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US Equity Strategy | North America

Weekly Warm Up: Party Like It's 2020, Not 1999

While comparisons to 1999 abound, we look at the similarities and the differences. Bottom line, we don't expect a narrow blow-off move this time. Instead, we expect a new economic cycle will lead to broader participation in the bull market once this ongoing correction is over.

In the past few weeks we have heard more comparisons to 1999. The similarities are numerous, but so are the differences. We do *not* think the US equity market is about to enter a narrow 1999 type blow-off move led by the Nasdaq. Instead, we believe the correction that began in early June is likely not over and has potential downside to 2800-2850 on the S&P 500. Once the correction is over, we expect a *broadening* of performance and leadership, with most sectors and stocks doing well in this new bull market.

The past month has been very difficult for many of the early cycle/recovery stocks. We think this underperformance represents a consolidation of the first leg higher during which cyclicals trounced defensives by 42%. This is a clear change of leadership from the late cycle environment of the past few years during which cyclicals consistently *under*performed defensives. The economic data supports our V-shaped recovery, which means we want to buy this dip in cyclicals as the market corrects over the next few weeks.

Many tech companies were beneficiaries of the stay-at-home environment, but much of this benefit was likely a pull forward of demand. Morgan Stanley's latest CIO Survey published this past week projects IT budgets to decline (4.4%) in 2020, a record decline and worse than the (3.5%) drop seen in our 1Q09 survey at the trough of the GFC recession. This makes perfect sense to us given the inherent cyclicality of technology capital spending. It also presents a risk and opportunity for investors who can discern between the true secular growers that are experiencing a sustainable acceleration in existing trends versus those that got a one-time boost from the lockdown.

Earnings growth is expected to trough in the second quarter at -45% y/y. Substantial dispersion between sectors/industry groups exists, with defensive areas expected to experience relatively better growth while cyclical areas are expected to see a severe decline in earnings. Coming out of a recession, we think it pays to buy those stocks with the lowest expectations—i.e., cyclicals, and to be careful with defensive stocks that have relatively high earnings growth expectations.

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What to Focus on this Week

Party Like It's 2020, Not 1999

In the past few weeks we have heard more comparisons to 1999, but we do *not* think the US equity market is about to enter a narrow 1999 type blow-off move led by the Nasdaq. The similarities are numerous, but so are the differences. We think the correction that began in early June is likely not over and has potential downside to 2800-2850 on the S&P 500. Once the correction is over, we expect a *broadening* of performance and leadership with most sectors and stocks doing well in this new bull market.

The narrow blow-off top narrative looks as follows:

1. **Growth + Low Rates + Liquidity:** The Nasdaq is the unequivocal leader year to date, which follows an incredible decade of outperformance. Technology stocks are the undisputed king due to their secular growth characteristics in a world of low growth, low rates, and excess liquidity.

2. **Covid Plays Into Secular Trends:** The Covid shock has accelerated existing digital trends that lead to even better-than-expected long-term growth for companies levered to such trends. This makes the secular growth story more compelling and argues for higher valuations.

3. **Better Companies Today:** Profitability and cash flow dynamics are much better now than in the late 1990s and the source of spending on technology goods and services is broader today and not funded by a spending bubble in telecommunications equipment.

4. **Valuations Aren't *As* Extreme:** While valuations for the stocks of the fastest growing companies are at the extreme levels witnessed during the tech bubble (50-100x sales), many of the largest tech stocks, and the Nasdaq overall, are only half as rich as they were at its March 2000 peak. In 1999, valuations doubled before the Nasdaq peaked. Excess liquidity from Y2K fears fueled the blow-off. This time, massive QE could do the same thing, especially with real 10-year yields more negative than at any time in the past 50 years.

While this story line is enticing, we think there are some very important differences versus the late 1990s:

1. **GDP Sensitivity Favors Cyclical Stocks:** We believe a V-shaped recovery is playing out, which means companies with more GDP sensitivity and fewer secular drivers should see the greatest inflection in earnings growth, particularly given already easy comps in this cohort last year.

2. **Bubble Valuations Hard Without Bubble Fundamentals:** In 1999, the economy was booming with excessive capex spending that bolstered tech growth rates. In the absence of bubble fundamentals or even a reset on 2H growth expectations that may now be too high as indicated by our recent CIO survey, it's unlikely we get the

blow-off move in valuations like 1999.

3. **Early Cycle Leadership Is Different From Late Cycle:** At the beginning of a new economic cycle, breadth expands to the lower quality, more cyclical areas of the market that have lagged. That is exactly what we have witnessed when using the March lows as a starting point, particularly when looking at sectors on an equal-weighted basis.

4. **Rates Upside:** To us, rates are the biggest wildcard for equity leadership in the second half of the year, but we still think higher back-end rates will prevail later this year as the recovery continues to surprise on the upside.

In our view, the differences above mean the best investment strategy for the next 6-12 months continues to be a barbell of *reasonably* priced growth stocks and cyclicals. While many investors we speak with agree with that strategy, very few have actually enacted it. For those who have, the recent correction has them second guessing their decision.

Market Breadth Should Continue to Improve

While Technology stocks are the unequivocal leader year to date, they are *not* the leader since the March 23rd lows (Exhibit 1), which in our view was the beginning of a new economic cycle and bull market. This is a major difference from 1999 when we were clearly still in a late-cycle economic expansion when markets get more narrow in their search for growth, quality and defensiveness. **At the beginning of a new economic cycle, breadth expands to the lower-quality, more cyclical areas of the market that have lagged.** That is exactly what we have witnessed when using the March lows as a starting point, particularly when looking at sectors on an equal-weighted basis.

There is no debating the fact that the past month has been very difficult for many of the early cycle/recovery stocks. However, we think it represents a consolidation of the first leg higher during which cyclicals have trounced defensively oriented stocks (Exhibit 2). To us, this represents a clear change of leadership from the late-cycle environment of the past few years during which cyclicals consistently *under*performed defensives. We think the recent correction in early cyclicals looks very similar to the correction experienced in 2016 coming out of the global manufacturing recession. In that particular episode, the initial leg higher saw cyclicals outperform defensives by 26% to recapture its 200-day moving average. This time around it was a 42% rally. In 2016, Brexit concerns led to a two-month consolidation. This time it's a rise in COVID cases leading to fears of another lockdown and a looming fiscal cliff. We expect both concerns to subside later this month if fatalities fail to follow case count increases and another fiscal stimulus bill is eventually passed. If the cyclical vs defensive leadership isn't enough evidence that something important changed in March, take a look at small versus large caps or the very broad Wilshire 5000 vs the narrower S&P 500 (Exhibit 3).

Exhibit 1: New Cycle Means New Leadership...

