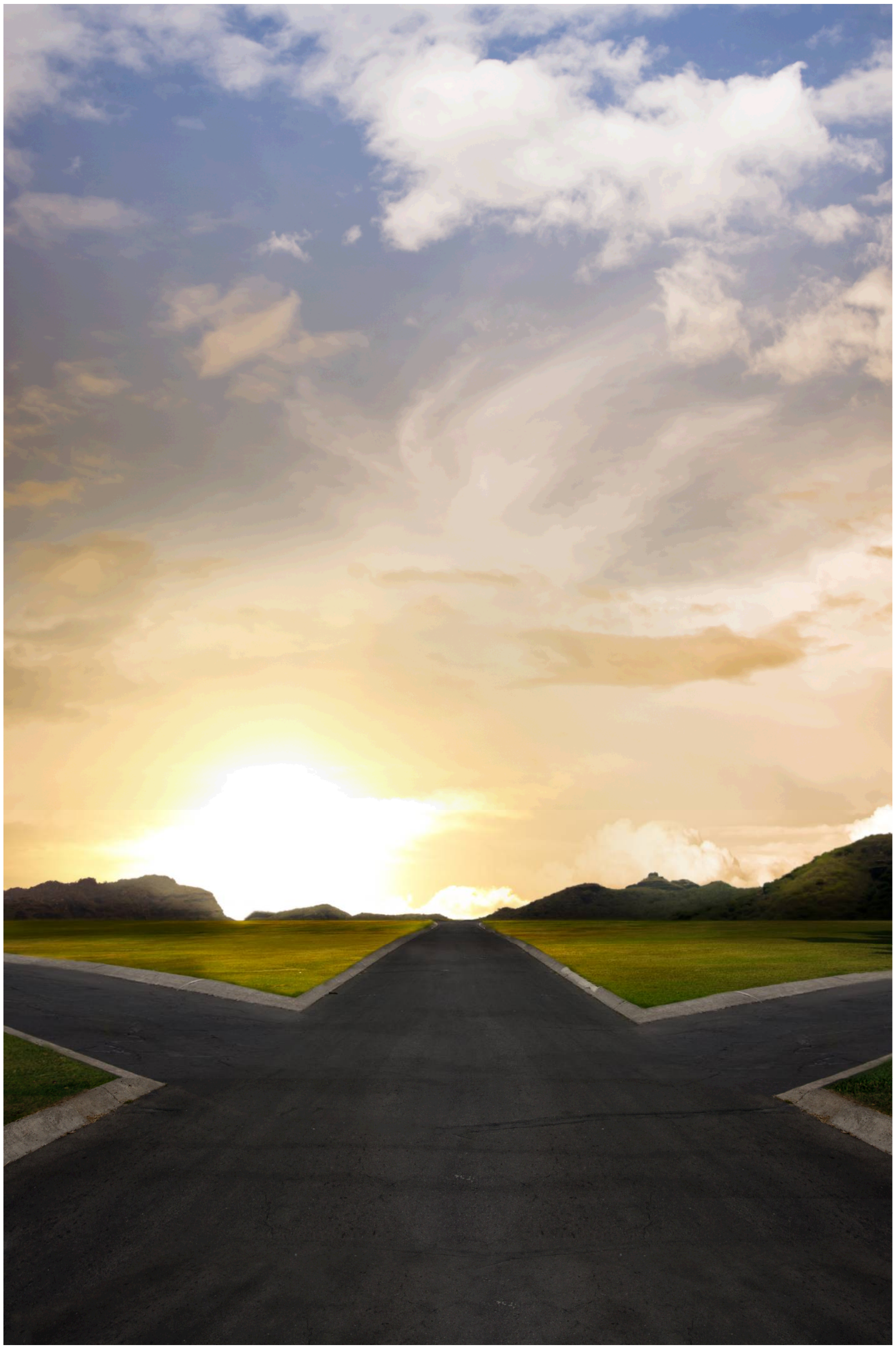
US Year Ahead 2017

Stocks for Every Strategy



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See page 96 for analyst certification and important disclosures.

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J.P.Morgan

December 1, 2016

Dear Investor,

As 2016 draws to a close with Donald Trump's surprise election victory, we still see more upside potential for equities. Prospects of expansionary fiscal policies under a relatively easy monetary backdrop are likely to help support further re-rating of the equity multiple. However, fundamental risks are also likely to be more significant — although there is the possibility of pro-growth policy reform under the new administration, the potential passage, timing, and efficacy of any measures are still very much unknown. A stronger US dollar and higher interest rates could potentially be sources of downside risk for corporate earnings and the equity multiple, especially if those trends are not supported by stronger growth expectations. Our Chief US Economist expects a small fiscal boost to US economic performance in 2017, which would add about 0.25% to annualized GDP growth beginning in 3Q17 and extending into 2018. The ongoing progress toward the Fed's inflation and employment objectives should keep it on track to slowly normalize short-term interest rates: we look for a hike in December and two more next year, taking the target range for interbank rates to 1.00-1.25% by the end of 2017.

Our Equity Strategist projects the S&P 500 to reach 2,400 by year-end 2017, implying 9% upside, driven by positive base effects from commodity-linked sectors and normalization of the US and global business cycles. Our EPS estimate of $128 is primarily policy neutral, as it does not incorporate proposed changes from the new US administration. We recommend investors remain overweight in Healthcare, Financials, Energy, and Materials, which should benefit from reflation and declining regulatory headwinds, and underweight in Staples and REITs, due to their low volatility and defensive nature. Our Technical Analysis team expects the current rally of the S&P 500 Index to extend into 2017, a continuation of the bullish bias it has maintained since the S&P 500 Index held key support and broke above 1,850 in February 2016.

Given the greater uncertainty we see for equities, many of our analysts advocate a tactical, wait-and-see approach. Companies that could be beneficiaries of individual and corporate tax reform, cash repatriation, infrastructure stimulus, and a more lenient regulatory environment appear attractive. Trade protectionism and the possible repeal of the Affordable Care Act are key themes to watch.

To help navigate the cross-currents, our year-ahead report showcases recommendations that reflect focused investing styles. Our analyst teams identify key drivers of sector stock prices and present targeted investment ideas suited to various investment strategies: growth, value, income-oriented, shorting, and market neutral. We round this out with commentary from our Strategy, Derivatives, Economics, Technical Analysis, and Commodities experts. As always, we remain committed to providing you with pertinent analysis that proves helpful in your investment decision-making process, and we hope that you find this report useful.

Nicholas Rosato Jr.

Head of North America Equity Research

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★ Indicates top pick.

Note: Unless otherwise noted, all stocks in this report are priced as of the close on November 23, 2016.

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US Stocks for Every Strategy

Introduction

For 2017, J.P. Morgan's US equity analysts selected "Stocks for Every Strategy," identifying the most compelling investment ideas in their coverage group across growth, value, income-oriented, short and market-neutral strategies. In addition, our analysts selected their top pick in their coverage.

Methodology and Strategy Index

This report identifies what our analysts view as the most compelling investment ideas in their coverage group across a variety of strategies, including growth, value, income oriented, shorting, and market neutral. Our 2017 Year Ahead ideas are tailored to five selected strategies and, as such, may vary from our fundamental ratings. For the rationale for our ratings, please refer to the investment thesis section of our latest company research. Below are links to the company pages on J.P. Morgan's research website for all stocks recommended in these strategies. Investors may refer to the analyst's most recent published company research note for the investment thesis, rationale for the price target, and for the risks to the rating and the price target.

Top Picks

Company Name	Ticker	Analyst	Price Target	End Date	Page
Advance Auto Parts, Inc.	AAP	Christopher Horvers, CFA	$196.00	31-Dec-17	56
Air Lease Corp.	AL	Jamie Baker	$41.00	31-Dec-16	49
Alexion Pharmaceuticals	ALXN	Anupam Rama	$170.00	31-Dec-17	73
Alliance Resource Partners	ARLP	John Bridges, CFA, ACSM	$18.00	31-Dec-17	81
Ally Financial	ALLY	Richard Shane	$27.00	31-Dec-17	71
American Airlines	AAL	Jamie Baker	$54.00	31-Dec-17	50
Aon	AON	Sarah E DeWitt, CFA	$130.00	31-Dec-17	69
Archer-Daniels-Midland	ADM	Ann Duignan	$36.00	31-Dec-17	47
Ardmore Shipping	ASC	Noah R. Parquette, CFA	$10.00	31-Dec-17	48
Berry Plastics	BERY	Tyler J. Langton	$58.00	31-Dec-17	83
Broadcom Limited	AVGO	Harlan Sur	$220.00	31-Dec-17	92
C.H. Robinson	CHRW	Brian P. Ossenbeck, CFA	$63.00	31-Dec-17	45
Callon Petroleum Company	CPE	Gabriel J Daoud Jr., CPA	$20.00	31-Dec-17	63
Canadian Natural Resources	CNQ.TO	Phil Gresh, CFA	C$52.00	31-Dec-17	60
CBS Corporation	CBS	Alexia S. Quadrani	$69.00	31-Dec-17	86
Celgene	CELG	Cory Kasimov	$136.00	31-Dec-17	72
Charter Communications	CHTR	Philip Cusick, CFA	$327.00	31-Dec-17	87
Ciena Corp.	CIEN	Rod Hall, CFA	$30.00	31-Dec-17	95
Colony Starwood Homes	SFR	Anthony Paolone, CFA	$35.00	31-Dec-17	70
Diebold, Incorporated	DBD	Paul Coster, CFA	$33.00	31-Dec-17	88
Dollar Tree, Inc.	DLTR	Matthew R. Boss, CPA	$104.00	31-Dec-17	57
Eli Lilly & Company	LLY	Chris Schott, CFA	$85.00	31-Dec-17	79
Equifax	EFX	Andrew C. Steinerman	$155.00	31-Dec-17	89
Exelon Corp.	EXC	Christopher Turnure	$37.00	31-Dec-17	64
Facebook	FB	Doug Anmuth	$175.00	31-Dec-17	85
First Republic	FRC	Steven Alexopoulos, CFA	$90.00	31-Dec-17	66

Company Name	Ticker	Analyst	Price Target	End Date	Page
FleetCor	FLT	Tien-tsin Huang, CFA	$194.00	31-Dec-17	91
Fortune Brands Home & Security	FBHS	Michael Rehaut, CFA	$68.00	31-Dec-17	54
Goodyear	GT	Ryan Brinkman	$43.00	31-Dec-17	51
Honeywell	HON	C. Stephen Tusa, Jr CFA	$139.00	31-Dec-17	46
Jazz Pharmaceuticals	JAZZ	Jessica Fye	$190.00	31-Dec-17	74
KLA-Tencor	KLAC	Harlan Sur	$90.00	31-Dec-17	93
Kraft Heinz Co.	KHC	Ken Goldman	$101.00	31-Dec-17	52
L-3 Communications	LLL	Seth M. Seifman, CFA	$175.00	31-Dec-17	44
Monsanto	MON	Jeffrey J. Zekauskas	$128.00	31-Dec-17	80
Newmont Mining	NEM	John Bridges, CFA, ACSM	$43.00	31-Dec-17	84
Parsley Energy	PE	Michael A Glick	$46.00	31-Dec-17	63
Pembina Pipeline Corp	PPL.TO	Jeremy Tonet, CFA	C$47.00	31-Dec-17	59
PNC Financial	PNC	Vivek Juneja	$107.00	31-Dec-17	65
Prudential Financial	PRU	Jimmy S. Bhullar, CFA	$95.00	31-Dec-17	68
Range Resources	RRC	Arun Jayaram	$46.00	31-Dec-17	61
Schlumberger	SLB	Sean C Meakim, CFA	$79.00	31-Dec-17	62
Synchronoss Technologies	SNCR	Sterling Auty, CFA	$65.00	31-Dec-17	94
Thermo Fisher Scientific	TMO	Tycho W. Peterson	$180.00	31-Dec-17	76
TPI Composites	TPIC	Paul Coster, CFA	$26.00	31-Dec-17	58
U.S. Steel Corp	X	Michael F. Gambardella	$37.00	31-Dec-17	82
UnitedHealth	UNH	Gary P Taylor	$178.00	31-Dec-17	77
US Foods	USFD	John Ivankoe	$29.00	31-Dec-17	55
VMware	VMW	Mark R Murphy	$90.00	31-Dec-17	90
Walgreens Boots Alliance Inc	WBA	Lisa C. Gill	$100.00	31-Dec-17	75
Zimmer Biomet Holdings Inc	ZBH	Michael Weinstein	$134.00	31-Dec-17	78

Growth

Company Name	Ticker	Analyst	Price Target	End Date	Page
Alexion Pharmaceuticals	ALXN	Anupam Rama	$170.00	31-Dec-17	73
American Airlines	AAL	Jamie Baker	$54.00	31-Dec-17	50
Arch Capital	ACGL	Sarah E DeWitt, CFA	$90.00	31-Dec-17	69
Arch Coal, Inc.	ARCH	John Bridges, CFA, ACSM	$75.00	31-Dec-17	81
Bristol-Myers Squibb Company	BMY	Chris Schott, CFA	$70.00	31-Dec-17	79
Burlington Stores	BURL	Matthew R. Boss, CPA	$100.00	31-Dec-17	57
Callon Petroleum Company	CPE	Gabriel J Daoud Jr., CPA	$20.00	31-Dec-17	63
CBOE Holdings	CBOE	Kenneth B. Worthington, CFA	$78.00	31-Dec-17	67
CBS Corporation	CBS	Alexia S. Quadrani	$69.00	31-Dec-17	86
Celgene	CELG	Cory Kasimov	$136.00	31-Dec-17	72
Charter Communications	CHTR	Philip Cusick, CFA	$327.00	31-Dec-17	87
Ciena Corp.	CIEN	Rod Hall, CFA	$30.00	31-Dec-17	95
Colony Starwood Homes	SFR	Anthony Paolone, CFA	$35.00	31-Dec-17	70
Cummins Inc	CMI	Ann Duignan	$120.00	31-Dec-17	47
Diamondback Energy	FANG	Michael A Glick	$128.00	31-Dec-17	63
Dollar Tree, Inc.	DLTR	Matthew R. Boss, CPA	$104.00	31-Dec-17	57
Edwards Lifesciences	EW	Michael Weinstein	$135.00	31-Dec-17	78
Eli Lilly & Company	LLY	Chris Schott, CFA	$85.00	31-Dec-17	79

Company Name	Ticker	Analyst	Price Target	End Date	Page
Equifax	EFX	Andrew C. Steinerman	$155.00	31-Dec-17	89
First Republic	FRC	Steven Alexopoulos, CFA	$90.00	31-Dec-17	66
Fortune Brands Home & Security	FBHS	Michael Rehaut, CFA	$68.00	31-Dec-17	54
GoPro, Inc.	GPRO	Paul Coster, CFA	$13.00	31-Dec-17	88
Hecla Mining	HL	John Bridges, CFA, ACSM	$8.00	31-Dec-17	84
HubSpot	HUBS	Mark R Murphy	$63.00	31-Dec-17	90
Ingersoll Rand	IR	C. Stephen Tusa, Jr CFA	$77.00	31-Dec-17	46
Jazz Pharmaceuticals	JAZZ	Jessica Fye	$190.00	31-Dec-17	74
Marriott International	MAR	Joseph Greff	$84.00	31-Dec-17	53
Netflix Inc	NFLX	Doug Anmuth	$140.00	31-Dec-17	85
Parsley Energy	PE	Michael A Glick	$46.00	31-Dec-17	63
Pioneer Natural Resources	PXD	Arun Jayaram	$190.00	31-Dec-17	61
Range Resources	RRC	Arun Jayaram	$46.00	31-Dec-17	61
Rexford Industrial Realty	REXR	Michael W. Mueller, CFA	$24.00	31-Dec-17	70
salesforce.com	CRM	Mark R Murphy	$95.00	31-Dec-17	90
Scotts Miracle-Gro Co.	SMG	Jeffrey J. Zekauskas	$92.00	31-Dec-17	80
Square	SQ	Tien-tsin Huang, CFA	$15.00	31-Dec-17	91
Star Bulk Carriers	SBLK	Noah R. Parquette, CFA	$8.00	31-Dec-17	48
Starbucks	SBUX	John Ivankoe	$59.00	31-Dec-17	55
Steel Dynamics, Inc.	STLD	Michael F. Gambardella	$41.00	31-Dec-17	82
SVB Financial Group	SIVB	Steven Alexopoulos, CFA	$142.00	31-Dec-17	66
Synchronoss Technologies	SNCR	Sterling Auty, CFA	$65.00	31-Dec-17	94
Textron	TXT	Seth M. Seifman, CFA	$43.00	31-Dec-17	44
TJX Companies	TJX	Matthew R. Boss, CPA	$85.00	31-Dec-17	57
TPI Composites	TPIC	Paul Coster, CFA	$26.00	31-Dec-17	58
Tractor Supply	TSCO	Christopher Horvers, CFA	$78.00	31-Dec-17	56
Valero Energy Partners, LP	VLP	Jeremy Tonet, CFA	$54.00	31-Dec-17	59
Walgreens Boots Alliance Inc	WBA	Lisa C. Gill	$100.00	31-Dec-17	75
Webster Financial Corporation	WBS	Steven Alexopoulos, CFA	$55.00	31-Dec-17	66
Xcel Energy	XEL	Christopher Turnure	$47.00	31-Dec-17	64
XPO Logistics	XPO	Brian P. Ossenbeck, CFA	$52.00	31-Dec-17	45

Value

Company Name	Ticker	Analyst	Price Target	End Date	Page
Advance Auto Parts, Inc.	AAP	Christopher Horvers, CFA	$196.00	31-Dec-17	56
Aetna	AET	Gary P Taylor	$129.00	31-Dec-17	77
Agilent Technologies	A	Tycho W. Peterson	$52.00	31-Dec-17	76
Air Lease Corp.	AL	Jamie Baker	$41.00	31-Dec-16	49
AK Steel	AKS	Michael F. Gambardella	$11.00	31-Dec-17	82
Allergan plc	AGN	Chris Schott, CFA	$300.00	31-Dec-17	79
Ally Financial	ALLY	Richard Shane	$27.00	31-Dec-17	71
Anadarko Petroleum	APC	Arun Jayaram	$70.00	31-Dec-17	61
Ardmore Shipping	ASC	Noah R. Parquette, CFA	$10.00	31-Dec-17	48
Ball Corporation	BLL	Tyler J. Langton	$91.00	31-Dec-17	83
Bank of America	BAC	Vivek Juneja	$20.50	31-Dec-17	65
Berry Plastics	BERY	Tyler J. Langton	$58.00	31-Dec-17	83

Company Name	Ticker	Analyst	Price Target	End Date	Page
Black Hills Corp.	BKH	Christopher Turnure	$64.00	31-Dec-17	64
Broadcom Limited	AVGO	Harlan Sur	$220.00	31-Dec-17	92
Canadian Natural Resources	CNQ.TO	Phil Gresh, CFA	C$52.00	31-Dec-17	60
Cliffs Natural Resources	CLF	Michael F. Gambardella	$10.00	31-Dec-17	82
Cloud Peak Energy	CLD	John Bridges, CFA, ACSM	$7.00	31-Dec-17	81
Cognizant	CTSH	Tien-tsin Huang, CFA	$64.00	31-Dec-17	91
ConocoPhillips	COP	Phil Gresh, CFA	$52.00	31-Dec-17	60
CSX	CSX	Brian P. Ossenbeck, CFA	$35.00	31-Dec-17	45
Delta Air Lines, Inc.	DAL	Jamie Baker	$65.00	31-Dec-17	50
Diebold, Incorporated	DBD	Paul Coster, CFA	$33.00	31-Dec-17	88
Disney	DIS	Alexia S. Quadrani	$118.00	31-Dec-17	86
Eaton Corp.	ETN	Ann Duignan	$65.00	31-Dec-17	47
Express Scripts	ESRX	Lisa C. Gill	$93.00	31-Dec-17	75
Facebook	FB	Doug Anmuth	$175.00	31-Dec-17	85
Foot Locker	FL	Matthew R. Boss, CPA	$79.00	31-Dec-17	57
Gilead Sciences	GILD	Cory Kasimov	$101.00	31-Dec-17	72
Goodyear	GT	Ryan Brinkman	$43.00	31-Dec-17	51
Invesco Ltd.	IVZ	Kenneth B. Worthington, CFA	$37.00	31-Dec-17	67
KeyCorp	KEY	Steven Alexopoulos, CFA	$15.50	31-Dec-17	66
Level 3 Communications	LVLT	Philip Cusick, CFA	$62.00	31-Dec-17	87
MGM Resorts International	MGM	Joseph Greff	$38.00	31-Dec-17	53
Monsanto	MON	Jeffrey J. Zekauskas	$128.00	31-Dec-17	80
Newmont Mining	NEM	John Bridges, CFA, ACSM	$43.00	31-Dec-17	84
Oasis Petroleum	OAS	Michael A Glick	$15.00	31-Dec-17	63
Pembina Pipeline Corp	PPL.TO	Jeremy Tonet, CFA	C$47.00	31-Dec-17	59
PNC Financial	PNC	Vivek Juneja	$107.00	31-Dec-17	65
Prudential Financial	PRU	Jimmy S. Bhullar, CFA	$95.00	31-Dec-17	68
PTC Inc	PTC	Sterling Auty, CFA	$60.00	31-Dec-17	94
PulteGroup Inc.	PHM	Michael Rehaut, CFA	$26.00	31-Dec-17	54
QEP Resources, Inc.	QEP	Gabriel J Daoud Jr., CPA	$24.00	31-Dec-17	63
Red Hat	RHT	Mark R Murphy	$91.00	31-Dec-17	90
RenaissanceRe	RNR	Sarah E DeWitt, CFA	$135.00	31-Dec-17	69
Robert Half International	RHI	Andrew C. Steinerman	$46.00	31-Dec-17	89
Signature Bank	SBNY	Steven Alexopoulos, CFA	$150.00	31-Dec-17	66
Spirit AeroSystems	SPR	Seth M. Seifman, CFA	$61.00	31-Dec-17	44
Thermo Fisher Scientific	TMO	Tycho W. Peterson	$180.00	31-Dec-17	76
TPI Composites	TPIC	Paul Coster, CFA	$26.00	31-Dec-17	58
TreeHouse Foods Inc.	THS	Joshua A Levine	$79.00	31-Dec-17	52
U.S. Steel Corp	X	Michael F. Gambardella	$37.00	31-Dec-17	82
UnitedHealth	UNH	Gary P Taylor	$178.00	31-Dec-17	77
Viavi	VIAV	Rod Hall, CFA	$11.00	31-Dec-17	95
VMware	VMW	Mark R Murphy	$90.00	31-Dec-17	90
Vornado Realty Trust	VNO	Anthony Paolone, CFA	$115.00	31-Dec-17	70
Whirlpool	WHR	Michael Rehaut, CFA	$182.00	31-Dec-17	54
Zimmer Biomet Holdings Inc	ZBH	Michael Weinstein	$134.00	31-Dec-17	78

Income Oriented

Company Name	Ticker	Analyst	Price Target	End Date	Page
8point3 Energy Partners LP	CAFD	Paul Coster, CFA	$20.00	31-Dec-17	58
Alliance Resource Partners	ARLP	John Bridges, CFA, ACSM	$18.00	31-Dec-17	81
Ares Capital	ARCC	Richard Shane	$17.00	31-Dec-17	71
Boeing Company	BA	Seth M. Seifman, CFA	$155.00	31-Dec-17	44
CenturyLink	CTL	Philip Cusick, CFA	$28.00	31-Dec-17	87
Dow Chemical	DOW	Jeffrey J. Zekauskas	$60.00	31-Dec-17	80
Exelon Corp.	EXC	Christopher Turnure	$37.00	31-Dec-17	64
Franco-Nevada	FNV	John Bridges, CFA, ACSM	$73.00	31-Dec-17	84
Garmin Ltd.	GRMN	Paul Coster, CFA	$51.00	31-Dec-17	88
General Motors	GM	Ryan Brinkman	$43.00	31-Dec-17	51
Honeywell	HON	C. Stephen Tusa, Jr CFA	$139.00	31-Dec-17	46
Iron Mountain	IRM	Andrew C. Steinerman	$46.00	31-Dec-17	89
KLA-Tencor	KLAC	Harlan Sur	$90.00	31-Dec-17	93
Kraft Heinz Co.	KHC	Ken Goldman	$101.00	31-Dec-17	52
Maxim Integrated Products	MXIM	Harlan Sur	$48.00	31-Dec-17	92
McDonald's	MCD	John Ivankoe	$127.00	31-Dec-17	55
Microchip Technology	MCHP	Harlan Sur	$76.00	31-Dec-17	92
Paychex Inc	PAYX	Tien-tsin Huang, CFA	$62.00	31-Dec-17	91
QUALCOMM	QCOM	Rod Hall, CFA	$70.00	31-Dec-17	95
STAG Industrial, Inc.	STAG	Michael W. Mueller, CFA	$23.50	31-Dec-17	70
Sunoco Logistics Partners LP	SXL	Jeremy Tonet, CFA	$30.00	31-Dec-17	59
Teekay LNG	TGP	Noah R. Parquette, CFA	$20.00	31-Dec-17	48
The Carlyle Group	CG	Kenneth B. Worthington, CFA	$19.00	31-Dec-17	67
VEREIT, Inc.	VER	Anthony Paolone, CFA	$11.00	31-Dec-17	70

Shorting

Company Name	Ticker	Analyst	Price Target	End Date	Page
Archer-Daniels-Midland	ADM	Ann Duignan	$36.00	31-Dec-17	47
Avangrid, Inc	AGR	Christopher Turnure	$38.00	31-Dec-17	64
C.H. Robinson	CHRW	Brian P. Ossenbeck, CFA	$63.00	31-Dec-17	45
Cornerstone OnDemand	CSOD	Mark R Murphy	$25.00	31-Dec-17	90
Ensco	ESV	Sean C Meakim, CFA	$7.00	31-Dec-17	62
F5 Networks	FFIV	Rod Hall, CFA	$145.00	31-Dec-17	95
Federated Investors, Inc.	FII	Kenneth B. Worthington, CFA	$24.00	31-Dec-17	67
Forum Energy Technologies	FET	Sean C Meakim, CFA	$12.00	31-Dec-17	62
General Electric Co.	GE	C. Stephen Tusa, Jr CFA	$28.00	31-Dec-17	46
Intelsat	I	Philip Cusick, CFA	$0.00	31-Dec-17	87
iRobot Corporation	IRBT	Mark Strouse, CFA	$44.00	31-Dec-17	88
McCormick & Co., Inc.	MKC	Ken Goldman	$94.00	31-Dec-17	52
Tesla Motors	TSLA	Ryan Brinkman	$180.00	31-Dec-17	51
Western Union	WU	Tien-tsin Huang, CFA	$22.00	31-Dec-17	91

Equity Strategy

More Upside Potential but Also Greater Uncertainty

Head of US Equity Strategy and Global Quantitative Research

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J.P. Morgan Securities LLC

Equity upside will likely be closely linked to an improving earnings delivery. Prospects of expansionary fiscal policies under a relatively easy monetary backdrop are likely to help support further re-rating of the equity multiple. We expect S&P 500 to reach 2,400 by year-end 2017, implying 9% upside. Our EPS estimate of $128 is mostly policy neutral, as it does not incorporate proposed changes from the new US administration. This earnings upside potential of 7-8% is largely driven by positive base effects from commodity-linked sectors and normalization of the US and global business cycles. We think that, fundamentally, risks for equities in 2017 are likely to be higher compared to this year. Prospects of pro-growth policy reforms under the new US administration are main sources of upside risk to our targets, but both the passage and efficacy of these measures are far from certain at this moment. Stronger USD and higher rates are main sources of downside risk for corporate earnings and the equity multiple, especially if those trends are not supported by stronger growth expectations.

State of the Business Cycle

Recent flow of macro data indicates that the 8-year-old US business cycle remains intact and has entered a new intra-cycle expansion phase after being in contraction for most of last year. Since February, the JPM US business cycle indicator (US QMI) has been re-accelerating from recession-like levels. The recent US election outcome and the pro-growth agenda of the new US administration, if carried through, will likely increase the longevity of the expansion phase. On the global front, the pick-up in EM and, more recently, European business cycle indicators (EM and Europe QMIs) have also been supportive.

Improving Fundamentals

In 2017 we expect S&P 500 EPS growth of 7-8% (vs. 3% CAGR over this profit cycle). Our EPS estimate of $128 is driven by stronger revenue growth, flat margins, and continued stock repurchases. Revenues should return to an above-trend growth rate of 6%. The key sector for revenue growth potential next year is Energy, given that it is expected to contribute ~40% of S&P 500 revenue growth (base effect). Technology (+7% y/y) and Healthcare (+4% y/y) are expected to contribute roughly ~25% of incremental top-line growth; however, the move in USD will likely be the most important factor for these multinational sectors in terms of revisions. Net income margins are likely to remain flat. They peaked in 3Q15 at 10.7% and have drifted lower to 10.5% as of 3Q16. While we expect stronger top-line growth to drive operating margin improvement (EBIT %), the current macro backdrop will likely exert some pressure (e.g., increasing wages, stronger USD, diminishing interest expense savings) resulting in flat net income margin of 10.4% in 2017. Share repurchases should continue to provide 1-2% upside to EPS.

Style Positioning

A reflationary backdrop in an expansionary phase of the business cycle should remain supportive of further rotation into Value, while continuing to pose risk for Low Vol and Quality styles. Even though during 2H style valuations have normalized relative to the market and their own history, Value currently still trades at a significant discount while Low Vol and Quality at a premium. The key risk to our call is a reversal in the global reflationary trend, perhaps best epitomized in rising bond yields. The US election outcome appears to have accelerated this process with prospects of pro-growth policy reforms. In essence, the policy baton is expected to move from monetary to some form of fiscal expansion. However, this transition could be fraught with risks — rates may be hiked too soon and too aggressively, USD strength could become unsustainable, and the expected pro-growth measures could fall victim to congressional paralysis.

Sector Positioning

Over the medium term, we maintain our sector views and recommend investors remain overweight sectors that would benefit from reflation and declining regulatory headwinds (Healthcare, Financials, Energy, and Materials) and underweight low volatility and defensive sectors (Staples and REITs). However, in the short term, we are turning less constructive on Financials given its recent outsized relative outperformance and significant increase in rate expectations with the Fed Funds futures curve fully pricing in FOMC dots through the end of 2017.

Equity Derivatives Strategy

Risks for Equity Markets

Equity Derivatives Strategy
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In our 2016 Outlook for equity markets we forecasted an increase in both volatility and tail risk (our forecast was for the VIX to average 16-18 this year). The trailing 12M average level of the VIX peaked at 18 after Brexit and then declined to ~16. Tail Risk was also pronounced, with volatility of volatility spiking on Brexit and shortly before the US election (volatility of VIX at ~125). However, what was surprising is that in the aftermath of two seismic events – Brexit and US elections – market volatility quickly declined, pulling the average levels of volatility lower throughout 2H16. It took several weeks for volatility to subside in the aftermath of the August 2015 sell-off, but it took only few days after Brexit, and a few hours after the US election.

So what is driving the VIX and is it still a good measure of equity market risk? There are several factors that we believe can explain the behavior of equity volatility this year. The first one is structural and we described it as market pinning during most of July and August, caused by option positioning. At the peak of market pinning in August, the S&P 500 realized less than 5% annualized volatility and moved less than 10bps on a number of days. As Brexit, the US election, and the September volatility spike were well-anticipated events, they also resulted in covering of option hedges, and opportunistic selling of volatility. Low/negative bond yields increased the allure of selling volatility (and buying equities) and put further pressure on volatility levels. Finally, it appears that the time horizon of macro traders has shortened dramatically, likely as a result of increased participation of machines and algorithms that are quicker to adjust to significant events and can eliminate trading activity of slower investors (such as the overnight post-election move).

What will market volatility be in 2017? We think that fundamentally, **risks for equities in 2017 are higher compared to this year**. We expect an **increased level of geopolitical risk** and increased uncertainties related to the new US administration. In Europe, significant risks include fallouts from Brexit, the referendum in Italy, elections in France and Germany, and continued tension relating to immigrants from the Middle East. The Middle East will likely see further turmoil in relation to developments in Syria, and low oil prices that continue to exert pressure on budgets of oil exporters. While the US macroeconomic cycle may get a boost from the proposed fiscal stimulus, corporate tax reform and de-regulation, both the passage and efficacy of these measures are far from certain at this moment.

The **main market risk for equities will come from a strong USD and higher rates**, in our view, which can destabilize equity P/E, Emerging Markets, the housing market, and US equity segments such as multinationals, domestic manufacturing, materials, bond proxies, etc. Higher USD and bond yields will also undercut the ability of the new US administration to revive US manufacturing or use the fiscal deficit to re-ignite growth. With additional rate hikes imminent and the record level of the USD, we are at an increased risk of repeating the scenario from January 2016 where fundamental and systematic investors were selling at the same time in the aftermath of a Fed hike (albeit, some risks are lower this time, such as higher Oil prices and a lack of focus on China/CNY). According to our macroeconomic model, the VIX also appears to be ~3 points too cheap (1 standard deviation) relative to dozens of macroeconomic variables.

However, **we are not convinced that the average VIX level will capture these increased risks and think that the VIX in 2017 will likely trade in a similar range to 2016**. Periods of low volatility may mask underlying fundamental risks. These quiet periods will be followed by quick outbursts of volatility that may not last long enough to be captured by an average investor. Hedgers may buy volatility ahead of an event and sell shortly before the catalyst to capture volatility grinding higher (rather than a spectacular increase). To gauge market risks, equity investors should watch for **further increases in bond yields and strengthening of USD**. Geopolitical developments should be gauged from both **traditional and non-traditional data sources** (such as big data sentiment indicators, independent media outlets, etc.) given the failure of many traditional data sources to anticipate geopolitical developments this year. In addition to the aforementioned risks, an upside risk to our base case volatility view is if the US were to enter a recession (to which our Economists assign only a 28% chance over the next 12 months), and a downside risk for volatility would be a quick and effective US fiscal stimulus alongside continued monetary accommodation that causes a rally in risky asset classes.

Economics

2017 US Outlook

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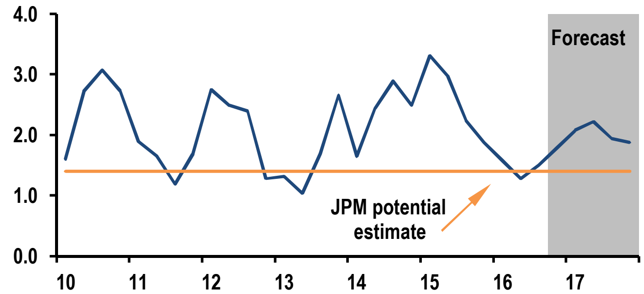
As 2016 draws to a close, the US economy appears to have grown at a hum-drum pace of about 1.8% (4Q/4Q), quite similar to last year's 1.9% performance. We've been looking for a similar slow slog forward next year, though recent political developments add some interesting risks to that otherwise milquetoast forecast. On the one hand, if President-elect Trump and his Republican allies in Congress push through the large tax cuts and the equally large increases in defense and infrastructure spending on which he campaigned, the implied fiscal stimulus could push growth above 3%. On the other hand, if the incoming administration prioritizes increasing import duties and deporting large numbers of immigrants, the disruptions to critical supply chains could have a chilling effect on business activity. For the time being, we are expecting a small fiscal boost, which would add about 0.25% to annualized GDP beginning in 3Q17 and extending into 2018.

