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STATE OF THE MARKET
Brexit biggest risk, but still…"stocks are the new bonds"

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Executive Summary

Key calls

Global Markets

Credit and Commodities

State of the Economy

Earnings Outlook

Equity Strategy

Sectors and Styles

Key thoughts: Still a case for 2H16 rally in equities.

We highlight 6 incremental developments below, which support the case for a 2H16 rally:

1. **Brexit base case still enables markets to climb higher as Brexit (without EU contagion) is less of a global risk than oil at $26.**
2. **The 5% sell-off in two days historically is associated with "knee-jerk" reactions. Since 1940, when this took place while the S&P 500 was above its 50D and 200D (9 times), stocks rallied 9 of 9 times in next 3 months—average gain is 7%.**
3. **EPS recovery driven by recovery in exports and aided by weaker USD. Energy EPS does not yet reflect the recovery in the oil price deck.**
4. **USD while buffeted by policy rates is still following inflation more closely. Markets discount policy and growth divergences. And seems to be underestimating inflation.**
5. **High-yield markets are on track to be up 12% and stocks have always returned gains.**
6. **Global search for carry is driving "stocks as new bonds"**

Focus on YIELD PARITY: We like stocks with dividend yields > their own bond yield. Stick with Value and stocks correlated to HY.

WHAT COULD GO WRONG?

There are many issues potentially becoming so significant that the economy and markets succumb to the risks**:**

- **Brexit becomes EU contagion:** Clearly greatest concern for investors at the moment.
- **Policy uncertainty:** A broader issue for markets is the inability to track policy risk which has grown in frequency in past few years.
- **China:** China is navigating an extremely challenging balance of slowing credit growth/expansion while transitioning growth from an investment-oriented to consumption oriented model. The structural changes over the past decade have resulted in China and its EM neighbors increasingly operating as an ecosystem, with the US less affected by “shocks” in China.
- **Commodity producers:** Commodity producers are seeing increasing financial stress, stemming from falling volumes and prices, currency weakening and diminished confidence by capital markets.
- **Deflation:** Falling inflation and the pernicious effects of deflation weigh on markets– particularly since debt burdens become very difficult to manage in a falling pricing environment.
- **Credit cycle:** Default expectations have risen in 2016, stemming concerns about falling commodity prices and reduced market liquidity. Investors have pulled nearly $80 billion from high-yield mutual funds over the past 18 months.
- **Central bank policy divergence:** Lastly, investors worry about policy errors from Central Banks. The Fed might resume tightening while other major countries are easing. Hence, the fear of a continued surge in USD and therefore more headwinds to US corporates.

2Q16 Strategies: 4 of 6 outperforming

The quarter to date performance of our 6 strategies is highlighted below. As noted 4 of 6 strategies are beating the S&P 500.

- These strategies are market agnostic (not directional) and take advantage of macro conditions that we believe are improving.
- **In general, we believe these strategies will do better if the S&P 500 reaches new highs, but we still see these as market agnostic.**

Figure: Fundstrat Portfolio Strategy Recommendations for 2Q16

Fundstrat Theme	Execution of Strategy	Representative Tickers	Avg 2Q16 performance: Absolute	Avg 2Q16 performance: Relative
1. Laggards become Leaders	***Long:*** Leisure products, Trucking, Healthcare Services, Life Science Tools	**Leisure Products**: BC	-7.2%	-7.7%
		Trucking: UHAL	4.9%	4.4%
		Healthcare Services: DGX, ESRX, LH, MD	10.9%	10.3%
		Life Science Tools: BIO, PKI, Q, TECH, VWR	4.8%	4.3%
	Avoid: Gold stocks, Utilities	**Laggards become Leaders total:**	**5.9%**	**5.4%**
2. Quality spread rally (BB vs CCC)	Buy Small-caps (over Large)	Russell 2000 over S&P 500 (IWM over SPY) EM stocks over DM stocks	**1.6%**	**1.0%**
3. USD outright weakens	Buy stocks inverse correlation to USD ***Styles:*** Value ***Sectors***: Energy, Materials, Telecoms	FOSL, LVS, VIAB, FLR, VMI, CAT, CMI, EMR, DOV, KMT, KEX, FLIR, TRMB, IBM, EMN, PX, ALB, RS, XOM, DO, NE, RDC, FTI, OII, SLB, WDR, AXP, L, NFG, MDU	**-1.6%**	**-2.1%**
4. Credit-conditions easing (on oil bottom)	Buy Value and Low-quality	WDC, XRX, FSLR, F, BBY, PHM, AN, TXT, JEC, MOS, BBT, FITB, L, RF, KEY, CMA, LUK, ZION, VLO, MRO, CAH, POM	**-0.9%**	**-1.4%**
5. FANG ends with a "dang"	Buy Value over Momentum	IBM, TXN, MCD, GE, MMM, UNP, DD, LYB, PX, WY, HST, IRM, PFE, LLY, PEP, CL, KMB, GIS, HSY, VZ	**2.1%**	**1.9%**
6. Stocks are the "new bonds"	Cyclicals:	CSCO, IBM, EMR, CAT, GE, UPS, TGT, CMI, QCOM, TXN, PX, BA, INTC, XLNX, MMM, ADP	-0.7%	0.2%
	Near-Cyclicals (Energy/Financials):	HSBC, CVX, XOM, OXY, NOV, PRU, AMP, JPM, WFC, BLK, USB, CME, BBT	2.9%	3.8%
	Defensives:	SO, PM, DUK, KO, PFE, PG, WEC, MRK, ED, ES, XEL, JNJ, D, PPL, HSY, ABBV, MO, PEP, KMB, CL, LLY	2.1%	3.0%
		Stocks new bonds total:	**1.4%**	**2.3%**

4 of 6 strategies beating S&P 500 quarter-to-date…

Source: Fundstrat, Bloomberg.

Staples and Utes not over-valued… other sectors cheaper

The fact that US risky assets (bonds and stocks) have better yields, in our view, is a multi-year relative value tailwind for stocks. And it also means that if this were true, we should expect US yield-oriented stocks to have higher multiples.

- **As shown below, this is indeed the case—Utilities and Staples (both stable groups) have seen their PE soar to 18X-20X today.**
- **We do not necessarily think this is over-valued—rather, it is arguably the "right multiple" to pay for equities. And instead, the rest of the market will gradually re-rate on a relative value basis.**

Figure: Valuation and performance of sectors and styles
As of 5/27/2016

	Name		BBG ticker	YTD performance: Absolute	YTD performance: Relative	P/E multiple: '16E (Y+1)	P/E multiple: '17E (Y+2)	P/E multiple: Z-Score (Y+2)	Div yield	Rel to 10-yr yield
Broad Market Indices	S&P 500		SPX	1.3%	**0.0%**	17.6x	15.5x	0.41	2.2%	70 bp
	Russell 2000		RTY	-0.4%	**-1.7%**	24.9x	19.9x	0.75	1.7%	18 bp
	Value		SVX	3.2%	**1.9%**	16.3x	14.2x	1.12	2.7%	122 bp
	Growth		SGX	-0.5%	**-1.8%**	19.2x	17.1x	1.04	1.7%	18 bp
	Dow Jones Industrial Avg		INDU	1.5%	**0.2%**	16.5x	14.6x	0.38	2.6%	110 bp
	Dow Transports		TRAN	-1.3%	**-2.6%**	12.7x	11.7x	-0.57	1.6%	5 bp
Cyclicals	Technology	OW	S5INFT	-2.2%	**-3.5%**	16.7x	14.9x	-0.10	1.7%	20 bp
	Discretionary	N	S5COND	-0.8%	**-2.2%**	17.7x	15.8x	0.03	1.7%	16 bp
	Industrials	OW	S5INDU	3.1%	**1.8%**	16.4x	15.0x	0.27	2.3%	78 bp
	Materials	OW	S5MATR	4.6%	**3.3%**	17.6x	15.2x	0.79	2.3%	78 bp
Near Cyclicals	Financials	OW	S5FINL	-5.6%	**-6.9%**	13.9x	12.5x	0.54	2.4%	90 bp
	Energy	OW	S5ENRS	13.3%	**12.0%**	97.6x	30.4x	3.32	3.1%	157 bp
Defensives	Healthcare	N	S5HLTH	-1.4%	**-2.7%**	15.9x	14.4x	0.51	1.7%	16 bp
	Staples	UW	S5CONS	6.6%	**5.3%**	21.8x	19.8x	2.25	2.5%	103 bp
	Utilities	UW	S5UTIL	18.6%	**17.3%**	18.6x	18.0x	2.01	3.3%	177 bp
	Telecom	OW	S5TELS	20.0%	**18.7%**	14.8x	14.2x	-0.79	4.3%	280 bp

Essentially first time div yield is premium to 10-year yield since 1950s…

The P/E of Staples and Utilities at 18-20X P/E 2017 reflects the "true market" multiple.

And these groups still have attractive yields…

Source: Fundstrat, Bloomberg.

Brexit scenarios not all negative outcomes for equities…

Figure: Current probability weighted outlook into YE 2016

Scenario		Probability as of 6/28/16	**S&P 500 YE 2016**
UPSIDE	Brexit off table / EU fiscal stimulus	5.0%	**2,500**
	Brexit loses momentum	15.0%	**2,300**
BASE CASE	Brexit but EU softens stance	22.5%	**2,200**
	Brexit	25.0%	**2,150**
	Brexit and UK recession in 2H16	25.0%	**2,100**
DOWNSIDE	Brexit and vindictive Europe stance	5.0%	**1,950**
	Brexit, Frexit, Itexit, Euro-area recession	2.5%	**1,700**
	Probability weighted value		**2,168**
	Street consensus target (@12/31/15)		**2,154**

Markets higher than current level…

Source: Fundstrat, Bloomberg.

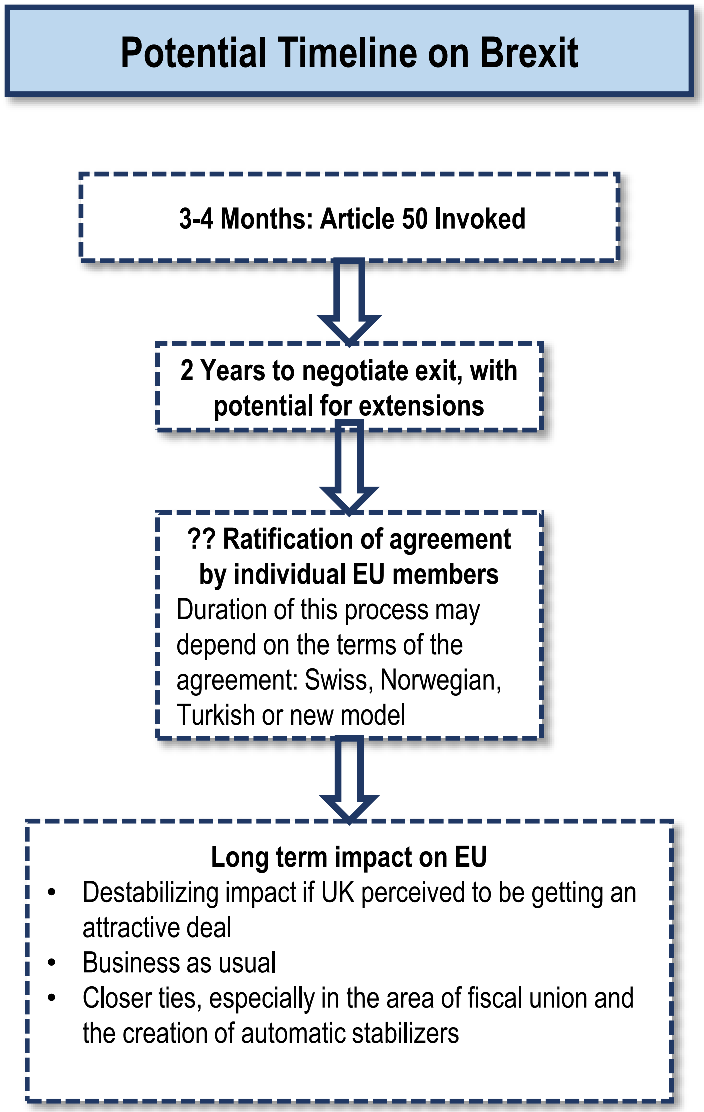
No doubt, Brexit developments are going to become significant factors in overall equity market performance over the next 6 months.

- **Notably, the key issues will be the form of new relationship (Norway, Swiss or Turkish, see next page) and the timing of Brexit itself.**
- **Financials are at the epicenter of Brexit and therefore, any sustained recovery in global markets is dependent by a sustained recovery in European banks.**
- More importantly, as we highlight on the left, we believe that shifts in timing and of nature of policy leader negotiations will affect market outcomes.
- We do not believe all outcomes need to be negative for equity markets. In fact, as highlighted, we believe that even the current scenario of Brexit on track still justifies equities rising from here.

The equity markets can be "positively" surprised by changes in the Brexit outlook, either a delay, overtures from EU, anything that is perceived to lessen the risk of a UK recession…

Brexit does not mean end of UK and EU relations…

Figure: Economists point to a prolonged period of uncertainty…



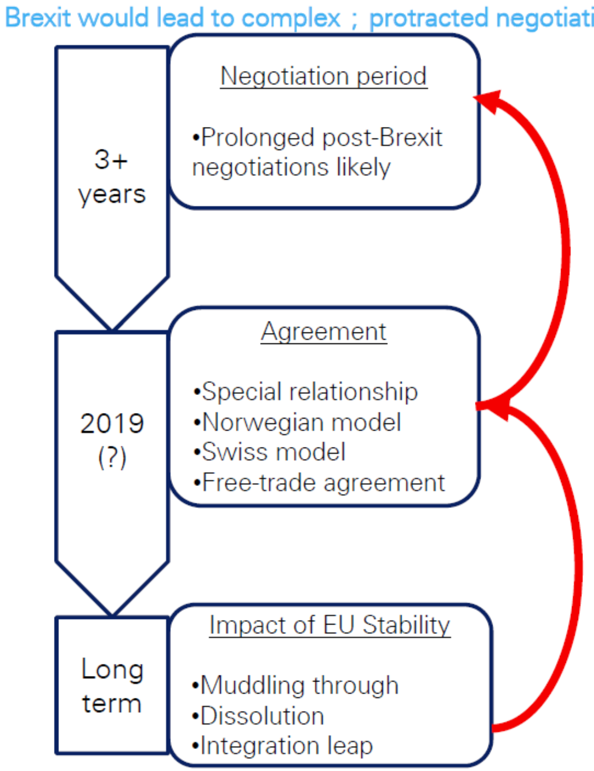
What could a post-exit agreement between the UK and the EU look like?

- **Norway:** Norway is both a member of the European Free Trade Association and the European Economic Area. Under this arrangement, Norway has access to the European Single Market, but has the freedom to independently negotiate trade deals with Non-EU countries. Norway contributes to the EU and EEA budgets, accepts free movement of goods, services, capital and labor, but, despite certain participation rights, no voting rights on rule setting or legislation. In addition, Norway has certain restrictions on fishery, food and beverage exports to the EU as well as on exports of goods with high non-EU component import content.
- **Switzerland:** As a member of the EFTA but not the EEA, Switzerland makes a smaller contribution to EU budgets, and accesses the Single Market largely through bilateral trade agreements. Switzerland has to accept some of the requirements of free movement of goods, labor and capital, but has restrictions on services, specifically financial services. The EU has formally decided to not replicate the Swiss model.
- **Turkey:** Turkey has a customs union with the EU, which means Turkey must maintain external trade and other tariffs that are aligned with EU rules without a say in crafting the rules. Turkey receives partial access to the common market, but does not contribute to the EU budget.
- **We believe the most likely outcome for the UK** is reduced access to the Single Market at a reduced contribution, leading to the potential for jobs to move into the EU. In particular we would view financial services jobs to be at risk in this scenario.
- **A less likely, more positive outcome for the UK** could involve some form of accepting free movement of goods, services, capital and labor; and continued contributions to the EU Budget. This is unlikely in our view: A large part of the Leave argument centered around budget contributions and the free movement of labor.

BREXIT: Timeline protracted…

Figure: Economists point to a prolonged period of uncertainty…

Uncertainty will continue until we know the UK bargaining position



Source: DB European Economics and FX Strategy

What a UK exit agreement from the EU might look like

Norwegian option (EEA membership). Norway is a member of both EFTA (the European Free Trade Association) and – crucially – the EEA (European Economic Area). The latter affords Norway access to the Single Market, while at the same time being outside the EU significantly reduces other common legislation (notably in the spheres of agriculture, home affairs, foreign and defence). It also gives Norway the freedom to conduct its own free trade agreements with non-EU countries. But in return Norway must accept the EU's Four Freedoms (those of goods, services, capital and labour); it has no say in decision making when it comes to the rules of the Single Market (so called 'regulation without representation'); it still pays a contribution to the EU and EEA budgets; and being outside the customs union the EU applies 'Rules of Origin' to trade, requiring tariffs to be applied to exports containing significant content sourced from outside the EU.

Swiss option (comprehensive bilateral agreements). Switzerland is a member of EFTA but not the EEA. It achieves widespread access to the Single Market through bilateral trade agreements under which it accepts the EU's Four Freedoms and pays a reduced contribution to the EU's annual budget. As with Norway, Switzerland is free to conduct free trade agreements with non-EU countries. Not only has the EU formally decided not to replicate the Swiss option in general with third countries, but it is worth noting that Switzerland has no agreements in relation to services, and in particular none on financial services.

Turkish option (customs union with EU). Turkey and the EU have shared a customs union for the past 20 years (though it does not cover agriculture or services), which requires Turkey to "align itself ... with the preferential customs regime of the Community". This obliges the country to adopt commercial rules and tariffs that are equivalent to those of the EU despite having no say in the crafting of those rules. This model gives only partial access to the Single Market, though it also requires no contribution be made to the EU budget.

Source: DB European Economics and FX Strategy

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What an agreement might look like

Our central case scenario is that the negotiations would lead to a decrease in the UK's access to the Single Market. Hence, we focus on this scenario.

A more positive scenario would envisage a "successful negotiation". In this scenario the impact on the EU economy would probably be minor relative to the status quo. However, by "successful negotiation" we mean a compromise that would not increase moral hazard across the EU and would give the UK full access to the Single Market.

The former would require the UK to accept the four freedoms and only a modest decrease in its net contribution to the EU budget. We are skeptical that such an outcome could be reached.

Source: DB European Economics and FX Strategy

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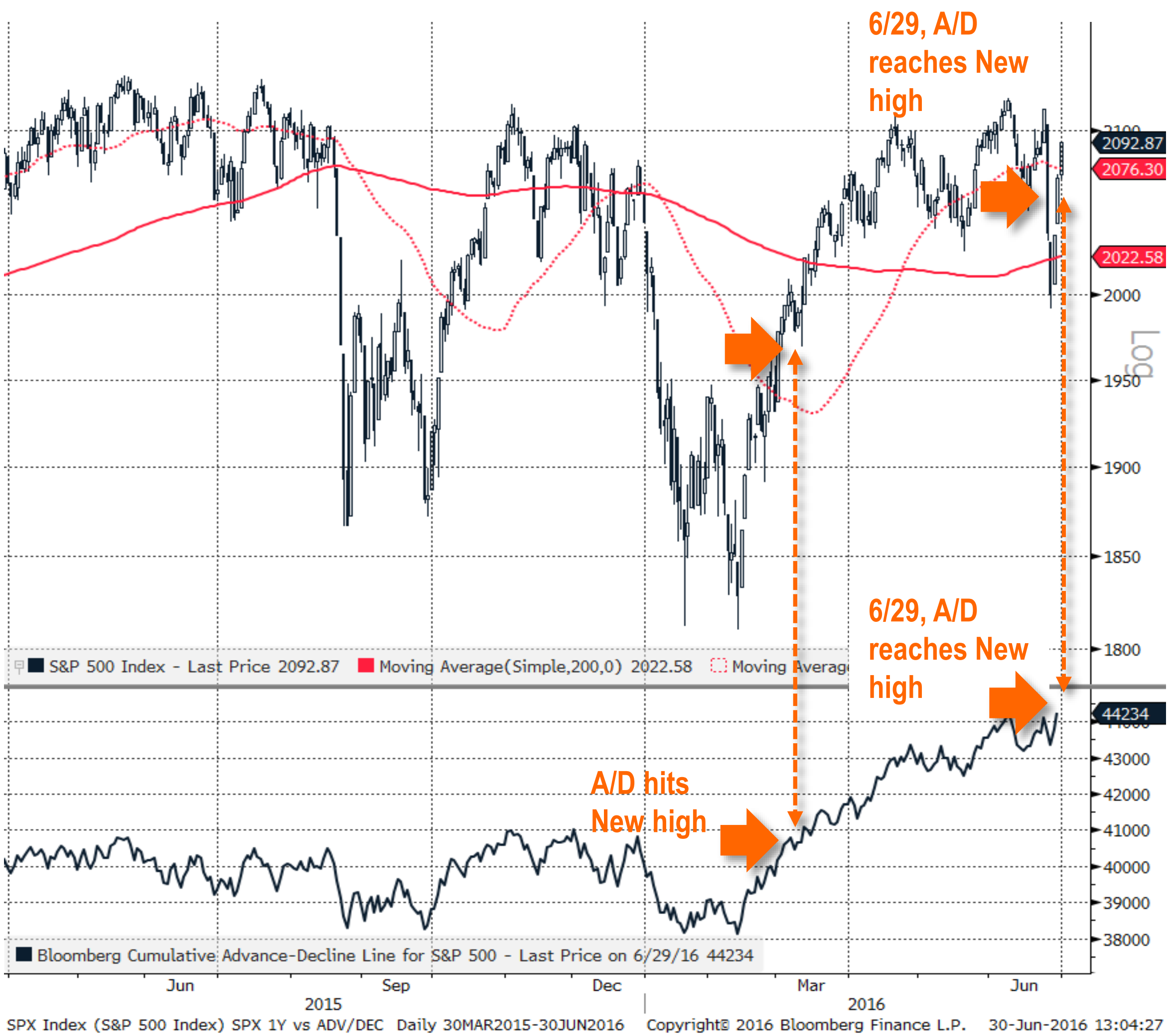
S&P 500 re-traced much of Brexit loss… A/D new high this week…

Figure: S&P 500 price performance



Source: Fundstrat, Bloomberg.

The S&P 500 showed impressive resilience this week, recovering most of the decline that followed last week's Brexit negative shock.

- As our clients know, we have been watching the trend in the S&P 500 advance/decline line (TRADCADS Index <<GO>>).
- **As highlighted on the left, the A/D decline reached a new high on 6/29, even as the S&P 500 remains 1% below its recent highs.**
- **We believe the stronger internals bode well for the S&P 500 to make an eventual new high.**

The A/D line hit a new high on 6/29 **which we believe also suggests the S&P 500 is set to make new all-time new highs…**

BREXIT: $26 Oil is a bigger problem for the global economy than Brexit…

Brexit, on the surface, and strictly Brexit alone, poses a smaller risk to the global economy than the collapse in oil seen in late-2015/early-2016…

Figure: Comparing $26 oil to Brexit…

Oil at $26		Brexit – UK recession
Oil supply 96.4 mbpd x 365 days = **35.2 billion per year** Price vs '14-'15 avg x -$46 per barrel **Annual impact = $1.6 trillion**	**Back of envelope** Each $1 in oil is $35b impact…	UK economy (USD) $2.8 trillion Mild recession x 2% peak to trough decline **Economic impact = $56 billion**
Significant as 40% of global economy (on PPP basis) is commodity producing nations	**Impact Global Economy**	Significant as UK is the 6th largest economy and 2nd largest in the EU
Significant as Energy sector is one of the largest sectors in the US economy and 2nd largest producer of oil globally.	**US Exposure**	Significant US exports $110b-plus annually to UK and is 5% of US exports.
Collapse in oil posed significant systematic risks to the banking sector	**Systemic Risks**	Brexit is not a systematic risk to banks. Further disruption in the EU is the systematic risk

BREXIT: UK market best, Asia quietly outperforming…

Figure: Global Markets Performance

Sorted based on relative performance from 6/23 to 6/30

Ticker	Name	Country	Market cap, USD Billions	Price on 6/23/16	Price on 06/30/16	Absolute Change	Absolute YTD Performance
UKX	**Ftse 100 Index**	**GB**	**$2,226.4**	**6338.100**	**6504.330**	**2.6%**	4.2%
STI	Straits Times Index Sti	SI	$281.6	2793.850	2840.930	1.7%	(1.5%)
SHCOMP	Shanghai Se Composite	CH	$3,736.4	2891.960	2929.606	1.3%	(17.2%)
SHSZ300	Csi 300 Index	CH	$3,260.2	3117.320	3153.920	1.2%	(15.5%)
NIFTY	Nifty 50	IN	$821.8	8270.450	8287.750	0.2%	4.3%
SENSEX	S&P Bse Sensex Index	IN	$660.1	27002.220	26999.720	(0.0%)	3.4%
SMI	Swiss Market Index	SZ	$988.1	8023.050	8020.150	(0.0%)	(9.0%)
IBOV	Brazil Ibovespa Index	BZ	$466.7	51559.820	51606.480	0.1%	19.0%
TWSE	Taiwan Taiex Index	TA	$764.7	8676.680	8666.580	(0.1%)	3.9%
KFX	Omx Copenhagen 20 Index	DE	$301.7	960.101	957.582	(0.3%)	(5.6%)
HSI	Hang Seng Index	HK	$1,643.4	20868.340	20794.370	(0.4%)	(5.1%)
SPTSX	S&P/Tsx Composite Index	CA	$1,504.4	14131.380	14075.580	(0.4%)	8.2%
MEXBOL	Mexico Ipc Index	MX	$266.4	46145.920	45870.560	(0.6%)	6.7%
INDU	Dow Jones Indus. Avg	US	$5,126.3	18011.070	17911.130	(0.6%)	2.8%
KOSPI	Kospi Index	SK	$998.7	1986.710	1970.350	(0.8%)	0.5%
AS51	S&P/Asx 200 Index	AU	$1,087.5	5280.684	5233.375	(0.9%)	(1.2%)
SPX	**S&P 500 Index**	**US**	**$18,028.5**	**2113.320**	**2092.370**	**(1.0%)**	2.4%
INDEXCF	Micex Index	RU	$428.6	1919.270	1891.090	(1.5%)	7.4%
HEX	Omx Helsinki Index	FI	$235.3	8024.214	7903.813	(1.5%)	(8.1%)
XU100	Bist 100 Index	TU	$162.6	77989.870	76817.190	(1.5%)	7.1%
OBX	Obx Stock Index	NO	$158.8	549.790	541.230	(1.6%)	0.4%
CCMP	Nasdaq Composite Index	US	$7,233.7	4910.041	4828.812	(1.7%)	(3.6%)
SAXCME	S&P Asia 50 Index Cme	HK	$1,971.8	3382.550	3315.750	(2.0%)	1.2%
TA-100	Tel Aviv 100 Index	IS	$180.0	1240.220	1211.210	(2.3%)	(7.9%)
OMX	Omx Stockholm 30 Index	SW	$489.1	1360.730	1323.575	(2.7%)	(8.5%)
TOP40	Ftse/Jse Africa Top40 Ix	SA	$578.7	47453.530	45974.310	(3.1%)	0.4%
NKY	Nikkei 225	JN	$2,673.8	16238.350	15575.920	(4.1%)	(18.2%)
WIG	Wse Wig Index	PD	$215.3	46826.850	44748.530	(4.4%)	(3.7%)
BE500	Bloomberg European 500	EC	$8,302.5	232.990	221.440	(5.0%)	(10.4%)
CAC	Cac 40 Index	FR	$1,217.0	4465.900	4237.480	(5.1%)	(8.6%)
MSER	Msci Euro	EC	$3,649.0	1008.030	953.660	(5.4%)	(11.4%)
DAX	Dax Index	GE	$982.1	10257.030	9680.090	(5.6%)	(9.9%)
SX5E	**Euro Stoxx 50 Pr**	**EC**	**$2,431.2**	**3037.860**	**2864.740**	**(5.7%)**	(12.3%)
ATX	Austrian Traded Atx Indx	AS	$56.9	2242.110	2095.960	(6.5%)	(12.6%)
IBEX	Ibex 35 Index	SP	$517.4	8885.300	8163.300	(8.1%)	(14.5%)
FTSEMIB	Ftse Mib Index	IT	$372.2	17966.170	16197.780	(9.8%)	(24.4%)
ASE	Athex Composite Share Pr	GR	$36.3	617.690	542.120	(12.2%)	(14.1%)

Source: Fundstrat, Bloomberg,

UK best market

Asia markets have quietly gained during Brexit…

US in middle

We have listed the performance of various global equity markets since the negative Brexit shock.

- **The UK is the best performance global stock market since the Brexit announcement—in fact, the FTSE 100 is 2.6% above its closing prior to the vote.**
- **As shown on the left, what has been quite surprising is the quiet outperformance of Asia markets.**
- While there are multiple factors behind this, one inference, we believe is credible, is that this suggests that Asian markets do not necessarily see global recession risk from Brexit at the moment.

BREXIT: Recovery in banks ultimately needed to affirm global risk-on

Below is a list of the 19 major groups in the STOXX Europe 600, sorted from best to worst. Not entirely a surprise, but Banks saw the greatest sell-off following the Brexit vote. We have listed the bank performance by country as well.

- **Banks are at the epicenter of the risks of Brexit. Hence, a credible recovery in banks is needed to affirm a sustained rally in global markets. Italian and Greek banks, in particular, suffered the greatest decline.**

Figure: STOXX Europe 600 industry group performance

Sorted based on relative performance from 6/23 to 6/27

		Price returns after Brexit (6/23 - 6/27)		Price returns (YTD)	
	Group name	Absolute	Relative	Absolute	Relative
	STOXX Europe 600 Index	-10.9%	0.0%	-10.7%	0.0%
1	Healthcare	-3.1%	7.8%	-6.3%	4.5%
2	Food & Beverage Products	-4.4%	6.5%	-2.2%	8.6%
3	Chemicals	-7.8%	3.1%	-10.9%	-0.2%
4	Oil & Gas	-7.8%	3.0%	8.3%	19.1%
5	Personal & Household Goods	-8.0%	2.9%	-0.0%	10.7%
6	Technology	-9.3%	1.5%	-11.0%	-0.2%
7	Utilities	-9.6%	1.3%	-5.0%	5.8%
8	Basic Resources	-10.5%	0.4%	15.8%	26.5%
9	Telecom	-11.7%	-0.9%	-13.4%	-2.6%
10	Media	-12.0%	-1.1%	-12.6%	-1.9%
11	Construction & Materials	-12.3%	-1.5%	-6.8%	4.0%
12	Industrials Goods & Services	-12.4%	-1.5%	-5.7%	5.1%
13	Retail	-12.7%	-1.9%	-13.8%	-3.0%
14	Real Estate	-13.4%	-2.6%	-7.3%	3.4%
15	Automobiles & Parts	-13.7%	-2.8%	-24.9%	-14.2%
16	Travel & Leisure	-16.3%	-5.4%	-19.0%	-8.3%
17	Insurance	-17.6%	-6.8%	-22.8%	-12.1%
18	Financial Services	-17.8%	-7.0%	-18.3%	-7.5%
19	Banks	-21.0%	-10.2%	-31.4%	-20.7%

STOXX 600 Banks – by country

			Price returns after Brexit (6/23 - 6/27)		Price returns (YTD)	
	Group name	# stocks	Absolute	Relative	Absolute	Relative
	STOXX Europe 600	600	-10.9%	0.0%	-9.8%	0.0%
	STOXX 600 Banks Index	47	-21.0%	-10.2%	-31.3%	-21.5%
1	Ireland	1	-1.6%	9.2%	13.5%	23.4%
2	Austria	2	-6.2%	4.7%	-10.2%	-0.4%
3	Czech	1	-6.8%	4.1%	-8.1%	1.7%
4	Sweden	4	-9.2%	1.7%	-13.5%	-3.7%
5	Norway	1	-9.5%	1.3%	-9.5%	0.3%
6	Denmark	3	-11.6%	-0.7%	-5.3%	4.5%
7	Portugal	1	-14.6%	-3.8%	-62.8%	-52.9%
8	Spain	7	-17.6%	-6.7%	-27.0%	-17.2%
9	Switzerland	3	-18.4%	-7.5%	-31.9%	-22.0%
10	Germany	2	-18.5%	-7.6%	-42.2%	-32.4%
11	Netherlands	2	-21.5%	-10.7%	-27.1%	-17.3%
12	France	4	-21.9%	-11.1%	-31.8%	-22.0%
13	Belgium	1	-23.5%	-12.6%	-23.8%	-14.0%
14	Britain	6	-27.7%	-16.9%	-19.3%	-9.5%
15	Italy	8	-28.9%	-18.0%	-60.1%	-50.2%
16	Greece	2	-37.9%	-27.0%	-41.0%	-31.2%

Source: Fundstrat, Bloomberg.
Note: price performance based on aggregate sub-indices maintained by index vendors.

SELL-OFF MEANS BOUNCE: S&P 500 fell 5% in two-days, N=50 since 1940

Equities saw a massive knee-jerk reaction to the Brexit vote. In our view, this highlights how markets have developed a negative bias, particularly when it comes to policy surprise. **A 5% move in two days is a 3.5 standard deviation event.**

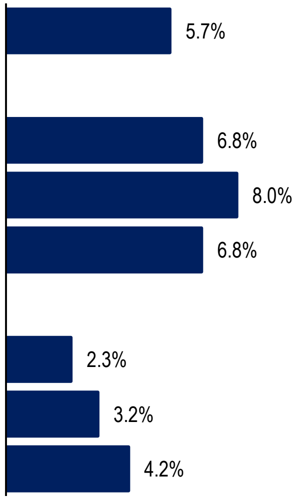
- **Of these 50 instances, 16 occurred when the S&P 500 was above either its 50-day or 200-day moving average (in a bull trend). As shown below, markets tend to have snapback bounces whenever the S&P 500 is in a bull trend.**

Figure: S&P 500 subsequent performance based on price as % of 50D and 200D moving averages
50 instances of a 5% sell-off within 2 days since 1940

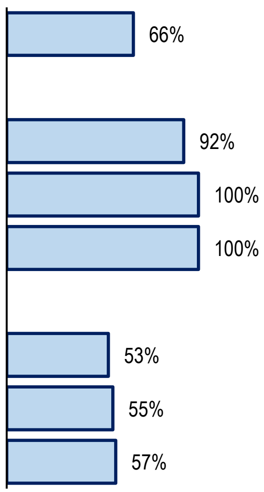
Current		
Price	P/50D	P/200D
2,070.77	100%	102%

S&P 500 price % of MAVG before sell-off	# of instances	S&P 500 forward performance (median) +5D	+1M	+3M	+6M	S&P 500 win ratio +5D	+1M	+3M	+6M
All instances	50	0.5%	2.0%	5.7%	6.5%	54%	62%	66%	76%
> 200D	13	0.9%	1.8%	6.8%	3.9%	54%	69%	92%	85%
> 50D	12	2.2%	1.5%	8.0%	12.5%	58%	67%	100%	92%
> 50D and 200D	9	0.9%	1.2%	6.8%	10.0%	56%	67%	100%	89%
< 50D and 200D	34	0.2%	2.6%	2.3%	5.8%	53%	59%	53%	71%
< 50D	38	0.2%	2.7%	3.2%	4.6%	53%	61%	55%	71%
< 200D	37	0.3%	2.3%	4.2%	6.6%	54%	59%	57%	73%

3M forward return (median)



3M forward win ratio



Source: Fundstrat, Bloomberg.

SELL-OFF MEANS BOUNCE: 9 instances when S&P 500 >50D and >200D

As shown below, in those 9 instances (>50D and >200D), the S&P 500 bottomed shortly and delivered strong 3M and 6M returns**.**

- **A 5% selloff in 2 days markets often bottom within 5 days or less (5 of 9 times) and generally when P/50D is 94%. This is about where the S&P 500 is currently.**
- **More encouraging, note the strong returns in the 3M and 6M periods, with gains of 7%/10%, respectively and win ratios >90%**

Figure: 9 instances of a 5% 2-day selloff when S&P was above both 50D and 200D moving averages
Since 1940

	Instances of a 5% selloff within 2 days			S&P 500 final low			S&P 500 forward performance			
	Start of selloff	End of selloff	S&P 500 2-day % chg	# trading days until low	Further decline %	P/50D at low	+5D	+1M	+3M	+6M
1	10/23/1997	10/27/1997	-7.8%	0	0.0%	93%	7.1%	8.5%	10.5%	23.9%
2	4/12/2000	4/14/2000	-7.5%	0	0.0%	95%	5.7%	4.7%	11.3%	1.3%
3	10/11/1989	10/13/1989	-6.5%	0	0.0%	96%	4.1%	1.8%	1.9%	3.2%
4	8/19/2015	8/21/2015	-5.2%	3	-5.2%	90%	0.9%	-0.2%	6.0%	-2.7%
5	2/18/1946	2/20/1946	-5.5%	4	-3.2%	94%	-1.3%	1.2%	7.3%	3.1%
6	9/22/1955	9/26/1955	-6.1%	11	-4.2%	94%	-0.3%	-0.8%	6.8%	14.1%
7	9/9/1986	9/11/1986	-5.0%	13	-2.2%	95%	-1.2%	0.1%	5.5%	23.4%
8	6/22/1950	6/26/1950	-5.5%	15	-7.9%	91%	-2.6%	-4.6%	5.7%	10.0%
9	10/28/2011	11/1/2011	-5.2%	17	-4.9%	96%	4.7%	2.2%	8.7%	15.4%
Above both 50D and 200D	Average		-6.0%	7	-3.1%	94%	1.9%	1.4%	7.1%	10.2%
9 instances	Median		-5.5%	4	-3.2%	94%	0.9%	1.2%	6.8%	10.0%
	Win ratio						56%	67%	100%	89%
Current	6/23/2016	6/27/2016	-5.3%	0	0.0%	96%	—	—	—	—

Source: Fundstrat, Bloomberg.

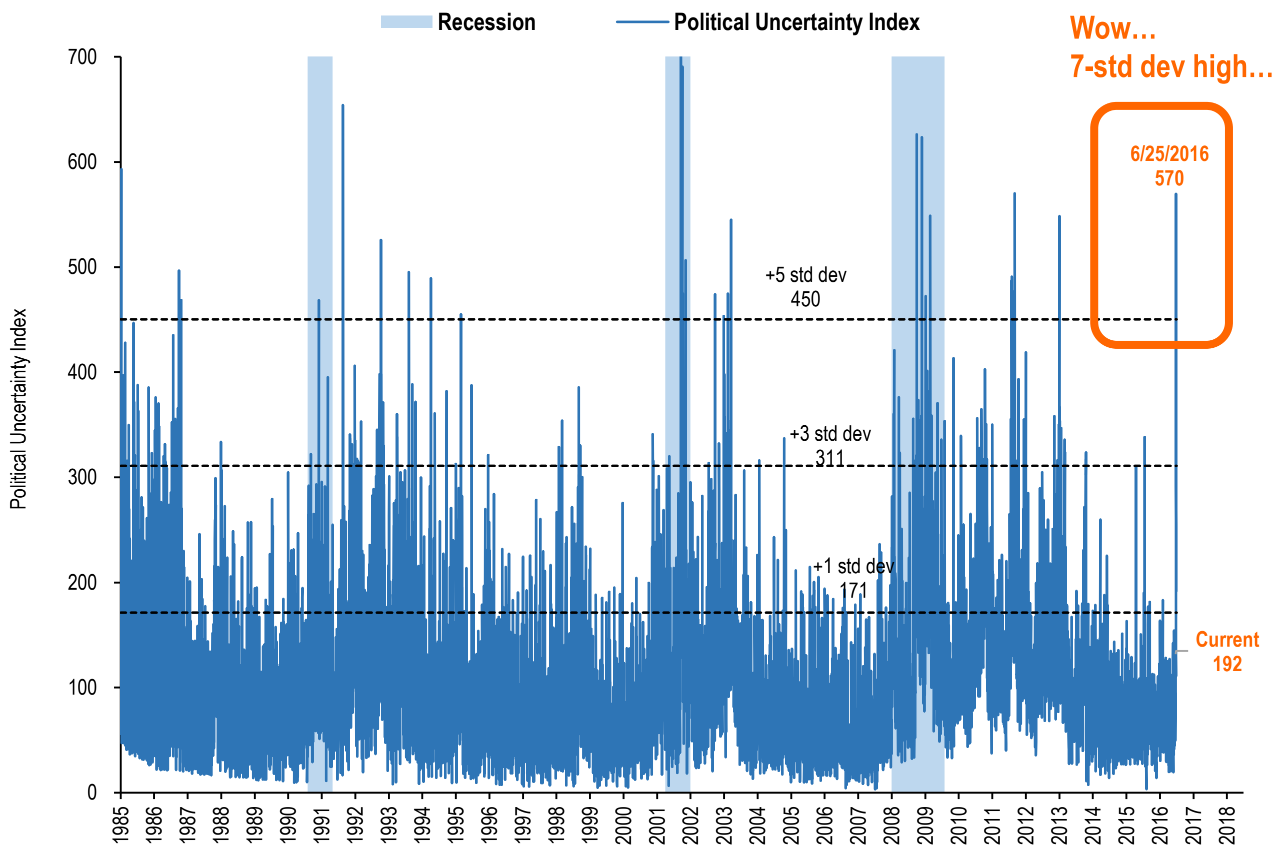
The S&P 500 was both above its 50D and 200D on 6/23, right before the sell-off started…

Political uncertainty surged 7-std dev… since '85, a bullish signal

A group, politicaluncertainty.com, tracks political uncertainty, measured as citations in 1,000-plus newspapers. This reading spiked to 570 on 6/25/16, a 7 std-deviation surged. Since 1985, this has happened on 25 dates.

