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To our Clients, Friends, and Colleagues,

Table of Contents

1	Opening Comments
2	Equity Market Outlook for 2025
5	Fixed Income Markets in 2024 & Outlook for 2025
6	Closing Remarks
7	Appendix A: The Tradeoff Between Inflation and P-Es
8	Appendix B: Valuation May be a Poor Timing Tool, but It's Important
9	Appendix C: Trees Don't Grow to the Sky
10	Disclosures

If there is one thing we have learned after years of trying to predict the direction of equity markets, there are too many variables to consider, some are qualitative in nature, and others are completely unpredictable. While this has always been the challenge, we remind investors that three major variables weigh heavily on the appreciation potential of the market in any given year, and especially over the long run. These major variables are Monetary Policy, Fiscal Policy, and the ability of the Economy, along with productivity, to drive corporate profit growth.

When we published our letter last year, we thought that the equity market would move higher, but we never imagined it would post another plus 20% year. We anticipated that the Federal Reserve would cut rates, but we believed Monetary Policy would remain restrictive. The FOMC reminded investors at that time that further slowing of the economy would be necessary for their 2% inflation target to be achieved. And as we expected, the Fed eased gradually and executed policy without causing a recession in 2024.

With respect to Fiscal Policy, we felt that the latent liquidity from the U.S. Government's COVID related spending programs would wane, and the government would continue to spend in deficit as politicians voted that it was better to raise debt ceilings and extend spending programs than not. Notwithstanding the government's inclination to spend, we thought the liquidity that the government could provide in 2024 would be less than during the COVID years.

With Monetary and Fiscal Policy stimulus diminished, we expected that economic growth would slow, but we would not see a recession. This slower growth, we believed, would make it difficult for S&P 500 2024 earnings growth expectations to be achieved. To our surprise, however, corporate profit growth proved to be more resilient than we imagined given our Monetary, Fiscal, and Economic growth outlooks. Assuming analyst's 4Q-24 earnings expectations are met, corporate profit growth for the S&P 500 in 2024 will be 11.5%, right in line with the 11.4% analysts predicted at the start of the year.

If earnings alone were responsible for driving stock market performance in 2024, S&P 500 price appreciation would have come in just above our "flat to up 10%" target range. However, profit growth was not the only factor driving equity markets. When we published our letter a year ago, we thought that the S&P 500's 19.9x forward P/E multiple was extended, and that given our Monetary and Fiscal Policy outlook that some P/E compression should be expected. Remarkably, the forward P/E multiple instead ended 2024 at 21.9x. This multiple expansion, in our opinion, owes itself largely to one theme and that theme's impact on Technology, Media, and Telecommunication (TMT) stock prices and earnings. That dominant theme was Artificial Intelligence (AI). Surging demand for AI hardware, software, and services, and growing confidence about its pace and durability, propelled TMT stocks. The TMT segment (including Amazon and Tesla) drove 71.4% of the entire S&P 500's market cap appreciation and 74.6% of its increase in earnings. Within that group, the six Mega Cap stocks known as the MAGMAN (Microsoft, Apple, Google, Meta, Amazon, and Nvidia) alone contributed 51.1% of the S&P 500's appreciation and 63.1% of its increase in earnings. Even more surprising, Nvidia itself contributed 20.8% of the market's appreciation and 22.5% of its earnings growth. The impact of this narrow leadership on portfolio performance relative to the S&P 500 cannot be understated. If you built a portfolio that did not have any of the MAGMAN stocks in 2024, you would have a performance drag of 11.9 percentage points versus the S&P 500. If you failed to own just Nvidia, the drag was 4.8 percentage points. This being the challenging portfolio management environment with which we were confronted, we are content with the performance of our balanced individual equity and global equity ETF portfolios in 2024. These portfolios have generous exposure to TMT companies that benefit from the expansion of AI technology and services, as well companies from other themes and sectors we believe have solid long-term growth potential.

Sources: FactSet Research; Standard & Poor's. Data as of 12/31/24.

We achieved our performance this year while sticking to the well-established principals we have outlined in prior year-end letters. We don't make oversized bets in any one security, sector, or theme, and we own securities that fall in to two broad classes: GAARP (growth at a reasonable price) and Value (which can have correlated or uncorrelated exposure to the economic cycle, and that oftentimes pay an above-market dividend yield). We have exposure to almost all economic sectors, and we overweight and underweight sectors and investment themes based on our investment cycle outlook. We focus our individual stock selections in what we believe are important themes for the year ahead and the long run: 1) Digital Technology & Transformation, 2) Health and Aging, 3) Reshoring, Infrastructure & Green Technology, and 4) durable secular, not cyclical, growth stories in all segments. Our investment philosophy guides us toward companies that we believe can benefit from long-term growth themes, but at the same time exhibit proven and profitable business models.

Though diversification across themes and sectors made keeping pace with the S&P 500 very difficult in 2024; experience tells us that this investment philosophy produces solid performance over the long run with lower volatility and higher dividend yields. More importantly, that same experience reminds us that historically there have been times when a narrow segment of market caught investors fancy only to fall back to earth as investors readjusted their expectations or moved on to better values in other areas of the marketplace. Investors would be wise not to forget that.

