# The GIC Weekly

**LISA SHALETT**

*Head of Wealth Management Investment Resources*

*Head of Investment & Portfolio Strategies Morgan Stanley Wealth Management*

*Lisa.Shalett@morganstanley.com*

*+1 212 296-0335*

## What We Are Talking About

- **Oil Skids.** Some see the recent 20%-plus slide in oil prices as a harbinger of slowing global growth or a replay of 2014-15 oil-price crash that caused a global minirecession; in contrast, we see the current market driven by a confluence of oversupply and a radical shift in geopolitics and US policy; West Texas Intermediate (WTI) oil peaked at $76 per barrel exactly 24 hours after the discovery of the murder of Saudi journalist Jamal Khashoggi; US granted waivers on Iranian exports to punish the Saudis at the same time US production surprised to the upside; in response, Saudis upped output to assert market dominance; we expect a rebound in 2019 to the $68-$71 range for WTI and $78 for Brent, prices that are well above the industry's significantly improved break-even prices. **Consider** adding energy stocks, bonds and master limited partnerships with good cash flows and dividend support.

## Oil Skids

In October, the US stock market tumbled nearly 10%, in large part because of a better-than-expected economy. Reports of low unemployment and stronger wages were driving real interest rates up, pushing inflation expectations higher and cementing the pace of expected Federal Reserve rate hikes, all of which combined to compress price/earnings ratios. Beneath the surface, investors experienced ferocious sector rotation with growth, momentum and cyclical themes giving way to value, quality and defensive, a dynamic that was particularly punishing to the tech and consumer discretionary darlings that had dominated this cycle. This volatility, coming against the backdrop of third-quarter earnings reports, dominated the headlines and obscured the weakness in the oil markets. In many ways this was surprising as oil markets spent most of 2018 getting tighter. Inventories were drawn down, production peaked and year-over-year price gains ran at 30% to 40% as investors discounted Iranian sanctions, Permian Basin bottlenecks and chaos in oil producers Angola and Venezuela.

Although stocks found some footing this month, weakness in oil has persisted. In the

### Upcoming Catalysts

Nov. 20 US housing starts
Nov. 21 Japan CPI
Nov. 21 U. of M. Consumer Sentiment Index
Nov. 21 US durable goods orders
Nov. 21 US Leading Economic Index
Nov. 22 Euro Zone consumer confidence
Nov. 22 Japan Manufacturing PMI
Nov. 23 Markit Euro Zone Composite PMI
Nov. 23 Markit Euro Zone Manufacturing PMI
Nov. 23 Markit Euro Zone Services PMI
Nov. 23 Markit US Composite PMI
Nov. 23 Markit US Manufacturing PMI
Nov. 23 Markit US Services PMI

**Please refer to important information, disclosures and qualifications at the end of this material.**

first 12 trading days of November, West Texas Intermediate (WTI) fell more than $20 per barrel from the recent $76 peak; Brent oil slid to $65 from $86. Oil is officially in a bear market. With energy stocks getting crushed and spreads on energy-related high yield bonds widening by more than 100 basis points in only six weeks, investors are asking whether the move in oil is an early warning sign of economic weakness or worse, a reprise of the global minirecession suffered in 2014-2015 when the US fracking-driven supply glut and the Saudis' aggressive but ill-fated response to it crashed global capital spending. We have no reason to believe we are in a similar situation. Martijn Rats, Morgan Stanley & Co.'s global energy strategist, notes that by historical standards, global inventories remain lean, days-of-demand coverage is well below the five-year average and OPEC's spare capacity is low and expected to remain so. This suggests a return to 2015's low of $26 per barrel is highly unlikely barring a collapse in global growth. While some economic data suggest a modest slowing from the best levels in decades, and we are expecting a downshift in US growth, we see no imminent messages in the recent oil-price data. In fact, we see prices rebounding as the market remains relatively balanced through 2019, with Brent prices around $78 (see *Chart of the Week,* page 3).

Consider the case for a rebound, starting with radically shifting US policy and the geopolitics of OPEC supply. We find it no coincidence that the WTI oil prices peaked on Oct. 3, exactly 24 hours after word that US-based Saudi journalist Jamal Khashoggi had been murdered in Istanbul. Almost immediately, the Saudis, defensive and defiant in the face of global outrage, upped oil production to protect their market share. In turn, the US, promising retribution, announced that the largest importers of Iranian oil—China, India, South Korea, Turkey, Italy, Greece, Taiwan and Japan—would get six-month waivers from sanctions on Iranian exports. This policy action punished the Saudis while rewarding Iran, their strategic enemy, and lowered prices at the gas pumps heading into Election Day. This added roughly 200,000 barrels per day back to the market. US trade policy has an impact here, too, to the extent tariff-related issues weigh on non-US growth. Thus, any progress on China-US trade talks could ultimately be bullish for oil, too.

Beyond the policy-driven distortions, market demand has remained resilient while supply has surprised on the upside. MS & Co.'s Rats still forecasts year-over-year demand growth of 1.5 million barrels a day this year and 1.4 million in 2019, underpinned by global GDP growth of 3.8% and 3.7%, respectively. On the supply side, US fracking productivity continues to impress, with national output hitting a record 11.35 million barrels in August, up nearly 20% versus a year ago. Producers have also been able to work around pipeline bottlenecks, defying original forecasts. We see these supply surprises being short-lived as they disproportionately benefitted from good weather and the below-average hurricane season in the Gulf of Mexico.

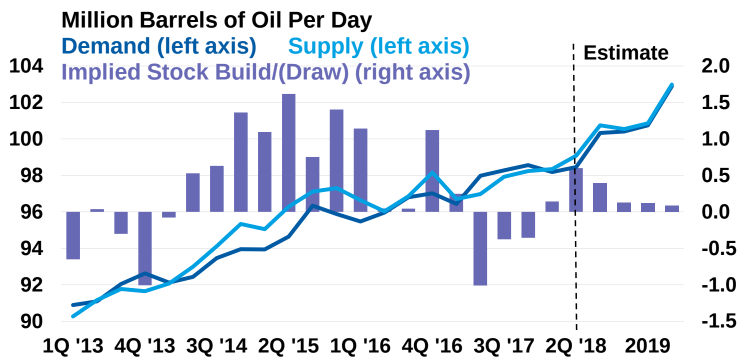
A final point to consider is that the 1.4 million barrels per day in OPEC/Russia production cuts that were announced two years ago have now been fully unwound, in many instances a function of key producers like Saudi Arabia and Russia battling the strengthening US dollar. We expect this dynamic to peak by the end of the year. OPEC 2.0 is set to meet in Vienna next month and many expect that the cartel will reinstate cuts of 1.0 million barrels a day. What's also likely to keep a floor under prices next year is the International Maritime Organization's requirement to reduce marine/shipping emissions by Jan. 1, 2020. Complying with the regulation will require that shippers move away from high-sulfur fuel oil to distillates, increasing overall crude demand. This is critical because the maritime industries comprise fully 50% of global demand for fuel oil.

