North America Equity Market Outlook: Third-Quarter 2020

Following the market's rebound, stocks are trading much closer to our fair value estimates.

Morningstar Equity Research
June 26, 2020

Contents

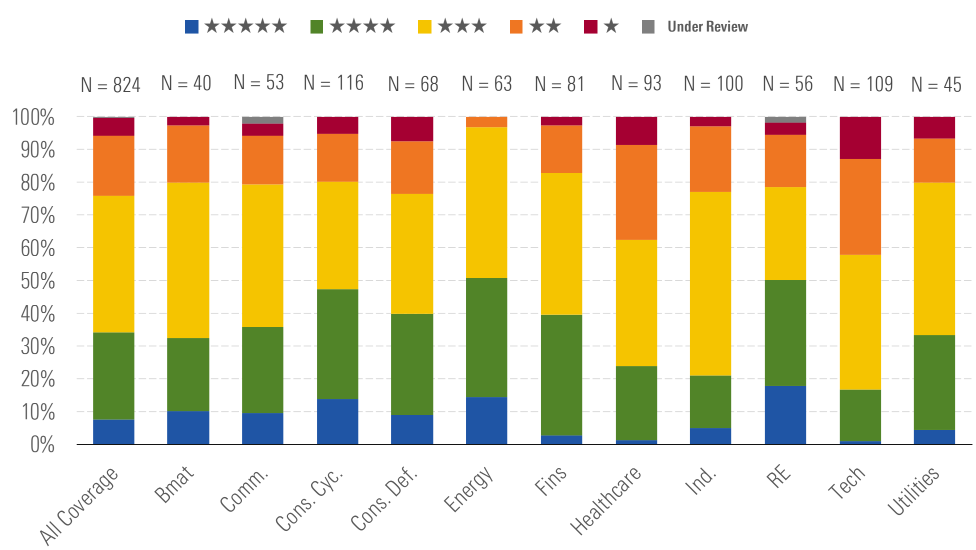
Jeffrey Stafford, CFA
Director of Equity Research, North America
jeffrey.stafford@morningstar.com

The stock market's swift recovery has us seeing much less value in the North American equity market—although pockets of opportunity remain. As concerns about the coronavirus pandemic began to dissipate and economies reopened, the Morningstar US Market Index surged almost 25% from the end of the first quarter. The median stock in our North American equity coverage now trades at only a 5% discount to our fair value estimate compared with a 22% discount near the end of March. Of the roughly 800 North American stocks we cover, 34% carry an undervalued rating of 4 or 5 stars. Three months ago, a hefty two thirds of our coverage was undervalued. Of the 11 sectors we cover, the median stock trades at a more than 10% discount in only three compared with 10 last quarter.

Key Takeaways

- Tech and healthcare are starting to look expensive. The median stock in each sector trades at a more than 5% premium to our estimate of intrinsic value.
- Plenty of opportunities remain in energy and consumer cyclical stocks. Oil prices are well below our long-term estimate, and in consumer cyclical, nearly 80% of travel and leisure stocks are cheap.
- Three months ago, we had 224 stocks rated 5 stars in our North American coverage. As of June 23, that number had shrunk to 61.

One Third of Our North American Coverage Is Undervalued, Down From Two Thirds Recently
Star rating distribution by sector (North American-domiciled firms only).



Source: Morningstar. Data as of June 23, 2020.

Highlighted Companies

Company and Sector	Morningstar Rating	Fair Value Estimate	Current Price	Uncertainty Rating	Moat Rating	Price / Fair Value	Market Cap (M)
Basic Materials							
Albemarle (ALB)	★★★★	$125	$76.12	High	Narrow	0.61	8,092.97
CF Industries Holdings (CF)	★★★★★	$52	$29.8	High	None	0.57	6,371.16
Ingredion (INGR)	★★★★★	$125	$84.03	Medium	Narrow	0.67	5,627.74
Communication Services							
Comcast (CMCSA)	★★★★	$47	$39.2	Medium	Wide	0.83	178,914.98
Fox (FOX)	★★★★	$39	$27.81	High	Narrow	0.71	16,943.66
Omnicom Group (OMC)	★★★★	$79	$54.1	High	Narrow	0.68	11,592.70
Consumer Cyclical							
Hanesbrands (HBI)	★★★★★	$23	$11.27	Medium	Narrow	0.49	3,922.36
Macy's (M)	★★★★★	$17.6	$7.15	High	None	0.41	2,214.14
Tapestry (TPR)	★★★★★	$35	$13.78	High	Narrow	0.39	3,804.64
Consumer Defensive							
Anheuser-Busch InBev (BUD)	★★★★★	$96	$52.1	Medium	Wide	0.54	102,314.82
Pilgrims Pride (PPC)	★★★★★	$34.5	$17.87	High	None	0.52	4,409.21
US Foods Holding (USFD)	★★★★★	$31	$20.7	Medium	None	0.67	4,559.84
Energy							
Enbridge (ENB)	★★★★	$40	$30.93	Medium	Wide	0.77	62,851.94
Enterprise Products Partners (EPD)	★★★★	$25.5	$19.02	Medium	Wide	0.75	41,573.92
Schlumberger (SLB)	★★★★★	$48	$19.57	High	Narrow	0.41	27,159.50
Financial Services							
American International Group (AIG)	★★★★★	$59	$32.05	High	None	0.54	27,604.37
Berkshire Hathaway (BRK.B)	★★★★	$228	$181.01	Medium	Wide	0.79	440,681.68
Truist Financial (TFC)	★★★★	$54	$40.04	High	Narrow	0.74	53,954.99
Healthcare							
CVS Health (CVS)	★★★★	$92	$64.43	Medium	Narrow	0.70	84,215.86
Intercept Pharmaceuticals (ICPT)	★★★★	$153	$81.88	Very High	None	0.54	2,697.38
Pfizer (PFE)	★★★★	$42.5	$32.77	Low	Wide	0.77	182,031.90
Industrials							
Crane (CR)	★★★★★	$80	$55.46	Medium	Narrow	0.69	3,215.49
Herc Holdings (HRI)	★★★★★	$49	$28.53	Medium	None	0.58	830.54
WESCO International (WCC)	★★★★★	$87	$37.22	High	Narrow	0.43	1,861.87
Real Estate							
Pebblebrook Hotel Trust (PEB)	★★★★	$23.5	$13.96	Very High	None	0.59	1,825.36
Simon Property Group (SPG)	★★★★★	$154	$70.13	High	None	0.46	21,442.61
Ventas (VTR)	★★★★	$50	$35.46	High	None	0.71	13,229.23
Technology							
Cognizant Technology Solutions (CTSH)	★★★★	$70	$55.2	Medium	Narrow	0.79	29,840.02
Palo Alto Networks (PANW)	★★★★	$305	$229.31	High	Narrow	0.75	22,120.59
VMware (VMW)	★★★★	$202	$149.23	High	Narrow	0.74	62,534.87
Utilities							
AES (AES)	★★★★★	$20	$13.84	Medium	None	0.69	9,202.32
Duke Energy (DUK)	★★★★	$95	$81.85	Low	Narrow	0.86	60,147.68
Edison International (EIX)	★★★★	$70	$55.77	Medium	Narrow	0.80	20,286.87

Data as of June 23, 2020.

Economic Outlook | We Don't Think the Market Is Too Optimistic, as We Forecast Strong Long-Run U.S. Economic Recovery

The Morningstar US Market Index has come thundering back since its late March nadir and is now down merely 7% year to date, even as the coronavirus pandemic persists. While many investors are wondering if the market is exhibiting irrational exuberance, we think the rebound has been broadly warranted, as we forecast a strong long-run recovery in the U.S. economy. We expect U.S. GDP to drop 5.1% in 2020 but surge back in 2021 and experience further catch-up growth in following years (Exhibit 1a). By 2024, we think U.S. GDP will recover to just 1% below our expectations before the pandemic.

Though we agree with consensus forecasts that second-quarter U.S. GDP will be brutal, we're expecting a much quicker recovery. Even while social distancing weighs heavily on some industries, we think the rest of the economy can recover substantially in the second half of 2020 (Exhibit 1b). Retail sales, employment, and other data show that this recovery has already begun for the U.S. We expect broad availability of a vaccine to erase the coronavirus' direct impact on the U.S. and global economies by mid-2021.

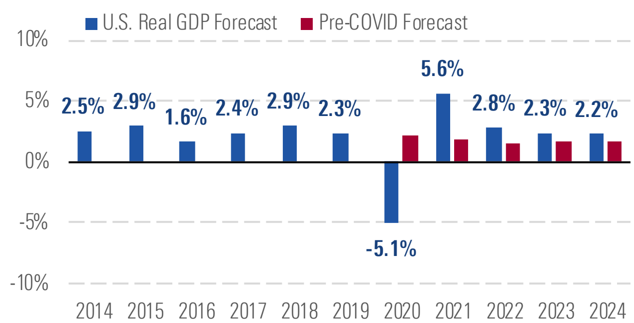
The most important question for investors is what the long-run impact of the pandemic will be on the economy. Our analysis shows the typical stock valuation is drastically more sensitive to the long-run impact on GDP than the short-run impact (Exhibit 1c). We've examined the history of global recessions for clues on the coronavirus recession's impact on long-run economic growth and found that many recessions don't have a long-run impact on the economy. The worst recessions in terms of long-run impact (the Great Depression or the Great Recession) are generally the product of persistent economic policy error.

We've distilled what we learned on what causes recessions to go wrong into a long-run impact scorecard (Exhibit 1d), where we rate the coronavirus' recession. Most important, policy response has been extremely impressive, especially the United States' historically large fiscal stimulus. Likewise, we think risks of a financial crisis are small currently, as central bankers are unconstrained by the moral hazard quandary. Underlying structural issues going into this recession pale compared with the economic distortions before the Great Recession. We forecast a long-run impact on U.S. and global GDP of just negative 1%.

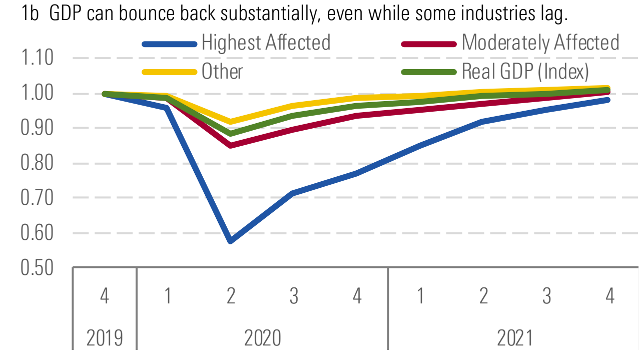
Preston Caldwell | preston.caldwell@morningstar.com

Exhibit 1 We Forecast a Strong Long-Run U.S. Economic Recovery

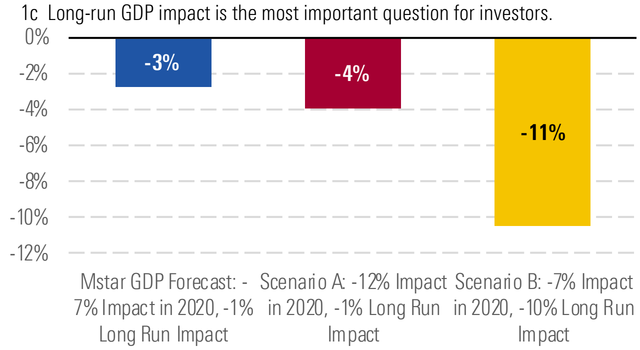
1a U.S. GDP will fall sharply in 2020, but we expect rapid catch-up afterward.



1b GDP can bounce back substantially, even while some industries lag.

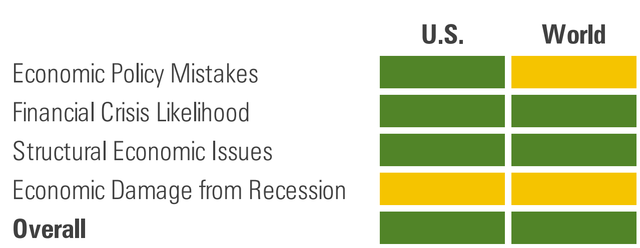


1c Long-run GDP impact is the most important question for investors.



1d Earlier recessions suggest only a mild long-run hit from the coronavirus.

COVID-19 Long Run Economic Impact Scorecard



Source: U.S. Bureau of Economic Analysis, Morningstar.
Data as of June 23, 2020.

Basic Materials | Market Recovery Leaves Opportunities in Basic Materials Largely Limited to Agriculture and Chemicals

The Morningstar US Basic Materials Index outperformed the broader market in the second quarter of 2020 by over 400 basis points (Exhibit 2a). Year to date, the sector has now lagged the Morningstar US Market Index by over 800 basis points, down from a year-to-date loss of more than 760 basis points a quarter ago. Trailing one-year underperformance fell to 530 basis points, down from more than 1,000 basis points a quarter ago. As a result of the second-quarter rally, just a third of the U.S. basic materials stocks we cover now trade in 4- or 5-star territory (Exhibit 2b). However, we think investors can still find attractive risk-adjusted opportunities in the sector, particularly in the agriculture and chemicals industries.

In agriculture, our base case for 2020 assumes that farmers will still plant crops globally. Because of more favorable weather this spring, crop plantings for both corn and soybeans, which account for most acres planted in the U.S., are well ahead of recent historical averages (Exhibit 2c). Further, South American farmer economics remain solid. Both factors bode well for agriculture input demand during the second half of the year, as farmers should continue to apply fertilizer and chemicals to maximize crop yields.

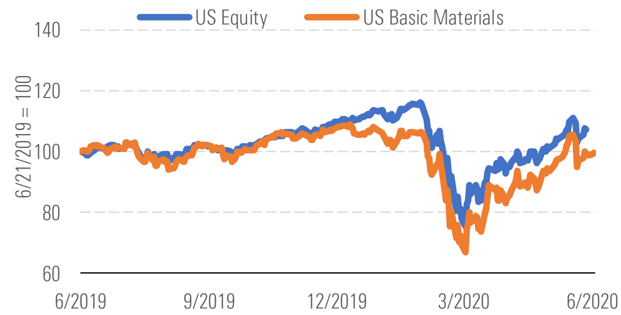
Ingredient producers saw mixed impact from the coronavirus, as sales to food-service customers declined because of lower restaurant sales, partially offset by an increase in packaged-food sales. As restaurants reopen, we expect ingredient volumes to rise during the second half of the year and see little impact to 2021.

