US Equity and Derivatives Strategy
US Equities: Uncertainty 101

Equity Strategy

Americas

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Higher Volatility is a Multi-Year Reality

The US equity market's volatile reaction to the surprise outcome of the 6/23 UK Referendum reinforces the idea that the China FX devaluation in August 2015 began a cyclically higher volatility regime (see 8/26/15, US Equities: Game Over?) which typically lasts 3 – 5 years (Figure 1). Such elevated uncertainty, contrary to common wisdom, need not signal a discrete end to the Bull market, and has been a regular occurrence in the "late innings" of extended rallies. Whether politically inspired events (Debt Ceiling, 2011, Eurozone "Whatever it Takes" 2012, China FX Deval 2015) or "confidence crises" (2010 "soft patch", 2014 "health scare selloff", 2016 "Recession that Wasn't") each volatile selloff along the way, averaging a decline of 12.7% and taking an average of 132 days to regain the high price from the decline's start, has proven to be a buying opportunity. Absent a US recession, which Chief US Economist Maury Harris does not believe is likely in 2016 or 2017, we view the structural bull market as being intact.

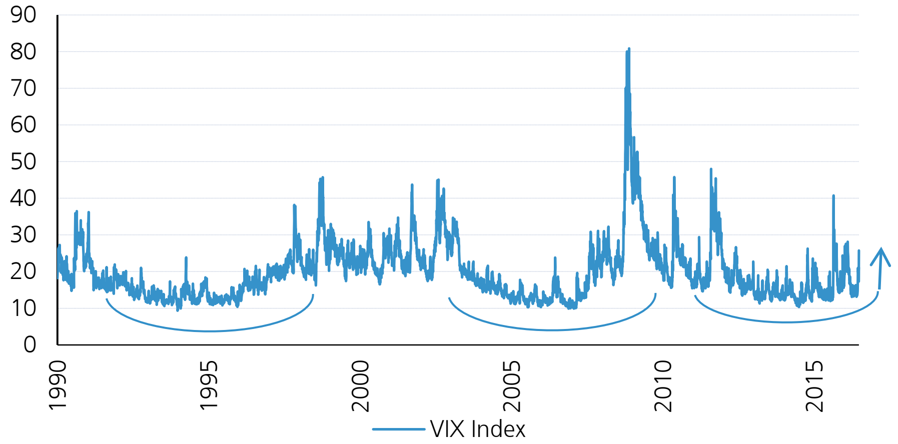
Selectivity is Key – Higher Quality Affords an Edge

In a world of higher volatility where growth is forecast to remain moderate, interest rates are eventually expected to continue rising, and valuation looks stretched in both cyclical and defensive areas, we believe stock selection is critical. Quality, defined as companies whose operating metrics (i.e. Profitability, Financial Health, Efficiency) are both high and rising and which have underperformed in the quarter leading up to the UK vote, look to prospectively outperform in Q3. Along with our Quant Team and with input from UBS' North American fundamental research analysts, we screen for such Buy rated names. The full list of "UK Leave Bouncers" stocks is available on p. 5.

Option Dislocation, Option Opportunity?

The "fear" of market dislocation as measured by historically high option skew (downside puts more expensive than upside calls) has not subsided since the 6/23 vote. Given a relationship as extreme as that seen at the depth of the 2007-09 bear market, investors could look to gain exposure to US equities by going long an S&P 500 December 2,075c/1,800p risk reversal. Details on p 5-6.

Figure 1: 25 Years -Smooth Sailing Followed by Intense Storms

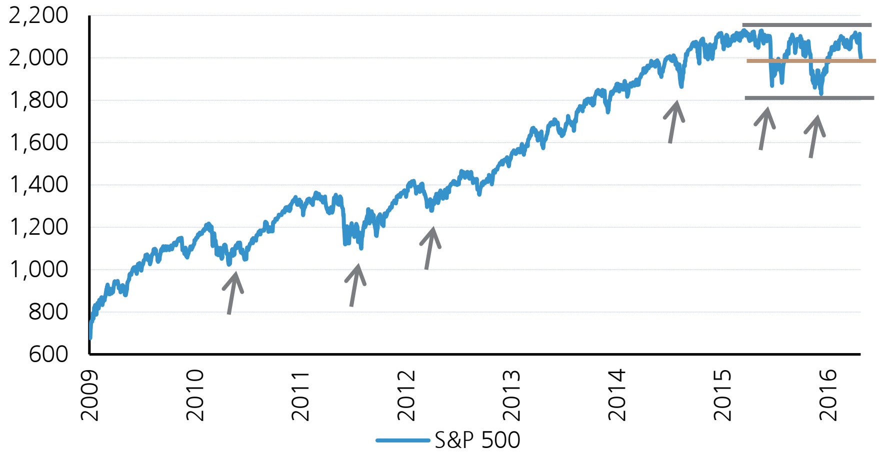


Source: Bloomberg, UBS

Higher Volatility is a Multi-Year Reality

Given the numerous market uncertainties (Politics both US and Global, China, Fed policy, Growth and Earnings sustainability, now renewed European political instability), particularly within the past two years' frustrating range (Figure 2) it is hardly surprising that the equity market has, in our view, shifted to a cyclically higher volatility regime (Figure 1, p.1).

Figure 2: Setbacks along the S&P 500 Bull Run



Source: Bloomberg, UBS

All the selloffs along the way since 2009 – averaging a decline of 12.7% and lasting an average of 132 days to regain the high price from the decline's start (Figure 3) - have proven to be buying opportunities.

