

Global Investment Committee | October 2026

On the Markets

Speed *and* Magnitude

As October begins, investors should count themselves lucky. Despite a surge in interest rates, ongoing geopolitical tension, higher oil and diesel fuel prices, and reassessment of Federal Reserve policy, US equities have been resilient. The S&P 500, up 12% for the year to date, sits just 1.9% below its all-time high, while exhibiting relatively low volatility at the cap-weighted index level. The conventional 60/40 stock/bond portfolio, meanwhile, has delivered a 5.4% year-to-date return. That's not a result one might expect near the end of a six-month period when the two- and 10-year US Treasury yields, respectively, increased roughly 150 and 110 basis points, with the benchmark 10-year note at one point exceeding 5.3%, a 24-year high.

Equity market resilience reflects accelerating economic growth, stable labor markets, improving earnings expectations and an AI-capex boom apparently insensitive to borrowing costs and oil prices. Perhaps even more constructively, valuations have declined from 22.5 times forward earnings in January to about 19.5—in line with a rising cost of capital, even amid profit-growth forecasts of 30% for 2026 and 17% for 2027. Several economic indicators have reinforced the growth narrative recently. Namely, purchasing managers' indexes are at five-year highs, capital-goods orders are expanding close to 15% on an annualized basis and personal consumption is up 3.8% annualized, while nominal second quarter GDP growth is estimated to have reached 8.3%. Equally important, despite Fed handwringing and related rhetoric, while inflation is close to 3%, it has not been accelerating, and market-based expectations remain anchored near 2.5%.

That is not to say that rising rates don't matter. We acknowledge that damage has been done below the market's surface and beyond the strength of the AI trade. Small-cap US equities are off approximately 10% since Aug. 14, as the equal-weighted index has fallen around 6.5%. Market breadth has deteriorated sharply. At the end of September, only 20.6% of stocks were above their 50-day moving average—down from nearly 70% in the summer—while the median stock had declined more than 15% from its 52-week high. Rate-sensitive regional bank stocks, consumer durables, cyclicals and housing-linked equities have suffered, as markets have reconcentrated around the AI ecosystem. More importantly, history suggests that the speed and magnitude of the rate repricing will ultimately find some victims.

Lisa Shalett

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With that, we are watching for vulnerabilities in both public and private credit markets, as well as in currencies.

As for Treasuries, the GIC views the recent rerating as mostly rational, driven by a variety of factors. These include higher sustained real growth and policy neutral rates, Fed policy-framework changes under Chair Warsh's new leadership and robust global sovereign and corporate debt issuance. Furthermore, the buyer base has shifted—away from price-insensitive central banks, insurers and pension funds and toward private investors and hedge funds seeking fair risk premiums. That said, the Treasury market has been exhibiting caution. It is discounting three to four more rate hikes, or 100 additional basis points of tightening, while our forecasts are more dovish.

Noting solid fundamentals and what is currently priced into markets, the GIC is tactically constructive on both US equities and intermediate-term Treasuries heading into the fourth quarter. Morgan Stanley & Co. maintains a midyear 2027 S&P 500 price target of 8,300 and expects the 10-year Treasury yield to decline toward 4.7% by December 2027.

Investors should not confuse market resilience with an absence of risk, however. Nor should they confuse time lags with regard to changing costs of capital with a lack of risk. We are focusing on the strategic-horizon implications of what we see largely as a secular, step-change normalization of rates. This should ultimately mean lower equity returns and less generous valuations.

It also means a return to the debate about US debt sustainability. Unlike the typical scenario of rising deficits amid recessions, debt and deficits are expanding during an economic boom. With new Treasury borrowing costs exceeding 5% across much of the yield curve, slower nominal growth could easily result in interest expenses compounding the debt burden. This would reduce fiscal flexibility during the next recession or crisis and leave the US with less discretionary firepower to retool defenses or upgrade our infrastructure for the technology revolutions ahead. ■

GLOBAL ECONOMICS

Three Central Banks, One Direction

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

Resilient growth and renewed energy pressures are pushing the Fed, ECB and BOJ toward higher rates. The paths differ, but the implication is similar—more tightening than markets expected earlier this year, alongside a firmer US dollar.

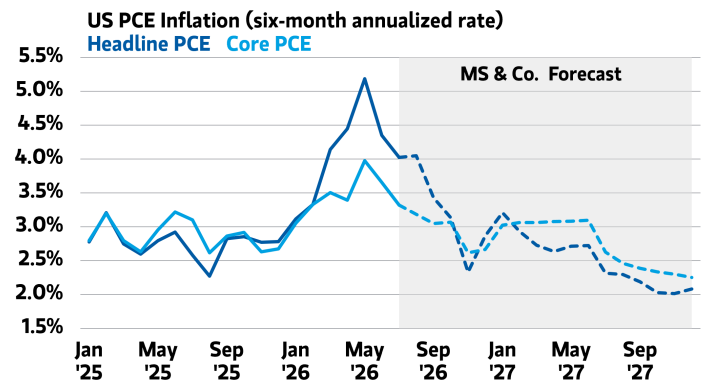
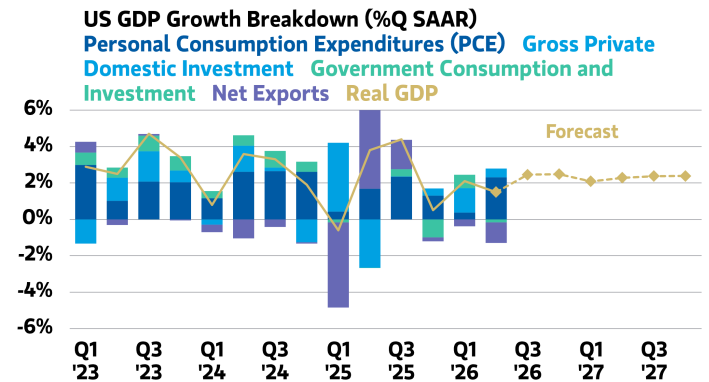
Over the past two weeks, our economists have revised their outlooks for the Federal Reserve, the European Central Bank and the Bank of Japan to include more rate hikes. Each economy faces different challenges, but all three central banks are arriving at a similar conclusion: Growth has remained remarkably resilient despite large shocks, and renewed energy price pressures have increased the risk that inflation will prove more persistent than previously expected.

The clearest example, and our biggest revision, is the Fed. While for much of the year we had thought the Fed would avoid hiking rates, now in addition to the increase at the September FOMC meeting, we expect two more hikes, in December and March, bringing the terminal rate to 4.25%–4.50%. While Chair Warsh highlighted the inflationary implications of higher energy and commodity prices, the more important signal was the assessment that policy is still not sufficiently restrictive. Although Chair Warsh said that he does not think that a neutral-rate estimate is helpful in making policy decisions, he nevertheless described the September move as “removing a dose of accommodation,” and the rest of the FOMC did revise its estimate of the neutral policy rate upward (albeit very slightly).

In our view, the Fed appears to be reassessing not just the outlook for inflation but the amount of restraint required to bring it sustainably back to target. Still, we see the shift as more of a recalibration than a fundamental change in policy, so the market may have overestimated how much hiking is left.

The shift has important market implications. Our rates strategists expect investors to pull forward additional tightening expectations in the near term while increasingly questioning how long policy can remain at restrictive levels before growth eventually slows. More broadly, a Fed that appears more sensitive to energy-driven inflation pressures strengthens the case for a firmer dollar. Over recent months, rising energy prices supported the euro because investors assumed the ECB would respond more aggressively than the Fed. That perceived asymmetry may now be changing. If investors conclude that both central banks are prepared to lean against energy-related inflation risks, higher energy prices become less euro-supportive and increasingly dollar-supportive. Our foreign exchange strategists therefore continue to favor dollar strength, particularly against the Japanese yen.

A Higher Expected Oil Price Path Means Slower Disinflation in 2027, While More Restrictive Policy Weighs on Growth



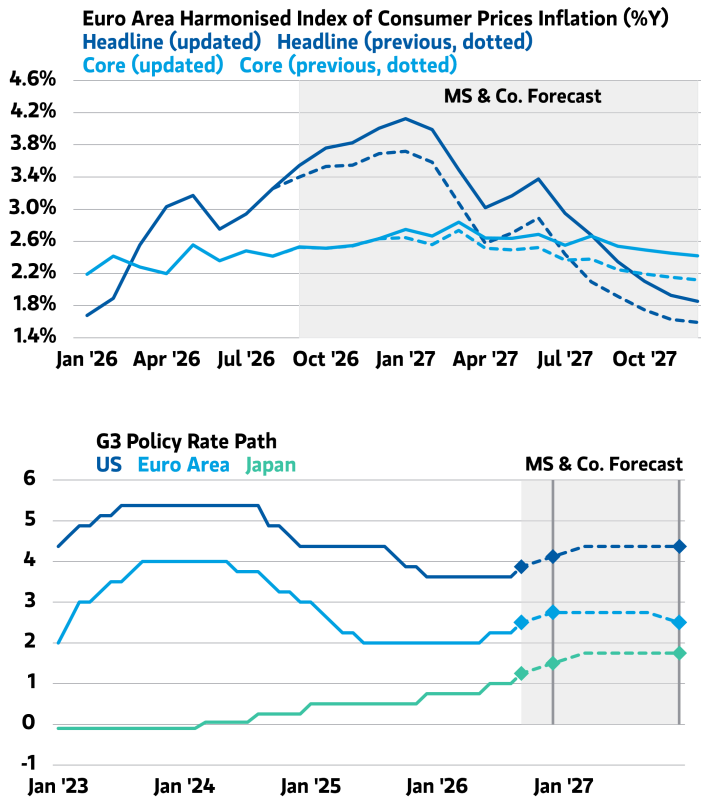
Source: BLS, BEA, Morgan Stanley & Co. Research forecasts, Morgan Stanley Wealth Management Global Investment Office as of Sept. 21, 2026

Europe faces a similar inflation challenge, though through a different transmission channel. The renewed rise in natural gas and energy prices has led our economists to revise their inflation outlook materially higher and to add another ECB rate hike in December, followed by a much shallower easing cycle in 2027. Importantly, however, energy prices alone do not explain the change in outlook. Euro area activity has proved more resilient than anticipated, reducing concerns that modest additional tightening would derail growth. As a result, the ECB is increasingly focused on preventing higher energy costs from feeding into broader inflation dynamics, even as policy rates move further into restrictive territory (see chart).

Japan may appear different, but the underlying story is surprisingly similar. For decades, the BOJ's challenge was generating inflation. Today, policymakers are increasingly concerned about the possibility that inflation could overshoot target. After the BOJ's hike last week, we expect it to raise rates to 1.5% in December, and then to 1.75% in March.

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We See Materially Higher Inflation in the Euro Area; We Bring Forward Our Expectations for the BOJ's Next Hike to December and Pencil in a Further Hike in March



Source: Eurostat, Fed, ECB, BOJ, Morgan Stanley & Co. Research forecasts, Morgan Stanley Wealth Management Global Investment Office as of Sept. 21, 2026

Like the Fed and ECB, the BOJ faces an economy that has absorbed tighter financial conditions better than expected. Yet unlike the Fed and ECB, strategists believe markets have become too aggressive in pricing the eventual destination for rates, creating scope for expectations to be revised lower over time. Consequently, while Japanese rates may continue to rise gradually, our foreign exchange strategists still expect the broader trend of yen weakness to reemerge once temporary positioning effects fade.

