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2016 U.S. Equity Market Outlook: *The Receding Tide*

Gina Martin Adams, CFA, CMT
Institutional Equity Strategist
Wells Fargo Securities, LLC
(212) 214-8043
gina.martinadams@wellsfargo.com

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All estimates/forecasts are as of March 21, 2016 unless otherwise stated.

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2016 Equity Market Themes

Monetary Policy Shift Still Center Stage

In our view, the end of U.S. balance sheet expansion and great easing in Europe, Japan and China in 2015 marked the first leg of a great policy divergence. Fed “liftoff” should begin the second leg of the theme. Adjustments to shifting policy conditions are likely continue to create higher volatility and greater dispersion of returns, in our view.

Quality is the New Black

While 2015 returns were concentrated among momentum and growth names, rising rates seem likely to highlight quality as a theme in the year ahead. With the cycle aging and credit metrics deteriorating, investors should be wary of yield traps and careful not to overly rely on growth or value to carry performance.

Center of Volatility Shifts

Fed tightening is not likely to materially slow down economic growth, but could have significant impacts on performance in financial markets. While the first stage of adjustment to policy change most impacted commodity and currency markets, we suspect the next stage will more strongly center on rates.

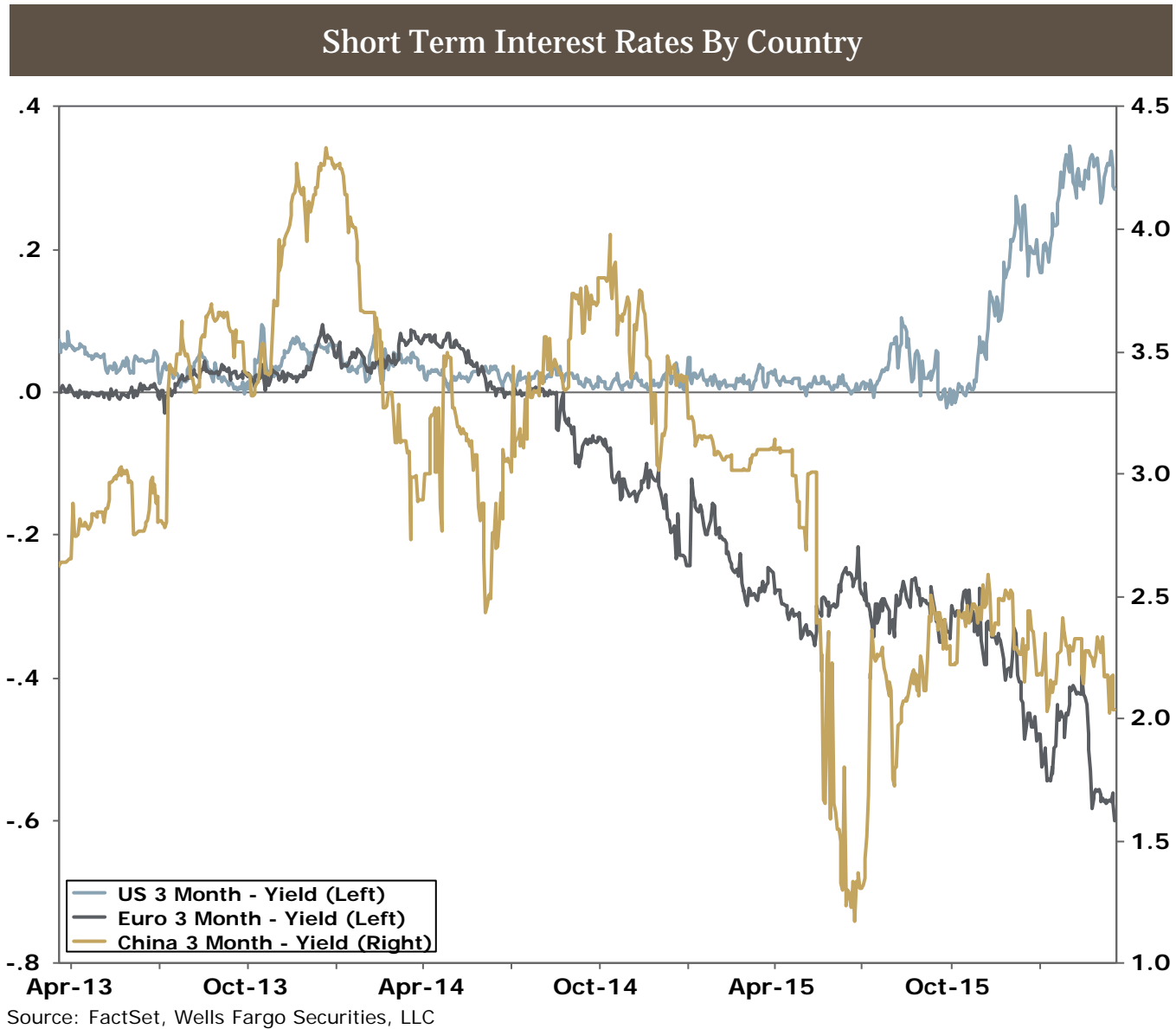
Domestic Growth Maintains

The U.S. consumer is likely to continue to offer stability, given improving income prospects, better balance sheets, rising wealth and relatively high savings. The non-consumer economy remains a tale of two worlds, as a construction recovery offsets a manufacturing slump.

Election Year

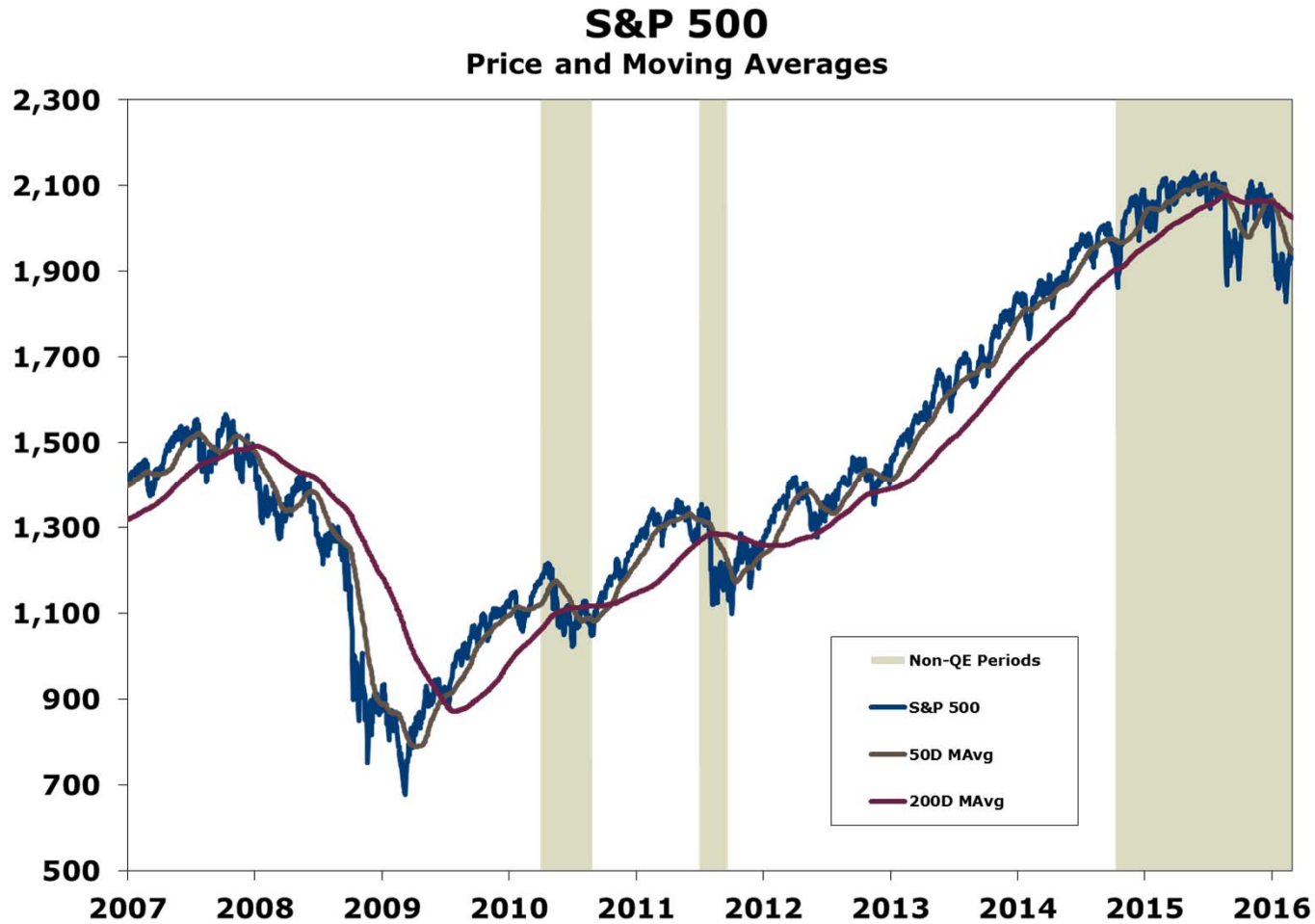
U.S. competitiveness is falling, the corporate tax rate is the highest among OECD countries, health care is more than 20% of the consumer wallet, and the electorate is highly disappointed in current leadership in Washington. There is plenty of room for policy recommendations to rock the boat this year.

Monetary Policy Shift Still Center Stage



Monetary Policy Shift Still Center Stage (Cont'd)

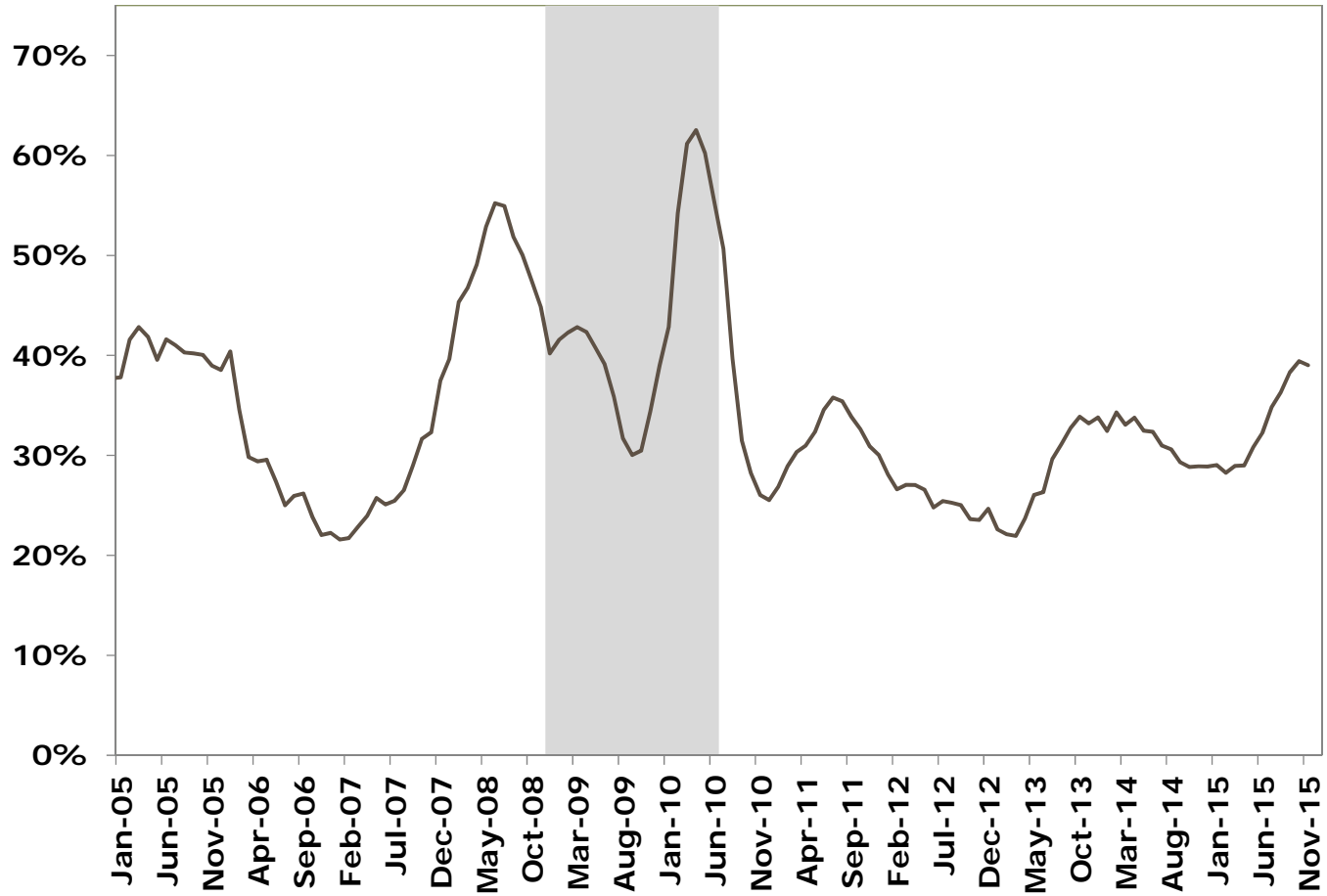
S&P 500, With & Without QE



Source: FactSet, Wells Fargo Securities, LLC

S&P 500 Sector Return Dispersion

S&P 500 Sector Return Dispersion
Monthly YoY Price Change, 12MMA, Highest less Lowest Return

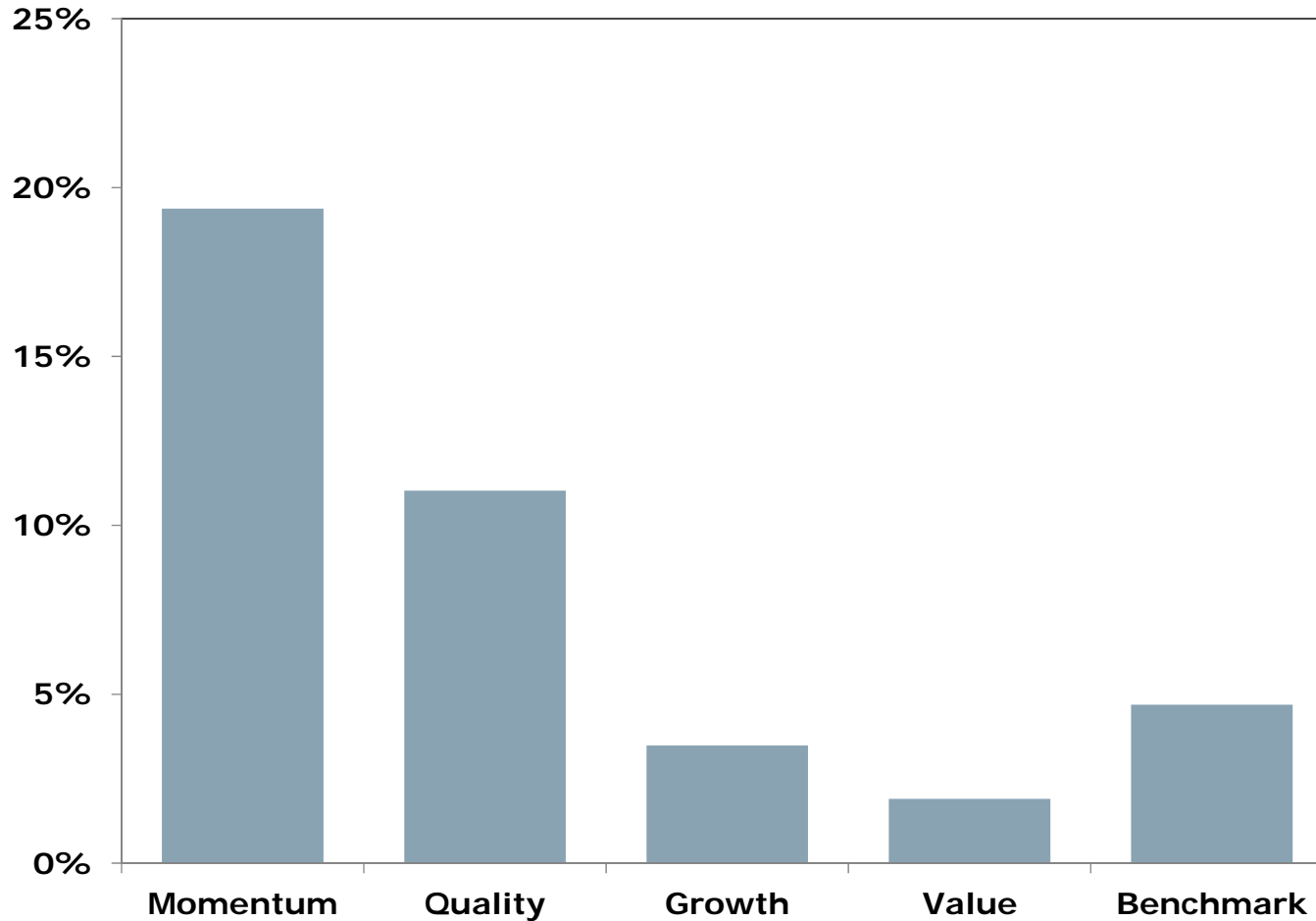


Source: FactSet, Wells Fargo Securities, LLC

Quality is the New Black (Cont'd)

