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CORPORATE BEIGE BOOK

UPBEAT AS EXPECTED

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KEY TAKEAWAYS

The LPL Research Corporate Beige Book Barometer continues to exhibit upbeat sentiment from companies during the third quarter of 2017.

About 60% of S&P 500 companies mentioned hurricanes during their conference calls, highlighting the broad impact.

The positive tone from management teams appears to support a positive near-term earnings outlook even without factoring the potential benefits from tax reform.

Companies remained generally upbeat during the third quarter earnings season, based on the LPL Research Corporate Beige Book Barometer.

This is hardly surprising, given actual earnings results were good again and estimates of future earnings held up relatively well as companies provided forward-looking guidance.

POSITIVE SENTIMENT CONFIRMS EARNINGS STRENGTH

Corporate sentiment remained very upbeat during the third quarter based on our count of positive and negative words in earnings conference call transcripts. We observed a pickup in strong words, little change in the number of weak words, and a resulting increase in the differential between strong and weak words, which remains very positive [Figure 1]. Accordingly, the ratio of positive-to-negative words continued its steady climb since the end of the China and oil-driven downturn in spring of 2016 [Figure 2]. Specifically, from the third quarter of 2016 to the third quarter of 2017, the ratio of strong-to-weak words rose steadily from 2.6 to 7.1.

ANOTHER STRONG EARNINGS SEASON

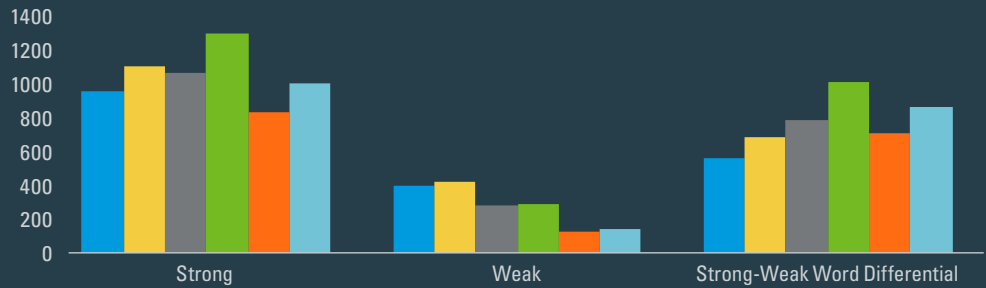
The S&P 500 Index grew earnings more than 8% year-over-year for the third quarter. Excluding the impact of hurricanes within the insurance group, corporate America produced its third straight quarter of double-digit earnings growth. The amount of upside to earnings estimates was slightly below average in the quarter, but we consider the season a success given the strong upside to revenue forecasts and generally upbeat outlooks from corporate management teams. [Review our overview of earnings season.](#)

Earnings call transcripts analyzed took place starting in mid-October extending through the third week of November.

LPL Research Corporate Beige Book—Q3 2017

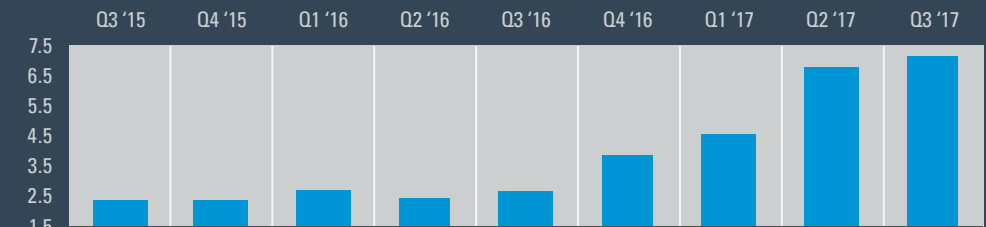
1 Companies Remain Upbeat Based on Corporate Beige Book

● Q2 2016 ● Q3 2016 ● Q4 2016
● Q1 2017 ● Q2 2017 ● Q3 2017



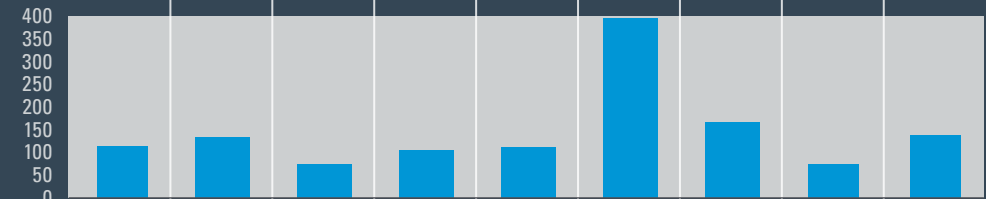
2 Ratio of Strong-to-Weak Words Continues Steady Climb

