North America Market Outlook: Q4 2023

Market briefly touches fair value—then retreats.

Morningstar Equity Research

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

Preston Caldwell
Head of U.S. Economics
Morningstar Research Services LLC

MORNINGSTAR®

Table of Contents

U.S. Equity Market Valuation Overview

U.S. Equity Market Trades at an 8% Discount to a Composite of Our Equity Fair Valuations

U.S. Stock Market Trading at an 8% Discount to Fair Value Estimates

According to a composite of the over 700 stocks we cover that trade on U.S. exchanges, as of Sept. 25, 2023, the U.S. equity market was trading at a price/fair value of 0.92, representing an 8% discount to our fair value estimates.

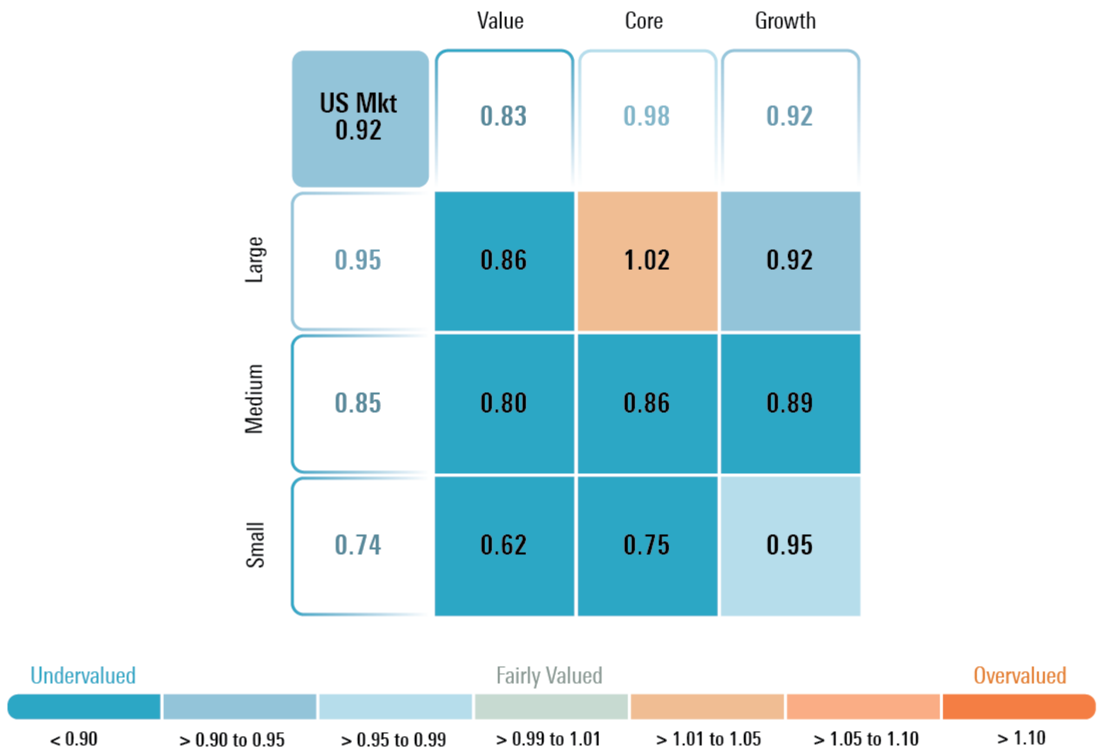
Upward momentum propelled the market higher in July, and our price/fair value metric briefly touched fair value before the market gave up those gains and then some. Hawkish commentary from the U.S. Federal Reserve, rising energy prices, and higher interest rates took their toll in August and September. The Morningstar US Market Index dropped 2.26% quarter to date through Sept. 25. Year to date, the broad market remains up 13.88%.

Growth stocks remain the predominant factor for this year's returns, yet, as we noted in our August 2023 monthly outlook, growth stocks rose into overvalued territory, trading at a 4% premium to fair value. Growth gave back 5.70% quarter to date yet remains up a solid 20.84% year to date. Following this pullback, we now advocate for moving back to a market weight position in growth while remaining overweight in value and underweight in core.

Large-cap stocks held their value better to the downside this past quarter, dropping only 1.45%. Year to date, by capitalization, large-cap stocks remain the driving force of the broad market as they have risen 17.53%. For long-term investors, according to our valuations, both mid-cap and small-cap stocks both remain at much greater discounts to fair value.

U.S. Stock Market Trading at 8% Discount to Composite of Fair Value Estimates

Valuations of Morningstar's equity research coverage by Equity Style Box.



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

U.S. Equity Market Briefly Touches Fair Value, Now Back to a Discount

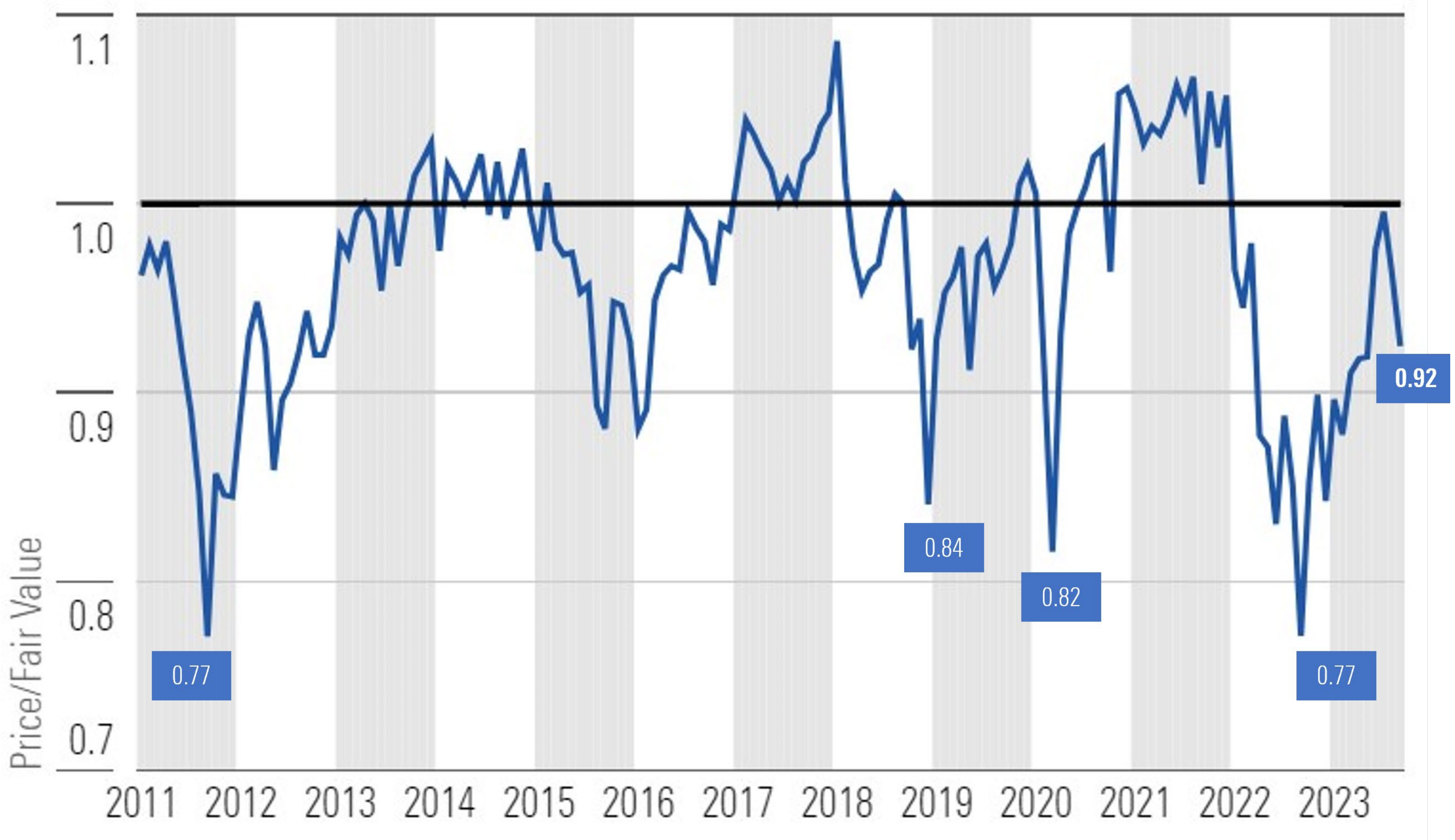
The U.S. stock market briefly touched fair value before retreating in August and September.

For the most part, the stocks that represent the Magnificent Seven (Apple, Amazon, Alphabet, Meta Platforms, Microsoft, Nvidia, Tesla) ran out of steam during the third quarter. At the end of the past quarter, these stocks accounted for approximately 75% of the market return. As of Sept. 25, they account for 69%. Only Alphabet and Meta were able to post gains whereas the other five stocks all fell. We noted last quarter that, following the runup earlier this year only Alphabet remained in 4-star territory whereas the other six were trading at 3-star or 2-star levels.

We continue to expect short-term volatility as the market prices in an economic slowdown beginning in the fourth quarter. Looking forward, further gains will be driven by a widening out of returns across the market, specifically in the value category, which remains the most undervalued, according to our valuations.

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

After briefly touching fair value, the U.S. stock market retreats and is now trading at a discount to our fair valuations.



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

U.S. Stocks Retreat During Third Quarter

The Morningstar US Equity Market Index fell 2.26% quarter to date through Sept. 25, bringing the year-to-date return off its highs to 13.88%. After leading the market higher for much of the year, growth experienced the greatest pullback, dropping 5.70%. By capitalization, large-cap stocks held their value to the downside the best, dropping only 1.45% whereas the risk off sentiment drove mid-cap and small-cap down 4.48% and 4.63%, respectively.

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

Growth stocks feel the brunt of the selloff.

		Value	Core	Growth
	US Mkt −2.26	−0.66	−1.04	−5.70
Large	−1.45	0.09	−0.05	−3.69
Medium	−4.48	−2.48	−4.19	−6.67
Small	−4.63	−3.13	−4.06	−6.70

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 Sept. 25, 2023.

Year-to-Date Returns (Percent): 2023

Yet, growth remains far ahead thus far this year.

		Value	Core	Growth
	US Mkt 13.88	3.37	7.44	20.84
Large	17.53	4.91	8.47	27.71
Medium	3.65	−1.32	3.86	9.03
Small	5.64	−0.65	7.96	10.36

Negative Returns — Positive Returns

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

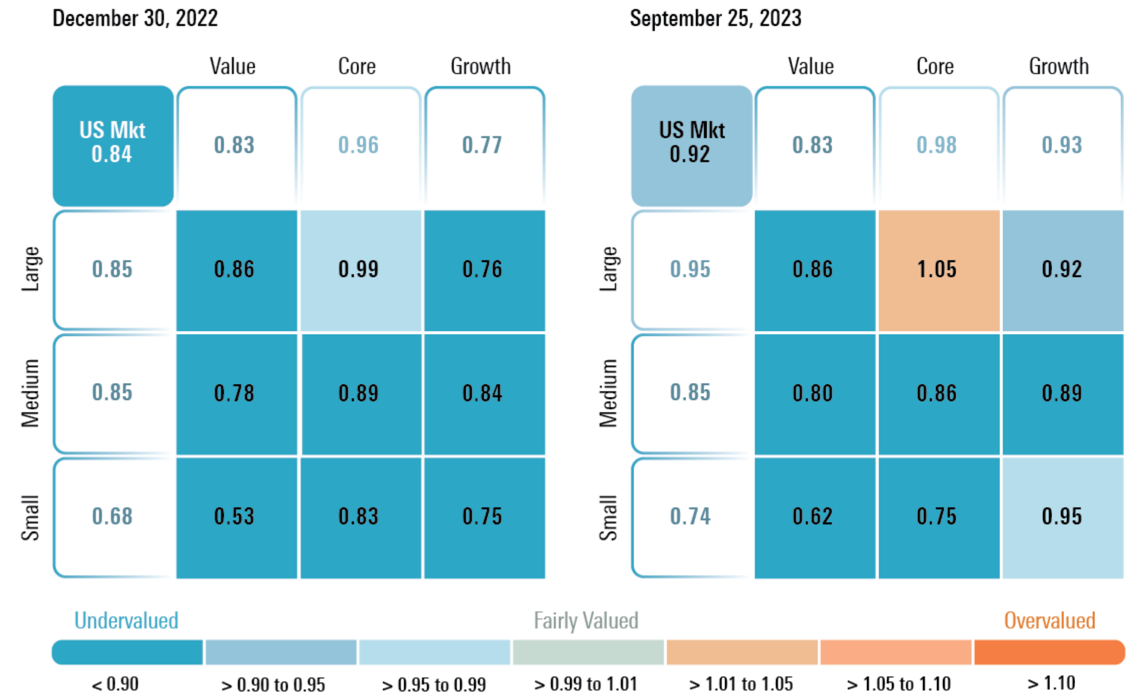
Source: Morningstar. Data as of Sept. 25, 2023.

Time to Move to Back to Market Weight in Growth Category

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. At this point, it appears that the best positioning is to move growth back to market weight as it trades near the same discount as the broad market. By market capitalization, with large-cap stocks now trading at less of a discount to fair value than the broad market, investors may look to underweight large-cap stocks in favor of overweighting mid-cap and small-cap stocks.

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

After surging high enough to move into overvalued territory in July, growth stocks have retreated and are back to market weight.



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

Quarter-to-Date Sector Returns

Surging oil prices lead to a broad rally across the energy sector. However, while price per barrel of oil surged 27% during the quarter, the Morningstar US Energy Index only rose 12.48%. According to our valuations, we think returns in the energy sector were held back as the sector was only trading at a slight discount to our fair value estimate coming into the quarter.

Communications rose 2.77% with the bulk of the performance driven by gains in Alphabet and Meta Platforms and bolstered by cable companies such as 4-star rated Comcast and Charter Communications.

Financials eked out a small gain of 1.47% as several undervalued regional banks bounced off their lows and a budding resurgence in investment banking activity propelled several investment banks higher.

Real estate fell across the board as only a few stocks were able to withstand the downward pressure from rising interest rates and lingering concerns about the viability of urban office space.

Returns by Sector (Percent): Quarter to Date

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

Cyclical		Sensitive		Defensive	
Basic Materials	–4.56	Communication Services	2.77	Consumer Defensive	–3.78
Consumer Cyclical	–4.18	Energy	12.48	Healthcare	–2.03
Financial Services	1.47	Industrials	–4.19	Utilities	–2.98
Real Estate	–7.25	Technology	–4.69		

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 Sept. 25, 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 this year. For example, communications was the most undervalued and has risen 38.66%. Consumer cyclicals were the second most undervalued and have gained 24.79%. Technology was the third most undervalued sector and has risen 36.00%.

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 the year and have struggled thus far this year. Utilities have performed the worst, dropping 8.51%, followed by healthcare and consumer defensive, which have fallen 2.88%, and 1.78%, respectively.

Energy, which was the most overvalued sector coming into the year has posted a 6.36% return but has lagged the 12% increase in oil prices over the same period.

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	3.96	Communication Services	38.66	Consumer Defensive	–1.78
Consumer Cyclical	24.79	Energy	6.36	Healthcare	–2.88
Financial Services	2.95	Industrials	7.22	Utilities	–8.51
Real Estate	–3.95	Technology	36.00		

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 Sept. 25, 2023.

Magnificent Seven Responsible for 69% of Market Gains

The stock market rally has been unusually concentrated this year. According to an attribution analysis of the Morningstar US Market Index, the returns from only seven stocks account for 69% of the total market return thus far this year.

Excitement surrounding the emergence of artificial intelligence, specifically, natural language processing tools, such as ChatGPT, drove stocks significantly higher for any companies that may stand to benefit from the future implementation of this technology.

Magnificent Seven Responsible for 69% of Market Gains

Name/Ticker	Index Weighting (%)	YTD Return (%)	YTD Contribution to Index Return (%)
Apple AAPL	6.18	35.10	1.85
Nvidia NVDA	1.98	184.83	1.82
Microsoft MSFT	5.50	33.09	1.60
Alphabet GOOGL	3.11	47.63	1.28
Amazon.com AMZN	2.51	53.71	1.09
Meta Platforms META	1.29	148.53	1.09
Tesla TSLA	1.38	98.90	0.89

Source: Morningstar. Data as of Sept. 25, 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 9/25/23	Price ($) 12/31/22	Price ($) 9/25/23	Change (%)	Fair Value 12/31/22	Fair Value 9/25/23	Change (%)	P/FV 12/31/22	P/FV 9/25/23
Apple AAPL	★★★	★★	130	176	35.5%	130	150	15.4%	1.00	1.17
Nvidia NVDA	★★★★	★★★	146	422	188.9%	200	480	140.0%	0.73	0.88
Microsoft MSFT	★★★★	★★★	240	318	32.4%	320	360	12.5%	0.75	0.88
Alphabet GOOGL	★★★★★	★★★★	88	131	48.6%	160	161	0.6%	0.55	0.81
Amazon.com AMZN	★★★★★	★★★	84	131	56.3%	150	150	0.0%	0.56	0.88
Meta Platforms META	★★★★★	★★★	120	301	150.0%	260	311	19.6%	0.46	0.97
Tesla TSLA	★★★★★	★★★	123	247	100.5%	250	215	**-14.0%**	0.49	1.15

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

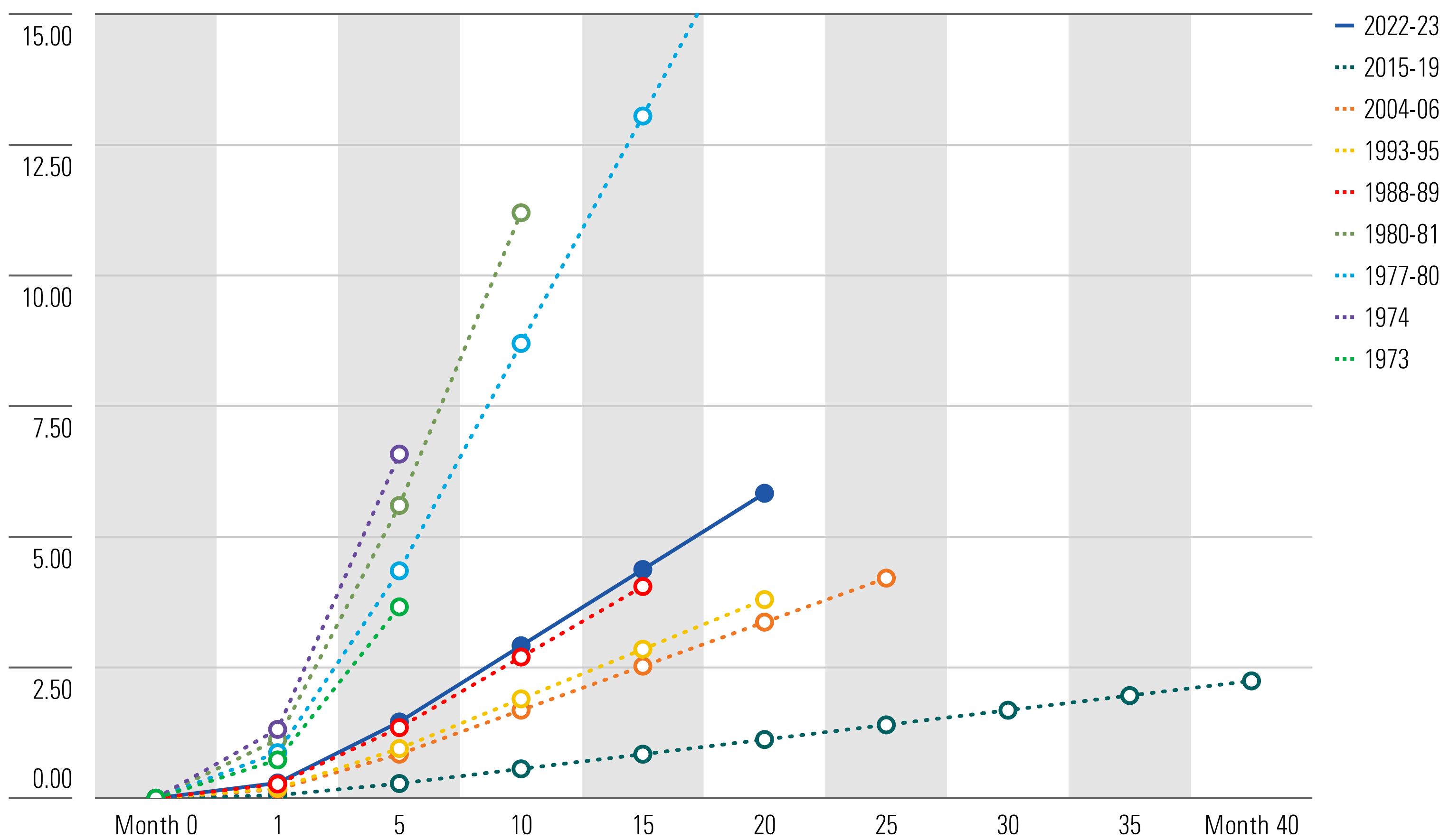
The End of This Monetary Policy Tightening Cycle

As we expected, the Federal Reserve hiked the federal-funds rate to a range of 5.25%-5.50% at its July meeting and then held interest rates steady at the September meeting.

We expect that the July hike will be the final interest rate increase of this monetary policy tightening cycle. 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.

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.

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

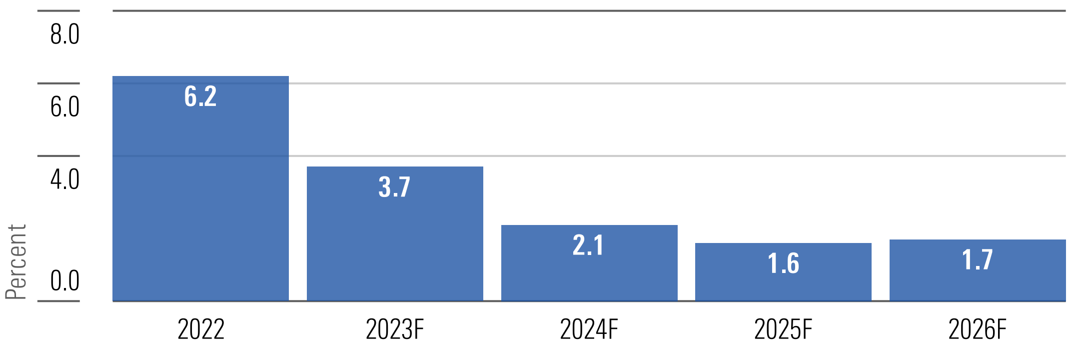


Source: Morningstar. Data as of Sept. 25, 2023.

Headline Inflation Ticking Higher, but Core Inflation Continues to Moderate

Headline Consumer Price Index has started to ratchet back up as high energy prices and other factors have pushed the broad measure of overall inflation slightly higher. However, core inflation, which strips out food and energy prices, continues to moderate. We have adjusted our inflation forecast slightly higher to reflect the rebound in these components, but we continue to expect that major drivers of high inflation in 2022, such as the supply chain bottlenecks and other sources of high inflation, will further unwind over the next few years, providing prolonged deflationary pressure. At the end of the day, a combination of easing supply constraints and Fed tightening will win the battle against inflation.

