



# 8 September 2020 – Market Update

## Warning: Ice on the road ahead

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

European and US investors returned from their traditional summer holiday period to a market pullback, with the VIX spiking to highs of 38<sup>1</sup> after hovering throughout August around the low 20s. The US led the decline as the S&P 500 fell 4.3% over two trading days during the first week of September and the NASDAQ was down 6.2%<sup>2</sup>. There may have been an element of profit-taking driving the pullback after the huge rally markets experienced since the March sell-off.

We are concerned that despite the market rally we have experienced since March, as we already look ahead to winter, exuberant investors may in time hit ice, with the potential to skid off the road. As the economic impact of COVID-19 becomes clearer and, potentially, support from governments and central banks tails off, the key risk is that the momentum could be derailed. The pullback may be a warning sign that a long-anticipated correction is on its way, which could be significant in scale.

Despite the positive sentiment in parts of the market, we do not believe it is the right time to increase equity exposure. The opportunity to raise equity levels may present itself before the end of 2020, should a correction bring valuations and sentiment – which are currently extreme – back to more reasonable levels, but we are prepared to be patient, to maintain portfolio volatility close to target levels.



**ANDREW HARMSTONE**  
*Managing Director,  
Lead Global Portfolio Manager,  
Global Balanced Risk Control  
Team*



**MANFRED HUI**  
*Managing Director,  
Co-Lead Global Portfolio  
Manager, Global Balanced  
Risk Control Team*



**CHRISTIAN GOLDSMITH**  
*Executive Director,  
Portfolio Specialist,  
Global Balanced Risk  
Control Team*

<sup>1</sup> Bloomberg, as of 4 September 2020.  
<sup>2</sup> Bloomberg, 3 and 4 September 2020.

## **Tactical Positioning**

Since our last note on 21 August, we have not made any changes to our broad asset mix. However, we continue to look for tactical opportunities and have made the following changes, which we discuss below:

### **German equities**

We are relatively optimistic on EU growth given the following:

1. The manufacturing sector's stronger relative growth prospects in the short-term should benefit the EU greatly, as the sector represents a larger proportion of the EU GDP relative to the US. The EU also has stronger consumer spending trends and welfare support than the US. Moreover, short-term work programmes in the EU are expected to be extended in 2020. In contrast, the US's supplementary benefits expired at the end of July 2020, with Congress failing to agree on further stimulus before the August recess.
2. The agreement of the EU Recovery Plan in July 2020, with capital of EUR 750bn expected to be mobilised in early 2021 through to 2024<sup>3</sup>.
3. National fiscal spending plans have already been announced in Germany (worth 9% of GDP over 2020-21) and France (4% of GDP for 2021-22)<sup>4</sup>.

Overall, eurozone GDP growth is expected to be higher than in the US for the next three quarters. However, within the EU, we expect Germany to emerge from the crisis the fastest, having suffered relatively less of a hit to growth compared with other EU economies, and is better placed to outperform during the recovery. For this reason on 20 August we moved from neutral to overweight German equities.

With respect to fundamentals, Germany has contained the pandemic outbreak relatively well and is well placed to continue to outperform on this front, owing to both more hospital capacity and a more effective health policy response. Moreover, Germany's economy has a high share of manufacturing relative to EU peers and conversely a lower share to those sectors most affected by containment measures, such as tourism. The periphery's elevated exposure to tourism and the recent disruption to summer travel, suggest economies such as Italy and Spain will see another outsized hit to growth in Q3 2020. Germany has also announced and implemented sizeable fiscal support year-to-date. When looking at valuations, Germany's attractive relative FY2 PE multiples and an under-allocation to the country by investors support the case for outperformance.

3. EU Commission. [www.ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/recovery-plan-europe\\_en](http://www.ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/recovery-plan-europe_en)

4. Source: GS, Europe on track for outperformance.

**Germany’s manufacturing exposure is the highest among EMU countries and is currently benefitting from strong auto export demand**



Source: OECD, World Bank, Datastream, MSIM. Data as of 1 September 2020. Forecasts/estimates are based on current market conditions, subject to change and may not necessarily come to pass.

However, there are a number of key risks to Germany’s recovery, the biggest of which is its reliance on external demand, which could be jeopardised by a hard Brexit, renewed trade tensions between the US and China and a slower global recovery due to persistent surges in COVID-19 cases across many US states. During the two-day pullback the DAX was down 3%<sup>5</sup> however, this is a position which we believe should play out positively in the long term. Indeed, on the trading day following the pullback, the DAX partially recovered and was up 2%<sup>6</sup>.

**Global renewable energy**

On 20 August for portfolios that permit it, we added to our position in global renewable energy, which we first initiated on 20 July 2020. This was based on our continued conviction of this sector’s exposure to positive structural growth trends, which are increasingly being supported by both government policy and economic incentives to invest in clean energy. Whilst the iShares Global Clean Energy ETF was down 8.5%<sup>5</sup>, it regained some of this on the trading day following the pullback and was up 3.8%<sup>6</sup>. We believe this is also a position which will benefit over the long term.

