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US Equity Strategy | North America

2020 Outlook – What Investors Are Saying

Marketing our 2020 outlook, many investors agree that global growth is bottoming and see relative upside in ex-US equities. Points of disagreement: investors see more upside for earnings growth and valuation.

Our 2020 outlook in brief: Easier monetary policy and trade stabilization will help global growth accelerate, but only stabilize GDP growth in the US at 1.8%, leaving pressure on corporate margins from tight labor markets. Near term, central bank liquidity could help the S&P 500 overshoot the upper end of our 2020 bull case of 3,250, but by April, the liquidity tailwind will fade and the market will focus more on the fundamentals, where uncertainty is higher than normal. We could see growth surprising to the upside or the downside, depending on a number of uncertain outcomes on trade and rates. After the recent rally, equity markets are now pricing a decent recovery, so upside appears limited. Uncertainty means rotations should continue and their durability will depend on whether growth is accelerating or decelerating. We expect the market to vacillate between a pro-cyclical outcome and a defensive one as data come in and trade tensions and the election evolve. In either case, we think Growth stocks could be the underperformer as the crowded source of funds. A better ex-US growth outlook and cheaper valuations means we prefer ex-US equities to the US.

In marketing our outlooks, we saw a number of areas where investors generally agreed with us. . . We heard broad agreement that a US-China trade deal looks likely but unexciting, that global growth is troughing and that ex-US equities offered better return prospects relative to the US. Investors seemed more positive on Asia and EM, but a reasonable number also saw European upside. Most investors see limited upside to the S&P but agree central bank balance sheet expansion could lead to an overshoot of fair value.

. . and a number of areas where opinions differed. We heard common push back that we are (modestly) too bearish on earnings growth and the outlook for cyclicals, as many investors expect better global growth to translate into more robust US earnings growth. We also received push back on our relative preference for defensives, with some investors seeing cyclical upside vs defensives as growth and rates inflect and other, less sanguine investors, preferring Growth to defensives given only a modest rebound expected in the US economy. Another common theme was that we are not bearish enough around the potential impact of the US election on business sentiment, investment, and the market multiple.

MORGAN STANLEY & CO. LLC

Michael J Wilson
EQUITY STRATEGIST
M.Wilson@morganstanley.com +1 212 761-2532

Adam Virgadamo, CFA
EQUITY STRATEGIST
Adam.Virgadamo@morganstanley.com +1 212 761-1376

Andrew B Pauker
EQUITY STRATEGIST
Andrew.Pauker@morganstanley.com +1 212 761-1330

Michelle M. Weaver
EQUITY STRATEGIST
Michelle.M.Weaver@morganstanley.com +1 212 296-5254

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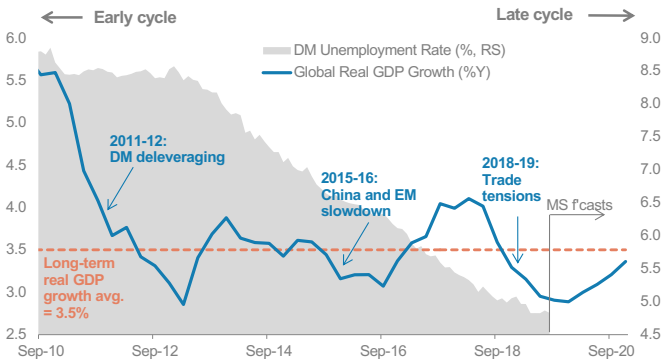
What to Focus on This Week

2020 Outlook: Where investors agreed with us

Marketing our 2020 outlooks, we heard broad agreement that a US-China trade deal looks likely, that global growth is troughing and that ex-US equities offer better return prospects relative to the US. We go through the points of broader agreement from investors below.

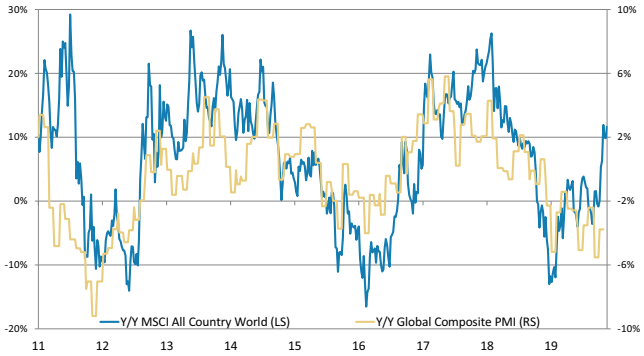
Global growth is troughing. Our economists have global growth going from 3% in 2019 to 3.2% in 2020 (Exhibit 1). The inflection in growth is supported by trade tensions and monetary policy that are concurrently easing and is principally led by emerging market countries. Clients were almost universally on board with this call, with many noting that global PMIs look to be showing signs of troughing. As we pointed out in our equities outlook, market performance and sentiment seem to line up with the idea that the trough in global growth is in and potentially priced (Exhibit 2).

Exhibit 1: Another Mini-cycle Recovery in the Context of a Late-cycle Expansion



Source: Haver Analytics, CEIC, national sources, IMF, Morgan Stanley Research forecasts; Note: Global GDP includes economies under Morgan Stanley coverage, and the real GDP growth is the PPP-based GDP-weighted average.

Exhibit 2: Market Is Pricing a Turn in PMIs

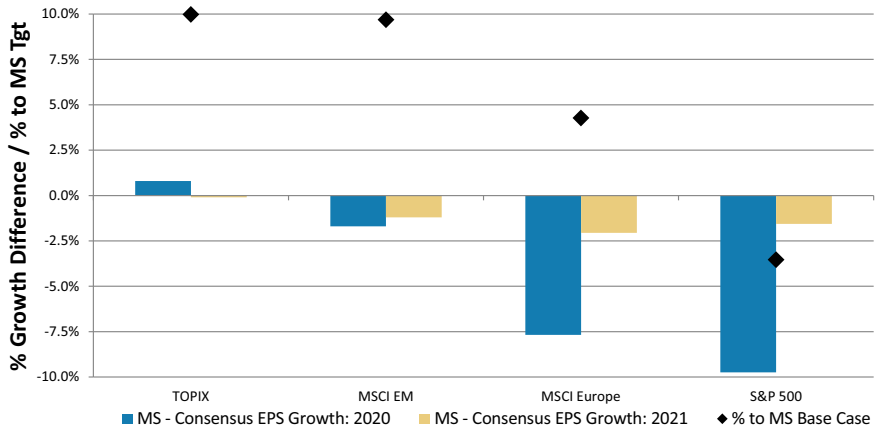


Source: Markit, national sources, IMF, Morgan Stanley Research.

