WEALTH MANAGEMENT

Morgan Stanley

May 17, 2017

Dear Client,

The S&P 500 sold off 44 points, or 1.8% today, to close at 2,357 as headlines from Washington appeared to catalyze a risk-off move across markets that saw Treasuries rally and stocks falter, together contributing to the S&P 500 recording its first 1% down day in nearly two months, and marking the index's worst day of 2017. Ten-year Treasury yields fell 11 basis points on the day, settling near 2.21% as of the 4 p.m. equity market close. It seemed all eyes were on politics today, as many market participants attributed today's sell-off to continued uncertainty emanating from Washington as the situation between the President and former FBI director continues to develop—there was little else to point to in today's economic data or corporate earnings releases to justify today's weakness.

While the latest headlines from Washington may have triggered today's selling, in reality we have seen very muted volatility across markets in recent weeks, while stocks have enjoyed a nice run (S&P 500 total return +8% YTD coming into today), likely leaving many participants looking for reasons to sell and contributing to today's sharp sell-off. A move like today's, in the context of the run markets have had in recent months, is not out of the ordinary.

Bank stocks were notable underperformers today, with the S&P 500 Financials sector off 3%, as the move lower in Treasury rates appeared to weigh on the sector. Despite the move lower in financial stocks in recent weeks, we remain positive on the sector, as financials continue to trade at cheap relative valuations to the broader market, and posted strong earnings results in the first quarter, results MS & Co. Banks Analyst Betsy Graseck believes can continue to improve throughout the year. On the flip side, crude oil was notably strong today, with the front-month Brent Crude oil contract rallying ~1% on the session, bucking the risk-off trend seen in other markets.

While the news out of Washington has been hard to ignore, does little to inspire confidence, and will be difficult to handicap as to what is likely to play out in the months ahead, we would stress that the rally in global equities that has taken place in the last 12-18 months began well before last year's election and, in our view, has been built on strong and improving fundamentals, not political dreams. To this end, the 1Q earnings season in the US is all but complete, and large-cap US companies, as measured by the S&P 500, have posted ~15% year-over-year earnings growth in the first quarter of the year; this is the strongest recorded growth in profits seen since 2011. While on the economic front 1Q GDP growth in the US disappointed, MS & Co. economists believe 2Q GDP is likely to post 5%+ growth (in nominal terms), and recent economic releases, including yesterday's strong Industrial Production release, corroborate this improving growth. Ultimately, we see this strong and improving earnings and economic data supporting markets in the months ahead, even if the situation in Washington remains turbulent.

The events in the US weighed on international markets as well, though we feel that fundamentals remain strong overseas. Europe has seen better economic data flow through to earnings growth and the region continues to trade at a discount to the US. In Japan, equities are even cheaper and are accompanied with expectations for over 20% earnings growth this year. In addition, corporate governance reforms are leading to increased shareholder returns, and expectations for a weaker yen would benefit Japan. While political headlines may impact the market in the short term, ultimately we see strong and improving global fundamentals supporting equities.

Market data provided by Bloomberg.

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

Disclosures

either the Employee Retirement Income Security Act of 1974, as amended ("ERISA") or under section 4975 of the Internal Revenue Code of 1986 as amended ("Code") in providing this material.

Morgan Stanley Smith Barney LLC, its affiliates and Morgan Stanley Financial Advisors do not provide legal or tax advice. Each client should always consult his/her personal tax and/or legal advisor for information concerning his/her individual situation and to learn about any potential tax or other implications that may result from acting on a particular recommendation.

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.

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

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.

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

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

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.

This material is disseminated in the United States of America by Morgan Stanley Smith Barney LLC.