INVESTMENT MANAGEMENT

Morgan Stanley

Jim Caron on CNBC:
The Road to Rate Normalization

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The Road to Rate Normalization May Not Seem Normal…at First

- Restoring organic economic growth is critical for 2017 and beyond, rather than relying on "managed" growth through excessively easy monetary policy.

- Interest rates have been kept artificially low for so long that these low rate levels now seem to be the "normal."

- As a result, any rise in rates from the current low levels seems abnormal. But as learned in 2016, having rates too low for too long can have more costs than benefits.

- Central bank's policy made a mistake in 2016 by upping quantitative easing (QE) and entertaining negative rates. This is now in the process of reversing.

- A rising rate cycle, that reflects improving economic conditions and a lessening of tail risks, <u>IS A GOOD THING</u> in our opinion.

- We believe there can be some positive side-effects to rising rates and less policy interference:
    - **Less malinvestment of capital** – corporations will need to invest through capital expenditure (Cap-ex) and business investment, instead of issuing debt and buying back stock
    - **Productivity** – business investment has been sorely lacking and is what is needed to kick-start productivity
    - **Credit creation** – rising rates make creating credit more economical for financial institutions
    - **GDP growth** – efficient allocation of capital, productivity and credit creation drive <u>ORGANIC</u> growth

- **Bottom line:** Interest normalization is the first and necessary ingredient to start a business cycle that is organic and driven by fundamentals instead of policy manipulation.

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