MARKET OUTLOOK | OCT. 6, 2025

Q4 2025 North America Market Outlook

There is no margin for error.

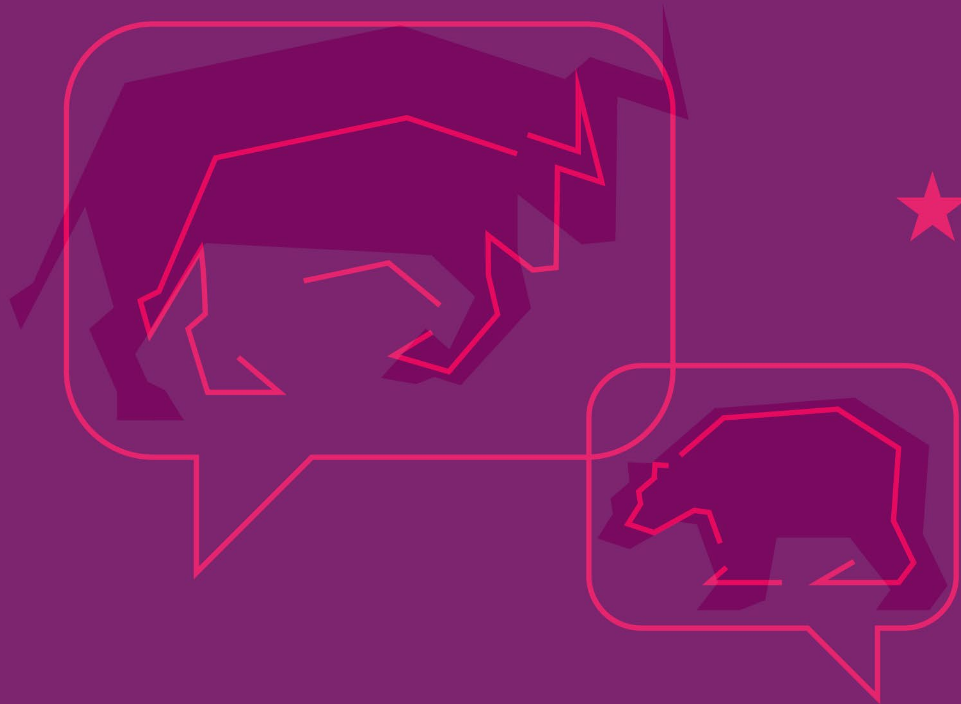

Table of Contents

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US Equity Market Valuation Overview

US Equity Market Trading at a 3% Premium to a Composite of Our Fair Value Estimates

Based on a composite of our intrinsic valuations of the more than 700 stocks we cover that trade on US exchanges, as of Sept. 30, 2025, we calculated that the US equity market was trading at a price/fair value estimate of 1.03. This represents a 3% premium to our fair value estimates. While not unprecedented, since 2010, the US stock market has traded at a higher premium only 15% of the time.

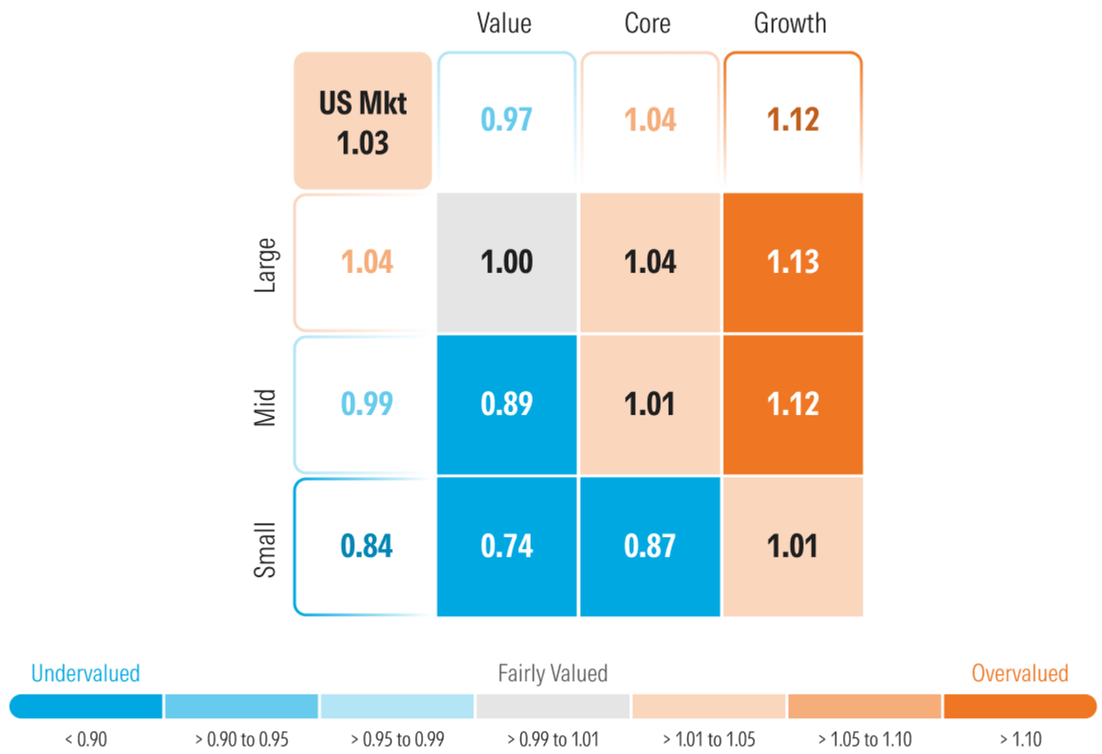
By capitalization, small-cap stocks remain very attractive, trading at a 16% discount to our fair value estimate. Mid-cap stocks trade just a hair under fair value estimate, and large-cap stocks are at a 4% premium.

By style, value remains undervalued, trading at a 3% discount, whereas core stocks are at a 4% premium and growth stocks are at a 12% premium. Since 2010, the growth category has traded at a higher premium only 5% of the time.

The current market valuation represents a huge rebound from early April, when the market was trading at a 17% discount to fair value. In fact, in our special Market Outlook update published on April 7, 2025, and on the April 7 episode of our weekly podcast, The Morning Filter, we moved to an overweight recommendation on US stocks. However, as stocks approached fair value estimate, we had moved back to market weight.

US Stock Market Trading Above Fair Value Estimate

Valuations of Morningstar's equity research coverage by equity style box.



No Margin for Error: AI Buildout Boom Offsetting Macroeconomic Weakness

With the market trading slightly above fair value estimates, investors face a narrow margin for error. Many AI mega-cap stocks trade near or exceed FVE, offering no cushion should AI growth slow. For future returns to outpace the cost of equity, either valuations must stretch into overvalued territory, AI development must surpass already lofty expectations, or productivity gains must drive earnings growth beyond base-case forecasts.

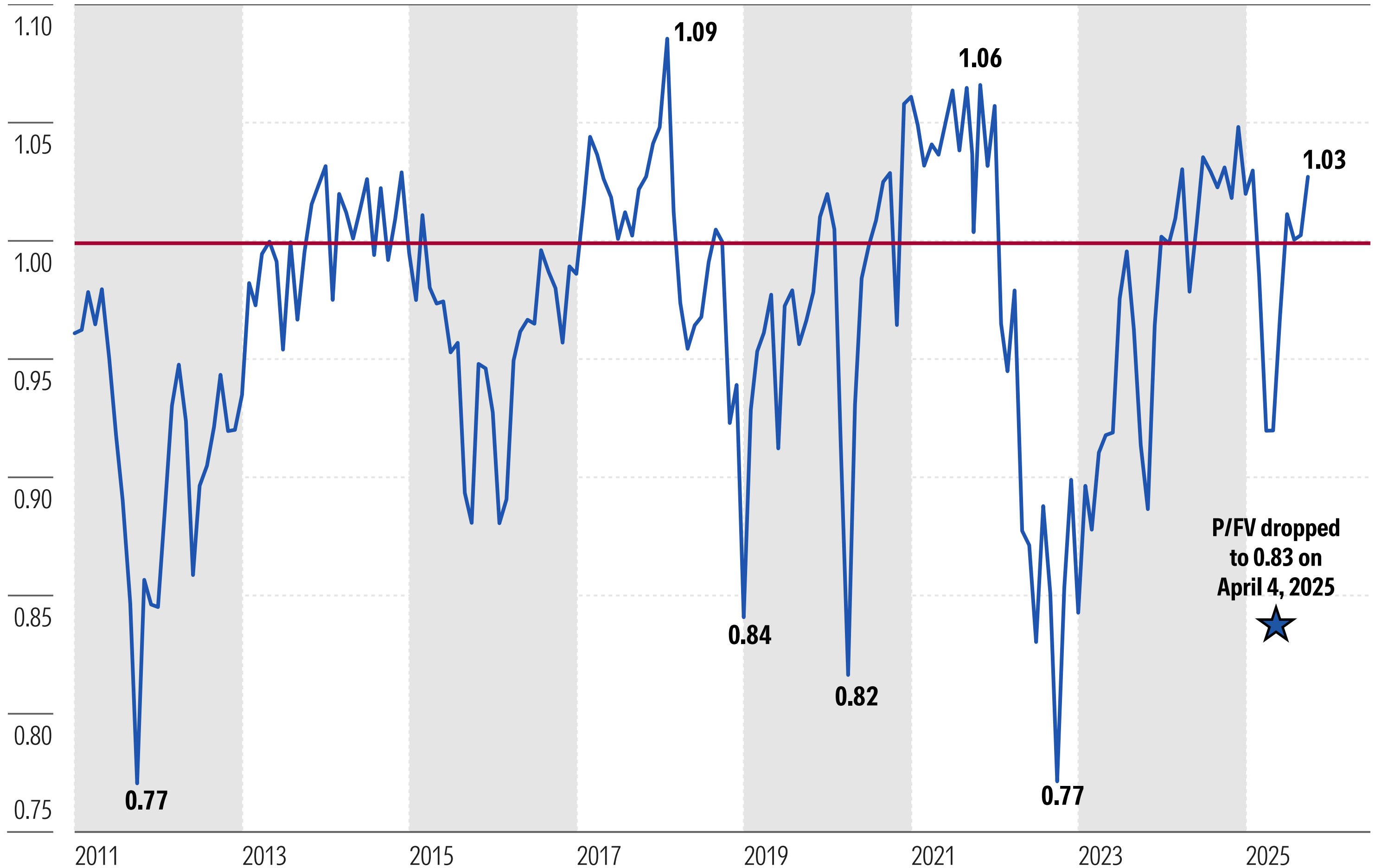
Looking ahead, the market is walking a tightrope. The positive momentum from AI buildout and anticipated monetary easing barely offsets negative macroeconomic headwinds and inflationary pressures. AI spending is helping sustain growth that might otherwise have faltered.

Additionally, the Fed is expected to cut rates twice by year-end, and long-term rates are projected to decline, with the 10-year Treasury averaging 3.9% in 2026. However, over the next four quarters, slowing consumption growth, sluggish new home building, and fading stimulus measures will take their toll on the economy.

Trade negotiations and tariffs remain a wildcard. While tariffs have yet to impact inflation meaningfully, we forecast PCE will rise to 3.0% in 2026 before easing.

Historical Morningstar US Equity Research Coverage Price/Fair Value Estimate at Month-End

Market returns outpacing valuation increases.



Source: Morningstar. Data as of Sept. 30, 2025.

Core Leads as Rebound in Apple and Alphabet Account for Outperformance

The Morningstar US Market Index rose a solid 8.09% in the third quarter of 2025.

Core stocks led the way, rising 8.28%. An attribution analysis reveals that the return was highly concentrated, as just two stocks (Apple and Alphabet) accounted for over 50% of its total return.

Within growth, Nvidia accounted for one-quarter of the return and the addition of Tesla, Broadcom, and Microsoft account for 55% of the category return.

Returns in the value category were much more broadly diversified as no single stock or group of stocks represented an outsized percentage of the category return.

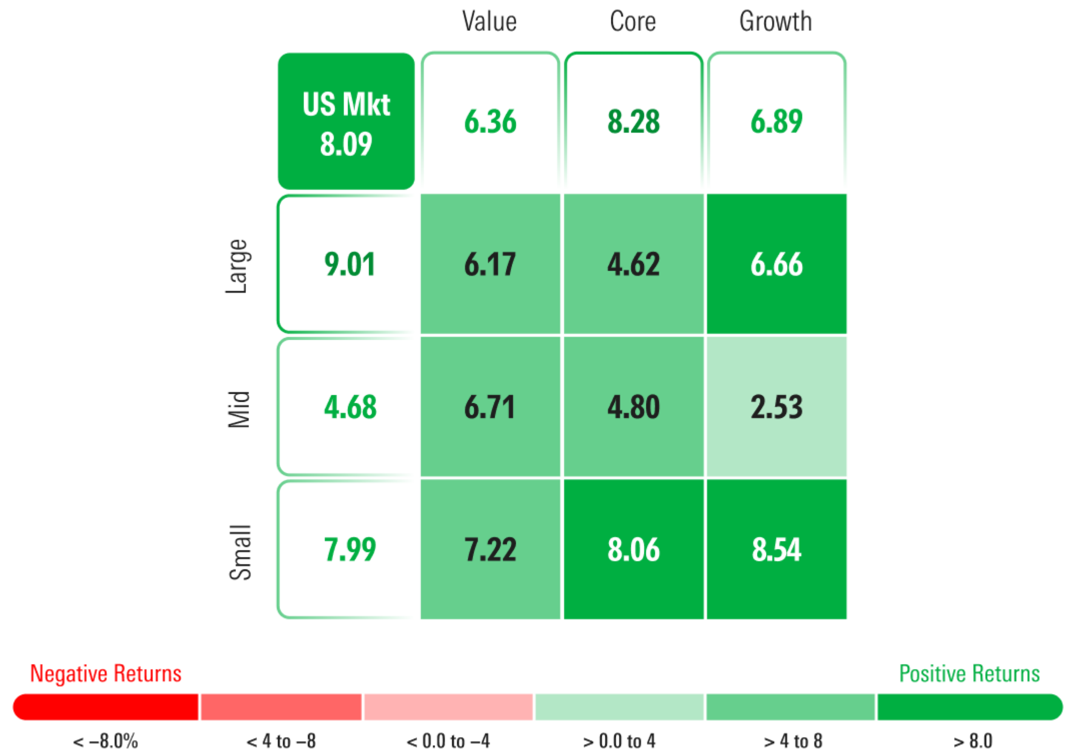
Within the large-cap space, five stocks: Apple, Nvidia, Alphabet, Tesla, and Broadcom, accounted for over 70% of the return.

Returns were broadly diversified across the mid-cap and small-cap space as no single stock or group of stocks represented an outsized percentage of the category return.

Within the mid-cap space, the greatest returns were driven by consumer cyclical, industrials, and financial services sectors.

Among small-caps, the greatest returns were driven by technology, industrials, and financial services sectors.

Morningstar US Market Index Rose 8.09% During the Third Quarter



Source: Morningstar. Data as of Sept. 30, 2025.

AI Buildout Boom Boosts Growth While Undervalued Value Caught a Bid

While returns remain more concentrated than usual by sector, they are less concentrated by individual stock contributions. An attribution analysis of the growth category reveals that the five stocks with the highest contribution (Nvidia, Microsoft, Meta, Palantir, and Broadcom) accounted for less than half the total return year to date. By sector, technology accounted for 55% of the total return, and including industrials and communications, it accounted for 85% of the total return.

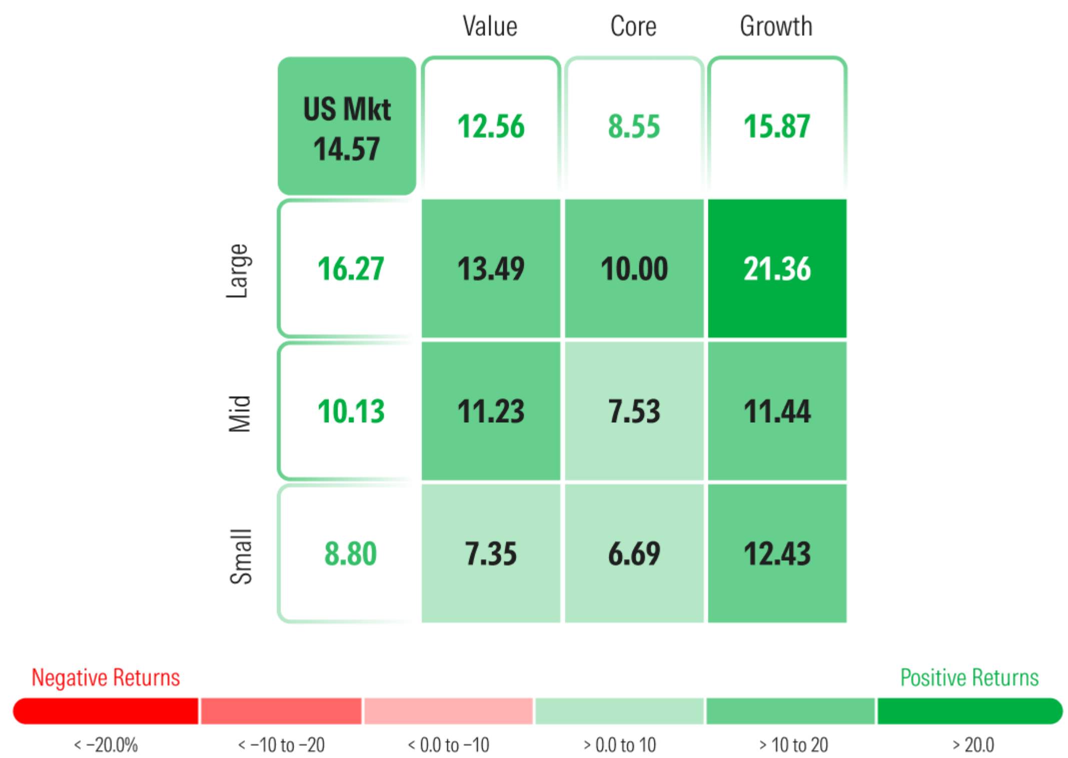
Similarly, within the value category, individual stock contributions were less concentrated as returns were more broadly diversified. By sector, financials, technology, and healthcare accounted for more than 60% of the index return. Returns were broadly diversified by stock across the core index but concentrated by sector. Technology, industrials, and communications accounted for over three-quarters of its return.

The return for the large-cap index was concentrated. Nvidia alone accounted for 21% of the return. Adding Microsoft, Broadcom, Meta, and Alphabet accounts for over 50% of the return. By sector, technology accounted for over half of the return, and the addition of the financial and communication services sectors accounted for 80% of its gain.

Within the mid-cap space, technology, financials, and industrials accounted for three-quarters of its return. By sector, returns were also concentrated in small-caps as industrials, technology, and financials accounted for three-quarters of the return. For both the mid-cap and small-cap indexes, no individual stocks had a material effect.

Morningstar US Market Index Rose 14.57% Year to Date 2025

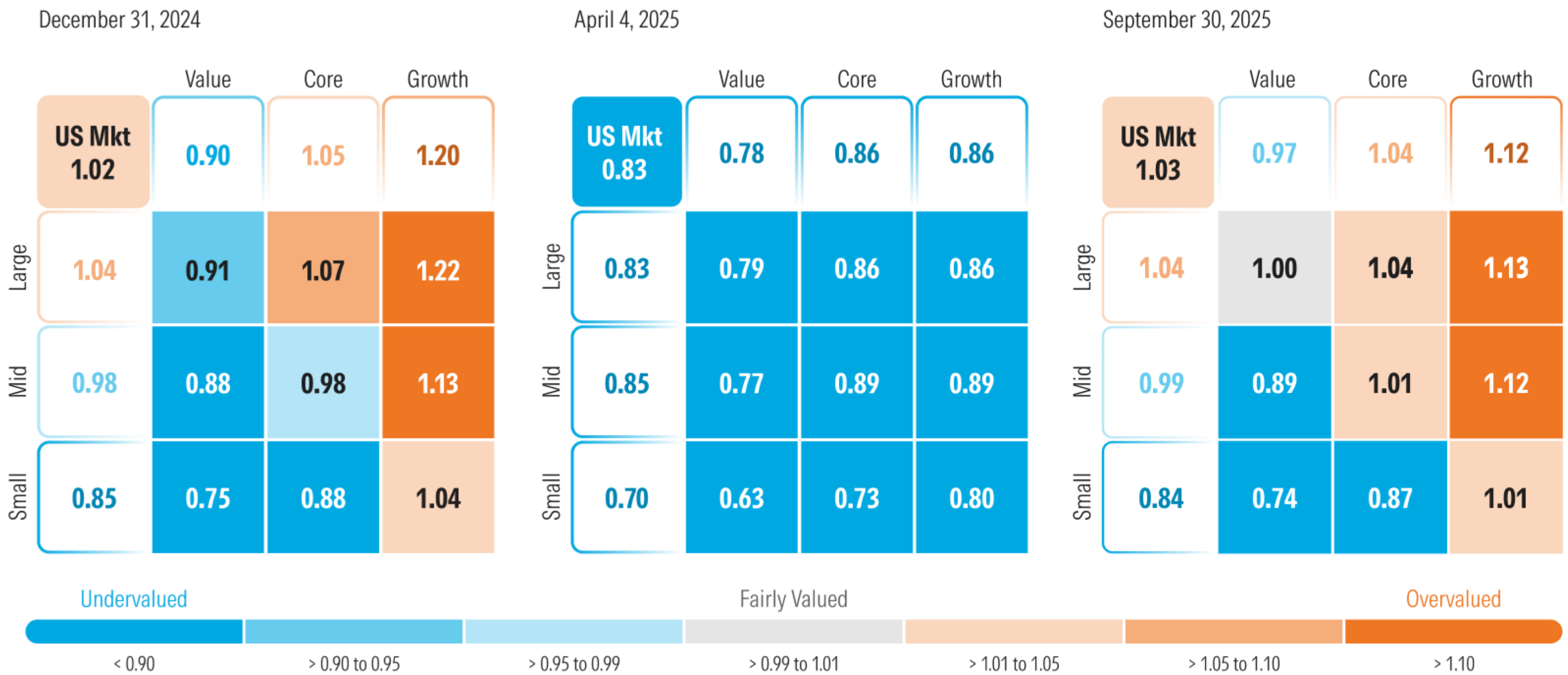
AI buildout boom boosts growth



Swift Selloff and Subsequent Rally Take Stocks Back to a Rare Premium

Stocks started the year at a rare premium to our fair value estimate, then plunged deep into undervalued territory, hitting a 17% discount to fair value on April 4. Stocks bottomed out just after we moved to an overweight recommendation in our special Market Outlook update published on April 7, 2025, and on the April 7 episode of our weekly podcast, The Morning Filter. Just as quickly as stocks plunged, they rebounded to new all-time highs and returned to a slight premium to a composite of our fair values.

Change in Morningstar Equity Research Coverage Price/Fair Value Estimates Over the Course of the Year



Source: Morningstar. Data as of Sept. 30, 2025.

Communications, Tech, and Industrials Lead the Way

Communications led the way during the third quarter, rising 12.75% driven by Alphabet's 38% return. In fact, the amount Alphabet contributed was greater than the sector return. Thus, the rest of the sector would have declined without Alphabet's contribution.

Apple, Nvidia, and Broadcom accounted for almost 60% of the gain in Technology. Within consumer cyclical, it was all about Tesla, whose 40% return accounted for three-quarters of the sector return. Rounding out the top gainers, the utility sector continued to rally as it's considered a secondary derivative play on AI.

Although real estate is expected to benefit from easing monetary policy and lower interest rates, it has lagged far behind. Wireless towers and housing-related stocks were the worst performers. Financials lagged as gains early in 2025 pushed the sector into overvalued territory. Concerns surrounding potential changes to regulation and reimbursement rates pressured healthcare stocks. The consumer defensive sector was the only one to see a loss last quarter. Seven of the top 10 largest index holdings , including Philip Morris, Costco, and Coca-Cola, declined.

Returns by Sector: Third-Quarter 2025 (%)

Rotation out of consumer defensive led to sector loss as investors chased the everything-else rally.

Cyclical		Sensitive		Defensive	
Basic Materials	6.11	Communication Services	12.75	Consumer Defensive	−2.71
Consumer Cyclical	8.90	Energy	5.80	Healthcare	4.51
Financial Services	4.07	Industrials	6.25	Utilities	7.75
Real Estate	3.19	Technology	12.40		

Negative Returns — Positive Returns

< −8.0%	< 4 to −8	< 0.0 to −4	> 0.0 to 4	> 4 to 8	> 8.0

Source: Morningstar. Data as of Sept. 30, 2025.

Still All About AI

Returns were concentrated in those sectors most closely tied to the buildout boom in artificial intelligence. Communications services was the top performing sector, yet returns for the communication services sector were especially concentrated, as two AI plays, Meta Platforms and Alphabet accounted for 73% of the sector's return.

The normally staid utilities sector was the second best-performing sector in the first half. Utility stocks benefited from both being considered a second derivative play on artificial intelligence, as well as declining interest rates.

Within technology, Nvidia by itself accounted for 30% of the return and adding in Broadcom, Microsoft, Palantir, and Oracle accounted for almost 70% of the sector return.

Consumer defensive lagged as investors rotated out of the sector and healthcare muddled along as investors were concerned that potential changes to regulation and reimbursement rates would impair earnings growth. Mediocre performance of consumer cyclical sector as consumers continued to feel the lingering effects from inflation and weak wage growth.

Returns by Sector: Year-to-Date 2025 (%)

Anything AI has surged higher this year.

Cyclical		Sensitive		Defensive	
Basic Materials	12.43	Communication Services	25.64	Consumer Defensive	2.05
Consumer Cyclical	5.29	Energy	6.53	Healthcare	3.52
Financial Services	14.01	Industrials	16.29	Utilities	21.06
Real Estate	6.21	Technology	20.55		

Negative Returns | Positive Returns

< −20.0% | < −10 to −20 | < 0.0 to −10 | > 0.0 to 10 | > 10 to 20 | > 20.0

Source: Morningstar. Data as of Sept. 30, 2025.

Attribution Analysis: Contributors

Returns broadened out across the market in the third quarter as many of those stocks that led the market in the first half of the year started to run out of steam.

Year-to-date, the top 10 contributors to the broad market return have accounted for only 53% of the total return, compared with 74% during the first half of the year.

Even though concentration tied to single stocks declined, returns were still mainly tied to artificial intelligence. Of these top 10 contributors, seven are directly tied to the buildout boom in AI. JPMorgan was the lone value stock to make the top 10.

While four of these stocks were rated 4 stars at the beginning of the year, only Microsoft remains a 4-star.

Returns Broaden Out: Ten Stocks Account for Only 53% of Market Return

Name/Ticker	Index Weighting (%)	YTD Return (%)	YTD Contribution to Index Return (%)
Nvidia NVDA	5.90	38.94	2.25
Microsoft MSFT	5.90	22.88	1.34
Broadcom AVGO	1.97	42.30	0.84
Meta Platforms META	2.57	25.43	0.60
Alphabet GOOGL	3.58	28.42	1.08
Palantir PLTR	0.45	141.20	0.41
JP Morgan Chase JPM	1.33	31.59	0.41
Oracle ORCL	0.54	68.77	0.34
GE Aerospace GE	0.43	80.36	0.26
Netflix NFLX	0.83	34.51	0.24

Source: Morningstar. Data as of Sept. 30, 2025.

Attribution Analysis: Contributors' Valuations

Attribution Analysis: Top 10 Stocks' Valuations

Name/Ticker	Rating 12/31/24	Rating 9/30/25	Price ($) 12/31/24	Price ($) 9/30/25	Change (%)	Fair Value 12/31/24	Fair Value 9/30/25	Change (%)	P/FV 12/31/24	P/FV 9/30/25
Nvidia NVDA	★★★	★★★	134	187	38.9%	130	190	46.2%	1.03	0.98
Microsoft MSFT	★★★★	★★★★	422	518	22.9%	490	600	22.4%	0.86	0.86
Broadcom AVGO	★★	★★★	232	330	42.3%	190	325	71.1%	1.22	1.02
Meta Platforms META	★★★	★★★	586	734	25.4%	560	850	51.8%	1.05	0.86
Alphabet GOOGL	★★★★	★★★	189	243	28.4%	220	237	7.7%	0.86	1.03
Palantir Technologies PLTR	★	★★	76	182	141.2%	21	115	447.6%	3.60	1.59
JP Morgan Chase JPM	★★	★★	240	315	31.6%	178	235	32.0%	1.35	1.34
Oracle ORCL	★★★★	★★★	167	281	68.8%	195	330	69.2%	0.85	0.85
GE Aerospace GE	★★★★	★★	167	301	80.4%	194	266	37.1%	0.86	1.13
Netflix NFLX	★	★	891	1,199	34.5%	550	750	36.4%	1.62	1.60

Source: Morningstar. Data as of Sept. 30, 2025.

Attribution Analysis: Detractors

No single stock was a significant detractor to the market return. The only common theme appears to be several stocks that are considered to be at risk from artificial intelligence disrupting their business. The other detractors have idiosyncratic issues that have led to losses this year.

Five of these stocks were rated 1- or 2-stars at the beginning of the year. Following these losses, none are still rated 1- or 2-stars. In many cases, we think the stocks have fallen too far and eight of the ten are now rated 4- or 5-stars.

No Single Stock a Significant Detractor to Market Performance

Name/Ticker	Index Weighting (%)	YTD Return (%)	YTD Contribution to Index Return (%)
UnitedHealth Group UNH	0.65	(31.74)	(0.26)
Salesforce CRM	0.45	(29.11)	(0.16)
Accenture ACN	0.34	(29.90)	(0.11)
Fiserv FI	0.18	(37.24)	(0.08)
Adobe ADBE	0.30	(20.67)	(0.07)
Merck & Co. MRK	0.38	(15.63)	(0.06)
The Trade Desk TTD	0.06	(58.30)	(0.06)
ServiceNow NOW	0.35	(13.19)	(0.05)
Chipotle Mexican Grill CM	0.12	(35.01)	(0.05)
UPS UPS	0.13	(33.76)	(0.05)

Source: Morningstar. Data as of Sept. 30, 2025.

