

RSM US MIDDLE MARKET

BUSINESS INDEX

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Q1 2019



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RSM US MIDDLE MARKET BUSINESS INDEX

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RSM US LLP and The Harris Poll have collected data on middle market firms from a quarterly survey that began in the first quarter of 2015. The survey is conducted four times a year, in the first month of each quarter: January, April, July and October. The survey panel, the Middle Market Leadership Council, consists of 700 middle market executives, and is designed to accurately reflect conditions in the middle market. The data are weighted to ensure that they correspond to the U.S. Census Bureau data on the basis of industry representation.

A reading above 100 for the MMBI indicates that the middle market is generally expanding; below 100 indicates that it is generally contracting. The distance from 100 is indicative of the strength of the expansion or contraction.



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RSM US LLP and the U.S. Chamber of Commerce have joined forces to present the RSM US Middle Market Business Index (MMBI)—a first-of-its-kind middle market economic index developed by RSM in collaboration with Moody's Analytics, the financial intelligence provider. We publish the MMBI quarterly to give voice to the middle market and raise awareness of this crucial, yet underrepresented, segment of the economy.



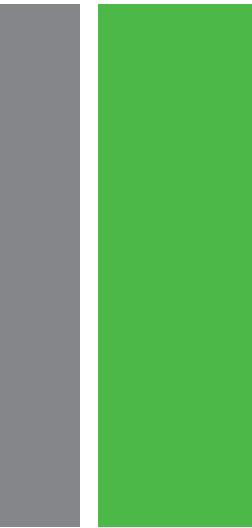
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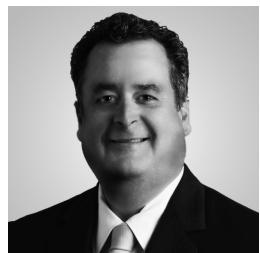
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MIDDLE MARKET SENTIMENT **TUMBLERS SHARPLY** TO 124.1 IN FIRST QUARTER

JOSEPH BRUSUELAS, CHIEF ECONOMIST, RSM US LLP



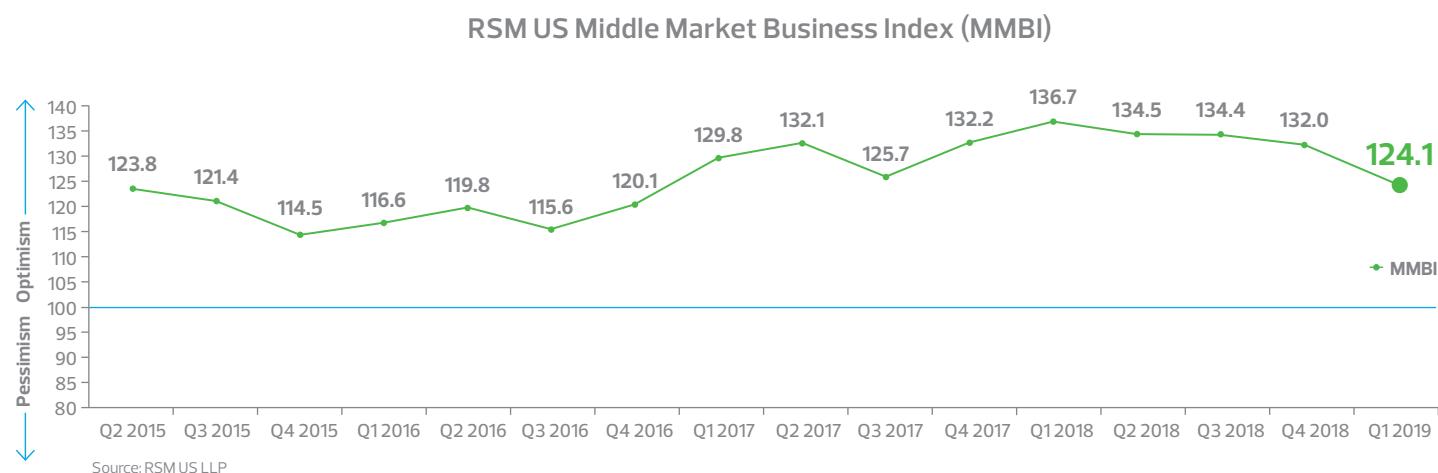
Joseph Brusuelas is the chief economist for RSM US LLP. Brusuelas has 20 years of experience analyzing U.S. monetary policy, labor markets, fiscal policy, economic indicators and the condition of the U.S. consumer. As co-founder of the award-winning *Bloomberg Economics Brief*, Brusuelas was named one of the 26 economists to follow by the *Huffington Post*.

This publication represents the views of the author(s), and does not necessarily represent the views of RSM. This publication does not constitute professional advice.

“Tariffs continue to threaten economic growth and create a cloud of uncertainty hanging over U.S. businesses of every size, including America’s middle market companies. The longer tariffs remain in place, the greater the damage to our nation’s economy and more businesses that will suffer hits to their bottom line. It’s imperative that Washington’s leaders pursue free and fair trade policies that promote economic growth and job creation.”

– Neil Bradley, Executive Vice President and Chief Policy Officer, U.S. Chamber of Commerce

The first quarter RSM US Middle Market Business Index tumbled to 124.1 from 132 in the prior period, as sentiment softened about the economy following uncertain U.S. trade policy and volatility in the financial markets.



MIDDLE MARKET SENTIMENT TUMBLES SHARPLY IN FIRST QUARTER

TRADE TENSIONS, BROAD ECONOMIC CONCERNS SURFACE IN RSM SURVEY DATA

by **Joseph Brusuelas**, Chief Economist, RSM US LLP

The RSM US Middle Market Business Index (MMBI) tumbled in the first quarter to 124.1 from 132. The decline in both current conditions and the expected outlook on the economy and capital expenditures should be interpreted by policymakers as a signal that the uncertainty tax generated by the direction of U.S. trade policy and recent volatility in financial markets has spilled over into the real economy. If risks around trade policy lift and financial market volatility abates, middle market business sentiment will likely stabilize. But, if that uncertainty tax persists, and financial market volatility doesn't abate, then ongoing policy risk may create conditions for an early termination of the current long-running business cycle.

Middle market perceptions of current and expected revenues, profits, wages and capital expenditures all point to rising challenges for the middle market beyond the partial government shutdown that occurred Dec. 22, 2018 to Jan. 25 2019. Note that the MMBI first quarter survey was conducted from Jan. 14 to Feb. 1, which means the partial government shutdown already concluded for part of the survey period.