Equity Market Outlook in 2025

As we look to 2025, we can't help but feel even more uncertain than we did a year ago. The new administration's plans for spending, taxes and regulation could very well have positive economic impacts, but those relating to tariffs and mass deportations might not. Furthermore, the sequence by which these policies are enacted will determine whether the impacts, be them positive or negative, on Monetary Policy, Fiscal Policy, and the stock market is felt this year or next. With regards to Monetary Policy, we believe that the Fed will continue to move to a less restrictive policy stance in 2025, but we do not believe policy will become excessively easy anytime soon. Speaking in mid-November about the economic outlook, Federal Reserve Chairman Jerome Powell explained:

> *"The economy is not sending any signals that we need to be in a hurry to lower rates. The strength we are currently seeing in the economy gives us the ability to approach our decisions carefully. Ultimately, the path of the policy rate will depend on how the incoming data and the economic outlook evolve. We remain resolute in our commitment to the dual mandate given to us by Congress; maximum employment and price stability."*

Source: Fed Chairman Jerome Powell speech on Economic Outlook at the World Affairs Council, the Federal Reserve Bank of Dallas, and the Regional Chamber. November 14, 2024.

Because the Fed aims to anchor policy adjustments to incoming data, we believe it risks keeping policy relatively restrictive for too long. And given its commitment to its dual mandate of maximum employment and price stability, one should question if the Fed will have the courage to lower rates if inflation progress slows in the face of deteriorating labor market or economic conditions. While we do not see the signs of a major economic slowdown or resurgent inflation at this time, investors should not forget that the Fed is still recalibrating Monetary policy and that the possibility of a mistake cannot be dismissed.

Turning to Fiscal Policy, no matter which candidate won the 2024 Presidential election, if they honored their election promises, the government would be expected to spend well into deficit in 2025. While spending hawks will do their best to defend against overly aggressive spending policies, with one-party control and an administration promising both increased spending and tax cuts, Fiscal Policy is likely to be more expansionary in 2025 than pundits thought before the election. Where Fiscal Policy could pose a problem for Monetary Policy is if it leads to stagnating or even worse resurgent inflation. In that regard, the new administration is preparing to take a hardline stance on tariffs and immigration, positions that many agree will be inflationary. The new administration's policies, their sequencing, and the unpredictability of their combined impact on inflation over the short and long-run will make the Fed's job more difficult; and force them to be even more data dependent. Furthermore, it remains to be seen how interest rates will respond to these potentially inflationary policies as well as the widening deficit, increasing debt level, and the swelling servicing costs they may cause. Anchoring policy to its Dual Mandate would suggest that if confronted with economic deterioration at a time of stagnant or even rising inflation that the Fed would be reluctant to ease Monetary Policy further. The Fed is fully aware that rising inflation would increase interest rates, and this would slow the economy, raise debt service burdens, and negatively impact stock market valuations. Complicating matters, geopolitical conflicts or tariff wars could disrupt trade and supply chains adding to the inflation conundrum. **(Readers can refer to Appendix A: "The Tradeoff Between Inflation and P-Es" for more detail on this topic.)**

Speaking about the administration's policies at his Economic Outlook presentation in mid-November, Fed Chairman Jerome Powell noted that the Fed would not adjust policy in advance of their impacts and would take a wait and see approach. On the topic of fiscal policy, he said:

> *"It takes quite a long time to get a bill through Congress… and it won't have any economic effects this year [2025], but it will be more 2026 or 2027. I think we have time to make assessments about what the net effects of policy changes will be on the economy before we react with policy."*

With respect to tariff policy, he noted:

> *"We don't stand in judgement over these policies in any way. What matters for us is to what extent will new policies have an effect on our mandate goals of maximum employment and price stability, and do we need to change our policy because of these changes in order to achieve those goals…We are going to be careful to wait and better understand the net effect of these things as these things effect the achievement of our goals."*

Source: Fed Chairman Jerome Powell' speech on Economic Outlook at the World Affairs Council, the Federal Reserve Bank of Dallas, and the Dallas Regional Chamber. November 14, 2024.

In short, the Fed at its own peril will continue to employ data dependency when setting Monetary Policy in 2025, and this stance could magnify uncertainty. Notwithstanding the unpredictability of the new administration's policy objectives, less restrictive Monetary Policy and expansionary Fiscal Policy should keep the economy on sound footing in 2025; and with the additional tailwind of improved productivity, corporate profit growth should also be supported.

