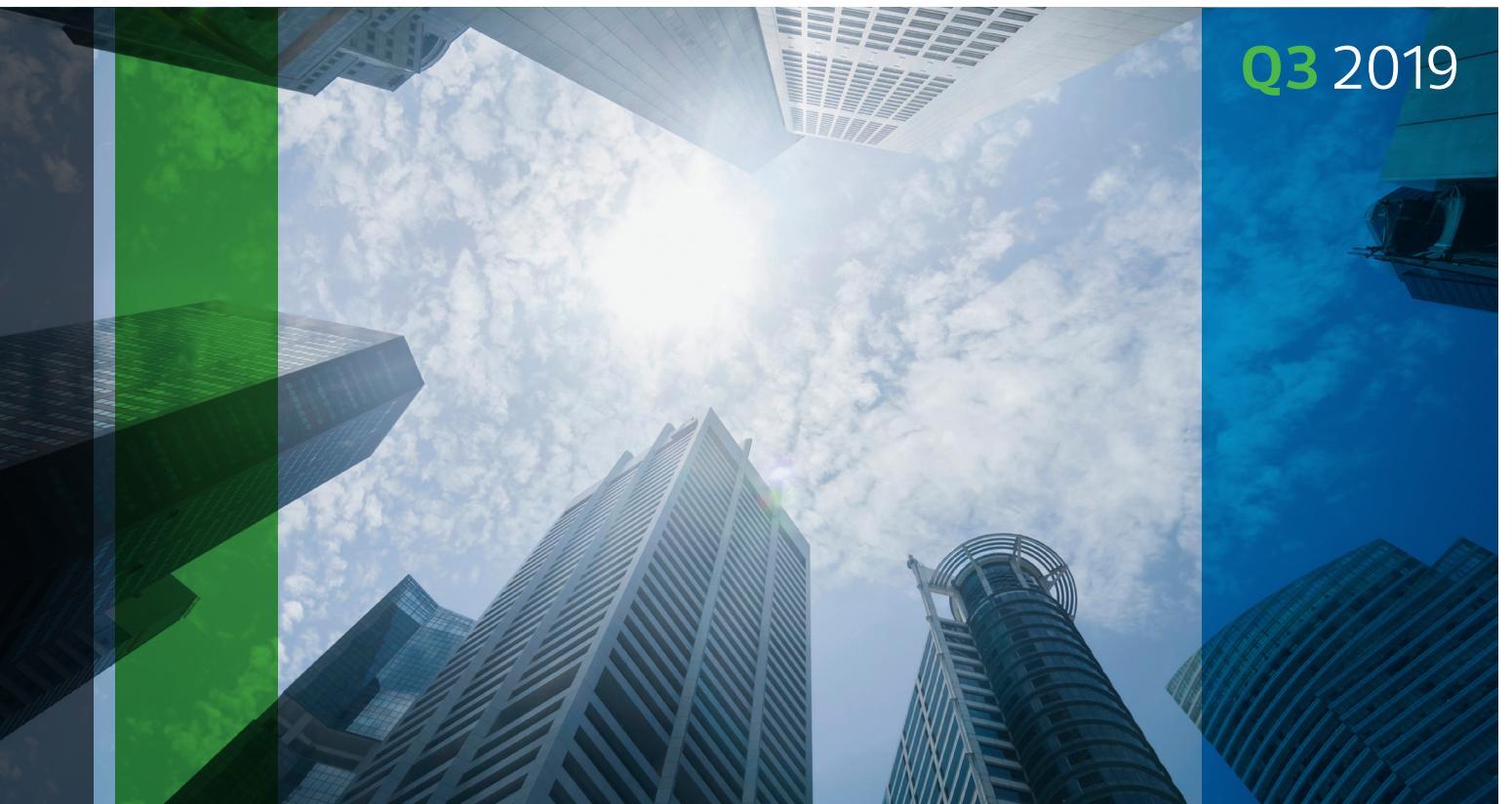


RSM US MIDDLE MARKET

# BUSINESS INDEX

IN PARTNERSHIP WITH THE  
U.S. CHAMBER OF COMMERCE



Q3 2019



U.S. CHAMBER OF COMMERCE



# RSM US MIDDLE MARKET BUSINESS INDEX

IN PARTNERSHIP WITH THE  
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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.



U.S. CHAMBER OF COMMERCE





# MIDDLE MARKET SENTIMENT WEIGHED DOWN BY UNCERTAINTY, SLOWING GLOBAL GROWTH; LOSES NEARLY 3 POINTS IN Q3

**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.

**“Rising tariffs and policy uncertainty are preventing midsize businesses—which employ millions of Americans—from investing and growing. To guard against a possible recession, policymakers need to restore economic certainty and that means deescalating trade tensions with China, passing USMCA, and investing in the future through an infrastructure package.”**

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

Middle market business sentiment declined in the third quarter of 2019 to 129.4 from 132.3 in the prior period, as overall global economic growth slowed and the trade war escalated.

RSM US Middle Market Business Index (MMBI)



# MMBI DECLINES AMID SLOWING GLOBAL GROWTH, HEIGHTENED UNCERTAINTY

## REVENUES AND PROFITS STRONG, DESPITE UNDERLYING RISK

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

Middle market business sentiment declined in the third quarter of 2019 to 129.4 from 132.3 in the prior period, as overall global economic growth slowed, the manufacturing sector continued to contract and tariffs began to affect business results. While current-quarter sentiment remains solid, forward-looking indicators in the survey's subindices denote some risk for middle market businesses in the months ahead.

It is important to note that the third-quarter MMBI survey was conducted prior to the most recent escalation of the trade war between the United States and China, the resulting impact on the global supply chain and the ensuing tightening of financial conditions reflected in declining stock prices, an inversion of the yield curve and a widening of credit spreads in the bond market. These developments may cause further deterioration of middle market business sentiment in coming quarters (see our *Middle Market Insight on tariffs* on page 14).

