October 5th, 2022

fundstrat | Fundstrat Global Advisors
150 East 52nd St, 31st floor
New York, NY 10022

Global Portfolio Strategy

SECTOR UPDATE: EQUITY MARKET DOWNSIDE RISK REMAINS — BARBELL DEFENSIVE NON-CYCLICALS & OFFENSIVE GROWTH OVER CYCLICALITY

EXECUTIVE SUMMARY

We did a deep dive into our sector (GICS L-1) work and have updated our thoughts. We are reiterating our mainly Defensive non-cyclical and Offensive Growth bias with above Neutral views for HC, Staples, Utilities, Energy, and Tech, while remaining below Neutral on Cyclicals (CD, Materials, Industrials, Financials and Comm Services).

Despite the U.S. equity market having an explosive start to October, our work and key indicators remain unfavorable. The ASM indicator for the S&P 500 is continues to weaken and still needs more time to reach its maximum pessimistic reading for this cycle. Historically, this does not bode well for the equity market and becoming prematurely bullish has not benefitted investors. Additionally, the Fed's ongoing battle against elevated inflation and tight labor markets is not likely to end for at least 1-2 quarters, which will likely contribute to the ongoing adjustment lower in both valuation multiples and forward profit expectations. At some point on the horizon, bad news and the challenging macro backdrop will finally be OVERLY discounted, which will ultimately precede THE equity market bottom and usher in the next opportunity for equity investors. Remain cautious, patient, and fully alert for opportunities as the run into yearend could be quite volatile.

Therefore, we continue to suggest investors sell tactical oversold rallies if they should occur as the reward/risk is still unfavorable.

MACRO / BIGGER PICTURE CONCLUSIONS

- The rally that started in October has the bulls reenergized as in their minds, all is coming into alignment — excessive pessimism, goods inflation that has peaked and is falling, a Fed that will likely cave, and the positive seasonals as we move towards year-end. Unfortunately, my work does not support anything more than a short duration small magnitude bounce.

- Forward profits still need to be lowered, and Chair Powell and Crew have time and time communicated their commitment to defeat inflation and create slack in the labor market despite the hopes of the doves/bulls that they are likely to end their tightening cycle sooner rather than later.

- Based on this, I am still advising being careful, cautious, and patient while being full alert for potential opportunities that may present themselves during my expected challenging period.

- For relative investors, my work has and remains quite clear by suggesting a portfolio construction that consists of a barbell of Defensive non-cyclicals and Offensive Growth relative to Cyclicality.

SECTOR CONCLUSIONS

- Most preferred sectors are HC, Staples, Utes, Energy, and Tech.

- Least preferred sectors include CD, Materials, Industrials, Financials, and Comm Services.

Health Care	ABOVE
Staples	
Utilities	
Energy	TILT - ABOVE
Technology	
Real Estate	
Comm Services	TILT - BELOW
Financials	
Industrials	
Materials	BELOW
Consumer Disc	

Brian Rauscher, CFA AC
Head of Global Portfolio Strategy and Asset Allocation
212-293-7137
brian.rauscher@fundstrat.com

Jonathan Lesser
212-293-7133
jonathan.lesser@fundstrat.com

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Summary Conclusions

Bottom line: The S&P 500 has once again started an oversold tactical bounce based on resurfacing hopes for a Dovish Fed Pivot occurring sooner rather than later. My key indicators and read of the macro suggest that this is highly unlikely, and the rally will lose steam before the month of October ends — probably much sooner. My research is still signaling that there is still considerable downside risk for the equity markets and I am expecting a definitive break below the September low as I am targeting 3200-3000. As has been the case all year, there will likely be tactical oversold bounces along the way that strategic investors should avoid chasing as my research signals that they are bull traps.

My main assumptions remain unchanged.

- Headline Inflation has peaked.
- The U.S. economy is decelerating not collapsing, and fears of slowing have not reached their maximum level.
- Forward expectations for corporate profits are too high and most certainly will need to be lowered, especially names that are more sensitive to cyclicality.
- There has neither been a price nor fundamental capitulation yet, but they will both likely happen at some point in front of us.
- THE equity market bottom, a clear break of the September lows and heading towards next downside target of 3200-3000, will likely be met by key indicators finally reaching negative extremes, which will be contrarian bullish.
- Selling rallies and not buying dips.

Based on this, I am still advising being careful, cautious, and patient while being full alert for potential opportunities that may present themselves during my expected challenging period.

For relative investors, my work still sees attractiveness in a mix of Defensive non-cyclicals and Offensive Growth. I continue to be interested in the highfliers of the last cycle as some of them are now down over 60-80% and are heading towards negative extremes, which are likely setting up compelling entry points for investors with a multi-year investment horizon.

Sector changes

On a sector basis, **I am not making any changes this month as the key indicators have not shown any strong evidence to do so.**

My recommendations are as follows — 1) Full Above (Staples and HC); 2) Tilt Above (Utilities, Energy, and Tech); 3) Tilt Below (Comm Services and Financials); and 4) Full Below (Consumer Discretionary, Industrials, and Materials).

Brian Rauscher, CFA: 212-293-7132
Brian.rauscher@fundstrat.com

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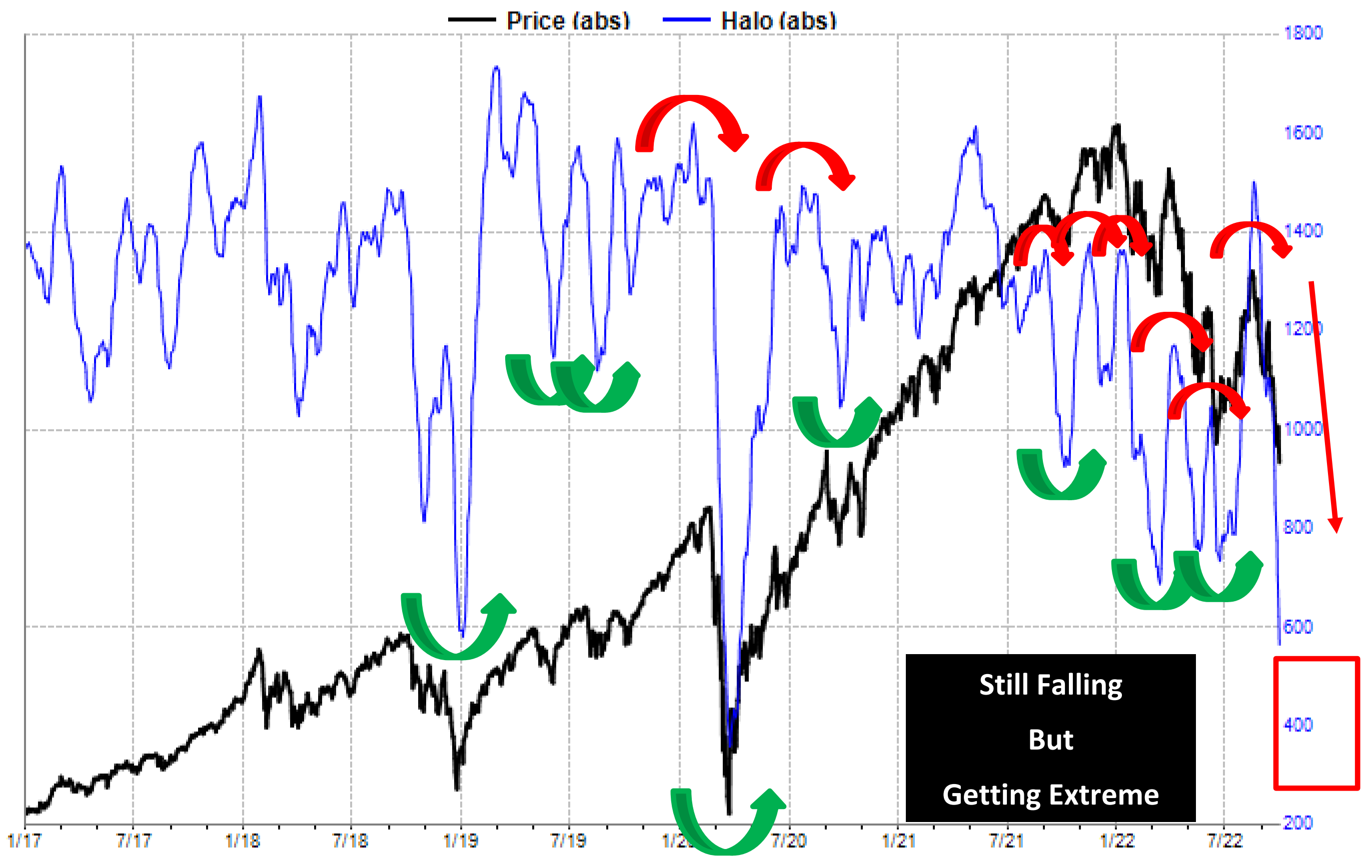
*S&P 500 TACTICAL OVERVIEW — HALO **

My preferred tactical indicator (HALO, blue line below) for the index has provided many significant tactical reversal signals since 4Q18, which all ended up rewarding investors, and continues to be value-added. In last month's update, I commented that HALO had rolled over and that September would likely be weak while my key metric was falling. Well, HALO just didn't fall it collapsed and is still declining. Importantly, it is now in negative extreme territory, and I will be alert for a positive inflection, which would be a contrarian bullish signal. My best guess is one of two scenarios — 1) a plunge that exceeds the COVID low and keeps going; or 2) a short cycle roll up that weakly fails and heads lower.