A final factor that distinguishes now from the 2014-2015 oil slump is corporate health. Despite skepticism that fracking productivity gains could be sustained, we are seeing stable margins, disciplined capital spending, solid cash flows and measured use of the capital markets for debt and equity financing. The breakeven for US frackers is now estimated at below $40 per barrel. This suggests that while spread widening for energy-related high yield bonds poses a risk, the vulnerability of companies to higher financing costs has been much reduced.

**Bottom Line:** The correction in the oil markets is neither a forewarning of recession nor a repeat of 2014-2015 economic downturn. We think much of this is the result of policy decisions that have bolstered supply just at the time where trade-related anxieties have restrained demand. As policy normalizes, non-US growth recovers and OPEC 2.0 helps rebalance markets, we expect prices to rebound next year. This support energy-related stocks and bonds, especially since companies have continued to reduce break-even levels, strengthen balance sheets and show discipline with capital spending. **Watch** the US dollar for a peak that will likely help ease pressure on oil prices. **Consider** adding energy stocks, bonds and master limited partnerships with good cash flows and dividend support. ■

## Chart of the Week: Oil's Oversupply Is Temporary

Unlike the glut that tanked global oil markets in 2014-2015 and caused a minirecession, the current episode looks like it will be more short-lived. While US fracking productivity has once again helped swell inventories, geopolitics and trade policy are more to blame. Specifically, Washington's decision to dilute the impact of the Iran sanctions by granting waivers to eight countries appears to have completely closed the previously forecast market shortfall of 0.2 million barrels per day. As we illustrate (see chart), markets probably can no longer support forecasts of $85-per-barrel Brent oil in 2019. However, markets are expected to be roughly in balance next year with prices resetting closer to $78, nearly 20% higher than they are today.




Source: IEA, Morgan Stanley & Co. Research as of Nov. 14, 2018

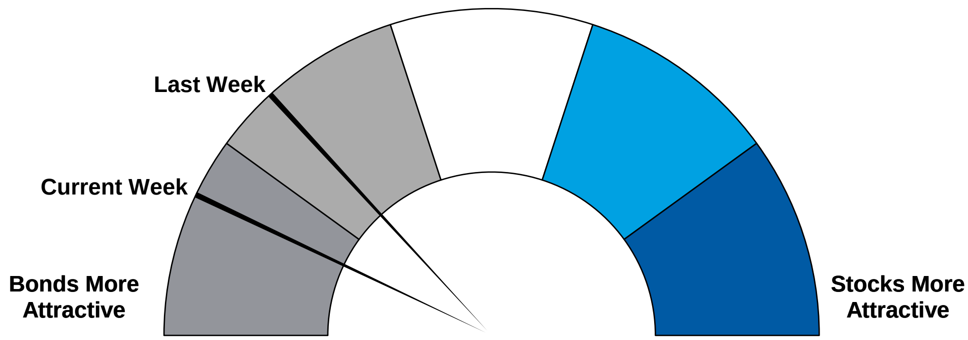
## Asset Class Performance and Heat Map (as of Nov. 16, 2018)

| Asset Class | Annualized Returns (%) | | | | | | | Yield | Valuation | | Volatility (%) | | Correlation to Global Equities | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cash** | **YTD** | **1-Yr.** | **2017** | **3-Yr.[1]** | **5-Yr.[1]** | **10-Yr.[1]** | **20-Yr.[1]** | **Current YTM** | **Current YTM** | **Avg. YTM[2]** | **30 Days** | **20 Yrs.[1]** | **30 Days** | **20 Yrs.[1]** |
| **90-Day US Treasury Bills** | 1.6 | 1.7 | 0.9 | 0.9 | 0.6 | 0.3 | 1.8 | 2.24 | 2.24 | 1.81 | 0.07 | 0.56 | -0.22 | -0.04 |
| **Global Equities** | | | | | | | | **Current Div. Yld.** | **Current P/E** | **Avg. P/E[2]** | | | | |
| **US Large-Cap Growth** | 7.4 | 10.4 | 30.2 | 13.8 | 14.1 | 15.3 | 6.0 | 1.12 | 19.5 | 21.0 | 27.5 | 17.1 | 0.94 | 0.89 |
| **US Large-Cap Value** | 1.7 | 6.1 | 15.1 | 9.7 | 9.1 | 11.0 | 6.3 | 3.02 | 13.4 | 13.8 | 16.3 | 13.7 | 0.91 | 0.88 |
| **US Mid-Cap Growth** | 1.0 | 5.0 | 22.0 | 8.1 | 8.7 | 14.5 | 7.9 | 0.71 | 18.3 | 26.6 | 26.2 | 22.6 | 0.95 | 0.80 |
| **US Mid-Cap Value** | -2.1 | 1.9 | 17.0 | 10.0 | 9.1 | 14.0 | 9.4 | 2.86 | 13.9 | 14.4 | 15.9 | 15.8 | 0.87 | 0.87 |
| **US Small-Cap Growth** | 3.9 | 8.0 | 23.4 | 12.4 | 9.8 | 15.4 | 10.7 | 0.61 | 23.7 | 24.1 | 26.6 | 21.3 | 0.94 | 0.83 |
| **US Small-Cap Value** | -2.3 | 1.3 | 11.5 | 9.5 | 8.0 | 13.5 | 9.8 | 2.70 | 15.8 | 17.2 | 19.4 | 16.9 | 0.91 | 0.84 |
| **Europe Equity** | -9.6 | -6.6 | 26.2 | 3.1 | 1.8 | 7.2 | 4.5 | 3.72 | 12.5 | 14.0 | 15.0 | 17.9 | 0.77 | 0.94 |
| **Japan Equity** | -7.7 | -4.9 | 24.4 | 5.8 | 5.2 | 7.0 | 3.8 | 2.31 | 11.9 | 19.6 | 20.0 | 16.4 | 0.18 | 0.70 |
| **Asia Pacific ex Japan Equity** | -8.2 | -3.9 | 26.0 | 7.0 | 1.2 | 10.0 | 8.7 | 4.22 | 13.8 | 14.6 | 15.7 | 19.6 | 0.35 | 0.88 |
| **Emerging Markets** | -12.7 | -9.9 | 37.8 | 6.9 | 1.1 | 8.2 | 9.1 | 2.94 | 10.6 | 11.3 | 18.9 | 21.9 | 0.69 | 0.87 |
| **Global Fixed Income** | | | | | | | | **Current YTM** | **Current Spread** | **Avg. Spread[2]** | | | | |
| **Short-Term Fixed Income** | 0.7 | 0.7 | 0.8 | 0.8 | 0.8 | 1.7 | 3.1 | 3.01 | 19.0 | 31.0 | 0.8 | 1.4 | -0.47 | -0.13 |
| **US Fixed Income** | -2.0 | -1.6 | 3.5 | 1.0 | 1.8 | 3.9 | 4.5 | 3.55 | 47.0 | 54.0 | 2.5 | 3.4 | -0.31 | -0.02 |
| **International Fixed Income** | -3.7 | -2.3 | 9.8 | 1.9 | -0.5 | 2.8 | 3.3 | 1.40 | 57.0 | 49.0 | 4.1 | 7.9 | 0.32 | 0.32 |
| **Inflation-Protected Securities** | -4.4 | -2.3 | 9.0 | 2.4 | 0.8 | 4.4 | 5.5 | - | - | - | 4.4 | 7.7 | 0.18 | 0.45 |
| **High Yield** | -3.0 | -1.8 | 10.4 | 5.8 | 4.0 | 11.3 | 8.2 | 7.17 | 458.0 | 500.0 | 3.1 | 9.5 | 0.52 | 0.75 |
| **Emerging Markets Fixed. Inc.** | -7.6 | -4.1 | 15.2 | 2.9 | -2.6 | 4.1 | 7.8 | 6.63 | 301.0 | 335.5 | 8.4 | 11.7 | 0.51 | 0.66 |
| **Alternative Investments** | | | | | | | | **Current Div. Yld.** | | | | | | |
| **Real Estate/REITs** | -1.8 | 0.4 | 15.0 | 4.3 | 4.7 | 9.9 | 8.7 | 4.14 | - | - | 9.7 | 17.7 | 0.52 | 0.79 |
| **MLP/Energy Infrastructure[3]** | -1.7 | 4.1 | -6.5 | -1.5 | -4.8 | 8.3 | - | 7.92 | - | - | 20.2 | 18.5 | 0.83 | 0.56 |
| **Commodities ex Prec. Metals** | -2.1 | 1.2 | 0.2 | -1.0 | -8.1 | -5.6 | 0.7 | - | - | - | 16.7 | 16.8 | -0.07 | 0.44 |
| **Precious Metals** | -9.3 | -7.8 | 10.9 | 0.1 | -4.0 | 4.5 | 6.4 | - | - | - | 12.0 | 19.1 | 0.20 | 0.19 |
| **Hedged Strategies[4]** | -5.0 | -3.7 | 6.0 | 0.6 | 0.1 | 1.4 | - | - | - | - | 4.5 | 6.0 | 0.93 | 0.65 |
| **Managed Futures[5]** | -4.8 | -3.7 | 2.5 | -1.3 | -0.2 | -1.5 | - | - | - | - | 6.2 | 7.9 | -0.30 | 0.19 |
| **S&P 500** | 4.1 | 7.9 | 21.8 | 11.5 | 11.3 | 13.2 | 6.6 | 1.88 | 15.6 | 15.9 | 21.07 | 14.4 | 0.96 | 0.95 |
| **Russell 2000** | 0.5 | 4.1 | 14.6 | 10.7 | 8.0 | 12.4 | 8.6 | 1.32 | 25.9 | 20.3 | 24.84 | 19.3 | 0.92 | 0.82 |
| **MSCI EAFE** | -8.8 | -5.7 | 25.6 | 4.1 | 2.5 | 7.4 | 4.7 | 3.42 | 12.5 | 14.9 | 11.71 | 16.3 | 0.76 | 0.96 |
| **MSCI AC World** | -2.6 | 0.8 | 24.6 | 8.3 | 6.7 | 10.3 | 5.9 | 2.58 | 13.8 | 15.4 | 15.76 | 15.2 | 1.00 | 1.00 |

