MARKETING DECK

Cautious 1H, up 2H
Another year about sectors…
April 2017

fundstrat

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Revised: was 2150

	1H	YE
S&P 500 Target	2200-2225	2275

Key drivers:

- Growth accelerates
- Inflation gains
- Deregulation
- First term dynamics
- Ominous yield curve
- Bond proxies hurt S&P 500
- Lower bond supply keeps rates low

Portfolio Strategy

OW CRAP Computers, Resources, American banks, Phone carriers.

OW FANG

OW Laggards

OW Stocks are "new bonds" (yield parity)

Top Longs	Top Avoids
Energy	Healthcare
Telecoms	Staples
Financials	Utilities

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For Reg AC certification and other important disclosures, see slide 102.

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Executive Summary

Our clients know that we have been steadfast supporters of this equity market since 2009, as our constructive stance was supported by an attractive combination of: (i) attractive valuations (median PE was 9X in 2009), (ii) supportive central banks, (iii) supportive debt markets (spread rally), (iv) balance sheet repair with "pent-up" demand, and (v) investor skepticism—all collectively supporting our "buy the dips" arguments.

- **As we highlight in this latest Portfolio Strategy overview, many of these factors have become neutral and potentially headwinds.**

- Among those ***Negative*** for stocks: (i) the distribution of P/Es more expensive than 2000 and 2007 top (Slide 3); (ii) yield curve flattened, suggesting slower growth (Slide 9); (iii) High-yield was widened (Slide 7) and to a lesser extent, Fed is tightening and investment sentiment is no longer bearish.

- We do not believe a "bear market" is around the corner, as we believe there remains substantial pent-up demand, given investment spending is still near 50-year lows (Slide 18) and de-regulation is supportive of transforming earnings for Financials, Energy and Manufacturing.

- Still, with median P/E at 19X, the upside for stocks can be achieved by one of three ways: (i) P/E rises to 20X or beyond (never sustained this); (ii) EPS revisions are sharply higher (not likely) or (iii) equities pullback 5%-8%, or 1.5X PE turns. **This latter argument is what we expect, particularly given the poor equity returns associated with flattening curves in past 50 years (Slide 9).**

- **Thus, we see the conditions in place for a 1H drawdown, although our original 2150 target does seem awfully hard to reach— we now look for equities to pullback to 2200-2225 in 1H (vs 2150 prior).**

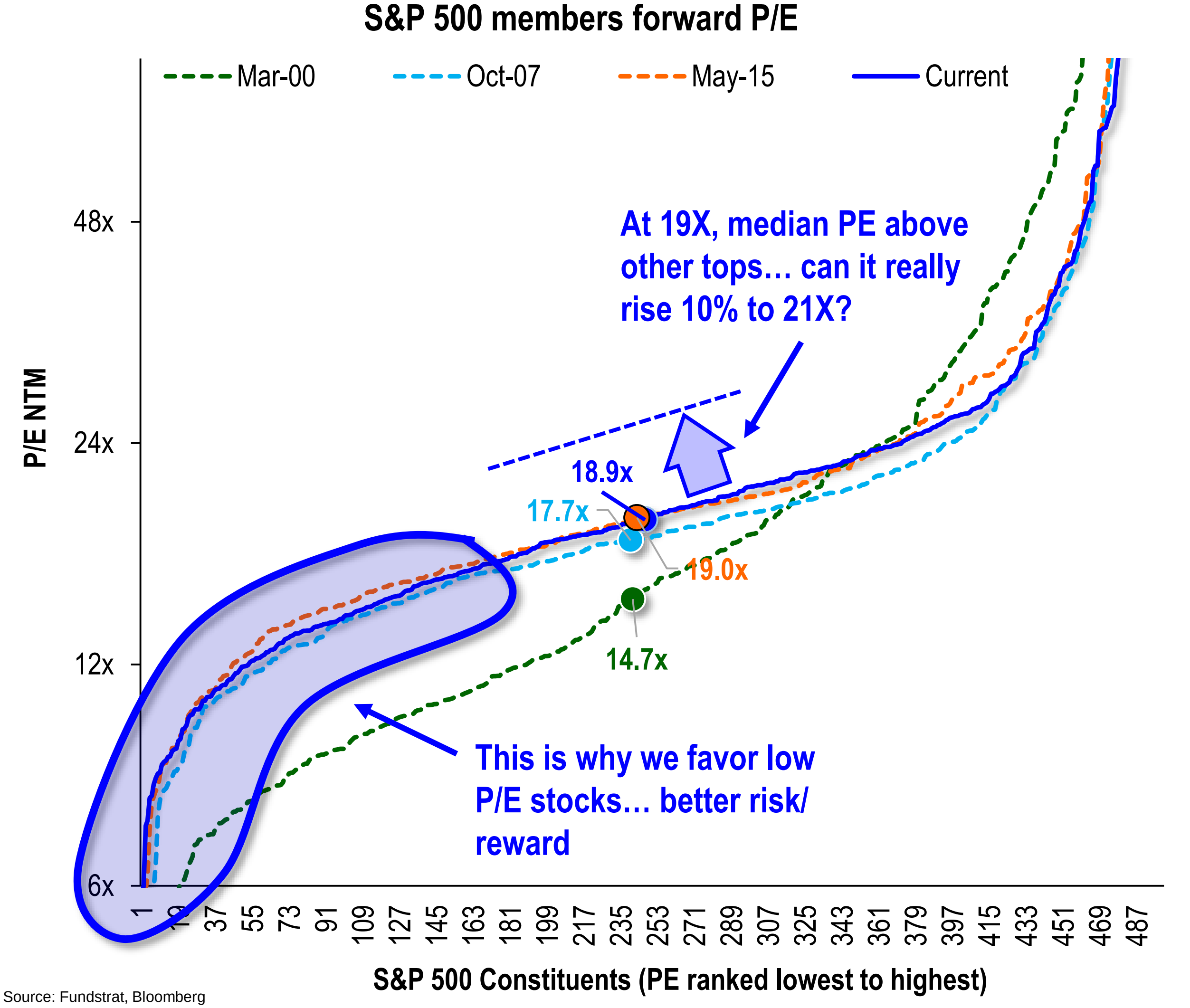
PORTFOLIO STRATEGY: We favor "E" growth, and "low P/E"—hence 4 strategies: CRAP, FANG, laggards and Stock are "new bonds"

P/E above prior tops:
Investors not paid to own equities here...

The S&P 500 P/E distributions at market peaks are remarkably similar. Notice the identical distributions at Oct. 2007, May 2015 and today.

- **Equities are more expensive today, with median P/E of 19X**
- ***This is wrong if*—EPS growth is higher than expected.**
- ***This is wrong if*—tax cuts are bigger than reflected and hence, realized P/E is lower.**
- **But this speaks to the broader issue—ARE INVESTORS PAID TO BUY STOCKS HERE?**

Figure: S&P 500 P/E of individual constituents at major market peaks

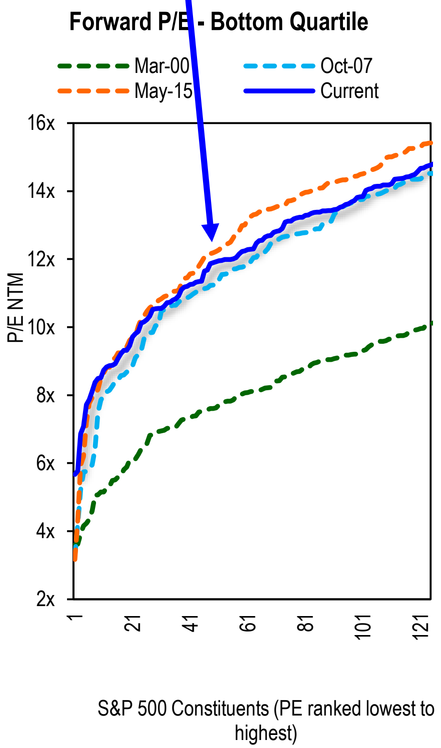


Source: Fundstrat, Bloomberg

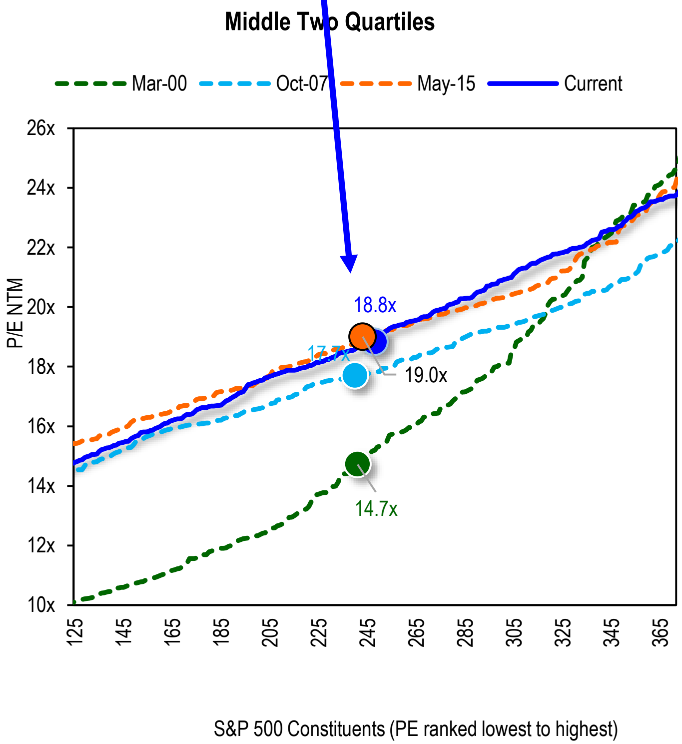
P/E high across the spectrum of S&P 500:
Top and Bottom quintile more expensive than other tops

Figure: S&P 500 P/E of individual constituents at major market peaks

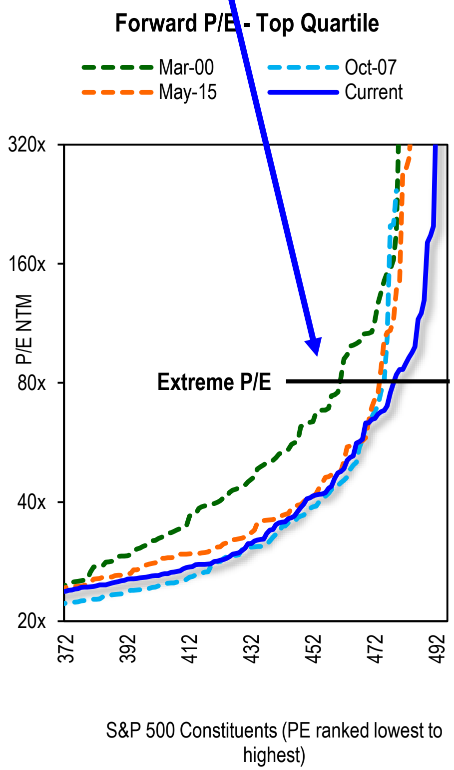
Bottom quartiles of P/E well above those in 2000, 2007…



Middle quartiles of P/E well above those in 2000, 2007 and 2015



In Top quartiles of P/E, only 2000 saw greater multiples…



Source: Fundstrat, Bloomberg

P/E high across the spectrum of S&P 500:
Top and Bottom quintile more expensive than other tops

Looking at the market cap of the S&P 500 within each quartile, today shows that the most expensive stocks, at 23% share of market cap is larger than 2007 and 2015.

And more reason we like "low P/E" is because this is 24% of market cap, and where we believe better ideas can be found…

Figure: Market Cap ranges of each P/E Quintile (sorted by forward P/E)

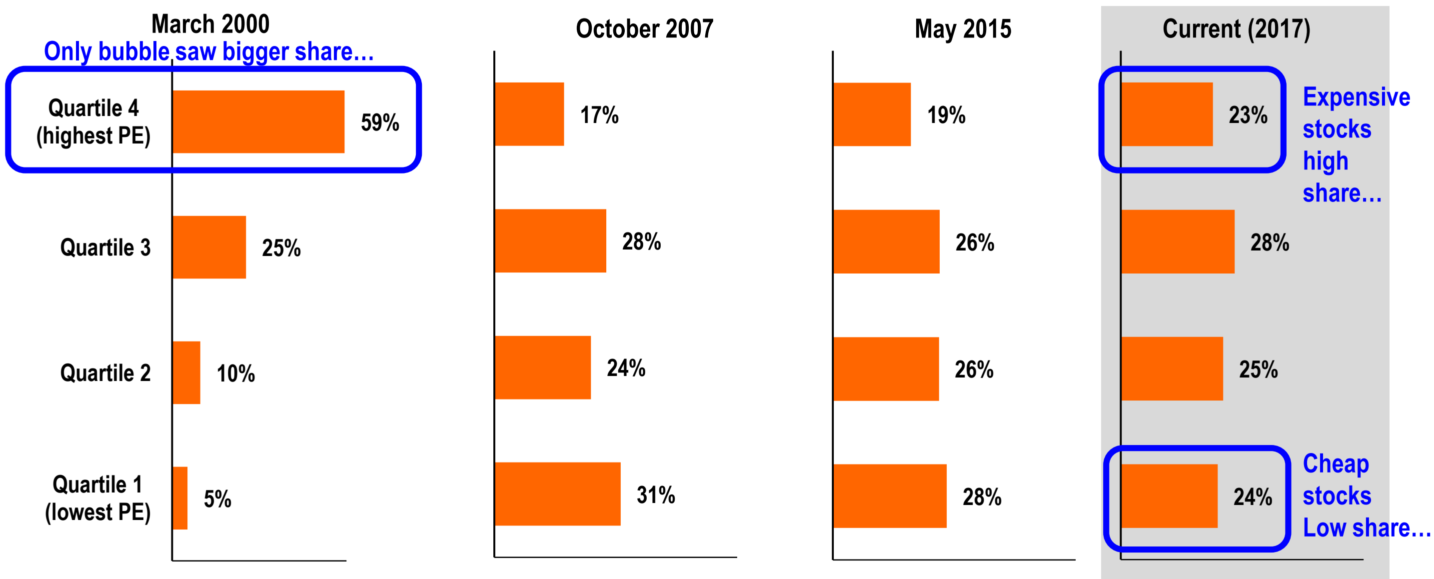


Figure: S&P 500 P/E of individual constituents at major market peaks

	2011	2012	2013	2014	2015	2016	2017E	2018E
S&P 500 Consensus EPS	$99.00	$104.00	$110.00	$119.00	$117.00	$118.00	$130.78	$146.70
S&P 500 EPS YoY % chg	16.5%	5.1%	5.8%	8.2%	(1.7%)	0.9%	10.8%	12.2%
S&P 500 Energy EPS YoY % chg	32.9%	(5.6%)	(5.7%)	(3.9%)	(61.7%)	(74.1%)	296.4%	45.9%

If one believes "E" is the upside in equities, then Energy should be the group to own…

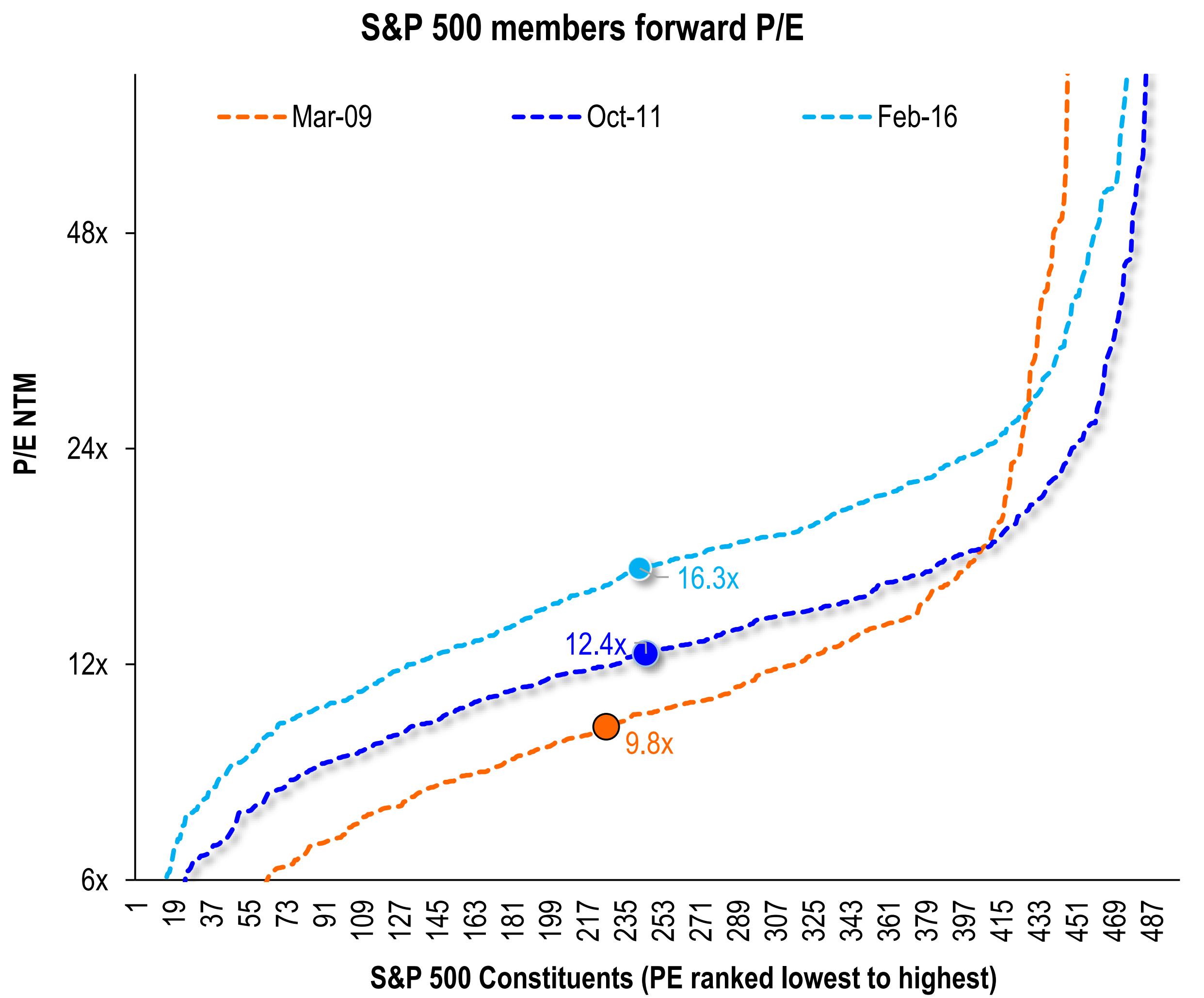
Source: Fundstrat, Bloomberg

Better P/E entry points in past:
Feb 2016 median P/E was 16X vs 19X currently

The entry point for the S&P 500 was better in February 2016.

- **Median P/E was 16X vs 19X today.**
- ***At 2150-2200*—Median P/E is 17.5X, while not at Feb 2016 levels, offers better risk/reward.**
- ***This is wrong if*—flows into equities are so strong that stocks see "super-valuations."**
- **Upside to stocks from here is based on either "higher than peak P/E" or "upside to EPS"**

Figure: S&P 500



Source: Fundstrat, Bloomberg

Past widenings of >60bp equate to S&P 500 drawdowns of 4% to >10%

We highlighted instances of HY widening by 60bp or more since 2010 and plotted the comparative impacts on S&P 500.

- **Since 2010, there have been 13 instance where HY spreads were in a downtrend an widened 60bp (below).**
- **As highlighted, the S&P 500 saw a drawdown in each instance, falling by at least 4% (22% max drawdown).**

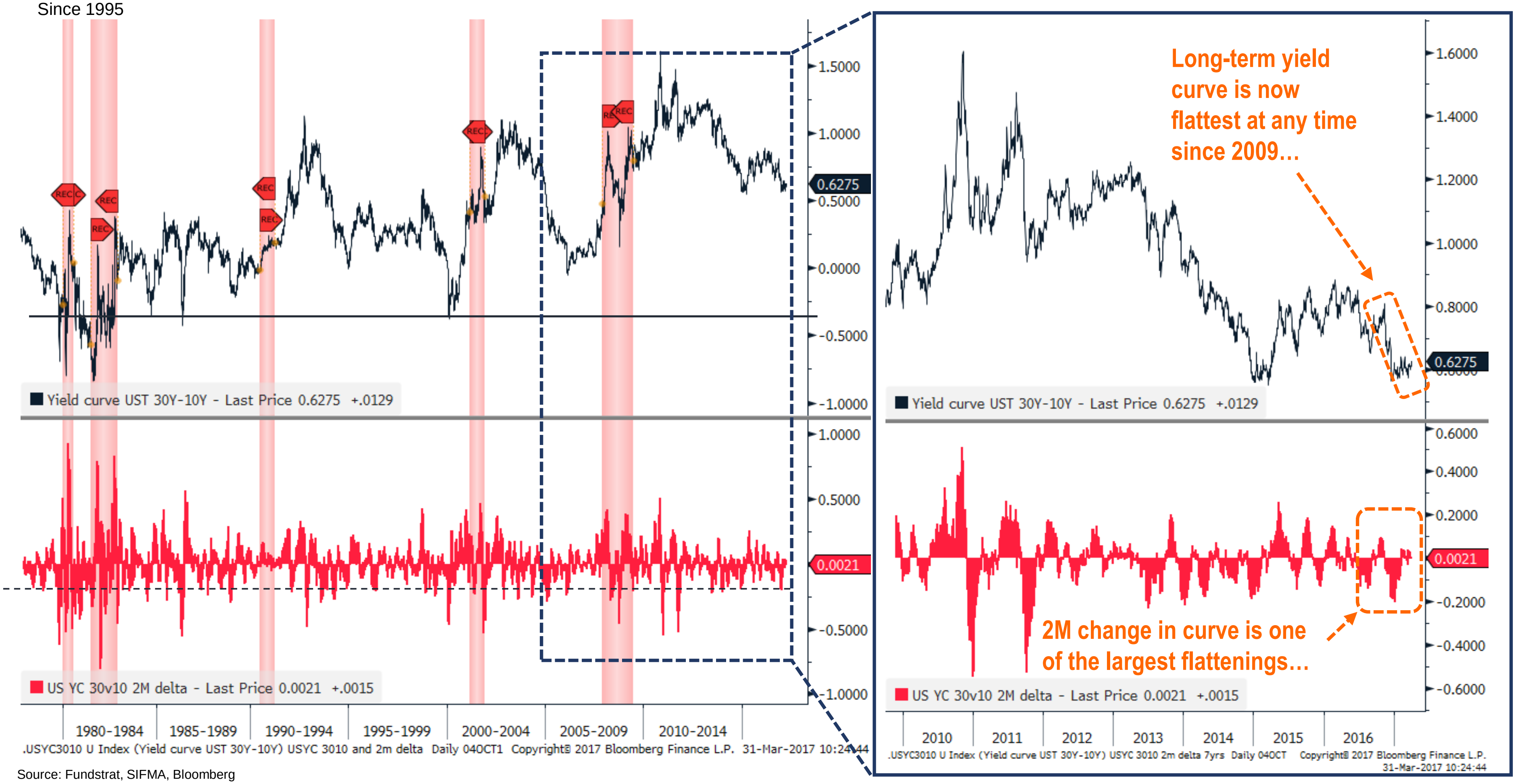
Figure: High-yield OAS spreads and S&P 500 price levels
Since 2010

Source: Fundstrat, Bloomberg, Factset

Bond market sees slower growth:
Long-term yield curve suggest

The long-term yield curve is one of the most reliable predictors of business cycle turns. It has flattened sharply since election day. **This is negative but the reasons are not entirely clear—we believe bond markets are confused but generally implies economic growth is less robust than implied by equity markets.**

Figure: Long-term yield curve (30Y less 10Y) and the 2M change in LT yield curve
Since 1995



Source: Fundstrat, SIFMA, Bloomberg

Bond market sees slower growth:
Past 40 years, created headwinds for stocks…

Figure: Return matrix: 6-month S&P 500 under various changes in Yield Curve and Level of LT yield curve
Since 1977. X-axis: 2M Change in LT yield curve. Y-axis: Level of Yield Curve

6-mo S&P 500 forward return

Flattening — Decile of Spread Delta (60 days) — Steepening

Decile of Yield curve: 30Y les 10Y (Curve Inverted ↕ Curve Steep)

		1	2	3	4	5	6	7	8	9	10
		-0.58 to -0.15	-0.15 to -0.09	-0.09 to -0.05	-0.05 to -0.02	-0.02 to 0.00	0.00 to 0.03	0.03 to 0.06	0.06 to 0.10	0.10 to 0.16	0.16 to 0.53
1	-0.43 to 0.03	6.6%	1.7%	(1.3%)	3.0%	2.4%	(5.5%)	(2.5%)	(5.2%)	(3.0%)	(0.1%)
2	0.03 to 0.12	2.7%	5.9%	2.7%	7.9%	7.0%	7.8%	6.2%	3.6%	2.5%	(5.3%)
3	0.12 to 0.19	6.3%	5.0%	2.8%	1.3%	7.5%	[illegible]	7.9%	8.8%	11.6%	[illegible]
4	0.19 to 0.27	4.6%	6.5%	10.8%	10.9%	[illegible]	8.3%	9.0%	4.5%	6.3%	9.2%
5	0.27 to 0.36	1.7%	5.9%	5.2%	6.3%	7.7%	10.3%	10.6%	11.3%	11.3%	5.0%
6	0.36 to 0.54	(3.4%)	[illegible]	(1.2%)	(1.8%)	[illegible]	(4.7%)	(1.9%)	(1.8%)	(1.0%)	[illegible]
7	0.54 to 0.73	(4.2%)	(1.0%)	(2.6%)	(8.6%)	(5.6%)	(4.3%)	(4.5%)	(12.4%)	(3.3%)	5.3%
8	0.73 to 0.85	0.3%	7.6%	4.1%	5.9%	3.5%	7.9%	3.2%	5.7%	5.6%	4.3%
9	0.85 to 1.02	11.9%	10.2%	9.2%	7.6%	7.2%	8.3%	6.7%	7.6%	9.3%	5.3%
10	1.02 to 1.60	6.1%	6.5%	4.7%	5.5%	5.6%	7.4%	7.5%	7.7%	8.2%	9.5%

Yield curve as of 1/1/17:
Rows is level 30Y less 10Y
Columns is 20D change in spread

YELLOW is Yield curve as of 3/3/17:

RED is Yield curve as of May 2017 if it yield curve stabilizes here

Win-ratio 6-mo forward

Decile of Spread Delta (60 days)

Decile of Yield curve: 30Y les 10Y (Curve Inverted ↕ Curve Steep)

		1	2	3	4	5	6	7	8	9	10
		-0.58 to -0.15	-0.15 to -0.09	-0.09 to -0.05	-0.05 to -0.02	-0.02 to 0.00	0.00 to 0.03	0.03 to 0.06	0.06 to 0.10	0.10 to 0.16	0.16 to 0.53
1	-0.43 to 0.03	72%	23%	18%	23%	32%	13%	25%	24%	34%	34%
2	0.03 to 0.12	59%	64%	46%	81%	69%	58%	38%	63%	52%	32%
3	0.12 to 0.19	87%	75%	60%	61%	77%	83%	68%	75%	78%	84%
4	0.19 to 0.27	92%	89%	94%	91%	83%	90%	83%	73%	69%	71%
5	0.27 to 0.36	81%	86%	80%	78%	77%	84%	89%	95%	90%	58%
6	0.36 to 0.54	39%	54%	57%	56%	44%	46%	60%	51%	52%	58%
7	0.54 to 0.73	63%	69%	45%	21%	29%	42%	24%	8%	36%	56%
8	0.73 to 0.85	80%	97%	86%	85%	80%	81%	71%	64%	69%	64%
9	0.85 to 1.02	100%	92%	84%	80%	88%	85%	75%	76%	82%	67%
10	1.02 to 1.60	92%	87%	81%	76%	81%	90%	90%	94%	83%	84%

Our matrix is based on curve behavior since 1977…

The takeaway is that as the LT yield curve stabilizes (flattens), we are moving right along *row 7*

If the long-term curve does not steepen, by **May 2017**, stocks eventually have only ***an 8% win-ratio (12% decline)…***

Source: Fundstrat, Bloomberg, FactSet

Post-Presidential returns: 1H usually negative YTD print…

We have listed the 29 "First Term" years on the right.

- We have listed the Dec 31 close to 1H trough (far right).
- **As shown, the median 1H drawdown is 7% and only 2 years saw no drawdown. Those two years were 1928 and 2012.**
- **The trough typically happens within 58 trading days, or sometime in the first quarter.**
- Because we do not anticipate a recession, we think the downside risk is closer to 5%-7%--this is 120 to 150 points on the S&P 500/

Figure: 1H drawdowns of First Term of a New President
Since 1900

	a		b		c		a --> b		a --> c	
	Election year	Year-end Price	1H Peak of Post-election Year		1H Trough		Year-end to 1H Peak		Year-end to 1H Trough	
			Date	Price	Date	Price	Days	Return	Days	Return
1	1900	6.14	6/17/1901	6.89	1/21/1901	5.71	168	12.1%	21	(7.0%)
2	1904	6.16	4/14/1905	7.37	1/25/1905	6.05	104	19.6%	25	(1.8%)
3	1908	7.56	6/14/1909	8.29	2/23/1909	7.03	165	9.6%	54	(7.0%)
4	1912	7.68	1/9/1913	7.79	6/11/1913	6.35	9	1.5%	162	(17.4%)
5	1916	8.36	1/3/1917	8.73	2/2/1917	7.66	3	4.4%	33	(8.4%)
6	1920	6.16	5/5/1921	7.04	6/20/1921	5.71	125	14.3%	171	(7.3%)
7	1924	10.38	6/30/1925	11.53	3/30/1925	10.12	181	11.0%	89	(2.6%)
8	1928	23.98	6/28/1929	27.41	1/8/1929	24.17	179	14.3%	8	0.8%
9	1932	6.92	6/27/1933	10.98	2/27/1933	5.53	178	58.7%	58	(20.1%)
10	1936	17.27	3/10/1937	18.67	6/28/1937	15.12	69	8.1%	179	(12.4%)
11	1940	10.57	1/10/1941	10.86	5/1/1941	9.30	10	2.7%	121	(12.0%)
12	1944	13.28	6/26/1945	15.37	1/23/1945	13.21	177	15.7%	23	(0.5%)
13	1948	15.28	1/7/1949	15.61	6/13/1949	13.55	7	2.2%	164	(11.3%)
14	1952	26.59	1/5/1953	26.66	6/10/1953	23.54	5	0.3%	161	(11.5%)
15	1956	46.56	6/17/1957	48.24	2/12/1957	42.39	168	3.6%	43	(9.0%)
16	1960	58.11	5/17/1961	67.39	1/3/1961	57.57	137	16.0%	3	(0.9%)
17	1964	84.30	5/13/1965	90.27	6/28/1965	81.60	133	7.1%	179	(3.2%)
18	1968	103.80	5/14/1969	106.16	6/23/1969	96.23	134	2.3%	174	(7.3%)
19	1972	118.05	1/11/1973	120.24	6/25/1973	102.25	11	1.9%	176	(13.4%)
20	1976	106.88	1/1/1977	107.46	5/31/1977	96.12	1	0.5%	151	(10.1%)
21	1980	135.33	1/6/1981	138.12	2/20/1981	126.58	6	2.1%	51	(6.5%)
22	1984	166.26	6/28/1985	191.85	1/4/1985	163.68	179	15.4%	4	(1.6%)
23	1988	277.72	6/27/1989	328.44	1/3/1989	275.31	178	18.3%	3	(0.9%)
24	1992	438.82	3/10/1993	456.33	1/8/1993	429.05	69	4.0%	8	(2.2%)
25	1996	753.85	6/20/1997	898.70	1/2/1997	737.01	171	19.2%	2	(2.2%)
26	2000	1,320.28	1/30/2001	1,373.73	4/4/2001	1,103.25	30	4.0%	94	(16.4%)
27	2004	1,213.55	3/7/2005	1,225.31	4/20/2005	1,137.50	66	1.0%	110	(6.3%)
28	2008	890.64	6/12/2009	946.21	3/9/2009	676.53	163	6.2%	68	(24.0%)
29	2012	1,402.43	5/21/2013	1,669.16	1/1/2013	1,426.19	141	19.0%	1	1.7%
	2016									
	Median						133	7.1%	58	(7.0%)

Key groups have "round-tripped"
Suggests market internals are actually more "defensive"

Figure: Energy stocks and oil back to pre-election levels…
Since 2016

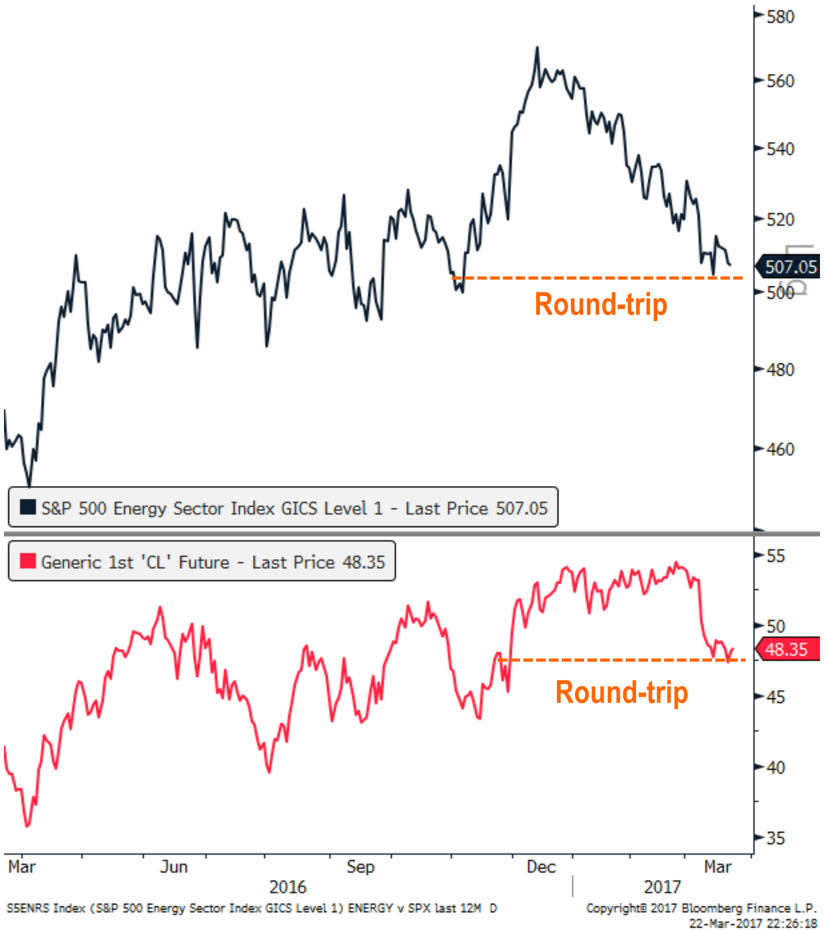
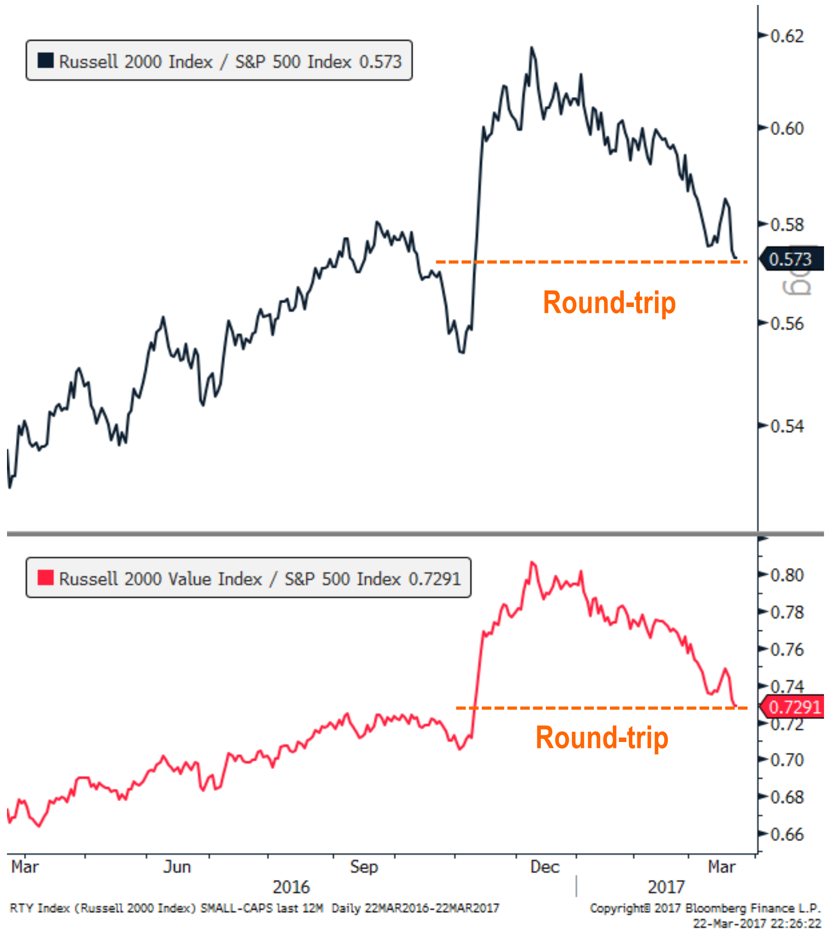


