

WEALTH MANAGEMENT

June 4, 2019

What Happened in the Markets?

- US stocks rose sharply on Tuesday, as the S&P 500 gained 2.1% to close at 2,803. The other two major US averages also advanced on the day. The NASDAQ Composite increased 2.6%, while the Dow Jones Industrial Average added more than 500 points, or 2.1%.
- Equities rebounded on Tuesday following a negative day for US stocks during the previous session. While trade tensions and concerns over an economic growth slowdown continue to loom over markets, investors turned their attention to the latest public comments from key Federal Reserve officials, including Chairman Powell, which signaled that the Fed is willing to take appropriate actions to sustain the economic expansion. The remarks were interpreted by investors to be supportive of equity markets, suggesting that the Fed is open to reducing interest rates if needed. Technology stocks led the rally, a day after the group sold off sharply on reports that the government planned to investigate several prominent firms on antitrust grounds.
- Ten of the 11 S&P sectors finished higher on the session. Technology (+3.3%), Materials (+2.8%) and Financials (+2.7%) led the rally, while Real Estate (-0.6%), Utilities (-0.0%), and Staples (+0.8%) lagged.
- Treasuries declined sharply with yields on longer-duration bonds increasing the most. The benchmark 10-year yield climbed to around 2.12% as of the 4 p.m. equity market close, reversing most of the previous day's action. The prices of Brent (+1.2%) and WTI (+0.6%) Crude oil rose, while the price of gold also moved higher, extending its recent gains. The US dollar weakened slightly against its major peers as measured by the US Dollar Index.

Catalysts for Market Move

US equities gained Tuesday, as the S&P 500 recorded its strongest daily performance since January, climbing 2.1% on above-average volume. The rally was fairly broad-based, with nearly 90% of companies in the S&P 500 finishing higher on the session. The tech-heavy NASDAQ Composite, which suffered the steepest decline during the previous session, gained the most among the major US benchmarks. By comparison, the Dow increased roughly in line with the S&P 500. Looking at investing styles, growth stocks outperformed value by 0.6%, as measured by the Russell 1000 Growth and Value indices. Further, small-caps edged out large-cap stocks by 0.4%, as measured by the Russell 2000 and Russell 1000 indices, while cyclical stocks led defensives by 3.7%, reflecting the day's risk-on tenor. Outside the US, European benchmarks ended their session broadly higher with the Euro Stoxx 50 Index gaining 1.0%. The Shanghai Shenzhen CSI 300 Index fell 0.9% while the Japanese Nikkei was flat in overnight trading.

Concerns over global trade tensions and slowing economic growth took a back seat on Tuesday as investors focused instead on comments from Federal Reserve officials, which suggested that the central bank is open to lowering interest rates as necessary. Speaking at a conference on Tuesday morning, Chairman Powell remarked that the Fed is closely watching important developments such as trade negotiations, and while the impacts of these issues to the US economic outlook are uncertain, the Fed would take appropriate action to "sustain the economic expansion, with a strong labor market and inflation near its symmetric 2% objective." US stocks rallied as investors interpreted the Chairman's comments to mean that the Fed would be open to cutting interest rates. Heading into Tuesday, futures markets were already implying that the Fed would lower rates by 0.25% two or more times before the end of 2019. The Chairman's comments provided investors with some evidence that the Fed's views on future policy and the market's expectations were not misaligned. Other Fed officials have voiced similar views this week, including St. Louis Fed President Bullard, who went as far as saying a near-term rate cut may be warranted in order to revive inflation expectations and provide insurance against a downturn on Monday. Other factors supporting the day's positive market sentiment included reports that Republicans in the Senate may push back against the White House's decision to apply tariffs on Mexico. Meanwhile, Mexico's president made encouraging comments about reaching an agreement with the US before the tariffs would take effect on June 10.

The S&P 500's rally marked the seventeenth 1%+ move of 2019, and the 10th in which stocks advanced. The VIX Index, a market-based measure of future S&P 500 volatility, declined to 17 as of the equity market close. US equity valuations still appear to be underpricing the risks of higher inflation, pressures to corporate margins, and a slowdown in capital spending. The combination of high valuations, underappreciated risks to corporate profits, and escalating geopolitical uncertainty suggests to us that market volatility will remain elevated in the coming months. The S&P 500 Index is currently up 12% year to date, while the NASDAQ Composite has gained 13%, and the Russell 2000 Index has risen 12%. Following Tuesday's rally, the S&P 500 and NASDAQ remain 5% and 8% below their recent all-time highs, respectively. The S&P 500's consensus forward price-to-earnings multiple is currently at 16x, suggesting valuations remain full.

The Global Investment Committee's Outlook

The market environment in 2018 was one of the most challenging for equity investors since the Financial Crisis, with every region and most stocks delivering negative returns. Unusually, bonds and alternative investments simultaneously fared poorly, reducing the effectiveness of asset allocation in balancing out the losses with some gains. In sharp contrast with how 2018 ended, 2019 began with a sharp and broad rally across the majority of risk asset classes. Beginning in January, the dramatic pivot by the Federal Reserve to embrace a patient policy approach helped ease financial conditions and improve market sentiment. Overall, the GIC expects 2019 will be a better year than 2018 both in terms of absolute returns and the breadth of those returns. However, with significantly more good news currently priced into markets, the GIC advises caution as US equity valuations remain full and earnings forecasts may have further to fall. While the GIC remains overweight equities relative to fixed income, it believes international stocks, particularly emerging markets, may offer the most upside potential going forward. Within fixed income, the GIC remains underweight corporate credit, and prefers high-quality short-duration bonds as a proxy for cash, which it will look to deploy throughout 2019 as opportunities arise. It also recommends a moderate allocation to long-duration Treasuries as a defensive portfolio hedge against the risk of a future equity or credit market correction.

