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Weekly Warm-up: Boring Is Beautiful with Bear Market Rally Over; Stay Defensively Biased

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After one of the roughest quarters in history for stocks and bonds collectively, the markets better reflects the "Fire" part of our narrative; but now it's about the "Ice," and that's decidedly worse for stocks relative to bonds. We are doubling down on defensives, with the bear market rally now over.

1Q was rough even with the strong finish. The first quarter was one of the worst on record for the collective performance of stocks and bonds, with the latter worse than the former. This makes sense given investor concern focused more on the "Fire" (inflation and the Fed) than the "Ice" (growth slowdown). However, that leaves us more constructive on bonds than stocks over the near term as growth concerns take center stage – hence our doubling down on a defensive bias.

The bear market rally is over. While 1Q was rough for most stocks, the second half of March was exceptionally strong. The rally was predictable from a technical perspective, but it was always a bear market rally in our view, and now we think it's over. Our analysis of Friday's ISM manufacturing survey shows the orders component is now below inventories for the first time since the expansion began. This book to bill proxy for the broader manufacturing sector suggests meaningful downside to the headline ISM over the next few months, which does not bode well for the S&P500.

Boring is beautiful. Defensive sectors and stocks have outperformed both growth and value since our 2022 Outlook was published. The exceptions have been Energy and Materials, which have been the biggest beneficiaries of geopolitical turmoil. Despite the windfall for these sectors, defensives have even outperformed cyclicals at the broader level. We think this is further confirmation of our view that defensives remain the place to be. Boring is beautiful and we are doubling down on that theme today with growth and the rally fading into 2Q.

Market is paying up for dividend *yield*, not growth – i.e., bond proxies. Our latest quantitative analysis shows the market has been paying more for dividend *yield* rather than dividend *growth* since late last year. We think this is also supportive of our view that growth is becoming the primary concern for equity investors rather than higher rates. Just like the other analysis of market internals we do, this quantitative approach suggests the indices are vulnerable to growth slowing, particularly after the strong rally of the past few weeks.

What to Focus on This Week

1Q Was Rough Even with the Strong Finish

Given how bad first quarter returns were for both stocks *and* bonds, most investors (both asset owners and manager) were probably happy to see it end. Furthermore, the rally in the second half of March made it considerably better for stocks than it was looking just a few weeks ago. In the end, **bond returns ranked much worse than stocks from a historical perspective, with Treasuries posting their worst quarter in 50 years (Exhibit 1).**

Exhibit 1: One of the worst quarters since 1973 for stocks and bonds, particularly the latter

	Quarter End	ACWI	Quarter End	SPX	Quarter End	AGG	Quarter End	UST	Quarter End	60/40
1	Dec-08	-22.8%	Sep-74	-26.1%	Mar-80	-8.7%	Mar-22	-5.6%	Dec-08	-11.7%
2	Mar-20	-21.7%	Dec-87	-23.2%	Sep-80	-6.6%	Mar-80	-5.5%	Dec-87	-11.6%
3	Sep-02	-18.6%	Dec-08	-22.6%	Mar-22	-5.9%	Sep-80	-4.6%	Mar-20	-10.7%
4	Sep-90	-18.6%	Mar-20	-20.0%	Sep-81	-4.1%	Mar-21	-4.3%	Sep-02	-8.7%
5	Sep-11	-17.9%	Jun-70	-18.9%	Mar-21	-3.4%	Dec-16	-3.8%	Sep-81	-8.5%
6	Sep-08	-17.1%	Sep-02	-17.6%	Dec-79	-3.1%	Jun-04	-3.2%	Sep-90	-8.4%
7	Sep-01	-15.0%	Sep-01	-15.0%	Dec-16	-3.0%	Mar-94	-3.0%	Dec-18	-7.7%
8	Mar-90	-14.7%	Sep-90	-14.5%	Mar-94	-2.9%	Jun-09	-3.0%	Sep-01	-7.1%
9	Dec-18	-13.1%	Sep-11	-14.3%	Sep-87	-2.7%	Sep-87	-2.9%	Sep-11	-7.1%
10	Mar-01	-12.8%	Dec-18	-14.0%	Jun-04	-2.4%	Dec-10	-2.6%	Mar-09	-7.0%
11	Jun-10	-12.7%	Jun-02	-13.7%	Jun-13	-2.3%	Mar-96	-2.3%	Jun-02	-6.8%
12	Sep-98	-12.7%	Mar-01	-12.1%	Jun-84	-2.1%	Sep-81	-2.2%	Mar-80	-6.7%
13	Mar-09	-11.3%	Sep-75	-11.9%	Jun-87	-1.8%	Jun-08	-2.1%	Mar-01	-6.1%
14	Sep-15	-9.9%	Jun-10	-11.9%	Mar-96	-1.8%	Jun-13	-1.9%	Jun-10	-5.7%
15	Mar-08	-9.7%	Mar-09	-11.7%	Jun-15	-1.7%	Mar-92	-1.8%	Sep-08	-5.5%
16	Jun-02	-9.5%	Sep-81	-11.5%	Mar-18	-1.5%	Jun-87	-1.8%	Mar-77	-5.4%
17	Mar-92	-7.9%	Sep-98	-10.3%	Dec-78	-1.4%	Mar-99	-1.6%	Mar-22	-5.3%
18	Dec-00	-6.8%	Dec-73	-10.0%	Dec-10	-1.3%	Jun-15	-1.6%	Mar-08	-5.1%
19	Jun-12	-6.4%	Mar-08	-9.9%	Mar-92	-1.3%	Mar-90	-1.4%	Sep-98	-4.5%
20	Mar-22	-5.7%	Sep-08	-8.9%	Sep-79	-1.3%	Mar-09	-1.3%	Dec-78	-4.3%

Source: Morgan Stanley Research Cross Asset Team

More Fire than Ice…

The tough 1Q was very much in line with our view coming into 2022 – i.e. we didn't see many fat pitches given the Fed's (and other central banks') resolve to fight the surge in inflation in the face of slowing growth (Tightening Fed and Slowing Growth = Defense). Whether it was for technical or fundamental reasons, bond and stock markets ignored this risk into year end 2021. Apparently, they required an additional prompt, which the Fed supplied with the minutes of its December meeting on January 5th. From that moment, both stocks and bonds made a sharp U-turn and never really looked back for the entire first month of the year.

In short, headline indices in stocks and bonds finally adjusted to the Fire part of our narrative, a risk that started to price under the surface in early November when Powell was renominated. With inflation on everyone's mind in 1Q more than any other risk, it makes sense that bonds would be worse than equities. It also makes sense that stocks most vulnerable to higher rates did even worse than the more diversified S&P 500 index – i.e. the Nasdaq performance was considerably worse than both the S&P 500 and Russell 2000, a very rare occurrence over the past few years. And, this is after a major rally in the past two weeks that was led by the Nasdaq. Our takeaway is that markets were preoccupied with the Fed's sharp pivot more than anything else and it played out in asset prices, appropriately.

... but now comes the slowdown

Of course, the other major driver of markets in Q1 was the war in Ukraine. While tensions had been building since late last year, it's fair to say markets had ignored this risk as much as the Fed's pivot. The only difference is that the Fed's pivot was well telegraphed while Russia's invasion was far from a sure thing and more of an unknown known to most, including us. Obviously, such an event did materially factor into the risks for 1Q by accentuating the Fire *and* Ice – i.e., it made inflation worse while dampening growth prospects simultaneously. It has also rattled confidence for both businesses and consumers, especially in Europe. **This was not in our calculus when we made our forecasts for 2022. As such, we find ourselves incrementally more negative on growth trends than we were at the end of last year.**

Last fall we pushed out the timing of the Ice part of our narrative to 1H22 when we realized the economy still had plenty of strength left for companies to deliver on earnings growth. **But, now investors face multiple headwinds to growth that will be harder to ignore** – payback in demand from last year's fiscal stimulus, demand destruction from high prices, food and energy price spikes from the war that serve as a tax, and inventory builds that have now caught up to demand. While the first three headwinds are somewhat appreciated, we think the last one is not. Specifically, we have been highlighting the risk for supply to overwhelm demand in many goods this year while most have viewed the recent build in inventory as mainly a positive that will help tame inflation. While we agree with the premise of that rosy conclusion, we would also warn investors to be careful what you wish for. Inflation has been an elixir for profits for most of this recovery. Until now, companies have had little problem passing along higher costs, hence why we have inflation. However, as supply catches up to demand, pricing power will likely dissipate and discounting could return in many areas of consumer goods that typically are price takers. We're also liable to see cancellation of orders that were doubled up due to the shortages, another theme we have been discussing for months. Semiconductor stocks and other areas of the market that have very fragmented supply chains look to be the most vulnerable in our view.

The bear market rally is over

On that score, **Friday's ISM release showed a sharp deterioration in the orders component. Relative to inventories, it looks even worse, with the inventory component of the index now below orders for the first time since the recovery began.** Think of this as a book to bill for the broader manufacturing economy. Based on our Ice and over-ordering thesis, we have been expecting this and now it is here. As we have shown in prior notes, **this differential between the orders and inventories components leads the headline index (Exhibit 2). Importantly for investors, it suggests the S&P 500 has another rough month(s) ahead** (Exhibit 3). Bottom line, the rally in stocks over the past few weeks has been remarkable, but in our view it has all the characteristics of a bear market rally, and we view month/quarter end as the perfect spot for it to come to an end.

