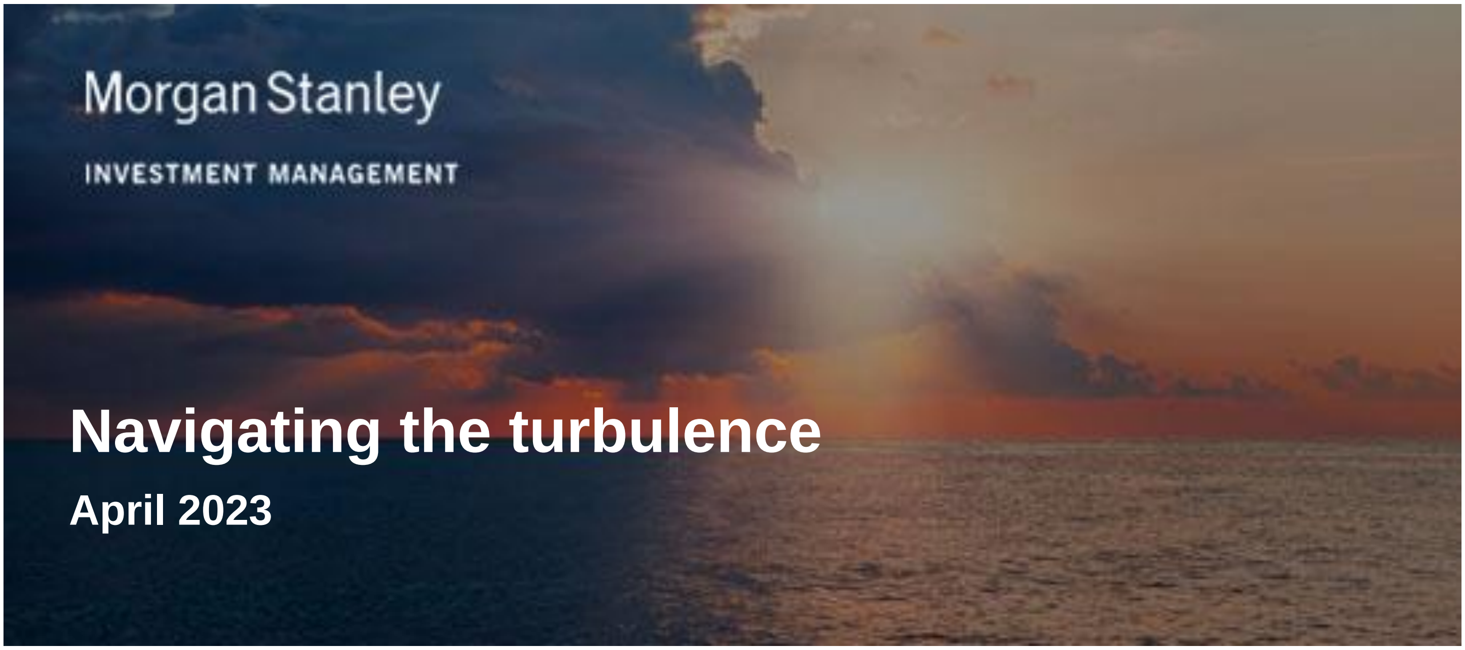


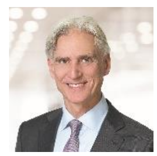
Morgan Stanley

INVESTMENT MANAGEMENT

Navigating the turbulence

April 2023

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



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Regional equity markets predominantly rebounded in March, with the US being the best performer as the S&P 500 (TR) (USD) returned 3.7%. The MSCI Japan Index returned 1.8%[1] (JPY) and the MSCI Emerging Markets (USD) Index was up 3.1%[1], while the MSCI Europe Index was flat, up just 0.1%[1] in local currency terms. Financials was the worst performing sector this month as the MSCI ACWI Financials Index returned -7.1%[2], given the negative news flow in the sector. The US 10-Year yield also fell, reflecting this negative sentiment as investors moved towards higher quality assets; the yield ended the month at 3.5%[2] after reaching a high of 4.06%[3] at the beginning of March. As equities rebounded, the VIX index moved down, reaching 18.7 by month end[2].

Inflation continues to slow in the US clocking in at 6%[4] in February, the lowest since September 2021, while the job market continues to confound expectations with an additional 311,000[5] jobs in February, easily surpassing the forecast of 208,000[5]. The Fed has predominantly concentrated on inflation during the previous 18 months, yet recent financial system stress, partially brought on by the fastest rate of hikes

Notes:
[1] Bloomberg, 1-month returns, local currency unless otherwise stated, as of 31 March 2023.
[2] Bloomberg, 31 March 2023.
[3] Bloomberg, 2 March 2023.
[4] Bureau of Labor Statistics, 14 March 2023. https://www.bls.gov/news.release/pdf/cpi.pdf
[5] Bureau of Labor Statistics, 10 March 2023. https://www.bls.gov/news.release/pdf/empsit.pdf

on record, has, in our opinion, changed policy priorities. The expectation of the implied terminal rate has decreased as a result of investors debating how much farther the Fed can raise interest rates before creating additional stress.

While we do not view the recent banking sector volatility as systemic and a reflection of weakness in the banking sector, but rather a regional predicament as a result of mismanagement at certain banks, these events have provided the impetus to further tightening of financial conditions that the Fed rate hikes alone were unable to do. The Federal Open Market Committee (FOMC) meeting in March showed a cautious but resolute Fed, with another 25-basis point rate hike but dovish forward guidance signalling an imminent end to the rate hike cycle.

We anticipate that financial markets may remain turbulent in the near term given investor uncertainty about economic growth, inflation and Fed/Central Bank policy. However, a sharper recession is unlikely to occur if Fed policy maintains its current "tighter for longer" policy complemented by the "data dependent" caveat. If economic conditions stabilise, we could see upside in markets given what appears to be overarching negative sentiment and positioning.

Investment Implications

There remains a lot of negativity and fear in the markets and while we recognize the near term will likely be volatile and stressful, we remain cautious and balanced rather than defensive in our positioning as we believe a slowdown in economic activity and a reduction in longer term inflation risks are beneficial in the long run. That said, we trimmed overall equities exposure and remain nimble in our positioning, continuing to actively seek investment opportunities. It is in this context that we made the following tactical changes in March:

Eurozone Banks

We trimmed the exposure to Eurozone banks once the sector rebounded, given growing risks and lower absolute upside on rates and earnings for the banking sector. However, we continue to hold some exposure, to look beyond the short-term panic.

Japan equities

We removed the underweight to Japanese equities as earnings revisions have turned positive and the sector appears to be performing more in line with global equities. We also believe there is limited upside potential for the Yen and there appears to be less headwinds for currency appreciation.

Emerging Market equities

We removed the overweight from Emerging Market equities as we see limited positive potential outside of China. In contrast, Chinese equities continue to look attractive after the reopening of the economy.

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				
Eurozone			Latest		
Eurozone Banks				Latest	Previous
FTSE MIB				Latest	
US & EU Energy					Latest
UK			Latest		
Japan		Previous	Latest		
Asia ex Japan			Latest		
Emerging Markets			Latest	Previous	
China					Latest
Global Growth			Latest		
Global Infrastructure			Latest		
Global Property			Latest		
Commodities					
Gold			Latest		
Oil					Latest
Copper				Latest	

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

Latest view   Previous view

Source: MSIM GBaR team. Previous view is as of 28 February 2023 and current view is as of 31 March 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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