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Weekly Warm-up: Great Expectations Suggest More Rotations

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We upgrade the Energy sector to overweight amid a combination of inflecting relative earnings revisions, strong breadth and compelling valuation. The recent stability of crude prices also points to a catch up in both relative performance and earnings growth, in our view.

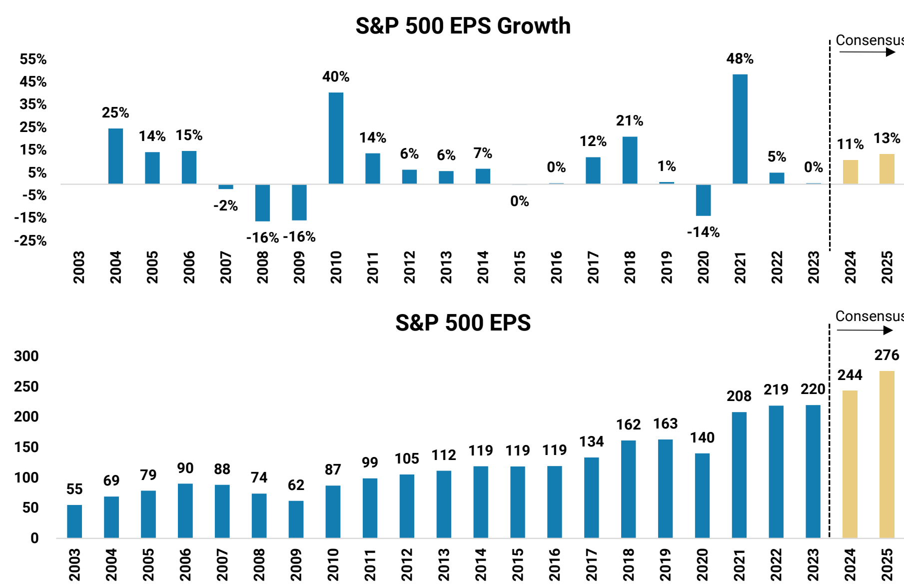
- **Great Expectations...**Over the past five months, the MSCI All Country World Index is up ~25% while many other asset prices are up double digits or more. We think this rally has been mostly about looser financial conditions and falling cost of capital as a result of the Fed's 4Q dovish shift. Further multiple expansion in the US is likely dependent on an upward inflection in earnings expectations for 2024 and 2025, which have been flat at the S&P level since last October.
- **Reflation Trades Back into Focus...**With the Fed appearing to be less concerned about inflation or looser financial conditions, reflation trades are coming back into vogue. The internals of the market appear to be onto this with some of the strongest breadth coming from the commodity cyclicals. On this front, large cap Energy is a classic late cycle winner that has underperformed the market materially since last September, but has shown strong relative performance and breadth recently. As we lay out in today's note, we think this recent outperformance continues. We recommend staying up the cap and quality curve within the sector.
- **Upgrading Energy to Overweight...**The sector's relative performance versus the S&P 500 has lagged the price of crude YTD, and Morgan Stanley's Global Commodities Strategist, Martijn Rats, recently raised his Brent forecast to $90/bbl by 3Q given incrementally tighter supply/demand balances. This view on the commodity plus inflecting relative earnings revisions, strong breadth and compelling valuation (8th percentile of historical EV/EBITDA levels) suggest to us that the divergence between oil prices and the sector's relative performance is likely to close via a catch up in Energy equities. Further, free cash flow margin for the space remains well above its historical average, net debt to EBITDA remains below its long-term run rate and the sector remains under-owned based on hedge fund net exposure. On a single stock basis, our North American Energy Research team led by Devin McDermott recommends COP, DVN, OXY, and FANG.

Great Expectations Suggest More Rotations

Over the past five months, the MSCI All Country World Index is up ~25% while many other asset prices are up double digits or more. What's driving this appreciation? Many factors are at work, but for stock indices, we think it's been mostly about easier financial conditions and higher valuations rather than improving fundamentals. Granted, higher asset prices often beget even higher asset prices as investors feel compelled to participate. From our perspective, it's hard to justify the higher index-level valuations based on fundamentals alone, given that 2024 and 2025 earnings forecasts have barely budged over this time period.

We rolled out our "boom-bust" thesis in 2020 based on the shift to fiscally dominant policy in response to the pandemic. At that point, our positive view on stocks was based on the boom in earnings we expected over the 2020-21 period as the economy roared back from pandemic lows. Our outlook anticipated both accelerating top-line growth and massive operating leverage as companies could reduce headcount and other costs while people were locked down at home. The result was the fastest earnings growth in 30 years and record-high margins/profitability – i.e., the boom in stocks was justified by the earnings boom that followed. Stock valuations were also supported by arguably the most generous monetary policy in history as the Fed slashed and held rates at zero long after the economy had bounced back from the pandemic. The Fed also continued quantitative easing throughout 2021, a year when S&P 500 earnings grew more than 45% to an all-time high (Exhibit 1).

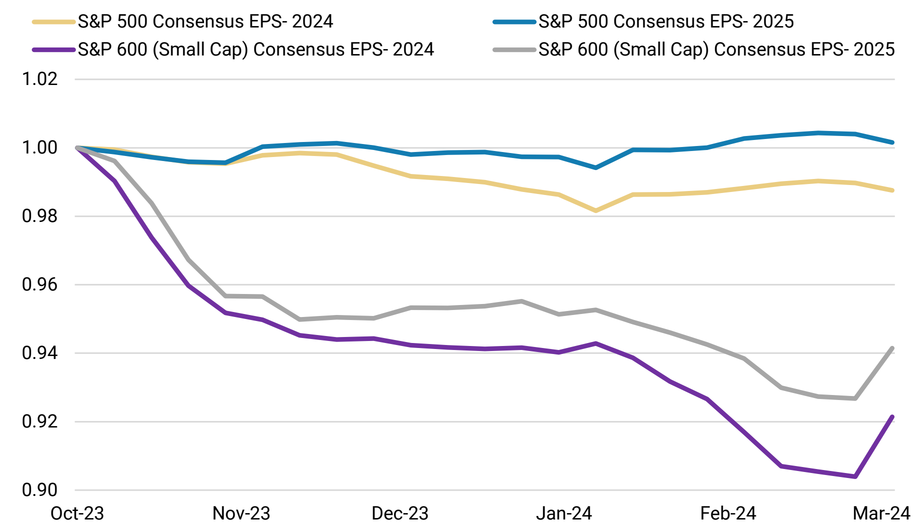
Exhibit 1: Consensus Expects A Rebound in EPS Growth This Year and Next



Source: FactSet, Morgan Stanley Research.

Today, stock valuations have reached similar highs relative to 2021 in anticipation of improving growth after the earnings slowdown most companies saw last year. While the recent easing of financial conditions may foreshadow such an acceleration in earnings, bottom-up expectations for 2024 and 2025 S&P 500 EPS remain flat post the Fed's 4Q dovish shift. Meanwhile, small cap EPS estimates are down 8% for 2024 and 6% for 2025, following the peak in front-end rates last October (Exhibit 2). We think one reason for the muted EPS revisions since last fall, particularly in small caps, is the continued policy mix of heavy fiscal stimulus and tight front-end rates, which we see crowding out many companies and consumers. While the narrowness of equity market performance over the last year has been closely scrutinized, it's just a reflection of the narrow earnings performance, in our view, and makes sense. This helps to explain why most stocks remain below their 2021 highs. As an offset, corporates are increasingly prioritizing operational efficiency — one of the key themes we have been focused on. A continued, broadening focus on efficiency gains that can offset cyclical headwinds and drive margins higher would certainly be a factor in taking earnings revisions higher from here.

Exhibit 2: EPS Expectations Are Flat for Large Caps Since Front End Rates Peaked in October and Are Down for Small Caps



Source: FactSet, Morgan Stanley.