Rest of world over US. The natural corollary to a global growth inflection led by countries outside the US is that globally levered markets with more export exposure should be relative beneficiaries. Our regional equity preferences reflect this dynamic – among the major regions, we have Japan and EM as relative overweights, in-line European exposure, and underweight US exposure – as we favored regions where earnings growth looked most likely to be achievable (Exhibit 3). Our colleagues in Asia also upgraded Korea given its outsized exposure to trade. The single "top choice" market varied by investor, but most tended to prefer markets ex-US on the better global growth theme. On the margin, we probably heard a bit more positive sentiment on EM and Asia, but this may have reflected some home bias given we spent time marketing in Asia last week. On net, we were a bit surprised at more clients warming up to both Japan and Europe after general disinterest in recent years. To be clear, investors are far from abandoning the US, and most are still overweight the region given the nearly universal belief in central banks' ability to reflate asset prices and confidence that the S&P 500

remains the "safest," if not the most levered, way to play an overshoot to the upside.

Exhibit 3: We Favor Markets With Higher Earnings Achievability

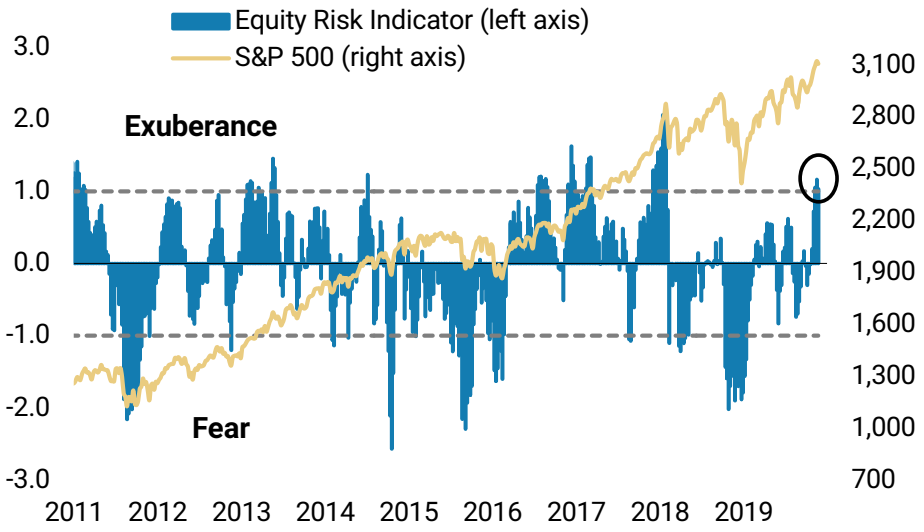


Source: FactSet, Morgan Stanley Research.

US & China trade negotiations will likely end with a benign market outcome. A durable pause in escalating trade tensions was a central point of our outlooks globally. A removal of uncertainty related to trade allowed our economists to assume better global growth and a reduction in global recession risks. The forecasts for better global growth are central to our views on rest of world over US equities and a weaker USD. Most investors with whom we spoke were similarly optimistic on the outcome for trade talks. While the exact details of a deal are hard to predict, the feeling seemed to be that the sides are likely close enough, and that incentives on both sides favor striking a deal that stops rising tariffs at a minimum and maybe sets a path to tariff rollbacks. Over the past few weeks, a majority of investors we spoke with are now expecting a rollback of the September tariffs with a Phase 1 deal or a credible path to achieving that rollback in Phase 2.

Forecasting the next two months, let alone a year, is hard, and uncertainty bands grow through the year. As is usually the case at this time of year, year end was keenly in focus for most investors. We noted that year-end seasonality and central bank liquidity could drive the market higher near term before a more subdued earnings outlook weighed on the broader market. Investors understood the upside case, but are also becoming increasingly aware of positioning that has turned rapidly positive and sentiment/technicals that are starting to look a bit stretched (Exhibit 4). In essence, there is hope for upside into year end, but lower conviction. Headed into 2020, we distinctly had the sense that the optimism on global growth and what it means for markets is more of a show-me story from 2H on as the initial inflection in growth will need to be sustained, and that is harder to do given a still late cycle environment.

Exhibit 4: Equity Risk Indicator (our proprietary sentiment/positioning gauge) Is in Exuberant Territory



Source: Morgan Stanley Research as of November 21, 2019.

Focus on rotations over index levels. We raised our S&P 500 bull/base/bear year-end 2020 cases to 3250/3000/2750. We expected that having a year-ahead target below the current S&P price level would invite some controversy and criticism. It didn't. Our 3000 base case assumes a 17x multiple (vs 17.5x current) on $177 in 2021 earnings (0%/9% EPS growth in 2020/2021). Investors thought we were perhaps a bit light on 2020 earnings, but were not confident about the multiple, which, on net, left them a little closer to our 3250 bull case. Either way, we did not hear too many voices calling for large upside for the S&P 500 index by the end of 2020, given US election and still late cycle economic dynamics. Instead, investors seemed to agree with our call that a modest growth environment and a stretched relative safety trade would make the market particularly susceptible to rotations over the year and that these rotations would be the key determinants of performance. Identifying how to position for these rotations now is where we started to hear a broader divergence of opinions – both from our views and among investors.

