INSIDE THE BUY-SIDE®

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Driven by an expanding economy, surprisingly strong earnings growth and a Federal Reserve that remained accommodative, U.S. stocks in 2014 extended the bull market that began in 2009. The year ended strong, with the NASDAQ finishing 13% higher, the S&P 500 gaining 11% and the DJIA expanding 7%.

Fourth quarter highlights included the S&P 500 breaking through the 2,000 mark for the first time and reaching all-time closing highs on December 29. Meanwhile, the Dow topped 18,000 for the first time in December.

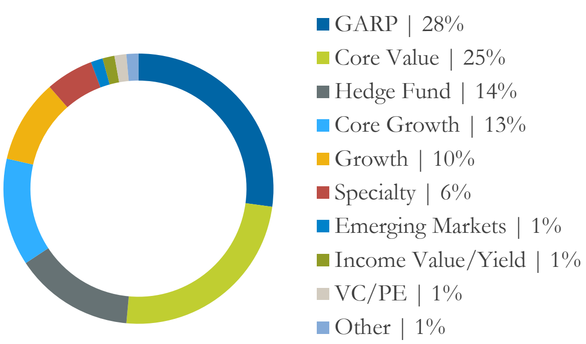
In our ongoing effort to track changes in global institutional investor sentiment and expectations, as well as provide insights heading into the coming earnings season, we surveyed 70 investment community professionals globally across multiple industry segments and investment styles.[1] Participating institutions manage upwards of $1.7 trillion in total assets.

The decline in the price of oil and with it, gasoline, continued unabated through the fourth quarter, fueling the continued debate regarding the sustainability of a strong U.S. economy against the backdrop of rising global and emerging market growth concerns. On a positive note, the fourth quarter benefited from a string of positive economic data in the U.S., including falling unemployment levels, and a strong dollar, in addition to the positive effect lower fuel prices have had on consumers' disposable income.

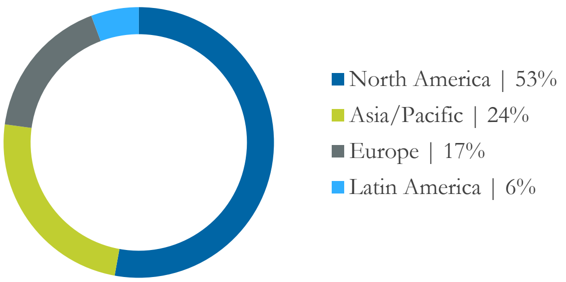
Internationally, China's central bank surprised markets in November with a rate cut to stimulate growth, which gave a boost to industrial and commodity shares, as well as Asia/Pacific markets in general.

Dealmakers, too, had a banner year; $3.5 trillion worth of global M&A transactions were announced in 2014, representing the biggest year in deal activity since 2007, while global IPOs raised $249 billion.[2]

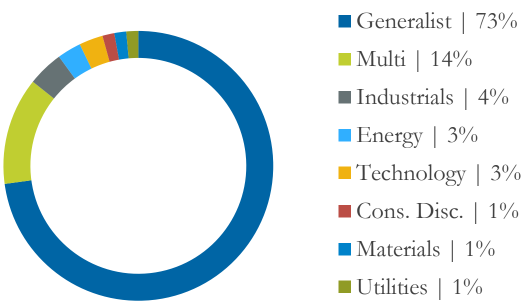
Investment Style



Geography



Sector



[1] Timeframe: December 5 – 29, 2014
[2] Source: Thomson Reuters

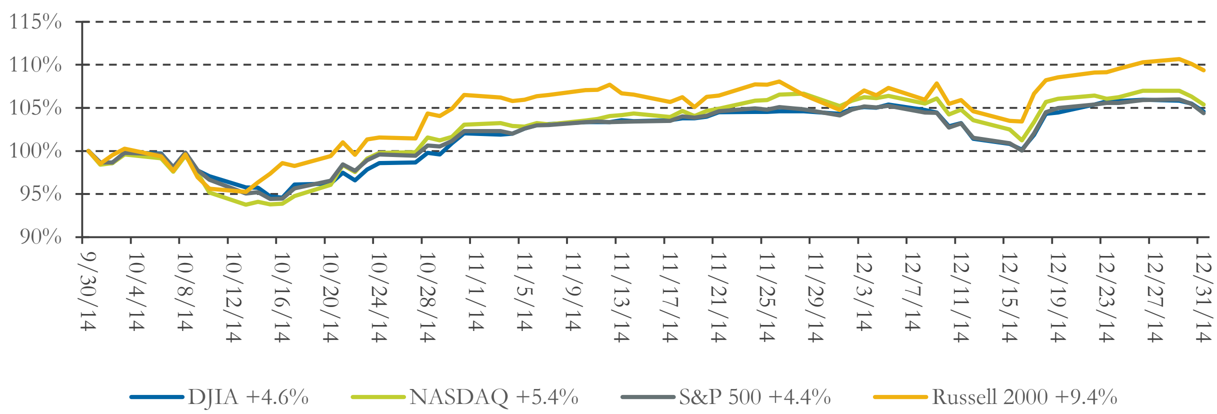
Key Trends

- Investor sentiment is more cautious than last quarter, reversing a three-quarter trend of improving views; regional differences are a key component of the overall picture
  - 48% of contributors report they are *cautiously optimistic* or *bullish*, down from 77% last quarter
  - 37% of investors, more than half of them stemming from Asia/Pacific, now hold a *neutral to bearish* outlook versus just 17% last quarter
- While 56% of investors describe executive tone as *cautiously optimistic*, 21% assert it is *more negative* compared with just 8% last quarter
- Despite significant concerns, 70% assert current market valuations are sustainable, down from 78% last quarter
  - 52% of participants maintain that present equity valuations only moderately reflect current and future currency risks
- As fourth quarter earnings season begins, 70% of contributors expect results to be *in line* with or *better than* consensus, down from last quarter's 76%
  - 53% of Asia/Pacific contributors see 4Q14 results coming in *worse than* consensus
- 60% believe 2015 company guidance will be *more cautious than usual*
- Investor confidence in companies' ability to deliver continued growth in EPS and FCF waned, following rising confidence in the previous three quarters
- The U.S. remains a bright spot, while the European economy continues to be the leading concern for investors, followed closely by those of Latin America and China, respectively
- For the third quarter in a row, surveyed investors assert that consistent cash flow is the most important performance differentiator
- Business reinvestment remains the top choice for use of excess free cash, a continuation from last quarter, followed by dividends and "smart" M&A
- Investment professionals remain bullish on healthcare, technology and, to a lesser extent, industrials, while they are bearish on energy, materials and utilities
- 40% of respondents anticipate that the Fed will raise the benchmark rate in 2Q15, consistent with last quarter's findings, while 29% expect it to occur in 3Q15
- IR Best Practice: 73% of surveyed investors are in favor of preannouncing a positive or negative earnings surprise