Attribution Analysis: Detractors' Valuations

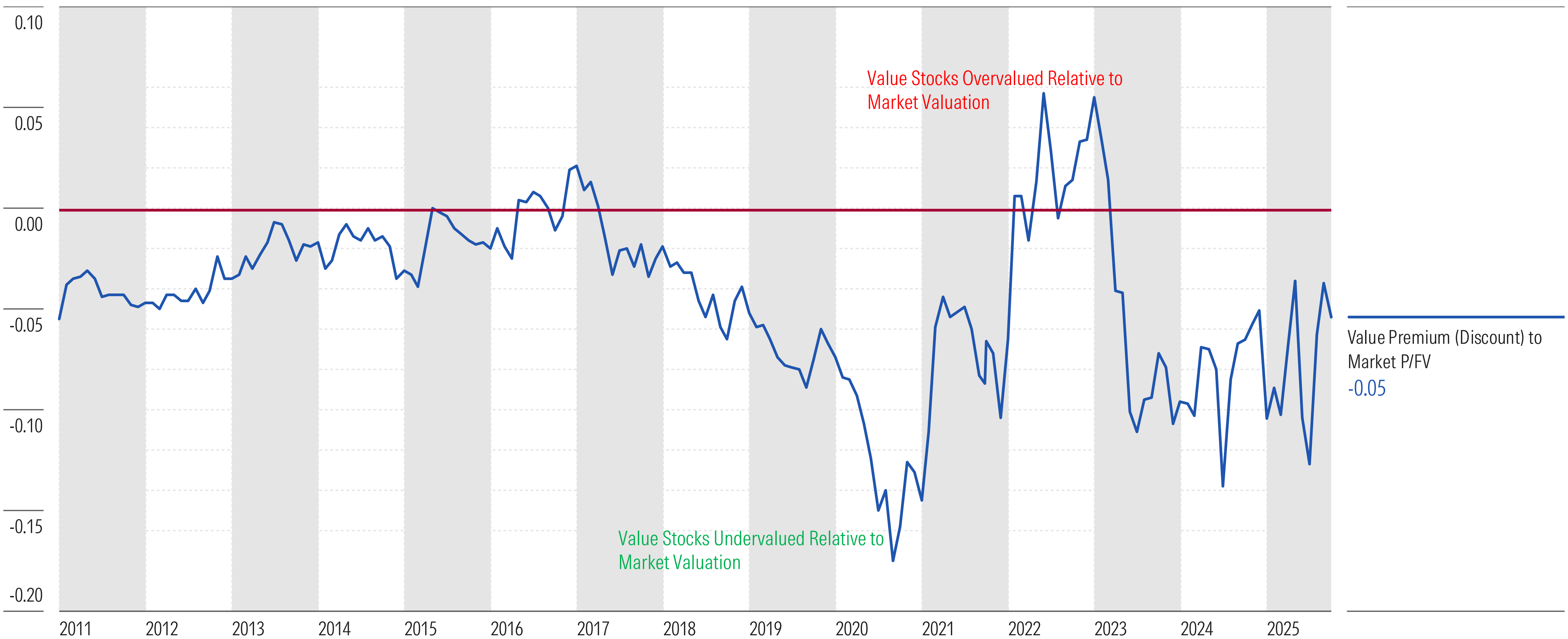
Attribution Analysis: Many of the Stocks That Detracted From Market Performance Becoming Attractively Valued

Name/Ticker	Rating 12/31/24	Rating 9/30/25	Price ($) 12/31/24	Price ($) 9/30/25	Change (%)	Fair Value 12/31/24	Fair Value 9/30/25	Change (%)	P/FV 12/31/24	P/FV 9/30/25
UnitedHealth Group UNH	★★★★	★★★	506	345	**-31.7%**	590	400	**-32.2%**	0.86	0.86
Salesforce CRM	★★★	★★★★	334	237	**-29.1%**	315	325	3.2%	1.06	0.73
Accenture ACN	★★	★★★★	352	247	**-29.9%**	323	267	**-17.3%**	1.09	0.92
Fiserv FI	★★	★★★★★	205	129	**-37.2%**	168	198	17.9%	1.22	0.65
Adobe ADBE	★★★★	★★★★	445	353	**-20.7%**	590	560	**-5.1%**	0.75	0.63
Merck & Co. MRK	★★★★	★★★★	99	84	**-15.6%**	120	111	**-7.5%**	0.83	0.76
The Trade Desk TTD	★	★★★★	118	49	**-58.3%**	60	63	5.0%	1.96	0.78
ServiceNow NOW	★★	★★★	1,060	920	**-13.2%**	900	1,050	16.7%	1.18	0.88
Chipotle Mexican Grill CMG	★	★★★★	60	39	**-35.0%**	42	46	9.5%	1.44	0.85
UPS UPS	★★★★	★★★★	126	84	**-33.8%**	150	113	**-24.7%**	0.84	0.74

Source: Morningstar. Data as of Sept. 30, 2025.

Value Stocks Continue to Trade at a Discount Relative to Broad Market Valuation

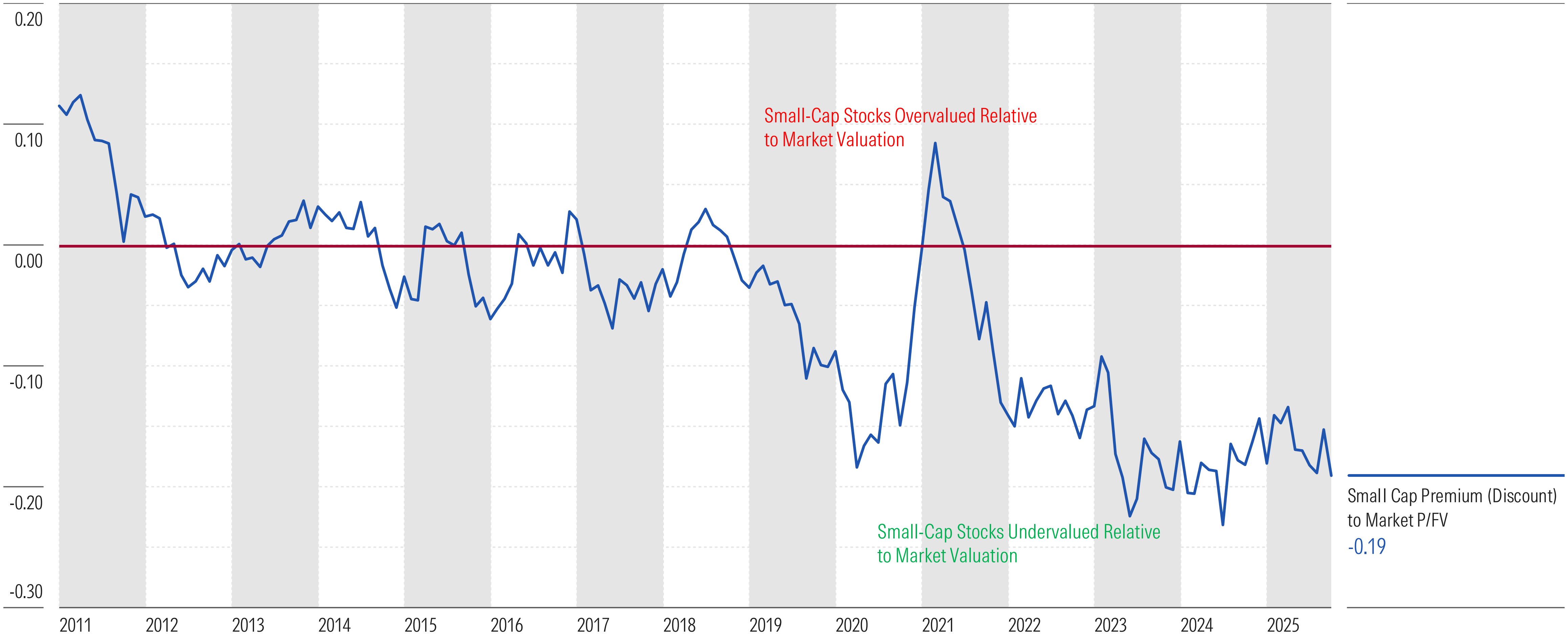
Valuations on Value Stocks Remain Attractive



Source: Morningstar. Data as of Sept. 30, 2025.

Small-Cap Stocks Continue to Trade at a Deep Discount Relative to Broad Market Valuation

Small-Cap Stocks Fail to Catch Up to Market and Remain Significantly Undervalued on Both Relative and Absolute Basis

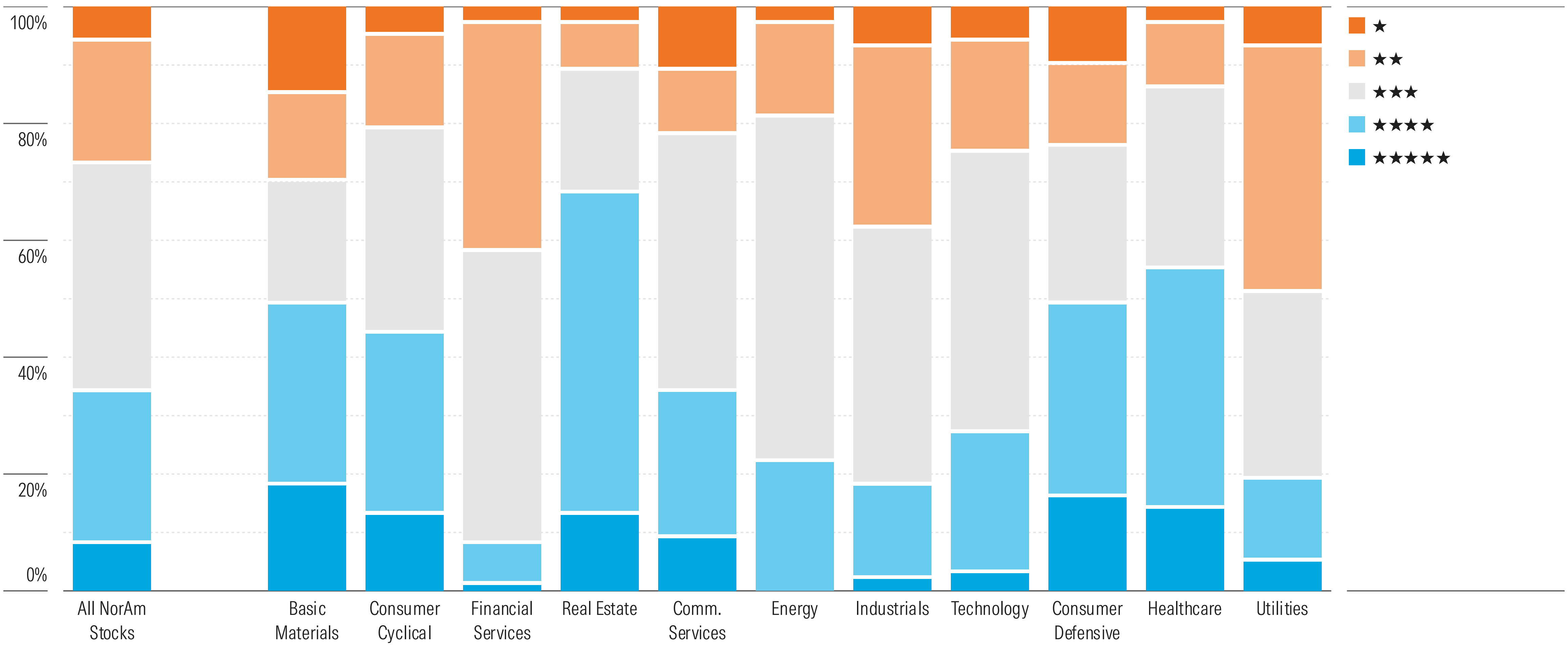


Source: Morningstar. Data as of Sept. 30, 2025.

Sector Valuations and Top Picks

Undervalued Opportunities Fewer and Farther Between

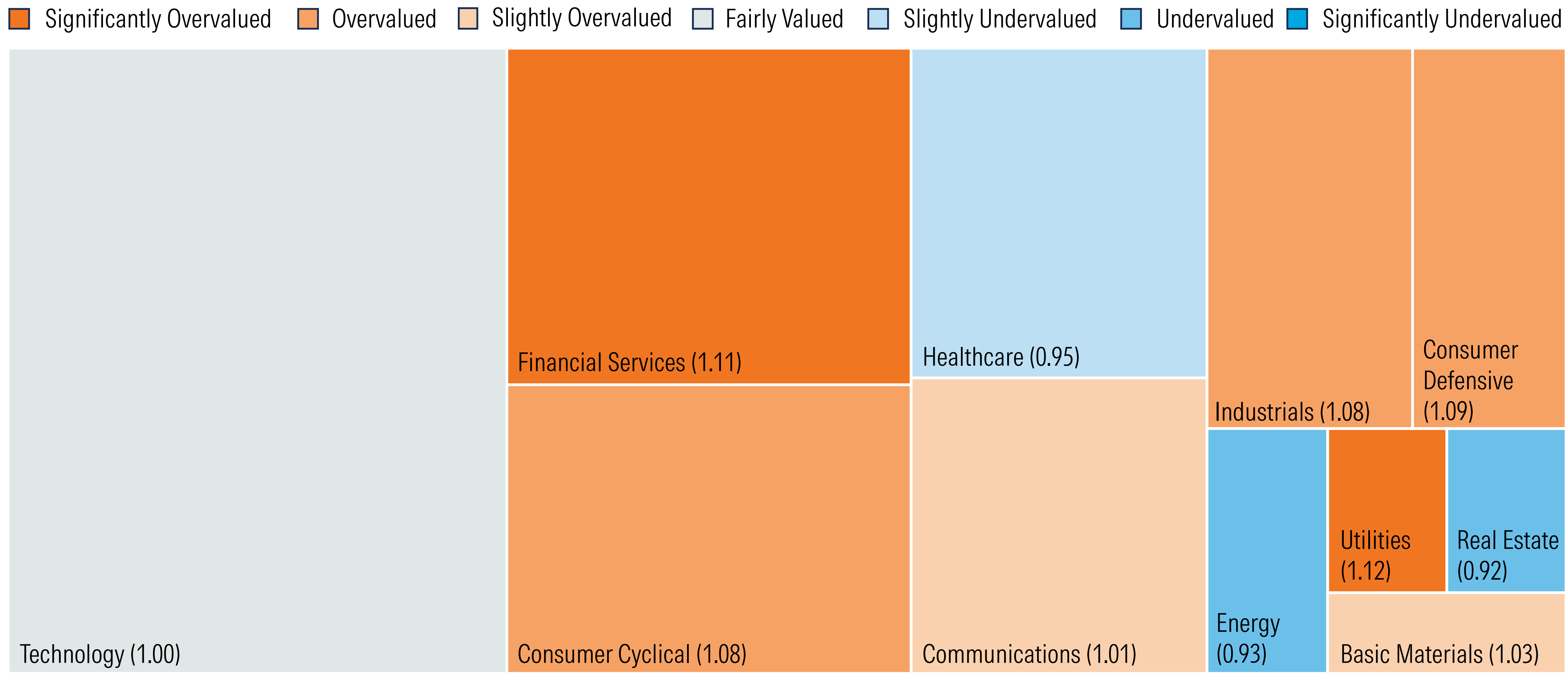
Morningstar Equity Star Ratings by Sector



Source: Morningstar. Data as of Sept. 30, 2025.

Undervalued Sectors Account for Small Percentage of the Market

Morningstar Equity Star Ratings by Sector



Source: Morningstar. Data as of Sept. 30, 2025.

After the Rally, What's Left? Only Real Estate, Energy, and Healthcare

With the broad market trading at a premium to fair value estimates, undervalued opportunities by sector have been drying up. Only real estate, energy, and healthcare remain undervalued. Even the communications sector, which had been one of the most attractively valued sectors since the beginning of this year, has climbed to just above fair value estimates.

Utilities remains the most overvalued sector. While we agree that the expansion of AI will greatly increase demand for electricity, and we incorporate that growth in our forecasts, we think the market is over-extrapolating too much growth for too long at current valuations.

Banks will benefit from a steepening yield curve as the Fed eases monetary policy and defaults remain low as the economy skirts a recession, yet the market is pricing in too much net interest income and not enough credit losses. Consumer defensive remains overvalued, yet overvaluation is concentrated in Walmart, Costco, and P&G, whereas many stocks in the sector are attractive.

With the economy poised to slow over the next year, highly valued industrials are poised to disappoint.

Morningstar Price/Fair Value Estimate Metric by Sector Weighted by Intrinsic Value

Figures below 1 are undervalued, while those above 1 are overvalued.

Cyclical		Sensitive		Defensive	
Basic Materials	1.03	Communication Services	1.01	Consumer Defensive	1.09
Consumer Cyclical	1.08	Energy	0.93	Healthcare	0.95
Financial Services	1.11	Industrials	1.08	Utilities	1.12
Real Estate	0.92	Technology	1.00		

Undervalued — Fairly Valued — Overvalued

< 0.90 | > 0.90 to 0.95 | > 0.95 to 0.99 | > 0.99 to 1.01 | > 1.01 to 1.05 | > 1.05 to 1.10 | > 1.10

Source: Morningstar. Data as of Sept. 30, 2025.

Cyclical Sectors: Best Picks

Nutrien, one of the world's lowest-cost producers of potash, returns to the Best Picks list. Bath & Body Works is on sale heading into the holidays. Caesars is poised to capture a high-single-digit revenue share of the domestic commercial gaming market. While listed as a technology name, Jack Henry provides core processing services to banks and is a high-quality name that rarely trades at a discount. LPL, the largest independent broker/dealer in the US, is expected to benefit from increasing assets under management as investors increasingly turn to financial advisors. It may take a while for excess capacity to be absorbed in cold storage space, but AmeriCold is one of the most undervalued stocks across our coverage.

Best Picks From Our Directors Across the Cyclical Sectors

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector
Eastman Chemical EMN	★★★★	63	100	0.63	Narrow	High	Basic Materials
FMC FMC	★★★★★	34	95	0.35	Narrow	High	Basic Materials
Nutrien NTR	★★★★	58	70	0.83	Narrow	High	Basic Materials
Bath & Body Works BBWI	★★★★★	26	62	0.42	Narrow	High	Consumer Cyclical
Caesars Entertainment CZR	★★★★★	28	61	0.46	None	High	Consumer Cyclical
Gildan Activewear GIL	★★★★★	57	93	0.62	Narrow	Medium	Consumer Cyclical
Jack Henry & Associates JKHY	★★★★	151	191	0.79	Wide	Medium	Technology
LPL Financial Holdings LPLA	★★★★	341	504	0.68	Wide	High	Financial Services
The Charles Schwab SCHW	★★★	97	105	0.92	Wide	High	Financial Services
AmeriCold Logistics COLD	★★★★★	12	27	0.46	None	Medium	Real Estate
Federal Realty Investment Trust FRT	★★★★	100	137	0.73	None	Medium	Real Estate
Healthpeak Properties DOC	★★★★★	19	28	0.69	None	Medium	Real Estate

Source: Morningstar. Data as of Sept. 30, 2025. New additions to the list this quarter in bold.

Economically Sensitive Sectors: Best Picks

Rogers Communications, a Canadian telecom provider, makes its inaugural appearance on the Best Picks List, as the stock has been overly punished amid a wireless industry slowdown. In an undervalued sector, Devon Energy is our pick among the domestic oil & gas producers. IDEX owns a collection of moaty businesses that tend to be leaders in their niche end markets and is a cash compounder with an impressive record of capital allocation and margin expansion

Best Picks From Our Directors Across the Economically Sensitive Sectors

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector
Comcast CMCSA	★★★★★	31	49	0.64	Narrow	Medium	Communication Services
The Walt Disney DIS	★★★	115	120	0.96	Wide	High	Communication Services
Rogers Communications RCI	★★★★★	36	48	0.74	Narrow	Low	Communication Services
Baker Hughes BKR	★★★	51	51	0.99	None	Medium	Energy
Devon Energy DVN	★★★★	36	50	0.71	Narrow	High	Energy
SLB SLB	★★★★	35	50	0.70	Narrow	High	Energy
CNH Industrial CNH	★★★★★	11	21	0.52	Narrow	Medium	Industrials
Fortune Brands Innovations FBIN	★★★★★	53	82	0.65	Narrow	Medium	Industrials
IDEX IEX	★★★★	162	210	0.77	Wide	Medium	Industrials
Atlassian TEAM	★★★★	165	230	0.72	Narrow	High	Technology
Microsoft MSFT	★★★★	515	600	0.86	Wide	Medium	Technology
NXP Semiconductors NXPI	★★★★	226	280	0.81	Wide	High	Technology

Source: Morningstar. Data as of Sept. 30, 2025. New additions to the list this quarter in bold.

Defensive Sectors: Best Picks

Freshpet is a new name on the Best Picks list , thanks to its unique fresh distribution and expanding store footprint, which position it well for growth. For long-term investors, Elevance, our favorite medical insurer, represents both a high-quality business and an attractive valuation in the managed care industry. GE HealthCare has overcorrected to account for tariff and AI risk. We are encouraged by management's transparent guidance and grasp of the tariff impact. Over the long term, we think GEHC can grow revenue in low to midsingle digits and improve its operating profit by several hundred basis points.

Best Picks From Our Directors Across the Defensive Sectors

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector
Campbell's CPB	★★★★★	31	62	0.50	Wide	Medium	Consumer Defensive
The Kraft Heinz KHC	★★★★★	26	51	0.50	Narrow	Medium	Consumer Defensive
Freshpet FRPT	★★★★★	52	105	0.50	None	High	Consumer Defensive
Elevance Health ELV	★★★★	320	507	0.63	Narrow	High	Healthcare
IQVIA IQV	★★★★★	181	268	0.67	Narrow	Medium	Healthcare
GE HealthCare Technologies GEHC	★★★★	73	89	0.82	Wide	Medium	Healthcare
Duke Energy DUK	★★★	123	121	1.01	Narrow	Low	Utilities
Edison International EIX	★★★★★	55	80	0.69	Narrow	Medium	Utilities
Eversource Energy ES	★★★★	71	73	0.97	None	Low	Utilities

Source: Morningstar. Data as of Sept. 30, 2025. New additions to the list this quarter in bold.

Valuation by Economic Moat

Wide-Moat Stocks Attractive Relative to Narrow and No-Moat Stocks

In a market that is fully valued, yet with the economy poised to slow on a sequential basis over the next year, we see better relative value in wide-moat stocks as narrow and no-moat-rated stocks are overvalued. In a downside scenario, we'd expect the stocks of companies that lack long-term, durable competitive advantages to decline further & faster than those with wide economic moats. Those few wide-moat and narrow-moat-rated stocks in the small-cap category are particularly attractive according to our valuations.

As a category, stocks with narrow moats have climbed well into overvalued territory as stocks such as 1-star-rated Netflix, 2-star-rated Tesla, and Palantir skew the valuation higher. Similar to wide-moat stocks, we continue to see opportunities in the small-cap space. No-moat stocks are trading at a premium. We would be especially cautious here, as these stocks are expected to sell off further and faster in an economic downturn.

Price/Fair Value Estimate by Economic Moat Rating Across Size and Style

Figures below 1 are undervalued, while those above 1 are overvalued.

Moat		Size: Large	Size: Mid	Size: Small	Style: Value	Style: Core	Style: Growth
None	1.05	1.13	1.05	0.90	0.99	1.00	1.29
Narrow	1.07	1.14	0.97	0.78	0.93	1.16	1.29
Wide	1.01	1.02	0.99	0.78	1.01	1.01	1.02

Undervalued — Fairly Valued — Overvalued

< 0.90 | > 0.90 to 0.95 | > 0.95 to 0.99 | > 0.99 to 1.01 | > 1.01 to 1.05 | > 1.05 to 1.10 | > 1.10

Source: Morningstar. Data as of Sept. 30, 2025.

Undervalued Large-Cap Stocks With Wide Economic Moats and Low or Medium Uncertainty

Examples of Low- or Medium-Uncertainty-Rated Companies With Long-Term, Durable Competitive Advantages at Discounts to Our Estimate of Intrinsic Valuation

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector
Bristol-Myers Squibb BMY	★★★★★	45	66	0.68	Wide	Medium	Healthcare
Danaher DHR	★★★★	198	270	0.73	Wide	Medium	Healthcare
Merck & Co. MRK	★★★★	84	111	0.76	Wide	Medium	Healthcare
Thermo Fisher Scientific TMO	★★★★	485	630	0.77	Wide	Medium	Healthcare
John Deere DE	★★★★	457	550	0.83	Wide	Medium	Industrials
Mondelēz Global MDLZ	★★★★	62	75	0.83	Wide	Low	Consumer Defensive
S&P Global SPGI	★★★★	487	570	0.85	Wide	Low	Financial Services
Pepsico PEP	★★★★	140	164	0.86	Wide	Low	Consumer Defensive
Microsoft MSFT	★★★★	518	600	0.86	Wide	Medium	Technology
Coca-Cola KO	★★★★	66	72	0.92	Wide	Low	Consumer Defensive
Accenture ACN	★★★★	247	267	0.92	Wide	Medium	Technology

Source: Morningstar. Data as of Sept. 30, 2025.

Undervalued Mid-Cap Stocks With Wide Economic Moats and Low or Medium Uncertainty

Examples of Low- or Medium-Uncertainty-Rated Companies With Long-Term, Durable Competitive Advantages at Discounts to Our Estimate of Intrinsic Valuation

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector
Constellation Brands STZ	★★★★★	135	225	0.60	Wide	Medium	Consumer Defensive
Kenvue KVUE	★★★★★	16	25	0.66	Wide	Medium	Consumer Defensive
Brown-Forman BF.B	★★★★★	27	40	0.68	Wide	Medium	Consumer Defensive
The Clorox Company CLX	★★★★	123	166	0.74	Wide	Medium	Consumer Defensive
Zimmer Biomet Holdings ZBH	★★★★	99	130	0.76	Wide	Medium	Healthcare
Copart CPRT	★★★★	45	57	0.79	Wide	Medium	Industrials
Tyler Technologies TYL	★★★★	523	650	0.80	Wide	Medium	Technology
Broadridge Financial Solutions BR	★★★★	238	290	0.82	Wide	Low	Technology
Masco MAS	★★★★	70	85	0.83	Wide	Medium	Industrials
GE HealthCare Technologies GEHC	★★★★	75	89	0.84	Wide	Medium	Healthcare
West Pharmaceutical Services WST	★★★★	262	310	0.85	Wide	Medium	Healthcare
Air Products and Chemicals APD	★★★★	273	321	0.85	Wide	Medium	Basic Materials
Agilent Technologies A	★★★★	128	151	0.85	Wide	Medium	Healthcare
Chipotle Mexican Grill CMG	★★★★	39	46	0.85	Wide	Medium	Consumer Cyclical

Source: Morningstar. Data as of Sept. 30, 2025.

Undervalued Small-Cap Stocks With Wide or Narrow Economic Moats and Low or Medium Uncertainty

Examples of Low- or Medium-Uncertainty-Rated Companies With Long-Term, Durable Competitive Advantages at Discounts to Our Estimate of Intrinsic Valuation

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector
Campbell's CPB	★★★★★	32	62	0.51	Wide	Medium	Consumer Defensive
Revvity RVTY	★★★★★	88	162	0.54	Narrow	Medium	Healthcare
Akamai Technologies AKAM	★★★★★	76	126	0.60	Narrow	Medium	Technology
Fortune Brands Innovations FBIN	★★★★★	53	82	0.65	Narrow	Medium	Industrials
Gentex GNTX	★★★★★	28	42	0.67	Narrow	Medium	Consumer Cyclical
EPAM Systems EPAM	★★★★	151	200	0.75	Narrow	Medium	Technology
IDEX IEX	★★★★	163	210	0.78	Wide	Medium	Industrials
Jack Henry & Associates JKHY	★★★★	149	191	0.78	Wide	Medium	Technology
AptarGroup ATR	★★★★	134	164	0.82	Narrow	Medium	Healthcare
Wyndham Hotels & Resorts WH	★★★★	80	96	0.83	Narrow	Medium	Consumer Cyclical
Choice Hotels International CHH	★★★★	107	128	0.84	Narrow	Medium	Consumer Cyclical
Crown Holdings CCK	★★★★	97	112	0.86	Narrow	Medium	Consumer Cyclical
Ingredion INGR	★★★★	122	140	0.87	Narrow	Medium	Consumer Defensive
Huntington Ingalls Industries HII	★★★★	288	324	0.89	Wide	Medium	Industrials

Source: Morningstar. Data as of Sept. 30, 2025.

US Economic Outlook

Morningstar Investment Management LLC

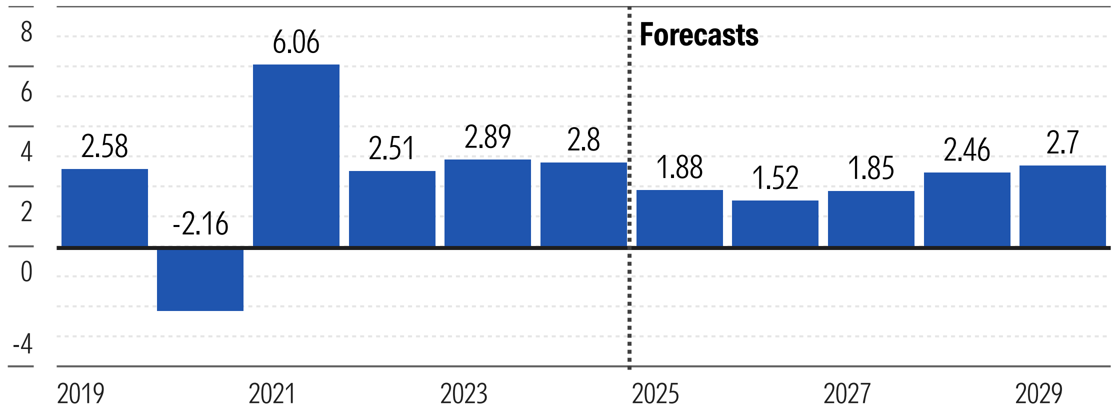
Tariffs Still to Weigh on GDP Growth and Push Up Inflation

We Expect Growth to Trough in 2026 but Rebound Thereafter

GDP growth is trending down, averaging 2.0% year over year in the second half of 2025, versus 2.8% in 2024. So far, this isn't due to tariffs, but rather some of the factors we had called out a year ago: more-cautious consumers, the fading of some temporary boosts (the factory building boom), as well as the lingering effects of high interest rates on housing, commercial real estate, and elsewhere.

