Morgan Stanley

Fourth Quarter 2017

The 545 Group

Investment Insights

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We are pleased to offer this quarter's "Investment Insights" newsletter summarizing our team's current views and opinions on relevant economic, geopolitical and capital market events. Please contact us if you would like to discuss the investment climate and your portfolio in more detail. As always, thank you for your business.

Global Economy

Despite a volatile news cycle filled with both domestic and geopolitical tension, the global economy continues to grow in a synchronous fashion, with earnings fundamentals and economic data providing support for markets worldwide. For the first time since the recovery from the financial crisis, all four major regions (US, Europe, Japan, and EM) are demonstrating earnings growth at the same time without overheating, which has kept central banks from overreacting, and thus financial conditions accommodative. [1] While the initial "Trump bump" and "reflation" trade directly following the November US Presidential election waned in the first half of 2017, recent developments in Washington, including extension of the debt ceiling wall and potential fiscal stimulus from tax reform have reignited the procyclical trade, with small/mid cap, financial, and technology stocks leading the way. Investors are fixated on an expected rate hike in December and our Chief Economist Ellen Zentner has revised her expectation to a total of 3 hikes in 2018, versus four previously. [2]

Global Stocks

Global equity markets have continued to perform well given accelerating global economic and earnings growth, supportive financial conditions, potential for fiscal stimulus and attractive valuations relative to fixed income. We have been somewhat surprised from the market's resilience and low volatility especially given recent domestic and geopolitical events. So far this year, the largest drawdown has only been 3%, which if it should hold, would be the shallowest since 1995. [3] Yes, we are now more than 8 years into the economic expansion, the current bull market is already relatively long-lived and some fear investor complacency but the usual factors that warn of a bear market or recession are not evident. We continue to foresee a favorable environment for equities albeit with increased volatility and pullbacks along the way, which investors should capitalize on for new money commitments. For the Developed Markets, we continue to favor the US, Europe and Japan. Within these, we expect the broader international markets to continue their outperformance in the near term, as they catch up to the last 8 years of outperformance by US stocks. From a sector perspective, we favor technology for outsized earnings growth, financials for expected higher interest rates, and industrials for policy developments and infrastructure build. [3] While there has been recent nervousness around North Korea, we remain cautiously optimistic on the Emerging Markets given their favorable growth outlook and modest valuations.

Global Bonds

In evaluating relative value of the equity markets, we keep a close eye on fixed income spreads and interest rates, as these have provided early warning signs to weakness in equity markets in the past. Quantitative easing programs totaling in excess of $1 trillion annually in recent years have been the primary reason for low interest rates globally. [3] The US has already begun to unwind their balance sheet and Europe will be close behind. We would expect that rates begin to rise from their historical low levels due to this "tapering", along with the fact that gross debt in the market is rising while interest coverage has been going down. Given the enormous fund flows into bonds (please refer to the chart on page 3), we are concerned on principal risk and investor redemptions from rising rates and therefore recommend high quality credits and short maturities, with relative underweight positions in high yield.

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Outlook and Opportunities

This section summarizes the 545 Group's current views on the relative attractiveness of major asset classes. We base these tactical weightings on our assessment of each asset class's relative attractiveness compared to that asset class's historical risk-adjusted return as well as other opportunities available across the investing landscape. These weightings do not consider each client's unique profile, preferences and/or constraints and therefore may not be applicable to you.

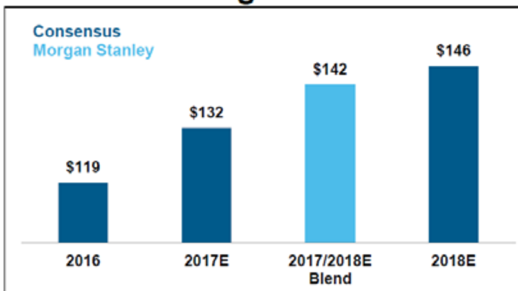
Asset Class	Weighting	Rationale
Cash	Under	Unattractive due to historically-low yields and potential opportunity cost from non-investment. Maintain as a reserve for new and opportunistic purchases
Investment Grade Bonds	In-Line	We expect rates to begin to rise with QE tapering and the Fed raising short-term rates
Opportunistic Bonds	In-Line	Underweight high yield due to tight spreads. Overweight inflation-protected securities given GDP growth prospects and anticipated rate increases
US Stocks	Over	MS Equity Strategy currently projects S&P500 to reach 2700. Returns late in the investment cycle have historically been high. Animal spirits are on the rise. We recognize this period of "euphoria" can end with lower returns but believe it can last through 2017
Non-US (Developed) Stocks	Over	Japan and Europe remain attractive. Europe political risk has somewhat abated, economic data is improving and valuations are fair. Japanese economy strengthening and stocks inaccurately reflect economic/earnings growth
Emerging Market Stocks	Over	Accelerating global growth, easing financial conditions in form of decelerating US$ strength and anticipated rate cuts, and stabilized commodity pricing
Alternative Investments	In-Line	Consider energy infrastructure, which should benefit from energy deregulation, new production, and new pipeline construction Certain Private Equity sectors, particularly opportunistic credit and middle market buyout funds may be attractive for investors who can accept liquidity constraints Underweight traditionally structured Hedge Funds

Charts of the Quarter

The following charts substantiate the views outlined in this quarterly piece.