Equity Markets Stage Another Strong Performance

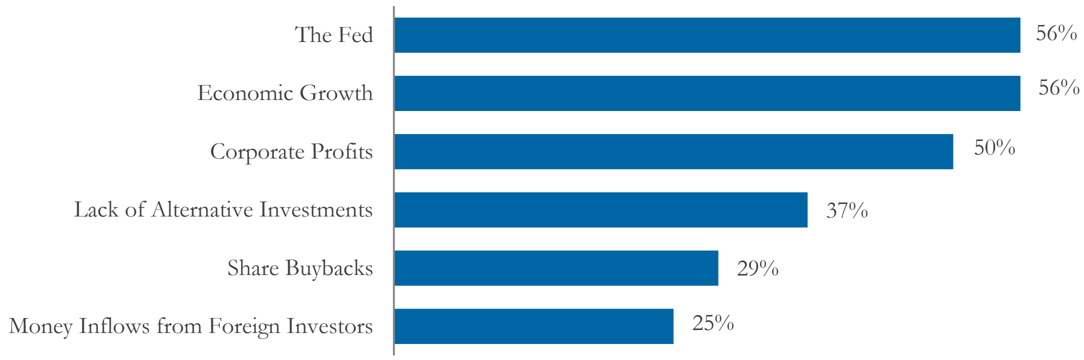
A sharp sell-off in U.S. equities in late September/early October proved little more than a speed bump for U.S. stocks, as the major indices, including the Russell 2000, posted a strong fourth quarter.

4Q14 Market Performance



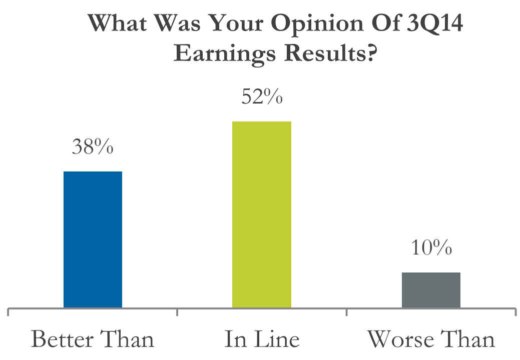
Survey participants cite Fed policy, economic growth and solid corporate earnings as the key drivers of the ongoing rally. Further, a lack of alternative investments offering compelling returns, outsized share buybacks and strong inflows from foreign investors also boosted equity markets.

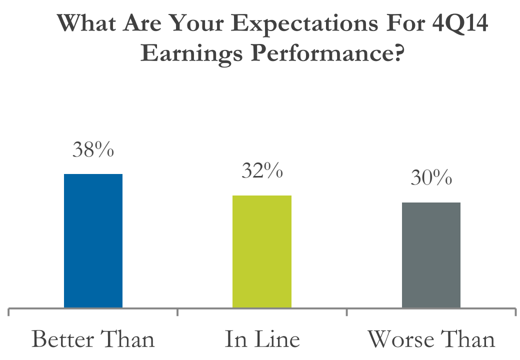
What Is The Primary Driver Of The Continued U.S. Equity Market Rally?

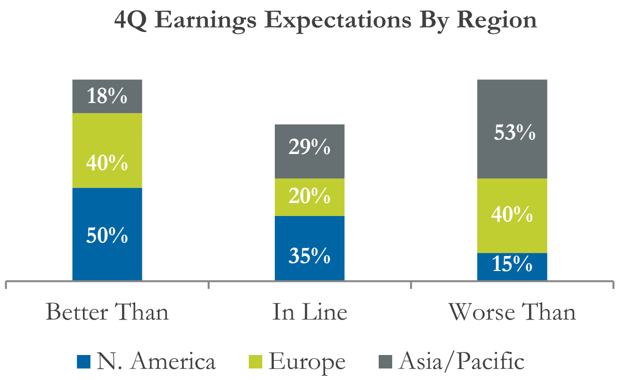


Earnings Outlook Softening, Especially For Asia/Pacific Investors

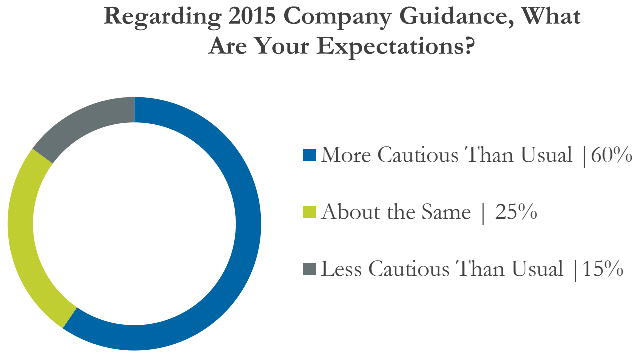
While 90% of participants either describe third quarter earnings as *in line* with or *better than* expected, the outlook for fourth quarter results is decidedly mixed. While U.S. GDP growth and falling oil prices support optimistic outlooks, expected interest rate hikes inject a note of caution to expectations. Notably, the percentage of respondents expecting fourth quarter results to be *in line* with or *better than* consensus estimates is 70%, down from 76% last quarter.







With fourth quarter performance largely priced into valuations, focus will be on company guidance for 2015. Indeed, 60% of surveyed investors believe that forecasts will be more cautious than usual.



