Morgan Stanley | RESEARCH

UPDATE

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US Equity Strategy | North America

Weekly Warm-up: Final Chapter of the Mid-Cycle Transition

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Will it be "Fire" or "Ice"? We don't know, but the ice scenario would be worse for markets and we are leaning in that direction given the fall in consumer confidence and reset lower in PMIs we expect. We're underweight consumer discretionary but with a strong preference for services over goods.

We think the mid-cycle transition will end with the rolling correction finally hitting the S&P 500. We've laid out two near-term risk paths that could lead to this outcome: "fire" (the Fed begins to remove monetary accommodation in response to an overheating economy) and "ice" (earnings revisions and higher frequency macro data points decelerate amid demand pull forward, supply chain issues and margin pressure). This week, we dive deeper into both of these paths and point to accelerating risks on both the policy and growth fronts.

The typical mid-cycle "fire" outcome would lead to a modest and healthy 10% correction in the S&P 500. However, the "ice" scenario is starting to look more likely, and could result in a more destructive outcome – i.e. a 20%+ correction. As a result, we continue to recommend a barbell of more defensively oriented quality (Healthcare and Staples) to protect from the "ice" scenario while keeping a leg in Financials to participate in the "fire" outcome as higher rates materialize.

On the decelerating growth ("ice") front, we point to downside risk to earnings revisions, consumer confidence and PMIs. These indicators are all highly correlated to S&P price on a rate of change basis, and thus we highlight what downside in these measures could mean for the S&P 500.

We remain constructive on services over goods within Discretionary….but services make up only 17% of the sector's market cap. Given the overconsumption that's already taken place within consumer goods and the fact that pricing is becoming demand destructive, we're wary of the Discretionary sector's heavy weight toward goods and remain underweight the sector. From an economic standpoint, the dynamic is different, as personal consumption is driven by services more so than goods. Thus, a reversion in goods personal consumption back to trend is less of an economic risk than a market one.

This past week, Morgan Stanley held its annual Industrials conference. Trucking companies at the conference were constructive overall on the outlook through 2022 as demand looks supportive while the supply equation could get worse from here. Airlines flagged the recent softening in demand due to the Delta variant but noted recent trends stabilizing over the past couple of weeks. Multi-Industry companies highlighted that supply chains are limiting near-term growth but 2022 looks solid and several supercycles are in the works.

What to Focus on This Week

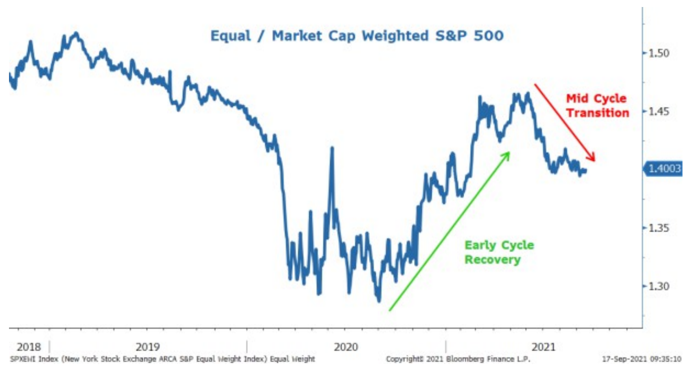
The Final Chapter of the Mid Cycle Transition Is Here

Since mid-March, we have espoused our mid-cycle transition narrative for US Equity markets. This has played out to script for the most part, with large-cap quality outperforming while the average stock has materially underperformed the S&P 500 (Exhibit 1 and Exhibit 2), the exact opposite of what occurred during the early cycle phase of recovery.

Exhibit 1: Large Cap Quality leads.....

Source: Bloomberg, Morgan Stanley Research

Exhibit 2: ...as Breadth Continues to Weaken



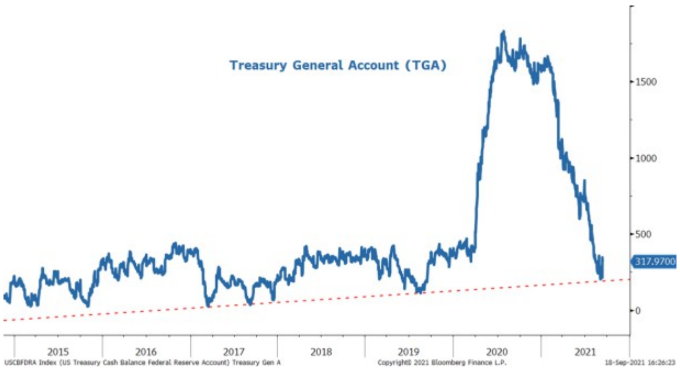
Source: Bloomberg, Morgan Stanley Research

Many commentators and clients continue to point to the S&P 500 near all-time highs as a leading indicator and rationale for even higher prices ahead. However, in our view, the relative strength of the S&P 500 and Nasdaq 100 is further confirmation that the market understands the mid-cycle transition narrative and has bought into it hook, line and sinker. After all, the S&P 500 is the highest quality large cap index in the world. In short, it *should* be outperforming right now. The question is whether the mid-cycle transition will end with a correction in this index as it typically does, or whether it's different this time? With our year end target 10% below current levels, our view is clear: **the mid-cycle transition will end with the rolling correction finally hitting the S&P 500.**

What's the Catalyst?

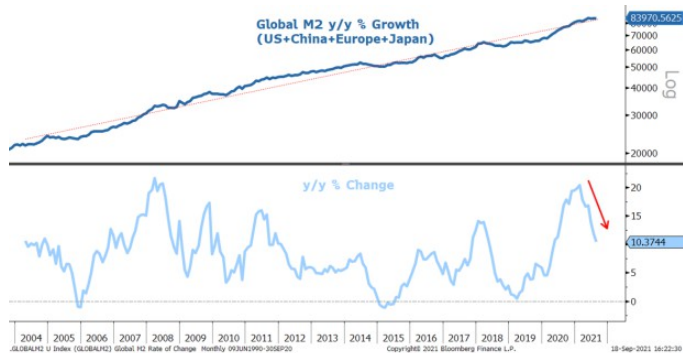
We have presented two potential scenarios for why / how the correction will ensue. The more traditional ending to a mid-cycle transition is a "fire" outcome whereby the recovery overheats and the Fed begins to remove accommodation. In the 1994 and 2004 transitions, that meant raising the Fed Funds Rate. In 2011, it was simply the ending of QE2. This time we think it is the tapering of asset purchases later this year/early next year. Given that the taper was effectively pre-announced at Jackson Hole 3 weeks ago, is it a coincidence that equity markets have been softer in September? Under this scenario, the economy reaccelerates from the summer slowdown but not enough to offset the tightening of financial conditions from higher back end rates and less liquidity in the system. In addition to the anticipated tapering of asset purchases later this year, we point to the fact that the Treasury's General Account (TGA) has fallen by $1T since March (Exhibit 3). While this has been a good offset to the decelerating M2 growth (Exhibit 4), that offset is probably finished now. Bottom line, this is the time of the mid cycle transition when P/Es for the broader index properly contract (Exhibit 5).

Exhibit 3: TGA Can't Fall Much Further...



