Morgan Stanley

WEALTH MANAGEMENT

INVESTMENT STRATEGY

MIDYEAR OUTLOOK

Global Investment Committee | June 2025

On the Markets

Grinding It Out

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It's probably an understatement to say that 2025 has generated its fair share of investor surprises. A rapid-fire policy agenda has targeted changes to immigration, regulation, health care and scientific research priorities along with realignment of trade and national security dynamics—fostering uncertainty and cross-asset volatility. Despite that, after their round trip, US equities are as richly priced as on Jan 1. While recession and stagflation odds have receded from their April 8 bear market highs, to assert that the US market is not undergoing regime change is to miss the forest for the trees.

Key to the regime change is a shift in US Treasury yields, led by multiyear normalization of long-term real rates and term premiums. Also supporting the change is a breakdown in longstanding correlations. The 10-year US Treasury yield is untethered from growth and inflation fundamentals, as suggested by its divergence from the copper/gold ratio; the US dollar is weakening despite higher real yields and falling commodities; gold has decoupled from real rates and the dollar; and credit spreads have failed to narrow back to Jan. 1 levels. Also concerning is that global sovereign debt issuance is poised to accelerate as the multipolar world demands fiscal stimulus from China, Japan and the EU and US fiscal health continues to deteriorate. In aggregate, the implication is that we move from a market powered by policy tailwinds and valuation expansion to one of policy headwinds and earnings dependence. That said, the short-term US economic implications still look decent: Growth should remain positive, inflation should moderate after absorbing tariff effects this summer and Federal Reserve rate cuts are likely to resume in 2026. While the proposed tax legislation is not particularly stimulative overall relative to cost, it offers tailwinds for select parts of the corporate and household sectors, suggesting that stock-picking may yield the best opportunities. Beyond US equity strategy, our portfolio construction approach leans toward maximum asset class, regional and sector diversification, as we believe that "the formula" of the past 15 years—passively owning US growth stocks—no longer offers the best risk-adjusted reward. Market leadership change is afoot, and complacency will be the enemy.

Enjoy the early days of summer and the midyear outlooks from our colleagues at Morgan Stanley & Co. Research. ■

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GLOBAL ECONOMICS

Global Economics: Skewed to the Downside

Seth B. Carpenter, Chief Global Economist, Morgan Stanley & Co. LLC

We anticipate global growth stepping down by a percentage point in 2025 from 2024, with US trade policy and the uncertainty it engenders serving as the main drivers. Central banks will need to confront the slowing, but the Federal Reserve will have to wait until inflation ebbs.

STRUCTURAL SHOCK. We see broad tariff imposition by the US as a structural shock to the global trading order, as the tariffs and associated uncertainty weigh on growth. Given the strong starting point to the year, however, it probably will not be enough to tip the globe into recession.

The risks from the trade shock are asymmetric. Our baseline view already assumes that the recently announced de-escalation persists but that tariffs are not eliminated. The economic damage is in train, and even fully undoing the tariffs would not restore global growth to where it would have been without them. Conversely, partial tariff re-escalation toward recent peaks would likely spell a recession for the US and thus the world.

GROWTH SLOWDOWN. In our baseline outlook, we forecast a slowdown in global growth from 3.5% on a Q4/Q4 basis in 2024 to 2.5% in 2025. We believe the trade shock will hit economies simultaneously, generally pushing them below potential growth. In the US, we anticipate a step down in real GDP growth—from 2.5%, Q4/Q4, in 2024 to 1.0% in both 2025 and 2026. Beyond tariffs, immigration restrictions also weigh on US growth, while we are skeptical of meaningful support from fiscal policy or deregulation.

In the eurozone, we don't expect growth to get above 1% per year throughout our forecast period, reflecting a step down in both private consumption and exports. For China, we see the tariff-related slowdown taking close to 0.5 percentage points off real growth in 2025 relative to 2024. We expect only a partial and supply-centric offset from fiscal policy, and we forecast low real GDP growth (4.0% Q4/Q4 in 2025 and 4.2% in 2026) and persistent deflation. In Japan, we see the global trade shock slowing exports, but nominal GDP reflation remaining in place, as consumer resilience persists. India remains the fastest growing economy in our coverage, with real GDP growth at 5.9%, Q4/Q4 in 2025 and 6.4% in 2026. In Mexico, with some tariff effects and a close connection to the US economy, we expect GDP to be flat, Q4/Q4, in 2025 and to recover to 1.6% in 2026.

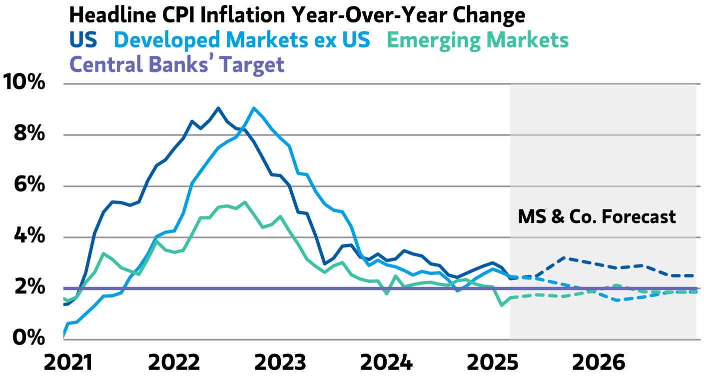
US DISINFLATION DIVERGENCE. While we expect global inflation to moderate eventually, the US is likely to differ from the rest of the world because of the imposition of tariffs (see chart). In the US, we see the fall in inflation toward target being interrupted by some pass-through from tariffs that peaks at the end of 2025. Tariffs tend to cause a level shift in prices, so over 2026 the retreat in inflation resumes, even in the US. In the US, we forecast core personal consumption expenditures (PCE) to reach a 4.5% quarterly seasonally adjusted annual rate before ebbing. While tariffs primarily boost goods inflation, immigration restrictions should limit the fall in services inflation. Ultimately, we see core PCE inflation remaining notably above the Fed's target throughout 2026.

Morgan Stanley & Co. Global GDP, Inflation and Monetary Police Rate Forecasts

	GDP (YoY)			Headline CPI (%Y)			Monetary Policy Rate (% p.a.)		
	2024	2025E	2026E	2024	2025E	2026E	2024 EOP	2025 EOP	2026 EOP
Global	**3.3**	**2.9**	**2.8**	**2.4**	**2.1**	**2.0**	-	-	-
G10	**1.7**	**1.3**	**1.0**	**2.7**	**2.5**	**2.2**	-	-	-
US	2.8	1.5	1.0	3.0	2.9	2.7	4.375	4.375	2.625
Eurozone^^	0.8	1.0	0.9	2.4	2.0	1.7	3.00	1.50	1.50
Japan*	0.2	1.0	0.5	2.7	2.8	1.4	0.25	0.50	0.50
UK	1.1	0.8	1.3	2.5	3.0	1.8	4.75	3.25	2.75
Emerging Markets	**4.6**	**4.1**	**4.1**	**2.2**	**1.8**	**1.9**	-	-	-
China**	5.0	4.5	4.2	0.2	0.0	0.3	1.50	1.25	1.25
India	6.7	6.2	6.4	4.9	3.8	4.2	6.50	5.50	5.50
Brazil	3.4	2.3	2.0	4.4	5.5	4.7	12.25	14.75	11.25
Mexico	1.5	0.0	1.0	4.7	3.4	3.7	10.00	7.50	7.00

Note: Global and regional aggregates are GDP-weighted averages, using PPP weights. CPI figures represent period averages. Policy rate indicated is the BOJ's uncollateralized overnight call rate upper limit. ^^ECB deposit facility rate; **Seven-day reverse repo rate. Turkey, Egypt, Ukraine and Argentina are excluded when calculating global EM GDP aggregate.
Source: Haver Analytics, IMF, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of May 20, 2025

Tariffs Could Foster Upcoming Divergence in Global Disinflation



Note: Emerging markets excludes Ukraine, Turkey, Egypt and Argentina.
Source: National statistical agencies, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of May 20, 2025

In the eurozone, we believe the slowdown in economic activity and strength of the euro versus the US dollar will push inflation below the ECB's target. In Japan, we expect inflation to remain positive but partly moderate as the yen appreciates, curbing import-price inflation. The deflation loop in China, meanwhile, continues, as we expect policy support to remain supply-centric, with the added impulse from tariff shocks keeping our GDP deflator forecast in the -0.5% to -1.0% range throughout 2025–2026.

MONETARY POLICY BALANCING ACT. Generally, we expect central banks to react to slower growth and somewhat softer inflation, with the exception of the Fed. We anticipate the Fed remaining on hold throughout 2025 because, until inflation peaks, it will be a bigger problem for the central bank than weak growth. Unemployment rises in our forecast but only modestly because immigration restrictions suppress labor supply. In our baseline, the Fed restarts its easing cycle in March 2026 and eventually cuts past neutral.

In the eurozone, already falling inflation, soft economic activity and an appreciating euro make the ECB's decisions somewhat easier. We forecast that the ECB will continue its easing cycle, bringing the policy rate below neutral to 1.5% by December 2025. In contrast, the Bank of Japan had been hiking, but we anticipate it being sidelined for the entire forecast period. Slower growth, moderating inflation and a strengthening yen obviate the need for higher rates. ■

This article was excerpted from the May 20 Morgan Stanley & Co. Research report, "Skewed to the Downside." For a copy of the full report, please contact your Financial Advisor.

US ECONOMICS

US Economics: Slower Growth but Firmer Inflation

Michael T. Gapen, Chief US Economist, Morgan Stanley & Co. LLC

Despite numerous policy announcements and scores of executive actions that significantly increased financial market volatility, our baseline US economic outlook remains largely unchanged relative to the start of the year. As the saying goes, the more things change, the more they stay the same.