- **Surges in political uncertainty have served as a contrarian buy signal. As shown below, whenever this reading has moved above 5-std deviations, we have seen markets higher 6M later 86% of the time, with a median gain of 12%.**
- **The only time this signal provided a bad reading was 9/30/2008 (after TARP I failure) as markets proceeded to fall another 32%.**

Figure: The Political Uncertainty Index reached a 7-std dev high on 6/25…



Source: Fundstrat, Bloomberg, PoliticalUncertainty.com

Figure: S&P 500 subsequent returns

Date	Political Uncertainty Index level	Political Uncertainty Z-Score	S&P 500 fwd perf +3M	S&P 500 fwd perf +6M	Recession
1/7/1985	593	7.0	9.0%	17.2%	
9/28/1986	496	5.7	6.3%	27.5%	
10/23/1986	468	5.3	12.9%	19.9%	
11/29/1990	469	5.3	16.0%	21.0%	x
8/20/1991	654	7.9	-0.2%	9.1%	
10/6/1992	526	6.1	6.7%	8.3%	
8/7/1993	495	5.6	2.4%	5.1%	
4/4/1994	489	5.6	1.7%	3.6%	
2/24/1995	455	5.1	8.3%	14.2%	
9/18/2001	719	8.9	10.7%	12.9%	x
11/7/2001	507	5.8	-3.2%	-5.9%	x
9/25/2002	474	5.3	6.3%	4.2%	
12/29/2002	453	5.0	-1.4%	11.5%	
2/12/2003	475	5.3	15.4%	21.0%	
3/19/2003	545	6.4	13.8%	18.6%	
9/30/2008	626	7.5	-23.6%	-32.5%	x
11/24/2008	623	7.5	-9.2%	4.1%	x
1/4/2009	472	5.3	-9.6%	-3.8%	x
2/25/2009	549	6.4	16.0%	34.4%	x
7/30/2011	487	5.5	-0.6%	1.6%	
9/3/2011	570	6.7	6.0%	16.7%	
1/1/2013	548	6.4	9.5%	13.2%	
Median		5.7	6.3%	12.2%	
Win ratio			68%	86%	
Current					
6/25/2016	570	6.9	—	—	

TARP I failure

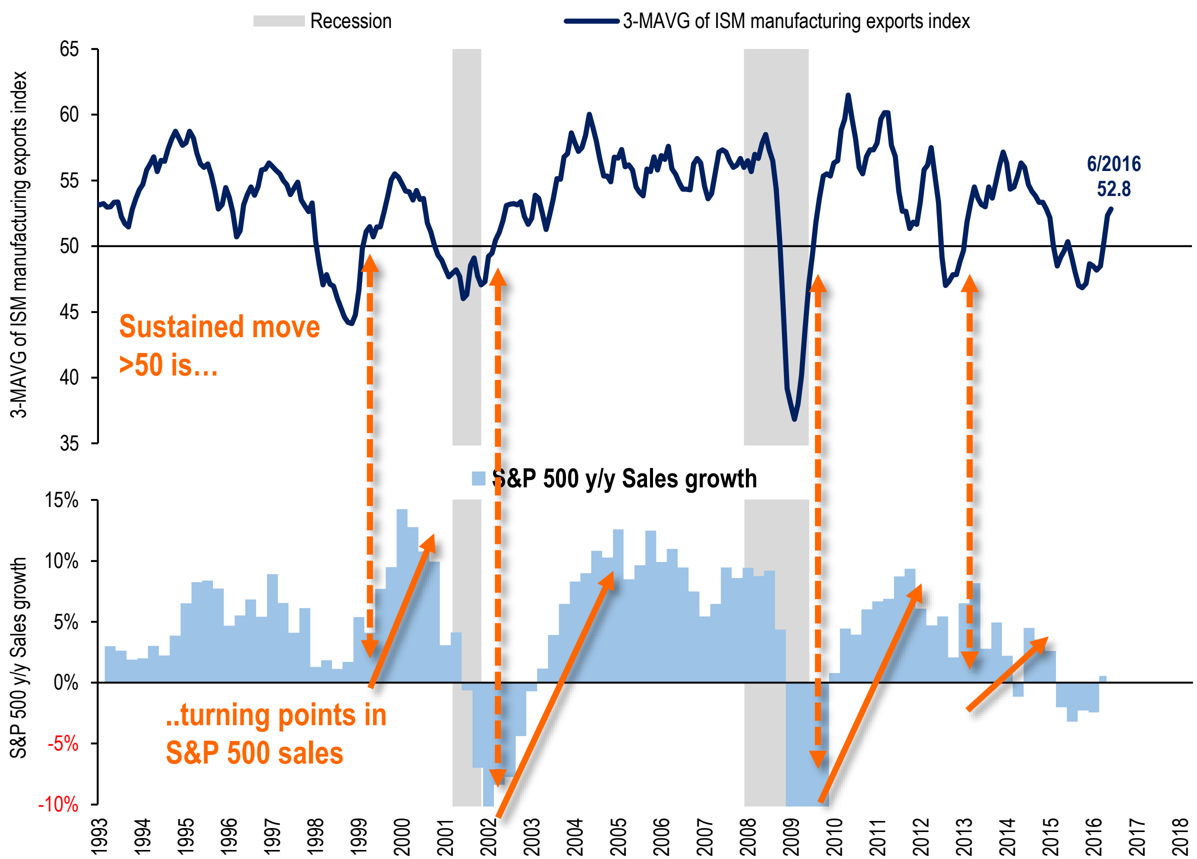
Positive Returns…

EPS RECOVERY: ISM Exports decisive turning points for S&P 500 sales…

As shown below, there have been 4 precedent instances where the ISM export orders were below 50 and made a sustained move above 50.

- **As the charts highlight below, each of those 4 precedent recoveries in ISM new export orders is associated with inflections in S&P 500 sales growth. This is intuitive, if export orders recover (helping GDP), this should also be positive for S&P 500 revenue growth.**

Figure: 3-MAVG of ISM manufacturing exports index and S&P 500 y/y Sales growth
Since 1993



Source: Fundstrat, Bloomberg, ISM.

Figure: ISM exports index recovers >50

Date	ISM exports index	3-MAVG of ISM exports index	S&P 500 y/y sales growth 1-year later
3/31/1999	50.1	51.1	12.8%
3/31/2002	50.6	50.5	1.2%
8/31/2009	55.5	51.8	3.9%
2/28/2013	53.5	51.8	2.2%
Average	52.4	51.3	5.0%
Median	52.1	51.5	3.1%
% of times positive			100%
6/30/2016	53.5	52.8	n/a

As shown on the table above, S&P 500 revenue growth has recovered over the next 12 months 100% of the time…

Source: Fundstrat, Bloomberg, ISM.

EPS RECOVERY: Exports highly correlated to S&P 500 revenue growth.

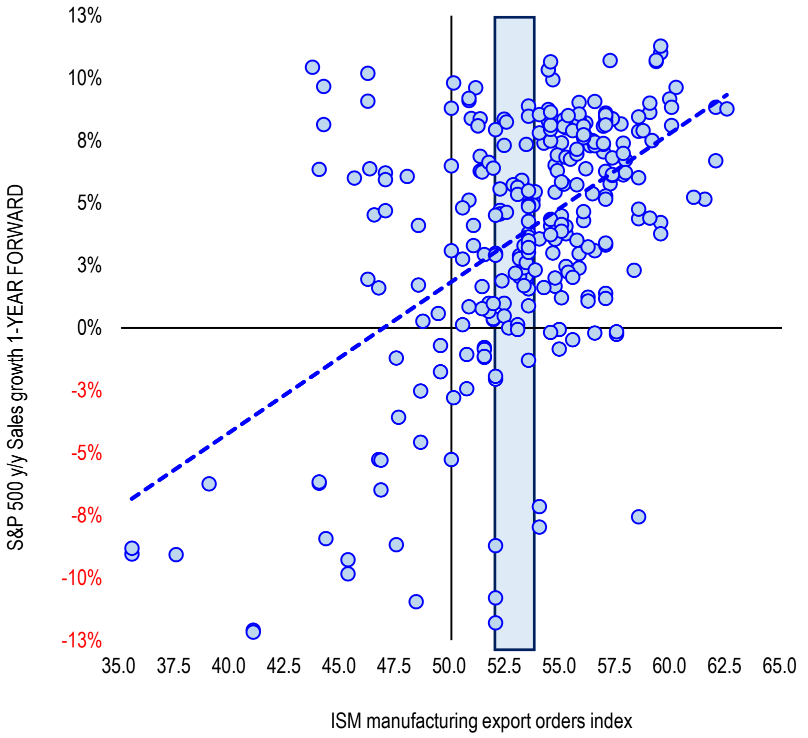
Being a bit more systematic, we can show that indeed, ISM export orders does lead to subsequent sales growth.

- **To illustrate this further, as you can see below, the level of ISM export orders explains the subsequent sales growth in the S&P 500.**
- The scatter chart on the bottom right best illustrates this as the plots between 52.1 and 53.3 (4th decile) have seen sales recover.

Figure: The current level of ISM Manufacturing Exports Index 3-MAVG is historically associated with 4.3% forward Sales growth for the S&P 500

Y/Y growth of US export orders and S&P 500 sales per share based on deciles of ISM manufacturing export orders index level (deciles calculated since 1992)

Deciles of 3-MAVG of ISM manufacturing exports index			US export orders (goods & services)		S&P 500 sales per share 1-year fwd	
Decile	Range of 3-MAVG	# instances	Avg y/y % change	% times positive	Avg y/y % change	% times positive
Highest	57.4 to 61.5	28	15.2%	100%	5.6%	93%
9	56.5 to 57.4	28	13.1%	100%	5.4%	89%
8	55.8 to 56.5	28	11.0%	100%	3.7%	82%
7	54.8 to 55.8	28	8.2%	93%	6.3%	93%
6	54.1 to 54.8	28	9.2%	100%	3.6%	86%
5	53.3 to 54.1	28	6.1%	96%	4.0%	77%
4	52.1 to 53.3	28	5.4%	86%	4.3%	93%
3	50.0 to 52.1	27	2.5%	70%	3.4%	81%
2	47.7 to 49.9	29	-3.3%	34%	-1.3%	50%
Lowest	36.8 to 47.7	27	-6.5%	19%	2.8%	75%
Total	36.8 to 61.5	279	6.1%	80%	3.9%	83%
Current	**52.8**		**-4.6%**			



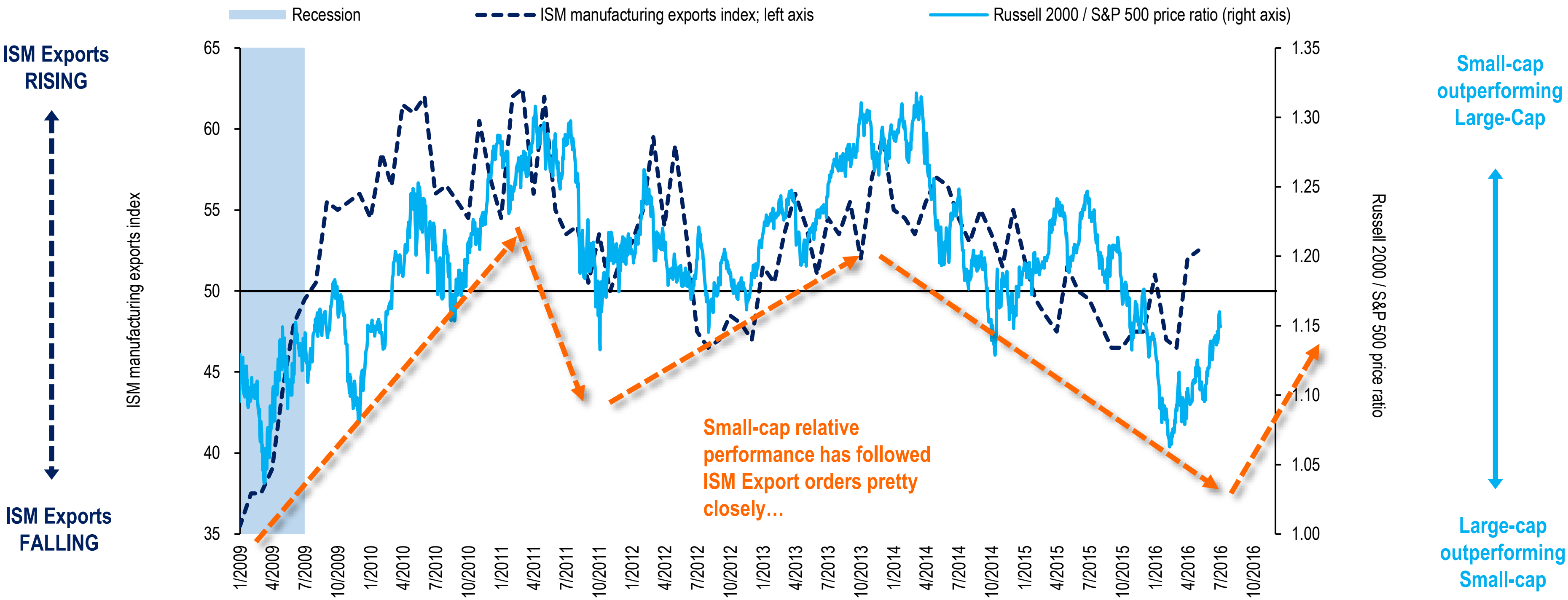
Source: Fundstrat, Bloomberg, ISM.

EPS RECOVERY: Small-Caps positively levered to recovery in ISM exports…

As shown below, a recovery in ISM export orders benefits small-caps (vs large-cap) and there has been an unusually strong relationship.

- **At first glance, this does not make sense—small-caps are not exporters, so why should a rise in export orders help small-caps?**
- **We think the generalized reason for this is a rise in export orders means GDP growth is picking up—hence, small-caps outperform when growth is stronger.**

Figure: Small-cap outperformance is positively correlated with the ISM manufacturing exports index
Since 2009



Source: Fundstrat, Bloomberg, ISM.

EPS RECOVERY: Cyclicals and Financials ***MOVE THE NEEDLE***…

We have heard investors tell us that the leadership of **Energy, Industrials, Materials** and **Financials** is not enough to offset the drag from **Healthcare** and **Consumer Discretionary** stocks. This is not the case:

- **As shown below, these 4 groups (positive levered to weaker USD, improving credit) are 36% of S&P 500 vs 27% for Healthcare and Consumer Discretionary.**

Figure: Deciles of S&P 500 EBIT margins

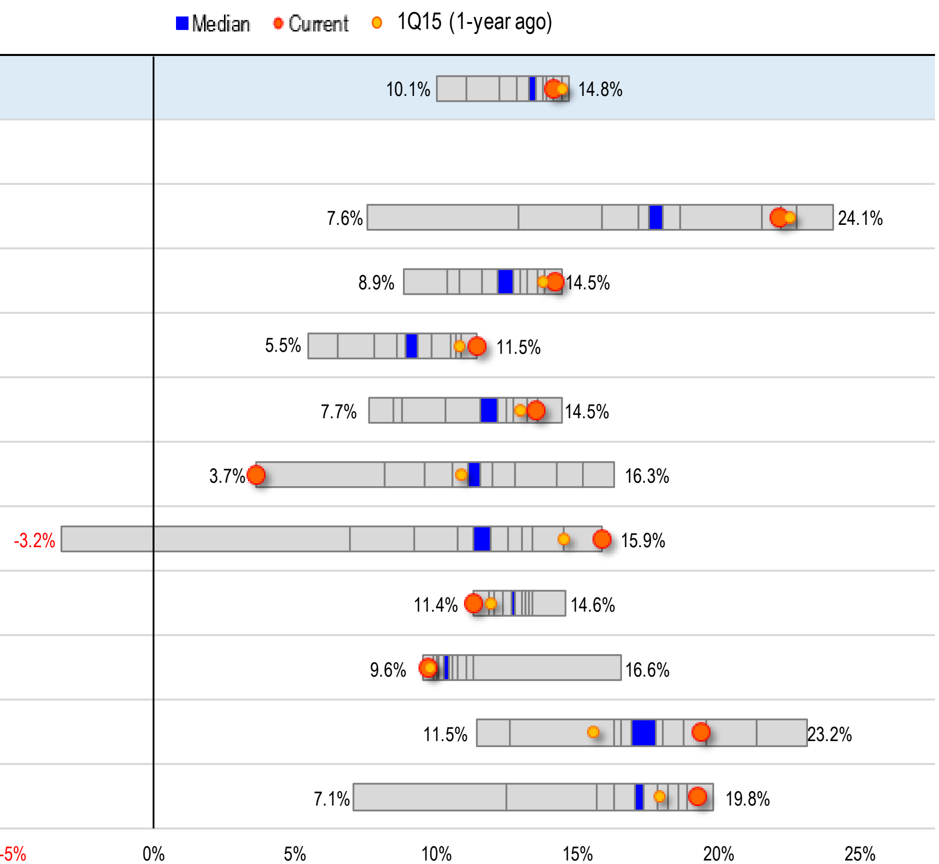
LTM EBIT margin on a quarterly frequency (since 1999)

% contribution to S&P 500 Sales		% contribution to S&P 500 EBIT		Market cap weight		
Sales ($B)	% share	Total EBIT	% share	Market cap	% share	
$8,408	100%	$1,510	100%	$18,858	100%	S&P 500
$1,265	15%	$281	19%	$3,810	20%	Technology
$1,217	14%	$174	11%	$1,871	10%	Industrials
$1,705	20%	$196	13%	$2,397	13%	Consumer Discretionary
$348	4%	$47	3%	$545	3%	Basic Materials
$900	11%	$33	2%	$1,336	7%	Energy
$1,432	17%	$328	22%	$2,986	16%	Financials sector (NET MARGIN)
$1,541	18%	$175	12%	$2,712	14%	Healthcare
$1,596	19%	$155	10%	$2,117	11%	Consumer Staples
$310	4%	$60	4%	$481	3%	Telecom
$315	4%	$61	4%	$604	3%	Utilities

Industrials, Financials, Energy and Materials are 36% of S&P 500

Healthcare and Discretionary combined are 27% of S&P 500

Deciles of LTM EBIT margin (quarterly frequency; since 1999)



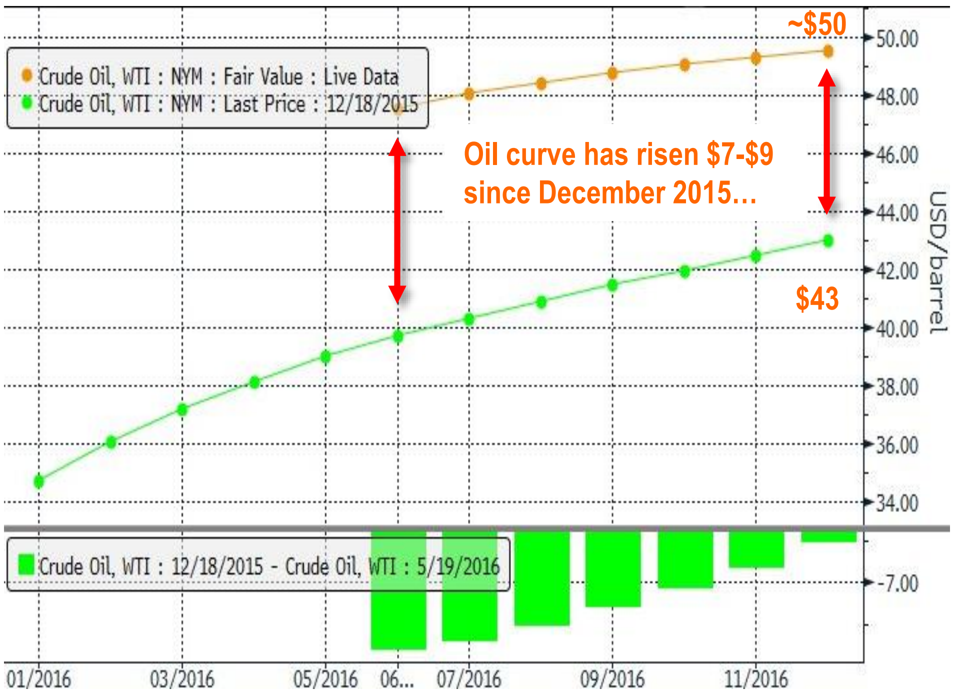
Source: Fundstrat, Bloomberg, FactSet.

EPS RECOVERY: Energy EPS *not fully reflecting* upward move in Oil curve…

When analysts modeled 2016 EPS for the **Integrated Oil** stocks, these were based on a 2016 oil forecast of $41.50, which was the price of the oil curve in December 2015.

- **Since then, oil has risen $7-$9 (depending at what point we look at on the strip) and this will have a dramatic impact on Integrated Oil's net income. If oil remains flat into year-end, this would add $25 billion in net income for the "majors", and add $2.61 in S&P 500 EPS.**

Figure: Oil curve is up $7-$9 since December 2015
Priced as of 5/19/16



Source: Fundstrat, FactSet, Bloomberg.
Note: oil curve based on Bloomberg CCRV. Incremental margin is forecasted to be 25% for oil price increases. Incremental net income and EPS is calendarized to adjust for fiscal year-end differences.

Figure: S&P 500 EPS impact from changes in Integrated Oils
Analysts forecasts for 2016 were based on $41.50 oil in 2016

RANGE 2016 Incremental Net Income

Oil Price Assumption (WTI)	$31.50	$36.50	$41.50	$49.40	$55.00	$65.00
XOM	($17,383)	($8,691)	–	$13,732	$23,466	$40,849
CVX	($9,632)	($4,816)	–	$7,609	$13,003	$22,635
COP	($2,034)	($1,017)	–	$1,607	$2,746	$4,780
OXY	($892)	($446)	–	$704	$1,204	$2,095
CNQ	($902)	($451)	–	$713	$1,218	$2,120
CVE	($879)	($439)	–	$694	$1,187	$2,065
Total Net Income	($31,721)	($15,861)	–	$25,060	$42,824	$74,545

$2.61 Upside to S&P 500 EPS if oil stays at $49.40

RANGE Incremental Impact to 2016 S&P500 EPS

Oil Price Assumption (WTI)	$31.50	$36.50	$41.50	$49.40	$55.00	$65.00
XOM	($1.92)	($0.96)	–	$1.52	$2.59	$4.51
CVX	($1.06)	($0.53)	–	$0.84	$1.44	$2.50
COP	($0.22)	($0.11)	–	$0.18	$0.30	$0.53
OXY	($0.10)	($0.05)	–	$0.08	$0.13	$0.23
CNQ	–	–	–	–	–	–
CVE	–	–	–	–	–	–
Incremental S&P 500 EPS	($3.31)	($1.65)	–	$2.61	$4.47	$7.77

EPS RECOVERY: Integrateds and E&Ps may add $70b in EBIT in 2017

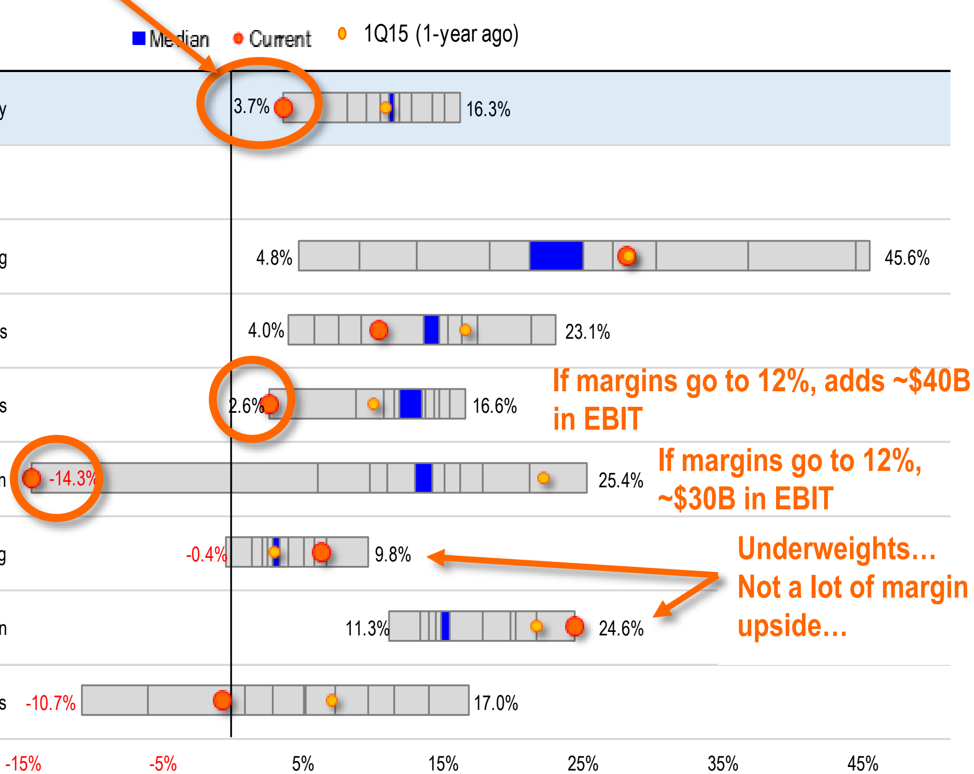
We see upside in Energy EBIT margins over the next few years, as oil prices recover. As we said in the past (and everyone knows), Energy companies only make money when oil prices are higher than they are now.

- **We believe Integrateds and E&Ps could add $70B in EBIT in next 12 months ($5 per S&P 500 share). In other words, major leverage on EPS from higher oil.**

Figure: Deciles of Energy Sector EBIT margins
Since 1999

Upside to Energy EBIT margins over new few years…

% of total sector Sales		% of total sector EBIT		Market cap weight			Deciles of LTM EBIT margin (quarterly frequency; since 1999)
Total Sales ($ mm)	% of total sector Sales	Total EBIT ($ mm)	% of total sector EBIT	Total mkt cap ($ mm)	% weight in sector		
$902,836	100%	$33,309	100%	$1,309,219	100%	Energy	
$12,402	1%	$3,501	11%	$12,857	1%	Oil & Gas Drilling	
$96,070	11%	$10,028	30%	$177,662	14%	Oil & Gas Equipment & Services	
$379,151	42%	$9,915	30%	$616,019	47%	Integrated Oil & Gas	
$111,293	12%	($15,945)	-48%	$312,076	24%	Oil & Gas Exploration & Production	
$265,933	29%	$17,111	51%	$94,572	7%	Oil & Gas Refining & Marketing	
$35,486	4%	$8,715	26%	$96,033	7%	Oil & Gas Storage & Transportation	
$2,501	0%	($16)	-0%	n/a	n/a	Coal & Consumable Fuels	

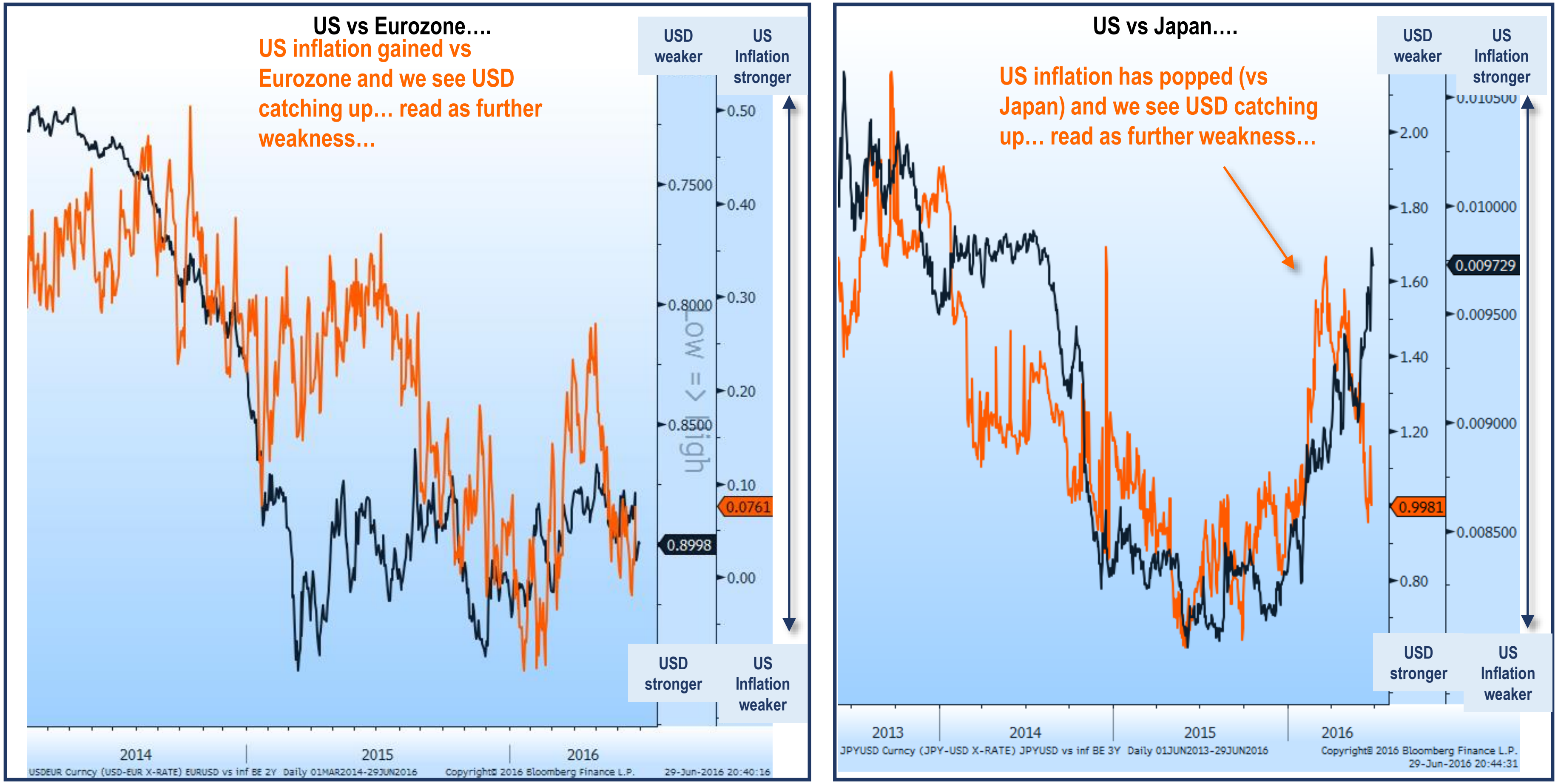


Source: Fundstrat, Bloomberg, FactSet

USD: ***Relative inflation*** argues USD should further weaken vs EUR and vs JPY

As shown below, US relative inflation (vs Eurozone and vs Japan) has been rising and as shown, has explained the weakening of the USD against EUR and JPY. In other words, as we argued for some time, policy rates (while logical) and relative real GDP growth (logical) explain some currency movement, but ***ultimately, relative inflation is an incremental driver. And with US inflation picking up, it should weaken the USD.***

Figure: EUR/USD vs USD/JPY and comparative inflation
Since 2013



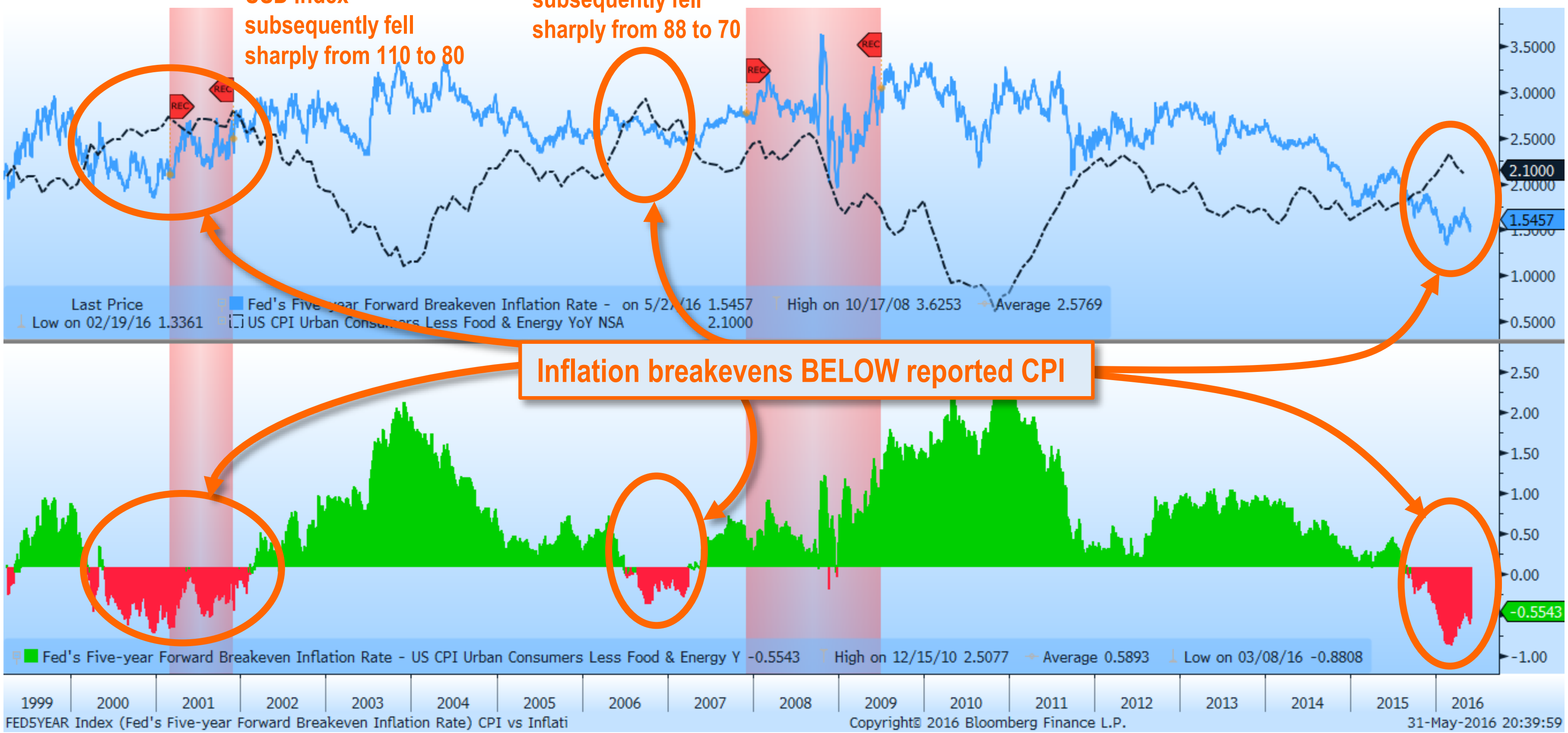
Source: Fundstrat, Bloomberg.

Lower US inflation arguably 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.

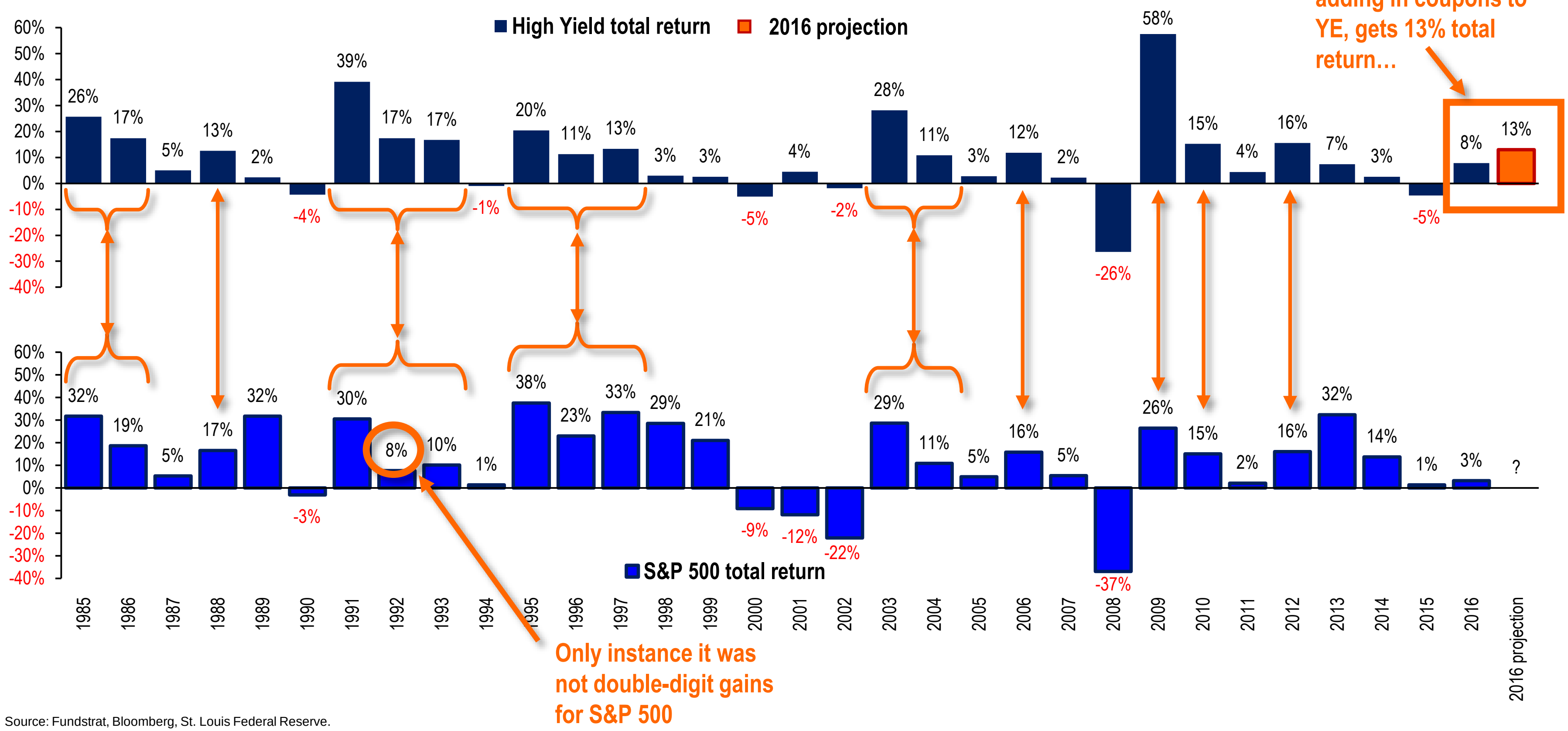
HIGH-YIELD: HY double-digits ~ equities average 22% gains…

Equity and high-yield generally move in tandem. As shown below, HY is set to gain 13% total return in 2016 (8% from coupon). And would represent the first double-digit year since 2012 for HY bonds.

- **Since 1985, there have been 15 years where HY has returned double-digits and equities gained at least 10% in 14 of the 15 years (8% in 1992). The average equity gain is 22% whenever high-yield returns are double-digit.**
- **In other words, history says there is a sizable catch-up trade coming in equities in the next 7 months.**

Figure: 14 of 15 times High Yield saw double-digit gains, Equities also posted double-digit gains…

Annual total return of High Yield and S&P 500



Source: Fundstrat, Bloomberg, St. Louis Federal Reserve.

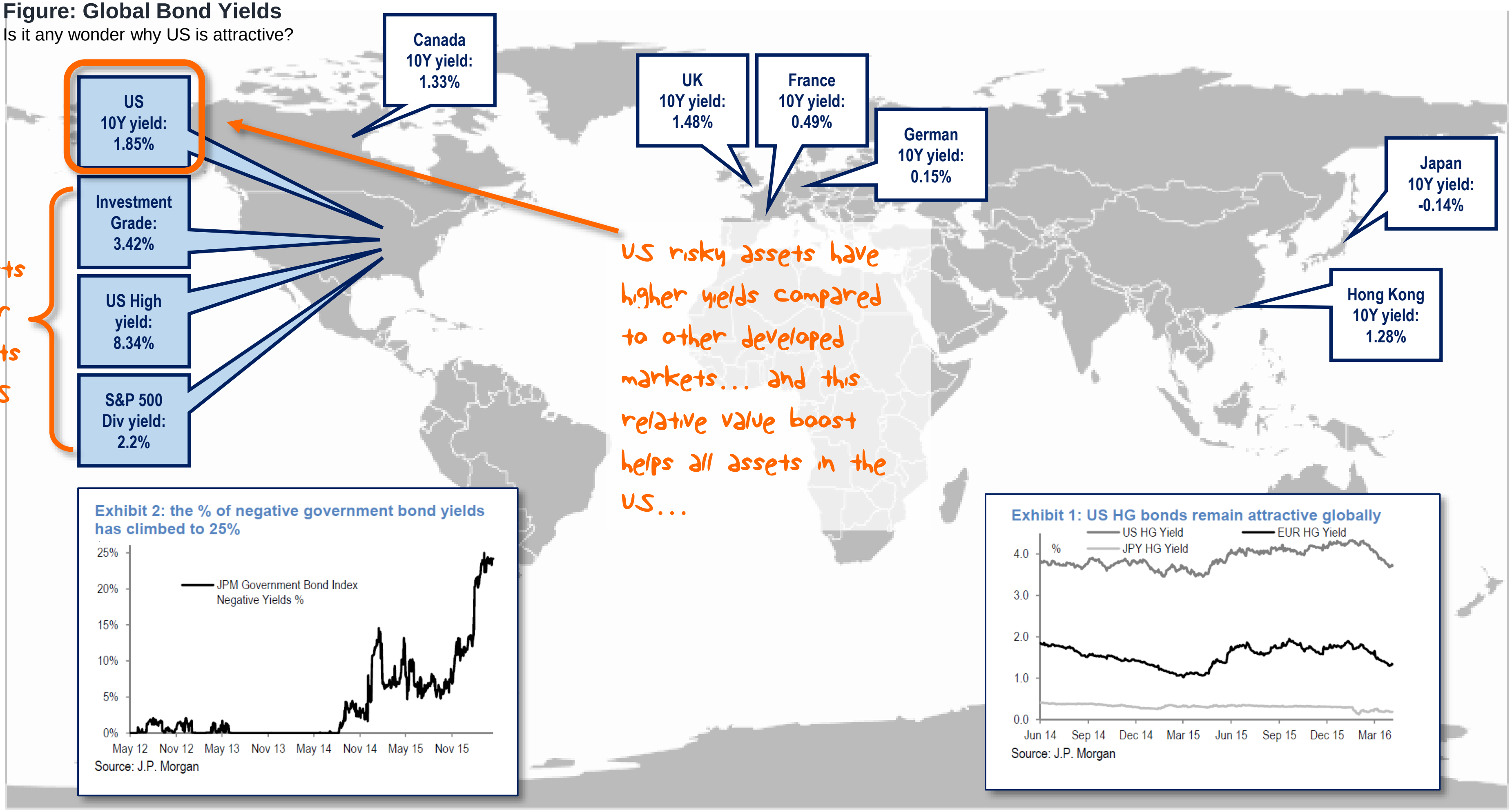
GLOBAL CARRY: investors migrate to US assets…

Foremost, we believe the US remains one of the most attractive places for fresh capital, given the relatively high-yields of US assets:

- From Eric Beinstein, Head of US High-grade Strategy at JPMorgan "**When we are asked for our spread view going forward we usually respond first with a simple answer – look at the level of German and Japanese 10yr yields (0.14% and -0.09%, respectively) vs the US HG credit 10yr yield (3.42%, 3.71% for the JULI overall) and it is clear that the global demand for yield is going to continue to pressure our yields lower**."

Figure: Global Bond Yields

Is it any wonder why US is attractive?



Boosts other assets in US

Source: Fundstrat, Bloomberg.