In our estimation, the causes of the recent economic slowdown are not a function of market pricing or an overhang in inventories or debt, but of trade policy risk. We are not suggesting that an end to the current business

cycle, which is approaching the longest-running economic expansion in post-World War II U.S. history, is imminent, but the probability of one has increased due to the uncertainty tax that lingers in the economy.

The past few months have been difficult for the U.S. economy. Our survey showed a net 37 percent of middle market executives indicated current economic conditions worsened somewhat, and just 32 percent indicated conditions improved somewhat or substantially, down from 48 percent in the prior quarter. For the first time in two years, a minority of middle market businesses (45 percent) said they expect the economy to improve during the next six months, while 32 percent expect it to worsen.

The fact that the survey was completed after the conclusion of the partial government shutdown implies that other broad economic factors were at work. These include a synchronized global economic slowdown, increasing trade tensions between the United States and China, several months of intense volatility across global asset classes in financial markets and declines in industrial production and retail sales in December and January. Other surveys, such as global and domestic CEO confidence surveys, and the Metlife & U.S. Chamber of Commerce Small Business Index, indicate similar sentiments.



In the current quarter, 43 percent of middle market executives point to improved revenues (down from 55 percent during the prior quarter), and 47 percent report better net earnings (down from 58 percent the prior quarter). Despite the souring economic outlook and modest deterioration in revenues and profits during the current quarter, middle market businesses expect improvement in the next six months with 62 percent expecting revenues to increase and 60 percent anticipating a rise in net earnings. The internal inconsistencies denote growing concern over the duration of the current business cycle. However, because policy is a choice, not a market-derived outcome, the policy direction can be altered, which would likely put a floor under middle market business prospects in the near term.

Over past several years, we have made the case that when the end of the business cycle arrives, it is unlikely to be a long, drawn-out affair. Rather, if the U.S. economy goes into recession, it will fall off a cliff. While that is not presently occurring, the decline in current outlays on capital expenditures to 33 percent and the full 20 percent of middle market leaders who stated they decreased outlays on capital expenditures is an important revelation about the nature of the uncertainty tax that is now damping fixed business investment among MMBI participants and likely firms of all sizes for the past several months.

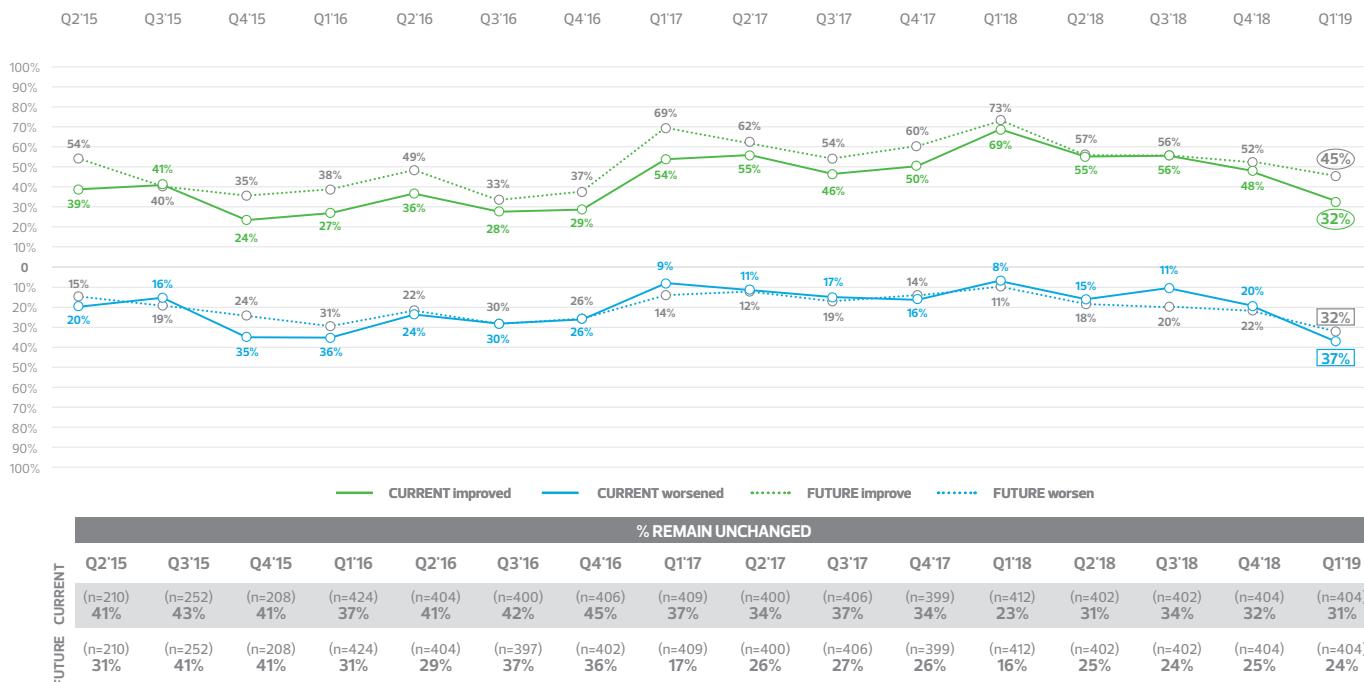
HIRING, COMPENSATION AND LENDING

The weakness in economic and financial difficulties that spilled over into the first quarter of the year has also influenced hiring and compensation conditions. Only 39 percent of middle market businesses indicated they would be increasing hiring in the first three months of 2019, and 50 percent stated they expect to increase it during the next two quarters. Compensation held up better than hiring, with 52 percent of executives indicating they increased compensation in the current quarter, and 59 percent stating they intend to do so going forward. While hiring and compensation are lagging indicators, the labor market remains tight, and the recent increase in first-time jobless claims corroborates what the middle market is saying.

Credit conditions and expectations for future middle market borrowing going forward eased, which echoes data from the U.S. Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices. Credit is modestly tightening, and because middle market firms are the marginal borrower and face higher borrowing costs, this is something that we will continue to closely monitor. Current inventory and the expected buildup of stocks also slowed relative to the previous quarter. Prices paid and prices received were relatively unchanged, with the exception of the 53 percent of participants who stated they expect to increase prices during the next six months relative to the 61 percent who previously reported they expected to do so in the final quarter 2018.

GENERAL ECONOMY PERFORMANCE

Thirty-two percent of executives reported they believe the general economy has improved in the current quarter, a significant drop since the last quarter (48 percent). Forty-five percent indicated they expect the economy to improve in the next six months, a significant drop over last quarter (52 percent).

