

# Wealth Management Perspectives

Morgan Stanley



# Where We Are: A Narrow Path for Upside Surprise

January 2026

**2025 ended as a solid year for both stocks and bonds. US equities proxied by the S&P 500 were up 18% while US bonds were up almost 7%. While the market narrative was again dominated by the pace of generative AI capex spending and the timing and magnitude of Fed easing, market action was characterized by material surprises:**

- The immateriality of Liberation Day tariffs and one of the strongest six-month rallies in the last 80 years from April through October.
- The 10% depreciation of the US dollar, which helped ROW markets outperform US by more than 1000 bp.
- The acceleration in gen AI capex spending and the resilience of the US consumer, despite awful sentiment and rising unemployment.
- Leadership by the Mag 7, but large dispersion within the cohort, with only 2-3 mega-caps outperforming the index; CAT substantially outperformed NVDA in 2025.
- While more stocks seemed to “participate” in the rally, total index concentration ended the year no better than where it started.
- Gold and silver were the best performing global assets by far, while bitcoin ended down for the year despite positive regulatory developments.
- Momentum factors faded into year end without a Santa Claus rally, and the value style began to outpace growth; we ended 2025 ~1% off all-time highs of 6,932.

**2026 should deliver roughly 10% upside for the S&P 500 based on the embedded strength of earnings, but the GIC is NOT as bullish as MS & Co.**

- Earnings expectations are already robust, up 14-15%, and embed significant productivity gains, operating margin expansion and taking operating leverage to new all-time highs. Most of the gains come from the beleaguered “493.”
- We think stimulus impact of OBBBA on consumer is overestimated versus overall sentiment; secular headwinds of credit build-up and residual “affordability.”
- We see enterprise-wide adoption of gen AI proceeding more slowly than many forecast.
- We think “fiscal dominance” will characterize the backdrop and that a weaker dollar, higher inflation, and a steeper yield curve, including a rise in long rates, are risks; interest rate sensitivity of the economy has changed; Stealth QE and Fed balance sheet expansion is a form of easing.
- The implication is the need for diversification from the 60/40; equity valuation multiples stall out, and long rates face rising inflation and term premiums.
- The new Monroe Doctrine, other geo-politics (World Cup, Olympics, 250<sup>th</sup> anniversary of America, and mid-term elections) sustain market volatility.

**We don't think that we are emerging from recession; 2026 will not mark a broad-based economic re-acceleration. Consequently, we are cautious about the pure passive index trade and small-cap beta. Instead, we think selectivity will matter. Within the context of being 300bps overweight US equities, we position GIC portfolios to be up in quality/larger capitalization.**

- Within US equities, we balance active/passive at 50/50; focused on quality and new leadership in financials, health care, and energy.
- Within Global equities, we are overweight US, Japan, and EM.
- Fixed income is a source of funds and moving toward underweight by mid-year with a focus on owning the belly of the curve; warming to high yield vs. private credit.

**Bull markets are meant to be ridden NOT timed, but exuberance should be tempered; GIC continues to recommend maximum portfolio diversification and risk management; focus on real assets including real estate and commodities, and infrastructure; like hedge funds and warming to 2026 new vintages in VC and growth Private Equity alongside select secondaries. In credit, focus on distressed and asset-backed. It's a risk manager's market, not a passive investor market.**

Source: Morgan Stanley Wealth Management Global Investment Office (GIO). 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. Past performance is no guarantee of future results. Estimates of future performance are based on assumptions that may not be realized. This material is not a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. Please refer to important information, disclosures and qualifications at the end of this material.

# What We Forecast: A Mid-Cycle Expansion

January 2026

| 2026E<br>US GDP Growth |      | 2026E<br>US Inflation          |     | Federal<br>Funds Rate                  |             | Two-Year/10-Year US<br>Treasury Yield |       |
|------------------------|------|--------------------------------|-----|--|-------------|---------------------------------------|-------|
| Real                   | 1.8% |                                |     | 3.0-3.25%                              |             |                                       |       |
| Nominal                | 4.5% | 2.8-3.0%                       |     | July vs. October Consensus             |             | 2.60%/4.05%                           |       |
| 2026E<br>Rest of World |      | 2026E<br>US Dollar             |     | 2026E/2027E<br>S&P 500 Earnings        |             | Price/Earnings<br>Multiples           |       |
| GDP                    | 3.2% | 1H                             | -6% | MS & Co.                               | \$317/\$356 | Current                               | 22.2x |
| Inflation              | 2.0% | 2H                             | +6% | Consensus                              | \$311/\$358 | Forecast                              | 22x   |
|                        |      | US Dollar Index (DXY) @<br>100 |     | MS & Co. Growth: 17%<br>Consensus: 15% |             | Fair Value                            | 17.8x |

**S&P 500 trades toward 7,500-7,800 MS & Co. base case annual target price.**

Source: Morgan Stanley Wealth Management GIO. Estimates are Morgan Stanley Wealth Management Global Investment Committee unless noted otherwise.

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# GIC Portfolio Positioning

January 2026

- **The GIC is rebalancing portfolios to focus on large cap quality equities who will best weather slowing growth and sticky inflation in 2026**
  - Magnificent Seven relative valuations have materially improved.
  - Market action suggests quality is cheap.
  - Quality cash flows will matter in a re-leveraging cycle; We are style neutral
  - Large-cap over small-cap; indices deconcentrate
- **2026 is mid-late cycle year where stock selection favors returns to favoring bigger capex exposed players with pricing power**
  - **Potential total portfolio return to average ~10%.**
  - Earnings growth and positive revisions, NOT multiples, pace gains.
  - Fiscal policy produces wide dispersion between beneficiaries and disadvantaged.
  - Momentum factors give way to idiosyncratic exposures...max active stock selection.
  - Stock/bond correlations remain volatile/positive as regimes remain unstable; pursue maximum portfolio level diversification.
- **US Equities: Overweight**
  - **Market Weight** the Magnificent Seven
  - **Underweight** unprofitable tech and small caps
  - **Balance equal-weighted index to cap-weighted;** max active management at 50% of US equity mix; Mag. 7 tax bill beneficiaries.
  - Prefer quality cyclical; GARP: financials, energy, domestic industrials, healthcare, media
  - **Adding** mid-cap growth names, which appear insulated from tariffs.

- **Rest of World Equities: Slight Overweight**
  - Japan and India favored longer-term secular positions.
  - **Overweight** EM ex-China; **Market Weight** China; LatAm highest conviction.
  - Europe focus on global brands and secular growth themes in defense, construction engineering and infrastructure.
- **Fixed Income: Underweight; the GIC is reducing fixed income exposure, and targeting a neutral duration relative to the benchmark**
  - Prefer IG corporate and munis
  - Moving to Neutral duration
- **Real Assets: Overweight**
  - Gold and industrial commodities
  - Residential REITs
  - Energy Infrastructure and MLPs
- **Hedge Funds: Overweight**
  - Equity Long/Short
  - Multi-Strategy; Absolute Return
  - **Underweight** Macro
- **Privates: Market Weight**
  - Prefer infrastructure and real assets
  - **Adding** to 2026 vintages of venture capital and growth equity
  - Equity secondaries
  - Private credit ABS and special situations only
  - **Underweight** PE buyout and direct lending

Source: Morgan Stanley Wealth Management GIO

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# 2026 Key Controversies

## 1. Market Valuations: It's "Show Me" Time on Earnings

- Overall index metrics are near historic extremes; S&P 500 index at ~22-23x forward earnings; Buffett indicator at historic high.
- But valuation extremes are concentrated among the top 10 names, which are historically more profitable and cash flow generative.
- The equal-weighted S&P 500 is relatively cheap in historic terms and could revalue if cyclical re-acceleration occurs.

## 2. Disinflationary Boom?

- Reacceleration, not recession risk is what is priced; market assumes another 50-75 bp of Fed cuts.
- Key is broadening of capex spending and recovery/stabilization of labor market (cyclical versus secular?); Six-month forward plans not encouraging.
- GIC sees GDP slowing in 1H2026, not re-accelerating; consumer still matters; manufacturing and housing lackluster.

## 3. Inflation Tamed?

- Readings are sticky and tariff risks remain as middle market corporate margins have absorbed price changes.
- 2026 brings renegotiation of USMCA: end of China Truce; India?
- Weaker US dollar is a headwind; monetary and fiscal stimulus could cause prices to run hot; Fed independence remains issue.
- Tug of war between lower oil prices, but higher electricity prices.

## 4. The K-Shaped Economy?

- Wealth effects may be swamping income effects, obscuring the true read of breadth of economic health.
- Monetary policy accommodation may exacerbate "bubbles."

## 5. Fed Independence and Fiscal Dominance

- New Fed Chair in May may mean new policy framework
- Fed focus shifts from cutting rates to accommodating balance sheet growth, front-end Treasury bill issuance and duration shortening

## 6. AI Productivity Gains and Corporate Margins A Productivity Renaissance?

- Promises are big, but adoption is only 15-20%.
- Productivity gains not yet in evidence, concentrated among tech companies themselves.
- Scale and size are overwhelming drivers, leaving the "493" and small-mid behind.

## 7. Credit Cockroaches?

- Private credit is the epicenter of stress, defaults plus "liquidity management exercises" are over 4%.
- Fed easing may not be enough as floating rate borrowing costs are well above large cap competitors.

## 8. AI Bubble?

- Spending is accelerating and FCF growth of Mag-7 has gone negative; GIC believes we are in the sixth inning for pricing potential.
- Ecosystem is increasingly using debt and interconnected vendor financing
- GPUs versus TPUs
- LLMs business models
- Quality of earnings and depreciation schedules

## 9. American Exceptionalism Everlasting?

- Valuation differentials extreme; growth advantages closing; debts/deficits become long run constraint.
- Rest of world outperforming by 1,000 bp in 2025.

Source: Morgan Stanley Wealth Management GIO

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# January 2026: Key Policy Developments

## 1. Venezuela

- **Market impact should be low.** The country's sovereign and PDVSA bonds are in default and there is no Venezuelan company fully listed in the US equity markets. The main market impact will likely be felt in the oil market. In the short-term, oil prices may be more volatile, but over time, they may move lower once more Venezuelan oil becomes available.
- **Civil war odds for now are low.** President Trump has said that the US will “run Venezuela” and its oil infrastructure until a transitional government can safely be put in place. This could lead to boots on the ground. Unlike Iraq, a civil war is unlikely because most of the country favors the end of the Maduro regime, which has been unrecognized since the 2018 elections. In the 2024 presidential election, around 69% of the vote was against Maduro.
- **Venezuela has the largest proven oil reserves in the world at 300 bn barrels, 222 trillion cubic feet of natural gas reserves, 8.6 billion metric tons of coal, and an estimated 10-15 million troy ounces of gold reserves.** Much of these reserves are untapped due to lack of investment, expropriations, and sanctions. Additionally, Venezuela's proximity to the US makes it militarily strategic, especially if foreign countries that are contrary to US interests use it as a military base. A ballistic missile would take between 5 and 6 minutes from Caracas to Miami.
- **This is about China and Energy.** The US actions in Venezuela highlight the new US National Security Strategy and revival of the Monroe Doctrine, focused on positioning the US as the dominant external power in the Americas and reducing non-hemispheric (China, Russia, Iran) influence in the region. **US Energy Dominance** is part of this strategy, and increased control of Venezuela's oil reserves benefits US interests.
- Expect increased US involvement in the region with implications to economic policy, security (terrorist drug cartels), and investments. These actions could influence presidential elections in 2026 in: Costa Rica (February), Peru (April), Colombia (May) and Brazil (October).

## 2. Stealth QE and \$200 Billion of MBS Purchases

- The White House ordered that Fannie and Freddie (both under the direction of Bill Pulte) engage in \$200 billion of purchases of MBS. The MS & Co. team equates this action with a flavor of QE (price insensitive buying with the hope of reducing mortgage spreads) and represents yet another attempt to shoot liquidity into the system and hold rates down. Most investors and home buyers are well aware that while the Fed has cut rates 175 bp since 2024, the 30-year **mortgage rate has fallen only 36 bp to 6.23%** while **the 30-year Treasury yield has risen 93 bp to 4.86%** and **the 2s/30s Treasury yield curve has steepened by more than 130 bp**—providing little relief to the housing affordability challenge.
- **MS & Co. analysts are forecasting that the QE actions may reduce 30-year mortgage rates by 15-25 bp**—something the President can point to going into the mid-term elections.
- That said, as we have reviewed many times, the structural mortgage lock-ins are profound. **40% of the US existing housing stock is now owned without any mortgage, and of those with mortgages, a full 65% still carry mortgages at 5% or less.**
- The GIC continues remains cautious about holding long duration rates as we see the pressures on higher for longer inflation and rising risks around fiscal debts and deficits continuing to pressure term premiums higher. 10-year Treasury term premiums have risen in the last 2 years to 75 bp, but remain well below the 80-year average of ~150 bp when policy predictability and risks are clearly rising. **Our preference for most clients in fixed income allocations is to stick with Munis and complement with distressed credit/select corporate credit for yield (4-6 years of duration).**
- **We believe these actions give further weight to the idea that going into the mid-terms the administration is going to pursue “RUN IT HOT” policies that are supportive to the bull case in the short term, but will create volatility for the bond market and produce challenges for the Fed and the new incoming chair.**

## 3. Industrial Policy & State Run Capitalism

- WH executive orders for the defense industry to focus on investment and efficiency versus CEO comp and share repurchases is a new strategy that markets need to watch.
- Residential housing reform versus institutional investors.
- Credit card interest limits at 10%.

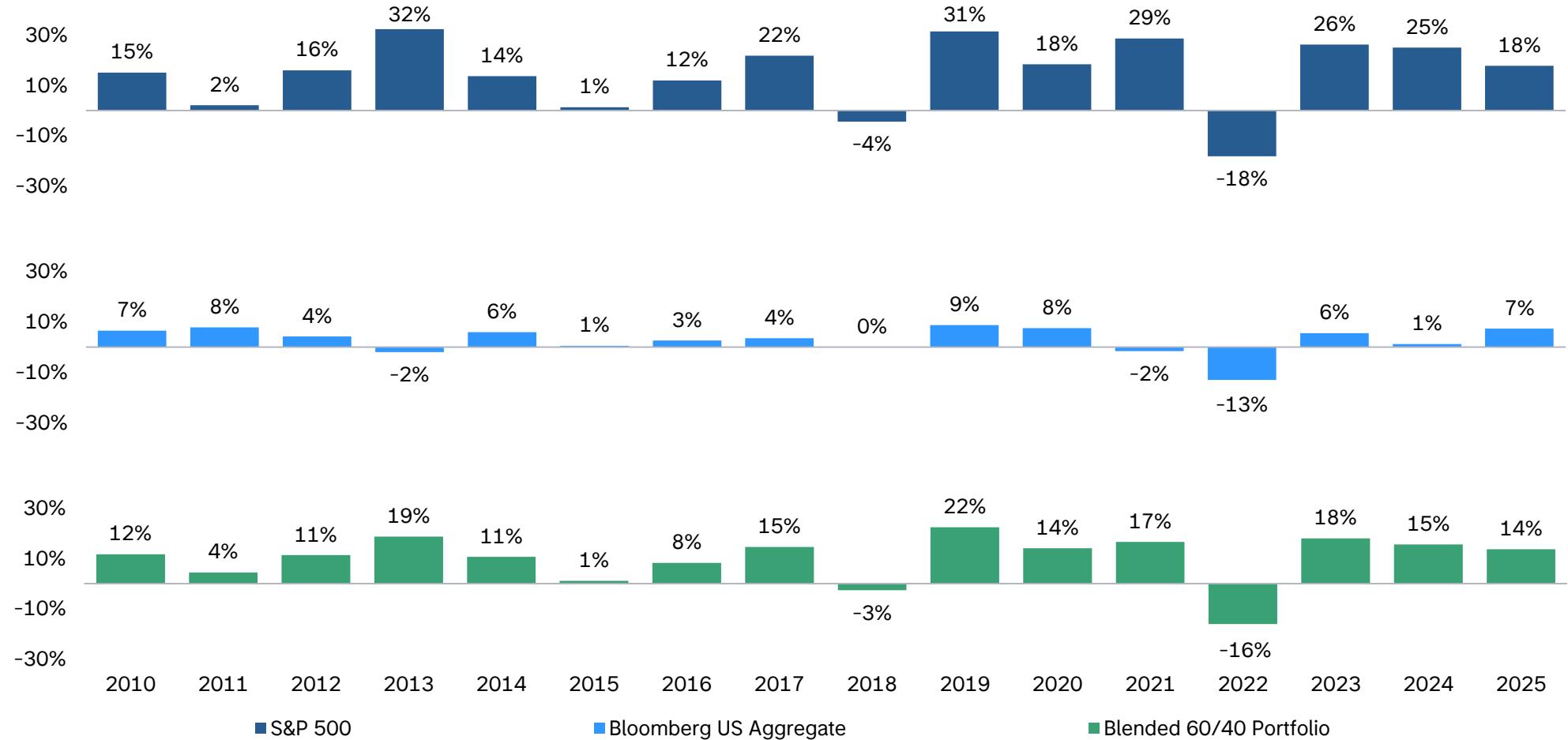
Source: Morgan Stanley Wealth Management GIO

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# 2025: Another Really Solid Year

## ASSET CLASS TOTAL RETURN BY YEAR

AS OF DECEMBER 31, 2025



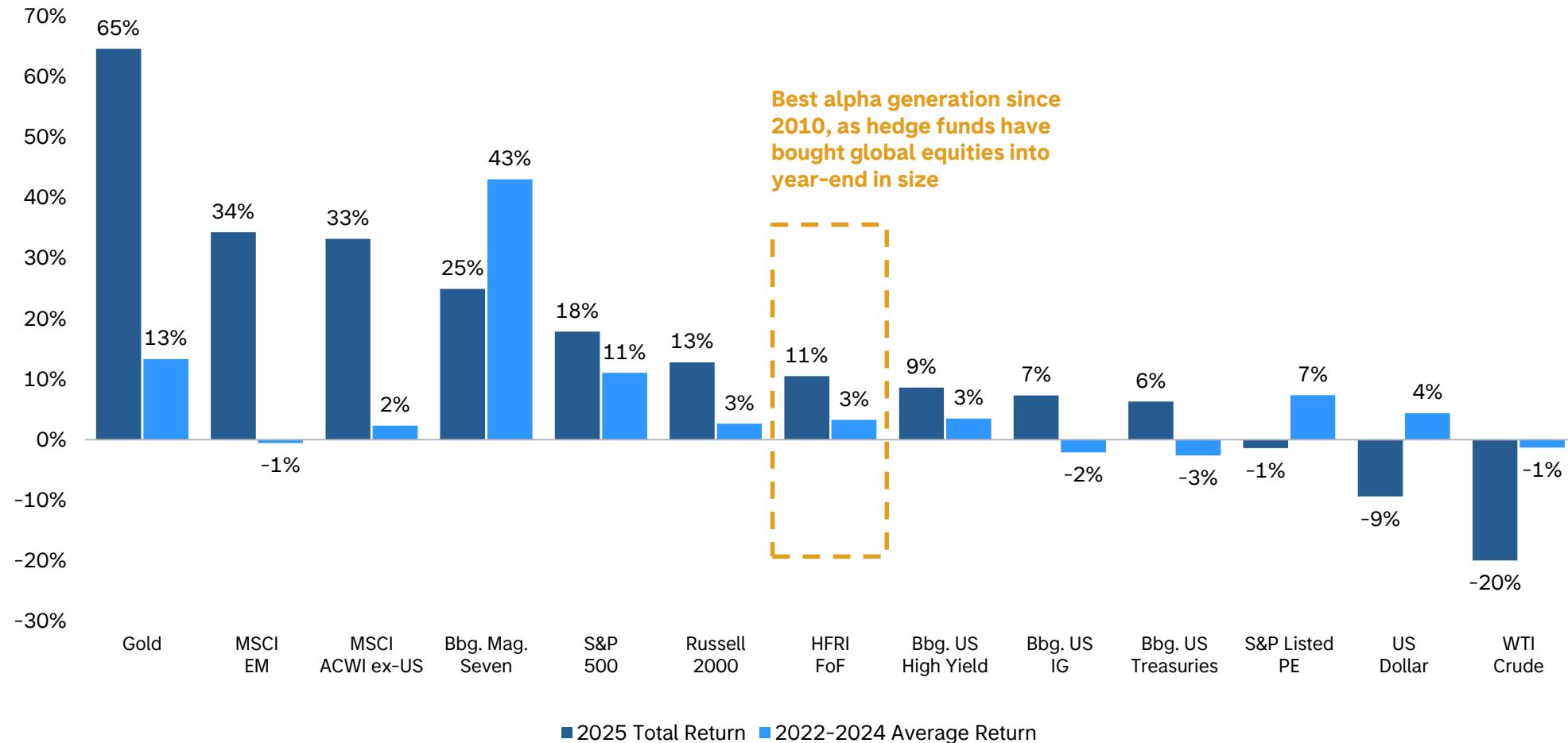
Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# The Case for Portfolio Diversification Returned as American Exceptionalism Paused

## 2025 TOTAL RETURN VS. 2022-2024 AVERAGE RETURN BY ASSET CLASS

AS OF DECEMBER 31, 2025



Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# But Concentration of Returns a Challenge for Active Managers

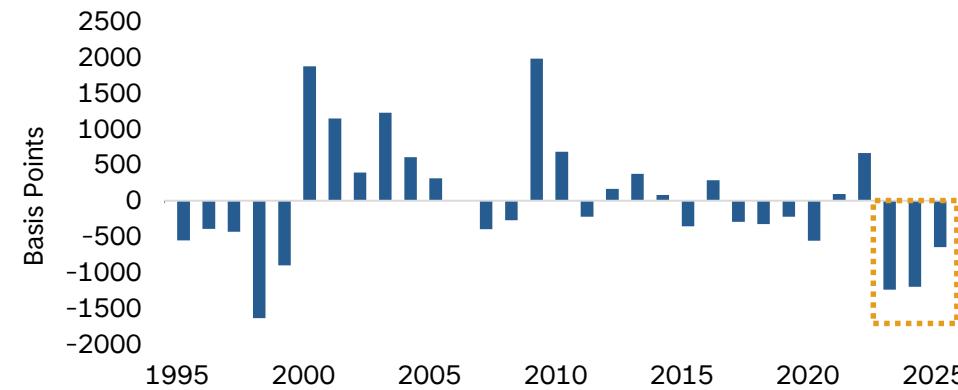
## 10 LARGEST COMPANIES SHARE OF S&P 500 MARKET CAP

AS OF DECEMBER 31, 2025



## EQUAL-WEIGHTED S&P 500 RELATIVE TO CAP-WEIGHTED

AS OF DECEMBER 31, 2025



Source: Morgan Stanley Wealth Management GIO, Bloomberg, Strategas

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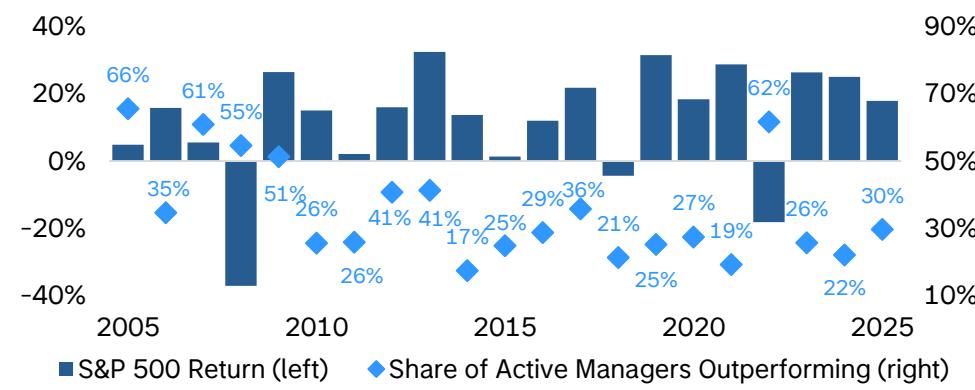
## 10 LARGEST COMPANIES' ATTRIBUTION TO S&P 500 RETURN

AS OF DECEMBER 31, 2025

| Year        | Share S&P 500 Return Attributed to 10 Largest Companies | S&P 500 Return |
|-------------|---|----------------|
| 2007        | 78.7%   | 3.5%           |
| 2023        | 68.4%   | 24.2%          |
| 2024        | 68.1%   | 23.3%          |
| 2020        | 58.9%   | 16.3%          |
| <b>2025</b> | <b>57.3%</b>  | <b>16.4%</b>   |
| 1999        | 54.5%   | 19.5%          |
| 2021        | 45.0%   | 26.9%          |
| 1998        | 36.8%   | 26.7%          |
| 1996        | 33.9%   | 20.3%          |
| 2017        | 33.3%   | 19.4%          |

