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# The Benedict-McLoughlin Report 2019 Investment Outlook

**By Christopher Benedict, CFA**

- Global equities have staged an impressive recovery from their late-2018 near-death experience.
- While this cyclical bear market may have overshot to the downside, it does appear that the economy has entered a new phase.
- I still believe there is money to be made in this bull market but, investors should expect a volatile ride over the next 12 – 18 months.

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Global equities have a had a strong start so far in 2019, rising 10.78% through the end of February, as measured by the MSCI All Country World Index.[1] The big question remains, however: Is this just a "dead cat" bounce from an extremely weak December or is it a continuation of the structural bull market after a relatively quick cyclical bear market? The answer, I believe, is…yes.

While the economy has shown some signs of weakness along with corporate profits, there were also some technical factors that exacerbated the year-end selloff. Tax-loss selling provided incremental supply and, as December wore on, a decent performance year was evaporating along with potential bonuses for many a portfolio/hedge fund manager. Furthermore, as equities got increasingly weaker throughout the month, U.S. Treasuries strengthened, driving longer-term interest rates lower and effectively flattening the yield curve. Of course, sharply lower equity prices and a flattening yield curve are both potentially ominous signals and certainly make astute investors sit up and take notice.

Importantly, we are beginning to see some validation that maybe the December sell-off was a little overdone. While the February jobs report was weaker than expected, the January report was strong. Taken together, the U.S. economy is adding an average of 166,000 jobs per month so far in 2019, which is respectable at this stage in the economic expansion.[2] And, while other indicators are also expansionary, there are some mixed signals emerging. For example, the Federal Reserve Bank of New York's 12-month recession probability model is at the highest level since March 2009 (albeit still below levels that preceded previous recessions).[3] Additionally, the outlook for corporate profitability has dampened. In fact, Morgan Stanley now predicts profit growth for S&P 500 companies of only 1% in 2019, down from a previous expectation of 5% growth.[4]

Net-net, I continue to believe this bull market has some legs left, albeit with more volatility and an increasing focus on stock selection. At a basic level, with equities valued at roughly historical averages and no recession in sight in the next 6 – 12 months, I expect equities to shadow economic/profit expectations for the foreseeable future. The Fed is likely on hold even if economic indicators stabilize in the short-term and would likely only hike rates again if there is an up-tick in inflation (even money, in my opinion). The housing market is stable, the employment market looks healthy and the global trade outlook likely improves from here.

## Investing 2.5 – Updating to Investing 1.0

As my regular readers know, I hypothesized in December 2016 that the Republican sweep of the elections would "push out" the next recession by a couple of years and effectively give risk assets a runway for about two to three more years (or two and half years, i.e., Investing "2.5"). Fast forward two years and, with the appropriate flexibility inherent in these types of predictions, I think we are now in an Investing "1.0" world. In other words, risk assets like global equities should continue to perform well through approximately mid-2020 as the outlook for economic growth and earnings looks fairly good.

Admittedly, as I wrote in my December 2018 "Monthly Musings", the first sense of doubt had crept in as I indicated that, up until December, all of my recession indicators had been green (i.e., low risk of recession). The combination of the steep sell-off in global equities and the flattening yield curve warranted a closer look as to whether the relatively long recovery since the Great Recession had run its course. I argued that it did not but, cited three main areas to watch closely: The Federal Reserve, trade policy and the geopolitical environment. Let's look at each in turn.

**The Fed:** The recent dovish pivot by the Federal Reserve was likely the biggest factor in the January market turnaround. After hiking rates nine times since the end of 2015 (albeit from effectively 0%), the economy finally began to feel the effects. And, of course, the Fed has also been tightening by allowing its balance sheet to run off, which has helped to increase longer term interest rates. Importantly, we are still not back to "normal" in regards to monetary policy. However, the delta or change since the start of the tightening cycle has been significant considering the very low starting point…and also considering the long duration that we spent stuck at 0%.