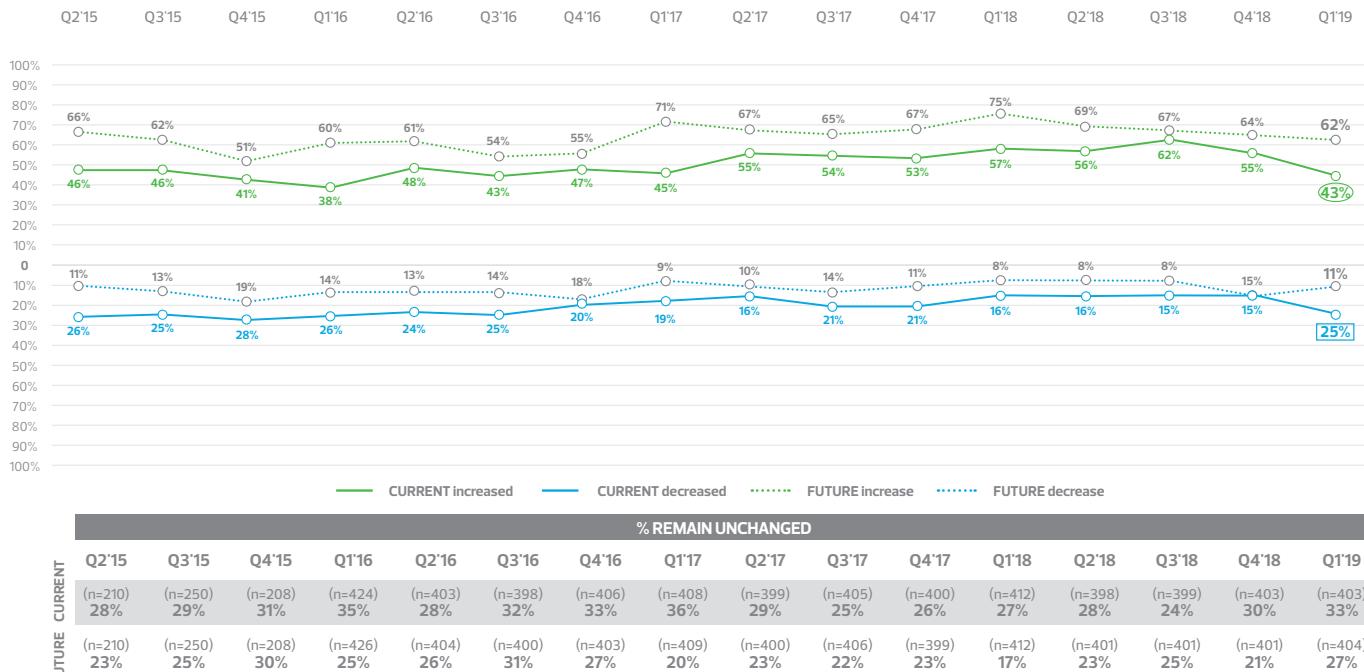


- First, thinking about the general economy this quarter versus last quarter, how would you describe the current general economy? Would you say the general economy has ...
- What are your expectations regarding the general economy over the next six months? Do you expect the general economy will ...

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

GROSS REVENUE PERFORMANCE

Forty-three percent of executives reported gross revenues increased in the current quarter, a significant drop over last quarter (55 percent). Similar to the previous quarter, 62 percent expect revenues to increase in the next six months.

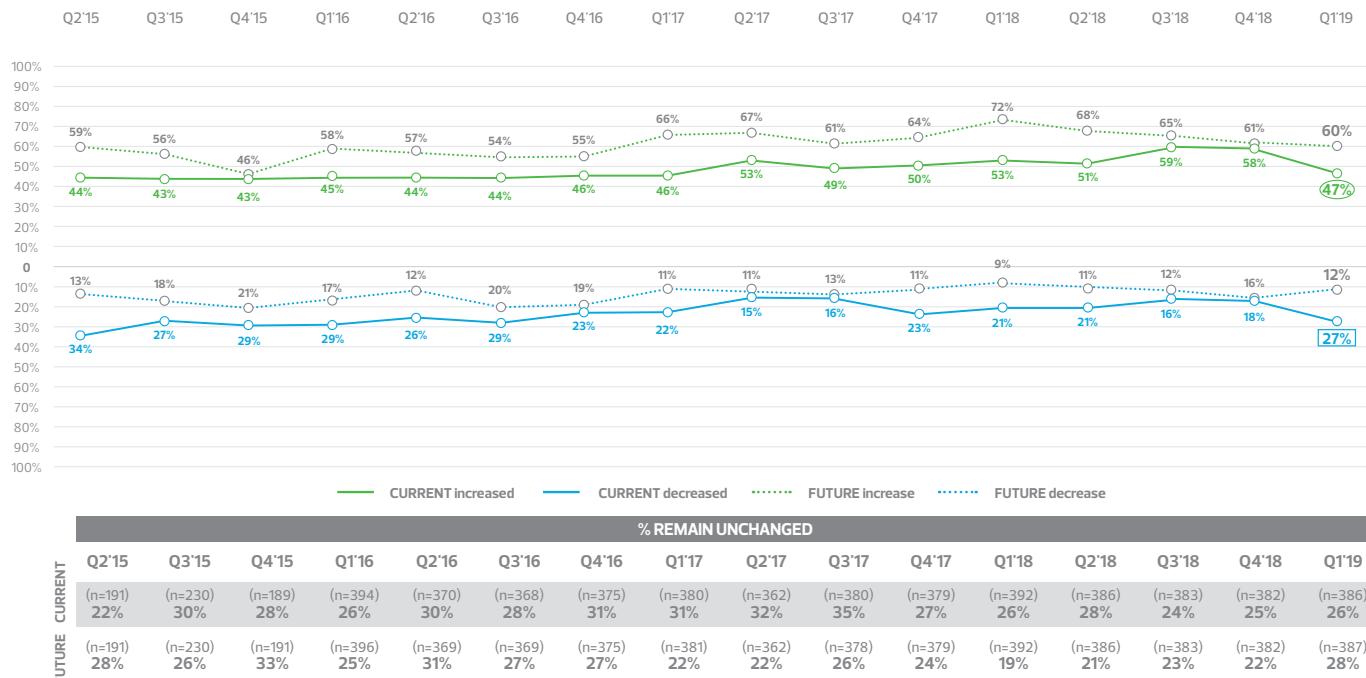


- Thinking about your organization's gross revenues/all incoming funds this quarter versus last quarter, how would you describe current gross revenues/all incoming funds? Would you say gross revenues/all incoming funds have ...
- What are your expectations regarding your organization's gross revenues/all incoming funds over the next six months? Do you expect gross revenues/all incoming funds to ...