## SHARE OF ACTIVE MANAGERS OUTPERFORMING THE S&P 500

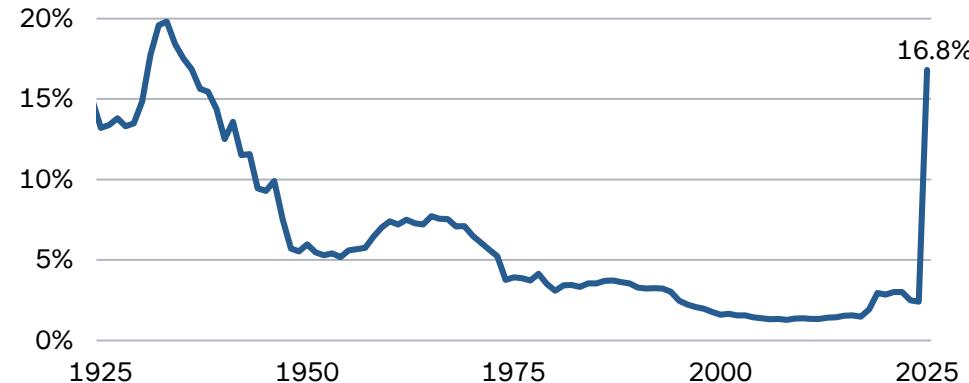
AS OF DECEMBER 31, 2025



# 2025 Surprise #1: Tariffs Only Modestly Impacted Inflation; Economy

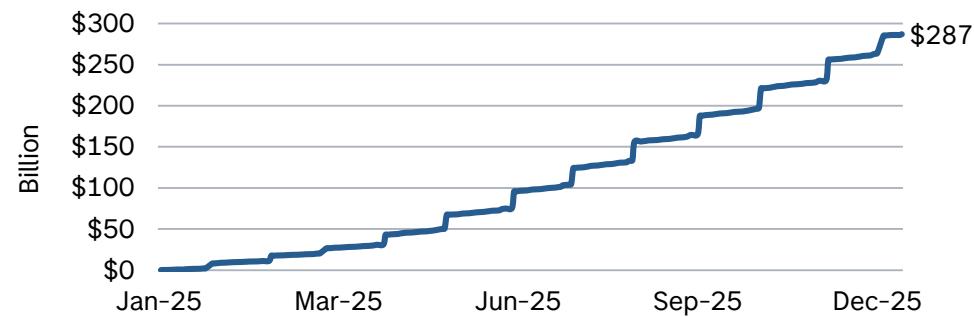
## EFFECTIVE TARIFF RATE

AS OF DECEMBER 31, 2025



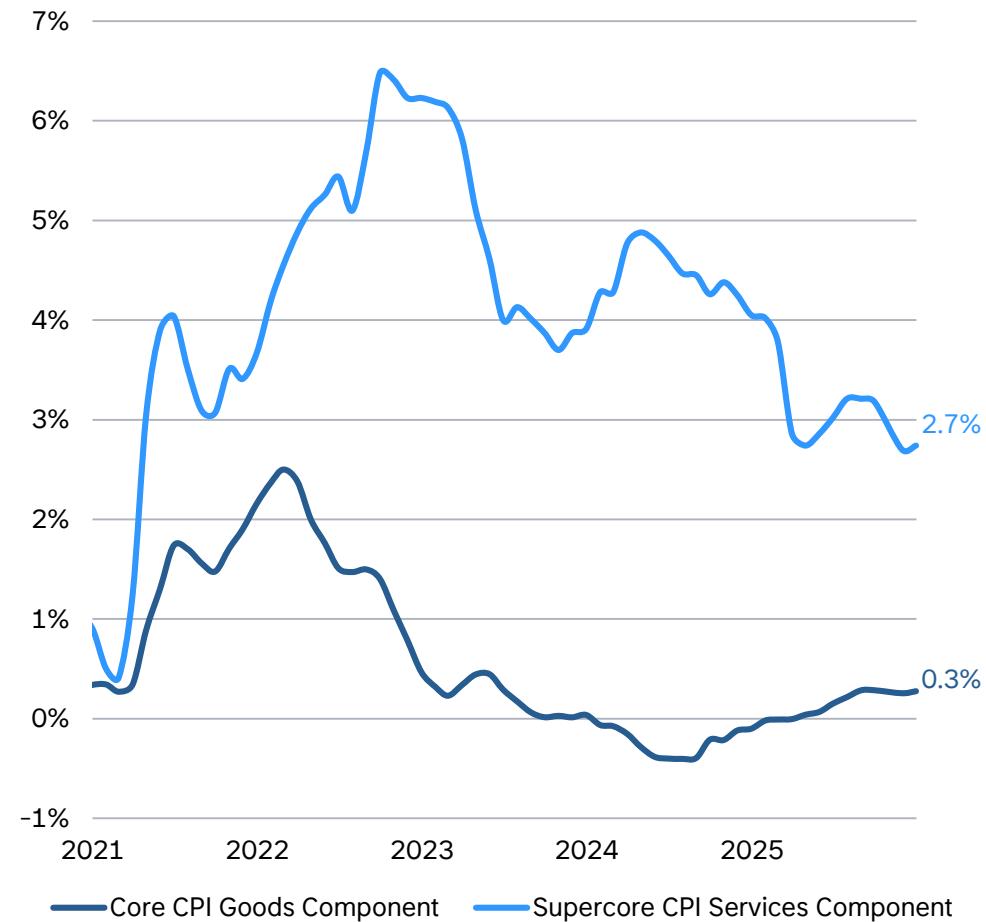
## MONTHLY TARIFF REVENUES COLLECTED

AS OF DECEMBER 31, 2025



## CPI GOODS AND SERVICES COMPONENTS, YEAR OVER YEAR

AS OF DECEMBER 31, 2025



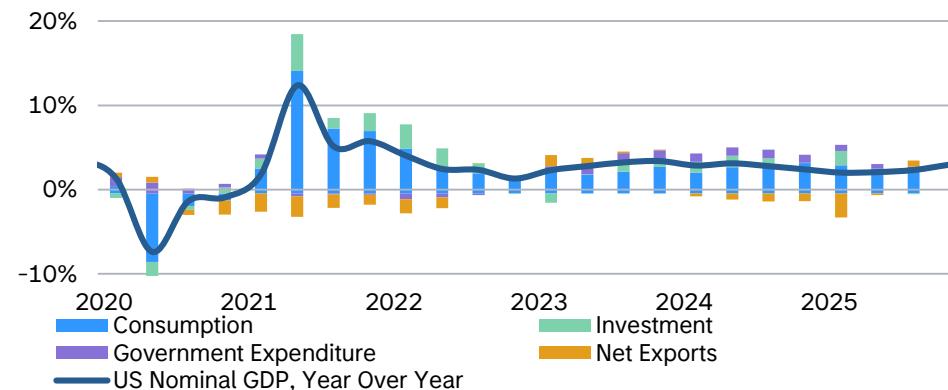
Source: Morgan Stanley Wealth Management GIO, Bloomberg, MS & Co. Research, Yale Budget Lab

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# 2025 Surprise #2: US Economic Growth Held Up, Powered by GenAI Capex Spend, Consumer

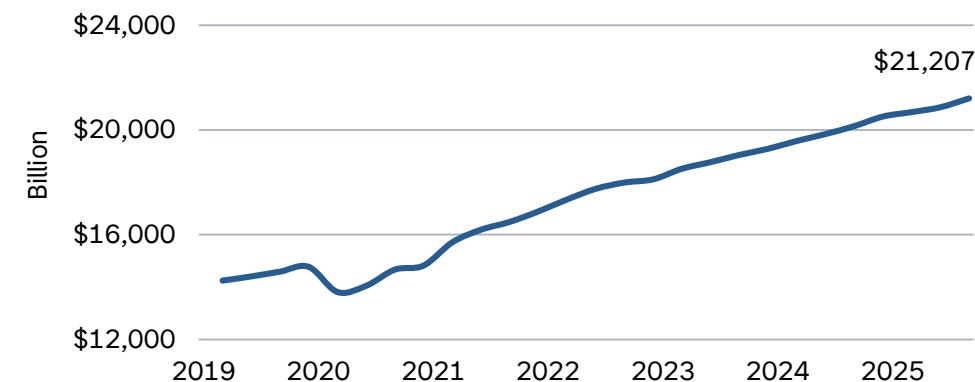
## CONTRIBUTIONS TO US NOMINAL GDP GROWTH (ANN.)

AS OF DECEMBER 31, 2025



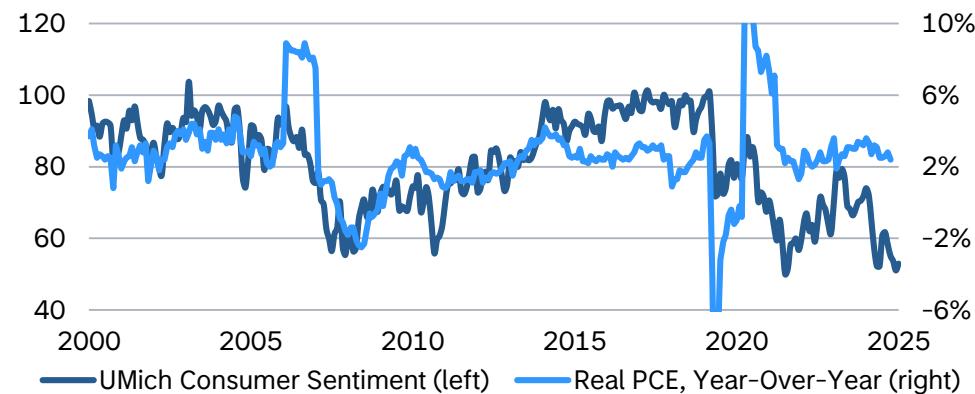
## PERSONAL CONSUMPTION EXPENDITURE

AS OF DECEMBER 5, 2025



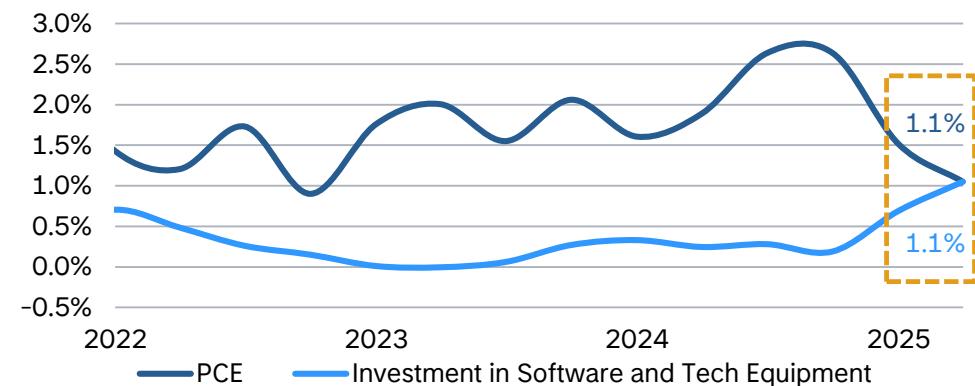
## REAL PCE VS. UMICH CONSUMER SENTIMENT

AS OF DECEMBER 31, 2025



## CONTRIBUTION TO REAL GDP GROWTH IN 1H2025

AS OF DECEMBER 31, 2025



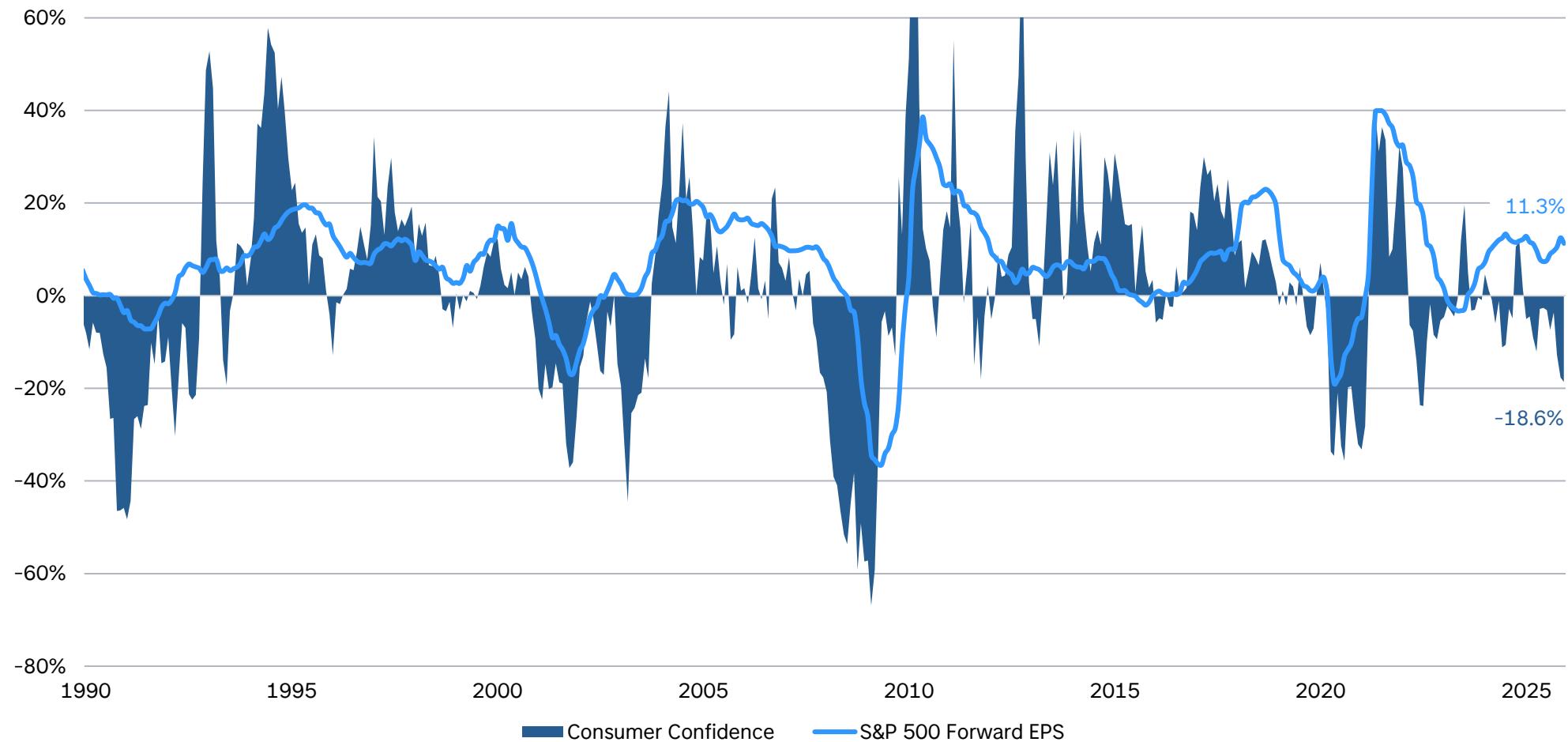
Source: Morgan Stanley Wealth Management GIO, Bloomberg, FRED, Haver Analytics, KKR. 4Q2025 GDP estimates are from Atlanta Fed GDPNow Forecast. Contribution to Real GDP growth uses the two-quarter moving average.

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# Corporate Profits Completely Disconnected from Consumer Sentiment

## CONSUMER CONFIDENCE, YEAR OVER YEAR VS. S&P 500 FORWARD EPS, YEAR OVER YEAR

AS OF DECEMBER 31, 2025



Source: Morgan Stanley Wealth Management GIO, Bloomberg, Strategas

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# 2025 Surprise #3: US Dollar Depreciation and RoW Outperformance

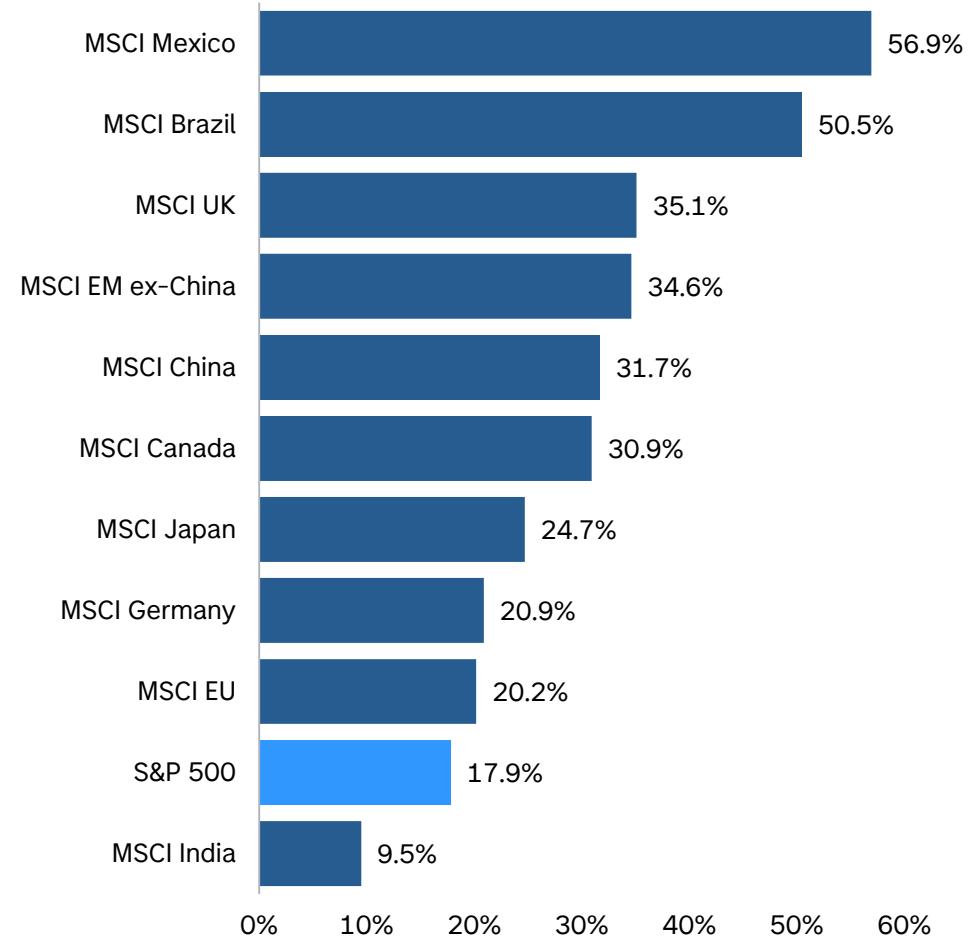
## US DOLLAR INDEX

AS OF DECEMBER 31, 2025



## 2025 TOTAL RETURN BY REGION

AS OF DECEMBER 31, 2025



Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# 2025 Surprise #4: Gold, Silver, Copper vs. Bitcoin

## GOLD VS. BITCOIN

AS OF DECEMBER 31, 2025



## SILVER VS. COPPER

AS OF DECEMBER 31, 2025



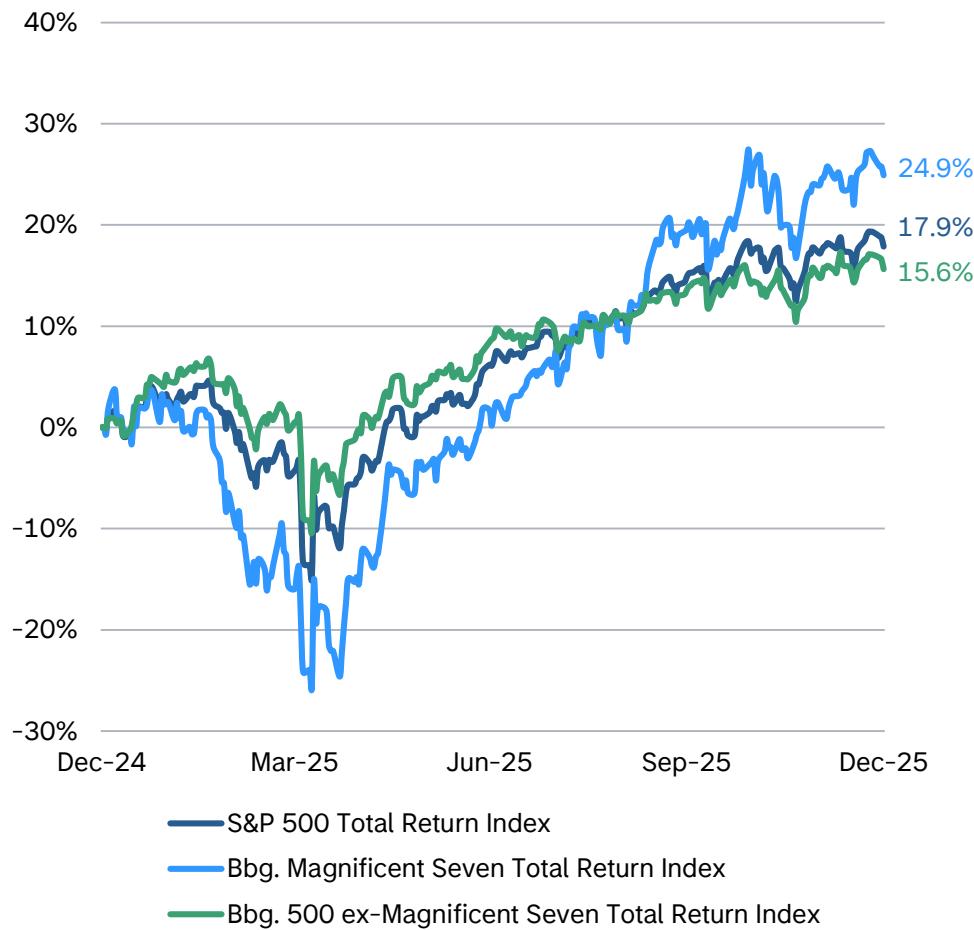
Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# 2025 Surprise #5: Magnificent 7 Dispersion

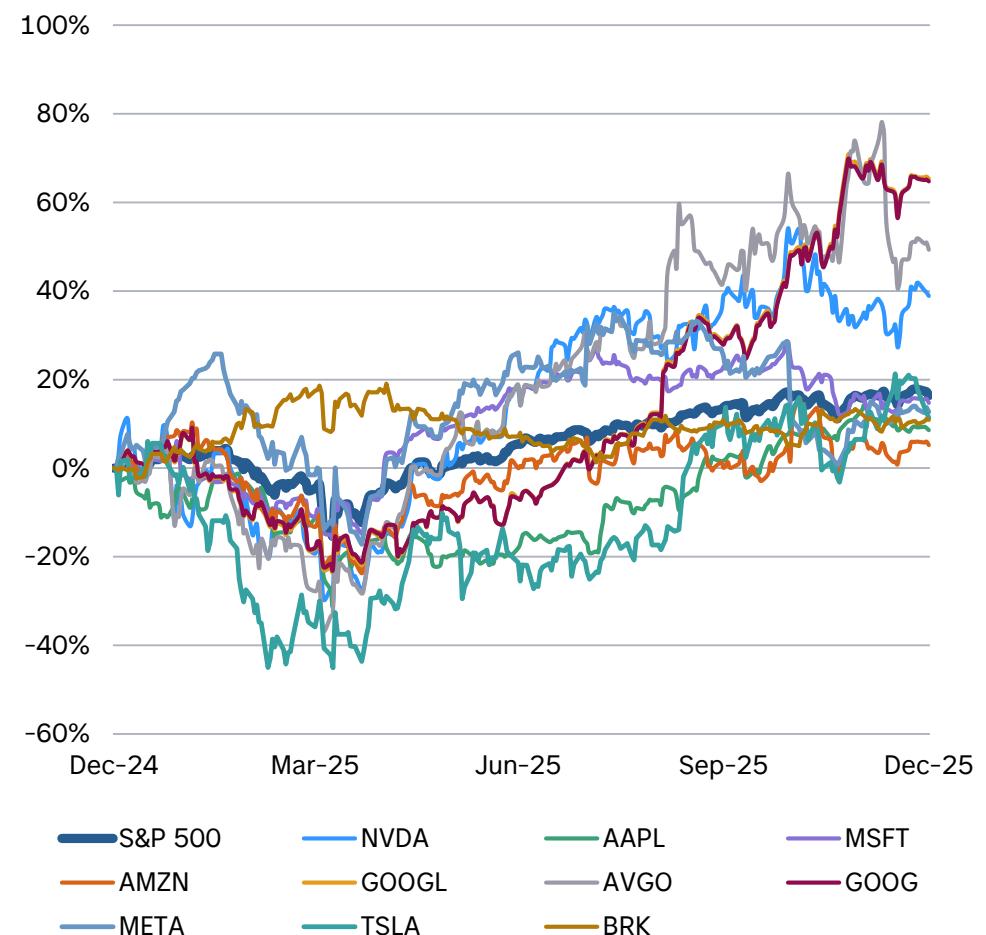
## S&P 500 VS. "S&P 493" VS. MAGNIFICENT SEVEN

AS OF DECEMBER 31, 2025 (DECEMBER 31, 2024 = 0)



## TOP TEN STOCKS BY MARKET CAP VS. S&P 500 PERFORMANCE

AS OF DECEMBER 31, 2025 (DECEMBER 31, 2024 = 0)



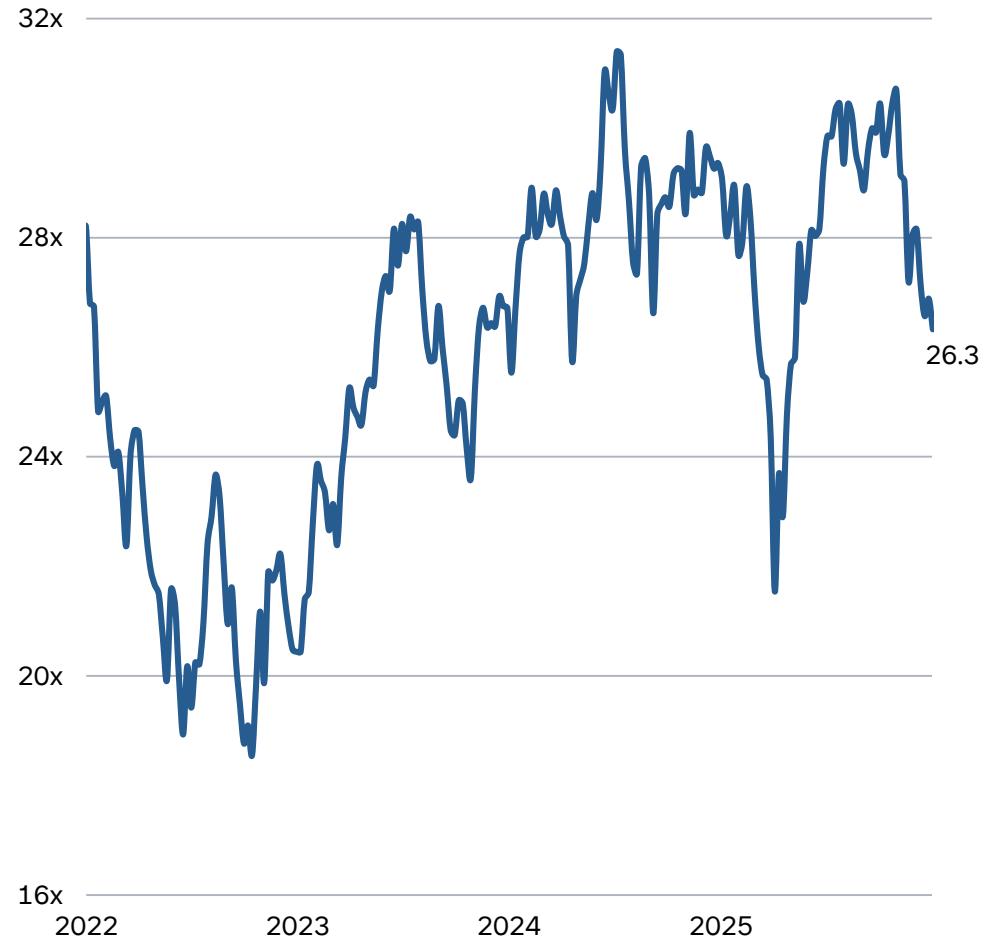
Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# 2025 Surprise #6: Multiple Expansion Ends

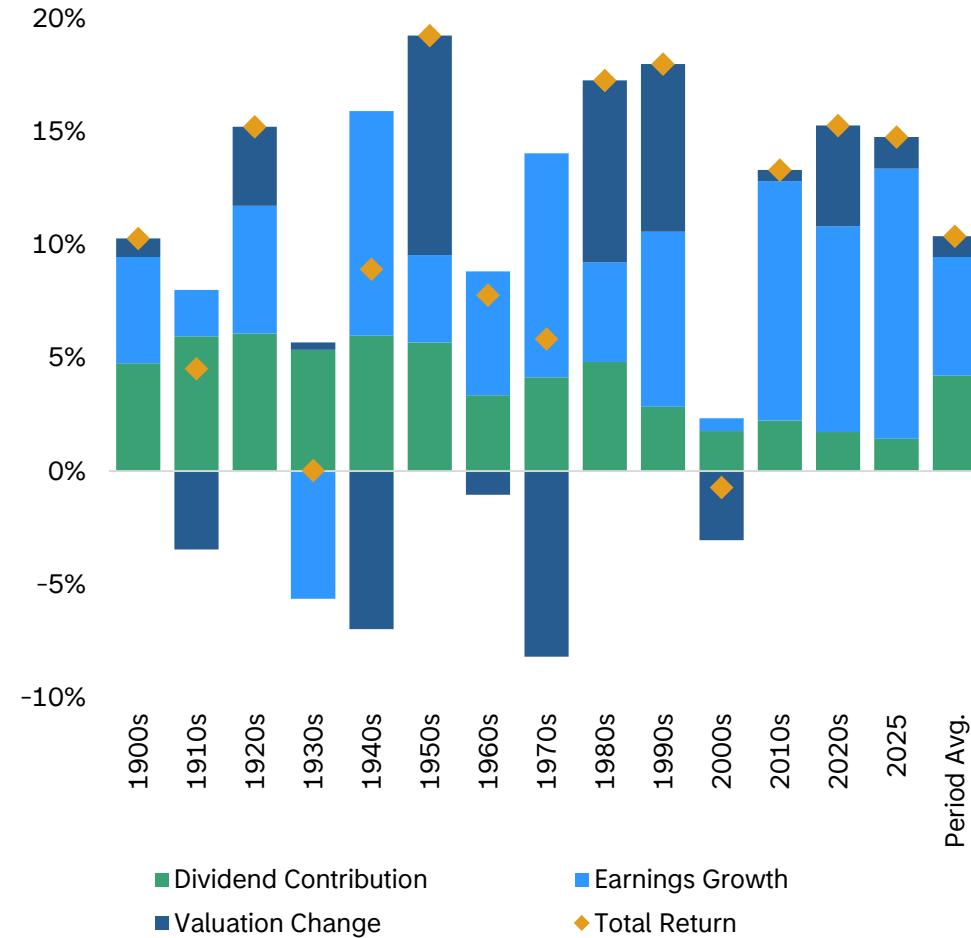
## S&P 500 INFO. TECH. 12-MONTH FORWARD P/E RATIO