S&P 500 GICS Level 1 - Sectors

S&P 500 Index



Source: Fundstrat Global Advisors

* NOTE – The proprietary Fundstrat Portfolio Strategy Halo Model is a multi-factor model that attempts to predict the forward 1 – 6 month relative performance of a group. The goal is to help both strategic accounts better time their implementation strategies that would be consistent with our more strategic conclusions derived by our sector/sub-industry 8-panels as well as our stock specific Estimate Revisions Model (ERM), and to generate tactical ideas for aggressive trading accounts.

The model has both momentum and contrarian characteristics. When the blue line, which is the model, is trending, our proprietary tool is in a momentum phase, and our research shows a high probability that relative performance will mirror the slope of the line. Importantly, because the model is built to oscillate, an extreme reading that inflects strongly suggests that a reversal in the most recent performance trend is likely to occur.

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Brian.rauscher@fundstrat.com

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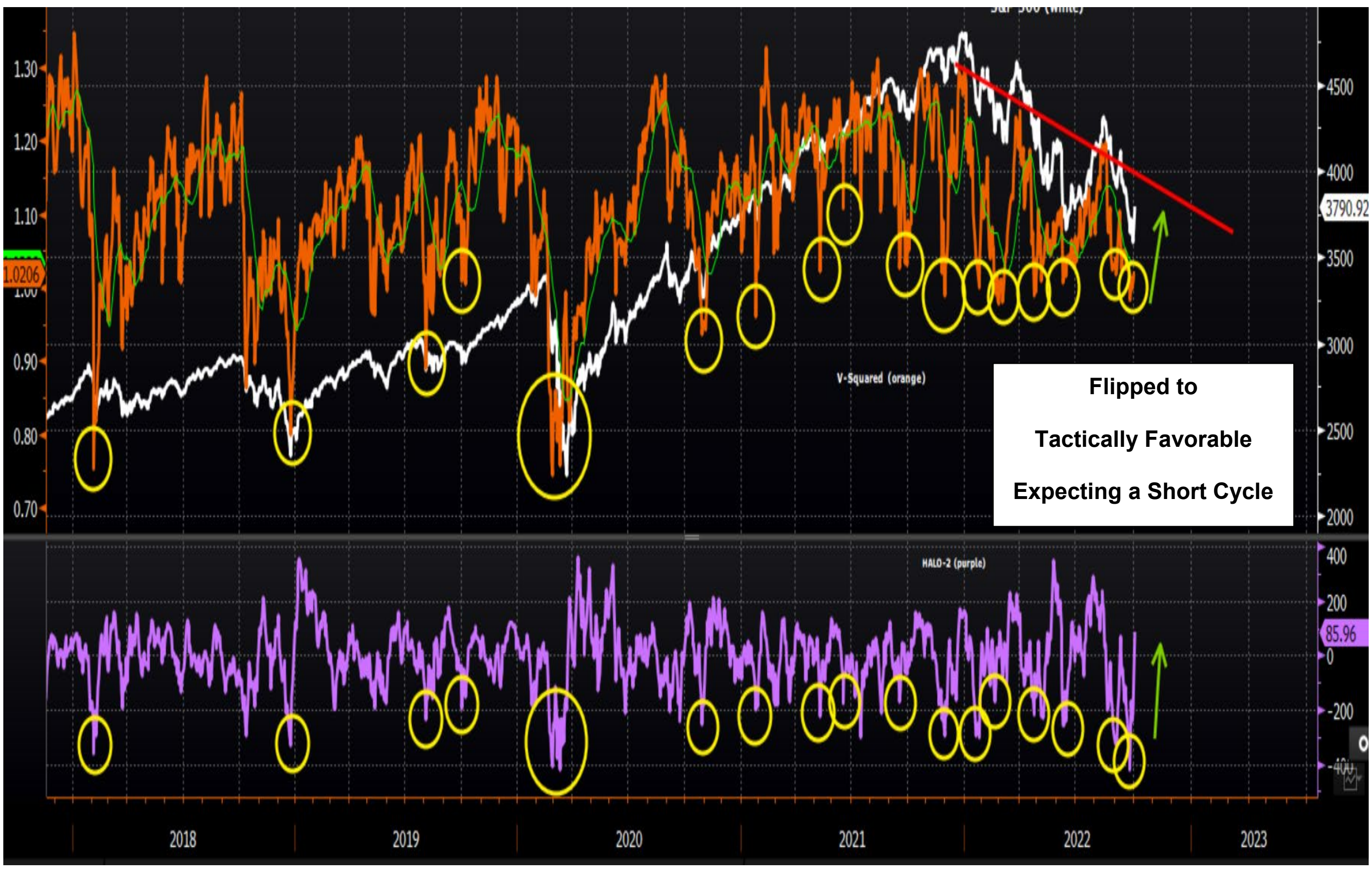
*DIVING DEEPER INTO THE TACTICAL OUTLOOK ***

When looking even closer into the S&P500 by using our highest-frequency and most aggressive tactical tools — V-squared (orange line top chart) and HALO-2 (purple line bottom chart) – which were extremely helpful in identifying many of the tactical trading reversals since 4Q17, they have both flipped to favorable on Monday after both reaching negative extremes. I pointed this out in my recent Whispers publication repeatedly over the last couple of weeks. So, while they are rising, it appears that another tactical oversold bull trap rally is likely to occur. I am not expecting a full cycle that will reach positive extremes, especially for V-squared. Hence, if this ends up being accurate, this bounce attempt will likely fail below 3900 before the month is over and maybe even sooner. The fact the "catalyst" for this squeeze up is the return of hope regarding the Dovish Fed Pivot that seems quite unlikely also suggests the clock is already ticking on this tactical rally to hit a brick wall.



Source: Fundstrat Global Advisors and Bloomberg

** NOTES – The proprietary Fundstrat Portfolio Strategy V-squared indicator shown in the top chart (orange line) shows the ratio of VXV (the 3-month CBOE S&P 500 Volatility Index) and the VIX (the 1-month CBOE S&P 500 Volatility Index). This tool is also useful for identifying aggressive tactical trading bottoms for the S&P 500.

October 5, 2022

Global Portfolio Strategy

fundstrat

SECTOR UPDATE: EQUITY MARKET DOWNSIDE RISK REMAINS — BARBELL DEFENSIVE NON-CYCLICALS & OFFENSIVE GROWTH OVER CYCLICALITY

The proprietary Fundstrat Portfolio Strategy HALO-2 Model, which is the purple line in the lower chart shown above, is the raw tactical data behind our standard HALO multi-factor model described on the previous page. It is useful for identifying aggressive tactical trading bottoms for the S&P 500.

Sector Overview

Although we look at the world from the top down, 90% of our idea generation is derived from a disciplined combination of our proprietary 8-panels and our mix of value-added supplemental tools (see Sector Methodology on following page), which remains the dominant part of our research process and is consistent with Fundstrat's data driven approach to research. Granted, we are always aware of the latest macro developments and news stories, but they do not usually have an overly dominant impact on our conclusions like other forecasters.

We reiterate our sector recommendations are shown below on the left table. For reference, we have included our previous views as well. The details behind our sector table can be found on pages 8-15.