At this point, the market believes the Fed is effectively done with its tightening cycle. A recent Bloomberg poll of economists indicated that the Fed Funds rate will peak 0.25% higher than current after one more hike later this year.[5] In my opinion, it matters little whether the Fed hikes zero, one or two more times in this cycle. It is the slope of the yield curve that will dictate how global equities and different sectors will perform from here…and I think it re-steepens. With an economy that should re-accelerate this year combined with a rising supply of longer term bonds due to both continued Fed balance sheet run-off and continued debt funded-massive deficits, intermediate and longer term rates should increase. This would, of course, hurt the performance of longer term bonds (see graph on p.9) but, should help the performance of economically sensitive sectors.

**Trade:** The current Administration signaled before the 2016 election that their intent was to change the terms of trade for the U.S., particularly with China. They kept their promise. And, while the path has been rough, it appears the U.S. will end up in a better trade position once a deal with China is made, although it will likely be incremental. However, the important point here, as it relates to Investing 1.0, is that the uncertainty associated with the recent trade "skirmish" should begin to dissipate and this should enable corporations to feel more comfortable making longer term investments. Additionally, as part of the Tax Cuts and Jobs Act of 2017, companies can now deduct 100% (vs 50%) of the costs of both new and used assets placed into service.[6] This is interesting as corporations may have been holding back on capital expenditures (and not taking advantage of this tax benefit) given the trade uncertainty…if the trade picture clears up, some pent up demand could be unleashed.

**Geo-political:** The U.S. and the U.K. are arguably the richest and most "advanced" societies on the planet…it is unfortunate that their political systems are not reflective of that. On one side of the "Pond", we have a country that voted to leave the European Union but, has not been able to find a way to execute it (even after countless votes). On the other side, we have social media battles, government shutdowns and a general lack of accomplishment. It is a wonder we have any credibility left. It is a further wonder that, in certain circles, the way to fix it is…wait for it…more control in the hands of the government! The good news is that I believe we are past maximum consternation as investors have essentially adapted to the new environment. The U.K. will ultimately decide on whether to leave or not (I believe this year) and, thankfully, regular U.S. elections do provide a pressure relief valve of sorts.

Overall, all of these factors turning positive or at least becoming less negative is really a shorter term phenomenon that I expect will allow us to get through the rest of my "Investing 1.0" time period in decent shape. However, some longer-term challenges do remain. Overall debt in the U.S. (government, household and non-financial business) is at 250% of GDP, the highest level in the post-World War II era.[7] And, it continues to get worse as the Administration's recent budget estimated a current year deficit of $1.1 trillion and continued sizable deficits for the forecastable future.[8] Of course, these deficits are debt funded. Another area of concern, and potentially one of the unintended consequences of Quantitative Easing, is the growing income inequality in the U.S. and around the world. According to the World Inequality Lab, The top 10% share of national income in the U.S./Canada was 47% in 2016 vs. 34% in 1980…this level is approaching the same levels last seen in the 1920's.[9] Overall, while we are not quite in the same environment as France was circa 1789, this trend is something that investors should pay attention to (aside from the moral reasons). Civil strife and potential social upheaval would hurt economic and profit growth and raise risk premiums in general. I believe that some of the recent political movements and increasing partisanship that currently exists in the U.S. are symptoms of this growing inequality gap…and, in the parlance of traders, gaps eventually get filled.

Admittedly, it is difficult to predict the next recession and when the bear market that typically accompanies it will begin. It is even harder to make portfolio adjustments that both de-risk at the proper time and then re-risk at the appropriate time. It is the old adage: Do not try and time the market. However, on the other hand, another old but, lesser known adage is: Do not pick up pennies in front of a steamroller. What this means, essentially, is that, as we approach full valuation in the stock market, the incremental potential return is not enough to warrant the risk taken to achieve it. I think we will be at that point sometime in 2020. Please read on to see how I expect asset allocation strategies will help me manage through this.

## Asset Allocation[10]

Of course, before any investor begins to analyze specific markets or securities, a proper asset allocation strategy should be established. Unfortunately, asset allocation often takes a back seat to specific securities or sectors in investment research reports and the financial media. This is a bit counterintuitive as the asset allocation decision is often described as one of the most important decisions an investor has to make. Every investor has unique objectives and risk tolerances and constructing an allocation strategy based on these unique characteristics can help minimize unnecessary risk given a certain return objective or, similarly, help maximize the expected return given a certain risk level. The fact that different asset classes and sub-asset classes are not perfectly correlated enables what amounts to be the closest thing to a "free lunch" in the investment world as overall portfolio risk may be reduced by combining asset classes that are uncorrelated (See graph on p.9). Therefore, it is my contention that a proper asset allocation strategy implemented *and managed* in a disciplined fashion by a qualified investment professional can add significant value. However, it is important to note that even proper diversification does not guarantee a profit or protect against a loss, as 2008 and early 2009 so vividly demonstrated.