AS OF DECEMBER 31, 2025



## S&P 500 DECOMPOSITION BY DECADE (ANN.)

AS OF DECEMBER 31, 2025



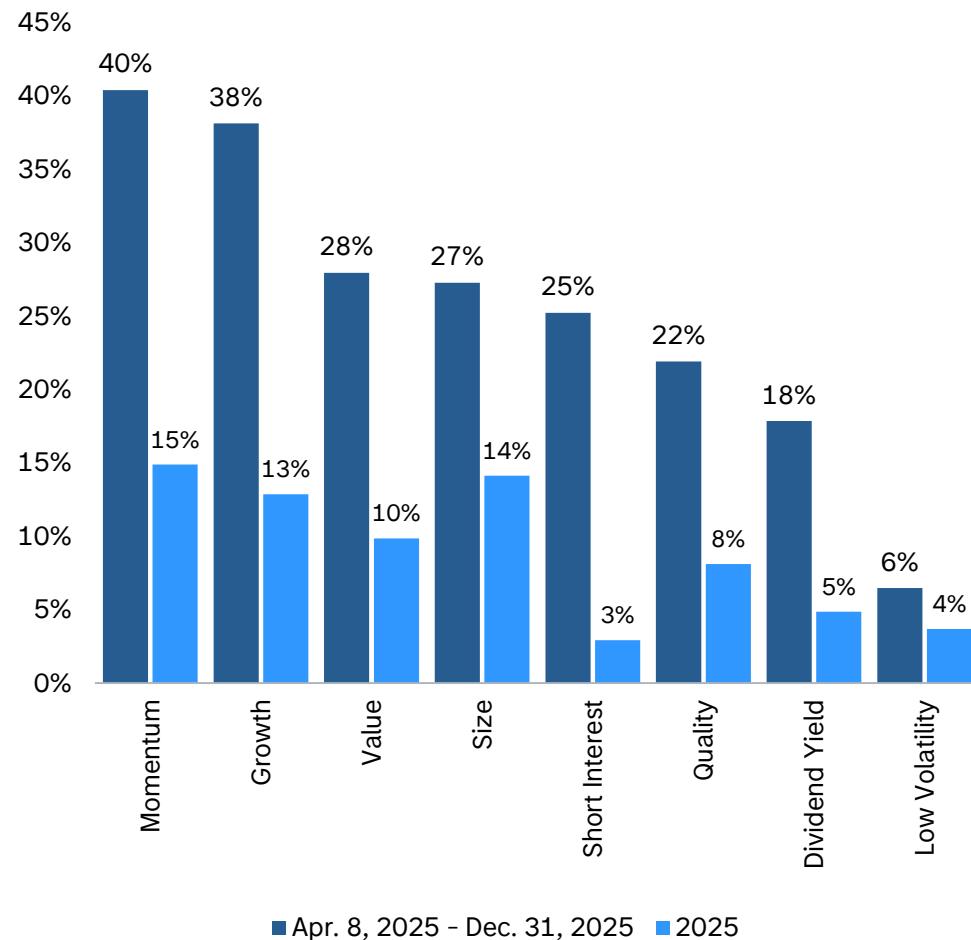
Source: Morgan Stanley Wealth Management GIO, Bloomberg, Robert Schiller, Strategas

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# 2025 Surprise #7: Junk Factors Lead; Small Caps Catch Up

## FACTOR PERFORMANCE

AS OF DECEMBER 31, 2025



## GROWTH VS. VALUE FACTOR INDEX

AS OF DECEMBER 31, 2025



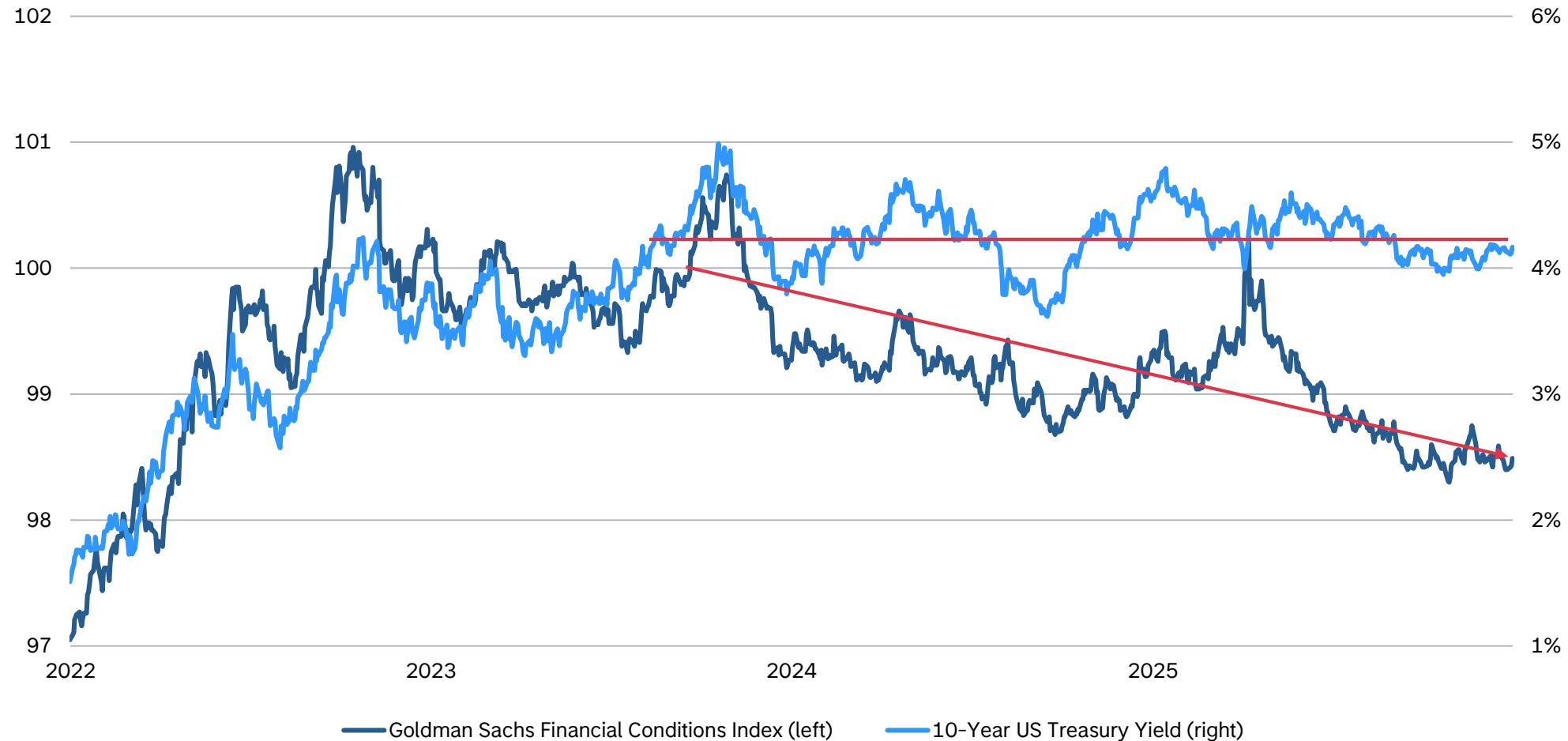
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# 2025 Surprise #8: Despite Anchored 10-Year Rates...Financial Conditions Continue to Ease

## GOLDMAN SACHS FINANCIAL CONDITIONS INDEX VS. 10-YEAR US TREASURY YIELD

AS OF DECEMBER 31, 2025



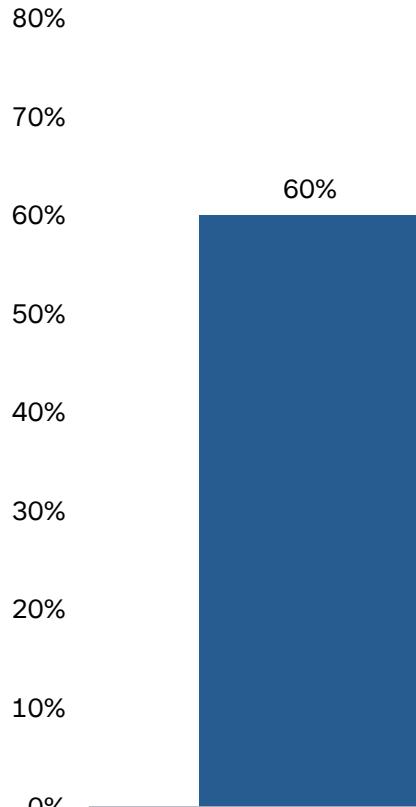
Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# This Three-Year Old Bull Market Has Been One Note

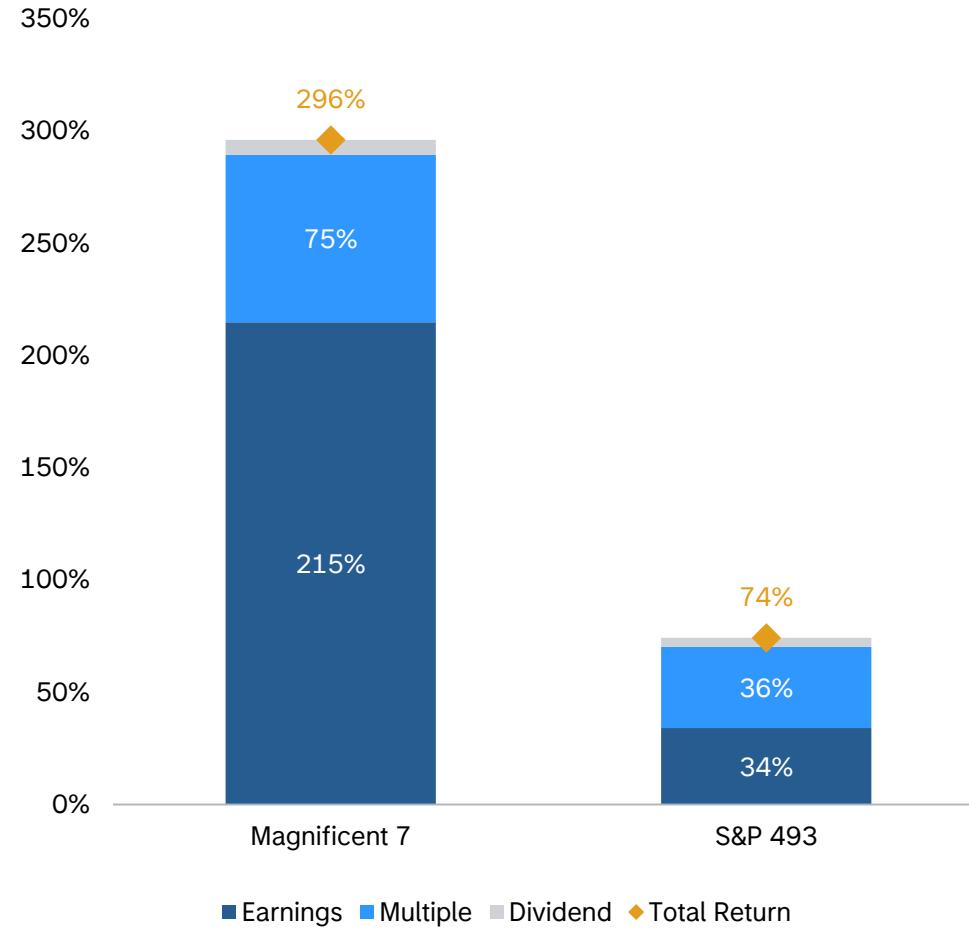
## MAG. 7 SHARE OF S&P 500 GROWTH SINCE OCT. 12, 2022

AS OF DECEMBER 31, 2025



## COMPOSITION OF TOTAL RETURNS SINCE OCT. 12, 2022

AS OF DECEMBER 31, 2025



Source: Morgan Stanley Wealth Management GIO, Bloomberg

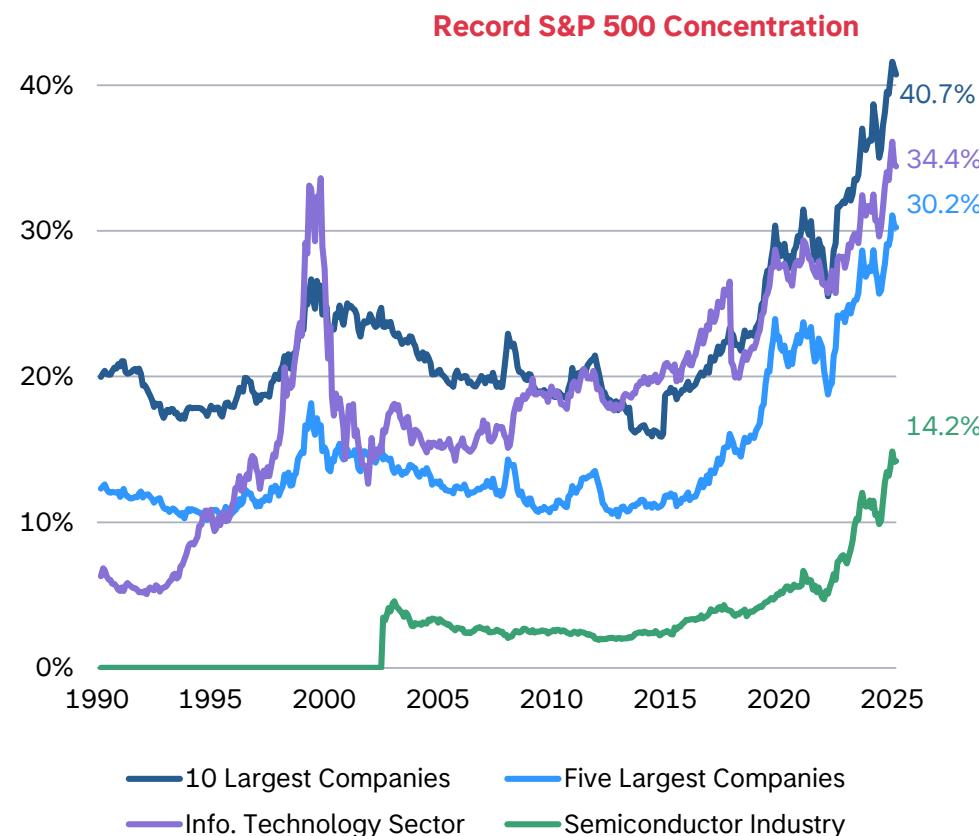
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# Producing a Concentrated and Expensive Market

## COMPOSITION OF S&P 500 BY WEIGHT

AS OF DECEMBER 31, 2025

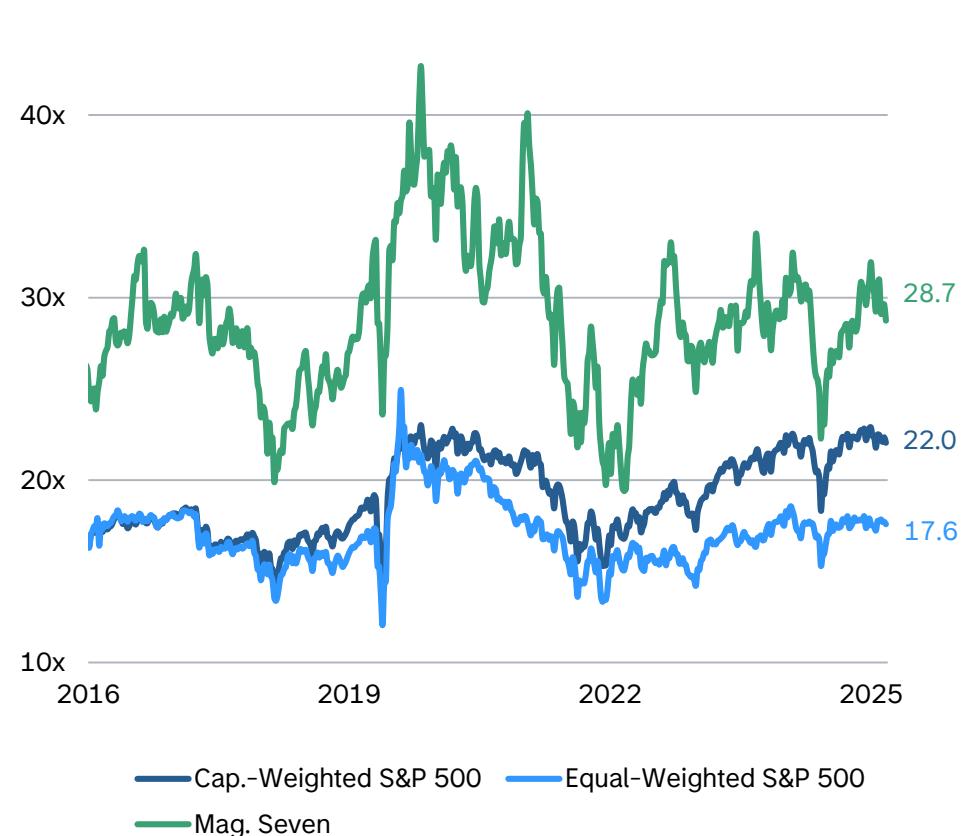
50%



## S&P 500 12-MONTH FORWARD P/E RATIO

AS OF JANUARY 2, 2026

50x



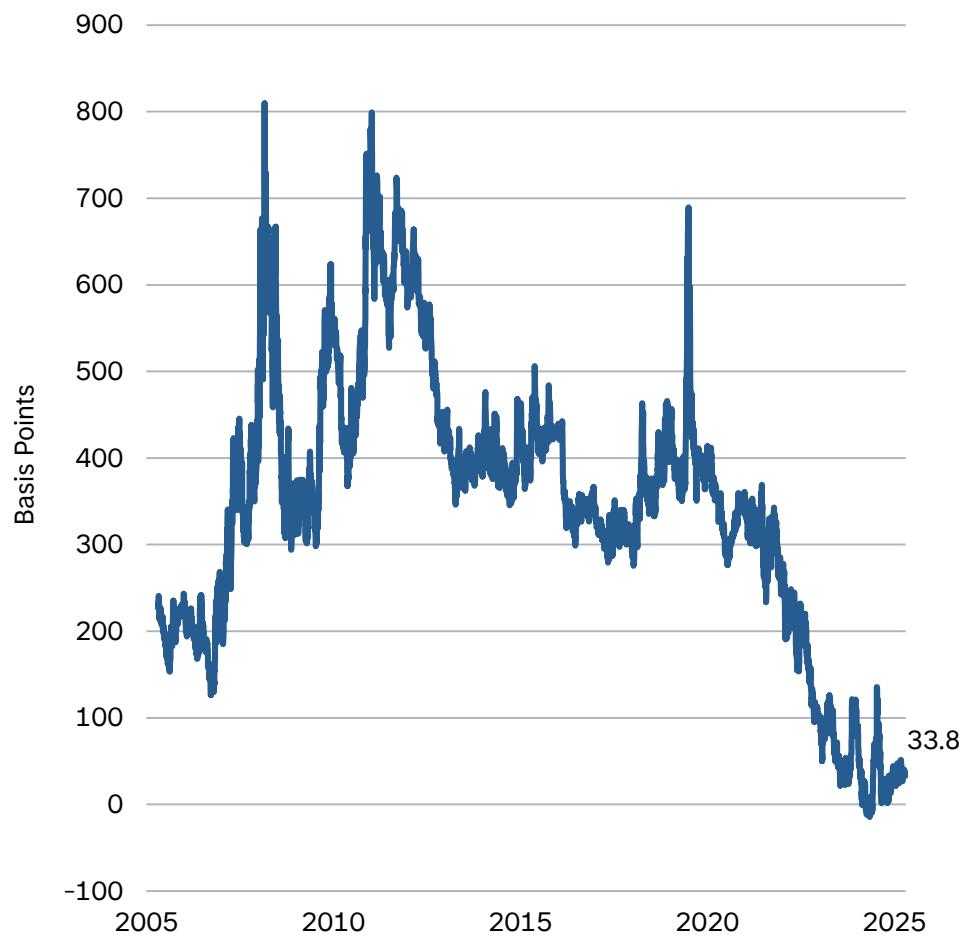
Source: Morgan Stanley Wealth Management GIO, Bloomberg, Strategas

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# Markets Appear Expensive Any Way You Look at It

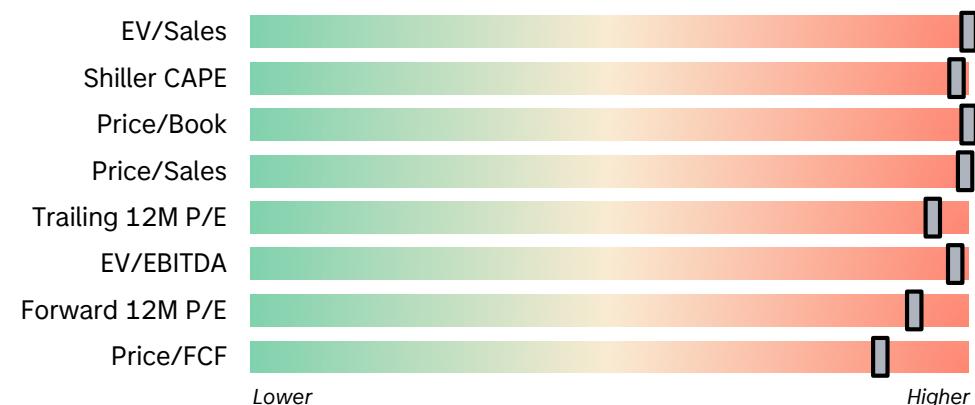
## EQUITY RISK PREMIUM

AS OF JANUARY 8, 2026



## S&P 500 VALUATION PERCENTILE RANKING

AS OF DECEMBER 31, 2025



## BUFFETT INDICATOR: MARKET CAP AS A SHARE OF GDP

AS OF JANUARY 2, 2026



Source: Morgan Stanley Wealth Management GIO, Bloomberg, Strategas. 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.

