

# Large Cap Global Core Pick List

## January 2019

### Sector Valuations

The market appears fully valued, with the market-capitalization-weighted average, uncertainty-adjusted price/fair value ratio for S&P 500 Index constituents that are under active Morningstar research coverage at 94% as of Dec. 31, down from last month's ratio of 99%.

The S&P 500 fell by 9.18% in December, closing at 2,506.85 at the end of the month. On a relative basis, utilities and healthcare ranked as the most expensive sectors, trading at roughly 100% of fair value. Energy was the cheapest, trading at 85% of fair value. Please refer to the table later in the report for more details on sector valuation.

As of Dec. 31, the Global Large Cap Pick List was priced at 76% of fair value. Consumer staples constituents presented the greatest opportunity, with a market-capitalization-weighted average price/fair value near 65%.

### Portfolio Commentary: Changes

We made numerous changes to the list this month. Beginning in the communication services sector, we added shares of **CBS** CBS (\$71 fair value estimate) and **Dish** DISH (\$43 fair value estimate). We then removed **NetEase** NTES (\$344 fair value estimate) and **KDDI** KDDIY (\$15 fair value estimate). Analyst Neil Macker notes:

"CBS derives a sustainable competitive advantage from its entertainment segment, which contributes more than 50% of EBITDA. Given our overarching premise that the value of high-quality content will continue to increase, the television production studio is the most attractive asset in the entertainment segment."

In the consumer discretionary sector, we added **Mattel** MAT (\$21 fair value estimate) and **Alibaba** BABA (\$240 fair value estimate) as we removed **Fiat Chrysler Automobiles** FCAU (\$29 fair value estimate) and **Bayerische Motoren Werke** BMWYY (\$44 fair value estimate). Analyst R.J. Hottovy details:

"We assign Alibaba a wide economic moat rating based on its strong network effect, where the value

of the platform to consumers increases with a greater number of sellers, and vice versa. Despite recent macroeconomic uncertainty, we expect China and Southeast Asia's digital commerce industry to have a very long runway of growth based on consumer disposable income and consumption trends, increasing Internet and mobile adoption rates, and a highly fragmented brick-and-mortar retail industry. This is in contrast with other network-based industries, which have often reached a more mature state by the time leading players fully establish a meaningful network effect.

"Alibaba's 'ecosystem' is made up of three leading Chinese online retailing platforms: Taobao Marketplace, China's largest online consumer-to-consumer shopping site; Tmall, China's largest third-party business-to-consumer platform for branded goods; and Juhuasuan, China's most popular group buying marketplace by monthly active users."

In the consumer staples sector, we omitted **Coty** COTY (\$12.70 fair value estimate) while adding **Conagra Brands** CAG (\$34.50 fair value estimate). Analyst Sonia Vora details:

"We think the recent acquisition of Pinnacle Foods will complement Conagra's brand set, as the combined entity will hold the number-two spot in the domestic frozen food aisle, but we don't expect it to materially enhance the firm's competitive edge. We believe the difficulties in creating differentiated products, declining center-store traffic, and competitive pressures have led to challenging category dynamics that could prove difficult to overcome if products fail to adapt to evolving consumer trends (as highlighted in second-quarter results, when lackluster innovation led to eroding sales and distribution for key brands like Birds Eye and Wish-Bone). Despite this challenge, Conagra is still targeting \$215 million in cost synergies from this deal (about 7% of Pinnacle's sales) by fiscal 2022, which we find achievable."

Turning to energy sector, we added shares **Exxon Mobil** XOM (\$90 fair value estimate) and **TransCanada** TRP (\$55 fair value estimate). We dropped **Total** TOT (\$77 fair value

### Elizabeth Collins, CFA

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### Daniel Rohr, CFA,

Director of Equity Research, North America

### Lorraine Tan, CFA

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### Alex Morozov, CFA

Director of Equity Research, Europe

### Patrick Dunn

Director of Global Research Operations

This list surfaces large cap global stocks within each Morningstar sector that we believe warrants consideration. Selection criteria is based on uncertainty-adjusted price/fair value ratios, although economic moats, or sustainable competitive advantages, are taken into consideration in the selection process as well. The above-mentioned selection criteria is applied against all constituents of the Morningstar Mid Cap Index (exclusive of S&P 500 component stocks) and the S&P 400 Index.

### Important Disclosure

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estimate) and **Conovus Energy CVE** (\$14 fair value estimate, down from \$16 after accounting for recent declines in commodity prices). Analyst Joe Gemino notes:

“There weren’t any surprises at TransCanada’s 2018 investor day. The company guided to EBITDA growth that is expected to approximate CAD 10 billion by 2021, which is in line with our forecasts. This forecast doesn’t include contributions from the Keystone XL. If placed into service, we think that cash flows from the project will begin to be accretive to the company in 2022. Regarding the Keystone XL, management is reviewing the options provided by the federal judge, who temporarily blocked construction of the project last week. Management believes that it’s too soon to determine the impact of the ruling on the schedule of the project. Additionally, TransCanada is awaiting the Nebraska Supreme Court’s decision on the approved route challenge. All signs point to a positive outcome for TransCanada.”