Figure 1: US GDP growth
%ch over 4 quarters

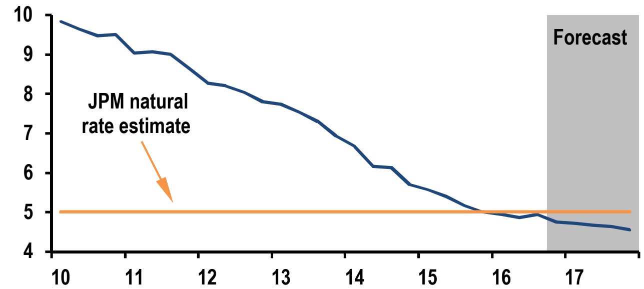


Source: J.P. Morgan.

While policy can potentially lift aggregate demand next year, there are fewer reliable policy remedies for the slow productivity growth that has plagued the economy. This slow productivity growth is the reason that even growth in the neighborhood of 2% (+/-0.25%) has been enough to support a robust need for businesses to keep hiring. And six consecutive years of job creation in excess of two million jobs per year has finally tightened labor markets to the point where we are seeing more convincing evidence of an acceleration in wage growth—albeit from a low starting point. Consumer price inflation has only partly followed suit. After averaging 1.4% in 2015, core PCE inflation—the Fed's preferred measure—has recently been running around 1.7%. The continued upward move in wages should put downward pressure on margins and upward pressure on prices, and we see core PCE inflation getting back to the Fed's target of 2.0% by the end of 2017. The ongoing progress toward the Fed's inflation and employment objectives should keep it on track to slowly normalize short-term interest rates: we look for a hike in December and two more next year, taking the target range for interbank rates to 1.00-1.25% by the end of 2017.

Figure 2: Unemployment rate

percent, sa



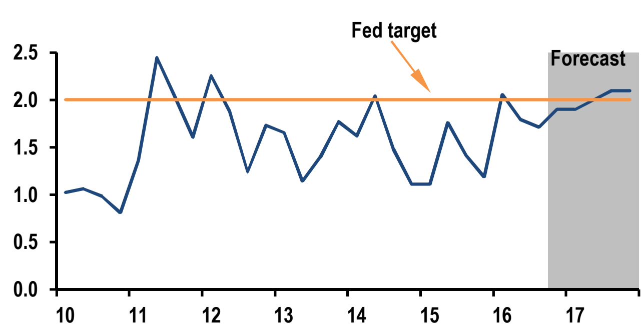
Source: J.P. Morgan.

Digging a little deeper into sectoral performance, the consumer was the mainstay of the economy in 2016, an outcome which we expect will mostly continue in 2017. Although the pace of job growth may be modestly slowing, wage gains are picking up. This vigor in labor income could get added support from tax cuts, further boosting disposable personal income. Household balance sheets remain healthy, supported by ongoing valuation gains in stocks and, particularly, houses, and the appetite for debt growth has remained modest. Consumer sentiment has also been supportive, as households have mostly been unfazed by global stress and political uncertainties. The one fundamental that looks a little less supportive relative to last year is energy prices. The tailwind of earlier declines in retail gas prices helped fuel a spending binge in early 2016 that already looks to be moderating a bit as we head into 2017.

Business capital spending, in contrast, was a notable laggard in 2016. Looking forward to 2017, one significant headwind to capex appears to be out of the way: cutbacks in capital outlays by energy companies. We look for business spending to pick up next year, but to only increase at a still-sober rate of 3.4%. A modest improvement in the foreign backdrop should help: our global colleagues expect trade-weighted growth outside the US to increase some from 2.2% last year to 2.5% in 2017. Even so, domestic exporters may still face some competitiveness challenges; the brightening of US growth prospects late in 2016 has put renewed upward pressure on the value of the dollar, foretelling another year of a challenging environment for US foreign trade.

Figure 3: Core PCE inflation

%ch at annual rate over 1 quarter



Source: J.P. Morgan.

Technical Strategy

Same views, wider berth

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Overview

Our outlook for the fixed income and equity markets are a natural progression of the views we have been leveraging for several months now. For equities, our outlook for the current rally to extend into 2017 is not only a continuation of the bullish bias we have maintained since the **S&P 500 Index** held key support and broke above **1,850** in Feb 2016, but also part of a narrative that spans back to late-2014. In our 2015 Outlook, we made the case the US equity market was transitioning from a fairly low-volatility rally phase into a highly volatile range that would persist for the better part of a year and have a 9-15% amplitude. While that favored moving to a more tactically oriented trading strategy for a period, it was forecasted to pause but not end the broader bull market that started in 2009. For the second half of 2016, we have maintained the view that the market was in the process of transitioning from a high-volatility range to a relatively low-volatility trend. The uncertainties surrounding the new administration in Washington present some risk to our view, and with that uncertainty, we tend to think the volatility compression normally associated with a bullishly trending environment may be muted to some degree. On the upside, the next zone of targets for the **S&P 500 Index** rest at **2,240-2,250**. Longer-term pattern objectives that are derived from the 1997-2013 and 2014-2016 range breakout projections rest at **2,430-2,486**. As a base-case outlook, we have had the former as our late-2016/early-2017 target. We have the latter penciled in as a potential target zone for late-2017/early-2018, but as a practice, we tend not to strictly adhere to longer-term equity targeting in a rally, particularly in late-cycle advances. Those dynamics tend to be varied, and as a result, we suggest managing long strategies like the ones we have suggested since Feb 2016 with trailed stop-loss orders until we see clear price patterns that suggest the rally has run its course. The late-1990s is a very good example when those late-cycle dynamics extended well beyond expectations, and indices like the NASDAQ 100 exceeded "rational" fundamental and technical targets by a wide margin.

On the rates side, we have been forecasting and monitoring the development of a bearish trend to higher yields ever since a number of our quantitative signals triggered in late-June and early-July. As that yield rise progressed, lower frequency momentum models flipped in support of the underlying bear trend, and the macro data started to provide fundamental teeth to what started as a position driven mean reversion. Based on that setup, and the recent acceleration of the rate rise that provides reinforcing evidence to support our original outlook, we expect the broader trend to extend into next year. Using the **10-year note** as a marker for the broader Treasury market, we ultimately expect yields to back up into the **2.38-2.50%** support zone in the first half of the year. As the move unfolds, we expect the front end of the curve to steepen, and the back end to remain in a volatile and broad range. We think the movements at the long end, which are largely driven by growth and inflation expectations, will initially pressure the belly and front end cheaper. However, there will also be episodes when the market moves to re-price Fed expectations as long end yields consolidate. While we think the front end of the curve maintains a fairly stable directional relationship with outright yield movements, the directionality of long end curves like **5s/30s** is likely to flip-flop in the first half of next year.

Late-cycle equity rally extensions come in all shapes and sizes

S&P 500 Index

Our last two equity year-ahead outlooks forecasted major transitions. In our 2015 Outlook, we thought the 2012-2014 impulsive trend to higher prices was about to give way to a much more volatile and range bound environment. That was driven by the traditional technical signals from Elliott wave count, momentum, market internals, and the proximity to key resistance parameters. It was also derived from the idea that the Fed was on the verge of abandoning ZIRP, and when looking back at the three times since 1980 when the Fed first moved to normalize rates following a recession, the **S&P 500 Index** traded in a nearly year-long broad and volatile range (Figure 4). While those corrections, which ranged in amplitude from 9% to 15%, provided support for a forecast that favored a meaningful departure from the bullish environment that kept the **VIX Index** mostly below **20** for more than two years, it also bolstered our preferred Elliott wave count that looked for a period of consolidation, but not the end of the broader bull trend that started with the **666** Mar 2009 bottom (Figure 5). The emergence from that multi-month holding pattern was the major theme from our 2016 Outlook.

Figure 4: So far, the S&P 500 Index performance surrounding the initial Fed hike following a recession is consistent with the prior occurrences since 1980

S&P 500 Index, monthly bars (log scale)

Source: J.P. Morgan, CQG

Figure 5: The S&P 500 Index is emerging from a multi-month consolidation pattern as an Elliott 5th wave starts to unfold. Our preferred count suggests that the current trend is a late-cycle rally extension, but one that can last for a while

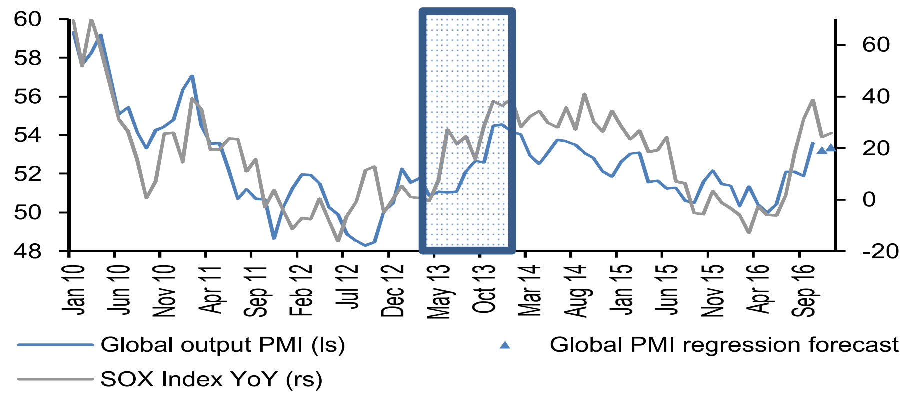
S&P 500 Index, weekly bars

Source: J.P. Morgan, CQG

We have managed a bullish medium to longer-term outlook ever since the **S&P 500 Index** held longer-term support in February, triggered a number of bullish signals across quantitative momentum and sentiment models we have developed, and then pushed above **1,850**. While similar Fed tightening induced consolidation patterns in 1983, 1994, and 2004 occurred early in those rally structures, we suspect that the 2017 and potentially 2018 price action will have more similarities to later-cycle behavior, similar to 1986, 1999, and 2006. **Since late-cycle rally dynamics tend to vary, we intend to maintain a bullish outlook and suggested positioning as long as the market keeps a positive trend structure. We think the index can extend to 2,240 by late-2016/early-2017, and then go on to accelerate to longer-term objectives in the mid-2,400s by late-2017/early-2018.** We will use those pattern derived targets as guideposts and not get stubbornly dug into an outlook one way or the other. The policy uncertainty surrounding the new administration in Washington raises the tail-risk on both ends of the spectrum further. That dynamic is ultimately what inspired this publication's title: *Same view, wider berth.* Our base-case technical outlook for the **S&P 500 Index** already implicitly leans on the idea that the market is underpricing economic growth potential for the next few quarters. If we are correct, that discovery cycle should lead to a more linear rally for the overall market into the first half of 2017. We think that process is already underway, as cyclically sensitive sectors and groups have already started to re-price and have led the improved manufacturing data realized over the past couple of months (Figure 6).

Figure 6: Strong cyclically sensitive equity index performance in the early-summer helped forecast improved manufacturing data in the late summer....

Philadelphia Semiconductor Index YoY (2m lead) and Global output PMI



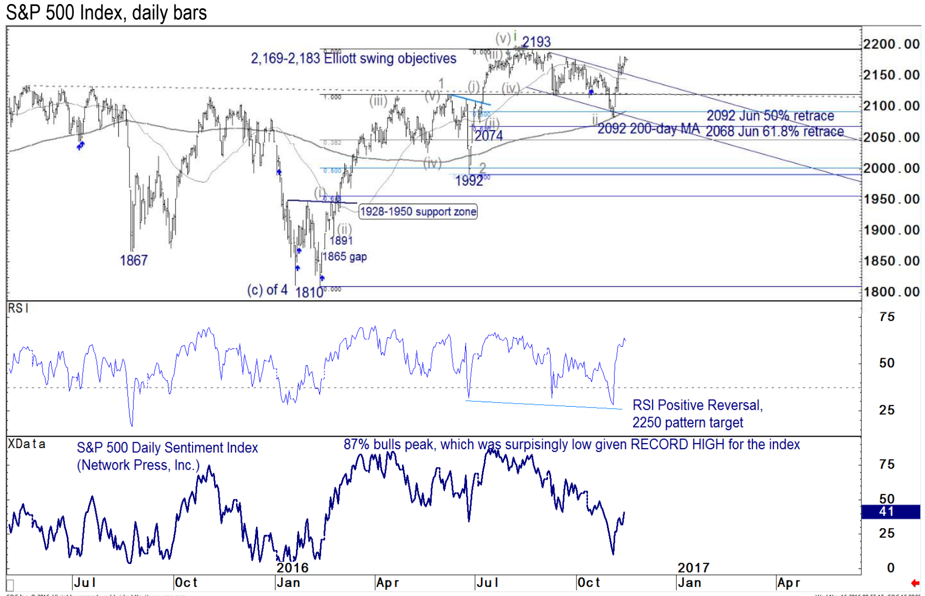
Source: J.P. Morgan, MARKIT

One change in our outlook that we have to be open to following the surprise election outcome is that volatility may not come down as much as we had originally thought. As a result, the rally into next year may not be as linear relative to our original thinking pre-election. In either outcome, we expect the price structure and Elliott wave count of the 2016-2017 rally to present a smaller version of the 2012-2014 structure (Figure 5).

Leaving policy uncertainty aside and just looking at the technical setup on its own merit, we continue to see plenty of reasons to maintain bullish positions in favor of an acceleration to higher prices. From a pure price pattern perspective, the summer extension of the 2016 rally took the index through key resistance that rests just above **2,100**. While the price action surrounding the election whipsawed that inflection, the pullback from the **2,193** Aug record peak had a corrective wave structure, held key support levels during NY trading hours, and drove sentiment to oversold levels quickly (Figure 7).

Figure 7: The medium-term outlook for the S&P 500 Index stays firmly in gear as long as the index is trading above key support layered between 2,060 and 2,120

S&P 500 Index, daily bars

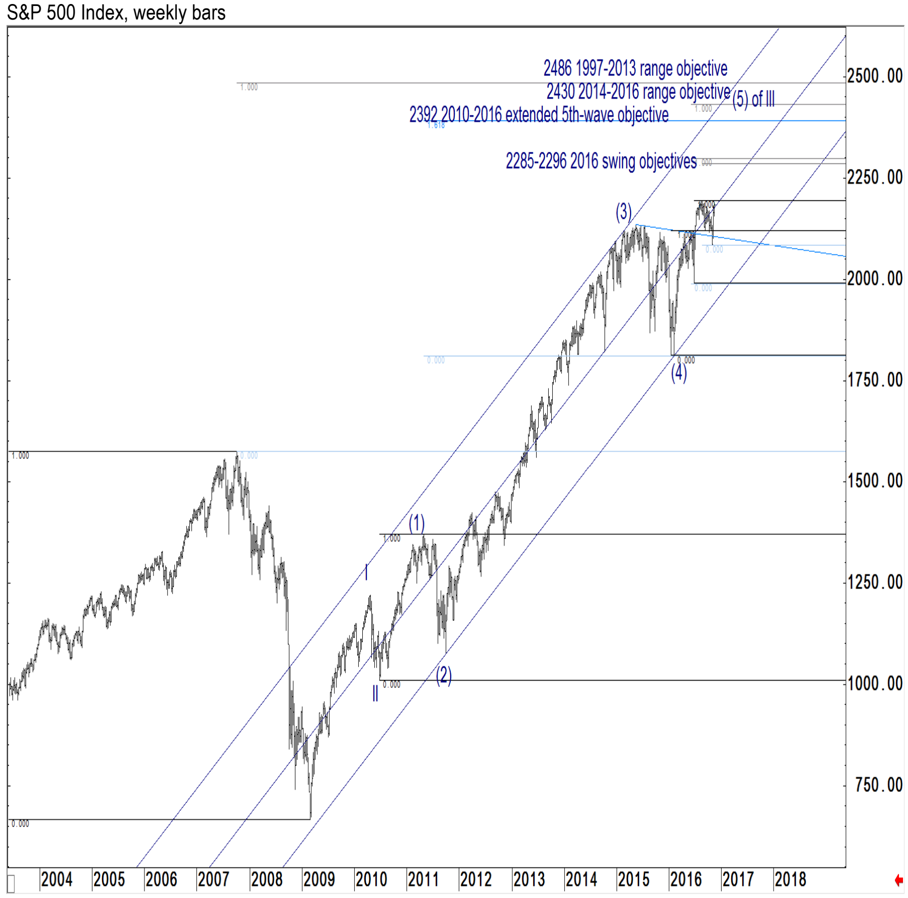


Source: J.P. Morgan, CQG

In our view, the bullish medium-term outlook stays firmly in gear as long as the market is trading above key support parameters layered between **2,060** and **2,120**. That zone includes the 2015 range highs, pre-election Sep-Oct range lows, Jun 2016 Fibonacci retracement levels, and rising 200-day MA (Figure 7). While breaks below that support would not immediately invalidate the bullish Elliott wave count presented in Figure 24, it would put the market on a slippery slope where bearish momentum could build quickly and hard earned gains accumulated since the first quarter of 2016 can disappear. We continue to suggest keeping stops for the bulk of long exposure just below that support zone. In an unfortunate event like the UK-vote whipsaw of equivalent levels in June, we would rather be in a place where we needed to chase strength to reposition than stubbornly keep ourselves for an outlook under threat. Below **2,060**, next support rests at the **2,046** Feb 38.2%, retrace, then **1,992-2,002** Feb 50% retrace/Jun trough, and **1,928-1,956** Feb 61.8% retrace/1Q16 base pattern breakout.

Figure 8: Next overhead resistance beyond 2,240 rests at 2,285-2,296, then 2,392, followed by 2,430-2,486 longer-term pattern targets. We see that latter as potential objectives for late-2017/early-2018

S&P 500 Index, weekly bars



Source: J.P. Morgan, CQG

On the upside, breaks through the **2,240** 2010-2016 extended Elliott 5th-wave objective and Feb-Jun 2016 .618 swing target would seek the next set of 2016 equal swings objectives at **2,285-2,296** (Figure 8). Longer-term resistance comes in at another extended Elliott 5th-wave target (**2,392**), followed by the 1997-2013 and 2014-2016 range objectives at **2,430-2,486**. The longer-term channel that confines this entire bull cycle also trends through the **2,400s** for much of 2017. Assuming we see the anticipated transition to an accelerated rally early in the year, we view that resistance area as a potential target zone for late-2017/early-2018.

Russell 2000 Index

Despite the general trend of **Russell 2000 Index** outperformance versus the S&P 500 Index, small caps came under significant pressure in the weeks leading up to the US Presidential election (Figure 9). That weakness saw the **Russell 2000** break Jul-Oct pattern support and a key longer-term chart inflection near **1,200** and accelerate lower to the short-term distribution pattern target and 200-day MA (Figure 10). The post-election rebound from **1,156** whipsawed the **1,200** inflection and quickly took the index to a new all-time high. With that, the relative performance ratio surged, and quickly extended the 2016 trend to retrace more than two thirds of the entire 2014-2015 underperformance trend. **We anticipate the Russell 2000 Index rally to extend into 2017, and small caps to continue to outperform large caps over that period.** Initial resistance for the index rests at **1,330-1,335**, potential targets for late-4Q16/early-1Q17 (Figure 10).

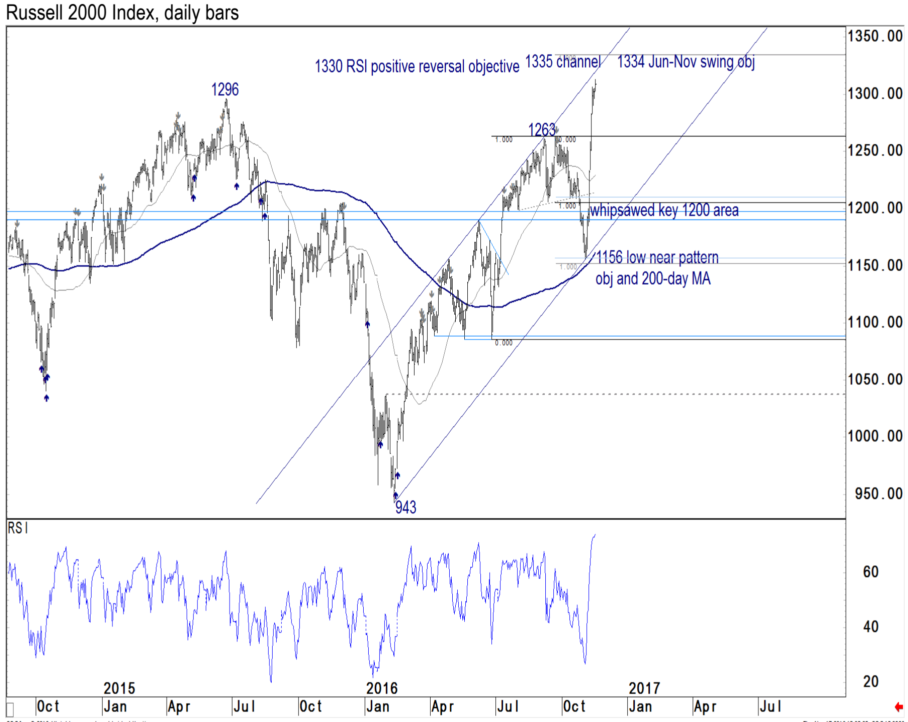
Figure 9: While there have been some material hiccups within the trend, the Russell 2000 has outperformed the S&P 500 Index since the Feb bottom. That trend has also pushed through a key chart inflection

Russell 2000 Index /S&P 500 Index ratio, daily closes

Source: J.P. Morgan, CQG

Figure 10: The Russell 2000 rebound from the 200-day MA extends to a new high, leaving 1,330-1,335 and 1,380 as the next resistance zone. The medium-term tone stays positive while above the 1,200 inflection

Russell 2000 Index, daily bars



Source: J.P. Morgan, CQG

Figure 11: The Russell 2000 Index has a similar Elliott count as the S&P 500. The next Elliott 5th-wave objective comes in at 1,380, with longer-term channel resistance near 1,500 and again near 1,600

Russell 2000 Index , weekly bars

Source: J.P. Morgan, CQG

Bigger picture and similar to our interpretation of the longer-term rally structure for the S&P 500 Index, we believe the **Russell 2000** is entering the acceleration phase of an Elliott 5th-wave advance (Figure 11). As noted above, we are hesitant to assign forecast levels where we would suggest to exit long equity index exposure in bull market environments, because the longevity and shapes of those rallies are ultimately dictated by the success or failures of late-cycle macro dynamics to take hold. That said, as a potential marker to watch through 2017, we highlight longer-term channel resistance on the Log scale weekly chart in Figure 11. There are two variations of that channel, one near **1,500** and one near **1,600** in the early months of next year. If we see a distribution pattern and other bearish technical signaling develop near that resistance next year, that could mark the end of this leg of the broader rally. However, there is a lot that would need to occur before we would entertain that idea. For now, the positive trending dynamics and absence of euphoric sentiment conditions favor managing bullish exposure with trailed stop-loss strategies. For the **Russell 2000** we suggest keeping the bulk of those stop levels below the **1,200** inflection for now and the balance below the **1,156** Nov trough. A move below there would invalidate the most bullish Elliott wave rally structure. If the rally accelerates to noted resistance above **1,300**, it would make sense to look at the **1,263** summer peak as a meaningful interim support area.

NASDAQ 100 Index

While the Technology Sector and the **NASDAQ 100 Index** did not participate in the immediate rally after the US election, it did hold the key support we had been monitoring throughout the typically weak Sep-Oct period and in the days surrounding the election. In our view, that keeps the broader bull trend intact. Over that period, the index held the first layer of medium-term support that includes the **4,629** Jun 38.2% retrace and **4,574** Apr 19 high. The next layer comes in at **4,460-4,500**, a zone we view as critical to the health of our broader bullish outlook (Figure 12). That includes the early-July pattern breakout zone, a confluence of Fibonacci retracement levels, and Feb 2016 channel support. As long as that support stays intact, we maintain the view that the **NASDAQ 100** is set to extend the longer-term bull trend that started with the **1,019** Nov 2008 bottom.

Figure 12: The NASDAQ 100 Index has underperformed since the election, but keeps a positive medium and longer-term outlook while above key support at 4,460-4,500

NASDAQ 100 Index, daily bars

Source: J.P. Morgan, CQG

Figure 13: Upside breakouts would first seek 5,038. There is a large confluence of objectives at 5,280-5,409

NASDAQ 100 Index, weekly bars

Source: J.P. Morgan, CQG

Similar to the other headline indices covered in this outlook, we think the market is in the latter waves of a longer-term trend, but one that can extend for a considerable period of time before maturing and running out of steam. For the **NASDAQ 100**, a break to new highs would first seek the **5,038** Elliott 5^{th}-wave target that extends from the most recent leg of the rally from the **3,889** Feb 2016 trough. We view the **5,250-5,409** confluence of swing objectives and other technical levels as a reasonable target zone for next year (Figure 12).

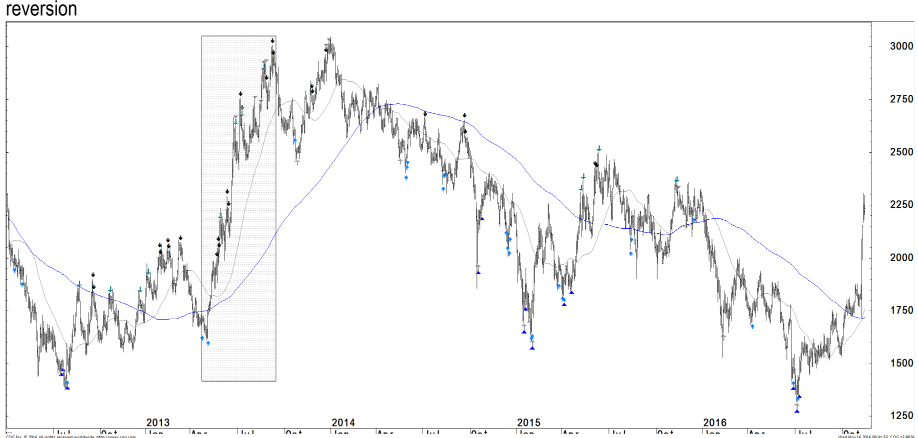
Higher rates with a split yield curve

Can the second half of 2016 yield rise turn into something bigger? We think it can

As we sit down to write this outlook, most points on the Treasury curve are trading through our anticipated fourth quarter target zones, levels thought unattainable by many just a few months ago. At this point, the rate backups from the belly through the long end match any of the medium-term trends that have developed following the 2013 taper tantrum. Multiple short-term indicators have swung from the extreme overbought readings registered in the early summer to extreme oversold territory. And as a strategy group, we are on the third or fourth set of bearish tactical trade suggestions meant to leverage what has been a medium-term bearish outlook held since the transition into the second half of the year. At some point between the time we first start writing this outlook and the time it is published, we imagine a set of short-term quantitative buy signals will trigger, the inverse of which caused us to adopt our bearish medium-term view in the first place. As a result, we have covered all but a small portion of our core short exposure in the front end, and will be on the lookout for tactical bullish trading opportunities further out on the curve once we see the noted signals trigger. Beyond just the tactical risk management and positioning, we are left to decide if Treasuries will remain in the bullishly skewed range environment that has defined the past three years, or if a more material transition to a bearish trend has taken place. If the former, the signaling that will likely come soon would provide an ideal entry into a bullish medium-term outlook favoring a significant retracement of the Jul-Nov selloff. However, in the latter scenario, the market is likely to see tactical bullish reactions to the referenced oversold condition and quantitative signals, but those retracements would be relatively shallow and short-lived. The last time that dynamic unfolded was during the summer of 2013, what is now referred to as the taper tantrum (Figure 14).

Figure 14: In aggressive trending environments, the market tends to show limited reaction to the tactical quantitative signals we have developed that forecast an increased probability for mean-reversion. The last time we saw that type of behavior was the summer

10-year note yield with algorithmic signals (blue and gray arrows) that forecast increased probability for mean reversion

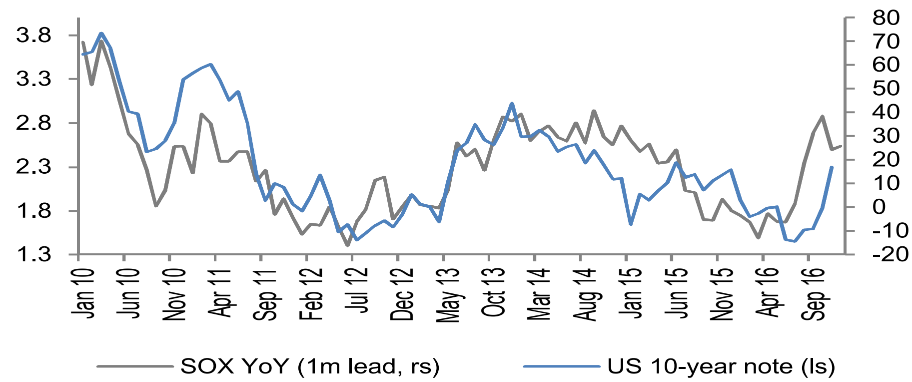


Source: J.P. Morgan, CQG

We believe the underlying technical dynamics favor the bearish outcome, and an eventual extension of the broader yield rise into next year. Not only do the lower-frequency weekly and monthly momentum model setups bolster that view, but the long end has not been able to bullishly respond in a material way to the higher frequency bullish signaling that has developed over the past several weeks for that point on the curve. That dynamic is more typical of emerging bear trends, a concept that gained more credibility as the 30-year bond then accelerated to higher yields and blew through our already aggressive fourth-quarter bear targets.

Furthermore, what started largely as a position driven mean-reversion trend following the post-BREXIT vote blow off to lower yields in June, acquired fundamental teeth at about the same time the lower frequency momentum models started to turn negative. In the summer we had forecasted an upside breakout for high beta and cyclically sensitive equity indices. While that forecast was purely a technical thesis derived from the price pattern and shifting momentum, once that move occurred, it provided a decent macro indicator that we felt would feed through into interest rates as the summer unfolded (Figure 6 and Figure 15). We have found the **Philadelphia Semiconductor Index (SOX Index)** YoY performance to be a good leading indicator for **Global output PMI**. Intuitively that makes sense, as semiconductors are largely a commoditized business where inventory and supply chain management provide a decent real-time indicator of current and projected economic activity. Since the underlying equity performance represents constant real-time channel checks by the investment community, it makes sense that the equity performance tends to lead the fundamental data releases with the highest correlation when shifted forward two months. That two month lead accounts for the time lag between the survey observation period and PMI data release.

Figure 15: Improved cyclically sensitive equity index performance also provided a fundamental input to join bearish technicals and drive Treasury yields higher. The recent SOX Index performance forecasts elevated PMI readings and yield levels into year-end
10-year note yield and Global output PMI



Source: J.P. Morgan

The **SOX Index** posted solid YoY performance over the past two months even though it has pulled back from the peak growth realized in September. The regression forecast model, which spans back to just after the financial crisis and shows a 0.6 r-square, projects the next two **Global output PMI** readings near current levels. Furthermore, even if the **SOX Index** does not rally further from current levels through the first quarter of 2017, the relatively easy year-ago comparisons would imply robust **PMI** readings over that period. As far as Treasury yields are concerned, even with the post-election spike to higher yields, the **10-year note** move toward **2.35%** still leaves some residual gap to the strong summer equity performance. The relationship between yields and the **SOX Index** YoY performance is not as tight as the **PMI** model, but on its own, that dynamic suggests that an aggressive and sustained retracement of the second half Treasury selloff is unlikely.

Lastly, the taper tantrum period, which marks the last time the Treasury market saw only muted reactions to the quantitative buy signals discussed above, also corresponded with the last time there was a material and lasting improvement in global manufacturing data. We do not think it is a coincidence that the market is showing signs of a similar signaling dynamic as manufacturing data follows equity performance higher.

30-year bond

While the long end struggled to keep up with the initial yield rise in the early-summer after the **30-year bond** set a **2.085%** Jul 11 record yield low, it stepped out to take the lead in September. Since then, each of the sharp trends to higher yields in early-Sep, early-Oct, and right after the Nov election steepened the back end of the Treasury curve. As the market coiled between Jul and Aug, the monthly momentum measure gave a new diverging sell signal, which is systematically indicated in Figure 16. While not a perfect indicator, historically, the market trended to higher yields in the months following the signal more often than not. As a low frequency signal, we suspect that momentum will help keep the market under pressure into the first half of 2017. Furthermore, as the bond stair stepped to higher yields, first hitting our **2.50%** initial target in October, and then extending further into early-Nov, we suspected it was carving out an Elliott count progression that fit within the context of an emerging longer-term bear trend (Figure 17). The fact that tactical momentum and position quantified signals failed to produce lasting rebounds also gave credibility to that view (Figure 18). In our development of those mean reversion signals, we have found it common for that dynamic to unfold early in an emerging trend, before the acceleration phase takes hold. Lastly, the post-election acceleration of the trend, through our already aggressive **2.75-2.775%** fourth quarter target zone confirmed our suspicion.

Figure 16: Longer-term momentum models gave bearish signaling soon after the market bearishly reversed from the 2.085% record yield low this summer. The bond has gone on to break the first of three longer-term trend lines

30-year bond yield, monthly bars; %

Source: J.P. Morgan, CQG

Figure 17: The bond is approaching three potential support layers at 3.04-3.045%, 3.12-3.14%, and 3.18-3.27%. We expect the lower zone to contain the market initially, then a choppy move to the higher layers into mid-2017

30-year bond yield, weekly bars; %

Source: J.P. Morgan, CQG

In our view, the yield rise that has taken the bond to **3.00%** marks the acceleration phase of the trend, which corresponds with the acceleration of the Elliott wave-3 on the weekly chart in Figure 8. The extreme oversold position, momentum, and sentiment metrics achieved with that move will eventually result in a new set of quantitative buy signals as soon as the bearish momentum fades on a tactical basis. Look for the resulting backing and filling that could unfold near the **3.04%** Jul 2012-Jul 2016 .618 swing objective, **3.045%** Dec 2013 50% retrace, **3.12%** Feb 2015-Jun 2016 equal swings target, and **3.14%** Nov 2015 yield high to eventually give way to an extension to higher yields into midyear (Figure 17). **Ultimately, that relatively choppy price action in relation to the straight-line move that followed the election would count out the Elliott wave-4s and wave-5s to decelerate the broader move and pave the way for a more material consolidation pattern or bullish trend reversal. Before that happens, we think the bond can stretch as far as the 3.255% Jun 2015 yield high and 3.27% Dec 2013 61.8% retrace.** Longer-term support parameters come in at **3.64%**, where the current selloff would equal the scope of the 2012-2013 trend, followed by the **3.78%** Apr 1997 monthly trend line (Figure 16), and **4.00%** Dec 2013 yield high.