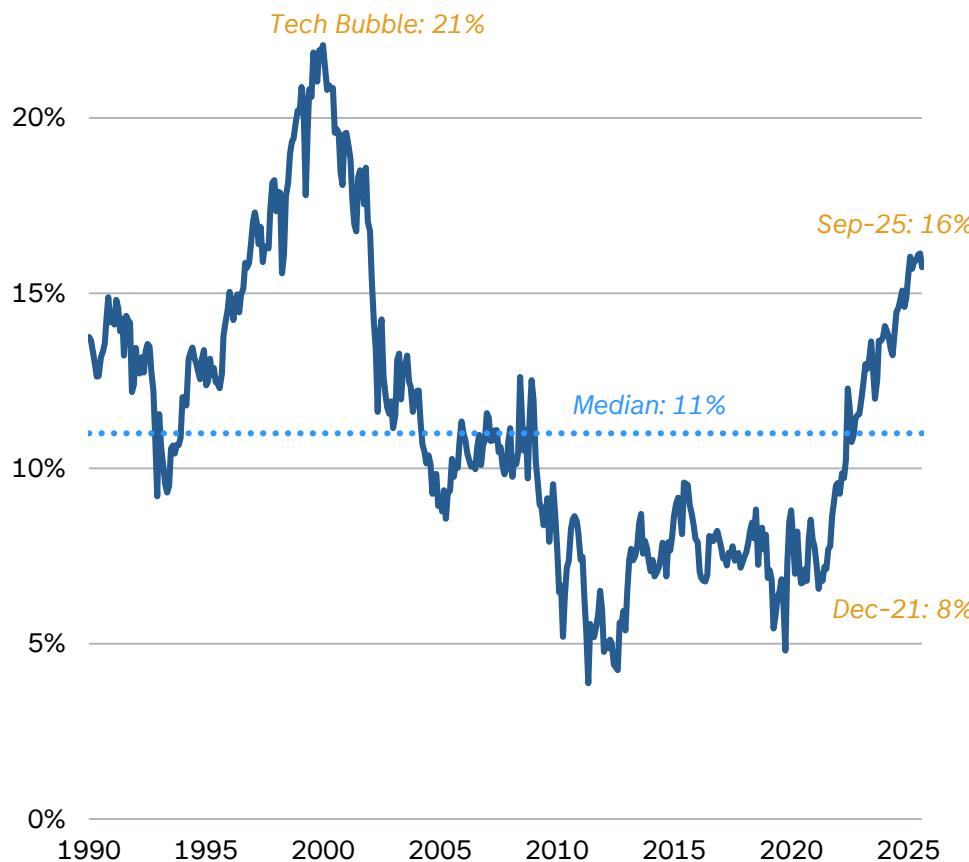
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# Markets Are Priced for Sustained Superior Earnings Growth for a Fourth Year Running

## S&P 500 MARKET-IMPLIED EPS GROWTH

AS OF DECEMBER 31, 2025

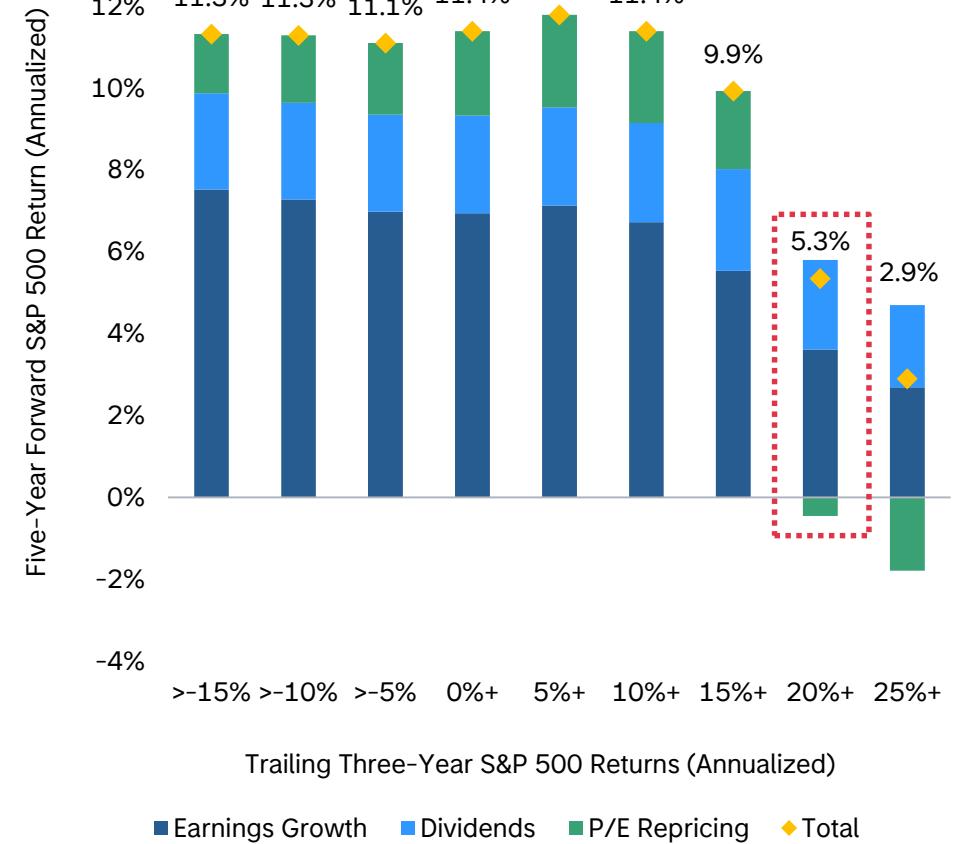
25%



## S&P 500 TRAILING VS. FUTURE PERFORMANCE, 1983-2025

AS OF DECEMBER 31, 2025

14%



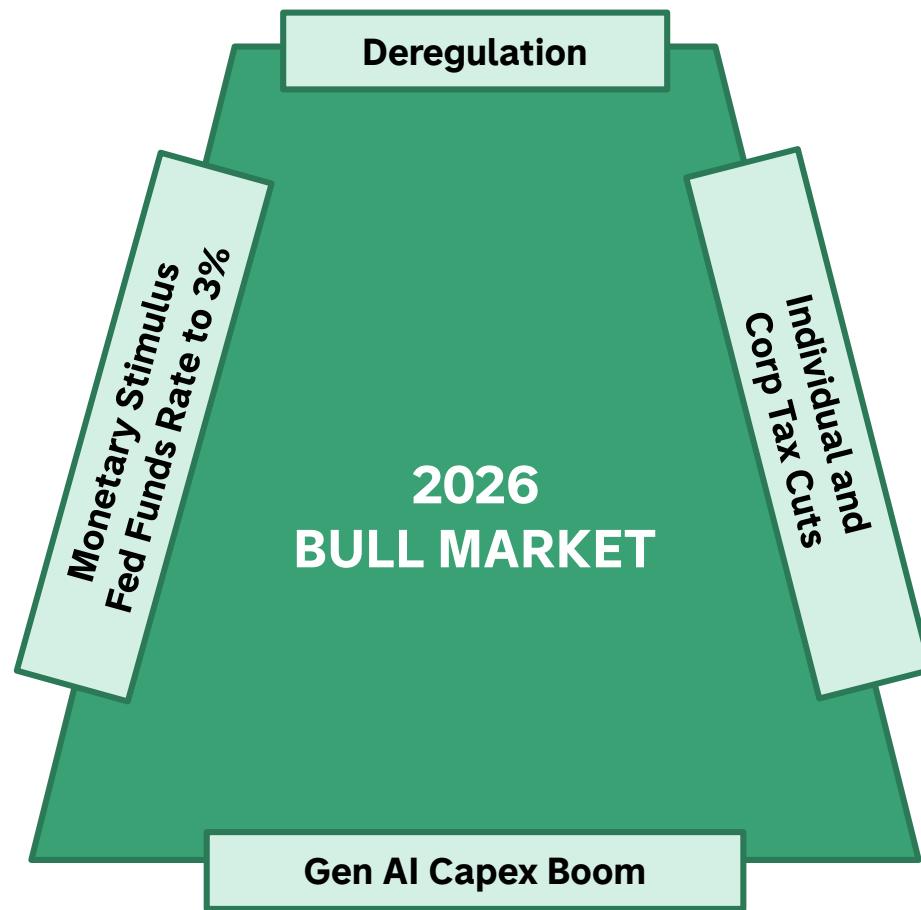
Source: Morgan Stanley Wealth Management GIO, KKR Global Macro & Asset Allocation Analysis. Market-implied EPS growth based on two-stage dividend discount model.

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# The Bull Case in 2026 Is Formidable...But Scope for Upside Surprise Limited

## DRIVERS OF THE 2026 BULL MARKET

AS OF JANUARY 14, 2026



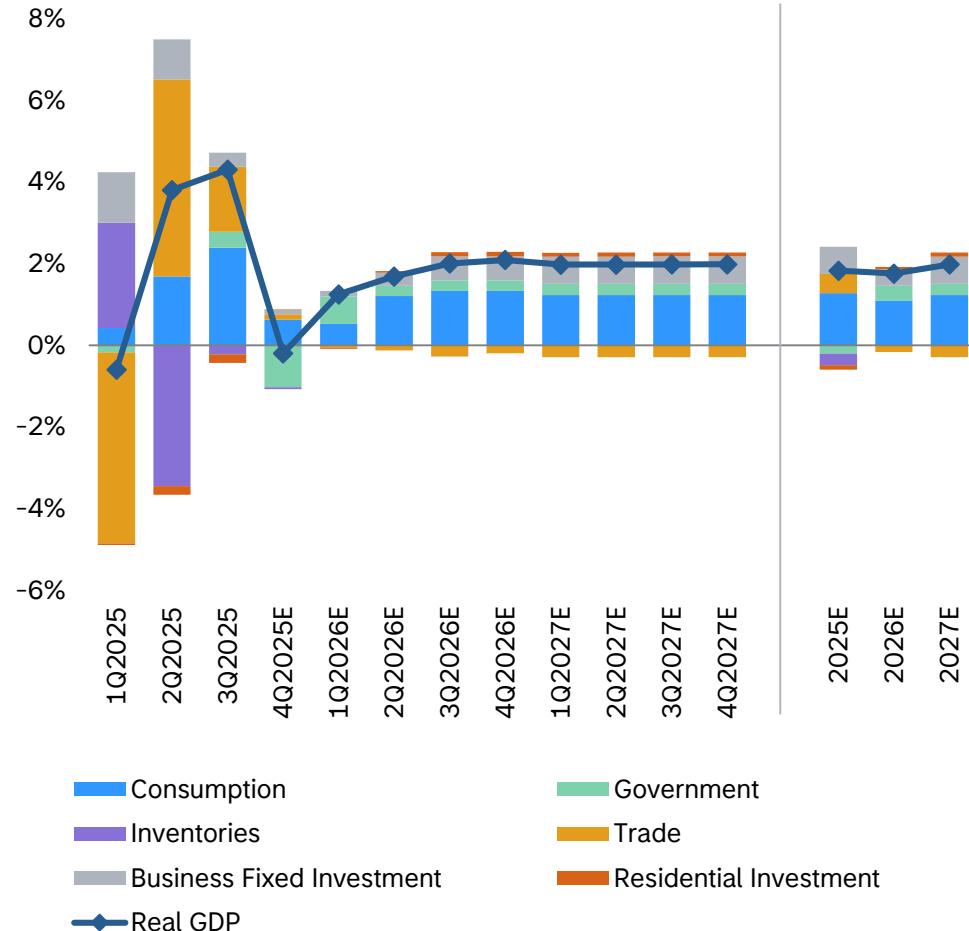
Source: Morgan Stanley Wealth Management GIO

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# GDP Growth Expected to Re-Accelerate Modestly

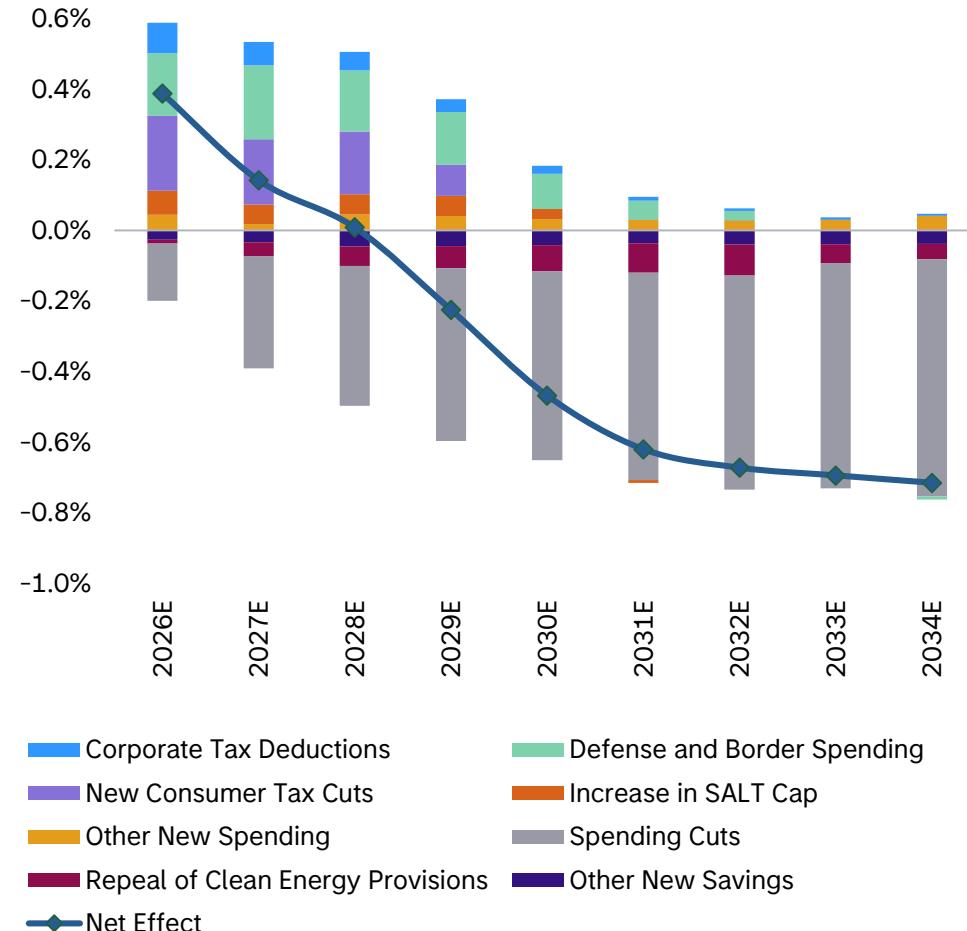
## MS & CO. OUTLOOK: CONTRIBUTIONS TO REAL GDP (ANN.)

AS OF DECEMBER 31, 2025



## MS & CO. OUTLOOK: OBBBA FISCAL EFFECTS ON GDP

AS OF DECEMBER 31, 2025



Source: Morgan Stanley Wealth Management GIO, Morgan Stanley & Co. (MS & Co.) Research, Bloomberg. Estimates are from MS & Co. Research US Economics Team.

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# Another 50bps of Rate Cuts Priced Through 2026

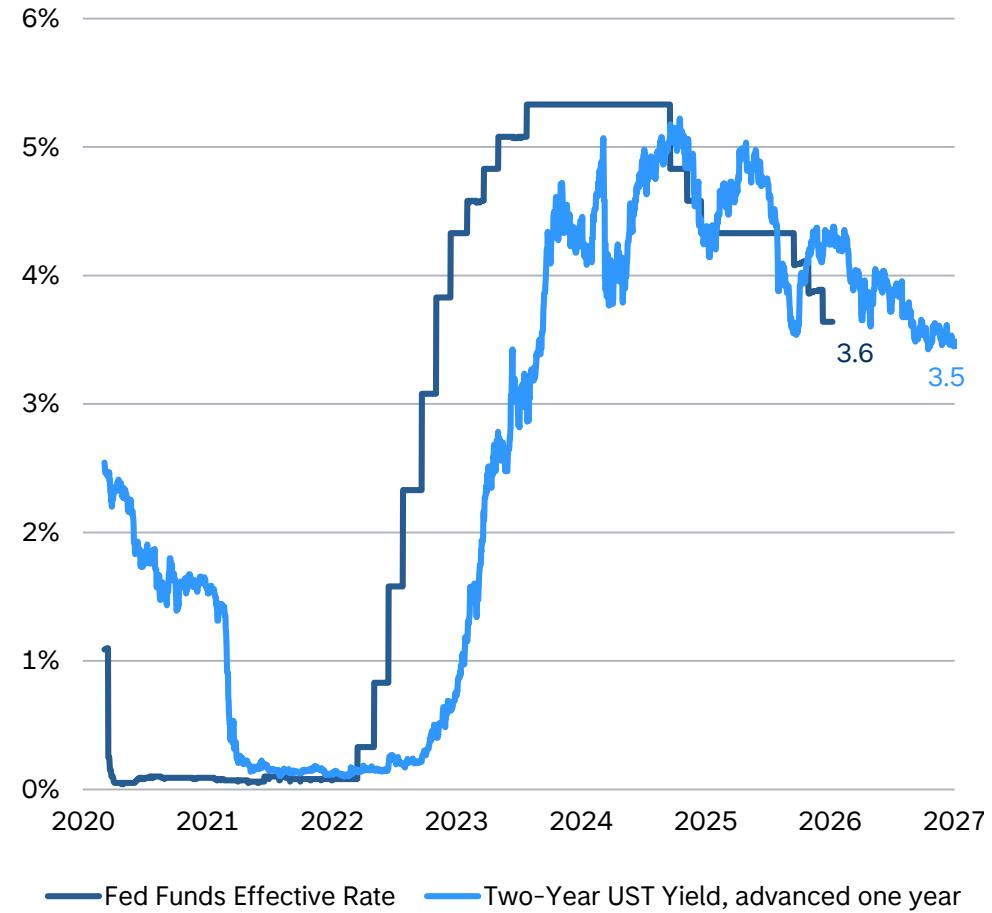
## 25-BP FED RATE CUTS PRICED THROUGH DEC. 2026

AS OF JANUARY 7, 2026



## FED FUNDS EFFECTIVE RATE VS. TWO-YEAR US TREASURY

AS OF JANUARY 7, 2026



Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# Earnings Expectations for 2026 Are Ambitious

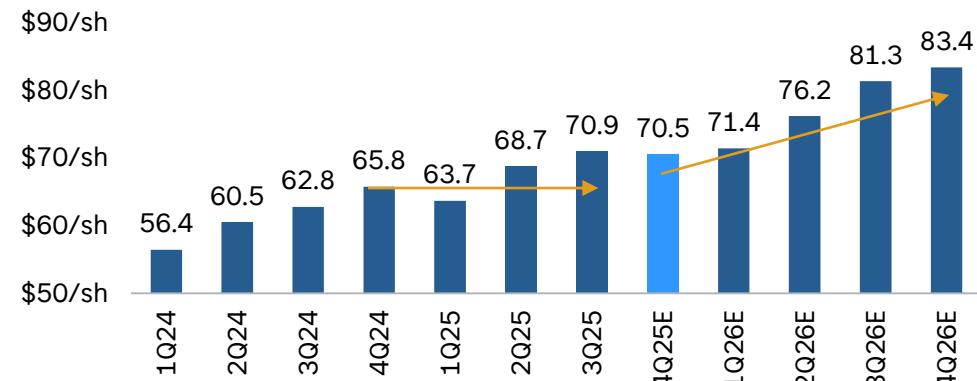
## S&P 500 EARNINGS REVISIONS BREADTH

AS OF JANUARY 9, 2026



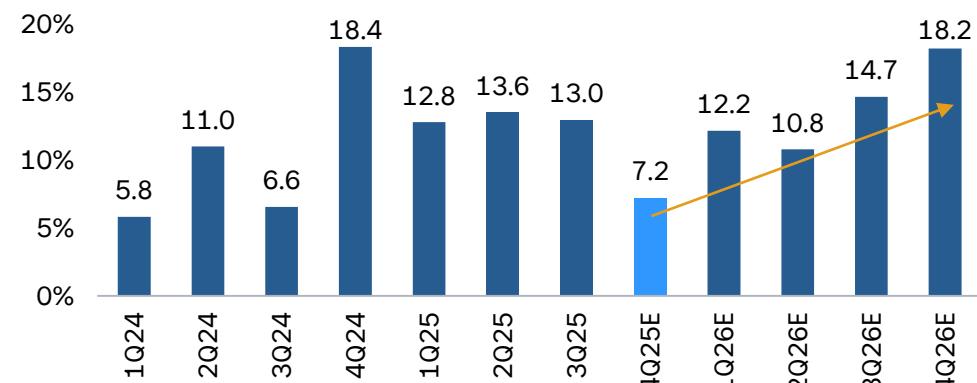
## S&P 500 CONSENSUS EPS

AS OF JANUARY 9, 2026



## S&P 500 CONSENSUS EPS YEAR-OVER-YEAR GROWTH

AS OF JANUARY 9, 2026



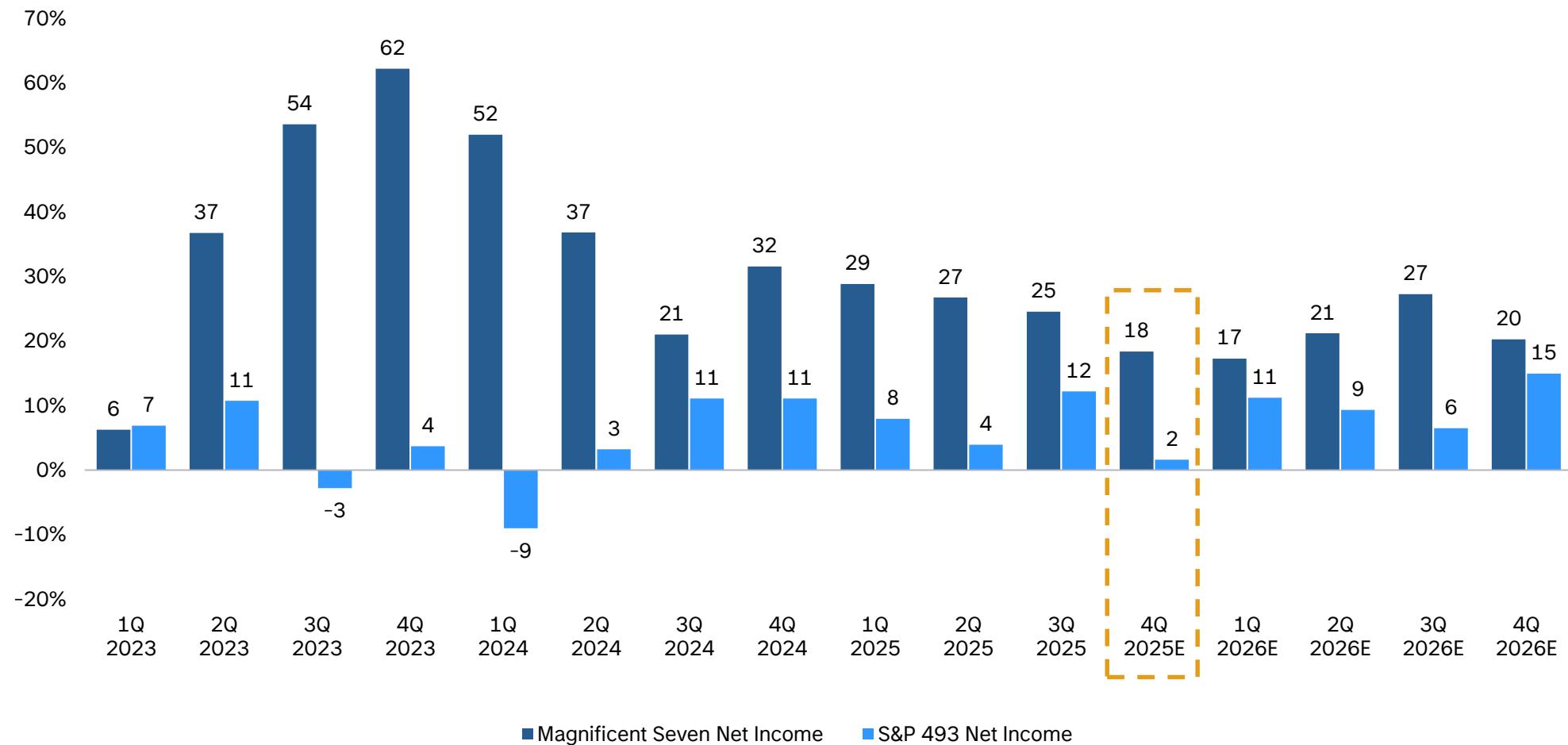
Source: Morgan Stanley Wealth Management GIO, MS & Co. Research. Earnings revisions breadth is defined as the number of positive analyst revisions minus the number of negative analyst revisions divided by the total number of revisions.

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# 2026 DEPENDS on “493” Reacceleration

## MAGNIFICENT SEVEN AND S&P 493 NET INCOME YEAR-OVER-YEAR GROWTH

AS OF JANUARY 9, 2026



Source: Morgan Stanley Wealth Management GIO, MS & Co. Research, consensus estimates

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# And Historically Exceptional Margins....Productivity

## S&P 500 OPERATING MARGIN

AS OF JANUARY 8, 2026



Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# Controversy #2: Disinflationary Boom?

Markets Are Pricing Cyclical Reacceleration

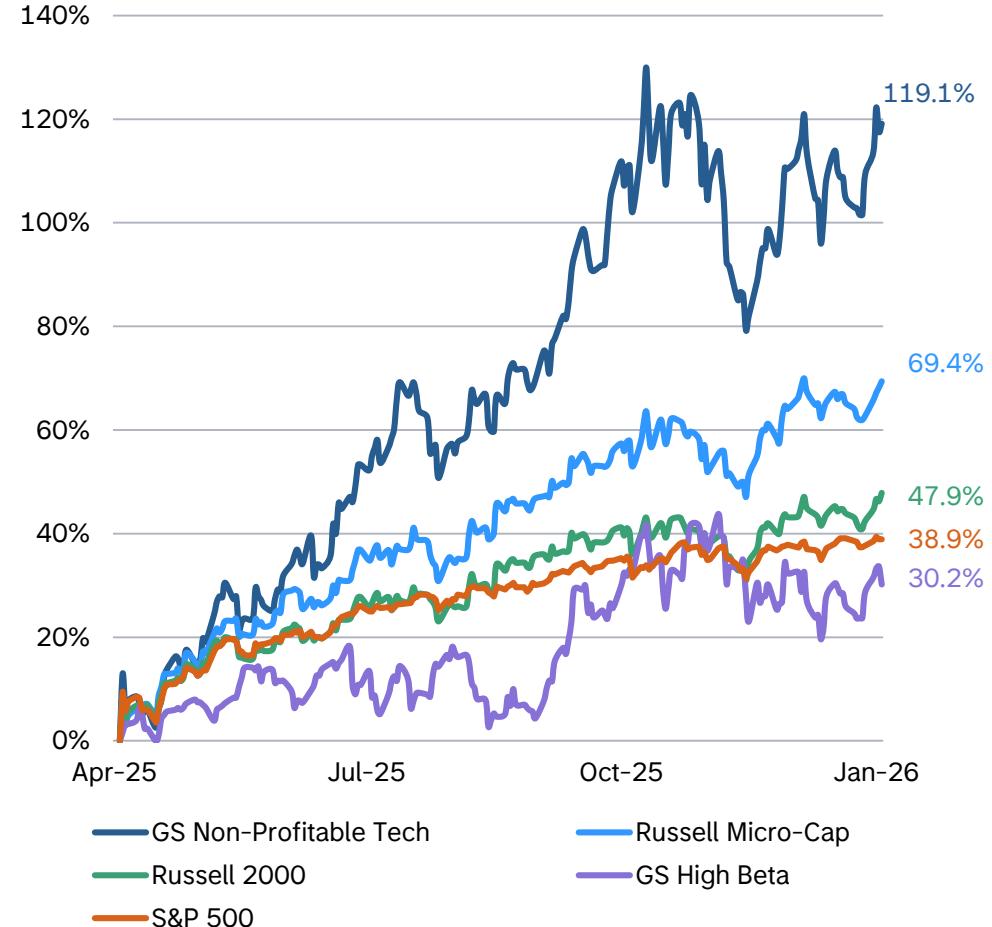
## GOLDMAN SACHS CYCLICALS VS. DEFENSIVES

AS OF JANUARY 9, 2026



## PERFORMANCE SINCE THE APRIL 8, 2025 TROUGH

AS OF JANUARY 8, 2026



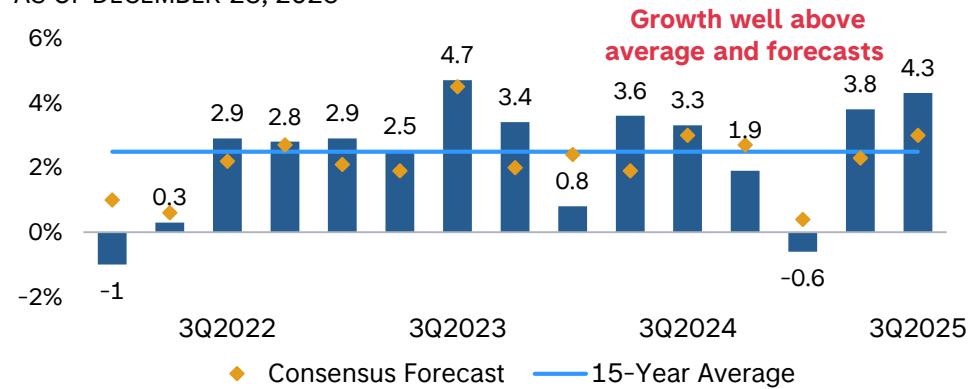
Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# Recession Has Been Nowhere in Sight; GDP Growth Healthy

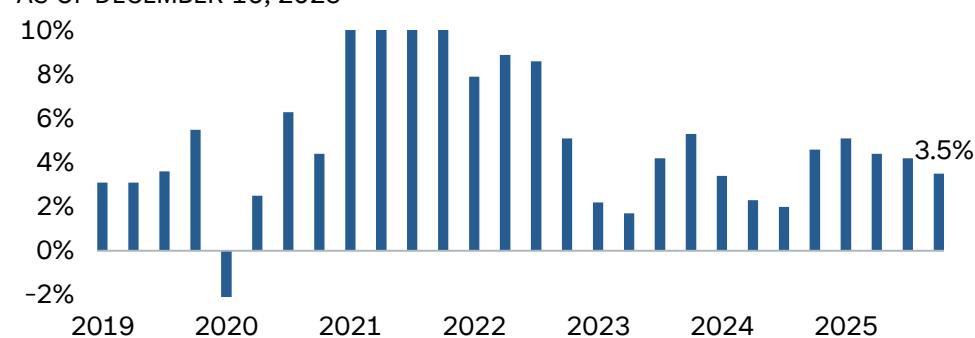
## QUARTERLY REAL GDP (ANNUALIZED)

AS OF DECEMBER 23, 2025



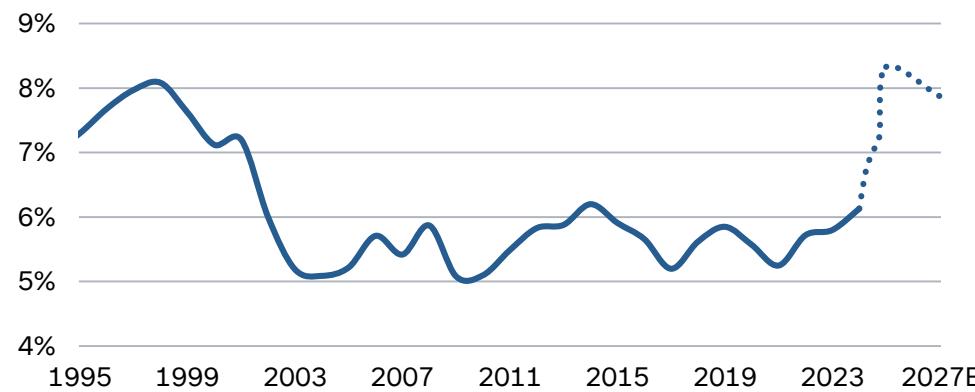
## US RETAIL SALES, YEAR-OVER-YEAR

AS OF DECEMBER 16, 2025



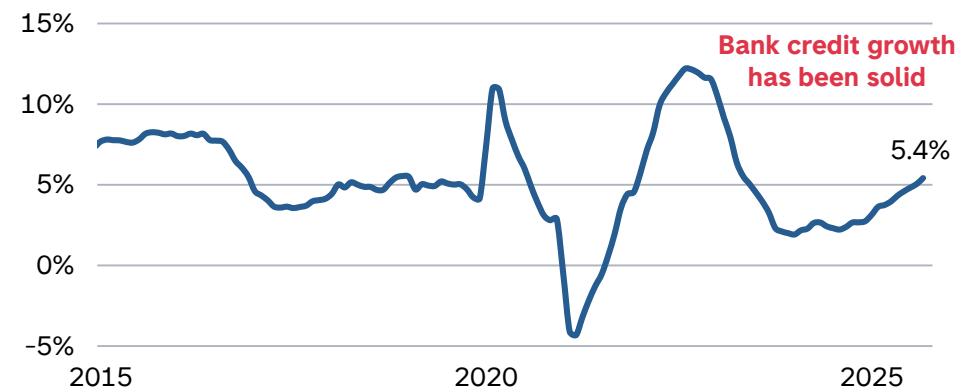
## S&P 500 CAPEX AS A SHARE OF SALES

AS OF JANUARY 9, 2026



## US BANK TOTAL LOANS, YEAR-OVER-YEAR

AS OF DECEMBER 31, 2025



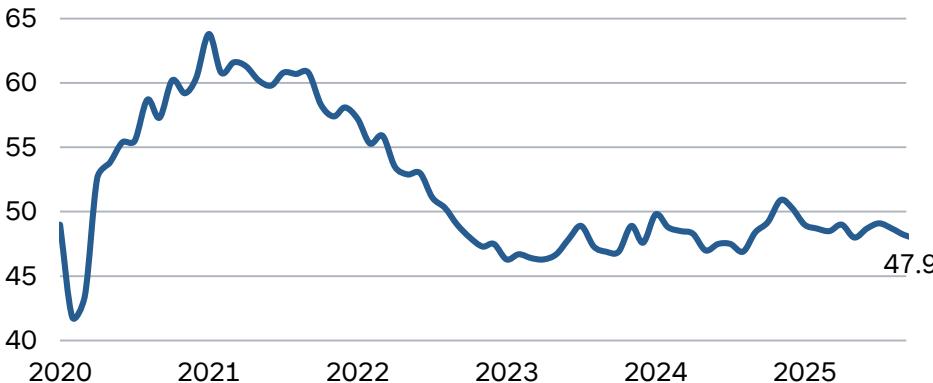
Source: Morgan Stanley Wealth Management GIO, Bloomberg. Capex as a share of sales uses consensus estimates. Retail sales data truncated for COVID-era.