"GDP growth continues to track higher than investors assume and consensus hikes after the third quarter stayed on the cautious side." **Hedge Fund, Multi | North America**

"The upward surprise trend continues and leading indicators like confidence and jobs, coupled with strength in housing will give the U.S. consumer a firm footing to keep spending." **GARP, Generalist | North America**

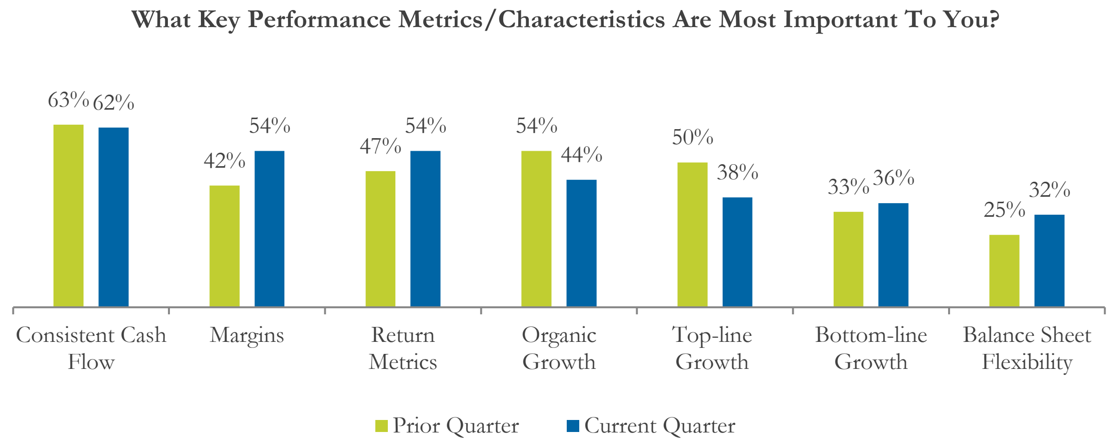
"Lower oil prices should be supportive for margin expansion. As well, there was a decent holiday shopping season." **Core Growth, Generalist | North America**

"I expect domestic-focused results to be slightly disappointing and the overseas earners to be ahead." **Core Value, Generalist | Asia/Pacific**

"Europe will be weaker than expected." **Core Value, Generalist | Europe**

Performance Metrics Update

For the third straight quarter, surveyed investors assert that consistent cash flow is the single most important performance characteristic, followed by margins and various return metrics. Balance sheet flexibility and bottom-line growth again were the lowest-rated, though both gained in importance quarter-over-quarter.



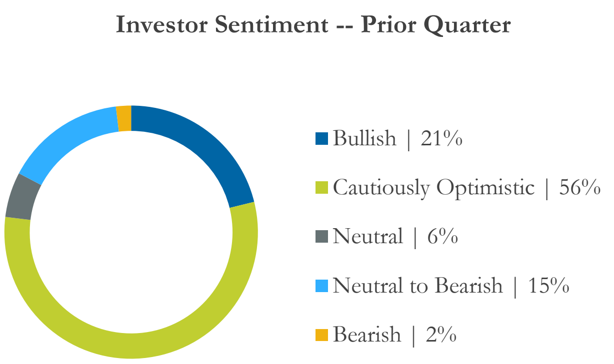
"With mixed end-market performance, organic growth becomes key. Companies have streamlined so much since the recession that margins are already looking peaky, so I look for more sustainable drivers." **Hedge Fund, Multi | North America**

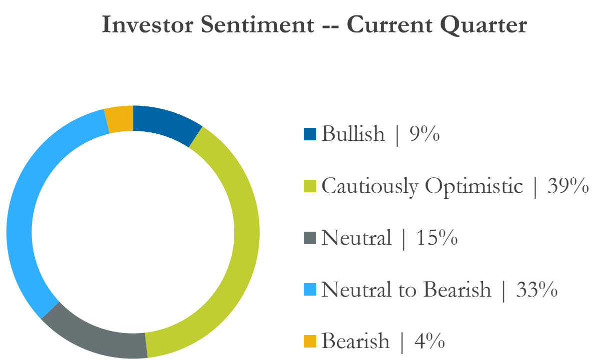
"Margin and ratio analyses are key to understanding earnings reports." **Core Growth, Generalist | North America**

"All of these metrics are important. In a good DCF model, you will estimate and calculate all of these characteristics." **Core Value, Multi | Latin America**

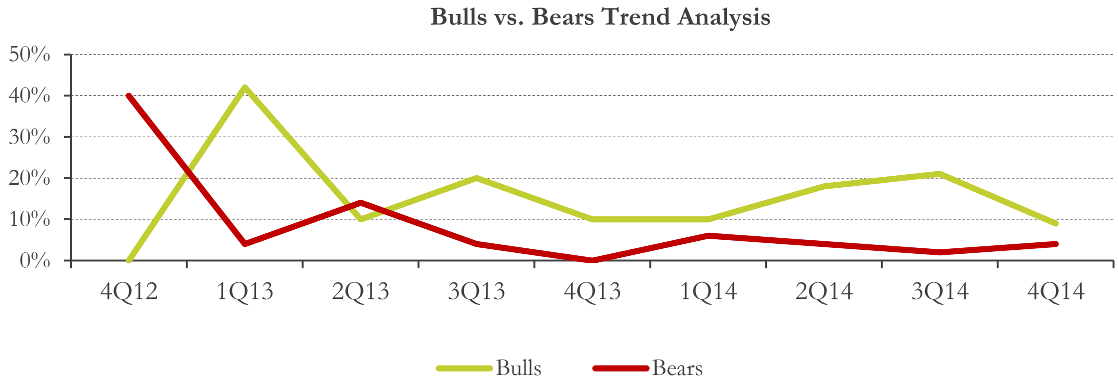
Market Sentiment Less Exuberant, More Bears

Despite the strong quarterly performance of U.S. equities, surveyed investor sentiment took a cooler stance in late 4Q14. Respondents describing themselves as *bullish* fell to just 9% from 21% last quarter, following three straight quarters of rising positive sentiment.





Moreover, *cautiously optimistic* sentiment declined to 39% from 56% last quarter and those holding a *neutral to bearish* outlook surged from 17% to 37%, an increase driven largely by Asia/Pacific investors, 59% of whom describe themselves as such.