Figure 18: The recent acceleration to higher yields despite repeated bullish tactical signals bolsters the idea that Treasuries are in an emerging longer-term bear trend

30-year bond yield, daily bars; %

Source: J.P. Morgan, CQG

Violated 1H16 range support now marks the first layer of resistance, near **2.75%**. The current bear trend for the bond stays firmly in gear while cheaper than the **2.63-2.64%** post-election breakdown. Secondary, and key medium-term resistance comes in at the **2.45-2.50%** Oct-Nov pattern yield lows, which currently corresponds with the 50-day MA and 200-day MA. Breaks richer than there would derail the bearish momentum associated with the longer-term trend, leaving the **2.26%** late-Sep yield low as the next meaningful resistance layer.

10-year note

Our outlook for the **10-year note** is driven by the same momentum setup and price pattern/Elliott count as the bond. While the **10-year note** failed to trigger the same tactical buy signals over the past several weeks as the bond has, this recent acceleration through **2.00%** has driven metrics like our *TY dollar-weighted Put/Call ratio* into oversold territory for the first time since Dec 2013, which ultimately positions that indicator to trigger a buy signal as soon as price action starts to decelerate (Figure 19). That setup and other oversold sentiment and position metrics like the aggregated US FI CFTC non-commercial futures position data raise the probability for mean reversion, which can see the market settle into a range at higher yield levels. We suspect that range can unfold near the **2.24%** Feb-Oct 2016 pattern objective, **2.30-2.34%** 2011 trend line, and **2.35%** Jun 2012-Jun 2016 .618 swing objective (Figure 20).

Figure 19: The 10-year note can settle into a range after the post-election blow-off move, but keeps a bearish trending bias while cheaper than 1.88% and the 1.70-1.72% area
10-year note yield, daily bars; %

Source: J.P. Morgan, CQG

Look for an interim holding pattern near those support parameters to make way for an eventual break to the next layer of support objectives in the first half of 2017. That includes the 2.38% Nov 2015 cheap, 2.40% Dec 2013 61.8% retrace, and 2.50% Jun 2015 yield high (Figure 20). Also note the Apr 2010 trend line, which rests at **2.555%** in Dec, **2.50%** in Mar, and **2.445%** in Jun (Figure 21). Longer-term channel support, which has contained each of the **10-year note** cycles since the mid-1990s, rests at **3.25%** in Dec, **3.22%** in Mar, and falls to **3.16%** by Jun (Figure 21). The latter isn't too far away from the **3.05%** Dec 2013 yield high.

Figure 20: We view the 2.38-2.50% area as a probable target zone for yield rises in the first half of 2017
10-year note yield, weekly bars; %

Source: J.P. Morgan, CQG

Figure 21: The 10-year note broke two longer-term trend lines on the monthly chart after triggering a bearishly diverging sell signal. That unfolded after the slight break to a 1.318% new all-time yield low

10-year note yield, monthly bars; %

Source: J.P. Morgan, CQG

Near-term resistance rests at the **2.00%** violated 2013 trend line (Figure 19), then **1.88%** post-elective breakdown. Similar to the bond, the **10-year note** has key medium-term resistance at the **1.70-1.72%** Oct-Nov yield lows, 50-day MA, and 200-day MA. Closes richer than that inflection would derail the bearish medium-term trend momentum. Secondary resistance parameters through there are clustered at the **1.51-1.53%** Sep-Oct yield lows.

5-year note

Even though the **5-year note** yield rise initially lagged points further out on the curve after the election, the belly of the curve quickly caught up and surpassed our ideal target zone for the fourth quarter, which included the **1.425%** May cheap, **1.47%** Jun-Sep equal swings objective, and **1.535%** Mar yield high (Figure 22). A yield rise from the **0.895%** Jun-Jul double yield lows to that target zone would have also matched the five other material backups that have unfolded since the 2013 taper tantrum. Despite that overshoot, we suspect that the deep oversold conditions achieved in Nov will lead to a period of consolidation within a developing bear market. The first layer of resistance rests at the violated **1.53%** and **1.425%** pivots noted above. As long as the retracement rallies within that holding pattern do not surpass the **1.35-1.37%** post-election breakdown, the broader bear trend stays firmly in gear. More significant resistance comes in at **1.20-1.24%**, which marks the Oct-Nov range riches (minus the election night whipsaw), 50-day MA, and 200-day MA.

Figure 22: There are three primary resistance zones we are focused on for the 5-year note, 1.535-1.56%, 1.425%, 1.35-1.37%

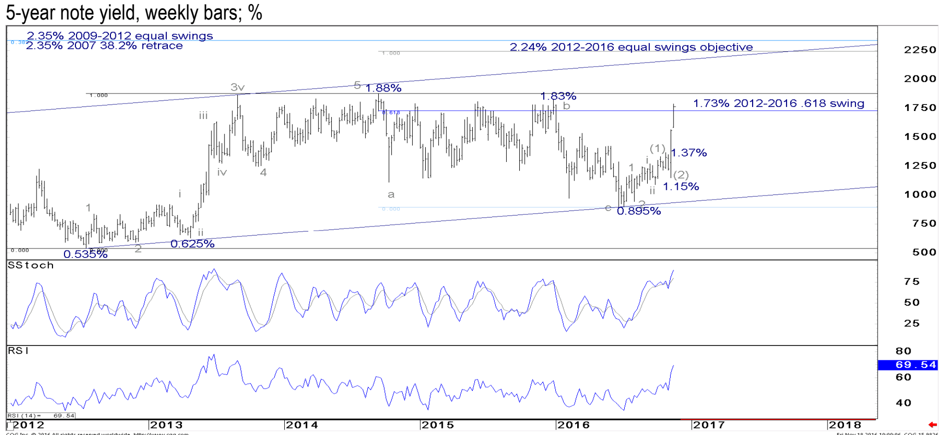
5-year note yield, daily bars; %

Source: J.P. Morgan, CQG

Look for the 1.81-1.88% 2013-2016 range cheaps to stay under bearish pressure in the first half of next year (Figure 23).

Figure 23: Look for the 5-year note to threaten the 1.81-1.88% 2013-2016 range cheaps in the first half of 2017, with longer-term support parameters at 2.24-2.43%

5-year note yield, weekly bars; %



Source: J.P. Morgan, CQG

Potential longer-term implications of the mid-2016 reversal to higher yields

Bigger picture, the **5-year note** could be carving out a multi-year bearish reversal pattern (Figure 24). The "neckline" for that pattern currently sits between **1.65%** and **1.70%** depending on how it is drawn. In our base-case scenario, the market will confirm a violation of that support in the first half of next year. Initial longer-term bear targets are clustered at **2.24-2.35%** (Figure 23). The reversal pattern itself has a measured move objective at near **3.50%**. More than anything else, that broader pattern provides background information and a qualitative input into our higher frequency decision making. That bearish longer-term pattern currently lines up with the bearishly shifting longer-term momentum models for all points on the curve, the long end's inability to stage a material rebound over the past several weeks despite bullish short-term signaling, and the unfolding bearish Elliott wave structure. In our view, we will need to see a decisive and sustained break through noted pattern support, and even after to some degree, the mentioned characteristics will need to repeatedly reinforce the bearish implications of the longer-term pattern for us to have confidence that the Treasury market is reversing the bull trend since 2007, and potentially the secular trend that is more than thirty years old.

Figure 24: Longer-term, the 5-year note is potentially carving out a multi-year bearish reversal pattern on the monthly chart

5-year note yield, monthly bars; %

Source: J.P. Morgan, CQG

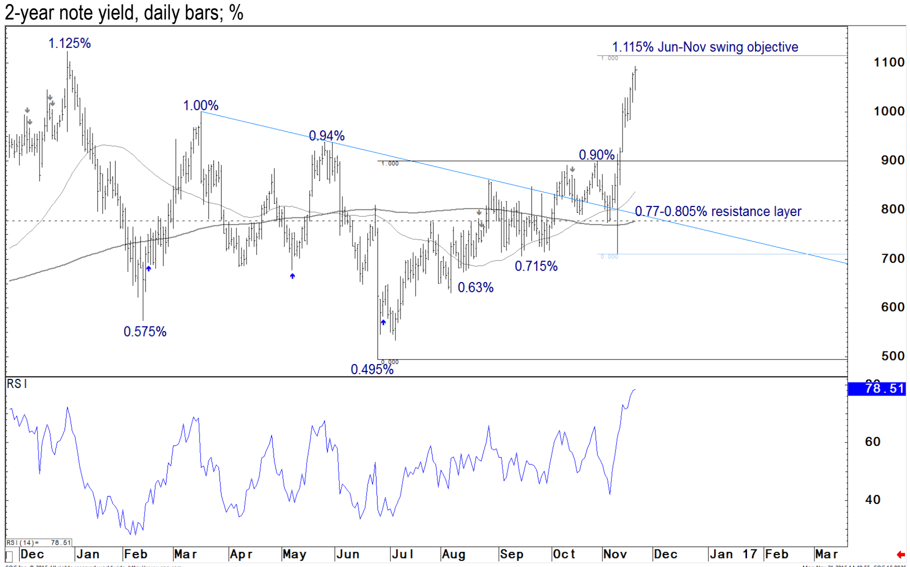
2-year note

As the **2-year note** emerged from the QE/ZIRP abyss in 2014 and even more so in 2015, the front end began to trade like a "real" market again. While still trading at very low yield levels, the pickup in volatility over that period made forecasting via tools like momentum and pattern recognition more feasible. Our view heading into the fourth quarter has remained consistent despite the whipsaws related to central bank meetings and the election; as long as the **2-year note** is trading cheaper than **0.715-0.725%** Aug-Sep yield lows, we anticipate continued bearish pressure and the potential for the trend to extend to the **1.125%** Dec 2015 cheap (Figure 25). While we think the front end can continue to play catchup into year end, following the large moves already realized further out on the curve, we also expect the broader yield rise to consolidate for a period of time, especially if that move entails a backup to the more extreme levels mentioned.

Into mid-2017, we think the bear trend at the front end will extend to other support parameters including the 1.22% Dec 2009 cheap, 1.24% Mar 2008 yield low, and 1.27% Jun 2008 38.2% retrace (Figure 26). Longer-term objectives rest at the **1.40%** 2011-2014 equal swings objective and **1.445%** Jun 2009 yield high. Given our yield targets for the belly and long end, those secondary levels for the **2-year note** are possible, but at this point we would not make a move into that zone our base-case scenario.

Figure 25: The 2-year note cheapened through 0.94-1.00% initial fourth quarter targets and is extending toward the 1.125% Dec 2015 yield high

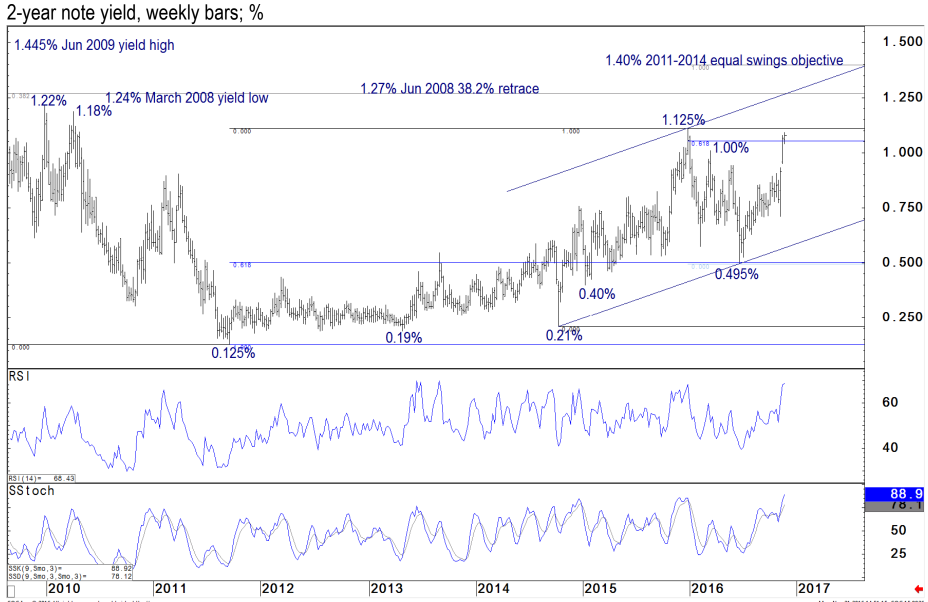
2-year note yield, daily bars; %



Source: J.P. Morgan, CQG

Figure 26: There is a medium-term support confluence at 1.22-1.27% with longer-term bearish objectives at 1.40-1.445%

2-year note yield, weekly bars; %



Source: J.P. Morgan, CQG

Conversely, despite the post-election whipsaw, we still view the **0.77-0.805%** inflection as a key threshold, as it includes the Mar-May 2016 internal trend line, 50-day MA, and 200-day MA. A move through **0.70%** would derail the bearish medium-term trend momentum, leaving the **0.63%** Aug rich and **0.495%** Jun yield bottom as longer-term resistance parameters.

Treasury Curve: Look for the belly to split the Treasury curve for most of the first half

2s/5s curve

While the long end acceleration to higher yields has led the Treasury market since September, the shifting volatility profile in front-end yield curves after the election is perhaps the most striking change in rates markets behavior. While the Jun-Oct **2s/5s curve** steepening directionally followed yields higher over that period, the price action lacked an impulsive character. By that we mean the bull flattening retracements within that trend overlapped much of the preceding steepening moves, and in many cases were more violent than the steepening trends as well. What started out as a grind to steeper curve levels accelerated in a material way after the election. In fact, in the week following the election, the curve covered almost twice as much ground as the steepening over the four months preceding it. That acceleration through the **43-47bp** local range resistance parameters and **54.5bp** Apr 2016 high put the market right on top of the first major zone of medium-term resistance (Figure 27). That includes the **66bp** Sep 2014 trend line, **67.5-70.5bp** 2015 range breakdown, and **73bp** Dec 2013 38.2% retrace.

Figure 27: There are three primary target zones where we would look for a pattern that suggests bear steepening can potentially transition to bear flattening: 66-73bp, 83-85bp, and 98-99bp. Our base-case outlook doesn't look for that transition early in 2017

2s/5s curve, daily closes; bp

Source: J.P. Morgan, CQG

We suspect this particular leg of the broader steepening trend will decelerate as it gets into that area, which would likely lead to a flattening retracement. There may be some bear flattening that occurs, particularly near FOMC meetings and/or economic data releases that may alter the odds for imminent Fed moves, but we think the broader directionality of bear steepening/bull flattening will persist through most of the first half of next year. Near-term support for the curve rests at the **54.5bp** Apr 2016 pivot, with more significant medium-term support at the **43-47bp** breakout acceleration. Secondary resistance comes in at the **83-85bp** 2010 38.2% retrace, 2013 50% retrace, Nov 2015 high, followed by another confluence of levels at **98-99bp**. That includes the 2013 61.8% retrace, 2010 50% retrace, and 2013-2014 pattern breakdown area. Ultimately, we suspect that a mostly bear steepening trend will eventually transition to a bear flattening trend at some point next year, more likely in the second half. We will be looking for a broader reversal pattern to setup near either of those two secondary resistance levels to suggest that transition is unfolding. Conversely, to lower levels, the **34bp** Jul low held key longer-term support at the **33bp** Jul 2012 multi-year range lows.

EDH7/EDH9 curve

The uptick in volatility and directional beta shift versus points further out on the curve is even more at the very front end of the Eurodollar curve. After grinding higher from a **29bp** Jul trough to **39bp** by late-Oct, the **EDH7/EDH9 curve** exploded higher and quickly closed in on the **78.5bp** Jul 2015-Jun 2016 equal swings objective. Similar to the **2s/5s curve**, the whites-greens Eurodollar calendar spread has key confluence of resistance parameters overhead.

Figure 28: : We think the initial whites-greens Eurodollar curve steepening will stall at the 78.5-88bp resistance zone, but expect it to extend to the 105.5-112bp resistance zone by mid-year
EDH7/EDH9 curve, daily closes; bp

Source: J.P. Morgan, CQG

That swing target marks the first zone, along with the **85.5bp** Nov 2013 38.2% retrace and **85.5-88bp** late-2015 top pattern. Look for this initial impulse to steeper levels to decelerate as it gets into that resistance, and potentially see a period of consolidation into early-2017. Ultimately, we anticipate an eventual extension to the second resistance confluence at **105.5-112bp** in the first half of next year. We have been expressing our view on the very front end of the curve with an **EDH7/EDH8** suggested trade strategy. At this point we have taken profits on a good portion of that position. Our game plan is to use corrective flattening moves to scale back into full exposure. Given the explosive nature of this last leg, we will need to first see where the move completes, then what the new volatility profile looks like before we can identify potential re-entry levels. For the **EDH7/EDH9 curve**, the **31.5-39bp** base pattern breakouts mark the first notable medium-term support confluence at the moment. We are not expecting a retracement to get close to those parameters, rendering them next to useless from a strategy perspective.

5s/30s curve

Following the **5s/30s curve** break through **128-129bp** Sep-Oct range resistance, the curve saw a post-election acceleration of the trend that started at the **103.5bp** Aug 31 low through to the next layer of resistance that includes the **141bp** May high, **141.5bp** Aug-Sep equal swing objective, and **144.5bp** Feb high (Figure 29). Ultimately, that move ended with a failure at those levels and rapid retracement of the steepening, as the belly caught up to the long end backup, and the bond started to mean revert. Look for more of the same in the first half of next year, as the curve continues to trade in a choppy range above longer-term support near **100bp** and below longer-term range resistance at **150-156.5bp**. Beyond the sharp swings we are anticipating for next year, we also do not think there will be a clear and consistent directional correlation to outright yields movement. The initial steepening from the late-Aug low accompanied a narrative of shifting DM central bank policy, and then was followed by an acceleration of improving manufacturing data and a surprise US election result. The second two factors drove growth and inflation expectations, which initially had a larger impact on the long end. We suspected that that type of acceleration in the long end would eventually dislodge Fed expectations and cause the belly to play catchup. The post-election beta shift confirmed that view. Ultimately, we think the first half of 2017 will present a case where the **5s/30s curve** is torn between the push and pull of shifting growth/inflation expectations and guesses about the FOMC's reaction function.

From a strategy perspective, that leaves us with the same approach for this curve that we have presented in our research for the past several weeks. As the curve will be difficult to forecast within the anticipated volatile range, we will look for clear reversal patterns near support and resistance levels toward the extremes of the expected range.

Figure 29: The 5s/30s curve has two primary zones of resistance for early-2017. The first is 141-144.5bp, with longer-term range resistance at 150-156.5bp. Look for a volatile range in the first half of the year and flip-flopping directional correlation

5s/30s curve, daily closes; bp

Source: J.P. Morgan, CQG

On the downside, sustained closes below **128bp** leave **122-124bp** and **115-116bp** as the next support areas. Longer-term support remains clustered at **100-103.5bp**. At some point a bear flattening trend will eventually break that support, but that is more likely in the latter half of 2017.

10-year TIPS breakevens

Even more so than long-end nominal yields, inflation markets blew through our fourth quarter spread widening objectives. In the case of **10-year TIPS breakevens** we had thought the early-Oct break through summer base pattern resistance at **152-155bp** would lead to a fourth quarter widening to the **172.5bp** Apr high, **175bp** longer-term channel trend line, and **176bp** 2012 38.2% retrace. From there, we thought the spread would consolidate, but that would unfold within a developing longer-term widening trend. In hindsight, we were right about the longer-term trend, but completely underestimated the market's potential to widen this quarter. The post-election acceleration put the spread right on top of the next major zone of levels that include the **190bp** Feb-Jun equal swings objective, **193bp** 2012 50% retrace, **193bp** Jun 2013 low, and **195bp** Apr 2015 peak (Figure 30).

Figure 30: 10-year TIPS breakevens quickly surged to the 193-196bp resistance zone after exceeding 172-176bp. The latter becomes key support. Look for widening above 200bp in 2017

10-year TIPS breakevens, weekly bars (daily closing data); bp

Source: J.P. Morgan, CQG

We think the spread will decelerate in that area over the near term and form a consolidation pattern. However, it is important to note that breakevens are now trading above the upper end of a year-long base pattern and multi-year channel trend line. In our view, the current acceleration higher confirms our long-standing outlook that breakevens were set to resume the longer-term widening trend that started with the **0bp** 2008 trough. That view stays intact as long as the spread holds above the **165-175bp** inflection. On the upside, we think the spread can test **211-213bp** resistance parameters in the first half of 2017, with the potential to extend as far as the **228-230bp** 2013-2014 range highs

Global Commodities

2017 Outlook

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Post-election euphoria, reflation re-frames 2017 commodities price trajectory (*Scott C. Speaker*)

J.P. Morgan Commodities Research approached 2016 with generally tepid expectations for prices broadly as efficiencies in several of the upstream industries extended further despite an ongoing process of price-driven supply/demand rationalization. As we approach 2017, much of that rationalization has already occurred and we find ourselves more broadly constructive in the near term despite event-driven risks that have already injected significant premiums into several of the markets within the sector.

Oil: No good deed goes unpunished (*David Martin*)

Oil markets stand on the cusp of a bifurcation in price action, driven by the success, or failure, of OPEC to reach an agreement at the end of November. Our base case outlook is that there is a 60% chance of a successful OPEC meeting, which will tighten oil markets next year. Our modal view is for end-2017 Brent and WTI prices to reach \$60/bbl and \$58/bbl, respectively.

Natural Gas: Outside of this ark, all is deluge *(Scott C. Speaker, Shikha Chaturvedi)*

We have been consistently pointing toward a tight supply/demand balance in the North American natural gas market and remained unbowed despite a mild November that has only partially damaged the supportive 2017 narrative. Given that the natural gas market solves “problems” with price, the trajectory in the second half of 2017 and into 2018 is highly dependent on the heights that prices will reach in the first and second quarters.

Base & Precious Metals: After major rebasing, can DM markets carry the momentum in 2017? (*Natasha Kaneva, Gregory C. Shearer*)

A major re-basing in metals prices took place during the last month as the reflation trend extends on post-Trump hopes of growth. We keep our 2017 aluminum price unchanged, lift our copper, nickel, and zinc forecasts, and trim our gold and silver price outlooks. In general, for us to become outright bullish, we would prefer to see higher global (rather than just US) growth, a weaker US dollar, and inflow of passive (rather than just fast) money into the space. The main downside risks to our more constructive view for base metals in 2017 is that China usually trumps the US as far as industrial metals are concerned, and Chinese policy once again is expected to sway from growth to rebalancing.

Agriculture: Strong consumption to eat into agri commodities stocks through 2017 (*Tracey Allen*)

Agri commodity futures are expected to receive considerable support from outside markets through 2017—notably from the reflationary environment, stronger economic growth and rising crude oil prices. However, US dollar strength is the notable headwind that will likely weigh on the complex. From a fundamental point of view, we enter 2017 with record-high grains & oilseed stocks—despite record strong consumption. Soft commodity balance sheets are still working through the impacts of El Niño–related production constraints in 2016 and remain in drawdown mode.

Commodities Technicals ***(Niall O'Connor, Thomas Anthonj)***

The reversal from the early-2016 lows for Crude raises the risk that a sustained medium-term recovery can develop; still, the potential for additional range action suggests a challenging short-term setup. The setback from the mid-summer highs in Precious Metals, however, suggests that the accumulation phase of the new up-trend is complete, which bears an extended setback risk. Apart from Zinc, which plays technically in a league of its own and more in line with Precious Metals, we still see a fairly high risk for the other Base Metals to revisit their 2015/2016 lows.

Commodities Derivatives ***(Arindam Sandilya, Matthias Bouquet)***

Crude vol should remain trapped between tightening balances on the one hand and policy uncertainty plus dollar strength on the other. Realized vol will likely clock in the low to mid 30s, consistent with $50-60 oil, pegging Brent M3 ATM vol around 40%. The US election rattled Metals markets, but the dislocations in vols, skews, and correlations should correct as the knee-jerk reaction gives away to a reappraisal of the impact of US fiscal and trade policies.

Commodities Index Forecasts (*Gregory C. Shearer*)

We now foresee the S&P GSCI ER index strengthening strongly into year-end (+5%) on gains in energy before returning nearly 2% in 2017. We also look for the BCOM ER Index to strengthen into year-end (+3%) before weakening by -3% in 2017 as forecasted softness in metals prices is more acute given the relatively higher weights.

Trade Recommendations (*Scott C. Speaker*)

In **oil** we recommend going long the Brent Dec'17 $60/bbl call and short the $45 put, long the Dec'17 Brent – WTI spread, and long the Mar'17-Dec'17 Brent futures spread while staying long the Jun'17 Brent 55-60 call spread. In **natural gas** we recommend going long the NYMEX $3.50 Feb'17 call option, long the SoCal Border Feb'17 basis, and short the UK NBP natural gas summer 2017 strip against NYMEX NG summer 2017 strip. In **metals** we recommend going long Mar'17 LME Zinc. In **agriculture** we recommend going long ICE Dec'17 #2 Cotton, long CBOT Jul'17 Kansas Wheat vs Chicago Wheat, and long the May'17 ICE #11 Sugar 20.5-23.0 call spread. In **technicals** we see an opportunity to get long gold and silver if prices dip towards $1,135/oz and $15.50/oz, respectively. In **derivatives strategy** we recommend going long the Brent Jun'17 51-57 1*2 call spread and selling Brent Mar'17 straddles vs buying WTI Mar'17 straddles, delta-hedged while staying long Mar'17 Brent ATM straddles vs short Jun'17 ATM straddles, vega-neutral (1:0.75 notionals) and short the Feb'17 Copper 25D call (strike 6300).

Post-mortem on 2016 forecasts and trade recommendations (*Scott C. Speaker*)

Among the underlying sectors, natural gas trades generally had the highest success rate and oil spread trades saw a success rate of 71%. Reflecting the more tactical nature of trades in the high-volatility natural gas market, the average holding period of the 10 outright closed fundamental trades declined from 19 days to eight days year over year.

Cross-sector Outlook

J.P. Morgan Commodities Research approached 2016 with generally tepid expectations for prices broadly as efficiencies in several of the upstream industries extended further despite an ongoing process of price-driven supply/demand rationalization. As we approach 2017, much of that rationalization has already occurred and we find ourselves more broadly constructive in the near-term despite event-driven risks that have already injected significant premiums into several of the markets within the sector.

Ironically, our expectations in late-2015 for commodities price formation in 2016 were primarily driven by the individual fundamentals of each product within the energy, metals, and agricultural space, while our expectations for 2017 are being largely driven by ancillary conditions or events that will influence multiple commodities markets as well as those others, foreign exchange (FX) and rates, to name two, that have their own influence on commodities. The timing of the US presidential and congressional elections and the magnitude of price moves in its wake are likely having an outsized impact on market participant and observer psychology, but such is the nature of transcendent potential shifts in US trade and monetary policy.

One could certainly argue that results in 2016 were a mixed bag relative to our expectations, as the themes we identified in late-2015 largely played out while timing remained elusive. We expected the theme of producers “doing more with less” to be dominant across oil, natural gas, and industrial metals and expected several specific events to help shape market psychology and demand-side development – from the Iran nuclear agreement to the advent of LNG exports from the US lower-48 states, but could be accused of underestimating the influence of Chinese monetary policy on certain markets and OPEC’s willingness to test the fortitude of higher cost structure oil producers.

In the coming year, we can likely expect a similar level of volatility around events such as the upcoming OPEC Ministerial meeting and several key European elections, as well as improving GDP growth expectations in both EM and DM, FX shifts changing product export competitiveness, reflationary governmental policies, and headlines regarding US President-elect Donald Trump’s cabinet choices and policy priorities. The OPEC meeting, which could frame price formation for the entirety of calendar 2017, will be an influence on several other commodities markets in varying degrees as agricultural markets, global and North American natural gas markets, and, to a lesser extent, certain metals markets feel the impact of shifts in oil and oil product prices.

One proxy for the commodities markets broadly, the Bloomberg Commodity Index (BCOM), which is comprised of roughly 31% energy, 35% grains/softs/livestock, and 33% industrial/base metals, is trading generally flat to year-ago levels, but took an exceedingly volatile path over the past 12 months to get there. It bottomed just under 73 in late-January 2016 and reached just less than 90 in June before bouncing around in the third quarter to reach its level of around 83 currently. A tightening crude balance, should OPEC agree on an output deal and global demand-side growth meet expectations, could largely provide a trajectory for that index in 2017, given that WTI and Brent combined comprise 15% of the index.

In terms of individual commodity views within the total basket, there are seasonal, operational, and infrastructure-driven components to several of the markets that force deviation from the gently rising price path expected for crude oil across the calendar year. Some of the quarterly price expectations for agricultural products and North American natural gas are assumptions regarding industry reactions to higher prices in earlier quarters, and the fading copper price in the second half of 2017 is a function of supply-side influences amid slow but steady demand growth.

Aerospace and Defense

Still Tactical in Aero; a Pivotal Year for Defense

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Bloomberg **JPMA SEIFMAN** <GO>

B/E Aerospace	NR
Boeing Company	N
Bombardier	N
General Dynamics Corp.	N
Harris Corporation	OW
L-3 Communications	OW
Lockheed Martin	N
Northrop Grumman	N
Raytheon	OW
Rockwell Collins	NR
Spirit AeroSystems	OW
Textron	OW
TransDigm Group Inc	N
Triumph Group	N

We maintain a tactical view on commercial aero in light of slower orders and a modest deterioration in fundamentals, albeit to levels that are still solid, including 1) mid-single digit traffic growth, 2) an ~80% load factor, 3) profitable airlines, and 4) readily available financing. Cycle concerns mean aero stocks have seen relative de-rating and in our view, this situation presents trading opportunities when stocks are lower in their ranges. Big backlogs should support production plans but a recession would still drive a downturn and this is a risk. Another is that rising rates impair emerging market carriers' financing options but we see no sign of this yet. For defense, the election raises budget expectations and this seems reasonable to us, though the magnitude of any increase is TBD, as are the specifics. We will learn more during 2017 but stocks have already moved and the lag between budgets and spending means it will be 2018-19 before the new administration can affect defense P&Ls materially. Business jet demand remains weak but tax cuts and higher government spending could accelerate growth, resulting in some relief.

Stocks for Every Strategy

Growth – Textron (TXT/$45.78/Overweight)
A pickup in US growth, should it occur, would likely benefit Cessna bizjet demand since the unit focuses on small/mid-sized jets sold to domestically-oriented companies. Demand has been depressed for years and a pickup would support sales, margins, and most immediately, valuation, in our view. We also see potential for Bell Helicopter to grow earnings again, following the oil and gas driven route in this end market.

Value – Spirit AeroSystems (SPR/$58.12/Overweight)
Sentiment has improved in recent months but the stock still trades at a 2017 P/E of ~12x, reflecting concerns about the cycle and negotiations with BA. The stock offers upside even if the discount remains with potential for outperformance if it narrows. Cash flow drivers include 737 and A350, partially offset by 777.

Income Oriented – Boeing (BA/$149.74/Neutral)
BA has returned ~10% of its market cap to shareholders via dividends and buybacks each of the past two years and we see potential for cash flow growth in the years ahead with management apparently committed to its capital deployment strategy.

★ **Market Neutral – L-3 Communications (LLL/$154.99/Overweight) vs. Northrop Grumman (NOC/$247.59/Neutral)**
LLL has the highest free cash flow yield in our defense group at 7.5%, or ~300 bps above NOC, which has the lowest. While we believe NOC should trade at a premium we see potential for it to narrow as LLL has already reset expectations for its 2017 and could be a nearer-term beneficiary of incremental short cycle defense spending. NOC, meanwhile, has more long cycle exposure so it should take more time for higher spending to show up in numbers. In addition, January will bring NOC's first guidance for 2017 and we believe it may be conservative, which could create a headwind for a stock that is at an all-time high after rising 13% the past month vs +2% for the market.

Airfreight & Surface Transportation

US Rails Positioned Well for Tax Policy Reform, Long Awaited Volume Inflection

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C.H. Robinson	UW
Canadian National Railway	N
Canadian Pacific Railway	N
CSX	OW
Echo Global	OW
Heartland Express	UW
Kansas City Southern	OW
Knight Transportation	UW
Norfolk Southern	N
Ryder System, Inc.	N
Swift Transportation Company	N
Union Pacific	N
Werner Enterprises	N
XPO Logistics	OW

Although the process of sorting through which campaign promises become policy will continue into 2017, we view the US railroads as the primary beneficiaries of potential corporate tax reform, while infrastructure stimulus and pro-coal policies would provide minimal benefit to rail volumes. Tax reform appears to be a high priority of the Republicans who importantly can utilize the reconciliation process to avoid a filibuster. A stronger US$ and concerns of trade protectionism are worth monitoring but the prospect of improving volumes and lower taxes favor the US rails, of which we prefer CSX versus NSC and UNP.

Our top pick is Underweight C.H. Robinson (CHRW), which we believe faces further margin compression in the current cycle, increased competition from the entrance of Uber into freight brokerage, and negative fund flows from a style rotation away from low-volatility stocks. The company would benefit from potential tax reform as well but faces more challenging fundamental and technical headwinds in 2017.

Stocks for Every Strategy

Growth – XPO Logistics (XPO/$45.55/Overweight)

XPO ($52 PT) is a beneficiary of secular tailwinds from growth in e-commerce and outsourced logistics. After material growth from two large acquisitions in 2015, XPO is now focused on cross-selling their broad portfolio of transport services and cutting costs from the more recent Con-way acquisition to drive organic EBITDA growth. In addition, reduced integration costs, less cash interest expense, and lower capex should lead to 2017E FCF doubling vs. 2016E.

Value – CSX (CSX/$34.93/Overweight)

CSX ($35 PT) is taking strides to improve efficiency by reducing head count, rationalizing the declining coal network, and improving asset utilization; as the second least efficient operator among peers there is significant scope for improvement and we expect clear delineation of their “CSX of Tomorrow” strategy early in 2017. CSX would also be a primary beneficiary of US corporate tax reform, which could drive EPS estimates 20-30% higher in 2018. We expect CSX can command a premium to the historical average justified by the improving network and potential upside to favorable corporate tax reform.

★ **Short Idea – C.H. Robinson Worldwide (CHRW/$74.12/Underweight)**

CHRW ($63 PT) achieved cycle peak margins in 1Q16 and has exhibited few offsets to an extended period of negative N.A. truckload fundamentals, which at first had led to an unusual period of margin expansion and volume share gains. However, as strongly C.H.-favorable contracts reset, normalizing to depressed industry levels, the company experienced negative price growth that more than offset increased volumes. CHRW historically underperforms after cycle margins peak and we do not expect a tighter truckload market and wider broker spreads until 2018.