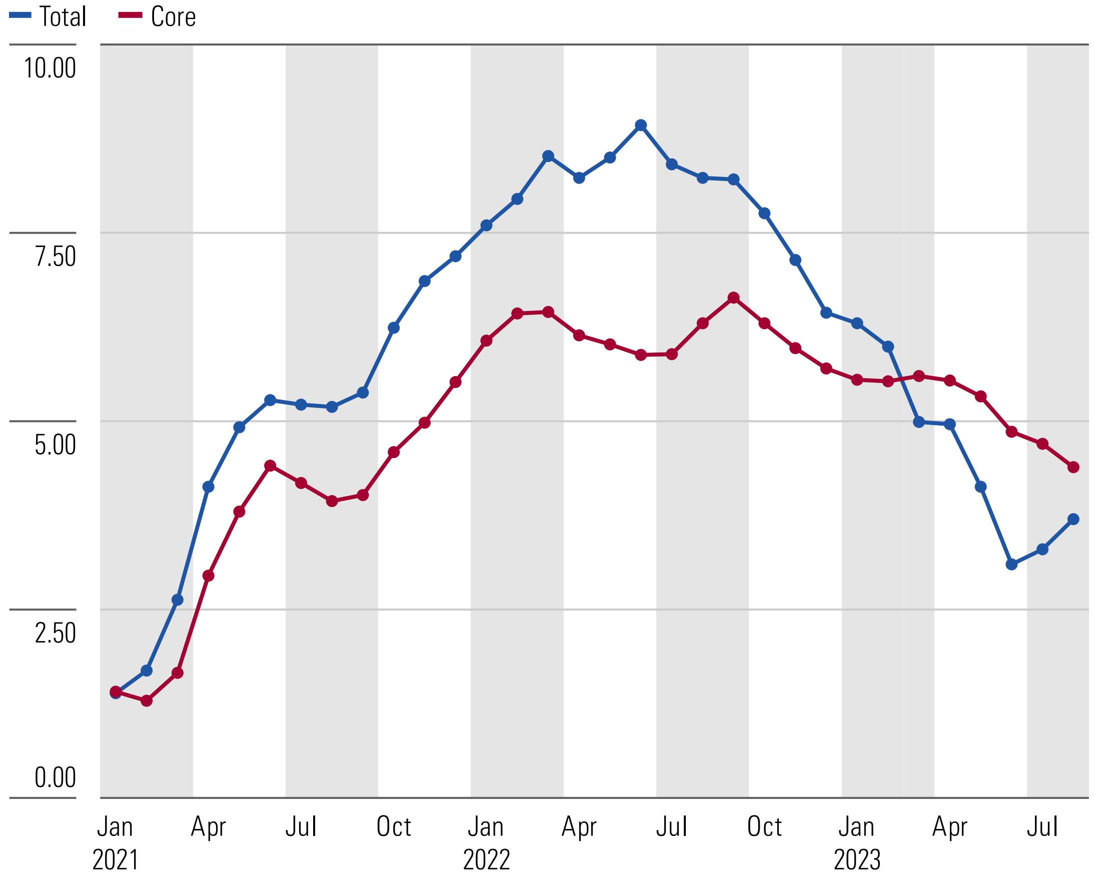
U.S. Annual Inflation Forecasts (Percent)



Source: U.S. Bureau of Economic Analysis and Morningstar. Data as of Sept. 25, 2023.

Consumer Price Index Year-Over-Year Increase (Percent)

Headline inflation ticking up on higher energy, but core continues to moderate.



Source: U.S. Bureau of Economic Analysis and Morningstar. Data as of Sept. 25, 2023.

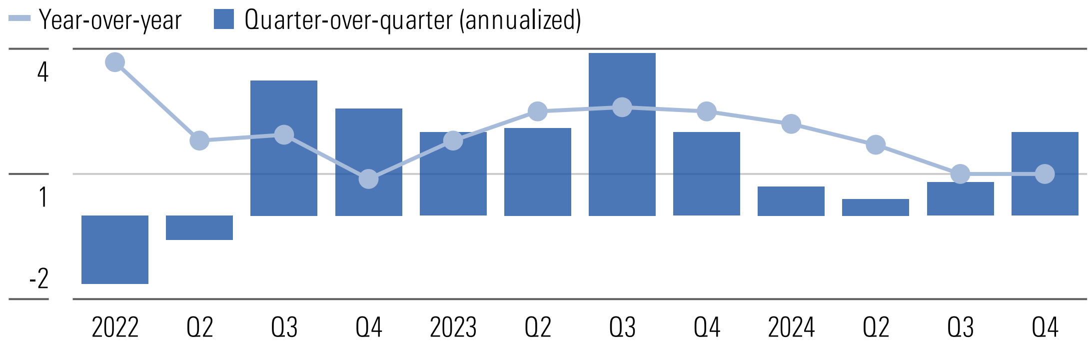
Rate of Economic Growth to Begin Slowing Sequentially Until Q2 2024, but No Recession

The U.S. economy continues to defy restrictive monetary policy. We bumped up our forecast for economic growth for the third quarter and now expect GDP for 2023 of 2.3%. Yet, we still expect higher interest rates will take their toll. We forecast that the rate of economic growth will begin to start slowing in the fourth quarter and the rate of growth will continue to slow until bottoming out in the second 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 later this year and/or early next year. However, we suspect that any sell-offs would be relatively shallow and not anywhere near the magnitude of the market decline in 2022.

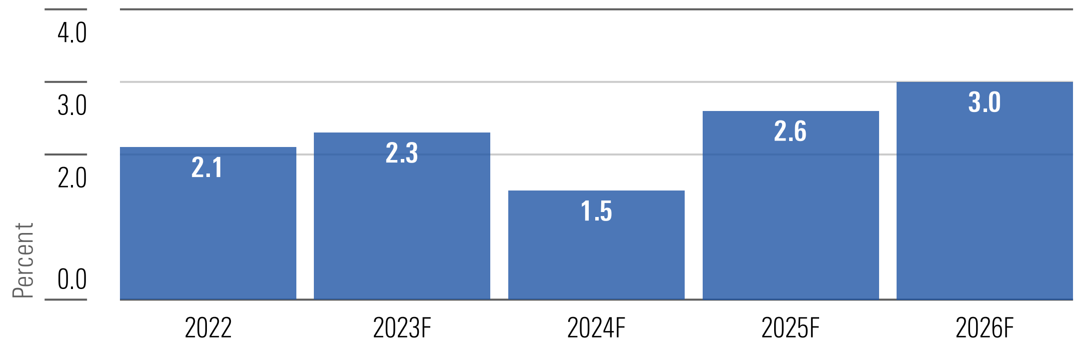
Today we see a much different situation than we did at the beginning of 2022. At that time, the market was broadly overvalued, inflation rising, interest rates were poised to rise substantially, and the economy was slowing. In today's situation, the market is slightly undervalued, inflation moderating, interest rates have, or are near, their peak, and while economic growth is slowing, we do not expect a recession and see stronger economic growth beginning in the latter half of 2024.

U.S. Real Quarterly GDP Forecasts (Percent)



Source: U.S. Bureau of Economic Analysis and Morningstar. Data as of Sept. 25, 2023.

U.S. Real Annual GDP Forecasts (Percent)



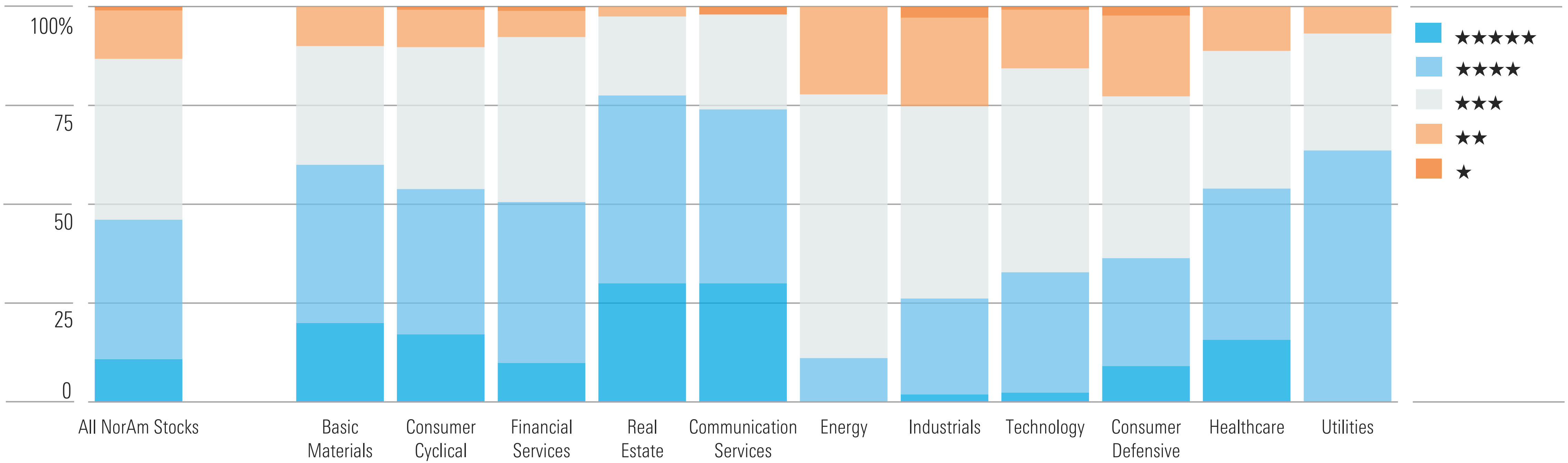
Source: U.S Bureau of Economic Analysis and Morningstar. Data as of Sept. 25, 2023.

Sector Valuations and Top Picks

Star Rating Distribution Remains Relatively Stable

The percentage of 4- and 5-star-rated stocks was relatively unchanged at 46% as compared with 45% last quarter and percentage of 1- and 2-star stocks has only declined to 13% from 15%. The real estate sector has the highest percentage of undervalued stocks at 78% while the communications sector runs a close second at 74%. Undervalued opportunities are tough to come by in the energy sector as only 11% are rated 4 or 5 stars whereas 22% are rated 1 or 2 stars. Similarly, in the industrials sector, only 26% are undervalued and 25% are overvalued. One of the biggest shifts occurred among in the utility sector as 64% of our coverage is now undervalued as compared with only 30% last quarter.

Morningstar Equity Star Ratings by Sector



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

Move Back to Market Weight in Technology Sector; Communications and Real Estate Most Attractive

Last quarter, we moved to an underweight in the technology sector as it was trading at a 7% premium to fair value. The combination of a pullback across the tech sector in conjunction with raising the fair value on Nvidia has brought the price to fair value down to 0.98. As such, now is a good time to move back to a market weight position.

Communications rose another 3% in the third quarter through Sept. 25 and a total of almost 39% thus far this year, yet at a price to fair value of 0.81 remains one of the more undervalued sectors.

The title for the most undervalued sector now belongs to real estate at a price to fair value of 0.79. Rising interest rates have been playing havoc in this space and commercial real estate, especially urban office space, has been under intense investor scrutiny. Valuations for office space have been declining as employees show a continued preference to work from home and average urban office occupancy levels have stabilized at only 50%. While office valuations may remain under pressure, we see value for investors in other real estate assets such as retail malls where foot traffic continues to rebound.

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	0.87	Communication Services	0.81	Consumer Defensive	0.98
Consumer Cyclical	0.91	Energy	1.03	Healthcare	0.96
Financial Services	0.89	Industrials	0.96	Utilities	0.91
Real Estate	0.79	Technology	0.98		

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 Sept. 25, 2023.

Cyclical Sectors: Best Picks

This quarter, we swapped out Citigroup for Wells Fargo. We like that Wells Fargo has a stronger franchise from a profitability perspective and it is further along in its turnaround timeline. Wide-moat-rated International Flavors & Fragrances is also a new addition. Over the past 10 years, only twice has its stock briefly traded in 5-star territory. We think the market is overextrapolating near-term fundamental weakness in its commodity-oriented products too far into the future. Wide-moat-rated Charles Schwab is also a new addition to the best picks list that over the past 10 years has rarely traded at such a deep discount to our fair value estimate.

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	★★★★★	167	350	0.48	Narrow	High	Basic Materials	Mid Core
Corteva Agriscience CTVA	★★★★	51	70	0.73	Wide	Medium	Basic Materials	Mid Core
Int'l Flavors & Fragrances IFF	★★★★★	68	130	0.52	Wide	High	Basic Materials	Mid Value
Nordstrom JWN	★★★★★	14	40	0.36	Narrow	Very High	Consumer Cyclical	Small Value
Hanesbrands HBI	★★★★★	4	20	0.20	Narrow	High	Consumer Cyclical	Small Value
V.F. VFC	★★★★★	17	60	0.29	Narrow	High	Consumer Cyclical	Small Value
PayPal Holdings PYPL	★★★★★	59	135	0.44	Narrow	High	Financial Services	Large Core
The Charles Schwab SCHW	★★★★	55	80	0.69	Wide	High	Financial Services	Large Core
Wells Fargo WFC	★★★★★	42	61	0.68	Wide	Medium	Financial Services	Large Value
Federal Realty Investment Trust FRT	★★★★★	92	142	0.65	None	Medium	Real Estate	Mid Core
Park Hotels & Resorts PK	★★★★★	12	27	0.45	None	High	Real Estate	Small Core
Ventas VTR	★★★★★	42	72	0.59	None	Medium	Real Estate	Mid Core

Source: Morningstar. Data as of Sept. 25, 2023. New additions to the list this quarter in **bold**.

Economically Sensitive Sectors: Best Picks

Devon Energy is new to the best picks list, and one of the few undervalued oil exploration and production stocks under our coverage. Norfolk Southern has slipped into 4-star territory, one of the few times it has over the past 10 years. We think the market is overestimating near-term operational issues as it overhauls tracks following a train derailment earlier this year. New to the best picks list is Snowflake, a data management provider that hosts enterprise data on which artificial intelligence models are run.

Best Picks From Our Directors Across the Economically Sensitive Sectors

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector	Style Box
Pinterest PINS	★★★★	26	36	0.72	Narrow	Very High	Communication Services	Mid Value
The Walt Disney Company DIS	★★★★★	81	145	0.56	Wide	High	Communication Services	Large Core
Verizon Communications VZ	★★★★★	33	54	0.61	Narrow	Medium	Communication Services	Large Value
Devon Energy DVN	★★★★	48	61	0.78	Narrow	High	Energy	Mid Core
Equitrans Midstream ETRN	★★★★	10	15	0.63	Narrow	High	Energy	Small Value
TC Energy TRP	★★★★	36	48	0.76	Narrow	Medium	Energy	Large Value
Johnson Controls International JCI	★★★★	55	72	0.77	Narrow	Medium	Industrials	Mid Core
ManpowerGroup MAN	★★★★	74	109	0.68	None	High	Industrials	Small Value
Norfolk Southern NSC	★★★★	203	239	0.85	Wide	Medium	Industrials	Large Value
Cognizant Technology Solutions CTSH	★★★★	70	94	0.74	Narrow	Medium	Technology	Mid Core
Snowflake SNOW	★★★★	150	231	0.65	None	Very High	Technology	Large Growth
Teradyne TER	★★★★	96	157	0.61	Wide	High	Technology	Mid Core

Source: Morningstar. Data as of Sept. 25, 2023. New additions to the list this quarter in **bold**.

Defensive Sectors: Best Picks

Based on its high sensitivity to interest rates the utility sector has been the worst-performing sector thus far this year, yet in many cases we think the market has overreacted to the downside. While our top picks remain unchanged from last quarter, we are seeing a plethora of stocks that have moved into 4-star territory. Near-term weakness, especially in its Asia business, has pushed Estée Lauder stock down over 40% thus far this year and is now rated 5 stars, the only time over the past 10 years it has done so.

Best Picks From Our Directors Across the Defensive Sectors

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector	Style Box
Anheuser-Busch InBev BUD	★★★★★	55	90	0.61	Wide	Medium	Consumer Defensive	Large Core
Estée Lauder EL	★★★★★	145	249	0.58	Wide	Medium	Consumer Defensive	Large Core
Kraft Heinz KHC	★★★★★	34	53	0.65	None	Medium	Consumer Defensive	Mid Value
Illumina ILMN	★★★★★	131	269	0.49	Narrow	High	Healthcare	Mid Value
Moderna Therapeutics MRNA	★★★★★	98	266	0.37	None	Very High	Healthcare	Mid Growth
Zimmer Biomet ZBH	★★★★★	117	175	0.67	Wide	Medium	Healthcare	Mid Core
Duke Energy DUK	★★★★	93	105	0.89	Narrow	Low	Utilities	Large Value
Entergy ETR	★★★★	96	120	0.80	Narrow	Low	Utilities	Mid Value
NiSource NI	★★★★	27	33	0.81	Narrow	Low	Utilities	Mid Value

Source: Morningstar. Data as of Sept. 25, 2023. New additions to the list this quarter in **bold**.

Valuation by Economic Moat

Stocks With Wide Economic Moats Outperforming in 2023, Leaving Undervalued Opportunities Hard 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 Sept. 25, the Morningstar Wide-Moat Focus Index has increased 17.56% as compared with the Morningstar US Market Index, which has risen 13.88%.

As such, as a category, stocks with wide moats are now trading at less of a discount to fair value than the broad market. Considering stocks with a narrow economic moat are trading at about the same discount as those with a wide moat, we would steer our investments into the wide-moat category.

Stocks for those companies we rate as no moat (those that don't have long-term durable competitive advantages) have lagged and are trading at a significant discount to fair value. While the margin of safety here provides investors with a downside cushion, we caution investors to pick and choose carefully among no moat rated stocks, especially as the economy is poised to take a downward turn.

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

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

Moat		Size: Large	Size: Mid	Size: Growth	Style: Value	Style: Core	Style: Growth
None	0.82	0.79	0.85	0.72	0.81	0.82	0.85
Narrow	0.93	0.99	0.84	0.76	0.85	0.97	0.98
Wide	0.93	0.94	0.87	0.82	0.83	1.01	0.91

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 Sept. 25, 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
Estée Lauder EL	★★★★★	USD	145	249	0.58	Wide	Medium	Consumer Defensive
U.S. Bank USB	★★★★★	USD	34	52	0.65	Wide	Medium	Financial Services
Raytheon Technologies RTX	★★★★★	USD	72	111	0.65	Wide	Medium	Industrials
Yum China YUMC	★★★★★	USD	57	84	0.67	Wide	Medium	Consumer Cyclical
Wells Fargo WFC	★★★★★	USD	42	61	0.68	Wide	Medium	Financial Services
Pfizer (Pharmaceuticals) PFE	★★★★	USD	33	48	0.69	Wide	Medium	Healthcare
Medtronic MDT	★★★★	USD	80	112	0.71	Wide	Medium	Healthcare
Comcast CMCSA	★★★★	USD	45	60	0.75	Wide	Medium	Communication Services
Kenvue KVUE	★★★★	USD	21	28	0.76	Wide	Medium	Consumer Defensive
Gilead Sciences GILD	★★★★	USD	75	97	0.77	Wide	Medium	Healthcare
Intercontinental Exchange ICE	★★★★	USD	109	137	0.80	Wide	Medium	Financial Services
Altria Group MO	★★★★	USD	42	52	0.81	Wide	Medium	Consumer Defensive
Ecolab ECL	★★★★	USD	172	210	0.82	Wide	Medium	Basic Materials

Source: Morningstar. Data as of Sept. 25, 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	★★★★★	USD	117	175	0.67	Wide	Medium	Healthcare
Campbell Soup CPB	★★★★	USD	42	61	0.69	Wide	Medium	Consumer Defensive
Kellogg's K	★★★★	USD	59	84	0.71	Wide	Medium	Consumer Defensive
Corteva Agriscience CTVA	★★★★	USD	51	70	0.73	Wide	Medium	Basic Materials
Agilent Technologies A	★★★★	USD	112	151	0.74	Wide	Medium	Healthcare
Keysight Technologies KEYS	★★★★	USD	131	170	0.77	Wide	Medium	Technology
Allegion ALLE	★★★★	USD	104	135	0.77	Wide	Medium	Industrials
BNY Mellon BK	★★★★	USD	43	55	0.78	Wide	Medium	Financial Services
The Clorox Company CLX	★★★★	USD	132	168	0.79	Wide	Medium	Consumer Defensive
Northern Trust NTRS	★★★★	USD	69	86	0.80	Wide	Medium	Financial Services
Tyler Technologies TYL	★★★★	USD	389	475	0.82	Wide	Medium	Technology
Otis (Electrical Equipment) OTIS	★★★★	USD	81	98	0.83	Wide	Low	Industrials
Waters WAT	★★★★	USD	271	323	0.84	Wide	Medium	Healthcare

Source: Morningstar. Data as of Sept. 25, 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
Sealed Air SEE	★★★★★	USD	33	54	0.60	Narrow	Medium	Consumer Cyclical
Stericycle SRCL	★★★★	USD	46	60	0.77	Narrow	Medium	Industrials
Western Union WU	★★★★	USD	13	17	0.77	Narrow	Medium	Financial Services
Wyndham Hotel Group WH	★★★★	USD	71	89	0.80	Narrow	Medium	Consumer Cyclical
Ingredion INGR	★★★★	USD	98	120	0.82	Narrow	Medium	Consumer Defensive
Vontier VNT	★★★★	USD	31	37	0.83	Narrow	Medium	Technology
Gentex GNTX	★★★★	USD	32	38	0.85	Narrow	Medium	Consumer Cyclical
Portland General Electric POR	★★★★	USD	43	50	0.86	Narrow	Low	Utilities
Mattel MAT	★★★★	USD	22	25	0.86	Narrow	Medium	Consumer Cyclical
Allison Transmission ALSN	★★★★	USD	59	66	0.90	Narrow	Medium	Consumer Cyclical
New Jersey Resources NJR	★★★★	USD	42	45	0.94	Narrow	Low	Utilities

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

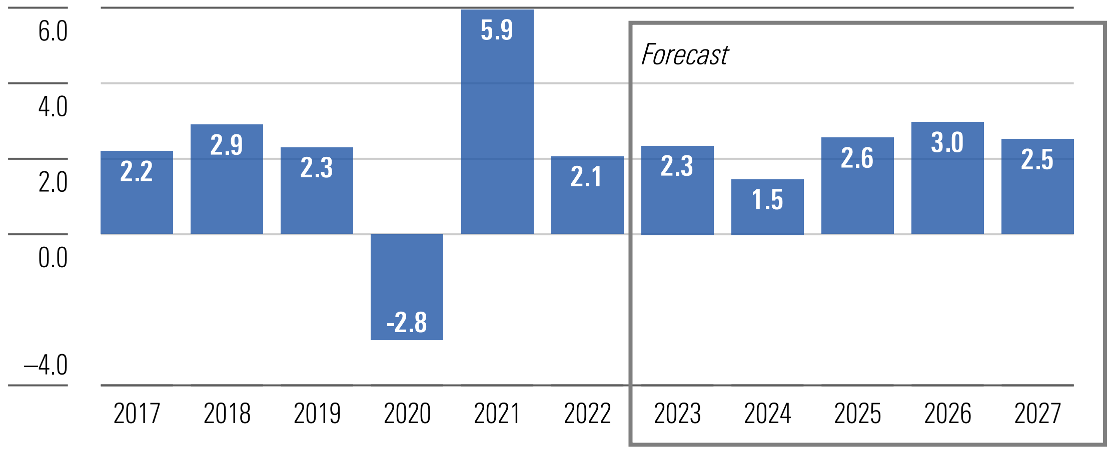
U.S. Economic Outlook

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 2025 and following years as the Fed eases monetary policy. For full coverage of our latest economic views, see our U.S. Economic Pulse: September 2023.

U.S. Real GDP Growth (Percent)



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. However, 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 (Percent), PCE Price Index

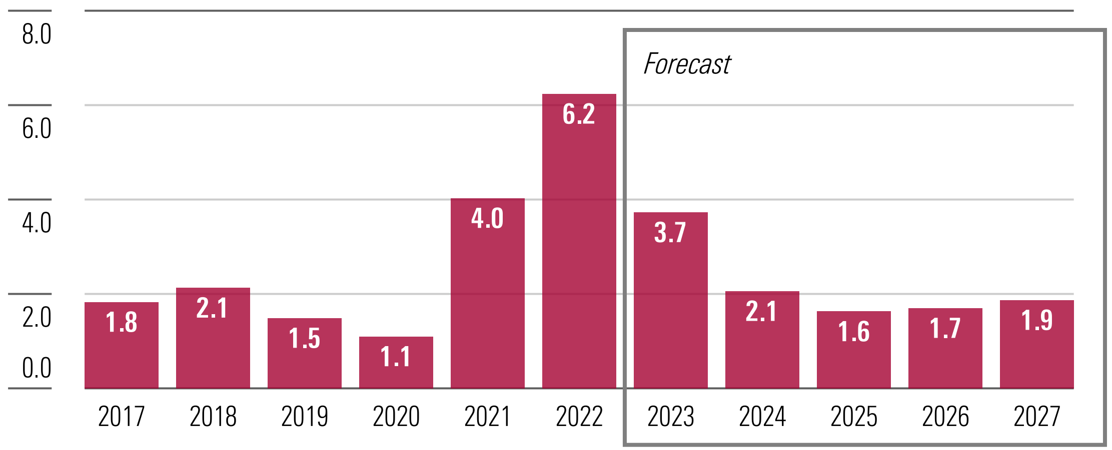


Exhibit sources: Bureau of Economic Analysis, Morningstar.