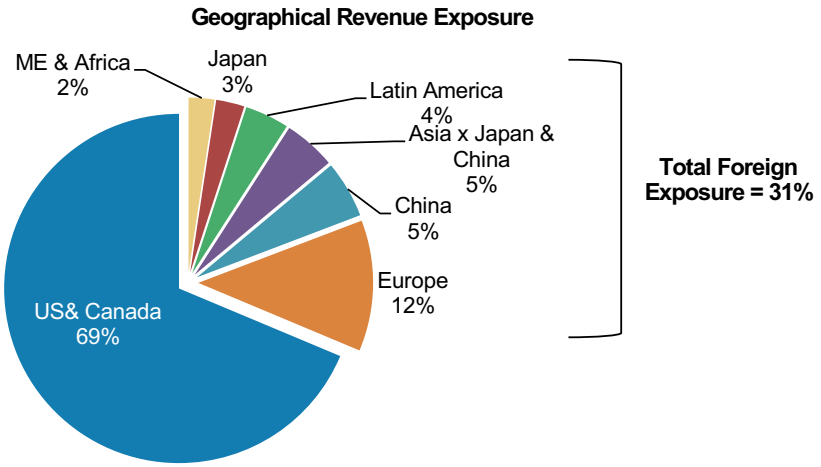
2020 Outlook: Where investors had different opinions

Marketing our 2020 outlooks, we heard some common push back that we are too bearish on earnings growth and the outlook for cyclicals, are overstating rotational risks in Growth, and are not bearish enough around the potential impact of the US election on business sentiment, investment, and the market multiple. We go through the points of broader push back from investors below.

We're too bearish earnings. We didn't hear from many investors who were very bullish on the S&P 500 price, but most were marginally more positive than us, with the base cases closer to our bull case. Some of this is simply due to timing – i.e. our targets are based on where we think S&P 500 will trade at year end 2020 rather than throughout the year. The key fundamental difference in views was around earnings. Similar to last year, our earnings model is telling us that the consensus forecast of 10% EPS growth in 2020 is likely to miss and actually be closer to 0%. Many investors seemed to think that with better global growth and a weaker USD, consensus markdowns should be closer to

their "usual", meaning we should end the year with ~5% EPS growth if not a bit more. Those who were more bullish cited a global economy that should lift exports for tech- and commodity-focused firms. We're sympathetic to the view that rising global growth should favor firms and industries geared toward international markets, and if global growth surprises to the upside, our earnings forecasts may prove too bearish with respect to those parts of the market. In the aggregate though, we'd note that US company revenues tie roughly 70% to North America and another 12% to Europe (Exhibit 5), so an EM inflection in growth can only go so far to offset US domestic earnings and margin pressures. Furthermore, if one is bullish on global growth accelerating, we believe there are more direct and cheaper ways to get exposure to it via international markets – namely, Japan, S. Korea and Germany.

Exhibit 5: US Company Sales Don't Line Up With Regions Where Growth Is Inflecting Most Next Year



Source: FactSet, Morgan Stanley Research Estimates

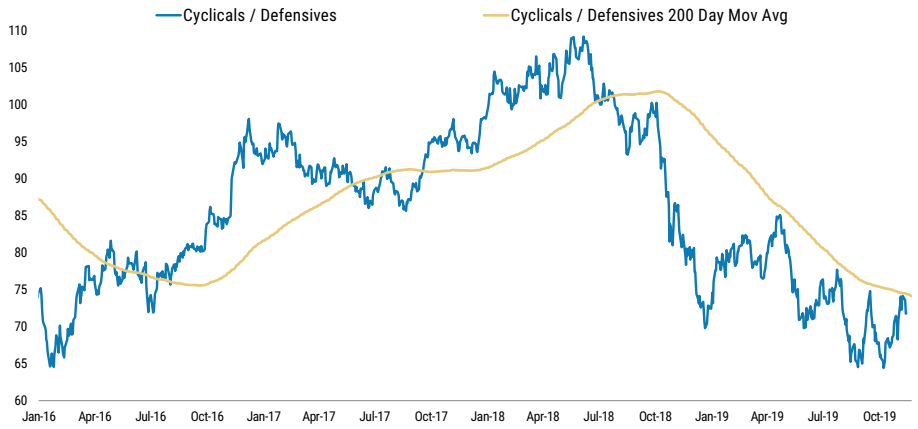
Defensive positioning is likely to be wrong, the right trade is. . . We retain our defensive overweights – Staples and Utilities – along with Financials for a cyclical hedge that we think is priced appropriately for downside risks. Our views on broad-based earnings risk and a market that we think is already pricing in the effects of easing trade tensions and monetary policy leaves us reluctant to chase cyclicals after a recent rally, and we think rotational risk (on faster or slower growth) works against the crowded Growth factor. There was not a lot of support for this view, but the push back came in two forms:

- **. . .cyclicals.** One camp of investors believed that better global growth should translate to better US earnings, robust PMI rebounds, a resumption in business investment in the US, and a re-rating of cyclicals. This camp saw the recent rally of cyclicals vs defensives (Exhibit 6) as more durable and wanted to play for further upside on the back of a mini-cycle reset. They were also firmly of the view that recession risks are greatly reduced.

- **...Growth.** Another camp, and probably the majority, was focused on an inflecting, but still slow, growth outlook. On our forecasts, 1.8% GDP growth in the US next year is hardly exciting. They were of the view that the recent run in cyclicals pricing in better growth was about short covering and lowering a bear case probability on the economy, not a durable shift in attitudes on growth. In a low-growth world, they contend that owning Growth stocks is still the right path to higher returns.

When pressed for risks to Growth stocks, this group seemed more concerned about a further slowing that could impact Growth stock earnings and multiples if current forecasts are too optimistic (closer to our view) than a rotation into cyclicals in a better growth environment.

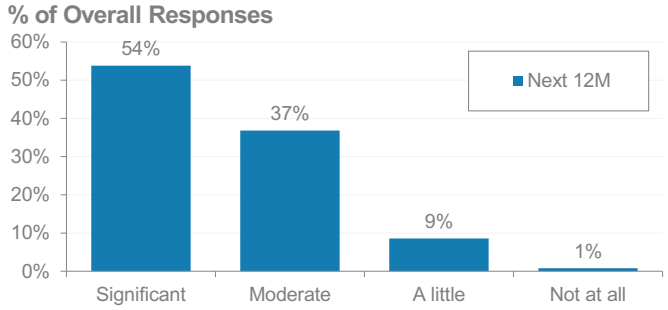
Exhibit 6: We're Skeptical Cyclicals Continue Recent Outperformance. Many Investors Disagree



Source: Bloomberg, Morgan Stanley Research. Note: The index above represents an equal notional pair trade of going long a group of higher beta cyclicals from the Discretionary, Energy, Industrials, Materials, and Technology sectors vs short a group of stocks from more defensive sectors – Health Care, Consumer Staples, Telco Services, an Utilities. The long and short sides are rebalanced to equal notional amounts at the start of each day.