We retain the primary elements of our policy assumptions for immigration, fiscal policy and deregulation. The main adjustment is around tariffs, which came much faster and were, at least for a while, much higher than we had penciled into our baseline. With this more intense policy implementation, we expect even slower growth and stickier inflation than we did coming into the year (see table). Then, we expected tariffs to weigh more on activity in 2026.

Morgan Stanley & Co. US Economic Forecast

	2023	2024E	2025E	2026E
Real GDP (% Q4/Q4)	**3.2**	**2.5**	**1.0**	**1.0**
Private Consumption	3.0	3.1	0.9	0.7
Gross Fixed Investment	5.0	2.3	1.4	0.7
Government Consumption	4.3	3.2	0.1	0.7
GDP Contribution (percentage points)				
Final Domestic Demand	3.1	2.8	1.4	1.2
Net Exports	0.5	-0.4	-0.5	0.0
Inventories	-0.4	0.0	0.1	-0.3
CPI (% Q4/Q4)	**3.2**	**2.7**	**3.0**	**2.5**
Core PCE* (% Q4/Q4)	**3.2**	**2.8**	**3.3**	**2.3**
Policy Rate (%)**	**5.375**	**4.375**	**4.375**	**2.625**
Unemployment Rate (% labor force)**	3.8	4.1	4.3	4.8
Labor Force Participation Rate (%)**	62.7	62.5	62.6	62.6
General Govt. Balance (% of GDP)	-6.4	-7.0	-6.3	-7.1
Gross Govt. Debt (% of GDP)	122.7	124.1	125.1	128.1
Current Account Balance (% of GDP)	-3.3	-3.9	-3.9	-2.5

*Personal Consumption Expenditures Index **End of Period
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of May 20, 2025

TARIFFS. We think the average effective tariff rate, at 13%, will stay in place as trade negotiations persist. This assumption incorporates the 10% across-the-board tariff on imports; additional levies that bring the total tariff rate on China to 40%; tariffs on steel, aluminum and autos; and exemptions for trade that complies with the United States-Mexico-Canada Agreement (USMCA). We assume that potential forthcoming tariffs on pharmaceuticals, chips and copper, among other items, will be roughly offset by exemptions achieved through bilateral negotiations and a reduction in tariffs on non-USMCA-compliant goods. While down from the level observed on April 2, the effective tariff rate in our revised midyear baseline outlook is much higher than the 8%–9% we assumed in our year-ahead outlook.

IMMIGRATION. Immigration restriction remains an underappreciated factor, including with regard to monetary policy. We assume that immigration flows slow from approximately 3 million per year in 2022–2024, to approximately 1 million in 2025 and 500,000 in 2026. As we noted in our Feb. 20 report, "Immigration and the Macroeconomy," restrictive immigration policies create adverse supply and demand effects via slower labor force growth and fewer consuming households. In our view, the data suggests that supply effects outweigh demand effects. Immigration controls reduce growth in personal consumption via less employment while keeping the labor market tight since slow labor force growth reduces the breakeven employment rate. Less immigration also reduces potential growth through slower growth in trend hours.

FISCAL POLICY. After the rush of trade and immigration policies in the first half of 2025, we think attention will temporarily shift back toward fiscal policy, where the federal government still needs to pass a budget and raise the debt limit. Our baseline assumes full extension of the Tax Cuts and Jobs Act (TCJA). We also assume some additional measures—such as a domestic manufacturing credit and no tax on tips—that will be largely offset by other "pay-fors" and cuts to social spending programs.

On net, a mostly unchanged fiscal stance is likely to mean the contribution from fiscal policy to growth falls from 0.7 percentage points in 2023 and 0.5 in 2024 to only 0.1 this year and next. Staffing cuts and outlays from the Department of Government Efficiency (DOGE) imply risks to contractionary policy this year, but the fiscal process points to the risk of easing next year.

SLOWER GROWTH. We forecast real US GDP growth of 1.0% on a fourth-quarter-over fourth-quarter basis in 2025 and 2026. The Q4/Q4 growth numbers hide a slowdown in quarterly growth rates that trough close to a 0.5% quarterly seasonally adjusted annual rate in the fourth quarter of 2025 and the first quarter of 2026. The primary drivers of the slowdown are the direct effects of tariffs as a tax on consumption and capital. Prolonged uncertainty and low confidence remain wildcards. We forecast personal consumption expenditures (PCE) to slow to 0.9% and 0.7%, respectively, this year and next (Q4/Q4) while nonresidential fixed investment moderates to 1.4% and 0.7% over the same periods.

We expect a slow-growing economy to demand less labor, as immigration controls sharply reduce available labor supply. We forecast employment growth to slow from its 144,000 per month pace in the first four months of 2025 to around

50,000 per month in 2026. With a much lower breakeven rate, the unemployment rate should rise only slowly—from its current 4.2% reading to 4.3% in this year's fourth quarter and 4.8% in the fourth quarter of 2026.

INFLATION IMPACT. We believe tariff-induced gains in goods prices will cause headline and core PCE to rise to 3.0% (Q4/Q4) and 3.3%, respectively, in 2025. The three-month annualized impulse to inflation should peak in the third quarter of 2025 at 4.5%–5.0% before falling back. We assume that the effect of tariffs on inflation will prove transitory, though several years of above-target inflation could make inflation expectations more upwardly malleable than we anticipate.

FED CUTS IN 2026. We see the Federal Reserve on hold this year, with back-loaded rate cuts in 2026. Three factors drive our expectations for the Fed to keep the target rate unchanged at 4.25%–4.5% until March 2026: 1) inflation rising before activity slows; 2) inflation further from the 2.0% per year target than employment; and 3) a Fed that would prefer to rely on actual data than forecasts. Thereafter, we expect the central bank to reduce its policy rate by 25 basis points per meeting to a terminal target range of 2.5%–2.75%. Even as the Fed eases, it will have to balance above-target (but slowing) inflation with rising labor market slack. We think that the Fed is a long way from initiating balance sheet expansion through asset purchases. ■

This article was excerpted from the May 20 Morgan Stanley & Co. Research report, "Skewed to the Downside." For a copy of the full report, please contact your Financial Advisor.

GLOBAL EQUITIES

Global Equities: Rebase Then Reinvest

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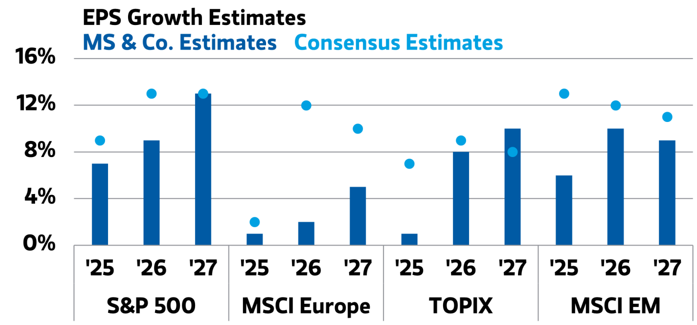
Effective US tariffs have fallen back sharply from the 100-year highs marked in April, sparking the recovery in global equities. Uncertainty should remain an overhang, however, as 90-day reprieves need to turn into more durable deals, while Section 232 tariffs on autos, steel and aluminum, as well as actions on semiconductors and pharmaceuticals, will likely impact major segments of equity indexes. From a corporate perspective, we anticipate meaningful earnings downgrades in the next three to six months among global cyclicals in autos, semiconductors, tech hardware and chemicals, as "pull-forwards" of inventory and supply chain disruptions are worked through amid slowing demand.

While these factors may have a larger impact on Asian and European equities, we see US earnings as relatively secure in this environment, with companies deploying pricing and sourcing strategies to mitigate tariff risk (see chart). US companies are also starting from relatively high profitability levels, with multinationals' earnings further supported by a weaker US dollar. The market is also likely to pivot toward secular growth themes with greater near-term visibility, including the artificial intelligence (AI) supply chain and beneficiaries of agentic AI capabilities. Overall valuations for global equities should find support into 2026 from lower policy rates and bond yields than priced in futures markets.

The weaker US dollar is one of the strongest narratives in our forecast, and we think investors need to account for it. Our colleagues' base-case forecast in mid-May of 11% appreciation for the euro and the Japanese yen by the end of 2026 will be a headwind for European and Japanese earnings, but a currency translation tailwind for US investors. Meanwhile, emerging market (EM) equities should benefit from local currency appreciation and easier financial conditions.

Stock market volatility is likely to remain high. Fundamental questions about the role of global and domestic institutions in a multipolar world, the outlook for tariff and nontariff barriers and the implications for global value chains are unlikely to be resolved quickly. Our economists' outlook for front-loaded inflation and for the Federal Reserve to hold rates through year-end may also contribute to more near-term downside volatility, while a sustained further lift in term premiums and long-term real yields would be another generalized risk. Ultimately, given the macro and asset class scenarios, we see risk/reward skewed more favorably for US equities, neutral for Europe and with a downside bias in EM and Japan.

We See Stronger EPS Growth and Less Slippage Than Consensus for the S&P 500 Versus Other Regions



Source: IBES, FactSet, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of May 20, 2025

US. Coming into 2025, we thought the first half would be more challenging ahead of a more constructive second half and 2026. While we've been surprised by the magnitude and speed of the growth headwinds tied to tariffs, our view around policy sequencing still holds. From our perspective, the level of tariffs announced on "Liberation Day" was so dramatic, it led to what can only be described as capitulatory price action. As a result, we think that the price lows are in, assuming we don't experience a deep recession. This makes sense in the context of the average stock in the S&P 500 Index already having endured a 30% drawdown this year.

Given equities' tendency to focus on the next six to 12 months, markets are now looking forward to a more accommodative policy agenda for stocks, including incentivizing infrastructure investment, tax breaks, deregulation and rate cuts. Most importantly, the recent reduction in the headline tariff rate on China from 145% to 30% significantly lowers recession risk. Our economists do not see a recession as their base case, but they do forecast seven 25-basis-point rate cuts in 2026, which should support above average valuations.

