

Morningstar's Best Ideas for 2017 and Beyond

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Morningstar Overview and Philosophy

- ★ Provide financial information to individuals, advisors, and institutions
- ★ We believe our competitive edge comes through bottom-up research; we have a huge database of information
- ★ Currently have 300 analysts worldwide, focusing on stocks, mutual funds, ETFs, and fixed income
- ★ We're best known for our fund and stock research, but research on bonds, asset allocation and retirement planning are growing emphases.
- ★ Equity philosophy: Bottom up, with a focus on quality and valuation
- ★ Fund philosophy: Also bottom up, because past returns aren't predictive. Agnostic on index v. active debate

Ground Rules for Best Ideas

Investors can successfully employ an element of opportunism in their portfolios, provided they:

- ★ Are operating with a sensible long-term asset-allocation mix
- ★ Regularly rebalance (“tactical lite”)
- ★ Focus on what they can control (bottom-up security selection) rather than what they can’t (macro factors)
- ★ Swim against the tide when initiating new positions in their portfolios

Let's Get Oriented: Market Fair Value

Top News

U.S. Stocks Eke Out Small Gains, Snap 3-Day Slump

Oil Settles Under \$32 for the First Time in More Than 12 Years

Alcoa Reports 18% Drop in Revenue

Lululemon Shares Pop on Improved Earnings Outlook

Shire Agrees to Acquire Baxalta in \$32 Billion Deal

OECD Leading Indicators Point to Steadying China Growth

Upcoming Earnings and Data Releases

Monday Earnings: Alcoa

Tuesday Earnings: CSX

Wednesday Data: Fed Beige Book

Thursday Earnings: Intel, JPMorgan

Thursday Data: Initial Jobless Claims

Friday Earnings: BlackRock, Citigroup, Wells Fargo

Friday Data: Retail Sales, Producer Price Index, Empire Manufacturing, Industrial Production, UMich Consumer Sentiment

Popular Stock Quotes

Apple

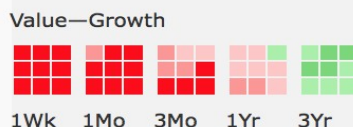
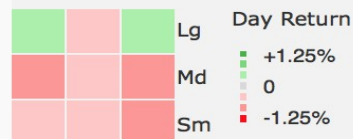
ExxonMobil

Berkshire Hathaway

AT&T

Walt Disney

Market Barometer

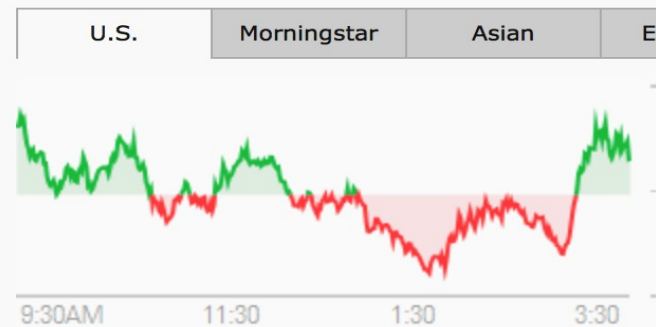


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High Yield CDs & Savings Accounts.

Stock Market Updates

- ▶ Running Commentary
- ▶ Story Stocks
- ▶ Up/Downgrades
- ▶ Gainers/Losers/Most Active

Market Indexes



Index	Value	Change
DJIA	16,398.57	52.12
S&P 500	1,923.67	1.64
NASDAQ	4,637.99	-5.64
Morningstar US Market	4,802.21	-0.15
Morningstar Small Cap	6,717.49	-29.75

Data as of 01-11-2016

The **Fidelity OneQ ETF** closely tracks the Nasdaq Composite Index, one of the most widely watched benchmarks in the world.

