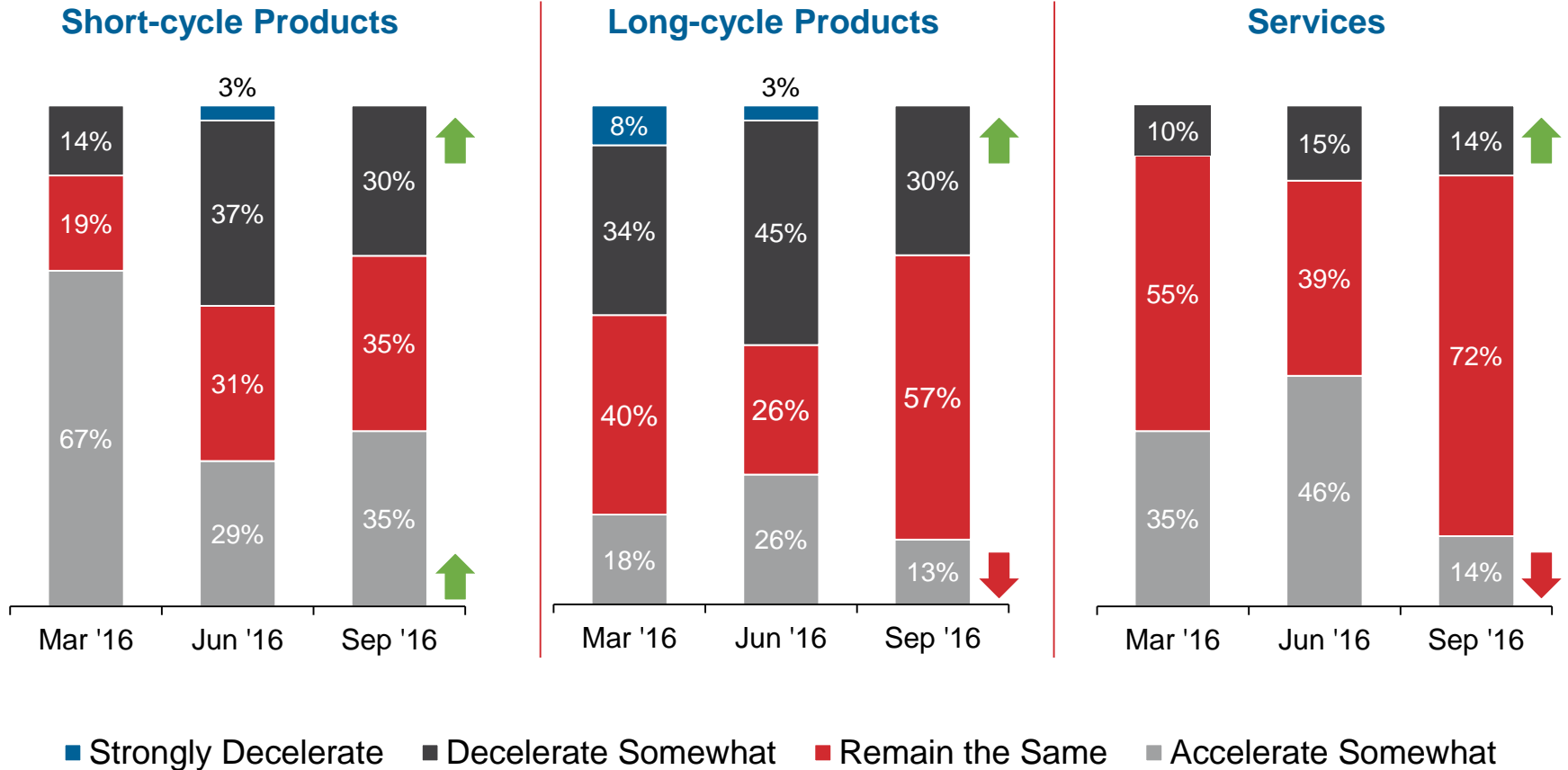
“Already bearishly positioned.” Buy Side, N.A.

“We have a service-related bias in Industrials. Will look selectively to take more cyclical risk if valuation multiples compress sufficiently.” Buy Side, N.A.

“Asset mix decisions.” Buy Side, N.A.