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

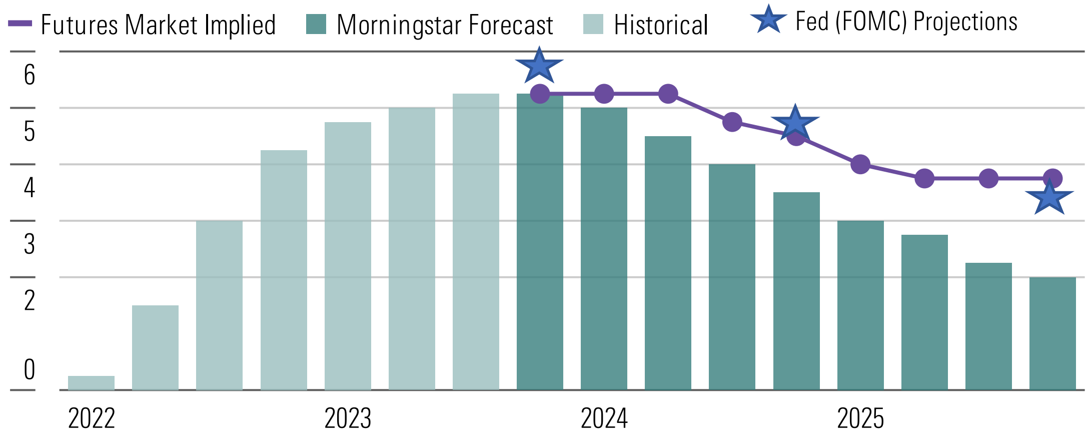
The Fed's most recent hike was by 0.25 points back in July, bringing the federal-funds rate up to 5.25%-5.5%. Markets expect that the Fed is done hiking for the rest of the year, and we agree with this. The question now is when the Fed will eventually start cutting rates, and by how much.

We still expect the Fed to cut aggressively in 2024 as inflation normalizes and economic growth weakens. But given the incremental uptick in both our near-term GDP growth and inflation expectations, we've pushed our expected start date for cuts to March 2024 from February previously.

Still, given the upward shift in market expectations, we continue to project much steeper rate cuts than the market (as well as the Fed). We expect a federal-funds rate of 3.5-3.75% at year-end 2024 (100 basis points below the market) and 2%-2.25% at end of 2025 (175 basis points below the market).

Hot economic data in the face of the Fed's tightening campaign has led some to surmise that the U.S. economy's equilibrium real interest rate has increased. Thus, long-term bond yields have drifted upward, with the 10-year Treasury hitting 4.6% in September, the highest since 2007. However, we doubt the economy will continue to thrive for long while suffering under such high interest rates, thus we think the Fed will eventually need to drive rates lower.

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



Treasury Yields (Percent)

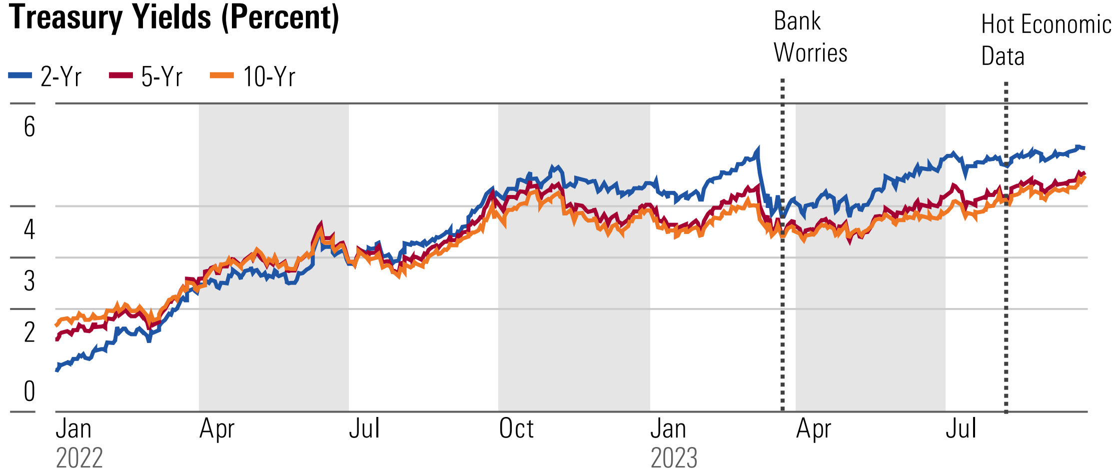


Exhibit sources: Federal Reserve, Chicago Mercantile Exchange (top).

Spotlight | Mega-Cap Stocks

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

Most Mega-Cap Stocks Rated 4 or 5 Stars at the End of 2022 Have Outperformed the Market in 2023

Name/Ticker	Rating 12/30/22	Rating 9/25/23	Price ($) 12/30/22	Price ($) 9/25/23	Change (%)	Fair Value 12/30/22	Fair Value 9/25/23	Change (%)	P/FV 12/30/22	P/FV 9/25/23
Microsoft MSFT	★★★★	★★★	240	318	32.4%	320	360	12.5%	0.75	0.88
Alphabet GOOGL	★★★★★	★★★★	88	131	48.6%	160	161	0.6%	0.55	0.81
Amazon.com AMZN	★★★★★	★★★	84	131	56.3%	150	150	0.0%	0.56	0.88
Berkshire Hathaway BRK.A	★★★★	★★★	468,711	548,360	17.0%	555,000	555,000	0.0%	0.84	0.99
Tesla TSLA	★★★★★	★★★	123	247	100.5%	250	215	**-14.0%**	0.49	1.15
Nvidia NVDA	★★★★	★★★	146	422	188.9%	200	480	140.0%	0.73	0.88
Meta Platforms META	★★★★★	★★★	120	301	150.0%	260	311	19.6%	0.46	0.97
Bank of America BAC	★★★★	★★★★	33	28	**-16.7%**	39	35	**-10.3%**	0.85	0.79
Broadcom AVGO	★★★★	★★★	559	834	49.1%	624	815	30.6%	0.90	1.02

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

Updated List of Undervalued Mega-Cap Stocks

Alphabet is the sole undervalued mega-cap stock. This past quarter, Berkshire Hathaway dropped off the list as its stock price rose enough to take its rating to 3-stars. Bank of America remains 4-stars, but as its stock price fell, its market cap has fallen below our cut off. Two other 4-star rated stocks whose market capitalizations are near $200 billion, but not enough to be deemed mega-cap, include Salesforce and Themo Scientific.

Heading Into 2023, There Were Nine Mega-Cap Stocks Rated 4 or 5 Stars; Only One Remains

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector	Style Box	Market Cap ($B)
Alphabet GOOGL	★★★★	137	161	0.85	Wide	High	Communication Servic	Large Growth	1,737.7

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

All but One Overvalued Mega-Cap Stock Has Underperformed

Nine of 10 1- or 2-Star-Rated Mega-Cap Stocks Identified at the Beginning of Year Has Underperformed the Market

Name/Ticker	Rating 12/31/22	Rating 9/15/23	Price ($) 12/31/22	Price ($) 9/15/23	Change (%)	Fair Value 12/31/22	Fair Value 9/15/23	Change (%)	P/FV 12/31/22	P/FV 9/15/23
UnitedHealth Group UNH	★★	★★★	530	487	**-8.2%**	426	462	8.5%	1.24	1.05
Johnson & Johnson JNJ	★★	★★★	177	161	**-8.6%**	164	164	0.0%	1.08	0.98
Procter & Gamble PG	★★	★★	152	153	1.3%	125	136	8.8%	1.21	1.13
Eli Lilly LLY	★★	★	366	576	57.4%	273	368	34.8%	1.34	1.56
Chevron CVX	★★	★★★	179	167	**-7.2%**	149	172	15.4%	1.20	0.97
The Home Depot HD	★★	★★	316	321	1.8%	270	263	**-2.6%**	1.17	1.22
AbbVie ABBV	★★	★★	162	152	**-5.9%**	120	126	5.0%	1.35	1.21
Merck & Co. MRK	★★	★★★	111	108	**-3.1%**	97	103	6.2%	1.14	1.04
Coca-Cola KO	★★	★★★	64	58	**-8.9%**	58	60	3.4%	1.10	0.97
Pepsico PEP	★★	★★★	181	180	**-0.5%**	170	176	3.5%	1.06	1.02

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

Updated List of Overvalued Mega-Cap Stocks for 2023

The one addition this quarter is Walmart, as its stock rose enough to push its rating to 2 stars. Five stocks dropped off the list (Nvidia, Broadcom, Merck, Coca-Cola, PepsiCo) based on a combination of falling stock prices and adjustments to our fair value estimates. Most notable was the increase in our fair value estimate on Nvidia to $480.

Stocks Rated 1 or 2 Stars With Market Capitalizations of $250 Billion and Greater

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector	Style Box	Market Cap ($B)
Apple AAPL	★★	175	150	1.17	Wide	High	Technology	Large Core	2,736.1
Eli Lilly LLY	★	576	368	1.56	Wide	High	Healthcare	Large Growth	546.5
Walmart WMT	★★	165	145	1.14	Wide	Medium	Consumer Defensive	Large Core	443.1
Procter & Gamble PG	★★	153	136	1.13	Wide	Low	Consumer Defensive	Large Core	361.7
The Home Depot HD	★★	321	263	1.22	Wide	Medium	Consumer Cyclical	Large Core	321.4
Oracle ORCL	★	114	76	1.50	Narrow	Medium	Technology	Large Core	312.1
AbbVie ABBV	★★	152	126	1.21	Narrow	High	Healthcare	Large Value	268.5

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

Fixed-Income Outlook Q4 2023

Bonds Battered as Interest Rates March Higher in Q3

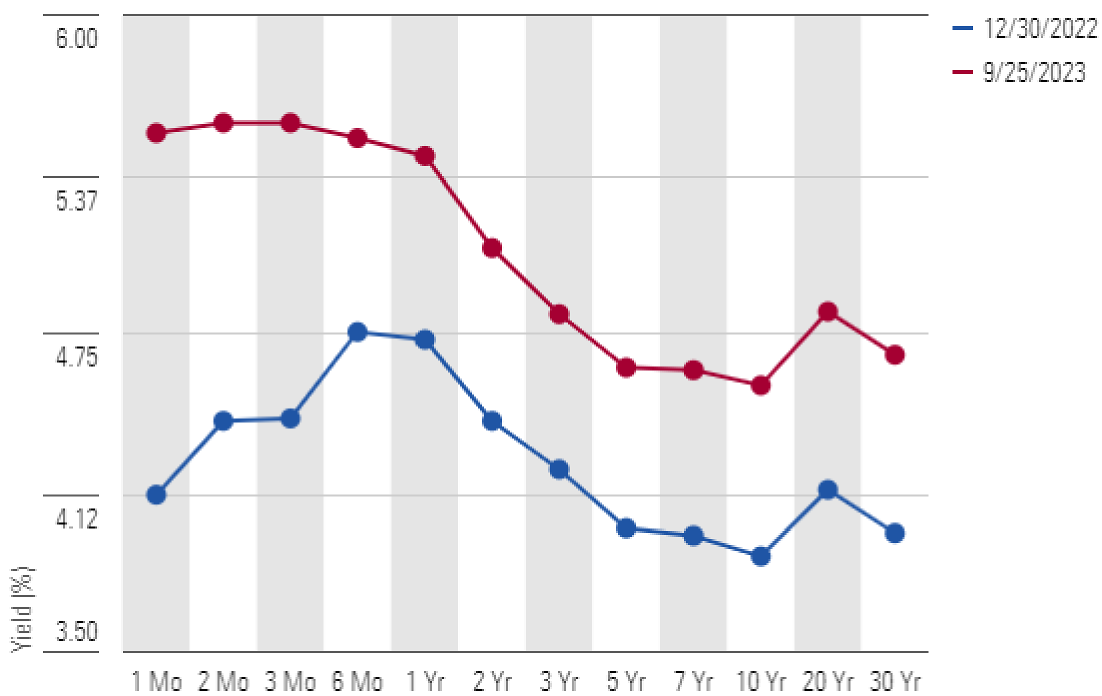
The Morningstar US Core Bond Index (our broadest proxy for the fixed-income market) fell 2.95% in the third quarter through Sept. 25. The amount that long-term bond prices fell as long-term interest rates rose overwhelmed the amount of yield carry. However, shorter duration bonds and bonds that trade with additional credit spreads over interest rates generally performed better. Although yields could rise further from here as short-term momentum pushes Treasuries down further, looking forward, we continue to think interest rates either have, or are close to, their peaks.

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

Morningstar Index	Effective Yield	Duration	2022	1Q 2023	2Q 2023	QTD 3Q 2023	YTD 2023
ABS	6.14%	2.1	-4.42%	2.05%	0.16%	0.88%	3.11%
CMBS	6.24%	3.9	-9.84%	1.63%	-0.43%	-0.80%	0.38%
Core Bond	5.34%	6.0	-12.99%	2.92%	-0.82%	-2.95%	-0.93%
Corporate Bond	5.88%	6.9	-15.71%	3.61%	-0.30%	-2.60%	0.61%
High-Yield Bond	8.69%	3.6	-11.09%	3.68%	1.65%	0.74%	6.16%
MBS	5.54%	6.0	-11.94%	2.48%	-0.53%	-3.68%	-1.82%
TIPS	2.51%	5.6	-11.85%	3.38%	-1.45%	-2.45%	-0.61%
Treasury Bond	4.87%	5.8	-12.43%	2.97%	-1.37%	-2.95%	-1.44%

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

Yield Curve Becomes Even Further Inverted



Source: U.S. Treasury, Morningstar. Data as of Sept. 25, 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.

Looking forward, we forecast that the rate of economic growth will begin to slow sequentially in the fourth quarter and bottom out in the second quarter of 2024. We also project that inflation will remain on a downward trend for the remainder of 2023 and in the beginning of 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 have risen since the September FOMC meeting as Federal Reserve officials intimate to the market their opinion that rates will need to stay higher for longer to battle inflation. According to our economic models, even after incorporating the recent surge in oil prices, we forecast that inflation will remain on a steady, downward trend.

Our U.S. economics team forecasts that the Fed will begin to cut short-term interest rates early next year and project the federal-funds rate will average 4.71% over the course of 2024 and average 2.94% in 2025.

In the longer end of the curve, we project the yield on the 10-year U.S. Treasury will average 3.25% in 2024 and 2.50% in 2025. As such, we continue to think investors should look to lengthen out their duration over the next 12 months as short-term rates will begin to subside once the Fed begins to ease monetary policy.

Interest-Rate Forecast

Average interest rate per calendar year.

Interest Rate (%)	2023E	2024E	2025E	2026E	2027E
Federal Funds	5.04	4.71	2.94	1.79	1.63
10-Year UST	3.85	3.25	2.50	2.75	2.75

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

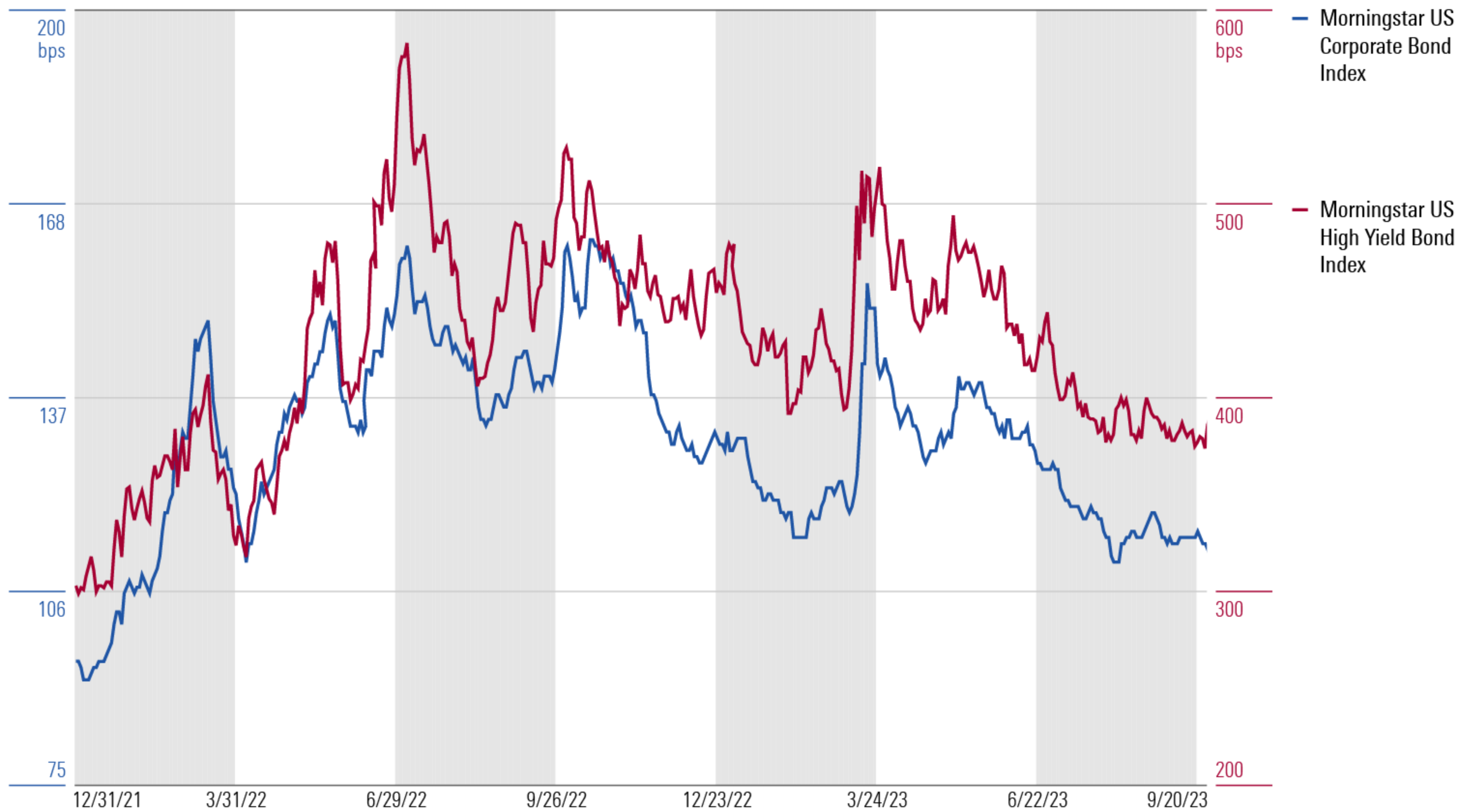
Corporate Bond Market

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 19 basis points to +111. In the high-yield corporate bond market, the average spread of the Morningstar US High-Yield Index tightened 85 basis points to +394.

According to our economic projections, while we expect the rate of economic growth to slow for the next three quarters before beginning to expand, we do not forecast a recession. As such, we do not expect to see a meaningful increase in downgrades or defaults. While corporate credit spreads are not as attractive as they were at the beginning of the year, we continue to view the current spread as reasonable compensation for the extra risk of investing in corporate bonds.

Corporate Credit Spreads Tighten

Year to date, investment-grade and high-yield spreads tightened 19 and 85 basis points, respectively.



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

Basic Materials

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

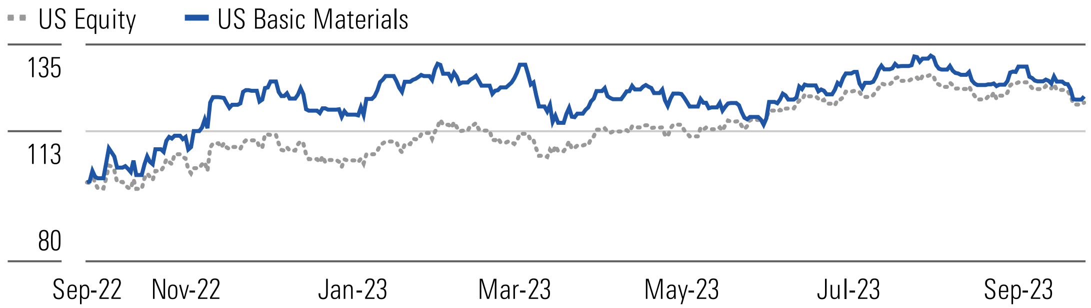
As Basic Materials Sector Underperforms, We See Strong Opportunities

The Morningstar US Basic Materials Index underperformed the broader market during the third quarter of 2023. The basic materials index declined 4.6% during the quarter, while the U.S. market index was down 2.3%. However, on a trailing 12-month basis, the basic materials sector outperformed the market by 150 basis points. We see opportunities across the sector with the majority (60%) of the stocks trading in either 5-star or 4-star territory, particularly in chemicals, metals and mining, and forest products.

Specialty chemicals producers will likely see profits decline in 2023 due to an economic slowdown. For food and beverage specialty ingredients producers, which are typically less affected during a slowdown, recent cost inflation has resulted in some consumers trading down to private-label brands, causing volume declines at many consumer-packaged goods companies. As a result, ingredients demand is seeing a larger-than-normal slowdown. However, we expect the inventory destocking will prove temporary, with demand beginning to normalize by the end of the year. Additionally, falling input prices, namely crop prices, as measured by the World Bank Food Index, should provide input cost relief, helping to restore profits.

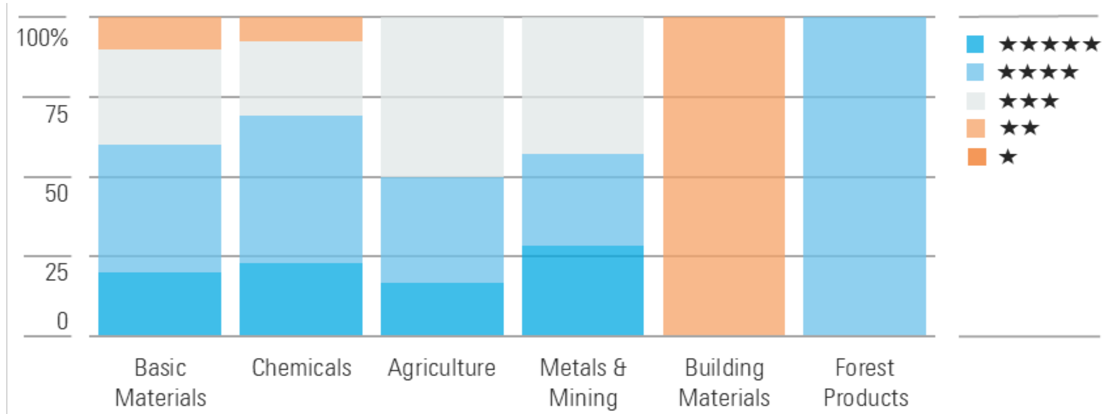
In agriculture, falling crop prices have led to lower demand from farmers for crop inputs. While farmers may cut back on fertilizer and crop chemicals in a lower-crop-price environment, they will typically continue to pay up for premium seeds, as these products can boost crop yields in excess of their premium cost, supporting higher farmer incomes.

The Basic Materials Index Underperformed the Broader Market Index



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

Sixty Percent of Our Basic Materials Names Trade in 5-Star or 4-Star Territory

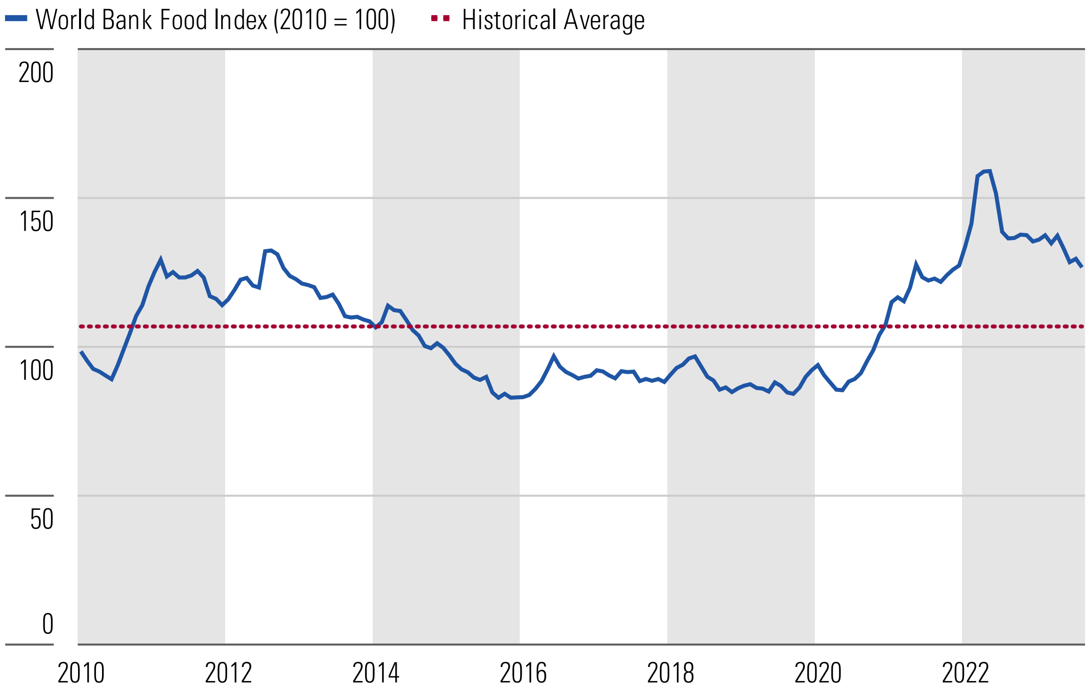


Source: Morningstar. Data as of Sept. 25, 2023.