Figure: Small-caps & Small-cap Value round-tripped (vs S&P 500)
Since 2016

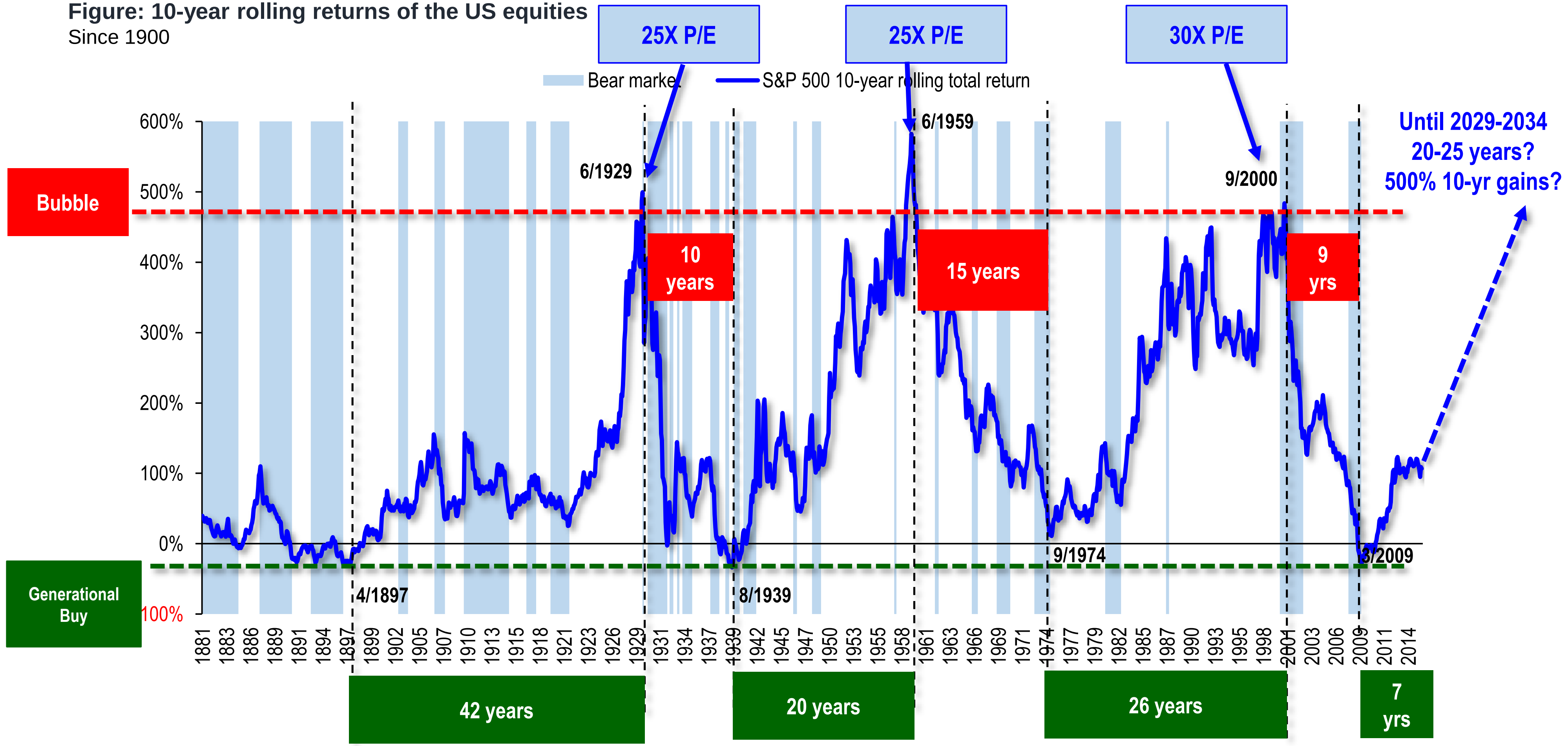


Secular bull cycles last 20-42 years… we are 7 years into this one

As shown below, long-term bull markets have lasted 20-42 years and generate cumulative returns of 500% or more…

- ***The current bull market has risen for 7 years and 10-year rolling returns are around 100%...***

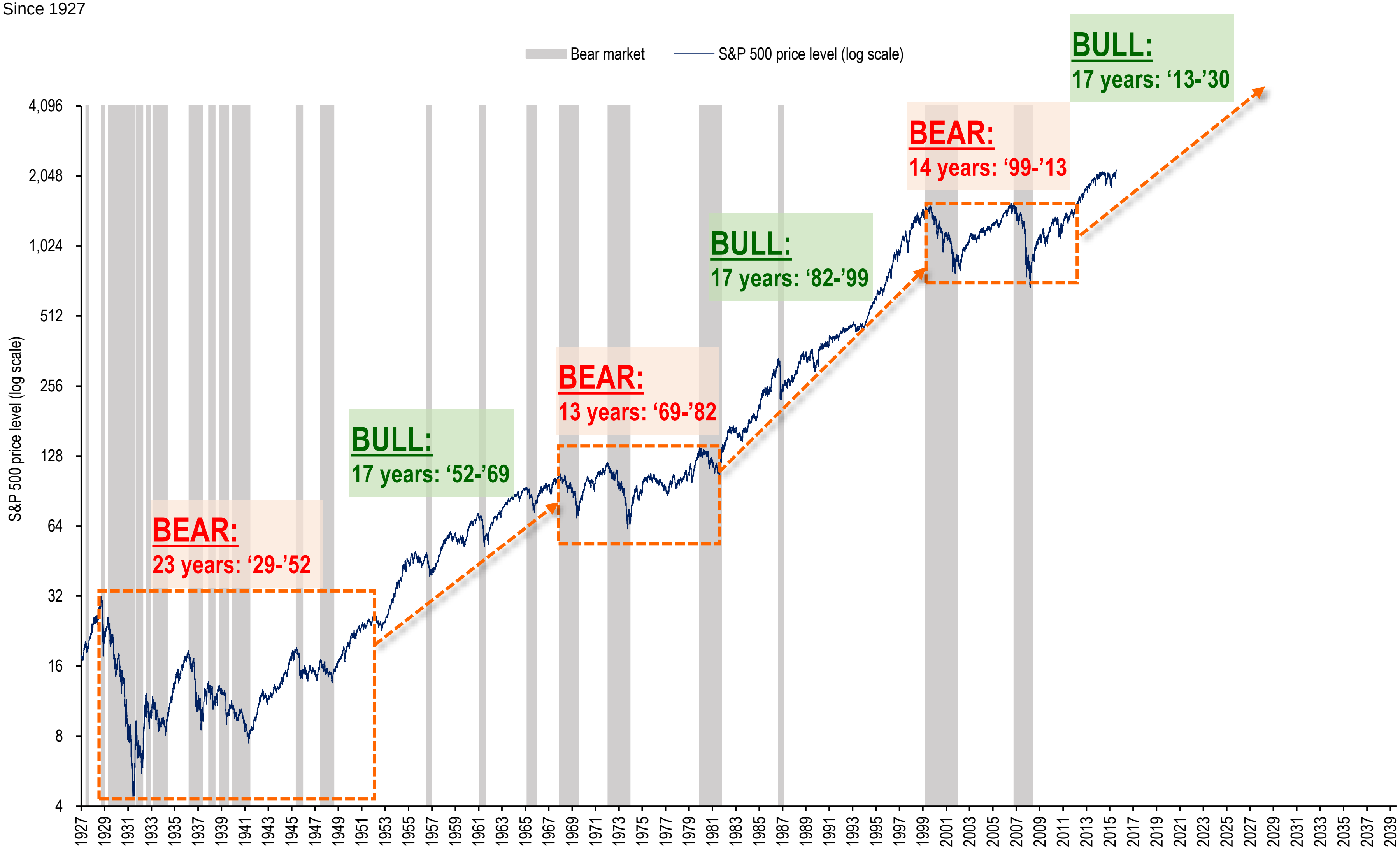
Figure: 10-year rolling returns of the US equities
Since 1900



Source: Fundstrat, Bloomberg.

LONG CYCLES: Bull markets have lasted 17 years since 1927…

Figure: The bull market ends in 2030?
Since 1927



Source: Fundstrat, Bloomberg

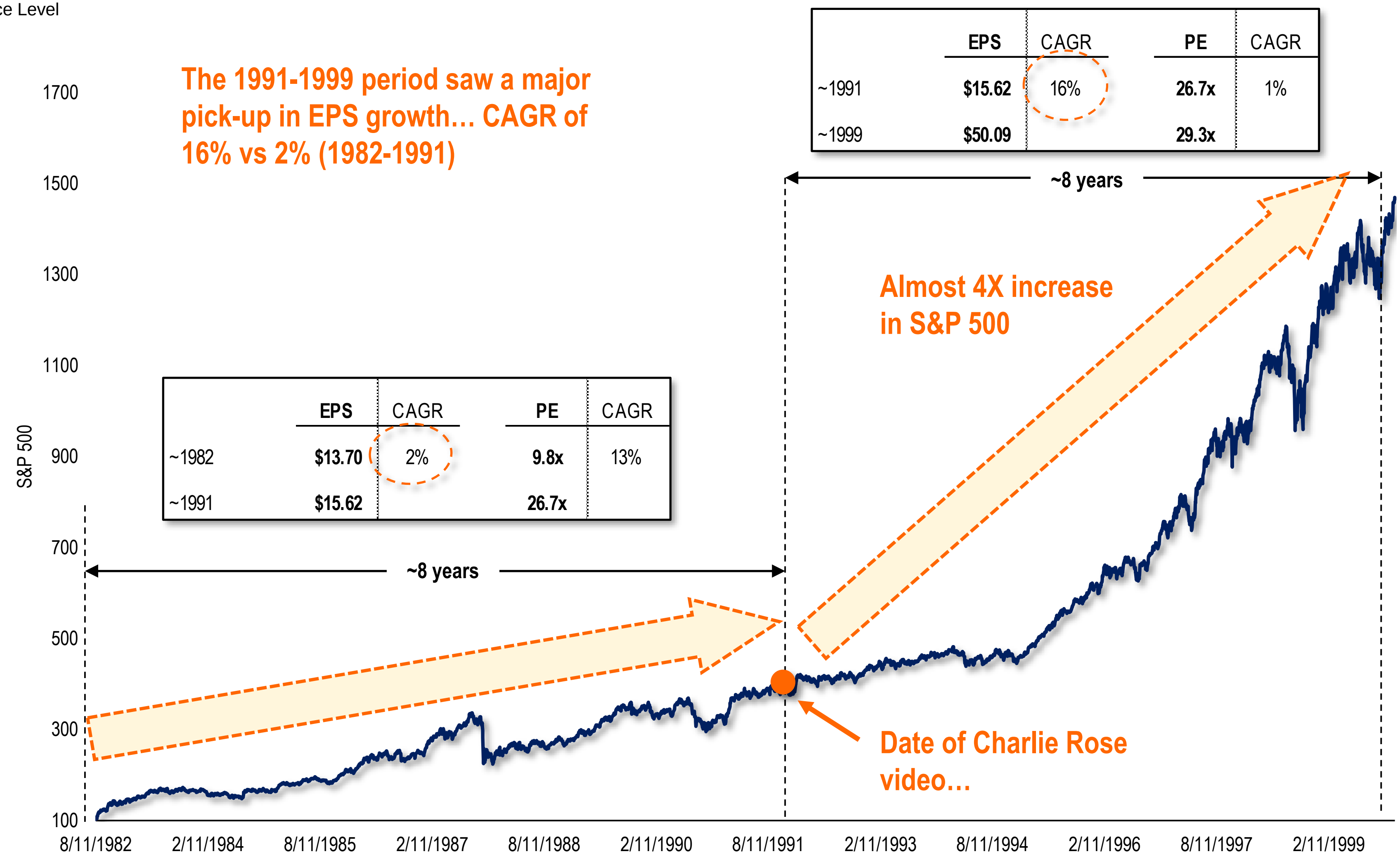
...Yet, the S&P 500 rose 4X from 1991 to 1999

Despite cautious sentiment, the S&P 500 managed to rise by 271% from 1991 to 1999

- **P/E expanded to 29X slightly, but the engine for growth was EPS, which expanded from $16 to $50.**

Figure: S&P 500 from 1982 to 1999

Price Level



	EPS	CAGR	PE	CAGR
~1991	$15.62	16%	26.7x	1%
~1999	$50.09		29.3x	

	EPS	CAGR	PE	CAGR
~1982	$13.70	2%	9.8x	13%
~1991	$15.62		26.7x	

Source: Fundstrat, Bloomberg, Factset

1952: Eisenhower wins and 1980: Reagan and Republicans sweep…

Figure: S&P 500

But the building of the national highway created a big lift to GDP… and set stage for a 17-year bull market….

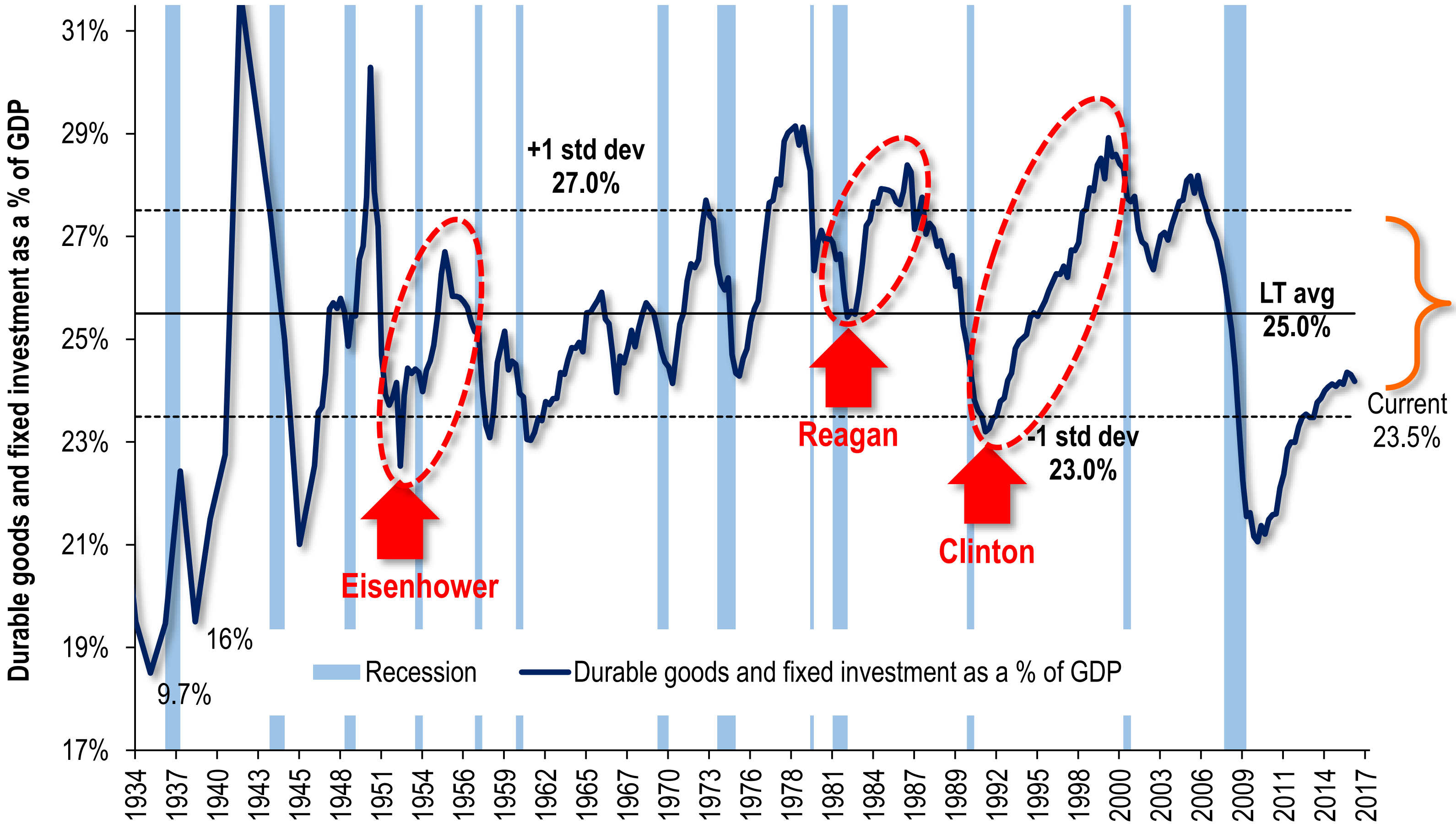
But the tax cuts and boost to confidence led to big lift to GDP… and set stage for a 17-year bull market….

Source: Fundstrat, Bloomberg

Investment spending is at "recession" levels still....

Normalizing this spending level would mean $3.5T in additional GDP growth over the next decade…

Figure: Investment spend as % GDP
Since 1934



Reaching prior highs is a $700b increase in investment spending…

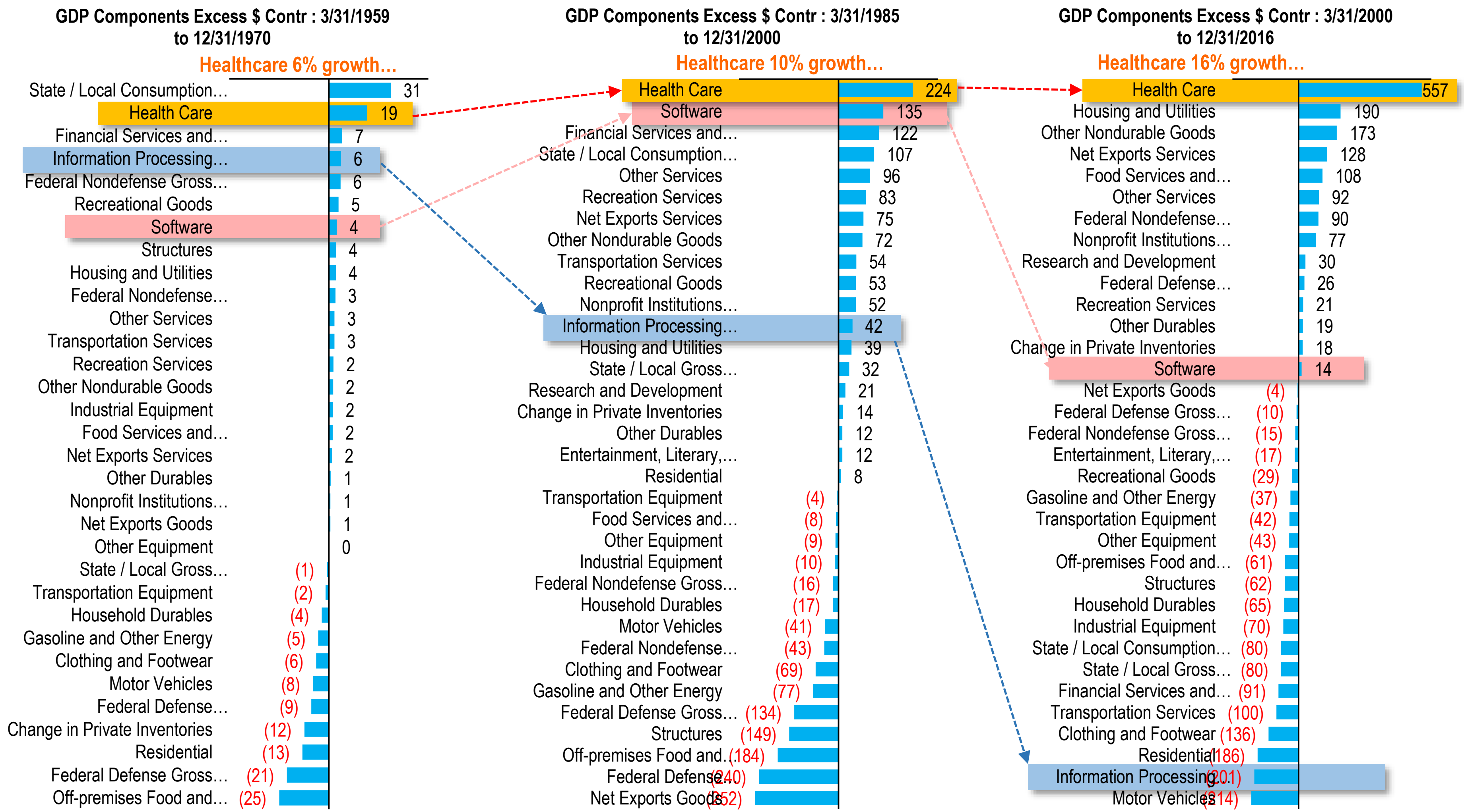
…over a decade, adds $3.5T to GDP growth….

Source: Fundstrat, Bloomberg

GDP drivers by decade:

Healthcare crowding out rest of economy… *Technology* to surge

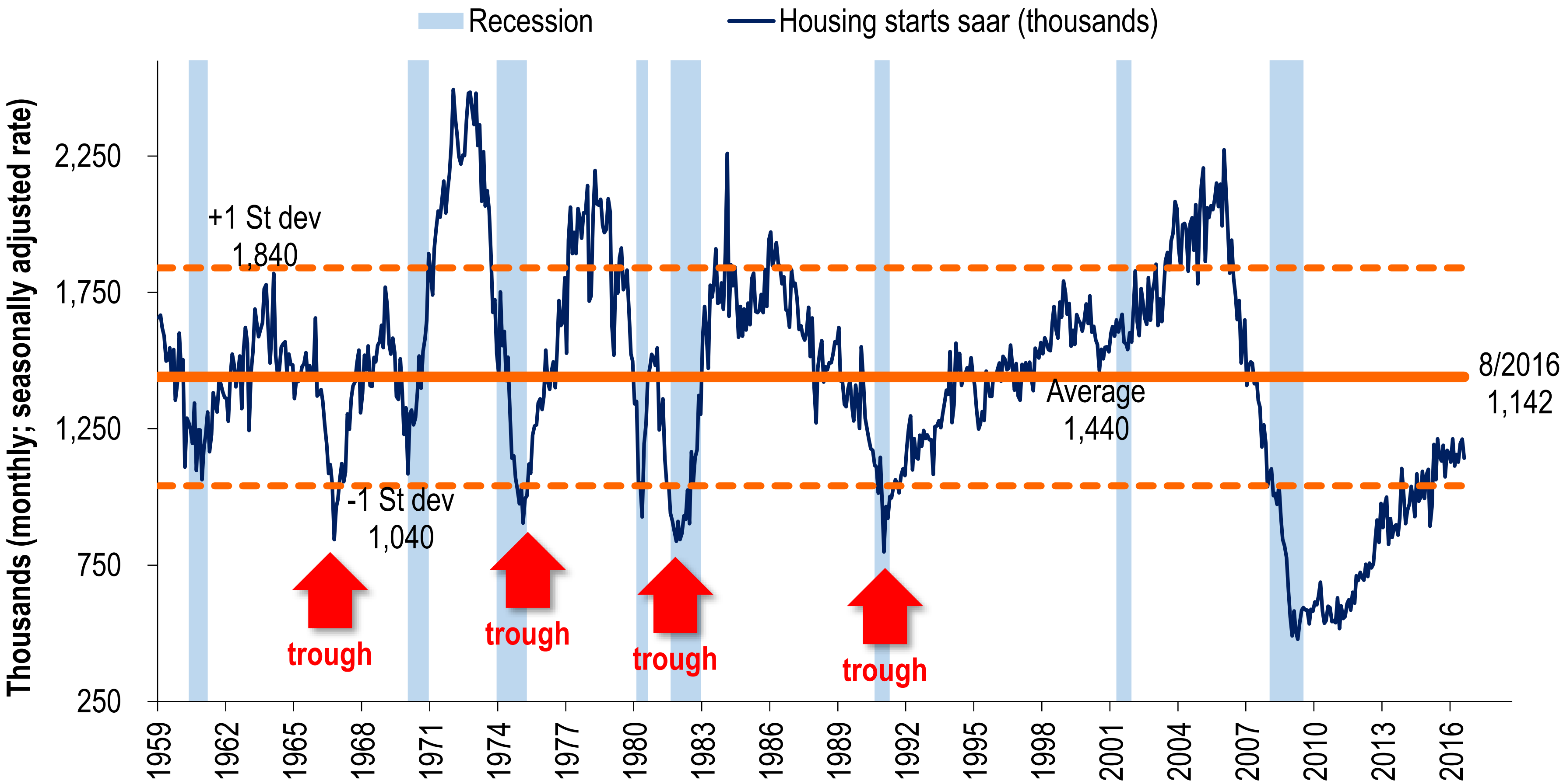
- **Healthcare spending surged in past 16 years, in our view, crowding out other areas of GDP spending. It is 2.5X bigger contributor to growth than any other GDP component—does that make sense??**



Source: BEA, Fundstrat, Bloomberg

HOUSING: We need to build 1.5-2.0mm homes…

Figure: Housing Starts since 1959
Since 1959

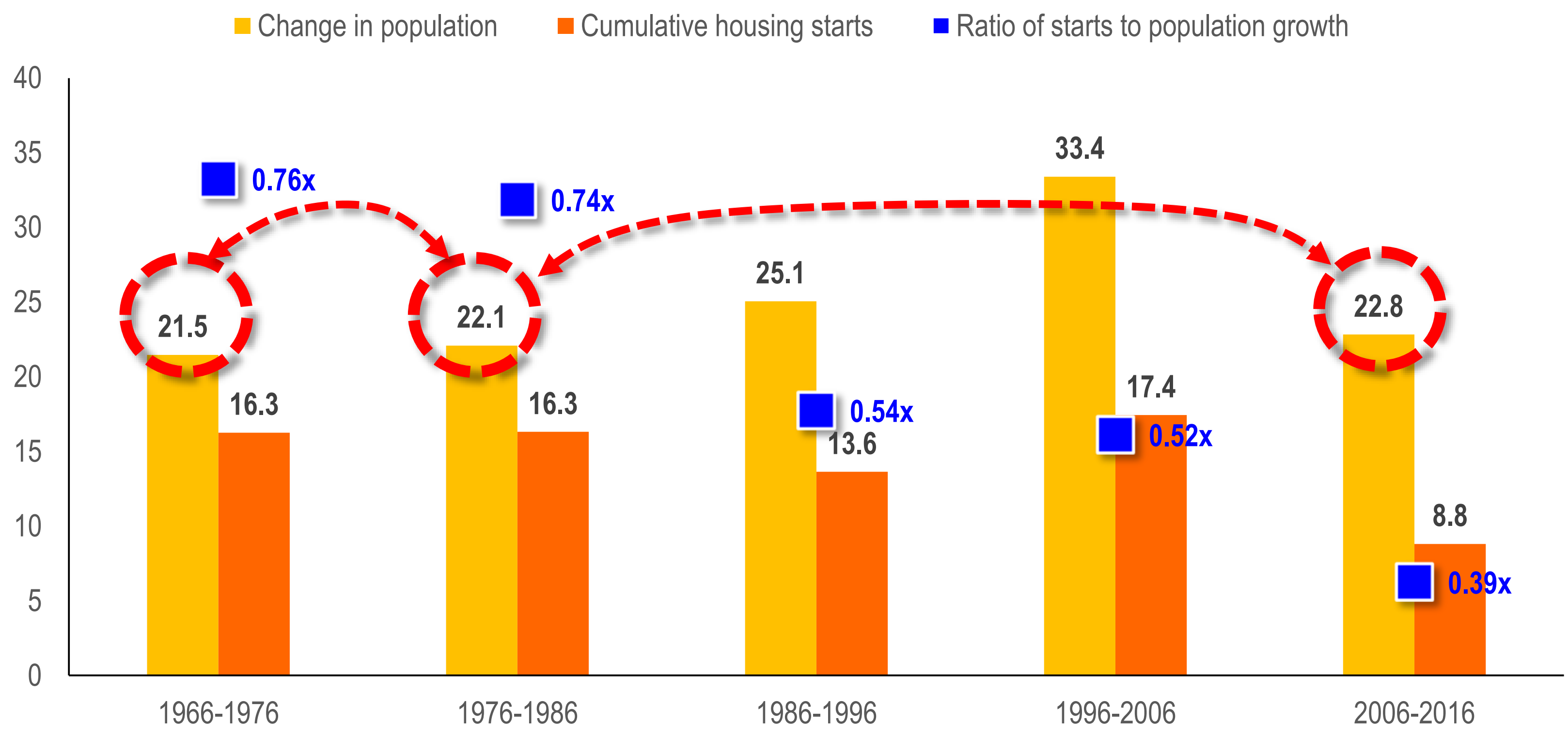


Source: Fundstrat, Bloomberg, BEA.
Note: we are including government fixed investment during the WWII period to account for the reclassification of private property as public property.

U.S. housing market still undersupplied…

Since 2006, the U.S. population has increased by 23 million. Historically, we would have built around 11mm homes over the past 10 years to accommodate this growth. Instead, we built around 8.8mm homes.

Figure: Changes in housing starts and population growth
From 1966



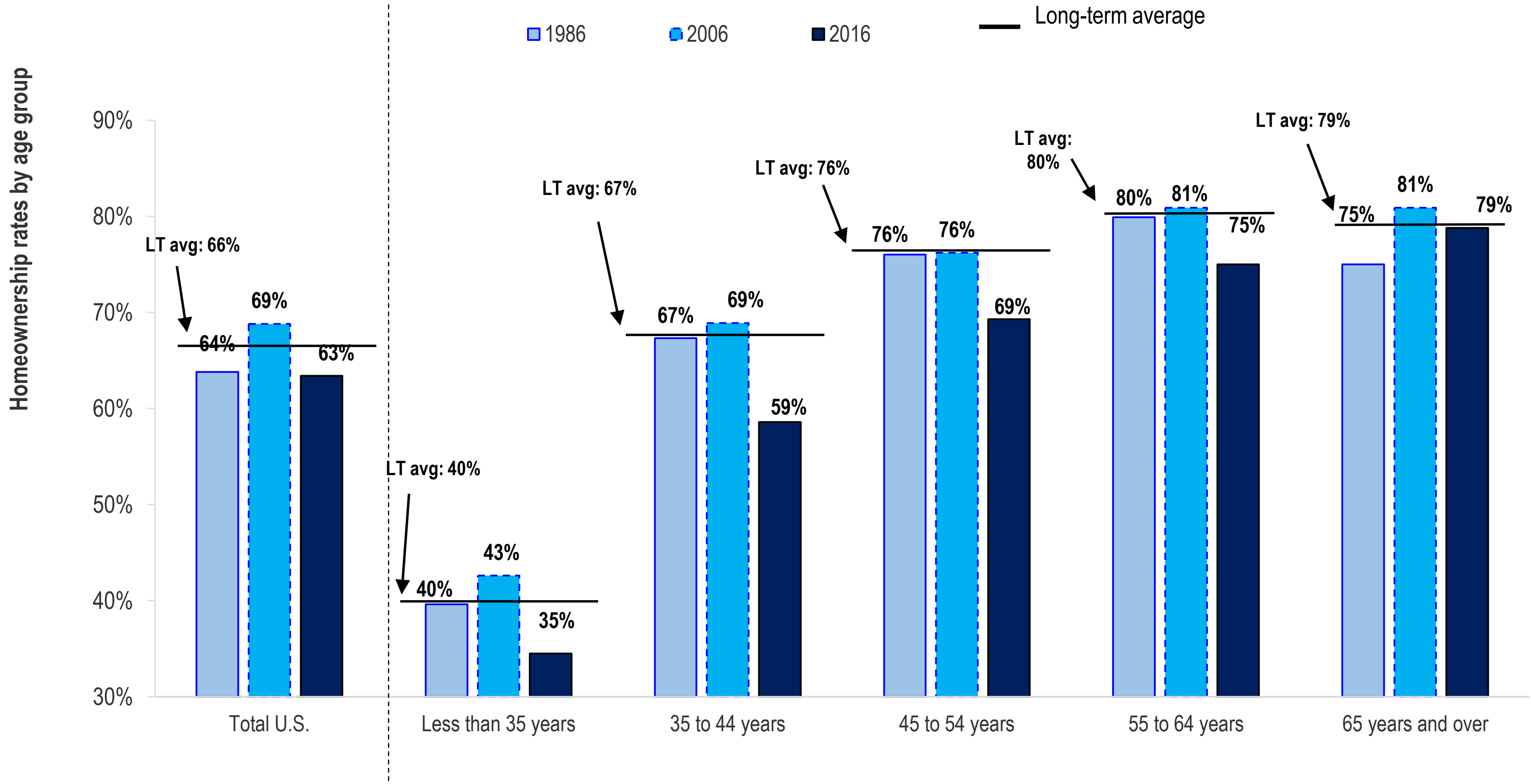
Source: Fundstrat, Bloomberg

Homeownership rates are below long-term average…upside

In our view, this drop in homeownership rates is held back by the loss of access to credit (bankruptcies, etc.) as well as the lingering damage from the financial crisis.

- **This is not a function of demographics—meaning, homeownership rates actually rise with age—hence, the aging population should increase overall homeownership rates.**

Figure: Homeownership rates by age
From 1986



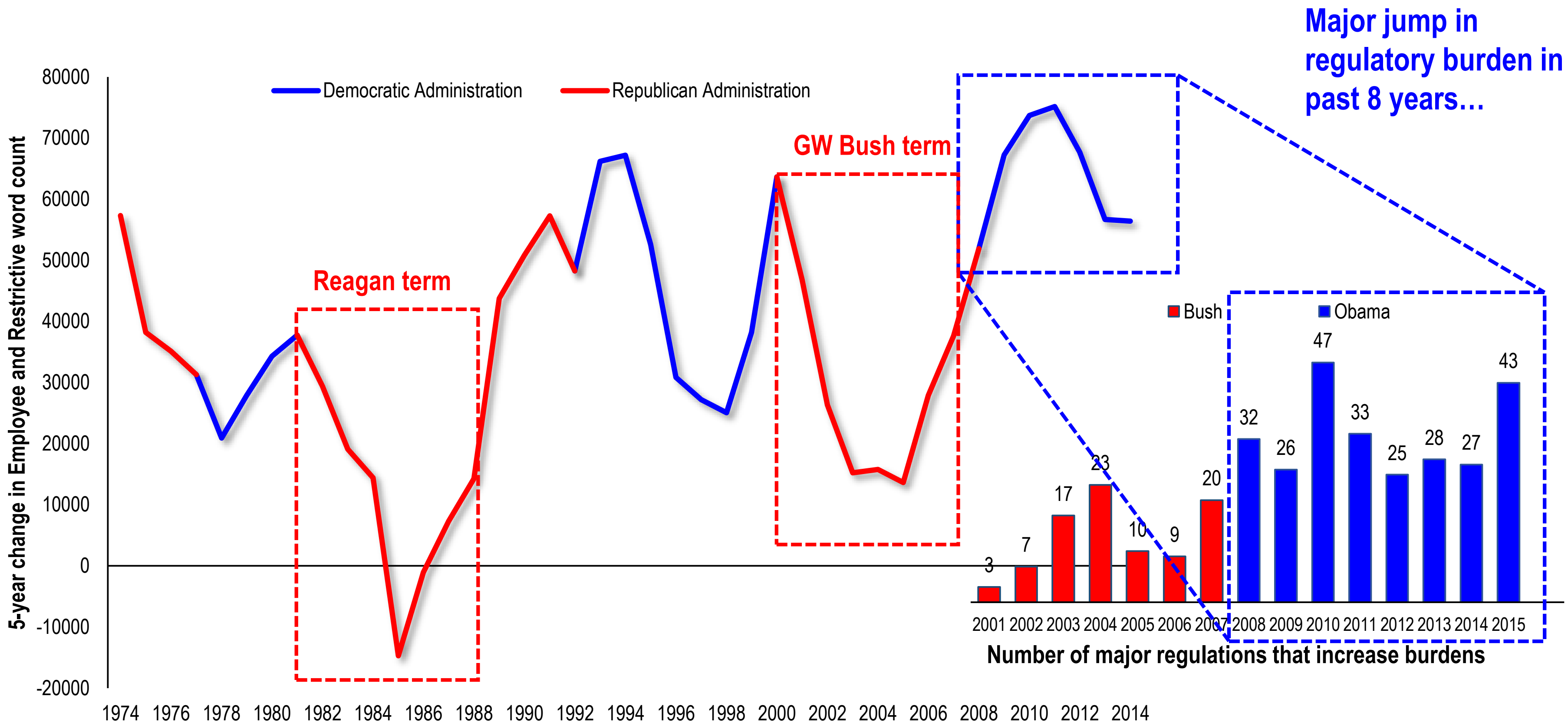
Source: Fundstrat, Bloomberg

Last 8 years largest jump regulatory burden in 50 years…

Using data from the Mercatus Center, the last 8 years has seen a sharp jump in restrictive regulations for businesses.