That said, we see longer-maturity rates as the main near-term risk to stocks. The 10-year US Treasury yield has been hovering around our key 4.5% level—the point where rate sensitivity should increase for equity markets. If longer-term yields remain elevated, they can keep a lid on multiples for now, and keep the S&P 500 Index in our first half range of 5,500 to 6,100, before upward progress continues to our 12-month price target of 6,500 (see table).

The drivers of our 6,500 base-case price target are a 21.5 price/earnings (P/E) multiple and 12-month forward earnings per share (EPS) of $302. We have not adjusted our target throughout the recent correction and reiterate that its achievability is more likely by the middle of 2026 versus the end of 2025 given the magnitude of the first half's drawdown and the lagged impacts of tariff uncertainty on earnings over the next couple of quarters. We see 2025 EPS of $259 (7% growth), 2026 EPS of $283 (9% growth) and 2027 EPS of $321 (13% growth).

Global Equity Index Forecast Summary

Index	June 2026 Base- Case Index Target (% upside from May 19)	MS & Co. Base-Case EPS Forecast Year Over Year (%)		
		2025	2026	2027
S&P 500	6,500	259	283	321
	9%	*7%*	*9%*	*13%*
MSCI Europe	2,250	142	145	151
	3%	*1%*	*2%*	*5%*
TOPIX	2,900	185	200	220
	6%	*1%*	*8%*	*10%*
MSCI Emerging Markets	1,200	84	92	100
	3%	*6%*	*10%*	*9%*

Source: FactSet, IBES, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of May 20, 2025

The earnings path should be aided by Fed rate cuts in 2026, dollar weakness and broader realization of AI-driven efficiency gains. We think that the S&P 500's valuation will stay elevated at 21.5, as our work shows that it's rare to see multiple compression in periods of above-median EPS growth and declining fed funds, which is our base case by the middle of next year. Our bull case price target of 7,200 assumes a faster recovery from the tariff overhang, and our bear case target of 4,900 considers a deep recession.

We continue to recommend staying up the quality curve in cyclicals. Industrials are best positioned to benefit from the administration's focus on a domestic infrastructure build-out. We move utilities from overweight to equal-weight as we reduce defensive exposure. We recommend large-cap over small-cap equities, as large caps have superior pricing and supplier-bargaining power, as well as less sensitivity to sticky long-term rates. Finally, we continue to prefer US equities to international stocks as earnings revisions start to inflect higher for the S&P 500 versus the MSCI ACWI ex USA Index.

Europe. We forecast approximately 3% upside for the MSCI Europe Index by June 2026, rising to about 8% with buybacks and dividends. We expect only 1.3% earnings growth this year and 2.2% in 2026. We see parallels between the economic uncertainty created from the temporary 150% spike in oil prices at the outset of the Gulf War in the early 1990s and tariff uncertainty today. The phases of European equity market reaction to tariff escalation and de-escalation have thus far largely matched the earlier period.

Our playbook suggests that uncertainty can linger, limiting recovery in business confidence, investment, and, most of all, hiring and consumer confidence. This should create choppy, sideways trading and a renewed rotation into relatively defensive/resilient pockets of the market. In terms of multiples, European equities rerated amid slowing growth in the early 1990s on hopes around rate cuts and for a more pronounced rebound. We expect European equities to rerate to a 15.2 P/E multiple, breaking out from their valuation downtrend range relative to the US by June 2026.

We broadly prefer defensives over cyclicals. On a sector basis, we are overweight banks, defense, software, telecom, business services, real estate and diversified financials. We are underweight metals and mining, semiconductors, luxury, autos, energy, transport, and pulp and paper.

Asia/EM. We see modest upside across Asia Pacific and emerging markets indexes through mid-2026, as well as for major markets, including Japan, China and India. Overall, we expect earnings to slip well below consensus given the impact on exporter margins and volumes from a global slowdown and inventory digestion in the second half of this year. This sets up a solid but not exceptional recovery in 2026, as improved Asia and EM foreign exchange earnings translation helps offset still-muted macro conditions. We continue to prefer domestic demand over exporters.

We retain core overweight positions in India, Singapore and the United Arab Emirates (UAE), which benefit from secular growth and reform tailwinds. Indian equities remain expensive relative to history, but we expect valuations to be upheld by domestic retail and institutional flows and an above-consensus 15% compound annual growth rate (CAGR) for earnings in 2025–2026. Singapore and the UAE continue to offer compelling value for their profitability.

We remain equal-weight Chinese equities, balancing a favorable bottom-up story for profitability champions versus still-deflationary macro conditions for domestic cyclicals. In Latin America, we are overweight Brazil, as we see potential for cheap valuations to be rerated by easier global macro conditions, an end to monetary tightening and the potential for the market to start anticipating a shift in domestic policy mix as late-2026 elections come into view. In Japan, we prefer domestic exposure to the twin engines of corporate reform and nominal reflation. This includes financials, real estate, construction, IT services and defense. We are cautious on cyclical exporters including autos, electronic components, semiconductors, semiconductor equipment and chemicals. ■

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GLOBAL CREDIT

Global Credit: Rolling With It

Andrew Sheets, Global Head of Corporate Credit Resarch, Morgan Stanley & Co. International plc+

In 2024, credit investors enjoyed the best of all worlds: a rare mix of moderate global growth, moderating inflation and, despite strength in equities, moderate corporate activity. It's hard to see that combination returning anytime soon. In contrast, our 2025–2026 growth forecast calls for above-average recession risk across regions. After all, markets still face higher tariffs than before the current administration; greater uncertainty for corporations and consumers regarding where policy ends up; and higher odds that the Federal Reserve will keep policy restrictive for longer.

While 2024 was all about moderation, we believe 2025–2026 is about a fundamentally wider range of economic outcomes, a challenge for asymmetric payoffs in credit. That said, the bull case is maybe, just maybe, the US will continue to moderate its tariff stance, show flexibility on demands and continually roll various 90-days pauses. The bear case is that the current respite is the eye of the storm, and only the first wave of surprises and positioning adjustment has passed through.

Corporate Credit Spread Forecasts

	Q2 2026 Base-Case Forecasts	
	Current Spread (as of May 20)	Spread Forecast
US Investment Grade	89	90
US High Yield	312	335
US Leveraged Loans	410	425
Europe Investment Grade	102	110
Europe High Yield	326	350
Asia Investment Grade	84	100

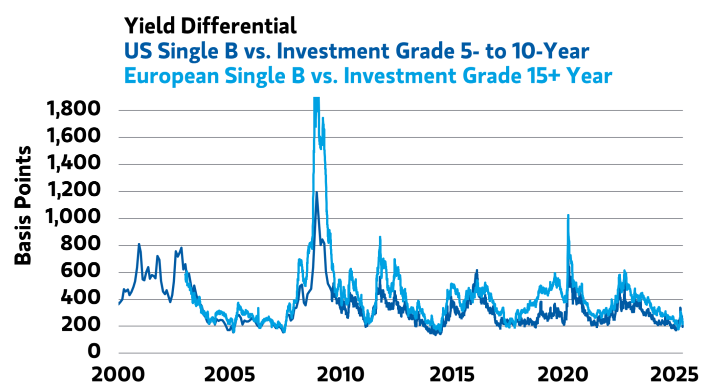
Note: US investment grade (high yield) and leveraged loan spreads forecast for the Bloomberg US Corporate Investment Grade (High Yield) Bond and PitchBook LSTA Loan indexes.
Source: Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of May 20, 2025

GO UP IN QUALITY. How should investors respond? We favor going up in quality, as we expect investment grade (IG) to deliver better total and risk-adjusted returns than high yield (HY). Here's why. IG credit demand remains strong, driven by yield-focused buyers. At present, those yields remain attractive, and look even better adjusted for expected inflation. One reason yields have risen is the supply of government-issued sovereign debt. But here IG has an advantage, with much more flexibility to adjust issuance based on market conditions. And there is another cross-asset advantage. A key risk to our otherwise positive US equity outlook is that interest rates continue to press higher. But this scenario could be good for high-quality credit, driving even stronger yield-based demand.

We think that this story is especially attractive in intermediate-term US maturities thanks to steeper spread/yield curves, which boost roll-down. Five-to-ten-year IG bonds offer an attractive yield of about 5.5% and low dollar prices. In Europe, carry and roll-down of long-term IG bonds are near decade highs. Note that this enthusiasm does not extend to Asia, where IG spreads are simply too rich.

LOWER-RATED ISSUES. Lower-rated bonds are a different story. Our forecasts for decelerating, subpar growth and elevated policy rates present a much more challenging proposition for the smaller, more cyclical, more leveraged issuers that dominate the lower ratings. The lack of rate cuts through year-end is an added challenge for weaker capital structures already dealing with weak interest coverage ratios and low free cash flow. This problem is especially acute for CCC-rated credits and major portions of the low-single-B cohort. What's more, single Bs offer historically low yield pickup versus IG in both the US and Europe (see chart).

Single Bs Offer Historically Low Yield Pickup Relative to IG Across the US and Europe



Source: Bloomberg, IHS Markit, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of May 16, 2025

Our concerns continue to be macro rather than micro. Nonfinancial leverage across our global IG and HY markets remains stable, while interest coverage is average. Financial credit metrics are historically strong, as corporations have been restrained post-COVID. Therefore, our fundamental concerns are narrower. We're focused on two areas: companies with the wrong capital structure for this higher-for-longer rate environment, concentrated in single Bs and CCCs; and issuers for which weak equity performance may signal future fundamental weakness that credit isn't yet pricing.

REGIONAL AND SECTOR VIEWS. While we forecast attractive total returns across regions, we prefer the US over Europe, and Europe over Asia. We expect European credit to lag that of the US given richer valuations and trade uncertainty, while Asia should underperform, given tight spreads and weaker growth.