Exhibit 2: Orders lead headline...

Source: Bloomberg, Morgan Stanley Research

Exhibit 3: ... Signaling lower S&P 500

Source: Bloomberg, Morgan Stanley Research

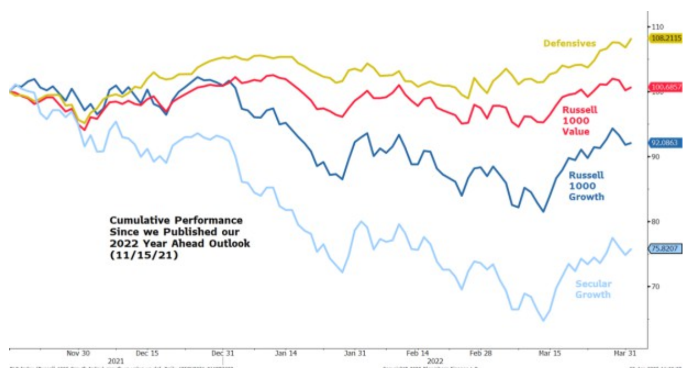
Boring is beautiful

Based on our Fire and Ice narrative and all of the building evidence to support it, we have been defensively positioned in our strategy recommendations since we published our year ahead outlook back in mid November. While not a straight line, **this positioning has worked well** and has dominated a growth or cyclicals bias (Exhibit 4 and Exhibit 5). Our big miss was being equal weight Energy although in our Fresh Money Buy list we have effectively been overweight with our 10% position in Exxon as a "defensively" oriented energy stock. Bottom line, defensive positioning has been the right move.

Exhibit 4: Defensives and Energy Dominating

Source: Bloomberg, Morgan Stanley Research

Exhibit 5: While Beating Growth & Value

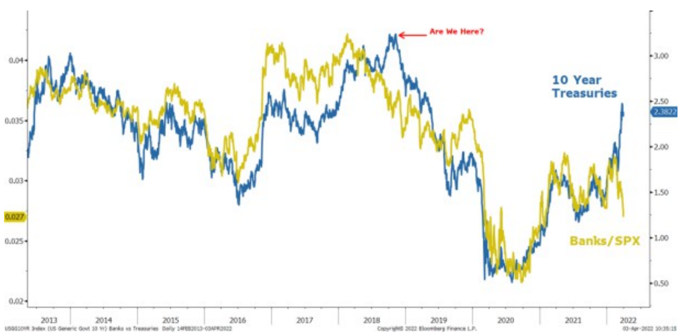


Source: Bloomberg, Morgan Stanley Research

This defensive domination may surprise readers given the large weighting of Energy within cyclicals and the fact that rates have moved up so much in the past several months. **Typically, defensives act poorly in a rising rate environment as they serve as a bond proxy in many ways. However, bond proxies are doing well,** especially over the past week when Real Estate and Utilities were the best-performing sectors. **It's also worth noting that on the back of Friday's strong labor market report, 30-year bonds rallied 2 points from the intra-day lows.** Some of this may be due to the ISM report discussed above but our sense is that the markets are starting to price in our Ice scenario right on cue. **As we have written in our recent research, we think 30-year Treasuries offer an excellent hedge against the growth scare we expect now that the Fed is fully priced.** Last week's price action seems to support such a view and we're sticking to it with our reiteration of defensive stocks as the place to be. **We remain overweight Utilities, REITs and Healthcare.** Conversely, we are underweight Consumer Discretionary and cyclical Tech while keeping equal weights in everything else and focusing on stock picking. Suffice it to say, we are also recommending Defensives over both cyclicals and growth. See more on what's working from a quantitative perspective in the section below.

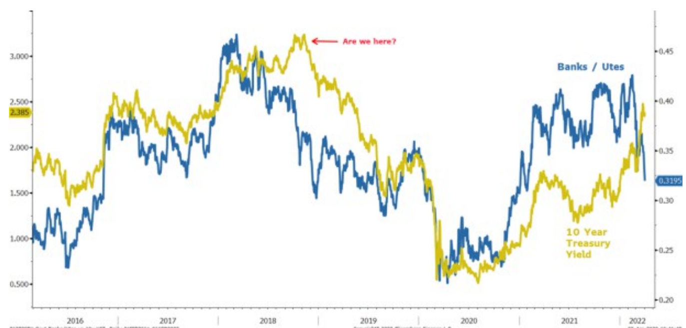
With our recent downgrade of Banks, we think the pair of Utilities over Banks looks particularly attractive. With Banks positively correlated to back end rates, this is another example of the internals of the market saying we close to a top (Exhibit 6 and Exhibit 7). Obviously, the inversion of the yield curve is also supportive of this relative value trade as it signals late cycle, a time when Utilities dominate early cycle groups like Banks. The pair is also highly correlated to the ISM manufacturing index, which is headed lower in our view (Exhibit 8).

Exhibit 6: Why are Banks lagging rates?



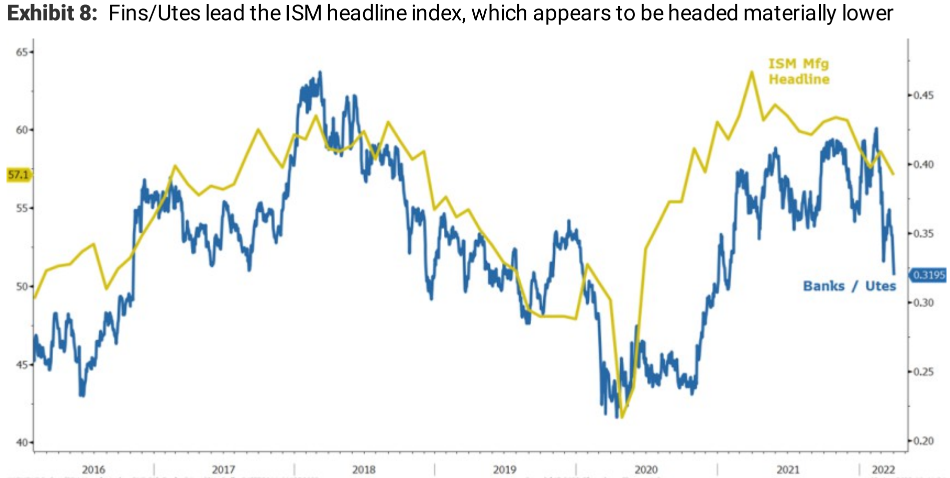
Source: Bloomberg, Morgan Stanley Research

Exhibit 7: Why is Banks/Utes falling?



Source: Bloomberg, Morgan Stanley Research

Exhibit 8: Fins/Utes lead the ISM headline index, which appears to be headed materially lower

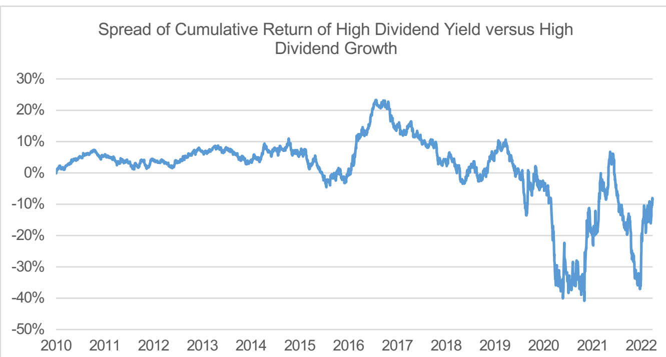


Source: Bloomberg, Morgan Stanley Research

Quant's Weekly Chart and Factor Update

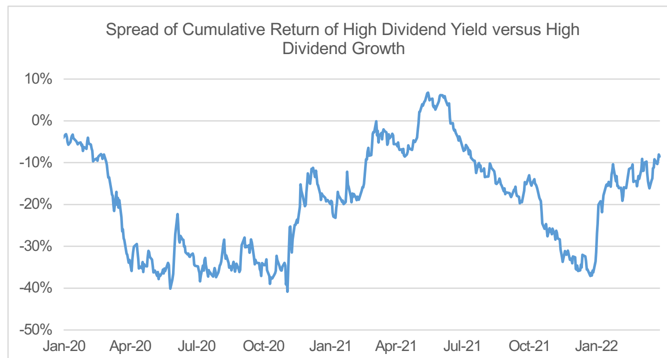
Investors are paying for high dividend yield rather than high dividend growth. We look at the relative performance of high dividend yield stocks versus high dividend growth stocks in the market, and high dividend yielders have been outperforming high dividend growers since late last year (Exhibit 9). From an individual factor perspective, high dividend yield stocks outperform low dividend yield stocks since December although the last 2 months have been more bumpy (Exhibit 11). During the same period, high dividend growth has been underperforming (Exhibit 12).