- **As shown below, Republican administrations tend to see a decline in regulatory burdens.**

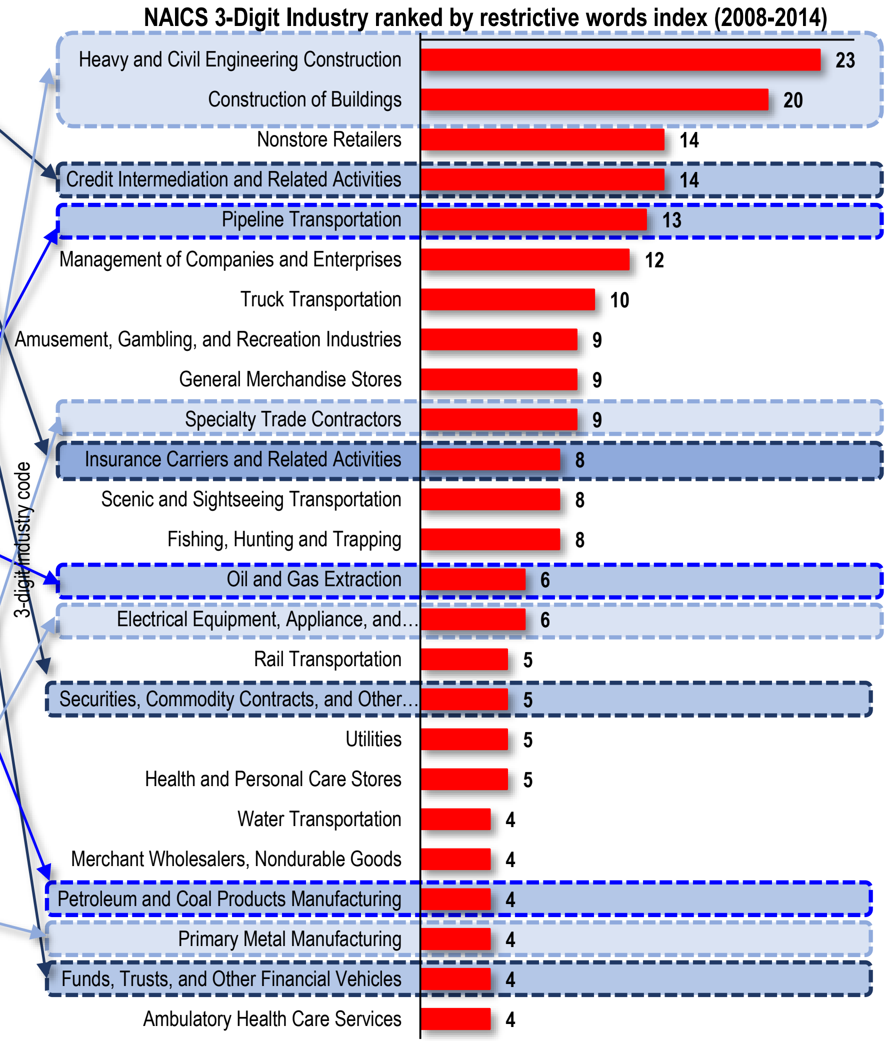
Figure: Regulatory burden 5-year rolling, as measured by change in rise restrictive work and employment regulations
Since 1974. Measured by counting rules and regulations using restrictive wording. 5-year rolling.



Source: Fundstrat, Mercatus Center (George Mason University)

3 sectors poised to benefit most…

Figure: Industries with greatest rise in regulatory burden since 2008
Based on CAGR of restrictive regulations



Source: Fundstrat, Mercatus Center

Financials—selected regulations

- Dodd-frank: $36B implementation cost
- Pay disclosure ratio (2015)--$1.3B and $0.5B annually.
- Reg. SBSR (2015)—Swap: $0.4B annually
- DOL Fiduciary rule—$11B annually

Energy—selected regulations

- MATS (Mercury Air Toxics Standard) (2015)—$10B annually
- EPA Clean Power Plan—$10B annually
- EPA methane emissions restrictions(2015)—$0.6B annually
- Curbing methane emissions (May 2016)—$0.8B annually

Manufacturing—selected regulations

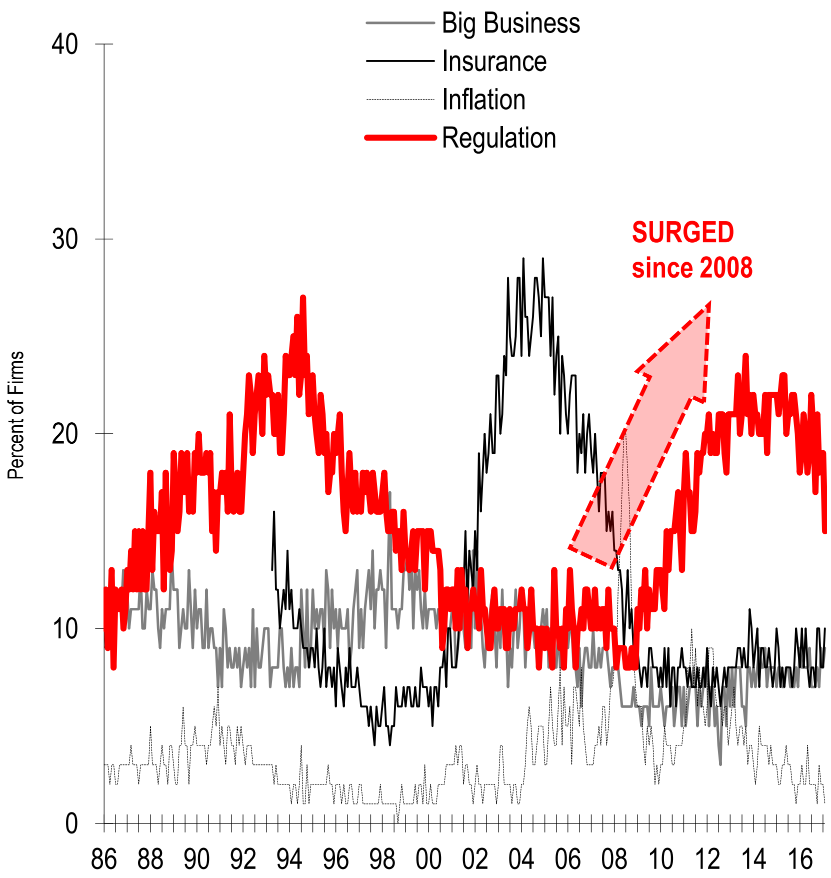
- CAFÉ (2009/2012)—$8B annually
- Safety stds pet foods (2015)—$1.7B annually
- Energy conservation stds for lamps (2015)—$0.9B annually
- Energy stds for commercial HVAC (2016)—$0.8B annually

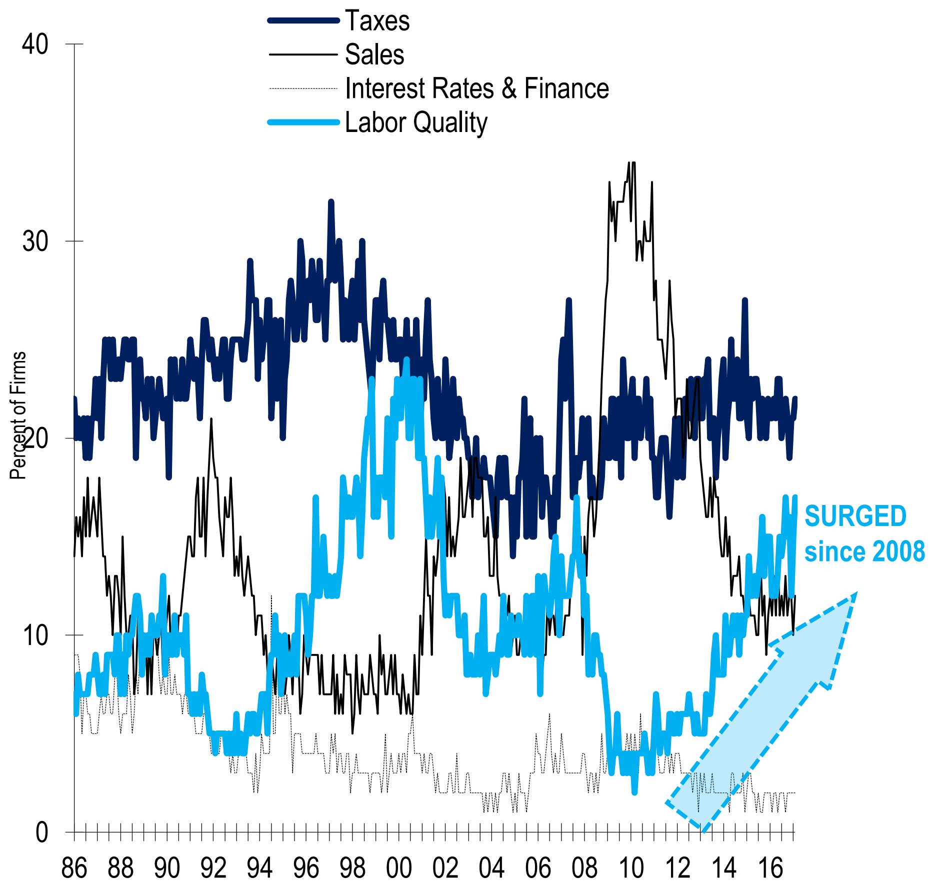
Source: Fundstrat, and various industry news sources and reports

Small-biz concerns: RISE in regulation and labor

As shown below, small businesses have seen a sharp rise in concerns about regulation and labor quality in past 8 years.

- **Thus, we should not be surprised to see a surge in "animal spirits" with the new administration.**



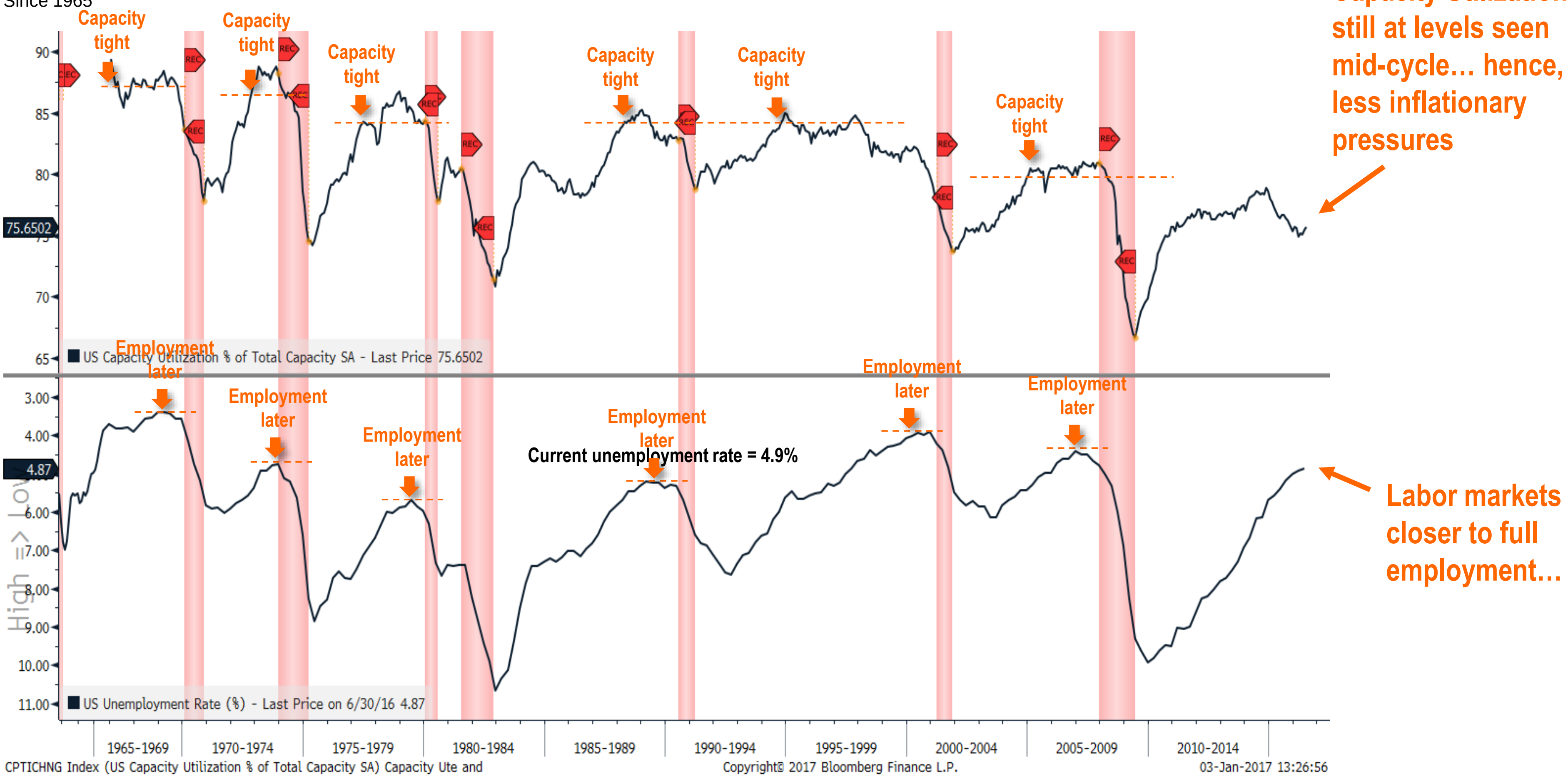


Inflationary pressures in ***wages***, not capital assets

As we have discussed in past reports, we see the inflationary pressures developing in labor markets.

- **The first time since the 1950s where labor markets tightened before "assets" tightened.**

Figure: Wage inflation before "capital equipment" inflation
Since 1965



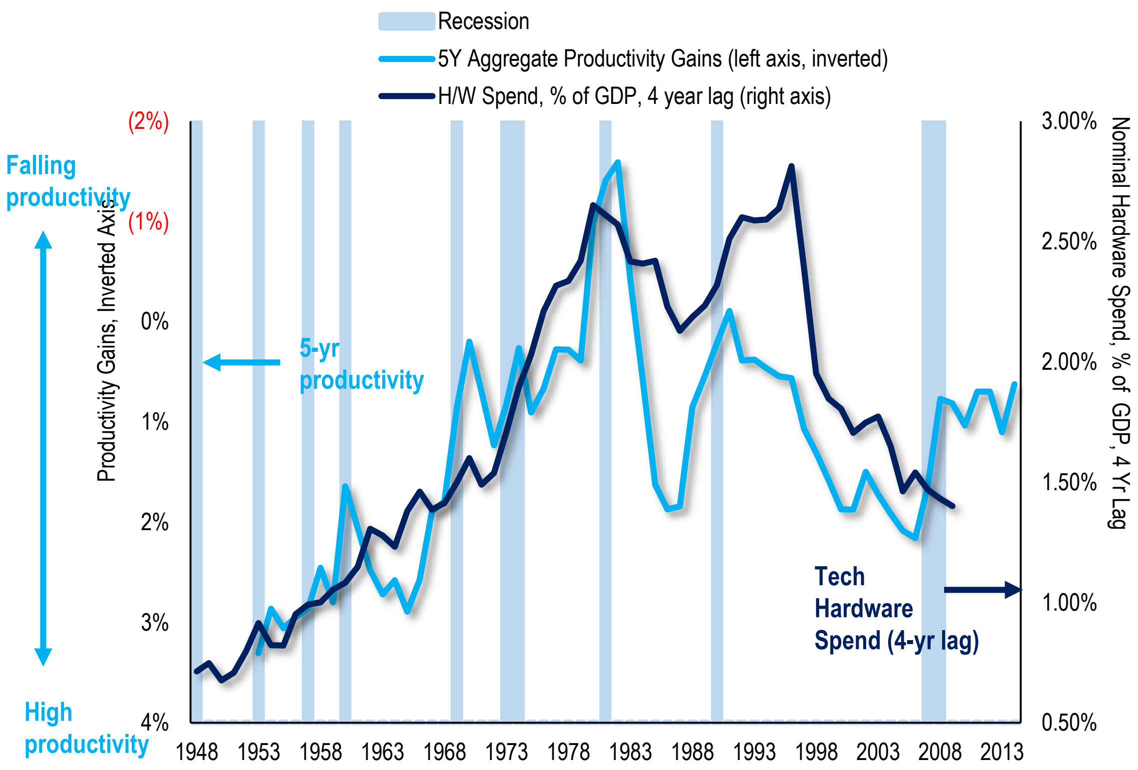
Source: Fundstrat, Bloomberg.

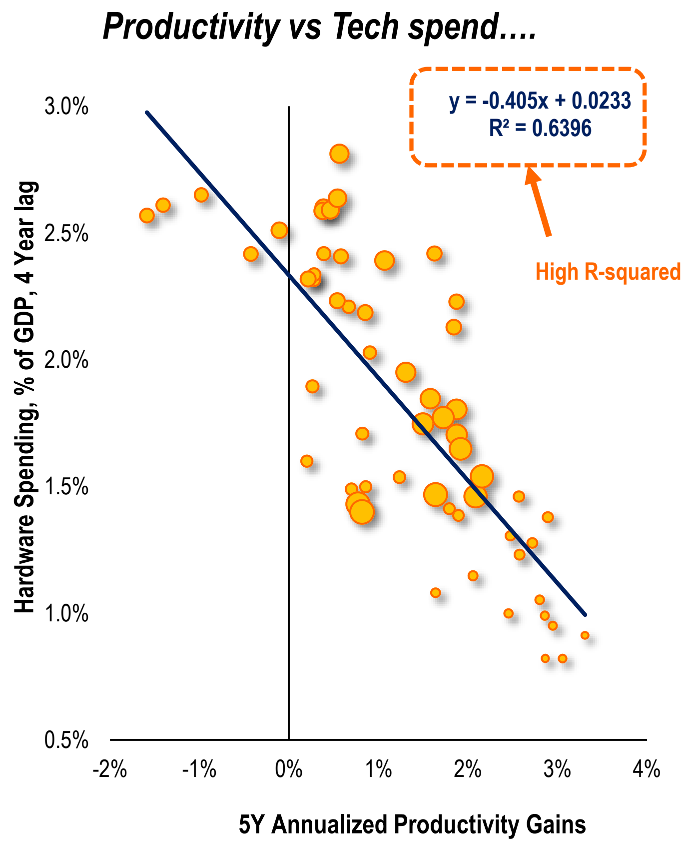
To offset wages, reliance on "automation"...

We have plotted the relationship between low productivity (5-yr rolling) and technology spending (IT hardware).

- **As shown, periods of low productivity are followed by a rise in technology spend.**
- **This is logical, after all, the responses to falling productivity are: automation, export jobs or inflation**

Figure: Historically, cycles of low productivity lead to a surge in Technology spend to boost productivity
Since 1948





Source: Fundstrat, Bloomberg.

TECHNOLOGY: In the '50s–Technology stocks led 10 consecutive years

As shown below, technology stocks outperformed during the 1950s, which is one of the few inflation cycles led by wages and labor.

- **In other words, if the inflation cycle plays out like we suspect, Technology stocks, particularly "Industrial technology" will lead for the next few years.**

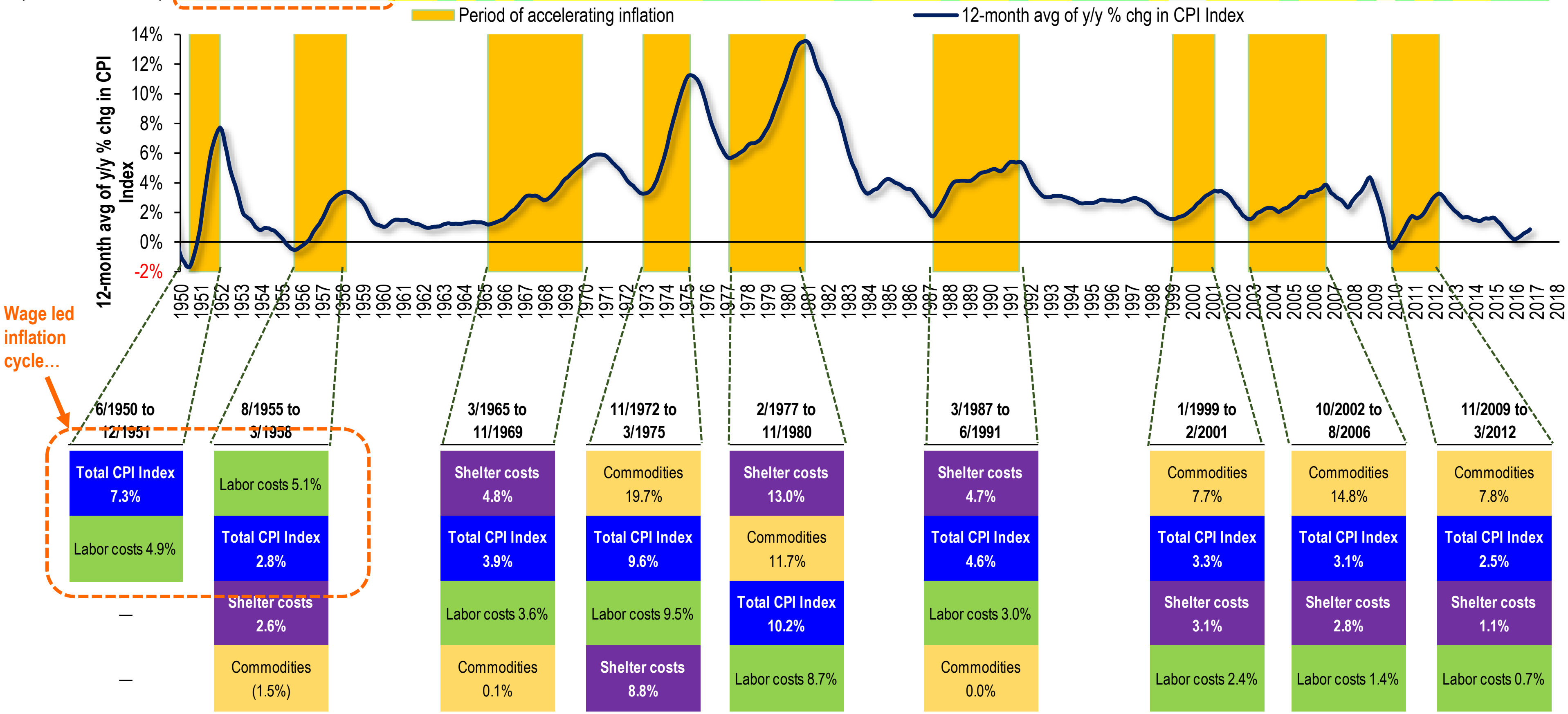
Figure: CPI since 1950

Tech led 10 consecutive years

Technology (Relative to S&P 500)	'50	'51	'52	'53	'54	'55	'56	'57	'58	'59	'60	'61	'62	'63	'64	'65	'66	'67	'68	'69	'70	'71	'72
	-2	4	1	7	24	5	23	11	11	18	1	-14	-11	6	-5	22	0	50	-35	-3	-32	-4	-13

Technology (Relative to S&P 500)	'73	'74	'75	'76	'77	'78	'79	'80	'81	'82	'83	'84	'85	'86	'87	'88	'89	'90	'91	'92	'93	'94	'95
	-3	-7	0	1	5	10	-15	-13	-19	32	9	-13	-7	-31	10	-14	-37	10	-20	-4	13	21	5

Technology (Relative to S&P 500)	'96	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'17
	23	-3	51	59	-31	-13	-14	20	-7	-3	-6	12	-5	36	-4	1	0	-3	7	5	3



Source: Fundstrat, Bloomberg

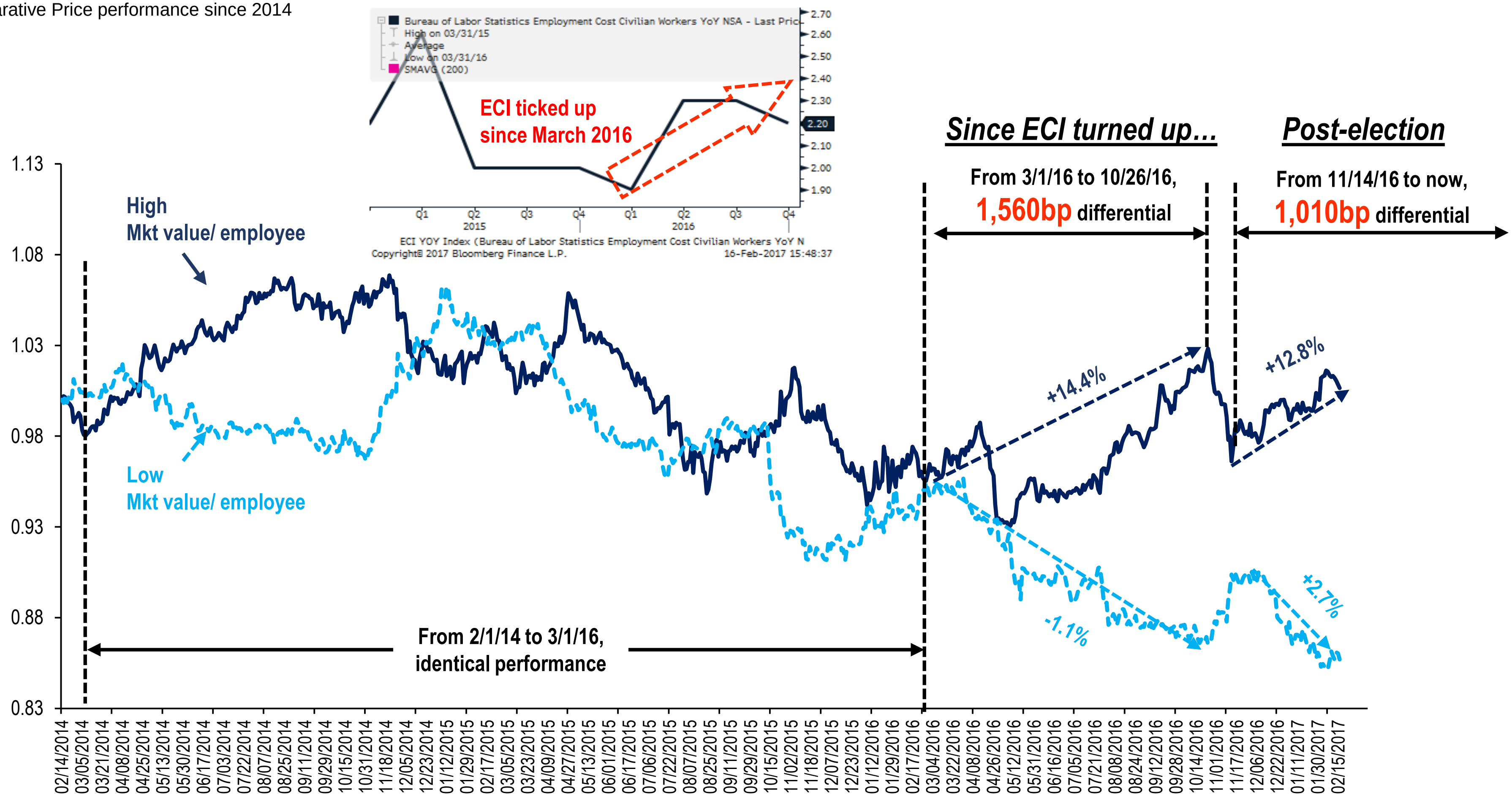
Wage inflation *1,010bp relative* performance since election day

What may surprise investors is how significant "wage inflation" exposure has explained equity performance since election day.

- **As shown below, since the Presidential election, high market value per employee (low exposure to wage inflation) outperformed the opposite by 1,010bp—a staggering differential in performance.**
- **Prior to March 2016 (when ECI turned up), there was almost no differential in price performance. And March 2016 to election day, it represented 1,560bp of price performance differential.**

Figure: Market Value per Employee—High versus Low

Comparative Price performance since 2014



Source: Fundstrat, FactSet, Bloomberg.

fundstrat

Why Market value/ employee measures "wage inflation" risk

We have a simple illustration below to explain why "market value/ employee" is a measure of "wage inflation risk.

- **As shown below, by simplifying the equation, market value per employee ascribes the equity value attributed for each unit of an employee—it is a ratio.**
- **Therefore, the higher this value, the *__lower__* the wage inflation risk.**

Figure: Components of Equity Franchise Value
Per Fundstrat

Components of *__franchise__* value

Wage inflation here

Components of Equity Value

Plant assets + Intellectual property + Debt leverage + Employee labor = Market Value Equity

Isolate "non-labor" components by simplifying

$$\text{Plant assets} + \text{Intellectual property} + \text{Debt leverage} + \frac{\text{Employees}}{\textit{Employees}} = \frac{\text{Market Value Equity}}{\textit{Employees}}$$

Implied "value" of non-labor for each unit of labor

$$\frac{\text{Market Value}}{\text{Employee}}$$

__High__ **market value Per employee**

__LOW__ **Wage inflation risk**

Source: Fundstrat, Bloomberg, Factset

Technology and Energy tend to be least sensitive…
…Consumer Discretionary most sensitive…

- **The least sensitive (highest market value per employee) are companies like Internet ($9mm per employee), E&Ps ($7mm), etc.**
- **The most sensitive are Food retail and other types of retailers.**

Figure: Top and Bottom Wage sensitives by Industries

Rank	Industry	# of Companies	Market Cap, $M	Number of Employees	Market Value / Employee ('000s)	Relative Perf, YTD
	S&P 500	**500**	**$20,284,076**	**24,319,620**	**$834.1**	**1.3%**
1	Internet Software & Services	6	$995,381	103608	$9,607	2.8%
2	Biotechnology	8	$564,466	77395	$7,293	4.1%
3	Oil & Gas Exploration & Produc	18	$384,705	60957	$6,311	0.3%
4	Integrated Oil & Gas	3	$642,611	146100	$4,398	(2.4%)
5	Oil & Gas Storage & Transporta	4	$114,290	26232	$4,357	1.7%
6	Tobacco	3	$352,546	94600	$3,727	(1.8%)
7	Distillers & Vintners	2	$46,481	13400	$3,469	(3.1%)
8	Home Entertainment Software	2	$52,024	15800	$3,293	1.3%
9	Financial Exchanges & Data	5	$132,328	42303	$3,128	0.8%
10	Commodity Chemicals	1	$36,139	13000	$2,780	2.0%
11	Application Software	5	$164,264	60535	$2,714	1.7%
12	Systems Software	5	$685,141	281062	$2,438	1.2%
13	Brewers	1	$21,398	9100	$2,351	1.1%
14	Data Processing & Outsourced S	11	$517,697	221095	$2,342	1.9%
15	Semiconductor Equipment	3	$64,252	28680	$2,240	(1.2%)
16	Pharmaceuticals	11	$1,015,035	458681	$2,213	2.3%
17	Investment Banking & Brokerage	4	$246,049	111739	$2,202	1.9%
18	Construction Materials	2	$31,238	14486	$2,156	0.7%
19	Semiconductors	13	$578,629	273201	$2,118	(1.9%)
20	Specialized Consumer Services	1	$4,907	2400	$2,044	1.7%
21	Water Utilities	1	$12,982	6700	$1,938	(0.6%)
22	Internet & Direct Marketing Re	5	$525,985	271538	$1,937	2.7%
23	Household Products	5	$355,994	198300	$1,795	0.4%
24	Multi-Utilities	11	$207,070	115336	$1,795	(0.9%)
25	Fertilizers & Agricultural Che	4	$72,469	41800	$1,734	2.0%

Rank	Industry	# of Companies	Market Cap, $M	Number of Employees	Market Value / Employee ('000s)	Relative Perf, YTD
119	Food Retail	2	$40,856	518000	$79	(3.7%)
118	Aluminum	1	$5,605	60000	$93	7.8%
117	Department Stores	3	$24,744	262400	$94	(12.6%)
116	Homefurnishing Retail	1	$6,187	62000	$100	(0.1%)
115	Computer & Electronics Retail	1	$13,382	125000	$107	(1.4%)
114	Hypermarkets & Super Centers	2	$284,252	2426000	$117	(0.4%)
113	Tires & Rubber	1	$8,221	66000	$125	0.7%
112	Household Appliances	1	$13,969	97000	$144	1.0%
111	General Merchandise Stores	3	$79,772	509700	$157	(0.6%)
110	Health Care Facilities	2	$39,316	248600	$158	1.7%
109	Auto Parts & Equipment	2	$27,537	169000	$163	2.0%
108	Office Services & Supplies	1	$2,967	14800	$200	3.8%
107	Construction & Engineering	3	$19,835	95495	$208	0.3%
106	Advertising	2	$29,235	122300	$239	(2.0%)
105	Apparel Retail	6	$115,250	479304	$240	(1.8%)
104	Building Products	4	$64,698	264800	$244	1.1%
103	Restaurants	5	$225,262	883330	$255	(0.6%)
102	Automobile Manufacturers	2	$106,215	414000	$257	3.5%
101	Trucking	2	$14,935	54662	$273	(0.6%)
100	IT Consulting & Other Services	5	$278,822	1012757	$275	0.0%
99	Hotels, Resorts & Cruise Lines	4	$97,044	349500	$278	0.1%
98	Air Freight & Logistics	4	$170,724	587556	$291	(0.7%)
97	Publishing	1	$6,984	24000	$291	2.5%
96	Electronic Manufacturing Servi	1	$24,106	75000	$321	(3.4%)
95	Distributors	2	$23,991	70700	$339	0.2%

Source: Fundstrat, Bloomberg, Factset

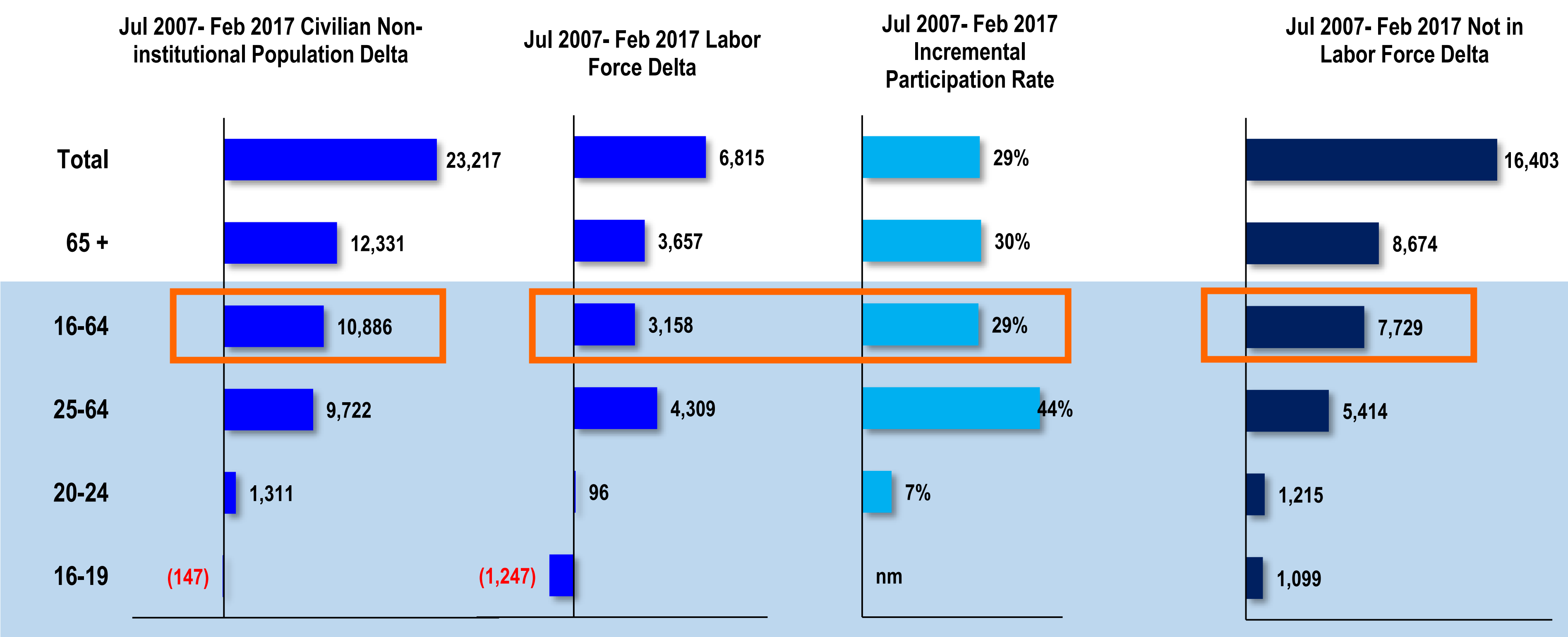
29% of incremental population in labor force

Since 2008 working age (16-64) grew by 11mm, force mere 3.7mm

As shown below, more than half of the drop in the labor force participation rate is due to the a plunge in participation rate of working age population (16-64).