The common thread across all three central banks is that the energy shock has changed the inflation conversation, but resilience in growth has changed the policy conversation. Policymakers increasingly appear to believe that economies can withstand higher rates than previously assumed and that inflation risks remain uncomfortably elevated. For investors, the next year is increasingly likely to be characterized by higher policy rates and a stronger dollar than markets expected at the beginning of the year. ■

This article was excerpted from the Sept. 21 Morgan Stanley & Co. Research report, "Three Central Banks, One Direction." For a copy of the full report, please contact your Financial Advisor.

GLOBAL POLICY

AI Sovereignty: Policy, Market and Economic Implications

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Sovereign control over critical AI infrastructure, models and supply chains is a strategic imperative for governments. This should increase the AI capex opportunity—\$860 billion in the US this year alone—and the risk of broader technology restrictions. We see the resulting fragmentation of spending across US, Chinese and regional AI ecosystems creating opportunities in several sectors.

“Sovereign AI” is becoming a key principle for technology, industrial and national-security policy. We see it as a country’s ability to develop and deploy AI with meaningful control over the underlying infrastructure, data, talent, energy, supply chains and technology stack. That does not imply seeking full self-sufficiency: We believe it’s more plausible to expect governments to combine domestic capacity with selective reliance on trusted partners, while reducing exposure to adversarial technology providers, legal regimes and infrastructure.

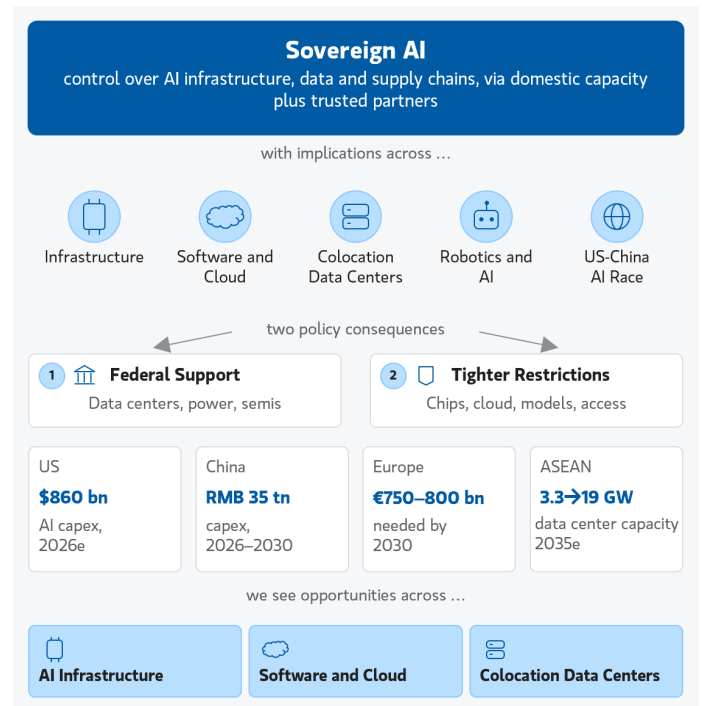
This national-security framing is central to our still-constructive view on AI-capex spending in spite of political pushback in the US (see chart). Given the geopolitical realities (see our July 14 report, “Power Struggle: AI, Data Centers & Local Backlash”), we do not expect the US government to impose a broad pause or nationwide moratorium on data-center development.

We think the progression from AI competition to the physical layer of the data-center build-out means that federal lawmakers recognize the strategic imperative of AI and are likely to continue supportive policy—from permitting reform to Defense Production Act expansion—facilitating, rather than reversing, the build-out. Said differently, compute capacity is increasingly viewed as strategic infrastructure, and restricting domestic build-out would risk weakening US competitiveness relative to China.

This competitive backdrop underscores our view for AI policy after the US midterm elections: AI policy initiatives seem likely to take shape regardless of the election outcome, reflecting bipartisan alignment around AI as a strategic priority, but with emerging regulatory and societal constraints.

This shift toward AI as a strategic, capital-intensive “arms race,” with policy as an enabler, should continue to support the AI investment cycle and associated infrastructure demand, albeit with a slightly different approach depending on the composition of Congress.

AI Sovereignty: Policy and Market Implications



Source: Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of Aug. 19, 2026

We see election outcomes as more likely to shape the pace and geographic distribution of deployment across friction points such as energy availability, permitting and labor constraints given that public pushback is emerging as a binding constraint.

Regulation, meanwhile, is likely to remain incremental and fragmented: Core areas like AI safety, data governance and infrastructure siting may see targeted action, but broader efforts appear unlikely in the near term.

THE DE-RISKING POLICY TOOLKIT. A “de-risking” pattern between the US and China has evolved as both sides pursue national security interests over economic efficiencies. That’s come alongside a more active government role in strategically relevant sectors; governments are using either policy tools—including federal incentives such as grants, loans and CHIPS Act-style incentives—or more blunt instruments to insulate key supply chains, like tariffs, under a variety of authorities.

Sovereign AI fits within that broader shift from economic integration toward technological multipolarity. The US and China are increasingly prioritizing national security and resilience over economic efficiency, even where this results in higher costs, duplicated capacity or reduced market access.

In that vein, we see an increasing probability of both US and Chinese AI policy intervention, which could lead to a greater bifurcation of the global market. The de-risking is most stark

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in the higher-tech segments of the economy, where hawkishness on China appears to indicate the overall direction of travel. We expect further divergence between the two economies through policy tools like export controls and restrictions on commodities such as memory, as well as a higher effective tariff rate on China versus other US trading partners, even for nonstrategic goods.

In our view, this backdrop—and the geopolitical realities that accompany the progression of AI into the physical layer—is a key reason that the US is unlikely to enact a nationwide data-center ban or moratorium in the near term.

CHINA'S EXPANDING MARKET. Given the increasing competition between the US and China, we see a larger global total addressable market for Chinese AI-solution providers than the market appreciates.

China's AI is entering a new phase—one defined less by catching up in capability and more by capturing value. The country's AI narrative has shifted decisively from training to inference, from technology to application and from potential to real earnings. Rather than competing purely at the frontier, China is optimizing for speed, cost efficiency and system-level integration, enabling AI to diffuse rapidly across the real economy (see our May 10 report, "China AI 2.0.").

Hence, China may not need to lead at the technological frontier to build a commercially significant AI ecosystem. Focusing on inference, deployment speed, cost efficiency and system integration may support faster adoption across both industrial and consumer applications.

BEYOND CHIP CONTROLS. A shift from physical products with military end-uses that are the typical targets of export controls to the digital realm creates a more complex enforcement challenge; AI models can be downloaded, accessed through application programming interfaces, hosted in third countries or deployed through offshore cloud infrastructure. That raises the question: What tools can governments use to implement and enforce export controls on things like model usage?

The distinction between physical and digital restrictions is important. Chip and equipment controls constrain the ability to develop future systems. Model, cloud and distribution controls limit access to capabilities that already exist. In our view, policymakers will continue to prioritize both.

We therefore see chips and semiconductor-manufacturing equipment as likely to remain critical, but governments are likely to place greater emphasis on the infrastructure through which AI is trained, hosted, distributed and accessed.

Potential policy tools include the following:

- Restrictions on offshore data-center and cloud capacity
- Know-your-customer and end-user verification requirements
- Reporting obligations for advanced compute
- Limits on hosting or distributing designated foreign models
- Model-marketplace and app-store restrictions
- Procurement and cybersecurity standards

What do we think is likely? We see a more restrictive environment overall ahead, given public statements from the administration and the inherent national security concerns highlighted by various groups of stakeholders, including industry and government officials.

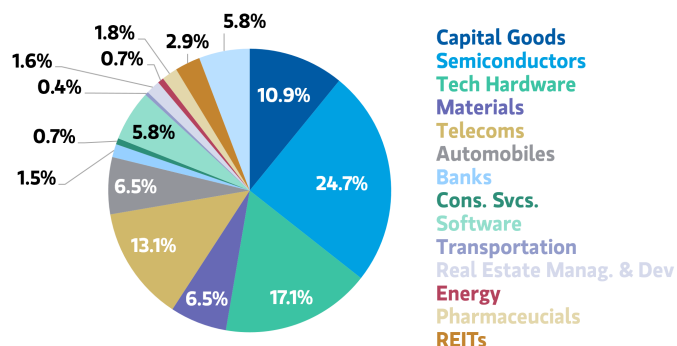
In practice, that likely means a middle path that seeks to balance two objectives: first, permitting a certain amount of open-weight models to facilitate proliferation, model development and access; and second, preventing theft of American intellectual property in frontier large language models (LLMs). In our view, that could be achieved by putting certain Chinese AI model developers on a restricted list and prohibiting usage of those companies' models by US firms.

AI SOVEREIGNTY'S INVESTMENT IMPLICATIONS. In our thematic investing, we now include "AI Sovereignty & Semi Localization" as a subtheme that identifies and quantifies exposure to the trend across more than 3,800 companies globally. For almost a decade, we have had a research focus on China's semiconductor localization trend, and this remains a core part of the AI competition dynamic, given the efforts to reduce dependency on US technology. We have now broadened the scope to include broader beneficiaries from the sovereign AI theme.

From a sector perspective, this brings in a raft of global companies that have exposure to compute infrastructure and the AI model and application layer, including trusted vendors in infrastructure software, cybersecurity and information technology services. National champion telecom companies and conglomerates are committing investments to position as preferred partners for clients in the government and critical infrastructure sectors. We also see capital goods and materials companies as beneficiaries of the investment supercycle, including those related to the additional capex needed to improve AI sovereignty (see chart).

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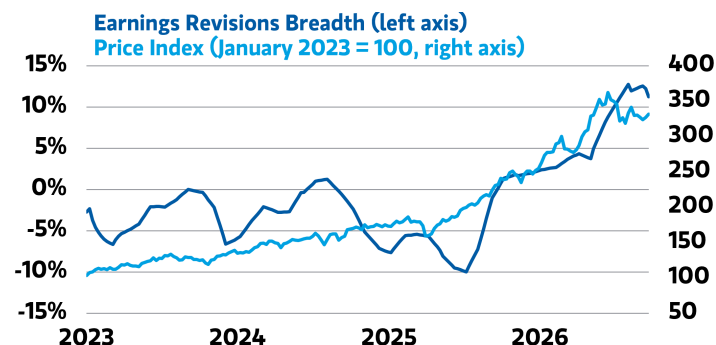
AI Sovereignty & Semi Localization Companies by Industry



Source: Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of Aug. 19, 2026

Overall, we see AI Sovereignty & Semi Localization as one of the fastest-growing themes in the equity market. Consensus forecasts are for earnings-per-share growth in the high teens over 2027 and 2028 for the median company with core, significant or moderate exposure (see chart).

AI Sovereignty & Semi Localization Stocks: Earnings Revisions Have Accelerated



Source: FactSet, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of Aug. 19, 2026

This article was excerpted from the Aug. 19 Morgan Stanley & Co. Research report, "AI Sovereignty: Policy, Market and Economic Implications." For a copy of the full report, please contact your Financial Advisor.

