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US Equity Research

From the Director of Equity Research for the Americas: Charts That Caught My Eye

MORGAN STANLEY RESEARCH
North America

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A guiding principle at Morgan Stanley Research is to enhance your investment process by delivering unique insights that separate the signal from the noise. An intuitively designed and well-crafted chart can often accomplish this with exceptional clarity. With that mission in mind, these charts in our recently published research stood out to me:

(1) Credit: Investment-grade credit gross issuance volume is exceptionally strong but is running below 2020's record pace.

(2) Apple: Strong App Store revenues in May could point to an upside surprise for the June quarter.

(3) Salesforce.com: Management commentary signals a renewed focus on balancing growth *and* margins.

(4) Utilities: The group looks attractive on dividend yield relative to bonds; we also map EPS growth vs. relative P/Es.

(5) Equity Strategy: S&P earnings revisions appear to have peaked, which usually means lower P/Es to come.

(6) Agribusiness: Tight stocks should keep corn and soy prices elevated, driving earnings momentum in the supply chain.

Please reach out to me with feedback on these or any other key investment debates.
Thank you for your partnership.

David Adelman
Director of Equity Research for the Americas

Morgan Stanley appreciates your support in the *Institutional Investor All-America Research Survey*.

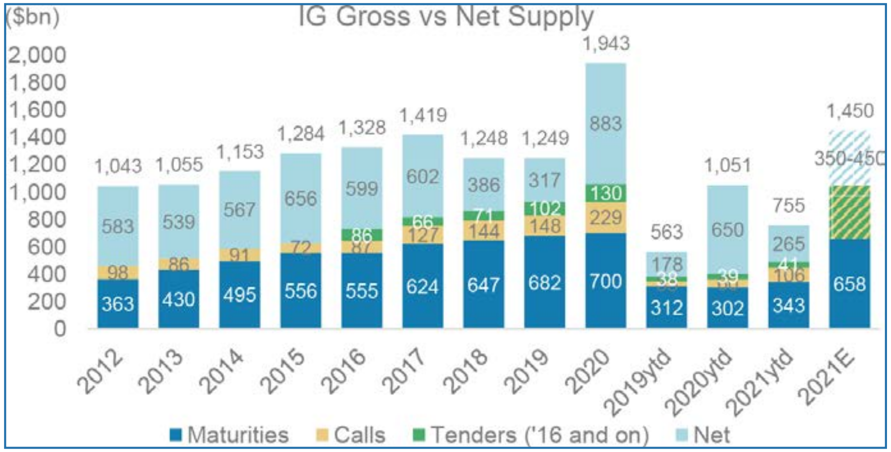
For some of my brief thoughts on our partnership, see this short video.

1. Investment Grade Credit Strategy: Supply on the Offense

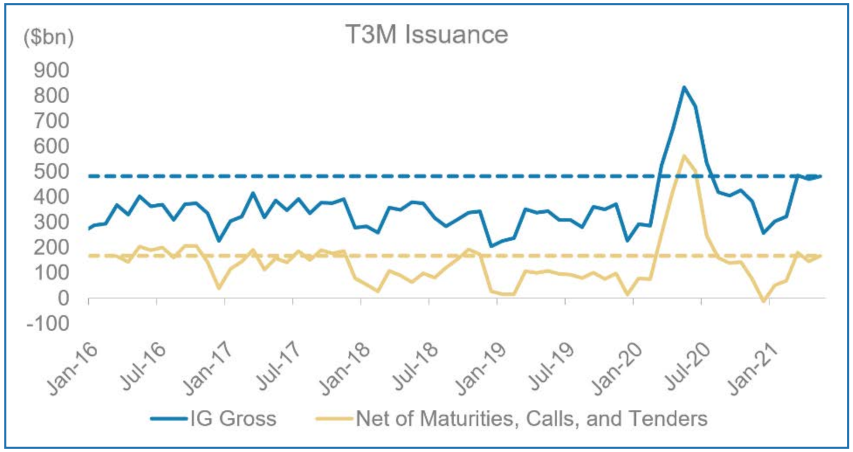
Our Credit Strategists have raised their 2021 Investment Grade supply forecast to $1.45 trillion — which would make this the busiest year for deals excluding the outlier year of 2020. They expect corporates to evaluate using debt to finance M&A, buybacks, capex, and general corporate purposes / higher leverage. Additionally, our economists are calling for a strong capex cycle, which could become an incremental use of proceeds for debt issuance. Looking below the headline number, our credit strategists expect net supply for 2021 to be in the $350-450bn range (vs. an estimated ~$600bn in 2017) after accounting for an elevated pace of calls, tenders, and higher maturities.