The heightened level of concern around the economy's direction is most noticeable in the relatively low number of middle market executives who indicated they expect to boost capital outlays on fixed business investment—a telltale sign of the heightened "uncertainty tax" resulting from instability in the macroeconomic environment.

In the current quarter, 49% of executives polled say they expect to increase capital spending during the next six months, down from 51% a year ago. Meanwhile, 44% increased capital expenditures in the current quarter, edging up slightly from 41% a year ago and 39% in the most recent period. Combined with the 42% of executives who noted an improvement in the economy in the current quarter and the 46% who expect continued improvement over the next six months, it is clear that the risk of deterioration in middle market business sentiment is elevated for the near-term.

Even with the modest growth in the economy that will likely define the second half of 2019, middle market businesses should begin to engage in the type of stress testing and financial modeling of their balance sheets consistent with the latter phases of past business cycles. Given the elevated risks in the global economy, which have spread to U.S. manufacturing and may shortly spill over into the U.S. services sector, the prudent path ahead involves planning for a premature end to the current business cycle (see our *Middle Market Insight on page 17 on business considerations*).



## A FOCUS ON BUSINESS SENTIMENT

A decelerating economy and increasing trade tensions underscore the importance of monitoring business and consumer sentiment. The question remains whether recent events will lead to even further deterioration in sentiment, which in turn will damp overall economic activity. During potential economic inflection points, business sentiment takes on increased importance and can provide an early warning sign of greater slowdowns in capital expenditures, hiring and compensation.

While middle market business sentiment tracked in the MMBI does not imply near-term risk of a greater slowdown—remaining well above levels consistent with an economic downturn—the easing in MMBI subindices relative to the top line does denote some impending risk. These forward-looking economic indicators reflect the broader slowdown in growth: Revenues, net earnings, hiring and planned capital outlays all weakened in the third quarter compared to a year ago; inventories, compensation and borrowing were stagnant.

## POLICY IMPLICATIONS

The MMBI third-quarter survey results are consistent with other business sentiment and CEO surveys, as well as our own RSM US Manufacturing Outlook Index, which reflects

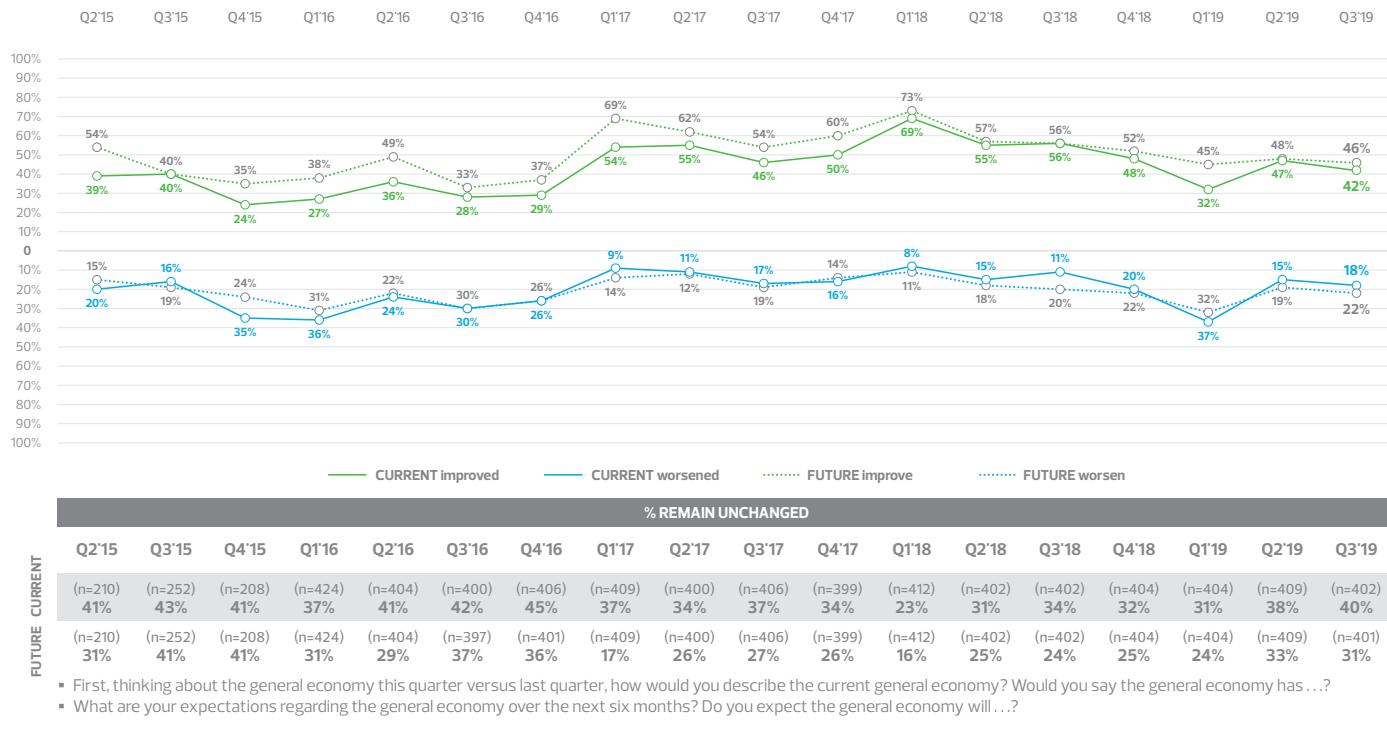
an ongoing downturn in the automotive and aerospace sectors. The manufacturing sector represents that part of the economy with the widest exposure to global disruptions caused by the trade war and volatility in the currency markets.

The global economy is slowing at a much faster pace than the U.S. economy, and it is now clear that worldwide manufacturing—which is interwoven with far-reaching supply chains—is in recession. Exposure to this sector will likely lead to a slower pace of growth in coming quarters, as well as a potential spread to the services sector, unless there is a significant change in trade policy. A key indicator of services sector performance, the ISM Non-Manufacturing Index, shows that services are now growing at their slowest pace in a decade.