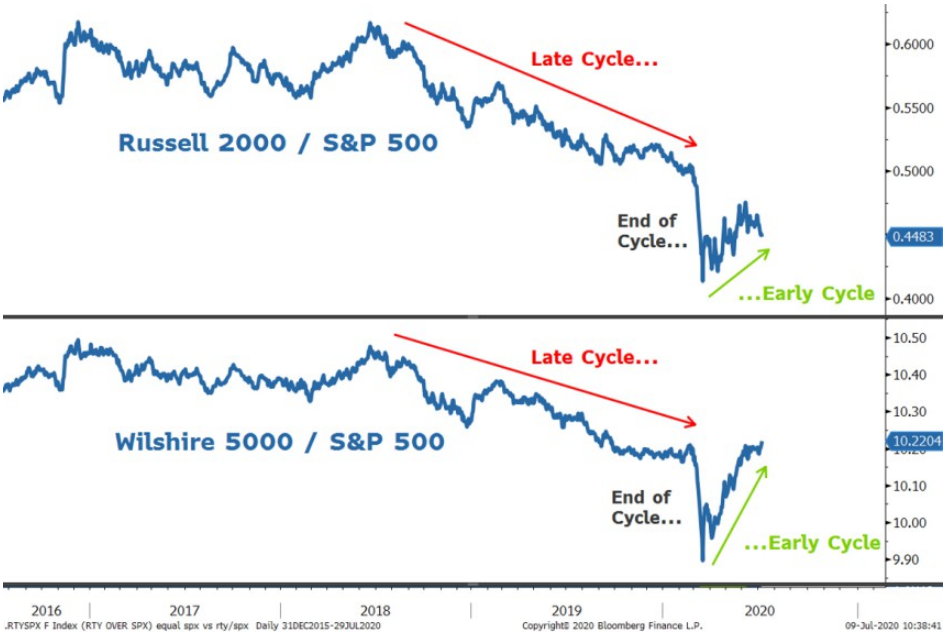
S&P 500 Total Return Since March 23, 2020 Low			
Cap Weight		**Equal Weight**	
Energy	59%	Energy	68%
Consumer Discretionary	56%	Consumer Discretionary	56%
Materials	53%	Materials	54%
Information Technology	53%	Industrials	49%
Industrials	44%	**S&P 500**	**45%**
S&P 500	**43%**	Information Technology	45%
Real Estate	41%	Health Care	45%
Health Care	38%	Financials	44%
Communication Services	37%	Real Estate	37%
Financials	34%	Communication Services	37%
Utilities	29%	Utilities	30%
Consumer Staples	22%	Consumer Staples	26%

Source: FactSet, Morgan Stanley Research.

Exhibit 2: ...Recent Consolidation Looks Like 2016

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.

Exhibit 3: Small Caps and Broader Indices Show a Broadening Out or Relative Outperformance

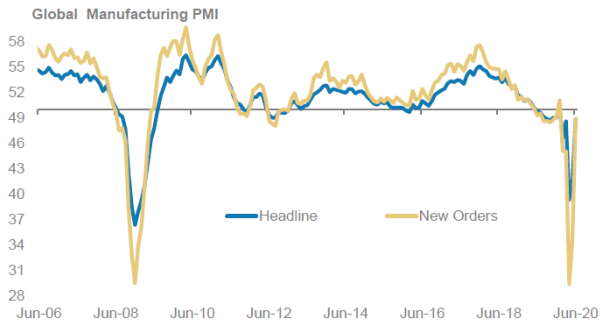


Source: Bloomberg, Morgan Stanley Research.

Economically Sensitive Stocks With Low Expectations to Lead

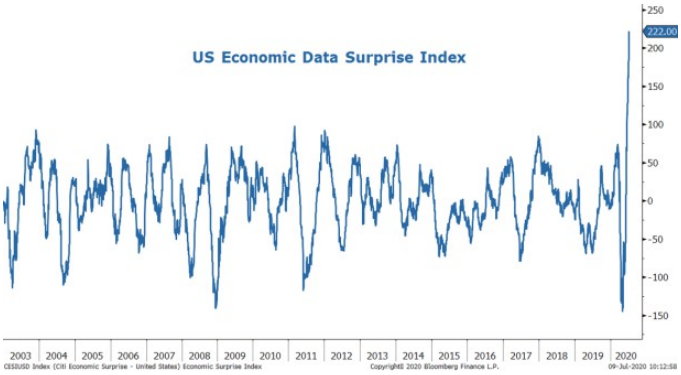
This rotation is very much in line with our Recession Playbook and our recommendations since early April to be overweight cyclical sectors and small caps and underweight defensives. We see no reason why these new trends aren't correct, or sustainable, given other signs that our V-shaped recovery is playing out. In addition to global PMIs, which are perhaps the best coincident and leading indicators (Exhibit 4), the economic surprise index in the United States has reached unprecedented heights (Exhibit 5).

Exhibit 4: Global PMIs Confirming the V Recovery



Source:Markit, Haver Analytics, IMF, national sources, Morgan Stanley Research. Note: Prior to April 2001, Canada, Indonesia and Colombia are excluded due to lack of data.

Exhibit 5: Economic Surprises Have Never been Greater



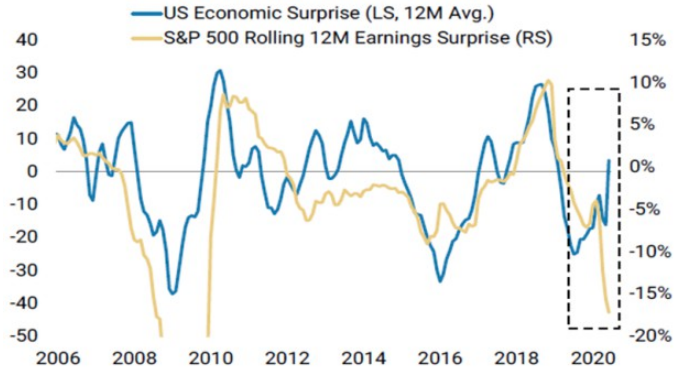
Source: Bloomberg, Morgan Stanley Research

Higher economic surprises mean better earnings revisions to come. Part of this is a function of economic forecasts getting cut too much at the depths of the recession. Earnings revisions likely found the same fate but with revision breadth bottoming in mid April, equity markets never looked back. As a result, we are confident earnings revision breadth (Exhibit 6) will continue to move higher as we enter 2Q earnings season and earning surprises follow economic ones (Exhibit 7).

Exhibit 6: Earnings Revision Breadth Has Bottomed

Source: Bloomberg, Morgan Stanley Research

Exhibit 7: While Earnings Surprises Will Follow



Source: Bloomberg, FactSet, Morgan Stanley Research

Such a thesis is most supportive to economically sensitive stocks where expectations have been chopped the most and operating leverage is likely to be the greatest coming out of the recession. This is very different than 1999 when such companies were experiencing late-cycle cost pressure and *negative* operating leverage, like we witnessed last year. In other words, companies with the greatest operating leverage and lowest expectations should have the most upside. This is not to say that high expectation stocks can't work. They can, and likely will, since it's a bull market but we think cyclicals can participate too and even outperform as the recovery progresses and low expectation stocks go up more.