EE/MI

More "Hope and Change"; Valuation Reflects Optimism

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3M	N
Atkore	N
Dover	N
Emerson Electric Co.	N
Fortive Corp.	N
General Electric Co.	UW
HD Supply	N
Honeywell	OW
Hubbell Inc.	N
Ingersoll Rand	OW
Lennox International	N
Pentair PLC	N
Rockwell Automation	UW
Roper Technologies	N
TriMas	OW
United Technologies	N
WABCO	N
Watsco	N
Wesco International	N

We see a mixed fundamental backdrop, juxtaposed against elevated stock valuations. Following an eventful 3Q earnings season, 2017 EPS estimates have been revised down by 2-3% on average, with organic sales revised down by ~100bps, and we currently forecast MSD EPS growth for the group next year. Stocks initially reacted negatively, but multiples subsequently expanded with the new source of hope the election, which at face value is positive assuming that leadership is actually successful in getting things done, though there is likely increased uncertainty near term as the money gets sorted, a risk for guidance/1H results. Bottom line, we feel worse fundamentally, not better, and multiples having expanded materially on lower numbers despite higher interest rates show an unfavorable skew of expectations.

Stocks for Every Strategy

Growth – Ingersoll-Rand (IR/$75.58/Overweight)

This year's result has raised the prospect that IR is an improved franchise, and our deep dive into the businesses shows there is something different here with operational excellence feeding into franchise vitality. We expect a confident tone from this coming spring investor day, at which we expect three-year targets that should conservatively point to 10%+ EPS growth and ~$7 in FCF per share, with potential upside from capital allocation. The stock still seems cheap today at a 20% weighted discount, and with increased confidence in next year's trajectory, we think the stock should continue to re-rate.

★ **Income Oriented – Honeywell (HON/$113.83/Overweight)**

Near-term fundamentals are soft, in line with the group's, but organic growth and margins should improve in '17, and there are several non-fundamental levers to get to DD EPS growth. HON stands out as one of the best positioned to take advantage of a potential repatriation holiday in the new gov't, with ~7% of the market cap possibly freed up. This is in addition to balance sheet optionality in the $20-25B range, showing above-average capital deployment potential, a key upside lever (or support mechanism in a more negative scenario). The stock trades at an across-the-board discount on most valuation metrics, and we think it deserves a premium.

Short Idea – General Electric (GE/$31.34/Underweight)

We see material risk to earnings coupled with weak cash flow conversion and below-average balance sheet optionality. The stock is trading at a 40% premium vs the group on FCF and a 5% premium on a weighted basis. Risk-reward is also unfavorable at current levels vs the group showing a weighted downside of ~15-20% vs the group average of down 5-10%.

Market Neutral – Dover (DOV/$72.25/Neutral) vs. Emerson (EMR/$55.05/Neutral)

Both DOV and EMR have the highest oil & gas exposure to the group at ~35% and ~30%, respectively. However, DOV is more levered to recovering US onshore oil & gas at ~10-15% of revs vs EMR's greater exposure to later-cycle offshore and downstream/midstream capex (~25% combined). Further, we see more relative downside risks to standing FY17 consensus at EMR vs DOV. On top of this, DOV screens amongst the cheapest stocks in our coverage at ~15% weighted discount vs. EMR currently trading at a ~5% premium. Both DOV and EMR generate strong FCF, but even on this front DOV is trading at a ~20% discount vs. EMR at parity.

Machinery

Post-Election Valuations Look Stretched; 2017 Fundamental Outlook Unchanged

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Actuant Corp	UW
AGCO Corp.	UW
Allison Transmission Holdings	N
Archer-Daniels-Midland	UW
Bunge Limited	N
Caterpillar Inc.	N
CNH Industrial	UW
Cummins Inc	N
Deere & Co.	UW
Eaton Corp.	N
Illinois Tool Works	N
Joy Global	N
Kennametal Inc.	N
Manitowoc Co.	N
Milacron	N
Navistar Int'l	N
Oshkosh Corp.	OW
PACCAR Inc.	UW
Parker Hannifin	N
Terex Corp	N

The Machinery sector has outperformed the S&P 500 in 2016 YTD and is up 9.0% since the US presidential elections on the premise that a $1 trillion infrastructure bill will be implemented in the near term. However, we caution that it will take time to develop a bill, to secure funding to pay for such a bill and to prioritize and implement suitable projects. At best, the impact on the Machinery space is likely to show up in sales by late 2018, in our view. On the other hand, it seems highly probable that the US dollar will remain stronger, especially vs. emerging market currencies (mainly the Brazilian real and the Mexican peso), and thus we would expect the US agriculture industry to suffer disproportionally as we go through 2017 and beyond. Beyond these catalysts, the group should outperform the S&P 500 if GDP accelerates, but will likely underperform if interest rates rise on higher inflation (wage inflation in particular).

Stocks for Every Strategy

Growth – Cummins Inc (CMI/$140.80/Neutral)

Cummins (CMI) is trading at a 17.9x P/E multiple on 2017E earnings, which looks cheap relative to its machinery peers (21.7x P/E); if 2017 were to signal the trough of the truck cycle, a ~20x P/E may be warranted. Incremental emissions standard changes in emerging markets and Europe for on and/or off-highway equipment should provide revenue growth for CMI in 2018 and beyond. Additionally, as part of its consent decree, VW is required to fund a $2.7 billion environmental mitigation trust to support retrofitting and replacing old commercial vehicles; this could be a material tailwind for CMI's Distribution business from 2017 to 2019. Offsetting these positives, there is a risk that NA truck continues to decline into 2018 and/or CMI loses market share more rapidly to vertically integrated OEMs. As such, while we remain Neutral, we would buy the stock opportunistically on any macro-related pullback.

Value – Eaton Corp (ETN/$66.49/Neutral)

Eaton (ETN), trading at 15.1x 2017 EPS, appears to be the best value in our coverage as the overall group is trading at 21.7x on 2017 estimates. The company has 25% of its sales leveraged to US construction (mostly non-residential) and should benefit if construction activity picks up into 2018. That said, there is a risk that US non-residential construction is at a peak and rising interest rates could weigh on new construction activity. Although we remain Neutral, we would buy the stock opportunistically on any macro-related pullback.

★ **Short Idea – Archer-Daniels-Midland Co (ADM/$43.25/Underweight)**

Our Underweight rating is predicated on the potential impact of a Trump administration on US agriculture, most notably from a stronger US dollar. Additionally, any disruption to trade with key partners (especially Mexico) would have an outsized impact on the US agricultural economy, in our view, especially for major exporters such as ADM (Mexico is the third largest export market for US agriculture and the largest export market for US corn). Furthermore, uncertainty over the future of the EPA and renewable fuels policy may undermine ADM's strategic options with regards to its ethanol dry mill assets (which are currently under review); similarly, uncertainty around the volume requirements for biodiesel in 2018 and expiring tax credits in 2016 may weigh on demand for soybean oil and therefore crush margins in 2017.

Shipping

Recovery in Product Tankers Expected in 2017; Dry Bulk Looking Interesting

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Ardmore Shipping	OW
Costamare	OW
DHT Holdings	N
Diana Shipping	N
Dorian LPG	OW
Euronav	N
GasLog	UW
GasLog Partners	N
Golden Ocean	UW
Navios Maritime Acquisition	OW
Navios Maritime Holdings	N
Navios Maritime Midstream Partners	N
Navios Maritime Partners	OW
Scorpio Bulkers	OW
Scorpio Tankers	OW
Seaspan	UW
Star Bulk Carriers	OW
Teekay LNG	OW
Teekay Tankers	N
Tsakos Energy Navigation	OW

Crude tankers: We expect the rate environment to continue to deteriorate over the course of 2017 as supply growth peaks. On the demand side, we look for a fall off in Chinese stockpiling to drag on demand growth. However, optional upside could occur in the event of heavy floating storage. Depending on the course of new vessel ordering, H2/17 could be an opportunistic time to re-invest in the sector.

Product tankers: We expect supply pressures to ease substantially in H2/17 and look for a classic supply driven shipping upcycle then. On the demand side, inventory drawdown is important to re-establish arbitrage trades and less localized voyages. Generally, **we believe the product tanker sector is the most attractive in shipping right now**.

LNG: We look for a gradually recovering market over the course of 2017 but we believe the recovery will lag market expectations. Low oil prices will continue to keep east-west arbitrage low and voyages localized.

Dry bulk: While we are increasingly bullish on the prospects for dry bulk shipping, we do think that the surge in rates experienced in Q4 will reverse in Q1 as seasonal effects end and supply growth is temporarily increased. Profit taking at these levels is prudent, with the idea to re-establish positions at lower levels later in 2017.

Containers: Container rates should stabilize in 2017 as supply growth bottoms out. Demand growth will be the chief driver of the market and we will be looking to Trump's new policies for direction. Barriers to trade could hamper global trade growth, while lower taxes/infrastructure spending could give a near-term boost to demand.

LPG: Heavy supply growth is coming to an end and we expect LPG rates to come off the bottom. Policies to stimulate US energy production could be a demand boost.

Stocks for Every Strategy

Growth – Star Bulk Shipping (SBLK/$5.30/Overweight)

Our top pick in the Dry Bulk sector given its liquidity runway, valuation discount (normalized NAV of $9.87) and low cost structure.

★ **Value – Ardmore Shipping (ASC/$6.65/Overweight)**

Our top pick in the Product Tanker sectors due to the steep discount to NAV ($9.85), modestly leveraged capital structure, high spot exposure and low cost structure.

Income Oriented – Teekay LNG (TGP/$15.05/Overweight)

We like the company's high charter coverage, which insulates it from the still troubled LNG shipping market. With the recent capital raises, we see a path to dividend normalization by the beginning of 2018.

Market Neutral – Navios Maritime Holdings (NM/1.68/Neutral) vs. Navios Maritime Acquisition (NNA/$1.66/Overweight)

Long NNA and short NM could be an attractive trade within the Navios structure given the relative valuations (NNA 2017E normalized NAV = $2.18, NM 2017E normalized NAV = ($1.64)) and the security within the intercompany loan, whereby the loan is secured by NM's entire holdings in NNA and majority state in Navios South America Logistics.

Aircraft Leasing

Leasing Fundamentals Are Still Intact, and Our Bias Is with Growth-Oriented Companies

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AerCap Holdings N.V.	OW
Air Lease Corp.	OW
Aircastle Limited	N
Alaska Air Group, Inc.	OW
American Airlines	OW
Delta Air Lines, Inc.	OW
FLY Leasing Ltd.	UW
JetBlue Airways Corp.	N
Southwest Airlines Co.	OW
Spirit Airlines	N
United Continental Holdings, Inc.	OW
Virgin America	N

Our constructive 2017 outlook for aircraft leasing is underpinned by inherently solid fundamentals: continued robust global traffic trends, record profits for many airlines (therefore improving credit metrics) and availability of low-cost capital for growth. However, we believe that the historically-low yield environment for sovereign debt has drawn excess capital in to the sector. Furthermore, there is heightened skepticism on whether OEM production rates are properly aligned with demand. We also acknowledge the robust current debate in regards to asset values, particularly for certain older "orphaned" widebody aircraft with limited engine residual value (i.e. B777-200ER, A330-200). Appraiser values on those aircraft remain aggressive, in our view; though in reality comprise a very small portion (< 5%) of the public lessor fleets. In contrast, the larger narrowbody market remains robust, in terms of both asset values and demand for next generation A320neo and B737 MAX aircraft now entering service. The continued low fuel price environment has extended the economic life of mid-life and mature aircraft but has not resulted in meaningful longer-term fleet planning changes from the airlines. This endorses the view that airline managements still seek new, fuel-efficient aircraft as a hedge against the potential for higher oil down the road and supports the global trend of aircraft upgrades. This, in turn, supports our view that the most compelling risk-to-reward for aircraft leasing stocks remains with companies that have significant growth prospects via an OEM orderbook, such as AerCap (AER, OW) and Air Lease (AL, OW). One final note on the potential for rising interest rates in 2017 – ceteris paribus, higher funding costs are a negative for the aircraft leasing industry as their net interest margin (NIM) and ROE metrics would be compressed, but investors should note that significant fixed rate debt (via swaps), improving lessor credit profiles and ratings, and the ability to index new leases with funding cost escalators, each provide insulation against higher interest rates. Our top pick is Air Lease (AL).

Stocks for Every Strategy

★ **Value – Air Lease Corp. (AL/$36.05/Overweight)**

Air Lease emerges as our top pick backed by its well-placed order book of next-generation aircraft (91% placed through 2018 and 82% through 2019) that fuels a visible growth pipeline along with an existing portfolio of high quality assets. With an owned fleet of 244 aircraft and order book of 372 aircraft, AL is the leasing name most levered to growth. The average fleet age is 3.7 years, and management has expressed a strategy of maintaining a lessor fleet that is among the most modern in order to capture the economic benefits of owning the latest technology. Air Lease also happens to be comparatively easy to model, with fewer moving parts compared to our other Overweight picks such as AER, resulting in investors gravitating towards Air Lease in an environment characterized by uncertainty. AL is trading at a premium (P/E and P/B) to the leasing space given a superior, youthful fleet composition and above-peer future growth prospects. In terms of risks, a reduction in global air traffic demand trends (particularly high growth expected in the emerging markets) would have an adverse impact on AL' s business. AL also remains highly leveraged to both funding costs and access to capital and any deterioration in the credit market could cause us to become less constructive on AL.

Airlines

2017 expected to deliver positive RASM & renewed confidence on the industry's renaissance

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AerCap Holdings N.V.	OW
Air Lease Corp.	OW
Aircastle Limited	N
Alaska Air Group, Inc.	OW
American Airlines	OW
Delta Air Lines, Inc.	OW
FLY Leasing Ltd.	UW
JetBlue Airways Corp.	N
Southwest Airlines Co.	OW
Spirit Airlines	N
United Continental Holdings, Inc.	OW
Virgin America	N

As we enter 2017, the setup for investors in the airline industry is likely better than any time since the consolidation period closed in late 2013. We acknowledge that the primary driver for equity performance is RASM, and following two years of industry RASM declines in 2015-16, we are conservatively modeling ~1% for the industry in 2017. We see the RASM inflection point being established on account of: 1) slower ASM growth, as ~2.5% capacity growth in 2017 is 100bps tighter than 2015-16; 2) continued self-help with more rational pricing, as evidenced by the nine successful fare increases taken by the industry in 2016; 3) more stable fuel prices, creating a more predictable revenue environment; 4) and lastly, easier year-over-year comparisons, acknowledging that while Atlantic yield deterioration is likely to continue, there's the potential for at least modest cyclical recovery in the Latin and Pacific regions with slight improvement domestically. To boot, there has never been a period of three consecutive years of unit revenue declines since deregulation. Taking a step back, we've long argued that "this time it's different," and the industry is sufficiently consolidated with shareholder-oriented management teams, and stronger balance sheets capable of weathering an economic downturn. Yet the equities still trade at large discounts to other high quality industrial sectors. Berkshire Hathaway recently disclosed ~$1.6 billion investment in the Big Three, an added vote of confidence from one of the world's most respected value investors after years of bias against the airlines as un-investible. Our top pick is AAL.

Stocks for Every Strategy

★ **Growth – American Airlines Group (AAL/$46.34/Overweight)**

American is our top pick in the sector, and simply put, history favors the RASM leader. Our estimated +2.1% figure in 2017 eclipses both United and Delta by >100 bps. A part of the anticipated RASM outperformance is driven by modest recovery in Latin America and healthier competitive dynamics in the DFW hub, but also the various revenue levers the company is still rolling out including de-contented basic economy in the US and an enhanced premium economy product internationally. In other words, American should not only benefit from the industry's continued demand growth and pricing and supply discipline, but also has company-specific initiatives with further upside from being able to plan consolidated schedules and fleet plans for the first time since the merger. Our 2017 estimates do reflect margin contraction on higher fuel and labor, but given the market failed to reward American for lower fuel prices, we expect that this will be taken in stride as long as RASM trends in the right direction. For 2018, we are modeling ~20% EPS growth, underpinned by a flattish fuel assumption and very modest +0.5% RASM.

Value – Delta Air Lines (DAL/$49.21/Overweight)

Delta is still the favored name among first time investors and those returning with a degree of skepticism. The combination of a well-tenured management team, a track record of operational success, and a favorable domestic hub structure all drive industry leading margins among the legacies. While we are modeling modest RASM growth of ~1% in 2017-18, the chief attraction of Delta at this point in the cycle is the predictable free cash flow ($3.5-$4.0 billion) over the next two years and the least amount of forecast risk vs. American and United. In other words, in our view, the ~9x 2017 EPS multiple is paltry for a company that is increasingly demonstrating the attributes of a high quality industrial transport.

Autos & Auto Parts

Into 2017, Prefer Low Valuation & Low Expectation Goodyear Tire and General Motors to High Valuation & High Expectation Tesla Motors

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Adient	N
American Axle	NR
Autoliv Inc.	N
BorgWarner Inc.	OW
Camping World	N
Cooper Tire	N
Copart, Inc.	N
Dana Inc	N
Delphi Automotive	OW
Ferrari	N
Ford Motor	OW
General Motors	OW
Gentex Corporation	N
Goodyear	OW
Harman International	NR
KAR Auction Services, Inc.	OW
Lear Corporation	N
Magna International Inc.	OW
Meritor Inc.	N
Tenneco Inc.	OW
Tesla Motors	UW
Tower International	N
Visteon Corporation	OW
Samik Chatterjee	
Gentherm	OW
Mobileye	N
Sensata	OW

The global auto industry is expected to grow less quickly in 2017, with light vehicle production forecast to rise +1.3% vs. +3.6% in 2016. This has resulted in lower valuation and lower expectations for auto stocks with broad exposure to the cycle.

Stocks for Every Strategy

★ **Value – Goodyear Tire & Rubber (GT/$31.14/Overweight)**

We see deep value in GT shares, which trade at just 5.4x, within their historical trading range of ~5.0x to ~5.5x, despite structural change which has allowed for significantly stronger margin and a substantially de-levered balance sheet. The firm has been dogged by accusations of "over-earning" amidst the low raw material price environment, which we believe investors have used as an excuse to not re-rate the stock higher despite the obvious structural improvements. However, at a recent investor day, management disclosed that of the large +740 bps improvement in its operating margin over the past five years, only +90 bps has related to lower raw material prices, with by far the largest drivers of improvement being structural factors such as cost saves (+370 bps) and a richer mix of tires sold (+290 bps). The investor day also laid out management projections for a large multi-year increase in profitability and a step-change in return of capital to shareholders. The shares are lower now than prior to the investor day, given that near-term results and outlook have tracked softer, seemingly undermining investor confidence in management's ability to achieve the out-year targets, although our analysis suggests the driver of softer near-term results (lower demand for commercial vehicle tires, partly driven by channel stocking actions ahead of imposition of final tariffs on Chinese imports) is cyclical and set to begin to reverse as early as 1H17.

Income Oriented – General Motors (GM/$34.25/Overweight)

GM trades at just 2.7x NTM EBITDAPO, a discount to the low-end of our sense of its normalized historical trading range of roughly 3.0x to 4.0x, despite significant structural improvements in the North American automotive industry and the company, which in our view argue for a premium to history. Auto parts suppliers, for example, trade at premiums to history (6.2x NTM EBITDAP vs. 5.3x long-run average), in part given the improvements at OEMs such as General Motors, which have made for a structurally healthier and more profitable industry for all market participants. We note GM also sports a 4.4% dividend yield, making it attractive to income oriented investors, and yields 13.2% free cash flow to equity, on our 2017 estimates. GM has another ~$4.0 bn remaining on a repurchase program management intends to complete by 2017-end, equating to 8% of shares outstanding.

Short Idea – Tesla Motors (TSLA/$196.65/Underweight)

Even after a recent decline, we believe Tesla shares are overvalued. We see a high probability of a dilutive capital raise to support aggressive capacity expansion and other long-term investments, and regard the recently approved Solar City transaction as potentially contributing to Tesla's already large and ongoing cash burn while also serving as a management distraction. Meanwhile, the company will face several milestones in 2017 relative to launch of the Model 3 mass-market car (e.g., volume targets, start of production dates, etc.), which we believe will be difficult for the company to meet. We also believe that competition for electric vehicles will increase in 2017 even as the regulatory environment in the United States (Tesla's largest market) may become less of a tailwind.

Food Producers

Though Rising Rates Present a Headwind, We See Opportunities (Particularly KHC)

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Bloomberg **JPMA GOLDMAN** <GO>

Ken Goldman	
Blue Buffalo Pet Products, Inc.	OW
Campbell Soup Co.	N
Conagra Brands Inc	OW
Dean Foods Co.	N
General Mills, Inc.	N
Hain Celestial Group, Inc.	OW
Hershey Co.	N
J.M. Smucker Co.	OW
Kellogg Co.	N
Kraft Heinz Co.	OW
Kroger Co.	OW
McCormick & Co., Inc.	UW
Mead Johnson Nutrition Co.	N
Mondelēz International, Inc.	OW
Sanderson Farms, Inc.	N
Sprouts Farmers Market, Inc.	N
Tyson Foods	N
WhiteWave Foods Co.	N
Whole Foods Market, Inc.	N
Joshua A Levine	
TreeHouse Foods Inc.	OW
Thomas Palmer, CFA	
Darling Ingredients Inc.	OW

Though the higher interest rates provide a headwind to the entire group, certain stocks present idiosyncratic opportunities. We see further M&A and cost cutting driving better-than-expected EPS for KHC, our tope pick. We think the risk/reward for THS is turning favorable given poor sentiment. And we remain comfortable with our outlook on MKC, that the valuation is not necessarily justified.

Stocks for Every Strategy

★ **Income Oriented – Kraft Heinz (KHC/$82.44/Overweight)**

KHC, our top pick, offers among the highest dividend yields in our food coverage (2.9% today vs. median 2.3%). Given the company's stated goal to cut waste and expand cash flow, we think dividends will remain a healthy part of the strategy, even after the next deal. Few companies we cover are as committed to cash flow and dividends as KHC, and with rates rising, fewer and fewer consumer staples companies have yields above the 10-year (KHC is an exception).

Value – TreeHouse (THS/$69.18/Overweight)

Given recent reductions in estimates due to merger integration challenges, TreeHouse currently is the cheapest stock on cash in the industry, sporting an 8%+ free cash flow yield (average ~5%). Investor skepticism is likely to continue in the near term, with potentially guiding 2017E below consensus, but we think investors will be looking for improving top line trends at Private Brands as the key metric. As the company evolves its new go-to-market strategy over the next few months, we expect performance to improve. Overall, though the next quarter or two are likely to remain under pressure, we believe the upside to the stock from sales stabilization and the integration outweighs the well-established concern in the market.

Short Idea – McCormick (MKC/$91.08/Underweight)

Although we admire MKC's management team and its recently strong execution, we are Underweight the shares because we anticipate margin expansion slowing from here, Nielsen-measured takeaway has already decelerated, and we continue to view valuation as lofty. This year's estimated EBIT margin expansion of ~70 basis points (MKC's strongest in years) has been boosted by 1) low-single digit raw material inflation, 2) mix effects from the launch of organic spices, and 3) some price increases (something the company has not taken in US markets every year). MKC has already cautioned that inflation should tick up next year, and we look for lessening help from mix, as the company begins to lap the launch of organic spices. We already are seeing Nielsen numbers fade a bit, too. Trading north of 23x NTM EPS, the MKC stock trades at a 3x premium to the packaged food space, despite an estimated EPS CAGR (FY15-18E) that is below the space (8.2% vs. 9.8%).

Market Neutral – Kraft Heinz (KHC/$82.44/Overweight) vs. McCormick (MKC/$91.08 Underweight)

Both KHC and MKC are well-run companies. However, we feel that KHC's margin focus and drive to do meaningfully accretive M&A make its shares attractive. On the flip side, though MKC sports an above-average top line organic growth rate, slowing margin expansion (and thus decelerating EPS growth) along with a high relative (and absolute) multiple are likely to limit upside. Since 3G took ownership of Kraft, these two packaged food stocks have been only 41% correlated.

Gaming and Lodging

Gaming: LV and Regional Trends Stable, Wait for Macau Pullback; Lodging: Last Innings

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Belmond Ltd	N
Boyd Gaming Group	OW
Carnival Corporation	N
Chesapeake Lodging Trust	N
Choice Hotels International	N
Extended Stay America	N
FelCor Lodging Trust	N
Gaming and Leisure Properties, Inc.	OW
Hilton Worldwide	NR
Host Hotels & Resorts Inc.	UW
Hyatt Hotels Corporation	N
La Quinta Holdings	N
Las Vegas Sands Corp.	N
LaSalle Hotel Properties	N
Marriott International	OW
Melco Crown Entertainment	N
MGM Growth Properties	OW
MGM Resorts International	OW
Norwegian Cruise Line	N
Penn National	OW
Pinnacle Entertainment	OW
Red Rock Resorts	OW
Royal Caribbean Cruises	N
Ryman Hospitality Properties	N
Scientific Games Corporation	N
Sunstone Hotel Investors Inc.	N
Wyndham Worldwide	OW
Wynn Resorts	N
Dan Politzer, CFA	
Churchill Downs	N

Macau-centric gaming stocks are tough to love right now, in our view. The stocks (excluding WYNN) in the 3Q16 moved meaningfully higher on slightly better 3Q hold-adjusted top-line and EBITDA performance and overall better headline gross gaming revenue growth. Now, EBITDA expectations are higher, as are valuations (EV/EBITDA or FCF yields) that we find less than appealing, creating risk-rewards that are no better than even. Meanwhile, in the US, the LV Strip is seeing decent low-single-digit-plus net revenue growth. The group segment has been strong, gaining share of total US group spend, benefitting from perceived value and limited supply growth, generating attractive room RevPAR growth—a trend we see continuing into 2017. The LV locals market should continue to benefit from improving local macro factors (population, job, and wage growth). US regional markets have experienced mixed GGR performance as of late but FCF yields are attractive. Lastly, slots investment is not growing, and the equipment space is still tough/competitive.

Lodging fundamentals continue to be lackluster, driven by slowing corporate transient pricing/demand as well as moderating group segment demand. With the uninspiring 3Q16 earnings season now complete, forward period RevPAR and earnings expectations have come down, and we continue to expect RevPAR growth for the 4Q16 and 2017 to exhibit further slowing growth (flattish in the 4Q and low single digits next year), reflecting these demand dynamics as well as the impact of increasing supply growth, which is especially keen in top 25 MSA/gateway cities.

Stocks for Every Strategy

Value – MGM Resorts International (MGM/$28.47/Overweight)

We view MGM as a combination of self-help, share gains, and value. All in all, we continue to think MGM is the best risk-reward in gaming, given its domestic gaming focus benefitting from solid group and convention trends in LV (share gains), its margin improvement opportunity as it executes on its PGP target (2017 impact goal of $400m), attractive absolute and relative valuation, and mixed investor sentiment. Taking into account MGM's current share price levels and backing out its stakes in MGP and MGM China, the implied EV/EBITDA valuation for MGM's other assets is a relatively undemanding <8.0x on 2017E, a valuation that (1) we think is likely to change with continued PGP-related margin improvement and potentially accretive transaction activity at MGP, (2) gives little, below-peer asset value credit for Bellagio, MGM Grand, and National Harbor, which we think will go into MGP at some point in the future, and (3) an improving balance sheet/net leverage position from here.

Growth – Marriott International (MAR/$78.08/Overweight)

We like MAR for its mid-single-digit footprint growth potential and the benefits, over time, from its recently completed acquisition of Starwood (G&A leverage, accelerating capital return, Sheraton fix), which should allow it to grow attractively and above peers, which we think should offset the doldrums of the moderating lodging cycle. Even with modest RevPAR and moderating fee growth, post-HOT MAR has attractive growth with potential levers. Positive catalysts from here include asset sales (we haven't modeled), fixing the sub-100-index Sheraton brand (we are not giving any credit here), more sizable EPS accretive buybacks (we are modeling what the old, stand-alone MAR would have done, not more), and upside relating to timing/amount of G&A/cost/revenue synergies.

Homebuilding and Building Products

We Favor a Selective Approach

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Michael Rehaut	
Beazer Homes	N
Caesarstone	N
CalAtlantic Group, Inc.	OW
Century Communities	N
D.R. Horton	N
Fortune Brands Home & Security	OW
KB Home	N
Lennar	N
LGI Homes	OW
Masco Corp.	OW
MDC Holdings	UW
Meritage Homes	N
Mohawk Industries	N
NVR, Inc.	N
Owens Corning	N
Ply Gem	N
PulteGroup Inc.	OW
Stanley Black & Decker	N
Taylor Morrison Home Corp.	N
The New Home Company	N
Toll Brothers	OW
USG Corporation	N
WCI Communities	N
Whirlpool	OW
William Lyon Homes	OW
Jason A Marcus	
Armstrong World Industries	N
Beacon Roofing Supply	OW
Masonite	OW

While the housing market's current moderate rate of recovery, which we expect will continue, combined with our outlook for decelerating earnings growth and gross margin contraction for some builders, should continue to result in a somewhat more choppy and challenging backdrop for the homebuilders, at the same time, we continue to believe attractive opportunities remain within the sector as we continue to focus on builders that generally feature attractive relative value paired with an average to above fundamental outlook. As a result, we remain broadly constructive on the sector – and would particularly recommend buying on pullbacks – based on our longer term view that the housing market recovery should continue to unfold over at least the next 2-3 years. Regarding our building products names, we expect solid 3-5% repair/remodel end market growth and focus on a "bottoms up" approach that features catalyst driven ideas.

Stocks for Every Strategy

★ Growth – Fortune Brands Home & Security (FBHS/$57.08/Overweight)

While FBHS' valuation continues to lead our building products universe, at the same time, trading at roughly 18x our 2017E EPS and 12x our 2017E EBITDA, we note that both of these metrics are at or near the low end of their ranges for FBHS over the last four years, with over the last two years its forward P/E averaging roughly 20x and its forward EV/EBITDA averaging over 12x. As a result, we rate FBHS Overweight, as we believe its current valuation is reasonable if not attractive relative to its recent history, while moreover, it does not fully reflect our outlook for continued solid EPS growth and accretive reinvestment of free cash flow. Driving our outlook for FBHS' solid EPS growth is the company's strong track record of growing modestly above the market and realizing incremental margins of at least 25-30%, while we also expect the company to continue to accretively reinvest its FCF via acquisitions and share repurchase, as it has had net share repurchases of roughly $800 million since 2014 and purchased five companies with sales of roughly $850 million for over $1.0 billion since mid-2013.

Value – Whirlpool (WHR/$165.32/Overweight)

Trading at only 11.8x and 10.0x our 2016E and 2017E EPS as well as at 7.0x and 6.2x our 2016E and 2017E EBITDA, we believe WHR's valuation is attractive, representing 10-15% discounts against its 4-year averages across both P/E and EV/EBITDA. Moreover, fundamentally, we believe reasonable visibility exists for WHR achieving solid EPS growth in 2017, driven by continued cost synergies, modest volume growth, positive price/mix and incremental productivity benefits. As a result, we expect WHR to outperform its peers over the next 12 months, thereby supporting our relative Overweight rating.

Value – PulteGroup (PHM/$18.99/Overweight)

We view PHM's valuation as attractive, trading at 8.9x our 2017E EPS, which represents a roughly 10% discount to its larger-cap peers. Moreover, we estimate PHM will demonstrate above average EPS growth and ROE improvement in 2017, which should result in its valuation becoming more in-line with its peers, particularly as we expect its ROE in 2017 to be near if not at the top of its larger-cap peers (ex-NVR).

Restaurants

Supply Growth > Demand, Tight Labor and Stabilizing Commodities Make Stock Selection Important Despite Technology

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Bloomin' Brands	OW
Brinker International	OW
Chef's Warehouse	N
Chipotle Mexican Grill, Inc.	OW
Darden Restaurants	N
DineEquity Inc.	N
Domino's Pizza Inc	N
Dunkin' Brands	N
Fogo de Chão	N
McDonald's	OW
Planet Fitness	OW
Shake Shack	N
Starbucks	OW
Sysco Corporation	N
Texas Roadhouse Inc.	N
The Cheesecake Factory, Inc.	N
The Wendy's Company	N
US Foods	OW
Yum Brands	OW

We continue to see supply (unit development growth) outpace demand (employment growth), which implies negative same store traffic trends will continue throughout 2016 and perhaps 2017. Labor pressure is the industry's largest headwind and costs are expected to be less than offset by y/y COGS improvement as commodities stabilize. To partially offset these pressures, the industry is embarking on many technology initiatives, including mobile ordering & pay, customized loyalty, and delivery to reduce long-term costs and increase customer relevance.

Stocks for Every Strategy

Growth – Starbucks (SBUX/$57.59/Overweight)

We believe SBUX is on track for 4% Americas comps and ~15% EPS growth, despite comps in F16 slowing from 9% to 5%, as we see the primary driver as customized "My Starbucks Rewards" loyalty driving multi-year results. Other drivers include: 1) Mobile Order and Pay running at ~7% in September but "could very soon see up to 10% of transactions," 2) product innovation around a general focus of "premiumization," 3) day part expansion in the form of afternoon, lunch, and evening. SBUX's ~8% y/y unit growth F17E-F19E is aided by the company's various store formats: express, reserve, roastery, and drive-thru, and is matched with COGS savings and G&A leverage initiatives. We believe investors should own SBUX for its longevity of ~15% EPS growth and reasonable current C18E trading multiple.

Income Oriented – McDonald's (MCD/$120.14/Overweight)

Business in transition but has yet to optimize G&A, capex, and capital structure, all providing for a higher quality income stream (82% franchised at F15 end to 93% by F18E end and 95% long term). Recent company commentary around being a "leaner, more efficient and more nimble organization" + "working with outside advisors to thoroughly analyze our G&A" provides support for our belief that more can be done around G&A efficiency than the current ~$500m reduction guidance. Although reimages are likely to keep near-term capital spend at a level "similar to what it is today", opportunity exists F18 and out as refranchising efforts near completion, which in turn should support higher leverage. MCD trades at what we view as an attractive ~3% dividend yield and 5% yield on F18E FCF. We expect to see FCF growth outpace net income as the capex > D&A trend converges to a more equal relationship over time.

Market Neutral – Long US Foods (USFD/$23.46/Overweight) vs. Short Sysco (SYY $53.56/Neutral)

USFD seemingly has greater long-term opportunity than SYY given the operating income margin delta (3QC16 – 4.5% at SYY vs 2.4% at USFD) despite more similar than dissimilar product and customer mixes matched with superior merchandising and technology at USFD. Additionally, SYY's capital spend plan, including international M&A, is arguably more risky than USFD's deleverage + tuck-ins. Our Dec-17 price targets, both based on a 5% C18E FCF yield, imply an annualized TSR of ~21% at USFD and ~6% at SYY (target EBITDA multiples of 9.3x and 12.0x). Some degree of multiple divergence is warranted given SYY's clearly communicated cost cutting and operating income gain targets + better cash efficiency ratio (i.e., lower capex as a % of EBITDA), but the trading gap has widened too far between the two, in our view. We reiterate our Neutral rating on SYY due to valuation and low visibility on further strategic decisions.