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

NET EARNINGS PERFORMANCE

Forty-seven percent of middle market executives reported net earnings increased in the current quarter, a significant drop over last quarter (58 percent).

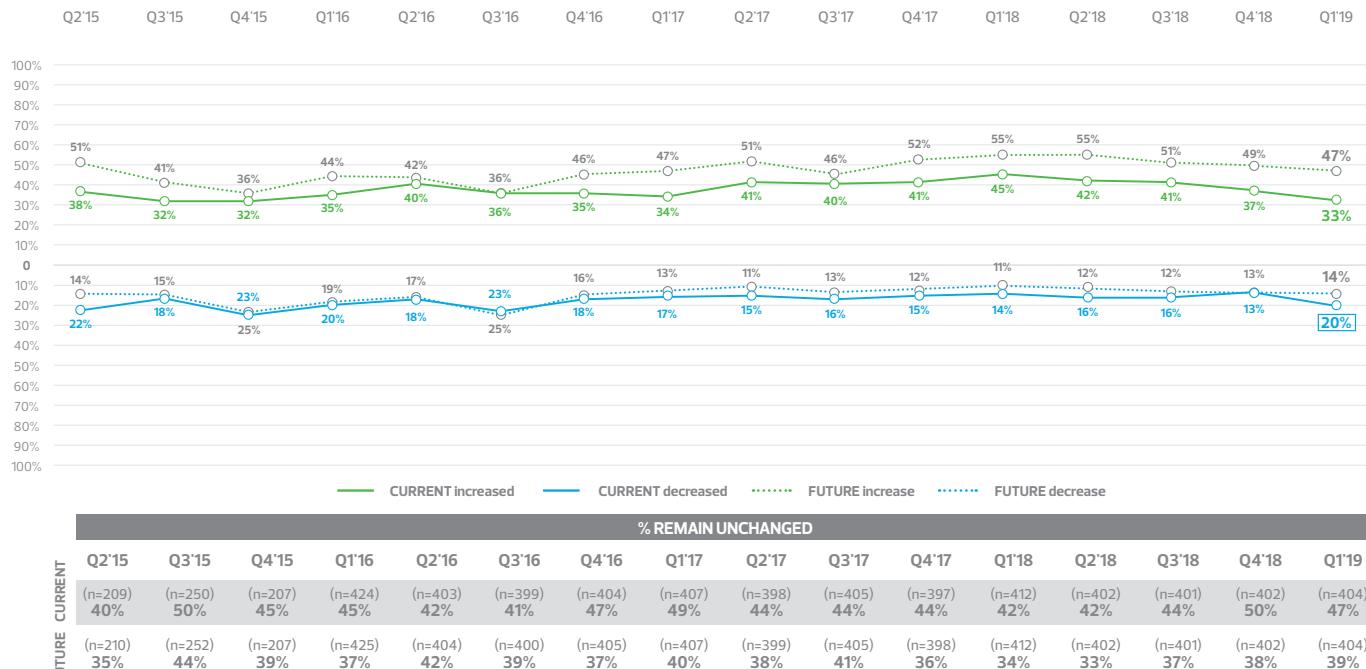


- Thinking about your organization's net earnings (after expenses, etc.) for the most recent quarter results versus the prior quarter results, how would you describe the level of your most recent quarter net earnings results? Would you say net earnings results have ... (among those not nonprofits)
- What are your expectations regarding your organization's net earnings results (after expenses, etc.) over the next six months? Do you expect net earnings results to ... (among those not nonprofits)

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

AGGREGATE CAPITAL EXPENDITURES/INVESTMENTS PERFORMANCE

Similar to the prior quarter, 33 percent of middle market executives indicated capital expenditures increased during the current period. Twenty percent indicated capex decreased, significantly more than last quarter (13 percent).



- Thinking about your organization's aggregate capital expenditures or investments this quarter versus last quarter, how would you describe your organization's current capital expenditures/investments? Would you say capital expenditures/investments have ...
- What are your expectations regarding your organization's aggregate capital expenditures or investments over the next six months? Would you say capital expenditures/investments will ...

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

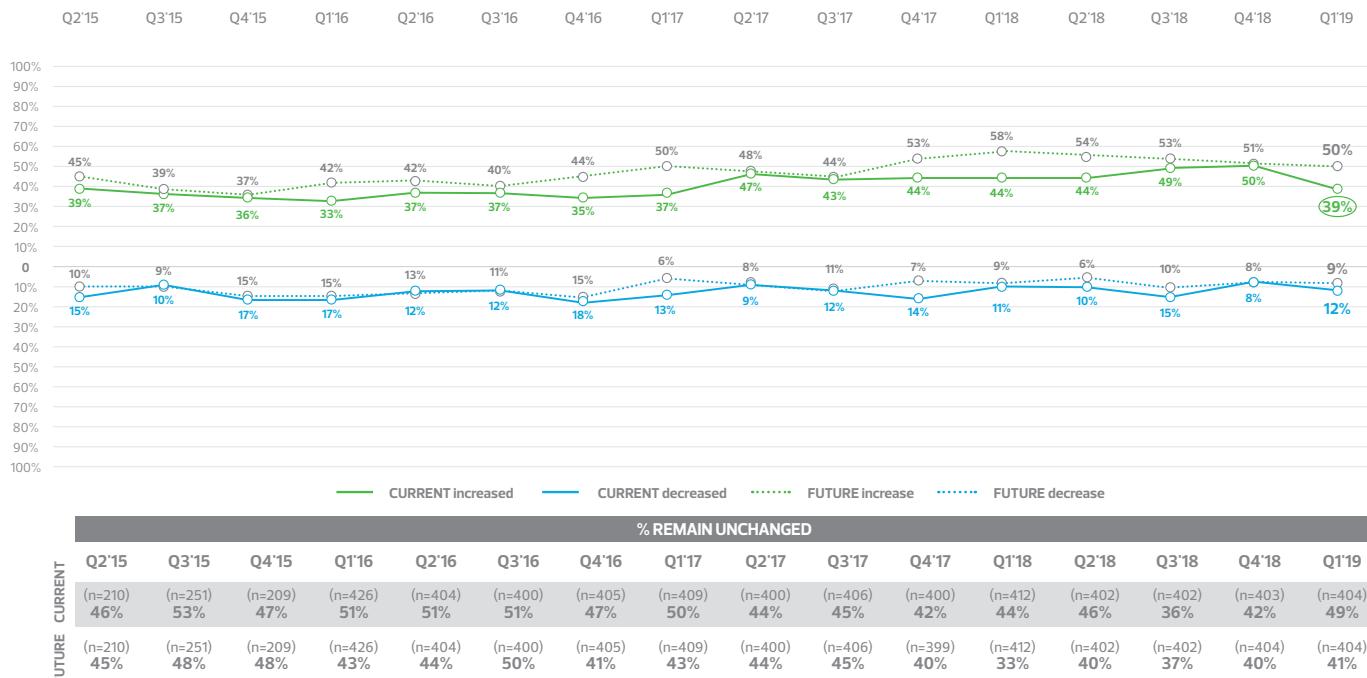
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OVERALL HIRING LEVELS

Thirty-nine percent of middle market executives reported hiring levels increased in the current quarter, a significant drop over last quarter (50 percent).