Figure 3: Major Bull Market Drawdown Events

	Start Date	End Date	% Drop	Peak to Trough (Calendar Days)	Days to exceed correction from High (trading Days)
"Soft Patch"	4/23/2010	7/2/2010	-16.0%	70	154
Debt Ceiling	4/29/2011	10/3/2011	-19.4%	157	205
"Whatever it Takes"	4/2/2012	5/18/2012	-8.7%	46	108
"Health Scare"	9/18/2014	10/16/2014	-7.4%	28	30
China FX Devaluation	8/17/2015	8/25/2015	-11.2%	8	77
"Recession that Wasn't"	11/3/2015	2/11/2016	-13.3%	100	218
UK "Leave"	6/8/2016	?	-5.6%	?	
	Average	(ex – Leave):	-12.7%	68	132

Source: Bloomberg, UBS

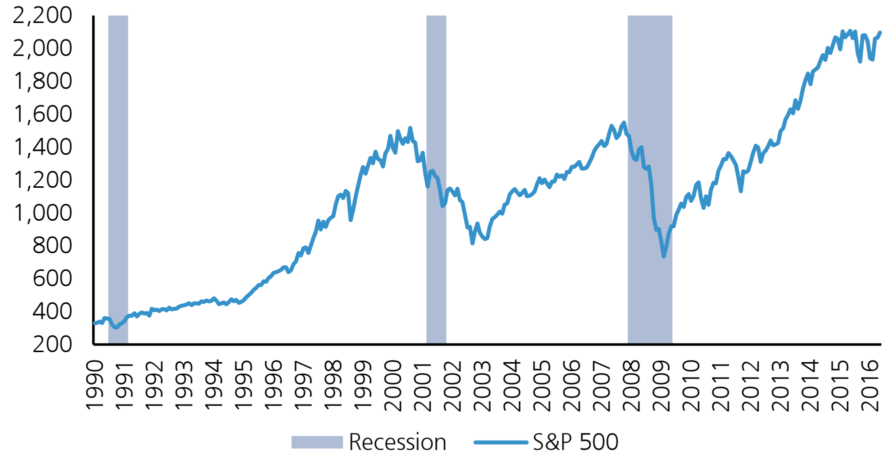
Why do we believe that despite the heightened risk that "It is not different this time?" – that new all-time highs lie ahead for the S&P 500?

In our 6/24 note It's 'Leave' – what it means for the US we cite the historical precedent of every Fed rate hike cycle since 1977 being followed by a new high –

with an average gain of 33.2% and an average time to the market peak of 25 months after the Fed's first hike. In the current cycle, 6+ months post the 12/16/15 hike, the S&P 500 has yet to attain a new high.

As well, no bull market top of the past 25 years has been struck without a recession beginning within 12 months of the market peak (Figure 4); with Q2 growth tracking above 2% and Chief US Economist Maury Harris seeing only a small probability of recession in the remainder of 2016 (GDP forecast to grow 2%+) and 2017 (Growth forecast 2.5%) the May 2015 S&P 500 peak is yet again unlikely to be "The Top".

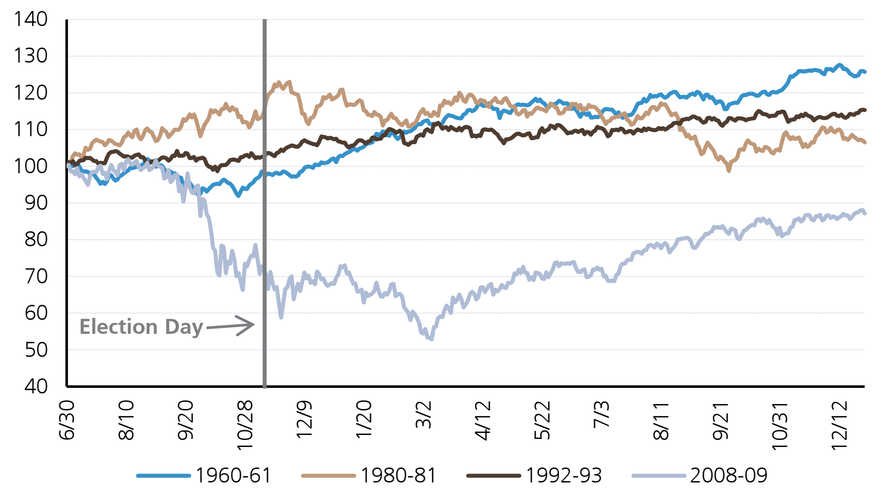
Figure 4: Only Recessions Kill the Bull



Source: Bloomberg, UBS

So although the combination of escalating political concerns in the UK and continental Europe will combine with the well telegraphed record of high volatility in prior US "change election" years similar to 2016's such as 1960, 1980, 1992 and 2008 (Figure 5), the post GFC rally, supported by a dividend yield over 80bp higher than the 10 year bond yield of 1.45% and earnings still on track to grow 5.9% in 2017 (UBSe $126), appears in our view to have further to run.

Figure 5: Election Year S&P 500 Returns (Based at 100 on 6/30 before election)



Source: Bloomberg, UBS

Selectivity is Key – Higher Quality Affords a Margin of Safety

In our 11/10/15 "US Outlook 2016: Into the Late Innings" report, we noted the need for greater selectivity as the Bull Market enters "the Late Innings". As the Bull ages, selectivity is critical as not all stocks typically participate in the late stages of the rally, which we believe began at the February 11, 2016 low. In our view, this dynamic is no different post last week's 'Leave' vote.

In a rising rate, rising volatility and slow growth environment, where downside risk is increasingly in focus and both cyclical and defensive names look expensive (Figure 6) we look for high quality names that our analysts believe have been unfairly punished since the end of Q1.

