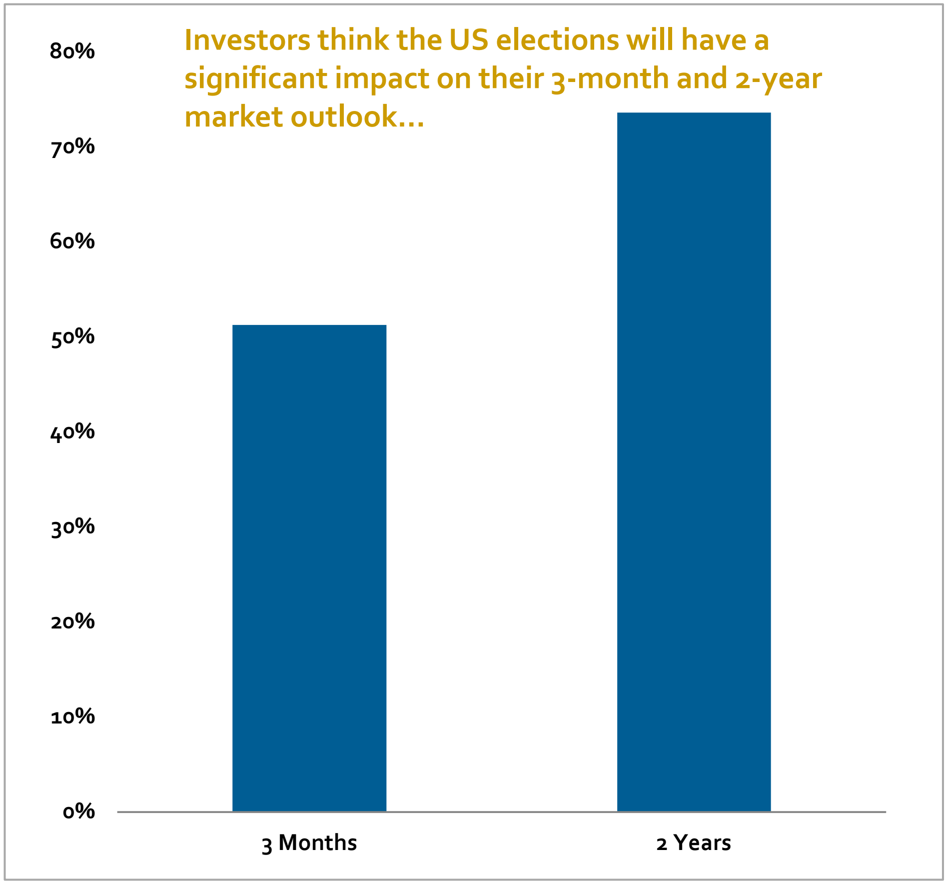
Morgan Stanley

Wealth Management Perspectives

Polls Show Investors Are Concerned About the Election

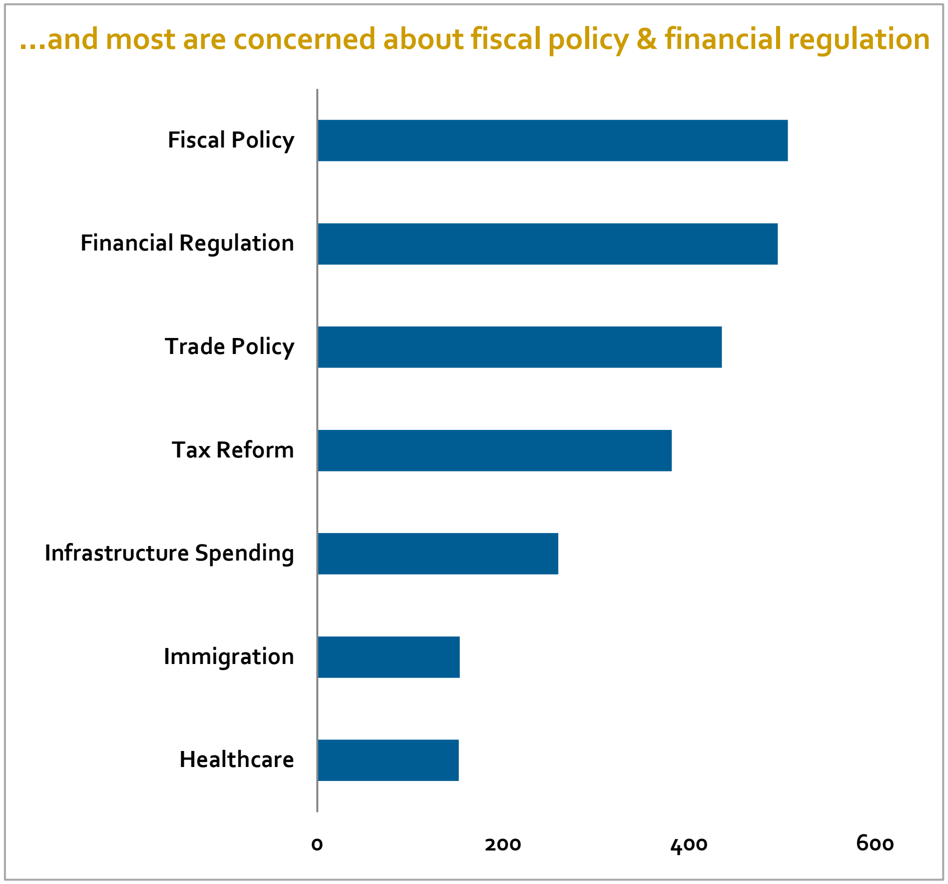
Investors Think the US Election Will Significantly Impact Their Outlook