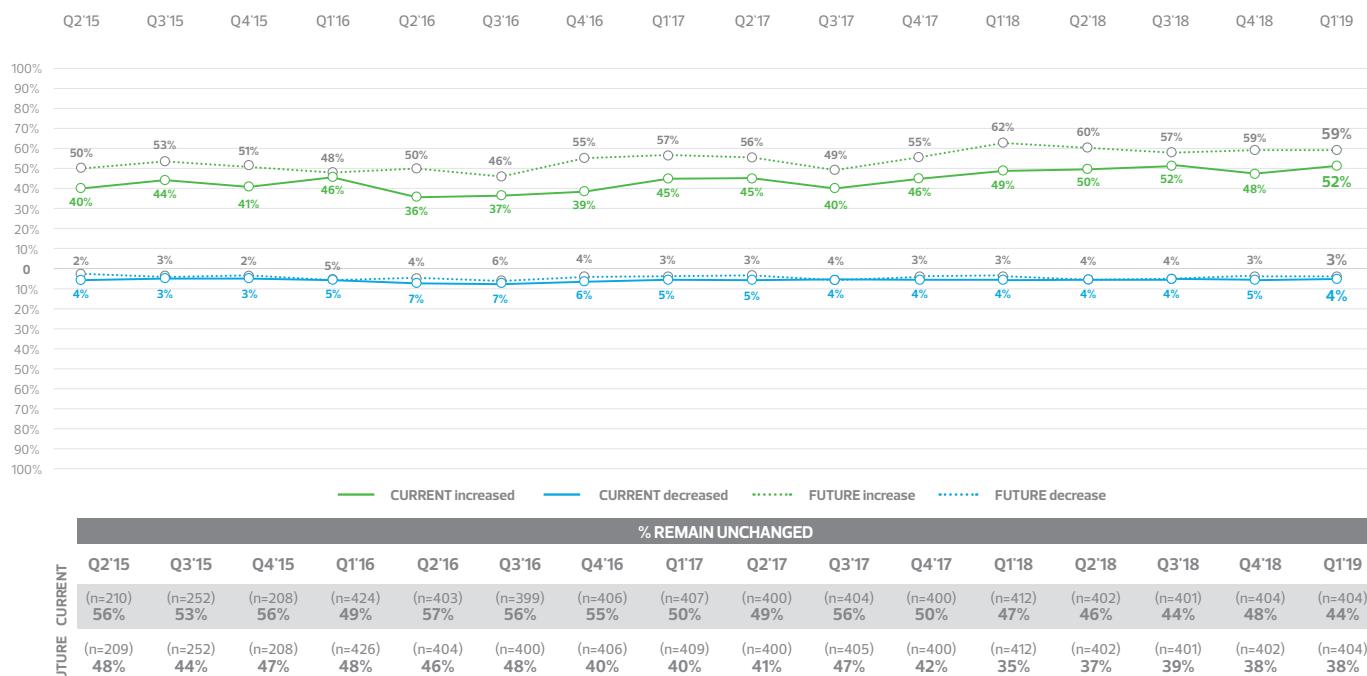


- Thinking about your organization's overall hiring levels this quarter versus last quarter, how would you describe your current hiring levels? Would you say hiring levels have ...
- What are your expectations regarding your organization's overall hiring levels over the next six months? Do you expect hiring levels to ...

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

EMPLOYEE COMPENSATION

Responses regarding employee compensation were comparable for this quarter versus the last quarter.

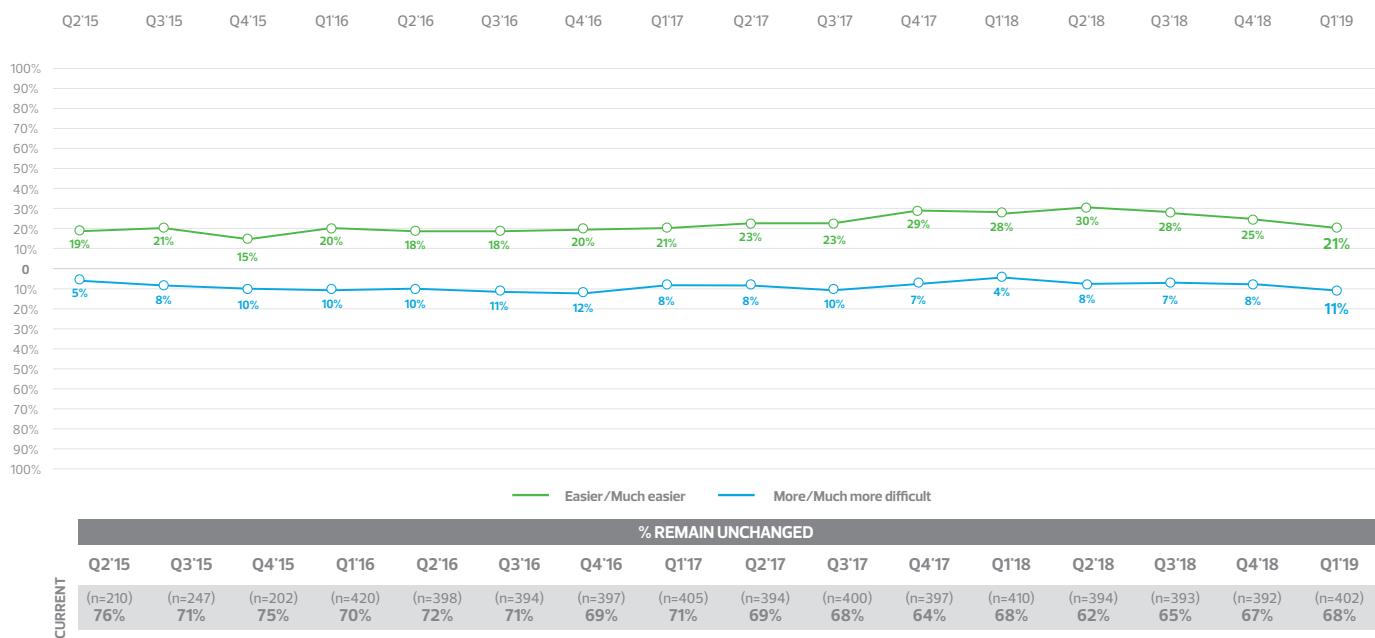


- Thinking about employee compensation at your organization this quarter versus last quarter, how would you describe the current employee compensation level on average? Would you say employee compensation, on average, has ...
- What are your expectations regarding your organization's employee compensation over the next six months? Would you say employee compensation, on average, will ...