Our Global Coverage Universe = Fairly Valued as of 1/10/2017

Select Time Period

1M

3M

YTD

1Y

3Y

5Y

Max

Coverage Universe:

All Rated Stocks

52-Week High

9/7/2016

52-Week Low

2/11/2016

All-Time High

12/31/2004

All-Time Low

11/20/2008

1.04

0.86

1.14

0.55

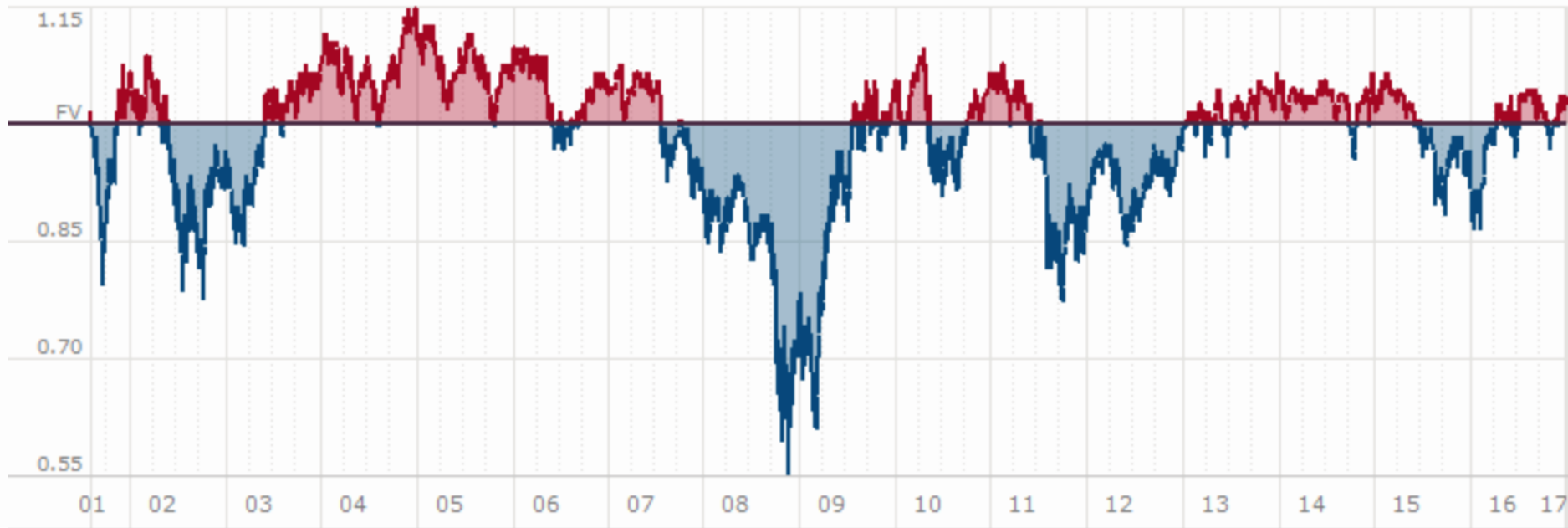
Today's Ratio: 1.03

— Fair Value

● Overvalued

● Undervalued

8/1/2001 - 1/10/2017



Median price/fair values by investment style box reveals *a bit* (but not a lot) more nuance on that number

- * Large Value: 1.01
- * Large Blend/Core: 1.03
- * Large Growth: 1.04
- * Mid Value: 1.04
- * Mid Blend: 1.03
- * Mid Growth 1.06

Data as of 11/17/16.

Wide Moats Are the Cheapest of the Three Moat Bands Currently

Select Time Period

1M

3M

YTD

1Y

3Y

5Y

Max

Coverage Universe:

Size of Moat (Business Quality) > Wide

52-Week High
1.03

8/29/2016

52-Week Low
0.84

1/21/2016

All-Time High
1.07

6/16/2003

All-Time Low
0.54

11/20/2008

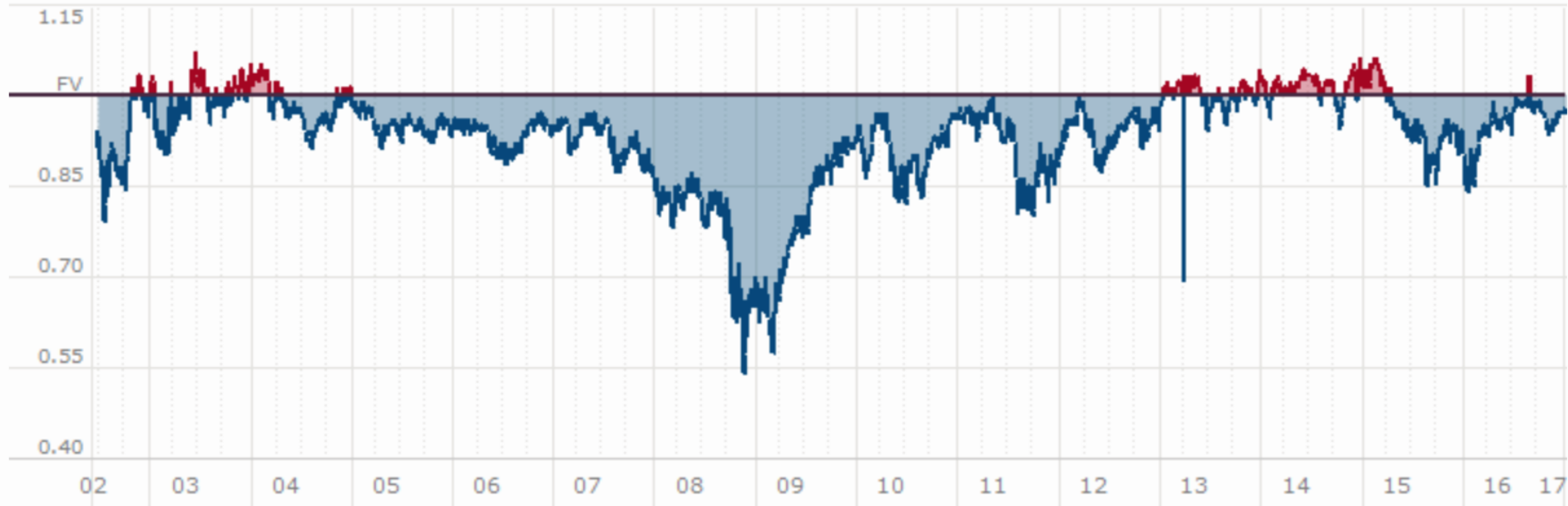
Today's Ratio: 0.98

— Fair Value

● Overvalued

● Undervalued

6/3/2002 - 1/10/2017



Wide economic moat examples (13% of coverage universe) include Altria, BlackRock, Alphabet (Google), Harley-Davidson, Amazon.com.

Narrow Moats: Slightly More Expensive

Select Time Period

1M

3M

YTD

1Y

3Y

5Y

Max

Coverage Universe:

Size of Moat (Business Quality) > Narrow

52-Week High
1.04

8/15/2016

52-Week Low
0.87

2/11/2016

All-Time High
1.11

12/31/2004

All-Time Low
0.57

11/20/2008

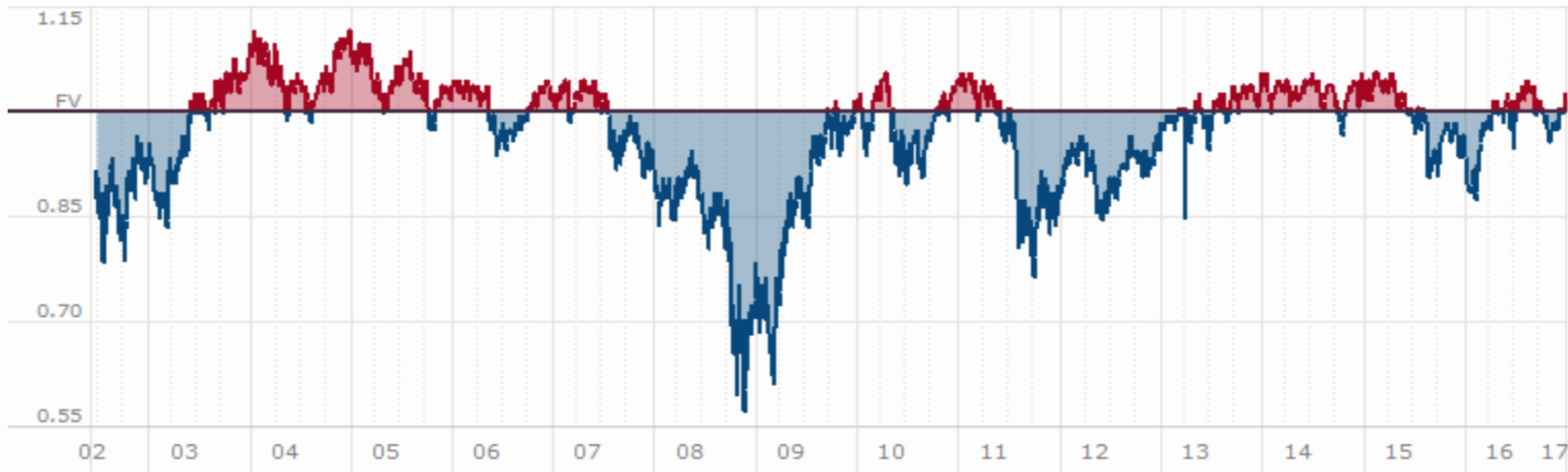
Today's Ratio: 1.01

— Fair Value

● Overvalued

● Undervalued

6/3/2002 - 1/10/2017



Narrow economic moat examples include Citigroup, Coach, Whole Foods. Within our coverage universe, 43% of companies have narrow moats.