Source: Fundstrat Global Advisors

Current Fundstrat Portfolio Strategy Sector Recommendations (NO CHANGES)

Health Care Staples	ABOVE
Utilities Energy Technology	TILT - ABOVE
Real Estate	
Comm Services Financials	TILT - BELOW
Industrials Materials Consumer Disc	BELOW

Changes Made on 9/1 — Fundstrat Portfolio Strategy Sector Recommendations

Health Care Staples	ABOVE
Utilities Energy Technology	TILT - ABOVE
Real Estate	
Comm Services Financials	TILT - BELOW
Industrials Materials Consumer Disc	BELOW

Brian Rauscher, CFA: 212-293-7132
Brian.rauscher@fundstrat.com

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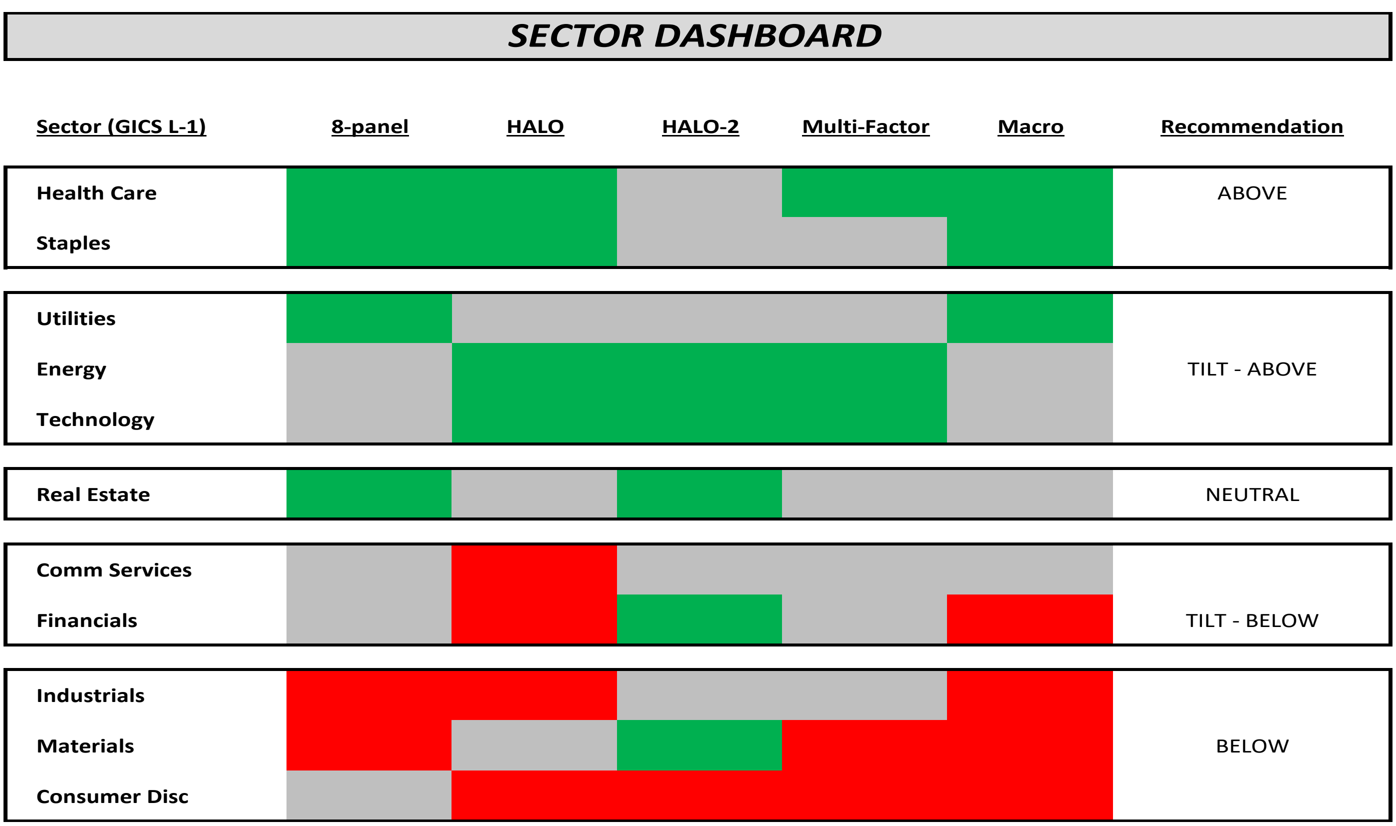
Source: Fundstrat Global Advisors

SECTOR METHODOLOGY — PROPRIETARY 8-PANELS & MORE

When looking through the key indicators that dominate my sector selection methodology, the same conclusions continue to be flashed, which is that the Cyclical areas of the equity market continue to look most at risk. I reiterate my comments that the process of lowering forward earnings and having pessimism overshoot still has plenty of work to be done before reaching contrarian positive level. As a result, my view is to stay cautious and defensive as the aggressive shift back to risk and offense is still on the horizon. At times like these, having an objective process that has had a successful long-term forecasting record can prove quite valuable when one's mind and emotions begin to wobble and question the signals provided by the disciplined process, and hear the siren's song to follow the crowd to the proverbial cliff. Over our two decades of being on the Street, a hard lesson learned has been to not overly react to sharp unsupported moves in either direction and to stay the course of the objective indicators that have helped navigate challenging market action over the years.

My sector dashboard is quite helpful at presenting my key indicators and visually identifying conclusions, and there has been little, if any evidence to supporting making any large shifts to my sector views. Thus, my recommendations for the dominant cyclical sectors, CD, Industrials, and Materials are full below benchmark. Furthermore, my work clearly shows that Growth, both defensive (HC and Staples) and offensive (Tech) are looking relatively more attractive. (Please note – our full below benchmark view for CD reflects the broader equal-weighted sector, and not the cap-weighted group that is dominated by AMZN, which our work has a favorable view. So, XLY could outperform solely because of AMZN, but the equal-weighted sector is an underperformer).

The Sector Dashboard includes the following: 1) 8-panels (see appendix on pages 8-16 for description); 2) HALO; 3) HALO-2; 4) Multi-factor model; 5) Our subjective opinion of how our view of the macro backdrop will likely impact each sector. We also have five sector weighting recommendations so we can better express our sector thoughts using the Sector Dashboard as it blends our strategic and tactical views (i.e., strategic favorable but tactically negative).



Brian Rauscher, CFA: 212-293-7132
Brian.rauscher@fundstrat.com

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Source: Fundstrat Global Advisors

Above Neutral Sectors

Health Care

- The sector 8-panel remains favorable, valuation is attractive, and its PROs are supportive.

- The HALO indicators are mixed with a favorable bias, which strongly suggests that any tactical relative weakness should be used to raise exposure.

- Multi-Factor model and Macro are still favorable, which should provide additional tailwinds for outperformance in the months ahead.

- **Macro comments**: As I have discussed for a few months, my research is still suggesting that cyclical earnings expectations should keep falling. Importantly, this should benefit the more stable and less cyclical profits for HC, which has been the historic precedent as the sector has been seen as relatively attractive during similar economic backdrops.

- **Bottom line**: Health Care continues to have a relative attractive mix of indicators and my work indicates that investors will be well served to raise exposure on any relative weakness if it occurs during October.

Staples

- The 8-panel for Staples is still favorable, and its other key indicators are also supportive of relative performance gains.

- The HALO indicators are mixed with a favorable bias, which strongly suggests that any tactical relative weakness should be used to raise exposure.

- Multi-Factor model and Macro are mixed with a favorable bias, which should provide additional tailwinds for outperformance in the months ahead.

- **Macro comments**: My core thesis for Staples continues to be that the relative stability and low amount of cyclicality for the sector's forward profits contributes to its relative attractiveness, which has historically been sought after by investors when fears about forward profits are on the rise.

- **Bottom line**: Staples remains a relative attractive mix of indicators and my works signals that investors will be well served to raise exposure on any relative weakness if it occurs during October.

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SECTOR UPDATE: EQUITY MARKET DOWNSIDE RISK REMAINS — BARBELL DEFENSIVE NON-CYCLICALS & OFFENSIVE GROWTH OVER CYCLICALITY

Utilities

- Utilities still has a supportive 8-panel remaining, as well as an attractive mix of several favorable key indicators that have historically led to relative performance gains.
- The HALO indicators are both neutral as they reached positive extremes, and once they moderate on tactical relative weakness it will be an opportunity to raise exposure.
- Multi-Factor model and Macro are mixed with a favorable bias, which should provide additional tailwinds for outperformance in the months ahead.
- **Macro comments**: The sector has historically benefited when cyclical forward earnings are at risk and being lowered, and the domestic economy has strong headwinds because of the Fed's ongoing monetary tightening cycle.
- **Bottom line**: The sector continues to have a relative attractive mix of indicators and my works signals that investors will be well served to raise exposure on any relative weakness if it occurs during October.