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# But Manufacturing Is Lackluster and Sentiment Weak...No Evidence of Broadening Capex Boom

## ISM MANUFACTURING

AS OF DECEMBER 31, 2025



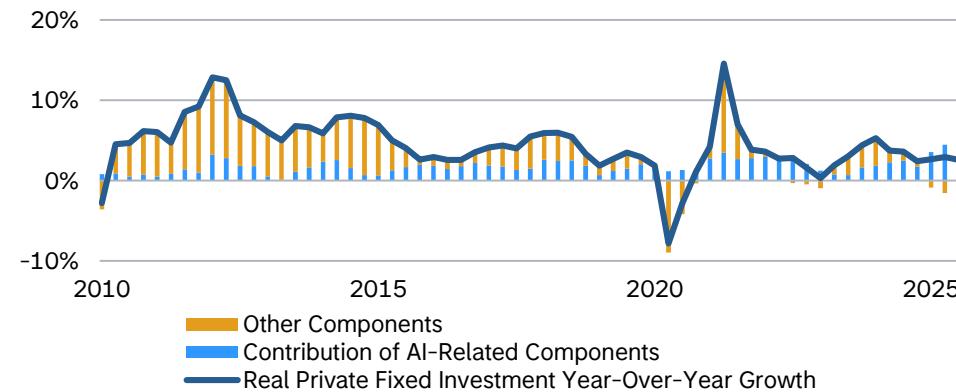
## US ROUNDTABLE CEO ECONOMIC CONDITIONS SURVEY

AS OF DECEMBER 31, 2025



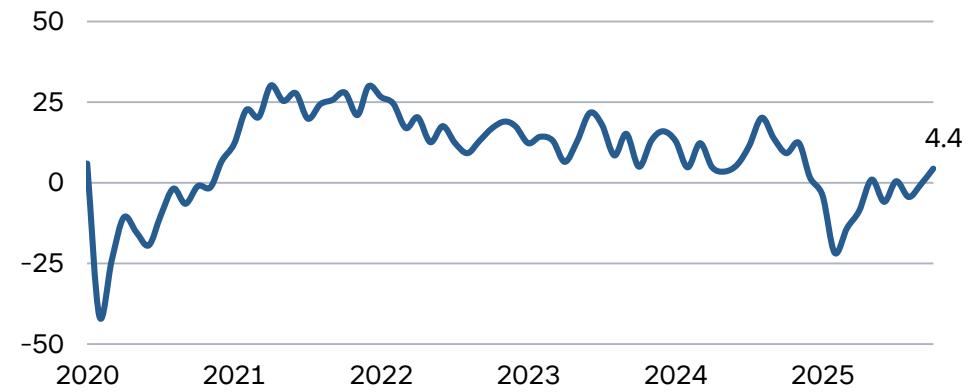
## CONTRIBUTIONS TO REAL PRIVATE FIXED INVESTMENT

AS OF DECEMBER 31, 2025



## CEO INTENTIONS OF CAPEX IN SIX MONTHS

AS OF DECEMBER 31, 2025



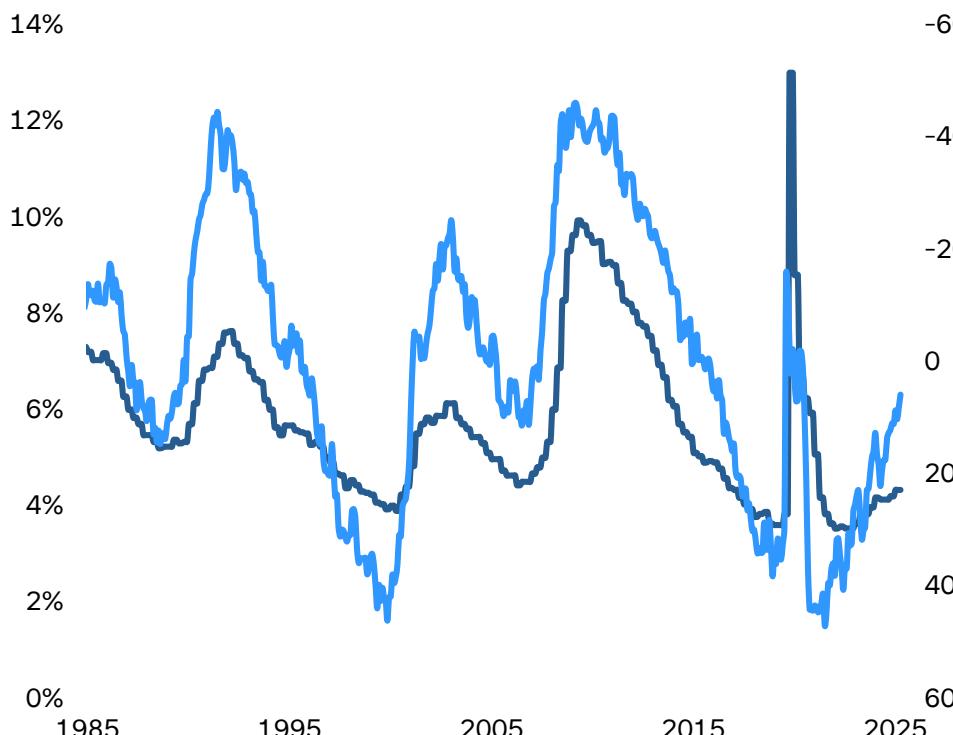
Source: Morgan Stanley Wealth Management GIO, Bloomberg, Pantheon Macro

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# Labor Market Looks Fragile; Gets Worse Before It Gets Better

## UNEMPLOYMENT RATE VS. LABOR DIFFERENTIAL

AS OF DECEMBER 31, 2025

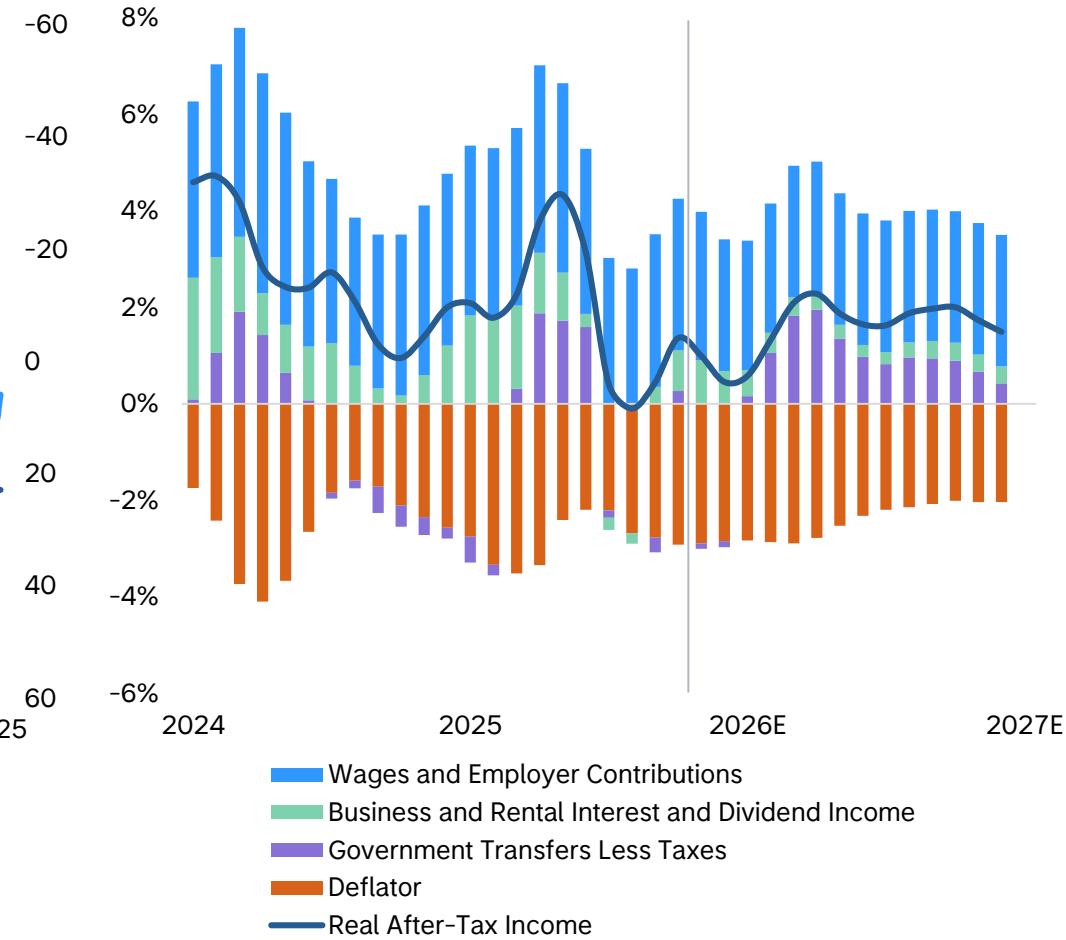


— Unemployment Rate (left)

— Conference Board Labor Differential, inverted (right)

## REAL AFTER-TAX INCOME, QUARTER OVER QUARTER (ANN.)

AS OF DECEMBER 31, 2025



- Wages and Employer Contributions
- Business and Rental Interest and Dividend Income
- Government Transfers Less Taxes
- Deflator
- Real After-Tax Income

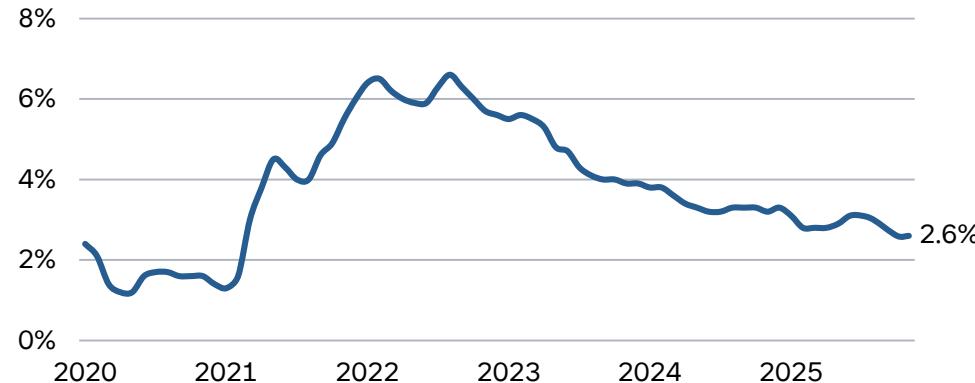
Source: Morgan Stanley Wealth Management GIO, Bloomberg, Pantheon Macro. Consensus estimates are from Pantheon Macro.

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# Controversy #3: Inflation Is Tamed?

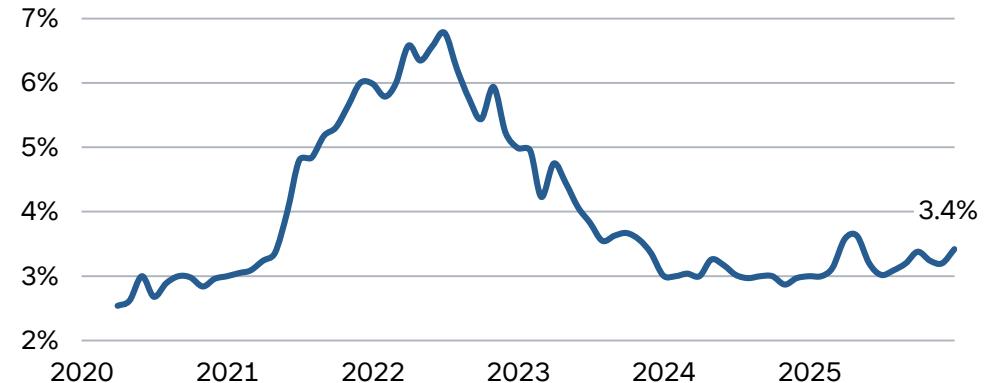
## US CORE CPI YEAR-OVER-YEAR CHANGE

AS OF DECEMBER 31, 2025



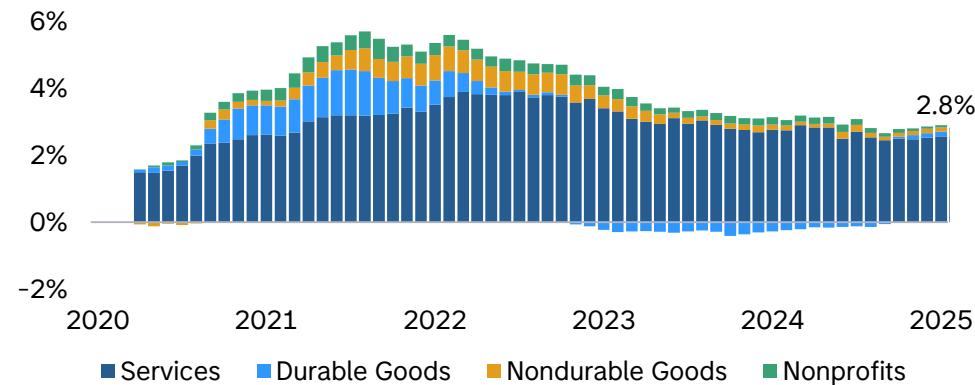
## NY FED ONE-YEAR INFLATION EXPECTATIONS

AS OF DECEMBER 31, 2025



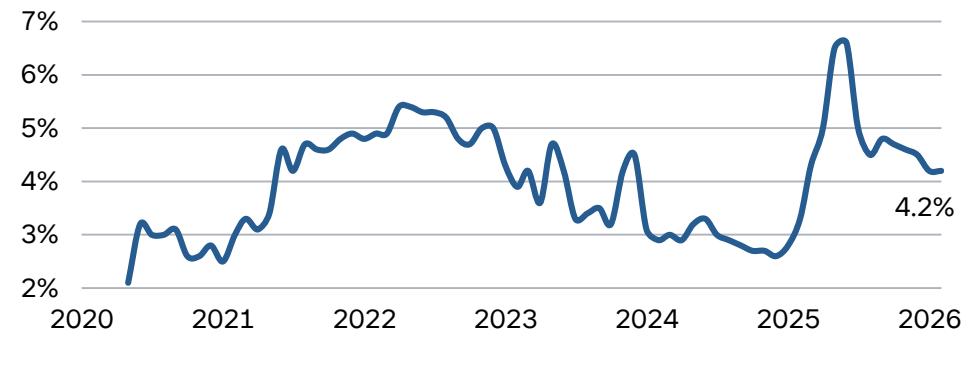
## CONTRIBUTIONS TO CORE PCE, YEAR-OVER-YEAR

AS OF DECEMBER 5, 2025



## U. MICHIGAN ONE-YEAR INFLATION EXPECTATIONS

AS OF JANUARY 9, 2026



Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# Markets Are Very Relaxed About Inflation Risk

## ZERO-COUPON INFLATION SWAP RATES

AS OF JANUARY 9, 2026

4.0%

3.5%

3.0%

2.5%

2.0%

1.5%

Jan-24

Apr-24

Jul-24

Oct-24

Jan-25

Apr-25

Jul-25

Oct-25

Jan-26

One-Year      Two-Year      One-Year, One-Year Forward      Five-Year, Five-Year Forward

2.45%  
2.40%  
2.40%  
2.39%

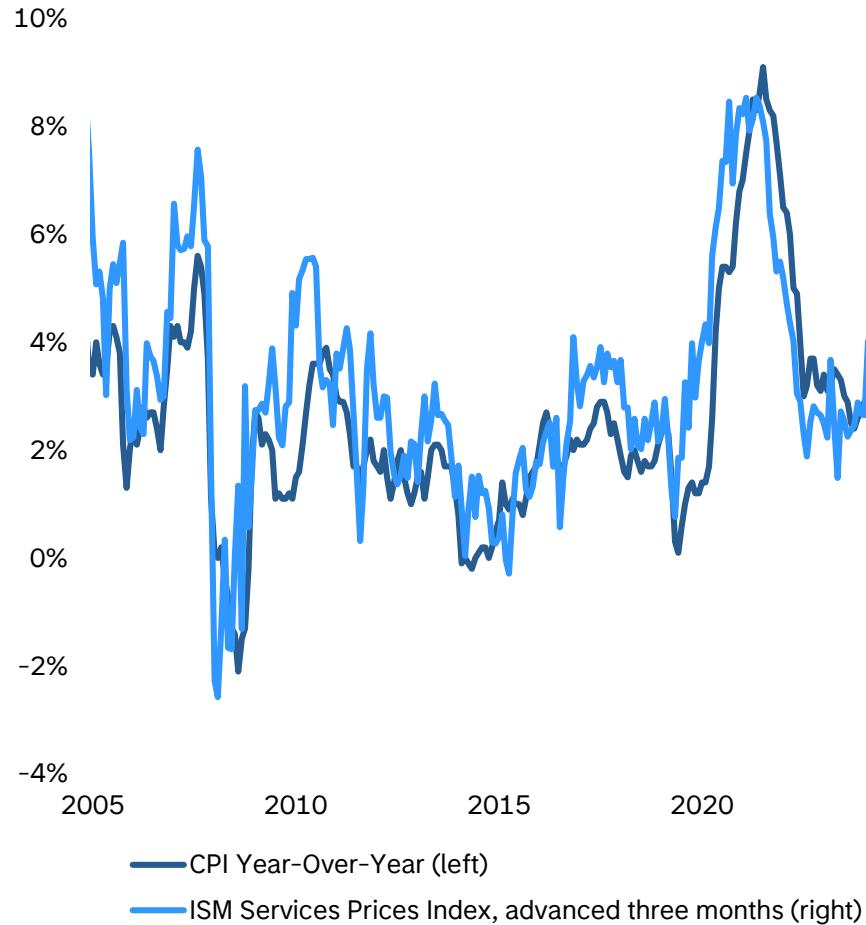
Source: Morgan Stanley Wealth Management GIO, Pantheon Macro

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# Pricing Pressure in the Supply Chain Is Building

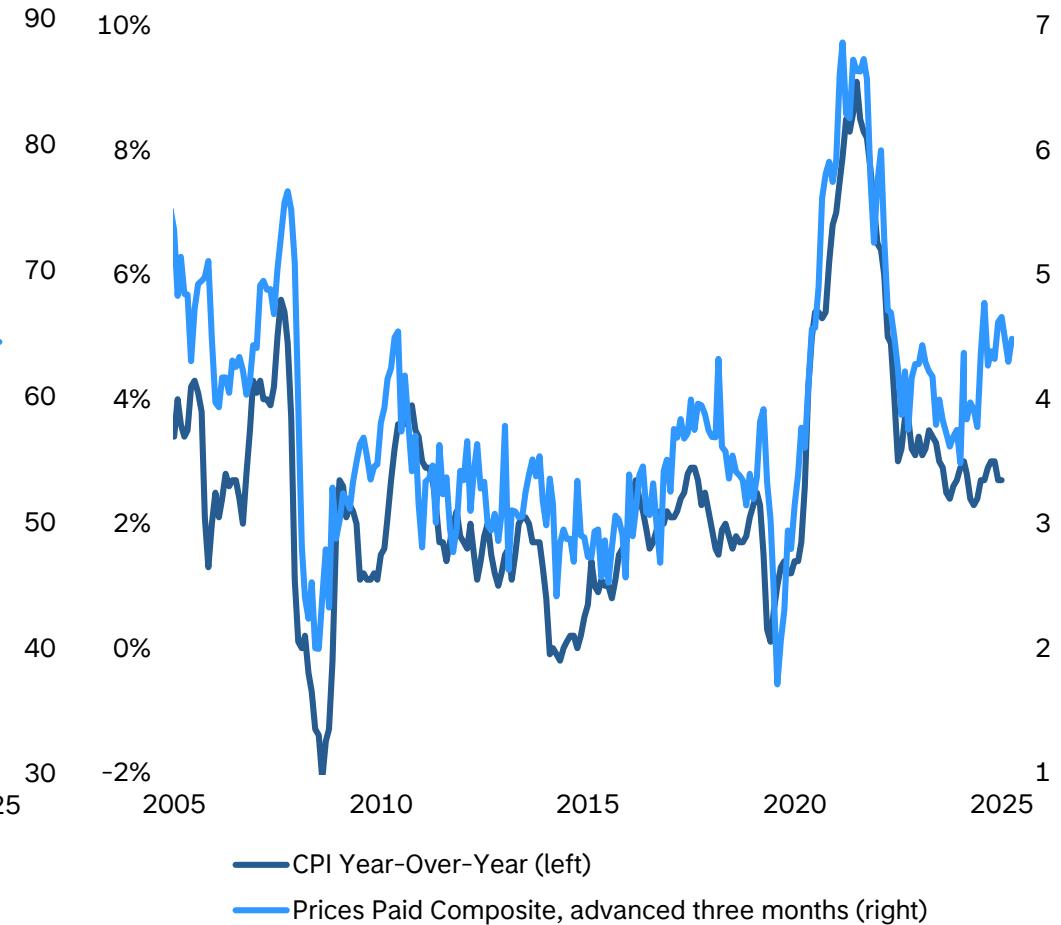
## ISM SERVICES PRICES INDEX VS. CPI

AS OF DECEMBER 31, 2025



## NFIB AND REGIONAL FED SURVEYS PRICES PAID VS. CPI

AS OF DECEMBER 31, 2025



Source: Morgan Stanley Wealth Management GIO, Bloomberg. Prices Paid Composite use the average of the NFIB Selling Prices Survey, ISM Prices Paid, and the Federal Reserve Bank of Philadelphia Prices Paid Manufacturing Survey.

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# Controversy #3: Fiscal Dominance Is Here

Especially if Fed Independence Is Questioned

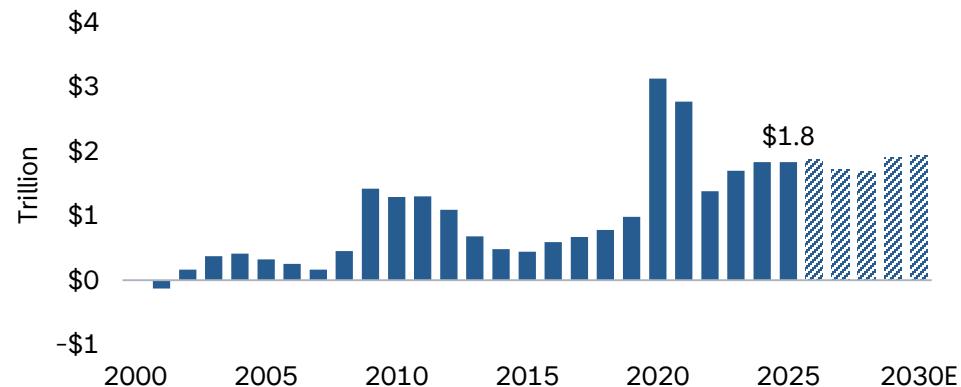
## FEDERAL BALANCE SHEET FORECAST

AS OF DECEMBER 31, 2025



## US BUDGET DEFICIT PROJECTIONS

AS OF DECEMBER 31, 2025



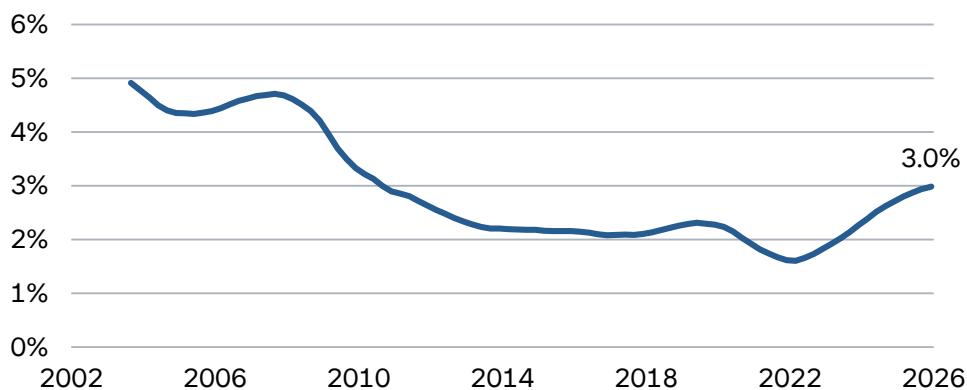
## US INTEREST OUTLAY AS A SHARE OF TAX REVENUE

AS OF DECEMBER 31, 2025



## US GOVERNMENT WEIGHTED AVERAGE COST OF DEBT

AS OF JANUARY 7, 2026



Source: Morgan Stanley Wealth Management GIO, MS & Co. Research, Bloomberg, Congressional Budget Office (CBO), FRED. US Deficit estimates are from CBO. Federal Balance Sheet estimates are from the MS & Co. Research US Economics Team.