Absent a larger policy error on trade, significant changes to interest rates or an exogenous shock to energy markets, our forecast stands that there will be no recession in 2019; however, we stress that the risks of an economic downturn over the next 12 months are now elevated.

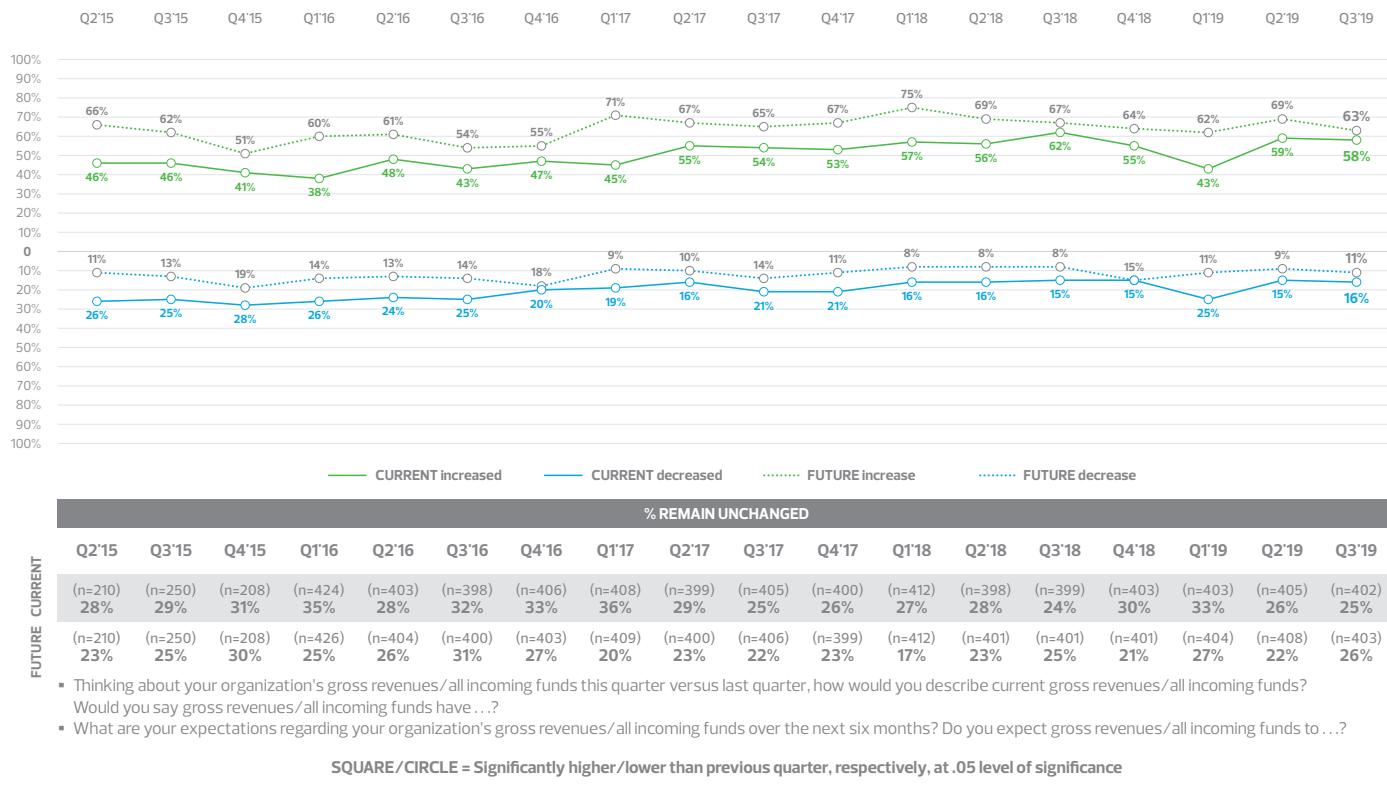
## GENERAL ECONOMY PERFORMANCE

Forty-two percent of middle market executives believe the general economy improved in the current quarter. Forty-six percent expect the economy to improve in the next six months.