GLOBAL CARRY: Gov't bonds have delivered strong returns YTD

Another reason relative value plays into equities later this year is that government bonds have already delivered impressive returns YTD. As shown below on the right, investors have earned double-digit gains owning many 30-year bonds.

- **In fact, as shown below, many European government bonds trade at astoundingly high prices (as percent of par), meaning the fall in yields is obviously delivering impressive total return gains.**

Figure: Comparative yields and prices of government bonds

	5 Year Bond			10 Year Bond			30 Year Bond		
	Price	Bond coupon	Yield to Maturity	Price	Bond coupon	Yield to Maturity	Price	Bond coupon	Yield to Maturity
Americas									
United States	100	1.125%	1.053%	101	1.625%	1.513%	104	2.500%	2.318%
Canada	101	0.750%	0.628%	103	1.500%	1.126%	140	3.500%	1.764%
Brazil (USD)	105	4.875%	3.636%	108	6.000%	4.936%	89	5.000%	5.812%
Colombia (USD)	108	4.375%	2.764%	107	4.500%	3.579%	104	5.000%	4.754%
Mexico (USD)	106	3.500%	2.142%	108	4.125%	3.142%	105	4.600%	4.305%
EMEA									
United Kingdom	105	1.500%	0.451%	109	2.000%	0.947%	139	3.500%	1.768%
France	102	0.000%	-0.328%	103	0.500%	0.215%	158	3.250%	0.945%
Germany	103	0.000%	-0.558%	106	0.500%	-0.127%	160	2.500%	0.380%
Italy	100	0.450%	0.363%	102	1.600%	1.369%	107	2.700%	2.377%
Spain	102	0.750%	0.265%	106	1.950%	1.253%	113	2.900%	2.320%
Portugal	109	3.850%	1.863%	98	2.875%	3.067%	103	4.100%	3.949%
Sweden	122	3.500%	-0.254%	107	1.000%	0.302%			
South Africa	94	6.750%	8.232%	112	10.500%	8.763%	92	8.750%	9.536%
Netherlands	102	0.000%	-0.404%	104	0.500%	0.104%	163	2.750%	0.519%
Switzerland	115	2.000%	-0.996%	119	1.250%	-0.572%	233	4.000%	-0.052%
Asia / Pacific									
Japan	102	0.100%	-0.312%	103	0.100%	-0.235%	106	0.300%	0.093%
Australia	119	5.750%	1.678%	120	4.250%	2.010%			
New Zealand	118	6.000%	2.031%	120	4.500%	2.353%			
Hong Kong	108	2.310%	0.606%	111	2.070%	0.953%			
China	100	2.580%	2.670%	100	2.900%	2.853%			
India	102	7.800%	7.386%	101	7.590%	7.444%			
South Korea	104	2.000%	1.303%	104	1.875%	1.475%	111	2.000%	1.569%
% above Par	91%			95%			88%		
% above 105	41%			55%			63%		
% above 110	18%			23%			50%		

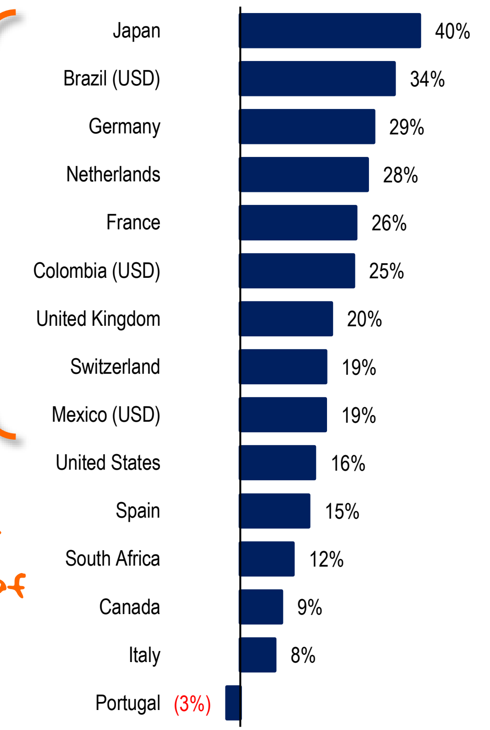
Source: Fundstrat, Bloomberg.

impressive...

Swiss 30Y bonds trade at 233% of par!!!

Figure: YTD return 30-year bonds

Local currency except where noted



Source: Fundstrat, Bloomberg.

STYLES: Weekly absolute performance

Figure: Trailing 1-week absolute performance of styles
Since April 2016

4/27/2016	5/4/2016	5/11/2016	5/18/2016	5/25/2016	6/1/2016	6/8/2016	6/15/2016	6/22/2016	6/29/2016
High Beta 2.5%	Low Volatility 0.2%	Momentum (D.J.) 1.1%	FS: Credit easing 0.8%	High Beta 4.3%	Russell 2000 1.9%	FS: USD weakens 3.7%	Low Volatility -0.4%	FS: Credit easing 1.7%	Low Volatility 1.1%
FS: Credit easing 2.0%	Dividend Yield -1.1%	Low Volatility 1.1%	High Beta 0.0%	Contrarian 3.7%	Contrarian 1.5%	Contrarian 2.4%	FS: Value over FANG -0.6%	High Beta 1.7%	Dividend Yield 0.1%
FS: USD weakens 1.8%	FS: Value over FANG -1.3%	Growth 0.9%	Growth -0.8%	Russell 2000 3.5%	Dividend Yield 1.1%	Russell 2000 2.2%	Dividend Yield -1.6%	FS: USD weakens 1.5%	Momentum (D.J.) 0.1%
Russell 2000 1.0%	Growth -1.5%	Mega-Cap 0.8%	S&P 500 -0.8%	FS: Credit easing 3.4%	Low Volatility 1.0%	Dividend Yield 1.9%	FS: Stocks "new bonds" -1.7%	FS: Stocks "new bonds" 1.2%	Mega-Cap -0.1%
Dividend Yield 0.9%	FS: Stocks "new bonds" -1.6%	FS: Value over FANG 0.7%	Mega-Cap -0.8%	FS: USD weakens 3.4%	Momentum (D.J.) 0.9%	High Beta 1.9%	Momentum (D.J.) -1.8%	Value 1.1%	FS: Value over FANG -0.4%
Equal Weight 0.9%	Mega-Cap -1.6%	S&P 500 0.7%	Value -0.9%	Equal Weight 2.4%	High Beta 0.7%	FS: Credit easing 1.8%	Mega-Cap -2.0%	Equal Weight 1.0%	Growth -0.6%
Contrarian 0.8%	Momentum (D.J.) -1.6%	Dividend Yield 0.6%	Equal Weight -0.9%	Value 2.2%	FS: Credit easing 0.7%	Low Volatility 1.4%	Growth -2.0%	Dividend Yield 1.0%	S&P 500 -0.7%
Value 0.7%	S&P 500 -2.1%	FS: Credit easing 0.5%	Momentum (D.J.) -0.9%	Momentum (D.J.) 2.1%	Equal Weight 0.7%	FS: Value over FANG 1.4%	S&P 500 -2.2%	Low Volatility 0.9%	FS: Stocks "new bonds" -0.7%
FS: Stocks "new bonds" 0.6%	Value -2.7%	Equal Weight 0.4%	Russell 2000 -1.1%	S&P 500 2.1%	Growth 0.5%	FS: Stocks "new bonds" 1.4%	Value -2.5%	FS: Value over FANG 0.9%	Value -0.8%
FS: Value over FANG 0.3%	Equal Weight -2.9%	Value 0.4%	Low Volatility -1.5%	Mega-Cap 2.1%	FS: Stocks "new bonds" 0.4%	Equal Weight 1.4%	Equal Weight -2.8%	Momentum (D.J.) 0.8%	Equal Weight -1.5%
Momentum (D.J.) 0.1%	Russell 2000 -3.6%	FS: Stocks "new bonds" 0.3%	FS: Stocks "new bonds" -1.5%	FS: Stocks "new bonds" 2.1%	S&P 500 0.4%	Momentum (D.J.) 1.2%	Russell 2000 -3.3%	S&P 500 0.7%	Russell 2000 -1.5%
Low Volatility -0.2%	FS: USD weakens -4.0%	Russell 2000 0.1%	FS: USD weakens -1.6%	Growth 2.0%	Value 0.3%	Value 1.2%	FS: USD weakens -4.0%	Contrarian 0.5%	Contrarian -3.2%
S&P 500 -0.3%	Contrarian -5.1%	High Beta -0.2%	Dividend Yield -1.8%	Dividend Yield 2.0%	FS: Value over FANG 0.3%	S&P 500 0.9%	Contrarian -4.5%	Mega-Cap 0.4%	High Beta -3.3%
Growth -1.3%	FS: Credit easing -7.1%	Contrarian -0.4%	FS: Value over FANG -1.9%	FS: Value over FANG 1.3%	Mega-Cap 0.2%	Mega-Cap 0.7%	FS: Credit easing -5.5%	Growth 0.2%	FS: Credit easing -3.6%
Mega-Cap -1.4%	High Beta -7.2%	FS: USD weakens -0.8%	Contrarian -2.0%	Low Volatility 0.6%	FS: USD weakens 0.1%	Growth 0.7%	High Beta -5.5%	Russell 2000 0.0%	FS: USD weakens -4.4%

= Fundstrat theme strategy
= styles with higher risk
= S&P 500
= all other styles

Fundstrat theme definitions:

USD weakens:
Buy stocks inverse correlation to USD (Value style, Energy / Materials / Telecom sectors)

Credit easing:
Buy inverse correlation to HY spreads (Value and Low-Quality)

FANG ends with DANG:
Leaders rarely lead the following year. Buy Value over Momentum.

Stocks are the "new bonds":
Buy stocks where dividend yield > co's own bond yield.

Source: Fundstrat, Bloomberg.

STRATEGY: Stocks are the New Bonds

Sector	#	Ticker	Company name	Current Price	Mkt cap ($ mm)	3m avg daily liquidity ($ mm)	YTD perf (relative to S&P 500)	Dividend Payout Ratio	a Regular Dividend Yield	b Special Dividend + Buyback Yield	c = a+b CASH RETURN Yield	d = a + 0.25*b Adjusted CASH RETURN yield	e Adjusted Bond Yield	f = a - e Dividend Yield less Bond Yield	g = d-e CASH RETURN yield less Bond yield	2017E P/E	Issuer Rating
Discretionary	1	TGT	Target Corp	$69.82	$41,143	$452.3	(6.5%)	41.5%	3.4%	9.2%	12.6%	5.7%	3.0%	42	271	12.4x	A
Industrials	2	BA	Boeing Co/The	$129.87	$82,729	$584.5	(12.9%)	51.0%	3.4%	9.4%	12.7%	5.7%	2.9%	42	276	13.6x	A
	3	CAT	Caterpillar Inc	$75.81	$44,265	$396.2	8.9%	143.8%	4.1%	3.8%	7.8%	5.0%	3.1%	92	186	21.3x	A
	4	EMR	Emerson Electric Co	$52.16	$33,557	$190.7	6.4%	64.1%	3.6%	4.9%	8.6%	4.9%	2.5%	113	236	16.1x	A
	5	GE	General Electric Co	$31.48	$289,479	$1,006.4	(1.6%)	113.1%	2.9%	10.3%	13.2%	5.5%	2.9%	1	256	18.1x	AA+
	6	MMM	3M Co	$175.12	$106,213	$322.1	13.6%	52.6%	2.5%	5.2%	7.7%	3.8%	2.5%	6	135	19.6x	AA-
	7	PCAR	Paccar Inc	$51.87	$18,179	$126.4	6.7%	131.1%	1.9%		1.9%	1.9%	1.2%	63	63	13.7x	A+
	8	UPS	United Parcel Service-Cl B	$107.72	$95,081	$265.6	9.3%	54.3%	2.9%	3.0%	5.8%	3.6%	2.3%	58	131	17.3x	A+
Technology	9	ACN	Accenture Plc-Cl A	$113.29	$73,851	$252.9	5.7%	36.4%	1.9%	3.4%	5.3%	2.8%	0.0%	194	279	18.9x	A+
	10	ADI	Analog Devices Inc	$56.64	$17,408	$111.1	(0.3%)	77.9%	3.0%	2.8%	5.8%	3.7%	2.9%	5	75	17.4x	A-
	11	CSCO	Cisco Systems Inc	$28.69	$144,302	$642.5	3.0%	44.0%	3.6%	2.9%	6.5%	4.3%	2.9%	69	141	11.6x	AA-
	12	IBM	Intl Business Machines Corp	$151.78	$145,703	$579.3	7.6%	39.2%	3.7%	3.0%	6.7%	4.4%	2.5%	121	195	10.7x	AA-
	13	INTC	Intel Corp	$32.80	$154,882	$687.3	(7.5%)	51.2%	3.2%	2.6%	5.8%	3.8%	2.7%	45	110	12.6x	A+
	14	MSFT	Microsoft Corp	$51.17	$402,220	$1,644.4	(10.5%)	108.5%	2.8%	3.8%	6.6%	3.8%	2.7%	13	108	16.8x	AAA
	15	QCOM	Qualcomm Inc	$53.57	$78,690	$489.4	4.5%	60.6%	4.0%	14.5%	18.4%	7.6%	3.3%	69	431	11.4x	A+
	16	TXN	Texas Instruments Inc	$62.65	$62,915	$300.8	11.6%	49.8%	2.4%	4.3%	6.7%	3.5%	2.0%	47	154	18.7x	A+
	17	XLNX	Xilinx Inc	$46.13	$11,684	$129.9	(4.5%)	57.8%	2.9%	3.8%	6.7%	3.8%	2.6%	24	119	20.1x	A-u
Materials	18	APD	Air Products & Chemicals Inc	$142.04	$30,692	$149.1	6.5%	50.4%	2.4%	0.0%	2.4%	2.4%	1.9%	51	51	17.2x	A
	19	PX	Praxair Inc	$112.39	$32,061	$134.1	7.1%	55.6%	2.7%	1.6%	4.3%	3.1%	2.1%	57	98	18.5x	A
Energy	20	CVX	Chevron Corp	$104.83	$197,573	$683.4	13.8%	617.5%	4.1%	0.0%	4.1%	4.1%	2.5%	160	160	22.9x	AA-
	21	OXY	Occidental Petroleum Corp	$75.56	$57,708	$290.9	9.1%		4.0%	1.7%	5.7%	4.4%	3.1%	92	134	59.0x	A
	22	SLB	Schlumberger Ltd	$79.08	$110,018	$558.9	10.7%	157.9%	2.5%	1.8%	4.3%	3.0%	2.5%	5	49	38.8x	AA-
	23	XOM	Exxon Mobil Corp	$93.74	$388,703	$953.9	17.6%	94.3%	3.2%	0.8%	4.0%	3.4%	2.6%	58	77	22.0x	AA+
Financials	24	HSBC	Hsbc Holdings Plc-Spons Adr	$31.31	$124,067	$98.2	(23.4%)	81.0%	6.4%		6.4%	6.4%	4.7%	171	171	10.1x	A
	25	AMP	Ameriprise Financial Inc	$89.85	$14,898	$122.2	(18.3%)	31.4%	3.3%	12.4%	15.8%	6.5%	3.1%	26	337	8.5x	A
	26	AVB	Avalonbay Communities Inc	$180.39	$24,743	$142.9	(4.7%)	89.9%	3.0%	0.0%	3.0%	3.0%	2.7%	26	27	36.9x	A-
	27	BBT	Bb&T Corp	$35.61	$28,917	$174.6	(8.5%)	40.7%	3.1%	0.2%	3.3%	3.2%	2.8%	35	39	11.2x	A-
	28	BLK	Blackrock Inc	$342.53	$56,502	$203.4	(2.1%)	47.4%	2.7%	2.5%	5.1%	3.3%	2.5%	19	81	15.1x	AA-
	29	IVZ	Invesco Ltd	$25.54	$10,657	$131.7	(26.4%)	52.8%	4.4%	6.0%	10.4%	5.9%	3.2%	118	269	9.5x	A
	30	JPM	Jpmorgan Chase & Co	$62.14	$227,225	$983.8	(8.6%)	30.0%	3.1%	2.4%	5.5%	3.7%	2.8%	33	92	9.7x	A-
	31	MET	Metlife Inc	$39.83	$43,760	$291.6	(20.1%)	32.0%	4.0%	2.3%	6.3%	4.6%	3.9%	7	65	6.7x	A-
	32	PSA	Public Storage	$255.59	$44,315	$213.8	0.5%	108.8%	2.8%	0.0%	2.8%	2.8%	1.7%	107	107	33.1x	A
	33	SPG	Simon Property Group Inc	$216.90	$67,113	$275.1	8.9%	109.6%	3.0%	0.5%	3.5%	3.1%	2.7%	21	34	32.6x	A
Staples	34	KO	Coca-Cola Co/The	$45.33	$196,107	$582.4	2.8%	80.8%	3.1%	2.0%	5.1%	3.6%	2.5%	61	110	22.1x	AA-
	35	MO	Altria Group Inc	$68.96	$134,915	$391.6	15.8%	79.6%	3.3%	0.4%	3.7%	3.4%	3.3%	-1	9	20.7x	A-
	36	PEP	Pepsico Inc	$105.94	$153,022	$463.9	3.3%	79.9%	2.8%	2.9%	5.8%	3.6%	2.7%	18	91	20.7x	A
	37	PG	Procter & Gamble Co/The	$84.67	$225,379	$582.9	3.9%	90.6%	3.2%	3.7%	6.9%	4.1%	2.5%	68	161	20.8x	AA-
	38	PM	Philip Morris International	$101.72	$157,795	$431.8	13.0%	95.6%	4.0%	0.0%	4.0%	4.0%	2.6%	141	141	20.8x	A
Healthcare	39	ABBV	Abbvie Inc	$61.91	$100,131	$519.6	1.8%	64.4%	3.7%	7.5%	11.2%	5.6%	3.7%	3	191	11.0x	A-
	40	JNJ	Johnson & Johnson	$121.30	$333,653	$815.5	15.4%	54.1%	2.6%	1.6%	4.3%	3.1%	2.6%	2	43	17.3x	AAA
	41	LLY	Eli Lilly & Co	$78.75	$86,927	$310.4	(9.2%)	92.0%	2.6%	0.8%	3.4%	2.8%	2.5%	11	32	19.7x	AA-
	42	MRK	Merck & Co. Inc.	$57.61	$159,466	$492.3	6.4%	110.8%	3.2%	2.6%	5.8%	3.8%	2.4%	75	139	15.3x	AA
	43	PFE	Pfizer Inc	$35.21	$213,543	$1,232.4	6.4%	83.8%	3.4%	1.9%	5.4%	3.9%	3.2%	22	70	13.4x	AA
Utilities	44	CNP	Centerpoint Energy Inc	$24.00	$10,335	$79.3	28.0%		4.3%		4.3%	4.3%	3.4%	86	86	19.7x	A-
	45	DUK	Duke Energy Corp	$85.79	$59,092	$232.7	17.5%	83.5%	3.8%		3.8%	3.8%	3.3%	59	59	18.1x	A-
	46	PPL	Ppl Corp	$37.75	$25,555	$173.1	7.9%	66.3%	4.0%	0.0%	4.0%	4.0%	3.5%	55	55	15.5x	A-
	47	SO	Southern Co/The	$53.63	$50,335	$256.4	11.9%	84.4%	4.2%	0.0%	4.2%	4.2%	3.6%	62	62	18.1x	A-
		Average			$109,947	$428.8	2.6%	85%	3.3%	3.3%	6.3%	4.1%	2.7%	56	132	18.6x	
		Median			$78,690	$310.4	5.7%	66%	3.2%	2.6%	5.7%	3.8%	2.7%	51	110	17.4x	

Stocks are the New Bonds Screening Criteria

a. US Listed stocks with Market Cap >$10B
b. S&P Issuer Credit Rating of A- or better
c. Regular Dividend Yield > Issuer's own weighted average Bond Yield

Outperformed by 1,600bp annualized

Additions	Deletions
ACN	ADP
ADI	CL
APD	CME
AVB	CMI
CNP	D
IVZ	ED
MET	ES
MSFT	HSY
PCAR	KMB
PSA	NOV
SLB	PRU
SPG	USB
	WEC
	WFC
	XEL

Source: Fundstrat, Bloomberg, Factset,

STRATEGY: Changes to Large Cap "Stocks are the New Bonds"

Figure: Deletions on 6/30/16 from list published 4/8/2016

										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)	Rel. % Chg Since 4/8/16	Dividend Payout Ratio	Regular Dividend Yield	Special Dividend + Buyback Yield	CASH RETURN Yield	Adjusted CASH RETURN yield	Adjusted Bond Yield	Dividend Yield less Bond Yield	CASH RETURN yield less Bond yield	2017E P/E	Issuer Rating
Industrials	1	CMI	Cummins Inc	$112.44	$19,155	$221.3	25.1%	3.3%	49.0%	3.5%	6.5%	9.9%	5.1%	3.7%	(20)	142	14.3x	A+
Technology	2	ADP	Automatic Data Processing	$91.87	$41,850	$172.4	5.8%	(0.8%)	63.9%	2.3%	4.4%	6.7%	3.4%	2.4%	(13)	96	23.9x	AA
Energy	3	NOV	National Oilwell Varco Inc	$33.65	$12,688	$186.9	(2.2%)	13.1%		0.6%	11.9%	12.5%	3.6%	4.7%	(413)	(116)	-81.3x	A-
Financials	4	CME	Cme Group Inc	$97.40	$32,984	$160.2	4.8%	6.8%	131.1%	2.5%	2.7%	5.2%	3.2%	3.0%	(56)	[illegible]	21.0x	AA
	5	PRU	Prudential Financial Inc	$71.34	$31,532	$186.0	(15.1%)	(0.8%)	23.5%	3.9%	6.2%	10.2%	5.5%	5.7%	(174)	(19)	6.9x	A
	6	USB	Us Bancorp	$40.33	$69,626	$316.9	(8.2%)	(0.1%)	32.2%	2.5%	3.4%	6.0%	3.4%	2.6%	(6)	80	11.4x	A+
	7	WFC	Wells Fargo & Co	$47.33	$240,297	$910.1	(15.6%)	(2.0%)	37.0%	3.2%	3.7%	6.9%	4.1%	5.6%	(240)	(148)	10.8x	A
Staples	8	KMB	Kimberly-Clark Corp	$137.48	$49,510	$224.7	5.3%	(2.5%)	118.7%	2.7%	1.5%	[illegible]	3.1%	2.7%	(7)	31	20.9x	A
	9	CL	Colgate-Palmolive Co	$73.20	$65,369	$224.5	7.2%	0.5%	124.7%	2.1%	2.6%	4.7%	2.8%	2.5%	(35)	30	23.8x	AA-
	10	HSY	Hershey Co/The	$113.49	$24,216	$124.3	24.4%	21.1%	99.9%	2.1%	2.4%	4.4%	2.7%	2.4%	(34)	26	25.0x	A
Utilities	11	D	Dominion Resources Inc/Va	$77.93	$48,022	$206.4	12.5%	4.2%	83.3%	3.6%	0.0%	3.6%	3.6%	3.6%	(2)	(1)	20.1x	BBB+
	12	ED	Consolidated Edison Inc	$80.44	$24,467	$160.5	22.5%	3.3%	67.8%	3.3%		3.3%	3.3%	3.8%	(43)	(43)	19.4x	A-
	13	WEC	Wec Energy Group Inc	$65.30	$20,612	$120.3	24.6%	8.3%	68.7%	3.0%	0.0%	3.0%	3.0%	3.3%	(32)	(32)	21.0x	A-
	14	ES	Eversource Energy	$59.90	$19,001	$96.7	14.6%	2.5%	62.4%	3.0%	0.5%	3.4%	3.1%	3.0%	(8)	4	18.9x	A
	15	XEL	Xcel Energy Inc	$44.78	$22,746	$131.3	22.0%	6.7%	61.7%	3.0%	0.0%	3.0%	3.0%	3.2%	(19)	(19)	19.3x	A-
		Average			**$48,138**	**$229.5**	**0.1%**	**4.2%**	**73%**	**2.8%**	**3.3%**	**5.8%**	**3.5%**	**3.5%**	**(74)**	**3**	**11.7x**	
		Median			**$31,532**	**$186.0**	**0.1%**	**3.3%**	**66%**	**3.0%**	**2.7%**	**4.7%**	**3.3%**	**3.2%**	**(32)**	**4**	**19.4x**	

The 15 names coming off the list, outperformed by an average of 390bp since 4/8/16—that is 1,600bp annualized…

Figure: Additions to list on 6/30/16

								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	Regular Dividend Yield	Special Dividend + Buyback Yield	CASH RETURN Yield	Adjusted CASH RETURN yield	Adjusted Bond Yield	Dividend Yield less Bond Yield	CASH RETURN yield less Bond yield	2017E P/E	Issuer Rating
Industrials	1	PCAR	Paccar Inc	$51.87	$18,179	$126.4	6.7%	131.1%	1.9%		1.9%	1.9%	1.2%	63	63	13.7x	A+
Technology	2	ACN	Accenture Plc-Cl A	$113.29	$73,851	$252.9	5.7%	36.4%	1.9%	3.4%	5.3%	2.8%	0.0%	194	279	18.9x	A+
	3	ADI	Analog Devices Inc	$56.64	$17,408	$111.1	(0.3%)	77.9%	3.0%	2.8%	5.8%	3.7%	2.9%	5	75	17.4x	A-
	4	MSFT	Microsoft Corp	$51.17	$402,220	$1,644.4	(10.5%)	108.5%	2.8%	3.8%	6.6%	3.8%	2.7%	13	108	16.8x	AAA
Materials	5	APD	Air Products & Chemicals Inc	$142.04	$30,692	$149.1	6.5%	50.4%	2.4%	0.0%	2.4%	2.4%	1.9%	51	51	17.2x	A
Energy	6	SLB	Schlumberger Ltd	$79.08	$110,018	$558.9	10.7%	157.9%	2.5%	1.8%	4.3%	3.0%	2.5%	5	49	38.8x	AA-
Financials	7	AVB	Avalonbay Communities Inc	$180.39	$24,743	$142.9	(4.7%)	89.9%	3.0%	0.0%	3.0%	3.0%	2.7%	26	27	36.9x	A-
	8	IVZ	Invesco Ltd	$25.54	$10,657	$131.7	(26.4%)	52.8%	4.4%	6.0%	10.4%	5.9%	3.2%	118	269	9.5x	A
	9	MET	Metlife Inc	$39.83	$43,760	$291.6	(20.1%)	32.0%	4.0%	2.3%	6.3%	4.6%	3.9%	7	65	6.7x	A-
	10	PSA	Public Storage	$255.59	$44,315	$213.8	0.5%	108.8%	2.8%	0.0%	2.8%	2.8%	1.7%	107	107	33.1x	A
	11	SPG	Simon Property Group Inc	$216.90	$67,113	$275.1	8.9%	109.6%	3.0%	0.5%	3.5%	3.1%	2.7%	21	34	32.6x	A
Utilities	12	CNP	Centerpoint Energy Inc	$24.00	$10,335	$79.3	28.0%		4.3%		4.3%	4.3%	3.4%	86	86	19.7x	A-
		Average			**$71,107**	**$331.4**	**0.4%**	**87%**	**3.0%**	**2.1%**	**4.7%**	**3.4%**	**2.4%**	**58**	**101**	**21.8x**	
		Median			**$37,226**	**$181.5**	**3.1%**	**90%**	**2.9%**	**2.0%**	**4.3%**	**3.0%**	**2.7%**	**39**	**70**	**18.2x**	

Source: Fundstrat, Bloomberg, Factset,

Stocks are the New Bonds: SMID Cap

										a	b	c = a+b	d = a + 0.25*b	e	f = d-e	
		Ticker	Company name	Current Price	Mkt cap ($ mm)	3m avg daily liquidity ($ mm)	YTD perf (relative to Russell 3000)	Relative Performance Since 6/23/16	Dividend Payout Ratio	Regular Dividend Yield	Special Dividend + Buyback Yield	CASH RETURN Yield	Adjusted CASH RETURN yield	Adjusted Bond Yield	CASH RETURN yield less Bond yield	Issuer Rating
Discretionary	1	ABG	Asbury Automotive Group	$52.13	$1,155	$20.0	-22.1%	-1.3%	0.0%		26.6%	26.6%	6.6%	5.8%	86	BB+
	2	BBY	Best Buy Co Inc	$30.02	$9,689	$150.8	0.6%	2.1%	47.6%	3.7%	8.3%	12.0%	5.8%	3.6%	225	BB+
	3	DDS	Dillards Inc-Cl A	$59.13	$2,042	$38.5	-9.4%	3.7%	4.3%	0.5%	27.3%	27.8%	7.3%	5.7%	162	BBB-
	4	EAT	Brinker International Inc	$45.10	$2,513	$57.0	-5.3%	3.2%	36.2%	2.8%	14.1%	17.0%	6.4%	3.7%	266	BBB-
	5	GNC	Gnc Holdings Inc-Cl A	$23.64	$1,616	$44.1	-23.2%	-2.8%	25.4%	3.4%	56.7%	60.1%	17.6%	6.8%	1076	BB+
	6	GPS	Gap Inc/The	$20.74	$8,254	$161.2	-15.4%	1.5%	46.1%	4.4%	9.3%	13.7%	6.8%	5.6%	120	BB+
	7	HOG	Harley-Davidson Inc	$42.90	$7,769	$133.2	-4.9%	-3.9%	34.2%	3.3%	19.3%	22.5%	8.1%	3.3%	481	A-
	8	HRB	H&R Block Inc	$22.32	$4,922	$101.7	-32.4%	0.7%	52.0%	3.9%	41.0%	44.9%	14.2%	4.3%	990	BBB
	9	JWN	Nordstrom Inc	$37.11	$6,436	$188.8	-24.9%	0.2%	227.4%	4.0%	31.8%	35.8%	11.9%	4.1%	786	BBB+
	10	KSS	Kohls Corp	$37.61	$6,909	$137.6	-20.4%	2.9%	62.0%	5.3%	14.5%	19.8%	8.9%	5.2%	371	BBB
	11	SPLS	Staples Inc	$8.45	$5,461	$97.5	-10.1%	-4.2%	86.1%	5.7%		5.7%	5.7%	4.4%	127	BBB-
	12	TUP	Tupperware Brands Corp	$53.12	$2,683	$36.2	-3.9%	-9.2%	68.3%	5.1%		5.1%	5.1%	3.5%	165	BBB-
	13	WEN	Wendy'S Co/The	$9.37	$2,497	$38.0	-12.4%	-0.3%	46.7%	2.6%	45.4%	47.9%	13.9%	7.0%	692	B
	14	WYN	Wyndham Worldwide Corp	$67.23	$7,527	$90.6	-6.8%	-3.4%	35.4%	3.0%	9.0%	11.9%	5.2%	3.5%	171	BBB-
Industrials	15	AYR	Aircastle Ltd	$18.84	$1,485	$7.2	-9.2%	-6.7%	64.8%	5.1%	3.4%	8.5%	5.9%	4.8%	116	BB+
	16	GMT	Gatx Corp	$42.50	$1,738	$23.4	0.5%	-5.1%	30.8%	3.8%	16.2%	20.0%	7.8%	4.1%	368	BBB
	17	PBI	Pitney Bowes Inc	$17.01	$3,208	$31.4	-17.0%	-4.4%	39.0%	4.4%	8.2%	12.6%	6.5%	3.9%	259	BBB
	18	TKR	Timken Co	$29.58	$2,343	$25.7	4.1%	-7.8%	67.4%	3.5%	10.7%	14.2%	6.2%	4.2%	199	BBB
Technology	19	CSC	Computer Sciences Corp	$47.59	$6,627	$83.7	46.3%	-3.9%	366.4%	1.2%	25.6%	26.8%	7.6%	3.7%	392	BBB *-
	20	NCR	Ncr Corporation	$25.86	$3,204	$34.2	6.4%	-10.9%	0.0%		37.8%	37.8%	9.4%	5.6%	380	BB+
	21	NTAP	Netapp Inc	$23.18	$6,492	$78.1	-12.0%	-6.2%	65.6%	3.3%	14.8%	18.1%	7.0%	3.0%	398	BBB+
	22	NUAN	Nuance Communications Inc	$15.10	$4,216	$49.3	-23.4%	-3.7%			20.8%	20.8%	5.2%	3.9%	131	BB-
Materials	23	GEF	Greif Inc-Cl A	$35.55	$2,036	$10.2	16.0%	-5.2%	194.5%	4.7%	7.7%	12.4%	6.7%	3.6%	300	BB
	24	PKG	Packaging Corp Of America	$63.67	$5,992	$59.6	1.6%	-3.3%	47.3%	3.5%	4.3%	7.8%	4.5%	3.4%	112	BBB
Energy	25	TRGP	Targa Resources Corp	$40.98	$6,581	$107.6	52.1%	-4.2%	509.1%	8.9%		8.9%	8.9%	6.3%	263	BB-
Financials	26	AWH	Allied World Assurance Co	$33.70	$3,022	$18.5	-8.7%	-2.8%	343.6%	3.1%	8.8%	11.8%	5.3%	4.0%	125	BBB+
	27	AXS	Axis Capital Holdings Ltd	$52.11	$4,842	$27.0	-6.7%	0.9%	25.8%	2.7%	19.1%	21.8%	7.5%	3.4%	410	A-
	28	BGCP	Bgc Partners Inc-Cl A	$8.49	$2,329	$10.5	-12.8%	-2.4%	113.3%	7.5%		7.5%	7.5%	4.8%	270	BBB-
	29	BOKF	Bok Financial Corporation	$58.51	$3,871	$16.8	-1.5%	-3.9%	43.9%	2.9%	4.9%	7.8%	4.2%	3.4%	79	BBB+
	30	CNA	Cna Financial Corp	$29.90	$8,087	$4.5	-8.5%	-1.9%	260.2%	3.3%	6.7%	10.0%	5.0%	3.4%	162	BBB
	31	NAVI	Navient Corp	$11.42	$3,774	$41.0	0.4%	-5.3%	26.1%	5.6%	22.9%	28.5%	11.3%	8.1%	324	BB
	32	PBCT	People'S United Financial	$14.13	$4,392	$66.9	-11.9%	-7.4%	76.5%	4.8%	0.1%	4.9%	4.8%	3.6%	126	BBB+
	33	TRMK	Trustmark Corp	$23.69	$1,602	$9.8	3.5%	-2.8%	54.8%	3.9%		3.9%	3.9%	3.1%	75	BBB+
Staples	34	FLO	Flowers Foods Inc	$18.21	$3,766	$39.9	-14.6%	6.8%	65.6%	3.5%	2.9%	6.4%	4.2%	3.1%	115	BBB
	35	VGR	Vector Group Ltd	$21.73	$2,690	$15.8	-7.3%	5.1%	342.1%	7.4%		7.4%	7.4%	5.1%	224	B
Utilities	36	ABY	Atlantica Yield Plc	$17.13	$1,717	$7.4	-10.6%	-6.6%		10.0%		10.0%	10.0%	7.4%	267	B+
	37	AES	Aes Corp	$11.79	$7,770	$53.0	23.8%	-0.1%	97.2%	3.7%	6.7%	10.4%	5.4%	5.1%	32	BB
		Average			**$4,358**	**$57.2**	**-4.9%**	**-3%**	**103%**	**4%**	**17%**	**18%**	**7%**	**5%**	**293**	
		Median			**$3,774**	**$39.9**	**-8.5%**	**-3%**	**55%**	**4%**	**14%**	**13%**	**7%**	**4%**	**225**	

Source: Fundstrat, Bloomberg, Factset,

Stocks are the New Bonds: SMID Cap REITs

										a	b	c = a+b	d = a + 0.25*b	e	f = d-e	
		Ticker	Company name	Current Price	Mkt cap ($ mm)	3m avg daily liquidity ($ mm)	YTD perf (relative to Russell 3000)	Relative Performance Since 6/23/16	Dividend Payout Ratio	Regular Dividend Yield	Special Dividend + Buyback Yield	CASH RETURN Yield	Adjusted CASH RETURN yield	Adjusted Bond Yield	CASH RETURN yield less Bond yield	Issuer Rating
Diversified Reits	1	LPT	Liberty Property Trust	$38.37	$5,626	$34.6	**24.2%**	1.6%	106.0%	5.0%		5.0%	5.0%	3.3%	168	BBB
	2	LXP	Lexington Realty Trust	$9.67	$2,273	$11.2	**21.5%**	4.6%	130.8%	7.0%	1.2%	8.2%	7.3%	4.2%	312	BBB-
	3	SIR	Select Income Reit	$25.35	$2,266	$7.9	**28.5%**	5.4%	172.6%	7.9%		7.9%	7.9%	4.2%	371	BBB-
	4	VER	Vereit Inc	$9.81	$8,877	$58.6	**24.5%**	5.3%		5.6%		5.6%	5.6%	4.5%	112	BB
	5	WPC	Wp Carey Inc	$68.14	$7,146	$20.0	**16.1%**	4.2%	210.7%	5.8%		5.8%	5.8%	4.5%	124	BBB
Health Care Reits	6	MPW	Medical Properties Trust Inc	$15.29	$3,637	$34.8	**33.5%**	5.1%	123.4%	6.0%		6.0%	6.0%	5.6%	42	BB+
	7	OHI	Omega Healthcare Investors	$33.77	$6,355	$44.5	**-2.8%**	6.9%	146.2%	6.9%		6.9%	6.9%	4.9%	193	BBB-
	8	SBRA	Sabra Health Care Reit Inc	$20.37	$1,330	$10.0	**1.3%**	4.0%	308.6%	8.2%		8.2%	8.2%	5.0%	327	BB-
	9	SNH	Senior Housing Prop Trust	$21.12	$5,015	$31.7	**43.0%**	8.1%	318.1%	7.4%		7.4%	7.4%	4.5%	284	BBB-
Hotel & Resort Reits	10	HPT	Hospitality Properties Trust	$27.53	$4,172	$21.9	**5.9%**	2.8%	193.4%	7.4%		7.4%	7.4%	4.2%	317	BBB-
	11	RHP	Ryman Hospitality Properties	$48.11	$2,451	$11.9	**-6.2%**	-1.8%	107.6%	6.2%	0.0%	6.2%	6.2%	4.6%	160	B+
Office Reits	12	BDN	Brandywine Realty Trust	$16.29	$2,851	$24.6	**19.9%**	3.5%		3.9%	4.5%	8.4%	5.1%	3.9%	112	BBB-
	13	CXP	Columbia Property Trust Inc	$21.38	$2,640	$11.7	**-8.3%**	1.8%	326.1%	5.6%	1.6%	7.2%	6.0%	3.9%	212	BBB
	14	GOV	Government Properties Income	$22.39	$1,593	$13.3	**41.7%**	9.0%	274.4%	7.7%		7.7%	7.7%	3.2%	449	BBB-
	15	PDM	Piedmont Office Realty Tru-A	$21.02	$3,050	$12.9	**12.0%**	4.9%	76.0%	4.0%	5.9%	9.9%	5.5%	4.1%	134	BBB
Residential Reits	16	PPS	Post Properties Inc	$59.53	$3,184	$30.5	**1.3%**	5.8%	125.6%	3.2%	2.0%	5.2%	3.7%	3.2%	50	BBB
Retail Reits	17	CBL	Cbl & Associates Properties	$9.10	$1,554	$24.9	**-25.8%**	-0.7%	345.1%	11.6%		11.6%	11.6%	5.9%	576	BBB- *-
	18	DDR	Ddr Corp	$17.92	$6,548	$42.7	**7.0%**	5.9%	132.0%	4.2%	0.0%	4.3%	4.3%	3.6%	65	BBB-
	19	WPG	Wp Glimcher Inc	$10.90	$2,020	$23.9	**3.4%**	3.0%		9.2%		9.2%	9.2%	3.3%	589	BBB-
	20	WRI	Weingarten Realty Investors	$39.68	$4,979	$27.9	**15.4%**	6.1%	97.4%	3.7%	1.6%	5.3%	4.1%	3.6%	48	BBB
Specialized Reits	21	CXW	Corrections Corp Of America	$34.85	$4,094	$17.1	**32.2%**	4.8%	119.9%	6.2%		6.2%	6.2%	4.6%	157	BB+
	22	EPR	Epr Properties	$77.75	$4,945	$34.7	**33.7%**	7.6%	121.2%	4.9%	0.1%	5.1%	5.0%	4.4%	54	BB+
	23	GEO	Geo Group Inc/The	$33.16	$2,487	$15.0	**15.3%**	3.6%	131.0%	7.8%		7.8%	7.8%	5.7%	217	BB-
	24	GLPI	Gaming And Leisure Propertie	$33.97	$6,864	$87.3	**22.8%**	3.5%	178.8%	6.6%		6.6%	6.6%	3.8%	281	BB
	25	OUT	Outfront Media Inc	$23.34	$3,219	$19.3	**7.6%**	0.9%		5.8%		5.8%	5.8%	5.0%	79	BB-
	26	RYN	Rayonier Inc	$25.10	$3,083	$10.2	**13.7%**	0.2%	289.9%	4.0%	3.3%	7.3%	4.8%	3.8%	101	BBB-
		Average			**$3,933**	**$26.3**	**14.7%**	**4.1%**	**183%**	**6%**	**2%**	**7%**	**6%**	**4%**	**213**	
		Median			**$3,202**	**$22.9**	**15.4%**	**4.4%**	**139%**	**6%**	**2%**	**7%**	**6%**	**4%**	**164**	

Source: Fundstrat, Bloomberg, Factset,

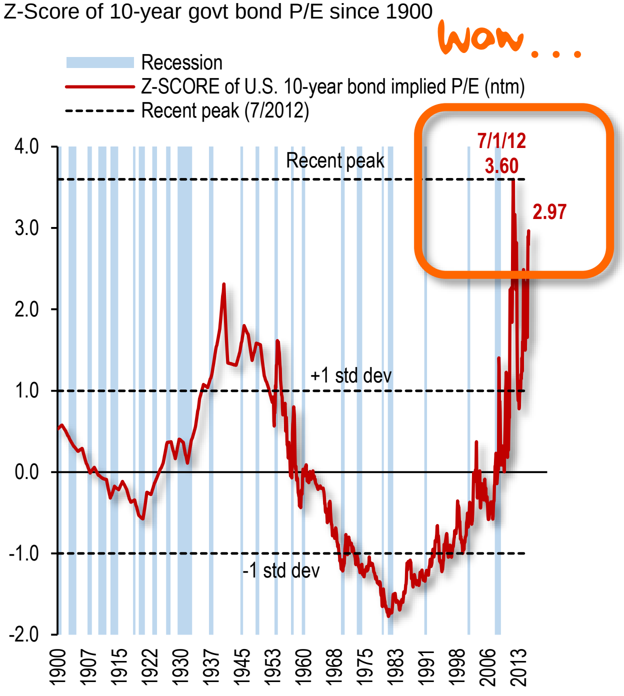
Executive Summary

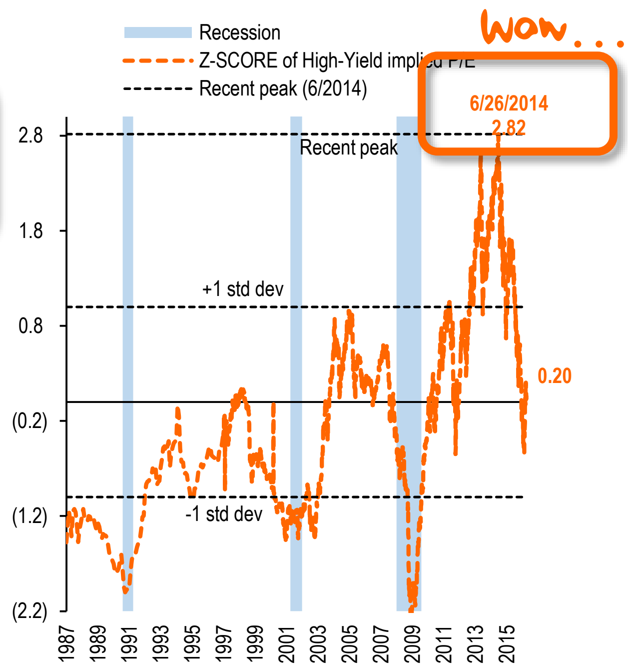
RATIONALE #3: Fixed income 3.0 std dev. expensive… equities de-rated

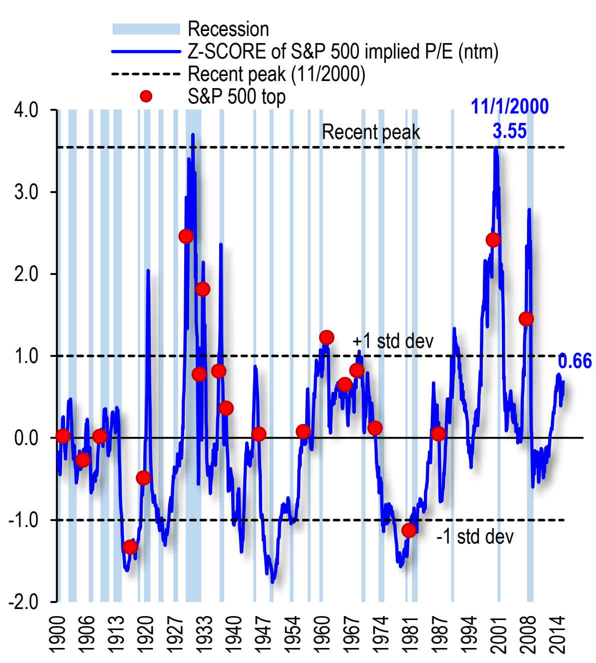
We realize investors have called equities expensive, but this is really not the case when one looks at long-term history. We “normalized” valuation between asset classes by doing two things: (i) we calculated # standard deviations from long-term trend (z-score) and (ii) we proxied PE for bonds by inverting their yield to worst.