Source: Bloomberg, Morgan Stanley Research

Exhibit 4: ...To Offset the Decelerating M2 Growth



Source: Bloomberg, Morgan Stanley Research

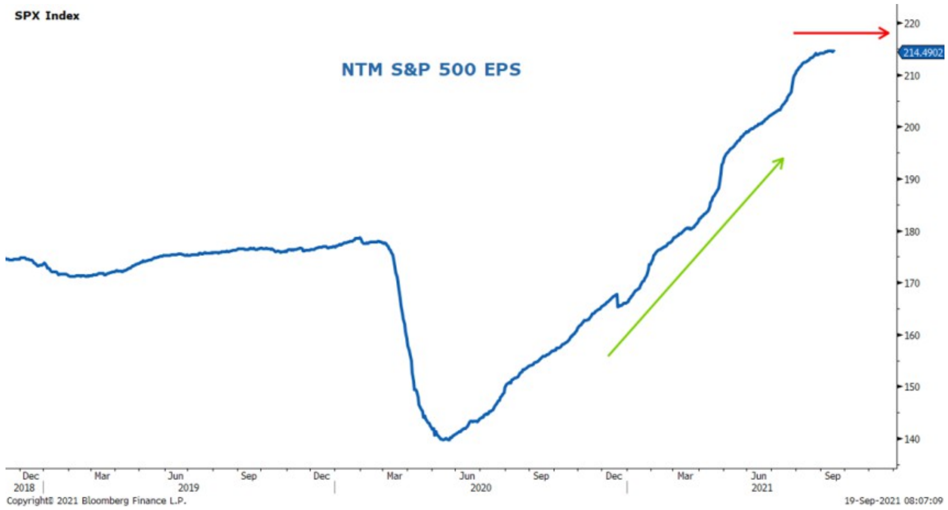
Exhibit 5: S&P 500 P/E Likely to Complete Its Typical 20% Mid Cycle Transition Decline This Fall

Source: Bloomberg, Morgan Stanley Research

As noted, **the internal rotations suggest the mid-cycle transition is right on schedule**. In addition to peak monetary accommodation, there is the inevitable peak rate of change in growth that occurs at this stage of the cycle. Given the extraordinary fiscal stimulus during this recession, we are concerned that the inevitable deceleration in growth will be much worse than what is currently expected. This is the "ice" scenario and would likely lead to a larger than normal mid-cycle transition correction in the S&P 500—i.e. 20%+.

To that end, **there are several key variables we are monitoring that currently support a view for a worse than expected growth deceleration. First is NTM earnings estimates**. Even if the economy rebounds in 4Q from the slowdown this summer, it likely won't translate into higher earnings estimates as incremental margins rollover due to higher costs and taxes. This is the mirror image of the past year when costs were being eliminated as revenues benefitted greatly from the fiscal stimulus. Indeed, NTM EPS estimates for the S&P 500 appear to have been flattening out over the past month after a record recovery to levels that are 20% above the prior peak (Exhibit 6). This will be critical to watch as we enter 3Q earnings season and companies update investors on costs/margins and potential payback in demand from the consumption binge earlier this year.

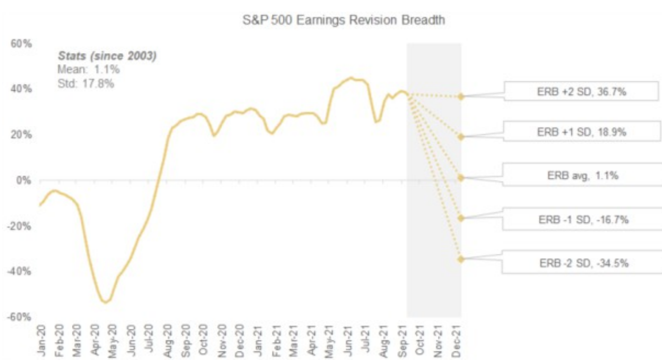
Exhibit 6: Are Forward Earnings Estimates Starting to Flatten Out After a Record Run?



Source: Bloomberg, Morgan Stanley Research

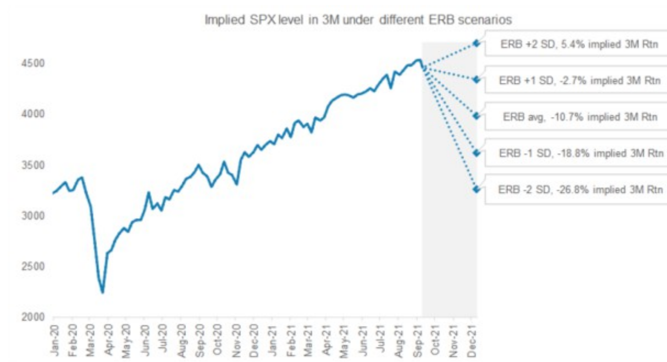
Another way to analyze this rate of change on earnings momentum is to look at earnings revision *breadth*, which we think is vulnerable to a simple reversion to the mean from today's very elevated levels of +2 standard deviations (Exhibit 7). If earnings revision breadth (ERB) normalizes to its average over the next 3 months, the S&P should fall approximately 11%. If the ERB falls toward 1 standard deviation below average, the S&P 500 should fall 19%, and at -2 standard deviations, the S&P 500 falls 27% (Exhibit 8).

Exhibit 7: ERB Should Normalize in Next 3 Months...



Source: Factset, Morgan Stanley Research

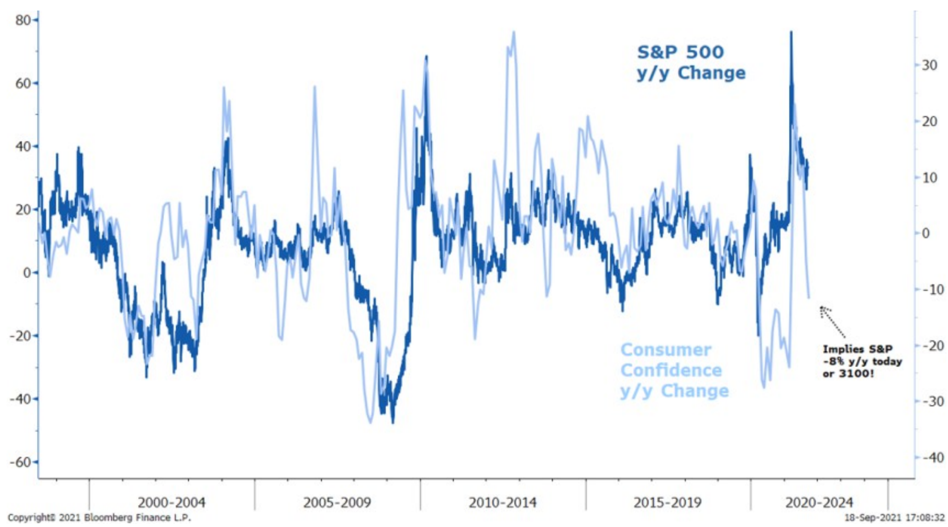
Exhibit 8: ...Which Doesn't Bode Well for SPX



Source: Factset, Morgan Stanley Research

Second, consumer confidence has recently fallen sharply. It started with the University of Michigan survey plummeting in August to lower levels than we witnessed during the entire pandemic and recession last year. While the Conference Board Consumer Confidence Survey remained elevated in July, it saw a big catch up to the downside in August as well. **These surveys are important variables for us because they have strong positive correlations to the y/y change in the S&P 500.** Based on the UMich survey, the S&P 500 appears vulnerable to *at least* a 10-20% correction if the survey doesn't improve next month (Exhibit 9). Our general view is that consumers aren't as naïve as they are often made out to be. They know the last year has been a bit of a bonanza working from home while receiving stimulus checks from the government that many didn't need (85% of all Americans received stimulus checks). Meanwhile, prices of everything are up a lot just as the extra money has stopped going out. That's a bad combo for sentiment and supports our payback in demand view and underweight on Consumer Discretionary stocks, particularly goods-related ones (see More on Services Over Goods within Discretionary).

Exhibit 9: Y/Y Change in S&P 500 Is Correlated to Y/Y Change in UMich Consumer Sentiment

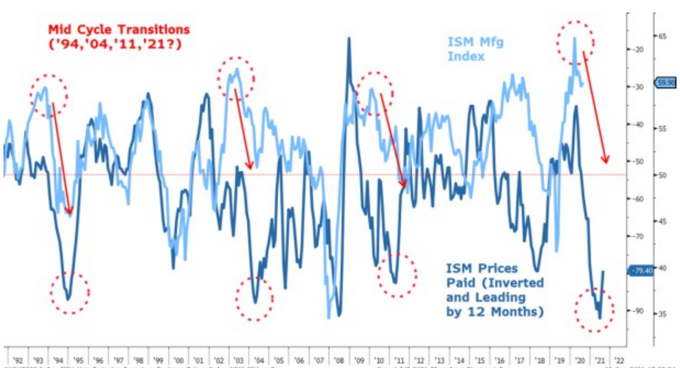


Source: Bloomberg, Morgan Stanley Research

Finally, while many businesses have done extremely well during the pandemic, the trends here are also likely to subside. Perhaps the best way to gauge the momentum in businesses overall comes from the Purchasing Manager Surveys. Earlier this year we reached record highs in many of the subcomponents and, much like economic surprise indices and earnings revision breadth measures, the PMIs are mean reverting. In fact, this feature was central to our mid-cycle transition call back in March. Indeed, the peak rate of change was in April just as the PMIs peaked as well. Importantly, the prices paid component (inverted) leads the headline by approximately 12 months and suggests the decline in the PMIs will likely be worse than typically witnessed during the mid-cycle transition phase – i.e., back toward 50, if not lower (Exhibit 10).