- **The labor force in total grew by 23 million in past decade, and by 11 million in the "working age" range of 16-64.**
- **Of those, only 3.2mm, or 29% joined the labor force—think about that, the incremental participation rate is 29%**

Figure: Population change and comparative changes in labor force
2007 vs today



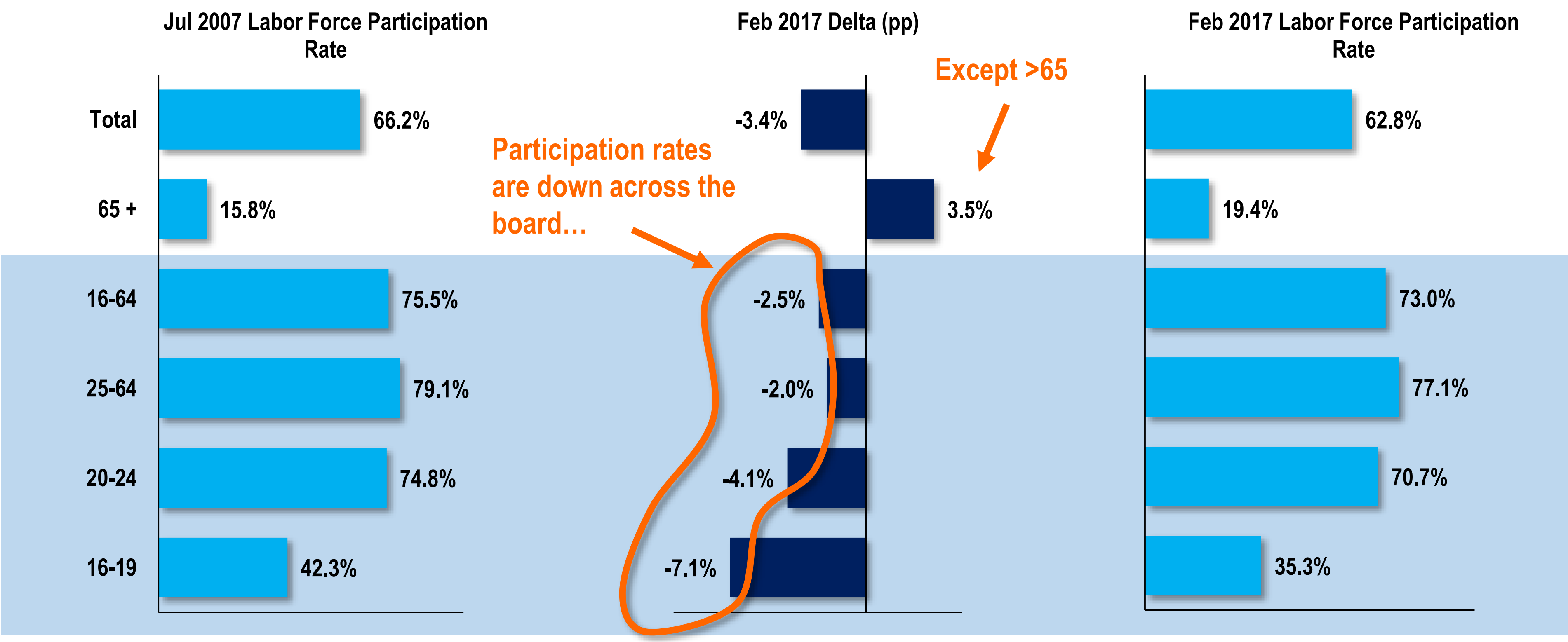
Participation rates down across the board

The aging of the population accounts for less than half of this…

Participation rates are down across the board—the plunge is most notable among millennials.

- **Millennials, in particular, have seen a collapse of participation rates. 20-24 plunged from 75% to 71% and teens 42% to 35%.**
- **Again, only half of the decline in the labor force is due to age—Krueger believe "chronic pain" explains this fall.**

Figure: Revised unemployment rates if Participation rates matched 2007 levels…
2007 vs today



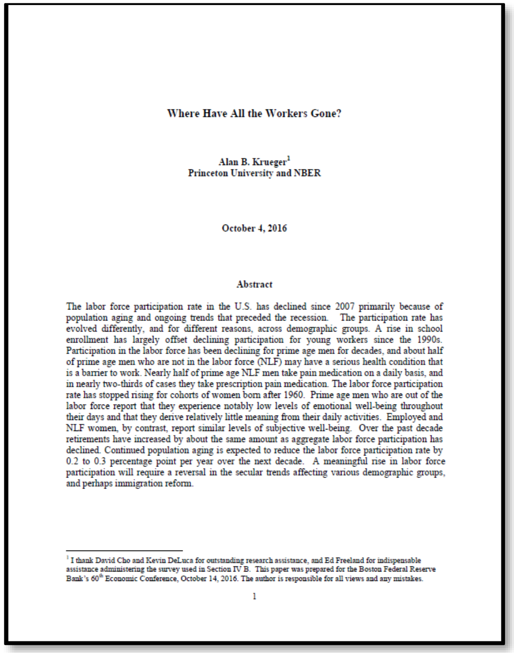
Plunge in participation rates:
Are *opiods* the reason for this?

From page 3….

NLF: Non-labor force, workers who dropped out

Third, addressing the decades-long slide in labor force participation by prime age men should be a national priority. This group expresses low levels of SWB and reports finding relatively little meaning in their daily activities. Because nearly half of this group reported being in poor health, it may be possible for expanded health insurance coverage under the Affordable Care Act to positively affect the health of prime age men going forward. The finding that nearly half of NLF prime age men take pain medication on a daily basis and that 40 percent report that pain prevents them from accepting a job suggests that pain management interventions could

From study by Alan Krueger October 4, 2016
https://www.bostonfed.org/-/media/Documents/economic/conf/great-recovery-2016/Alan-B-Krueger.pdf


Where Have All the Workers Gone?

Alan B. Krueger[1]
Princeton University and NBER

October 4, 2016

Abstract

The labor force participation rate in the U.S. has declined since 2007 primarily because of population aging and ongoing trends that preceded the recession. The participation rate has evolved differently, and for different reasons, across demographic groups. A rise in school enrollment has largely offset declining participation for young workers since the 1990s. Participation in the labor force has been declining for prime age men for decades, and about half of prime age men who are not in the labor force (NLF) may have a serious health condition that is a barrier to work. Nearly half of prime age NLF men take pain medication on a daily basis, and in nearly two-thirds of cases they take prescription pain medication. The labor force participation rate has stopped rising for cohorts of women born after 1960. Prime age men who are out of the labor force report that they experience notably low levels of emotional well-being throughout their days and that they derive relatively little meaning from their daily activities. Employed and NLF women, by contrast, report similar levels of subjective well-being. Over the past decade retirements have increased by about the same amount as aggregate labor force participation has declined. Continued population aging is expected to reduce the labor force participation rate by 0.2 to 0.3 percentage point per year over the next decade. A meaningful rise in labor force participation will require a reversal in the secular trends affecting various demographic groups, and perhaps immigration reform.

[1] I thank David Cho and Kevin DeLuca for outstanding research assistance, and Ed Freeland for indispensable assistance administering the survey used in Section IV B. This paper was prepared for the Boston Federal Reserve Bank's 60th Economic Conference, October 14, 2016. The author is responsible for all views and any mistakes.

1

From page 21….

The ATUS-WB also asked respondents, "Did you take any pain medication yesterday, such as Aspirin, Ibuprofen or prescription pain medication?" Fully 44 percent of prime age men who were out of the labor force acknowledged taking pain medication on the previous day, although this encompasses a wide range of medications.[21] This rate was more than double that of employed and unemployed men.[22] And if we limit the comparison to men who report a disability, those who were out of the labor force were more likely to report having taken pain medication (58 percent) than were those who were employed (32 percent), again suggesting the disabilities are more severe, on average, for those who are out of the labor force.

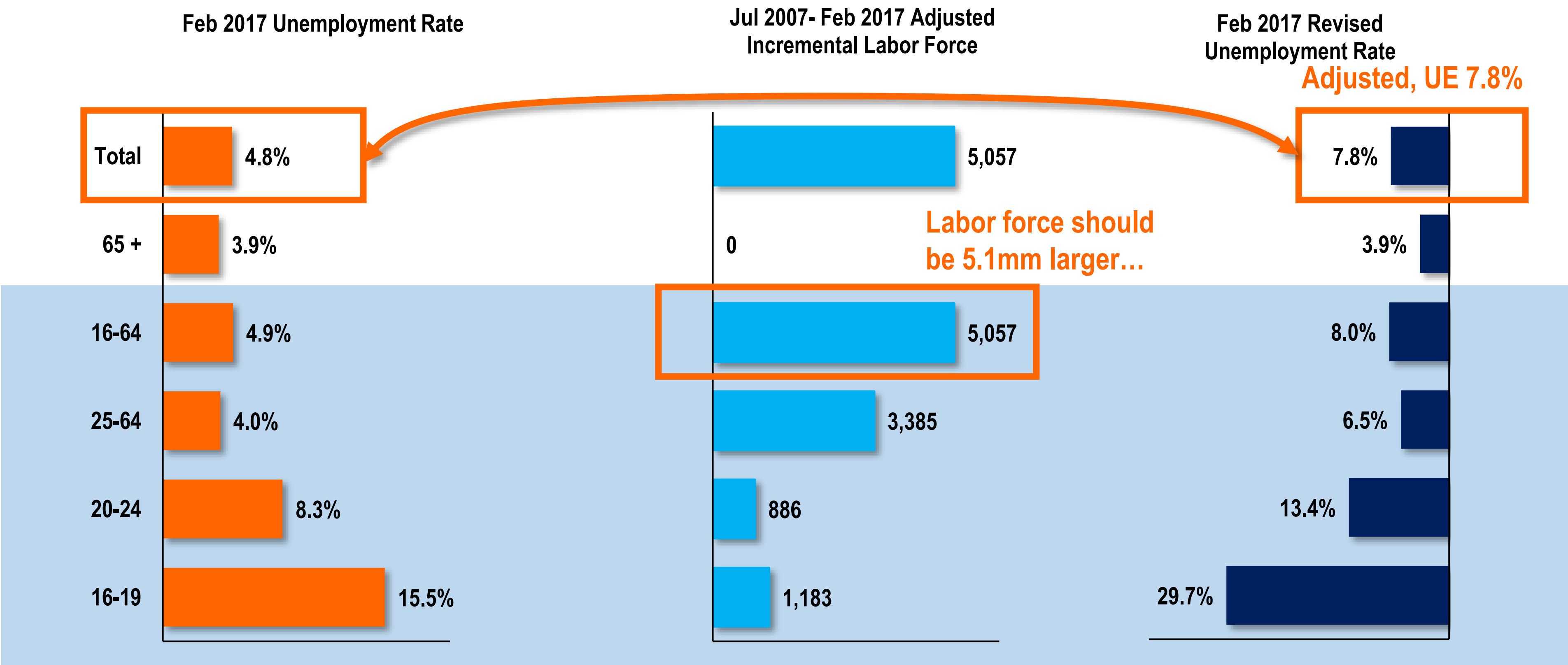
Unemployment rate should be 8% today…

5.1mm "working age adults" should be in the labor force

If participation rates of "working age" adults is normalized, unemployment rates should be higher.

- **As shown below, the labor force should be 5.1mm larger, accounting only for those age 16-64.**
- **Adjusted, the unemployment rate is 8.7% versus the 4.8% reported recently.**

Figure: Revised unemployment rates if Participation rates matched 2007 levels…
2007 vs today



Disinflation of ’12 to ’16 ending, as inflation expectations gain…

Markets are finally beginning to see a return to reflation—reversing the 4-year “disinflation” seen since 2012.

- **There are several drivers behind the reversal of disinflation: Oil and commodities no longer “over supplied”, USD flattening, China stabilizing, Europe recovering.**
- **CPI is still higher than inflation breakevens, suggesting that inflation breakevens could adjust even higher, as markets see a return to 2.5%-3.0% inflation expectations, or a “normal” inflation environment.**

Figure: 5-year inflation breakevens vs US CPI
Since 1999

Source: Fundstrat, Bloomberg.

Lower supply + higher coupons = smaller net supply

We see a favorable dynamic in fixed income in 2017—slightly higher interest paid (higher rates) and lower supply, means the "net supply of bonds" is close to zero in 2017.

- **This suggests that interest rates may rise less than expected, given the Fed tightening and higher inflation.**

Credit Supply Model

SUPPLY: In 2017, we estimate the "supply" of bonds will be around $1.4T, below the $1.55T issued in 2016 and about the same issuance as in 2015.

INTEREST P AID: we estimate that "interest paid" on existing bonds will rise to $1.36T, above the $1.3T in 2016, reflecting higher rates and higher outstandings.

NET SUPPLY: We estimate the net supply of bonds will be close to zero and the lowest figure since 2008

	2012	2013	2014	2015	2016E	2017E
Treasuries	$1,009	$849	$783	$632	$407	$419
Agency Debt	(188)	(117)	(154)	(133)	70	0
Municipals	(53)	(38)	(80)	(86)	2	(40)
Non-Agy MBS	(197)	(154)	(80)	(66)	(75)	(50)
Agency MBS	70	277	77	187	225	175
CMBS	(46)	(12)	(1)	(17)	(77)	(50)
ABS	(1)	26	31	4	5	10
CLOs	14	16	67	57	20	20
IG corporates	425	439	455	603	641	550
HY corporates	148	175	165	166	125	175
EM corporates	255	291	266	99	122	102
EM sovereign	34	40	29	26	85	56
Total Net Supply	**$1,470**	**$1,792**	**$1,558**	**$1,472**	**$1,550**	**$1,367**

minus

Credit Coupon Model

	2012	2013	2014	2015	2016	2017E		2012	2013	2014	2015	2016	2017E		2012	2013	2014	2015	2016	2017E
Money Market	$2,612	$2,714	$2,903	$2,807	$2,613	$2,613		0.5%	0.5%	0.4%	0.4%	0.3%	0.3%		$13	$12	$13	$10	$7	$9
Treasuries	11,028	11,834	12,481	13,169	13,622	14,041		2.1%	2.0%	2.0%	2.0%	2.0%	2.1%		236	237	250	268	274	290
Federal Agency Securities	1,443	1,574	1,649	1,775	1,876	2,026		2.5%	2.8%	2.9%	2.7%	2.8%	2.9%		35	44	48	47	53	58
Municipals	3,882	3,814	3,772	3,788	3,831	3,742		3.7%	4.2%	4.2%	3.6%	3.7%	3.7%		145	158	158	135	141	139
Mortgages	9,749	9,670	9,671	9,768	9,935	9,870	X	4.2%	3.9%	3.9%	3.8%	3.8%	3.9%	=	410	380	373	374	379	381
ABS	1,841	1,513	1,428	1,345	1,267	1,158		1.2%	1.1%	1.4%	1.7%	1.9%	1.9%		23	16	19	22	24	22
Investment grade	5,901	6,184	6,500	6,967	7,207	7,718		3.3%	3.1%	3.3%	3.4%	3.6%	3.6%		196	189	213	240	259	281
High yield	1,145	1,270	1,326	1,199	1,345	1,495		7.3%	6.1%	6.3%	7.7%	7.5%	7.6%		84	78	84	93	101	113
EM Corporates	191	374	412	375	402	504		5.7%	5.0%	5.6%	6.1%	5.7%	5.7%		11	19	23	23	23	29
EM Sovereign	453	494	516	539	637	693		4.9%	4.8%	5.6%	5.7%	5.7%	5.7%		22	24	29	31	36	40
Total Outstandings	**$38,244**	**$39,442**	**$40,657**	**$41,732**	**$42,735**	**$43,860**		**3.1%**	**2.9%**	**3.0%**	**3.0%**	**3.0%**	**3.1%**		**$1,174**	**$1,157**	**$1,211**	**$1,243**	**$1,297**	**$1,362**

= Net Supply (needing external demand)

	2012	2013	2014	2015	2016	2017E
Net excess Supply	**296**	**635**	**347**	**229**	**253**	**5**

Source: Fundstrat, SIFMA, Bloomberg

More upside in a "quality spread" rally...

As shown below, we see greater scope for "quality spreads" (CCC less BB) to rally relative to high-yield overall.

- **Quality spreads at 727bp are still above the long-term median (629bp) and well above a top quartile reading—yet, we are already at top quartile for high-yield spreads.**

Figure: BofA High-yield spreads (OAS) and Quality Spreads (CCC less BB)
Since 1996

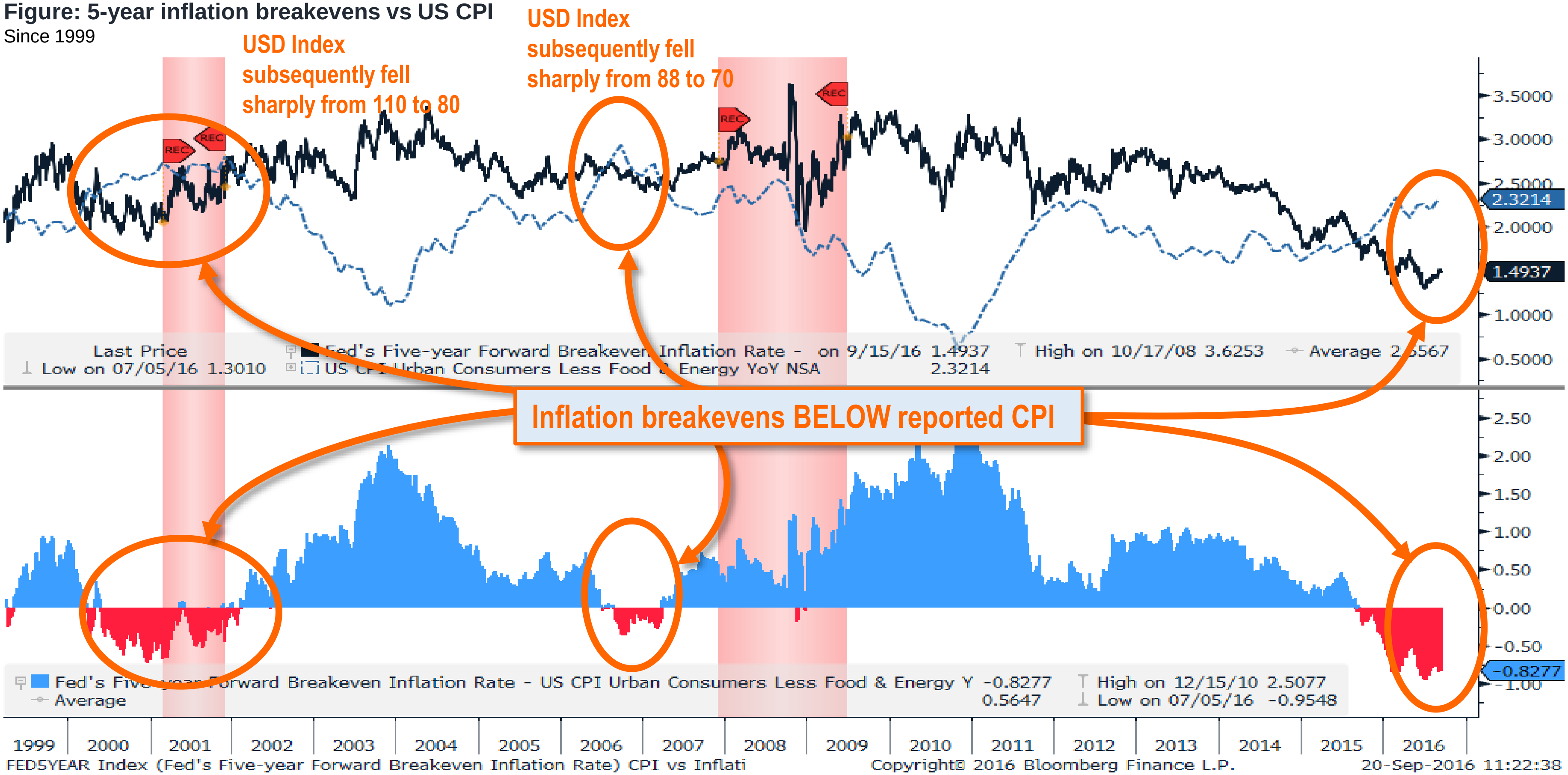
Source: Fundstrat, Bloomberg.

Lower US inflation transitory as markets "selling" inflation premia… downside to USD.

Financial markets seem to be pricing in the opposite. If we use Fed 5-year breakevens (5-yr US vs 5-yr US TIPS), we see that inflationary expectations have fallen steadily over the past few months. And in fact, are now below US CPI.

- **This was seen in 2000 and in 2006—and we know markets were "surprised" with inflation back then. Both in 2000 and 2006, the USD subsequently weakened.**
- **In other words, we believe USD could see further weakness as markets start to discount higher inflation. Again, the precedents as shown below were 2000 and 2006 and both saw USD subsequent USD weakness.**

Figure: 5-year inflation breakevens vs US CPI
Since 1999



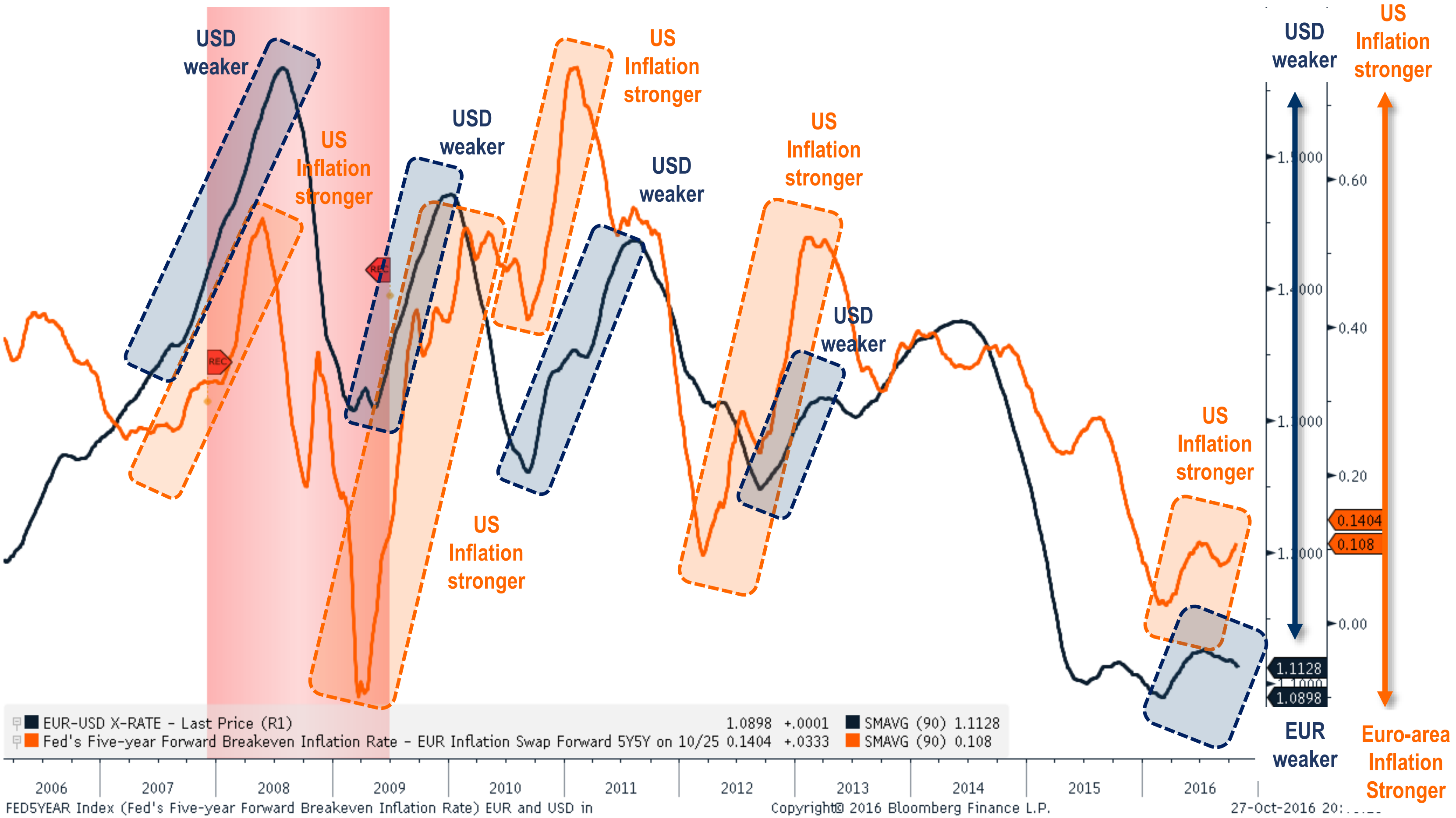
Source: Fundstrat, Bloomberg.

History shows when US relative inflation rises, USD weakens…

We plotted comparative inflation of the US vs Euro-zone (using inflation breakevens) and the USD/EUR exchange rate.

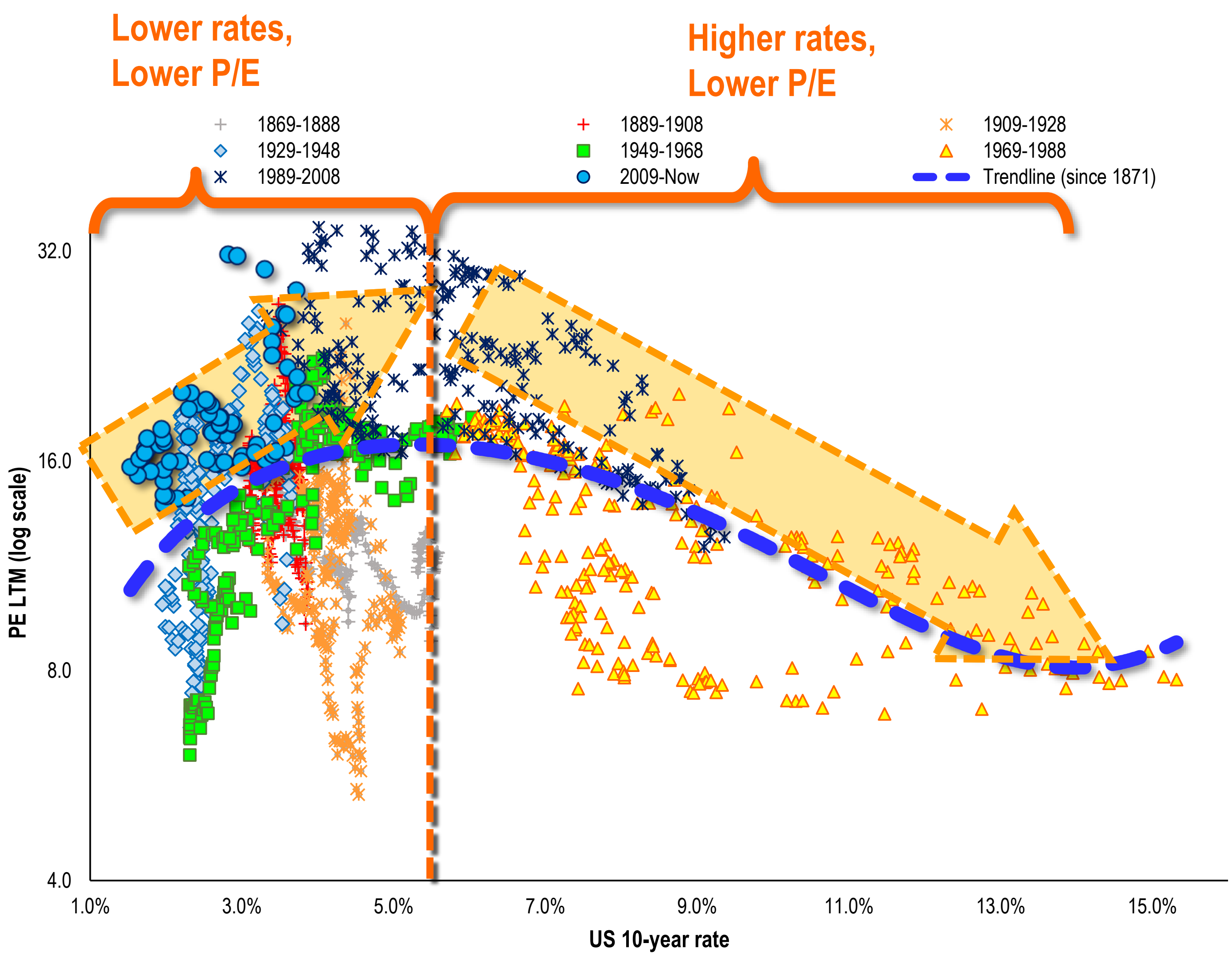
- **As shown below, whenever US inflation expectations rise (vs Eurozone), the USD tends to weaken (dark blue line). Given the tightening US labor market and likely lead on CPI, we believe this would add downside pressure to USD.**

Figure: USD/EUR versus 5-year inflation breakevens (US less EUR)
Since 2006



Source: Fundstrat, Bloomberg, Factset

US: History shows rising US interest rates do not lead to P/E compression



As we move from extraordinarily low interest rates, we expect P/E to actually expand…

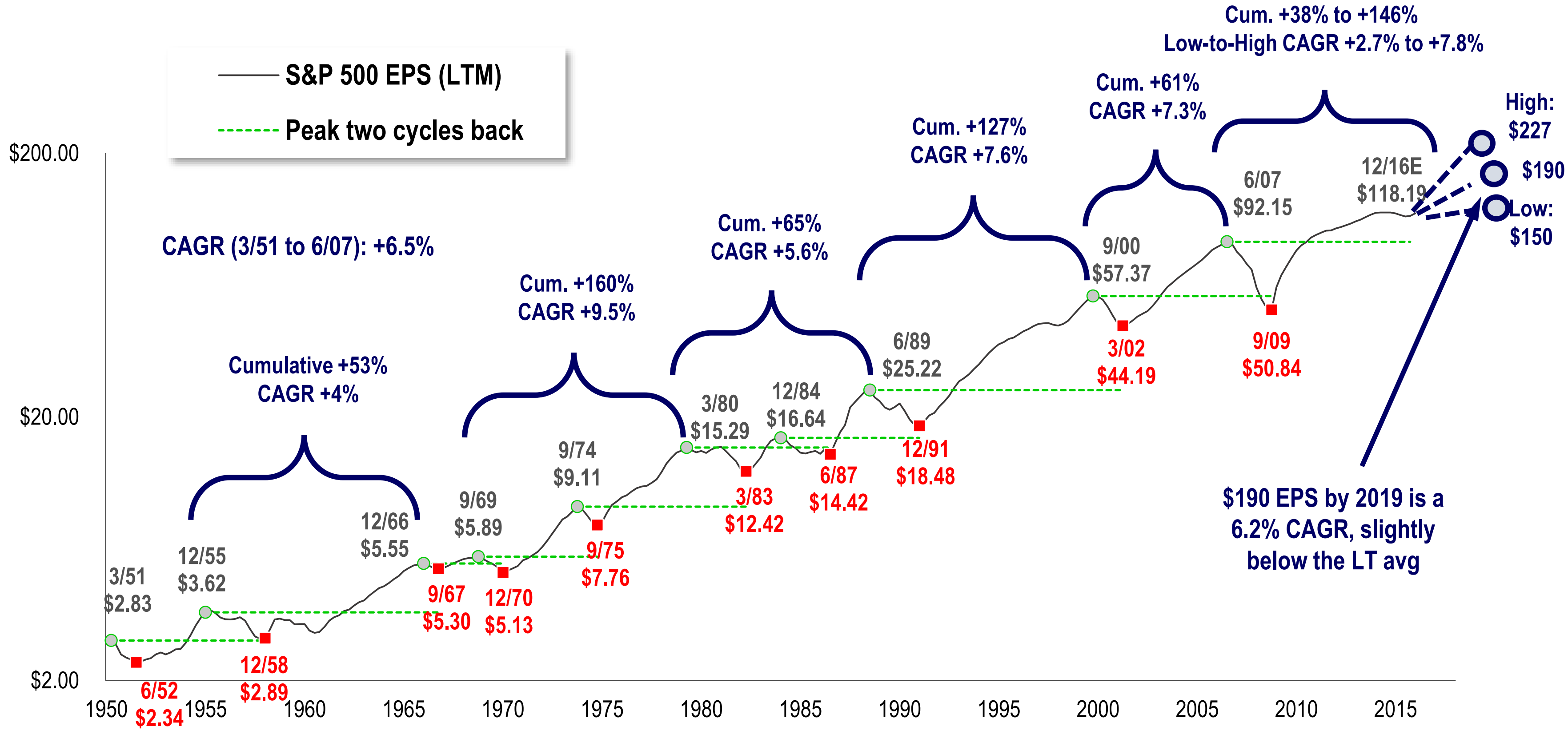
This has happened in the 20s, 40s, 50s, 60s and in almost every decade…

Source: Fundstrat, Bloomberg

History says S&P 500 EPS peaks ~$150-$220, CAGR of 7.5%

- Since 1950 S&P 500 EPS has compounded at 6.5% annually and about that level "peak-to-peak" in the intermediate cycles. That is about the rate of nominal GDP growth during that time.
- **This suggests a potential peak EPS of $195 this cycle compared to the currently estimated $118 of earnings for 2016.**

Figure: S&P 500 EPS historically compounds at 6.5% annually, implying $190 in EPS by 2019…
EPS cycles since 1950



Source: Fundstrat, Thomson Reuters.

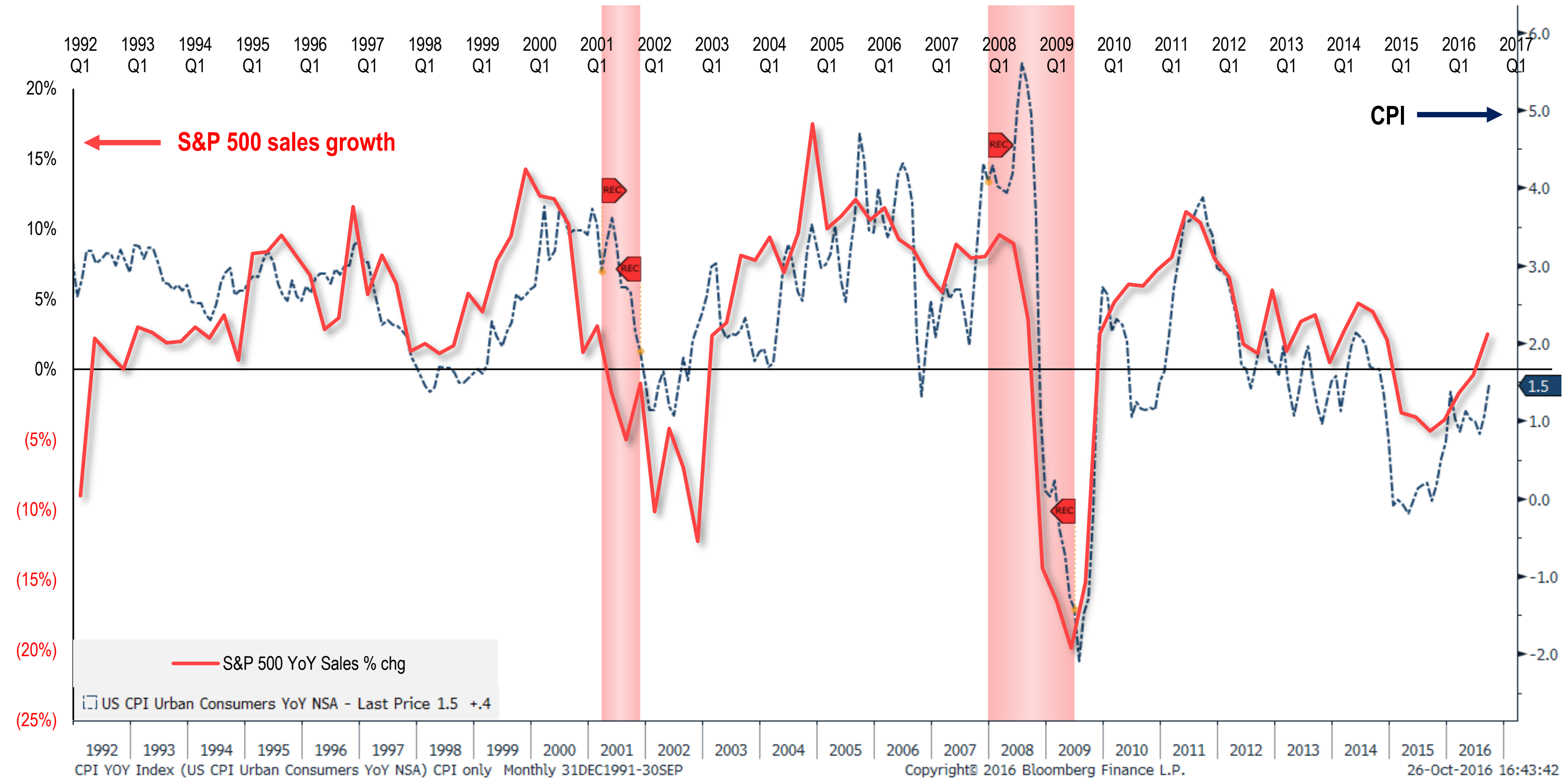
Higher inflation points to ***higher*** S&P revenue growth…

We have compared CPI and S&P 500 revenue growth below. And as shown, S&P 500 revenue growth tracks changes in CPI fairly closely.