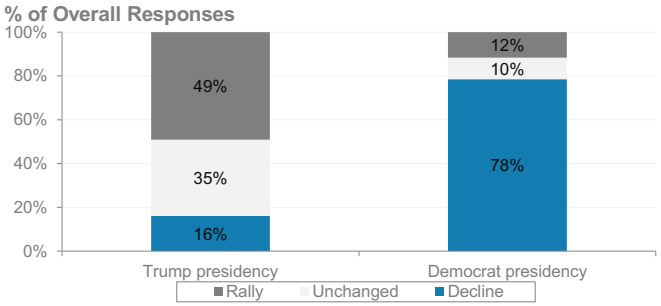
The election is a bigger deal than we make it out to be. We took the view that, given a complicated mix of variables, and the need for a unified government outcome to deliver meaningful policy change for the economy as a whole, that the impact to the overall direction of the market is not reliably predictable this far out. There are too many other fundamental forces that can impact the direction of markets, so outside of certain sectors where even regulatory impact could be important, we cannot call the impact of the election on the market at this time. Many investors had a different view. These investors cited risk to business sentiment and investment heading into the election and the potential for regulatory change to affect large swaths of the economy, even in the absence of legislation, as real headwinds for the economy. Similarly they saw headwinds to valuation given higher uncertainty. We note that this is consistent with the results of the investor survey from our 2020 Election Outlook where most investors expected the election to have a significant impact (Exhibit 7), with impact projected to be more negative with a Democratic win (Exhibit 8).

Exhibit 7: Survey Results: What impact, if any, does the US presidential election have on your market outlook over the next 12 months?



Source: Morgan Stanley Research.

Exhibit 8: Survey Results: How do you expect equities to perform during the first three months of a Trump/Democrat presidency?



Source: Morgan Stanley Research.

Fresh Money Buy List Updates

Each week, we will use a section of our Weekly Warm Up to provide brief updates on select stocks on our Fresh Money Buy List.

Exhibit 9: Fresh Money Buy List - Stats & Performance

Company Name	Ticker	MS Analyst Rating	Sector	Market Cap ($Bn)	Price	MS PT	% to MS PT	MS Analyst	Date Added	Total Return Since Inclusion	
										Absolute	Rel. to S&P
Walt Disney Co	DIS	Overweight	Communication Services	$269	$148.29	$160.00	8%	Swinburne, Benjamin	3/14/2018	46.1%	29.8%
Humana Inc	HUM	Overweight	Health Care	$46	$338.24	$360.00	6%	Goldwasser, Ricky	7/19/2018	7.7%	(5.8%)
Iqvia Holdings Inc	IQV	Overweight	Health Care	$29	$143.74	$170.00	18%	Goldwasser, Ricky	3/14/2018	36.0%	19.7%
Coca-Cola Co.	KO	Overweight	Consumer Staples	$229	$53.03	$60.00	13%	Mohsenian, Dara	8/5/2019	2.1%	(4.7%)
Microsoft	MSFT	Overweight	Information Technology	$1,153	$149.59	$157.00	5%	Weiss, Keith	3/14/2018	62.8%	46.5%
NextEra Energy Inc	NEE	Overweight	Utilities	$113	$233.38	$242.00	4%	Byrd, Stephen	3/14/2018	56.8%	40.4%
Philip Morris Intl.	PM	Overweight	Consumer Staples	$128	$82.38	$92.00	12%	Kaufman, Pamela	7/29/2019	(2.6%)	(6.1%)
Procter & Gamble Co.	PG	Overweight	Consumer Staples	$318	$120.29	$134.00	11%	Mohsenian, Dara	3/18/2019	19.8%	8.1%
Progressive Corp	PGR	Overweight	Financials	$42	$70.83	$84.00	19%	Phillips, Michael W.	12/3/2018	11.4%	(3.6%)
T-Mobile US, Inc.	TMUS	++	Communication Services	$68	$78.59	++	++	Flannery, Simon	3/14/2018	20.9%	4.6%
Current List Performance											
Average (Eq. Weight)				$240			11%			26.1%	12.9%
Median				$120			11%			20.4%	6.4%
% Positive Returns (Abs. / Rel.)										90%	60%
% Negative Returns (Abs. / Rel.)										10%	40%
Avg. Hold Period (Months)											14.8
All Time List Performance											
Average (Eq. Weight)										11.9%	2.7%
Median										7.7%	(3.6%)
% Positive Returns (Abs. / Rel.)										65%	41%
% Negative Returns (Abs. / Rel.)										35%	59%
Avg. Hold Period (Months)											12.0

++ Rating and other information has been removed from consideration in this report because, under applicable law and/or Morgan Stanley policy, Morgan Stanley may be precluded from issuing such information with respect to this company at this time.

Performance returns shown above represent local currency total returns, including dividends and excluding brokerage commission. Returns are calculated using the closing price on the last trading day before the date shown in the "Date Added" column through close on the last trading day prior to publication of this report for stocks currently on the list and through close on the day of removal for stocks formerly on the list. These figures are not audited. Past performance is no guarantee of future results.