As of July 12, 2016



Issues Investors are Most Concerned With

As of July 12, 2016

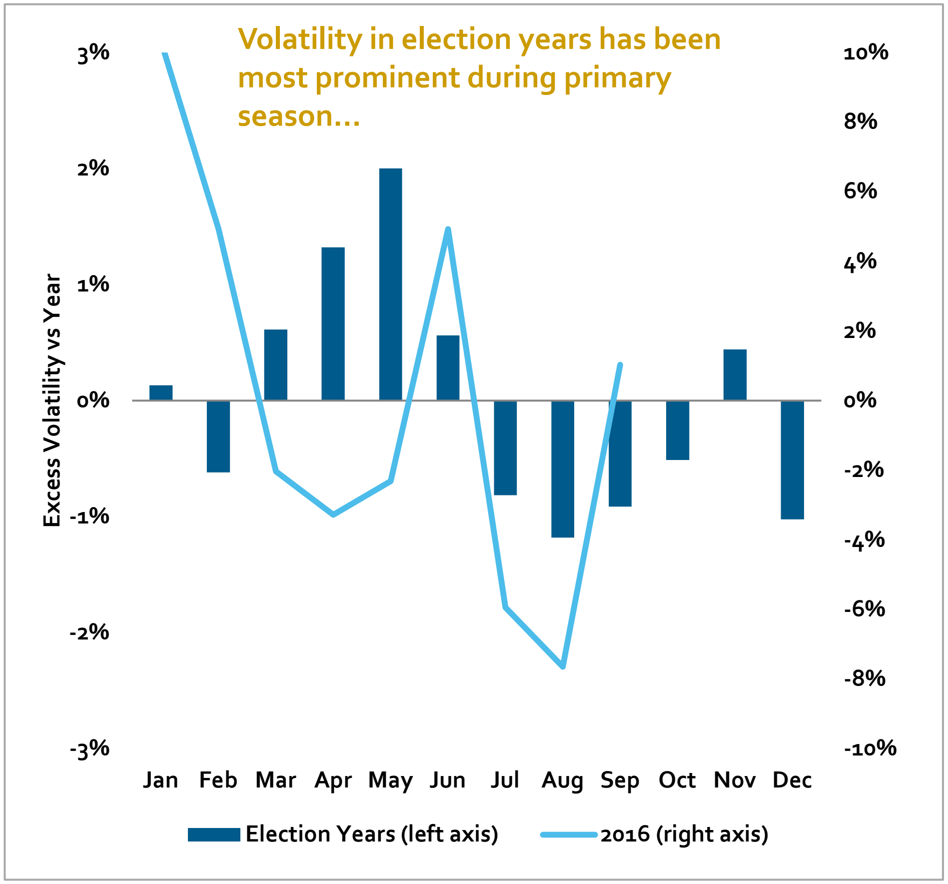


Source: Morgan Stanley & Co. Research Investor Survey

Historically, Election Day Has Not Catalyzed Volatility

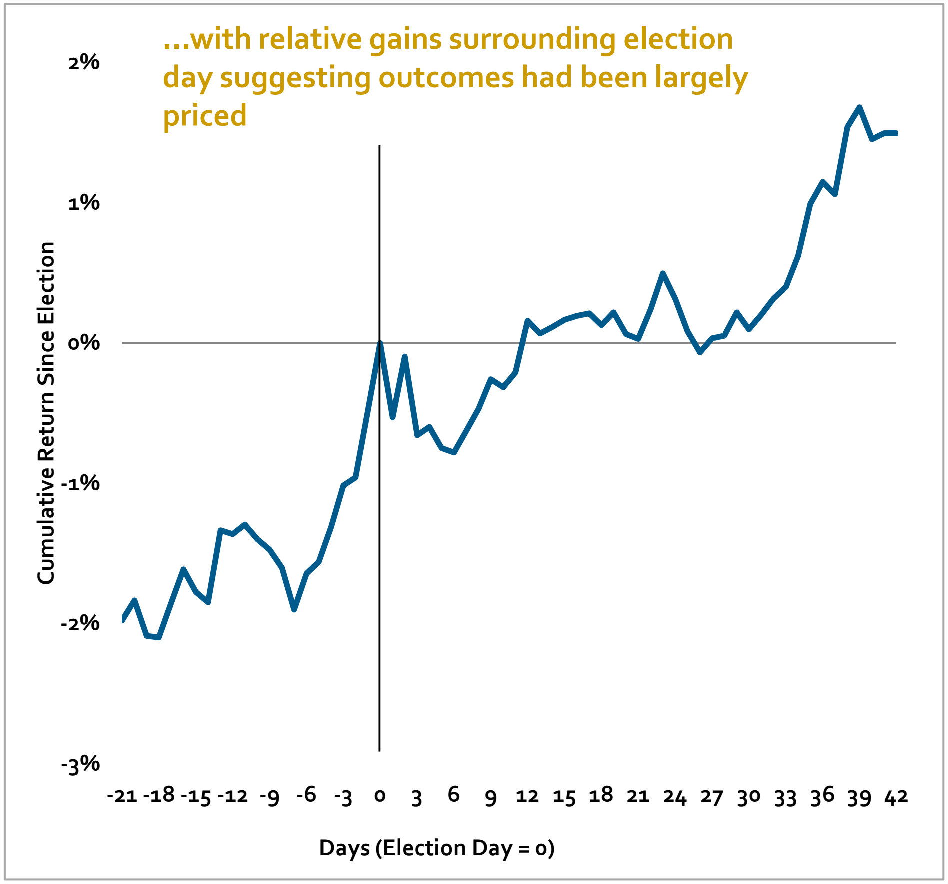
S&P 500 Monthly Excess Volatility During Election Years