Although the impact of the pandemic will result in reduced lithium demand in 2020, the decline should be short-lived. The largest source of lithium demand comes from electric vehicles. COVID-19 government stimulus packages in China and throughout Europe have included EV subsidies and charging infrastructure investment. We expect EV sales to rise sequentially during the second half of the year and continue to grow in 2021. This should boost lithium demand and balance the market in 2021, with larger price increases in 2022.

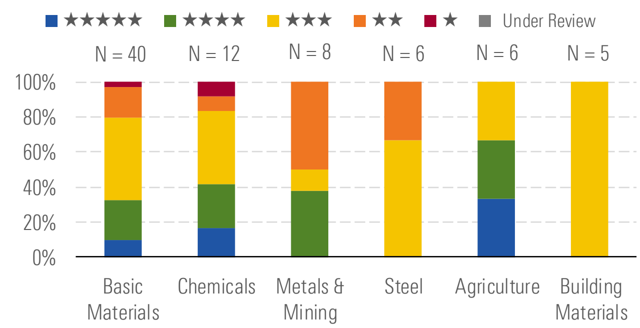
Kristoffer Inton | kristoffer.inton@morningstar.com

Exhibit 2 Continued Underperformance Has Created Opportunities

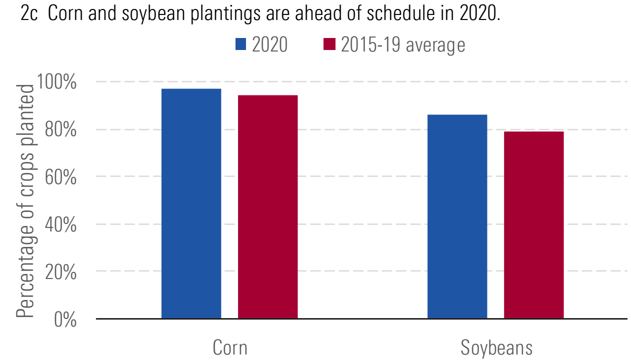
2a U.S. materials index versus the U.S. equity index.



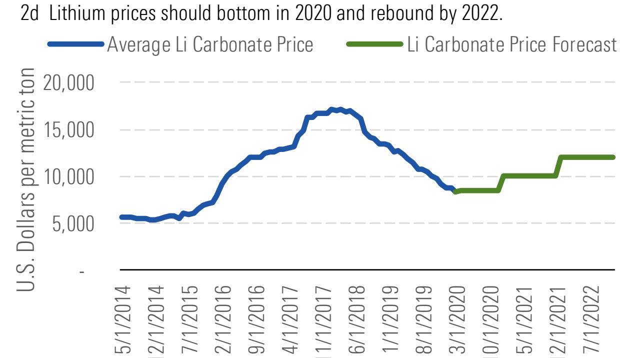
2b Just one third of materials stocks trade at attractive discounts.



2c Corn and soybean plantings are ahead of schedule in 2020.



2d Lithium prices should bottom in 2020 and rebound by 2022.



Source: Morningstar, USDA.
Data as of June 23, 2020.

Basic Materials | Top Picks

Basic Materials | Quick Takes

Company (Ticker)		Rating	
CF Industries Holdings Inc (CF)		★★★★★	With our outlook for a recovery in U.S. planted acres coming to fruition, we forecast strong demand for ag inputs, including nitrogen fertilizer. In our view, the market sell-off has created an opportunity for long-term investors to pick up CF Industries, which is among the lowest-cost nitrogen fertilizer producers globally. CF trades in 5-star territory at nearly 45% below our $52 per share fair value estimate.
Price	**Fair value**	**Uncertainty**	
$29.80	$52.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$6.37	None	Standard	
Company (Ticker)		**Rating**	
Ingredion Inc (INGR)		★★★★★	Our top pick to play the recovery in ingredients demand is narrow-moat Ingredion, which trades in 5-star territory at roughly a 35% discount to our fair value estimate. As Ingredion increases its proportion of specialty ingredients, such as natural sweeteners or plant-based proteins, which command higher pricing, we see profit growth and margin expansion.
Price	**Fair value**	**Uncertainty**	
$84.03	$125.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$5.63	Narrow	Standard	
Company (Ticker)		**Rating**	
Albemarle Corp (ALB)		★★★★	Narrow-moat Albemarle is the largest lithium producer globally. The stock trades in 4-star territory at nearly a 40% discount to our $125 per share fair value estimate. As one of the lowest-cost lithium producers globally, Albemarle is well positioned to maintain decent profit margins even as lithium prices fall. Over the long term, we contend that higher lithium prices will be needed to incentivize lower-quality supply to meet demand from growing adoption of electric vehicles. We view current share prices as an attractive entry point for a quality lithium producer.
Price	**Fair value**	**Uncertainty**	
$76.12	$125.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$8.09	Narrow	Standard	

Source: Morningstar. Data as of June 23, 2020.

Communication Services | The Battered Television and Advertising Businesses Have Created Communications Opportunities

The Morningstar US Communication Services Index has bounced back nicely along with the broader market, gaining 25% since the end of March versus a 23% gain for the Morningstar US Market Index (Exhibit 3a). Facebook, which accounts for about 18% of the sector index, has been the star performer, gaining about 43% over this period and shooting to a 10% premium to our fair value estimate. Traditional telecom stocks, less affected during the market sell-off, have underperformed. AT&T and Verizon, which account for a combined 15% of the index, have gained only about 4% each. Of the two telecom giants, AT&T is more attractive, trading at an 18% discount to our fair value estimate and providing a 7% dividend yield that we believe is sustainable. AT&T has made numerous strategic missteps over the past few years, but we expect it will adhere to a more prudent path under new CEO John Stankey.

The biggest discrepancy between our outlook and the market sits in the traditional media segment. Smaller firms focused on the traditional television market have rebounded somewhat over the past three months but remain far below our fair value estimates in many cases. ViacomCBS, for example, has gained nearly 70% during the current quarter but remains down about 45% year to date and still sits at less than half our fair value estimate. Stocks like AMC Networks, Fox, and Discovery are in similar positions.

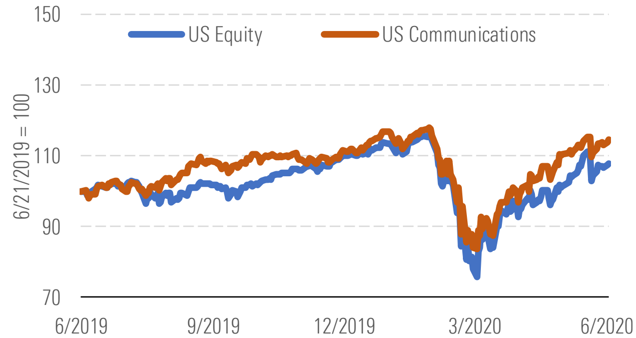
The market appears concerned with two primary factors: the accelerating decline in traditional television customers and the potential for a very sharp drop in advertising revenue during the pandemic. Cable and satellite companies like Comcast and AT&T lost a collective 1.8 million television customers during the first quarter alone, or about 2% of the total (Exhibit 3c). The pay-television market faces several challenges, but we still believe older consumers and dedicated sports fans will lend stability.

On the advertising front, we don't expect television to suffer the same fate as newspapers during the financial crisis, where advertisers failed to return to the medium as the economy recovered. Television remains one of the few ways to reach a large audience simultaneously, and firms are getting better at targeting and measuring ad campaigns. In addition to the media firms, we also believe agencies that help direct ad spending, like Omnicom and Interpublic Group, will see business rebound over the next year, as well.

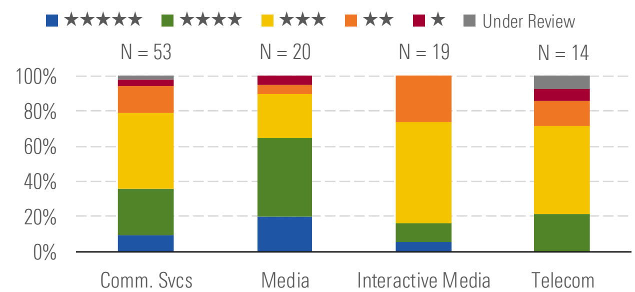
Michael Hodel, CFA | michael.hodel@morningstar.com

Exhibit 3 The Rebound in Communication Stocks Has Been Uneven

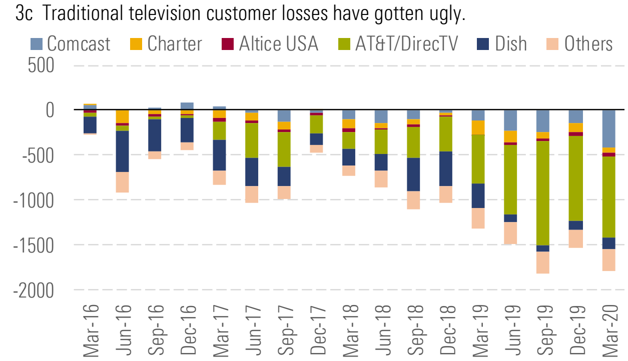
3a The sector has followed the market thanks to winners like Facebook.



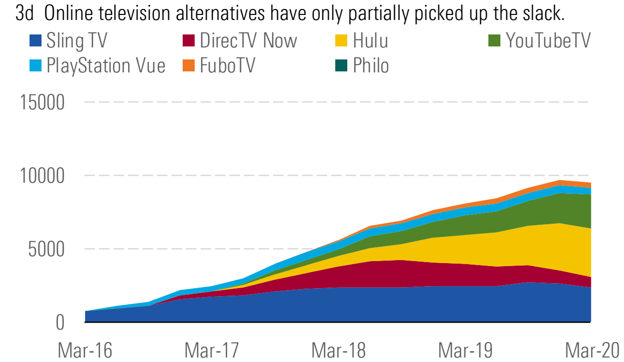
3b Traditional media looks best, especially television-focused firms.



3c Traditional television customer losses have gotten ugly.



3d Online television alternatives have only partially picked up the slack.



Source: Morningstar, company filings.
Data as of June 23, 2020.

Communication Services | Top Picks

Communication Services | Quick Takes

Company (Ticker)		Rating	
Omnicom Group Inc (OMC)		★★★★	We expect Omnicom, the world's second-largest ad agency holding company, will return to growth in 2021. As the economy begins to recover over the next year, ad spending should increase, benefiting Omnicom. Plus, as the firm helps clients navigate the pandemic, the handholding could strengthen its client relationships, resulting in fewer account reviews over the long run. In addition, Omnicom's dividend remains intact, as the firm improved liquidity earlier this year. Given the tight relationship between economic growth and ad spending, any indication of an economic recovery should improve sentiment around this stock.
Price	**Fair value**	**Uncertainty**	
$54.10	$79.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$11.59	Narrow	Standard	
Company (Ticker)		**Rating**	
Comcast Corp (CMCSA)		★★★★	Comcast's core cable business (about 70% of consolidated EBITDA) is in great shape and should see minimal impact from the coronavirus. While television customer losses have worsened, the firm now earns far more profit providing Internet access, where it continues to gain market share. The theme parks and movie businesses will struggle in 2020, but they are relatively small. Longer term, the parks business and movie studio are key assets behind Comcast's media efforts. The Sky acquisition added to Comcast's debt, but the balance sheet remains solid. Net debt is at about 3 times EBITDA versus around 5 times at cable peers Charter and Altice USA.
Price	**Fair value**	**Uncertainty**	
$39.20	$47.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$178.91	Wide	Standard	
Company (Ticker)		**Rating**	
Fox Corp (FOX)		★★★★	By selling Twenty First Century Fox's entertainment assets to Disney in 2019, Rupert Murdoch created a unique media firm, heavily focused on live events, primarily via Fox News, the Fox broadcast network, and FS1. Murdoch has effectively turned Fox into a large-scale bet on his own long-held belief on the value of live sports and news in the U.S. Given their importance to the pay-television bundle, Fox is well-positioned to capitalize on those trends. The recent market sell-off across media has made valuation more attractive, with the shares trading at more than 25% below our fair value estimate.
Price	**Fair value**	**Uncertainty**	
$27.81	$39.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$16.94	Narrow	Standard	

Source: Morningstar. Data as of June 23, 2020.

Consumer Cyclical | As Reopening Begins, Widespread Opportunities Are Available, Especially in Travel and Leisure

Although uncertainty surrounding the coronavirus pandemic affected consumer cyclical companies more than others at its peak, the industry has begun to rebound. Trailing 12-month returns for the sector are up 37% compared with the market's 23% return, which runs in sharp contrast to a quarter ago, when the sector lagged the market's performance by 300 basis points (Exhibit 4a).

Despite the appreciation, we still think the sector offers pockets of value. We continue to see significant opportunity in travel and leisure, with shares in the subsector trading at a median price/fair value estimate discount of more than 20%, with more than half of our coverage trading in 4- or 5-star territory (Exhibit 4b).

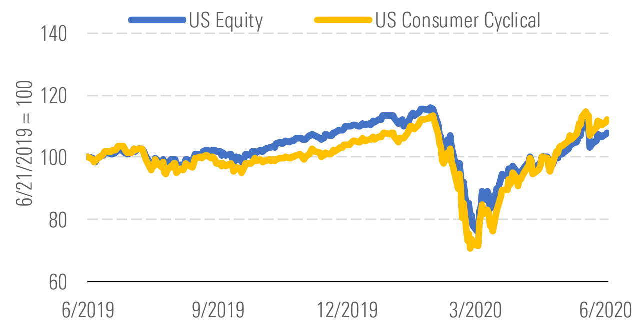
As states start to lift mandatory lockdowns, which has extended to include the reopening of nonessential businesses, we think consumers' pent-up demand could aid the trajectory of these more discretionary operators. This is already playing out, as May retail sales data (up nearly 18% on an adjusted basis month over month) pointed to growth in many areas, including home furnishings, retail apparel and accessories, and automotive parts (Exhibit 4c). While we think the pace of spending could prove lumpy, we believe the bulk of the retraction in consumer spending was likely concentrated in the second quarter, buoying our expectations for further sales gains over the next few quarters.

