Morgan Stanley Wealth Management

November, while volatile, provided positive returns for equities and bonds. The mid-November pullback paradoxically stemmed from much better-than-expected economic data which lessened the odds of a December rate cut (spoiler: we still think the Fed cuts this month). For the month, the S&P 500, Dow Jones Industrial, and Nasdaq Composite Indices rose 0.2 percent, 0.6 percent, and 0.7 percent respectively. Smaller stocks also rallied in the last week of the month and posted positive November returns. The Russell Midcap and Russell 2000 (Small caps) both rose 0.6 percent. Developed International markets as measured by the MSCI EAFE index also climbed 0.6 percent. Bucking their trend, emerging markets declined a bit with the MSCI Emerging Markets Index falling 2.4 percent – EM remains the best performing stock segment this year up 30.4 percent through the first 11 months. The Bloomberg Aggregate US Bond index rose 0.6 percent for the month and the Bloomberg US Municipal Index rose 0.1 percent.

As we do each December, we like to review our beginning of the year predictions. We made 5 major predictions last December and added another in April (that inflation would not rise as much as the media suggested it would from the Trump administration's tariffs.) Right now, it looks like we will end up self-scoring 5 out of 6 as correct.

Prediction one was that despite some volatility and more dispersion in Mag 7 performance, we thought both stocks and bonds would offer positive returns in 2025. We further predicted Morgan Stanley's year end 2025 call of 6,500 on the S&P 500 was about right but that their 3.55 percent yield call on the 10-year bond was too optimistic. Right now, the S&P is around 6,800 and the current yield on the 10-year is 4.09 percent (this was authored on December 1st). While the year is not quite over, both stocks and bonds have provided substantive returns so far. Through the end of November, the MSCI All Country World Index was up 21.6 percent, and the Bloomberg US Aggregate Bond index was up 7.5 percent.

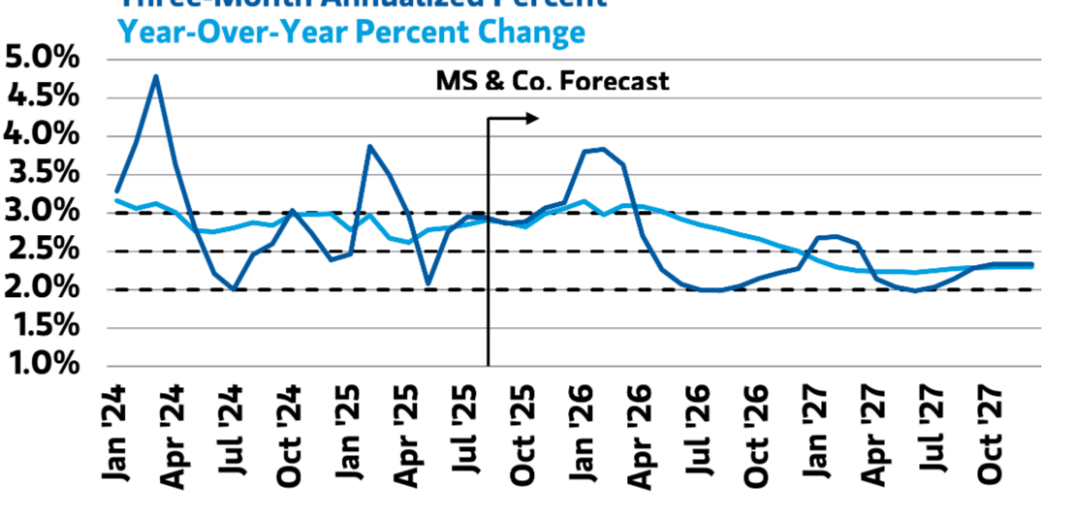
Prediction 2 was that there would be at least one major correction of more than 10 percent. We thought it might concentrate in the Mag 7 stocks (traders can't sell what they don't own). A market correction began in March and culminated in April with the Trump Liberation Day announcement. At the peak draw down on April 8th, the S&P 500 had declined almost 28 percent from its 12/31/2024 close. The Mag 7 as measured by the Bloomberg Magnificent 7 Total Return Index had declined about 35.5 percent to that same intraday low.

