Morgan Stanley

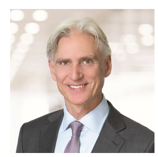
INVESTMENT MANAGEMENT

2 October 2020 – Market Update
Road to Recovery: 2020’s Final Lap

SOLUTIONS & MULTI-ASSET | GLOBAL BALANCED RISK CONTROL TEAM | MARKET PULSE

As we enter the last quarter of 2020, we face some obstacles which threaten the road to recovery. We are now within weeks of the US Presidential election, which could produce an even higher degree of uncertainty than usual, with the potential for a drawn-out resolution if the outcome is contested. In addition, the US Congress has not yet decided on a fiscal stimulus package to replace the expired programmes[1], which were helping to prop up the economy earlier in the year.

These matters could be resolved by the beginning of 2021, clearing the road for recovery to continue. However, near-term uncertainty could be a source of short term volatility. The September momentum break pushed equity valuations down moderately, but they still appear stretched. All of these point to the likelihood of a further correction and volatility.



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US election uncertainty

It is possible that we will not see a clear election result immediately and were he to lose, President Trump has said that there are circumstances where he would not commit to a peaceful transition of power. If the results are in fact challenged or the process of confirming the winner is dragged out significantly, this could trigger market volatility.

1. Paycheck Protection Program (PPP) and the extra $600 per week unemployment payment from the CARES Act, which expired at the end of July. The US Coronavirus Aid, Relief, and Economic Security Act, signed 27 March 2020. $2 trillion stimulus package to support the economy due to the impact of COVID-19 pandemic. www.home.treasury.gov/policy-issues/cares

Gridlock in Congress

Congress has been in gridlock over a fiscal stimulus package for some months now. However, as urgent as it was at the end of July when programmes expired, the timeframe is now even more limited. Recently, Jerome Powell, Chairman of the Federal Reserve, re-affirmed the Fed's commitment to supporting the recovery[2]. However, testifying to the House Select Committee, he stressed the need for more fiscal stimulus. Despite this, if the Democrats and Republicans cannot confirm a deal soon, there is a real concern that there will be no package until after the election, which would be another blow to recovery in Q4. The Democrats are currently proposing a $2.2tn bill - an update of the Heroes Act, for which the House voted in favour on 1 October. The White House appears to be counter offering with a potential $1.6tn bill, though the details at the time of writing are not yet concrete. Evidently, the situation is dynamic and could change at any time.

Whilst we are focusing on the US in this note, stimulus from other governments across the globe is not forgotten. For instance, there are a number of updates to the EU's Green Deal including details on the €750bn Recovery Fund, of which President von der Leyen would like to see 37% spent on European Green Deal objectives, with €225bn of the Fund to be raised through green bonds[3].

Longer term there are reasons to be positive

In all, Q4 2020 has plenty of uncertainties likely to hinder growth in the short-term. At least one large US-based retail broker has increased their margin requirements and we view this as another indication that an increasing number of market participants foresee a period of volatility. However, looking at the longer-term, we believe most issues could be resolved by the beginning of 2021. Furthermore, there is still the potential for progress in tackling the virus from two angles, either through a vaccine and/or advancements in treatment.

Investment positioning

Since our last note, we have not made any changes to our tactical positioning and retain a significantly below average exposure to equities. Moreover, towards the end of September, we moderately reduced exposure to risk assets, as part of our continual calibration of the portfolios we manage, to ensure we remain on track with respect to target volatility. We are "keeping our powder dry" to propel reinvestment once the volatility outlook improves.

2. Chairman Jerome Powell, Coronavirus Aid, Relief, and Economic Security Act, 22 September 2020 www.federalreserve.gov/newsevents/testimony/powell20200922a.htm
3. Morgan Stanley Research. Sustainability Update. CO2 Spotting: EU Green Deal and China's carbon pledge. Published 1 October 2020.

Broad Asset Allocations

We have provided the latest effective asset allocation weights of each of our five Luxembourg SICAV funds in the following table, as of 1 October 2020.

	VOLATILITY P.A. [1]	EQUITY %	FIXED INCOME %	COMMODITIES %	CASH %*	
					PHYSICAL	SYNTHETIC*
MS INVF Global Balanced Risk Control Fund of Funds (EUR)	4% – 10%	26.0	62.7	2.0	5.8	3.6
MS INVF Global Balanced Income Fund (EUR)	4% – 10%	24.7	56.1	1.9	9.4	8.0
MS INVF Global Balanced Fund (EUR)	4% – 10%	28.2	59.3	2.0	10.2	0.3
MS INVF Global Balanced Defensive Fund (EUR)	2% – 6%	12.4	69.2	1.0	7.6	9.8
MS INVF Multi-Asset Risk Control Fund (USD)	4% - 10%	0.8	69.9	1.9	24.5	2.9

*Synthetic cash created from derivatives positions.
We have provided the effective weights for 1 October 2020 at the time of publication. Weights may deviate marginally from these weights after publication due to data revisions.

Source: Global Balanced Risk Control team, Morgan Stanley Investment Management. Allocations are subject to change on a daily basis and without notice. For information only and not a recommendation to buy or sell specific investment strategy. MS INVF standards for Morgan Stanley Investment Funds. [1.] Volatility targets are indicative ranges. There is no assurance that these targets will be attained.

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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. 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. **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**

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