This brings us to a topic that we believe will gain much more attention in 2025, earnings and stock market valuation. While a company's Price-Earnings (P/E) ratio or P/E to long-term earnings growth (PEG) ratio may be viewed as quantitative factors, investors should not forget that that earnings and the earnings growth expectations that underpin them are in some regards qualitative. Earnings forecasts rely heavily on equity analysts "educated guesses" about the earnings potential of a company's products or services. As stock prices move through analyst's price targets, these analysts can stretch the limits of these qualitative judgements to find ways to keep a stock's valuation palatable for current and future investors. And in times when the market is inspired by the "possible, but yet to be fully realized" potential of themes like semiconductors in the 1960s, the Internet in the 1990s, and Artificial Intelligence today, investors can find themselves more willing to accept lofty valuations, or even worse to ignore them altogether. Over the past 50 years, there have been occasions when investors have confidently accepted a P/E ratio on forward earnings of more than 25x, and occasions when they were unwilling to accept even 10x. There have also been times when investors had no problem accepting a forward earnings yield on the S&P 500 that was 2.6 percentage points lower than a riskless 10-Year Treasury, and occasions when they demanded a yield that was 7.1 percentage points higher than the riskless 10-Year Treasury. We would remind investors that periods of very high P/E ratios and high Treasury yield to earnings yield spreads have historically been accompanied by heightened stock market speculation. With the current forward P/E multiple at 21.9x; the forward earnings yield now at parody with the riskless 10-Year Treasury Yield for the first time in over 20 years; and S&P 500 earnings and earnings growth potential so heavily tied to the fortunes of a narrow group of companies in one theme, valuation should be given more attention when forecasting the price appreciation potential of the S&P 500 both this year and in the coming decade. **(Readers can refer to Appendix B: "Valuation May be a Poor Timing Tool, but It's Important" for more detail on this topic.)**

Sources: FactSet Research; Standard & Poor's; Federal Reserve. Data as of 12/31/24.

In a recent investment strategy report, a Wall Street investment bank forecasted that the S&P 500 would appreciate just 3% per year over the next ten years. Considering that the S&P 500 since its inception in 1957 has compounded at an annual rate of 10.3%, it comes as a surprise to us that this forecast did not gain more attention. In the report, the authors noted that when adding a "market concentration" factor to their model, it reduced the 10-year appreciation forecast by 4 percentage points to 3% per year. Their research should serve as a warning to investors who have dramatically overweighted their portfolios to the popular Artificial Intelligence theme, and to the Mega Cap companies that are driving it. Investors who have watched markets for as long as we have should remember that the last period of extreme Mega Cap concentration in one theme occurred in the late 1990s with the excitement surrounding the Internet. Then, the S&P 500 index peaked at 1527 in March 2000 before tracing out a major decline and slow recovery that did not see the index return to its previous high until May 2007. While investors in a "market capitalization" weighted S&P 500 waited more than 7 years just to break even, those in an "equal weighted" S&P 500 index would have enjoyed returns of 8.9% per year. Remove the many suffering technology companies from that "equal weighted" index and the return would have been even higher. If that is not dramatic enough, in the two years leading up to the S&P 500 index's Dot Com Bubble peak on 3/24/2000, the performance of the "market cap" weighted S&P 500 exceeded that of the "equal weighted" S&P 500 by 32 percentage points. But over the next two years as these leading Mega Cap technology companies failed to meet investors lofty expectations, the "equal weighted" S&P 500 index outperformed the "market cap weighted" S&P 500 by almost 36 percentage points.

While there is no guarantee that history will repeat itself, investors should not dismiss the fact that the S&P 500 is now concentrated in a narrow group of stocks, and the AI theme that underpins them. We should point out that over the two years leading up to the S&P 500's recent high on 12/6/24 the "market cap" weighted S&P 500 outperformed the "equal weighted" S&P 500 by almost 27 percentage points. And over the two years ended 12/31/24, the spread was 29.5 percentage points, not that far from the relative performance advantage it posted during the two years before the peak of the Dot Com Bubble. Accordingly, investors should keep equity portfolio diversification in mind if they are looking to achieve long-term returns in line with what equities have provided historically. (**Readers can refer to Appendix C: "Trees Don't Grow to the Sky" for more detail on this topic.)**

Sources: Goldman Sachs, Portfolio Strategy Research, October 18, 2024; https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp.. FactSet Research; Standard & Poor's; Federal Reserve. Data as of 12/31/24.

Before providing our S&P 500 target for 2025, it is helpful to consider what the so-called brightest minds on Wall Street are expecting. As of year-end 2024, Wall Street's top strategists, on average, forecasted that the S&P 500 index will finish 2025 at 6624, which suggests 12.4% appreciation. At the same time, the bottom-up estimate, which is derived from the median 12-month analyst price target for each of the S&P 500 index companies stood at 6722, suggesting 14.3% appreciation. If one relies solely on expected earnings growth to drive their S&P 500 forecast, the bottom-up analyst expectation for S&P 500 earnings growth in 2025 is 14.7%. We believe that the earnings growth rate represents the best-case scenario for stock market appreciation in 2025 given that the S&P 500 exited the year at a P/E multiple on 12-month forward earnings of 21.9x, a lofty perch from both a historical average and all-time high point of view. We think that the uncertainties around Fed Policy recalibration; the bond and stock market's acceptance of increased deficit spending; the impact of the new administration's economic and global policies as they apply to economic growth and inflation; and the economy's ability to drive broader corporate profit beyond the Technology/AI theme will have to be resolved to the market's satisfaction to avoid P/E multiple compression, a tall order in our opinion. Also, given that the earnings yield of the S&P 500 is at parity with the 10-year Treasury Bond yield for the first time in over 20 years, the valuation advantage of investing in riskier long-term assets (stocks) versus lower-risk assets (Treasury bonds) has narrowed considerably. Given this backdrop of a stretched stock market valuations and numerous policy uncertainties, equity investors should anticipate lower returns and more volatility in 2025. We expect that the forward P/E multiple will be lower by year-end and that S&P 500 index appreciation in the 5% to 10% range is a more reasonable expectation for 2025.