This would imply the Headline PMI is down 10-20% y/y by December. Given a tight relationship with the y/y change in the S&P 500, the implication is that the S&P could see at least a 10-20% decline over the next 3 months (Exhibit 11). **Bottom line, the typical "fire" outcome would lead to a modest and healthy 10% correction in the S&P 500, in our view. However, the "ice" scenario is starting to look more likely, in our opinion, and could result in a more destructive and unexpected outcome. As a result, we continue to recommend a barbell of more defensively oriented quality (Healthcare and Staples) to protect from the "ice" scenario while keeping a leg in Financials to participate in the "fire" outcome should higher rates materialize**.

Exhibit 10: PMIs Are Headed Lower We Think...



Source: Bloomberg, Morgan Stanley Research

Exhibit 11: ...Which Also Doesn't Bode Well for SPX

Source: Bloomberg, Morgan Stanley Research

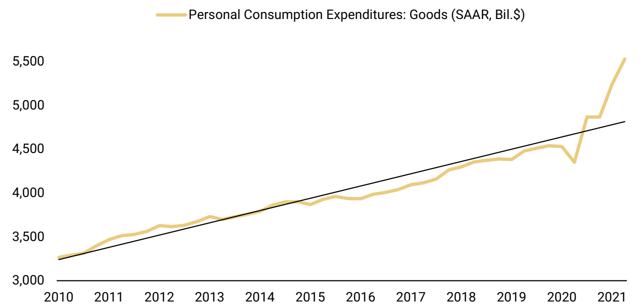
More on Services Over Goods within Discretionary

We remain relatively constructive on services over goods within Discretionary...but note that services only make up 17% of the sector's market cap. Given the overconsumption that's already taken place within consumer goods and the fact that pricing is becoming demand destructive, we're weary of the Discretionary sector's heavy weight toward goods and remain underweight the sector. From an economic standpoint the dynamic is different as personal consumption is driven by services more so than goods. Thus, **a reversion in goods personal consumption back to trend is less of an economic risk than a market one.**

We recently reiterated our preference for services (the Consumer Services industry group) over goods (the Retailing and Consumer Durables industry groups) within the overall Consumer Discretionary sector (see Weekly Warm-up: Fire or Ice?). Our economists expect US consumer balance sheets to remain healthy through 2022, and that excess consumer savings will remain ~$2 trillion in aggregate. This should continue to support healthy spending in areas where pent-up demand still exists. We think Consumer Services (hotels, restaurants, airlines, and other travel-related companies) should benefit from this and from the wallet share shift from goods to services we expect to persist over the next 12 months. Obviously, this view is contingent on the path of Covid. The more optimistic news on that front is that our US Biotech analyst Matthew Harrison believes that the current Delta wave has peaked (see COVID-19: Daily Update on Pandemic Status and Vaccination Progression). Further, US airline and hotel trends have receded somewhat as a result of the Delta variant, but actually still look fairly resilient (see Travel & Leisure Activity Tracker), and public transit mobility trends have notched higher in recent weeks (see the Mobility Dashboard in COVID-19: Daily Update on Pandemic Status and Vaccination Progression).

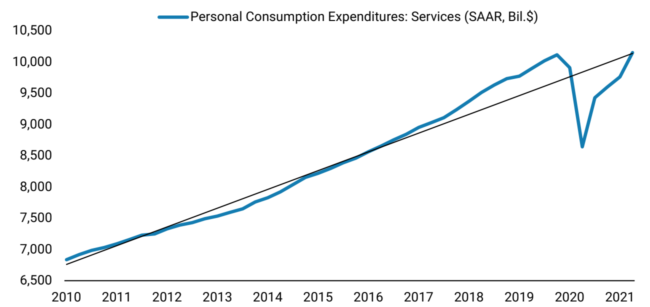
Conversely, we have been focused on the idea that a demand pull forward due to Covid took place in the goods-oriented areas of the sector (Consumer Durables and Retailing). One way we have illustrated this is through retail sales, which remain well above trend. We think a reversion to trend in retail sales is coming as the boost from government stimulus payments fades and consumers have exhibited overconsumption in consumer goods. This week, we illustrate this dynamic by showing how far above trend Goods Personal Consumption Expenditure is (Exhibit 12). We think this dynamic poses a continued risk to Consumer Durables and Retailing over coming months as we have explained in detail in recent weeks. We think this issue is compounded by (1) the fact that surging prices in the goods economy are becoming demand destructive from a consumer standpoint, and (2) that cost pressures continue to surge for many of these companies, posing a risk to profit margins. To the points made above on pent-up demand for services, Exhibit 13 shows that services personal consumption expenditure has not seen this overconsumption dynamic as a result of Covid and is just now back to trend.

Exhibit 12: Goods Consumption Is Well Above Trend...



Source: Haver Analytics, Morgan Stanley Research.

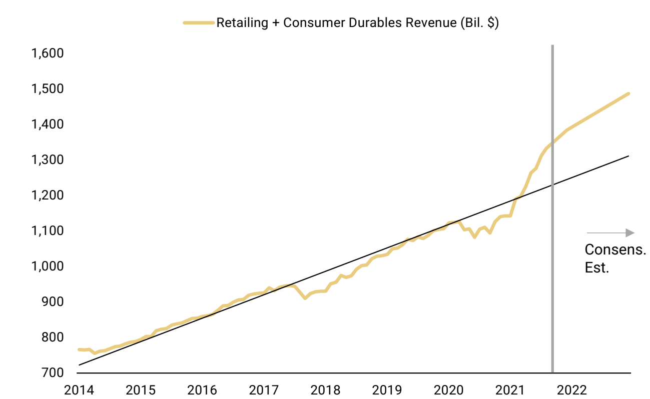
Exhibit 13: ...While Services Consumption Is Just Now Back to Trend



Source: Haver Analytics, Morgan Stanley Research.

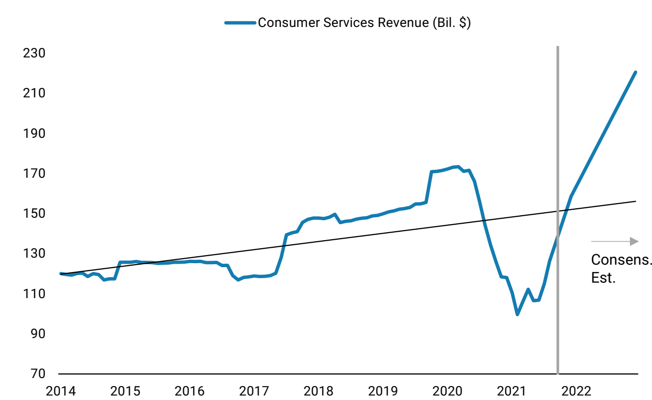
From an equity perspective, the dynamic is similar. Exhibit 14 shows that Retailing + Consumer Durables revenue is already well above trend and is expected to continue to accelerate through 2022 based on consensus estimates. While Consumer Services revenue is expected to accelerate meaningfully in 2022, it is just now back to trend – not already above it (Exhibit 15). Critically, as we pointed out in Weekly Warm-up: Fire or Ice? Consumer Services is not priced for this acceleration as its relative performance remains historically depressed – a very different dynamic from the goods-oriented groups within Discretionary, which have seen much stronger relative performance post-Covid. Exhibit 16 and Exhibit 17 show that the wallet share shift dynamic from goods to services is in consensus numbers, but again, we would argue that dynamic is not yet in the price for services.

Exhibit 14: Retailing + Consumer Durables (i.e., Goods) Revenue Already Above Trend...