Quality & Momentum Are Favored Factors for 2016

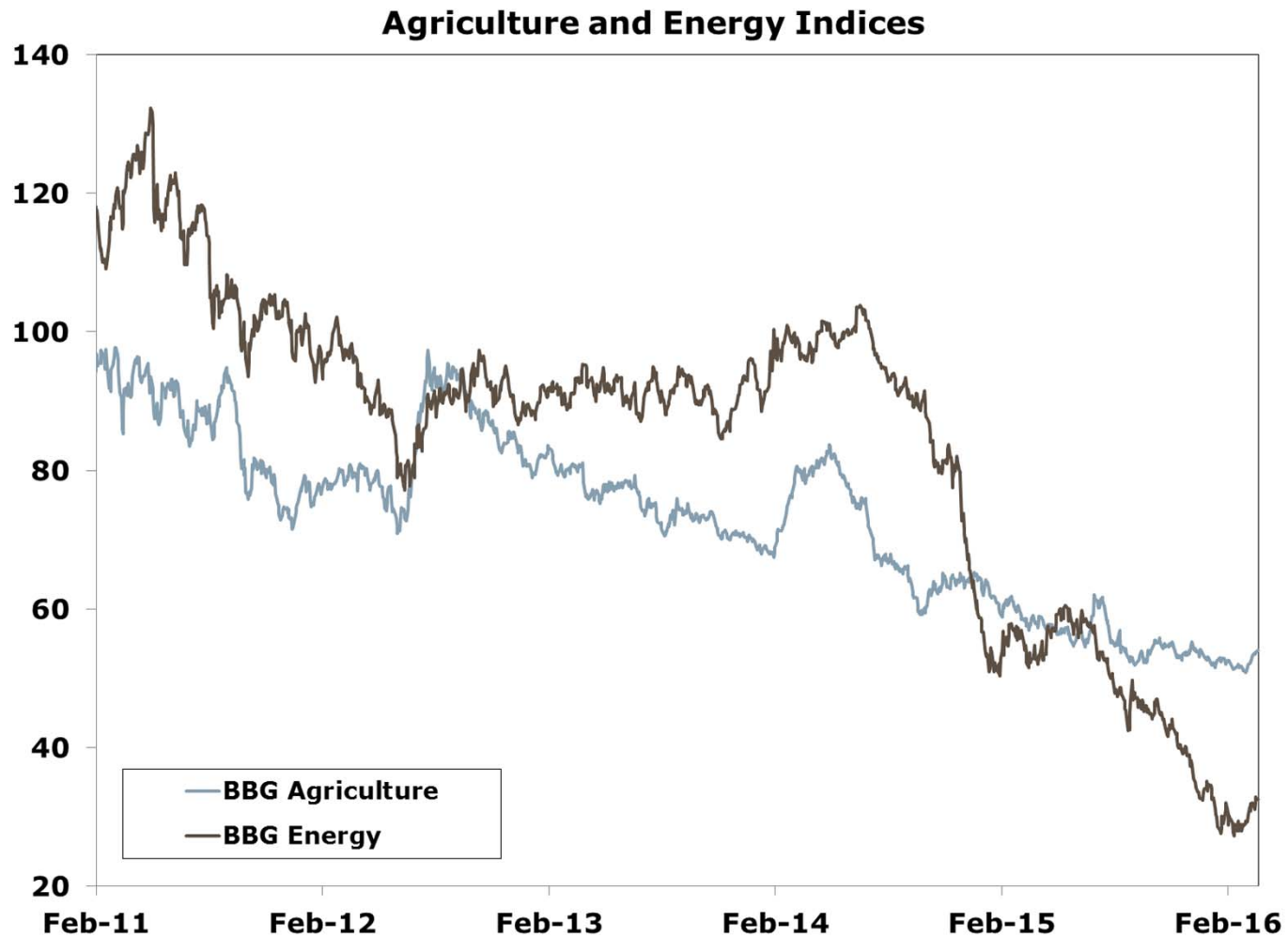
Average 12M Returns Following Initial Rate Hikes, 1990-Present



Source: FactSet, Wells Fargo Securities, LLC

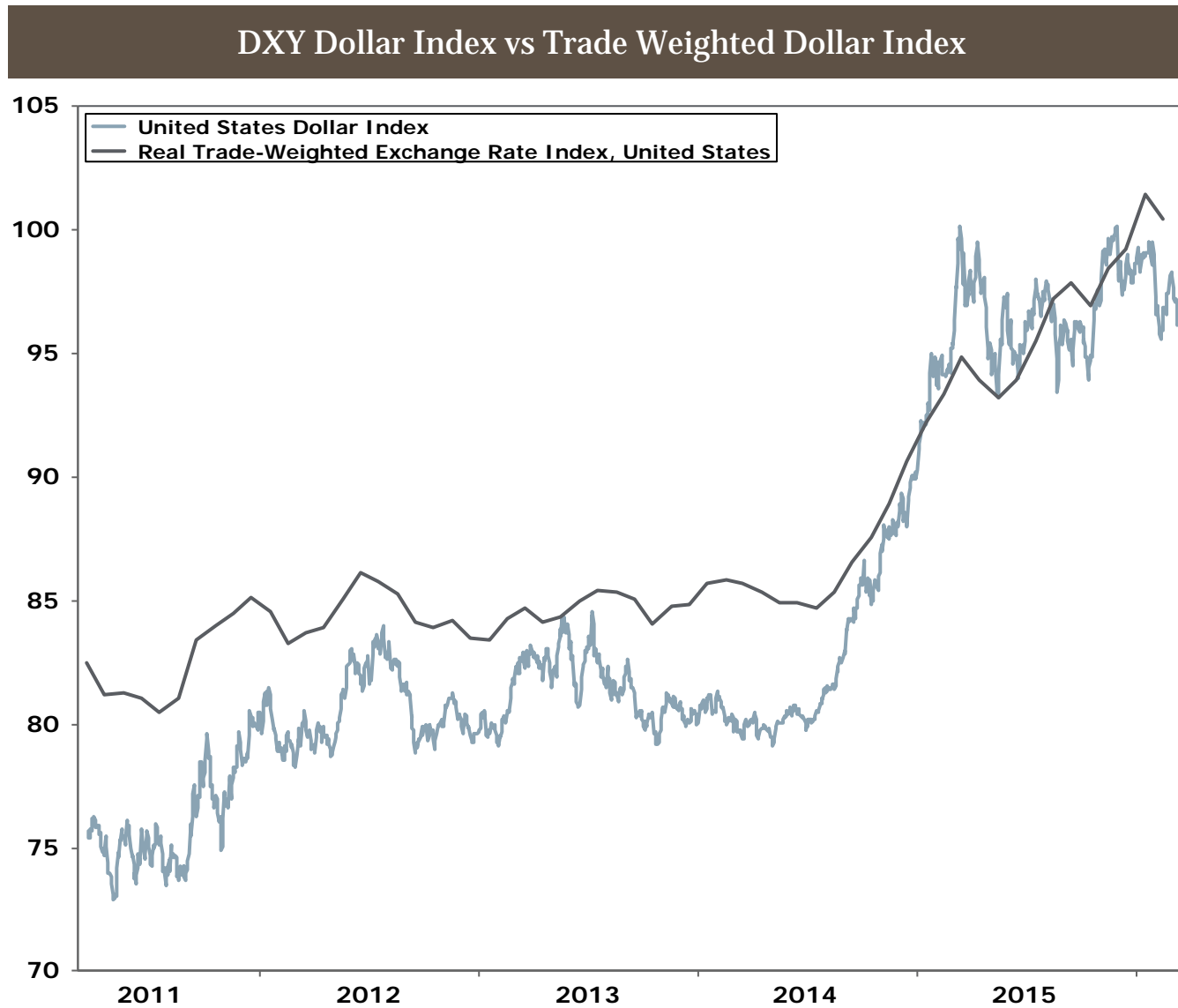
Commodities and Currencies Still Make Waves

Energy and Agriculture Commodity Indices



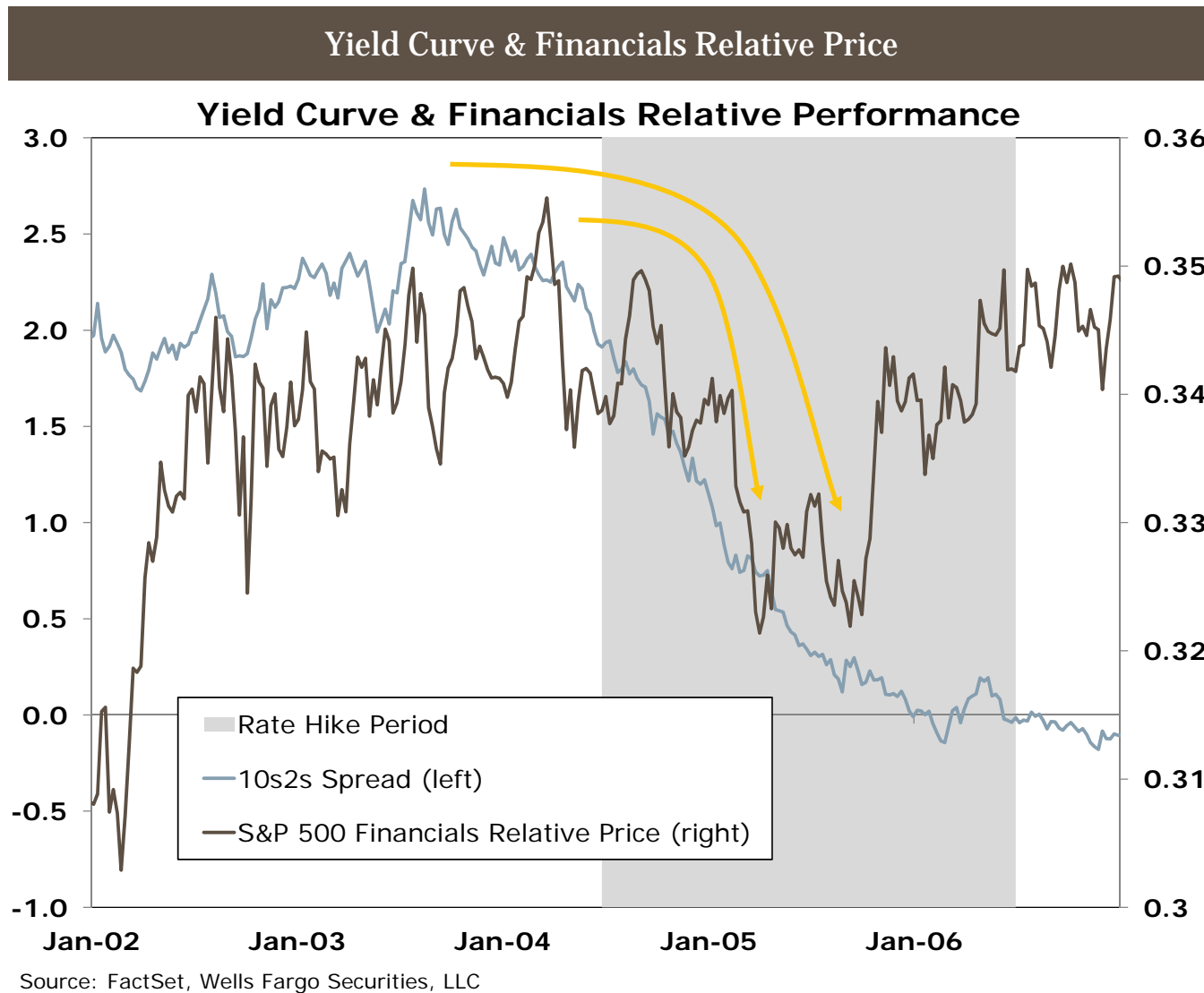
Source: Bloomberg, Wells Fargo Securities, LLC

Commodities and Currencies Still Make Waves (Cont'd)