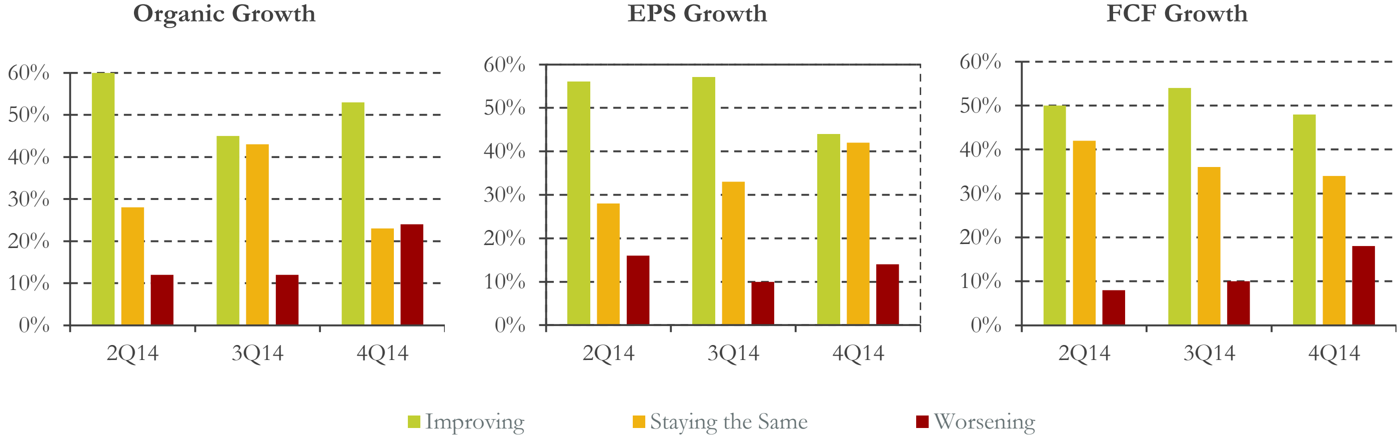


"Equity market valuations remain attractive, global economic growth forecasts are generally supportive for equities and their relative value versus other asset classes is compelling. On the negative side, market indices remain near record highs with the potential to negatively impact sentiment, particularly for retail investors." **Core Growth, Generalist | Latin America**

"Although fundamental data continues to come in strongly, there always appears to be something weighing on the market: energy oversupply, geopolitical pressure, a slowdown in China, etc. Thus far, the market keeps pushing through but it takes nerves of steel to hang on." **Hedge Fund, Multi | North America**

Performance Metrics Channel Check

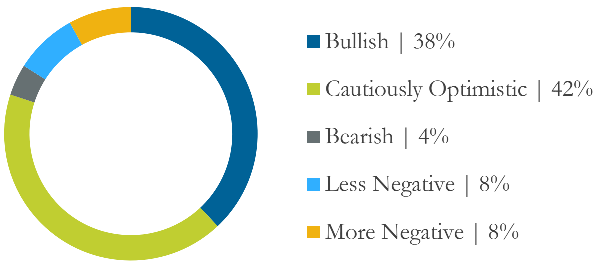
In line with the bearish turn in sentiment, our quarterly channel check on performance metrics indicates less confidence in companies' ability to deliver continued growth in EPS and FCF than was seen last quarter, though the percentage of those who expect improvement in organic growth grew, from 45% to 53%. As well, the number of investors who see these metrics worsening rose across the board from last quarter.



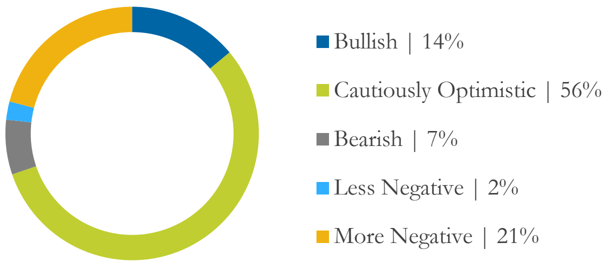
Management Tone Softens

Surveyed investors report management tone is less positive. Specifically, respondents reporting a *bullish* stance from management declined from 38% last quarter to just 14% this quarter, while those reporting a *more negative* tone rose from 8% to 21%. Significantly, more than half of investors describing management tone as *more negative* are Asia/Pacific participants.

Management Tone -- Prior Quarter



Management Tone -- Current Quarter



> *"Companies are still guiding conservatively to give themselves wiggle-room to outperform if end markets improve. Still, they are excited about strong current demand and volume."* **Hedge Fund, Multi | North America**

> *"In Brazil, there is great pessimism with the government and with the economy but it depends on the company and the sector."* **Core Value, Multi | Latin America**

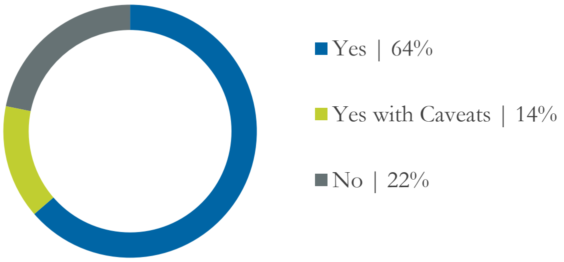
> *"The overall tone is one of uncertainty."* **Core Value, Generalist | Asia/Pacific**

Despite Current Market Trends, Valuations Seen As Sustainable

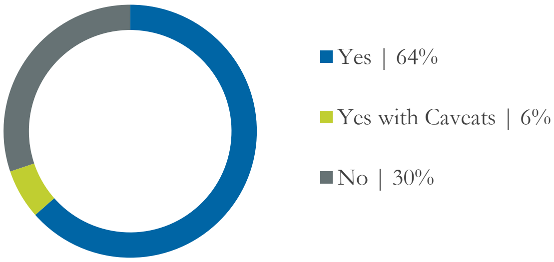
The percentage of investors who consider current market valuations sustainable declined quarter-over-quarter to 70% from 78% last quarter.

Are Markets Sustainable At Current Levels?

3Q14



4Q14



Valuations are still supported by "growing global GDP" as well as historically low interest rates and inflation, say those surveyed. To that effect, several investors suggest interest rate action on the part of the Fed and other central banks in 2015 will shape perceptions of fair value for stocks. As in past suveys, European investors are somewhat more skeptical of current market valuations than their North American counterparts, as just 70% believe valuations are sustainable versus 76% of North American contributors.

Continuing, 30% of all contributors and 47% of Asia/Pacific-based respondents doubt the sustainability of market levels, seeing "a lot of risk out in the market" and asserting that "P/E ratios are too high for the lack of organic growth."