Energy

- The sector 8-panel has tilted to neutral as its ASM indicator is at a positive extreme level but is not yet showing signs of a second derivative. Hence, I continue to monitor Energy for a downgrade to Neutral.
- The HALO indicators have both flipped back to favorable and suggests that the sector is poised for another outperformance run.
- Multi-Factor model and Macro are still mixed with a favorable bias and signals any tactical weakness could be used to buy.
- **Macro comments**: With crude prices beginning to firm off the lower end of its 2022 price range, the sector is once again experiencing tailwinds.
- **Bottom line**: The sector continues to have a relative attractive mix of indicators that keeps us at above neutral, but I continue to monitor for a potential downgrade.

Technology

- The 8-panel for the sector has been bouncing between favorable and neutral for several months and has been neutralish the last two months. Importantly, however, it hasn't shifted enough to either upgrade/downgrade Tech. Cyclical sub-industries continue to look relatively weaker.
- The HALO indicators have both flipped to favorable and suggests the sector should have some outperformance in the coming months.
- Multi-Factor model and Macro are mixed with a favorable bias, which should provide additional tailwinds for outperformance in the months ahead.
- **Macro comments:** If the 10yr yield rises to 3.5% or higher, my work suggest the sector would lag as high valuation multiple stocks would be pressured. However, I have low confidence that rates need to reach those levels. When the 10-yr yield begins to fall, the sector's earnings will matter more.
- **Bottom line**: I have been looking for a reason from my indicators to change my recommendation for Tech, but there has been little evidence to raise or lower and thus will stay at tilt above

Below Neutral Sectors

Communication Services

- There has been little change to the sector 8-panel for several months. It remains weak with scant evidence of any positive inflections.
- The HALO indicators are mixed with a negative bias.
- Multi-Factor model and Macro are both neutral and provides little signaling.
- **Macro comments**: The overall sector does not appear to be majorly impacted either way on higher inflation and rising rates as Comm Services is now an area split by legacy Telecom and newer Tech/Media/Consumer related areas.
- **Bottom line**: The sector continues to relatively struggle as its earnings revisions have been and continue to be weak. We are still looking for a positive inflection from a negative extreme, which would be a contrarian favorable signal before year end.

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Financials

- The sector's 8-panel is still not showing any signs of strength, and evidence continues to grow that further weakening is likely to occur through year end.

- The HALO indicators are mixed with an unfavorable bias suggesting that relative rallies should be used to lower exposure.

- Multi-Factor model and Macro are mixed with an unfavorable bias.

- **Macro comments**: As economic slowdown fears increase and the likelihood of a bearish curve flattening, the sector historically does not perform well during this backdrop.

- **Bottom line**: Fins will likely underperform once rate pressures subside, and anxiety shifts towards economic slowing.

Industrials

- The 8-panel for Industrials is still experiencing unfavorable shifts and this historically has not boded well for relative performance.

- The HALO indicators are mixed with an unfavorable bias suggesting that relative rallies should be used to lower exposure.

- Multi-Factor model and Macro are mixed with an unfavorable bias.

- ***Macro comments***: As the Fed keeps tightening, the sector will likely be negatively impacted as economic slowdown fears begin to increase through year end.

- **Bottom line:** Global growth has significant headwinds and does not help support the sector as its forward earnings outlooks likely need lowering.

Brian Rauscher, CFA: 212-293-7132
Brian.rauscher@fundstrat.com

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Materials

- The sector 8-panel continues remains weak and is deteriorating.
- The HALO indicators are mixed with an unfavorable bias suggesting that relative rallies should be used to lower exposure.
- Multi-Factor model and Macro are mixed with a favorable bias, which suggests that any tactical strength should be used to lower exposure.
- ***Macro comments*:** As the Fed keeps tightening, the sector will likely be negatively impacted as economic slowdown fears begin to increase through year end.
- **Bottom line:** Global growth has significant headwinds and does not bode well for the sector as its forward earnings outlooks likely need lowering.

CD *

- The sector's 8-panel continues to weaken and is nearing its negative extreme, but there is no evidence of positively inflecting yet.
- The HALO indicators have both flipped to unfavorable bias.
- Multi-Factor model and Macro are now both unfavorable.
- **Macro comments**: Bearish concerns over higher energy prices and elevated inflation continue to be partially offset by a supportive labor market and wages. Yet, my research continues to suggest that the U.S. consumer is not that strong and cracks will begin to show up into year end.
- **Bottom line**: CD's indicators continue to weaken and fears of slowing consumer spending will likely grow over the next several months.

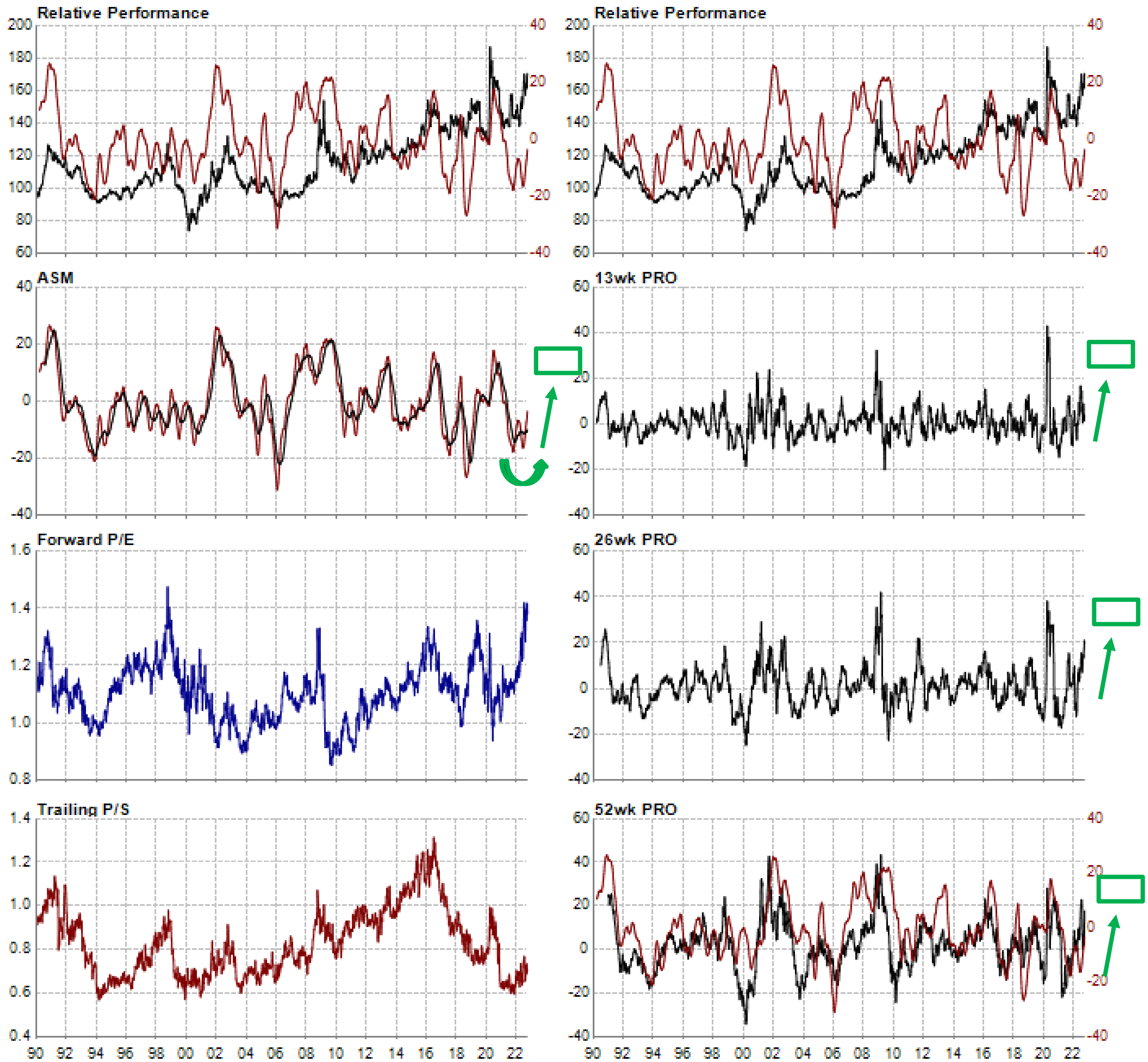
* (Please note – our full below benchmark view for CD reflects the broader equal-weighted sector, and not the cap-weighted group that is dominated by AMZN. Our work has a favorable view on the stock. So, XLY could outperform solely because of AMZN, but the equal-weighted sector is an underperformer).

Please see the following Sector (GICS L-1) 8-panels on pages 12-15.