See [Supply on the Offense (May 27, 2021)](#)

IG Issuance Has Fallen from 2020 Levels, but Is Well Ahead of 2019's Pace and Could Reach the 2017 Total



However, Net Issuance Is Less Extreme — Near the Top of the Typical Historical Range



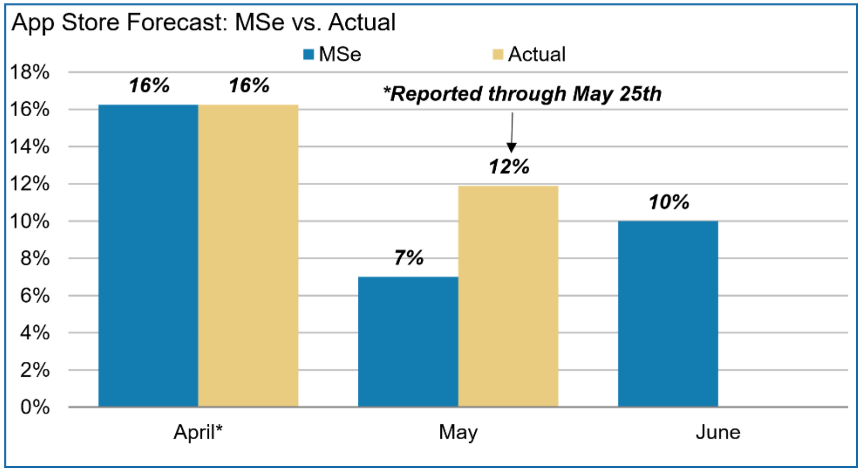
Source: Morgan Stanley Research, Dealogic, Bloomberg

2. Apple: App Store Could Drive an Upside Revenue Surprise for the June Quarter

Following the App Store's weaker-than-expected performance in April, many investors are asking our IT Hardware team whether Apple (AAPL, $124, Overweight) is entering a period of downward pressure on Services revenue growth as economies reopen and Y/Y compares become more difficult. In response, our team dug into the App Store data earlier than their customary month-end check-in. Their findings are bullish: They estimate that through May 25, App Store net revenue is up 12% Y/Y month-to-date, 5ppt ahead of their +7% Y/Y forecast. Assuming performance did not meaningfully deviate from the MTD trend over the final 6 days in May, App Store growth is trending up 14% Y/Y quarter-to-date, 3ppt ahead of their +11% Y/Y June-quarter forecast. Said another way, to meet or exceed their +11% June quarter App Store forecast, the App Store would need to grow just 5% Y/Y in the month of June, below our team's current +10% Y/Y forecast.

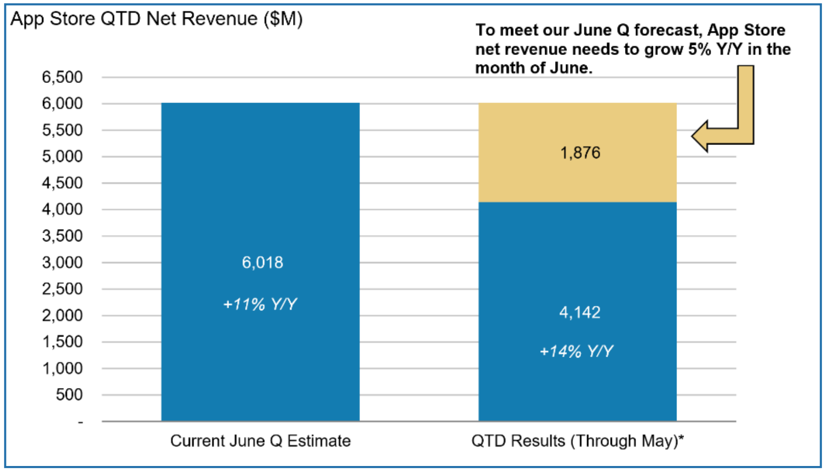
See ***What Investors Are Asking: How Is the App Store Trending Month to Date? (May 27, 2021)***

We Estimate That Through May 25, App Store Net Revenue in May Is Up 12% Y/Y, Well Above Our +7% May Forecast