Figure 6: Valuation "Heatmap" - Forward PE

	S&P 500	Tech	HealthCare	Industrials	Cons Disc	Cons Staples	Financials*	Energy	Utilities	Telecom	Materials
1990	11.3	10.7	15.1	11.2	11.0	13.3	1.4	13.4	10.4	12.7	9.2
1991	13.6	12.4	17.9	12.9	16.5	15.3	1.5	13.4	11.1	13.1	13.3
1992	14.3	13.8	16.8	13.2	17.2	16.1	1.6	15.9	12.0	13.6	14.9
1993	14.6	16.8	13.5	14.5	16.0	14.8	1.8	16.7	13.7	16.1	16.3
1994	13.1	15.1	13.7	13.7	12.7	14.4	1.6	16.5	11.2	14.7	15.7
1995	13.2	14.4	16.7	13.8	12.2	16.0	1.8	15.7	11.8	14.7	10.2
1996	15.0	16.5	19.3	16.1	14.2	18.2	2.0	16.4	12.2	14.6	13.7
1997	17.5	20.5	23.0	18.1	15.0	21.5	2.7	18.3	12.4	16.7	16.0
1998	20.6	26.9	29.2	19.2	19.7	23.9	3.1	20.4	15.1	20.8	16.6
1999	23.3	37.6	28.7	21.7	22.8	22.6	3.4	26.0	14.6	23.5	18.4
2000	22.1	39.1	27.8	21.4	20.2	18.5	3.5	18.9	15.2	18.8	11.5
2001	20.2	31.8	25.7	20.3	23.2	19.3	3.0	15.9	13.8	19.3	17.2
2002	17.5	27.0	20.6	17.1	20.9	17.8	2.5	18.4	10.6	14.4	18.1
2003	16.5	25.3	18.0	17.2	19.1	17.1	2.1	15.4	12.1	14.1	18.0
2004	16.5	22.5	17.6	18.2	18.4	18.1	2.2	14.9	13.8	17.0	15.3
2005	15.1	19.6	17.3	16.5	17.7	17.4	2.0	11.9	15.0	14.6	13.1
2006	14.5	18.9	16.7	15.7	16.5	17.4	2.1	10.2	14.4	14.3	13.0
2007	14.7	19.4	16.0	15.8	16.8	17.4	1.9	11.8	16.0	15.4	14.7
2008	12.3	14.5	12.6	12.7	13.5	15.1	1.3	9.6	13.6	11.9	12.9
2009	13.0	14.9	10.9	13.5	14.2	13.1	1.0	13.0	11.2	12.1	16.8
2010	12.7	13.3	11.0	14.7	14.4	13.7	1.1	11.4	11.9	12.6	13.9
2011	12.2	12.3	11.4	13.4	14.1	14.2	1.0	11.0	13.5	14.0	12.0
2012	12.5	12.1	12.3	12.6	14.7	15.3	1.0	10.7	14.6	15.0	12.4
2013	14.1	13.0	15.0	14.7	16.8	16.5	1.2	12.2	15.3	15.1	14.4
2014	15.5	15.2	16.6	16.1	17.6	17.7	1.4	13.9	16.2	13.5	16.4
2015	16.3	15.7	16.7	15.5	18.3	19.3	1.4	22.1	15.9	12.9	15.8
2016	15.8	15.5	14.9	15.4	17.3	20.3	1.3	25.6	17.0	13.2	16.3
Current	15.5	14.9	14.5	15.1	16.2	20.3	1.2	26.7	18.1	14.1	15.7

Source: FactSet, UBS (*P/B used for Financials)

In addition, despite fairly limited exposure to Europe and the UK specifically, many of the stocks on our screen have also underperformed since the outcome of the UK referendum last week. Not only do our analysts believe the companies are well positioned going forward, but a majority of the names also benefit from ample balance sheet flexibility (i.e. large cash balances) that should enable their respective management teams to continue to repurchase shares and search for accretive M&A opportunities.

Below we present a list of UBS Buy-rated companies in the S&P 500 that are characterized as both 'High Quality' and 'Improving Quality' according to our UBS Quantitative Strategy team (See Winter, 4/17/14, Global Quantitative Research

Monographs – Investing in Quality), names that have also underperformed the broader index since the end of Q1. A summary of analysts' views as to why they expect these UBS-rated stocks to outperform in the months ahead is provided starting on page 7.

In our view, these companies could be expected to outperform in the event growth remains challenged and volatility remains elevated amidst the increased uncertainty, both domestically and abroad.