- **In other words, we believe the recent upturn in S&P 500 sales growth has "legs" as inflation begins to strengthen in the US.**

Figure: CPI and S&P 500 sales growth

CPI Urban Consumer ex-Energy & Food and S&P 500 sales per share growth y/y



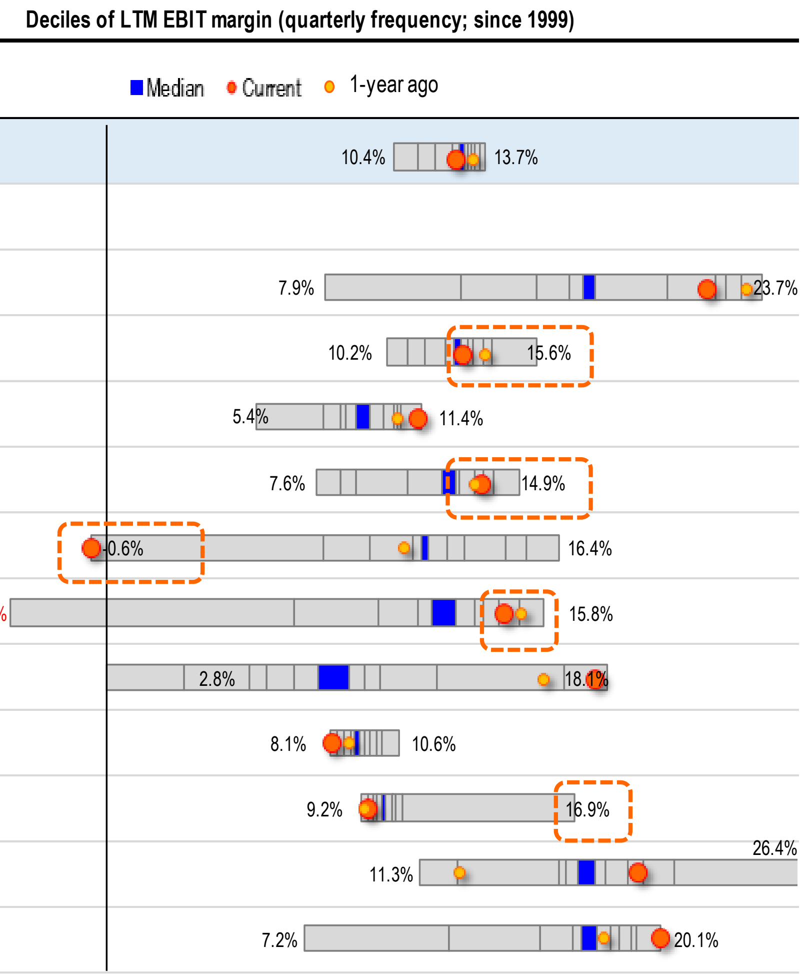
Rising inflation supports upside in EBIT margins…

The greatest upside in margins, in our view, is **Energy (oil)** and **Financials (higher rates and de-regulation)**. We see upside in **Industrials (de-regulation and inflation)** margins as well.

Figure: Deciles of S&P 500 EBIT margins

Since 1999

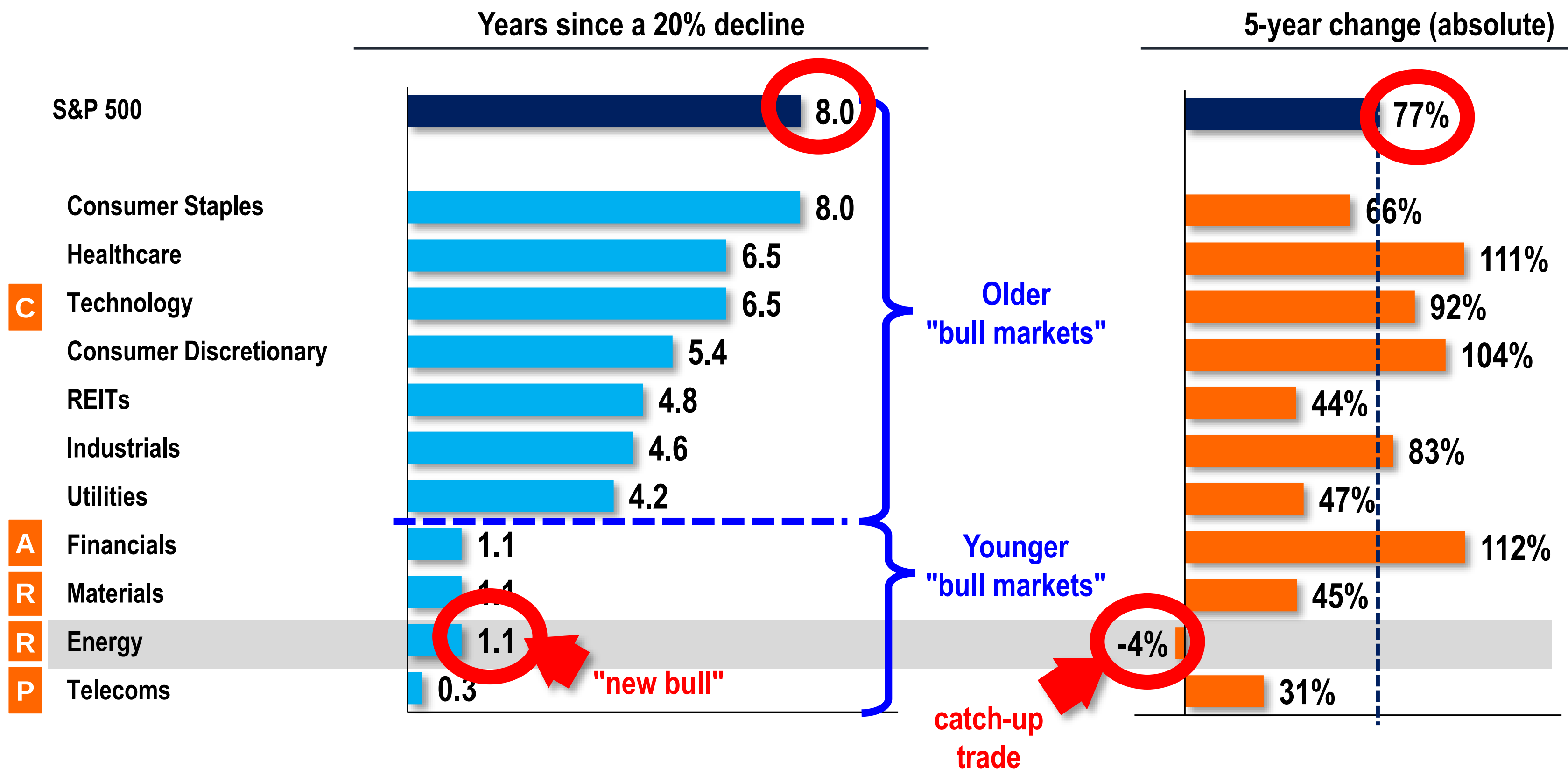
% contribution to S&P 500 Sales		% contribution to S&P 500 EBIT		Market cap weight		
Sales ($B)	% share	Total EBIT	% share	Market cap	% share	
$10,242	100%	$1,137	100%	$20,969	100%	S&P 500
$1,149	11%	$252	22%	$4,597	22%	Technology
$1,187	12%	$164	14%	$2,098	10%	Industrials
$1,580	15%	$178	16%	$2,621	12%	Consumer Discretionary
$318	3%	$45	4%	$592	3%	Basic Materials
$885	9%	$30	3%	$1,334	6%	Energy
$1,278	12%	$30	3%	$2,906	14%	Financials sector (NET MARGIN)
$83	1%	$22	2%	$607	3%	Real Estate
$1,573	15%	$150	13%	$2,887	14%	Healthcare
$1,573	15%	$147	13%	$2,182	10%	Consumer Staples
$305	3%	$59	5%	$492	2%	Telecom Services
$312	3%	$60	5%	$654	3%	Utilities



Source: Fundstrat, Factset, Bloomberg

fundstrat

Why we care more about ***Sectors*** than about ***Index*** in 2017...



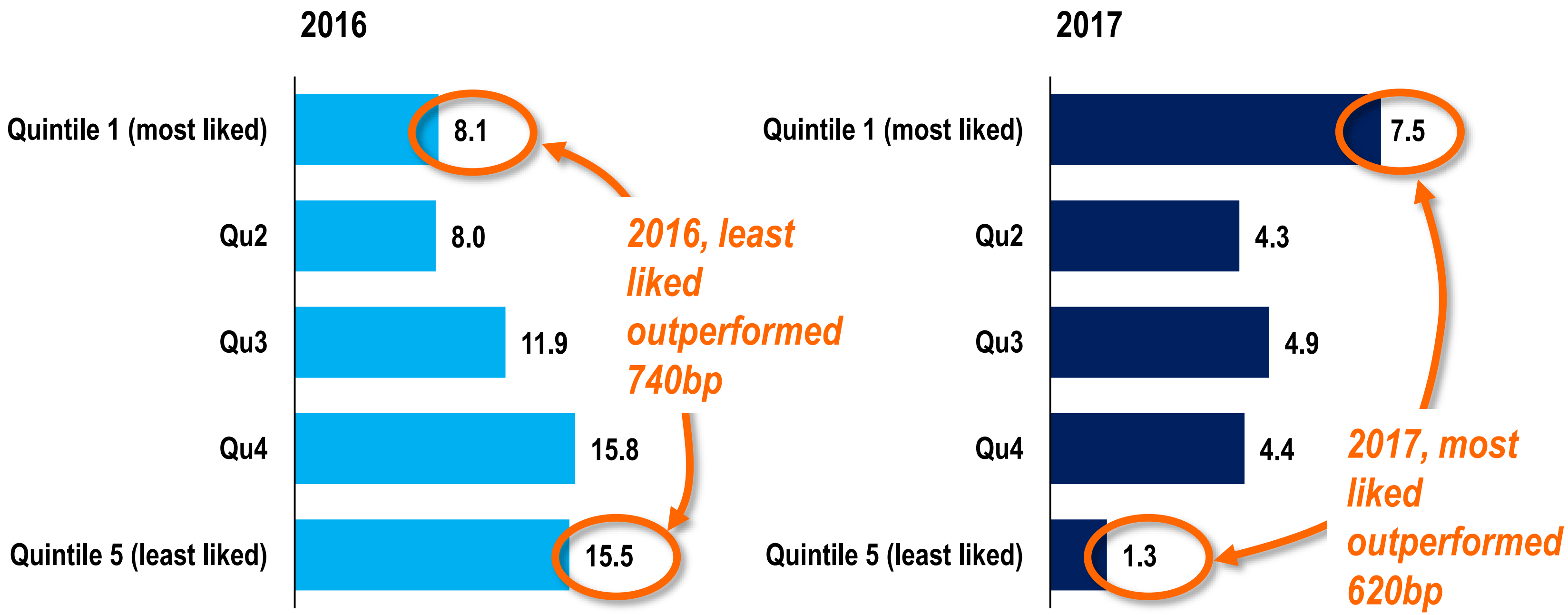
Source: Fundstrat, Bloomberg, Factset

Sell-side favorite stocks outperform 2017– reverse of 2016

In 2017 so far, sell-side consensus stocks (most liked) outperformed meaningfully, reversing the relative performance in 2016.

- **"Consensus favorites" outperformed by 620bp YTD—this almost entirely reverses what we saw in 2016. We discuss on the next page. This has been generally true across all sectors—with stocks "more liked" and "less shorted" outperforming YTD.**
- **Did the sell-side suddenly become great stock pickers? As for why this is happening, it is not entirely clear—however, it seems to be somewhat incongruous with the broader narrative that equity markets are "embracing" this rally. If markets were embracing risk, we would expect non-consensus names to outperform.**
- **In other words, the outperformance of consensus stocks, in our view, suggests investors need to exercise some wariness.**

Figure: Quintile of FC mean rating and comparative stock price performance
S&P 500



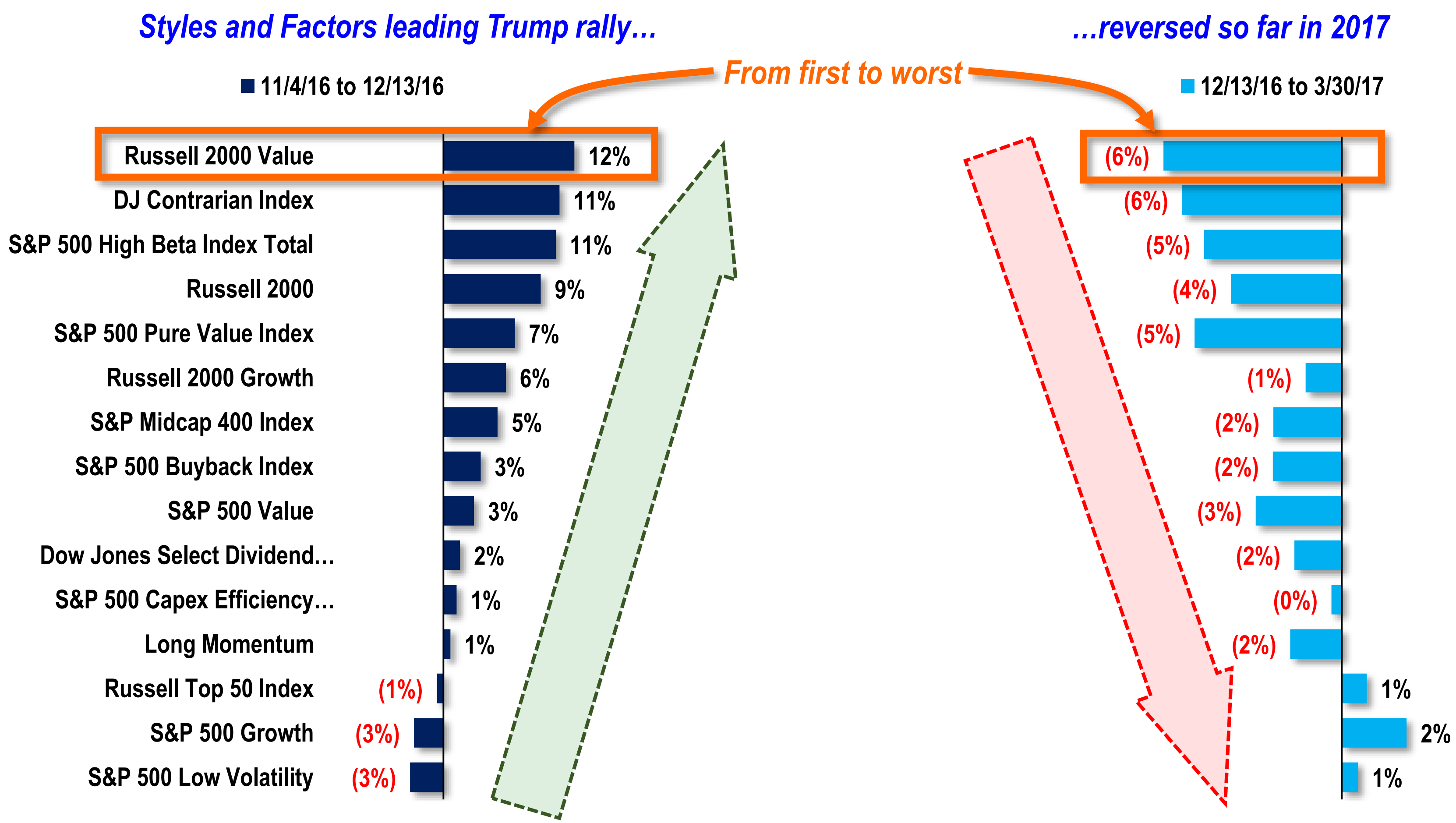
Source: Fundstrat, FactSet, Bloomberg.

TRUMP RALLY REVERSAL: Leading factors reversed in 2017…

What surprises us is the abrupt reversal of leadership of style factors since election day—in the past 5 months, sectors leading from election day to 12/13/16 have abruptly reversed.

- **For instance, Russell 2000 Value has gone from the best to the worst style factor, in a matter of 5 months.**

Figure: Relative performance of Styles and Factors — from election day to 12/13/16 and 12/13/16 to today
Percent change relative to S&P 500



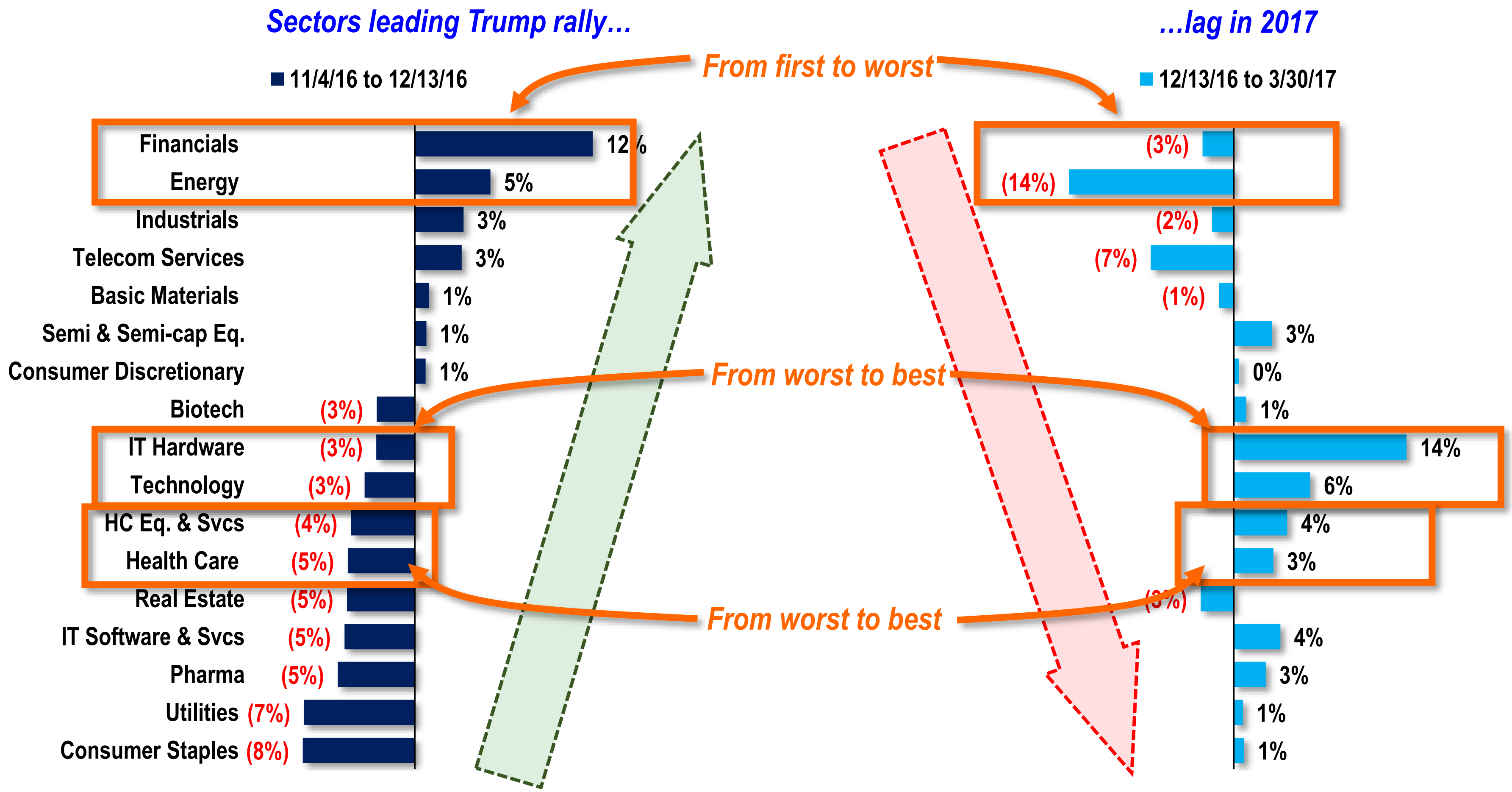
Source: Fundstrat, FactSet, Bloomberg.

TRUMP RALLY REVERSAL: Sector leadership inverted in 2017

Similarly, sector leadership abruptly reversed since December, and we highlighted key reversals below.

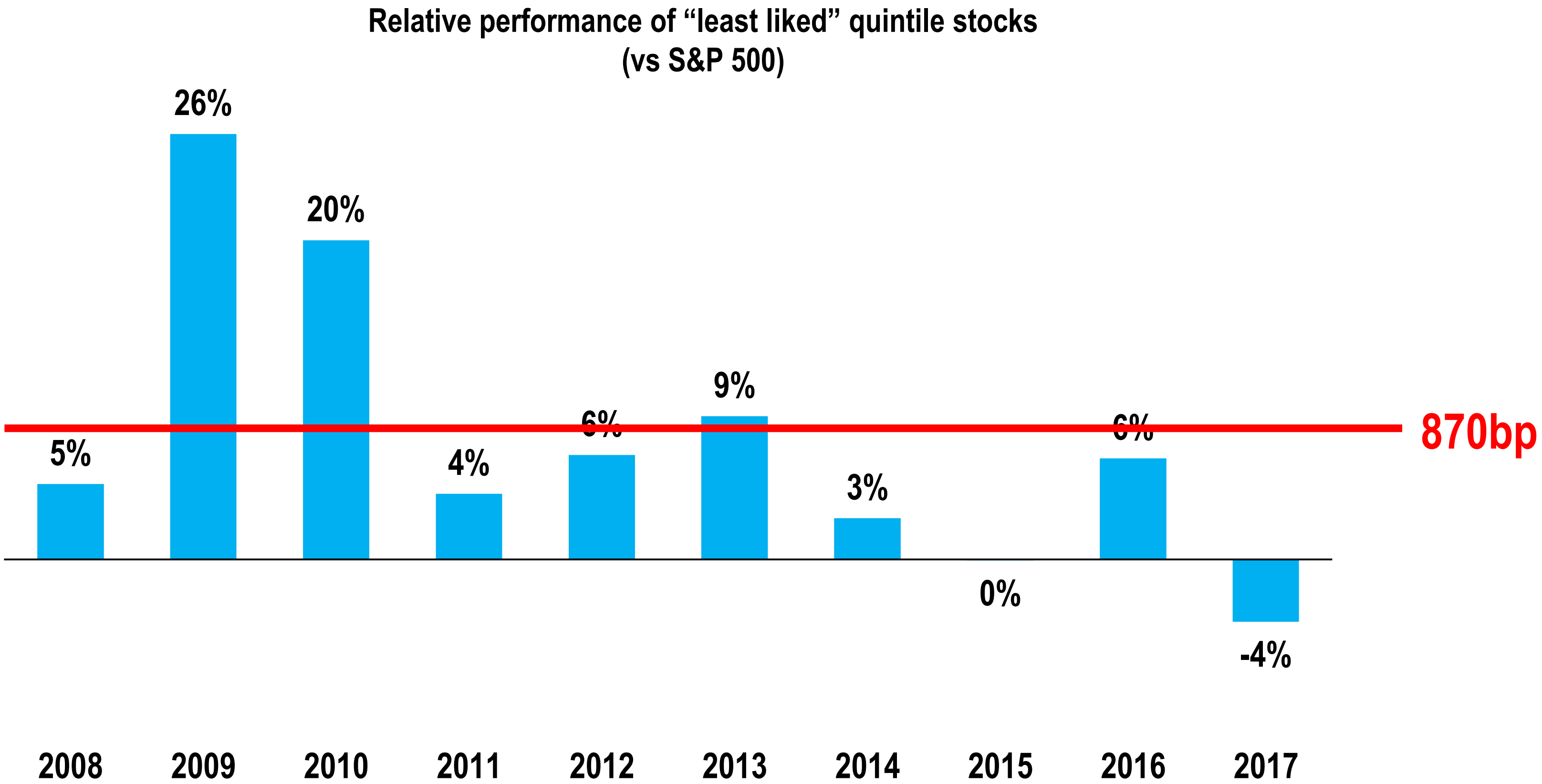
- **Question: is this cyclical reversal/Defensive leadership consistent with "accelerating GDP" and "reflation/de-regulation"? We do not think so, and this should be resolved with either Defensive leadership being temporary. Or the broader market faces a drawdown.**

Figure: Relative performance of Sectors — from election day to 12/13/16 and 12/13/16 to today
Percent change relative to S&P 500

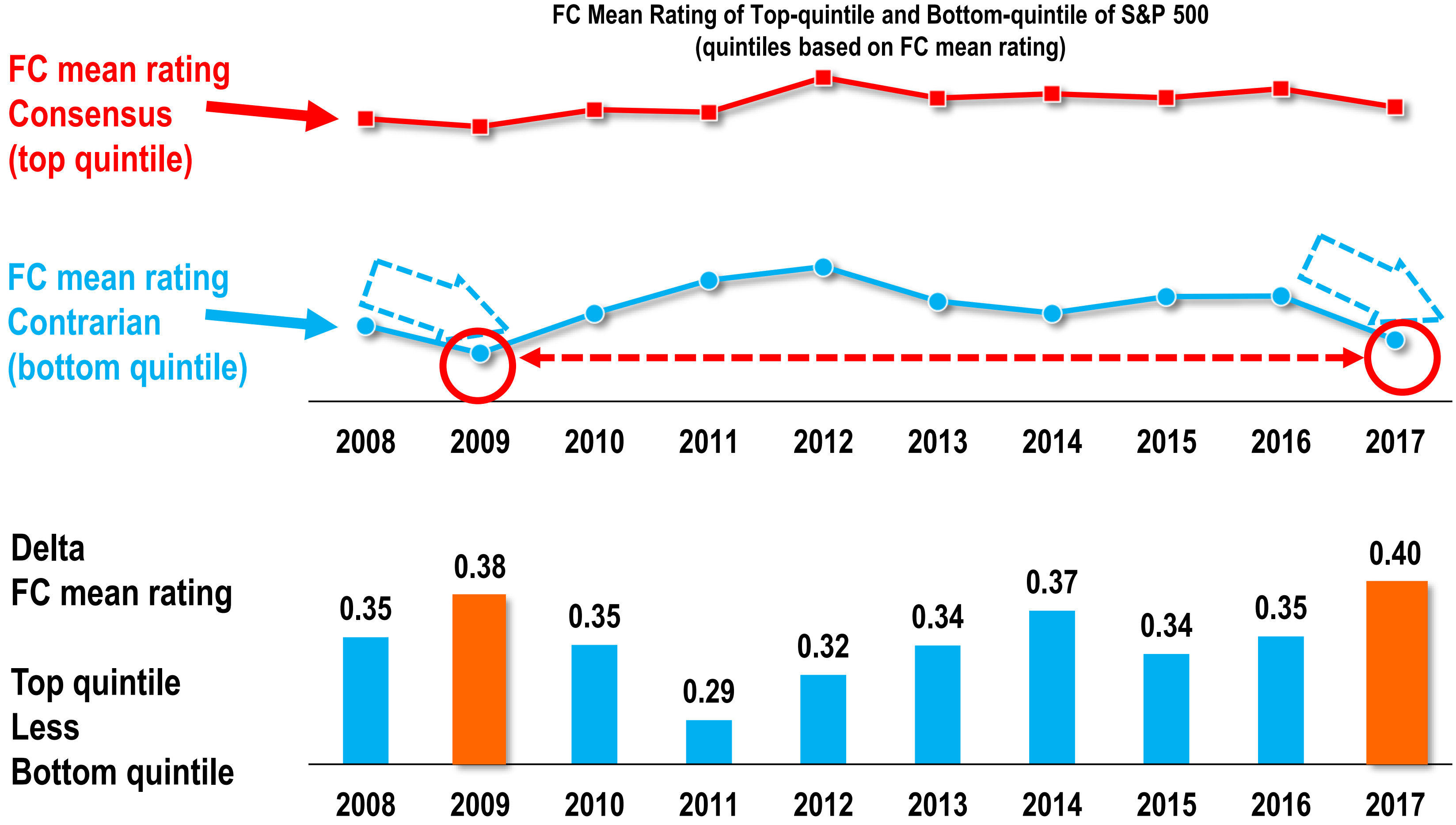


Source: Fundstrat, FactSet, Bloomberg.

Least liked stocks (Contrarian) outperformed every year since 2008…



Sell-side most negative on *Contrarian* ideas since 2009



Portfolio Strategy: Reflation means time to be more contrarian…

As for portfolio strategy, we see reflation (rising inflation expectations) as one of the key drivers of portfolio strategy over the next few years—a theme we have discussed for much of 2016.

- **Being "contrarian" is arguably the best strategy as inflation expectations rise. The chart shows that contrarian-style investing weakened as inflation fell but it is now improving.**
- **As to why: we believe falling inflation means "bond proxy" and "growth" work—both are consensus style approaches.**

Figure: Performance of Contrarian style investing versus inflation expectations…
Last 5 years

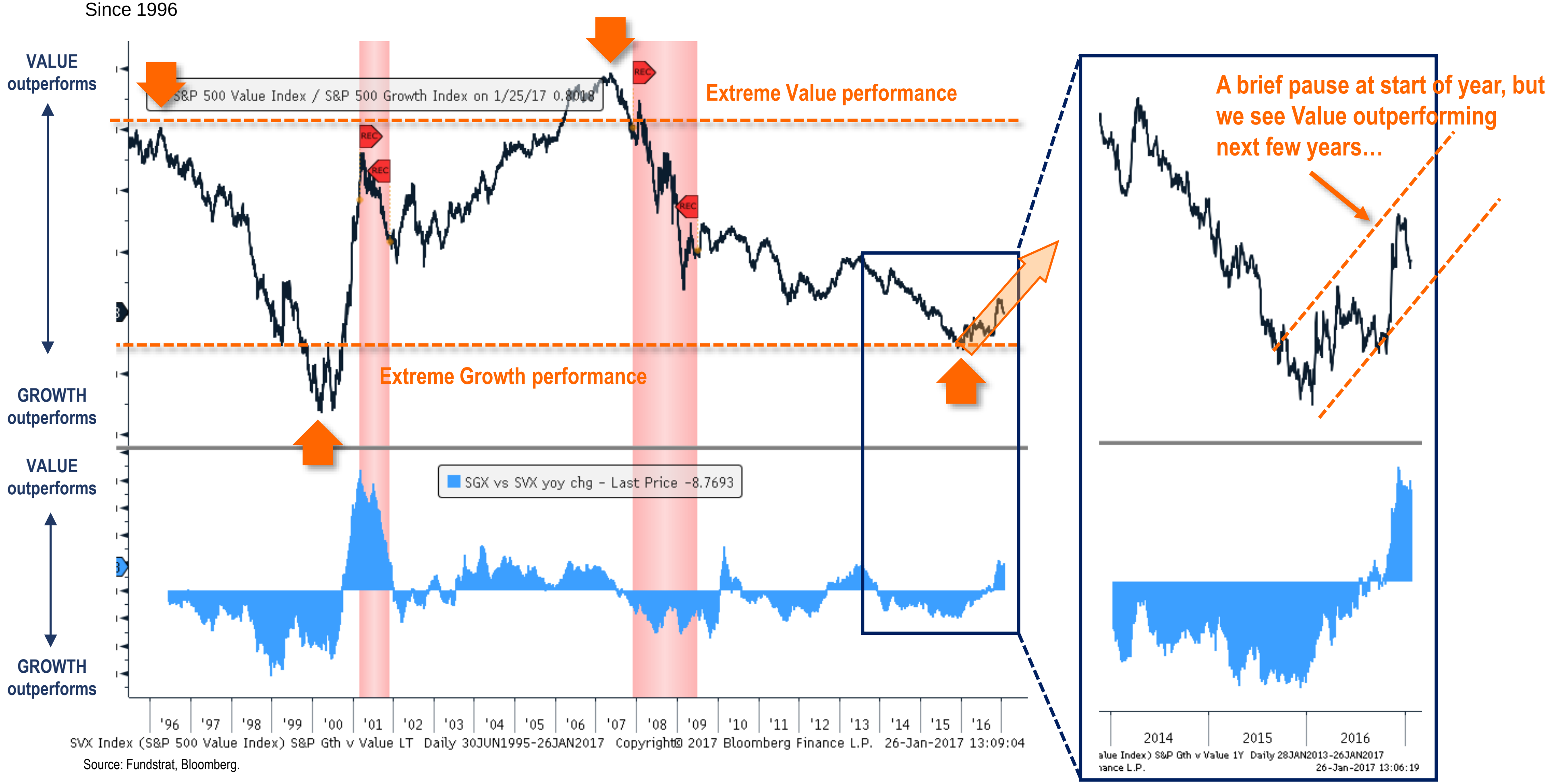
Source: Fundstrat, Bloomberg, Factset

We favor Value, we see it reversing a *20-yr extreme*

Taking a step back, the massive outperformance of Growth over Value has taken us to 20-year extremes as shown below:

- As shown, we are now back to a price ratio last seen in the late-1990s, right before **Value** began its decade-long outperformance. **Another reason to be bullish on Value.**

Figure: Comparative Price Ratio: Value versus Growth
Since 1996



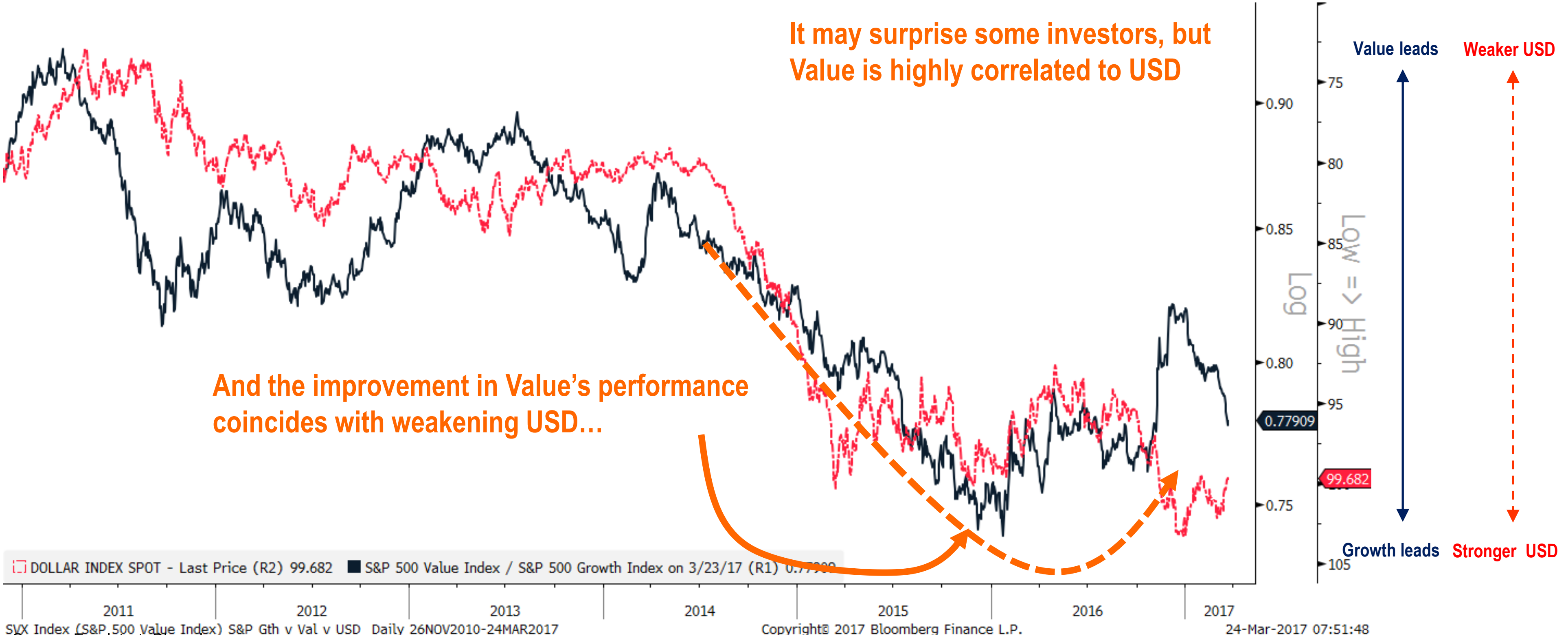
Source: Fundstrat, Bloomberg.