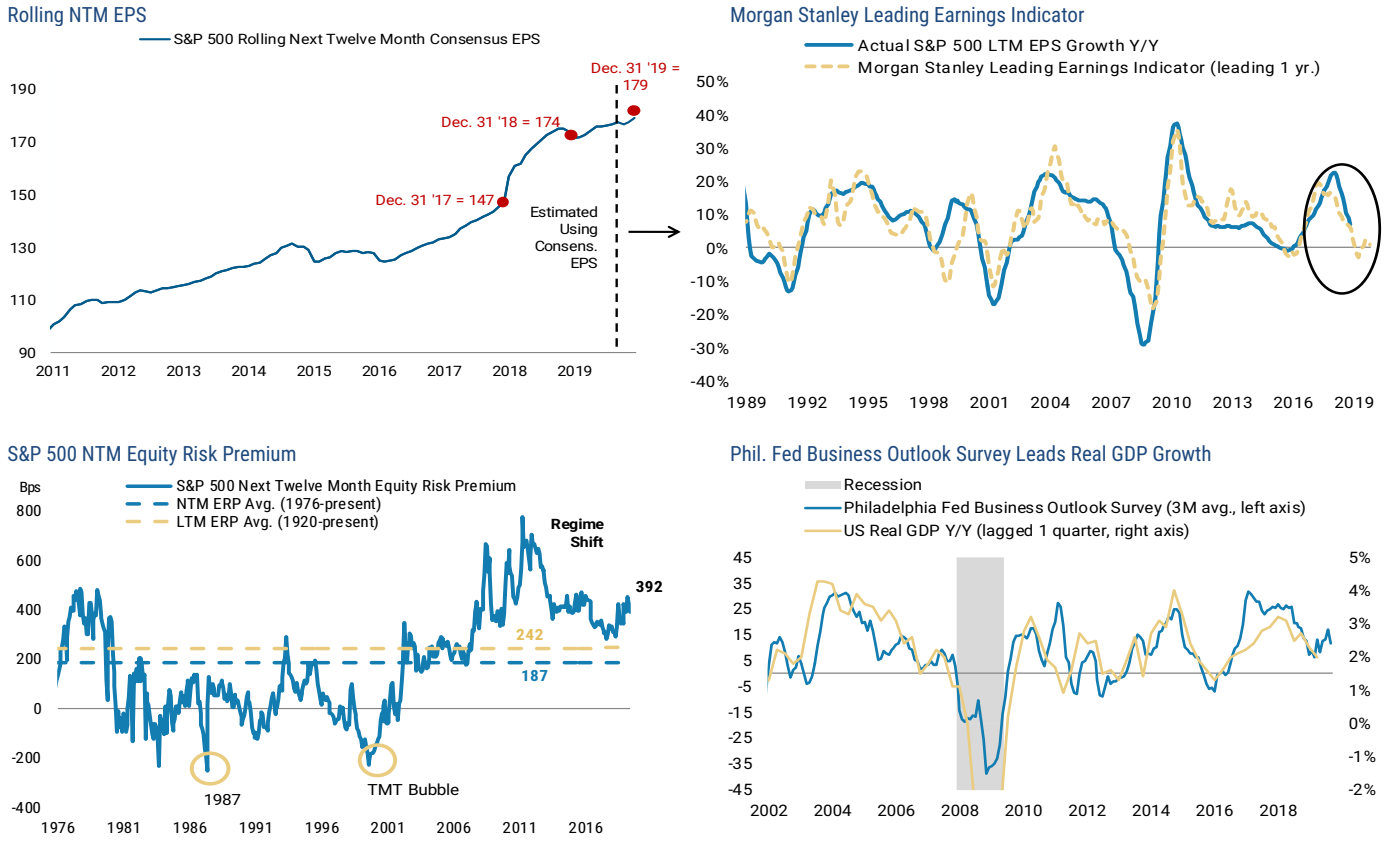
Source: Bloomberg, Morgan Stanley Research

Humana (HUM), Ricky Goldwasser

- **Takeaways from Meeting with Management Support Our Bullish View** - Meeting w/ management reinforces laser focused strategy on expanding existing MA book and delivering operating efficiencies that should translate into an accelerated earnings profile beyond 2020. HIF repeal provides upside optionality in 2021, new Warren plan favorable as well. Raising PT to $360.

Weekly Charts to Watch

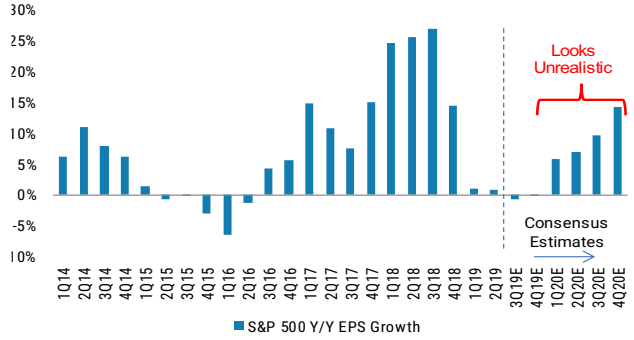
Exhibit 10: Four Charts to Focus On



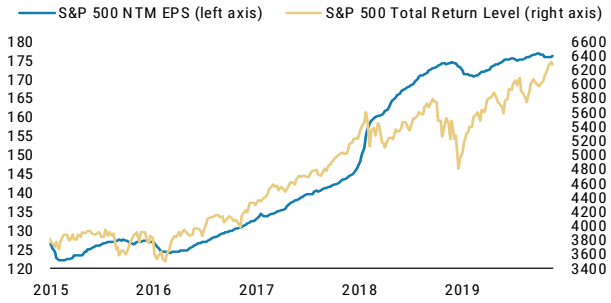
Source: FactSet, Bloomberg, Robert Shiller, Morgan Stanley Research. Top Left: As of October 31, 2019. Top right: As of October 31, 2019. Bottom Left: As of November 21, 2019. Bottom Right: As of October 31, 2019. MS Leading Earnings Indicator is a macro factor based earnings model that leads actual earnings growth by one year with a 0.7 12-month leading correlation. Note: S&P 500 fundamental data used post March 1993; Top 500 by market cap data used before 1993. LTM equity risk premium average is since 1920. ERP based on forward earnings yield and 10-year Treasury Yield.

