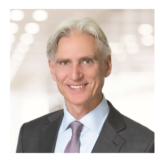
Morgan Stanley

INVESTMENT MANAGEMENT

21 August 2020 – Market Update

Global markets: China's positive outlook may not benefit the rest of the world

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



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The rally in global markets appears to be slowing, even as the S&P 500[1] finally regained losses suffered during the late February to March market plunge. Whilst there are tentative reasons for optimism, reflected in US and European manufacturing PMIs, and improving capex intentions, there are also indications of near-term deterioration in growth, supporting our view to stay cautious. In addition, the delay in an agreement on further US fiscal stimulus does raise the risk to the economic recovery, which is very dependent on abundant government support. This is a further reason to remain cautious. Moreover, unlike past crises we believe that the rest of the world cannot rely on China to stimulate and pull the world out of recession.

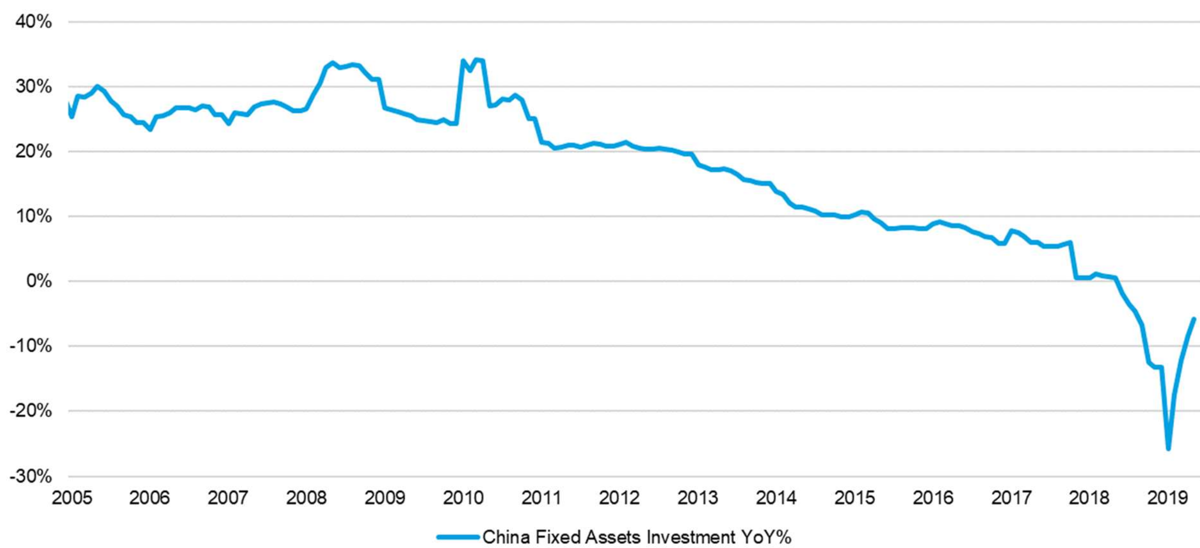
The signs continue to point to deterioration in economic growth in the near-term. In most Developed Market countries consumer confidence improved meaningfully in June, but has since come down in the US and stalled in the eurozone[2]. Savings intentions also rose in the EU, reflecting concerns over a resurgence of COVID-19. As discussed in previous notes, bankruptcies continue to increase and there is evidence in the US unemployment figures that temporary unemployment is turning into permanent unemployment.

[1] The S&P 500 fell 34% from 19 February 2020 to 23 March 2020. The S&P 500 closed 3386, 19 February 2020 and closed 3390, 18 August 2020. 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.
[2] In the US consumer confidence index variation was -29.9% 15 June 2020 versus 15 December 2019, but this fell to -35.6% in 15 July 2020 versus 15 December 2019. Source: The conference board.

China's positive outlook may not benefit the rest of the world

We have had a positive view on China since we initiated an overweight position in February. This view has only been further reinforced subsequently and we added further to our China overweight during July. A number of factors are contributing to a positive picture for China. Fundamentals have been improving and not only is China ahead of other countries in its recovery from the pandemic, since 2018 broad credit growth has been and remains, a strong stimulus for the Chinese economy.

However, whilst their policy is benefiting China, unlike previous crises such as the Great Financial Crisis and the 2015 Chinese stock market collapse, we do not expect China to play the same key role in pulling the rest of the world out of recession. For instance, China is avoiding stimulating the economy through debt and is deploying less capex than in past crises. Secondly, China's position has evolved politically over the years. During previous crises, relations were being built and there was the incentive to be co-operative. However, the US-China trade tensions over the past few years mean that China may not have the same political reasons to unleash stimulus on the same scale as before. The net effect of this policy shift is higher net exports and a reduced benefit for the rest of the world. Indeed, in July Chinese imports were up 13.2% over the past 3 months versus 18.7% for exports[3]. Therefore, we are seeing recovery in both, but exports are recovering faster.



Source: Datastream, Markit, MSIM. Data as of 5 August 2020.

Reasons for some optimism

There are reasons to be optimistic given some of the data is pointing to an increase in activity in 2H 2020. For instance, increasing corporate confidence is being reflected in improving US manufacturing capex intentions[4]. In addition, manufacturing PMIs have been strong globally, especially for Europe, but we are also seeing a rebound in the US, China and Brazil. New orders in Europe were strong, particularly with respect to Germany, Italy, France, UK and Poland. For Germany the increase can be attributed to pent-up demand, but also increased demand for exports to China. This is encouraging, especially in light of the fact we have been in a manufacturing

[3] Source: Bloomberg. China Import Trade in USD (CNFRIMP$ Index), China Export Trade in USD (CNFREXP$), as of 31 July 2020.
[4] Source: Average future capital expenditure for New York, Philadelphia and Texas diffusion indices was -6.4 in April 2020 and 15.6 in July 2020. Source: Federal Reserve Bank of St Louis. www.fred.stlouisfed.org. A diffusion index is a statistical measure often used to detect economic turning points. It aggregates multiple indicators by examining whether they are trending upward or downward, but ignores the magnitude of the movement.

downturn since end 2017 to the beginning of 2020. However, we believe caution should be exercised given manufacturing job cuts, and despite new orders and intentions rising, the absolute output activity is suppressed. Whilst there may be some bright spots, as discussed in our last note, there is the potential for reversal in the positive economic data.

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 20 August 2020.

	VOLATILITY P.A. [1]	EQUITY %	FIXED INCOME %	COMMODITIES %	CASH %*	
					PHYSICAL	SYNTHETIC*
MS INVF Global Balanced Risk Control Fund of Funds (EUR)	4% – 10%	31.4	61.8	1.9	5.3	-0.5
MS INVF Global Balanced Income Fund (EUR)	4% – 10%	27.0	54.9	1.9	10.2	6.0
MS INVF Global Balanced Fund (EUR)	4% – 10%	32.7	55.9	2.0	2.5	6.8
MS INVF Global Balanced Defensive Fund (EUR)	2% – 6%	11.7	70.1	1.4	6.8	10.0
MS INVF Multi-Asset Risk Control Fund (USD)	4% - 10%	23.0	60.3	2.2	9.6	4.9

*Synthetic cash created from derivatives positions.
We have provided the effective weights for 20 August 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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MSCI All-Country World Index: The Morgan Stanley Capital International (MSCI) All Country World Index (ACWI) is a free float-adjusted market capitalisation index that is designed to measure equity market performance in the global developed and emerging markets.

Purchasing Managers Index (PMI): The Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

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

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