> *"Global equity markets are generally still at a discount to fair value on an earnings basis from a long-term perspective."* **Core Growth, Generalist | Latin America**

> *"The world is more of a benign place than we give it credit for. I do not know that there is a rationale for a massive correction at these levels. Whether it's the right valuation or not, I don't know."* **GARP, Generalist | North America**

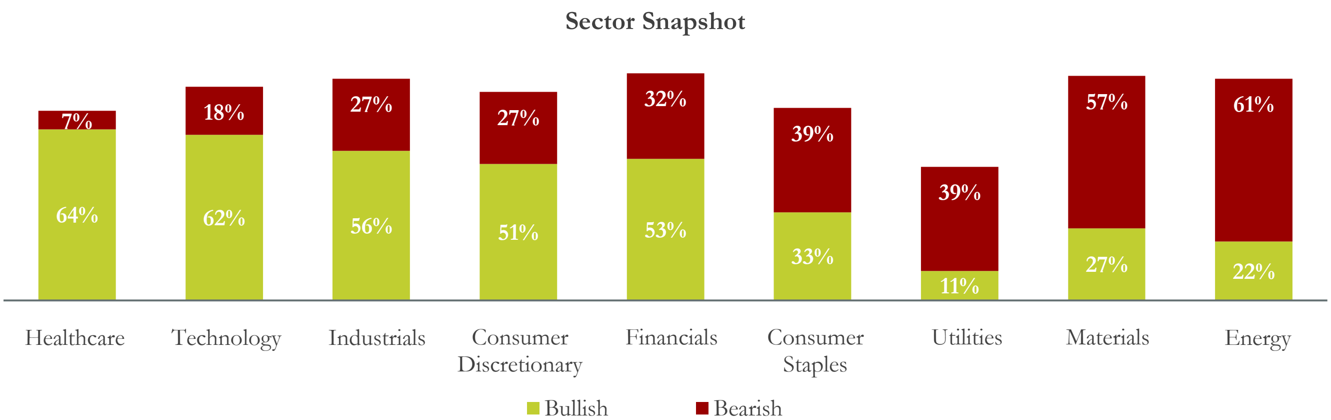
> *"Profit declines have flattened out and many firms are benefiting from falling oil prices, suggesting better valuations with upside potential."* **Core Growth, Generalist | Europe**

> *"As long as the U.S. economy improves and the rest of the world stabilizes, the valuations are fine."* **Core Growth, Generalist | North America**

> *"Apart from companies hit by the fall on commodity prices directly, we do have growing global GDP."* **Core Value, Generalist | U.K.**

Investment Sector Trends

Surveyed investment professionals indicate that healthcare, and in particular pharmaceuticals, and technology, mainly software and internet-related, are the sectors earning the most bullish sentiment. As well, industrials, financials and consumer discretionary stocks continue to garner favor from the buy side but have seen erosion in sentiment from last quarter.



Conversely, investors maintain a bearish stance towards energy, in particular oil and gas, materials, specifically metals and mining, utilities and consumer staples, most notably tobacco.

Bulls

> *"Leisure cyclicals, non-bank financials, healthcare and technology are the areas where I think people are spending money."* **Core Value, Generalist | Asia/Pacific**
>
> *"Rising interest rates should improve banks' interest margins and rate upcycles have historically correlated with industrial outperformance."* **Hedge Fund, Multi | North America**
>
> *"Lower oil prices should be supportive for margin expansion in many sectors and the decent holiday shopping season should boost the retail sector."* **Core Growth, Generalist | Latin America**

Bears

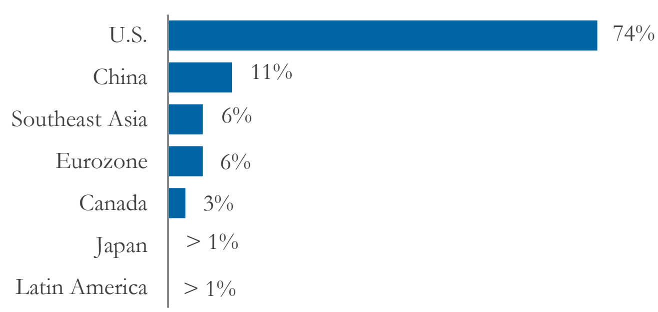
> *"Sectors that serve as bond proxies are likely to get hit when rates rise."* **Hedge Fund, Multi | North America**
>
> *"Higher interest rates and continued lack of government spending increases will negatively impact utilities."* **GARP, Generalist | North America**
>
> *"The downtrend in commodities stocks will be ongoing given over oversupply concerns."* **Core Value, Generalist | North America**
>
> *"P/E ratios are too high for the lack of organic growth and reduced ability to raise payout ratios."* **Generalist | Asia/Pacific**
>
> *"We anticipate the expected growth won't arrive in the banking sector."* **Core Growth | Asia/Pacific**

Around The World: Few Worries About the U.S.

U.S.

Optimism about the U.S. relative to other regions remains strong and is actually higher quarter-over-quarter. Currently, 74% maintain it is the region on which they are most bullish compared to 61% last quarter. Moreover, the U.S. economy elicits the least concern among a variety of issues facing investors, followed closely by inflation. Participants attribute the positive sentiment to the improving jobs outlook,

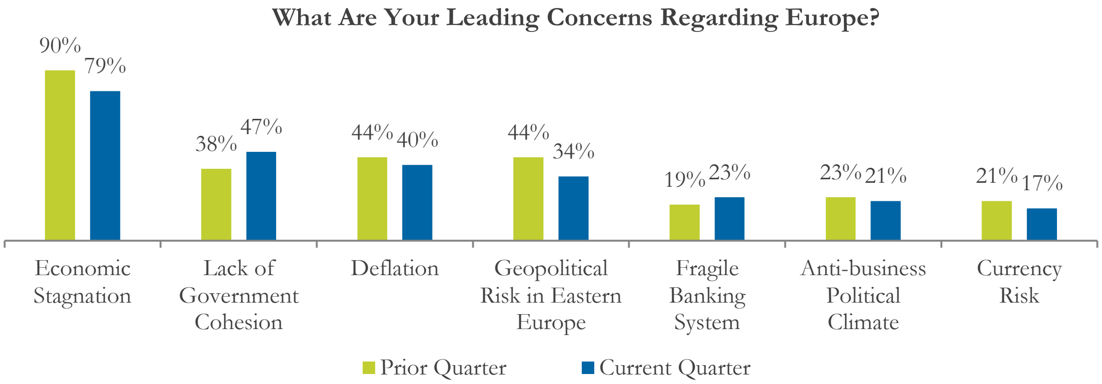
Looking Out 12 Months, On Which Region Are You Most Bullish?



strengthening GDP, low interest rate and inflation environment and a belief that tumbling fuel prices will be a boon to consumer spending.