- As shown below, 10-yr bonds have become unusually expensive (post-bubble burst) while equities have remained relatively inexpensive.
- **In fact, when one thinks about rising rates and higher inflation, doesn’t it make sense bonds cheapen even faster?**

Figure: Comparative Valuation of 10-yr US Bonds, High-yield Bonds and Equities
Z-Score of 10-year govt bond P/E, implied P/E of HY bonds and equity PE







Source: Fundstrat, Bloomberg, St. Louis Fed.

The big story, in our view, is the USD is about to roll over…

As we argued in our 2016 outlook (December 2015), we expected the USD to actually weaken in 2016, contrary to consensus. The driver, in our view, is relative inflation developments and the fact that strong USD was a crowded trade.

Figure: USD since 2001
Daily

Source: Fundstrat, Bloomberg.

USD: History shows once USD breaks 200D, it tends to further weaken…

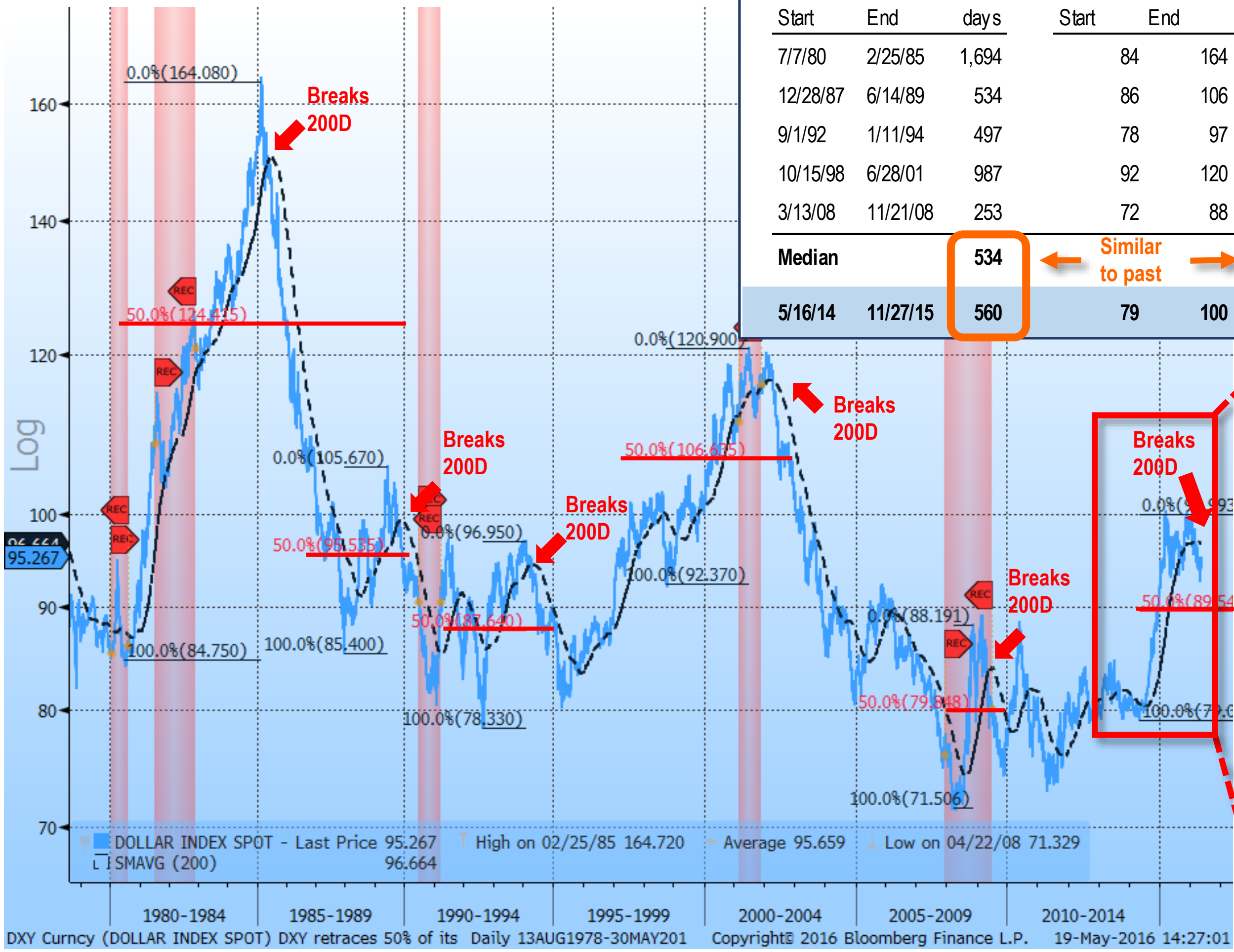
The USD has fallen below its 200d moving average this week and as shown below, generally has signaled a correction ahead. The precedent 5 USD rallies are highlighted below but note that the current rally is nearly identical to the prior 5.

- **The median rally was 24% lasting 534 days (vs 27%/560 days currently) and then a 50% retrace took 175 days. This implies DXY would fall another 5% to 90 by mid-2016, as shown below.**

Figure: USD always retraces 50% of its gains…
US Dollar Index (DXY Index) since 1978

Date and duration USD rally…			Magnitude of USD rally…			How long to retrace 50% of USD gains…			
Start	End	# days	Start	End	% chg	Retrace level	Date	# Days	Ratio vs rally
7/7/80	2/25/85	1,694	84	164	95%	124	12/27/85	305	0.18
12/28/87	6/14/89	534	86	106	23%	96	12/6/89	175	0.33
9/1/92	1/11/94	497	78	97	24%	88	6/27/94	167	0.34
10/15/98	6/28/01	987	92	120	30%	106	7/3/02	370	0.37
3/13/08	11/21/08	253	72	88	22%	80	12/18/08	27	0.11
Median		**534**			**24%**	**96**		**175**	**0.33**
5/16/14	**11/27/15**	**560**	**79**	**100**	**27%**	**90**	**5/29/16**	**185**	**0.33**

Similar to past



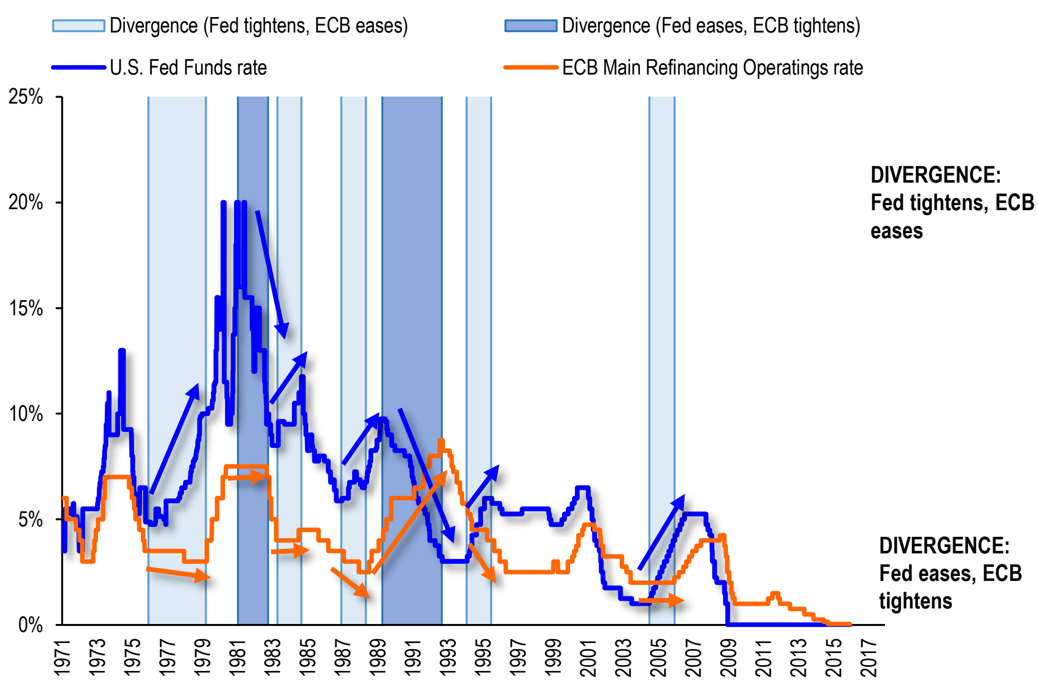
Source: Fundstrat, Bloomberg.

USD: USD probably weakens in 2016

And as highlighted below, there are 7 times when the path of the central banks diverged. Of these 7 instances, 5 were the result of Fed tightening while the ECB was easing. This is most analogous to today—Fed is set to tighten in December, while the ECB continues to introduce additional measures to ease.

- **Thus, 45% of the time, the Fed is tightening while Europe is easing. In other words, this is surprisingly common.**
- **This shows underlying policy is not the sole determinant of currencies (we think it's inflation). Moreover, as highlighted below, the S&P 500 actually performs surprisingly well when Fed and ECB diverge via Fed tightening. The market gains a median of 9% (80% win ratio)**.

Figure: 45% of the time, Fed tightens while ECB eases
7 divergences since 1971



Source: Fundstrat, FactSet, Bloomberg.
Note: we are using the Deutsche Bundesbank Discount rate from 1971 until 1998. From 1999 until 2015, we are using the ECB Main Refinancing Operations Announcement Rate.

Figure: USD tends to weaken in those cases… S&P 500 does well
$ billions

			Policy rates at start			Policy direction		DXY index change			S&P 500 performance		
	Start of diverge	End of diverge	Fed	ECB	Duration (# of months)	Fed	ECB	+1 mos	+3 mos	+6 mos	+1 mos	+3 mos	+6 mos
1	12/1975	3/1979	4.9%	3.5%	40	↑	↓	0.1%	0.6%	3.9%	-1%	10%	10%
2	4/1983	8/1984	8.5%	4.0%	17	↑	↓	-0.2%	4.3%	5.4%	5%	6%	9%
3	12/1986	4/1988	5.9%	3.5%	17	↑	↓	-2.0%	-6.1%	-7.3%	-3%	14%	16%
4	1/1994	6/1995	3.0%	5.8%	17	↑	↓	-1.6%	-2.7%	-6.6%	-2%	-5%	-4%
5	6/2004	12/2005	1.0%	2.0%	18	↑	↔	1.2%	-0.7%	-9.0%	-3%	-2%	7%
	Median				17			-0.2%	-0.7%	-6.6%	-2%	6%	9%
	% of times positive							40%	40%	40%	20%	60%	80%
1	1/1981	9/1982	20.0%	7.5%	21	↓	↔	6.1%	8.5%	22.8%	-2%	1%	-4%
2	4/1989	8/1992	9.8%	4.0%	41	↓	↑	1.4%	4.1%	2.3%	4%	8%	21%
	Median				31			3.7%	6.3%	12.5%	1%	5%	9%
	% of times positive							100%	100%	100%	50%	100%	50%

Source: Fundstrat, FactSet, Bloomberg.
Note: we are using the Deutsche Bundesbank Discount rate from 1971 until 1998. From 1999 until 2015, we are using the ECB Main Refinancing Operations Announcement Rate.

Currencies are looking through negative rates (and instead focusing on inflation?)

Additionally, as shown below, the impact of Quantitative easing by other Central banks is having a fading impact on their respective currencies. We illustrate the impacts from ECB (Europe) and BoJ (Japan) below:

- **The ECB since mid-2014 has taken roughly 8 actions (QE, etc) and as shown, 3 of the last 4 actions have seen the EUR actually gain overall against the USD. Similarly, notice that the Yen has actually been strengthening since mid-2015, even as the BoJ maintains a massive bond buying program.**
- **WHY? Arguably, the "carry-trade" of selling EUR or JPY to buy USD is crowded and history shows such trades can be "de-stabilized" by either tightening financial conditions or excess speculation (Brunnermeier, et all, November 2008)**

Figure: ECB and major actions since 2014

8 monetary actions since 2014

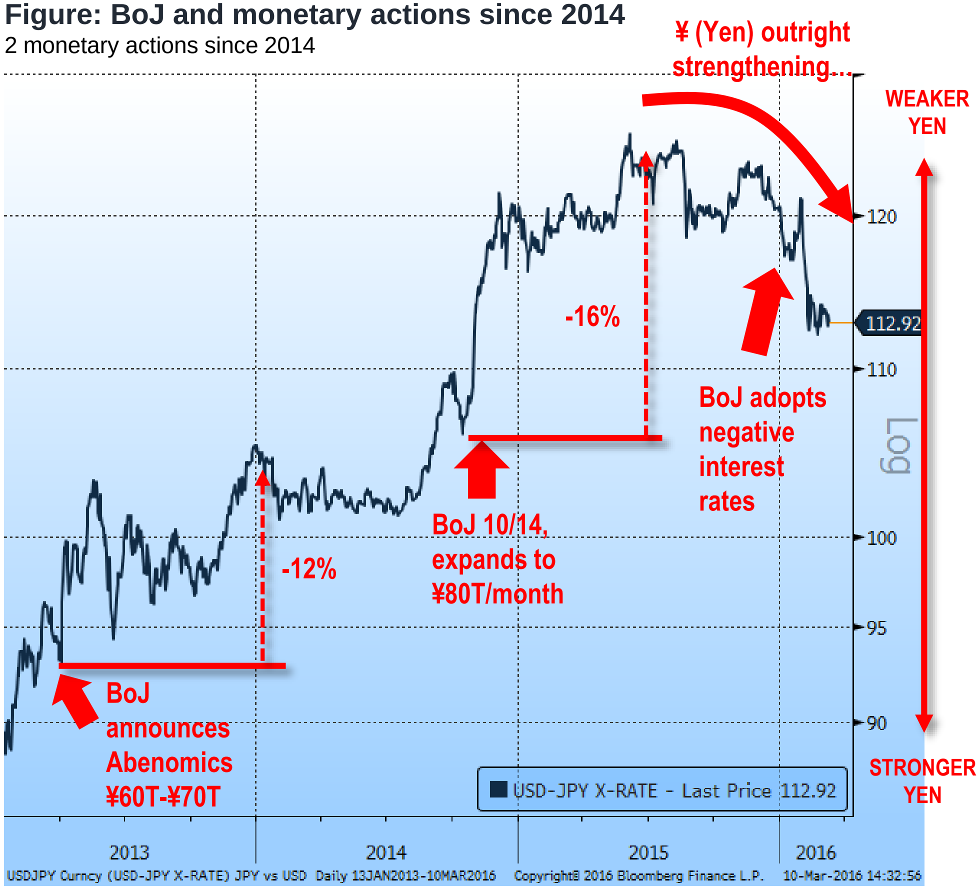
Date	Program	EUR/USD +0	EUR/USD +3m	EUR vs USD % chg
6/5/14	ECB cut deposit rates for banks to -0.1%	1.37	1.30	-5.2%
9/4/14	Governing council decides to initiate third covered bond program	1.29	1.24	-4.4%
10/2/14	Announces ABS and covered bond purchase agreements	1.27	1.20	-5.3%
1/22/15	Expand asset purchase program to €60b per month until Sept 2016	1.14	1.07	-5.6%
3/9/15	Initiates third covered bond program	1.09	1.13	4.0%
9/3/15	ECB (Draghi) at a news conference makes strong statement ECB prepared to expand bond buying.	1.11	1.09	-1.6%
12/3/15	ECB cut overnight rates further to -0.3%	1.09	1.10	0.2%
3/10/16	ECB cuts refinancing rate from 0.05% to 0% and cuts bank deposit rate from -0.3% to -0.4%	1.10	1.12	1.8%

Source: Fundstrat

3 of last 4 actions by ECB saw EUR actually gain vs USD...

Figure: BoJ and monetary actions since 2014

2 monetary actions since 2014



Source: Fundstrat

Executive Summary

Key calls

Global Markets

Credit and Commodities

State of the Economy

Earnings Outlook

Equity Strategy

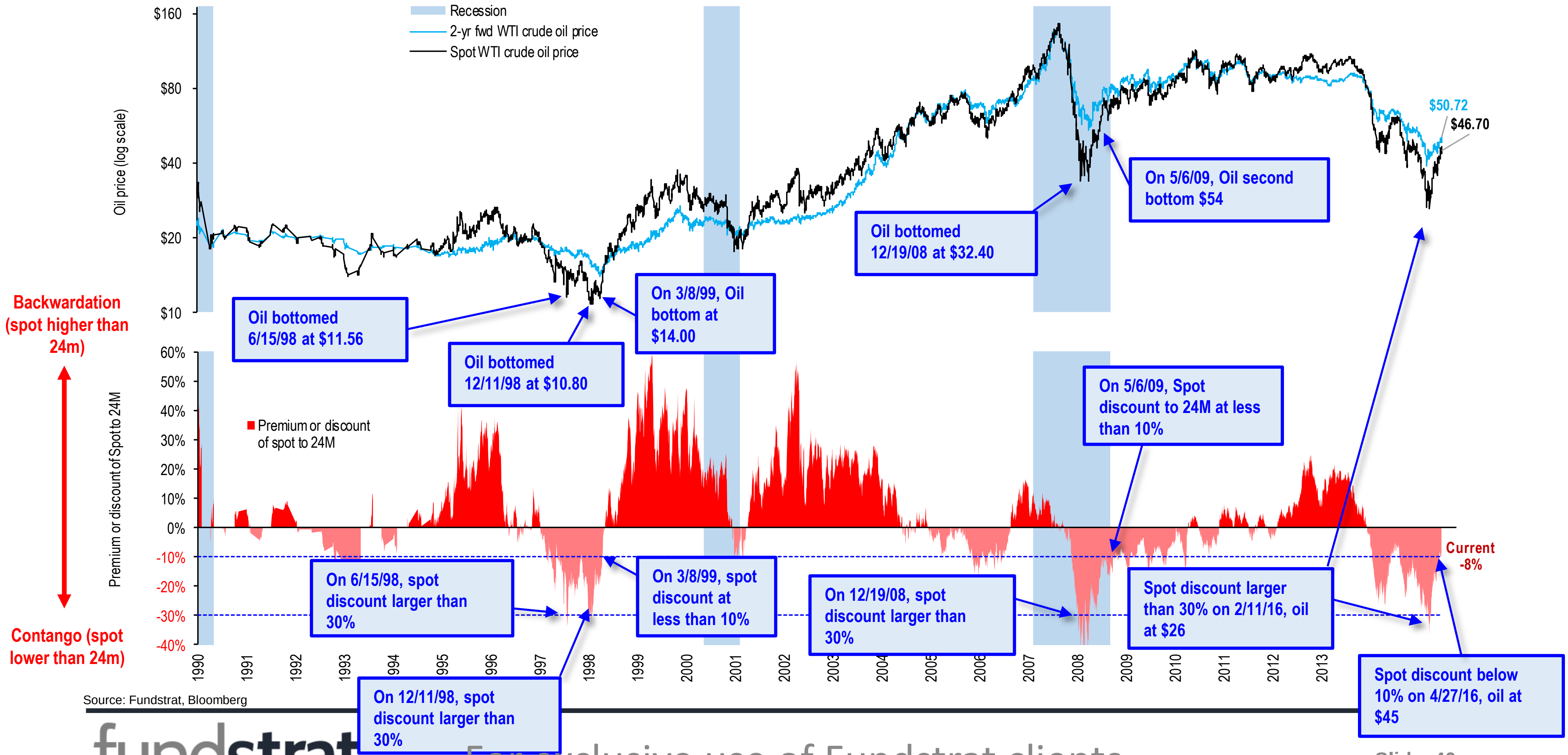
Sectors and Styles

Oil: Past *MAX* contango… suggesting "within zip code" of oil bottom

We recently wrote about the extreme contango seen in oil markets (we looked at spot vs 24m) and how the sizable discount of spot to 24m (contango) was seen at major lows for oil. Contango results from such excess supply that current oil is priced well below future oil:

- **Interestingly, in 12/19/08, oil was similar at extreme contango (30% discount of spot to future) and that happened to be the ultimately low for oil in 2008 (it stayed low for 2 more months). In other words, as imbalanced as the oil market remains, we believe price is closer to a bottom than more investors appreciate.**

Figure: WTI price and the discount of "spot" vs "24 months forward" WTI
Since 1990



Source: Fundstrat, Bloomberg

The recovery of oil to $40 helps to alleviate pressure on High-yield

Past bottoms in oil have seen big moves in the price over the next 9-12 months, implying that the rebound from $26 to $40 could hold, and potentially be the first leg of a steeper rally. Granted, this would need to be supported by an improvement in supply dynamics as well as continued demand visibility.

- **The impact on the HY market is substantial. As shown below, HY are sensitive to oil and at current levels, but if oil can rally to $45, we will see a substantially reduced Energy default rate compared to when oil was at its low in February of $26.**

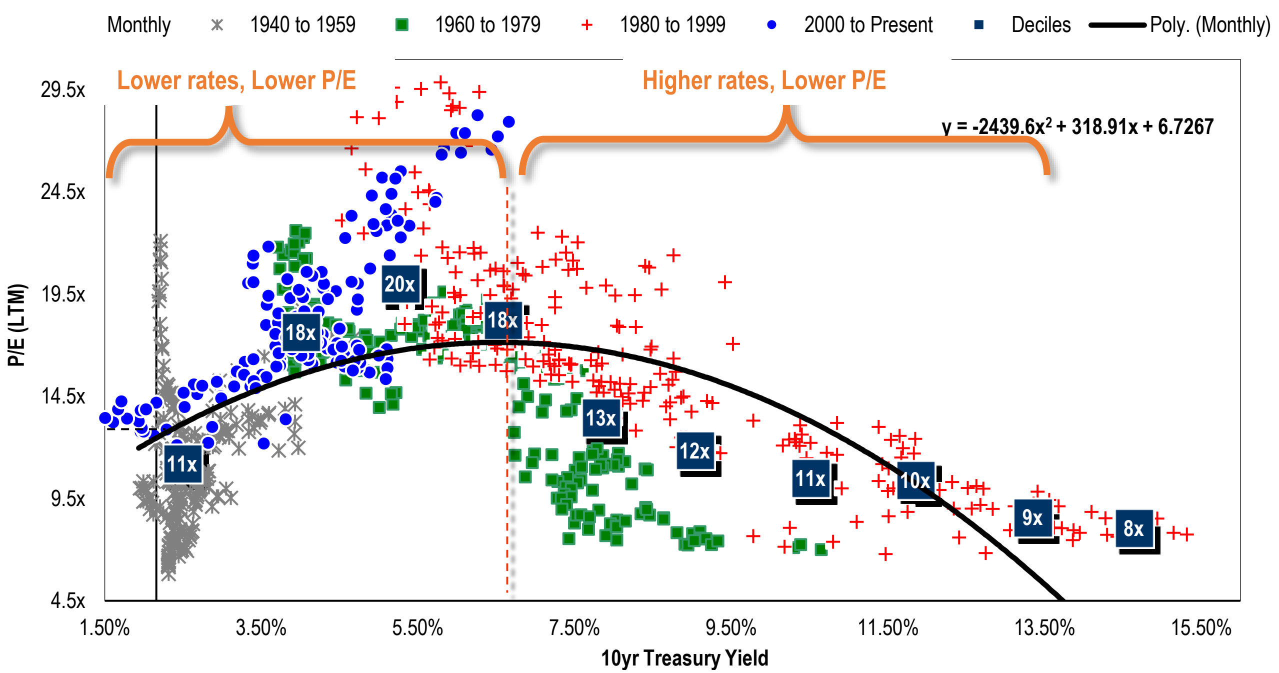
Figure: WTI crude and price performance of iBoxx HY ETF (ticker: HYG)
Since 2013

Source: Fundstrat, Bloomberg

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

- The highest P/Es have been associated with rates between 5.5% and 6.5%. This was true in the 60s, 70s, 80s, and 00s.
- That is, across many decades high P/Es have been synonymous with rates about double current levels. **And P/E was never below 15x during those years.**

January 1940 to Present P/E (LTM) vs 10yr Treasury Yield



Source: Fundstrat, Bloomberg

Executive Summary

- Key calls
- Global Markets
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Of all major global economies, US labor market tightened the most since '09

In our view, the best measure of an economy's underlying health is the unemployment rate trend. As shown below, the US posted the biggest improvement in unemployment rate since 2009, as it halved from 10% to 5%.

- **This improvement is even more notable when considering that the median improvement was only 0.8%.**

Figure: Unemployment rate chg since '09
From 2009 peak

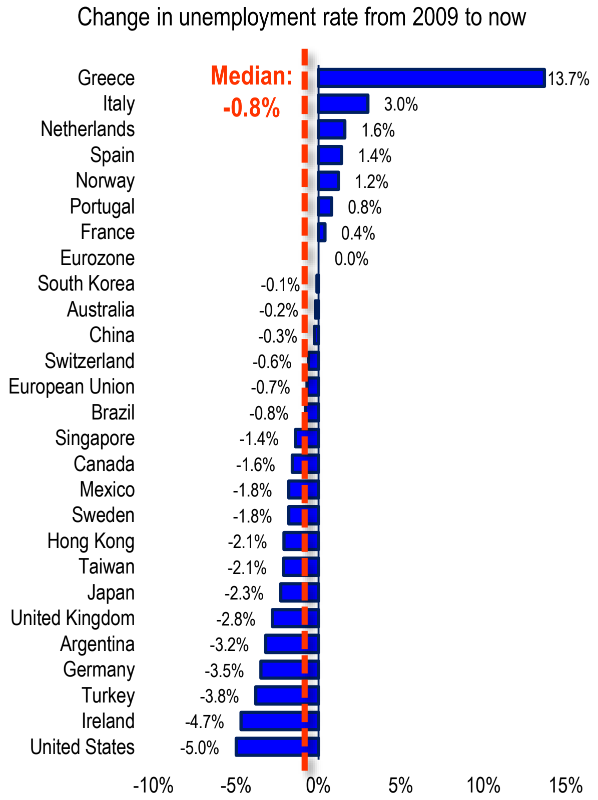


Figure: Current unemployment rate
As of 5/2016

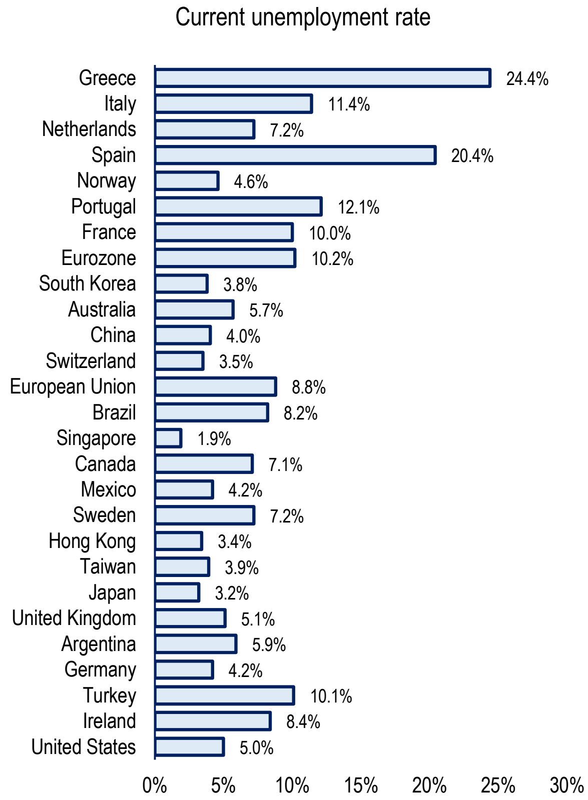
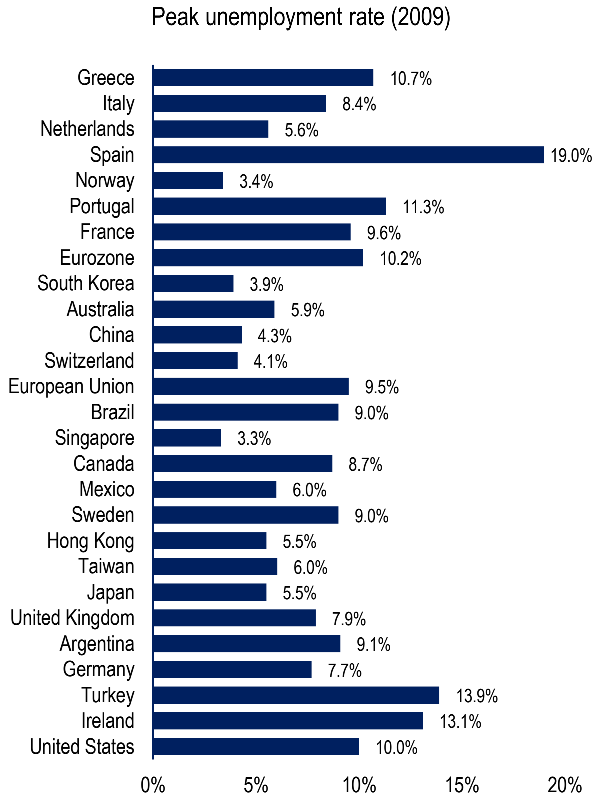


Figure: 2009 unemployment rate peak
Level at 2009 peak



Source: Fundstrat, Bloomberg.

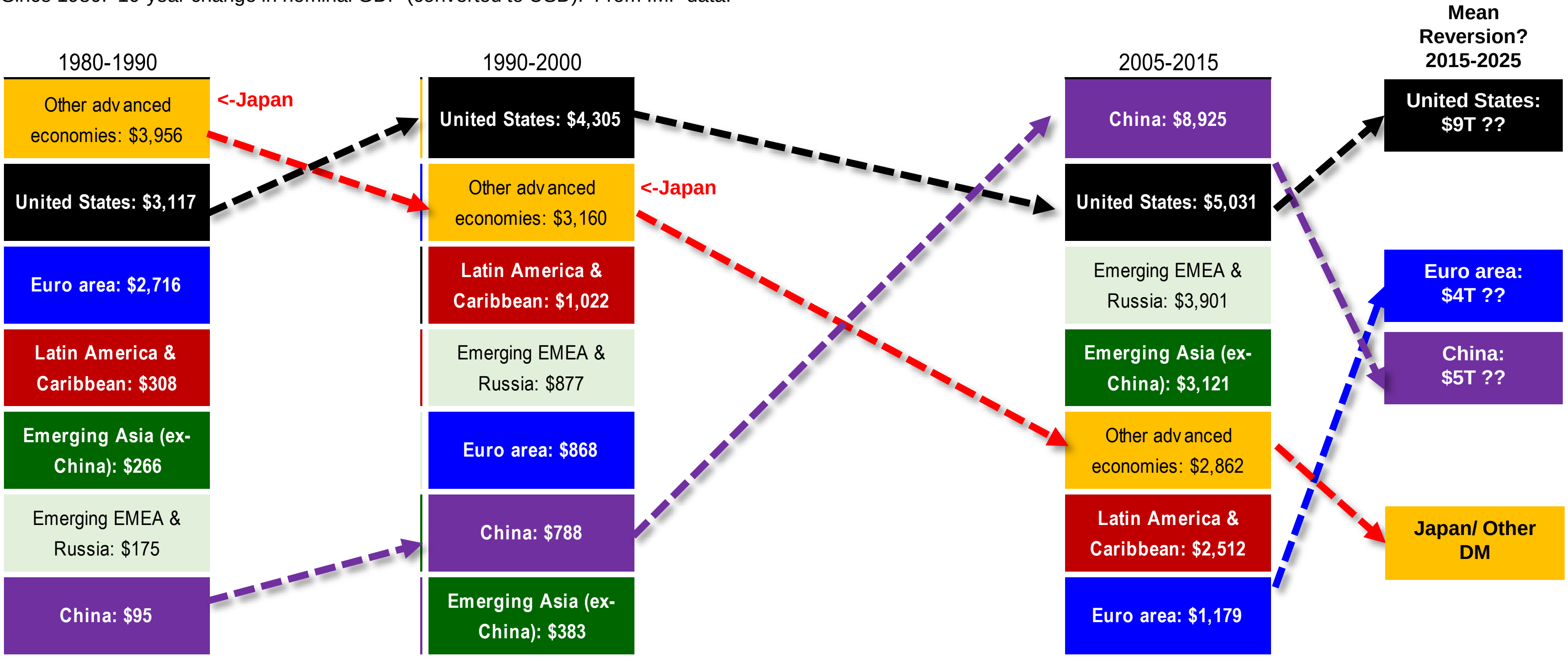
CHINA: Will U.S. be driver of global growth in next decade?

We have listed the key contributors to global growth for each decade below (5 year intervals), based on data provided by the IMF. And a few things really stand out. Foremost, one can see the ascendancy of China over the 35 years, as its contribution to global growth surged to nearly $9T in the past 10 years (and well above the U.S.). But as we think about the next decade, one can make the case that U.S. and even Europe become important contributors to global growth:

- For Europe, we can see the pathway, driven by completion of existing reforms, completion of the painful de-leveraging and new regulation and even the positives of the influx of refugees (growing the population);
- For the U.S., the incremental drivers are a recovery in: (i) U.S. housing, (ii) corporate capital spending, (iii) new administration; (iv) millennials and (v) eventual innovation from Energy production.

Figure: Which regions dominated growth in each 10-year period?

Since 1980. 10-year change in nominal GDP (converted to USD). From IMF data.

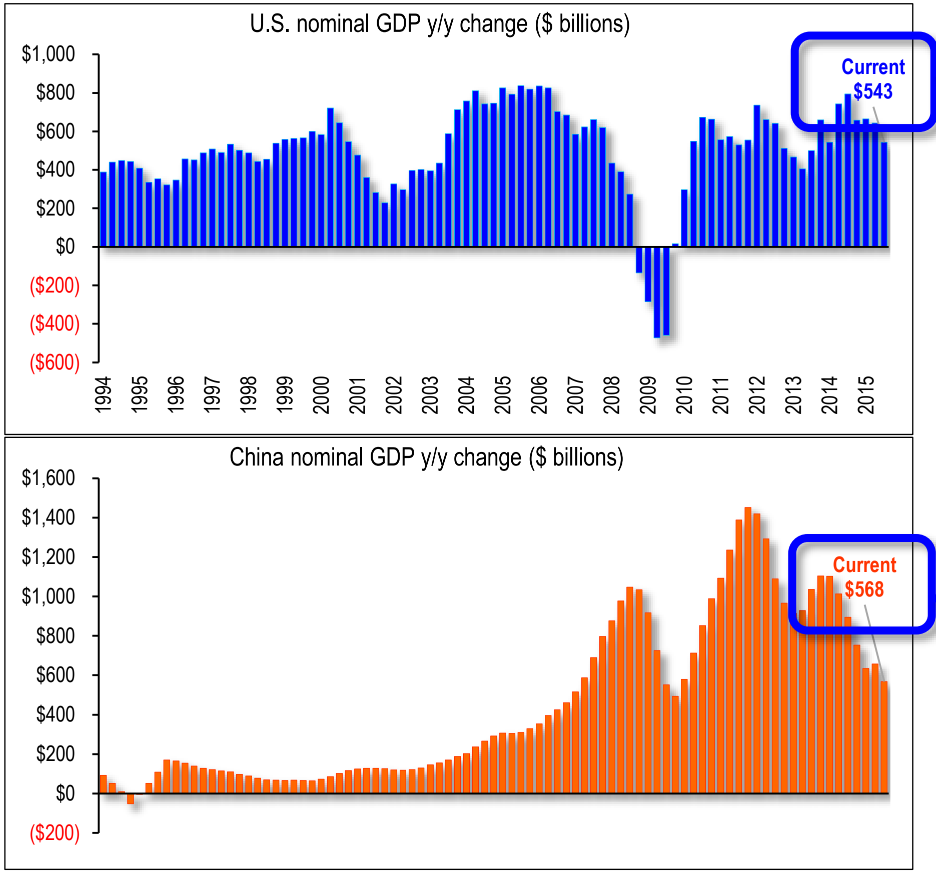


Source: Fundstrat, FactSet, Bloomberg, IMF.

CHINA: US is outgrowing China for the first time in a decade

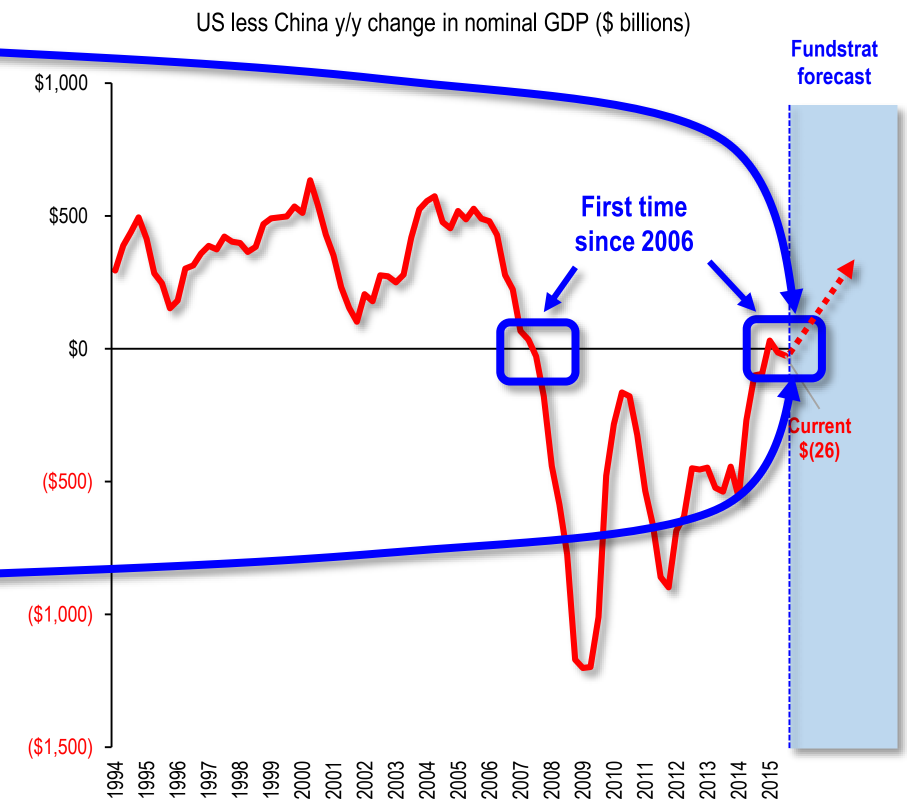
- We see U.S. growth remaining fairly healthy, supported by a rise in housing investment, consumer durables purchases, non-residential and even business investment spend (yes, even with oil depressed). **Over the next decade, the US could potentially add more GDP dollars than China.**

Figure: U.S. and China GDP growth Y/Y
$ billions



Source: Fundstrat, Bloomberg.

Figure: Spread between US GDP and China GDP growth y/y
$ billions



Source: Fundstrat, Bloomberg.

