Morgan Stanley

INVESTMENT MANAGEMENT

SLIMMON'S TAKE > TAKEAWAYS & KEY EXPECTATIONS

Andrew Slimmon July 2020 Equity Market Commentary

SOLUTIONS & MULTI-ASSET | APPLIED EQUITY ADVISORS TEAM | SLIMMON'S TAKE | JULY 2020

AUTHOR

ANDREW SLIMMON
Managing Director and Senior Portfolio Manager, Applied Equity Advisors

1. For Applied Equity Advisors (AEA), June has capped off a good quarter and successful year-to-date.

   Congratulations to the AEA team, portfolio manager Phillip, portfolio specialist Leslie, our analysts: Hannah, Roby and Steven and our trader, Jack. They made the transition to "work from home" for AEA seamless and successful.

2. If 'Don't Fight the Fed' is so obvious, why are so many doing exactly that, evidenced by continued high levels of pessimism and piles of cash on the side-lines?

   The Fed is only ultra-accommodative when something is terribly wrong with the economy. They do not normally pump liquidity when everything is perfect. Yet investors focus more on the problem than the Fed's actions.

   Last week, one Fed official described the current economic environment as *"the thick fog of uncertainty*" and "*downside risks prevail*", calling for "*a sustained commitment to accommodation along with fiscal support.*"[1]

   There isn't a more comforting message for investors. It's the "all-clear" signal for risk assets, in my opinion! The Fed is your friend.

   However, also last week, a different Fed official said that 2021 "*will see an above-trend growth*."[2] This seems to be a message that the liquidity pump could be shut down or at least reduced next year. Don't expect the Fed to be as accommodative next year.

   I believe 2020 is likely to be a surprisingly good year for equities, but 2021 might disappoint.

---

[1] ActionForex.Com. Fed's Brainard. July 15, 2020

[2] CNBC.com. Fed's Kaplan. July 14, 2020

The returns of the market referred to in the commentary are those of representative indices. 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.

3. As highlighted in the charts in last month's commentary, secular growth stocks are in a bubble similar to 1999-2000. Bubbles ultimately pop, and the carnage is painful.

   Yet, bubbles can inflate *far longer than bears expect.*

   We also showed that the best time to buy value stocks has been when exiting recessions.

   BUT it's not a straight line up and to the right in the value names. Weak holders tend to be shaken out due to the uncertainty of the economic recovery. Especially when there is rampant speculation in secular growth stocks, as we see today.

   The question is when to sell the winners and buy the laggards?

4. As a "core manager" we can manage the style transition in our portfolios gradually. Our positioning in the US has migrated from broadly less value / more growth at the beginning of the year to more value / less growth for our three active strategies today.[3] This was a gradual transition which should continue in the direction of value.

   In our opinion, managing this transition within a core portfolio is far easier than trying to determine the best time to pull the ripcord on a growth manager and allocate to a value manager.

5. Lately we have received a number of questions about Europe.

   Remember, we only have a fixed amount of assets to allocate across all regions. In our view, Asia ex-Japan and the US are far more fertile areas to invest capital than Europe, or Japan, for that matter.

   We are willing to bet that value stocks in the US will work, because we expect the US to experience a strong economic rebound in 2021 as per the above quote from the Fed. We are less convinced of a strong economic rebound in Europe, and that would be required given Europe's heavy weight toward cyclical sectors.

6. One final point on regional weightings. In our global strategies we are underweight the US, but only due to our significant allocation to Asia ex-Japan. In our opinion, when the books are closed on 2020, Asia ex-Japan will be the only region of the world that will have outperformed the US.

7. What about the US Presidential election and its impact on the market?

   Here are some facts:

   a) Since 1929, the stock market has performed better under Democratic Presidents than Republican.[4]
   b) Since 1912, in the 100 trading days leading up to a Presidential election, the market has rallied every time a Republican was ultimately re-elected and traded down 80% of the time when a Democrat candidate unseated the Republican.[5]
   c) Since 1900, there have been six Presidents who have run for re-election when the economy has experienced a recession at some point in the two years before the election. With the exception of Calvin Coolidge in 1924, none of the six were re-elected. On the flip side, without a recession, we have re-elected the sitting President *every time*.