No Moats Most Expensive of All

Select Time Period

1M

3M

YTD

1Y

3Y

5Y

Max

Coverage Universe:

Size of Moat (Business Quality) > None

52-Week High

8/29/2016

52-Week Low

2/11/2016

All-Time High

3/29/2013

All-Time Low

11/20/2008

1.10

0.84

1.36

0.53

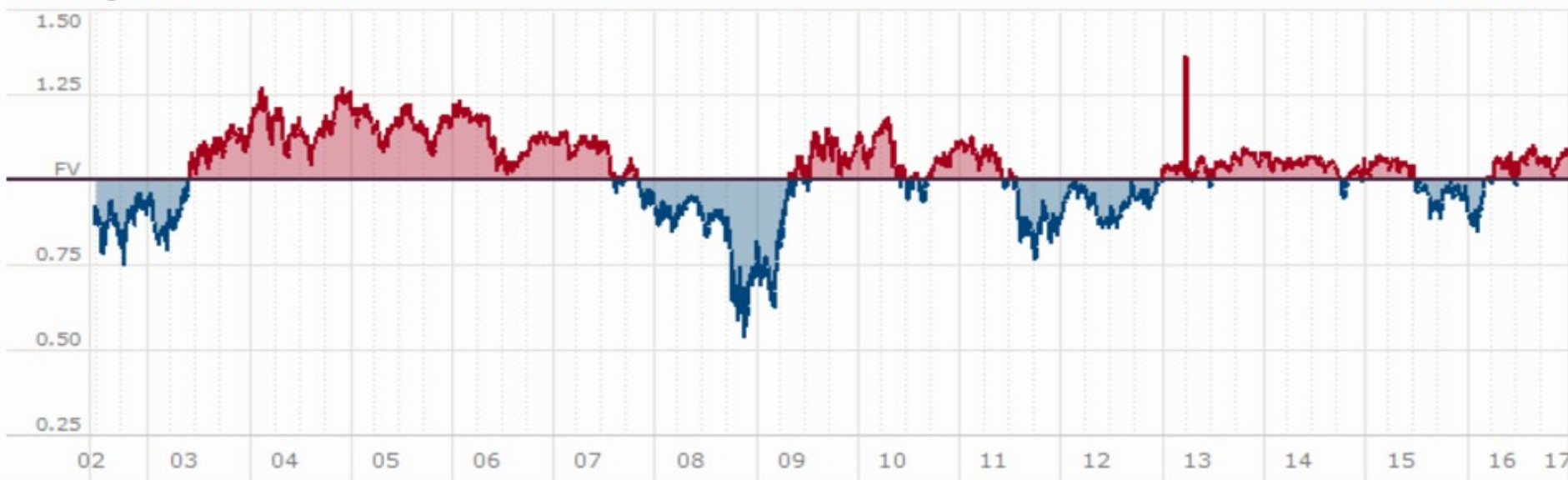
Today's Ratio: 1.08

— Fair Value

● Overvalued

● Undervalued

6/3/2002 - 1/12/2017



Examples of companies with *no* economic moats include Allstate, Dick's Sporting Goods, Honda Motor, Darden Restaurants, Southwest Airlines. (44% of stocks in our coverage universe do not have moats.)

The Sector Lens: Another View of Valuations

Economically Sensitive (1.06)

Communications Svc.
P/FV: 0.96

Energy P/FV: 1.20

Industrials: 1.07

Technology: 1.03

Cyclical (1.02)

Basic Materials: 1.18

Consumer Cyclical
P/FV: 1.00

Financial Services
P/FV: 1.02

Real Estate 0.96

Defensive (0.99)

Consumer Defensive
P/FV: 1.01

Utilities P/FV: 1.03

Health P/FV: 0.92

Data as of 1/12/17.

Sector Valuation graph available on Stocks cover page.