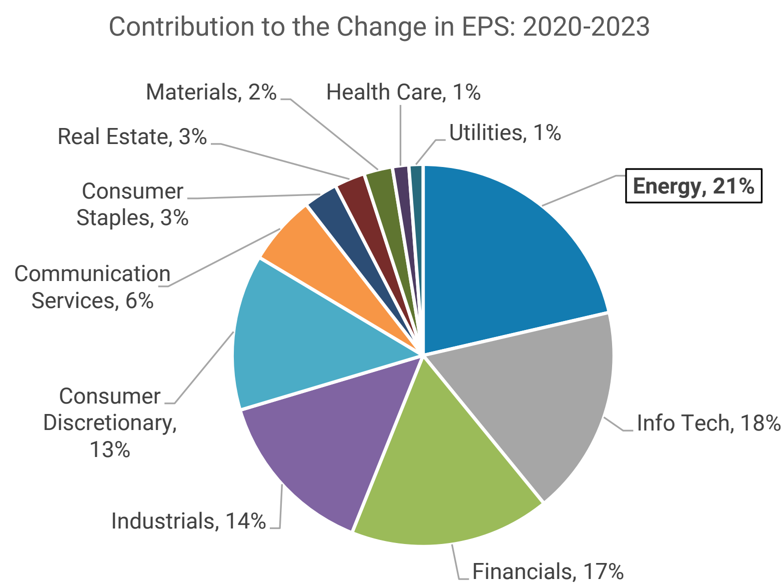
The question for investors at this stage is whether the market can finally broaden out in a more sustainable fashion. As we noted last week, we're starting to see breadth improve for several sectors. Looking forward, we believe a durable broadening comes down to whether other stocks/sectors can deliver on earnings growth. One sector showing strong breadth is Industrials, a classic late-cycle winner and a beneficiary of major fiscal outlays (e.g., IRA and the CHIPS Act) and the AI-driven data center buildout. A new sector displaying strong breadth is Energy (Exhibit 3), which is the best performer over the last month but is still lagging considerably since the October rally began. Taking the Fed's recent messaging into account and assuming it is less concerned about inflation or looser financial conditions, commodity-oriented cyclicals and Energy in particular could be due for a catch-up. It may also surprise some readers that Energy has contributed more to the change in S&P earnings since the pandemic than any other sector (Exhibit 4), yet it remains one of the cheapest and most under-owned areas of the market (see below for more).

Exhibit 3: Energy and Industrials Showing Strong Breadth

	% Rank Since March 2020						
Sector	% Memb. Above 200D MA	% Memb. Above 50D MA	% Memb. W/ New 52W Highs*	% Memb. W/ New 4W Highs*	EW Vs. Cap Weight Rel. Perf.	% Memb. W/ Wkly. Advance*	Average
Energy	61%	78%	84%	99%	93%	92%	**85%**
Industrials	82%	79%	95%	80%	88%	74%	**83%**
Materials	74%	88%	97%	90%	22%	97%	**78%**
Consumer Discretionary	72%	69%	92%	61%	68%	63%	**71%**
Financials	86%	74%	89%	72%	1%	64%	**64%**
Utilities	44%	65%	70%	58%	93%	54%	**64%**
Information Technology	85%	66%	86%	60%	0%	52%	**58%**
Health Care	68%	56%	84%	52%	30%	58%	**58%**
Consumer Staples	56%	81%	50%	65%	2%	77%	**55%**
Real Estate	61%	38%	79%	61%	54%	32%	**54%**
Communication Services	70%	38%	84%	37%	0%	27%	**43%**
S&P 500	81%	80%	92%	76%	1%	70%	**67%**

Source: Bloomberg, Morgan Stanley Research. *Based on 4-week moving average.

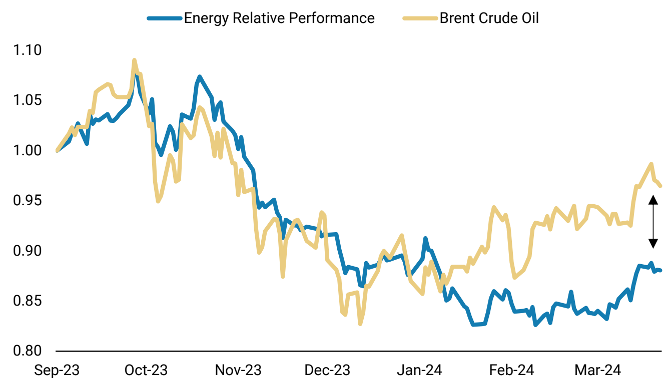
Exhibit 4: Energy Has Contributed More to the Change in S&P Earnings Since the Pandemic Than Any Other Sector



Source: Refinitiv, S&P, Morgan Stanley Research.

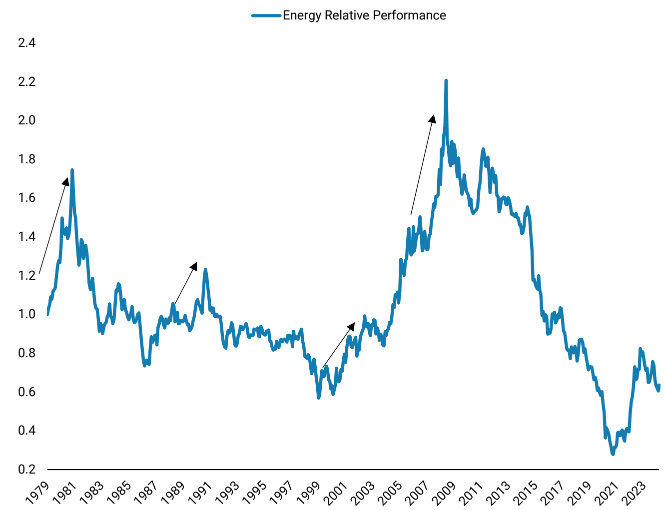
We point out that the Energy sector's relative performance versus the S&P 500 has lagged the price of crude YTD (Exhibit 5). Morgan Stanley's Global Commodities Strategist, Martijn Rats, recently raised his Brent forecast to $90/bbl by 3Q given incrementally tighter supply/demand balances. This view on the commodity plus inflecting relative earnings revisions, strong breadth and compelling valuation (see below) suggest to us that the divergence between oil prices and the sector's relative performance is likely to close via a catch up in Energy equities. Further, we continue to believe we're in a late cycle market environment, which has historically been supportive of Energy outperformance (Exhibit 6).

Exhibit 5: Energy Sector's Relative Performance Versus the S&P 500 Has Lagged the Price of Crude



Source: Bloomberg, Morgan Stanley Research.

Exhibit 6: Energy Is Historically A Late Cycle Outperformer



Source: Bloomberg, Morgan Stanley Research.

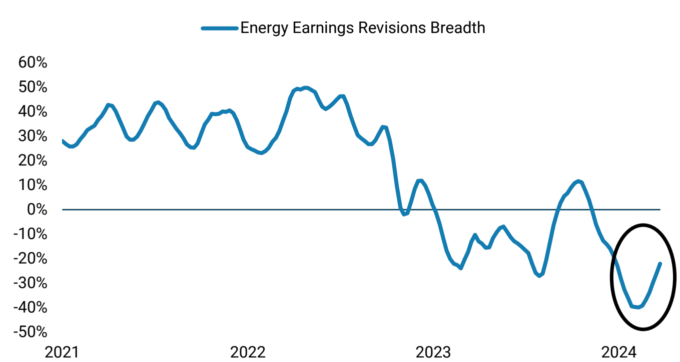
On the valuation front, Exhibit 7 shows that subgroups across the sector look attractive on an EV/EBITDA and free cash flow yield basis. The sector overall is currently trading in just the 8th percentile of historical forward EV/EBITDA levels and in the 82nd percentile of historical forward free cash flow yield levels. In Exhibit 8 and Exhibit 9 , we illustrate that absolute and relative earnings revisions breadth for the Energy sector appears to be bottoming. Further, the recent upside in crude on a Y/Y basis, points to upside in forward EPS growth for the Energy sector (Exhibit 10).

Exhibit 7: Valuation Looks Broadly Attractive Across the Sector

Relative Valuation Percent Rank Summary							
	Oil & Gas Drilling	Oil & Gas Equipment & Services	Integrated Oil & Gas	Oil & Gas Exploration & Production	Oil & Gas Refining & Marketing	Oil & Gas Storage & Transport	Energy
LTM EV/EBITDA	1%	1%	4%	4%	8%	9%	3%
NTM EV/EBITDA	4%	1%	5%	14%	23%	9%	8%
LTM FCF Yield	76%	98%	85%	84%	90%	72%	85%
NTM FCF Yield	92%	95%	83%	80%	88%	67%	82%

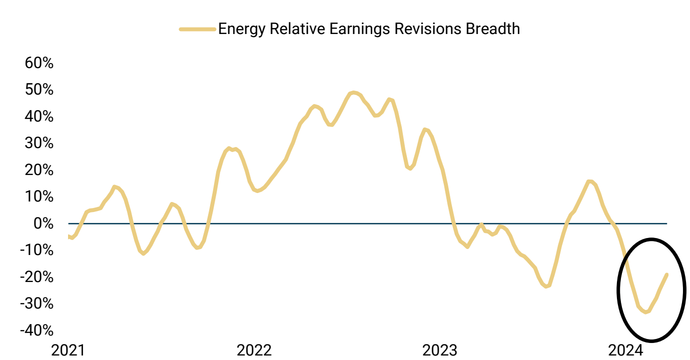
Source: FactSet, Morgan Stanley Research. NTM: Next Twelve Month Bottom-Up Consensus.