Overweight *Value* if the USD is weakening…

Value has been highly correlated to USD and the relationship is highlighted on the chart below. There are a few reasons why we believe this relationship exists:

- **A modest factor is that Value has a higher OW in Energy (700bp more than Growth) and Industrials (200bp) but this OW in Energy does not explain the difference.**
- **Rather, we think the driver is that Value (sector neutral) has lower valuations and therefore is more positively levered to implied higher inflation—that is, weaker USD tends to lead to higher import costs—this would de-rate higher multiple stocks. And thus, the incremental boost on EPS is better levered in Value stocks.**

Figure: Value (relative to S&P 500) is highly correlated to performance of the US Dollar
Since 2011



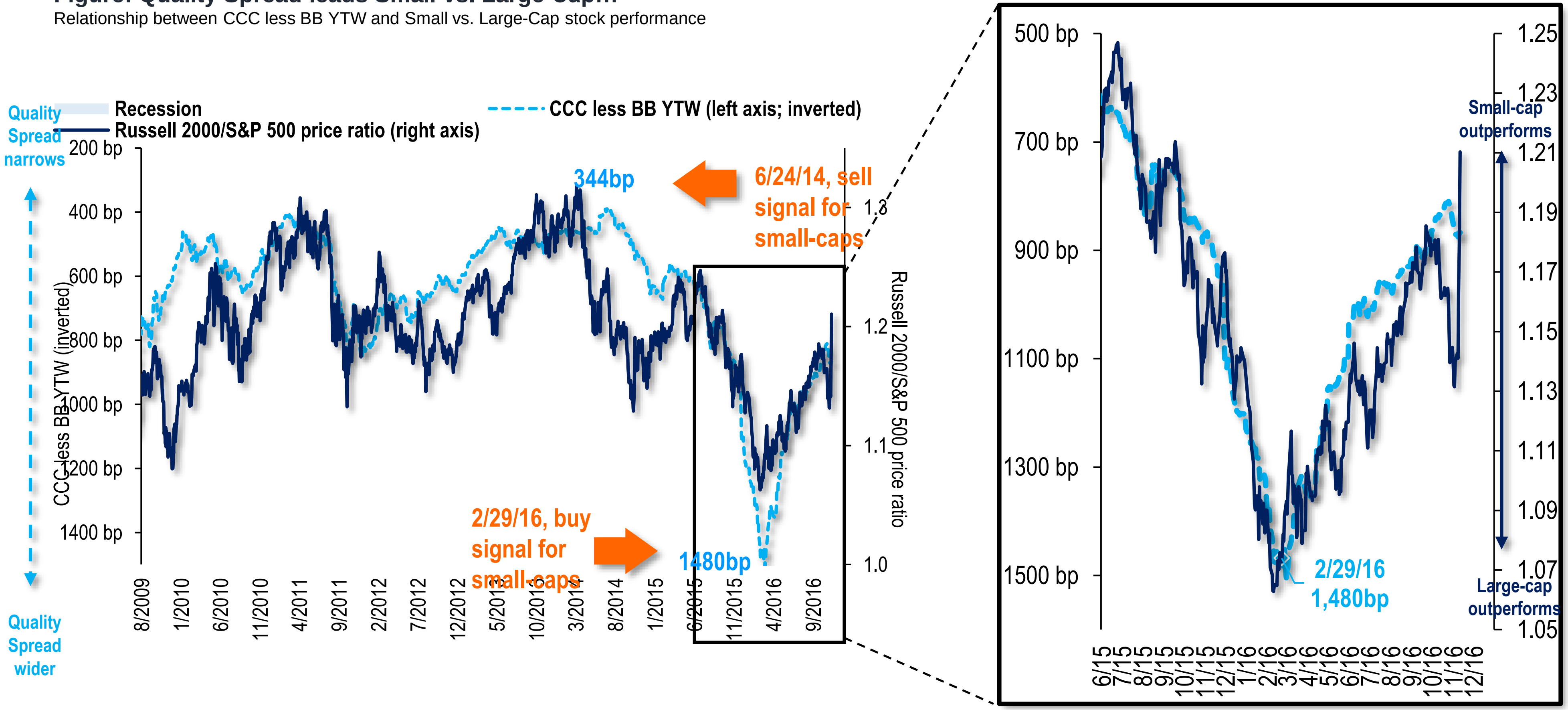
Source: Fundstrat, Bloomberg.

Buy Small-caps: Quality spread rally (BB vs CCC) argues this

As shown below, historically, small-caps and quality spreads tend to move together. Not surprising given CCC relative value is a "risk premia" measure and argues for small-caps to outperform as well.

- **Given that we expect the quality spread to continue to rally, we think small-caps will continue to outperform from here. This is in addition to the ISM exports argument.**

Figure: Quality Spread leads Small vs. Large-Cap…
Relationship between CCC less BB YTW and Small vs. Large-Cap stock performance



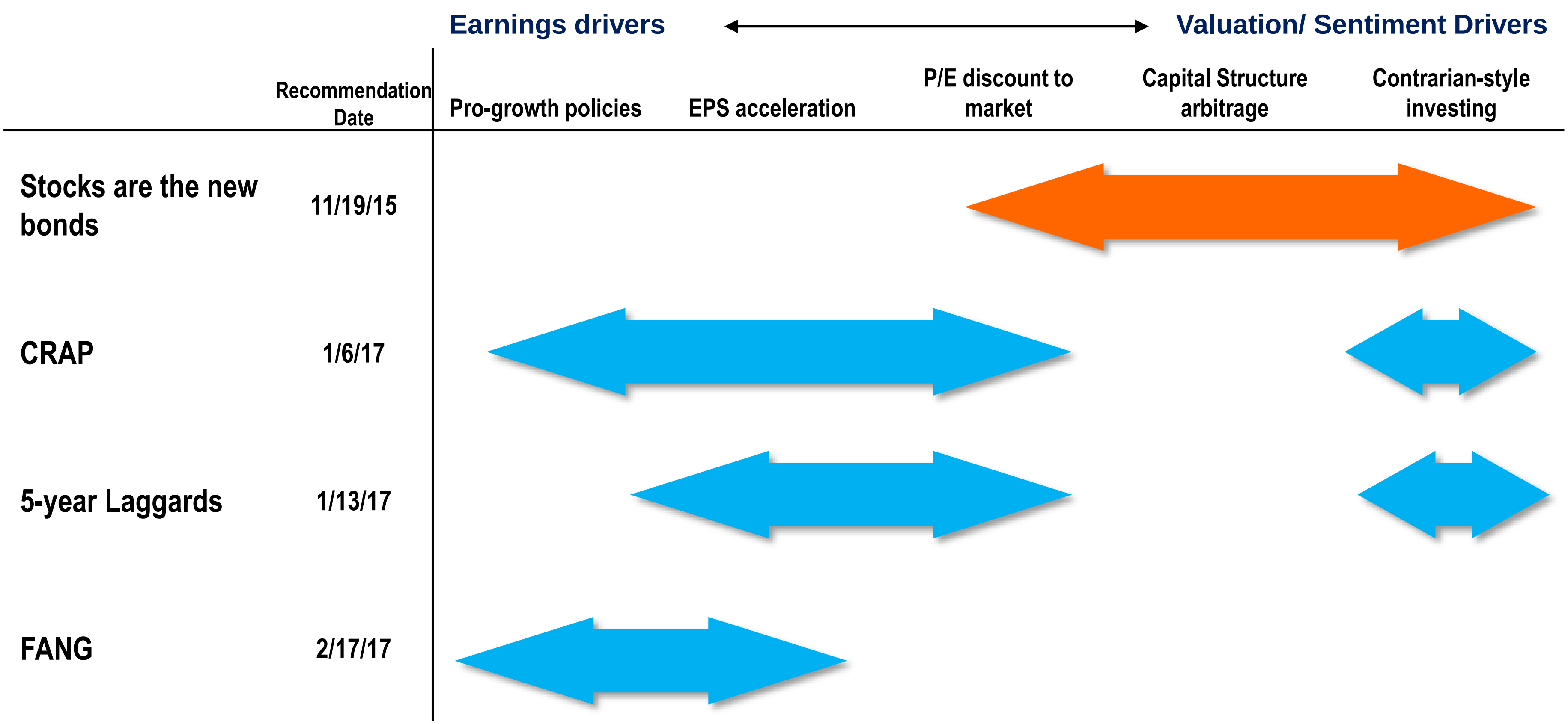
Source: Fundstrat, FactSet, Bloomberg.

FUNDSTRAT PORTFOLIO STRATEGIES

As noted below, we favor “stocks are the new bonds,” or yield parity, which falls more into the spectrum of “capital structure” arbitrage and contrarian-style investing (see report from last week, discussing why contrarian-style stocks should gain).

- **Yield Parity “Stocks are New Bonds” is complementary to our other 2017 strategies, CRAP, Laggards and FANG.**

Figure: Comparative Matrix of Attractive Factors and Portfolio Strategies recommended by Fundstrat
2017 Strategies



Source: Fundstrat, Bloomberg, Factset

Overweight CRAP: EPS upside…

		'17 EPS growth			NTM P/E			Total Return	
		'16 →	'17		Now →	by YE		EPS % chg + P/E % chg	
		$121	$135		17X	15.5X			
	S&P 500		+11%	+		-10%	=	~0%	
C	Technology		+10%		16X			>+7%	
R	Energy		+390%		30X			>+20%	Top pick
	Materials		+20%		16X			>+7%	
A	Financials		+11%		13X			>+7%-10%	Top pick
P	Telecoms		+10%		14X			>+20%	Top pick
Neutrals	Industrials		+2%		18X			0%	
	Discretionary	OW to N	+5%		18X			0%	
	Healthcare		+6%		15X			-5%-10%	Top avoid
Under Weights	REITS		-12%		37X			-5%-10%	
	Staples		+6%		19X			-5%-10%	Top avoid
	Utilities		+1%		17X			-5%-7%	Top avoid

Best EPS growth and upside…

P/E expansion stories

Risk of P/E de-rating

Overweight CRAP: Leverage to positive 2017 trends

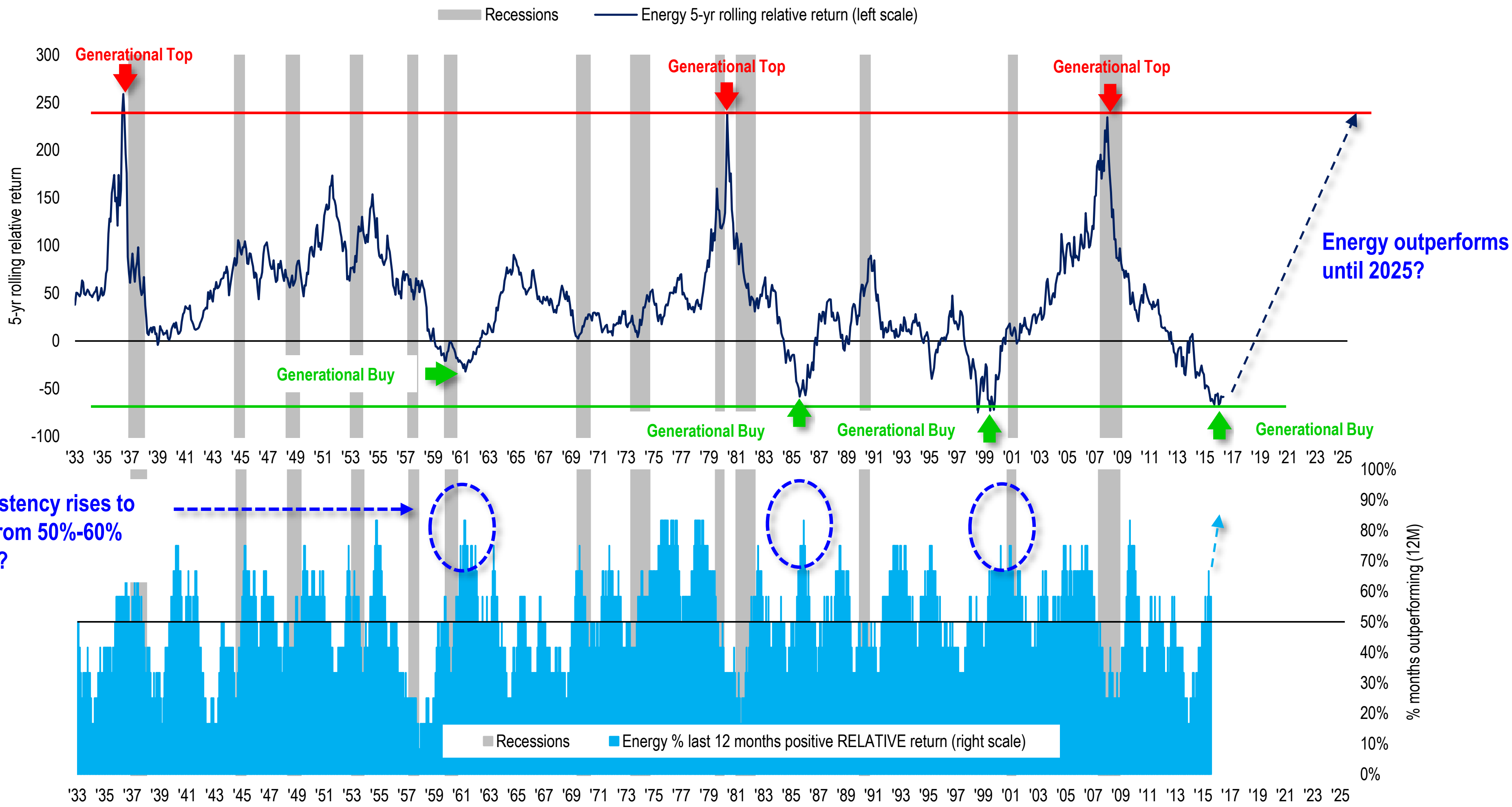
		De-regulation	Inflation	Investment recovery
		As noted, we see several sectors poised to gain from de-regulation. Specifically, most levered Energy, Financials and Manufacturing	Inflation, led by wages, will lead to higher returns for capital intensive/ resource sectors. Raising demand for credit as capex gains	Fiscal stimulus, higher "animal spirits" and higher expected nominal return drives investment spending.
C	Technology		↑ Wage gains drives automation	↑ Obvious
R	Energy	↑ Top 3 beneficiary	↑ Obvious	↑ Obvious
	Materials	↑ Beneficiary	↑ Obvious	↑ Obvious
A	Financials	↑ Top 3 beneficiary	↑ Higher rates benefit financials	↑ Credit demand gains
P	Telecoms	↑ Gain on changes in Net Neutrality	↑ Boosts ROIC	↑ Obvious
Neutrals	Discretionary			
	Industrials	↑ Top 3 beneficiary	↑ Industrial automation	↑ Obvious
	Healthcare	↓ Likely to see increased risks…	↑ Generally indexed to inflation	
Under Weights	REITS			
	Staples		↓ Bad for bond proxies	
	Utilities		↓ Bad for bond proxies	

PORTFOLIO STRATEGY: Energy may be the "fat pitch" next 8-years

Potentially, Energy may have the most upside of any of the **CRAP** (Computers aka "old tech", Resources, Banks and Phone carriers) sectors that we like in 2017.

- **The sector made a generational low last year and we see the sector potentially leading next 8 years.**

Figure: Rolling 5-yr returns Energy (vs S&P 500) and "win-ratio" % months positive
Since 1933



Source: Fundstrat, Bloomberg, Factset

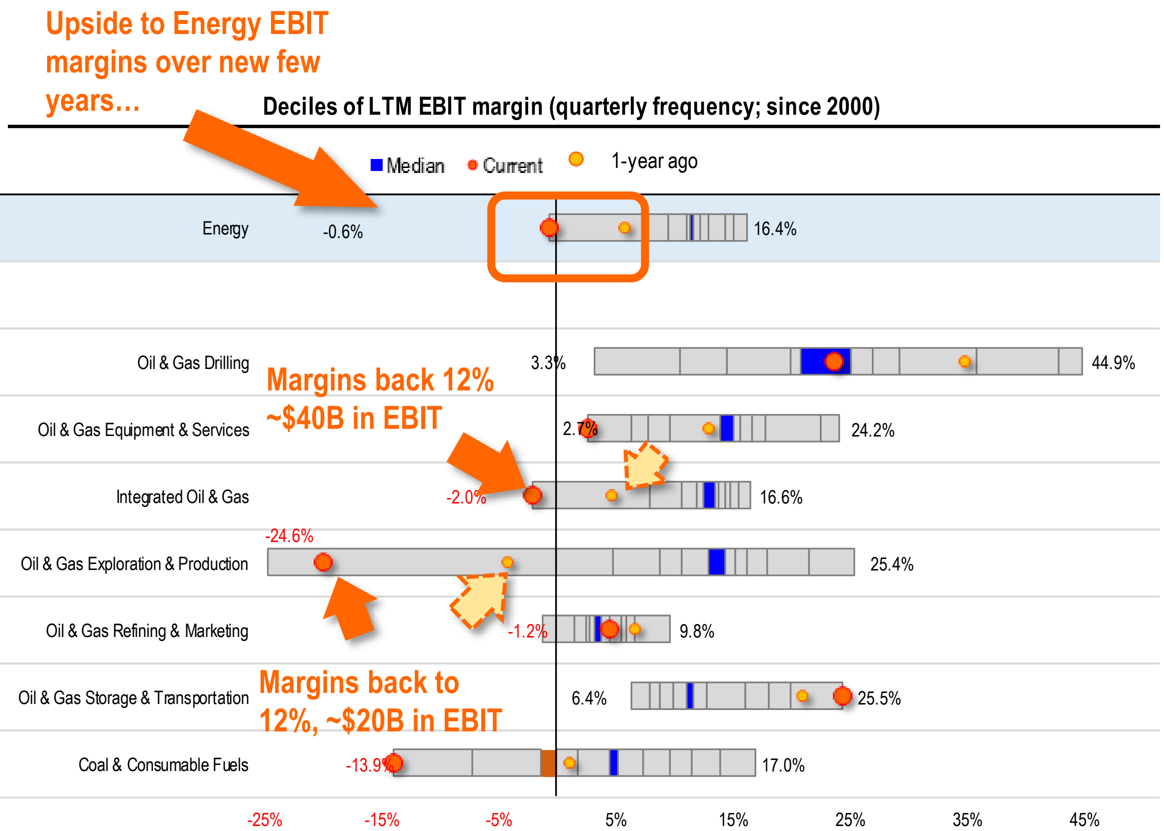
Energy margins are ZERO, *recovery* adds another $7 in 2017

Another big lever to pull is the normalization of profit margins for Energy companies. As shown below, the profit margins of Integrateds and E&Ps are depressed due to the rapid decline in oil prices—look how swiftly margins fell over the past 12 months.

- **A normalization of margins in 2017 for Integrateds and E&Ps could add $60B in EBIT over next 12 months and $5-$8 per S&P 500 share, depending on the magnitude of NOLs.**

Figure: Deciles of Energy Sector EBIT margins
Since 1999

	% of total sector Sales		% of total sector EBIT		Market cap weight	
	Total Sales ($ mm)	% of total sector Sales	Total EBIT ($ mm)	% of total sector EBIT	Total mkt cap ($ mm)	% weight in sector
Energy	$729,844	100%	($4,421)	100%	$1,334,353	100%
Oil & Gas Drilling	$6,662	1%	$1,583	-36%	$12,000	1%
Oil & Gas Equipment & Services	$64,490	9%	$1,721	-39%	$207,841	16%
Integrated Oil & Gas	$315,221	43%	($6,432)	145%	$592,753	44%
Oil & Gas Exploration & Production	$91,167	12%	($18,146)	410%	$333,341	25%
Oil & Gas Refining & Marketing	$221,641	30%	$10,131	-229%	$106,989	8%
Oil & Gas Storage & Transportation	$28,654	4%	$7,002	-158%	$81,430	6%
Coal & Consumable Fuels	$2,009	0%	($280)	6%	n/a	n/a



Source: Fundstrat, Bloomberg.

Healthcare and Energy CDS both outperforming Markit Index

Similarly, we have seen strong performance of credit default swaps (CDS) for Energy and Healthcare.

- **Yet, we see a significant divergence between Energy CDS (rising) and Energy equities (collapsing).**
- **In our view, this divergence favors Energy equities.**

Figure: Comparative Performance of Energy and Healthcare equities and CDS (vs benchmark)
Past 12 months

Source: Fundstrat, Bloomberg, Factset

Energy & Healthcare ***best performing*** HY sectors YTD

The comparative returns of the 10 major sectors in HY are shown below, sorted from best to worst.

- **Energy is the second performing sector in HY YTD (behind Healthcare), yet Energy is worst S&P 500 sector YTD, underperforming by 1,200bp.**

Figure: Sector returns in High-yield, sorted best to worst, YTD
Past 12 months

Energy and Healthcare are two best performing sectors…

	Mar '16	Apr '16	May '16	Jun '16	Jul '16	Aug '16	Sep '16	Oct '16	Nov '16	Dec '16	Jan '17	Feb '17	Mar '17	YTD 2017
Overall High Yield	**4.6%**	**3.9%**	**0.6%**	**1.1%**	**2.6%**	**2.1%**	**0.6%**	**0.4%**	**(0.7%)**	**1.8%**	**1.6%**	**1.4%**	**(0.5%)**	**2.58%**
Healthcare	0.2%	2.6%	(0.6%)	(0.1%)	2.3%	1.3%	(0.1%)	(2.0%)	(2.8%)	2.3%	1.8%	3.3%	(1.1%)	**3.95%**
Energy	12.7%	10.4%	1.6%	3.7%	1.5%	3.7%	2.0%	1.4%	(0.1%)	2.9%	2.8%	0.8%	(0.7%)	**2.85%**
Utilities	5.6%	4.9%	(0.0%)	0.6%	3.5%	1.0%	0.0%	0.4%	(2.0%)	1.2%	2.7%	0.5%	(0.3%)	**2.83%**
Materials	6.2%	5.8%	0.4%	1.8%	3.2%	2.1%	1.0%	1.0%	(0.1%)	1.1%	1.9%	1.3%	(0.5%)	**2.77%**
Financials	3.1%	1.9%	0.4%	0.7%	2.3%	1.5%	0.2%	0.3%	(0.8%)	1.5%	1.2%	1.6%	0.0%	**2.76%**
Communications	2.3%	2.1%	0.5%	0.2%	3.5%	2.2%	0.2%	0.1%	(0.4%)	1.8%	1.5%	1.7%	(0.7%)	**2.56%**
Industrials	4.5%	3.4%	0.8%	1.0%	2.4%	2.1%	0.4%	0.9%	0.1%	2.4%	1.3%	1.6%	(0.4%)	**2.50%**
Technology	2.8%	1.3%	1.5%	0.8%	3.4%	2.2%	1.3%	1.0%	(0.4%)	1.6%	0.6%	1.4%	0.0%	**2.02%**
Discretionary	3.6%	2.1%	0.2%	0.4%	2.8%	1.6%	0.5%	0.3%	(0.8%)	1.2%	0.9%	1.1%	(0.4%)	**1.58%**
Staples	2.7%	2.0%	0.6%	0.5%	2.3%	2.4%	(0.0%)	0.4%	(1.0%)	1.2%	1.0%	1.1%	(0.6%)	**1.43%**

Source: Fundstrat, FactSet, Bloomberg.

Click here to jump ahead

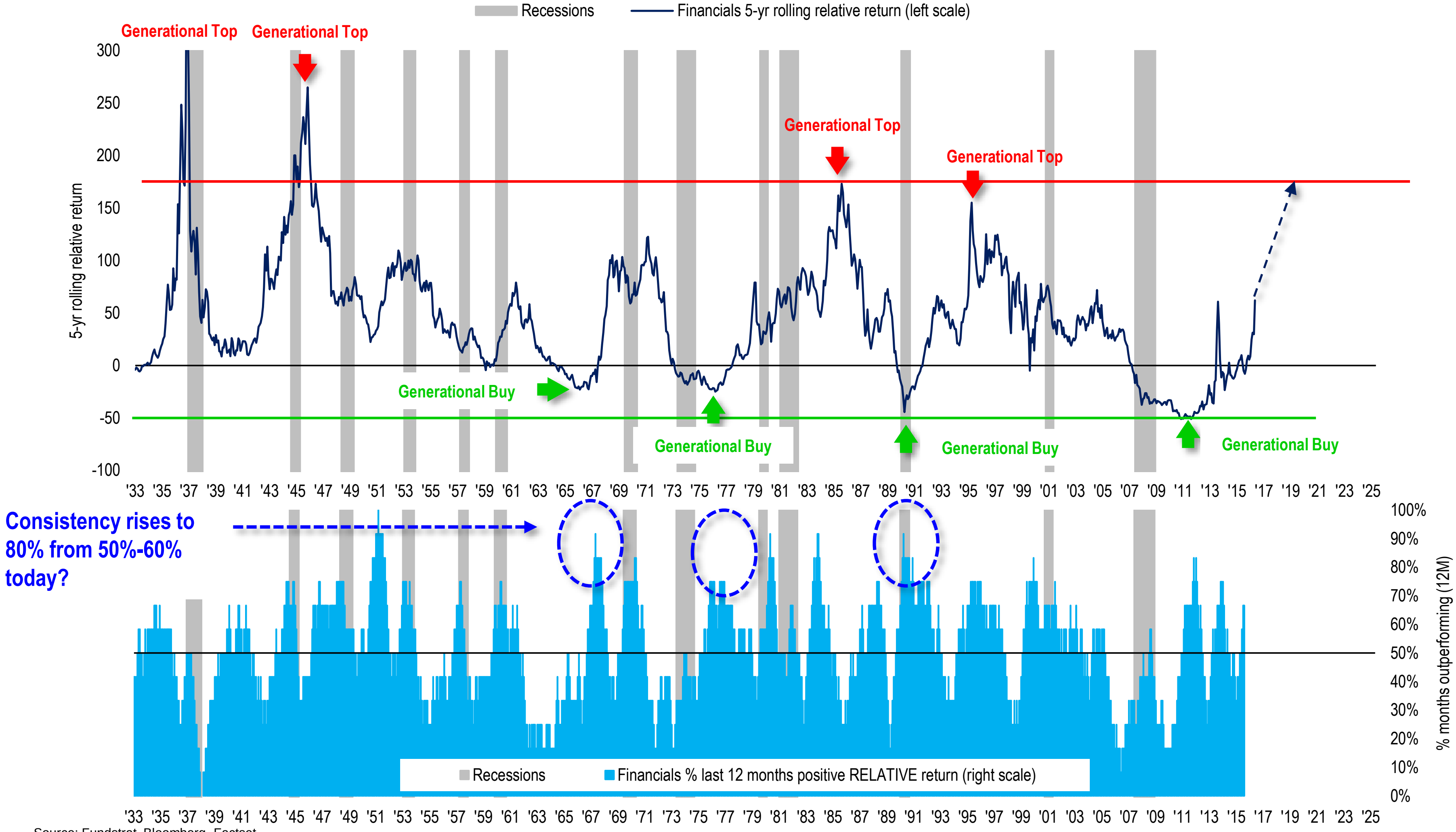
Summary	Pent-up demand	De-regulation	Labor markets	Credit, etc.	Valuation
Factors	CRAP	FANG	Laggards	Stocks new bonds	Sectors

Financials made a "generational low" in 2012, and nobody believed it

Financials made a similar low in 2012—and few investors really embraced the sector in 2012.

- **Bottoms are always choppy and even in 2016, as many banks traded below tangible book, investors remained skeptical.**

Figure: Rolling 5-yr returns Financials (vs S&P 500) and "win-ratio" % months positive
Since 1933



Source: Fundstrat, Bloomberg, Factset

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Financial can gain *at least 90%* from here

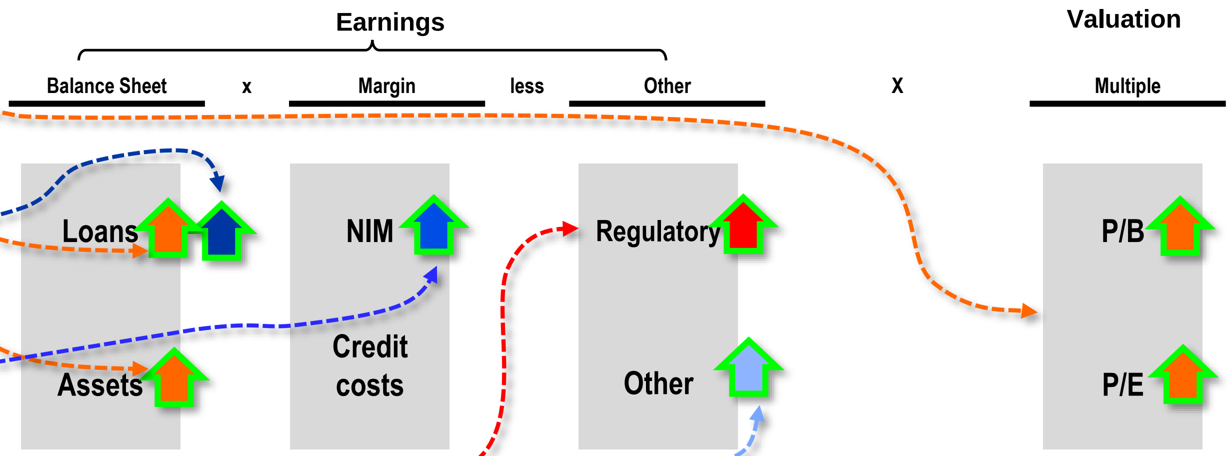
Macro outlook — CEO confidence, Capex growth

Loan Growth — Improved demand, GDP growth

NIM / rates — Higher NIM, Re-investment rate

Regulation — Potential for reduced costs

Taxes — Expected net reduction



Net income upside

+$40B to +$60B

2016 Net Income: $180B

+$15B | **+$10B to $18B** | **+$15B**

Equity upside

	15x	$750B
P/B	1.0X	$2.0T
Upside		$2.8T
		+90%

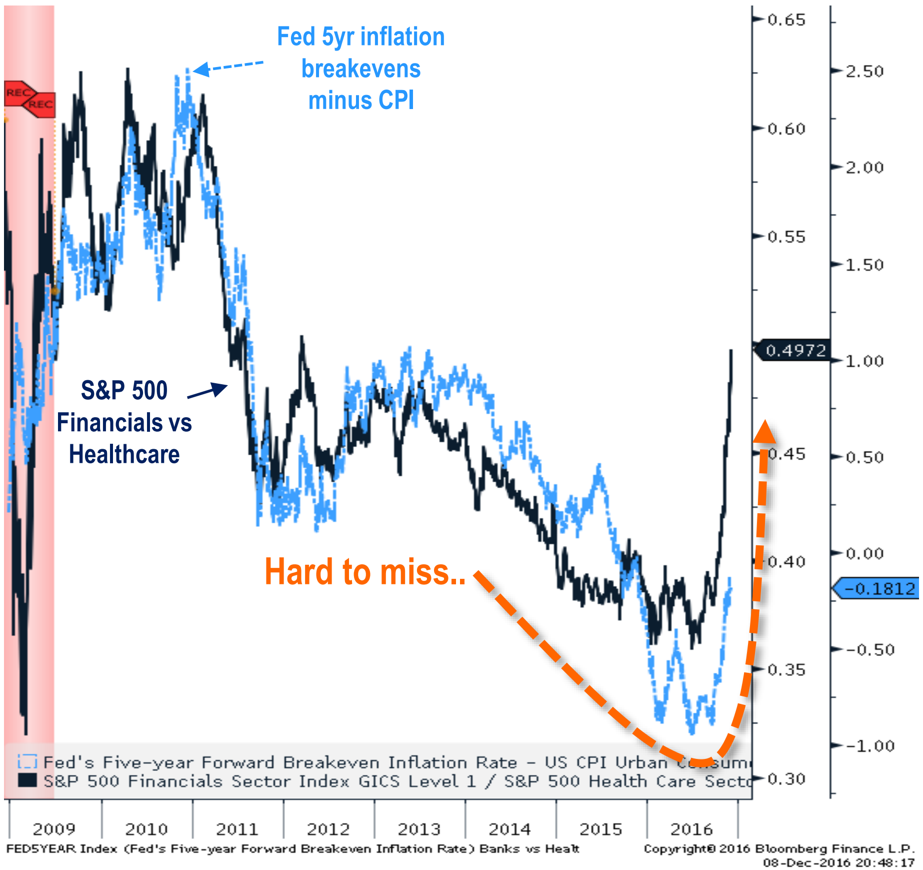
Financials can still double…

Portfolio Strategy: See this rotation into Banks from Healthcare?

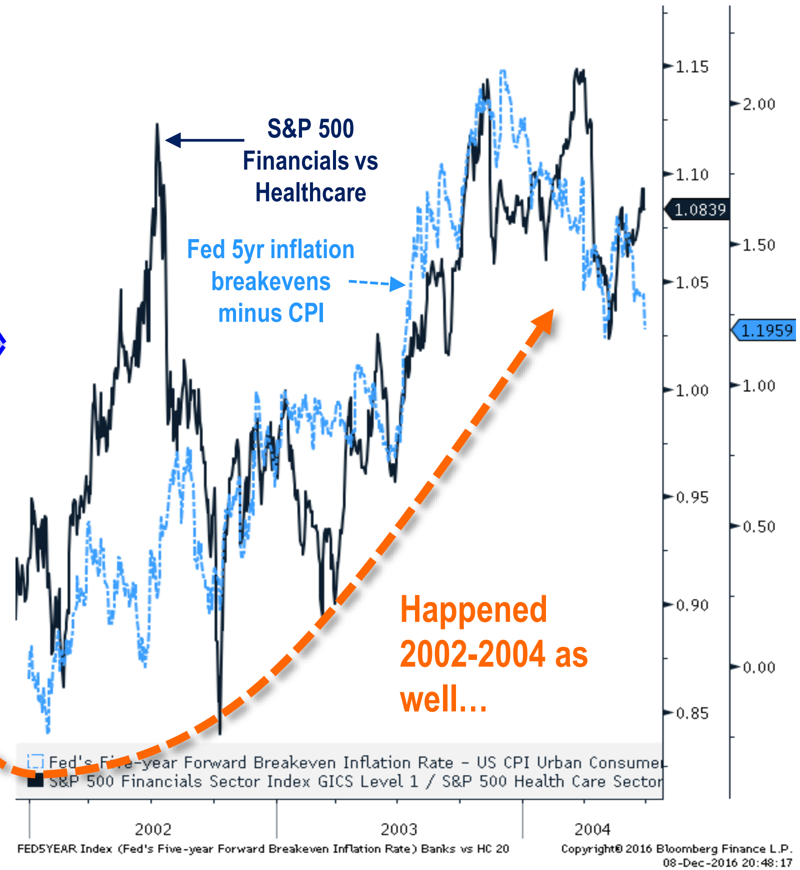
- **The logic is that rising inflation raises interest rates (good for banks), higher investment spend (good for banks) and coupled with overall GDP growth (less good for Healthcare). Hence, this rotation.**

Figure: The rising in inflation expectations should drive a multi-year rotation into Banks
Light blue line: Fed 5-yr breakevens less CPI. Dark line: S&P 500 Financials vs Healthcare

Since 2009, inflation premia has explained rotation between Banks and Healthcare…



In 2002, when inflation rose, this same rotation into Banks from Healthcare took place…



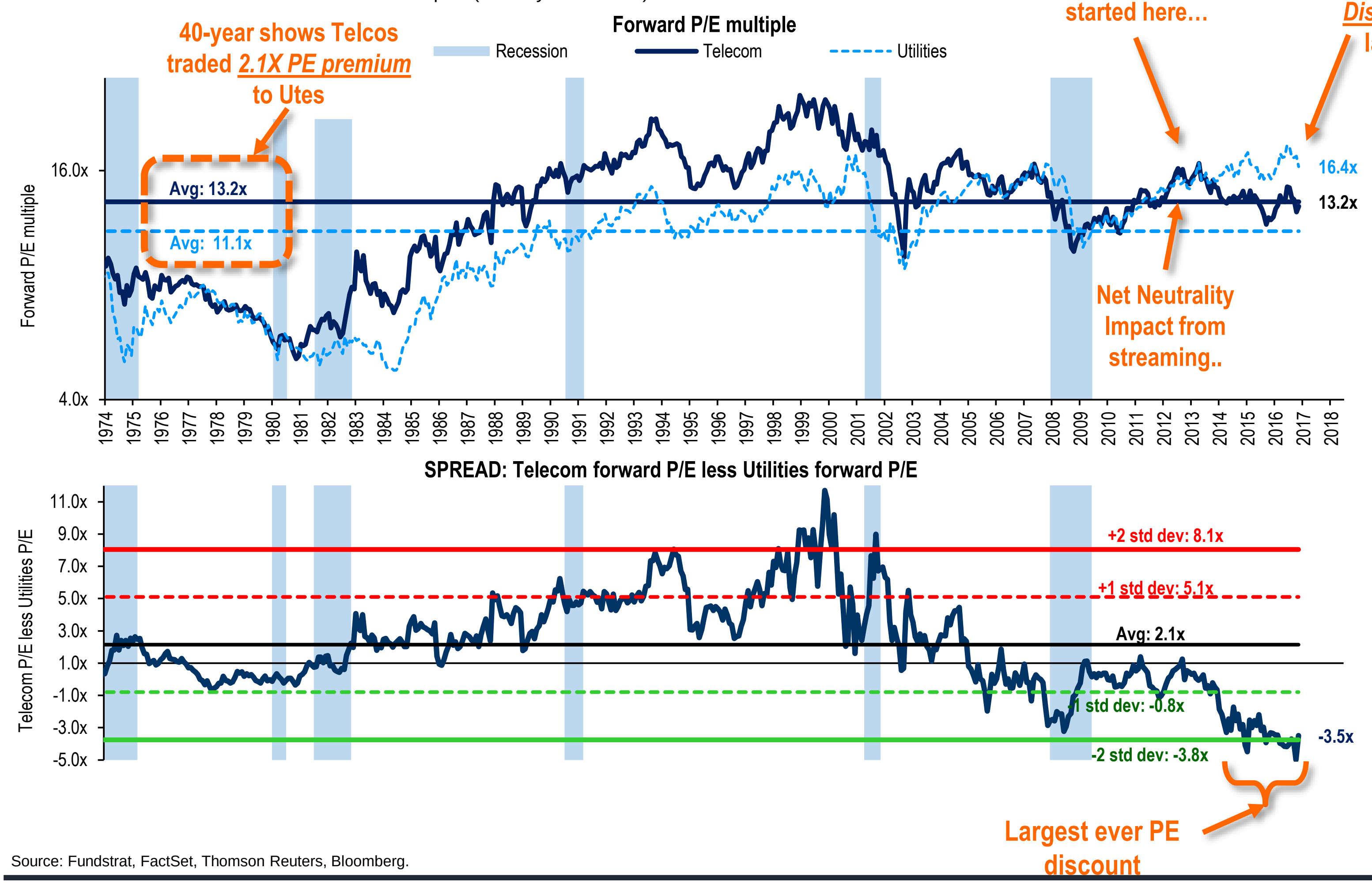
Source: Fundstrat, Bloomberg, Factset

Telcos vs Utilities: Simple as playing PE convergence ~45% upside…

We have highlighted the comparative 40 year PE of Telcos and Utilities. And as shown, we expect to see a convergence of PE

- **The convergence we see is a 6.4X P/E rise of Telcos (vs Utilities) and would be a 45% upside move in Telecoms.**

Figure: CONVERGENCE OF PE: Comparative NTM PE Telecom vs Utilities
Differential of Telecom vs. Utilities sector P/E multiples (monthly since 1974)



The convergence is 6.4X P/E if Telcos (vs Utes) revert to the 40-year PE relationship.

