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# **US Equity Strategy** | North America

# Weekly Warm-up: More Derating as Revision Breadth Rolls

The mid-cycle transition de-rating is advanced but unfinished. Falling earnings revision breadth this fall will likely complete that process. We like a barbell of defensives (h/c and staples) and rate plays (financials) as Fed moves toward tapering.

Weak breadth reflects De-rating under the surface. Our mid cycle transition continues with weak breadth, quality stocks doing better and an overall de-rating of P/Es for most stocks. The only missing ingredient to complete the transition is a more meaningful index level de-rating and correction. Until then, we continue to recommend avoiding early cycle sectors and shifting more defensively in one's quality skew. We remain overweight healthcare and staples as a way to defend against the near term growth deceleration and reversion to trendline. We also remain overweight financials as a hedge against rising rates into the fall as the Fed communicates its tapering schedule and the growth deceleration stabilizes.

Peaking revisions breadth implies a poor risk reward skew near term. We built a quantitative framework around earnings revisions breadth to forecast 3 month forward S&P (and sector/industry) returns based on revisions breadth scenarios. Breadth mean reverts making this framework most useful as breadth approaches and bounces off of extreme levels - like now. Breadth maintaining current levels (~2 std. dev. above LT avg.) implies a forward 3 month returns of just 1.2% while a move back down to average levels implies returns of -14% - a poor risk reward skew. As we move into 2H21 and past the main drivers of 1H beats - reopening, restocking, stimulus checks, reserve releases, crypto wealth effect (more 1Q21) - we expect a continued normalization of earnings revisions breadth off extremes. On this metric, Energy stands out for an even less attractive risk reward skew while Utilities stand out on the positive side.

**Utilities to EW, Energy to UW.** With our more defensive tilt and the risk reward skews outlined above, we're changing our order of preference between Utilities (to equal weight from underweight) and Energy (from equal weight to underweight). Our Utilities analyst Stephen Byrd also notes a few positive considerations: (1) Utilities are double beneficiaries if Democrats pass legislation more support for clean energy growth and an ability to pass along higher corporate taxes to customers, (2) Utility stocks are already pricing higher interest rates, (3) and there is no spread between BBB bond yields and utility dividend yields which is unusual (bonds typically yield 150-250 bps more). On Energy, our analysts maintain a positive bias given strong free cash flow projections, but given our more cautious view on risk assets, the limited house upside forecast for oil, the importance of rate of change in oil price to sector performance, our revisions breadth analysis above, and a worsening technical picture for Energy equities, our top down preference skews more negative pending a price reset.

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For more see our Thematic Alpha landing page.

#### Fresh Money Buy List Update

We present a snapshot of performance stats for our Fresh Money Buy List. For more information on the current list, performance calculation methodology, and updates from our Research analysts, please see the Fresh Money Buy List section of this note.

Fresh Money Buy List - Quick Stats						
Annualized Perf. Since Inception (Mar. 2018)						
Absolute vs S&P 500						
27.8%	14.6%					
YTD Total Return						
Absolute vs S&P 500						
22.4% 3.7%						
Average Stock Perf	ormance (All Time)					
Absolute	vs S&P 500					
32.8% 13.4%						
Stock Performance Hit Rate (All Time)						
% Positive Abs. Returns % Positive Rel. Returns						

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# What to Focus on This Week

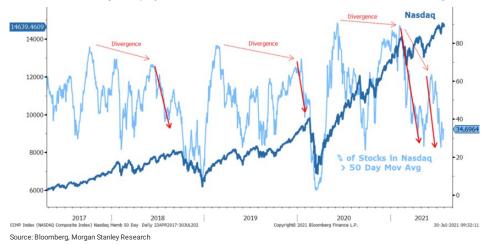
# What to Make of the De-rating Under the Surface?

We have been highlighting for months the narrowing breadth in the market. Recently, we have recorded some of the weakest readings ever witnessed as major indices make all-time highs (Exhibit 1). Weak breadth is usually a sign of underlying concern about something. While there is never a shortage of concerns and it often creates a wall of worry to climb in a bull market, breadth this weak usually means the concerns are piling up rather than going away. We think it's all part of the typical mid cycle transition more than anything else.

To summarize, we have characterized the current economic situation as the transition from early to mid cycle, the time of the expansion where we are past the peak rate of change and therefore maximum monetary accommodation. With the NBER recently declaring the end to the COVID-19 recession as far back as May 2020, our timing of this mid cycle transition starting back in March seems spot on. Years associated with prior mid cycle transitions include 1994, 2004, and 2011. In all cases, US equity markets were characterized by the following features: Falling P/E, narrowing leadership, a skew towards quality and a 10-20% correction in the major indices.