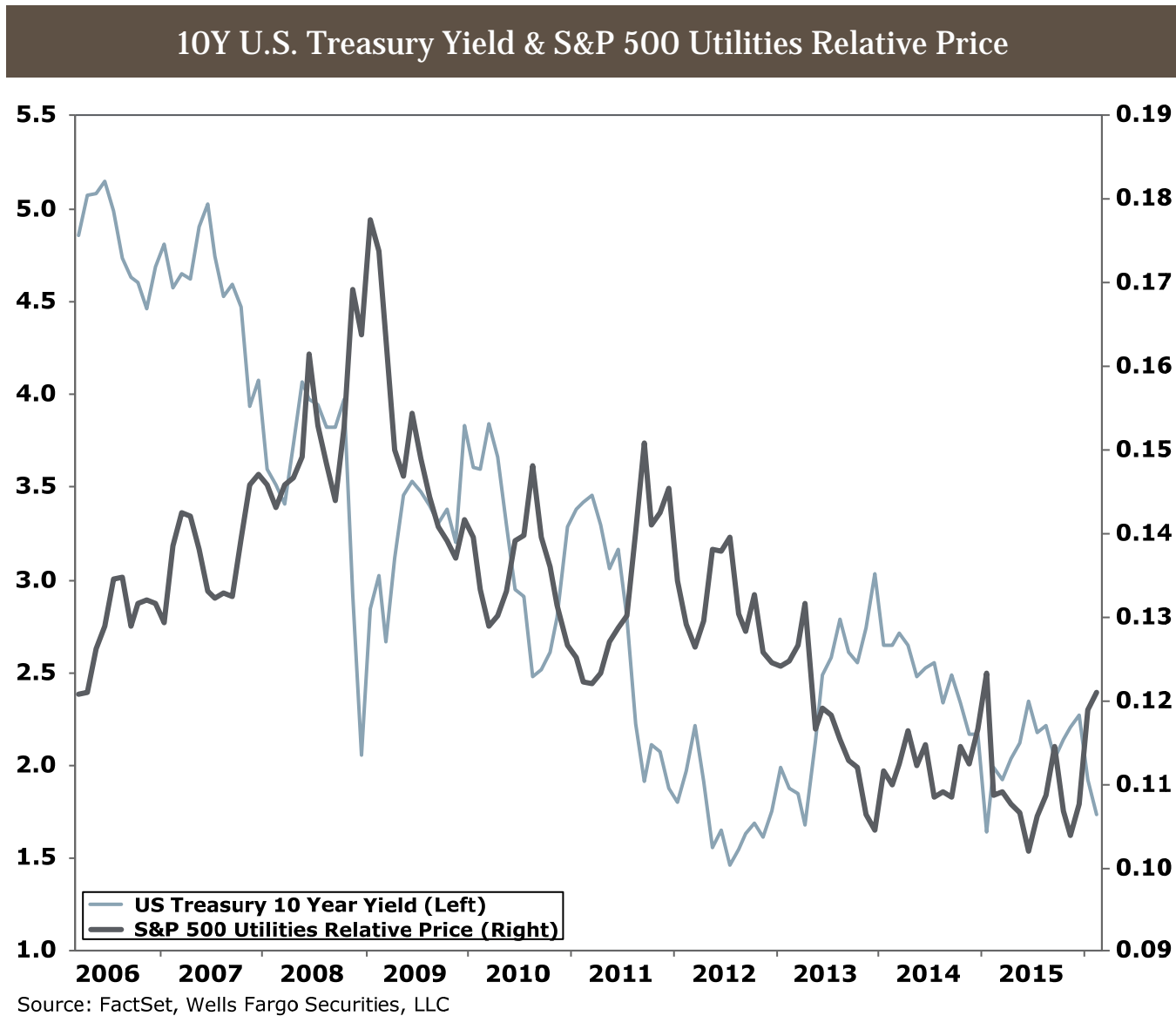


Source: FactSet, Wells Fargo Securities, LLC

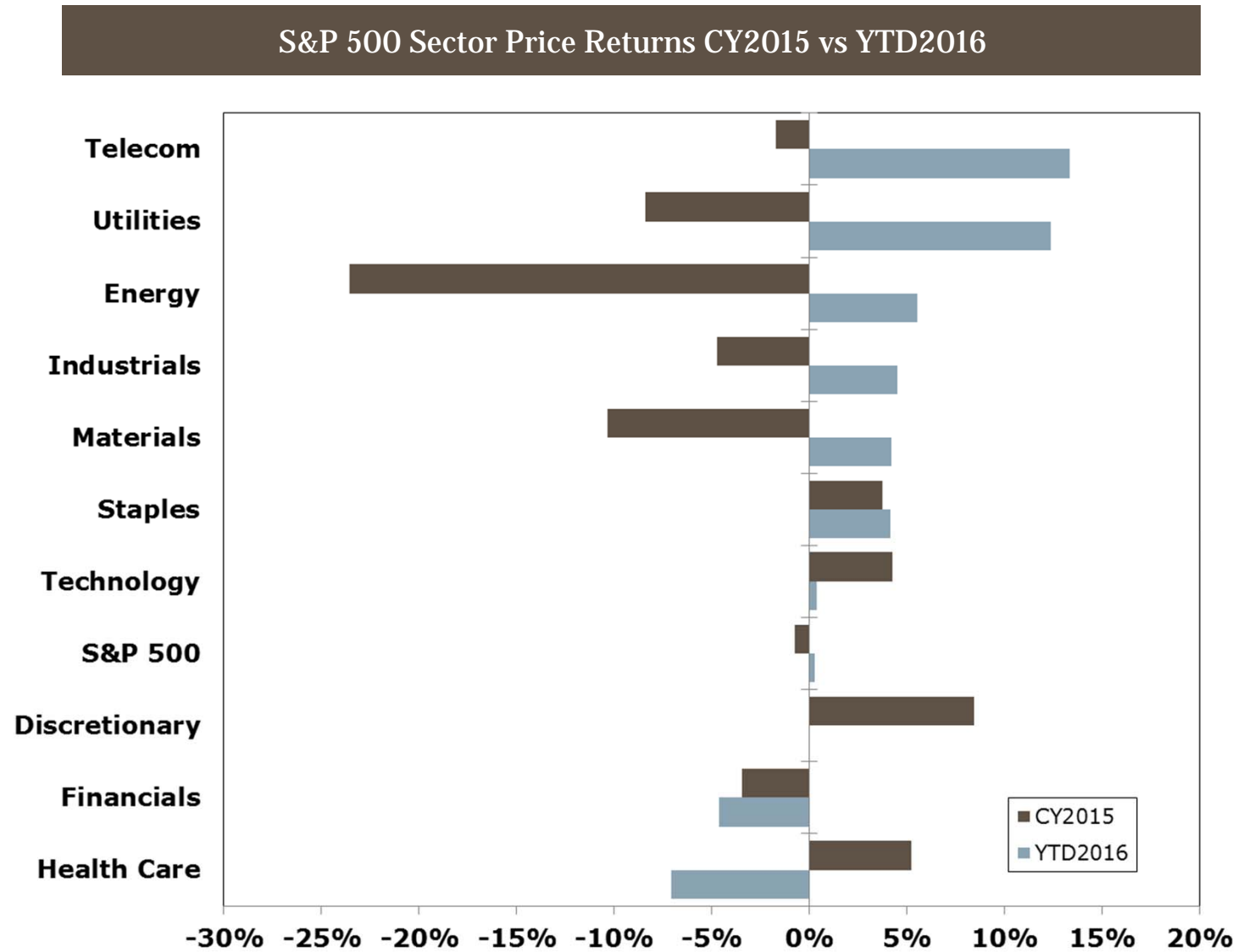
Rate-Sensitives May Become the Key Center of Volatility



Rate-Sensitives May Become the Key Center of Volatility (Cont'd)

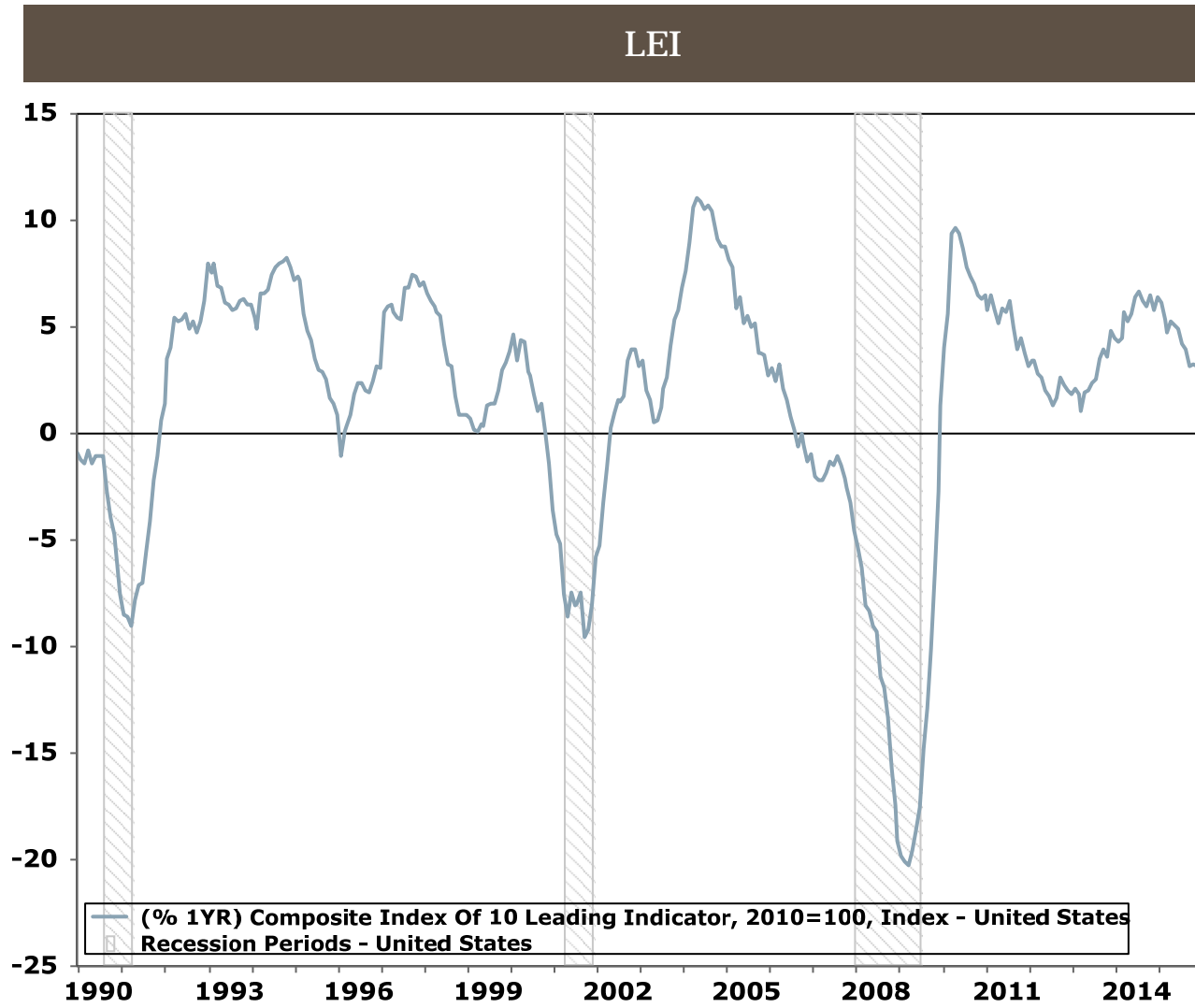


Rate-Sensitives May Become the Key Center of Volatility (Cont'd)



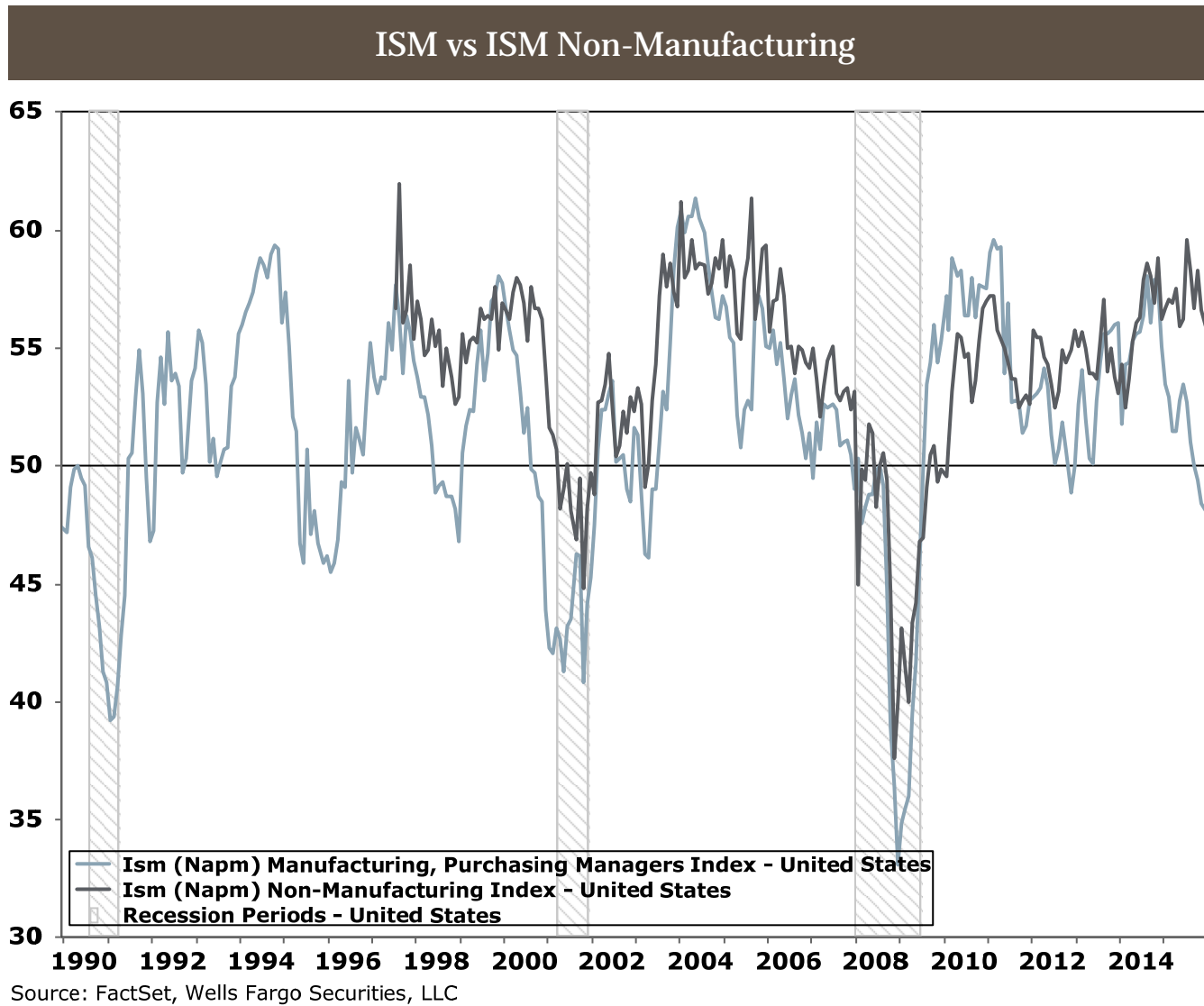
Source: FactSet, Wells Fargo Securities, LLC