Note: Performance values calculated using USD. 1. As of Oct. 31, 2018. 2. 20-year average as of Oct. 31, 2018. 3. Volatility and Correlation: June 30, 2006 – Present. 4. Volatility and Correlation: Jan 31, 1998 – Present Hedged strategies consist of hedge funds and managed futures 5. Volatility and Correlation: February 28, 1998 – Present. Cheap = Below -0.5 standard deviation; Moderate = Between +0.5 standard deviation and -0.5 standard deviation; Expensive = Above +.5 std dev. Standard deviation (volatility) is a measure of the dispersion of a set of data from its mean.
Source: Factset, Bloomberg, Morgan Stanley Wealth Management GIC.

| | | |
|---|---|---|
| Cheap | Low | Low |
| Moderate | High | High |
| Expensive | | |

## Short-Term Stock and Bond Indicator



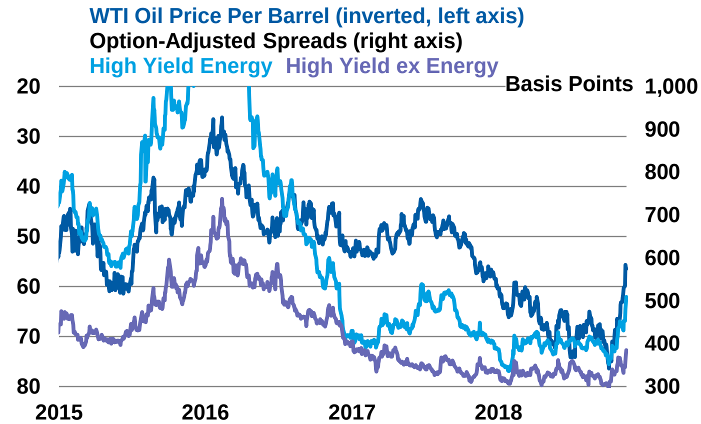

| | Macro | | Policy | | Fundamentals | | Sentiment and Technicals | |
|---|---|---|---|---|---|---|---|---|
| | Growth | Inflation | Rates | Liquidity | Valuation & Market | Earnings | Sentiment | Technicals |
| Current | Neutral | Neutral | Neutral | Very Negative | Very Negative | Neutral | Very Negative | Neutral |
| Last Week | Neutral | Very Negative | Neutral | Neutral | Very Negative | Neutral | Neutral | Neutral |

| Indicator | Category | Reading |
|---|---|---|
| PMI (+) | Growth | Risk Off |
| Durable Goods (+) | | Neutral |
| Retail Sales (+) | | Risk On |
| Manufacturing Hours Worked (+) | | Neutral |
| Commodity Prices (+) | Inflation | Neutral |
| Yield Curve: 10-Yr./Three-Mo.(-) | Rates | Risk On |
| Yield Curve: Two-Yr./Three-Mo.(-) | | Neutral |
| Pace of Interest Rate Hikes (-) | | Neutral |
| Term Premium Model (-) | | Risk On |
| High Yield Spreads (-) | Liquidity | Risk Off |
| Investment Grade Spreads (-) | | Neutral |
| Financial Conditions (-) | | Risk Off |
| S&P 500 Earnings/Baa Yield (+) | Valuation & Market Behavior | Risk Off |
| Large vs. Small Performance (-) | | Risk Off |
| High- vs. Low-Quality Performance (-) | | Risk Off |
| High- vs. Low-Beta Performance (+) | | Risk Off |
| S&P 500 Forward Price/Earnings Ratio (+) | | Neutral |
| Earnings Revisions Breadth (-) | Earnings | Neutral |
| Global Risk Demand (+) | Sentiment | Risk Off |
| Implied Currency Volatility (-) | | Neutral |
| Five-Yr. Macro Sensitivity (-) | | Neutral |
| % Stocks Above 200-Day Moving Avg. (+) | Technicals | Neutral |
| Cumulative Advance/Decline (+) | | Neutral |
| S&P 500 Put/Call Ratio (-) | | Risk On |
| Emerging Market Fund Flows (+) | | Neutral |
| Smart Money Flow Index (+) | | Risk Off |
| Note: + Indicates that a rise in the indicator is linked to a more favorable outlook for risk assets; - indicates that a rise in the indicator is linked to a less favorable outlook for risk assets. Color coding is set in accordance with the impact on risk assets. | | Positive for Stocks Relative to Bonds |
| | | Neutral |
| | | Negative for Stocks Relative to Bonds |