5. Bloomberg, over 3 and 4 September 2020.

6 Bloomberg, on day return, as of 7 September 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 8 September 2020.

	VOLATILITY P.A. <sup>1</sup>	EQUITY %	FIXED INCOME %	COMMODITIES %	CASH %*	
					PHYSICAL	SYNTHETIC*
MS INVF Global Balanced Risk Control Fund of Funds (EUR)	4% – 10%	32.4	62.3	1.9	6.1	-2.6
MS INVF Global Balanced Income Fund (EUR)	4% – 10%	29.5	55.2	1.9	10.4	3.1
MS INVF Global Balanced Fund (EUR)	4% – 10%	33.8	56.4	2.0	7.3	0.5
MS INVF Global Balanced Defensive Fund (EUR)	2% – 6%	16.7	70.6	1.4	5.8	5.6
MS INVF Multi-Asset Risk Control Fund (USD)	4% - 10%	25.2	60.2	2.2	8.4	4.1

\*Synthetic cash created from derivatives positions.

We have provided the effective weights for 8 September 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. <sup>1</sup> Volatility targets are indicative ranges. There is no assurance that these targets will be attained.

## RISK CONSIDERATIONS

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**

**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. **Diversification** does not protect you against a loss in a particular market; however, it allows you to spread that risk across various asset classes.

## 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.

**DAX index:** This index represents 30 of the largest and most liquid German companies that trade on the Frankfurt Exchange.

**NASDAQ Composite Index:** A broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market.

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

**Price-Earnings (P/E)** is the price of a stock divided by its earnings per share for the past 12 months. Sometimes called the multiple, P/E gives investors an idea of how much they are paying for a company's earning power. The higher the P/E, the more investors are paying, and therefore the more earnings growth they are expecting.

**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.

## DISCLOSURES

The views and opinions are those of the author as of the date of publication and are subject to change at any time due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all portfolio managers at Morgan Stanley Investment Management

(MSIM) or the views of the firm as a whole, and may not be reflected in all the strategies and products that the Firm offers.

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.

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.

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.

The information herein is a general communications which is not impartial and has been prepared solely for information 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.

The material contained herein has not been based on a consideration of any individual client 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.

**Past performance is no guarantee of future results.** Charts and graphs provided herein are for illustrative purposes only. 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.

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

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 product's relevant offering document. There are important differences in how the strategy is carried out in each of the investment vehicles.

## 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 4th Floor Junghofstrasse 18-26, 60311 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.

**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 nor 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 publication 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 accepts 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.

## LatAm

**BRAZIL.** This document does not constitute a public offering of securities for the purposes of the applicable Brazilian regulations and has therefore not been and will not be registered with the Brazilian Securities Commission (Comissão de Valores Mobiliários) or any other government authority in Brazil. All information contained herein is confidential and is for the exclusive use and review of the intended addressee of this document, and may not be passed on to any third party.

**CHILE.** Neither the Fund nor the interests in the Fund are registered in the Registry of Offshore Securities (el Registro de Valores Extranjeros) or subject to the supervision of the Commission for the Financial Market (la Comisión para el Mercado Financiero). This document and other offering materials relating to the offer of the interests in the Fund do not constitute a public offer of, or an invitation to subscribe for or purchase, the Fund interests in the Republic of Chile, other than to individually identified purchasers pursuant to a private offering within the meaning of Article 4 of the Chilean Securities Act (la Ley del Mercado de Valores) (an offer that is not "addressed to the public at large or to a certain sector or specific group of the public").

**COLOMBIA.** This document does not constitute an invitation to invest or a public offer in the Republic of Colombia and is not governed by Colombian law. The interests in the Fund have not been and will not be registered with the National Register of Securities and Issuers (el Registro Nacional de Valores y Emisores) maintained by the Financial Supervisory Authority of Colombia (la Superintendencia Financiera de Colombia) and will not be listed on the Colombian Stock Exchange (la Bolsa de Valores de Colombia). The interests in the Fund are being offered under circumstances which do not constitute a public offering of securities under applicable Colombian securities laws and regulations. The offer of the interests in the Fund is addressed to fewer than one hundred specifically identified investors. Accordingly, the interests in the Fund may not be marketed, offered, sold or negotiated in Colombia, except under circumstances which do not constitute a public offering of securities under applicable Colombian securities laws and regulations. This document is provided at the request of the addressee for information purposes only and does not constitute a solicitation. The interests in the Fund may not be promoted or marketed in Colombia or to Colombian residents unless such promotion and marketing is carried out in compliance with Decree 2555 of 2010 and other applicable rules and regulations related to the promotion of foreign financial and securities related products or services in Colombia.

