North America Market Outlook: Q1 2024

What a 'return to normal' means for stocks.

Morningstar Equity Research

Dave Sekera, CFA
Chief U.S. Market Strategist
Morningstar Research Services LLC

Preston Caldwell
Chief U.S. Economist
Morningstar Research Services LLC

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U.S. Equity Market Currently Trading at Fair Value as Compared With a Composite of Our Equity Valuations

U.S. Stock Market Trades Up to Hit a Composite of Our Fair Values

According to a composite of the more than 700 stocks we cover that trade on U.S. exchanges, as of Dec. 21, 2023, the U.S. equity market was trading at a price/fair value estimate of 1.00, meaning the market is trading equal to the composite of our fair value estimates.

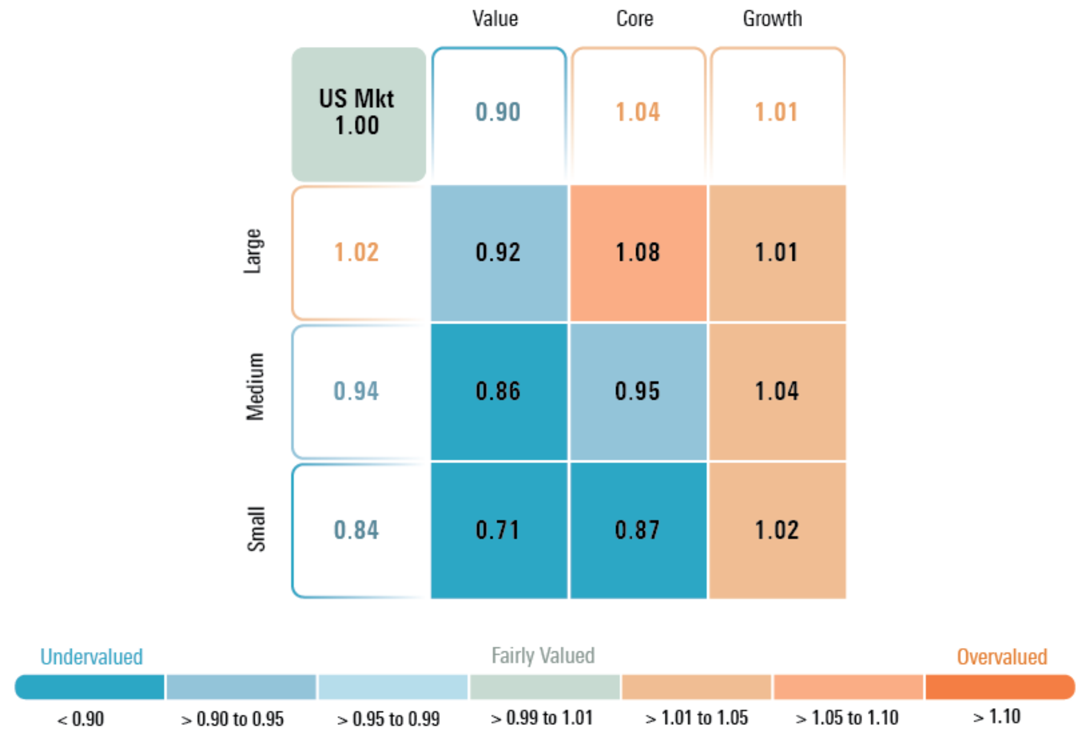
Stocks dropped precipitously in late October as the yield on the 10-year U.S. Treasury approached 5%. However, this year's "Santa Claus Rally" came early in November as interest rates failed to breach 5% and have since subsided. The rally continued following the Fed's December meeting as the market interpreted Chair Jerome Powell's remarks to mean the Fed was done hiking rates and is now mulling when to ease monetary policy.

The Morningstar US Market Index surged 11.52% quarter to date through Dec. 21. Year to date, the broad market is up 25.80%. While growth stocks continued to outpace the broad market, it did so by a lower amount than earlier in the year when the so-called Magnificent Seven Big Tech firms of Alphabet, Apple, Amazon.com, Meta Platforms, Microsoft, Nvidia, and Tesla ruled the market. Quarter to date, growth stocks rose 14.43%, whereas core and value increased by 10.10% and 8.65%, respectively. By capitalization, small-cap stocks outperformed, rising 13.37% while mid-cap and large-cap rose 11.91% and 11.25%, respectively.

For long-term investors, value stocks remain the most attractive, trading at a 10% discount to fair value, while core stocks are trading into overvalued territory and growth at fair value. By capitalization, small-cap stocks remain the most attractive at a 16% discount followed by mid-cap at a 6% discount, while large cap are a little above fair value.

U.S. Stock Market Trading at Fair Value

Valuations of Morningstar's equity research coverage by equity style box.



Source: Morningstar. Data as of Dec. 21, 2023.

U.S. Equity Market Bounces Back After Brief Selloff

The U.S. stock market briefly sold off in October as long-term interest rates rose but came roaring right back as soon as rates began to subside.

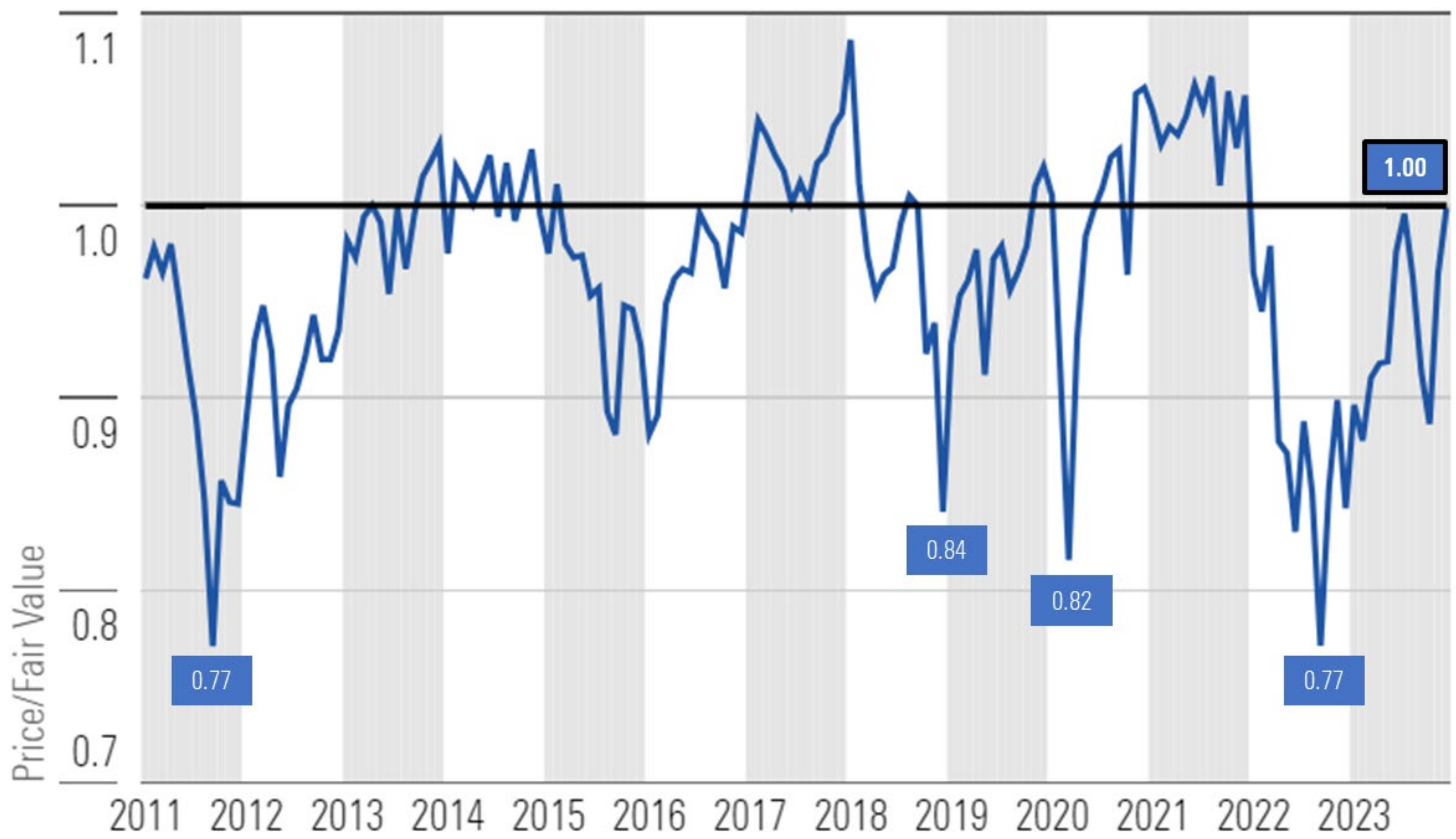
After dominating the market in the first half of 2023, the Magnificent Seven (Apple, Amazon, Alphabet, Meta Platforms, Microsoft, Nvidia, Tesla) have run out of steam as five are now trading in fair value territory and Apple is overvalued. Gains in the fourth quarter have been more broadly spread out across the market. For example, the Magnificent Seven accounted for 75% of the market return at the end of June, but as of Dec. 21, they account for only 52%.

The next test for the markets will come in February and March when companies report earnings. We are not so concerned about earnings as we are concerned that management teams may look to lower the bar on the market's expectations for earnings growth in 2024.

We expect further gains will continue to be driven by a widening out of returns across the market, specifically into the value category, which remains the most undervalued according to our valuations, as well as down in capitalization into small-cap stocks.

Historical Morningstar U.S. Equity Research Coverage Price/Fair Value Estimate at Month's End

U.S. stock market rallies right back up to fair value.



Source: Morningstar. Data as of Dec. 21, 2023.

U.S. Stocks Bounce Back During Fourth Quarter

The Morningstar US Equity Market Index rose 11.52% quarter to date through Dec. 21, bringing the year-to-date return to 25.80%. Growth stocks continued to lead the way, but by much less of a margin than earlier in the year. Both value and core categories performed well in the fourth quarter. Returns also spread down in capitalization as small-cap stocks outperformed large-cap stocks.

Quarter-to-Date Returns (Percent): Fourth-Quarter 2023

Growth stocks lead the way, but returns broaden across categories and capitalization.

		Value	Core	Growth
	US Mkt 11.52	8.65	10.10	14.43
Large	11.25	6.87	9.80	16.48
Medium	11.91	13.02	9.08	13.88
Small	13.37	15.16	11.70	13.44

Negative Returns — Positive Returns

< −8.0% | < −4 to −8 | < 0.0 to −4 | > 0.0 to 4 | > 4 to 8 | >8.0

Source: Morningstar. Data as of Dec. 21, 2023.

Year-to-Date Returns (Percent): 2023

Yet growth remains the winner this year by a wide margin.

		Value	Core	Growth
	US Mkt 25.80	10.89	17.12	37.95
Large	29.30	10.64	17.64	48.22
Medium	15.28	9.88	12.53	24.49
Small	19.85	14.36	20.54	25.52

Negative Returns — Positive Returns

< −20.0% | < −10 to −20 | < 0.0 to −10 | > 0.0 to 10 | > 10 to 20 | >20.0

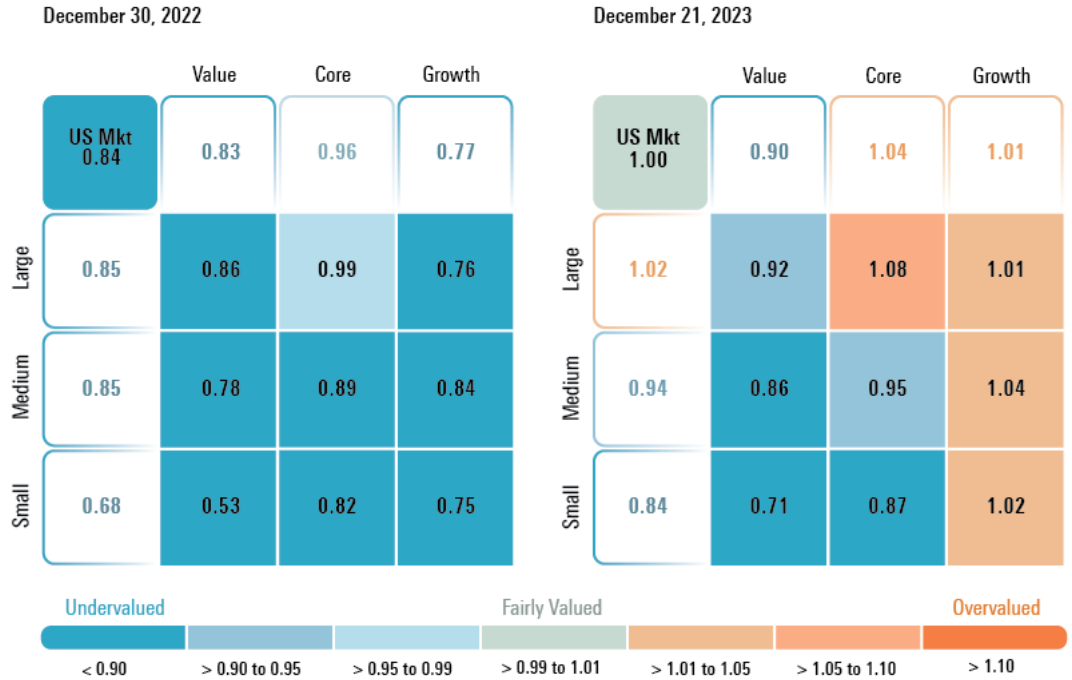
Source: Morningstar. Data as of Dec. 21, 2023.

Remain Overweight Value Category and Small-Cap Stocks

For active investors, this has been a busy year. At the beginning of the year, we advocated for a barbell-shaped portfolio consisting of overweight positions in the value and growth categories and underweight core. As growth rallied, we moved to market weight in May and underweight in July. In the third-quarter 2023 Outlook, we moved growth back to market weight as it was trading near the same discount as the broad market. Today, we continue to advocate for an overweight in value, underweight in core, and market weight in growth. By market capitalization, we continue to advocate for an underweight position in large-cap stocks in favor of overweighting small-cap stocks and a slight overweight in mid-cap stocks.

Change in Morningstar Equity Research Coverage Price/Fair Value Estimates Over the Course of the Year

Value stocks remain the most attractive style category as growth has risen to fair value.



Source: Morningstar. Data as of Dec. 21, 2023.

Quarter-to-Date Sector Returns

Returns were broad-based in the fourth quarter as everything, except energy, rose. Stocks closely tied to the economy performed best. The market appears to have come around toward our view that while the rate of economic growth will likely slow, we expect a soft landing as opposed to a recession.

Furthermore, as interest rates subsided, sectors correlated to rates such as real estate and utilities caught a tailwind after having posted the worst returns in the third quarter. Not surprisingly, stocks with defensive characteristics such as consumer defensive and healthcare lagged, as those sectors were fully valued at the end of the last quarter.

Energy stocks slid as oil prices fell from over $90/barrel at the end of September to just under $74 by Dec. 21.

Returns by Sector (Percent): Quarter to Date

The sectors most tied to the economy rose in the fourth quarter, except energy, which retreated. Defensive stocks lagged.

Cyclical		Sensitive		Defensive	
Basic Materials	10.39	Communication Services	11.90	Consumer Defensive	4.02
Consumer Cyclical	13.44	Energy	–5.63	Healthcare	5.08
Financial Services	13.45	Industrials	12.41	Utilities	7.09
Real Estate	16.68	Technology	16.89		

Negative Returns — Positive Returns

< –8.0%	< –4 to –8	< 0.0 to –4	> 0.0 to 4	> 4 to 8	>8.0

Source: Morningstar. Data as of Dec. 21, 2023.

Year-to-Date Sector Returns

Sectors that were the most undervalued according to our valuations at the end of last year have seen the greatest returns thus far in 2023. For example, communications was the most undervalued and has risen 54.77%. Consumer cyclicals were the second-most undervalued and have gained 40.82%. Technology was the third-most undervalued sector and has risen 58.60%.

Sectors that were the most overvalued according to our valuations at the end of last year have struggled. For example, defensive sectors were slightly overvalued at the beginning of 2023 and have struggled. Utilities have performed the worst, dropping 8.38%, followed by healthcare and consumer defensive, which have only eked out barely positive gains of 0.56%, and 0.64%, respectively. Similarly, energy, which was the most overvalued sector coming into the year, has just barely stayed in the green with a 0.53% return.

Returns by Sector (Percent): Year to Date

Gains in energy, communications, and financials were unable to offset losses across the rest of the market.

Cyclical		**Sensitive**		**Defensive**	
Basic Materials	14.28	Communication Services	54.77	Consumer Defensive	0.64
Consumer Cyclical	40.82	Energy	0.53	Healthcare	0.56
Financial Services	14.91	Industrials	19.68	Utilities	–8.38
Real Estate	10.61	Technology	58.60		

Negative Returns — Positive Returns

< –20.0% | < –10 to –20 | < 0.0 to –10 | > 0.0 to 10 | > 10 to 20 | >20.0

Source: Morningstar. Data as of Dec. 21, 2023.

Magnificent Seven Responsible for 52% of Market Gains

In the first half of 2023, the stock market rally was unusually concentrated. According to an attribution analysis of the Morningstar US Market Index, at the end of June, the returns from only seven stocks accounted for approximately 75% of the total market return for the first half of the year. At that time, we noted that we thought the Magnificent Seven was running out of steam as those stocks approached our fair value estimates. We also noted that according to our valuations we expected further gains would broaden out across the rest of the market which remained at much more attractive valuations.

As the market has continued to rise and returns have broadened out, as of Dec. 21, the same attribution analysis reveals that the Magnificent Seven now only account for 52% of the total market return.

Magnificent Seven Responsible for 52% of Market Gains Year to Date Through Dec. 21, 2023

Name/Ticker	Index Weighting (%)	YTD Return (%)	YTD Contribution to Index Return (%)
Microsoft MSFT	5.68	55.76	2.78
Apple AAPL	6.23	49.83	2.67
Nvidia NVDA	2.16	235.23	2.32
Amazon.com AMZN	2.63	83.14	1.72
Alphabet GOOGL	3.22	59.15	1.60
Meta Platforms META	1.39	194.24	1.43
Tesla TSLA	1.42	106.61	0.96

Source: Morningstar. Data as of Dec. 21, 2023.

Further Returns From These Seven Stocks May Be Limited From Here

Six of These Seven Stocks Started the Year Rated With 4 or 5 Stars; Only One Remains 4-Star, Five Are 3-Star, and One Is Rated 2-Stars

Name/Ticker	Rating 12/31/22	Rating 12/21/23	Price ($) 12/31/22	Price ($) 12/21/23	Change (%)	Fair Value 12/31/22	Fair Value 12/21/23	Change (%)	P/FV 12/31/22	P/FV 12/21/23
Microsoft MSFT	★★★★	★★★	240	374	55.8%	320	370	15.6%	0.75	1.01
Apple AAPL	★★★	★★	130	195	49.8%	130	160	23.1%	1.00	1.22
Nvidia NVDA	★★★★	★★★	146	490	235.2%	200	480	140.0%	0.73	1.02
Amazon.com AMZN	★★★★★	★★★	84	154	83.1%	150	155	3.3%	0.56	0.99
Alphabet GOOGL	★★★★★	★★★★	88	140	59.2%	160	161	0.6%	0.55	0.87
Meta Platforms META	★★★★★	★★★	120	354	194.2%	260	322	23.8%	0.46	1.10
Tesla TSLA	★★★★★	★★★	123	255	106.6%	250	210	**-16.0%**	0.49	1.21

Source: Morningstar. Data as of Dec. 21, 2023.

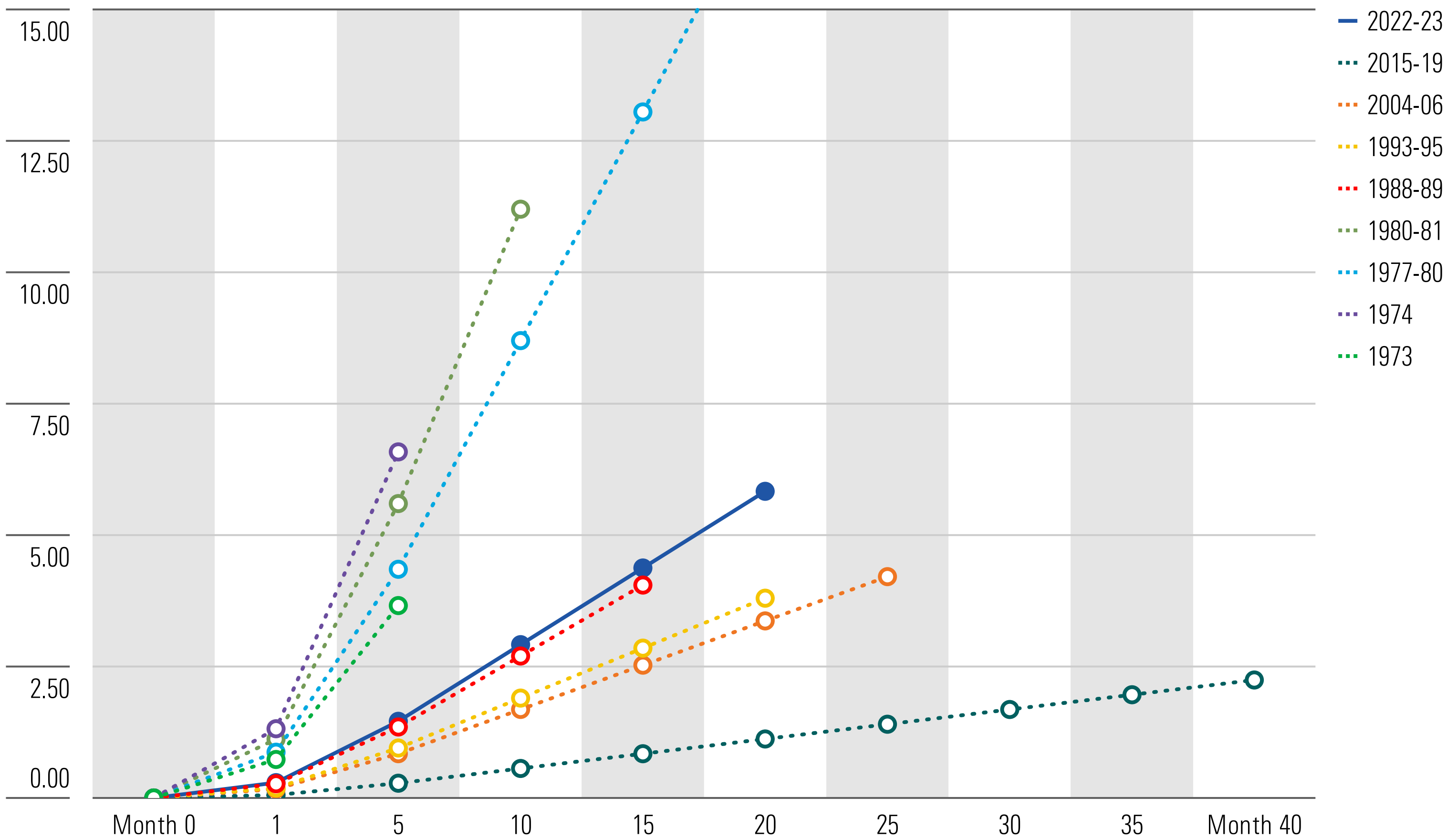
At End of This Monetary Policy Tightening Cycle, Shift To Easing in 2024 Coming

As we expected, the Federal Reserve held interest rates steady at its December meeting. We had previously noted that we had expected that the July hike would be the final interest-rate increase of this monetary policy tightening cycle.

This monetary tightening cycle has been the steepest and fastest over the past 40 years, yet far less restrictive than the policy during the 1970s and '80s. While the economy has held up better than expected in the face of this tightening cycle, we still expect that the rate of economic growth will slow throughout most of 2024.

We expect that slowing economic growth and declining inflation will prompt the Fed to begin loosening monetary policy and begin lowering the federal-funds rate, possibly as early as March 2024. We forecast six interest-rate cuts over the course of 2024, double that of the Fed's current projection.

Current Monetary Policy Tightening Cycle Is Fastest and Steepest Since 1980-81



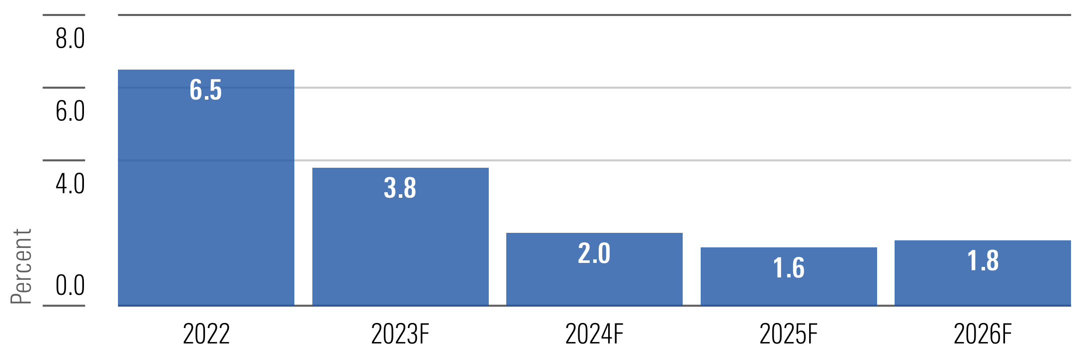
Source: Morningstar. Data as of Sept. 25, 2023.

Inflation Remains on a Downward Path

Both headline and core Consumer Price Index readings have remained on a downward trend. We continue to forecast that inflation will moderate over the course of 2024 and into 2025.

According to our projections, the major drivers of high inflation, such as the supply chain bottlenecks, shortages, and other disruptions, will further unwind over the next few years, providing prolonged deflationary pressure. In fact, our below-consensus forecast calls for inflation to fall below the Fed's 2% inflation target in 2025 before beginning to slightly rise back up.