This year has been no different, but looks incomplete in our view. More specifically, there has been an extreme narrowing in leadership and shift towards quality; and while we have seen a de-rating in equity valuations, it's been more modest than prior mid cycle transitions which has allowed the major averages absent of a 10%+ correction, at least so far. We think the primary missing ingredient for that correction is Fed's slower than normal withdrawal of monetary accommodation given how much progress has already been made. This delay in removing accommodation has kept long term interest rates much lower than the economic fundamentals would suggest. Given the very high quality nature of the S&P 500 and Nasdaq 100, these indices have remained very resilient even as the average stock has fared quite poorly since March. For example 44% of the Russell 2000 small cap index has experienced a 20%+ drawdown this year.

Exhibit 1: The Strongest Equity Index has some of the weakest breadth on record. AMaZiNg

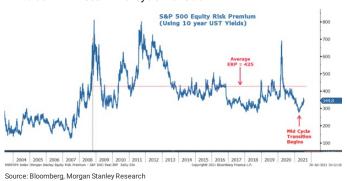


Another way to measure the internal strength of the market is to look at the de-rating we have seen beneath the surface. Last week we showed how the average PE for the S&P 500 has declined twice as fast as the market cap weighted PE in percentage terms (Exhibit 2). That divergence has continued with further de-rating for the average stock. Just like with market breadth of price, we think the average PE leads the market cap weighted PE and until that stabilizes, the PE for the S&P is vulnerable. Ultimately, we think the PE for both the average and market cap weighted S&P 500 will fall toward 18x by year end as rates move higher (1.8% is our year end target for 10 year Treasury yields) and the equity risk premium settles in around 375bps which is still 50bps below the post GFC/financial repression era average (Exhibit 3).

Exhibit 2: Average PEs Leading the Decline



Exhibit 3: ERP rises in Mid-Cycle Transition



fact, the average PE for the S&P 500 is down to 18.8x from 21x in late March/early April when the mid cycle transition began. The bad news is that the market cap weighted S&P 500 PE is sill north of 21x and has about 15% to go to reach our year end target. As noted above, we think the de-rating will continue into the fall as rates and ERP rise and the mid cycle transition finishes. At the sector level, the PE de-rating has been even more severe (Exhibit 4). This is especially true for the early cycle sectors like Transports, Autos, Materials, Banks, Semis and Retailing. Consumer Services and Energy PEs have also been hit hard as many of these fit into the negative Delta variant narrative on re-opening. On the other side of the ledger are defensives like Real Estate,

Utilities, Healthcare, Software and Staples. In short, our mid cycle transition has played

The good news is that this process is well under way already for the average stock. In



out at the sector level and we see no reason why it won't finish with the typical index level reset on PEs and price.

Exhibit 4: Dispersion in De-rating is Notable with Early Cycle Sectors leading on Downside.

Fwd PE: Maximum Drawdowns in Multiple vs Recovery

Fwd PE: Maximum Drawdowns in Muluple vs Recovery									
Industry Group	PE Max Drawdown	Recovery: Present vs Peak							
Real Estate	-14.9%	3.5%							
Utilities	-9.5%	2.6%							
HC Equipment & Services	-9.1%	2.0%							
Pharma, Biotech, & Life Sciences	-11.4%	1.8%							
Software & Services	-9.6%	0.1%							
Commercial & Professional Services	-18.2%	0.0%							
Hosuehold & Personal Products	-12.6%	-1.3%							
Food Beverage & Tobacco	-4.2%	-3.7%							
Food & Staples Retailing	-9.3%	-5.4%							
S&P 500	-8.9%	-6.7%							
Diversified Financials	-9.9%	-7.4%							
Media & Entertainment	-15.9%	-7.8%							
Capital Goods	-11.5%	-7.9%							
Insurance	-12.0%	-9.7%							
Telecom	-10.3%	-10.7%							
Retailing	-15.3%	-10.7%							
Consumer Durables & Apparel	-17.2%	-11.7%							
Semis & Semi Equip	-21.8%	-13.5%							
Tech Hardware & Equipment	-25.1%	-18.8%							
Banks	-23.5%	-21.6%							
Materials	-24.7%	-22.3%							
Consumer Services	-48.9%	-32.7%							
Autos & Components	-37.4%	-36.3%							
Transportation	-36.1%	-39.3%							
Energy	-57.8%	-57.0%							