Sources: FactSet Research; Standard & Poor's; Bloomberg; Federal Reserve. Data as of 12/31/24.

Fixed Income Markets in 2024 and the Outlook for 2025

We wrote in last year's letter that we expected a more normalized bond market return, described as a "coupon" like return for the year. Coming into December that was playing out as the market was tracking to a 5.00-5.50% total rate of return. However, December has seen a dramatic back-up in rates leading to a steeper yield curve and lower bond prices. This was largely driven by two main factors. The first is Fed policy and the forward look into 2025 on that front (more on the Fed to follow). The second is the expected impact of the policies of the incoming administration. The market views the potential impacts of tax cuts, mass deportation, and tariffs as inflationary and thus has taken longer interest rates near their highest levels of the year. This has led to the Bloomberg Aggregate bond index shedding 3.06% in the 4th quarter, bringing YTD returns down to just +1.25%.

As we entered 2024 the general consensus was for a buoyant bond market spurred on by a Federal Reserve that would be aggressively easing interest rates. The market, and most pundits, had as many as six rate cuts built in for the year. We were skeptical that the Fed would be that accommodative and felt that two to three rate cuts was the more likely outcome. In the end the Fed cut three times by a total of 100bps bringing the current fed funds target range to 4.25-4.50%. While this is a more accommodative stance it is by no means an "easy" policy environment. After their most recent cut the Fed made it clear the hurdle for future cuts was far higher given sticky inflation readings and an economy that is still expanding. It is also implicitly understood that the Fed wants to see the effects of the above-mentioned policy shifts before embarking on further rate cuts.

Even with the 100bps of rate cuts, longer rates have risen steadily since the first move. In our minds that was to be expected and makes sense. The Fed is not cutting rates into a recessionary environment. Rather they are attempting to normalize policy towards a neutral rate in an economy that is still expanding. Furthermore, they are doing this with inflation readings remaining well above their 2.0% target (most recently core PCE, the Fed's preferred inflation gauge, came in at an annualized rate of 2.4%).

Starting in 2023 we began extending duration off the very short profile we had in the ultra-low-rate era. We advocated for moving towards a medium duration somewhere in the 4.0-4.5 year area. We took our most aggressive approach as the 10yr pierced 5.0% in later 2023, peaking just inside of 5.3%. Earlier in 2024 longer rates rallied all the way into 3.6% on the 10yr and we felt this was well overdone and went back to favoring a shorter profile. As we stand today, with the 10yr nearing 4.6%, we do feel value is coming back into medium duration municipal bonds and we are comfortable with 4-6 year calls where we are getting between 90-100% of treasury rates. That said we are still being picky as to what structures we buy given the bias in the market for rates to creep higher.

Though we see increasing value in the municipal bond space, the same cannot be said for credit. Both investment grade and high yield bond spreads are right up against their tightest historical levels (72bps for investment grade credit and roughly 250bps for high yield). The credit markets are largely priced for perfection, and any form of a weaker economy could see spreads widen significantly. Where we do own corporate bonds and/or high yield, we are sticking to short duration and the higher quality areas of both markets. We have long liked the preferred/hybrid space within credit and have chosen that over high yield in recent years. Though spreads here are also nearing their tights, the quality of the issuers (typically bulge bracket banks and large, diverse utilities) gives us far more confidence. We are marrying different structures and call dates, always using fixed/floating rate varieties. We view most of the back-end spreads as attractive for these credits and would be comfortable with these bonds either being called away or extending and floating. Typically, in our models we hold between 15-20% in these securities and currently we are operating at the lower end of that band, leaving room to add on potential spread widening.

Sources: U.S. Bureau of Economic Analysis; Federal Reserve; Bloomberg

One area we pointed to as we entered 2024 was the government agency market. We felt there was very solid value in this corner of the market and still feel that way as we move into 2025. We are getting significant pick-up over comparable treasuries and even over most investment grade corporate spreads. In most cases we buy 10-20 year finals with anywhere from three month to one year call features. Whether the bonds are called at their initial date or are left outstanding, we find the 5.50-6.0% coupons as an attractive, high-quality place to be.