1928 to 2012, excluding 1932 and 2008



S&P 500 Return Before and After Historical Elections

1928 to 2012, excluding 1932 and 2008

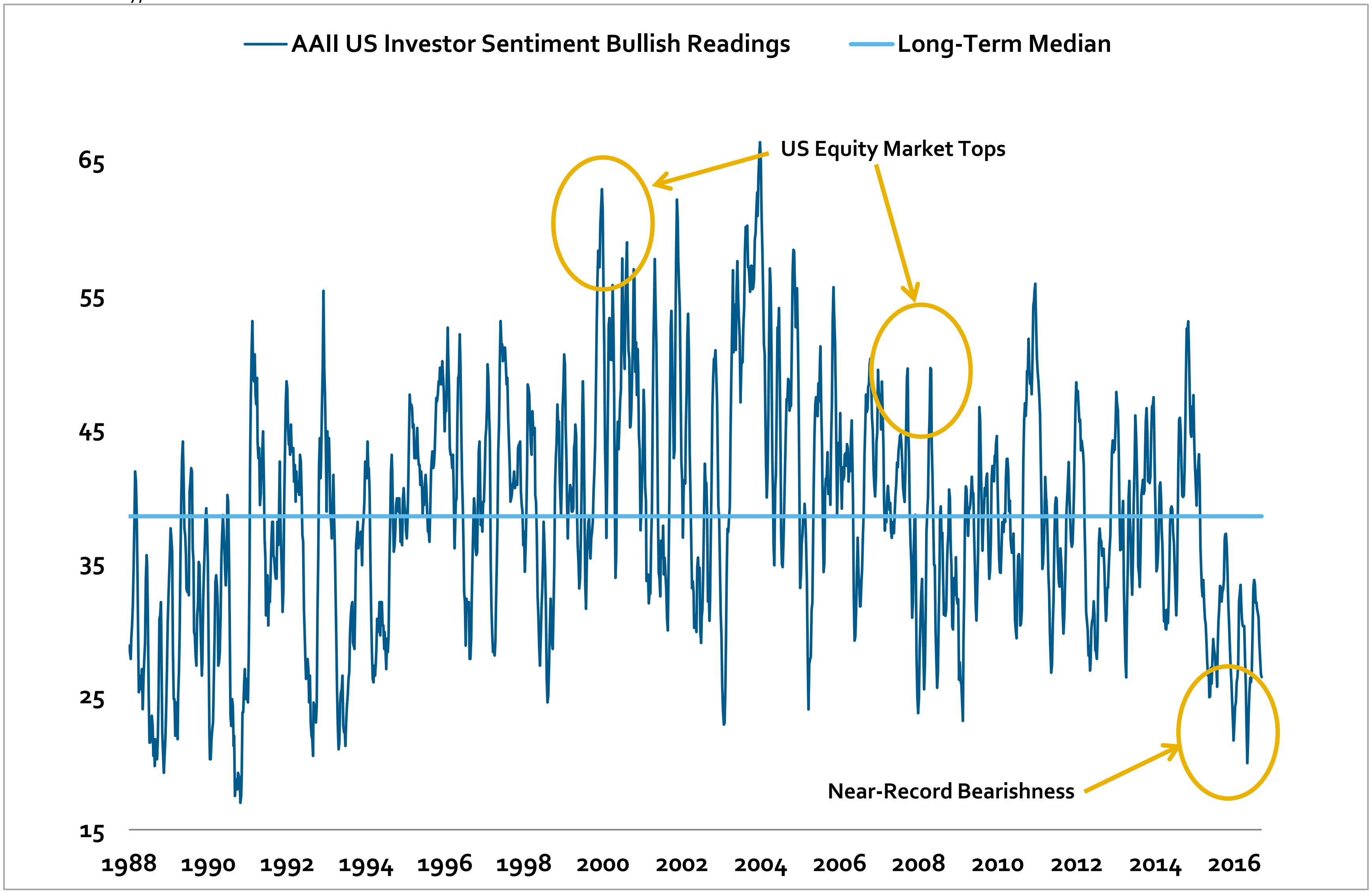


Source: Bloomberg, Morgan Stanley Wealth Management GIC

This Is *Not* How Markets Top

American Association of Individual Investors – US Investor Sentiment Bullish Readings (four-week avg.)