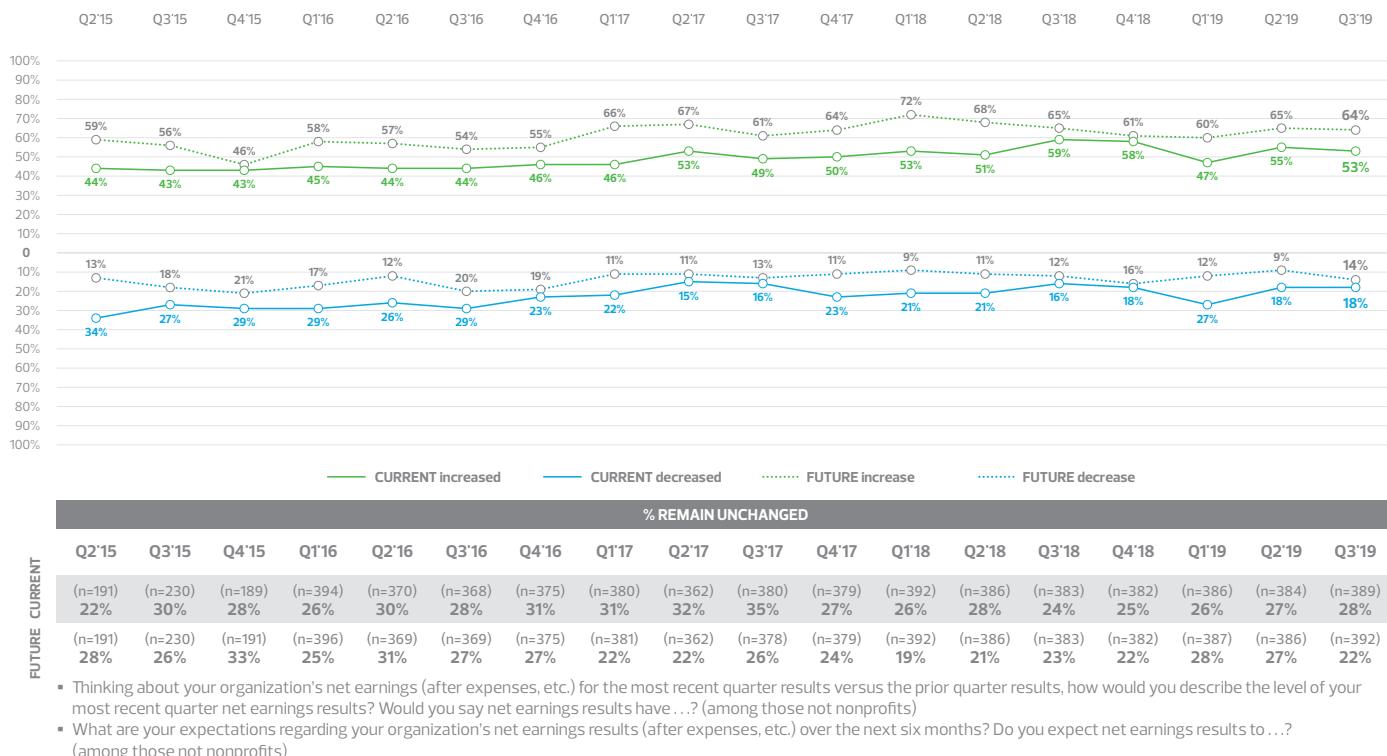
## GROSS REVENUE PERFORMANCE

Fifty-eight percent of executives reported gross revenues increased in the current quarter. Sixty-three percent expect revenues to increase in the next six months.



## NET EARNINGS PERFORMANCE

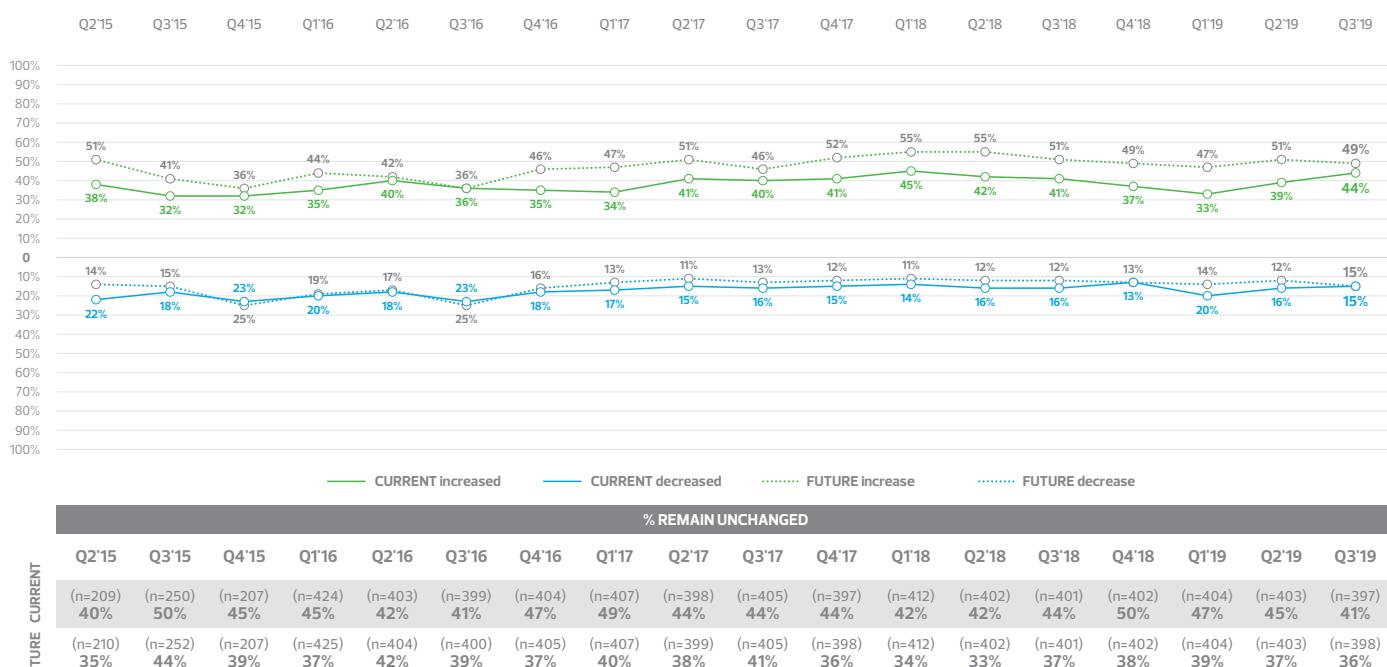
Fifty-three percent of middle market executives reported net earnings increased in the current quarter. Sixty-four percent expect earnings to increase in the next six months.



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

## AGGREGATE CAPITAL EXPENDITURES/INVESTMENTS PERFORMANCE

Similar to the prior quarter, 44% of middle market executives indicated capital expenditures increased during the current period.