We also believe consumers are ready to resume consuming food away from home, albeit slowly, as social distancing requirements are relaxed. We're already seeing a moderation in the decline of U.S. chain restaurant transactions and expect these trends to continue into July (Exhibit 4d). As of the beginning of June, over 68% of restaurant units have reopened according to market researcher NPD Group. However, we expect uneven traffic at restaurants in the back half of the year, as they may need to reduce capacity again if a second wave of the pandemic appears, and consumer spending is impaired by still-elevated unemployment. We believe that companies with the scale to be more aggressive on pricing in the near term (value-oriented players tend to outperform during economic shocks) and those with robust mobile platforms and healthy balance sheets (both at the corporate and franchisee level) are best positioned to weather this uneven recovery period.

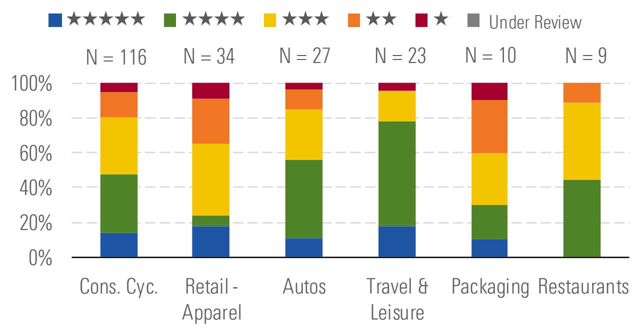
Erin Lash, CFA | erin.lash@morningstar.com

Exhibit 4 Consumer Cyclical Firms Poised to Bounce as Lockdowns Lifted

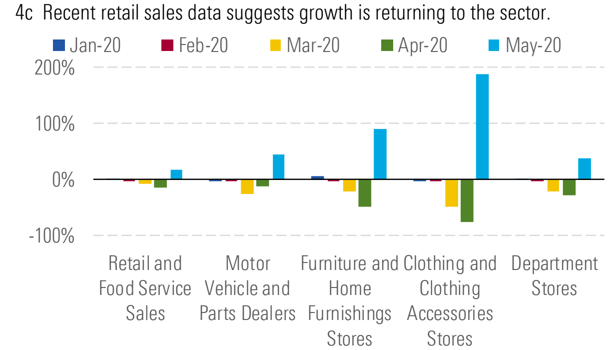
4a The sector has begun to outperform the market.



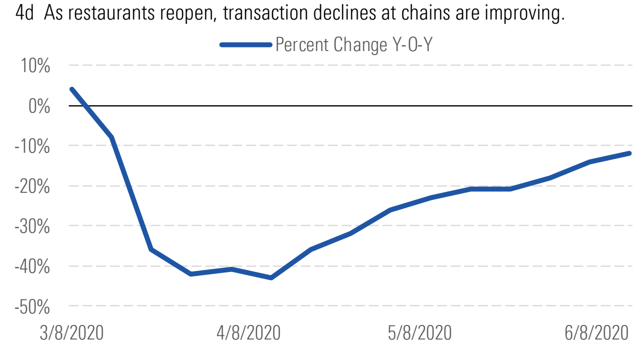
4b But opportunities remain across every subsector.



4c Recent retail sales data suggests growth is returning to the sector.



4d As restaurants reopen, transaction declines at chains are improving.



Source: Morningstar, U.S. Census Bureau, NPD.
Data as of June 23, 2020.

Consumer Cyclical | Top Picks

Consumer Cyclical | Quick Takes

Company (Ticker)		Rating	
Hanesbrands Inc (HBI)		★★★★★	We believe narrow-moat Hanesbrands' transformation is underappreciated, with investors focused on its low-growth innerwear operations and partial dependence on U.S. physical retail. But through a series of acquisitions since 2013, the firm transformed its brand portfolio into a more diversified and global operation with higher returns. While the coronavirus has slammed all apparel firms, we think Hanes may recover faster than most because its products have limited fashion risk, are purchased regularly regardless of economic conditions, and are available in a vast array of retail outlets, some of which didn't close during the pandemic.
Price	**Fair value**	**Uncertainty**	
$11.27	$23.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$3.92	Narrow	Standard	
Company (Ticker)		**Rating**	
Tapestry Inc (TPR)		★★★★★	We view Tapestry as attractive, trading at about a 60% discount to our intrinsic value. Although Tapestry's efforts to fix its Kate Spade and Stuart Weitzman brands have stalled, we believe its successful restructuring of Coach (71% of 2019 revenue) will bolster returns. While the short-term outlook is murky as a result of the pandemic, we don't think Coach's brand strength (the source of our narrow moat rating) or the firm's financial health will be impaired. We expect this brand strength and pricing power to support revenue growth for the firm in the long term, particularly given the opportunity we see to grow the brand in China.
Price	**Fair value**	**Uncertainty**	
$13.78	$35.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$3.80	Narrow	Poor	
Company (Ticker)		**Rating**	
Macy's Inc (M)		★★★★★	Although Macy's has struggled to find growth in recent years as consumers have moved to e-commerce and discount stores and away from department stores, we still believe it is an attractive investment at around a 60% discount to our fair value estimate. Macy's is one of the 10 largest e-commerce companies in the U.S., and its digital sales jumped 80% in May while its stores were closed due to the pandemic. We believe Macy's will close its worst-performing stores soon and that the downsized firm will return to profitability next year. Our long-term view assumes no sales growth but operating margins of about 5%.
Price	**Fair value**	**Uncertainty**	
$7.15	$17.60	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$2.21	None	Standard	

Source: Morningstar. Data as of June 23, 2020.

Consumer Defensive | As Coronavirus Lockdowns Ease, Investors Interested in Consumer Defensive Have a Chance to Gain From an Economic Rebound

The consumer defensive sector trailed the broader market's impressive rebound this quarter, generating an 11.8% return compared with the market's 23.1% gain through June 23 (Exhibit 5a).

Despite this, we think the space has become more heated, such that the median stock in our coverage now trades at just a 1% discount to our fair value estimates (Exhibit 5b). This runs in contrast to the 14% discount the aggregated space boasted three months ago. Consumer packaged goods and nonalcoholic beverages offered bargains at the onset of the pandemic in the U.S., but shares have since bounced. However, we still believe there are values in the sector. Specifically, tobacco and alcoholic beverages provide opportunities, trading at 26% and 16% discounts to our valuations, respectively.

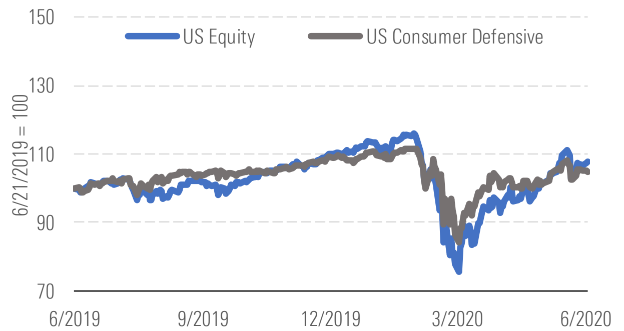
When shelter-in-place mandates were announced, consumers rushed to stock their pantries with essential fare. Because of the rapid rise in purchases, which prompted out-of-stocks or limited supplies of certain items, manufacturers halted previously slated promotions. This is shown in an index (Exhibit 5c) by Numerator, a market research firm, of top promoted grocery products. Compared with the same week in 2019, products sold on promotion across a number of categories since March 2020 are tracking lower, with a reading of under 100 signifying fewer items sold on promotion than the period last year. The initial buying surge has waned and lockdowns have lifted, so items sold on sale have begun to edge higher. We think promotions may persist if a prolonged recession ensues. However, given a lack of switching costs, we think firms across the sector will need to invest in R&D and marketing to ensure their brands and retail relationships aren't impaired.

Protein price increases have been more pronounced since April (Exhibit 5d), which we attribute partially to disrupted production at several meat processing plants due to the spread of COVID-19. These jobs are labor-intensive, with workers in proximity, impeding social distancing efforts. Beef and pork producers have been disproportionately affected (30%-35% industrywide) compared with poultry (4%-5%), as beef and pork plants tend to be larger, with more employees. While increased safety and sanitation costs are likely to persist, beef and pork profit margins should hold up because of lower livestock costs and higher selling prices.

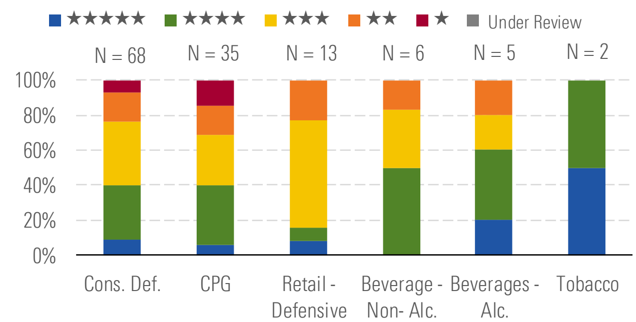
Erin Lash, CFA | erin.lash@morningstar.com

Exhibit 5 Consumer Defensive Trails the Market, but Value Exists

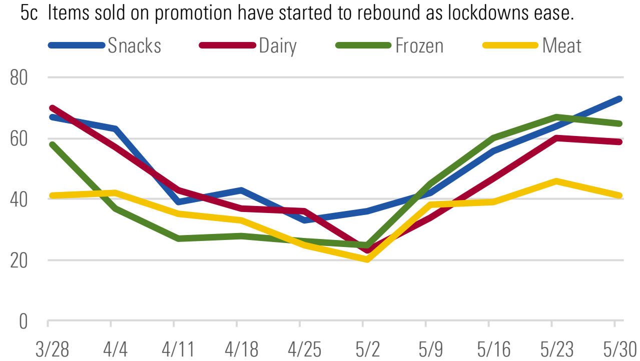
5a Consumer defensive has underperformed the broader market.



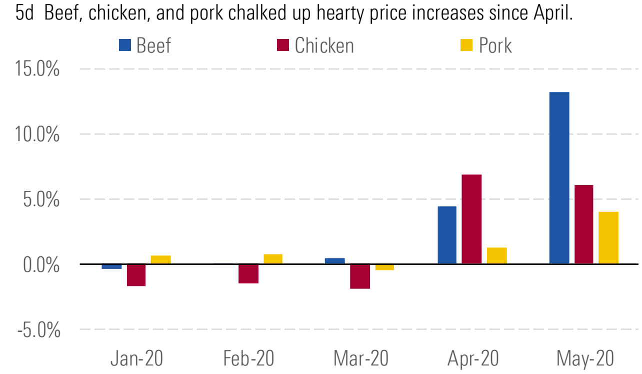
5b Tobacco and alcoholic beverages look most attractive.



5c Items sold on promotion have started to rebound as lockdowns ease.



5d Beef, chicken, and pork chalked up hearty price increases since April.



Source: Morningstar, Numerator, U.S. Department of Agriculture.
Data as of June 23, 2020.

Consumer Defensive | Top Picks

Consumer Defensive | Quick Takes

Company (Ticker)		Rating	
Anheuser-Busch InBev (BUD)		★★★★★	We think investors should consider wide-moat Anheuser-Busch InBev, trading about 50% below our assessment of intrinsic value. Although sales have taken a hit from coronavirus disruptions, we expect revenue to pick up when social distancing guidelines are relaxed (about 33% of 2019 sales were on-premises) and to grow high single digits in 2021. AB InBev is the most leveraged among the brewing group, but we think the firm has enough liquidity to operate through the pandemic. We believe the firm is well positioned for the long term, with monopolylike positions and cost advantages in developing markets that continue to generate value.
Price	**Fair value**	**Uncertainty**	
$52.10	$96.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$102.31	Wide	Exemplary	
Company (Ticker)		**Rating**	
Pilgrims Pride Corp (PPC)		★★★★★	We consider Pilgrim's Pride an attractive investment, with shares trading almost 50% below our fair value estimate. Pilgrim's CEO has temporarily stepped aside after being indicted on criminal charges of price fixing, with the trial set for August, but we think the business remains attractive. We believe Pilgrim's is poised to benefit from China removing its ban on imports of U.S. chicken and from the global protein shortage caused by African swine fever. And even amid the coronavirus pandemic and its 50% food-service exposure (which skews toward quick-service restaurants), we expect strength in retail to largely offset weak restaurant sales.
Price	**Fair value**	**Uncertainty**	
$17.87	$34.50	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$4.41	None	Standard	
Company (Ticker)		**Rating**	
US Foods Holdings Corp (USFD)		★★★★★	Shares of no-moat US Foods trade around a 40% discount to our intrinsic value. Consumers avoided away-from-home food consumption during the pandemic, and as such, the food-service industry slowed, which hasn't spared any operator. Despite the hit to sales, we expect US Food's growth to gradually improve in the second half of 2020 as customers revert to prior habits. And we don't believe this slowdown has hampered its liquidity profile. Although we've ratcheted back our fair value estimate for US Foods by 17% since the start of the pandemic, shares are down 54% year to date, creating an attractive opportunity.
Price	**Fair value**	**Uncertainty**	
$20.70	$31.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$4.56	None	Standard	

Source: Morningstar. Data as of June 23, 2020.