As Basic Materials Sector Underperforms, We See Strong Opportunities

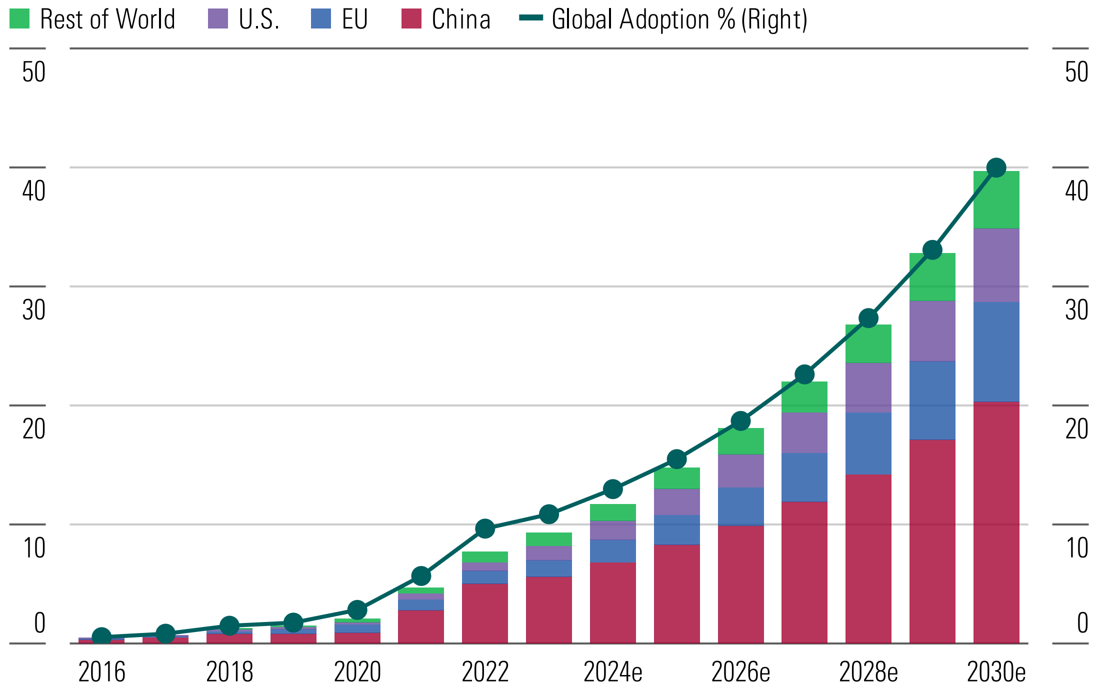
Lithium demand will more than triple by 2030 from 2022 largely because of increased electric vehicle adoption, as EVs rise to 40% of global auto sales by 2030, up from 10% in 2022. Lithium is one of the best ways to invest in rising EV adoption as all EV batteries require lithium. Prices are currently near $30,000 per metric ton. 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 $35,000 per metric ton from 2023 to 2030.

Food and Beverage Ingredient Input Prices Are Falling, Easing Cost Inflation



Source: World Bank. Data as of September 2023.

Global Electric Vehicle Adoption Will Grow to 40% by 2030



Source: Morningstar, IEA, U.S. EPA, Ward's, ACEA, CAAM. Data as of September 2023.

SECTOR TOP PICKS

Basic Materials

Name/Ticker		Rating	
International Flavors & Fragrances (IFF)		★★★★★	International Flavors & Fragrances is our top pick to invest in a specialty ingredients recovery. The stock trades at a nearly 50% discount to our $130 per share fair value estimate. IFF's shares plunged following the company's second-quarter earnings call as management cut guidance for the third time in 2023, as demand declined in the commodity ingredients business more than management's prior guidance. However, the specialty business, which generates 75% of revenue, has held up fairly well, with two of the four specialty businesses starting to see profit recovery during the second quarter. As specialty ingredients demand stabilizes and input costs decline, we expect profits will recover.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
67.84	130.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
17.40	Wide	Standard	

Name/Ticker		Rating	
Corteva (CTVA)		★★★★	Our top pick to invest in strong seeds demand is wide-moat Corteva. The stock trades at a more-than 25% discount to our $70 per share fair value estimate. Corteva is an ag inputs pure-play company, with seeds and crop protection each generating around half of profits. As the company develops new premium products, we forecast Corteva will see profit growth and margin expansion over the next couple of years even if crop prices continue to fall.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
51.42	70.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
36.39	Wide	Standard	

Name/Ticker		Rating	
Albemarle (ALB)		★★★★★	Albemarle is our top pick to play strong lithium demand and higher prices from rising EV adoption. The stock trades at a little over 50% of our $350 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 creates the cost advantage that underpins our narrow moat rating. Albemarle also offers the relatively lowest risk among the lithium producers under our coverage as the plan to quadruple lithium production capacity by the end of the decade will be done largely through the replication of the company's existing downstream conversion facilities.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
168.21	350.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
19.58	Narrow	Standard	

Communication Services

Michael Hodel | michael.hodel@morningstar.com

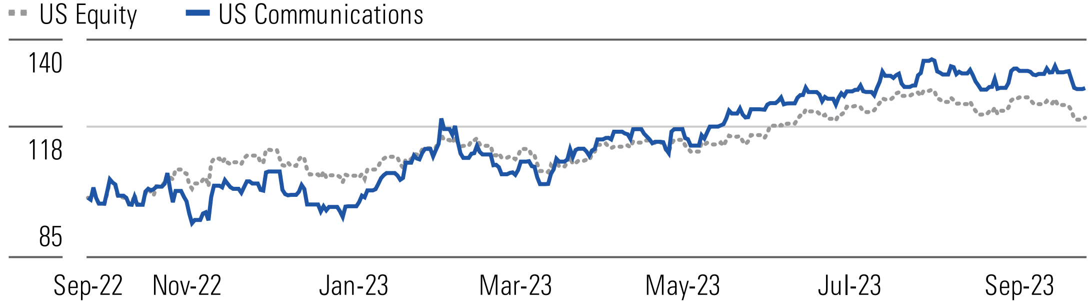
Traditional Media and Telecom Shares Continue to Languish, but We See Better Times Ahead

The surge in Meta and Alphabet shares during 2023 remains the primary story within the sector, but other pockets of strength have emerged. Cable companies Charter and Comcast have rebounded despite their struggles to add broadband customers. Both have used heavy discounting to take share in the wireless business via their wholesale agreement with Verizon, a strategy we don't like. However, pricing in the core broadband market remains strong despite fixed-wireless competition from Verizon and T-Mobile. We still think the market is overly pessimistic concerning Comcast and Charter's long-term prospects, but their share prices are no longer unreasonably low, in our view.

The telecom carriers received another blow to sentiment when The Wall Street Journal published a series of articles on the potential environmental liabilities of lead-sheathed cables. We don't believe this issue should be of significant concern for investors. We continue to see signs that competition in the U.S. wireless industry is growing increasingly rational. Each of the three major carriers has implemented price or fee increases or added high-end plans designed to increase revenue per customer. T-Mobile also initiated a dividend, adding to its share repurchase efforts, demonstrating its expectation that cash flow will remain solid. We expect improving cash flow at AT&T and Verizon will provide a lift to both firms' shares in the coming quarters.

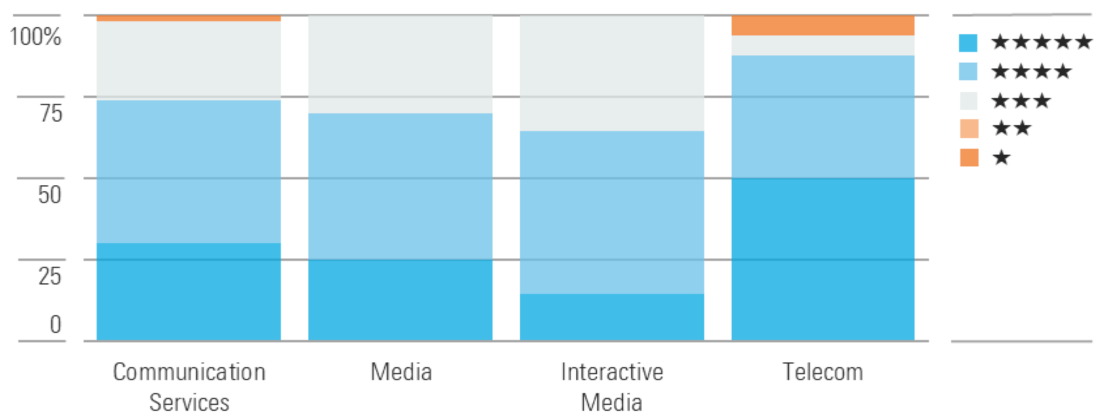
The fear surrounding the telecom industry and rising interest rates have dragged on wireless tower stocks over the past months, creating an attractive opportunity to buy these stocks for the first time in several years. Shares of Crown Castle have been hit particularly hard as it operates only the U.S., where growth prospects have diminished as the carriers' initial 5G investments wrap up.

A Strong Rally in Meta and Alphabet Shares Has Defined Communication Services



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

Traditional Telecom and Media Continue to Provide Opportunities

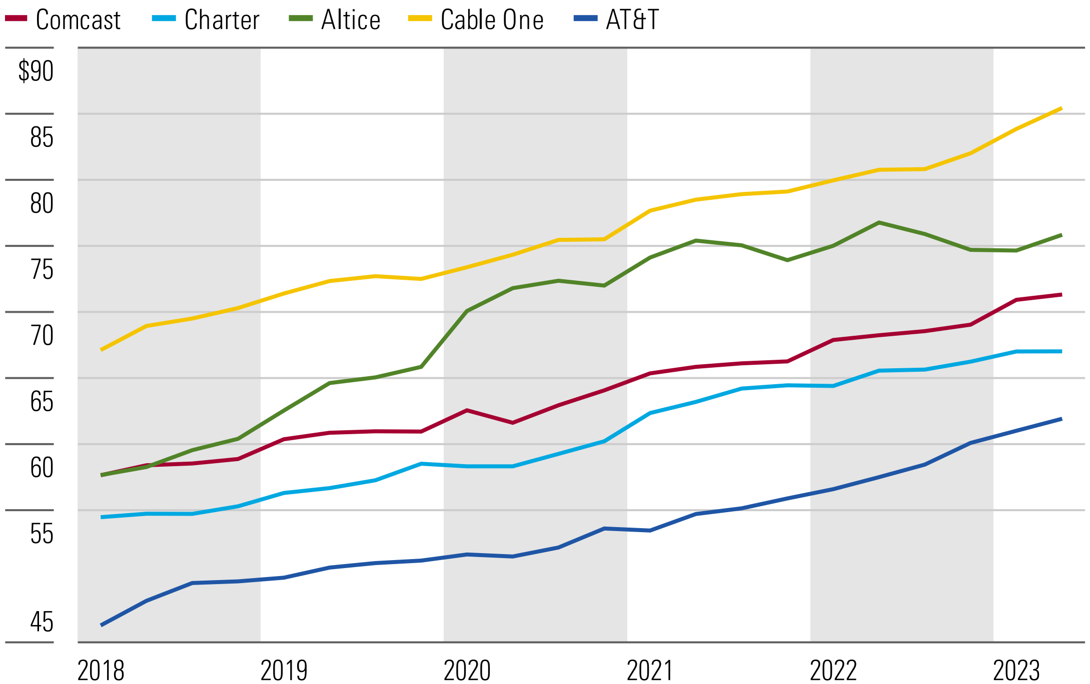


Source: Morningstar. Data as of Sept. 25, 2023.

Outside of Netflix, the Market Expects Little Recovery in Profitability Across Media Firms

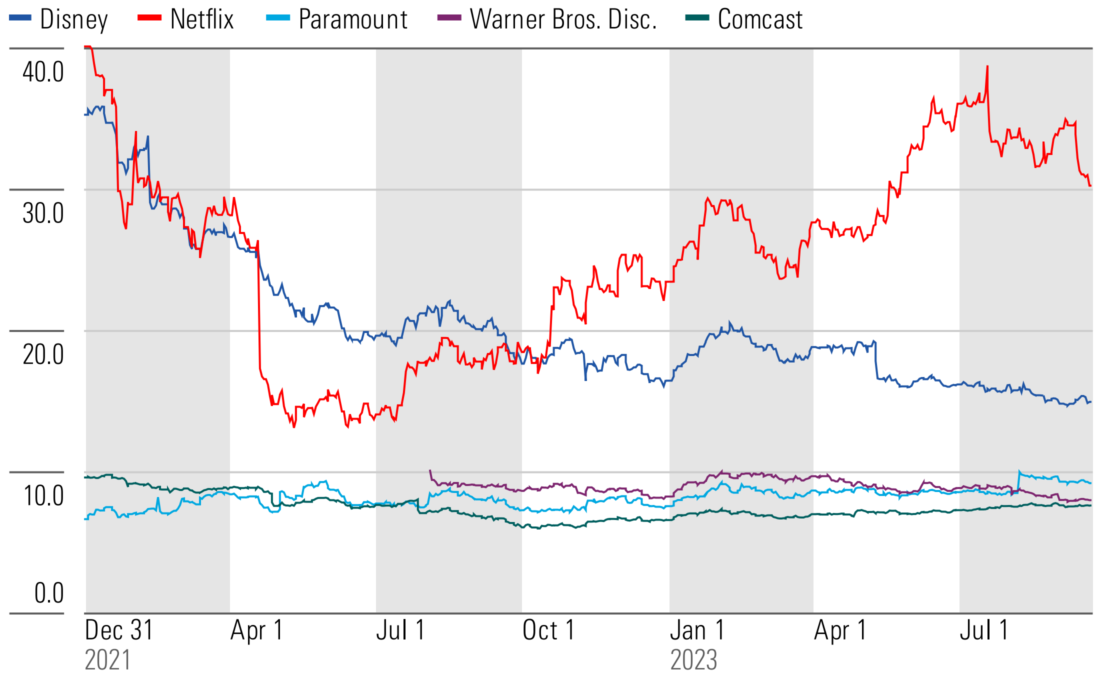
While Crown is trading at a larger discount to our fair value estimate, we still slightly prefer American Tower, which offers exposure to multiple emerging markets around the world where future network investment will likely remain elevated for several years to come. The traditional media business also remains mired in pessimism as streaming losses mount and traditional television customers, a source of critical cash flow, continue to cut the cord. We see emerging signs for hope, though, as firms have started to increase pricing for streaming services while cutting back on content investments (albeit with help from the writers' and actors' strikes). In addition, we believe the renewed carriage agreement between Charter and Disney could serve as a blueprint to increase the value of traditional television service and better integrate it with streaming services to stem the decline of this important business.

Monthly Broadband Revenue per Customer: Competition Remains Rational



Source: Morningstar equity research, company reports. Data as of Sept. 22, 2023.

Enterprise Value/Trailing EBITDA: Investors Expect Little Streaming Improvement



Source: Morningstar equity research, company reports. Data as of Sept. 22, 2023.

Communication Services

Name/Ticker		Rating	
Disney (DIS)		★★★★★	We believe Disney remains the best-situated traditional media firm to navigate the transition to streaming. The firm's deep content library, teeming with major franchises, and its strong studios provide both Disney's famous family-friendly fare and content suited to older audiences. We expect that fans will continue to flock to the parks and resorts, generating solid profitability while reinforcing its content popularity. Plans to invest aggressively in the parks over the next decade should enhance its unique experiences. We expect the emphasis on revenue and costs over the next year to continue, but the flagship streaming service Disney+ should continue to build momentum with audiences around the world while moving toward profitability.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
81.01	145.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
148.23	Wide	Exemplary	

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 cable wins are increasing market share and competition among the carriers appears stiff. 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, coupled with a modest contribution from new services like edge computing and Fios expansion, should enable Verizon to slowly increase revenue. Continued cost-reduction efforts should allow margins to hold roughly steady over time as well, while a rational competitive environment keeps a lid on needed capital spending.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
33.28	54.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
139.41	Narrow	Standard	

Name/Ticker		Rating	
Pinterest (PINS)		★★★★	Pinterest's network effect is strengthening as more advertisers adopt its ad performance measurement tools, which we think will increase ad prices on the platform. The firm's second-quarter results showed initial progress along these lines. At the same time, continuing user growth and improvements in engagement are providing more opportunities for advertisers to reach an audience. Finally, we think with the Amazon partnership, Pinterest is now at the forefront of retail media options toward which advertisers continue to allocate more ad dollars.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
26.72	36.00	Very High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
17.46	Narrow	Standard	

Consumer Cyclical

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

Discretionary Spending Uncertainty Continues to Drive Attractive Consumer Cyclical Valuations

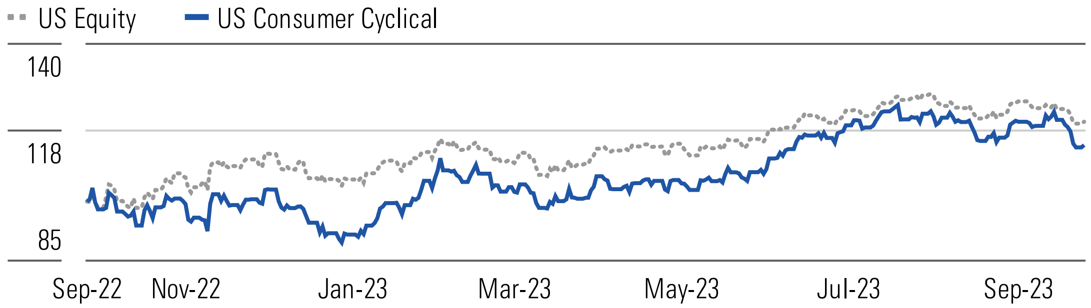
The Morningstar U.S. Consumer Cyclical Index declined 4.2% in the third quarter, a touch below the broader market's 2.3% decline. Preserved by the sector's static results, compelling investment opportunities remain, in our view, as the median consumer cyclical stock trades at a 17% discount to our fair value estimate, with 54% of our coverage trading in 4- or 5-star territory. Specifically, apparel continues to stand out as the most undervalued sector, trading at a 46% discount to our intrinsic valuations.

Though consumers have exhibited symptoms of caution, overall spending has remained relatively resilient despite the challenging backdrop of elevated interest rates and inflation's drag on personal savings. While persistent macroeconomic pressures could stretch consumers further, we believe that this risk is already reflected in share prices and that such steep discounts to our fair value estimates are unwarranted.

Even though conditions may prompt consumers to alter their spending habits, we believe there is still pent-up demand for travel. Since January 2023, the number of monthly U.S. Transportation Security Administration, or TSA, passenger scans averaged 0.38% ahead of comparable 2019 levels, tracking near all-time highs despite mounting inflation. We contend tailwinds related to hybrid work models and the human-ingrained desire to travel should enable trends to persist, offering further growth.

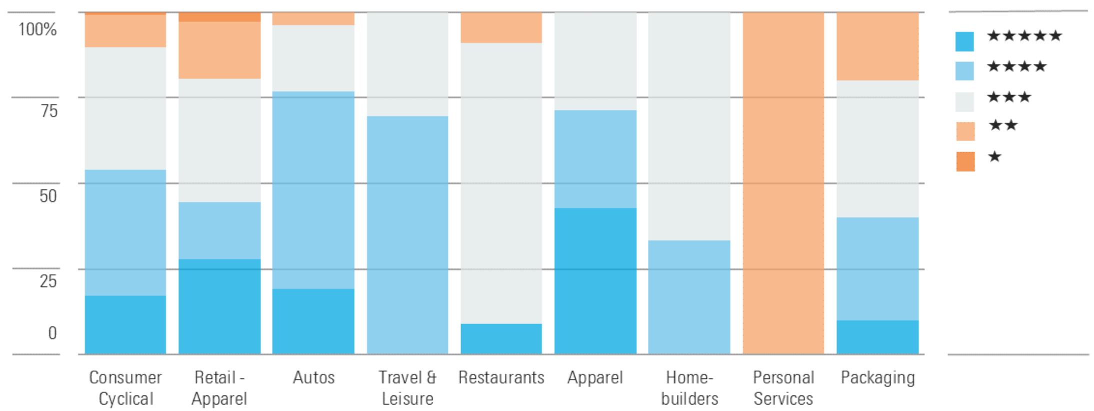
In lieu of ditching inimitable travel plans, we believe consumers could increasingly shun restaurants to preserve cash by opting to consume more meals at home.

Investors Remain Reluctant to Embrace Consumer Cyclical Shares in Q3



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

Bargain Hunters Have a Chance to Swallow Up Apparel and Travel Stocks

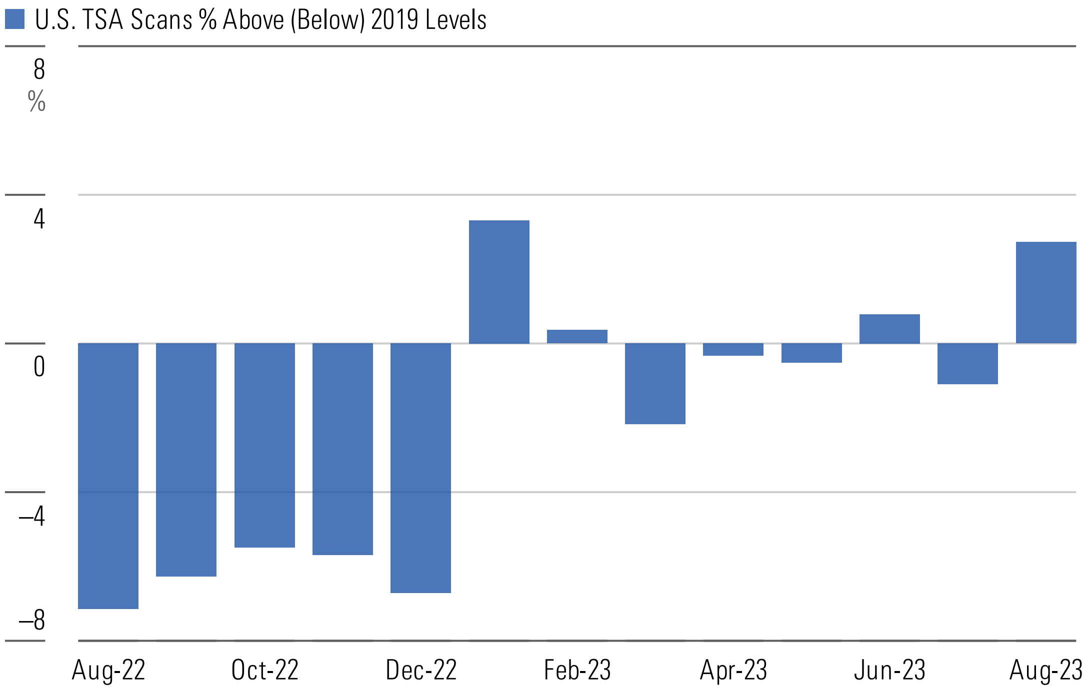


Source: Morningstar. Data as of Sept. 25, 2023.