We expect GDP growth to trough in 2026, owing to the impact of tariffs, along with the aforementioned factors. Starting in 2027, we expect growth to improve as the tariffs' impact fades and the economy responds to monetary loosening. See our latest US Economic Outlook for more details.

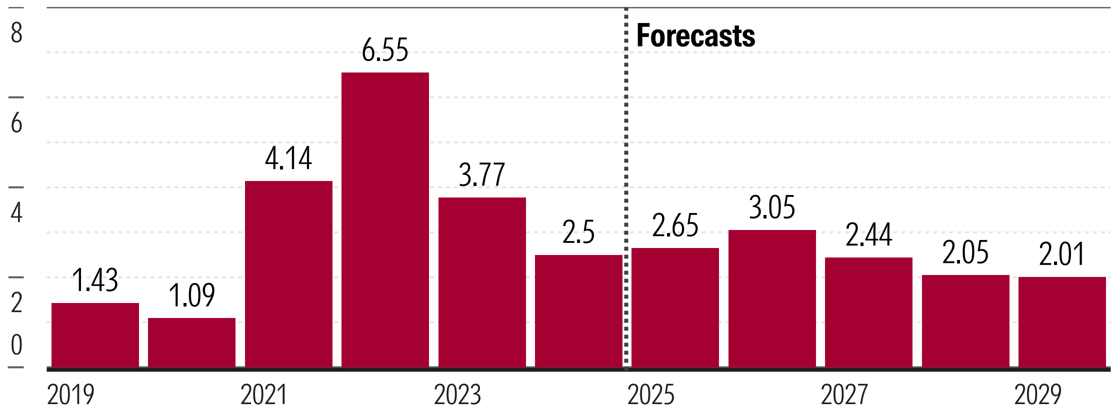
US Real GDP Growth Annual Averages



Inflation to Rise Again on Tariffs

The US had nearly beaten back inflation, which dropped from 6.6% in 2022 to 2.5% in 2024. But tariffs are breathing new life into inflation, starting with goods prices, but likely flowing into the rest of the economy with a lag. Businesses are reluctant to raise prices, but they will eventually be forced to do so. As such, we expect inflation to peak in 2026. After that, inflation is expected to drop off as the slack created by weak GDP growth generates disinflationary pressure.

Inflation (%, PCE): Forecast Revisions[1] Annual Averages



[1] Our inflation measure is the Personal Consumption Expenditures Price Index, which has several advantages over the Consumer Price Index and is preferred by the Fed.

Source: Morningstar Investment Management LLC.

Further Fed Rate Cuts Still to Come

By End of 2027, Our Projections Are 75 Basis Points Below Market Expectations

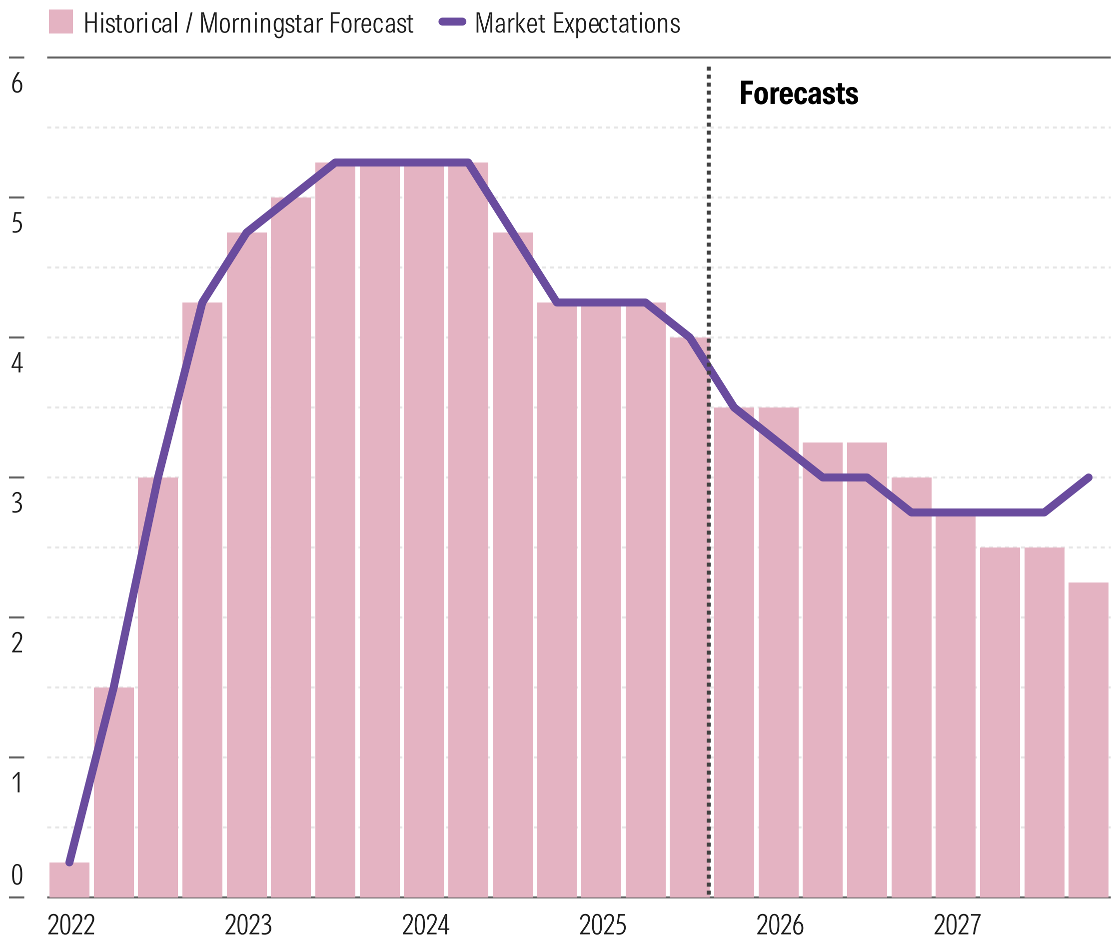
The federal-funds rate was at a lofty plateau of 5.25%-5.50% from July 2023 to September 2024. From September to December 2024, the Fed cut rates by 100 basis points and then paused for a period of time. In September 2025, the Fed began what's likely to be a new round of rate cuts with a 25-basis-point cut. Following the September meeting, the federal-funds rate target range is 4.00-4.25%. However, that's still well above the prepandemic 2017-19 average of 1.7%.

Tariffs have complicated the Fed's job. Inflation is expected to rise, although this may be a one-time impact. At the same time, growth will slow, likely bringing slack into the economy and labor market. This puts the two prongs of the Fed's dual mandate in conflict. GDP growth and especially the labor market appear to have weakened significantly so far in 2025. Moreover, the Fed has been signaling its intention for eventual rate cuts for some time, so postponing further cuts indefinitely would effectively constitute a tightening of monetary policy. Thus, we expect the Fed to proceed with another two cuts in 2025. We expect another two cuts in 2026 and three in 2027.

(%) Annual Average	2024	2025	2026	2027	2028	2029
Fed-Funds Rate	5.14	4.24	3.48	2.79	2.35	2.35
10-Year Treasury	4.21	4.30	3.90	3.50	3.25	3.25
30-Year Mortgage	6.73	6.60	5.90	5.25	5.00	5.00

Federal-Funds Rate Expectations, %

Bottom of target range

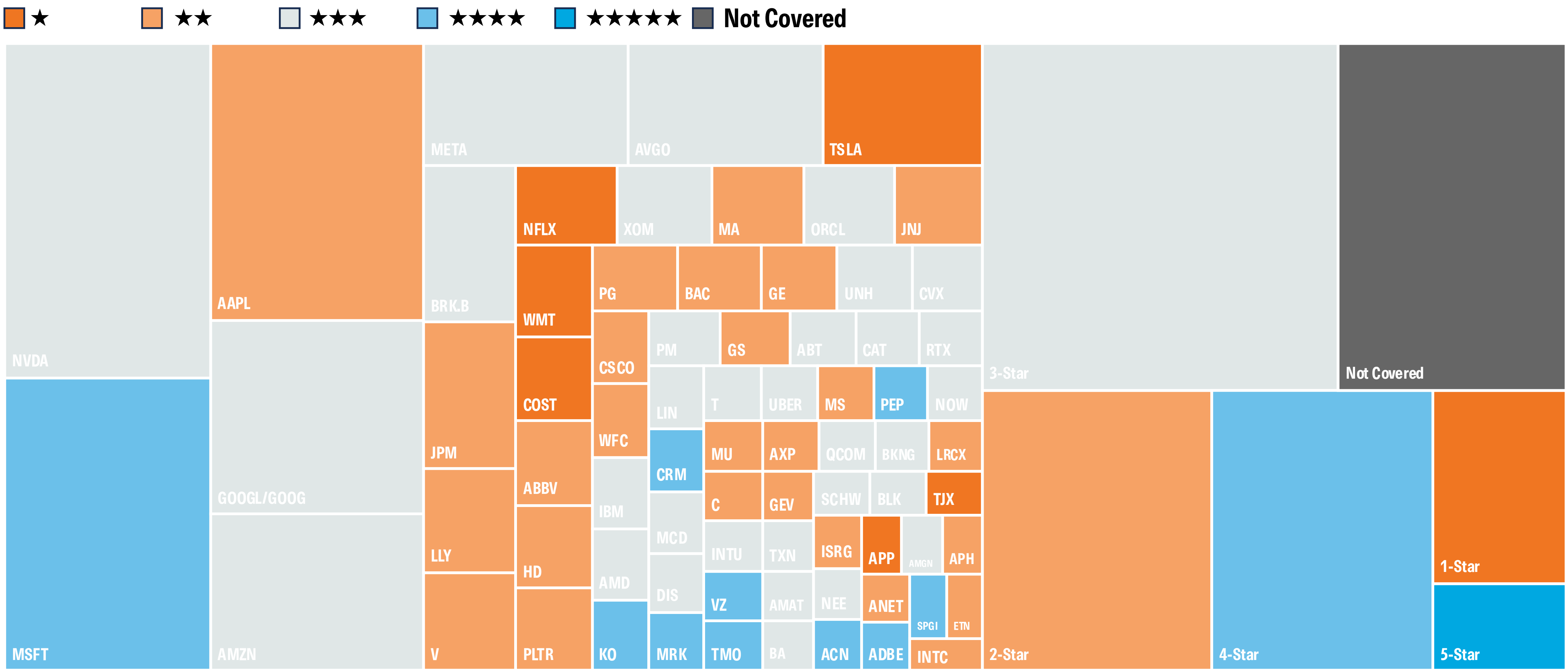


Source: Chicago Mercantile Exchange, Federal Reserve, Morningstar Investment Management LLC.

Spotlight | Mega-Cap Stocks

Star Ratings Across Morningstar US Market Index

There Are Very Few Deals Left Among the Market's Largest Players

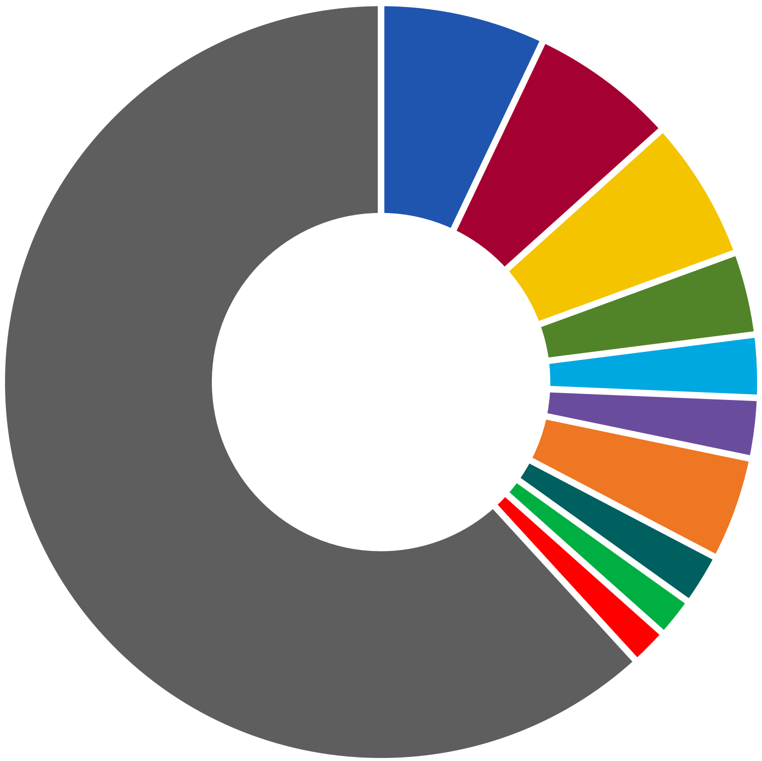


US Market Concentration Continues to Climb as the Biggest Get Bigger

Concentration risk has increasingly grown as the big get bigger faster than the broad market growth. As such, even diversified index allocations have outsized risk exposure to just a few stocks.

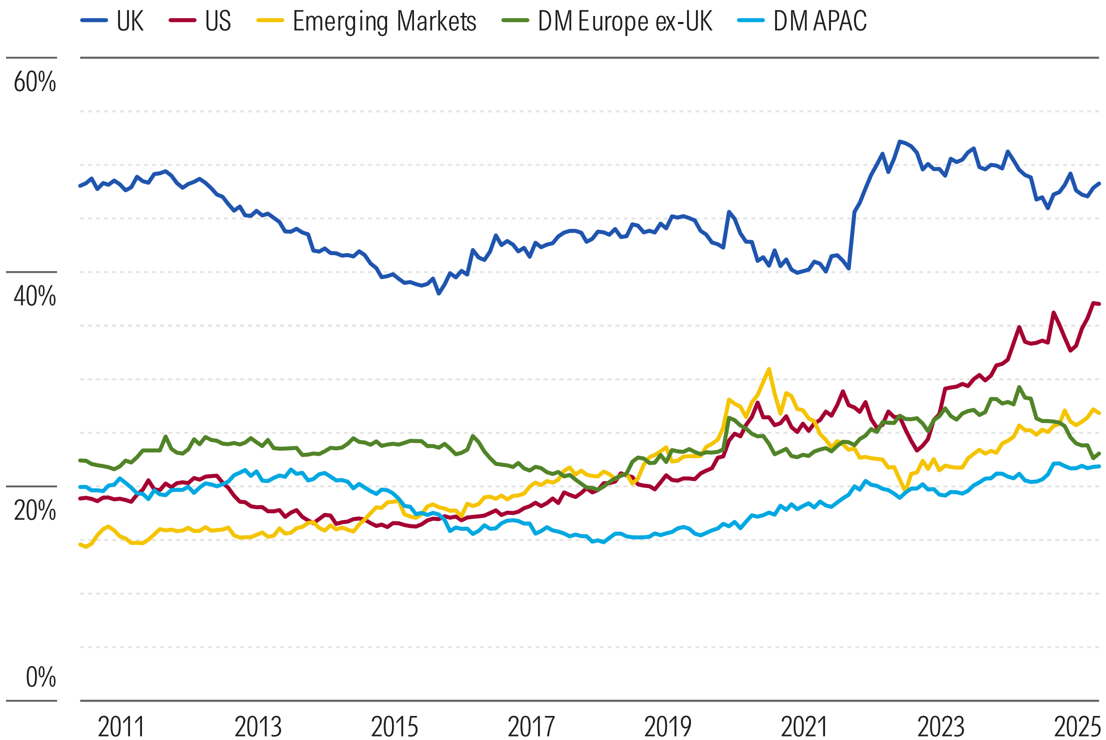
Concentration in the US market has continued to climb to new heights, especially following over the past two years as the AI buildout boom sends AI-related stocks to new historical highs.

Morningstar US Market TR Index Portfolio Concentration



NVDA	7.0%
MSFT	6.2%
AAPL	6.0%
AMZN	3.4%
META	2.5%
AVGO	2.4%
GOOGL/GOOG	4.3%
TSLA	2.0%
BRK.B	1.5%
JPM	1.4%
Other	63.3%

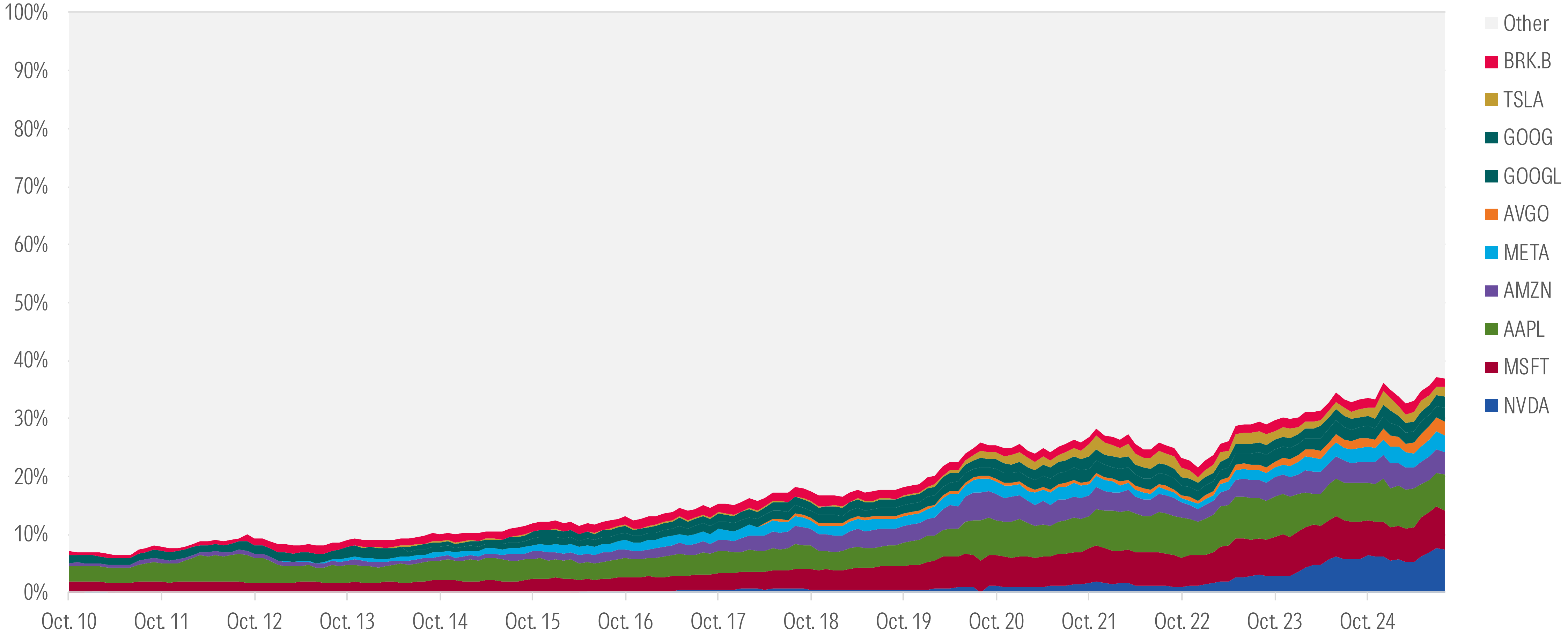
Concentration Compared With Peers



Source: Morningstar. Data as of Sept. 30, 2025 (Left). Data as of Aug. 31, 2025 (Right).

Mega-Cap Stocks Continue to Grow as a Percentage of Index

Current Top-10 Stock Weights in the Morningstar US Market Index Over Time



Source: Morningstar. Data as of Sept. 30, 2025.

Undervalued Mega-Cap Performance

Composite of Mega-Cap Stocks Rated 4- or 5-Stars Last Quarter Generally Outperformed

Name/Ticker	Rating 6/30/25	Rating 9/30/25	Price ($) 6/30/25	Price ($) 9/30/25	Change (%)	Fair Value 6/30/25	Fair Value 9/30/25	Change (%)	P/FV 6/30/25	P/FV 9/30/25
Alphabet GOOGL	★★★★	★★★	176	243	37.9%	237	237	0.0%	0.74	1.03
Exxon Mobil XOM	★★★★	★★★	108	113	4.6%	135	129	**-4.4%**	0.80	0.87
UnitedHealth Group UNH	★★★★	★★★	312	345	10.7%	473	400	**-15.4%**	0.66	0.86
Johnson & Johnson JNJ	★★★★	★★★	153	185	21.4%	164	172	4.9%	0.93	1.08
Salesforce CRM	★★★★	★★★★	273	237	**-13.1%**	325	325	0.0%	0.84	0.73
McDonald's MCD	★★★★	★★★	292	304	4.0%	312	317	1.6%	0.94	0.96

Source: Morningstar. Data as of Sept. 30, 2025.

Even With Stock Market Hitting New Highs, Valuations Matter

Even Though Market Hits New Highs, Many Mega-Cap Stocks Rated 1- or 2-Stars Pulled Back

Name/Ticker	Rating 6/30/25	Rating 9/30/25	Price ($) 6/30/25	Price ($) 9/30/25	Change (%)	Fair Value 6/30/25	Fair Value 9/30/25	Change (%)	P/FV 6/30/25	P/FV 9/30/25
Broadcom AVGO	★★	★★★	276	330	19.7%	225	325	44.4%	1.23	1.02
Tesla TSLA	★★	★★	318	445	40.0%	250	250	0.0%	1.27	1.78
JP Morgan Chase JPM	★	★★	290	315	8.8%	195	235	20.5%	1.49	1.34
Walmart WMT	★	★	98	103	5.4%	64	64	0.0%	1.53	1.61
Eli Lilly LLY	★★	★★★	780	763	**-2.1%**	650	650	0.0%	1.20	1.17
Visa V	★★	★★	355	341	**-3.9%**	306	306	0.0%	1.16	1.12
Netflix NFLX	★	★	1,339	1,199	**-10.5%**	750	750	0.0%	1.79	1.60
Costco Wholesale COST	★	★	990	926	**-6.5%**	620	620	0.0%	1.60	1.49
Procter & Gamble PG	★★	★★	159	154	**-3.6%**	140	147	5.0%	1.14	1.05
The Home Depot HD	★★	★★	367	405	10.5%	308	335	8.8%	1.19	1.21
Palantir Technologies PLTR	★★	★★	136	182	33.8%	100	115	15.0%	1.36	1.59
Philip Morris PM	★★	★★★	182	162	**-10.9%**	150	153	2.0%	1.21	1.06
Cisco Systems CSCO	★★	★★	69	68	**-1.4%**	56	61	8.9%	1.24	1.12
IBM IBM	★★	★★★	295	282	**-4.3%**	242	264	9.1%	1.22	1.07
Wells Fargo WFC	★★	★★	80	84	4.6%	69	72	4.3%	1.16	1.16

Source: Morningstar. Data as of Sept. 30, 2025.

Updated List of Undervalued Mega-Cap Stocks

Several New Wide-Moat Stocks Added to List of Undervalued Mega-Caps

Name/Ticker	Rating	Price ($)	Fair Value ($)	P/FV	Economic Moat	Uncertainty	Sector
Microsoft MSFT	★★★★	518	600	0.86	Wide	Medium	Technology
Coca-Cola KO	★★★★	66	72	0.92	Wide	Low	Consumer Defensive
Salesforce CRM	★★★★	237	325	0.73	Wide	High	Technology
Merck & Co. MRK	★★★★	84	111	0.76	Wide	Medium	Healthcare
Pepsico PEP	★★★★	140	164	0.86	Wide	Low	Consumer Defensive

Source: Morningstar. Data as of Sept. 30, 2025.

Updated List of Overvalued Mega-Cap Stocks

Updated List of Overvalued Mega-Cap Stocks

Name/Ticker	Rating	Price ($)	Value ($)	P/FV	Moat	Uncertainty	Sector
Apple AAPL	★★	255	210	1.21	Wide	Medium	Technology
Tesla TSLA	★★	445	250	1.78	Narrow	Very High	Consumer Cyclical
JP Morgan Chase JPM	★★	315	235	1.34	Wide	Medium	Financial Services
Walmart WMT	★	103	64	1.61	Wide	Medium	Consumer Defensive
MasterCard MA	★★	569	520	1.09	Wide	Medium	Financial Services
Visa V	★★	341	306	1.12	Wide	Medium	Financial Services
Netflix NFLX	★	1,199	750	1.60	Narrow	High	Communication Servic
Palantir Technologies PLTR	★★	182	115	1.59	Narrow	Very High	Technology
Costco Wholesale COST	★	926	620	1.49	Wide	Medium	Consumer Defensive
The Home Depot HD	★★	405	335	1.21	Wide	Medium	Consumer Cyclical
AbbVie ABBV	★★	232	184	1.26	Wide	High	Healthcare
Bank of America BAC	★★	52	46	1.12	Wide	Medium	Financial Services
Procter & Gamble PG	★★	154	147	1.05	Wide	Low	Consumer Defensive
GE Aerospace GE	★★	301	266	1.13	Wide	Medium	Industrials
Cisco Systems CSCO	★★	68	61	1.12	Wide	Medium	Technology

Source: Morningstar. Data as of Sept. 30, 2025.

Fixed-Income Outlook

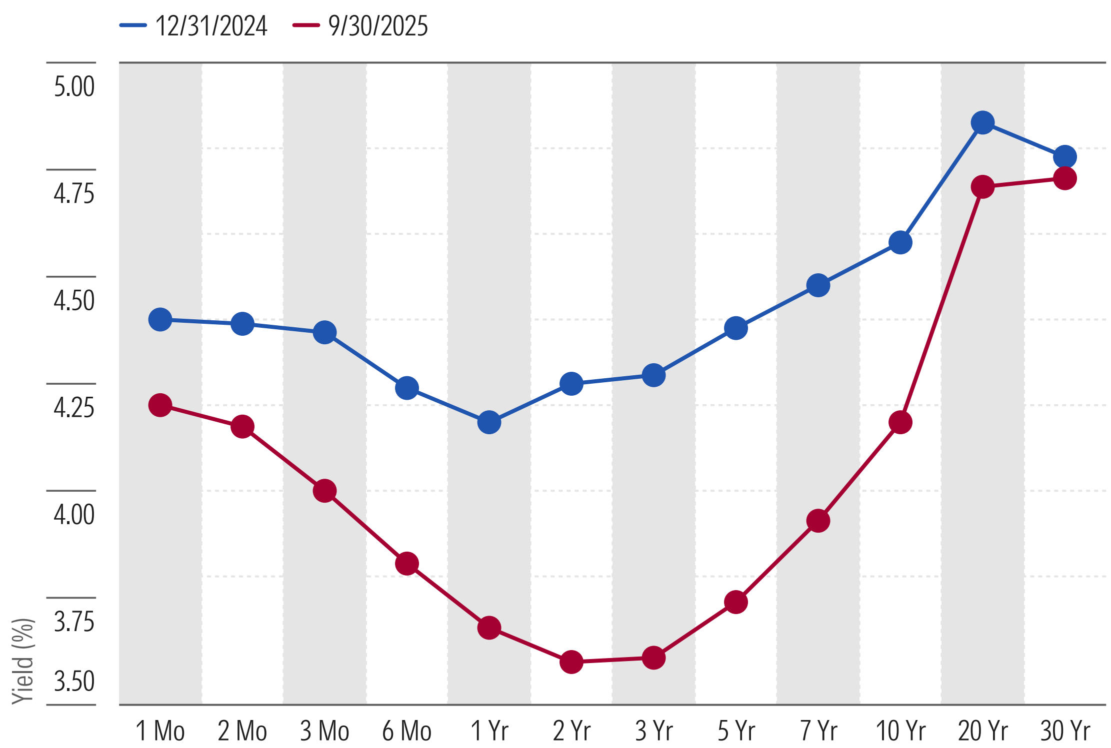
Declining Interest Rates and Tighter Credit Spreads Drive Returns Higher

The Morningstar US Core Bond Index, our proxy for the broad bond market, rose a solid 6.09% year to date. As the bond market prices in additional cuts to the federal funds rate, yields in the short to middle part of the yield curve have tightened the most. For example, year to date, yields on the three-year US Treasury bonds declined by 66 basis points whereas in the longer end of the curve, the yield on the 10-year US Treasury only declined 42 basis points.

Morningstar US Fixed-Income Index Returns (%)

Morningstar Index	Effective Yield	Duration	2022	2023	2024	YTD 2025
ABS	4.55%	2.2	-4.42%	6.18%	5.87%	4.51%
CMBS	4.48%	3.8	-9.84%	5.17%	4.73%	6.19%
Core Bond	4.37%	5.9	-12.99%	5.31%	1.36%	6.09%
Corporate Bond	4.80%	7.1	-15.71%	8.41%	2.13%	6.89%
High-Yield Bond	6.51%	3.0	-11.09%	13.48%	8.20%	7.16%
MBS	4.80%	5.5	-11.94%	4.97%	1.34%	6.64%
TIPS	1.42%	5.0	-11.85%	3.68%	2.08%	6.89%
Treasury Bond	3.94%	5.9	-12.43%	3.88%	0.76%	5.36%

Interest Rates Decline the Most Across Three-Year to Five-Year USTs



Source: Morningstar. Data as of Sept. 30, 2025.

Interest-Rate Forecast

Morningstar's US economics team projects that the Fed will ease monetary policy through the end of 2025 and will continue to ease monetary policy further in 2026 and into 2027. This projection is predicated on their forecast that the rate of economic growth will slow through the second quarter of 2026. Although tariffs will lead inflation higher in 2026, inflation is expected to moderate thereafter.

We continue to believe that investors will be best served by holding longer-duration bonds, which capture the high yield carry along with potential future price appreciation. This is in line with our US economics team's forecast of a multiyear period of declining yields. In the longer end of the curve, they project the yield on the 10-year US Treasury will average 4.30% in 2025, 3.90% in 2026, 3.50% in 2027, and 3.25% in 2028.

