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US Equity Strategy | North America

Weekly Warm-up: Easy Come, Easy Go; Earnings Preview; Tax Loss Selling Screen

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Last week packed in a year's worth of volatility both up and down as the market battle between deteriorating fundamentals and supportive technicals continues. Ultimately, fundamentals prevail, in our view, but it could take longer than we would like.

Easy come, easy go…last week was another wild one with one of the largest 2-day rallies in history followed by one of the roughest closes in recent memory. We think this could continue in the near term as deteriorating fundamentals clash with arguably oversold markets, pervasive bearishness and technical support at the 200-week moving average. With the heart of earnings season still 2 weeks away, and the jobs data now behind us, markets can chop back and forth and even drift higher before it becomes obvious that earnings forecasts are too high.

Dividends futures lead EPS forecasts…Dividend futures have started to roll over and reflect the market's view on where earnings estimates are headed. IG credit spreads seem to agree even as the S&P 500 refuses to price it until it actually happens. This is just more market based evidence that the bear market will not be over until the deteriorating fundamental picture is more fully discounted, something we think will be dictated by when companies throw in the towel (3Q or 4Q earnings season) and/or an external financial shock.

We run our annual tax loss selling screen…The screen results in 50 names that may see technical pressure due to tax loss selling. The screen looks for stocks that were likely favored and widely held among investors at the beginning of the year and had negative price returns to generate a tax loss. As compared to recent years, we expanded our downside range given that the average stock is down 20% YTD.

We run our 3Q earnings preview…with 5.5% of S&P 500 market cap reporting this week. 3Q22 expectations are down 8% since the April peak while S&P 500 ex Energy estimates are down 11%. We provide further commentary and exhibits on consensus sales/EPS expectations, guidance, revisions, earnings contributions, and historical earnings surprise**…we also highlight a new episode of our Equities Unplugged podcast**.

What to Focus on This Week

Easy Come, Easy Go

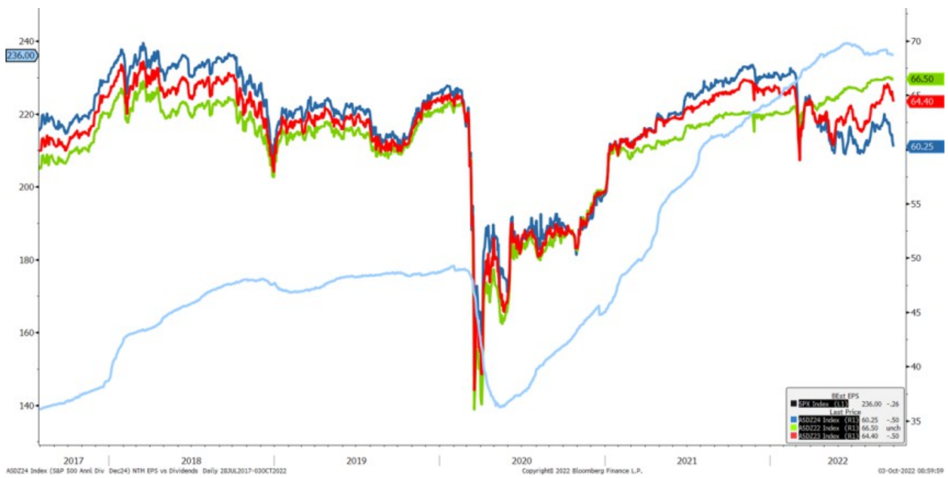
Last week started with one of the bigger 2-day rallies in history only to give most of it back by Friday's close. The culprit for this extreme 2 way volatility is a combination of deteriorating fundamentals with oversold/supportive technicals. As noted last week, September was the worst month in what's been a brutal year. Retail was a net seller for the first time since March 2020 while CTAs sold $75B in equity exposure according to our QDS team. On a scale of 1-10 that's probably an 8 in terms of how bad it can get from these 2 very important investor groups. In other words, the equity market was primed for a rally especially with the S&P 500 closing right on it's 200-WEEK moving average the prior friday. There was also a lot of fear circulating about an imminent financial "accident." With that accident failing to materialize over the weekend, the rally was vicious, forcing short sellers to cover. Low quality stocks led the rally as further evidence the rebound was just bear market action rather than the beginning of a new bull.

There is also still lingering hope for a Fed pivot. In last week's note, we suggested that dream may return in the short term as talk of financial accidents prevailed. To be sure, the BOE has already fully pivoted and is doing QE once again to deal with it's localized financial stress in the Gilts market. Meanwhile, the RBA and Polish central bank hiked less than expected at their planned meetings last week. However, as we discussed last week, this does not mean the Fed is ready or able to do the same, and only the Fed can really solve the global economic and financial market stress by printing US Dollars. On that score, the economic data that matter the most for such a pivot, jobs and inflation, continue to dash any hopes for a more dovish Fed.

However, the sell out of CTAs and retail to some degree does keep 2 way risk alive in the short term in our view as it gets quiet for the next few weeks on the earnings front. Over the past month, there has been overwhelming evidence that our call for lower earnings next year is coming to fruition. Large, important companies across a wide swath of industries have either reported or pre-announced earnings and guided significantly lower for 4Q. Some of these misses were as much as 30% which is exactly what's needed for next year's estimates to finally take the step function lower we think is necessary for the bear market to be over. The question is will enough of this happen during 3Q earnings season or will we need to wait for 4Q reporting in January/February when companies tend to formally guide for the next year? We think the evidence is already there (hence, why we cut our estimates so much a month ago) and should be strong enough this quarter for bottom-up consensus estimates to finally come down to reality but we just don't know for sure. Therefore, over the next two weeks, stocks could continue to exhibit 2 way risk and defend the 200-week moving average at ~3590.

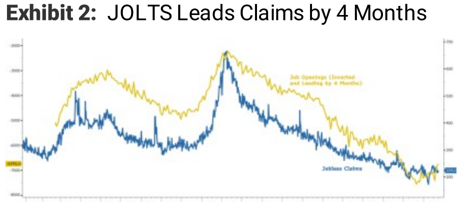
One interesting development that supports our less optimistic view on 2023 earnings is in the dividend futures market. More specifically, we've noticed that dividend futures have traded materially lower even as forward EPS forecasts have remained sticky on the upside (Exhibit 1; dark blue line, red line, green line are '24, '23, '22 dividend futures, respectively; light blue line is forward EPS). We think this is the cleanest version of the market's view on earnings as dividends are so closely tied to EPS. One reason this might be happening now is that cash flows are becoming more at risk. This is tied to the lower quality EPS we predicted earlier this year as companies struggled with the timing on costs versus revenues as the economy fully re-opened. Things like inventory (see below), labor costs and other latent expenses are wreaking havoc on cash flow. Accrual accounting EPS will follow 6-12 months later. One area in particular we think investors should be tracking closely is working capital. Our analysis shows many companies burning lots of cash simply operating their business as many of the tailwinds during the locks downs turn into headwinds. In short, it's just another sign that our materially lower than consensus EPS forecasts next year are likely to be correct. If anything, we are now leaning more toward our bear case on EPS for next year which is $190.

Exhibit 1: Dividend Futures Are Rolling Over Particularly for 2024--Leading NTM EPS, In Our View



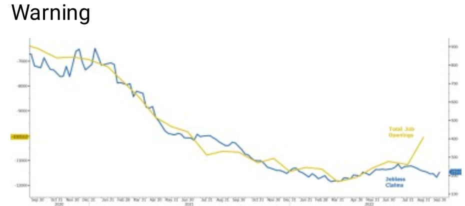
Looking closely again at Exhibit 1 it's interesting, and rare, for FY2 dividend futures (blue line) to trade below FY1 (red line). In other words, the dividend futures market which is essentially a market based view of forward EPS is saying that 2024 dividends (and EPS) will be lower than 2023. We think this may be explained by the conclusion the recession won't arrive until later in 2023 or 2024 which syncs up with the Fed's summary of economic projections and dot plot. We would challenge that view even with the recent jobs data simply due to our forecast on EPS and deterioration we are already seeing in cash flows. In other words, if our earnings forecast comes to fruition, companies will have to take more significant action on labor--i.e., layoffs. Early warning signs on that front are emerging as evidenced by the recent drop in job offerings (Exhibit 2 and Exhibit 3).

Exhibit 2: JOLTS Leads Claims by 4 Months



Source: Bloomberg, Morgan Stanley Research

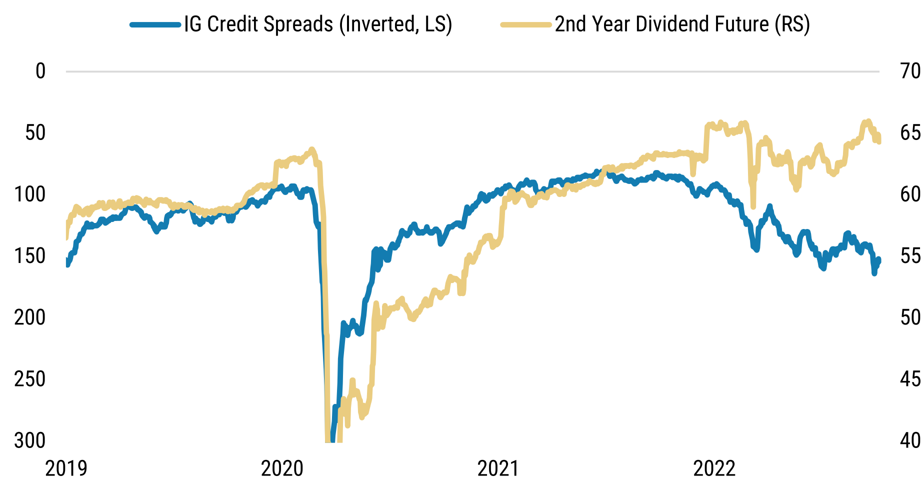
Exhibit 3: Recent Decline May be Early Warning



Source: Bloomberg, Morgan Stanley Research

But our concern is not so much with the economy but the earnings dynamic we have been discussing all year, and particularly over the past several months. Once again, markets often need the engraved invitation from a higher power to tell them what's going on. For bond markets it's the Fed and for stocks it's company management teams. As evidence both markets can be late at the turns, we compared IG credit spreads to the 2nd year dividend futures market. Both are leading NTM EPS indicators to some degree but IG credit spreads may be closer to reality. The point here is that all markets will figure it out at the same time, likely when it becomes too obvious to ignore any longer. That moment can come for several reasons...the economic data falls off a cliff, companies decide to throw in the towel on next year's guidance/forecasts or there is some "event" that is so bad the market decides to just price its impact on the economy and earnings immediately. IG spreads are further along in this adjustment process and one reason we prefer IG to SPX.

Exhibit 4: Credit Markets Are Further Along than Equities in Discounting Earnings Risk



Source: Bloomberg, Morgan Stanley Research

Bottom line, the P/E compression this year is due to rates rising rather than concern about growth. This is further evidenced by the very low equity risk premium (currently 260bps) we still observe. The bear market will not be over until either EPS forecasts are more in line with our view, or the P/E better reflects that risk via the equity risk premium channel. As we have been stating for quite awhile, that P/E is closer to 13x rather than the current 15-16x, in our view.

Taking Stock of the Inventory Problem

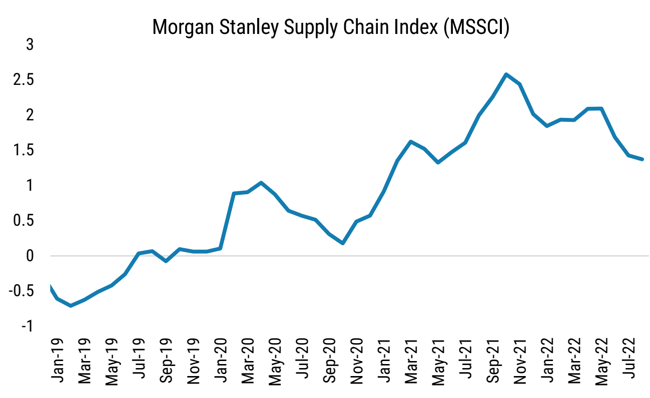
Please note, this section is an excerpt from our Insight report Taking Stock of the Inventory Problem, please see that note for additional details.

The Strategy View

The problem with inventory is twofold - supply chain bottlenecks are clearing while demand, especially demand for goods, is slowing. Supply chains have stabilized for most industries and goods imports into the United States has surged higher on both a real and nominal basis. Our Global Economics team's proprietary MS Supply Chain Index shows supply chains have continued loosening with lower global demand playing a key role in reducing bottlenecks (Exhibit 5).

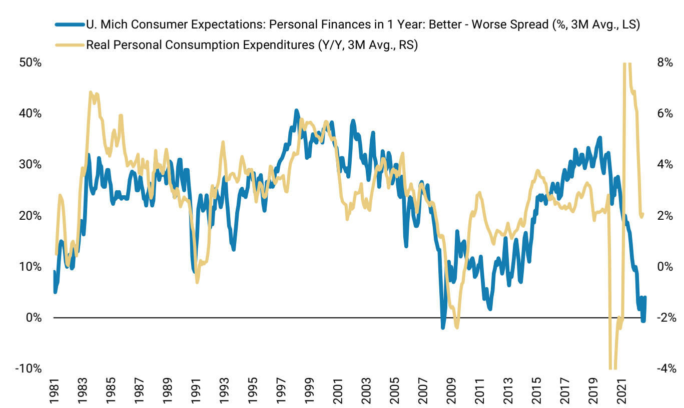
Consumers overspent on a number of goods related items, especially durable goods like furniture, tech products and leisure equipment, as a result of Covid/lockdowns. Goods consumption, on a real basis, has been declining since the second quarter of 2021 and is now back near trend. **We are expecting overall demand to slow beyond the payback in overconsumption of goods.** While Consumer Confidence has rebounded from the all time lows observed this summer it remains weak and we expect consumers to pare back spending. The spread between consumers who expect their personal finances to be better vs worse in one year remains low which points to downside in real personal consumption expenditure (PCE) (Exhibit 6).

Exhibit 5: MS Supply Chain Index



Source: Haver, Clarckson, Morgan Stanley Economics Research

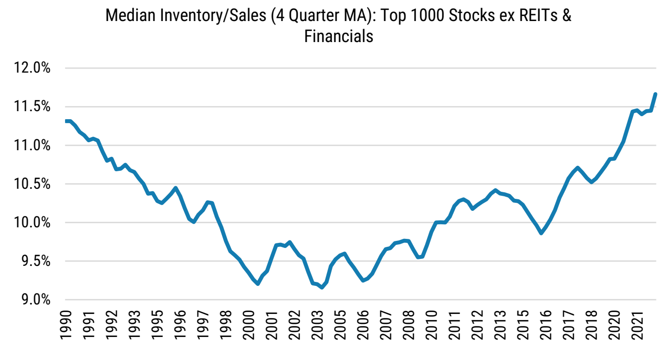
Exhibit 6: Personal Finance Expectations vs PCE



Source: Haver, Morgan Stanley Research

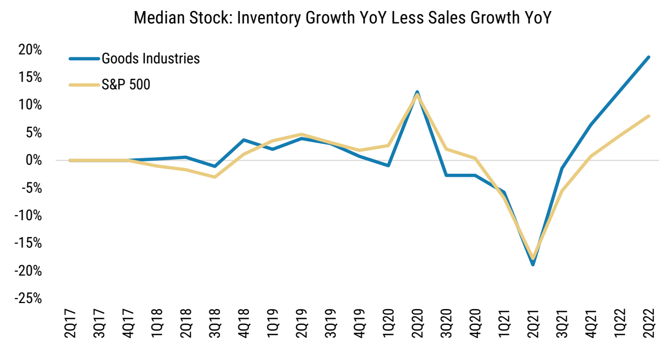
Inventory to Sales for the median US company has been on the rise since the Financial Crisis and is now at the highest level since 1990 (Exhibit 7). Inventory to sales ratios have increased substantially and are sitting at elevated levels for the Consumer Staples, Industrials, and Tech sectors. We also looked at the spread between year over year inventory growth and sales growth to see which industries have the biggest mismatch between inventories and top line growth. **The *median* company within goods producing industries has a whopping 19% mismatch between inventory and sales growth (Exhibit 8).** Industries that produce durable goods are seeing a bigger mismatch between inventory and sales growth than industries that produce consumable goods.

Exhibit 7: Top 1000 US Companies: Median Inventory to Sales Ratio



Source: Compustat, Morgan Stanley Research

Exhibit 8: Spread between Inventory YOY and Sales YOY for Median Company

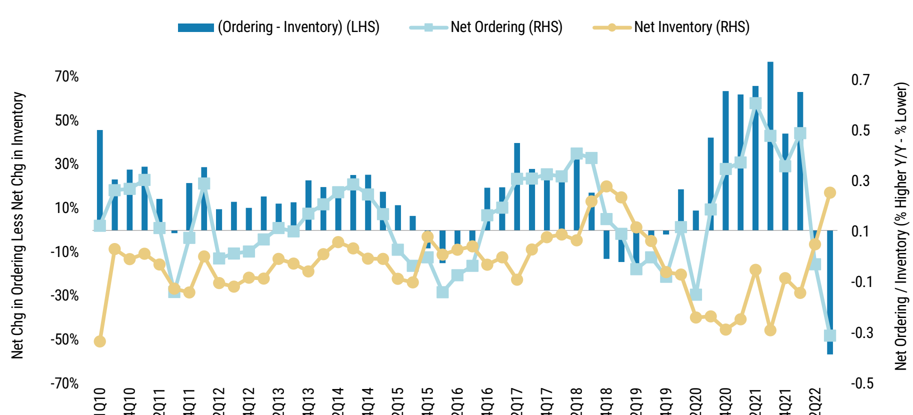


Source: FactSet, Morgan Stanley Research.

For the US economy at large, inventories for all companies (publicly traded and privately held) are gradually rebuilding as supply chains free up and demand slows. Over half of the shortfall in real inventories since the beginning of 2020 has come from motor vehicles and parts. Inventory building in retail as a result of supply chain pressures and demand easing will provide alleviation on core goods inflation in our US Economics team's forecasts through 2023.

