Morgan Stanley

INVESTMENT MANAGEMENT

Is the worst of the monetary policy behind us?

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CUSTOMISED SOLUTIONS | GLOBAL BALANCED RISK CONTROL TEAM | PATH | 5 October 2023

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Equity markets fell rapidly for the second month, following a robust rally in the first half of 2023 as markets adjust to the new regime of heightened volatility and higher interest rates. The S&P 500 Index returned -4.8%[1] (USD) while the MSCI Europe (EUR) Index fell 1.5%[1]. The MSCI Japan Index (JPY) remained marginally positive at 0.5%[1]. Emerging markets also remained in negative territory with the MSCI EM (USD) Index down 2.6%[1]. Regionally, the UK market gained significantly as the FTSE 100 Index (GBP) returned 2.4%[1] partly due to its tilt towards the energy sector which was supported by a sharp rise in oil prices. The US 10-Year Treasury yield has been well over 4% in September, ending the month at 4.57%[2], almost 50bps higher than August end, resulting in the biggest monthly change this year. Given the increase in volatility, the VIX Index has been rising throughout the month, reaching 17.6[2] at month end.

As expected, Federal Reserve officials left the interest rate unchanged in September. But even though the Fed is on the cusp of its potential terminal rate hike to fight inflation, officials warned that a higher-for-longer approach is likely to be needed to keep inflation under control as long as the economy is strong. While the market attempts to reconcile the higher for longer policy of the Fed amid concerns of a potential recession, it is also probable that another rate hike will occur in 2023. This policy stance could push the economy into a mild recession in the first six months of 2024. However, this could be good for markets as it does not erode the underlying strength of the economy. Moreover, markets may be able to weather a recession that arrives sooner and is milder, rather than a recession that arrives late and could result in a hard landing for the economy.

Notes:

[1] Bloomberg, 1-month returns, local currency unless otherwise stated, as of 30 September 2023.

[2] Bloomberg, 30 September 2023.

Financial markets averted further volatility on account of the US reaching its debt ceiling as the last-minute agreement between Republicans and Democrats to extend the government's funding for a further 45 days has postponed the decision on the 2024 budget until mid-November, when Congress will need to reach a decision on the current budget.

As economic headwinds diminish while monetary policy tightening persists, we believe diversification* should remain a priority for investors moving forward.

Investment Implications

We did not make a significant number of tactical adjustments and maintained our overall positioning in September as we are confident in our current position and remain aligned with the portfolios' risk objectives. We maintain exposure to segments of the market that have lagged as they could catch up on the back of better-than-expected macro-outcome. We still prefer carry over duration and have been allocating to cash given elevated yields. We made the following tactical changes in September:

EURUSD

We downgraded our view on EURUSD exposure while still remaining positive, based on our updated assessment of the relative EU-US growth outlook and the challenges facing the Chinese economy, as we no longer see sustained upside in the EURUSD. Real yield differentials are likely to continue to move in favour of the US, opening the door for further EUR weakness.

Japanese Yen

We also downgraded our view on JPY to neutral as we believe that the Bank of Japan will likely disappoint the market by not adjusting policy in the near term.

***Diversification does not eliminate the risk of loss.**

The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results. See Disclosure section for index definitions.**

Tactical Positioning

We have provided our tactical views below:

Asset Class	--	-	=	+	++
Equity					
US				Latest view	
US Small Cap					Latest view
Eurozone		Latest view			
EU Energy				Latest view	
UK			Latest view		
Japan				Latest view	
Asia ex Japan			Latest view		
Emerging Markets			Latest view		
China		Latest view			
Global Infrastructure			Latest view		
Global Property			Latest view		
Commodities					
Gold			Latest view		
Oil			Latest view		
Copper			Latest view		

Asset Class	--	-	=	+	++
Fixed Income					
US IG Credit		Latest view			
European IG Credit			Latest view		
US High Yield			Latest view		
EU High Yield			Latest view		
EM HC Sov Debt			Latest view		
EM LC Sov Debt				Latest view	
Mexican LC Sov Debt				Latest view	
EM Corporate Debt			Latest view		
US Treasuries			Latest view		
EU Core Gov. Bonds		Latest view			
EU Peripheral Gov. Bonds			Latest view		
Greek Gov. Bonds				Latest view	
UK Gilts		Latest view			
JGBs		Latest view			
Asset Backed Securities					Latest view
Currencies					
Euro				Latest view	Previous view
GBP			Latest view		
JPY			Latest view		Previous view

Latest view   Previous view

Source: MSIM GBaR team. Previous view is as of 31 August 2023 and current view is as of 30 Septembert 2023. For informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The tactical views expressed above are a broad reflection of our team's views and implementations, expressed for client communication purposes. The information herein does not contend to address the financial objectives, situation or specific needs of any individual investor. The signals represent the GBaR team's view on each asset class. A negative signal indicates a negative or underweight relative view, a positive signal indicates a positive or overweight relative view.

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There is no assurance that the Strategy will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in this portfolio. Please be aware that this strategy may be subject to certain additional risks. There is the risk that the Adviser's **asset allocation methodology and assumptions** regarding the Underlying Portfolios may be incorrect in light of actual market conditions and the Portfolio may not achieve its investment objective. Share prices also tend to be volatile and there is a significant possibility of loss. The portfolio's investments in **commodity-linked notes** involve substantial risks, including risk of loss of a significant portion of their principal value. In addition to commodity risk, they may be subject to additional special risks, such as risk of loss of interest and principal, lack of secondary market and risk of greater volatility, that do not affect traditional equity and debt securities. **Currency fluctuations** could erase investment gains or add to investment losses. **Fixed-income securities** are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest-rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. **Longer-term securities** may be more sensitive to interest rate changes. **Equity and foreign securities** are generally more volatile than fixed income securities and are subject to currency, political, economic and market risks. Equity values fluctuate in response to activities specific to a company. Stocks of **small-capitalization companies** carry special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies. The risks of investing in **emerging market** countries are greater than risks associated with investments in foreign developed markets. **Exchange traded funds (ETFs)** shares have many of the same risks as direct investments in common stocks or bonds and their market value will fluctuate as the value of the underlying index does. By investing in exchange traded funds ETFs and other **Investment Funds**, the portfolio absorbs both its own expenses and those of the ETFs and Investment Funds it invests in. Supply and demand for ETFs and Investment Funds may not be correlated to that of the underlying securities. **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the portfolio's performance. A **currency forward** is a hedging tool that does not involve any upfront payment. The use of **leverage** may increase volatility in the Portfolio.

INDEX DEFINITIONS

The indexes shown in this report are not meant to depict the performance of any specific investment, and the indexes shown do not include any expenses, fees or sales charges, which would lower performance. The indexes shown are unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

Consumer Price Index: The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

JOLTS (Job Openings and Labor Turnover Survey): This monthly survey, conducted by the Bureau of Labor Statistics, collects data on job openings, hires and separations from some 16,000 US businesses. It covers all nonagricultural industries in the public and private sectors for the 50 states and the District of Columbia.

MSCI Europe Index: The **MSCI Europe Index** captures large and mid-cap representation across 15 Developed Markets (DM) countries in Europe.

MSCI Emerging Markets Index captures large and mid cap representation across 27 Emerging Markets (EM) countries. With 1,417 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI Japan Index: The MSCI Japan Index is designed to measure the performance of the large and mid-cap segments of the Japanese market.

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

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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A separately managed account may not be appropriate for all investors. Separate accounts managed according to the particular Strategy may include securities that may not necessarily track the performance of a particular index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required.

For important information about the investment managers, please refer to Form ADV Part 2.

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