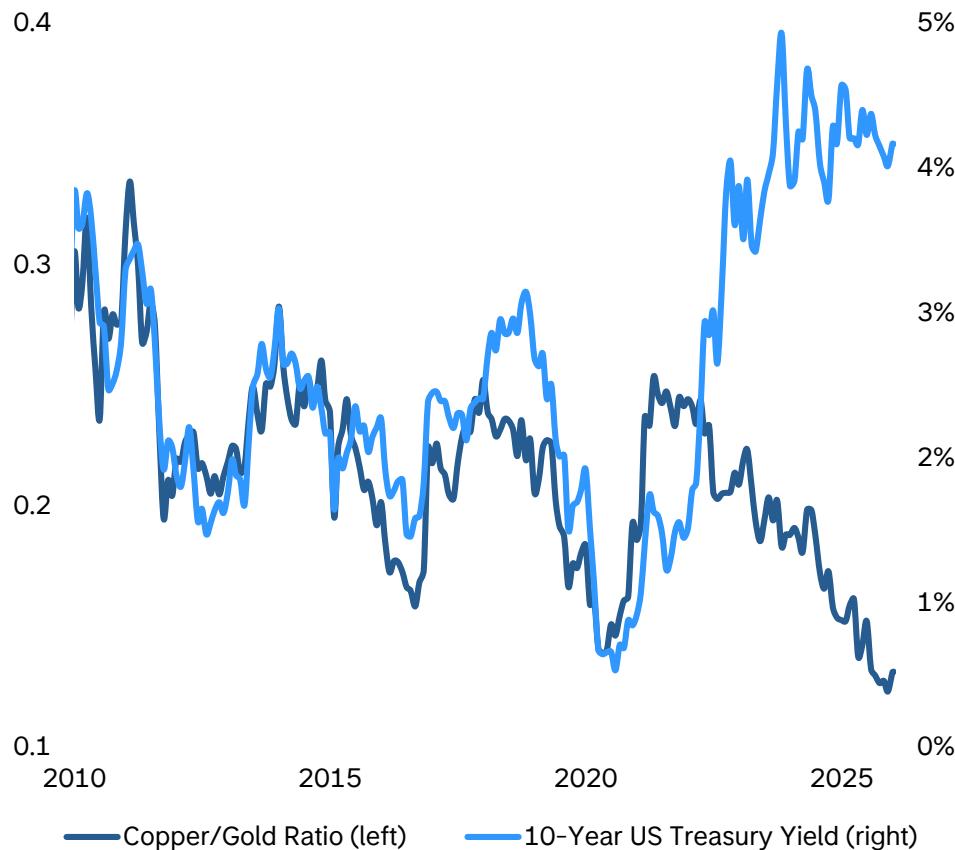
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# US Treasuries Are Signaling a Regime Change...

## COPPER/GOLD RATIO VS. 10-YEAR US TREASURY YIELD

AS OF JANUARY 9, 2026

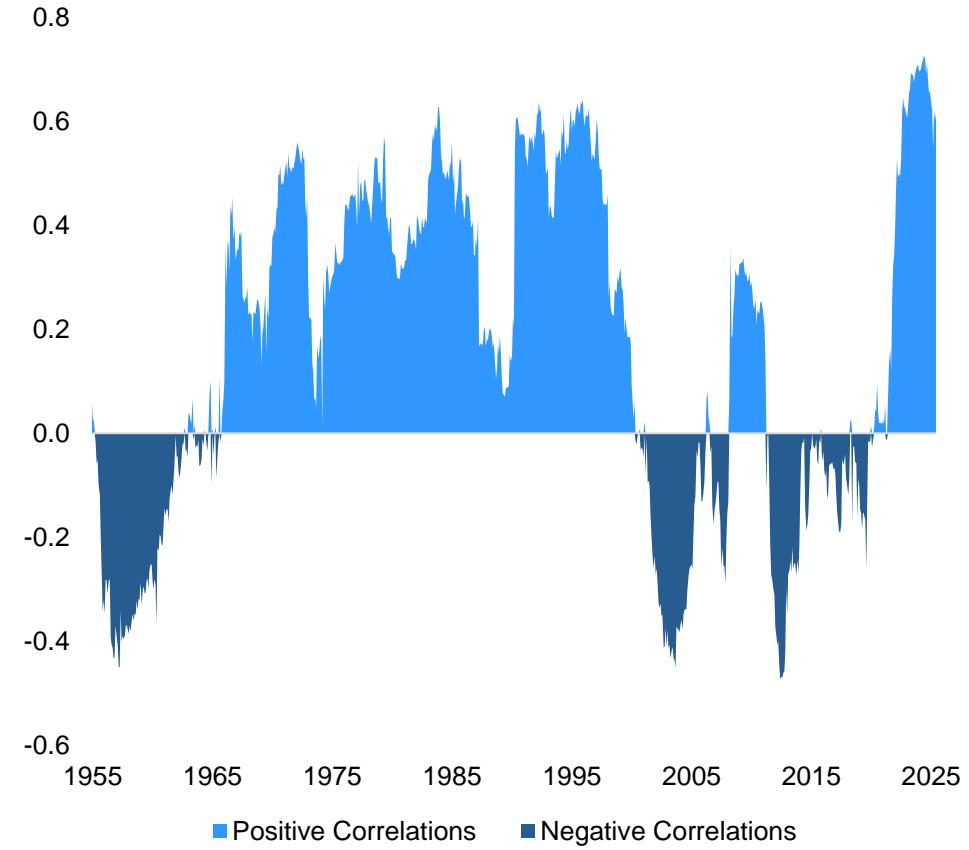
0.4



## ROLLING THREE-YEAR STOCK-BOND CORRELATIONS

AS OF DECEMBER 31, 2025

0.8



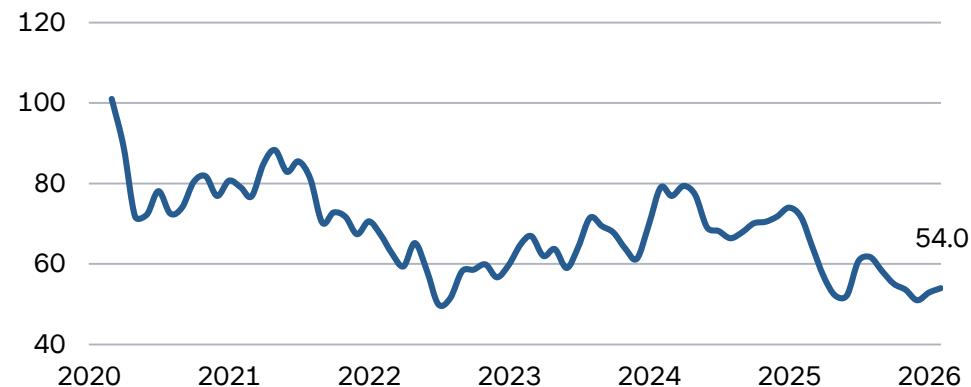
Source: Morgan Stanley Wealth Management GIO, Bloomberg. Correlation is a statistical measure of how two securities move in relation to each other. This measure is often converted into what is known as correlation coefficient, which ranges between -1 and +1. Perfect positive correlation (a correlation 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.

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# Controversy #4: Is the Consumer Really Resilient?

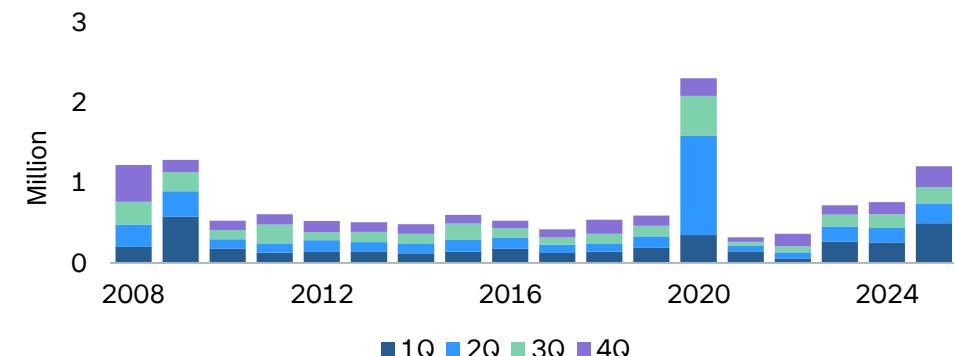
## UNIVERSITY OF MICHIGAN CONSUMER CONFIDENCE

AS OF JANUARY 9, 2026



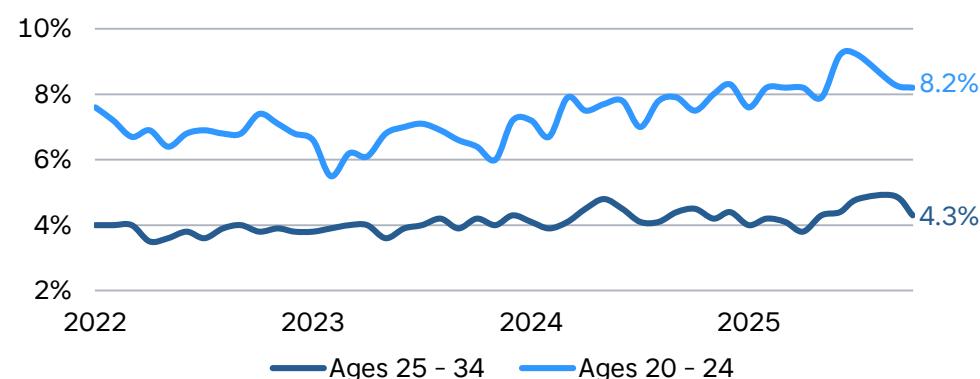
## CHALLENGER LAYOFFS

AS OF DECEMBER 31, 2025



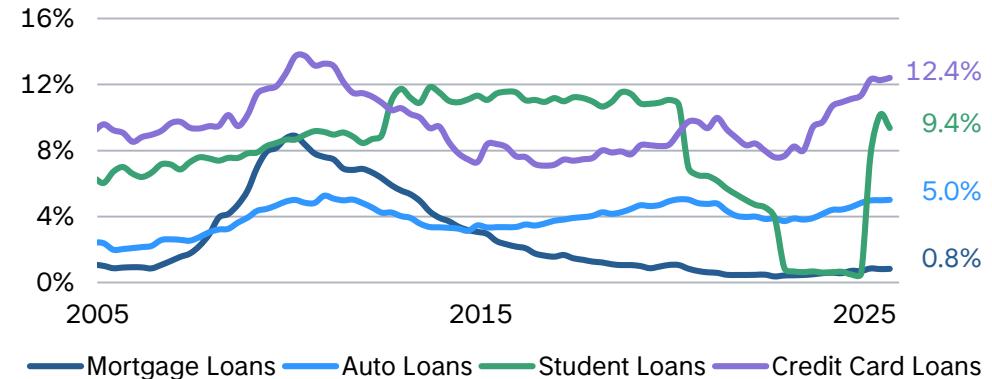
## YOUTH UNEMPLOYMENT RATE

AS OF DECEMBER 31, 2025



## OVER 90-DAY DELINQUENCY RATES

AS OF DECEMBER 31, 2025



Source: Morgan Stanley Wealth Management GIO, Bloomberg, Pantheon Macro

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# The K-Economy: Wealth Effects Now Larger Than Income Effects

## SHARE OF TOTAL NET WORTH BY INCOME COHORTS

AS OF DECEMBER 31, 2025

50%

40%

Top 20% → 71%

30%

20%

10%

0%

Lowest Quintile

Second Quintile

Third Quintile

Fourth Quintile

Top Quintile  
(Without Top 1%)

47.5

23.9

## SHARE OF PCE BY INCOME COHORTS

AS OF DECEMBER 31, 2025

50%

40%

Top 40% → 61%

30%

20%

10%

0%

Lowest Quintile

Second Quintile

Third Quintile

Fourth Quintile

Top Quintile

39.5

21.5

16.7

13.1

Source: Morgan Stanley Wealth Management GIO, MS & Co. Research  
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# Controversy #5: A Productivity Renaissance?

Forecasts Largely Driven by Margins

## S&P 500 TRAILING 12-MONTH EBIT MARGIN VS. NET MARGIN

AS OF JANUARY 9, 2026

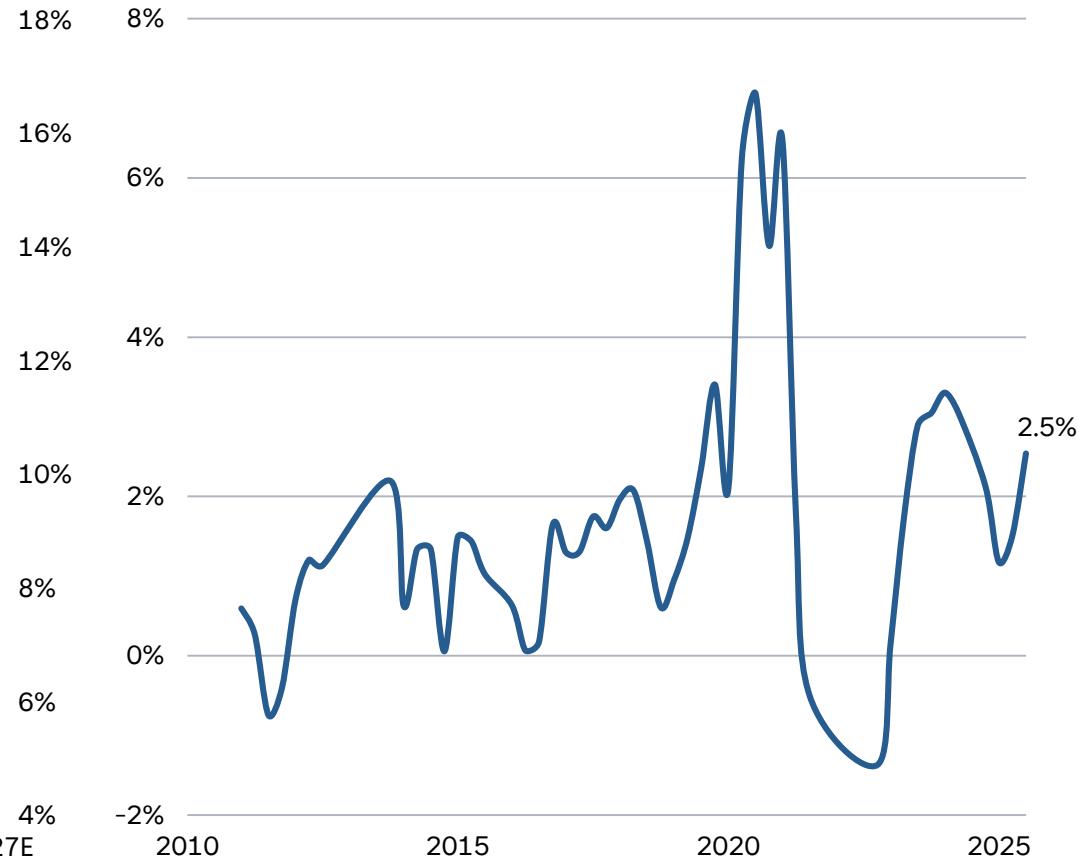
22%



## BUSINESS SECTOR LABOR PRODUCTIVITY, YEAR-OVER-YEAR

AS OF DECEMBER 31, 2025

8%



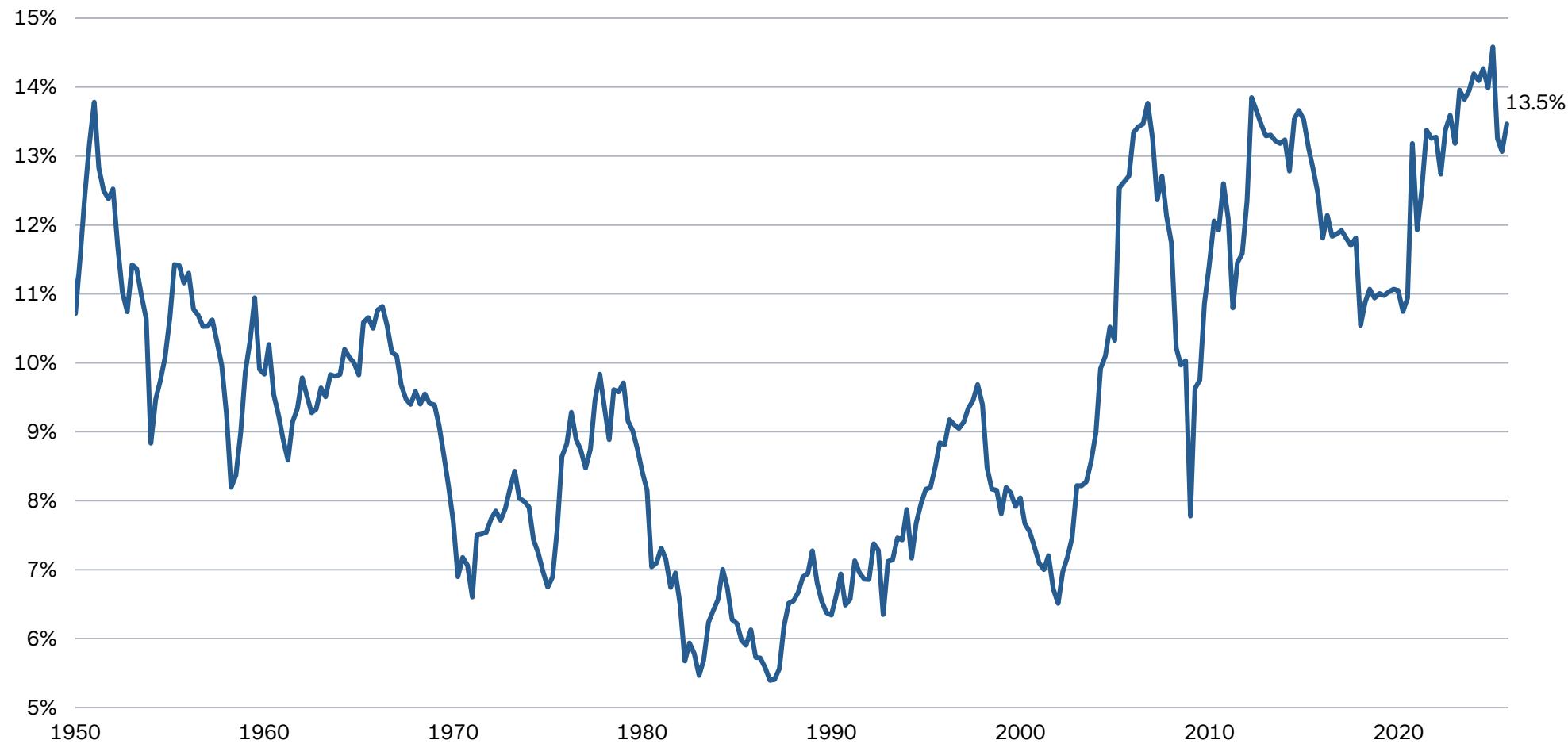
Source: Morgan Stanley Wealth Management GIO, MS & Co. Research, Haver Analytics, consensus estimates

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# Corporate Profits as Share of US GDP Have Peaked; Margins Compressing?

## NIPA US CORPORATE PROFITS AS SHARE OF GDP

AS OF DECEMBER 31, 2025



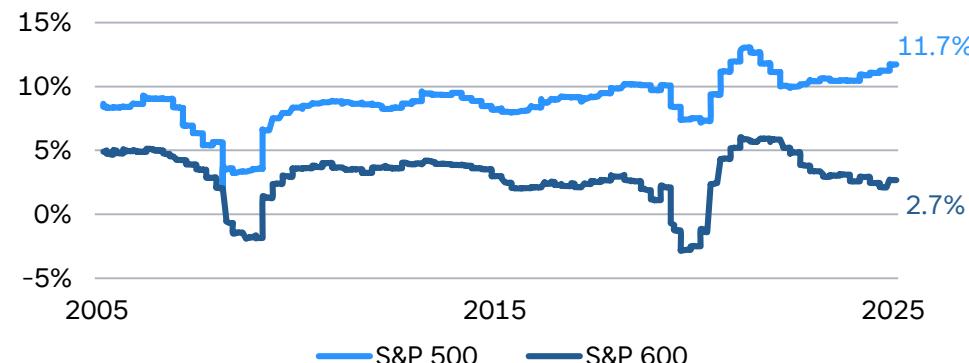
Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# The Largest Companies Are Dominating Productivity Gains

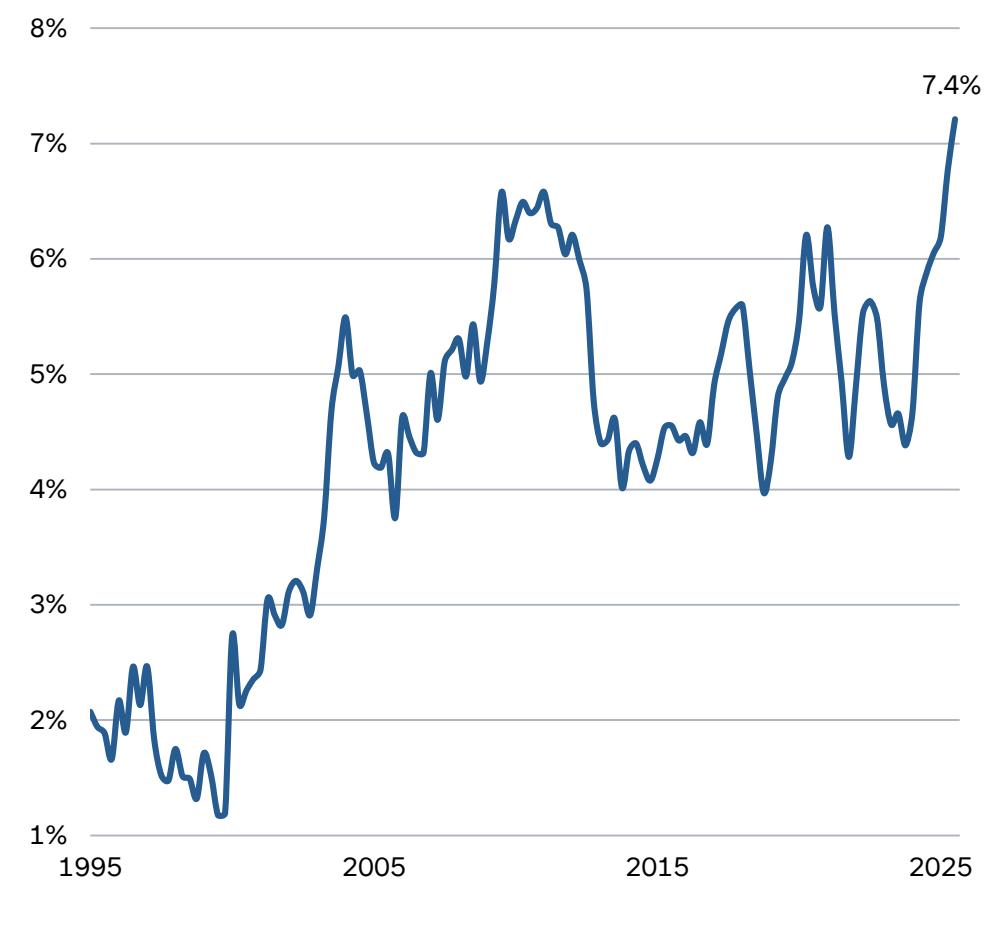
## PROFIT MARGINS OF THE S&P 500 VS. S&P 600

AS OF JANUARY 9, 2026



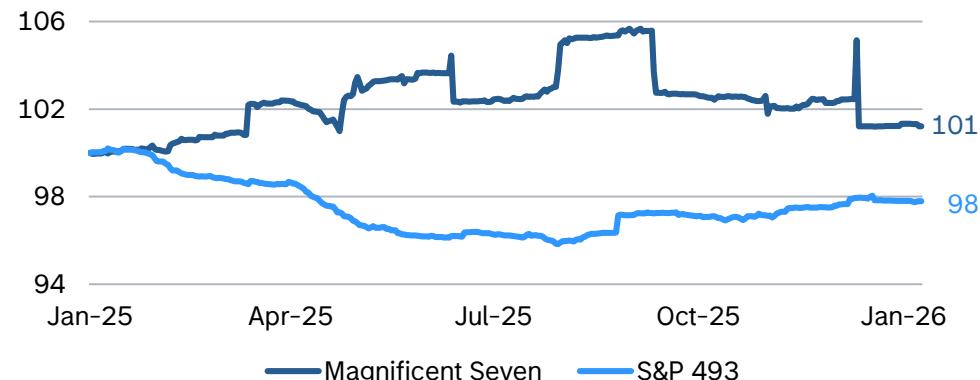
## RUSSELL 3000 SHARE OF UNPROFITABLE COMPANIES

AS OF DECEMBER 31, 2025



## MARGIN GROWTH FORECASTS OF MAG. 7 VS. S&P 493

AS OF JANUARY 9, 2026 (JANUARY 1, 2025 = 100)



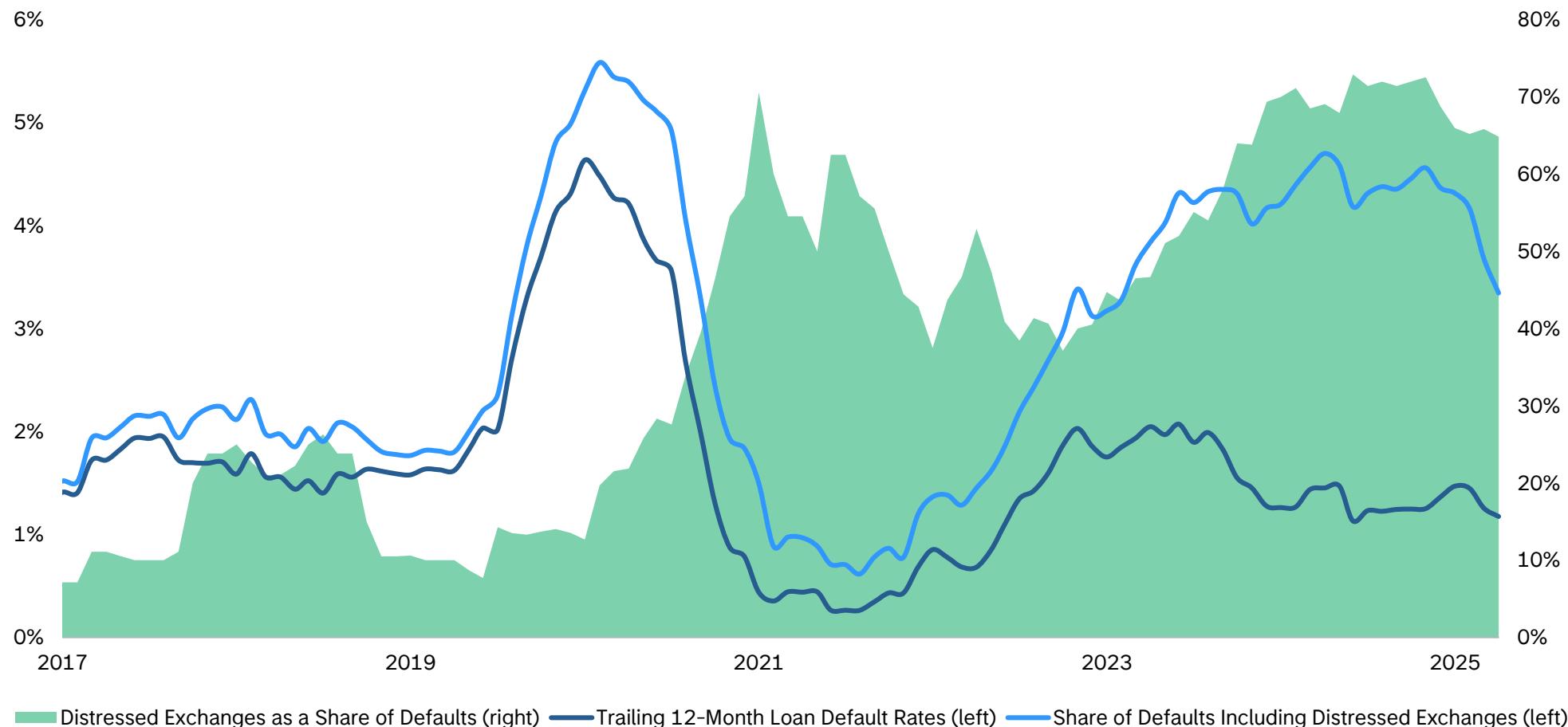
Source: Morgan Stanley Wealth Management GIO, Apollo Global Management, Bloomberg, Piper Sandler. Note: Zombie companies are defined as those having three consecutive years of interest coverage ratio < 1.