Secular Trends vs Demand Pull Forward & High Expectations

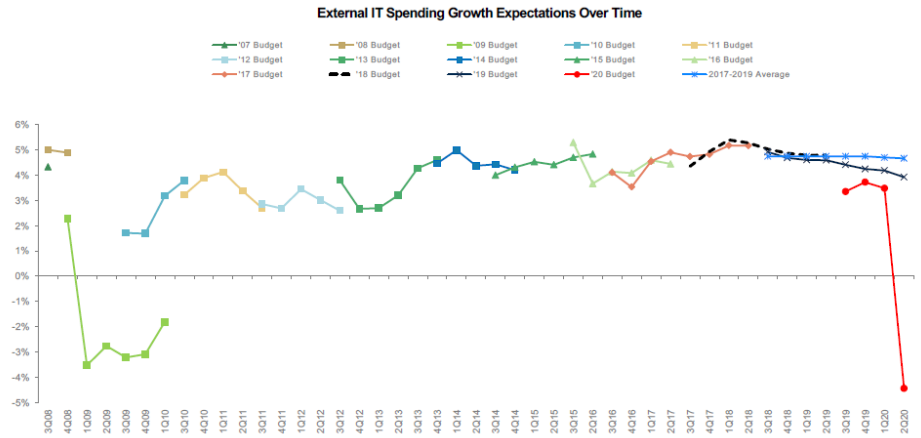
Due to the fact that many tech companies were beneficiaries of the stay-at-home environment, these stocks are now being credited for their defensive properties as much as their growth. This has led to some unrealistic valuations and/or expectations for certain beneficiaries that may have experienced a *pull forward* of demand rather than an acceleration of existing trends. 2Q earnings season may be a challenge for investors trying to discern between the two.

Supporting that view is **the latest CIO Survey published by our tech team this past week which suggests many tech companies may not be as defensive or immune to the recession as perceived** (2Q20 CIO Survey—Is Wall Street Pulling Too Far Ahead of Main Street?). According to the survey, CIOs now expect IT budgets to decline (4.4%) in 2020, a record low and worse than the (3.5%) drop seen in our 1Q09 survey at the trough of the Great Financial Crisis recession (Exhibit 8). This makes perfect sense to us given the inherent cyclicality of technology capital spending. Once again, **the risk and opportunity for investors will be discerning between the true secular growers that are experiencing a sustainable acceleration in existing trends versus those that got a one-time boost from the Covid-19 lockdown.**

The following is a key quote from the report that discusses this important dynamic as we enter 2Q earnings season:

- "**Despite the significant growth deceleration expected, it is clear the technologies enabling the 'new normal' resulting from Covid-19 are seeing more sustained tailwinds** – **particularly collaboration software and security software** which saw the largest uptick in growth expectation from our 1Q20 survey, as well as networking equipment (see our accompanying Networking VAR Survey), VPN/remote access and cloud computing, which all saw large jumps in defensibility in this survey. Additionally, long-term spending intentions remain relatively unchanged and the long-term secular catalysts continue to accelerate (i.e. workloads running in the public cloud rose to 25% from 21% in our 2Q19 survey, as the outlook for long-term penetration continues to uptick); **the question is whether near-term investor expectations are properly calibrated for the severity of these deteriorating spend intentions, particularly in more frothy areas of the market such as software where CY20 consensus revenue estimates have only been adjusted down by ~1.4% since January 1st on average……Said another way, while confident in the ability of these secular growth trends to drive upside to CY21 revenues, the realities of 2020 IT budgets may disappoint expectations for a better CY2H20."**

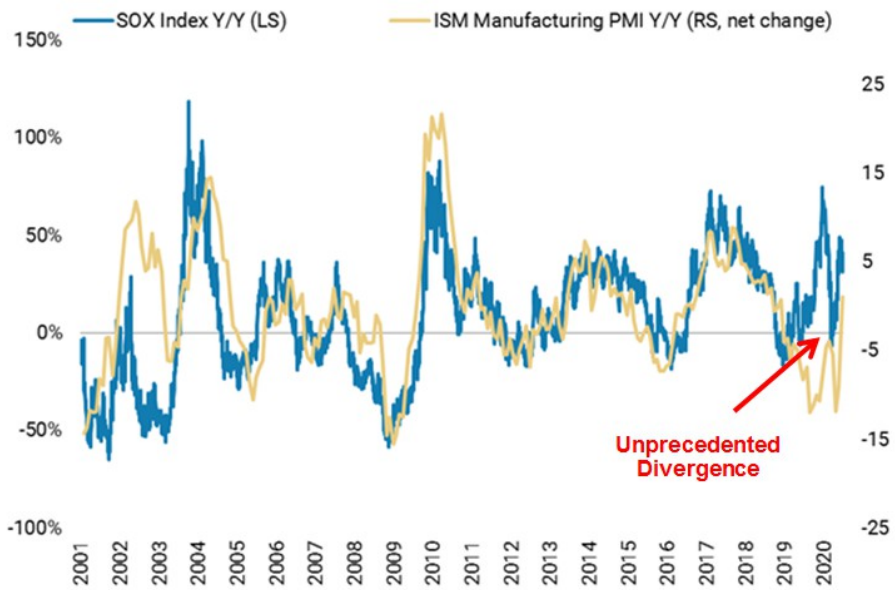
Exhibit 8: Latest MS CIO Survey Suggests Many Tech Companies Will Not Be Immune to the Recession



Source: AlphaWise, Morgan Stanley Research. n=100 (US and EU data). Note: 3Q15 CIO survey reflects data from a different survey vendor.

One could easily make the argument that the substantial cut to CIO spending intentions is just another example of expectations getting cut too far, which represents an attractive buying point for the stocks. This is very similar to our argument for the broader equity market and cyclicals in particular. As noted earlier, **Tech is inherently cyclical and tends to trade as such around market troughs, led by semiconductors and hardware. However, as we also noted, these stocks have acted more defensively and non-cyclical this time starting in 2019.** Semiconductors in particular did not behave as they typically do with the economy heading toward the end of the cycle (Exhibit 9).

Exhibit 9: Semiconductors Diverged from ISM Last Year Like Never Before



Source: Bloomberg, Morgan Stanley Research.

We think the outperformance of cyclical tech has been a function of two things: 1) semiconductors and tech hardware (Apple in particular) are generating higher returns on capital than ever before and therefore are being treated (correctly) as *high-quality* cyclicals. The quality factor (high ROIC, low leverage) has rarely been treated more positively than the past few years. 2) The US tariffs on China combined with concerns about IP infringement and future restrictions on US technology sales to China led to some double ordering of both devices and equipment last fall. We think both of these issues helped the sector buck its usual late-cycle performance pattern. The relationship in Exhibit 9 appears to be more in sync today even though the group may still be a little ahead of itself. Suffice it to say from a macro standpoint, semiconductors do fit the bill of our barbell strategy of growth + cyclicality so we would look to buy semiconductors if they were to sell off in the near term on disappointing earnings/guidance or concerns about tech budgets getting slashed in 2H20.

Summing It Up: 2020≠ 1999

Going back to the 1999 analogy, today's recessionary environment is very different from 1999 when the economy was booming and most companies were engaging in classic late-cycle behavior that entails excessive spending on capex, including technology goods. As a result, many of the largest tech companies were growing revenue 50%+ in 1999, especially those levered to the bubble in telecommunications spending. These bubble fundamentals are what led to the bubble valuations. **In the absence of bubble fundamentals or even a reset on 2H growth expectations that may now be too high, it's unlikely we get the blow-off move in valuations like 1999.**

Instead, we expect a *broadening* out of participation once this correction is over. As stated in our Mid Year Outlook last month, we think the correction that began in early June has downside to 2800 on the S&P 500. It should trough if the next fiscal stimulus bill is passed, which we think should coincide with more evidence that the fatality risk from the virus may be fading alongside more constructive data on potential vaccines.