By sector, in the US, we prefer utilities, money-center banks and telecom as ways to play defense. We dislike cyclicals broadly, especially energy, and cyclical subsectors within financials, such as consumer-exposed issuers and business development companies.

Among European sectors, we remain cautious on cyclicals, especially energy, and prefer utilities, banks and select health care companies. In Asia, we prefer non-China IG bonds, as tariff uncertainty disproportionately hurts Chinese issuers. ■

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US PUBLIC POLICY

US Public Policy: Expected Path Into Year-End

Michael Zezas, Global Head of Fixed Income Research & Public Policy, Morgan Stanley & Co. LLC

We titled our 2025 global strategy year-ahead outlook "Timing Is Everything" on the premise that policy sequencing and severity would be the defining factors for risk assets into this year, driving a wide bull-bear range. Accordingly, we highlighted tariffs and immigration as earlier areas of focus, followed by a slower-moving tax bill and deregulation agenda. That view informed our economists' expectations for slower growth and stickier inflation.

The path has been different from our expectations. While we expected high tariff rates to be announced on "Liberation Day" as the Trump administration was seeking bilateral trade negotiations, the levels exceeded our projections. Looking toward the second half of this year and into 2026, tariff uncertainty remains, but we see the administration pivoting to a more growth-positive part of its policy agenda. There is slightly more clarity on the fiscal path, as both chambers of Congress have aligned on a strategy to extend the expiring 2017 Tax Cuts and Jobs Act (TCJA) and implement more tax cuts, which we see being largely offset by savings found elsewhere. That expectation is part of the reason for our US equity strategists' constructive 12-month forward S&P 500 Index price target of 6,500, while our economists still see a risk to growth as the lagged effects of tariffs work their way into the growth and inflation data.

TARIFFS. We expected aggregate US tariffs to ramp up over time in 2025 toward a state not only featuring tariff levels skewed toward China, but incorporating levies on Europe and specific products, with those covered by the United States-Mexico-Canada Agreement (USMCA) largely spared. Our base case reflects that uneven implementation across the board: a 10% baseline for most trading partners, higher tariffs on China but at a workable rate, higher escalation risk for Europe and longer-lasting product-specific Section 232 tariffs, such as those on steel, aluminum, autos, copper and semiconductors. China tariff levels are lower than the medium-term steady state we previously penciled in (30% vs. 43%) and were achieved faster.

The end state we envision is still one in which the US keeps higher barriers on trade in the aggregate relative to the beginning of the year, still with a skew toward China but to a lesser degree. We expect no incremental "reciprocal" tariffs on top of this for the rest of the world ex China, as we see negotiations with allies progressing sufficiently to continue delaying implementation of Liberation Day tariffs. That said, in key jurisdictions such as Europe, we see high risk of temporary re-escalation on negotiation sticking points.

Trade policy uncertainty has been meaningfully reduced versus April, but in the aggregate, it's still high. The scope of bilateral trade negotiations remains in flux, as public appearances from key officials continue to reveal little about the principles and parameters of ongoing negotiations. Hence, there are plenty of potential sticking points to stall progress, particularly if the administration is pressing for the type of reforms it sought from China in 2019's "Phase Two" discussions. Accordingly, twists and turns in the form of shifting implementation timelines and rhetoric should be expected, and re-escalation is always possible.

We expect the US wants to maintain tariffs on China at a level that is elevated but that doesn't rupture the bilateral trade relationship. There could be tit-for-tat escalation around these levels as the two sides work toward a more durable deal. That said, a deal coming together quickly would reflect the US administration seeking concessions more in keeping with Phase One (reflecting the deal achieved during Trump 1.0) rather than Phase Two (efforts to resolve the more complex issues of the trade relationship, which the first Trump administration pushed out to a later date). Conversely, President Trump could remove the 20% fentanyl-related tariffs and/or replace them with a higher overall levy to reflect disproportionate treatment of China versus the rest of the world.

FISCAL POLICY. Our fiscal base case calls for TCJA extension with some additional tax cuts, though short of the full suite President Trump pledged on the campaign trail. Coming into this year, we assumed that the incoming Congress would seek to extend most of the TCJA in addition to some incremental policy changes, such as the domestic manufacturing tax credit, adjustments to the deduction cap on state and local taxes (SALT) and peeling back some of the Inflation Reduction Act's (IRA) tax credits or direct spending allocations. We are still of that view, but the budget resolution that will be used to draft the Senate's version of the bill scores the TCJA extension on a current policy baseline, i.e., with effectively a near-zero cost to roll forward. Doing so allows for $1.5 trillion of additional tax cuts that were not in our baseline before. Consensus in the caucus seems to be most firm around no tax on tips and a domestic manufacturing tax credit, as opposed to areas like no taxes on Social Security or overtime. We anticipate a domestic manufacturing tax cut or tax rebate as a proxy for a lower corporate rate, given our view that an across-the-board corporate rate decrease does not have unanimous support in the Republican Party.

We do expect "pay-for" provisions to mostly offset the incremental tax cuts. Specifically, we see a modification to the expiring SALT cap, legislative rollbacks of the IRA and other federal programs, and tariff revenue scored separately from the tax bill. Congressional Republicans from swing districts and states with relatively high tax rates have long pushed for the expiration of the SALT cap, which was approximately a $1 trillion revenue raiser in the original TCJA. We see that group settling for modification rather than full expiration of the cap given the magnitude of potential savings from leaving it in place. In terms of other savings, we assume Congress is able to codify some cuts identified by the Department of Government Efficiency (DOGE), particularly some portion of recouped improper payments and workforce reductions. Tariff revenue in line with our tariff baseline supplements these savings.

IMMIGRATION. Border flows and deportations have both been lower than we anticipated coming into the year, roughly offsetting each other and leaving expectations for 2025 net migration largely unchanged. Encounters at the US border, an indicator of unauthorized migration, have seen a sustained drop of about 90% since Inauguration Day to fewer than 30,000 per month. By contrast, deportations have fallen short of the administration's stated goals, as recent figures from Immigration and Customs Enforcement (ICE) suggest less than 20,000 per month. These trends inform our US economists' tight labor market outlook into 2026.

We expect a gradual increase in deportations driven by continued executive action and legislation. Given the significant restrictions already in place from both the US and Mexico, we think it would be difficult to reduce border flows further. On deportations, the administration has consistently highlighted funding as a limiting factor. The fiscal bill expected to pass later this year would provide an additional $200 billion for immigration enforcement, but faster deportations will likely still take time to implement due to legal and logistical constraints such as cooperation from state and local governments and construction of new detention facilities.

DEREGULATION. In general, deregulation is slow. So far, the impacts have been more sectoral than macro. As expected, President Trump's appointments have exhibited a lighter-touch regulatory approach across key agencies like the Environmental Protection Agency, Federal Trade Commission and Department of Justice. Congress has also played a role by leveraging the Congressional Review Act to overturn a handful of Biden-era rules, with some 50 more that could be targeted, mostly in the energy and climate spaces. Future deregulatory efforts, however, will be driven largely by executive action and must follow a lengthy rule-rewriting process.

In the long run, we see more potential macro impacts from financial deregulation in the financial sector, and our equity analysts expect several regulatory changes to support US bank activity. Proposed changes to the supplementary leverage ratio (SLA) and global systemically important banks (GSIB) surcharge, for instance, could come as early as the fourth quarter. We also expect faster and more transparent antitrust approvals to support mergers and acquisitions and capital markets activity across various industries, depending on market conditions. ■

This article was excerpted from the May 21 Morgan Stanley & Co. Research report, "Expected Policy Path Into Year-End." For a copy of the full report, please contact your Financial Advisor.

INTEREST RATES

G10 Rates: The Eye of the Storm

Matthew Hornbach, Global Head of Macro Strategy, Morgan Stanley & Co. LLC

Government bond markets should be caught in the eye of the tariff-induced storm in the second half of 2025. Morgan Stanley & Co. economists see global growth slowing as a result of the tariffs put in place by the Trump administration while consumer price inflation encounters bumps on its way back to central bank targets in the G10 economies.

We see tariff uncertainty keeping monetary policy on hold at the Federal Reserve and the Bank of Japan (BOJ) but allowing for easier policy from the European Central Bank (ECB) and the Bank of England (BOE). The skew of risks around growth favors a weaker outcome, while the skew of risks around inflation seems roughly balanced. As a result, the skew of risks around monetary policy favors lower policy rates, which we think will boost investors' desire to buy government bonds, not to sell them.

US. We expect US Treasury yields to continue range-trading through the third quarter of 2025 before starting to move lower in the fourth. We forecast the 10-year yield to reach 4.0% by the end of 2025 (see table). Then, yields are likely to stage a much larger decline in 2026 as the Fed delivers 175 basis points of rate cuts on the back of weaker growth and inflation moving back to target. As a result, we forecast the 10-year yield to end 2026 just above 3.0%.

In our base case, the Treasury yield curve also range-trades through the third quarter before steepening in the fourth as investors anticipate lower fed funds. By our estimates, the two-year/10-year curve reaches 55 basis points by year-end—slightly steeper than recent levels—but breaks above 100 basis points in 2026's second half.

Our bull and bear scenarios for US Treasuries align with two alternative scenarios from our economists: an upside case, in which tariffs come down even further than the present, and a downside case, in which the US enters recession for the first time since COVID. The scenario in which the tariff threat to the US economy abates sees the Fed reduce rates 100 basis points less than in the baseline—leaving the fed funds target range 75 basis points lower in 2026, as the 10-year Treasury yield never breaks below 4.0%.

The scenario in which the US economy enters recession sees the Fed cut the fed funds target range by 75 basis points this year and another 250 basis points next year. The two-year/10-year Treasury yield curve steepens dramatically—reaching nearly 100 basis points by year-end and surpassing 150 basis points by the end of 2026. The bull case sees the 10-year yield dipping below 2.5% as investors contemplate the Fed taking the policy rate to zero.