Retailing – Broadlines & Hardlines

AAP and TSCO Positioned for Sales Growth Acceleration

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Advance Auto Parts, Inc.	OW
AutoZone, Inc.	N
Bed Bath & Beyond	N
Best Buy	N
Costco Wholesale Corporation	OW
Dick's Sporting Goods	N
Genuine Parts Company	N
GNC Holdings	N
Lowe's Companies, Inc.	N
Michaels	N
Office Depot	N
O'Reilly Automotive	N
Party City	OW
Staples	N
Target Corporation	N
The Container Store	N
The Home Depot	OW
Tractor Supply	OW
Ulta Salon, Cosmetics & Fragrance, Inc.	OW
Vitamin Shoppe, Inc	N
Wal-Mart Stores, Inc.	N
Wayfair	N
Williams-Sonoma, Inc.	OW

Our coverage is at a crossroad with widespread deceleration in sales growth over the past year and rates set to rise, which is categorically bad across our universe from a fundamental perspective. On the other hand, the majority of our companies are primarily-to-exclusively US-based, so the potential for individual and corporate tax reform is powerful (with the latter a potential 15-20% boost to stock values). All in, we favor names where one could see acceleration in same-store sales growth given the dual-impact on valuation and earnings growth. We are also on watch that housing-related stocks see pressure from sales deceleration and the recent jump in interest rates.

Stocks for Every Strategy

★ **Value – Advance Auto Parts (AAP/$171.04/Overweight)**

AAP represents the best turnaround story in one of the best sectors in retail. New CEO Tom Greco (formerly head of Pepsi's Frito Lay) is assembling a culture-changing management team with improved execution and customer-focus as top priorities. 2017 will largely be a year of reversing bad decisions and "stopping the bleeding" while early supply chain/technology initiatives take shape. In addition, management will change/simplify the metrics employees (from senior management to store managers) are measured on with strong ties to compensation. Moreover, a "normal" winter after 2016's hot summer should yield further improvement in same-store sales given AAP's sector high exposure to the northern US and the sensitivity of sales trends to extreme weather deviations. Finally, management's 500-bp margin opportunity is consistent with our view on profitability potential while we believe earnings for 2017 have largely been de-risked. At 21x PE on 2018, the stock looks "expensive" but long term earnings potential could be 2x current levels (and management is targeting a five-year plan).

Growth – Tractor Supply Company (TSCO/$75.04/Overweight)

We continue to believe that TSCO is biased to the upside given easing comparisons on record warmth a year ago, achievable to beatable guidance, positive long term company fundamentals (growth opportunity, strong management team, low AMZN risk), and macro headwinds (high oil and ag market exposure) that will ultimately turn. We also believe the 3Q call effectively took 2017 guidance risk off the table and positions for upward revisions. We are encouraged that September turned positive and the company is reacting to trends. Feedback on TSCO largely reflects the current apathetic state of retail investors with questions on the long term growth algorithm in focus. However, we expect this fickle bunch to react as comps accelerate due to the factors noted earlier. Finally, we note that TSCO's core customer could see a confidence boost from the election results and the stock fits into the 100% US focused retailer bucket, which could see dual benefits from potential tax reform (corporate and individual).

Retailing – Dept Stores & Specialty Softlines

Follow The Traffic – Selective Stance with Structural Story Focus

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Matthew R. Boss, CPA	
Abercrombie & Fitch	N
Acushnet Holdings Corp.	N
American Eagle Outfitters	N
Ascena Retail Group Inc	N
Big Lots, Inc.	N
Boot Barn	N
Burlington Stores	OW
Coach, Inc	N
CST Brands	NR
DAVIDsTEA	N
Dillard's, Inc.	UW
Dollar General Corp.	N
Dollar Tree, Inc.	OW
Foot Locker	OW
J.C. Penney Co., Inc.	N
Kohl's Corp.	N
L Brands, Inc	N
lululemon athletica inc.	OW
Macy's, Inc.	N
Michael Kors	N
Murphy USA	N
NIKE, Inc.	OW
Nordstrom, Inc.	N
Ollie's Bargain Outlet Holdings	OW
PVH Corp.	N
Ralph Lauren Corporation	N
Ross Stores	N
The Gap, Inc.	UW
TJX Companies	OW
Under Armour, Inc.	N
Urban Outfitters	N
V.F. Corporation	N
Anne Samuel	
Signet Jewelers	N

We recommend a selective approach across our Department Stores and Specialty Retail sectors focused on the combination of compounding earnings growth profiles within expanding pie segments, and multi-year sound structural stories with top and bottom line drivers in place. By segment, we continue to see growth within Off Price, Athletic, and the Dollar stores. Stock specific, we see long opportunity in Off-Price (TJX/BURL) with a widening traffic/top-line dichotomy versus the department stores and take selective exposure across Specialty Softlines with Foot Locker (FL) as the diversified portfolio approach to play the Athletic space. At the low-end, we remain selective and favor DLTR as a "self-help" multi-year integration story with drivers in place.

Stocks for Every Strategy

★ **Growth – Dollar Tree, Inc. (DLTR/$88.86/Overweight)**

OW-rated DLTR represents a self-help integration story in a growing dollar store sector with 8+ years sq ft. growth remaining (JPM saturation analysis w/ incremental 13K dollar store opportunities pointing to 40,000 total industry units in 7-8 years based on current growth rates at DG/DLTR). Importantly, mgmt remains confident in FDO EBIT margin expansion over time pointing to a 19-20% bottom-line profile in FY17/18 with $1.5B+ in annual cash flow generation by FY19 setting up a mid-teens compounding algorithm by our model.

Growth – TJX Companies (TJX/$79.43/Overweight)

OW rated TJX continues to take market share in apparel retail illustrated by the 500bp+ SSS spread versus department store peers TTM and high quality of traffic driven sales. Looking ahead, brick and mortar consolidation and E-commerce expansion stand as structural positives for Off-Price in '17/18, with underlying earnings growing double-digits, and nearly a decade of high-barriers-to-entry growth on tap by our math (Homegoods + Intl).

Growth – Burlington Stores (BURL/$89.68/Overweight)

We view OW rated BURL as a compelling mid-cap opportunity with sales/square foot almost one-third that of peers (significant productivity opportunity) and a branded cycle still in the early innings (BURL works with 4,500+ vendors vs. TJX at 16,000). Multi-year, BURL represents a retail rarity given the trio of (1) Traffic-driven SSS w/ dept store consolidation a market share accelerator, (2) Brick & Mortar square footage growth w/ 75% expansion to 1,000 store target over time (vs. 590 today), and (3) 500bps+ of EBIT margin opportunity. Bottom-line, we see 20%+ EPS growth for the next three-plus years as reasonable driven by low- to mid-single-digit SSS, mid-single-digit square footage growth, 20bps of annual margin expansion (2-3% FC hurdle), and ongoing debt deleverage.

Value – Foot Locker (FL/$74.19/Overweight)

We see OW rated FL as the diversified portfolio way to play athletic given the company's global brand diversification (NKE, Adidas, UA & Puma), market share consolidation opportunity (FINL/TSA = 50-80bps on our math), and channel agnostic Omni-channel approach. FL represents a multi-year low-double-digit earnings growth story (low-teens TRP) driven by mid-single digit SSS combined with International square footage equating to a mid-single-digit top-line algorithm. Although not assumed in our estimates today, we see growth in FL's women's concept (SIX:02/Lady FL) as a potential upside opportunity given the expanding women's athletic pie today.

Energy

Alternative Energy

Shelter from the Storm

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Paul Coster, CFA	
3D Systems Corporation	UW
8point3 Energy Partners LP	OW
Canadian Solar	OW
Cree	NR
Diebold, Incorporated	OW
Fabrinet	OW
First Solar, Inc	N
Flex Ltd	OW
Garmin Ltd.	N
GoPro, Inc.	OW
Logitech International	N
MTS Systems Corp	OW
NCR Corporation	OW
NICE Ltd	OW
Ormat Technologies	N
Plantronics Inc	N
Rambus Inc.	N
Stratasys, Ltd.	UW
SunPower Corporation	N
Synaptics Inc.	OW
TerraForm Global, Inc.	N
TerraForm Power, Inc.	N
TPI Composites	OW
Trimble Inc	N
TTM Technologies	OW
Veeco Instruments	N
Verint Systems, Inc.	OW
Zebra Technologies	OW
Mark Strouse, CFA	
Cubic Corp	N
DigitalGlobe, Inc.	N
iRobot Corporation	UW
SolarEdge Technologies	OW
TASER International Inc.	OW
Paul J Chung	
Dolby Laboratories, Inc.	N

2017 is likely to be a challenging year for Alternative Energy stocks, owing to peaking deployment activity, incrementally less favorable government policies regarding renewables, excess capacity (in solar) and deflationary expectations that influence investment activity.

Wind MW deployment activity is peaking, but overall demand should stay relatively steady and the Turbine OEMs and their suppliers should be solidly profitable throughout the year even if they are struggling for y/y growth .

By contrast, Solar MW deployment activity will probably decline, industry-wide revenues will fall, and excess manufacturing capacity will place pressure on margins. Business models and balance sheets in both the utility and the residential sectors will be under pressure.

Meanwhile YieldCo owners of wind and solar assets should continue to realize steady cash-flows, enabling delivery against dividend commitments, however rising interest rates may weigh on dividend-paying assets generally.

Generalists and risk-averse investors should therefore be looking elsewhere, that said; we believe there are a handful of stocks worth considering, including Overweight-rated TPIC and CAFD.

Our top Alt Energy stock idea for 2017 is TPIC; a growth and value idea.

Stocks for Every Strategy

★ **Growth and Value– TPI Composites (TPIC/$14.77/Overweight)**
As a supplier of composite blades to the global wind turbine industry, TPIC is benefiting from an ongoing shift toward outsourced build-to-print blade manufacturing in major wind markets, including Mexico, Turkey and China. The firm has contracts in hand that yield visibility into as much as $4.2 billion, which necessitates investment in capacity that should come on line in 2017. The stock, a recent IPO, looks undervalued so should appeal to both growth and value investors.

Income Oriented – 8Point3 Energy Partners (CAFD/$13.56/Overweight)
8Point3, a pure-play renewable energy YieldCo, is generating cash flow from a best-in-class portfolio of solar assets, and has already acquired projects from its sponsors that fund DPS growth of 12 – 15% in 2017 through early 2018. The firm is largely untouched in this time frame by a slump in the upstream solar industry, and offers investors a compelling 2017 yield of 7.8%, with growth that should mitigate the effect of rising interest rates.

Energy MLPs/Oil & Gas Transportation & Storage

Playing Offense + Defense for the Recovery – We Seek Quality with Exposure to Best Basins

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Jeremy Tonet, CFA	
AmeriGas Partners, L.P.	N
Antero Midstream Partners LP	OW
Boardwalk Pipeline Partners, LP	OW
Buckeye Partners, L.P.	N
CenterPoint Energy, Inc.	OW
Cheniere Energy Partners LP Holdings, LLC	NR
Cheniere Energy Partners, L.P.	OW
Cheniere Energy, Inc.	NR
Columbia Pipeline Partners LP	N
CONE Midstream Partners LP	N
DCP Midstream Partners, LP	N
Dominion Midstream Partners	OW
Enable Midstream Partners, LP	OW
Enbridge Energy Partners, L.P.	NR
Enbridge Inc	NR
Enbridge Income Fund Holdings	N
Energy Transfer Equity, L.P.	OW
Energy Transfer Partners, L.P.	OW
EnLink Midstream Partners, LP	N
EnLink Midstream, LLC	N
Enterprise Products Partners L.P.	OW
EQT GP Holdings, LP	N
EQT Midstream Partners, LP	OW
Ferrellgas Partners, L.P.	UW
Gibson Energy Inc.	N
Global Partners LP	N
Kinder Morgan, Inc.	OW
Macquarie Infrastructure Corporation	OW
Magellan Midstream Partners, L.P.	N
Midcoast Energy Partners, L.P.	NR
MPLX LP	OW
Noble Midstream Partners LP	OW
Nustar Energy L.P.	N
ONEOK Partners, L.P.	N
ONEOK, Inc.	UW
Pembina Pipeline Corp	OW
Phillips 66 Partners LP	OW
Plains All American Pipeline, L.P.	N
Plains GP Holdings, L.P.	N
Spectra Energy Partners, LP	NR
Sprague Resources LP	N
Suburban Propane Partners, L.P.	N
Sunoco Logistics Partners LP	OW
Targa Resources Corp.	N
TC Pipelines, LP	N
Tesoro Logistics LP	OW
The Williams Companies, Inc.	NR
TransCanada Corp	NR
Valero Energy Partners, LP	OW
VTTI Energy Partners LP	OW
Western Gas Equity Partners LP	OW
Western Gas Partners LP	OW
Williams Partners L.P.	NR
Andrew R Burd	
Archrock Partners LP	OW
Crestwood Equity Partners LP	N
CSI Compressco LP	N
PennTex Midstream Partners, LP	N
Southcross Energy Partners, L.P.	UW
Sunoco L.P.	OW
USA Compression Partners, LP	N

Regulatory environment flips to a tailwind. We view the impact of the recent US election on the sector as clearly positive. On the federal level, we see an end to the political hostage-taking of projects, such as DAPL. We expect the federal regulatory process to improve, reversing the recent trend of ever-longer review processes. Still, commodity production remains the key driver of energy infrastructure demand, and we see improving technology and higher prices supporting volume growth.

WTI recovery trajectory uncertain, but the worst clearly in the past. With the current spread to the 10-yr at 5.1% versus the 15-yr average of 3.4%, the AMZ yield of 7.5% remains attractive after improving from the oversold 8.5% yield we reported in this note last year. As most MLPs have taken their medicine (e.g., expensive equity issuances, asset sales, distribution cuts), the worst appears in the rear view window. We expect continued yield compression with operational execution and incremental B/S and coverage repair. Over time, as long as the global marginal bbl is not US unconventional, we believe that production growth will drive demand for new energy infrastructure and in turn, growth for midstream MLPs.

We recommend a balanced portfolio with offense & defense. With upside leverage to ramping producer activity, we see a favorable risk-reward proposition for select producer sponsored G&P, especially given the downside protection when sponsors step in proactively to provide support as needed. Our top picks for those levered to the low end of the cost curve and supportive sponsors include: AM (AR/Appalachia), EQM (EQT/Appalachia), NBLX (DJ/NBL), and WES/WGP (APC/Delaware). We also recommend portfolios include blue chip core holdings with defensive characteristics, scale and economically irreplaceable assets such as EPD, MIC and PPL. We recommend SXL for higher income with leverage to a broader recovery.

Stocks for Every Strategy

★ **Value – Pembina Pipeline Corporation (PPL/C$38.88/Overweight)**

The full impact of Pembina's de-risked ~$5.5bn project backlog should materialize in 2018, translating into a <13x EV/EBITDA multiple that trails peers despite PPL's >70% take-or-pay margins, accelerating dividend growth and below peer debt leverage *(defense)*. Moreover, investors get a free option on Montney producer activity, improving propane prices, and/or capturing any unsecured projects *(offense)*.

Growth – Valero Energy Partners LP (VLP/$41.52/Overweight)

VLP suffered from guilt by association in 2016, trading lower in sympathy with peers and opening a solid entry point given the competitive 2018 valuation (7.2% DCF yield vs 8.5% group avg), lower leverage (~3.0x vs ~4.2x), higher coverage (1.9x vs 1.2x) and higher growth (25% 3yr CAGR vs 11%).

Income – Sunoco Logistics Partners LP (SXL/$24.01/Overweight)

The proposed merger of ETP and SXL will create the second largest MLP after EPD, with guidance of double-digit distribution growth with >1.0x coverage over the near term. After investors punished SXL units ~7% lower (vs up ~1% for AMZ) on the day of the merger announcement, likely due to less concentrated Permian leverage, we see the 8.5% yield and >10% near term distribution growth as a mispricing that will correct over time with execution.

Integrated Oils & Refining

Slow Recovery to Mid-Cycle Fundamentals

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Alon USA Energy	NR
Canadian Natural Resources	OW
Cenovus Energy	N
Chevron Corp	OW
ConocoPhillips	OW
CVR Refining, LP	N
Delek Holdings	NR
Exxon Mobil Corp	N
HollyFrontier	N
Husky Energy	N
Imperial Oil	N
Marathon Petroleum	N
Occidental Petroleum	UW
PBF Energy	N
Phillips 66	N
Suncor Energy	N
Tesoro Corporation	N
Valero Energy	OW
Western Refining	N

US Refiners have had a difficult 2016 after a very strong 2015, driven by excess product inventories and even tighter crude differentials. While the worst case scenario in 2H16 was averted on fundamentals with some drawdown in inventories, we still see a slow recovery in refinery utilization requiring a multi-year path to normalized earnings. On the positive side, election results could help the more RIN exposed merchant refiners (CVRR, PBF, HFC, VLO). However, the timing of any relief is unclear and likely not imminent, particularly in light of the recent report published by the EPA defending the point of obligation at the refinery level. While we will have more clarity on potential 2017 RIN headwinds after the EPA publishes its requirements this month, for now we assume that earnings will remain below mid-cycle in 2017, presenting some risk to consensus estimates, albeit likely less than the 2015 to 2016 revision cycle.

The **integrateds coverage group** has generally outperformed in 2016 (group +14%, S&P +8%) due to further progress on capex/opex cuts and a perception that crude supply/demand dynamics could start to tighten in 2017. On strip-like pricing ($55 Brent), we expect the group to flip to positive FCF in 2017 and for most of our group to achieve FCF/dividend coverage. Focus in 2017 should shift away from damage control and towards capital allocation, with organic production growth, acquisitions, delevering, and share buybacks all competing for limited capital. We favor the prudent use of capital as high return projects are likely limited at strip pricing. Reflation of costs in a higher crude price environment is a key risk we will be watching, particularly in US shale given recent rig count additions. However, on mid/long cycle, we could see even more cost reductions on deflation/productivity.

Stocks for Every Strategy

Value – ConocoPhillips (COP/$46.30/Overweight)

COP underperformed peers in 2015 and early 2016 on high leverage and a high dividend obligation as industry fundamentals declined, culminating with a ~2/3 dividend cut in February. Since the dividend cut and as laid out in its recent analyst day, the company has refocused on reducing debt ($7B reduction targeted through 2019) aided by an aggressive asset sale program ($5-8B in 2017-18), while also targeting some share buybacks ($3B authorization), allowing the company to “walk” (delever) and “chew gum” (repurchase shares). Guidance suggests the company can at least meet its debt repayment goals at <$50 Brent, while high leverage to crude pricing could lead to substantial upside at $55+ Brent. While we believe investors view the company’s plan mostly positively, upside on the stock should come more from execution (e.g. asset sales, continued solid quarterly results), where we think the company could make progress in 2017.

★ **Value – Canadian Natural Resources (CNQ.CN/$32.70/C$44.11/Overweight)**

While leverage had been the main concern for CNQ early in the year, the company has highlighted several levers available to pull to shore up its balance sheet in a downside scenario. On strip pricing, we believe the company can reach the top end of its target leverage range (1.8-2.2x net debt/EBITDA) without pulling these levers as it continues to complete a long-cycle capital program focused on a shift towards exposure to oil sands production (e.g., Horizon). Looking ahead to 2018, we think with the balance sheet within the range of comfort and with project capex rolling off, the company can simultaneously achieve strong FCF generation, production growth, and top tier return of capital (share buybacks). Further, a group-high 2020E sustaining FCF yield outlines a still attractive entry point, despite outperformance thus far in 2016.

Large-Cap Oil & Gas Exploration & Production

E&P: In the OPEC Zone

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Anadarko Petroleum	OW
Antero	N
Apache Corp	N
Chesapeake Energy	N
Cimarex	N
Concho Resources	OW
Continental Resources	OW
Devon Energy	OW
EOG Resources	N
EP Energy	N
EQT Corp	OW
Hess	N
Marathon	UW
Murphy	N
Noble Energy	OW
Pioneer Natural Resources	OW
Range Resources	OW
Southwestern Energy	N

We see a tale of two halves in 2017, with upside operating leverage in 1H supporting further gains in stocks giving way to a more challenging investing environment in 2H. Planned OPEC cuts should not significantly change long-term fundamentals, but do provide an important bridge through a potentially vulnerable part of the cycle (i.e., a supply imbalance in 1H17). The decision also appears to limit downside as we believe it signals OPEC's intent to protect oil prices below $50 per bbl, which has positive implications for the sector. For 2017, we favor oil stocks over gas and companies levered to quality rocks at the low end of the US oil cost curve (Midland Basin, Delaware Basin, and STACK). Our recommended beta exposure is to the Williston Basin given the positive uplift from enhanced completions on recoveries and well level returns in the Bakken. We expect OPEC's cuts to spur more aggressive capex increases by producers as they look to chase growth.

Stocks for Every Strategy

Growth – Pioneer Natural Resources (PXD/$185.51/Overweight)

We expect PXD to deliver differentiated oil growth given its large runway of drilling locations and significant resource potential. The company expects 15% production growth through 2020 with cash flows expanding 25% per annum during this period. We believe the next key catalyst for the stock is potential uplift from Version 3.0 of the company's completion enhancement program in the Midland Basin, which is testing even higher proppant loads, more clusters, and tighter stage spacing.

★ **Growth – Range Resources (RRC/$36.78/Overweight)**

RRC has one of the industry's most attractive positions in the core of the Southern Marcellus Shale, and the company now boasts high quality asset bases with FT in two geographic areas after its acquisition of MRD. We think the optionality embedded in a dual best-in-class asset portfolio supported by multiple outlets for price optimization makes RRC a differentiated growth story relative to the bulk of its Appalachia peers. We believe near-term catalysts include potential well results from look-alike structures around the Terryville field, which could add up to $2-$4 per share to our NAV if the acreage is successfully de-risked.

Value – Anadarko Petroleum (APC/$65.00/Overweight)

We believe APC's updated 5-year production outlook, which supports 10-12% per annum oil growth, justifies inclusion into the 'oil growth club' and should narrow the stock's relative discount over time. We see several intriguing near-term catalysts for APC, including incremental asset sales that could support further de-leveraging as well as a simplification of the story as APC looks to focus its US asset base on the three "D's"—DJ Basin, Delaware Basin, and Deepwater.

Market Neutral – Devon Energy (DVN/$45.04/Overweight) vs. Marathon (MRO/$16.78/Underweight)

DVN and MRO both provided positive longer term outlooks in their 3Q16 prints, after which both stocks are up ~17% and are trading at nearly 8x 2018E EV/EBITDA despite the fact that DVN provides higher relative growth on 2018E. On 2018E production, DVN provides nearly 9% growth vs. MRO at 3%. We expect DVN's STACK position to generate more positive news flow relative to MRO's. We believe DVN has numerous catalysts in the form of spacing tests, including the Leon Gundy, Chablis and Dorothy pilots. On the other hand, MRO's mixed STACK update with 2 strong wells and 3 weaker results in its recently acquired Payrock acreage was largely overlooked given MRO's long term US Resource growth guidance. MRO still has more work to do in proving up the acquired acreage, primarily in the eastern part of Canadian County.

Oil Services & Equipment

Cyclical Shale Activity Recovery Under Way, But Structural Cost Deflation May Dilute Profits

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Aspen Aerogels	N
Baker Hughes Inc	N
Calfrac Well Services	N
Core Laboratories	OW
Diamond Offshore Drilling	N
Dril-Quip	N
Ensco	UW
FMC Technologies	N
Forum Energy Technologies	UW
Frank's International	N
Halliburton Co.	OW
Helmerich & Payne	UW
MRC Global	OW
Nabors Industries	OW
National Oilwell Varco	N
Noble Corp	UW
NOW Inc.	N
Oceaneering	UW
Oil States International	N
Patterson-UTI Energy	UW
Precision Drilling	N
Rowan Companies	OW
Schlumberger	OW
Superior Energy Services	N
TETRA Technologies	OW
Transocean	UW
Trican Well Service	N
Weatherford International	OW

The OSX is poised to underperform the broader market again in 2016 (7% YTD, 8% S&P 500), which it has consistently done to varying degrees since 2011. However, this year's underlying results are substantially more mixed as the market has priced in a strong recovery for North American onshore (NAM-levered stocks +26% YTD) while the consensus outlook for offshore activity continued to push right (offshore-levered stocks -12%). With an OPEC meeting still looming as we go to print, we acknowledge volatility is set to continue for the stocks.

Offshore has been a near unanimous short for over three years now; while there is little long-only support, we think the consensus has congealed around 2H17 as a bottoming for rig activity. We disagree, and maintain our call for 2H18 as an appropriate base case for an activity trough, particularly for floaters. As a result, we see further downside risk for offshore drillers as well as services and equipment.

In North America, there has been a cognitive dissonance between 2017 E&P budgets and spot oil prices for much of this year. Operators have remained steadfast in their plans for 2017 spending pegged to a +$50 world, even as WTI has spent most days well below that crucial threshold. At some point, rubber will meet the proverbial road, and oil prices will align to the budgets or budgets will reset. We think risk is skewed towards the latter. Admittedly, the aggressive hedging undertaken on those days when the price has hung around $50 has helped de-risk cash flow (and thus budgets) to a reasonable degree. But it remains unclear what exactly would trigger reassessment of D&C programs next year if oil stays in its current $40-50 range. Production growth is surprising to the upside, and we suspect those with the most favored acreage mostly plow ahead (the "E&P Growth Club" as coined by our E&P colleagues), though there's a sizable portion we believe would be forced to retreat.

2017 is the first true test of our "circular logic" argument for US onshore. We think the shale cost deflation cycle can run longer and harder than many expect, keeping a lid on pricing. Meanwhile, we don't see enough room for everyone to make money in a narrow, W-shaped recovery. As we go through next year, 2018's potential will come into better focus, and if pricing power fails to deliver the substantial earnings growth implied by current valuations, we see potential for a material correction in estimates and the stocks. Thus, our preferred relative OW is bellwether **SLB**. ★

Stocks for Every Strategy

Market Neutral – Nabors (NBR/$14.54/Overweight) vs. Helmerich & Payne (HP/$70.23/Underweight)
This pair trade should prove effective if US land activity and dayrate expectations reset lower in 2017; we also think NBR's int'l onshore growth potential is underappreciated. The convergence of these growth rates should also drive a narrowing of the multiples gap between the two as well (NBR 6.5x 2018e v HP 11x).

Short Idea – Forum Energy Technologies (FET/$21.20/Underweight)
We think FET has good assets, a solid balance sheet (despite negative EBITDA today), and a capital light, FCF model. But at 14x our 2018e EBITDA, we expect enthusiasm for FET's short-cycle equipment exposure to wane as expectations reset.

Short Idea – Ensco (ESV/$8.97/Underweight)
We believe expectations for a 2H17 offshore activity bottom remains premature (consensus implies ~40% revenue replacement). ESV's revenue rollover profile (-50% y/y v. peers -35%) is among the steepest, and the liquidity bridge through 2021 could tighten should key deepwater markets not recover until 2H18-2019.

SMid-Cap E&P

Focus on Debt-Adjusted Growth, NAV Expansion Catalysts in 2017

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Bloomberg **JPMA DAOUD** <GO>

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Cabot Oil & Gas	N
Carrizo Oil & Gas	OW
Diamondback Energy	OW
Energen	OW
Gulfport Energy	OW
Jones Energy	OW
Laredo Petroleum	N
Newfield Exploration	OW
Oasis Petroleum	OW
Parsley Energy	OW
PDC Energy	OW
Rice Energy	N
RSP Permian	N
SM Energy	N
Whiting Petroleum	N
WPX Energy	OW

Gabriel J Daoud Jr.	
Bill Barrett Corporation	N
Bonanza Creek Energy, Inc.	UW
BP Prudhoe Bay Royalty Trust	UW
Callon Petroleum Company	OW
Eclipse Resources Corporation	N
EV Energy Partners, L.P.	N
Legacy Reserves LP	N
Matador Resources Company	OW
Memorial Production Partners LP	N
Pacific Coast Oil Trust	N
QEP Resources, Inc.	OW
Synergy Resources Corporation	OW
Vanguard Natural Resources, LLC	N

Relative to the JPM View, our commodities team expects a continued recovery in oil prices in 2017 (we note the outcome of OPEC talks was unclear at the time of writing), while our equity strategy team remains OW energy, and sees the US election outcome as further strengthening this thesis via reduced regulations and a potentially enhanced growth outlook. In the context of these views, we believe the SMid-Cap E&P sector is well-positioned heading into 2017. Compared to this time last year, balance sheets are stronger and asset quality has improved markedly across virtually all basins. With the balance sheet trade in the rear view mirror, heading into 2017, we believe investors will re-focus on debt-adjusted growth, which historically has been strongly correlated with equity performance and resource catalysts that can drive NAV expansion.

Stocks for Every Strategy

★ **Growth: Callon Petroleum Company (CPE/$16.24/Overweight)**

CPE grew stronger throughout the year with significant well productivity and efficiency gains, an improved balance sheet and an increased Midland Basin footprint owing to two transformative Howard County acquisitions. We forecast a ~40% oil production CAGR through '18 alongside numerous resource catalysts in Howard County that should drive NAV expansion.

★ **Growth: Parsley Energy (PE/$35.92/Overweight)**

Parsley should continue to post peer-leading oil growth (JPMe ~49%), and has a catalyst-rich drilling program that could drive material expansion to the company's NAV in both the Delaware (2nd flow unit in the Wolfcamp, 3rd Bone Spring) and Midland (Upper Wolfcamp A, stagger-stack opportunities). In addition, the company recently increased its hedge position and now has ~54% of our projected 2017 oil volumes hedged, providing downside protection in the event oil pulls back.

Growth: Diamondback Energy (FANG/$100.77/Overweight)

FANG is among the lowest-cost and most efficient operators in US E&P. We see the company as notably well-positioned to drive efficient (30%+) growth over the next few years, which should drive material compression in the company's valuation metrics. We see resource catalysts as the company begins drilling in the Delaware Basin in early 2017.

Value: Oasis Petroleum (OAS/$13.15/Overweight)

We continue to view the Williston as an underrated basin within the investment community. OAS' single-well returns at Wild Basin are among the strongest in US E&P, which should allow the company to grow volumes by double-digits within cash flow over the next two years. We do see Williston producers as potentially benefitting from reduced regulation via the approval of the DAPL pipeline, which could drive basin-wide differentials below $4/bbl.

Value: QEP Resources (QEP/$18.55/Overweight)

QEP stands well-positioned to deliver ~10% oil production growth in '17 on the back of the Permian transition/acceleration that should also lift unhedged corporate margins and drive multiple expansion, in our view. NAV expansion potential also remains given Spraberry and Bakken wells that continue to outperform type curves. A&D can also be a catalyst with a potential Pinedale sale funding an oily acquisition.

Utilities & Power

Rate Pressure, Mildly Lower Capex Opportunities Create Headwinds

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AES Corp.	OW
Allete Inc.	UW
American Electric Power	N
Atmos Energy	OW
Avangrid, Inc	UW
Black Hills Corp.	OW
Dominion Resources	N
Duke Energy Corp.	N
Emera Inc.	N
Entergy Corp.	N
Exelon Corp.	OW
FirstEnergy	OW
Great Plains Energy	N
Hawaiian Electric Industries Inc.	N
NextEra Energy Inc.	NR
Nextera Energy Partners	N
NiSource Inc.	N
Pattern Energy	OW
PG&E Corp.	OW
Portland General Electric Co.	UW
Public Service Enterprise Group	N
Sempra Energy	N
South Jersey Industries	N
Spire Inc	UW
Westar Energy Inc	N
Xcel Energy	OW

We see regulated utilities as roughly pricing in current interest rates, with much of the cushion against higher rates seen in mid-2016 now eliminated. Aside from the risk of further rising rates on relative valuation, we see mildly lower capex potential through the end of the decade stemming from a likely de-emphasis of the Clean Power Plan, partly offset by the potential for higher authorized ROEs. We see the group as being one of the smallest beneficiaries of any corporate tax rate reduction due to benefits being passed back to customers. Companies with large non-utility businesses such as D, EXC and PEG would benefit most, while those with large non-utility interest expense and/or other drags are at risk, such as GXP, ETR and FE, in our opinion. Given JPM's forecasted 2.55% 10yr treasury yield by Dec '17 we calculate a range of between 2% upside and 11% downside potential for the current P/E multiple by year end, with the potential for modestly lower earnings estimates and lower future investment potential. Our top pick is EXC.

Stocks for Every Strategy

Growth: Xcel Energy (XEL/$39.52/Overweight)

Large renewable development potential and distribution investment should drive strong rate base growth through at least 2019, and combined with improved regulatory environments should allow lag catch up to drive 6%+ EPS growth in 2018-19. Investment is being funded with no equity, and we expect dividend growth to remain above 6% as well. At a roughly in line valuation to large regulated peers on 2017, we feel investors are not yet appreciating the improved earnings potential, or the ability to own much of the renewable projects in MN.

Value: Black Hills (BKH/$59.59/Overweight)

Aggressive synergy execution through 2018, combined with organic customer growth and near-term electric generation and transmission investments position BKH well versus peers, in our opinion. When added to reduced drag from the E&P business and lower interest expense, we feel earnings over the next two years have risk to the upside. The current discount to electric and gas utility peers does not reflect this, in our opinion.

★ **Income: Exelon (EXC/$32.58/Overweight)**

Management's expectation of strong 7-9% utility segment growth, combined with aggressive debt reduction at the power segment, creates an undervalued execution story that implies a <5x EBITDA story on the power side, in our opinion. Authorized ROE tied directly to interest rates in IL helps limit the effects of rising interest rates on EXC more than peers, and the 3.9% yield is among the best in the sector.

Short: Avangrid (AGR/$37.53/Underweight)

We see downside for 2017-19 consensus estimates as networks rate base and earnings growth does not live up to management expectations in the face of several large rate cases and new projects fail to materialize. Renewables development differentiates AGR from most peers, but is also more than priced into shares, in our opinion.

Banks – Large Cap

Waiting for Trump – Changes by New Administration Key Driver

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Bank of America	OW
Bank of New York Mellon Corp.	OW
BB&T Corporation	N
Citigroup Inc.	OW
Citizens Financial Group	OW
Fifth Third Bancorp	N
Northern Trust	N
PNC Financial	OW
Regions Financial	N
State Street	N
SunTrust Banks, Inc.	OW
U.S. Bancorp	N
Wells Fargo	N

We expect the performance for large bank stocks in 2017 to be driven by the changes to be made by the incoming Republican Administration. Bank stocks have outperformed very sharply recently in anticipation of big changes in three key areas: 1) further rate hikes beyond what we already have in our estimates and steepening of the yield curve; 2) fiscal stimulus via increased infrastructure spending and lower taxes; and 3) looser regulation. These could drive higher loan growth and net interest margin, lower expenses, and reduction in capital - to a lesser extent, potential for some increase in fee income. Banks have seen decent loan growth recently with some increase in credit card lending yoy but continued pressure on net interest margins and high expense growth. Credit quality remains benign but we are watching CRE plus subprime auto and credit card loans. We expect continued pressure on expenses led by regulatory and tech spending plus building of new business lines by regionals. However mortgage banking revenues are likely to decline materially.