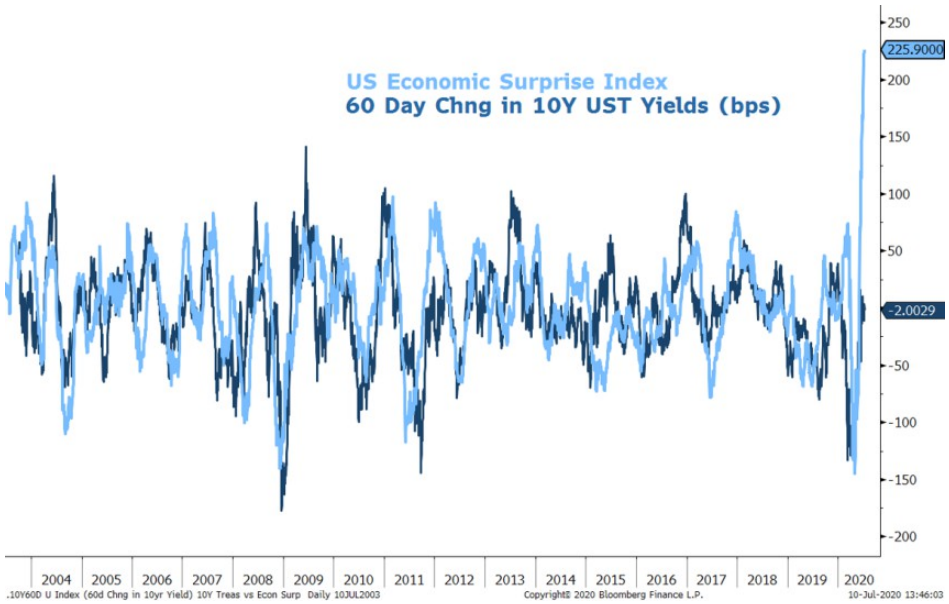
The bottom line is that our Recession Playbook barbell of *reasonably priced* high-quality growth + cyclicals at the expense of defensives has been working. Over the past month, secular growth stocks have trounced cyclicals, but this follows a period in May/early June when cyclicals trounced growth. We'd call it a draw since the market lows in March. Having both sides of the barbell provides a nice internal hedge. The loser is defensives, which also supports our view that we are in a new economic cycle and bull market. We see little evidence to suggest that view is incorrect or at risk of reversing. To the contrary, we have been pleasantly surprised by just how strong the high frequency economic data has been over the past few months. **While it's tempting to put all of your eggs in just one side of the barbell, i.e high-quality growth stocks, we recommend using this correction to add to the cyclical side and party like it's 2020, not 1999.**

Exhibit 10: Growth *and* Cyclicals Make a Good Pair. Own Them Both in a Barbell Strategy

Source: Bloomberg,Morgan Stanley Research.
Note: The index above represents an equal notional pair trade of going long a group of secular growth stocks that should post double-digit earnings growth in most economic environments vs short a group of higher beta cyclicals from the Discretionary, Energy, Industrials, Materials, and Technology sectors. The long and short sides are rebalanced to equal notional amounts at the close of each day.

Where we have been dead wrong is thinking the *unreasonably* priced (i.e. very expensive) growth stocks would be left behind with the defensive stocks. We think this is due to the fact that long-term interest rates have remained pinned even in the face of much better economic data and other evidence of a V-shaped recovery (Exhibit 11). We can thank the Fed for this divergence but we question whether it is sustainable or even desirable to want such low rates to persist at the back end if growth is really recovering. To us, **rates are the biggest wildcard for equity leadership in the second half of the year but we still think higher back-end rates will prevail later this year as the recovery continues to surprise on the upside.** The move we envision should act as a gating factor on the stocks with the most extreme valuations and bond proxies. Therefore, one should continue to be disciplined on valuation for growth stocks while adding more cyclicality into this correction that we think still has some downside.

Exhibit 11: How Much Longer Can US Treasury Yields Ignore the Economic Data?



Source: Bloomberg, Morgan Stanley Research

A Brief Look Ahead to Earnings

Earnings growth is expected to trough in the second quarter at -45% y/y, but with substantial dispersion between sectors/industry groups (Exhibit 12). Most defensive areas are expected to experience moderate negative growth while cyclical areas are expected to see a severe decline in earnings. Several groups within Consumer Discretionary and Energy are expected to have negative EPS in absolute terms. The numbers are expected to moderate during the third and fourth quarters. We will be watching this earnings season very closely for clues about the third and fourth quarter and whether more cuts to guidance are coming.

Exhibit 12: Quarterly and Annual EPS and Sales Expectations

	2Q20		3Q20		4Q20		2020	
	EPS	Sales	EPS	Sales	EPS	Sales	EPS	Sales
Communication Services	-30.6%	9.0%	-19.3%	-3.4%	-31.1%	-0.4%	-14.8%	-1.9%
Media & Ent	-41.0%	11.8%	-24.2%	-4.4%	-42.7%	-0.4%	-17.9%	-0.9%
Telecom	-14.9%	7.7%	-13.7%	-4.4%	-7.1%	-2.9%	-11.5%	-5.9%
Consumer Discretionary	-115.0%	28.9%	-50.0%	-8.4%	-43.9%	-2.6%	-56.6%	-8.6%
Autos	-298.0%	128.9%	-70.2%	-12.1%	11.8%	-0.8%	-126.2%	-18.6%
Consumer Durables	-102.4%	38.3%	-38.9%	-15.5%	-39.6%	-9.8%	-34.7%	-12.5%
Consumer Services	-188.0%	134.1%	-114.3%	-40.2%	-119.8%	-22.8%	-104.1%	-31.8%
Retailing	-44.3%	1.1%	-17.2%	1.3%	-25.8%	2.6%	-27.8%	1.0%
Energy	-151.6%	75.4%	-115.1%	-32.7%	-118.0%	-28.4%	-104.0%	-30.9%
Financials	-52.9%	2.1%	-28.6%	-4.4%	-28.0%	-4.9%	-36.6%	-6.4%
Banks	-70.5%	-2.1%	-43.0%	-5.4%	-42.1%	-4.2%	-54.4%	-2.3%
Diversified Financials	-35.7%	4.4%	-22.0%	-4.9%	-12.7%	-5.6%	-25.4%	-13.3%
Insurance	-35.1%	4.7%	0.2%	-3.3%	-18.0%	-3.9%	-9.6%	-2.4%
Health Care	-16.1%	1.5%	-6.6%	3.8%	-2.6%	6.4%	-3.0%	5.3%
HC Equipment & Services	-16.0%	3.9%	-13.6%	0.5%	-15.6%	4.2%	-8.5%	3.3%
Pharma, Biotech, & Life Sciences	-15.6%	5.1%	-1.3%	4.4%	7.4%	6.5%	1.1%	4.5%
Industrials	-90.1%	35.9%	-59.2%	-19.1%	-52.4%	-11.0%	-48.9%	-14.2%
Capital Goods	-53.0%	25.8%	-38.0%	-14.9%	-27.2%	-8.2%	-28.0%	-10.5%
Commercial & Professional Services	-24.9%	12.7%	-13.6%	-6.6%	-13.8%	-3.3%	-9.2%	-3.8%
Transportation	-169.7%	76.4%	-117.9%	-31.2%	-121.2%	-18.9%	-107.0%	-24.9%
Materials	-37.6%	16.0%	-24.5%	-8.9%	-16.8%	-4.1%	-21.0%	-7.4%
Real Estate	-13.4%	11.9%	-11.9%	-8.2%	-12.1%	-5.2%	-8.0%	-4.9%
Staples	-16.1%	1.4%	-3.6%	0.4%	0.7%	1.4%	-1.4%	2.0%
Food & Staples Retailing	-21.4%	0.0%	-4.9%	1.8%	-3.5%	1.9%	-1.8%	3.5%
Food Beverage & Tobacco	-15.9%	4.7%	-4.7%	-1.5%	4.2%	0.9%	-3.7%	-0.6%
Hosuehold & Personal Products	-11.2%	3.6%	0.3%	-0.8%	-3.7%	0.2%	5.1%	1.3%
Tech	-10.0%	-0.8%	-3.8%	-0.6%	-19.5%	2.1%	0.9%	1.7%
Semis	-1.3%	-8.2%	0.3%	5.9%	-5.1%	1.8%	-1.1%	4.6%
Software & Services	-11.5%	0.0%	-2.2%	0.0%	-12.9%	2.6%	3.0%	3.8%
Tech Hardware	-14.1%	0.9%	-8.1%	-2.8%	-34.7%	2.4%	-0.2%	-1.1%
Utilities	-5.8%	1.4%	1.1%	-2.4%	59.1%	3.9%	0.4%	-1.4%
S&P 500	-44.8%	13.5%	-24.3%	-6.8%	-23.9%	-3.1%	-22.2%	-5.3%