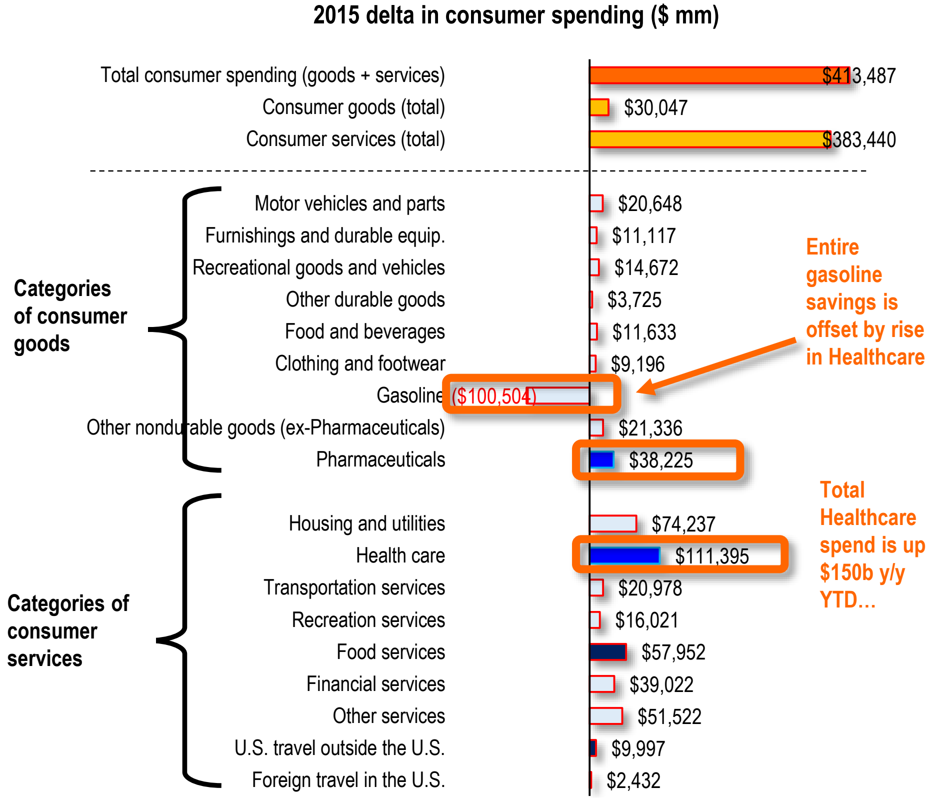
OIL: Gasoline dividend: Healthcare, Restaurants and Travel

We compiled data on consumer spending from the BEA. The U.S. consumer spent 24% less on gasoline in 2015 (a total $ decline of $100B). Spending overall is up 3.5% y/y in nominal terms, but the composition of increase is useful.

- The two largest increases were Healthcare and Restaurants and in total were half of increase. Apparel spending was essentially flat. **Healthcare, in fact, gobbled up all of the $100b gasoline dividend.**
- Outside of Healthcare and Food, the other increase was the right in travel services, both domestic and foreign.

Figure: Dollar change in PCE

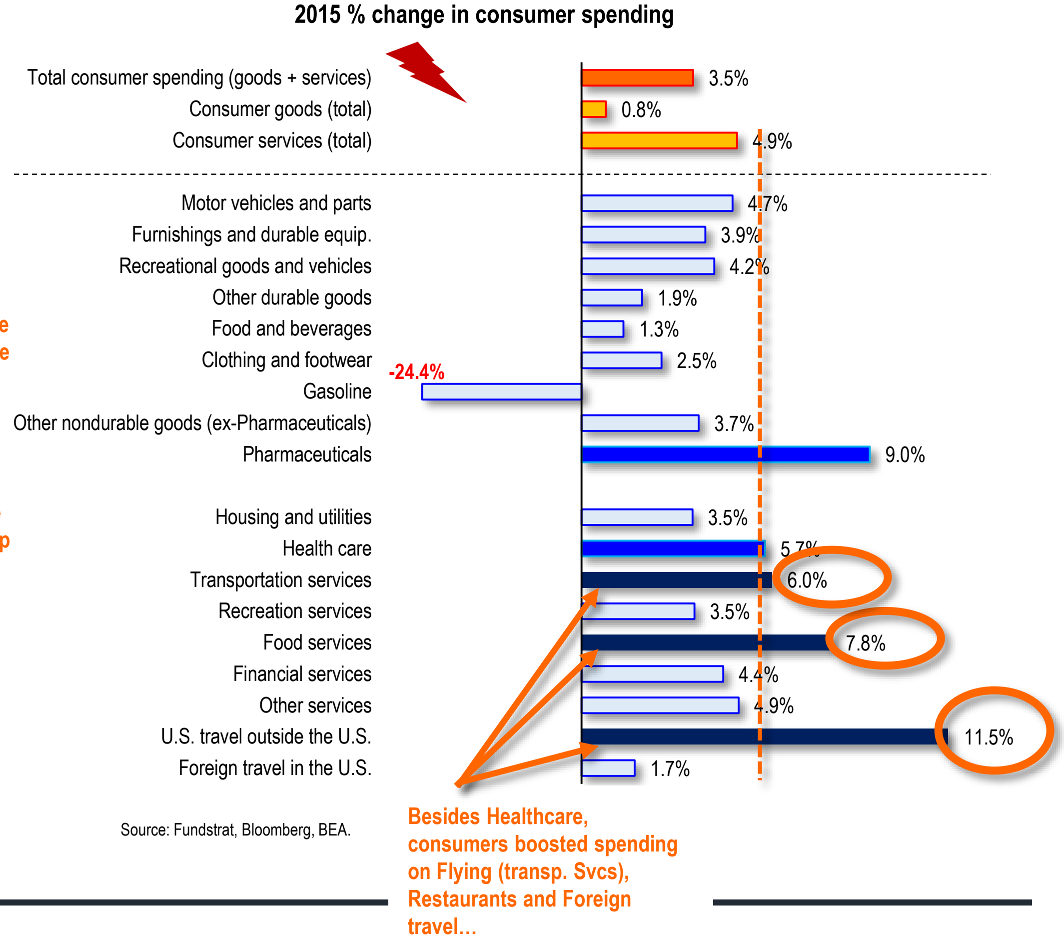
Y/Y delta in consumer spending ($ mm) by BEA category



Source: Fundstrat, Bloomberg, BEA.

Figure: Percentage change in PCE

Y/Y % change in consumer spending by BEA category; SCALE BROKEN at -5%



Source: Fundstrat, Bloomberg, BEA.

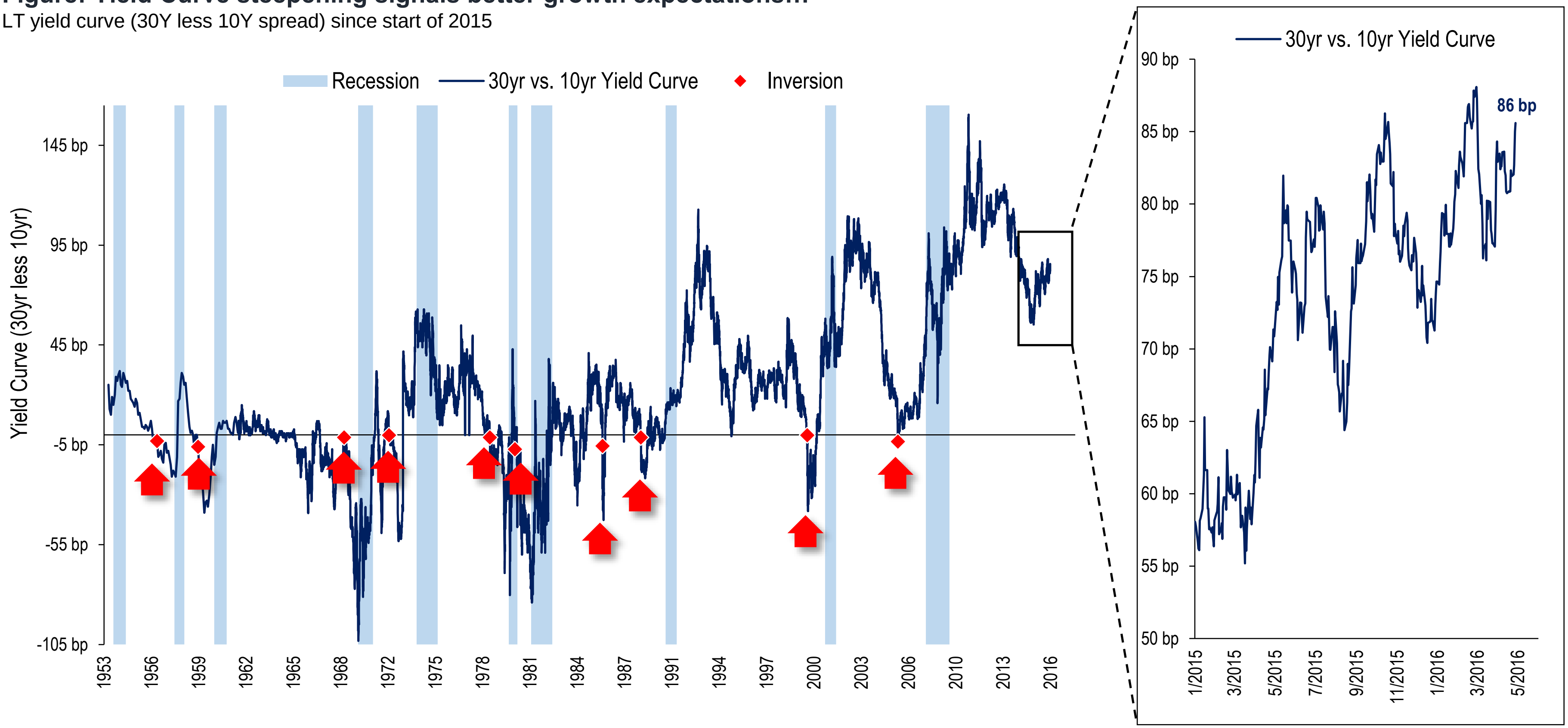
RECESSION RISK: Long-term yield curve is steepening

One of the best leading indicators of recession risk is the long-term yield curve. At the moment, the long-term yield curve remains fairly steep.

- The LT yield curve has inverted before every recession. Additionally, a steep curve implies long-term investments generate positive returns, hence, supporting notion of positive returns on incremental investment.

Figure: Yield Curve steepening signals better growth expectations…

LT yield curve (30Y less 10Y spread) since start of 2015



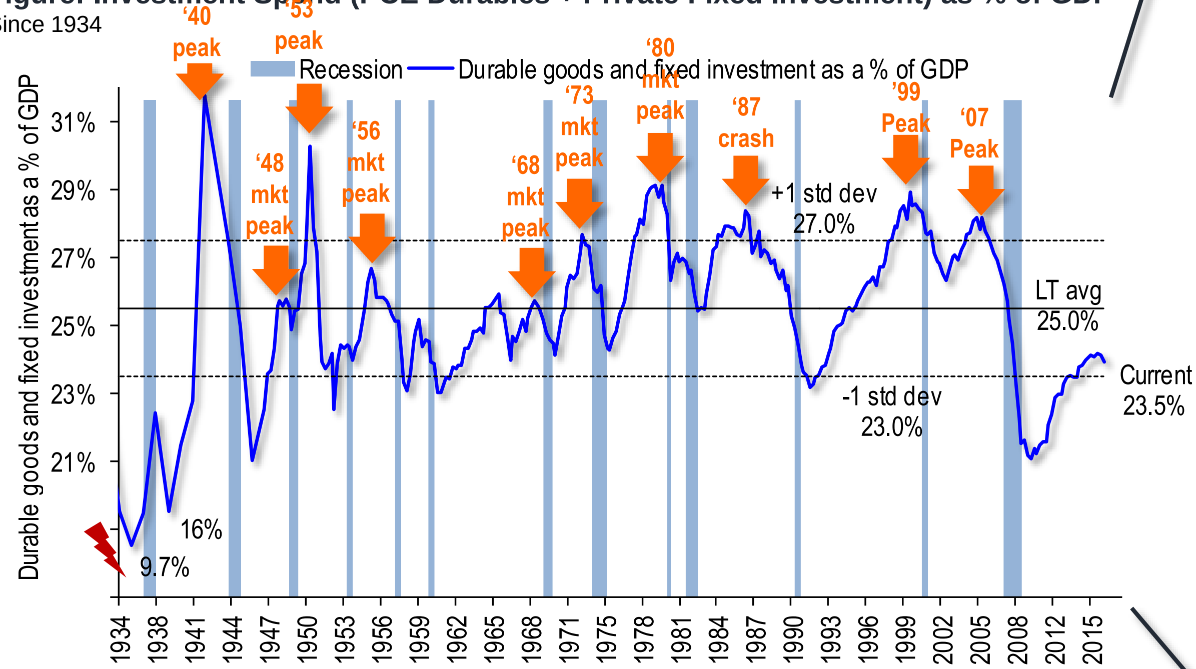
Source: Fundstrat, Bloomberg.

US GDP (cont'd): Investment spending >27% of GDP marks bull market tops…

Below is a chart showing U.S. investment spending (components on the right) since 1934.

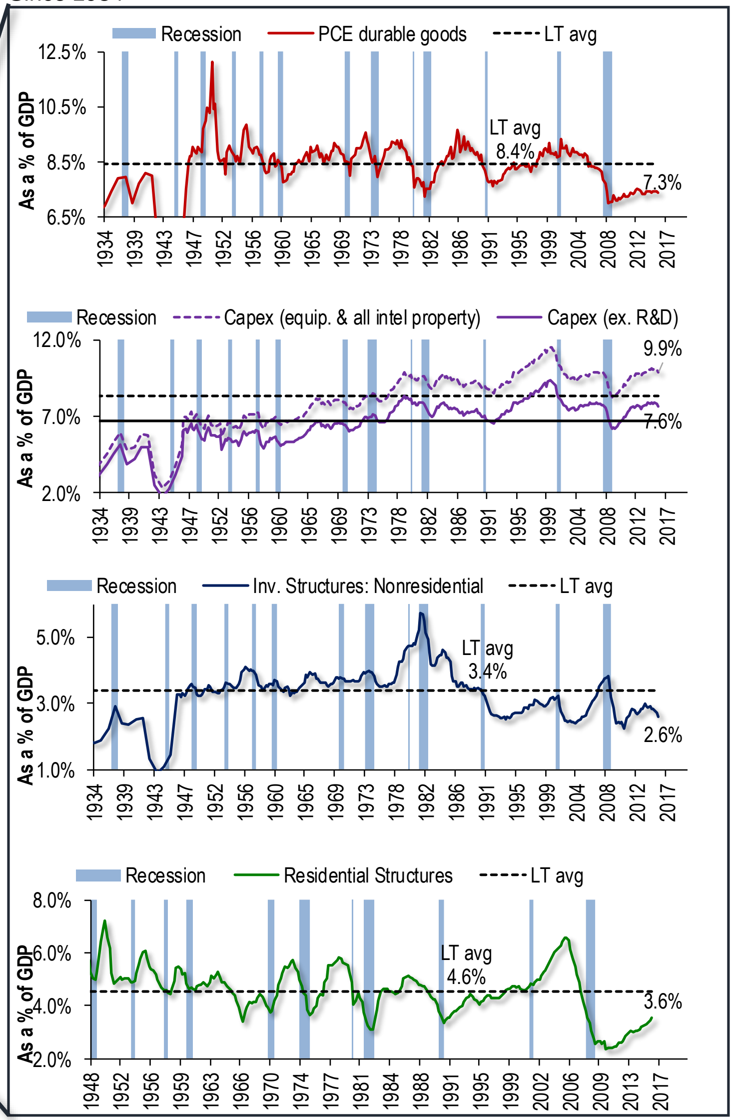
- As shown below, there has not been a bull market top seen without investment spending being at significantly higher levels than the current 23% today. Each 100bp increase in this figure is about $180b in GDP terms of investment spending increase.
- Some will argue this is due to capex being permanently lower, but as the charts on the right show, capex is only about one-third of this figure. And consumer purchases of durables and construction represent the other two-thirds.
- In other words, the absence of a current credit cycle (which drives investment spending), implies the bull market has not arguably reached maturity.

Figure: Investment Spend (PCE Durables + Private Fixed Investment) as % of GDP
Since 1934



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.

Figure: Components of Investment Spend
Since 1934



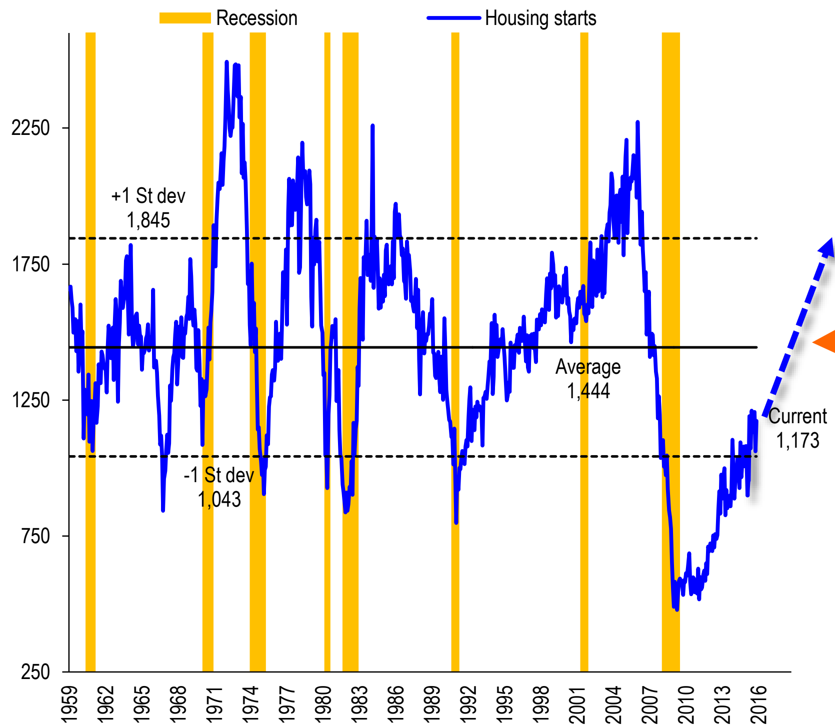
Source: Fundstrat, Bloomberg, BEA.

U.S. housing market still undersupplied…

Foremost, we believe there remains a lot of pent-up demand, especially in US housing. As shown below, US housing starts at 1.173 million per year remains at recession levels and below the 1.45mm long-term average.

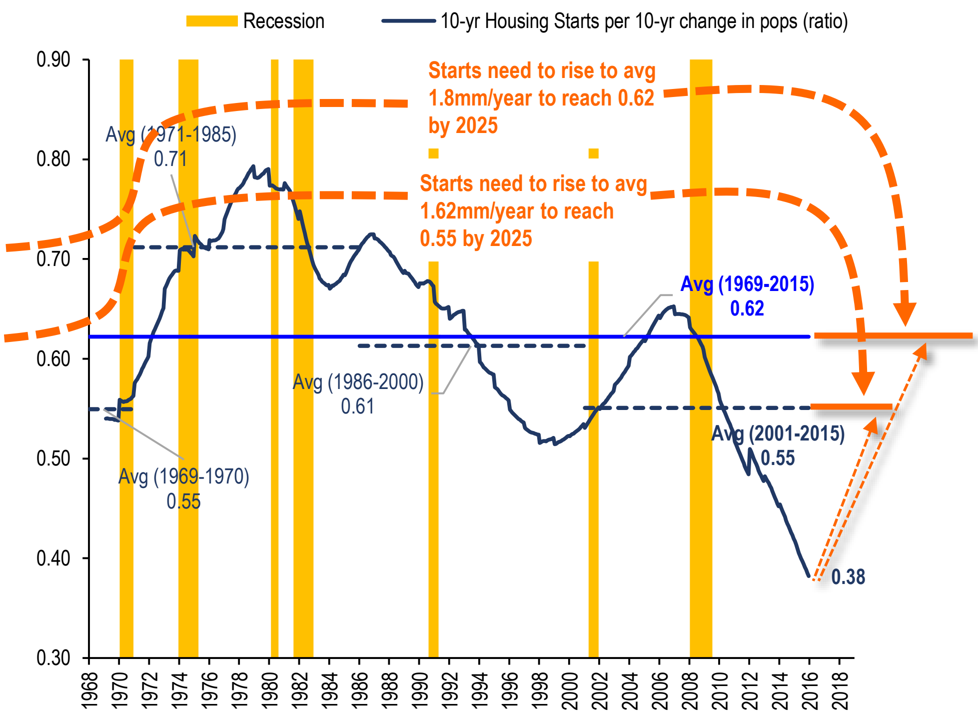
- But a better way to think about this is to look at housing starts for a change in population. On the bottom right, we calculated the number of housing starts compared to the change in US population over a 10-year period. The long term ratio is 0.62, meaning we need to built 62 homes for every 100 increase in population.
- **Recently, this ratio was 38, the lowest ever in 50 years. For this to recover to the long-term average of 62, we need to average 1.8mm starts per year for the next 10 years.**

Figure: U.S. housing starts are still at a recession levels.
Annualized housing starts since 1959



Source: Fundstrat, Bloomberg, Datastream.

Figure: We have built fewest homes ever for increase in population
Ratio of 10-yr sum of housing starts per 10-yr change in population



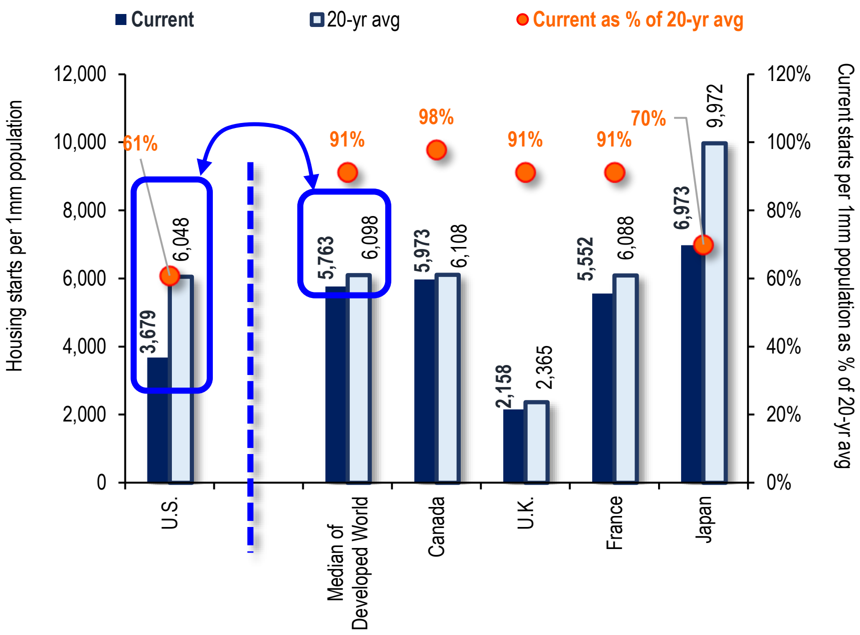
Source: Fundstrat, Bloomberg, Datastream.

If US starts matched developed nations, starts closer to 1.8mm

The U.S. is undersupplying housing compared to the rest of the world adjusting for population. Below, we show housing starts per 1mm people and the median of developed nations is around 5,763 starts per 1mm people.

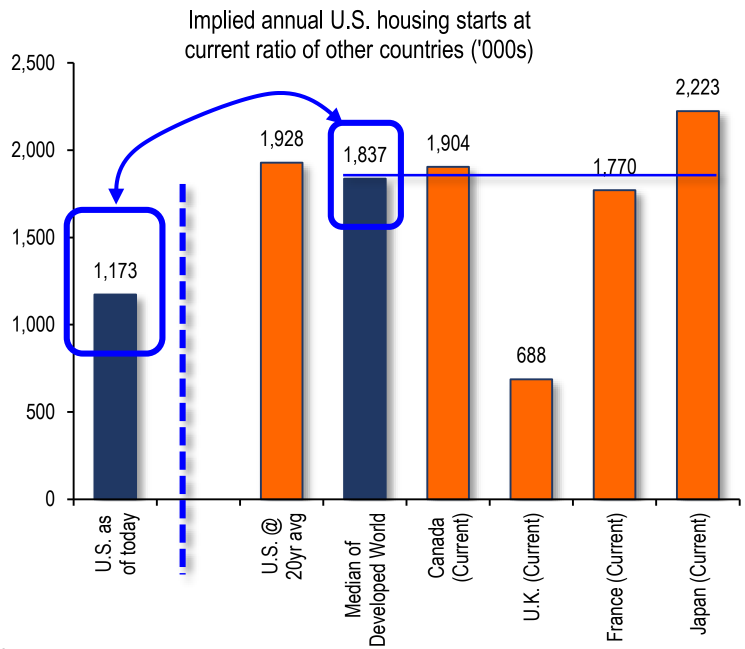
- At the high side is Japan which is currently building around 7,000 homes per 1 million residents but most countries are building homes at about 90% of the long-term average for that nation.
- **Currently, the U.S. is building 3,679 which is 36% less than other developed nations. In fact, if we built homes at this adjusted rate, US starts would be closer to 1.8mm per year.**
- As shown below, the long-term averages of the US are pretty similar to the rest of the world, at about 6,000 homes built per million residents annually.

Figure: U.S. housing starts lag RoW…
Housing starts per 1mm population vs 20-yr avg



Source: Fundstrat, Bloomberg, Datastream.

Figure: U.S. should be at closer to 1.8mm annual starts
Implied U.S. housing starts @ 20-yr avgs

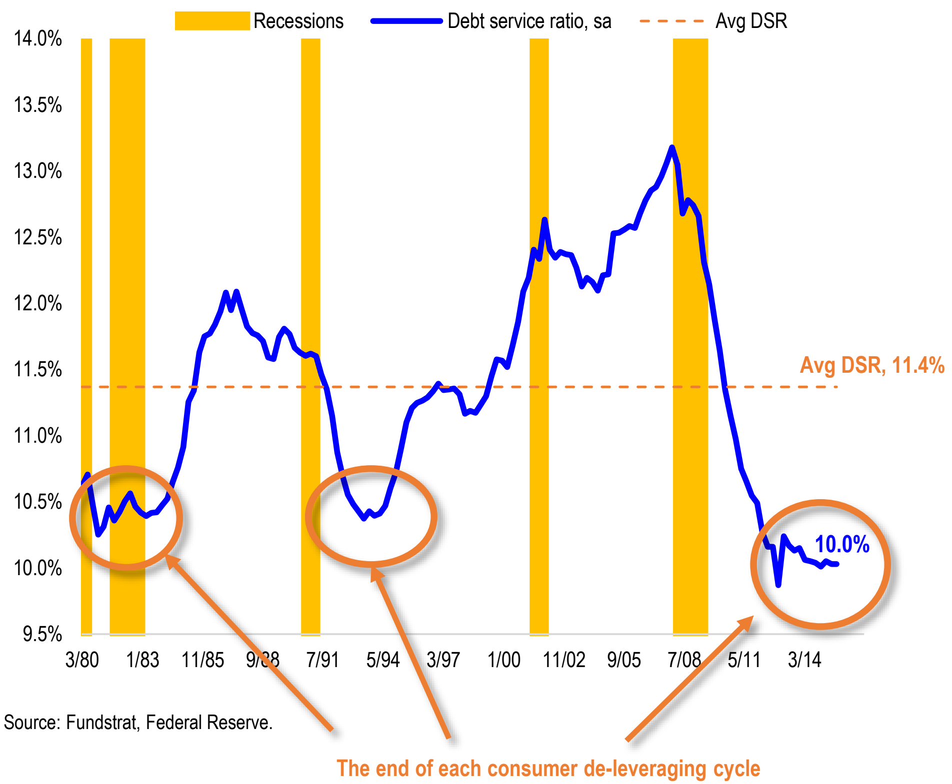


Source: Fundstrat, Bloomberg, Datastream.

US: Consumers at the end of a de-leveraging cycle

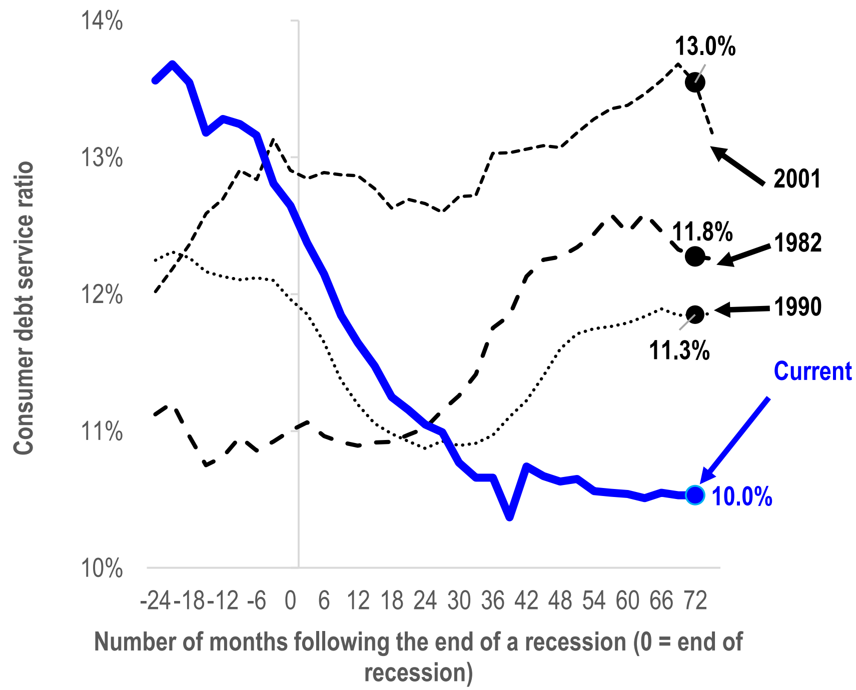
- Debt service ratios in the previous expansions began to rise 2 years into an expansion; by contrast, today we are in the 7th year of an expansion and the DSR is still falling.
- The Debt Service Ratio is well below the 11.3%-13% seen at this point in past expansions.

Figure: Consumer debt service ratio
Since 1980



Source: Fundstrat, Federal Reserve.

Figure: Debt service ratio for prior expansions
'82, '90, and '01



Source: Fundstrat, Federal Reserve.

Consumer Revival as blemishes from ***Financial Crisis*** "discharged"

From FICO's Ethan Dornheim: "..it takes seven years for most derogatory information to come off consumer credit files… this credit indicator to decline substantively…between 2014 and 2016"

From FICO

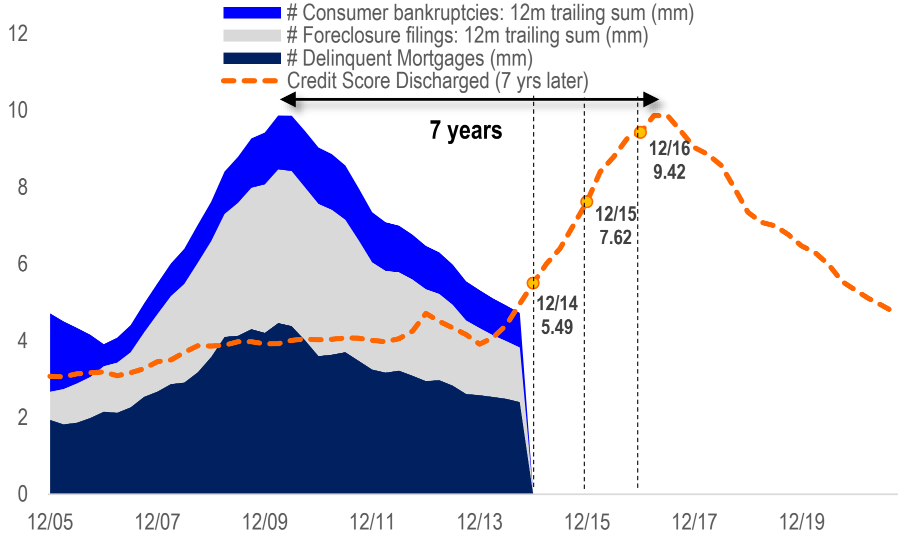
An assertion that these credit blemishes drop in 2015 and beyond…

Blemishes from late payments all the way down to bankruptcies and judgments remain on a consumer's credit history for 7 years. As shown below, if we advance this wave of distress/foreclosures/bankruptcies forward 7 years, we see the first of these "discharges" in 2014.

- The first wave of these will see their 7th year by the end of 2014 (5.5mm households) and within the next two years, the bulk of the financial crisis will be cleansed/discharged from consumer balance sheets.
- Interestingly, the "caution" stemming from the crisis (and resulting avoidance of leverage) has resulted in another 7.6mm Americans with super credit—***In other words, there is a tale of two Americas.***

Figure: Wave of consumer balance sheet resets coming…

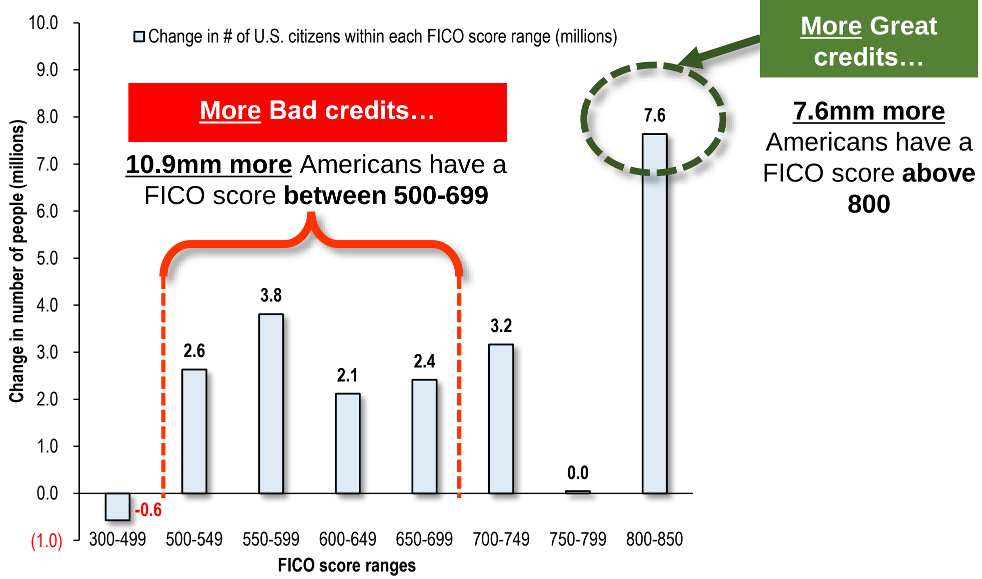
Schedule of consumer bad credit discharges



Source: Fundstrat, Bloomberg, Mortgage Bankers Association, Realty Trac Inc, American Bankruptcy Institute.
Note: For # of foreclosures, pre-2005 periods use the 2005 annual number as a proxy.

Figure: Tale of two FICOs: surge in "super credits" and "sub-700"

Change in # of Americans at each tranche of FICO scores (2014 vs. 2005)



Source: Fundstrat, Fair Isaac Corporation.

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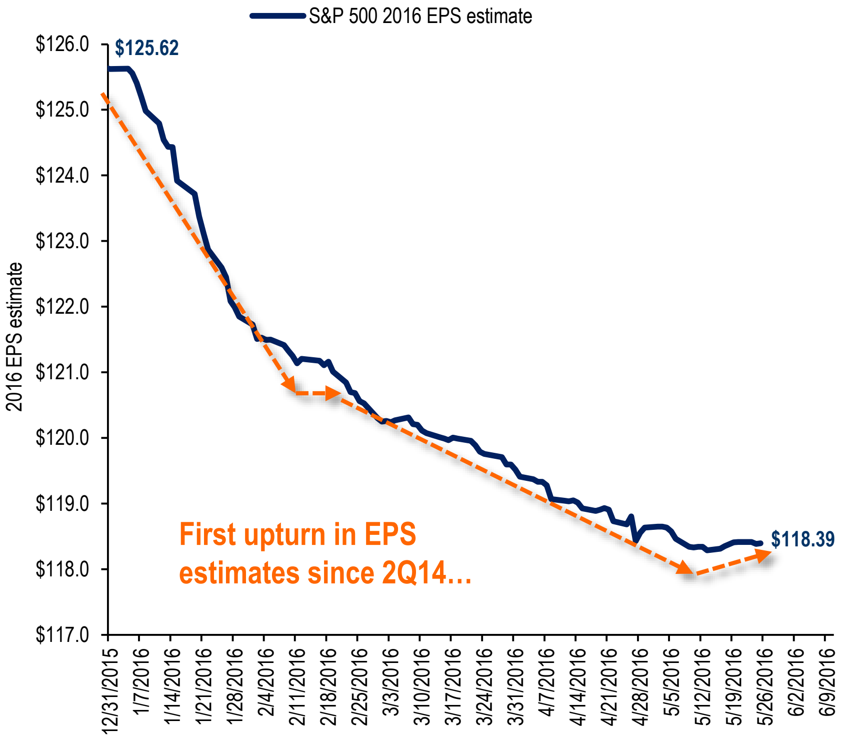
If one squints, 2016 EPS revisions are stabilizing…

Last week, we discussed how EPS estimates are starting to rise for **Industrials**, **Basic Materials** and **Energy** companies (a version replicated below right). And this is resulting in the first upward increase in rolling EPS estimates since 2Q14. As shown on the chart on the bottom left, EPS estimates for 2016 have been rising in the past month.

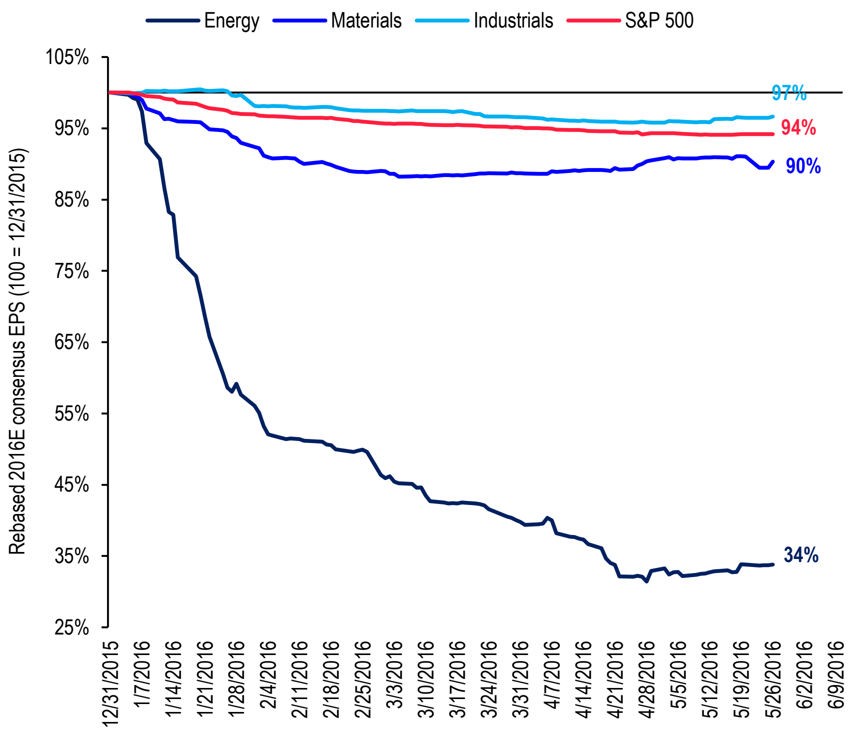
- **The drivers for the higher EPS estimates have been the weaker USD and the improvement in commodity prices (especially oil). And as we noted last week, the upturn in Energy EPS estimates does not yet fully reflect the higher strip prices for oil (futures). We are encouraged that EPS revisions are moving up for several groups, including Energy, Materials and Industrials.**
- **The broader implication is that improving estimates argue that the earnings recession looks to be ending.**

Figure: 2016 EPS estimates
As of 5/26/2016



Source: Fundstrat, Bloomberg, FactSet.

Figure: EPS revisions reflect weaker USD, better commodities
As of 5/26/2016



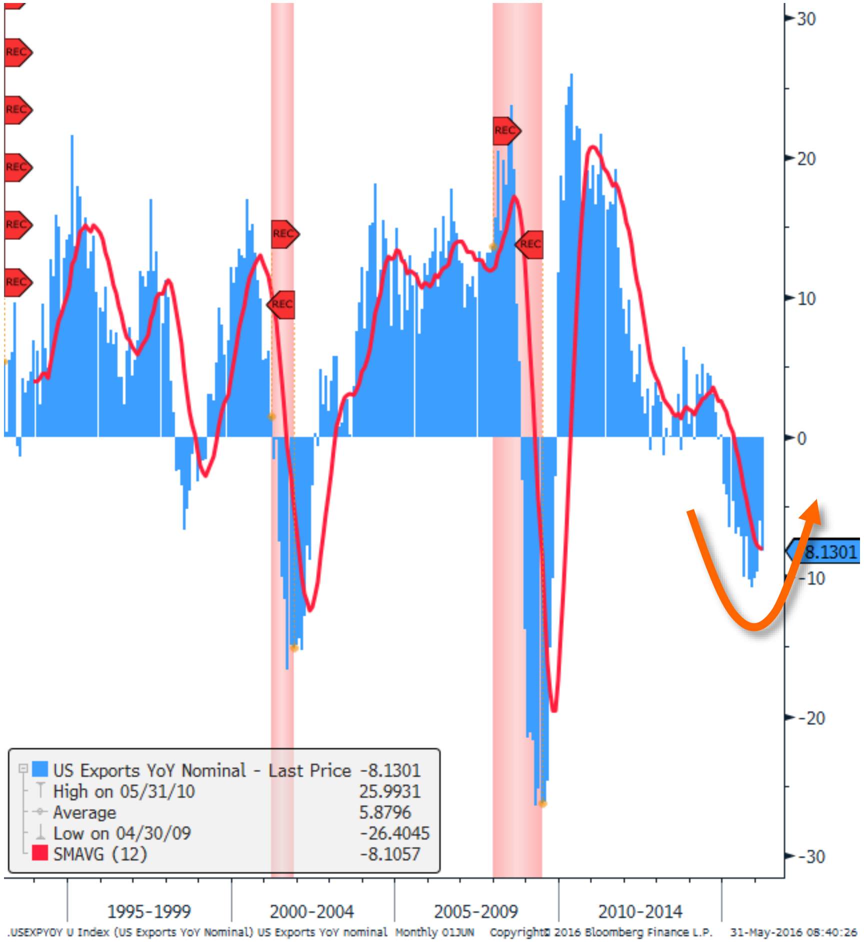
Source: Fundstrat, Bloomberg, FactSet.

Weaker USD and stabilizing commodities argue S&P 500 sales stabilize…

Global growth remains weak and is evidenced by the poor performance of US exports. Exports are beginning to stabilize, after falling for several quarters, reflecting stabilizing USD and commodities.