In the financials sector, **Affiliated Managers Group AMG** (\$150 fair value estimate, down from \$175 after updating for near- to medium-term profitability and revenue assumptions) was removed from the list. We replaced this name with **Wells Fargo WFC** (\$67 fair value estimate). Analyst Eric Compton details:

“Wells Fargo is the top deposit-gatherer in the United States. Its strategy rests on deep customer relationships, sound risk management, and operational excellence. Successful execution of this strategy over decades has resulted in a wide economic moat, clearly evidenced in the company’s financials. Wells Fargo consistently paid less for balance sheet funding than most of its competitors over the past decade, and has also generated more revenue per dollar of assets than most peers over time. We attribute this low-cost funding to a loyal base of longtime customers—indeed, account closures did not spike during the worst of its sales problems, demonstrating that customers are willing to stick with the bank. Unlike its major competitors, Wells is not a top player in the capital markets. Its business model is more akin to regional banks than to money center institutions.”

In the healthcare sector, we removed shares of **Biogen BIIB**

(\$420 fair value estimate), **Royal Philips PHG** (\$48 fair value estimate) and **Incyte INCY** (\$97 fair value estimate) and added **CVS Health CVS** (\$96 fair value estimate), **AmerisourceBergen ABC** (\$106 fair value estimate) and **Fresenius Medical Care FMS** (\$46 fair value estimate). Analyst Karen Andersen notes:

“AmerisourceBergen is one of three large pharmaceutical distributors and is the main supplier to large pharmacy outlets Walgreens and Express Scripts’ mail order pharmacy. The firm has a highly integrated strategic agreement with Walgreens where it supplies all of the retail pharmacy’s drug inventory, including generics. This last aspect is key—supplying higher-margin generic drugs to one of the biggest generic drug retailers outlets is a major positive for profits, capital efficiency, and invested capital returns.

“Over the course of fiscal 2018, the management team did an excellent job integrating approximately 1,900 Rite Aid stores into its distribution operations. We believe this reflects the strong scale, leverage, and efficiency that have been built through the last several years. Additionally, AmerisourceBergen will have the opportunity to procure its generic inventory from the already colossal Walgreens Boots Alliance development.”

In the industrials sector, we added **BAE Systems BAESY** (\$33 fair value estimate) and **Raytheon RTN** (\$212 fair value estimate) as we removed **Masco MAS** (\$44 fair value estimate) and **Caterpillar CAT** (\$186 fair value estimate). Analyst Denise Molina details:

“The United Kingdom promotes BAE as a national champion in crucial areas such as aircraft carriers, naval vessels and submarines, armoured fighting vehicles, general munitions, and network-enabled capability. As the dominant—and, in many instances, the only—player in these markets, BAE enjoys an unbeatable advantage. BAE’s strong relationship with the British government is an intangible asset, as the government has a golden share in the business, which can block a foreign takeover. In 2012, a merger between BAE and EADS collapsed, as the companies could not resolve state concerns about the deal, with the U.K., French, and German governments unable to reach agreement. The U.K. wanted its counterparts to agree to limit their

influence in the merged firm in order to maintain BAE's strong working relations with the U.S. Pentagon."

In the information technology sector, we omitted **Nokia NOK** (\$7.60 fair value estimate) and **Broadcom AVGO** (\$300 fair value estimate) while adding **Alliance Data Systems ADS** (\$210 fair value estimate) and **Applied Materials AMAT** (\$49 fair value estimate). Analyst Abhinav Davuluri writes:

"We believe Applied Materials has a wide economic moat based on its intangible assets around equipment design expertise and research and development cost advantages required to compete for the business of leading-edge manufacturers. These characteristics have allowed it to become the top vendor in the semiconductor equipment market. Applied's scale and resources allow a research and development budget in excess of \$2 billion to serve cutting-edge technologies and thus benefit from inflections such as fin field-effect transistors, or FinFET, and 3D NAND."

Turning to materials sector, we added shares of **Nutrien NTR** (\$68 fair value estimate). We dropped **Martin Marietta Materials MLM** (\$240 fair value estimate). Analysts Seth Goldstein and Andrew Lane note:

"In the highly fragmented farm retail industry, Nutrien is pursuing an acquisition strategy to expand its retail store base, which should improve bargaining power with suppliers. The company also benefits from selling proprietary and private-label products at its newly acquired stores. We expect this segment, which accounted for roughly two thirds of pro forma gross profit in 2016, to generate relatively steady cash flows. In addition to its retail operations, Nutrien produces all three primary crop nutrients. With over 20% market share, Nutrien is the world's largest producer of potash by capacity. Its Canadian mines mostly sit on the lower half of the cost curve and have generated profits even when prices are below the marginal cost of production. Nutrien's nitrogen fertilizer business includes both high- and low-cost assets, much of it depending on the cost of natural gas."