Past performance is no guarantee of future results. Estimates of future performance are based on assumptions that may not be realized. This material is not a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. Please refer to important information, disclosures and qualifications at the end of this material.

# Controversy #6: Credit Cockroaches?

## DEFAULT RATES MAY BE MISLEADING

AS OF DECEMBER 31, 2025



Source: Morgan Stanley Wealth Management GIO, MS & Co. Research

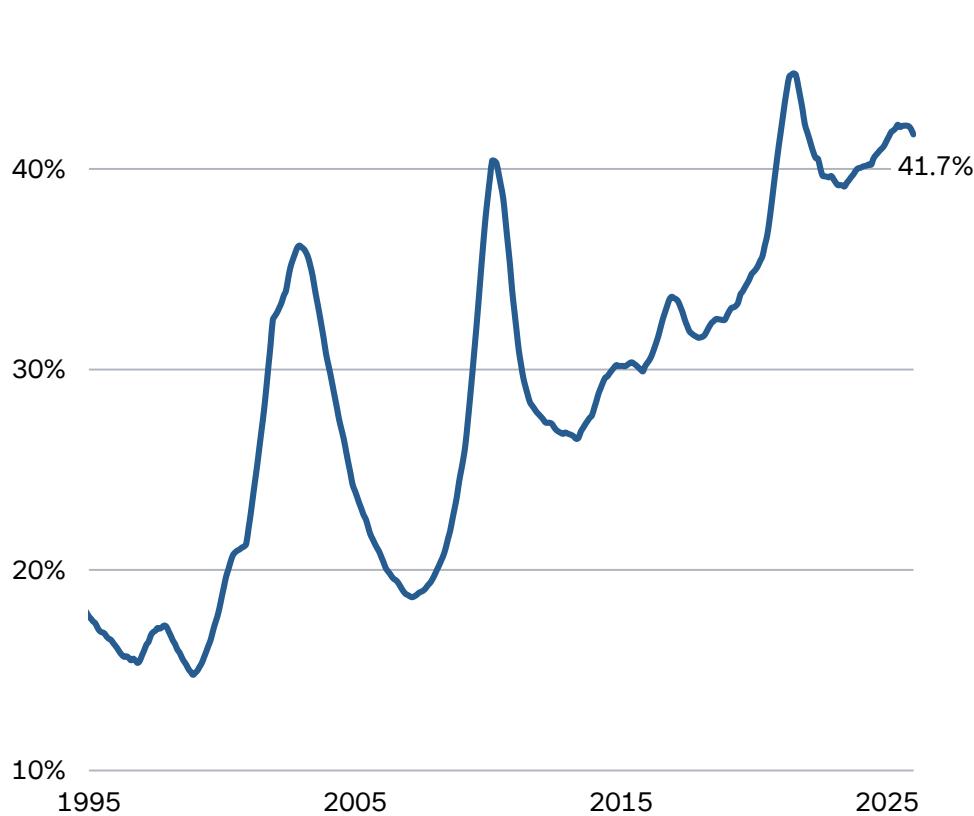
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# Smaller Companies Are Stressed

## RUSSELL 2000: SHARE OF UNPROFITABLE COMPANIES

AS OF DECEMBER 31, 2025

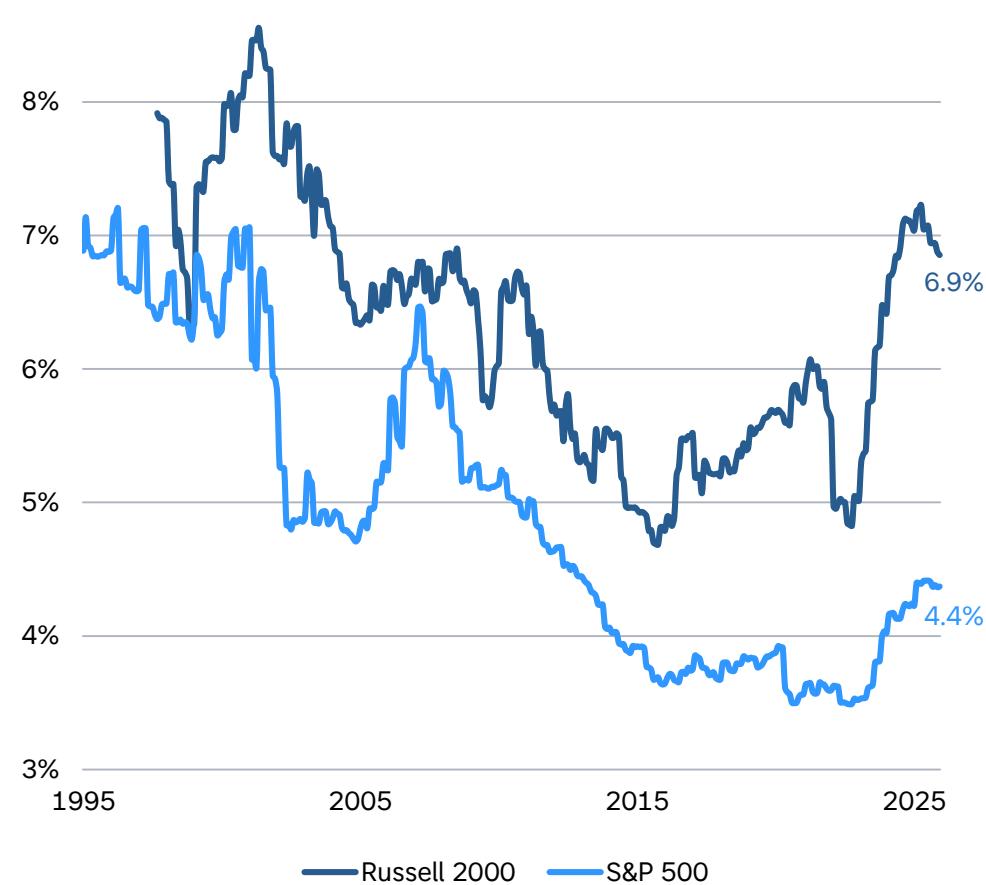
50%



## INTEREST EXPENSE AS A SHARE OF DEBT

AS OF DECEMBER 31, 2025

9%



Source: Morgan Stanley Wealth Management GIO, Strategas

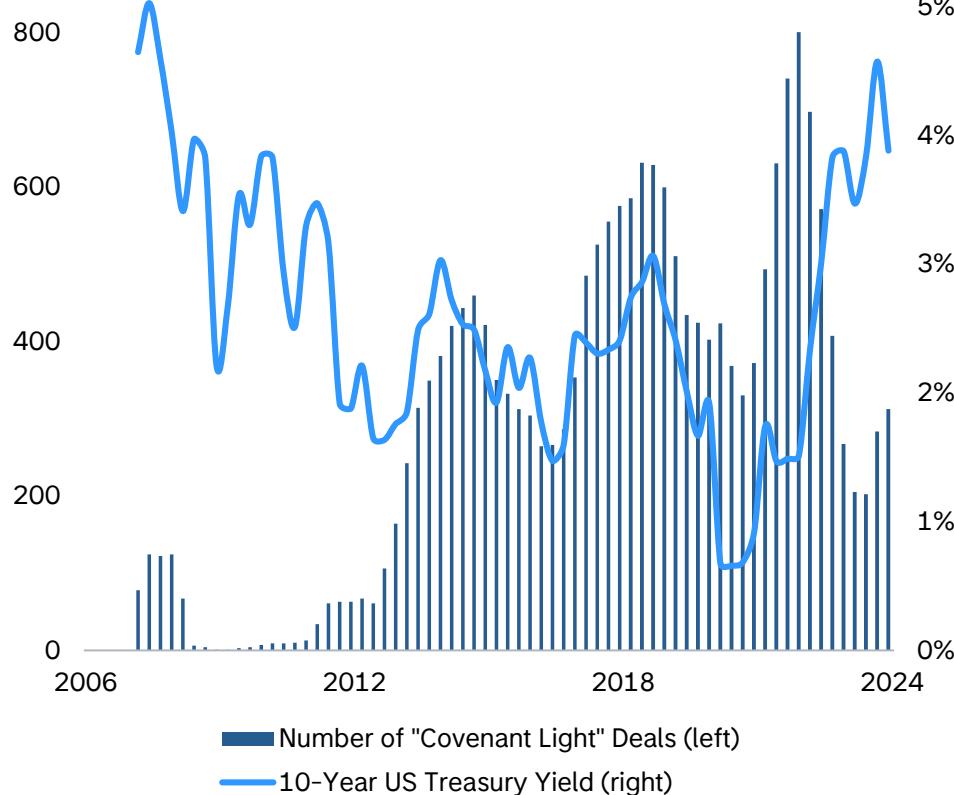
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# Private Market Could Be Source of Credit Disappointments

## “COVENANT LIGHT” LEVERAGED LOANS VS. 10Y UST YIELD

AS OF DECEMBER 31, 2025

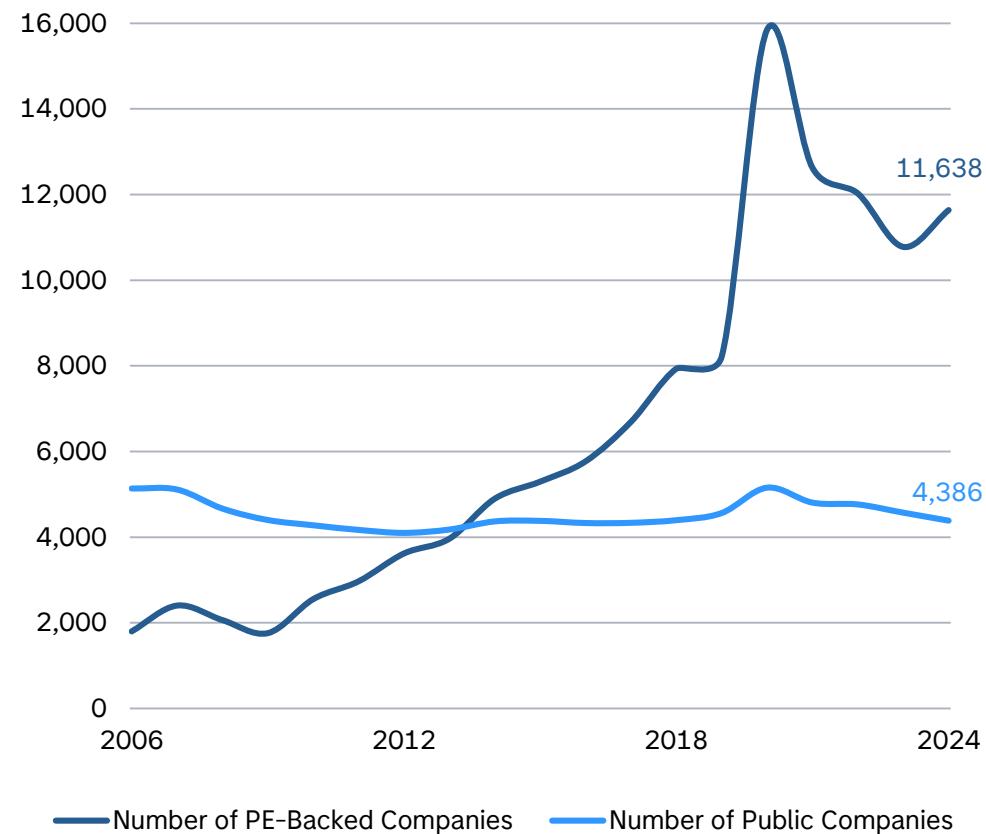
1000



## US PE-BACKED COMPANIES VS. PUBLIC COMPANIES

AS OF DECEMBER 31, 2025

18,000

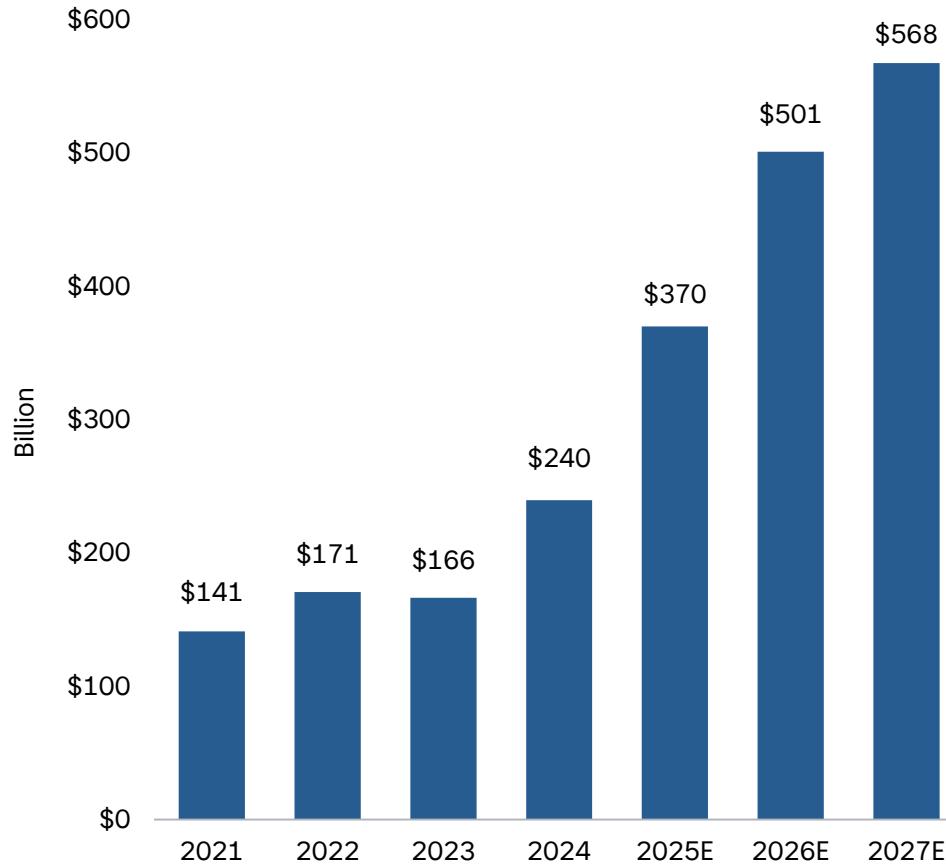


Source: Morgan Stanley Wealth Management GIO, BCA Research. Note: Number of “covenant light” leveraged loans is the four-quarter moving average. Figures reflect the most recently available data. Past performance is no guarantee of future results. Estimates of future performance are based on assumptions that may not be realized. This material is not a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. Please refer to important information, disclosures and qualifications at the end of this material.

# Controversy #7: An AI Bubble?

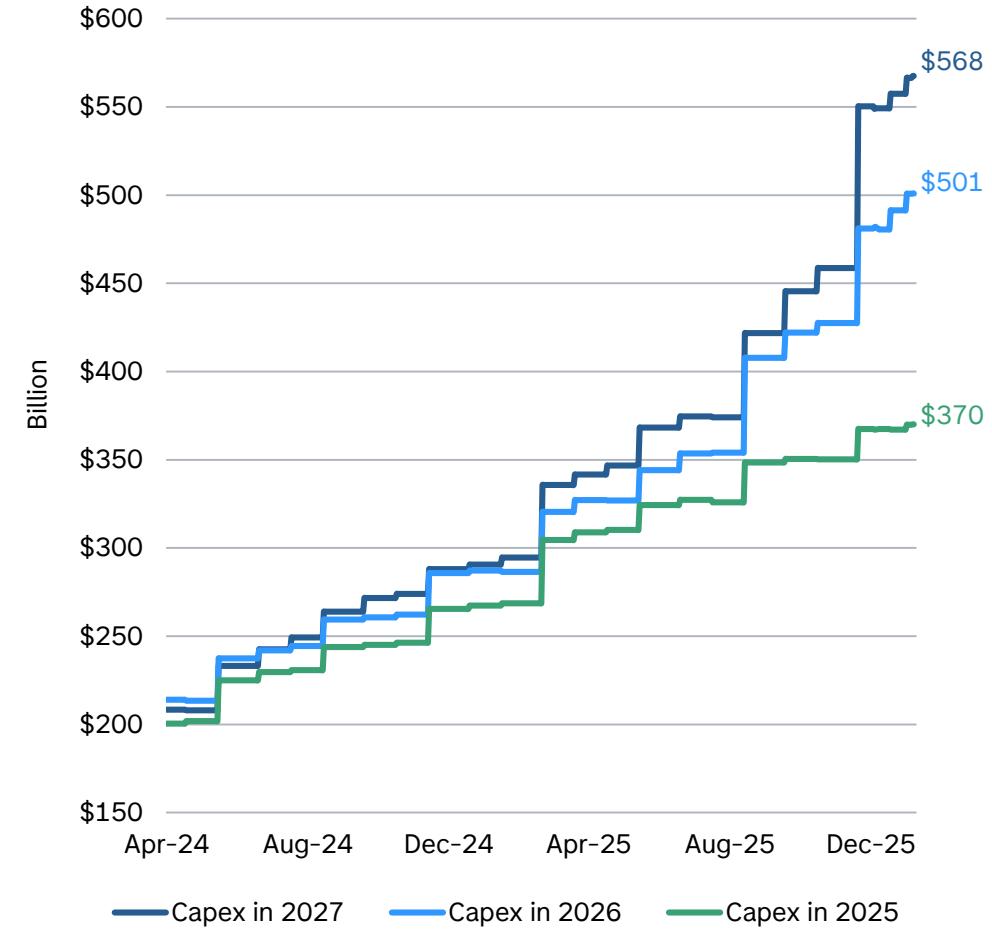
## CAPEX SPENDING OF AI HYPERSCALERS

AS OF JANUARY 7, 2026



## CHANGE IN CAPEX FORECASTS FOR HYPERSCALERS

AS OF JANUARY 7, 2026



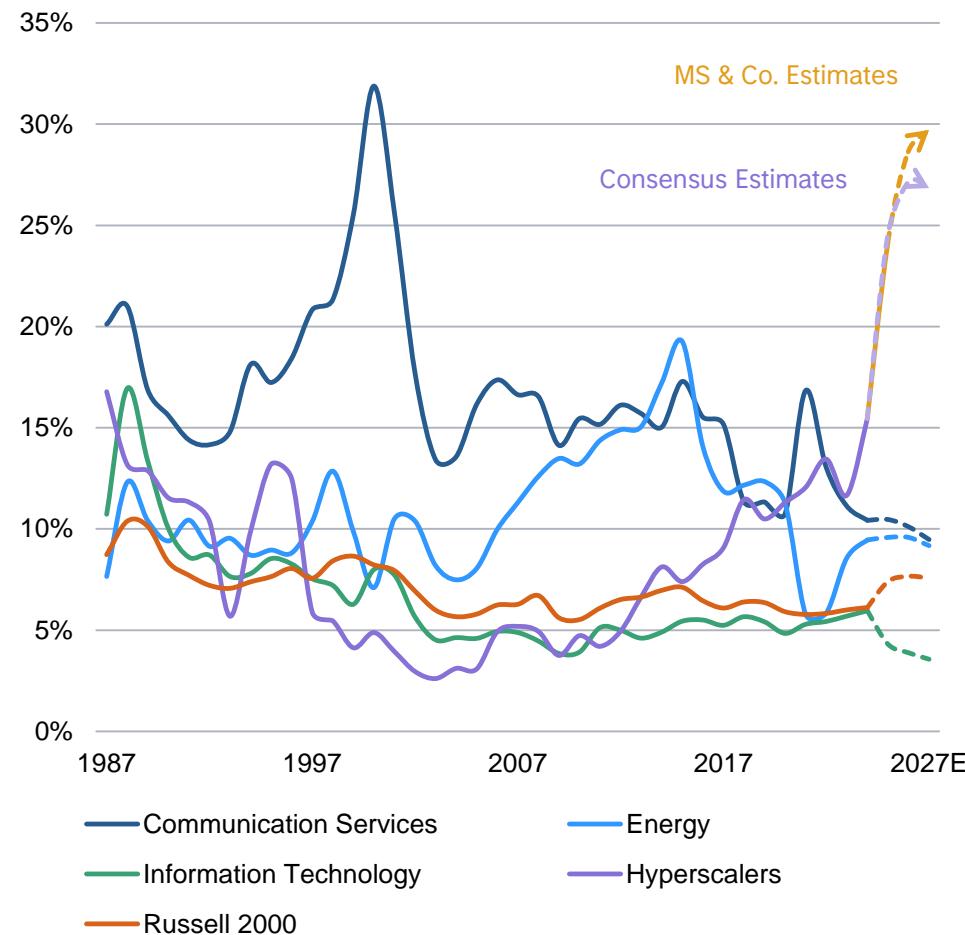
Source: Morgan Stanley Wealth Management GIO, ASR estimates

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# Gen AI Capex Boom: In Context, Where Are We?