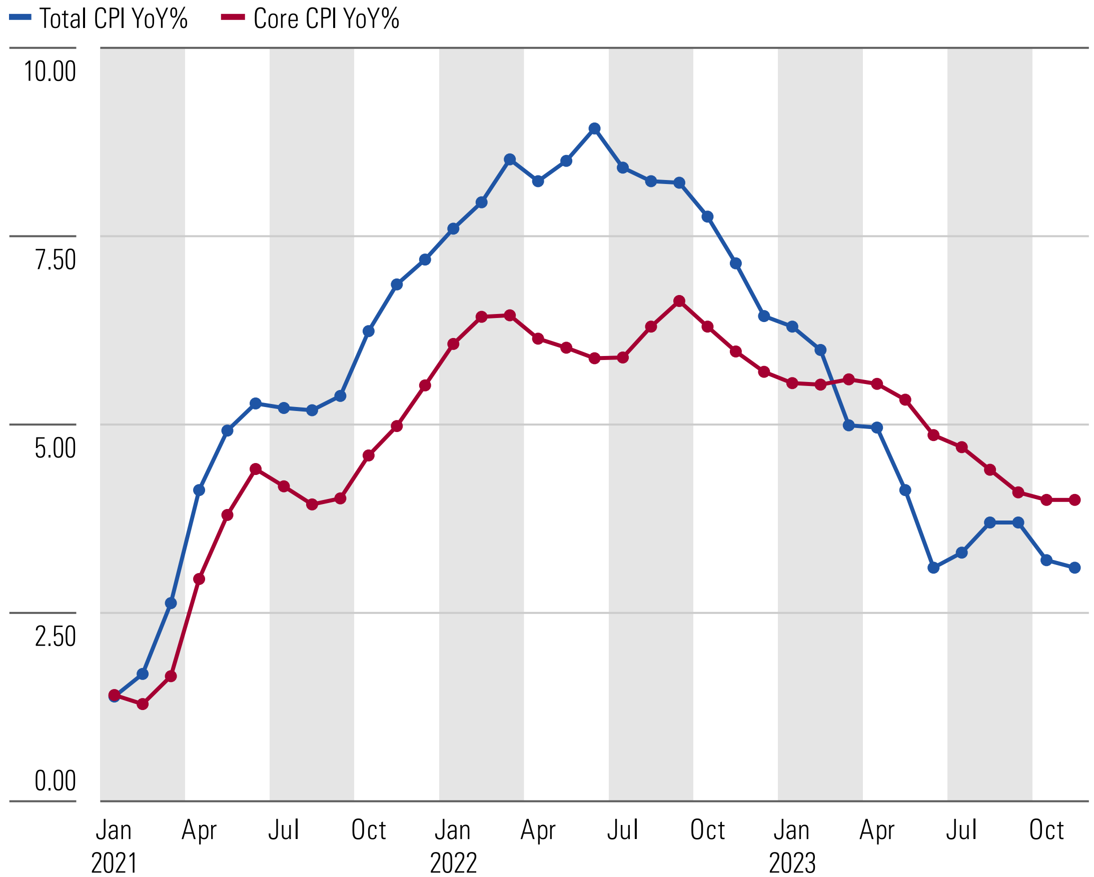
U.S. Annual Inflation Forecasts



Source: U.S. Bureau of Economic Analysis and Morningstar. Data as of Dec. 18, 2023.

Consumer Price Index Year-Over-Year Increase

Headline and core inflation readings remain on downward path.



Source: U.S. Bureau of Economic Analysis and Morningstar. Data as of Dec. 18, 2023.

Rate of Economic Growth to Begin Slowing Sequentially Until Q3 2024, but No Recession

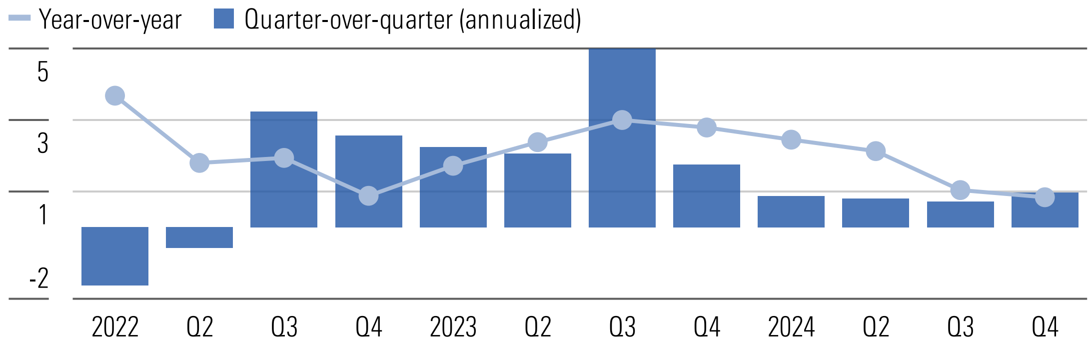
The U.S. economy continued to defy restrictive monetary policy as real GDP surged to 5.2% in the third quarter, which led us to increase our real GDP forecast for 2023. However, we still expect higher interest rates, restrictive monetary policy, and tight lending restrictions will take their toll on the economy. We forecast that the rate of economic growth has begun slowing in the fourth quarter and the rate of growth will continue to slow until bottoming out in the third quarter 2024. From there, our expectation for easing monetary policy will allow economic growth to begin to expand steadily thereafter.

The slowing rate of growth may pressure earnings growth over the next few quarters which could lead to a negative market sentiment and in turn push the market down early this year. However, we suspect that any selloffs would be relatively shallow and not anywhere near the magnitude of the market decline in 2022.

Today we see a much different situation than we did at either the beginning of 2022 or 2023. In early 2022, the market was broadly overvalued, inflation rising, interest rates were poised to rise substantially, and the economy was slowing. In early 2023, the market was significantly undervalued, and 2022's headwinds were poised to abate.

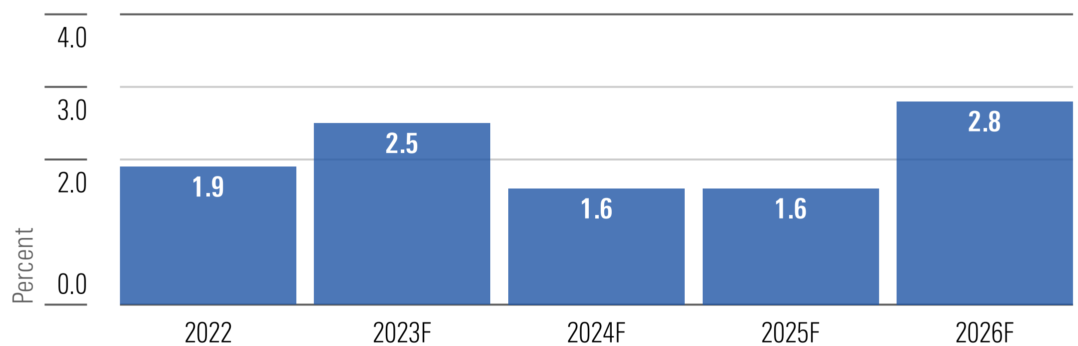
As we head into 2024, the market is trading at fair value, inflation continues to moderate, interest rates are projected to fall further, and while economic growth is slowing, we do not expect a recession and see stronger economic growth beginning in late 2024. In our opinion, 2024 is lining up to be the first year that not only are we past the disruptions caused by the pandemic, but also past the dislocations caused by those disruptions.

U.S. Real Quarterly GDP Forecasts



Source: U.S. Bureau of Economic Analysis and Morningstar. Data as of Dec. 18, 2023.

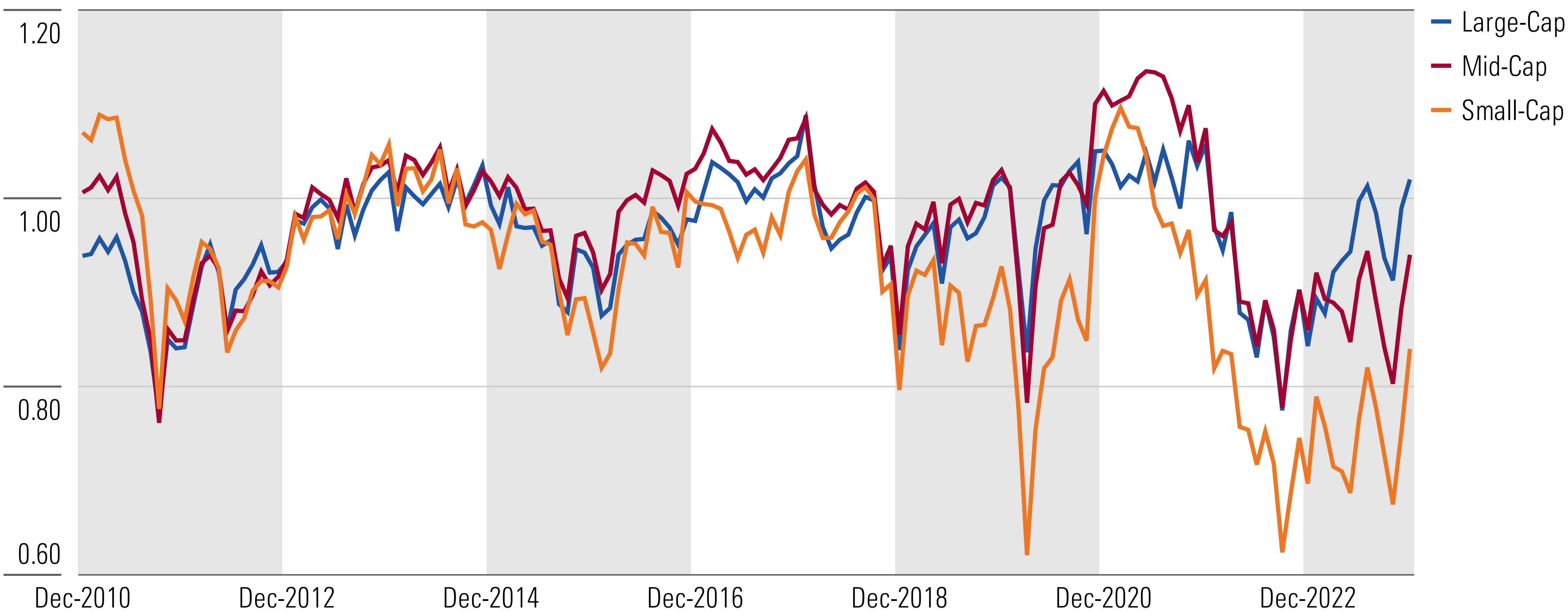
U.S. Real Annual GDP Forecasts



Source: U.S. Bureau of Economic Analysis and Morningstar. Data as of Dec. 18, 2023.

Price/Fair Value by Capitalization

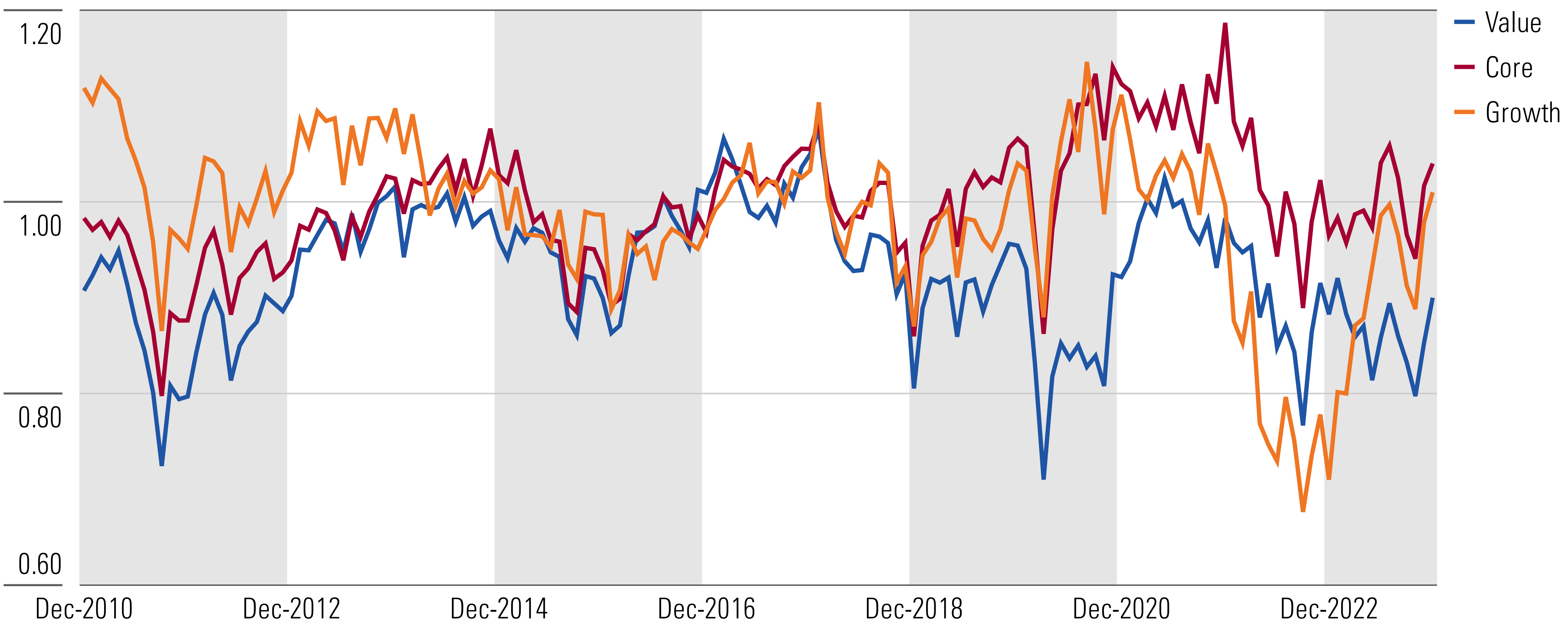
Small-Cap Stocks Remain at Wide Discount to Large-Cap and Mid-Cap Stocks



Source: Morningstar. Data as of Dec. 21, 2023.

Price/Fair Value by Style

Value Stocks Remain at Wide Discount to Core and Growth Stocks



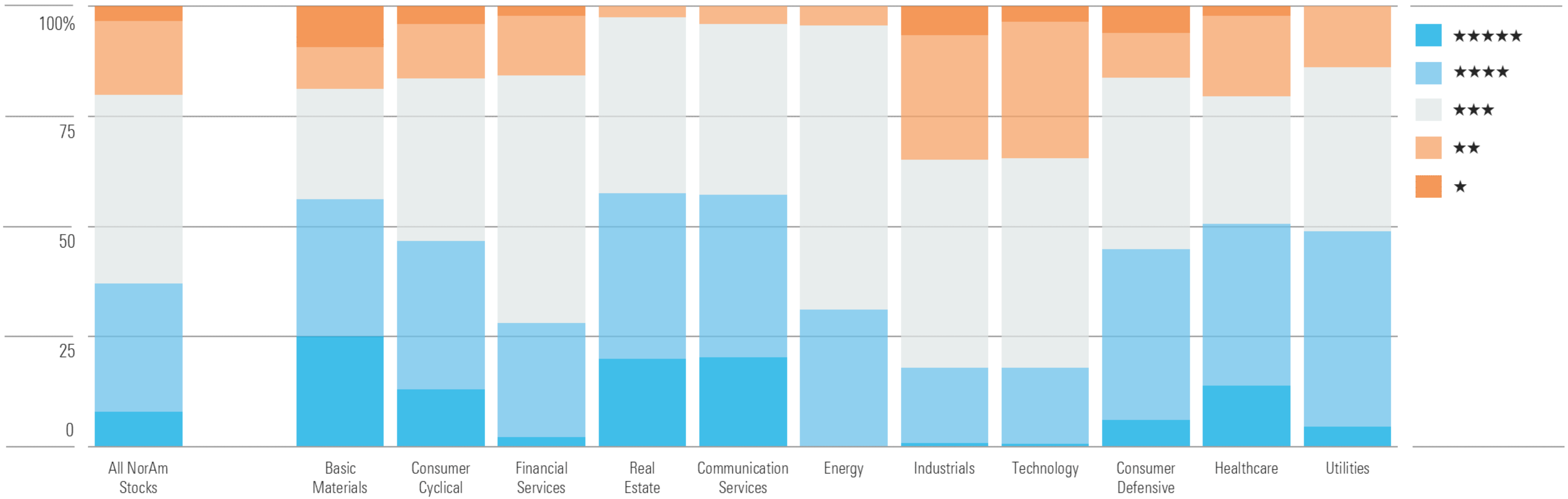
Source: Morningstar. Data as of Dec. 21, 2023.

Sector Valuations and Top Picks

Market May Be Fairly Valued, but Still a Wide Dispersion of Under- and Overvalued Stocks

While the market composite has hit fair value, we continue to see a wide dispersion of undervalued and overvalued stocks. As two of the most undervalued sectors, there are a high percentage of undervalued stocks in the communications and real estate sectors. Conversely, with the technology sector rising into overvalued territory, there are fewer opportunities. After pulling back in the fourth quarter, we are seeing an increase in the number of undervalued energy stocks, specifically among the exploration and production oil stocks. We also see new 5-star-rated stocks in the utilities sector. We are also seeing more attractively valued stocks in the consumer defensive sector, specifically among the packaged-food producers.

Morningstar Equity Star Ratings by Sector



Source: Morningstar. Data as of Dec. 21, 2023.

Move to Underweight Technology & Industrials and Overweight Energy

Last quarter, we moved to a market weight in the technology sector as it had fallen back into line with the broad market valuation. Following its almost 17% surge in the fourth quarter, it's now time to move back to an underweight as it now trades at a 9% premium. Industrials have continued their climb higher and also should be underweighted as the sector trades at a 5% premium.

Following an almost 17% increase in real estate, it is no longer the most undervalued sector and is tied with energy as the second most undervalued with an 8% discount. Energy declined by almost 6% last quarter whereas our fair value estimates remained relatively steady and the sector should now be considered as an overweight.

Communication services regains the title of most undervalued, trading at an 11% discount to our fair value estimate.

Lastly, the consumer cyclical sector rose over 13% last quarter and the sector should be moved to market weight, as it's trading near our fair value.

Morningstar Price/Fair Value Metric by Sector Weighted by Intrinsic Value

Figures below 1 are undervalued, while above 1 are overvalued.

Cyclical		Sensitive		Defensive	
Basic Materials	0.93	Communication Services	0.89	Consumer Defensive	0.99
Consumer Cyclical	1.02	Energy	0.92	Healthcare	0.97
Financial Services	0.97	Industrials	1.05	Utilities	0.93
Real Estate	0.92	Technology	1.09		

Undervalued — Fairly Valued — Overvalued

< 0.90%	> 0.90 to 0.95	> 0.95 to 0.99	> 0.99 to 1.01	> 1.01 to 1.05	> 1.05 to 1.10	> 1.10

Source: Morningstar. Data as of Dec. 21, 2023.

Cyclical Sectors: Best Picks

This quarter, we added FMC and Newmont Mining. FMC is our top pick to invest in crop chemicals as we forecast a recovery in demand. Not only is Newmont Mining trading at a large margin of safety but it provides significant upside leverage if gold were to remain high. We added Hasbro as we think investors are overextrapolating pressure on recent performance from weak discretionary demand, entertainment-related strikes, and inventory rightsizing too far into future. In the real estate sector, we added triple-net lease provider Realty Income. Realty Income has the highest correlation to movements in interest rates under our coverage.

Best Picks From Our Directors Across the Cyclical Sectors

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector	Style Box
Albemarle ALB	★★★★★	145	300	0.48	Narrow	High	Basic Materials	Mid Value
FMC FMC	★★★★★	62	110	0.56	Narrow	High	Basic Materials	Small Value
Newmont NEM	★★★★	41	53	0.78	None	Medium	Basic Materials	Large Core
Hanesbrands HBI	★★★★★	4	19	0.22	Narrow	Very High	Consumer Cyclical	Small Value
Hasbro HAS	★★★★★	51	88	0.58	Narrow	Medium	Consumer Cyclical	Small Value
VF VFC	★★★★★	19	57	0.34	Narrow	High	Consumer Cyclical	Small Value
The Charles Schwab SCHW	★★★	68	80	0.85	Wide	High	Financial Services	Large Core
PayPal Holdings PYPL	★★★★★	62	135	0.46	Narrow	High	Financial Services	Large Core
Wells Fargo WFC	★★★★	49	55	0.90	Wide	Medium	Financial Services	Large Value
Federal Realty Investment Trust FRT	★★★★	104	142	0.74	None	Medium	Real Estate	Small Core
Realty Income O	★★★★★	57	76	0.75	None	Low	Real Estate	Mid Core
Ventas VTR	★★★★★	49	72	0.69	None	Medium	Real Estate	Mid Core

Source: Morningstar. Data as of Dec. 21, 2023. New additions to the list this quarter in **bold**.

Economically Sensitive Sectors: Best Picks

We added Comcast as we suspect the market overestimating deterioration in traditional TV and underestimating growth in broadband. In energy, we added APA, as it is a catalyst-driven name that might outperform in a challenging oil price environment, and global oil producer Exxon is trading at a wide margin of safety. We replaced all three industrials stocks this quarter. We forecast Allegion will benefit from increased retrofitting and upgrading its end markets. With its extensive product portfolio of off-highway products, we expect CNH will benefit as customers replace their aging fleet and from increased infrastructure spending. We think the selloff in RTX's stock from Pratt & Whitney's engine recall is overblown.

Best Picks From Our Directors Across the Economically Sensitive Sectors

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector	Style Box
Comcast CMCSA	★★★★	44	60	0.73	Wide	Medium	Communication Services	Large Value
The Walt Disney Company DIS	★★★★	92	115	0.80	Wide	High	Communication Services	Large Core
Verizon Communications VZ	★★★★★	37	54	0.69	Narrow	Medium	Communication Services	Large Value
APA APA	★★★★	36	56	0.64	None	Very High	Energy	Mid Value
Equitrans Midstream ETRN	★★★★	10	15	0.68	Narrow	High	Energy	Small Value
Exxon Mobil XOM	★★★★	102	123	0.83	Narrow	High	Energy	Large Value
Allegion ALLE	★★★★	123	142	0.87	Wide	Medium	Industrials	Mid Core
CNH Industrial CNHI	★★★★	12	16	0.75	Narrow	High	Industrials	Large Value
RTX RTX	★★★★	82	112	0.73	Wide	Medium	Industrials	Large Value
Cognizant Technology Solutions CTSH	★★★★	74	94	0.79	Narrow	Medium	Technology	Mid Core
Snowflake SNOW	★★★	197	231	0.85	None	Very High	Technology	Large Growth
Teradyne TER	★★★★	107	147	0.73	Wide	High	Technology	Mid Core

Source: Morningstar. Data as of Dec. 21, 2023. New additions to the list this quarter in **bold**.

Defensive Sectors: Best Picks

Following its spinoff, WK Kellogg stock suffers from its small market capitalization and negative market sentiment surrounding cereal. Yet, we forecast margins will improve as supply chain enhancements drive operational efficiencies. We are also optimistic about a return to mid- to high-single-digit adjusted operating margins at Tyson, driven by easing input cost inflation and supply/demand rebalancing. WEC Energy combines best-in-class management and above-average growth opportunities supported by constructive regulation across most of its jurisdictions, yet trades at a significant discount to our fair value estimate.

Best Picks From Our Directors Across the Defensive Sectors

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector	Style Box
Estée Lauder EL	★★★★	145	200	0.73	Wide	Medium	Consumer Defensive	Mid Growth
WK Kellogg KLG	★★★★★	13	27	0.48	None	Medium	Consumer Defensive	Small Core
Tyson Foods TSN	★★★★★	52	82	0.63	None	Medium	Consumer Defensive	Mid Core
Illumina ILMN	★★★★★	140	228	0.62	Narrow	High	Healthcare	Mid Value
Moderna MRNA	★★★★★	91	227	0.40	None	Very High	Healthcare	Mid Growth
Zimmer Biomet ZBH	★★★★★	120	175	0.68	Wide	Medium	Healthcare	Mid Core
Entergy ETR	★★★★	100	120	0.83	Narrow	Low	Utilities	Mid Value
NiSource NI	★★★★★	26	33	0.79	Narrow	Low	Utilities	Mid Value
WEC Energy Group WEC	★★★★	82	96	0.86	Narrow	Low	Utilities	Mid Core

Source: Morningstar. Data as of Dec. 21, 2023. New additions to the list this quarter in **bold**.

Valuation by Economic Moat

Stocks With Wide Economic Moats Outperform in 2023, Leaving Undervalued Opportunities Harder to Find

Stocks of companies that we rate with a wide economic moat have well outpaced the broad market rally this year. Year to date through Dec. 21, the Morningstar Wide-Moat Focus Index has increased 31.65% as compared with the Morningstar US Market Index, which has risen 25.80%.

As such, as a category, stocks with wide moats are now fully valued as compared with the broad market. Yet, while as a category wide-moat stocks are fully valued, we continue to see opportunities in the mid-cap and small-cap space.

Stocks with a narrow economic moat trade at a slight discount, and stocks of companies we rate as not having a moat are trading at the greatest discount. For investors willing to wade into the waters of investing in companies that do not have long-term durable competitive advantages, we caution investors to pick and choose carefully among no-moat-rated stocks, especially as the economy is poised to slow.

Price/Fair Value Estimate by Economic Moat Rating Across Size and Style

At a similar discount to fair value, we prefer stocks of companies with a wide moat over narrow moats.

		Size			Style		
Moat		Large	Mid	Small	Value	Core	Growth
None	0.95	1.03	0.94	0.89	0.93	0.97	0.99
Narrow	0.98	1.02	0.94	0.80	0.89	0.98	1.12
Wide	1.01	1.02	0.95	0.82	0.90	1.09	0.99

Undervalued — Fairly Valued — Overvalued

< 0.90 | > 0.90 to 0.95 | > 0.95 to 0.99 | > 0.99 to 1.01 | > 1.01 to 1.05 | > 1.05 to 1.10 | > 1.10

Source: Morningstar. Data as of Dec. 21, 2023.

Undervalued Large-Cap Stocks With Wide Economic Moats and Low or Medium Uncertainty

Examples of Low- or Medium-Uncertainty-Rated Companies With Long-Term, Durable Competitive Advantages at Discounts to Our Estimate of Intrinsic Valuation

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector
Yum China YUMC	★★★★★	42	80	0.52	Wide	Medium	Consumer Cyclical
Pfizer PFE	★★★★★	28	42	0.67	Wide	Medium	Healthcare
Medtronic MDT	★★★★	82	112	0.73	Wide	Medium	Healthcare
RTX RTX	★★★★	82	112	0.73	Wide	Medium	Industrials
Comcast CMCSA	★★★★	44	60	0.73	Wide	Medium	Communication Services
Altria Group MO	★★★★	40	52	0.78	Wide	Medium	Consumer Defensive
Bristol-Myers Squibb BMY	★★★★	51	63	0.81	Wide	Medium	Healthcare
Gilead Sciences GILD	★★★★	79	97	0.81	Wide	Medium	Healthcare
U.S. Bank USB	★★★★	43	52	0.83	Wide	Medium	Financial Services
Thermo Fisher Scientific TMO	★★★★	527	600	0.88	Wide	Medium	Healthcare
Emerson Electric EMR	★★★★	96	109	0.88	Wide	Medium	Industrials
Honeywell HON	★★★★	205	229	0.90	Wide	Medium	Industrials
Wells Fargo WFC	★★★★	49	55	0.90	Wide	Medium	Financial Services

Source: Morningstar. Data as of Dec. 21, 2023.

Undervalued Mid-Cap Stocks With Wide Economic Moats and Low or Medium Uncertainty

Examples of Low- or Medium-Uncertainty-Rated Companies With Long-Term, Durable Competitive Advantages at Discounts to Our Estimate of Intrinsic Valuation

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector
Zimmer Biomet ZBH	★★★★★	120	175	0.68	Wide	Medium	Healthcare
Campbell Soup CPB	★★★★	43	61	0.70	Wide	Medium	Consumer Defensive
Corteva Agriscience CTVA	★★★★★	47	67	0.71	Wide	Medium	Basic Materials
Estée Lauder EL	★★★★	145	200	0.73	Wide	Medium	Consumer Defensive
Kenvue KVUE	★★★★	21	28	0.77	Wide	Medium	Consumer Defensive
Constellation Brands STZ	★★★★	236	274	0.86	Wide	Medium	Consumer Defensive
Tyler Technologies TYL	★★★★	412.49	475	0.87	Wide	Medium	Technology
Huntington Ingalls Industries HII	★★★★	254	285	0.89	Wide	Low	Industrials
Otis (Electrical Equipment) OTIS	★★★★	88	98	0.90	Wide	Low	Industrials
BNY Mellon BK	★★★★	51	56	0.92	Wide	Medium	Financial Services
Hershey HSY	★★★★	181	197	0.92	Wide	Low	Consumer Defensive
Agilent Technologies A	★★★★	139	151	0.92	Wide	Medium	Healthcare
Yum Brands YUM	★★★★	130	139	0.94	Wide	Low	Consumer Cyclical

Source: Morningstar. Data as of Dec. 21, 2023.