● Ratio of Strong-to-Weak Words



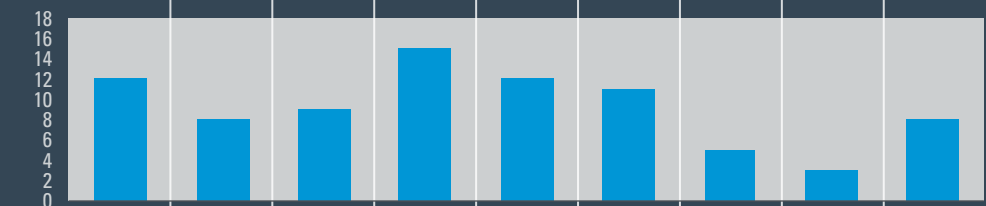
3 Tax Mentions Increased Amid Reform Effort But Well Off 2016 Election Levels

● Number of Tax Mentions



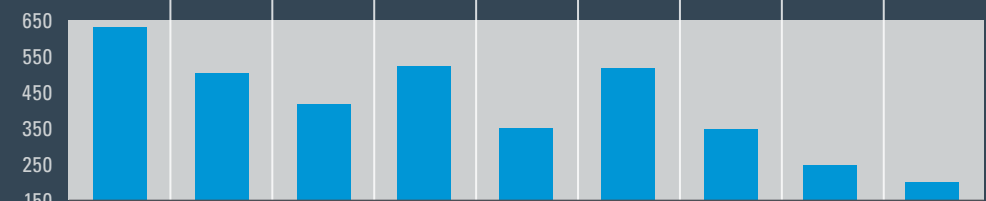
4 Recession Talk Virtually Nonexistent

● Number of Recession Mentions



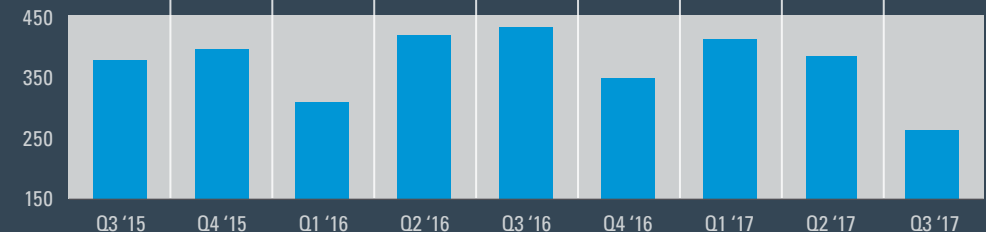
5 U.S. Dollar Weakness Has Led to Fewer Currency Mentions

● Number of Currency Mentions



6 Oil Price Stability Finally Leads to Fewer Energy Mentions

● Number of Energy Mentions



Source: LPL Research, Bloomberg 12/06/17

Data represent number of mentions during third quarter 2017 earnings conference calls for companies that have reported as of 11/22/17.

The improvement in management sentiment is encouraging and consistent with the strong earnings season and generally upbeat guidance. We believe the positive tone from management teams supports our outlook for the potential of more solid earnings gains next year, as noted in our [Outlook 2018: Return of the Business Cycle](#).

Here are some excerpts from call transcripts supporting the positive sentiment on the macro environment:

- “With respect to customers, the feedback from discussion with customers is I think pretty optimistic about their prospects, what they’re seeing in terms of demand.”
— *Vehicle Manufacturer*
- “As we move into the fourth quarter, the macroeconomic environment looks solid. We also remain confident about the holiday season, as consumer sentiment remains elevated. Looking outside the U.S., global growth projections have moved higher as performance in Europe and China continues to exceed expectations.” — *Transport*
- “The economy from our perspective continues to look steady. Customers continue to be somewhat optimistic, there’s a bit more optimism about fiscal or tax reform and the ability to see that improved growth rates in the economy.” — *Bank*

POLICY FOCUS CENTERED ON TAX REFORM

While the amount of attention corporate management teams have paid to the Trump administration on their earnings calls has fallen in recent quarters, tax reform has continued to get a lot of air time [Figure 3]. The tax issue got more attention during the November 2016 election, but mentions in transcripts we analyzed roughly doubled from the second quarter to the third as the bills worked their way through Congress. Specifically, the word “tax” or its variants were mentioned over 400 times during fourth quarter 2016 earnings conference calls before falling to below 70 in the

THE CORPORATE BEIGE BOOK BAROMETER

The LPL Research Corporate Beige Book Barometer is our measure of corporate sentiment where we use earnings conference call transcripts to gauge overall sentiment among corporate management teams. To do so, we count the number of strong words (or variations of “strong”) and the number of weak words (or variations of “weak”), and compare the two. (Examples of strong words include “robust,” “solid,” and “optimistic”; examples of weak words include “soft,” “fragile,” and “pessimistic.”) We can then compare that differential with prior quarters to make comparisons over time. Although not every single call transcript is analyzed, we believe the trends observed provide valuable insights.

second quarter of 2017 and then rising to 126 last quarter. Mentions of other key policy initiatives were little changed and fairly infrequent, although “infrastructure” got a bump from 18 in the second quarter to 33 in the third.