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

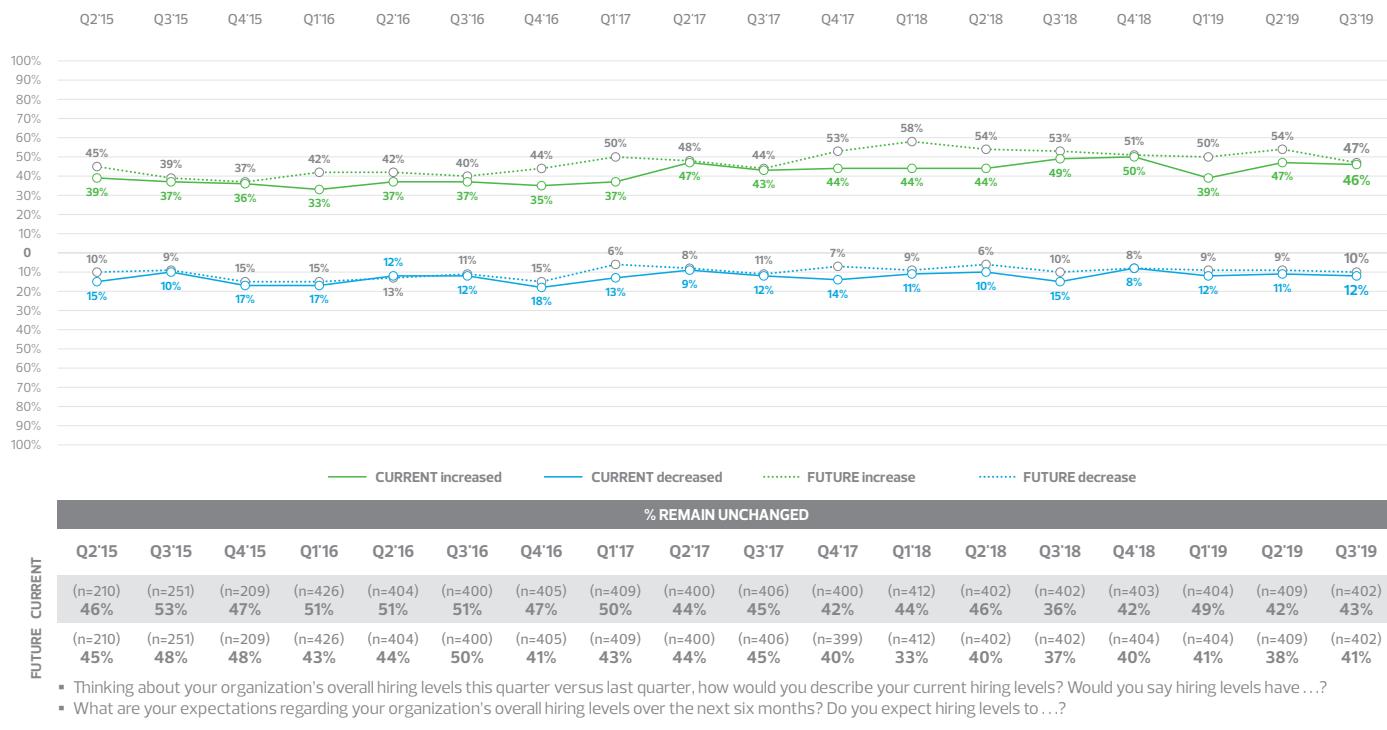
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BUSINESS INDEX Q3 2019



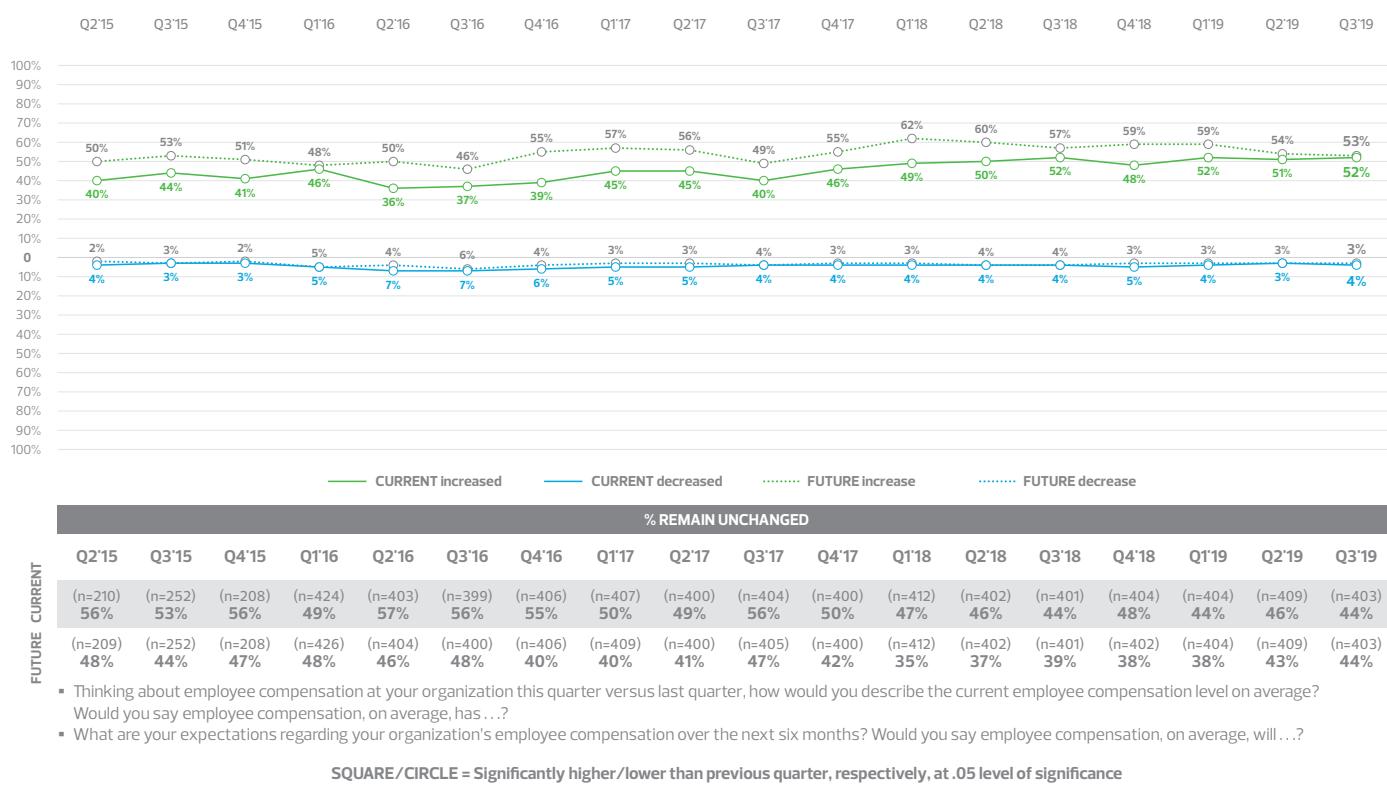
## OVERALL HIRING LEVELS

Forty-six percent of middle market executives reported hiring levels increased in the current quarter.