Undervalued Small-Cap Stocks With Wide or Narrow Economic Moats and Low or Medium Uncertainty

Undervalued Small-Cap Stocks With Wide or Narrow Economic Moats and Low or Medium Uncertainty

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector
Hasbro HAS	★★★★★	51	88	0.58	Narrow	Medium	Consumer Cyclical
Sealed Air SEE	★★★★★	37	54	0.68	Narrow	Medium	Consumer Cyclical
Western Union WU	★★★★★	12	17	0.70	Narrow	Medium	Financial Services
Allison Transmission ALSN	★★★★	58	74	0.79	Narrow	Medium	Consumer Cyclical
Mattel MAT	★★★★	19	24	0.79	Narrow	Medium	Consumer Cyclical
Stericycle SRCL	★★★★	50	59	0.85	Narrow	Medium	Industrials
Gentex GNTX	★★★★	32	38	0.85	Narrow	Medium	Consumer Cyclical
Portland General Electric POR	★★★★	43	50	0.87	Narrow	Low	Utilities
WESCO International WCC	★★★★	175	197	0.89	Narrow	Medium	Industrials
Ingredion INGR	★★★★	108	120	0.90	Narrow	Medium	Consumer Defensive
Choice Hotels International CHH	★★★★	113	125	0.90	Narrow	Medium	Consumer Cyclical
Wyndham Hotel Group WH	★★★★	80	88	0.90	Narrow	Medium	Consumer Cyclical
Vontier VNT	★★★★	34	38	0.91	Narrow	Medium	Technology

Source: Morningstar. Data as of Dec. 21, 2023.

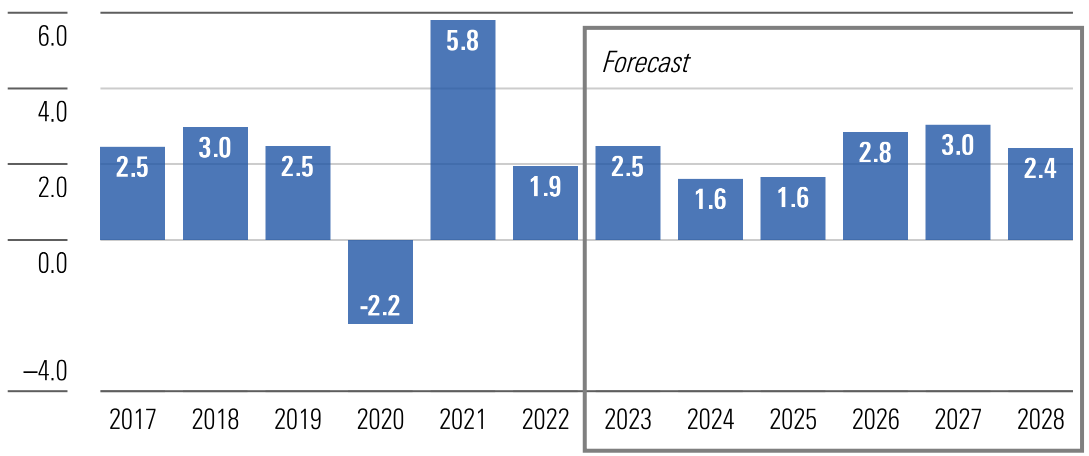
U.S. Economic Outlook

We Still Expect Inflation to Plummet, Allowing the Fed to Cut Rates and Jump-Start GDP Growth

GDP Growth Dips in 2024 but Recovers in 2025

It was widely expected that the Fed's rate hikes (the largest in 40 years) would slow GDP growth in 2023, but that hasn't panned out. While rate hikes have hit housing activity, overall GDP growth has remained resilient owing to free-spending consumers and a manufacturing building boom. Also, financial conditions have been placid since the turbulence from the March 2023 bank failures subsided. Yet, despite near-term strength in the economic data, we believe the impact of high rates has yet to fully play out. We expect growth to slow in 2024, before bouncing back in second-half 2025 and the following years as the Fed eases monetary policy. For full coverage of our latest economic views, see our U.S. Economic Pulse: December 2023.

U.S. Real GDP Growth (%) *Annual Averages*



Inflation Should Return to Normal in 2024

Inflation in 2022 reached its highest level in 40 years, as supply constraints combined with excess demand to drive up prices. But supply constraints are alleviating, and the Fed's rate hikes have pulled back demand. As a result, we expect inflation to fall greatly in 2023, and back to the Fed's 2% target by 2024. The price spikes in energy, durable goods, and other areas have been unwinding, a process we expect to last for several years. Also, housing's contribution to high inflation is fading as housing demand normalizes.

U.S. Inflation Rate (%), PCE Price Index *Annual Averages*

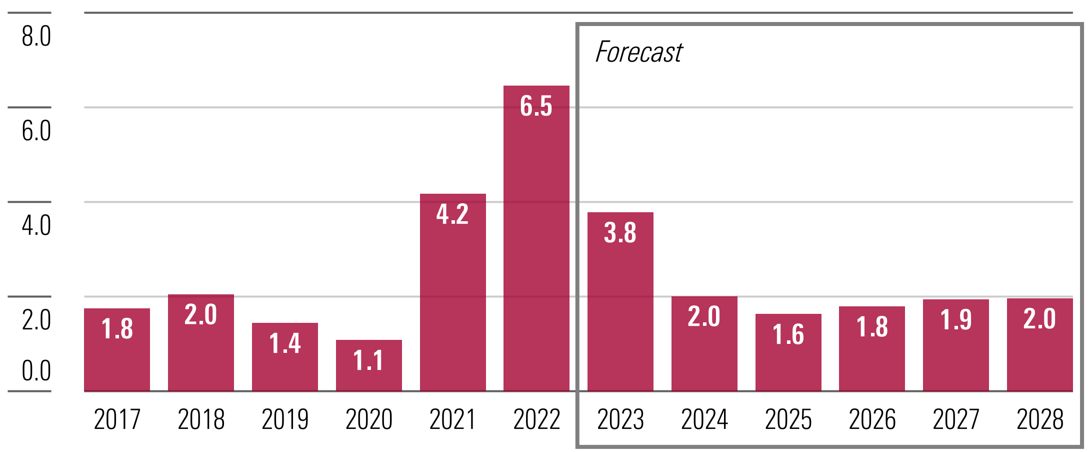


Exhibit sources: U.S. Bureau of Economic Analysis, Morningstar.

Despite Erstwhile Resilience, the Economy Will Ultimately Need a Reduction in Interest Rates to Thrive

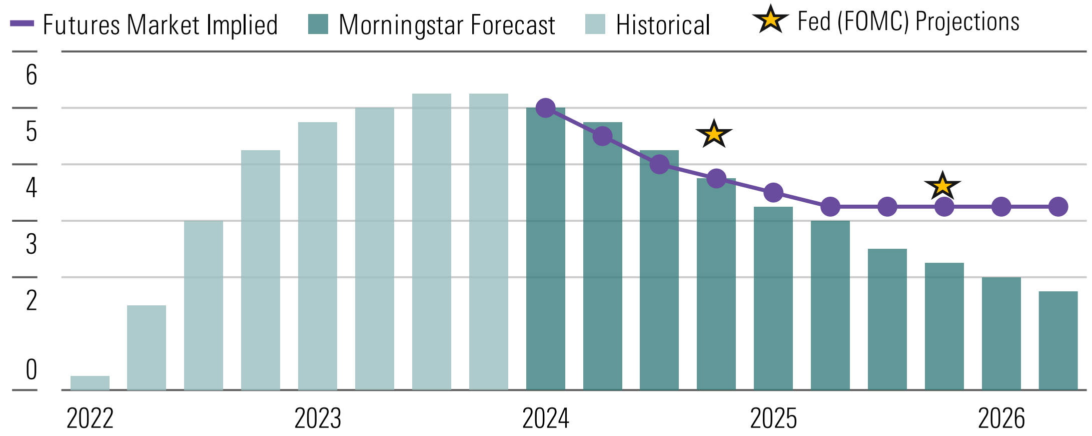
We Expect the Fed to Cut Aggressively in 2024 and 2025

In the near term, market expectations have essentially converged with our view that the Fed will cut rates heavily in 2024. The revision in market views is also reflected in falling bond yields, with the 10-year Treasury falling to 3.9% from a recent high of 5%.

The Fed is still reluctant to discuss rate cuts, but we believe that inflation will have sufficiently normalized to push the Fed to make a cut in March 2024. We expect core PCE inflation to hit 2.4% year over year in March, and Fed Chair Jerome Powell recently acknowledged that it should begin to bring the federal-funds rate down from currently highly "restrictive" levels once the inflation target is within range.

Further inflation reduction and weakness in economic growth should push the Fed to cut further throughout 2024 all the way through early 2026. We expect a federal-funds rate of 3.75%-4% at year-end 2024, 2%-2.25% at the end of 2025, and 1.75%-2% by the first half of 2026. There remains a divergence between our forecast and market expectations if you look out to 2026 (about 150 basis points). We expect inflation in 2025 and 2026 to come in below the Fed's 2% target and unemployment to remain slightly elevated (above 4%) until later 2026, which should push the Fed to continue cutting until the federal-funds rate is just under 2%. Commensurately, we continue to believe the neutral rate of interest has not greatly shifted compared with prepandemic levels (the federal-funds rate averaged 1.7% over 2017 to 2019).

Federal-Funds Rate (%) Expectations (Bottom of Target Range)



Treasury Yields (%)

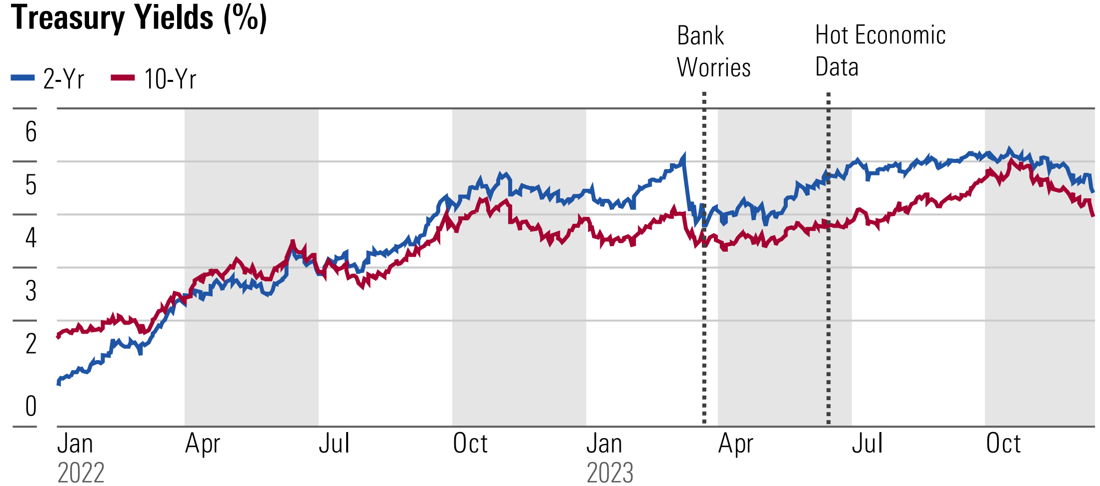


Exhibit sources: Federal Reserve, Chicago Mercantile Exchange (top).

Spotlight | Mega-Cap Stocks

Mega-Cap Stocks Soared Higher Year to Date, but Most Have Run Their Course

Most Mega-Cap Stocks Rated 4- or 5-Stars at the Beginning of 2023 Have Outperformed the Market

Name/Ticker	Rating 12/30/22	Rating 12/21/23	Price ($) 12/30/22	Price ($) 12/21/23	Change (%)	Fair Value 12/30/22	Fair Value 12/21/23	Change (%)	P/FV 12/30/22	P/FV 12/21/23
Microsoft MSFT	★★★★	★★★	240	374	55.8%	320	370	15.6%	0.75	1.01
Alphabet GOOGL	★★★★★	★★★★	88	140	59.2%	160	161	0.6%	0.55	0.87
Amazon.com AMZN	★★★★★	★★★	84	154	83.1%	150	155	3.3%	0.56	0.99
Berkshire Hathaway BRK.A	★★★★	★★★★	468,711	541,000	15.4%	555,000	600,000	8.1%	0.84	0.90
Tesla TSLA	★★★★★	★★★	123	255	106.6%	250	210	**-16.0%**	0.49	1.21
Nvidia NVDA	★★★★	★★★	146	490	235.2%	200	480	140.0%	0.73	1.02
Meta Platforms META	★★★★★	★★★	120	354	194.2%	260	322	23.8%	0.46	1.10
Bank of America BAC	★★★★	★★★	33	33	0.2%	39	35	**-10.3%**	0.85	0.95
Broadcom AVGO	★★★★	★★	559	1,127	101.6%	624	970	55.4%	0.90	1.16

Source: Morningstar. Data as of Dec. 21, 2023.

Updated List of Undervalued Mega-Cap Stocks for 2024

The rise of the Magnificent Seven and surge in anything AI-related, led to a rotation out of numerous large-cap, high-quality stocks in 2023. For example, Exxon, Johnson & Johnson, Pepsi, and Thermo Scientific have all pulled back to levels we now consider to be attractive. While we continue to expect a soft landing in the economy, several of these stocks should exhibit defensive characteristics while the rate of economic growth slows.

Stocks Rated 4 or 5 Stars With Market Capitalizations of $200 Billion and Greater

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector	Style Box	Market Cap ($B)
Alphabet GOOGL	★★★★	140	161	0.87	Wide	High	Communication Services	Large Growth	1,765.4
Berkshire Hathaway BRK.A	★★★★	541,000	600,000	0.90	Wide	Low	Financial Services	Large Growth	775.3
Exxon Mobil XOM	★★★★	102	123	0.83	Narrow	High	Energy	Large Value	406.6
Johnson & Johnson JNJ	★★★★	155	164	0.94	Wide	Low	Healthcare	Large Value	372.7
Pepsico PEP	★★★★	167	180	0.93	Wide	Low	Consumer Defensive	Large Core	229.6
McDonald's MCD	★★★★	291	310	0.94	Wide	Low	Consumer Cyclical	Large Core	211.4
Thermo Fisher Scientific TMO	★★★★	527	600	0.88	Wide	Medium	Healthcare	Large Core	203.4

Source: Morningstar. Data as of Dec. 21, 2023. New additions to the list this quarter in **bold**.

All but One Overvalued Mega-Cap Stock Have Underperformed

Nine of 10 Mega-Cap Stocks Rated With 1- or 2-Stars Identified at the Beginning of Year Have Underperformed the Market

Name/Ticker	Rating 12/31/22	Rating 12/21/23	Price ($) 12/31/22	Price ($) 12/21/23	Change (%)	Fair Value 12/31/22	Fair Value 12/21/23	Change (%)	P/FV 12/31/22	P/FV 12/21/23
UnitedHealth Group UNH	★★	★★★	530	520	**-1.9%**	426	520	22.1%	1.24	1.00
Johnson & Johnson JNJ	★★	★★★★	177	155	**-12.3%**	164	164	0.0%	1.08	0.94
Procter & Gamble PG	★★	★★	152	144	**-4.8%**	125	138	10.4%	1.21	1.05
Eli Lilly LLY	★★	★★	366	572	56.4%	273	450	64.8%	1.34	1.27
Chevron CVX	★★	★★★	179	151	**-16.0%**	149	172	15.4%	1.20	0.88
The Home Depot HD	★★	★★	316	349	10.5%	270	263	**-2.6%**	1.17	1.33
AbbVie ABBV	★★	★★	162	153	**-5.6%**	120	126	5.0%	1.35	1.21
Merck & Co. MRK	★★	★★★	111	106	**-4.1%**	97	103	6.2%	1.14	1.03
Coca-Cola KO	★★	★★★	64	58	**-8.8%**	58	60	3.4%	1.10	0.97
Pepsico PEP	★★	★★★★	181	167	**-7.6%**	170	180	5.9%	1.06	0.93

Source: Morningstar. Data as of Dec. 21, 2023.

Updated List of Overvalued Mega-Cap Stocks for 2024

Although not large enough to be considered one of the Magnificent Seven, Broadcom has doubled in 2023 and is now rated 2 stars after starting the year with 4 stars. Netflix has also surged, rising 66% and Costco followed suit, rising 45%. While we rate these companies with economic moats, we think the market has gotten ahead of itself on valuation as each are now overvalued.

Stocks Rated 1- or 2-Stars With Market Capitalizations of $200 Billion and Greater

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector	Style Box	Market Cap ($B)
Apple AAPL	★★	195	160	1.22	Wide	Medium	Technology	Large Core	3,027.8
Eli Lilly LLY	★★	572	450	1.27	Wide	High	Healthcare	Large Growth	543.0
Broadcom AVGO	★★	1,127	970	1.16	Wide	Medium	Technology	Large Core	527.7
The Home Depot HD	★★	349	263	1.33	Wide	Medium	Consumer Cyclical	Large Core	347.3
Procter & Gamble PG	★★	144	138	1.05	Wide	Low	Consumer Defensive	Large Core	340.0
Costco Wholesale COST	★	665	460	1.45	Wide	Medium	Consumer Defensive	Large Core	295.2
Oracle ORCL	★★	106	83	1.28	Narrow	Medium	Technology	Large Core	291.0
AbbVie ABBV	★★	153	126	1.21	Narrow	High	Healthcare	Large Value	269.4
Netflix NFLX	★★	492	410	1.20	Narrow	High	Communication Servic	Large Growth	215.2
Accenture ACN	★★	349	271	1.29	Wide	Medium	Technology	Large Core	218.7

Source: Morningstar. Data as of Dec. 21, 2023. New additions to the list this quarter in **bold**.

Fixed-Income Outlook 2024

See Important Disclosures at the end of this report.

Bonds Battered as Interest Rates March Higher in Q3

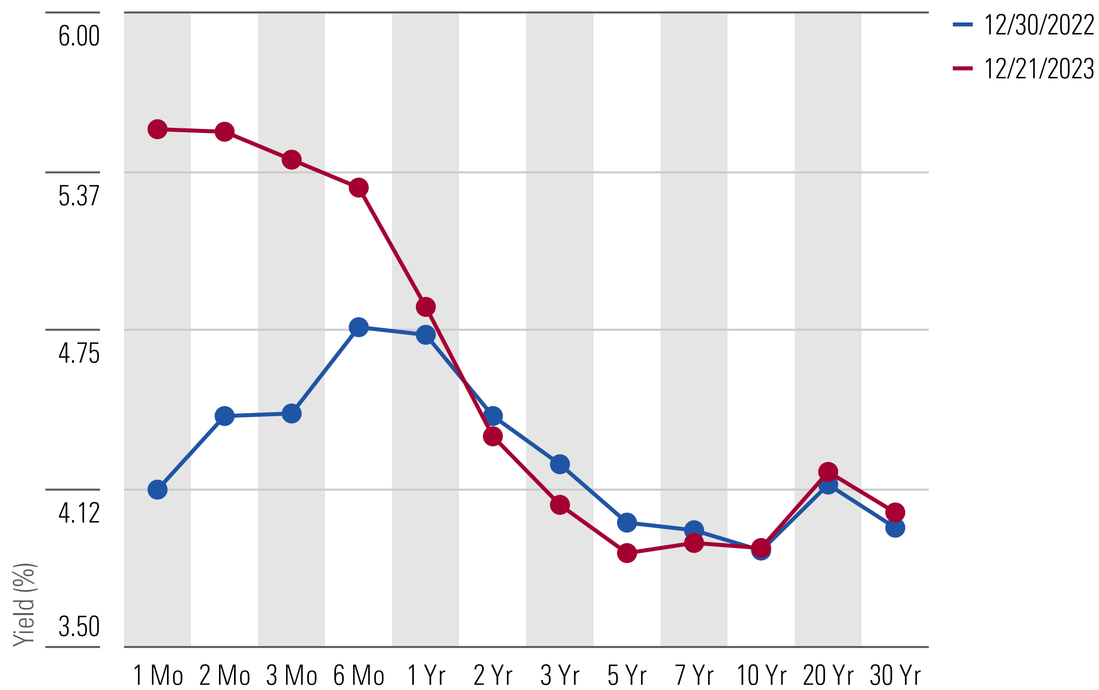
Following the worst bond market ever in 2022, fixed-income markets have largely normalized and rebounded in 2023. For the year to date, fixed-income returns are positive, with those bonds that trade with a credit spread having performed better than U.S. Treasuries. Through Dec. 21, the Morningstar US Core Bond Index, our proxy for the broad bond market, increased 5.03%. The return was supported by a combination of underlying yield carry and tightening credit spreads.

Morningstar US Fixed Income Index Returns Year to Date (Percent)

Morningstar Index	Effective Yield	Duration	2022	1Q 2023	2Q 2023	3Q 2023	4QTD 2023	YTD 2023
ABS	5.87%	2.1	-4.42%	2.05%	0.16%	0.99%	2.67%	5.97%
CMBS	5.92%	3.9	-9.84%	1.63%	-0.43%	-0.78%	4.51%	4.93%
Core Bond	4.96%	6.0	-12.99%	2.92%	-0.82%	-3.18%	6.28%	5.03%
Corporate Bond	5.46%	7.0	-15.71%	3.61%	-0.30%	-2.99%	7.83%	8.05%
High-Yield Bond	8.13%	3.5	-11.09%	3.68%	1.65%	0.57%	6.58%	12.95%
MBS	5.20%	5.8	-11.94%	2.48%	-0.53%	-4.08%	6.93%	4.55%
TIPS	2.34%	5.3	-11.85%	3.38%	-1.45%	-2.57%	4.71%	3.94%
Treasury Bond	4.49%	5.9	-12.43%	2.97%	-1.37%	-3.01%	5.30%	3.72%

Source: Morningstar. Data as of Dec. 21, 2023.

Yield Curve Becomes Even Further Inverted



Source: U.S. Treasury, Morningstar. Data as of Dec. 21, 2023.

Interest-Rate Forecast

We think the Federal Reserve's next move will not be to hike rates, but to begin cutting rates in early 2024.

We forecast that the rate of economic growth has begun to slow and will continue to decelerate sequentially each quarter until bottoming out in the third quarter of 2024. We also project that inflation will remain on a downward trend in 2024. In our view, the combination of a slowing economy and declining inflation will provide the Fed the room it will need to begin easing monetary policy, possibly as soon as the March 2024 meeting.

Interest rates plummeted after the December Fed meeting as the market interpreted Chair Jerome Powell's statement and commentary during the press conference that the Fed was not only done hiking interest rates but would begin considering when to start moving to a less restrictive monetary policy.

Our U.S. economics team forecasts that the Fed will begin to cut short-term interest rates in early 2024 and project the federal-funds rate will fall to a range of 3.75%-4% by the end of the year. We also forecast that the federal-funds rate will remain on downward path, dropping to 3% by the end of 2025.

In the longer end of the curve, we project the yield on the 10-year U.S. Treasury will average 3.50% in 2024 and 2.75% in 2025. In our midyear bond market update, we began to advise investors to lengthen their duration. According to our forecasts, we continue to think investors will be best served in longer-duration bonds and locking in the currently high interest rates.

Interest-Rate Forecast

Average interest rate per calendar year.

Interest Rate (%)	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
Federal-Funds	4.85	3.17	2.04	1.88	1.88
10-Year UST	3.50	2.75	2.50	2.75	2.75

Source: Morningstar. Data as of Dec. 18, 2023.

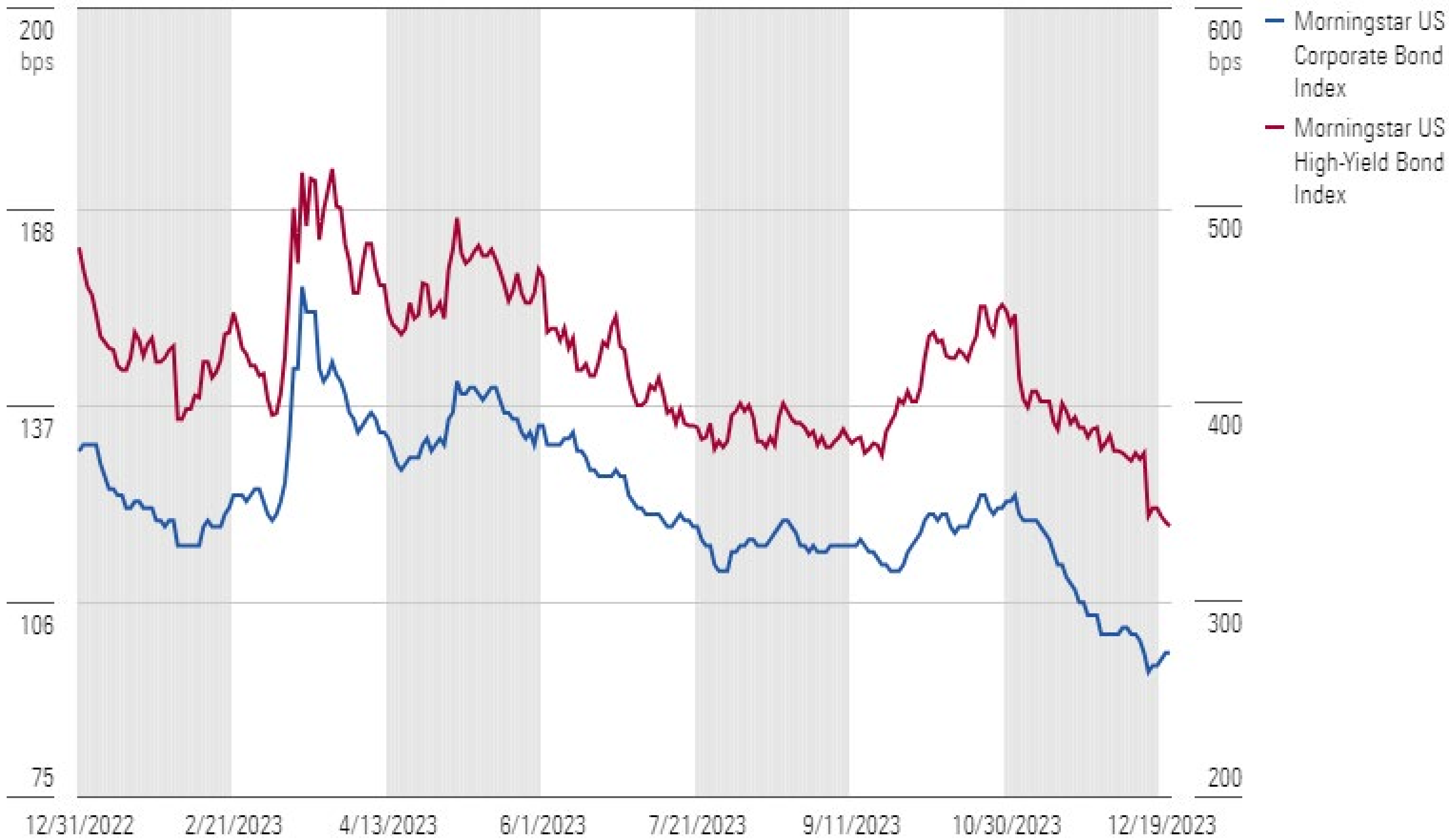
Corporate Bond Market

Corporate credit spreads tightened over the course of the quarter. In the investment-grade corporate bond market, the average spread of the Morningstar US Corporate Bond Index tightened 18 basis points to +98. In the high-yield corporate bond market, the average spread of the Morningstar US High-Yield Index tightened 63 basis points to +338.