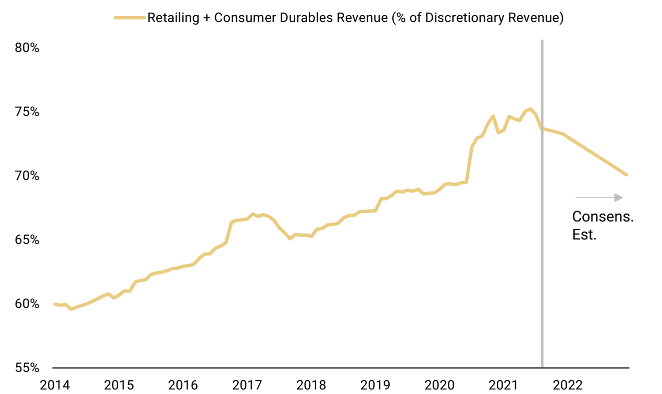
Source: Compustat, Refinitiv, Morgan Stanley Research.

Exhibit 15: ...Consumer Services Revenue Back to Trend but Expected to Exceed Trend in 2022



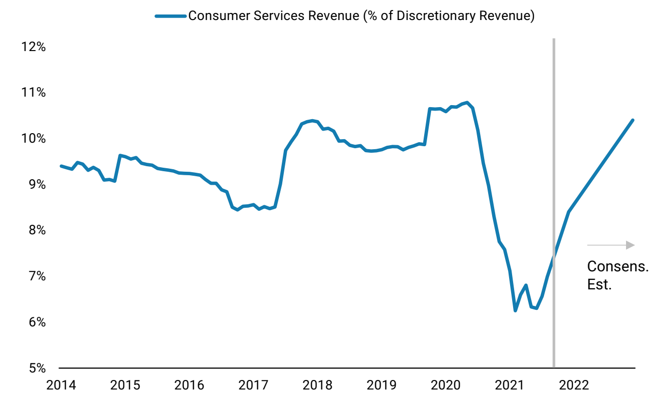
Source: Compustat, Refinitiv, Morgan Stanley Research.

Exhibit 16: Wallet Share Shift within Consumer Discretionary Reflected in Lower Expectations for Goods Revenue as a Percent of Total...



Source: Compustat, Refinitiv, Morgan Stanley Research.

Exhibit 17: ...And Higher Expectations for Services Revenue

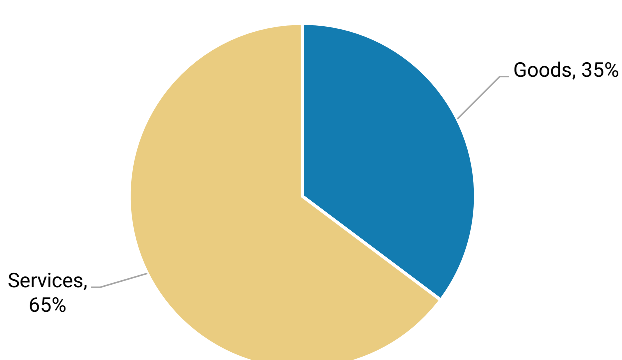


Source: Compustat, Refinitiv, Morgan Stanley Research.

Finally, and perhaps most importantly, we think it's worth focusing on the idea that the economic breakdown of goods vs. services within overall personal consumption (a component of GDP) is very different from the market cap breakdown of goods vs. services within the Consumer Discretionary sector. Personal consumption is much more heavily weighted toward services as Exhibit 18 shows, which should limit the effects of a reversion to trend in goods consumption on the overall economy as wallet share shift toward services continues to play out. The story is much different, however, within the Consumer Discretionary sector. **Goods make up 83% of Consumer Discretionary market cap, while services make up just 17%. Given (1) this skew and (2) the overconsumption dynamics within goods that we laid out earlier, the Consumer Discretionary sector is disproportionately exposed to a reversion to trend in consumer goods. This is a key reason why we are underweight the Consumer Discretionary sector despite our relative preference for Consumer Services at the sub-sector level.**

Exhibit 18: Services Are the Much Larger Contributor to Personal Consumption from an Economic Standpoint...

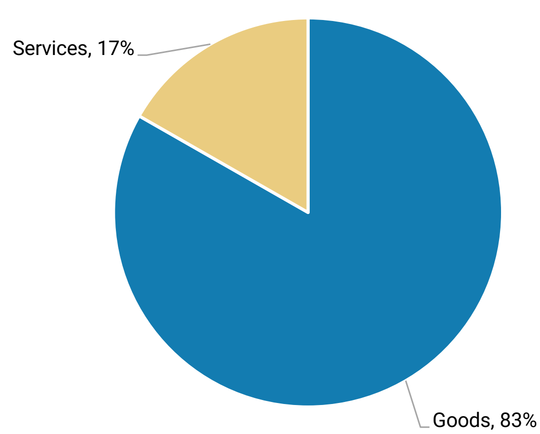
Breakdown of Personal Consumption Expenditure



Source: Haver Analytics, Morgan Stanley Research.

Exhibit 19: ...While Goods Are the Much Larger Contributor to Consumer Discretionary Market Cap

Breakdown of Consumer Discretionary Market Cap

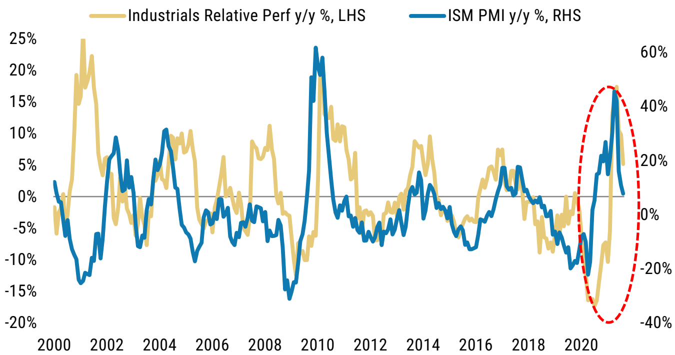


Source: FactSet, Morgan Stanley Research.

Industrials Conference Recap

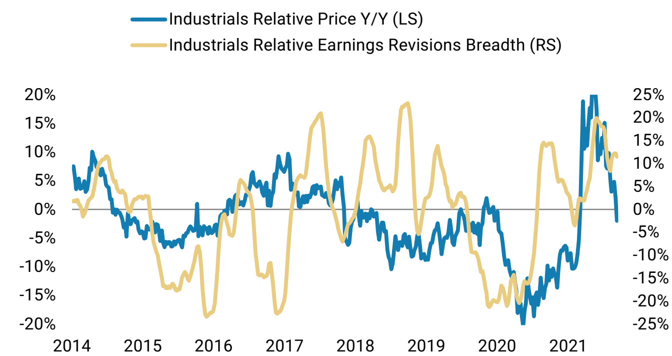
This past week, Morgan Stanley held its annual Industrials conference. We have an equal-weight rating on the Industrials sector as it remains vulnerable to the mid-cycle transition / decelerating growth, but greater spending on infrastructure and a hot capex cycle offer potential offsets. Relative performance has been leading relative earnings revisions lower, which suggests further revisions to the downside may already be priced in the sector.

Exhibit 20: PMIs Are Pointing to a Lower Path for Industrials



Source: Bloomberg, Morgan Stanley Research

Exhibit 21: Relative Performance Has Not Rolled Over to the Same Extent as Revisions



Source: FactSet, Morgan Stanley Research

Trucking companies at the conference were very constructive on the outlook through 2022 as demand looks supportive while the supply equation could get worse from here. Several also flagged that peak season should be strong though sequential changes may be more muted given they have been operating at "peak-like" levels for some time.

Airlines flagged the recent softening in demand due to the Delta variant but noted recent trends stabilizing over the past couple of weeks, and some management teams even pointed to a slight uptick over the past week. ESG was also a key focus with many airlines stating that Sustainable Aviation Fuel (SAF) is top of mind but not yet scalable and/or cost effective. Labor shortages, inflation, and Covid-19 remain headwinds, but many airlines expect a strong holiday season ahead of us.

Multi-Industry companies highlighted that supply chains are limiting near-term growth but 2022 looks solid and several supercycles are in the works. The supply chain focus was clear throughout the week. Long-term opportunities in digitization/automation, electrification, decarbonization and other "-ations" yet to be determined are solid if not outright hastened by the current environment.