Source: Bloomberg, Morgan Stanley Research

What this means is the early cycle/reopening stocks have de-rated and de-risked quite a bit at this point. The question is whether it's time to rotate back? We think it's still a bit premature as the more defensive areas of the market are likely to have their day of relative outperformance. At this point, we believe our thesis of peak rate of change and a payback in demand for many companies is starting to play out. The results and/or guidance from companies like NFLX, AMZN, UPS, TXN, CAT and others are starting to support that view and it's likely to get worse for the past year's winners before it stabilizes. That means big time deceleration in earnings revision breadth as we lay out in the next section. This has nothing to do with the Delta variant or other exogenous shocks to demand. Instead, what we're talking about is just reversion to trendline demand. We think that risk is greatest for many essential businesses that were able to operate during the pandemic and semiconductor and hardware companies that greatly benefitted from the pull forward in demand for electronic devices required for the economy to operate during the lock downs.

Our strategy recommendations for portfolio managers during the remainder of the mid cycle transition is to take a more conservative/defensive approach. As such we are overweight Healthcare and Staples. We also stay overweight Financials as a hedge against the rise in rates we expect once the delta variant fears subside and the Fed begins to communicate its tapering schedule this fall. We are also upgrading Utilities to Neutral today and downgrading Energy to Underweight based on our earnings revision breadth analysis below.



# Peaking Revisions + High Prices = Poor Risk/Reward

## We have long noted a link between earnings revisions breadth and y/y performance. As

a part of our framework, we frequently compare earnings revisions breadth (the difference between the number of upwardly revised sell side EPS estimates minus downwardly revised estimates over the total number of estimate changes for a group of stocks) to year on year performance. As we show below, a long term correlation of 63% (i.e. 39.6% R2) is observed between these measures for the S&P 500 based on data from 2003 to present (Exhibit 5). In general this relationship holds across sectors and industry groups as well, those with varying strengths - Health Care and Staples tend to show weaker links between y/y performance and revisions breadth while the links are strong for Discretionary and Financials (Exhibit 6).

Exhibit 5: Y/Y Performance Is Related to Earnings Revisions Breadth

Source: Refinitiv, Factset, Morgan Stanley Research



**Exhibit 6:** Discretionary and Financials Performance Tend to Show the Strongest Links with Revisions Breadth; Health Care and Staples the Weakest

Sector / Industry Group	ERB vs Y/Y Perf R^2
S&P 500	39.6%
Communication Services	27.1%
Telecommunication Services	12.2%
Media & Entertainment	20.8%
Consumer Discretionary	47.0%
Automobiles & Components	19.1%
Consumer Durables & Apparel	54.3%
Consumer Services	41.8%
Retailing	35.4%
Consumer Staples	7.0%
Food & Staples Retailing	19.7%
Food, Beverage & Tobacco	0.2%
Household & Personal Products	0.4%
Energy	40.4%
Financials	42.1%
Banks	28.9%
Diversified Financials	13.7%
Insurance	39.8%
Health Care	2.2%
Health Care Equipment & Services	5.3%
Pharmaceuticals, Biotechnology & Life Sciences	3.5%
Industrials	33.3%
Capital Goods	29.5%
Commercial & Professional Services	24.8%
Transportation	32.1%
Information Technology	39.1%
Software & Services	23.8%
Technology Hardware & Equipment	31.9%
Semiconductors & Semiconductor Equipment	41.9%
Materials	39.6%
Real Estate	37.7%
Utilities	29.8%

Source: Refinitiv, Factset, Morgan Stanley Research

### Our quantitative analysis builds on that relationship to help project forward 3 month

**returns.** We first run linear regressions of y/y performance on earnings revisions breadth across the market and at the sector/industry group level. Then we project the y/y performance for each cohort group under various scenarios for earnings revisions breadth. With the predicted y/y performance, together with the price level 9 months ago, we calculate the implied price level for index in 3 months and compare to spot price to project a scenario-based forward 3 month return estimate.



#### Our view is that revisions breadth is likely to continue normalizing from here ...

Notwithstanding the "beats" from this earnings season, we're seeing earnings revisions breadth for next year starting to roll off of all time highs (Exhibit 7), a dynamic we have been predicting for a few months. As we move into 2H21 and past the main drivers of 1H beats - reopening, restocking, stimulus checks, reserve releases, crypto wealth effect (in 1Q21) - we expect a continued normalization of earnings revisions breadth. The bear case for revisions is higher corporate tax rates, which would quickly force revisions to extreme lows as all analysts are forced to flow through higher tax rates. With the recent vote by the Senate to move forward with a bi-partisan infrastructure bill, the odds of a corporate income tax increase just went up. Looking at Exhbit 3, its impact on ERB should be the reverse of what we saw at the end of 2017/early 2018.