As of October 7, 2016

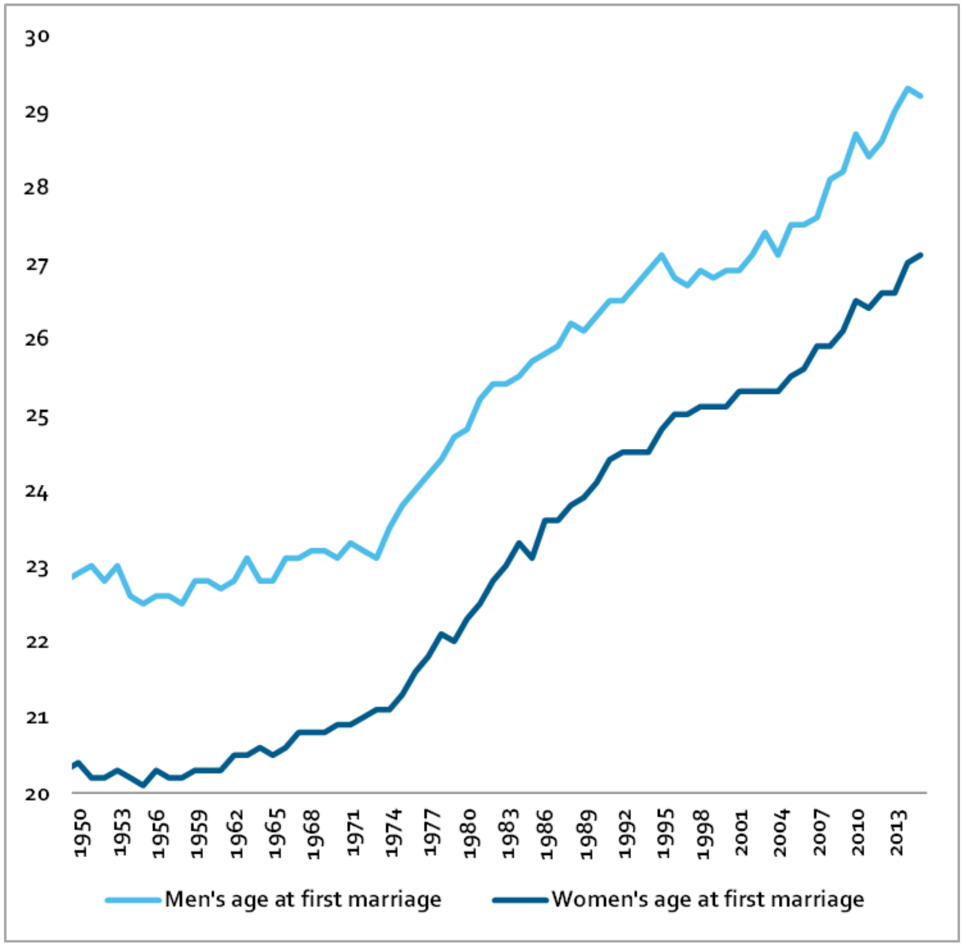


Source: Bloomberg, Morgan Stanley Wealth Management GIC

Millennials Are Getting Married Later in Life, Delaying Household Formations

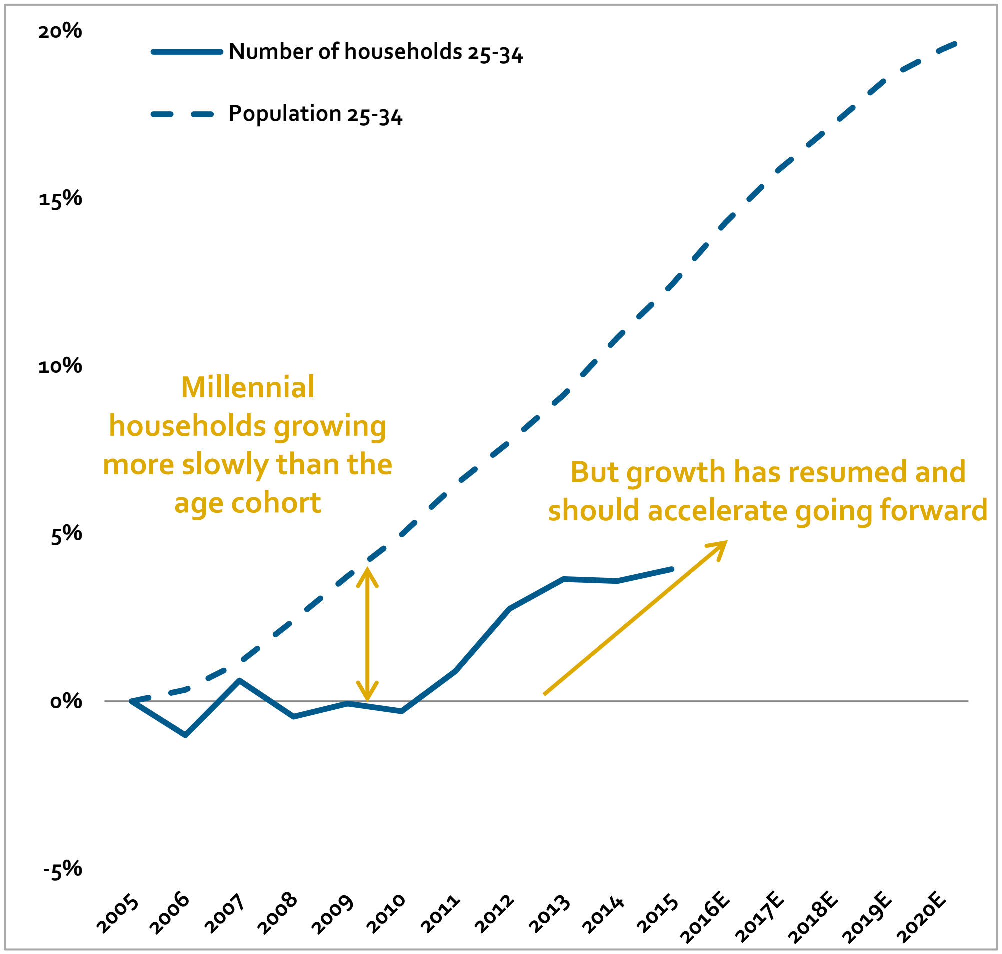
Median Age at First Marriage

As of December 31, 2014



US Population and Household Growth Since 2005

As of December 31, 2015



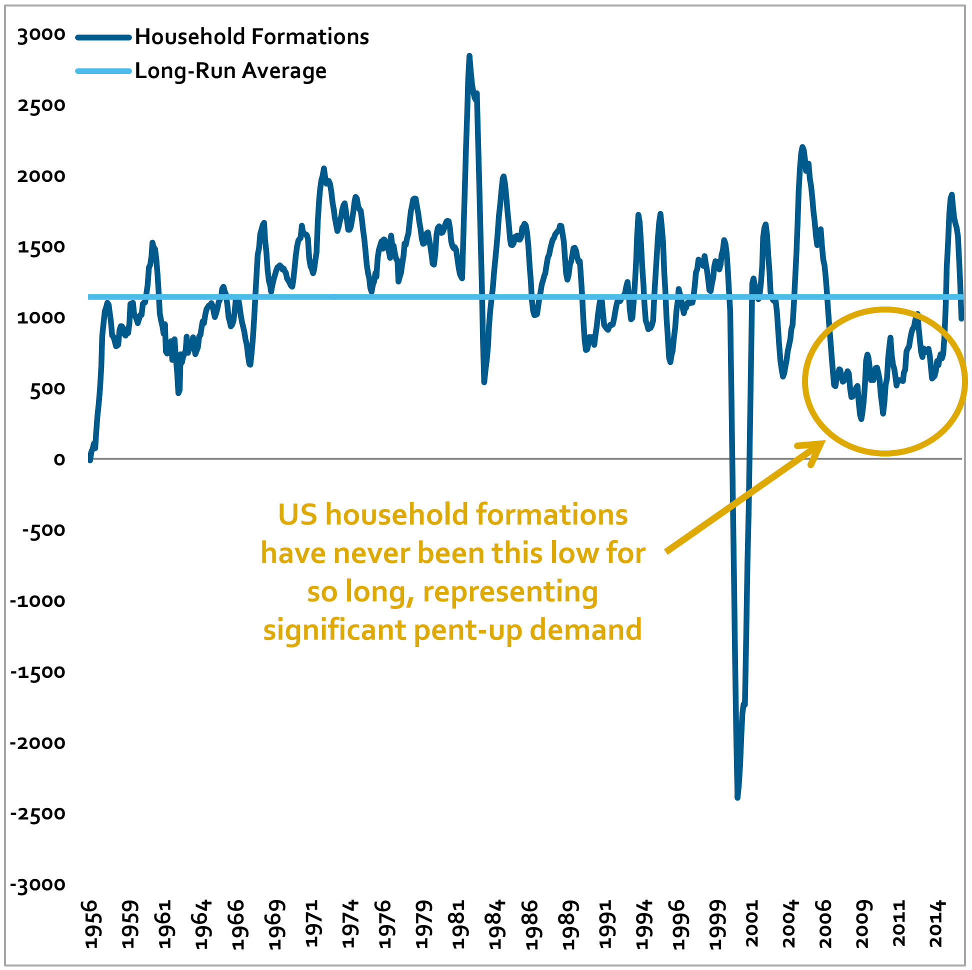
Source: Haver Analytics, Census Bureau, Morgan Stanley Wealth Management GIC

Demand Drivers: US Household Formations Inflected Upward

Household formations are a key factor affecting home purchase demand. The slowdown in household formations post 2008 has reversed and now stands at the long-run average.