For those who have been reading our letters for several years, you will know that we preach a flexible and diverse approach to investing across the fixed income landscape. The last three years have exemplified the value of this investing approach. The Bloomberg Aggregate Index has an annualized return over that time frame of -2.43%. In that same stretch our average fixed income account has annualized at a positive 1.90% per year. Not being constrained to a specific duration mandate nor a specific sleeve (i.e. all municipals or all treasuries etc.) are the biggest drivers behind this. Being nimble and being able to shift duration and credit exposures as we see fit is the key to navigating what has been an exceptionally difficult bond market.

It seems clear heading into 2025 that interest rate volatility is here to stay. The market will be hanging on each key piece of data, as well as the words coming out the Fed to set the path of interest of rates. Our view is that the current rate back-up has once again created an opportunity to lock in some longer-term bonds. However, we would not dive in with both feet as we feel rates could ebb higher and credit spreads inevitably need to widen from here. With careful selection we think accounts could once again see a coupon like return by the time we reach the end of 2025. In the overall scheme of things, after 14 years of zero interest rates, we have a far better investing environment with bonds. Though the previous couple of years have seen heightened volatility, the income streams we have been able to lock in for our accounts are stable and will provide a far better overall return then the previous period. Against a backdrop where risk assets are pushing up against all time high valuations, we do feel that investors can add to fixed income at these levels as both a ballast, and a driver of mid-single digit consistent yields.

Closing Remarks

Guiding client portfolios through the unexpected is difficult and knowing when to make adjustments and when to stand one's ground takes experience. As we have told clients many times over the years, remaining diversified, not making any outsized bets in any one industry group or theme, not over-concentrating your assets in a single security, and allowing time to work its compounding magic, is what we believe to be one of the best playbooks for long-term investing success. We believe that the Continuum Group has historically shown itself to be a very good navigator of risk during periods of uncertainty, each time striving to emerge from turbulent periods stronger than when we entered. Our team has access to a deep bench of financial professionals and tools to build financial plans and monitor the financial health of our clients. A better understanding of your financial health will help improve the chances that you can achieve your financial goals & objectives. We encourage you to take advantage of this offering.

We hope that you have appreciated our accessibility and wise counsel during these times. Your support of our service and investment philosophy has led to new relationships with additional friends and family members. We greatly appreciate this and hope that you will continue to refer others who might benefit from our investment strategies and services. If you have any questions about your investments, as well as any other topics relating to your financial wellbeing or future, we are always happy to discuss them with you. As always, the entire team is here waiting to assist you.

For those who wish to learn more about The Continuum Group at Morgan Stanley, we encourage you to visit our new website at: https://advisor.morganstanley.com/the-continuum-group.

Most Sincerely Yours,

The Continuum Group at Morgan Stanley

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Appendix A: The Tradeoff Between Inflation and P-Es

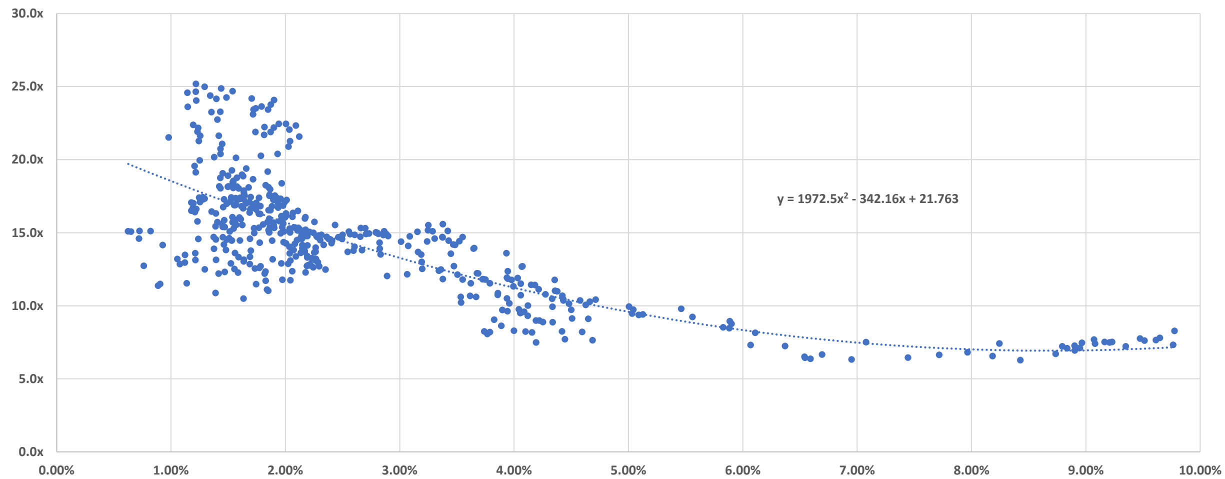
In past letters we have attempted to teach our clients a little bit about what affects equity prices, and to point out historical periods when the valuation and performance of certain asset classes have deviated far from the norm; sometimes creating opportunities, but more often risks for those who are unaware. There will always be things going on in the markets that catch investor's attention, such as industry reports, natural disasters, wars, election results, and geopolitical events. While all these things are important, they generally have manageable, short-term impacts on the financial markets. We believe the real hammer on fixed income and equity markets has been and will always be the Federal Reserve because of its ability to change interest rates and the amount of liquidity that is available to financial system participants and businesses. Accordingly, what the Fed is doing or is expected to do at any given time is the most important factor for investors to be aware of and comfortable with. This is why so much time is spent debating whether Fed Policy is appropriate given the trajectory of inflation and unemployment.