Figure 7: UK Leave Bouncers

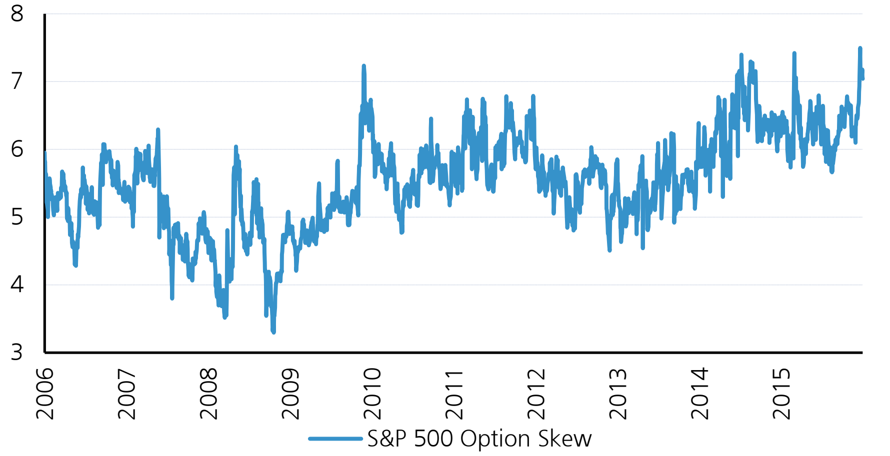
						% Revenue Geographic Breakdown	Company Price Return	Relative Return	
Ticker	Company	Analyst	Rating	Upside Price Target	Sector	Europe	2D Company Price Return	2D	Since Q1
DAL	Delta Air Lines Inc	Darryl Genovesi	Buy	61.9%	Industrials	14.7%	-12.9%	-7.6%	-28.6%
PANW	Palo Alto Networks Inc	Brent Thill	Buy	54.2%	Technology	15.0%	-7.8%	-2.5%	-25.6%
RCL	Royal Caribbean Cruises Ltd	Robin M Farley	Buy	60.7%	Consumer Disc	11.3%	-14.5%	-9.2%	-16.8%
LUV	Southwest Airlines Co	Darryl Genovesi	Buy	38.7%	Industrials	-	-7.1%	-1.8%	-15.1%
NKE	Nike Inc	Michael Binetti	Buy	34.9%	Consumer Disc	23.2%	-4.1%	1.2%	-12.7%
CCL	Carnival Corp	Robin M Farley	Buy	30.6%	Consumer Disc	32.7%	-11.6%	-6.3%	-14.4%
DKS	Dick's Sporting Goods Inc	Michael Lasser	Buy	32.3%	Consumer Disc	-	-1.8%	3.6%	-11.4%
GOOG	Alphabet Inc	Eric J Sheridan	Buy	31.7%	Technology	9.4%	-4.8%	0.5%	-7.4%
COL	Rockwell Collins Inc	David E Strauss	Buy	23.2%	Industrials	17.4%	-6.5%	-1.2%	-9.1%
SBUX	Starbucks Corp	Dennis Geiger	Buy	30.4%	Consumer Disc	5.8%	-4.3%	1.0%	-7.2%
PPG	PPG Industries Inc	John E Roberts	Buy	31.7%	Materials	26.5%	-11.3%	-5.9%	-8.6%
HD	Home Depot Inc	Michael Lasser	Buy	20.3%	Consumer Disc	-	-2.8%	2.5%	-3.7%
MCD	Mcdonald's Corp	Dennis Geiger	Buy	18.7%	Consumer Disc	33.5%	-4.1%	1.3%	-4.6%
TJX	TJX Companies Inc	Michael Binetti	Buy	15.6%	Consumer Disc	14.0%	-4.4%	1.0%	-3.3%
AAP	Advance Auto Parts Inc	Michael Lasser	Buy	13.8%	Consumer Disc	-	-0.7%	4.6%	-1.2%
DIS	Walt Disney Co	Douglas Mitchelson	Buy	22.9%	Consumer Disc	12.4%	-4.7%	0.7%	-2.1%
EBAY	Ebay Inc	Eric J Sheridan	Buy	40.8%	Technology	31.6%	-8.6%	-3.2%	-1.9%
ORLY	O'Reilly Automotive Inc	Michael Lasser	Buy	13.9%	Consumer Disc	-	1.3%	6.7%	0.7%
FB	Facebook Inc	Eric J Sheridan	Buy	37.7%	Technology	24.9%	-5.3%	0.0%	-1.6%
ADBE	Adobe Systems Inc	Brent Thill	Buy	34.3%	Technology	21.6%	-5.6%	-0.2%	-0.3%

Source: Bloomberg, FactSet, UBS. (Note: Percent revenue exposure to Europe references actual/estimated regional exposure)

Option Dislocation, Option Opportunity?

Although the market appeared to be "overhedged" coming into the EU referendum (see 6/16 Are Investors Overhedged?), the unexpected outcome essentially validated the notion that in the S&P 500, options markets were pricing in a level of "fear" as represented by historically high option skew (downside puts more expensive than upside calls) that exceeded even the depth of the 2007-09 bear market (Figure 8).

Figure 8: S&P 500 Skew (90%/100%) – Very Skewed

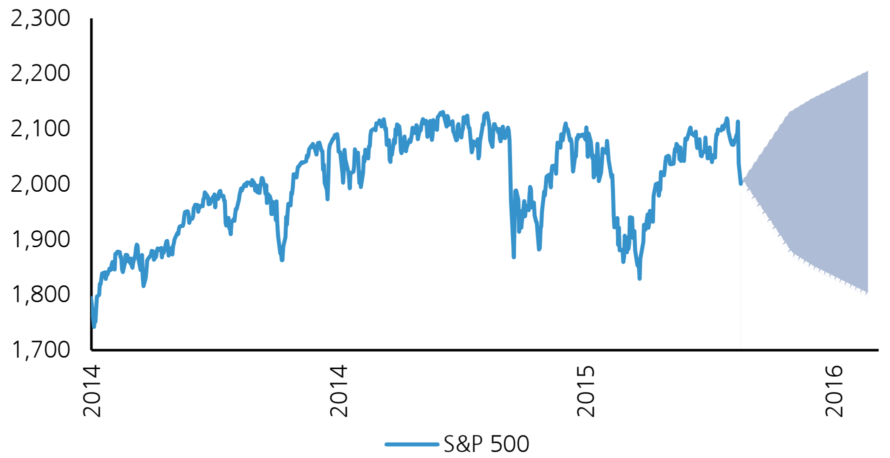


Source: Bloomberg, UBS

That this level of option skew remains despite the initial event risk having passed represents to us a pricing extreme that affords the investor an attractive opportunity to add to US equity market exposure. Thus we recommend that investors consider going long (buy call/sell put) an S&P 500 December 2,075c ($52.90, 16.9% volatility, 33 delta)/1,800p ($54.50, 24% volatility, 26 delta) risk reversal, which can be implemented for a credit of $1.60 based on the 6/27 S&P 500 close of 2,000.54.

What is especially attractive about this structure is the idea that not only is the 1,800 strike lower than any price in SPX since early 2014 (Figure 2, p.2) but even when thinking about the potential path for the S&P 500 over these next volatile 6 months, 1,800 is at the very lower bound of what the market is pricing as likely to be seen during 2016 given the heightened risk perceptions (Figure 9).

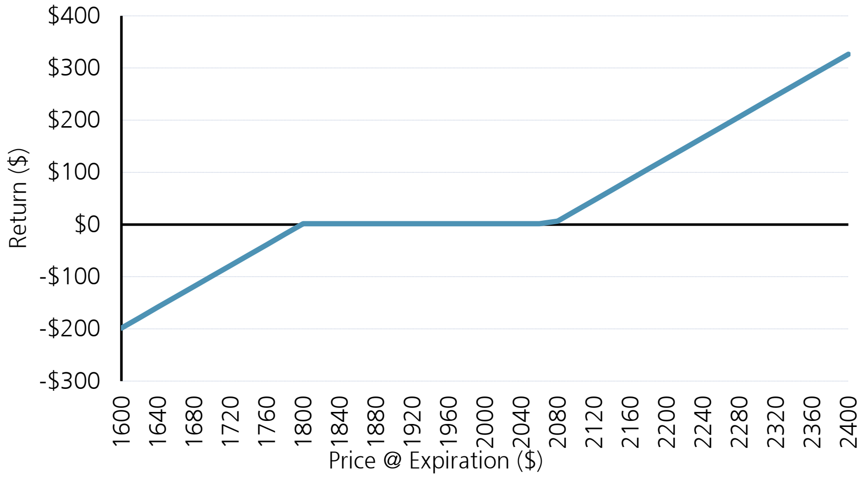
Figure 9: Option Implied S&P 500 Path Risk through 12/2016



Source: Bloomberg, UBS

Payout profile of the S&P 500 December 2,075c /1,800p risk reversal is shown at expiration (Figure 10).