Source: Sensor Tower, Morgan Stanley Research

If the App Store Grows 12% Y/Y for all of May, App Store Net Revenue Would Need to Grow Just 5% Y/Y in June to Meet Our Current June-Quarter Forecast



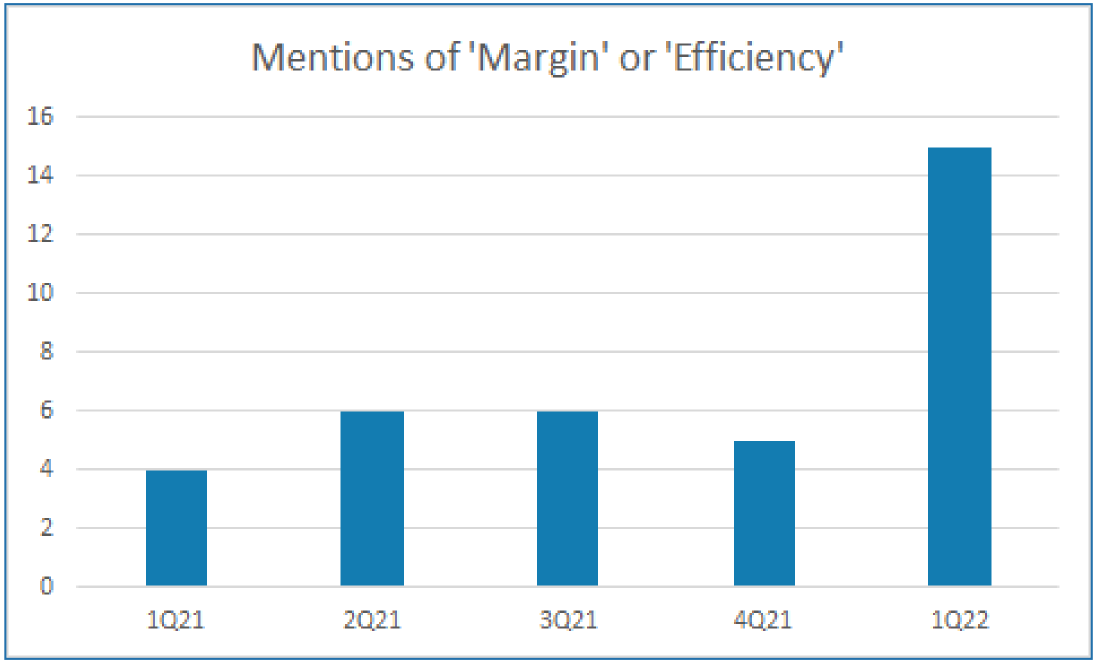
Source: Sensor Tower, Morgan Stanley Research; *QTD results assume the App Store grows 12% Y/Y for the full month of May

3. Salesforce.com: Management Commentary Signals a Focus on Growth *and* Margins

Our Software team recently upgraded Salesforce.com (CRM, $237) to Overweight, in part based on expectations of a more constructive approach on margins. Indeed, for 1Q Salesforce reported operating margins of 20.2%, 250 bps ahead of consensus and +770 bps YoY, and management raised its FY22 operating margin guidance to 18% for the full year (despite 160 bps of incremental margin headwinds expected from acquisitions). In addition, management's commentary — as evidenced by the frequency with which they mentioned "margin" or "efficiency" — appears to signal a change in philosophy for the company. Our team views this as an important step in rebuilding investors' confidence, which they think should drive CRM shares higher.

See Q1 Results - Executing on Improving Growth AND Margins (May 28, 2021)

Management Commentary Signals a Renewed Focus on a Balance of Growth *and* Margins