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

ACCESS TO CREDIT

Current perceptions regarding access to credit are comparable to the levels observed in the fourth quarter.



CURRENT

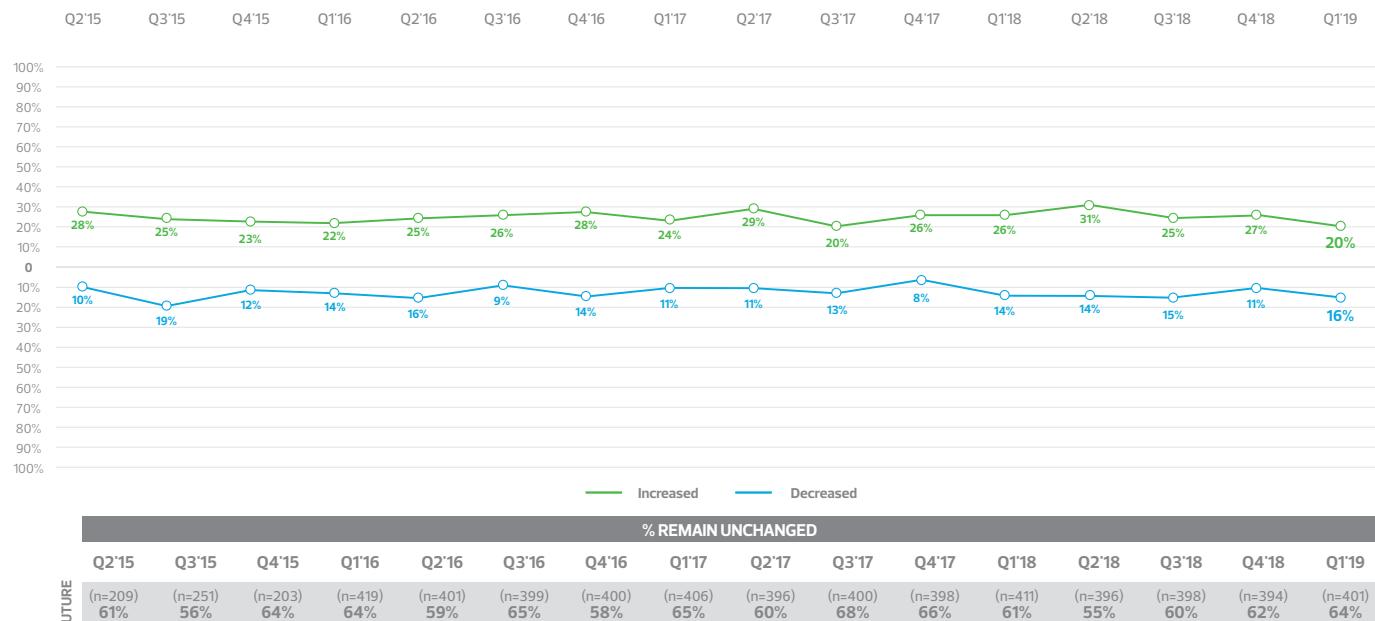
% REMAIN UNCHANGED																
Q2'15	Q3'15	Q4'15	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18	Q3'18	Q4'18	Q1'19	
(n=210) 76%	(n=247) 71%	(n=202) 75%	(n=420) 70%	(n=398) 72%	(n=394) 71%	(n=397) 69%	(n=405) 71%	(n=394) 69%	(n=400) 68%	(n=397) 64%	(n=410) 68%	(n=394) 62%	(n=393) 65%	(n=392) 67%	(n=402) 68%	

- Thinking about the availability or ease with which your organization can borrow money this quarter versus last quarter, how would you describe current access to credit? Would you say that accessing credit is ...

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

PLANNED BORROWING

Expectations for planned borrowing over the next six months are comparable to the last quarter.



FUTURE

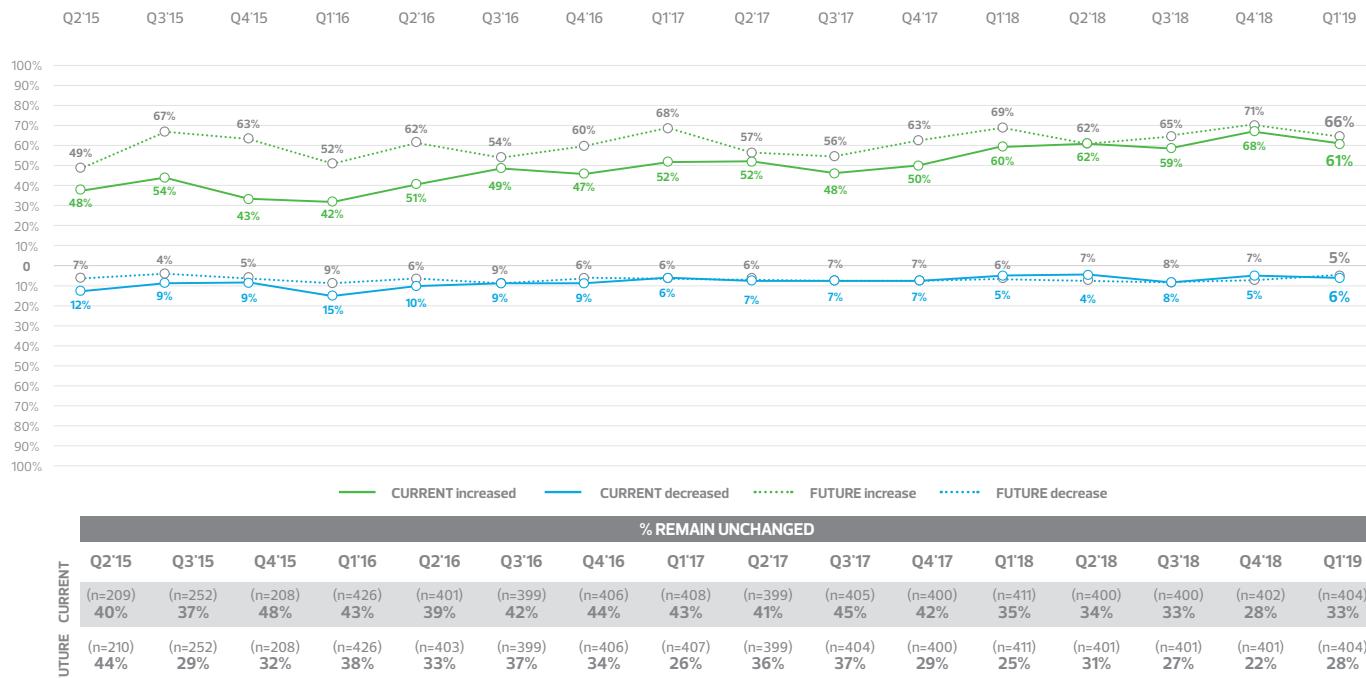
% REMAIN UNCHANGED																
Q2'15	Q3'15	Q4'15	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18	Q3'18	Q4'18	Q1'19	
(n=209) 61%	(n=251) 56%	(n=203) 64%	(n=419) 64%	(n=401) 59%	(n=399) 65%	(n=400) 58%	(n=406) 65%	(n=396) 60%	(n=400) 68%	(n=398) 66%	(n=411) 61%	(n=396) 55%	(n=398) 60%	(n=394) 62%	(n=401) 64%	