Discretionary Spending Uncertainty Continues to Drive Attractive Consumer Cyclical Valuations

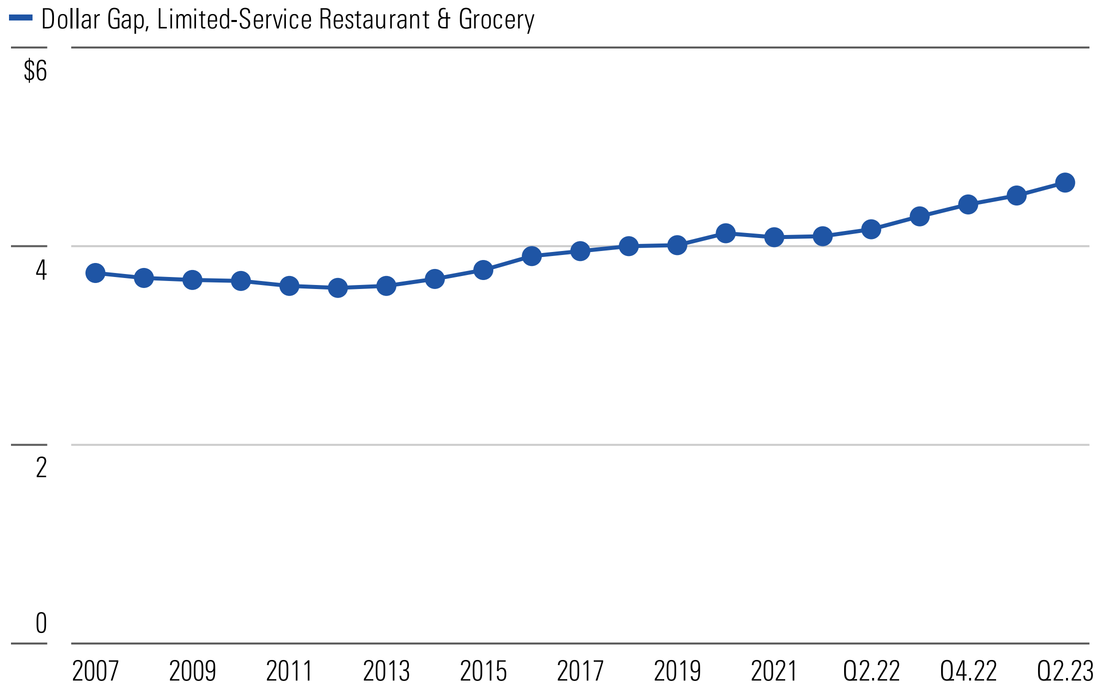
Even as the absolute difference in price between the grocery and restaurant channels remained relatively flat during the pandemic, this changed beginning in second-quarter 2023, when the total dollar gap between limited-service restaurants and grocery stores increased 11% to $4.64 from $4.17 versus a year ago. In our view, stepped-up promotions in the grocery aisle (now that supply demand imbalances have generally been rectified), along with greater financial stress on consumers stands to pressure restaurant sales and traffic trends. That said, we don't surmise restaurants will sit still. Instead, we believe operators will bolster innovation in their core offerings and experience to maintain traffic and entice consumers.

Passenger Counts Tracking Close to 2019 Figures Despite Inflation



Source: Euromonitor, BLS data, Morningstar calculations. Data as of July 31, 2023.

Stepped-Up Grocery Promotions Make Restaurant's Premium Appear Lofty



Source: Transportation Security Administration. Data as of Aug. 31, 2023.

Consumer Cyclical

Name/Ticker		Rating
Hanesbrands Inc (HBI)		★★★★★
Price (USD)	**Fair Value (USD)**	**Uncertainty**
4.19	19.70	High
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**
1.37	Narrow	Standard

We believe narrow-moat Hanesbrands, trading at a deep 79% discount to our $19.70 fair value estimate, offers a good investment opportunity. We surmise the market has been overly focused on short-term challenges, including the impact of inflation, high interest rates, and softer consumer demand, but has underestimated its potential for free cash flow generation, progress in clearing excess inventory, and improving mix shift. We anticipate that lower input costs and its strategy to boost Champion and North American innerwear, streamline its portfolio, and engage consumers will improve its profitability.

Name/Ticker		Rating
VF Corp (VFC)		★★★★★
Price (USD)	**Fair Value (USD)**	**Uncertainty**
17.47	60.00	High
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**
6.70	Narrow	Standard

Narrow-moat VF's shares are attractive, trading at a 71% discount to our $60 fair value estimate. We believe investors are fixated on its challenges, including the slowdown in Vans' sales, elevated inventories, and recent dividend cut but are 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. While it may take some time for Vans and Supreme to return to sales growth, we believe VF is taking the proper steps and improving its supply chain efficiency.

Name/Ticker		Rating
Nordstrom Inc (JWN)		★★★★★
Price (USD)	**Fair Value (USD)**	**Uncertainty**
14.13	40.00	Very High
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**
2.32	Narrow	Standard

Narrow-moat Nordstrom's shares trade at around a 65% discount to our $40 fair value estimate. While recent results have been bumpy, we still see the firm as a top operator in the U.S. apparel market, boasting a loyal customer base drawn to its differentiated products and strong customer service. We believe the company is making progress with its efforts to manage its inventory and improve its supply chain while juicing its sales of premium brands and the profitability of its digital sales. We surmise investors discount Nordstrom's potential for over 200 basis points of operating margin improvement over the next two years.

Consumer Defensive

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

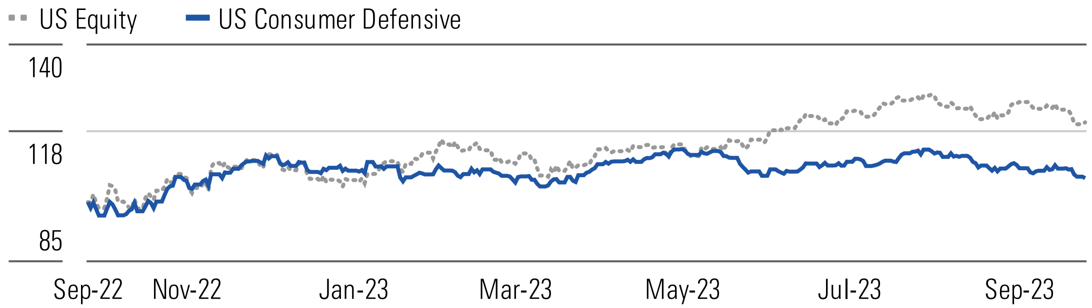
Moaty Consumer Defensive Operators Should Prove to be Winners Amid Intensifying Competitive Angst

The Morningstar US Consumer Defensive Index significantly trailed the broader market over the past year, printing just a 6.1% gain versus the market's 20.3% appreciation.

The space isn't flush with bargains, however, as the median consumer defensive stock now trades at just a 9% discount to our assessment of intrinsic valuation. Nonetheless, we see compelling investment opportunities in the consumer-packaged goods, or CPG, realm, where roughly 36% of our coverage resides in 4- or 5-star territory. We suspect heightened competitive pressures and macro uncertainties have called into question whether operators will keep investing behind their brands (in the form of consumer-valued innovation and marketing) or favor near-term share and profit gains. We view this spending as key in supporting brand relevance and pricing power in the sector.

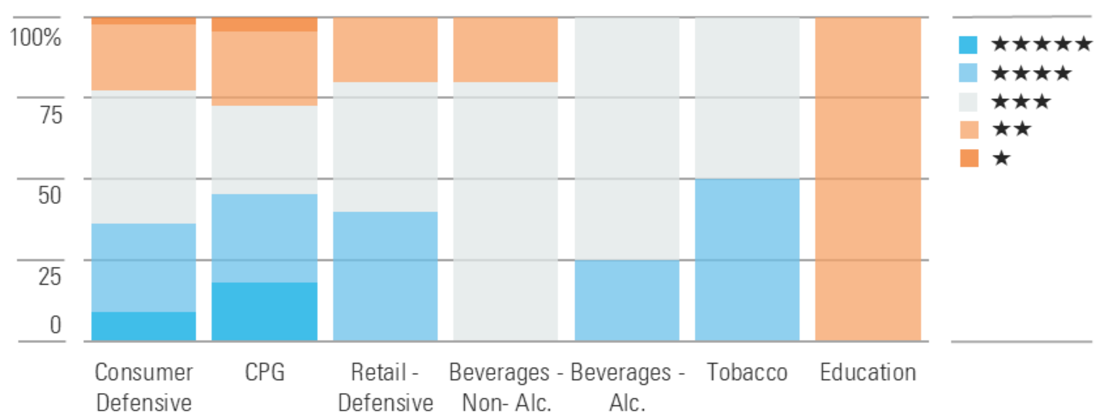
Consumers are facing a rash of pressures on their pocketbooks (higher interest rates, increased gas prices, and the resumption of student loan repayments to name a few), which may prompt increased trade down to lower-priced private label fare and/or a shift in spending to more value-oriented discount stores. Against this backdrop, we surmise CPG volumes could remain depressed, even after lapping several rounds of pricing in recent years. We posit stepped-up promotional spending (which has lain idle in light of massive supply demand imbalances) could be utilized to thwart declining unit sales and market-share losses. While this could shake the near-term competitive landscape, we still believe leading, competitively advantaged branded operators will prioritize brand investments longer term to bolster their standing with retailers and end consumers.

Consumer Defensive Stocks Lagged the Market's Gain the Past Year



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

CPG Operators Largely Remain in the Bargain Bin

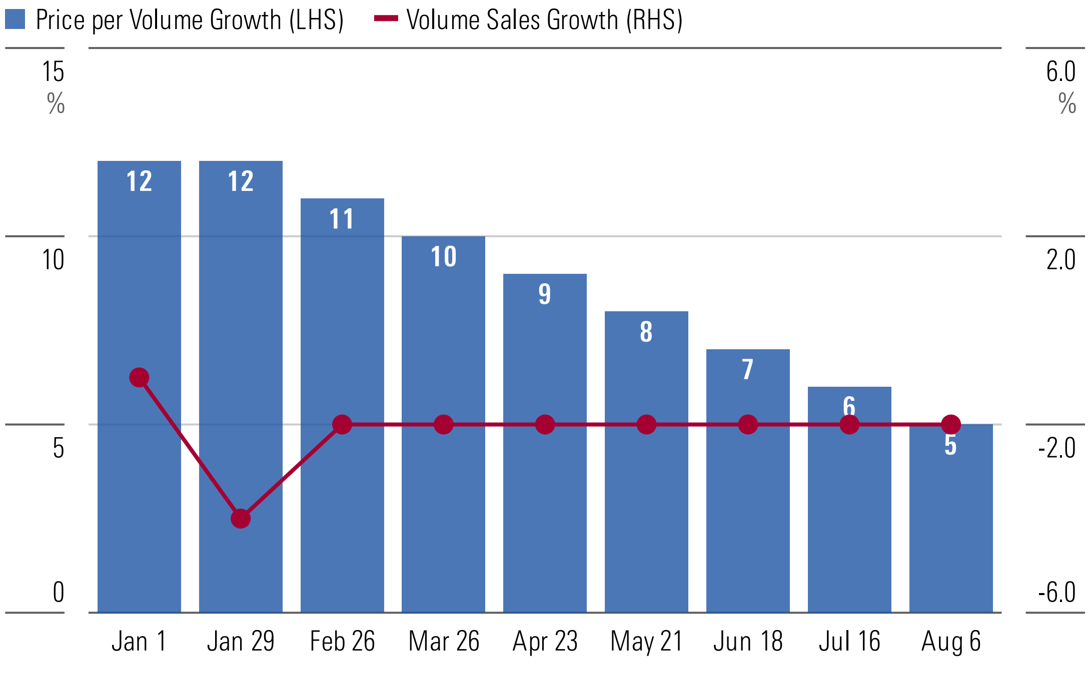


Source: Morningstar. Data as of Sept. 25, 2023.

Moaty Consumer Defensive Operators Should Prove to be Winners Amidst Intensifying Competitive Angst

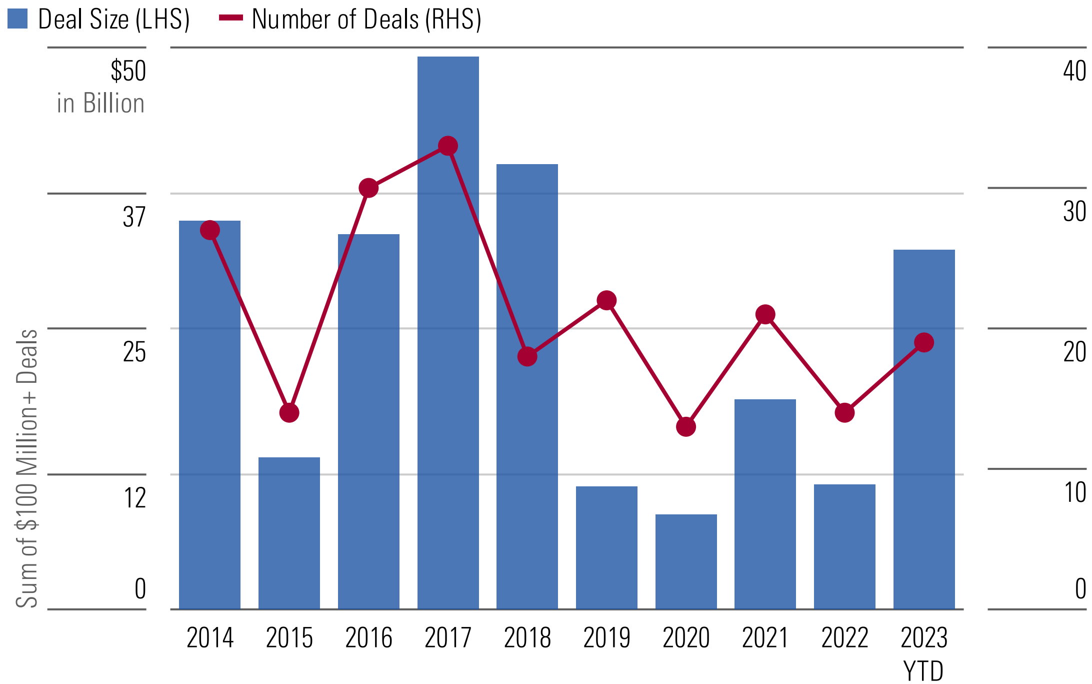
To combat stagnating CPG growth, acquisition deal flow has surged after lying dormant the past few years. This has come despite rising interest rates, which inherently makes such purchases more expensive. We see the strategic merits of tie-ups that open the door to more attractive categories and geographies (that is, those that boast a more robust growth profile) and/or complement the acquirer's existing product portfolio. However, we don't believe buying growth necessarily stands to buoy the competitive standing of operators across the sector, and paying too much could challenge the ability to unlock any potential benefits of the transaction.

Despite Moderating Unit Price Growth, CPG Volumes Remain Depressed



Source: NielsenIQ, Total USxAOC, 4 weekly periods ending July 29, 2023, Morningstar. Data as of Sept. 12, 2023.

CPG Operators Have Had a Hankering for Acquisitions



Source: PitchBook data, Morningstar. Data as of Sept. 12, 2023.

Consumer Defensive

Name/Ticker		Rating	
Estée Lauder (EL)		★★★★★	We believe wide-moat Estee Lauder's shares are attractive, trading at a 41% discount to our $249 fair value estimate. While a slow travel retail recovery in China has been impairing demand and margins, we don't think this will affect 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, paired with the premiumization trends, we think Estee's stock will gravitate to our valuation over time.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
147.62	249.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
52.04	Wide	Standard	

Name/Ticker		Rating	
Kraft Heinz (KHC)		★★★★★	No-moat Kraft Heinz trades at a 36% discount to our $53 fair value estimate while boasting a 4% dividend yield. We suspect investors are skeptical about the firm's ability to lean on price increases without a material volume contraction in a challenging economic (higher inflation and weakening consumer spending) and competitive (increased promotional activities by other brands) environment. However, we have a favorable view of the firm's efforts to unearth cost savings and extract inefficiencies to support brand investments (marketing and research and development), which should help support its volume long term.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
34.16	53.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
42.12	None	Standard	

Name/Ticker		Rating	
Anheuser-Busch InBev (BUD)		★★★★★	Shares of wide-moat Anheuser-Busch InBev are on sale, trading at a 37% discount to our $90 valuation. While we sense investors' concerns about the firm's near-term financial risk, we think the favorable effects of a weaker U.S. dollar against some major currencies should provide a tailwind over the next 12 months. Further, if the firm continues to grow EBIT as inflation slows, this should help accelerate the reduction of the net debt/EBITDA ratio. Longer term, we believe AB InBev will benefit from its dominant position in developing countries in Africa and Latin America, given those markets' structurally higher growth prospects.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
56.44	90.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
109.50	Wide	Exemplary	

Energy

Stephen Ellis | stephen.ellis@morningstar.com

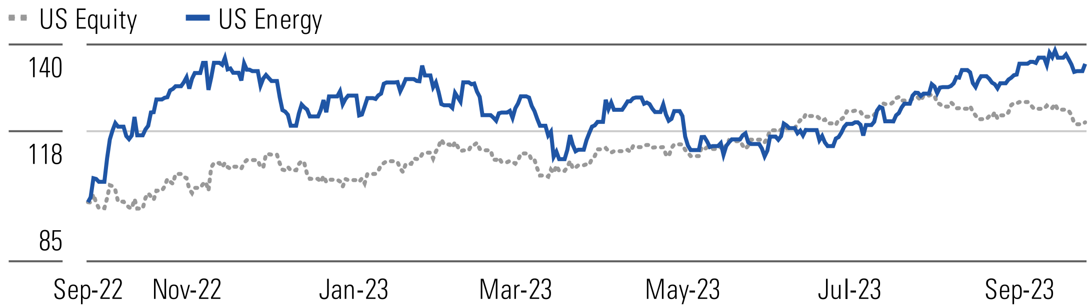
Energy Stocks Outperform, Helped by Tight Oil Market

With the improvement in the oil and gas price environment, it's not a surprise that energy stocks returned to outperforming the market this quarter. However, with less than 15% of our energy coverage undervalued, investors are clearly underwriting a higher-for-longer oil price scenario and have already assumed that poor gas-market conditions in 2023 and 2024 will reverse over the long run.

U.S. (Henry Hub), Asia (JKM), and Europe (TTM) natural gas prices improved significantly during the quarter with a 35%, 45%, and 28% increase, respectively, since the prior quarter. We see this primarily as a risk-on trade as investors are more concerned about the potential for Australian liquefied natural gas strikes, disruptions to U.S. LNG supply, and the prospects for a colder-than-normal winter than they are with, for example, sizable gas consumption declines in the European Union. A very warm U.S. summer helped U.S. gas inventories, given the increase in power demand.

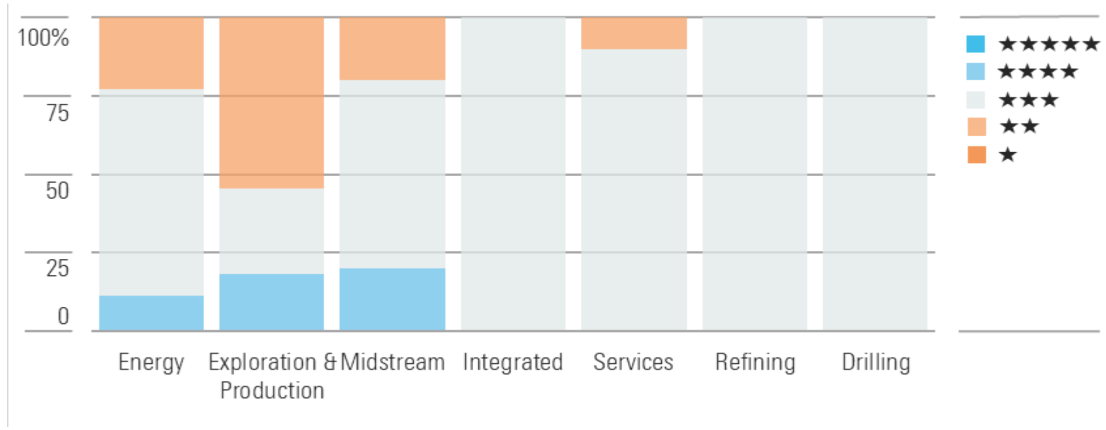
Global oil prices have increased 20% (WTI) and 27% (Brent) since the prior quarter. We attribute this mainly to the ongoing oil market tightening actions taken by Saudi Arabia and Russia over the last few months, driving a large supply deficit. The repeated extensions by Saudi Arabia and Russia of about 1.3 million barrels of oil per day in cuts indicate concerns over the sustainability of China's oil demand (the majority of global oil demand growth this year), increased Iranian supply, and the need to fund its own significant social spending efforts. However, we also think the extensions were timed to sow additional market uncertainty around short-term supply, maximizing near-term oil prices.

Stronger Oil and Gas Prices Prompted a Surge in Energy Stocks



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

The Energy Space Looks Fairly Valued Across All Subsectors

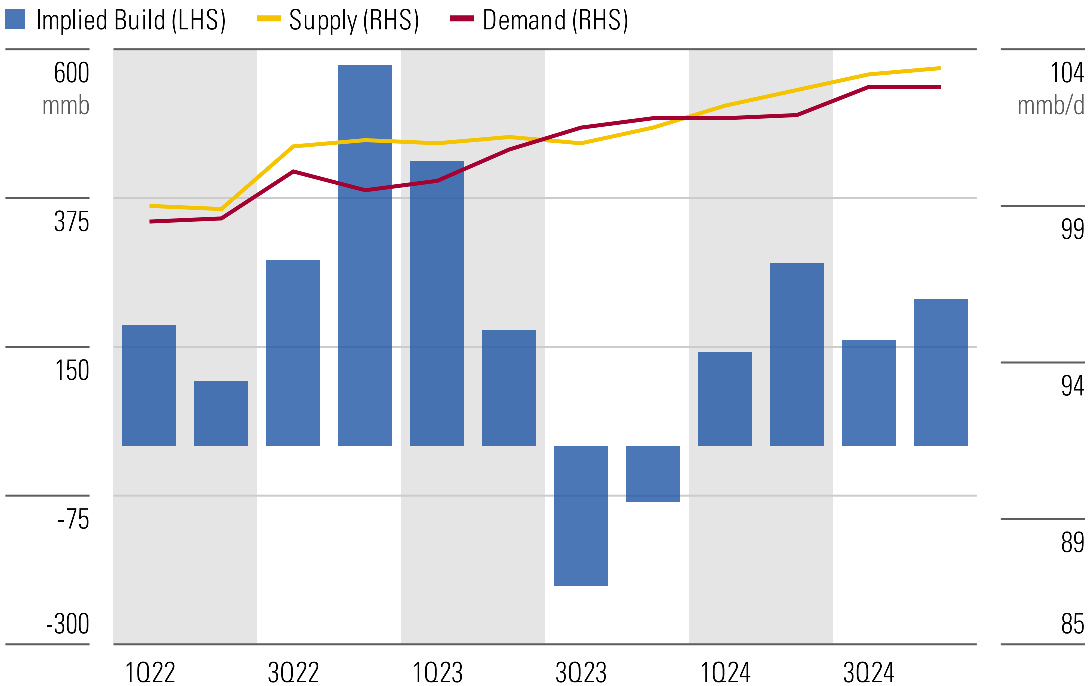


Source: Morningstar. Data as of Sept. 25, 2023.

Saudi Arabian and Russian Cuts Have Created A Huge Oil Supply Deficit

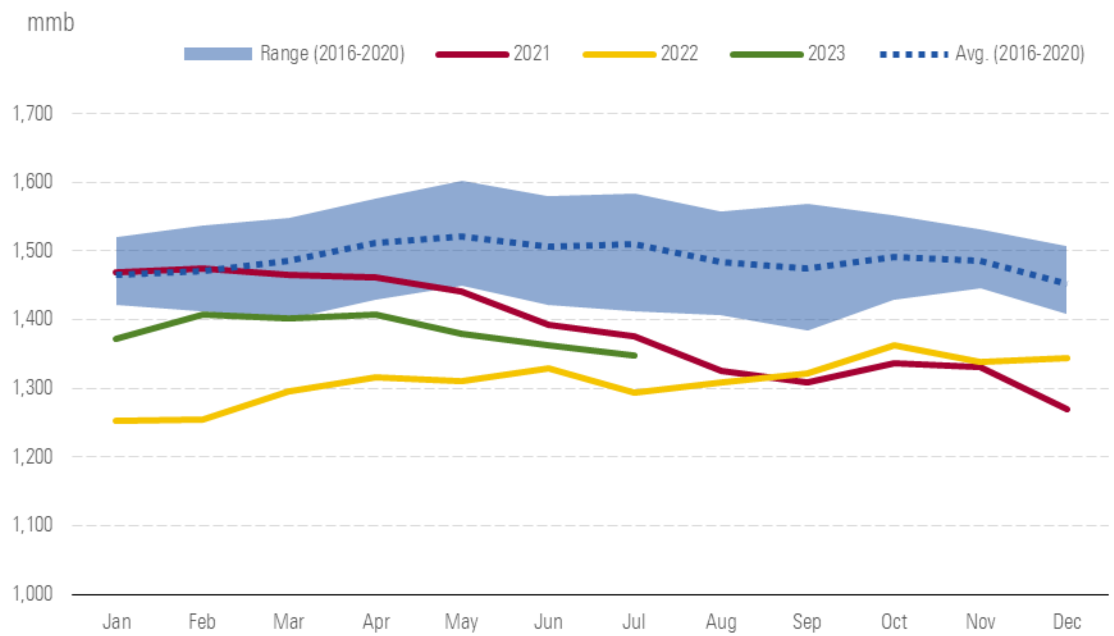
Since June, Saudi Arabia and Russia have extended monthly supply cuts of 1 million bpd and 300,000 bpd to the end of 2023. Initially, these cuts were described as temporary, but they have been repeatedly extended to the market's surprise. The combination of the extension plus steep earlier cuts from the rest of OPEC, has pushed the market into likely one of its biggest supply deficit in the last decade, with at least 2.3 million bpd shortage expected for the third quarter. Inventory has declined nearly an estimated 60 million barrels since the start of 2023 and remain well below five-year averages. Ongoing declines are a near certainty given the size of the supply deficit, which will require barrels from storage.