Exhibit 8: Absolute Earnings Revisions Breadth Appears to be Inflecting...



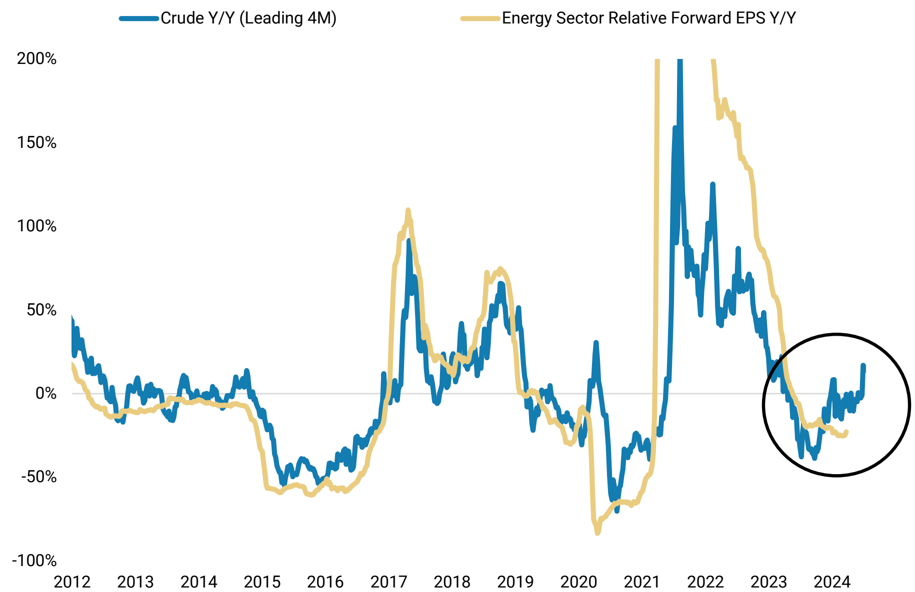
Source: FactSet, Morgan Stanley Research.

Exhibit 9: ...As Does Relative Earnings Revisions Breadth



Source: FactSet, Morgan Stanley Research.

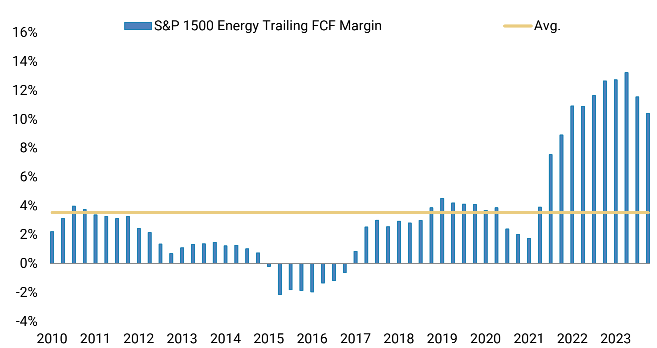
Exhibit 10:
Recent Upside in Crude on a Y/Y Basis Points to Upside in Forward EPS Growth for the Energy Sector



Source: FactSet, Morgan Stanley Research.

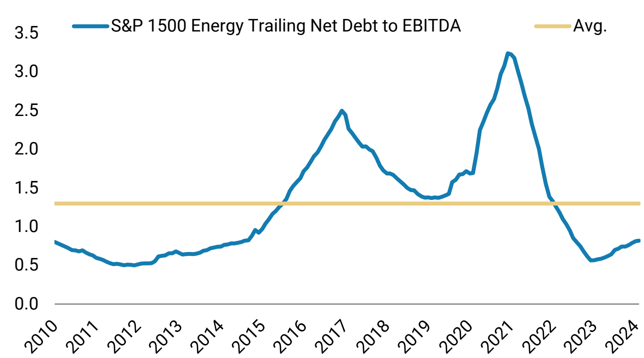
While free cash flow margins have come down slightly over the past 2 quarters, they remain well above the historical run rate (Exhibit 11). In terms of leverage, the sector's net debt to EBITDA ratio remains below the historical average going back to 2010 (Exhibit 12). Positioning data also looks compelling—Energy is in just the 17th percentile of historical hedge fund net exposure levels (Exhibit 13). Morgan Stanley's North American Energy Research team led by Devin McDermott recommends a quality bias. On a single stock basis, they recommend COP, DVN, OXY, and FANG.

Exhibit 11: Energy Free Cash Flow Margins Well Above Historical Average...



Source: FactSet, Morgan Stanley Research.

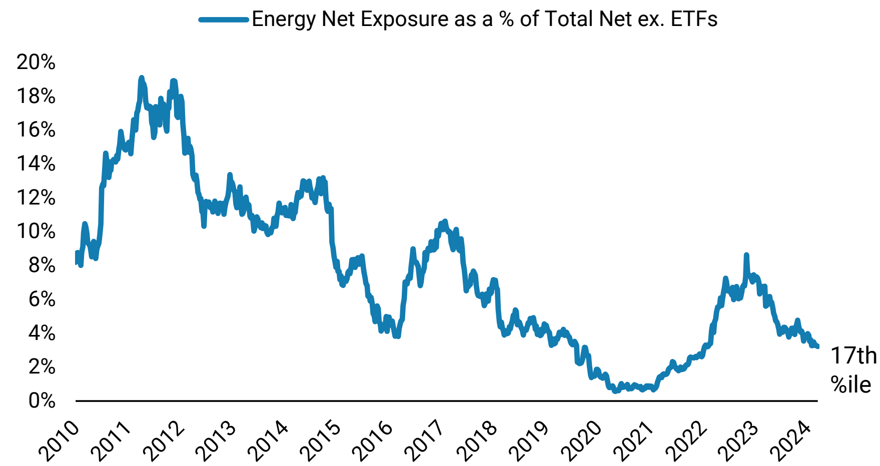
Exhibit 12: ...And Net Debt to EBITDA Well Below Historical Average



Source: FactSet, Morgan Stanley Research.

Exhibit 13:

Hedge Fund Net Exposure to the Energy Sector Is Low Vs. History



Source: Morgan Stanley Prime Brokerage.

Fresh Money Buy List

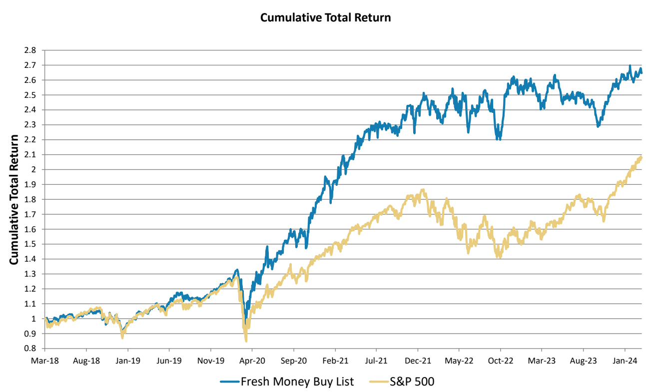
Exhibit 14: Fresh Money Buy List - Stats & Performance

Company Name	Ticker	MS Rating	Sector	Market Cap ($Bn)	Price	MS PT	% to MS PT	MS Analyst	Date Added	Total Return Since Inclusion	
										Absolute	Rel. to S&P
CenterPoint Energy Inc	CNP	Overweight	Utilities	$17.5	$27.87	28.00	0.5%	Arcaro, David	3/21/2022	1.0%	(17.4%)
Coca-Cola Co.	KO	Overweight	Consumer Staples	$258.2	$59.88	65.00	8.6%	Mohsenian, Dara	3/28/2022	3.4%	(12.9%)
Colgate-Palmolive Co	CL	Overweight	Consumer Staples	$72.8	$88.45	93.00	5.1%	Mohsenian, Dara	3/27/2023	23.5%	(7.3%)
McDonald's Corporation	MCD	Overweight	Consumer Discretionary	$201.6	$279.14	327.00	17.1%	Harbour, Brian	10/18/2021	21.8%	2.9%
Mondelez International Inc	MDLZ	Overweight	Consumer Staples	$95.3	$70.75	78.00	10.2%	Kaufman, Pamela	7/19/2021	16.6%	(6.7%)
SBA Communications	SBAC	Overweight	Real Estate	$23.3	$215.48	242.00	12.3%	Flannery, Simon	6/7/2021	(28.9%)	(55.2%)
Verizon Communications	VZ	Overweight	Communication Services	$166.0	$39.49	44.00	11.4%	Flannery, Simon	12/19/2022	16.2%	(19.3%)
Walmart Inc	WMT	Overweight	Consumer Staples	$488.6	$60.68	67.00	10.4%	Gutman, Simeon	3/27/2023	30.2%	(0.6%)
Current List Performance											
Average (Eq. Weight)				$165.4			9.5%			10.49%	(14.57%)
Median				$130.6			10.3%			16.4%	(10.1%)
% Positive Returns (Abs. / Rel.)										88%	13%
% Negative Returns (Abs. / Rel.)										13%	88%
Avg. Hold Period (Months)											22.8
All Time List Performance											
Average (Eq. Weight)										27.1%	6.0%
Median										16.4%	(1.1%)
% Positive Returns (Abs. / Rel.)										80%	45%
% Negative Returns (Abs. / Rel.)										20%	55%
Avg. Hold Period (Months)											17.5

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.