   If the result of the upcoming election were purely consistent with history, Joe Biden would be elected in November. The market would be weak ahead of the election, but ultimately it would do fine.

   For those who need a "but this time could be different" scenario, here are two:

   a) Biden is viewed as a centrist candidate. Therefore the market may not react as negatively as it has in the past with the thought of a potential Democratic President.
   b) Clearly when it comes to re-elections, we vote with the economy and our wallets. It's hard to argue with the data. If the economy is in a

[3] Based on Morningstar core/value and growth ratings as of July 20, 2020.

[4] Forbes, Democrats vs. Republicans. July 26, 2016.

[5] Sentiment Trader. June 16, 2020.

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

recession, then the wallet is thinner, especially for those who have lost their jobs.

But is the wallet thinner this time? A University of Chicago study found that 68% of workers who received unemployment insurance through the CARES act have had benefits that exceed their lost earnings. More notably, the average benefit is 134% of lost earnings.[6] Therefore, for many, the wallet is actually ***thicker***.

Andrew

[6] FEE. Foundation for Economic Education. June 15, 2020

RISK CONSIDERATIONS

THERE IS NO ASSURANCE THAT A PORTFOLIO 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 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 PORTFOLIO MAY BE SUBJECT TO CERTAIN ADDITIONAL RISKS. IN GENERAL, EQUITIES SECURITIES' VALUES ALSO FLUCTUATE IN RESPONSE TO ACTIVITIES SPECIFIC TO A COMPANY. STOCKS OF SMALL- AND MEDIUM-CAPITALIZATION COMPANIES ENTAIL SPECIAL RISKS, SUCH AS LIMITED PRODUCT LINES, MARKETS AND FINANCIAL RESOURCES, AND GREATER MARKET VOLATILITY THAN SECURITIES OF LARGER, MORE ESTABLISHED COMPANIES. INVESTMENTS IN FOREIGN MARKETS ENTAIL SPECIAL RISKS SUCH AS CURRENCY, POLITICAL, ECONOMIC, MARKET AND LIQUIDITY RISKS. ILLIQUID SECURITIES MAY BE MORE DIFFICULT TO SELL AND VALUE THAN PUBLICLY TRADED SECURITIES (LIQUIDITY RISK). NON-DIVERSIFIED PORTFOLIOS OFTEN INVEST IN A MORE LIMITED NUMBER OF ISSUERS. AS SUCH, CHANGES IN THE FINANCIAL CONDITION OR MARKET VALUE OF A SINGLE ISSUER MAY CAUSE GREATER VOLATILITY.

DEFINITIONS

The indexes are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an index. Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto. The **S&P 500® Index** measures performance of the large cap segment of the U.S. equities market, covering approximately 75% of the U.S. market, including 500 leading companies in the U.S. economy. The **Russell 1000 Index** is an index of approximately 1,000 of the largest companies in the U.S. equity market. The Russell 1000 is a subset of the Russell 3000 Index. It represents the top companies by market capitalization. The Russell 1000 typically comprises approximately 90% of the total market capitalization of all listed U.S. stocks. The **MSCI World Index** is a free float adjusted market capitalization weighted index that is designed to measure the global equity market performance of developed markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends. The **Shanghai Composite Index** is a capitalization-weighted stock market index designed to track the price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange. Standard deviation is a measure that is used to quantify the amount of variation or dispersion of a set of data values.