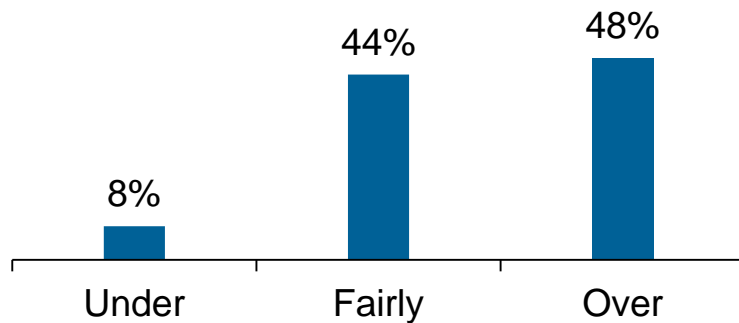
*Jun '16 values do not equal 100% due to 3% “Liquidating” not displayed on chart

Trend: Product And Service Order Rates Should “Remain The Same” QoQ;
Another “Stabilization” Data Point

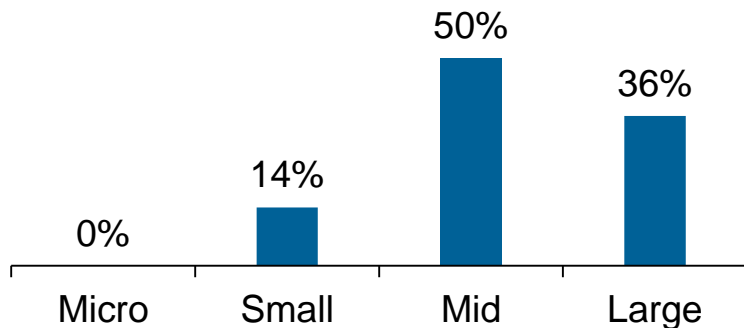


92% Classify Industrials As Fairly To Overvalued; A Stock Picker's Market Is
Upon Us

How Would You Classify Industrial Valuations In General?



Which Market-cap Theme Is Currently Most Appealing?



67%

Believe Share Buybacks Are Not A Good Use Of Excess Free Cash Given Current Valuations

48%

Assert the Industrial Sector Is In A Recession (up from 46% QoQ But Down From 69% In Dec '15)

84%

Are Placing More Emphasis On Balance Sheet Strength When Making An Investment Decision (up from 74% QoQ)

Straight From The Buy / Sell Side: **On Market-cap Themes**

Large-cap

“Are generally more stable, diverse earnings streams.”

Buy Side, N.A

“Most appealing because mid-cap valuations are most extended and I expect increasing volatility for small-caps. For large-caps, valuations are pretty comparable to history, so I’d give the nod to large -caps at the moment.” **Buy Side, N.A.**