EUROZONE. Our base-case economic scenario features a sluggish domestic impulse coupled with lingering uncertainties at the global level. We expect growth to remain below potential, just 1.0% in 2025 and 0.9% in 2026. This is mainly due to lower private consumption and trade tensions weighing on exports.

Modest aggregate consumption by 2026 should result in inflation eventually undershooting the ECB's 2.0% target, settling at an average annual rate of 2.0% in 2025 and 1.7% in 2026. In this context, our economists expect the ECB to cut the deposit rate to 1.5% by December of this year. However, we think that the ECB will keep rates on hold in 2026, given its accommodative stance and a nonrecessionary setting. We expect the benchmark 10-year Bund to reach 2.4% by December 2025.

We see a different dynamic next year, however, with external factors dominating. With the Fed easing toward neutral, we expect lower US rates across the board to exert downward pressure on long-dated European forward rates.

UK. We anticipate a slowdown in both economic activity and inflation during the second half of this year. We expect GDP growth to remain below potential, at 0.8% in 2025 and 1.2% in 2026. Headline inflation is projected to be around 2.6% by year-end and to average 1.8% in 2026.

Morgan Stanley & Co. Base-Case Government Bond Yield Forecasts

	Two-Year			Five-Year			10-Year			30-Year		
	Q4 '25	Q2 '26	Q4 '26	Q4 '25	Q2 '26	Q4 '26	Q4 '25	Q2 '26	Q4 '26	Q4 '25	Q2 '26	Q4 '26
US	3.45	2.60	2.00	3.60	2.95	2.50	4.00	3.45	3.10	4.60	4.15	3.90
Germany	1.60	1.55	1.55	1.95	1.90	1.85	2.40	2.35	2.25	3.00	2.90	2.80
Japan	0.60	0.45	0.50	0.80	0.60	0.60	1.15	0.90	0.85	2.65	2.20	2.15
UK	3.65	3.30	2.95	3.90	3.65	3.40	4.35	4.10	3.80	5.00	4.65	4.30
Australia	3.45	3.25	3.15	3.70	3.50	3.45	4.40	4.30	4.25	4.95	4.85	4.80
New Zealand	3.30	3.10	2.95	3.90	3.70	3.55	4.50	4.25	4.05	5.15	4.90	4.70
Canada	2.35	1.90	1.75	2.60	2.30	2.20	3.00	2.80	2.70	3.40	3.20	3.10

Source: Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of May 20, 2025

The domestic and global slowdown should prompt the BOE to ease monetary policy. We project the bank rate to end 2025 at 3.25%, broadly in line with what most policymakers view as the UK's neutral rate. In 2026, we anticipate two additional rate cuts in the first half of the year, bringing the terminal rate to 2.75%. We expect the 10-year gilt yield to end 2025 at 4.35% and 2026 at 3.8%, around 40 basis points and 100 basis points lower than current market implied forwards, respectively.

JAPAN. We expect the Japanese government bond (JGB) yield to grind lower throughout the forecast horizon, as the market prices future BOJ rate hikes. Our economists forecast the BOJ to stay on hold up to the end of next year as they think that it will need extra time to assess the potential impact of US tariffs on corporate earnings and the subsequent wage negotiations. The prospective global economic slowdown could also make it difficult for the BOJ to continue policy normalization.

We believe short- to medium-term rate expectations will be repriced lower as the market prices out future BOJ hikes. Without domestic structural buyers' demand, long-end JGBs should face further yield steepening pressure. All told, we forecast the 10-year JGB yield to reach 1.15% in 2025's fourth quarter and 0.9% in 2026's second quarter.

DOLLAR BLOC. We expect the Canadian and Australian yield curves to steepen, with the Bank of Canada (BOC) cutting significantly more than priced and the Reserve Bank of Australia (RBA) cutting in line with market pricing due to a challenging global growth outlook. Having steepened significantly from an aggressive cutting cycle, we believe the New Zealand curve is likely to flatten.

In Australia, the growth outlook is less impacted by increased global trade barriers than its G10 peers, though this is largely priced. The direct US tariff impact is negligible. Moreover, the decline in commodity prices that are relevant for Australia has been fairly contained so far. Fiscal support should continue due to the recent election outcome, which should keep long-end yields relatively supported even as weak global growth allows long-end rates to decline in sympathy with other developed market bond markets.

The Reserve Bank of New Zealand (RBNZ) has cut 200 basis points thus far, reaching the upper bound of its neutral estimate and providing less room for investors to price in significantly more easing from the current level. Given the contained nature of fiscal plans versus Australia and Canada, net issuance should decline in New Zealand in 2026. After a technical recession in 2024, we see growth in New Zealand improving in 2025 and 2026 as rate cuts make their way through the economy, but downside risks to global growth imply that long-end rates are likely to decline despite improved domestic growth prospects.

In Canada, bond yields should decline over the next year, influenced by some further near-term BOC monetary policy easing and a pronounced economic slowdown in Canada in 2026. The economy is likely to weaken from negative US spillovers and Canadian consumers and businesses pulling back on consumption and investment decisions given economic and policy uncertainty. ■

This article was excerpted from the May 20 Morgan Stanley & Co. Research report, "All Eyes on US." For a copy of the full report, please contact your Financial Advisor.

COMMODITIES

Commodities: Risks Building

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Our midyear 2025 outlook includes expectations for lower crude oil prices amid lackluster demand growth, a potential rebound for gold from its recent pullback and building demand risks for copper.

Commodities Base-Case Forecasts

	Q4 2025	Q2 2026
Brent Crude (price per barrel)	$57.5	$55.0
Gold (price per ounce)	$3,500	$3,250
Copper (price per pound)	$4.22	$4.31

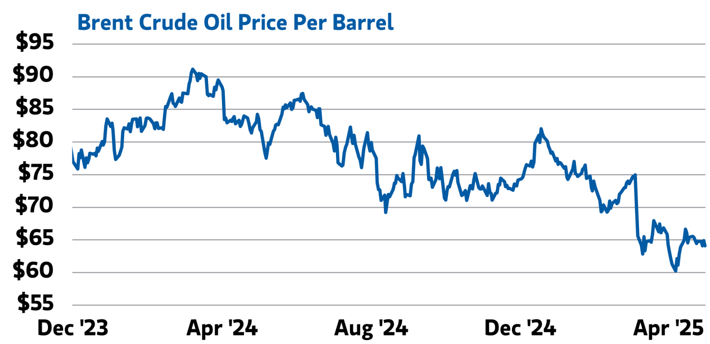
Source: Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of May 21, 2025

ENERGY. The oil market currently appears broadly balanced, if not somewhat tight. Refiners are returning from seasonal maintenance, which typically peaks in early May. With strong refining margins, they have every incentive to run at high rates over the summer, when end-user demand benefits from the typical driving season. This outlook changes rapidly following the summer, however. By the fourth quarter, we expect the market to enter meaningful oversupply, driven by the following three factors.

- **Below-trend demand growth:** Tariffs are a headwind for sectors such as trade, transportation and manufacturing—in short, the oil-intensive parts of the global economy. Notwithstanding swings in the outlook for tariffs, we suspect the uncertainty they create will be sufficient to drive full-year demand growth down to about 0.7 million barrels per day (mb/d), well below trend. This will likely become apparent later this year when seasonal demand tailwinds flip to seasonal headwinds.
- **Robust non-OPEC supply growth:** Non-OPEC supply growth hit a flat spot in 2024 but has reaccelerated in recent months. We peg it at roughly 1.2 mb/d, exceeding demand growth. Unlike previous periods of strong non-OPEC supply over the past decade, this is not just driven by US shale but features contributions from many countries, including Brazil, Guyana, Argentina and Canada.
- **Accelerated unwind of OPEC production cuts:** Notwithstanding the relatively "soft" fundamental outlook, OPEC has started to unwind 2.2 mb/d of production cuts in April. Including condensate, we estimate that OPEC supply will increase by about 0.4 mb/d on a year-over-year basis in 2025.

With these estimates, the balance in the oil market is approximately 1.0 mb/d weaker in 2025 than in 2024. As the market was broadly balanced last year, this also results in oversupply of about 1.0 mb/d across 2025. Based on current trends, this increases further to 1.5–2.0 mb/d in 2026. Such surpluses are rare and probably mean that supply and/or demand needs to change to prevent that outcome. That is unlikely to happen with Brent crude oil at its recent price near $65 per barrel, however (see chart). Instead, we expect Brent to fall into the mid-$50s for a period in the first half of 2026 to aid market rebalancing.

We Expect Brent Crude Prices to Fall Into the Mid-$50s in the First Half of 2026

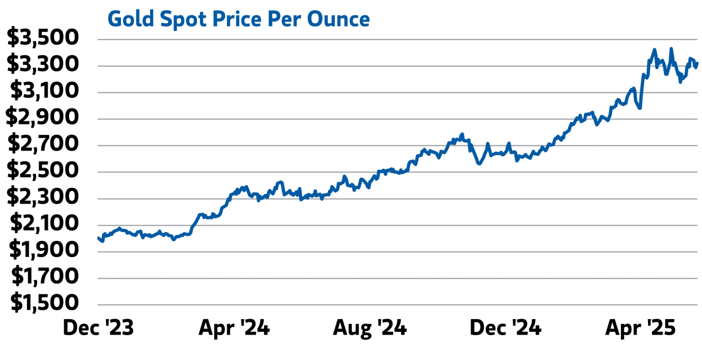


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of May 29, 2025

PRECIOUS METALS. Gold has pulled back from its all-time high of $3,500 per ounce (see chart) but remains well supported by still-elevated central bank buying, robust bar and coin purchases and a sizeable uplift in exchange-traded fund (ETF) buying since the start of 2025. High prices are starting to hurt some demand, however, especially for jewelry. In fact, without the ETF inflows, gold demand would have been down year over year in the first quarter, making those flows the key driver from here, in our view. After very strong inflows for the year to date, ETFs saw outflows in late April and early May, which were matched almost exactly by increases in the S&P 500 Index and US dollar strength. This suggests that competition from other asset classes is currently the biggest threat to gold.