Source: FactSet, Morgan Stanley Research

Current trends and comparison both matter to the growth outlook. We think it is important to look at 2020 expectations in the context of last year's earnings recession where many industry groups saw flat or negative earnings growth. Sectors that performed poorly in 2019 will have the benefit of easy comparisons this year and a very easy two-year stack heading into 2021 (Exhibit 13). **Per the above, we think the relative performance of groups that outperformed in growth last year and are expected to outperform this year might be challenged as more economically sensitive areas of the market begin to show greater growth off multiple years of easier comps in a recovery environment.**

Two industry groups within Tech fall on either side of this divide. Semiconductors ranked 21st out of 24 industry groups on earnings growth in 2019. They are now expected to come in first in 2020, which feels like a reasonable reversal to us especially

in the context of a new economic cycle. **On the other hand, Software has back to back years of relatively strong earnings growth while we are in the midst of an economic recession. The group's defensive properties will be tested over the next 6 months given the high expectations that are in the price.**

Exhibit 13: Will the Last Be First?

Industry Group	2020 Rank	2019 Rank
Semis	1	21
Utilities	2	7
Hosuehold & Personal Products	3	8
Software & Services	4	3
Real Estate	5	16
Tech Hardware	6	14
Telecom	7	17
Pharma, Biotech, & Life Sciences	8	6
Food Beverage & Tobacco	9	18
HC Equipment & Services	10	4
Food & Staples Retailing	11	15
Commercial & Professional Services	12	2
Insurance	13	1
Diversified Financials	14	19
Materials	15	22
Media & Ent	16	13
Retailing	17	11
Capital Goods	18	20
Banks	19	5
Consumer Durables	20	10
Energy	21	24
Transportation	22	9
Consumer Services	23	12
Autos	24	23

Source: FactSet, 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 14: Fresh Money Buy List - Stats & Performance

Company Name	Ticker	MS Rating	Sector	Market Cap ($Bn)	Price	MS PT	% to MS PT	MS Analyst	Date Added	Total Return Since Inclusion	
										Absolute	Rel. to S&P
Citizens Financial Group, Inc	CFG	Overweight	Financials	$10.3	$24.18	$36.00	48.9%	Zerbe, Ken	4/20/2020	23.8%	12.5%
Walt Disney Co	DIS	Overweight	Communication Services	$216.5	$119.34	$135.00	13.1%	Swinburne, Benjamin	3/14/2018	18.3%	(2.3%)
Humana Inc	HUM	Overweight	Health Care	$51.2	$381.58	$500.00	31.0%	Goldwasser, Ricky	7/19/2018	22.2%	4.5%
Johnson & Johnson	JNJ	Overweight	Health Care	$380.1	$142.37	$170.00	19.4%	Lewis, David	2/3/2020	(3.1%)	(2.7%)
Linde PLC	LIN	Overweight	Materials	$119.5	$225.95	$205.00	(9.3%)	Andrews, Vincent	3/23/2020	50.0%	11.0%
MasterCard, Inc.	MA	Overweight	Information Technology	$298.6	$295.68	$311.00	5.2%	Faucette, James	3/2/2020	2.2%	(6.4%)
Microsoft	MSFT	Overweight	Information Technology	$1,637.3	$213.67	$230.00	7.6%	Weiss, Keith	3/14/2018	133.9%	113.3%
Procter & Gamble Co.	PG	Overweight	Consumer Staples	$323.8	$123.89	$134.00	8.2%	Mohsenian, Dara	3/18/2019	24.9%	9.1%
PVH Corp.	PVH	Overweight	Consumer Discretionary	$3.2	$44.37	$80.00	80.3%	Greenberger, Kimberly	4/20/2020	(1.1%)	(12.4%)
S&P Global Inc	SPGI	Overweight	Financials	$85.2	$351.81	$361.00	2.6%	Kaplan, Toni	3/23/2020	68.9%	29.9%
T-Mobile US, Inc.	TMUS	Overweight	Communication Services	$93.0	$107.05	$115.00	7.4%	Flannery, Simon	3/14/2018	65.0%	44.4%
Current List Performance											
Average (Eq. Weight)				$292.6			19.5%			36.8%	18.3%
Median				$119.5			8.2%			23.8%	9.1%
% Positive Returns (Abs. / Rel.)										82%	64%
% Negative Returns (Abs. / Rel.)										18%	36%
Avg. Hold Period (Months)											13.5
All Time List Performance											
Average (Eq. Weight)										21.8%	8.5%
Median										18.8%	(1.1%)
% Positive Returns (Abs. / Rel.)										63%	46%
% Negative Returns (Abs. / Rel.)										38%	54%
Avg. Hold Period (Months)											11.4