Note: Commodity prices are represented by the Bloomberg Commodity Index; pace of interest rate hikes by the Morgan Stanley Pace of Rate Hikes Index; high yield spreads by the Bloomberg Barclays Aggregate US High Yield Index; investment grade spreads by the Bloomberg Barclays US Aggregate Index; financial conditions by the Morgan Stanley Financial Conditions Index; global risk demand and implied currency volatility by the Morgan Stanley Standardized Global Risk Demand Index. For more information on our Term Premium Model, please refer to our special report, *Using the Term Premium to Manage Portfolio Duration*, March 2016.
Source: Morgan Stanley Wealth Management GIC, Morgan Stanley & Co., Haver Analytics, Bloomberg, FactSet as of Nov. 16, 2018

## Fixed Income Insight: High Yield Bonds Weathering Oil's Bear Market

In the past six weeks, West Texas Intermediate oil has dropped roughly $20 per barrel to $56, a decline in excess of 20%. While high yield energy bonds have seen nearly 144 basis points of spread widening to 509 basis points, consider the 2015-2016 period when these bonds' spreads widened to more than 1,000 basis points (see chart). The contagion to the broader high yield market is also more orderly now. Ex energy, high yield spreads are 85 basis points wider but essentially flat with previous year-to-date highs. We read these better-behaved markets as a sign of not only temporary pricing conditions but better quality balance sheets, more disciplined capital spending and lower break-even points for producers. In our view, opportunities for an oil price recovery may exist for patient investors.




Source: Bloomberg as of Nov. 2, 2018

## Government Debt Monitor

| US | | | | |
|---|---|---|---|---|
| | Yield (%) | | | Total Return (%) |
| **Treasury Benchmark** | **Current** | **ΔWTD** | **ΔYTD** | **YTD** |
| 3-Month | 2.34 | 0.00 | 0.97 | 1.57 |
| 2-Year | 2.80 | -0.12 | 0.92 | 0.58 |
| 5-Year | 2.88 | -0.16 | 0.67 | -0.72 |
| 10-Year | 3.06 | -0.12 | 0.66 | -3.57 |
| 30-Year | 3.32 | -0.07 | 0.58 | -8.60 |
| 2-Yr./10-Yr. Spread (bp) | 26 | 0.52 | -25.94 | - |
| 10-Yr. TIPS Breakeven (bp) | 203 | -2.47 | 4.54 | - |
| Interest Rate Volatility† (bp) | 60 | 6.89 | 13.84 | - |

## Fixed Income Spread Dashboard

| | | Duration (Yrs.) | Yield-to-Worst (%) | OAS (bp) | OAS Range** Rich | Cheap |
|---|---|---|---|---|---|---|
| Investment Grade | MBS* | 4.85 | 3.73 | 40 | 9 | 44 |
| | AAA | 4.32 | 3.15 | 25 | 18 | 42 |
| | AA | 5.47 | 3.28 | 18 | 8 | 20 |
| | A | 7.07 | 4.02 | 100 | 68 | 104 |
| | BBB | 7.04 | 4.73 | 171 | 115 | 173 |
| High Yield | BB | 4.48 | 5.94 | 299 | 212 | 347 |
| | B | 3.78 | 7.46 | 439 | 332 | 510 |
| | CCC | 3.48 | 12.61 | 985 | 728 | 1,172 |

Unless stated, indexes utilized are FTSE Broad Investment Grade, FTSE High Yield, and FTSE Global Indexes
†Interest Rate Volatility measured by Merrill Lynch Option Volatility Estimate (MOVE) Index
*MBS distills high grade agency-rated mortgage-backed securities, a substantial subsector of investment grade indexes.
**OAS stands for Option-Adjusted Spread or spread over the Treasury. Grey diamond denotes current OAS; blue circle denotes two-year average.
Source: Bloomberg, The Yield Book® Software and Services. © 2018 FTSE Index LLC. All rights reserved. Data as of Nov. 16, 2018

## Government Debt Monitor

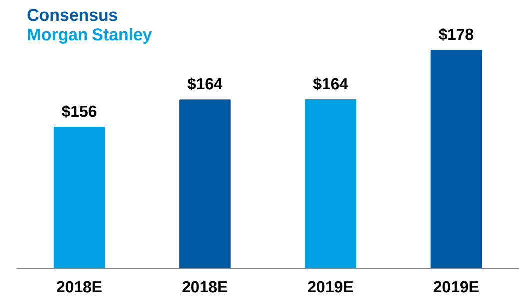
| Global | | | | |
|---|---|---|---|---|
| | Yield (%) | | | Total Return (%)* |
| **10-Year Govt. Bond** | **Current** | **ΔWTD** | **ΔYTD** | **YTD** |
| France | 0.76 | -0.02 | -0.02 | 2.94 |
| Germany | 0.37 | -0.04 | -0.06 | 3.83 |
| Japan | 0.10 | -0.02 | 0.06 | 2.06 |
| Spain | 1.63 | 0.04 | 0.08 | 3.36 |
| UK | 1.41 | -0.08 | 0.22 | 1.55 |
| 3-Month LIBOR | 2.64 | 0.02 | 0.95 | - |
| **US Tax Exempt** | | | | |
| 10-Year AAA Muni | 2.69 | -0.11 | 0.71 | -0.67 |
| 10-Yr. Muni/UST Ratio | 87.50 | 0.40 | 5.24 | - |

## Benchmark Returns

| | Total Returns (%) | | |
|---|---|---|---|
| **Index** | **YTD** | **MTD** | **2017** |
| Bloomberg Barclays US Aggregate | -1.95 | 0.43 | 3.54 |
| Bloomberg Barclays US MBS | -1.13 | 0.58 | 2.47 |
| Bloomberg Barclays US IG Corporate | -3.71 | 0.06 | 6.42 |
| Bloomberg Barclays Municipal | -0.67 | 0.35 | 5.45 |
| Bloomberg Barclays US High Yield | -0.08 | -1.00 | 7.50 |
| Bloomberg Barclays Global Aggregate | -3.07 | 0.40 | 7.39 |
| JPMorgan Emerging Market | -5.81 | -0.21 | 9.32 |

*Global total returns reflect Citigroup 7- to 10-year bond indexes and Muni total returns reflect Bloomberg Barclays Municipal Bond Index Total Return
Source: Bloomberg, Thomson Reuters Municipal Market Data (MMD) as of Nov. 16, 2018

## S&P 500 Earnings Estimates




Source: FactSet, Thomson Reuters, Morgan Stanley & Co. Research as of Nov. 16, 2018