In the real estate sector, **Macerich MAC** (\$59 fair value estimate) was removed from the list. We replaced this name with **Boston Properties BXP** (\$143 fair value estimate).

Analyst Michael Wong details:

"Boston Properties posted a slight beat to our top- and bottom-line estimates for the quarter, and we are not anticipating major changes to our \$143 fair value for the firm or our no-moat rating. Strong economic fundamentals, particularly employment growth, continue to benefit the best office landlords as more tenants compete to rent their space. We see this impact the company's income statement through 80-basis-point growth in same-store occupancy, which beat our expectation of no growth, and 3.56% in re-leasing spreads, though this missed our estimate of 5%-7%. Top-line growth drove same-store cash net operating income up 2.5% from the third quarter in 2017. We think these results show the quality of Boston Properties' portfolio, which we think is essential because many of their tenants use high-quality office space to attract high-skill workers. The resulting funds from operations of \$1.64 beat our estimates by a penny and management raised guidance for the annual bottom line to be more in line with our expectations."

In the utilities sector, we removed shares of **PPL PPL** (\$31 fair value estimate, down from \$35 after cutting our assumption for regulatory returns at PPL's U.K. utility) and added **Dominion Energy D** (\$84 fair value estimate). Analyst Charles Fishman explains:

"Wide-moat infrastructure projects illustrate Dominion's conservative strategy pivot. We expect wide-moat businesses to generate half of Dominion's operating earnings by 2022. The balance of earnings will come from regulated gas and electric utilities with some of the most constructive regulation and attractive growth potential in the country. The pending acquisition of narrow-moat Scana modestly dilutes Dominion's wide moat, but the political theater of Scana's failed nuclear project should fade and result in an accretive transaction. Although annual dividend increases have averaged 9% the past five years, we believe Dominion likely will revisit its dividend growth target—currently in line with EPS growth. We think Dominion's attractive yield, elevated payout ratio, and an estimated 172 million more common shares outstanding (27% increase) by 2019 year-end versus 2017, will likely result in the board reducing dividend growth to low single digits."

## Adjusted Price/Fair Value Ratio

Attractiveness	Lower Bound	Upper Bound	Notes
Cheap	0.000	0.800	Assets are trading at or below Morningstar's "Consider Buying" price.
Undervalued	0.801	0.900	Assets are trading above Morningstar's "Consider Buying" price, but are still at a discount to our fair value estimate.
Fully Valued	0.901	1.100	Assets are trading within a band that is not materially different from Morningstar's fair value estimate.
Overvalued	1.101	1.250	Assets are trading above Morningstar's fair value estimate, but are still below our "Consider Selling" price.
Expensive	1.251	—	Assets are trading at or above Morningstar's "Consider Selling" price.

## Fair Value Per Sector

Morningstar Sector	S&P Sector Weight (%)	Sector P/V (%)	Pick List P/V (%)
Communication Services	9.88	92.44	81.53
Consumer Discretionary	9.61	91.56	78.40
Consumer Staples	7.34	92.21	65.30
Energy	5.22	84.70	76.01
Financials	12.35	91.02	78.44
Healthcare	15.08	99.99	75.93
Industrials	8.49	92.59	81.36
Information Technology	19.55	93.23	82.02
Materials	2.59	94.92	82.42
Real Estate	2.75	98.07	85.83
Utilities	3.33	101.97	87.50

## Largest Negative and Positive Price Movements During December

Company	Ticker	Beg. Price Per Share (USD)	End Price Per Share (USD)	Return (%)
Stericycle	SRCL	48.07	36.69	-23.67
Philip Morris International	PM	86.53	66.76	-22.85
DaVita	DVA	66.06	51.46	-22.10
Coty Class A	COTY	8.34	6.56	-21.34
Hanesbrands	HBI	15.91	12.53	-21.24
Alexion Pharmaceuticals	ALXN	123.15	97.36	-20.94
Albemarle	ALB	96.32	77.07	-19.99
Cardinal Health	CAH	54.83	44.60	-18.66
Western Digital	WDC	45.39	36.97	-18.55
SL Green Realty	SLG	96.42	79.08	-17.98
Tencent Holdings ADR	TCEHY	40.08	39.47	-1.52
Bayerische Motoren Werke ADR	BMWYY	27.38	26.97	-1.49
JD.com ADR	JD	21.23	20.93	-1.41
Incyte	INCY	64.25	63.59	-1.03
Imperial Brands ADR	IMBBY	30.46	30.52	0.20
General Electric	GE	7.50	7.57	0.93
KDDI ADR	KDDIY	11.64	11.85	1.80
NetEase ADR	NTES	227.07	235.37	3.66
Nokia Oyj ADR	NOK	5.47	5.82	6.40
Broadcom	AVGO	237.41	254.28	7.11