The Oil Market Will Be Short of Supply for The Rest of 2023



Source: EIA. Data as of Sept. 12, 2023.

OECD Inventory Will Continue to Decline to Meet Supply Gap



Source: OPEC. Data as of Sept. 12, 2023.

Energy

Name/Ticker		Rating	
Devon Energy (DVN)		★★★★	A high-quality inventory and cost-focused management team make Devon one of our top picks. Its Exemplary management team allocates capital very well in an industry that has cost shareholders billions of dollars. For example, we are fans of the variable capital return model. After 50% of free cash is distributed, the remainder will fund buybacks and strengthen the balance sheet.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
46.59	61.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
30.44	Narrow	Exemplary	

Name/Ticker		Rating	
TC Energy (TRP)		★★★★	TC Energy is dealing with multiple investor concerns: too-high debt, lingering worries over Coastal GasLink overruns, and skepticism over the planned 2024 liquids spinoff. In contrast, we think the planned CAD 5 billion-plus sale in process, plus another CAD 3 billion in additional sales and CAD 1 billion in optimization opportunities provide plenty of capital to reduce debt. For Coastal GasLink, we see it as 91% complete and TC management has emphasized its confidence in meeting its schedule and budget. Finally, for the liquids spinoff, we see it as highlighting the quality and growth opportunities available in the gas and power portfolios, including carbon capture and hydrogen.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
36.39	48.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
36.45	Narrow	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 will likely bring online the related Hammerhead and MVP Southgate (Equitrans owns 47% via a joint venture) projects, and combined, all three efforts should increase EBITDA about 30% from 2023 levels.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
9.54	15.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
4.12	Narrow	Poor	

Financial Services

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

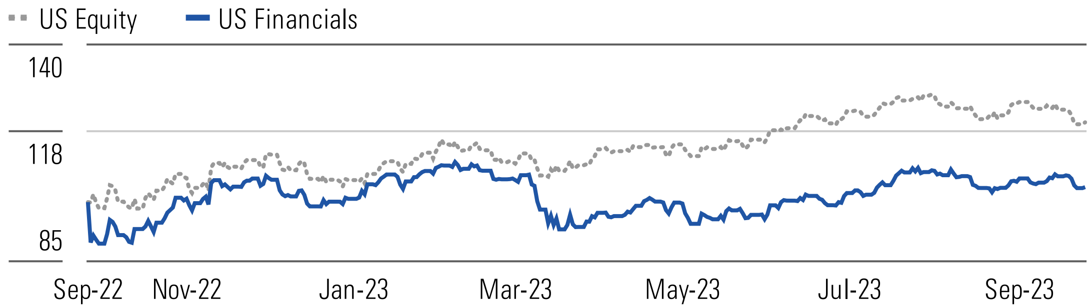
Most Financials Are Still Cheap In A Higher-for-Longer Interest Rate Environment

The Morningstar US Financial Services Index significantly underperformed the Morningstar US Markets Index over the previous year, up only 3.8% compared with 20.3% for the benchmark, and moderately outperformed the previous quarter, up 1.5% compared with the market's decline of 2.3%. The median North American financial sector stock trades at a 13% discount to its fair value estimate, compared with a 14% discount at the end of second-quarter 2023 and a 23% discount at the end of 2022's third quarter. We currently rate around 50% of the North American financial sector stocks that we cover as undervalued 5- or 4-star stocks with about 7.5% rated overvalued 2- and 1-star stocks.

At the Federal Reserve Open Market Committee held in September, participants maintained both the target federal-funds rate at 5.25%-5.5% and the median assessment for the end of 2023 federal funds rate of 5.5%-5.75%. However, the median participant assessment of the appropriate monetary policy rate, according to the dot plot, for 2024 and 2025 increased 50 basis points compared with the June dot plot to 5.1% and 3.9%, respectively. It seems like participants are signaling interest rates being higher for longer.

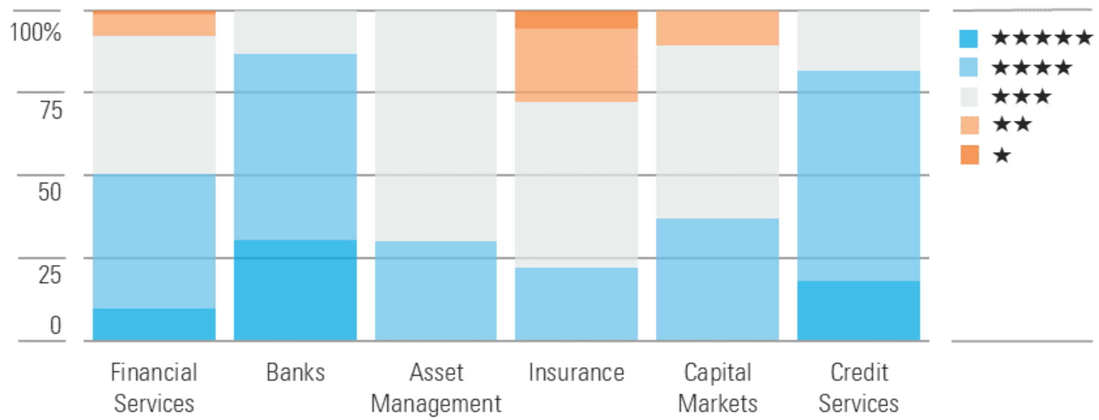
Many banks and credit services companies have sold off this year, and we currently rate them as being the more undervalued industries in the financial sector. They are facing an earnings headwind from higher interest rates increasing funding costs that lower net interest income growth.

Financials Moderately Outperformed the Market in the Previous Quarter



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

We See the Most Value in Banks and Credit Services

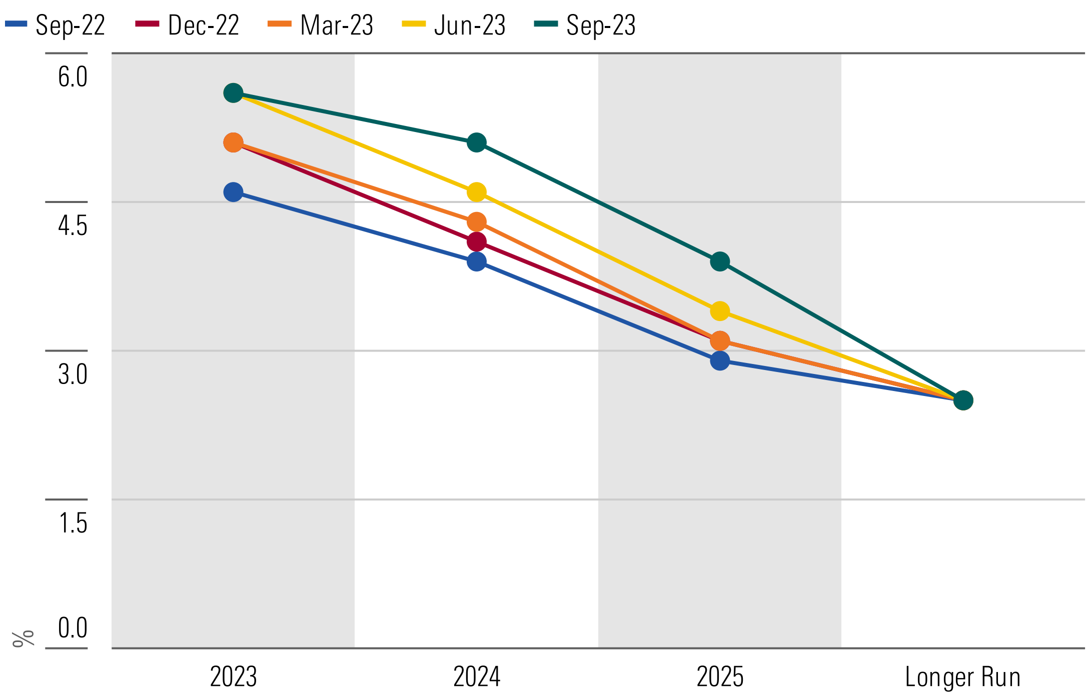


Source: Morningstar. Data as of Sept. 25, 2023.

Most Financials Are Still Cheap In A Higher-for-Longer Interest Rate Environment

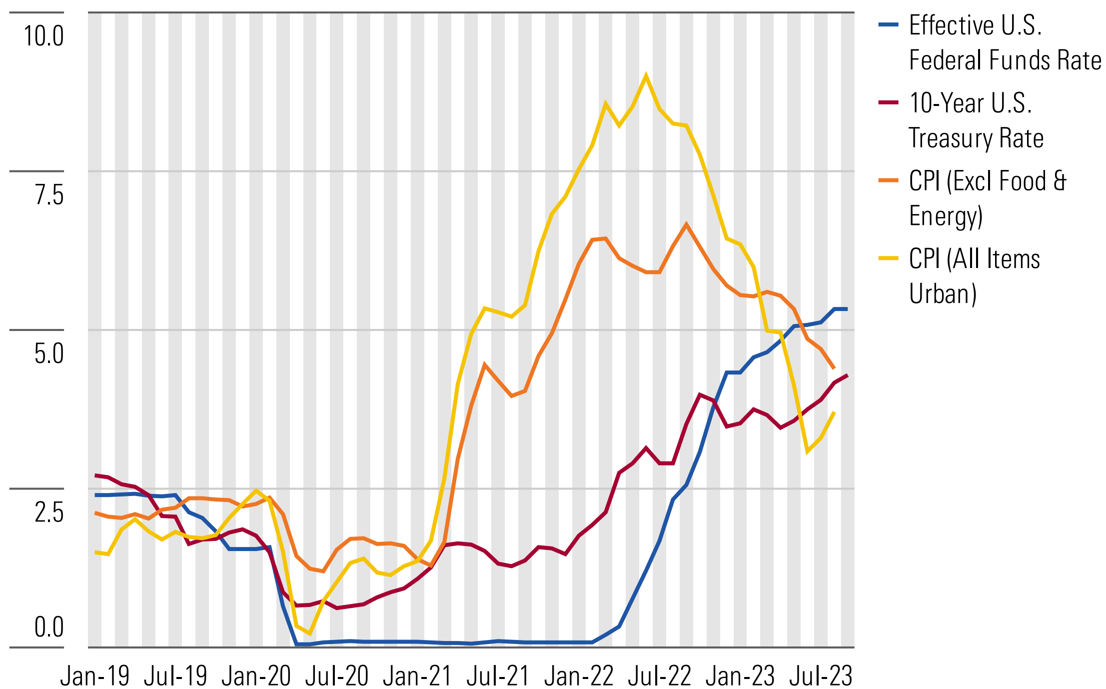
Additionally, credit costs should continue to climb as the Federal Reserve cools the economy, excess savings from the COVID-19 restrictions are depleted, and student loan payments resume. We are also likely to see headlines concerning the capital position of financial institutions, as higher interest rates increase unrealized losses on their fixed-income securities portfolios and higher regulatory capital guidelines are debated. While these are all negative developments, we believe the market has overly penalized the banks for these issues and that shares are undervalued based on long-term, normalized earnings.

FOMC Assesses Interest Rates Being Higher for Longer Is Appropriate



Source: U.S. Federal Reserve. Data as of Sept. 20, 2023.

Short- and Long-Term Interest Rates Have Recently Been Rising



Source: U.S. Department of the Treasury. Data as of Sept. 20, 2023.

Financial Services

Name/Ticker		Rating
Charles Schwab (SCHW)		★★★★
Price (USD) 55.15	**Fair Value (USD)** 80.00	**Uncertainty** High
Market Cap (USD B) 100.80	**Economic Moat** Wide	**Capital Allocation** Exemplary

Charles Schwab is a fundamentally strong company that has sold off due to headline risks and earnings headwinds that should soon reverse. The recent increase in U.S. interest rates will likely add to the company’s unrealized loss position on its U.S. Treasury and agency mortgage-backed securities holdings even as it decreases shareholders equity. That said, Charles Schwab is still solid from a regulatory capital perspective and has access to liquidity. 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.

Name/Ticker		Rating
Wells Fargo (WFC)		★★★★★
Price (USD) 41.23	**Fair Value (USD)** 61.00	**Uncertainty** Medium
Market Cap (USD B) 152.06	**Economic Moat** Wide	**Capital Allocation** Standard

While Citigroup is a bit cheaper than Wells Fargo overall, we like that Wells has a stronger franchise from a profitability perspective and that Wells is further along in its turnaround timeline. Given the potential timelines at play, plus the difficulties that come along with franchises like Citigroup that 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, 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 NII in Q3 2023. The regulatory timeline and further banking sector stress remain important risks to consider.

Name/Ticker		Rating
PayPal (PYPL)		★★★★★
Price (USD) 57.88	**Fair Value (USD)** 135.00	**Uncertainty** High
Market Cap (USD B) 64.63	**Economic Moat** Narrow	**Capital Allocation** Standard

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.

Healthcare

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

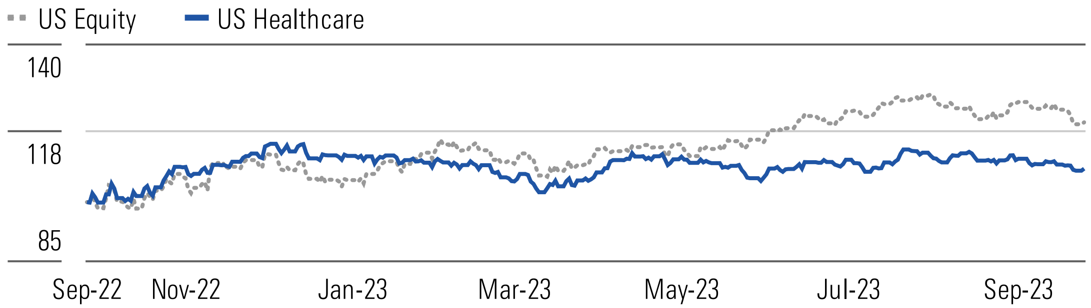
Healthcare Valuations Look Attractive Across Most Industries

Over the past 12 months, the overall equity performance has been above that of Morningstar's U.S. Healthcare Index. With the overall market appearing less concerned about recessionary pressures, healthcare seems to have slightly fallen out of favor relative to the overall market. If recessionary concerns return, we believe the innovation within healthcare along with the defensive nature of the sector should support more stable demand relative to the rest of the market.

On valuation, we view the healthcare sector as undervalued. Our coverage trades below our overall estimate of intrinsic value with an aggregate price to fair value metric of 0.84. Besides the medical distribution industry, the remaining healthcare industries look undervalued. We see the most 5-star stock calls in the biopharma industry.

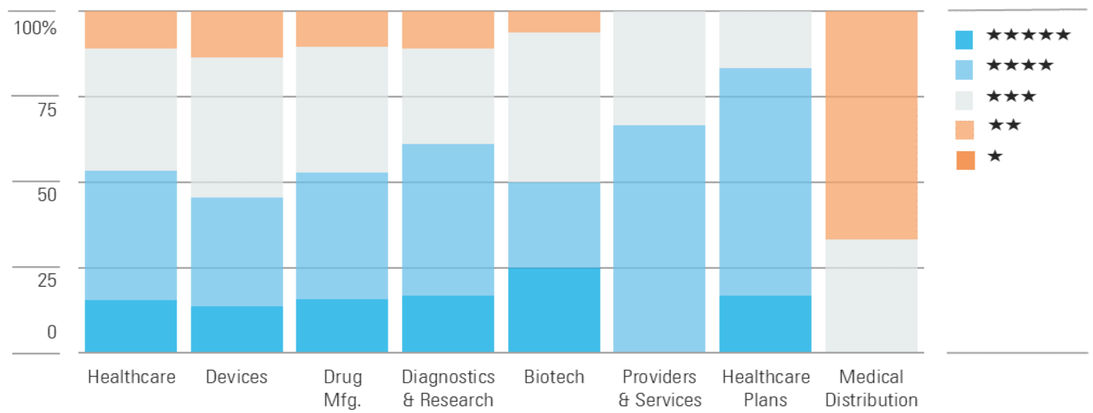
Within the largest healthcare industry by market capitalization, the biopharma group looks undervalued, with the market not fully appreciating the innovation in several therapeutic areas, including oncology, immunology, and rare diseases. In the healthcare plan industry, we believe the short-term headwinds of potential pharmacy benefit reforms and falling support in Medicaid and Medicare Advantage are creating undervalued opportunities as the industry can offset these challenges over the long run. In the large device industry, we see a mixed valuation picture with some stocks offering compelling valuation after falling from a bullish run during the COVID-19 pandemic.

Healthcare Underperformed the Market in Q2



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

We See the Most 5-Star Stocks in the Biopharma Industry

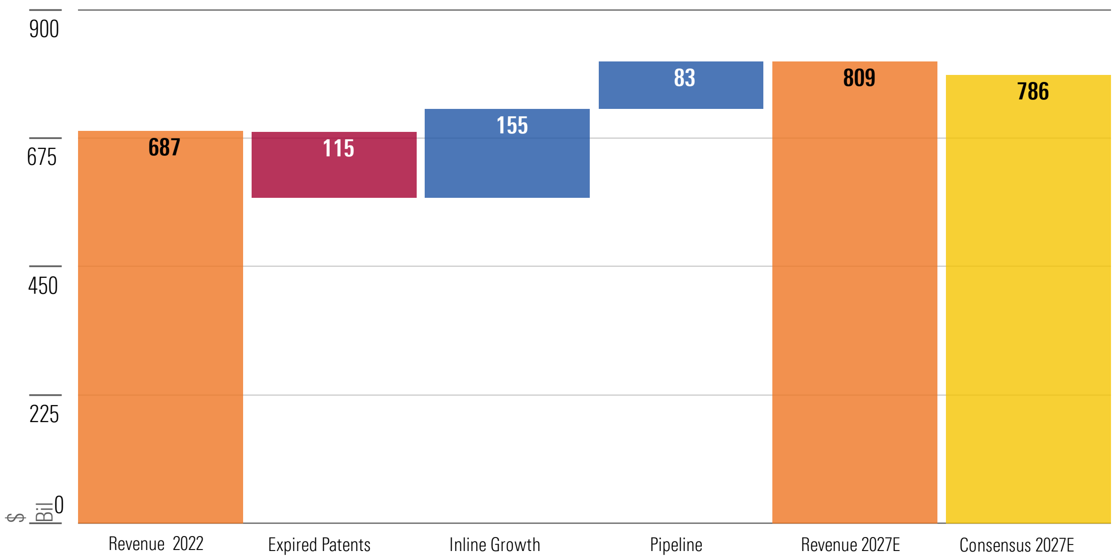


Source: Morningstar. Data as of Sept. 25, 2023.

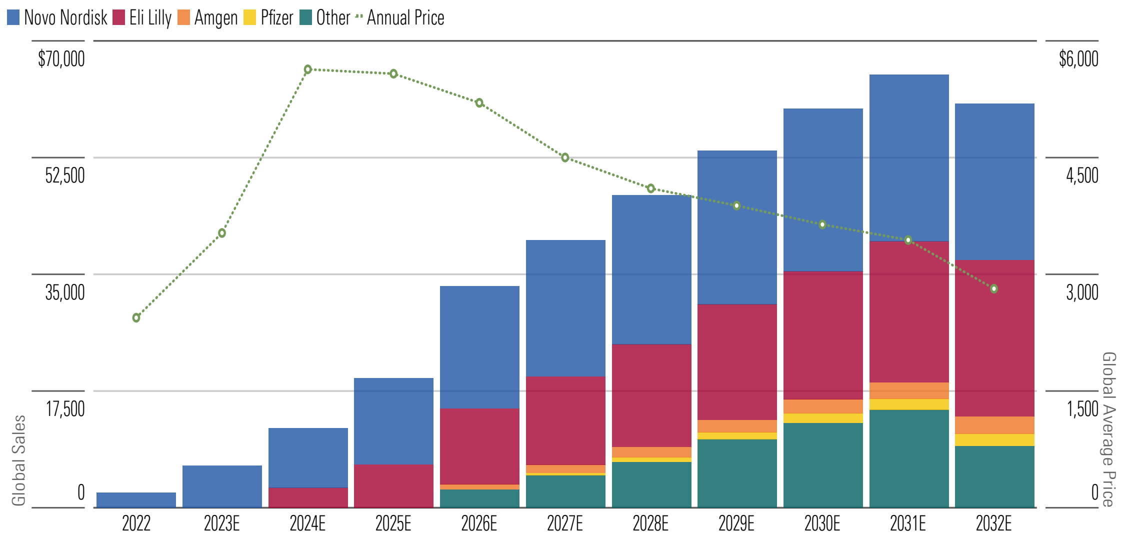
Biopharma Industry Well-Positioned for Steady Long-Term Gains, Buoyed by Continued Innovation

We believe the market is underappreciating pipeline innovation that should support 4.5% compound annual earnings growth over the next five years (excluding Covid products) for the large cap biopharma industry. The market appears overly concerned by U.S. drug policy changes in the Inflation Reduction Act, a drag on acquisitions from Federal Trade Commission scrutiny, and patent losses. Covid vaccines and treatments also create tough comparables that mask strong underlying industry growth. However, we expect the industry will continue its steady growth despite the headwinds. The obesity drug market has shown excellent innovations and is poised to grow to $65 billion by 2031, led by Novo Nordisk and Eli Lilly. While we see the biopharma industry as undervalued, we view these leading weight loss drug makers as slightly overvalued with the market getting overly excited about the stocks.

Biopharma Firms To Grow at 4.5% 5-Year CAGR Excluding Pfizer's COVID-19 Sales



In the Likely $65 Billion Global Obesity Market, Lilly and Novo Poised To Dominate



Source: Morningstar. Left chart includes sales at AbbVie, Amgen, AstraZeneca, Bayer, Biogen, BioMarin, Bristol, Gilead, GSK, J&J, Eli Lilly, Merck, Novartis, Novo Nordisk, Pfizer, Regeneron, Roche, Sanofi.
Data as of Sept. 8, 2023.

Healthcare

Name/Ticker		Rating	
Illumina (ILMN)		★★★★	Illumina represents a growth-at-a-reasonable-price opportunity for investors with a long-term horizon. As the leading provider of genomic sequencing tools, the company should be able to capitalize on the continued expansion of these applications in research and clinical settings through its legacy business. While Illumina may face more competition in its legacy genomic sequencing technology, the factors that determine its economic moat in genomic sequencing (intangible assets and switching costs) should help Illumina generate economic profits, especially considering its coming-to-market sequencing instruments. Also, Illumina owns the Grail liquid biopsy assets. Recent Illumina share prices appear to only value the legacy business, meaning investors are getting a free option on the Grail assets, which could pay off in the long run even if Illumina unwinds Grail.
Price (USD)	Fair Value (USD)	Uncertainty	
132.44	269.00	High	
Market Cap (USD B)	Economic Moat	Capital Allocation	
20.80	Narrow	Standard	

Name/Ticker		Rating	
Moderna (MRNA)		★★★★	Moderna shares were on a roller coaster in 2021. We think investors were first overly enthusiastic about the potential of the company's technology but subsequently too bearish on its post-coronavirus growth. We have modest expectations for sales of the firm's COVID-19 vaccine following massive pandemic demand in 2021 and 2022, but Moderna's pipeline of mRNA-based vaccines and treatments is advancing rapidly. Even as sales dip in 2023-24, we're increasingly confident in the long-term sales trajectory of the firm's diversified pipeline. The firm's phase 3 RSV and flu vaccine candidates and approved COVID-19 vaccine could eventually form the basis for a single vaccine, and a personalized cancer therapy has generated impressive data in melanoma.
Price (USD)	Fair Value (USD)	Uncertainty	
99.99	266.00	Very High	
Market Cap (USD B)	Economic Moat	Capital Allocation	
37.36	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	
116.85	175.00	Medium	
Market Cap (USD B)	Economic Moat	Capital Allocation	
24.52	Wide	Exemplary	

Industrials

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

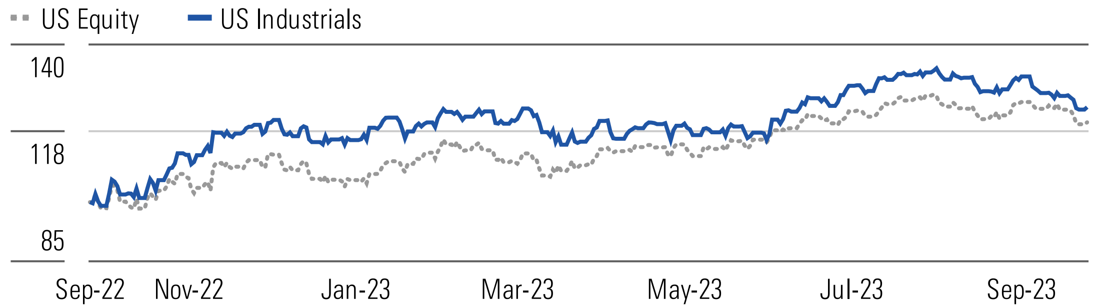
Like the U.S. Economy, the Industrials Sector Remains Resilient

The Morningstar US Industrials Index lagged the Morningstar US Market Index during the third quarter of 2023 but outperformed on a trailing 12-month basis. Industrials sector performance was led by industrial distribution and products, construction, and transportation & logistics. In contrast, the aerospace & defense and waste management industries were laggards.