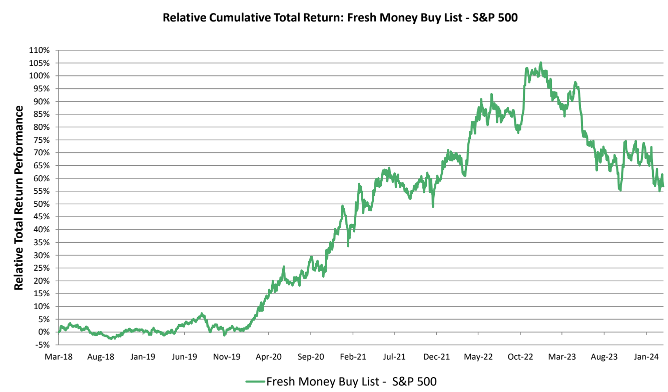
Source: Bloomberg, Morgan Stanley Research

Exhibit 15: Fresh Money Buy List & S&P 500 Cumulative Total Return



Source: Bloomberg, Morgan Stanley Research

Exhibit 16: Fresh Money Buy List / S&P 500 Cumulative Relative Return



Source: Bloomberg, Morgan Stanley Research

Factor Update

We select a few key factors to monitor in Exhibit 17 and Exhibit 18 to help study market drivers from a factor standpoint. These Exhibits focus on factors within the US Top 1,000 by market cap universe. Some key takeaways on performance in the last month:

- Quality underperformed Junk (-1.5% relative return) and the overall market (-0.8% relative return versus the overall Top 1,000 universe).
- Value has been muted over Growth (+0.1% relative return), and the overall market (+0.0% relative return versus the overall Top 1,000 universe).
- High Momentum stocks have outperformed low momentum stocks (+6.4% relative return) and the overall market (+4.8% relative return).
- Small Caps underperformed Large Caps in the trailing month.

Exhibit 17: Top 1,000 Factor Returns

Top 1000 Factor Return as of Mar 21, 2024

Factor	1 Week			1 Month			YTD Ret	12M Ret
	Ret	1W Chg	1M Chg	Ret	1M Chg	3M Chg		
Quality / Junk	-0.8%	↓	↓	-1.5%	↓	↑	0.5%	-4.8%
Quality	2.0%	↑	↓	5.0%	↑	↓	7.5%	22.2%
Junk	2.9%	↑	↑	6.5%	↑	↓	7.0%	27.0%
Value / Growth	1.2%	↑	↓	0.1%	↑	↓	-5.4%	-11.8%
Value	3.3%	↑	↑	5.8%	↑	↓	4.0%	18.7%
Growth	2.1%	↑	↑	5.8%	↑	↓	9.4%	30.5%
Cyclical / Defensive	1.8%	↑	↑	4.0%	↑	↓	2.4%	8.6%
Cyclical	3.5%	↑	↑	8.0%	↑	↓	8.0%	28.1%
Defensive	1.7%	↑	↓	4.0%	↑	↓	5.7%	19.5%
12M Momentum	1.5%	↑	↑	6.4%	↑	↑	14.8%	15.4%
High Momentum	4.0%	↑	↑	10.6%	↑	↑	15.1%	36.5%
Low Momentum	2.4%	↑	↑	4.2%	↑	↓	0.4%	21.1%
Size (Small / Large)	1.1%	↑	↑	-0.9%	↑	↓	-6.2%	-5.8%
Small Cap	3.3%	↑	↑	4.7%	↑	↓	3.1%	23.4%
Large Cap	2.2%	↑	↑	5.6%	↑	↓	9.3%	29.2%

Source: Compustat, Morgan Stanley Research

Exhibit 18: Excess Return Versus Broader Top 1,000 Universe

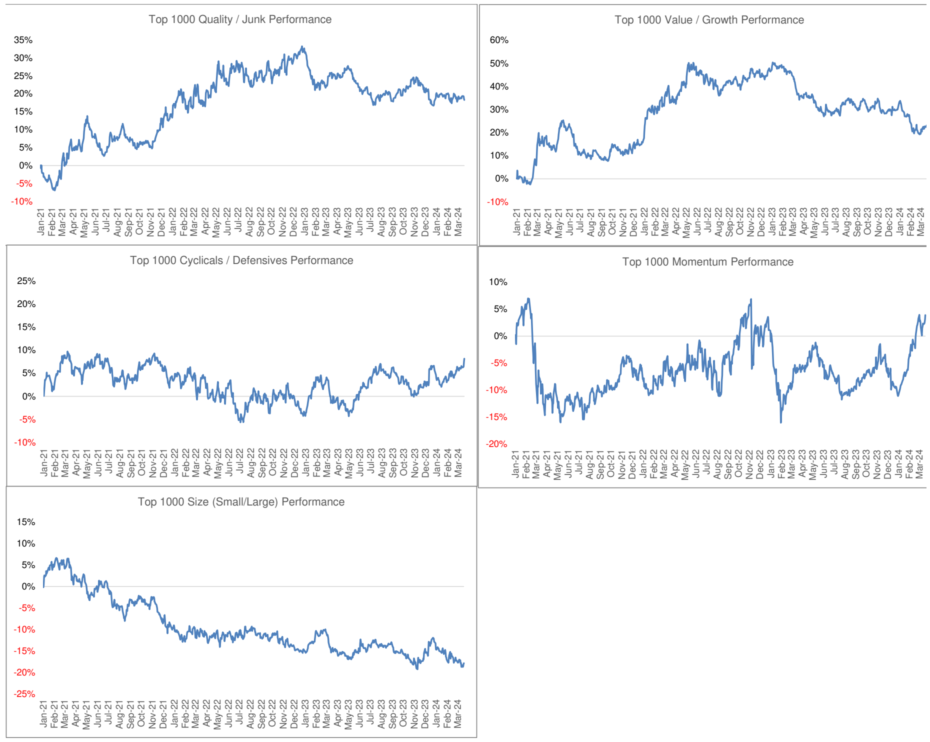
Top 1000 Excess Factor Return versus Broader Top 1000 Return as of Mar 21, 2024

Factor	1 Week			1 Month			YTD Ret	12M Ret
	Ret	1W Chg	1M Chg	Ret	1M Chg	3M Chg		
Quality / Junk								
Quality	-0.6%	↓	↓	-0.8%	↓	↑	0.5%	-2.9%
Junk	0.3%	↑	↑	0.7%	↑	↓	0.1%	1.9%
Value / Growth								
Value	0.7%	↑	↓	0.0%	↑	↓	-3.0%	-6.4%
Growth	-0.5%	↑	↑	0.0%	↓	↓	2.4%	5.4%
Cyclical / Defensive								
Cyclical	0.9%	↑	↑	2.2%	↑	↑	1.1%	3.0%
Defensive	-0.9%	↓	↓	-1.8%	↓	↑	-1.3%	-5.6%
Momentum								
High Momentum	1.4%	↑	↑	4.8%	↑	↑	8.2%	11.4%
Low Momentum	-0.2%	↓	↓	-1.6%	↑	↓	-6.6%	-4.0%
Size (Small / Large)								
Small Cap	0.7%	↑	↑	-1.1%	↑	↓	-3.9%	-1.7%
Large Cap	-0.4%	↓	↓	-0.2%	↓	↑	2.3%	4.1%

Source: Compustat, Morgan Stanley Research

Exhibit 19 shows performance of these pairs in time series graph form.

Exhibit 19: Cumulative Factor Performance Since 2021



Source: Compustat, Morgan Stanley Research

We include an extensive list of factors and their returns in Exhibit 20 .