Energy | Energy Stocks Have Rallied From March Lows, but the Sector Still Looks Cheap

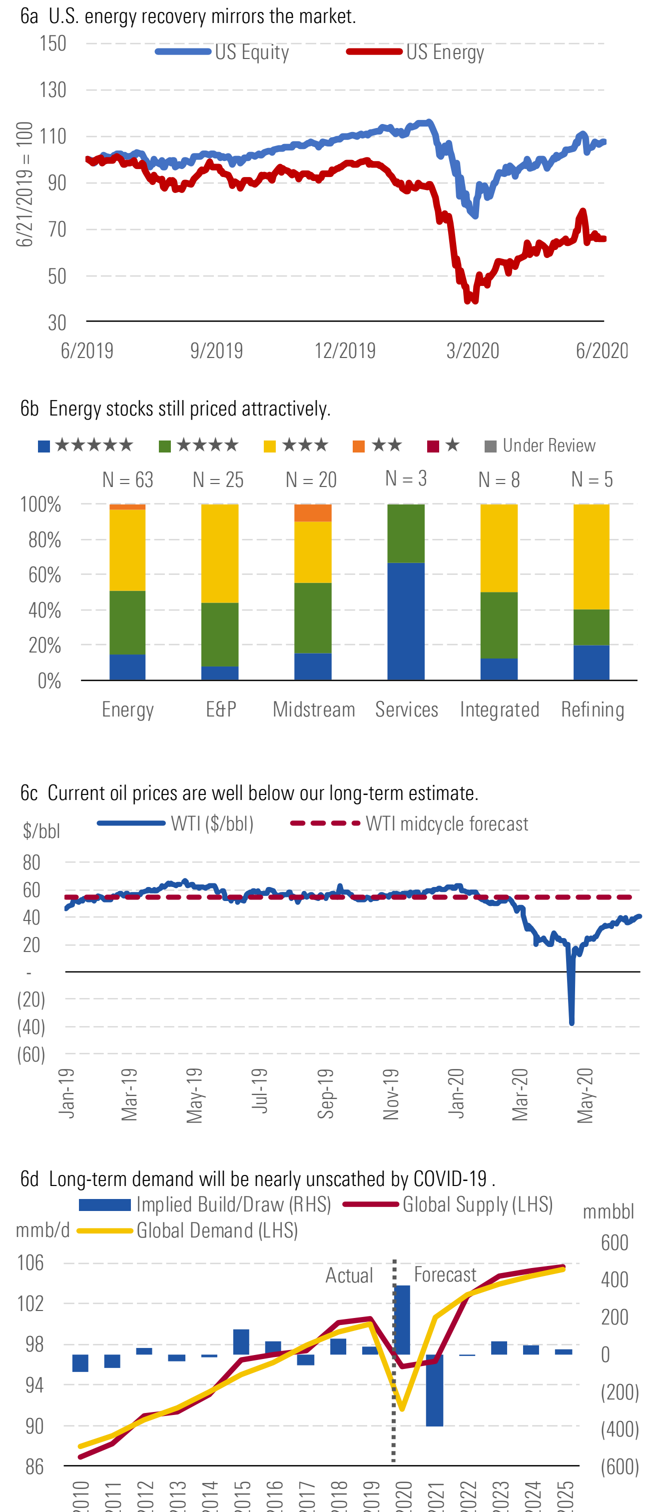
The energy industry still faces a very difficult environment, but the outlook brightened somewhat during the second quarter. The Morningstar US Energy Index mirrored the broader market rebound, gaining 37% in the period. And oil prices rallied sharply, with the West Texas Intermediate benchmark roughly doubling since the end of March. But by and large, the sector remains undervalued and trades at a 23% discount (Exhibit 6b).

The worst of the pandemic-related collapse in oil and gas consumption is probably behind us, given that most economies around the world are showing signs of reopening. In the U.S., reduced social distancing and unprecedented fiscal stimulus should continue to support the recovery in the second half of 2020. And on the supply side, OPEC and its partners have U-turned after recklessly launching a price war in March and have now pledged substantial production cuts (collectively withholding almost 10 million barrels per day). Producers outside OPEC are also tightening their belts and truncating growth plans. In the U.S., the number of active horizontal drilling rigs has fallen by almost two thirds since the end of March, which means domestic output is likely to decline by 1.5 mmbpd over the course of 2020.

These cutbacks won't stop crude stockpiles from ballooning temporarily, but we still expect inventories to drift back to normal levels during 2021. Accordingly, we see no reason to change our midcycle price estimates of $55/bbl WTI and $60/bbl Brent. U.S. shale is still the marginal producer in our global framework, and the shale business model does not work in the current price environment. Without a rebound in oil prices, producers will have no incentive to grow their production or even replace declines, resulting in a downward spiral for supply that could eventually turn the current glut into a shortage. But prices cannot sustainably exceed our midcycle forecasts, either. Shale wells today are much cheaper on a per barrel basis than the large, complex megaprojects that would have set prices in a world without U.S. shale. Over the long run, we think U.S. shale well cost inflation will remain subdued, due to the no-moat nature of many shale services, and that wider adoption of current technologies coupled with decades of attractive drilling opportunities will cap unit costs.

Dave Meats, CFA | david.meats@morningstar.com

Exhibit 6 Outlook Brightening for Oil and Energy Stocks



Source: Morningstar data and estimates, EIA.
Data as of June 23, 2020.

Energy | Top Picks

Energy | Quick Takes

Company (Ticker)		Rating	
Enterprise Products Partners LP (EPD)		★★★★	Enterprise Products Partners is well positioned to deal with the industry downturn over the next one to two years. The partnership has liquidity of $8 billion compared with $2.3 billion in maturities through the end of 2021, and 78% of its customer base is investment-grade. Fee-based earnings make up 80%-90% of earnings. Take-or-pay commitments make up 45%-55%, more resilient areas such as storage and demand-driven pipeline exposure make up about 20%-30%, and volume-exposed fees make up the balance.
Price	**Fair value**	**Uncertainty**	
$19.02	$25.50	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$41.57	Wide	Exemplary	
Company (Ticker)		**Rating**	
Schlumberger Ltd (SLB)		★★★★★	Schlumberger remains our top oilfield-services pick. Thanks to its strong balance sheet and focus on less-volatile international markets, we expect it to weather the storm facing oil markets over the next two years. Investors shouldn't be discouraged by the temporary dividend cut, which is a wise precautionary move given the severe near-term industry environment. In the long run, we think Schlumberger will benefit from secular growth in international capital expenditures. Also, we think the company is poised to gain market share and improve margins via its efficiency-boosting integrated and performance-linked project initiatives.
Price	**Fair value**	**Uncertainty**	
$19.57	$48.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$27.16	Narrow	Exemplary	
Company (Ticker)		**Rating**	
Enbridge Inc (ENB)		★★★★	We see over 30% upside in wide-moat Enbridge's stock. We think uncertainty surrounding long-term Mainline utilization has made investors tentative. In our view, the market underappreciates the long-term cash flows from the Mainline. We anticipate that all three major Canadian pipeline expansion projects will be built by the end of 2023. This naturally creates concerns about the utilization of Enbridge's Mainline system. Even though producers look to cut capital spending, we still expect growth when crude prices reach our forecast midcycle levels. We think advancements associated with solvent-assisted technology will lower oil sands break-evens, leading to long-term Canadian production that will surprise to the upside and add 1.3 million barrels of oil per day over the next decade. Investors shouldn't expect Mainline underutilization to last long, as we expect it to operate near full capacity as supply ramps up to our forecast levels by 2026. Enbridge offers an attractive dividend, which is yielding around 7% at current levels.
Price	**Fair value**	**Uncertainty**	
$30.93	$40.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$62.43	Wide	Standard	

Source: Morningstar. Data as of June 23, 2020.

Financial Services

After the Recent Run in Stock Prices, Investors Need to Be More Careful With Financials

The Morningstar US Financial Services Index has significantly underperformed the Morningstar US Market Index over the previous year, down 5.7% compared with an increase of 7.7% (Exhibit 7a). However, the U.S. financial sector has had a strong recovery over the previous quarter, up 19% compared with the market's 23%. Even with the recent increase in stock prices, the median North American financial sector stock still trades at an 11% discount to its fair value estimate but below a 30% discount a quarter ago. With our assessment that many financial sector stocks are less undervalued than they were a quarter ago, investors should be much more discerning of which stocks they choose and cognizant of the risks they're taking.

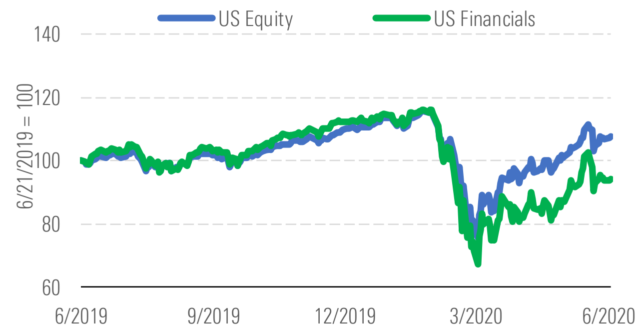
We continue to believe that the most undervalued industry in the North American financial sector is banks. For banks, two of the primary drivers of their valuation are interest rates and loan losses. Interest rates will likely stay low for an extended period. According to the U.S. Federal Open Market Committee's dot plot from June 2020, members believe the federal-funds rate should stay in the 0% to 0.25% range through 2022 (Exhibit 7c). While banks increased their allowance for loan losses in the first quarter of 2020 and we expect them to continue provisioning for pandemic-related loan losses in the second quarter, loan charge-offs have remained muted (Exhibit 7d). We believe that the up to $1,200 stimulus checks, $600 of additional unemployment benefits, and loan- and rent-payment forbearance have delayed banks from charging off loans. If further government stimulus isn't passed, such as an extension of enhanced unemployment benefits past July, charge-offs could spike in the second half of 2020. We believe that banks have enough capital to survive these near-term negatives and that they can be suitable for long-term investors.

Outside of banks, we see fewer bargains in the financial sector. The investment-management firms we considered undervalued at the end of the first quarter are mostly fairly valued after the run in the stock market. The median North American insurer we cover also trades at around an only 8% discount to its fair value estimate, which is a relatively small margin of safety, given the insurance industry's exposure to interest rates, asset prices, and tail risk of large insurance claims from the pandemic.

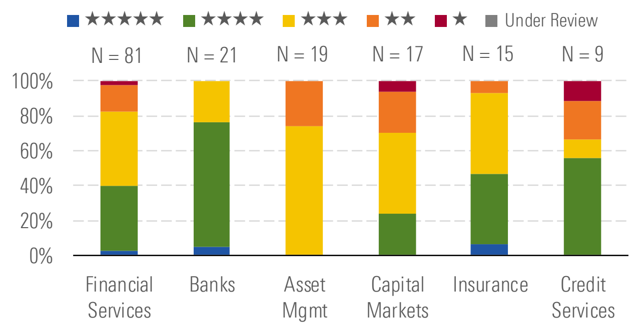
Michael Wong, CFA, CPA | michael.wong@morningstar.com

Exhibit 7 Earnings Headwinds Are Likely; Financials Are Fairly Valued

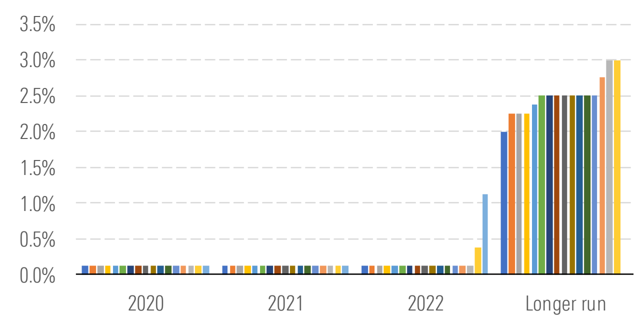
7a Financials made a comeback in the previous quarter.



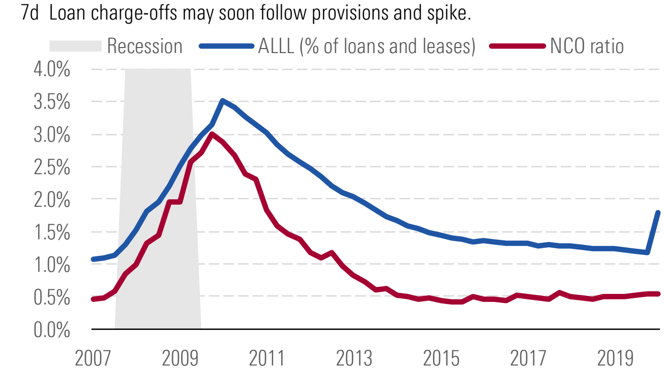
7b After run in the market, most financials are fairly valued.



7c Interest rates likely to be lower for longer.



7d Loan charge-offs may soon follow provisions and spike.



Source: Morningstar, U.S. Federal Reserve.
Data as of June 23, 2020.

Financial Services | Top Picks

Financial Services | Quick Takes

Company (Ticker)		Rating	
American International Group (AIG)		★★★★★	AIG CEO Brian Duperreault was a primary architect behind peer Chubb's strong franchise that has generated industry-leading underwriting margins. He pledged that AIG would generate an underwriting profit in 2019, and the company achieved that goal. With steady improvement in underwriting results in recent quarters and recently unveiling a plan to take out $1 billion in costs by 2022, we believe AIG is gradually trending toward peer results. However, in the near term, progress will likely be obscured by coronavirus-related claims on the property and casualty side of the business and capital markets pressure on AIG's life insurance operations.
Price	**Fair value**	**Uncertainty**	
$32.05	$59.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$27.60	None	Standard	
Company (Ticker)		**Rating**	
Berkshire Hathaway Inc (BRK.B)		★★★★	We remain impressed with Berkshire Hathaway's ability to generate high-single- to double-digit growth in book value per share. Believing it will take some time before the firm succumbs to the impediments created by its size, and that the ultimate departure of CEO Warren Buffett and Vice Chairman Charlie Munger will have less of an impact than many may believe, we're always looking for opportunities to put money to work in the name. Berkshire has a ton of cash on hand, with the potential to repurchase a ton of stock, making it an ideal defensive name in a slowing economy or down market.
Price	**Fair value**	**Uncertainty**	
$181.01	$228.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$440.68	Wide	Exemplary	
Company (Ticker)		**Rating**	
Truist Financial Corp (TFC)		★★★★	We believe Truist is in a unique situation. The bank recently underwent a major merger of equals before the COVID-19 downturn started, which may explain why the name trades at a larger discount. However, recent commentary from management about its ability to keep cost synergies on pace, BB&T's historically strong credit underwriting, and the combined bank's strong overall banking franchise lead us to have confidence that the bank can withstand the upcoming downturn and that it will emerge stronger once it's over. As such, we see an attractive risk/reward for Truist's shares at today's prices.
Price	**Fair value**	**Uncertainty**	
$40.04	$54.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$53.95	Narrow	Standard	

Source: Morningstar. Data as of June 23, 2020.