Exhibit 9: High div. yielders outperform high div. growers



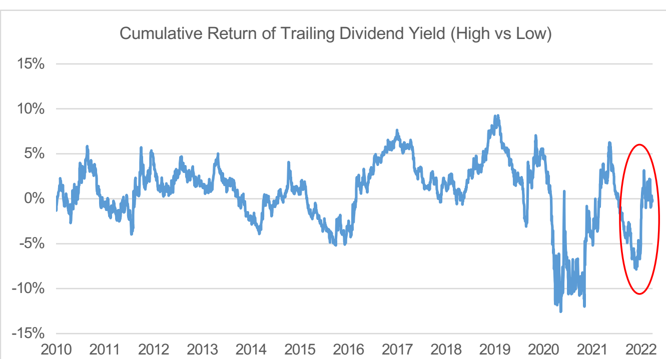
Source: ClariFi, Morgan Stanley Research

Exhibit 10: ...Shorter term view



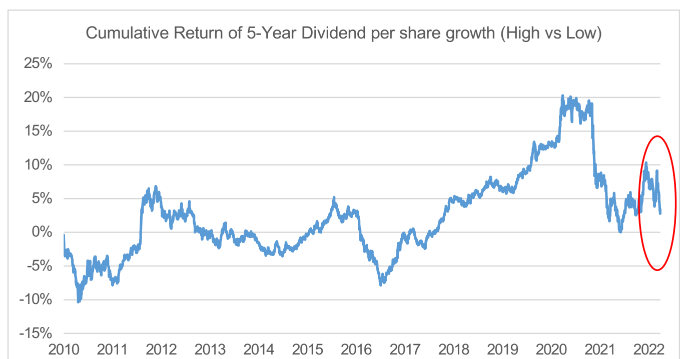
Source: ClariFi, Morgan Stanley Research

Exhibit 11: High div. yielders outperform low div. yielders since last year end



Source: ClariFi, Morgan Stanley Research

Exhibit 12: High div. growers underperform low div. growers



Source: ClariFi, Morgan Stanley Research

Factor Update

We select a few key factors to monitor in Exhibit 13 and Exhibit 14 to help study market drivers from a factor standpoint. These Exhibits focus on factors within the US Top 1000 by market cap universe. Some key takeaways on performance in the last month:

- Quality has outperformed Junk (+1.3% relative return); Quality has been one of the best performing factors (out of those listed below) relative to the broad Top 1000 (+0.9% relative outperformance).
- Value has outperformed Growth (+1.5%) and the overall market (+0.5% relative return versus the overall Top 1000 universe).
- Cyclicals are up +0.5% in absolute terms, underperforming Defensives (-1.9%); but that performance spread widens when we exclude Energy from Cyclicals, which has seen relatively strong performance amid the recent squeeze in crude prices; Cyclicals-Ex Energy have underperformed Defensives by -2.7%.
- High Momentum stocks have outperformed low momentum stocks (+0.1% relative return) and the overall market (+0.5% relative return).
- Small Caps have underperformed Large Caps by -1.7%.

Exhibit 13: Top 1000 Factor Returns

Top 1000 Factor Return as of Mar 31, 2022

Factor	1 Week	1 Month	YTD	12 Months
Quality / Junk	0.6%	1.3%	3.1%	13.4%
Quality	0.5%	2.6%	-3.7%	11.5%
Junk	0.0%	1.4%	-6.7%	-1.9%
Value / Growth	0.6%	1.5%	14.8%	18.1%
Value	0.4%	2.3%	1.5%	11.5%
Growth	-0.2%	0.7%	-13.4%	-6.5%
Cyclical / Defensive	-1.9%	-1.9%	-0.6%	-3.5%
Cyclical	-0.8%	0.5%	-5.1%	3.8%
Defensive	1.1%	2.4%	-4.5%	7.2%
Cyclical xEnergy / Defensive	-2.0%	-2.7%	-4.1%	-8.0%
Cyclical xEnergy	-0.9%	-0.4%	-8.6%	-0.8%
12M Momentum	-1.0%	0.1%	-2.1%	3.4%
High Momentum	-0.5%	2.3%	-6.7%	2.0%
Low Momentum	0.5%	2.1%	-4.7%	-1.4%
Size (Small / Large)	-0.2%	-1.7%	-1.6%	-14.7%
Small Cap	0.2%	0.8%	-6.5%	-3.9%
Large Cap	0.4%	2.6%	-4.9%	10.8%

Source: ClariFi, Morgan Stanley Research

Exhibit 14: Excess Return Versus Broader Top 1000 Universe

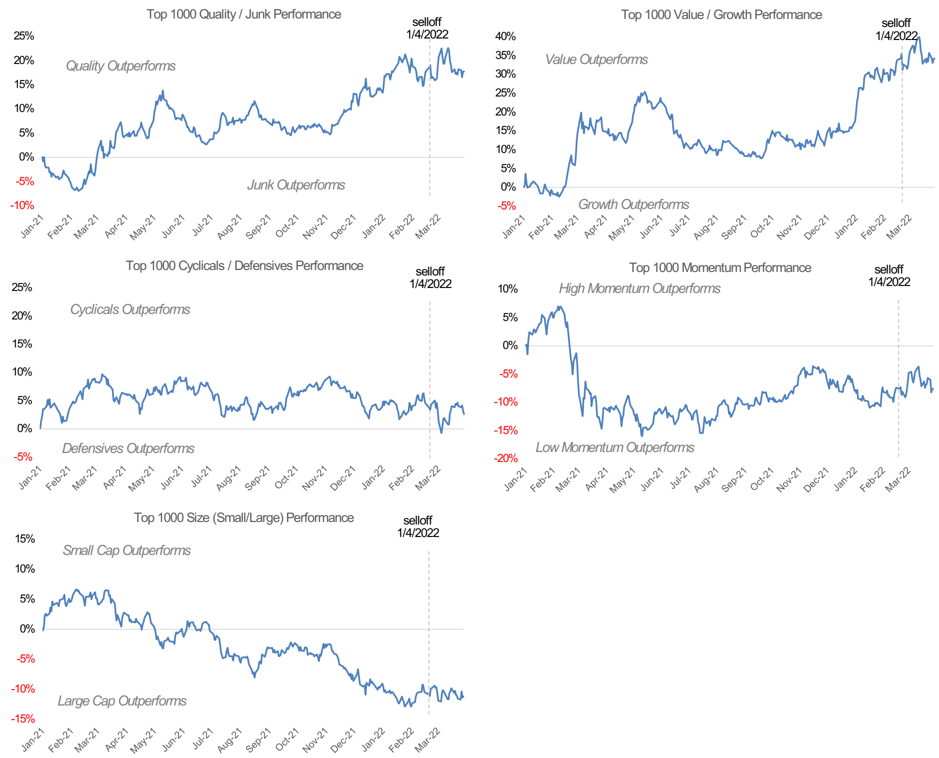
Top 1000 Excess Factor Return versus Broader Top 1000 Return as of Mar 31, 2022

Factor	1 Week	1 Month	YTD	12 Months
Quality / Junk				
Quality	0.4%	0.9%	2.0%	7.8%
Junk	-0.2%	-0.3%	-1.1%	-5.6%
Value / Growth				
Value	0.2%	0.5%	7.2%	7.8%
Growth	-0.4%	-1.0%	-7.7%	-10.3%
Cyclical / Defensive				
Cyclical	-1.0%	-1.2%	0.6%	0.0%
Defensive	0.9%	0.6%	1.2%	3.5%
Cyclical xEnergy / Defensive				
Cyclical xEnergy	-1.1%	-2.1%	-2.9%	-4.6%
Momentum				
High Momentum	-0.6%	0.5%	-1.0%	-1.7%
Low Momentum	0.3%	0.4%	1.0%	-5.1%
Size (Small / Large)				
Small Cap	0.0%	-0.9%	-0.8%	-7.6%
Large Cap	0.2%	0.8%	0.8%	7.1%

Source: ClariFi, Morgan Stanley Research

Exhibit 15 shows performance of these pairs in time series graph form.

Exhibit 15: Cumulative Factor Performance Since 2021



Source: ClariFi, Morgan Stanley Research

We include an extensive list of factors and their returns in Exhibit 16. We break down the factor spread return by their long and short portfolio and display the top and bottom performing portfolio legs last month in Exhibit 17.

