

OCTOBER 31, 2011

Near Normal

Comparing current quarter surprises in the S&P 500 to the last few quarters, it is looking pretty normal, with the main difference being in the magnitude of positive surprises in the sales line. However, one should keep in mind that past quarters had positive surprises relative to rising estimates, while this quarter positive surprises are against estimates that have declined significantly in the lead up to reporting season. Downward revisions at the close of each quarter are pretty normal, but the most recent experience was especially steep. We do find it interesting that sectors that suffered the greatest downward earnings revisions, like Energy, Industrials, and Information Technology, also had some of the largest positive surprises. Maybe that dower view was a little pessimistic. Of the larger sectors, Industrials has the highest percentage of positive surprises and Staples the lowest. In a sense that is logical. Economically sensitive earnings expectations have become quite modest, while defensive sector earnings outlooks have barely budged.

Q4 Reporting Season	% Reported	% Beat (EPS / Sales)	Median Reported % Surprise (EPS / Sales)	Median Q3'10 - Q3'11 % Earnings Growth	Median Q4'10 - Q4'11 Expected Earnings Growth	Median 2011 Expected Growth
S&P 500	56%	79% / 67%	3.5% / 0.9%	12.1%	10.1%	12.9% / 7.8%
Ex Financials	55%	82% / 68%	3.5% / 0.9%	11.9%	10.0%	12.8% / 8.1%
Smith Group Large Cap	68%	100% / 77%	4.5% / 0.9%	24.4%	18.0%	25.7% / 15.3%

S&P 500 Sectors						
Consumer Discretionary	37%	75% / 71%	2.6% / 1.5%	15.5%	10.3%	16.4% / 7.7%
Consumer Staples	44%	69% / 85%	0.8% / 0.8%	5.0%	8.0%	6.5% / 6.5%
Energy	50%	74% / 74%	5.2% / 2.2%	45.7%	22.0%	28.6% / 21.9%
Financials	68%	68% / 64%	3.8% / 0.6%	12.7%	10.7%	13.2% / 4.9%
Health Care	65%	86% / 73%	2.1% / 1.2%	10.6%	9.3%	11.9% / 5.8%
Industrials	73%	92% / 67%	4.4% / 0.7%	19.4%	14.9%	18.4% / 9.6%
Info Tech	62%	87% / 72%	4.8% / 0.7%	6.6%	3.6%	10.3% / 8.4%
Materials	80%	72% / 56%	3.9% / 0.8%	15.7%	16.2%	21.0% / 11.9%
Telecom	38%	100% / 33%	1.5% / -0.4%	7.0%	0.0%	6.7% / 12.3%
Utilities	21%	100% / 17%	3.3% / -1.9%	1.9%	6.3%	2.9% / 3.4%

Guidance

Company guidance accompanying earnings reports has been mixed. While there have been more negative than positive statements, that is actually normal. The current positive/negative ratio is pretty close to the long-term average, although, it is quite a bit lower than recent experience. Lower growth expectations for the fourth quarter of 2011 are still in the double digits, but just barely. As reporting season winds down some of the downward pressure on expectations should abate. The fastest growth in the current quarter is still in sectors exposed to the global economic cycle like Energy, Materials, and Industrials, and it is being driven by top line growth. Worries of economic slowing is very real but actual earnings delivered still is not reflecting those dire scenarios. Actual earnings is not confirming the worst expectations yet.

Past performance is not indicative of future results. As with any investment vehicle, there is always a potential for profit as well as the possibility of loss. Nothing contained in this presentation should be construed as a recommendation to buy or sell a security or economic sector.