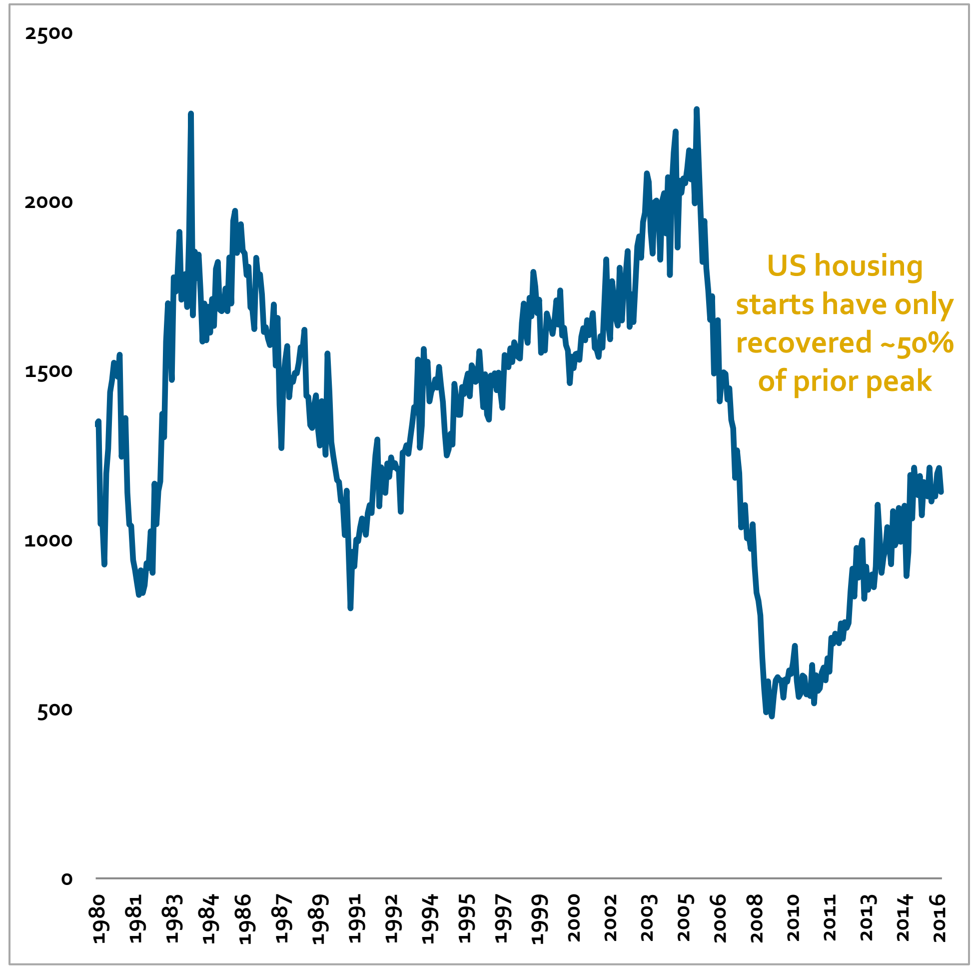
US Household Formations

6-month moving average, as of June 30, 2016



US Housing Starts

As of August 30, 2016

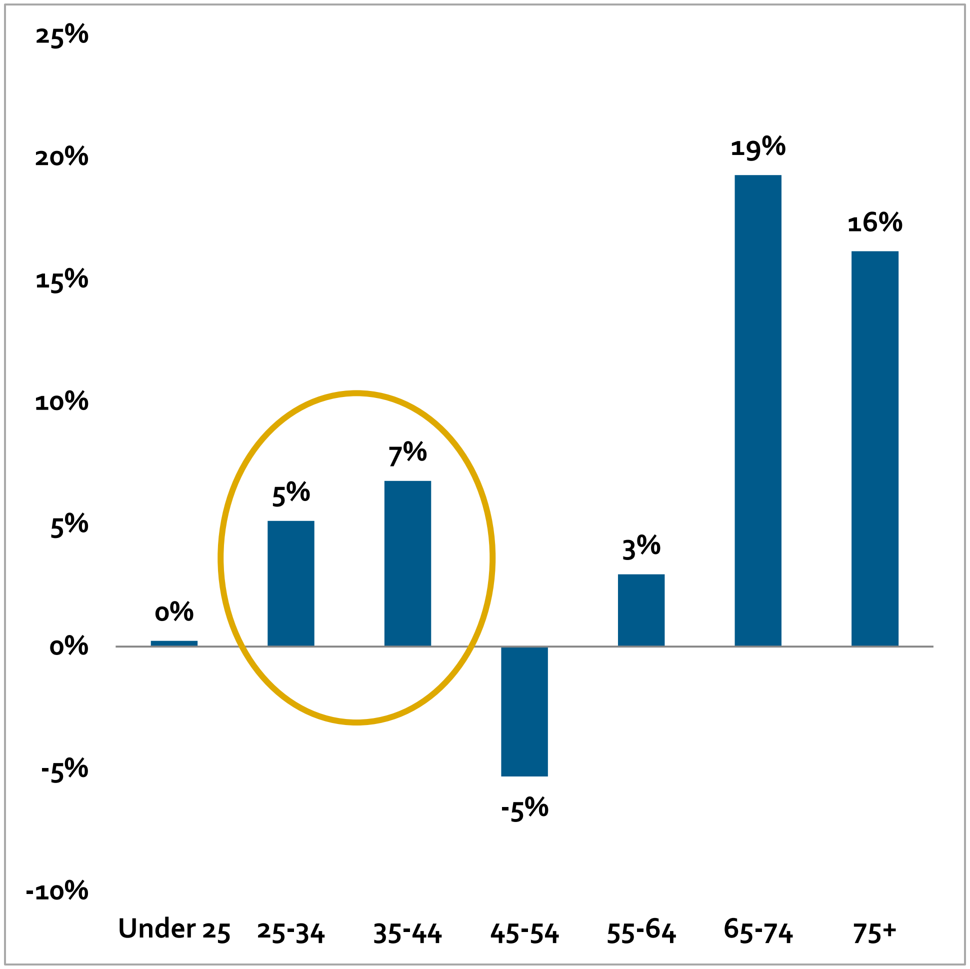


Source: Bloomberg, Morgan Stanley Wealth Management GIC

Demand Drivers: Projected Growth in First-Time Home Buyers

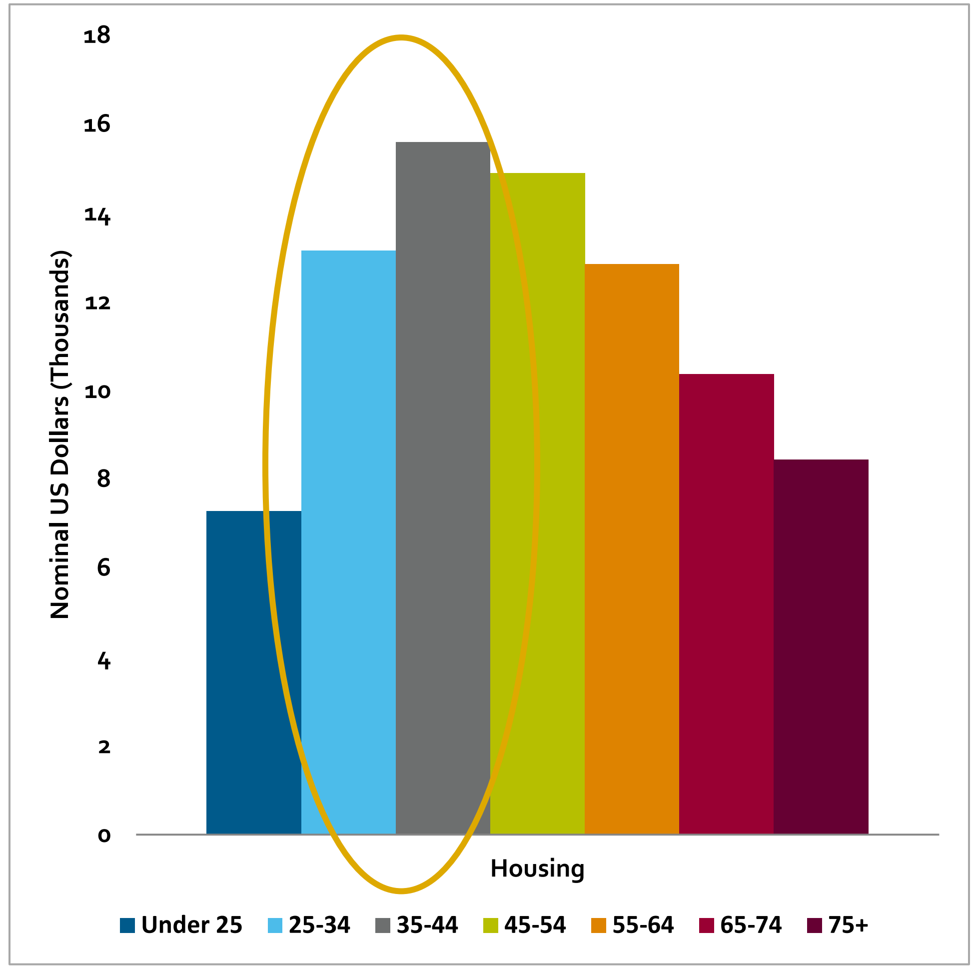
US Population Projected Change Over the Next 5 Years by Age Cohort