Exhibit 20: Full List of Factor Spread Returns (Long - Short)

Equal Weighted Factor Return (Spread) in Top 1000 as of March 21, 2024

Factor Name	1 Week			1 Month			3M Ret	YTD Ret	12M Ret
	Ret	1W Chg	1M Chg	Ret	1M Chg	3M Chg			
9-Month Price Momentum (High vs Low)	1.9%	↑	↑	7.0%	↑	↑	12.9%	13.3%	6.8%
12-Month Price Momentum (High vs Low)	1.5%	↑	↑	6.4%	↑	↑	14.4%	14.8%	15.4%
12m-1m Residual Momentum (High vs Low)	1.7%	↑	↑	6.3%	↑	↑	13.2%	13.5%	16.6%
6-Month Price Momentum (High vs Low)	1.1%	↑	↑	5.3%	↑	↑	7.3%	7.7%	5.9%
Asset Turnover (High vs Low)	0.4%	↓	↑	4.6%	↑	↑	7.0%	8.0%	15.3%
CapEx-to-Sales (Low vs High)	0.3%	↓	↓	4.5%	↑	↑	6.8%	7.5%	19.9%
Industry Cyclical vs Defensive	1.5%	↑	↑	4.3%	↑	↑	2.6%	3.9%	14.2%
Cyclical vs Defensive	1.8%	↑	↑	4.0%	↑	↓	1.4%	2.4%	8.6%
3-Month Price Momentum (High vs Low)	1.8%	↑	↑	3.8%	↑	↑	2.4%	2.2%	-15.3%
Price-to-Sales (Cheap vs Expensive)	1.4%	↑	↑	3.4%	↑	↑	1.9%	2.3%	6.6%
Sales per Employee (High vs Low)	1.5%	↑	↑	3.3%	↑	↑	4.3%	5.4%	15.1%
Interest Coverage (High vs Low)	-0.3%	↓	↓	3.1%	↑	↑	9.1%	9.5%	5.9%
Price-to-Cash Flow (Cheap vs Expensive)	0.7%	↓	↑	3.1%	↑	↑	6.4%	6.8%	13.9%
Net Cash Variability (Low vs High)	1.9%	↑	↑	2.9%	↑	↑	-1.9%	-1.3%	-9.6%
5-Year EPS Growth (High vs Low)	-0.9%	↓	↓	2.8%	↑	↑	4.2%	4.4%	7.4%
Cash Flow Coverage (High vs Low)	-0.3%	↓	↑	2.8%	↑	↑	4.9%	5.1%	11.8%
1-Year Dividend per share growth (High vs Low)	0.6%	↓	↑	2.6%	↑	↑	4.6%	4.9%	4.9%
Return on Invested Capital (High vs Low)	-0.6%	↓	↓	2.6%	↑	↑	9.0%	9.9%	6.8%
Composite Quality (High vs Low)	-0.2%	↓	↓	2.5%	↑	↑	6.1%	6.4%	13.6%
Financial Leverage (Low vs High)	-0.5%	↓	↓	2.4%	↑	↑	6.2%	6.8%	13.8%
1-Month Estimate Revisions (%) (High vs Low)	0.8%	↑	↑	2.2%	↑	↑	4.6%	4.8%	9.0%
Inventory Turnover (High vs Low)	-0.4%	↓	↑	2.1%	↑	↑	3.6%	4.1%	10.6%
ROE (High vs Low)	-0.9%	↓	↓	2.1%	↑	↑	6.1%	6.6%	0.6%
Operational Efficiency (High vs Low)	0.4%	↓	↓	2.0%	↑	↑	2.8%	3.3%	7.3%
Cash Flow / Debt (High vs Low)	-0.6%	↓	↓	2.0%	↑	↑	5.6%	7.0%	7.9%
ROA (High vs Low)	-0.7%	↓	↓	2.0%	↓	↑	9.3%	9.8%	7.4%
Gross Profit / Assets (High vs Low)	-0.1%	↓	↓	1.9%	↑	↑	6.8%	7.5%	12.6%
Enterprise Value-to-Operating Income (Low vs High)	0.6%	↓	↓	1.9%	↓	↑	4.8%	5.4%	5.7%
Sales Revisions (High vs Low)	0.3%	↑	↑	1.9%	↑	↑	6.9%	6.8%	7.2%
Up vs Down Sales Revisions (High vs Low)	0.5%	↑	↓	1.8%	↑	↑	6.4%	6.1%	6.6%
Free Cash Flow-to-Debt (High vs Low)	-0.7%	↓	↓	1.7%	↑	↑	6.1%	7.3%	10.0%
Composite Sentiment (High vs Low)	0.5%	↑	↑	1.7%	↓	↑	10.5%	10.5%	13.7%
Operating Leverage (High vs Low)	-0.3%	↓	↓	1.7%	↑	↑	3.4%	2.8%	3.6%
Short-Term Accruals (Low vs High)	0.9%	↑	↑	1.7%	↑	↑	-1.0%	-0.2%	1.4%
Smoothed Estimate Revisions (%) (High vs Low)	0.6%	↑	↑	1.6%	↓	↑	7.0%	7.2%	11.7%
Enterprise Value-to-Free Cash Flow (Low vs High)	0.2%	↓	↓	1.5%	↑	↑	5.0%	6.3%	13.2%
Price-to-Forward Earnings (Cheap vs Expensive)	0.9%	↓	↓	1.5%	↑	↑	1.6%	2.1%	1.5%
Composite Free Cash Flow (High vs Low)	0.2%	↓	↓	1.4%	↑	↑	5.1%	6.4%	12.5%
CapEx-to-Depreciation (Low vs High)	-0.2%	↓	↓	1.4%	↑	↑	1.3%	1.2%	8.3%
5-Year Dividend per share growth (High vs Low)	0.5%	↓	↑	1.4%	↓	↑	3.1%	2.8%	3.1%
Y/Y %Change in number of employees (Low vs High)	0.6%	↑	↓	1.1%	↑	↑	0.3%	0.2%	-6.4%
Price-to-Operating Income (Cheap vs Expensive)	0.8%	↓	↓	1.1%	↓	↑	3.7%	4.0%	4.0%
Enterprise Value-to-EBITDA (Low vs High)	0.8%	↑	↓	1.1%	↑	↑	2.6%	2.9%	2.3%
Composite Accruals (Low vs High)	0.8%	↑	↑	1.1%	↑	↑	1.2%	1.8%	8.9%
CapEx-to-Assets (Low vs High)	0.3%	↓	↑	1.0%	↑	↑	1.9%	1.2%	8.6%
Debt-to-Assets (Low vs High)	-0.3%	↓	↑	1.0%	↑	↑	0.3%	0.0%	-1.5%
Earnings Revisions (High vs Low)	0.0%	↑	↓	1.0%	↑	↑	2.4%	2.5%	2.0%
1-Year EPS Growth (High vs Low)	-1.1%	↓	↓	1.0%	↓	↑	4.6%	5.6%	2.7%
Y/Y Change in Inventory/Sales (Low vs High)	0.1%	↓	↑	0.9%	↓	↓	3.5%	4.2%	14.5%
Total Yield (High vs Low)	0.1%	↓	↑	0.9%	↑	↑	-0.4%	0.0%	1.3%
Price-to-EBITDA (Cheap vs Expensive)	0.8%	↑	↓	0.9%	↑	↑	1.3%	1.3%	-0.5%
Earnings Estimate Revisions (High vs Low)	-0.4%	↓	↑	0.8%	↑	↑	2.0%	2.4%	0.7%
Free Cash Flow Yield (High vs Low)	0.3%	↓	↓	0.7%	↑	↑	4.0%	5.2%	9.7%
Accruals (Low vs High)	0.6%	↑	↑	0.7%	↑	↑	1.5%	2.0%	9.5%
Cash-to-Market Cap (High vs Low)	1.1%	↑	↑	0.6%	↑	↓	-4.2%	-3.5%	0.3%
Sales Estimate Revisions (High vs Low)	-0.9%	↓	↓	0.6%	↑	↑	2.4%	2.5%	-1.3%
Composite Value (Cheap vs Expensive)	0.0%	↓	↓	0.5%	↑	↑	0.2%	0.8%	-2.1%
Cash-to-Debt (High vs Low)	0.6%	↑	↑	0.4%	↑	↓	-2.2%	-1.5%	-1.5%
Debt-to-Equity (Low vs High)	0.1%	↓	↑	0.4%	↑	↑	-1.1%	-1.6%	-6.0%
Composite Growth (High vs Low)	-1.0%	↓	↓	0.4%	↓	↑	3.7%	4.3%	2.8%
Debt-to-EBITDA (Low vs High)	0.1%	↑	↑	0.1%	↑	↓	-1.5%	-1.1%	11.7%
Sales Variability (Low vs High)	-0.8%	↓	↓	0.1%	↓	↑	2.5%	1.9%	-6.1%
Value vs Growth	1.2%	↑	↓	0.1%	↑	↓	-5.4%	-5.4%	-11.8%
Up-to-Down Revisions (High vs Low)	0.4%	↑	↓	0.0%	↓	↑	1.2%	1.6%	4.0%
Tangible Book/Price (Cheap vs Expensive)	1.5%	↑	↑	-0.1%	↑	↓	-4.5%	-4.3%	-4.8%
Profitability (High vs Low)	-1.1%	↓	↓	-0.2%	↑	↑	3.3%	3.6%	7.1%
Net Margin (High vs Low)	-1.2%	↓	↓	-0.3%	↓	↑	5.2%	5.6%	-0.9%
Earnings Stability (High vs Low)	-1.5%	↓	↓	-0.4%	↑	↑	2.1%	1.3%	0.5%
Sales Growth Stability (High vs Low)	-1.2%	↓	↓	-0.5%	↓	↑	2.4%	1.6%	4.6%
Price-to-Earnings (Cheap vs Expensive)	-0.4%	↓	↓	-0.5%	↑	↑	0.2%	0.9%	0.0%
Forecast long term growth (High vs Low)	-0.9%	↓	↑	-0.5%	↓	↓	3.8%	4.4%	11.4%
Gross Margin (High vs Low)	-0.8%	↓	↓	-0.6%	↑	↓	1.0%	1.2%	2.8%
Inventory-to-Sales (Low vs High)	-0.4%	↓	↓	-0.6%	↑	↑	-0.7%	-1.1%	1.6%
Cash-to-Assets (High vs Low)	0.4%	↑	↑	-0.6%	↑	↓	-3.0%	-2.4%	3.6%
5-Year Sales Growth (High vs Low)	0.3%	↑	↑	-0.7%	↓	↓	-2.6%	-1.4%	5.9%
Receivables Turnover (High vs Low)	-0.4%	↑	↓	-0.7%	↓	↑	0.8%	1.4%	2.6%
Debt-to-Capital (Low vs High)	0.0%	↓	↑	-0.7%	↓	↓	-1.3%	-1.4%	-3.4%
Price-to-Book (Cheap vs Expensive)	1.1%	↑	↑	-0.8%	↑	↓	-5.2%	-5.6%	-9.6%
Estimate Dispersion (Low vs High)	-1.3%	↓	↓	-0.8%	↓	↑	4.3%	3.9%	-2.0%
Reduction in Shares Outstanding (Low vs High)	-0.2%	↓	↓	-0.8%	↓	↑	0.7%	1.2%	-7.2%
Analyst Coverage (High vs Low)	-0.7%	↓	↓	-0.9%	↓	↓	-1.1%	-1.3%	2.2%
Size (Small vs Large)	1.1%	↑	↑	-0.9%	↑	↓	-6.0%	-6.2%	-5.8%
Net Cash Ratio (High vs Low)	-0.6%	↓	↑	-1.1%	↓	↓	-1.1%	-0.6%	-1.1%
Long-Term Operating Leverage (High vs Low)	0.5%	↑	↑	-1.2%	↑	↓	-2.9%	-2.9%	-8.2%
Trailing Dividend Yield (High vs Low)	0.2%	↓	↓	-1.3%	↑	↓	-8.2%	-8.4%	-13.5%
Cash Ratio (High vs Low)	0.8%	↑	↑	-1.4%	↓	↓	-4.2%	-3.5%	-5.3%
Quality vs Junk	-0.8%	↓	↓	-1.5%	↓	↑	0.9%	0.5%	-4.8%
ROE Variability (Low vs High)	-1.1%	↓	↓	-1.7%	↓	↓	-2.3%	-2.4%	-2.4%
Incremental Margin (High vs Low)	0.2%	↑	↑	-1.8%	↓	↓	-3.8%	-3.6%	-7.9%
1-Year Sales Growth (High vs Low)	-0.2%	↑	↑	-1.9%	↓	↓	0.4%	1.1%	5.3%
Operating Margin (High vs Low)	-1.3%	↓	↓	-2.0%	↓	↑	2.5%	2.4%	-9.6%
1-Month Reversal (Low vs High)	-0.2%	↓	↓	-2.3%	↓	↑	3.4%	3.1%	-1.7%
EPS Variability (Low vs High)	-1.3%	↓	↓	-3.0%	↓	↓	-4.1%	-4.3%	-9.8%
Reinvestment Rate (High vs Low)	-1.3%	↓	↓	-3.3%	↓	↓	-3.5%	-3.5%	-5.8%
12m Volatility (Low vs High)	-2.6%	↓	↓	-3.6%	↓	↑	4.6%	3.4%	-9.7%
Operating Income Variability (Low vs High)	-0.9%	↓	↓	-3.8%	↓	↓	-3.8%	-3.9%	2.6%
Dividend Payout Ratio (High vs Low)	-1.4%	↓	↓	-4.2%	↓	↓	-4.1%	-4.0%	-8.4%