For more on our view on the sector and analyst top picks, please see US Equity Strategy: Industrials Conference: Strategy Sector Views + Analyst Stock Picks (13 Sep 2021).

Fresh Money Buy List

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 and the exhibits below shows performance stats.

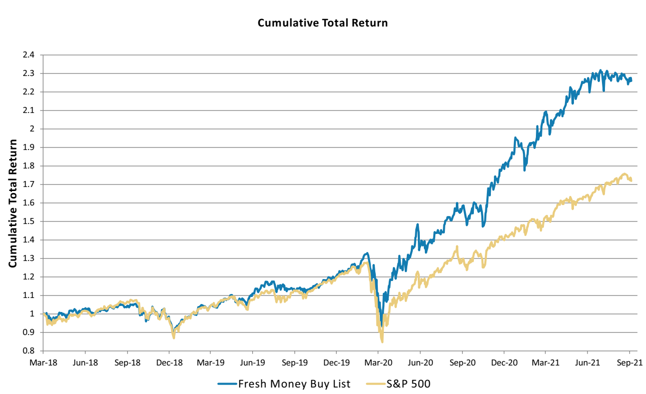
Exhibit 22: Fresh Money Buy List - Stats & Performance

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
Alphabet Inc.	GOOGL	Overweight	Communication Services	$1,881.2	$2,813.55	3,000.00	6.6%	Nowak, Brian	4/5/2021	32.1%	21.1%
Exxon Mobil Corporation	XOM	Overweight	Energy	$234.5	$55.39	84.00	51.7%	McDermott, Devin	2/22/2021	8.9%	(5.5%)
Humana Inc	HUM	Overweight	Health Care	$52.3	$406.80	513.00	26.1%	Goldwasser, Ricky	7/19/2018	31.1%	(35.8%)
MasterCard, Inc.	MA	Overweight	Information Technology	$338.6	$343.13	451.00	31.4%	Faucette, James	3/2/2020	19.1%	(34.8%)
Mondelez International Inc	MDLZ	Overweight	Consumer Staples	$85.2	$60.97	69.00	13.2%	Mohsenian, Dara	7/19/2021	(5.1%)	(7.9%)
SBA Communications	SBAC	Overweight	Real Estate	$38.8	$354.14	405.00	14.4%	Flannery, Simon	6/7/2021	13.4%	8.2%
Simon Property Group Inc	SPG	Overweight	Real Estate	$43.3	$131.77	161.00	22.2%	Hill, Richard	2/16/2021	24.7%	11.0%
Synchrony Financial	SYF	Overweight	Financials	$27.6	$48.43	65.00	34.2%	Graseck, Betsy	2/22/2021	28.4%	14.0%
Welltower Inc.	WELL	Overweight	Real Estate	$36.5	$86.46	100.00	15.7%	Hill, Richard	2/22/2021	28.4%	13.9%
Current List Performance											
Average (Eq. Weight)				$304.2			23.9%			20.1%	(1.8%)
Median				$52.3			22.2%			24.7%	8.2%
% Positive Returns (Abs. / Rel.)										89%	56%
% Negative Returns (Abs. / Rel.)										11%	44%
Avg. Hold Period (Months)											10.7
All Time List Performance											
Average (Eq. Weight)										32.6%	12.8%
Median										23.3%	10.4%
% Positive Returns (Abs. / Rel.)										79%	55%
% Negative Returns (Abs. / Rel.)										21%	45%
Avg. Hold Period (Months)											13.4

Performance returns shown above and below 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.

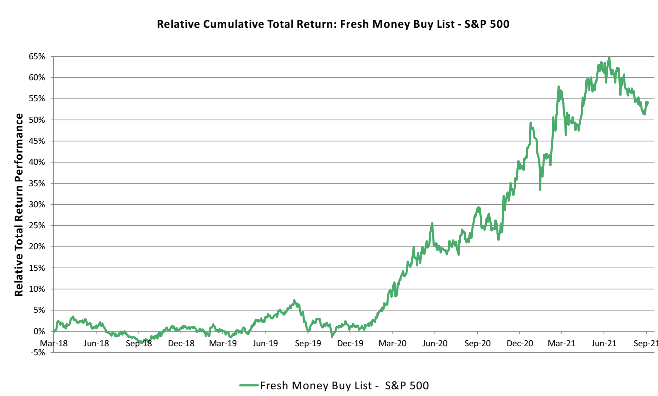
Source: Bloomberg, Morgan Stanley Research estimates.

Exhibit 23: Fresh Money Buy List & S&P 500 Cumulative Total Return



Source: Bloomberg, Morgan Stanley Research.

Exhibit 24: Fresh Money Buy List / S&P 500 Cumulative Relative Return



Source: Bloomberg, Morgan Stanley Research.

Alphabet (GOOGL), Brian Nowak

- Our teams analyze potential AAPL and GOOGL impacts from app store fee changes, discuss direct payment opt-in rates (is MTCH a harbinger?), size potential benefits to mobile publishers/networks and lay out 3 ripple effects to monitor next (direct negotiations, FB gaming, future lawsuits).

- What Happened? On Friday, the US District Court issued a ruling on the Epic v. Apple lawsuit where Epic alleged that AAPL was engaging in unfair practices on the iOS App Store. The court found in favor of AAPL on all counts, except Epic's claim that the App Store anti-steering provisions violate California's competition laws. The ruling concluded that those provisions, which effectively require many app developers to use AAPL's in-app payment processing, are anticompetitive and the court issued an injunction directing AAPL to remove the restrictions nationwide, effective 12/9/21. While there could likely be an appeal (and this could still be a multi-year process) there are some important implications of this ruling.

- Internet Takeaways: We see a wide range of impacts across our Internet coverage with mobile gamers and ad networks the biggest potential beneficiaries where every 10% of in-app revenue that shifts to direct payments driving 5%+ upside to mobile publisher 2023 EBITDA. Tinder's experience of an estimated 40% direct payments suggests the largest gaming developers could see meaningful earnings upside that could then be reinvested in user acquisition benefitting the mobile ad networks at U and APP. MTCH and BMBL could also see 400-850bps of potential gross margin expansion from lower app fees though we expect some of this would be reinvested in marketing and R&D and it will take several quarters to see the full impact as existing subscribers are unlikely to switch payment processors. For Google, every 10% of Play revenue that shifts direct leads to a 1% impact to 2023 total company EBITDA; however, this assumes all developers see a shift whereas in reality, it is likely to only impact the largest developers, which reduces the impact to Google.

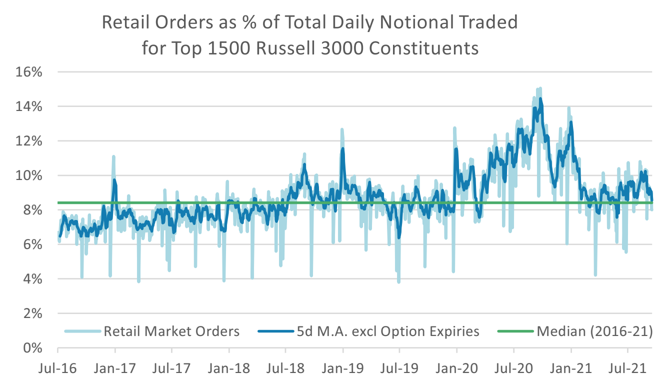
What's Retail Doing?

Our Quantitative Equity Strategy team recently introduced a novel way to track the activity of retail traders using publicly available data. We provide a few updates and key observations on the retail trader using this approach.

A few key observations:

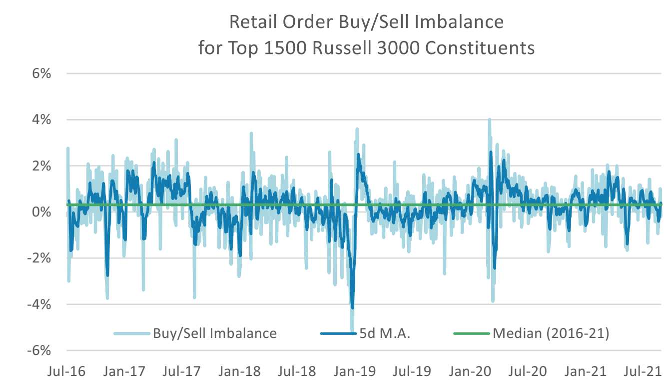
- Retail participation is currently at 8.0% of the total market volume, which is in the 37th percentile relative to the last 5 years, and switched to a drop after a modest upward trend over the last few months.
- Order imbalance remains slightly positive. It currently sits at 0.6% or 63rd percentile relative to the last 5 years.
- Imbalance is positive for most sectors as of September 16. It is most positive relative to sector history in Materials (98th %-ile) and Energy (91st %-ile), while Industrials the most negative in buy/sell imbalance. Industrials, Staples, Communication Services and Real Estate are the sectors with negative buy/sell imbalances.