Exhibit 11: US Earnings Snapshot

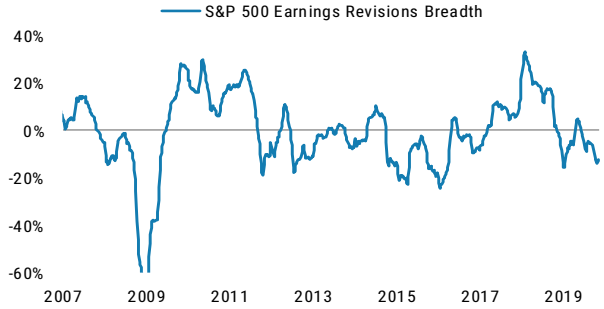
S&P 500 Y/Y EPS Growth



S&P 500 NTM EPS vs. Total Return Level



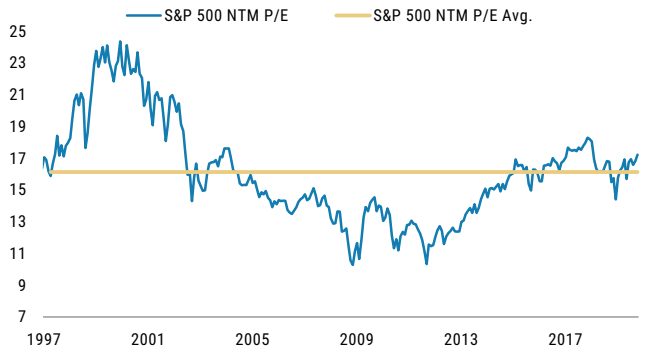
S&P 500 Earnings Revisions Breadth



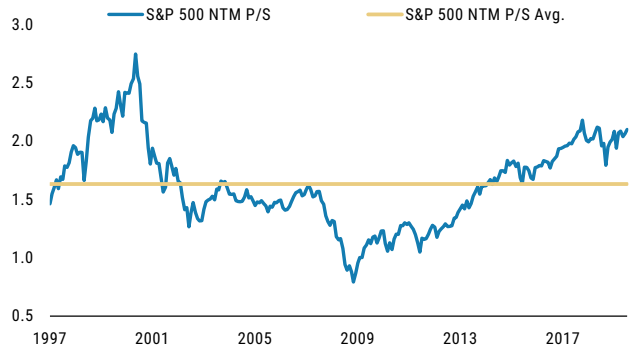
Source: Thomson Financial, FactSet, Morgan Stanley Research. Top: As of November 22, 2019. Bottom: As of November 20, 2019.

Exhibit 12: US Equity Market Traditional Valuation Measures

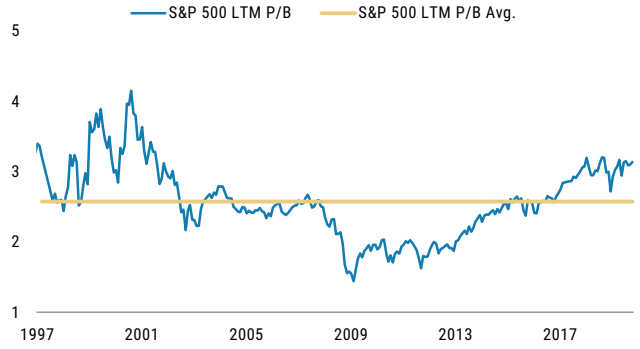
S&P 500 NTM P/E



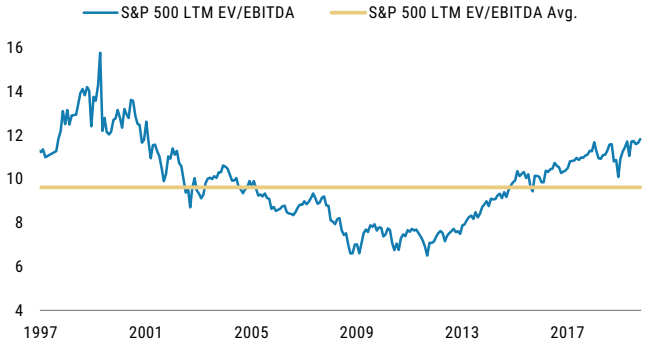
S&P 500 NTM P/S



S&P 500 NTM P/B



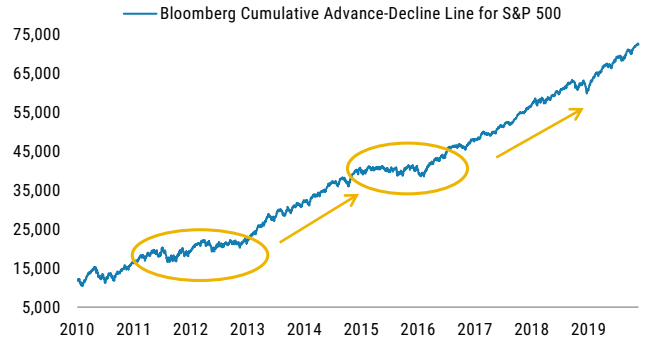
S&P 500 NTM EV/EBITDA



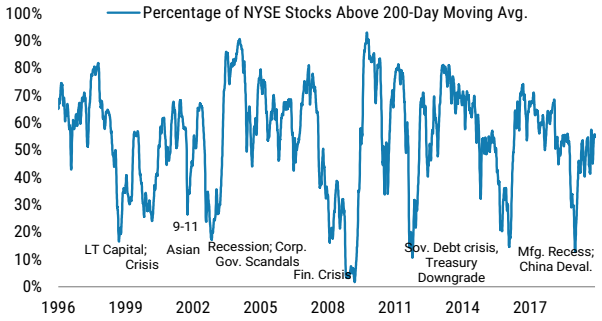
Source: FactSet, Morgan Stanley Research as of October 31, 2019. Monthly Data. Note: S&P 500 fundamental data used post March 1993; Top 500 by market cap data used before 1993.

Exhibit 13: US Equity Market Technicals and Financial Conditions

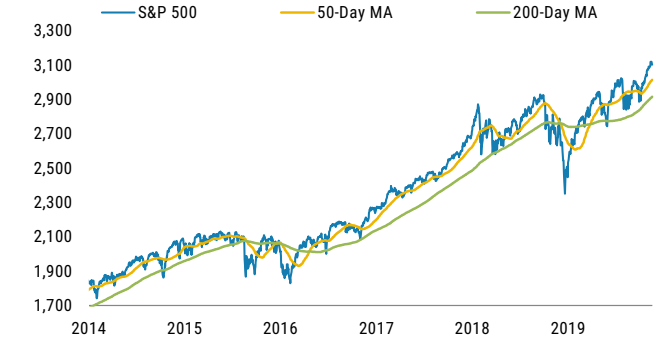
S&P 500 Cumulative Advance-Decline



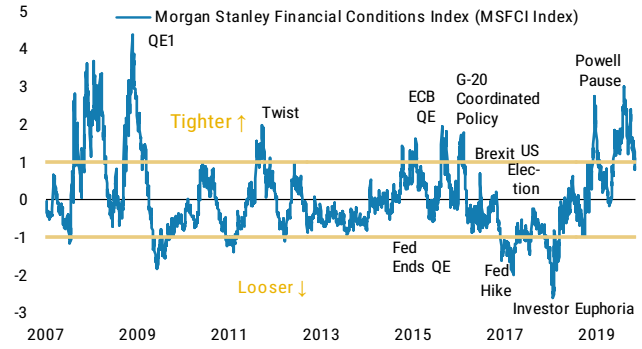
S&P 500 Percent Members Above 200-Day Moving Average