Europe

Outside the U.S., the European economy remains a leading concern for investors and regional economic stagnation is top of mind, followed by lack of government cohesion and worries about deflation. For European stocks, 2014 returns were mixed, with the U.K.'s FTSE 100 and France's CAC 40 posting small losses while Germany's DAX 30 edged out a slight gain. More broadly, the Stoxx Europe 600 gained 4.3%. The ECB signaled in November that it was prepared to take increasingly aggressive action to fight very low inflation in the region through purchases of large amounts of private-sector debt and government bonds.



Notably, U.S. investors express significantly more unease this quarter than in 3Q14, with 48% considering themselves "very concerned" about the health of the region currently versus 17% last quarter. However, the majority of contributors also report being only moderately concerned about companies that are overweight Europe.[3]

China

While a slowing Chinese economy remains a worry for investors, the actions taken by the country's central bank, which cut the one-year lending rate by 0.4% in November, was a positive development. Still, 40% of all those surveyed and 38% of Asia/Pacific investors are bearish on China.

Japan

Participants are broadly downbeat toward Japan, where efforts to combat the long-term economic malaise have yet to bear fruit.

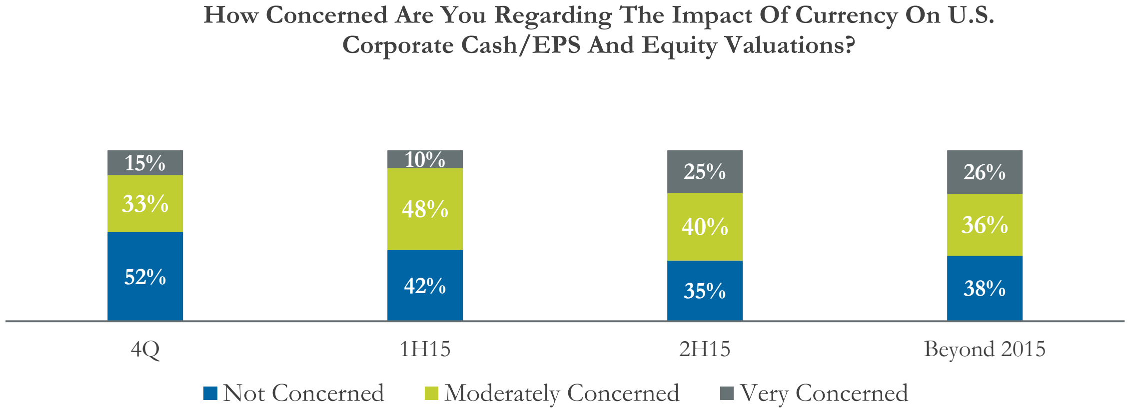
Latin America

Ongoing concerns about economic policy and declining commodity prices led those surveyed to be most negative about Latin America.

[3] > 25% exposure

Currency Risks

Regarding currency risk, the level of concern increases steadily as investors look farther out through 2015 and beyond.



Moreover, better than half of those surveyed, or 52%, assert that present equity valuations only moderately reflect current and future currency risks and no respondents consider those risks to be fully reflected in valuations.

Top Concerns in Descending Order

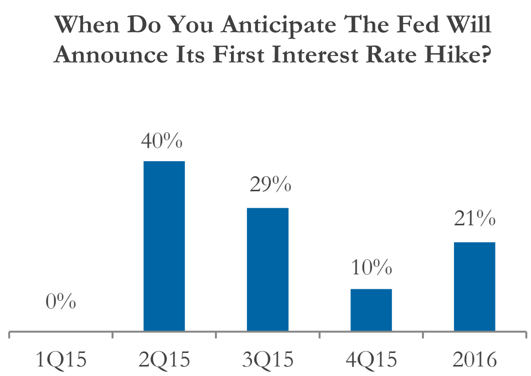
Prior Quarter	***Current Quarter***
EU Stagnation/Deflation	EU Stagnation/Deflation
Geopolitical Tensions	Latin America Economy
China Slowdown, Real Estate Market	China Slowdown
Latin America Economy	Geopolitical Tensions

"The ECB knows that growth is slowing and they are taking appropriate measures. That is why it is not something to panic about. With China, I do not think the concerns are overblown either. They are appropriate. People are not panicking but they are concerned about it." **GARP, Generalist | North America**

"There is no doubt that growth in China is slowing. There is no doubt that there is weakness in Europe. Japan has its challenges. Many emerging markets are linked to China and the drop in oil prices hurts certain countries. The soft global growth picture is a part of the lower commodity price story. Lower commodities are not just the cost of gas at the pump; many of these things are going down. All of these provide stimulus to consumer-focused economies, like the U.S. It enables interest rates to stay lower for longer." **Core Value, Generalist | North America**