I essentially address asset allocation strategy at three levels; long-term (strategic) target allocation ranges, short/intermediate-term (tactical) adjustments within target ranges, and periodic re-balancing. For example, considering a hypothetical investor with a strategic target allocation of 50% stocks and 50% bonds (for the sake of simplicity, ignore other asset classes for the moment), I would target strategic ranges of 35 – 65% for stocks and 35 – 65% for fixed income as opposed to actual fixed-point targets of 50% each. Once a strategic range is established, I then tactically determine where in the range we should be. The more attractive I believe equities are, for example, the higher the allocation within the range. Of course, these ranges also apply to sub-asset classes like small versus large capitalization equities, for example (see table on next page). Finally, a re-balancing review is done at least annually or following significant market moves.

The philosophical underpinning of my approach to asset allocation is rooted in the belief that the core of an investment portfolio should be strategically positioned for the long-term, given the specific objectives and risk tolerance of the investor. To be sure, wholesale market-timing calls (i.e., shifting entire allocation into all stocks or all cash, for example) have historically proven difficult to execute consistently. However, by allowing subtle, tactical shifts within the strategic ranges, skilled portfolio managers can potentially take advantage of relative value discrepancies while still leaving room for error. For example, if equities appear cheap relative to fixed income, than an investor can adjust their allocation to the high end of a strategic range. If the investor turns out to be correct, than they would benefit. If they turned out to be wrong, then they would be negatively affected but, the negative effects would be relatively contained due to the existence of set parameters. Compare that to a market timer who might move 100% into equities, for example, if they believed equities were the most attractive asset class, right in the middle of a bear market. This investor could potentially experience significant declines which could take many years to make up. Similarly, investors that move to 100% cash may run the risk of getting back in the stock market too late in order to achieve their long-term return objectives.

Finally, careful monitoring and rebalancing are considered essential components of a disciplined approach. A major benefit of rebalancing, of course, is the potential reduction of overall portfolio volatility. For example, if stocks outperform bonds for a period of time, eventually an investor's allocation to stocks will likely grow to a percentage above the high end of the strategic range. In this case, rebalancing would require trimming stocks and adding to fixed income. Recent examples of this would have been during the stock market run-up in the late 1990s and 2006 - 2007 where trimming stocks and adding to fixed income served investors well while the opposite move in late 2002/early 2003 and late 2008/early 2009 was the appropriate adjustment. By incorporating rebalancing in an asset allocation strategy, an investor is essentially "forced" to sell relatively dear assets while buying relatively cheap assets. Buying low and selling high has never served an investor wrong. It will be important for investors to continue to monitor their portfolios as relative performance of certain sub-asset classes (i.e., US equities relative to international equities, for example) may have stretched relative valuations too far and will eventually succumb to the "reversion to the mean" phenomenon that tends to repeat itself in financial markets.

### Hypothetical Allocation Ranges with a Balanced Allocation and Average Risk Tolerance*

| Asset Class | Minimum (%) | Target (%) | Maximum (%) |
|---|---|---|---|
| Domestic Large Cap Equities | 10% | 20% | 40% |
| Global Small/Mid Cap Equities | 0% | 5% | 15% |
| International/EM Equities | 5% | 15% | 30% |
| **Total Equities** | **25%** | ***40%*** | **55%** |
| **Asset Class** | **Minimum (%)** | **Target (%)** | **Maximum (%)** |
| Tax-Exempt Fixed Income | 5% | 20% | 35% |
| Global Taxable Fixed Income | 0% | 10% | 25% |
| High Yield | 0% | 10% | 20% |
| **Total Fixed Income** | **25%** | ***40%*** | **55%** |
| Specialty/Alternative/Opportunistic** | 5% | 20% | 35% |
| **Total** | | **100%** | |

*For illustrative purposes only and should not be construed as a specific recommendation.