S&P 500 with Moving Averages



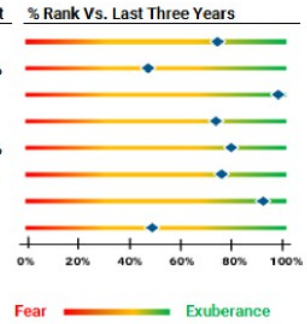
Morgan Stanley Financial Conditions Index

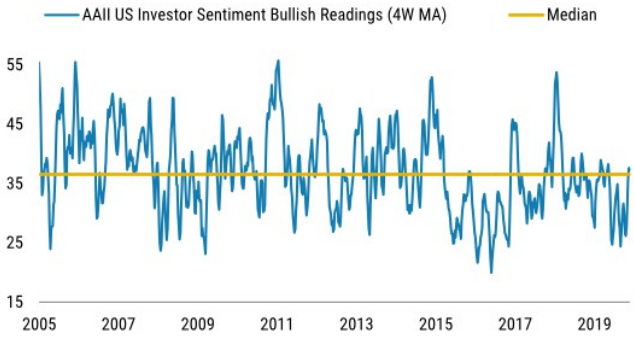


Source: Bloomberg, Morgan Stanley Research. All: As of November 21, 2019

Exhibit 14: US Equity Market Sentiment

Indicator	Latest	% Rank Vs. Last Three Years
MS & Co. Standardized GRDI	1.2	
US AAII % Bulls	34.2%	
S&P 500 Mutual Fund Beta	1.1	
S&P 500 30-Day Rel. Strength Index	60.9	
% S&P 500 Members > 200-Day MA	74.4%	
% S&P 500 >/< 200-Day MA	6.5%	
S&P 500 Put/Call[1]	0.6	
VIX Index[1]	13.2	

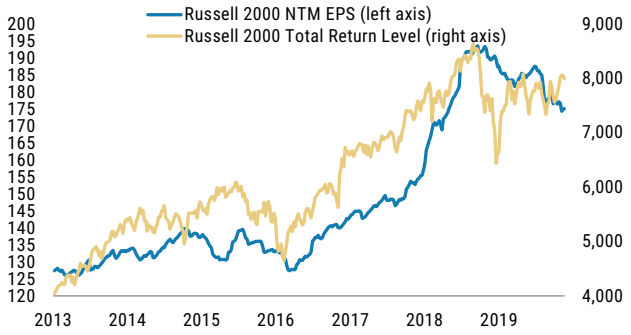




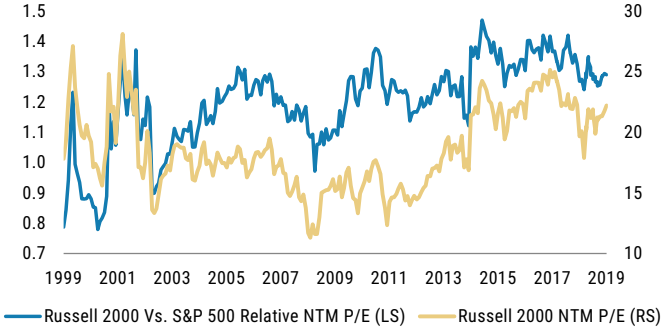
Source: Bloomberg, FactSet, Morgan Stanley Research. As of November 21, 2019.

Exhibit 15: US Small Cap Equities

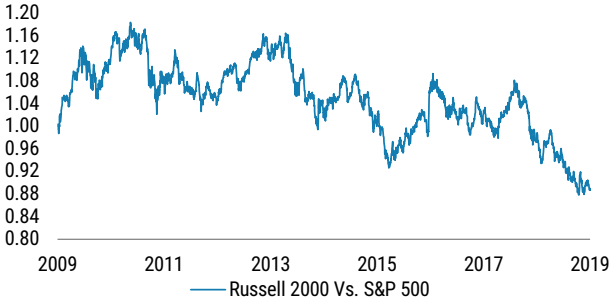
Russell 2000 NTM EPS vs. Total Return Level



Russell 2000 NTM P/E and Relative NTM P/E vs. S&P 500



Russell 2000 Relative Performance vs. S&P 500



Source: FactSet, Morgan Stanley Research. Top Right: As of October 31, 2019. Top Left and Bottom: As of November 21, 2019.

Exhibit 16: We Have a Mid 2020 Price Target of $2,750

Morgan Stanley S&P 500 Price Target: Year End 2020

Landscape	Earnings	Multiple	Price Target	Upside / Downside
Bull Case	$180	18.0x	3,250	4.7%
Base Case	$177	17.0x	3,000	-3.3%
Bear Case	$172	16.0x	2,750	-11.4%
Current S&P 500 Price as of:		11/21/2019	3,104	

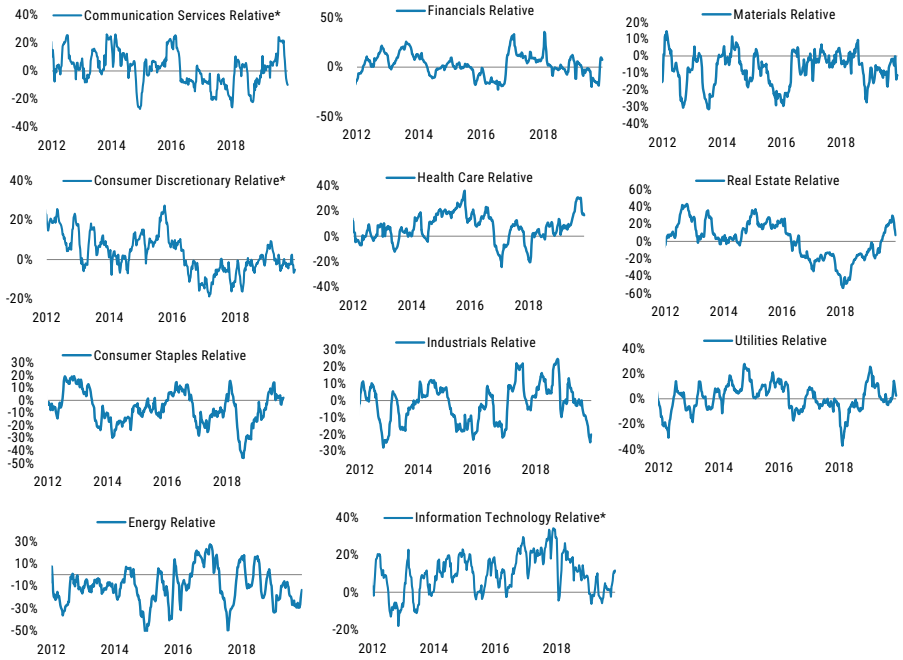
Source: Morgan Stanley Research.
Note: We apply a forward PE multiple to 2021 EPS estimates.