- What are your expectations regarding your organization's planned borrowing over the next six months? Would you say your organization's borrowing will ...

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

AMOUNT PAID FOR GOODS AND SERVICES

Sixty-one percent of middle market executives reported the amount paid for goods and services increased in the current quarter.



% REMAIN UNCHANGED																
FUTURE	CURRENT															
	Q2'15	Q3'15	Q4'15	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18	Q3'18	Q4'18	Q1'19
(n=209)	40%	37%	48%	43%	39%	42%	44%	43%	41%	41%	45%	42%	35%	34%	28%	33%
(n=210)	44%	29%	32%	38%	33%	37%	34%	26%	36%	37%	37%	29%	25%	31%	22%	28%

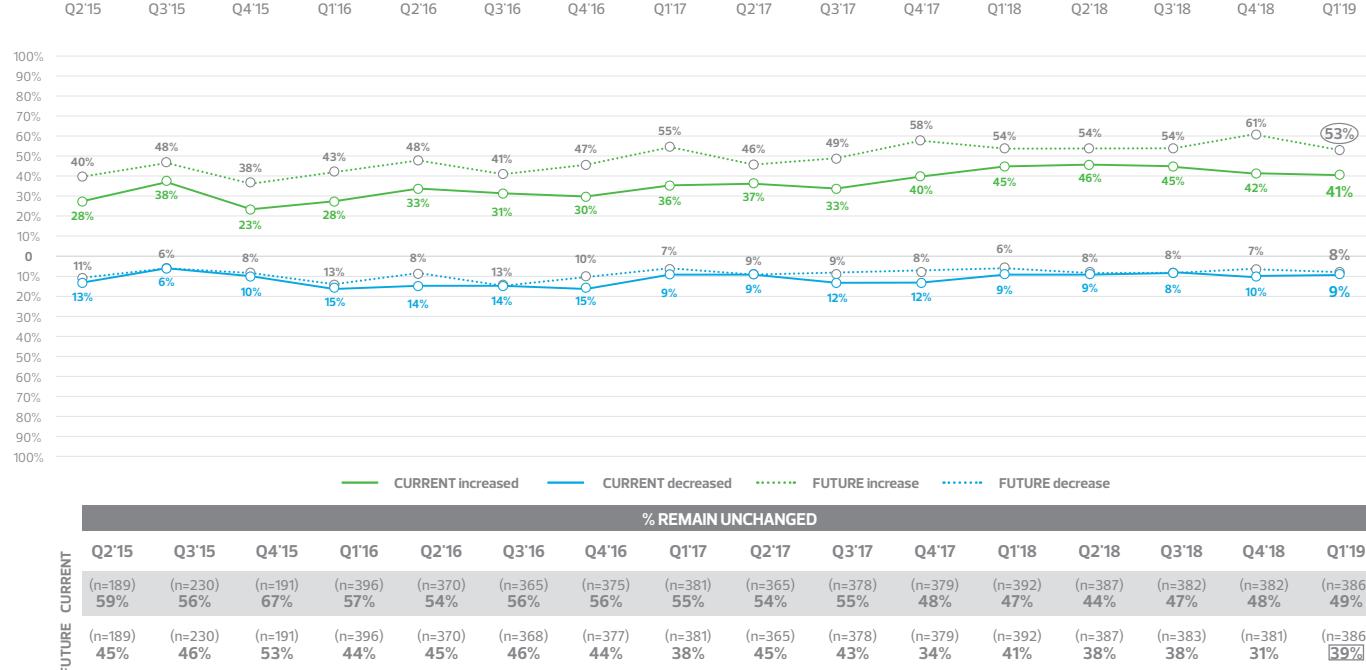
Thinking about the prices that your organization pays for all goods and services, except labor, this quarter versus last quarter, how would you describe the current general level of prices paid? Would you say prices paid, on average, have ...

What are your expectations regarding the general level of prices that your organization will pay for all goods and services, except labor, over the next six months? Would you say prices paid, on average, will ...

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

AMOUNT RECEIVED FOR GOOD AND SERVICES

Fifty-three percent expect that the amount received for goods and services will increase over the next six months, a significant drop over last quarter (61 percent).



FUTURE	CURRENT															
	Q2'15	Q3'15	Q4'15	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18	Q3'18	Q4'18	Q1'19
(n=189)	59%	56%	67%	57%	54%	56%	56%	55%	54%	55%	48%	47%	44%	47%	48%	49%
(n=189)	45%	46%	53%	44%	45%	46%	44%	38%	45%	43%	34%	41%	38%	31%	31%	39%

Thinking about the prices that your organization received for all of its goods and services this quarter versus last quarter, how would you describe the current general level of prices received? Would you say prices received by your organization, on average, have ... (among those not nonprofits)

What are your expectations regarding the general level of prices that your organization will receive for all goods and services over the next six months? Would you say the prices received by your organization, on average, will ... (among those not nonprofits)

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

INVENTORY LEVELS

Current perceptions and future expectations regarding inventory levels are comparable to the levels observed in the fourth quarter.