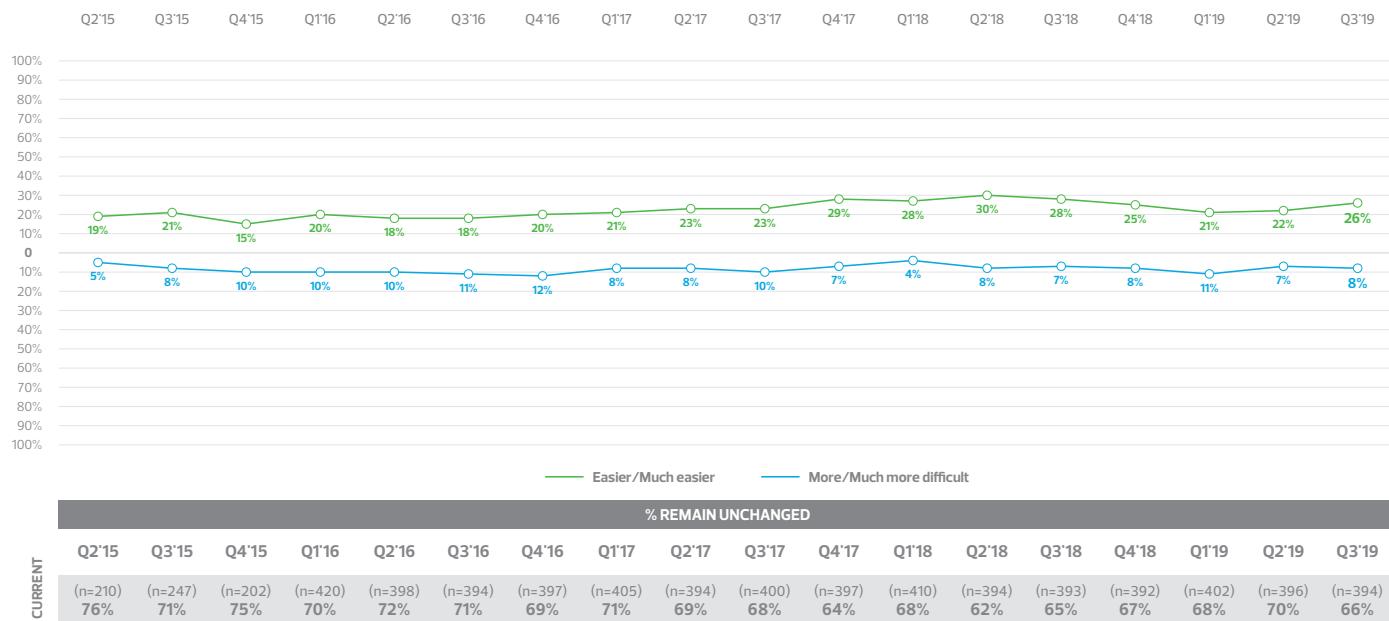
## EMPLOYEE COMPENSATION

About half of middle market executives say compensation for employees has increased—similar to the previous quarter.



## ACCESS TO CREDIT

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



- 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

Thirteen percent of middle market executives expect planned borrowing over the next six months will decrease.

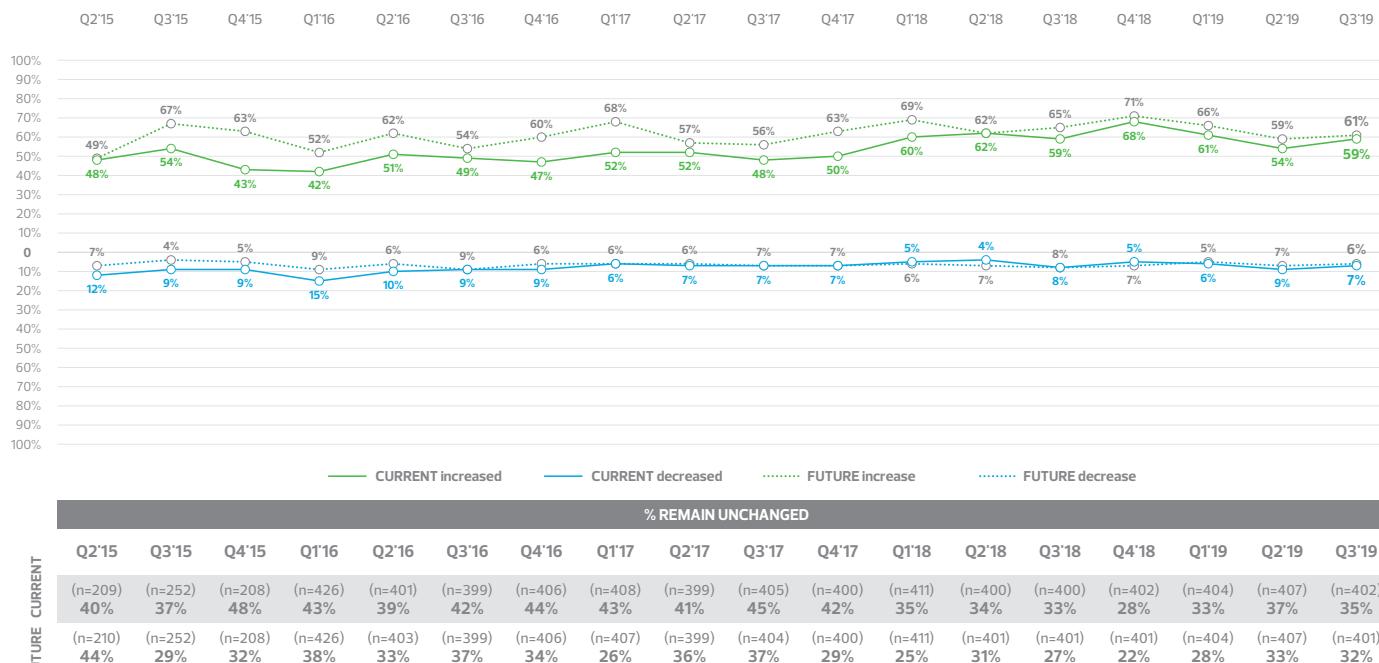


- What are your expectations regarding your organization's planned borrowing over the next six months? Would you say your organization's borrowing will...?