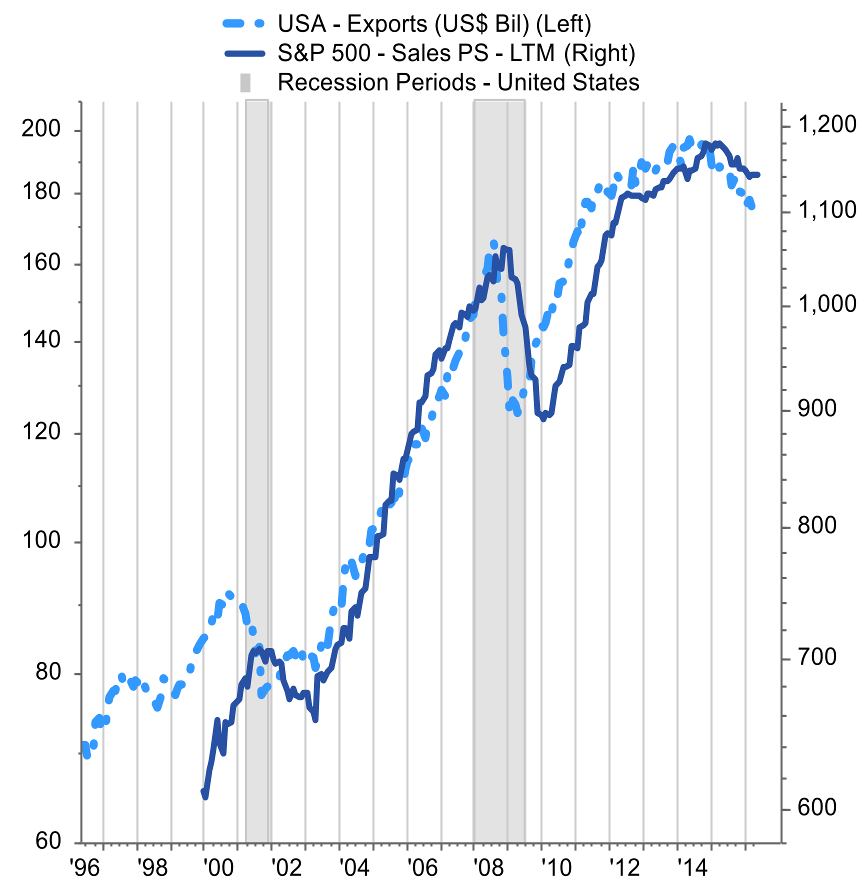
- **As shown below, exports tend to be highly correlated to S&P 500 revenue growth.**

Figure: Exports YoY % change (nominal)
Bloomberg



Source: Fundstrat, Bloomberg, FactSet.

Figure: Exports and S&P 500 sales growth
As of 5/26/2016



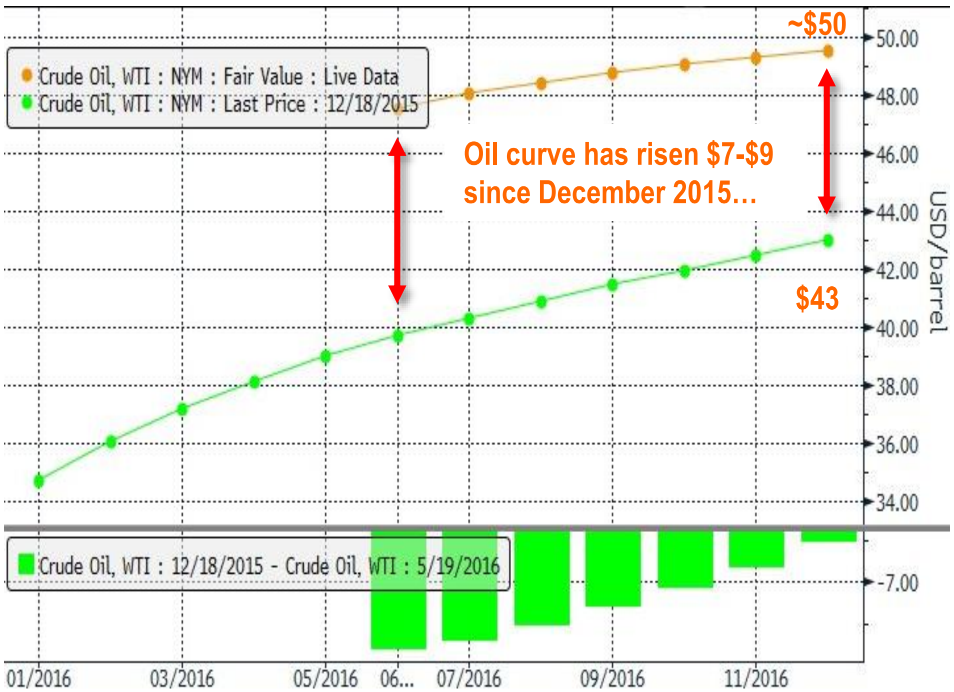
Source: Fundstrat, Bloomberg, FactSet.

But Energy 2016 EPS ***not fully reflecting*** upward move in Oil curve…

When analysts modeled 2016 EPS for the **Integrated Oil** stocks, these were based on a 2016 oil forecast of $41.50, which was the price of the oil curve in December 2015.

- **Since then, oil has risen $7-$9 (depending at what point we look at on the strip) and this will have a dramatic impact on Integrated Oil's net income. If oil remains flat into year-end, this would add $25 billion in net income for the "majors", and add $2.61 in S&P 500 EPS.**

Figure: Oil curve is up $7-$9 since December 2015
Priced as of 5/19/16



Source: Fundstrat, FactSet, Bloomberg.
Note: oil curve based on Bloomberg CCRV. Incremental margin is forecasted to be 25% for oil price increases.
Incremental net income and EPS is calendarized to adjust for fiscal year-end differences.

Figure: S&P 500 EPS impact from changes in Integrated Oils
Analysts forecasts for 2016 were based on $41.50 oil in 2016

	RANGE 2016 Incremental Net Income					
Oil Price Assumption (WTI)	**$31.50**	**$36.50**	**$41.50**	**$49.40**	**$55.00**	**$65.00**
XOM	($17,383)	($8,691)	–	$13,732	$23,466	$40,849
CVX	($9,632)	($4,816)	–	$7,609	$13,003	$22,635
COP	($2,034)	($1,017)	–	$1,607	$2,746	$4,780
OXY	($892)	($446)	–	$704	$1,204	$2,095
CNQ	($902)	($451)	–	$713	$1,218	$2,120
CVE	($879)	($439)	–	$694	$1,187	$2,065
Total Net Income	**($31,721)**	**($15,861)**	**–**	**$25,060**	**$42,824**	**$74,545**

$2.61 Upside to S&P 500 EPS if oil stays at $49.40

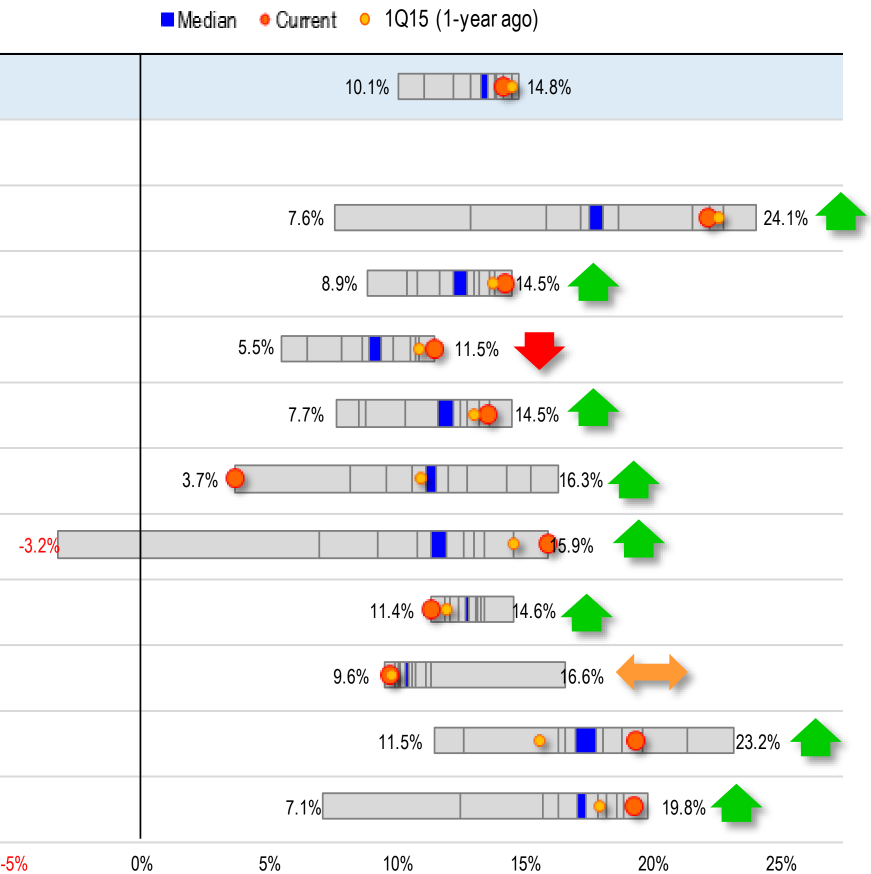
	RANGE Incremental Impact to 2016 S&P500 EPS					
Oil Price Assumption (WTI)	**$31.50**	**$36.50**	**$41.50**	**$49.40**	**$55.00**	**$65.00**
XOM	($1.92)	($0.96)	–	$1.52	$2.59	$4.51
CVX	($1.06)	($0.53)	–	$0.84	$1.44	$2.50
COP	($0.22)	($0.11)	–	$0.18	$0.30	$0.53
OXY	($0.10)	($0.05)	–	$0.08	$0.13	$0.23
CNQ	–	–	–	–	–	–
CVE	–	–	–	–	–	–
Incremental S&P 500 EPS	**($3.31)**	**($1.65)**	**–**	**$2.61**	**$4.47**	**$7.77**

S&P 500 EBIT margins

Figure: Deciles of S&P 500 EBIT margins
Since 1999

% contribution to total S&P 500 Sales		% contribution to total S&P 500 EBIT		Market cap weight		
Total Sales ($ mm)	% of total S&P 500 Sales	Total EBIT ($ mm)	% of total S&P 500 EBIT	Market cap ($ mm)	% weight in S&P 500	
$8,407,843	100%	$1,510,114	100%	$18,478,932	100%	S&P 500
$1,264,613	15%	$280,789	19%	$3,704,773	20%	Technology
$1,216,919	14%	$173,533	11%	$1,839,720	10%	Industrials
$1,705,421	20%	$195,678	13%	$2,356,977	13%	Consumer Discretionary
$348,058	4%	$47,279	3%	$535,098	3%	Basic Materials
$900,162	11%	$33,071	2%	$1,309,219	7%	Energy
$1,431,928	17%	$328,435	22%	$2,908,998	16%	Financials sector (NET MARGIN)
$1,540,742	18%	$175,010	12%	$2,655,765	14%	Healthcare
$1,595,508	19%	$155,335	10%	$2,094,241	11%	Consumer Staples
$310,126	4%	$60,162	4%	$475,246	3%	Telecom
$314,828	4%	$60,822	4%	$598,895	3%	Utilities

Deciles of LTM EBIT margin (quarterly frequency; since 1999)



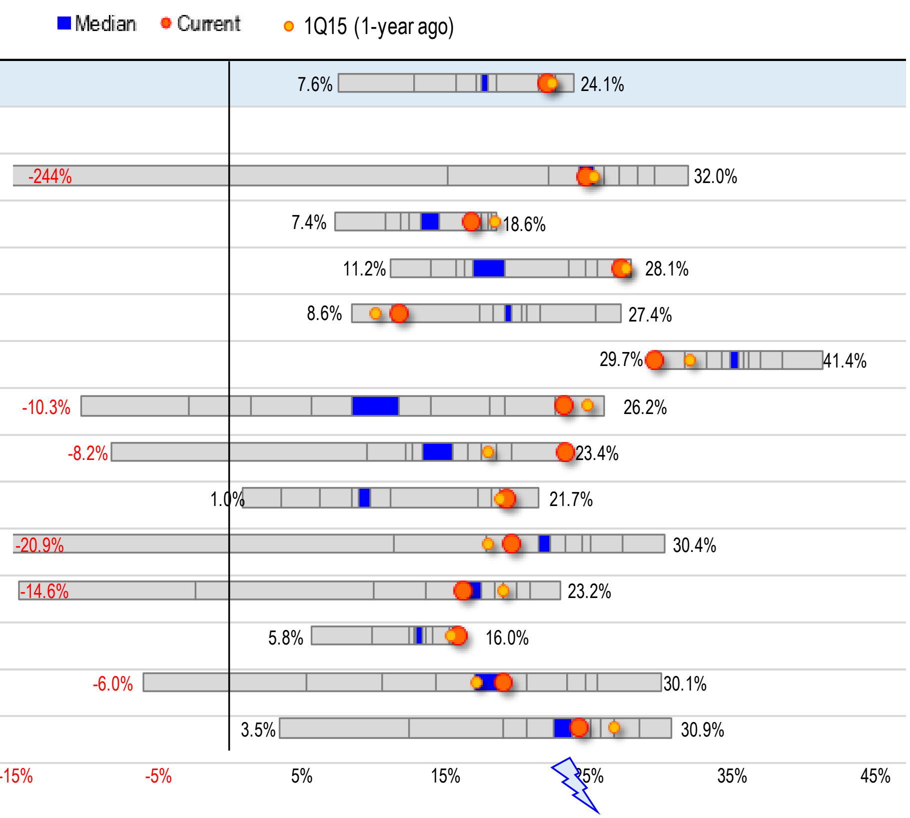
Source: Fundstrat, Factset, Bloomberg

Technology sector EBIT margins

Figure: Deciles of Technology 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	Mkt cap ($ mm)	% weight in sector	
$1,264,613	100%	$280,745	100%	$3,704,773	100%	Technology
$181,933	14%	$45,211	16%	$800,423	22%	Internet Software & Services
$133,794	11%	$22,652	8%	$258,267	7%	IT Consulting & Other Services
$94,492	7%	$25,878	9%	$451,621	12%	Data Processing & Outsourced Services
$21,672	2%	$2,568	1%	$156,342	4%	Application Software
$136,542	11%	$40,553	14%	$592,723	16%	Systems Software
$8,956	1%	$2,091	1%	$50,507	1%	Home Entertainment Software
$68,464	5%	$16,050	6%	$178,155	5%	Communications Equipment
$434,137	34%	$83,877	30%	$654,760	18%	Technology Hardware, Storage & Peripherals
$1,557	0%	$307	0%	$4,130	0%	Electronic Equipment & Instruments
$14,660	1%	$2,400	1%	$38,564	1%	Electronic Components
$12,017	1%	$1,925	1%	$20,713	1%	Electronic Manufacturing Services
$18,302	1%	$3,510	1%	$49,015	1%	Semiconductor Equipment
$138,087	11%	$33,723	12%	$449,552	12%	Semiconductors

Deciles of LTM EBIT margin (quarterly frequency; since 1999)



Source: Fundstrat, Factset, Bloomberg

INDUSTRIALS: Conglomerates and Machinery key to upside

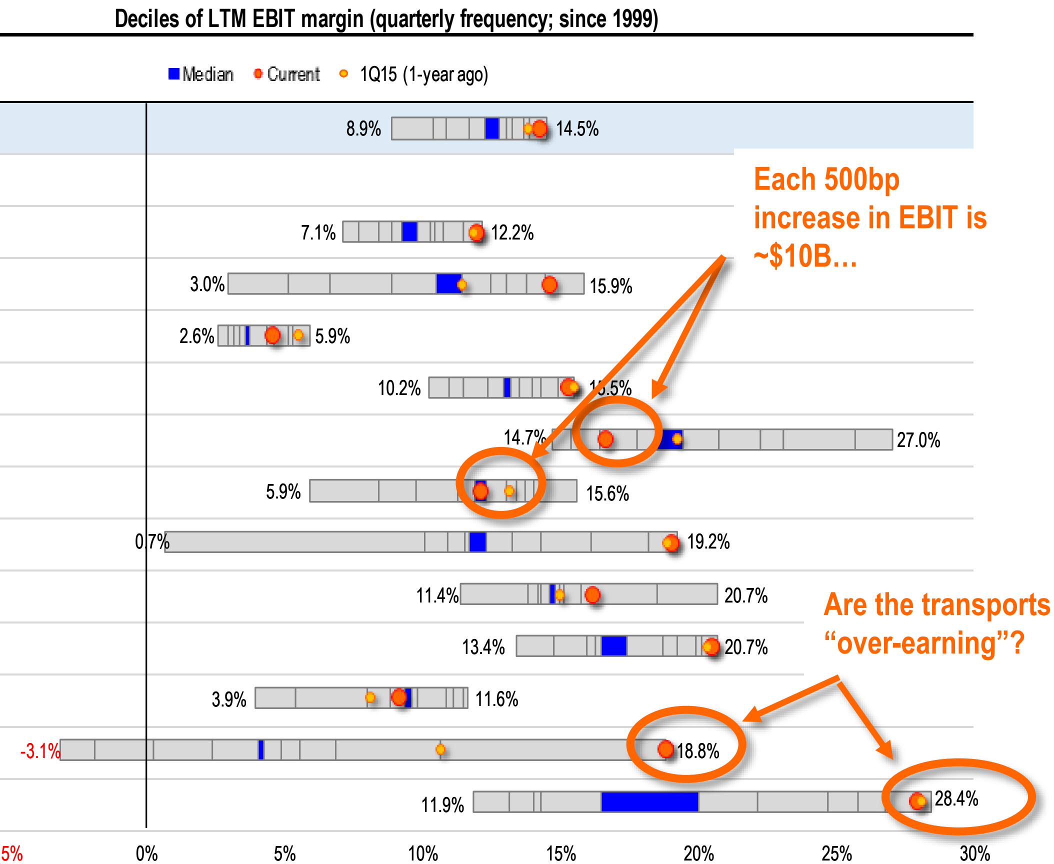
We all know about the industrial recession that has been underway for several years.

- **And as a consequence, margins are underperforming in Conglomerates and Machinery stocks. We believe these groups benefit from a recovery in commodity prices (end market customers) and by a weakening USD. As shown below, each 500bp improvement in EBIT (from depressed levels) is $20b in total, or $1.33 per S&P 500 share.**

Figure: : Deciles of Industrials 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	Total market cap ($ mm)	% weight in sector	
$1,216,919	100%	$173,533	100%	$1,839,720	100%	Industrials
$344,460	28%	$41,165	24%	$475,176	26%	Aerospace & Defense
$9,210	1%	$1,347	1%	$16,873	1%	Building Products
$37,462	3%	$1,709	1%	$16,213	1%	Construction & Engineering
$55,221	5%	$8,443	5%	$96,768	5%	Electrical Equipment
$176,783	15%	$29,401	17%	$457,477	25%	Industrial Conglomerates
$188,180	15%	$22,798	13%	$232,106	13%	Machinery
$19,660	2%	$3,739	2%	$32,390	2%	Trading Companies & Distributors
$43,108	4%	$6,975	4%	$82,198	4%	Commercial Services & Supplies
$17,636	1%	$3,610	2%	$55,845	3%	Professional Services
$126,705	10%	$11,596	7%	$132,781	7%	Air Freight & Logistics
$139,180	11%	$26,195	15%	$101,335	6%	Airlines
$59,313	5%	$16,556	10%	$140,557	8%	Road & Rail

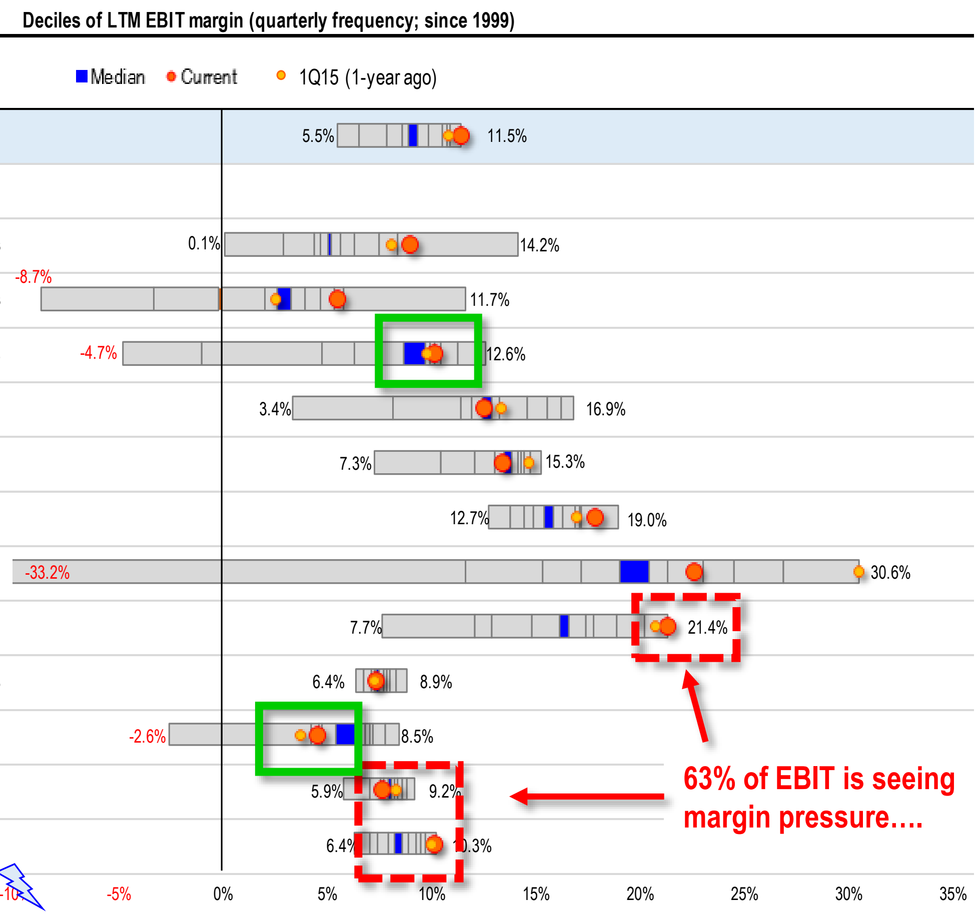


Source: Fundstrat, Bloomberg, FactSet

Consumer Discretionary sector EBIT margins

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	
$1,705,421	100%	$195,678	100%	$2,356,977	100%	Discretionary sector
$76,117	4%	$6,836	3%	$60,008	3%	Auto Components
$307,909	18%	$17,070	9%	$106,342	5%	Automobiles
$74,472	4%	$7,576	4%	$94,783	4%	Household Durables
$10,159	1%	$1,274	1%	$21,153	1%	Leisure Products
$81,803	5%	$11,024	6%	$155,403	7%	Textiles, Apparel & Luxury Goods
$123,515	7%	$22,127	11%	$332,386	14%	Hotels, Restaurants & Leisure
$3,042	0%	$688	0%	$4,499	0%	Diversified Consumer Services
$325,040	19%	$69,467	36%	$520,705	22%	Media
$15,280	1%	$1,124	1%	$23,806	1%	Distributors
$131,174	8%	$5,966	3%	$454,724	19%	Internet & Catalog Retail
$170,372	10%	$13,036	7%	$104,405	4%	Multiline Retail
$386,538	23%	$39,489	20%	$478,762	20%	Specialty Retail



Source: Fundstrat, Factset, Bloomberg

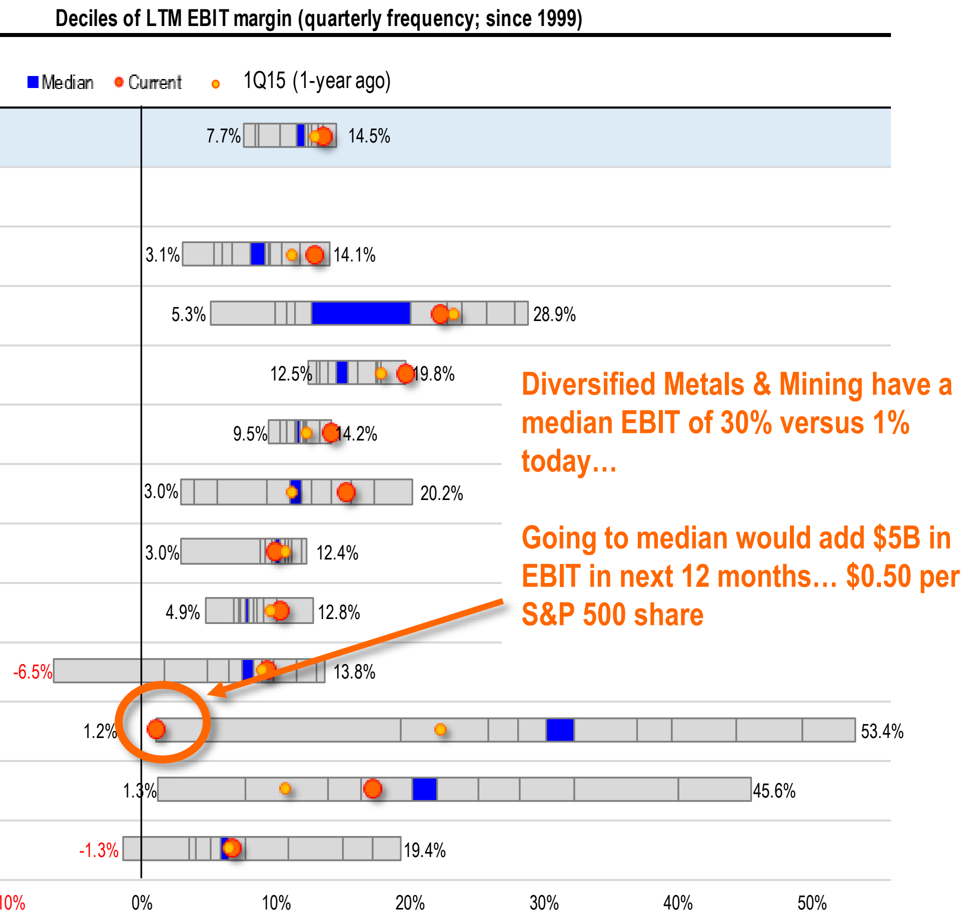
MATERIALS: Biggest upside in margins is "Diversified Metals & Mining"

Basic materials is a significantly smaller weight in the S&P 500 but because of the magnified impact on EBIT margins from changes in commodity prices, the sector has some impact on overall EPS.

- **Just a normalization in Diversified Metals & Mining EBIT margins would add $5B in EBIT, or $0.50 per S&P 500 share.**

Figure: Deciles of Basic Materials 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	
$315,309	100%	$41,193	100%	$500,917	100%	Materials sector
$83,508	26%	$10,863	26%	$128,021	26%	Diversified Chemicals
$30,816	10%	$6,898	17%	$68,812	14%	Fertilizers & Agricultural Chemicals
$25,787	8%	$5,099	12%	$62,131	12%	Industrial Gases
$43,240	14%	$6,120	15%	$99,862	20%	Specialty Chemicals
$6,962	2%	$1,065	3%	$27,652	6%	Construction Materials
$14,146	4%	$1,414	3%	$13,043	3%	Metal & Glass Containers
$47,911	15%	$4,977	12%	$42,105	8%	Paper Packaging
$22,508	7%	$2,102	5%	$12,204	2%	Aluminum
$16,263	5%	$192	0%	$14,249	3%	Diversified Metals & Mining
$7,729	2%	$1,338	3%	$17,948	4%	Gold
$16,439	5%	$1,125	3%	$14,889	3%	Steel



Source: Fundstrat, Bloomberg, FactSet

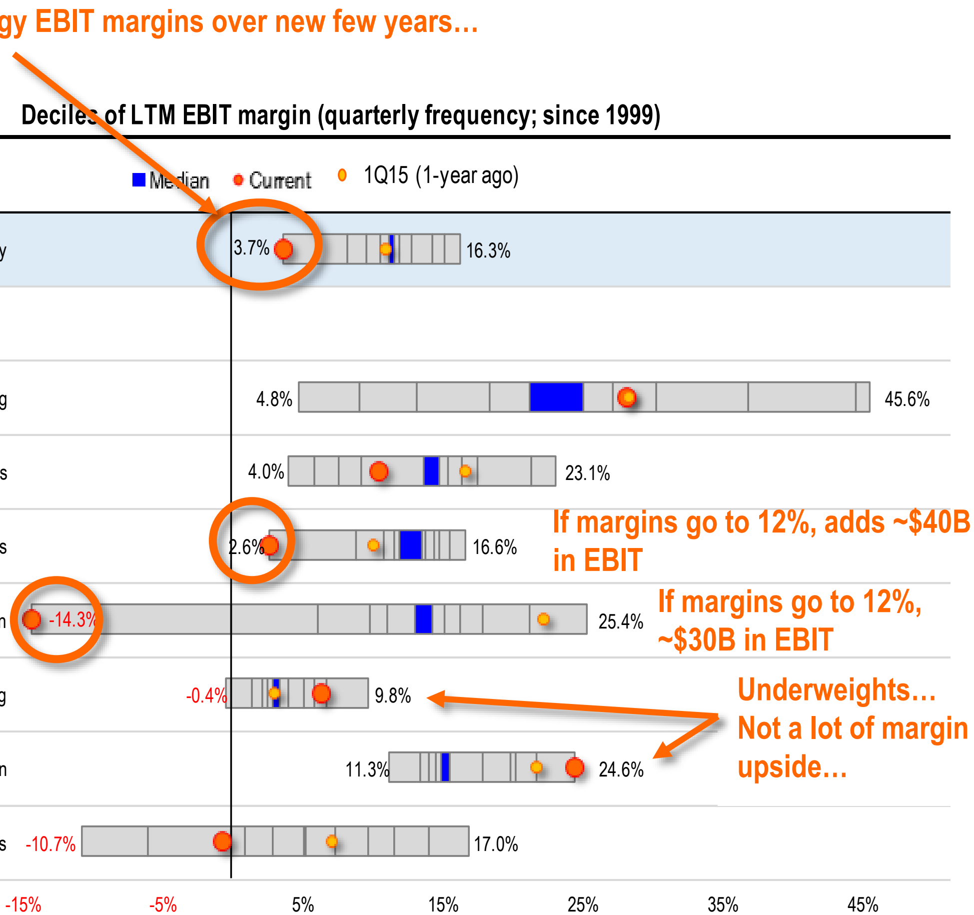
ENERGY EPS UPSIDE: Integrateds and E&Ps may add $70b in EBIT in 2017

We see upside in Energy EBIT margins over the next few years, as oil prices recover. As we said in the past (and everyone knows), Energy companies only make money when oil prices are higher than they are now.

- **We believe Integrateds and E&Ps could add $70B in EBIT in next 12 months ($5 per S&P 500 share). In other words, major leverage on EPS from higher oil.**

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	
$902,836	100%	$33,309	100%	$1,309,219	100%	Energy
$12,402	1%	$3,501	11%	$12,857	1%	Oil & Gas Drilling
$96,070	11%	$10,028	30%	$177,662	14%	Oil & Gas Equipment & Services
$379,151	42%	$9,915	30%	$616,019	47%	Integrated Oil & Gas
$111,293	12%	($15,945)	-48%	$312,076	24%	Oil & Gas Exploration & Production
$265,933	29%	$17,111	51%	$94,572	7%	Oil & Gas Refining & Marketing
$35,486	4%	$8,715	26%	$96,033	7%	Oil & Gas Storage & Transportation
$2,501	0%	($16)	-0%	n/a	n/a	Coal & Consumable Fuels



Source: Fundstrat, Bloomberg, FactSet

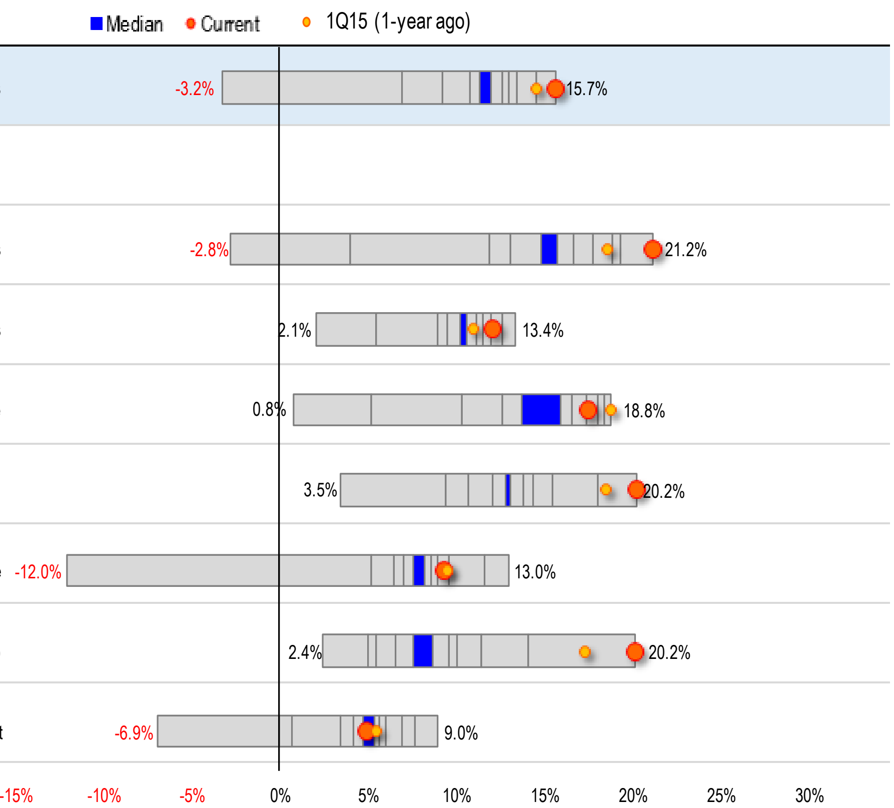
Financials sector net margins

Figure: Deciles of Financials sector NET margins

Since 1999

% of total sector Sales		% of total sector net income		Market cap weight		
Sales ($ mm)	% of total Sales	Net income ($ mm)	% of total net income	Market cap ($ mm)	% weight in sector	
$1,451,712	100%	$348,682	100%	$2,908,997	100%	Financials
$458,972	32%	$143,029	41%	$1,019,195	35%	Banks
$242,356	17%	$46,711	13%	$305,586	11%	Diversified Financial Services
$85,615	6%	$33,409	10%	$148,285	5%	Consumer Finance
$158,886	11%	$47,510	14%	$385,378	13%	Capital Markets
$427,217	29%	$56,578	16%	$485,229	17%	Insurance
$67,810	5%	$20,457	6%	$555,729	19%	Real Estate Investment Trusts (REITs)
$10,856	1%	$987	0%	$9,597	0%	Real Estate Management & Development

Deciles of LTM NET margin (since 1999; quarterly frequency)



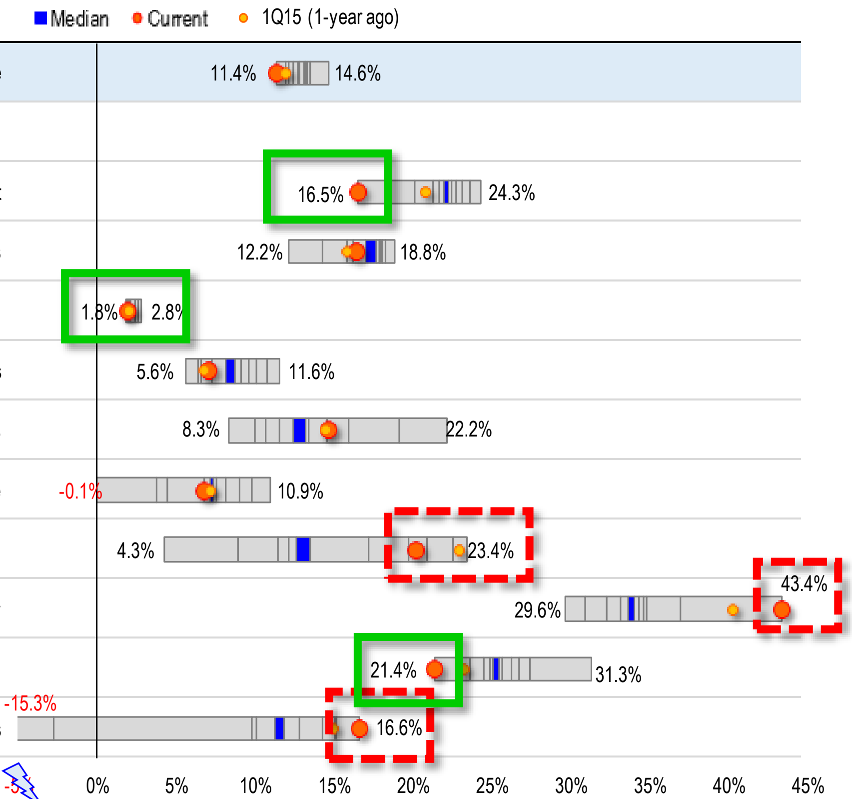
Source: Fundstrat, Factset, Bloomberg

Healthcare sector EBIT margins

Figure: Deciles of Healthcare 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	
$1,540,742	100%	$175,010	100%	$2,655,765	100%	Healthcare
$113,193	7%	$18,720	11%	$421,268	16%	Health Care Equipment
$2,674	0%	$438	0%	$14,138	1%	Health Care Supplies
$456,347	30%	$8,608	5%	$99,513	4%	Health Care Distributors
$131,707	9%	$9,260	5%	$85,702	3%	Health Care Services
$48,721	3%	$7,162	4%	$41,659	2%	Health Care Facilities
$411,790	27%	$27,824	16%	$265,044	10%	Managed Health Care
$4,425	0%	$895	1%	$18,304	1%	Health Care Technology
$108,225	7%	$46,972	27%	$579,119	22%	Biotechnology
$236,130	15%	$50,568	29%	$1,020,444	38%	Pharmaceuticals
$27,530	2%	$4,563	3%	$110,575	4%	Life Sciences Tools & Services

Deciles of LTM EBIT margin (quarterly frequency; since 1999)



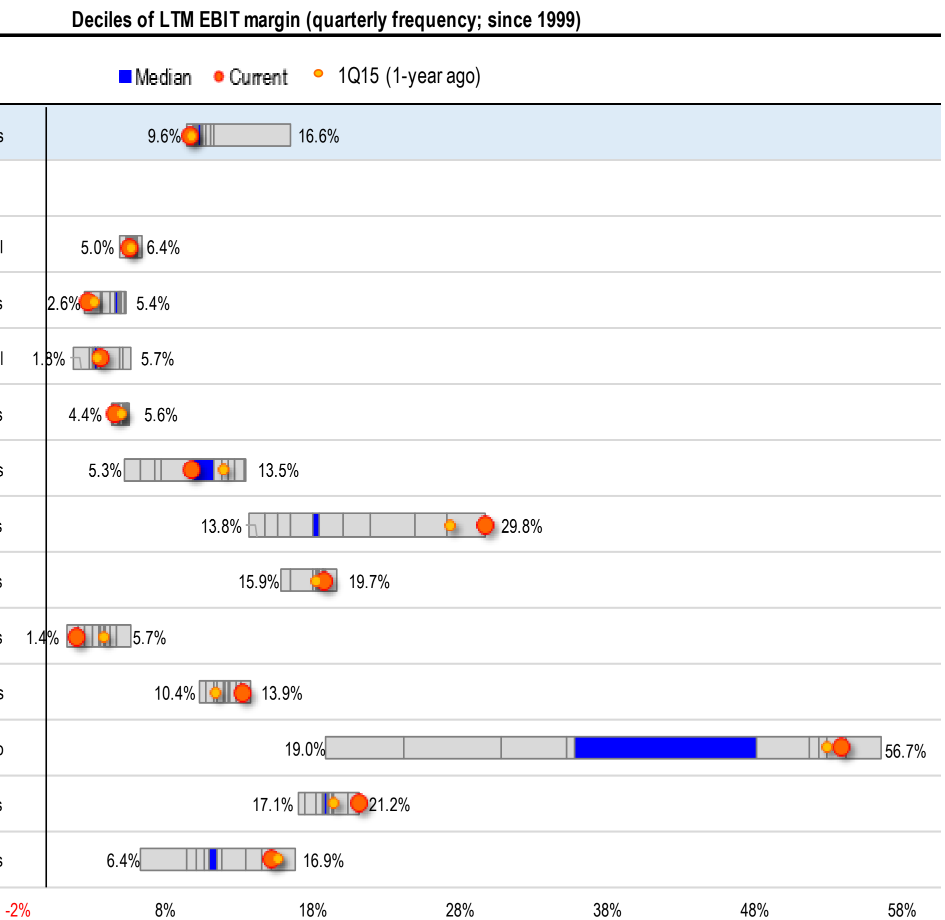
Source: Fundstrat, Factset, Bloomberg

Consumer Staples sector EBIT margins

Figure: Deciles of Consumer Staples 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 market cap ($ mm)	% weight in sector	
$1,595,609	100%	$155,334	100%	$2,094,241	100%	Consumer Staples
$266,213	17%	$14,947	10%	$188,001	9%	Drug Retail
$48,865	3%	$1,379	1%	$27,269	1%	Food Distributors
$125,376	8%	$4,559	3%	$43,195	2%	Food Retail
$598,683	38%	$27,726	18%	$280,492	13%	Hypermarkets & Super Centers
$3,568	0%	$351	0%	$18,842	1%	Brewers
$9,408	1%	$2,804	2%	$38,236	2%	Distillers & Vintners
$122,720	8%	$23,098	15%	$393,887	19%	Soft Drinks
$67,639	4%	$1,347	1%	$23,762	1%	Agricultural Products
$172,813	11%	$23,078	15%	$362,328	17%	Packaged Foods & Meats
$56,174	4%	$30,353	20%	$347,378	17%	Tobacco
$113,087	7%	$24,002	15%	$350,658	17%	Household Products
$11,064	1%	$1,690	1%	$20,195	1%	Personal Products



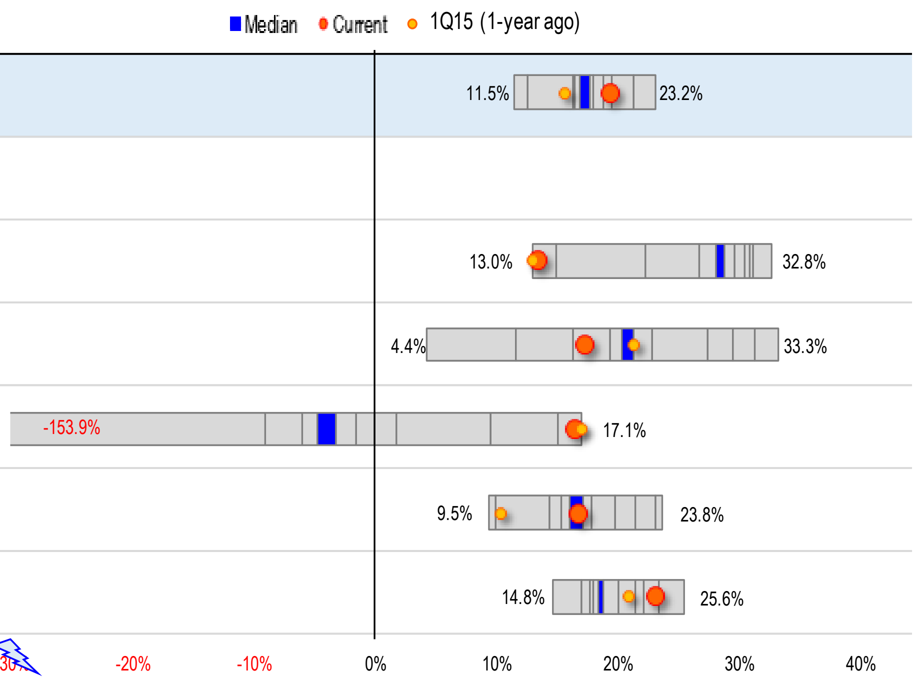
Source: Fundstrat, Factset, Bloomberg

Telecom sector EBIT margins

Figure: Deciles of Telecom 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	
$310,126	100%	$60,162	100%	$478,572	100%	Telecom
$17,900	6%	$2,637	4%	$14,825	3%	Centurylink Inc
$5,576	2%	$983	2%	$5,983	1%	Frontier Communications Corp
$8,229	3%	$1,358	2%	$18,983	4%	Level 3 Communications Inc
$146,801	47%	$24,634	41%	$236,883	49%	At&T Inc
$131,620	42%	$30,550	51%	$201,899	42%	Verizon Communications Inc