The U.S. economy remains resilient even as inflation persists above the Fed's 2% target and economic growth slows across Europe and China. Second-quarter earnings were generally positive for the industrials sector, with over two-thirds of our coverage beating FactSet consensus EPS expectations. The sector benefitted from healing supply chains and favorable pricing, but the tight labor market is still challenging. Even so, staffing company stocks have underperformed suggesting the market is still weary of a recession and a loosening labor market. Nevertheless, we maintain our positive long-term outlook for U.S. staffing firms.

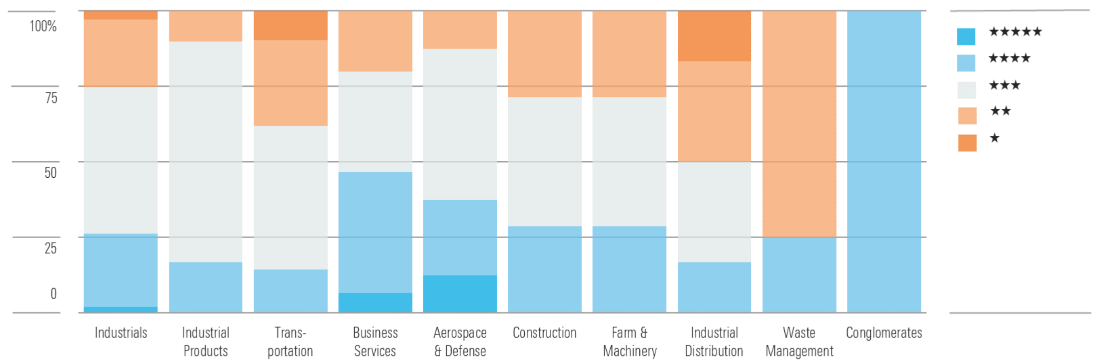
Construction companies have been among sector leaders in terms of stock performance this year, but those that have more commercial exposure have lagged due to concerns about the commercial real estate market. However, we maintain our favorable long-term outlook for the construction industry, and we continue to see tailwinds from the Inflation Reduction Act, which incentivizes environmentally conscious building practices and materials. Heating, ventilation, and air-conditioning manufacturing is an example of an industry that should benefit from the IRA, but we think this opportunity is already priced in for most HVAC stocks.

Industrials Underperform in Q3 but Trailing 12-Month Outperformance Continues



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

Industrials Sector Fairly Valued but Some Opportunities Available

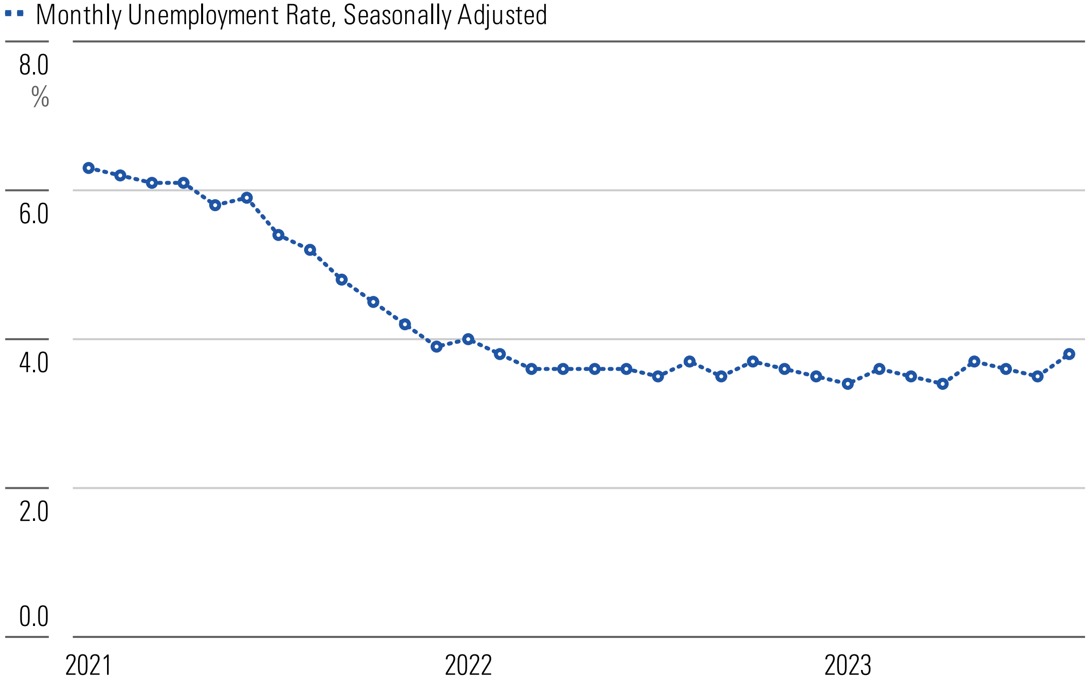


Source: Morningstar. Data as of Sept. 25, 2023.

Like the U.S. Economy, the Industrials Sector Remains Resilient

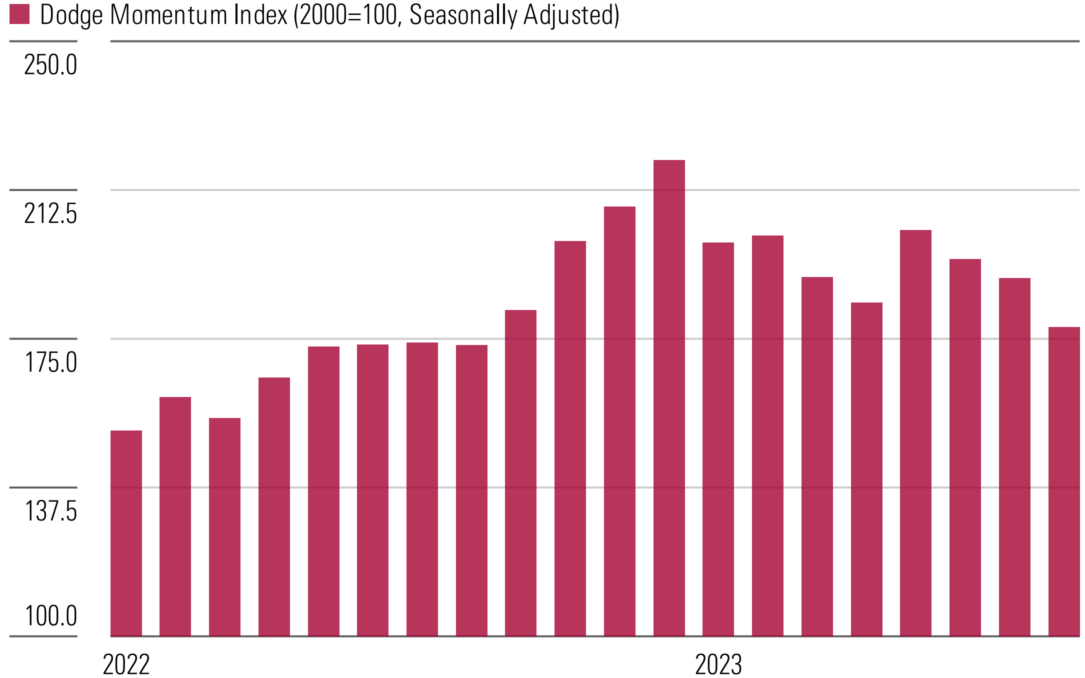
Transportation & logistics stocks saw mixed returns during the quarter. Many airlines have cut guidance for the rest of the year on higher fuel and labor costs. We maintain our view that U.S. airlines operate in a no-moat industry and capacity additions will beget increased competition. Railroads have seen volume headwinds from sluggish industrial production and heavy truck competition for intermodal. Overall, railroad valuations look reasonable, and the market appears to be agreeing with our outlook but concerns over near-term East Palestine derailment-related volume and margin disruption create longer-term upside opportunity for Norfolk Southern's stock price, in our view.

Tight Labor Market Is Still a Challenge for the Sector



Source: U.S. Bureau of Labor Statistics, Morningstar. Data as of September 2023.

Commercial Construction Activity Has Moderated



Source: Dodge Construction Network, Morningstar. Data as of September 2023.

Industrials

Name/Ticker		Rating
ManpowerGroup (MAN)		★★★★
Price (USD)	**Fair Value (USD)**	**Uncertainty**
73.36	109.00	High
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**
3.65	None	Standard

Manpower is one of the three largest multinational firms in the fragmented and over $600 billion global staffing industry. It offers each main staffing service (temporary, permanent, and project based) across a variety of professions under its four subsidiary brands. Despite operating in a highly competitive and cyclical industry, we believe Manpower will benefit from an increase in recruitment outsourcing as companies look to improve labor efficiency. It will also continue to strategically grow its higher-margin businesses to improve profitability amid an uncertain job landscape.

Name/Ticker		Rating
Johnson Controls (JCI)		★★★★
Price (USD)	**Fair Value (USD)**	**Uncertainty**
55.15	72.00	Medium
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**
37.48	Narrow	Standard

Johnson Controls manufactures, installs, and services HVAC systems, building management systems and controls, industrial refrigeration systems, and fire and security solutions. Commercial HVAC accounts for about 40% of sales; fire and security represents 40% of sales; and residential HVAC, industrial refrigeration, and other solutions account for the remaining 20% of revenue. Johnson Controls is in a strong position to benefit from increased demand for energy-efficient building products and solutions, as well as greater adoption of higher-margin services.

Name/Ticker		Rating
Norfolk Southern (NSC)		★★★★
Price (USD)	**Fair Value (USD)**	**Uncertainty**
202.50	239.00	Medium
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**
46.06	Wide	Standard

Class-I railroad Norfolk Southern operates in the Eastern United States. On more than 20,000 miles of track, the firm hauls shipments of coal, intermodal traffic, and a diverse mix of automobile, agriculture, metal, chemical, and forest products. Although the company is dealing with the aftermath of the East Palestine derailment and wage inflation, the case for long-term intermodal segment growth remains solid. We see this wide moat stock's current discount to our fair value as a buying opportunity.

Real Estate

Kevin Brown | kevin.brown@morningstar.com

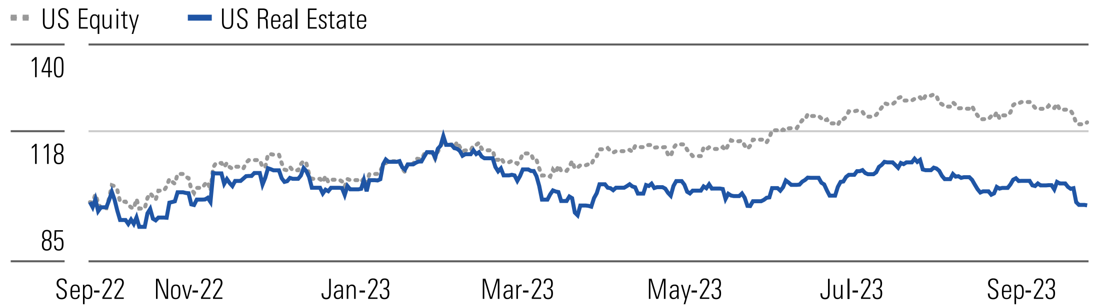
High Interest Rates Lead to Sector Negative Stock Performance Despite Solid Net Operating Income Growth

The Morningstar U.S. Real Estate Index is down 0.8% over the trailing twelve months, which is significantly worse than the 20.3% gain seen by the broader U.S. equity market over the same period. The real estate sector was down 7.2% in the third quarter of 2023, underperforming the broader US equities market that was down 2.3% in the quarter. The real estate sector has underperformed the broader equity markets despite the companies reporting same-store net operating income growth above historical average as higher interest rates has reduced the impact of external growth for many companies.

The real estate sector is currently trading significantly below our fair value estimates. The median real estate stock now trades at a 26% discount to our estimate of fair value, which is better than most other North American sectors. Currently, 30% of the real estate sector is trading in the 5-star range, 48% is trading in the 4-star range, 20% 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.

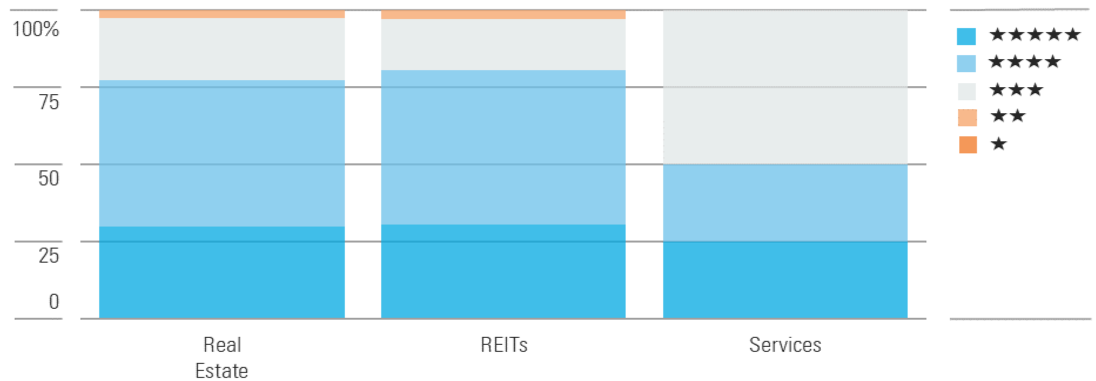
Since 2000, the REIT sector has demonstrated a significant negative relationship between the relative stock performance of the sector and interest rate movements for the 10-year U.S. Treasury. While many income-oriented investors favor REIT investments for their dividend payments during periods of low interest rates, rising rates cause income-oriented incomes to rotate money out of the sector and into lower-risk investments. Additionally, rising interest rates increase the debt costs that many REITs rely upon to fund acquisitions and development projects, so external growth becomes less accretive to REIT cashflows as interest rates rise.

Real Estate Has Underperformed U.S. Equities Over Past 12 Months



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

Three-Quarters of Real Estate Sector Is Trading at a Discount to Fair Value Estimate

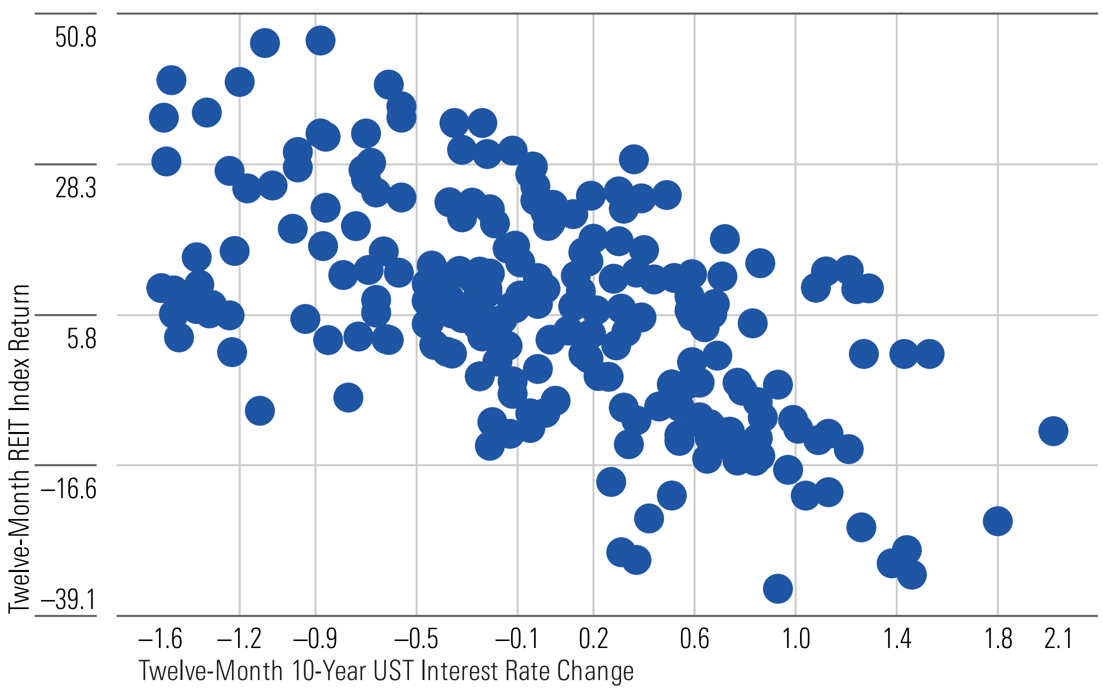


Source: Morningstar. Data as of Sept. 25, 2023.

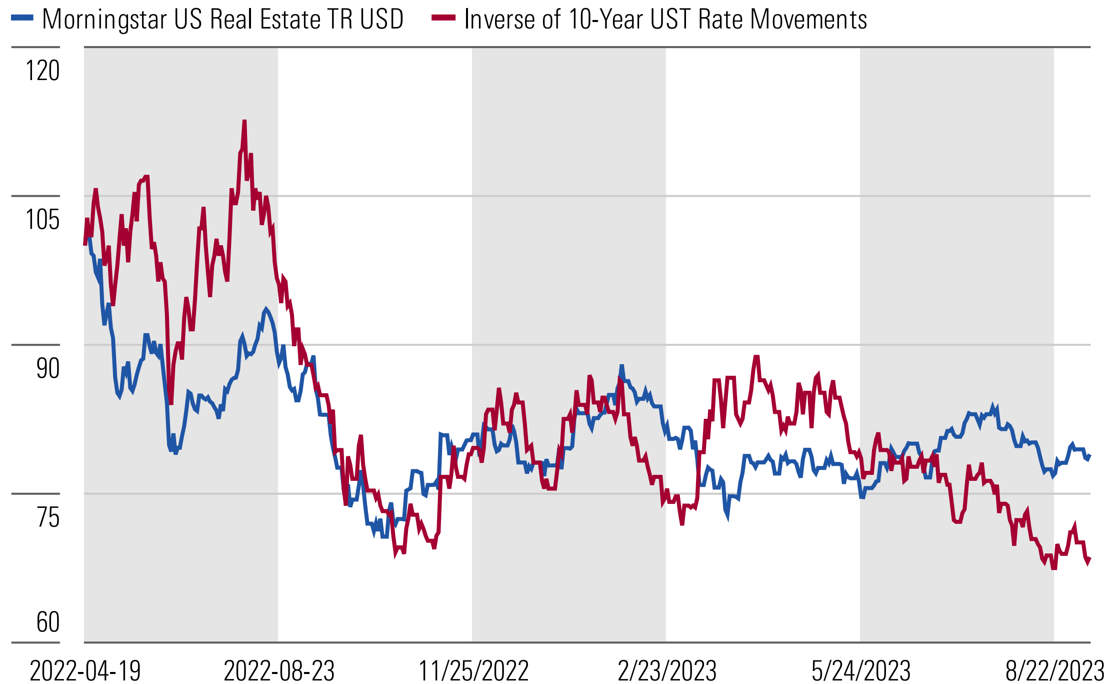
High Interest Rates Lead to Sector Negative Stock Performance Despite Solid Net Operating Income Growth

Due to the strong, negative correlation, rising interest rates in 2022 directly led to the negative performance of the real estate sector in 2022. While interest rates have mostly flattened out since October 2022, the higher rates have kept REIT stock prices down. The REITs have thus far reported higher interest expense and lower acquisition and development activity compared with prior years. However, most real estate subsectors have also produced rate, revenue, and net operating income growth above the historical average thus far in 2023. Rising interest rates have limited long-term impact on REIT cashflows, so we believe many companies in the sector are trading at a discount due to short-term disruption caused by higher interest rates.

Relative Performance of REIT Sector Negatively Correlated with Interest Rate



REIT Index Mirrored Inverse of Interest Rate Movements Over Past 18 Months



Source: Federal Reserve Economic Data, U.S. Bureau of Labor Statistics, FTSE Russell, Morningstar Direct. Data as of Sept. 7, 2023.

Real Estate

Name/Ticker		Rating	
Park Hotels & Resorts Inc (PK)		★★★★★	While the coronavirus significantly impacted Park's operating results with high-double-digit revenue per available room (revPAR) declines and negative hotel EBITDA in 2020, the company's portfolio has significantly improved operations over the past two years. Leisure travel rebounded to pre-pandemic levels in 2021 with group travel returning to pre-pandemic levels in 2022. The company has produced revPAR growth of almost 18% thus far in 2023 and we anticipate that the continued recovery of business travel combined with above average inflation will lead to a few more years of above average growth.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
11.92	26.50	High	
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 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 double-digit re-leasing spreads on newly signed leases for the past three quarters. The company has a large development pipeline of mixed-use assets that should provide significant growth when the projects deliver over the next few years.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
92.90	139.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
7.53	None	Exemplary	

Technology

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

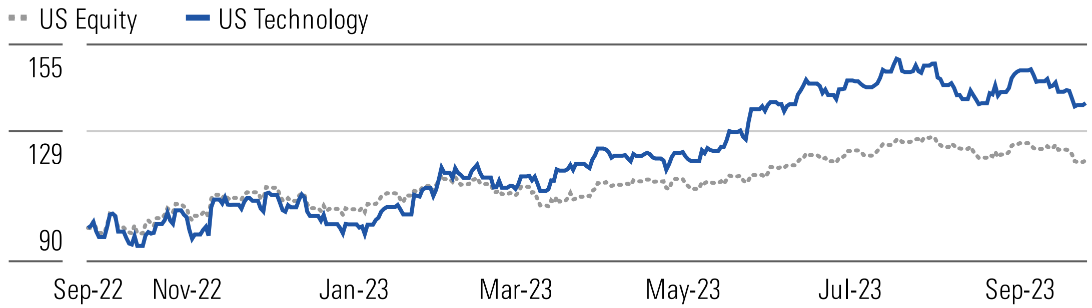
Technology Remains a Top Performer Such That We Now See Limited Buying Opportunities

After a tumultuous year in 2022, the tech recovery that began in the first quarter of 2023 and continued in the second quarter seemed to pause during the third quarter. While technology companies generally reported solid second-quarter results, macro concerns such as interest rates, are once again taking center stage. Despite modest underperformance versus the broader market throughout the third quarter, tech remains the best-performing sector by a wide margin over the last 12 months. While mega-cap stocks were driving performance earlier this year, the sector has broadened out such that we see diversity in market caps and tech industries among the best performers. We remain confident in secular tailwinds in technology, such as cloud computing, artificial intelligence, and rising semiconductor demand. We still see some select buying opportunities in semis and software, despite macroeconomic uncertainty.

The most important catalyst across technology at present revolves around generative artificial intelligence. 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.