Earnings Revisions Breadth vs YoY Performance for S&P 500

80%

60%

40%

-20%

-80%

2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021

Earnings Revisions Breadth YoY S&P 500 Performance

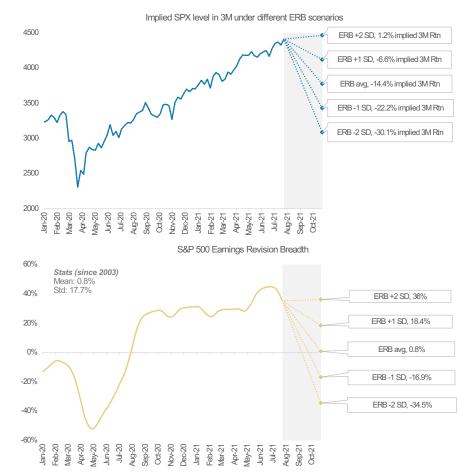
Exhibit 7: Earnings Revisions Breadth Has Begun Normalizing, A Process We Expect to Continue

Source: Refinitiv, Factset, Morgan Stanley Research

... which implies a poor risk reward for SPX over the next 3 months. Unless revisions breadth works back toward the highs, risk reward skew for price returns looks poor over the next 3 months. Revisions breadth maintaining their current levels (roughly 2 standard deviations above long term averages) implies a forward 3 month return of 1.2% while a move back down to average levels of revisions breadth implies returns of -14% - a poor risk reward skew (Exhibit 4).



Exhibit 8: Peaking Earnings Revisions and High Prices Create a Poor Risk/Reward Skew



Source: Refinitiv, Factset, Morgan Stanley Research

#### On this basis among industry groups, we see the worst risk/reward in Energy ... In

Exhibit 9 we show those sectors and industry groups where revisions breadth has a R2 > 0.25 with performance as well as the current z-score of revisions breadth and the implied returns under various 3 month forward scenarios. Energy's negatively skewed risk/reward stands out. Current earnings revisions breadth in Energy sits at 47%, about 1.5 standard deviations above long term average. The breadth moved up 4% in the past 3 months, but in the past month stalled, suggesting a possible turn lower has begun. The implied 3 month return is -34% if earnings revision breadth normalize to long term average and -15.5% even if the revisions breadth improve to 2 standard deviations above average. The R2 of 40% on revisions breadth and Energy performance (Exhibit 6) of course leaves room for other factors, but also has reasonably high explanatory power that should not be ignored. Financials and Comm Services also look more vulnerable than the broader average. We maintain our overweight in Financials on the view long term rates are making an important low. We are neutral on Energy and Comm Services.

... and the best in Utilities. For Utilities, current revisions breadth is -10% (-0.42 z-score), and it was revised down 5% in the last month. The implied 3 month return will up +7.2% if earnings revisions breadth remains average, and just -0.3% if the breadth drops continues dropping to 1 standard deviation below average.



Based on this analysis and outsized absolute and relative skews in ERB, we are upgrading Utilities to Neutral from Underweight and downgrading Energy to Underweight from Neutral today.

Exhibit 9: Revisions Breadth Suggests Poor Risk/Reward in Energy, More Positive in Utilities

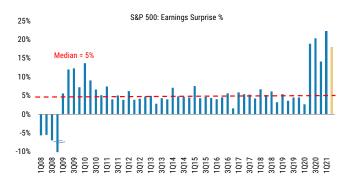
Sector / Industry Group	ERB Current Z- Score	ERB to +1 SD vs Avg: Implied 3 Mo Px Perf	ERB to Avg: Implied 3 Mo Px Perf	ERB to -1 SD vs Avg: Implied 3 Mo Px Perf
S&P 500	1.95	-6.6%	-14.4%	-22.2%
Communication Services	1.11	-10.8%	-17.9%	-25.0%
Consumer Discretionary	2.26	5.8%	-5.8%	-17.4%
Consumer Durables & Apparel	2.01	-1.9%	-14.9%	-27.9%
Consumer Services	1.32	3.5%	-6.7%	-17.0%
Retailing	2.47	4.4%	-6.0%	-16.4%
Energy	1.51	-24.8%	-34.1%	-43.4%
Financials	1.54	-12.6%	-24.6%	-36.7%
Banks	1.13	-17.6%	-28.7%	-39.8%
Insurance	1.59	-4.3%	-16.5%	-28.8%
Industrials	1.53	-6.7%	-15.7%	-24.7%
Capital Goods	1.39	-8.8%	-17.5%	-26.3%
Transportation	1.26	-0.8%	-9.9%	-18.9%
Information Technology	1.55	-3.1%	-13.2%	-23.2%
Technology Hardware & Equipment	1.35	1.0%	-11.1%	-23.1%
Semiconductors & Semiconductor Equipment	1.12	-1.9%	-14.9%	-28.0%
Materials	2.00	0.2%	-10.7%	-21.6%
Real Estate	1.74	-11.2%	-17.6%	-24.0%
Utilities	-0.42	14.8%	7.2%	-0.3%