**Specialty/Alternative/Opportunistic may include hedge funds, private equity, real estate as well as tactical investments that are shorter term in nature.

*Please note that alternative investments, such as hedge funds and funds of hedge funds are made available only to qualified investors and involve varying degrees of risk.*

Importantly, many new investment vehicles are making this process easier for the knowledgeable investor. Not only should investors broaden their horizons geographically speaking, I believe they also need to broaden their horizons in terms of investment vehicles as well. Gone are the days where an investor just had to consider stocks, bonds and mutual funds. Today, we have Separately Managed Accounts (SMAs), Exchange Traded Funds (ETFs), closed-end funds, asset-linked Certificates of Deposit and, of course, an increasing number of alternative strategies (for qualified investors). Furthermore, over 2000 international companies are tradable in the U.S. via American Depository Receipts (ADRs). These choices, while potentially daunting, enable private investors as well as smaller institutions to invest on the same playing field as the largest and most sophisticated institutional investors. From my perspective, these choices enable tremendous flexibility to match specific client objectives with the appropriate investment allocation, the appropriate investment vehicle, and the ability to manage the entire process in the most effective manner.

## Current Strategy

Given my outlook for a re-acceleration in the economy from the slow Q4 2018, I do believe, where suitable, investors may want to consider modestly overweighting global equities (with a value tilt) and, on the income side, underweighting duration while utilizing a diversified approach (i.e., use more than just investment grade bonds to achieve an income target). That said, with less certainty surrounding the economic outlook in what has been an admittedly lengthy economic expansion, I would expect a fair amount of volatility in what just might be the final phase of this cycle. I would also expect stock selection to be rewarded much more than what has largely been an index-dominated bull market since the Great Recession.

Importantly, there still are a number of pockets in global equities where valuations remain attractive such as emerging markets (EM) and global dividend payers, in general, which I believe offer decent upside. EM equities have been chronic underperformers throughout this bull market…the MSCI All Country World Index has performed 500 basis points better than the MSCI Emerging Net Total Return USD Index per annum since the end of 2009 through February of this year.[11] Whether it was concerns over the Fed's tightening policy or concerns about the Chinese economy, emerging market investors have had plenty to worry about. Now, the Fed is largely done and China is implementing expansionary policies and should also see a better trade environment. In fact, expected EM GDP growth in 2020 will be three percentage points higher than that of U.S. GDP growth, the highest gap in seven years.[12] Combine this expected growth differential with attractive relative valuations and the opportunity in EM looks promising, in my opinion.

I believe developed international markets also look attractive for similar reasons (see graph on p.10). In particular, higher-yielding global dividend payers may offer both attractive valuations and an income stream that potentially provides a nice boost to total return in a good market and potentially cushion the blow in a weak market. Importantly, these opportunities exist in several different sectors including energy and financials. Financials have suffered of late as the yield curve has flattened. If I am correct in my analysis that the yield curve will re-steepen, financials could do well. The low valuations and dividend yields could potentially limit the downside if I am wrong.

On the income side, I continue to take a diversified approach to income investing given that interest rates are still at historically low levels. Despite what looks like a missed opportunity to lock in a 3.24% "risk-free" return for 10 years back in November, I still believe investors will get another chance at higher yields for intermediate and longer term bonds before the end of this rate cycle. If you look at any other time period besides the height of QE a few years ago, both monetary and fiscal policies are still pretty accommodative. Even after significant tightening, most of the U.S. Treasury yield curve still does not provide a meaningful real (net of inflation) return.

Income investors have struggled with low interest rates since the Great Recession and it has been harder to generate income during this regime, particularly if limited to only highly rated bonds (see graph on p.10). Some investors try to counteract this by taking extreme duration risk (i.e., buying very long-term bonds) but, even this strategy is losing its effectiveness as the yield curve flattens. Investors willing to assume more risk and would like to achieve a decent return in the fixed income portion of their portfolios may want to consider overweighting high yield corporate and emerging market bonds. Given the higher spreads (i.e., higher yields), I continue to believe it is more beneficial to take appropriate credit risk as opposed to interest rate risk at this point. Investors may also want to consider dividend-paying energy infrastructure companies, Business Development Companies (BDC's) and dividend-paying common equites to generate income.