US EQUITIES

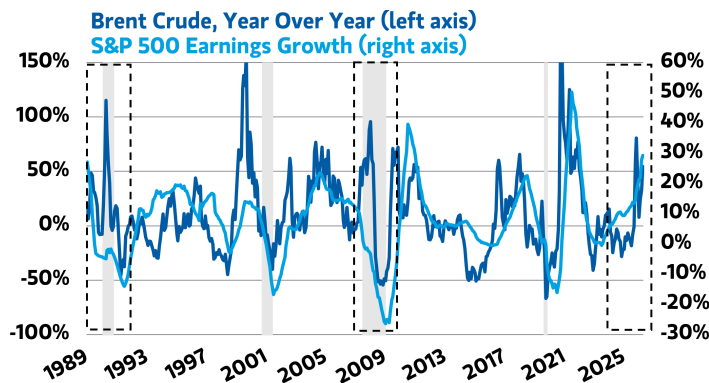
How Will the Market Fix Its Bad Breadth?

Michael Wilson, Chief Investment Officer and Chief US Equity Strategist, Morgan Stanley & Co. LLC

Our stronger-earnings-plus-lower-multiples narrative for 2026 tells the story, but the divergence between the S&P 500 Index and market breadth must be reconciled. If bond volatility doesn't ease, we lean toward a meeting in the middle. Stick with large-cap quality.

While the S&P 500 has made little headway since early June, adjustments beneath the index surface have been significant. As we have emphasized all year, earnings strength is doing the heavy lifting as higher energy prices and interest rates pressure valuations. That also makes higher crude prices—and especially those for refined products—more of an inflation risk than a growth risk given the strength of the business/earnings cycle (see chart).

The Rise in Energy Prices Is Less of a Risk to Growth Given the Strength of the Business Cycle



Source: FactSet, Bloomberg, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of Sept. 30, 2026

Earnings-per-share (EPS) revisions breadth continues to improve, led by the higher-quality S&P 500 versus the lower-quality Russell 2000. In fact, recent S&P 500 EPS revisions strength points to a performance catch-up. This is classic midcycle behavior, in our view. It also lines up nicely with our hotter-but-shorter cycle framework, which we introduced during COVID.

MIDCYCLE DYNAMICS. We continue to disagree that an S&P 500 just below an all-time high overlooks the numerous risks facing equity markets. More than 50% of Russell 3000 Index stocks have declined at least 20% since June, while the S&P 500 forward price/earnings (P/E) ratio is back near 19, which was the March low. Meanwhile, median-stock EPS growth is in the mid-teens, and index earnings revisions breadth is approaching cycle highs. In other words, earnings have

absorbed significant valuation compression at the index level—a classic midcycle dynamic.

Many of the groups experiencing the largest drawdowns are typical early-cycle winners that in many cases meaningfully outperformed from the trough of the April 2025–June 2026 rolling recession. In June, we made the call that earnings revisions breadth was peaking from a rate-of-change standpoint for early-cycle winners, a key signpost indicating an upcoming transition from early cycle to midcycle and quality factor leadership. The Federal Reserve's more hawkish pivot is another sign that we have moved from early cycle to midcycle.

Diving further into the breadth situation, the share of S&P 500 stocks above their 200-day moving average rose from 59% in late May to roughly 75% over the summer before falling to 49% recently. Importantly, breadth was still expanding as crude oil and yields moved higher. The sharper deterioration came *after* the Fed's Jackson Hole meeting. We believe that suggests the recent narrowing is more about the additional tightening being discounted. The same shift is visible in rates. Faster nominal GDP growth and higher energy prices drove much of the first-half rise in yields, but since late August, the move has increasingly reflected the Fed's hawkish pivot, which is happening against a strong growth backdrop—i.e., not bad for equities overall even if it does impact leadership. Nevertheless, we believe this divergence between breadth and the S&P 500 needs to reconcile before the bull market fully resumes.

CONTEMPLATING THE FED. Chair Warsh's message at Jackson Hole was not simply that inflation needed to fall, but that it needed to fall "fast enough," suggesting that financial conditions were not restrictive enough for the new chair. September's hike reinforced that reaction function. Still, greater willingness to tighten does not tell us how much tightening is ultimately required. At approximately 4.8%, the two-year US Treasury yield is up since Jackson Hole, as the bond market has potentially moved to an overly hawkish near-term posture. The good news is that the Treasury term premium remains well behaved, which throws some cold water on fears around fiscal sustainability, or a Fed that is far behind the curve.

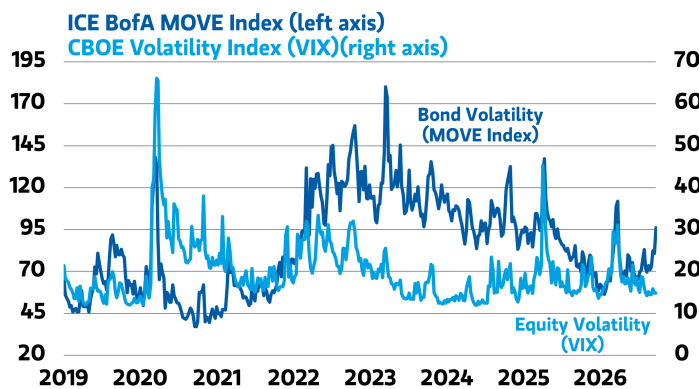
On the other side of the equation, Chair Warsh is a new leader who may not share the philosophy of the four prior Fed chairs or the members of the FOMC today. Most notably, Warsh is much further in the monetarist camp and believes that inflation is determined more by money supply growth. That creates additional uncertainty for investors to contemplate what a Warsh-era Fed could mean for financial markets. More specifically, while the market may be assuming too many rate hikes over the next year, it may be misjudging Warsh's willingness to use the balance sheet to either fund fiscal deficits or stabilize financial conditions at the first sign

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of trouble. In our view, Warsh will ultimately provide the liquidity, if necessary, but markets might want to test his resolve first. The recent rise in yields and bond volatility is a step in that direction.

We have long pointed to bond volatility and funding market stress as key variables the Fed will respond to, no matter who is in charge. The near-term question for equity investors is whether this spills over to equity volatility, which has remained remarkably subdued during the recent breakdown in breadth and valuations. We think that will determine how the divergence between breadth and the index is ultimately resolved (see chart).

Whether Bond Volatility Calms Down May Determine How the Poor Breadth of the Equity Market Gets Resolved



Source: Bloomberg, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of Sept. 25, 2026

Bottom line, we think markets are well aware of the numerous headwinds for stocks—higher energy prices, a tighter Fed, AI disruption, return-on-invested-capital (ROIC) uncertainty and geopolitical instability, to name a few. In fact, the equity market has elegantly solved for these concerns via lower valuations and rotations across sectors and factors. Furthermore, our calls for this year line up quite nicely with how the market has adjusted to the changing environment. These include our projections for an early cycle to midcycle transition, an AI enabler-to-adopter rotation and a reemergence of quality leadership in June.

FAVORING LARGE-CAP QUALITY. Beneath the index level, we continue to prefer large-cap quality, as the midcycle rotation continues to play out, with quality and operating-efficiency factors still leading. This fits with our constructive view on AI adopters and the broader shift in momentum toward services-oriented, asset-light and fee-based businesses. From here, we see the improving EPS revisions overlay as the key differentiator within quality. With revisions breadth strengthening across the S&P 500, we favor quality stocks where fundamentals are still being revised higher, and our Quality + Improving EPS revisions screen in our Sept. 21 report “Classic Mid-Cycle,” highlights this cohort heading into earnings season. The only remaining question is how the divergence between bad breadth and the index level relative to its 200-day moving average is ultimately reconciled. ■

This article was excerpted from the Sept. 28 Morgan Stanley & Co. Research report, “How Will the Market Fix Its Bad Breadth?” For a copy of the full report, please contact your Financial Advisor.

CHINA

China's Next Industrial Revolution

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China is entering a new phase of industrial development, moving beyond its historical advantages of low-cost and manufacturing scale toward ecosystem and innovation leadership. We see profound implications for its industrial supercycle, manufacturing profit migration and position in global manufacturing value chains.

Every major industrial revolution has reshaped the global economic order. Great Britain led mechanization through steam power in the 19th century. The US dominated mass production and electrification in the 20th century. Germany and Japan became synonymous with industrial precision and engineering excellence. And the digital revolution of the past three decades has elevated the US into the world's dominant software and internet power.

With the rise of AI, we believe the next industrial revolution is around the corner and will become the most consequential transition for industry since the rise of electrification and the internet. Unlike previous industrial revolutions centered primarily on technological progress, the next one—which we call China's Industry 5.0—is simultaneously a productivity revolution, geopolitical response, manufacturing reorganization and strategic capital supercycle.

Since China began to open up in the late 1970s, its industrial base has undergone a continual upgrade and today accounts for around 28% of the value-add in global manufacturing. The country's manufacturing has evolved into a large, cost-competitive and efficient base.

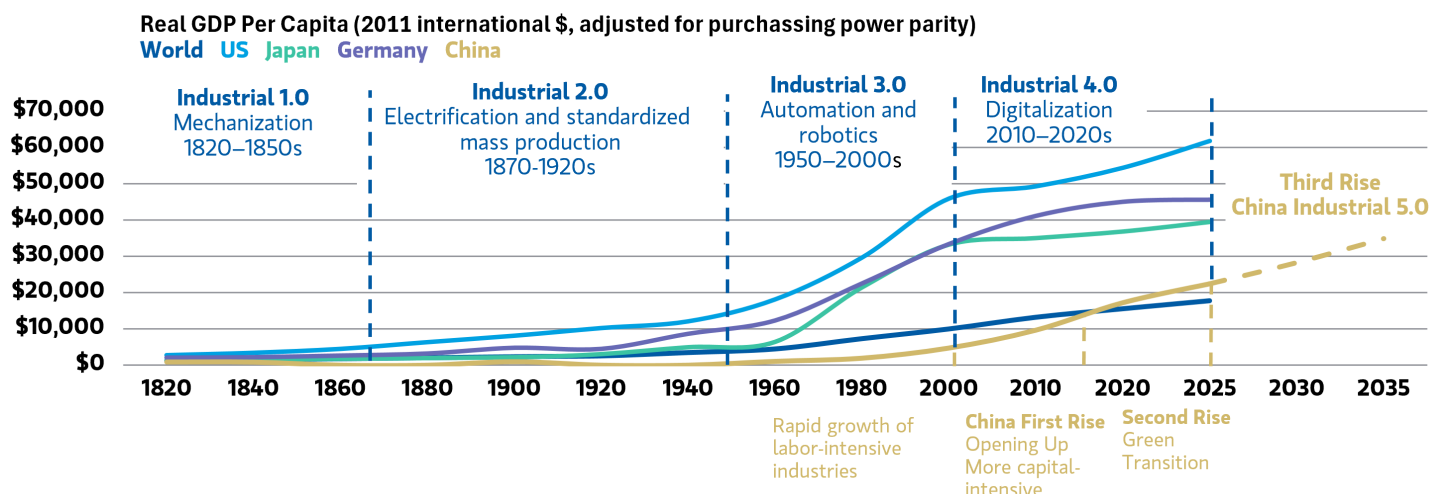
We believe the country's scale and global leading industries, such as solar power, batteries, electric vehicles (EVs) and drones, will extend into more frontier industries, such as embodied AI—essentially physical AI that interacts with and learns from its environment. The new industrial revolution in China follows the ages of mechanization, electrification, automation and digitalization (see chart).

INDUSTRIAL LANDSCAPE TRANSFORMED. In the next decade, we expect China's manufacturing leadership to evolve from scale and cost toward ecosystem and industrial innovation leadership. We see five transformational trends to come.