Exhibit 16: Full List of Factor Spread Returns (Long - Short)

Equal Weighted Factor Return (Spread) in Top 1000 as of Mar 31, 2022

Factor Name	1 Week	1 Month	3 Month	YTD	12 Months
Accruals (Low vs High)	1.2%	3.2%	9.1%	9.0%	16.5%
Composite Accruals (Low vs High)	0.7%	2.9%	7.9%	7.6%	10.7%
Y/Y Change in number of employees (Low vs High)	0.8%	2.6%	13.6%	13.4%	18.0%
Inventory-to-Sales (Low vs High)	1.5%	2.5%	2.8%	2.7%	4.1%
Long-Term Operating Leverage (High vs Low)	0.3%	2.2%	2.9%	2.8%	0.7%
Operating Leverage (High vs Low)	1.0%	1.9%	5.4%	5.1%	10.5%
Value vs Growth	0.6%	1.5%	15.2%	14.8%	18.1%
Incremental Margin (High vs Low)	0.1%	1.4%	3.4%	3.3%	6.6%
Cash-to-Assets (High vs Low)	0.2%	1.4%	-7.1%	-6.6%	-20.4%
Quality vs Junk	0.6%	1.3%	3.5%	3.1%	13.4%
Inventory Turnover (High vs Low)	1.0%	1.2%	5.1%	5.1%	10.4%
Net Cash Variability (Low vs High)	-0.7%	1.1%	3.8%	3.7%	11.6%
Financial Leverage (Low vs High)	-0.4%	1.1%	-1.1%	-1.1%	7.6%
Tangible Book/Price (Cheap vs Expensive)	-1.0%	1.0%	2.0%	2.1%	-3.7%
Price-to-Cash Flow (Cheap vs Expensive)	-0.5%	0.9%	-2.2%	-2.1%	-10.3%
Cash Flow Coverage (High vs Low)	-1.1%	0.8%	0.1%	0.1%	-2.7%
Cash-to-Debt (High vs Low)	-0.2%	0.7%	-6.2%	-5.7%	-17.1%
Operational Efficiency (High vs Low)	0.0%	0.6%	9.4%	9.3%	12.5%
Cash Flow / Debt (High vs Low)	-1.2%	0.6%	0.6%	0.2%	19.0%
9-Month Price Momentum (High vs Low)	-1.3%	0.6%	-3.5%	-4.1%	0.3%
Cash-to-Market Cap (High vs Low)	-1.2%	0.5%	3.9%	4.3%	-4.4%
Earnings Stability (High vs Low)	1.2%	0.5%	2.6%	2.4%	13.5%
Operating Income Variability (Low vs High)	1.4%	0.4%	-4.8%	-4.6%	-5.7%
1-Year EPS Growth (High vs Low)	-0.3%	0.4%	2.5%	2.1%	11.9%
Free Cash Flow-to-Debt (High vs Low)	-0.8%	0.4%	0.5%	0.0%	18.9%
Net Debt-to-Market Cap (Low vs High)	-0.2%	0.4%	-11.9%	-11.6%	-17.5%
Sales Variability (Low vs High)	0.6%	0.4%	6.9%	6.6%	15.4%
Cash Ratio (High vs Low)	0.7%	0.3%	-8.2%	-7.8%	-22.9%
6-Month Price Momentum (High vs Low)	-1.2%	0.3%	-0.6%	-1.1%	4.8%
Reduction in Shares Outstanding (Low vs High)	-0.5%	0.2%	6.7%	6.2%	22.8%
CapEx-to-Depreciation (Low vs High)	0.9%	0.1%	7.8%	7.5%	6.2%
12-Month Price Momentum (High vs Low)	-1.0%	0.1%	-1.5%	-2.1%	3.4%
Composite Quality (High vs Low)	0.6%	0.1%	1.4%	1.1%	12.9%
Operating Margin (High vs Low)	-0.5%	0.1%	2.3%	1.8%	16.5%
Analyst Coverage (High vs Low)	-0.3%	0.1%	1.0%	1.2%	9.0%
Debt-to-EBITDA (Low vs High)	-0.1%	0.1%	-6.6%	-5.9%	-8.8%
Net Cash Ratio (High vs Low)	-0.4%	0.1%	-9.8%	-9.5%	-14.9%
Debt-to-Capital (Low vs High)	-0.3%	0.1%	-5.3%	-5.2%	-10.8%
Enterprise Value-to-Free Cash Flow (Low vs High)	-1.7%	0.1%	12.4%	11.9%	29.0%
1-Month Reversal (Low vs High)	0.9%	0.0%	-7.5%	-7.0%	-7.9%
Free Cash Flow Yield (High vs Low)	-1.4%	0.0%	12.3%	11.8%	27.3%
Sales per Employee (High vs Low)	-1.3%	-0.1%	1.4%	1.5%	5.1%
Y/Y Change in Inventory/Sales (Low vs High)	-0.3%	-0.2%	1.5%	1.5%	3.4%
Debt-to-Assets (Low vs High)	-0.7%	-0.2%	-4.6%	-4.6%	-4.8%
Debt-to-Equity (Low vs High)	-0.5%	-0.2%	-5.0%	-4.9%	-4.6%
Receivables Turnover (High vs Low)	-0.4%	-0.3%	0.8%	0.9%	3.5%
Short-Term Accruals (Low vs High)	-0.1%	-0.3%	1.8%	1.7%	-3.0%
Composite Value (Cheap vs Expensive)	-1.5%	-0.3%	8.7%	8.3%	20.6%
Trailing Dividend Yield (High vs Low)	0.2%	-0.3%	6.7%	6.7%	-2.1%
Forecast long term growth (High vs Low)	-0.6%	-0.3%	-2.1%	-2.1%	-0.1%
Gross Margin (High vs Low)	0.8%	-0.5%	-4.4%	-4.3%	-5.3%
Sales Growth Stability (High vs Low)	1.0%	-0.5%	-1.5%	-1.6%	7.0%
Composite Free Cash Flow (High vs Low)	-1.6%	-0.6%	11.5%	11.0%	27.6%
12m Volatility (Low vs High)	0.5%	-0.6%	3.3%	2.7%	19.9%
3-Month Price Momentum (High vs Low)	-0.8%	-0.6%	-1.5%	-2.0%	1.2%
Price-to-Book (Cheap vs Expensive)	-0.9%	-0.7%	8.8%	8.6%	3.9%
CapEx-to-Assets (Low vs High)	0.1%	-0.7%	0.0%	0.0%	-9.0%
Reinvestment Rate (High vs Low)	0.5%	-0.8%	-1.0%	-1.0%	3.4%
Estimate Dispersion (Low vs High)	0.5%	-0.8%	1.7%	1.3%	16.1%
CapEx-to-Sales (Low vs High)	-0.2%	-0.8%	1.4%	1.3%	-0.1%
Industry Cyclical vs Defensive	-2.1%	-0.8%	-0.5%	-0.9%	2.9%
Total Yield (High vs Low)	-0.8%	-0.9%	3.2%	3.3%	2.1%
ROE (High vs Low)	-0.2%	-0.9%	0.2%	-0.4%	15.3%
Dividend Payout Ratio (High vs Low)	0.8%	-0.9%	-0.4%	-0.3%	1.3%
Price-to-Sales (Cheap vs Expensive)	-1.9%	-1.0%	13.4%	13.0%	24.1%
1-Month Estimate Revisions (%) (High vs Low)	-1.0%	-1.1%	-4.0%	-4.4%	-7.1%
EPS Variability (Low vs High)	0.4%	-1.1%	-2.1%	-2.3%	2.7%
Net Margin (High vs Low)	-0.5%	-1.1%	0.9%	0.3%	17.1%
12m-1m Residual Momentum (High vs Low)	-1.1%	-1.2%	-3.1%	-3.6%	4.5%
Composite Growth (High vs Low)	-0.7%	-1.2%	-0.5%	-0.8%	4.8%
Up-to-Down Revisions (High vs Low)	-1.4%	-1.3%	0.0%	-0.3%	7.1%
Smoothed Estimate Revisions (%) (High vs Low)	-1.2%	-1.4%	-2.6%	-2.8%	4.1%
Sales Estimate Revisions (High vs Low)	-1.0%	-1.5%	-3.5%	-3.8%	0.7%
Return on Invested Capital (High vs Low)	-1.1%	-1.5%	3.0%	2.3%	20.5%
Profitability (High vs Low)	0.1%	-1.6%	-3.7%	-3.7%	5.3%
Composite Sentiment (High vs Low)	-1.0%	-1.6%	-6.2%	-6.3%	-2.3%
5-Year EPS Growth (High vs Low)	-1.3%	-1.7%	-5.6%	-5.7%	-1.6%
Up vs Down Sales Revisions (High vs Low)	-0.9%	-1.7%	-5.1%	-5.3%	-0.2%
Size (Small vs Large)	-0.2%	-1.7%	-1.7%	-1.6%	-14.7%
Enterprise Value-to-EBITDA (Low vs High)	-2.6%	-1.7%	13.7%	13.0%	30.2%
Earnings Estimate Revisions (High vs Low)	-1.8%	-1.8%	-2.3%	-2.7%	4.0%
Earnings Revisions (High vs Low)	-1.9%	-1.8%	-1.3%	-1.6%	6.6%
ROE Variability (Low vs High)	0.1%	-1.8%	-4.6%	-4.8%	0.5%
Sales Revisions (High vs Low)	-1.1%	-1.9%	-3.9%	-4.1%	1.1%
Asset Turnover (High vs Low)	-1.8%	-1.9%	2.1%	1.9%	14.7%
Cyclical vs Defensive	-1.9%	-1.9%	-0.6%	-0.6%	-3.5%
Price-to-Forward Earnings (Cheap vs Expensive)	-1.9%	-1.9%	12.4%	12.0%	30.0%
Price-to-EBITDA (Cheap vs Expensive)	-2.2%	-2.1%	13.4%	12.7%	26.8%
ROA (High vs Low)	-1.5%	-2.3%	0.4%	-0.2%	17.3%
Price-to-Operating Income (Cheap vs Expensive)	-2.3%	-2.3%	11.1%	10.4%	25.5%
1-Year Dividend per share growth (High vs Low)	-1.3%	-2.4%	-3.5%	-3.7%	-1.5%
Enterprise Value-to-Operating Income (Low vs High)	-2.7%	-2.4%	11.6%	10.9%	29.7%
Interest Coverage (High vs Low)	-1.7%	-2.5%	-2.9%	-3.5%	15.8%
Price-to-Earnings (Cheap vs Expensive)	-1.7%	-2.6%	7.6%	7.0%	19.6%
1-Year Sales Growth (High vs Low)	-1.5%	-2.9%	-13.0%	-12.8%	-12.5%
5-Year Dividend per share growth (High vs Low)	-1.6%	-3.1%	-5.4%	-5.6%	-1.7%
5-Year Sales Growth (High vs Low)	-2.0%	-3.2%	-13.2%	-12.8%	-17.2%
Gross Profit / Assets (High vs Low)	-1.2%	-3.6%	-7.9%	-7.7%	-2.5%