It goes without saying that we all want our investments to appreciate, and in times when the Fed is injecting liquidity into the financial system, and therefore the economy, this generally becomes the case. So, it is no surprise that with inflation having eased from its peak and the employment supply/demand situation in better balance that pundits continue to call for the FOMC to continue lowering policy rates. But at what risk? We can't stress enough how important it is that the Fed maintain control over inflation, or how negative the impact would be on intermediate- to long-term equity market appreciation if it makes a policy mistake, and inflation reaccelerates. Given the number of uncertainties the Fed is confronted with and its intention to be data dependent when making policy changes, the risk that the Fed could make a policy mistake is higher than it was a year ago. In the attempt to quantify the implications of a mistake, the scatter graph below shows the S&P 500 P/E Ratio on next-12-month earnings (i.e. Forward P/E

Ratio) versus the annual rate of change of the Fed's "preferred" inflation measure, the Core Personal Consumption Expenditure Price Index (Core PCE Y/Y%), plotted monthly from 1980 to 2019 (the year before COVID).

What is clear from this relationship is that the Forward P/E Ratio on the S&P 500 declines as Core PCE Y/Y% rises. Importantly, when Core PCE Y/Y% approaches and goes below 2%, P/E multiples above 15x dominate, but when the Core PCE Y/Y% approaches and exceeds 4%, P/E multiples fall well below 15x.

The Core PCE Price Index Y/Y% versus the S&P 500 Forward P/E Multiple (1980 to 2019)



Sources: Standard and Poor's; U.S. BEA; Factset Research. Data plotted monthly for the period 1/1980 to 12/2019.

As of the November 2024 data release, the Core PCE Y/Y% stood at 2.8%, with the year-end 2024 S&P 500 Forward P/E at 21.9x. Based on the pre-COVID relationship between Core PCE inflation and P/Es shown above, the S&P 500 forward P/E ratio would be expected to be closer to 14x if Core PCE inflation is at 2.8%. If we instead use the 2.5% FOMC median projection for 2025, an S&P 500 forward P/E of almost 15x would be expected. This leaves the current forward P/E well above where this model would imply. What this suggests to us is that the stock market is counting on continued FOMC success bringing inflation back down to its 2% target. Long story short, if equity investors begin to believe that the Fed's progress on reducing inflation has stalled or even reversed, P/E multiples could contract, and do so by enough to offset the determinant of long-term stock market appreciation, rising earnings. That being the case, if the equity market is to continue to be the primary driver of investor portfolio returns over the intermediate to long run, progress on inflation must continue.

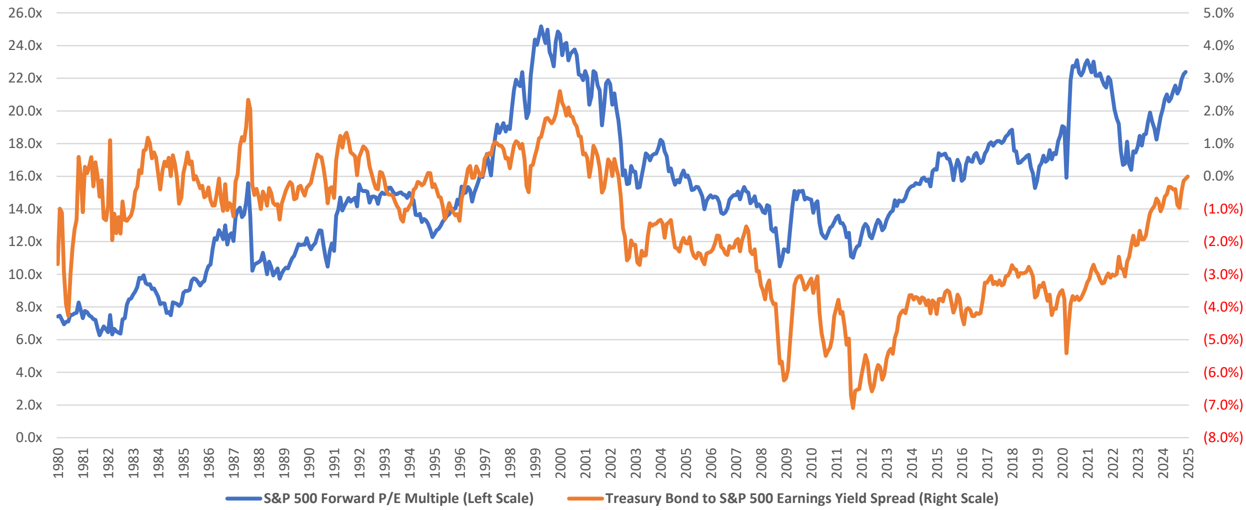
Sources: Standard and Poor's; U.S. Bureau of Economic Analysis; FactSet Research; FOMC Summary of Economic Projections December 18, 2024; Stock Market Data as of 12/31/24.