While the amount of extra spread provided on corporate bonds appears adequate based on our economic outlook, by no means are credit spreads cheap. Over the past 23 years, only 15% of the time has the spread on the Morningstar US Corporate Bond Index been below the current spread of +98 basis points. Over the same period, only 12% of the time has the spread on the Morningstar US High-Yield Bond Index been below its current spread of plus 338 basis points.

Corporate Credit Spreads Tighten

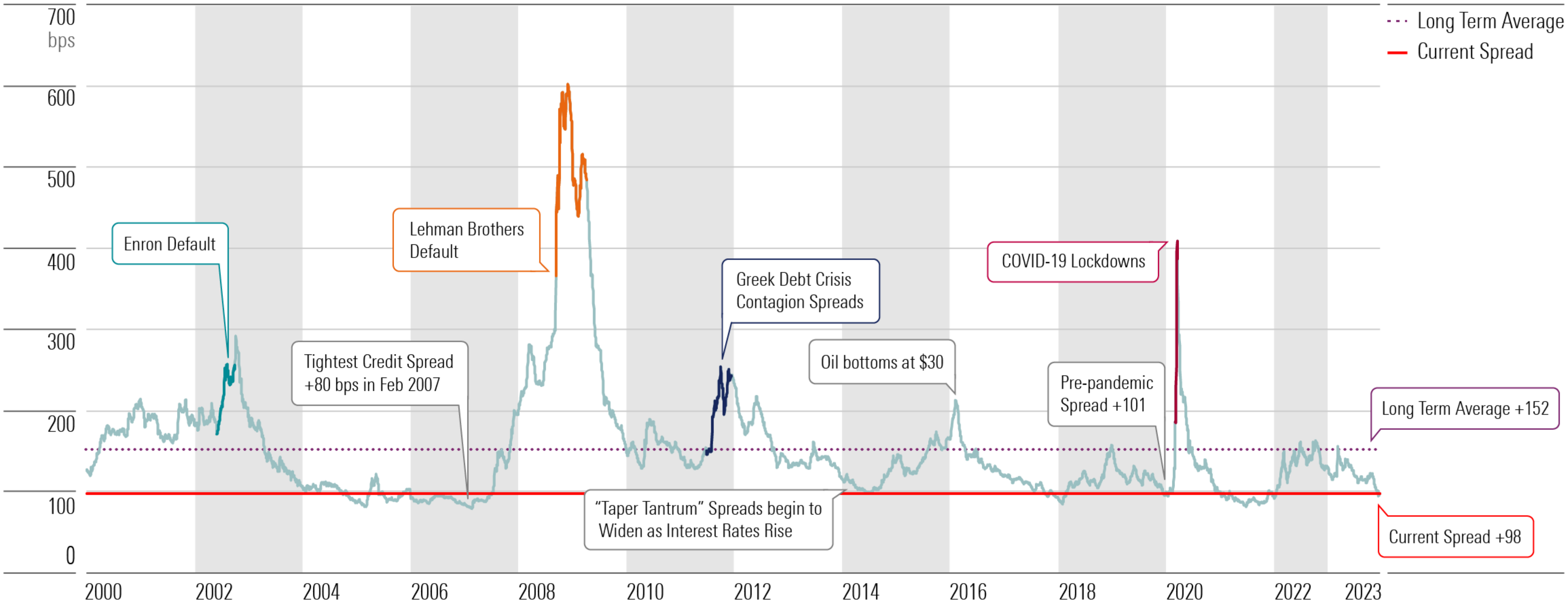
Year to date, investment-grade and high-yield spreads tightened 32 and 141 basis points, respectively.



Source: Morningstar. Data as of Dec. 21, 2023.

Long-Term Average Credit Spread for Investment-Grade Corporate Bond Market

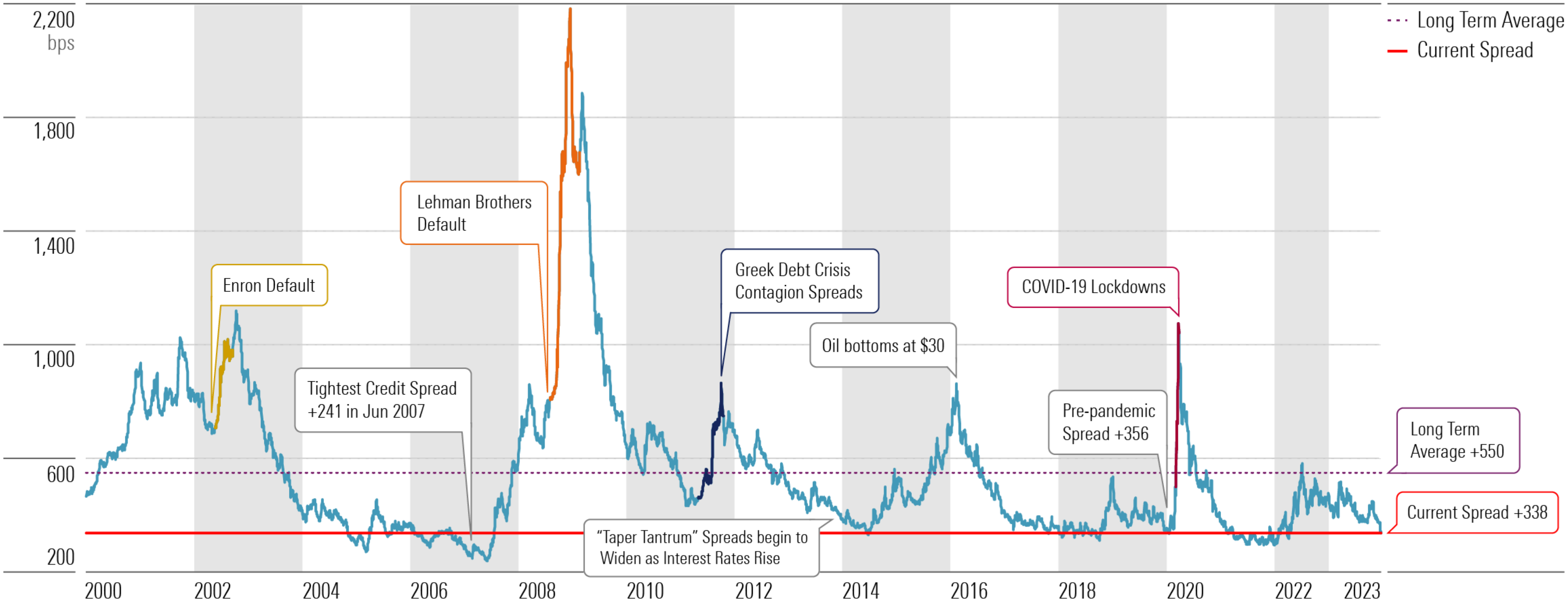
Morningstar US Corporate Bond Index Average Credit Spread



Source: Morningstar. Data as of Dec. 21, 2023.

Long-Term Average Credit Spread for High-Yield Corporate Bond Market

Morningstar US High Yield Bond Index Average Credit Spread



Source: Morningstar. Data as of Dec. 21, 2023.

Basic Materials

Seth Goldstein, CFA | seth.goldstein@morningstar.com

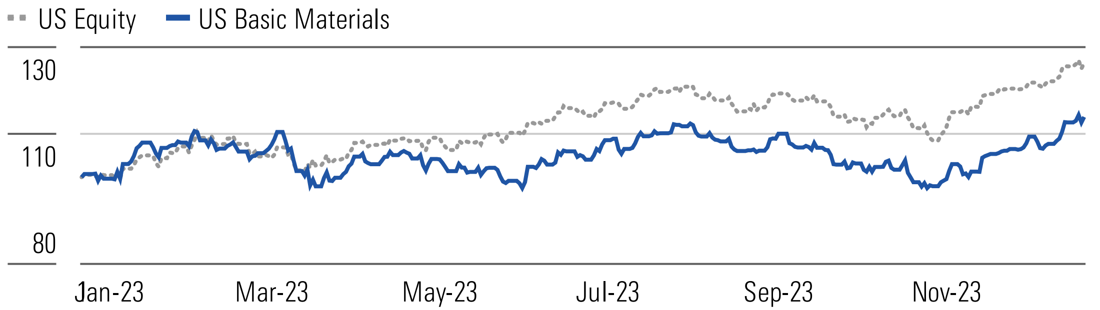
As Basic Materials Sector Underperforms, We See Strong Opportunities

The Morningstar US Basic Materials Index underperformed the broader market during the fourth quarter of 2023. The materials index was up 10.4% during the quarter, but the rally was 110 basis points below the Morningstar US Market Index, which posted an 11.5% gain. On a trailing 12-month basis, the materials sector underperformed the market by 1,250 basis points. However, we see opportunities across the sector with the majority (56%) of the stocks trading in either 5-star or 4-star territory. Undervalued industries include chemicals, agriculture, metals and mining, and forest products.

Lithium demand will more than triple by 2030 from 2022 largely due to increased electric vehicle adoption as EVs rise to 40% of global auto sales by 2030, up from 10% in 2022. Over the long term, we view lithium as one of the best ways to invest in rising EV adoption as all EV batteries require lithium. In the near term, prices have fallen as supply caught up with demand due to inventory destocking among battery producers. Prices are currently around $17,000 per metric ton. However, as destocking ends, we expect prices will stabilize and rise in 2024. As EV sales continue to grow, we forecast demand growth will accelerate leading to prices rising by the end of the year. We forecast prices will average $30,000 per metric ton from 2023 to 2030.

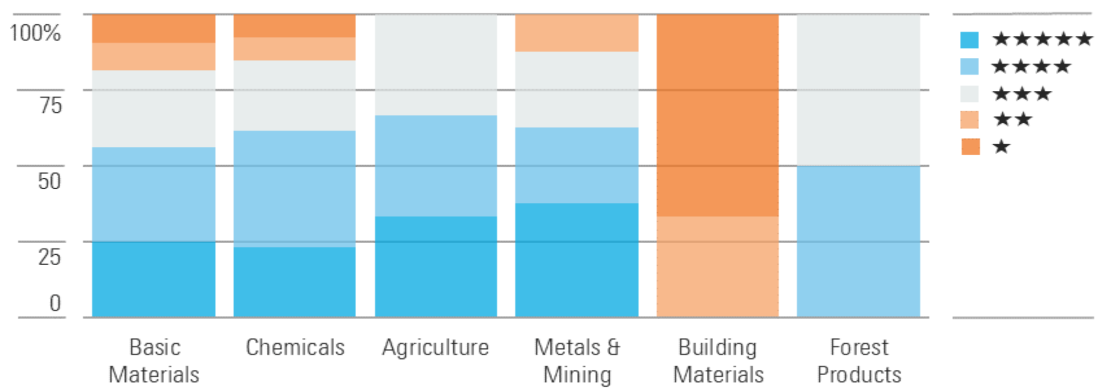
Crop chemicals demand has declined due to inventory destocking as product availability from disrupted COVID-19 supply chains are no longer a concern among farmers and farm retailers. However, as destocking has largely run its course, we expect industry growth will resume in 2024. Crop chemicals producers should return to profit growth as demand normalizes.

The Basic Materials Index Underperformed the Broader Market Index



Source: Morningstar. Data as of Dec. 21, 2023.

Nearly 60% of Our Basic Materials Names Trade in 5- or 4-Star Territory

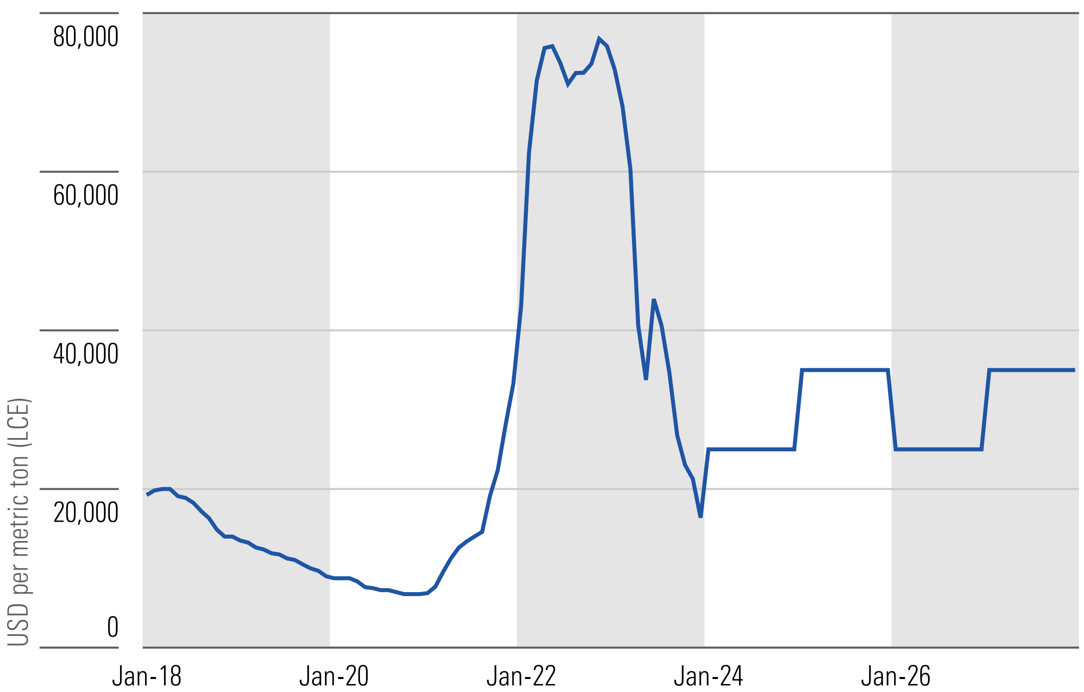


Source: Morningstar. Data as of Dec. 21, 2023.

As Basic Materials Sector Underperforms, We See Strong Opportunities

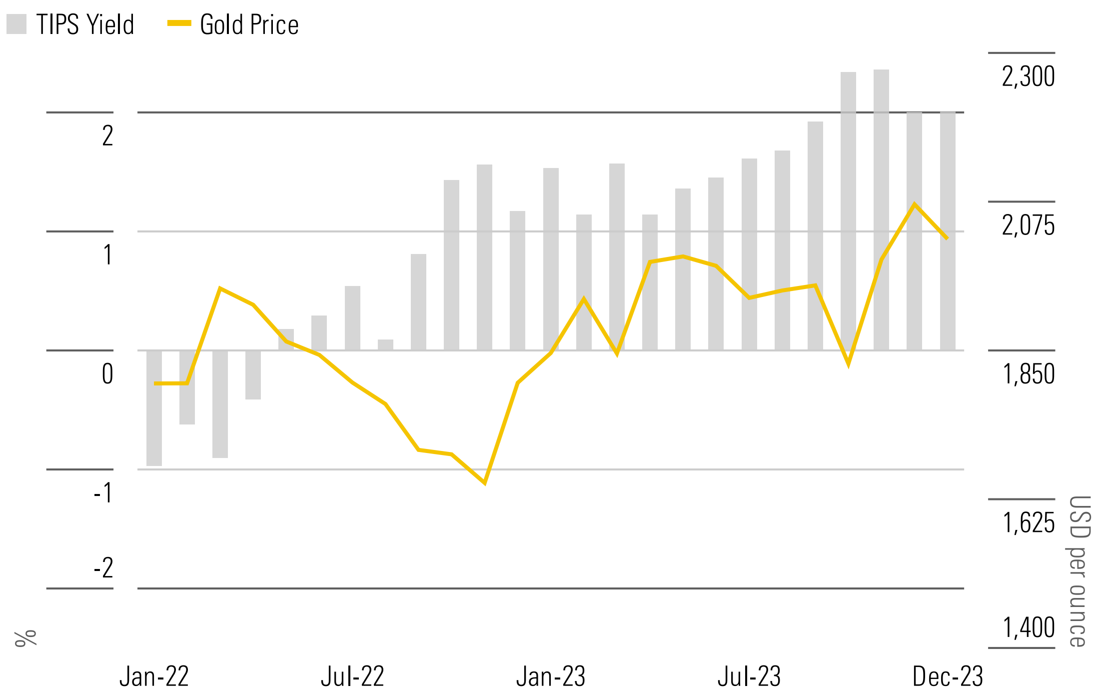
Gold investment lacks cash flows for owners and rising yields make bonds relatively more attractive, and vice versa. With the world's central banks hiking rates in response to inflation, many gold miners have been out of favor. However, spot gold prices have risen recently to around $2,030 per ounce on expectations we are close to peak interest rates, a tailwind to share prices. Over the longer term, we forecast gold prices to decline to roughly $1,740 per ounce midcycle from 2027, based on our estimate of the marginal cost of production.

Lithium Prices Will Rise in 2024 as Demand Growth Outpaces Supply



Source: Platts, LME, Benchmark Minerals, Fastmarkets, Morningstar. Data as of Dec. 4, 2023.

Gold Prices Rose in 2023 on Expectations of Falling Real Interest Rates



Source: Morningstar. Data as of Dec. 5, 2023.

Basic Materials

Name/Ticker		Rating	
Albemarle (ALB)		★★★★★	Albemarle is our top pick to play strong lithium demand and rising prices from growing EV adoption. The stock trades at a little less than 60% of our $300 per share fair value estimate. Albemarle's main business is lithium, which generates roughly 90% of profits. The company produces lithium from three of the best resources globally, which create the cost advantage that underpins our narrow moat rating. Among our covered lithium producers, Albemarle also offers the lowest relative risk. We think the company can triple its lithium production capacity by the end of the decade by replicating the company's existing downstream conversion facilities.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
145.45	300.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
17.62	Narrow	Standard	

Name/Ticker		Rating	
FMC (FMC)		★★★★★	Our top pick to invest in crop chemicals demand recovery is narrow-moat FMC. The stock trades at around 50% of our $110 per share fair value estimate. FMC is a crop protection pure-play company. The market is concerned with the industry recovery and FMC's patent expiration risk of its diamide products, which currently generate the majority of profits. However, as the industry recovers and the company develops new premium products from its strong R&D pipeline, we forecast FMC will see profit growth and margin recovery.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
62.10	110.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
7.85	Narrow	Standard	

Name/Ticker		Rating	
Newmont (NEM)		★★★★	Newmont's acquisition of Newcrest extends its lead as the world's largest gold miner, with pro forma 2023 sales of roughly 7.3 million ounces of gold. The combined company also has material copper production of roughly 160,000 metric tons and numerous development projects that we think are valuable and perhaps overlooked. We think Newmont's shares are undervalued given its weak sales volumes in the first nine months of 2023, which have led to elevated unit cash costs. However, as volumes recover, unit cash costs should fall. The market hasn't favored gold miners due to rising interest-rate concerns. Rising rates increase the opportunity cost of holding gold.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
41.43	53.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
48.31	None	Standard	

Communication Services

Michael Hodel | michael.hodel@morningstar.com

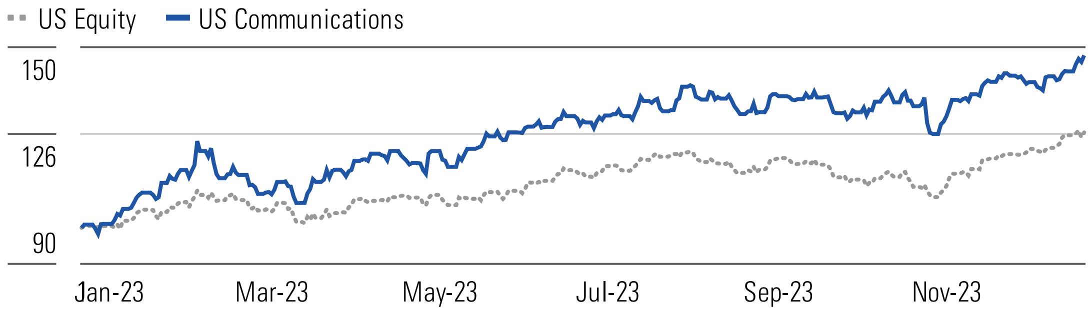
The Surge in Digital Advertising Demand Has Been Impressive, but We Expect Some Moderation in 2024

We estimate digital advertising revenue increased roughly 15% year over year during the third quarter, with growth accelerating impressively throughout 2023 following a modest revenue decline in late 2022. Nearly every platform has benefited, but Meta and Amazon stand out as clear winners. Amazon's ad revenue is approaching $50 billion annually, making it the clear number three in the online ad world. We believe the market now fully appreciates the strength of these businesses, as Alphabet trades at only a modest discount to our fair value estimate and Meta trades at a slight premium.

We wouldn't be surprised to see a slowdown in digital ad spending growth in 2024. The industry will start to lap improvements in measurement capabilities made recently, which have helped offset the impact of changes to Apple's privacy policies that were implemented in 2021. Improved sales on new features like Meta's Reels may also provide less of a benefit going forward. In addition, Morningstar expects slower economic growth in 2024, and advertisers may simply take a breather after a period of very strong demand, at least partially offsetting political spending.

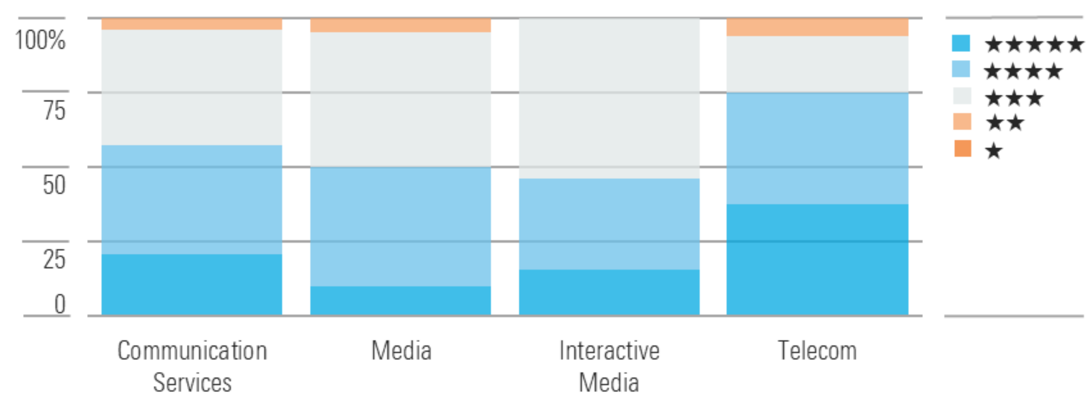
Traditional television advertising and subscription revenue remain in a tailspin as audiences cut the cord on cable television. However, most media companies have increased prices for their streaming services, somewhat lifting the relative cost of streaming content versus cable. The major media firms have also sharply curtailed content spending recently, improving profitability overall. While the actors' and writers' strikes caused some of this decline, we believe the industry is taking a more measured approach to the content investments surrounding their streaming offerings.

Alphabet and Meta Have Powered Communication Services Gains



Source: Morningstar. Data as of Dec. 21, 2023.

The Rally in Online Media Has Left Few Opportunities; Telecom Still Attractive

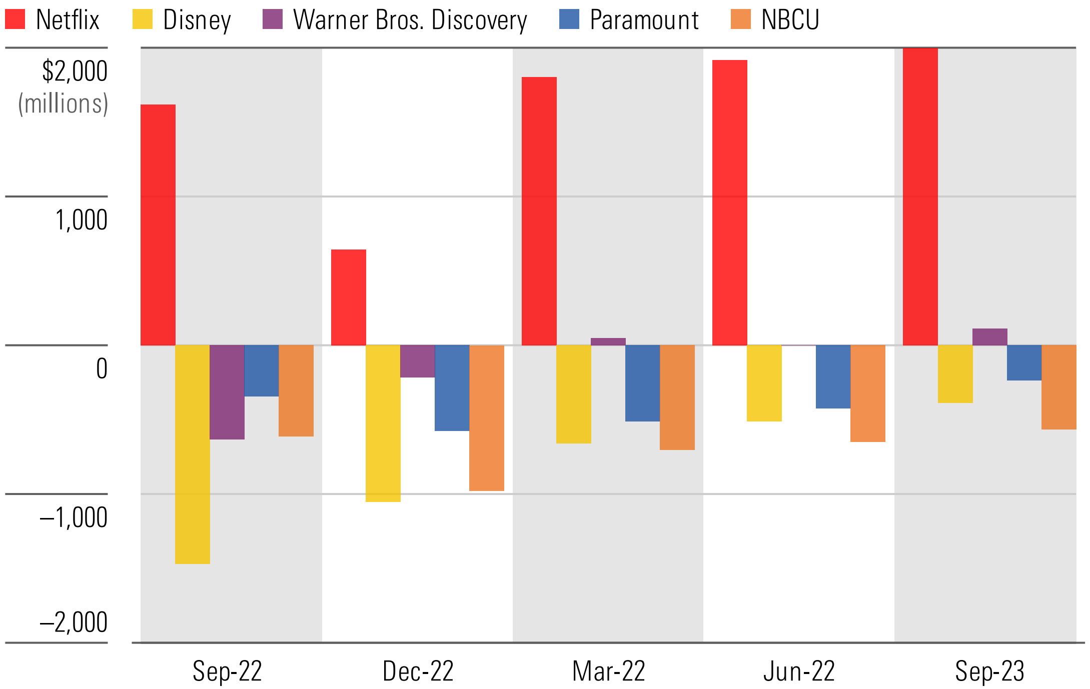


Source: Morningstar. Data as of Dec. 21, 2023.