Where appropriate, non-traditional investments such as total and absolute return strategies are also an important part of a well balance portfolio, in my opinion. These strategies attempt to achieve a decent return regardless of how equity markets are performing and may help to reduce overall portfolio risk due to their low correlation to traditional equities and fixed income. Please see the tables on the next page and on p.11 for a summary of my overweights and underweights

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## Tactical Allocation Tilts

| Equities: | +1 | Fixed Income: | …-1 | Alternative Investments: | …Equal |
|---|---|---|---|---|---|
| U.S. | …-1 | Treasuries | …-1 | | |
| Int'l/Em. Mkts | …+1 | Inv. Grade Corp./Muni's | Equal | | |
| Growth | …-2 | High Yield | …+1 | | |
| Value | …+2 | | | | |
| Large Cap | Equal | | | | |
| Small/Mid Cap | Equal | | | | |

| Legend | |
|---|---|
| …+2 | 20% Overweight |
| …+1 | 10% Overweight |
| Equal | Equal Weight |
| …-1 | 10% Underweight |
| …-2 | 20% Underweight |

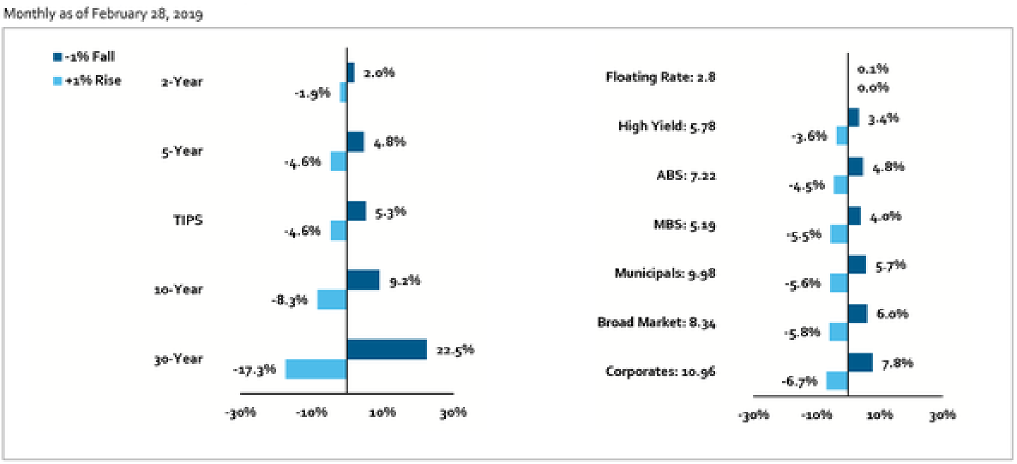
*For illustrative purposes only and should not be construed as a specific recommendation. Alternative investments are made available only to qualified investors and involve varying degrees of risk.*

## (Other) Things to Watch

- **U.S. Deficit/U.S. Dollar**: Although in better shape than during the Great Recession, we continue to run large deficits and it appears that this will improve only modestly over the next year or two, assuming we do see continued growth. The U.S. dollar has been fairly stable and potentially has some upside as interest rates likely stay higher in the U.S. vis a vis Europe and Japan. However, too much weakness in the Yen and the Euro can cause regional trade issues and not everybody's currency can weaken at the same time. That said, the clearest case for renewed dollar strength remains vs. the Yen, in my opinion.
- **The "Welfare State"**: Social safety nets play an important role in a modern economy; however, they can also dis-incentivize people from becoming productive members of society. There is an optimal point and any country/economy that goes beyond this point risks developing a culture where risk-taking is less prevalent, which could reduce economic dynamism at the margin. The current Administration appears to want to bring the U.S. back towards that optimal point.
- **Terrorism:** Sporadic terrorist strikes in Western nations remind us that the threat is still there. While these attacks in the West are serious, they pale in comparison to what has been happening in the Middle East, particularly in Syria. Besides the obvious and tragic human toll, it is a combination of the waste of resources used to combat terrorism (military, police, etc.) as well as a reduction in overall freedom that acts as a detriment to economic activity. Overall, terrorism adds to global uncertainty and this increases the risk premium for investors (i.e., lower asset valuations, all else equal). And, unfortunately, terrorism will continue to be a perennial risk and terrorists will continue to be active globally. Of course, a worst case would result from a terrorist strike using Weapons of Mass Destruction (WMD), either nuclear or biological. A large enough event has the potential to negatively affect globalization and even population growth.
- **Europe/Brexit:** Despite the impending exit of the U.K. from the E.U. (maybe?), Europe has the potential to be become a positive force for the global economy. While the membership of the European Union may, in fact, be different two years from now, the original reasons for the European Union (efficiency, increased global competitiveness, etc.) are as relevant as ever, in my opinion. Investors should hope for a relatively orderly evolution.
- **U.S. Housing Market**: The statistics appear to be consistent with a fairly healthy and normal housing market. Prices have been rising modestly in the past couple of years and housing starts have improved from unsustainably low levels. Overall, I expect the housing market to be relatively stable for the foreseeable future although the path of interest rates is a wild card. If rates rise too fast, it could counteract improving fundamentals overall.