Our Transportation team's Shipper Survey reveals that net ordering levels dropped to "off-the-chart" levels (-40% y/y decline) not seen in the 12+ years of the survey (Exhibit 9). This decline is much steeper than what we have seen in past downturns in 2016 and 2019. **Simultaneously, net inventory levels also rose sharply – albeit not to record levels – these are inventory levels last seen in 2018 as we built up inventories into tariff risk only to de-stock through 2019.** The net gap between ordering and inventories is also the highest in the 12 year history of this survey question. **Almost half of respondents say that their inventory is higher and ordering is lower going forward – which firmly indicated an over-inventoried/de-stocking condition.**

Exhibit 9: Shipper Survey: Ordering - Inventory

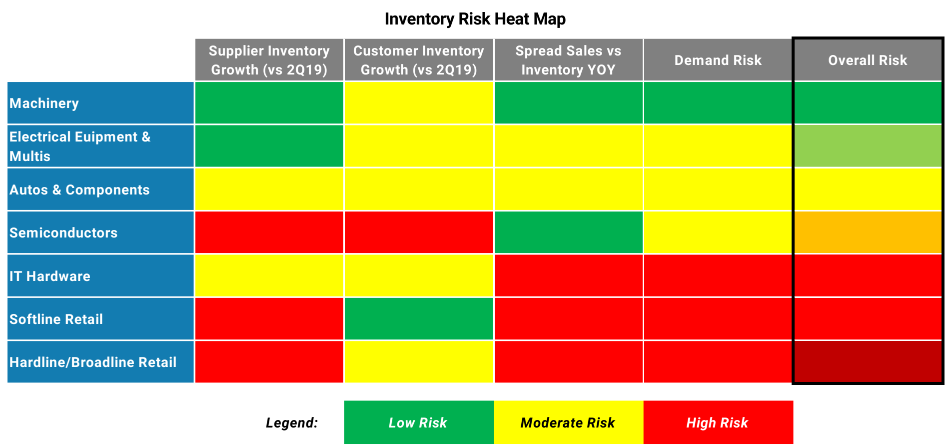


Source: Morgan Stanley Freight Pulse Surveys

Faced with a glut of inventory, companies will need to decide whether they want to accept high costs to continue holding inventory, destroy inventory, keep prices high and take a hit on the number of units sold, or slash prices to stimulate demand. **We believe many will turn to aggressive discounting to solve their inventory problem which is likely to spark a "race to the bottom" as companies attempt to cut prices faster than peers and move out as much inventory as possible.** This dynamic will weigh heavily on margins and fuel the earnings slowdown we are predicting.

While risk from excess inventory is a broad problem for the market and for goods producing industries we wanted to assess which industries were relatively more or less at risk. **We aggregated company level supply chain data leveraging our quant team, industry data, and analysts' view of demand into a inventory risk heat map (Exhibit 10). Consumer retailers and IT Hardware face the most risk from an inventory perspective while semiconductors and autos companies face a moderate amount of risk.** Machinery and Electrical Equipment/Multi-Industry companies face the lowest amount of risk. This largely lines up with our sector ratings; we are underweight Consumer Discretionary and Tech Hardware while we are Equal-Weight Consumer Staples, Industrials, and Tech ex-Hardware. Our Overweights are Utilities, Health Care, and Real Estate, all sectors that are not goods intensive.

Exhibit 10: Inventory Risk by Industry



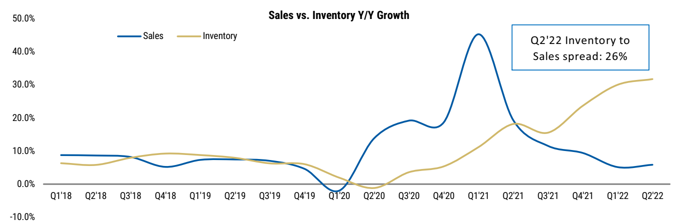
Source: Morgan Stanley Research.
Note: This heat map incorporates an analysis run by our Quant team aggregating inventory dollars across the supply chain for S&P 500 companies. It examines the change in inventory from both the supplier and customer perspective versus 2019. We also looked at the spread in sales and inventory growth YOY as of 2Q. Colors were assigned for the supplier/customer columns and sales vs inventory growth column based on relative rankings. Demand risk was determined based on analyst commentary.

Analyst Industry Perspectives

Consumer goods retailers, who were among the first to see problems from excess inventory, believe a peak in inventory growth is in sight. The hardlines/broadlines retail team expects inventory levels to remain relatively high vs historical averages as companies continue to right-size their in-stock levels through the rest of '22 and believe inventories could be peaking. Inventory levels should begin to normalize in the subsequent quarters as demand continues to moderate off of pandemic levels and supply chain disruptions ease. This comes as the spread between inventory and sales growth on a y/y basis is the widest in recent years with the average company seen inventory growth outpace sales growth by ~2600 bps (Exhibit 11).

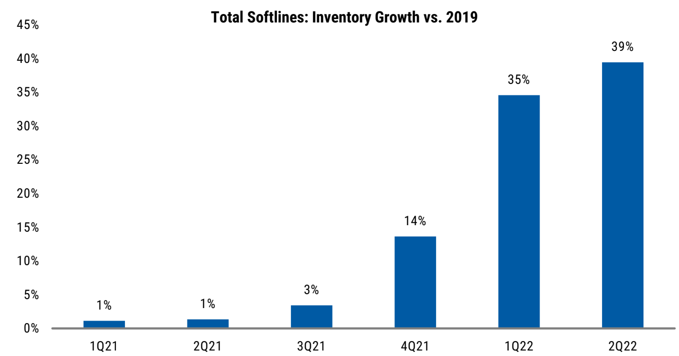
Softlines inventory growth is still accelerating, though we expect growth broadly peaks in 3Q22 before beginning to normalize in late-4Q22 and more fully in 1H23. We expect inventory growth to worsen in 3Q22, from already alarming 2Q levels, given: 1) elongated order lead times, 2) soft consumer demand, & 3) the recent easing of supply chain delays, as confirmed by select retailers & brands. Looking to late-4Q22 & 1H23 though, retailers' inventory levels should begin to normalize, on 1) end-of-season clearance activity in late 4Q, 2) the flow-thru of order cuts in mid-1H22, & 3) further supply chain normalization. For wholesalers, we anticipate a potential lag to this timeframe before inventory normalizes given brands have only recently acknowledged elevated industry-wide inventories.

Exhibit 11: Historical average inventory and sales y/y growth across Hardline/Broadline/Food Retail



Source: Company data, Morgan Stanley Research. Average includes: WMT, TGT, HD, LOW, BBY, WSM, DKS, FIVE, OLLI, DLTR, DG, ULTA, FND, AAP, AZO, ORLY, TSCO and RH.

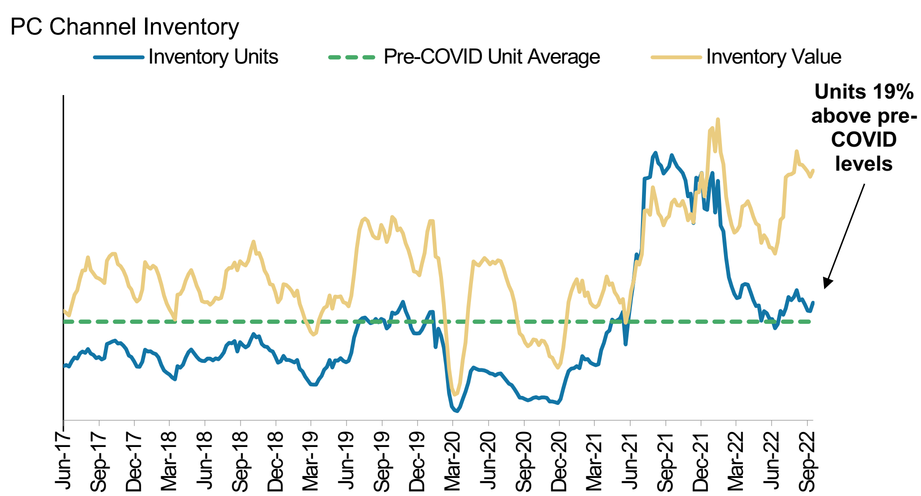
Exhibit 12: Inventory growth accelerated to +39% vs. 2019 in 2Q22, from +35% in 1Q22



Source: Company data, Refinitiv Eikon, Morgan Stanley Research

Within Tech Hardware, consumer markets have already seen softening demand and excess inventory; the team believes this dynamic will spread to enterprise markets. PC and consumer hardware end markets have been the first to see demand normalize back towards the historical trendline, which we believe is due to extreme levels of overconsumption during COVID reversing, exacerbated by macro and inflation concerns (Exhibit 13). This demand deterioration is also now spilling over into the enterprise infrastructure markets - worsened by 1H22 order pull-forward - which will likely see more of a correction in 2H22 & early 2023. **This is driving a return of discounting, which should exacerbate operating de-leverage across the group.**

Exhibit 13: PC channel inventory is 20% above pre-COVID levels.

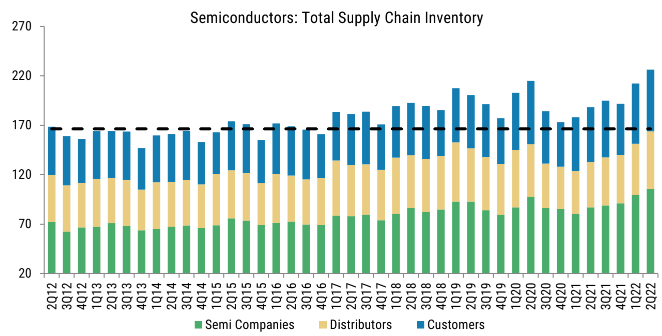


Source: Morgan Stanley Research

The global semiconductor shortage that took hold during the pandemic remained a persistent problem for many industries, most notably automobiles. Semiconductor inventory has continued to build across the supply chain and the Semiconductors team believes that higher volume markets will continue to correct this year, while broad based markets should see a correction in 2023 (Exhibit 14). **For the markets where semiconductors make up the majority of the bill of materials - PCs, smartphones, servers -inventories exceeded the tolerance of the customers, and we are starting to see reductions that are fairly severe, in some cases**. Behavior is very different in markets where semiconductors make up less than 10% of the bill of materials - including automotive, industrial, infrastructure, and some enterprise markets where demand and the desire to stockpile remains strong.

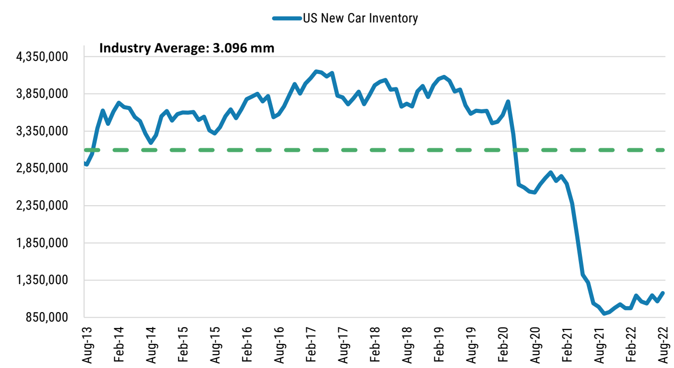
The disruption of the global semiconductor industry that began during Covid has resulted in widespread disruption to global auto production, and has led us to the current state of the automotive industry; near record low inventories, elevated pricing, and a strapped consumer (Exhibit 15). **To compensate for the supply tight environment over the past 18-24m, OEMs have relied heavily on price and mix shifts to generate their EBIT. As such, we believe there are potential headwinds to the OEM's margins, as well as auto dealer margins**, as these factors normalize into '23, especially when factoring any potential slowdown in the macro environment.

Exhibit 14: Semis Inventory Throughout Supply Chain Increased 12 Days Q/Q; 59 Days Above Median



Source: Refinitiv, Morgan Stanley Research

Exhibit 15: US New Car Inventory

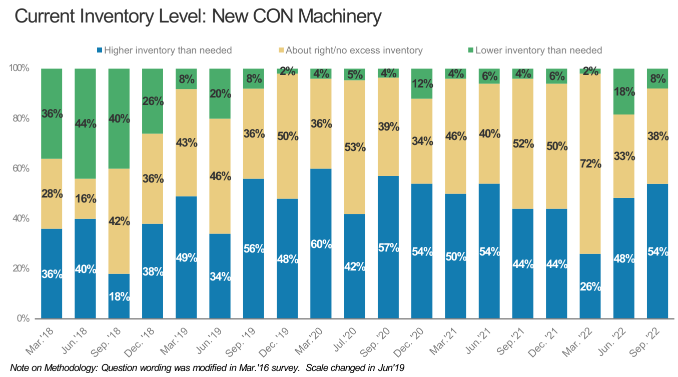


Source: Motor Intelligence, Morgan Stanley Research

Inventory and inventory to sales are rising across multi-industry Industrial companies, which most companies explain as a combination of safety stock and Work In Progress awaiting delayed parts. **The Industrials team sees inventories closer to the consumer (e.g., housing) as having the greatest de-stocking risk, both at the customer level and companies' own inventory.**

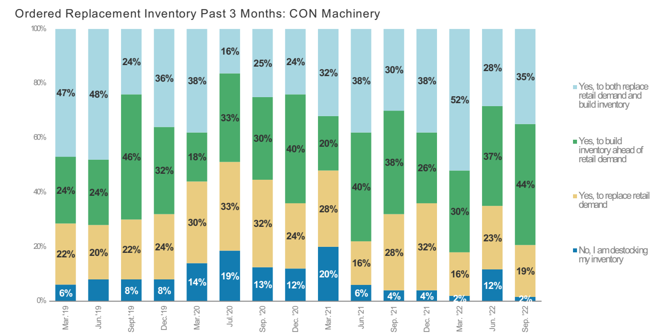
Not all industries are at risk from the inventory theme and some are still benefiting from idiosyncratic supply chain bottlenecks. Machinery is one such industry and inventories across the channel generally remain in-line to below long-term averages - with particularly acute inventory challenges in Ag Equipment. Supply chain challenges across the Machinery complex in both 2021 and 2022 have coincided with strong upcycles across nearly every Machinery end market over the same period - resulting in broad-based de-stocking and depleted inventory levels within the dealer channel (Exhibit 16). A proprietary dealer survey also indicates that a plurality of dealers are re-stocking inventories ahead of retail demand as opposed to re-stocking to replace inventory (i.e. indicating that an incremental step up in retail sales will need to take place in order to clear this inventory) (Exhibit 17).

Exhibit 16: Construction Equipment Dealers: Current New Construction Machinery Levels



Source: AlphaWise, Morgan Stanley Research

Exhibit 17: Construction Dealers: Inventory Order Intentions



Source: AlphaWise, Morgan Stanley Research

Single Stock Ideas

We also asked analysts to share Overweight rated stocks that they believe have upside or Underweight/Equal-weight stocks that they believe have downside over the next 3 to 6 months on the inventory theme. We present companies with upside in Exhibit 18 and those with downside in Exhibit 19.

Exhibit 18: Companies with Upside on the Inventory Theme Over the Next 3-6 Months

Companies with Upside on the Inventory Theme Over the Next 3-6 Months

Ticker	Company Name	GICS Sub-Industry	MS Analyst	MS Rating	Price
CNHI	CNH Industrial NV	Agricultural & Farm Machinery	Cumming, Dillon	Overweight	12.07
DE	Deere & Company	Agricultural & Farm Machinery	Cumming, Dillon	Overweight	355.47
BURL	Burlington Stores, Inc.	Apparel Retail	Greenberger, Kimberly	Overweight	122.28
ROST	Ross Stores, Inc.	Apparel Retail	Greenberger, Kimberly	Overweight	88.24
TJX	TJX Companies Inc	Apparel Retail	Greenberger, Kimberly	Overweight	65.09
CARR	Carrier Global Corp.	Building Products	Pokrzywinski, Joshua	Overweight	37.21
JCI	Johnson Controls International plc	Building Products	Pokrzywinski, Joshua	Overweight	52.45
TT	Trane Technologies plc	Building Products	Pokrzywinski, Joshua	Overweight	151.57
ETN	Eaton Corp. Plc	Electrical Components & Equipment	Pokrzywinski, Joshua	Overweight	142.45

Source: FactSet, Morgan Stanley Research

Exhibit 19: Companies with Downside on the Inventory Theme Over the Next 3-6 Months

Companies with Downside on the Inventory Theme Over the Next 3-6 Months

Ticker	Company Name	GICS Sub-Industry	MS Analyst	MS Rating	Price
ANF	Abercrombie & Fitch Co. Class A	Apparel Retail	Greenberger, Kimberly	Underweight	16.38
AEO	American Eagle Outfitters, Inc.	Apparel Retail	Greenberger, Kimberly	Underweight	10.79
GPS	Gap, Inc.	Apparel Retail	Straton, Alex	Underweight	9.8
URBN	Urban Outfitters, Inc.	Apparel Retail	Greenberger, Kimberly	Equal-Weight	21.71
F	Ford Motor Company	Automobile Manufacturers	Jonas, Adam	Equal-Weight	12.36
GM	General Motors Company	Automobile Manufacturers	Jonas, Adam	Equal-Weight	34.63
ABG	Asbury Automotive Group, Inc.	Automotive Retail	Jonas, Adam	Underweight	152.68
AN	AutoNation, Inc.	Automotive Retail	Jonas, Adam	Equal-Weight	101.03
CVNA	Carvana Co. Class A	Automotive Retail	Jonas, Adam	Equal-Weight	21.13
GPI	Group 1 Automotive, Inc.	Automotive Retail	Jonas, Adam	Underweight	152.74
LAD	Lithia Motors, Inc.	Automotive Retail	Jonas, Adam	Underweight	211.35
PAG	Penske Automotive Group, Inc.	Automotive Retail	Jonas, Adam	Underweight	100.92
SAH	Sonic Automotive, Inc. Class A	Automotive Retail	Jonas, Adam	Underweight	44.59
HAYW	Hayward Holdings, Inc.	Building Products	Pokrzywinski, Joshua	Equal-Weight	9.32
BBY	Best Buy Co., Inc.	Computer & Electronics Retail	Gutman, Simeon	Equal-Weight	66.81
GRMN	Garmin Ltd.	Consumer Electronics	Woodring, Erik	Equal-Weight	82.47
SONO	Sonos, Inc.	Consumer Electronics	Woodring, Erik	Equal-Weight	14.69
FND	Floor & Decor Holdings, Inc. Class A	Home Improvement Retail	Gutman, Simeon	Equal-Weight	73.95
WSM	Williams-Sonoma, Inc.	Homefurnishing Retail	Gutman, Simeon	Equal-Weight	126.06
CRCT	Cricut, Inc. Class A	Household Appliances	Woodring, Erik	Underweight	9.97
PNR	Pentair plc	Industrial Machinery	Pokrzywinski, Joshua	Underweight	42.08
MU	Micron Technology, Inc.	Semiconductors	Moore, Joseph	Underweight	54.62
HPQ	HP Inc.	Technology Hardware Storage & Peripherals	Woodring, Erik	Underweight	26.48
LOGI	Logitech International S.A.	Technology Hardware Storage & Peripherals	Woodring, Erik	Underweight	47.04
STX	Seagate Technology Holdings PLC	Technology Hardware Storage & Peripherals	Woodring, Erik	Equal-Weight	55.71
FAST	Fastenal Company	Trading Companies & Distributors	Pokrzywinski, Joshua	Underweight	47.38
GWW	W.W. Grainger, Inc.	Trading Companies & Distributors	Pokrzywinski, Joshua	Underweight	509.59
WSO	Watsco, Inc.	Trading Companies & Distributors	Pokrzywinski, Joshua	Underweight	268.19

Source: FactSet, Morgan Stanley Research

Tax Loss Selling Screen

We run our annual screen for stocks that may see technical pressure due to tax loss selling. A common point of discussion heading into 4Q (when the taxable year ends for many investors) is which stocks might be subject to a bit of extra selling pressure as investors look to harvest tax losses. Without detailed knowledge of holdings and churn, it is difficult to say with certainty what stocks are the top candidates for tax loss selling. However, given the level of interest we have seen on the topic, we used some simplifying assumptions to produce a list of stocks that may have a greater probability of underperforming into year end on this technical basis. Given that the average stock is down nearly 20% YTD, we made some adjustments to our typical screening process.