As of December 31, 2015



Portfolio Spend on Housing by Age Cohort

As of December 31, 2015



Source: Bloomberg, Morgan Stanley Wealth Management GIC

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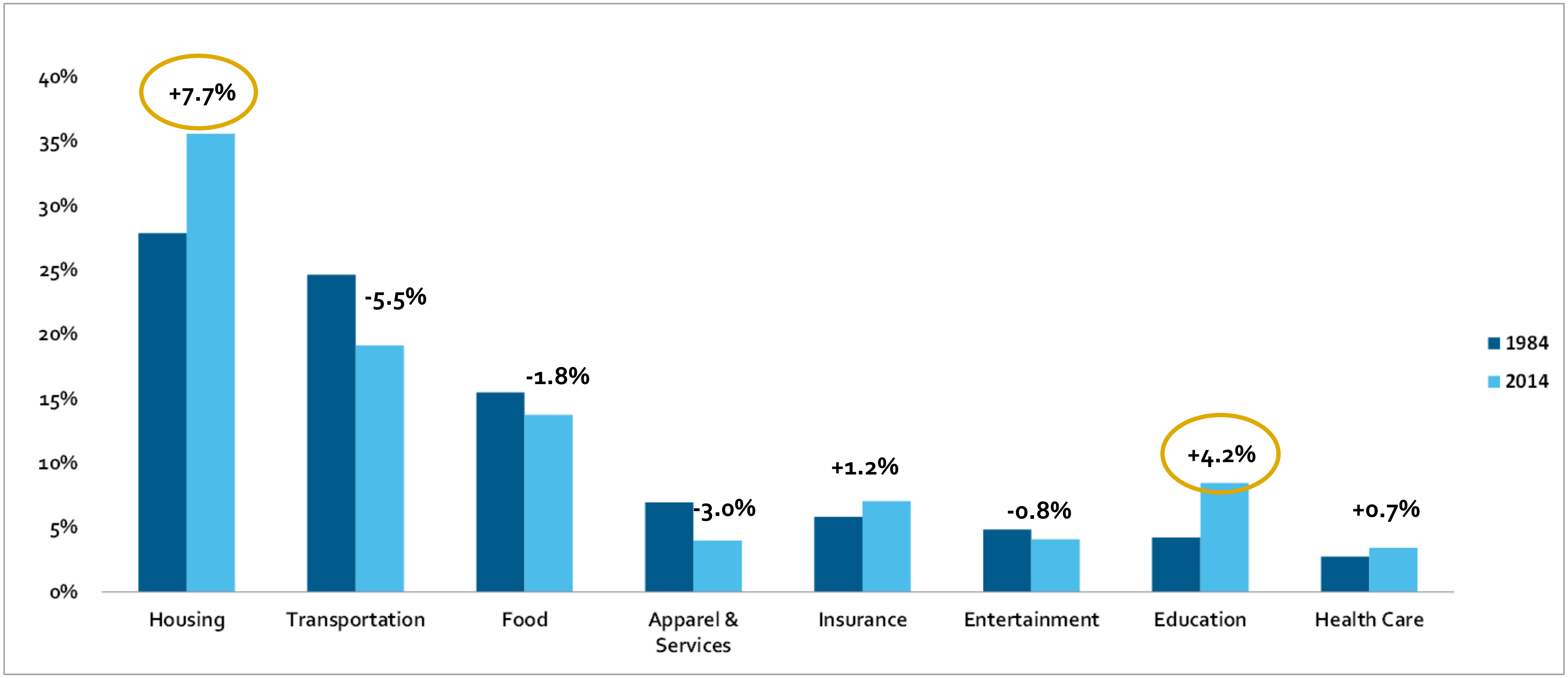
Millennials Are Spending Much More on Housing and Education Than Their Parents Did

Expenditures of People Under 25 as a Percent of Their Total Spending

As of December 31, 2014

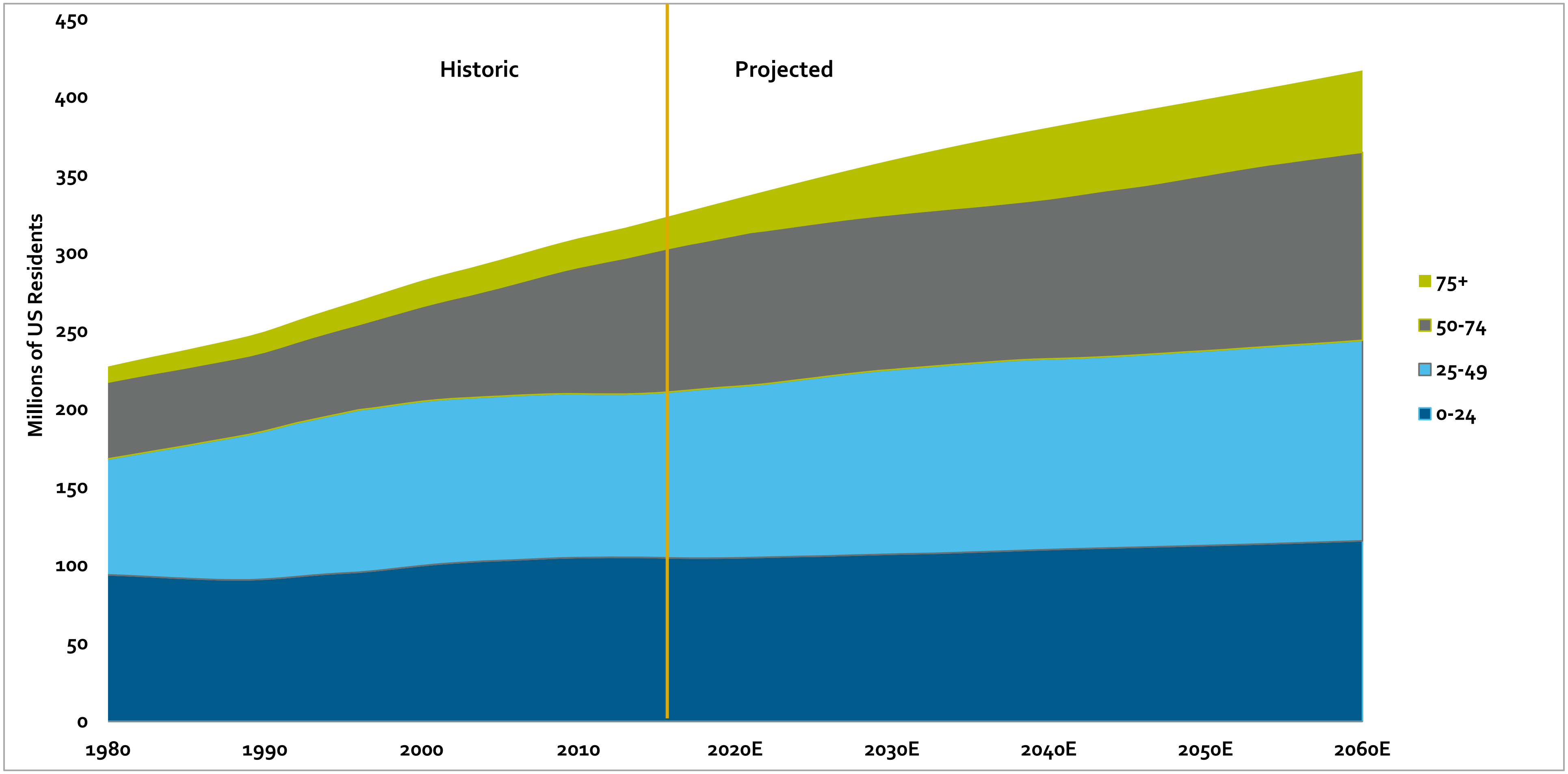


Source: Haver Analytics, Bureau of Labor Statistics, Morgan Stanley Wealth Management GIC