Source: Refinitiv, Factset, Morgan Stanley Research

Another sign the good news is known at this point

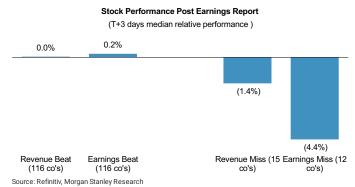
Companies are beating earnings estimates by 18% (Exhibit 12) - this is well above the typical 5% beat but has been in line with what we have seen for other quarters since covid hit. The market expects companies to beat at this point and companies that do so trade in line with the market three days after reporting (Exhibit 13). Those who miss estimates are punished sharply with the median company missing on revenue underperforming 1.4% and the median company missing on earnings underperforming 4.4%.

Exhibit 10: Earnings Surprise



Source: Refinitiv, Morgan Stanley Research

Exhibit 11: Beat vs Miss Performance





# 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 12: Fresh Money Buy List - Stats & Performance

Company Name	Ticker	MS Rating	Sector	Market Cap	Price MS PT	MS DT % to MS		Date	Total Return Since Inclusion		
Company Name	ricker	IVIS Rating	Sector	(\$Bn)	Price	IVIS PI	PT	WS Arialyst	Added	Absolute	Rel. to S&P
Alphabet Inc.	GOOGL	Overweight	Communication Services	\$1,800.0	\$2,694.53	\$3,000.00	11.3%	Nowak, Brian	4/5/2021	26.5%	16.7%
Exxon Mobil Corporation	XOM	Overweight	Energy	\$243.7	\$57.57	\$84.00	45.9%	McDermott, Devin	2/22/2021	11.5%	(1.7%)
Humana Inc	HUM	Overweight	Health Care	\$54.7	\$425.86	\$500.00	17.4%	Goldwasser, Ricky	7/19/2018	37.2%	(27.8%)
MasterCard, Inc.	MA	Overweight	Information Technology	\$380.8	\$385.94	\$451.00	16.9%	Faucette, James	3/2/2020	34.0%	(18.3%)
Mondelez International Inc	MDLZ	Overweight	Consumer Staples	\$88.4	\$63.26	\$69.00	9.1%	Mohsenian, Dara	7/19/2021	(1.6%)	(3.2%)
SBA Communications	SBAC	Overweight	Real Estate	\$37.3	\$340.99	\$337.00	(1.2%)	Flannery, Simon	6/7/2021	9.0%	4.9%
Simon Property Group Inc	SPG	Overweight	Real Estate	\$41.6	\$126.52	\$150.00	18.6%	Hill, Richard	2/16/2021	18.4%	5.9%
Synchrony Financial	SYF	Overweight	Financials	\$26.8	\$47.02	\$65.00	38.2%	Graseck, Betsy	2/22/2021	24.7%	11.5%
Welltower Inc.	WELL	Overweight	Real Estate	\$36.7	\$86.86	\$86.00	(1.0%)	Malhotra, Vikram	2/22/2021	28.0%	14.9%
Current List Performance Average (Eq. Weight) Median % Positive Returns (Abs. / Rel.) % Negative Returns (Abs. / Rel.) Avg. Hold Period (Months)				\$301.1 \$54.7			17.2% 16.9%			20.9% 24.7% 89% 11%	0.3% 4.9% 56% 44% 9.0
All Time List Performance Average (Eq. Weight) Median % Positive Returns (Abs. / Rel.) % Negative Returns (Abs. / Rel.) Avg. Hold Period (Months)										32.8% 23.3% 79% 21%	13.4% 5.9% 55% 45% 12.7

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.

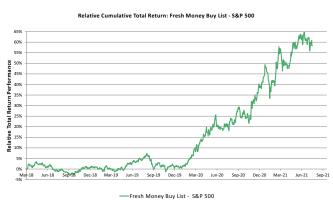
Source: Bloomberg, Morgan Stanley Research estimates.