Exhibit 17: Sector Recommendations

Morgan Stanley Sector Recommendations			
Overweight	Consumer Staples	Financials	Utilities
Neutral	Comm Services	Energy	Health Care
	Industrials	Materials	Real Estate
Underweight	Discretionary	Technology	

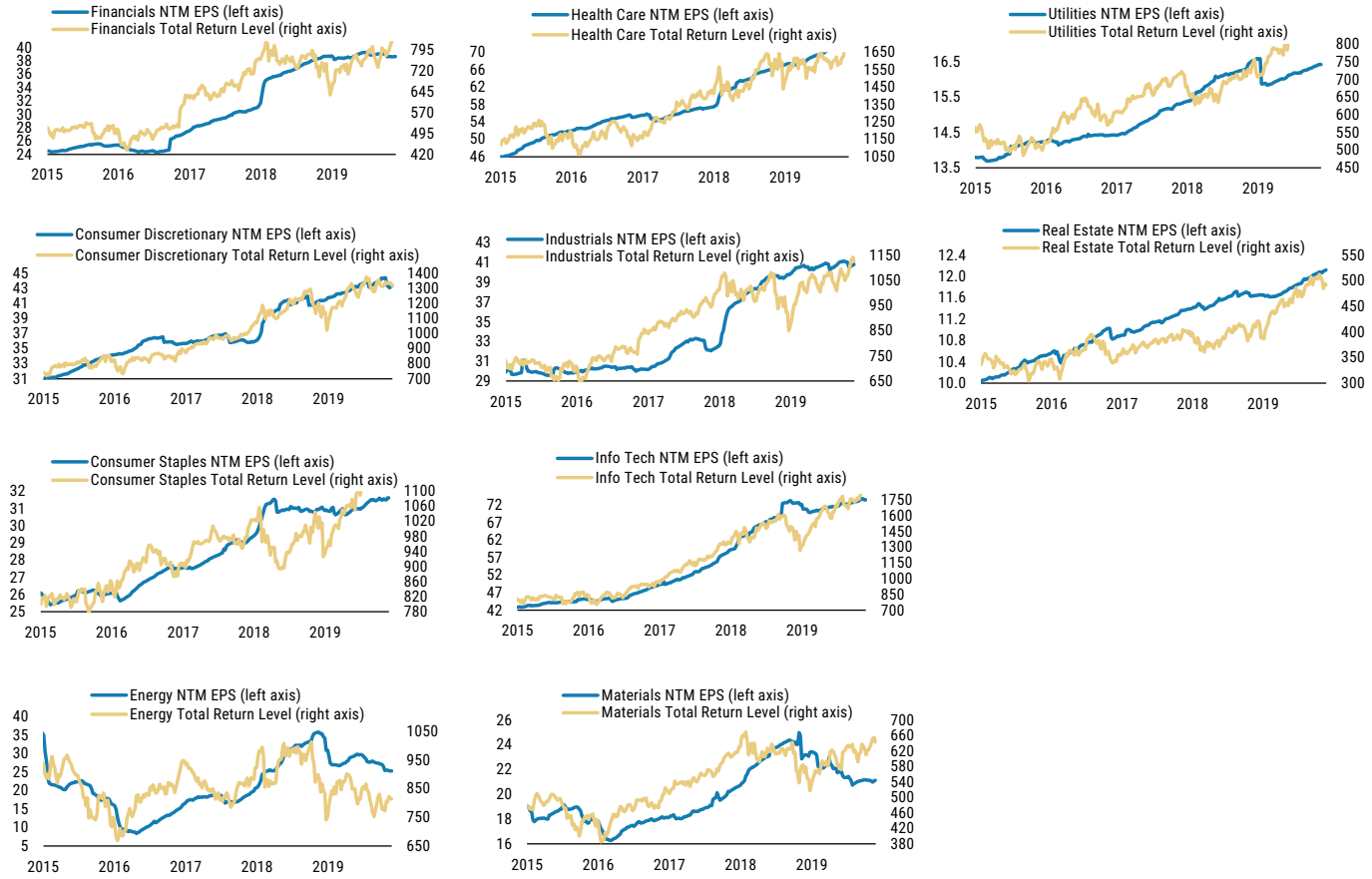
Source: Morgan Stanley Research

Exhibit 18: Earnings Revisions Breadth



Source: FactSet, Morgan Stanley Research. As of November 20, 2019. Sectors with * use current, fixed constituents.

Exhibit 19: US Sector NTM EPS vs. Total Return Level



Source: FactSet, Morgan Stanley Research as of November 21, 2019.

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(as of October 31, 2019)

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STOCK RATING CATEGORY	COVERAGE UNIVERSE COUNT	COVERAGE UNIVERSE % OF TOTAL	INVESTMENT BANKING CLIENTS (IBC) COUNT	INVESTMENT BANKING CLIENTS (IBC) % OF TOTAL IBC	INVESTMENT BANKING CLIENTS (IBC) % OF RATING CATEGORY	OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC) COUNT	OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC) % OF TOTAL OTHER MISC
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Equal-weight/Hold	**1438**	**45%**	**310**	**46%**	**22%**	**679**	**47%**
Not-Rated/Hold	**1**	**0%**	**0**	**0%**	**0%**	**1**	**0%**
Underweight/Sell	**568**	**18%**	**77**	**12%**	**14%**	**229**	**16%**
TOTAL	**3,168**		**668**			**1439**	

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