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

## AMOUNT PAID FOR GOODS AND SERVICES

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



FUTURE CURRENT

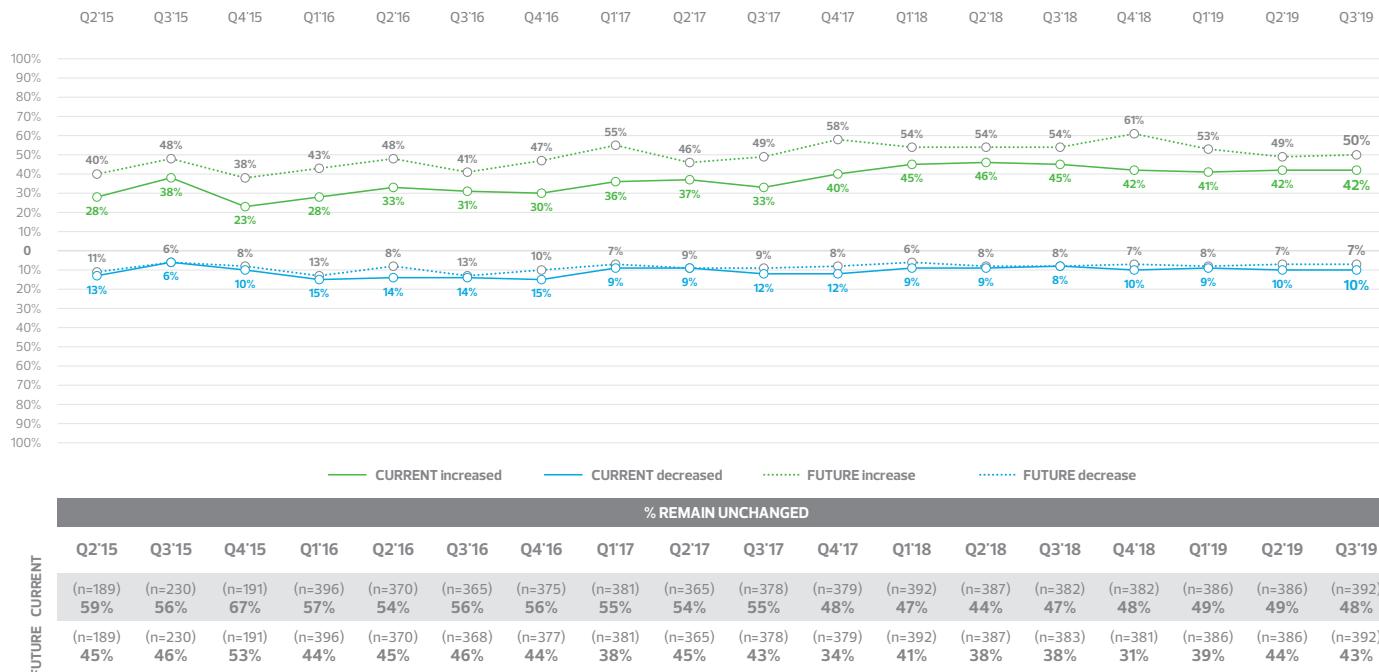
FUTURE

- 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

Forty-two percent of middle market executives reported the amount received for goods and services increased in the current quarter.



FUTURE CURRENT

- 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 stated in the second quarter.



## 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

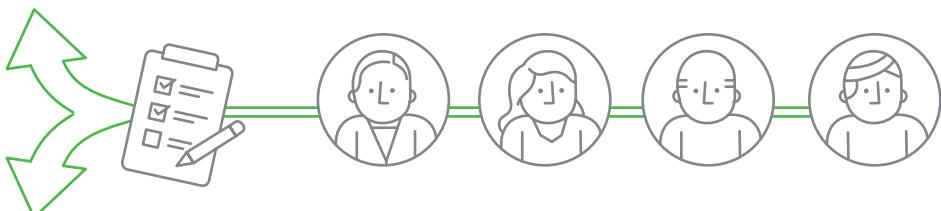
1. What are your expectations regarding the general economy?
2. What are your expectations regarding your organization's gross revenues?
3. How would you describe the level of your organization's most recent quarter net earnings results?
4. What are your expectations regarding your organization's aggregate 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?



# MIDDLE MARKET INSIGHT: TARIFFS CONTINUE TO WEIGH ON BUSINESS

A significant number of executives report that tariffs were having a negative impact on their business prior to the recent escalation of the trade war and the subsequent volatility in the foreign exchange markets that began in the middle of the third quarter.

**40%** of executives surveyed said the imposition of tariffs on imported goods was having a negative impact on their business.