Healthcare

Healthcare Sector Valuations Less Appealing Following Robust Market Rebound

Morningstar's US Healthcare Index has increased 12% over the trailing 12 months, as global concerns regarding the coronavirus eased significantly in the second quarter (Exhibit 8a). Additionally, the returns have outperformed the broader equity market performance of an 8% gain. We believe the solid underlying fundamentals of the healthcare sector are supporting the returns. Also, the defensive nature of healthcare is likely supporting relative returns, as concerns around recessions and other coronavirus impacts weigh more heavily on other sectors. On the policy front, we expect investor attention to return to potential changes in the U.S. with the upcoming elections. However, the fears of major healthcare policy change in the U.S. appear to have faded, with the more moderate Joe Biden the presumptive Democratic nominee for president.

Overall, we view the healthcare sector as slightly overvalued following the recent market rebound. Our coverage trades at a premium to our overall estimate of intrinsic value, with the median price/fair value at 1.06. Given strong recent market gains, we see fewer buys in the sector, with less than a fourth of our coverage rated 4 or 5 stars (Exhibit 8b). However, the most undervalued firms are in the drug manufacturer and managed-care industries.

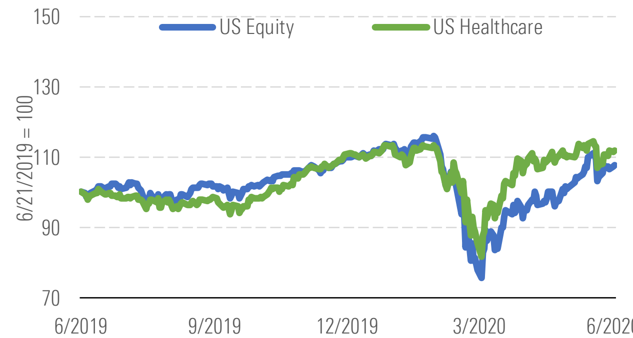
On coronavirus impact, we see fewer negative headwinds to the drug and managed-care industries as patients prioritize drug therapy and avoid costly elective surgeries that can weigh on managed-care margins. Conversely, we expect increased negative pressure to the device, dental, life sciences, and hospital industries as patients avoid in-office visits and hospitals reduce capacity to perform high-margin elective procedures.

We expect the healthcare group to emerge largely unscathed from the recession related to the coronavirus over the long term, as healthcare demand is less sensitive to the economy. In the last recession, the drug and biotech groups held up well (Exhibit 8c). Additionally, we expect the duration of the coronavirus pandemic and related economic pressures to ease by 2021 largely due to the strong progress with vaccine development (Exhibit 8d). However, we don't expect these vaccines will drive major cash flows for the drug companies due to likely pricing at nonprofit or near nonprofit levels. Nevertheless, we expect the drug industry to use the goodwill generated in creating the vaccines to help in long-term drug pricing negotiations.

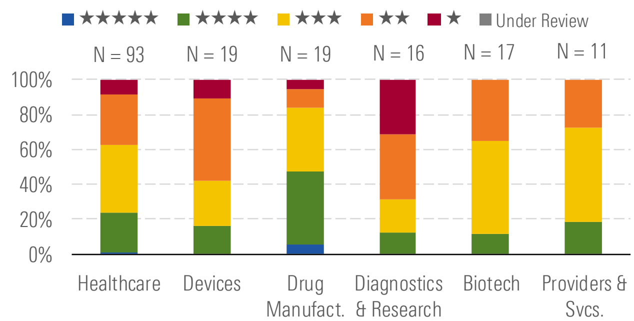
Damien Conover, CFA | damien.conover@morningstar.com

Exhibit 8 Healthcare Sector Has Outperformed Over Past 12 Months

8a Healthcare sector index versus market index.



8b Star rating distribution and average P/FV for sector and key industry groups.



8c Big Pharma and Biotech revenue and income held up in last recession.

	2006	2007	2008 (Recession)	2009 (Recession)	2010
U.S. GDP growth (annual %)	2.9%	1.9%	*-0.1%*	*-2.5%*	2.6%
World GDP Growth (annual %)	4.4%	4.3%	*1.9%*	*-1.7%*	4.3%
Big Pharma and Big Biotech Median Growth					
Revenue Worldwide	7%	8%	*7%*	*6%*	6%
Operating Income	8%	9%	*11%*	*11%*	5%

8d Leading coronavirus vaccine candidates and expected timelines.

Firm/Treatment	Start Phase 3	Accelerated Approval	2021 Capacity (Doses)
Moderna's mRNA-1273	July	December	500 million-1 billion
AstraZeneca's AZD1222	August	Early 2021	2 billion
Pfizer/BioNTech's BNT162	August	Early 2021	Several hundred million
J&J's Ad26.COV2-S	September	Early 2021	More than 1 billion
Novavax's NVX-CoV2373	October	Early 2021	More than 1 billion
CureVac vaccine	October	Early 2021	Several hundred million
Sanofi/Glaxo's vaccine	Early 2021	Mid-2021	1 billion

Source: Morningstar, World Bank, and company filings.
Data as of June 23, 2020.

Healthcare | Top Picks

Healthcare | Quick Takes

Company (Ticker)		Rating	
Pfizer Inc (PFE)		★★★★	The market is underappreciating Pfizer's next-generation drugs, which should drive strong long-term growth. Further, the pipeline drugs focus on areas of unmet medical need where pricing power is strong. Additionally, the company is facing very few major patent losses over the next five years, which should also support steady growth. Lastly, the divestment of the established products group Upjohn to Mylan creates a new entity with robust cash flows, likely supporting a strong dividend. Also, we expect Pfizer's operations to be more immune to disruptions caused by coronavirus outbreaks.
Price	**Fair value**	**Uncertainty**	
$32.77	$42.50	Low	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$182.03	Wide	Standard	
Company (Ticker)		**Rating**	
Intercept Pharma Inc (ICPT)		★★★★	We believe that Intercept's obeticholic acid, or OCA, will be the first approved drug for nonalcoholic steatohepatitis, a serious but common liver disease with limited treatment options. We estimate that the NASH market could grow to over $4 billion in 2023 on a probability-weighted basis. Given OCA's strong efficacy, we think Intercept is likely to take the majority of patient share in this lucrative market until better competitors enter the market in 2022. We think the market is overly concerned about OCA's side effects and believe that Intercept's OCA, if approved in 2020, will enjoy several years of strong returns.
Price	**Fair value**	**Uncertainty**	
$81.88	$153.00	Very High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$2.70	None	Standard	
Company (Ticker)		**Rating**	
CVS Health Corp (CVS)		★★★★	The firm's combination with Aetna should put the company in a much more attractive competitive position as the industry moves toward a more integrated service offering. Investors should benefit from meaningful cost and selling synergies associated with the combination of a leading medical benefits business with the largest PBM and retail pharmacy network in the country. However, the social distancing period caused by the coronavirus is a concern for the retail business, but we don't forecast this as a long-term headwind.
Price	**Fair value**	**Uncertainty**	
$64.43	$92.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$84.22	Narrow	Standard	

Source: Morningstar. Data as of June 23, 2020.

Industrials

Industrials Rebound as the U.S. Reopens; We See Opportunities Across Aerospace and Defense, Construction, and Distribution

The Morningstar US Industrials Index has significantly underperformed the broader U.S. equity market over the trailing 12 months, falling 7.6% compared with the Morningstar US Market Index's 7.7% year-to-date gain (Exhibit 9a). Most industries represented in the industrials index have underperformed year to date; however, aerospace and defense, construction and construction machinery, and airline stocks were hit particularly hard as investors worried about the coronavirus' long-term impact on air travel and the broader economy. However, as COVID-19 restrictions eased across the United States and signs of an economic recovery began to emerge, investor sentiment in the industrials sector greatly improved. The Morningstar US Industrials Index increased 18% quarter to date, trailing the broader U.S. equity market by 470 basis points (Exhibit 9a).

After a steep decline in April, industrial production modestly rebounded in May as the U.S. economy began to reopen (Exhibit 9c). Manufacturing increased 3.8% month over month; automobile and aerospace and transportation manufacturing increased 120.8% and 8.1%, respectively. We expect industrial production will continue to rebound as the U.S. economy recovers, which will benefit manufacturing and industrial distribution companies. The housing market has been a bright spot during the pandemic, and some forward-looking indicators, such as purchase mortgage applications, point toward a V-shape housing recovery. In addition to a rebounding U.S. housing market, a potential infrastructure bill would be a boon for construction-oriented industrials companies.

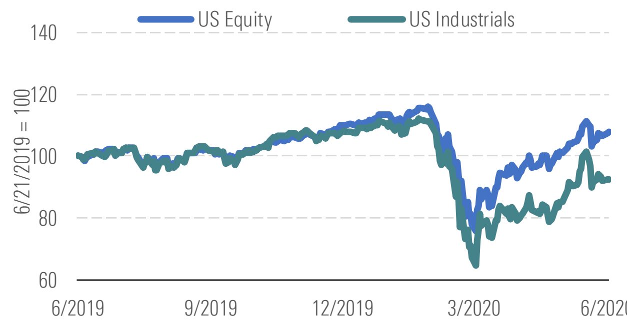
While U.S. air travel is still significantly below prior-year levels, demand has been increasing since mid-April (Exhibit 9d) as more Americans set aside coronavirus fears and return to the skies. If this trend continues like we expect, we see upside for many airline and aerospace and defense stocks.

After strong quarter-to-date sector stock performance, only about 20% of our U.S. industrials coverage looks undervalued to us; last quarter, about 70% of our coverage had 4- or 5-star ratings. Still, we see attractive investment opportunities across the aerospace and defense, construction, and industrial distribution industries.

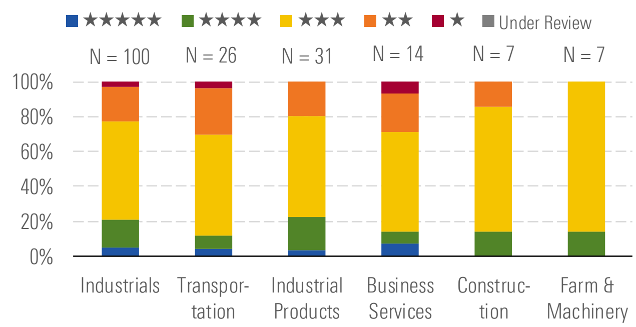
Brian Bernard, CFA | brian.bernard@morningstar.com

Exhibit 9 Investor Sentiment Has Improved Across Industrials Coverage

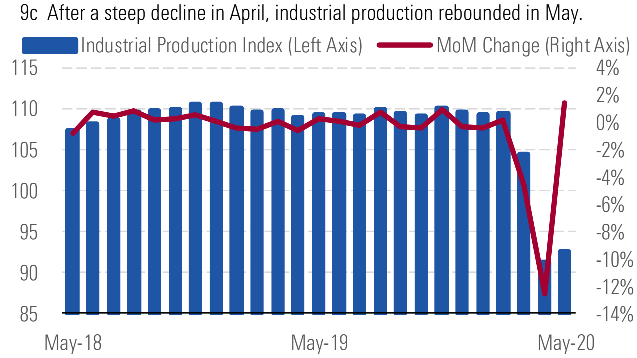
9a Despite recent rally, industrials have underperformed year to date.



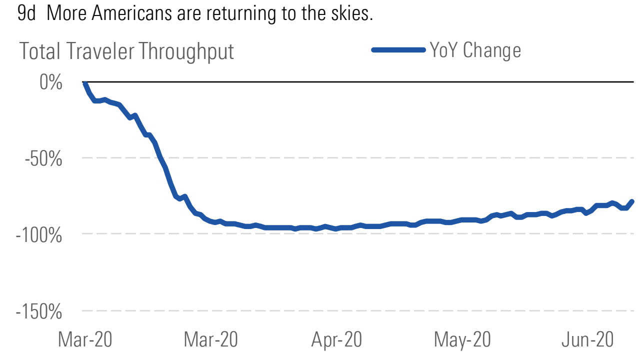
9b About 20% of our U.S. industrials coverage is 4 or 5 stars.



9c After a steep decline in April, industrial production rebounded in May.



9d More Americans are returning to the skies.



Source: Morningstar, Federal Reserve Bank of St. Louis, Deere.
Data as of June 23, 2020.

Industrials | Top Picks

Industrials | Quick Takes

Company (Ticker)		Rating	
Crane Co (CR)		★★★★★	Crane, which owns a portfolio of moaty, leading-market-share businesses that manufacture highly engineered, mission-critical products, remains one of the most undervalued stocks in our industrials coverage. Market sentiment has rapidly turned negative on the narrow-moat company because of its exposure to both the aerospace and the oil and gas end markets. We acknowledge that the company faces multiple near-term headwinds; however, we think plenty of bad news is already priced in at current levels, and shares are trading at an attractive margin of safety for long-term investors.
Price	**Fair value**	**Uncertainty**	
$55.46	$80.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$3.22	Narrow	Standard	
Company (Ticker)		**Rating**	
Herc Holdings Inc (HRI)		★★★★★	Herc Holdings is the third-largest equipment rental company in North America, with 3% market share, trailing United Rentals and Sunbelt Rentals. COVID-19 affected many elements of Herc's business in late March and April, and rental revenue declined as much as 25%. However, construction has continued in many geographies, and infrastructure development has proceeded largely without interruption and could increase significantly as a result of future stimulus packages advocated by President Donald Trump. These projects will require large amounts of equipment and, given the uncertainty, rentals may be favored over purchases.
Price	**Fair value**	**Uncertainty**	
$28.53	$49.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$0.83	None	Standard	
Company (Ticker)		**Rating**	
WESCO International Inc (WCC)		★★★★★	Wesco recently acquired Anixter International. At over $17 billion in sales, the combined entity will dwarf W.W. Grainger as the largest U.S.-based industrial distributor. Wesco's $200 million cost synergy target seems like an achievable goal, and we also see opportunities for revenue synergies (from cross-selling and enhanced pricing power) and improved capital efficiency as digitalization efforts promote a shorter cash conversion cycle. We think investor sentiment will become more favorable for Wesco as the market begins to realize the growth, earnings power, and free cash flow generation potential of the combined entity.
Price	**Fair value**	**Uncertainty**	
$37.22	$87.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$1.86	Narrow	Standard	

Source: Morningstar. Data as of June 23, 2020.