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

S&P Global Inc (SPGI), Toni Kaplan

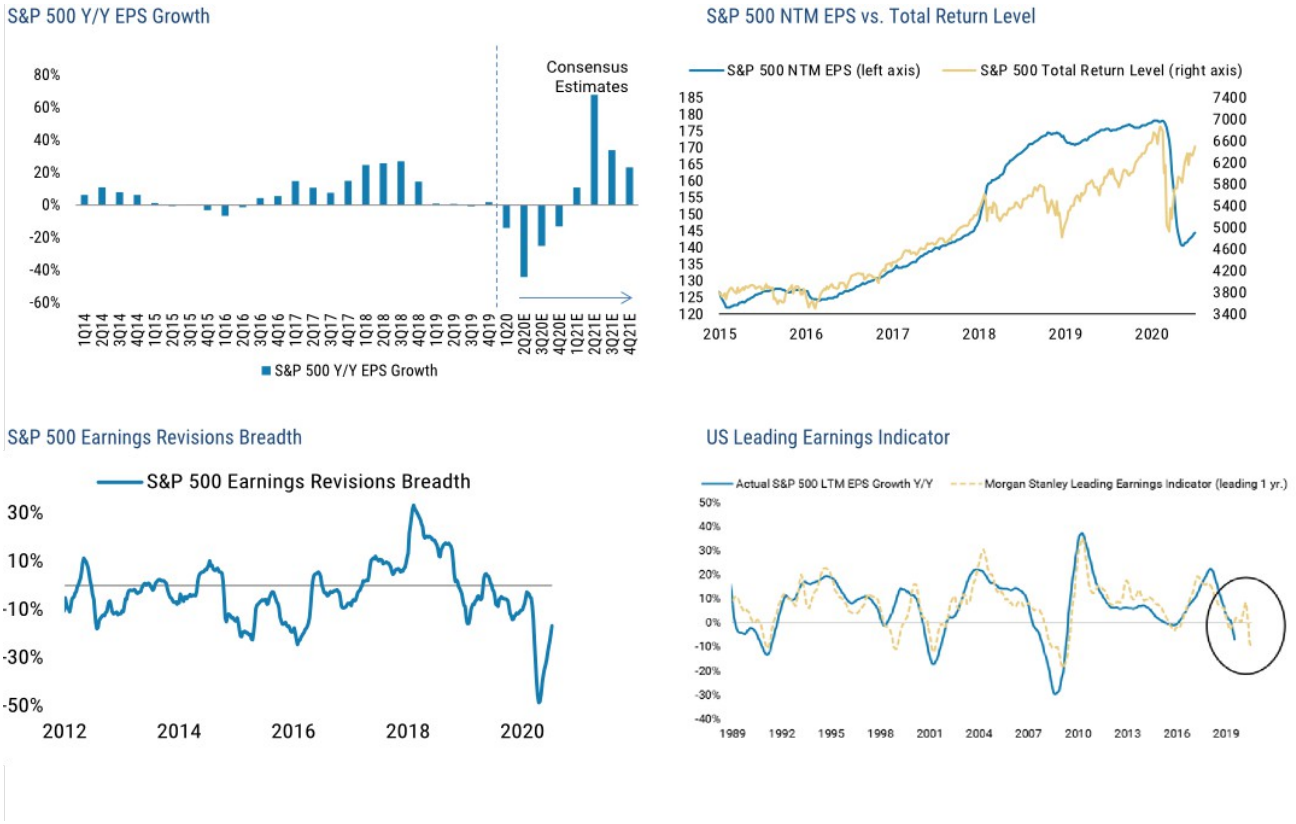
- **2Q Preview: Estimates Up Again on Continued Strong Issuance** - We are 3% above cons on '20 EPS for SPGI and 7% above for MCO, and as such, we expect both to raise guidance. We prefer OW-rated SPGI given its portfolio of businesses and higher recurring revenue, and raise our PT to $361. We recently upgraded SPGI to OW (from EW) (see Business & Education Services: 2020 Outlook: Setting Relative Preferences; Upgrading TRU, SPGI, VRSK to OW, MCO to EW) as we are confident around sustained mid-single-digit organic growth, with ~100bps of annual margin expansion driving low-double-digit EPS growth ('19-'24 CAGR). We see potential upside to revenue from the China opportunity, ESG, and Kensho, and we see continued upside to margins given that we view SPGI as a ~70% incremental margin business. Though we would note that multiples for both SPGI and MCO have increased recently, neither company looks over-extended when compared to the broader S&P 500. Both SPGI (43% premium) and MCO (41% premium) currently trade ~in-line with their 1 year average relative to the S&P 500. Between the two rating agencies, we continue to prefer SPGI to MCO given its more diversified revenue streams and higher subscription revenue base.

Microsoft (MSFT), Keith Weiss

- **CIO Survey Highlights Near-term Durability and Improving Long-term Secular Position** - Contrary to the broader IT deceleration signaled in our 2Q20 CIO Survey, results for Microsoft show durable near-term spending trend and strengthening long-term positioning. A unique combination of strong secular positioning and a reasonable multiple keeps MSFT a top pick. Increase PT to $230.

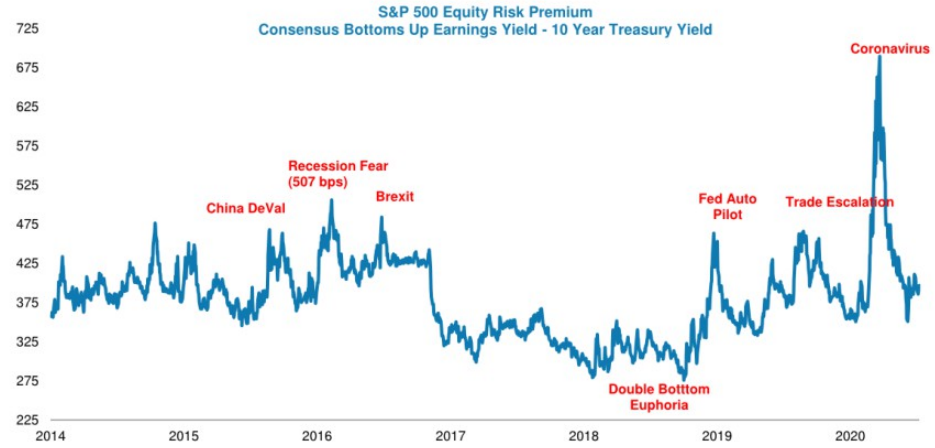
Weekly Charts to Watch

Exhibit 15: US Earnings Snapshot



Source: Thomson Financial, FactSet, Morgan Stanley Research. As of July 9, 2020 Bottom right As of June 30, 2020. 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.

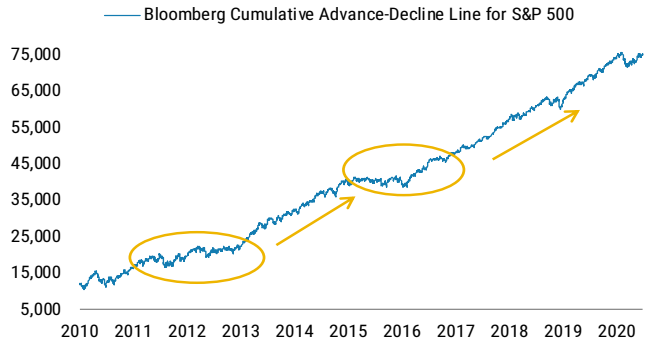
Exhibit 16: S&P 500 Equity Risk Premium



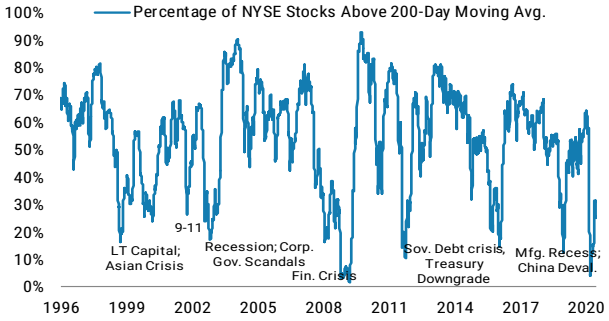
Source: Bloomberg, Morgan Stanley Research. As of July 9, 2020