**Large Cap Global Core Picks** (Data as of Dec. 31, 2018)

Company	Ticker	Economic Moat™	Uncertainty Rating	Current Price (USD)	Fair Value (USD)	Adj. Price/Fair Value	Morningstar Rating	Market Cap (USD Mil)	Industry	Relative Attractiveness
<b>Communication Services—Undervalued</b>										
Baidu ADR	BIDU	Wide	High	158.60	322	0.75	★★★★★	55,281.70	Internet Content & Information	Cheap
Telefonica ADR	TEF	Narrow	High	8.46	15	0.79	★★★★★	43,588.39	Telecom Services	Cheap
Vodafone Group ADR	VOD	Narrow	High	19.28	32	0.80	★★★★	51,839.96	Telecom Services	Undervalued
CBS Class B	CBS	Narrow	High	43.72	71	0.81	★★★★	16,369.06	Media - Diversified	Undervalued
Tencent Holdings ADR	TCEHY	Wide	High	39.47	64	0.81	★★★★	381,656.64	Internet Content & Information	Undervalued
BT Group ADR	BT	Narrow	High	15.20	24	0.82	★★★★	29,979.26	Telecom Services	Undervalued
Dish Network Class A	DISH	None	Very High	24.97	43	0.83	★★★★	11,677.82	Pay TV	Undervalued
<b>Consumer Discretionary—Cheap</b>										
Hanesbrands	HBI	Narrow	Medium	12.53	27	0.64	★★★★★	4,519.98	Apparel Manufacturing	Cheap
LKQ	LKQ	Narrow	Medium	23.73	47	0.67	★★★★★	7,550.95	Auto Parts	Cheap
Mattel	MAT	Narrow	High	9.99	21	0.74	★★★★★	3,448.06	Leisure	Cheap
Daimler	DDAIF	None	High	52.77	98	0.77	★★★★★	56,182.12	Auto Manufacturers	Cheap
Alibaba Group Holding ADR	BABA	Wide	High	137.07	240	0.79	★★★★★	352,534.42	Specialty Retail	Cheap
Lennar	LEN	None	High	39.15	68	0.79	★★★★★	12,635.51	Residential Construction	Cheap
JD.com ADR	JD	None	High	20.93	36	0.79	★★★★★	29,860.77	Specialty Retail	Cheap
Volkswagen ADR	VWAGY	None	High	15.60	27	0.79	★★★★	79,721.91	Auto Manufacturers	Cheap
Altana	AABA	None	High	57.94	98	0.80	★★★★★	34,914.49	Asset Management	Cheap
Volkswagen ADR	VWAPY	None	High	15.72	27	0.80	★★★★	79,721.91	Auto Manufacturers	Cheap
<b>Consumer Staples—Cheap</b>										
British American Tobacco ADR	BTI	Wide	Low	31.86	59	0.54	★★★★★	72,764.12	Tobacco	Cheap
Anheuser-Busch InBev ADR	BUD	Wide	Low	65.81	118	0.56	★★★★★	129,134.97	Beverages - Brewers	Cheap
Imperial Brands ADR	IMBBY	Wide	Low	30.52	48	0.64	★★★★★	28,766.38	Tobacco	Cheap
Philip Morris International	PM	Wide	Low	66.76	102	0.65	★★★★★	103,780.02	Tobacco	Cheap
General Mills	GIS	Wide	Low	38.94	57	0.68	★★★★★	23,237.40	Packaged Foods	Cheap
Conagra Brands	CAG	Narrow	Medium	21.36	35	0.75	★★★★★	10,372.68	Packaged Foods	Cheap
<b>Energy—Cheap</b>										
Enterprise Products Partners	EPD	Wide	Low	24.59	36	0.69	★★★★★	53,671.65	Oil & Gas Midstream	Cheap
Energy Transfer	ET	None	Medium	13.21	22	0.73	★★★★★	34,571.90	Oil & Gas Midstream	Cheap
Exxon Mobil	XOM	Narrow	Low	68.19	90	0.76	★★★★★	288,703.31	Oil & Gas Integrated	Cheap
TransCanada	TRP	Narrow	Medium	35.70	55	0.77	★★★★★	32,696.21	Oil & Gas Midstream	Cheap
Enbridge	ENB	Wide	Medium	31.08	47	0.77	★★★★★	62,954.82	Oil & Gas Midstream	Cheap

