As fundamental investors, we pay close attention to companies’ profit and revenue forecasts, which help us to gauge their health and future prospects. Not surprisingly, outlook revisions traditionally occur during earnings season, when companies issue their own report cards. As another quarterly earnings season approaches, we are evaluating the lessons learned from the previous period as well as our expectations for the next one.

In the second quarter, the number of U.S. companies raising their outlook above the consensus estimate reached its highest level since 2011. In our view, their report cards were largely dominated by A’s: Acquisitions, Activists, America and Avoidance of taxes. All of these factors played a role in driving earnings and shareholder value.

- **Acquisitions**: We witnessed a dramatic surge in activity, as firms deployed low-cost capital and cash in highly accretive deals.
- **Activists**: They came out in full force, with no company immune to their influence, and they have been successfully advocating for shareholder-friendly actions like dividends and buybacks.
- **America**: Companies with the greatest exposure to North America had the most positive outlooks, as the U.S. moves along the path of a durable recovery.
- **Avoidance of taxes**: One of the biggest stories of the second quarter was the avoidance of high U.S. tax rates, as several U.S. firms employed tax inversions to their advantage.

### Number of U.S. Companies Revising Their Outlook Above Consensus

Source: Cornerstone Macro, as of 7/28/14.
For the third quarter, we are anticipating an influx of C’s: Currency, Commodities and U.S. Consumers.

- **Currency:** A central theme in upcoming reports may be the dramatic strength of the U.S. dollar against the euro and yen, as seen in the latter half of the period. We expect this to impact the top lines and outlooks of many U.S. large-cap companies, which derive an average of 40% of their revenue outside the U.S. Although the data in aggregate may spark investor concern, we believe it is driven primarily by currency translation. However, for a smaller group of companies, the currency moves will dramatically alter their competitive advantage. For example, companies with their costs in euros or yen and their revenues in U.S. dollars will have an advantage over companies with both costs and revenues in U.S. dollars.

\[ \begin{align*} \text{Rise in Trade-Weighted Dollar} & \end{align*} \]

[Graph showing the rise in trade-weighted dollar from December 2013 to September 2014. Source: Bloomberg, as of 9/18/14]

- **Commodities:** We believe the steep drop in dollar-based commodity prices, including crude oil and corn, will be reflected in companies’ reports and outlooks. Obviously, some will be helped by the decline, while others will be hurt. Overall, however, lower commodity prices should provide a tremendous benefit to a consumption-driven economy like the U.S.

\[ \begin{align*} \text{Drop in Brent Crude Oil Prices} & \end{align*} \]

[Graph showing the drop in Brent crude oil prices from December 2013 to September 2014. Source: Bloomberg, as of 9/18/14]

- **Consumers:** Recent positive developments for U.S. consumers, such as lower gasoline prices, ongoing deleveraging and improving employment and wage growth, should flow through to third-quarter reports. In fact, we estimate that every 10-cent decline in gasoline prices is the equivalent of an annual $13 billion tax cut. Buttressing further improvement in the data are easy comparisons, which have resulted in low expectations.

\[ \begin{align*} \text{Decline in Daily Average Gasoline Prices} & \end{align*} \]

[Graph showing the decline in daily average gasoline prices from $3.10 to $3.80. Source: Bloomberg, as of 9/17/14]

These anticipated trends will also have an impact on our investment views. In the Financials sector, we anticipate a resurgence in capital-markets activity, which has been depressed for four quarters. We expect the recent currency shifts and the prospect for higher U.S. short rates to drive the increase in capital-markets activity. Within Consumer Discretionary, we are looking for better same-store sales from U.S. retailers, as shoppers’ sentiment is buoyed by an improving employment picture and lower gasoline prices. In the Energy space, we expect falling crude prices to pressure the top and bottom lines of integrated energy companies and exploration & production firms. Overall, while our fundamental view remains favorable on the U.S. market, outlook revisions will provide a telling measurement of the health and prospects for U.S. companies. We believe the recent dramatic changes in currencies, commodities and consumer mindset will be major drivers of the aforementioned outlooks and hold the keys to the winners and losers. As such, we will anticipate and analyze the cues provided by management in the weeks ahead.
About the Author

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Brian is the Senior Portfolio Manager on The Boston Company's Dynamic Large Cap Value strategy, a position he has held since 2003. He also functions as the team analyst responsible for the health care and financials sectors. Brian has 23 years of industry experience and has been with the firm since 1997.

Brian joined The Boston Company as a Research Analyst on the Small and Mid Cap Opportunistic Value Team, focusing on financial services and consumer-related stocks. In 2000, he became a portfolio manager of the firm’s Mid Cap Value strategy at the time of its successful launch.

Before joining the firm, he was a Research Analyst on the Vanguard Windsor Fund at Wellington Management. Prior to that, he was an Assistant Director of General Electric Capital Corp.’s corporate treasury group and graduated from GE’s Financial Management Program (FMP).

Brian received a BA in Economics and International Relations from Bucknell University and an MBA from Columbia Business School with a concentration in Finance. Brian is a member of the Beta Gamma Sigma Honor Society.