Figure 1. 12-Month Base Case Price Target for the S&P 500 is 2700 [1]

S&P 500 Earnings Estimates



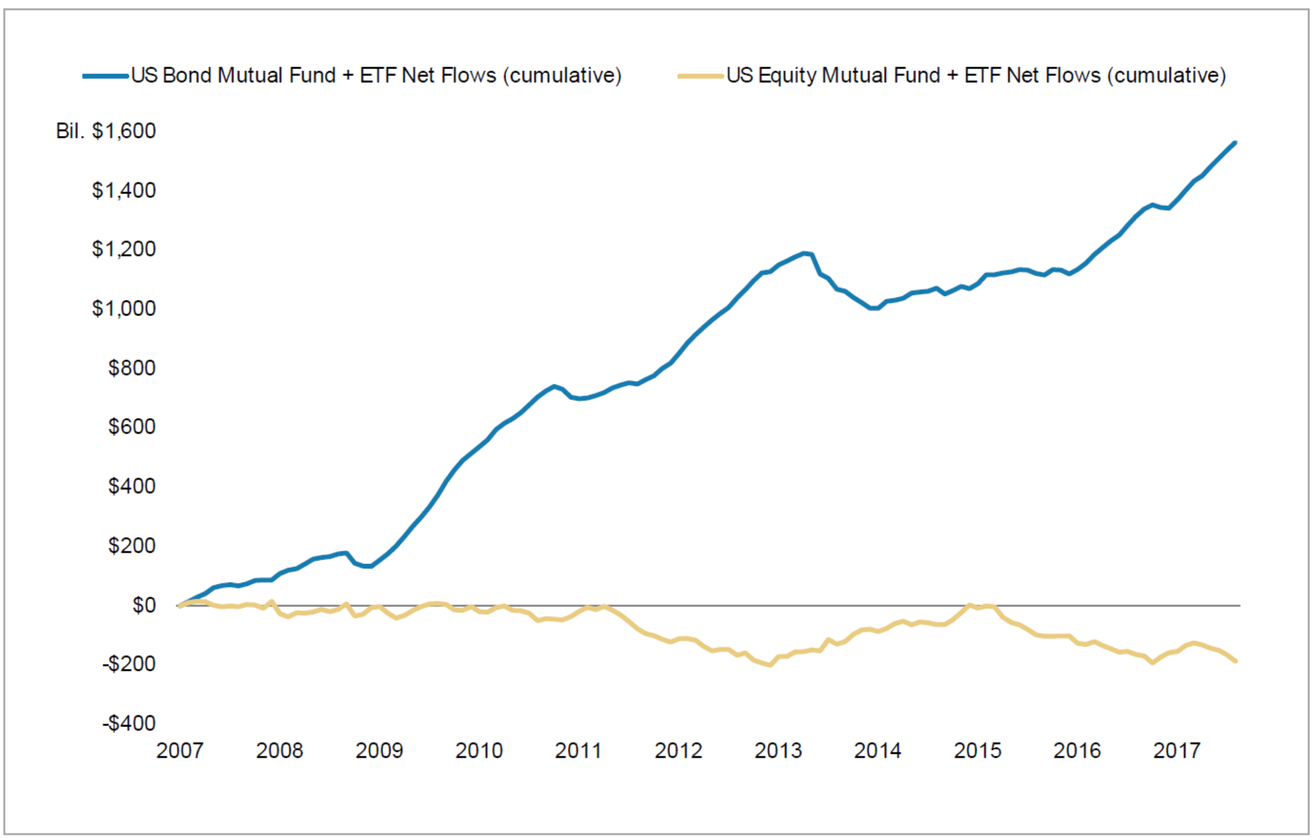
Source: FactSet, Thomson Reuters, Morgan Stanley & Co. Research as of Sept. 29, 2017

MS & Co. S&P 500 12-Month Price Target

Landscape	Earnings	Price/Earnings Multiple	Price Target	Upside / Downside
Bull Case	142.00	21.1	3,000	19.1%
Base Case	142.00	19.0	2,700	7.2%
Bear Case	126.50	16.6	2,100	-16.6%
Current S&P 500 Price			2,519	

Source: Thomson Reuters, Morgan Stanley & Co. Research as of Sept. 29, 2017

Figure 2. Cumulative US Equity Mutual Fund + ETF Net Flows Are Still Negative Since 2007 [4]



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The 545 Group at Morgan Stanley Private Wealth Management

Our investment team's roots at Morgan Stanley date to 1979 when Morgan Stanley entered the private wealth management industry. We have each spent the majority – if not all – of our careers at Morgan Stanley, a unique differentiator in an industry of constant change. Collectively, we represent over 100 years of experience structuring, implementing and managing wealth for sophisticated investors, their families and their related charitable entities. [3] This team of private wealth advisors, analysts, traders, portfolio reporting experts and customer service associates has built a nationally recognized practice focused on catering to the needs of ultra-wealthy investors.