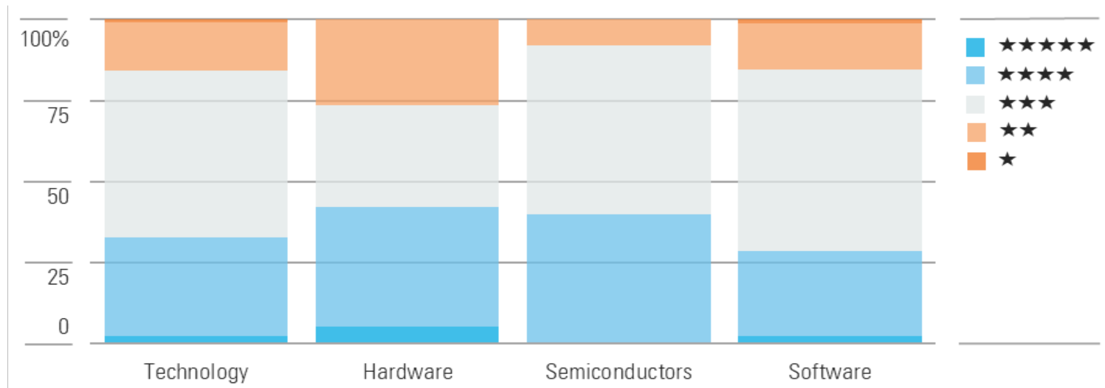
The Morningstar US Technology Index is up 37.4% on a trailing 12-month basis, compared with the U.S. equity market up 20.3%. Over the past quarter, tech was down slightly alike the U.S. equity market, but both were effectively flat. The median U.S. technology stock is 8% undervalued, and we see less of a margin of safety than when these stocks were 20%-25% undervalued nine months ago. We see the median hardware, software, and semis stocks as approximately fairly valued.

Technology Has Been a Strong Outperformer in 2023



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

We See the Majority of Technology Stocks as Approximately Fairly Valued

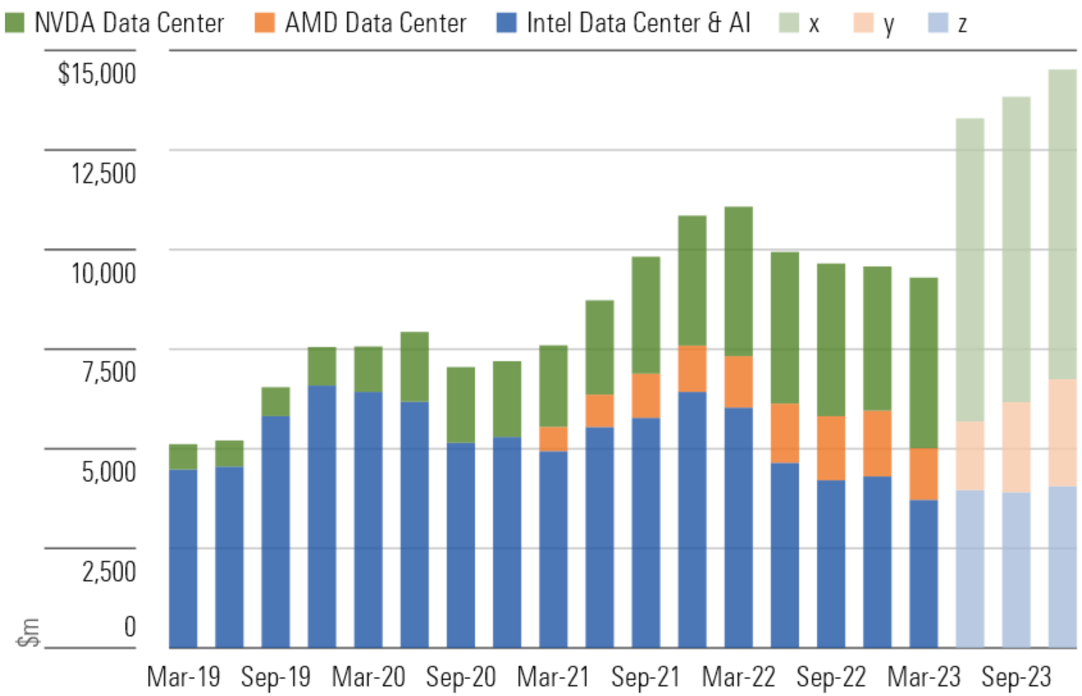


Source: Morningstar. Data as of Sept. 25, 2023.

We Think the AI Boom Is In Its Infancy

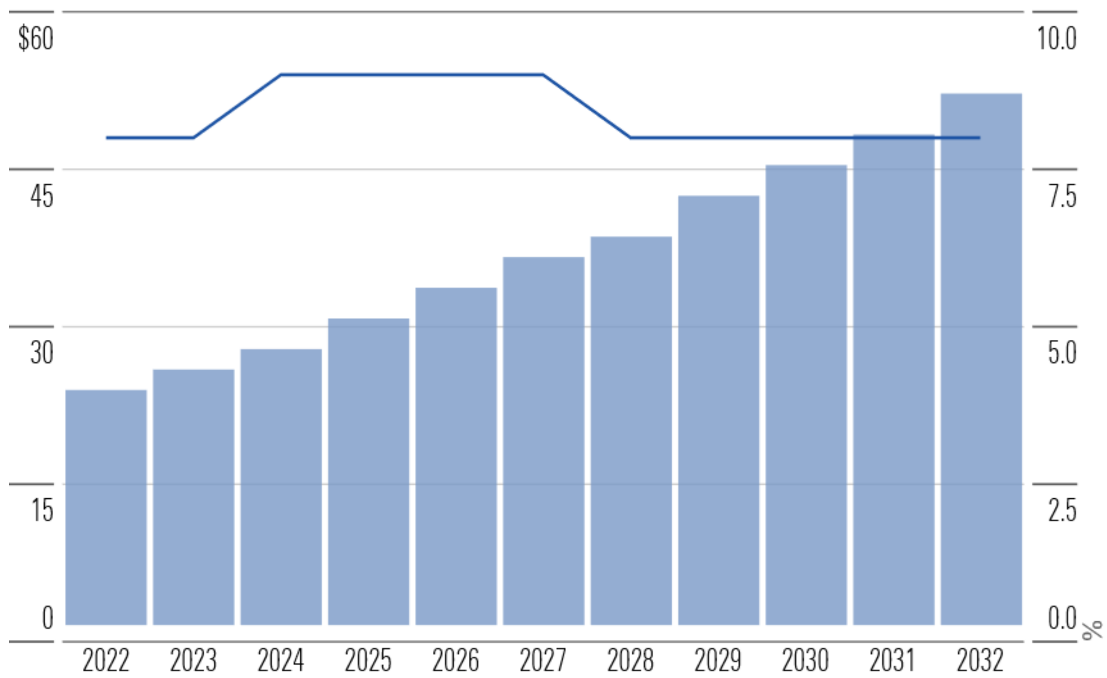
Few companies are as well positioned to capitalize on the burgeoning AI market as Nvidia, which posted exceptionally strong results in each of its last two quarters. With limited direct competition and surging demand, we expect the company to experience explosive near-term growth for data center applications. Separately, we think computer aided design (CAD) and product lifecycle management (PLM) software, which includes companies like AutoDesk, is very sticky and offers attractive returns for investors. We also believe growth in these niches is more stable even if less robust than some other areas within software. We see the CAD and PLM market growing in the high single digits to $52 billion in 2032.

Nvidia Is Poised to Dominate the Data Center/AI Chip Space in 2023



Source: Morningstar. Data as of June 9, 2023.

We See the CAD and PLM Market Growing to $52 Billion by 2032



Source: Morningstar. Data as of June 26, 2023.

Technology

Name/Ticker		Rating	
Snowflake (SNOW)		★★★★	In our opinion, Snowflake is well positioned to capitalize on the data explosion and the underlying data need 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**	
149.70	231.00	Very High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
49.37	None	Exemplary	

Name/Ticker		Raing	
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**	
69.61	94.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
35.22	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 represents impressive intangible assets that inform our wide economic moat rating.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
95.40	157.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
14.85	Wide	Standard	

Utilities

Travis Miller | travis.miller@morningstar.com

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

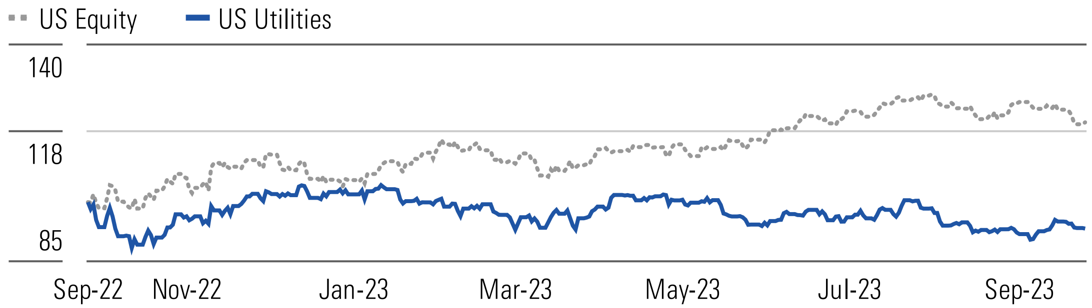
Is the Worst Over Yet For Utilities?

This year has been painful for utilities investors. The Morningstar US Utilities Index is down nearly 7% in the trailing 12 months. This is by far the worst year-to-date performance of any sector, trailing the Morningstar US Market Index by 27 percentage points.

As we discussed early this year, we thought utilities returns were bound to normalize after a decade of historically strong returns. Utilities have returned 11% annually since the 2008-09 financial crisis, nearly matching the total U.S. market return, including dividends. In 2022, utilities beat the market by 21 percentage points, the sector's best relative performance since 2000. A big drop in utilities stocks in late 2022 and continuing into 2023 has been tough medicine to swallow. The upside is that valuations are back to what we consider fair for the sector. Some utilities have valuations that haven't been this attractive in a decade.

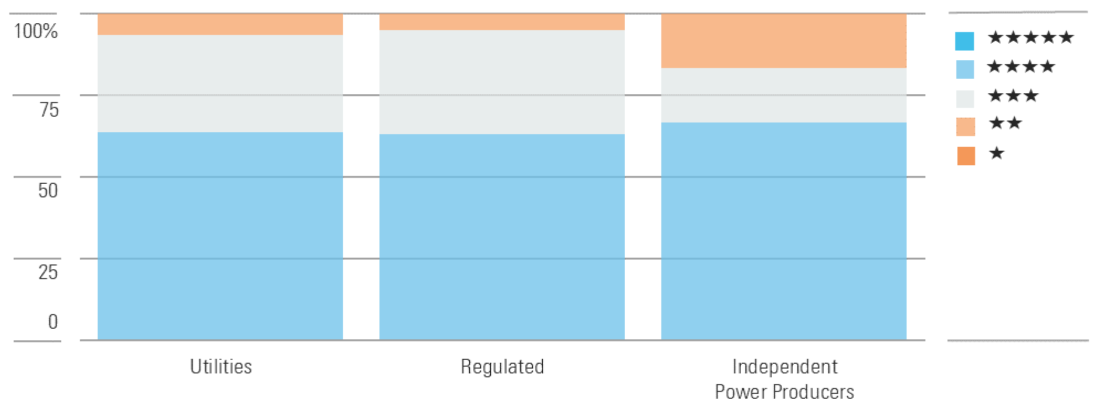
We think U.S. utilities have entered the Goldilocks zone—not too hot and not too cold. Inflation and higher interest rates have cooled a decade of abnormally high valuations. But utilities' fundamentals are better than they have been in decades. Earnings growth for many utilities is robust. Balance sheets are strong. Dividends are well covered and growing. We expect 8%-10% total returns from utilities at today's valuations, including the sector's 3.5% average dividend yield. We expect earnings and dividends to grow 6% on average. Our top picks have higher yields and/or higher growth with solid underlying fundamentals.

Utilities Have Trailed the Market in 2023 as Inflation, Interest Rates Hit Hard



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

Falling Stock Prices, Growing Earnings Mean More Attractive Utilities Valuations

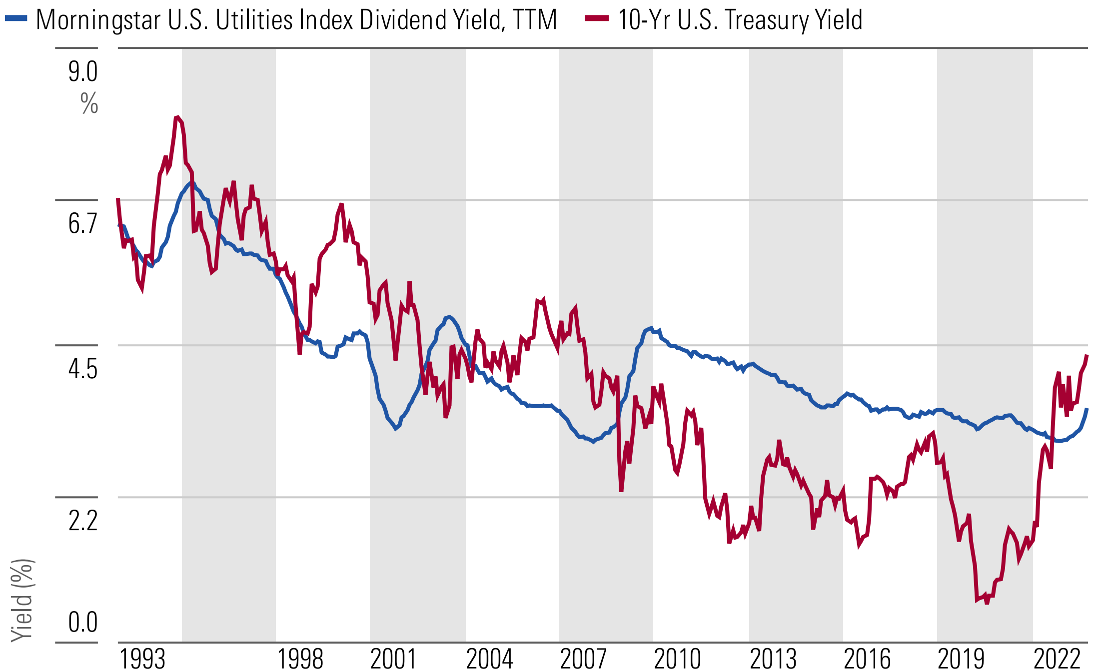


Source: Morningstar. Data as of Sept. 25, 2023.

Higher Interest Rates, Inflation Could Slow Earnings Growth

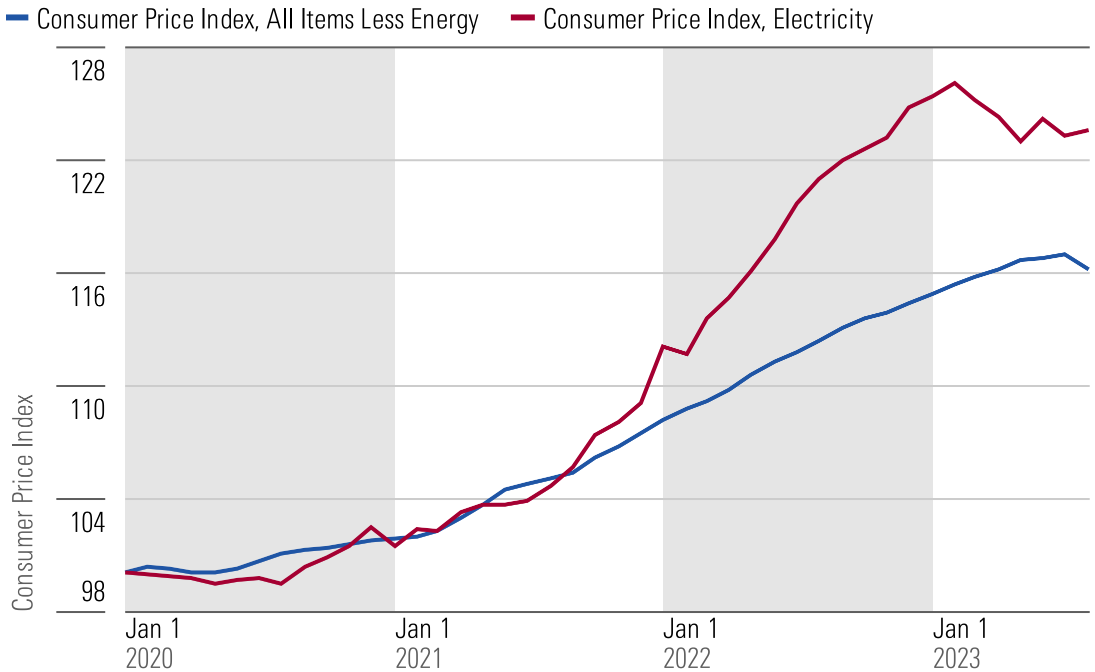
One drag on utilities stocks has been the sharp rise in interest rates, which makes utilities' dividends less attractive and increases financing costs. We think most utilities can adjust and won't feel a huge earnings headwind yet because they issued most of their long-term debt when rates were exceptionally low. However, trying to recover higher financing costs by increasing customer bills will be tougher when electricity prices already are climbing faster than core inflation. Regulatory risk will be a key factor to watch.

Interest Rates Top Utilities' Dividend Yields for First Time Since 2008-09



Source: Morningstar. Data as of Sept. 20, 2023.

Electricity Prices Continue to Outpace Inflation for Nonenergy Items



Source: U.S. Federal Reserve Economic Data. Data as of Sept. 20, 2023.

Utilities

Name/Ticker		Rating	
Entergy (ETR)		★★★★	Entergy offers one of the most attractive combinations of yield, growth, and value in the utilities sector with a 4.6% dividend yield and our 7% annual earnings growth outlook. Entergy's 14 P/E is a 15% discount to the sector average P/E. 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)	**Fair Value (USD)**	**Uncertainty**	
96.55	120.00	Low	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
20.33	Narrow	Standard	

Name/Ticker		Rating	
NiSource (NI)		★★★★	Even though NiSource trades at a similar valuation as its peers, we think it has one of the longest runways of growth in the sector. NiSource's transition from fossil fuels to clean energy in the Midwest supports at least a decade of growth potential. 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. It plans to close its last coal-fired power plant in 2028 and add wind, solar, and energy storage. Its six gas utilities have ample near-term investment and regulatory support in areas that support gas.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
26.69	33.00	Low	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
11.03	Narrow	Standard	

Name/Ticker		Rating	
Duke Energy (DUK)		★★★★	After divesting its renewable energy business, Duke has a clear pathway to achieving management's 5%-7% annual earnings growth target. Duke's $65 billion capital investment plan for 2023-27 is focused on clean energy and infrastructure upgrades to reduce carbon emissions. New legislation in North Carolina supports the clean energy transition. Florida offers opportunities for solar growth. Duke's 4.6% yield is among the highest in the sector, but dividend growth will lag earnings growth until its payout ratio comes down.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
93.33	105.00	Low	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
71.91	Narrow	Standard	

General Disclosure
"Morningstar" is used throughout this section to refer to Morningstar, Inc., and/or its affiliates, as applicable. Unless otherwise provided in a separate agreement, recipients of this report may only use it in the country in which the Morningstar distributor is based. Unless stated otherwise, the original distributor of the report is Morningstar Research Services LLC, a USA-domiciled financial institution.

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

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

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

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

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

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

Risk Warning
Please note that investments in securities are subject to market and other risks, and there is no assurance or guarantee that the intended investment objectives will be achieved. Past performance of a security may or may not continue in the future and is no indication of future performance. A security investment's return and an investor's principal value will fluctuate so that, when redeemed, an investor's shares may be worth more or less than their original cost.

A security's current investment performance may be lower or higher than the investment performance noted within the report. Morningstar's Uncertainty Rating is a useful data point with respect to sensitivity analysis of the assumptions used in our determining a fair value price.

Conflicts of Interest

- No interests are held by the analyst with respect to the securities subject of this investment research report.
- Morningstar, Inc., may hold a long position in the securities subject of this investment research report that exceeds 0.5% of the total issued share capital of the security. To determine if such is the case, please click https://www.morningstar.com/company/disclosures/holdings.
- Analysts' compensation is derived from Morningstar, Inc.'s overall earnings and consists of salary, bonus, and in some cases restricted stock.
- Morningstar's overall earnings are generated in part by the activities of the Investment Management and Research groups, and other affiliates, that provide services to product issuers.
- Neither Morningstar, Inc., nor the Equity Research Group receives commissions, compensation, or other material benefits in connection with providing research, nor do they charge companies to be rated.
- Morningstar employees may not pursue business or employment opportunities outside Morningstar within the investment industry (including, but not limited to, working as a financial planner, an investment professional or investment professional representative, a broker/dealer or broker/dealer agent, a financial writer, reporter, or analyst) without the approval of Morningstar's Legal and if applicable, Compliance teams.
- Neither Morningstar, Inc., nor the Equity Research Group is a market maker or a liquidity provider of the securities noted within this report.
- Neither Morningstar, Inc., nor the Equity Research Group has been a lead manager or co-lead manager over the previous 12 months of any publicly disclosed offer of financial instruments of the issuer.
- Morningstar, Inc.'s Investment Management group has arrangements with financial institutions to provide portfolio management/investment advice, some of which an analyst may issue investment research reports on. In addition, the Investment Management group creates and maintains model portfolios whose underlying holdings can include financial products, including securities that may be the subject of this report. However, analysts do not have authority over Morningstar's Investment Management group's business arrangements or allow employees from the Investment Management group to participate or influence the analysis or opinion prepared by them.
- Morningstar, Inc., is a publicly traded company (ticker: MORN) and thus a financial institution the security of which is the subject of this report may own more than 5% of Morningstar, Inc.'s total outstanding shares. Please access Morningstar, Inc.'s proxy statement, "Security Ownership of Certain Beneficial Owners and Management" section at https://shareholders.morningstar.com/investor-relations/financials/sec-filings/default.aspx.

Morningstar may provide the product issuer or its related entities with services or products for a fee and on an arm's-length basis, including software products and licenses, research and consulting services, data services, licenses to republish our ratings and research in their promotional material, event sponsorship, and website advertising. Further information on Morningstar's conflict-of-interest policies is available at http://global.morningstar.com/equitydisclosures.

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

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

For Recipients in New Zealand: This report has been issued and distributed by Morningstar Australasia Pty Ltd and/or Morningstar Research Ltd (together 'Morningstar'). This report has been prepared and is intended for distribution in New Zealand to wholesale clients only and has not been prepared for use by New Zealand retail clients (as those terms are defined in the Financial Markets Conduct Act 2013).

The information, views and any recommendations in this material are provided for general information purposes only, and solely relate to the companies and investment opportunities specified within. Our reports do not take into account any particular investor's financial situation, objectives or appetite for risk, meaning no representation may be implied as to the suitability of any financial product mentioned for any particular investor. We recommend seeking financial advice before making any investment decision.

For recipients in Canada: This research is not prepared subject to Canadian disclosure requirements.

For recipients in Hong Kong: The report is distributed by Morningstar Investment Management Asia Limited, which is regulated by the Hong Kong Securities and Futures Commission to provide investment research and investment advisory services to professional investors only. Neither Morningstar Investment Management Asia Limited nor its representatives are acting or will be deemed to be acting as an investment advisor to any recipients of this information unless expressly agreed to by Morningstar Investment Management Asia Limited.

For recipients in India: This investment research is issued by Morningstar Investment Adviser India Private Limited. Morningstar Investment Adviser India Private Limited is registered with SEBI as a Portfolio Manager (registration number INP000006156) and as a Research Entity (registration number INH000008686). Morningstar Investment Adviser India Private Limited has not been the subject of any disciplinary action by SEBI or any other legal/regulatory body. Morningstar Investment Adviser India Private Limited is a wholly owned subsidiary of Morningstar Investment Management LLC. In India, Morningstar Investment Adviser India Private Limited has one associate, Morningstar India Private Limited, which provides data-related services, financial data analysis, and software development. The research analyst has not served as an officer, director, or employee of the fund company within the last 12 months, nor have they or their associates engaged in market-making activity for the fund company.

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

For recipients in Korea: The report is distributed by Morningstar Korea Ltd., which has filed to the Financial Services Committee. Neither Morningstar Korea Ltd. nor its representatives are acting or will be deemed to be acting as an investment advisor to any recipients of this information.

For recipients in Singapore: This report is distributed by Morningstar Investment Adviser Singapore Pte Limited, which is licensed and regulated by the Monetary Authority of Singapore to provide financial advisory services in Singapore. Recipients of this report should contact their financial advisor in Singapore in relation to this report. Morningstar, Inc., and its affiliates rely on certain exemptions (Financial Advisers Regulations, Section 28(1)(e), Section 32B and 32C) to provide its investment research to recipients in Singapore.

22 West Washington Street
Chicago, IL 60602 USA

About Morningstar® Equity Research™

Morningstar Equity Research provides independent, fundamental equity research differentiated by a consistent focus on durable competitive advantages, or economic moats.

Information on Morningstar's Equity Research methodology is available from https://www.morningstar.com/research/signature.