Deciles of LTM EBIT margin (quarterly frequency; since 1999)

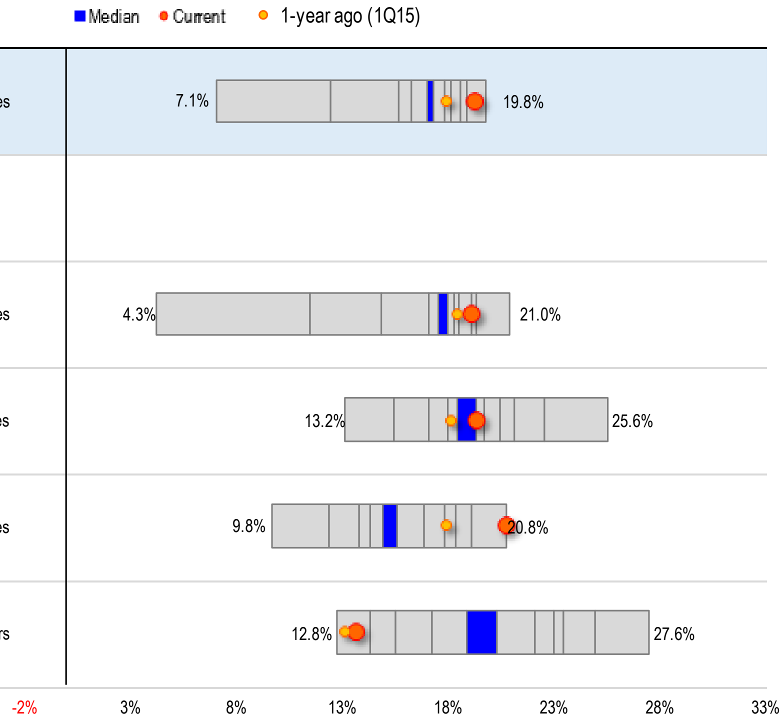


Source: Fundstrat, Factset, Bloomberg

Utilities sector EBIT margins

Figure: Deciles of Utilities sector EBIT margins
Since 1999

% of total sector Sales		% of total sector EBIT		Market cap weight		Deciles of LTM EBIT margin (quarterly frequency; since 1999)
Total Sales ($ mm)	% of total sector Sales	Total EBIT ($ mm)	% of total sector EBIT	Total mkt cap ($ mm)	% weight in sector	
$312,512	100%	$59,890	100%	$585,896	100%	Utilities
$186,689	60%	$35,870	60%	$362,703	62%	Electric Utilities
$3,885	1%	$753	1%	$7,915	1%	Gas Utilities
$91,996	29%	$19,151	32%	$203,192	35%	Multi-Utilities
$29,941	10%	$4,116	7%	$12,085	2%	Independent Power Producers & Energy Traders



Source: Fundstrat, Factset, Bloomberg

Executive Summary

- Key calls
- Global Markets
- Credit and Commodities
- State of the Economy
- Earnings Outlook
- **Equity Strategy**
- Sectors and Styles

WHAT MAKES 2016 UNIQUE? Leaders became Laggards (vice versa)

2016 has proven to be a challenging year for clients (an understatement) and one of the reasons for this is that leadership changed abruptly (groups leading or lagging for 5-7 years):

- Long-time leaders like Healthcare and Consumer Discretionary have turned into laggards in 2016. And Growth underperformed in 2016. The two sectors and this style are popular both with hedge-fund and long only managers. Hence, creating turmoil.
- **Similarly, groups which were "easy to short (underweight)" have become leaders—with sizable gains.**

Figure: Leaders become Laggards and vice versa…
Annual performance (relative to S&P 500) since 2008

LEADERS

Group name	Consec. # yrs of outperform (as of 2015 YE)	2007	2008	2009	2010	2011	2012	2013	2014	2015	YTD 2016
Healthcare sector	5					10%	2%	9%	12%	6%	-4%
Biotechnology	5					22%	24%	45%	21%	6%	-13%
Healthcare Distributors	9	0%	1%	20%	5%	8%	2%	32%	14%	6%	-14%
Consumer Discretionary	1		4%	15%	13%	4%	8%	11%	-3%	9%	-0%
Apparel Retail	7			46%	19%	22%	16%	5%	5%	2%	-6%
Pure Growth	7			26%	14%	0%	1%	13%	2%	2%	-2%

LEADER 5 years

LEADER 7 years

LEADER 7 years

We downgraded Healthcare on 12/17/15

We downgraded Discretionary on 11/13/15

LAGGARDS

Group name	Consec. # yrs of underperform (as of 2015 YE)	2007	2008	2009	2010	2011	2012	2013	2014	2015	YTD 2016
Energy sector	4						-11%	-7%	-21%	-23%	8%
Oil and Gas Exploration	6				-4%	-7%	-11%	-4%	-23%	-35%	12%
Coal/Consumable Fuels	5					-47%	-41%	-39%	-47%	-79%	88%
Materials	5					-12%	-1%	-7%	-7%	-10%	5%
Metals and Mining	5					-37%	-20%	-15%	-49%	-70%	71%
Gold	5					-2%	-36%	-80%	-29%	-4%	87%
Steel	6				-1%	-25%	-28%	-19%	-23%	-18%	17%
Heavy Machinery	5					-12%	-7%	-20%	-12%	-31%	13%
Communications Equip.	6				-16%	-5%	-2%	-13%	-1%	-13%	-2%
Value	9	-4%	-3%	-6%	-0%	-3%	1%	-1%	-2%	-5%	2%

Commodity Bust 6 years

Commodity Bust 5 years

Industrial Recession 5 years

Value LAGGED 9 years…

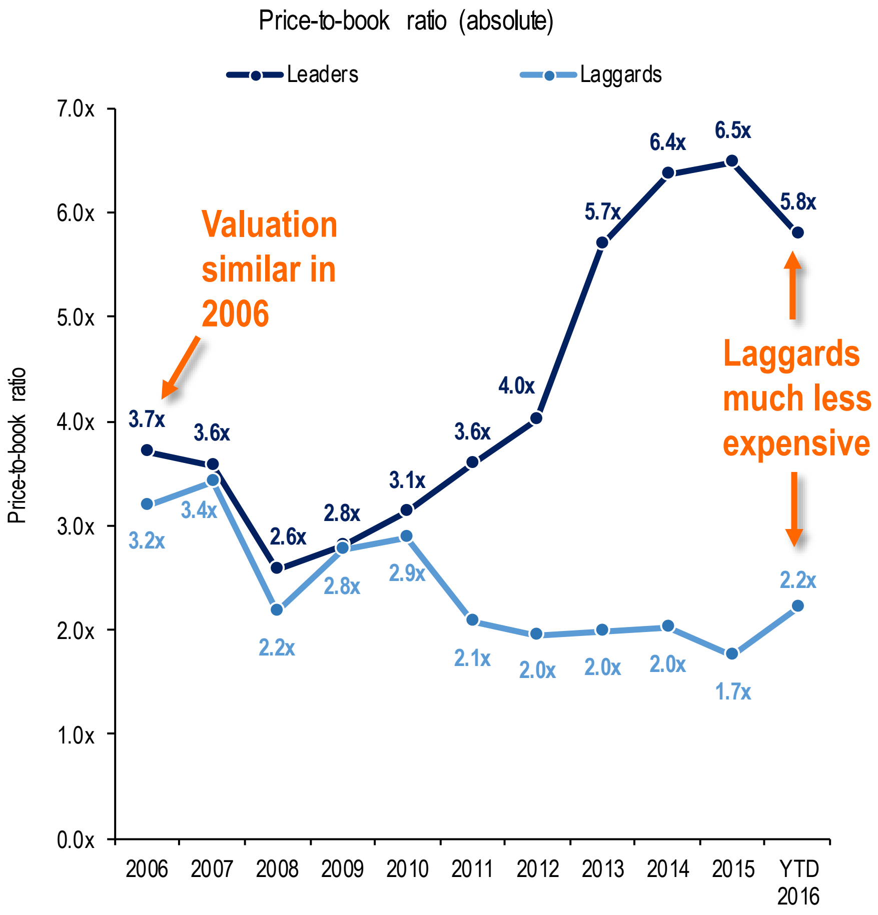
Source: Fundstrat, FactSet, Bloomberg.

LAGGARDS TO LEADERS: Better risk/reward in laggards…

As shown below, since 2006, the risk/rewards of leading groups (prior page) have risen while falling for those lagging groups:

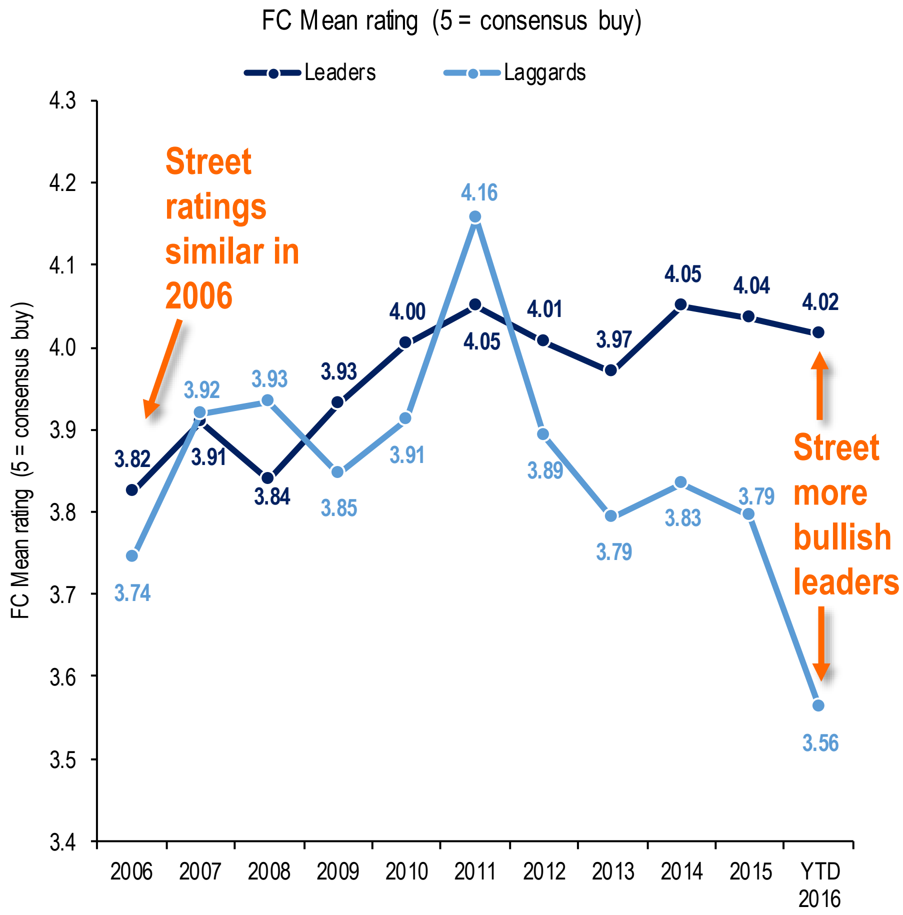
- **And a similar story is seen in Street consensus ratings… diverged since 2006.**

Figure: Multiples expanded significantly for Leaders
Year-end price-to-book ratio of Leaders and Laggards (since 2006)



Source: Fundstrat, FactSet, Bloomberg.

Figure: Laggards became "less liked" as they underperformed
Year-end FC Mean rating (5=buy) of Leaders and Laggards (since 2006)



Source: Fundstrat, FactSet, Bloomberg.

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 1982 (relative to S&P 500)

Annual performance (relative)

Sector name	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
S&P 500	15%	17%	1%	26%	15%	2%	12%	27%	-7%	26%	4%	7%	-2%	34%	20%	31%	27%	20%	-10%	-13%	-23%	26%	9%	3%	14%	4%	-38%
Value	-2%	5%	2%	-3%	1%	-2%	4%	-6%	-4%	-8%					-2%	-4%	-14%	-9%	14%	-0%	1%	3%	4%	1%	4%	-4%	-3%
Growth	3%	-4%	-3%	4%	-3%	2%	-3%	7%	4%	9%	-2%	-8%	2%	2%	2%	4%	14%	8%	-12%							4%	3%
Pure Value	—	—	—	—	—	—	—	—	—	—	—	—	—	—	-7%	-0%	-19%	-25%	19%	21%	3%	11%	14%	8%	4%	-10%	-11%
Pure Growth	—	—	—	—	—	—	—	—	—	—	—	—	—	[illegible]	[illegible]	[illegible]	11%	40%	2%	-5%	-9%	15%	7%	4%	-7%	2%	-1%
Technology	30%	13%	-10%	-5%	-28%	11%	-12%	-35%	7%	-20%	[illegible]	13%	21%	5%	23%	-3%	51%	59%	-31%	-13%	-14%	20%	-7%	-3%	-6%	12%	-5%
Consumer Discretionary	25%	6%	-5%	-1%	3%	-3%	8%	-10%	-8%	12%	13%	6%	-8%	-16%	-10%	1%	13%	[illegible]	-11%	15%	-1%	10%	3%	-10%	4%	-18%	4%
Industrials	1%	11%	-6%	-3%	-6%	1%	-5%	-2%	[illegible]				[illegible]	2%	2%	-6%	-17%	0%	15%	[illegible]						6%	-3%
Basic Materials	-12%	9%	-14%	0%	9%	11%	-5%	-9%	[illegible]				5%	-17%	-7%	-25%	-35%	3%	-8%	14%					2%	16%	-9%
Financials	-3%	2%	5%	17%	-4%	-15%	2%	4%	-18%	18%	15%	1%	-5%	16%	12%	14%	-17%	-17%	34%	3%	7%	2%	-1%	1%	3%	-24%	-18%
Energy	-36%	-1%	-2%	-17%	-4%	1%	5%	2%	5%	-24%	-7%	4%	1%	-8%	1%	-9%	-29%	-4%	23%	1%	10%	-4%	20%	26%	9%	29%	3%
Healthcare	5%	-9%	3%	9%	14%	6%	2%	14%	21%	24%	-23%	-18%	12%	20%	-1%	11%	16%	-31%	46%	0%	3%	-13%	-9%	2%	-8%	2%	14%
Consumer Staples	12%	-4%	7%	7%	11%	8%	3%	15%	19%	12%	-1%	-13%	8%	2%	3%	-0%	-13%	-36%	25%	5%	17%	-17%	-3%	-2%	-2%	8%	21%
Utilities	-5%	-12%	8%							-10%	-4%	1%	-16%	-9%	-20%	-13%	-17%	-32%	62%	-19%	-10%	-5%	11%	10%	3%	12%	7%
Telecom	-17%	-15%	15%	2%	[illegible]				-11%	-18%	7%	4%	-7%	3%	-22%	6%	23%	-2%	-30%	-1%	-13%	-23%	7%	-12%	19%	5%	5%

Value regime

Growth regime

PURE Value regime

Technology 1992-1999

Discretionary 1991-1993

Energy and Banks 2000-2008

Healthcare/Staples 1983-1991

Source: Fundstrat, Bloomberg, FactSet, Thomson Reuters Datastream.

LAGGARDS TO LEADERS: Hallmarks of regime change

Taking a broader step back, there are some reasons to believe 2016 is the start of a regime change:

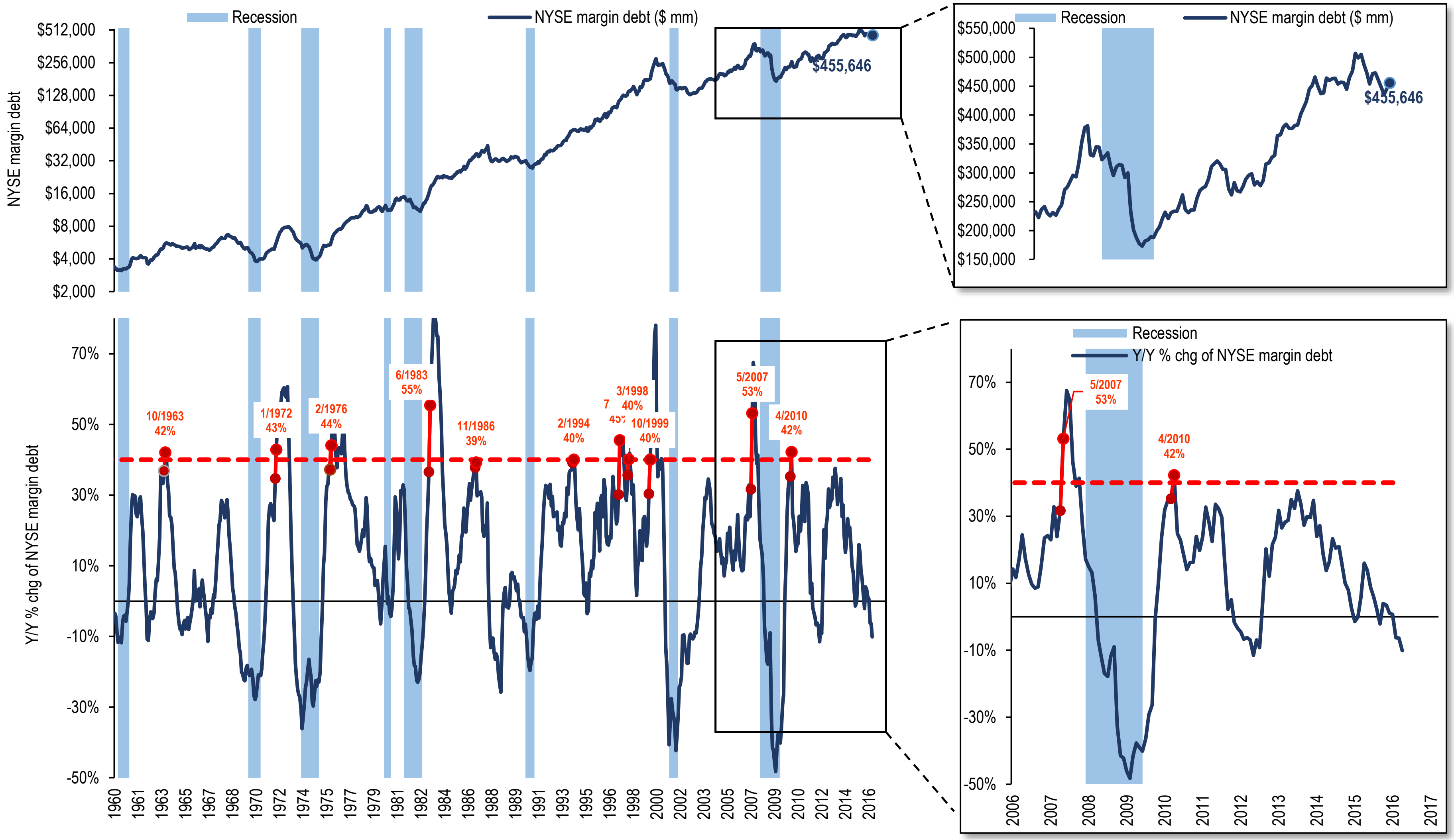
- **As shown below, the drivers here are changes in global growth drivers as well as currency, inflation trends and eventually equity flows.**

	1982-1990	1990-1999	2000-2006	2007-2015	2016-future…
Global growth driver	Japan	US and DM Technology boom	China and Commodity producers Housing	China	US and G7
Saving Flow	To: Japan From: G7	To: Asia From: Japan/G7	To: Commodity producers From: G7	To: US & Chinese consumers From: Commodity producers	To: G7 and EM From: US & China consumers
USD trend	Weakening	Rising	Weakening	Rising	Weakening
Inflation	Falling	Flat	Rising	Falling	Rising
Equity flows	Negative	Positive	Flat	Negative	Positive

MARGIN DEBT: warning sign is when it rises 40% yoy…

As shown below, it is not the level of margin debt that marks market highs….rather it is the yoy change in margin debt…

Figure: Margin debt and y/y % change since 1960 (right side is a zoom since 2006)
Monthly data since 1960



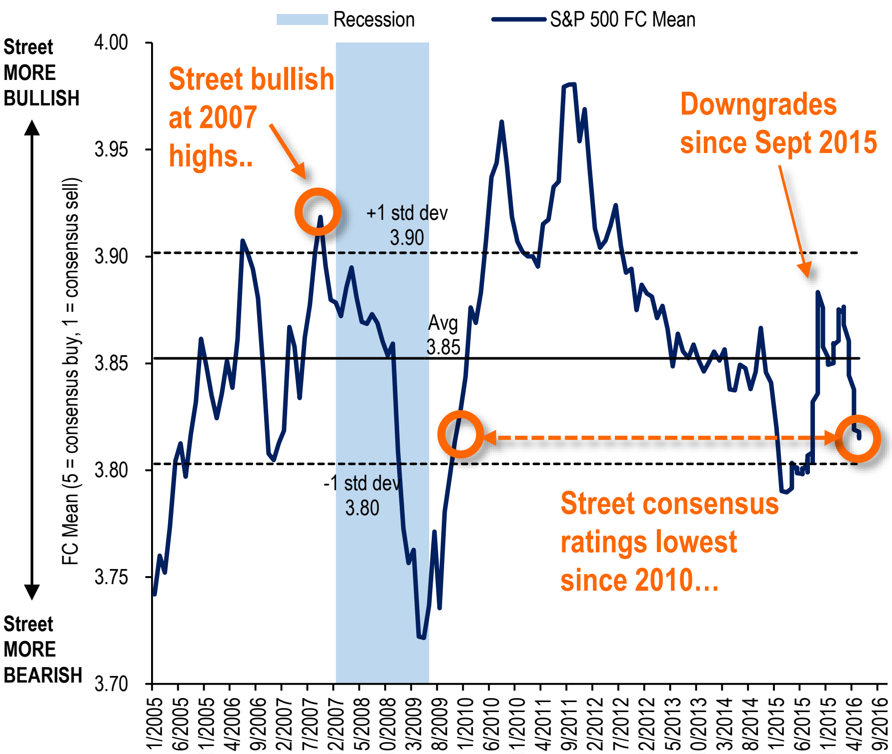
Source: Fundstrat, Bloomberg, FactSet.

Street *less bullish* on stocks than anytime since 2010, contrarian signal…

As shown below, sell-side analysts (Street consensus) have steadily downgraded stocks since September 2015 (measured numerically as consensus ratings, a 5=Buy).

- **As shown below, Street consensus ratings are now the lowest since in 6 years and back to levels seen in November 2010. This hardly feels euphoric. In fact, as shown below, Street was considerably more bullish in 2007 and peak bullishness coincided with the 2007 market tops. Notably, analysts are the least bullish on Energy stocks in more than 15 years—in other words, one could argue the bad news is reflected in analyst ratings.**
- **The downturn in analyst sentiment runs contrary to the improvement in credit (discussed) and the stabilization of EPS revisions.**

Figure: S&P 500 FC mean rating
Since 2005



Source: Fundstrat, Bloomberg, FactSet.
Note: S&P 500 FC mean rating is an equally-weighted average of the FC mean rating for the current list of S&P 500 constituents.

Figure: Deciles of FC mean for the S&P 500 sectors
As of 5/26/2016

Analysts are least bullish on Energy in more than 15 years…

= current   = 1 year ago

Worse sell-side sentiment ←→ Better sell-side sentiment

Group name	Bottom decile	2nd	3rd	4th	5th	6th	7th	8th	9th	Top decile	1-yr delta
S&P 500	3.70	3.78	3.84	3.86	3.87	3.90	3.92	3.95	4.10	4.31	-0.01
Technology	3.73	3.88	3.90	3.94	4.00	4.04	4.07	4.09	4.16	4.53	0.00
Consumer Discretionary	3.71	3.82	3.86	3.89	3.95	3.99	4.01	4.04	4.16	4.32	-0.01
Industrials	3.71	3.81	3.84	3.89	3.93	3.95	3.98	4.03	4.09	4.25	-0.09
Basic Materials	3.57	3.71	3.80	3.86	3.90	3.93	3.98	4.03	4.11	4.33	-0.10
Financials	3.56	3.63	3.67	3.73	3.78	3.80	3.82	3.88	4.09	4.31	0.10
Energy	3.72	3.82	3.89	3.95	4.02	4.06	4.10	4.13	4.22	4.51	-0.10
Healthcare	3.83	3.90	3.96	3.99	4.02	4.06	4.07	4.09	4.30	4.44	-0.03
Consumer Staples	3.58	3.62	3.65	3.68	3.70	3.74	3.79	3.85	3.95	4.14	0.00
Utilities	3.29	3.50	3.57	3.61	3.64	3.69	3.74	3.81	3.87	3.92	-0.07
Telecom	3.10	3.30	3.45	3.56	3.62	3.68	3.76	3.90	4.07	4.72	0.09

Source: Fundstrat, Bloomberg, FactSet.
Note: FC mean rating for each sector is an equally-weighted average of the FC mean rating for the current list of each sector's constituents.

RATIONALE #4: Historical liquidation of stocks will reverse…

To appreciate the magnitude of liquidation of equities, take a look at the chart on the bottom left. We calculate what percentage of annual household savings is allocated to equities. As shown, householders have been "net sellers" since 2007.

- This is the largest liquidation in history and surpasses the 10% liquidation during the decade from 1979 to 1989—that was the precedent decade before the massive inflows into equities in the 1990s.
- **We believe this "net selling" is a factor behind the more pronounced cyclicality of equities in the past few years. Intuitively, this makes sense—after all, without natural buyers, equities would be more volatile.**
- **Given the attractive relative value of stocks and the tendency of mean reversion, we believe we will see equity flows reverse and turn positive in the new few years.**

Figure: Annual HH allocation to equity as % of fin assets acq

Since 1956. Equity flows include mutual funds, ETFs, and HH direct ownership of stocks

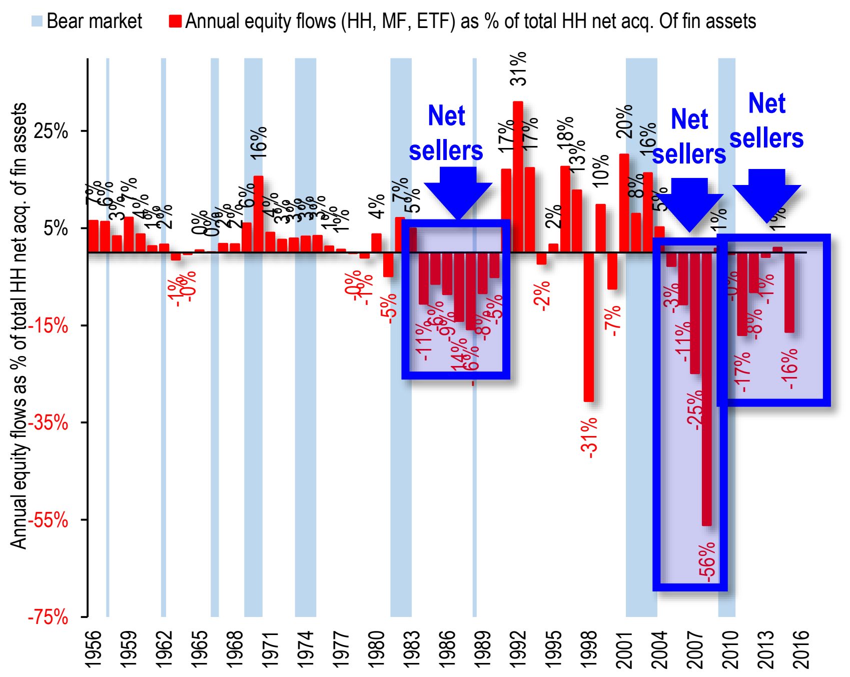
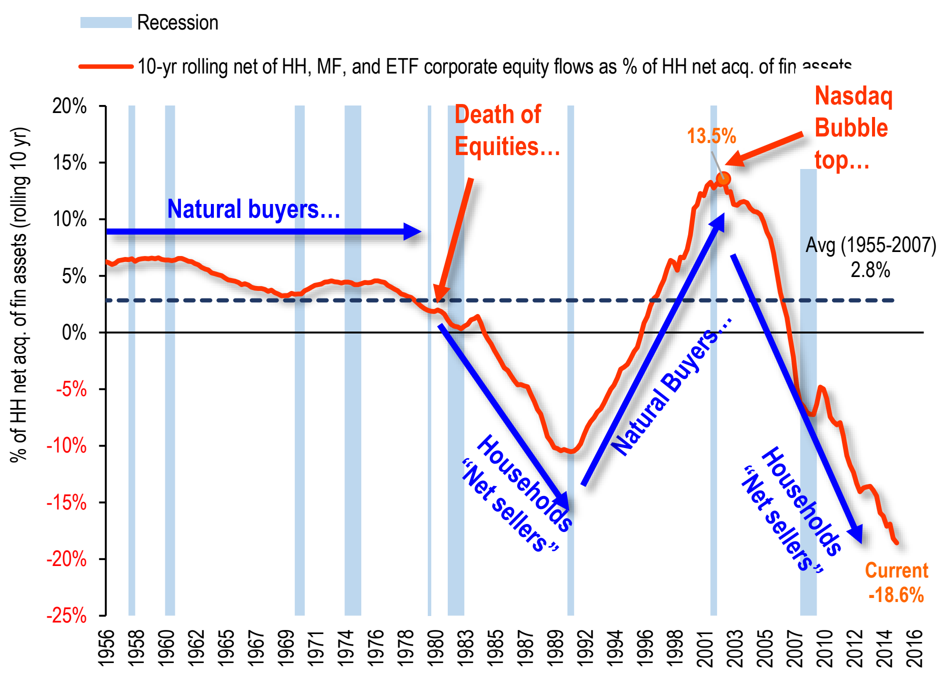


Figure: Households have been massive net-sellers of equities

Since 1956



Source: Fundstrat, Bloomberg, Federal Reserve.

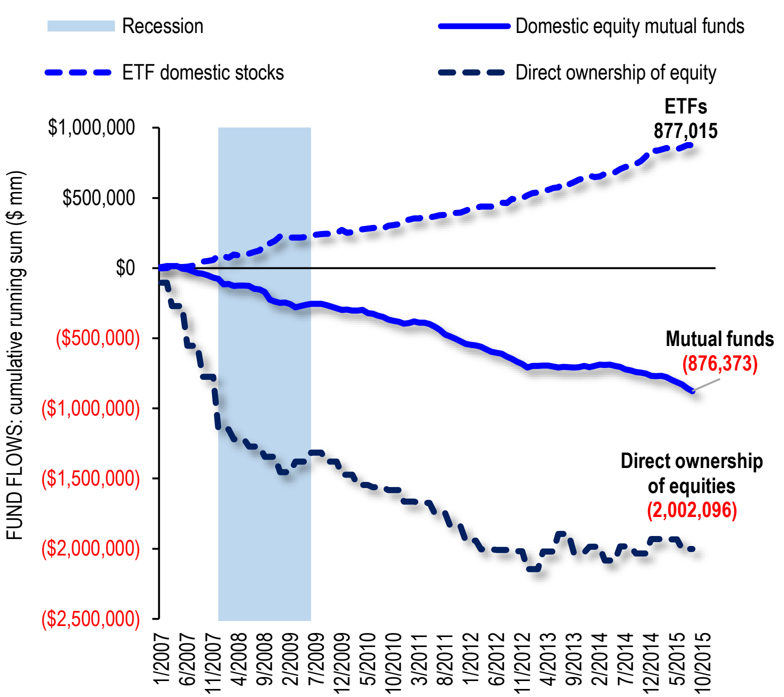
RATIONALE #1: Households have *only bought bonds* since 2007…

Households have not been buying equities generally since 2007. This is evident on the chart on the left below. As shown, there has been a substantial liquidation of equity ownership, most notably in direct ownership of stocks.

- The largest decline has been direct ownership of stocks (down $2T) and this reflects the buyback programs of US corporates. Essentially, they have been buying equity holdings from households (institutional ownership of stocks is essentially the same). The only area of purchases has been domestic equity ETFs.
- **Instead of equities, households have diverted $2.4T into bonds, $1T into international equities and $100b into high-yield.**

Figure: Households liquidated equities holdings since '07

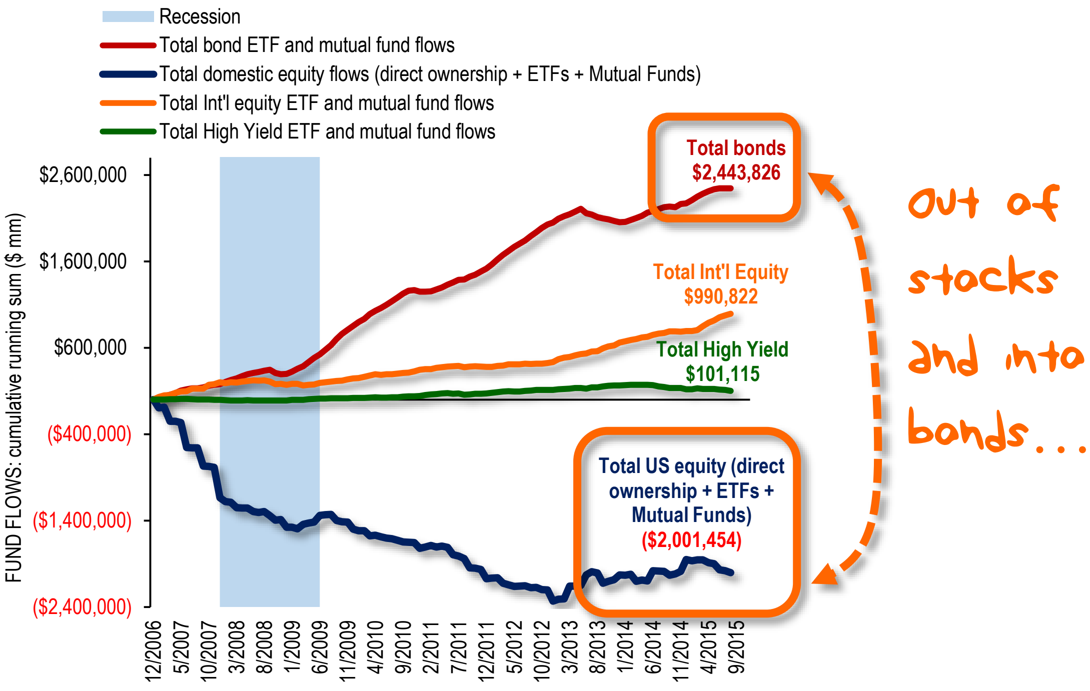
Cumulative U.S. equity flows since 2007 ($ mm)



Source: Fundstrat, ICI, Bloomberg. Federal Reserve Flow of Funds.

Figure: $2T in U.S. equity *OUTFLOWS* since 2007

Domestic / Int'l equity, bond, and high yield ETF and mutual fund flows since 2007 ($ mm)

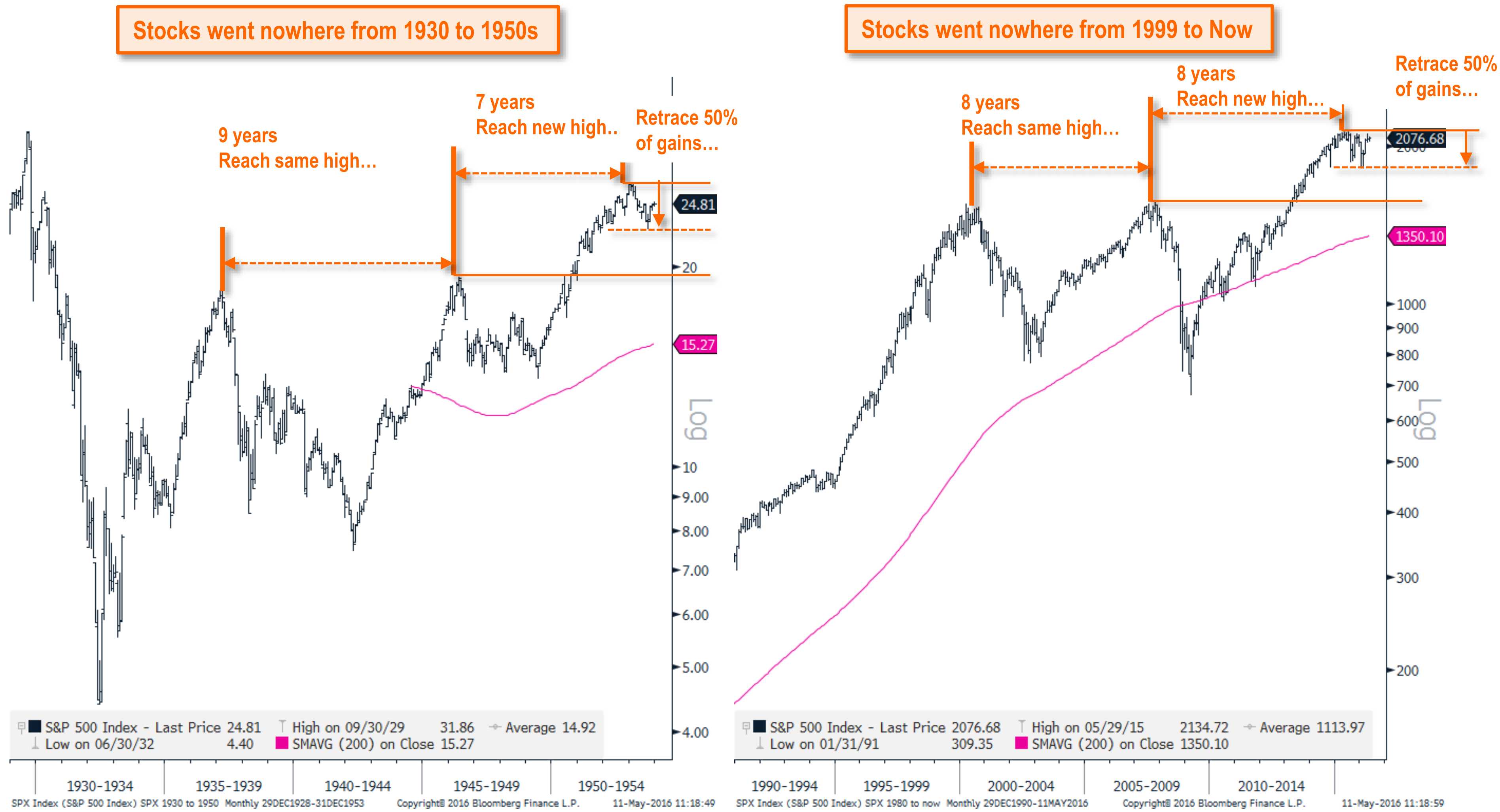


Source: Fundstrat, ICI, Bloomberg.

This is similar to the S&P 500 in the 1950s

Does the phrase "stocks have gone nowhere for 20 years" sound familiar? We saw this in 1930 to 1950s and looks very similar to the 1999 to 2016 period…

Figure: S&P 500 Monthly

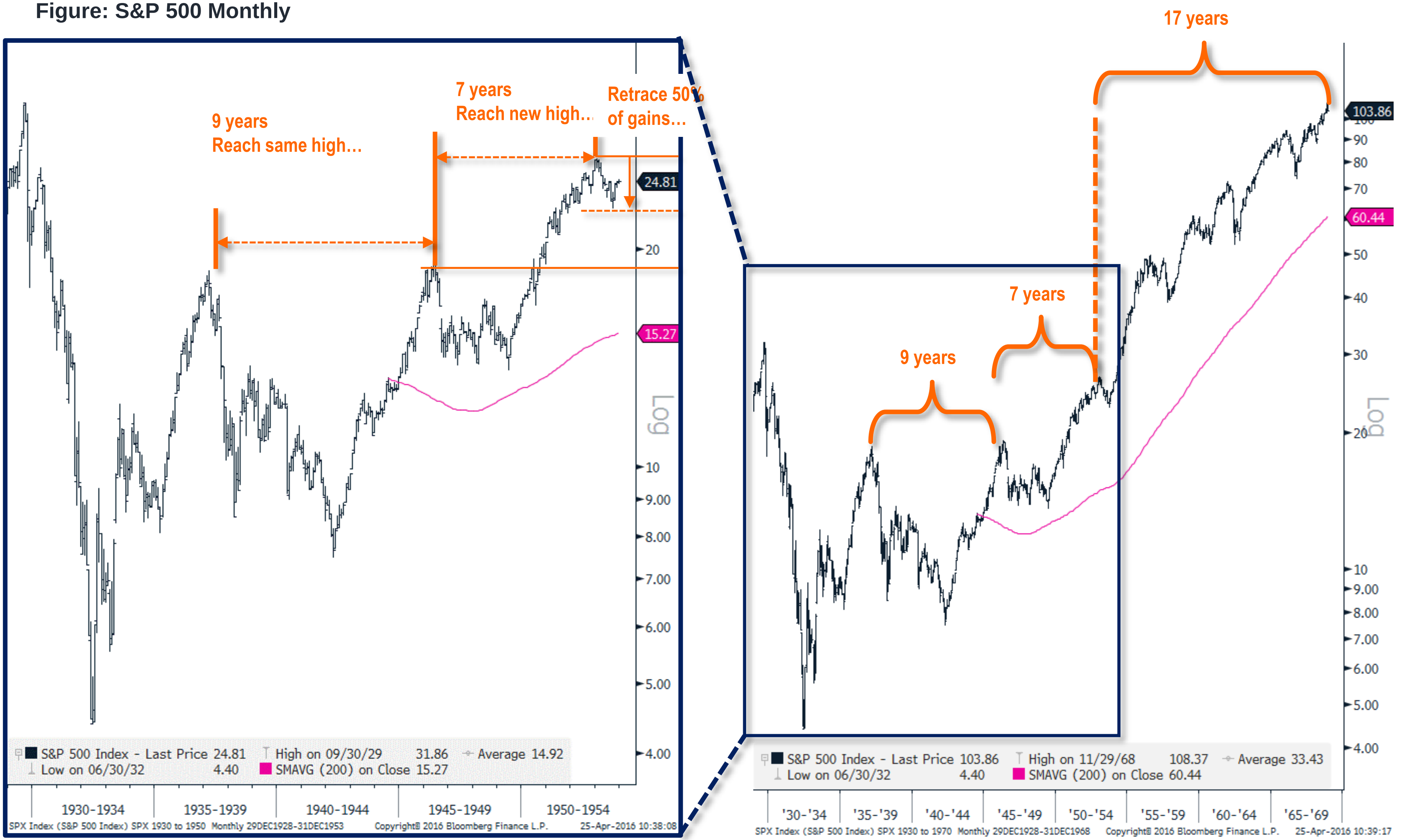


Source: Fundstrat, Bloomberg.