## MS & Co. 12-Month Forward Price Target for the S&P 500

| Landscape | Earnings | Price/Earnings Multiple | Price Target | Upside / Downside |
|---|---|---|---|---|
| Bull Case | $176 | 17.5 | 3,000 | 9.6% |
| Base Case | $168 | 16.5 | 2,750 | 0.5% |
| Bear Case | $160 | 15.5 | 2,400 | -12.3% |
| | **Current S&P 500 Price** | | 2,736 | |

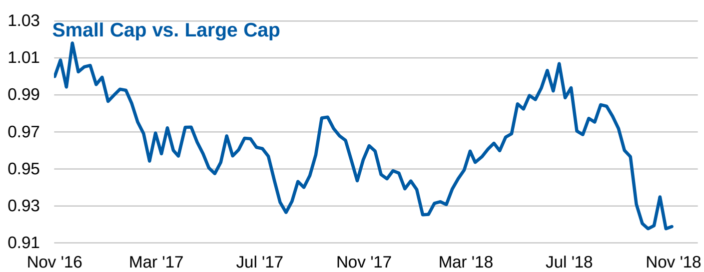
Note: Price targets use forward 12-month earnings estimate
Source: Thomson Reuters, Morgan Stanley & Co. Research as of Nov. 16, 2018

## S&P 500 Sector Performance and Valuation (as of Nov. 16, 2018)

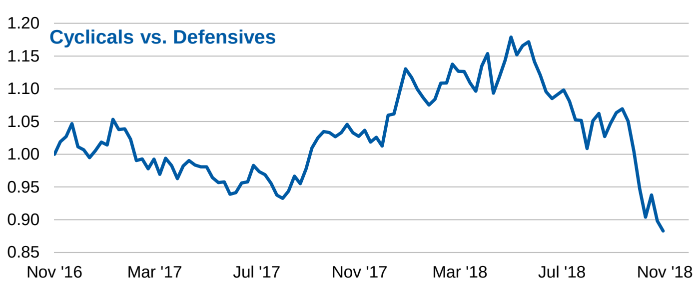
| Index Name | Total Return | | | Dividend Yield (%) | Beta | 20-Year Avg. Forward 12-Mo. PE | Forward 12-Mo. P/E* |
|---|---|---|---|---|---|---|---|
| | WTD (%) | YTD (%) | 1-Year (%) | | | | |
| ***S&P 500*** | ***-1.54*** | ***4.11*** | ***8.80*** | ***1.88*** | | ***15.9*** | ***15.6*** |
| Energy | -1.91 | -4.61 | 2.72 | 3.03 | 0.94 | 17.5 | **13.9** |
| Materials | 0.43 | -7.45 | -2.26 | 1.93 | 1.00 | 14.0 | **15.4** |
| Industrials | -0.62 | -3.70 | 4.00 | 1.98 | 1.01 | 16.2 | **15.2** |
| Consumer Discretionary | -3.74 | 7.87 | 15.57 | 1.28 | 1.03 | 18.0 | **19.8** |
| Consumer Staples | -1.70 | 0.26 | 6.09 | 2.83 | 0.54 | 16.9 | **18.5** |
| Health Care | -1.01 | 12.85 | 15.96 | 1.56 | 0.96 | 16.9 | **15.9** |
| Financials | -1.27 | -2.81 | 4.22 | 1.83 | 1.03 | 12.7 | **11.7** |
| Information Technology | -2.37 | 9.26 | 10.33 | 1.49 | 1.31 | 20.6 | **16.4** |
| Telecommunication Services | -1.07 | -6.86 | 9.25 | 1.49 | 0.81 | 16.1 | **16.8** |
| Utilities | 0.00 | 6.97 | 0.86 | 3.32 | 0.18 | 14.2 | **16.8** |
| Real Estate | 0.98 | 4.25 | 3.20 | 3.28 | 0.48 | 15.3 | **17.8** |

*Dark blue/light blue/gray fill denotes whether current relative forward 12-month P/E is low/neutral/high relative to history.
Source: Morgan Stanley & Co. Research

## Performance of Style and Cap Pairs (as of Nov. 16, 2018)









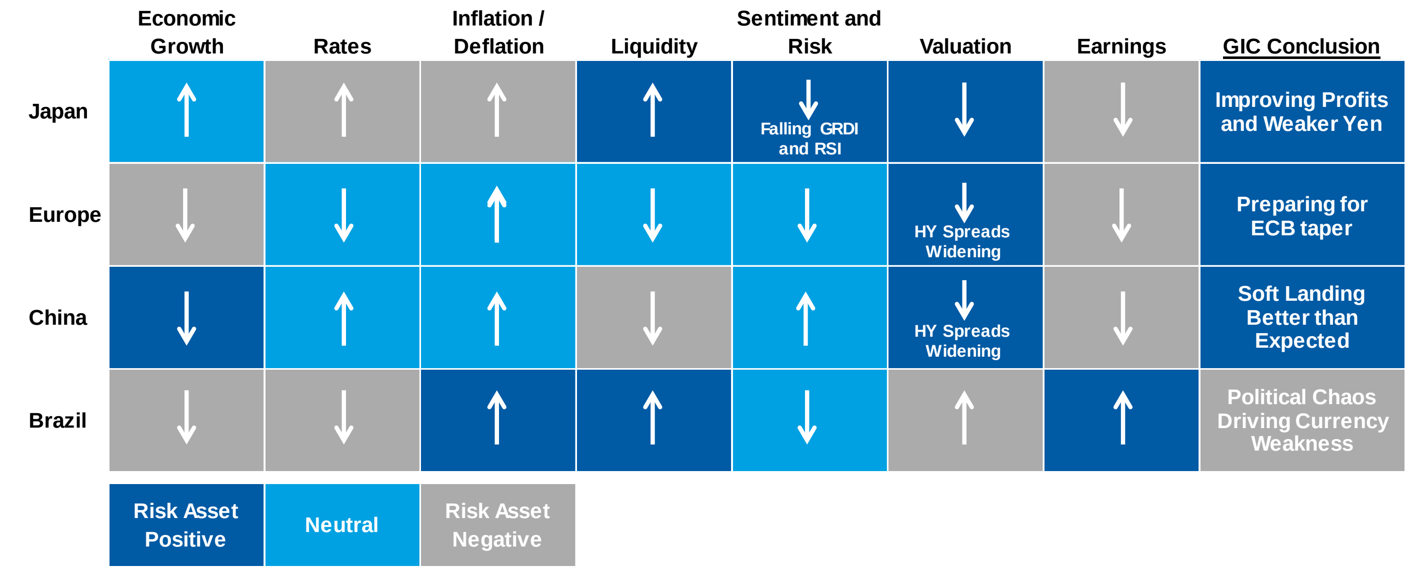
Source: Morgan Stanley & Co. Small Cap is represented by the Russell 2000 Index; Large Cap represented by the Russell 1000 Index; Growth represented by the Russell 1000 Growth Index; Value represented by the Russell 1000 Value Index.Cyclicals and Defensives, and Quality and Junk are based on Morgan Stanley & Co. Research analysis.