Constructing the Screen - Some Assumptions

To construct the list of candidates we needed to determine:

1. Which stocks were likely favored and widely held among investors earlier in the year and

2. Which of these had absolute price returns sufficient to generate a meaningful tax loss.

On the first point, we looked to sell side consensus ratings on stocks as of the end of the second full week of each calendar year (January 14, 2022). We use this time frame as it allows some time after January 1 for deployment of capital after the start of the calendar year. Specifically, we screened for stocks in the top quintile of average sell side ratings at this point in time each January.

On the second part, we historically have looked for stocks that have seen at least a 10% drop in their price from the mid-January date used in part 1 of the screen to the end of the third calendar quarter. We would then cap this downside at price declines of 25% over the same period as we found that the largest price drops tended to show something of a rebound in 4Q. This year, we had to expand our screen - instead of using between -10% to -25% downside, we used two criteria again: 1) stocks in the bottom tercile of performance during the testing period and 2) removed the bottom four percentile of performers. We chose the bottom four percentile as this was the average percentile removed historically from 2002 to 2021 that would have typically removed stocks below a 25% drawdown in an effort to retain continuity with previous testing.

We ran this screen on the S&P 500 index and identified 50 names. **Our goal is not to present a 'sell list,' but instead look for stocks that could see technical selling pressure into year-end.**

Exhibit 20: Tax Loss Selling Candidates that Could See Selling Pressure into Year-End

Ticker	Company	Sector Name	Indgroup Name	Rating Percentile As of 1/14/22	Price Return: Jan. 14 to End Sept.	Price Return Percentile - Jan. 14 to End Sept.	Price as of 9/30/22	MS Rating
AAL	American Airlines Group, Inc.	Industrials	Transportation	93%	-35%	22%	12.04	Equal-Weight
ANSS	ANSYS, Inc.	Information Technology	Software & Services	76%	-36%	19%	221.7	-
AOS	A. O. Smith Corporation	Industrials	Capital Goods	74%	-40%	14%	48.58	-
BALL	Ball Corporation	Materials	Materials	81%	-47%	7%	48.32	Equal-Weight
BBY	Best Buy Co., Inc.	Consumer Discretionary	Retailing	86%	-37%	18%	63.34	Equal-Weight
BEN	Franklin Resources, Inc.	Financials	Diversified Financials	99%	-39%	15%	21.52	Underweight
C	Citigroup Inc.	Financials	Banks	70%	-38%	17%	41.67	Underweight
CE	Celanese Corporation	Materials	Materials	68%	-48%	6%	90.34	Equal-Weight
CHD	Church & Dwight Co., Inc.	Consumer Staples	Household & Personal Products	95%	-31%	30%	71.44	Underweight
CHTR	Charter Communications, Inc. Class A	Communication Services	Media & Entertainment	72%	-50%	5%	303.35	Equal-Weight
CLX	Clorox Company	Consumer Staples	Household & Personal Products	99%	-31%	31%	128.39	Underweight
CSCO	Cisco Systems, Inc.	Information Technology	Technology Hardware & Equipment	67%	-35%	22%	40	Equal-Weight
CTSH	Cognizant Technology Solutions Corporation Class A	Information Technology	Software & Services	79%	-34%	23%	57.44	Equal-Weight
DPZ	Domino's Pizza, Inc.	Consumer Discretionary	Consumer Services	77%	-34%	23%	310.2	Equal-Weight
EBAY	eBay Inc.	Consumer Discretionary	Retailing	86%	-42%	11%	36.81	Underweight
FFIV	F5, Inc.	Information Technology	Technology Hardware & Equipment	76%	-39%	15%	144.73	Equal-Weight
GRMN	Garmin Ltd.	Consumer Discretionary	Consumer Durables & Apparel	76%	-39%	14%	80.31	Equal-Weight
HPE	Hewlett Packard Enterprise Co.	Information Technology	Technology Hardware & Equipment	71%	-32%	29%	11.98	Underweight
HPQ	HP Inc.	Information Technology	Technology Hardware & Equipment	97%	-35%	21%	24.92	Underweight
IP	International Paper Company	Materials	Materials	89%	-36%	20%	31.7	-
IVZ	Invesco Ltd.	Financials	Diversified Financials	81%	-45%	8%	13.7	Equal-Weight
KEY	KeyCorp	Financials	Banks	80%	-41%	12%	16.02	Equal-Weight
LNC	Lincoln National Corporation	Financials	Insurance	78%	-41%	12%	43.91	Overweight
LUMN	Lumen Technologies, Inc.	Communication Services	Telecommunication Services	100%	-41%	12%	7.28	Underweight
MAS	Masco Corporation	Industrials	Capital Goods	72%	-31%	32%	46.69	-
MHK	Mohawk Industries, Inc.	Consumer Discretionary	Consumer Durables & Apparel	95%	-47%	8%	91.19	-
MKTX	MarketAxess Holdings Inc.	Financials	Diversified Financials	95%	-40%	13%	222.49	Equal-Weight
MMM	3M Company	Industrials	Capital Goods	98%	-38%	16%	110.5	Underweight
MRNA	Moderna, Inc.	Health Care	Pharmaceuticals Biotechnology & Life Sciences	71%	-42%	10%	118.25	Equal-Weight
NTRS	Northern Trust Corporation	Financials	Diversified Financials	69%	-36%	19%	85.56	Equal-Weight
NVR	NVR, Inc.	Consumer Discretionary	Consumer Durables & Apparel	72%	-30%	33%	3987.08	-
ORCL	Oracle Corporation	Information Technology	Software & Services	87%	-30%	32%	61.07	Equal-Weight
PARA	Paramount Global Class B	Communication Services	Media & Entertainment	93%	-48%	6%	19.04	Underweight
PKI	PerkinElmer, Inc.	Health Care	Pharmaceuticals Biotechnology & Life Sciences	91%	-33%	28%	120.33	-
PNC	PNC Financial Services Group, Inc.	Financials	Banks	72%	-33%	27%	149.42	Underweight
PNR	Pentair plc	Industrials	Capital Goods	82%	-39%	15%	40.63	Underweight
QRVO	Qorvo, Inc.	Information Technology	Semiconductors & Semiconductor Equipment	76%	-47%	8%	79.41	Equal-Weight
RHI	Robert Half International Inc.	Industrials	Commercial & Professional Services	98%	-33%	26%	76.5	-
ROK	Rockwell Automation, Inc.	Industrials	Capital Goods	90%	-34%	24%	215.11	Overweight
SHW	Sherwin-Williams Company	Materials	Materials	69%	-34%	24%	204.75	Overweight
TFC	Truist Financial Corporation	Financials	Banks	71%	-35%	20%	43.54	Equal-Weight
TFX	Teleflex Incorporated	Health Care	Health Care Equipment & Services	70%	-38%	16%	201.46	Equal-Weight
TROW	T. Rowe Price Group	Financials	Diversified Financials	99%	-40%	14%	105.01	Equal-Weight
UAL	United Airlines Holdings, Inc.	Industrials	Transportation	76%	-30%	32%	32.53	Equal-Weight
UHS	Universal Health Services, Inc. Class B	Health Care	Health Care Equipment & Services	92%	-34%	24%	88.18	-
USB	U.S. Bancorp	Financials	Banks	74%	-36%	19%	40.32	Equal-Weight
VNO	Vornado Realty Trust	Real Estate	Real Estate	96%	-50%	5%	23.16	Underweight
VTRS	Viatris, Inc.	Health Care	Pharmaceuticals Biotechnology & Life Sciences	87%	-44%	9%	8.52	-
WBA	Walgreens Boots Alliance, Inc.	Consumer Staples	Food & Staples Retailing	96%	-42%	10%	31.4	Underweight
WHR	Whirlpool Corporation	Consumer Discretionary	Consumer Durables & Apparel	91%	-38%	17%	134.81	-

Source: Factset, Morgan Stanley Research

A Note of Caution

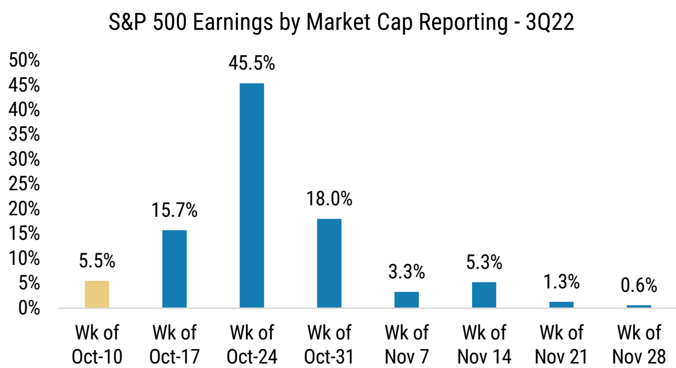
Given the frequency with which we receive this question, we wanted to attempt a screening methodology that uses publicly available and easily accessible data. Whether or not the top tercile of sell side ratings is a good proxy for buy-side ownership and sentiment on a given stock can be debated. The time periods we used to assess underperformance could easily have been different and implicitly assumes longer term ownership than the time horizon of many market participants.

We view the analysis above as only one consideration when looking at these stocks and encourage investors to also remain focused on the macro and micro stories likely to drive prices.

3Q Earnings Preview

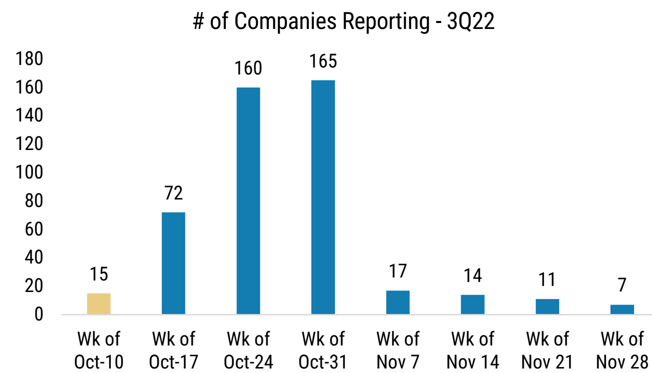
Large cap banks kick off the third quarter earnings season this week with 5.5% of market cap reporting (15 companies). This earnings season in particular holds importance as it could shape the debate between the bulls and the bears. A sharp reduction in earnings estimates could signal significant earnings cuts and a potential earnings recession. On the other hand, more resilient 3Q numbers and stable guidance could suggest a more moderate earnings correction or at least push the earnings debate until January's fourth quarter reporting season. As always, the third quarter numbers will be important and drive short-term moves in the market but investors are more closely watching for 2023FY guidance. The market has started to see cracks with some bellweather stocks reporting both top-line and bottom-line misses in recent weeks; however, the majority of company guidance still suggests that margin and earnings are in a healthy state despite many of the macro headwinds in play. 2022 and 2023 earnings are down 2% and 4% since mid-year while our 2023 EPS target is still 12% lower. **The broad consensus among our client base is that 2023 earnings are too high but we estimate clients are closer to a -5% cut rather than our -12% target.**

Exhibit 21: 3Q Reporting Season by Market Cap



Note: Includes 461 of S&P 500 companies and 95.2% of S&P market cap from Oct. 10 through Dec. 2. Data as of Oct 5th, 2022.
Source: Bloomberg, Morgan Stanley Research

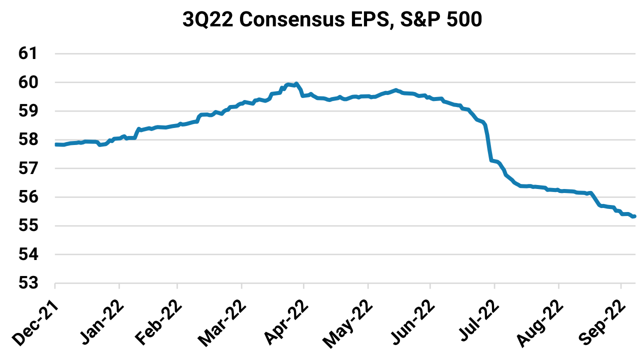
Exhibit 22: 3Q Reporting Season by Company Count



Note: Includes 461 of S&P 500 companies and 95.2% of S&P market cap from Oct. 10 through Dec. 2. Data as of Oct 5th, 2022.
Source: Bloomberg, Morgan Stanley Research

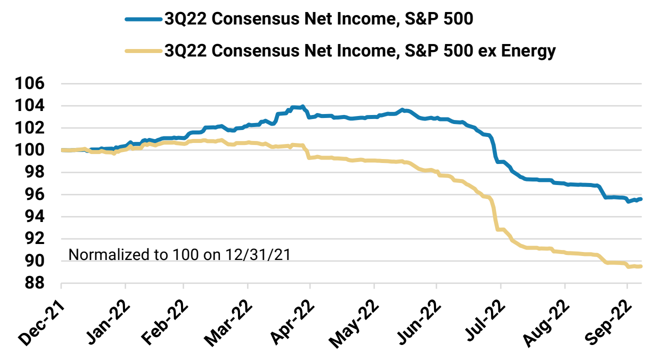
A lowered bar for 3Q earnings; 3Q22 expectations are down 8% since the April peak while S&P 500 ex Energy estimates are down 11%. Broadly speaking, companies have likely managed the quarter well enough to provide a soft beat given the lower bar. Out-year estimates for FY2023 have also trended lower in the recent quarter but not to the same magnitude as 3Q22 - suggesting that companies see the 3Q headwinds as manageable or potentially transitory. Estimates for FY2023 have been trending lower since June with the S&P 500 5% below peak and S&P 500 ex Energy nearly 7% below peak.

Exhibit 23: 3Q Estimates Have Fallen Into Earnings



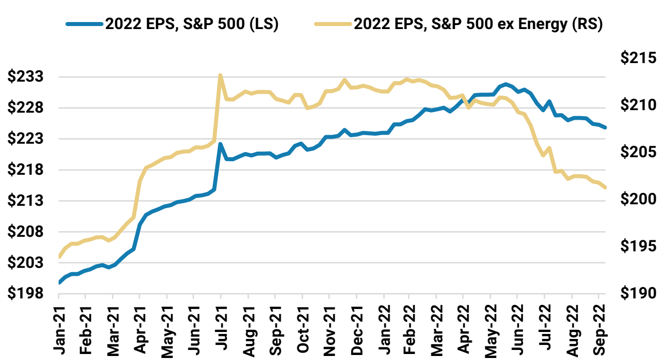
Source: Factset, Morgan Stanley Research

Exhibit 24: S&P 500 ex Energy Cuts Have Been More Severe



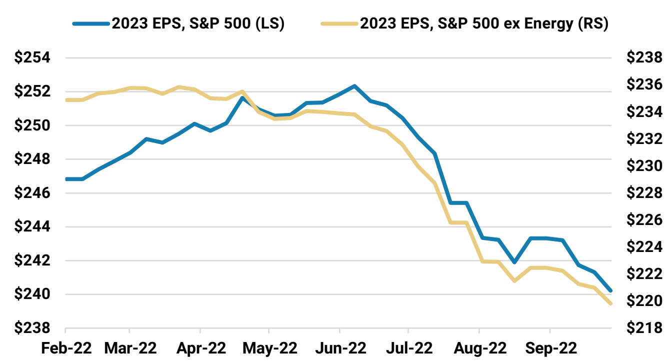
Source: Refinitiv, Morgan Stanley Research

Exhibit 25: 2022 Estimates Have Been More Resilient with 1H in the Books



Source: Refinitiv, Morgan Stanley Research

Exhibit 26: 2023 Estimates are Down 5% Since June; ex Energy Estimates are down 7%



Source: Refinitiv, Morgan Stanley Research

Company Guidance and Revisions

We start a tracker of the most notable earnings reports through the 3Q reporting season and populated it with recent pre-announcements and off-season reports. The list is not meant to be all-inclusive but rather to track key trends in corporate guidance. We will continue to update and publish the list through earnings season.

1. Levi Strauss (LEVI) - 10/7
    a. "cut its adjusted earnings per share and net revenue growth outlook for the full year"
    b. "as the company **grapples with the impact of a stronger dollar, weakness in its European markets and supply-chain disruption.**"
    c. Sees adjusted EPS $1.44 to $1.49, saw $1.50 to $1.56, estimate $1.54
2. Advanced Micro Devices (AMD) - 10/6
    a. "Advanced Micro Devices Inc.'s preliminary third-quarter sales **missed projections by more than $1 billion**"
    b. Revenue at $5.6B vs analyst and company forecasts at $6.7B
    c. "AMD blamed the PC market for hurting sales, citing **weaker demand and a build-up of inventory** in the supply chain"

3. Amazon (AMZN) - 10/6

   a. "Amazon.com Inc. **plans to hire 150,000 seasonal workers**, about the same as last year"
   b. "The announcement follows Walmart Inc.'s decision to hire some 40,000 seasonal workers this year, down from 150,000 in 2021."
   c. "In an email to recruiters, the company reportedly said it was **halting hiring for all global corporate roles**, including technology positions, in its Amazon stores business, which covers retail and operations. Approximately 20,000 openings were posted in that division as of Monday evening."

4. Allstate (ALL) - 10/5

   a. "The consensus estimate for Allstate Corp.'s next EPS report was reduced by 11 percent" on Hurricane Ian impact

5. Carnival Cruise Lines (CCL) - 9/30

   a. "Passenger ticket revenue grew nearly nine-fold to $2.60 billion, but missed the FactSet consensus of $3.10 billion"

6. Micron (MU) - 9/29

   a. "We made s**ignificant reductions to CapEx** and now expect fiscal 2023 CapEx to be around $8 billion, down more than 30% year-over-year. "
   b. "It's been an unprecedented downturn, sharp and sudden, and it has, of course, associated inventory builds. It suppressed our income, of course. And then, we've got elevated CapEx as it happened so quickly."