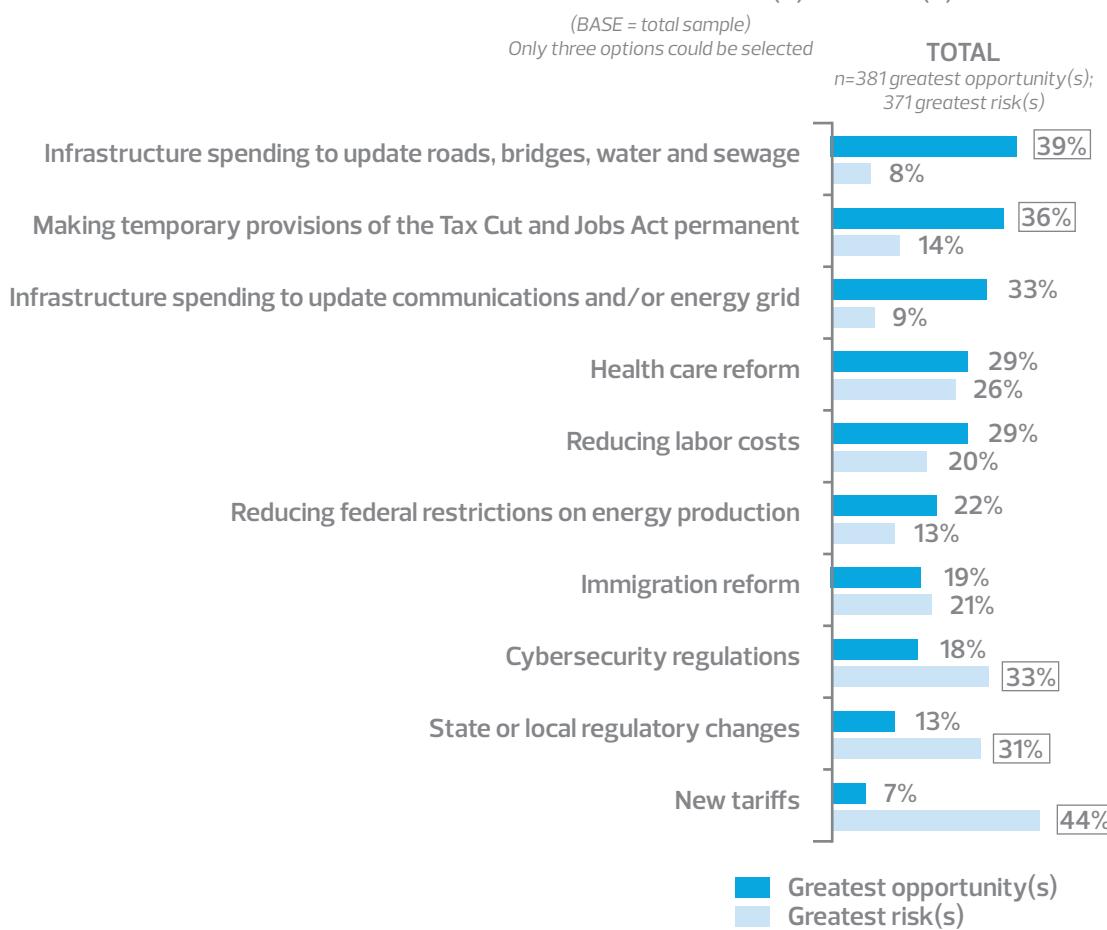


**26%** said retaliatory tariffs placed on exported goods were damaging to their business.

## POLICY CONSIDERATIONS FROM THE MIDDLE MARKET

Cessation of the trade war, investment in infrastructure and making permanent the temporary provisions of the Tax Cuts and Jobs Act top the list of policy priorities for middle market businesses as indicated in our third quarter MMBI special questions. These are followed closely by cybersecurity regulation, which is increasing costs for businesses as they work to navigate the growing patchwork of global and state regulations.

### POLICY CHANGES PRESENT GREATEST OPPORTUNITY(S) AND RISK(S) TO ORGANIZATION



R3 Which of the following policy changes presents the greatest opportunity(s) and the greatest risk(s) to your organization? Please select up to three in each column.

# MIDDLE MARKET INSIGHT: END-OF-BUSINESS-CYCLE CONSIDERATIONS

With increased risk due to the trade war, a global and domestic manufacturing slowdown and volatility in financial markets, middle market leaders should begin stress testing their businesses. The following seven items and key questions can serve as a place to begin:



## END-OF-BUSINESS-CYCLE CONSIDERATIONS FOR MIDDLE MARKET EXECUTIVES

- In the event of an economic slowdown and tighter financial conditions, how are you preparing your business for changes in cash flows and costs, inventory management, talent recruitment, acquisitions, supply chain, capital expenditures and more?
- What investments do you plan to make in the coming 12 months to improve your business with respect to your customer base, technology, new product launches and other growth strategies? What stress could these efforts put on your business if the economy slows?
- Have you completed a thorough review of processes and procedures, both on the operational side of your business, as well as within the back office? This effort may lead to much-needed improvements and cost-saving efficiencies, especially helpful in an economic downturn.
- Have you made moves to diversify your supply chain to mitigate exposure to tariffs?
- Have you evaluated key tax considerations? Assess your tax situation and make sure you are positioned to take advantage of all benefits.
- Do you have a perspective on how shifts in the broader economy may affect competitors, your suppliers or others in your space that could affect your business and/or your market opportunities?

## MIDDLE MARKET INSIGHT: SILVER LINING IN THE SLOWDOWN

The inverted yield curve indicates that interest rates will continue to decrease and likely remain low for a significant period of time. If we enter an economic downturn, middle market businesses with strong balance sheets stand to benefit by financing productivity-enhancing investments in technology at very low rates or growing their footprints through mergers and acquisitions. Capital investment across the middle market has been tepid throughout the current business cycle, so a slowdown could represent a significant opportunity for leading middle market businesses to gain competitive advantage.



## SELECT COMMENTARY HIGHLIGHTING EXECUTIVES' TOP-OF-MIND CONCERN IN THE THIRD QUARTER ILLUSTRATES THE IMPACT OF TARIFFS AND TRADE POLICY.

"Tariffs."

"Tariffs being imposed on other trade partners in the world."

"It is the global politics and arguments."

"The biggest business problem that we have is getting materials on time to finish projects and move on. Shipping is inconsistent for most vendors."

"Complying with an ever-changing system of regulations in a polarized economic and political culture."

"The bottom line is that uncertainty leads to a short-term focus."

# 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 403 executives completed the survey, which was conducted between July 15, 2019 and Aug. 2, 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.

For more information on RSM, please visit [www.rsmus.com](http://www.rsmus.com).

For media inquiries, please contact Terri Andrews, National Public Relations Director, +1 980 233 4710 or [terri.andrews@rsmus.com](mailto:terri.andrews@rsmus.com).

For details about RSM US LLP thought leadership, please contact Deborah Cohen, Thought Leadership Director, +1 312 634 3975 or [deborah.cohen@rsmus.com](mailto:deborah.cohen@rsmus.com).



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For media inquiries, please contact the U.S. Chamber of Commerce at +1 202 463 5682 or [press@uschamber.com](mailto:press@uschamber.com).

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