Appendix B: Valuation May be a Poor Timing Tool, but It's Important

If you listen to most market timers, they will tell you that valuation is a poor timing tool that fails to predict stock and equity market trends and turns. We would not disagree with that point of view. However, valuation does tell you a lot about the market's "expectations" for earnings growth and therefore equity price appreciation. When P/E ratios are high and bond yields well exceed equity yields, investors are expecting a lot from the companies and indexes they invest in; and when P/E ratios are low and earnings yields well above bond yields, they are not expecting much at all. Additionally, when a market changes trend in a high valuation state, the movement lower tends to be steeper and longer, and when a market changes trend in a low valuation state, the movement higher tends to be sharper and longer.

As of 12/31/24, the S&P 500 was trading at a P/E on 12-month forward earnings of 21.9x, which is in the top 11% of observations data back to 1980. Excluding the temporarily inflated P/E multiples of the COVID period, the graph below shows that the market is now trading at its highest P/E multiple since the Dot-Com Bubble. The bond-to-stock yield spread also bears mention. In December, the yield on the 10-Year Treasury reached parity with yield of the S&P 500 based on 12-month forward earnings for the first time since May 2002 when the Dot-Com Bubble was deflating. While not yet at the level of the Dot-Com peak, the current bond-to-stock yield compares unfavorably with the average -2.9% over the past ten years. This would suggest that Fiscal and Monetary policy mistakes, or a change in thinking about the potential of AI could have deeper and longer lasting impacts on the equity market.

S&P 500 Valuation: Forward P/E Multiple and the Bond-to-Stock Yield Spread

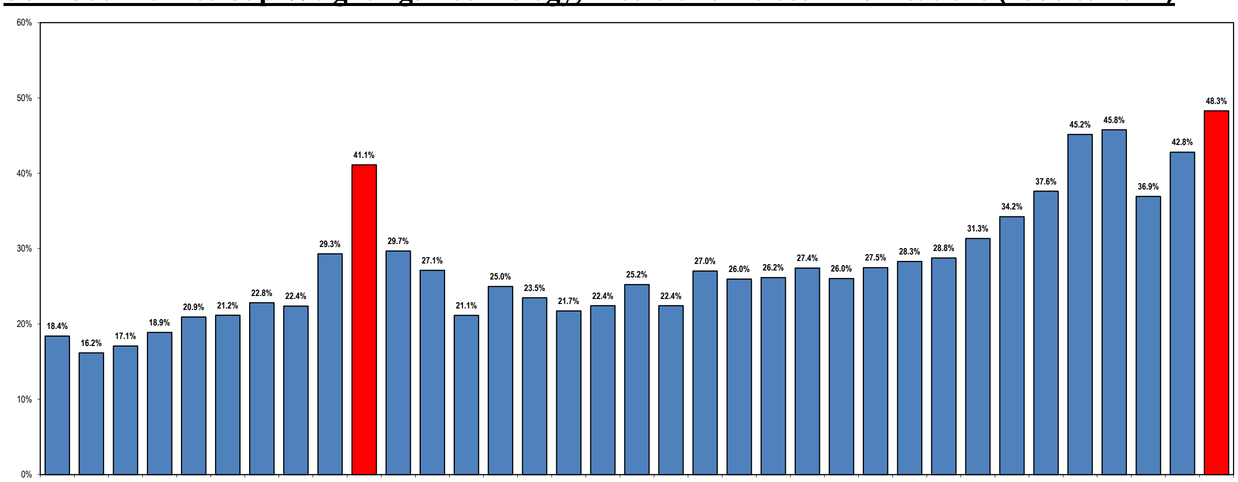


Sources: Standard and Poor's; FactSet Research. Federal Reserve; Stock and Interest Rate. Data as of 12/31/24.

Appendix C: Trees Don't Grow to the Sky

There is a well-known proverb that reads, "Trees Don't Grow to the Sky." If you Google that proverb, the search engine will return "A business adage taken from a German proverb, warning against straight-line thinking. The product, the customer, the market will not continue to grow simply because they have always grown in the past. Growth becomes Maturity; Maturity becomes Decline. The lifecycle moves forward." This proverb could serve as a warning to investors about stock market positioning.