Source: Compustat, Morgan Stanley Research

We monitor dispersion metrics on a percentile basis relative to history (Exhibit 21). Dispersion levels have come down closer to median levels after being elevated for most of 2022. Looking under the surface, there is greater variance at the industry group level with a number of industries in their top quartile historically. Specifically, high dispersion is present in Auto and Household, while there are lower relative dispersion levels in Utilities, Telecom and Energy, suggesting macro factors are a driving force.

Exhibit 21: Historical Dispersion Metrics by Industry Group

	Return Dispersion	Earning Yield Dispersion	Book/Price Dispersion	Earnings Estimate Dispersion
S&P 500	50%	29%	42%	83%
Energy	8%	10%	35%	60%
Materials	14%	72%	37%	72%
Capital Goods	58%	88%	43%	47%
Commercial & Professional Services	33%	16%	28%	87%
Transportation	48%	61%	41%	77%
Automobiles & Components	71%	79%	82%	65%
Consumer Durables & Apparel	47%	44%	63%	77%
Consumer Services	69%	49%	28%	76%
Consumer Discretionary Distribution & Retail	85%	29%	40%	86%
Consumer Staples Distribution & Retail	23%	69%	98%	71%
Food, Beverage & Tobacco	49%	70%	78%	34%
Household & Personal Products	70%	81%	47%	83%
Health Care Equipment & Services	25%	10%	60%	26%
Pharmaceuticals, Biotechnology & Life Sciences	31%	51%	48%	68%
Banks	34%	79%	73%	72%
Financial Services	71%	40%	36%	79%
Insurance	40%	48%	23%	57%
Software & Services	67%	34%	13%	84%
Technology Hardware & Equipment	76%	77%	58%	53%
Semiconductors & Semiconductor Equipment	60%	29%	47%	85%
Telecommunication Services	22%	7%	61%	11%
Media & Entertainment	27%	71%	78%	83%
Utilities	56%	36%	1%	4%
Equity Real Estate Investment Trusts (REITs)	47%	30%	86%	71%

Source: Compustat, Morgan Stanley Research

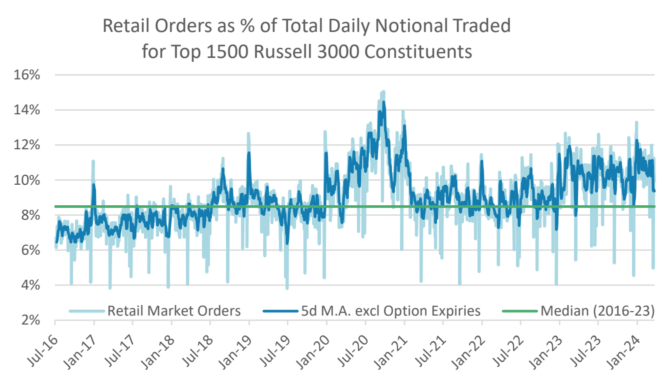
What's Retail Doing?

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:

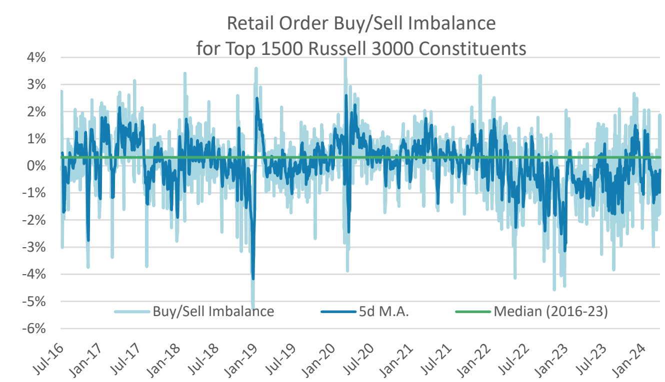
- Retail participation is currently at 9.4% of the total market volume, and at 66th%-ile relative to the last 6 years.
- Order imbalance was slightly negative at -0.1% (34th percentile relative to the last 6 years).
- Imbalance was positive in most sectors, except Materials, Tech, Utilities and Industrials.

Exhibit 22: Retail orders as a % of notional traded above median...