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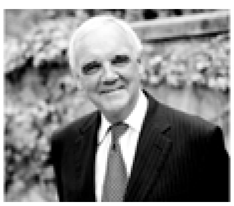

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[3] *Experience by advisor: Greg Vaughan, 34 years; Bob Dixon, 37 years; Mark Douglass, 24 years, Jason Bogardus, 15 years.*

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This newsletter contains forward looking statements and there can be no guarantees they will come to pass. Historical data shown represents past performance and does not guarantee comparable future results. The information and statistical data contained herein have been obtained from sources believed to be reliable but in no way are guaranteed by Morgan Stanley as to accuracy or completeness.

Interest in 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, local tax-exemption typically applies if securities are issued within one's city of residence.

Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in an issuer's credit rating, or creditworthiness, causes a bond's price to decline. Finally, bonds can be subject to prepayment risk. When interest rates fall, an issuer may choose to borrow money at a lower interest rate, while paying off its previously issued bonds. As a consequence, underlying bonds will lose the interest payments from the investment and will be forced to reinvest in a market where prevailing interest rates are lower than when the initial investment was made. **NOTE:** High yield bonds are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues.

International investing may not be suitable for every investor and is subject to additional risks, including currency fluctuations, political factors, withholding, lack of liquidity, the absence of adequate financial information, and exchange control restrictions impacting foreign issuers. These risks may be magnified in emerging markets.

An investment cannot be made directly in a market index.

The MSCI ACWI All Country World Index is a weighted index designed to provide a broad measure of equity-market performance throughout the world. As of January 2009, this index contains stocks from 46 different countries. There are 23 countries classified as developed markets and 23 countries considered emerging markets. Typically the index is built first at the country level, and then the 46 indexes are aggregated into the MSCI All Country World Index.

The MSCI Europe Index captures large and mid cap representation across 15 Developed Markets (DM) countries in Europe*. With 445 constituents, the index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.
The MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 320 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. An investment cannot be made directly in a market index.

The **MSCI EAFE Index (Europe, Australasia, Far East)** is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. As of June 30, 2014, the **MSCI EAFE Index** consists of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of June 30, 2014, the **MSCI Emerging Markets Index** consists of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey, and United Arab Emirates.
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Barclays Capital Global Aggregate Bond: This index provides a broad-based measure of the global investment-grade, fixed-rate debt markets.

Barclays Capital US Corporate High Yield Bond: This index is composed of fixed-rate, publicly issued, non-investment grade debt.

Barclays U.S. Aggregate Bond Index covers the USD-denominated, investment-grade (rated Baa3 or above by Moody's), fixed-rate, and taxable areas of the bond market. This is the broadest measure of the taxable U.S. bond market, including most Treasury, agency, corporate, mortgage-backed, asset-backed, and international dollar-denominated issues, all with maturities of 1 year or more. An investment cannot be made directly in a market index.

The Lipper Short Term Muni Index consists of municipal debt issues with dollar-weighted average maturities of one to five years. Number of Index Components: 10. An investment cannot be made directly in a market index.

The Citi High Yield Market Index is a broad measure of the North American high yield market. An investment cannot be made directly in a market index.

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An investment in alternative investments can be highly illiquid, is speculative and not suitable for all investors. Investing in alternative investments is only intended for experienced and sophisticated investors who are willing to bear the high economic risks associated with such an investment. Investors should carefully review and consider potential risks before investing. Some of these risks may include:

- 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 the fund and none is expected to develop;
- volatility of returns;
- restrictions on transferring interests;
- 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
- manager risk.

Individual funds will have specific risks related to their investment programs that will vary from fund to fund.

Private equity interests may be highly illiquid, involve a high degree of risk and be subject to transfer restrictions.

Stocks of small and 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.

Morgan Stanley Smith Barney LLC ("Morgan Stanley"), its affiliates and Morgan Stanley Financial Advisors or Private Wealth Advisors do not provide tax or legal advice. Clients should consult their tax advisor for matters involving taxation and tax planning and their attorney for matters involving trust and estate planning and other legal matters.

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<u>Sources used in this publication:</u>

[1] Morgan Stanley Research: Michael Wilson, *On the Markets,* October 2017
[2] Morgan Stanley Research: Ellen Zentner, *On the Markets,* October 2017
[3] Morgan Stanley Research: Vijay Chandar, *Daily Positioning,* October 4, 2017
[4] Morgan Stanley Research: Haver Analytics, ICI, Morgan Stanley Research, August 31, 2017