Figure 10: S&P 500 Risk Reversal Payout Profile



Source: Bloomberg, UBS

Commentary on Selected Stocks

In this section we provide commentary on the stocks screened to explain recent underperformance, reaffirm the bull case, and see what further downside to the stock in a worsening "Leave" scenario would look like.

Palo Alto Networks (PANW), Buy, $180 PT

Brent Thill
+1 415 352 4694

Q: What has driven recent underperformance?

Shares have been under pressure from two consecutive rounds of margin guidance down-ticking, a miss/inline guide exiting F3Q16 earnings, growth decelerating, and souring sentiment on cybersecurity spending. NTM EV/S has compressed from 9x to 5x YTD, or roughly 1x above PANW's trough levels. The “Leave” vote appears to be overly discounted (PANW = 20% exposure to EMEA vs. FTNT, CHKP at 35%+) with CY17/CY18 EV/FCF valuation at 11x/9.4x EV/FCF now giving virtually no credit to PANW's 30%+ topline growth and 35%+ FCF margins.

Q: What is the downside risk to the current share price from the UK's vote to leave?

Sales cycle elongation and general IT spending malaise stemming from UK’s economic uncertainty are the downside factors. And while PANW prices in USD and sees no theoretical translation impact, the significant shrinkage in "real" purchasing power resulting from USD/GBP at 30-yr highs could manifest in a multi-quarter growth slowdown in the region.

Q: What are the signposts to watch?

Channel partners' commentary and proprietary checks around linearity and spending outlook; peers' performance (who will report Jul-end vs. PANW's late Aug/early Sep).

Adobe Systems (ADBE), Buy, $122 PT

Brent Thill
+1 415 352 4694

Q: What has driven recent underperformance?

High expectations ahead of May quarter earnings, and only inline/slight upside, plus back end loaded Marketing Cloud forecast.

Q: What is the downside risk to the current share price from the UK's vote to leave?

Modest downside on FX translation risk. UBSe est approx 11% rev mix from UK.

Q: What are the signposts to watch?

Co-specific: faster than expected adoption of Creative Cloud subscriptions and indicators of potential ARPU rise LT. Better momentum in Marketing Cloud.

Delta Air Lines (DAL), Buy, $54 PT

Darryl Genovesi
+1 212 713 4016

Q: What has driven recent underperformance?

- Is it sentiment driven… has UK's "Leave" vote been overly discounted?

Yes, DAL has sold off ~15% following the Leave vote, which is similar to its entire Europe exposure at ~14% of revenue (~18% including unconsolidated equity earnings).

- Is it company specific (ie. lowered guide, mgmt transition, etc)?

Aside from Europe, there haven't been other company specific events that would explain the ~15% sell-off Friday/Monday.

- Levels of valuation support?

Even in a severe recession, similar to 2008-09 when industry revenue fell ~15% over a two-year period, we estimate that DAL would still generate $4.00+ in EPS with stock now trading at 8-9x that. We view late 2014 Ebola crisis as most relevant period of significant demand uncertainty and stock bottomed around $31, which would have represented 6-7x then-year NTM EPS expectation. 6-7x our trough EPS estimate would imply downside to ~$29.

Q: What is the downside risk to the current share price from the UK's vote to leave?

- European recession?

Stock has already priced in a severe demand decline in Europe. The more worrisome scenario is a global macro contagion.

- Continued USD strength?

Roughly ~20% of DAL revenue is derived from a foreign point-of-sale. The DXY has strengthened ~3% over the last few days, and the stronger dollar would therefore drive ~60 bps of consolidated revenue weakness all else equal. Oil is also lower since the Leave vote, which more than offsets the f/x headwind.

- Trade Negotiation/Political Uncertainty?

Based on our discussions with airline leadership, the Open Skies agreement between the US and the EU is likely unaffected by the impending UK exit. The US will need to reach a new Open Skies agreement with the UK, which we would expect to largely mirror the current framework.

Q: What are the signposts to watch?

- Improving European macro outlook?

We will be closely monitoring travel agency booking trends and capacity levels to and from Europe. Additionally, we will be watching for reallocation of capacity into the domestic US market or other markets globally should European demand fall off meaningfully.

- Stock specific catalysts?

Improvement in the unit revenue (PRASM) trend, capacity adjustments, competitive capacity movements, labor negotiations (pilots).

Southwest Airlines (LUV), Buy, $51 PT

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Q: What has driven recent underperformance?

- Is it sentiment driven… has UK's "Leave" vote been overly discounted?

Yes, this is predominantly sentiment-driven. LUV stock has corrected about 10% following the "Leave" vote. LUV has no direct exposure to the UK or greater Europe. Substantially all of its capacity is deployed into the domestic US market. Potential secondary impact if some competitive capacity is reallocated from foreign to domestic markets as a result of weaker Europe demand, but we would expect this to have only a modest impact, and particularly in longer-haul domestic markets where LUV has comparably less exposure.

- Is it company specific (ie. lowered guide, mgmt transition, etc)?

Aside from Europe, there haven't been other company specific events that would explain the ~10% sell-off Friday/Monday. LUV held an Investor Day Thursday, and stock modestly underperformed on it (pre Leave vote), although we thought message was generally positive and wouldn't have expected any follow-on weakness from that.

- Levels of valuation support?