Traditional bank stocks are trading at peak P/E multiples, both on absolute and relative basis, seen in the last Fed tightening cycle on the hope that banks would benefit from the additional levers listed above. We expect that the impact of the additional levers is likely to come primarily in 2018 other than the potential for tax rates to be cut more quickly. All our banks should benefit from these changes. If regulatory changes are made to benefit small and midsize banks to a greater extent, our midsize regionals could benefit from that, depending on the details of the changes. Several other unknowns remain from the new Administration, most notably trade policy changes. Some of these could slow global growth and/or increase inflation. Strengthening of the dollar could also offset the impact of some of these changes and pressure domestic manufacturers that are big exporters.

Trust banks should also see some benefits from the above drivers but less than traditional banks because net interest income is only 20-25% of total revenues – the trust banks are asset sensitive but do very little lending. Core asset servicing and asset management revenues will see mixed impact with higher rates hurting fixed income assets but some benefit to money market funds.

Stocks for Every Strategy

★ **Value – Long PNC Financial (PNC/$111.14/Overweight)**

We recommend PNC Financial which has potential to increase earnings by adding duration on some of its excess liquidity with long term rates higher into 2017. PNC is continuing to also manage expenses carefully and invest in new technology. PNC is trading at 14.8x 2017E EPS.

Value – Long Bank of America (BAC/$20.56/Overweight)

We continue to recommend Bank of America long term due to its high asset sensitivity, plan to further reduce expenses, and outlook for increased capital return in 2017. Bank of America trades at 12.8x 2017E EPS and 1.25x TBV.

Banks – Mid and Small Cap

Election a Game Changer with a Laundry List of Potential Catalysts Now on the Table

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Astoria Financial	UW
BancorpSouth	N
BankUnited	OW
Comerica Incorporated	N
Cullen/Frost Bankers Inc.	UW
First Hawaiian	OW
First Horizon National	N
First Republic	OW
Florida Community Bank	OW
Great Western Bancorp, Inc.	OW
Huntington Bancshares	N
KeyCorp	OW
M&T Bank	N
New York Community Bank	UW
People's United Financial	NR
PrivateBancorp, Inc.	NR
Signature Bank	OW
SVB Financial Group	OW
Synovus Financial Corp.	N
TCF Financial Corporation	N
Umpqua Holdings Corporation	N
Valley National Bancorp	N
Webster Financial Corporation	OW
Zions Bancorporation	N
Benjamin M Lurio	
FB Financial	N
Opus Bank	OW
Jason M Oetting	
F.N.B. Corporation	N
MB Financial	N

With bank stocks pricing in rates being "low for long" as well as an ongoing regulatory burden before the election, we viewed the election results as a game changer with rates seemingly now headed higher and the regulatory burden likely to ease with "everything" now on the table and up for debate. Moreover, it's a potential scenario of seeing regulatory relief simultaneous with an improvement in interest rates as well as economic growth which could benefit NIMs, loan growth, expense levels, capital return, tax rates and M&A. Rather than a short-term benefit, we see these as potential positive catalysts helping over the near term as well as continuing to accrue over the longer term. Contrasted to the historical 2.50x TBV multiple for the sector, bank stocks now trade at 1.95x 2017e TBV. Given the magnitude of potential positive catalysts ahead, however, we think the recent turn in the group will likely represent a valuation inflection point.

Stocks for Every Strategy

★ Growth – First Republic (FRC/$82.37/Overweight)
FRC is perhaps the most differentiated regional bank in the industry in that it grows 2-3x faster than the typical bank and simultaneously has a risk profile that is among the lowest in the industry, making this the most attractive risk/reward in our group. On top of 15%+ EPS growth expected in 2017, FRC is also a ROE expansion story with wealth management growth. Click here for our recent investor day takeaways.

Growth – SVB Financial (SIVB/$156.12/Overweight)
With the exit markets looking like they are unthawing heading into 2017 and VC investment and fundraising remaining historically strong, we see SIVB as positioned to deliver strong growth and improving credit quality. The bank is strongly positioned as the go-to bank for the innovation economy and given its rate sensitivity and expectation to grow well above peers, we see further multiple expansion.

Growth – Webster Financial (WBS/$49.22/Overweight)
Post the election, health savings accounts have moved into the spotlight given the incoming administration's ambitions to expand the program. Within the bank sector, we see Webster as positioned as a clear winner within the HSA business which now represents about 20% of net income. In fact, plans to repeal and replace ACA with a solution that includes HSAs could drive a significant boost to the already fast growing HSA business. Click here for our HSA primer.

Value – Signature Bank (SBNY/$150.35/Overweight)
We view SBNY as currently trading at an attractive value as historically the bank has traded at near 20% premiums to peers, but the multiple has contracted due to investor concern surrounding its CRE concentration and implications for growth as well as its taxi medallion portfolio. We see multiple expansion as the market realizes the growth profile of the bank is intact. Also, any scaling back or repeal of the $50bn SIFI line would be a significant positive.

Value – KeyCorp (KEY/$17.52/Overweight)
KEY shares continue to trade at a depressed multiple relative to peers in our coverage group as well as to a basket of larger regional banks. This is due in part to the market being skeptical on the bank's recent acquisition of First Niagara, but with that being said we like the combination of (1) the bar being very low and (2) management being highly motivated to deliver stronger performance results than originally outlined. To that end, early indicators are positive with momentum building which should help close the valuation gap to peers.

Brokers, Asset Managers and Exchanges

2017- Likely a Better Year For Brokers, Asset Managers, and Exchanges

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Apollo Global Management	OW
Ares Management	OW
Bats Global Markets, Inc.	N
BlackRock	OW
Blackstone	N
CBOE Holdings	N
Charles Schwab	OW
CME Group Inc.	N
Eaton Vance Corp	UW
Federated Investors, Inc.	UW
Franklin Resources	N
Invesco Ltd.	OW
Investment Technology Group	N
Janus Capital Group	N
KCG Holdings	N
LPL Financial Holdings Inc.	N
Manning & Napier	UW
Moelis	OW
Nasdaq	N
Oaktree Capital Group, LLC	N
Och-Ziff Capital Management	OW
Pzena Investment Management	N
T. Rowe Price Group, Inc	UW
The Carlyle Group	OW
The Intercontinental Exchange	N
Virtu Financial	N

We believe that 2017 should be a better year for the stocks under our coverage, with potential for each sector to outperform. We note that 2016 was a poor year as sector returns on an equal market cap basis were negative for each traditional asset managers, alternative asset managers, and brokers. Only exchanges outperformed.

However, 2017 brings opportunities for each sector we follow.

- **Traditional Asset Managers.** We see opportunities in changes to the US tax code driving earnings higher both for US investments broadly, as well as asset managers specifically. However, we expect fundamentals to remain challenging with active equity outflows and a pickup in fee compression. With valuations low, any rally in equity markets would likely drive both higher earnings and multiple expansion.
- **Alternative Asset Managers.** We see the next fundraising cycle kicking off in 2017. This combined with prior vintage funds coming into carry and better realizations should make 2017 a better year for alternative manager earnings.
- **Exchanges.** We see 2017 as potentially experiencing greater volatility. With Congress and the White House aligned, agenda items including tax and regulatory reforms could see progress. Higher markets and higher interest rates could drive higher activity levels, higher earnings, a better outlook and combined better volatility and volumes.

Stocks for Every Strategy

Growth – CBOE (CBOE/$68.43/Neutral)
We see potential for CBOE stock to perform well around its recently announced acquisition of Bats. We see potential for synergies to beat expectations in terms of both size and timing and we see potential for synergies from bringing new technology to CBOE driving greater trading volumes and revenue. As a full tax payer, we see CBOE benefitting from any reform of the US tax code.

Value – Invesco (IVZ/$31.66/Overweight)
We continue to see Invesco as our best value investment. Invesco remains an inexpensive asset manager trading at 12x 2017 estimates vs 14.5x for the sector. We see Invesco gaining traction in its passive and alternative products as investors continue their focus on cheap beta and alpha. While Invesco has a big book of domestic equity investments that is vulnerable to outflows, good performance should limit attrition.

Income Oriented – Carlyle (CG/$15.90/Overweight)
Carlyle remains a strong income generating investment idea. We estimate a distribution of $1.68 in 2017, which indicates a 10% cash yield. We see Carlyle entering its next fundraising cycle at the end of 2017, carrying through to 2019. Given strong performance, new funds will be larger than existing ones. Furthermore, we expect prior vintage funds to come into carry and to see a slightly increased pace of realizations, which we expect will drive earnings higher.

Short Idea – Federated Investors (FII/$27.73/Underweight)
We see continued potential for underperformance of Federated Investors. A key equity fund which accounts for ~60% of equity AUM has experienced a meaningful decline in performance and is likely to lead to accelerating firmwide outflows. Lost market share in its core money market fund business is likely to weigh on EPS growth going forward.

Life Insurance

Long PRU

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Bloomberg **JPMA BHULLAR**<GO>

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AFLAC, Inc.	N
American International Group	N
Assurant, Inc.	N
Fidelity & Guaranty Life	N
Genworth Financial, Inc.	N
Hartford Financial Services	N
Lincoln National	N
MetLife, Inc.	OW
Principal Financial Group	UW
Prudential Financial	OW
Reinsurance Group of America	N
Third Point Reinsurance Ltd.	N
Torchmark Corp	N
Unum Group	N
Voya Financial, Inc.	N
Pablo Singzon	
American Equity Investment Life	OW

We maintain our neutral outlook for the life insurance sector, but have become incrementally negative following the recent surge in stock prices. After lagging the broader market in 2014 and 2015, the life insurance sector has outperformed in 2016, driven entirely by gains after the presidential election. The sector has traded up on the expectation of lighter regulations and higher interest rates, and we believe that current valuation levels already reflect best-case scenarios for most stocks. On a fundamental basis, however, we expect insurers' results to be marked by poor returns and weak operating trends barring a sustained increase in interest rates. On the other hand, capital flexibility for share repurchases/dividend hikes and rational price competition across most product lines remain notable positives. We could become more constructive on the life insurance group if interest rates continue to increase or stocks pull back to more reasonable levels. Among our coverage companies, we are highlighting Prudential (PRU) as our top long idea.

Stocks for Every Strategy

★ **Value – Prudential Financial (PRU/$100.64/Overweight)**

In our view, PRU's superior ROE, healthy business trends, and attractive valuation will enable the stock to outperform. We forecast PRU to generate a mid-teens ROE over the next few years, well above our 10-11% forecast for the life insurance sector. Furthermore, we expect PRU's business trends to be fairly healthy, marked by steady flows in the asset management and retirement divisions, improving margins in the group benefit segment, robust returns in the Japan business, and steady capital deployment. Also, we feel that potential deregulation from the new administration reduces Prudential's exposure to possibly onerous SIFI capital standards. On valuation, we believe that Prudential's current multiple offers very attractive risk-reward as the stock trades roughly in line with the life insurance sector on a P/BV basis (despite a meaningfully higher ROE) and at a large discount on a P/E basis (with similar growth potential). PRU is trading at 1.4x book value (ex. AOCI) and 9.7x 2017E EPS versus group multiples of 1.3x and 11.3x, respectively.

Property & Casualty Insurance

Industry Should Generate Consistent Profitability with Optionality on M&A

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Bloomberg **JPMA DEWITT** <GO>

Allied World Assurance	OW
Allstate	OW
Aon	OW
Arch Capital	OW
Arthur J. Gallagher	UW
Brown & Brown	UW
Chubb Ltd	N
Everest Re	N
Kinsale	OW
Marsh & McLennan	OW
Progressive	N
RenaissanceRe	OW
Travelers	N
Validus Holdings	OW
Willis Towers Watson	UW
XL Group Ltd	N

We expect P&C insurers to generate consistent returns and book value growth, and the potential for further M&A could provide upside. Additionally, we think the sector could benefit from a broader rotation into financials following a Republican sweep during the elections as well as potential reductions in corporate tax rates, although the performance could lag other financials which have more leverage to rising interest rates and potential federal regulatory relief. While lower P&C insurance prices as well as slowing reserve releases probably mean ROEs and earnings have peaked, we still think the industry can generate consistent returns because the P&C cycle is shallower than prior cycles and competition appears rationale. Finally, we think M&A could pick up, which would be a positive catalyst, as P&C insurers seek to deploy growing excess capital for inorganic growth to buy scale, buy growth or diversify.

Stocks for Every Strategy

Growth – Arch Capital (ACGL/$81.61/Overweight)

We see upside in ACGL shares as it grows in mortgage insurance following the acquisition of United Guaranty (AIG's mortgage insurance business). The deal transforms ACGL into a specialty powerhouse that is more diversified with better growth opportunities and a higher ROE. Mortgage insurance is benefiting from one of the hardest markets ever following the mortgage crisis. Although ACGL shares trade above other P&C insurers on P/book, we see upside based on valuing the mortgage insurance business using embedded value (we believe the best way to value a mortgage insurer because it generates premiums and earnings over a multi-year period unlike P&C insurance). If we value ACGL's P&C insurance business at 1.3x BV and mortgage insurance at $5bn ($3.4bn of UGC BV plus $1.7bn of embedded value or $38/shr), we see upside to $100 (+20%).

★ **Market Neutral – Aon (AON/$113.51/Overweight) vs. Willis Towers Watson (WLTW/$124.56/Underweight)**

We think AON will benefit as it grows organically over time with faster earnings growth due to shifting the mix toward higher margin business. This, coupled with lower uses of cash, should result in impressive free cash flow growth and an attractive 8% 2017E FCF yield (7% ex stock based comp). We prefer AON to WLTW and we remain concerned about WLTW's recent merger. Strategically, the merger diversifies WLTW's revenue stream and results in a tax benefit. However, large insurance brokerage acquisitions have historically led to some challenges, including high costs to retain talent, revenue dis-synergies, and culture clashes. WLTW trades at 14x 2017E cash EPS and we prefer AON (15x 2017E cash EPS) for a modest premium with no integration risk.

Value – RenaissanceRe (RNR/$130.60/Overweight)

We believe sentiment on RNR is negative because it is a pure play reinsurer, which is the most competitive segment of the market. However, RNR has shifted their business mix and is now larger in specialty lines and Lloyd's than property catastrophe reinsurance for the first time in its history. RNR should have significant capacity to grow these lines without adding additional capital. Meanwhile, we believe RNR has one of the best management teams with a strong track record. RNR's valuation is near historical lows. However, even if the multiple does not expand, we think book value growth should drive stock price appreciation.

REITs/Real Estate

Stay on the Sidelines as the Past Year's Bullish Themes Have Faded

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Anthony Paolone, CFA	
AIMCO	N
Alexandria Real Estate Equities	OW
Altisource Residential	N
American Campus Communities	N
American Homes 4 Rent	N
AvalonBay Communities	OW
Boston Properties	N
Brandywine Realty Trust	OW
Camden Property Trust	N
CBRE Group, Inc	OW
Colony Starwood Homes	OW
Corporate Office Properties	N
Cousins Properties	N
Douglas Emmett, Inc.	OW
EdR	N
EPR Properties	OW
Equity Residential	N
Essex Property Trust	OW
Getty Realty	UW
Jones Lang LaSalle Inc	OW
Kilroy Realty	OW
Lexington Realty Trust	N
Mack-Cali Realty	N
Piedmont Office Realty Trust	N
Post Properties	NR
PS Business Parks	N
RE/MAX Holdings Inc.	N
Realogy Holdings Corp.	N
Realty Income	N
Silver Bay Realty Trust	N
SL Green Realty Corp.	OW
TIER REIT	N
UDR, Inc.	OW
VEREIT, Inc.	N
Vornado Realty Trust	OW
Washington Real Estate Investment Trust	N
Michael W. Mueller, CFA	
Acadia Realty Trust	N
Brixmor Property Group	N
CBL & Associates Properties	N
DCT Industrial Trust	OW
DDR Corp	N
Duke Realty	N
Equity One Inc.	NR
Federal Realty Investment Trust	OW
First Industrial Realty Trust	N
General Growth Properties	N
HCP, Inc.	N
Healthcare Realty Trust	N
Healthcare Trust of America	N
Kimco Realty Corporation	OW
Liberty Property Trust	N
Macerich	N
MedEquities	N
Medical Properties Trust	N
Pennsylvania REIT	N
Prologis	OW
Public Storage	N
Ramco-Gershenson Properties Trust	N
Regency Centers	NR
Retail Opportunity Investments Corp.	N
Retail Properties of America	UW
Rexford Industrial Realty	OW
Simon Property Group	OW
STAG Industrial, Inc.	N
Tanger Factory Outlet Centers	N
Taubman Centers	OW
Weingarten Realty Investors	N
Welltower Inc.	N

Our 2017 outlook is consistent with the stance we laid out in our September 2016 commercial real estate update where we backed off our bullish view of the sector. The prospect of higher interest rates, some moderation in job growth, and cyclical peaks in commercial real estate supply deliveries all act as headwinds to REIT stocks in 2017, in our view. NOI and earnings growth are both set to slow as a result of the aforementioned, and several themes that helped the stocks in the first nine months of 2016 have faded, such as the GICS code change and search for domestic yield.

The recent presidential election results raise the prospect of higher economic growth, in our view. This would be good news for underlying commercial real estate trends just like it would be for all businesses. However, real estate trends tend to lag other industries and have less “beta” to economic changes. Thus we don't see REIT stocks as being prime beneficiaries of investors seeking incremental economic growth themes. In the meantime, interest rates are moving higher and could beg the question of whether cap rates should move up (driving commercial real estate values down if there is not a meaningful offset in cash flow growth). Thus in a nutshell, the election results may exacerbate the challenges we see for the stocks.

We continue to place the greatest emphasis on stock selection given a historical rulebook for property type selection that appears on its back; for instance, it is hard to recommend health care and net lease when rates are rising, even though that is where one would typically go when the cycle slows. That said, we continue to like the industrial and strip center sectors. Office also looks okay given the valuation discount and the ability to buy quality major coastal portfolios cheaply. In residential, we prefer the single family rental stocks. Overall, we recommend focusing on stocks where upward revisions to FFO and NAV are likely to occur.

Stocks for Every Strategy

Growth – Rexford Industrial (REXR/$22.19/Overweight)

Small cap Rexford continues to be an interesting stock in that it is a local sharpshooter in the SoCal industrial markets and is well positioned to drive above average growth via its value-add acquisition and repositioning strategies.

Growth – Colony Starwood Homes (SFR/$30.33/Overweight)

SFR’s single family rental home portfolio is hitting its stride, and we believe it has runway for mid-to-high single digit same store NOI growth for the next two years while its conventional apartment REIT peers see growth slow to low single digits.

Value – Vornado (VNO/$96.49/Overweight)

We believe VNO's asset base is high quality in a desirable market - NYC - yet trading at a 20%+ discount to underlying real estate. The pending spin-off of its DC portfolio should help act as a catalyst.

Income Oriented – STAG Industrial (STAG/$23.30/Neutral)

STAG has exposure to the industrial sector, which we like, and in additional to driving growth via higher acquisitions, it offers investors an attractive 6%+ dividend yield.

Income Oriented – VEREIT (VER/$8.30/Neutral)

VER’s 6.7% dividend yield is sustainable, in our opinion, and 2017 should be a year in which the company’s growth engine (spread investing) is turned on again…leading to growth in 2018.

Specialty and Consumer Finance

Politics Aside

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AGNC Investment Corp.	N
Ally Financial	OW
American Capital	N
American Express	N
Annaly Capital	N
Apollo Commercial Real Estate Finance	N
Apollo Investment	N
Ares Capital	OW
Ares Commercial Real Estate Corp.	OW
BlackRock Capital Investment Corp	N
Blackstone Mortgage Trust	OW
Capital One	OW
Discover Financial	N
Essent	OW
Fifth Street Finance Corp.	N
FS Investment Corp.	N
Ladder Capital	OW
MFA Financial	OW
Navient	OW
On Deck Capital	N
OneMain Holdings	OW
PennantPark Investment	N
PennyMac Financial Services	N
Sallie Mae	OW
Santander Consumer (SC)	N
Solar Capital	OW
Synchrony Financial	OW
TPG Specialty Lending	N
Two Harbors	OW
Western Asset Mortgage	N
WhiteHorse Finance	N

It seems for most investors, Father Time cannot usher out 2016 fast enough. After a difficult two month start to the year, stocks rose steadily through early November, culminating in a significant rise with the "Trump Rally" brought on after the election. Hopefully, we will get a volatility (and emotional) break into year-end…

We believe 2017 beckons with the **favorable prospects of (1) higher rates, (2) stable labor markets, and (3) a more benign regulatory environment.** The countervailing **concern is credit**. In our view, stocks can continue to climb the credit "wall of worry" as the consumer remains healthy. Our conviction is based upon our view that solid labor markets will provide a foundation for "normal" credit performance and profitability moving forward, as opposed to another existential credit crisis. We note, globally fixed income prices remain inflated on combination of favorable fundamentals and underlying technical driving heightened demand.

Top Pick – Ally Financial. We believe ALLY's current discount to TBVPS (~0.67x) reflects a highly unlikely "tail-risk" scenario. We expect price to converge towards TBPVS as ALLY improves ROE and executes accretive share repurchases.

Stocks for Every Strategy

★ Value – Ally Financial (ALLY/$19.95/Overweight)

Throughout 2016, ALLY has continued to execute on its strategic initiatives of introducing its capital return plan (dividend and share buyback) and improving profitability (prioritizing yield and building its deposit base); however, shares remain at a notable discount to regional banks (P/TBV ~0.67x vs. regional banks 1.6x-1.7x). We believe ALLY's discounted multiple reflects negative investor sentiment surrounding the auto credit cycle despite relatively stable credit metrics; we believe ALLY is pricing in an extreme "tail-risk" scenario of sustained losses at >5x current levels. We believe price will converge with TBPVS as ALLY continues to execute on its self-help strategy of improving ROE and making accretive share repurchases.

Income Oriented – Ares Capital Corp. (ARCC/$15.76/Overweight)

We believe ARCC's strong origination platform, sizable balance sheet, and ample liquidity position the company well for a rising rate environment. With a portfolio of predominantly floating rate assets, we estimate that ARCC's asset sensitive model would see net income increase by ~$45M annually should interest rates increase 100bps. We believe ARCC's proposed acquisition of ACAS will be completed in early January, and we expect the combination will be accretive to ARCC on an NII and NAV basis as the assets are redeployed into new income-generating investments on a single integrated platform. Meanwhile, ARCC maintains a 9.8% dividend yield and trades at a modest discount (0.94x) to NAV.

Market Neutral – Blackstone Mortgage Trust (BXMT/$29.72/Overweight) vs. AGNC Investment Corp. (AGNC/$18.92/Neutral)

Within mortgage equities, we recommend clients to go long asset and credit sensitivity and short duration risk given the recent shift higher in rates and the consistency of the economy. As such, we continue to recommend BXMT as it is one of the most asset-sensitive names in our universe (86% floating rate loans) and should benefit from strong commercial real estate fundamentals. On the other hand, AGNC, with the highest concentration of agency assets within our coverage list, is likely to lag the group as rates continue to rise and asset values are pressured longer term. Given the likely pressure to asset values and the relatively flat curve, we remain Neutral on AGNC.

Biotechnology

Will Trump Continue to Bump Biotech? CELG Top Large Cap Pick for 2017

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Cory Kasimov	
ACADIA Pharmaceuticals	OW
Acorda Therapeutics Inc.	NR
Alkermes PLC	OW
Amgen Inc	N
aTyr Pharma	OW
Biogen	OW
BioMarin Pharmaceuticals	OW
bluebird bio	OW
Celgene	OW
Clovis Oncology	N
Editas Medicine	N
Gilead Sciences	OW
Incyte Corporation	OW
Juno Therapeutics	N
MannKind Corporation	UW
Novocure LTD	OW
Puma Biotechnology	OW
Regeneron Pharmaceuticals	N
Sage Therapeutics	OW
Seattle Genetics	N
Spark Therapeutics	OW
Ultragenyx	OW
Vertex Pharmaceuticals	OW

Whitney G Ijem	
Karyopharm Therapeutics	OW
Keryx Biopharmaceuticals	N
Sangamo BioSciences	OW
ZIOPHARM Oncology	N

Biotech had a rollercoaster of a year in 2016 following a prolonged bull run (the sector entered 2015 with the NBI up 218% since 2011 vs. the S&P +66%). Drug pricing noise that began in late 2015 not surprisingly intensified in an election year (2016: NBI -16% and BTK -12% vs. S&P 500 +8%), although Trump's surprising win spurred an upswing (NBI +16% and BTK +20% in the 5 trading days post the election vs. +4% for the S&P) as the market generally assumed the likelihood of significant pricing reform emanating from Washington was significantly diminished. We agree to a point; while sweeping policy change is unlikely, we continue to think that changes are already in motion and expect the industry to be increasingly self-policed, while the broader focus on drug prices continues. Without the political weight behind the issue though, we anticipate the headline risk will be less and thus see the potential for biotech outperformance and a shift back to company fundamentals.

We continue to expect investor risk appetite for biotech to be driven by high-profile clinical and regulatory catalysts and commercial performance. Additional support for the sector could come from M&A, which we saw sputter along in 2016; the potential for increased activity could be facilitated by new tax reform, plush pharma balance sheets, and more mature biotech pipelines. While perhaps less pronounced than in the past year, we continue to see the biggest fundamental risk to the sector to be around building pressure against premium pricing (and unjustified price increases).

Stocks for Every Strategy

★ **Growth – Celgene (CELG/$120.85/Overweight)**

We believe CELG is well positioned over the intermediate term given the company's strong fundamental base business with solid volume (not price) driven growth, an increasingly broad/deep pipeline, an attractive valuation (it's trading at ~17x 2017 consensus EPS despite a >20% EPS CAGR through 2020), a strong management team, and an aggressive BD strategy. That combined with a catalyst rich 2017/18, *sixteen* Phase 3 data readouts are expected in the next two-plus years, leads us to conclude that the setup for the coming year is a good one.

Value – Gilead (GILD/$75.30/Overweight)

As we described earlier this year (see note here), we believe GILD remains at something of a crossroads heading into 2017. Coming off a year of significant underperformance (shares down 25% vs. NBI -13%), it's not surprising that sentiment is quite poor. Trading at an industry low multiple (7x vs. large cap biotech at 13x and US pharma at 15x) and as one of two dividend-paying companies in the biotech sector with a very strong balance sheet, there's substantial inbound interest on the name. However, for the multiple to change, something needs to go right. Thus, in the end, we still believe the GILD story really boils down to: 1) finding a bottom for HCV; 2) progress on the new product pipeline; and/or 3) perhaps most importantly, what happens on the M&A front. Value names are obviously tough to come by in biotech, but if a couple of things can indeed go right, 2017 could be a comeback year for GILD.

Biotechnology – SMid

Shift Back to Fundamentals But Would Still Be Selective in SMIDs; Alexion Top Pick

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Agios Pharmaceuticals	OW
Alexion Pharmaceuticals	OW
Alnylam Pharmaceuticals	N
Amicus Therapeutics	OW
Ariad Pharmaceuticals	UW
Array BioPharma	OW
ChemoCentryx, Inc.	OW
Dynavax	N
Idera Pharmaceuticals	OW
Ignyta	OW
Infinity Pharmaceuticals	N
Ironwood Pharmaceuticals	OW
Merrimack Pharmaceuticals	N
Mesoblast	N
Neurocrine Biosciences	OW
Ophthotech	OW
Otonomy	N
OvaScience	N
PTC Therapeutics	N
Rigel Pharmaceuticals	OW

Biotech had a roller-coaster of a year in 2016 following a multi-year bull run (the sector entered 2015 with the NBI up 218% since 2011 vs. +66% on the S&P). Election related drug pricing noise that began in late 2015 not surprisingly continued to weigh on the sector in 2016 (NBI -16% and BTK -12% vs. S&P 500 +8%), although we believe the Trump win spurred an upswing (NBI +16% and BTK +20% in the 5 trading days post the election vs. +4% for the S&P) as the market generally assumed the likelihood of significant pricing reform emanating from Washington was significantly diminished. We agree, although continue to think changes are already in motion and expect the industry to be increasingly self-policed while the broader focus on drug prices continues. Without the political weight behind the issue though, we think the headline risk will be less and thus see the potential for biotech outperformance and a shift back to company fundamentals.

We continue to expect investor risk appetite for biotechs to be driven by high-profile clinical and regulatory catalysts and commercial performance. Additional support in the sector could come from M&A, which we saw sputter along in 2016; the potential for increased activity could be facilitated by new tax reform, plush pharma balance sheets, and more mature biotech pipelines. While perhaps less pronounced than in the past year, we continue to see the biggest fundamental risk to the sector to be around building pressure against premium pricing.

Stocks for Every Strategy

★ **Growth – Alexion (ALXN/$118.92/Overweight)**

After underperforming in 2016 (YTD -38% versus NBI -16%), we believe Alexion shares are poised for outperformance. Of note, while an investigation into allegations related to Soliris sales practices is ongoing, at this point, we view this as more of a hiccup than a material event, and believe that several potential bear case scenarios have been avoided (i.e., re-stating of prior financials, drug supply issue, etc; see note here). Looking forward, we believe Alexion's complement business has multiple defense points that provide outer year protection from biosimilar / branded competition (a key bear thesis on the name). Indeed, central to this thesis is ALXN1210, which we believe is underappreciated asset overall (see note here). Further, on the commercial side, we expect continued outperformance from Strensiq and would note that expectations for Kanuma remain low. Finally, we believe that Alexion's pipeline is undervalued and provides multiple shots on goal over the next ~12 months (Soliris myasthenia gravis, Soliris neuromyelitis optica, SBC-103, ALXN1007, etc).

Biotechnology – SMid

Shift Back To Fundamentals But Would Still Be Selective In SMIDs; JAZZ Top Pick

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Aegerion Pharmaceuticals	N
Alder Biopharmaceuticals	OW
AMAG Pharmaceuticals	N
Arena Pharmaceuticals, Inc.	N
BioCryst Pharmaceuticals	N
Cempra	N
Chimerix	N
Emergent BioSolutions	OW
Enanta Pharmaceuticals	OW
Esperion Therapeutics	N
Halozyme Therapeutics	OW
ImmunoGen	N
Ionis Pharmaceuticals	N
Jazz Pharmaceuticals	OW
Lexicon Pharmaceuticals	N
Nektar Therapeutics	OW
Novavax	N
Orexigen Therapeutics	N
Radius Health	OW
The Medicines Company	OW
United Therapeutics	N

Biotech had a roller-coaster of a year in 2016 following a multi-year bull run (the sector entered 2015 with the NBI up 218% since 2011 vs. +66% on the S&P). Election related drug pricing noise that began in late 2015 not surprisingly continued to weigh on the sector in 2016 (NBI -16% and BTK -12% vs. S&P 500 +8%), although the Trump win spurred an upswing (NBI +16% and BTK +20% in the 5 trading days post the election vs. +4% for the S&P) as the market generally assumed the likelihood of significant pricing reform emanating from Washington was significantly diminished. We agree, although continue to think changes are already in motion and expect the industry to be increasingly self-policed while the broader focus on drug prices continues. Without the political weight behind the issue, we think the headline risk will be less and thus see the potential for biotech outperformance and a shift back to company fundamentals.

We continue to expect investor risk appetite for biotechs to be driven by high-profile clinical and regulatory catalysts and commercial performance. Additional support in the sector could come from M&A, which we saw sputter along in 2016; the potential for increased activity could be facilitated by new tax reform, plush pharma balance sheets, and more mature biotech pipelines. While perhaps less pronounced than in the past year, we continue to see the biggest fundamental risk to the sector to be around building pressure against premium pricing.

Stocks for Every Strategy

★**Growth – Jazz Pharmaceuticals (JAZZ/$111.65/Overweight)**

We see Jazz delivering mid-teens top-line and EPS growth over the next several years driven by new launches as well as core driver Xyrem and over time see the company diversifying its reliance on this asset, particularly through strong growth in the hem-onc franchise. We see a healthy stream of catalysts ahead as we move into 2017. Specifically, we expect topline phase III data for JZP-110 in OSA in 1Q17 followed by topline phase III narcolepsy data in 2Q/17 (filing late 2017). We expect the rolling submission for Vyxeos will be complete by early-2017 suggesting a potential launch by 3Q/17. We will also continue to monitor Xyrem litigation/CP/IPR updates with a trial date vs. Hikma approaching in the spring. While a line extension strategy has been (partly) revealed, we acknowledge that the lack of clarity on the durability of original Xyrem represents a clear overhang on the stock and a resolution of that uncertainty would represent a positive for shares, in our view. Bigger picture, with incremental visibility into some of Jazz's next-gen plans and a number of catalysts ahead in 2017, we see a meaningful upside case in the stock from current levels.

Healthcare Technology & Distribution

Rx Channel Underlying Fundamentals Intact

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AmerisourceBergen	N
Cardinal Health	N
Cerner	OW
CVS Health	OW
Diplomat Pharmacy, Inc.	N
Express Scripts	OW
Henry Schein Inc	N
LabCorp	OW
McKesson Corporation	OW
Owens & Minor, Inc.	N
Patterson Companies	N
Premier, Inc.	OW
Quest Diagnostics	N
Rite Aid	N
Teladoc, Inc.	OW
Walgreens Boots Alliance Inc	OW
Stephanie J. Davis, CFA	
Advisory Board	OW
Allscripts	OW
athenahealth	N
Cotiviti	OW
Evolent Health	OW
HealthEquity	OW
Quality Systems	UW

For 2017, we see continued positive impact to the overall Rx channel from an aging population that uses more prescriptions, rising generic dispensing rates and increased sales of specialty drugs (which we expect to grow in the high-teens/low 20% range over the next few years). Further, we believe strong cash flow generation will provide increased flexibility for M&A, dividends and/or share buybacks. We expect the combination of these factors to drive solid underlying EPS growth across most of the Rx channel in 2017 and beyond. For 2017, we continue to focus on companies with strong management teams, catalysts for growth and consistent superior cash flow generation.

Stocks for Every Strategy

★ **Growth – Walgreens Boots Alliance (WBA/$84.05/Overweight)**

We believe recently signed PBM relationships and the Rite Aid acquisition position Walgreens Boots Alliance well for growth in 2017 and beyond. From an overall strategic standpoint, we view the company's efforts to transform the global pharmaceutical supply chain favorably, and we cite benefits from procurement synergies, cross-selling products and sharing best practices. While the retail pharmaceutical reimbursement environment remains challenging, we believe the new PBM pharmacy relationships will help to offset this with incremental volume on a fixed cost base. Beyond the Rite Aid transaction we anticipate the strong cash flow of WBA will position them well to deliver positive shareholder capital returns.