Exhibit 25: Retail orders as a % of notional traded have recently seen a drop ...



Source: Morgan Stanley Research, Morgan Stanley Quantitative and Derivative Strategies, Compustat

Exhibit 26: ... and the mix has shifted towards more buying



Source: Morgan Stanley Research, Morgan Stanley Quantitative and Derivative Strategies, Compustat

Exhibit 27: Retail's buy/sell imbalance has switched positive

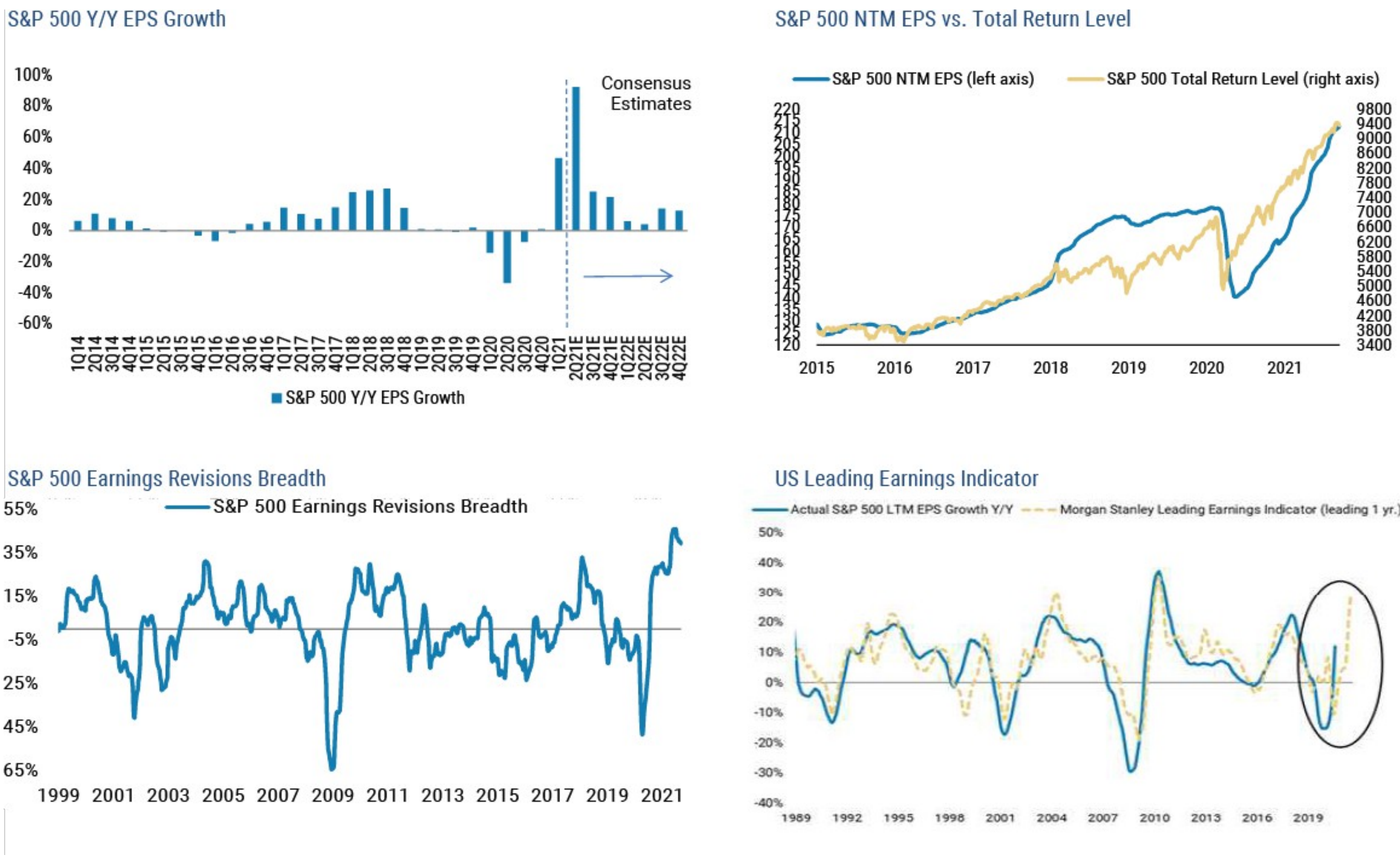
	Retail Participation			Buy/Sell Imbalance		
Sector	**2016-21 Median**	**Current**	**p-tile**	**2016-21 Median**	**Current**	**p-tile**
Energy	6.7%	7.5%	0.72	-0.40%	2.5%	0.91
Materials	5.6%	7.4%	0.90	0.5%	4.2%	0.98
Industrials	6.8%	6.3%	0.35	-0.1%	-1.0%	0.25
Consumer Discretionary	11.3%	9.4%	0.22	0.7%	0.7%	0.48
Consumer Staples	6.3%	4.8%	0.08	-0.6%	-1.2%	0.37
Health Care	6.0%	7.0%	0.77	-0.4%	1.3%	0.86
Financials	5.6%	5.1%	0.25	-0.1%	0.6%	0.64
Information Technology	10.8%	10.2%	0.35	0.5%	0.6%	0.54
Communication Services	8.7%	8.7%	0.50	0.3%	-0.3%	0.33
Utilities	4.0%	3.1%	0.10	-1.3%	1.6%	0.87
Real Estate	3.6%	2.7%	0.07	0.5%	0.0%	0.41
Model Universe (Top 1500)	**8.4%**	**8.0%**	**0.37**	**0.3%**	**0.6%**	**0.63**

Source: Morgan Stanley Research, Morgan Stanley Quantitative and Derivative Strategies, Compustat

For more on the methodology, please see Quantitative Equity Research: The Rise of the Retail Trader (30 Jun 2021).

Weekly Charts to Watch

Exhibit 28: US Earnings Snapshot



Source: Thomson Financial, FactSet, Morgan Stanley Research. Top and bottom left: As of Sept 17, 2021 Bottom right As of Aug 31, 2021. 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.

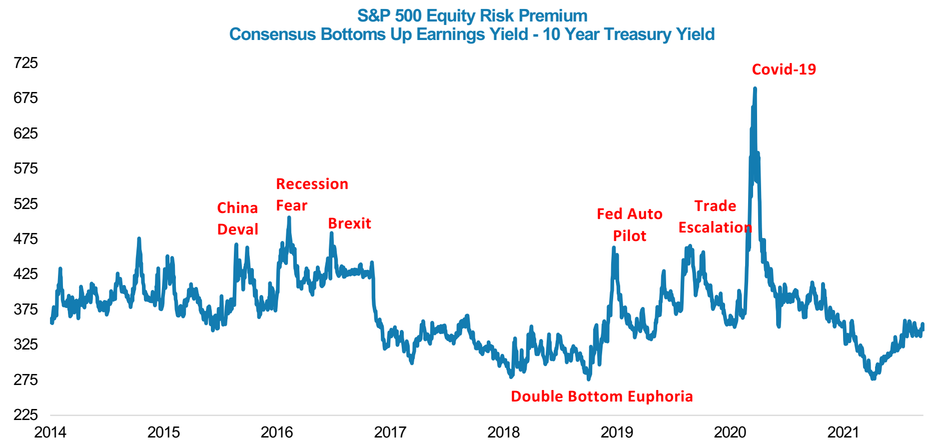
Exhibit 29: S&P 500 Price Target

Morgan Stanley S&P 500 Mid Year 2022 Price Target

Landscape	Earnings	Multiple	Price Target	Upside / Downside
Bull Case	$238	20.0x	4,800	7.3%
Base Case	$221	19.0x	4,225	-5.6%
Bear Case	$211	17.5x	3,700	-17.3%
Current S&P 500 Price as of:		9/16/2021	4,474	