Real Estate

Real Estate Has Declined More Than the Broader Equity Markets, but We See the Best Values Among the Hardest-Hit Subsectors

The Morningstar US Real Estate Index fell 8.7% over the trailing 12 months (Exhibit 10a) and is underperforming the broader U.S. equity market by 16.4%, as the sector has not shown the same recovery in the second quarter as the broader equity market. However, real estate performance has diverged significantly by subsector. The real estate sector is currently trading at a significant discount. Our coverage currently trades at a 19% discount to our estimate of intrinsic value compared with a 3% premium on average at the end of the fourth quarter. Currently, the real estate sector is 18% 5-star and 32% 4-star, with only 18% of the total sector trading in either a 1-star or 2-star range (Exhibit 10b).

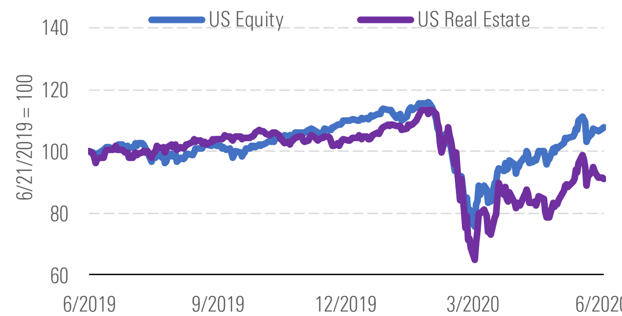
The average dividend for real estate firms is higher than the rest of our coverage (Exhibit 10c). To receive tax-free status, REITs are required to pay out most of their net income as dividends to shareholders, so these companies are frequently included in portfolios of income-oriented investors. As a result of the recent equity sell-off, dividend yields have dramatically increased. We currently believe that most REITs will continue to pay their dividend, making these high yields very attractive to investors.

We have seen significant bifurcation in the performance of the different real estate subsectors. Sectors that are more sensitive to the impacts of the coronavirus have seen significantly worse total return performance year to date (Exhibit 10d). Global travel restrictions and lingering fears of the virus spreading have caused massive occupancy declines for the hotel industry. Malls across the country were closed for several months, and consumers are only slowly returning to stores as the country reopens. The virus has a higher lethality rate among the senior population, affecting occupancy at healthcare companies exposed to senior housing. All three sectors have underperformed the broader real estate sector. Meanwhile, while the industrial and self storage sectors declined initially, they have outperformed the broader real estate sector, and the industrial sector has produced a positive return year to date in 2020. These sectors are outperforming, as they should be relatively insulated from the worst effects of the virus on the global economy. That said, we currently see some of the best values among the hardest-hit subsectors. Given our long-term outlook, we believe that the hotel, mall, and healthcare sectors will rebound and see years of strong growth once the global crisis is over.

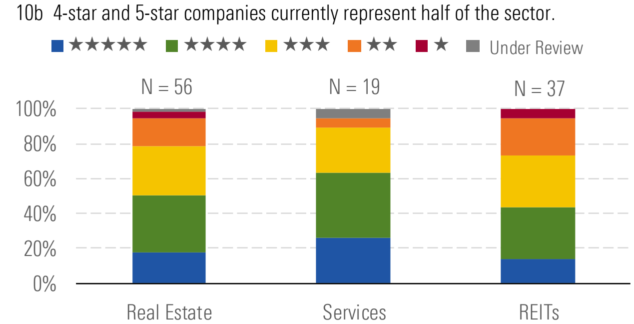
Kevin Brown | kevin.brown@morningstar.com

Exhibit 10 Real Estate Sold Off Due to Hard-Hit Subsectors

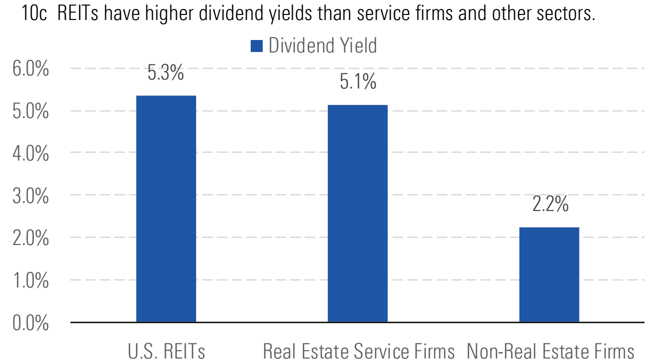
10a Real estate is down and has underperformed the global equity index.



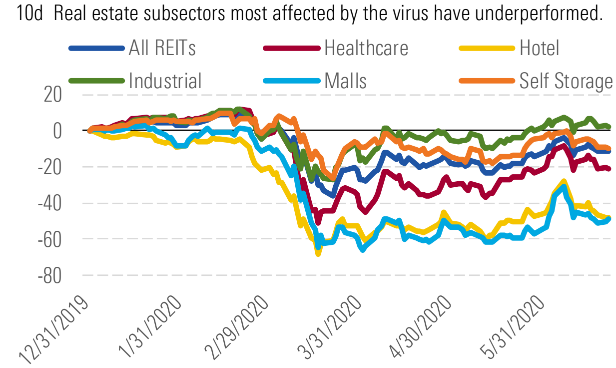
10b 4-star and 5-star companies currently represent half of the sector.



10c REITs have higher dividend yields than service firms and other sectors.



10d Real estate subsectors most affected by the virus have underperformed.



Source: Morningstar, S&P Global.
Data as of June 23, 2020.

Real Estate | Top Picks

Real Estate | Quick Takes

Company (Ticker)		Rating	
Simon Property Group Inc (SPG)		★★★★★	Class A malls continue to outperform other forms of brick-and-mortar retail. Over the 12 months ending in February, Simon's tenants produced 6.5% sales per square foot growth, and the company ended the first quarter of 2020 with a healthy 94% occupancy level. The stock has sold off significantly over the past few months as fears of the coronavirus impact on brick-and-mortar retail sales grew among investors. Simon has long-term leases with tenants, so it should continue to receive rent even during the current crisis. While many weaker retailers may go bankrupt because of the lack of sales, we think Simon's attractive portfolio will be able to quickly fill any vacancies.
Price	**Fair value**	**Uncertainty**	
$70.13	$154.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$21.44	None	Exemplary	
Company (Ticker)		**Rating**	
Pebblebrook Hotel Trust (PEB)		★★★★	Global travel bans and fears of traveling have significantly affected the hotel industry. We think that Pebblebrook's upper upscale hotel portfolio could see almost a 50% decline in revenue in 2020 and a nearly 100% decline in operating profit. However, we think that the industry should rebound, with several years of strong growth, and the company should eventually return to 2019 peak levels. While we have lowered our outlook for the company, we think that the recent sell-off in the name is overdone, given our long-term outlook for the hotel industry.
Price	**Fair value**	**Uncertainty**	
$13.96	$23.50	Very High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$1.83	None	Exemplary	
Company (Ticker)		**Rating**	
Ventas Inc (VTR)		★★★★	Ventas owns high-quality assets in the senior housing, medical office, and life science fields. While the company's medical office and life science portfolios should be relatively unaffected by the coronavirus outbreak, the senior housing portfolio is likely to experience a very significant impact to occupancies, as the virus has the highest lethality rate among senior citizens. However, while the coronavirus will stunt net operating income for the industry in 2020 and potentially 2021, the industry should see strong long-term growth from the coming demographic wave of baby boomers aging into senior housing facilities.
Price	**Fair value**	**Uncertainty**	
$35.46	$50.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$13.23	None	Exemplary	

Source: Morningstar. Data as of June 23, 2020.

Technology

Tech Stocks Have Outperformed the Broader Market in 2020, but Buying Opportunities Are Now Rare

Like the broader stock market, technology stocks sold off at the end of the first quarter over concerns about the coronavirus but rebounded sharply thanks to renewed optimism around the economic damage from the pandemic. That said, the long-term tech story is compelling, as the pandemic might be accelerating the trend toward cloud computing, remote working, and other technology productivity solutions. As of June 23, the Morningstar US Technology Index was up 35% on a trailing 12-month basis, vastly outperforming the U.S. equity market, which is up 7.7% in the same period (Exhibit 11a). Over the past three months, tech readily outperformed the broader market during the COVID-19 rebound, up 31.4% compared with the broader U.S. equity market, which was up 23.1% as of June 23. Before coronavirus concerns, tech stocks fared well in late 2019, with optimism about a resolution to the U.S.-China trade wars that weighed on the sector in late 2018 and at times in 2019.

As of June 23, the median U.S. technology stock was 6% overvalued, a dramatic reversal from the attractive opportunities three months ago when the sector was 20% undervalued. We see very few buy ideas today, similar to the months immediately before the pandemic. Hardware is still the cheapest subsector, with the median stock 5% undervalued today. However, the higher-quality names under our coverage tend to be in semiconductors and software. While both sectors were nicely undervalued a quarter ago, both have rebounded, and the median stock in both subsectors are now 12% overvalued (Exhibit 11b).

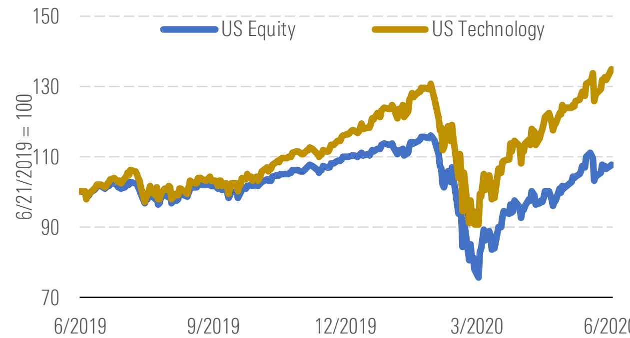
A quarter ago, amid the broader market sell-off, we saw buying opportunities across high-quality software names. We're especially fond of their business models, as these firms generate revenue on a subscription basis with little risk of cancellations, even as work shifts to homes and away from the office. Software was also resilient during the credit crisis (Exhibit 11c), and if there is another round of coronavirus shutdowns, we would again look toward software as a safe haven.

Cybersecurity also appears to be a bit of a haven. Besides the subscription revenue model, additional solutions are being deployed as more people work remotely. The risk for bad actors disrupting data traffic won't slow down any time soon, so IT departments will remain proactive in monitoring its various software and solutions that each employee needs to be productive. We think the $100 billion-plus cybersecurity market will grow at a five-year CAGR of 9% (Exhibit 11d).

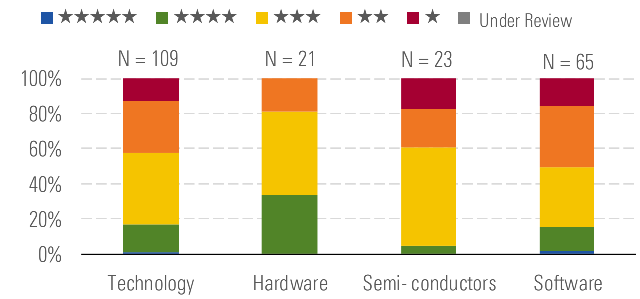
Brian Colello, CPA | brian.colello@morningstar.com

Exhibit 11 Tech Remains an Outperformer in 2020

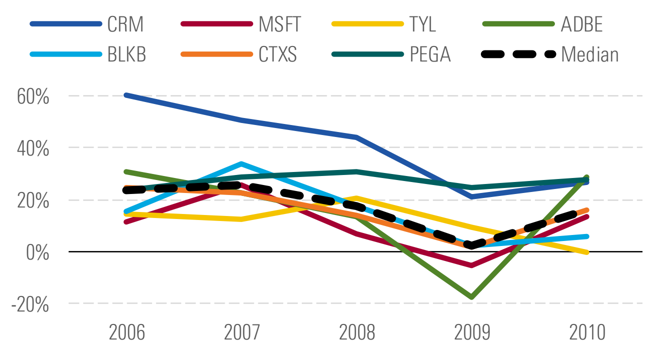
11a Tech outperformed broader market in both the recent sell-off and rebound.



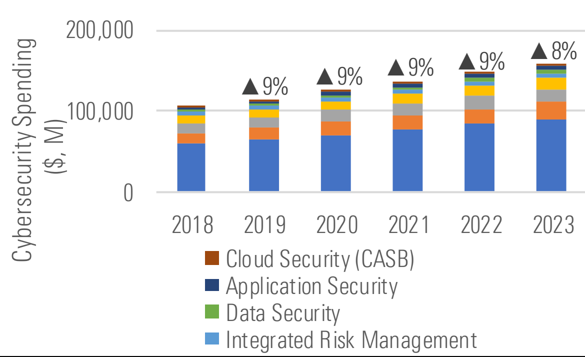
11b Tech has now rebounded after the COVID-19-driven sell-off.



11c Sample of software firms in '08-09 point to robust revenue amid a recession.



11d Cybersecurity spending should rise at a 9% CAGR through 2023.



Source: Morningstar, Gartner, PitchBook.
Data as of June 23, 2020.

Technology | Top Picks

Technology | Quick Takes

Company (Ticker)		Rating	
Cognizant Technology (CTSH)		★★★★	We see an attractive long-term investment opportunity in narrow-moat Cognizant Technology Solutions, as we think the market has overcompensated for the effects of the coronavirus and the company's recent Maze ransomware attack. We recognize that 2020 will be a tough year for Cognizant, as we expect that IT discretionary spending will suffer and the company will have to endure increased costs to mitigate and further secure its systems after the Maze attack. However, we think that Cognizant is well positioned in the long term to keep pushing its reputation past a back-office outsourcer to higher-value technical offerings.
Price	**Fair value**	**Uncertainty**	
$55.20	$70.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$29.84	Narrow	Standard	
Company (Ticker)		**Rating**	
Palo Alto Networks (PANW)		★★★★	Narrow-moat cybersecurity pure play Palo Alto Networks trades at an attractive discount to our fair value estimate. In our view, cyber threats do not yield to any global economic concerns, and the severely increased fines for data privacy woes and a dearth of talent within security make cybersecurity a top concern for enterprises. To supplement its firewall market leadership, Palo Alto aggressively built out a platform that contains cloud security and threat response automation. In our view, entities will favor adding on Palo Alto's security subscriptions over managing various vendors to alleviate toolset management burden.
Price	**Fair value**	**Uncertainty**	
$229.31	$305.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$22.12	Narrow	Standard	
Company (Ticker)		**Rating**	
VMWare (VMW)		★★★★	We believe that VMware's position as the commonality between public clouds, private clouds, and on-premises ecosystems gives it an enviable position. In our view, the company has nicely made the transition away from relying on server sales, and has established itself as a key player in more nascent high-growth areas. The diversification into markets such as container management, end-user computing, software-defined networking, and security should help insulate VMware from hardware spending pauses or softer virtualization demand.
Price	**Fair value**	**Uncertainty**	
$149.23	$202.00	High	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$62.53	Narrow	Standard	

Source: Morningstar. Data as of June 23, 2020.