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

Exhibit 23: ... and order imbalance has been largely negative



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

Exhibit 24:

Retail Participation and Buy/sell Imbalance

	Retail Participation			Buy/Sell Imbalance		
Sector	**2016-22 Median**	**Current**	**p-tile**	**2016-22 Median**	**Current**	**p-tile**
Energy	6.6%	4.4%	0.00	-0.35%	0.2%	0.64
Materials	5.4%	3.5%	0.01	0.3%	-1.1%	0.15
Industrials	6.3%	4.2%	0.01	-0.3%	-0.1%	0.54
Consumer Discretionary	12.0%	11.7%	0.46	0.5%	0.8%	0.64
Consumer Staples	5.8%	3.7%	0.01	-0.6%	1.3%	0.89
Health Care	5.5%	3.6%	0.01	-0.7%	1.3%	0.93
Financials	5.6%	4.9%	0.13	-0.1%	1.7%	0.91
Information Technology	11.3%	14.8%	0.96	0.4%	-0.8%	0.14
Communication Services	9.4%	6.8%	0.27	0.1%	0.7%	0.69
Utilities	3.7%	2.9%	0.05	-1.4%	-0.6%	0.68
Real Estate	3.5%	3.1%	0.21	0.3%	0.2%	0.49
Model Universe (Top 1500)	**8.8%**	**9.4%**	**0.66**	**0.2%**	**-0.1%**	**0.34**

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 25: US Earnings Snapshot

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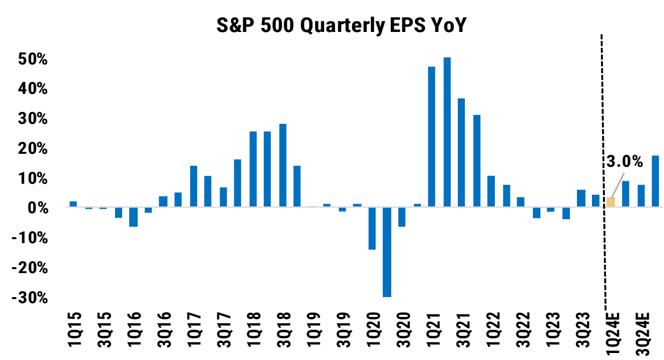
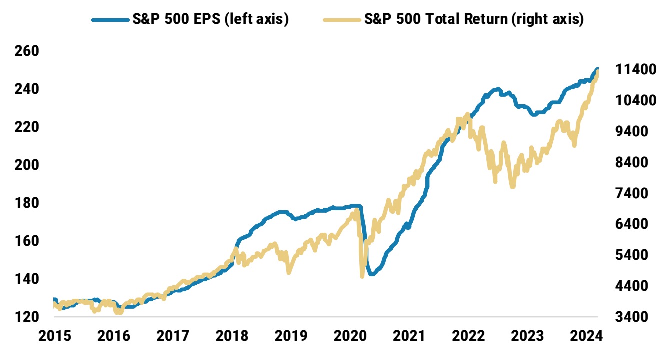
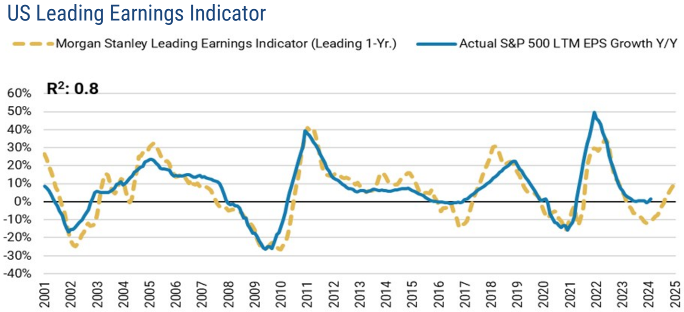
S&P 500 Y/Y EPS Growth



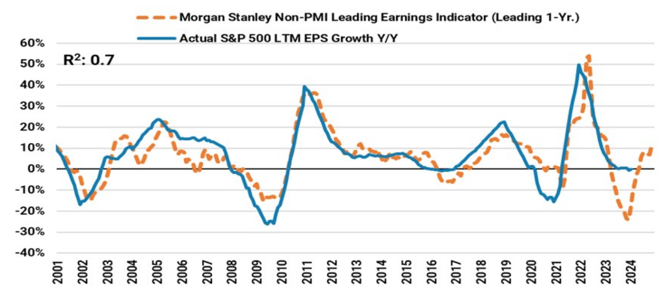
S&P 500 NTM EPS vs. Total Return Level



US Leading Earnings Indicator



US Non-PMI Leading Earnings Indicator



Source: Refinitiv, FactSet, Morgan Stanley Research. Top: As of Mar 22, 2024. Bottom left as of Feb 29, 2024. Bottom right as of Dec. 31, 2023. MS Leading Earnings Indicator inputs: ISM Mfg. PMI, Conference Board Consumer Confidence, housing starts, credit spreads. Weightings float over time based on rolling correlation of a given factor versus EPS growth. MS Non-PMI Leading Earnings Indicator inputs: Philadelphia Fed economic activity, Creighton U. business confidence, Chicago Fed supplier deliveries, Atlanta Fed wage tracker (inverse signal), NFIB small bus. most important problem inflation (inverse signal), and Brave-Butters-Kelley cycle component of monthly GDP. Weightings are fixed over time.;

Exhibit 26: S&P 500 Price Target

						MS Top Down EPS Estimates			Bottom Up Consensus EPS Estimates		
	Current Price	MS Next 12M Price Target	MS Next 12M Price Target % to Current	Current P/E	MS Next 12M P/E Target	2023	2024	2025	2023	2024	2025
Bear	5,234	3,850	-26%	21.0x	16.5x	$206	$192	$234	$220	$244	$276
Growth						*-6%*	*-7%*	*22%*	*0%*	*11%*	*13%*
Base	5,234	4,500	-14%	21.0x	17.0x	$215	$229	$266	$220	$244	$276
Growth						*-2%*	*7%*	*16%*	*0%*	*11%*	*13%*
Bull	5,234	5,050	-4%	21.0x	17.5x	$222	$251	$289	$220	$244	$276
Growth						*1%*	*13%*	*15%*	*0%*	*11%*	*13%*

As of: 03/22/2024

Note: We use 2025 forward earnings to project our price target which takes into account our June earnings forecast (currently $266 base case).

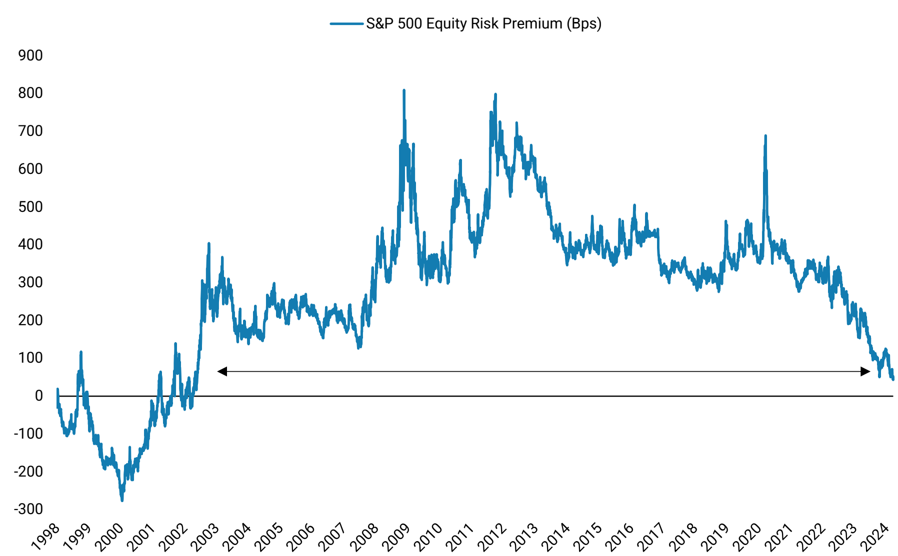
Source: Factset, Morgan Stanley Research

Exhibit 27: Sector Ratings

Morgan Stanley Sector Recommendations			
Overweight	Health Care	Staples	Utilities
	Energy		
Neutral	Comm. Services	Industrials	Financials
	Real Estate	Materials	Tech
Underweight	Broad Consumer Cyclicals		