Interest-Rate Forecast

Average interest rate per calendar year.

Interest Rate (%)	**2025E**	**2026E**	**2027E**	**2028E**	**2029E**
Federal-Funds	4.24	3.48	2.79	2.35	2.35
10-Year UST	4.30	3.90	3.50	3.25	3.25

Source: Morningstar. Data as of Sept. 30, 2025.

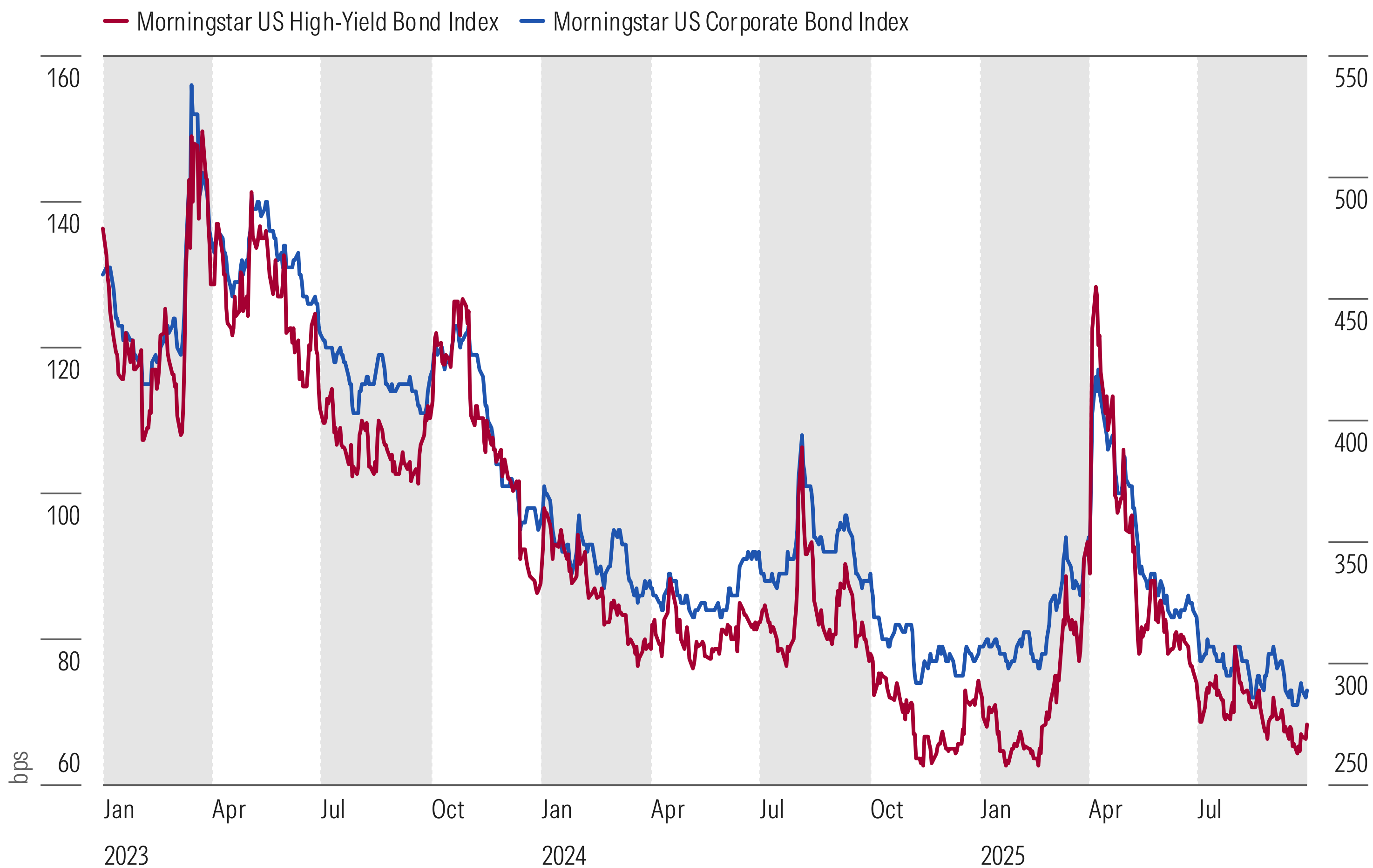
Corporate Bond Market: Are You Getting Paid Enough?

Corporate credit spreads tightened during the third quarter. In the investment-grade market, the average spread of the Morningstar US Corporate Bond Index tightened 10 basis points to +73 as of Sept. 30. Intra-quarter, the spread reached +71, a new historically tight level.

The average spread of the Morningstar US High-Yield Index tightened 17 basis points to +275. While this spread has yet to return to its historically tightest level, which was +258 on Feb. 18, 2025, less than 3% of the time since 2000 have high-yield bonds traded at a tighter spread than now.

We continue to forecast a soft economic landing. In this scenario, while default rates are expected to remain near normalized levels and credit rating downgrades to stay low, we don't think investors are being adequately compensated for credit risk. In fact, DBRS Morningstar notes that in the private credit market, there has been an increasing reliance on external capital support to compensate for weaker cash flow generation among private borrowers. They believe ongoing sales and EBITDA growth pressure is likely to contribute to further downgrades and defaults over the next six to 12 months.

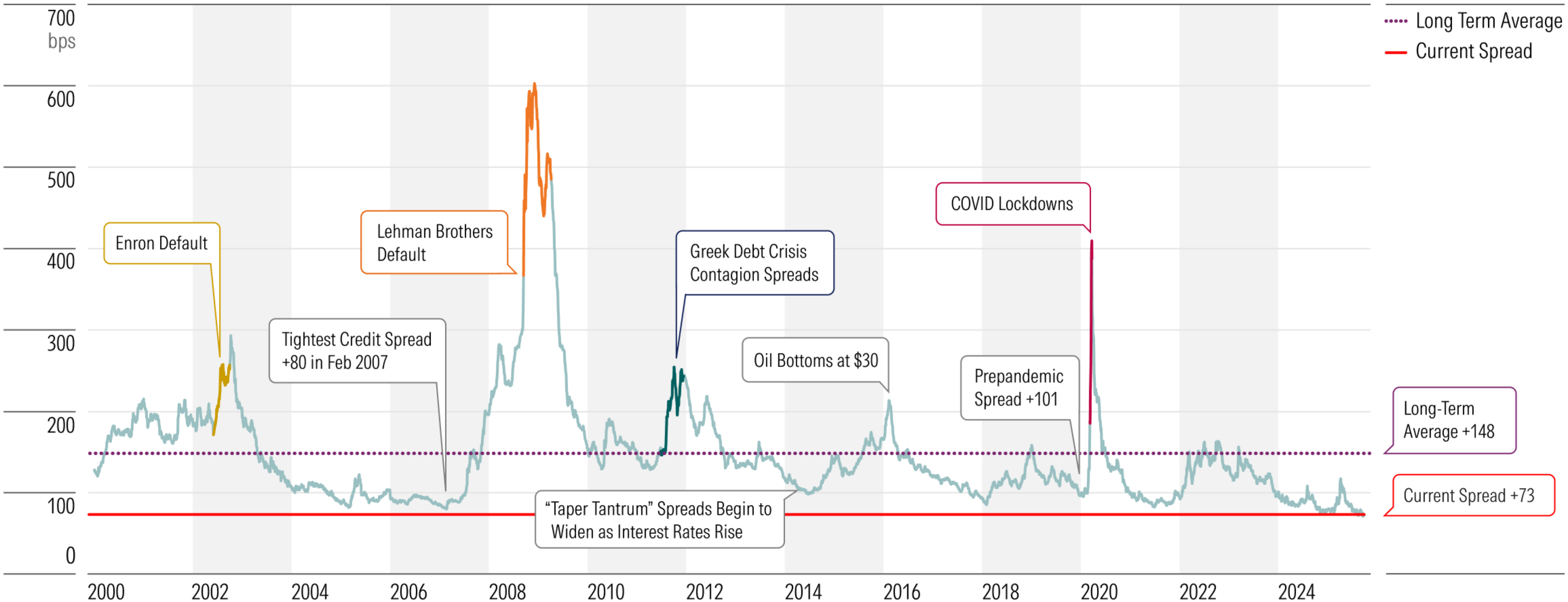
Corporate Credit Spreads Hit New Historically Tight Levels



Source: Morningstar. Data as of Sept. 30, 2025.

Long-Term Average Credit Spread for Investment-Grade Corporate Bond Market

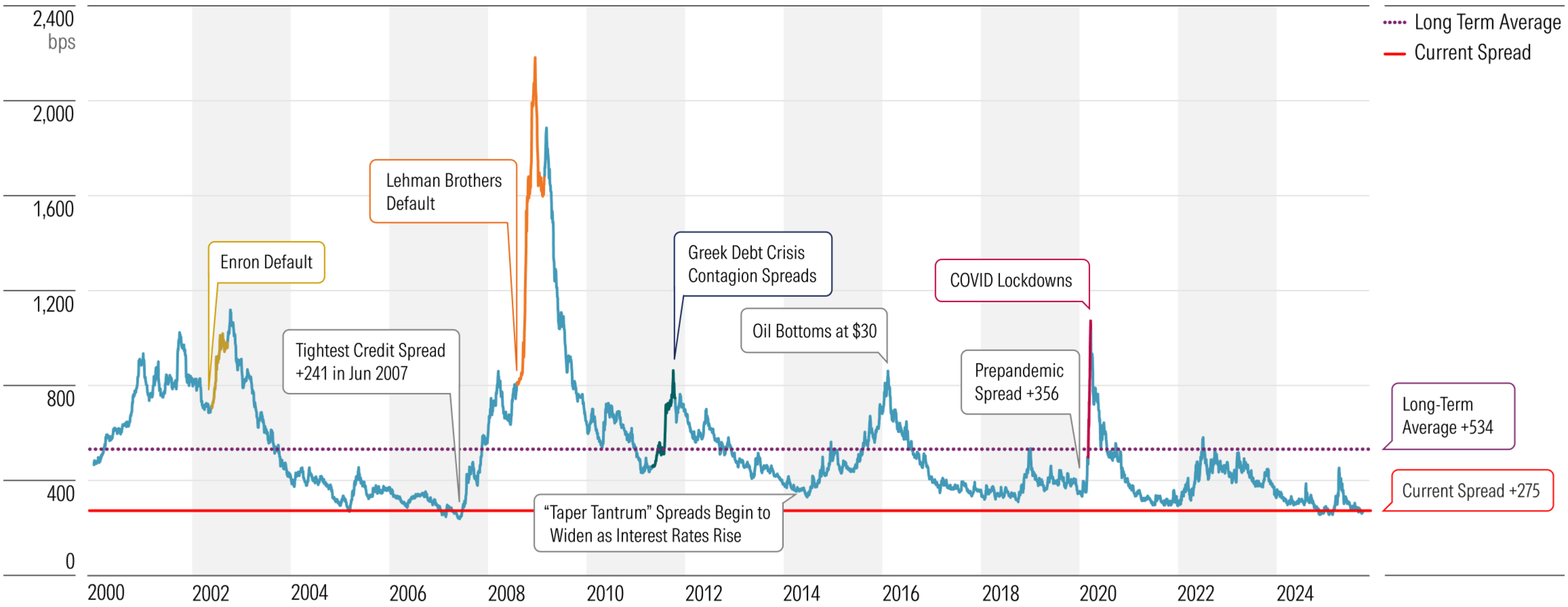
Long-Term Average Credit Spread for Investment-Grade Corporate Bond Index



Source: Morningstar. Data as of Sept. 30, 2025.

Long-Term Average Credit Spread for High-Yield Corporate Bond Market

Long-Term Average Credit Spread for High-Yield Corporate Bond Index



Source: Morningstar. Data as of Sept. 30, 2025.

Sector Outlooks

Basic Materials

Seth Goldstein, CFA | seth.goldstein@morningstar.com

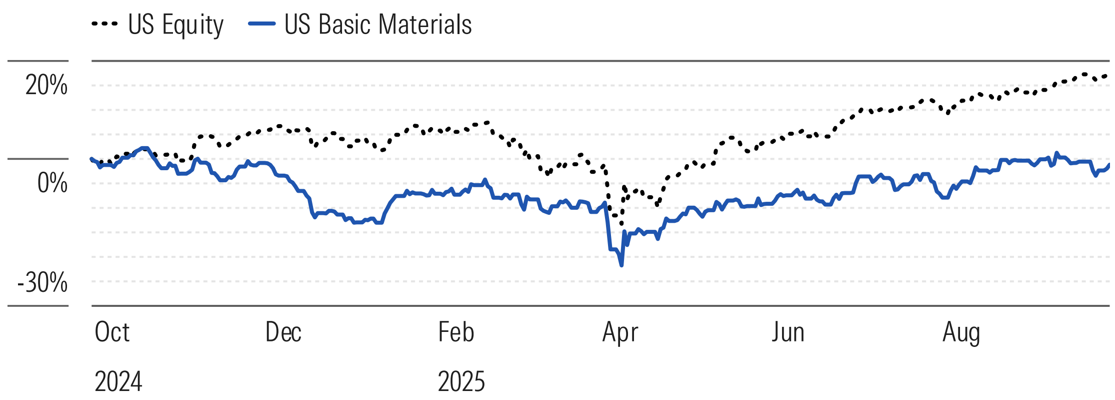
Basic Materials Sector Underperforms, but We See Opportunities in Chemicals and Agriculture

The Morningstar US Basic Materials Index underperformed the US market index during the third quarter. Yet, we see opportunities across the sector with over 45% of the stocks trading in 5-star or 4-star territory, and the sector as a whole trading below our fair value estimate. We see the most opportunities in the chemicals sector, where most stocks under our coverage are trading in 5-star or 4-star territory. Guidance below consensus estimates led to the sale of shares by multiple chemical producers during the quarter.

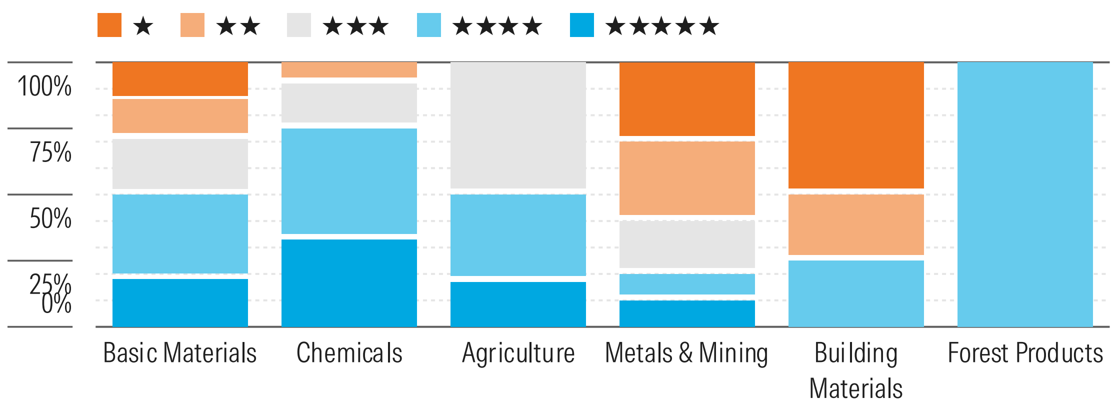
In the chemicals industry, weak demand is being driven by a tariff-related economic slowdown. Additionally, for commodity chemicals, there is a global oversupply due to overcapacity in China. In response, supply is being shut down in Europe and Asia, except in China, and growth projects in North America are being delayed. Production is below the trailing 10-year average. Lower production has an outsize effect on profits due to the high fixed-cost nature of chemical production. While we expect cyclically low profits in 2025, we expect a small increase in 2026, followed by further normalization in 2027 and beyond. This should result in a full recovery for producer profits.

In agriculture, crop chemical producers are expected to see higher second-half profits, driven by the end of inventory destocking. Destocking began in 2023 as the excess inventory built up during the covid-19 pandemic began to unwind. However, with inventory levels back to normal in the key growing markets of North America, South America, and Europe, we expect more normalized demand and a profit rebound in the fourth quarter.

The Basic Materials Index Rose During Q3 on an Improving Near-Term Outlook



A Little Less Than Half of Basic Materials Stocks Trade in 5-Star or 4-Star Territory



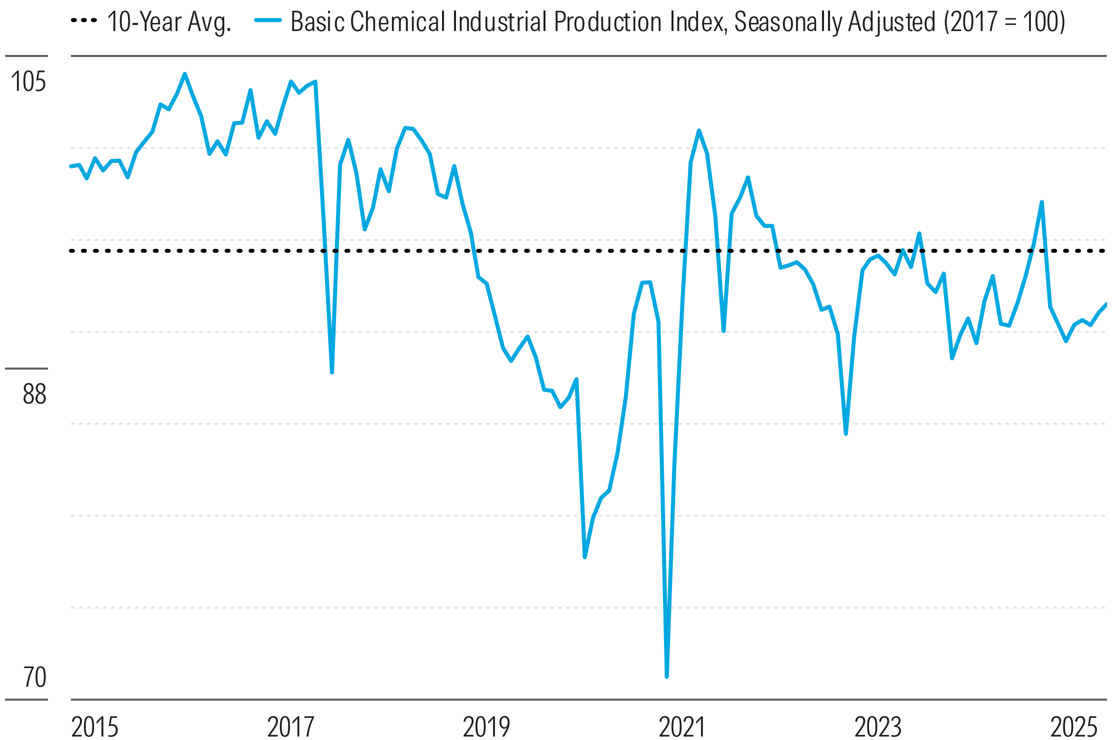
Source: Morningstar, Federal Reserve Bank of St. Louis. Data as of Sept. 30, 2025.

Higher Potash Prices Should Boost Producer Profits in Second Half of 2025 and Into 2026

Since hitting a multiyear low in the fourth quarter of 2024, potash prices have risen and are now close to our long-term forecast in the mid-$300 per metric ton range. For producers, rising prices should start to boost profits as there is typically a lag between rising spot prices and price realizations. We anticipate that higher potash prices will support increased profits in the second half of 2025 and 2026, as we expect prices to remain at current levels.

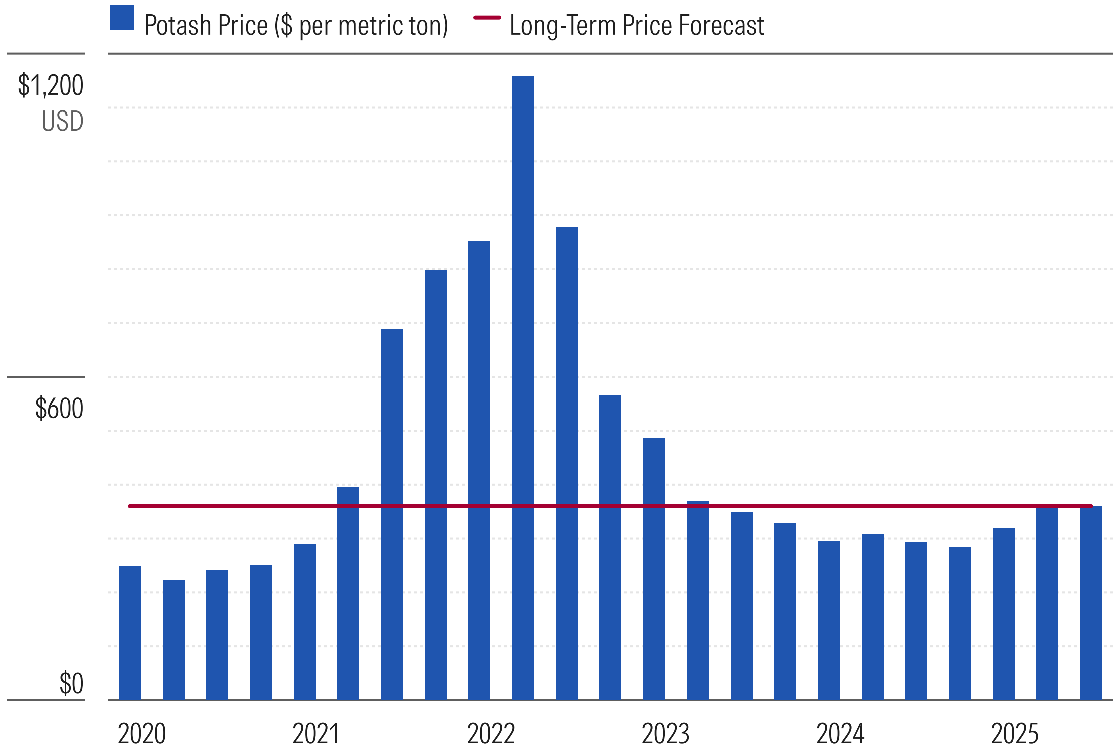
US Basic Chemical Production Is Below the Trailing 10-Year Average

US Basic Chemicals Production Index, 2017 = 100



Potash Prices Have Risen to Around Our Long-Term Forecast

Potash price per metric ton



Source: Morningstar, Federal Reserve Bank of St. Louis, World Bank.

Basic Materials Top Picks

Name/Ticker		Rating	
Eastman Chemical (EMN)		★★★★	Eastman is our top pick to invest in a medium-term rebound in chemicals demand. The stock trades around 35% below our $100 fair value estimate. Eastman's narrow-moat rating comes from its specialty chemicals, which are protected by patents and command premium pricing. This should allow the company to perform better than its commodity chemicals peers during a downturn and see a quick recovery when demand returns. Eastman should continue to generate free cash flow above dividends even in the downturn and maintains a healthy balance sheet, which should support shares.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
62.66	100.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
7.2 B	Narrow	Standard	

Name/Ticker		Rating	
FMC (FMC)		★★★★★	FMC is our top pick to invest in stabilizing crop protection demand. The stock trades at less than 45% of our $95 fair value estimate. FMC's narrow-moat rating comes from its patent-protected differentiated crop chemicals portfolio, which creates strong pricing power as farmers will pay up for premium products that protect against pests. As a crop chemicals pure-play, FMC was hit harder than its peers by inventory destocking and falling sales. However, with inventory levels back to normal, we point to strong growth in the second half of the year and further growth 2026 as a catalyst for shares.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
33.51	95.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
4.2 B	Narrow	Standard	

Name/Ticker		Rating	
Nutrien (NTR)		★★★★	Our top pick to invest in potash is Nutrien. The stock trades around 20% below our $70 (CAD 97) fair value estimate. Nutrien is one of the lowest-cost potash producers globally, which underpins our narrow-moat rating. While Nutrien also sells nitrogen and phosphate and runs a farm retail business, potash generates the largest portion of profits. We forecast Nutrien will see profit growth in 2025 as potash prices rise, and its low-cost potash business will see higher long-term profits as prices remain at current levels.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
57.76	70.16	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
28.1 B	Narrow	Exemplary	

Source: Morningstar. Data as of Sept. 30, 2025.

Communication Services

Michael Hodel | michael.hodel@morningstar.com

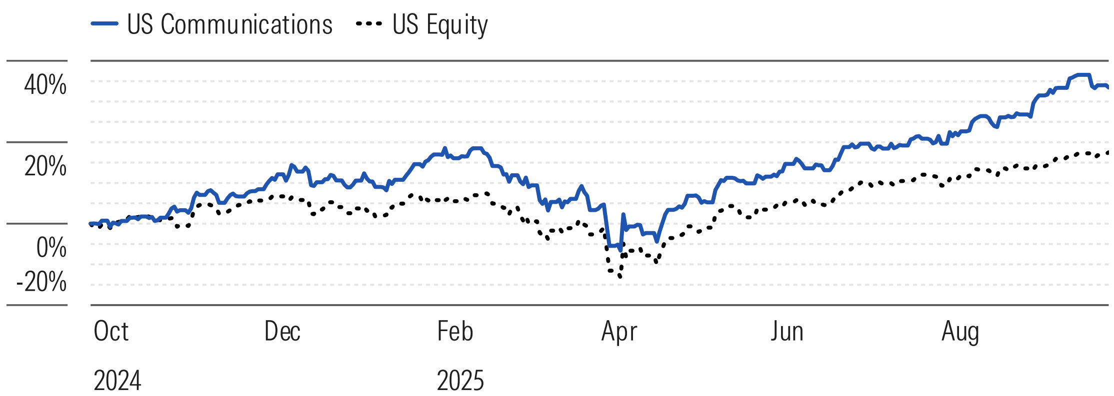
Alphabet and Meta's Ad Dominance Continues to Expand

Digital advertising demand has roared back, at least in the traditional search and social segments—both Alphabet's Google Search and Meta posted accelerating sales growth during the second quarter, driven by high-single-digit pricing increases. The emerging connected-television market has struggled, though, amid surging inventory as viewers migrate from traditional television to streaming and toward ad-supported offerings. Several media firms noted that streaming ad prices have been weak, and the five traditional media companies we track—Disney, NBC, Warner, Paramount, and Fox—collectively reported only a 2% increase in streaming ad revenue from last year.

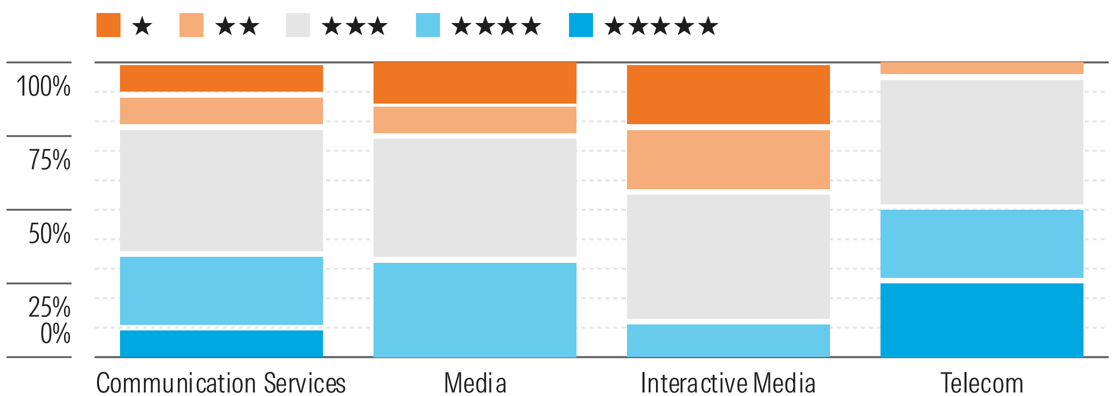
We expect the streaming ad prices to solidify as advertisers gain experience with the medium, much as has happened with other digital offerings like Instagram Reels. Targeting and measurement should also improve, boosting demand. Still, we don't believe the advertising opportunity is large enough to allow Netflix to sustain its current growth rate as its most important markets, especially the US, near maturity. We still view Netflix's share as substantially overvalued. For traditional media firms, streaming ad revenue won't replace declining traditional television revenue anytime soon, but we expect it will enable their streaming operations to continue improving margins.

Alphabet shares have also surged on the release of proposed remedies in the Google Search antitrust case. The court's decision largely confirmed our view, and we haven't adjusted our fair value estimate, which sits below the stock price for the first time in over a year. We still believe the firm is well-positioned with its cloud business and AI capabilities, but the stock is no longer a top pick at its current valuation.

With Alphabet Joining the Tech Rally, Communication Services Has Surged



We See The Biggest Opportunities in Telecom Stocks That Have Been Left Behind



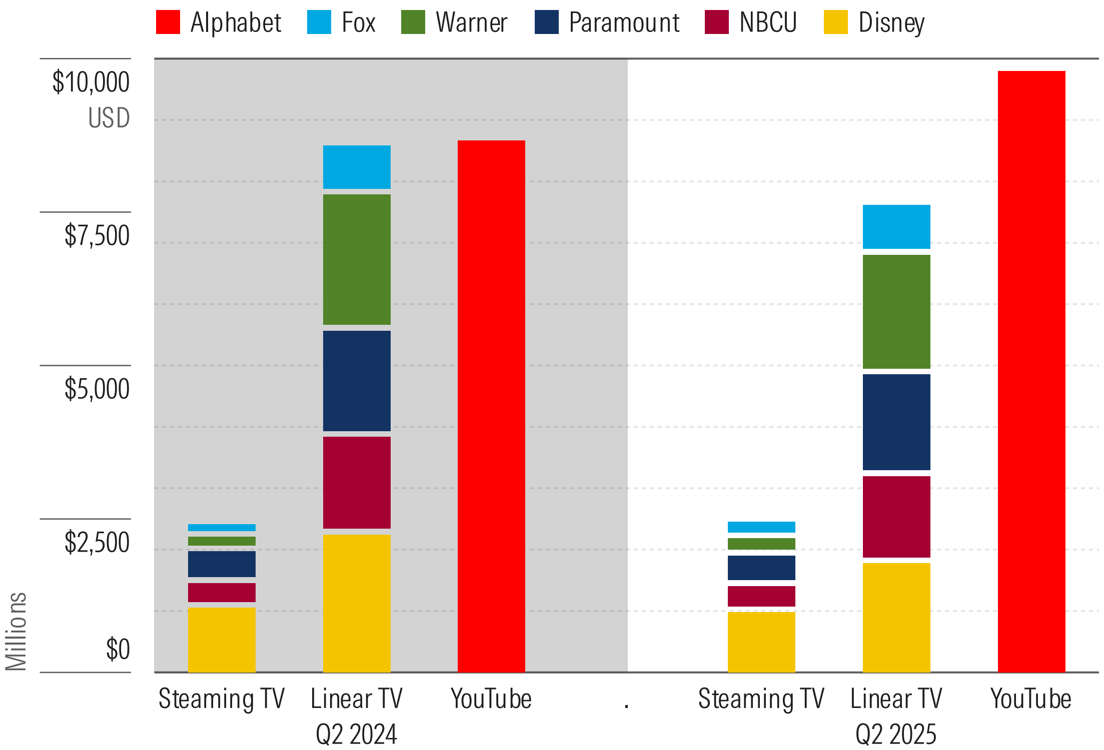
Source: Morningstar. Data as of Sept. 30, 2025.