7. Nike (NKE) - 9/29

   a. "Finally, **inventories were $9.7 billion, up 44%** compared to the prior year, driven by volatility and transit times in North America, strategic decisions to buy inventory for future seasons earlier..."
   b. "As a result, we are taking decisive action to clear excess inventory, focusing on specific pockets of seasonally late product, predominantly in apparels. While **we expect this to have a transitory impact on gross margins this fiscal year,** we believe this cost will be far outweighed by the benefit of clearing marketplace capacity to align seasonally relevant product, storytelling and retail experiences for the consumer."

8. Carmax (KMX) - 9/29

   a. "We believe industry sales were also impacted by a **shift in consumer spending prioritization from large purchases to smaller, discretionary items.** In response to the current environment and consumer demand, we have continued to offer a higher mix of lower-priced vehicles."
   b. "CarMax saw **profit drop by more than 50%** in its second quarter, as **higher prices and economic concerns weighed on Americans**' appetite for its preowned cars and trucks."

9. Apple (AAPL) – 9/28

   a. Apple Inc. is backing off plans to increase production of its new iPhones this year after an **anticipated surge in demand failed to materialize**, according to people familiar with the matter.
   b. Removed initial plan to increase iPhone 14 units by 6M in 2H22

10. Florida Power & Light Co. (FPL1) – 9/28

a. On Hurricane Ian: 'there will be damage that is beyond repair and **will require a complete rebuild'** – Chief Executive

11. VF Corp (VFC) – 9/28

    a. "VF is revising its FY23 outlook due to lower-than-expected Q2'FY23 results, coupled with ongoing uncertainty in the current environment, weaker than anticipated back-to-school performance at Vans and **increasing inventories leading to a more promotional environment** in North America in the fall

    b. Sees adjusted EPS $2.60 to $2.70, saw $3.05 to $3.15, estimate $3.04 (Bloomberg Consensus)

12. Steelcase (SCS) – 9/21

    a. "Targets reductions of about $20m of annualized spending in 3q, including **elimination of up to 180 salaried positions** across the Americas core business and Corporate functions"

    b. "In response to inflation and supply chain challenges throughout this year, we have been **pulling back on our planned level of incremental spending** while staying invested in our most critical strategic initiatives"

13. Ford Motor Company (F) – 9/19

    a. "inflation-related supplier **costs will run about $1 billion higher than expected** in the current quarter"

14. FedEx (FDX) – 9/15

    a. "The company said that adjusted earnings per share will come in at $3.44, a far cry from analysts consensus' estimates of $5.14 a share. Adjusted operating income of $1.23 billion will be well below the $1.49 billion reported in the year-earlier period."

    b. **Withdrew guidance for rest of year**

15. Nvidia (NVDA) - 9/12

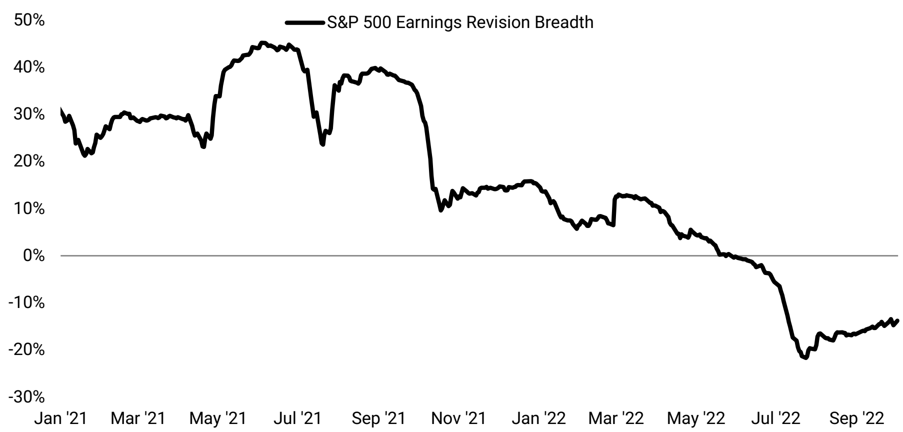
    a. "Within that would be a situation that we will do an **inventory correction in our Gaming**, but also our Pro Visualization business, both our desktops and notebooks. That means that we will be underselling into the market as we work through that inventory that is in the channel. That would be a sequential decrease from Q2 to Q3 for those businesses. But we had expected a growth in our Automotive business"

Earnings revisions breadth is negative, meaning that more analysts are cutting their estimates than revising them higher. S&P 500 revisions breadth currently sits at -15% which tells us the direction of EPS is likely lower. One notable trend that has been absent ahead of the 3Q22 earnings season has been a sharp downward move in revisions breadth as we have seen in the previous quarters. Looking at Exhibit 27, there has been sharp downward revisions for the past several quarters in the two weeks prior to earnings and then followed by a bump higher as actuals beat estimates. We can't say what this means for certain but it could be a sign that something is different this quarter.

Revisions breadth is negative for most S&P 500 industry groups but there are incremental winners and losers. There are only five industry groups with positive *levels* of earnings revision breadth: Telecom, Energy, Insurance, Commercial & Professional

Services, and Food & Staples Retailing. The biggest declines since 2Q have come in Household & Personal Products, Consumer Durables, Software & Services and Materials. Industries that saw notable improvement since 2Q are Food & Staples Retailing, Autos, Insurance and Capital Goods.

Exhibit 27: Earnings Revision Breadth is Firmly in Negative Territory



Source: FactSet, Morgan Stanley Research

Exhibit 28: Change in Absolute Earnings Revisions Breadth by Sector & Industry Group

Earnings Revisions Breadth Change

Sector, Industry Group	30-Jul	30-Aug	30-Sep	Change Since July
Communication Services	-41.7%	-49.4%	-46.0%	-4.3%
Media & Ent	-41.7%	-49.2%	-45.9%	-4.2%
Telecom	-20.4%	-23.1%	-20.2%	0.1%
Consumer Discretionary	-30.3%	-32.2%	-29.1%	1.1%
Autos	-24.1%	1.3%	-0.9%	23.3%
Consumer Durables	-52.3%	-71.6%	-68.9%	-16.6%
Consumer Services	-27.2%	-32.7%	-25.9%	1.3%
Retailing	-18.8%	-20.7%	-21.2%	-2.4%
Energy	36.2%	27.6%	32.2%	-4.0%
Financials	-17.3%	-8.2%	-2.8%	14.5%
Banks	2.5%	4.0%	6.6%	4.1%
Diversified Financials	-37.4%	-21.5%	-18.0%	19.3%
Insurance	-15.2%	-5.8%	5.4%	20.6%
Health Care	-23.0%	-27.2%	-28.0%	-5.0%
HC Equipment & Services	-26.6%	-29.7%	-31.2%	-4.5%
Pharma, Biotech, & Life Sciences	-18.8%	-24.3%	-24.3%	-5.5%
Industrials	-20.9%	-11.6%	-8.3%	12.6%
Capital Goods	-26.3%	-13.9%	-7.6%	18.7%
Commercial & Professional Services	-5.9%	-6.6%	-3.1%	2.8%
Transportation	-13.0%	-7.7%	-12.4%	0.6%
Materials	-19.2%	-32.9%	-35.4%	-16.2%
Real Estate	-2.1%	3.4%	5.7%	7.8%
Staples	-14.7%	-18.9%	-16.2%	-1.4%
Food & Staples Retailing	-11.8%	-8.4%	21.5%	33.2%
Food Beverage & Tobacco	-2.8%	-6.1%	-11.4%	-8.6%
Household & Personal Products	-52.1%	-67.6%	-70.0%	-18.0%
Tech	-21.4%	-21.5%	-24.8%	-3.5%
Semis	-16.2%	-11.6%	-11.7%	4.5%
Software & Services	-9.9%	-16.0%	-26.2%	-16.3%
Tech Hardware	-29.0%	-23.8%	-18.5%	10.5%
Utilities	0.1%	2.6%	2.5%	2.4%
S&P 500	-17.0%	-16.8%	-15.2%	1.8%

Source: FactSet, Morgan Stanley Research

We show how consensus 3Q22, FY2022, and FY 2023 EPS estimates have evolved YTD and since June in Exhibit 29. Year to date, earnings have been revised modestly lower for the third quarter with Energy as the only positive contribution at +108% higher. **The biggest YTD drag on earnings has come from Consumer Discretionary and Communication Services while the largest drag in the past three months has come from Semis and Materials.**

Exhibit 29: Revisions to 3Q22, 2022, and 2023 Earnings Estimates

	YTD			Since 6/30		
Sector, Industry Group	**3Q22**	**2022**	**2023**	**3Q22**	**2022**	**2023**
Communication Services	-22.0%	-15.5%	-14.9%	-13.2%	-8.5%	-9.0%
Media & Entertainment	-25.6%	-17.9%	-16.8%	-15.6%	-10.3%	-10.6%
Telecom	-7.9%	-5.3%	-5.6%	-6.7%	-3.8%	-4.0%
Consumer Discretionary	-23.3%	-24.4%	-14.9%	-13.0%	-10.0%	-8.0%
Autos	-10.7%	6.0%	5.3%	-7.6%	-0.3%	-2.3%
Consumer Durables	-7.2%	-6.4%	-23.5%	-9.8%	-8.1%	-16.7%
Consumer Services	-32.2%	-44.3%	-14.7%	-20.2%	-18.6%	-8.5%
Retailing	-28.9%	-33.8%	-18.2%	-12.8%	-12.9%	-7.0%
Energy	107.7%	102.5%	90.9%	7.4%	11.1%	12.4%
Financials	-5.8%	-2.8%	-0.9%	-4.6%	-1.4%	-1.7%
Banks	0.0%	-0.9%	1.7%	-2.1%	-1.3%	-1.3%
Diversified Financials	-10.3%	-4.8%	-4.6%	-6.0%	-0.9%	-2.4%
Insurance	-9.8%	-2.5%	1.1%	-8.2%	-2.7%	-1.2%
Health Care	-9.6%	-1.4%	-3.5%	-7.7%	-0.7%	-1.6%
HC Equipment & Services	-8.2%	-0.8%	-4.1%	-3.4%	0.2%	-1.7%
Pharma, Biotech, & Life Sciences	-10.5%	-1.9%	-3.3%	-10.0%	-1.2%	-1.6%
Industrials	-3.9%	-4.4%	-5.1%	-6.4%	-3.5%	-5.6%
Capital Goods	-4.7%	-5.8%	-3.0%	-5.4%	-2.5%	-2.9%
Commercial & Professional Services	-7.0%	-2.9%	-5.1%	-8.3%	-6.1%	-6.3%
Transportation	-1.0%	-0.7%	-9.1%	-7.1%	-4.2%	-10.7%
Materials	2.3%	8.7%	3.3%	-16.1%	-5.4%	-6.7%
Real Estate	2.1%	2.4%	0.9%	-1.8%	-2.2%	-1.6%
Staples	-8.8%	-2.9%	-4.4%	-5.3%	-1.0%	-2.0%
Food & Staples Retailing	-10.2%	-3.2%	-3.0%	-6.4%	-2.9%	-2.6%
Food Beverage & Tobacco	-6.6%	-1.1%	-3.3%	-3.8%	0.3%	-0.7%
Household & Personal Products	-14.1%	-8.0%	-9.5%	-8.7%	-2.9%	-5.2%
Tech	-8.9%	-1.9%	-5.2%	-9.0%	-4.6%	-7.4%
Semis	-12.4%	-5.1%	-11.7%	-16.5%	-11.5%	-17.6%
Software & Services	-7.5%	-2.7%	-4.7%	-5.7%	-2.0%	-3.5%
Tech Hardware	-7.8%	1.7%	-0.5%	-6.3%	-2.1%	-3.6%
Utilities	-3.7%	4.1%	2.4%	-0.4%	3.8%	1.6%
S&P 500	-4.2%	0.2%	-1.6%	-6.8%	-2.4%	-3.7%

Source: FactSet, Morgan Stanley Research

Earnings Contribution

Energy and Financials drive an outsized amount of earnings for their market cap while Discretionary and Tech lag. This outsized contribution from Financials and Energy persists in both 2022 and 2023. However, growth contribution is a different story with Energy being the primary laggard on 2023FY EPS growth (-19.8%). The main contributors to 2023 growth are expected to come from Discretionary, Financials and Communication Services while Energy and Materials - the commodity beneficiaries - are the only sectors with a negative growth contribution.

Exhibit 30: 2022 Earnings Contribution: Energy Leads Growth Contribution

	S&P 500	Cons. Disc.	Cons. Staples	Energy	Fins.	Health Care	Indust.	Tech	Materials	Comm Services	Utilities	REITS
2022 Consensus Y/Y EPS Growth	7.5%	3.6%	4.5%	154.4%	-14%	5.0%	32.2%	4.5%	15.4%	-17.0%	5.1%	14.4%
Contribution to 2022 EPS Growth	NA	3.5%	3.4%	90.2%	-36.0%	10.9%	26.0%	13.0%	6.5%	-24.2%	1.8%	4.8%
% of Total 2022 EPS	NA	7.1%	5.6%	10.4%	15.0%	16.2%	7.5%	21.3%	3.4%	8.3%	2.6%	2.7%
Current Market Cap Weight	NA	11.5%	6.7%	5.0%	11.0%	15.0%	7.9%	26.7%	2.5%	8.1%	3.0%	2.6%
Spread: 2022 EPS Weight Vs. Current Market Cap Weight	NA	-4.4%	-1.1%	5.4%	4.0%	1.2%	-0.4%	-5.4%	0.9%	0.2%	-0.4%	0.0%

Source: Refinitiv, Morgan Stanley Research

Exhibit 31: 2023 Earnings Contribution: Tech and Discretionary Lead Growth Contribution

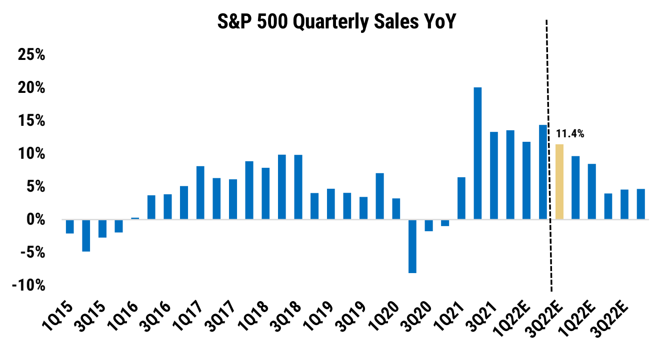
	S&P 500	Cons. Disc.	Cons. Staples	Energy	Fins.	Health Care	Indust.	Tech	Materials	Comm Services	Utilities	REITS
2023 Consensus Y/Y EPS Growth	7.1%	26.0%	7.3%	-13.5%	11.2%	-1.0%	14.3%	9.7%	-8.0%	18.8%	5.4%	7.9%
Contribution to 2023 EPS Growth	NA	25.8%	5.7%	-19.8%	23.5%	-2.3%	15.1%	29.1%	-3.9%	21.8%	2.0%	3.0%
% of Total 2023 EPS	NA	8.3%	5.6%	8.4%	15.5%	15.0%	8.0%	21.9%	2.9%	9.2%	2.6%	2.7%
Current Market Cap Weight	NA	11.5%	6.7%	5.0%	11.0%	15.0%	7.9%	26.7%	2.5%	8.1%	3.0%	2.6%
Spread: 2022 EPS Weight Vs. Current Market Cap Weight	NA	-3.2%	-1.1%	3.4%	4.6%	0.0%	0.1%	-4.9%	0.4%	1.1%	-0.4%	0.1%

Source: Refinitiv, Morgan Stanley Research

Sales

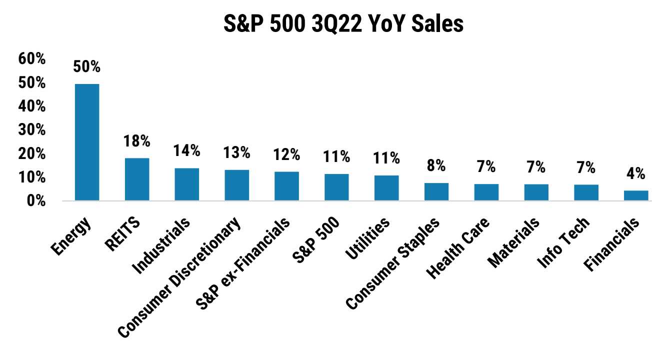
Sales for 3Q22 are expected to print at 11% for the S&P 500. The variance however is wider at the sector level with Energy expecting 50% and Financials only at 4%. Consensus FY2022 earnings growth is 12% YoY while 2023 growth is expected at 5% YoY. Notably, Energy is expected to transition from being the largest top-line contributor in 2022 (+51%) to being the only detractor at -1% sales YoY in 2023.