Even in a severe recession, similar to 2008-09 when industry revenue fell ~15% over a two-year period, we estimate that LUV would still generate ~$2.25 in EPS with stock now trading at ~15x that. We view late 2014 Ebola crisis as most relevant period of significant demand uncertainty and stock bottomed around $31, which would have represented ~12x then-year NTM EPS expectation. 12x our trough EPS estimate would imply downside to ~$27.

Q: What is the downside risk to the current share price from the UK's vote to leave?

LUV does not have any Europe exposure and has only negligible foreign currency exposure.

Q: What are the signposts to watch?

We will be watching for reallocation of capacity into the domestic US market or other markets globally should European demand fall off meaningfully.

- Stock specific catalysts?

Improvement in the unit revenue (PRASM) trend, capacity adjustments, competitive capacity movements, labor negotiations (pilots and flight attendants).

Rockwell Collins (COL), Buy, $100 PT

David Strauss
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Q: What has driven recent underperformance?

We believe investors are overly concerned on COL's near-term growth outlook as it has guided to a heavily back-half loaded fiscal year. We still see COL as one of the best 12-month stories in A&D driven by what we expect will be accelerating EPS and cash flow conversion.

Q: What is the downside risk to the current share price from the UK's vote to leave?

The UK vote to leave, on its own, is unlikely to impact COL meaningfully. However, a broader European recession could hurt its commercial systems and IMS businesses (~60% of total). We note sales to Europe represented 17% of COL's FY15 total.

Q: What are the signposts to watch?

A350/737 MAX/CSeries production ramp-up progress; defense contract awards; new bizjet deliveries; and bizjet utilization.

McDonald's (MCD), Buy, $138 PT

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+1 212 713 9313

Q: What has driven recent underperformance?

U.S. same-store-sales deceleration concerns. Industry data and company management teams have highlighted deceleration in restaurant sector sales trends since April. With recent market expectations for MCD 2Q U.S. SSS likely closer to 2.5% relative to the consensus 3.6%, concerns are increasingly focused on the challenge of lapping robust prior year comps by 4Q. That said, following the recent pullback in shares, we see limited downside given demand for quality and consistency in this environment, and believe continued global momentum and upcoming growth initiatives can help shares grind higher.

Q: What is the downside risk to the current share price from the UK's vote to leave?

Given MCD's UK and overall Europe revenue exposure, developments are likely to impact currency and operating results. But MCD's value proposition and several years of momentum in the UK should mitigate further downside from here.

Q: What are the signposts to watch?

More detail on recent QSR and overall restaurant sales trends, further changes in FX.

Starbucks (SBUX), Buy, $70 PT

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Q: What has driven recent underperformance?

Americas same-store-sales and traffic deceleration concerns. Expectations and caution for possible below consensus F3Q Americas SSS (+6.2%) and sequentially decelerating traffic trends has driven share weakness. Despite near-term caution, we continue to view SBUX as among the best growth opportunities in the group, with good visibility into the sustainability of LT earnings growth.

Q: What is the downside risk to the current share price from the UK's vote to leave?

Despite a relatively small percentage of sales from the UK, near-term visibility into results in Europe could now be more limited.

Q: What are the signposts to watch?

Near-term QSR trends, FX changes.

Walt Disney Co (DIS), Buy, $116 PT

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Q: What has driven recent underperformance?

Walt Disney's underperformance this year has been due to secular concerns regarding ESPN and FY17 EPS growth, which faces pressure from record content success in FY16 and a one-time step up in programming amortization due to the NBA renewal. This has led Disney to be one of the top-10 most shorted stocks in the U.S. (source: UBS). The UK's vote has further exacerbated declines given modest levels of business conducted in the U.K. and Europe. Disney trades at 15.6x CY16e P/E, below its 16.7x 10-yr average and below the S&P500 average vs. typically trading at a 10+% premium during non-recessionary periods.

Q: What is the downside risk to the current share price from the UK's vote to leave?

While Walt Disney fully hedges forward 4 quarters of international currency exposure, and modestly beyond then as well, the stock could continue to re-rate negatively based on lower earnings visibility due to recession risk in the U.K. / Europe (where Disney has 12% of its revenue and 13% of its profits) and due to the impact of the strong dollar on U.S. park attendance & weak Pound/Euro on Paris Park attendance (17% of attendance comes from the UK).

Q: What are the signposts to watch?

Where currencies settle out and whether the UK's "Leave" vote drives meaningful negative macro impacts in the U.K. and Europe; How well Disney's new Shanghai Disneyland park performs; Pace of cord cutting / cord shaving in the US; Whether the introduction of Hulu and DirecTV online bundles of live channels will boost investor confidence in near-to-medium term growth for media networks; And the potential performance of Rogue One: A Star Wars Story (Dec. '16) and Beauty and the Beast (Feb. '17).

Alphabet (GOOG), Buy, $880 PT

Eric Sheridan
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Q: What has driven recent underperformance?

Sentiment driven on the back of one-off, publicized Q2 channel checks as well as UK concerns. We believe this is overdone – our ad checks do not suggest a deceleration beyond what is already implied by our (and Street) forecasts and our fundamental outlook remains largely unchanged. We currently expect 21% earnings growth in 2017 – by comparison, the stock is trading at 14x P/E ex-cash on our '17 EPS estimate.

Q: What is the downside risk to the current share price from the UK's vote to leave?

While further FX downside can be largely hedged, we may see the stock re-rate negatively based on lower earnings visibility from a potential slowdown in European business activity (i.e., reduced advertising budgets), unresolved trade negotiations (impacting European go-to-market approach and employee/cost structure) & uncertainty over European regulatory inquiries. In our 2017 estimates, we estimate 10% of revenue is from the UK and 15% of revenue is from the EU ex-UK, respectively.

Q: What are the signposts to watch?

European business spending activity, updates on regulatory proceedings, political resolution to affirm trade relations, FX.

eBay (EBAY), Buy, $32 PT

Eric Sheridan
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Q: What has driven recent underperformance?