Source: ClariFi, Morgan Stanley Research

Exhibit 17: Best and Worst Performing Factor Leg Returns

Best 20 Performing Equal Weighted Group Return in Top 1000 as of Mar 31, 2022

Group	1 Week	1 Month	3 Month	YTD	12 Months
Top 1000 (Equal Weighted)	0.2%	1.7%	-5.8%	-5.7%	3.7%
Low 5-Year Dividend per share growth	1.3%	3.8%	1.1%	1.2%	13.0%
Low 1-Year Dividend per share growth	1.0%	3.8%	0.9%	0.8%	15.8%
Low 1-Year Sales Growth	1.0%	3.5%	0.0%	0.2%	6.3%
Low Gross Profit / Assets	0.7%	3.5%	-3.7%	-3.5%	0.2%
Low Composite Accruals	0.3%	3.4%	-3.2%	-3.2%	5.0%
High Inventory Turnover	0.7%	3.4%	-0.7%	-0.8%	12.0%
Low Interest Coverage	1.6%	3.3%	-5.6%	-5.1%	-7.3%
Low Inventory-to-Sales	0.7%	3.3%	-4.6%	-4.6%	2.1%
High Price-to-Operating Income	1.3%	3.2%	-11.9%	-11.3%	-15.1%
High ROE Variability	0.5%	3.2%	-2.5%	-2.4%	6.8%
Low ROA	1.2%	3.1%	-8.9%	-8.4%	-9.9%
High Price-to-EBITDA	1.3%	3.1%	-12.8%	-12.2%	-15.3%
Low 5-Year Sales Growth	1.1%	3.1%	-0.8%	-0.8%	6.7%
High Enterprise Value-to-Operating Income	1.5%	3.1%	-12.2%	-11.6%	-16.3%
Low Accruals	0.4%	3.1%	-3.9%	-3.8%	7.1%
Low Net Debt-to-Market Cap	0.3%	3.0%	-12.0%	-11.5%	-9.2%
High Operating Leverage	1.0%	3.0%	-2.6%	-2.6%	6.5%
Low Asset Turnover	1.1%	3.0%	-8.5%	-8.3%	-7.6%
Low Dividend Payout Ratio	0.1%	3.0%	-1.8%	-2.0%	9.0%
High Cash-to-Assets	0.6%	3.0%	-10.5%	-10.1%	-10.0%

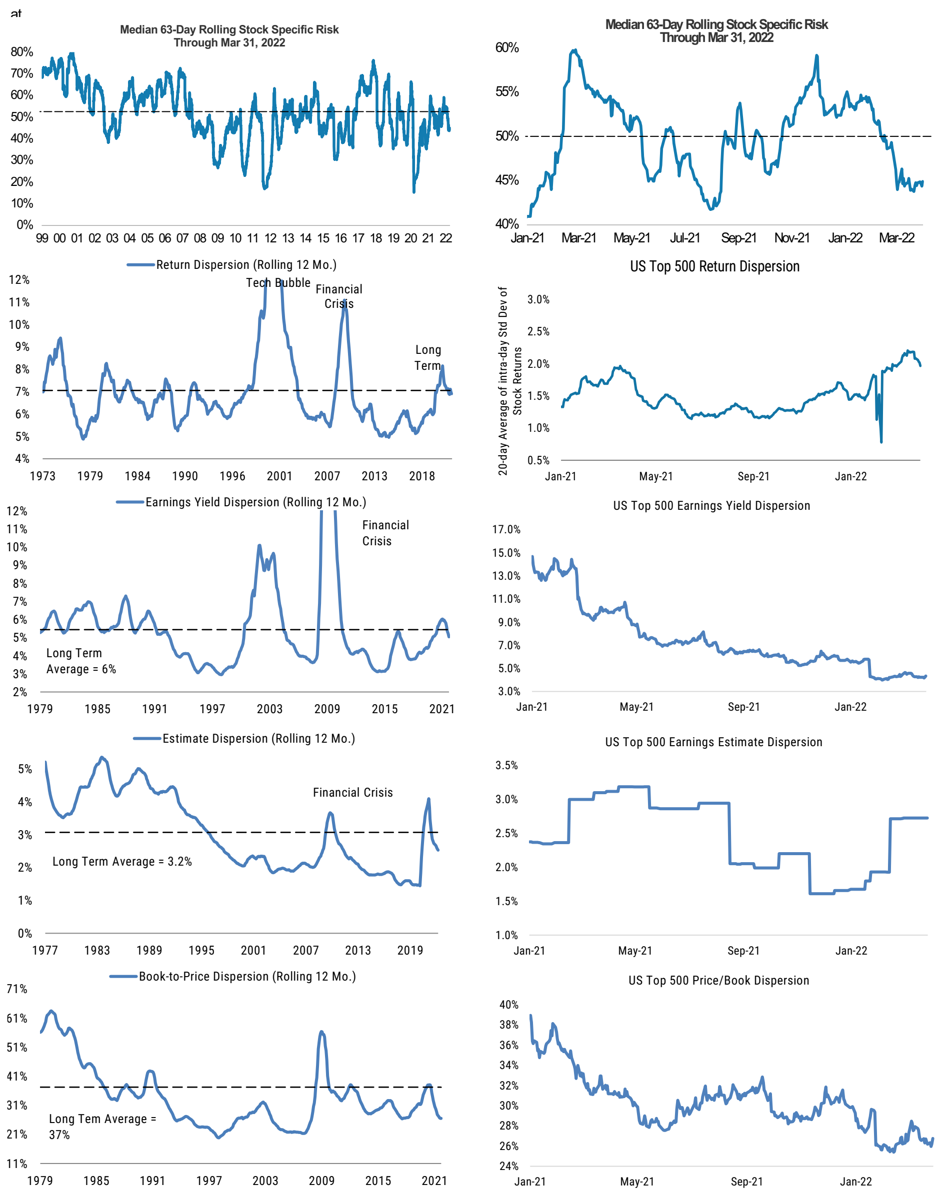
Worst 20 Performing Equal Weighted Group Return in Top 1000 as of Mar 31, 2022

Group	1 Week	1 Month	3 Month	YTD	12 Months
Top 1000 (Equal Weighted)	0.2%	1.7%	-5.8%	-5.7%	3.7%
Low Enterprise Value-to-Operating Income	-1.2%	0.6%	-0.7%	-0.7%	13.4%
High Sales Revisions	-0.4%	0.6%	-8.5%	-8.5%	2.5%
High Smoothed Estimate Revisions (%)	-0.5%	0.6%	-7.7%	-7.7%	-0.9%
High 1-Year Sales Growth	-0.5%	0.6%	-12.9%	-12.6%	-6.2%
Low Y/Y Change in Inventory/Sales	-0.5%	0.6%	-6.3%	-6.3%	4.8%
High Sales Estimate Revisions	-0.7%	0.6%	-7.0%	-7.0%	5.6%
High Earnings Revisions	-1.1%	0.5%	-6.3%	-6.3%	7.5%
Low Price-to-Forward Earnings	-0.8%	0.5%	-0.7%	-0.6%	14.5%
Cyclical	-0.8%	0.5%	-5.1%	-5.1%	3.8%
High Up vs Down Sales Revisions	-0.2%	0.5%	-9.1%	-9.1%	1.5%
High Composite Accruals	-0.4%	0.5%	-11.1%	-10.8%	-5.7%
High Net Cash Variability	0.6%	0.4%	-7.6%	-7.5%	-0.7%
Low Price-to-Earnings	-0.9%	0.3%	-1.9%	-1.9%	10.6%
High Profitability	0.2%	0.3%	-9.2%	-9.0%	3.2%
High Earnings Estimate Revisions	-1.2%	0.2%	-6.6%	-6.6%	5.9%
High Accruals	-0.8%	-0.1%	-13.0%	-12.8%	-9.4%
High Gross Profit / Assets	-0.6%	-0.1%	-11.5%	-11.2%	-2.4%
High 5-Year EPS Growth	-0.7%	-0.2%	-9.1%	-9.1%	3.3%
High 5-Year Sales Growth	-0.9%	-0.2%	-14.0%	-13.6%	-10.5%
High Y/Y Change in number of employees	-0.2%	-0.3%	-13.4%	-13.2%	-8.0%

Source: ClariFi, Morgan Stanley Research

In Exhibit 18, we continue to monitor a number of dispersion metrics on a long-term and short-term basis. For most forms of dispersion, 2021 marked a local peak with these measures falling back towards/below long-term averages. Stock specific risk remains muted as geopolitical uncertainty and macro risk prevail. Return dispersion has risen for most of 2022 but recently saw a tightening in back half of March with the latest market rally.