- Thinking about your organization's inventory levels this quarter versus last quarter, how would you describe current inventory levels? Would you say inventory levels have...
- What are your expectations regarding your organization's planned inventory levels over the next six months? Would you say your inventory levels will... (among those that have inventory)

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

CYBERTHREATS FOR MIDDLE MARKET COMPANIES RISE BUT CONFIDENCE LEVEL INCREASES, MMBI DATA SHOW

Unauthorized users will attempt to access proprietary data at more than half of the middle market businesses polled by the MMBI survey in the first quarter—up significantly from 47 percent in 2018—illustrating that companies continue to battle the moving target of cyberthreats afflicting organizations of all sizes.

At the same time, some 93 percent of executives polled in the survey said they are confident in their organization's current measures to thwart attacks on critical information at their businesses.

Daimon Geopfert, national leader, security and privacy consulting at RSM, said this confidence speaks to a growing information gap between C-suite executives and their information technology teams that deal with day-to-day incidents on the ground.

"The numbers keep getting worse, but the group in their focus keeps getting more confident," says Geopfert, adding that he sees examples of this disconnect firsthand in his consulting practice.

Meanwhile, actual data breaches at middle market companies are creeping up as well; 15 percent of companies polled for the MMBI said they experienced a breach in 2018, compared with 13 percent a year earlier.

A special report based on the cybersecurity findings from the first quarter MMBI survey will be released in April.

The issue of data privacy is heating up in the United States following the advent of Europe's General Data Protection Regulation (GDPR) standard in May 2018. California has taken the lead on implementing legislation to protect the privacy of consumers in that state with a law that takes effect in 2020. Meanwhile, Congress has held recent hearings on the pros and cons of related legislation at the federal level.

MMBI survey respondents said moves to protect their companies' data security flanks included updating security protocols (73 percent), purchasing new software or updating existing systems (61 percent) and revamping privacy policies (55 percent). Sixty-eight percent of executives indicated their organization has a dedicated function for data security and privacy.

RSM and the U.S. Chamber of Commerce are following the issue of data security closely. A special report based on the cybersecurity findings from the first quarter MMBI survey will be released in April.

TOP OF MIND IN THE FIRST QUARTER

We asked about cybersecurity in this quarter's special questions section. Meanwhile, it appears that cyber-related themes were among the leading issues for many of the business owners polled. Here is a sampling of cyber-focused responses when executives were asked to describe "a top business concern" for their companies. RSM will issue an MMBI special report on our cyber findings in April.

"Cybercrime is the biggest problem our business is facing."

"Security and technology implementation, integration of it and process for profits and risk."

"Security issues. Worrying that our anti-virus and firewalls are always up to date."

"Facing security issues and spending a lot of money to protect company data."

"Security breach incidents."

"The risk of fraud. Taking business from online communication and the risk of fraud."

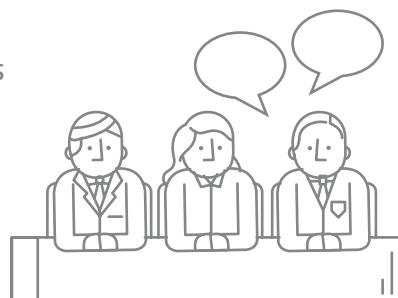
"We are facing security risk all the time."

"The top business problem facing our organization is the company data sometimes goes into risk because of lack of security."

"Security and compliance have been our major pain points for quite some time."

"Financial security electronic risk management."

"Cybersecurity is a major ongoing issue."



MIDDLE MARKET LEADERSHIP COUNCIL SURVEY: CURRENT PERCEPTIONS AND FUTURE EXPECTATIONS

METHODOLOGY

WHO

- A total of 700 senior executives were recruited by The Harris Poll via telephone using a Dun & Bradstreet (D&B) sample.
- These 700 panel members were invited by The Harris Poll to participate in four surveys in a one-year period.
- A total of 404 executives completed the survey, which was conducted between Jan. 14 and Feb. 1, 2019.
- All middle market executives were qualified as U.S. full-time senior executive decision-makers.
- *Selected industries included the following:*
 - Agriculture, forestry, fishing and hunting; mining, quarrying, and oil and gas extraction; utilities; construction; manufacturing; wholesale trade; retail trade; transportation and warehousing; information; finance and insurance; real estate and rental and leasing; professional, scientific, and technical services; administrative and support; waste management and remediation services; educational services; health care and social assistance; arts, entertainment and recreation; accommodation and food services; and other services (except public administration)

Other executive categories include the following:

- Nonfinancial or financial services companies with revenue of \$10 million–\$1 billion
- Financial institutions represented by AUM \$250 million–\$10 billion
- Executives involved in or responsible for business strategy or financial management strategy

WHEN

- Interviews were conducted on a quarterly basis over a 12-month period.

HOW

- Potential middle market executives were emailed a link to an online survey.
- Follow-up calls were made to middle market executives who did not respond to the online survey; they were given the option to complete the survey via telephone.

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RSM US Chief Economist Joe Brusuelas teams up with business author and co-host, Robert Reiss, for a series of provocative discussions with middle market CEOs. Get the details on game-changing strategies in industries ranging from restaurants to retail and manufacturing.

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HOW THE MMBI IS CONSTRUCTED

The MMBI is borne out of the subset of questions in the survey that ask middle market executives to report the change in a variety of indicators. Middle market executives are asked a total of 20 questions patterned after those in other qualitative business surveys, such as those from the Institute of Supply Management and the National Federation of Independent Businesses.

The 20 questions relate to changes in various measures of their business; such as revenues, profits, capital expenditures, hiring, employee compensation, prices paid, prices received and inventories. Middle market executives are asked to report the change from the previous quarter and to state the likely direction of these same indicators six months ahead. See a sample of the questions in Table 1.

The MMBI is a composite index computed as an equal weighted sum of the diffusion indexes for 10 survey questions plus 100 to keep the MMBI from becoming negative. The index is designed to capture both current and future conditions, with five questions on middle market executives' recent experience and five on their expectations for future activity.

TABLE 1: RSM US Middle Market Business Index questions

1. What are your expectations regarding the general economy?
2. What are your expectations regarding your organization's gross revenues?
3. How would you describe the level of your organization's most recent quarter net earnings results?
4. What are your expectations regarding your organization's aggregate capital expenditures or investments?
5. What are your expectations regarding your organization's overall hiring levels?
6. How would you describe your organization's current employee compensation level on average?
7. How would you describe current access to credit?
8. What are your expectations regarding your organization's planned borrowing?
9. How would you describe the current general level of prices received?
10. What are your expectations regarding your organization's planned inventory levels?

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U.S. CHAMBER OF COMMERCE