“Have access to the most financing options.” **Sell Side, N.A**

Mid-cap

“There is more growth coming from mid-cap names.” **Buy**

Side, N.A

“More self-help opportunities in slow-growing environment.” **Sell Side, N.A.**

“Forex benefit.” **Sell Side, Europe**

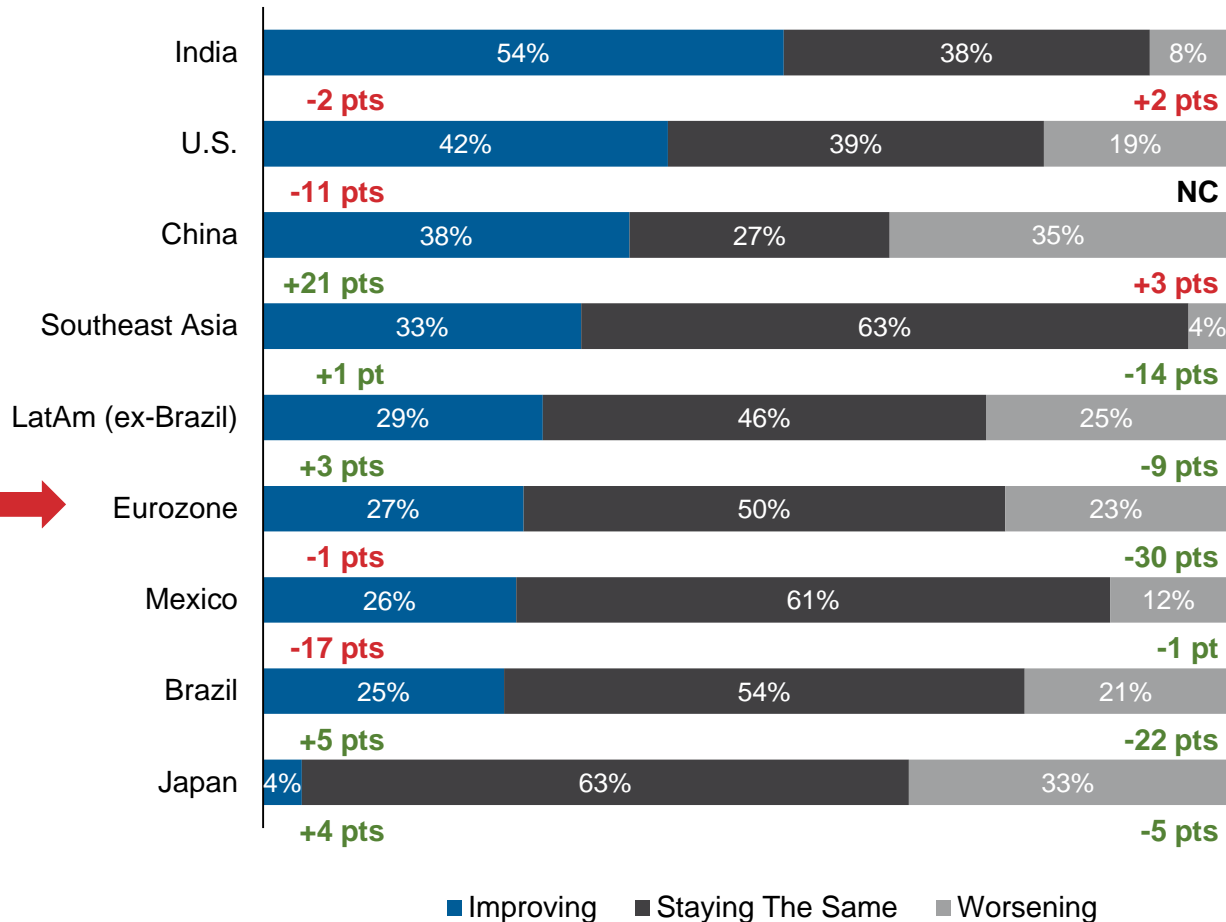
Small-cap

“Management decisions come through to the bottom line more effectively and quickly.”

Sell Side, Europe

Sentiment On India Remains Strong While China Seen As Improving (Our Channel Checks Would Suggest Otherwise)

Over The Next Six Months, What Are Your Expectations For The Following Economies?