The Surge in Digital Advertising Demand Has Been Impressive, but We Expect Some Moderation in 2024

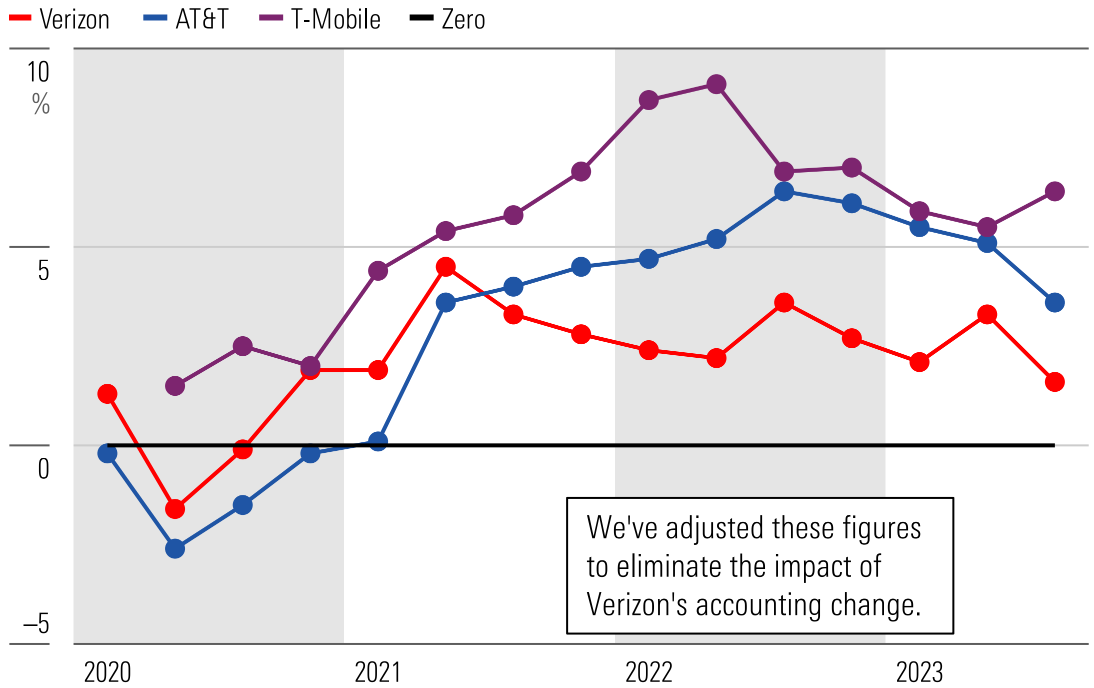
In the U.S. telecom services market, AT&T and Verizon have lapped the price increases they implemented in mid-2022, slowing reported growth. T-Mobile has outperformed primarily because of its aggressive push into the fixed-wireless home broadband market. We continue to see stability and rationality within the wireless market, which bodes well for cash flow across each of the Big Three U.S. carriers in 2024, which we expect will lead to improved stock performance.

Monthly Broadband Revenue per Customer: Competition Remains Rational



Source: Company reports, Morningstar research. Data as of Nov. 15, 2023.

Enterprise Value/Trailing EBITDA: Investors Expect Little Streaming Improvement



Source: Company reports, Morningstar research. Data as of Nov. 15, 2023.

Communication Services

Name/Ticker		Rating	
Verizon (VZ)		★★★★★	Verizon remains the cheapest of the three major U.S. wireless carriers relative to our fair value estimate. Investors have soured on Verizon and its peers as Comcast and Charter have taken market share. Verizon specifically has struggled to improve wireless customer growth over the past year. We believe the firm will likely continue to gradually lose wireless market share, which we've factored into our fair value estimate. Pricing gains and a modest contribution from new services like edge computing should enable Verizon to increase revenue slowly. Continued cost-reduction efforts should allow margins to hold roughly steady over time as well.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
37.43	54.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
157.38	Narrow	Standard	

Name/Ticker		Rating	
Disney (DIS)		★★★★	We recently lowered our Disney fair value estimate, but we still believe the firm's deep content library, teeming with major franchises and strong studios, provides it with the resources to be successful over the long term. We believe Disney will remain aggressive with its streaming ambitions, but we expect it will also look to shore up its legacy television business. This effort will likely blur the lines between these business models, as Disney+ and Hulu are included in the packages offered by traditional distributors like Comcast and Charter. We also expect that fans will continue to flock to the parks and resorts, providing a source of revenue while helping build and reinforce major content franchises.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
92.02	115.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
166.50	Wide	Standard	

Name/Ticker		Rating	
Comcast (CMCSA)		★★★★	We expect very modest broadband customer growth in the coming years, with fiber and wireless networks gaining share, but we also believe price competition will remain rational, allowing broadband prices to rise. Comcast will need to increase network spending in the coming years to keep pace with the capabilities of the phone companies' fiber networks. The net result is that we expect cable cash flow to grow modestly over the coming years. The NBCUniversal business isn't as strong, in our view, but it remains an important media asset. The theme parks also remain a strong and growing contributor.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
44.02	60.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
176.48	Wide	Standard	

Consumer Cyclical

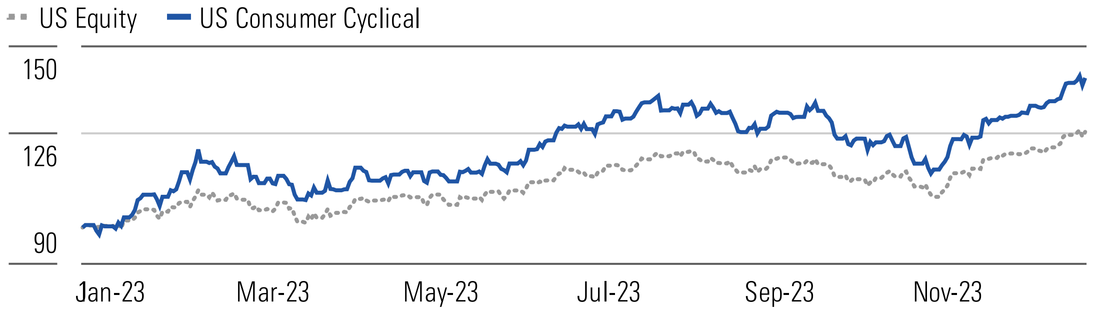
Erin Lash, CFA | erin.lash@morningstar.com

Discounts Retain Their Allure as Investors Dwell on the Near-Term Financial Health of the Consumer

The US Consumer Cyclical Index popped 13.4% in the fourth quarter, echoing the overall market's upswing. Still, we remain optimistic about investment prospects within the consumer cyclical space, as the median stock trades at a 10% discount to our intrinsic valuation, and nearly half of our coverage is in 4- or 5-star territory. More precisely, we pinpoint apparel as one of the most undervalued sectors, trading at an 11% average discount to our fair value estimates. We suspect investors' reluctance to embrace apparel shares is primarily rooted in ongoing uncertainty regarding consumers' financial health. However, we think that this concern is more than reflected in share prices. Ultimately, we think investors are overly fixated on the industry's short-term hurdles and overlooking the long-term profit prospects that firms can achieve through efficiency measures.

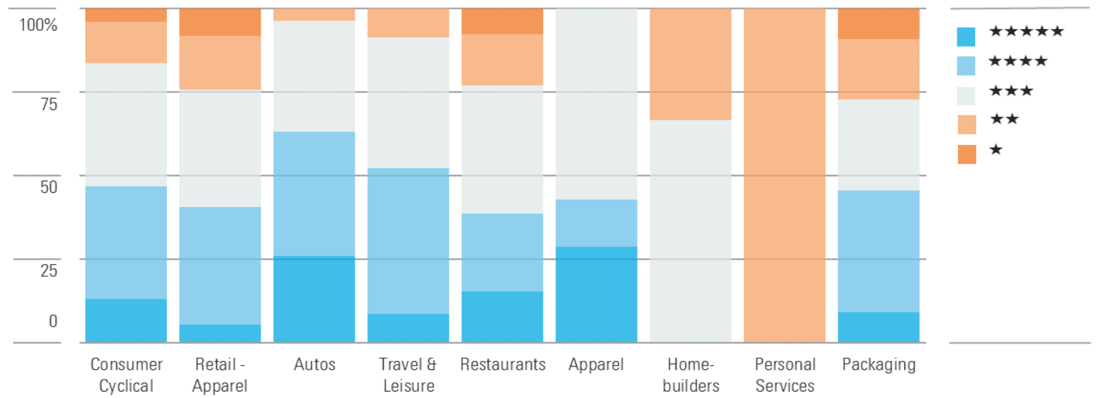
Despite the challenges of cumulative inflation and elevated interest rates, consumers have proved quite resilient. However, with excess savings accumulated during the pandemic running thin and up against the resumption of student-loan repayments, consumers' financial health is showing some cracks. For one, the percentage of new delinquencies among credit card borrowers soared to its highest point over the last eight years in third-quarter 2023, affecting all income demographics but most pronounced in the lowest income bracket. Against this backdrop, consumers may be forced to modify spending patterns, potentially making more significant cuts in discretionary expenditures. In the near term, we believe firms best fit to navigate a more challenging spending climate will appeal to consumers' search for value and convenience by offering a stream of innovation, robust loyalty programs, and digital capabilities.

Discretionary Stocks Appreciated in Sync With the Market in Q4



Source: Morningstar. Data as of Dec. 21, 2023.

Discounts in Apparel Stocks Are Primed for the Taking

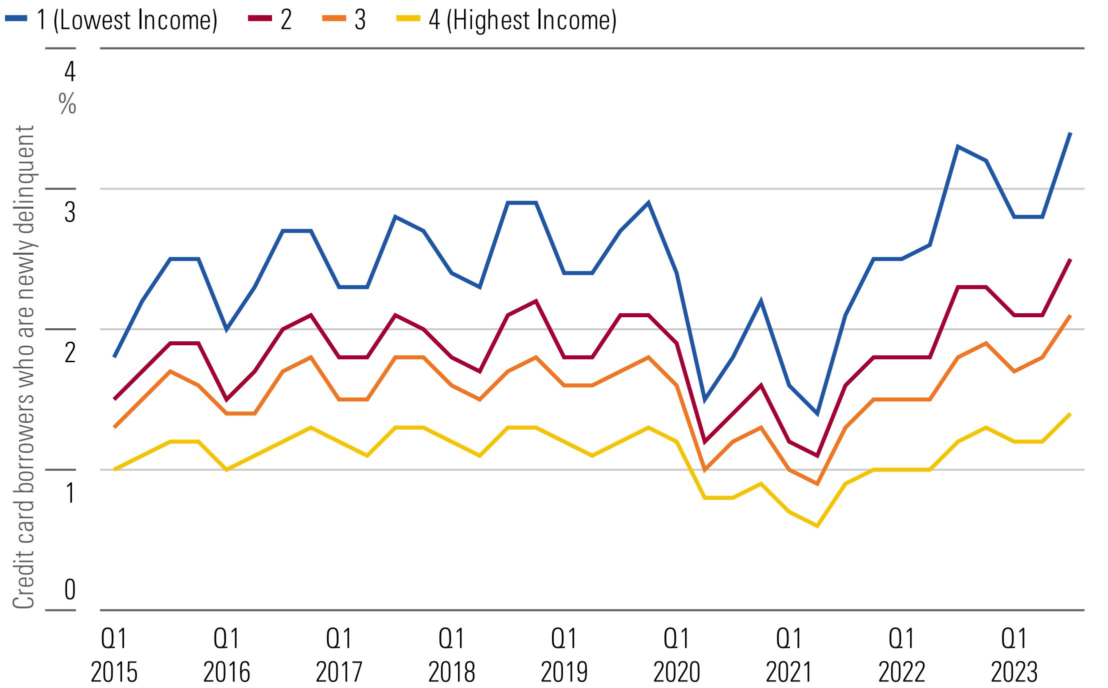


Source: Morningstar. Data as of Dec. 21, 2023.

Discounts Retain Their Allure as Investors Dwell on the Near-Term Financial Health of the Consumer

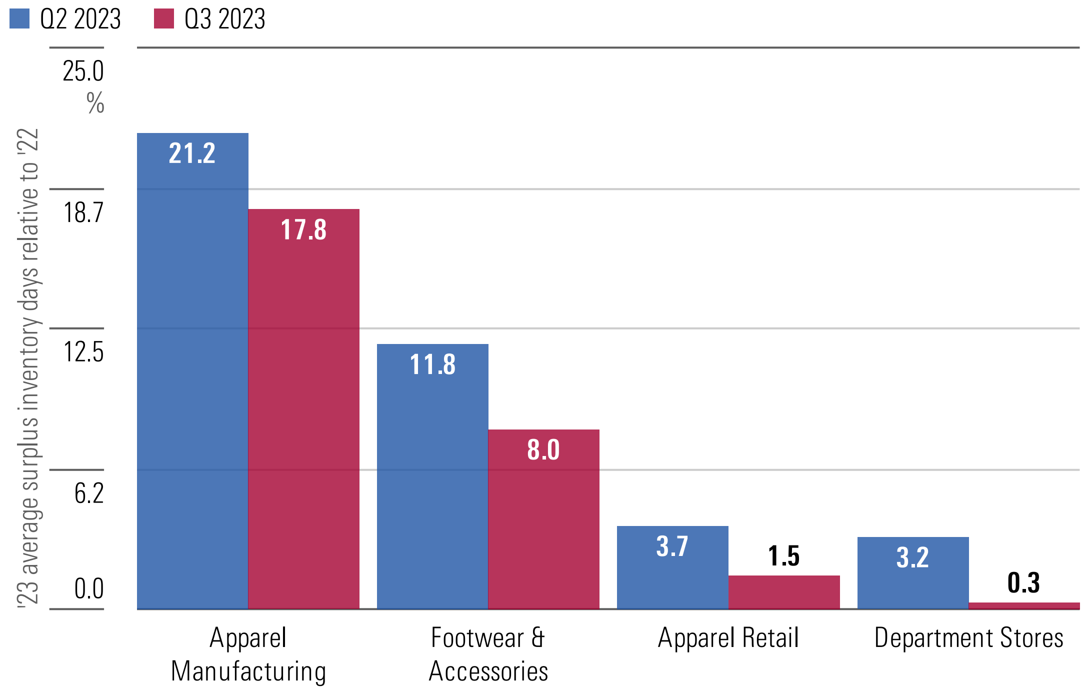
In light of consumer frugalness and recent supply chain problems, apparel retailers and manufacturers have been diligently working to decrease inventory levels from 2022's holiday selling season, initially through aggressive markdowns and order cancellations. And we've seen modest improvement (though still outpacing a year ago). In our view, it is critical firms continue to temper inventory levels to avoid excessive discounting and improve operational efficiencies in 2024, thereby boosting profitability even if consumer demand remains weak.

Credit Card Delinquencies Unmask a Trend of Consumers Falling Behind



Source: New York Fed Consumer Credit Panel, Equifax, American Community Survey. Data as of Nov. 7, 2023.

Declining Apparel Inventories Should Make 2024 More Fashionable



Source: PitchBook, Morningstar, company reports. Data as of Dec. 10, 2023.

Consumer Cyclical

Name/Ticker		Rating	
VF Corp (VFC)		★★★★★	Narrow-moat VF's shares trade at a roughly 70% discount to our $57 fair value estimate. We believe the market is dwelling on its challenges, including the slowdown in Vans' sales, elevated inventories, and dividend cuts but is overlooking its potential for sales growth and margin improvement in the medium term. VF has exposure to the attractive active and outdoor categories, and The North Face achieved 17% constant-currency sales growth in fiscal 2023. In October, VF's new CEO introduced a strategy focusing on Vans' innovation and management, a new platform in the Americas, cost cuts, and debt reduction.
Price (USD) 19.21	**Fair Value (USD)** 57.00	**Uncertainty** High	
Market Cap (USD B) 7.27	**Economic Moat** Narrow	**Capital Allocation** Standard	

Name/Ticker		Rating	
Hanesbrands Inc (HBI)		★★★★★	We believe narrow-moat Hanesbrands, trading at a steep 80% discount to our $18.80 fair value estimate, presents an attractive investment opportunity. We surmise investors are overly focused on near-term hurdles, including the impact of inflation, elevated interest rates, and softer consumer demand, while overlooking its prospects for free cash flow generation, its progress in managing surplus inventory, and its improving mix shift. We expect that lower input costs and its strategy to enhance Champion and North American innerwear, streamline its portfolio, and engage consumers will improve its profitability after a challenging 2023.
Price (USD) 4.17	**Fair Value (USD)** 18.80	**Uncertainty** Very High	
Market Cap (USD B) 1.52	**Economic Moat** Narrow	**Capital Allocation** Standard	

Name/Ticker		Rating	
Hasbro Inc (HAS)		★★★★★	Trading at a hefty 45% discount to our $88 fair value estimate, we believe narrow-moat Hasbro's shares are very undervalued. We surmise investors are over-indexing numerous challenges, which have had an impact on its recent performance, such as weak discretionary demand, entertainment-related strikes, discontinuation of underperforming lines, and inventory rightsizing. Although demand headwinds may take time to unravel, we believe the differentiated market leader will continue to invest in innovation to boost sales, while the divestiture of entertainment assets should help propel Hasbro to 21% operating margins longer term from 16% in 2022.
Price (USD) 51.08	**Fair Value (USD)** 88.00	**Uncertainty** Medium	
Market Cap (USD B) 7.09	**Economic Moat** Narrow	**Capital Allocation** Standard	

Consumer Defensive

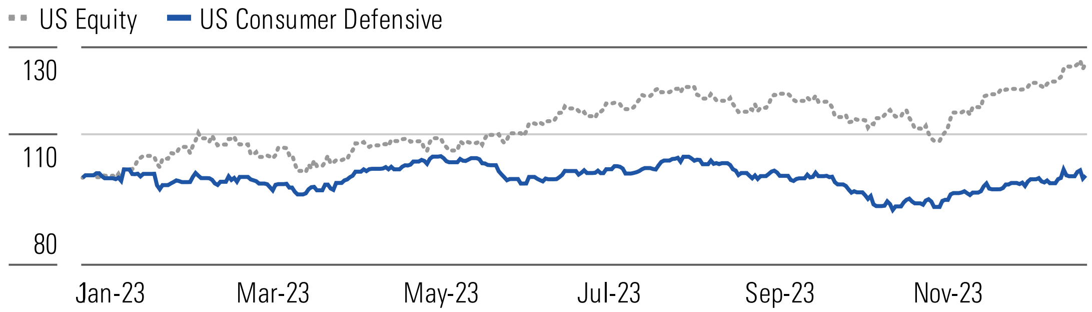
Erin Lash, CFA | erin.lash@morningstar.com

Moaty Consumer Defensive Operators Well-Positioned to Navigate Macro Headwinds and Competitive Landscape

The US Morningstar Consumer Defensive Index advanced 4% in the fourth quarter, trailing the market's 11.5% return by 750 basis points. With this tepid performance, the median consumer defensive stock appears slightly undervalued, trading at a 7% discount to our fair value estimates. We see opportunities in consumer packaged goods, or CPG, where nearly 60% of our coverage trades in 4- or 5-star territory. We believe this illustrates investors' concerns about the unsettled economy, heightened competitive pressures, and inflation's impact on consumer purchasing behavior while underappreciating the product innovation and brand strength that ultimately support pricing power in the CPG realm.

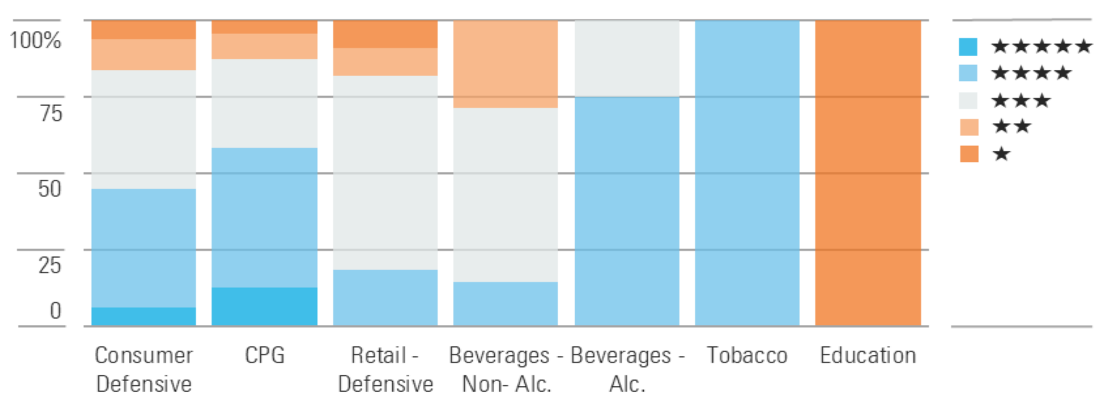
We aren't blind to consumers' search for value amidst strained financial resources, and the near-term impact it is having on retailers. From the first week in October to the week ending Dec. 3, both trips and basket size increased at a low-single-digit percentage on average at mass and low- to mid-single-digit at dollar channels, a stark contrast to a high-single-digit average decline within the drug channel, which tends to sit at the premium tier. While we view this shift as a temporary byproduct of the economic backdrop, we see continued opportunities for growing online penetration. And even as e-commerce showed a volatile track record of late (as consumers balance delivery fees with the channel's convenience), we believe retailers that continue to invest in omnichannel capabilities to enhance seamless shopping experiences are better poised to win with consumers long term.

Consumer Defensive Sector Realized Lukewarm Gains in Q4



Source: Morningstar. Data as of Dec. 21, 2023.

We See Attractive Opportunities in Consumer Packaged Goods

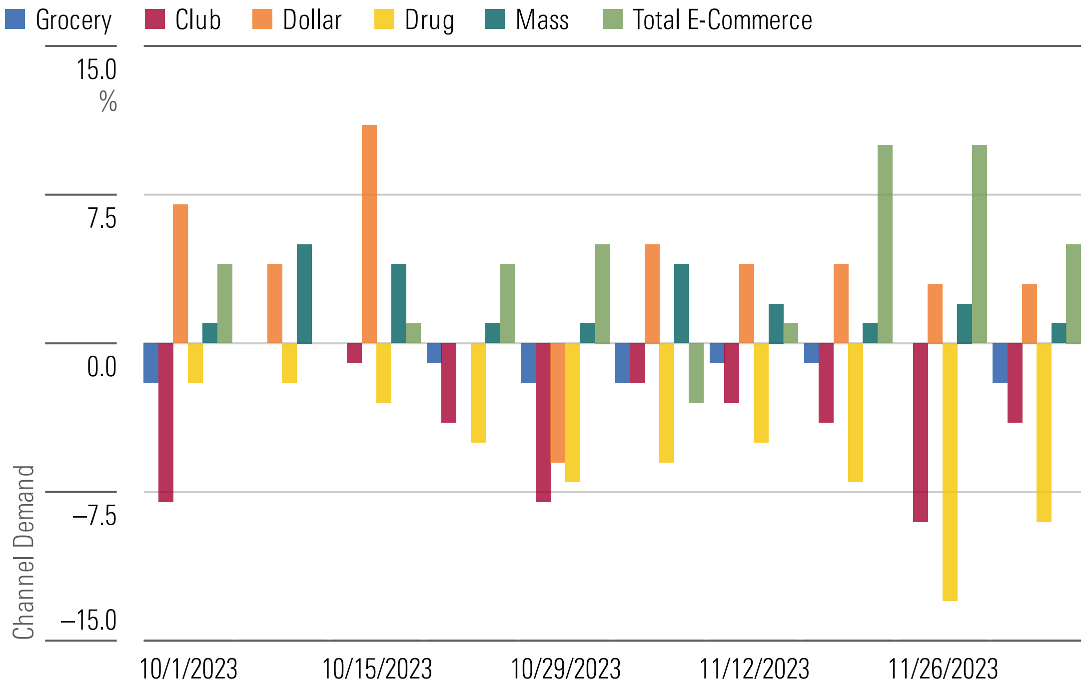


Source: Morningstar. Data as of Dec. 21, 2023.

Moaty Consumer Defensive Operators Well-Positioned to Navigate Macro Headwinds and Competitive Landscape

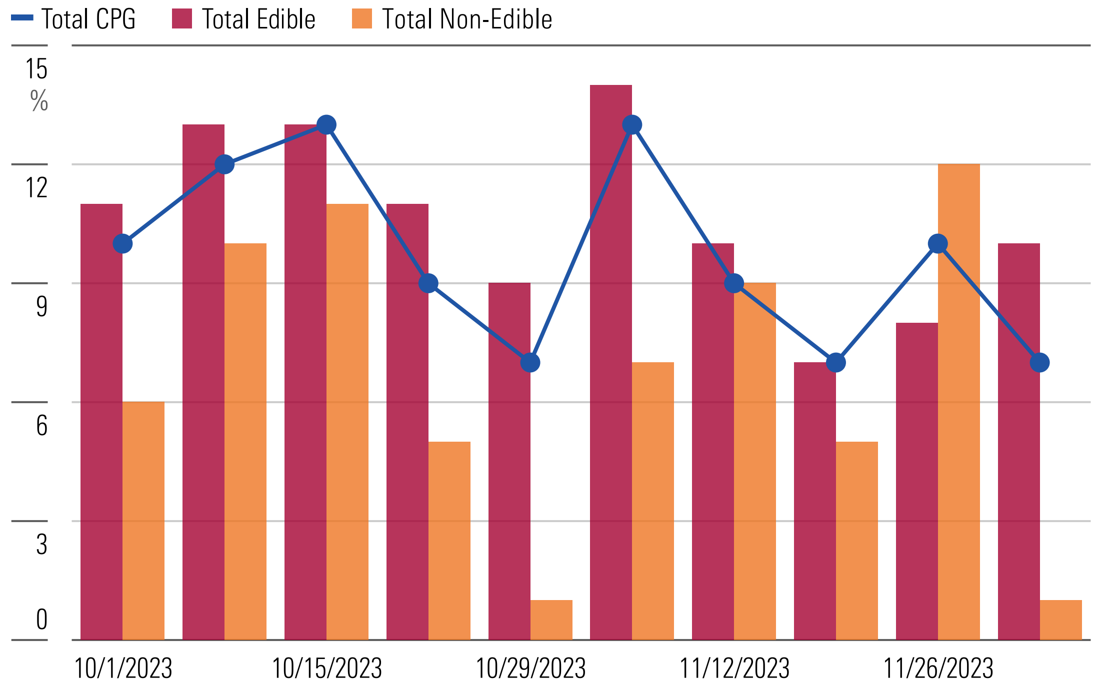
CPG manufacturers are also keen to appeal to a value-conscious consumer. While promotions weren't used when supply and demand were off kilter, promotional intensity has more recently stepped up—total CPG promotional levels jumped 10% on average over the last 10 weeks versus the same period a year ago. We see this as stemming from consumers trading down to private label; however, the activity could become value-destructive if used exclusively to drive near-term volumes and market share, as such initiatives fail to reinforce brand standing. Instead, we contend that firms that continuously funnel investments behind their brands (through consumer-valued innovation and marketing) while choosing to deploy promotions prudently will be able to withstand competitive pressures profitably.

Consumers Are Flocking to Discount Retail Channels



Source: Circana CPG Channel Shift Index. Data as of Dec. 13, 2023.

Widespread Promotional Activities Pervade CPG Space



Source: Circana CPG Promotions Index. Data as of Dec. 13, 2023.