Exhibit 17: US Equity Market Technicals and Financial Conditions

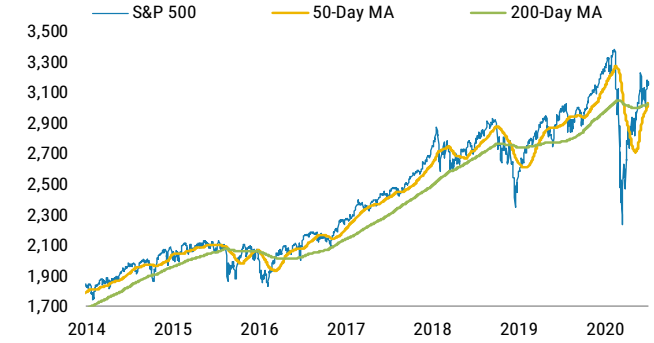
S&P 500 Cumulative Advance-Decline



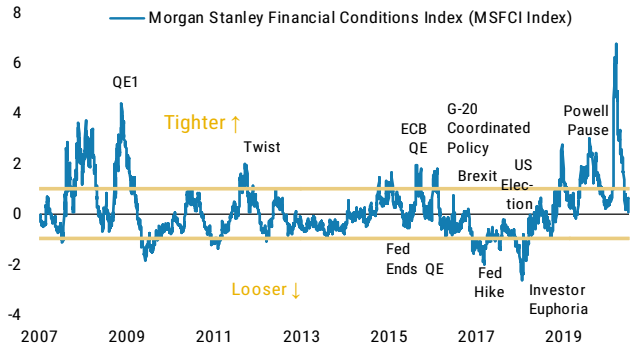
S&P 500 Percent Members Above 200-Day Moving Average



S&P 500 with Moving Averages

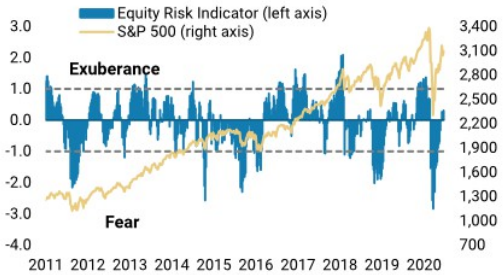


Morgan Stanley Financial Conditions Index



Source: Bloomberg, Morgan Stanley Research. All: As of July 9, 2020

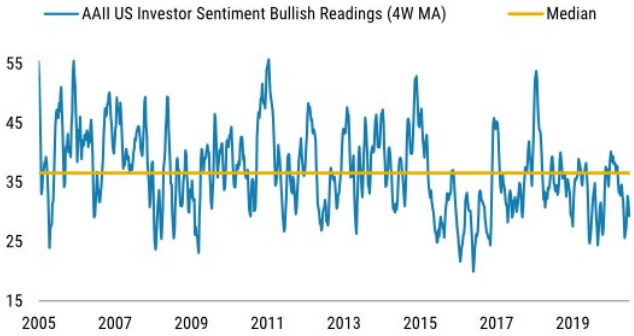
Exhibit 18: US Equity Market Sentiment



Indicator	Latest	% Rank Vs. Last Three Years
MS & Co. Standardized GRDI	0.8	
US AAII % Bulls	24.1%	
S&P 500 Mutual Fund Beta	0.9	
S&P 500 30-Day Rel. Strength Index	51.3	
% S&P 500 Members > 200-Day MA	38.7%	
% S&P 500 >/< 200-Day MA	0.2%	
S&P 500 Put/Call[1]	0.6	
VIX Index[1]	34.7	

0% 20% 40% 60% 80% 100%

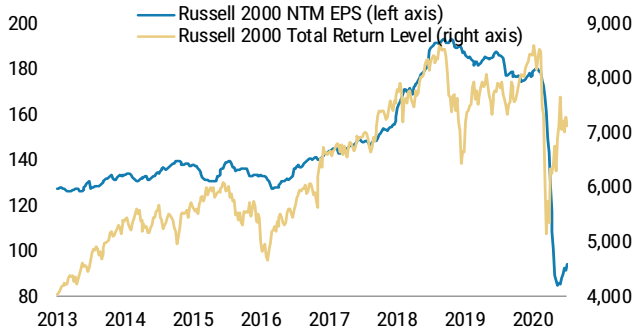
Fear — Exuberance



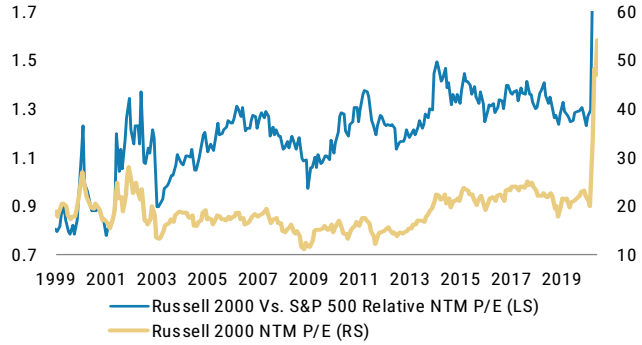
Source: Bloomberg, FactSet, Morgan Stanley Research. As of June 26, 2020.

Exhibit 19: US Small Cap Equities

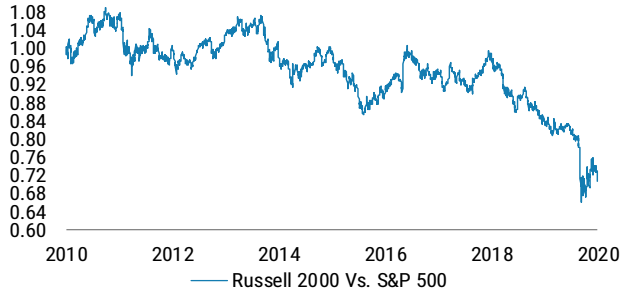
Russell 2000 NTM EPS vs. Total Return Level



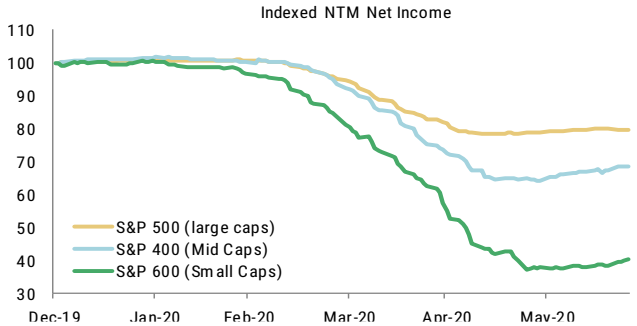
Russell 2000 NTM P/E and Relative NTM P/E vs. S&P 500



Russell 2000 Relative Performance vs. S&P 500



NTM EPS by Cap Size



Source: FactSet, Morgan Stanley Research. Top Right: As of June 30, 2020. Top Left and Bottom: As of July 9, 2020