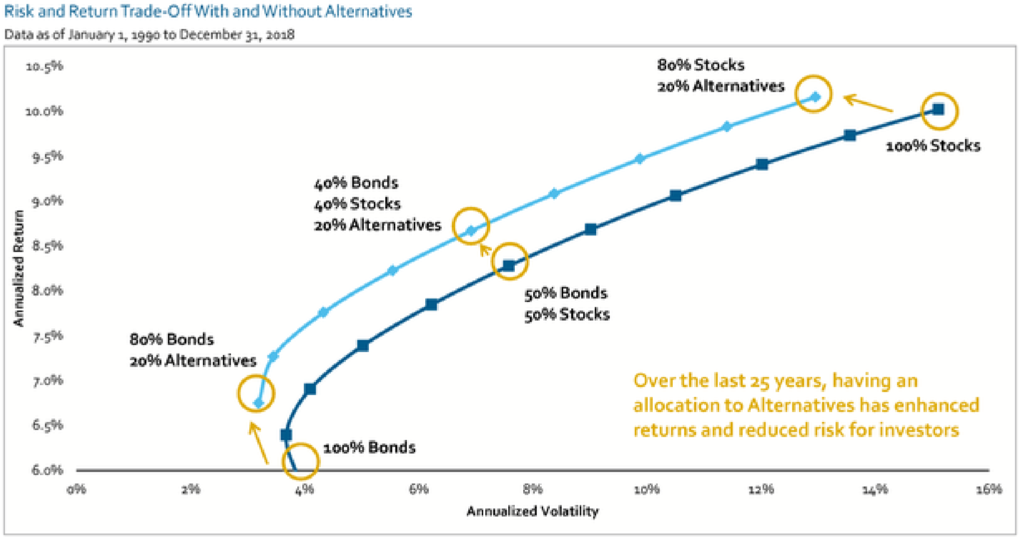
## GRAPHS OF INTEREST

### Total Return Impact of a 1% Rise/Fall in Interest Rates



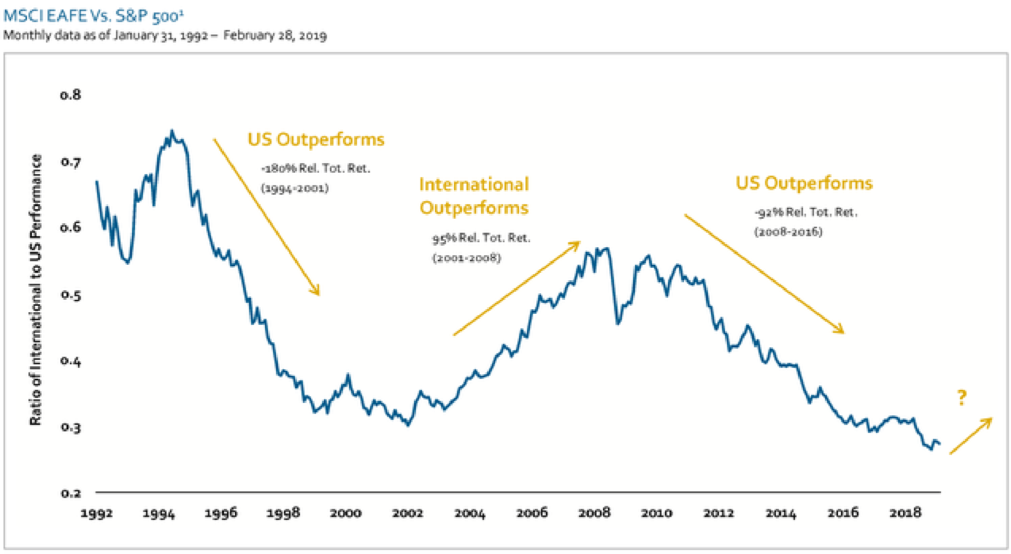

Source: Morgan Stanley Wealth Management GIC

### Benefits of Diversification (12/31/18)



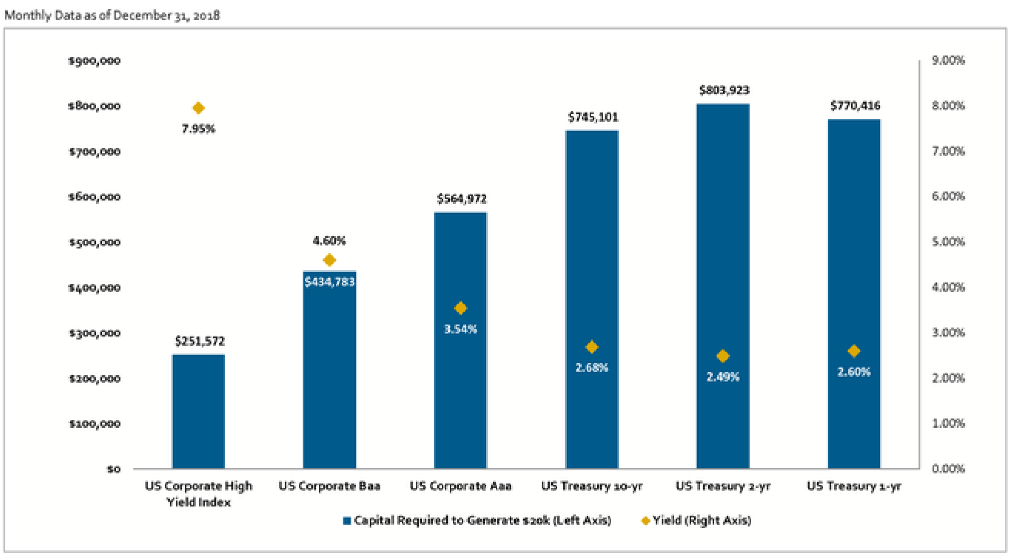

Source: Morgan Stanley Wealth Management GIC

## U.S. vs. International Equities (2/28/19)




Source: Morgan Stanley Wealth Management GIC

## Capital Required to Generate $20k a Year in Fixed Income (12/31/18)




Source: Morgan Stanley Wealth Management GIC

## Overweights and Underweights

| Asset Class/ Industry/Sector | Reason |
|---|---|
| **Overweights** | |
| Large Cap Multi-Nationals | Still cheaper than small caps on many metrics. Large cap multi-nationals are generally in stronger financial shape and are more exposed to global growth, particularly from emerging markets. U.S. based multinationals would get added benefit from a stabilizing U.S. dollar over time. |
| Consumer Discretionary | Consumers have been helped by low interest rates for years as well as a healthy labor market. Relatively low energy prices are further help. This combination should help the housing, retail and consumer technology sectors, among others. Any wage improvement would be a boost. |
| High Dividend Yield Equities | Over the long run, dividends have accounted for a significant portion of the total return in equities. I believe this will be the case over the short and intermediate term as well. |
| Emerging Markets (Consumer Focused) | I believe we are in a significant shift of economic "power" from a U.S./Europe driven economic model to one where emerging market consumers decide that they would like a similar lifestyle which they increasingly see Westerners enjoy on the TV/Internet. There is still a very wide per-capita income gap between the emerging and developing markets that I expect will continue to narrow over time. Importantly, this dynamic should create a positive feedback loop for the global economy. |
| Energy (Mid-Stream) | After a significant bear market in 2015/2016, the price of oil has stabilized. However, the stocks of energy companies remain largely depressed. OPEC should continue to support the market and the energy sector typically does better in the late cycle and when inflation is rising. |
| Corporate/High Yield Fixed Income | In the context of an overall underweight in fixed income, I continue to overweight this sub-asset class. An expansionary economic backdrop should help keep yield spreads relatively tight. |