Recession Risk is still Minimal in our View

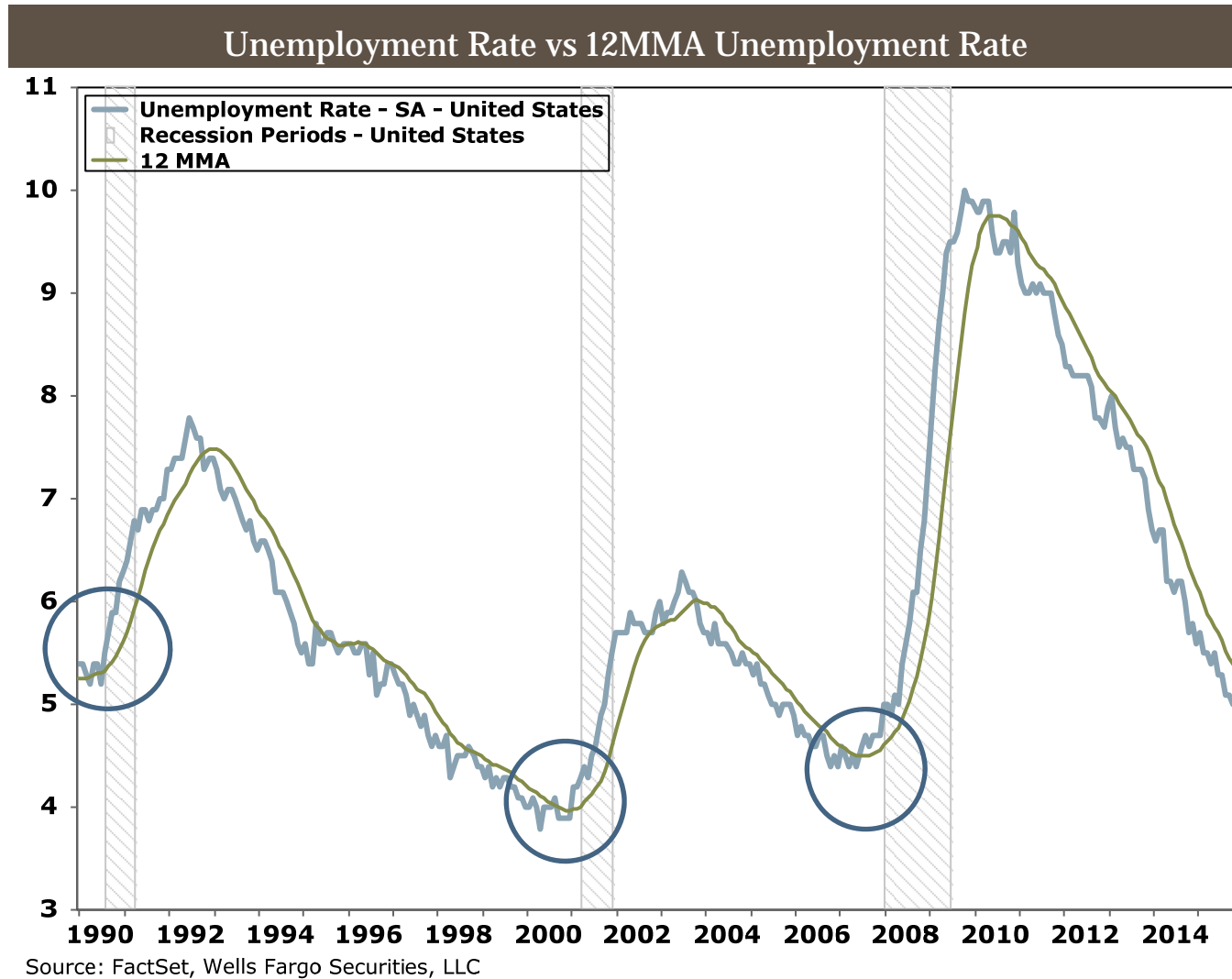


Source: FactSet, Wells Fargo Securities, LLC

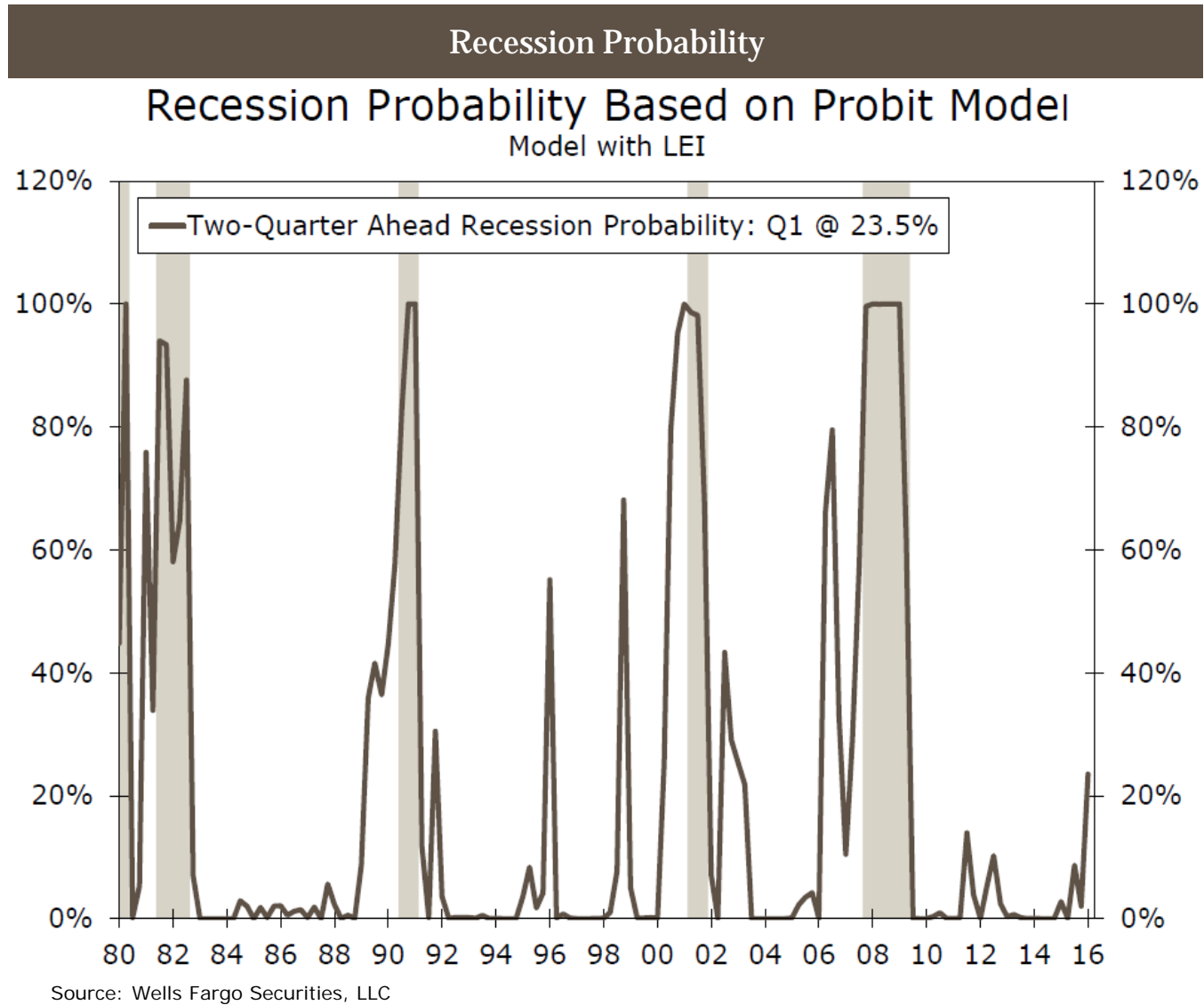
Recession Risk is still Minimal in our View (Cont'd)



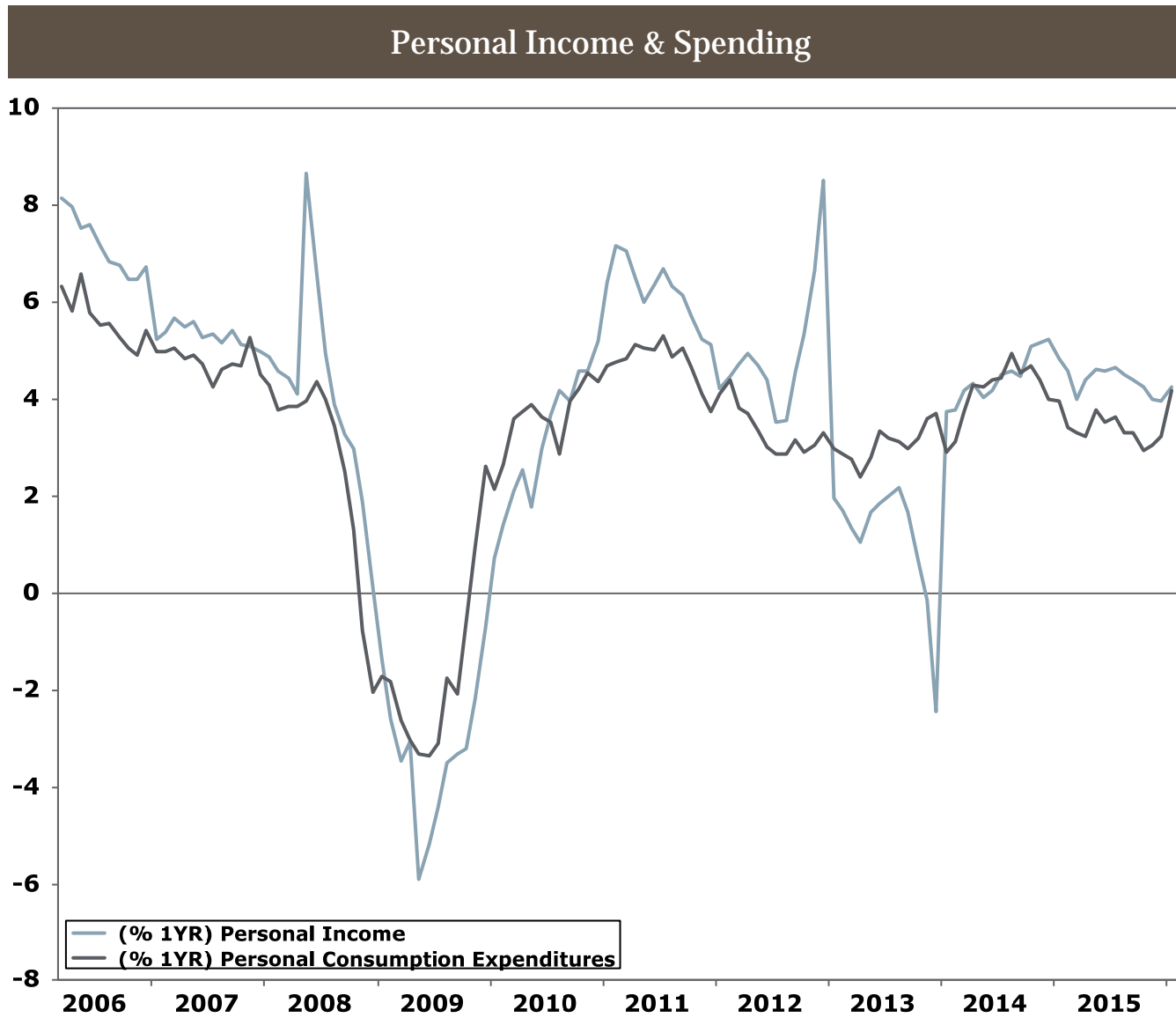
Recession Risk is still Minimal in our View (Cont'd)



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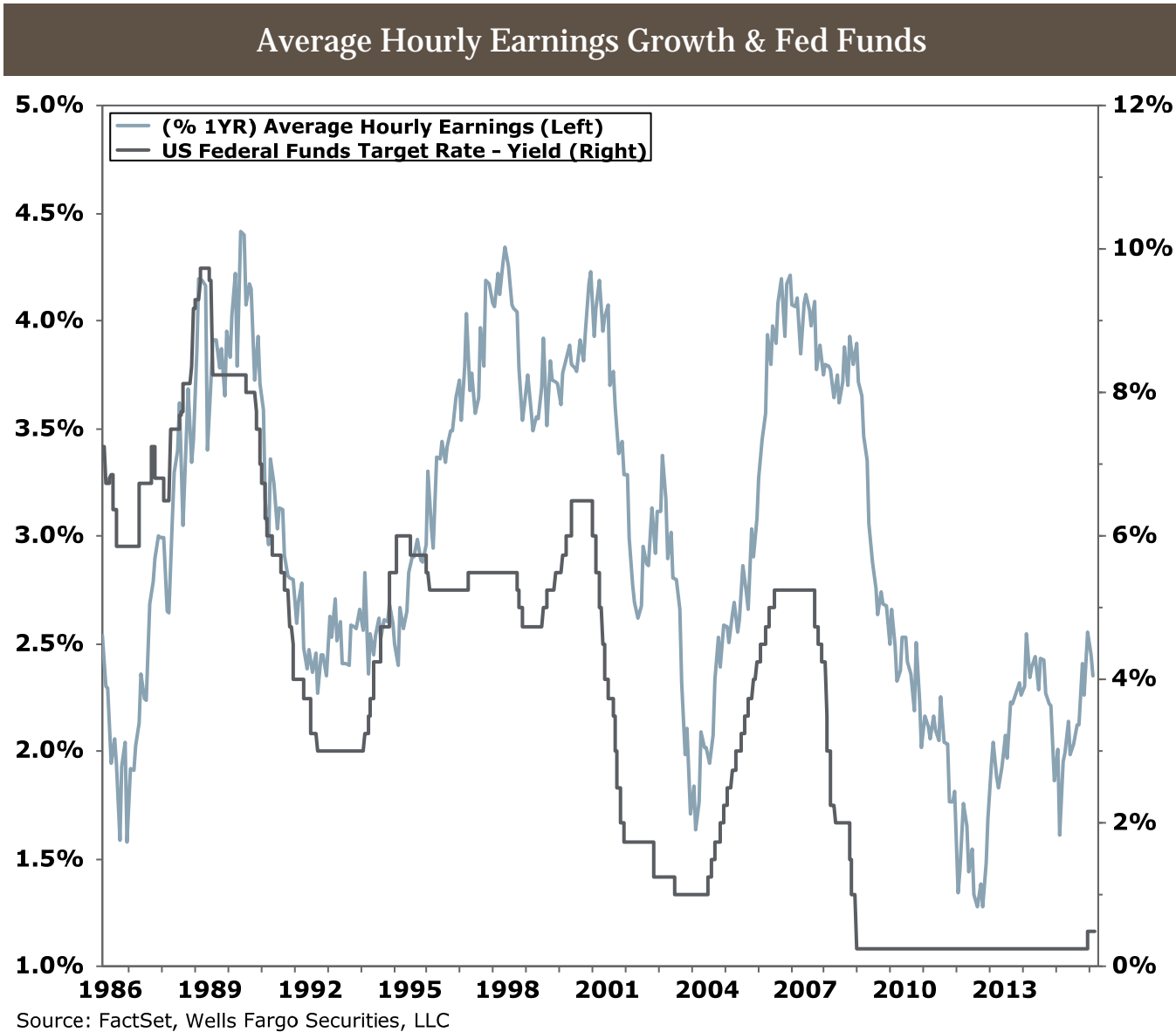