Market data provided by Bloomberg.

Dow Jones Industrial Average (DJIA): A price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry.

Euro STOXX 50 Index: Provides a blue-chip representation of supersector leaders in the Eurozone.

NASDAQ Composite Index: A broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market.

NIKKEI 225 Index: This price-weighted index is comprised of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange.

Russell 1000 Index: measures the performance of the 1,000 largest US companies based on total market capitalization.

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Russell 2000 Index: measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

Russell 1000 Growth Index: measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index: measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

S&P 500 Index: The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization US stocks.

Shanghai Shenzhen CSI 300 Index: A free-float weighted index that consists of 300 A-share stocks listed on the Shanghai or Shenzhen Stock Exchanges.

US Trade-Weighted Dollar Index: A weighted average of the foreign exchange value of the US dollar against a subset of the broad index currencies that circulate widely outside the US.

VIX: This is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 Index options. Often referred to as the fear index or the fear gauge, it represents one measure of the market's expectation of stock market volatility over the next 30-day period.

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International investing entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economies. **Investing in foreign emerging markets** entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks. **Investing in currency** involves additional special risks such as credit, interest rate fluctuations, derivative investment risk, and domestic and foreign inflation rates, which can be volatile and may be less liquid than other securities and more sensitive to the effect of varied economic conditions.

The value of **fixed income securities** will fluctuate and, upon a sale, may be worth more or less than their original cost or maturity value. Bonds are subject to interest rate risk, call risk, reinvestment risk, liquidity risk, and credit risk of the issuer. **High yield bonds** are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues. **Duration**, the most commonly used measure of bond risk, quantifies the effect of changes in interest rates on the price of a bond or bond portfolio. The longer the duration, the more sensitive the bond or portfolio would be to changes in interest rates. Generally, if interest rates rise, bond prices fall and vice versa. Longer-term bonds carry a longer or higher duration than shorter-term bonds; as such, they would be affected by changing interest rates for a greater period of time if interest rates were to increase. Consequently, the price of a long-term bond would drop significantly as compared to the price of a short-term bond.

Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment. **Investing in smaller companies** involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity. **Stocks of medium-sized companies** entail special risks, such as limited product lines, markets, and financial resources, and greater market volatility than securities of larger, more-established companies. **Value investing** does not guarantee a profit or eliminate risk. Not all companies whose stocks are considered to be value stocks are able to turn their business around or successfully employ corrective strategies which would result in stock prices that do not rise as initially expected. **Growth investing** does not guarantee a profit or eliminate risk. The stocks of these companies can have relatively high valuations. Because of these high valuations, an investment in a growth stock can be more risky than an investment in a company with more modest growth expectations.

Alternative investments may be either traditional alternative investment vehicles, such as hedge funds, fund of hedge funds, private equity, private real estate and managed futures or, non-traditional products such as mutual funds and exchange-traded funds that also seek alternative-like exposure but have significant differences from traditional alternative investments. The risks of traditional alternative investments may include: can be highly illiquid, speculative and not suitable for all investors, loss of all or a substantial portion of the investment due to leveraging, short-selling, or other speculative practices, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized, absence of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than open-end mutual funds, and risks associated with the operations, personnel and processes of the manager. Non-traditional alternative strategy products may employ various investment strategies and techniques for both hedging and more speculative purposes such as short-selling, leverage, derivatives and options, which can increase volatility and the risk of investment loss. These investments are subject to the risks normally associated with debt instruments and also carry substantial additional risks. Investors could lose all or a substantial amount of their investment. These investments typically have higher fees or expenses than traditional investments. **Investing in commodities** entails significant risks. Commodity prices may be affected by a variety of factors at any time, including but not limited to, (i) changes in supply and demand relationships, (ii) governmental programs and policies, (iii) national and international political and economic events, war and terrorist events, (iv) changes in interest and exchange rates, (v) trading activities in commodities and related contracts, (vi) pestilence, technological change and weather, and (vii) the price volatility of a commodity. In addition, the commodities markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity, participation of speculators and government intervention. **Physical precious metals** are non-regulated products. Precious metals are speculative investments, which may experience short-term and long term price volatility. The value of precious metals investments may fluctuate and may appreciate or decline, depending on market conditions. If sold in a declining market, the price you receive may be less than your original investment. Unlike bonds and stocks, precious metals do not make interest or dividend payments. Therefore, precious metals may not be suitable for investors who require current income. Precious metals are commodities that should be safely stored, which may impose additional costs on the investor. The Securities Investor Protection Corporation ("SIPC") provides certain protection for customers' cash and securities in the event of a brokerage firm's bankruptcy, other financial difficulties, or if customers' assets are missing. SIPC insurance does not apply to precious metals or other commodities. **Yields** are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

REITs investing risks are similar to those associated with direct investments in real estate: property value fluctuations, lack of liquidity, limited diversification and sensitivity to economic factors such as interest rate changes and market recessions.

Because of their narrow focus, **sector investments** tend to be more volatile than investments that diversify across many sectors and companies. **Technology stocks** may be especially volatile.

Asset allocation and diversification do not assure a profit or protect against loss in declining financial markets.

The **indices** are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

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