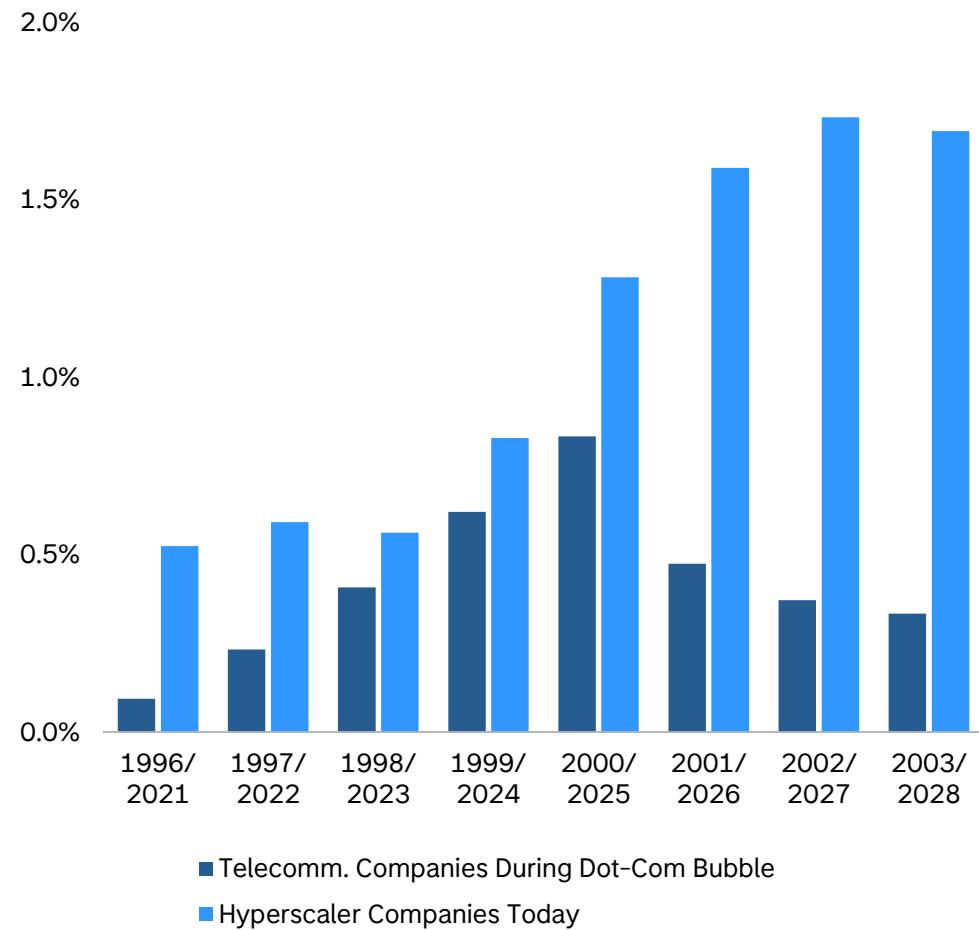
## CAPITAL EXPENDITURE AS A SHARE OF SALES

AS OF JANUARY 9, 2026



## CAPITAL EXPENDITURE AS A SHARE OF GDP

AS OF DECEMBER 31, 2025



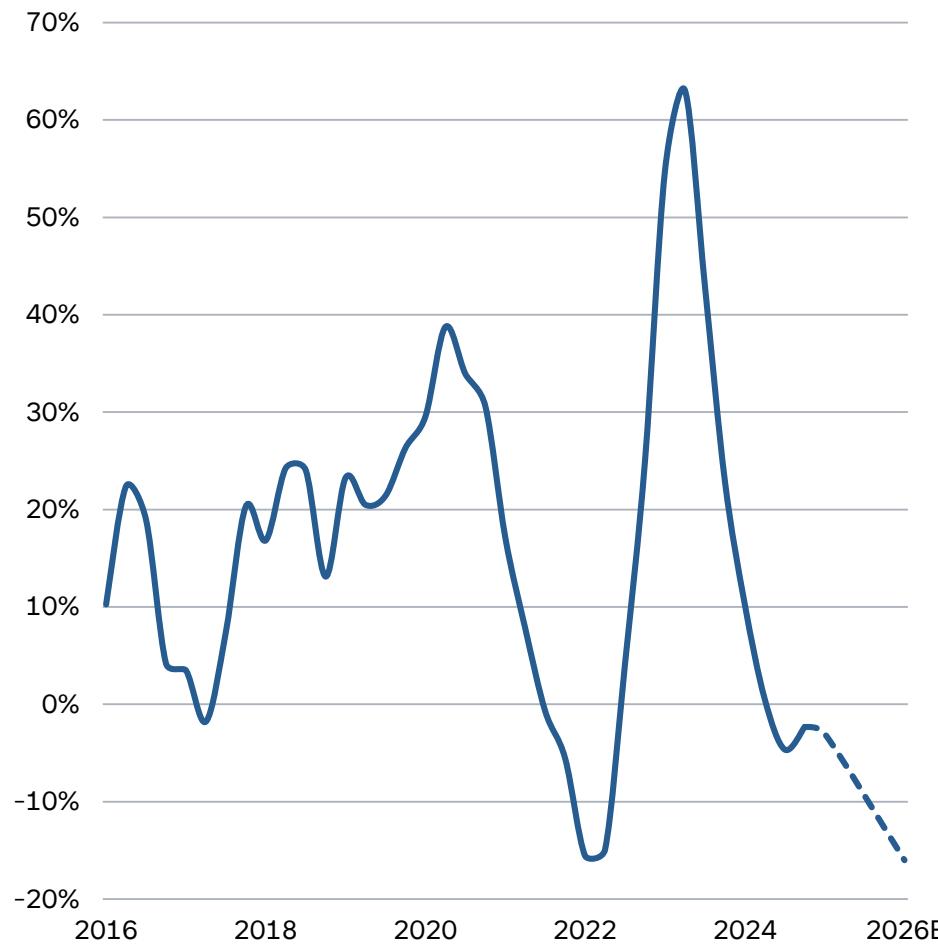
Source: Morgan Stanley Wealth Management GIO, Apollo Global Management, MS & Co. Research and consensus estimates

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# Hyperscaler Free Cash Flow Growth Negative; Debt Financing Increasing

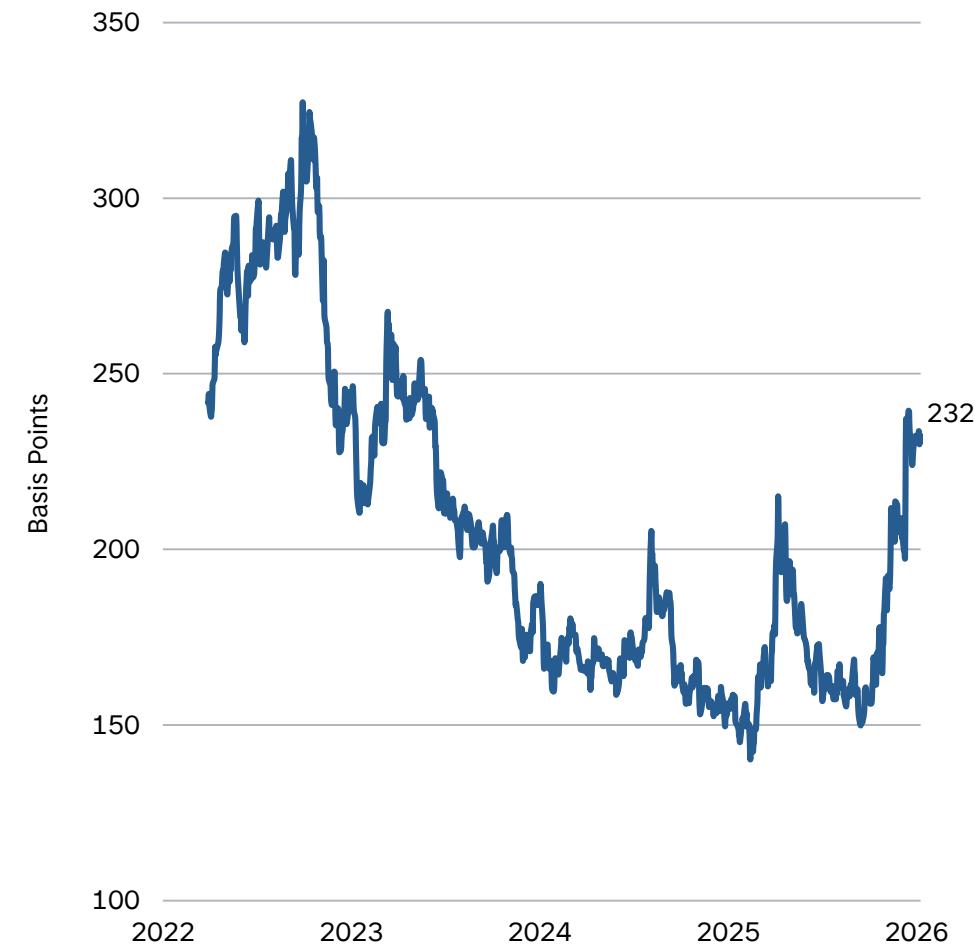
## MAG 7 FREE CASH FLOW, YEAR-OVER-YEAR

AS OF DECEMBER 31, 2025



## ORACLE OAS TO 10-YEAR SWAP CURVE

AS OF JANUARY 9, 2026



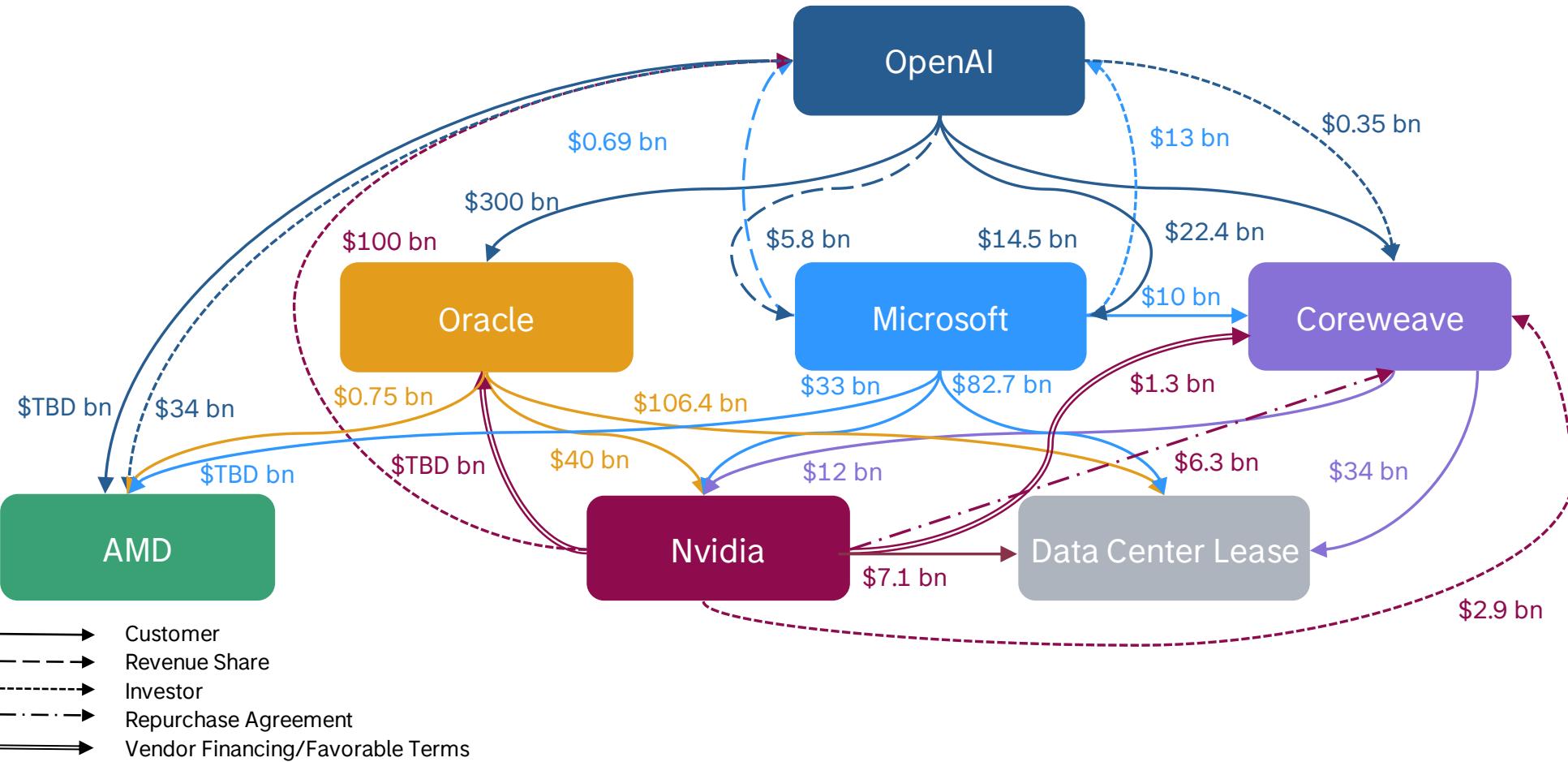
Source: Morgan Stanley Wealth Management GIO estimates, Bloomberg, Strategas. Option-adjusted spread (OAS) is a measurement of the spread of a fixed income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option.

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# Risk Is Increasing Circularity

## AI ECOSYSTEM CAPITAL FLOWS

AS OF DECEMBER 31, 2025



Source: Morgan Stanley Wealth Management GIO, MS & Co Research, "AI: Mapping Circularity," October 8, 2025.

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# And New Bottlenecks

## SANDISK (SNDK) PERFORMANCE

AS OF JANUARY 9, 2026

*"NVDA is still growing, but shortages are now evident in DRAM, NAND, and CPUs and wafer supply may be next. More subtly, advanced chips increasingly rely on materials once viewed as commodities—films, glass, laminates—that now require extreme purity and precision. These inputs are no longer cheap or abundant. Japan has several of these supply-chain choke-point companies, and they're largely underfollowed."*

- MS & Co. Tech Sales and Trading



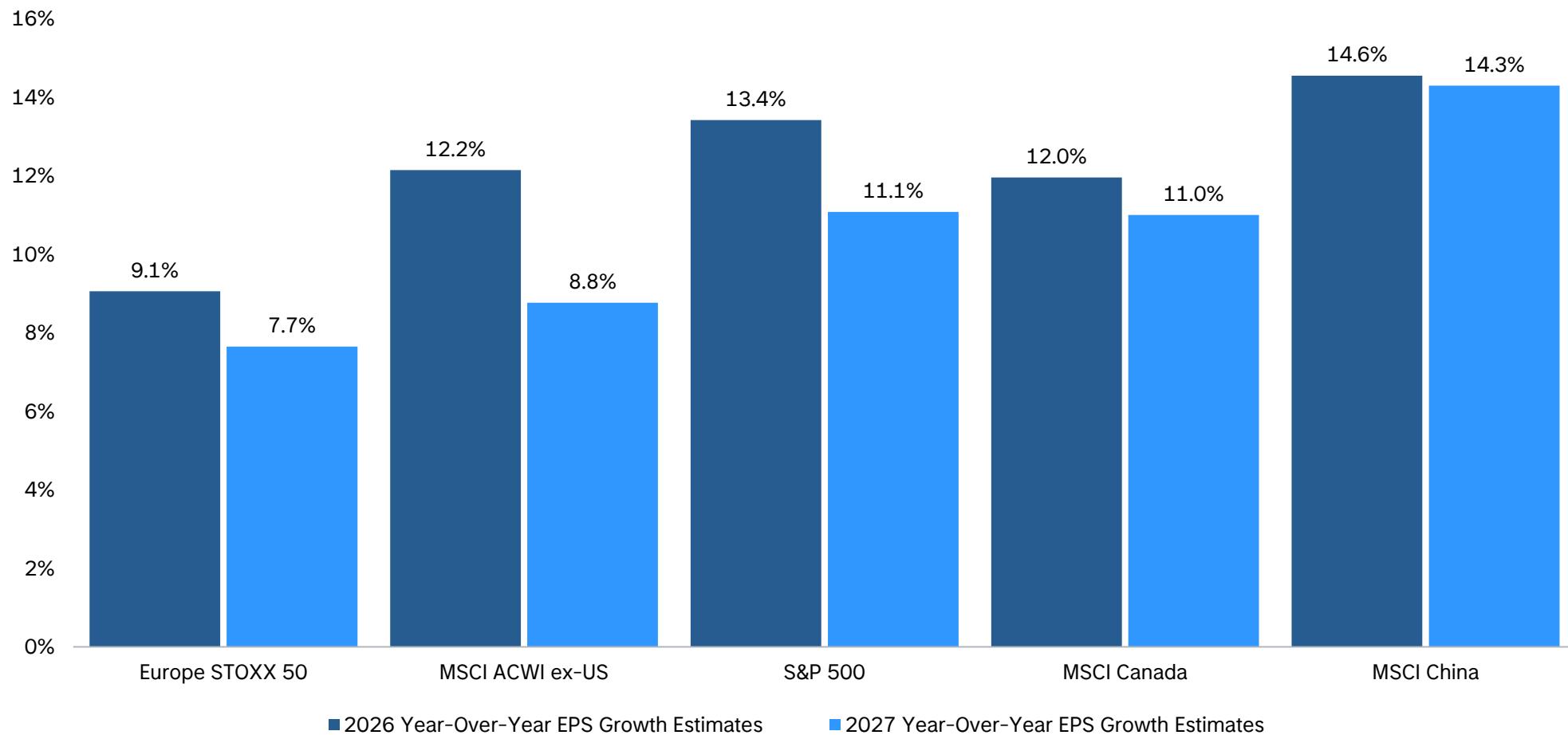
Source: Morgan Stanley Wealth Management GIO, Bloomberg. Over the period low of 4/4/2025 to 1/9/2026, SNDK rose 1025% vs. 29% for the S&P 500.

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# Controversy #8: American Exceptionalism Everlasting?

## AMERICA'S PROFIT GROWTH PREMIUM NARROWING

AS OF JANUARY 9, 2026



Source: Morgan Stanley Wealth Management GIO, Bloomberg, FactSet, consensus estimates

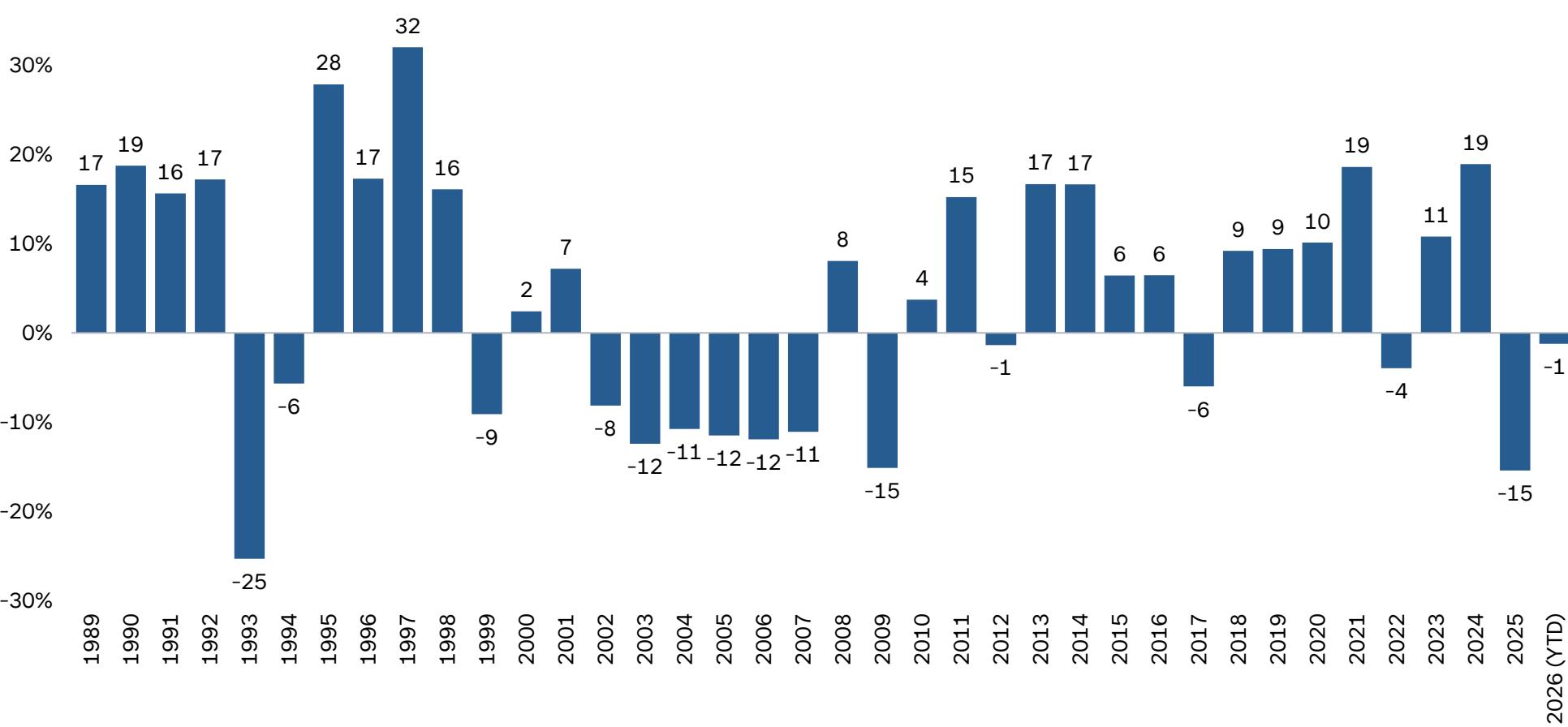
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# US Trailing Rest of World by Most Since 2009

## MSCI US YEARLY RETURN LESS MSCI ACWI EXCLUDING US YEARLY RETURNS

AS OF JANUARY 9, 2026

40%



Source: Morgan Stanley Wealth Management GIO, Bloomberg

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# Non-US Stocks Relatively Cheap; Fundamentals Good

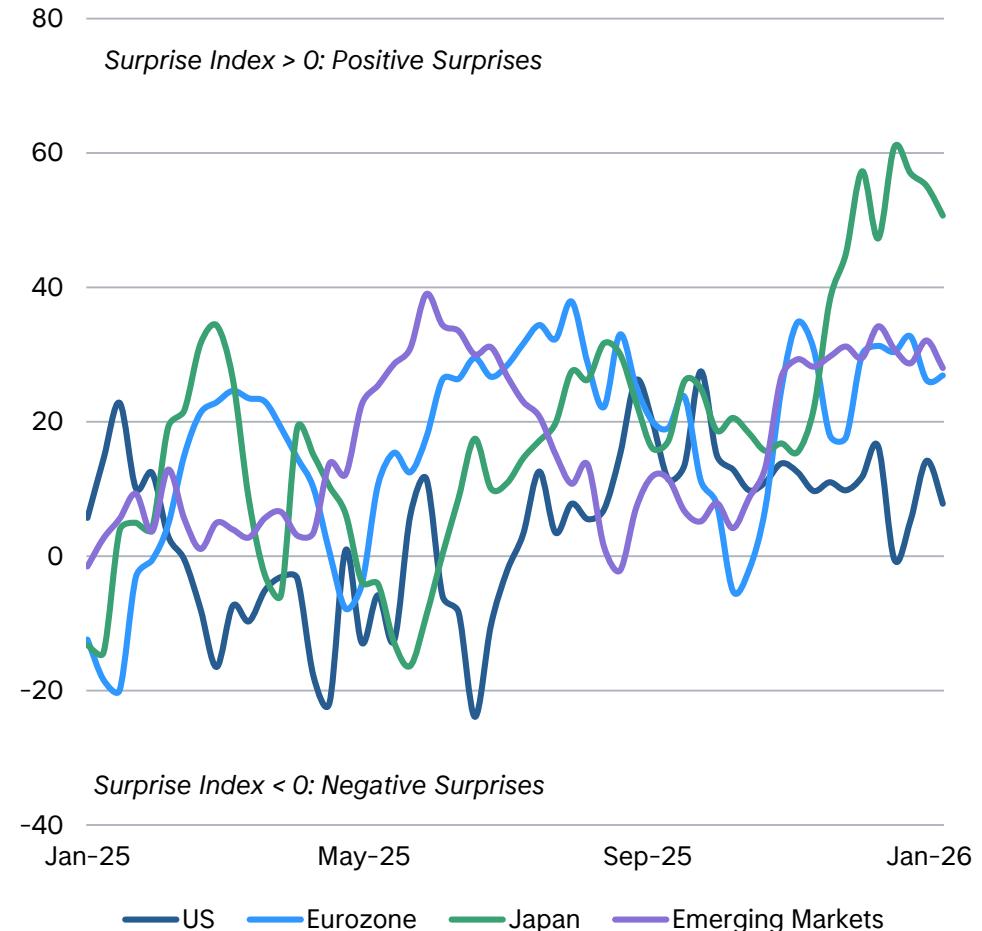
## GLOBAL EQUITY MARKET VALUATIONS AND EARNINGS

AS OF JANUARY 9, 2026

|                   | MSCI Index    | 12-Month Forward P/E | 12-Month Forward P/E Relative to: | Trailing Three-Yr. | 12-Month Forward EPS |             |           |
|-------------------|---------------|----------------------|-----------------------------------|--------------------|----------------------|-------------|-----------|
|                   |               | Current              | History                           | MSCI ACWI          | EPS Growth           | Est. Growth | Revisions |
| Developed Markets | US            | <b>22.4x</b>         | 1.3x                              | 1.2x               | 6.7%                 | 15.0%       | 0.3       |
|                   | Japan         | <b>17.2x</b>         | 1.1x                              | 0.9x               | 11.5%                | 34.4%       | 1.3       |
|                   | Canada        | <b>17.5x</b>         | 1.2x                              | 0.9x               | 0.9%                 | 12.1%       | 0.3       |
|                   | UK            | <b>13.7x</b>         | 1.1x                              | 0.7x               | -2.7%                | 2.8%        | 0.4       |
|                   | Europe ex-UK  | <b>16.5x</b>         | 1.2x                              | 0.9x               | 1.6%                 | 11.2%       | 0.2       |
| Emerging Markets  | China         | <b>12.3x</b>         | 1.1x                              | 0.6x               | 6.5%                 | 17.3%       | 0.4       |
|                   | India         | <b>21.3x</b>         | 1.2x                              | 1.1x               | 17.6%                | 18.9%       | 0.2       |
|                   | Taiwan        | <b>19.2x</b>         | 1.3x                              | 1.0x               | 2.5%                 | 22.7%       | -0.1      |
|                   | Korea         | <b>9.5x</b>          | 1.0x                              | 0.5x               | 3.9%                 | 30.3%       | 7.7       |
|                   | Latin America | <b>11.1x</b>         | 1.0x                              | 0.6x               | -12.3%               | 14.1%       | -4.4      |

## CITI ECONOMIC SURPRISE INDEXES

AS OF JANUARY 9, 2026



Source: Morgan Stanley Wealth Management GIO, Bloomberg. Note: Global equity market valuation history is based on MSCI data since 2006. Revisions are changes in consensus estimates over the prior month.

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# Geo-Politics Are Creating Opportunities in EM

## Emerging Markets are likely to benefit from the positive combination of rising economic growth and falling inflation.

- China's global trade surplus continues to grow robustly, and they are exporting deflation. They have made up 100% of the volume lost to US trading and tariffs.
- EM is benefitting from stronger currencies, especially against the US dollar, which is flattening purchasing power.
- EM is benefitting from the materials and commodities boom.
- Cheaper oil is substantial positive for India and China.

## Tariffs are not likely to be a show-stopper in 2026.

- Supreme Court ruling will likely slow things as will mid-term election pressures.
- One-year China truce (after the elections).
- India probably emboldened by events.

## EM will likely benefit from both China and US approaches to gen AI.

- China is open source and application specific; cheaper; lower power chips.
- US is energy intensive, with NVIDIA-centric architectures.

## The New Monroe Doctrine creates opportunities for US dollar investors in Latin America: China will likely fill other voids.

### EMERGING MARKETS FORWARD P/E RELATIVE TO S&P 500

AS OF JANUARY 12, 2026



Source: Morgan Stanley Wealth Management GIO, Bloomberg

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and demand imbalances, resource depletion and exploration risk. MLPs also carry interest rate risk and may underperform in rising interest rate environments. In addition, MLP funds accrue deferred income taxes on net operating gains and capital appreciation; as a result their after-tax performance could differ significantly from that of its underlying assets.

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MSWM, managers, MS & Co., and their affiliates receive compensation and fees in connection with these services. MSWM believes that the nature and range of clients to which such services are rendered is such that it would be inadvisable to exclude categorically all these companies from an account.

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**Residential mortgage loans and home equity lines of credit** are offered by MSPBNA, Member FDIC an Equal Housing Lender. Nationwide Mortgage Licensing System Unique Identifier #663185. **The proceeds from a residential mortgage loan (including draws and advances from a home equity line of credit) are not permitted to be used to purchase, trade, or carry eligible margin stock; repay margin debt that was used to purchase, trade, or carry margin stock; or to make payments on any amounts owed under the note, loan agreement, or loan security agreement; and cannot be deposited into a MSSB or other brokerage account.** The pledged-asset feature allows eligible securities to be used as a substitute for a cash down payment. The pledged-asset feature allows eligible securities to be used as an alternative to a cash down payment. Clients must maintain collateral levels and may be subject to liquidation if requirements are not met. Interest-only and adjustable-rate mortgages (ARMs) carry specific risks, including payment increases and higher total interest costs. ARMs are based on the SOFR 30-Day Average. Relationship-based pricing is available based on eligible household assets held at the Firm.

**Cards and Cash Management:** Debit Cards offered through the Firm are issued by MSPBNA under license from Mastercard. American Express Cards offered through the Firm include the Platinum Card®, Blue Cash Preferred®, and the Morgan Stanley Credit Card. Eligibility requires an "Eligible Account" at the Firm. Cards are issued by American Express National Bank. Terms, conditions, and restrictions apply. The Greenlight App and Debit Card is provided by Greenlight Financial Technologies, not the Firm or any of its affiliates. The Morgan Stanley CashPlus is a brokerage account offered through MSSB. Conditions and restrictions apply. For more information, see the CashPlus Disclosure Statement.

**Deposit Products and FDIC:** Under the Bank Deposit Program, free credit balances held in an account(s) at Morgan Stanley Smith Barney LLC are automatically deposited into an interest-bearing deposit account(s) at FDIC-insured banks. Certain conditions must be met. For more information, view the Bank Deposit Program Disclosure Statement. The Savings and Preferred Savings Programs offer FDIC-insured deposit accounts at Morgan Stanley Private Bank, National Association, Member FDIC or Morgan Stanley Bank, N.A., Member FDIC. The Savings programs are not intended for clients who need to have frequent access to funds and those funds will not be automatically accessed to reduce a debit or margin loan in your brokerage account. Withdrawals are limited to 10 per calendar month, and excess withdrawals may incur fees. Promotional rates may be offered from time to time and are subject to change at any time.

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