Sentiment driven around intra-quarter retail spending trends. We believe this is overdone – we have seen inline to better consumption trends for online retail broadly, with offline peers losing share. Our fundamental outlook remains largely unchanged, as we expect 12% earnings growth in 2017. The stock is trading at 11.4x NTM P/E vs. an average of 13.3x since EBAY's 2015 split from PYPL.

Q: What is the downside risk to the current share price from the UK's vote to leave?

While further FX downside can be largely hedged, we may see the stock re-rate negatively based on lower earnings visibility from a potential slowdown in European consumer activity and unresolved trade negotiations (impacting both end demand and eBay's employee/cost structure in the region). In our 2017 estimates, we estimate 16% of revenue is from the UK and 28% of revenue is from the EU ex-UK, respectively.

Q: What are the signposts to watch?

European consumer spending activity, political resolution to affirm trade relations, FX.

Facebook (FB), Buy, $150 PT

Eric Sheridan
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Q: What has driven recent underperformance?

Sentiment driven on the back of broad digital advertising market trends as well as UK concerns. We believe this is overdone – our ad checks suggest an in-line to better result vs. our (and Street) forecasts and our fundamental outlook remains largely unchanged. The stock is trading at 16x NTM EV/EBITDA vs. a 3-year average of 19x.

Q: What is the downside risk to the current share price from the UK's vote to leave?

Historically, Facebook has not typically hedged its foreign revenue exposure. In our 2017 estimates, we estimate 10% of revenue is from the UK and 15% of revenue is from the EU ex-UK, respectively. We may see the stock re-rate negatively based on lower earnings visibility from a potential slowdown in European business activity (i.e., reduced advertising budgets) & unresolved trade negotiations (impacting European go-to-market approach and employee/cost structure).

Q: What are the signposts to watch?

FX, European business spending activity, political resolution to affirm trade relations.

PPG Industries (PPG), Buy, $130 PT

John Roberts
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Q: What has driven recent underperformance?

Heavily sentiment driven. In addition to 28% exposure to EMEA, there are concerns about global auto production. These concerns resulted in a widening valuation gap with peer SHW which is more focused on architectural paint and has less European exposure. PPG is being impacted by risk-on sentiment.

Q: What is the downside risk to the current share price from the UK's vote to leave?

With ~28% of sales in EMEA, a European recession will negatively impact results and stronger USD will be a headwind (mostly transactional).

Q: What are the signposts to watch?

The company doesn't provide specific guidance but improving European macro outlook will be viewed positively.

Nike (NKE), Buy, $70 PT

Michael Binetti
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Q: What has driven recent underperformance?

Last quarter Nike reported a deceleration in global futures (to +17% in F3Q from +20% in F2Q) - and futures are typically a good leading indicator for revenues. That said, we think this was largely driven by retailers cancelling orders once they saw inventories rising in the spring. We also believe concerns about the basketball category (which we estimate is only a mid-single-digit percentage of NKE's total revenues, ex-Jordan) slowing are overdone.

Q: What is the downside risk to the current share price from the UK's vote to leave?

Only about 5% of NKE's total sales come from the UK, and NKE hedges currencies about one year out. That said, we think the bigger risk is the uncertainty surrounding how much current political headlines weigh on consumer sentiment – and similarly, consumer discretionary spending in Europe – in the near term.

Q: What are the signposts to watch?

Earnings on 6/28, global future orders growth, FY17 guidance update given recent macro events.

The TJX Companies (TJX), Buy, $85 PT

Michael Binetti
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Q: What has driven recent underperformance?

The recent underperformance is heavily sentiment driven, largely reflecting the impact from the UK vote to leave, in our view. (UK represents ~9% of TJX's global sales). Our fundamental outlook remains unchanged - we continue to see market share gains (especially in the US) and EPS upside opportunity driven by TJX's global store fleet and supply chain - a key competitive advantage, in our view. Every point of comp translates into $0.06 - 0.11 of FY17E EPS upside. Currently, shares are trading at 20x forward P/E, slightly above its 3-year average of 19x.

Q: What is the downside risk to the current share price from the UK's vote to leave?

We estimate about 9% of TJX's total sales come from the UK (14% from Europe) with different buying offices in Europe (including the UK and Germany). We believe further downside from the leave vote fall-out should be limited, although there could potentially be some new regulations stemming from the change. That said, we continue to be confident in TJX's global infrastructure – particularly in Europe, where it does not have much offprice competition – and note TJX's history of benefiting from disruptions in the marketplace.

Q: What are the signposts to watch?

Any changes to the European macro outlook, any updates to FY17E guidance (reflecting FX impact).

Dick's Sporting Goods (DKS), Buy, $53 PT

Michael Lasser
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Q: What has driven recent underperformance?

Concerns surrounding the disintermediation of the sporting goods category and risks related to consumer discretionary spending have weighed on DKS' performance. The market is valuing it similarly to some of the challenged hardline retailers (BBBY, BBY, SPLS, ODP) at 13.6x our NTM EPS estimate, which is a discount to its 3 year historical average of 15.6x.

Q: What is the downside risk to the current share price from the UK's vote to leave?

DKS' domestic focus should insulate it better than most within the retail landscape. We have previously noted a $31 valuation in a downside scenario.

Q: What are the signposts to watch?

Key catalysts that could spur share price improvement include how its sales respond to TSA clearance activity through the back to school season, how much of a merchandise margin benefit it sees from acquiring off-price inventory that vendors were otherwise shipping to TSA, and the level of margin improvement associated with DKS bringing its eCommerce operations in-house in January 2017.

Home Depot (HD), Buy, $150 PT

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Q: What has driven recent underperformance?

There has been debate surrounding both the current state of the home improvement cycle and the promotional environment within the category. Still, HD is trading at 19.3x our NTM EPS estimate, which is below its 3-year historical average of 19.5x.

Q: What is the downside risk to the current share price from the UK's vote to leave?

While its downside driven by the referendum fallout is limited, the biggest risk is associated with demand for home improvement products and the position within the cycle. Should demand come to a halt, HD could trade at $94.