As Baby Boomers Live Longer, US Population Skews Older

Projected US Residents by Age Group

As of December 31, 2014

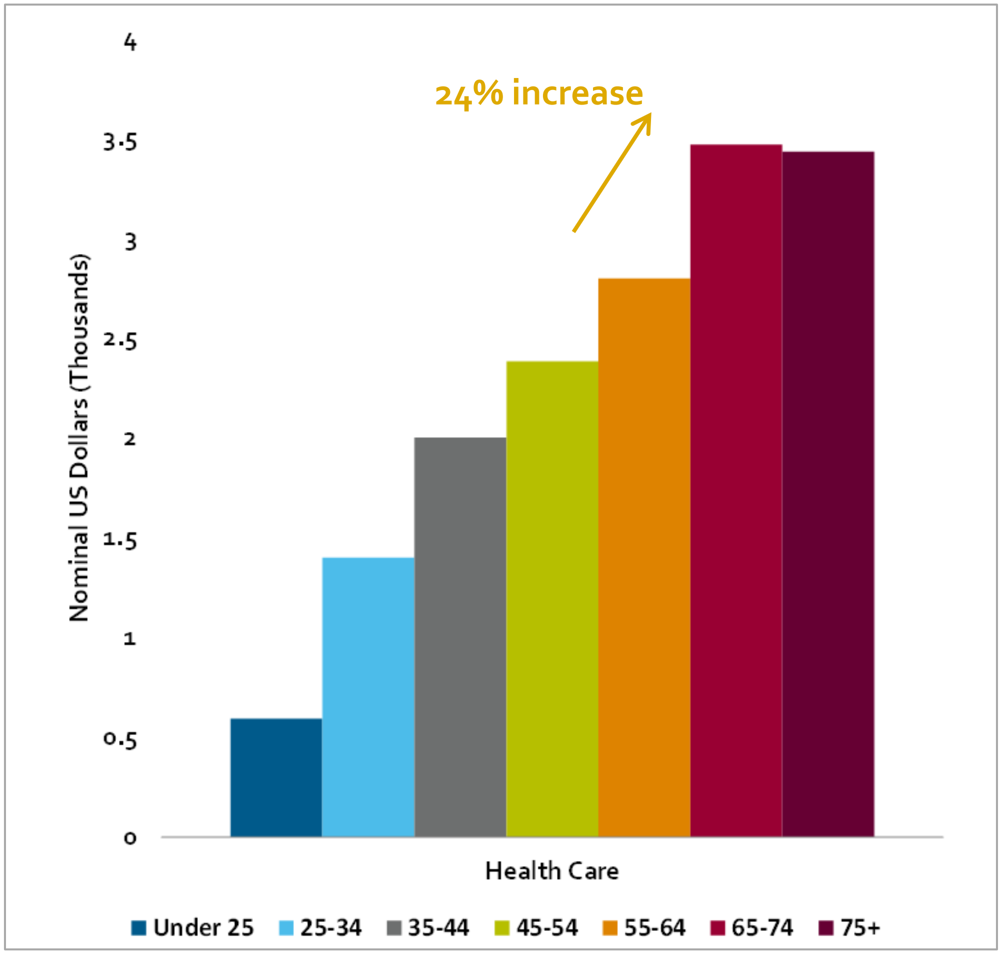


Source: Haver Analytics, US Census Bureau, Morgan Stanley Wealth Management GIC. Projections are from the "middle series" published by Census and are based on the middle assumptions for future fertility, life expectancy, and net immigration levels as of July 1 of each year.

Demographic Tailwinds Likely to Support Health Care Spending Through 2060

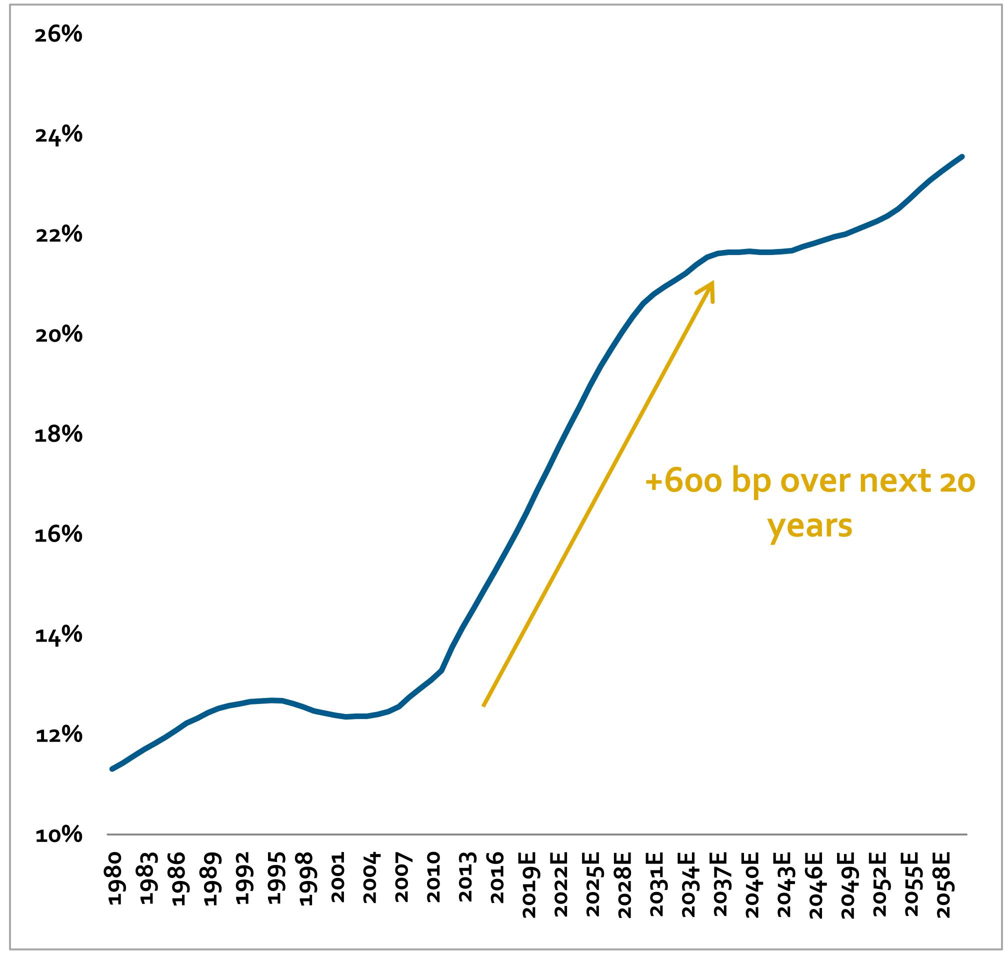
Health Care Expenditures by Age Cohort

30-year average, as of December 31, 2014



Percent of US Population Over 65

As of December 31, 2014



Source: Haver Analytics, Bureau of Labor Statistics, US Census Bureau, Morgan Stanley Wealth Management GIC