## Large Cap Global Core Picks (Data as of Dec. 31, 2018)

Company	Ticker	52 Week High	52 Week Low	Total Return YTD (Daily)	Total Return 1-Yr (Daily)	Div. Per Share TTM	Div. Yield % Current	Div. Yield % Forward	EPS Est. Growth % Mean 5-Yr	Forward EPS Est.
<b>Communication Services</b>										
Baidu ADR	BIDU	284.22	154.61	-32.28	-32.28	—	—	—	24.90	9.66
Telefonica ADR	TEF	10.57	7.70	-7.78	-7.78	0.49	5.52	5.39	18.13	0.81
Vodafone Group ADR	VOD	32.75	18.45	-34.11	-34.11	1.85	9.03	5.66	9.66	1.32
CBS Class B	CBS	61.59	41.38	-24.68	-24.68	0.72	1.65	1.65	14.31	5.73
Tencent Holdings ADR	TCEHY	61.00	31.54	-23.76	-23.76	0.11	0.29	0.02	17.45	1.42
BT Group ADR	BT	18.97	13.53	-11.25	-11.25	1.06	6.39	3.88	4.62	1.81
Dish Network Class A	DISH	50.49	23.22	-47.71	-47.71	—	—	—	-18.84	2.35
<b>Consumer Discretionary</b>										
Hanesbrands	HBI	23.33	11.57	-37.21	-37.21	0.60	4.79	4.79	3.99	1.78
LKQ	LKQ	43.86	23.14	-41.65	-41.65	—	—	—	13.79	2.52
Mattel	MAT	18.88	9.09	-35.05	-35.05	0.00	—	—	10.00	0.26
Daimler	DDAIF	94.41	51.00	-32.31	-32.31	4.38	8.52	8.52	-6.03	10.20
Alibaba Group Holding ADR	BABA	211.70	129.77	-20.51	-20.51	—	—	—	25.10	7.16
Lennar	LEN	72.17	37.29	-37.84	-37.84	0.16	0.41	0.41	26.13	6.11
JD.com ADR	JD	50.68	19.21	-49.47	-49.47	—	—	—	37.99	0.27
Volkswagen ADR	VWAGY	23.27	14.70	-20.56	-20.56	0.46	2.96	2.96	-3.93	3.44
Altaba	AABA	82.45	54.75	-17.05	-17.05	—	—	—	7.39	0.55
Volkswagen ADR	VWAPY	46.52	14.97	-58.22	-58.22	0.93	5.97	5.97	-3.93	3.44
<b>Consumer Staples</b>										
British American Tobacco ADR	BTI	71.45	30.67	-48.47	-48.47	2.72	8.35	8.53	-16.00	4.17
Anheuser-Busch InBev ADR	BUD	117.06	64.55	-38.05	-38.05	4.24	5.01	5.01	6.55	5.02
Imperial Brands ADR	IMBBY	44.02	28.70	-22.76	-22.76	2.30	7.98	11.26	1.03	3.82
Philip Morris International	PM	111.25	64.67	-32.56	-32.56	4.42	6.73	6.83	7.18	5.29
General Mills	GIS	60.69	36.42	-31.02	-31.02	1.96	5.03	5.03	4.01	3.18
Conagra Brands	CAG	39.43	20.22	-41.04	-41.04	0.85	3.98	3.98	5.23	2.23
<b>Energy</b>										
Enterprise Products Partners	EPD	30.05	23.10	-0.77	-0.77	1.71	6.97	7.04	14.84	1.99
Energy Transfer	ET	19.34	11.68	-16.40	-16.40	1.21	9.24	9.24	-15.04	1.49
Exxon Mobil	XOM	89.30	64.65	-14.61	-14.61	3.18	4.74	4.81	4.20	5.27
TransCanada	TRP	49.89	34.58	-22.31	-22.31	2.15	5.88	5.67	0.00	3.09
Enbridge	ENB	41.21	28.82	-15.21	-15.21	2.09	6.63	7.13	0.00	1.99