Consumer Defensive

Name/Ticker		Rating	
Tyson Foods (TSN)		★★★★★	Trading at roughly a 40% discount to our $82 fair value estimate, no-moat Tyson's shares are on sale while offering a 4% dividend yield. Despite inflationary headwinds and challenges in the beef and pork segments, we don't see any structural changes to meat markets that warrant a permanent change to profitability. We remain optimistic about a return to mid- to high-single-digit adjusted operating margins, driven by easing input cost inflation and supply-demand rebalancing. Tyson's ongoing productivity efforts should enhance long-term efficiency and support margin recovery as well.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
51.66	82.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
18.55	None	Standard	

Name/Ticker		Rating	
Estee Lauder (EL)		★★★★★	We believe wide-moat Estee Lauder's shares are attractive, trading at around a 30% discount to our $200 fair value estimate. Although a slow travel retail recovery in China has impaired demand and margins, we remain constructive on the firm's long-term prospects. We believe Estee's stepped-up brand investments and solid execution will help bring its margins back to historical levels while ensuring the firm's standing (underpinned by category-leading brands and preferred vendor status) remains in place. Further, we believe Estee is poised to benefit from secular premiumization trends across developed and emerging markets.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
145.46	200.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
51.65	Wide	Standard	

Name/Ticker		Rating	
WK Kellogg (KLG)		★★★★★	No-moat WK Kellogg trades at a 55% discount to our $27 fair value estimate. Although its sole exposure to the challenged cereal category and small scale have diminished its standing with retailers and suppliers, we see a path to higher profits. The firm's priority is upgrading its outdated supply chain, which we believe will enhance operational efficiencies and structurally lift margins, with our midcycle EBITDA margin reaching 14% (from the 9% we model in fiscal 2023), while also providing the fuel to invest in consumer-valued product innovation and marketing support to solidify its standing in the mature cereal aisle.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
13.01	27.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
1.13	None	Standard	

Energy

Stephen Ellis | stephen.ellis@morningstar.com

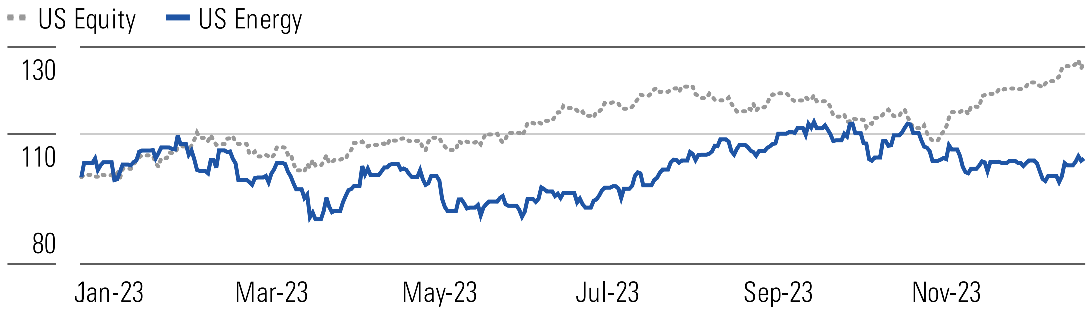
Energy Stocks Are Weaker in Wake of Israel-Hamas War Amid Oil Demand Concerns

After a strong performance in the third quarter, we are not surprised to see the sector flatline during the fourth quarter and underperform the broader market. The market is very much in wait-and-see mode, with 2024 budgets arriving soon and initial guidance from management teams.

Concerns over OPEC+ output cuts by Russia and Saudi Arabia tightening the market have been diminished in the wake of ongoing oil demand weakness. These factors account for the decline in oil prices following the initial spike in the wake of the outbreak of war between Israel and Hamas, and have no doubt played a major factor in the new 2.2 million bbl/d of OPEC+ cuts in the first quarter of 2024. Only about 896,000 bbl/d are incremental to existing voluntary cuts that we expected to be extended. All of these cuts are voluntary, instead of being official OPEC adjustments, meaning that it is harder for OPEC+ to police and enforce compliance. The cuts include an extension of the Saudi Arabian "lollipop" of 1 million bbl/d first announced in June 2023. Russia will increase its voluntary cut to 500,000 bbl/d from the 300,000 bbl/d announced earlier this year, consisting of 300,000 bbl/d of crude oil and 200,000 bbl/d of refined products.

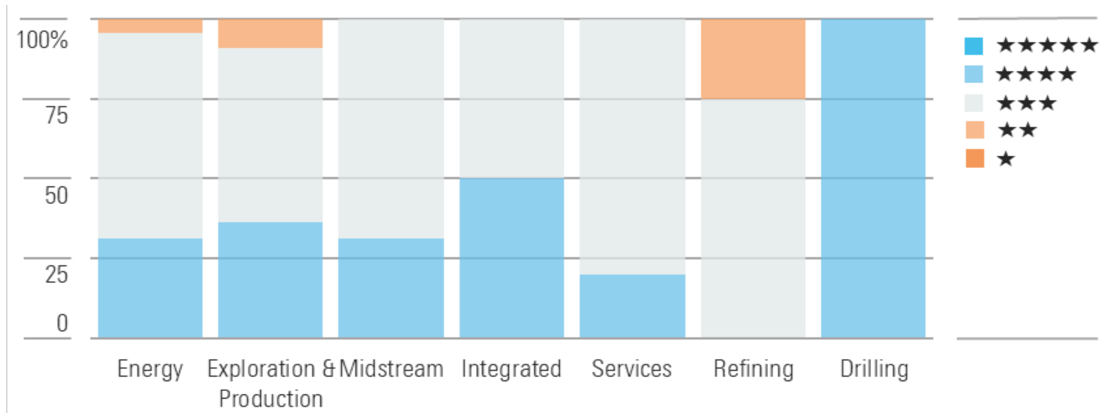
Like last quarter, we continue to believe the market remains laser-focused on potential gas supply disruptions, including Australian liquefied natural gas strikes, a cold European Union winter, and any potential disruptions from the Israeli-Hamas conflict. We anticipate the market will be volatile until late 2024 when new U.S. liquid natural gas export capacity is added, acting as a market-relief valve.

After Huge Recent Run Earlier in 2023, Energy Stocks Flatline in Q4



Source: Morningstar. Data as of Dec. 21, 2023.

More Bargains Are Showing Up in the Energy Sector

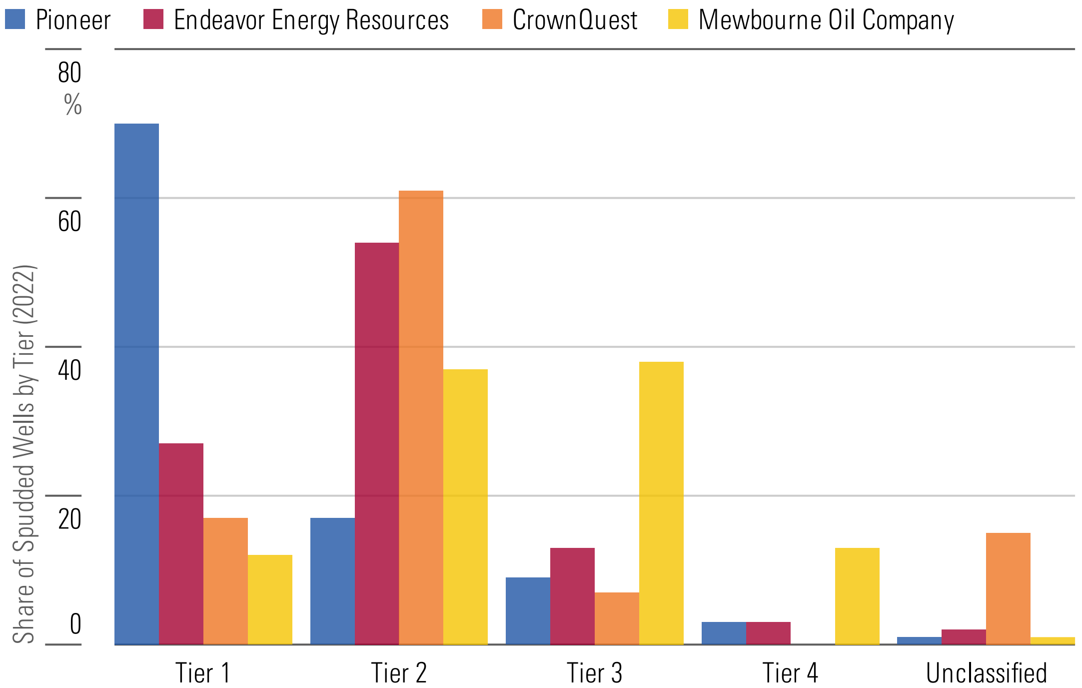


Source: Morningstar. Data as of Dec. 21, 2023.

Permian M&A Remains Focus Area for Oil; U.S. Gas Inventories Continue to Look Weak Until Late 2024

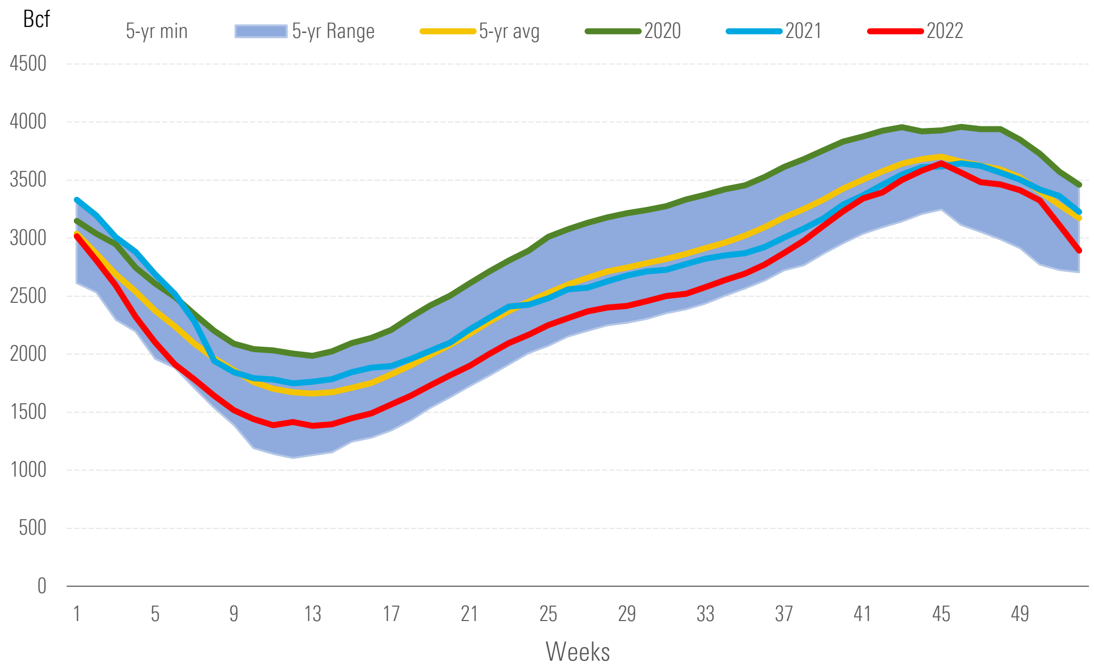
After ExxonMobil's deal to acquire Pioneer, acquirers will have to accept a large stepdown in acreage quality for the Permian Basin, in our view. Speculation has focused on three major private operators due to potential valuation discounts compared with public operators, as well as capital constraints given higher interest rates. With CrownRock (owned by CrownQuest) just acquired by Occidental, the focus now shifts to a potential Endeavor sale. We think U.S. gas inventories continue to look ugly. We would not be surprised to see inventory levels exceed five-year averages by more than 20% sometime this winter. We would not expect to see sustained drawdowns until new U.S. LNG capacity is added in late 2024.

Permian M&A Is Red Hot; With Pioneer and CrownRock Acquired, Endeavor Next?



Source: Rystad. Data as of Dec. 14, 2023.

U.S. Gas Inventories Continue to Cruise Well Above Historical Averages



Source: U.S. Energy Information Administration. Data as of Nov. 10, 2023.

Energy

Name/Ticker		Rating	
ExxonMobil (XOM)		★★★★	ExxonMobil plans to double earnings and cash flow from 2019 levels by 2027 on a combination of structural operating cost reductions, portfolio improvement, and growth across its upstream, downstream, and chemical segments. Exxon estimates that under the current plan, it will generate about $100 billion in surplus cash, after funding investments and paying the dividend, during the next five years. Combined with currently higher-than-expected commodity prices, its current repurchase program of $35 billion through 2024, is likely just the beginning.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
101.73	123.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
411.23	Narrow	Exemplary	

Name/Ticker		Rating	
APA Corp (APA)		★★★★	APA is hoping for a game changer with its exploration assets in Suriname. The firm has announced a string of promising discoveries and may have a final investment decision in 2024. We think the project will move forward and the market isn't giving enough credit. Our fair value estimate assumes three production vehicles with 180 mb/d capacity. That pegs Suriname at a sizable percentage of APA's equity, so we like the upside as a catalyst-driven name that might outperform in a challenging oil and gas price environment.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
35.94	56.00	Very High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
11.43	None	Standard	

Name/Ticker		Rating	
Equitrans Midstream (ETRN)		★★★★	With the path forward now clear for the Mountain Valley Pipeline, we continue to think the stock is undervalued as investors are no longer pricing in an MVP cancellation but are not fully reflecting its contributions either. We think Equitrans Midstream will likely bring the related projects Hammerhead and MVP Southgate online. When combined with other MVP-related opportunities, including expanding the MVP 500 million cubic feet per day, EBITDA should increase about 40% from 2023 levels.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
10.17	15.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
4.47	Narrow	Poor	

Financial Services

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

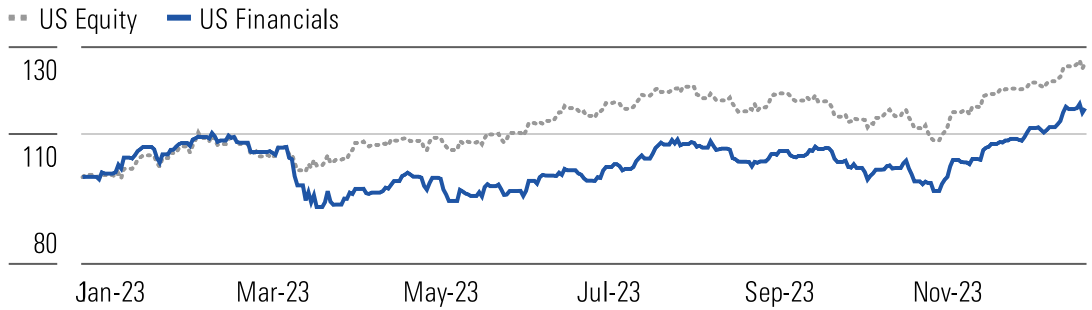
After Recent Gains, Still Pockets of Undervalued Financial Companies

The median North American financial sector stock trades at a 2% discount to its fair value estimate compared with a 12% discount at the end of the third quarter of 2023. We currently rate around 30% of the North American financial sector stocks that we cover as undervalued 5- or 4-star stocks with about 15% rated overvalued 2- and 1-star stocks.

At the Federal Reserve Open Market Committee held in December, participants maintained the target federal-funds rate at 5.25% to 5.5% and decreased the median assessment for the end of 2024 federal-funds rate to 4.6% from 5.1%. One of the narratives in the market is that the Federal Reserve should lower nominal interest rates as inflation cools to keep the real interest rate from climbing, because a higher real interest rate would increase the probability of a recession.

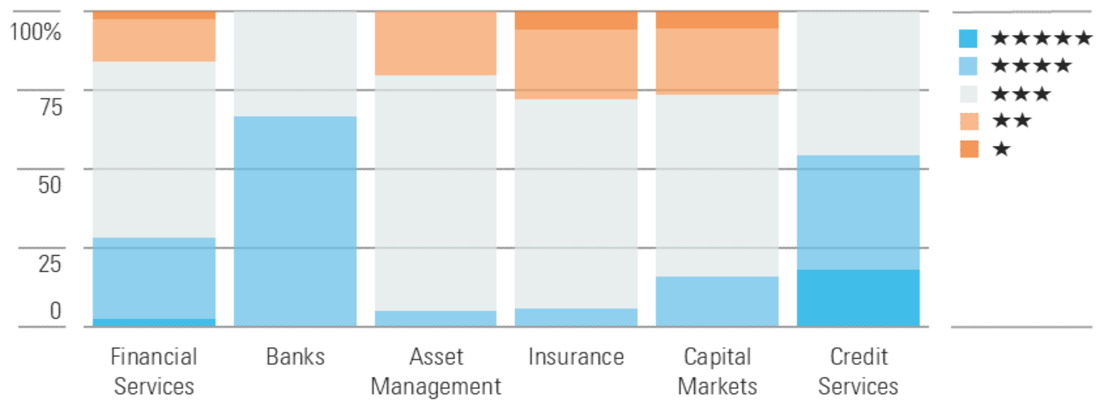
2024 will likely be an interesting year for financials. Lower interest rates will have varying effects on banks and other financials depending on the net effect of lower funding costs compared with the pressure on yields of interest-earning assets. Lower interest rates could also stem the flow of cash from low-yielding deposits into higher-yielding CDs and money market funds. Financial asset prices have recovered on the prospect of lower interest rates, which has improved the capital position of many financial companies as unrealized losses on balance sheets from fixed-income securities diminish, and increased the earnings power of asset- and wealth-management firms.

Financial Sector Boosted by Lower Interest Rates



Source: Morningstar. Data as of Dec. 21, 2023.

We Still See the Most Value in Banks and Credit Services

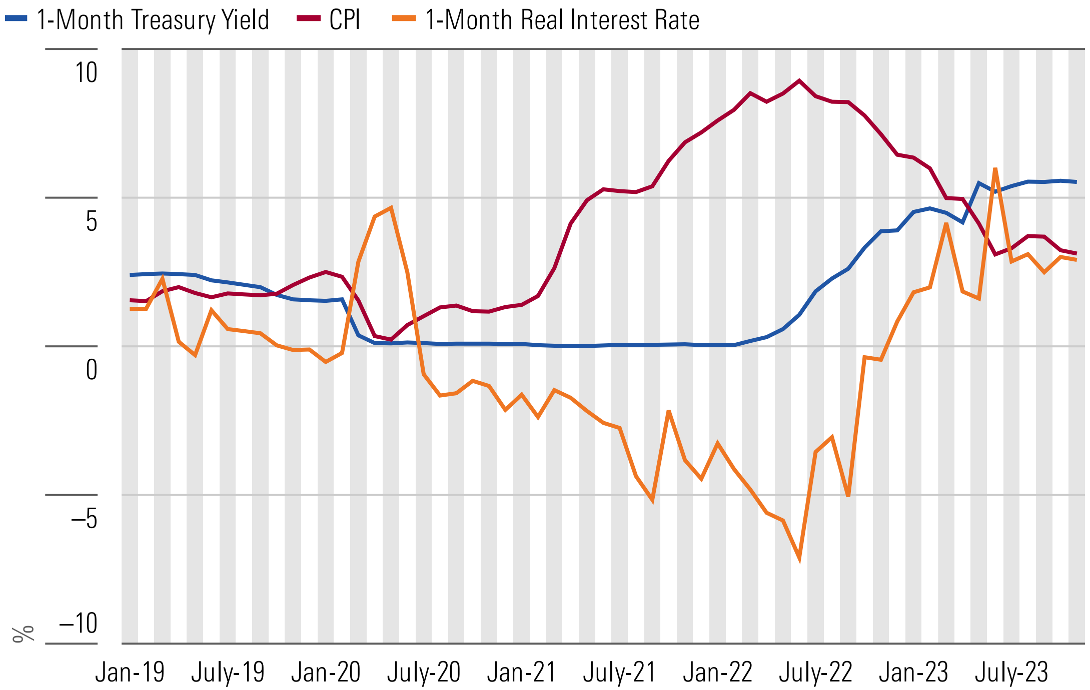


Source: Morningstar. Data as of Dec. 21, 2023.

After Recent Gains, Still Pockets of Undervalued Financial Companies

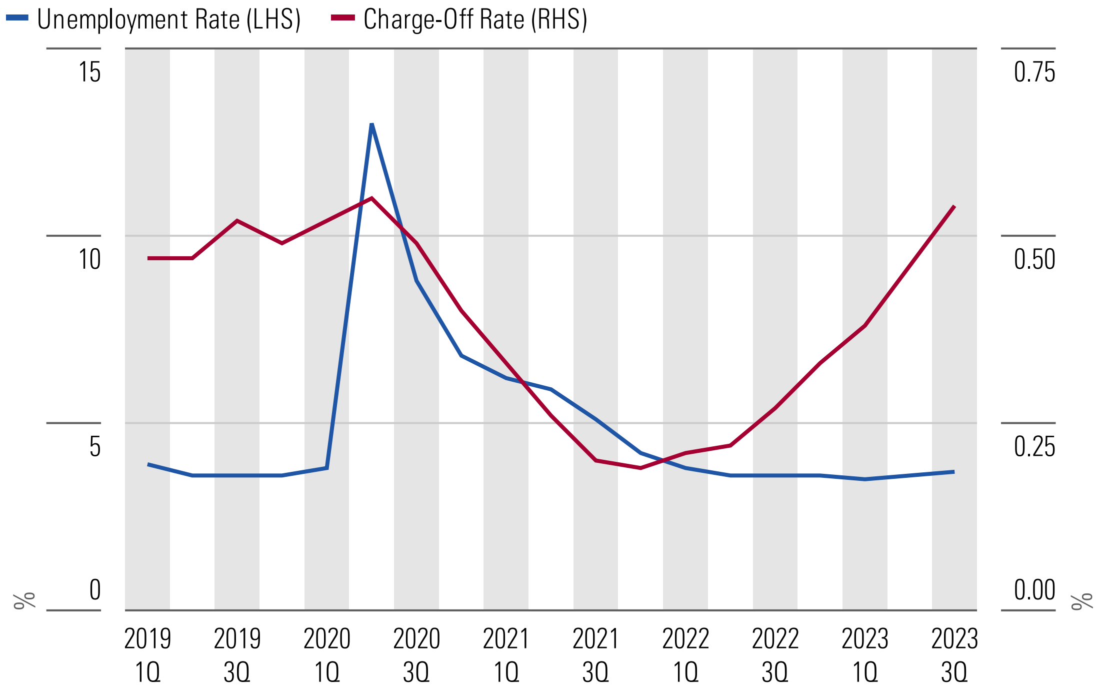
While the market is increasingly adopting the view that the U.S. economy will experience a soft landing, it doesn't mean that everything is stable to improving. The Federal Open Market Committee participants are still forecasting the unemployment rate to increase to 4.1% in 2024 from 3.7% in November 2023. The charge-off rate on loans at commercial banks has also been increasing. While our base case is for a relatively stable economy and improving earnings for the financial sector, the lagged effect of tighter monetary policy from previous quarters on the economy remains a risk.

Managing Real Interest Rates Is a Focus for the Federal Reserve



Source: U.S. Bureau of Labor Statistics, U.S. Federal Reserve. Federal Reserve Bank of Cleveland. Data as of Dec. 18, 2023.

Unemployment and Charge-Offs Are Still Rising



Source: U.S. Bureau of Labor Statistics, U.S. Federal Reserve. Data as of Dec. 18, 2023.

Financial Services

Name/Ticker		Rating	
Charles Schwab (SCHW)		★★★	Charles Schwab is a fundamentally strong company that has sold off due to headline risks and earnings headwinds that are reversing. The recent decline in U.S. interest rates will decrease the company's unrealized loss position on its U.S. Treasury and agency mortgage-backed securities holdings, which will improve the company's capital position. In the next couple of quarters, we expect the company to pay down increasing amounts of its high-cost borrowings that will boost its net interest income and earnings.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
68.18	80.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
125.76	Wide	Exemplary	

Name/Ticker		Rating	
Wells Fargo (WFC)		★★★★	While Citigroup is a bit cheaper than Wells Fargo overall, we like that Wells has a stronger franchise from a profitability perspective and Wells is further along in its turnaround timeline. Given the potential timelines at play, plus the difficulties that come along with franchises like Citigroup which are structurally less profitable than peers, we would favor Wells Fargo today. Wells is also not dealing with the same capital or earnings pressure issues that many regionals are dealing with today, lowering the rate risk exposure. While the timing is always difficult to know, the bank could have a positive regulatory catalyst in 2024, and the bank seems to be setting up for outperformance on net interest income. The regulatory timeline and further banking sector stress remain important risks to consider.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
49.45	55.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
179.73	Wide	Standard	

Name/Ticker		Rating	
PayPal (PYPL)		★★★★★	PayPal's shares have since fallen about 80% from their pandemic peak to a level materially below their prepandemic price. With market confidence in the stock at a low ebb, we see a potentially good long-term opportunity. While we recognize the headwinds PayPal faces in the near term, in the long term the company's fate remains tied to the high-growth e-commerce space, with Venmo providing some additional upside option value. Historically, PayPal has demonstrated it can take share in this area, and we think it continues to do so on an overall basis. We believe the company retains a strong competitive position.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
62.06	135.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
67.11	Narrow	Standard	

Healthcare

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

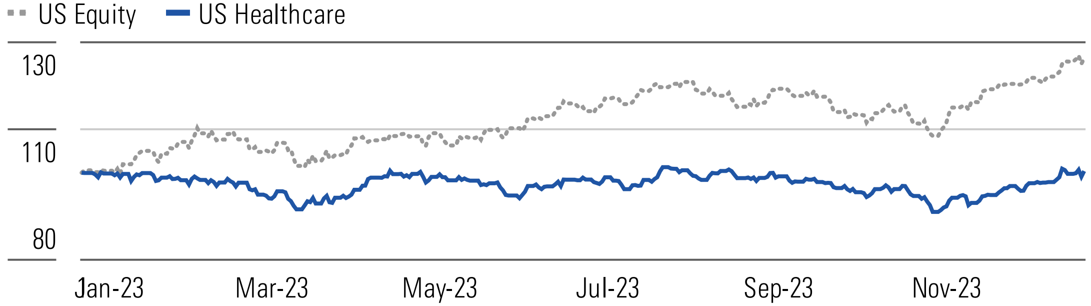
Healthcare Valuations Look Attractive Across Almost All Industries

Over the past 12 months, overall equity performance has outperformed Morningstar's US Healthcare Index by 26%. Concerns about recessionary pressures appear to have decreased, making the more defensive healthcare sector relatively less attractive over the past several months.

On valuation, we view the healthcare sector as undervalued, with over 50% of the sector rated as 4- or 5-star. In aggregate, our healthcare coverage trades below our overall estimate of intrinsic value. Besides medical distribution, the remaining healthcare industries look undervalued.

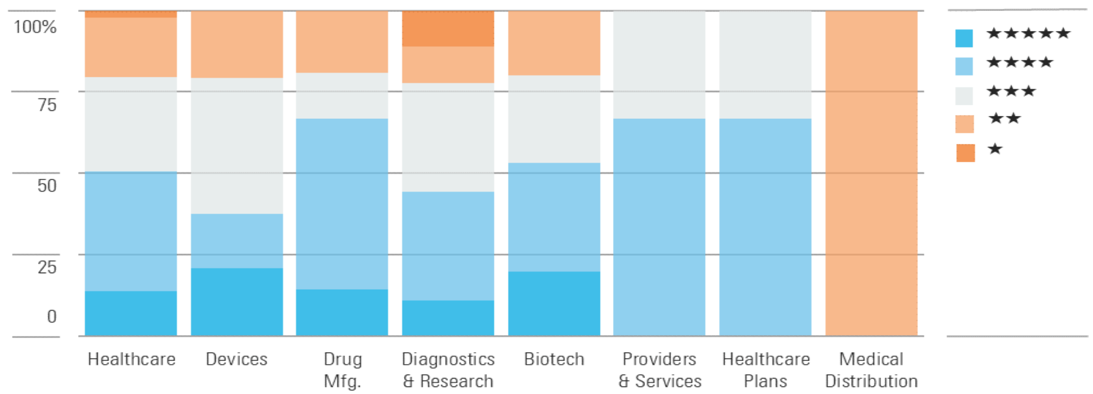
Within the biotech and drug manufacturing group, the market is not fully appreciating the innovation in several therapeutic areas, including oncology, immunology, and rare diseases. In the healthcare plan industry, we believe the short-term headwinds of potential pharmacy benefit reforms, Medicaid redeterminations and Medicare Advantage deceleration are creating undervalued opportunities as the industry can offset these challenges over the long run. In the device and diagnostic industries, we see compelling valuations after falling from a period of over-optimism during the peak of the COVID-19 pandemic. As perceptions normalize across healthcare, we believe the overall sector will increase in value. From a regional perspective, we believe the industry's largest market in the U.S. will likely face some volatility during the 2024 election cycle and related political rhetoric, but we are not expecting major fundamental changes for most healthcare industries.