STAPLES (ABOVE BENCHMARK)

S&P 1500 GICS Level 1 - Sectors

Consumer Staples



Source: Fundstrat Global Advisors

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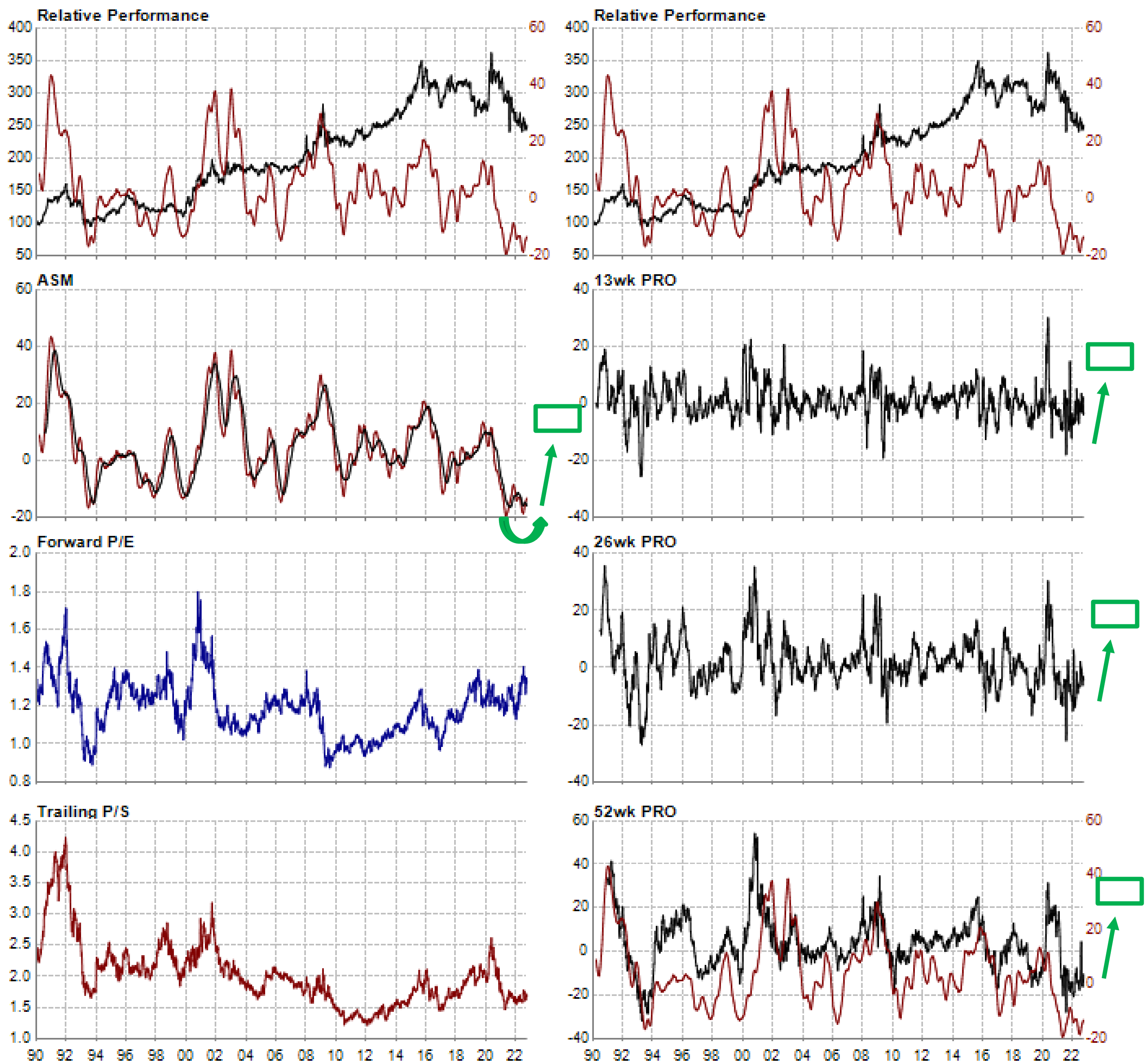
SECTOR UPDATE: EQUITY MARKET DOWNSIDE RISK REMAINS — BARBELL DEFENSIVE NON-CYCLICALS & OFFENSIVE GROWTH OVER CYCLICALITY

HEALTH CARE (ABOVE BENCHMARK)

S&P 1500 GICS Level 1 - Sectors

Health Care



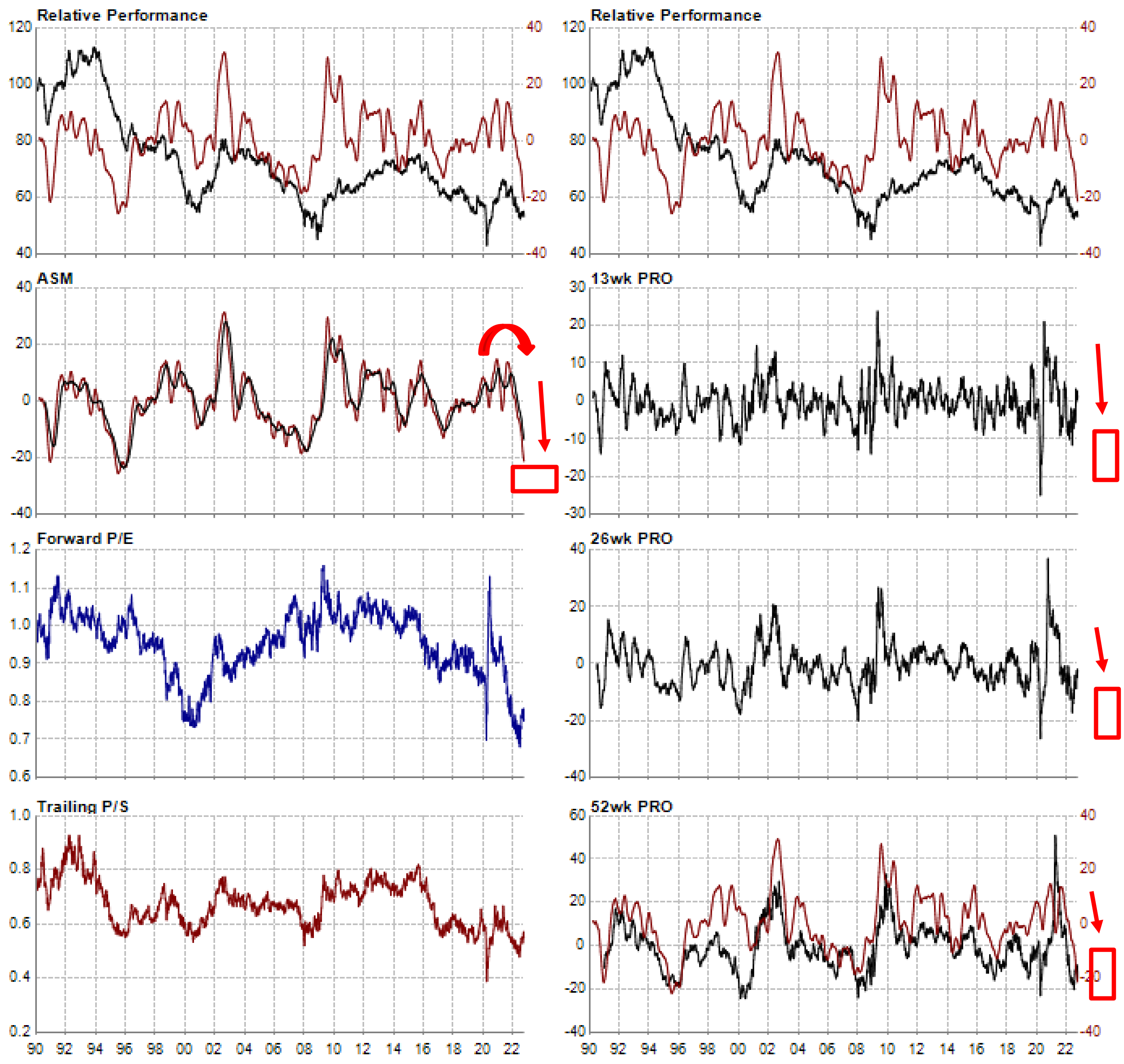
Source: Fundstrat Global Advisors

Brian Rauscher, CFA: 212-293-7132
Brian.rauscher@fundstrat.com

CONSUMER DISCRETIONARY (BELOW BENCHMARK)