EchoStar's Spectrum Sale Cements the Big Three US Carriers' Wireless Dominance

EchoStar's decision to sell a portion of its wireless spectrum to AT&T and SpaceX has shaken up the traditional telecom world. The firm will shut down its wireless network, leaving big three wireless carriers as the only significant US network operators. The move eliminates the risk that EchoStar's large chunk of spectrum would fall into the hands of a well-heeled new entrant, such as a tech giant or cable company. SpaceX's nationwide control of a desirable spectrum block is likely to extend its lead in satellite services.

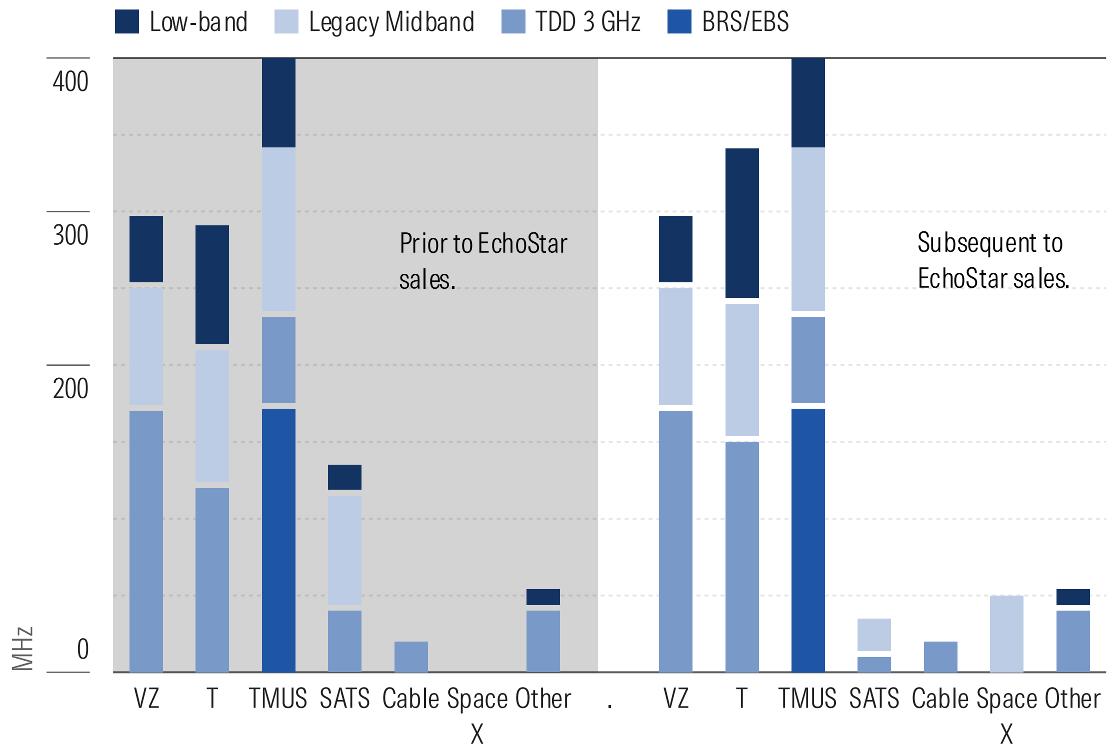
Television Advertising Revenue by Platform

Streaming growth paused as YouTube continues to grow and traditional TV declines.



Spectrum Holdings by Carrier, Los Angeles Market

The Big Three US wireless network owners extend their dominance.



Source: Company reports, Federal Communications Commission, Morningstar.

Communication Services Top Picks

Name/Ticker		Rating
Comcast (CMCSA)		★★★★★
Price (USD)	**Fair Value (USD)**	**Uncertainty**
31.49	49.00	Medium
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**
116.3 B	Narrow	Standard

Comcast continues to shed broadband customers, pushing its share lower as investors fear this business is entering perpetual decline. We believe those fears are unwarranted. Unlike fixed-line phone service or traditional television offerings, demand for basic internet connectivity isn't going anywhere. The market is undergoing a shift in competitive balance, but we expect this shift to run its course as fiber network expansion matures and wireless network capacity is absorbed. We believe competition will remain rational, allowing broadband prices to rise. Comcast's shares yield more than 4%, and the firm has been using excess cash flow to repurchase shares.

Name/Ticker		Rating
Disney (DIS)		★★★
Price (USD)	**Fair Value (USD)**	**Uncertainty**
114.78	120.00	High
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**
206.4 B	Wide	Standard

We view Disney as modestly undervalued. It faces significant economic and headline risk. However, economic weakness is built into our model, and if this weakness does not materialize, the stock looks cheap. The relative valuation looks especially compelling after the big recent run-up in lesser-quality companies, like Paramount and Warner Bros. Discovery, and the excessively rich valuation on Netflix. Experiences, which accounts for most of Disney's profits, has been very strong and has ongoing sales and profit catalysts. Stabilization of media results should also lead Disney's stock to become more in favor than it has been the past several years, when all traditional video media firms have been depressed

Name/Ticker		Rating
Rogers Communications (RCI.B)		★★★★★
Price (USD)	**Fair Value (USD)**	**Uncertainty**
35.66	47.74	Low
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**
19.4 B	Narrow	Standard

Among Canadian telecom stocks that have been overly punished amid a wireless industry slowdown, Rogers is our favorite. We don't anticipate wireless results to turn upward any time soon, but the stock is more than priced for weak sales growth. New wireless customer additions should remain below historical rates as the government reduces immigration, and Quebecor is now competing in the national market. Competition should continue weighing on prices. We don't envision such a weak market being a permanent change. We are more optimistic on the firm's fixed-line business than we have been in years, as BCE and Telus have slowed fiber network expansion.

Source: Morningstar. Data as of Sept. 30, 2025.

Consumer Cyclical

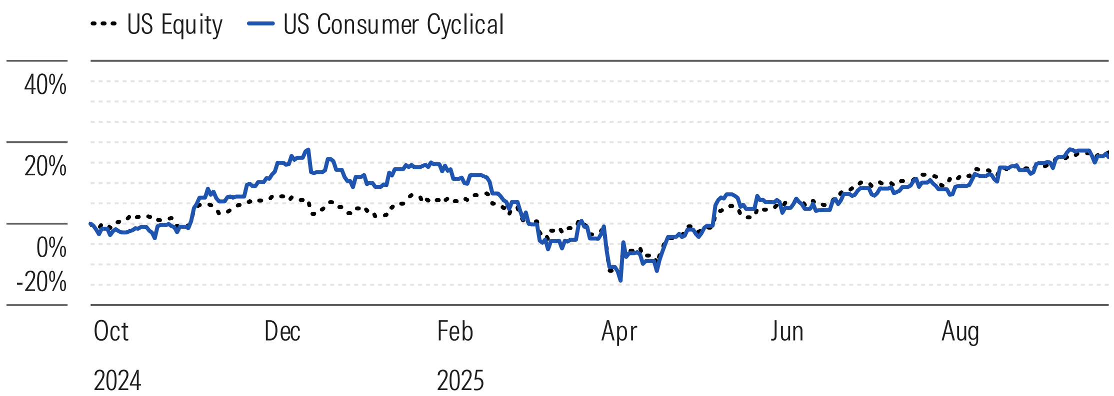
Erin Lash, CFA | erin.lash@morningstar.com

Opportunities for Value Remain in the Consumer Cyclical Realm Even Amid Near-Term Consumer Uncertainty

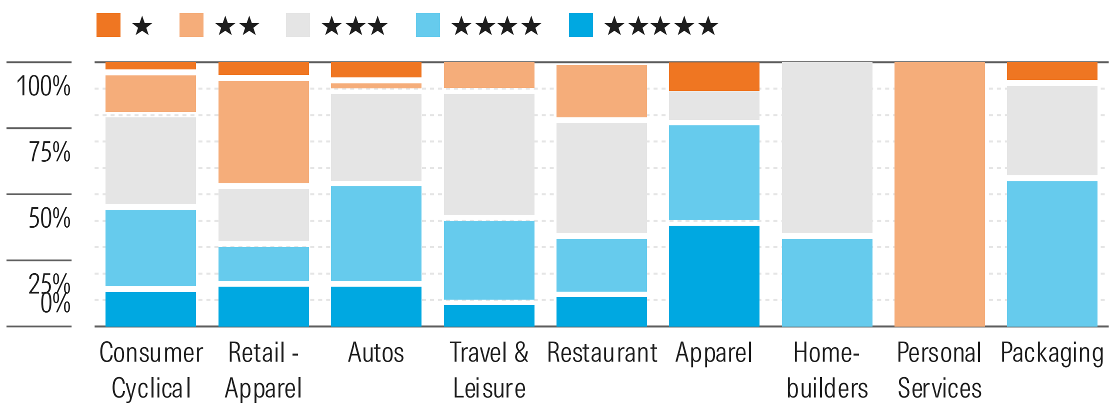
The Morningstar US Consumer Cyclical Index rose, outpacing the broader market in the third quarter. Around 40% of our sector coverage holds a 4- or 5-star rating, with the median stock trading at a 4% discount to our fair value estimates as Tesla pulls the average higher. We view the apparel manufacturing industry (trading 36% below our fair value estimate) as particularly attractive, as 75% of our coverage sits in undervalued territory. We surmise the market's concerns are rooted in uncertainty around the degree to which tariffs and the weakening economic landscape will hinder consumers' discretionary spending levels.

One byproduct of this uncertain economic landscape has been a shift in consumer spending patterns. More specifically, since November 2024, the growth in goods consumption has outpaced that of services, with goods growth averaging around 3% over the past three months, compared with less than 2% growth for services. This has manifested in slower spending growth at restaurants and in the travel industry, which are more discretionary enclaves. We expect cautious consumer spending to persistently affect demand for discretionary services as long as this uncertainty remains. While value-driven options are likely more in favor now, particularly in the apparel industry, we surmise stout investments in innovation and marketing will facilitate an enhanced share position for leading brands (which often sell premium merchandise) in time as consumer spending behaviors normalize.

Consumer Cyclical Generally Tracked the Market Through Q3 ...



... But Bargains Plentiful in the Apparel Industry

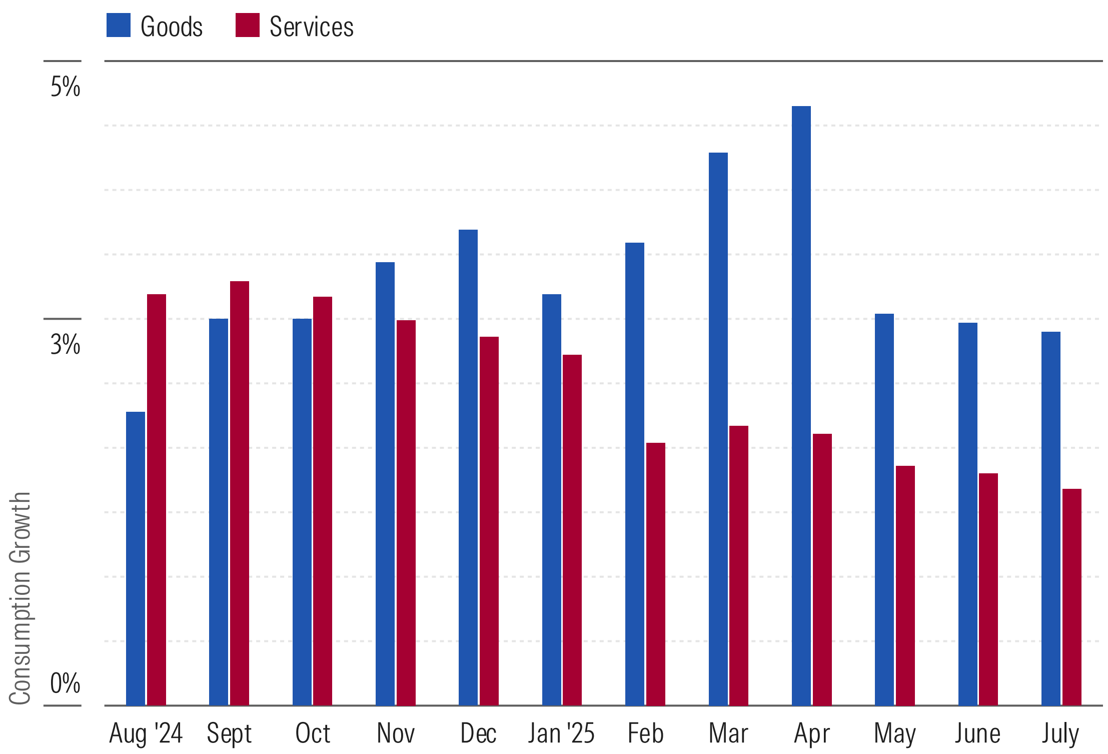


Source: Morningstar. Data as of Sept. 30, 2025.

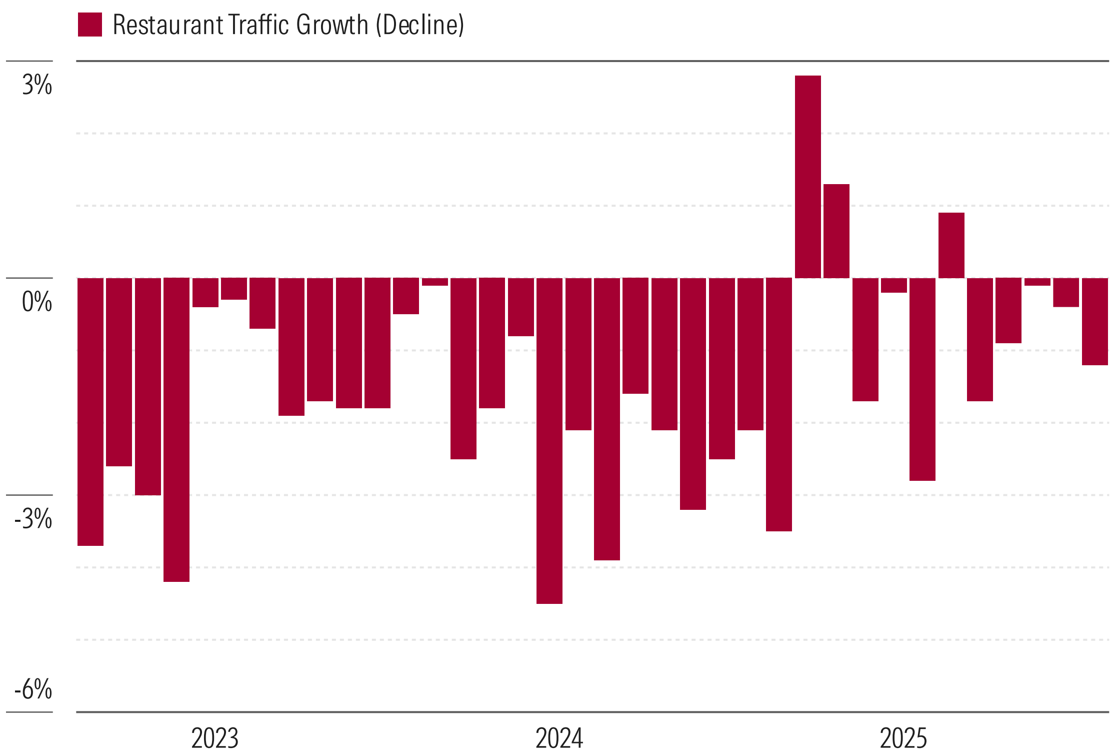
Opportunities for Value Remain in the Consumer Cyclical Realm Even Amid Near-Term Consumer Uncertainty

Against a strained consumer spending backdrop, the challenges facing restaurants have been compounded by the need to raise prices over the past few years to offset pronounced inflationary headwinds stemming from stepped-up raw material, labor, and transportation costs. Despite the near-term traffic pressure that has ensued, operators investing in enhanced technology, capabilities, and menu offerings should ultimately realize improved visit trends and margins that trend back to prepandemic levels over time.

Growth for Goods Has Outpaced Services Throughout the First Half of 2025



Restaurant Traffic Continues to Decline Due to Inflationary Headwinds



Sources: US Bureau of Economic Analysis (left) and Revenue Management Solutions (right). Data as of Sept. 16, 2025.

Opportunities for Value Remain in the Consumer Cyclical Realm Even Amid Near-Term Consumer Uncertainty

Name/Ticker		Rating	
Caesars Entertainment Inc (CZR)		★★★★★	We believe no-moat Caesars Entertainment is an attractive investment opportunity, trading around a 60% discount to our $61 per share fair value estimate. Although tariff policies could negatively impact travel and gaming demand in the near term, we forecast Caesars to capture a high-single-digit revenue share of the $72 billion domestic commercial casino gaming market. High financing costs have raised concerns about Caesars' elevated debt level. However, management has a record of generating cash flows from strategic tie-ups to pay down debt rather than boosting shareholder returns via dividends or share repurchases. And we think it will continue to employ the same tactics; we forecast debt/adjusted EBITDA will fall to around 4 times (from our forecast of 6.4 times in 2025) over the next few years.
Price (USD) 27.87	**Fair Value (USD)** 61.00	**Uncertainty** High	
Market Cap (USD B) 5.8 B	**Economic Moat** None	**Capital Allocation** Exemplary	

Name/Ticker		Rating	
Bath & Body Works Inc (BBWI)		★★★★★	Bath & Body Works trades 60% below our $62 per share fair value estimate, rendering shares a bargain. We believe cost inflation and consumer uncertainty will normalize over time, which should buoy long-term category growth. Further, we posit that the firm's efforts to unlock cost savings, while also implementing new pricing mechanisms, should lead to operating margin improvement. As such, we expect BBWI to realize 3% sales growth on average over the next decade, driven by 2.8% growth from its stores, 3.4% digital growth, and 6% international growth, against an approximate 170 basis point expansion in operating margins to 18%.
Price (USD) 26.06	**Fair Value (USD)** 62.00	**Uncertainty** High	
Market Cap (USD B) 5.3 B	**Economic Moat** Narrow	**Capital Allocation** Standard	

Name/Ticker		Rating	
Gildan Activewear Inc (GIL)		★★★★★	Narrow-moat Gildan's shares trade at roughly 40% discounts to our fair value estimates of USD 93/CAD 128. We believe the market undervalues the benefits of the acquisition of narrow-moat Hanesbrands to Gildan. We anticipate the deal will greatly improve Gildan's flailing consumer operations while strengthening its leading position on printwear basics in North America. In addition, Gildan anticipates opportunities to improve manufacturing efficiency in acquired factories and cut costs.
Price (USD) 57.50	**Fair Value (USD)** 92.58	**Uncertainty** Medium	
Market Cap (USD B) 8.6 B	**Economic Moat** Narrow	**Capital Allocation** Standard	

Source: Morningstar. Data as of Sept. 30, 2025.

Consumer Defensive

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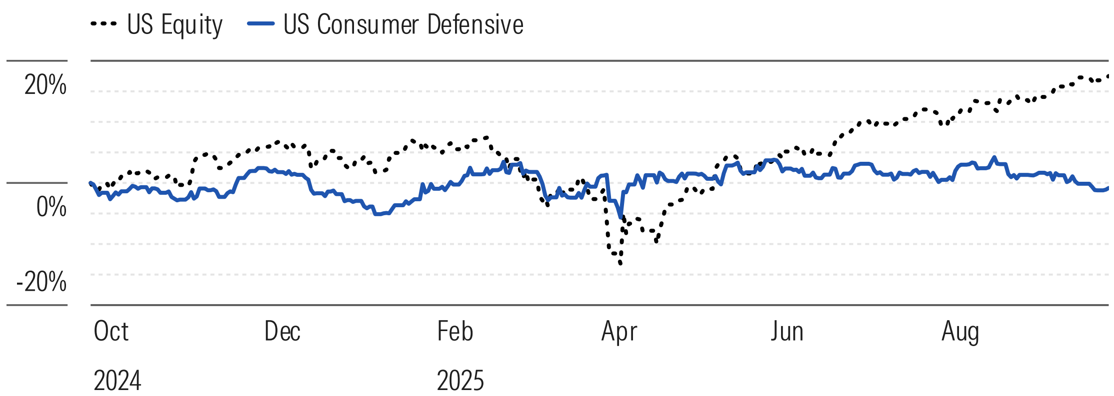
Firms Prioritizing Innovation Should Be Poised to Adapt to Evolving Consumer Trends Despite Macro Uncertainty

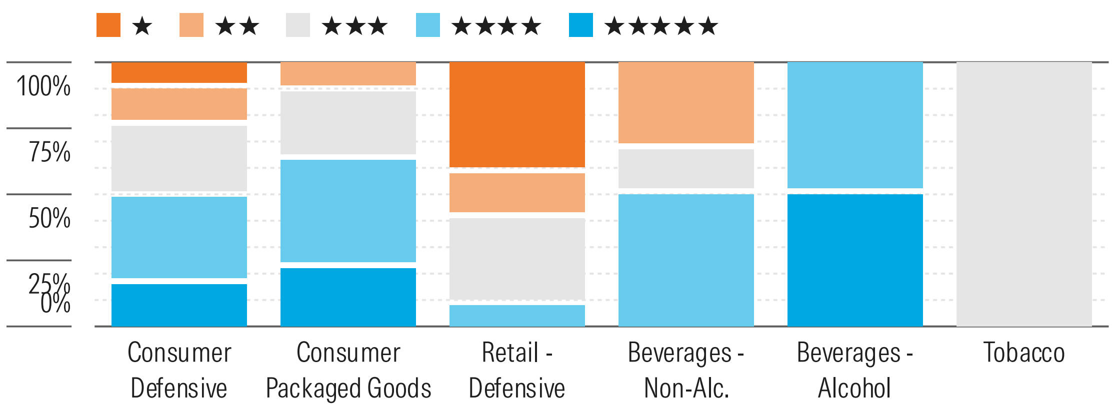
The Morningstar US Consumer Defensive Index has declined in the third quarter, underperforming the broader market's gain. Within our coverage universe, the median stock is trading at a 6% discount to our intrinsic valuation, whereas Walmart and Costco pull the average above fair value. Approximately 40% of names are rated 4 or 5 stars, indicating attractive long-term potential. The most compelling undervalued opportunities lie in the alcoholic beverages and consumer packaged goods subsectors, which trade at 27% and 16% discounts to our fair value estimates, respectively. We attribute this muted sentiment to persistent inflationary pressures and evolving trade policies, which continue to weigh on consumer confidence. Nevertheless, we believe that firms that continue to invest in innovation are well-positioned not only to navigate this uncertain environment but also to capitalize on emerging growth opportunities.

While consumers remain cautious amidst the economic malaise, grocery trips have not declined. In fact, Circana notes that shoppers are visiting stores more frequently but spending less per trip, with 30% buying on deals. However, this hasn't manifested in outsize private-label sales gains. Instead, the US private-label share across a host of categories within the consumer defensive sector has remained relatively flat. In some categories, such as oral care, it has even declined by roughly 970 basis points to 6.5% over the past five years. The exceptions have been categories with limited brand differentiation, where consumers tend to make purchase decisions based on price, such as retail tissue. Private-label products now boast a 35.8% share, up from 32% prepandemic. However, we believe that firms that continue to innovate and introduce differentiated products are well-positioned to grow, even in a challenging macro and competitive environment.

Consumer Defensive Firms Fall Behind the Market's High-Single-Digit Rise in Q3



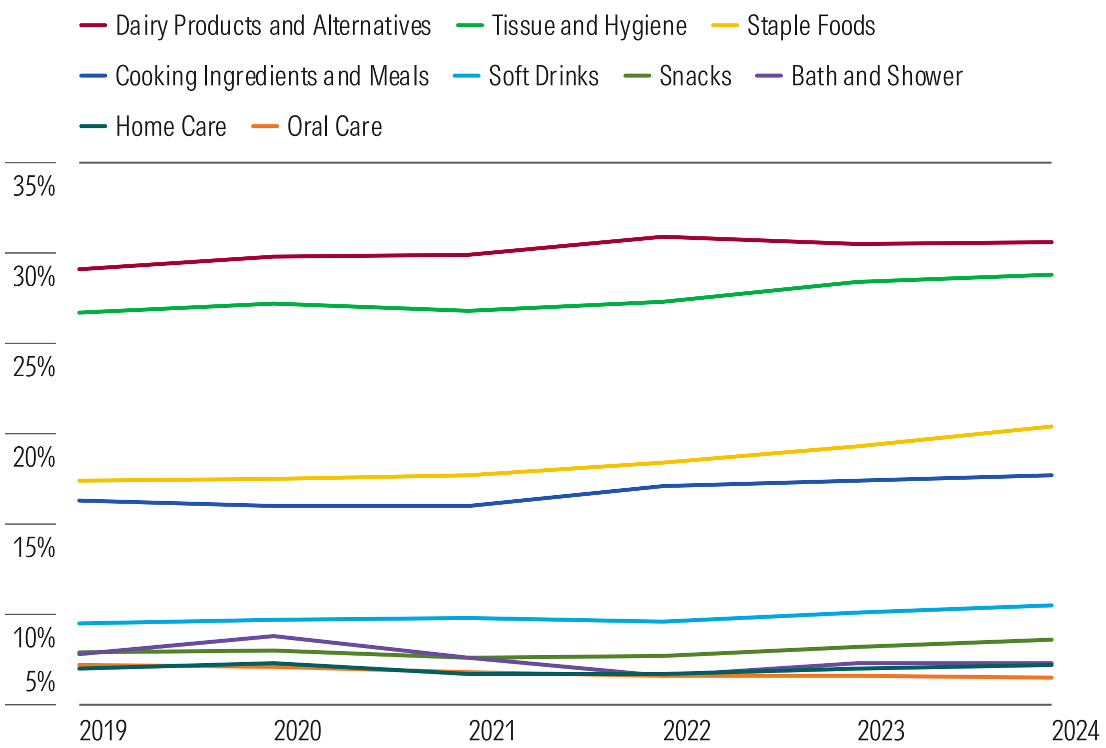
Rendering Alcoholic Beverages and CPG Attractive Investment Opportunities



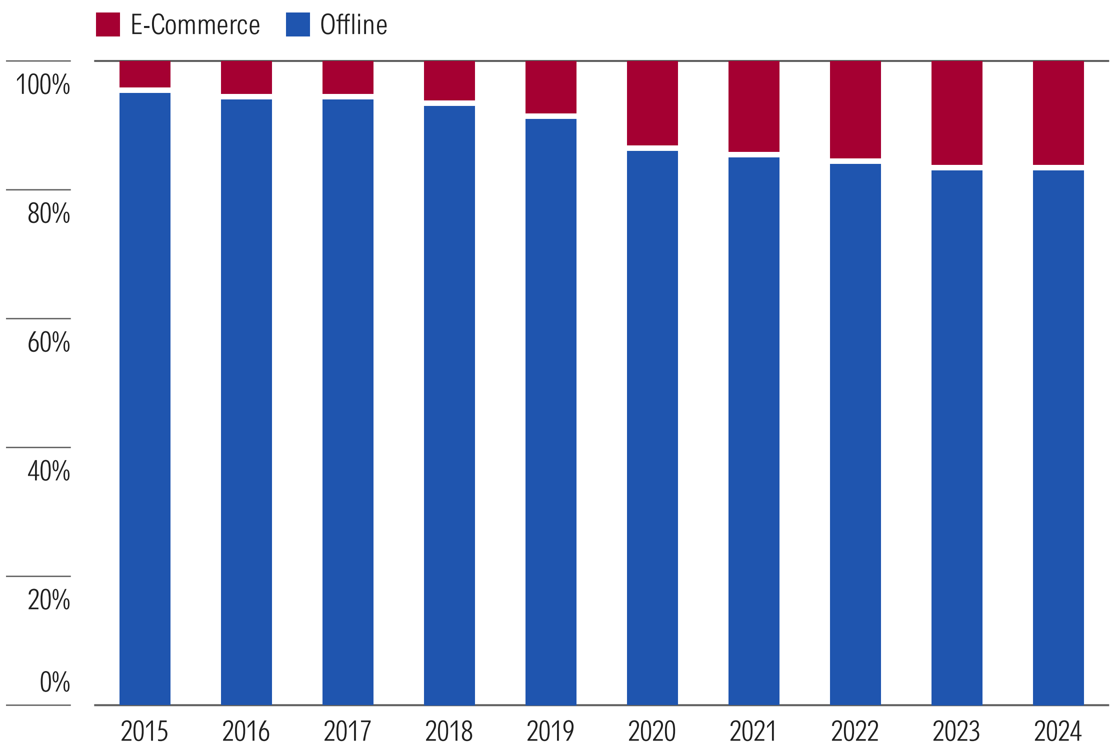
Firms Prioritizing Innovation Should Be Poised to Adapt to Evolving Consumer Trends Despite Macro Uncertainty

Accessibility remains a key driver of sales growth, with firms increasingly investing in omnichannel strategies. That said, e-commerce adoption has lagged in the consumer defensive sector, accounting for less than 20% of CPG and nonalcoholic beverage sales, with brick-and-mortar stores capturing the majority. Still, while digital capabilities may be more essential for discretionary categories, pandemic-driven shifts have pushed even consumer defensive brands to enhance their omnichannel strategies to stay visible across shopping touchpoints.