Healthcare Underperformed the Market in 2023



Source: Morningstar. Data as of Dec. 21, 2023.

Besides Medical Distribution, Healthcare Industries Look Undervalued

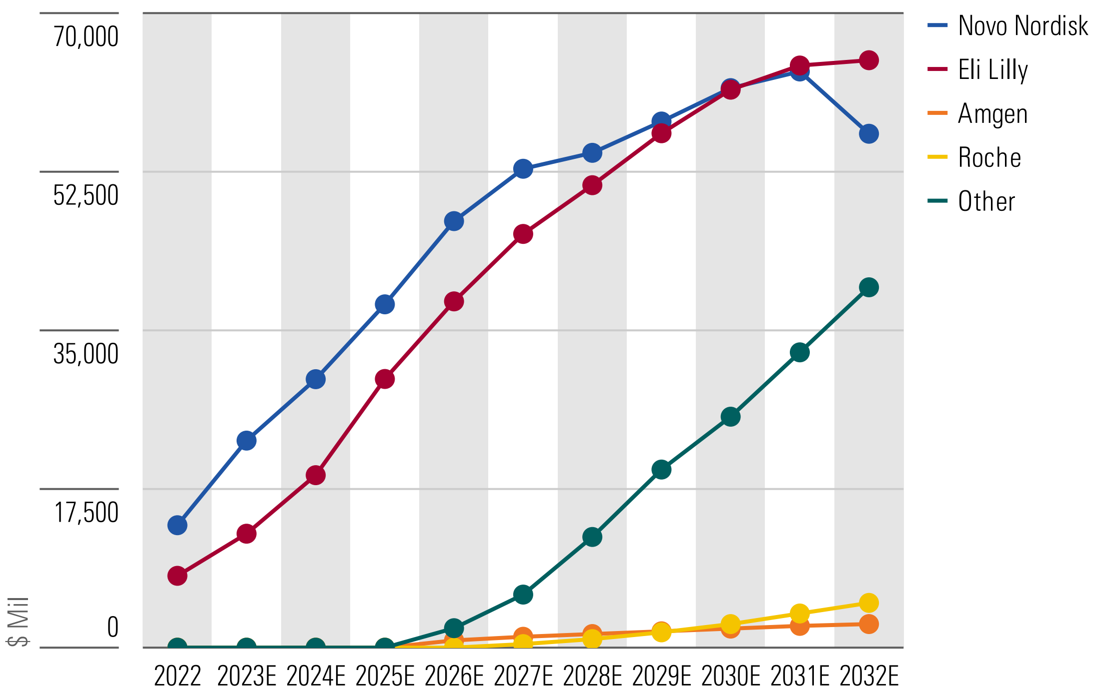


Source: Morningstar. Data as of Dec. 21, 2023.

Obesity Drugs Dominate News Flow, but Leading Companies Look Overvalued Relative to Other Opportunities

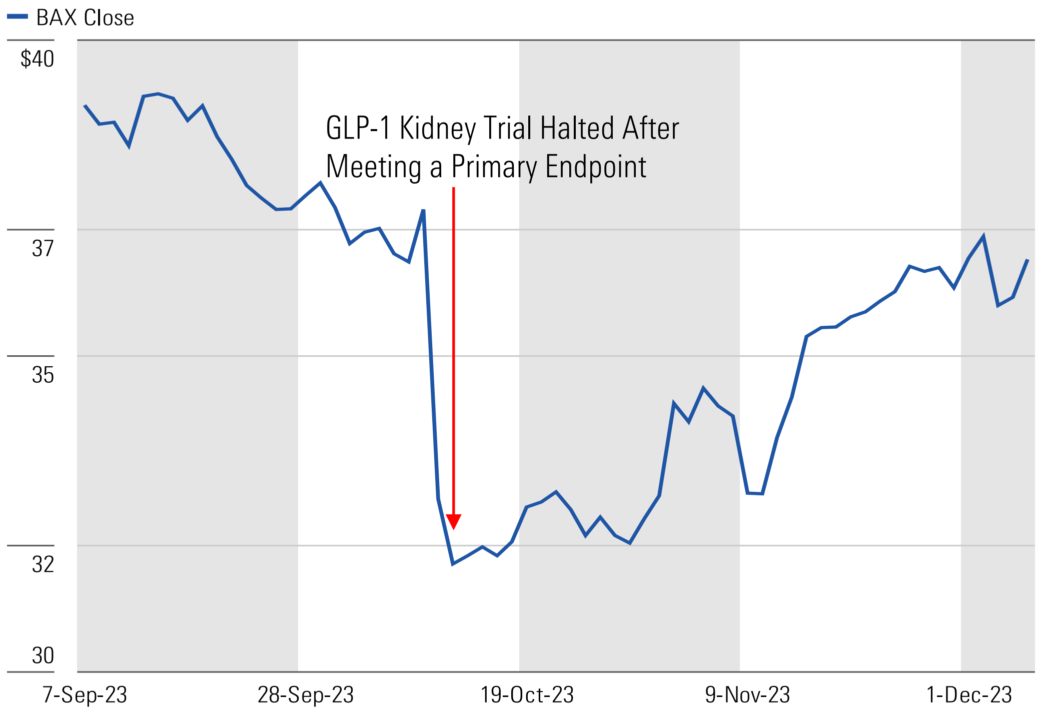
Eli Lilly and Novo Nordisk hold an excellent position in launching new GLP-1 obesity drugs. While we forecast over $150 billion in global GLP-1 sales by the end of the decade (see lower left graphic), we see these leading firms as overvalued, with the market likely too optimistic on the stocks. Next-generation obesity drugmakers such as Roche and Pfizer look more attractive. Also, several device stocks have overreacted negatively, as we don't think the drugs will disproportionately have an impact on device demand (see Baxter example at lower right).

Global Projections of GLP-1 Drug Sales



Source: Morningstar. Data as of December 2023.

Baxter Overreacts Negatively to Positive GLP-1 Study In Kidney Disease



Source: Morningstar. Data as of December 2023.

Healthcare

Name/Ticker		Rating	
Illumina (ILMN)		★★★★★	Illumina may face more competition in its legacy genomic sequencing technology than it has in the past, but we think the factors that determine its economic moat in genomic sequencing—intangible assets and switching costs for end users—remain intact and should help the firm generate economic profits for the long run, especially considering its new sequencing instruments that are launching. Also, Illumina owns the Grail liquid biopsy assets, which are targeting a nascent exponential technology opportunity for the earlier detection of cancer. It is possible that Illumina will have to divest Grail in 2024, and a tax-free spinoff could be a good way to satisfy regulators while also giving Illumina shareholders long-term optionality in the Grail technology
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
140.05	228.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
22.15	Narrow	Standard	

Name/Ticker		Rating	
Moderna (MRNA)		★★★★★	While we have modest expectations for sales of the firm's COVID-19 vaccine following massive pandemic-fueled demand in 2021 and 2022, we think Moderna's pipeline of mRNA-based vaccines and treatments is advancing rapidly across multiple therapeutic areas. As of September 2023, Moderna had 43 development candidates in clinical trials. Even if sales dip in 2023-24 ahead of new launches from the pipeline, we're increasingly confident in the long-term sales trajectory of the firm's diversified pipeline. We think Moderna's technology looks well validated in respiratory virus vaccines (RSV vaccine to launch in 2024, Covid/flu combo to launch in 2025), oncology (melanoma launch possible by 2025), and rare diseases (accelerated approvals also possible).
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
94.90	227.00	Very High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
36.61	None	Standard	

Name/Ticker		Rating	
Zimmer Biomet Holdings (ZBH)		★★★★★	With the addition of smaller competitor Biomet, Zimmer is the undisputed king of large-joint reconstruction. We expect favorable demographics, which include aging baby boomers and rising obesity, to fuel solid demand for large-joint replacement that should offset price declines. However, Zimmer stumbled into a series of pitfalls in 2016-17, including integration issues, supply challenges, and quality concerns, but new management has tackled these issues, and the firm is poised to ramp up its growth.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
120.57	175.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
25.43	Wide	Exemplary	

Industrials

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

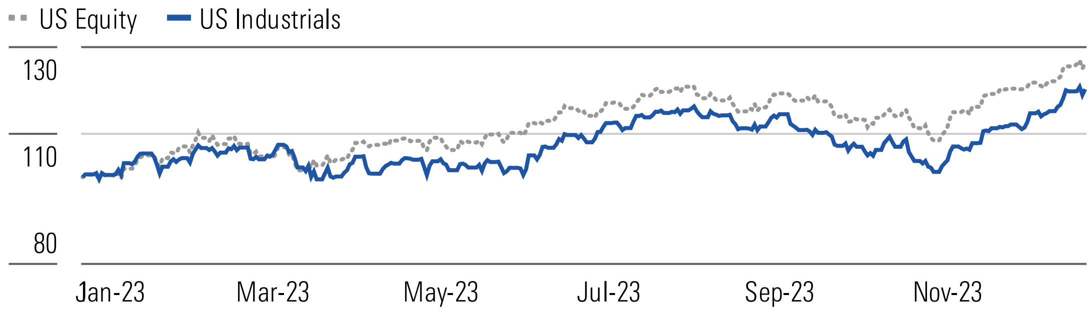
Industrials Sector Is Fairly Valued, but We Still See Compelling Investment Opportunities

We view the industrials sector as overall fairly valued, but we still see compelling investment opportunities across aerospace and defense, industrial products, construction, and farm and heavy construction machinery.

The U.S. economy remains resilient even as inflation persists above the Fed's 2% target and economic growth slows across Europe and China. Third-quarter earnings were generally positive for the industrials sector, with over three-fourths of our coverage beating FactSet consensus EPS expectations. Despite the increased probability of a soft landing, investors remain concerned about nonresidential real estate markets, particularly commercial and office verticals, as elevated construction costs, tighter lending standards, and higher office vacancy rates will likely dampen construction activity. As a result, companies with significant commercial construction exposure, such as Allegion and Johnson Controls, have underperformed. Nevertheless, some nonresidential verticals, such as healthcare and education, should see solid construction activity in 2024, and our longer-term construction outlook remains constructive.

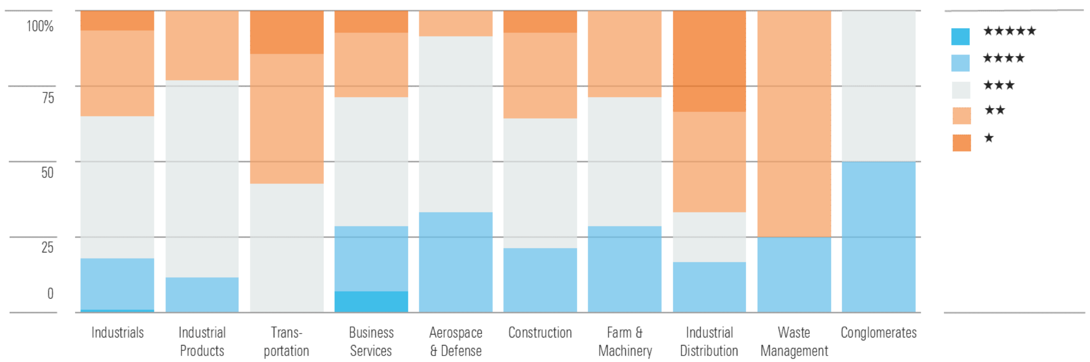
The ag downcycle has led to downward price pressure on ag machinery stocks over the past few months. Lower global crop prices have led to less farmers bringing crops to market, particularly in South America. However, the North American region remains favorable, as crop supplies are still relatively low, especially in soybeans. U.S. corn supplies are higher today than in the past few years, which has resulted in lower corn prices. U.S. farm incomes are coming down from record levels, but still sit at relatively high levels, giving us confidence that many farmers will continue to replace aging machinery in the near term.

Industrials Underperform Broader U.S. Equity Market Over Trailing 12 Months



Source: Morningstar. Data as of Dec. 21, 2023.

Industrials Sector Fairly Valued, but Some Opportunities Are Available

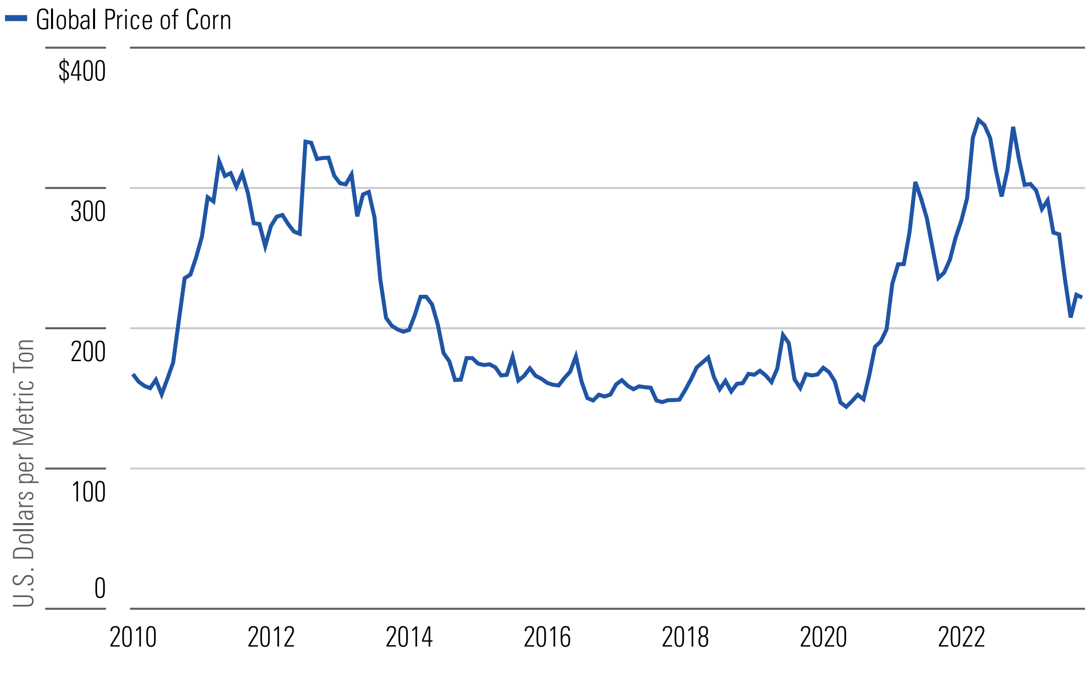


Source: Morningstar. Data as of Dec. 21, 2023.

Industrials Sector Is Fairly Valued, but We Still See Compelling Investment Opportunities

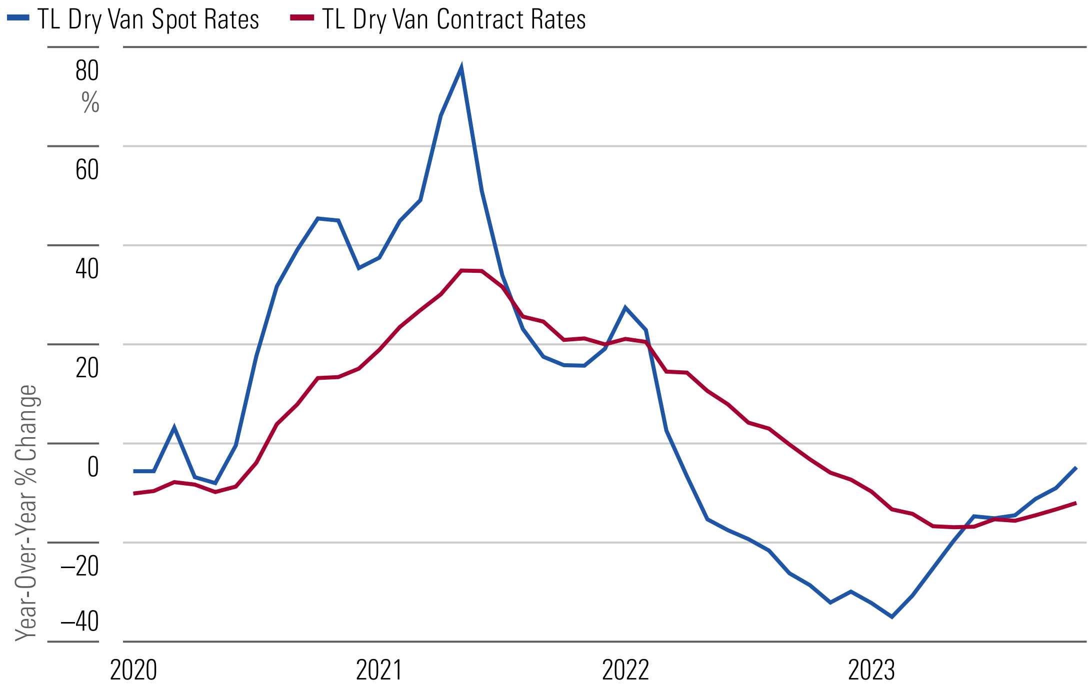
Transportation and logistics firms continued to experience mixed financial performance. Less-than-truckload carriers benefited from the bankruptcy of Yellow Logistics in August driving market share gains for many players. Comparatively, declining spot and contract rates have had a negative impact on the brokers C.H. Robinson and Landstar as well as truckload carrier Knight-Swift. Even so, we expect the truckload sector supply/demand equation to find better balance as 2024 progresses, resulting in modest improvement in spot and contract prices.

Corn Prices Are Lower, but We Think Farmers Will Still Replace Aging Equipment



Source: IMF, Federal Reserve Bank of St. Louis, Morningstar. Data as of October 2023.

Dry Van Truckload Spot Rates Have Likely Bottomed



Source: DAT Freight & Analytics, Morningstar. Data as of November 2023.

Industrials

Name/Ticker		Rating	
CNH Industrial (CNHI)		★★★★	CNH Industrial provides customers with an extensive product portfolio of off-highway products. Specifically, the company addresses two core end markets, agriculture and construction equipment. CNH has meaningfully more exposure within the agriculture industry, accounting for 90% of off-highway profits, which we view as a positive given the replacement cycle in large ag equipment. In our view, both verticals should benefit from near-term tailwinds supported by aging fleet refreshes and increased infrastructure spend. Also, we believe CNH should drive incremental value through the development of precision ag.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
11.98	15.80	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
15.69	Narrow	Standard	

Name/Ticker		Rating	
Allegion (ALLE)		★★★★	Allegion is a global leader in security products and solutions. Allegion operates through two segments: Americas and International. At over 70% of sales and 80% of segment profitability, the Americas segment is Allegion's largest and strongest business benefiting from leading positions in locking systems, door closures, and exit devices. Looking ahead, we expect both segments to benefit from increased retrofit and upgrade spending across commercial and residential end markets driven by greater adoption of electronic products.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
126.11	142.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
11.17	Wide	Standard	

Name/Ticker		Rating	
RTX Corp (RTX)		★★★★	In late July 2023, RTX subsidiary Pratt & Whitney announced a recall of one of its most popular jet engines, which power many Airbus A320s, due to possible contamination of the metal used to make a certain rotor part. The recall will cost the company billions in compensation to its airline customers, many of whose jets will be grounded while the engines are inspected and serviced on an accelerated schedule. Despite this, we see RTX as having a very promising runway of profitable demand in most of its businesses, especially in commercial aerospace, and believe that the stock's selloff on the recall news was overblown.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
83.27	112.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
120.70	Wide	Exemplary	

Real Estate

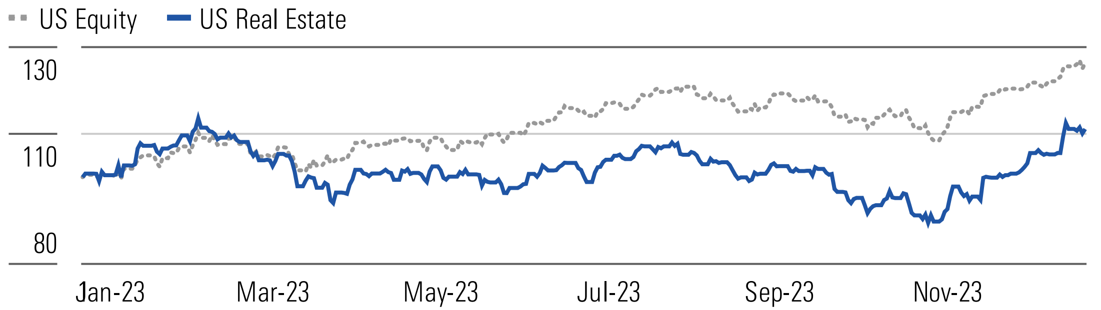
Kevin Brown | kevin.brown@morningstar.com

Interest-Rate Movements Make Real Estate Underperform in the Past 12 Months, but Outperform in the Quarter

The Morningstar US Real Estate Index increased 11.1% over the trailing 12 months, well below the 26.4% gain seen by the broader U.S. equity market over the same period. However, the real estate sector was up 16.7% in the fourth quarter of 2023, outperforming the 11.5% performance produce by the broader U.S .equities market in the quarter. The real estate sector's performance has been driven by interest-rate movements through the year. While same-store net operating income growth is decelerating for most real estate subsectors from the historic highs seen in 2022, most subsectors are still producing growth at or above historical average levels and we anticipate the trend of slowing but at or above average growth continuing into 2024.

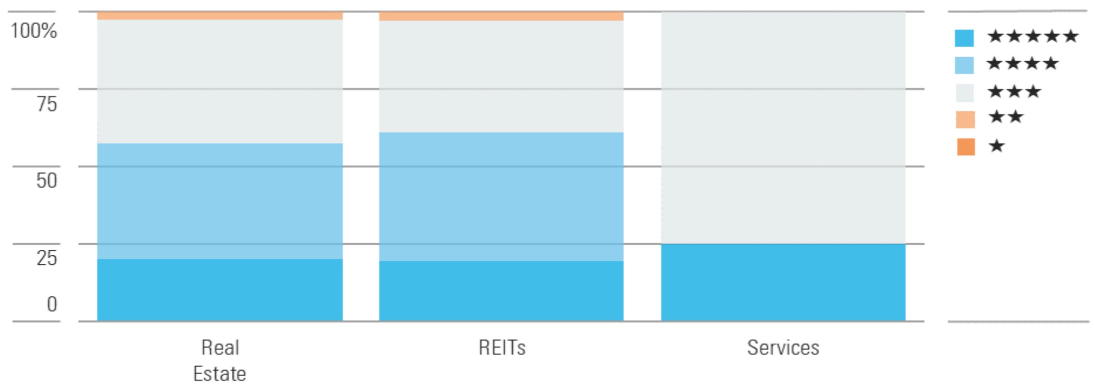
The real estate sector is currently trading significantly below our fair value estimates. Our real estate coverage currently trades at a 13% discount to our estimate of fair value, which is in line with or better than most other North American sectors. Currently, 20% of the real estate sector is trading in the 5-star range, 38% is trading in the 4-star range, 40% is trading in the 3-star range, and only 2% is trading in the 2-star range while no company is currently trading in the 1-star range.

Real Estate Sector Underperforming Broader U.S. Equities in 2023



Source: Morningstar. Data as of Dec. 21, 2023.

Majority of Real Estate Companies Trading at Discount to Fair Value

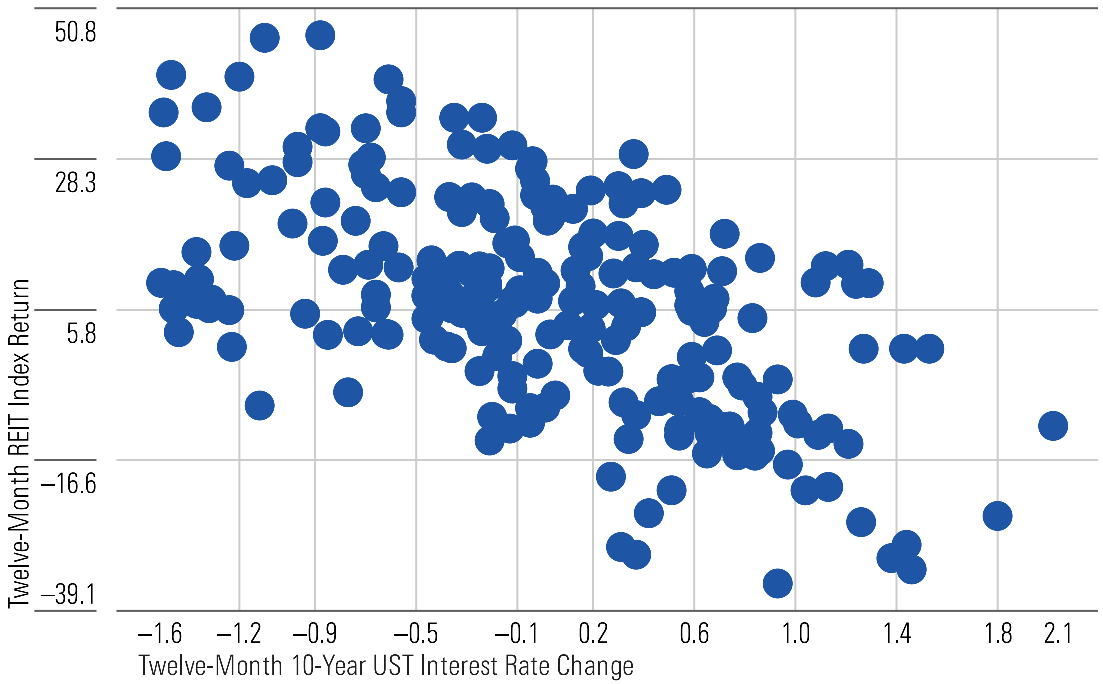


Source: Morningstar. Data as of Dec. 21, 2023.