First, AI will be at the heart of manufacturing operating systems. The largest productivity gains from steam and electricity came only after factories reorganized around them, and we believe AI will follow the same pattern: Factory and operational platforms will be built with AI as their core architecture, actively coordinating workflows, predicting problems and making decisions rather than just acting as an added software tool. China has the world's largest physical manufacturing base, and more than 100 million industrial devices are already digitally connected. The strategic opportunity is to turn those connected assets into common sensing, reasoning and execution systems.

Second, physical labor will become "software-upgradable" capital equipment. Manufacturing will be increasingly conducted by groups of embodied AI, including various robots—humanoid, industrial and collaborative—as well as autonomous mobile robots, autonomous guided vehicles and vertical take-off and landing vehicles (VTOLs). Software upgrades will improve capital equipment, extending automation from highly standardized production into flexible high-mix manufacturing and converting deployment into data generation.

China Poised to Rise Again With Industry 5.0



Source: Madison Project data, IMF, Morgan Stanley & Co. Research estimates, Morgan Stanley Wealth Management Global Investment Office as of Sept. 25, 2026

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The country has a leading edge in manufacturing high-quality robots at lower cost, an important factor supporting deployment: Based on our forecasts, robotics sales across the relevant categories in the Chinese market will rise from approximately 8 million in 2025 to 29 million in 2030 and 76 million in 2035.

Third, we expect the gaps in China's domestic digital and manufacturing technologies to narrow, opening the way for the country to independently design, operate and continually upgrade complex industrial systems. China's largest sovereignty gaps are currently concentrated upstream in the industrial "brain, nervous system and precision layer," including advanced semiconductors and related equipment and materials; industrial software and control systems; high-end computer numerical control equipment; qualified advanced materials; and foundational processes. We expect these gaps to narrow materially over the next decade, because China's large downstream market provides lead customers, qualification opportunities and operating feedback; also, China is second globally in R&D spending.

Fourth, China will increasingly export entire "ecosystems." It already exports more manufactured products than any other economy, and the trend is toward exporting the full system around them—an EV ecosystem, for example, that includes batteries, charging or swapping, intelligent-driving software, energy management, financing and recycling. A smart-factory ecosystem combines robots, controls, production lines, software, commissioning and maintenance—areas in which China as a major provider will be able to take market share. China should also establish standards influence, which should follow commercial adoption, not precede it, in our view.

Finally, we anticipate AI-accelerated industrial discoveries, increasing the "lab-to-fab" pathway. This is the least mature of the five breakthroughs we expect but potentially the most transformative. It would mark a shift from sequential, human-led R&D toward a closed-loop, discovery-to-manufacturing system. We think China will lead industrial technology innovation in some areas, especially in foundational layers, such as advanced materials, precision equipment, sensors, semiconductor processes and biotechnology, where it has made significant investments.

WHY CHINA IS SET TO LEAD. China is not building Industry 5.0 from scratch: It is based on an industrial system already operating at unmatched scale and full product category coverage.

In this system, Chinese government policy generally establishes long-term direction, lowers early adoption barriers and often acts as both a growth accelerator and a risk mitigator. Meanwhile, large downstream customers provide qualification and operating data, while local industry clusters connect equipment, components, materials and software, as engineers and competing firms rapidly refine products.

China's financial system reinforces this process, providing relatively stable, long-tenor funding for strategic sectors, while allowing companies to absorb lengthy qualification cycles before commercial returns emerge. Well-developed and highly efficient infrastructure enables fast, low-cost product iteration and accelerates deployment.

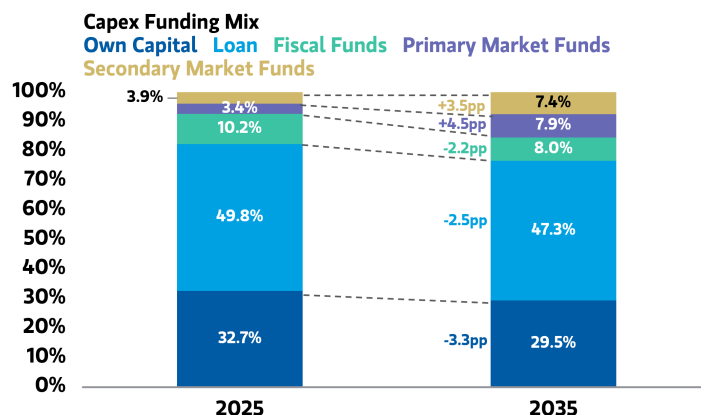
China's rise in new energy vehicles (NEV) provides the clearest example. China reached approximately 51% of global NEV sales in 2025 after combining central policy direction, infrastructure support, local-government competition, complete industrial clusters and intense private-sector iteration. China's battery, motor, power-electronics and charging ecosystems then created a reinforcing scale advantage.

DECADE-LONG CAPEX SUPERCYCLE. Industrial revolutions have always been capex-intensive. We expect around Rmb340 trillion (\$50 trillion) in cumulative industrial investment in 2026–2035, with Industry 5.0 creating about Rmb80 trillion (\$12 trillion) of incremental capex demand.

As AI diffusion raises demand for both intangible and physical investment, the global capex supercycle should support external demand and help absorb overcapacity. We thus expect the industrial capex/GDP ratio to rise from 17.4% in 2025 to roughly 19.5% by 2035, which is slightly higher than its previous peak of 19.2% in 2011, providing a counterweight to structurally weaker property and traditional infrastructure capex.

Based on our estimates, external funding already accounted for roughly 60%–70% of annual industrial capex during 2020–2025. We expect bank loans to remain the anchor at around 47% of funding over the next decade. Corporate retained earnings and owned capital should provide roughly one-quarter to one-third of funds. Fiscal funds and capital markets in China and Hong Kong should provide the strategic and risk-bearing layers (see chart).

Financing China's \$12 Billion in Industrial Capex



Source: CEIC, WIND, PBOC, NFRA, IMF, PE data, company data, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of Sept. 9, 2026

ON THE MARKETS

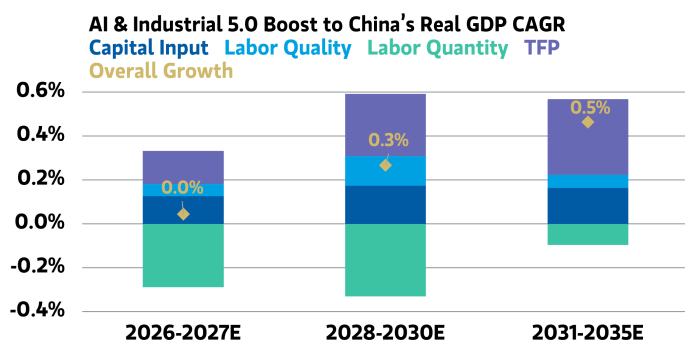
ECONOMIC BENEFITS TO CHINA. We expect China's industrial-enterprise profit margin to recover from approximately 5% in 2025 to 8% by 2035. But this is unlikely to be uniform across manufacturing; rather, Industry 5.0 should drive profit-pool migration from downstream to upstream.

We also see return on equity (ROE) improving. The ROE for the MSCI China Index has already edged up from a trough of roughly 9%–10% in mid-2023 to around 11% as of May 2026, an early indication that a decade-long erosion may be stabilizing. By 2028, we forecast potential ROE improvement of approximately 6%–7% for the energy sector, 2%–3% for materials, 2%–3% for industrials and 8%–9% for information technology, together contributing around 2% to MSCI China's overall index ROE.

In addition, AI and Industry 5.0 should lift China's potential GDP and partially cushion the drag of an aging and declining population. We have raised our potential growth forecasts by 30 basis points to 4.3% for 2028–2030 and by 50 basis points to 3.9% for 2031–2035—enough to meet Beijing's target of doubling GDP growth in 2020–2035 (see chart).

The increases reflect a capex-heavy industrial transformation and a three-percentage-point cumulative gain in total factor productivity (TFP) from economy-wide AI diffusion.

Potential Boost to China's GDP



Source: CEIC, Morgan Stanley & Co. Research estimates, Morgan Stanley Wealth Management Global Investment Office as of Sept. 9, 2026

We also expect policy rebalancing to stay calibrated, keeping China in a low-inflation environment over the medium term. Finally, our base case is that China's share of global manufacturing value-add will rise from 28% today to around 30% by 2035.

GLOBAL IMPLICATIONS. China is not the only beneficiary of AI and physical AI diffusion, of course. We anticipate a multipolar industrial-capex cycle, benefiting global capital goods demand, with different regions capturing different layers of value.

While we expect China to lead in scaled physical deployment and integrated industrial systems, the US is poised to lead in frontier technology, capital and demand; Europe in selected software, automation and complex equipment; and Japan in precision and production efficiency. Korea and Taiwan are likely to remain central to the technology-intensive upstream layers of the AI cycle.

NOT A LINEAR MOVE. Industrial revolutions have not always progressed smoothly. Railroads, telecom and semiconductor companies, solar power and EVs all experienced prolonged periods of capital destruction before consolidation and ecosystem dominance emerged. Similarly, China's Industry 5.0 may initially suppress returns before creating long-term winners.

The largest risk is not technological failure, but economically inefficient success. China excels at scaling capacity, cutting costs and diffusing technology fast—but the same strengths could breed overcapacity, deflation and margin compression if demand cannot keep pace with supply. The road from investment to productivity, profits and income is thus likely to be bumpy, and policy or external shifts could quickly alter its pace and quality.

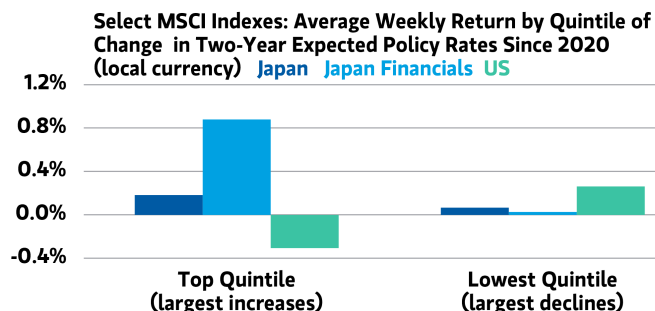
Along these lines, we have developed two alternative scenarios to our base case, with policy, technology and geopolitics being the key swing factors in China's share of global manufacturing GDP. In the bull case, economic rebalancing accelerates and there is healthy reflation, lifting share from the current 28% to 33%. In the bear case, deflation becomes more entrenched amid premature policy tightening, and China's share falls to 27%. ■

This article was excerpted from the Sept. 9 Morgan Stanley & Co. Research report, "China's Next Industrial Revolution." For a copy of the full report, please contact your Financial Advisor.

Short Takes

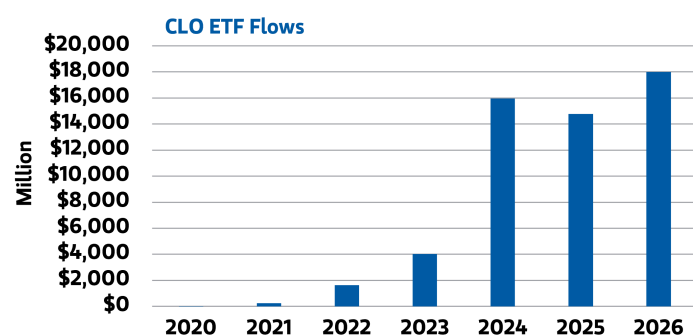
Could Higher Rates Derail Japan's Equity Market?