Exhibit 18: US Top 500 Dispersion Metrics: Long-term and Short-Term



Source: ClariFi, Morgan Stanley Research

Lastly, we monitor these dispersion metrics on a percentile basis relative to history (Exhibit 19). Return dispersion remains historically elevated but has declined in recent weeks. Valuations dispersion per earnings yield and book/price differs widely by industry group with elevated readings in consumer sectors (Food & Staples Retailing and Consumer Durables). Lastly, S&P 500 earnings estimate dispersion is historically high across most industries with Utilities and Telecom Services as the outliers at near all-time dispersion lows.

Exhibit 19: Historical Dispersion Metrics by Industry Group

	Percentile Since 2000			
	Return Dispersion	Earning Yield Dispersion	Book/Price Dispersion	Earnings Estimate Dispersion
S&P 500	65%	50%	31%	85%
Energy	19%	9%	25%	62%
Materials	10%	72%	16%	64%
Capital Goods	66%	81%	54%	77%
Commercial & Professional Services	19%	66%	92%	78%
Transportation	67%	48%	8%	69%
Automobiles & Components	26%	83%	77%	68%
Consumer Durables & Apparel	58%	86%	95%	85%
Consumer Services	84%	77%	32%	93%
Retailing	83%	66%	13%	65%
Food & Staples Retailing	97%	91%	97%	91%
Food, Beverage & Tobacco	33%	56%	49%	82%
Household & Personal Products	81%	43%	0%	86%
Health Care Equipment & Services	64%	40%	38%	70%
Pharma, Biotech & Life Sciences	46%	85%	87%	89%
Banks	56%	74%	46%	80%
Diversified Financials	72%	87%	50%	84%
Insurance	40%	53%	62%	90%
Software & Services	71%	30%	46%	77%
Technology Hardware & Equipment	80%	68%	66%	20%
Semiconductors & Semi Equipment	83%	45%	49%	31%
Telecommunication Services	34%	40%	40%	0%
Media & Entertainment	47%	47%	50%	89%
Utilities	19%	26%	53%	6%
Real Estate	75%	54%	32%	73%

Source: ClariFi, Morgan Stanley Research

Fresh Money Buy List

Exhibit 20: Fresh Money Buy List - Stats & Performance

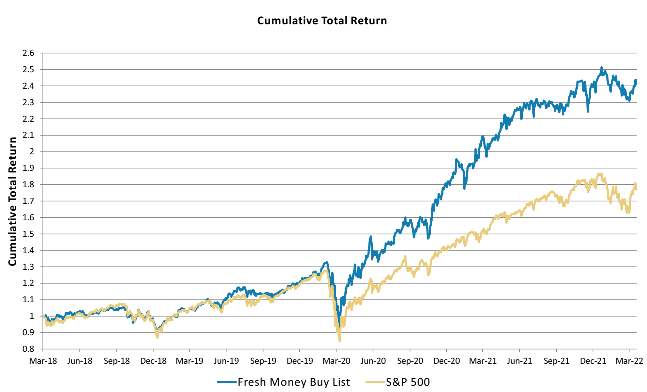
Company Name	Ticker	MS Rating	Sector	Market Cap ($Bn)	Price	MS PT	% to MS PT	MS Analyst	Date Added	Total Return Since Inclusion	
										Absolute	Rel. to S&P
AT&T, Inc.	T	Overweight	Communication Services	$171.1	$23.96	28.00	16.9%	Flannery, Simon	12/20/2021	2.7%	4.1%
CenterPoint Energy Inc	CNP	Overweight	Utilities	$19.6	$31.22	31.00	(0.7%)	Byrd, Stephen	3/21/2022	7.5%	5.7%
Coca-Cola Co.	KO	Overweight	Consumer Staples	$272.4	$62.83	76.00	21.0%	Mohsenian, Dara	3/28/2022	2.1%	2.2%
Exxon Mobil Corporation	XOM	Overweight	Energy	$351.7	$83.06	95.00	14.4%	McDermott, Devin	2/22/2021	67.4%	49.4%
Humana Inc	HUM	Equal-Weight	Health Care	$56.0	$441.85	436.00	(1.3%)	Goldwasser, Ricky	7/19/2018	43.1%	(28.9%)
McDonald's Corporation	MCD	Overweight	Consumer Discretionary	$185.1	$248.90	287.00	15.3%	Glass, John	10/18/2021	3.9%	1.8%
Mondelez International Inc	MDLZ	Overweight	Consumer Staples	$88.2	$63.53	73.00	14.9%	Kaufman, Pamela	7/19/2021	0.5%	(5.4%)
SBA Communications	SBAC	Overweight	Real Estate	$37.9	$350.61	384.00	9.5%	Flannery, Simon	6/7/2021	12.7%	4.2%
Simon Property Group Inc	SPG	Overweight	Real Estate	$43.7	$132.96	160.00	20.3%	Hill, Richard	2/16/2021	28.7%	11.5%
Welltower Inc.	WELL	Overweight	Real Estate	$43.7	$97.64	100.00	2.4%	Hill, Richard	2/22/2021	47.1%	29.1%
Current List Performance											
Average (Eq. Weight)				$126.9			11.3%			21.6%	7.4%
Median				$72.1			14.6%			10.1%	4.2%
% Positive Returns (Abs. / Rel.)										100%	80%
% Negative Returns (Abs. / Rel.)										0%	20%
Avg. Hold Period (Months)											11.3
All Time List Performance											
Average (Eq. Weight)										31.3%	12.6%
Median										19.2%	4.2%
% Positive Returns (Abs. / Rel.)										81%	59%
% Negative Returns (Abs. / Rel.)										21%	41%
Avg. Hold Period (Months)											13.1

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.

++ 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.

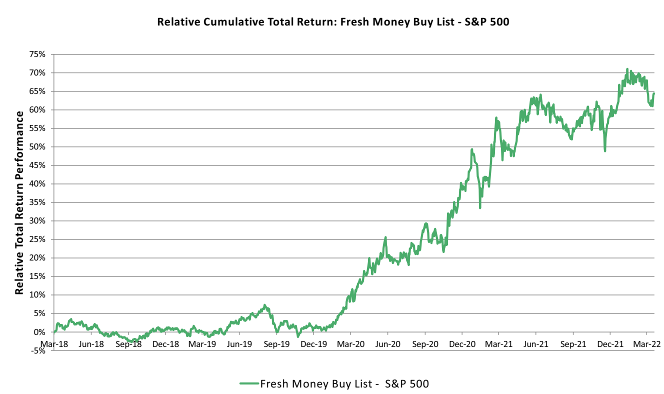
Source: Bloomberg, Morgan Stanley Research estimates.

Exhibit 21: Fresh Money Buy List & S&P 500 Cumulative Total Return



Source: Bloomberg, Morgan Stanley Research.

Exhibit 22: Fresh Money Buy List / S&P 500 Cumulative Relative Return



Source: Bloomberg, Morgan Stanley Research.

McDonald's (MCD), John Glass

- 1Q22 Commodities Update: Food Costs Taking Another Bite: Our index increased 28% y/y in 1Q, with chicken breast and corn the biggest drivers. With geopolitical developments added, crops and produce drove our index up in March 8% m/m to a new high. This price spike could pose a risk to 2H margin forecasts which contemplate some alleviation in inflation.

- Our commodity index increased 28% y/y in 1Q22 and rose 3% above 4Q21 levels to a new high again. Some poultry items and corn were most inflationary similar to prior months. The Morgan Stanley Commodity Index averaged 251 in 1Q vs 243 in 4Q21 and 196 in 1Q21. On a y/y basis, chicken breast (+7 pts), corn (+4 pts), coffee (+3 pts), and ground beef (+3 pts) led the increase, while tomatoes (-1 pt) declined the most. Nearly all other components in our index climbed higher y/y. Price inflation in the same items drove y/y growth in the month of March. Crops and produce underpinned an 8% m/m gain in our index, the widest sequential increase since May 2021, in contrast with key proteins as the driver in prior months. Geopolitical developments and production constraints lifted prices of corn (3 pts), lettuce (3 pts), and wheat (2 pts). This more than offset a pullback in chicken wings (-1 pt) and tomatoes (-1 pt). Although driven by seemingly temporary factors that could evolve rapidly, if commodity prices were to hold at current levels, we'd anticipate some downside risk to our current margin expectations for 2H22, which contemplate some reduction in commodity cost inflation as companies lap last year's 2H21 inflation levels. Stocks in our coverage reflect this to some degree and contracting partly protects restaurants from this material spot price inflation, though the risk could drag into 2023 if new contracts are struck at higher prices following recent developments.