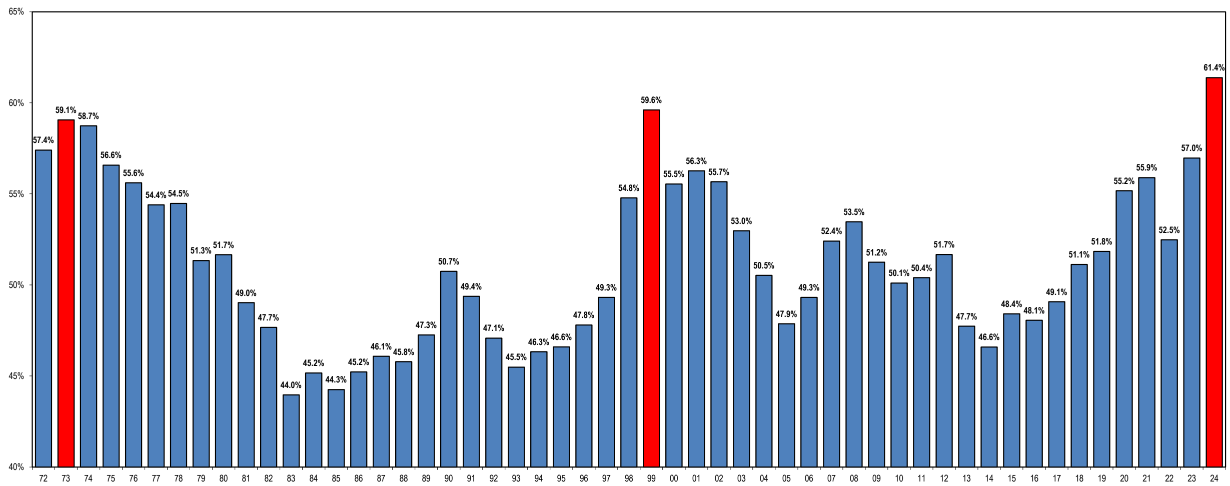
S&P 500 Market Cap Weighting: Technology, Media and Telecommunications (1990 to 2024)



Sources: Standard and Poor's; FactSet Research. TMT group includes AMZN and TSLA. Data plotted as of 12/31/24.

The S&P 500's total market cap has become heavily skewed towards a favored few Mega-Cap Technology, Media, and Communications (TMT) companies. As of year-end 2024, the TMT group (including Amazon and Tesla) accounted for 48.3% of the total S&P 500 market cap, which is higher than the 41.1% in 1999 at the height of the Dot-Com Bubble. Additionally, the Top 50 companies by market cap in the S&P 500 (i.e. the "Mega Caps") accounted for a record 61.4% of total S&P 500 market cap; exceeding the prior all-time peaks of 59.1% in 1973 during the "Nifty 50" bubble and 59.6% in 1999 during the Dot-Com bubble.

S&P 500 Market Cap Weighting: 50 Largest Companies (1972 to 2024)



Sources: Standard and Poor's; FactSet Research. Data plotted as of 12/31/24.

We have all heard about the stock market's rise this year and how it has been driven by the "Magnificent 7" companies that are changing how the world views technology, its industrial application, and how it will be used by the consumer. In those claims we can't help but hear the echoes of the "Nifty 50" of 1973.

Making no purchase recommendations, the "Magnificent 7" of 2024 included Apple, Alphabet, Amazon, Meta, Microsoft, Nvidia, and Tesla. As of year-end 2024, these companies accounted for 32.6% of the S&P 500's market capitalization. Looking back some 50 years, the "Magnificent 7" of 1972 made up 24.3% of the S&P 500's market cap and included AT&T, Eastman Kodak, General Electric, General Motors, IBM, Sears & Roebuck, and Xerox. At the time, these where considered the companies to own as they were changing how the world viewed technology, its industrial application, and how it would be used by the consumer. Sound familiar? Two years later when their exceedingly lofty expectations returned to normalcy, the market cap of the "Magnificent 7" of 1972 were sharply lower. Furthermore, these companies did not return to their 1972 peak market cap level for 10 years. On the other hand, the remainder of the index was 65% higher 10 years later. Accordingly, if this era's "Magnificent 7" were to fail to meet analyst's expectations, they could exert downward pressure on the overall index that even good performance from the remainder of the index would be unable to offset. The important point is that if you are looking for equity appreciation in the years to come you may be better served using a more diversified approach in your equity portfolio.

Sources: Standard and Poor's; FactSet Research; Stock Market Data as of 12/31/24.

Disclosures

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The **S&P 500 Top 50 Index** consists of 50 of the largest companies from the S&P 500, reflecting U.S. mega-cap performance. Index constituents are weighted by float-adjusted market capitalization. The index is reconstituted annually.

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Please contact your Financial Advisor for a complete listing of all transactions that occurred during the last twelve months.

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

NOTE: High yield bonds are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues.

Duration, the most commonly used measure of bond risk, quantifies the effect of changes in interest rates on the price of a bond or bond portfolio. The longer the duration, the more sensitive the bond or portfolio would be to changes in interest rates. Generally, if interest rates rise, bond prices fall and vice versa. Longer-term bonds carry a longer or higher duration than shorter-term bonds; as such, they would be affected by changing interest rates for a greater period of time if interest rates were to increase. Consequently, the price of a long-term bond would drop significantly as compared to the price of a short-term bond.

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

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Preferred securities can be called prior to maturity, which may reduce yield if purchased at a premium. Preferred securities may be subject to other call features or corporate restrictions that may have an effect similar to a call. Prices may fluctuate reflecting market interest rates and the issuer's credit status.