Stocks broke to the upside in the 1950s…

As shown, the "stocks went nowhere for 20 years" was resolved with a 17-year breakout of equities. As shown, stocks subsequently quadrupled between 1952 and 1969.

Figure: S&P 500 Monthly



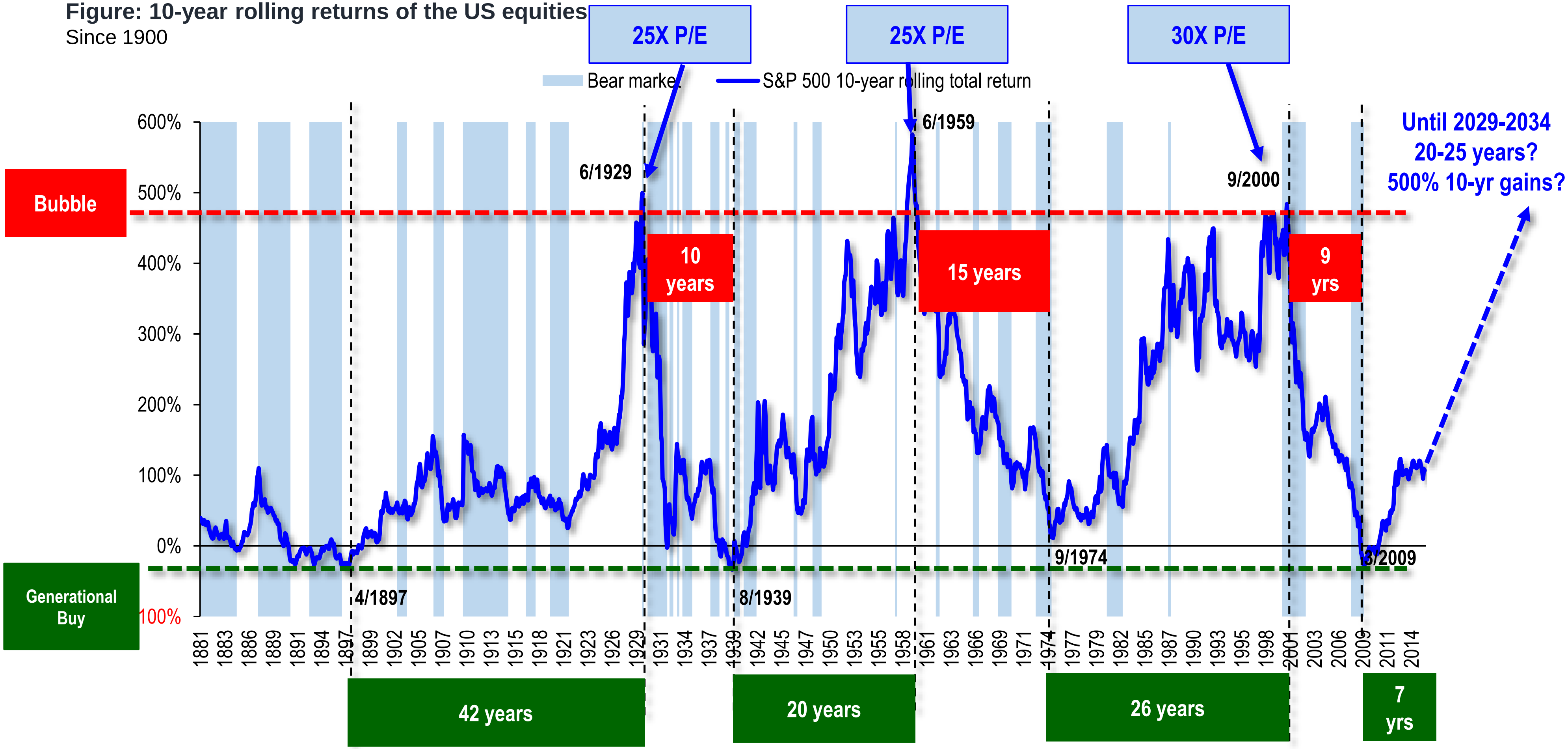
Source: Fundstrat, Bloomberg.

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.

Executive Summary

- Key calls
- Global Markets
- Credit and Commodities
- State of the Economy
- Earnings Outlook
- Equity Strategy
- **Sectors and Styles**

- USD outright weakens
- Oil bottoms and HY improves
- Quality spread HY rally (BB vs CCC)
- FANG ends with a “dang” (Value over FANG)
- Stocks are the “new bonds”
- Laggards become Leaders

STRATEGY: Value is highly correlated to macro variables of USD, oil and HY

The natural question is how does an investor position for a weakening of USD and a bottom in oil? The easy answer is to look at the correlation of sectors and styles of USD (we also showed oil and yield curve and high-yield).

- **Value is the most inversely correlated with USD (-0.93)—thus, is arguably the most leveraged to a USD weakening.**
- As to why? Weaker USD is generally stimulative to GDP growth and hence, boosts growth outlook. Moreover, Value is heavily comprised of Industrials, Energy, Old-Tech and all of these groups have large non-USD businesses, hence, a weakening is a tailwind for EPS.
- The sector negatively impacted is Consumer Discretionary. As shown, Consumer Discretionary has the highest positive correlation to USD (0.75), hence the most negative exposure.
- **Similarly, Value is the most positively correlated with Oil prices rising.**
- **Hence, we favor Value over Growth and Value over Momentum (FANG ends with a DANG).**

Figure: 1-yr correlation: Markets vs Styles and Sectors

Based on daily price data; since March 2015 (except DXY Index). P-values below 0.01 for all correlations.

		DXY Index during surge (5/2014 to 3/2015)	WTI crude oil	High-Yield STW
	S&P 500	0.78	0.73	-0.79
Styles	Small vs. Large-Cap	-0.27	0.86	-0.94
Styles	MSCI U.S. momentum	0.94	-0.83	0.84
Styles	Pure Value	-0.93	0.93	-0.95
Styles	S&P 500 Low Quality	0.46	0.91	-0.97
Sectors	Technology	0.78	-0.62	0.69
Sectors	Discretionary	0.75	-0.68	0.70
Sectors	Industrials	-0.37	0.06	-0.04
Sectors	Materials	-0.79	0.84	-0.84
Sectors	Financials	0.30	0.53	-0.67
Sectors	Energy	-0.95	0.91	-0.90
Sectors	Healthcare	0.94	0.25	-0.38
Sectors	Staples	0.69	-0.86	0.93
Sectors	Utilities	0.35	-0.69	0.75
Sectors	Telecom	-0.85	-0.47	0.57

Red = strong positive correlation (above 0.60)
Green = strong inverse correlation (below -0.60)

Source: Fundstrat, FactSet, Bloomberg.

Energy, Materials and Industrials credit rally *outpaced* equity move…

As we have noted in our recent reports, we believe the outperformance of resources (**Energy** and **Materials**) and **Industrials** is not a dead-cat bounce. We have compared the performance of the credit (investment grade CDS vs Markit IG) and the relative performance of the equity.

- **As shown below, the CDS move has outpaced the recovery in the equities—what is particularly notable is the outperformance of Basic Materials CDS, which is back to 2012 levels, while the equity is still close to 2015 lows.**

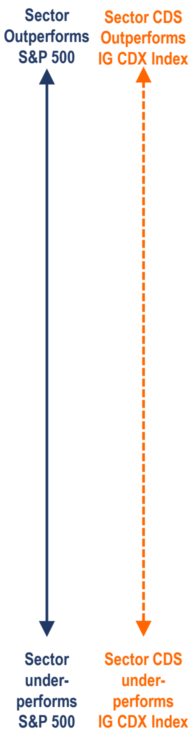
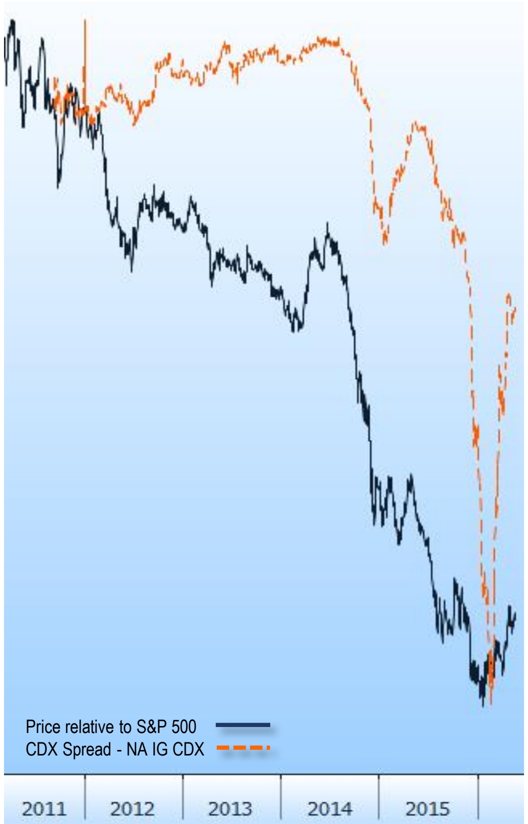
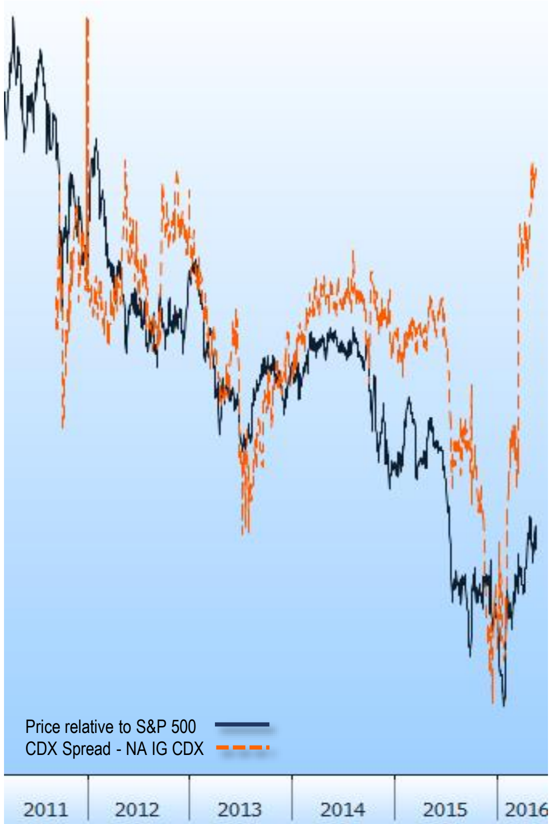


Figure: Energy equity vs. CDX (credit)
Blue line = relative price ratio, Orange line = CDX



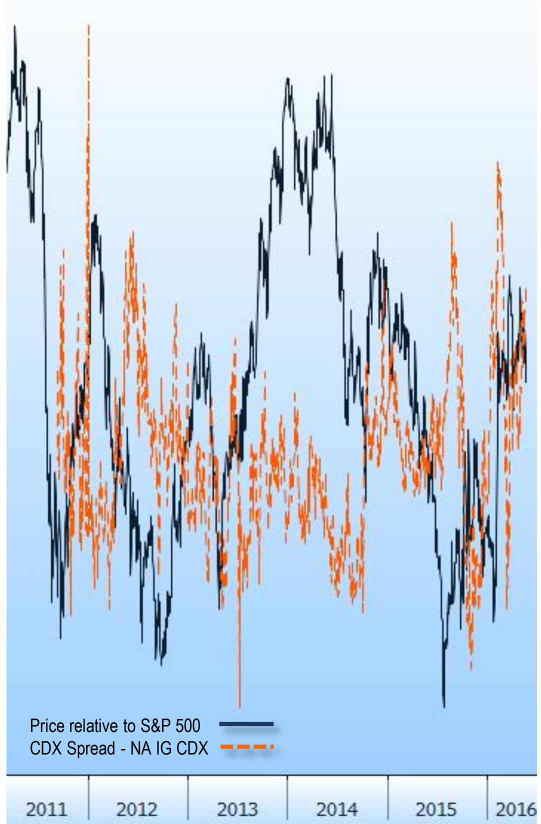
Source: Fundstrat, Bloomberg.

Figure: Materials equity vs. CDX (credit)
Blue line = relative price ratio, Orange line = CDX



Source: Fundstrat, Bloomberg.

Figure: Industrials equity vs. CDX (credit)
Blue line = relative price ratio, Orange line = CDX



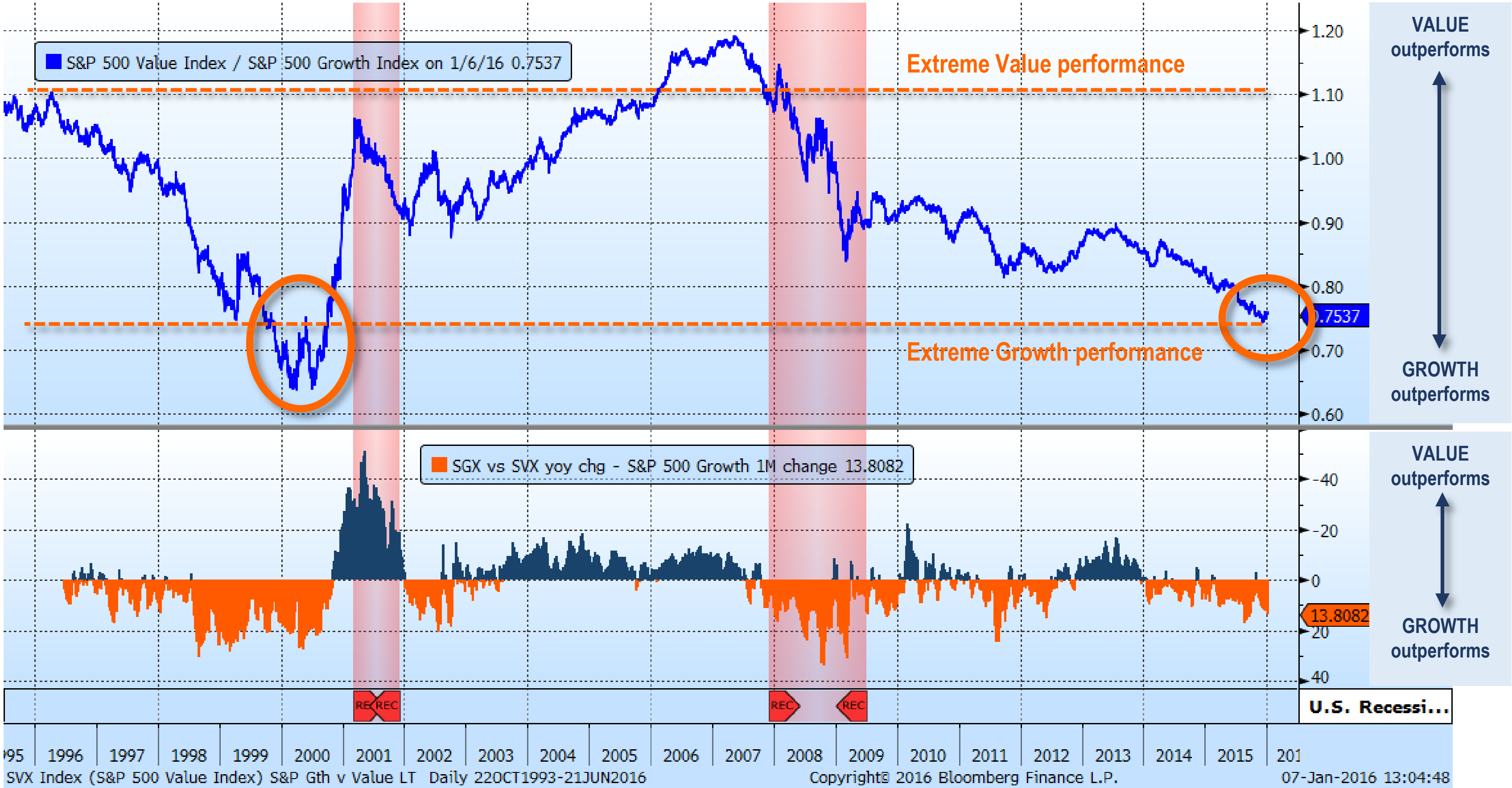
Source: Fundstrat, Bloomberg.

STRATEGY: VALUE over GROWTH, Growth *stretched* to 20-year highs…

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: S&P 500 Value vs. Growth price ratio
Since 1995



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.

OW *Low-quality* to leverage the rally in HY and easing credit conditions

Low-quality stocks, which are lower margin and higher debt-ratio companies, have moved in lock-step with high-yield. The relationship is logical.

- **When HY rallies, this implies an easing of credit conditions. Easing credit conditions benefits the weaker companies in any sector. Thus, the rally in HY should benefit low-quality stocks.**
- **In fact, as shown on the previous slide, across all 10 sectors this outperformance of low-quality was prevalent but most notable among Cyclicals and Near-Cyclicals.**

Figure: HY STW and comparative performance of S&P 500 Low-Quality Index (relative to S&P 500 High-Quality Index)
Last 5 years

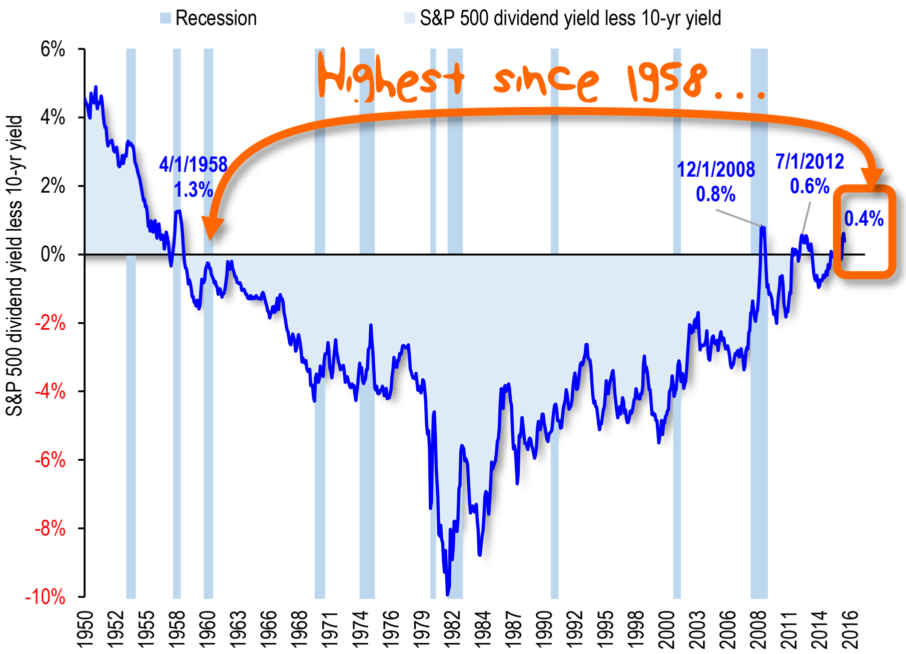
Source: Fundstrat, Bloomberg.

RATIONALE #2: Stocks are the new "bonds" paying more than 10-year…

Equity valuations are also finding support from dividends. The drop in equity prices has pushed dividend yields to over 2.1%, and given the current 10Y yield of 1.71%, means equities are now yielding more than 10Y bonds. ***In fact, this yield is even greater when taking into account the differences in taxation.***

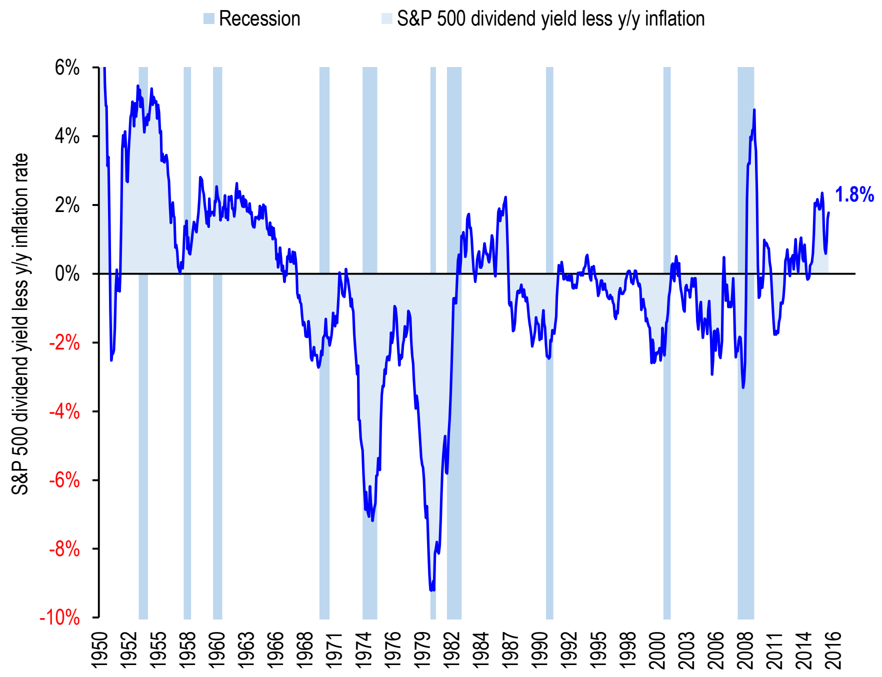
- **The differential in dividend yield and bond yield is shown on the bottom left figure. And as shown, this parity in yields is something we have not seen for 50-years—really since the late 50s. There was a short period in the 2011/2012 period where this also existed. And we know stocks did very well subsequently.**
- With inflation and interest rates potentially rising in 2016, we again see this valuation argument for equities as compelling. After all, dividend yields for equities rise over time while interest coupons are fixed.

Figure: Dividend yield less 10-year yield nearing 50-year high…
S&P 500 dividend yield less 10-year yield since 1950



Source: Fundstrat, Bloomberg.

Figure: Real dividend yield highest since 2008 crash…
S&P 500 dividend yield less y/y change in CPI Index



Source: Fundstrat, Bloomberg.

#2: 87% of the original "Stocks are the new bonds" outperformed, by *600bp on avg*

On November 20, 2015, we highlighted 30 stocks we saw as "stocks are new bonds" because the dividend yield exceeded the bond yield.

- **26 of these stocks outperformed. Those stocks where bond yields rose *generally underperformed*.**

Figure: Spread of div yield less bond yield is wider today vs. November 2015 for over half of our original list

Original "Stocks are the New Bonds" screen, first published in our 11/20/2015 report titled "Equities are the new bonds in 2016"

= yield increase since Nov 2015 or div yield less bond yield turned negative

			Perf since 11/19/2015		YTD 2016 perf		Dividend yield			Bond yield			Div yield less bond yield		
	Ticker	Company name	Absolute	Relative	Absolute	Relative	November 2015	Current	Delta	November 2015	Current	Delta	November 2015	Current	Delta
Technology	IBM	Intl Business Machines Corp	8%	10%	8%	8%	3.8%	3.6%	-25 bp	3.2%	2.4%	-80 bp	67 bp	123 bp	55 bp
	CSCO	Cisco Systems Inc	1%	3%	2%	2%	3.1%	3.6%	49 bp	2.8%	2.0%	-79 bp	26 bp	155 bp	128 bp
Discretionary	TGT	Target Corp	16%	18%	12%	12%	3.2%	2.8%	-35 bp	2.8%	2.7%	-18 bp	37 bp	20 bp	-17 bp
Industrials	CAT	Caterpillar Inc	6%	8%	9%	9%	4.5%	4.2%	-31 bp	3.0%	3.3%	25 bp	144 bp	88 bp	-56 bp
	CMI	Cummins Inc	7%	9%	19%	20%	4.0%	3.8%	-22 bp	3.1%	3.7%	68 bp	92 bp	1 bp	-90 bp
	EMR	Emerson Electric Co	5%	7%	11%	11%	3.8%	3.6%	-17 bp	3.0%	2.7%	-36 bp	77 bp	96 bp	19 bp
	DE	Deere & Co	2%	4%	-0%	-0%	3.2%	3.2%	-7 bp	2.8%	3.2%	41 bp	42 bp	-6 bp	-48 bp
	GE	General Electric Co	1%	3%	-2%	-2%	3.0%	3.0%	0 bp	2.8%	2.5%	-32 bp	24 bp	56 bp	32 bp
	UPS	United Parcel Service-Cl B	-0%	2%	8%	8%	2.8%	3.0%	16 bp	2.6%	2.4%	-20 bp	17 bp	54 bp	36 bp
Financials	HSBC	Hsbc Holdings Plc-Spons Adr	-27%	-25%	-26%	-26%	5.0%	8.3%	329 bp	3.4%	4.2%	78 bp	162 bp	412 bp	250 bp
Energy	COP	Conocophillips	-25%	-23%	-14%	-14%	5.5%	2.5%	-298 bp	3.3%	4.4%	107 bp	216 bp	-190 bp	-406 bp
	CVX	Chevron Corp	4%	6%	5%	5%	4.7%	4.6%	-8 bp	2.9%	2.0%	-90 bp	179 bp	262 bp	83 bp
	NOV	National Oilwell Varco Inc	-24%	-22%	-15%	-15%	4.8%	6.4%	164 bp	4.0%	5.2%	128 bp	84 bp	120 bp	36 bp
	XOM	Exxon Mobil Corp	3%	4%	6%	6%	3.6%	3.6%	2 bp	2.8%	2.0%	-80 bp	80 bp	162 bp	82 bp
	OXY	Occidental Petroleum Corp	-8%	-6%	3%	3%	4.0%	4.5%	49 bp	3.2%	3.0%	-14 bp	78 bp	141 bp	64 bp
Healthcare	PFE	Pfizer Inc	1%	3%	1%	2%	3.4%	3.6%	16 bp	3.0%	2.5%	-56 bp	41 bp	113 bp	72 bp
	JNJ	Johnson & Johnson	7%	9%	6%	6%	2.9%	2.8%	-12 bp	2.5%	2.4%	-7 bp	41 bp	36 bp	-5 bp
	MRK	Merck & Co. Inc.	2%	4%	5%	5%	3.3%	3.3%	1 bp	2.9%	2.6%	-29 bp	40 bp	71 bp	31 bp
Staples	PM	Philip Morris International	17%	19%	14%	15%	4.8%	4.1%	-65 bp	3.0%	2.6%	-49 bp	174 bp	158 bp	-16 bp
	PG	Procter & Gamble Co/The	9%	11%	5%	5%	3.5%	3.3%	-14 bp	2.3%	2.4%	14 bp	123 bp	95 bp	-29 bp
	WMT	Wal-Mart Stores Inc	12%	14%	11%	11%	3.2%	2.9%	-29 bp	2.9%	2.9%	3 bp	31 bp	-1 bp	-31 bp
	KO	Coca-Cola Co/The	8%	9%	8%	8%	3.1%	3.0%	-17 bp	2.9%	1.7%	-113 bp	26 bp	122 bp	96 bp
Utilities	SO	Southern Co/The	12%	14%	8%	8%	4.9%	4.4%	-50 bp	3.1%	2.2%	-91 bp	178 bp	219 bp	41 bp
	DUK	Duke Energy Corp	16%	18%	11%	11%	4.9%	4.3%	-62 bp	3.1%	2.9%	-22 bp	177 bp	137 bp	-40 bp
	PPL	Ppl Corp	10%	11%	9%	10%	4.5%	4.1%	-42 bp	3.3%	3.9%	59 bp	118 bp	17 bp	-102 bp
	ED	Consolidated Edison Inc	20%	22%	18%	18%	4.1%	3.5%	-67 bp	3.2%	3.0%	-18 bp	96 bp	48 bp	-48 bp
	XEL	Xcel Energy Inc	14%	16%	14%	14%	3.6%	3.3%	-26 bp	3.0%	2.9%	-10 bp	57 bp	41 bp	-16 bp
	D	Dominion Resources Inc/Va	6%	8%	8%	8%	3.8%	3.8%	1 bp	3.4%	3.5%	18 bp	42 bp	26 bp	-16 bp
	WEC	Wec Energy Group Inc	17%	19%	15%	15%	3.7%	3.3%	-33 bp	3.3%	2.6%	-79 bp	31 bp	78 bp	46 bp
	ES	Eversource Energy	11%	13%	11%	11%	3.3%	3.2%	-13 bp	3.1%	2.7%	-41 bp	16 bp	44 bp	27 bp
	Average		4%	6%	6%	6%	3.9%	3.8%	-8 bp	3.0%	2.9%	-14 bp	84 bp	90 bp	6 bp
	% of stocks positive		83%	87%	83%	83%									

Source: Fundstrat, Bloomberg, FactSet.
Note: Bond yield is the weighted average YTM of all the company's outstanding bonds.

Bonds rallied more than equities...

PORTFOLIO STRATEGY: 50 “Stocks are the new bonds”

Below is Part duex of our “stocks are the new bonds” list. The criteria is as follows:

- **(i) Div yield is greater than the co’s own long-term bond yield (7-10Y maturity), (ii) market cap is above $10B, and (iii) S&P credit rating is A- or better.**

Figure: 50 “Stocks are the new bonds”
Priced as of 4/7/2016

	50 "Stocks are the new bonds"				Screen Metrics				
	Name	Ticker	Market Cap ($mm)	YTD relative perf	Dividend yield [1]	Bond yield [2]	Div yield less bond yield	S&P credit rating [3]	New on 4/8/15
Technology	Cisco Systems Inc	CSCO	$138,887	2%	3.6%	2.0%	155 bp	AA-	
	Intl Business Machines C	IBM	$142,451	8%	3.6%	2.4%	122 bp	AA-	
	Qualcomm Inc	QCOM	$74,789	0%	4.0%	3.0%	103 bp	A+	x
	Texas Instruments Inc	TXN	$57,450	4%	2.7%	1.8%	95 bp	A+	x
	Intel Corporation	INTC	$148,834	-8%	3.3%	2.7%	66 bp	A+	x
	Xilinx, Inc.	XLNX	$11,791	-2%	2.7%	2.3%	41 bp	A-	x
	Automatic Data Processir	ADP	$41,079	6%	2.3%	2.3%	9 bp	AA	x
Discretionary	Target Corp	TGT	$48,941	12%	2.8%	2.7%	20 bp	A	
Industrials	Emerson Electric Co	EMR	$34,002	11%	3.6%	2.7%	96 bp	A	
	Caterpillar Inc	CAT	$43,191	9%	4.2%	3.3%	88 bp	A	
	Boeing Company	BA	$82,684	-12%	3.4%	2.8%	66 bp	A	x
	General Electric Co	GE	$284,404	-2%	3.0%	2.5%	56 bp	AA+	
	United Parcel Service-Cl	UPS	$91,896	8%	3.0%	2.4%	54 bp	A+	
	3M Company	MMM	$101,267	11%	2.7%	2.2%	42 bp	AA-	x
	Cummins Inc	CMI	$17,902	20%	3.7%	3.7%	1 bp	A+	
Materials	Praxair Inc	PX	$31,856	9%	3.2%	2.4%	87 bp	A	x
Financials	Hsbc Holdings Plc-Spons	HSBC	$115,560	-26%	8.6%	1.0%	758 bp	A	
	Cme Group Inc	CME	$31,209	2%	6.6%	3.3%	324 bp	AA-	x
	Bb&T Corp	BBT	$26,343	-14%	3.5%	2.0%	145 bp	A-	x
	U.S. Bancorp	USB	$67,874	-8%	2.8%	2.2%	59 bp	A+	x
	BlackRock, Inc.	BLK	$54,337	-3%	2.8%	2.2%	57 bp	AA-	x
	Wells Fargo & Company	WFC	$237,337	-14%	3.3%	2.9%	44 bp	A	x
	JPMorgan Chase & Co.	JPM	$209,895	-13%	3.3%	2.8%	43 bp	A-	x
	Ameriprise Financial, Inc.	AMP	$15,323	-14%	3.2%	2.9%	35 bp	A	x
	Prudential Financial, Inc.	PRU	$31,104	-14%	4.1%	3.8%	27 bp	A	x
Energy	Chevron Corp	CVX	$178,651	5%	4.6%	2.0%	263 bp	AA-	
	Exxon Mobil Corp	XOM	$342,063	6%	3.7%	2.0%	163 bp	AAA	
	Occidental Petroleum Co	OXY	$52,988	3%	4.5%	3.0%	143 bp	A	
	National Oilwell Varco In	NOV	$10,737	-15%	6.5%	5.2%	125 bp	A-	

					Screen Metrics				
	Name	Ticker	Market Cap ($mm)	YTD relative perf	Dividend yield [1]	Bond yield [2]	Div yield less bond yield	S&P credit rating [3]	New on 4/8/15
Healthcare	Pfizer Inc	PFE	$202,592	2%	3.6%	2.5%	114 bp	AA	
	Abbvie Inc	ABBV	$95,932	0%	3.9%	2.9%	97 bp	A	x
	Merck & Co. Inc.	MRK	$153,805	5%	3.3%	2.6%	72 bp	AA	
	Johnson & Johnson	JNJ	$301,404	6%	2.8%	2.4%	36 bp	AAA	
	Eli Lilly and Company	LLY	$82,384	-11%	2.7%	2.6%	14 bp	AA-	x
Staples	Philip Morris Internationa	PM	$156,024	15%	4.1%	2.6%	159 bp	A	
	Hershey Co/The	HSY	$19,571	2%	3.4%	2.1%	126 bp	A	x
	Coca-Cola Co/The	KO	$200,681	8%	3.0%	1.7%	123 bp	AA-	
	Procter & Gamble Co/Th	PG	$225,128	5%	3.4%	2.4%	95 bp	AA-	
	Altria Group, Inc.	MO	$124,086	9%	3.7%	3.2%	56 bp	A-	x
	PepsiCo, Inc.	PEP	$151,389	4%	2.9%	2.3%	55 bp	A	x
	Kimberly-Clark Corpora	KMB	$49,286	7%	2.7%	2.4%	34 bp	A	x
	Colgate-Palmolive Com	CL	$63,019	6%	2.2%	2.0%	25 bp	AA-	x
Utilities	Southern Co/The	SO	$46,293	8%	4.4%	2.2%	219 bp	A-	
	Ppl Corp	PPL	$25,247	10%	4.1%	2.2%	183 bp	A-	
	Duke Energy Corp	DUK	$54,614	11%	4.3%	2.9%	137 bp	A-	
	Wec Energy Group Inc	WEC	$18,595	15%	3.3%	2.6%	78 bp	A-	
	Eversource Energy	ES	$18,017	11%	3.2%	2.7%	44 bp	A	
	Xcel Energy Inc	XEL	$20,719	14%	3.3%	2.9%	42 bp	A-	
	Dominion Resources Inc	D	$44,963	8%	3.8%	3.5%	26 bp	AAA-	
	Consolidated Edison Inc	ED	$22,326	18%	3.5%	3.3%	17 bp	A-	
	Median		$60,235	5%	3.4%	2.5%	69 bp		
	Average		$96,018	2%	3.6%	2.6%	101 bp		
	% of stocks positive			72%					

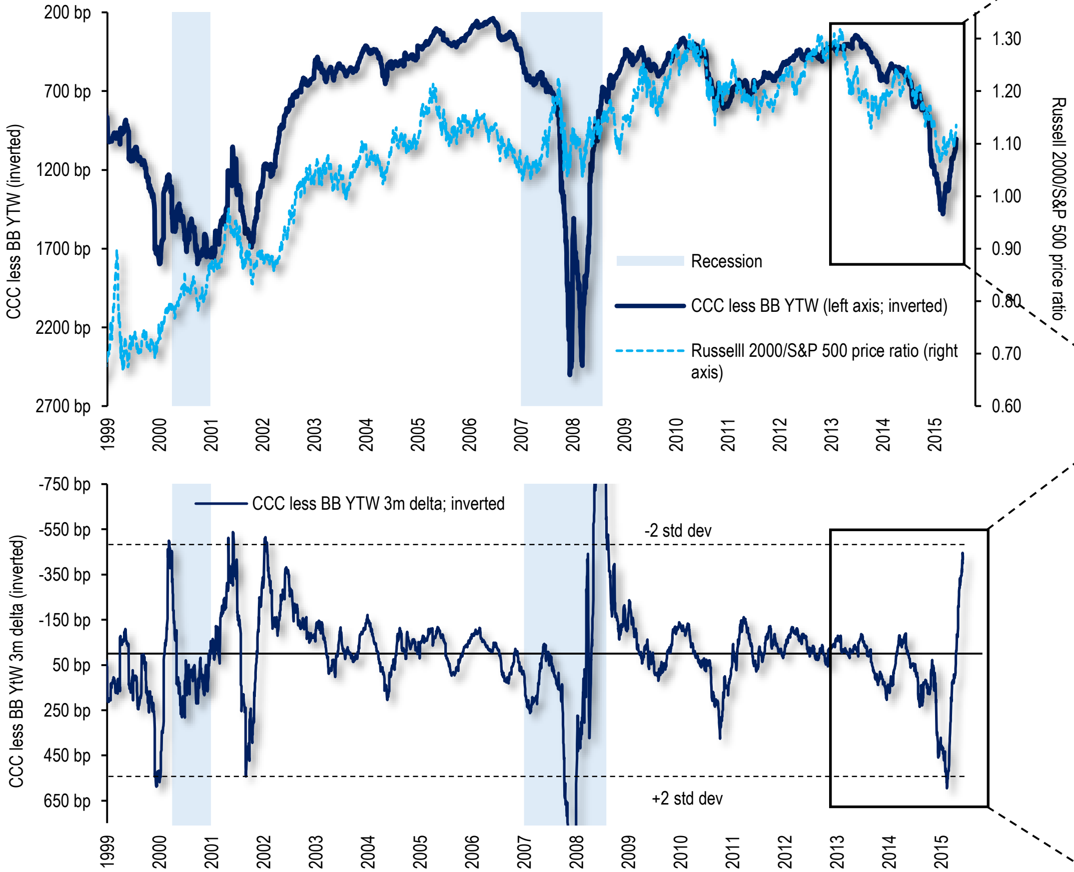
Source: Fundstrat, Bloomberg.
(1) 12 months forward estimated dividend yield.
(2) Weighted avg YTM of the co’s long-term bonds (7-10Y maturity).
(3) We are using the higher rating in the event of a split rating between S&P and Moody’s.

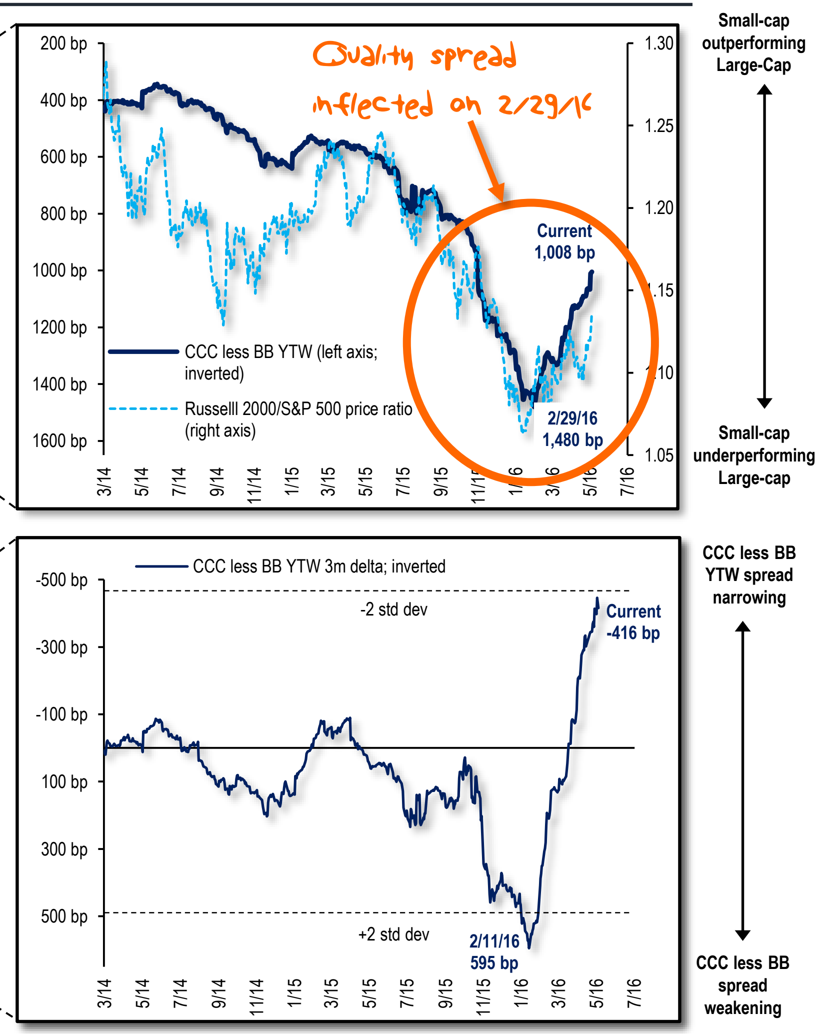
Quality spread (CCC vs BB) narrows, positive for Small vs. Large-Cap

As credit conditions ease, the quality spread is similarly narrowing—the spread between CCC (speculative grade) and BB (higher end HY) bonds. As shown below, this has been historically correlated with improved relative performance of small-cap (vs large):

- **The Quality spread inflected on 2/29/16 and as a consequence, we added Small-Cap to our favored investment themes list on 4/1/16.**
- **Over the last month alone, Quality spread narrowed by 416bp (a 2 std dev delta), and Small-Caps outperformed Large by 120bp.**

Figure: Narrowing of Quality Spread (CCC less BB) positive for Small-caps…
Relationship between "Quality Spread" (CCC less BB YTW) and Small vs. Large-Cap stock performance





Source: Fundstrat, Bloomberg, St. Louis Federal Reserve, BofA Merrill Lynch.
Note: "CCC" and "BB" yield-to-worst is based on BofA Merrill Lynch US HY Semi-Annual YTW.

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