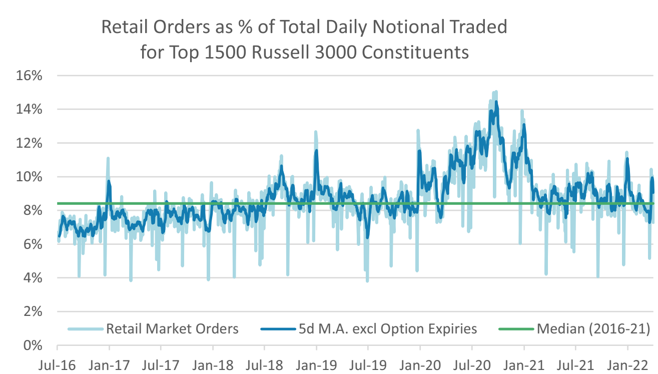
What's Retail Doing?

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:

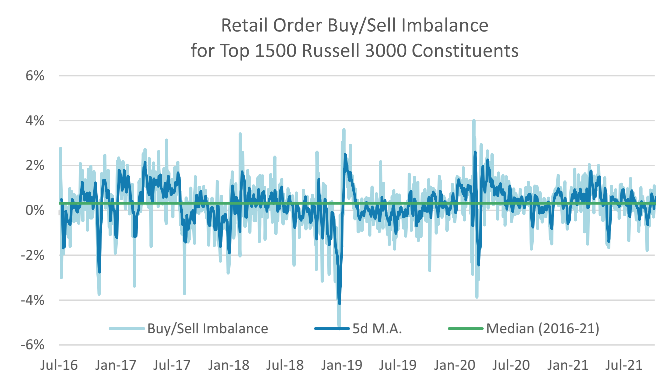
- Retail participation is currently at 9.1% of the total market volume,and at 70th %-ile relative to the last 5 years.
- Order imbalance remains positive last week. It currently sits at 0.8% or 76th percentile relative to the last 5 years.
- Imbalance is positive on market level and in most sectors, except in Utilities and Health Care. It is most positive relative to sector history in Staples (95th %-ile), and Financials (92nd %-ile). Staples is most positive in buy/sell imbalance.

Exhibit 23: Retail orders as a % of notional traded now above median



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

Exhibit 24: ... and positive in order imbalance



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

Exhibit 25: Retail's buy/sell imbalance is most positive in Staples

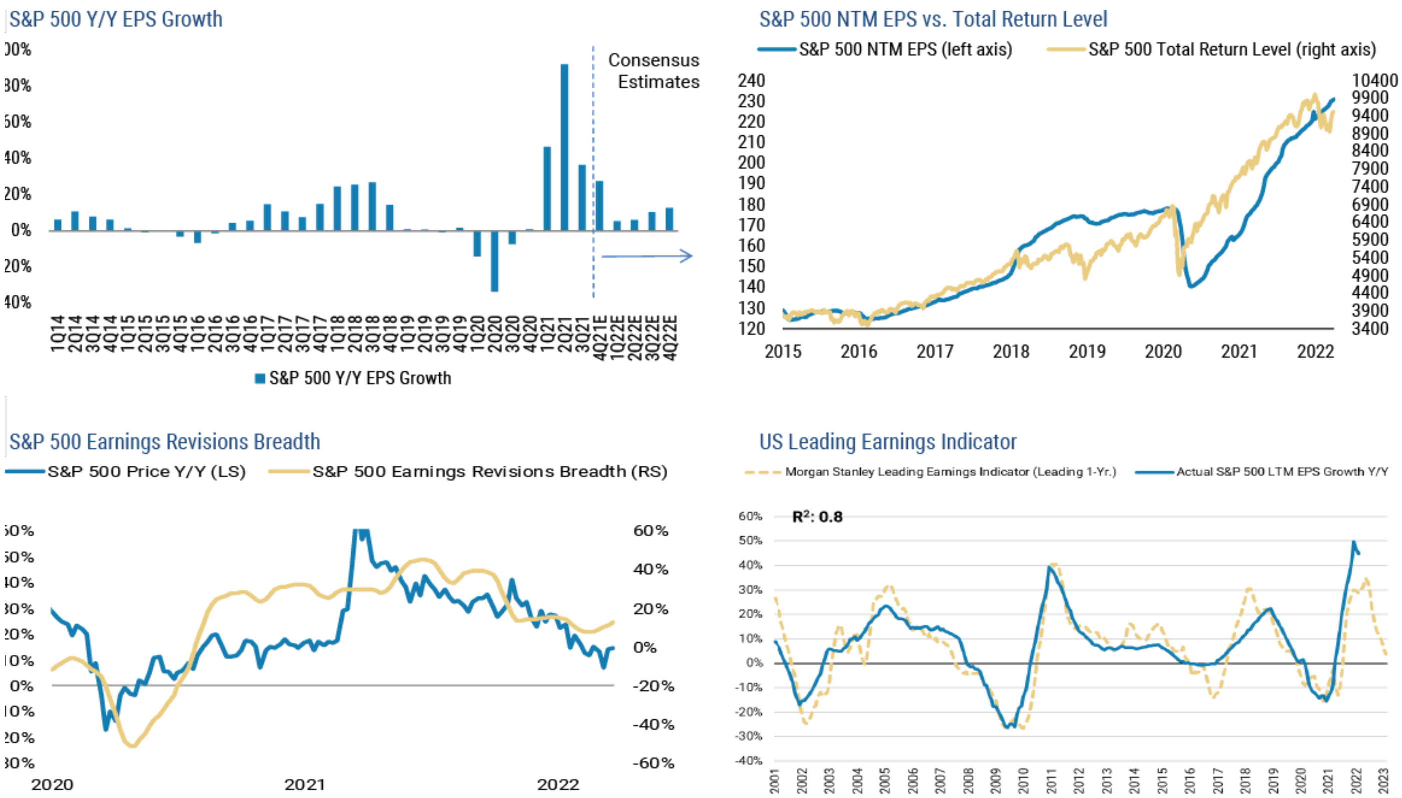
	Retail Participation			Buy/Sell Imbalance		
Sector	**2016-21 Median**	**Current**	**p-tile**	**2016-21 Median**	**Current**	**p-tile**
Energy	6.7%	8.6%	0.89	-0.34%	0.4%	0.67
Materials	5.7%	7.3%	0.90	0.5%	0.9%	0.61
Industrials	6.7%	5.8%	0.18	0.0%	1.0%	0.84
Consumer Discretionary	11.3%	11.1%	0.46	0.7%	0.2%	0.24
Consumer Staples	6.1%	5.1%	0.15	-0.5%	2.1%	0.95
Health Care	6.0%	4.1%	0.02	-0.3%	-0.3%	0.54
Financials	5.6%	5.9%	0.64	0.0%	1.9%	0.92
Information Technology	10.8%	12.1%	0.83	0.5%	0.8%	0.65
Communication Services	8.7%	10.1%	0.60	0.3%	1.7%	0.88
Utilities	3.9%	3.4%	0.19	-1.2%	-1.3%	0.48
Real Estate	3.5%	2.8%	0.05	0.6%	1.9%	0.76
Model Universe (Top 1500)	**8.5%**	**9.1%**	**0.70**	**0.3%**	**0.8%**	**0.76**

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 26: US Earnings Snapshot



Source: Refinitiv, FactSet, Morgan Stanley Research. Top and bottom left: As of Apr 1, 2022 Bottom right As of Feb 28, 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 27: S&P 500 Price Target

Morgan Stanley S&P 500 Year-End 2022 Price Target

Landscape	Earnings	Multiple	Price Target	Upside / Downside
Bull Case	$265	18.8x	5,000	10.0%
Base Case	$245	18.0x	4,400	-3.2%
Bear Case	$225	17.2x	3,900	-14.2%
Current S&P 500 Price as of:		4/1/2022	4,546	

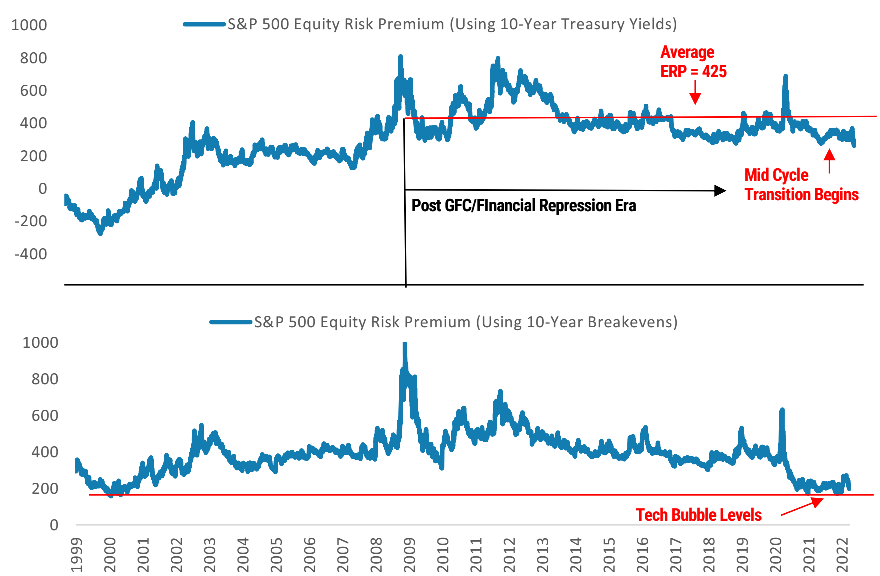
Note: We use 2022YE forward earnings to project our price target which takes into account our 2023YE earnings forecast (currently $245 base case).
Source: Bloomberg, Morgan Stanley Research