Exhibit 32: 3Q22 Sales Expected at 11.4%



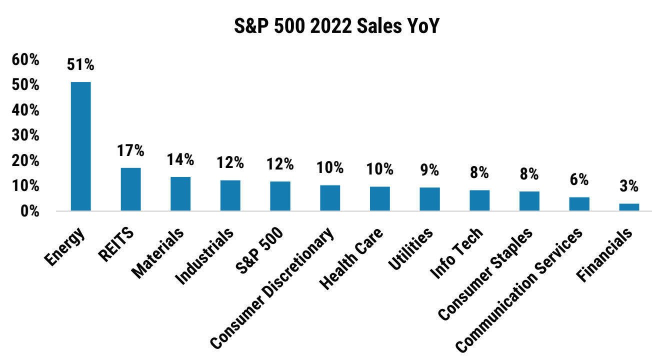
Source: Refinitiv, Morgan Stanley Research

Exhibit 33: 3Q22 Sales by Sector



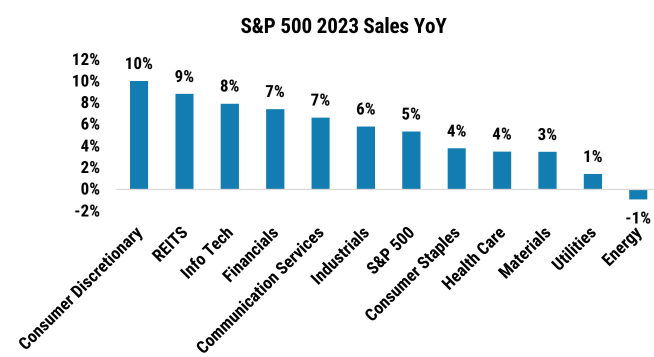
Source: Refinitiv, Morgan Stanley Research

Exhibit 34: 2022 Sales Are Led by Energy



Source: Refinitiv, Morgan Stanley Research

Exhibit 35: While 2023 Sales See Energy as a Detractor

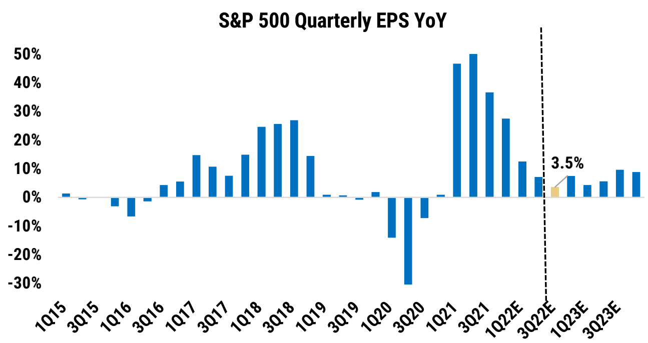


Source: Refinitiv, Morgan Stanley Research

EPS

3Q22 is expected to be the trough in earnings growth at 3.5%. EPS growth is expected to average 7% through 2023 year-end according to quarterly estimates. Looking at the sector breakdown for 3Q22, Energy, Industrials and REITs are expected to see the largest growth while expectations for nearly half the sectors are in negative territory with Financials and Comm. Services seeing double digit declines. **Similar to top-line growth, Energy flips from being the leader in 2022 EPS growth and then flips to be the primary laggard in 2023 EPS growth at -13% YoY.**

Exhibit 36: 3Q22 EPS Growth is Expected to be 3.5% YoY

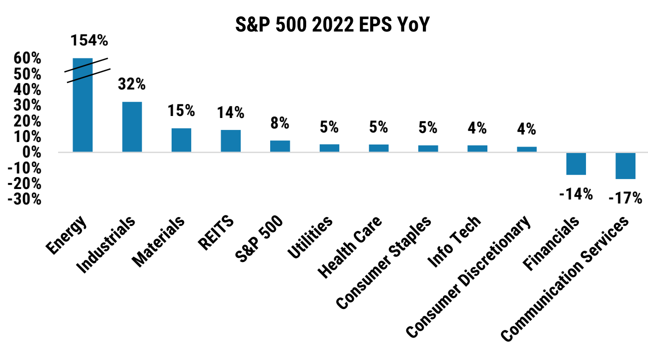


Source: Refinitiv, Morgan Stanley Research

Exhibit 37: Energy expects 119% EPS Growth While Half the Sectors are expected to see Declines YoY

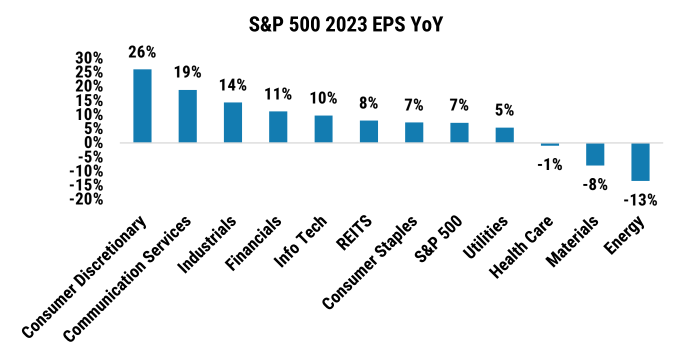
Source: Refinitiv, Morgan Stanley Research

Exhibit 38: 2022 EPS Growth is Expected at 8% YoY



Source: Refinitiv, Morgan Stanley Research

Exhibit 39: 2023 EPS Growth is Pricing Another 7% YoY



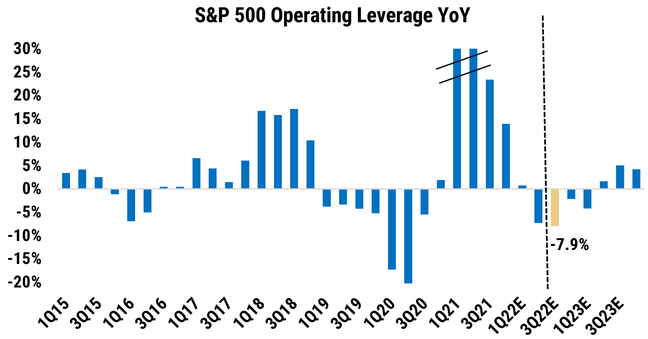
Source: Refinitiv, Morgan Stanley Research

Operating Leverage

Operating leverage cuts both ways and is now negative. Operating leverage drove the outsized earnings in 2020/2021 as high demand and low costs worked through the income statement. However, we believe what goes up must come down and the same effect that worked to the upside in 2020's acceleration will work on the downside in 2023's deceleration. Rising costs will outpace top-line sales growth and **the S&P 500 is expecting -8% operating leverage in 3Q22**. We define operating leverage as EPS growth YoY minus Sales growth YoY - negative figures meaning that earnings are growing slower than top-line sales. S&P 500 operating leverage is expected to remain negative until 2Q23.

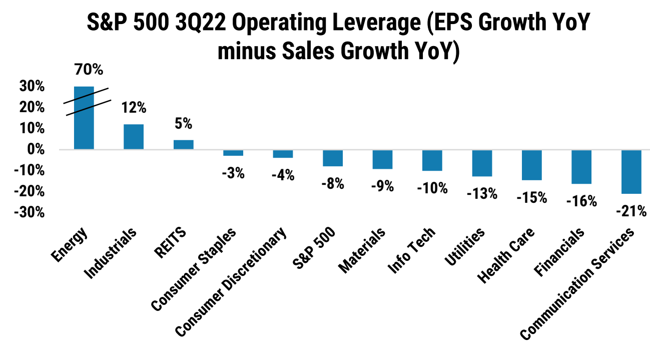
Energy, Industrials and REITs are the only sectors expected to have positive operating leverage in 3Q22. The majority of sectors are expecting negative double digit numbers with Communication Services expecting -21% leverage. The operating leverage picture is expected to improve from 2022 to 2023 with most sectors moving from negative to positive levels. The primary exceptions are again the commodity beneficiaries - Energy and Materials - that are expected to have negative double digit leverage in 2023.

Exhibit 40: S&P 500 Expects -8% Operating Leverage in 3Q22



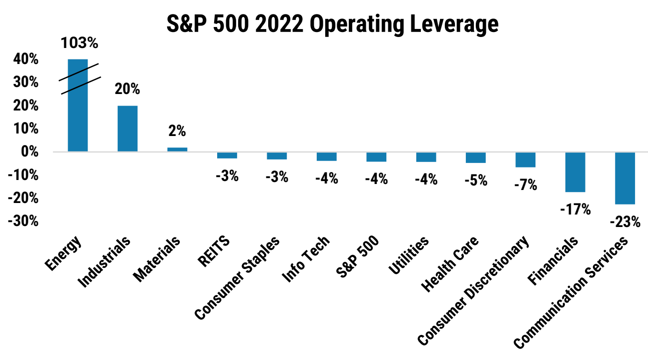
Source: Refinitiv, Morgan Stanley Research

Exhibit 41: Energy, Industrials, and REITs are the Only Sectors with Positive Expectations in 3Q22



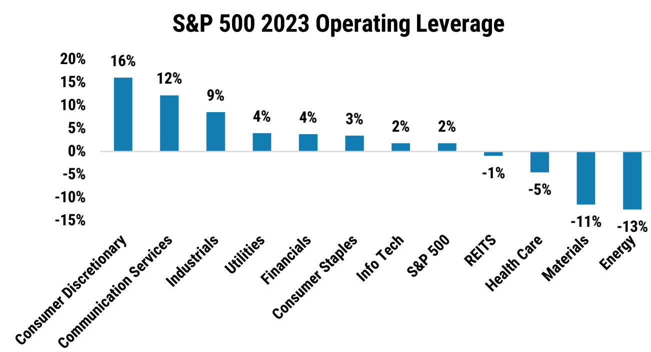
Source: Refinitiv, Morgan Stanley Research

Exhibit 42: The Majority of Sectors Expect Negative Operating Leverage in 2022



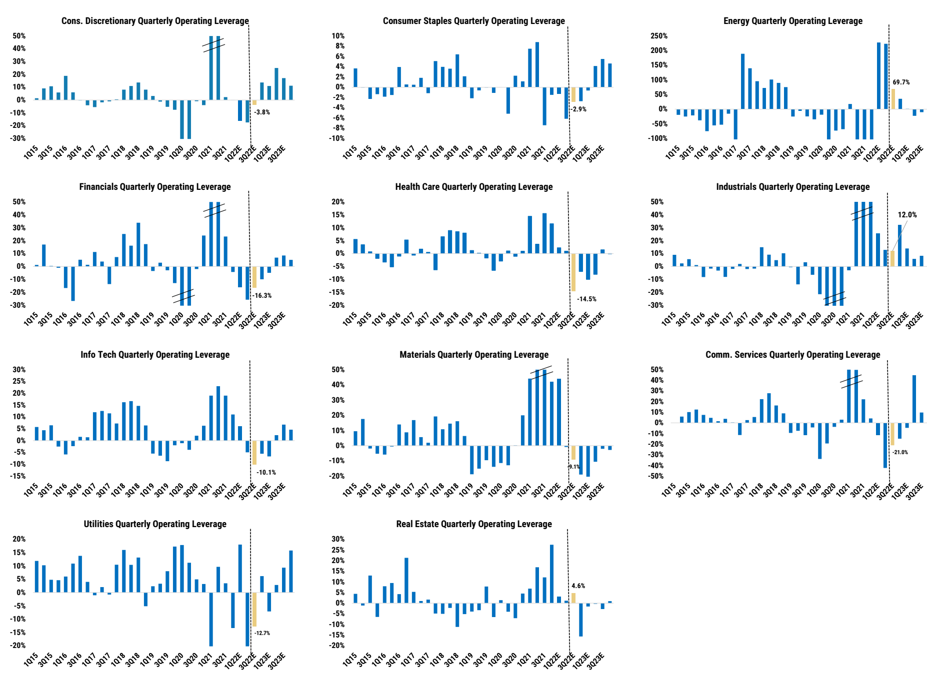
Source: Refinitiv, Morgan Stanley Research

Exhibit 43: Operating Leverage Flips from Negative to Positive for Most Sectors in 2023



Source: Refinitiv, Morgan Stanley Research

Exhibit 44: Operating Leverage by Sector

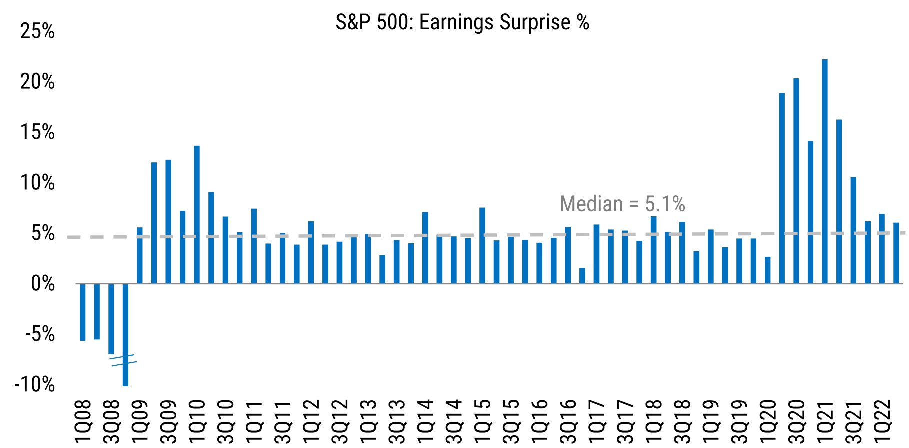


Source: Refinitiv, Morgan Stanley Research

Earnings Surprise

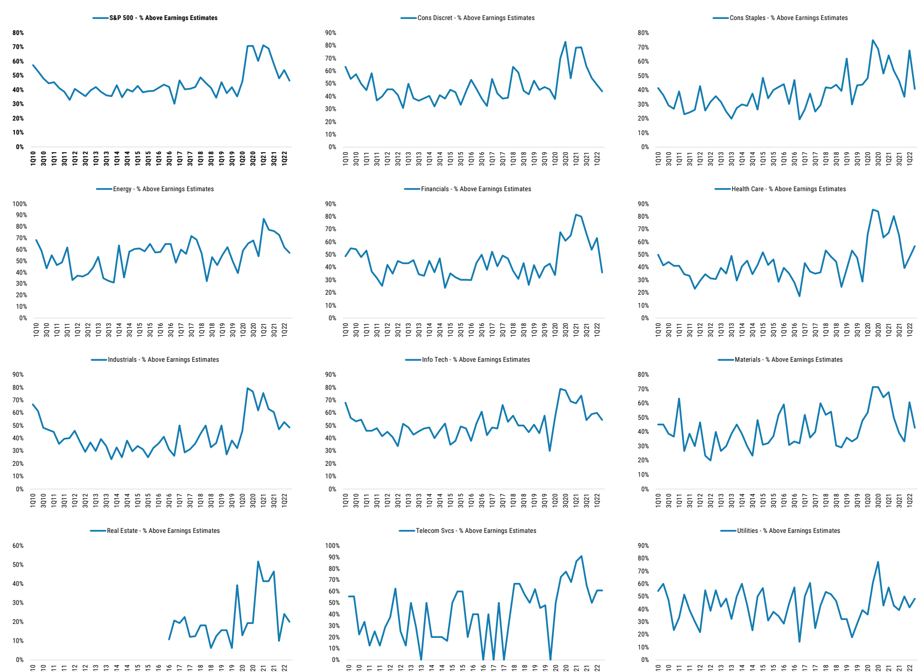
S&P 500 earnings beat by 5% on average per quarter historically. The number of companies that beat varies by sector as shown in Exhibit 45. Then in Exhibit 46, we detail the magnitude of these beats over time. In recent quarters, the breadth of beats has been relatively strong in Communication Services and Healthcare while breadth has been weakening in Financials and Consumer Discretionary. Looking specifically at the companies that beat expectations, the magnitude of these beats has been coming down for the index in recent quarters. Specifically, Technology, Financials, and Discretionary are seeing a lower magnitude of beats from their latest 2Q22 numbers.

Exhibit 45: S&P 500 Earnings Surprise



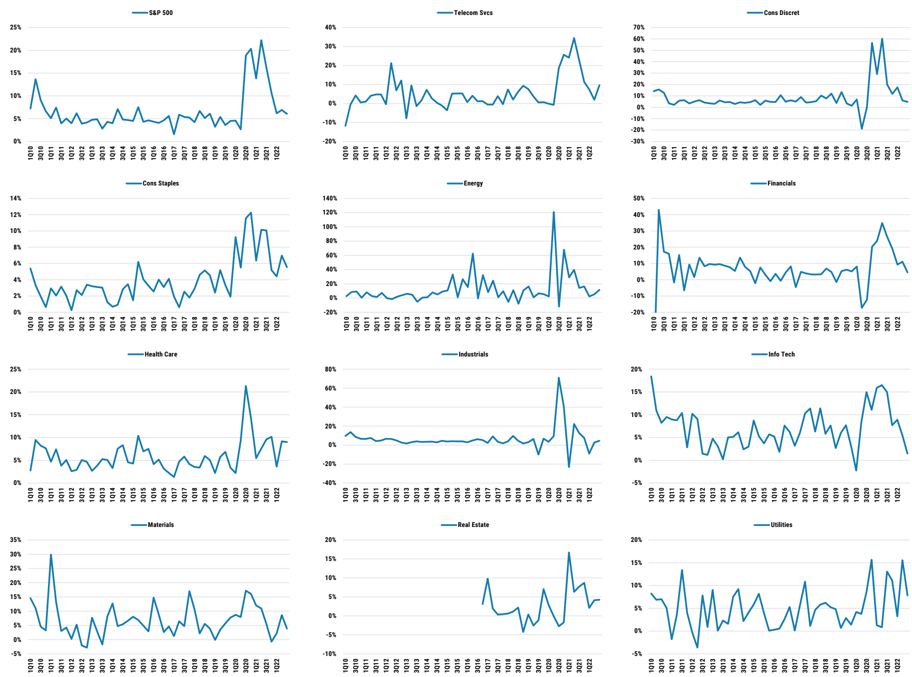
Source: ClariFi, Refinitiv, Morgan Stanley Research

Exhibit 46: Percentage of Companies Reporting Above Estimates (Breadth)



Source: Source: ClariFi, Refinitiv, Morgan Stanley Research

Exhibit 47: Historical Magnitude of Quarterly Beats (Actual vs Estimate)



Source: ClariFi, Refinitiv, Morgan Stanley Research

Factor Update

We select a few key factors to monitor in Exhibit 48 and Exhibit 49 to help study market drivers from a factor standpoint. These Exhibits focus on factors within the US Top 1,000 by market cap universe. Some key takeaways on performance in the last month:

- Junk has outperformed Quality (+2.2% relative return) and the overall market (+0.7% relative return versus the overall Top 1,000 universe).
- Growth has outperformed Value (+2.3% relative return) and the overall market (+0.9% relative return versus the overall Top 1,000 universe).
- Cyclicals has outperformed defensives (+2.6% relative return) and the overall market (+1.3% relative return versus the overall Top 1,000 universe).
- High Momentum stocks have outperformed low momentum stocks (+2.6% relative return), and the overall market (+1.6% relative return).
- Small Caps outperformed Large Caps on the downside by 1.1% this week.