Gold already briefly touched our $3,500 third quarter target, but as long as ETF inflows return, we think the elevated range can hold for now. In particular, we observe strong ETF inflows in China, and the elevated Shanghai gold premium suggests strong physical demand even at these prices. In our view, the changing tariff and growth backdrops are likely to keep markets swinging between "risk on" and "risk off," keeping gold volatile. A rebound in investor positioning in COMEX futures could bring additional upside, while further ETF outflows would likely pressure prices. A large decline in the dollar could also bring our bull case into play ($4,200 per ounce in the second half of 2025), given recently strong dollar/gold inverse correlation.

Gold Has Pulled Back From Its All-Time High

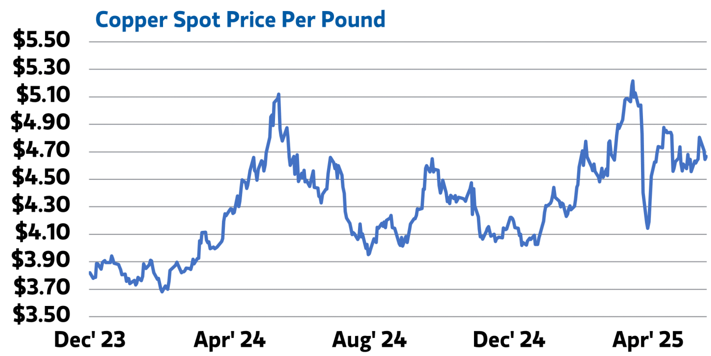


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of May 29, 2025

COPPER. The physical copper market looks tight for now, with inventories drawing rapidly in China, select contracts in backwardation (as indicated by lower futures prices than the spot price) and smelter treatment charges turning even more negative, suggesting challenges in sourcing mined copper. This is partly explained by the scramble to send copper to the US ahead of potential tariffs, which will likely continue until any tariff announcement comes. China demand indicators also suggest some front-loading, particularly of air conditioner exports.

The tariff pathway will dictate the second half demand outlook. In April, China's manufacturing purchasing managers' index (PMI) dipped to 49, while new export orders fell to 44.7, with our economists noting that factories are quickly losing orders due to the tariff impact. With the 90-day agreement to lower China tariffs, we could see front-loaded shipments and production continue for now, delaying any demand roll-off. Our base case sees copper well supported around current levels (see chart) but fading modestly into the third quarter as demand weakness comes through. A large move lower in US dollar would support commodities more broadly. ■

We View the Copper Price as Well Supported Currently



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of May 29, 2025

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Q&A

Investing Amid Uncharted Macro and Policy Waters

Trade and tariffs are front and center these days, forcing investors to think beyond their borders. That's nothing new for Matthew McLennan, co-head of the Global Value Team and portfolio manager at First Eagle Investments. Even if the Trump administration dials back tariffs a bit from current levels, he thinks this "backdoor consumption tax" will cause a meaningful fiscal contraction. And since US equities are richly valued versus the rest of the world, he encourages investors to look abroad, where the opportunities appear better. McLennan recently shared his views with Dan Skelly, head of market research and strategy at Morgan Stanley Wealth Management. Below is an edited version of their May 16 conversation.

Dan Skelly (DS): Matt, it's been a volatile year, to say the least. Let's start with trade policy, which has been whipping markets around. We've seen some fairly aggressive moves, followed by some pause and de-escalation. What are your expectations for tariff and trade policy?

Matt McLennan (MM): The evolution of trade policy partially reflects broader forces at work. We came into the year with a lot of enthusiasm around the Trump administration, the potential for deregulation, productivity growth with AI and the like. What fueled the market in the past few years, and arguably the reason we didn't have a recession, was incredibly easy fiscal policy. And that contributed to more nominal economic growth than perhaps would have been the case—and stronger profit margins.

While that was constructive, the problem was that the fiscal dynamic, which I think has driven the trade dynamic to an extent, was starting to feel intractable, especially when you had deficits in the 7% range and around 4% unemployment.

Since politicians are not interested in addressing entitlements, risk perception began to creep into the bond market. And perhaps the biggest trend that sort of preceded all this was interest rates having broken out on the upside after a 40-year downtrend. With that, we've seen interest expense on federal government debt exceed defense expenditures. The Trump administration saw tariffs as an opportunity, on the one hand, to raise tax revenues, and on the other, to address the large US current account imbalance.

Markets were somewhat shocked when the large tariffs were announced because their weighted average was north of 20% of net imports. And that would lead to fiscal contraction, arguably enough to create a recession. We saw that start to show up in the soft data, as consumer expectations about the economy plummeted. Consumer expectations for inflation went up, and that started to raise stagflation fears. And I think the administration, reflexively, has backtracked a little bit given the pause and the moderation of some tariffs.

While what's been proposed, alongside the efforts of DOGE, is a meaningful fiscal contraction, it might not be enough to change some of the complex fiscal dynamics because the budget problem is worsening, rates are rising and entitlement spending continues to grow. There may be some tax relief on things like tips and the SALT deduction, but the difficult fiscal policy is still ahead of us.

DS: Are your expectations high for meaningfully lowering tariffs with China or any of the other major trading partners? Or is there too much uncertainty to make a prediction?

MM: The UK deal provides a hint as to where things are going. We are still talking about a century-high base level of tariffs. Trump's negotiating style is to start with a big demand and then to sort of retract it to something that people feel comfortable with. But it's still a large shift from what we had.

When we look at where things are settling with China, 30%-plus tariffs is still a high number. On a weighted-average basis, it looks like tariffs are going to be settling around the mid-teens. And they are going to create some structural shifts because many of the supply chains for large-cap US firms have been built in the past two decades. The change in the tariff regime will create a fairly lengthy adjustment period.

DS: Do you expect that the shift from the painful medicine of trade restructuring to the policy of tax change and deregulation will positively impact markets? Will these factors be almost offsetting given the negative drag from tariffs? How do you look at those other policy initiatives in terms of their ultimate impact on growth and markets?

MM: Tariffs are almost like a backdoor consumption tax. In a sense, the administration is trying to take the tough medicine up front, whether it's tariffs or the fiscal adjustment initiatives under DOGE. And I think you're 100% right—that they're going to want to shift the focal point of markets and voters to the extension of the 2017 tax cuts and perhaps some additional tax reform and deregulation efforts in time for that sentiment to creep in ahead of midterm elections.

The bond market has sensed this narrative, and long-end yields have blown out. If markets start to perceive there is no credible fiscal narrative, it raises the risk of the administration having something like a "Liz Truss moment" in the UK, with bond vigilantes pressuring a tougher fiscal adjustment.

What's more, the Republican Congress has a very narrow margin to pass all these bills. The Republicans have their own constituencies, and I think the administration would hope, as you suggest, to take the bitter medicine up front and administer the candy later. But I think that the positioning of bond markets may disrupt that narrative and the delicate equilibrium within the GOP.

DS: Let's shift from macro and policy to markets. What is your view on US equities versus the rest of the world?

MM: We entered this year with the rest of the world trading at a 50-year low relative to the S&P 500. So US equities have had a sustained period of outperformance, leading to a valuation gap. Though risk exists everywhere, it is better priced internationally. From a pure valuation standpoint, the S&P 500 has been trading at around 24 times trailing earnings and a 4% earnings yield. For the rest of the world, the earnings yield is closer to 7%.

And as good as the US story has been for the past decade, it's hard to imagine that the productivity differential or the real economic growth differential between the US and the rest of the world is going to be as big as that gap in the earnings yield implies. In investing, you make money based on the imbalance between price and prospects, not just on an assessment of prospects.

The second thing I would say is that, as the US has started to retrench geopolitically, it's really shaken up the snow globe—especially in Europe and parts of Asia. Having just spent a week traveling in Europe speaking to companies and policymakers, I would say that the second-order consequence of this is to open a different set of possibilities internationally. I think we're going to see that Europe, China and other parts of the world may ease fiscal policy, while at the same time the US may need to tighten fiscal policy.

Alongside that, we've sensed that "animal spirits" may be reigniting internationally. And we're certainly seeing much better trends in corporate governance in Europe and Asia. Many more companies are returning capital to shareholders. So the dynamic between fiscal policy, animal spirits and capital allocation has become better at a time when relative valuations are stretched, all of which argues for looking at international equities.

The other thing I would note is that the US has benefited for some time because the dollar is a global reserve currency. But a sequence of events has played out over the past few years since Russia's invasion of Ukraine—whether it was the US sanctioning the ability of the Russians to access their US Treasuries or the recent tariff shocks. They have made international holders of Treasuries feel like, if the US is willing to put barriers on trade goods, maybe it would change the terms on the securities that we hold.

From a currency standpoint, we've started to see countries that are reserve accumulators shifting their mix. The US had a dominant role in their currency reserves, but that is changing now that the eurozone and Japan, for example, offer positive interest rates. And we've obviously seen gold perform very well relative to long-dated Treasuries. And so there may be a currency argument for looking abroad.

DS: What are the top international regions or countries that you would point to today?

MM: Broadly speaking, the valuation deck is lower, whether you're talking about Europe, Southeast Asia, Northeast Asia or Latin America. For us, it's really been much more about what we're seeing from the bottom up in terms of industry opportunities. In economies that may be riskier, like Latin America, we've seen real opportunities in defensive industries, such as brewing and convenience stores. In Japan, there are great opportunities in companies that are either manufacturers of precision products, with large R&D budgets and global sales forces, or insurance companies that benefit from a higher return on float. And in Europe, it's eclectic. In Northern Europe, we've seen opportunities in investment holding companies that trade at a discount to the securities they own and are buying back stock. But across Europe, including the UK, there are consumer staples companies with attractive free-cash-flow yields and defensible cash-flow-generative businesses.