Utilities

Utilities Have Fallen Behind Market Rally; Finally Some Buying Opportunities

Utilities are back to their normal, boring selves. And that's not a bad thing for investors who want steady, growing income without taking a huge valuation risk.

Until mid-February, utilities had trounced the market since early 2018, climbing to all-time high valuations based on Morningstar's fair value estimates. But frothy valuations now appear to be history.
Utilities fell 37% from their February peak and missed out on much of the market's second-quarter rally. The sector has traded near our fair value estimate on a median basis since May. Several utilities are attractively priced after the revaluation, which means investors finally have opportunities to add high-quality, stable income and growth to their portfolios by buying utilities.

The sector's fundamentals remain strong. The coronavirus economic disruption has been little more than a blip for most utilities. Big swings in electricity demand will weigh on second-quarter earnings, but normal summer weather and business reopenings should erase any fears of big earnings shortfalls. Most management teams are sticking with their long-term investment plans. We continue to forecast 5% annual growth across most of the sector.

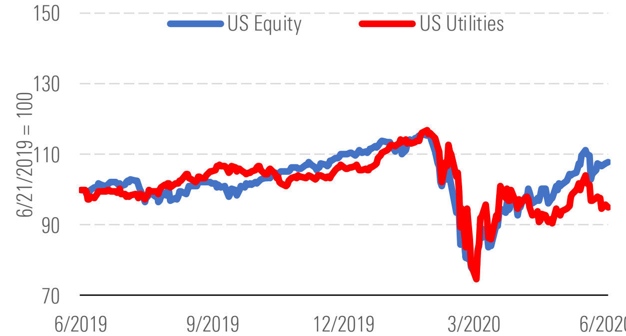
Our sector growth outlook and utilities' current dividend yields well above 3% offer compelling total returns, especially as interest rates have continued to fall through May and June. The 3.6% yield for the Morningstar Utilities Sector Index was a record-setting 290-basis-point premium to the 10-year U.S. Treasury yield as of late June. Some high-quality utilities with well-covered dividends and strong balance sheets now yield more than 4%, double that of the Morningstar US Market Index.

Natural gas infrastructure development underpinned much of the sector's growth during the last decade. Renewable energy will be this decade's growth opportunity. Utilities that are more aggressive, with billion-dollar investments in projects like offshore wind and utility-scale batteries, could be big winners, but delays or cost overruns could stretch the balance sheet and stall dividend growth. Conversely, utilities that ignore renewable energy will likely disappoint investors with lackluster growth. Investors should keep a close eye on policymaking and regulatory support to determine winners and losers.

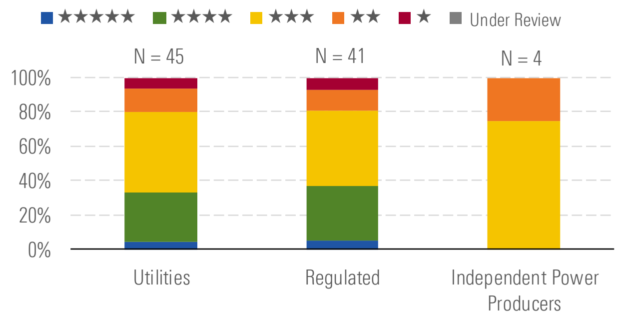
Travis Miller | travis.miller@morningstar.com

Exhibit 12 Utilities Revaluation Opens the Door for Defensive Investors

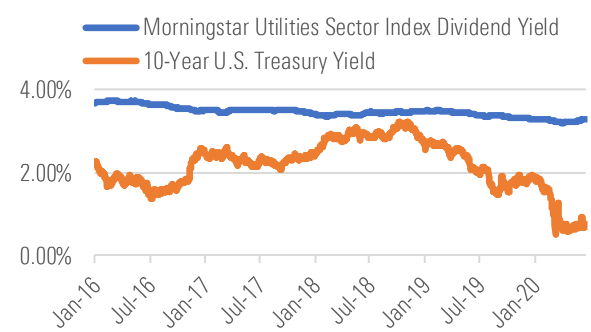
12a Utilities have lagged the market recovery since April.



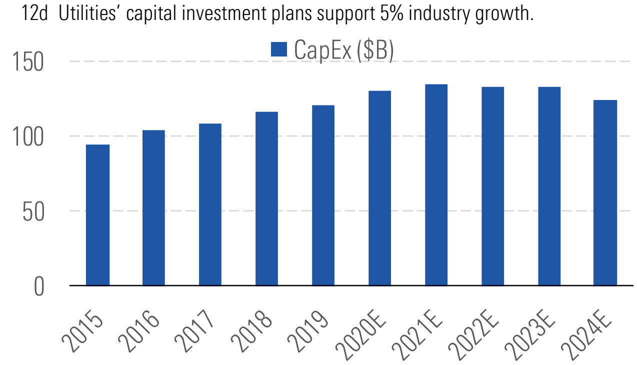
12b Moderating utilities valuations open more buying opportunities.



12c Utilities still a good place to turn for yield.



12d Utilities' capital investment plans support 5% industry growth.



Source: Morningstar, U.S. Treasury.
Data as of June 23, 2020.

Utilities | Top Picks

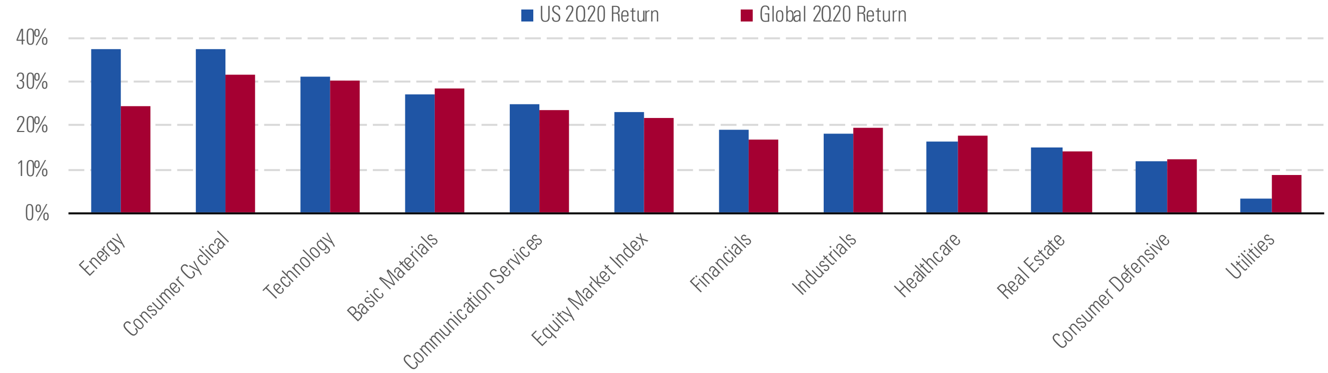
Utilities | Quick Takes

Company (Ticker)		Rating	
Edison International (EIX)		★★★★	California political risk will always be a concern for Edison. However, the state's progressive energy policies also create more growth opportunities for Edison than for most other U.S. utilities. Edison's electric-only business, recent regulatory success, and $5 billion annual investment plan give us confidence that it can grow earnings 6% beyond 2020. Edison has stakeholder support to harden the grid against natural disasters, integrate renewable energy, and support electric vehicle adoption. Now with the stock trading at a sizable discount to its peers and a 5% yield, Edison offers a triple play of value, growth, and income.
Price	**Fair value**	**Uncertainty**	
$55.77	$70.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$20.29	Narrow	Standard	
Company (Ticker)		**Rating**	
The AES Corp (AES)		★★★★★	AES has narrowed its geographic and business focus with a growing share of earnings in the U.S. The company has a stronger balance sheet, a rapidly growing renewable energy business, and a well-positioned battery storage joint venture with Siemens. In 2011, only 10% of pretax contribution to the parent was from the U.S. AES has about 5 gigawatts of renewable energy projects under construction or with signed power purchase agreements, many in the U.S. We expect these projects and investments in utility infrastructure will lift U.S. earnings to about half of consolidated earnings by 2024. This will provide more stable cash flow from moaty U.S. businesses that will benefit from our bullish view of renewable energy growth.
Price	**Fair value**	**Uncertainty**	
$13.84	$20.00	Medium	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$9.20	None	Standard	
Company (Ticker)		**Rating**	
Duke Energy Corp (DUK)		★★★★	We think Duke Energy's valuation discount to peers is unjustified given its favorable regulation and our outlook for consistent earnings and dividend growth. Florida regulation supports sector-leading allowed returns on equity, automatic base-rate adjustments, and good growth potential. North Carolina continues to support Duke's growth investments in electric and gas transmission and distribution infrastructure. South Carolina's recent rate-setting decision was disappointing, but we think Duke has enough growth in the state to compensate. We expect the Atlantic Coast Pipeline to withstand legal challenges, but Duke's remaining capital commitment represents just 4% of its five-year investment plan.
Price	**Fair value**	**Uncertainty**	
$81.85	$95.00	Low	
Market Cap (bil)	**Economic Moat**	**Stewardship**	
$60.15	Narrow	Standard	

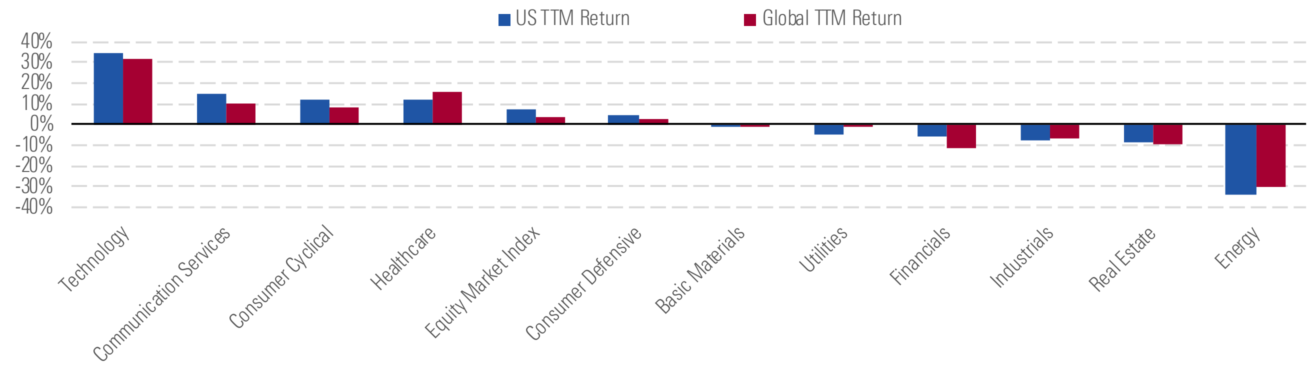
Source: Morningstar. Data as of June 23, 2020.

Appendix Global Coverage Snapshot

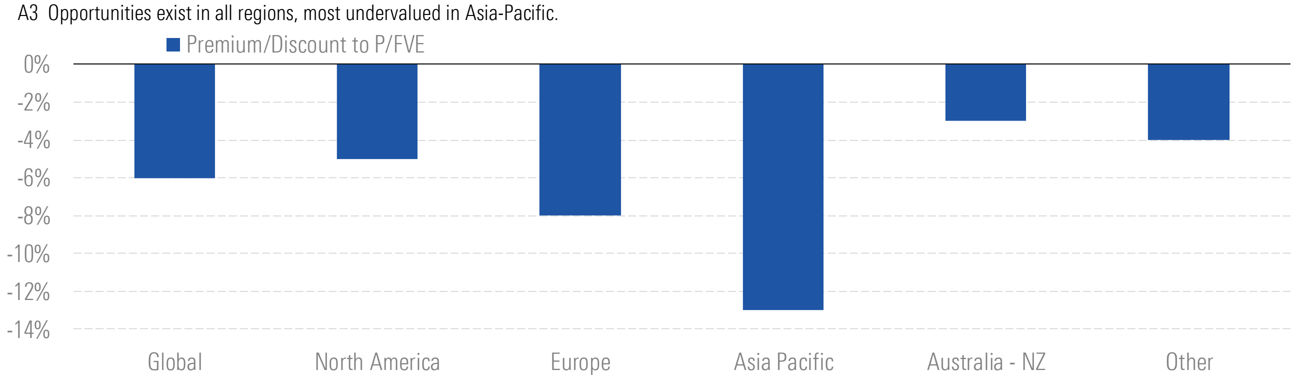
A1 Energy and consumer cyclical, hit hard in the initial downturn, rebound in the second quarter.



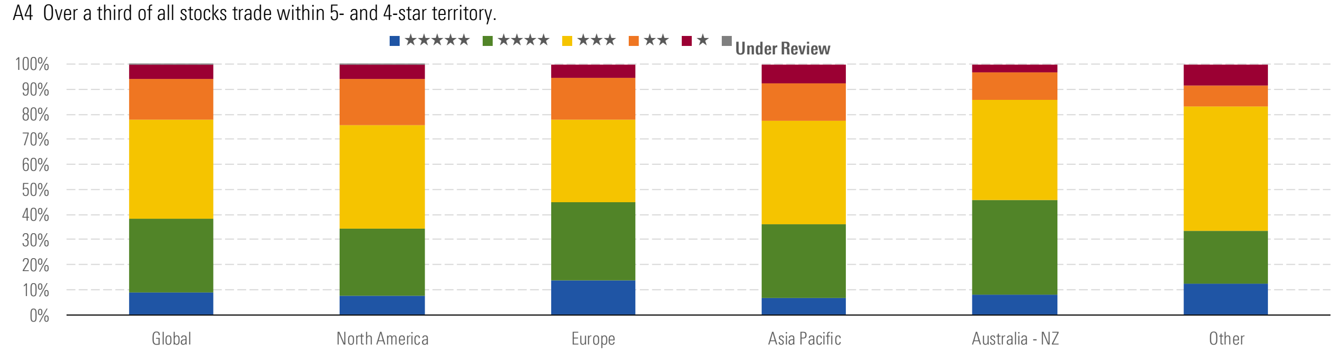
A2 Roughly half of sectors have a positive return over trailing 12 months.