The Domestic Outlook: U.S. Consumer Retains Momentum

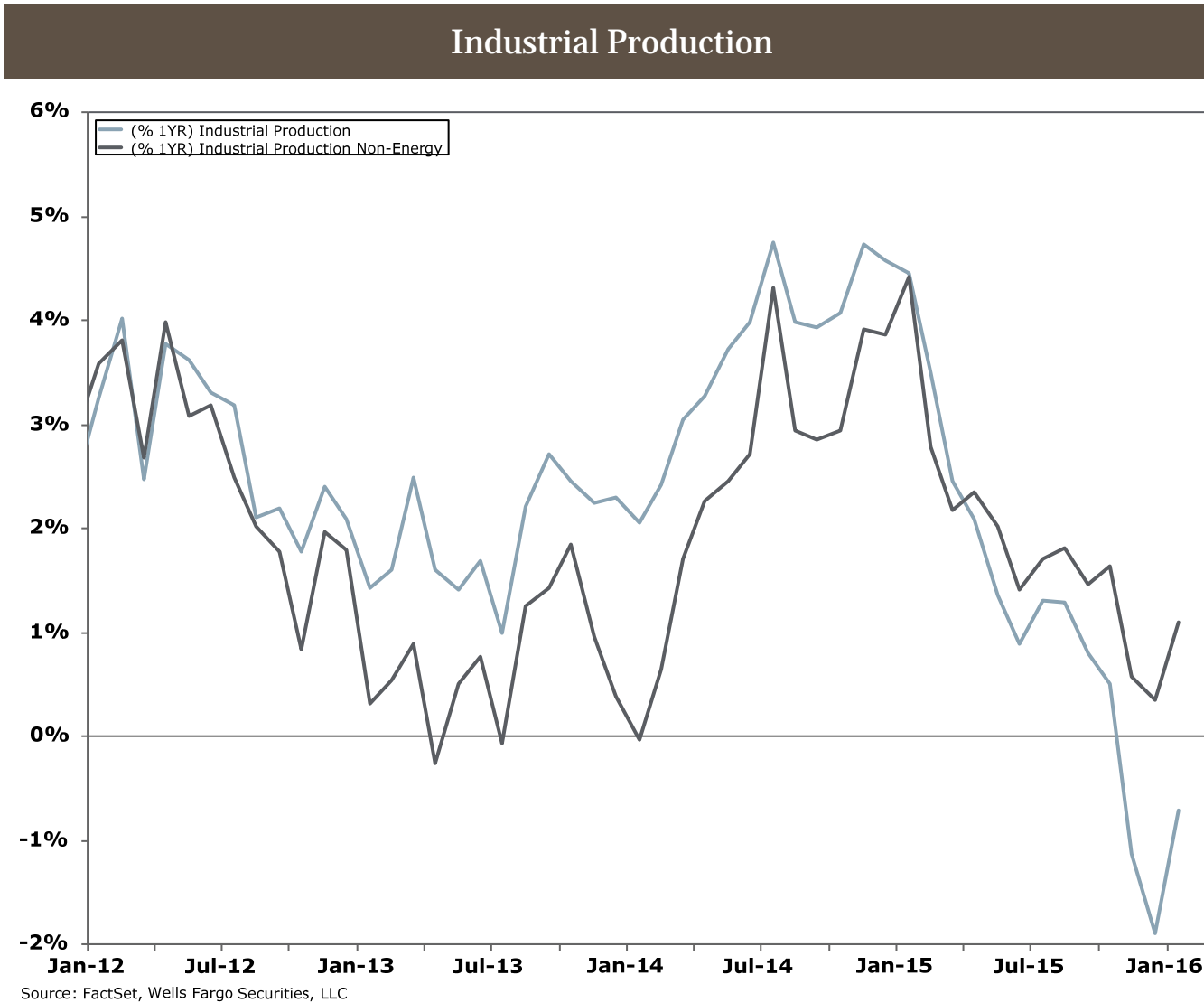


Source: FactSet, Wells Fargo Securities, LLC

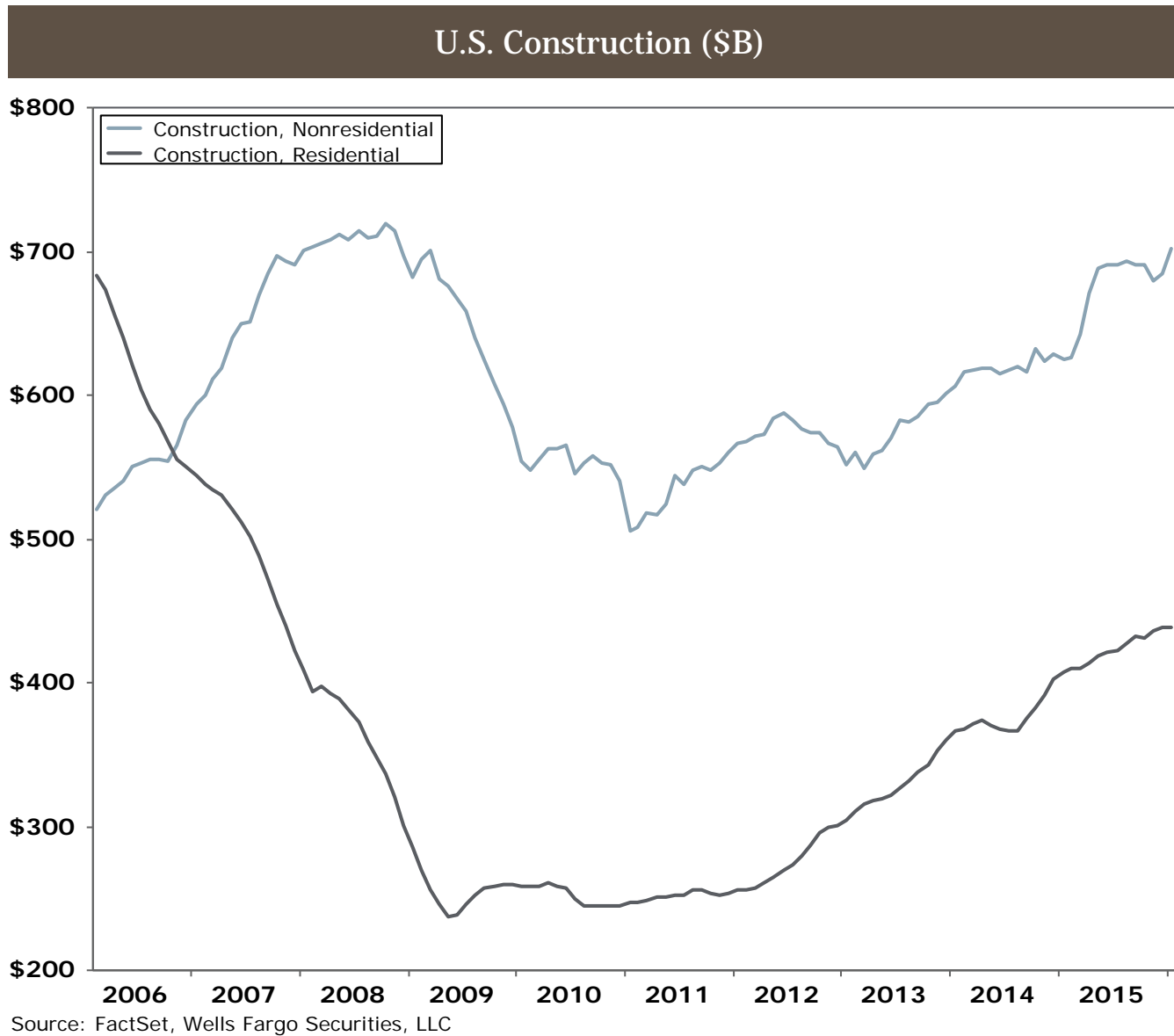
The Domestic Outlook: U.S. Consumer Retains Momentum (Cont'd)



Non-Consumer Economy: Tale of Two Worlds



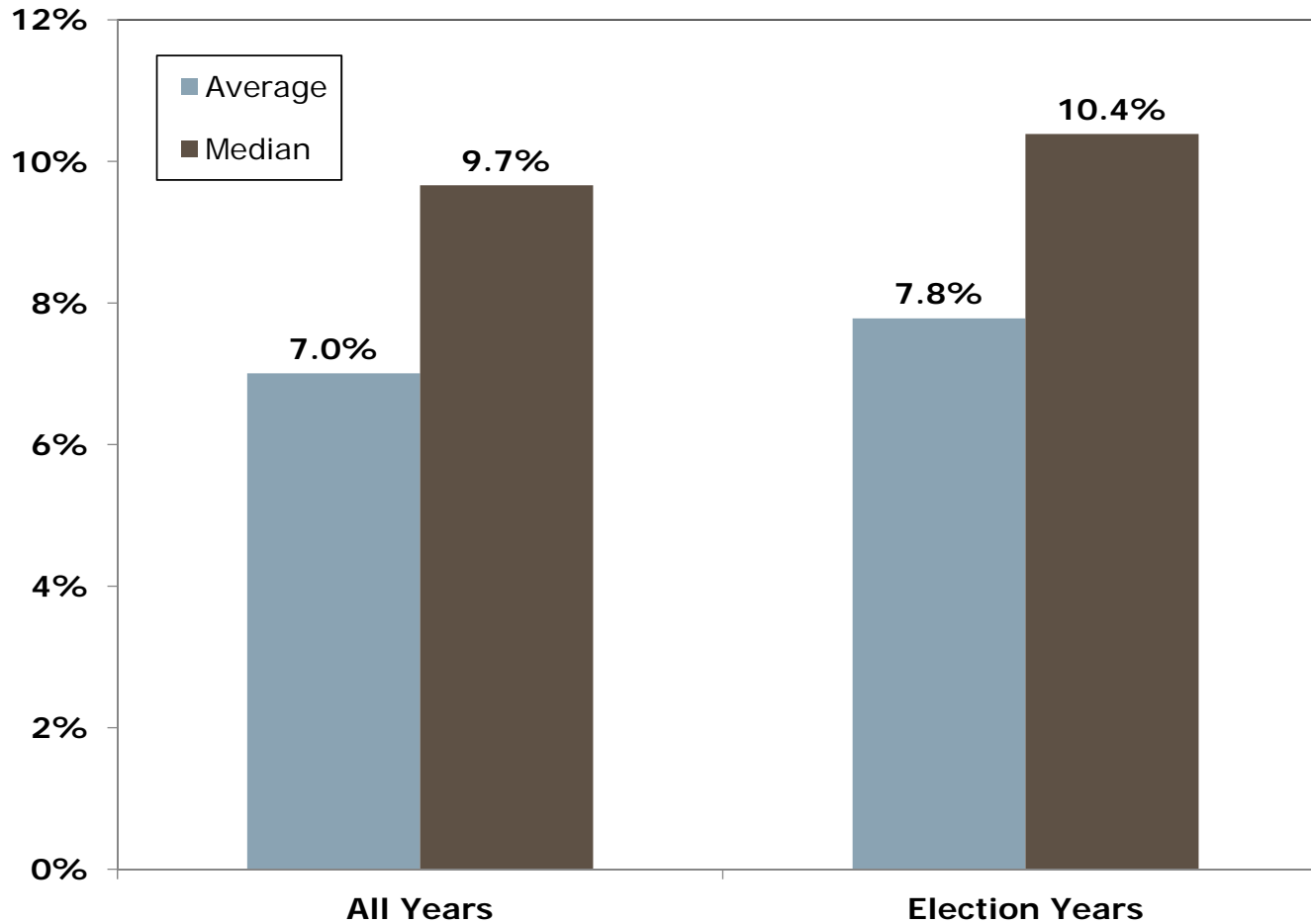
Non-Consumer Economy: Tale of Two Worlds (Cont'd)



The Election Year: New Uncertainty or Welcome Change?

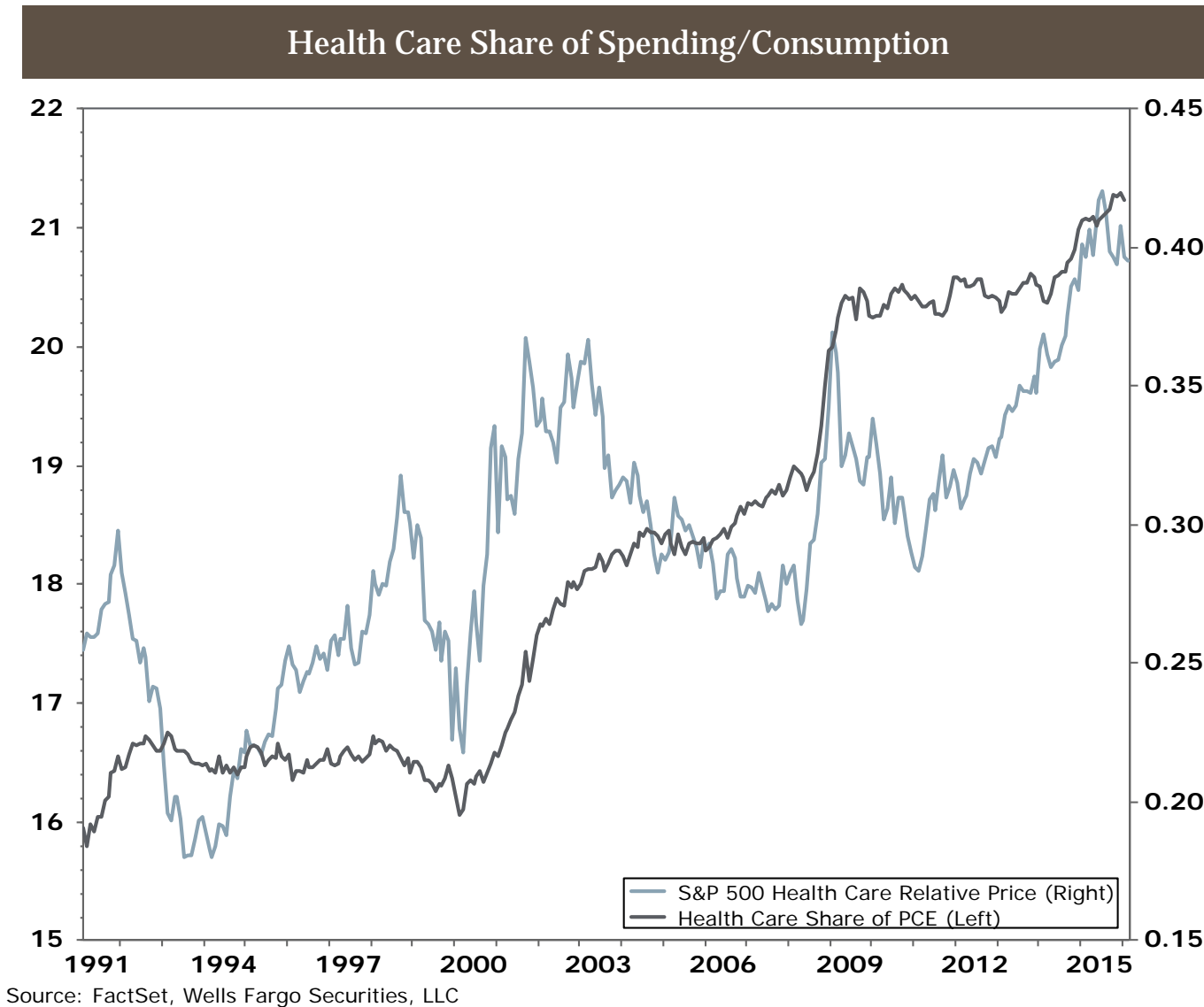
S&P 500 Presidential Election Year Performance, 1900 - Present

S&P 500 Presidential Election Year Performance, 1900 - Present



Source: FactSet, Wells Fargo Securities, LLC

The Election Year: New Uncertainty or Welcome Change? (Cont'd)



Our Technical View

Correction Within the Intermediate Term Bull

We believe the market is correcting within the scope of a longer term uptrend. We continue to point to a 1997-1998 style correction as more likely than a 2008-style bear market considering the genesis of the weakness is EM, commodities and currencies.

Longer Term Indicators Still Worrisome

That said, recovery back to former peak levels remains elusive for now, and is taking longer than usual. On average since 1950, it takes the index 220 days to fully recover non-recessionary losses of 10% or more and 863 days to recover recessionary losses of greater than 10%. By the end of February stocks had been trading below their peak for 270 days.