Here are some executives’ comments on Washington, D.C. policy initiatives:

- “I think there will be a good uptick in terms of investment ... so I’m pretty optimistic that the new tax law will be a good catalyst for growth.” — *Engineering and Construction*
- “While the economic outlook remains fairly promising, we see further upside potential from U.S. tax reform, which we strongly support. The current proposal will provide great incentives for companies to both reinvest and create jobs at home.” — *Transport*
- “It is important that Washington and the business community unite now behind a tax reform bill that will have a positive impact on domestic

jobs and on economic growth. Still remaining optimistic that something on this front can get done, we are not assuming reform in our 2017 guidance.” — *Healthcare*

- “Our commercial clients remain optimistic. They continue to look forward to continued implementation of a pro-growth agenda, particularly focused on meaningful tax reform.” — *Bank*
- “We support a pro-growth tax reform package, a significantly lower marginal rate, and we’re prepared to see certain preferences changed or eliminated. We think that will drive economic growth, which is a key factor in terms of our growth as a company.” — *Insurer*

STILL VERY LITTLE TALK OF RECESSION

Corporate executives generally try to stay away from the “R” word (recession) when talking with investors, confirmed by the small number of mentions of the word over the past several years. The word “recession” got a tiny bit more use in the third quarter [Figure 4], but its use is either international, e.g., Europe has escaped recession or Brazil is climbing out, or it is simply a reflection back to the Great Recession. Bottom line, recession is hardly a part of corporate managements’ vocabularies at this point, which along with our assessment of leading economic indicators, points to a very low probability of recession in the near term.

WEAKER DOLLAR LED TO FEWER MENTIONS

The amount of attention on currencies has fallen dramatically over the past two years, reflecting the stability and then weakness in the U.S. dollar. Recall a strong dollar is a drag on overseas earnings by U.S.-based multinationals, while a weak dollar provides a currency translation benefit.

Currency mentions fell 19% from the second quarter to the third, after roughly 30% drops during the prior

WIDESPREAD HURRICANE IMPACT

To put the widespread impact of the devastating hurricanes that hit Texas and Florida into context, the word “hurricane” was mentioned at least once during the earnings conference calls of 298 S&P 500 companies that reported results between September 14 and December 1, according to FactSet. Our search of the macroeconomic comments contained within earnings call transcripts compiled by Bloomberg revealed 580 mentions of hurricanes, storms, or weather, more than double the number of mentions of tax reform, energy, currency, China, or any other topic we could think to search.

two quarters [Figure 5]. That trend follows the path of annual changes in the dollar, which have gone from +3.6% (Q1 2017) to +4.1% (Q2 2017) to -2.4% (Q3 2017) and are estimated to be -6% in the fourth quarter of 2017 (based on the U.S. Dollar Index). Currency had a slight but barely discernable impact on overall S&P 500 earnings in the third quarter, and was therefore not needed as an excuse for shortfalls relative to expectations. During the fourth quarter, it is possible that a larger currency benefit gets more attention.

Here are several management comments on currency reflecting the tailwind:

- “The currency translation effects went from being a headwind to actually being a slight tailwind.” — *Capital Goods*
- “Our sales growth of more than 3% was driven by improving sales volume and favorable currency translation.” — *Materials*
- “In terms of currency translation, we received a tailwind of a half percent to one percent. We’re benefiting from dollar weakness most significantly versus the euro.” — *Payment Processor*

Our U.S. dollar view is slightly positive in 2018 due primarily to the divergences in global monetary policy, as discussed in *Outlook 2018*.

ENERGY GETTING LESS ATTENTION

The number of mentions of “oil” (and related “fuel”, “gas”, or “crude”) dipped during the third quarter [Figure 6]—not surprising given recent oil price stability relative to the extreme volatility in late 2015 and early 2016. What is surprising however, is that the number of mentions remained elevated during the second half of 2016 and first half of 2017, despite energy’s strong rally off of the early 2016 lows. Many of those mentions were in a positive context, as higher oil prices helped, and energy companies will always comment on energy prices, but we are still surprised that it took this long for energy to fall off of companies’ radar in a meaningful way.

CONCLUSION

Management sentiment during third quarter earnings season was again quite positive, which is not surprising given that actual earnings results were solid and forward estimates held up very well. The hurricane drags were evident in the numbers and comments from management teams. Still, we believe the overall positive tone from corporate America during earnings season supports a positive outlook for earnings growth through year end and into 2018. ■

We are saddened by the passing of Rich Yamarone, Bloomberg Economist, whose work was critical to our Corporate Beige Book analysis.

IMPORTANT DISCLOSURES

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All investing involves risk including loss of principal.

The fast price swings in commodities and currencies will result in significant volatility in an investor’s holdings.

INDEX DESCRIPTIONS

The Standard & Poor’s 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The USD Index measures the performance of the U.S. dollar against a basket of foreign currencies: EUR, JPY, GBP, CAD, CHF and SEK. The U.S. Dollar Index goes up when the dollar gains “strength” compared to other currencies.

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