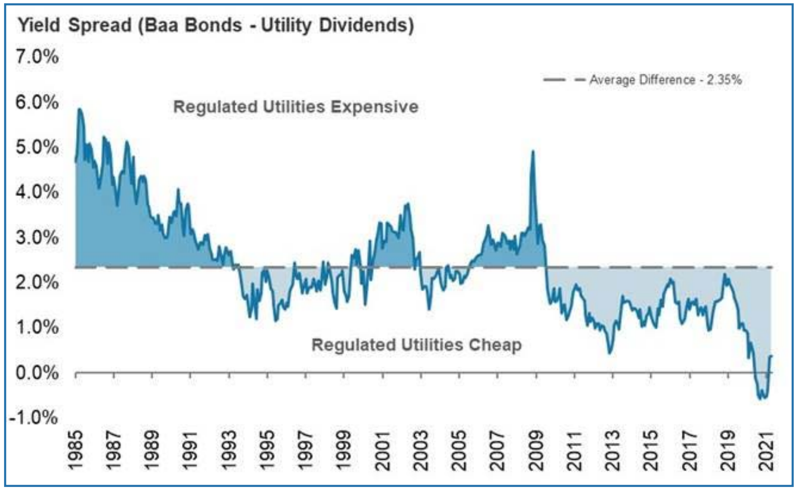


Source: Thomson Reuters and Morgan Stanley Research

4. Utilities: Yields Attractive Relative to Bonds; Mapping EPS Growth vs. Relative P/E

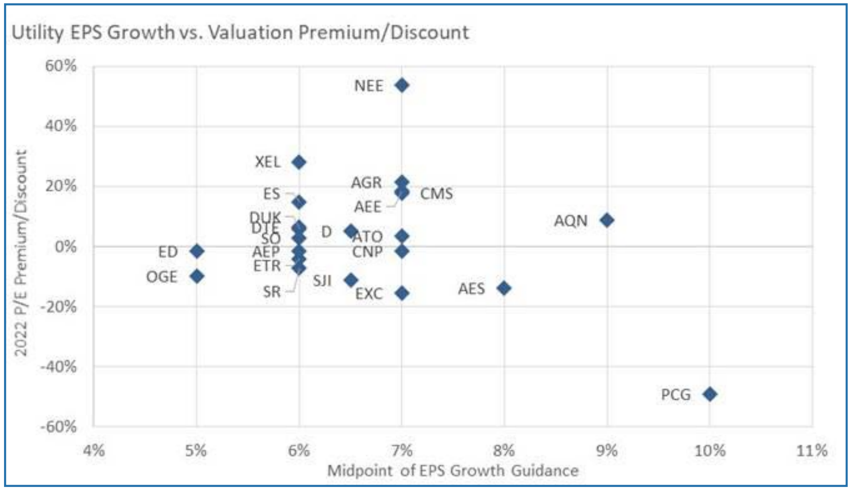
Our Utilities team recently outlined their recommended positioning in the context of the key criteria they focus on. Two charts that frame current valuations caught my eye. The first shows that Utility valuations currently screen very favorably relative to fixed income investments. The second compares the companies' targeted EPS growth rate to relative P/E multiples, using their proprietary Dividend Discount Model to calculate a P/E premium / discount differential between higher- and lower-growth utilities. Our team notes that stocks toward the bottom of this chart screen as especially attractive. *See* ***Positioning in 10 Graphics (May 27, 2021)***

Yield Comparison – Baa Corp. Bonds vs. Utility Dividends



Source: Bloomberg, Morgan Stanley Research

Midpoint of EPS Growth Guidance vs. Valuation Premium / Discount



Source: Company data, Thomson Reuters. Note: Exhibit excludes companies that have not provided a long-term EPS growth rate target

Share prices as of June 1: ED $77, OGE $34, XEL $70, ES $80, DUK $100, DTE $138, SO $63, AEP $85, ETR $105, SR $72, D $76, SJI $27, NEE $72, AGR $52, AEE $84, CMS $62, ATO $99, CNP $25, EXC $45, AES $26, AQN $15, PCG $10

5. Equity Strategy: Earnings Revisions Have Likely Peaked; De-Rating Usually Follows

Morgan Stanley's call for a V-shaped recovery is now largely the consensus view, and bottom-up 2022 EPS estimates for the S&P 500 are now ahead of our Equity Strategy team's forecasts for the first time since the recovery began. Our Strategists have often said that, at least for equities, it's generally "better to travel than arrive," and much of their current "mid-cycle transition" call is based on the arrival of the peak rate of change in both growth and policy — not negative growth or revisions, but simply a deceleration. For markets, such an adjustment typically means lower valuations, a process that began in 1Q for the most expensive stocks. Our team remains convinced that the de-rating process still has about 75% to go, or an approximate 15% decline in P/Es from here, meaning that investors should look for stocks where expectations can still rise more than P/Es fall. *See* ***Weekly Warm-up: Great Expectations on Earnings and Inflation (June 1, 2021)***