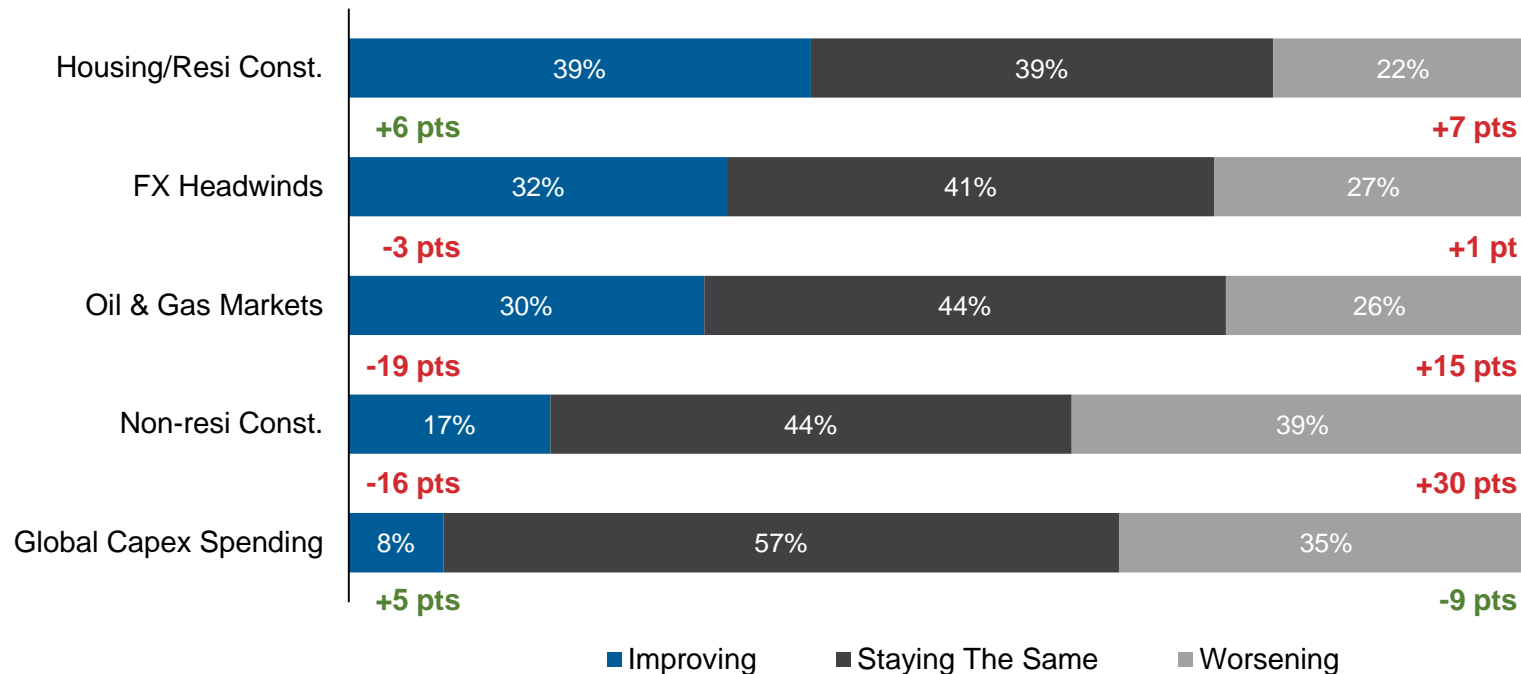


63% report being "somewhat concerned" or "not concerned" about Brexit fallout



Around The World: Concern On Non-resi Construction Spikes

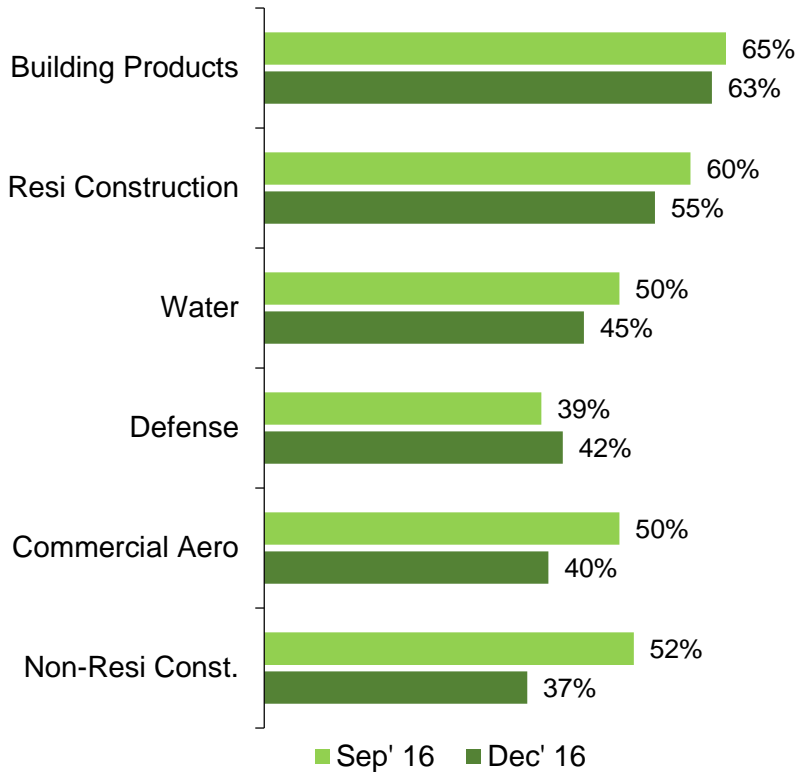
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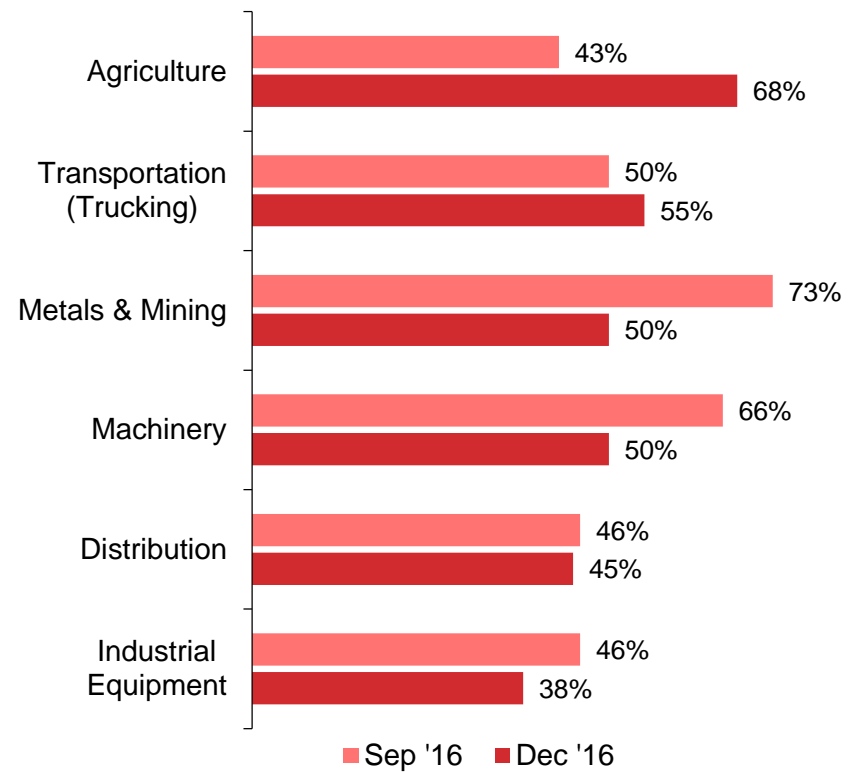
Some Significant Shifts In Subsector Sentiment Taking Place