Private-Label Gains Have Not Been Equivalent Across Consumer Staples Categories



E-Commerce Remains Only a Fraction of Sales; Brick and Mortar Still Dominant



Source: Euromonitor. Data as of Aug. 27, 2025.

Firms Prioritizing Innovation Should Be Poised to Adapt to Evolving Consumer Trends Despite Macro Uncertainty

Name/Ticker		Rating	
Kraft Heinz (KHC)		★★★★★	Narrow-moat Kraft Heinz trades at a roughly 50% discount to our $51 fair value estimate and offers a 6% dividend yield, underscoring its long-term investment appeal. In early September, the firm announced plans to separate its sauces, spreads, and seasonings business from its North American grocery brands, creating two public companies by the end of 2026. Despite softening consumer sentiment, we expect both entities to pursue cost efficiencies to fund brand investments, particularly strategic initiatives in research, development, and marketing. We project these efforts will support 1%-3% top-line growth and 20%-21% operating margins over the next decade.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
25.70	51.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
30.4 B	Narrow	Standard	

Name/Ticker		Rating	
Campbell's (CPB)		★★★★★	Trading at a 45% discount to our $62 fair value estimate, Campbell's presents a compelling investment opportunity. Consumers have become more deliberate in their choices, with their preferences skewing towards healthier options and value, which is pressuring organic sales growth across the industry. Campbell's aims to engage consumers in an intentional manner. As such, we expect ongoing innovation—around 5% of sales to R&D and marketing annually—and cost-saving initiatives to help the firm preserve its competitive edge and support our 2.7% 10-year average annual revenue growth forecast.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
30.87	62.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
9.4 B	Wide	Standard	

Name/Ticker		Rating	
Freshpet (FRPT)		★★★★★	No-moat Freshpet trades at a 48% discount to our $105 fair value estimate, offering an attractive entry point. Despite near-term headwinds such as slower dog adoption and cautious spending, Freshpet's unique fresh distribution and expanding store footprint position it well for growth. Furthermore, Freshpet is pursuing innovations in bag production that are driving higher-quality products at a lower cost, boosting profitability and reinforcing our 11.8% 10-year annual sales growth forecast. As such, we view the stock as a compelling long-term investment opportunity.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
52.41	105.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
2.6 B	None	Standard	

Source: Morningstar. Data as of Sept. 30, 2025.

Energy

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Accelerated Production Remains Central Pressure for Oil Prices

Latest Crude Increases Will Weigh on Oil Prices

OPEC+ aims to raise production by 547,000 barrels per day in September, with an additional 137,000 barrels per day scheduled for October. Still, barrels reaching the market will likely fall short of pledged volumes.

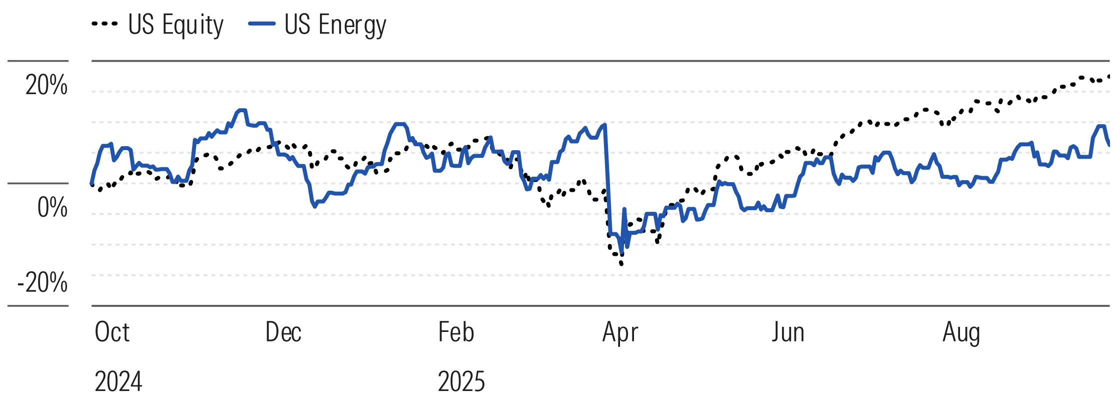
- The increases are the latest in a series of accelerated output hikes. The hikes are unwinding prior to production cuts that began in late 2023, a year ahead of schedule.
- Excess supply has yet to be reflected in inventory data or crude futures, primarily due to strategic stockpiling activity in China and summer seasonal trends.
- While more sanctions could more meaningfully impact Indian purchases of Russian oil, Brent prices mostly held steady during the quarter between the mid- and high-$60/bbl range. Traders largely shrugged off the latest supply increases.

If OPEC+ Delivers on New Targets, Market Could Become Oversupplied Next Year

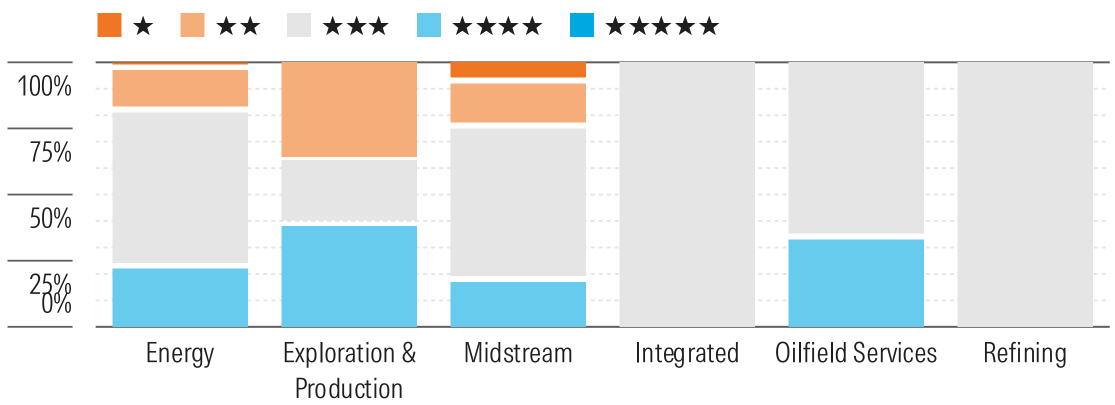
This will have a negative impact on the industry's stock prices but will also create long-term opportunities.

- We believe the increases are tied to efforts to take back share from US shale and political pressure to keep oil prices low; we don't think these goals will change soon.
- Upstream capital expenditure will drop by 4% this year, according to Rystad. Offshore investments could fall by 4%, while shale spending could decline by 7%.
- Lower spending creates discounts in oilfield services; while both are 4-star-rated stocks, higher shale spending headwinds are why we prefer SLB over Halliburton.

Macro Headwinds Fuel Pessimism, but Create Opportunities in Some Shares



We See Deals in Exploration and Production, Lifted by Long-Term Oil Price Outlook

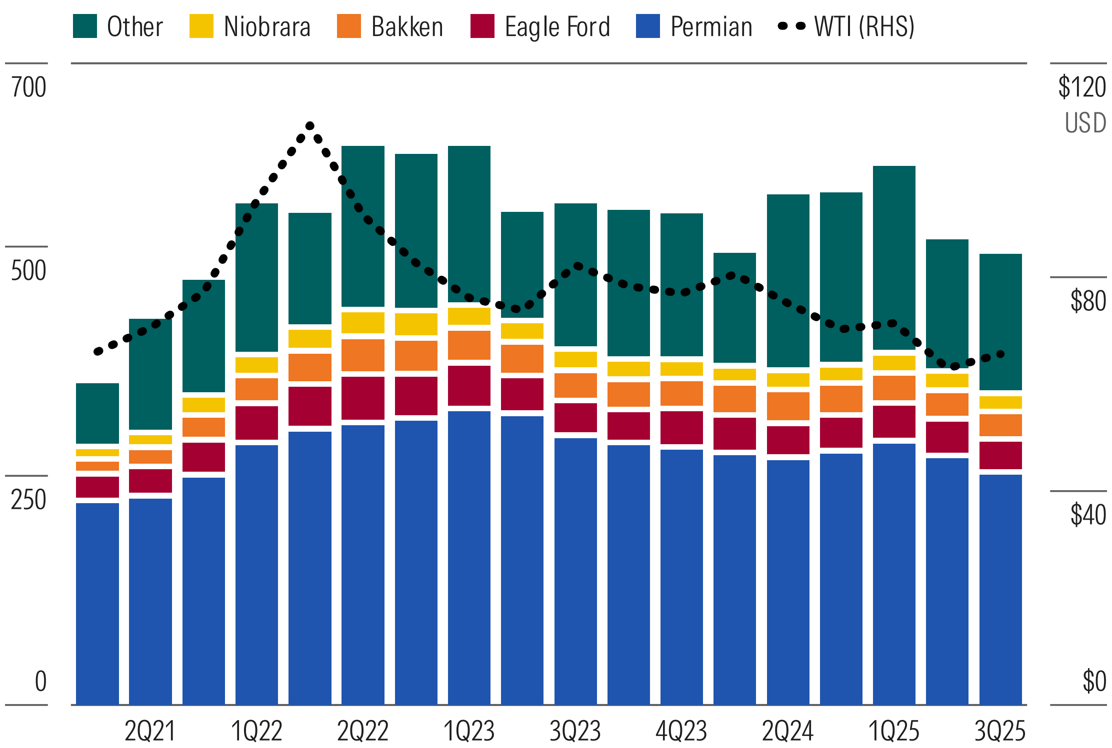


Source: OPEC, EIA., Rystad, Reuters. Data as of Sept. 30, 2025. The current members of OPEC are Algeria, Congo, Equatorial Guinea, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, Saudi Arabia, United Arab Emirates, and Venezuela. The additional members of OPEC and its partners or OPEC+ include Azerbaijan, Bahrain, Brunei, Kazakhstan, Malaysia, Mexico, Oman, Russia, South Sudan, and Sudan.

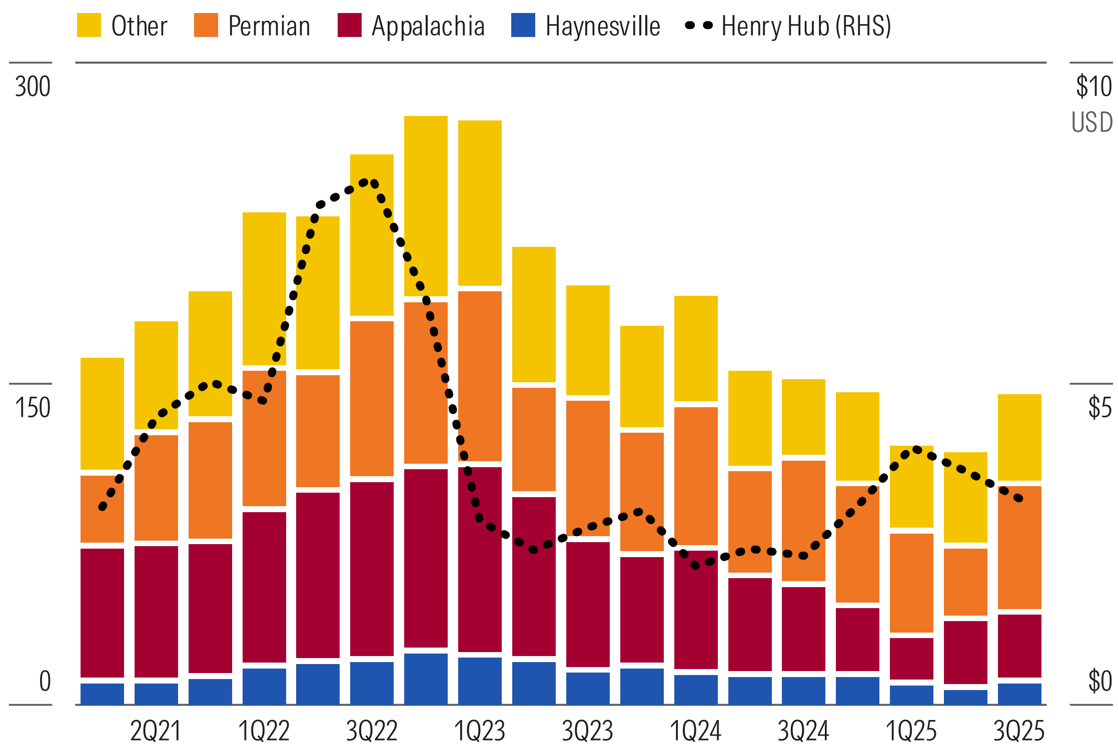
US Supply: Oil Drilling Faces Downward Pressure, but Gas Activity Promising

Permian-dominant producers remain more likely to cut drilling amid current or lower pricing levels. Larger operators there can cut volumes without materially pressuring either their unit economics or capital efficiency. The Permian's cost advantage of drilling new wells is also much narrower than serving existing wells. Diamondback and Devon once again modestly lowered their full-year capital expenditures in the third quarter; these 4-star-rated operators can still support their operations, investments, and capital returns.

US Oil Rig Counts Move Even Lower Due to Uncertain Backdrop



Higher Takeaway Capacity Prospects in the Permian Cause Gas Drilling to Rise



Source: Rystad, Morningstar. Chart data as of Sept. 29, 2025.

Energy Top Picks

Name/Ticker		Rating	
Devon Energy (DVN)		★★★★	Devon stands to materially benefit from its business optimization plan, capital recycling from divestitures, lower taxes from the "Big Beautiful Bill Act", and continued low-cost production from its crown jewel Delaware asset. In turn, we believe Devon trades at a highly attractive 14% yield to 2025 free cash flow. Strong FCF generation, coupled with its strong balance sheet, should allow Devon to return well over 50% of its FCF to shareholders, including $200 million to $300 million in undervalued repurchases per quarter.
Price (USD) 35.52	**Fair Value (USD)** 50.00	**Uncertainty** High	
Market Cap (USD B) 22.3 B	**Economic Moat** Narrow	**Capital Allocation** Exemplary	

Name/Ticker		Rating	
SLB (SLB)		★★★★	SLB is among the cheapest stocks in our global energy coverage with a moat. Its multiple trades in line with peer services firms, but it deserves a premium given its scale, suite of solutions, competitive position in some of the more attractive services markets, and technological advantage. These factors position SLB to outperform peers. SLB's offshore segment outside North America boasts a growing project opportunity set that could exceed $100 billion annually over the medium term. SLB's digital-related revenue is also highly accretive and more resilient to cyclical headwinds. We expect digital revenue can more than double by the end of 2025 to $3 billion and possibly climb to $4 billion by the end of the decade.
Price (USD) 35.11	**Fair Value (USD)** 50.00	**Uncertainty** High	
Market Cap (USD B) 52.5 B	**Economic Moat** Narrow	**Capital Allocation** Exemplary	

Name/Ticker		Rating	
Baker Hughes (BKR)		★★★	Gas exposure has proven a way for investors to outperform broader sector headwinds. While most stocks with meaningful exposure look expensive to us, Baker Hughes is an exception. The firm's IET segment should benefit from the booming growth in LNG capacity. We expect this need will continue given demand from fast-growing economies, geopolitical risks, and energy requirements from data centers powering AI. The acquisition of Chart Industries should accrete shareholder value, position Baker Hughes to win in secular growth markets, and strengthen its aftermarket revenue.
Price (USD) 50.55	**Fair Value (USD)** 51.00	**Uncertainty** Medium	
Market Cap (USD B) 49.8 B	**Economic Moat** None	**Capital Allocation** Standard	

Source: Morningstar. Data as of Sept. 30, 2025.

Financial Services

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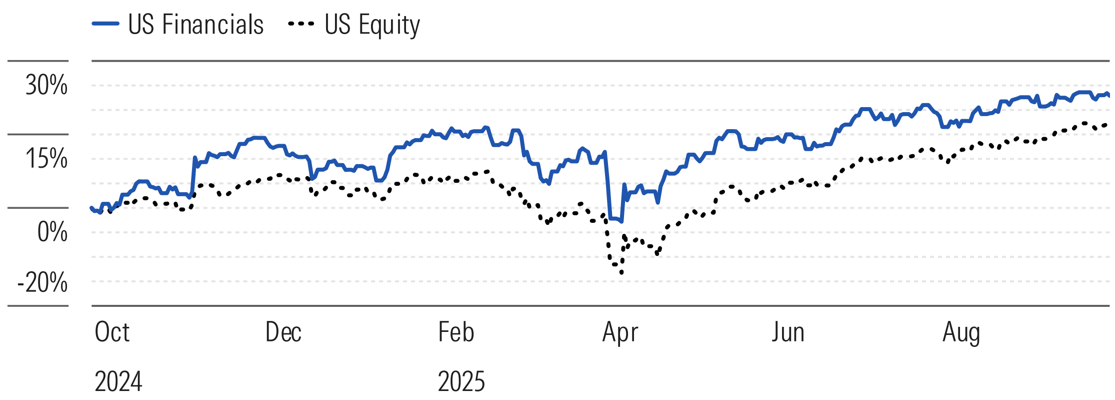
Financial Services Stocks Continue to Outperform the Market on Regulatory Support, Recovering Deal Activity

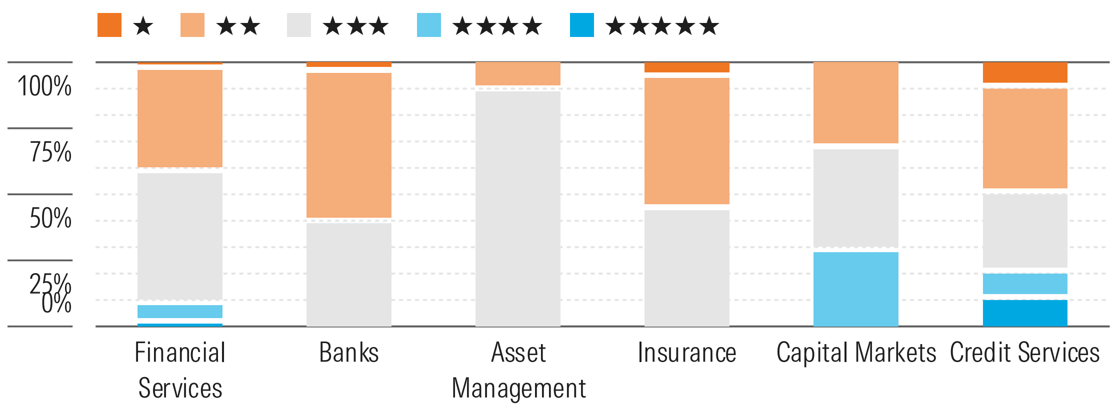
Financial services is heterogeneous, so different industries experience different drivers, but it would be challenging to think of a better setup for the sector. Regulators have exhibited a willingness to revisit capital requirements that were, at times, punitive, announcing reforms to the enhanced supplemental leverage ratio, or eSLR, in June. Vice Chair for Supervision of the Federal Reserve Board of Governors Michelle Bowman has announced an intention to consider bank regulations holistically, which many observers have interpreted to mean less overlapping regulation, lower compliance costs, and likely lower required levels of common equity Tier 1 capital—pointing toward an increase in bank profitability. Trade regulators have taken a more permissive stance toward sector mergers and acquisitions, and the prospect of lower interest rates points toward a recovery in sponsor activity after a muted period of alternative asset transaction activity. Against this backdrop, it's little surprise that the Morningstar US Financial Services index's 22.9% gain over the past year comfortably exceeds the 17.5% return delivered by the broader market, even with modest underperformance during the most recent quarter.

Still, we see risks as generally lying to the downside and believe that the market is getting ahead of its skis regarding valuations. As of Sept. 12, US banks, consumer finance companies, exchanges, asset managers, and insurers traded at market-cap-weighted premiums of 20%, 24%, 16%, 7%, and 9% to our respective valuations. The economy continues to hold up better than many expected. Still, fissures are emerging in the labor market , and with inflation that we're not convinced is fully priced in, particularly with Morningstar Chief US Economist Preston Caldwell's expectations for slowing real GDP growth until the second half of 2026.

A Slew of Industry Tailwinds Has Driven Strong Returns for the Financial Sector



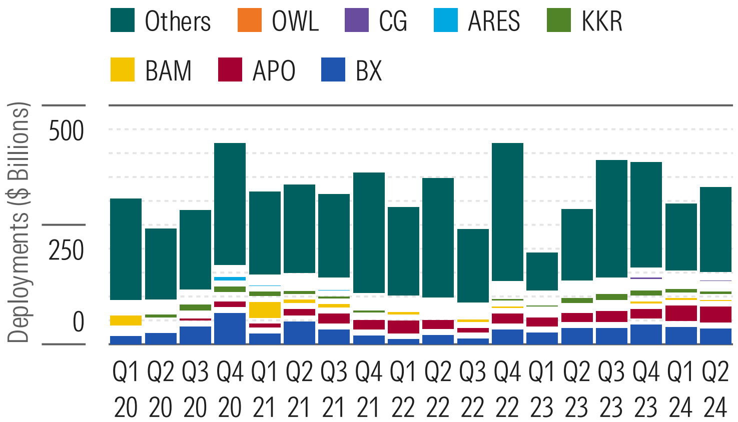
However, We View Risks as Skewing to the Downside From Here



Source: Morningstar estimates, Morningstar Direct. Data as of Sept. 30, 2025.

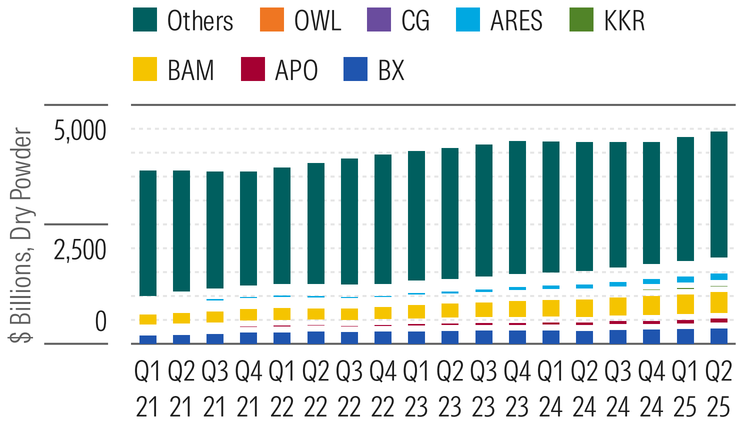
We're Optimistic Regarding Sponsor Activity, but Recovery May Take Longer Than the Market Expects

Deployments Improving but Have Room to Run



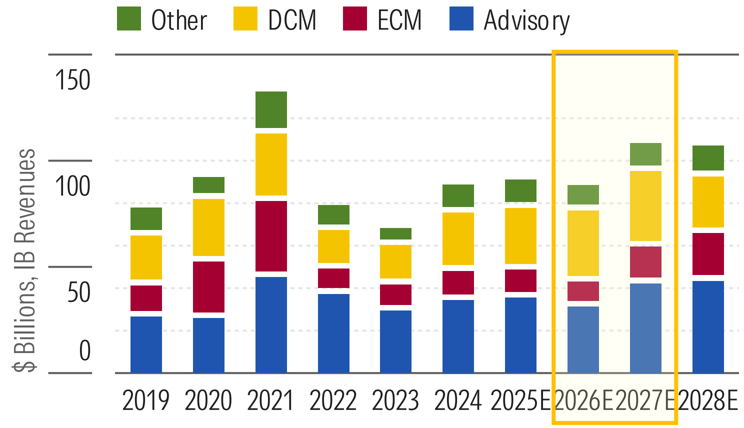
The average investment bank and alternative asset manager trade at a 24% and 10% respective premium to our valuations as of Sept. 12, reflective of our view that deployment (purchase) and realization (sale) activity by sponsors may not recover as quickly as the market seems to expect. Momentum from recent quarters is positive, but firms continue to struggle to exit prior investments and return capital to investors, with Goldman Sachs estimating that $4 trillion in investments remain "in play," as of September 2025.

Sponsors Are Holding $4.4 Trillion in Dry Powder



With $4.4 trillion in dry powder, by our math, at the end of the second quarter of 2025, the expected uptick in deal flow will be significant when it does come, but we find ourselves penciling in a recovery closer to the back end of wide-moat Goldman Sachs CEO David Solomon's 12 month-24 month estimate for that market unlocking.

We Expect a Surge in Activity in 2027



Our forecasts call for a significant recovery in investment banking revenue in 2027, largely driven by M&A advisory and equity underwriting, two categories that are particularly sensitive to sponsor activity. In the meantime, trading and financing businesses continue to perform at peak-cycle levels for the trading banks, offsetting cyclically lower investment banking revenue.

Source: Company filings, Morningstar estimates, PitchBook. Data as of June 30, 2025.

We See Pockets of Value in Wealth Management, Financial Technology

Name/Ticker		Rating	
LPL Financial Holdings (LPLA)		★★★★	We recently upgraded LPL Financial's economic moat rating to wide, from narrow, reflective of our view that the firm is poised to emerge as a long-term winner in the quickly growing independent broker dealer channel within the US wealth management landscape. Driven by a competitive technology platform, strong advisor payouts, a solid product shelf, and good adviser service, LPL has emerged as the platform of choice for transitioning financial advisors. The firm has led the industry in advisor recruiting over each of the past 8 years, and we now expect nearly 12% annual growth in client assets over the next decade, up from 8% previously, a view that is not reflected in current market prices.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
340.60	504.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
27.2 B	Wide	Standard	

Name/Ticker		Rating	
The Charles Schwab Corp (SCHW)		★★★	Charles Schwab is a high-quality name that sits at the confluence of two growth trends in financial services; retail investing and independent wealth management. We view most of the market's misunderstanding as tying to the firm's cash sweeps business, and by extension, its prospects for growing its base of net interest income. Driven by modestly higher projected client cash balances, a likely decision to return to its asset-heavy investment approach (rather than sweeping those deposits to third party banks), and recovering yields on its securities portfolio, we expect the firm to generate outstanding 16%, 23%, and 25% annual growth in revenue, operating profit, and EPS over the next five years.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
96.89	105.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
175.9 B	Wide	Exemplary	

Name/Ticker		Rating	
Jack Henry & Associates (JKHY)		★★★★	Unlike peers Fiserv and FIS, Jack Henry has largely stuck to its bank technology roots, with core processing and ancillary bank technology services comprising more than 60% of the firm's sales. Core processing is extremely sticky, and we estimate retention rates generally exceed 99%, adjusted for acquisitions. The high-quality name rarely trades at a discount to our fair value estimate, continues to grow its revenue at a 6% to 7% annual clip, and should be relatively insulated from systematic risks outside of its processing business.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
151.17	191.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
11. B	Wide	Exemplary	

Source: Morningstar. Data as of Sept. 30, 2025.

Healthcare

Karen Andersen, CFA | karen.andersen@morningstar.com

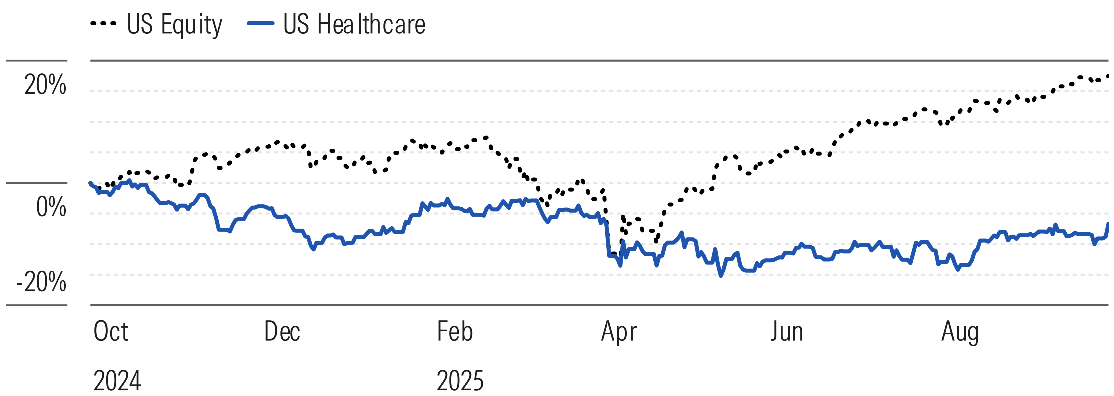
Policy Headwinds Continue to Weigh on Healthcare, but Valuations Remain Attractive

The Morningstar Healthcare Index has underperformed the Morningstar US Index by a meaningful margin, with a total return of -6.7% over the trailing 12 months, compared with 17.5% for the Morningstar US Index. After a brief rebound early in the year, the sector lost momentum in the second quarter due to rising uncertainty around potential US policy effects on growth rates for biopharma, healthcare plans, and medical technologies firms. We see potential for healthcare to close the performance gap in the coming months, driven by its defensive profile and improving clarity on policy risks.

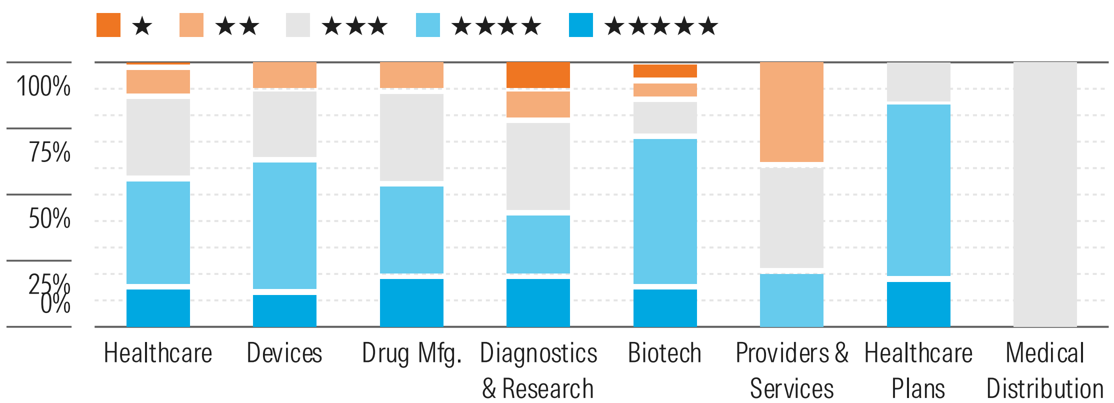
The sector looks relatively undervalued overall, with median price roughly 15% below our fair value estimates. Medical distribution stands out as the only overvalued industry, while healthcare plans and biotech companies look the most undervalued.