Such a move is 45% upside to Telecom stocks

Source: Fundstrat, FactSet, Thomson Reuters, Bloomberg.

FANG 2nd *largest* point contributor YTD, behind Technology

In the column labeled "f," we highlight the excess point contributions of each sector, treating FANG as a sector.

- **As shown below, FANG contributed 10 excess points to the S&P 500 return YTD—second only to Technology.**
- **Think of it this way—FANG is 6.4% of the market value of S&P 500. Its point contribution is 15.5%. The ratio of performance YTD versus base market value is 2.42X.**
- **Consumer Discretionary, ex-AMZN/NFLX, slips from 6.2% YTD to 4.9% (flat with market). Technology, ex-FB/GOOG, is still the best performing sector.**

Figure: Comparative "excess" points contribution to S&P 500 performance YTD
YTD

			a	b	c = b*SPX price on 12/31/16	d	e = (c*d)	f = e - (b*SPX point chg)	
		Sector	Mkt cap ($ mm) on 12/31/16	Weight	S&P 500 point value	% price chg	Contribution to point chg	**Excess point contribution**	**Rank**
		S&P 500	**$20,026,066**	**100.0%**	**2,345**	**4.8%**	**106.4**	**—**	**—**
Cyclicals	C	FANG	$1,280,415	6.4%	150	11.0%	16.5	**9.7**	**2**
	C	Technology ex-FB, GOOG	$3,264,689	16.3%	382	8.6%	32.7	**15.4**	**1**
		Consumer Disc. ex-AMZN, NFLX	$2,066,201	10.3%	242	4.9%	11.9	**0.9**	**4**
		Industrials	$2,041,068	10.2%	239	4.6%	11.0	**0.2**	**6**
	R	Basic Materials	$567,031	2.8%	66	5.7%	3.8	**0.8**	**5**
Near-	R	Energy	$1,478,066	7.4%	173	-4.1%	(7.1)	**(14.9)**	**12**
Cyclicals	A	Financials	$2,873,001	14.3%	336	4.5%	15.3	**0.0**	**7**
		Real Estate	$574,687	2.9%	67	2.2%	1.5	**(1.6)**	**9**
Defensives		Healthcare	$2,672,422	13.3%	313	6.2%	19.5	**5.3**	**3**
		Consumer Staples	$2,079,721	10.4%	244	4.0%	9.7	**(1.4)**	**8**
		Utilities	$612,727	3.1%	72	0.9%	0.6	**(2.6)**	**10**
	P	Telecom Services	$516,038	2.6%	60	-5.5%	(3.3)	**(6.1)**	**11**

FANG's relative strength added 9 *EXCESS POINTS*, or nearly 10% of the upside to the market

Technology is the largest contributor of *EXCESS POINTS* YTD for the S&P 500

Discretionary sees *YTD slip by 150bp* when AMZN/NFLX taken out.

Source: Fundstrat, Bloomberg, Factset

STOCK SELECTION: *Alternative* FANG

We identified 21 stocks that, over 5 years, showed consistent y/y absolute stock price performance and revenue growth, with revenue and EPS CAGRs more than 2x their sector medians, and market cap per employee in the top 3rd of their sector range.

Figure: Alternative FANG

		Company information												Fundamentals & Valuation				
								Analyst Ratings									
		Ticker	Company name	Current Price	Mkt cap ($ mm)	3m avg daily liquidity ($ mm)	YTD perf (relative to S&P 500)	FC Mean (5=Buy 1=Sell) [1]	Mean implied upside [2]	Dividend Yield	Issuer Rating	Short interest % of float	2018E sales growth [3]	2018E EPS growth [3]	Price	P/E ('18E)	ROE
Discretionary	1	MTN	Vail Resorts Inc	$179.36	$7,166	$68.4	6.3%	4.56	3%	2.0%	NR	3.3%	6%	11%	$179.36	31.3x	14%
	2	NVR	Nvr Inc	$1,899.02	$7,034	$45.6	9.1%	3.00	1%	--	BBB+	1.6%	8%	15%	$1,899.02	12.9x	33%
	3	SIRI	Sirius Xm Holdings Inc	$4.91	$23,128	$117.9	5.4%	4.16	6%	--	—	16.6%	6%	25%	$4.91	22.0x	—
Industrials	4	ALK	Alaska Air Group Inc	$96.02	$11,842	$114.5	3.7%	4.43	13%	1.4%	BB+	6.5%	8%	9%	$96.02	11.2x	34%
	5	AOS	Smith (A.O.) Corp	$49.63	$8,632	$52.7	0.0%	4.14	5%	--	—	3.0%	8%	9%	$49.63	21.7x	22%
	6	MIDD	Middleby Corp	$137.48	$7,911	$61.6	2.1%	4.22	7%	--	—	6.0%	7%	10%	$137.48	22.6x	22%
Technology	7	AVGO	Broadcom Ltd	$207.58	$82,820	$528.3	12.6%	4.84	5%	2.0%	BBB-	1.4%	6%	9%	$207.58	13.5x	1%
	8	LRCX	Lam Research Corp	$114.10	$18,580	$206.3	3.5%	4.60	14%	1.1%	BBB	7.2%	-1%	-5%	$114.10	13.1x	18%
	9	STMP	Stamps.Com Inc	$128.60	$2,193	$27.4	7.4%	5.00	19%	--	—	23.3%	15%	-3%	$128.60	16.8x	25%
Materials	10	CMP	Compass Minerals Internation	$78.75	$2,661	$21.4	-4.2%	3.22	-1%	3.7%	BB	18.9%	6%	34%	$78.75	16.8x	26%
	11	IFF	Intl Flavors & Fragrances	$123.84	$9,836	$75.0	0.4%	3.59	7%	2.1%	BBB+	5.2%	6%	10%	$123.84	19.3x	27%
	12	STLD	Steel Dynamics Inc	$37.19	$9,067	$141.9	-0.2%	4.18	9%	1.6%	BB+	5.0%	0%	4%	$37.19	14.1x	17%
Energy	13	FANG	Diamondback Energy Inc	$109.22	$9,846	$159.8	3.4%	4.63	18%	--	B+	5.4%	49%	63%	$109.22	19.4x	5%
	14	LNG	Cheniere Energy Inc	$46.80	$10,996	$106.5	8.3%	4.69	13%	--	BB-	7.9%	29%	1005%	$46.80	50.2x	—
Financials	15	MKTX	Marketaxess Holdings Inc	$191.59	$7,200	$39.9	25.7%	3.75	-6%	0.6%	—	1.2%	15%	22%	$191.59	39.4x	29%
	16	SCHW	Schwab (Charles) Corp	$41.43	$54,923	$351.5	0.3%	4.57	10%	0.8%	A	1.7%	13%	23%	$41.43	21.3x	13%
	17	WAL	Western Alliance Bancorp	$52.38	$5,504	$32.8	3.0%	4.82	6%	--	—	1.5%	12%	16%	$52.38	15.3x	15%
Real Estate	18	ADC	Agree Realty Corp	$48.21	$1,261	$8.9	0.0%	4.45	6%	4.1%	—	3.7%	16%	6%	$48.21	27.2x	7%
Staples	19	STZ	Constellation Brands Inc-A	$158.01	$31,001	$305.6	-1.6%	4.30	12%	1.1%	BBB-	3.9%	7%	13%	$158.01	18.7x	20%
Healthcare	20	ABMD	Abiomed Inc	$113.99	$4,963	$51.2	-3.5%	4.56	17%	--	—	4.8%	—	—	$113.99	#N/A	13%
Telecoms	21	TMUS	T-Mobile Us Inc	$60.61	$50,096	$259.0	0.7%	4.31	8%	--	BB	8.0%	6%	38%	$60.61	25.0x	5%
		Average			$17,460	$132.2	3.9%	4.29	8%	2%		6.5%	11%	66%		21.6x	18%
		Median			$9,067	$75.0	3.0%	4.43	7%	2%		5.0%	7%	12%		19.3x	18%
		% of stocks positive					81%		90%				95%	90%			100%

Source: Fundstrat, Bloomberg, Factset

LAGGARDS TO LEADERS: Regime change is every 7-10 years….

As shown below, regime change, takes place every 7-10 years. Hence, a portfolio manager with a decade of experience likely only has seen one regime change. **Because 2016 has the hallmarks of regime change (USD correlation, commodities bottom, etc), we believe many managers are failing to recognize this transition.**

Figure: Annual relative performance of sectors and styles

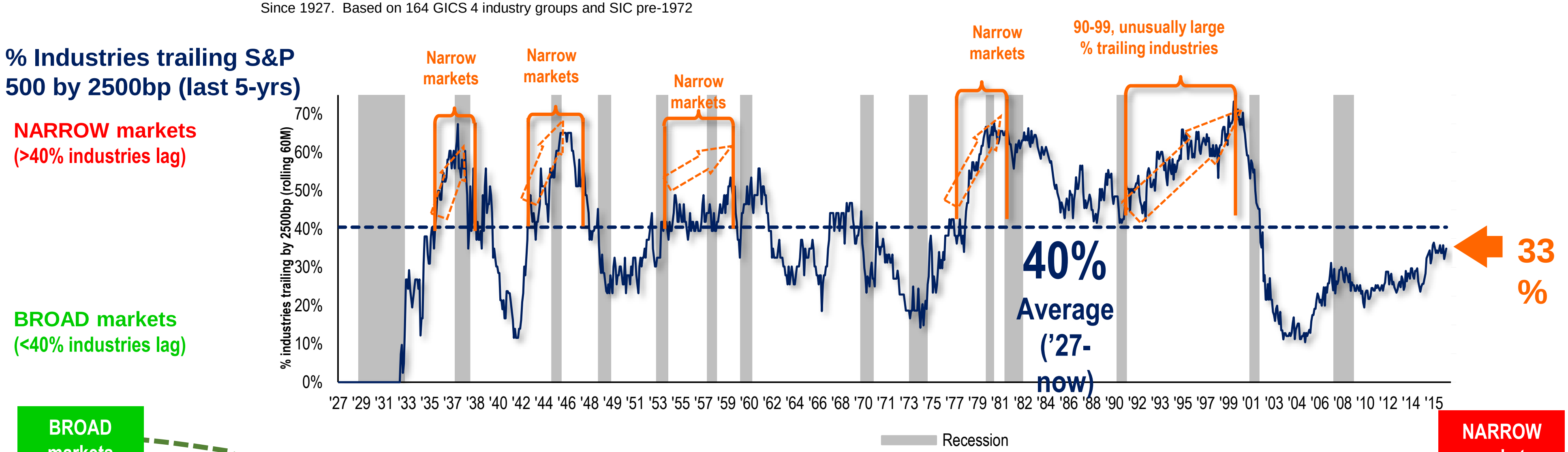
Since 1970 (relative to S&P 500)

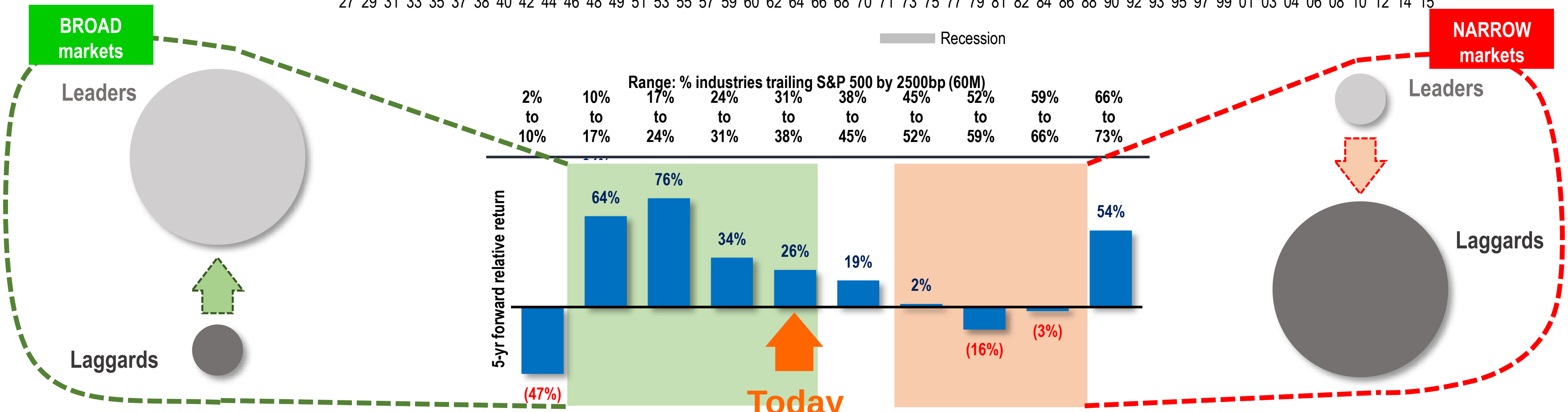
Sector name	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
S&P 500	0	11	16	-17	-30	32	19	-12	1	12	26	-10	15	17	1	26	15	2	12	27	-7	26	4	7
Value							9	3	-1	2	-8	2	-2	5	2	-3	1	-2	4	-6	-4	-8	2	8
Growth							-9	-4	2	-1	11	-4	3	-4	-3	4	-3	2	-3	7	4	9	-2	-8
Pure Value																								
Pure Growth																								
Technology	-32	-4	-13	-3	-7	0	1	5	10	-15	-13	-19	32	9	-13	-7	-31	10	-14	-37	10	-20	-4	13
Semis					-12	42	-14	-15	14	32	16	-45	39	44	-31	-32	-40	34	-30	-25	4	-2	58	46
IT Hardware	-20	-2	9	-6	-7	-1	2	7	9	-20	-17	-17	41	7	-9	-4	-33	3	-10	-46	14	-24	-7	12
IT Software	-14	-6	9	-8	-4	-12	-5	-1	9	5	-29	-9	-9	-9	-16	5	-6	31	-16	-18	9	23	13	19
Consumer Discretionary	-8	14	-3	-19	-9	29	-5	-7	-9	-14	-16	2	26	3	-7	-2	2	-4	7	-11	-11	12	13	6
Industrials	-6	7	-3	0	-10	5	6	3	14	-2	3	-17	0	9	-8	-5	-7	0	-6	-3	-4	0	2	9
Basic Materials	2	-8	-4	15	3	19	-3	-16	-3	7	-11	-13	-13	8	-16	0	9	11	-6	-10	-10	-5	3	3
Financials	1	6	-6	-4	-4	-15	4	4	1	2	-14	12	-4	1	4	16	-5	-16	2	3	-15	18	15	1
REITs	-10	6	-30	-39	-33	92	-20	10	3	60	16	5	23	2	2	25	10	-7	-4	-17	-41	19	8	27
Energy	21	-9	11	22	1	-12	8	6	4	23	33	-27	-38	1	-4	-16	-2	2	6	4	4	-24	-7	4
Healthcare	-27	14	1	-2	5	-14	-17	3	4	-10	-10	7	3	-10	1	8	13	6	1	13	18	24	-23	-18
HC Eq. & Services	-14	28	15	-3	2	-12	-29	7	-1	4	10	0	10	-28	-18	5	1	8	-5	15	18	12	-18	-20
HC Bio, Pharma, Tools	3	2	20	2	14	-32	-2	-3	12	-2	-5	0	-6	-10	3	13	19	2	-2	9	21	26	-23	-18
Consumer Staples	16	7	8	-9	1	0	-10	6	2	-16	-19	15	11	-5	6	6	10	7	2	14	17	12	-1	-13
Utilities	22	-14	-1	-9	-1	4	-2	12	-13	-16	-25	9	0	-5	15	-4	8	-12	2	0	2	-10	-4	1
Telecom	11	-13	9	8	16	-15	6	7	-2	-24	-33	30	-16	-10	19	5	4	-2	6	27	-11	-18	7	4

Sector name	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
S&P 500	-2	34	20	31	27	20	-10	-13	-23	26	9	3	14	4	-38	23	13	0	13	30	11	-1	7
Value	-2	-2	-2	-4	-14	-9	14	0	1	3	4	1	4	-4	-3	-6	0	-3	1	-1	-2	-5	4
Growth	2	2	2	4	14	8	-12	0	-1	-3	-4	-1	-4	4	3	6	0	3	-1	1	2	4	-4
Pure Value			-7	0	-19	-25	19	21	3	11	14	8	4	-10	-11	27	8	-3	10	16	-1	-10	7
Pure Growth			-2	-2	11	40	2	-5	-9	15	7	4	-7	2	-1	26	14	0	1	13	2	2	-4
Technology	21	5	23	-3	51	59	-31	-13	-14	20	-7	-3	-6	12	-5	36	-4	1	0	-3	7	5	2
Semis	18	1	56	-22	38	47	-14	-1	-26	66	-31	7	-22	7	-11	31	-5	-1	-18	4	21	-2	14
IT Hardware	22	4	18	-6	51	57	-25	-22	-18	28	0	-5	1	12	-3	41	-1	0	2	-13	16	-11	3
IT Software	19	6	34	8	53	62	-42	14	-6	-4	2	-5	-6	14	-5	32	-7	3	3	3	-1	17	-1
Consumer Discretionary	-8	-16	-10	1	13	5	-11	15	-1	10	3	-10	4	-18	4	15	13	4	8	11	-3	9	-4
Industrials	-3	2	2	-6	-17	0	15	6	-4	3	7	-3	-3	6	-3	-6	11	-3	-1	8	-4	-4	8
Basic Materials	5	-17	-7	-25	-35	3	-8	14	16	8	2	-1	2	16	[illegible]	22	7	-12	-1	-7	-7	-10	4
Financials	-5	16	12	14	-17	-17	34	3	7	2	-1	1	3	-24	-18	-9	-2	-18	13	4	2	-3	8
REITs	-5	-16	17	-2	-50	-32	31	15	8	-6	13	4	23	-24	-6	-3	15	8	3	-31	15	2	-10
Energy	1	-8	1	-9	-29	-4	23	1	10	-4	20	26	9	29	3	-12	5	3	-11	-7	-21	-23	11
Healthcare	12	20	-1	11	16	-31	46	0	3	-13	-9	2	-8	2	14	-6	-12	10	2	9	12	6	-9
HC Eq. & Services	7	11	-10	-17	-10	-41	66	8	9	1	8	14	-14	9	1	8	-9	6	0	4	14	8	-3
HC Bio, Pharma, Tools	14	23	1	18	21	-29	41	-2	2	-18	-16	-5	-4	-2	21	-12	-13	13	2	12	11	5	-12
Consumer Staples	8	2	3	0	-13	-36	25	5	17	-17	-3	-2	-2	8	21	-12	-2	11	-6	-7	1	4	-6
Utilities	-16	-9	-20	-13	-17	-32	62	-19	-10	-5	11	10	3	12	7	-17	-12	15	-16	-21	13	-8	1
Telecom	-7	3	-22	6	23	-2	-30	-1	-13	-23	7	-12	19	5	5	-21	0	1	-1	-23	-13	-1	-3

LAGGARDS works best when markets are "broad"…like today

Figure: Forward returns of "lagging industries"
Since 1927. Based on 164 GICS 4 industry groups and SIC pre-1972





Source: Fundstrat, Factset, Bloomberg

Narrowing the 60 worst to 6 laggard industries…

Biggest laggards since 2011 (5-yr) → Fundamentally Attractive → Positive Technical Analysis

Identifying Laggards:

Industries relative performance (vs S&P 500), worst to best
Win-ratio of Industry in past 8 years (vs S&P 500)

Fundamental Analysis:

Groups with trough ROE
Potential for margins to recover
Positive leverage to inflation (and/or)
Positive leverage to de-regulation (and/or)
Positive leverage to investment spending (and/or)

Technical Analysis:
provided by The Stig

Groups showing relative strength improvement
Not extended but timely
Potential for establishing leadership

Bottom Ranked	Industry	5-yr Relative Return	Bottom Ranked	Industry	5-yr Relative Return
1	Coal & Consumable Fuels	(160%)	30	Office Services & Supplies	(41%)
2	Marine	(157%)	31	Residential REITs	(40%)
3	Diversified Metals & Mining	(136%)	32	Hypermarkets & Super Centers	(39%)
4	Oil & Gas Drilling	(129%)	33	Communications Equipment	(38%)
5	Gold	(126%)	34	Trading Companies & Distributo	(37%)
6	Education Services	(117%)	35	Industrial Gases	(37%)
7	Independent Power Producers &	(102%)	36	Soft Drinks	(37%)
8	Homefurnishing Retail	(91%)	37	Specialty Stores	(36%)
9	Oil & Gas Exploration & Produc	(87%)	38	Office REITs	(35%)
10	Department Stores	(83%)	39	Retail REITs	(34%)
11	Precious Metals & Minerals	(83%)	40	Hotel & Resort REITs	(34%)
12	Oil & Gas Storage & Transporta	(81%)	41	Paper Products	(33%)
13	Personal Products	(81%)	42	Motorcycle Manufacturers	(32%)
14	Integrated Oil & Gas	(75%)	43	Metal & Glass Containers	(31%)
15	Apparel, Accessories & Luxury	(68%)	44	Specialized REITs	(29%)
16	Steel	(67%)	45	Construction & Engineering	(29%)
17	Oil & Gas Equipment & Services	(66%)	46	Multi-Utilities	(27%)
18	Casinos & Gaming	(62%)	47	Leisure Facilities	(27%)
19	Aluminum	(61%)	48	General Merchandise Stores	(26%)
20	IT Consulting & Other Services	(59%)	49	Commodity Chemicals	(26%)
21	Health Care Technology	(58%)	50	Auto Parts & Equipment	(26%)
22	Construction Machinery & Heavy	(57%)	51	Leisure Products	(25%)
23	Fertilizers & Agricultural Che	(57%)	52	Electrical Components & Equipm	(23%)
24	Electric Utilities	(53%)	53	Specialized Consumer Services	(19%)
25	Integrated Telecommunication S	(51%)	54	Publishing	(19%)
26	Agricultural & Farm Machinery	(46%)	55	Restaurants	(18%)
27	Automobile Manufacturers	(45%)	56	Commercial Printing	(18%)
28	Household Products	(43%)	57	Diversified REITs	(16%)
29	Computer & Electronics Retail	(41%)	58	Air Freight & Logistics	(16%)

	GICS 4 Code	5-year relative return
Oil & Gas Drilling	10101010	(129%)
Metal & Glass Containers	15103010	(31%)
Fertilizers & Agricultural Chemicals	15101030	(57%)
IT Consulting & Other Services	45102010	(59%)
Diversified Metals & Mining	15104020	(136%)
Marine	20303010	(157%)
Asset Management	40203010	9%
Communications Equipment	45201020	(38%)
Construction Machinery & Heavy	20106010	(57%)
Integrated Oil & Gas	10102010	(75%)
Oil & Gas Equipment & Services	10101020	(66%)
Steel	15104050	(67%)

	GICS 4 Code	5-year relative return
Oil & Gas Drilling	10101010	(129%)
Metal & Glass Containers	15103010	(31%)
Fertilizers & Agricultural Chemicals	15101030	(57%)
IT Consulting & Other Services	45102010	(59%)
Diversified Metals & Mining	15104020	(136%)
Marine	20303010	(157%)

34 ideas from the 6 lagging industries…

Below are the 34 stocks which are in those 6 groups and screen attractively, based on market capitalization over $500 million. We also excluded some companies that were similar to each other to narrow the list.

Figure: 34 stocks

Based on Russell 3000 constituents

		Company information: Ticker	Company name	Current Price	Mkt cap ($ mm)	3m avg daily liquidity ($ mm)	YTD perf (relative to S&P 500)	Analyst Ratings: FC Mean (5=Buy 1=Sell) [1]	Analyst Ratings: Mean implied upside [2]	Growth vs. Value: Value	Growth vs. Value: Growth	Momentum Factor: High	Momentum Factor: Low	Int'l Sales Quartile: Top	Int'l Sales Quartile: Bottom	EBIT Margin z-score	Mkt Cap/ Employee	Free Cash Flow Yield	Beta	Dividend Yield	Issuer Rating	Short interest % of float	Fundamentals & Valuation: 2018E sales growth [3]	2018E EPS growth [3]	P/E ('18E)	ROE
Marine	1	KEX	Kirby Corp	$65.20	$3,511	$38.1	-3.4%	2.83	-11%	x					x	(1.59)	$2,601	0.2%	1.29	--	BBB+	14.4%	7.2%	19.8%	23.6x	7%
	2	MATX	Matson Inc	$35.49	$1,520	$10.4	-1.1%	4.00	26%	x	x		x			0.27	$914		1.24	--	NR	3.0%	3.9%	11.9%	15.9x	20%
It Consulting & Other Services	3	ACN	Accenture Plc-Cl A	$115.78	$75,364	$290.3	-2.6%	4.06	12%		x					1.27	$196	0.3%	0.99	--	A+	1.8%	6.5%	9.0%	18.1x	65%
	4	ACXM	Acxiom Corp	$27.12	$2,101	$8.7	-0.2%	4.71	18%	x	x				x	(0.34)	$605		1.23	--	NR	4.0%	14.9%	47.6%	22.6x	1%
	5	CACI	Caci International Inc -Cl A	$123.70	$3,016	$21.9	-1.9%	3.92	0%	x					x	(1.10)	$152	2.3%	1.07	--	BB+	0.7%	2.9%	7.5%	18.3x	9%
	6	CSC	Computer Sciences Corp	$60.64	$8,539	$105.3	0.6%	3.60	9%	x		x				(0.15)	$145		1.33	--	BBB *-	6.3%	(0.2%)	11.9%	16.8x	-3%
	7	CSRA	Csra Inc	$32.97	$5,388	$40.3	2.1%	4.75	9%		x				x	0.72	$299	1.5%	--	--	BB+	1.7%	4.2%	8.1%	14.7x	23%
	8	CTSH	Cognizant Tech Solutions-A	$56.99	$34,576	$341.5	0.3%	4.14	12%		x		x			(1.92)	$156	2.2%	1.01	--	—	1.6%	10.4%	10.7%	14.0x	16%
	9	IBM	Intl Business Machines Corp	$167.95	$159,696	$581.9	-0.2%	3.31	-4%	x	x			x		0.02	$423	2.7%	1.03	3.3%	AA-	2.7%	(0.3%)	0.7%	12.1x	78%
	10	LDOS	Leidos Holdings Inc	$49.99	$7,517	$67.1	-3.7%	4.27	7%	x	x				x	(0.31)	$418	1.0%	1.07	--	BBB-	2.2%	3.1%	8.3%	14.4x	15%
	11	MANT	Mantech International Corp-A	$40.89	$1,576	$5.4	-4.6%	2.40	-6%	x					x	(0.41)	$219	1.2%	1.12	--	BB+	2.0%	4.7%	8.9%	24.6x	5%
	12	SAIC	Science Applications Inte	$85.05	$3,732	$28.1	-1.1%	3.86	0%		x	x			x	1.05	$249	0.6%	1.21	--	BB	6.8%	2.2%	13.9%	20.7x	37%
	13	TDC	Teradata Corp	$28.45	$3,696	$48.9	3.3%	2.50	-4%		x					(0.02)	$327	(0.6%)	1.28	--	—	14.1%	(0.9%)	3.2%	15.8x	11%
Diversified Metals & Mining	14	CMP	Compass Minerals Internation	$80.90	$2,733	$21.2	1.8%	3.00	-7%	x						(0.91)	$1,378	3.1%	0.87	3.5%	BB	19.5%	6.8%	30.2%	16.6x	19%
	15	MTRN	Materion Corp	$39.10	$780	$4.0	-2.7%	3.00	-18%	x		x				0.22	$318	2.4%	1.27	--	NR	2.8%	12.9%	11.6%	20.9x	5%
Fertilizers & Agricultural Che	16	AVD	American Vanguard Corp	$17.65	$518	$1.8	-9.2%	4.00	-0%	x		x				(0.66)	$1,493		1.31	--	—	3.1%	2.0%	9.7%	23.7x	4%
	17	CF	Cf Industries Holdings Inc	$34.51	$8,045	$163.7	8.2%	3.25	-19%	x						(2.00)	$2,873	(1.7%)	1.32	3.5%	—	13.7%	7.3%	158.3%	26.6x	2%
	18	FMC	Fmc Corp	$59.29	$7,935	$49.6	3.4%	3.68	-3%	x	x	x		x		0.23	$1,323	1.5%	1.10	1.1%	BBB	3.0%	5.0%	11.7%	16.0x	-1%
	19	MON	Monsanto Co	$107.33	$47,070	$212.6	0.6%	4.29	13%	x	x					(0.30)	$1,953		0.75	2.2%	BBB *+	1.0%	4.4%	14.2%	19.9x	41%
	20	MOS	Mosaic Co/The	$31.41	$11,001	$139.0	5.7%	2.48	-20%	x						(1.24)	$1,236	(0.3%)	1.18	3.6%	BBB-	9.1%	5.4%	32.5%	25.6x	5%
	21	SMG	Scotts Miracle-Gro Co-Cl A	$92.94	$5,579	$51.9	-4.1%	4.11	8%	x	x					(0.32)	$1,094	(5.6%)	0.83	--	BB	6.1%	4.3%	12.1%	19.6x	48%
Metal & Glass Containers	22	ATR	Aptargroup Inc	$73.33	$4,597	$21.5	-1.6%	3.18	7%	x	x			x		1.65	$354	1.5%	0.79	1.8%	—	3.2%	4.1%	10.7%	20.0x	16%
	23	BLL	Ball Corp	$77.05	$13,469	$95.4	1.2%	4.08	11%		x					(1.66)	$886	3.3%	0.99	0.7%	BB+	5.6%	1.6%	17.6%	15.3x	11%
	24	GEF	Greif Inc-Cl A	$53.80	$2,867	$11.9	3.4%	2.33	-4%	x		x				(0.38)	$232		1.13	3.1%	BB	6.7%	1.9%	9.5%	16.5x	8%
	25	OI	Owens-Illinois Inc	$19.04	$3,088	$49.9	8.0%	3.25	12%		x			x		0.01	$114	13.2%	1.39	--	BB	3.7%	1.7%	10.2%	7.0x	23%
	26	SLGN	Silgan Holdings Inc	$53.27	$2,933	$23.4	2.7%	3.00	-1%		x					1.19	$305		0.84	1.2%	BB+	5.7%	1.3%	9.3%	15.0x	23%
Oil & Gas Drilling	27	ATW	Atwood Oceanics Inc	$14.05	$1,102	$46.7	5.6%	2.30	-25%	x		x				(1.64)	$1,175	(0.1%)	1.90	0.0%	B+	33.6%	(10.1%)	(217.0%)	nm	9%
	28	DO	Diamond Offshore Drilling	$19.49	$2,673	$50.3	8.7%	2.51	-10%	x				x		(0.23)	$786	3.6%	1.55	0.0%	BB+	29.3%	(12.9%)	(96.1%)	nm	-18%
	29	HP	Helmerich & Payne	$79.01	$8,547	$128.2	0.7%	2.91	-8%	x		x				(4.00)	$2,077	0.6%	1.42	3.5%	BBB+	17.0%	33.3%	113.7%	nm	-1%
	30	NBR	Nabors Industries Ltd	$17.52	$4,966	$97.0	5.4%	4.19	5%	x		x				(1.81)	$368	(0.1%)	1.77	1.3%	BBB-	6.5%	31.2%	103.2%	nm	-21%
	31	PTEN	Patterson-Uti Energy Inc	$28.32	$4,194	$88.5	3.8%	3.84	-0%	x		x			x	(2.92)	$1,234	(0.7%)	1.31	0.3%	—	15.8%	46.5%	64.7%	nm	-12%
	32	RDC	Rowan Companies Plc-A	$20.19	$2,533	$53.6	5.5%	3.14	-17%	x						(0.46)	$724	3.3%	1.45	0.0%	B+	20.0%	(12.0%)	(167.6%)	nm	10%
	33	RIG	Transocean Ltd	$15.84	$6,167	$176.0	6.1%	2.44	-22%	x				x		0.18	$678	(2.3%)	1.62	--	—	15.2%	(3.7%)	(142.3%)	nm	8%
	34	UNT	Unit Corp	$26.87	$1,383	$15.8	-1.4%	3.89	3%	x		x			x	(0.47)	$1,173	1.4%	2.34	--	B+	12.4%	35.3%	126.2%	12.2x	-32%
		Average			**$13,306**	**$90.9**	**1.2%**	**3.45**	**-1%**									**1%**	**1.24**	**2%**		**8.7%**	**7%**	**8%**	**18.0x**	**13%**
		Median			**$3,963**	**$49.8**	**0.7%**	**3.46**	**-0%**									**1%**	**1.23**	**2%**		**5.9%**	**4%**	**11%**	**16.8x**	**9%**
		% of stocks positive					**59%**		**47%**														**79%**	**88%**		**79%**

Source: Fundstrat, FactSet, Thomson Reuters, Bloomberg.