Predicted To Grow Faster Than GDP



Predicted To Grow Slower Than GDP

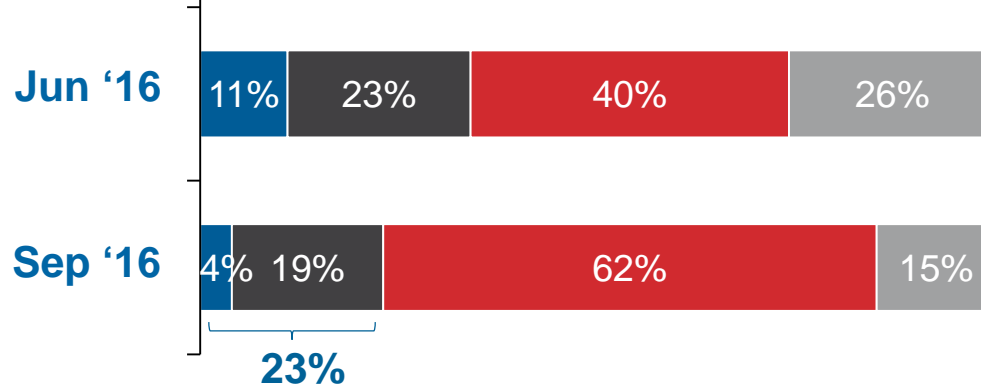
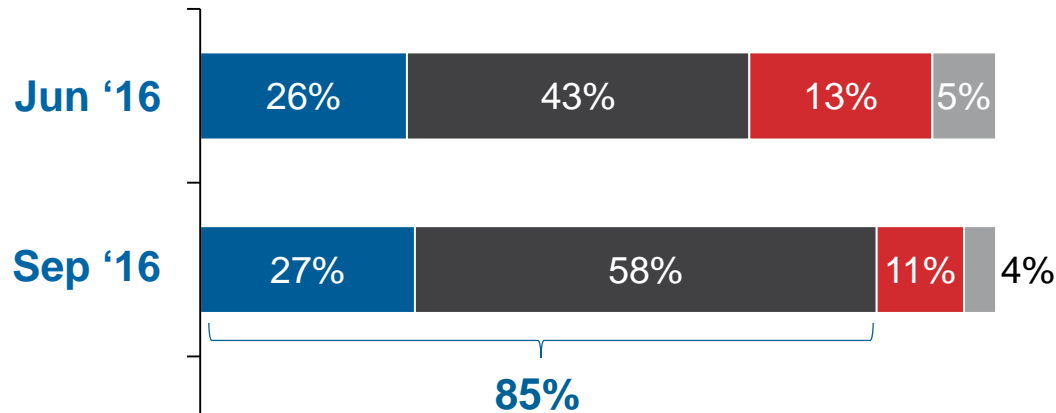


Sentiment On Building Products And Resi Construction Remain Strong While Bulls Retreat On Non-resi Construction

Ag Moving Back Into The Top 6 (With The Biggest Spike In Bearishness) And Metals & Mining Seeing Some Love

Market To Trump: Get Off Your Stump

Who Will Have The ~~Most Positive~~ Least Negative Impact On Markets?



**Survey Says:
The Hillster
(2 for 2)**



■ Very Negative ■ Negative ■ Neutral ■ Positive ■ Very Positive

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- SVP, Investor & Corporate Communications, Small-cap Healthcare IT

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