Volatility increased following the US election of Donald Trump as president and the appointment of Robert F. Kennedy Jr. to lead Health and Human Services. While we have not made significant valuation changes across the healthcare industry, we see high uncertainty surrounding many stocks, particularly in biopharma and healthcare plans. In biopharma, we think the long-term effect of tariffs will be a step up in tax rates (already largely factored into our models). We believe significant drug pricing policy changes will be difficult to implement by executive order, as Congress has not supported steep US price cuts (like most favored nation pricing) in the past. Within the rapidly growing obesity market, Novo Nordisk trades at a discount to its fair value estimate, as we still see strong competitive advantages despite Eli Lilly's growing market share.

Healthcare Lagged the Broader US Market Year to Date



Apart From Distribution, Most Healthcare Industries Look Undervalued

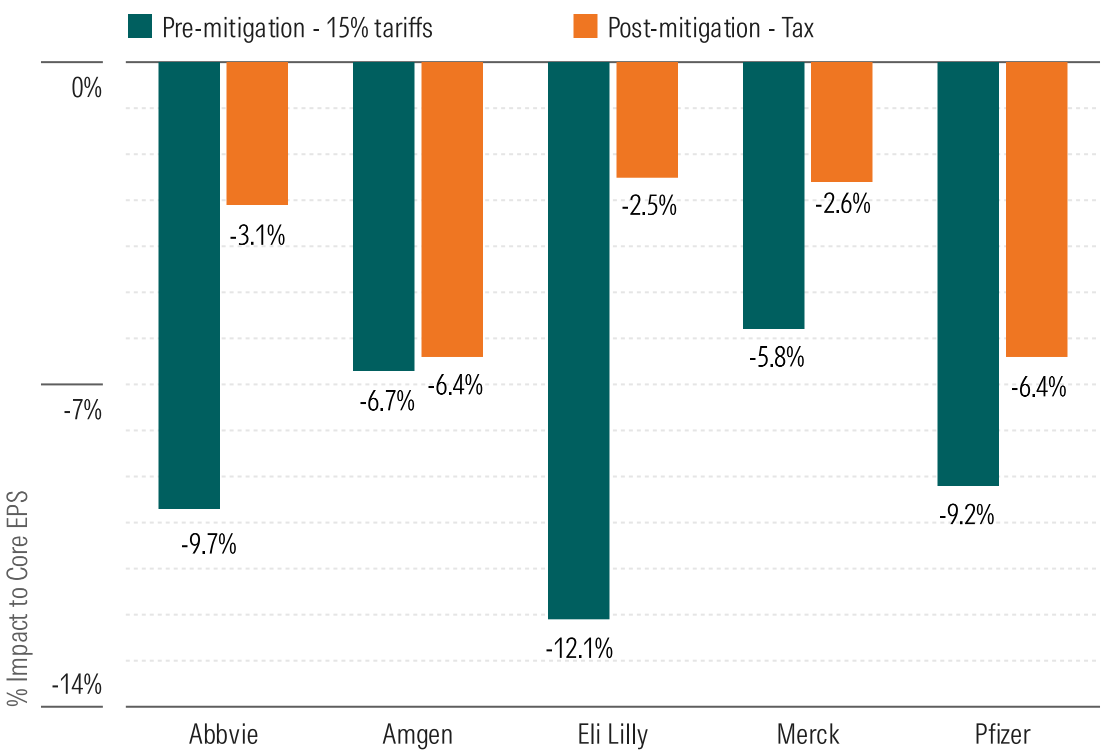


Source: Morningstar. Data as of Sept. 30, 2025.

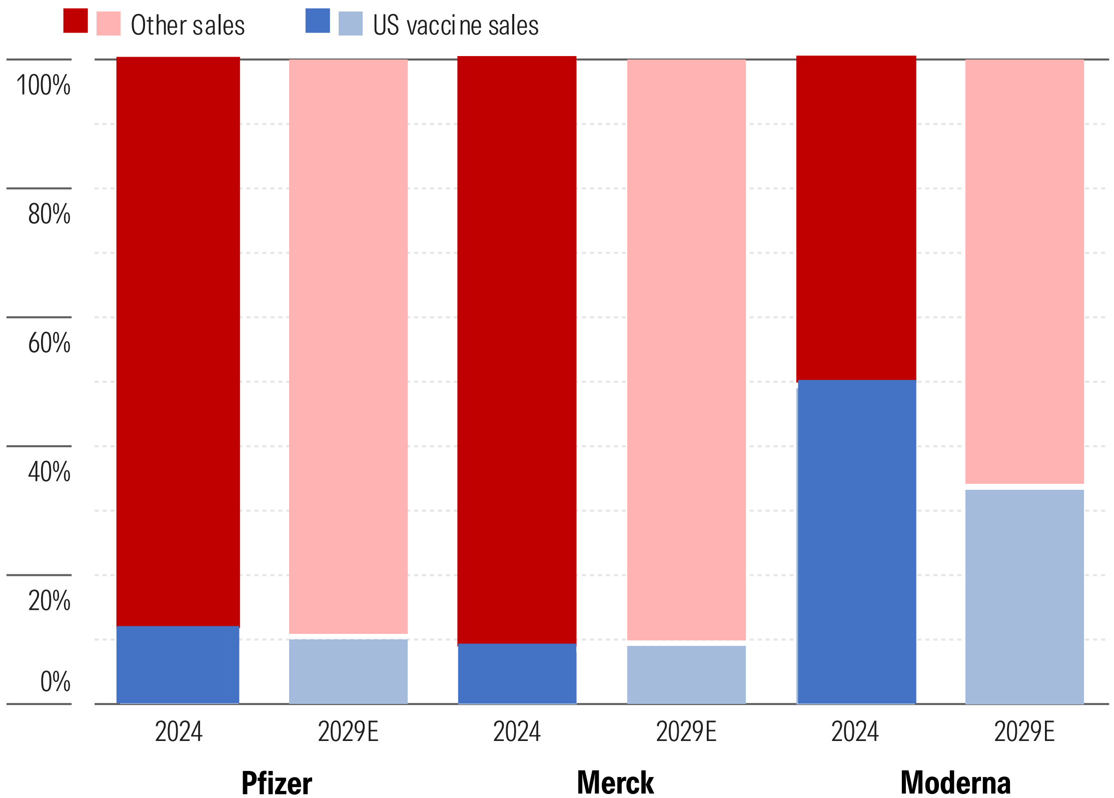
Tariff Exposure and Vaccine Uncertainty Weigh on Sentiment

We estimate that a 15% import tariff would have an average unmitigated impact of 9% on core earnings per share for US biopharma. While we expect the impact to subside as firms adjust, the most significant long-term consequence of relocating manufacturing to the US is higher taxes, and we see Pfizer as the most affected. The biggest firms have lower exposure to US vaccines, but a $500 million cut in HHS funding for mRNA research contracts, narrowed covid vaccine approvals, and changing CDC recommendations all create uncertainty.

EPS Sensitivity to Proposed US Pharma Tariffs



US Vaccine Sales Outlook of US-Based Companies



Source: Morningstar analysis of company reports, and Morningstar estimates as of September 2025.
Note: Amgen is a special case, and it is unlikely the current tariffs will be the catalyst for the full EPS impact from higher taxes shown here.

Healthcare Top Picks

Name/Ticker
GE HealthCare Technologies (GEHC)

Rating
★★★★

Price (USD)
73.09

Fair Value (USD)
89.00

Uncertainty
Medium

Market Cap (USD B)
33.4 B

Economic Moat
Wide

Capital Allocation
Standard

In April 2025, GE HealthCare's shares sold off sharply on the news of US tariffs. As a global enterprise with a complex supply chain, GEHC's business can be harmed by escalating tariffs between the US and its trading partners. Moreover, as an iconic US brand in a high-tech sector that employs artificial intelligence, it is also at risk of being caught in the US and China policy crossfire. We think the market has overcorrected for this risk, and we are encouraged by management's transparent guidance and firm grasp of the tariff impact. Over the long term, we think GEHC can grow revenue in low to mid-single digits and improve its operating profit by several hundred basis points, thanks to its ongoing investments in product development and optimization of its product mix and cost structure.

Name/Ticker
Elevance (ELV)

Rating
★★★★

Price (USD)
319.69

Fair Value (USD)
507.00

Uncertainty
High

Market Cap (USD B)
72. B

Economic Moat
Narrow

Capital Allocation
Standard

For long-term investors, Elevance represents both a high-quality business and an attractive valuation in the managed care industry. First, Elevance is our favorite medical insurer, with deep local market share that helps solidify its cost advantage particularly in its employer plan stronghold. Second, the company’s limited exposure to Medicare and its fast-growing non-insurance businesses have limited its earnings contraction in recent years, distinguishing Elevance versus most of its MCO peers. Finally, trading at only 10 times forward earnings with the potential to deliver double-digit earnings growth once it gets past growth headwinds in the individual exchanges (2026) and Medicaid (2027), we find Elevance shares attractive.

Name/Ticker
IQVIA (IQV)

Rating
★★★★★

Price (USD)
180.72

Fair Value (USD)
268.00

Uncertainty
Medium

Market Cap (USD B)
30.7 B

Economic Moat
Narrow

Capital Allocation
Standard

IQVIA’s shares have been negatively impacted by macroeconomic concerns and slowing biotech funding levels. However, we view these issues as near-term headwinds and IQVIA remains a global leader in providing clinical trial services and healthcare analytics. IQVIA’s backlog has continued to expand despite macroeconomic pressures, demonstrating its strength and resilience in booking new business. Further, the firm’s extensive and proprietary data analytics capabilities, along with its continued re-investment in new technology, including artificial intelligence, should support durable long-term growth.

Source: Morningstar. Data as of Sept. 30, 2025.

Industrials

Brian Bernard, CFA, CPA | brian.bernard@morningstar.com

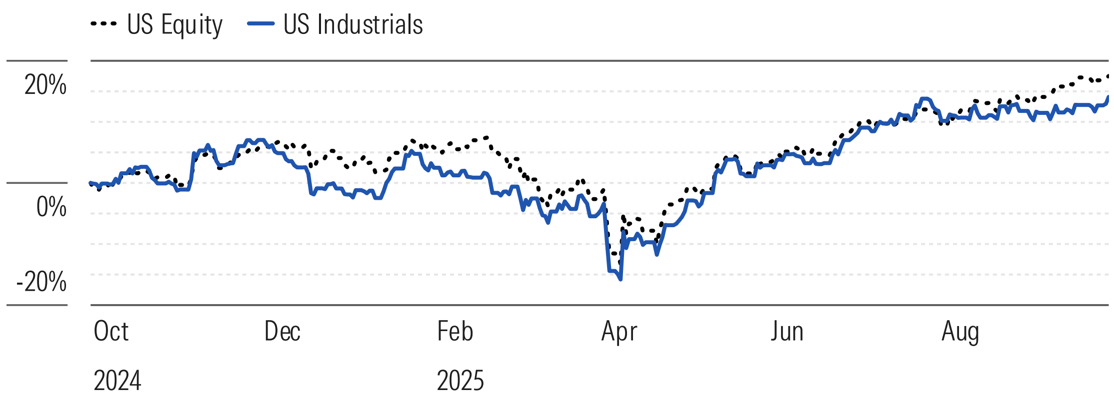
Industrials Fully Valued Despite Economic Uncertainty; Investment Opportunities Still Exist Across the Sector

The Morningstar US Industrials Index's year-to-date outperformance relative to the US Market Index narrowed during the third quarter as concerns about a slowing US economy weighed on cyclical stocks. While we view the sector as fully valued, there are compelling investment opportunities across most industry groups, particularly in the farm and heavy construction machinery industry. We see the opportunity for new technologies to transform the farming equipment industry, resulting in less cyclicality and higher margins over the business cycle. While agricultural data remains mixed, the US Department of Agriculture forecasts inflation-adjusted farm income will increase by 37% this year, which bodes well for farm equipment manufacturers.

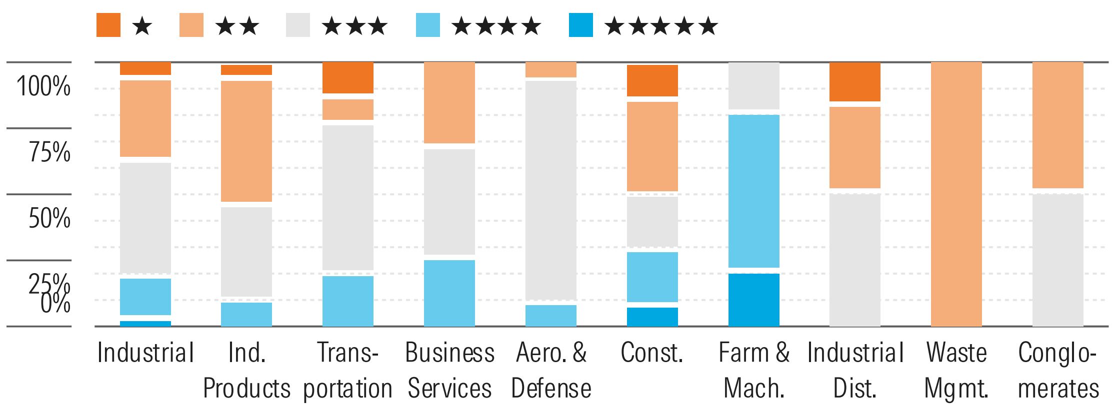
The aerospace and defense industry has realized the most substantial year-to-date stock outperformance relative to the broader market, as healthy demand dynamics persist across both the commercial aerospace and defense markets. We maintain our view that the global commercial aircraft fleet will nearly double over the next two decades, driven by secular growth and the replacement of older, less efficient aircraft.

Last quarter, approximately 80% of Morningstar-covered industrials exceeded consensus earnings expectations. However, we believe these results did not fully capture the impact of tariffs on cost structures. We anticipate that the second half of 2025 will provide a clearer view of tariff costs across the sector. In our view, firms with strong pricing power tied to intangible assets and/or customer switching costs will be most successful at raising prices to help mitigate tariff costs. Companies are also reducing costs and reorganizing supply chains to minimize the impact of tariffs.

Industrials Index Outperformance Shrank During the Third Quarter



We Still See Undervalued Stocks Across Most Sector Industry Groups



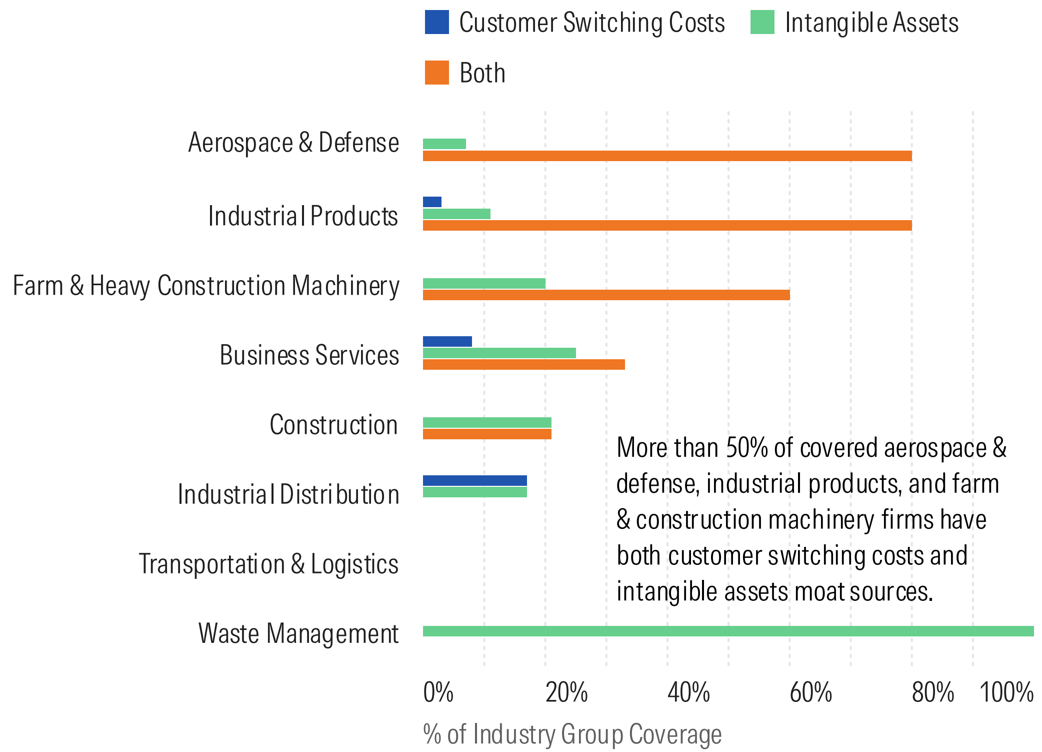
Source: Morningstar. Data as of Sept. 30, 2025. Const. is Construction.

Lower Interest Rates Could Revitalize Residential Construction Spending

As widely expected by the market, the Federal Reserve lowered its benchmark interest rate range by 25 basis points to 4.00%-4.25%. The market anticipates two more 25 basis-point cuts by the end of 2025 (that is, a target range of 3.50-3.75%). We expect a lower interest rate environment will spur construction spending, particularly residential construction, which has been restrained by poor affordability. Firms that manufacture or distribute building products or offer construction services are likely to benefit the most.

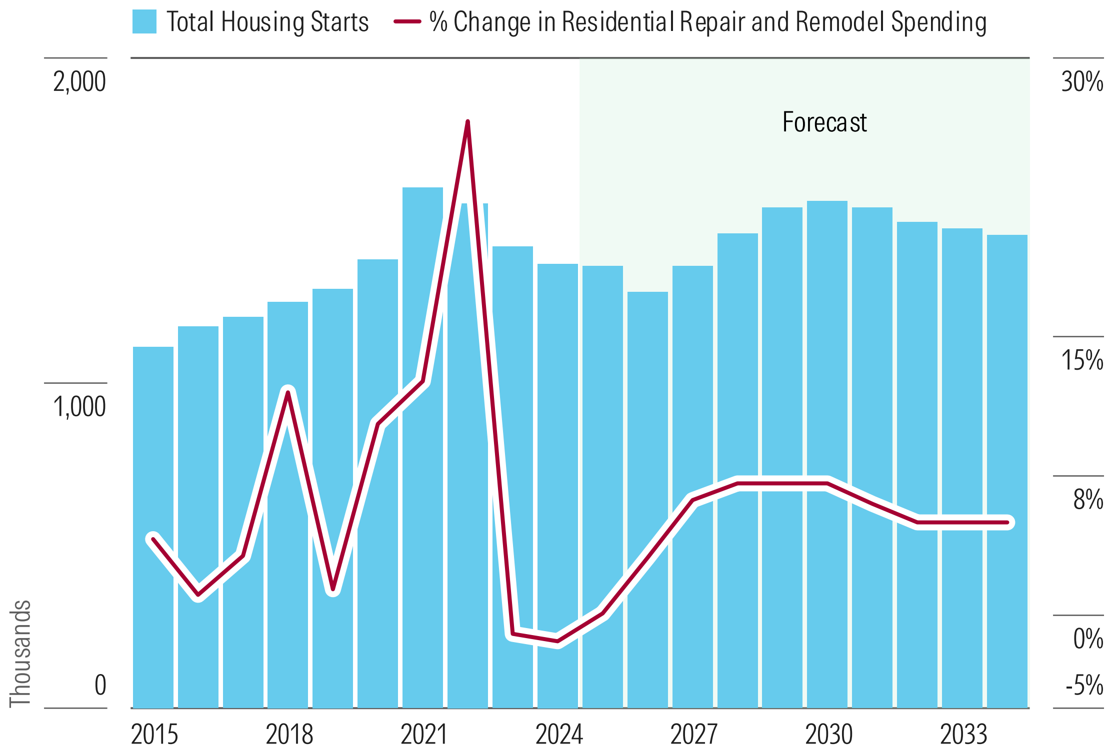
Competitively Advantaged Firms Can Flex Pricing Power to Mitigate Tariff Costs

Intangible assets and customer switching costs foster pricing power.



Lower Interest Rates Should Boost Residential Construction Spending

Poor affordability, due in part to elevated rates, has subdued residential construction.



Source: Morningstar, US Census Bureau, Joint Center for Housing Studies. Data as of September 2025.

Top Picks in Industrials

Name/Ticker		Rating	
CNH Industrial (CNH)		★★★★★	CNH Industrial is a global manufacturer of agricultural and construction equipment. In the long run, CNH will face steady, if not increasing, demand for its solutions to help feed a growing global population. Moreover, margin-rich technology add-ons to its product portfolio will continue improving CNH's returns and through-cycle financial profile. Though the performance gap versus Deere remains wide, CNH has earned its seat at the table and will benefit from favorable, long-term dynamics in global agriculture markets.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
10.91	21.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
13.6 B	Narrow	Standard	

Name/Ticker		Rating	
Fortune Brands Innovations (FBIN)		★★★★★	Fortune Brands is a competitively advantaged building products manufacturer with a portfolio of well-established brands, including Moen (plumbing fixtures), Master Lock (security), Therma-Tru (doors), and Fiberon (composite decking). We think Fortune Brands will grow faster than the US residential repair and remodel and new construction markets (weighted for the firm's exposure to these two markets), especially with its growing mix of connected products (that is, smart plumbing fixtures, leak detection devices, and home security products).
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
53.14	82.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
6.4 B	Narrow	Standard	

Name/Ticker		Rating	
Idex (IEX)		★★★★	Idex manufactures a wide array of products, ranging from equipment used in DNA sequencing to wastewater pumps to Jaws of Life hydraulic rescue tools. The firm differentiates itself by producing highly engineered products for a variety of niche markets, where it typically holds the number-one or -two market share position. We believe that the long-term growth drivers in the semiconductor and life sciences end markets remain intact. Therefore, we believe that investors will be rewarded once the cyclical headwinds subside and Idex returns to more normalized organic revenue growth.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
162.19	210.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
12.2 B	Wide	Exemplary	

Source: Morningstar. Data as of Sept. 30, 2025.

Real Estate

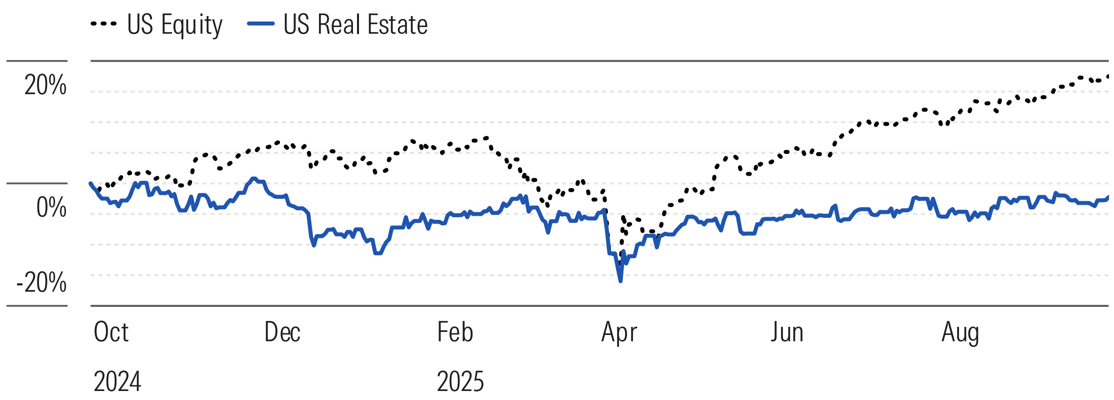
Kevin Brown, CFA | kevin.brown@morningstar.com

Real Estate Sector Underperforms in Third Quarter Despite Small Decline in Interest Rates

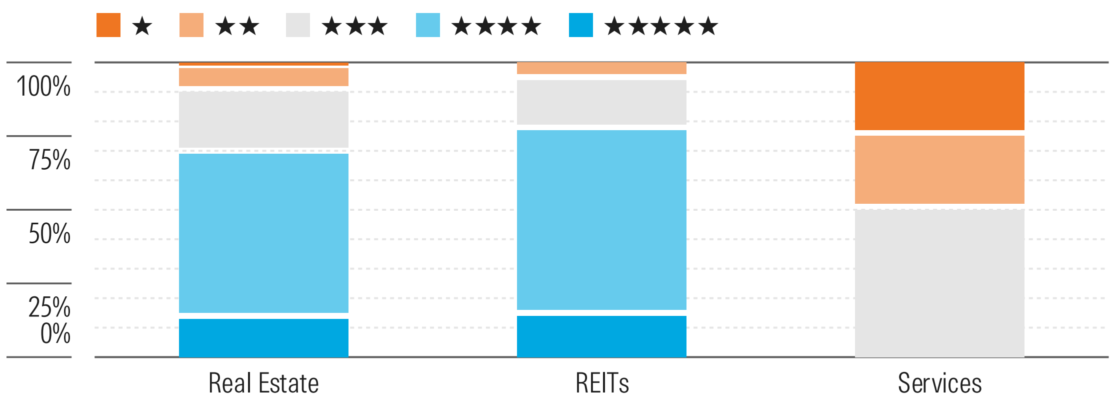
The Morningstar US Real Estate Index declined 2.2% over the trailing 12 months, significantly underperforming the 17.5% gain recorded by the broader US equity market during the same period. The real estate sector also underperformed the broader market in the third quarter. Interest rate movements have driven the real estate sector's performance over the past year, as the sector's performance is negatively correlated with changes in interest rates. Interest rates are up approximately 50 basis points from the low point seen last September, driving much of the sector's underperformance. However, the real estate sector declined in the third quarter despite interest rates generally falling, one of the first quarters in the past three years where the relationship has not held up. Same-store net operating income growth has flattened out, with an average year-over-year growth rate of around 2%, as expense growth remains slightly above revenue growth in many sectors. Most companies reported results that were generally in line with or slightly above our expectations on second-quarter earnings calls, and our estimates for 2025 generally remain within management's guidance for the year.

The real estate sector is currently trading below our fair value estimates. Our real estate coverage currently trades at a discount to our estimate of fair value, which is better than the average in North America. Currently, 13% of the real estate sector is trading in the 5-star range, 56% is trading in the 4-star range, 18% is trading in the 3-star range, 10% is trading in the 2-star range, while just 3% of the real estate companies in our coverage universe are trading in the 1-star range.

Real Estate Underperforms in Second and Third Quarters of 2025



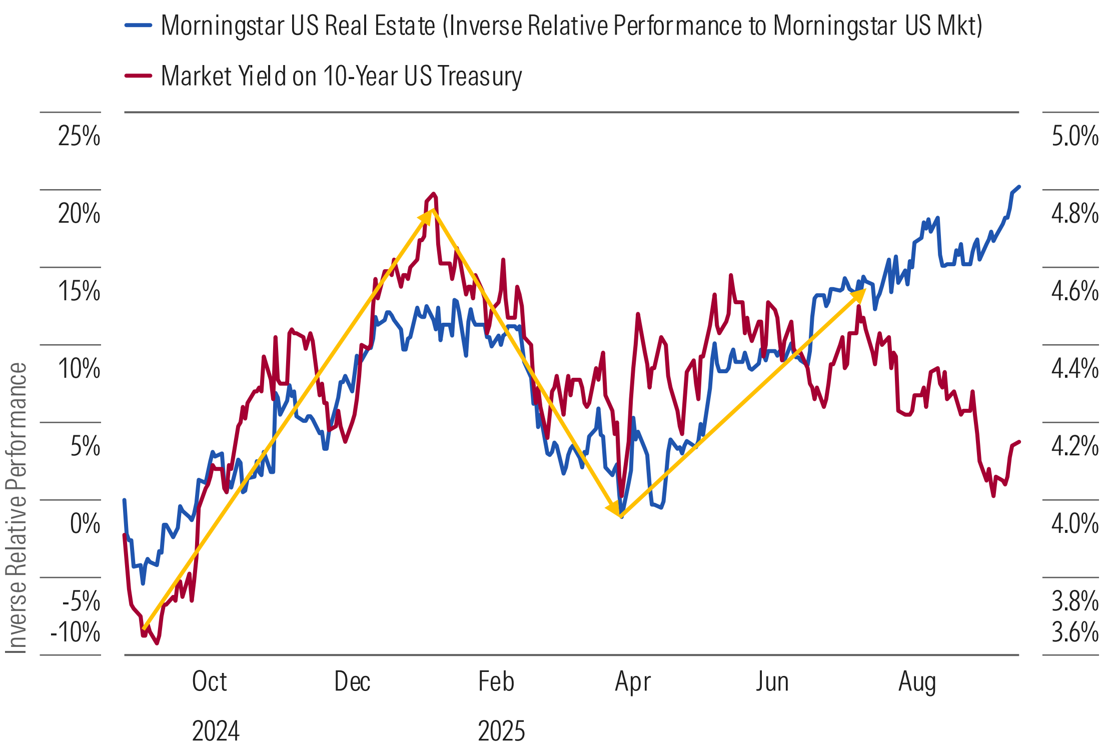
Three-Fourths of Real Estate Sector Trading at Material Discount to Fair Value



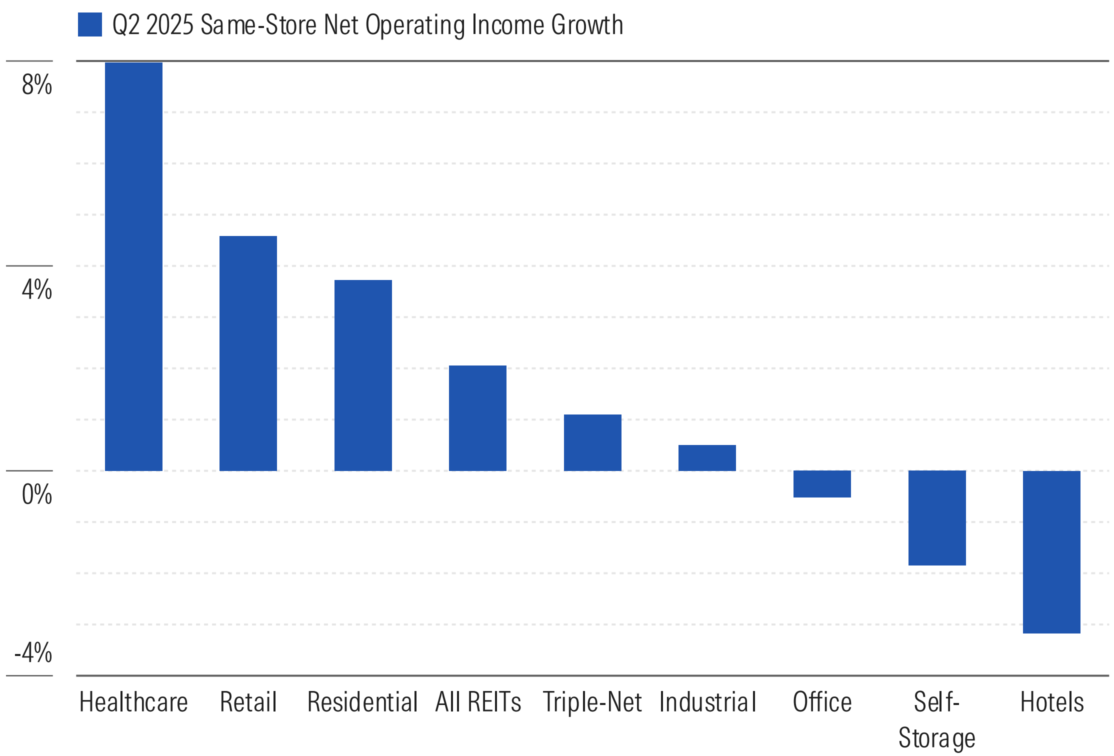
REIT Index Performance Moves With Interest Rates While Net Operating Income Growth Settles Near Inflation

The Morningstar US Real Estate Index has fallen about 4% since July 2024, with the index's performance relative to the Morningstar US Market Index mostly moving in line with changes in interest rates. Falling interest rates drove real estate outperformance in the first quarter, though rising rates erased much of that outperformance in the second quarter. However, the relationship hasn't held up in the third quarter, with the REITs underperforming despite falling interest rates. While REITs on average reported same-store net operating income growth of 2.1%, which is near inflation, during the second quarter, performance was bifurcated between three strong sectors and five with low- to negative growth.