S&P 1500 GICS Level 1 - Sectors

Consumer Discretionary



Source: Fundstrat Global Advisors

Brian Rauscher, CFA: 212-293-7132
Brian.rauscher@fundstrat.com

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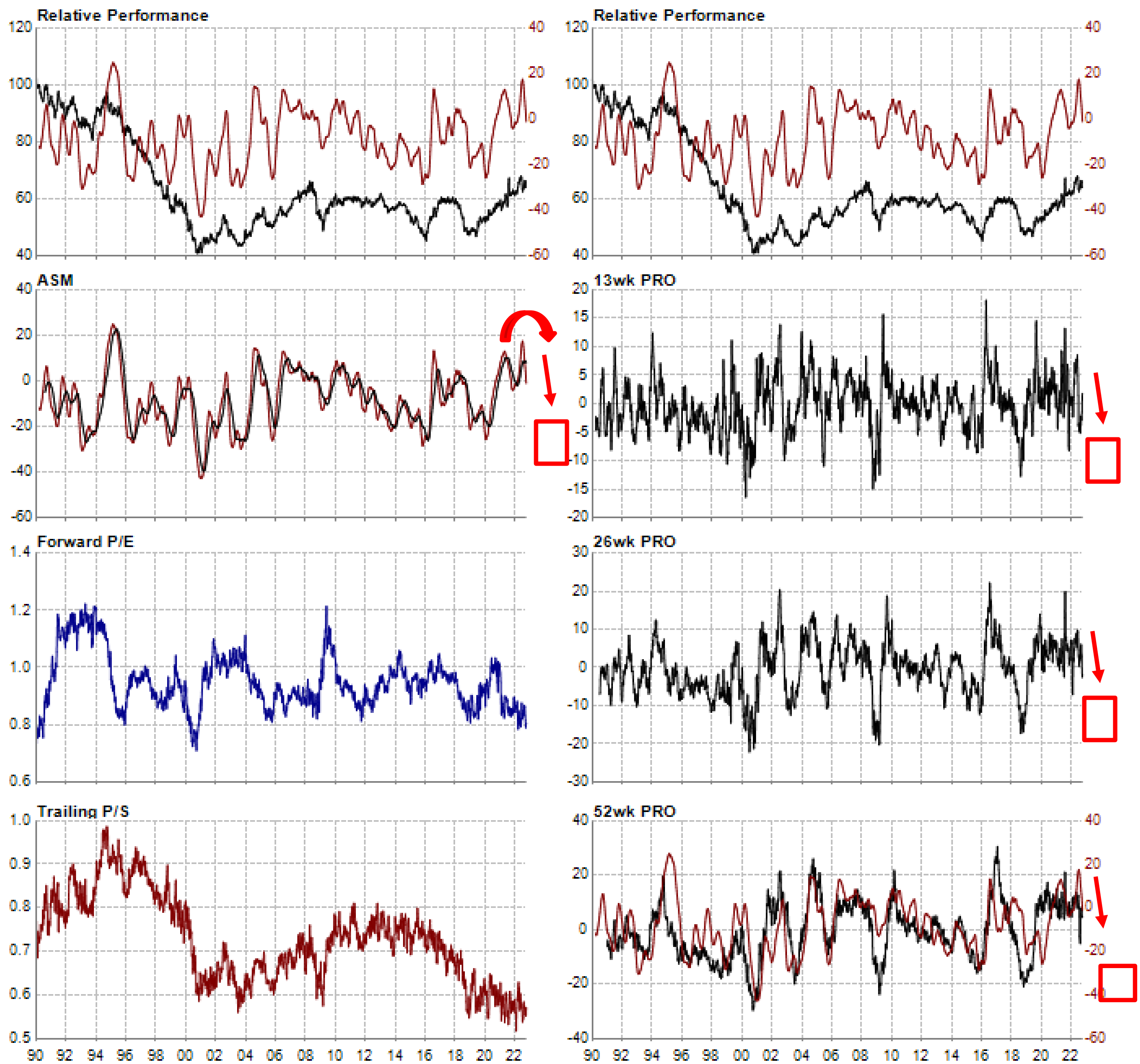
SECTOR UPDATE: EQUITY MARKET DOWNSIDE RISK REMAINS — BARBELL DEFENSIVE NON-CYCLICALS & OFFENSIVE GROWTH OVER CYCLICALITY

MATERIALS (BELOW BENCHMARK)

S&P 1500 GICS Level 1 - Sectors

Materials



Source: Fundstrat Global Advisors

APPENDIX

8-PANEL ANALYSIS

INTRO

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SECTOR UPDATE: EQUITY MARKET DOWNSIDE RISK REMAINS — BARBELL DEFENSIVE NON-CYCLICALS & OFFENSIVE GROWTH OVER CYCLICALITY

8-PANEL ANALYSIS - METHODOLOGY

Our proprietary 8-panel analysis is a key piece of information for new idea generation in our investment recommendation process. **It provides a subjective, but disciplined, assessment of reward and risk by examining earnings estimate revisions, valuation, and price reversion for sectors (GICS L-1), industries (GICS L-3), and sub-industries (GICS L-4) versus the market or its peers‡ to predict 9-18 month relative performance.**

The main inputs of an 8-panel chart page are as follows (see next page for example):

► **Analyst Sentiment Measure (ASM)*:** Our ASM indicator is a proprietary measure of relative earnings estimate revisions at the sector/sub-industry levels and is the most important input for the majority of our investment recommendations. It is both a momentum and contrarian tool depending on its level relative to the previous two decades. We will typically conclude that the investment trend for a recommendation is consistent with the slope of this historical time series, and that the maximum risk/reward opportunity occurs near the inflection point of an extreme reading.

Our analysis has found that the critical strategic factor to determine the dominant relative performance trend for most S&P GICS groupings is the aggregation of analyst behavior at the company level regarding their forward profit expectations. When the ASM is combined with extreme readings of several other 8-panel inputs, our research shows that the ASM has been a powerful leading relative performance indicator ("clustering" – see pages 12 and 13 for examples).

► **Valuation:** We view valuation as a measure of potential risk, and its importance comes from its current reading compared with levels at major historical relative performance inflections.

► **Price Reversion Oscillators (PRO):** Based on our analysis, the synthesis of three distinct time-duration price oscillators (short, medium, and long term) is an invaluable analytical technique for measuring price reversion. We utilize different increments of time for our standard strategic ideas (13wk, 26wk, 52wk) versus tactical ideas (2wk, 4wk, 8wk), but the concept is the same as we are looking for confirming overbought/oversold readings on all three metrics at the same time.

** At its core, our ASM indicator is built upon a publicly available formula — (Up Estimates – Down Estimates) / (Total Estimates) — that has been around for decades. We do not know its original derivation, but the earliest citing we can find is The Journal of Investing, "Earnings Revisions and Portfolio Returns", Fall 2001.*

Sources: Fundstrat Global Advisors and Factset

Brian Rauscher, CFA: 212-293-7132
Brian.rauscher@fundstrat.com

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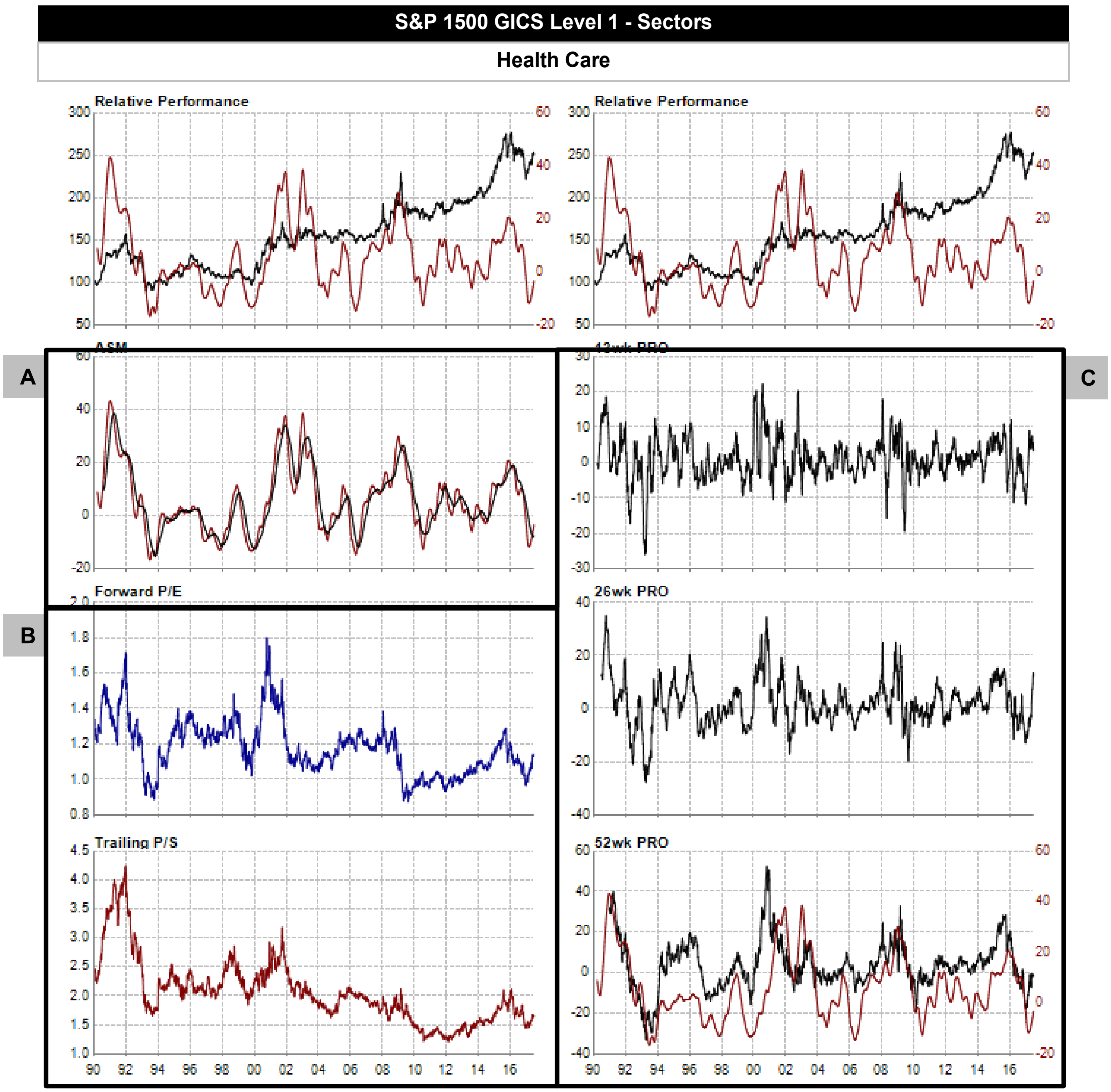
8-PANEL ANALYSIS – A POWERFUL, PROPRIETARY TOOL FOR IDEA SELECTION (EXAMPLE ONLY – DATA NOT LIVE)