## Morgan Stanley & Co. Forecasts (as of Nov. 16, 2018)

| | Real GDP Growth (%) | | | 10-Yr. Govt. Bond Yield (%) | | Headline Inflation (%) | | | Currency Versus US Dollar | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2017 | 2018E | 2019E | Q4 '18E | Q2 '19E | 2017 | 2018E | 2019E | Q4 '18E | Q2 '19E | Q4 '19E |
| **Global** | 3.7 | 3.8 | 3.7 | | | 2.5 | 2.9 | 3.2 | | | |
| **US** | 2.2 | 2.9 | 2.4 | 2.75 | 2.50 | 2.1 | 2.5 | 2.2 | | | |
| **Euro Zone** | 2.5 | 2.1 | 1.9 | | | 1.5 | 1.8 | 1.8 | 1.15 | 1.24 | 1.32 |
| **UK** | 1.7 | 1.3 | 1.1 | 1.60 | 1.85 | 2.7 | 2.5 | 2.2 | 1.30 | 1.39 | 1.50 |
| **Japan** | 1.7 | 0.9 | 1.5 | 0.08 | 0.18 | 0.5 | 1.0 | 1.0 | 108 | 100 | 93 |
| **Emerging Markets** | 4.8 | 4.9 | 4.8 | | | 3.1 | 3.6 | 4.0 | | | |
| **China** | 6.9 | 6.6 | 6.4 | 3.50 | 3.60 | 1.6 | 2.2 | 2.6 | 6.60 | 6.40 | 6.25 |

Source: Morgan Stanley & Co. Research

## Macro Factor Heat Map (as of Nov. 16, 2018)




Note: Text in a factor box denotes a color change; In **Japan**, Sentiment and Risk moved from risk asset neutral to risk asset positive as GRDI and RSI fell; In **China and Europe**, Valuation moved from risk asset neutral to risk asset positive as HY spreads widened; for further explanation of the chart, see page 9.

Source: Morgan Stanley Wealth Management GIC

## Market Factor Data Points (for the week ending Nov. 16, 2018)

| | Positives | Negatives |
|---|---|---|
| **Global Growth** | • Empire State Manufacturing Survey hit 23.3 in November vs. 20.0 expected<br>• Kansas City Fed Manufacturing Survey beat estimates in November at 15 vs. 11 forecast<br>• October US export prices grew 0.4% month over month vs. expectation of 0.1%<br>• US retail sales grew 0.8% month over month in October vs. 0.5% forecast<br>• Euro Zone third-quarter GDP came in at 1.7% year over year, meeting expectations<br>• October China industrial production grew at 5.9% vs. expectation of 5.8% | • Weekly initial jobless claims at 216,000 vs. 213,000 estimate<br>• Philadelphia Fed Business Outlook Survey at 12.9 vs. a projected 20.0 in October<br>• October US industrial production growth at 0.1% month over month vs. expectation of 0.2%<br>• US import prices up 0.5% month over month vs. 0.1% forecast<br>• Euro Zone industrial production missed estimates for September, down 0.3% month over month<br>• October China retail sales grew less than expected at 8.6% vs. 9.2% forecast |
| **Inflation** | • October US and Euro Zone CPI met forecasts for year over year change, US at 2.5% and Euro Zone at 1.7% | |
| **Sentiment and Flows** | | • October NFIB Small Business Optimism Index at 107.4 vs. expectation of 108.0 |

Source: Morgan Stanley Wealth Management GIC

## Tactical Asset Allocation Reasoning

| Global Equities | Relative Weight Within Equities | |
|---|---|---|
| US | Equal Weight | US equities have done exceptionally well since the global financial crisis, but they are now in the latter stages of a cyclical bull market. While the acceleration of the Trump/Republican progrowth agenda has created a booming economy and earnings outlook, it may also be sowing the seeds for the end of the cycle as the Fed is forced to raise rates and tighten policy in a more deliberate manner. With the exceptional run in growth and small-cap stocks, we reduced positions in both and favor large-cap value stocks back in July and that has worked well. We would be aggressive buyers of the S&P 500 at 2,500 or lower. |
| International Equities (Developed Markets) | Overweight | We maintain constructive on Japanese and European equity markets in the long term. The populist movements around the world are now spreading to Italy, which may spur further fiscal support from Germany and France. This would be a potential positive catalyst. Japan is in a secular bull market. |
| Emerging Markets | Overweight | Emerging market (EM) equities are underperforming in 2018. Some of this is simply the result of a market that needs to consolidate strong gains the past few years. However, it is also directly related to the Fed's tightening campaign. We expect EM to find support not far from current levels and believe 2019 will be a better year. |
| **Global Fixed Income** | **Relative Weight Within Fixed Income** | |
| US Investment Grade | Underweight | We have recommended shorter-duration* (maturities) since March 2013, given the extremely low yields and potential capital losses associated with rising interest rates from such low levels. While interest rates have remained exceptionally low, US economic data have been very strong recently and the Fed is now raising rates at an accelerating pace. Adding some longer duration when 10-year US Treasury yields are above 3% makes sense. |
| International Investment Grade | Underweight | Yields are even lower outside the US, leaving very little value in international fixed income, particularly as the global economy begins to recover more broadly. While interest rates are likely to stay low, the offsetting diversification benefits do not warrant much, if any, position, in our view. |
| Inflation-Protected Securities | Overweight | With deflationary fears having become extreme in 2015 and early 2016, these securities still offer relative value in the context of our forecasted acceleration in global growth and our expectations for oil prices and the US dollar's year-over-year rate of change to revert toward 0%. That view played out in 2016 and 2017 but has not yet run its course. |
| High Yield | Underweight | We have zero exposure to high yield having reduced it completely in January. While credit spreads have likely reached a low for this cycle, they have been slow to rise. We think the risk of spreads widening have increased significantly with the rising risk of an earnings recession next year. |
| **Alternative Investments** | **Relative Weight Within Alternative Investments** | |
| Real Estate/REITs | Underweight | Real estate investment trusts (REITs) have underperformed global equities since mid-2016 when interest rates bottomed. We think it is still too early to reconsider our underweight zero allocation given the further rise in rates we expect and deteriorating fundamentals for the industry. Non-US REITs should be favored relative to domestic REITs. |
| Master Limited Partnerships/Energy Infrastructure* | Overweight | Master limited partnerships (MLPs) have traded better since their capitulation in March around the FERC regulatory announcement. However, recent price action has been much worse than expected given their 8% to 10% yields. We stick with this group as a hybrid cyclical with defensive characteristics. |
| Hedged Strategies (Hedge Funds and Managed Futures) | Equal Weight | This asset category can provide uncorrelated exposure to traditional risk-asset markets. It tends to outperform when traditional asset categories are challenged by growth scares and/or interest rate volatility spikes. As volatility becomes more persistent in 2018, these strategies should do better than in recent years. |

***For more about the risks to Master Limited Partnerships (MLPs) and Duration, please see the Risk Considerations section beginning on page 10 of this report.***