UST Rate Movements Have Been the Driving Factor Behind REIT Performance



Same-Store NOI Grew Just 2.1%, Though Significant Difference by Sector



Source: Federal Reserve Bank of St. Louis, Morningstar Direct, PitchBook, Data as of Sept. 22, 2025 (left chart).
Source: Company reports, Morningstar Direct. Data as of June 30, 2025 (right chart).

Top Picks in Real Estate

Name/Ticker		Rating	
Americold Logistics (COLD)		★★★★★	Americold's stock price has corrected about 50% in the past year. Much of the correction can be attributed to concerns related to a difficult outlook in the near term, as occupancy rates have fallen and rents are coming under increasing pressure. The pressure on the core rental segment fundamentals is both a function of moderating demand and incremental supply side additions in recent years. There are indications that speculative supply growth will be lower in the upcoming years, supporting occupancy recovery. We agree that the near-term outlook may be difficult, but the current valuation provides an attractive entry point for long-term oriented shareholders.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
12.49	27.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
3.6 B	None	Standard	

Name/Ticker		Rating	
Federal Realty (FRT)		★★★★	Federal Realty's high-quality retail centers should produce higher retail sales growth than the brick-and-mortar average, keeping occupancies high and driving high re-leasing spreads. Federal Realty's portfolio has the highest average population density and per capita income among all shopping center REITs. The company's strong internal and external growth prospects should also allow Federal to continue to support a high dividend yield. We believe the company has sold off due to 10% of rent coming from office tenants, but Federal's high-quality portfolio should trade at a multiple premium to the industry and its shopping center peers.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
99.92	137.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
8.6 B	None	Exemplary	

Name/Ticker		Rating	
Healthpeak Properties (DOC)		★★★★★	Healthpeak's management team strategically focused the company around the medical office and life science portfolios. These sectors should provide steady and recession-resistant revenue growth for the firm. Healthpeak's development pipeline should also produce yields above the company's cost of capital even in a higher interest rate environment, producing additional cash flow growth for shareholders. The company sold off due to rising interest rates, but we believe that the current market-implied cap rate undervalues Healthpeak's portfolio of stable assets.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
19.01	27.50	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
13.2 B	None	Standard	

Source: Morningstar. Data as of Sept. 30, 2025.

Technology

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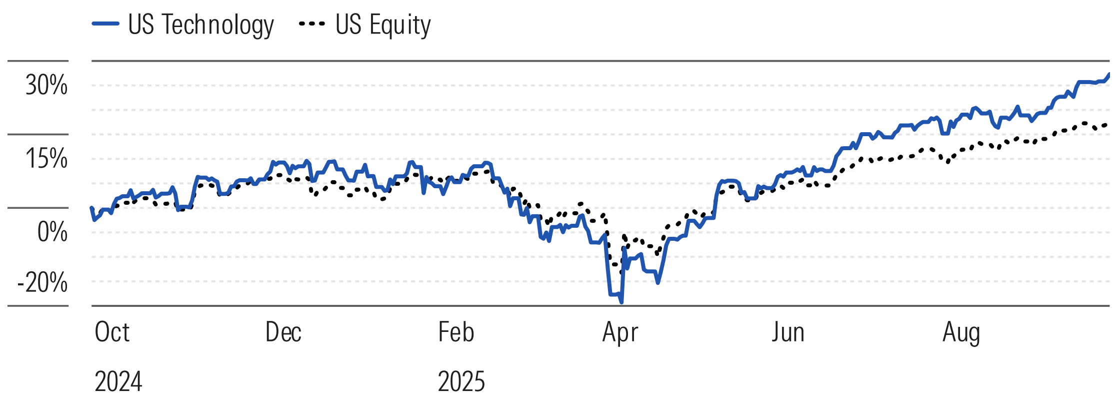
Strength in Technology Stocks Continues in the Third Quarter

Following a strong performance throughout 2024, the technology sector experienced a collapse in the first quarter and has been rebounding since early April. We view the sector as being slightly undervalued overall. Technology stocks began to rebound after the Trump administration introduced sweeping trade policy changes, including hefty tariffs. Hardware stocks have been strong throughout the year, while semiconductor stocks have been solid, and software stocks have lagged. Overall, tech was the second-strongest sector in the third quarter (to date), which serves as a continued rebound from a weak first quarter, when tech was the second-worst-performing sector. Over the past 12 months, tech's performance has been above average and is the second-best-performing sector, outperforming the market by more than 900 basis points. Our confidence in secular tailwinds, such as cloud computing, artificial intelligence, and the long-term expansion of semiconductor demand, remains unchanged. We see software as offering the most upside.

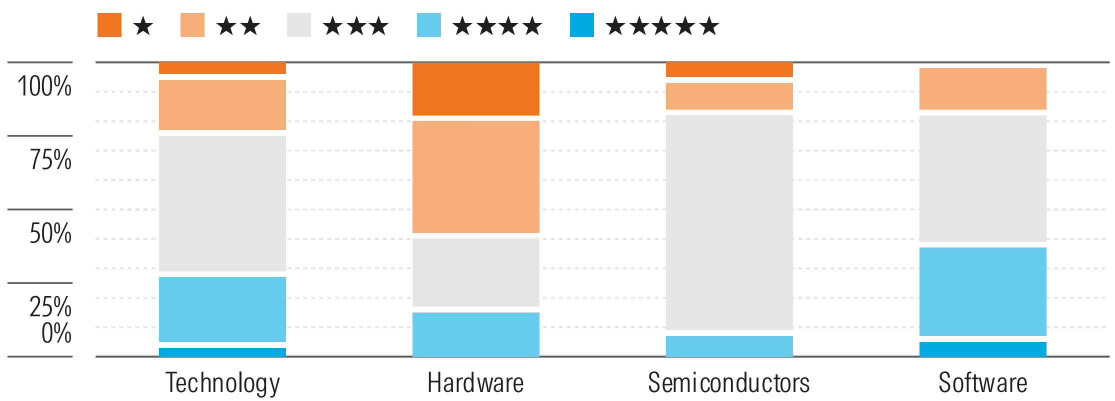
Generative AI remains the largest theme within the tech sector. Software firms are developing and incorporating next-generation AI capabilities into their solutions, while cloud providers are introducing new services and increasing capacity. Meanwhile, some semiconductor firms, such as Nvidia, are experiencing surging demand for AI and data center chip applications. We see attractive value within the AI theme as being scarce.

The Morningstar US Technology Index is up 27% on a trailing 12-month basis, compared with the US equity market, which is up 17.5%, as shown in the top exhibit. The median US technology stock is slightly undervalued, whereas the average is fairly valued, with little margin of safety. We view hardware as overvalued, with semiconductors fairly valued, and software as undervalued, as shown in the bottom panel at the right.

Technology Kicked Off 2025 in Ugly Fashion



We See Increasing Investment Opportunities Throughout the Tech Sector

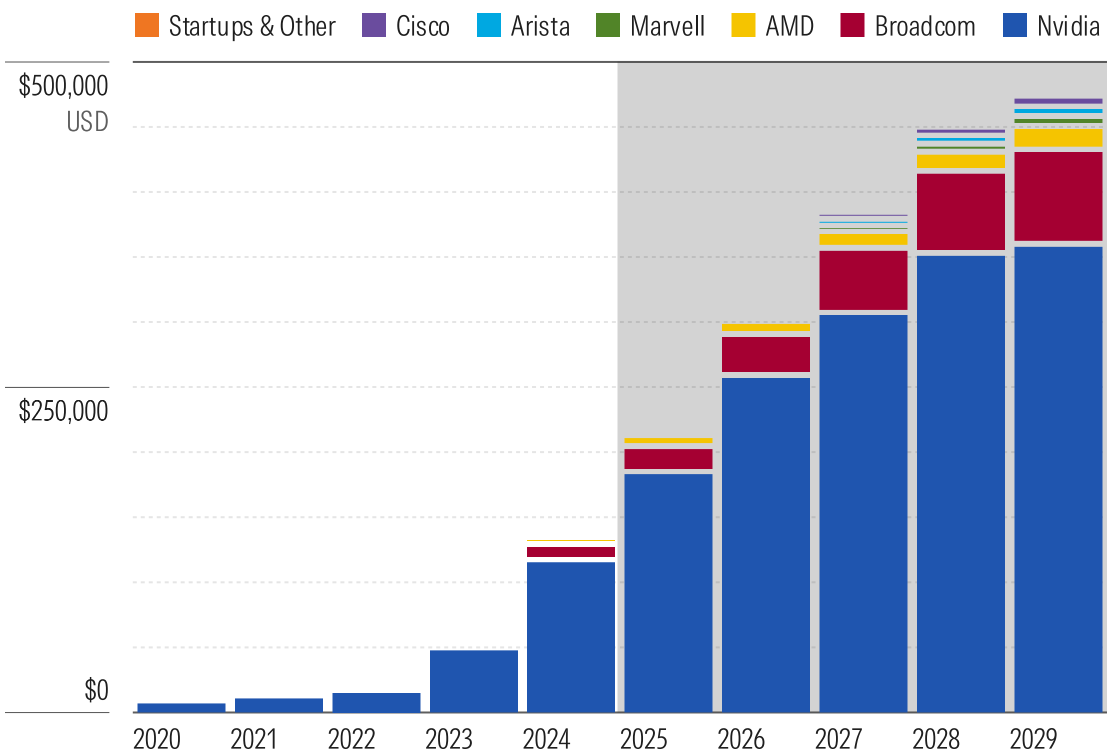


Source: Morningstar. Data as of Sept. 30, 2025.

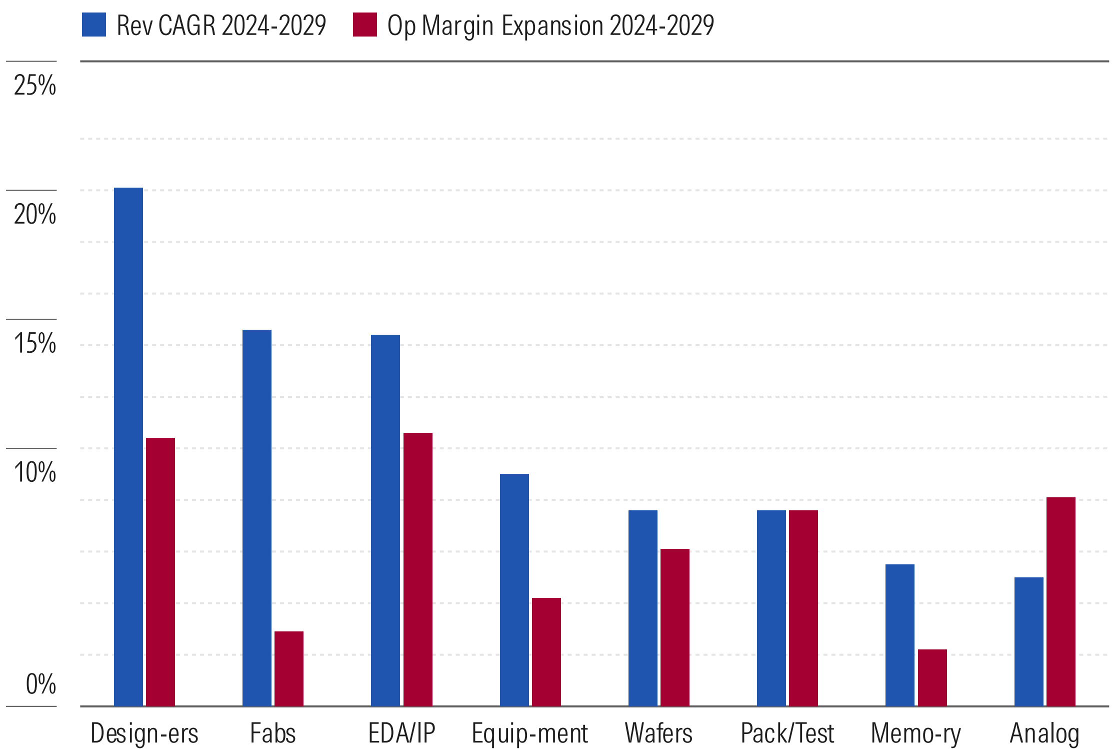
Semiconductor and Related Companies Are Benefiting Sharply From the Surge in AI Demand

We expect AI accelerator (AI chip) revenue will increase roughly four times over the next several years, making AI the most significant growth driver in the semiconductor industry. While Nvidia will lead this growth, we also see other chip vendors, such as Broadcom and AMD, benefiting as well. We also expect AI to extend into the rest of the semiconductor value chain, with fabs, EDA software, IP, memory, and equipment firms experiencing outsize growth. That means firms like TSMC, Synopsys, and ASML should also benefit from AI.

Artificial Intelligence Is a Generational Demand Driver for Semis Beyond Nvidia



AI-Related Growth Extends Beyond Semis



Source: Morningstar, PitchBook, company filings. Data as of Aug. 28, 2025.

Technology Top Picks

Name/Ticker		Rating	
Atlassian (TEAM)		★★★★	Atlassian is a leading provider of project management and collaboration solutions for software developers and continues to do well with expansion into service management. The firm is emerging from a model transition to be primarily cloud-based, which was inevitable and leaves it better ablet to innovate and compete with larger peers. Atlassian's broad portfolio helps establish a large base across clients of all sizes and gives the firm an opportunity to integrate AI throughout its growing portfolio. The firm is also investing in a salesforce to have more of a direct presence, which should further support topline growth efforts.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
165.31	230.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
43.4 B	Narrow	Standard	

Name/Ticker		Rating	
Microsoft (MSFT)		★★★★	Microsoft is one of our top picks in the technology sector. The company dominates several of its served markets, such as with Office in productivity software and Windows for PC operating systems, and has also established itself as one of two clear leaders in public cloud. We think the proliferation of hybrid cloud environments will continue to strengthen Microsoft's position with Azure. Further, the firm's investment in OpenAI has catapulted Microsoft into a leadership position in generative AI, which has driven an acceleration of Azure growth in recent quarters. Our growth estimates are centered around Azure, Microsoft 365 E5 migration, traction with the Power Platform for long-term value creation, and proliferation of AI.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
514.60	600.00	Medium	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
3850. B	Wide	Exemplary	

Name/Ticker		Rating	
NXP Semiconductors (NXPI)		★★★★	Wide-moat NXP Semiconductors is one of our top picks in semis. As automotive and industrial demand improves from cyclical and tariff softness, we anticipate that NXP will benefit from a recovery. We like NXP's outsize exposure to autos, where it obtains nearly 50% of its revenue. NXP is well diversified in autos with a broad portfolio of processors, microcontrollers, and analog parts. The firm should gain share in electrification and safety automotive products, too, such as radar and battery management systems. Overall, NXP's auto business is well tied to the secular tailwinds around rising chip content per vehicle.
Price (USD)	**Fair Value (USD)**	**Uncertainty**	
226.11	280.00	High	
Market Cap (USD B)	**Economic Moat**	**Capital Allocation**	
57. B	Wide	Standard	

Source: Morningstar. Data as of Sept. 30, 2025.

Utilities

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Utilities Stocks' Rally Slows in Summer, but Still Beating the Market Year to Date

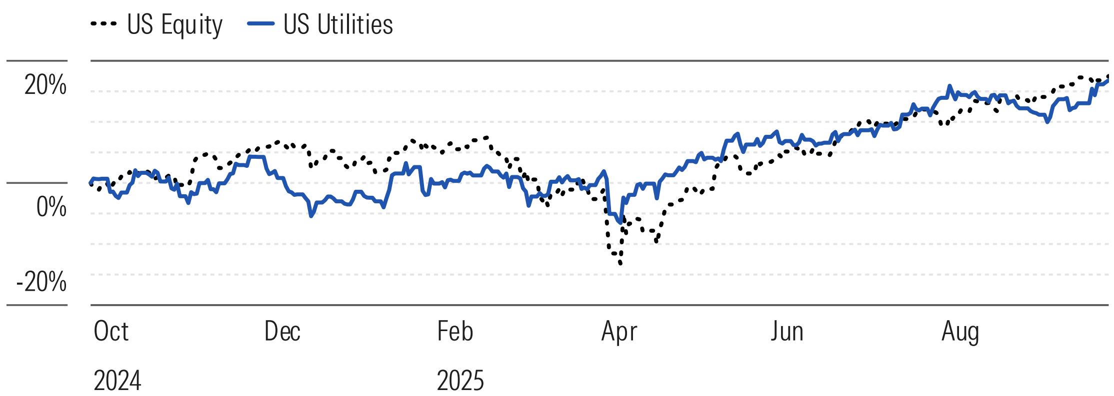
Utilities' remarkable run since late 2023 stalled this summer, a pullback we think was long overdue. The Morningstar US Utilities Index remains up 70% from its low in October 2023, including dividends, outperforming every sector except technology. But since the utilities index peaked in early August, utilities are one of only two sectors that are down.

The reversal comes despite a dovish turn in interest rates and weaker economic data, both typically bullish developments for utilities stocks. Investors' lackluster response validates our view that utilities' valuations have become too frothy.

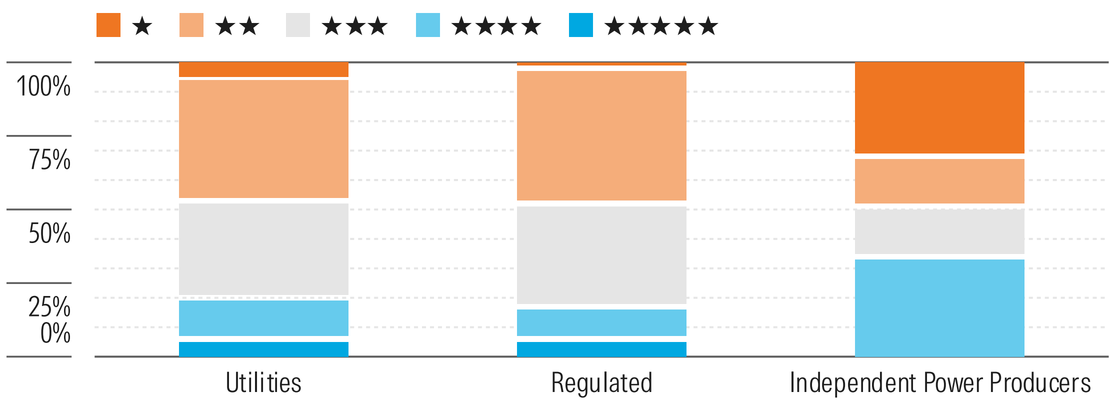
Utilities' valuations remain historically high, and we think there is more downside to come. We consider the sector overvalued as of late September. In addition, utilities' 3% average dividend yield is among the lowest in history. This suggests that investors are valuing utilities more for their growth than their income, a huge shift from utilities' typical investment profile. The low yields give investors little protection if utilities' growth prospects disappoint.

We continue to expect 6% annual earnings growth for most utilities through 2030 based on secular trends such as clean energy growth, data center energy demand, manufacturing onshoring, and economywide electrification. Most utilities are planning for the most energy demand growth and capital investment over several generations. If this growth continues and utilities stocks pull back further, investors should be ready to buy.

US Utilities Rally Tapers Off in Third Quarter



Market's Lofty Growth Expectations Have Inflated Many Utilities' Valuations

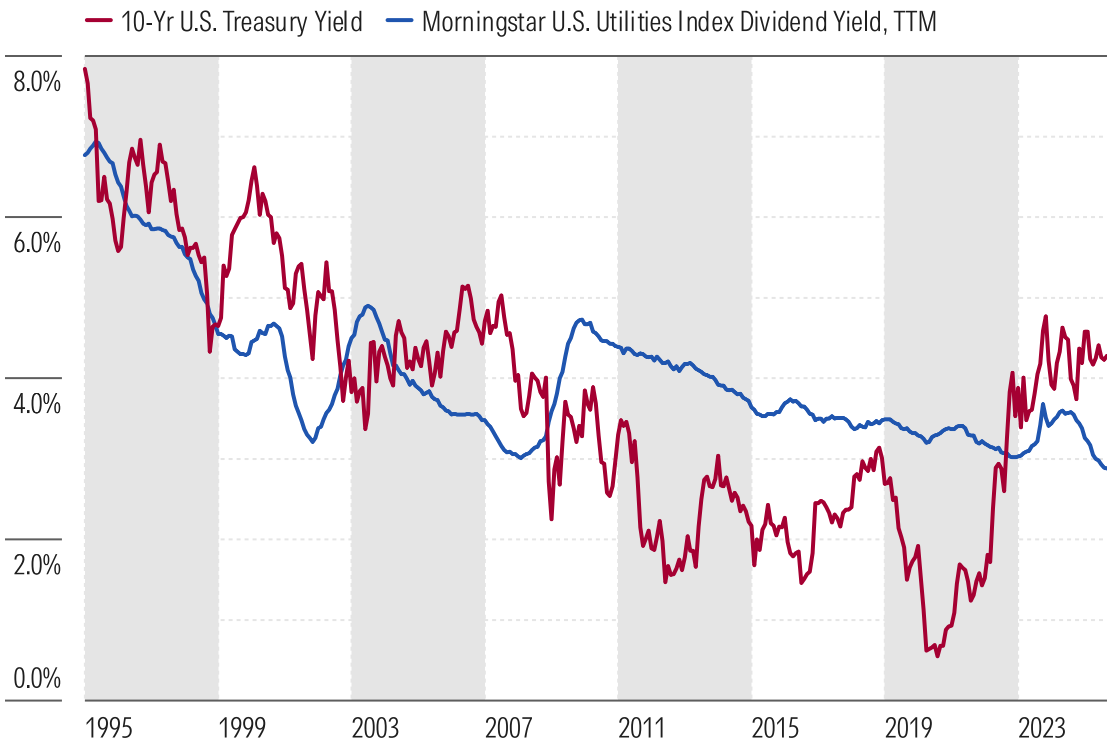


Source: Morningstar. Data as of Sept. 30, 2025.

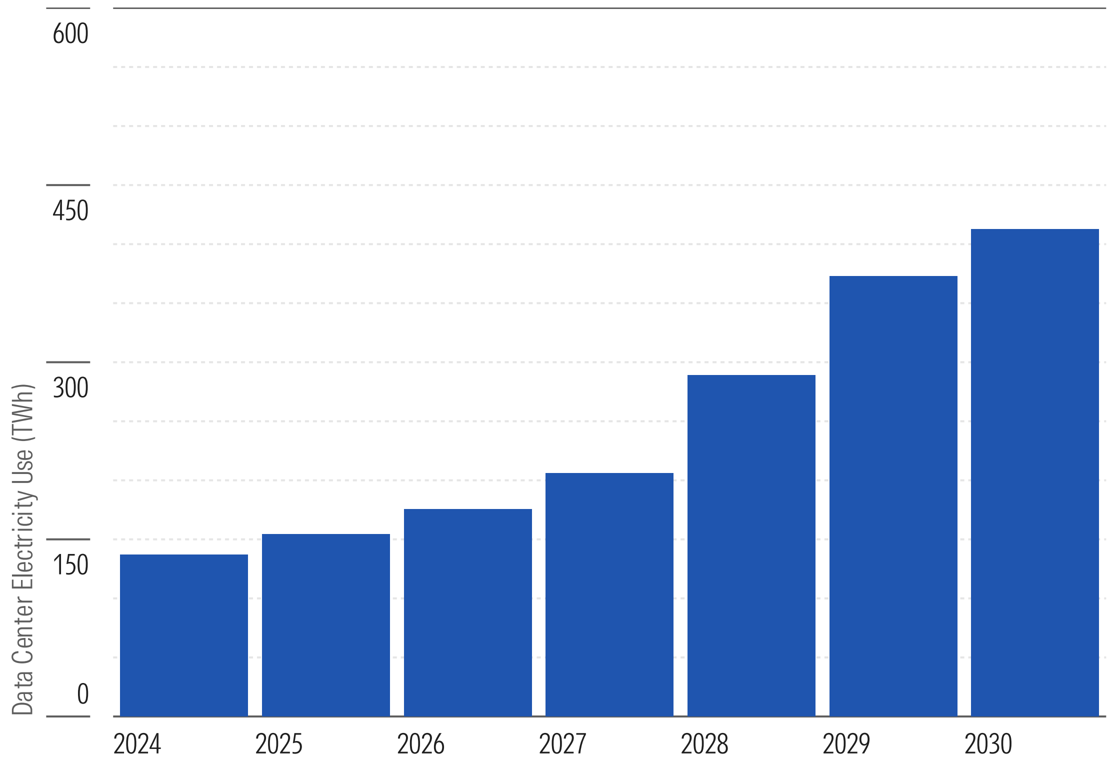
Investors Willing to Take Lower Yields; Data Center Demand Supports Earnings Growth

Utilities' 3% average dividend yield remains historically low on an absolute basis and relative to interest rates. Investors' growth expectations for utilities could dampen any prospect for higher yields regardless of how interest rates move in the near term. We expect interest rates to remain above utilities' dividend yields, provided the market expects elevated earnings growth, notably from new data center energy demand. Electricity use is up 3% through July, and we expect that growth to accelerate as more data centers come online.

Utilities' Dividend Yields Are Rarely This Low Relative to Interest Rates



Data Center Demand Expected to Increase Threefold by 2035



Source: Morningstar, US Federal Reserve, US Energy Information Administration. Data as of Sept. 23, 2025.

US Utilities Top Picks

Name/Ticker		Rating	
Eversource Energy (ES)		★★★★	Eversource will miss out on most of the data center growth excitement but has plenty of investment opportunities in transmission and distribution to support at least 6% annual earnings growth, at least through 2028. We think the Trump administration's opposition to offshore wind ultimately won't have a significant impact on Eversource despite the near-term uncertainty. We think Eversource can offset regulatory challenges in Connecticut by adding projects in Massachusetts, where regulation is more constructive. A turnaround in Connecticut offers earnings and valuation upside. Eversource's balance sheet leverage should be back to normal range by the end of this year.
Price (USD) 70.53	**Fair Value (USD)** 73.00	**Uncertainty** Low	
Market Cap (USD B) 26.2 B	**Economic Moat** None	**Capital Allocation** Standard	
Name/Ticker Duke Energy (DUK)		**Rating** ★★★	Duke has a clear pathway to achieving the high end of management's 5%-7% annual earnings growth target supported by the company's regulated subsidiaries. Duke's $87 billion capital investment plan for 2025-29 is focused on clean energy, grid infrastructure upgrades, and supporting load growth. We don't think the market appreciates the upside to Duke's capital plan and additional electricity demand growth from data centers. In North Carolina, Duke's most important jurisdiction, regulation has improved significantly due to recently passed legislation.
Price (USD) 122.80	**Fair Value (USD)** 121.00	**Uncertainty** Low	
Market Cap (USD B) 96.2 B	**Economic Moat** Narrow	**Capital Allocation** Standard	
Name/Ticker Edison International (EIX)		**Rating** ★★★★★	Edison's stock remains down 30% since the January fires despite positive regulatory and political developments this summer. We expect Edison will be able to access California's $21 billion AB 1054 Wildfire Fund for Eaton fire liabilities and the recently enacted $18 billion expansion for future fire liabilities, resulting in minimal shareholder losses. Investments in safety and widespread electrification to meet California's 2045 carbon-neutral target support our 7% average annual earnings growth outlook, at the high end of management's 5%-7% target.
Price (USD) 55.23	**Fair Value (USD)** 80.00	**Uncertainty** Medium	
Market Cap (USD B) 21.3 B	**Economic Moat** Narrow	**Capital Allocation** Standard	

Source: Morningstar. Data as of Sept. 30, 2025.

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