Exhibit 48: Top 1,000 Factor Returns

Top 1000 Factor Return as of Oct 06, 2022

Factor	1 Week Ret	1 Week 1W Chg	1 Week 1M Chg	1 Month Ret	1 Month 1M Chg	1 Month 3M Chg	YTD Ret	12M Ret
Quality / Junk	-3.2%	↓	↓	-2.2%	↓	↓	7.3%	13.7%
Quality	2.4%	↑	↑	-6.7%	↓	↓	-15.6%	-7.4%
Junk	5.6%	↑	↑	-4.5%	↑	↑	-22.9%	-21.2%
Value / Growth	-1.2%	↑	↓	-2.3%	↓	↑	15.6%	17.7%
Value	3.6%	↑	↑	-6.6%	↓	↑	-13.5%	-9.0%
Growth	4.8%	↑	↑	-4.3%	↑	↑	-29.1%	-26.7%
Cyclical / Defensive	3.4%	↑	↑	2.6%	↑	↑	-2.4%	-4.5%
Cyclical	6.1%	↑	↑	-3.8%	↑	↑	-19.5%	-16.1%
Defensive	2.8%	↑	↑	-6.5%	↓	↓	-17.1%	-11.6%
Cyclical xEnergy / Defensive	2.5%	↑	↑	1.7%	↑	↑	-7.7%	-9.7%
Cyclical xEnergy	5.3%	↑	↑	-4.7%	↑	↑	-24.8%	-21.3%
12M Momentum	-1.1%	↓	↓	2.6%	↓	↑	4.4%	8.0%
High Momentum	3.9%	↑	↑	-3.5%	↓	↑	-19.8%	-16.0%
Low Momentum	5.0%	↑	↑	-6.1%	↑	↑	-24.2%	-24.1%
Size (Small / Large)	1.4%	↑	↑	1.1%	↑	↑	-1.3%	-6.7%
Small Cap	4.6%	↑	↑	-4.8%	↑	↑	-20.9%	-19.9%
Large Cap	3.2%	↑	↑	-5.8%	↓	↑	-19.6%	-13.2%

Source: ClariFi, Morgan Stanley Research

Exhibit 49: Excess Return Versus Broader Top 1,000 Universe

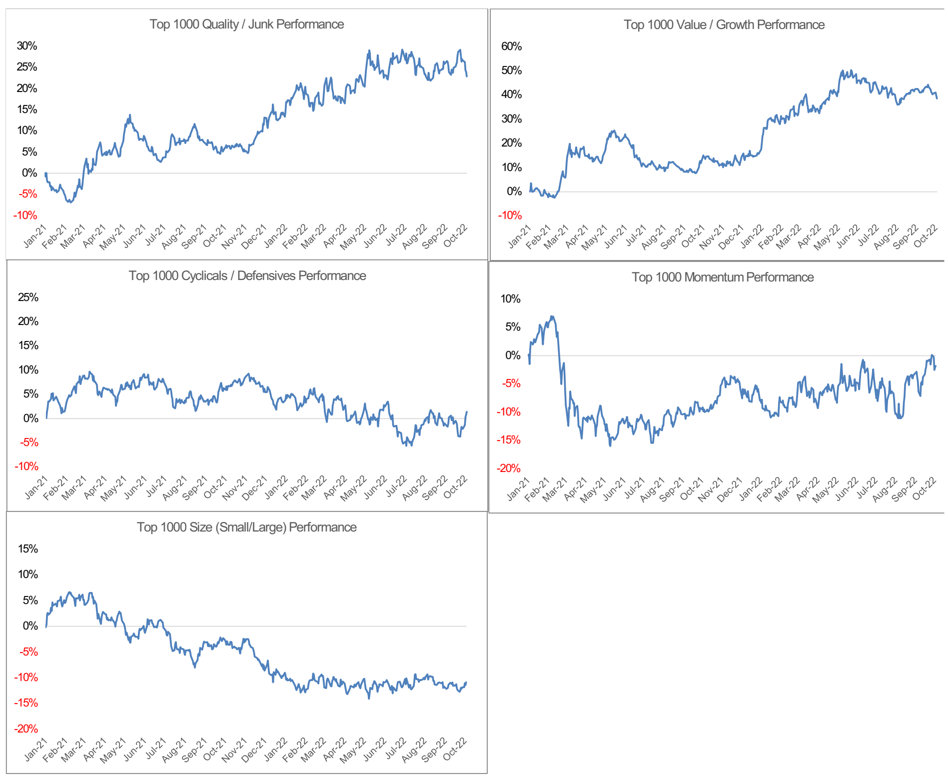
Top 1000 Excess Factor Return versus Broader Top 1000 Return as of Oct 06, 2022

Factor	1 Week Ret	1 Week 1W Chg	1 Week 1M Chg	1 Month Ret	1 Month 1M Chg	1 Month 3M Chg	YTD Ret	12M Ret
Quality / Junk								
Quality	-2.0%	↓	↓	-1.6%	↓	↓	4.4%	8.8%
Junk	1.2%	↑	↑	0.7%	↑	↑	-2.9%	-4.9%
Value / Growth								
Value	-0.8%	↑	↓	-1.4%	↓	↑	6.6%	7.2%
Growth	0.4%	↓	↑	0.9%	↑	↓	-9.1%	-10.5%
Cyclical / Defensive								
Cyclical	1.8%	↑	↑	1.3%	↑	↑	0.5%	0.2%
Defensive	-1.6%	↓	↓	-1.3%	↓	↓	2.9%	4.7%
Cyclical xEnergy / Defensive								
Cyclical xEnergy	0.9%	↑	↑	0.4%	↑	↑	-4.8%	-5.1%
Momentum								
High Momentum	-0.5%	↓	↓	1.6%	↓	↑	0.2%	0.2%
Low Momentum	0.6%	↑	↑	-0.9%	↑	↓	-4.2%	-7.8%
Size (Small / Large)								
Small Cap	0.2%	↑	↑	0.4%	↑	↑	-0.9%	-3.7%
Large Cap	-1.2%	↓	↓	-0.7%	↓	↓	0.4%	3.0%

Source: ClariFi, Morgan Stanley Research

Exhibit 50 shows performance of these pairs in time series graph form.

Exhibit 50: Cumulative Factor Performance Since 2021



Source: ClariFi, Morgan Stanley Research

We include an extensive list of factors and their returns in Exhibit 51. We break down the factor spread return by their long and short portfolio and display the top and bottom performing portfolio legs last month in Exhibit 52.

Exhibit 51: Full List of Factor Spread Returns (Long - Short)

Equal Weighted Factor Return (Spread) In Top 1000 as of Oct 6, 2022

Factor Name	1 Week Ret	1 Week 1W Chg	1 Week 1M Chg	1 Month Ret	1 Month 1M Chg	1 Month 3M Chg	3M Ret	YTD Ret	12M Ret
Net Cash Ratio (High vs Low)	0.3%	↓	↑	5.4%	↑	↑	4.3%	-5.5%	-7.1%
3-Month Price Momentum (High vs Low)	1.7%	↓	↑	5.3%	↑	↑	3.6%	1.4%	4.3%
Net Debt-to-Market Cap (Low vs High)	0.2%	↓	↑	5.3%	↑	↑	3.7%	-7.4%	-9.3%
Earnings Estimate Revisions (High vs Low)	1.2%	↓	↑	4.6%	↑	↑	6.1%	4.0%	9.5%
1-Month Estimate Revisions (%) (High vs Low)	1.7%	↑	↑	4.5%	↑	↑	6.5%	-1.2%	-2.7%
Cash-to-Debt (High vs Low)	1.1%	↓	↑	4.2%	↑	↑	2.9%	-6.8%	-11.6%
Debt-to-Assets (Low vs High)	0.4%	↓	↑	4.1%	↑	↑	2.0%	-2.0%	-0.2%
Debt-to-Capital (Low vs High)	0.4%	↓	↑	3.8%	↑	↑	1.8%	-2.8%	-3.2%
Gross Margin (High vs Low)	0.6%	↓	↑	3.6%	↑	↑	1.0%	-4.1%	-5.8%
Smoothed Estimate Revisions (%) (High vs Low)	0.9%	↓	↑	3.5%	↑	↑	8.8%	3.2%	4.0%
Cash-to-Assets (High vs Low)	1.2%	↓	↑	3.3%	↑	↑	2.4%	-10.0%	-16.6%
Cash Ratio (High vs Low)	1.5%	↑	↑	3.2%	↑	↑	1.7%	-10.2%	-15.6%
Cash Flow / Debt (High vs Low)	-0.3%	↓	↓	3.0%	↑	↑	3.2%	7.0%	16.6%
Sales Estimate Revisions (High vs Low)	0.8%	↓	↓	3.0%	↑	↑	4.0%	-0.1%	1.4%
12m-1m Residual Momentum (High vs Low)	1.5%	↑	↑	2.9%	↓	↑	10.5%	3.8%	8.2%
Tangible Book/Price (Cheap vs Expensive)	-0.2%	↓	↑	2.8%	↑	↑	2.4%	2.4%	2.6%
Cyclical vs Defensive	3.4%	↑	↑	2.6%	↑	↑	5.1%	-2.4%	-4.5%
9-Month Price Momentum (High vs Low)	-1.9%	↓	↓	2.6%	↓	↑	4.6%	1.5%	5.3%
1-Year Dividend per share growth (High vs Low)	1.2%	↓	↑	2.6%	↑	↑	5.0%	3.3%	6.7%
12-Month Price Momentum (High vs Low)	-1.1%	↓	↓	2.6%	↓	↑	6.3%	4.4%	8.0%
Debt-to-EBITDA (Low vs High)	-0.7%	↓	↑	2.4%	↑	↓	-1.4%	-9.3%	-13.8%
Earnings Revisions (High vs Low)	0.2%	↓	↑	2.4%	↑	↑	2.6%	1.0%	5.5%
Gross Profit / Assets (High vs Low)	0.5%	↓	↑	2.4%	↑	↑	-1.4%	-7.0%	-5.6%
6-Month Price Momentum (High vs Low)	-1.1%	↓	↓	2.3%	↓	↑	4.4%	5.3%	9.4%
Debt-to-Equity (Low vs High)	0.2%	↓	↑	2.3%	↑	↑	1.6%	-1.8%	-1.0%
Sales Revisions (High vs Low)	-0.4%	↓	↓	2.2%	↑	↑	3.2%	-2.3%	-0.6%
5-Year Dividend per share growth (High vs Low)	0.3%	↓	↓	2.1%	↑	↓	1.6%	2.1%	7.1%
Free Cash Flow-to-Debt (High vs Low)	-0.4%	↓	↓	2.0%	↓	↑	1.3%	5.0%	15.5%
Price-to-Cash Flow (Cheap vs Expensive)	0.1%	↓	↑	2.0%	↑	↑	2.8%	-2.9%	-6.9%
CapEx-to-Assets (Low vs High)	0.0%	↓	↑	2.0%	↑	↑	0.7%	4.4%	1.8%
Composite Sentiment (High vs Low)	0.8%	↑	↑	1.9%	↓	↑	7.6%	0.0%	3.1%
Up vs Down Sales Revisions (High vs Low)	-0.8%	↓	↓	1.9%	↓	↑	2.8%	-4.5%	-2.4%
Industry Cyclical vs Defensive	3.7%	↑	↑	1.6%	↑	↑	6.8%	-1.9%	2.7%
Net Cash Variability (Low vs High)	1.8%	↑	↑	1.6%	↑	↑	2.5%	-0.8%	3.4%
Enterprise Value-to-Free Cash Flow (Low vs High)	-0.1%	↓	↑	1.6%	↓	↑	0.3%	15.0%	26.9%
5-Year EPS Growth (High vs Low)	1.3%	↑	↑	1.5%	↑	↑	0.8%	-5.9%	-3.4%
Accruals (Low vs High)	-0.2%	↓	↓	1.5%	↓	↑	1.0%	8.8%	12.3%
Interest Coverage (High vs Low)	-0.5%	↓	↓	1.5%	↓	↑	1.6%	5.8%	16.5%
CapEx-to-Sales (Low vs High)	0.0%	↓	↑	1.4%	↑	↑	-0.3%	5.4%	8.3%
Cash-to-Market Cap (High vs Low)	1.7%	↑	↑	1.3%	↑	↑	-0.9%	-2.5%	-5.3%
Profitability (High vs Low)	0.5%	↓	↑	1.3%	↑	↓	-0.8%	-2.5%	0.8%
Composite Accruals (Low vs High)	-0.4%	↓	↓	1.2%	↑	↑	-1.4%	5.3%	5.9%
Financial Leverage (Low vs High)	-0.5%	↓	↓	1.2%	↑	↑	1.2%	1.2%	5.5%
Long-Term Operating Leverage (High vs Low)	-0.1%	↓	↓	1.1%	↑	↑	2.9%	2.5%	4.7%
Size (Small vs Large)	1.4%	↑	↑	1.1%	↑	↑	-0.6%	-1.3%	-6.7%
5-Year Sales Growth (High vs Low)	1.3%	↑	↑	1.1%	↑	↑	-0.4%	-17.4%	-21.5%
Inventory-to-Sales (Low vs High)	0.2%	↓	↓	1.0%	↑	↓	-0.7%	2.0%	0.7%
Y/Y Change in Inventory/Sales (Low vs High)	-0.1%	↑	↓	1.0%	↑	↑	2.2%	2.0%	5.2%
Dividend Payout Ratio (High vs Low)	-2.2%	↓	↓	1.0%	↓	↓	-2.8%	4.6%	8.4%
Enterprise Value-to-Operating Income (Low vs High)	1.1%	↑	↑	0.9%	↓	↑	1.9%	16.9%	29.2%
Reduction in Shares Outstanding (Low vs High)	-0.3%	↓	↓	0.9%	↓	↑	0.4%	14.0%	23.8%
12m Volatility (Low vs High)	-2.6%	↓	↓	0.9%	↓	↓	-1.7%	10.8%	21.6%
Forecast long term growth (High vs Low)	1.4%	↑	↑	0.9%	↑	↑	3.7%	-2.3%	-2.2%
Incremental Margin (High vs Low)	0.4%	↓	↑	0.8%	↓	↑	1.5%	4.9%	7.9%
Net Margin (High vs Low)	-0.8%	↓	↓	0.7%	↓	↑	-0.3%	7.1%	18.1%
ROA (High vs Low)	-0.4%	↓	↓	0.7%	↓	↑	1.7%	8.2%	20.1%
Return on Invested Capital (High vs Low)	-0.7%	↓	↓	0.6%	↓	↑	2.1%	10.6%	22.7%
Operating Margin (High vs Low)	-0.6%	↓	↓	0.6%	↓	↑	0.3%	6.5%	16.7%
Free Cash Flow Yield (High vs Low)	-0.2%	↓	↓	0.5%	↓	↑	-0.5%	13.7%	23.7%
Earnings Stability (High vs Low)	-1.4%	↓	↓	0.5%	↓	↓	-0.5%	7.4%	11.2%
Composite Value (Cheap vs Expensive)	-0.3%	↓	↑	0.5%	↓	↑	-1.5%	11.4%	20.1%
Up-to-Down Revisions (High vs Low)	-1.0%	↓	↓	0.4%	↓	↑	1.0%	-1.1%	3.7%
ROE Variability (Low vs High)	-1.6%	↓	↓	0.4%	↑	↓	-0.8%	-0.1%	4.2%
Composite Free Cash Flow (High vs Low)	-0.2%	↓	↓	0.4%	↓	↑	-1.2%	12.6%	22.9%
Sales per Employee (High vs Low)	0.3%	↑	↑	0.3%	↑	↑	-1.3%	2.2%	6.6%
Cash Flow Coverage (High vs Low)	-0.3%	↓	↑	0.3%	↑	↑	2.1%	-0.7%	-3.1%
Operating Leverage (High vs Low)	0.1%	↑	↑	0.3%	↑	↑	2.0%	4.6%	9.5%
Asset Turnover (High vs Low)	0.1%	↓	↑	0.3%	↓	↑	-1.7%	4.5%	12.4%
1-Year Sales Growth (High vs Low)	1.2%	↑	↑	0.3%	↑	↑	2.8%	-17.7%	-19.4%
EPS Variability (Low vs High)	-2.7%	↓	↓	0.2%	↓	↓	-0.4%	3.5%	5.6%
Total Yield (High vs Low)	0.4%	↑	↑	0.2%	↓	↑	-1.1%	4.9%	4.6%
Composite Quality (High vs Low)	-1.1%	↓	↓	0.1%	↑	↑	-2.1%	2.9%	7.9%
Sales Growth Stability (High vs Low)	-1.6%	↓	↓	0.0%	↓	↓	-1.9%	3.8%	6.1%
CapEx-to-Depreciation (Low vs High)	0.1%	↑	↑	-0.1%	↓	↑	-1.8%	7.2%	7.9%
Operational Efficiency (High vs Low)	-0.8%	↓	↓	-0.1%	↓	↑	0.2%	11.6%	15.2%
Enterprise Value-to-EBITDA (Low vs High)	1.0%	↑	↑	-0.1%	↓	↑	0.4%	17.8%	28.7%
Receivables Turnover (High vs Low)	0.2%	↑	↓	-0.1%	↑	↓	0.0%	0.2%	2.0%
Price-to-Operating Income (Cheap vs Expensive)	1.2%	↑	↑	-0.2%	↓	↑	0.1%	15.3%	26.0%
Reinvestment Rate (High vs Low)	-2.0%	↓	↓	-0.2%	↓	↓	-4.3%	1.5%	4.9%
Inventory Turnover (High vs Low)	-0.3%	↓	↓	-0.3%	↑	↓	-0.6%	6.0%	5.3%
Estimate Dispersion (Low vs High)	-1.3%	↓	↓	-0.3%	↓	↓	-1.7%	7.7%	16.2%
ROE (High vs Low)	-0.3%	↓	↑	-0.4%	↓	↑	-0.2%	3.9%	12.2%
Price-to-Earnings (Cheap vs Expensive)	0.4%	↑	↑	-0.6%	↓	↑	-0.7%	10.4%	19.2%
Y/Y %Change in number of employees (Low vs High)	-1.3%	↓	↓	-0.6%	↓	↑	0.1%	15.8%	19.5%
Composite Growth (High vs Low)	0.4%	↑	↑	-0.6%	↓	↑	0.9%	-1.1%	1.8%
Price-to-Book (Cheap vs Expensive)	0.5%	↑	↑	-0.8%	↑	↑	-2.8%	8.2%	10.1%
Short-Term Accruals (Low vs High)	-1.1%	↓	↓	-0.9%	↓	↓	-2.3%	-1.2%	-2.9%
Price-to-Forward Earnings (Cheap vs Expensive)	0.9%	↑	↑	-0.9%	↓	↑	-0.6%	16.0%	24.5%
Sales Variability (Low vs High)	-1.0%	↓	↓	-1.2%	↓	↓	-1.8%	11.2%	16.1%
Trailing Dividend Yield (High vs Low)	-0.8%	↑	↑	-1.4%	↓	↓	-3.7%	8.6%	6.3%
1-Year EPS Growth (High vs Low)	0.1%	↑	↑	-1.6%	↓	↑	-0.8%	-0.6%	4.8%
Price-to-EBITDA (Cheap vs Expensive)	1.0%	↑	↑	-1.8%	↓	↑	-1.1%	15.7%	24.5%
Analyst Coverage (High vs Low)	-0.5%	↑	↓	-1.9%	↓	↓	-2.4%	-3.1%	-1.8%
Quality vs Junk	-3.2%	↓	↓	-2.2%	↓	↓	-1.9%	7.3%	13.7%
Value vs Growth	-1.2%	↑	↓	-2.3%	↓	↑	-1.1%	15.6%	17.7%
Operating Income Variability (Low vs High)	-2.8%	↓	↓	-2.7%	↓	↓	-5.6%	-5.0%	-7.3%
Price-to-Sales (Cheap vs Expensive)	0.6%	↑	↑	-2.8%	↓	↑	-4.5%	10.6%	18.8%
1-Month Reversal (Low vs High)	0.7%	↑	↑	-2.8%	↓	↓	1.6%	-5.5%	-6.9%