| Low Duration Bonds/Loans | In the context of an overall underweight in fixed income, I continue to overweight this area. The floating rate nature of these securities essentially eliminates any duration risk while still yielding around 2 percentage points above LIBOR.[13] Many of the existing securities outstanding are trading below par so there is the added potential of capital appreciation if credit markets remain stable. |
| Absolute/Total Return Strategies | In what I believe will be a relatively modest return environment over the next 10 years, strategies that are designed to achieve high single digit returns may be additive to overall portfolio returns. These strategies typically have a low correlation to traditional assets, which may help reduce overall portfolio risk. |
| **Underweights** | |
| Long-Term Fixed Income | Rates remain historically low. Real rate of return below historical average. The Fed continues to normalize monetary policy. Higher quality bonds relatively expensive versus equities. |
| U.S. Treasury Securities | Low yields, potential future inflation and increasing supply to fund record deficits pretty much sums it up. |
| Highly Valued Tech | Many of the mega cap technology companies have done spectacularly well and their valuations assume many more years of spectacular growth, which may be tough if we see increased regulation. |
| Developed Market Consumer Staples Stocks | Seen as a "safe haven" in the early years of the recovery, they are now expensively valued as a result. Further, other sectors have become more "palatable" as the global economy remains fairly healthy. |
| Real Estate | The U.S. commercial real estate has stabilized after the meltdown of 2008/2009. However, the recovery continues to be slow and dividend yields are still unattractive, particularly as overall interest rates rise. |

*For illustrative purposes only and should not be construed as a specific recommendation. A review of each investors financial situation and risk tolerances must be performed to determine suitability of any investments. * indicates new recommended overweight or underweight*

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The initial interest rate on an inflation-linked 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 CPI. However, there can be no assurance that these increases in CPI will occur. Some inflation-linked securities may be subject to call risk.

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.

The value of fixed income securities will fluctuate and, upon a sale, may be worth more or less than their original cost or maturity value. 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.