Value – Express-Scripts (ESRX/$76.81/Overweight)

We highlight a favorable fundamental backdrop for the PBM industry, driven by script volume growth, generics, specialty pharmacy and restrictive plan design. We believe ESRX should continue to see improving net new business trends, as evidenced by the recent strong retention rates and solid selling season. In our view, specialty represents a significant catalyst, as we expect plan sponsors to increasingly look to PBMs to help manage this rapidly growing area of spend. We view the expanded relationship with WBA positively and believe there are incremental opportunities to expand the relationship in mutually beneficial ways. While the overhang of the Anthem dispute weighs on the shares we believe that the current multiple, the lowest multiple across the Rx channel, reflects more than the loss of this relationship and we believe ESRX shares are undervalued.

Life Science Tools & Diagnostics

Coming Off a Shaky 3Q, We Continue to Recommend Select Exposure to the Group

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Accelerate Diagnostics	OW
Accuray	OW
Agilent Technologies	OW
Albany Molecular Research	OW
Bruker Corporation	N
Catalent	OW
Charles River Laboratories	OW
Danaher	OW
DENTSPLY SIRONA Inc	N
Foundation Medicine	N
GenMark Diagnostics	OW
Genomic Health	N
Hologic	OW
ICON Plc	N
Illumina, Inc.	OW
INC Research	OW
Intrexon	N
Intuitive Surgical, Inc.	OW
Invitae	OW
Luminex	N
Mettler-Toledo	N
Myriad Genetics Inc.	UW
NanoString	OW
Oxford Immunotec	OW
Pacific Biosciences Inc.	N
Patheon	OW
PerkinElmer	N
Qiagen N.V.	N
Quidel	N
Quintiles IMS Holdings Inc	OW
Thermo Fisher Scientific	OW
Varian Medical	N
VWR	OW
Waters	N
Zeltiq Aesthetics	N

From a stock perspective, the life science tools and diagnostics space generally outperformed healthcare in 2016, as the core tools group benefitted from fund flows out of more volatile sub-sectors (biotech, spec pharma, generics), while end market performance was generally healthy. Biopharma continues to represent the primary growth driver for the industry, despite fears around the biotech funding window remaining shut (although this has begun to ease) and toughening comps. On the diagnostics side, small-caps generally performed well on, or ahead of, new system launches (GNMK/AXDX/NSTG) and M&A (CPHD); with regards to this latter factor, we continue to see the industry set-up for further consolidation, as companies look to mitigate reimbursement headwinds and overlapping test menus. On the sequencing front, while ILMN continues to dominate the competition, adoption in the clinic continues to grapple with a slowly-evolving reimbursement landscape. Looking ahead, we expect 2017 to generally mirror what was seen this year, with ongoing headwinds in industrial and academic markets, driven by depressed commodity pricing and legislative uncertainty (new Trump administration, Brexit), respectively, being offset by ongoing strength in biopharma demand, which we expect to remain the clear outperformer in 2017. Given a sector rotation into the group that began in 2H15, however, valuation multiples remain rich (~19x forward P/E), and we, therefore, continue to recommend select exposure to the group.

Stocks for Every Strategy

★ **Value – Thermo Fisher (TMO/$143.51/Overweight)**

As a dominant supplier to the diversified life science tools, diagnostics, and broader industrial markets, Thermo should continue to be an industry consolidator in 2017 as the company utilizes growing free cash flow (>$3B in 2017E) for accretive acquisitions (acquired Affymetrix and FEIC in 2016), as well as share buybacks and the dividend, while a growing presence in key emerging markets, combined with potential for continued margin expansion and healthy end markets (biopharma in particular) make TMO a compelling investment in our view.

Value – Agilent (A/$44.65/Overweight)

Given exposure to fundamentally strong end markets (biopharma, food/environmental testing), we continue to believe that Agilent is well positioned to deliver solid top-line growth, as management has guided for 4.3% organic growth in FY17, while this growth rate should be considered in the context of a still-sluggish Chemical & Energy (C&E) market to which the company is more exposed vs. peers. There also remains a significant opportunity for further operating margin expansion (where Agilent lags peers) with current guidance of ~21% in FY17 still leaving room for upside, with expansion driven by a mix of cost reductions (~40%) and operating leverage (~60%).

Managed Care & Healthcare Facilities

Fundamentals are Trumped in 2017

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Acadia	N
Aetna	OW
AmSurg	NR
Anthem	N
Cigna	OW
Community Health Systems	N
DaVita Inc	N
Envision	NR
HCA	N
Humana	OW
Kindred	N
LifePoint	N
MEDNAX	OW
Molina	N
Surgical Care Affiliates	N
Team Health	N
Tenet	N
UnitedHealth	OW
Universal Health Services	OW
WellCare	N

The Trump Election win and the possibility of ACA repeal/replace create an overhang on the Healthcare Facilities & Managed Care sector for 2017. We have opined that health insurers with material Medicare-Advantage exposure (HUM, UNH, AET) stand to benefit from the new political regime. In addition, we expect the courts to rule in January on the two largest health insurance mergers in history (AET/HUM and ANTM/CI). We see a 50/50 possibility for AET/HUM and only a 10% chance that ANTM/CI will be approved. We see only modest downside for HUM if the deal is not approved and no material downside for the other companies involved. Health policy and antitrust decisions will dominate sentiment and valuation in 2017. In terms of fundamentals, we find managed care fundamentals to be mixed (with only the Medicare Advantage line of business out-performing in 2017) and healthcare facilities fundamentals to be generally weak (with soft patient volume growth weakening revenue growth even as labor costs pressure margins).

Stocks for Every Strategy

★ **Value – UnitedHealth (UNH/$153.54/Overweight)**

UNH occupies a unique position within the US healthcare delivery system, not only as a dominant payor of scale (in commercial, Medicare, and Medicaid markets) but also as a large and growing presence in local care delivery (physicians and ambulatory via OptumHealth), a newly acquired scale in pharmacy benefits management (OptumRX + Catamaran), and a fast-growing HCIT/consulting /RCM business leveraging its own data warehouse (OptumInsight). Despite its large size, we believe that UNH can deliver double - digit earnings growth while returning capital to shareholders over the next three to five years.

Value – Aetna (AET/$129.33/Overweight)

Aetna is a leading diversified health insurer with significant market share in commercial risk, commercial ASO, Medicare Advantage and Medicaid markets. AET's announced acquisition of HUM (if approved) will propel AET to leading share in Medicare Advantage – one of two robust secular growth opportunities in the health insurance market. We believe the transaction will accelerate AET's organic revenue and earnings growth, while adding EPS accretion from financing and cost synergies. While we see a 50/50 possibility that the DOJ will approve the HUM acquisition with material divestitures, and the pro forma earnings power of the company propels our price target, we think AET's stock is undervalued on a standalone basis, offering a favorable risk - reward opportunity for investors.

Market Neutral – HCA Holdings (HCA/$71.00/Neutral) vs. Tenet Healthcare (THC/$16.26/Neutral)

THC's ~ near-parity EV/EBITDA valuation is not warranted given materially weaker structural B/S & FCF profile. Note our Neutral rating on HCA is primarily based on our view that the preponderance of ACA catalysts have unfolded, and there remains some risk of rollback of coverage expansion under a Trump presidency. Our Neutral rating on THC is based on our negative fundamental view of core hospital assets and balance sheet that is tempered by modest ownership interest in USPI's more attractive operating profile.

Medical Supplies & Devices

Fundamentals Intact; Plenty to Choose from in 2017

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Michael Weinstein	
Abbott Laboratories	NR
Baxter Intl	N
Becton, Dickinson & Co	OW
Boston Scientific Corporation	OW
C.R. Bard Inc.	N
ConforMIS	N
Dexcom	OW
Edwards Lifesciences	OW
Endologix	N
Glaukos	OW
Insulet Corp	N
Intersect ENT	N
iRhythm	OW
Johnson & Johnson	N
Medtronic PLC	OW
Nevro	OW
Penumbra	OW
Spectranetics	OW
St Jude Medical	N
Stryker Corp	N
Zimmer Biomet Holdings Inc	OW
Robbie Marcus, CFA	
Inogen Inc	OW
Integra LifeSciences	OW
Andrew R Hanover	
NuVasive, Inc.	OW
The Cooper Companies, Inc.	N
Wright Medical Group NV	OW

MedTech stocks enjoyed a strong first three quarters of 2016, only to give up much of their outperformance on the back of weaker 3Q results and a market rotation both within healthcare and out of defensive names. As we go into 2017, we see sector fundamentals as largely intact and see opportunities to get more aggressive in several names. Our forecast calls for 4.6% organic revenue growth and 10.6% EPS growth, a tad below 2016 levels (5.1% organic revenue growth, 12.7% EPS growth) reflecting tougher comparisons and some initial conservatism on our end.

In the large-cap space, we see a handful of companies capable of generating 5-6% organic revenue growth and >10% EPS growth through the end of the decade. This includes BCR, BDX, BDX, MDT, and SYK. BAX has a lower top-line profile, but a balance sheet to deploy and the ability to deliver mid-teens EPS growth through 2020, while EW continues to grow double digits on the top and bottom-lines, reflecting the continued development of the TAVR market.

In small caps, we continue to favor a number of high growth, high quality stories including INGN, IRTC, NVRO, and PEN. We see small cap revenue growth moderating in 2017 on tougher comps and the maturation of several product launches, but for overall growth to remain robust. We will update our Top Picks on our sector outlook call on January 3.

Stocks for Every Strategy

Growth – Edwards (EW/$86.86/Overweight)

Over the past five years, Edwards has led the development of the transcatheter aortic valve market. In 2016, the TAVR market grew 34% and Edwards business (47% of 2015 sales) grew 38%. In 2017, we expect the TAVR market to grow ~25% and for Edwards' franchise to grow modestly below market rates. Longer-term, Edwards' ability to leverage its experience and expertise on the aortic side to the development of a transcatheter *mitral* market will be key to its success, in our view. We anticipate clinical trial read-outs from a US feasibility trial and a European CE mark trial to dictate 2017 stock performance.

★ **Value – Zimmer (ZBH/$101.00/Overweight)**

After several expressions of confidence in accelerating top-line, Zimmer came up short in the third quarter, suffering a series of self-inflicted wounds and effectively losing all credibility with the Street. Getting it back won't be easy, but with the stock trading at the biggest discount to its peers (35%) and the S&P (30%) in the company's history, with any signs of progress the stock should outperform.

Pharmaceuticals – Major & Specialty

Focus Squarely on Pipeline and New Product Launches

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Chris Schott, CFA	
AbbVie	N
Allergan plc	OW
Bristol-Myers Squibb Company	OW
Coherus	OW
Eli Lilly & Company	OW
Endo International PLC	OW
Mallinckrodt	N
Merck & Co., Inc.	OW
Momenta	OW
Mylan NV	OW
Perrigo Company	N
Pfizer Inc.	OW
Teva Pharmaceuticals	OW
Valeant Pharmaceuticals	N
Zoetis	N
Dana Flanders, CFA	
Akorn	OW
Impax Laboratories	N
OPKO	OW

With Major Pharma multiples having been under pressure in 2016, we are focused on pipeline opportunities and new product launches as potential upside drivers to our longer-term estimates. While pricing controversies continue to overshadow what we believe are solid longer-term fundamentals (although to a lesser extent post the elections), we believe these challenges are increasingly well reflected in both earnings and sector multiples. In terms of positioning, we are biased towards companies early in new product launch cycles, which we see as offering both attractive top line and margin expansion opportunities and in our view are better insulated from pricing pressures, with LLY representing our top pick followed by BMY and AGN as our favorite names in the space.

Stocks for Every Strategy

★ **Growth – Eli Lilly (LLY/$68.00/Overweight)**

We see an attractive setup for Lilly driven by a broad new product cycle in 2017 post the failure of solanezumab EXPEDITION-3 failure. We see a range of new product opportunities at Lilly that should support the company's growth targets, and are now forecasting ~5% top line and 14% EPS growth through 2020. This growth is driven by a number of $1+ billion product opportunities such as Trulicity, Jardiance, Taltz, baricitinib and abemaciclib. On valuation, although Lilly trades at ~17x 2017E EPS (a ~23% premium to Major Pharma peers), we see the valuation premium as more than justified by Lilly's significantly higher top-line and bottom-line growth relative to peers as well as the company's meaningful pipeline optionality.

Growth – Bristol-Myers Squibb (BMY/$56.75/Overweight)

With expectations in BMY shares clearly having reset post the failure of -026 (shares are down ~33% since August 5 (vs. +8% S&P 500), BMY shares reflect little for Opdivo in NSCLC with the company's ex I/O base business as well as I/O sales in non-lung indications supporting valuation at current levels. However, with company having addressed near- and long-term outlook, we see several drivers of Opdivo growth including ex-US growth and non-lung indications in the US which could help offset expected share pressure in the 2L lung market. Moreover, BMY's confirmed expansion of the PD-L1+ arm of its key 1L NSCLC study (CM-227) reduces the trial specific risks in our view and could help alleviate investor concerns on BMY's frontline lung position. As a result, we see a very favorable risk/reward on BMY shares into 2017.

Value – Allergan (AGN/$193.09/Overweight)

Allergan has a portfolio of durable brands with many of its core products delivering double-digit growth, and we see an opportunity in shares with forward estimates now reset. Coupled with an improved capital return profile (recent initiation of a dividend and current ~1.3% yield), we see valuation as highly attractive as AGN currently trades at ~12x 2017 EPS and ~12x EV/EBITDA, below large-cap global peers, despite a more attractive organic growth profile.

Chemicals

We Find Value in US Chemicals and Special Situation Companies

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Agrium	N
Air Products and Chemicals	OW
Albemarle Corporation	N
Ashland Global Holdings	N
Avery Dennison	OW
Axalta Coating Systems Ltd.	N
Cabot Corporation	N
Celanese	N
CF Industries Holdings, Inc.	N
Chemours	N
Compass Minerals International, Inc.	N
Dow Chemical	OW
DuPont	N
Eastman Chemical Company	OW
Ecolab Inc.	N
Ferro Corp	N
H.B. Fuller	OW
Huntsman Corporation	N
International Flavors & Fragrances	N
LyondellBasell Industries	N
Minerals Technologies	OW
Monsanto	OW
Novozymes	N
Orion Engineered Carbons	OW
Potash Corp.	N
PPG Industries	OW
Praxair	N
RPM International Inc.	N
Scotts Miracle-Gro Co.	OW
Sherwin-Williams	NR
The Mosaic Company	N
Valspar Corp	NR
Valvoline	N
Westlake Chemical Corp.	OW

Rebuilding domestic infrastructure is a priority for the new administration. Moreover, domestic energy opportunities may increase with a more favorable regulatory environment. Accordingly, we think money flows will be positive for the Chemical companies generally next year as managers weight their portfolios more toward diversified materials. Beneficiaries should be coatings and coatings intermediates companies, such as DOW and PPG. An acceleration of drilling activity for oil or gas, or pipeline building would lower raw material costs for petrochemical companies such as Dow, Lyondell and Westlake. In addition, there is increased awareness of corporate tax rates given a new political administration with lower corporate tax rate preferences. Companies such as Monsanto and Scotts Miracle-Gro generate ~60% and ~80%, respectively, of their revenues domestically. Lastly, protectionist policies may lead to higher industrial capacity utilization rates, lifting volumes of industrial gas companies such as Air Products and Praxair.

Stocks for Every Strategy

Growth – Scotts Miracle-Gro (SMG/$90.21/Overweight)

Scotts meaningfully increased its hydroponics (marijuana) business in 2016 through acquisitions. We estimate that Scotts' hydroponics business will represent about 10% of revenues in F2017. The hydroponics business has historically experienced annual growth rates of ~20%, and we expect growth to remain strong as seven states, including California and Florida, have recently approved new marijuana initiatives. We expect the segment to have run-rate operating margins of about 20% and account for approximately 10% of total EBITDA or about $60m in F2017.

★ **Value – Monsanto (MON/$102.42/Overweight)**

Monsanto shares offer an attractive risk/reward proposition, in our opinion. We think a reasonable floor price for the shares, in the event of a disruption of the Bayer/Monsanto combination, is $100/sh or 20x our F2018 EPS estimate. Should Bayer's purchase of Monsanto be consummated, Monsanto shareholders would receive $128/share, most likely by the end of 2017. We believe that Monsanto's product overlaps with Bayer are modest, manageable, and are unlikely to stand in the way of the transaction. We think the business combination is likely to lead to more agricultural innovation rather than less. Monsanto continues to increase its share of the global corn and soybean markets by demonstrating technology strength.

Income Oriented – Dow Chemical (DOW/$54.07/Overweight)

Dow's volume growth over the past few quarters has exceeded industry growth supported by debottlenecking freeing up additional capacities. Moreover, Dow is executing a large restructuring program and it is in the process of merging with DuPont. The core purpose of the combination is cost reduction and business separation. The DuPont results underscore the cost opportunities present for the combined entities. In the background are the expense reduction successes of Axalta and Air Products following management change.

Market Neutral – Air Products (APD/$140.75/Overweight) vs. Praxair (PX/$118.71/Neutral)

Part of the lure of Air Products shares are the options for growth created by its balance sheet. Seifi Ghasemi has historically fared well in buying and selling assets when he was CEO of Rockwood but also in divesting non-strategic assets. Were APD to be 1.5x levered versus its 1Q:F17 unlevered position it could spend in excess of $4b on acquisitions. Should the acquisitions return 10% pre-tax, the EPS accretion would be about $1.35 per share. Praxair's balance sheet at 2.7x net debt/EBITDA does not lend itself to similar acquisition opportunities.

Coal

Carbon Finds a Friend Though Met Coal Could Be Peaking

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Agnico-Eagle (CN)	N
Agnico-Eagle Mines	N
Alliance Resource Partners	OW
Arch Coal, Inc.	N
B2Gold	OW
B2Gold (CN)	OW
Barrick (CN)	N
Barrick Gold	N
Cloud Peak Energy	N
CNX Coal Resources	OW
Compania de Minas Buenaventura	OW
Eldorado (CN)	OW
Eldorado Gold	OW
Franco-Nevada	N
Franco-Nevada (CN)	N
Goldcorp (CN)	OW
Goldcorp Inc	OW
Hecla Mining	OW
Kinross (CN)	N
Kinross Gold	N
New Gold	N
New Gold (CN)	N
Newmont Mining	OW
NOVAGOLD (CN)	OW
NOVAGOLD Resources	OW
Pan American (CN)	N
Pan American Silver	N
Peabody Energy	NR
Silver Wheaton	N
Silver Wheaton (CN)	N
Stillwater Mining	N

Coking coal has reached levels last seen in 2011 and opportunities seem extremely promising for miners with uncommitted coal. We feel at around $300/t, coking coal is peaking now, although prices are likely to remain volatile and could be lifted again by any weather-related disruptions to Australian coal supplies during the coming rainy season. President elect Donald Trump had been a vocal friend to carbon-based energy during his campaign. And now, the Trump presidency promises to reduce regulation and may reverse some new regulations made by decree. However, given the scale of the renewables initiatives from the Obama administration and environmentally sensitive states, it could take some time before renewables stop taking share from coal and gas. And any new policies that support natural gas could even raise pressure on coal. China seems to be taking a long-term view on cutting excess coal capacity and seems willing to endure high prices in the short term to consolidate hard-won capacity cuts. This contributed to a sharp run-up in thermal coal prices in October and November.

Stocks for Every Strategy

Growth – Arch Coal (ARCH/$78.60/Neutral)

Arch Coal has emerged from the Chapter 11 process with a clean balance sheet and prospects for bumper met coal cash flows in 2017. The run-up in met coal prices has been so extreme that making forecasts for 2017 is tricky; most investors are haircutting the met coal forward curve that currently suggests a ~$230/t average. We are using an average 2017 price of $155/ton. Arch is likely to be well placed to be a consolidator in 2017 to the extent the FTC allows deals.

We expect any consolidation is likely to be more of the tack-on style rather than basin wide. The FTC and utilities have often pushed back against coal industry consolidation as customers have tried to keep its supply base as diverse as possible

Value – Cloud Peak (CLD/$6.09/Neutral)

Cloud Peak has recognized the growth opportunities for PRB coal in the US utility space is limited. The company's Spring Creek mine produces a higher BTU coal than the 8800btu/lb standard and is a little closer to the port facility in Vancouver than other PRB mines. This positions CLD to be an exporter; the company recently acquired more port capacity and extra coal reserves. Improved Pacific basin coal prices reopened the export market and the company has locked in more sales.

Increased exports were promising to offset the take-or-pay charges related to the underutilized port capacity in Vancouver and the stock was appreciating. However, the recent pullback in PacRim coal prices resulted in a pullback in the CLD stock price.

★ **Income Oriented – Alliance Resources (ARLP/$23.15/Overweight)**

ARLP is primarily an Illinois basin miner. Now that US coal fired power plants are scrubbed, making them relatively indifferent on sulfur content, we feel ARLP's low cost higher energy coal has an advantage. The company has worked hard to bring down costs and protect its distributions. The company is currently offering a 7.78% yield.

Metals & Mining

Higher Sheet Steel Prices Right Around the Corner

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AK Steel	OW
Alcoa	N
Allegheny Technologies	UW
Carpenter Technology	N
Century Aluminum Company	N
Cliffs Natural Resources	OW
Commercial Metals	N
Constellium	OW
Ferroglobe PLC	N
Freeport-McMoRan	NR
Haynes International	N
Kaiser Aluminum	N
Nucor Corp.	OW
Reliance Steel & Aluminum	N
Ryerson	N
Steel Dynamics, Inc.	OW
SunCoke Energy Partners, L.P.	N
Teck Resources	N
U.S. Steel Corp	OW
Worthington Industries	N

We believe we recently hit a positive inflection point for US steel sheet prices. Scrap prices have bottomed, and domestic mills have hiked sheet prices by a combined $100/ton over the past few weeks. Met coal prices have also gone through the roof, which should push steel prices higher globally. Already we are seeing improving sheet prices in China. Supply cuts in the US, which caused steel prices to rally in early to mid-2016, remain largely in place. Despite ArcelorMittal's planned restart of Indiana Harbor West and Big River Steel's scheduled EAF ramp-up in 2017, net domestic sheet production cuts are still significant at 9.2% of US apparent consumption (versus 11.6% prior to these developments). Additionally, steel imports have declined y/y on the heels of affirmative final duties from the three sheet trade cases. The trade environment continues to be positive for domestic producers, with the Department of Commerce recently initiating anti-circumvention probes into coated and cold-rolled sheet from Vietnam. Our top pick continues to be X, as we believe positive industry fundamentals and the re-pricing of 40% of its Flat-Rolled shipments for 2017 should drive significant earnings leverage and propel the stock higher.

Stocks for Every Strategy

Value – U.S. Steel (X/$33.06/Overweight)

X is the domestic steel stock most levered to a steel recovery given its higher fixed costs. X has strengthened its balance sheet meaningfully since the beginning of the year by doing an equity raise and paying down debt. Management thinks that X is now in a position to reinvest in the company. We believe X is positioned for higher earnings in 2017 as 40% of this year's Flat Rolled volumes were priced near the bottom of the cycle and steel prices now are higher than they were this time last year. Furthermore, given X's fixed cost leverage and our belief that we are at a positive inflection point in US sheet prices, X continues to be our top pick in our space.

Value – AK Steel (AKS/$9.18/Overweight)

AK's earnings should benefit from higher 2017 contract prices as well as its efforts to reduce its commodity exposure, focus on higher value products and control costs. Additionally, the company's FCF should get a boost from lower capex and pension contributions. This higher level of earnings and free cash flow should allow the company to continue to reduce its debt over time.

Value – Cliffs Natural Resources (CLF/$9.20/Overweight)

CLF remains the primary source of iron ore pellets to nearly all the integrated steel producers in the US We think CLF will soon see higher realized prices in its US Iron Ore business as hot-rolled coil prices are set to rebound. Our estimates and price target of $7 also reflect J.P. Morgan's house view on a 2017 seaborne iron ore price of $54/mt compared to the current spot price of $76/mt.

Growth – Steel Dynamics (STLD/$35.74/Overweight)

Besides benefitting from higher steel prices (though to lesser extent than integrated producers X and AKS), we think STLD should also continue to create value through capital allocation. The company has a solid balance sheet and strong free cash flows (even in the currently depressed steel price environment), and will likely continue to look at acquisitions, mainly in the downstream that would pull through steel operations capacity.

Packaging

Good Spot in a Lower Growth Economy

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Ball Corporation	OW
Berry Plastics	OW
Crown Holdings	OW
Owens-Illinois	N
Sealed Air	N
Silgan	N

We see the packaging space as an attractive sector in a lower growth economy. Over the past five years, EPS growth rates for the packagers have beaten the market, and we think the packaging companies in general should continue to post solid EPS growth from low single-digit volume gains, a positive price/cost spread and disciplined capital allocation. This stable and defensive growth, along with a valuation that remains at a modest discount to the market, should also continue to bode well for the stocks going forward. In general, we prefer companies with stable volume growth profiles as well as cost reduction and capital allocation opportunities, and are cautious on companies dealing with turnarounds or expecting ramps in volumes. Our top pick is OW-rated and Analyst Focus List pick Berry Plastics (BERY) followed by OW-rated BLL (BLL) and OW-rated Crown (CCK).

Stocks for Every Strategy

★ **Value – Berry Plastics (BERY/$46.34/Overweight)**

Our above-consensus EPS estimates for Berry should be driven by solid growth from Avintiv's health and hygiene markets, synergies from the deal, and lower interest expense. Additionally, Berry's pending AEP acquisition (set to close in December) should push our estimates even higher. The company's strong (and growing) free cash flows should allow it to reach its leverage goal by year-end 2017 and subsequently deploy the cash toward growth investments, share repurchases, and/or the potential initiation of a dividend. While Berry trades at a meaningful discount to the group on a FCF yield basis, we would expect this gap to narrow over time as the company pays down debt, demonstrates that its margins are sustainable, and benefits from Avintiv's higher growth rates.

Value – Ball (BLL/$77.66/Overweight)

We expect BLL's Rexam acquisition and synergies from the deal of greater than $300mm, global beverage can growth, investments such as Monterrey, and higher earnings in Aerospace and Food & Aerosol to drive solid, lower-risk EPS growth over the next several years (31% in 2018 and 18% in 2018). Additionally, FCF should benefit from working capital gains and potentially lower growth capex. With this strong FCF, we expect BLL to quickly reduce its debt and begin to repurchase shares potentially towards the end of 2017.

Precious Metals

Déjà Vu All Over Again

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Bloomberg **JPMA BRIDGES** <GO>

Agnico-Eagle (CN)	N
Agnico-Eagle Mines	N
Alliance Resource Partners	OW
Arch Coal, Inc.	N
B2Gold	OW
B2Gold (CN)	OW
Barrick (CN)	N
Barrick Gold	N
Cloud Peak Energy	N
CNX Coal Resources	OW
Compania de Minas Buenaventura	OW
Eldorado (CN)	OW
Eldorado Gold	OW
Franco-Nevada	N
Franco-Nevada (CN)	N
Goldcorp (CN)	OW
Goldcorp Inc	OW
Hecla Mining	OW
Kinross (CN)	N
Kinross Gold	N
New Gold	N
New Gold (CN)	N
Newmont Mining	OW
NOVAGOLD (CN)	OW
NOVAGOLD Resources	OW
Pan American (CN)	N
Pan American Silver	N
Peabody Energy	NR
Silver Wheaton	N
Silver Wheaton (CN)	N
Stillwater Mining	N

At the end of 2015, precious metals prices were driven to low levels on fears of rising rates. Here we are again with rates that have jumped on President elect Trumps' new growth plans that have sharply raised rates, the dollar and thus depressed gold prices. If the 2016 scenario repeats, precious metals equities could get oversold preparing the sector for any new trigger that could deliver a rally into 2017. Alternatively, if President elect Trump's spending plans come through, we could see the more industrially focused precious metals like the PGMs and silver outperforming gold.

Stocks for Every Strategy

Growth – Hecla (HL/$5.91/Overweight)

Hecla is 125 years young. The company is rejuvenating itself with a new shaft development at its Lucky Friday mine, new technology at its Greens' Creek mine and highly profitable operations at San Sebastian in Mexico. The company expects to be free cash flow positive at its Lucky Friday mine in 2017 and expects production to grow and costs to fall as it accesses the high grade ore at that mine. The company is also thinking longer term by buying into the Rock Creek and Montanore mine projects which should offer longer term opportunity.

★ **Value – Newmont Mining (NEM/$31.50/Overweight)**

Newmont has worked hard to reduce debt in its balance sheet aswith the closing of its sale of Batu Hijau in Indonesia as it receives another ~$900m of cash. The company has brought its debt down to the levels it required. After building the Merian, and Long Valley mines and buying CC&V the company has a stable production profile. A decision to go ahead with its Ahafo and Subika projects in Ghana could give Newmont a small growth profile.

Income Oriented – Franco Nevada (FNV/$56.99/Neutral)

Franco Nevada is not an operating miner, it's more of a mezzanine financier of mines, however we think it's very good at what it does. It began by buying mine royalties in the 1980s. More recently, as the industry preferred the greater financial flexibility of the streaming mechanism it has become active in this subsector. It has been very active as large diversified miners sold streams on long lived mines and now has a portfolio that offers production and a dividend.

Market Neutral – Stillwater Mining (SWC/$14.64/Neutral) vs. Barrick Gold (ABX/$14.63/Neutral)

If the new President's policies are successful in stimulating real growth, we'd expect the more industrial precious metals like platinum and palladium to outperform gold. It's with this idea in mind that we suggest being long SWC against the largest gold producer Barrick Gold. Stillwater has been making strong progress in cutting costs and speeding access to the higher grade ore in the Blitz deposit.

Barrick Gold is still the world's largest gold miner but faces falling production; we wrote earlier about strategies it could follow to re-charge its reserves. Alternatively, it can advance some of its larger projects. Barrick Gold has re-hired George Bee to work on strategies to advance the Pascua Lama project and recently beefed up the leadership at its JV with NOVAGOLD (NG) where we expect the company will receive permits for its Donlin Gold project in 2017. Whether ABX rejuvenates its production profile from M&A or through building out some of its projects in a lower gold price environment it risks dilution.

Internet

Secular Growth & Fundamentals Remain Strong; Mobile, L-T Investments & More Disruption

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Alphabet	OW
Alphabet Inc.	OW
Amazon.com	OW
Bankrate Inc	N
Care.com	N
Chegg, Inc.	OW
Criteo	OW
eBay, Inc	N
Expedia, Inc.	N
Facebook	OW
Groupon	N
IAC/InterActiveCorp	OW
LinkedIn Corp	N
Match Group	OW
Netflix Inc	OW
Pandora Media Inc	OW
The Priceline Group Inc	OW
TripAdvisor, Inc.	N
TrueCar Inc.	N
TubeMogul	OW
Twitter, Inc.	N
Yahoo Inc	NR
Yelp Inc.	OW
Zynga Inc	N

The Internet sector saw more balanced performance in 2016, w/our coverage universe performing in-line with the market YTD, up +8% on average & +9% on a market-cap weighted basis vs. the S&P 500 at +8%. **Heading into 2017, we think secular growth & underlying fundamentals remain solid across advertising** (growth close to 20%), **eCommerce** (~15%+ growth), **& online travel** (resilient despite security threats & some macro concern). We recognize there is heightened near-term uncertainty under the new Trump administration, with potential risks including net neutrality and more reflation-driven sector rotation, but overall we do not see major changes to sector fundamentals and we remain positive on the group. Key themes we are looking for in 2017 include: **1)** mobile monetization continuing to increase, closing the gap with usage and time spent across online advertising, eCommerce, online travel, etc.; **2)** heightened investment in major long-term growth opportunities; and **3)** continued disruption of traditional media and retail without major changes in trajectory or competitive dynamics.

Stocks for Every Strategy

★ **Value – Facebook (FB/$120.84/Overweight)**

FB saw healthy earnings beats, ad revenue growth, margin expansion, and significant upward earnings revisions in 2016, driving shares up 15% YTD (above the SPX up 8% and our Internet coverage universe market cap-weighted average up 9%). **However, overall enthusiasm toward the name is somewhat muted**, as evidenced by FB's blended forward P/E multiple, which has compressed ~36% YTD. In our view a number of concerns have contributed to the recent wall of worry including the upcoming opex guide, potential for meaningful revenue deceleration, slowing ad load growth, engagement, and competitive platforms. However, **we believe these fears are largely overdone and create a good buying opportunity**: **1)** FB has cautioned on heavy investment increases in previous years, only to ultimately come in toward the low end of the opex growth guide or below; **2)** we expect ad load growth to slow, but point out that consensus estimates already suggest revenue growth of 52% in 2016 going to 34% in 2017—healthy deceleration; **3)** engagement remains strong as FB showed upticks in DAU/MAU in every region in 3Q, FB MAU growth accelerated Y/Y, and Instagram Stories already has 100M+ DAUs; and **4)** we believe valuation of Facebook shares is compelling at 15.7x our above-consensus 2018 non-GAAP EPS of $7.71, in-line with Google.

Growth – Netflix (NFLX/$117.69/Overweight)

NFLX saw mixed performance in 2016, driven largely by increased churn related to its pricing change, slower than expected growth in new Int'l markets, and heavy content spend/cash burn. More recent concerns include the new administration's net neutrality stance and competition from AMZN's global video expansion. Heading into 2017, we believe sentiment remains mixed as NFLX is one of the most controversial stocks in our coverage universe. However, **we believe NFLX sets up as a cleaner story into 2017 w/pricing changes behind, revenue accretion from higher ASPs, stronger content, and more profitability.** Importantly, we think NFLX is on track toward 60M+ US subs and ~100M Int'l subs by 2020, w/material earnings power. We believe key drivers of upside in 2017 include: **1)** Y/Y net adds growth in both the US and int'l; **2)** material profitability in 2017; **3)** originals success as slate grows to over 1k hours in '17; **4)** ASP upside (we model ~10% in '17), which allows NFLX to both invest more and grow profit; & **5)** while we don't put much credence in near-term M&A potential, we do view NFLX as a highly strategic asset.

Media

In a Fast and Furious Changing Landscape, Content Remains King

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21st Century Fox	OW
AMC Networks	N
CBS Corporation	OW
Cinemark	OW
Discovery Communications	N
Disney	OW
Gannett Company	N
IMAX	N
Interpublic Group of Companies	OW
Lamar Advertising Co.	N
Lionsgate Entertainment	NR
Madison Square Garden Company	OW
MSG Networks	N
National CineMedia, Inc.	OW
New York Times Company	N
News Corp	N
Omnicom Group	OW
Outfront Media Inc	OW
Regal Entertainment	N
Scripps Networks Interactive	N
SeaWorld Entertainment	N
Sinclair Broadcast Group	N
TEGNA	N
Time Warner	NR
Viacom	OW
David Karnovsky, CFA	
Live Nation	OW

We are generally favorable on Media going into 2017, as the group should benefit from a strong advertising market, healthy box office trends and upcoming launches of several vMVPD services. Meanwhile, we expect the group will diverge further in both business performance and valuation as the companies with scale, leverage and "must-have" content will become increasingly important in a digital/OTT world.