Source: Morgan Stanley Wealth Management GIC as of Nov. 16, 2018

## Macro Factor Heat Map Key (see page 7)

| | Economic Growth | Rates | Inflation / Deflation | Liquidity | Sentiment and Risk | Valuation | Earnings | Conclusion |
|---|---|---|---|---|---|---|---|---|
| **Dark Blue** | Economic growth robust | Steep yield curve | Low-moderate and rising inflation | Liquidity robust in economy / banking system | Shorter-term sentiment and technicals bearish | Risk assets attractively valued | Earnings outlook robust | Confluence of factors supports a risk-on investment approach |
| **Light Blue** | Economic growth neutral | Normal yield curve | Low-moderate and declining inflation; moderate inflation; higher and falling inflation | Liquidity neutral in the economy / banking system | Shorter-term sentiment and technicals neutral | Risk assets neutral | Earnings outlook neutral | Confluence of factors supports a neutral investment approach |
| **Gray** | Economic growth anemic | Flat/inverted yield curve | Very high/low inflation/deflation; high and rising inflation | Liquidity low in economy / banking system | Shorter-term sentiment and technicals bullish | Risk assets are richly valued | Earnings outlook anemic | Confluence of factors supports a risk-off investment approach |
| **Up** | Growth accelerating | Yield curve steepening | Inflation rising | Liquidity increasing | Sentiment becoming more bullish | Valuations rising | Earnings outlook improving | |
| **Down** | Growth declining | Yield curve flattening | Inflation falling | Liquidity decreasing | Sentiment becoming more bearish | Valuations falling | Earnings outlook worsening | |
| **Signal Horizon** | One to three years | One to three years | One to three years | One to three years | One to three months | Six months to two years | Six months to two years | |
| **Inputs** | • Industrial production<br>• Unemployment<br>• Total return<br>• Earnings revisions<br>• Home prices<br>• OECD LEI (China and Brazil)<br>• MS & Co. ARIA (US) | • 10-year vs. 2-year government bond yield spread | • Consumer Price Index | • M1 growth<br>• Private credit growth<br>• Libor-OIS spread | • MS US Equity Risk Indicator (US)<br>• MS Combined Market Timing Indicator (Europe)<br>• MS Global Risk Demand Index<br>• Relative strength index<br>• Members above / below moving average.<br>• Index above / below moving average<br>• Consumer confidence | • Forward price/earnings ratio<br>• Price/book ratio<br>• Equity risk premium<br>• High yield option-adjusted spread | • Earnings revisions breadth<br>• Earnings surprise<br>• Return on equity | • Weighted average z-score of all factors |

## Index Definitions

***For index, indicator and survey definitions referenced in this report please visit the following:***
***http://www.morganstanleyfa.com/public/projectfiles/id.pdf***

# Risk Considerations

### MLPs

Master Limited Partnerships (MLPs) are limited partnerships or limited liability companies that are taxed as partnerships and whose interests (limited partnership units or limited liability company units) are traded on securities exchanges like shares of common stock. Currently, most MLPs operate in the energy, natural resources or real estate sectors. Investments in MLP interests are subject to the risks generally applicable to companies in the energy and natural resources sectors, including commodity pricing risk, supply and demand risk, depletion risk and exploration risk.

Individual MLPs are publicly traded partnerships that have unique risks related to their structure. These include, but are not limited to, their reliance on the capital markets to fund growth, adverse ruling on the current tax treatment of distributions (typically mostly tax deferred), and commodity volume risk.

The potential tax benefits from investing in MLPs depend on their being treated as partnerships for federal income tax purposes and, if the MLP is deemed to be a corporation, then its income would be subject to federal taxation at the entity level, reducing the amount of cash available for distribution to the fund which could result in a reduction of the fund's value.

MLPs carry interest rate risk and may underperform in a rising interest rate environment. MLP funds accrue deferred income taxes for future tax liabilities associated with the portion of MLP distributions considered to be a tax-deferred return of capital and for any net operating gains as well as capital appreciation of its investments; this deferred tax liability is reflected in the daily NAV; and, as a result, the MLP fund's after-tax performance could differ significantly from the underlying assets even if the pre-tax performance is closely tracked.

### Duration

Duration, the most commonly used measure of bond risk, quantifies the effect of changes in interest rates on the price of a bond or bond portfolio. The longer the duration, the more sensitive the bond or portfolio would be to changes in interest rates. Generally, if interest rates rise, bond prices fall and vice versa. Longer-term bonds carry a longer or higher duration than shorter-term bonds; as such, they would be affected by changing interest rates for a greater period of time if interest rates were to increase. Consequently, the price of a long-term bond would drop significantly as compared to the price of a short-term bond.

**International investing** entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economies.

**Alternative investments** often are speculative and include a high degree of risk. Investors could lose all or a substantial amount of their investment. Alternative investments are suitable only for eligible, long-term investors who are willing to forgo liquidity and put capital at risk for an indefinite period of time. They may be highly illiquid and can engage in leverage and other speculative practices that may increase the volatility and risk of loss. Alternative Investments typically have higher fees than traditional investments. Investors should carefully review and consider potential risks before investing. Certain of these risks may include but are not limited to: Loss of all or a substantial portion of the investment due to leveraging, short-selling, or other speculative practices; Lack of liquidity in that there may be no secondary market for a fund; Volatility of returns; Restrictions on transferring interests in a fund; Potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized; Absence of information regarding valuations and pricing; Complex tax structures and delays in tax reporting; Less regulation and higher fees than mutual funds; and Risks associated with the operations, personnel, and processes of the manager. Further, opinions regarding Alternative Investments expressed herein may differ from the opinions expressed by Morgan Stanley Wealth Management and/or other businesses/affiliates of Morgan Stanley Wealth Management.

Certain information contained herein may constitute forward-looking statements. Due to various risks and uncertainties, actual events, results or the performance of a fund may differ materially from those reflected or contemplated in such forward-looking statements. Clients should carefully consider the investment objectives, risks, charges, and expenses of a fund before investing.

Alternative investments involve complex tax structures, tax inefficient investing, and delays in distributing important tax information. Individual funds have specific risks related to their investment programs that will vary from fund to fund. Clients should consult their own tax and legal advisors as Morgan Stanley Wealth Management does not provide tax or legal advice.

Interests in alternative investment products are offered pursuant to the terms of the applicable offering memorandum, are distributed by Morgan Stanley Smith Barney LLC and certain of its affiliates, and (1) are not FDIC-insured, (2) are not deposits or other obligations of Morgan Stanley or any of its affiliates, (3) are not guaranteed by Morgan Stanley and its affiliates, and (4) involve investment risks, including possible loss of principal. Morgan Stanley Smith Barney LLC is a registered broker-dealer, not a bank.

**Managed futures investments** are speculative, involve a high degree of risk, use significant leverage, have limited liquidity and/or may be generally illiquid, may incur substantial charges, may subject investors to conflicts of interest, and are usually suitable only for the risk capital portion of an investor's portfolio. Before investing in any partnership and in order to make an informed decision, investors should read the applicable prospectus and/or offering documents carefully for additional information, including charges, expenses, and risks. Managed futures investments are not intended to replace equities or fixed income securities but rather may act as a complement to these asset categories in a diversified portfolio.