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<b>Financials—Cheap</b>										
American International Group	AIG	None	Medium	39.41	76	0.68	★★★★★	34,864.00	Insurance - Diversified	Cheap
ING Groep ADR	ING	None	Medium	10.66	19	0.72	★★★★★	41,890.44	Banks - Global	Cheap
Capital One Financial	COF	Narrow	Medium	75.59	127	0.73	★★★★★	35,803.69	Credit Services	Cheap
Credit Suisse Group ADR	CS	Narrow	High	10.86	23	0.74	★★★★★	27,998.34	Banks - Global	Cheap
Mitsubishi UFJ Financial Group ADR	MUFG	None	Medium	4.87	7	0.79	★★★★★	63,461.19	Banks - Global	Cheap
Wells Fargo	WFC	Wide	Medium	46.08	67	0.79	★★★★★	216,909.81	Banks - Global	Cheap
UBS Group	UBS	Narrow	High	12.38	21	0.79	★★★★★	46,310.81	Banks - Global	Cheap
<b>Healthcare—Cheap</b>										
McKesson	MCK	Wide	Medium	110.47	210	0.68	★★★★★	21,583.21	Medical Distribution	Cheap
Cardinal Health	CAH	Wide	Medium	44.60	82	0.70	★★★★★	13,288.18	Medical Distribution	Cheap
Allergan	AGN	Wide	Medium	133.66	245	0.70	★★★★★	45,081.64	Drug Manufacturers - Specialty & Generic	Cheap
Celgene	CELG	Narrow	Medium	64.09	116	0.70	★★★★★	44,815.05	Biotechnology	Cheap
Roche Holding ADR	RHHBY	Wide	Low	31.08	42	0.74	★★★★★	210,519.85	Drug Manufacturers - Major	Cheap
DaVita	DVA	Narrow	Medium	51.46	81	0.76	★★★★★	8,542.36	Medical Care	Cheap
Bayer ADR	BAYRY	Wide	High	17.57	32	0.77	★★★★★	64,602.17	Drug Manufacturers - Major	Cheap
Alexion Pharmaceuticals	ALXN	Narrow	High	97.36	172	0.78	★★★★★	21,720.69	Biotechnology	Cheap
CVS Health	CVS	Narrow	Medium	65.52	96	0.79	★★★★★	84,730.40	Health Care Plans	Cheap
Laboratory of America Holdings	LH	Narrow	Medium	126.36	184	0.79	★★★★★	12,749.72	Diagnostics & Research	Cheap
AmerisourceBergen	ABC	Wide	Medium	74.40	106	0.80	★★★★★	15,767.85	Medical Distribution	Undervalued
Fresenius Medical Care & KGaA ADR	FMS	Narrow	Medium	32.39	46	0.80	★★★★	19,877.45	Medical Care	Cheap
<b>Industrials—Undervalued</b>										
Stericycle	SRCL	Narrow	High	36.69	83	0.72	★★★★★	3,323.93	Waste Management	Cheap
Rolls-Royce Holdings ADR	RYCEY	Narrow	Medium	10.46	15	0.80	★★★★★	19,965.38	Aerospace & Defense	Cheap
Fanuc ADR	FANUY	Wide	High	15.06	25	0.80	★★★★★	29,279.21	Diversified Industrials	Undervalued
BAE Systems ADR	BAESY	Narrow	Medium	23.42	33	0.81	★★★★	18,621.20	Aerospace & Defense	Undervalued
Raytheon	RTN	Wide	Medium	153.35	212	0.82	★★★★	43,639.88	Aerospace & Defense	Undervalued
Siemens ADR	SIEGY	Narrow	Medium	56.08	78	0.82	★★★★	90,233.75	Diversified Industrials	Undervalued
General Electric	GE	Narrow	Very High	7.57	14	0.82	★★★★	65,844.73	Diversified Industrials	Undervalued

**Large Cap Global Core Picks** (Data as of Dec. 31, 2018)

Company	Ticker	52 Week High	52 Week Low	Total Return YTD (Daily)	Total Return 1-Yr (Daily)	Div. Per Share TTM	Div. Yield % Current	Div. Yield % Forward	EPS Est. Growth % Mean 5-Yr	Forward EPS Est.
<b>Financials</b>										
American International Group	AIG	65.05	36.16	-31.71	-31.71	1.28	3.25	3.25	12.33	4.91
ING Groep ADR	ING	20.58	10.21	-38.43	-38.43	0.72	6.63	6.63	7.90	1.65
Capital One Financial	COF	106.50	69.90	-22.48	-22.48	1.60	2.12	2.12	25.30	11.22
Credit Suisse Group ADR	CS	19.98	10.23	-37.70	-37.70	0.26	2.39	2.39	0.00	1.47
Mitsubishi UFJ Financial Group ADR	MUFG	8.11	4.64	-30.43	-30.43	0.19	3.85	3.85	3.40	0.70
Wells Fargo	WFC	66.31	43.02	-21.34	-21.34	1.60	3.56	3.73	10.50	5.11
UBS Group	UBS	20.89	11.61	-29.15	-29.15	0.67	5.24	5.24	13.90	1.56
<b>Healthcare</b>										
McKesson	MCK	178.86	106.11	-28.23	-28.23	1.41	1.32	1.41	7.64	14.12
Cardinal Health	CAH	75.75	42.17	-23.37	-23.37	1.88	4.24	4.27	59.29	5.35
Allergan	AGN	197.00	125.84	-16.53	-16.53	2.86	2.15	2.15	12.58	9.11
Celgene	CELG	109.98	58.59	-38.59	-38.59	—	—	—	21.30	10.11
Roche Holding ADR	RHHBY	32.58	26.30	1.84	1.84	1.06	3.48	3.48	6.20	2.27
DaVita	DVA	80.71	48.25	-28.78	-28.78	—	—	—	15.73	4.75
Bayer ADR	BAYRY	33.86	16.58	-40.87	-40.87	0.84	4.63	4.63	7.13	2.08
Alexion Pharmaceuticals	ALXN	140.77	92.56	-18.59	-18.59	—	—	—	17.67	8.76
CVS Health	CVS	83.88	60.14	-6.87	-6.87	2.00	3.05	3.05	8.98	7.34
Laboratory of America Holdings	LH	190.36	119.38	-20.78	-20.78	0.00	—	—	7.36	11.33
AmerisourceBergen	ABC	106.27	69.36	-17.29	-17.29	1.52	2.07	2.15	7.56	7.49
Fresenius Medical Care & KGaA ADR	FMS	57.94	31.18	-37.16	-37.16	0.65	1.95	1.95	7.50	2.53
<b>Industrials</b>										
Stericycle	SRCL	76.73	34.36	-46.04	-46.04	—	—	—	8.58	4.26
Rolls-Royce Holdings ADR	RYCEY	14.55	9.50	-7.11	-7.11	0.16	1.46	1.12	-21.00	0.37
Fanuc ADR	FANUY	30.42	14.10	-34.05	-34.05	0.83	5.28	7.00	2.51	0.70
BAE Systems ADR	BAESY	36.41	22.46	-21.20	-21.20	1.15	4.91	3.92	12.43	2.55
Raytheon	RTN	229.75	144.27	-16.09	-16.09	3.33	2.26	2.26	15.42	11.85
Siemens ADR	SIEGY	77.17	54.19	-15.72	-15.72	2.15	4.10	3.83	3.89	5.10
General Electric	GE	19.39	6.66	-54.50	-54.50	0.48	4.89	0.53	0.95	0.82