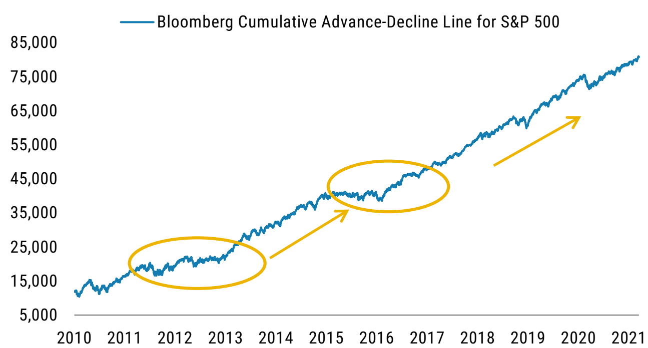
Source: Bloomberg, Morgan Stanley Research

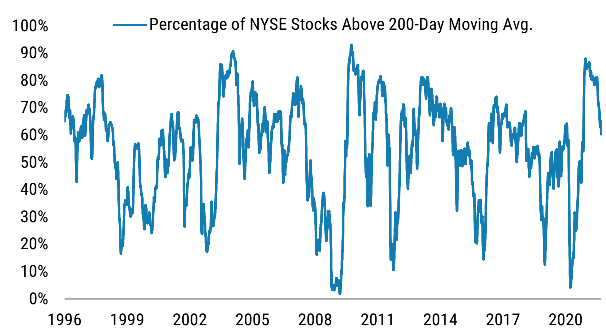
Exhibit 30: S&P 500 Equity Risk Premium

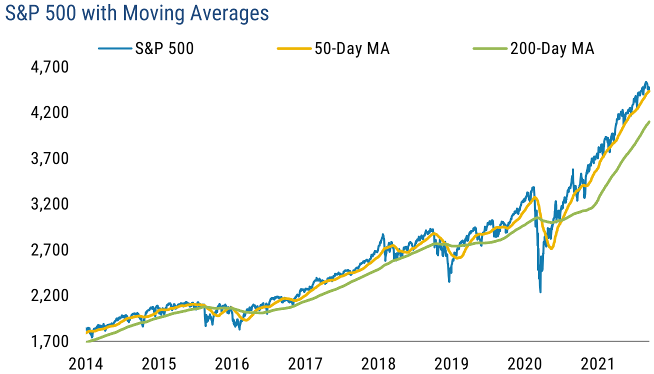


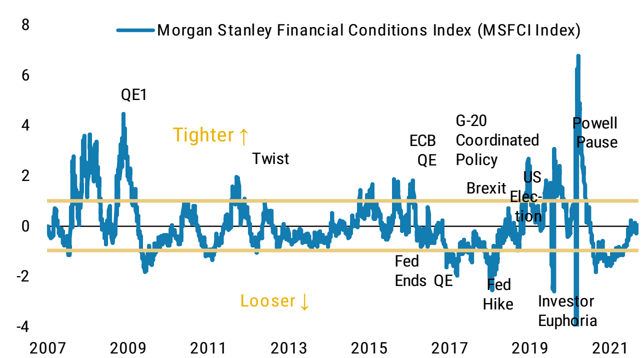
Source: Bloomberg, Morgan Stanley Research. As of Sept 16, 2021.

Exhibit 31: US Equity Market Technicals and Financial Conditions



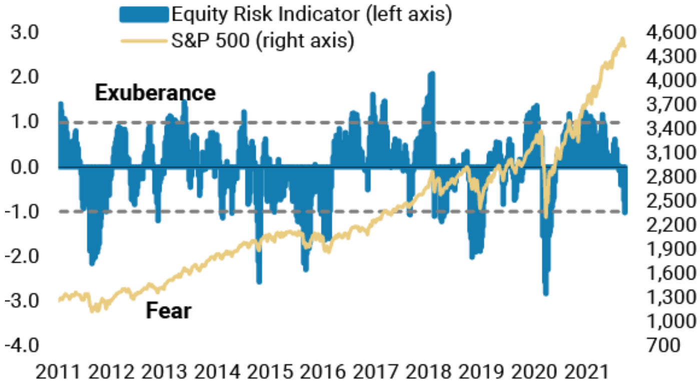


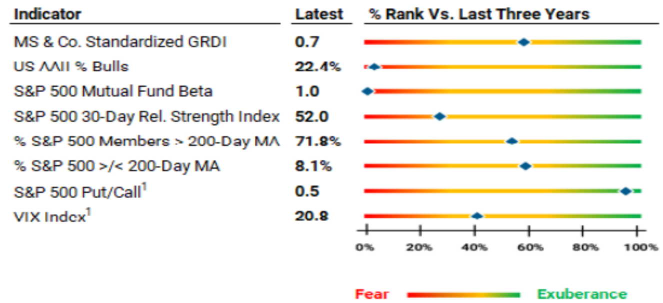


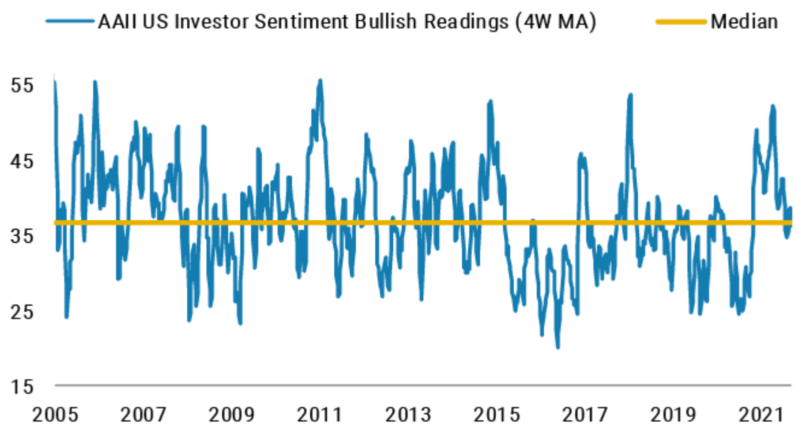


Source: Bloomberg, Morgan Stanley Research. All: As of Sept 16, 2021

Exhibit 32: US Equity Market Sentiment



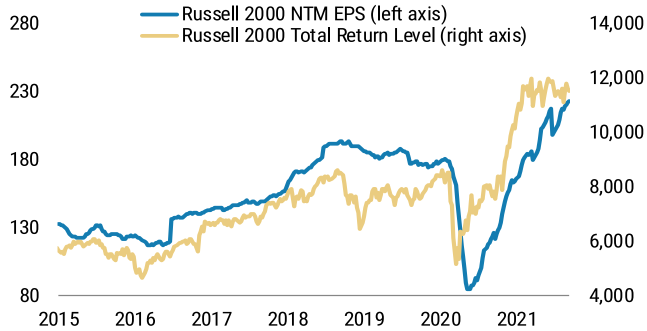




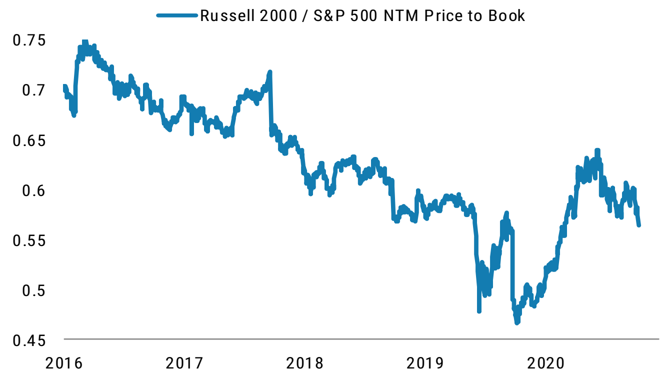
Source: Bloomberg, FactSet, Morgan Stanley Research. As of September 17, 2021.