Master Limited Partnerships (MLPs) are (rolled-up) 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. Because of their narrow focus, MLPs maintain exposure to price volatility of commodities and/or underlying assets and tend to be more volatile than investments that diversify across many sectors and companies. MLPs are also subject to additional risks including: investors having limited control and rights to vote on matters affecting the MLP, limited access to capital, cash flow risk, lack of liquidity, dilution risk, conflict of interests, and limited call rights related to acquisitions.

REITs are subject to special risk considerations similar to those associated with the direct ownership of real estate. Real estate valuations may be subject to factors such as changing general and local economic, financial, competitive, and environmental conditions. REITs may not be suitable for every investor.

Dividend income from REITs will generally not be treated as qualified dividend income and therefore will not be eligible for reduced rates of taxation.

***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 World Index** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. As of May 30 2011, the **MSCI World Index** consists of the following 24 developed market country indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States. An investment cannot be made directly in a market index.

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.

Sample Holdings consist of the top issues in each sector within the model portfolio as of 3/25/19. These sample holdings are for informational purposes only and should not be deemed to be a recommendation to purchase or sell the securities mentioned. There are no guarantees that any securities mentioned will be held in a client's account. It should not be assumed that the securities transactions or holdings discussed were or will be profitable. Data are indicative only as of the given date. Holdings will fluctuate, and no assurance can be given that an actual portfolio will be able to obtain the same attributes.

Please see additional important information at the end of this report

The individuals mentioned as the Portfolio Management Team are Financial Advisors with Morgan Stanley participating in the Morgan Stanley Portfolio Management program. The Portfolio Management program is an investment advisory program in which the client's Financial Advisor invests the client's assets on a discretionary basis in a range of securities. The Portfolio Management program is described in the applicable Morgan Stanley ADV Part 2, available at www.morganstanley.com/ADV or from your Financial Advisor.

Past performance of any security is not a guarantee of future performance. There is no guarantee that this investment strategy will work under all market conditions.

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