DS: What's your view on gold, which no doubt intersects with many of the policy, macro and market themes we've touched on?

MM: We own gold as a potential portfolio hedge, and it's excelled in that role during the past few years. Perhaps that was because its price was depressed relative to equities or relative to the stock of government debt when we were at the peak of the rate-tightening cycle. As policy risks emerged, gold basically returned to a more normal valuation relative to equities. It's arguably at a full valuation versus Treasuries, but perhaps that's called for, given fiscal dynamics.

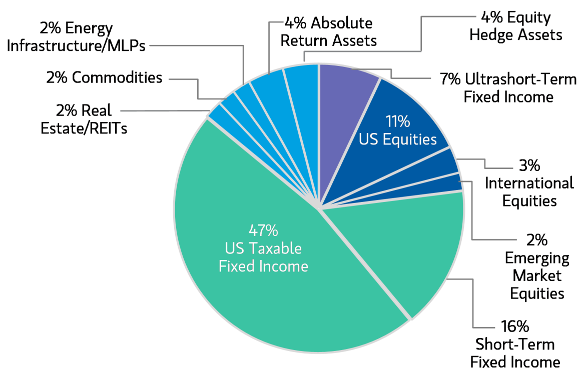
So, we think gold has basically moved from being undervalued to a more rational valuation. What happens going forward will be a function of whether policymakers can craft a rational fiscal path. We don't have a short-term directional view on gold. We own it as a defensive asset alongside equities because it gives you a more stable portfolio return and helps you capture the nominal drift in the world economy with less downside risk. ■

Matthew McLennan is not an employee of Morgan Stanley Wealth Management or its affiliates. Opinions expressed by him are his own and may not necessarily reflect those of Morgan Stanley Wealth Management or its affiliates.

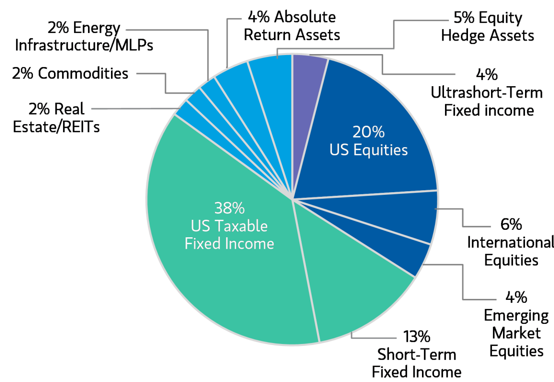
Global Investment Committee Tactical Asset Allocation

The Global Investment Committee provides guidance on asset allocation decisions through its various allocation models. The five models below include allocations to traditional assets, real assets and hedged strategies. They are based on an increasing scale of risk (expected volatility) and expected return.

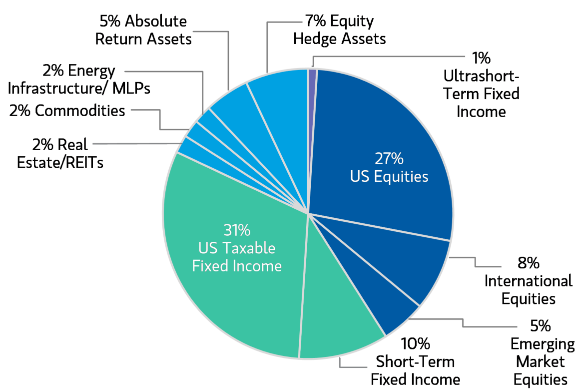
Wealth Conservation



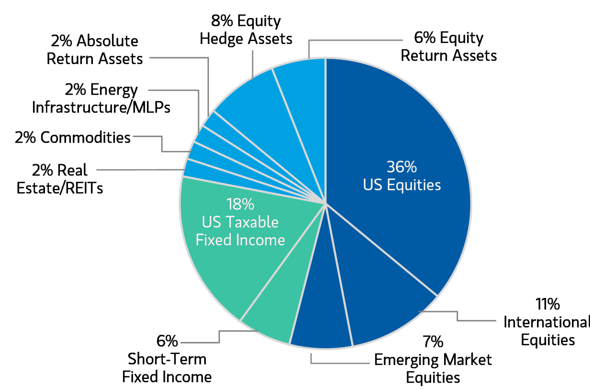
Income



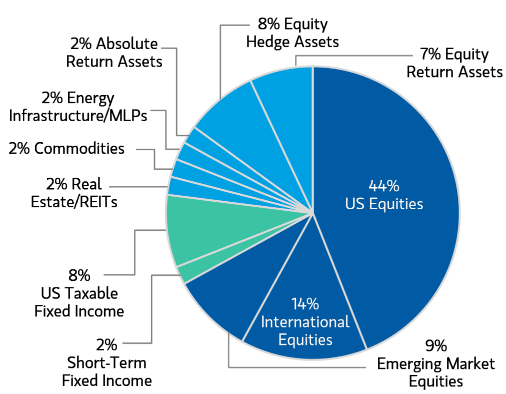
Balanced Growth



Market Growth



Opportunistic Growth



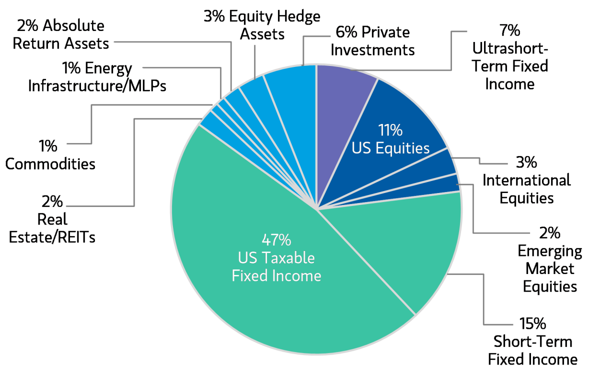
Key

- Ultrashort-Term Fixed Income
- Fixed Income & Preferreds
- Equities
- Alternatives

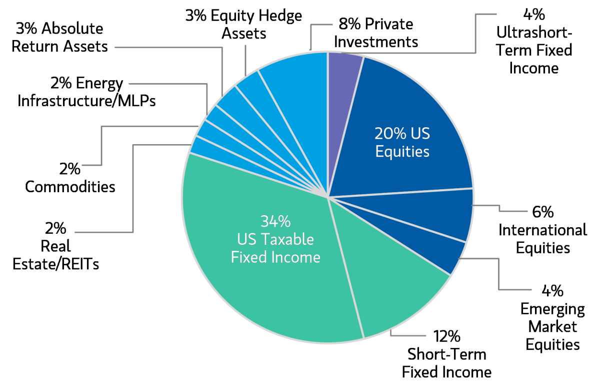
Source: Morgan Stanley Wealth Management GIC as of June 3, 2025

The Global Investment Committee provides guidance on asset allocation decisions through its various allocation models. The five models below include allocations to traditional assets and alternative investments, including privates, and are recommended for investors with over $10 million in investable assets. They are based on an increasing scale of risk (expected volatility) and expected return.