Colombian eligible investors acknowledge that the interests in the Fund (i) are not financial products, (ii) are transferable only in accordance with the terms of the Fund's constitutional documents and (iii) do not offer any principal protection.

Colombian eligible investors acknowledge Colombian laws and regulations (in particular, foreign exchange, securities and tax regulations) applicable to any transaction or investment consummated in connection with an investment in the Fund, and represent that they are the sole liable party for full compliance with any such laws and regulations. In addition, Colombian investors acknowledge and agree that the Fund will not have any responsibility, liability or obligation in connection with any consent, approval, filing, proceeding, authorization or permission required by the investor or any actions taken or to be taken by the investor in connection with the offer, sale or delivery of the interests in the Fund under Colombian law.

**MEXICO.** Any prospective purchaser of the interests in the Fund must be either an institutional investor (inversionista institucional) or a qualified investor (inversionista calificado) within the meaning of the Mexican Securities Market Law (Ley del Mercado de Valores) (the "Securities Market Law") and other applicable Mexican laws in effect.

The interests in the Fund have not and will not be registered in the National Registry of Securities (Registro Nacional de Valores) maintained by the Mexican Banking and Securities Commission (Comisión Nacional Bancaria y de Valores). The interests in the Fund may not be offered or sold in the United Mexican States by any means except in circumstances which constitute a private offering pursuant to Article 8 of the Securities Market Law and its regulations. No Mexican regulatory authority has approved or disapproved the interests in the Fund or passed on the solvency of the Fund. All applicable provisions of the

Securities Market Law must be complied with in respect of any sale, offer or distribution of, or intermediation in respect of, the Fund interests in, from or otherwise involving Mexico, and any resale of the interests in the Fund within Mexican territory must be made in a manner that will constitute a private offering pursuant to Article 8 of the Securities Market Law and its regulations.

**PERU.** The interests in the Fund have not been and will not be registered in Peru under Decreto Legislativo 862: Ley de Fondos de Inversión y sus Sociedades Administradoras or under Decreto Legislativo 861: Ley del Mercado de Valores (the "Securities Market Law"), and are being offered to institutional investors only (as defined in article 8 of the Securities Market Law) pursuant to a private placement, according to article 5 of the Securities Market Law. The interests in the Fund have not been registered in the securities market public registry (Registro Público del Mercado de Valores) maintained by, and the offering of the Fund interests in Peru is not subject to the supervision of, the Superintendencia del Mercado de Valores. Any transfers of the Fund interests shall be subject to the limitations contained in the Securities Market Law and the regulations issued thereunder.

**URUGUAY.** The offering of the Interests qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. The Interests will not be offered or sold to the public (Individuals or Companies) in Uruguay, except in circumstances which do not constitute a public offering or distribution through a recognized Exchange under Uruguayan laws and regulations. Neither the Fund nor the Interests are or will be registered with la Superintendencia de Servicios Financieros del Banco Central del Uruguay. The Fund corresponds to an investment fund that is not an investment fund regulated by Uruguayan law 16,774 dated September 27, 1996, as amended.

#### IMPORTANT INFORMATION

**EMEA: This marketing 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.**

This document contains information relating to the sub-fund ("Fund") of Morgan Stanley Investment Funds, a Luxembourg domiciled Société d'Investissement à Capital Variable. Morgan Stanley Investment Funds (the "Company") is registered in the Grand Duchy of Luxembourg as an undertaking for collective investment pursuant to Part 1 of the Law of 17th December 2010, as amended. The Company is an Undertaking for Collective Investment in Transferable Securities ("UCITS").

Applications for shares in the Fund should not be made without first consulting the current Prospectus, Key Investor Information Document ("KIID"), Annual Report and Semi-Annual Report ("Offering Documents"), or other documents available in your local jurisdiction which is available free of charge from the Registered Office: European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxembourg B 29 192. In addition, all Italian investors should refer to the 'Extended Application Form', and all Hong Kong investors should refer to the

'Additional Information for Hong Kong Investors' section, outlined within the Prospectus. Copies of the Prospectus, KIID, the Articles of Incorporation and the annual and semiannual reports, in German, and further information can be obtained free of charge from the representative in Switzerland. The representative in Switzerland is Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva. The paying agent in Switzerland is Banque Cantonale de Genève, 17, quai de l'Île, 1204 Geneva. The document has been prepared solely 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 information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable European regulation or Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research. 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. MSIM shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary. If you are a distributor of the Morgan Stanley Investment Funds, some or all of the funds or shares in individual funds may be available for distribution. Please refer to your sub-distribution agreement for these details before forwarding fund information to your clients. The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without MSIM' express written consent. All information contained herein is proprietary and is protected under copyright law.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley. This document may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this document in another language, the English version shall prevail.