Record Earnings Revisions Breadth

Source: FactSet, Morgan Stanley Research

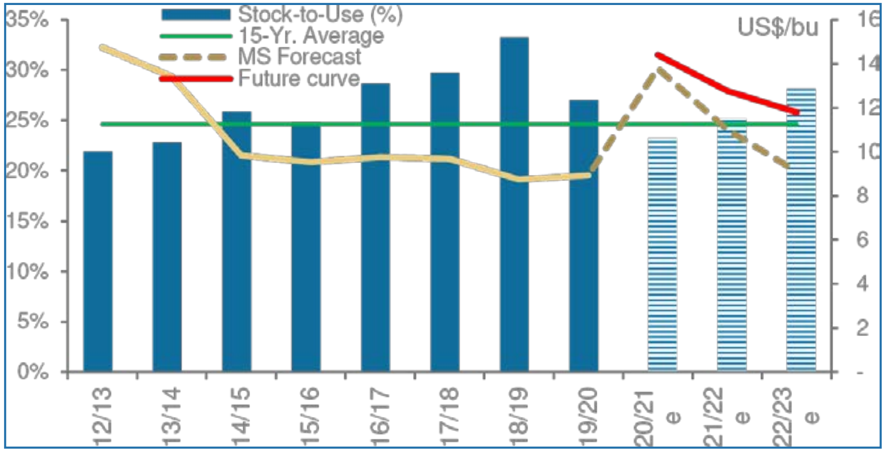
P/Es Are the Process of De-Rating and Have Another 15% to Go, in Our View

Source: Bloomberg, Morgan Stanley Research

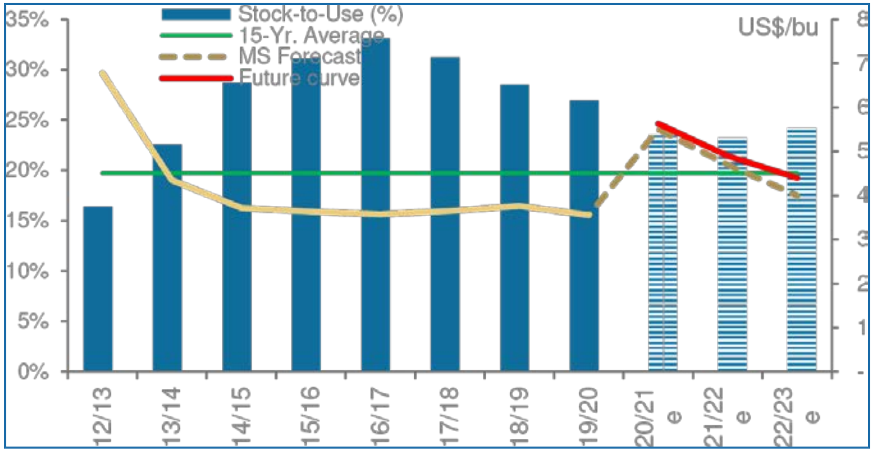
6. Agribusiness: Elevated Grain Prices Mean Earnings Momentum in the Supply Chain

Our global Agribusiness, Chemicals, and Machinery teams published a collaborative report that updated Morgan Stanley's global grains models and explored the implications through the supply chain. They conclude that soy and corn prices are peaking and driving acreage expansion, but in the short term, increased supply should merely catch up with already strong demand that has outpaced supply in the last two years, so prices should stay materially above the cost of production in 2021/22. That should warrant acreage expansion for farmers, as well as strong volumes and prices across the supply chain. With that ecosystem, they believe Machinery companies offer the most consistent combination of revenue growth and margin gains; OW-rated Deere (DE, $365) and AGCO (AGCO, $140) are our US Machinery analyst's top picks. *See* ***Tighter Stocks to Keep Grain Prices Elevated and Earnings Momentum in Supply Chain (May 28, 2021)***

Soybean Stocks-to-Use and Prices



Corn Stocks-to-Use and Prices



Source: USDA, Morgan Stanley Research estimates

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Equal-weight/Hold	**1430**	**41%**	**361**	**41%**	**25%**	**648**	**42%**
Not-Rated/Hold	**0**	**0%**	**0**	**0%**	**0%**	**0**	**0%**
Underweight/Sell	**530**	**15%**	**91**	**10%**	**17%**	**209**	**14%**
TOTAL	**3,477**		**872**			**1530**	

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