We believe the two main issues for our group are the rate of potential declines in traditional viewership/subscribers caused by emerging OTT players and the health of advertising. On the former, we believe new entrants into the market (DTV Now, Hulu Live) will not be overly disruptive and rather view niche players at lower price points (HBO Now, DISH's Sling TV) as greater threats. Certain networks with leverage and compelling content should disproportionately benefit from inclusion into these new offerings, partially mitigating declines, while others will likely suffer. On advertising, we expect healthy and stronger than initially expected television advertising trends, partially benefiting from a shift of some digital dollars back toTV.

Overall, we favor stocks with a streamlined group of "must-have" networks that have a greater ability to offset any traditional TV sub declines and will command a greater portion of both traditional and digital ad dollars. We also expect M&A to be a key theme in the sector, as the pending T/TWX, LGF/STRZA and potential CBS/VIAB deals may pressure smaller companies to partner with other distributors or media companies to gain scale and leverage to navigate the changing media landscape.

Stocks for Every Strategy

★ **Growth – CBS (CBS/$60.01/Overweight)**

CBS is our top pick in media. We are attracted to the company's streamlined assets – namely the CBS Network and Showtime – both of which are relatively insulated from the trends pressuring the pay-TV ecosystem. We also have a high degree of confidence in the long-term growth drivers, which include a continued ramp-up in retransmission and reverse compensation revenue, higher content sales led by strong demand abroad, and growth in the company's OTT platforms. 2017 will present a difficult comp, given a strong 2016 that featured the Super Bowl and a record year for political advertising (at least at CBS). While we model only slight gains in operating income next year, we still forecast 6% EPS growth, helped by continued shareholder returns, before a more robust growth profile returns in 2018. We view valuation as undemanding at 13.7x our 2017E adj. EPS, which is in line with CBS's long-term NTM P/E average and still well below the S&P's 16.6x.

Value – Disney (DIS/$98.26/Overweight)

Disney has unparalleled IP that can be monetized across its various divisions and longer-term growth opportunities across the company. Although F2017 is likely to be a more modest year for earnings growth, we believe the largest overhang on the stock, potential profit declines at ESPN, has been somewhat alleviated near term with improving sub trends recently and the potential to benefit from emerging OTT platforms as well as the network's own OTT service launch next year. Across the other divisions, we expect domestic parks to have strong attendance/spending trends and healthy margin expansion with the opening of Avatar Land in 2017, while Shanghai Disney should be close to breakeven next year with strong future earning potential. The Studio and Consumer Products segments are likely to have a softer F2017 on a difficult comparison, but we believe both segments will return to healthy double-digit operating income growth in F2018. DIS trades at 16.4x our F2017E adj. EPS, slightly below the S&P at 16.6x and the company's five-year average of 17x.

Telecom, Cable, and Satellite

Expect Charter's Integration to Gain Momentum; Like the CTL / LVLT Combo into Merger

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American Tower	OW
AT&T	NR
Cable One	N
CenturyLink	N
Charter Communications	OW
Cogent Communications	N
Comcast	OW
Communications Sales & Leasing, Inc.	OW
Crown Castle	N
DISH Network	OW
Equinix	N
Frontier	OW
Gogo	OW
Intelsat	UW
Level 3 Communications	OW
SBA Communications	N
Sirius XM Radio Inc.	N
Sprint Corp	N
Telephone & Data Systems	N
T-Mobile US Inc.	OW
US Cellular	N
Verizon Communications	N
Windstream	NR
Zayo	OW

Richard Choe	
BCE Inc	OW
CyrusOne	OW
Digital Realty Trust	N
QTS Realty Trust	OW
Rogers Communications	N
TELUS	N

With a more pro-business administration expected in Washington following the presidential election, we focus on companies that would benefit from deregulation (cable and ISPs) – particularly the FCC. In addition, our focus list may also benefit from a more amenable M&A review process and potential infrastructure/telecom fiscal spending. Within that context our favorite stock for 2017 is Charter given its potential for strong growth as it implements its operating strategy across the new TWC and BHN markets leading to solid free cash flow growth. In addition, we focus on CenturyLink, which offers an 8.9% dividend yield and Level 3 as its shares now offer an 8.5% return to CTL take-out price. In a less yield-centric world we focus on pairing dividend names and prefer Crown Castle to Verizon.

Stocks for Every Strategy

★ **Growth – Charter Communications (CHTR/$272.31/Overweight)**

Charter is our best long-term idea in both telecom and cable. We continue to like Charter for its potential growth and strong free cash flow generation post the merger with Time Warner Cable (TWC) and Bright House Networks (BHN). Charter should drive strong penetration and ARPU growth long term as it rolls out its new pricing and packaging to newly acquired markets. In our view, Charter's strong subscriber growth and substantial synergies should drive robust free cash flow ($21/share full taxed at today's rates in 2019) and solid capital returns (estimate $6b in 2017) or potential accretive M&A.

Value – Level 3 (LVLT/$56.57/Overweight)

CenturyLink agreed to buy LVLT for $26.50 in cash and 1.4286 shares of CTL stock, which implies an 8.5% return for LVLT holders assuming a one year to deal close and no change to CTL shares. We believe fundamental investors who are total-return focused should look to buy Level 3 to lock in that 8.5% return and what we expect to be a gradual increase in the CTL share price as the deal comes together.

Income Oriented – CenturyLink (CTL/$24.40/Neutral)

CenturyLink shares currently yield 8.9% dividend and we believe that the stock should be attractive to income oriented investors as we see limited downside or risk to a dividend cut. CenturyLink's dividend yield compares to 11.6% and 7.9% for Frontier and Windstream, respectively. We also believe that CTL's pending acquisition of LVLT makes a lot of sense from a strategic and cost savings perspective and substantial value in the merger. CenturyLink's acquisition of Level 3 should further fortify the dividend and we model a payout ratio of 55% in 2020 vs. ~64% on a stand-alone basis.

Short Idea – Intelsat (I/$3.75/Underweight)

We believe that the satellite industry continues to face secular headwinds as new entrants and more HTS capacity come in and we fear pricing could continue to decline, leaving Intelsat little room out of its large debt load. As such, we see more risks to the downside than upside and would continue to stay away.

Market Neutral – Crown Castle (CCI/$84.16/Neutral) vs. Verizon (VZ/$50.23/Neutral)

We are Neutral on Crown Castle as well as Verizon, as we see shares of both companies fairly valued, but favor the former's 4.5% dividend yield vs. the latter's 4.6%. Both companies are highly exposed to the US wireless market but we see Crown offering a sustained mid to high-single digit dividend growth to Verizon's low single and better revenue growth as well.

Applied & Emerging Technologies

Not for the Faint of Heart

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8point3 Energy Partners LP	OW
Canadian Solar	OW
Cree	NR
Diebold, Incorporated	OW
Fabrinet	OW
First Solar, Inc	N
Flex Ltd	OW
Garmin Ltd.	N
GoPro, Inc.	OW
Logitech International	N
MTS Systems Corp	OW
NCR Corporation	OW
NICE Ltd	OW
Ormat Technologies	N
Plantronics Inc	N
Rambus Inc.	N
Stratasys, Ltd.	UW
SunPower Corporation	N
Synaptics Inc.	OW
TerraForm Global, Inc.	N
TerraForm Power, Inc.	N
TPI Composites	OW
Trimble Inc	N
TTM Technologies	OW
Veeco Instruments	N
Verint Systems, Inc.	OW
Zebra Technologies	OW
Mark Strouse, CFA	
Cubic Corp	N
DigitalGlobe, Inc.	N
iRobot Corporation	UW
SolarEdge Technologies	OW
TASER International Inc.	OW
Paul Chung	
Dolby Laboratories, Inc.	N

Consisting of generally high-beta stocks, our SMid Cap Applied Tech coverage is liable to wild swings driven by programmatic risk-on/risk-off trades and rotation. Furthermore, the consumer electronics companies (including GoPro, Garmin and iRobot) can move violently at quarter-end, particularly approaching the holiday season when product cycles can make or break the story for the year, making year-ahead picks particularly perilous. Generally, we direct risk-averse investors toward value-ideas, which would include Diebold (DBD), NCR and Zebra Technology (ZBRA). Investors that are prepared to take on a high-risk/high-reward trade should consider GoPro, whose new Hero5/Karma drone product cycle could drive strong y/y growth and a return to profitability.

Our top long idea for 2017 is a value idea, Overweight-rated Diebold (DBD).

Stocks for Every Strategy

Growth – GoPro (GPRO/$9.88/Overweight)

The introduction of the Hero5 and the pending introduction of the Karma drone should lead to strong y/y growth against weak comps in the first half of 2017 and a return to profitability owing to expense reductions that will be executed in late 2016 through early 2017. Upgrades to the capture/edit/share software platform should continue to strengthen the brand and the company's position in the CE industry and within social media. This is a high-risk/high-return scenario, now dependent on impeccable execution (which was lacking in 2015-2016), but the stock has the potential to appreciate significantly if they get this product cycle right.

★ **Value – Diebold (DBD/$23.15/Overweight)**

By the February 2017 analyst day, noise associated with the acquisition should dissipate and investors should gain a clearer line of sight to the $160 million synergy target, debt deleveraging potential, and earnings power. The Financials Tier 2 pipeline remains robust and should flow through in 2HFY17, but in the meantime we expect volatility owing to inevitable acquisition related costs, while quality of earnings should remain depressed for a couple of quarters.

Income Oriented – Garmin (GRMN/$52.53/Neutral)

Garmin generates ~$400-$500mm in FCF annually driven by relatively high margin consumer electronics business that is well diversified across several end markets including Aviation, Auto, Marine, Fitness, and Outdoor. The firm's ~$400mm+ annual R&D budget ensures a steady cadence of new products to stay relevant and feed the FCF machine which currently well covers the 3.9% dividend yield. The firm has no debt with access to ~$2.4B in net cash or ~$12.90 cash per share with a history of repurchasing stock as well.

Short Idea – iRobot Corp (IRBT/$54.77/Underweight)

Owing to solid execution through FY16, investor expectations for revenue growth and leverage in FY17 and beyond are elevated. The stock now trades at ~23.4x FY17E consensus EPS, a premium to historical multiples and other consumer electronics comps. Continued execution presents a risk to the upside though we believe that a slowdown in consumer spending, increased competition, or execution missteps could present downside to consensus estimates.

Business & Information Services

Info Services Offers Durable Top-Line Growth; Business Services Poised to Outperform Cyclically

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Bloomberg **JPMA STEINERMAN <GO>**

Aramark	OW
Bright Horizons	OW
Cintas	OW
D&B	N
Equifax	OW
G&K Services	N
IHS Markit Ltd	N
Iron Mountain	OW
ManpowerGroup	OW
Nielsen Holdings PLC	OW
Resources Connection Inc	N
Robert Half International	OW
Thomson Reuters	N
TransUnion	OW
UniFirst	N
Verisk Analytics	OW

Business Services: US flexible staffing growth has been sparked by the post-election rebound as business confidence recovers. J.P. Morgan economists are forecasting US real GDP to grow 2% in 2017 following a 2.9% increase in 3Q16. Wage inflation has shown signs of progress which should be beneficial to flexible staffing growth and margins. European staffing revenues are recovering with conducive real GDP and strength in key markets such as France. We favor RHI.

Information Services: Information Services companies provide “need to have” information for professionals through subscription-based models. Dominant positioning in targeted end markets provide Information Services firms with high barriers to entry, while embedding strategies create close customer relationships, significant switching costs, and high renewal rates. We see Info Services stocks offering compounding top-line growth and high profitability. Our top pick is EFX.

Stocks for Every Strategy

★ **Growth – Equifax (EFX/$120.07/Overweight)**

Equifax (EFX) is one of three nation-wide consumer credit bureaus. New product investments and the penetration of adjacent new verticals have transformed EFX from a simple consumer credit bureau into a diversified risk management solutions provider with an expanded addressable market. Moreover, these moves, combined with a favorable consumer credit backdrop, have lifted EFX’s intermediate-term organic revenue growth profile into the 6-8% range (including double digits in 2016). We believe that higher growth driven by innovation is the new normal at EFX, a dynamic which places the company in a premium position relative to the Info Services peer group, which grow revenues in the mid-single-digit range on an average organic constant currency basis. The stock’s recent pullback post-election due to interest rate and ACA-related concerns creates a buying opportunity.

Value – Robert Half International (RHI/$44.80/Overweight)

Robert Half (RHI) is the world’s leading vendor of professional staffing services with a cornerstone in accounting staffing. RHI generates most of its revenues in the US. Staffing stocks are up since the US election but 2016 has been a year of sluggish US real GDP growth and revenue deceleration for RHI. A potential pro-business agenda with more growth and a potentially lower US corporate tax rate with President-elect Trump should be favorable for overall temporary help and permanent placement. RHI is also undertaking a natural evolution in digital services with the implementation of a new customer relationship management (CRM) system which creates a lead generation channel for RHI. JPM economists forecast a conducive US real GDP backdrop in 2017 (+2%) for temporary help and, even with the recent rally, RHI shares are still attractive.

Income Oriented – Iron Mountain (IRM/$33.10/Overweight)

Iron Mountain (IRM) is the largest global vendor of business records management services. Iron Mountain completed the acquisition of Recall, the #2 global competitor, in 2016. We view IRM as a growing annuity stream business with strong cash flows. IRM’s Storage revenues have seen consistent organic revenue growth while Service revenues have slowly begun to stabilize. Importantly, IRM is improving margins through its Transformation initiatives and Recall merger cost synergies. The expanding margin profile will support IRM’s goals of an increasing dividend. While exposure to broader REIT sector developments has created additional volatility in IRM shares, looking ahead, IRM’s expanding margin profile and consistent dividend (7% yield) increases will serve as a catalysts for shares.

Enterprise Software

Sustained Shift to Cloud; Focus on Out-of-Favor CF Generators with Co'-Specific Catalysts

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Apptio	N
BlackLine	N
Box	N
Cornerstone OnDemand	UW
Coupa	N
HubSpot	OW
Microsoft	N
Nutanix	N
Oracle	N
Paycom	N
Red Hat	OW
salesforce.com	OW
Splunk	N
Tableau	OW
Talend	N
Twilio	N
Ultimate Software	OW
VMware	OW
Workday	OW
Xactly	OW

Key areas within Enterprise Software – including companies providing cloud computing applications and platforms – have provided outsized returns for investors, and we expect continued growth in 2017. Conversely, as public cloud vendors e.g. AWS, Azure, Google Cloud, and Force.com expand their offerings, we expect sustained disruption of legacy on-premise vendors. Because the sector was lifted this year by a record SaaS M&A wave and a number of very successful IPOs, and sector rotation out of tech and into Financials appears to have begun, 2017 could be a tougher year highlighting the criticality of stock selection.

Stocks for Every Strategy

★ **Value – VMware (VMW/$79.35/Overweight)**

VMware is emerging from a trough of business growth buttressed by multiple growth vectors. Our survey work indicates resellers see 10% growth this year in their VMware practices, above the level we believe is necessary to see upside in the stock. Partner interviews highlight strength in emerging products, including vSAN and NSX, and now VxRail. Over several years, Dell's global distribution network can lead to $1B of incremental VMware revenue, per management.

Growth – salesforce.com (CRM/$73.95/Overweight)

Salesforce.com has blossomed into a true multi-product success story as it now rides atop CRM, marketing, service, and analytics clouds. We believe CRM is differentiated, having been tapped as a key player in the US Government's transition to the cloud. Additionally, SFDC has established itself as a premier Platform-as-a-Service for building and running next-generation IT applications. Salesforce is a structural share-gainer and an attractive long-term investment in the cloud space.

Growth – HubSpot (HUBS/$57.70/Overweight)

We think HubSpot stands out as a high quality SMB marketing automation vendor with notable customer appreciation of its "inbound marketing" methodology. Starting in 2017, HubSpot will sell a formalized "growth stack" of marketing, CRM, and sales tools, which reminds us that the company could be following a salesforce.com playbook, but for the SMB segment. We upgraded HUBS to OW in Oct following multiple compression and believe that near term complexities with billings, GBP exposure, and the timing of its INBOUND conference are already well understood.

Value – Red Hat (RHT/$78.75/Overweight)

We believe Red Hat is one of the few software companies with a disconnect between its consistent-to-potentially accelerating growth glidepath and its valuation. We believe Red Hat's unique open source model, anchored by its core operating system, positions it well in an increasingly hybrid cloud environment. In our view, Red Hat is capable of disrupting large swaths of the traditional infrastructure software market as global trust for open source software grows.

Short Idea – Cornerstone OnDemand (CSOD/$37.29/Underweight)

While we continue to see Cornerstone as a leader in cloud-based Talent Management, its recent results and outlook suggest a much lower growth trajectory than previously anticipated. We also think that a material sales reorg underway may cause further disruption into 2017. Additionally, we think HR survey data may be signaling a fundamental shift in buyer mentality toward integrated HCM suites rather than specialized Talent Management products.

Payments, Processors & IT Services

Optimistic Outlook for 2017

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Tien-Tsin Huang, CFA	
Accenture plc	OW
Automatic Data Processing	N
Black Knight Financial Services	OW
CDW	OW
Cognizant	OW
Computer Sciences	N
EVERTEC	N
FIS	OW
Fiserv, Inc.	N
FleetCor	OW
Genpact	N
Global Payments	OW
Globant	OW
Green Dot	N
IBM	N
Mastercard	OW
MoneyGram	N
Paychex Inc	N
PayPal	OW
Square	OW
TriNet	OW
Vantiv	OW
Verifone	N
Visa Inc.	OW
Western Union	UW
WEX Inc.	N
Xerox Corporation	N
Reginald Smith, CFA	
Alliance Data	OW
Cardtronics PLC	N
Puneet Jain	
Broadridge	N
ExlService Holdings Inc.	N
Syntel, Inc.	N
Virtusa Corp.	OW
WNS Holdings Ltd.	OW

We have a favorable sector view, prioritizing our payment processing coverage over our IT Services names when considering our Equity Strategy team framework for stronger organic growth and margin expansion in the US. Moreover, potential for cash repatriation holiday should benefit US incorporated firms with high foreign revenue mix (V, MA, CTSH should benefit the most in our coverage).

Stocks for Every Strategy

Growth – Square (SQ/$12.43/Overweight)

Since its IPO in late 2015, the knock on Square has been its lofty valuation and uncertain timeline to achieving at scale margins and profitability. Sentiment has improved in recent months, as Square has shown a commitment to profitability, evidenced by EBITDA upside (margins are on track to expand sixteen points in '16). From a growth perspective, Square is on track to grow adjusted revenues north of 30% in 2016, and 22% on an organic compounded annual basis through 2020 (tops in our coverage universe), and a favorable US economic backdrop helps Square.

Value – Cognizant (CTSH/$51.86/Overweight)

Cognizant is steadily transitioning from being a core growth stock to value/GARP as its growth rates and multiple have come in over the last year. The stock trades at 15x NTM earnings, at the low end of offshore peers' trading range of mid-to-high teens, and with potential for steady-to-improving revenue growth profile next year (we expect 10% growth in CY17) and relatively less risk to margins, we recommend CTSH has a top value pick for the next year. Fundamentally, CTSH should benefit from potential de-regulation and higher interest rates driving improved spending in the financial services vertical (40% of revenue).

Income Oriented – Paychex (PAYX/$58.05/Neutral)

PAYX has among the highest dividend yield of our coverage at 3.3%, and has consistently maintained a payout ratio in the mid-80s. JPM in-house view sees rates increasing during CY17, hurting the attractiveness of most income-producing equities, but PAYX should benefit fundamentally as it generates float income. Additionally, we see potential upside though PAYX's exposure to small businesses (average client has ~15 employees) during a period of economic growth.

Short Idea – Western Union (WU/$21.47/Underweight)

Western Union trades at 12x NTM earnings, slightly above its historical multiple of 11.5x, despite continued slow top-line growth and industry wide pricing pressure. Moreover, elections results could represent headwind for the sector, with America first agenda on jobs potentially hurting migration flows beyond Mexico which would be negative for WU. WU generates ~5% of revenue from Mexico.

★ **Market Neutral – FleetCor (FLT/$153.25/Overweight) vs. WEX (WEX/$109.04/Neutral)**

FLT shares are down 16% since reporting soft 3Q results on Nov 1st (S&P 500 up 2%) and trade at a discount to WEX (its slower growing competitor) for the first time in over four years. On a relative basis, FLT trades at a one and a half turn discount to WEX (at 20 times), despite a track record of faster EPS growth, versus a one and half and three turn premiums over the past one and three years, respectively. Moreover, we see greater potential for positive EPS revisions at FLT.

Semiconductors

Continued Growth in 2017 on Stable S/D Environment; M&A Should Keep a Bid in Stocks

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Harlan Sur	
Advanced Micro Devices	N
Analog Devices	N
Applied Materials	OW
Broadcom Limited	OW
Cavium Inc	OW
Cypress Semiconductor	N
Inphi	OW
Integrated Device Technology	OW
Intel	OW
KLA-Tencor	OW
Knowles	N
Lam Research	OW
Linear Technology	N
MACOM	OW
Marvell Technology Group	N
Maxim Integrated Products	OW
Mellanox Technologies	OW
Microchip Technology	OW
Micron Technology	OW
NVIDIA Corporation	N
NXP Semiconductors	N
ON Semiconductor Corporation	N
Orbotech	OW
Texas Instruments	OW
Vishay Intertechnology	N
Xilinx	N

Bill Peterson	
Qorvo	OW
Skyworks Solutions	N

Although semiconductor revenue growth in 2016 is on pace to be flat to slightly down, revenue growth has resumed in 2H16 following a mild inventory correction and we currently estimate 2017 Y/Y revenue growth of 2-5%. On the demand side, our global economics team is calling for GDP expansion in 2017 (GDP 2.8% in 2017 versus 2.5% in 2016). We continue to view the semiconductor industry as more stable / less cyclical characterized by mid- to high-single-digit annual revenue growth going forward. Furthermore, we expect M&A/consolidation and aggressive capital returns will likely keep a bid in our stocks through the year. With ~$100 billion in announced deal value in 2015 and over $100 billion YTD in 2016, we believe the M&A wave in semiconductors is not over and that the industry trend can provide support to semi stocks going forward. In an era of slowing growth and lower cyclicality, industry players are looking into M&A as an effective way to increase diversification, extend market leadership positions, and drive higher profitability (both earnings and FCF) and capital returns.

The SOX index has outperformed in 2016 (up >25% YTD) vs. the Nasdaq and S&P 500 at +7.5% and +8% YTD, respectively. However, in terms of valuation the SOX is trading at ~16x consensus 2017 estimated earnings a discount to S&P that is trading at ~17x, and we see average semiconductor stocks having 5-15% upside from current levels over the next 18 months. Our overall top pick in semis is Broadcom Limited (AVGO) on strong datacenter networking/wireless leadership, margin expansion, strong cash generation and shareholder returns.

Stocks for Every Strategy

★ **Value – Broadcom Limited (AVGO/$177.08/Overweight)**

Our top semiconductor pick Broadcom is a leader in mobile handsets, networking, enterprise storage, and broadband. After a series of mergers and acquisitions in prior years, Broadcom is now one of the largest semiconductor companies in the world with unmatched scale and technology capabilities in the industry. Moreover, Broadcom has a strong focus in maintaining large, sustainable market share in participating end markets which continue to generate sizable profits for the company. Of those markets, mobile handsets and data center networking in particular continue to exhibit favorable growth trends for Broadcom. AVGO currently trades at ~13x C17E earnings vs. the SOX index at ~16x.

Income Oriented – Maxim Integrated (MXIM/$39.96/Overweight)

We favor MXIM on margin performance, solid end-market exposure (automotive and industrial in particular), cash generation and capital return strategy. With disciplined capital expenditures, Maxim continues to generate significant cash and will likely maintain its 80% target payout ratio. MXIM's dividend yield of 3.4% is near its five-year average and the company has grown its dividend in each of the past five years.

Income Oriented – Microchip (MCHP/$66.11/Overweight)

Microchip has had a consistent record of solid execution and over the years has built itself into a strong player in the general MCU and analog space. After the acquisition of competitor Atmel, Microchip is now the #3 player in microcontrollers across a diverse set of end markets. The company has a strong shareholder return program as well, and has returned over $4.2B since 2007 ($2.8B in dividends and $1.4B in buybacks). Microchip has consistently grown its dividend in the past 8 years, and expects dividends paid in FY17 to be treated as return of capital (with favorable tax benefits for shareholders). MCHP's dividend yield is currently ~2.2%.

Semiconductor Capital Equipment

Expect Semicaps to Outperform on Market Share Gains and SAM Expansion; Top Pick KLAC

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Harlan Sur	
Advanced Micro Devices	N
Analog Devices	N
Applied Materials	OW
Broadcom Limited	OW
Cavium Inc	OW
Cypress Semiconductor	N
Inphi	OW
Integrated Device Technology	OW
Intel	OW
KLA-Tencor	OW
Knowles	N
Lam Research	OW
Linear Technology	N
MACOM	OW
Marvell Technology Group	N
Maxim Integrated Products	OW
Mellanox Technologies	OW
Microchip Technology	OW
Micron Technology	OW
NVIDIA Corporation	N
NXP Semiconductors	N
ON Semiconductor Corporation	N
Orbotech	OW
Texas Instruments	OW
Vishay Intertechnology	N
Xilinx	N
Bill Peterson	
Qorvo	OW
Skyworks Solutions	N

Although we have been in a multiyear period of modest wafer fab equipment (WFE) spending growth with 2017 spending growth likely to also come in low- to mid-single digits %, we believe semiconductor equipment companies under coverage will deliver above market top/bottom line growth on market share gains and as a result of served available market (SAM) expansion.

We remain confident on semiconductor capital equipment industry fundamentals driven by a more predictable capex spending environment (Moore's Law), rising capital intensity for advanced technologies (3D NAND, FinFETs, sub-2Xnm DRAM), and steady semiconductor industry unit growth. Semicap companies under coverage are also delivering mid- to high-single digit service revenue growth, boosting financial performance in a modest equipment spending growth environment. We believe such trends should drive margin expansion, free cash flow improvements, and a continued focus on capital return to shareholders.

We favor KLAC in semicaps on strong product cycles, market share gains and served available market (SAM) expansion, best-in-class gross/operating margins and growing shareholder returns.

Stocks for Every Strategy

★ **Income Oriented – KLA-Tencor (KLAC/$81.88/Overweight)**

KLAC is our top semicap pick on rising process control capital intensity, expectations of outperformance in 2017 on multiple product cycles (driving share gains and SAM expansion) and solid operation performance. The company continues to drive best-in-class gross/operating margin and strong free cash flow generation that supports increasing capital returns to shareholders. KLAC's dividend yield of ~2.6% outpaces equipment peers. KLAC trades at 14.5x C17E earnings vs. semicap peer average and SOX index at ~16x.

Software Technology

Performance Is Getting Trump'd (And That's a Good Thing)

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Adobe Systems	OW
Akamai Technologies, Inc.	N
Amdocs	N
ANSYS, Inc.	UW
Aspen Technology	UW
Autodesk	OW
AVG Technologies	N
Barracuda Networks	OW
CA Inc	N
Cadence Design Systems	N
Check Point Software	N
CoStar Group	OW
CyberArk	OW
Ellie Mae	OW
FireEye	N
Five9	OW
Fortinet, Inc	OW
GoDaddy Inc	OW
Guidewire Software	OW
Imperva	N
Intuit	N
LogMeIn	OW
Medidata Solutions	OW
Mentor Graphics	NR
Mimecast	OW
Monotype Imaging	UW
Neustar	N
New Relic	OW
Palo Alto Networks	OW
PTC Inc	OW
Q2 Holdings Inc.	OW
Qualys	N
RingCentral	OW
SecureWorks	OW
SS&C Technologies	OW
Synchronoss Technologies	OW
Synopsys Inc	N
TiVo Corp	OW
Veeva Systems	OW
VeriSign	UW
Web.com	N
Wix.com	N
Jackson E Ader	
Model N	OW
PROS Holdings	OW

The outcome of the presidential election looks to be very positive for the software technology universe for a couple of reasons. First, we see a direct benefit to some of the design companies that are utilized in infrastructure projects that are expected to get a lift from increased spending under a Trump administration. Those companies are Autodesk and PTC. Second, higher interest rates should lead to healthier banks that can invest more into modernizing systems and that should be very positive for Q2 (QTWO/$31.50/OW). Finally, there are a number of companies in our coverage with tremendous overseas cash balances that will benefit from a repatriation holiday including CA, VRSN, and ADSK.

Stocks for Every Strategy

★ **Growth – Synchronoss (SNCR/$49.52/Overweight)**

SNCR provides the activation technology that carriers like AT&T use to enable (turn on) your new smartphones like an iPhone that are purchased online and through other channels. That is ~40% of revenue but is only growing low single digits with ~18% operating margins. The other ~60% of revenue is a cloud business that helps carriers like Verizon provide backup, file sharing, photo/video storage, etc. That business is growing 30%+ and has operating margins north of 30%. Management is looking to divest the activation business leaving the high growth / highly profitable cloud business that currently trades at an implied 4.5-5x revenue multiple. We expect the market will re-rate this business higher as they see the fundamental metrics on a standalone basis and that is what we expect will move shares to our $65 target price.

Value – PTC Inc (PTC/$49.17/Overweight)

One of the direct beneficiaries of the Trump infrastructure plan is PTC. Their customers include the likes of John Deere and Caterpillar that likely see a lift and increase spending on design software as a result. In addition, PTC has a new version of its core CAD program that just launched so the timing is great. Also, the company is undergoing a subscription transition that has proven to be positive for software stocks in the past, and has an emerging IoT business making PTC one of the few companies investible for this theme.

Market Neutral – Long Autodesk (ADSK/$75.15/Overweight) and Short Ansys (ANSS/$94.01/Underweight)

Autodesk is another one of the companies that will directly benefit from infrastructure spending. Roughly a third of the business comes from companies utilizing its design solutions like AutoCAD and Civil3D for infrastructure related projects. ADSK is also going through a subscription transition like PTC and has recently authorized a $1.5B share repurchase program. Ansys some may consider to benefit from infrastructure spend, but the company is undergoing a CEO transition and more importantly a change to the head of sales that we think could be disruptive. Margins are expected to compress in 2017 and here the company is seeing a shift to lease from paid up that it is not being driven or effectively managed like the subscription transitions at PTC and ADSK. We think these moving parts will cause ANSS to trail the performance of ADSK and PTC.

Telecom & Networking Equipment/IT Hardware

Optical in focus for growth, QCOM for yield

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A10 Networks	OW
ADTRAN	OW
Apple Inc.	OW
Arista Networks	N
Brocade	N
Ciena Corp.	OW
Cisco Systems	N
CommScope	OW
Corning	N
F5 Networks	N
Hewlett Packard Enterprise	NR
HP Inc	N
Infinera	N
Juniper Networks	OW
Lumentum	OW
Motorola Solutions	N
NetApp	N
Nimble Storage	N
Pure Storage	N
QUALCOMM	OW
Seagate Technology	N
Viavi	OW
Western Digital	N

Heading into 2017, we expect spending to accelerate in several sub-categories, including 100G optical equipment, Broadband access infrastructure, wireless densification, flash-based storage systems and 25G switching. Within broader customer verticals, we continue to expect web 2.0 spending to remain robust, while other verticals such as Telecoms and Enterprise are likely to be influenced by macro. In the consumer electronics category, we are beginning to see some signs of improvement in consumer sentiment, but we believe it is too early to make any specific trading calls on consumer exposed stocks (AAPL, GLW, QCOM in our sector)

Stocks for Every Strategy

★ **Growth – Ciena (CIEN/$22.28/Overweight)**

We believe that major carriers are likely to continue ramping spending on 100G optical technology as demand for bandwidth continues to increase across users. We believe that, in addition to Longer-Haul terrestrial and submarine fiber networks, CIEN will benefit from the deployment of 100G technology to metro-level networks as well as webscale company networks. We also believe that Ciena, due to its acquisition of Nortel, has a material competitive product advantage when it comes to 100G optical technology and customer relationships.

Value – Viavi (VIAV/$8.05/Overweight)

We recently (on Oct 11) upgraded Viavi to Overweight as our sum-of-the-parts implies meaningful upside should the company improve NSE's operating profits. We believe that better spending in multiple testing end markets could act as a tailwind in CY17 to Viavi. In addition, the company could benefit from a 3D sensing opportunity in smartphones in late CY17 and beyond.

Income Oriented – QUALCOMM (QCOM/$68.13/Overweight)

Qualcomm is currently trading slightly below what we believe is the intrinsic value of the shares at ~$70 based on our sum of parts model. The stock has a dividend yield of 3.1% with limited downside risk due to the NXP deal in our opinion.

Short Idea – F5 Networks (FFIV/$143.90/Neutral)

F5 is beginning to benefit from solid momentum in security. In 2017, the company could also benefit from product refreshes across its portfolio. At its recent Analyst Day, the company has done a good job articulating its cloud vision. However, trading at 17x P/E and 4x EV/Sales, we believe the shares are reflecting flawless execution on product refresh as well as potential for a bid. With enterprise spending weak we believe a price reset in early 2017 is a possibility.

Market Neutral – Western Digital (WDC/$61.04/Neutral) vs. Seagate (STX/$38.82/Neutral)

Both Western Digital and Seagate are exposed to similar hard drive industry trends. However, WDC has acquired flash exposure through Sandisk while Seagate has no flash option. We expect flash memory to continue to take share from hard drives in 2017 in both consumer products and the data center. As a result we believe that WDC should outperform STX. We retain Neutral ratings on both stocks given ongoing demand risk for PCs given recent USD strength on ongoing iffy global macro conditions.

Companies Discussed in This Report (all prices in this report as of market close on 29 November 2016, unless otherwise indicated)
Advance Auto Parts, Inc. (AAP/$169.72[30 November 2016]/Overweight), Antero Midstream Partners LP (AM/$27.86/Overweight), Baxter Intl (BAX/$44.76/Neutral), Bayer (BAYGn.DE/€88.56[30 November 2016]/Neutral), Crown Holdings (CCK/$55.64/Overweight), DuPont (DD/$73.61[30 November 2016]/Neutral), EQT Midstream Partners, LP (EQM/$73.23[30 November 2016]/Overweight), Enterprise Products Partners L.P. (EPD/$25.33/Overweight), Inogen Inc (INGN/$65.15/Overweight), Macquarie Infrastructure Corporation (MIC/$81.94[30 November 2016]/Overweight), NCR Corporation (NCR/$38.75[30 November 2016]/Overweight), Nevro (NVRO/$80.06/Overweight), Noble Midstream Partners LP (NBLX/$32.78/Overweight), Penumbra (PEN/$64.55/Overweight), Schlumberger (SLB/$79.92/Overweight), Western Gas Equity Partners LP (WGP/$42.94[30 November 2016]/Overweight), Western Gas Partners LP (WES/$57.07[30 November 2016]/Overweight), Zebra Technologies (ZBRA/$78.81/Overweight), iRhythm (IRTC/$30.50[30 November 2016]/Overweight)

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