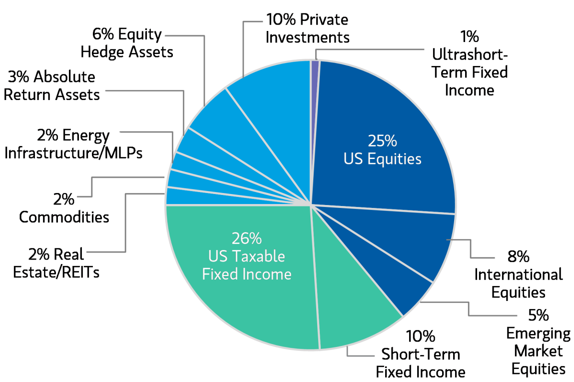
Wealth Conservation



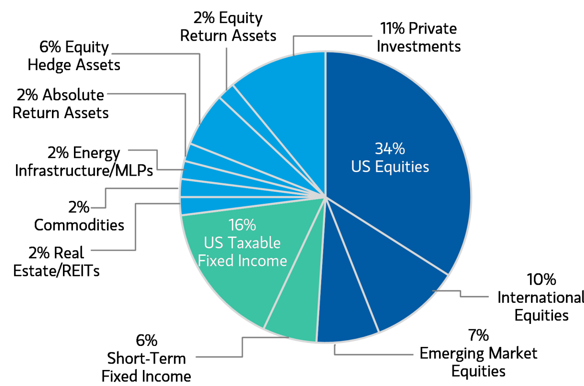
Income



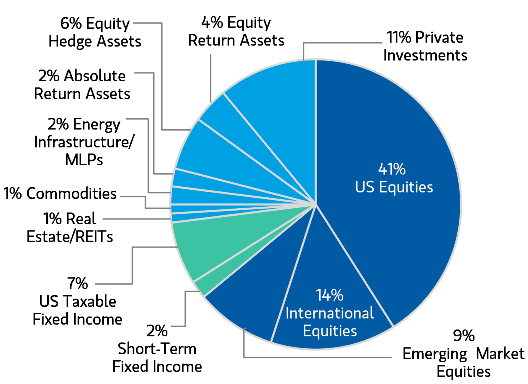
Balanced Growth



Market Growth



Opportunistic Growth



Key

Ultrashort-Term Fixed Income

Fixed Income & Preferreds

Equities

Alternatives

Source: Morgan Stanley Wealth Management GIC as of June 3, 2025

Tactical Asset Allocation Reasoning

Global Equities	Weight Relative to Model Benchmark	
US	Overweight	Stock indexes have experienced a round trip of April's bear market shock from tariffs, and aggregate valuations are as rich as they were in January on 3%–5% lower earnings estimates. That said, uncertainty remains elevated as equity investors appear highly complacent. An economic soft landing is still the base case as long as the labor market holds. The S&P 500 Index appears poised to grind out a 5%–10% gain this year, with interest rates (debt/deficits) the biggest constraint. We are buying equal-weighted indexes, quality-cash-flow stories in both growth and value universes and midcap growth names.
International Equities (Developed Markets)	Underweight	Recent outperformance has been catalyzed as responses to the “America First” agenda have driven fiscal stimulus and concerns about tariffs have been cooling rest-of-world (ROW) inflation. This is creating ROW opportunities to simultaneously enjoy monetary, fiscal and currency-related stimulus. The outlook is improving in Japan, Germany and the UK. Lower global oil prices help.
Emerging Markets	Overweight	China stimulus, while potentially insufficient to address the challenges of the country’s secular bear market, is likely enough to help stabilize the downturn in the short term. The US-China trade conflict remains a wild card, and we expect the “bazooka” of China stimulus may come in light of ongoing trade tensions. Given that valuations in the region are already nondemanding, we are inclined to be patient and wait for recovery. A weaker US dollar and lower global energy prices are positives for Latin America and Southeast Asia.
Global Fixed Income	**Weight Relative to Model Benchmark**	
US Investment Grade	Overweight	Corporate cash flows remain resilient, especially as odds of a soft landing continue to solidify. Spreads have partially adjusted to these realities, and default risk remains modest. While interest rates have backed up to reflect “higher-for-longer” expectations, there is good value and "coupon" in the belly of the curve. With geopolitical uncertainty high and equity valuations broadly rich, we like coupons of bonds with index-matching and shorter durations. Municipal securities are exhibiting good value but should be actively managed for credit concerns in a new world of federal funding priorities.
International Investment Grade	Market-Weight*	Yields are decent, central banks have begun to cut rates and there is room for spread tightening as economic growth improves. Currency impact is a tailwind for US dollar investors.
Inflation-Protection Securities	Market-Weight*	Real yields have sold off and are now bordering on cheap relative to the past two years. The securities could be a potential buy in a stagflationary environment.
High Yield	Market-Weight*	We have eliminated our exposure to the equity-like asset class to reduce equity beta of portfolios. High yield bonds rallied aggressively after the unprecedented provision of liquidity from the Fed and fiscal stimulus from Washington. However, we believe there is currently limited upside. Ultra-tight spreads may be the result of increasing competition for capital among private credit financial sponsors and general partners and may not fully reflect adequate compensation for default risk.
Alternative Investments	**Weight Relative to Model Benchmark**	
REITs	Market-Weight	We expect higher stock-bond correlations, which places a premium on the diversification benefits of investing in real assets. Nevertheless, with real interest rates positive and services inflation remaining quite sticky, we would need to be selective in adding to this asset class broadly. We are focused on interesting opportunities aimed at solving the residential housing shortage.
Commodities	Market-Weight	Global reflation, tense geopolitics, especially in the Middle East, and ongoing fiscal spending suggest decent upside potential for precious metals and industrial commodities, including energy-related.
MLP/Energy Infrastructure	Overweight	We previously increased exposure to real assets, with a preference for energy infrastructure and MLPs. Competitive yields and expectations for continued capital discipline amid stable oil and gas prices underpin our decision, as does hedging against geopolitical risks.
Hedged Strategies (Hedge Funds and Managed Futures)	Overweight	We recently added to equity hedged positions, noting the pickup in idiosyncratic risk, falling borrowing costs and rising volatility. The current environment appears constructive for hedge fund managers, who are frequently good stock pickers and can use leverage and risk management to potentially amplify returns. We prefer very active and fundamental strategies, especially high quality, low beta, low volatility and absolute return hedge funds.

*The GIC asset allocation models' benchmarks do not include any exposure to this asset class.
Source: Morgan Stanley Wealth Management GIC as of June 3, 2025

Disclosure Section

Important Information

The **Global Investment Committee (GIC)** is a group of seasoned investment professionals from Morgan Stanley & Co. and Morgan Stanley Wealth Management who meet regularly to discuss the global economy and markets. The committee determines the investment outlook that guides our advice to clients. They continually monitor developing economic and market conditions, review tactical outlooks and recommend asset allocation model weightings, as well as produce a suite of strategy, analysis, commentary, portfolio positioning suggestions and other reports and broadcasts.

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For index, indicator and survey definitions referenced in this report please visit the following: https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions

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Glossary

Alpha is the excess return of an investment relative to the return of a benchmark index.

Earnings revision breadth is defined as the number of positive analyst revisions minus the number of negative analyst revisions divided by the total number of revisions.

Hedged Strategy Definitions

Absolute return: This type of investing describes a category of investment strategies and mutual funds that seek to earn a positive return over time—regardless of whether markets are going up, down, or sideways—and to do so with less volatility than stocks.

Equity Hedge is a hedge fund investment strategy with a typical goal of providing equity-like returns while limiting the impact of downside market movements and volatility on an investor's portfolio. Managers utilize long and short positions, primarily in equity and equity-related instruments, to achieve this goal.

Risk Considerations

The sole purpose of this material is to inform, and it in no way is intended to be an offer or solicitation to purchase or sell any security, other investment or service, or to attract any funds or deposits. Investments mentioned may not be appropriate for all clients. Any product discussed herein may be purchased only after a client has carefully reviewed the offering memorandum and executed the subscription documents. Morgan Stanley Wealth Management has not considered the actual or desired investment objectives, goals, strategies, guidelines, or factual circumstances of any investor in any fund(s). Before making any investment, each investor should carefully consider the risks associated with the investment, as discussed in the applicable offering memorandum, and make a determination based upon their own particular circumstances, that the investment is consistent with their investment objectives and risk tolerance.

Alternative Investments

Alternative investments may be either traditional alternative investment vehicles, such as hedge funds, fund of hedge funds, private equity, private real estate and managed futures or, non-traditional products such as mutual funds and exchange-traded funds that also seek alternative-like exposure but have significant differences from traditional alternative investments. 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 appropriate 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.

It is important to note that only eligible investors can invest in alternative investment funds and that in order for an FA/PWA to engage a prospective investor in general discussions about Alternative Investments and specifically with regards to Private Funds, the prospective investor will need to be pre-qualified through the Reg D system.

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 appropriate 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.

Hedge funds may involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds, often charge high fees which may offset any trading profits, and in many cases the underlying investments are not transparent and are known only to the investment manager.

Hedge Funds of Funds and many funds of funds are private investment vehicles restricted to certain qualified private and institutional investors. They are often speculative and include a high degree of risk. Investors can lose all or a substantial amount of their investment. They may be highly illiquid, can engage in leverage and other speculative practices that may increase volatility and the risk of loss, and may be subject to large investment minimums and initial lockups. They involve complex tax structures, tax-inefficient investing and delays in distributing important tax information. Categorically, hedge funds and funds of funds have higher fees and expenses than traditional investments, and such fees and expenses can lower the returns achieved by investors. Funds of funds have an additional layer of fees over and above hedge fund fees that will offset returns.

Private Real Estate: 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.

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. Investing in an international ETF also involves certain risks and considerations not typically associated with investing in an ETF that invests in the securities of U.S. issues, such as political, currency, economic and market risks. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economics. ETFs investing in physical commodities and commodity or currency futures have special tax considerations. Physical commodities may be treated as collectibles subject to a maximum 28% long-term capital gains rates, while futures are marked-to-market and may be subject to a blended 60% long- and 40% short-term capital gains tax rate. Rolling futures positions may create taxable events. For specifics and a greater explanation of possible risks with ETFs¸ along with the ETF's investment objectives, charges and expenses, please consult a copy of the ETF's prospectus. Investing in sectors may be more volatile than diversifying across many industries. The investment return and principal value of ETF investments will fluctuate, so an investor's ETF shares (Creation Units), if or when sold, may be worth more or less than the original cost. ETFs are redeemable only in Creation Unit size through an Authorized Participant and are not individually redeemable from an ETF.

Investors should carefully consider the investment objectives and risks as well as charges and expenses of an exchange-traded fund or mutual

fund before investing. The prospectus contains this and other important information about the mutual fund. To obtain a prospectus, contact your Financial Advisor or visit the mutual fund company's website. Please read the prospectus carefully before investing.

An investment in **a money market fund (MMF)** is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund. The price of other MMFs will fluctuate and when you sell shares they may be worth more or less than originally paid. MMFs may impose a fee upon sale or temporarily suspend sales if liquidity falls below required minimums. During suspensions, shares would not be available for purchases, withdrawals, check writing or ATM debits.

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. MLPs carry interest rate risk and may underperform in a rising interest rate environment.

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** and **frontier markets**, since these countries may have relatively unstable governments and less established markets and economies.

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.

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-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.

Although they are backed by the full faith and credit of the U.S. Government as to timely payment of principal and interest, **Treasury Bills** are subject to interest rate and inflation risk, as well as the opportunity risk of other more potentially lucrative investment opportunities.

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.

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.

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.

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.

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.

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.

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 appropriate 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.

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.

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.

CDs are insured by the FDIC, an independent agency of the U.S. Government, up to a maximum of $250,000 (including principal and accrued interest) for all deposits held in the same insurable capacity (e.g. individual account, joint account, IRA etc.) per CD depository. Investors are responsible for monitoring the total amount held with each CD depository. All deposits at a single depository held in the same insurable capacity will be aggregated for the purposes of the applicable FDIC insurance limit, including deposits (such as bank accounts) maintained directly with the depository and CDs of the depository. For more information visit the FDIC website at www.fdic.gov.

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

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.

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

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.

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. **Health care sector stocks** are subject to government regulation, as well as government approval of products and services, which can significantly impact price and availability, and which can also be significantly affected by rapid obsolescence and patent expirations.

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