Exhibit 13: Fresh Money Buy List & S&P 500 Cumulative Total Return



Source: Bloomberg, Morgan Stanley Research.

**Exhibit 14:** Fresh Money Buy List / S&P 500 Cumulative Relative Return



Source: Bloomberg, Morgan Stanley Research.

### Alphabet (GOOGL), Brian Nowak

An Omni-Channel Free Cash Flow World - We raise PT to \$3,000 as 2Q results
highlight online ad TAM expansion and more durable multi-year revenue and FCF
growth. Cloud, YouTube and capital returns also positive. \$3,500 bull case has



~30% upside.

## Mastercard (MA), James Faucette

Int'l Tourism Recovery Still in 2H22 View - MA delivered strong 2Q results, with
upside across all revenue lines. We are encouraged by mgmt's more positive
commentary around recovering int'l tourism volume, which remains the key upside
contributor, and see incremental growth from higher adoption of cross-border
ecommerce. Raise PT to \$451.

#### Synchrony Financial (SYF), Betsy Graseck

• 2Q21 Review: Keep Ringing the Cowbell on Loan Growth - We see a buying opportunity after NII revisions from low rates & higher expenses from wage inflation weighed on the group. Why? Biggest push back on bank stocks, weak loan growth, is finally turning around. Look for acceleration in 2H21 in card & 1H22 in C&I which typically spikes post-recession. ... Synchrony Financial (SYF): Undervalued growth stock that we believe deserves a higher multiple than the 7x it gets today given its exposure to the recovery in consumer spending and loan growth which has only just begun. SYF further has the single highest level of excess capital and reserves out of all banks, at 21% of its market cap. We expect SYF will repurchase almost 30% of its shares outstanding over the next 2.5 years. Key catalysts ahead? Investor Day on Sept 9th, and coming Buy Now Pay Later launch later this year. Our PT of \$65 offers 38% potential upside from here, based on a target PE of 9.5x on 2023e EPS.

#### Simon Property Group (SPG), Richard Hill

- Eyes on the Prize We have increased conviction on SPG following KIM / SITC earnings that indicate a rapidly improving retail landscape. While open air centers are on stronger footing than malls, we think the bar for SPG to beat & raise is lower. As conviction in the recovery grows, we expect the stock to re-rate.
- ABCs of SPG, ABG & SPARC SPG's potential ~\$615mn gain on \$66mn investment now in focus with Authentic Brands' S-1 filing, adding another catalyst for SPG.
   While it won't impact FFO, cash flow could be used for deleveraging, dev/redev, or M&A (likely retailers). We provide a review of SPG's stakes in ABG & SPARC.

#### Welltower (WELL), Vikram Malhotra

• Its All About Pricing Power - Welltower beat, reporting adjusted FFO 79c versus MSe 77c and Cons 76c. Versus our model, the beat was driven by better RIDEA growth (mainly occupancy and pricing) and slightly lower interest expense. Cash SS-NOI RIDEA growth came in at negative 19% versus MSe at negative 23%. Occupancy was up 190bps on a spot basis (SS average occupancy was up 50bps q/q and down 670bps y/y), REVPOR growth was up 2.0% overall (1.1% in the US) versus expectations of flat to slightly negative. We note June occupancy q/q accelerated to 90bps after increasing 50bps in May and month to date as of July 23, 2021, RIDEA occupancy increased approximately 40 bps. The 3Q guide of 190bps compares to MSe at 190 and investor expectations at 150-200) and a good initial number in our view given growing delta variant concerns. Initial 3Q FFO guide at 78-83c compares to MS at 80c and Street at 78c. While bears may highlight declining senior housing triple net coverage / Promedica rent coverage and pro



forma leverage in the low to mid 6's, we see 2Q as a solid print, supporting our view on 1) senior housing pricing power especially amid a strong housing market, 2) pentup demand and 3) the set-up for 2022 on NOI recapture. Reiterate OW.



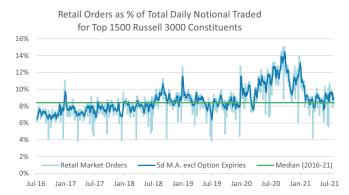
# What's Retail Doing?

Our Quantitative Equity Strategy team, led by Boris Lerner, 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 his approach.