A3 Opportunities exist in all regions, most undervalued in Asia-Pacific.



A4 Over a third of all stocks trade within 5- and 4-star territory.



Source: Morningstar. Data as of June 23, 2020.

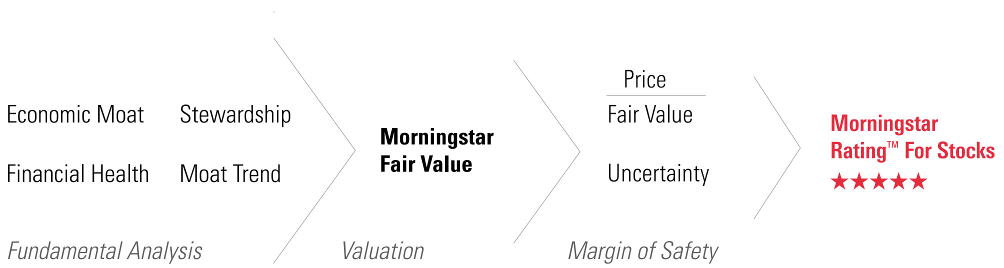
Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, in-depth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss short-term market price movements), but we believe these negatives are mitigated by deep analysis and our long-term approach.

Morningstar's equity research group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Morningstar Research Methodology



Source: Morningstar.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate, and (4) the current market price. This process ultimately culminates in our single-point star rating.

Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward their cost of capital more quickly than companies with moats.

To assess the sustainability of excess profits, analysts perform ongoing assessments of the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger, stable where we don't anticipate changes to competitive advantages over the next several years, or negative where we see signs of deterioration.

Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last 5 to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in working capital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested (RONIC)—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market value weights.

Uncertainty Around That Fair Value Estimate

Morningstar's uncertainty rating captures a range of likely potential intrinsic values for a company and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The uncertainty rating represents the analysts' ability to bound the estimated value of the shares in a company around the fair value estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

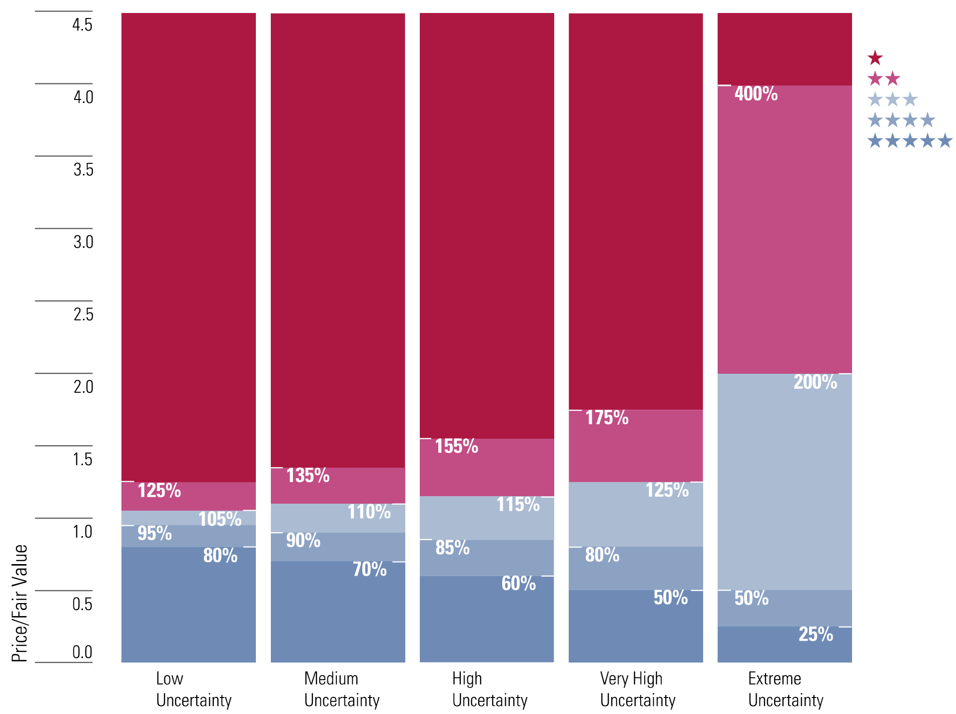
Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case and a 25% probability that the company will perform worse than the bear case. The distance between the bull and bear cases is an important indicator of the uncertainty underlying the fair value estimate.

Our recommended margin of safety widens as our uncertainty regarding the estimated value of the equity increases. The more uncertain we are about the estimated value of the equity, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the uncertainty rating provides guidance in portfolio construction based on risk tolerance.

Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

- Low: Margin of safety for 5-star rating is a 20% discount and for 1-star rating is a 25% premium.
- Medium: Margin of safety for 5-star rating is a 30% discount and for 1-star rating is a 35% premium.
- High: Margin of safety for 5-star rating is a 40% discount and for 1-star rating is a 55% premium.
- Very high: Margin of safety for 5-star rating is a 50% discount and for 1-star rating is a 75% premium.
- Extreme: Margin of safety for 5-star rating is a 75% discount and for 1-star rating is a 300% premium.

Morningstar Equity Research Star Rating Methodology



Market Price

The market prices used in this analysis and noted in the report come from the exchange on which the stock is listed, which we believe is a reliable source.

For more details about our methodology, please go to http://global.morningstar.com/equitydisclosures.

Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically recalculated at the market close on
every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow and, based on thorough and ongoing analysis, raise or lower their fair value estimates
as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn
5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true, the market price will converge on our fair value estimate over time, generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience, and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk-adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to capital loss.

Risk Warning

Please note that investments in securities are subject to market and other risks, and there is no assurance or guarantee that the intended investment objectives will be achieved. Past performance of a security may or may not be sustained in the future and is no indication of future performance. A security investment return and an investor's principal value will fluctuate so that, when redeemed, an investor's shares may be worth more or less than their original cost. A security's current investment performance may be lower or higher than the investment performance noted within the report. Morningstar's uncertainty rating serves as a useful data point with respect to sensitivity analysis of the assumptions used in our determining a fair value price.

General Disclosure

Unless otherwise provided in a separate agreement, recipients accessing this report may only use it in the country in which the Morningstar distributor is based. Unless stated otherwise, the original distributor of the report is Morningstar Research Services LLC, a U.S.-domiciled financial institution.

This report is for informational purposes only and has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. This publication is intended to provide information to assist institutional investors in making their own investment decisions, not to provide investment advice to any specific investor. Therefore, investments discussed and recommendations made herein may not be suitable for all investors: Recipients must exercise their own independent judgment as to the suitability of such investments and recommendations in the light of their own investment objectives, experience, taxation status, and financial position.

The information, data, analyses, and opinions presented herein are not warranted to be accurate, correct, complete, or timely. Unless otherwise provided in a separate agreement, neither Morningstar, Inc. nor the Equity Research Group represents that the report contents meet all of the presentation and/or disclosure standards applicable in the jurisdiction the recipient is located.

Except as otherwise required by law or provided for in a separate agreement, the analyst, Morningstar, Inc., and the Equity Research Group and their officers, directors, and employees shall not be responsible or liable for any trading decisions, damages, or other losses resulting from, or related to, the information, data, analyses, or opinions within the report. The Equity Research Group encourages recipients of this report to read all relevant issue documents (e.g., prospectus) pertaining to the security concerned, including without limitation, information relevant to its investment objectives, risks, and costs before making an investment decision and, when deemed necessary, to seek the advice of a legal, tax, and/or accounting professional.

The Report and its contents are not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country, or other jurisdiction where such distribution, publication, availability, or use would be contrary to law or regulation or which would subject Morningstar, Inc. or its affiliates to any registration or licensing requirements in such jurisdiction.

Where this report is made available in a language other than English and in the case of inconsistencies between the English and translated versions of the report, the English version will control and supersede any ambiguities associated with any part or section of a report that has been issued in a foreign language. Neither the analyst, Morningstar, Inc., nor the Equity Research Group guarantees the accuracy of the translations.

This report may be distributed in certain localities, countries and/or jurisdictions ("Territories") by independent third parties or independent intermediaries and/or distributors ("Distributors"). Such Distributors are not acting as agents or representatives of the analyst, Morningstar, Inc., or the Equity Research Group. In Territories where a Distributor distributes our report, the Distributor is solely responsible for complying with all applicable regulations, laws, rules, circulars, codes, and guidelines established by local and/or regional regulatory bodies, including laws in connection with the distribution third-party research reports.

Conflicts of Interest

- No interests are held by the analyst with respect to the security subject of this investment research report.
    - Morningstar, Inc. may hold a long position in the security subject of this investment research report that exceeds 0.5% of the total issued share capital of the security. To determine if such is the case, please click http://msi.morningstar.com and http://mdi.morningstar.com.
- Analysts' compensation is derived from Morningstar, Inc.'s overall earnings and consists of salary, bonus, and in some cases restricted stock.
- Neither Morningstar, Inc. nor the Equity Research Group receives commissions for providing research nor do they charge companies to be rated.
- Neither Morningstar, Inc. nor the Equity Research Group is a market maker or a liquidity provider of the security noted within this report.
- Neither Morningstar, Inc. nor the Equity Research Group has been a lead manager or co-lead manager over the previous 12 months of any publicly disclosed offer of financial instruments of the issuer.
- Morningstar, Inc.'s investment management group does have arrangements with financial institutions to provide portfolio management/investment advice, some of which an analyst may issue investment research reports on. However, analysts do not have authority over Morningstar's investment management group's business arrangements nor allow employees from the investment management group to participate or influence the analysis or opinion prepared by them.
- Morningstar, Inc. is a publicly traded company (ticker symbol: MORN) and thus a financial institution the security of which is the subject of this report may own more than 5% of Morningstar, Inc.'s total outstanding shares. Please access Morningstar, Inc.'s proxy statement, "Security Ownership of Certain Beneficial Owners and Management" section http://investorrelations.morningstar.com/sec.cfm?doctype=Proxy&year=&x=12
- Morningstar, Inc. may provide the product issuer or its related entities with services or products for a fee and on an arms' length basis including software products and licenses, research and consulting services, data services, licenses to republish our ratings and research in their promotional material, event sponsorship, and website advertising.

Further information on Morningstar, Inc.'s conflict of interest policies is available from http://global.morningstar.com/equitydisclosures. Also, please note analysts are subject to the CFA Institute's Code of Ethics and Standards of Professional Conduct.

For a list of securities that the Equity Research Group currently covers and provides written analysis on, please contact your local Morningstar office. In addition, for historical analysis of securities covered, including their fair value estimate, please contact your local office.

For Recipients in Australia: This Report has been issued and distributed in Australia by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544; ASFL: 240892). Morningstar Australasia Pty Ltd is the provider of the general advice ('the Service') and takes responsibility for the production of this report. The Service is provided through the research of investment products. To the extent the Report contains general advice, it has been prepared without reference to an investor's objectives, financial situation, or needs. Investors should consider the advice in light of these matters and, if applicable, the relevant Product Disclosure Statement before making any decision to invest. Refer to our Financial Services Guide (FSG) for more information at http://www.morningstar.com.au/fsg.pdf.

For Recipients in Hong Kong: The Report is distributed by Morningstar Investment Management Asia Limited, which is regulated by the Hong Kong Securities and Futures Commission to provide services to professional investors only. Neither Morningstar Investment Management Asia Limited nor its representatives are acting or will be deemed to be acting as an investment advisor to any recipients of this information unless expressly agreed to by Morningstar Investment Management Asia Limited. For enquiries regarding this research, please contact a Morningstar Investment Management Asia Limited Licensed Representative at http://global.morningstar.com/equitydisclosures.

For Recipients in India: This Investment Research is issued by Morningstar Investment Adviser India Private Limited. Morningstar Investment Adviser India Private Limited is registered with the Securities and Exchange Board of India (Registration number INA000001357) and provides investment advice and research. Morningstar Investment Adviser India Private Limited has not been the subject of any disciplinary action by SEBI or any other legal/regulatory body. Morningstar Investment Adviser India Private Limited is a wholly owned subsidiary of Morningstar Investment Management LLC. In India, Morningstar Investment Adviser India Private Limited has one associate, Morningstar India Private Limited, which provides data-related services, financial data analysis, and software development. The Research Analyst has not served as an officer, director, or employee of the fund company within the last 12 months, nor has it or its associates engaged in market-making activity for the fund company.

* The Conflicts of Interest disclosure above also applies to relatives and associates of Manager Research Analysts in India
* The Conflicts of Interest disclosure above also applies to associates of Manager Research Analysts in India. The terms and conditions on which Morningstar Investment Adviser India Private Limited offers Investment Research to clients varies from client to client and are detailed in the respective client agreement.

For recipients in Japan: The Report is distributed by Ibbotson Associates Japan, Inc., which is regulated by Financial Services Agency. Neither Ibbotson Associates Japan, Inc. nor its representatives are acting or will be deemed to be acting as an investment advisor to any recipients of this information.

For recipients in Singapore: For Institutional Investor audiences only. Recipients of this report should contact their financial adviser in Singapore in relation to this report. Morningstar, Inc. and its affiliates rely on certain exemptions (Financial Advisers Regulations, Section 32B and 32C) to provide its investment research to recipients in Singapore.

About Morningstar® Institutional Equity Research™

Morningstar Institutional Equity Research provides independent, fundamental equity research differentiated by a consistent focus on sustainable competitive advantages, or Economic Moats.

For More Information

+1 312 696-6869
equitysupport@morningstar.com

22 West Washington Street
Chicago, IL 60602 USA