**Investing in commodities** entails significant risks. Commodity prices may be affected by a variety of factors at any time, including but not limited to, (i) changes in supply and demand relationships, (ii) governmental programs and policies, (iii) national and international political and economic events, war and terrorist events, (iv) changes in interest and exchange rates, (v) trading activities in commodities and related contracts, (vi) pestilence, technological change and weather, and (vii) the price volatility of a commodity. In addition, the commodities markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity, participation of speculators and government intervention.

**Physical precious metals** are non-regulated products. Precious metals are speculative investments, which may experience short-term and long term price volatility. The value of precious metals investments may fluctuate and may appreciate or decline, depending on market conditions. If sold in a declining market, the price you receive may be less than your original investment. Unlike bonds and stocks, precious metals do not make interest or dividend payments. Therefore, precious metals may not be suitable for investors who require current income. Precious metals are commodities that should be safely stored, which may impose additional costs on the investor. The Securities Investor Protection Corporation ("SIPC") provides certain protection for customers' cash and securities in the event of a brokerage firm's bankruptcy, other financial difficulties, or if customers' assets are missing. SIPC insurance does not apply to precious metals or other commodities.

**Bonds** are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

**Bonds rated below investment grade** may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

**Interest on municipal bonds** is generally exempt from federal income tax; however, some bonds may be subject to the alternative minimum tax (AMT). Typically, state tax-exemption applies if securities are issued within one's state of residence and, if applicable, local tax-exemption applies if securities are issued within one's city of residence.

**Treasury Inflation Protection Securities' (TIPS)** coupon payments and underlying principal are automatically increased to compensate for inflation by tracking the consumer price index (CPI). While the real rate of return is guaranteed, TIPS tend to offer a low return. Because the return of TIPS is linked to inflation, TIPS may significantly underperform versus conventional U.S. Treasuries in times of low inflation.

**Ultrashort bond funds** Ultra-short bond funds are mutual funds and exchange-traded funds that generally invest in fixed income securities with very short maturities, typically less than one year. They are not money market funds. While money market funds attempt to maintain a stable net asset value, an ultra-short bond fund's net asset value will fluctuate, which may result in the loss of the principal amount invested. They are therefore subject to the risks associated with debt securities such as credit and interest rate risk.

**Ultrashort-term fixed income** asset class is comprised of fixed income securities with high quality, very short maturities. They are therefore subject to the risks associated with debt securities such as credit and interest rate risk

The majority of $25 and $1000 par **preferred securities** are "callable" meaning that the issuer may retire the securities at specific prices and dates prior to maturity. Interest/dividend payments on certain preferred issues may be deferred by the issuer for periods of up to 5 to 10 years, depending on the particular issue. The investor would still have income tax liability even though payments would not have been received. Price quoted is per $25 or $1,000 share, unless otherwise specified. Current yield is calculated by multiplying the coupon by par value divided by the market price.

The initial interest rate on a **floating-rate security** may be lower than that of a fixed-rate security of the same maturity because investors expect to receive additional income due to future increases in the floating security's underlying reference rate. The reference rate could be an index or an interest rate. However, there can be no assurance that the reference rate will increase. Some floating-rate securities may be subject to call risk.

The market value of **convertible bonds** and the underlying common stock(s) will fluctuate and after purchase may be worth more or less than original cost. If sold prior to maturity, investors may receive more or less than their original purchase price or maturity value, depending on market conditions. Callable bonds may be redeemed by the issuer prior to maturity. Additional call features may exist that could affect yield.

Some $25 or $1000 par **preferred securities** are QDI (Qualified Dividend Income) eligible. Information on QDI eligibility is obtained from third party sources. The dividend income on QDI eligible preferreds qualifies for a reduced tax rate. Many traditional 'dividend paying' perpetual preferred securities (traditional preferreds with no maturity date) are QDI eligible. In order to qualify for the preferential tax treatment all qualifying preferred securities must be held by investors for a minimum period – 91 days during a 180 day window period, beginning 90 days before the ex-dividend date.

Principal is returned on a monthly basis over the life of a **mortgage-backed security**. Principal prepayment can significantly affect the monthly income stream and the maturity of any type of MBS, including standard MBS, CMOs and Lottery Bonds. Yields and average lives are estimated based on prepayment assumptions and are subject to change based on actual prepayment of the mortgages in the underlying pools. The level of predictability of an MBS/CMO's average life, and its market price, depends on the type of MBS/CMO class purchased and interest rate movements. In general, as interest rates fall, prepayment speeds are likely to increase, thus shortening the MBS/CMO's average life and likely causing its market price to rise. Conversely, as interest rates rise, prepayment speeds are likely to decrease, thus lengthening average life and likely causing the MBS/CMO's market price to fall. Some MBS/CMOs may have "original issue discount" (OID). OID occurs if the MBS/CMO's original issue price is below its stated redemption price at maturity, and results in "imputed interest" that must be reported annually for tax purposes, resulting in a tax liability even though interest was not received. Investors are urged to consult their tax advisors for more information.

**Asset-backed securities** generally decrease in value as a result of interest rate increases, but may benefit less than other fixed-income securities from declining interest rates, principally because of prepayments.

**Yields** are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

**Equity securities** may fluctuate in response to news on companies, industries, market conditions and general economic environment.

Companies paying **dividends** can reduce or cut payouts at any time.

**Investing in smaller companies** involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity.

**Stocks of medium-sized companies** entail special risks, such as limited product lines, markets, and financial resources, and greater market volatility than securities of larger, more-established companies.

**Value investing** does not guarantee a profit or eliminate risk. Not all companies whose stocks are considered to be value stocks are able to turn their business around or successfully employ corrective strategies which would result in stock prices that do not rise as initially expected.

**Growth investing** does not guarantee a profit or eliminate risk. The stocks of these companies can have relatively high valuations. Because of these high valuations, an investment in a growth stock can be more risky than an investment in a company with more modest growth expectations.

**Asset allocation and diversification** do not assure a profit or protect against loss in declining financial markets.

The **indices** are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

The **indices selected by Morgan Stanley Wealth Management** to measure performance are representative of broad asset classes. Morgan Stanley Smith Barney LLC retains the right to change representative indices at any time.

**Credit ratings** are subject to change.

**REITs investing** risks are similar to those associated with direct investments in real estate: property value fluctuations, lack of liquidity, limited diversification and sensitivity to economic factors such as interest rate changes and market recessions.

Because of their narrow focus, **sector investments** tend to be more volatile than investments that diversify across many sectors and companies.

**Technology stocks** may be especially volatile. Risks applicable to companies in the **energy and natural resources** sectors include commodity pricing risk, supply and demand risk, depletion risk and exploration risk.

**Rebalancing** does not protect against a loss in declining financial markets. There may be a potential tax implication with a rebalancing strategy. Investors should consult with their tax advisor before implementing such a strategy.

**Investing in foreign emerging markets** entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks.

**Investing in foreign markets** entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks. **Investing in currency** involves additional special risks such as credit, interest rate fluctuations, derivative investment risk, and domestic and foreign inflation rates, which can be volatile and may be less liquid than other securities and more sensitive to the effect of varied economic conditions. In addition, international investing entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economies.

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