## Large Cap Global Core Picks (Data as of Dec. 31, 2018)

Company	Ticker	Economic Moat™	Uncertainty Rating	Current Price (USD)	Fair Value (USD)	Adj. Price/Fair Value	Morningstar Rating	Market Cap (USD Mil)	Industry	Relative Attractiveness
<b>Information Technology—Undervalued</b>										
Microchip Technology	MCHP	Wide	Medium	71.92	112	0.76	★★★★★	17,009.78	Semiconductors	Cheap
DXC Technology	DXC	None	High	53.17	91	0.79	★★★★★	14,893.64	Information Technology Services	Cheap
Skyworks Solutions	SWKS	Narrow	High	67.02	113	0.80	★★★★★	11,898.19	Semiconductors	Cheap
Alliance Data Systems	ADS	Narrow	Medium	150.08	210	0.81	★★★★	8,175.39	Credit Services	Undervalued
Intel	INTC	Wide	Medium	46.93	65	0.81	★★★★	214,188.52	Semiconductors	Undervalued
Western Digital	WDC	None	Very High	36.97	67	0.82	★★★★	10,700.03	Data Storage	Undervalued
Applied Materials	AMAT	Wide	High	32.74	49	0.83	★★★★	31,384.76	Semiconductor Equipment & Materials	Undervalued
Salesforce.com	CRM	Wide	Medium	136.97	180	0.84	★★★★	104,782.05	Software - Application	Undervalued
Canon ADR	CAJ	None	Medium	27.60	36	0.84	★★★★	29,363.92	Business Equipment	Undervalued
<b>Materials—Undervalued</b>										
Albemarle	ALB	Narrow	High	77.07	130	0.80	★★★★★	8,185.29	Specialty Chemicals	Cheap
Nutrien	NTR	Narrow	High	47.00	68	0.85	★★★★	28,818.98	Agricultural Inputs	Undervalued
<b>Real Estate—Undervalued</b>										
SL Green Realty	SLG	None	High	79.08	114	0.85	★★★★	6,743.21	REIT - Office	Undervalued
Boston Properties	BXP	None	Medium	112.55	143	0.86	★★★★	17,382.28	REIT - Office	Undervalued
<b>Utilities—Undervalued</b>										
Dominion Energy	D	Wide	Low	71.46	84	0.85	★★★★	46,911.59	Utilities - Diversified	Undervalued

## Large Cap Global Core Picks (Data as of Dec. 31, 2018)

Company	Ticker	52 Week High	52 Week Low	Total Return YTD (Daily)	Total Return 1-Yr (Daily)	Div. Per Share TTM	Div. Yield % Current	Div. Yield % Forward	EPS Est. Growth % Mean 5-Yr	Forward EPS Est.
<b>Information Technology</b>										
Microchip Technology	MCHP	104.20	60.70	-16.51	-16.51	1.45	2.02	2.03	11.54	7.00
DXC Technology	DXC	96.75	49.19	-34.00	-34.00	0.74	1.41	1.43	6.11	8.73
Skyworks Solutions	SWKS	115.98	62.71	-27.94	-27.94	1.34	2.09	2.27	11.19	8.15
Alliance Data Systems	ADS	278.33	142.58	-39.89	-39.89	2.23	1.52	1.52	12.43	23.10
Intel	INTC	57.60	42.04	4.27	4.27	1.17	2.56	2.56	8.12	4.59
Western Digital	WDC	106.96	33.83	-51.00	-51.00	2.00	5.41	5.41	-3.15	9.11
Applied Materials	AMAT	62.40	28.79	-34.59	-34.59	0.60	2.14	2.44	6.79	4.61
Salesforce.com	CRM	161.19	102.23	33.98	33.98	—	—	—	20.68	2.78
Canon ADR	CAJ	40.67	26.37	-24.28	-24.28	1.51	5.50	5.50	0.05	2.14
<b>Materials</b>										
Albemarle	ALB	138.67	71.89	-38.69	-38.69	1.33	1.74	1.74	9.29	6.10
Nutrien	NTR	58.99	40.41	-5.80	-5.80	1.45	3.47	3.66	0.00	3.80
<b>Real Estate</b>										
SL Green Realty	SLG	106.54	76.77	-18.39	-18.39	3.25	4.16	4.30	11.35	1.96
Boston Properties	BXP	132.82	107.84	-10.75	-10.75	3.35	3.11	3.38	6.68	3.13
<b>Utilities</b>										
Dominion Energy	D	81.67	61.53	-7.72	-7.72	3.28	4.67	4.67	6.66	4.25