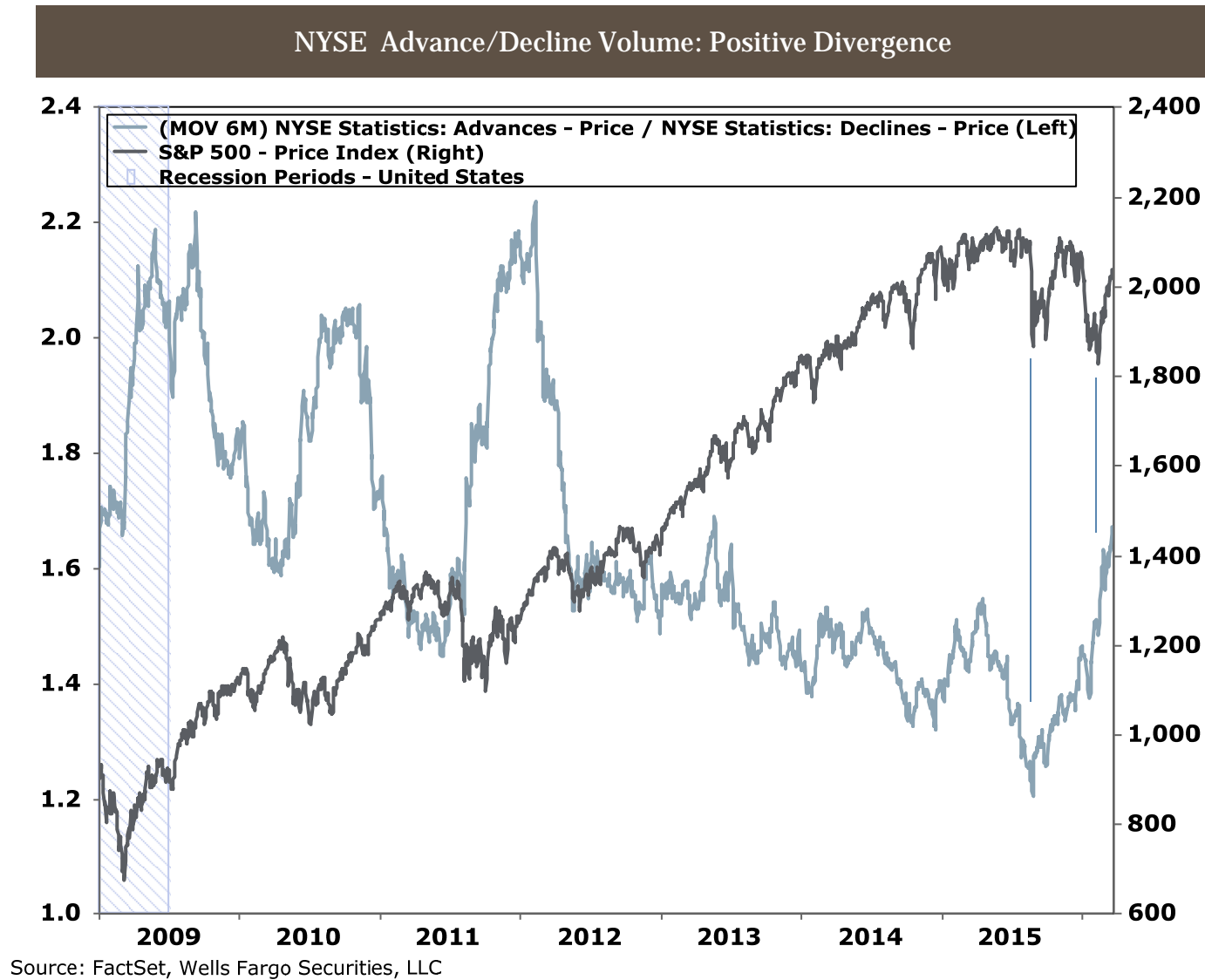
Intermarket Indicators Improving in Short Run

Until markets recover past former highs, we assume this to be another strong rally within the corrective trend. However, intermarket indicators are all confirming the near term rally in stocks. Corporate credit yields are recovering, commodity prices rallying, and smaller stocks participating in the recovery.

Sentiment and Flows are Supportive

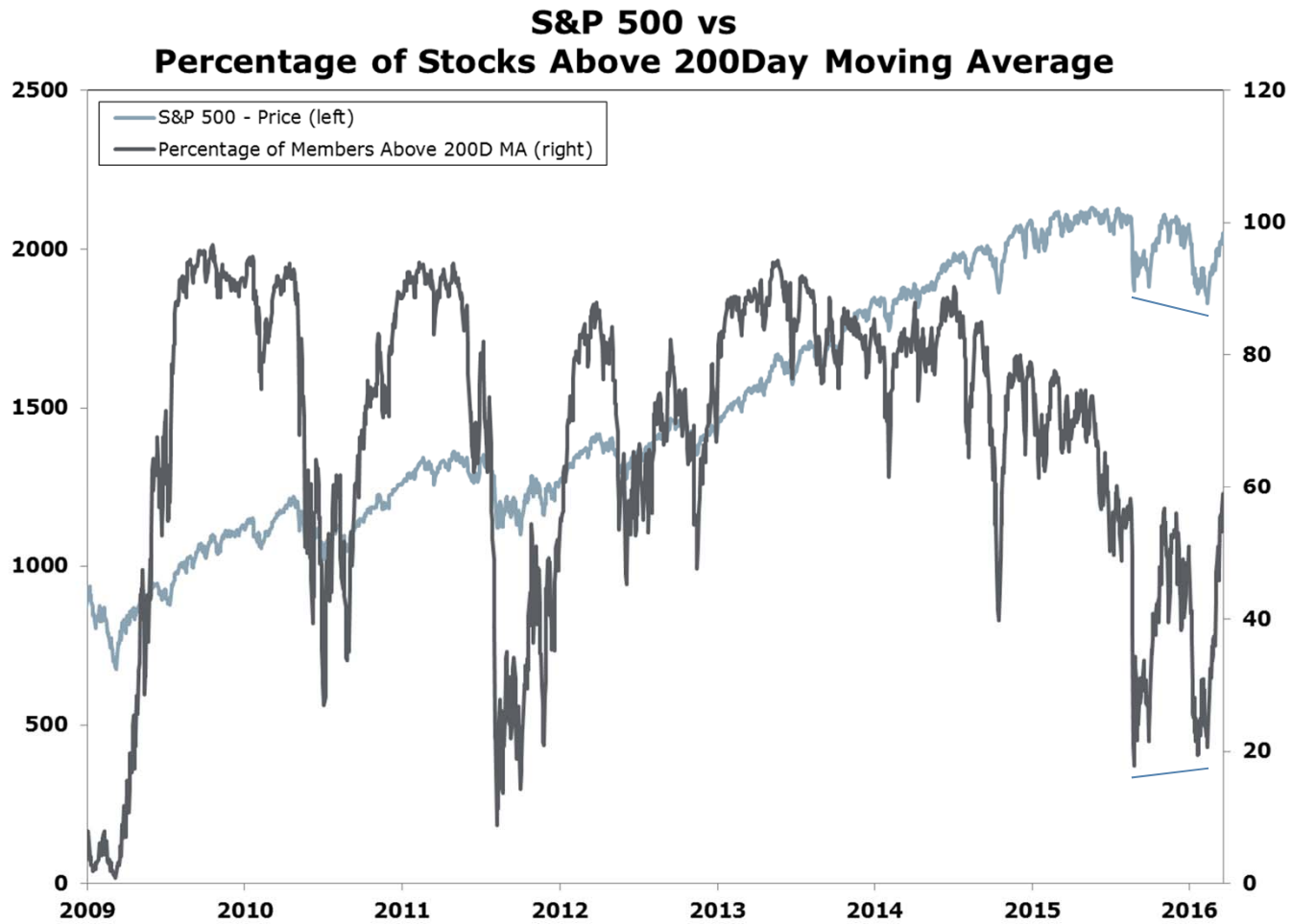
Sentiment is still rather bearish. Advisors are caving into the bear camp again, and there are more bears than bulls among individual investors, according to survey data. Equity outflows were \$32B last year and bond inflows were \$25.7B, the second consecutive year investors put more money to work in bonds than in stocks.

Equity Market Technicals (Cont'd)

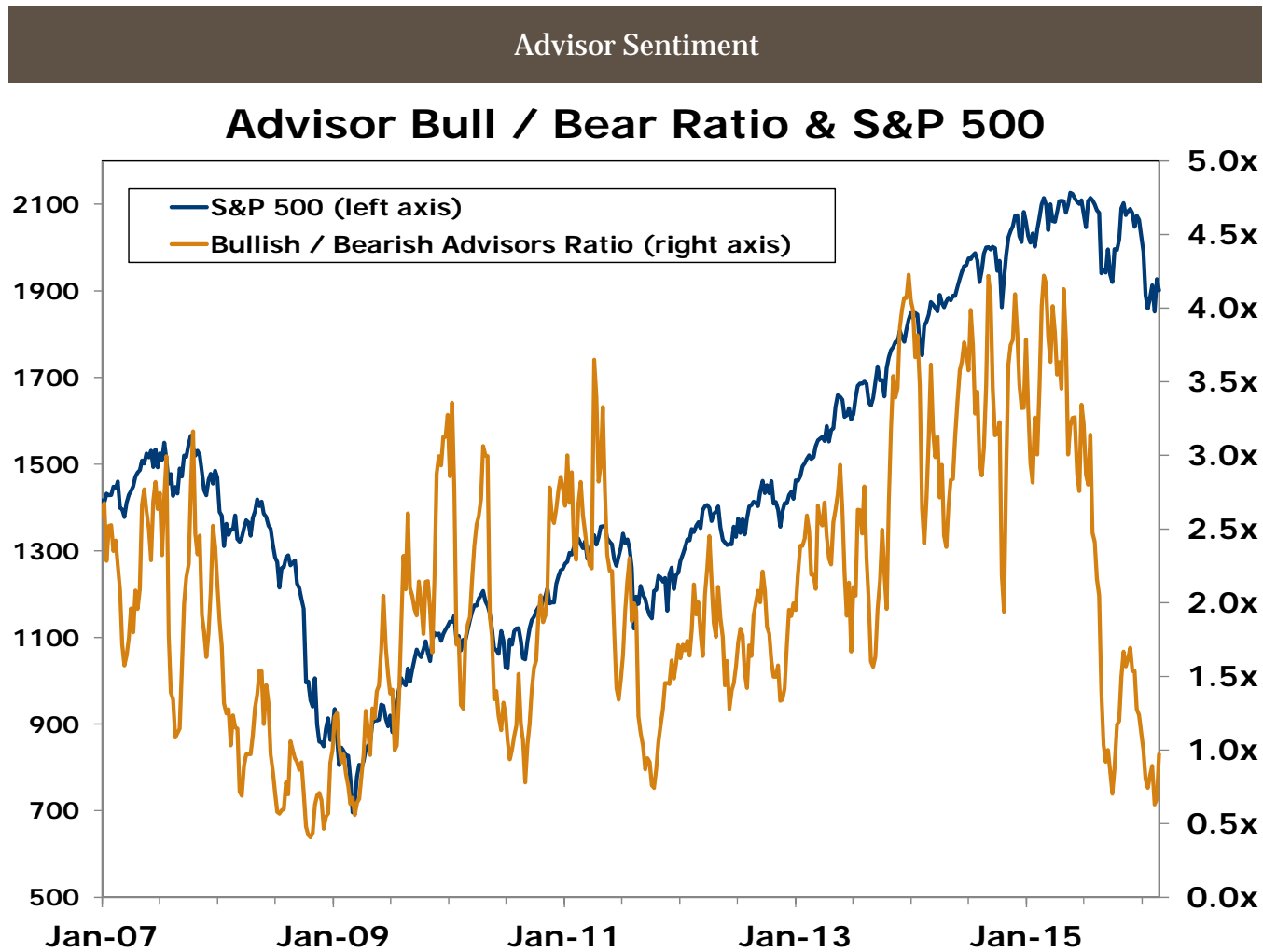


Equity Market Technicals (Cont'd)

S&P 500 Breadth: Positive Divergence



Equity Market Technicals (Cont'd)