#### A few key observations:

- Retail participation is currently at 8.8% of the total market volume, which is in the 62th percentile relative to the last 5 years
- Order imbalance has remained slightly positive. It currently sits at 0.6% or 63th percentile relative to the last 5 years.
- Imbalance is positive for majority of the sectors as of July 28, while more negative in Health Care and Energy. Real Estate and Utilities have the biggest absolute buy/sell imbalances.

**Exhibit 15:** Retail orders as a % of notional traded have recently seen a modest bounce ...



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

Exhibit 16: ... and the mix has shifted towards more buying



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

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Exhibit 17: Retail's buy/sell imbalance remains positive

	Reta	ail Participa	tion	Buy/Sell Imbalance			
	2016-21			2016-21			
Sector	Median	Current	p-tile	Median	Current	p-tile	
Energy	6.6%	6.5%	0.47	-0.4%	-0.3%	0.52	
Materials	5.6%	6.5%	0.77	0.5%	1.7%	0.75	
Industrials	6.8%	7.3%	0.62	-0.1%	1.3%	0.84	
Consumer Discretionary	11.3%	10.0%	0.30	0.8%	0.6%	0.46	
Consumer Staples	6.3%	4.5%	0.05	-0.6%	1.5%	0.84	
Health Care	6.0%	8.2%	0.93	-0.4%	-1.0%	0.35	
Financials	5.6%	4.2%	0.04	-0.1%	0.9%	0.70	
Information Technology	10.8%	11.2%	0.60	0.5%	0.2%	0.39	
Communication Services	8.4%	10.1%	0.61	0.4%	1.6%	0.76	
Utilities	4.0%	3.2%	0.12	-1.3%	1.9%	0.88	
Real Estate	3.6%	2.5%	0.05	0.5%	2.7%	0.82	
Model Universe (Top 1500)	8.4%	8.8%	0.62	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

1999 2001 2003 2005 2007 2009 2011 2013 2015 2017 2019 2021

42%

45%

40%

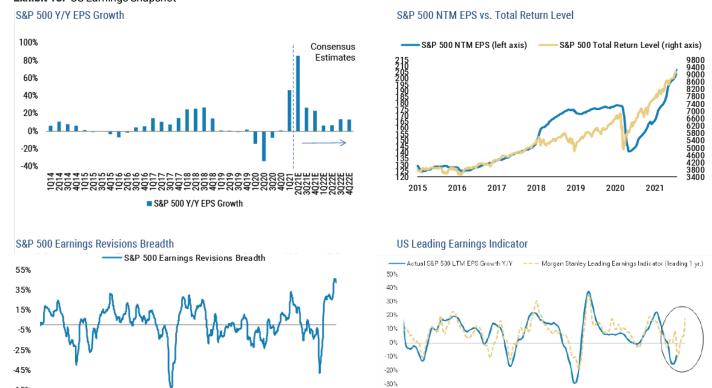
16%

Exhibit 18: US Earnings Snapshot

22%

39%

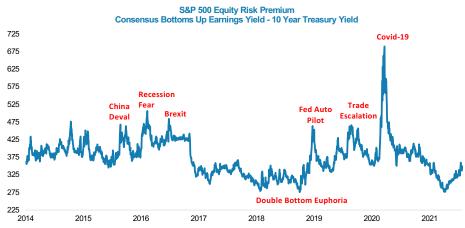
46%



Source: Thomson Financial, FactSet, Morgan Stanley Research. Top and bottom left: As of July 29, 2021 Bottom right As of June 30, 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.

1989

Exhibit 19: S&P 500 Equity Risk Premium



2001

2004 2007 2010 2013

Source: Bloomberg, Morgan Stanley Research, As of July 29, 2021.

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### Exhibit 20: US Equity Market Technicals and Financial Conditions

#### S&P 500 Cumulative Advance-Decline

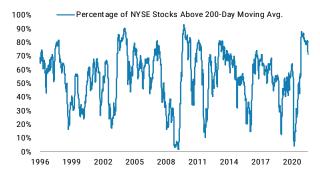


#### S&P 500 with Moving Averages

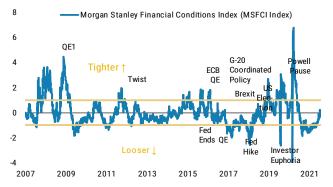


Source: Bloomberg, Morgan Stanley Research. All: As of July 29, 2021

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



#### Morgan Stanley Financial Conditions Index

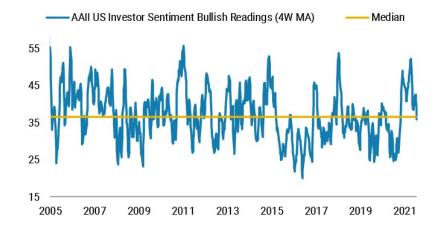


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Exhibit 21: US Equity Market Sentiment





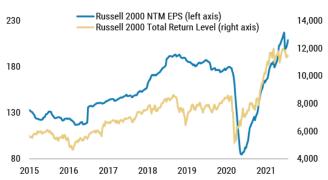


Source: Bloomberg, FactSet, Morgan Stanley Research. As of July 30, 2021.