Despite Internal Growth Above Historical Average, Negative Correlation With Interest Rates Driving Performance

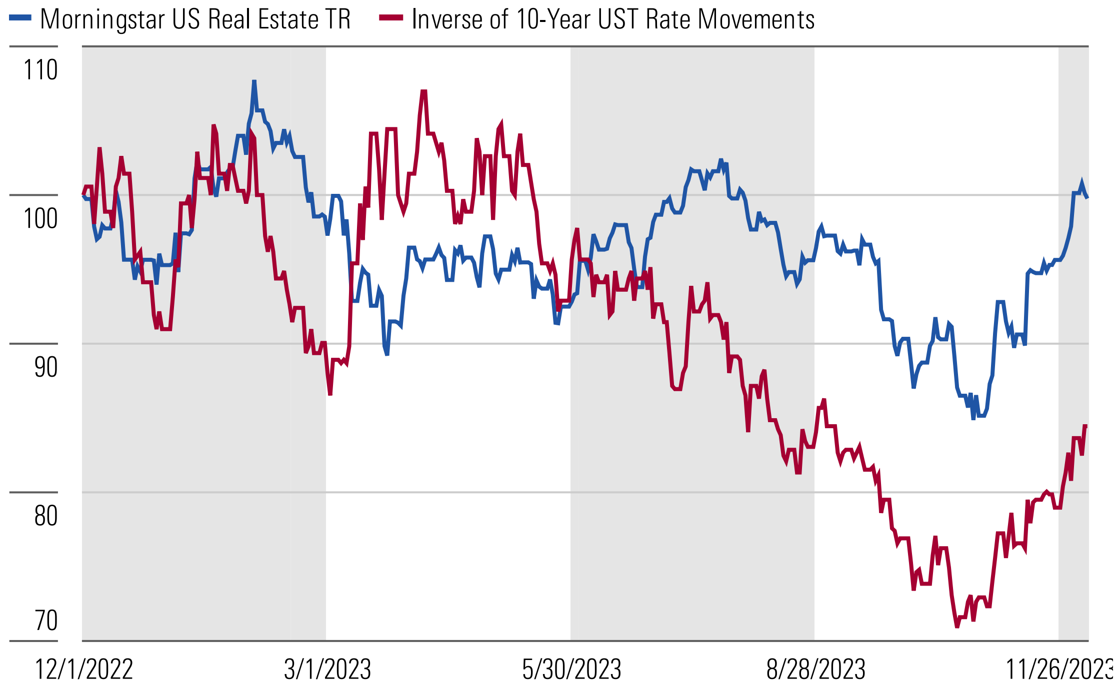
Much of the real estate sector's underperformance in 2023 is due to rising interest rates. Between July and October, rates on the 10-year U.S. Treasury climbed from 3.75% to almost 5% and the real estate sector saw a 15% decline in share prices over that timeframe. However, since mid-October 10-year U.S. Treasury rates have fallen to around 4.2% and real estate share prices have rallied back 15% in that period. The Federal Reserve did not lower rates in its most recent meeting but indicated it may consider cuts in 2024. Given that we expect rental rate, revenue, and net operating income growth to be at or above the historical average in 2024, we find the sector to be attractively valued.

Relative Performance of REIT Sector Negatively Correlated With Interest Rates



Source: FRED, U.S. Bureau of Labor Statistics, FTSE Russell, Morningstar. Data as of Dec. 5, 2023.

Since July, Real Estate Index Mirrored Inverse of Interest-Rate Movements



Source: FRED, Morningstar. Data as of Dec. 5, 2023.

Real Estate

Name/Ticker		Rating	
Realty Income (O)		★★★★★	Realty Income's portfolio should provide stable rental payments in nearly any economic environment. The company's assets are mostly leased to defensive retail tenants like pharmacies and gas stations that generally produce stable sales even in economic recessions. Additionally, the company's high coverage ratio further helps the tenants maintain rent payments even if it does experience a slowdown in sales. The company has sold off as it is one of the most sensitive names to rising interest rates given its high dividend payments and reliance on acquisitions for growth. However, we believe that the current market-implied cap rate undervalues the company's portfolio of stable assets.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
11.92	76.00	Low	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
2.58	None	Exemplary	

Name/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 were unaffected by either the pandemic or an economic recession, the senior housing portfolio saw a large drop in occupancy in the first year of the pandemic. However, occupancies have steadily recovered since the start of 2021 with the company reporting double-digit net operating income growth. Long-term, the industry should continue to see strong demand growth from the coming demographic wave of baby boomers aging into senior housing facilities that will produce high occupancy levels and rate growth.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
42.56	72.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
17.08	None	Exemplary	

Name/Ticker		Rating	
Federal Realty Investment Trust (FRT)		★★★★★	Federal Realty owns and operates high-quality shopping centers and mixed-use assets in eight of the largest metropolitan areas, and the average population density and average median household income around its portfolio is higher than any other retail REIT. Occupancy in Federal's portfolio has stabilized at 94%, and the company reported nearly double-digit re-leasing spreads on all leases for the past 12 months. The company has a large development pipeline of mixed-use assets that should provide significant growth as the projects stabilize over the next few years.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
92.90	142.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
7.53	None	Exemplary	

Technology

Dan Romanoff, CPA | dan.romanoff@morningstar.com

Eric Compton | eric.compton@morningstar.com

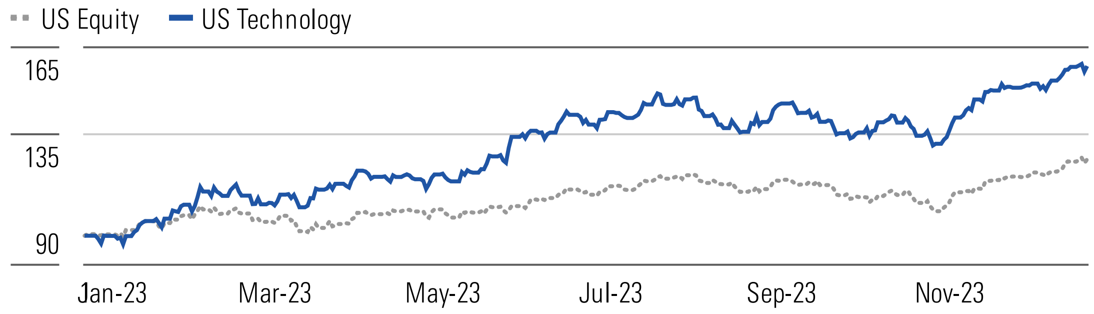
Technology Remains a Top Performer; We Now See Limited Buying Opportunities

After a challenging year in 2022, tech began to recover early this year, and after a pause in the fall, tech stocks rallied sharply into early December. Technology companies generally reported solid third-quarter results, but we think it would be naive to think that fundamentals are driving shares more recently as investors are contemplating rate cuts from the Fed in 2024. As a result, tech is the best-performing sector both year to date and thus far in the fourth quarter. While mega-cap stocks were driving performance earlier this year, smaller and lower-quality stocks have been stronger more recently. Cybersecurity names, in particular, have been very strong recently. We remain confident in secular tailwinds in technology, such as cloud computing, artificial intelligence, and rising semiconductor demand; although after strong performance for most of the year, we see fewer obvious buying opportunities within the sector.

The most important catalyst we see across technology at present revolves around generative AI. Software companies are developing and incorporating next-generation AI capabilities within their solutions, while cloud providers are introducing new services and ramping capacity, and semiconductor firms, notably Nvidia, are experiencing surging demand for AI and data center chip applications.

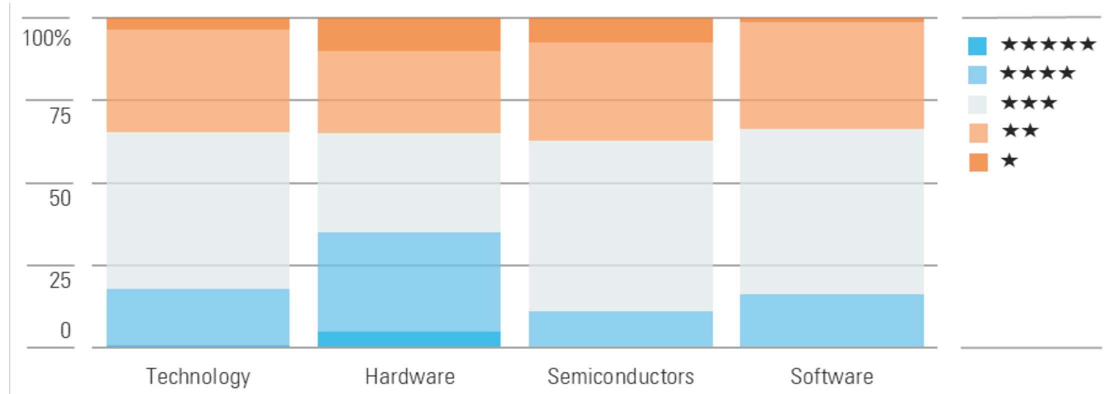
The Morningstar US Technology Index is up 58.5% on a trailing-12-month basis, compared with the U.S. equity market up 26.4%. Over the past quarter, both the U.S. equity market and tech were strong, but the tech sector outperformed. The median U.S. technology stock is slightly overvalued, trading at a 7% premium to its fair value estimate and with less of a margin of safety than when these stocks were 20%-25% undervalued to start the year.

Technology Has Been a Strong Outperformer in 2023



Source: Morningstar. Data as of Dec. 21, 2023.

We See the Majority of Technology Stocks as Slightly Overvalued

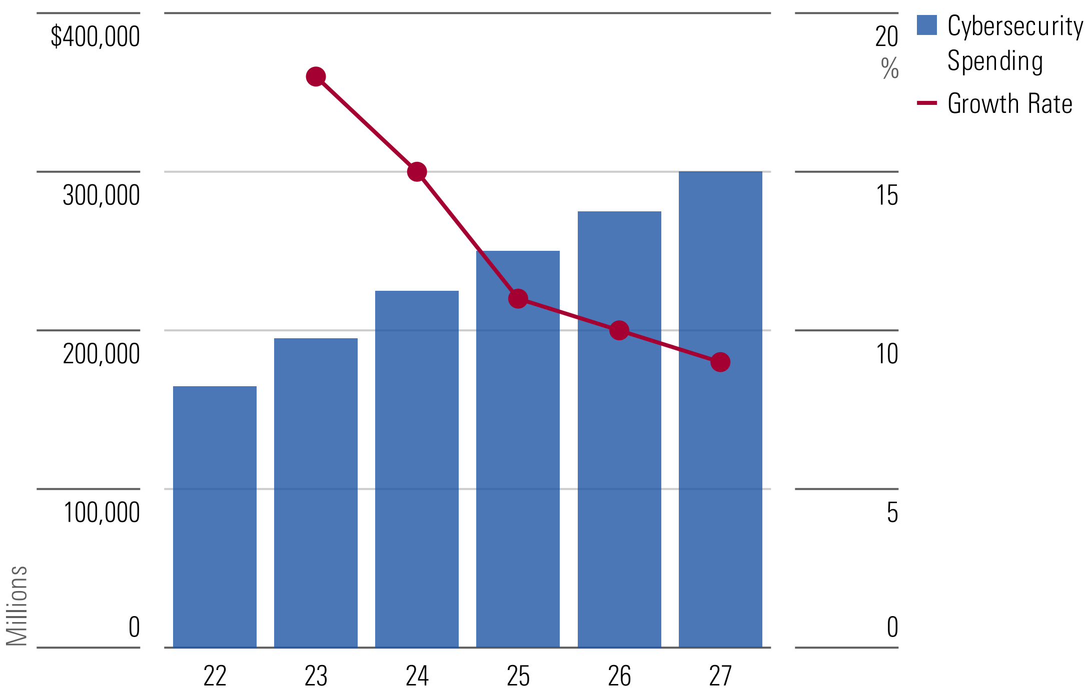


Source: Morningstar. Data as of Dec. 21, 2023.

We See Investment Opportunities Within Cybersecurity

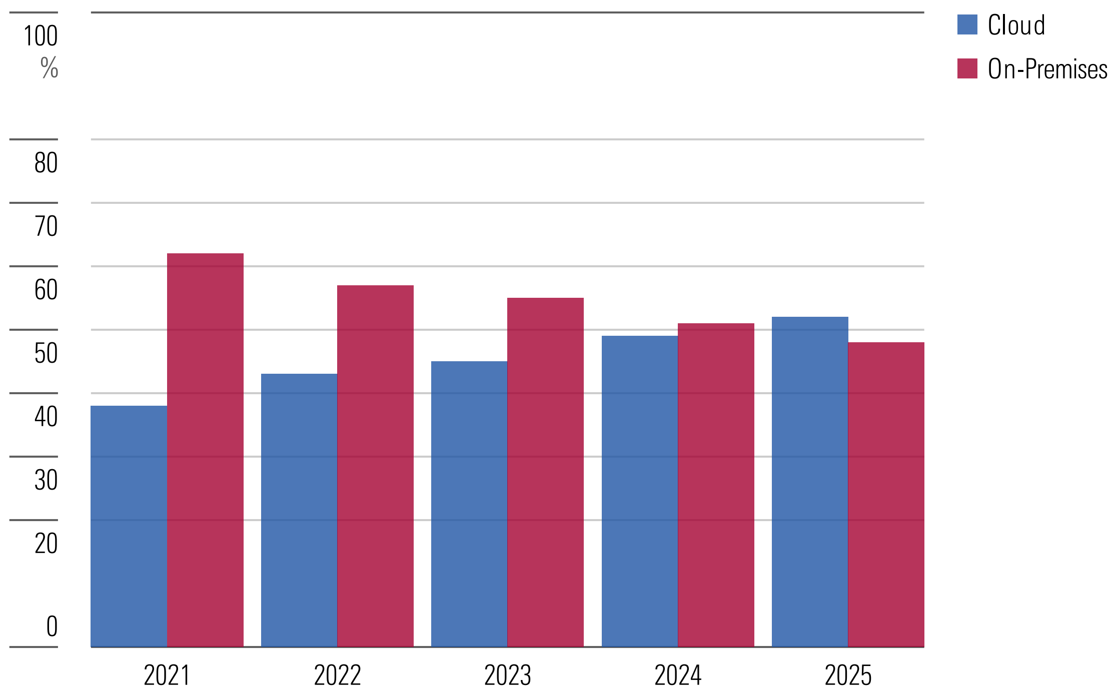
We project cybersecurity sales to expand at a 13% CAGR through 2027. We forecast significant growth in key areas such as endpoint, identity, and cloud, while areas such as firewalls and consumer are slated to grow at a more moderate pace. Over the last few years, customers have been shifting their spending from on-premises to the cloud. This shift is helping create a more complex threat landscape, necessitating increased investments in new security solutions built for the cloud. We expect cloud-native security solutions to outpace their on-premises peers as cloud migrations and digital transformations continue unabated, creating demand for cloud-native security solutions.

We Foresee Strong Growth in Cybersecurity Spending



Source: Morningstar, Gartner. Data as of October 2023.

The Shift to the Cloud Presents an Opportunity for Vendors



Source: Morningstar. Flexera. Data as of October 2023.

Technology

Name/Ticker		Rating	
Snowflake (SNOW)		★★★	In our opinion, Snowflake is well positioned to capitalize on the data explosion and the underlying data needed to make AI a reality. We think the market is significantly discounting Snowflake's potential by underestimating three key areas: datasphere (total data in existence) growth, how differentiated Snowflake's technology is, and the powerful potential of Snowflake's small but mighty data marketplace. This leaves meaty opportunity for investors, in our view, thanks to what we believe is a lack of understanding of this complex space and our expectation that Snowflake grows significantly over the next five years.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
195.70	231.00	Very High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
65.11	None	Exemplary	

Name/Ticker		Rating	
Cognizant Technology Solutions (CTSH)		★★★★	We think Cognizant is well positioned to continue to push its reputation past a back-office outsourcer to higher-value technical offerings—like digital engineering and AI solutions—as well as digital transformation consulting. In our view, smaller IT providers for digital transformation services will be squeezed out because of consolidation of accounts with larger vendors, like Cognizant. We bake in a five-year revenue compound annual growth rate of 8% for Cognizant, an acceleration of 5% over the last five years.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
75.14	94.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
37.69	Narrow	Standard	

Name/Ticker		Rating	
Teradyne Inc (TER)		★★★★	Teradyne is a chip-testing behemoth that uses a large research and development budget to produce top-tier automated test equipment and attain a leading market share, all while posting better profitability than its peers. Teradyne boasts especially strong relationships with Apple and TSMC, but we think the breadth and depth of its capabilities across many chip types and end applications represent impressive intangible assets that inform our wide economic moat rating.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
107.67	147.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
16.80	Wide	Standard	

Utilities

Travis Miller | travis.miller@morningstar.com

Andrew Bischof, CFA, CPA | andrew.bischof@morningstar.com

Will Utilities Reset or Repeat in 2024?

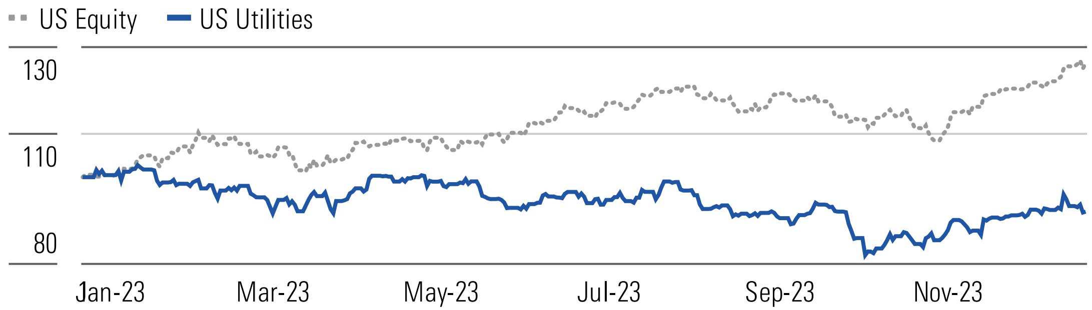
Utilities have been caught in the rinse-and-repeat cycle the past two years. In both 2022 and 2023, utilities' stock prices slowly rolled downhill for most of each year before rallying in the fourth quarter to trim the losses. Since 2021, only utilities' dividends have kept investors afloat. We think utilities are better positioned going into 2024 to produce the steadier, positive returns that utilities investors expect.

Earnings and dividend growth throughout 2022 and 2023 have rinsed out what we considered absurdly high valuations in 2019-20 while stock prices treaded water. Valuations across the sector have converged as fundamentals improved. Most utilities enter 2024 trading near their long-term historical market valuations and within 10% of our fair value estimates.

We think utilities' strong balance sheets, secure dividends, and robust long-term growth opportunities should support premium valuations for many utilities. However, there are headwinds that could stunt that growth. Regulators are keeping a close eye on customer bills, and customer rate increases will be difficult to justify. Higher interest rates could put some pressure on high-growth utilities that need to raise new debt to fund their growth investments.

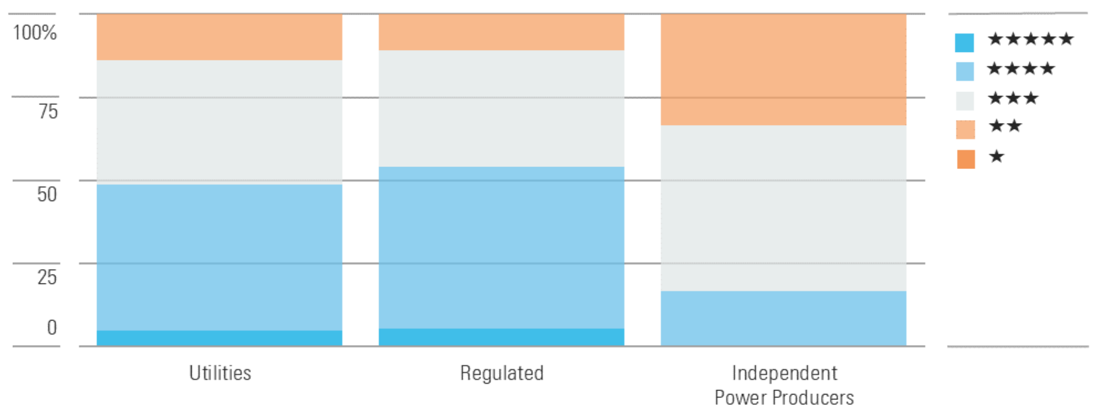
We think the best-positioned utilities are those in regions with strong energy demand growth and widespread support for clean energy investments. Parts of the Southeast and Midwest check those boxes for now.

Utilities' Fourth-Quarter Rally Recouped Some Losses in 2023



Source: Morningstar. Data as of Dec. 21, 2023.

Still-Attractive Values Among Utilities After Hitting Low in October

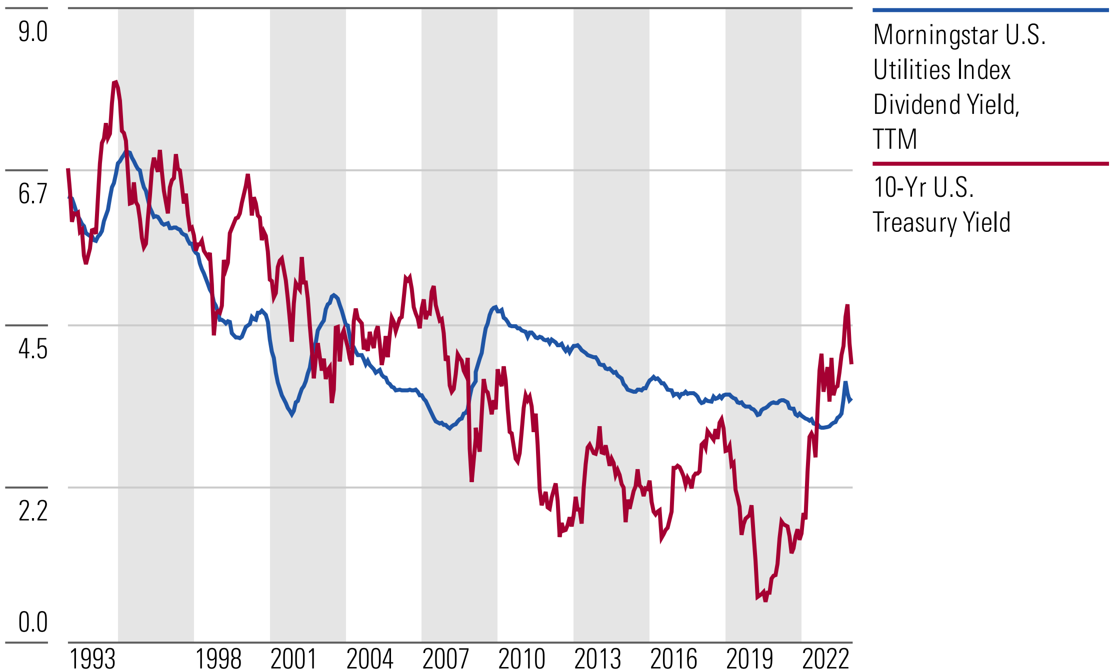


Source: Morningstar. Data as of Dec. 21, 2023.

Clean Energy Growth Opportunities Can Dull Interest-Rate Sensitivity

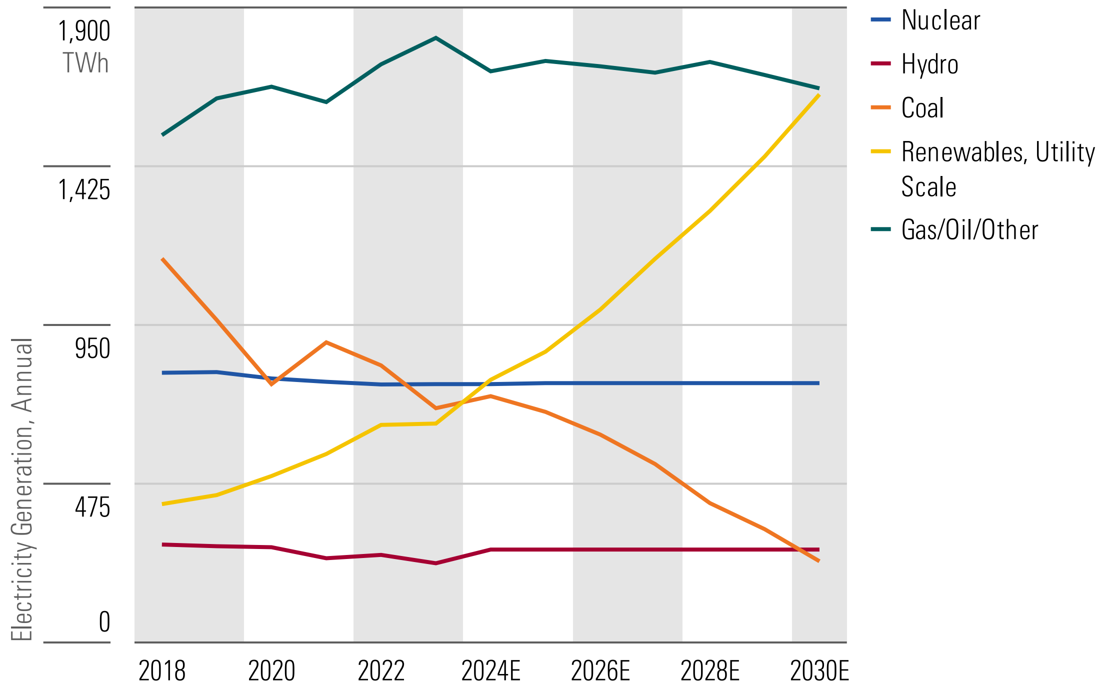
Utilities have been fighting the market's inconsistent interest-rate outlook for the past two years. Rising interest rates have made utilities' dividends less attractive on a relative basis and compressed valuations. Ultimately, we think utilities can mitigate some of that interest-rate sensitivity by executing their growth plans, including huge investments in clean energy during the next decade. That could help investors focus on utilities' fundamentals rather than short-term interest-rate swings.

Utilities' Dividend Yields Are Near Decade Highs, but So Are Interest Rates



Source: Morningstar, U.S. Federal Reserve. Data as of Dec. 14, 2023.

Clean Energy Investment Is Surging; Renewables Set to Top Coal in 2024



Source: Morningstar, U.S. Energy Information Administration. Data as of Dec. 15, 2023.

Utilities

Name/Ticker		Rating	
NiSource (NI)		★★★★★	Even though NiSource trades at a similar valuation as its peers, we think it has a superior runway of growth and deserves to trade at a premium. NiSource's transition from fossil fuels to clean energy in the Midwest supports at least a decade of faster growth than the U.S. utilities sector average. We expect NiSource to invest $15 billion over the next five years and as much as $30 billion during the next 10 years, leading to 7% earnings growth and similar dividend growth. Its electric utility plans to close its last coal-fired power plant in 2028 and replace the generation with wind, solar, and energy storage. Its six gas utilities have ample near-term investment and regulatory support in regions that are unlikely to abandon gas.
Price (USD) 26.27	**Fair Value (USD)** 33.00	**Uncertainty** Low	
Market Cap (USD B) 10.95	**Economic Moat** Narrow	**Capital Allocation** Standard	

Name/Ticker		Rating	
Entergy (ETR)		★★★★	Entergy offers one of the most attractive combinations of yield, growth, and value in the utilities sector with a dividend yield above 4% and the potential for 7% annual earnings growth. Above-average electricity demand growth, clean energy investments, and reliability/resiliency network investments are core growth drivers. Entergy also should benefit from industrial carbon emissions cuts, global energy demand, and green hydrogen development. We expect Entergy's valuation discount to disappear as the market becomes comfortable with Entergy's decadelong business transformation away from commodity-sensitive businesses.
Price (USD) 100.22	**Fair Value (USD)** 120.00	**Uncertainty** Low	
Market Cap (USD B) 21.30	**Economic Moat** Narrow	**Capital Allocation** Standard	

Name/Ticker		Rating	
WEC Energy Group Inc (WEC)		★★★★	WEC Energy combines best-in-class management and above-average growth opportunities supported by constructive regulation across most of its jurisdictions. The company increased and updated its capital plans, with plans to spend $23.4 billion, a $3.3 billion increase from its prior program. WEC will increase investments in renewable generation, natural gas generation, and transmission due to significant economic development in southeastern Wisconsin. This supports our 7% growth estimate, at the high end of management's 6.5%-7% guidance range.
Price (USD) 82.94	**Fair Value (USD)** 96.00	**Uncertainty** Low	
Market Cap (USD B) 26.40	**Economic Moat** Narrow	**Capital Allocation** Exemplary	

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