As Japan's equity market has rallied since 2023, the two-year Japanese government bond yield—a proxy for expected policy rates—has risen from near zero to roughly 1.9%, its highest level since 1995. Now, after the Bank of Japan raised the policy rate by 25 basis points last month, Morgan Stanley & Co. Research expects two more hikes, one in December and the other in March 2027. Can Japanese equities continue to hold up? Importantly, since the COVID-19 pandemic, periods of sharply rising BOJ rate expectations have coincided with modestly positive average local-currency returns for the MSCI Japan Index—unlike the negative returns often seen in the MSCI USA Index during comparable periods. Japanese financials have been particularly resilient.—*Alfredo Pinel, CAIA*



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Sept. 25, 2026

CLO ETF Flows Are Surging

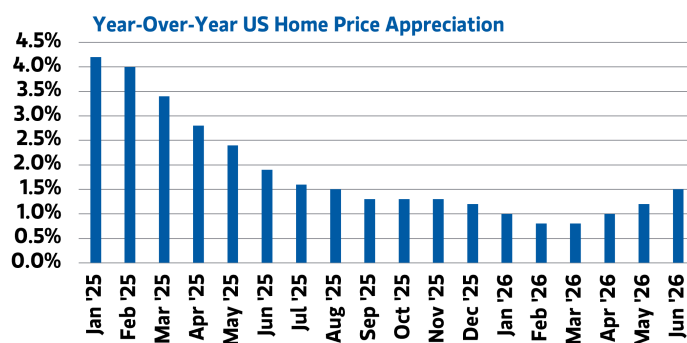


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Sept. 30, 2026

Investors have warmed up to collateralized loan obligation (CLO) ETFs. Inflows are on pace to hit a high watermark in 2026, and since the first funds came to market in 2020, the space has grown to more than 30 ETFs with a combined \$55 billion in assets under management. A CLO is backed by a portfolio of leveraged loans, with the cash flows typically divided across debt tranches and a residual, or equity, tranche. One reason CLOs may be attractive currently is that they are floating-rate assets and tend to fare well during rising interest rate environments. Because CLOs are backed by leveraged loans, however, even the highest-rated tranches are not immune to drawdowns during a credit dislocation.—*Michael Suchanick*

Home Price Appreciation Back on an Upward Trajectory

With interest rates on the rise broadly, mortgage rates have followed suit, and with that, many have been speculating what the impact will be on home prices. Somewhat ironically, they have actually begun to accelerate a little more rapidly following several quarters when the metric had declined. As noted by MS & Co.'s US housing strategist, James Egan, in his Sept. 14 report, "Assessing Affordability in the US Housing Market," the pool of homeowners incentivized to list their homes for sale has declined. Slowing inventory amid consistent sales volume has allowed for the reacceleration in price appreciation. He sees annualized home price appreciation rising from the recent level of 1.5% to 2.0% by year-end.—*Tyler Witt*



Source: Case-Shiller, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of June 1, 2026

US ECONOMICS

Millennials Are Wealthier Than You Think

Sarah Wolfe, Investment Strategist, Morgan Stanley Wealth Management

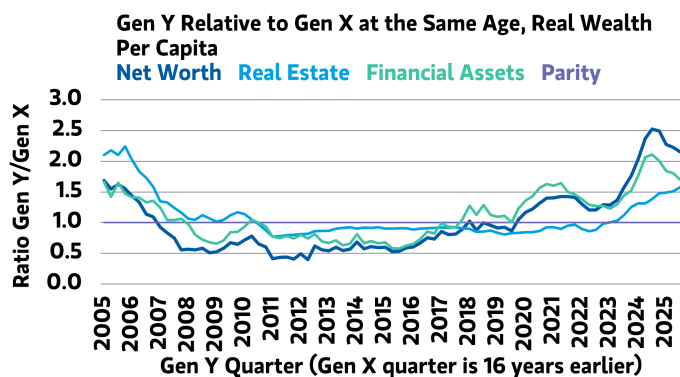
The millennial generation (Gen Y) was supposed to be the one that fell behind. But its members now hold more than twice the inflation-adjusted wealth per person than members of Gen X did at the same age. Where it came from and who inside the cohort actually owns it offer important lessons for financial planning.

Ask most people to rank Gen X and Gen Y by financial standing at the same stage of life, and the majority would say Gen X comes out ahead. Millions of millennials graduated from college amid one of the worst labor markets in 80 years, and many of them have felt that the American dream of making it to the middle class is out of reach.

But that's no longer what the data shows.

Using the Federal Reserve's distributed financial accounts, we compared Gen X (born between 1965 and 1980) and millennials (born between 1981 and 1996) at the identical age. The two cohorts are 16 years apart, which led us to compare them on the following basis: Gen X in 2009, when the generation spanned the ages of 29 to 44, against millennials in 2025, in the same range of 29 to 44. In constant 1982–1984 dollars, millennials today hold \$75,716 in net worth per person, on average. Gen X, at the same age, held \$32,009. Millennials are ahead by 2.4 times (see chart).

Millennials Have Overtaken Gen X at the Same Age



Note: Population denominators are resident population aged 29–44 in each comparison year, from Census Bureau estimates, so the identical age window holds for both cohorts. All data is inflation adjusted using the Consumer Price Index. Source: Federal Reserve Distributed Financial Accounts, US Census Bureau, Bureau of Labor Statistics, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2025

A LEAD THAT DIDN'T LAST. When both generations were young, Gen X was comfortably ahead. Through their twenties,

its members held a major advantage over where millennials would stand at the same age—more than double at the widest.

That lead narrowed steadily as members of both cohorts moved through their careers, disappearing by 2020. Gen X has not led at a matched age since. In fact, millennials have held the advantage in every comparison-year since, and the size of that advantage has only grown. The reversal traces to a specific event: the COVID-era boom in stocks and housing. It can also be explained by three key developments, roughly in the following order.

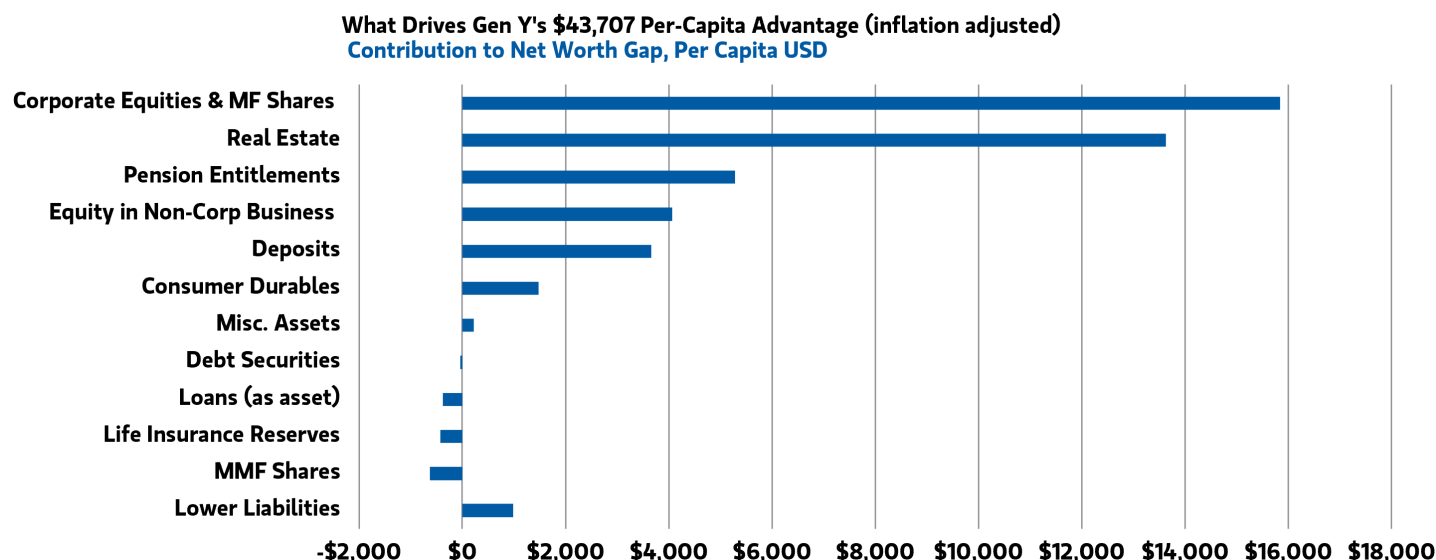
AUTOMATION WINDOW. First, retirement savings got automated after Gen X had already missed the window. The Pension Protection Act of 2006 gave employers a clear, tax-incentivized path to automatically enroll new hires in a 401(k) rather than requiring them to opt in, typically defaulting them into a target-date fund invested mostly in equities. According to research from Vanguard ("How America Saves," 25th Edition, 2026), participation runs above 90% under auto-enrollment versus roughly 60% when employees have to opt in. One Government Accountability Office comparison of workers hired before and after their employer adopted auto-enrollment ("Retirement System: A Comprehensive Re-evaluation Is Needed to Better Promote Future Retirement Security," published in October 2017) found that participation jumped from 37% to 86%. Gen X built its retirement savings mostly on the older, opt-in system. Millennials came in on the other side of that law, and the related impact started showing up in the data years before the overall wealth gap reversed.

Real estate, another source of wealth, took longer to turn. In 2018, Gen X still held more than double millennials' real estate wealth per capita. That gap, which did not narrow gradually, closed as millennials aged into their thirties and started buying homes at the highest rate of any age group. Millennials now enjoy a \$13,632 per-capita real estate advantage over Gen X on an age-matched basis (see following chart).

AVOIDING THE MARKDOWN. Second, missing 2008 as investors didn't mean millennials escaped the Great Financial Crisis (GFC)—it just hit them somewhere else. Born between 1965 and 1980, members of Gen X were between 28 and 43 when the crisis hit, old enough to own homes and hold equity portfolios large enough to take a real hit when financial markets fell by half. Millennials, born between 1981 and 1996, were between 12 and 27, mostly still in school or just starting careers, with too little invested to have much exposure to the crash. Gen X owned assets that were marked down in 2008 and 2009. Millennials, as a cohort, did not.

Notably, millennials graduating into that labor market paid a real cost of their own—in earnings rather than assets.

Equities and Housing Explain Two-Thirds of the Gen X-Millennial Wealth Gap



Note: The Fed discontinued its combined pension entitlements series, so the pension figures above are rebuilt from defined-contribution plans, defined-benefit plans and annuities, and tie exactly to reported financial assets in both years.

Source: Federal Reserve Distributed Financial Accounts of the United States, US Census Bureau, Bureau of Labor Statistics, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2025

According to research from University of California, Berkeley economist Jesse Rothstein, members of the subset of millennials that entered the workforce in 2009 earned wages roughly 2% lower than the cohorts just ahead of them. Such a wage penalty is consistent with the broader “scarring” literature on “recession graduates,” which contends that earnings effects typically persist for 10 to 15 years before fading. Rothstein’s data indicates that the dissipation is largely complete by the time workers reach their early thirties, though the accompanying hit to employment lasts longer. The financial crisis caused labor market distress for years, from 2008 to 2015, meaning half of millennials reached college graduation age in a labor market with elevated unemployment and depressed earnings.

Millennials paid for the crisis first with their paychecks, not their portfolios, and that cost was real. However, by 2025, the point at which we pick up the story, that impact had largely faded. Meanwhile, the missed hit to assets they never held in 2008 ended up working in their favor.