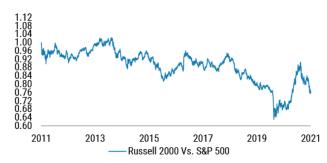
### Exhibit 22: US Small Cap Equities

#### Russell 2000 NTM EPS vs. Total Return Level



## Russell 2000 NTM P/B and Relative NTM P/B vs. S&P 500 Russell 2000 / S&P 500 NTM Price to Book 0.7 0.65 0.6 0.55 0.5 0.45 2017 2018 2016 2019 2020

#### Russell 2000 Relative Performance vs. S&P 500



Source: FactSet, Morgan Stanley Research. As if July 29, 2021

### NTM EPS by Cap Size

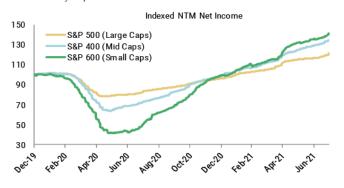


Exhibit 23: Our S&P 500 Price Target

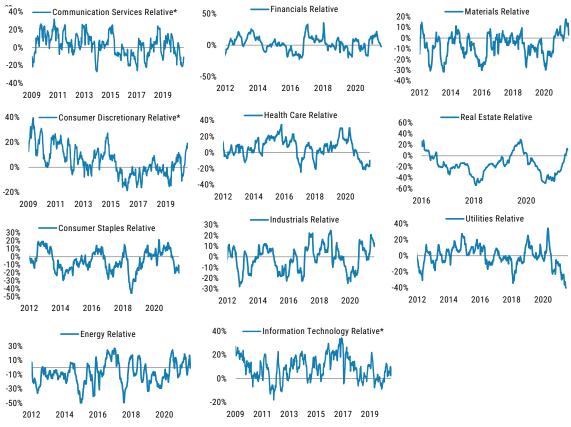
## Morgan Stanley S&P 500 Mid Year 2022 Price Target

Landscape	Earnings	Multiple	Price Target	Upside / Downside
Bull Case	\$222	20x	4,450	0.7%
Base Case	\$211	20x	4,225	-4.4%
Bear Case	\$199	19x	3,800	-14.0%
Current S&P 500	Price as of:	7/29/2021	4,419	

Source: Bloomberg, Morgan Stanley Research

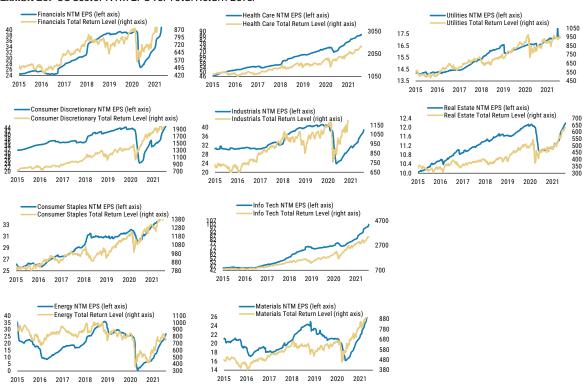






Source: FactSet, Morgan Stanley Research. As of July 28, 2021. Sectors with \* use current, fixed constituents

Exhibit 25: US Sector NTM EPS vs. Total Return Level



Source: FactSet, Morgan Stanley Research as of July 28, 2021



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	COVERAGE UI	NIVERSE	INVESTMEN	IT BANKING CLI	ENTS (IBC)	OTHER MAINVESTMENT CLIENTS (	SERVICES
STOCK RATING	COUNT	% OF	COUNT	% OF	% OF	COUNT	% OF
CATEGORY		TOTAL		TOTAL IBC	RATING		TOTAL
					CATEGORY		OTHER
							MISC
Overweight/Buy	1511	43%	421	48%	28%	676	44%
Equal-weight/Hold	1466	42%	372	42%	25%	654	43%
Not-Rated/Hold	1	0%	0	0%	0%	0	0%
Underweight/Sell	518	15%	84	10%	16%	199	13%
TOTAL	3,496		877			1529	

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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