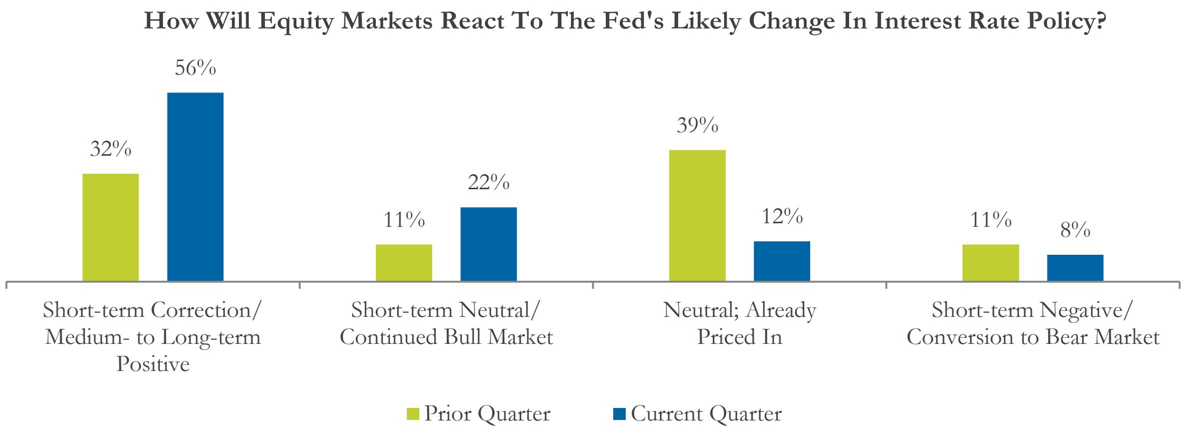
"We are hearing a lot of negativity about growth generally and how concerns about deflation are overblown. Growth will continue, although the view that it will be constrained and slower for longer is probably accurate, as we are working off significant debt burdens at a government level now. They can't really be reallocated as they could be if they were in the private or corporate sector instead." **Hedge Fund, Generalist | North America**

Rate Hike Update: Waiting for the Inevitable



With the Fed having officially brought its bond-buying program to an end in October, investors are now largely targeting the second or third quarter of 2015 for the Fed to hike its benchmark interest rate. While no one expects a hike in the first quarter, 40% of respondents believe the central bank will raise the benchmark rate in 2Q15 and 29% expect it to happen in 3Q15.

Notably, 22% now believe the central bank will hold off tightening until sometime in 2016, well above the 8% who suggested as much last quarter. Further, roughly two-thirds of all those surveyed, across all regions, anticipate that the combination of a weakening non-U.S. global economy, lower oil prices and the strong dollar will lead the Fed to be less aggressive in both the *timing* and *magnitude* of its near-term rate hikes.



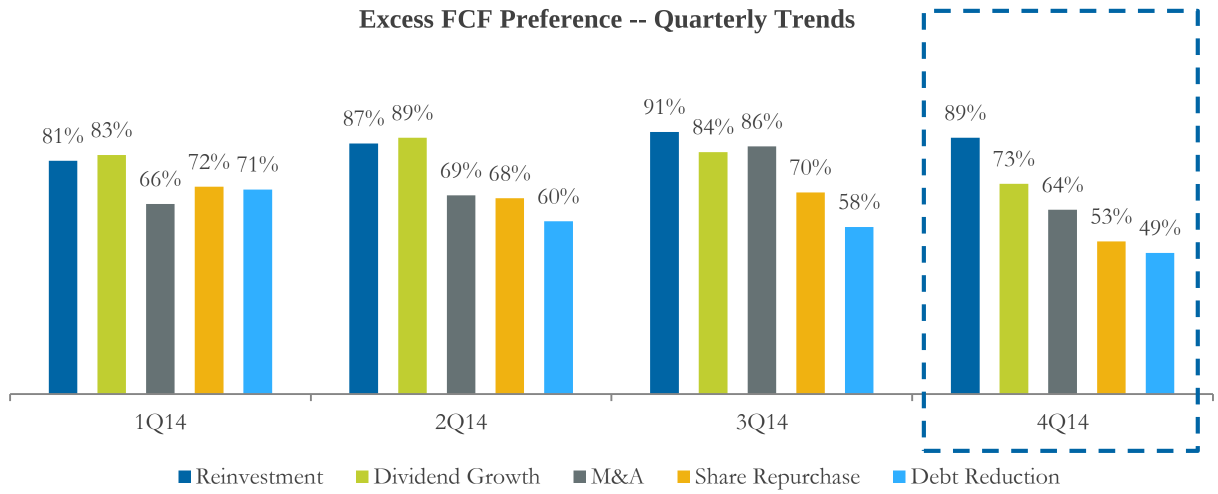
Finally, the majority of those surveyed, or 57%, expect the U.S. Treasury yield curve to be normal 12 months after the first rate hike; 21% see a steepening.

"It will probably be towards the end of 2015, if it is in 2015 at all. We may see the timeframe on that slip a bit. They are not going to raise them too soon; they are going to raise them too late." **Hedge Fund, Generalist | North America**

"The strong U.S. job market could accelerate the timing of a rate hike." **GARP, Generalist | North America**

Reinvestment Remains Top Preference; Buybacks Rank Lowest

Survey respondents make clear their preferences as to how companies should pursue growth and allocate free cash flow. Regarding growth, business reinvestment is the preferred method for deploying excess free cash for the second straight quarter, outpacing all other options for capital allocation. Of note, investor desire for M&A declined sharply, to 64% from 86%, a return to levels seen in the first half of 2014. Meanwhile, share repurchases continue to trail well behind dividend growth as the favored method for returning cash to shareholders as valuations continue to make dividends a more popular option.



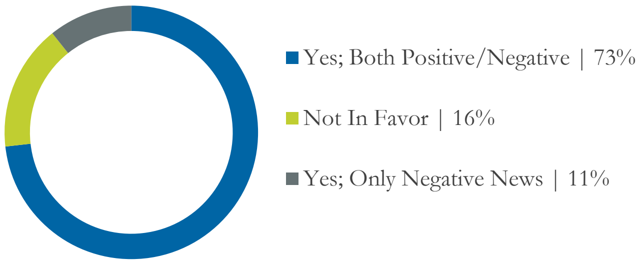
IR Best Practice: Preannouncing Earnings Surprises

The skill with which management teams and IR departments handle earnings surprises, whether communicating positive or negative news, can have a significant impact on the management teams' credibility. The decision to preannounce an earnings surprise involves careful consideration on the part of management and IR, including:

- Is the expected surprise of a "material" nature?
- How soon after ascertaining that there will be a "miss" or "beat" should the announcement be made?
- Will a press release suffice or is a conference call necessary?
- Beyond the numbers, how much additional information is needed to put the announcement in proper context?
- What should be the communication policy going forward?

Surveyed investors are strongly in favor of companies preannouncing earnings surprises, with 73% asserting they should be made regardless of whether the revision involves positive or negative news. "Surprises are not taken well" by the market, they note and the "longer a company sits" on surprising news the more opportunity there is for "abuse".

Are You In Favor Of Earning Surprises Preannouncements?