Source: S&P, Factset, Fundstrat Global Advisors

A) Analyst Sentiment Measure (ASM) B) Valuation C) Price Reversion Oscillators (PRO)

Brian Rauscher, CFA: 212-293-7132
Brian.rauscher@fundstrat.com

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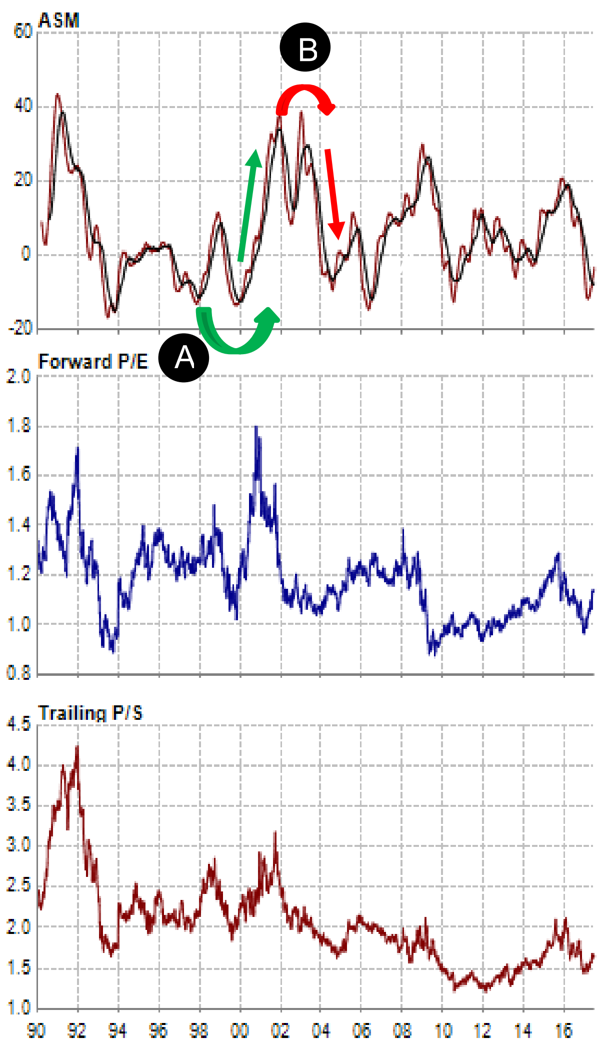
8-PANEL ANALYSIS – HOW TO USE

- We first begin with the Analyst Sentiment Measure (ASM) chart below (*top chart shown*) as our analysis finds that nearly every group in the market trades with a natural profit cycle that is the primary driver of relative performance.

- Our most-actionable, highest-conviction ideas occur when the ASM inflects from an extreme level. Specifically, the best long ideas occur when the ASM rolls up from a negative extreme (*point A below*), which our work suggests is at/near maximum entry point and when risk/reward is most favorable, while the best exit point is when the ASM rolls down from a positive level (*point B)*.



Source: S&P, Factset, Fundstrat Global Advisors

- As a reminder, a positive inflection reflects fewer analysts cutting forward estimates, and NOT analysts raising, and a negative inflection is when fewer analysts are raising. Our work suggests the bad or good news, respectively, is fully priced in at these points.

- When our ASM is clearly trending in one direction (*green and red arrows*), the model is in a momentum phase and the group's relative performance is likely to mirror the slope of our ASM.

- When evaluating an ASM inflection for new money, we add two valuation metrics to our analysis to further consider the group's relative favorability versus history and the market, with extreme valuation at an inflection point supporting a change in relative performance trend.

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Brian.rauscher@fundstrat.com

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8-PANEL ANALYSIS – HOW TO USE

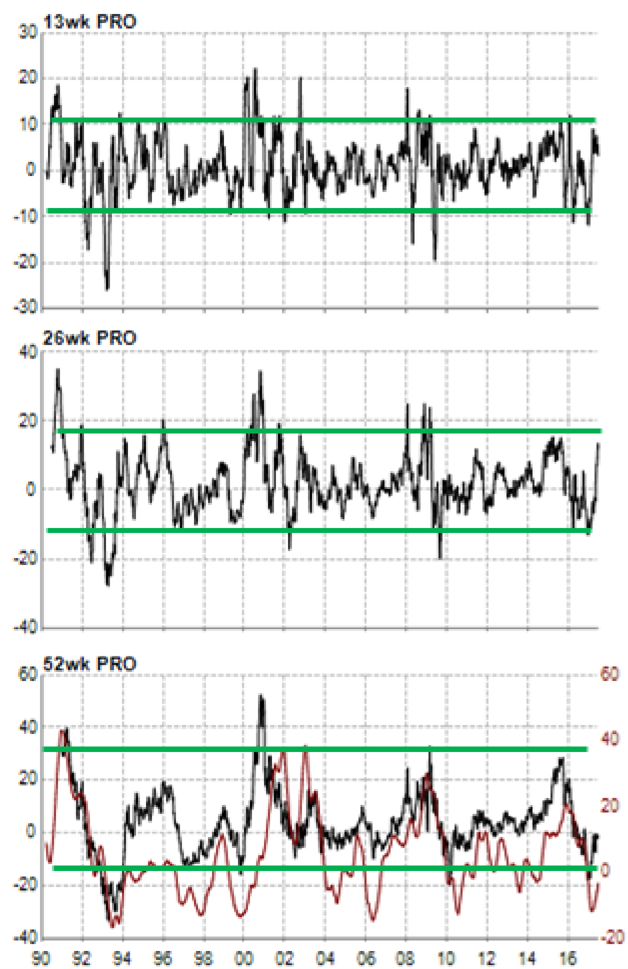
- Once we have determined that a particular group looks favorable or unfavorable from an earnings revision basis, we then turn to our Price Reversion Oscillator (PRO) charts below to help with implementation timing.

- We find that every group in the market trades with a natural rhythm, out-performing and underperforming by specific amounts over various time frames (we show 13, 26, and 52 weeks), and that this pattern is quite predictable and exploitable.

- When our price oscillators are at the low end of their oscillation range (i.e. oversold), our work suggests this presents a favorable entry point for new money. Conversely, exiting an overbought group while the ASM is inflecting lower captures the highest gains.

- Our highest-conviction, most-probable new money ideas occur when the stock is oversold at the time the ASM rolls up. When the ASM is positively sloped but a group is overbought, the ASM remains the dominant trend, but the magnitude of outperformance may be limited as the overbought condition is reversed.

- A group that is long-term oversold but short-term overbought may simply need time to digest gains before making another leg higher.