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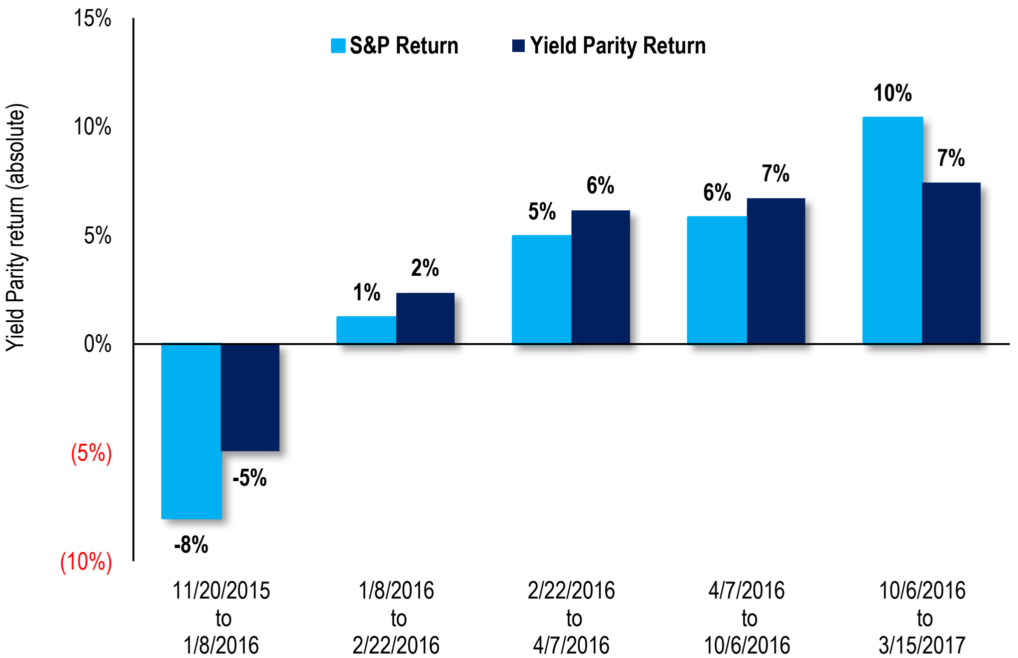
"Stocks are the new bonds" still delivering positive annualized gains

We have tabulated the relative performance of the "stocks are the new bonds" portfolio since November 2015, highlighting the annualized returns after each successive update.

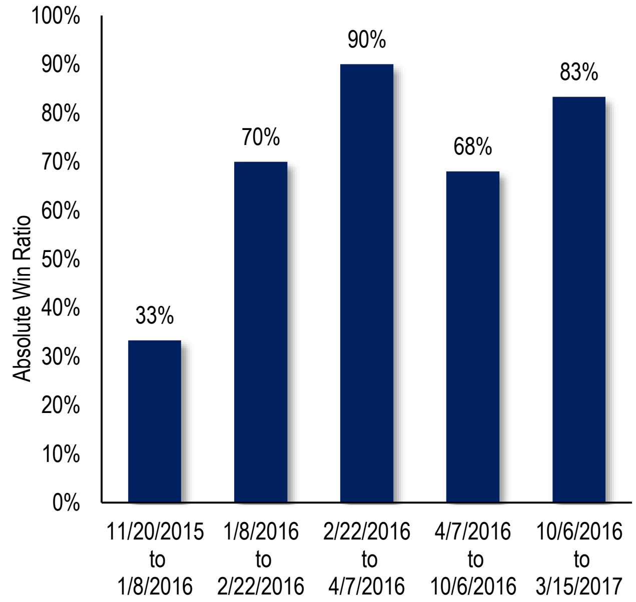
- **As highlighted, the performance of this strategy has been relatively robust—although in the most recent period, the S&P 500 has added 10% while the strategy only gained 7%. In other words, while the strategy delivered positive returns, it did not keep up with this most recent Trump surge.**
- **The rationale, as we noted in our original report (see "Equities are the new bonds in 2016" dated 11/20/2015) is that US companies should not have a higher dividend yield than their equivalent bond yield—after all, the default risk is the same.**

Figure: Annualized return (absolute)



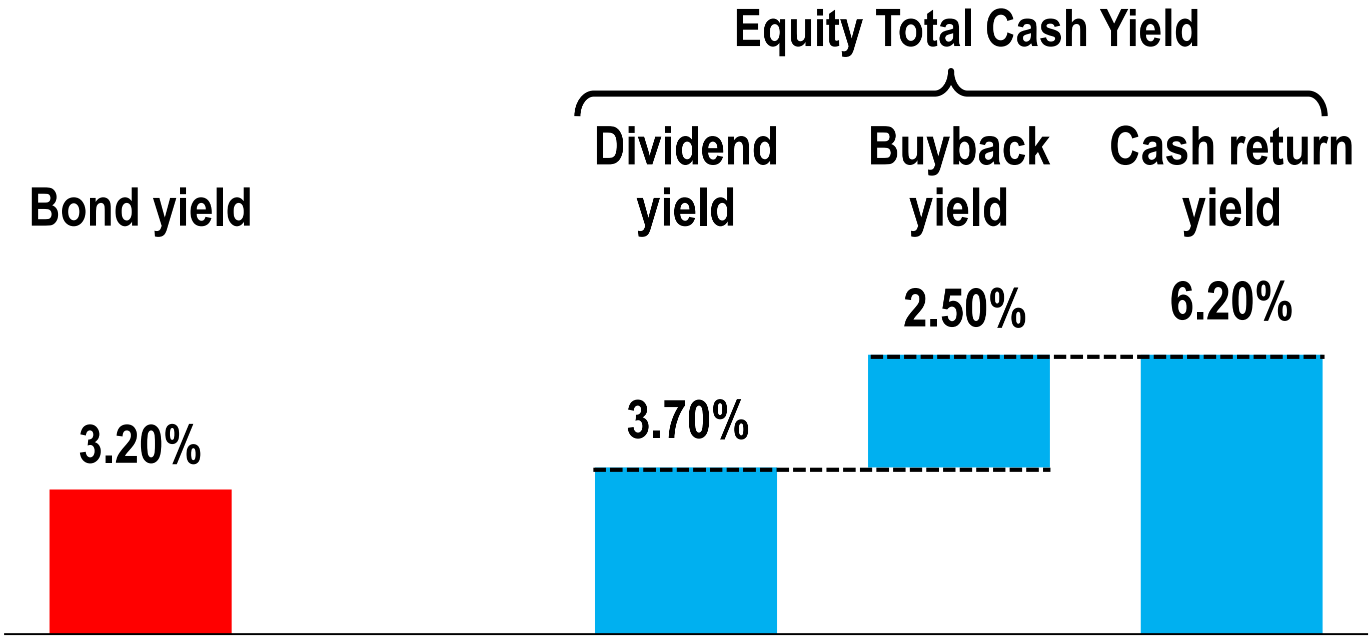
Source: Fundstrat, Bloomberg, FactSet.

Figure: Absolute win ratio



Source: Fundstrat, Bloomberg, FactSet.

The margin of safety:
Cash return *well ahead* of bond yield

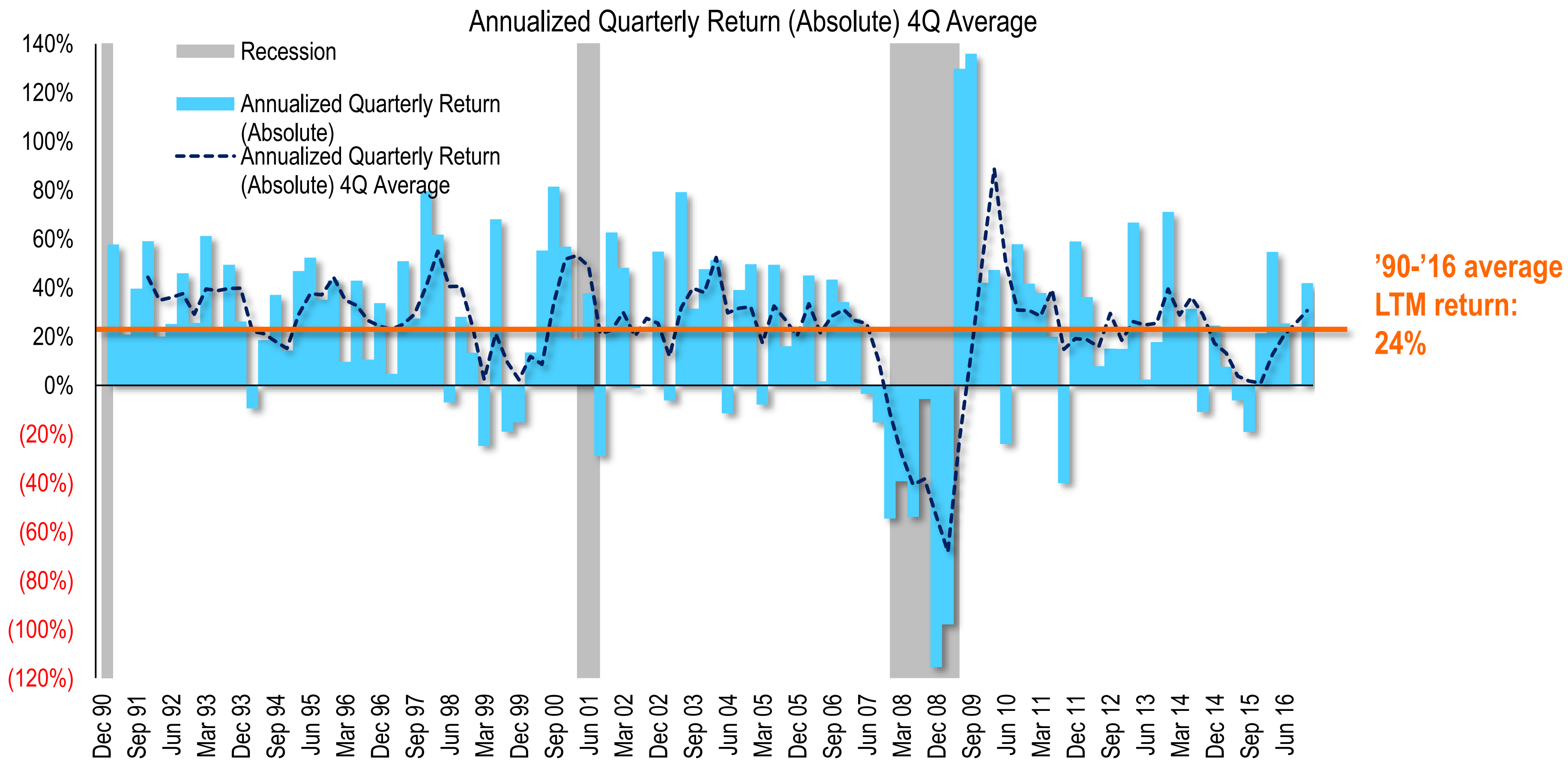


Since 1990, Yield parity had positive TTM returns 93% of quarters

Not surprisingly, yield parity (aka "Stocks are the new bonds") posted positive trailing 12M returns in most quarters since 1990. In fact, the only period where rolling returns were negative was during 2008.

- **The average 12M rolling return since 1990 has been 24%. Notably, returns in recent years are pretty close to those seen in earlier decades—suggesting the opportunity created by high dividend yield has seen consistent resolution. That is, the stock ends up rising.**

Figure: Annualized quarterly return (absolute) 4Q average
Since 1990. Based on S&P 500 constituents



Source: Fundstrat, Bloomberg, Factset

Does this work when *interest rates are rising*?

Dividend (2) / Stock Price (4) *versus* (3) ~~Coupon~~ / Bond Price (1)

		Inflation accelerates	Fed raises rates	Default Risk rises
1	Bond Price	↓	↓	Single-A rated
2	Dividend	↑↑	↑↑	stable
3	Stock Yield vs Bond Yield	same	same	same
4	Stock Price	↑↑	↑↑	stable

Figure: Change in Dividend per share and Change in Dividend Yield under different inflation scenarios
Since 1945

Median Yr+1 Dividend per Share % Change

Decelerating Δ <=-0.1	Picking Up Δ 0 to 1.9	Accelerating Δ >=2
4.9%	7.1%	9.2%

Median Yr+1 Delta in Dividend Yield (bp)

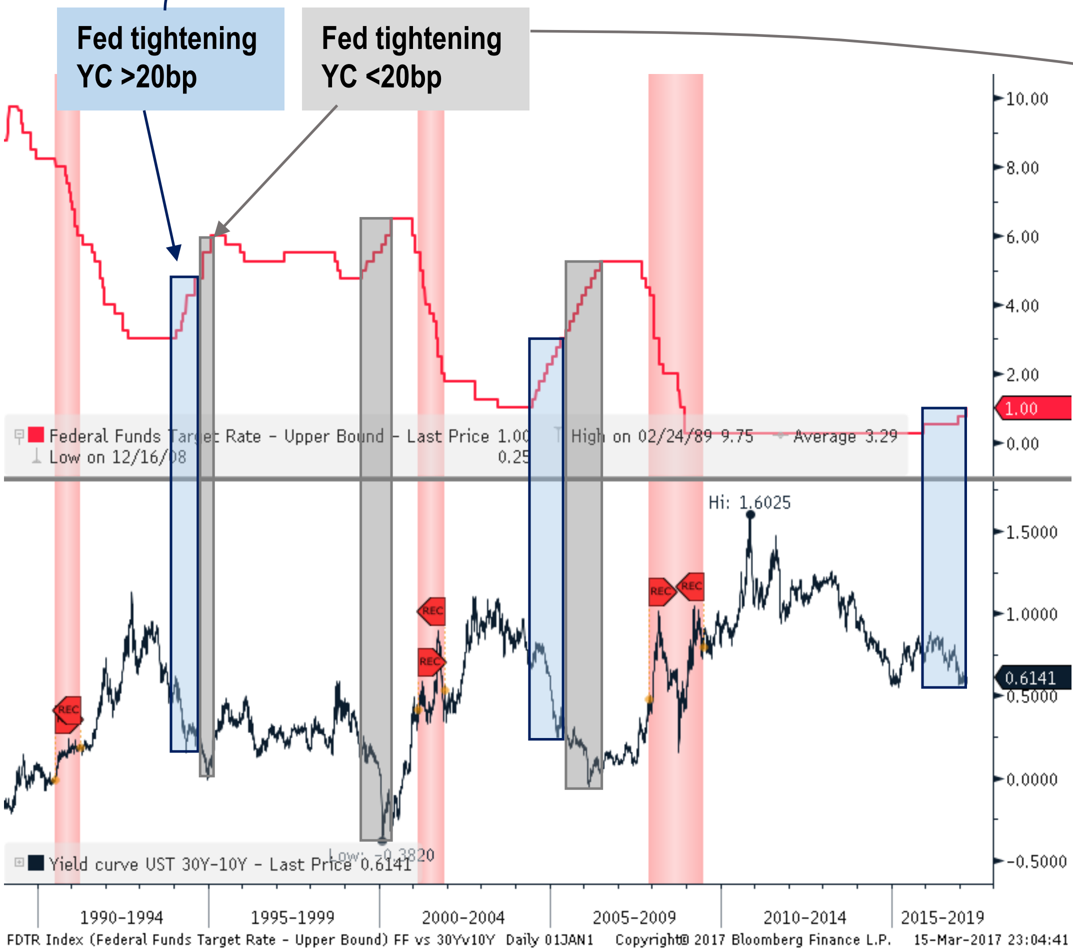
Decelerating Δ <=-0.1	Picking Up Δ 0 to 1.9	Accelerating Δ >=2
(9bp)	(1bp)	(1bp)

Yield Parity performance *improves* during Fed tightening cycles

We plotted the performance of yield parity during different Fed regimes (grid on the right).

- **Notably, when Fed is tightening, overall returns are superior on yield parity stocks—2,500bp annually (83% win-ratio). But the performance is even stronger when yield curve is <20bp.**

Figure: Yield Parity 1-Year forward relative (to S&P 500) performance during Fed cycles



12 Month Forward Performance

Long Term Yield Curve (30 Yr less 10 Yr) / Fed Policy

	Tightening	Easing	All Instances
>20 bps	18%	15%	15%
<20 bps	34%	4%	18%
All Instances	25%	13%	16%

12 Month Forward Win Ratio

Long Term Yield Curve (30 Yr less 10 Yr) / Fed Policy

	Tightening	Easing	All Instances
>20 bps	73% (11 / 15)	84% (58 / 69)	82% (69 / 84)
<20 bps	100% (9 / 9)	36% (4 / 11)	65% (13 / 20)
All Instances	83% (20 / 24)	78% (63 / 81)	80% (83 / 104)

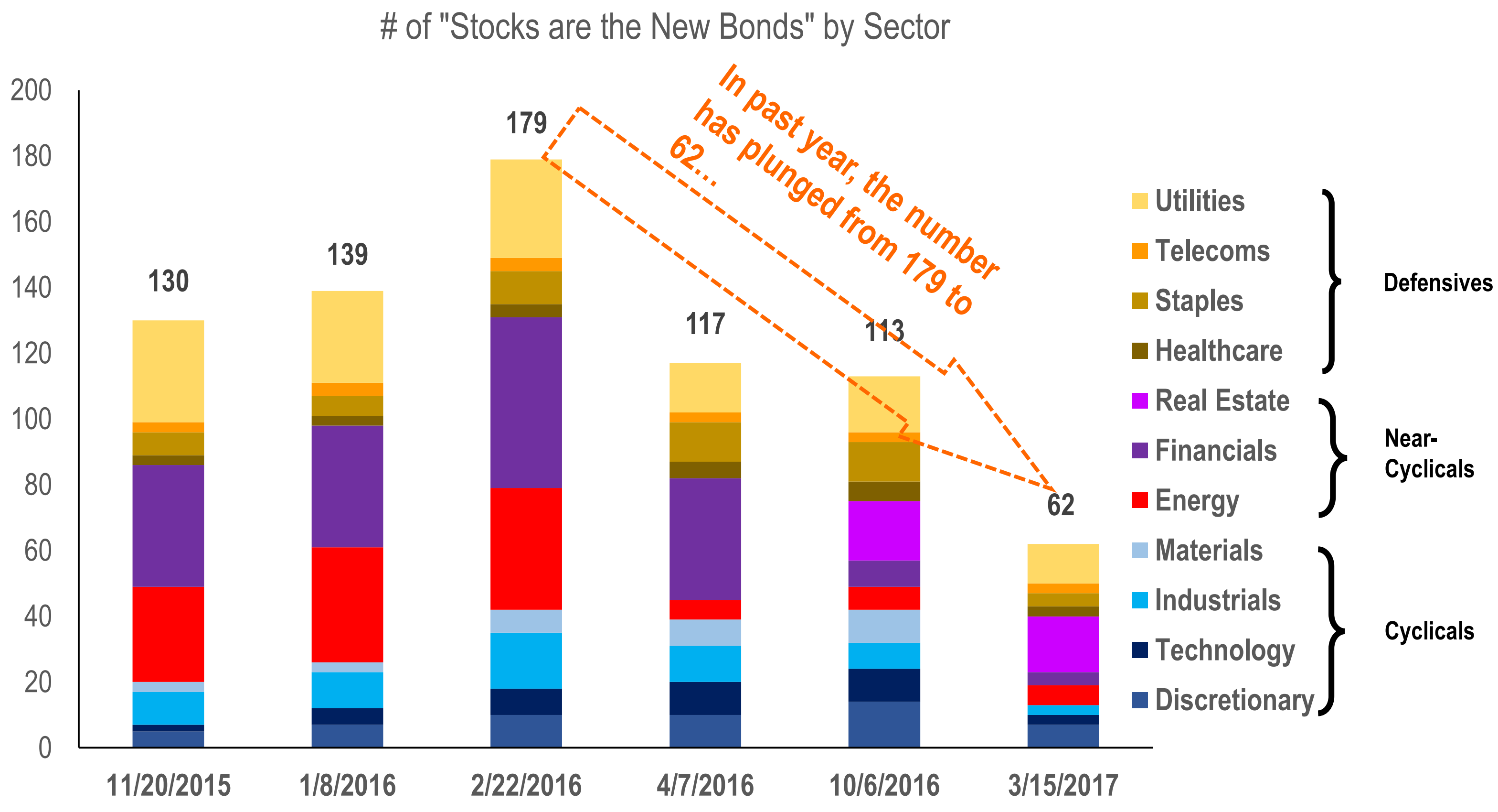
Source: Fundstrat, Bloomberg, Factset

Rising bond yields and stock prices = fewer "stocks are the new bonds"

As shown below, there are now 62 major US companies with a dividend yield exceeding their bond yield. This is down from the 113 in October 2016. The chart below shows a breakdown of companies.

- **There are clearly fewer opportunities today—a function more of rising stock prices (pushes div yield down) rather than higher bond yields. Real Estate, Utilities, Discretionary and Energy now make up the biggest components.**

Figure: Number of "stocks are the new bonds" have fallen since the election
Sector composition of "Stocks are the new bonds" since 11/20/2015



Source: Fundstrat, Bloomberg, FactSet.

Portfolio Strategy: Stay OW "Stocks are the bonds"–New List

Stocks are the New Bonds Screening Criteria

a. US Listed stocks with Market Cap >$5B
b. S&P Issuer Credit Rating of A- or better
c. Regular Dividend Yield > Issuer's own weighted average Bond Yield

Company information

									a	b	c = a + b	d = a + 0.25*b	e	f = a - e	g = d - e		
		Ticker	Company name	Current Price	Mkt cap ($ mm)	3m avg daily liquidity ($ mm)	YTD perf (relative to S&P 500)	Dividend Payout Ratio	Dividend Yield	Special Dvd + Buyback Yield	CASH RETURN Yield	Adj CASH RETURN Yield	Adj Wgt Avg Bond Yield	Dvd Yld less Bond Yield	Adj CASH RETURN less Bond Yield	2018E P/E	Issuer Rating
Discretionary	1	TGT	Target Corp	$54.59	$30,171	$452.8	-30.9%	50.9%	4.4%	11.9%	16.3%	7.4%	3.3%	107	405	13.4x	A
Industrials	2	CAT	Caterpillar Inc	$92.85	$54,455	$473.9	-6.3%	--	3.3%	1.7%	5.1%	3.8%	3.3%	-1	43	21.1x	A
	3	GE	General Electric Co	$29.75	$259,084	$917.2	-12.3%	99.2%	3.2%	8.5%	11.7%	5.4%	2.9%	35	248	15.6x	AA-
Technology	4	CSCO	Cisco Systems Inc	$34.23	$171,419	$653.1	6.8%	44.2%	3.4%	2.0%	5.4%	3.9%	2.9%	51	101	13.7x	AA-
	5	IBM	Intl Business Machines Corp	$177.24	$167,175	$619.9	0.3%	44.2%	3.2%	2.1%	5.2%	3.7%	2.9%	28	80	12.5x	AA-
Energy	6	CVX	Chevron Corp	$107.86	$204,190	$718.5	-14.8%	--	4.0%	0.0%	4.0%	4.0%	2.9%	113	113	17.1x	AA-
	7	OXY	Occidental Petroleum Corp	$63.82	$48,777	$331.2	-16.9%	--	4.8%	0.0%	4.8%	4.8%	3.3%	144	145	33.1x	A
	8	XOM	Exxon Mobil Corp	$82.07	$340,304	$1,007.6	-15.5%	158.8%	3.7%	0.2%	3.9%	3.7%	2.9%	78	83	17.1x	AA+
Financials	9	IVZ	Invesco Ltd	$32.68	$13,197	$100.5	1.3%	53.9%	3.4%	4.3%	7.8%	4.5%	3.3%	10	118	12.0x	A
Real Estate	10	PLD	Prologis Inc	$50.94	$26,925	$134.5	-10.0%	76.7%	3.5%		3.5%	3.5%	3.3%	15	15	39.2x	A-
	11	SPG	Simon Property Group Inc	$169.40	$54,180	$334.4	-11.1%	110.7%	4.1%	0.5%	4.6%	4.3%	3.3%	81	93	23.7x	A
Staples	12	PG	Procter & Gamble Co/The	$91.44	$233,764	$786.5	2.3%	76.8%	2.9%	7.7%	10.6%	4.8%	2.9%	5	196	22.2x	AA-
	13	WMT	Wal-Mart Stores Inc	$70.44	$216,476	$641.0	-4.5%	45.5%	2.9%	4.6%	7.4%	4.0%	2.9%	2	115	15.5x	AA
	14	KO	Coca-Cola Co/The	$42.25	$181,338	$579.8	-4.6%	92.6%	3.5%	2.1%	5.6%	4.0%	2.9%	62	114	21.8x	AA-
	15	PM	Philip Morris International	$112.70	$174,841	$438.5	16.7%	92.3%	3.7%	0.0%	3.7%	3.7%	3.3%	37	37	21.1x	A
Healthcare	16	ABBV	Abbvie Inc	$65.90	$105,039	$438.6	-1.2%	64.4%	3.9%	7.8%	11.7%	5.8%	3.3%	56	251	10.2x	A-
	17	MRK	Merck & Co. Inc.	$64.18	$176,211	$674.6	2.6%	131.0%	2.9%	1.9%	4.9%	3.4%	2.9%	5	54	15.3x	AA
	18	PFE	Pfizer Inc	$34.43	$205,035	$809.1	-0.5%	101.6%	3.7%	2.3%	6.0%	4.3%	2.9%	84	141	12.4x	AA
Telecoms	19	VZ	Verizon Communications Inc	$50.04	$204,000	$770.1	-12.7%	70.8%	4.6%	0.0%	4.6%	4.6%	3.8%	85	85	12.6x	BBB+
Utilities	20	AEP	American Electric Power	$66.01	$32,458	$144.4	-1.6%	181.9%	3.6%	0.0%	3.6%	3.6%	3.3%	25	25	17.0x	A-
	21	DUK	Duke Energy Corp	$81.62	$57,102	$242.2	-1.3%	90.7%	4.2%		4.2%	4.2%	3.3%	87	87	16.9x	A-
	22	OGE	Oge Energy Corp	$36.62	$7,313	$31.5	3.0%	68.2%	3.3%	0.0%	3.3%	3.3%	3.3%	-2	-2	17.9x	A-
	23	PPL	Ppl Corp	$36.74	$24,973	$113.7	1.4%	54.2%	4.3%	0.0%	4.3%	4.3%	3.3%	98	98	15.8x	A-
	24	SO	Southern Co/The	$50.19	$49,186	$222.5	-4.4%	85.9%	4.5%	0.0%	4.5%	4.5%	3.4%	106	106	16.1x	A-
	25	XEL	Xcel Energy Inc	$43.58	$22,105	$98.6	0.6%	61.6%	3.3%	0.1%	3.5%	3.3%	3.3%	-2	2	17.8x	A-
	26	WEC	Wec Energy Group Inc	$59.71	$18,844	$101.3	-4.7%	66.5%	3.5%		3.5%	3.5%	3.3%	16	16	18.2x	A-
		Average			$118,406	$455.2	-4.6%	83.6%	3.7%	2.5%	5.9%	4.2%	3.2%	51	106	18.1x	
		Median			$81,071	$445.7	-3.0%	76.7%	3.5%	1.7%	4.7%	4.0%	3.3%	44	95	16.9x	
		% of stocks positive					35%										

Deletions...

Ticker	Company Name	Rel. Perf since 10/6/16
VFC	Vf Corp	(11.9%)
BA	Boeing Co/The	22.6%
UTX	United Technologies Corp	0.4%
HON	Honeywell International Inc	(0.6%)
MMM	3M Co	1.0%
DOV	Dover Corp	(2.7%)
ITW	Illinois Tool Works	2.9%
ADP	Automatic Data Processing	9.2%
INTC	Intel Corp	(18.2%)
QCOM	Qualcomm Inc	(23.7%)
TXN	Texas Instruments Inc	4.9%
APD	Air Products & Chemicals Inc	(9.7%)
PX	Praxair Inc	(12.2%)
NUE	Nucor Corp	21.9%
AMP	Ameriprise Financial Inc	19.6%
BEN	Franklin Resources Inc	8.4%
BLK	Blackrock Inc	(1.6%)
BBT	Bb&T Corp	10.3%
AVB	Avalonbay Communities Inc	(0.4%)
EQR	Equity Residential	(7.0%)
PSA	Public Storage	(4.8%)
CLX	Clorox Company	2.6%
KMB	Kimberly-Clark Corp	(0.8%)
HSY	Hershey Co/The	4.5%
PEP	Pepsico Inc	(6.0%)
MO	Altria Group Inc	12.1%
DHR	Danaher Corp	1.3%
BMY	Bristol-Myers Squibb Co	(5.7%)
BMY	Bristol-Myers Squibb Co	(5.7%)
LLY	Eli Lilly & Co	(5.0%)
T	At&T Inc	(1.5%)
ES	Eversource Energy	1.8%
NEE	Nextera Energy Inc	1.4%
Average		**0.2%**

5 New names

Deletions outperformed by ~45bp annualized in a rising rate environment

Source: Fundstrat, Bloomberg, FactSet.

Consumer Discretionary sector EBIT margins

Focus on the "low margin" players like AMZN and margin growers like household durables.

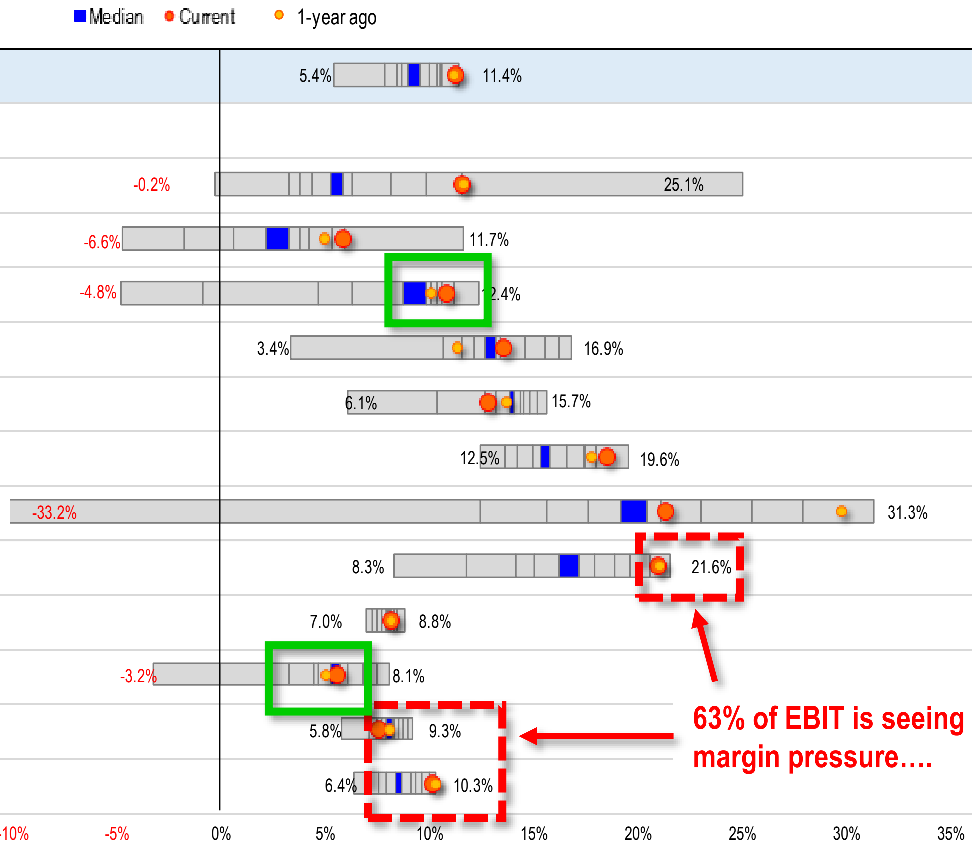
- **63% of the EBIT margins are in sectors facing enormous margin pressures.**

Figure: Deciles of Consumer Discretionary sector EBIT margins

Since 1999

% contribution to sector Sales		% contribution to sector EBIT		Market cap weight		
Total Sales ($ mm)	% of total sector Sales	Total EBIT ($ mm)	% of total sector EBIT	Market cap ($ mm)	% weight in sector	
$1,667,758	100%	$188,398	100%	$2,620,806	100%	Consumer Discretionary
$40,641	2%	$4,720	3%	$39,097	1%	Auto Components
$318,806	19%	$18,744	10%	$108,089	4%	Automobiles
$75,456	5%	$8,188	4%	$99,140	4%	Household Durables
$10,470	1%	$1,421	1%	$20,860	1%	Leisure Products
$71,167	4%	$9,144	5%	$136,721	5%	Textiles, Apparel & Luxury Goods
$115,081	7%	$21,357	11%	$339,241	13%	Hotels, Restaurants & Leisure
$3,029	0%	$648	0%	$4,837	0%	Diversified Consumer Services
$286,148	17%	$60,114	32%	$684,262	26%	Media
$23,749	1%	$1,943	1%	$23,014	1%	Distributors
$155,572	9%	$8,729	5%	$575,145	22%	Internet & Catalog Retail
$171,781	10%	$12,993	7%	$88,779	3%	Multiline Retail
$395,858	24%	$40,398	21%	$501,619	19%	Specialty Retail

Deciles of LTM EBIT margin (quarterly frequency; since 2000)



Source: Fundstrat, Factset, Bloomberg

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Healthcare sector EBIT margins

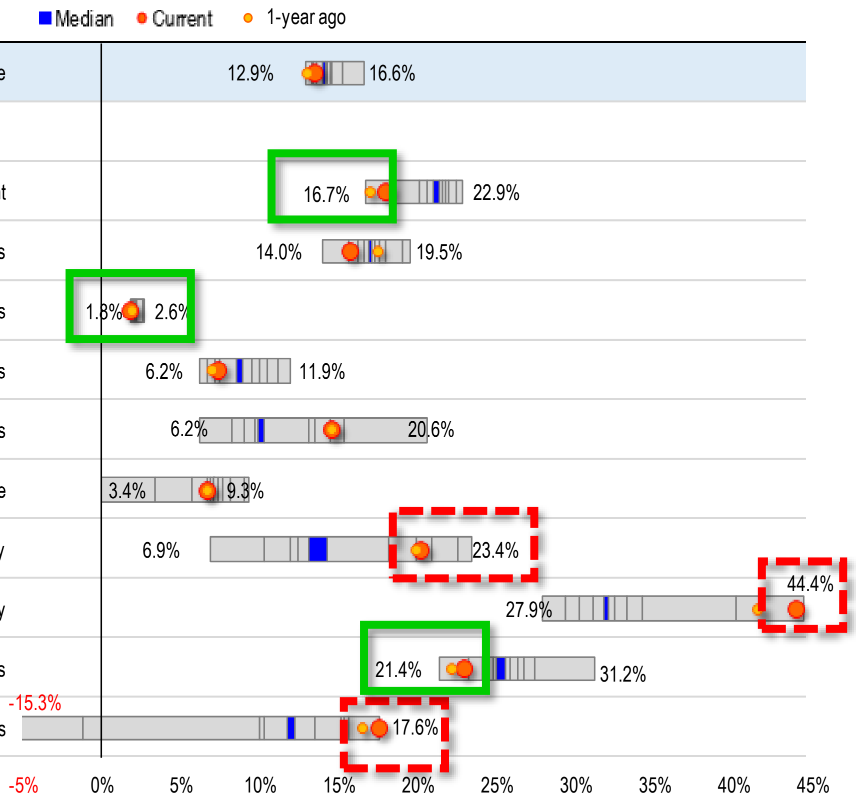
The groups most attractive, in our view, are those with lower EBIT margins.

- **This suggest we should favor groups like Pharma, HC equipment and distributors.**

Figure: Deciles of Healthcare sector EBIT margins

Since 1999

% contribution to sector Sales		% contribution to sector EBIT		Market cap weight		Deciles of LTM EBIT margin (quarterly frequency; since 2000)
Total Sales ($ mm)	% of total sector Sales	Total EBIT ($ mm)	% of total sector EBIT	Market cap ($ mm)	% weight in sector	
$1,658,522	100%	$193,343	100%	$2,887,279	100%	Healthcare
$137,067	8%	$24,638	13%	$521,147	18%	Health Care Equipment
$5,387	0%	$846	0%	$24,166	1%	Health Care Supplies
$483,554	29%	$8,884	5%	$93,355	3%	Health Care Distributors
$136,334	8%	$10,011	5%	$86,548	3%	Health Care Services
$49,982	3%	$7,279	4%	$41,180	1%	Health Care Facilities
$456,303	28%	$30,888	16%	$329,097	11%	Managed Health Care
$4,714	0%	$953	0%	$18,596	1%	Health Care Technology
$110,365	7%	$48,559	25%	$588,963	20%	Biotechnology
$243,406	15%	$55,760	29%	$1,050,784	36%	Pharmaceuticals
$31,411	2%	$5,526	3%	$133,443	5%	Life Sciences Tools & Services



Source: Fundstrat, Factset, Bloomberg

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Positive (+): The analyst expects the performance of his industry/sector coverage universe over the next 6-18 months to be attractive vs. the relevant broad market benchmark, being the S&P 500 for North America.

Neutral (N): The analyst expects the performance of his or her industry/sector coverage universe over the next 6-18 months to be in line with the relevant broad market benchmark, being the S&P 500 for North America.

Negative (-): The analyst expects his or her industry coverage universe over the next 6-18 months to underperform vs. the relevant broad market benchmark, being the S&P 500 for North America.

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