Exhibit 28: Sector Ratings

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

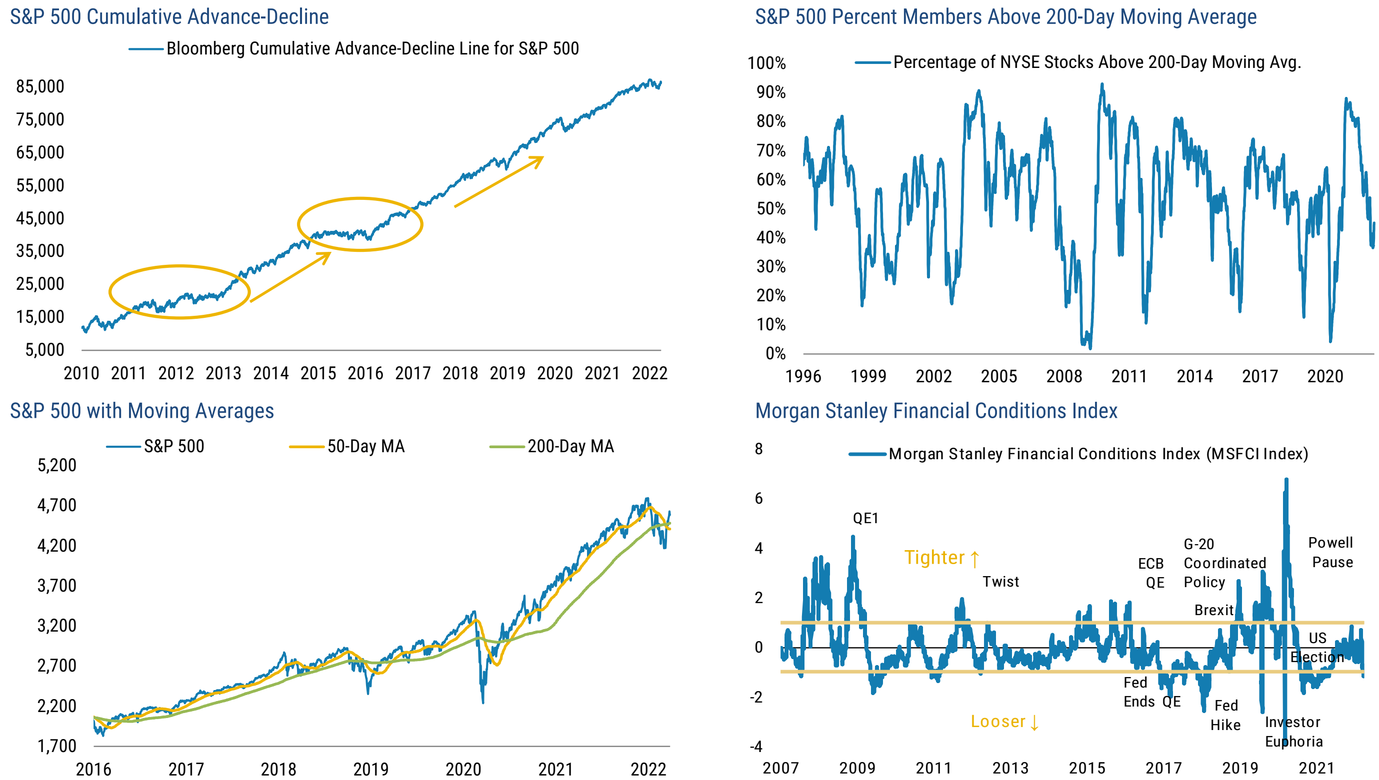
Source: Morgan Stanley Research

Exhibit 29: S&P 500 Equity Risk Premium using Nominal Rates and Breakevens



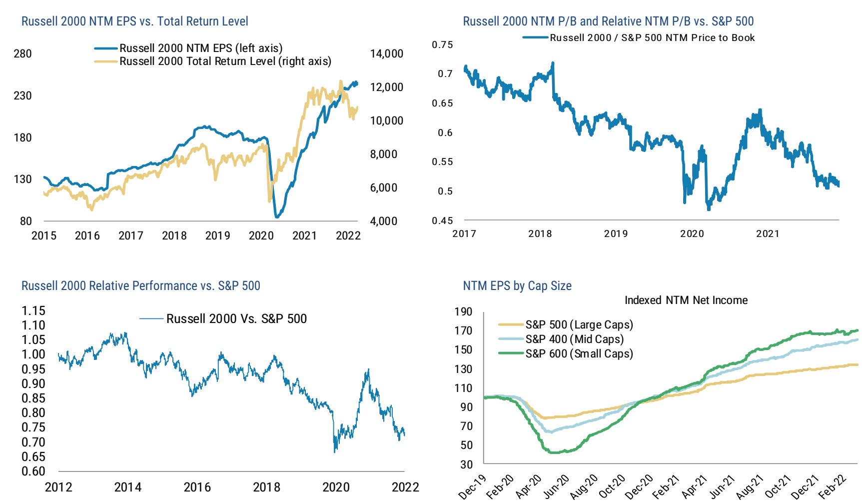
Source: Bloomberg, Morgan Stanley Research. As of Mar 31, 2022

Exhibit 30: US Equity Market Technicals and Financial Conditions



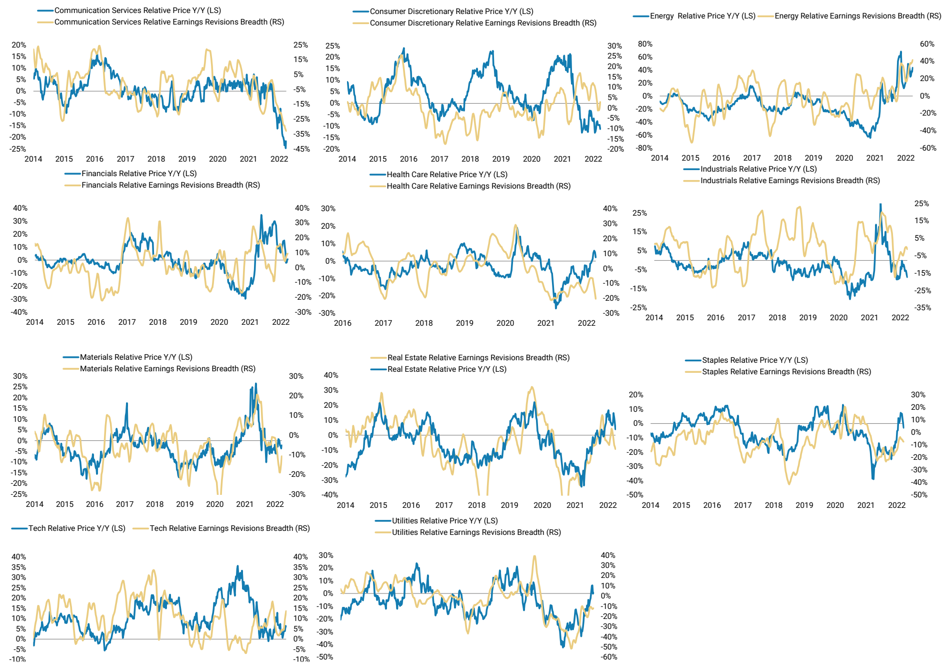
Source: Bloomberg, Morgan Stanley Research. All: As of Apr 1, 2022

Exhibit 31: US Small Cap Equities



Source: FactSet, Morgan Stanley Research. As of Apr 1, 2022

Exhibit 32: Earnings Revisions Breadth vs YoY Performance



Source: FactSet, Morgan Stanley Research. As of Mar 25, 2022

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(as of March 31, 2022)
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	COVERAGE UNIVERSE		INVESTMENT BANKING CLIENTS (IBC)			OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC)	
STOCK RATING CATEGORY	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MISC
Overweight/Buy	**1438**	**41%**	**366**	**45%**	**25%**	**630**	**41%**
Equal-weight/Hold	**1539**	**44%**	**365**	**45%**	**24%**	**712**	**46%**
Not-Rated/Hold	**0**	**0%**	**0**	**0%**	**0%**	**0**	**0%**
Underweight/Sell	**552**	**16%**	**87**	**11%**	**16%**	**207**	**13%**
TOTAL	**3,529**		**818**			**1549**	

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