Exhibit 33: US Small Cap Equities

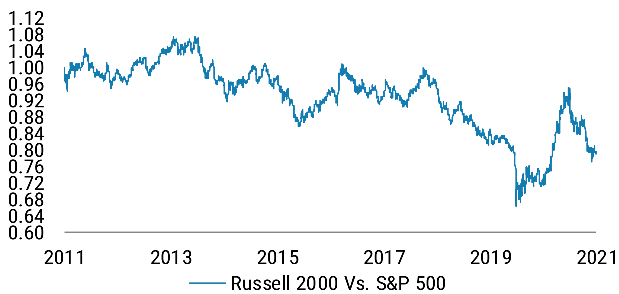
Russell 2000 NTM EPS vs. Total Return Level



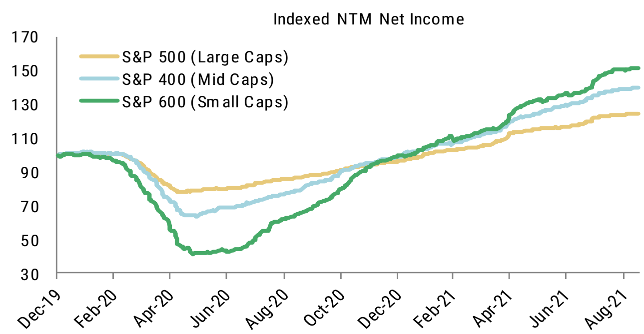
Russell 2000 NTM P/B and Relative NTM P/B vs. S&P 500



Russell 2000 Relative Performance vs. S&P 500

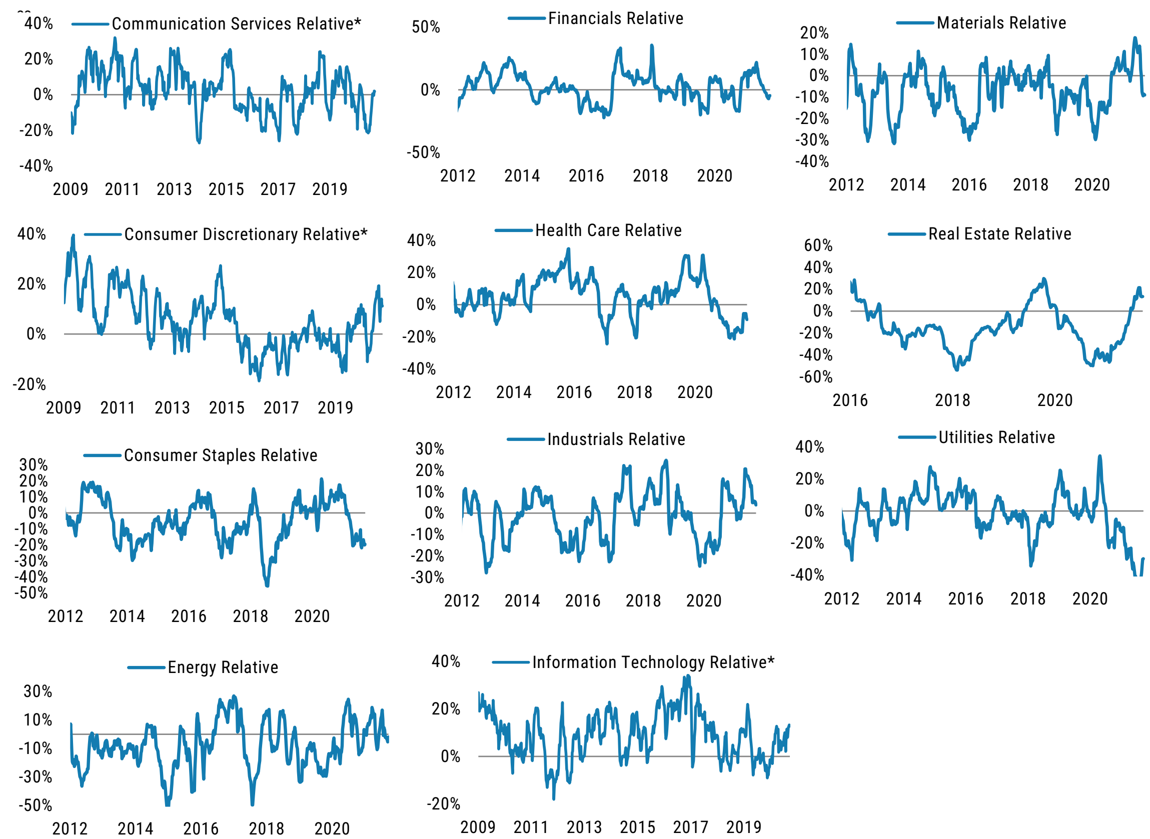


NTM EPS by Cap Size



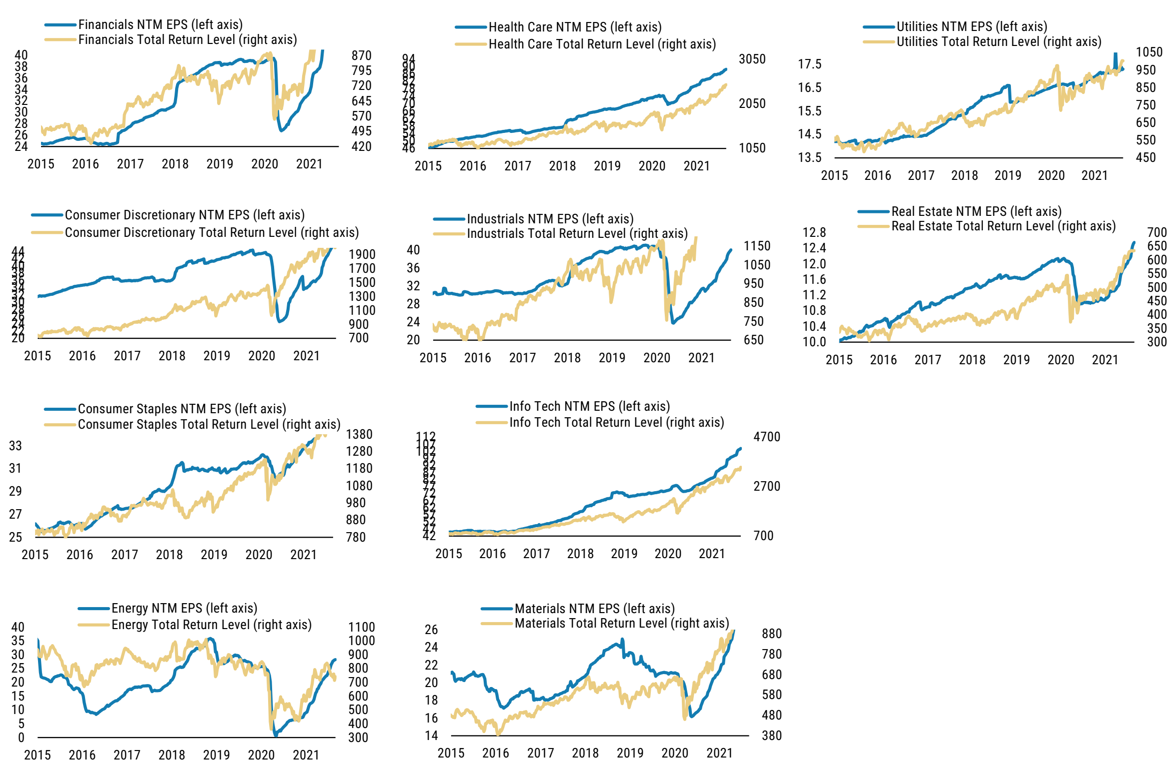
Source: FactSet, Morgan Stanley Research. As of Sept 16, 2021

Exhibit 34: Earnings Revisions Breadth



Source: FactSet, Morgan Stanley Research. As of Sept 16, 2021. Sectors with * use current, fixed constituents.

Exhibit 35: US Sector NTM EPS vs. Total Return Level



Source: FactSet, Morgan Stanley Research as of Sept 16, 2021

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Equal-weight/Hold	**1492**	**43%**	**376**	**43%**	**25%**	**670**	**44%**
Not-Rated/Hold	**1**	**0%**	**0**	**0%**	**0%**	**0**	**0%**
Underweight/Sell	**513**	**15%**	**80**	**9%**	**16%**	**191**	**13%**
TOTAL	**3,506**		**870**			**1527**	

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