ASSET-PRICE BOOM. Third, those setups subsequently collided with the biggest asset-price boom of either generation’s adult life. By 2020, many millennials had spent more than a decade automatically enrolled and invested in 401(k)s, with few meaningful crisis-related losses from which to recover. Gen Xers, by contrast, had already lived through one crash and were investing on a slower, opt-in track established a generation earlier. When stocks and home prices surged during and after the pandemic, millennials had more money already positioned to benefit, and more time left

for it to compound. At that moment, the ranking flipped, and it has not flipped back.

WHAT THE AVERAGE HIDES. Everything above describes the aggregate. The aggregate, however, is not synonymous with the individual household. Distributed Financial Accounts of the United States data reports cohort wealth that we divide by cohort population: a mean, not a median. That distinction matters more here than almost anywhere else in economic data because the largest driver of the millennial advantage is also the most unevenly distributed major asset class. Corporate equities and mutual funds now make up 17.5% of the average millennial’s total assets, versus 4.9% for Gen X at the same age; in dollar terms, millennial equity holdings are 5.7 times greater than those of Gen X. Equity ownership in the US is concentrated among a relatively small share of households. “Millennials hold 2.4 times the wealth Gen X did” is a true statement about millennials overall; it is not necessarily true about the millennial in the middle of the group.

THE NEXT GENERATION. Gen Z is currently standing where millennials once did: entering, or in, early adulthood during a rapidly changing job market while being told a version of the same story millennials heard. This time, it is a mix of how artificial intelligence will create a more challenging labor market for young adults, that housing affordability is at an all-time low and that the massive run-up in equities is behind us. There is reason to take that seriously. The bar for financial security has moved higher for every successive generation: The middle-income share of households has fallen from 61%

ON THE MARKETS

in 1971 to 51% today, shelter inflation is running at roughly 6.6 times its 1978 level against a 4.8-times increase in income and the wealth gap between the top 1% and the median household has widened from about 33 times in 1963 to roughly 70 times now. Those are real headwinds, and they are larger than anything millennials faced at the same age.

But our findings argue against treating the currently prevailing statistics as destiny. Gen X's disadvantage and millennials' advantage today were not established in 2009 or a decade later. They were formed by what happened to financial and housing markets afterward, a sequence that few economists forecast at the time. That argues for humility, on our part as well, regarding predictions of the outcome for Gen Z this far in advance.

Decisions based on cohort averages are also a poor substitute for an individual financial plan. The gap we examined was concentrated in equities and real estate, the two most

unevenly held assets on the household balance sheet. This means that the point at which any individual investor stands relative to a given generation depends far more on investor allocation, savings history and timing of ownership than on birth year. The useful question isn't whether you're ahead of or behind your generation's average; it's whether your own plan (savings rate, allocation, time horizon) would hold up if the market conditions that built this gap were to go the other way.

It would likely have been impossible to call the Gen X-Gen Y reversal in advance. That's worth remembering the next time someone claims to know how a generation's finances will turn out. ■

This article was excerpted from the Sept. 28 Morgan Stanley Wealth Management report, "Millennials Are Wealthier Than You Think." For a copy of the full report, please contact your Financial Advisor.

ALTERNATIVE INVESTMENTS

Funding the AI Build-Out Beyond the Balance Sheet

Todd Castagno, CFA, CPA, GVAT Strategist, Morgan Stanley & Co. LLC

Kate Konetzke, CFA, CPA, GVAT Strategist, Morgan Stanley & Co. LLC

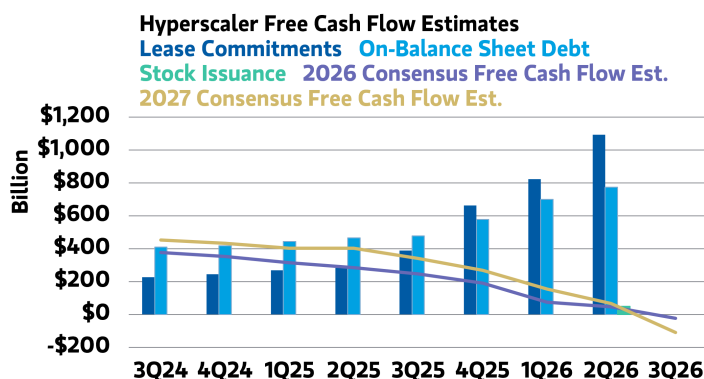
The hyperscalers are turning to external funding sources, including leases, debt and purchase commitments. Each new arrangement, whether on-balance-sheet or not, requires committing future cash, and further capex revisions require incremental sources of capital.

To build compute infrastructure and meet rising demand, the hyperscalers are currently reinvesting more than 40% of their sales into AI capital expenditure. Despite their high-margin legacy businesses, however, this level of investment cannot be sustained solely from current operating cash flow.

The hyperscalers, which provide cloud services and infrastructure at massive scale, have therefore turned to other funding sources. Each new financing arrangement, whether on balance sheet or not, requires committing future cash, and further capex requires incremental sources of capital. If financing costs increase with these incremental commitments, returns on new AI infrastructure investment will need to cover the rising cost of capital—an important consideration for investors.

Free cash flow at Amazon and Google turned negative in the second quarter this year, and another hyperscaler may follow that path before year-end. As free cash flow shrinks, the companies are increasingly relying on leasing, issuing debt, halting buybacks and issuing shares to fund their compute capacity goals (see chart).

Hyperscalers Turn to New Funding Sources



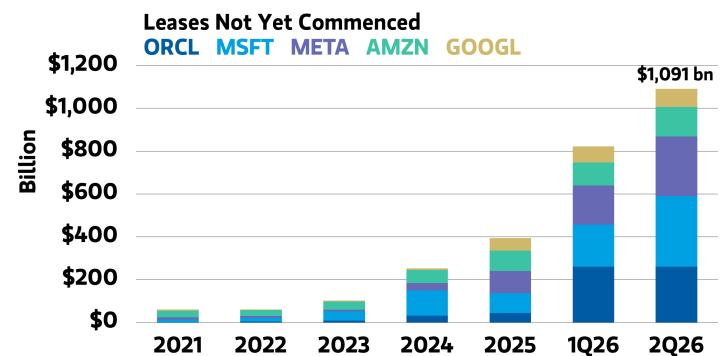
Source: Company filings, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of Aug. 25, 2026

THE FIRST EXTERNAL FUNDING SOURCE: LEASES. Leasing was the hyperscalers' first source of external funds. A substantial portion of data-center shells are funded today via

special purpose vehicles that raise capital from private credit and other institutional investors. Under these structures, developers and suppliers can borrow against long-dated leases, guarantees or purchase commitments from investment grade hyperscalers. This allows capacity to be built before the hyperscalers make any direct payments or recognize these liabilities on their own books.

Because these arrangements are off balance sheet, hyperscaler capital is effectively committed much sooner than on-balance-sheet leverage metrics would suggest. Based on their latest filings, hyperscalers have already committed to \$1.1 trillion in lease payments for data centers that have not started operating yet (see chart).

Hyperscalers' Commitments to Undiscounted Lease Payments



Source: Company filings, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of Aug. 25, 2026

The hyperscalers are also entering into large, long-dated purchase commitments for graphics processing units (GPUs), memory, manufacturing capacity, networking and other equipment for these data centers. Chip companies Nvidia and Broadcom have similarly begun securing memory, as well as capacity at semiconductor fabrication plants. All these purchase commitments now total more than \$1.7 trillion.

The commitments under each of these structures will only show up in free cash flow as payments are made, but the increasing size and duration of these commitments add to operating leverage. These contracts are strategically important while supply remains constrained, but if supply and demand normalize sooner than expected, companies may have to pay for unneeded capacity or attempt to renegotiate the terms.

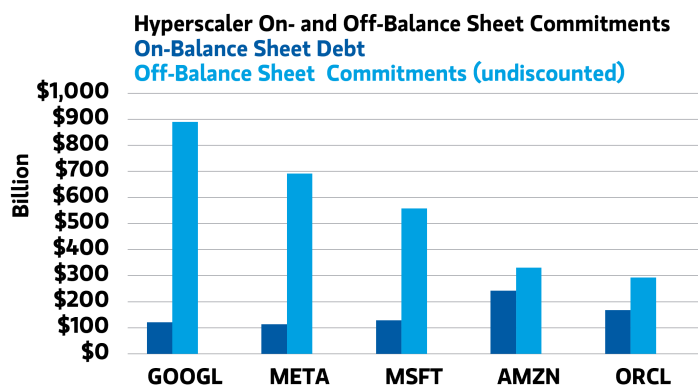
THE NEXT FINANCING LAYER: DEBT. On-balance-sheet debt has also been rising at the hyperscalers. First, as data centers are completed, the related operating or finance lease debt is brought on balance sheet. In addition, hyperscalers began issuing debt in late 2025 and accelerated their issuance this year. Now, their on-balance-sheet debt and lease liabilities, including short- and long-term liabilities, total \$770 billion.

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Hyperscaler debt issuance has risen from 2% of nonfinancial investment grade supply in 2025 to 19% so far in 2026. As further capex is funded increasingly by debt instead of cash, the economics of these projects grows more dependent on the cost of external capital, and recently, spreads have widened across AI debt.

Despite the increase in debt issuance, on-balance-sheet liabilities still pale in comparison to off-balance-sheet commitments (see chart). Hyperscalers have committed to buy compute equipment and support their future revenue. Meta and Google have been building compute to support their internal models, with their commitments exceeding their remaining performance obligation (RPO), or contracted revenue from customers; for compute sellers Microsoft and Amazon, commitments have been approaching RPO.

Hyperscaler Leverage: On Balance Sheet Versus Off Balance Sheet



Source: Company filings, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of Aug. 25, 2026

THIRD LEVER: LOWER BUYBACKS AND EQUITIES. So far, hyperscalers have relied more on leases and debt than on equity to fund their capex ambitions, although equity could become more useful if interest rates rise, credit spreads widen or AI investment remains elevated for longer than expected.

Rather than issuing shares, the hyperscalers have lately been preserving cash by reducing buybacks (except for Microsoft, which has yet to cut its share buybacks or issue debt). Historically, a significant portion of share repurchases was intended to offset the dilution from companies' stock-based compensation (SBC), but that offset is waning.

For instance, Google has cut its share buybacks from more than \$60 billion a year to zero; it also issued \$50 billion of equity in the second quarter this year, resulting in more than \$110 billion in cash for investing in AI infrastructure. Its shareholders have begun to experience dilution as a result, which is a big change: The company had reduced its share count by 13% from its peak over the last decade.

Dilution overall could increase as total stock-based compensation (SBC) continues to grow per unit of headcount (see our June 8 report, "The State of Stock-Based Compensation"). While this expense does not affect cash flow, it does affect investor economics. Given the need for cash to build, we expect SBC-related dilution to increase.

EMERGING FUNDING SOURCES. The technology companies involved in the AI build-out are finding new sources of funding as well. Oracle, for example, recently began using customer prepayments as a source of capex financing, disclosing \$4.6 billion in the most recent quarter. These prepayments are considered deferred revenue on the balance sheet, though they are more like debt than typical deferred revenue because they have a financing component: The prepayment is received more than a year in advance of when the revenue will be recognized.

In addition, Broadcom and Nvidia announced vendor-financing structures to help their customers access chips. Until recently, chips were mainly purchased with hyperscaler cash flows. Now, new chip SPVs are issuing debt to purchase chips and lease them to unrated AI labs. ■

This article was excerpted from the Aug. 25 Morgan Stanley & Co. Research report, "AI: Funding the Build-out Beyond the Balance Sheet." For a copy of the full report, please contact your Financial Advisor.