## Fair Value Changes

Company	Ticker	Old Fair Value (USD)	New Fair Value (USD)	Change (%)
Affiliated Managers Group	AMG	175	150	-14.29
Cenovus Energy	CVE	16	14	-12.50
PPL	PPL	35	31	-11.43
Bayer ADR	BAYRY	34	32	-5.88
Martin Marietta Materials	MLM	250	240	-4.00
Bayerische Motoren Werke ADR	BMWYY	45	44	-2.22
General Mills	GIS	58	57	-1.72
Albemarle	ALB	131	130	-0.76
General Electric	GE	13.7	13.9	1.46

# Research Methodology for Valuing Companies

## Overview

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

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

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

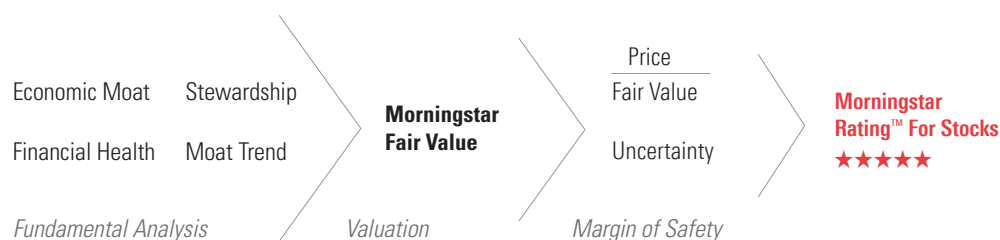
## Economic Moat

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

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

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

## Morningstar Equity Research Star Rating Methodology



**Estimated Fair Value**

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

Our model is divided into three distinct stages:

**Stage I: Explicit Forecast**

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

**Stage II: Fade**

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

**Stage III: Perpetuity**

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

value and that any new investment provides a return in line with estimated WACC.

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

**Uncertainty around that fair value estimate**

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

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

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

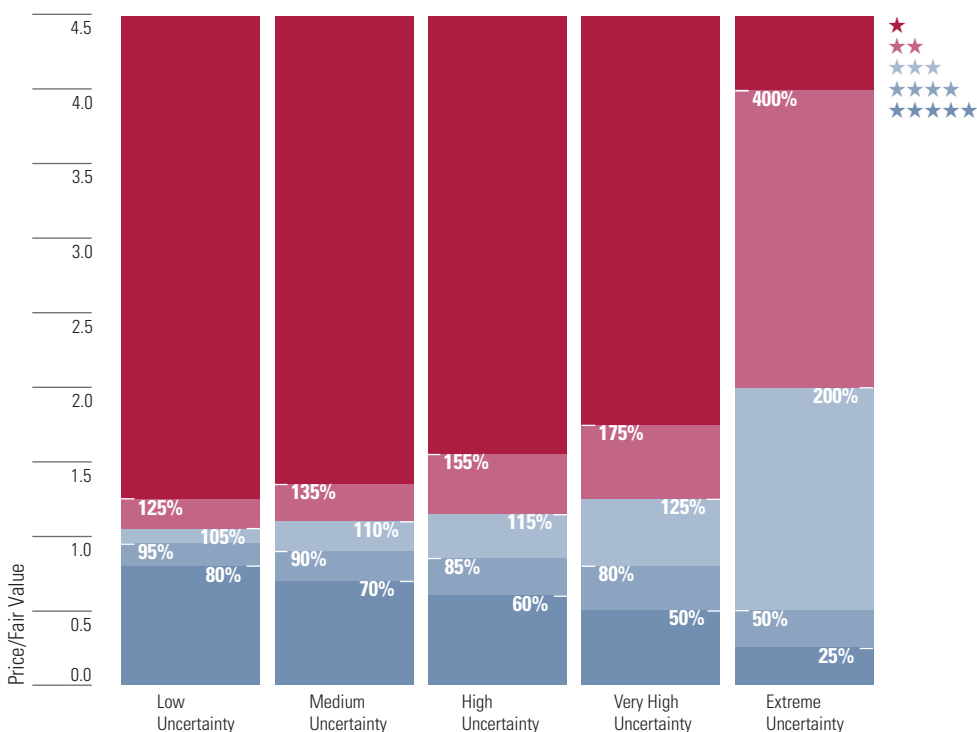
Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

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

basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

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

### Morningstar Equity Research Star Rating Methodology



### Market Price

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

For more details about our methodology, please go to [www.global.morningstar.com/equitydisclosures](http://www.global.morningstar.com/equitydisclosures).

### Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock’s current market price on a daily

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

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

The Morningstar Star Ratings for stocks are defined below:

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

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

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

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

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

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