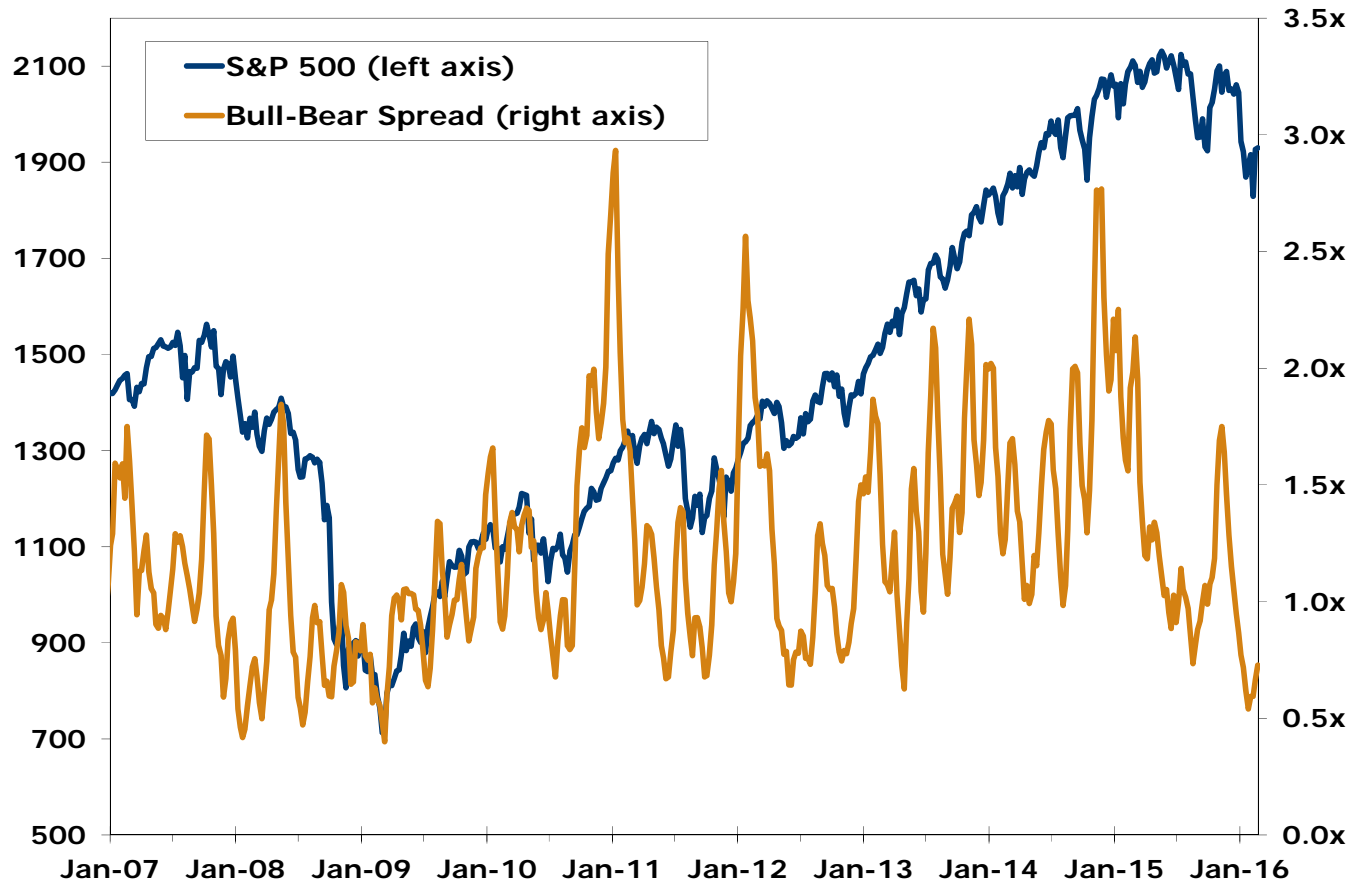


Source: courtesy of www.investorsintelligence.com, Wells Fargo Securities, LLC

Investors Sentiment

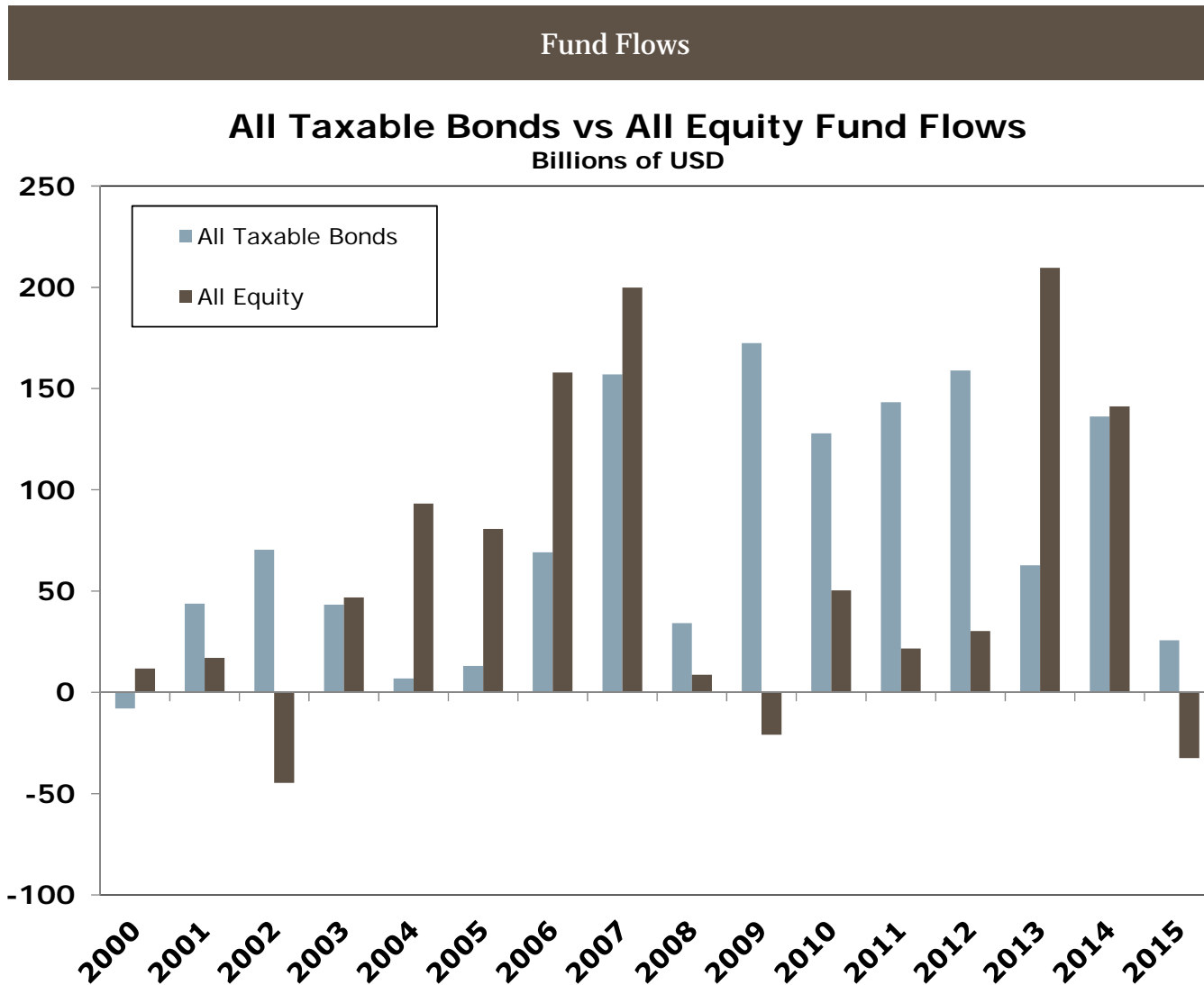
Investor Bull-Bear Ratio & S&P 500

% Bullish Investors / % of Bearish Investors, 4 week Moving Average



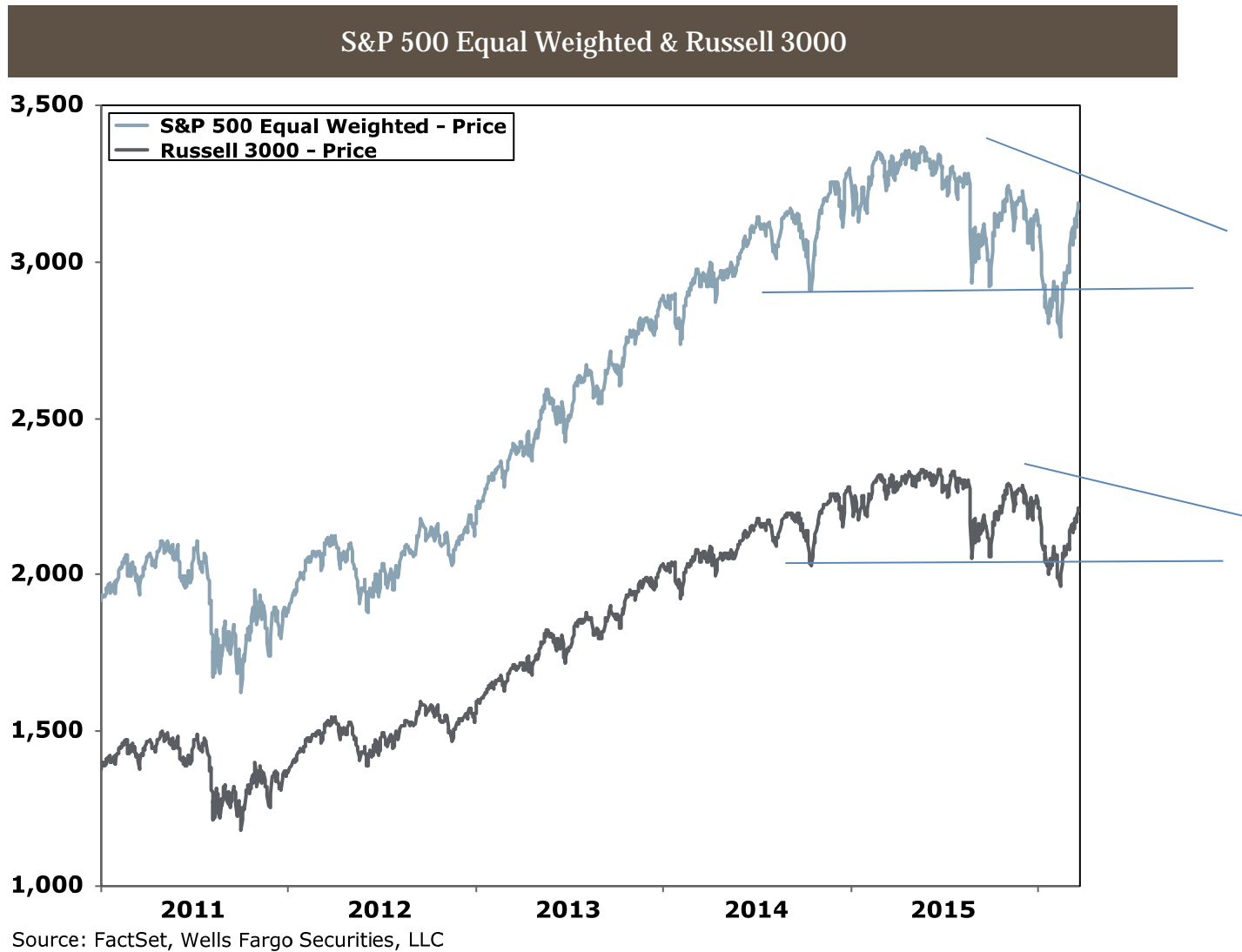
Source: AAI, Wells Fargo Securities, LLC

Equity Market Technicals (Cont'd)

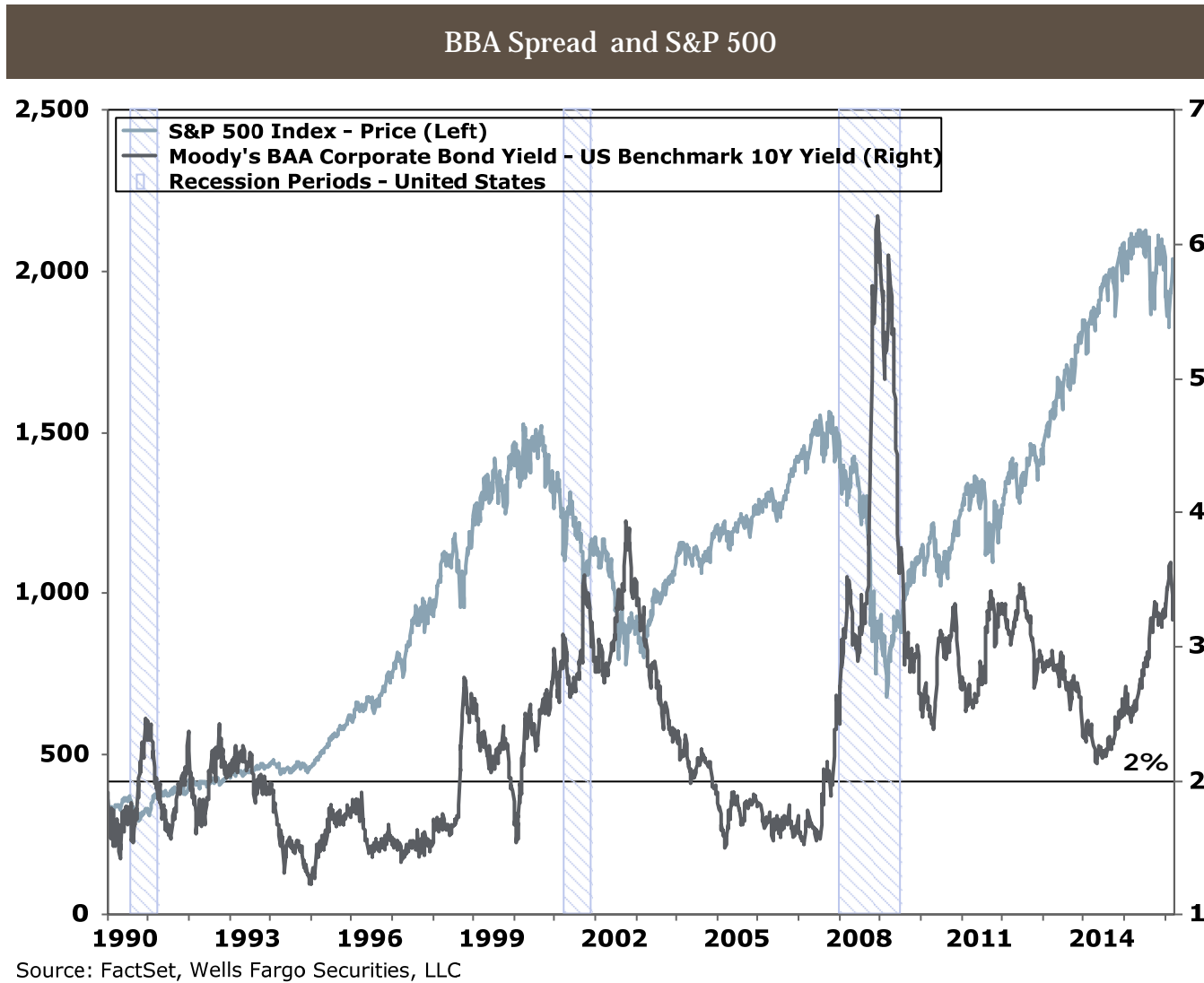


Source: Lipper, Inc. (www.lipperusfundflows.com), Wells Fargo Securities, LLC

Equity Market Technicals



Equity Market Technicals (Cont'd)



Our Fundamental View: Follow the Earnings Trend, Multiple is Likely Constrained By Fed

Earnings

S&P 500 EPS was flat in 2015 at \$117 and should grow 4% to \$121 in 2016E, in our view. The bottom-up consensus is also expecting \$121 in 2016E. We believe bottom-up consensus estimates appear relatively achievable for 2016, but much depends on oil and the dollar.

Leveraging Continues

Use of cash will likely continue to impact EPS growth and the ongoing leverage cycle should benefit shareholders over bondholders. We expect share count reduction of just over 2% in 2016, as share buybacks start to share the limelight with a growing M&A environment.

Biggest Risks

The biggest risk to our EPS model may be oil prices as oil and EPS are historically highly positively correlated. Ex-energy sector, we expect 6% EPS growth in 2016E. The yield curve also may present challenges. We assume the dollar will rise another 5% relative to trade-weighted currencies this year and the yield curve will continue to flatten, but not invert, over the next 12 months.

Valuation

Earnings form the basis for potential upside to stock prices, as valuations are unlikely to rise in the year ahead. The current PE on the S&P 500 remains a touch above historical average, not surprising in our view considering ample liquidity and low cost of capital.

Biggest Risks

First Fed funds rate hikes have historically been difficult for the equity market to absorb. We estimate each 25 bps move in the Fed funds rate should reduce the S&P 500 PE by 0.1X.

Earnings Forecast

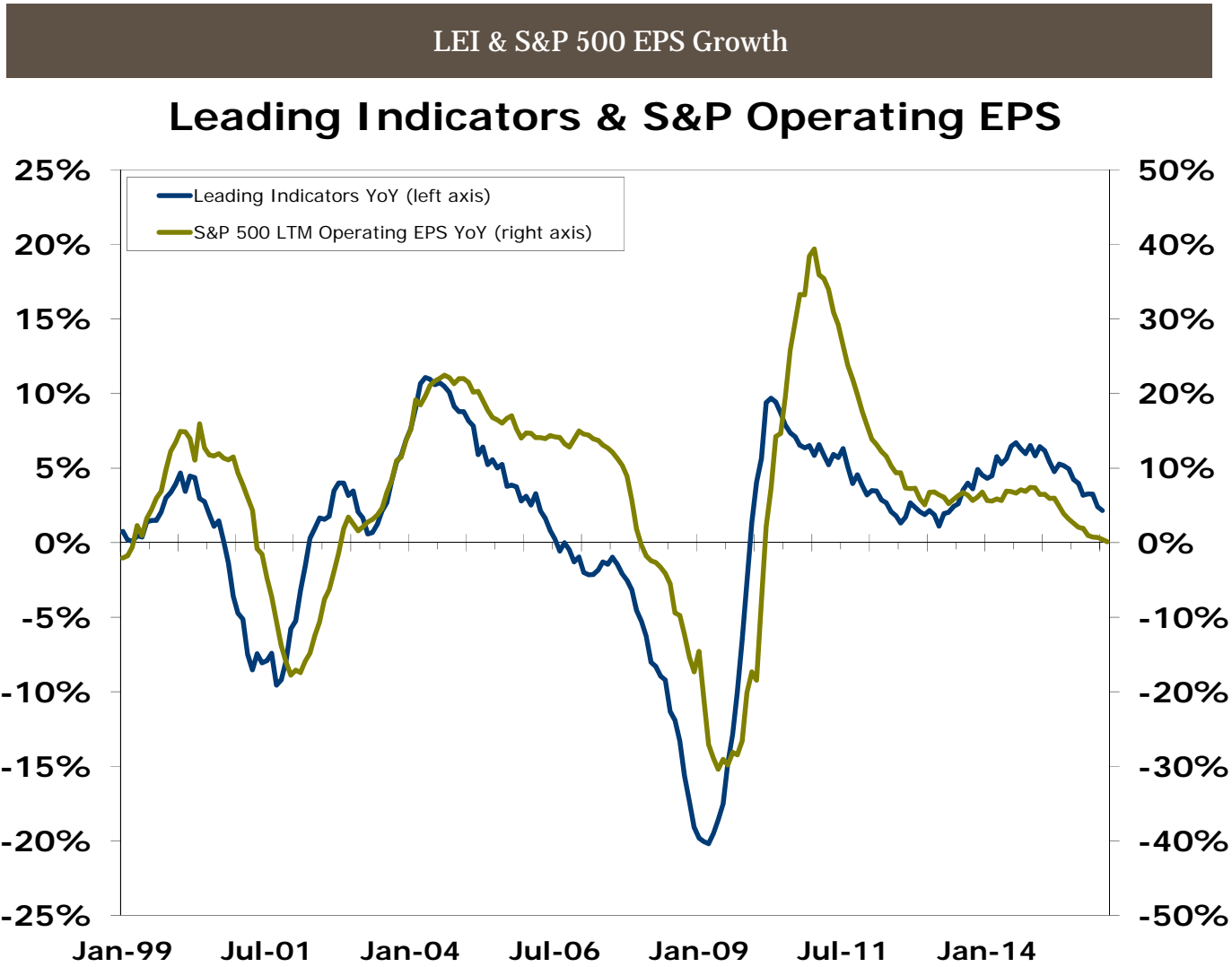
| S&P 500 EPS Estimate Growth | | | | | |
|-----------------------------|---------------------|--------------|--------------|------------------|--------------|
| Sector | Bottom-Up Consensus | | | Wells Fargo Ests | |
| | CY 2015 | CY 2016E | CY 2017E | CY 2016E | CY 2017E |
| Energy | -60% | -53% | 132% | -40% | 3% |
| Materials | -6% | -2% | 18% | -2% | 2% |
| Industrials | 2% | 4% | 10% | 3% | 4% |
| Discretionary | 13% | 12% | 13% | 15% | 8% |
| Staples | 0% | 3% | 10% | 5% | 5% |
| Health Care | 12% | 8% | 12% | 8% | 4% |
| Financials | 11% | 8% | 10% | 6% | 5% |
| Technology | 4% | 6% | 12% | 8% | 7% |
| Telecom | 22% | -6% | 5% | 0% | 3% |
| Utilities | 0% | 3% | 4% | 2% | 1% |
| S&P 500 | 0% | 4% | 13% | 4% | 5% |
| S&P 500 \$EPS | \$117 | \$121 | \$137 | \$121 | \$127 |