DISTRIBUTION

This communication is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

Ireland: Morgan Stanley Investment Management (Ireland) Limited. Registered Office: The Observatory, 7-11 Sir John Rogerson's, Quay, Dublin 2, Ireland. Registered in Ireland under company number 616662. Regulated by the Central Bank of Ireland. **United Kingdom:** Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA, authorised and regulated by the Financial Conduct Authority. **Dubai:** Morgan Stanley Investment Management Limited (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). **Germany:** Morgan Stanley Investment Management Limited Niederlassung Deutschland, Grosse Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Italy:** Morgan Stanley Investment Management Limited, Milan Branch (Sede Secondaria di Milano) is a branch of Morgan Stanley Investment Management Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), and whose registered office is at 25 Cabot Square, Canary Wharf, London, E14 4QA. Morgan Stanley Investment Management Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 08829360968. **The Netherlands:** Morgan Stanley Investment Management, Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of Morgan Stanley Investment Management Limited. Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **Switzerland:** Morgan Stanley & Co. International plc, London, Zurich Branch Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-115.415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41(0) 44 588 1074.

Japan: For professional investors, this document is circulated or distributed for informational purposes only. For those who are not professional investors, this document is provided in relation to Morgan Stanley Investment Management (Japan) Co., Ltd. ("MSIMJ")'s business with respect to discretionary investment management agreements ("IMA") and investment advisory agreements ("IAA"). This is not for the purpose of a recommendation or solicitation of transactions or offers any

particular financial instruments. Under an IMA, with respect to management of assets of a client, the client prescribes basic management policies in advance and commissions MSIMJ to make all investment decisions based on an analysis of the value, etc. of the securities, and MSIMJ accepts such commission. The client shall delegate to MSIMJ the authorities necessary for making investment. MSIMJ exercises the delegated authorities based on investment decisions of MSIMJ, and the client shall not make individual instructions. All investment profits and losses belong to the clients; principal is not guaranteed. Please consider the investment objectives and nature of risks before investing. As an investment advisory fee for an IAA or an IMA, the amount of assets subject to the contract multiplied by a certain rate (the upper limit is 2.20 % per annum (including tax)) shall be incurred in proportion to the contract period. For some strategies, a contingency fee may be incurred in addition to the fee mentioned above. Indirect charges also may be incurred, such as brokerage commissions for incorporated securities. Since these charges and expenses are different depending on a contract and other factors, MSIMJ cannot present the rates, upper limits, etc. in advance. All clients should read the Documents Provided Prior to the Conclusion of a Contract carefully before executing an agreement. This document is disseminated in Japan by MSIMJ, Registered No. 410 (Director of Kanto Local Finance Bureau (Financial Instruments Firms)), Membership: the Japan Securities Dealers Association, The Investment Trusts Association, Japan, the Japan Investment Advisers Association and the Type II Financial Instruments Firms Association.

U.S.

A separately managed account may not be appropriate for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any 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 manager, please refer to Form ADV Part 2.

Please consider the investment objectives, risks, charges and expenses of the funds carefully before investing. The prospectuses contain this and other information about the funds. To obtain a prospectus please download one at morganstanley.com/im or call 1-800-548-7786. Please read the prospectus carefully before investing.

Morgan Stanley Distribution, Inc. serves as the distributor for Morgan Stanley Funds.

NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A BANK DEPOSIT

Hong Kong: This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed or approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore**: This document should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"); (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This publication has not been reviewed by the Monetary Authority of Singapore. **Australia**: This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accept responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.

IMPORTANT INFORMATION

EMEA:

This communication has been issued by Morgan Stanley Investment Management Limited ("MSIM"). Authorised and regulated by the Financial Conduct Authority. Registered in England No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Prior to investing, investors should carefully review the strategy's / product's relevant offering document. There are important differences in how the strategy is carried out in each of the investment vehicles.

This material is a general communication, which is not impartial and has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. All investments involve risks, including the possible loss of principal. The information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

Except as otherwise indicated, the views and opinions expressed herein are those of the portfolio management team, are based on matters as they exist as of the date of preparation and not as of any future date, and will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date hereof.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific Morgan Stanley Investment Management product.

This communication is not a product of Morgan Stanley's Research Department and should not be regarded as a research recommendation. The information contained herein has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

Certain information herein is based on data obtained from third party sources believed to be reliable. However, we have not verified this information, and we make no representations whatsoever as to its accuracy or completeness.

MSIM has not authorised financial intermediaries to use and to distribute this document, unless such use and distribution is made in accordance with applicable law and regulation. Additionally, financial intermediaries