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A Cyclical Upturn at the End of the Cycle

As of October 12, 2016

- **The dramatic sell-off to start the year marked the end of a recession in the old economy that began two years ago—led by excessive oil supply, a strong US Dollar, and China's hard landing. We are now experiencing a sharp recovery.**
- Recent data supports this claim with improving global purchasing manager surveys, durable goods, factory orders, inventories and industrial company earnings revisions. Risk asset markets appear to be confirming this with better breadth and new market leadership from "deep" cyclicals and relative outperformance of old economy sectors.
- Coordinated policy action from the world's central banks has been a game changer led by the Fed's decision to back off on rate hikes in March and continued depreciation of the Chinese yuan. **However, the Fed may be further along in its rate hike cycle than generally assumed. We are "late cycle" in the US after seven years of economic recovery.**
- Political and geopolitical risks have weighed heavily on investors. However, the UK's referendum vote to leave the EU and the US Presidential election could be catalysts for global fiscal support as incumbents come under pressure.
- Interest rate markets are conveying little "fundamental" information. Technical bid suggests value lies in equities and other "risky" assets while actual risk may be more pronounced in "conservative" assets. Quality / safety are over-priced.
- Our global rebalancing thesis remains on track despite all of the shocks to the economy since the Financial Crisis ended seven years ago. We will be watching the following developments closely:
  - Fed and other central banks remain vigilant on financial conditions (*so far, so good*)
  - Known political events need to "expire" (*Brexit, US political election, Italian referendum, European elections*)
  - Economic and earnings growth acceleration (*3Q results are likely to further this argument*)
  - Italian / European banking system needs to be properly addressed (*could German bank settlement with DOJ be the catalyst?)*
  - Global fiscal stimulus is needed to create demand (*China and Japan underway; Europe and US to come?*)
- **Secular stagnation is a consensus view at this point for which asset markets are priced. Our work strongly suggests that many of the forces that have led to the prior decade's subpar growth may be close to reversing.**

Source: Morgan Stanley Wealth Management GIC

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The following hypothetical illustrates the compound effect fees have on investment returns: For example, if a portfolio's annual rate of return is 15% for 5 years and the account pays 50 basis points in fees per annum, the gross cumulative five-year return would be 101.1% and the five-year return net of fees would be 96.8%. Fees and/or expenses would apply to clients who invest in investments in an account based on these asset allocations, and would reduce clients' returns. The impact of fees and/or expenses can be material. **INSURANCE PRODUCTS AND ETF DISCLOSURES:** An investment in an **exchange-traded fund** involves risks similar to those of investing in a broadly based portfolio of equity securities traded on an exchange in the relevant securities market, such as market fluctuations caused by such factors as economic and political developments, changes in interest rates and perceived trends in stock and bond prices. **Variable annuities, mutual funds and ETFs are sold by prospectus only. The prospectus contains the investment objectives, risks, fees, charges and expenses, and other information regarding the variable annuity contract and the underlying investments, or the ETF, which should be considered carefully before investing. Prospectuses for both the variable annuity contract and the underlying investments, or the ETF, are available from your Financial Advisor. Please read the prospectus carefully before you invest. Variable annuities** are long-term investments designed for retirement purposes and may be subject to market fluctuations, investment risk, and possible loss of principal. All guarantees, including optional benefits, are based on the financial strength and claims-paying ability of the issuing insurance company and do not apply to the underlying investment options. Optional riders may not be able to be purchased in combination and are available at an additional cost. Some optional riders must be elected at time of purchase. Optional riders may be subject to specific limitations, restrictions, holding periods, costs, and expenses as specified by the insurance company in the annuity contract. If you are investing in a **variable annuity** through a tax-advantaged retirement plan such as an IRA, you will get no additional tax advantage from the variable annuity. Under these circumstances, you should only consider buying a variable annuity because of its other features, such as lifetime income payments and death benefits protection. Taxable distributions (and certain deemed distributions) are subject to ordinary income tax and, if taken prior to age 59½, may be subject to a 10% federal income tax penalty. Early withdrawals will reduce the death benefit and cash surrender value. **Equity securities** may fluctuate in response to news on companies, industries, market conditions and general economic environment. **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. **Master Limited Partnerships (MLPs): I**ndividual 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. **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. 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. **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. Risks of **private real estate** include: illiquidity; a long-term investment horizon with a limited or nonexistent secondary market; lack of transparency; volatility (risk of loss); and leverage. 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.

For index definitions to the indices referenced in this report please visit the following: http://www.morganstanleyfa.com/public/projectfiles/id.pdf

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. **Credit ratings** are subject to change. **Floating-rate securities.** 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. Companies paying **dividends** can reduce or cut payouts at any time. **Nondiversification:** For a portfolio that holds a concentrated or limited number of securities, a decline in the value of these investments would cause the portfolio's overall value to decline to a greater degree than a less concentrated portfolio. Portfolios that invest a large percentage of assets in only one industry sector (or in only a few sectors) are more vulnerable to price fluctuation than those that diversify among a broad range of sectors. The **indices selected by Morgan Stanley Wealth Management** to measure performance are representative of broad asset classes. Morgan Stanley Wealth Management retains the right to change representative indices at any time. Because of their narrow focus, **sector investments** tend to be more volatile than investments that diversify across many sectors and companies. **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. **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. Any type of **continuous or periodic investment plan** does not assure a profit and does not protect against loss in declining markets. Since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider his financial ability to continue his purchases through periods of low price levels. **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. This material is disseminated in the United States of America by Morgan Stanley Smith Barney LLC. Morgan Stanley Wealth Management is not acting as a municipal advisor to any municipal entity or obligated person within the meaning of Section 15B of the Securities Exchange Act (the "Municipal Advisor Rule") and the opinions or views contained herein are not intended to be, and do not constitute, advice within the meaning of the Municipal Advisor Rule. This material, or any portion thereof, may not be reprinted, sold or redistributed without the written consent of Morgan Stanley Smith Barney LLC.