Takeaways for U.S. Equity Investors

- ★ Stocks dropped below fair value in early 2016, but our coverage universe is now fairly valued
- ★ High-quality names (wide-moat) are cheaper than lesser-quality companies (no and narrow moat)
- ★ Defensive names look cheaper than more cyclically, economically sensitive ones
- ★ No style box square is appreciably cheaper than the rest

Best Stock Ideas for Quality-Conscious Equity Investors

4 or 5 stars (low market valuations relative to our estimates of fair value), wide moats, and low uncertainty ratings (16 as of 1/12/17)

Amgen AMGN

Coca-Cola KO

Colgate-Palmolive CL

Enterprise Products Partners EPD

Imperial Brands PLC IMBBY Magellan Midstream MMP

Merck MRK

Nestle NSRGY

Novartis NVS

Pfizer PFE

Procter & Gamble PG

Roche Holdings RHHBY (5 stars)

Spectra Energy LP SEP

Unilever NV UN

Unilever PLC UL

Wal-Mart Stores WMT

Best Ideas for Investors with Longer Time Horizons, Higher Risk Capacities

4 or 5 stars, wide moats, and *high* uncertainty ratings (9 as of 11/17/16)

Blackstone Group BX

CBRE Group CBG

Grupo Aeroportuario del Centro Norte OMAB

Grupo Aeroportuario del Pacifico PAC

Grupo Televisa TV

Guidewire Software GWRE

Jones Lang LaSalle JLL

Mead Johnson Nutrition MJN

Polaris Industries PII

Salesforce.com CRM

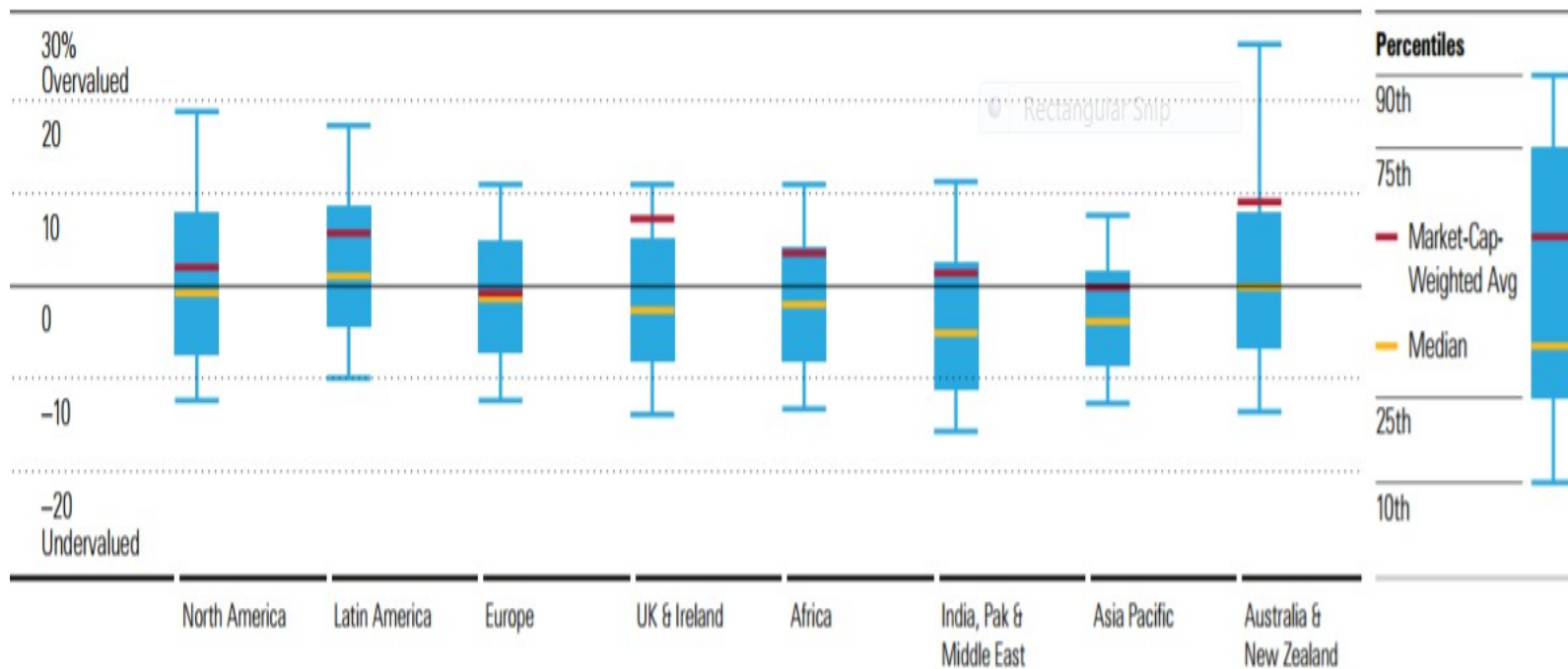
TransDigm Holdings TDG

YUM China Holdings YUMC

Best Ideas for U.S. Equity-Fund Investors: Large Caps

- ★ Large-cap stocks look (relatively) cheap right now; if you're rebalancing or putting money to work, tip your portfolio toward them.
- ★ Top large-cap picks with a heavy emphasis on wide-moat stocks:
 - ★ AMG Yacktman YACKX (68% wide moat)
 - ★ American Funds Washington Mutual AWSHX (62%)
 - ★ Dodge & Cox Stock DODGX (46%)
 - ★ Oakmark OAKMX (46%), Oakmark Select OAKLX (44%)
 - ★ Vanguard Equity-Income VEIPX (52%)
 - ★ Vanguard Dividend Appreciation VDADX/VIG (63%)
 - ★ Vanguard Total Stock Market Index VTSMX/VTI (46%)

Foreign Stocks: They Must Be Cheap, Right?



Data as of 10/31/216

Foreign Stock Takeaways

- ★ Although U.S. market has outperformed, N. American stocks don't appear to be significantly more expensive than many foreign markets currently
- ★ Many foreign markets have performed alright, but U.S. investors haven't benefited as much because of dollar's gains versus major foreign currencies
- ★ Asia-Pacific, Europe appear to offer attractive values currently

Best Ideas for International Fund Investors

- ★ Morningstar favorite core international funds include:
 - ★ Artisan International Value ARTKX
 - ★ Harbor International HIINX
 - ★ Oakmark International OAKIX
 - ★ Vanguard Total International Stock Market Index VGTSX
- ★ Morningstar's favorite emerging markets funds include:
 - ★ American Funds New World NEWFX
 - ★ DFA Emerging Markets DFEMX
 - ★ T. Rowe Price Emerging Markets Stock PRMSX

What Should Be on Bond Investors' Radar?

- ★ Recognize vulnerability of longer-term bonds in the face of rising interest rates
- ★ Run through a duration stress test: Duration minus SEC yield = approximate loss in a one-year period in which interest rates rose by one percentage point
- ★ Match duration to your time horizon
- ★ Use credit-sensitive bonds, dividend-paying stocks to augment, not supplant, high-quality bonds

Best Ideas for Bond Investors

- ★ Keep quality high, delegate to an active manager with a flexible strategy
- ★ Morningstar's favorite funds for time horizons of five years or more:
 - ★ Metropolitan West Total Return MWTRX
 - ★ Dodge & Cox Income DODIX
 - ★ Harbor Bond HABDX
 - ★ Vanguard Total Bond Market Index VBMFX
- ★ Favorite core short-term fund:
 - ★ Fidelity Short-Term Bond FSHBX

Best Ideas for Personal Finance: Mind Tax Efficiency

- ★ Manage taxable portfolio for tax efficiency: ETFs, traditional index funds, tax-managed funds, individual stocks
- ★ Check to see if munis offer better after-tax return than comparable taxable bond funds. (Favorite firm for munis: Fidelity.)
- ★ Mind asset location: Hold tax-inefficient assets like REITs, high-yield bonds, and TIPS inside of a tax-sheltered account
- ★ Consider IRA conversion: Roths most benefit those with long time horizons or affluent retirees; just get help, be careful about converting in lofty market
- ★ Consider “backdoor Roth” contributions/conversions, but be careful if you own Traditional IRA assets

Best ideas for Personal Finance: Don't Forget about Inflation!

- ★ Add inflation protection when inflation isn't splashed on the front page of your newspaper
- ★ Inflation is a particularly big threat for retirees, who have a large share of their portfolios in fixed-rate investments and are no longer working/eligible for COLA
- ★ TIPS can help hedge against inflation
- ★ Favorite TIPS funds: Vanguard Inflation-Protected Securities VIPSX, Vanguard Short-Term Inflation-Protected Securities VTIPX, Harbor Real Return HARRX
- ★ Commodities and especially stocks are also reasonable ways to hedge. Also: Bank-loan funds, precious metals equities

Questions?
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