Exhibit 20: We Have a Price Target of 3350

Morgan Stanley S&P 500 Price Target: June 2021

Landscape	Earnings	Multiple	Price Target	Upside / Downside
Bull Case	$176	21.0x	3,700	17.4%
Base Case	$168	20.0x	3,350	6.3%
Bear Case	$152	19.0x	2,900	-8.0%
Current S&P 500 Price as of:		7/9/2020	3,152	

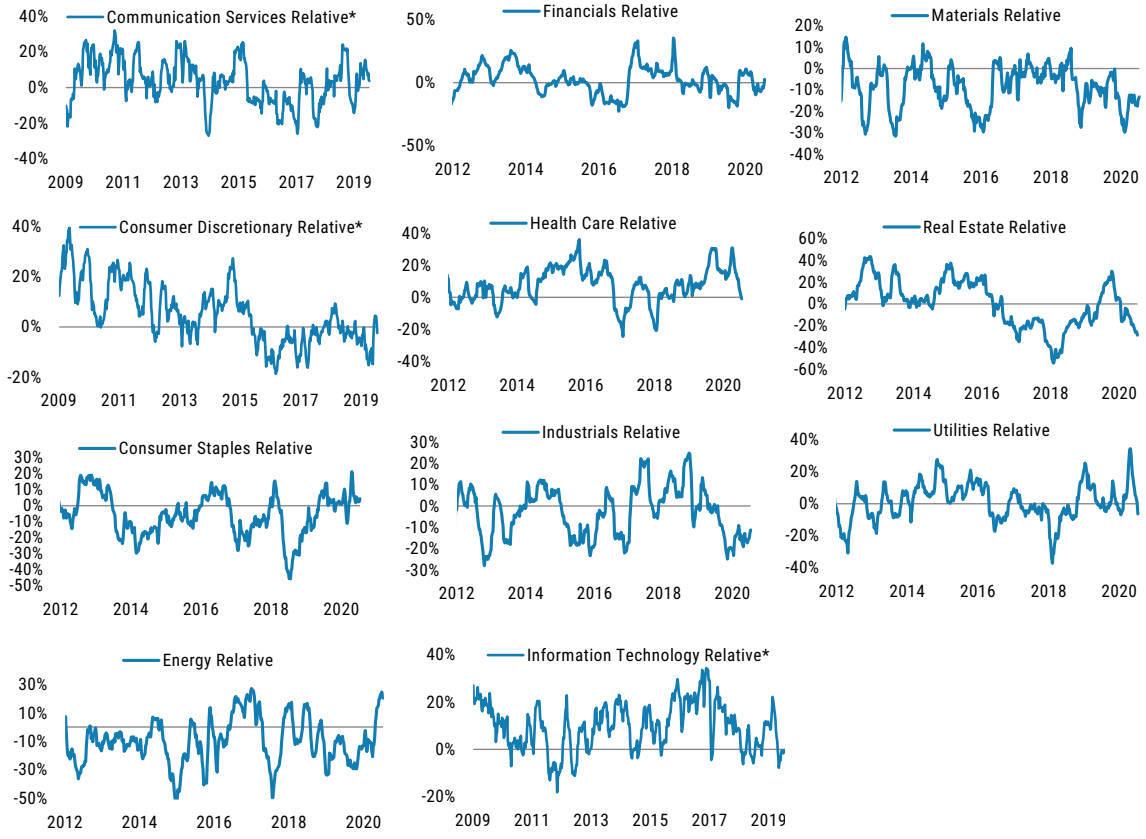
Source: Bloomberg, Morgan Stanley Research

Exhibit 21: Sector Ratings

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

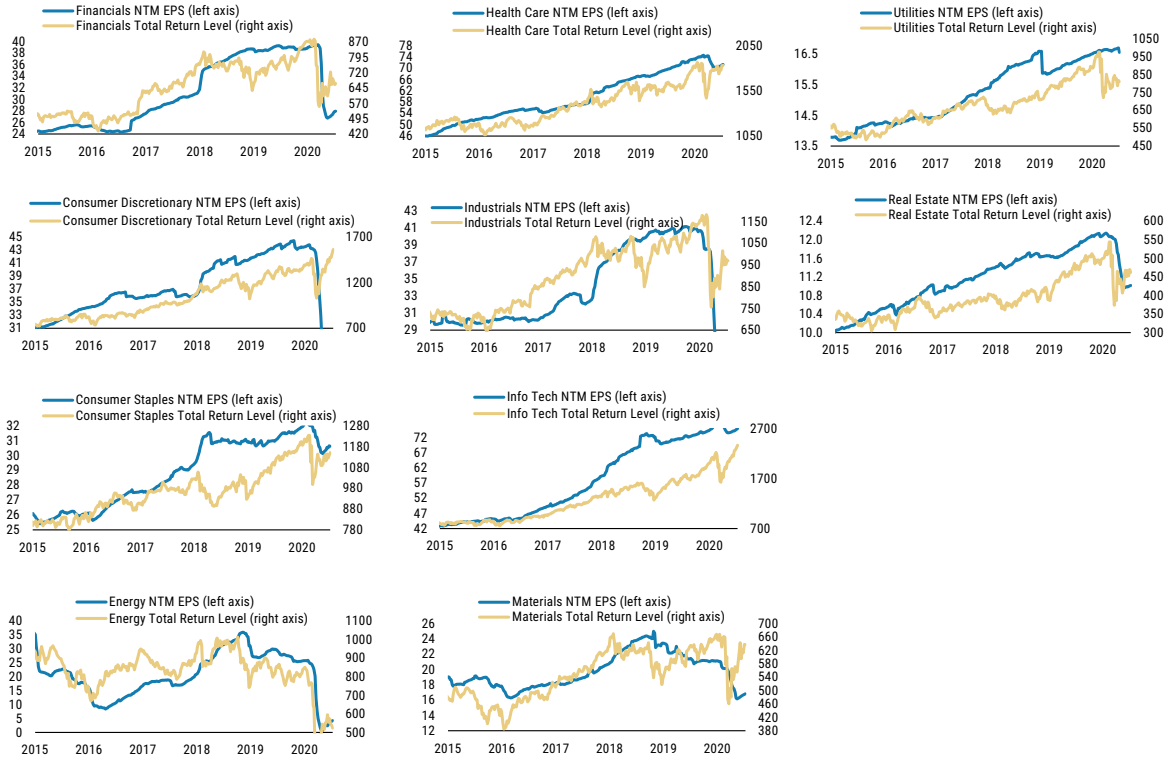
Source: Morgan Stanley Research

Exhibit 22: Earnings Revisions Breadth



Source: FactSet, Morgan Stanley Research. As of July 9, 2020. Sectors with * use current, fixed constituents.

Exhibit 23: US Sector NTM EPS vs. Total Return Level



Source: FactSet, Morgan Stanley Research as of July 9, 2020.

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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
Overweight/Buy	**1252**	**39%**	**323**	**43%**	**26%**	**565**	**38%**
Equal-weight/Hold	**1430**	**44%**	**336**	**45%**	**23%**	**690**	**47%**
Not-Rated/Hold	**5**	**0%**	**0**	**0%**	**0%**	**3**	**0%**
Underweight/Sell	**553**	**17%**	**84**	**11%**	**15%**	**225**	**15%**
TOTAL	**3,240**		**743**			**1483**	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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