Q&A

Beyond the Oil Shock: What's Next for Energy Markets

On-again, off-again negotiations to end the conflict between the US and Iran have led to greater volatility in the oil markets over the past few months. And that may well continue until the Strait of Hormuz officially reopens, according to Devin McDermott, equity and commodity strategist at Morgan Stanley & Co. Research. While these ups and downs may dominate headlines, they are hardly the only story in the energy sector. McDermott recently spoke with Morgan Stanley Wealth Management global strategist Alfredo Pinel about the wider outlook for energy—from oil and diesel to natural gas and electricity. Below is an edited excerpt from their conversation on Sept. 25.

Alfredo Pinel (AP): To start with the question on many investors' minds, what is the outlook for crude oil prices, given the uncertainty over the Iran war?

Devin McDermott (DM): Oil prices have generally been on the rise again lately as some of the supply “buffers” diminish, including strategic petroleum reserves. We’re calling for Brent crude oil to trade around \$100 per barrel by the fourth quarter of 2026, and we’re not far from there right now. It is certainly possible, if not likely, that we’ll continue to have short-term volatility around that price point based on escalation or de-escalation in the Middle East.

Once things reopen and normalize, we expect a gradual decline in the price of crude oil. Assuming a restart of flows through the Strait of Hormuz in the fourth quarter, we would expect the price of Brent to drop back down to the \$70s by later in 2027. So, while there has been a massive disruption, it’s not a structural change, in our view. It will eventually normalize over several quarters.

AP: Switching to refined products, the retail price for diesel in the US has set record highs lately above \$6.50 per gallon. What’s driving that surge, and where is the impact felt most?

DM: Diesel is where we’re seeing the most acute tightness right now. Currently, on a per-barrel basis, diesel costs over \$100 more than crude oil. That is four times the median difference between the two over the past several decades.

We see two key drivers of diesel prices. First, about a million-and-a-half barrels per day of refining capacity have been choked off from the global market behind the Strait of Hormuz, some of that due to the closure of the strait and some due to damage in the conflict. About one-third of the lost refining capacity—roughly half a million barrels per day—is diesel.

The second driver is the ongoing conflict between Russia and Ukraine. Drone strikes on Russian refineries have increased

over the past several months, and as a result, a little over three million barrels per day of refining capacity is offline in Russia now.

The combined lost supply from Russia and the Middle East, by our estimate, is around 1.3 million barrels per day, or 15% of the seaborne market. That’s very material and has put significant upward pressure on diesel prices, not just in the US but around the world.

Diesel is generally not a direct consumer or retail-facing product. It’s more business-to-business. It impacts the cost of transit and supply chains across many industrial end-markets and tends to show up on a lagged basis in consumer pricing through various products, including food and household goods.

AP: A group of US lawmakers has proposed a ban on diesel exports. Do you think that will happen?

DM: The US exports a little over a million barrels per day of diesel. Under a ban, those barrels would stay at home, but there’s not enough domestic demand to consume all of it. Storage would be needed—but compared with oil, refined products tend to have much less storage capacity. Once storage is filled, refiners would have to begin cutting runs, or production—which means reducing not just diesel output but also gasoline, jet fuel and heating oil, potentially driving those prices higher.

So, our view is that an outright ban on diesel exports is unlikely, but more moderate adjustments and voluntary restrictions are possible.

AP: War and geopolitics are affecting trade flows in natural gas as well. What’s your outlook for natural gas globally?

DM: The share of liquefied natural gas that typically flows through the Strait of Hormuz is the same as that of oil: about 20% of the world’s supply. Historically, most of that gas went to Asia, with a portion going to Europe.

However, from a demand profile standpoint, natural gas looks very different from oil: It’s extremely seasonal. Peak usage is during the winter as the primary fuel for heating. Many markets around the world rely on imported liquefied natural gas, or LNG, for their supply. When the Middle East conflict began in March and supplies dropped, we saw a deferral of buying activity. It was after the winter and a low-consumption period of the year for natural gas, so there was no need to draw down inventories.

But now, as we’re getting closer to the beginning of winter, we have the lowest storage levels in decades in some key markets, most notably Europe, which is creating upward price pressure. If there is a cold winter, it could theoretically bring Europe close to a full drawdown on storage.

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Our medium-term outlook, though, is that once the Strait of Hormuz reopens, most of the supply will return from Qatar, which is the key exporter behind the strait. We estimate that about 87% of capacity should come back online within one to two months of the strait reopening.

In addition, a tremendous amount of LNG capacity is under construction in North America, particularly in the US Gulf Coast area. This addition should help bring market prices back to normal relatively quickly over the course of 2027.

So, while low storage leaves LNG prone to further price spikes over the next several months, we expect some price moderation after the winter and a return to more historically normal levels as we move through next year.

AP: Staying with natural gas, how meaningful is the demand from AI and data centers today?

DM: As we see it, US natural gas has begun a new growth cycle. The first pillar of growth is LNG: Between 2025 and the early 2030s, the US is expected to more than double its LNG export capacity. And the second pillar is AI data centers, whose demand for power—specifically electricity—currently exceeds supply.

The US hasn't seen material growth in electricity consumption since the Great Financial Crisis. But growth should accelerate rapidly with the development of AI data centers across the US in the years ahead. We also expect a little uptick from manufacturing and a broader, more structural trend toward greater electrification—in appliances and electric vehicles, for example—in the later part of the decade.

Over the next 10 years, we think US electricity demand will increase at a compound annual growth rate of 2.5%–3%. To find comparable growth, you would have to go back around 50 years. And relative to the no-growth market since the financial crisis, it is a material inflection higher.

Natural gas makes up about 40% of our electricity mix in the US, and we think that share will hold roughly constant as the size of the market grows rapidly. Putting it all together, we think US natural gas demand will grow a little over 20% between now and 2030.

AP: Midstream companies, which provide energy pipelines, storage and other infrastructure, have seen strong earnings and equity returns so far this year. Do you think that can last?

DM: Yes, growth is back for energy infrastructure in the US. We came out of a world where energy demand growth domestically was softer, and growth in US shale, which had created a growth cycle for midstream companies in the 2010s, had slowed down.

Now, these companies have a new opportunity set, and in response, they have increased capital spending, and key large

players have increased growth investment. A rerating of the group has begun, tied in part to the repricing of the value of existing cash flows and incumbent infrastructure, and in part to the uptick in future growth prospects.

In terms of how long it will last, we see this as a durable structural growth cycle for natural gas that extends well beyond this decade.

AP: Do you see the rise in interest rates as a potential obstacle for midstream companies?

DM: We backtested midstream company performance over the past several decades, and we did find a linkage: When interest rates increased, midstream tended to underperform in a rate-hiking cycle, at least relative to the rest of energy. But that underperformance tended to be short-lived, and midstream companies typically outperformed once rates stabilized.

So, dislocations due to a short-term move higher in rates could actually create an attractive entry point in midstream companies. And unlike the past five years, when they were more steady-state businesses, the natural gas narrative and the opportunity from AI should turn midstream companies into much “growthier” businesses—more than just yield and income plays.

AP: As you look across the energy chain, where else do you see attractive opportunities? Are there any areas you think investors may be overlooking?

DM: With the price of Brent sitting around \$100 per barrel, our recommendation is to rotate more defensively within the space. Although energy stocks have not fully kept pace with crude oil, they have had a good performance streak this year.

More defensive areas would include some of the oil majors, pipeline companies—especially those focused on natural gas—and select large cap service oil companies, whose growth in free cash flow doesn't necessarily rely on commodity prices staying at these elevated levels. While refiners are benefitting from the tightness in diesel supplies and we see upside potential for earnings estimates, the stocks look more fully valued to us currently.

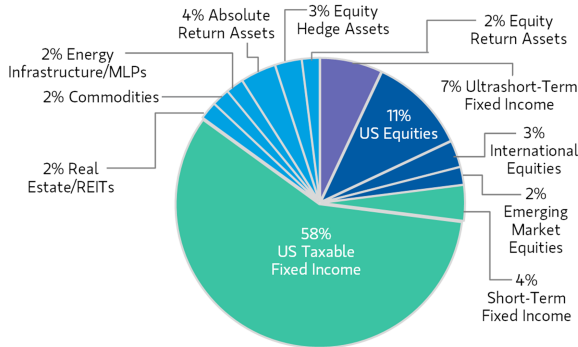
AP: Do you see any risks that might be underappreciated in the energy space?

DM: Geopolitics are inherently uncertain, and we generally advise against adding exposure to companies that have already rallied substantially alongside geopolitical disruption because it's hard to predict the longevity of the move. We suggest being opportunistic in energy stocks, adding on pullbacks or looking for companies that are not directly exposed to the situation in the Middle East, including those involved in domestic gas infrastructure. ■

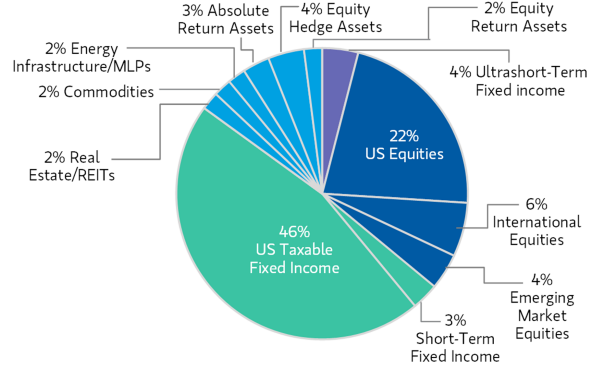
Global Investment Committee Tactical Asset Allocation

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.