Source: ClariFi, Morgan Stanley Research

Exhibit 52: Best and Worst Performing Factor Leg Returns

Best 20 Performing Equal Weighted Group Return in Top 1000 as of Oct 6, 2022

Group	1 Week Ret	1 Week 1W Chg	1 Week 1M Chg	1 Month Ret	1 Month 1M Chg	1 Month 3M Chg	3M Ret	YTD Ret	12M Ret
Top 1000 (Equal Weighted)	4.4%	↑	↑	-5.2%	↓	↑	-1.3%	-20.0%	-16.2%
High Cash Ratio	5.5%	↑	↑	-2.4%	↑	↑	0.9%	-24.3%	-24.9%
High Earnings Estimate Revisions	5.6%	↑	↑	-2.4%	↑	↑	1.5%	-18.5%	-12.0%
High 1-Month Estimate Revisions (%)	5.7%	↑	↑	-2.7%	↑	↑	2.3%	-22.1%	-21.4%
High Net Cash Ratio	4.8%	↑	↑	-2.8%	↑	↑	0.5%	-23.2%	-21.9%
High 3-Month Price Momentum	5.3%	↑	↑	-2.8%	↓	↑	0.2%	-21.2%	-17.3%
High Gross Margin	4.7%	↑	↑	-2.9%	↑	↑	0.7%	-19.8%	-17.0%
Low Net Debt-to-Market Cap	4.7%	↑	↑	-3.0%	↑	↑	-0.2%	-25.1%	-24.1%
Low Debt-to-Capital	4.7%	↑	↑	-3.0%	↑	↑	0.1%	-22.4%	-20.1%
High Smoothed Estimate Revisions (%)	5.1%	↑	↑	-3.1%	↑	↑	4.1%	-20.5%	-19.7%
High Cash-to-Debt	5.0%	↑	↑	-3.1%	↑	↑	-0.3%	-24.6%	-24.1%
High Cash-to-Assets	5.2%	↑	↑	-3.1%	↑	↑	-0.1%	-25.8%	-26.7%
Low Debt-to-Assets	4.7%	↑	↑	-3.4%	↑	↑	-0.7%	-24.4%	-20.5%
High 9-Month Price Momentum	3.6%	↑	↑	-3.5%	↓	↑	0.3%	-21.4%	-17.3%
High 12-Month Price Momentum	3.9%	↑	↑	-3.5%	↓	↑	1.4%	-19.8%	-16.0%
High 6-Month Price Momentum	3.8%	↑	↑	-3.6%	↓	↑	0.6%	-19.3%	-14.8%
Low Price-to-Cash Flow	4.8%	↑	↑	-3.8%	↑	↑	0.2%	-20.8%	-20.6%
Cyclical	6.1%	↑	↑	-3.8%	↑	↑	1.5%	-19.5%	-16.1%
High Operating Income Variability	6.2%	↑	↑	-3.8%	↑	↑	1.5%	-20.6%	-17.7%
Low Debt-to-EBITDA	4.4%	↑	↑	-3.9%	↑	↑	-3.5%	-30.1%	-32.8%
Low Enterprise Value-to-Free Cash Flow	4.7%	↑	↑	-3.9%	↓	↑	-1.1%	-13.3%	-5.4%

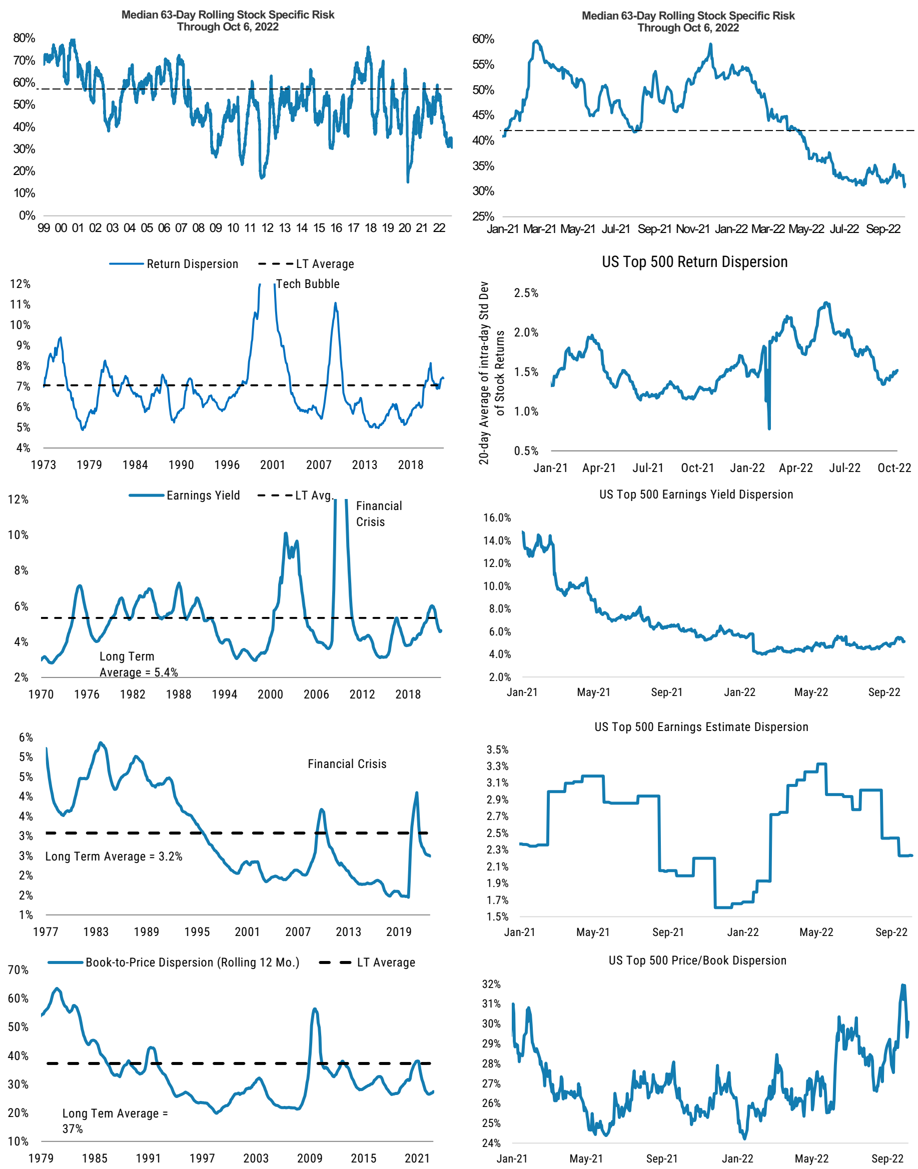
Worst 20 Performing Equal Weighted Group Return in Top 1000 as of Oct 6, 2022

Group	1 Week Ret	1 Week 1W Chg	1 Week 1M Chg	1 Month Ret	1 Month 1M Chg	1 Month 3M Chg	3M Ret	YTD Ret	12M Ret
Top 1000 (Equal Weighted)	4.4%	↑	↑	-5.2%	↓	↑	-1.3%	-20.0%	-16.2%
High Trailing Dividend Yield	3.6%	↑	↑	-6.7%	↓	↑	-3.8%	-11.2%	-6.0%
Quality	2.4%	↑	↑	-6.7%	↓	↓	-2.7%	-15.6%	-7.4%
High Debt-to-Capital	4.2%	↑	↑	-6.8%	↓	↑	-1.6%	-19.6%	-16.9%
Low 12m-1m Residual Momentum	3.7%	↑	↑	-6.9%	↓	↑	-7.1%	-25.0%	-24.4%
Low 1-Month Reversal	4.5%	↑	↑	-6.9%	↓	↑	-0.5%	-24.3%	-22.9%
Low Cash Flow / Debt	4.4%	↑	↑	-7.0%	↓	↓	-3.8%	-28.1%	-31.9%
Low 5-Year Dividend per share growth	4.0%	↑	↑	-7.0%	↓	↑	-2.9%	-17.5%	-13.7%
Low Price-to-Sales	5.1%	↑	↑	-7.0%	↓	↑	-3.9%	-16.1%	-9.5%
Low Sales Variability	3.8%	↑	↑	-7.0%	↓	↑	-3.8%	-18.4%	-12.8%
Low Earnings Estimate Revisions	4.4%	↑	↑	-7.1%	↓	↑	-4.6%	-22.5%	-21.5%
High Debt-to-Equity	4.3%	↑	↑	-7.1%	↓	↑	-2.8%	-21.5%	-18.8%
Low 1-Month Estimate Revisions (%)	3.9%	↑	↑	-7.2%	↓	↑	-4.2%	-20.9%	-18.6%
Low Cash-to-Debt	3.9%	↑	↑	-7.2%	↓	↑	-3.1%	-17.8%	-12.6%
Low Sales Estimate Revisions	4.5%	↑	↑	-7.3%	↓	↑	-6.8%	-22.7%	-18.0%
High Debt-to-Assets	4.3%	↑	↑	-7.5%	↓	↓	-2.7%	-22.4%	-20.4%
Low 1-Year Dividend per share growth	3.3%	↑	↑	-7.5%	↓	↑	-3.8%	-17.4%	-12.7%
Low Tangible Book/Price	4.6%	↑	↑	-7.7%	↓	↑	-3.8%	-18.8%	-14.8%
Low 3-Month Price Momentum	3.6%	↑	↑	-8.1%	↓	↓	-3.5%	-22.6%	-21.6%
Low Net Cash Ratio	4.5%	↑	↑	-8.2%	↓	↑	-3.8%	-17.7%	-14.9%
High Net Debt-to-Market Cap	4.6%	↑	↑	-8.3%	↓	↑	-3.9%	-17.7%	-14.7%

Source: ClariFi, Morgan Stanley Research

In Exhibit 53, we monitor a number of dispersion metrics on a long-term and short-term basis. For most forms of dispersion, 2021 marked a local peak with these measures now back at or below long-term averages. Stock-specific risk continues to fall (7th percentile historically) as geopolitical uncertainty and macro risk continue to weigh on equities broadly. Return dispersion remains elevated relative to the post-GFC cycle and has ticked higher heading into 3Q earnings season. To the opposite effect, earnings estimate dispersion has fallen in recent weeks. Lastly, price/book dispersion fell last week from its spike the week prior.

Exhibit 53: US Top 500 Dispersion Metrics: Long-term and Short-Term



Source: ClariFi, Morgan Stanley Research

We also monitor these dispersion metrics on a percentile basis relative to history (Exhibit 54). Return dispersion and earnings yields dispersion are slightly above historical levels and have been in this range for most of the third quarter. Although the S&P 500 is only slightly elevated, there is greater variance at the industry group level with a number of industries in their top two deciles historically. Specifically, high dispersion is present in

Media & Entertainment, Real Estate, and Materials while there are lower relative dispersion levels in Household & Personal Products and Utilities, suggesting macro factors are a driving force.

Exhibit 54: Historical Dispersion Metrics by Industry Group

	Return Dispersion	Earning Yield Dispersion	Book/Price Dispersion	Earnings Estimate Dispersion
S&P 500	63%	71%	57%	63%
Energy	84%	70%	32%	40%
Materials	66%	93%	41%	69%
Capital Goods	24%	88%	56%	15%
Commercial & Professional Services	93%	26%	21%	70%
Transportation	58%	75%	41%	56%
Automobiles & Components	82%	90%	91%	58%
Consumer Durables & Apparel	20%	91%	98%	72%
Consumer Services	40%	53%	62%	69%
Retailing	47%	81%	14%	70%
Food & Staples Retailing	64%	92%	98%	68%
Food, Beverage & Tobacco	41%	82%	62%	90%
Household & Personal Products	81%	37%	24%	28%
Health Care Equipment & Services	61%	52%	58%	30%
Pharma, Biotech & Life Sciences	43%	92%	50%	64%
Banks	20%	70%	46%	68%
Diversified Financials	61%	89%	57%	55%
Insurance	9%	76%	29%	74%
Software & Services	53%	56%	88%	44%
Technology Hardware & Equipment	5%	79%	84%	0%
Semiconductors & Semi Equipment	47%	73%	88%	23%
Telecommunication Services	8%	69%	78%	13%
Media & Entertainment	77%	72%	85%	87%
Utilities	76%	36%	56%	4%
Real Estate	80%	61%	85%	56%

Source: ClariFi, Morgan Stanley Research

Fresh Money Buy List

Exhibit 55: Fresh Money Buy List - Stats & Performance

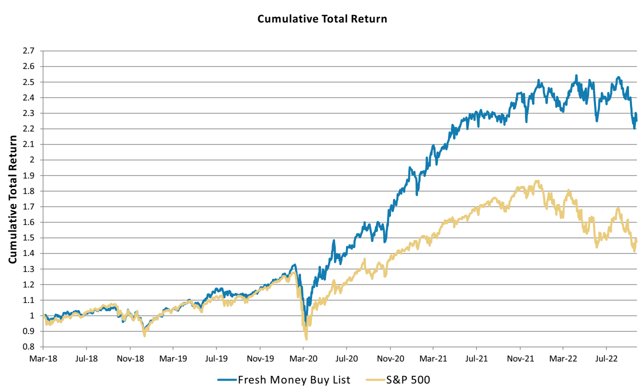
Company Name	Ticker	MS Rating	Sector	Market Cap ($Bn)	Price	MS PT	% to MS PT	MS Analyst	Date Added	Total Return Since Inclusion	
										Absolute	Rel. to S&P
AT&T, Inc.	T	Overweight	Communication Services	$109.2	$15.32	22.00	43.6%	Flannery, Simon	12/20/2021	(8.9%)	9.0%
CenterPoint Energy Inc	CNP	Overweight	Utilities	$17.2	$27.34	33.00	20.7%	Arcaro, David	3/21/2022	(4.8%)	10.5%
Coca-Cola Co.	KO	Overweight	Consumer Staples	$238.0	$55.03	68.00	23.6%	Mohsenian, Dara	3/28/2022	(9.2%)	7.6%
Exxon Mobil Corporation	XOM	Overweight	Energy	$425.3	$102.06	113.00	10.7%	McDermott, Devin	2/22/2021	109.8%	111.6%
Humana Inc	HUM	Overweight	Health Care	$63.2	$499.30	549.00	10.0%	Ha, Michael	7/19/2018	62.2%	19.1%
McDonald's Corporation	MCD	Overweight	Consumer Discretionary	$172.7	$234.75	285.00	21.4%	Glass, John	10/18/2021	(0.9%)	14.1%
Mondelez International Inc	MDLZ	Overweight	Consumer Staples	$76.8	$56.01	70.00	25.0%	Kaufman, Pamela	7/19/2021	(10.3%)	1.6%
SBA Communications	SBAC	Overweight	Real Estate	$28.9	$268.02	366.00	36.6%	Flannery, Simon	6/7/2021	(13.4%)	(3.7%)
Simon Property Group Inc	SPG	Overweight	Real Estate	$31.0	$94.68	131.00	38.4%	Kamdem, Ronald	2/16/2021	(5.3%)	(2.8%)
Current List Performance											
Average (Eq. Weight)				$129.1			25.5%			13.2%	18.6%
Median				$76.8			23.6%			(5.3%)	9.0%
% Positive Returns (Abs. / Rel.)										22%	78%
% Negative Returns (Abs. / Rel.)										78%	22%
Avg. Hold Period (Months)											17.4
All Time List Performance											
Average (Eq. Weight)										29.5%	15.9%
Median										15.1%	10.4%
% Positive Returns (Abs. / Rel.)										62%	59%
% Negative Returns (Abs. / Rel.)										38%	41%
Avg. Hold Period (Months)											14.7

Performance returns shown above and below represent local currency total returns, including dividends and excluding brokerage commission. Returns are calculated using the closing price on the last trading day before the date shown in the "Date Added" column through close on the last trading day prior to publication of this report for stocks currently on the list and through close on the day of removal for stocks formerly on the list. These figures are not audited. Past performance is no guarantee of future results.

++ Rating and other information has been removed from consideration in this report because, under applicable law and/or Morgan Stanley policy, Morgan Stanley may be precluded from issuing such information with respect to this company at this time.

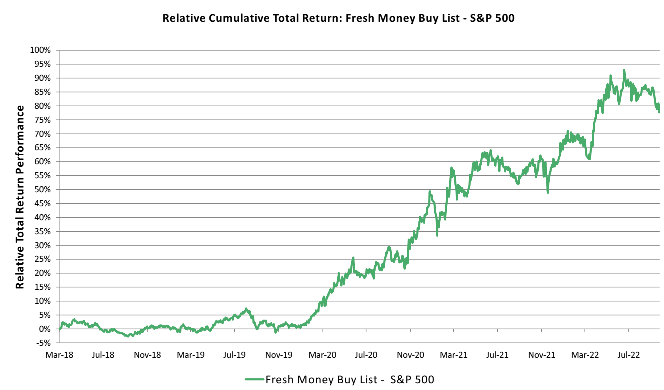
Source: Bloomberg, Morgan Stanley Research estimates

Exhibit 56: Fresh Money Buy List & S&P 500 Cumulative Total Return



Source: Bloomberg, Morgan Stanley Research.

Exhibit 57: Fresh Money Buy List / S&P 500 Cumulative Relative Return



Source: Bloomberg, Morgan Stanley Research.

Humana (HUM), Michael Ha

- First Look – MA Star Ratings Released; HUM Sees Improvement in Largest Contract while CVS/UNH/CNC Decline.
    - Who Improved? - Humana and Cigna both gained +0.5 star rating in their largest contract. Humana's largest contract ID comprises ~30% of their MA lives and for Cigna ~44% of MA lives.
    - Who Declined? - CVS declined 1.0 star, Centene declined 1.5 stars, United declined 0.5 star and Bright Health declined 0.5 star in their largest contract. CVS' largest contract ID comprises ~38% of their MA lives, Centene ~10%, United ~11% and Bright Health ~63%.
    - Who Retained? - Kaiser, Elevance and Alignment retained STAR ratings in their largest contract. Kaiser's largest contract ID comprises ~71% of their MA lives, Elevance ~16% and Alignment ~93%.

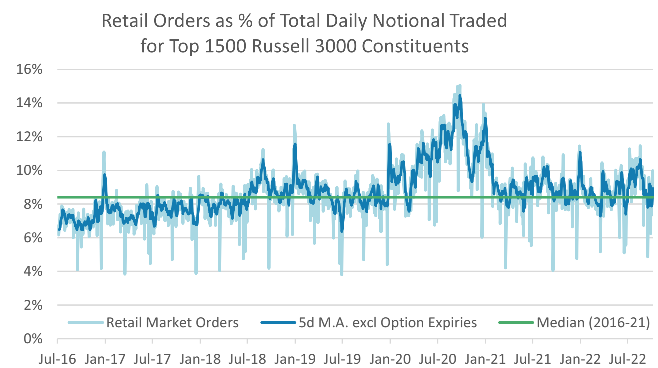
What's Retail Doing?

Our Quantitative Equity Strategy team recently introduced a novel way to track the activity of retail traders using publicly available data. We provide a few updates and key observations on the retail trader using this approach.