Source: First Call, FactSet, Wells Fargo Securities, LLC estimates

Earnings Forecast (Cont'd)

| EPS Sensitivity - Scenario Analysis | | | |
|-------------------------------------|----------------------|-----------------------|----------------|
| 2016 EPS Scenario Analysis | | | |
| LEI YoY | WTI Oil Avg Price | Implied EPS Growth | Implied EPS |
| 4.0% | \$50 | 10.6% | \$129 |
| 3.3% | \$45 | 7.6% | \$126 |
| 2.5% | \$38 | 3.7% | \$121 |
| 1.8% | \$30 | -0.2% | \$117 |
| 1.0% | \$25 | -3.2% | \$113 |

Source: FactSet, Wells Fargo Securities, LLC estimates

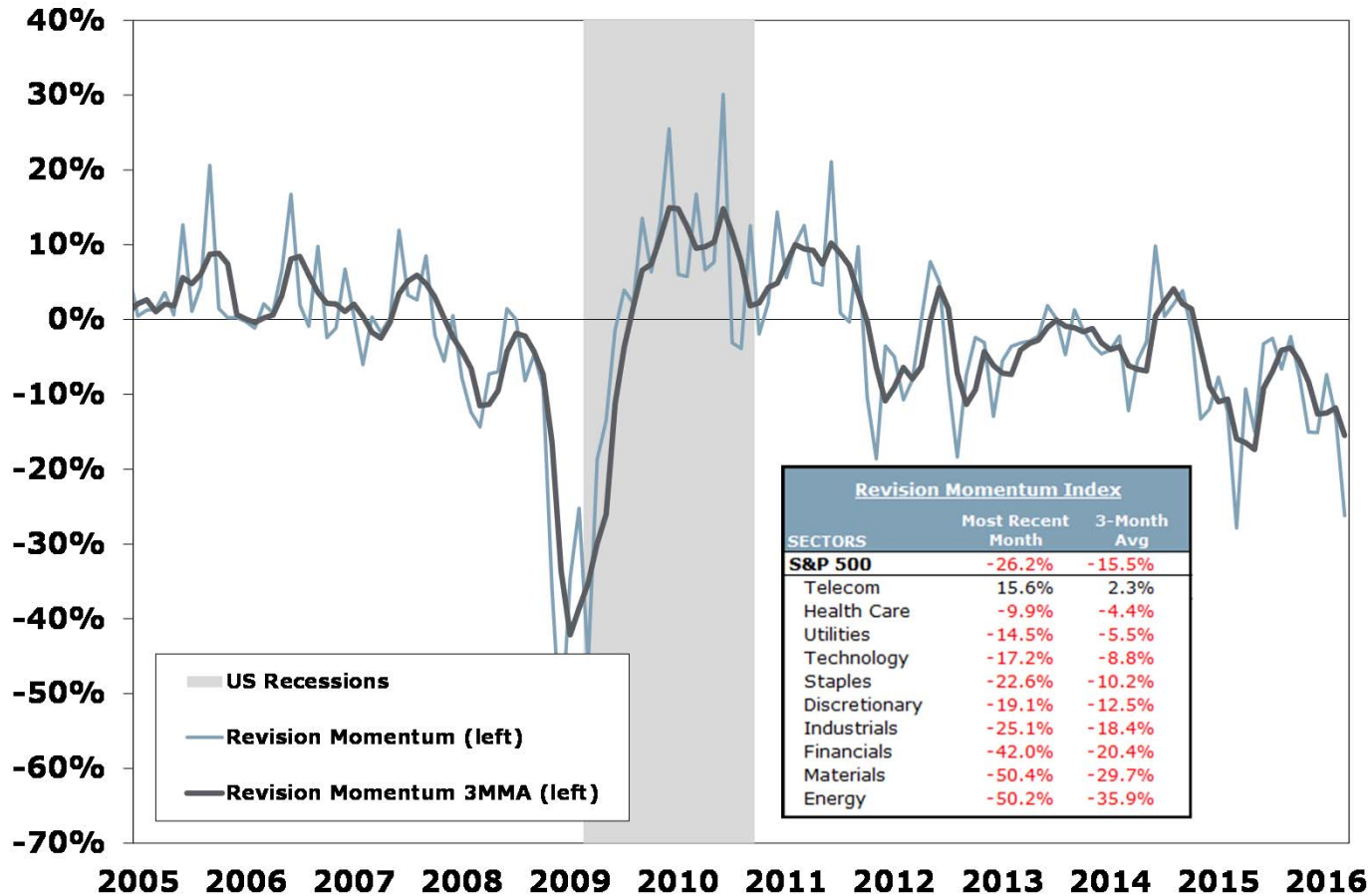


Source: IBES, First Call, FactSet, Wells Fargo Securities, LLC Estimates

S&P 500 Earnings Revision Momentum

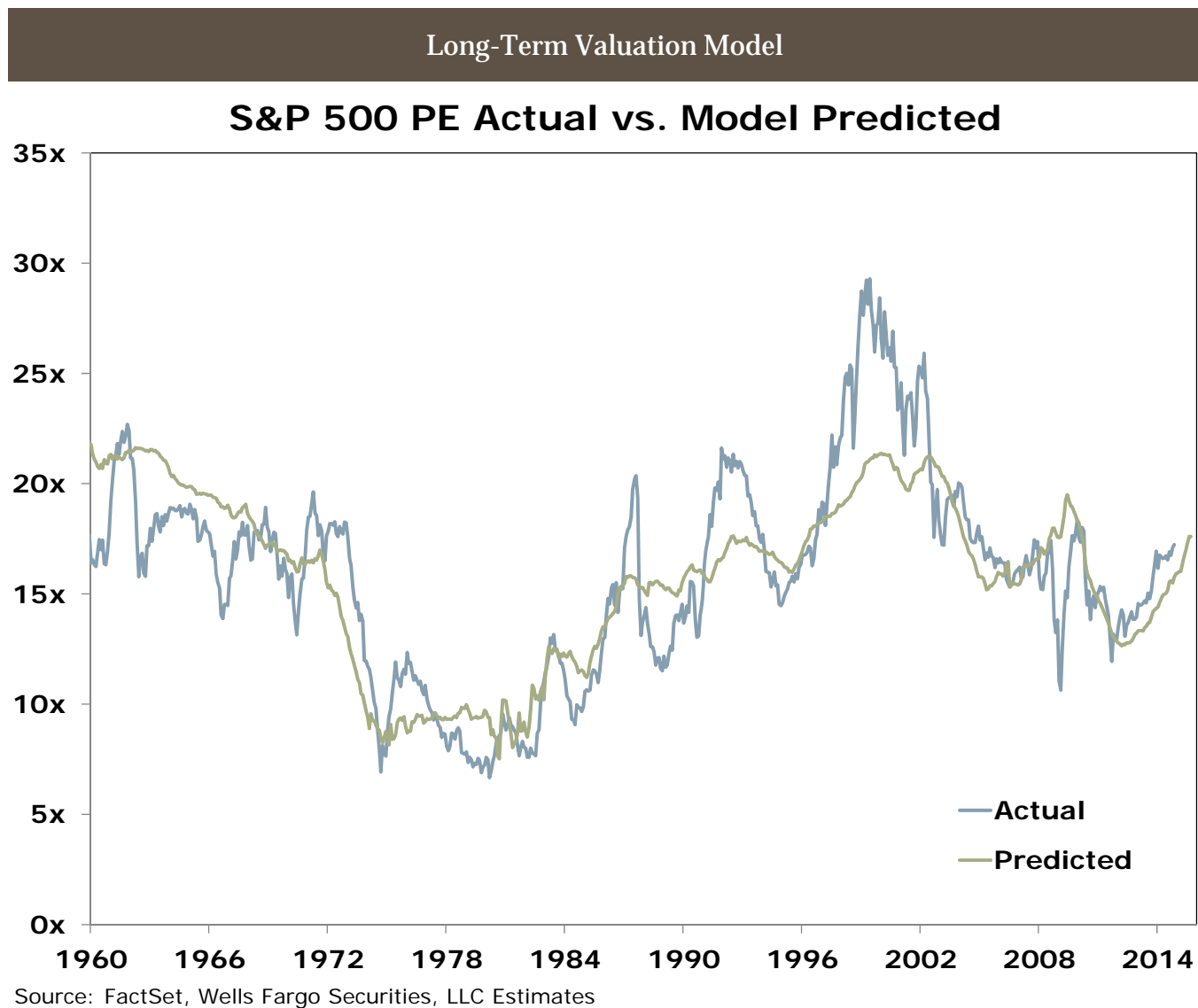
S&P 500 Earnings Revision Momentum

Number of Up Revisions less Down Revisions divided by Total Estimates

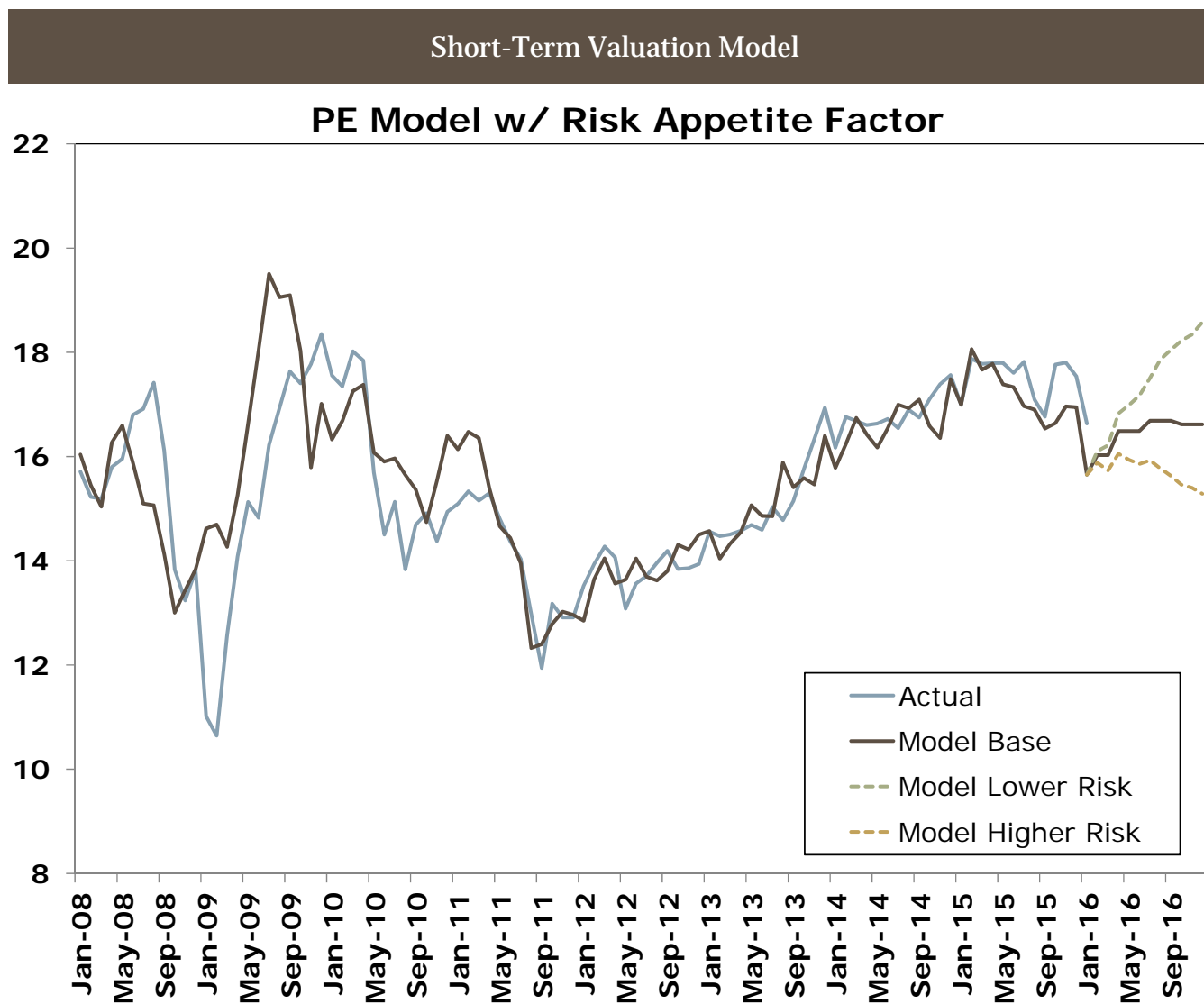


Source: IBES, FactSet, Wells Fargo Securities, LLC

Valuation & Fair Value Estimate



Valuation & Fair Value Estimate (Cont'd)



Source: FactSet, Wells Fargo Securities, LLC

Style, Sector and Industry Recommendations

| Sector & Industry Recommendations | | | | |
|-----------------------------------|---------------|--|--|---|
| | | Industry Rating (Relative to Sector) | | |
| SECTOR | | Overweight | Market Weight | Underweight |
| OVERWEIGHT | Technology | Internet Software & Services Software | IT Services Semiconductors & Equipment Hardware, Storage, and Peripherals | Communications Equipment Electronic Equipment |
| | Discretionary | Consumer Services | Retailing Media Household Durables | Leisure Equipment & Products Autos & Components Textile, Apparel & Luxury Goods |
| | Telecom | | Integrated Telecom Alternative Carriers | |
| MARKET WEIGHT | Industrials | Aerospace & Defense Commercial Services & Supplies Building Products | Industrial Conglomerates Transportation Electrical Equipment | Construction & Engineering Machinery |
| | Staples | Tobacco | Food & Staples Retailing Beverages Food Products | Household Products Personal Products |
| | Energy | | Oil, Gas & Fuels Energy Equipment & Services | |
| | Health Care | Equipment & Supplies Health Care Technology | Providers & Services Life Science Tools & Services | Biotechnology Pharmaceuticals |
| UNDERWEIGHT | Materials | Construction Materials | Chemicals Containers & Packaging | Metals & Mining |
| | Utilities | | Electric Utilities Gas Utilities Multi-Utilities Independent Power & Renewables | |
| | Financials | Insurance | Real Estate Banks Diversified Financial Services | Capital Markets Consumer Finance |

Source: FactSet, Wells Fargo Securities, LLC

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2=Market Perform: The stock appears appropriately valued, and we believe the stock's total return will be in line with the market over the next 12 months. HOLD

3=Underperform: The stock appears overvalued, and we believe the stock's total return will be below the market over the next 12 months. SELL

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O=Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

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U=Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

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As of: March 21, 2016

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