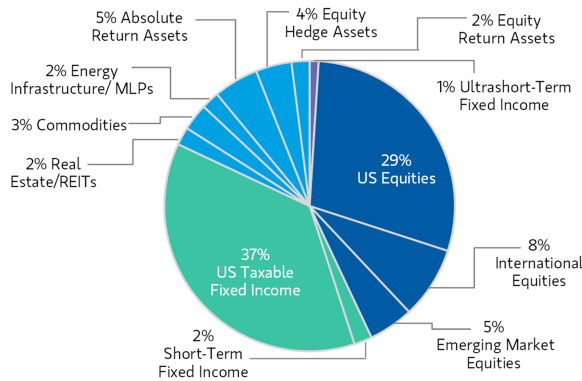
Wealth Conservation



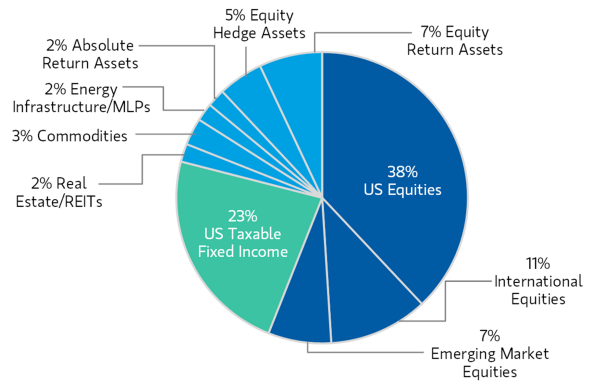
Income



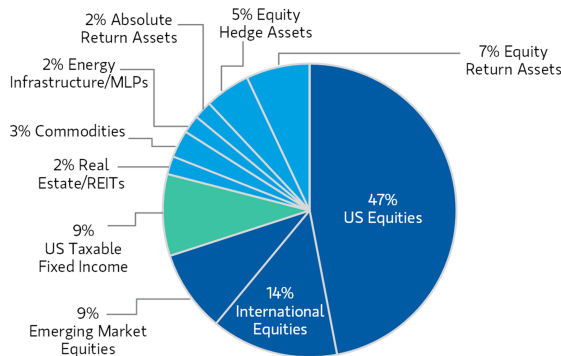
Balanced Growth



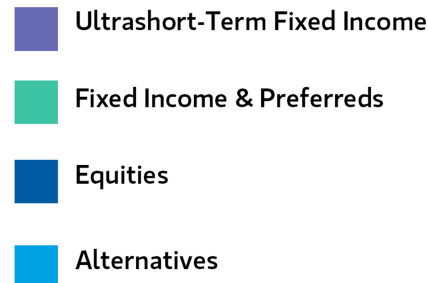
Market Growth



Opportunistic Growth



Key

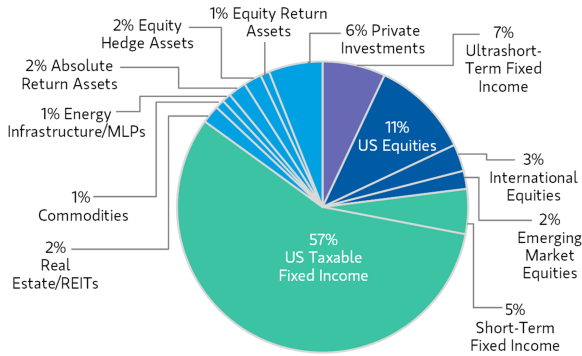


Source: Morgan Stanley Wealth Management GIC as of July 1, 2026

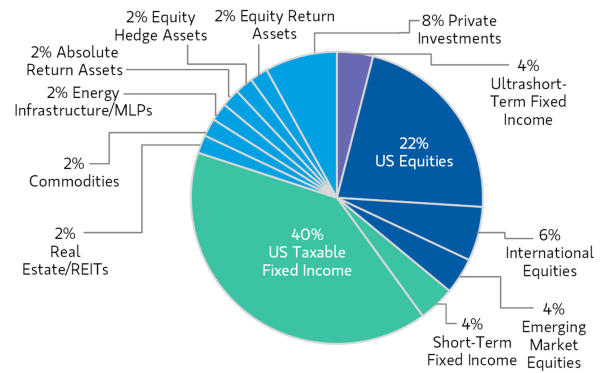
ON THE MARKETS

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.

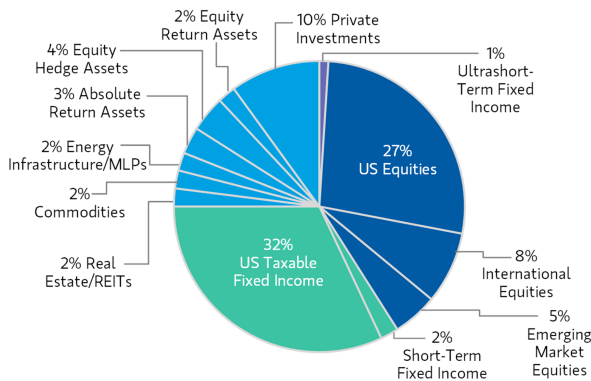
Wealth Conservation



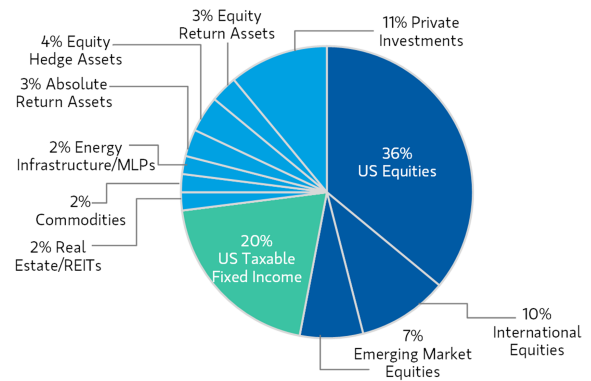
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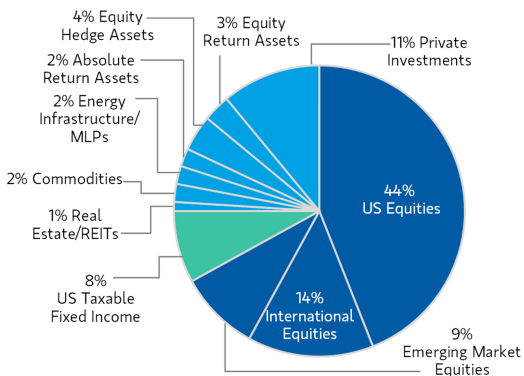
Balanced Growth



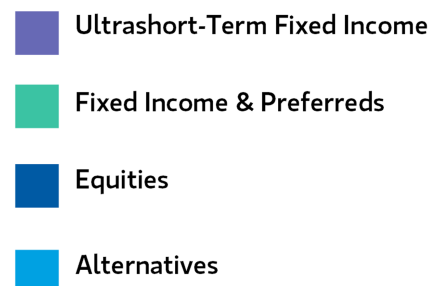
Market Growth



Opportunistic Growth



Key



Source: Morgan Stanley Wealth Management GIC as of July 1, 2026

Tactical Asset Allocation Reasoning

Global Equities		Weight Relative to Model Benchmark
US	Overweight	The productivity-boom thesis catalyzed by the GenAI-capex build-out, along with aggressive fiscal and regulatory stimulus, has become very much consensus. Forecasts are ambitious and embed an expectation for cyclical broadening that takes "S&P 493" earnings growth from 6%–8% in 2025 to 24%–26% in 2026. In a market that is already expensive, concentrated and complacent, this suggests the aperture for upside surprise is narrow, and markets are apt to be quite brittle in the face of exogenous shocks. With midterm-election-related policy already hitting a fever pitch, potential for these undiscounted events to occur is rising. Thus, while we are bullish (with MS & Co.'s 2Q2027 S&P 500 Index target at 8,300), we prefer stock-picking to simply owning the cap-weighted index. Favor financials, health care, select industrials and energy.
International Equities (Developed Markets)	Underweight	Fiscal stimulus, a response to the "America First" agenda, has helped to drive recent outperformance. This is creating rest-of-world (ROW) opportunities that may simultaneously enjoy monetary, fiscal and currency-related stimulus. The outlook is improving in Japan, as corporate restructuring occurs alongside a reflationary surge three decades in the making.
Emerging Markets	Overweight	The "new Monroe Doctrine" creates opportunities not only for pro-business political stability in Latin America, but also for direct investment. For Asia, strategic realignment opportunities continue to surface, as the US turns away and the US-China trade conflict has effectively reached a one-year truce, fostering opportunities. India remains a recommended secular growth long. The GIC reduced its overweight after a significant rally in semiconductor names, which skewed index composition.
Global Fixed Income		Weight Relative to Model Benchmark
US Investment Grade	Underweight	The GIC maintains close-to-neutral views in investment grade. In the first half of 2026, solid growth, supported by fiscal stimulus, and inflationary pressures supported a higher-for-longer interest rate environment. Should the Fed maintain a "hold" versus enacting a hike as its next move, investors could find some value in IG. As a point of caution, we do anticipate a surge in IG corporate issuance, on the back of increasing capex and rising M&A deal activity. Given the picture, we recommend limited short-duration exposure and moving toward the "belly of the curve" to capture decent coupons with lower price volatility. We see the long end continuing to be plagued by structural imbalances that show up as widening term premiums.
Opportunistic Fixed Income	Market-Weight	High yield is competing effectively, with better liquidity, greater transparency and more favorable credit quality than private credit. In ROW and emerging market debt, yields are decent, and there may be modest room for spread tightening, as economic growth improves.
Alternative Investments		Weight Relative to Model Benchmark
Real Assets	Overweight	We expect higher stock-bond correlations, which place 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 industrial metals, energy infrastructure and interesting opportunities aimed at solving the residential housing shortage.
Hedged Strategies	Overweight	We added to equity hedged positions early in 2026, noting the pickup in idiosyncratic risk and rising stock level dispersion. 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/market neutral strategies.

Note: Opportunistic Fixed Income includes Inflation-Linked Securities, High Yield Fixed Income, International Fixed Income and Emerging Market Fixed Income. The GIC asset allocation models' benchmarks do not include exposure to Opportunistic Fixed Income. Real Assets includes Real Estate/REITs, Commodities and Energy Infrastructure/MLPs. Hedged Strategies include Absolute Return Assets, Equity Hedge Assets and Equity Return Assets.

Source: Morgan Stanley Wealth Management GLC as of July 1, 2026

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Disclosure Section

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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.

Artificial Intelligence (AI) A field of study that seeks to train computers to process large amounts of unstructured information in a manner similar to human intelligence, capable of performing tasks such as learning and problem solving.

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole.

Correlation This is a statistical measure of how two securities move in relation to each other. This measure is often converted into what is known as correlation coefficient, which ranges between -1 and +1. Perfect positive correlation (a correlation coefficient of +1) implies that as one security moves, either up or down, the other security will move in lockstep, in the same direction. Alternatively, perfect negative correlation means that if one security moves in either direction the security that is perfectly negatively correlated will move in the opposite direction. If the correlation is 0, the movements of the securities are said to have no correlation; they are completely random. A correlation greater than 0.8 is generally described as strong, whereas a correlation less than 0.5 is generally described as weak.

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.

Equity risk premium is the excess return that an individual stock or the overall stock market provides over a risk-free rate. The risk-free rate represents the interest an investor would expect from an absolutely risk-free investment over a specified period of time.

Term premium is the excess yield that investors require to commit to holding a long-term bond instead of a series of shorter-term bonds.

Price to forward earnings calculates the price-to-earnings ratio that uses projected future earnings.

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Real Gross Domestic Product (GDP) is the GDP of the country measured at current market prices and adjusted for inflation or deflation.

Volatility This is a statistical measure of the dispersion of returns for a given security or market index. Volatility can either be measured by using the standard deviation or variance between returns from that same security or market index. Commonly, the higher the volatility, the riskier the security.

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.

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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 economies. 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.

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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.

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.

Derivative instruments. Options, futures contracts, options on futures contracts, forward contracts, swaps and structured products are examples of derivative instruments. Risks of derivative instruments include imperfect correlation between the value of the instruments and the

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underlying assets; risks of default by the other party to certain transactions; risks that the transactions may result in losses that partially or completely offset gains in portfolio positions; and risks that the transactions may not be liquid. Please see the fund's prospectus for additional information.

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

Annuities are long term tax-deferred retirement savings vehicles. Annuities are generally subject to surrender charges. A surrender charge is a penalty you have to pay if you sell or withdraw money from an annuity before it matures. The time before an annuity's maturity is called the surrender period and usually lasts for several years after purchase. Surrender charges reduce the value of your annuity and its returns. Early withdrawals will reduce the death benefit and cash surrender value.

Under current law, a nonqualified annuity that is owned by an individual is generally entitled to tax deferral. IRAs and qualified plans—such as 401(k)s and 403(b)s—are already tax-deferred. Therefore, a deferred annuity should be used only to fund an IRA or qualified plan to benefit from the annuity's features other than tax deferral. These include lifetime income and death benefit options.

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