A few key observations:

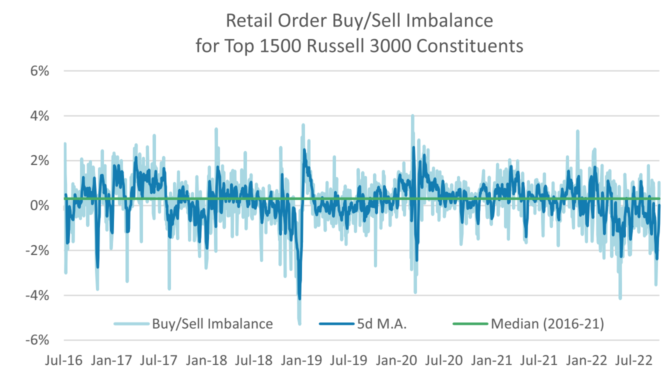
- Retail participation is currently at 8.9% of the total market volume,and at 65th %-ile relative to the last 5 years.
- Order imbalance remains negative last week with the exception of Friday at neutral levels (35th percentile relative to the last 5 years).
- Imbalance is mixed on sector levels. It is most negative relative to history in Health Care (1st %-ile), while most positive in Energy (35th %-ile). It is most negative in Utilities.

Exhibit 58: Retail orders as a % of notional traded slightly above median



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

Exhibit 59: ... and order imbalance has been largely negative



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

Exhibit 60: Retail's buy/sell imbalance is most negative in Health Care

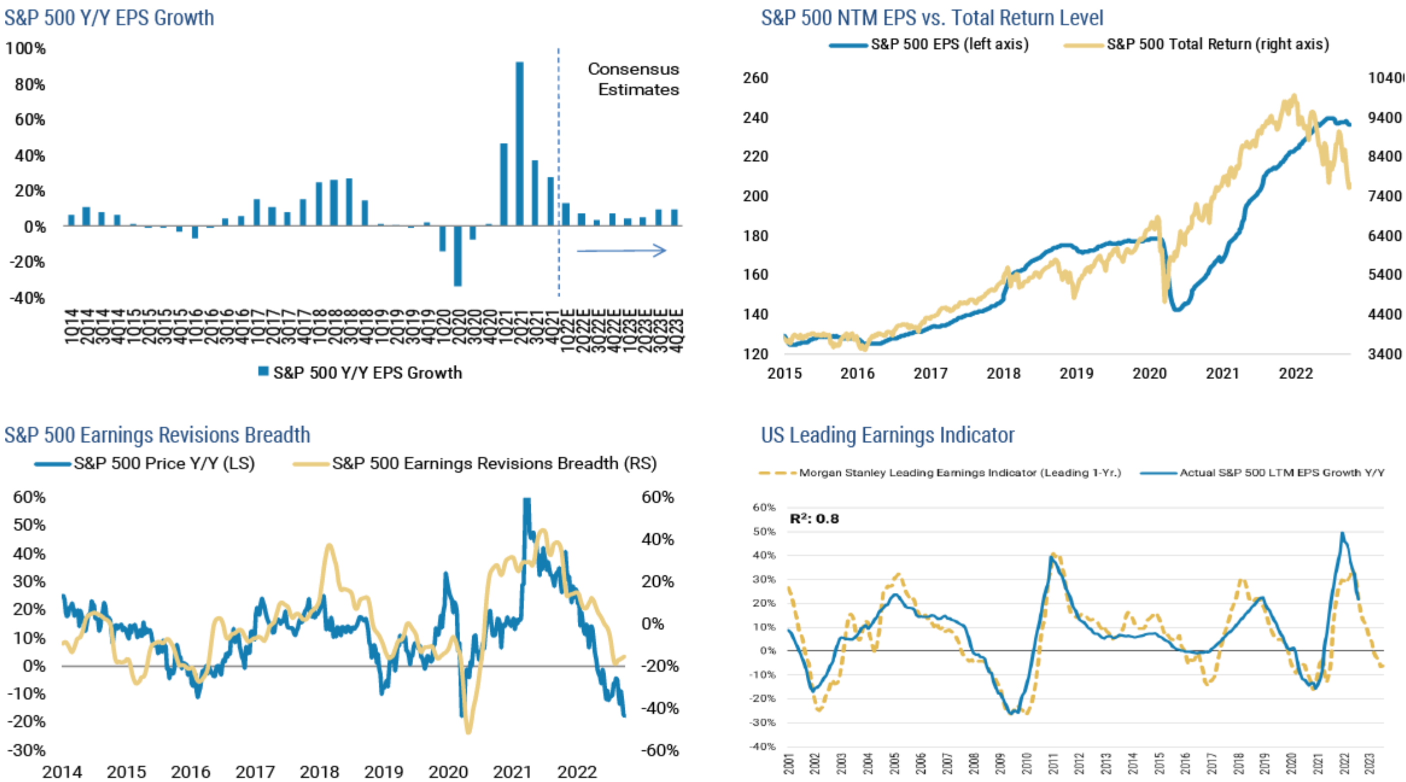
	Retail Participation			Buy/Sell Imbalance		
Sector	**2016-22 Median**	**Current**	**p-tile**	**2016-22 Median**	**Current**	**p-tile**
Energy	6.8%	8.0%	0.77	-0.28%	-0.2%	0.51
Materials	5.6%	4.5%	0.09	0.5%	-1.0%	0.12
Industrials	6.6%	5.2%	0.03	-0.1%	-1.3%	0.13
Consumer Discretionary	11.4%	13.5%	0.83	0.6%	0.7%	0.56
Consumer Staples	6.0%	4.6%	0.09	-0.5%	0.3%	0.68
Health Care	5.9%	4.0%	0.03	-0.4%	-1.7%	0.20
Financials	5.6%	5.1%	0.24	0.0%	-1.2%	0.19
Information Technology	10.9%	11.9%	0.77	0.5%	0.2%	0.38
Communication Services	9.1%	11.0%	0.68	0.3%	-0.6%	0.20
Utilities	3.8%	2.9%	0.05	-1.2%	-0.2%	0.73
Real Estate	3.5%	3.1%	0.23	0.5%	-0.6%	0.27
Model Universe (Top 1500)	**8.5%**	**8.9%**	**0.65**	**0.3%**	**0.0%**	**0.35**

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

For more on the methodology, please see Quantitative Equity Research: The Rise of the Retail Trader (30 Jun 2021).

Weekly Charts to Watch

Exhibit 61: US Earnings Snapshot



Source: Refinitiv, FactSet, Morgan Stanley Research. Top and bottom left: As of October 7, 2022 Bottom right As of September 1, 2022. MS Leading Earnings Indicator is a macro factor based earnings model that leads actual earnings growth by one year with a 0.7 12-month leading correlation. Note: S&P 500 fundamental data used post March 1993; Top 500 by market cap data used before 1993. LTM equity risk premium average is since 1920. ERP based on forward earnings yield and 10-year Treasury Yield.

Exhibit 62: S&P 500 Price Target

Morgan Stanley S&P 500 June 2023 Price Target

Landscape	Earnings	Multiple	Price Target	Upside / Downside
Bull Case	$244	18.2x	4,450	22.3%
Base Case	$219	17.7x	3,900	7.2%
Bear Case	$205	16.3x	3,350	-8.0%
Current S&P 500 Price as of:		10/7/2022	3,640	

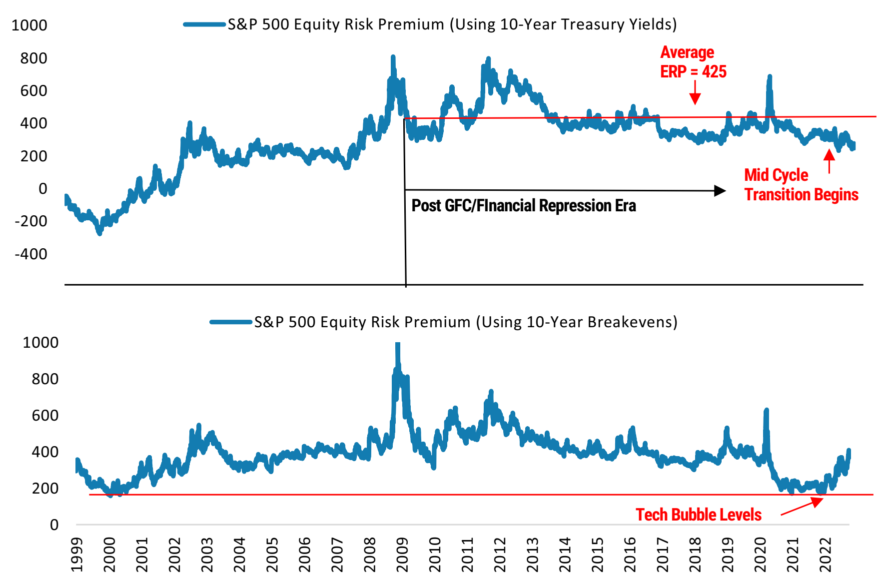
Note: We use June 2023 forward earnings to project our price target which takes into account our June '24 earnings forecast (currently $219 base case).
Source: Bloomberg, Morgan Stanley Research

Exhibit 63: Sector Ratings

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

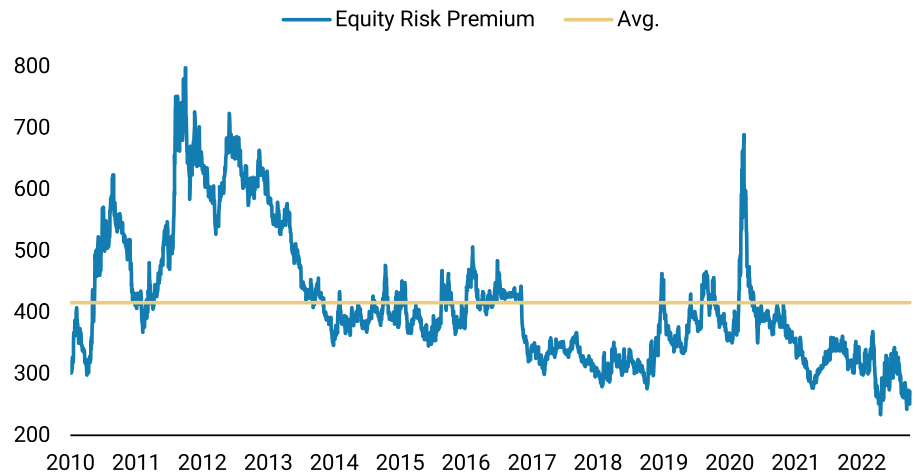
Source: Morgan Stanley Research

Exhibit 64: S&P 500 Equity Risk Premium using Nominal Rates and Breakevens



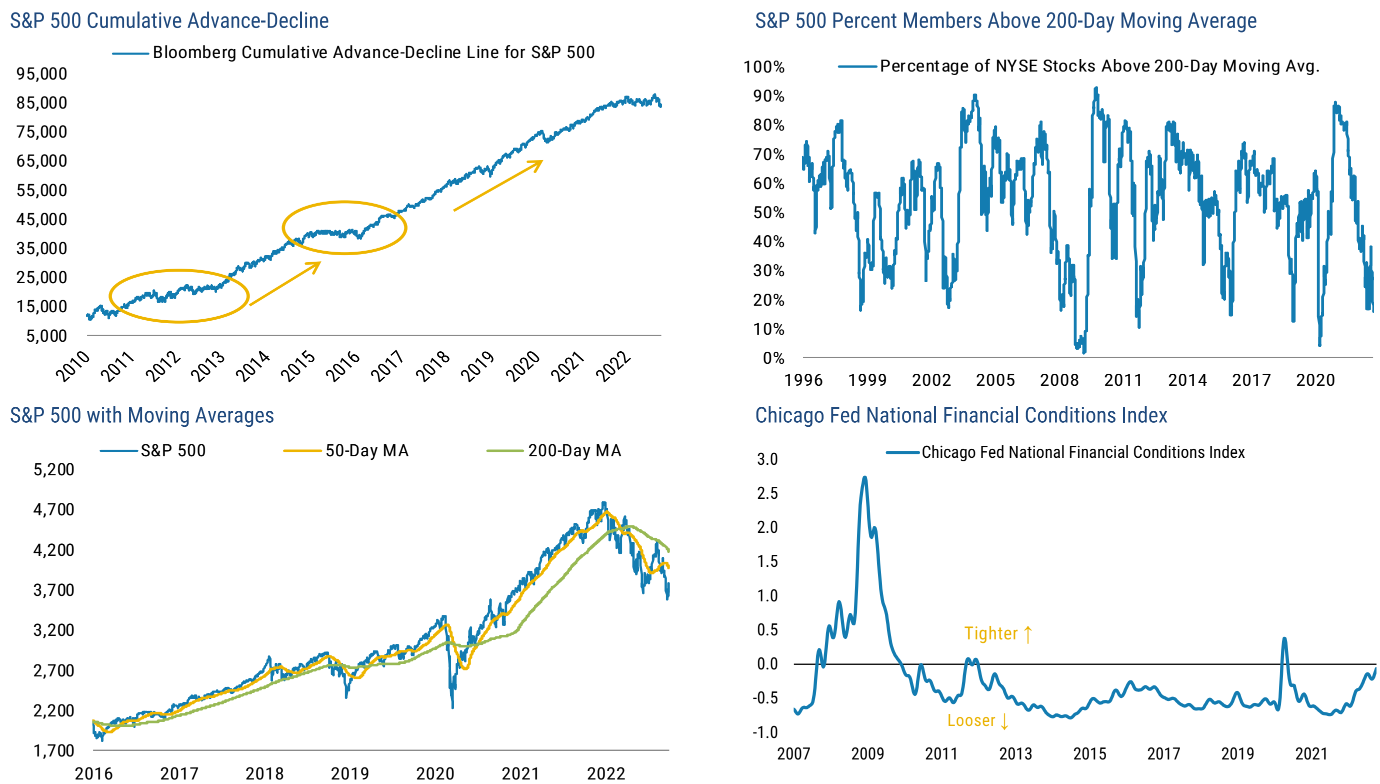
Source: Bloomberg, Morgan Stanley Research. As of October 7, 2022

Exhibit 65: Equity Risk Premium is Below Post-GFC Average



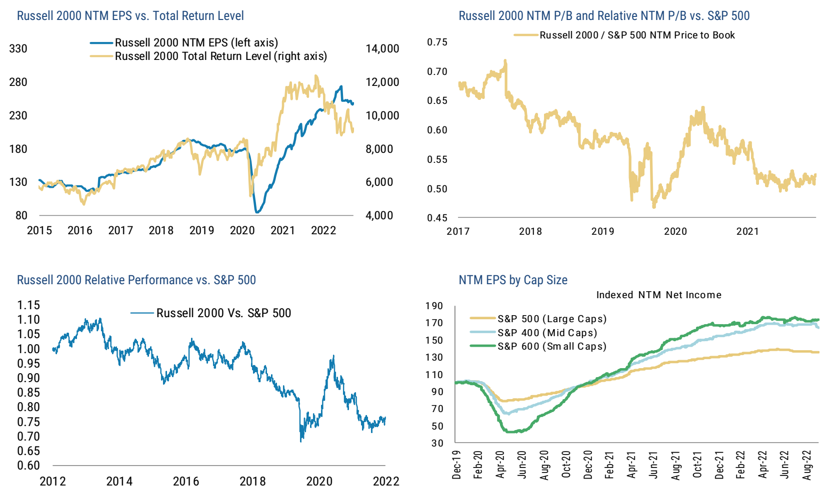
Note: Equity risk premium is calculated as the S&P 500 forward 12M earnings yield minus the nominal 10-Year Treasury.
Source: Bloomberg, Morgan Stanley Research

Exhibit 66: US Equity Market Technicals and Financial Conditions



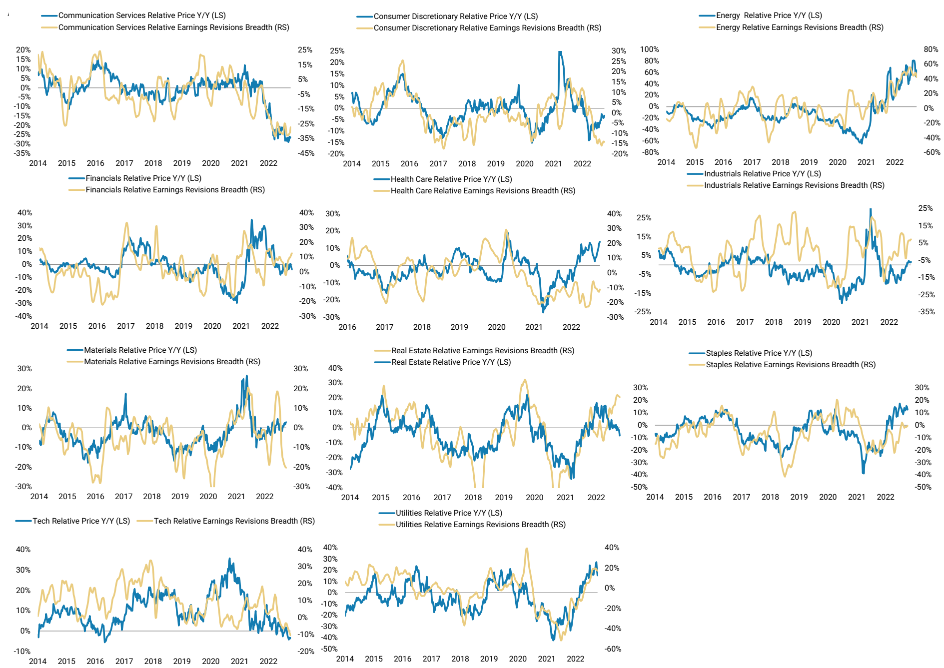
Source: Bloomberg, Morgan Stanley Research. All: As of October 7, 2022

Exhibit 67: US Small Cap Equities



Source: FactSet, Morgan Stanley Research. As of October 7, 2022

Exhibit 68: Earnings Revisions Breadth vs YoY Performance



Source: FactSet, Morgan Stanley Research. As of October 7, 2022

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(as of September 30, 2022)

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STOCK RATING CATEGORY	COVERAGE UNIVERSE COUNT	COVERAGE UNIVERSE % OF TOTAL	INVESTMENT BANKING CLIENTS (IBC) COUNT	IBC % OF TOTAL IBC	IBC % OF RATING CATEGORY	OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC) COUNT	MISC % OF TOTAL OTHER MISC
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Equal-weight/Hold	**1582**	**45%**	**335**	**47%**	**21%**	**702**	**46%**
Not-Rated/Hold	**0**	**0%**	**0**	**0%**	**0%**	**0**	**0%**
Underweight/Sell	**610**	**17%**	**84**	**12%**	**14%**	**219**	**14%**
TOTAL	**3,534**		**714**			**1511**	

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