Q: What are the signposts to watch?

Monthly building materials retail sales should provide further clarity on how recent near-term trends after HD reported strong 1Q numbers.

Advance Auto Parts (AAP), Buy, $175 PT

Michael Lasser
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Q: What has driven recent underperformance?

The bar for AAP was considerably lowered following 1Q as it reserved the right to invest in the business to improve its long-term set up. But, still the market believes there is upside to the company's guidance. AAP is currently trading at 18.5x our NTM EPS estimate, which is above its 3-year historical average of 16.8x. Though, the entire group is trading above its average due to industry tailwinds driven by lower fuel prices.

Q: What is the downside risk to the current share price from the UK's vote to leave?

AAP should trade in-line with the auto parts group should there be further fallout. Though, the auto parts sector should be comparatively durable relative to more discretionary categories. We see a $130 downside valuation.

Q: What are the signposts to watch?

Signs of internal progress at AAP would be sequential improvement of comp growth with 2Q results combined with future stabilization of sales trends as well as long-term margin improvement.

O'Reilly Automotive (ORLY), Buy, $305 PT

Michael Lasser
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Q: What has driven recent underperformance?

Macro tailwinds within the sector, while supportive, are expected to slow as year-over-year gas price declines moderate. Though, we believe ORLY should be able to continue to outperform the industry by a decent margin. ORLY is trading at 24.2x our NTM EPS estimate, which is above its 3-year historical average of 22.1x, reflecting the favorable industry backdrop.

Q: What is the downside risk to the current share price from the UK's vote to leave?

Its ability to execute in periods of varying levels of demand should position ORLY better than most retailers should there be increasing volatility. Our downside valuation for ORLY is $233.

Q: What are the signposts to watch?

Indications of continued strong performance include stable comp growth on a sequential and multi-year stack basis combined with solid margin expansion.

Royal Caribbean (RCL), Buy, $106 PT

Robin Farley
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Q: What has driven recent underperformance?

Concerns over North American sourced European demand prior to "Leave" concerns, and overall European macro spill-over impact and FX implications on earnings post the vote. The sector is currently trading at 9x '17E EPS vs. its 3-, 5- and 10-yr historical average of 14-16x, as the market continues to price in FY'16 EPS miss.

Q: What is the downside risk to the current share price from the UK's vote to leave?

About 27%-30% of passengers are European sourced (includes UK), and UK is around 12%-13%. Every ten percentage point change in FX could impact annualized 2016 EPS ~$0.68-$0.69 to our EPS estimate.

Q: What are the signposts to watch?

Q3'16 yield guidance from CCL and any forward commentary on outlook in the back half and in '17E. Load factor and pricing trends in mature markets and in China.

Carnival (CCL), Buy, $57 PT

Robin Farley
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Q: What has driven recent underperformance?

Concerns over North American sourced European demand prior to "Leave" concerns, and overall European macro spill-over impact and FX implications on earnings post the vote. The sector is currently trading at 9x '17E EPS vs. its 3-, 5- and 10-yr historical average of 14-16x, as the market continues to price in FY'16 EPS miss.

Q: What is the downside risk to the current share price from the UK's vote to leave?

About 33%-34% of passengers are European sourced (includes UK), and 11% of CCL's capacity is in UK sourcing brands but UK-sourced passengers are 7% of total. Every ten percentage point change in FX could impact annualized 2016 EPS ~$0.30 to our EPS estimate.

Q: What are the signposts to watch?

Q3'16 yield guidance from CCL and any forward commentary on outlook in the back half and in '17E.

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Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
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Source: UBS. Rating allocations are as of 31 March 2016.
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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Adobe Systems Inc.[16]	ADBE.O	Buy	N/A	US$90.85	27 Jun 2016
Advance Auto Parts, Inc.[16]	AAP.N	Buy	N/A	US$153.78	27 Jun 2016
Alphabet Inc.[6b, 6c, 7, 16, 22]	GOOG.O	Buy	N/A	US$668.26	27 Jun 2016
Carnival Corp.[2, 4, 7, 14, 16]	CCL.N	Buy	N/A	US$43.64	27 Jun 2016
Delta Air Lines[4, 5, 6a, 6c, 7, 16]	DAL.N	Buy	N/A	US$33.36	27 Jun 2016
Dick's Sporting Goods, Inc.[16]	DKS.N	Buy	N/A	US$40.07	27 Jun 2016
eBay[6b, 7, 16]	EBAY.O	Buy	N/A	US$22.72	27 Jun 2016
Facebook[16, 22]	FB.O	Buy	N/A	US$108.97	27 Jun 2016
Home Depot Inc.[16]	HD.N	Buy	N/A	US$124.67	27 Jun 2016
McDonald's[16]	MCD.N	Buy	N/A	US$116.30	27 Jun 2016
Nike Inc.[16, 22]	NKE.N	Buy	N/A	US$51.89	27 Jun 2016
O'Reilly Automotive, Inc.[4, 6a, 16]	ORLY.O	Buy	N/A	US$267.73	27 Jun 2016
Palo Alto Networks[16]	PANW.N	Buy	N/A	US$116.76	27 Jun 2016
PPG Industries Inc.[8, 16]	PPG.N	Buy	N/A	US$98.69	27 Jun 2016
Rockwell Collins Inc.[8, 13, 16]	COL.N	Buy	N/A	US$81.15	27 Jun 2016
Royal Caribbean[16]	RCL.N	Buy	N/A	US$65.95	27 Jun 2016
Southwest Airlines[6c, 7, 16]	LUV.N	Buy	N/A	US$36.76	27 Jun 2016
Starbucks[6c, 7, 16, 18a]	SBUX.O	Buy	N/A	US$53.69	27 Jun 2016
The TJX Companies, Inc.[16]	TJX.N	Buy	N/A	US$73.53	27 Jun 2016
Walt Disney Co[7, 16, 18b]	DIS.N	Buy	N/A	US$94.38	27 Jun 2016

Source: UBS. All prices as of local market close.
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