Source: Morgan Stanley Research

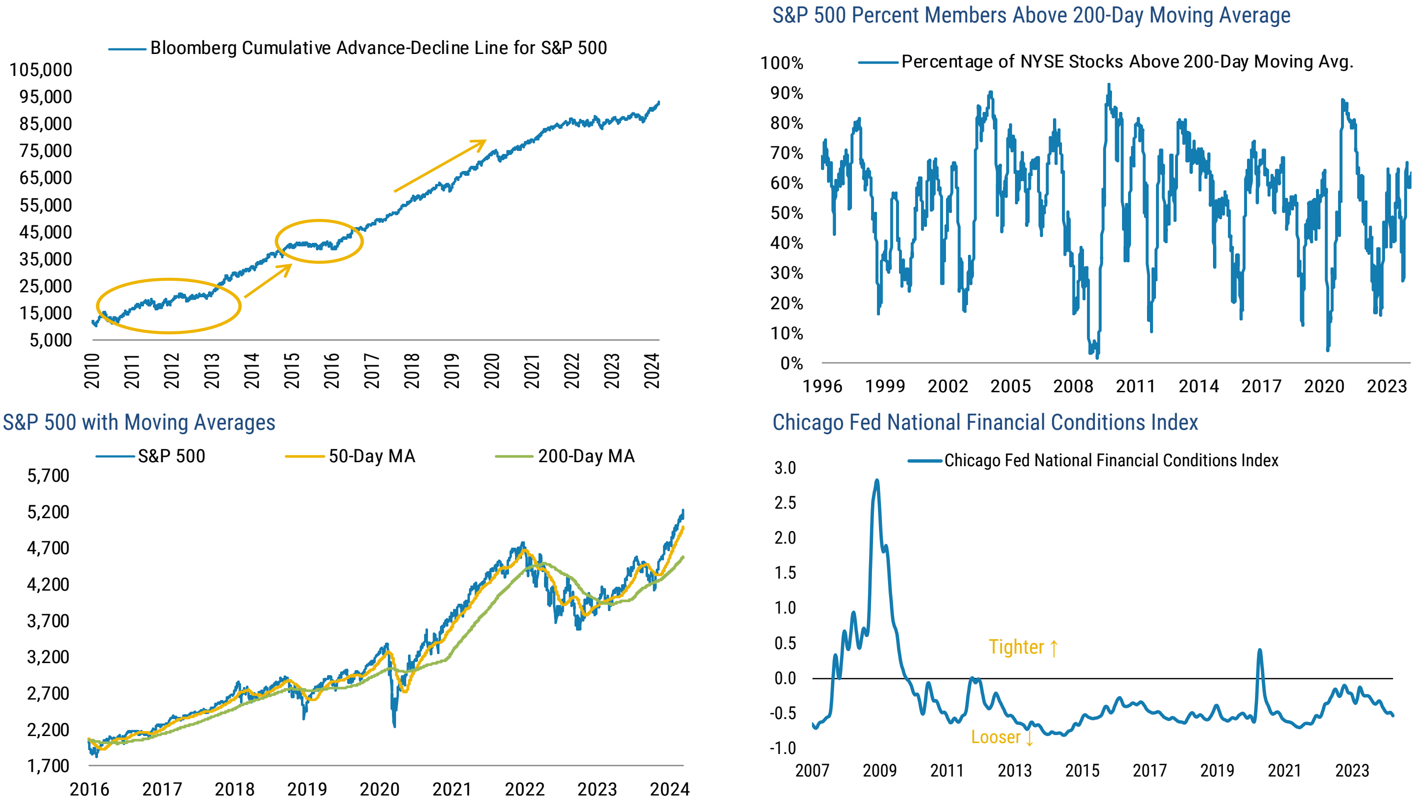
Exhibit 28: Equity Risk Premium is at 20 year lows at time when earnings risk is at 20 year highs



Note: Equity risk premium is calculated as the S&P 500 forward 12M earnings yield minus the nominal 10-Year Treasury.

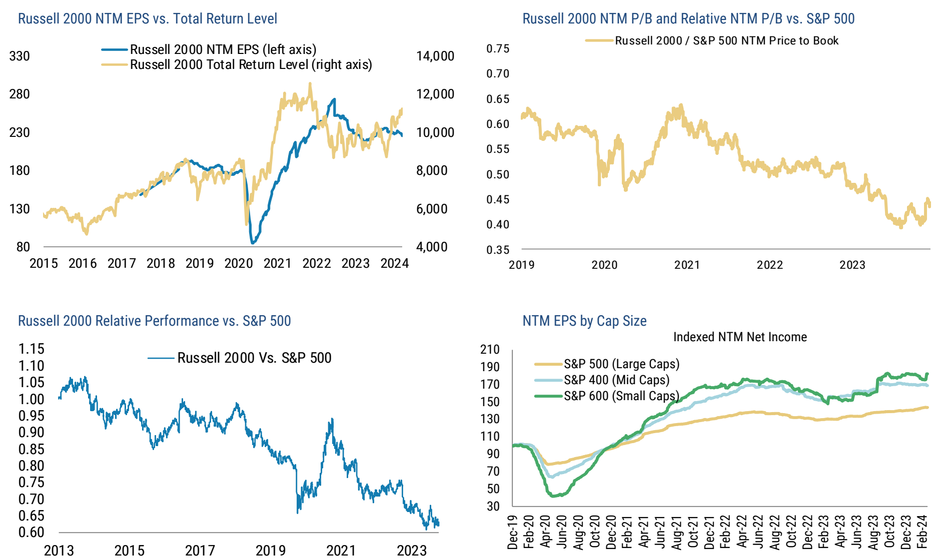
Source: As of Mar. 22, 2024. Bloomberg, Morgan Stanley Research

Exhibit 29: US Equity Market Technicals and Financial Conditions



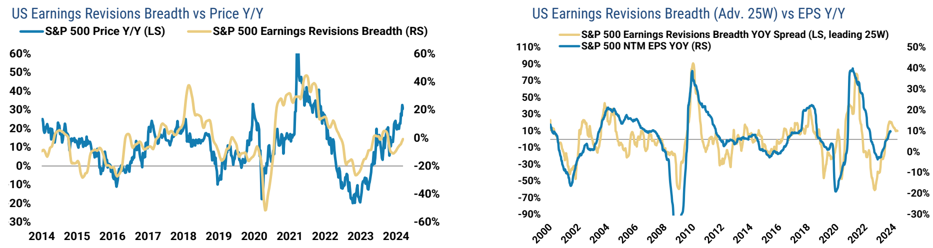
Source: Bloomberg, Morgan Stanley Research. As of Mar 22, 2024

Exhibit 30: US Small Cap Equities



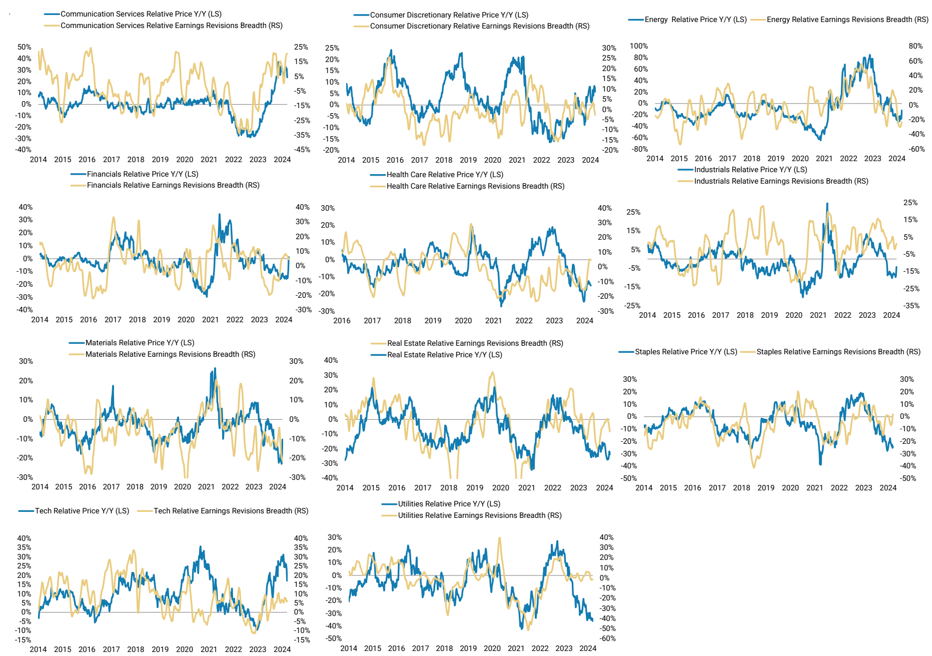
Source: FactSet, Morgan Stanley Research. As of Mar 22, 2024

Exhibit 31: Earnings Revision Breadth Moves with Price but Leads EPS



Source: FactSet, Morgan Stanley Research

Exhibit 32: Earnings Revisions Breadth vs YoY Performance



Source: FactSet, Morgan Stanley Research. As of Mar 22, 2024

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Global Stock Ratings Distribution

(as of February 29, 2024)

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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	1425	38%	296	43%	21%	626	40%
Equal-weight/Hold	1704	45%	321	46%	19%	718	45%
Not-Rated/Hold	3	0%	0	0%	0%	1	0%
Underweight/Sell	634	17%	76	11%	12%	239	15%
Total	3,766		693			1584	

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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