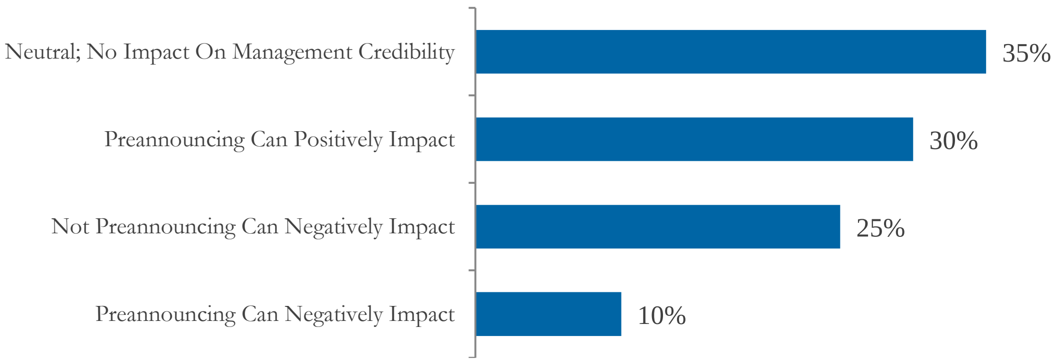
> *"If it is material then they should preannounce. I believe 10% relative to guidance could be considered material. They should announce as soon as they figure it out."* **Deep Value, Generalist | North America**

> *"Investors place a premium on consistency and a discount on uncertainty. If there's risk of an unanticipated negative announcement, this would factor into the risk portion of valuation."* **Hedge Fund, Multi | North America**

> *"It all depends on where you are. If people are looking for $1.00 and you come in at $0.75, you had better say something. If people are looking for $1.00 and you come in at $0.95, how do you preannounce a nickel? There is a legitimate way of not preannouncing and telling people you are at the low-end of the range."* **GARP, Generalist | North America**

The impact on management credibility, a key facet of the investment process for many active money managers, can be substantial. One-third of contributors report that preannouncing can positively affect credibility, while 24% contend that not preannouncing can negatively impact management's reputation.

How Does Preannoucing Impact Management's Credibility



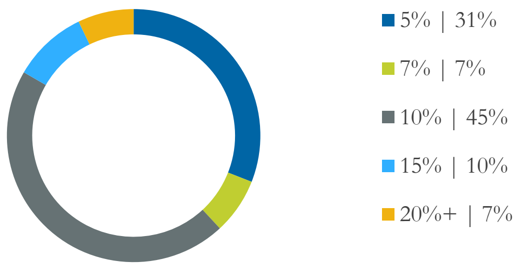
> *"It probably gives them some benefit but if you miss, you miss. If you miss because of your own actions, your credibility is hurt. If you miss because you did not give a realistic appraisal of the macro forces at hand and it is worse, or if you did not adequately bank on it, then your credibility is hurt. On the other hand, if your execution was fine but you just got caught up in something and didn't make any promises on what you thought the macro would do, your credibility is not bolstered*

but it's not impacted as much as some of those other scenarios." **Core Value, Generalist | North America**

"It can have negative short-term impacts but if it is not too often, in the long run it is neutral." **Deep Value, Generalist | North America**

"It enhances credibility even if they are negatively preannouncing; it is going to be negative anyways." **Core Growth, Generalist | North America**

As to what threshold a "miss" warrants a preannouncement, 83% of participants peg the level at between 5% and 10% above or below a company's current guidance. The remainder suggest a relevant threshold of greater than 15%.



Finally, in discussing worst practices when issuing a preannouncement, a "lack of detail" or providing "incomplete information" is at the top of investors' lists. Holding a conference call in conjunction with a preannouncement is preferred. Issuing a one-sentence statement that the company is going to miss guidance is "the worst thing to do", as is issuing revised guidance that is not met.

"If you preannounce because business got worse and you don't have a realistic view of where the business is going, that is pretty bad because now you have set yourself up to continue to miss expectations instead of getting it all out there. If there is a problem, just be honest with everyone, lay it out there and move on rather than have it continue to bleed out." **Hedge Fund, Generalist | North America**

"Making a negative preannouncement and then beating the announcement is not good." **Core Growth, Generalist | North America**

"Not matching preannouncements with a supplemental call is a worst practice." **Core Growth, Generalist | North America**

"Providing incomplete information is a worst practice. If you just preannounce one metric without providing a full press release that is a worst practice." **Hedge Fund, Generalist | North America**

"Avoid sugarcoating it. If you have to eat crow, you do not want to nibble at it. If you have bad news, be conservative in how bad it is going to be and be transparent. Provide the guidelines of how the company is going to work through it and steps it is going to take. This may come a bit after the preannouncement, after the surprise. The worst is when a company denies that bad news is coming, holds onto guidance and does not admit things have changed. That company will lose credibility." **GARP, Generalist | North America**

"Worst practices I've seen are not including investor presentations and not returning my calls; going into lockdown mode. Even if you do not have all of the information as to why what happened did happen, I feel better about them if they say, 'Here's what we know, here's what we don't' and go from there. If I feel like they are hiding the ball, the possibility for it to be much worse than they said is still there. That uncertainty is going to cause a discount to be applied. Accessibility, transparency and our feeling that they are actually giving us all of the information and not hiding the other shoe that's about to drop are all important." **Hedge Fund, Generalist | North America**

"The best thing to do is to be as descriptive as you can about what happens and try to quantify it as best you can. The worst thing to do is to give a one sentence statement that you are going to miss and then not really elaborate on why." **Core Value, Generalist | North America**

"In terms of worst practices, I prefer to see greater transparency into the business. Tell us what is going on with your business and why what has happened has happened. Looking ahead, will the issues that led to the preannouncement continue to be a problem for the company? What are the risks and opportunities you see from that?" **Hedge Fund, Generalist | North America**

"Not fully explaining the reasons behind deviation from original guidance is a worst practice." **GARP, Multi | Asia Pacific**

"A worst practice is not revealing all the bad news upfront and needing more than one announcement to get the information out." **Core Value, Generalist | Europe**

"Providing an inadequate explanation for the surprise preannouncement." **GARP, Generalist | North America**

"Issuing updated guidance that needs to again be revised is a worst practice." **GARP, Multi | Asia Pacific**

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