Source: S&P, Factset, Fundstrat Global Advisors

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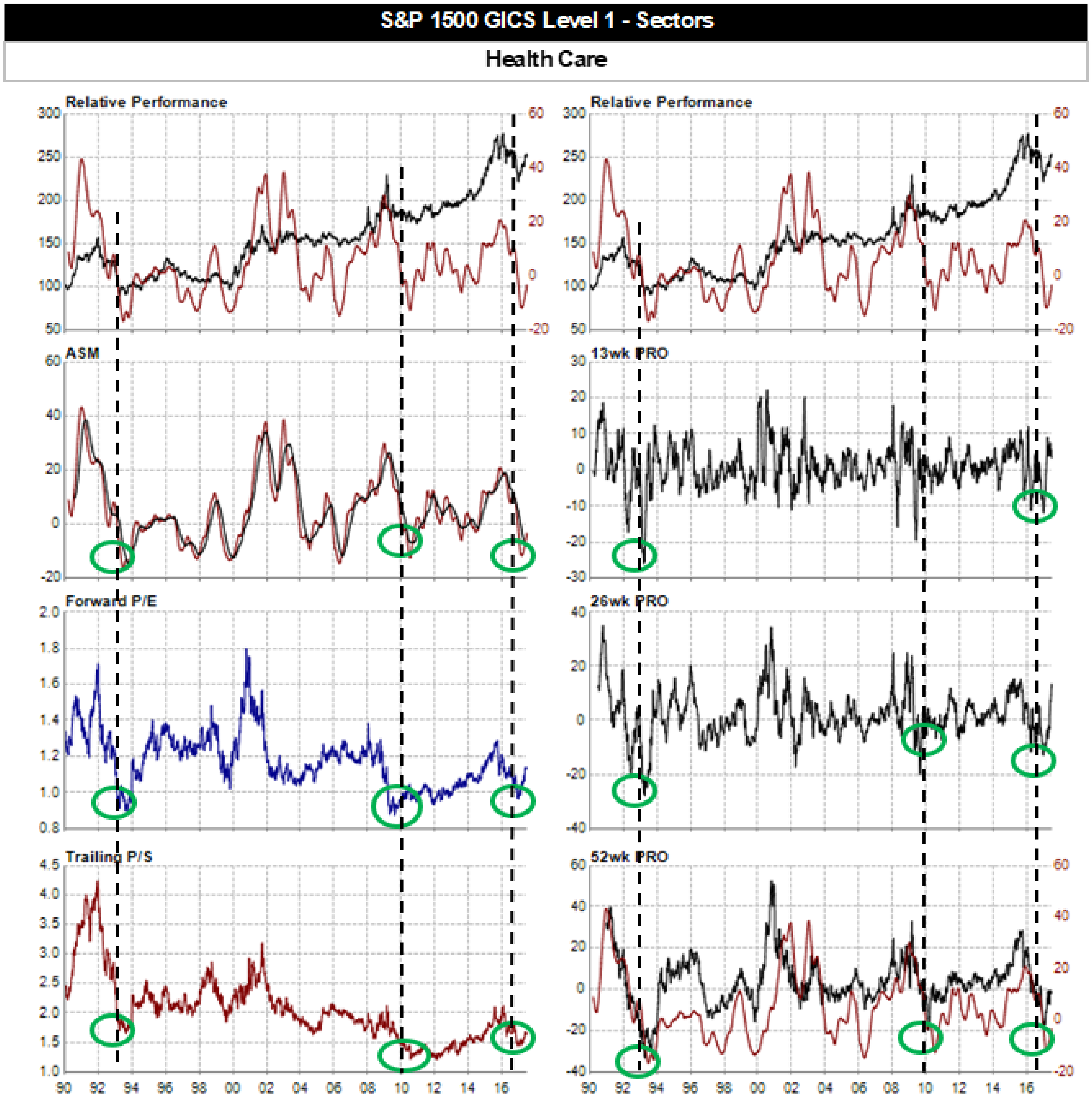
8-PANEL ANALYSIS – BUY SIGNAL CLUSTERING



Potential Relative Buy Signal — 5 or 6 negative readings

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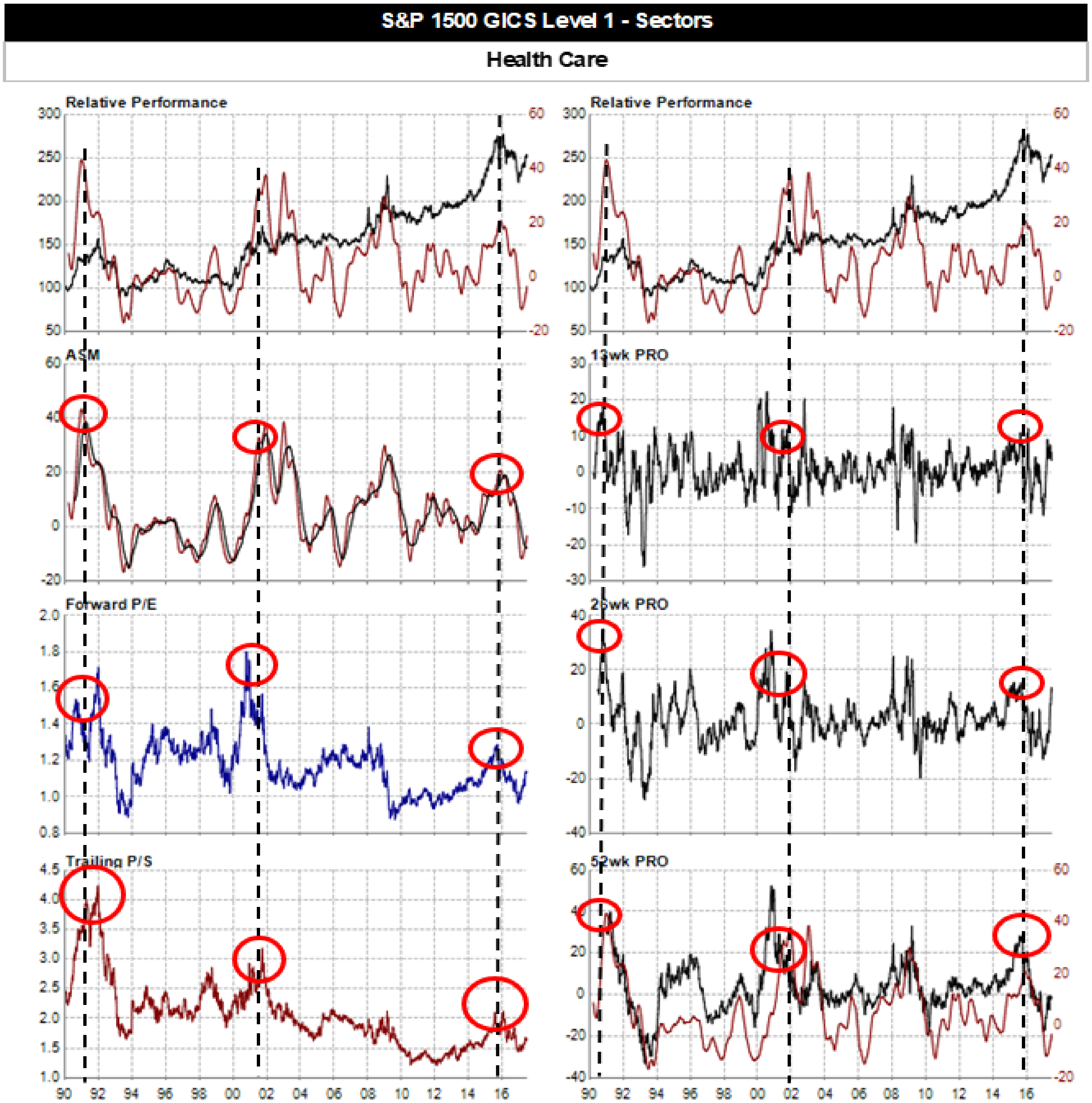
8-PANEL ANALYSIS – SELL SIGNAL CLUSTERING



Potential Relative Sell Signal — 5 or 6 positive readings

Brian Rauscher, CFA: 212-293-7132
Brian.rauscher@fundstrat.com

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Positive (+): The analyst expects the performance of his industry/sector coverage universe over the next 6-18 months to be attractive vs. the relevant broad market benchmark, being the S&P 500 for North America.

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++: Fully confirmed earnings revision trend = favorable
P+: Red line positive inflection, gray line not confirming yet = aggressive or early warning positive = favorable
N- : Red line negative inflection, gray line not confirming yet = aggressive or early warning negative = unfavorable
--: Fully confirmed earnings revision trend = unfavorable

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Brian Rauscher, CFA: 212-293-7132
Brian.rauscher@fundstrat.com

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