Prediction 3 was that the S&P 493 would outperform the Mag 7 for the year and that value would outperform growth. We were incorrect here, though the S&P 493 performed better than 4 of the Mag 7 seven stocks. Two of the other three did so well, however, that our prediction proved inaccurate. We are kicking ourselves for not making this a global, rather than a domestic statement, as it would then have then rung true. The best stock returns in 2025 came not from the Mag 7, but from international and emerging markets equities. We correctly believed the market would broaden out and advised clients to maintain significant mid, small and international exposure -- but focused to exclusively on domestic stocks when we made the specific prediction.

Prediction 4 was that Small and Mid-Cap stocks would have a positive year. As of the end of November, the Russell Midcap was up 10.9 percent for the year and the Russell 2000 (small caps) gained 13.5 percent.

Prediction 5 was that inflation would remain sticky in 2025. We thought the Fed would only be able to cut rates 2-3 times, which was much less than the average of pundit predicted last December. If the Fed cuts this month (we still think they will), that would be three 2025 cuts. As it stands right now, the Fed's Inflation Nowcast for 2025 sits at 2.96 percent, about the same as 2024 inflation of 2.94 percent. (Just for reference, CPI inflation measured 4.69 percent in 2021, 8.0 percent in 2022 and 4.12 in 2023.)

Our 6th major prediction, which we made in April during the Liberation Day sell off, was that the much-feared tariff hyperinflation would not come to pass. That also appears correct 8 months into the new tariff regime.



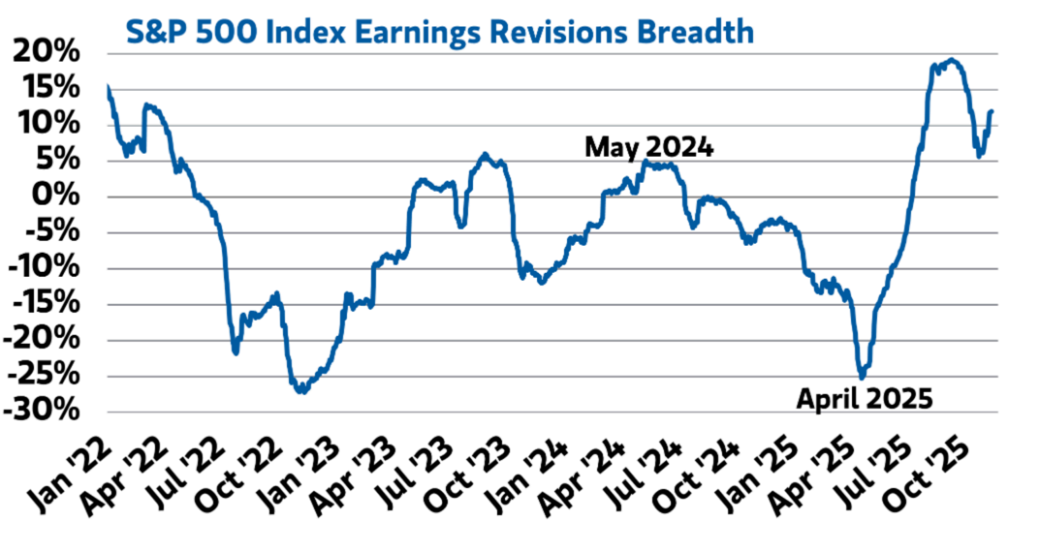
Source

While we have not finalized our 2026 predictions yet, we hope we won't spoil things too much by telling you we remain cautiously optimistic as we end 2025 and begin 2026, our nation's semiquincentennial year. We think there's potential for a Santa-Claus rally to close out 2025, especially if the Supreme Court invalidates some or most of the Trump tariffs – a de facto corporate tax cut. In our opinion, better-than -expected consumer spending data will be the theme this month – the Black Friday and Cyber Monday sales data was surprisingly robust. When Q3 GDP is finally released on December 23rd (delayed from the government shutdown), we think it will exceed the highest of current predictions of major research institutions and Wall Street banks.

Ultimately, our team expects positive returns from both stocks and bonds again next year – albeit with heightened volatility. Morgan Stanley's Chief Investment Officer Lisa Shalett framed it this way in this month's On the Markets , "in 2025, fears of headwinds from immigration action and tariff policy reform evolved into a broadening bull case—tied to faith in stimulus from monetary easing and the One Big Beautiful Bill Act, financial deregulation and an anticipated surge in capex and AI-related productivity gains. 2026, however, is apt to be a lumpier ride. In our view, idiosyncratic navigation and execution will produce winners and losers, demanding greater emphasis on picking and choosing. After all, much of 2025 has been about upside surprises regarding economic resilience, and that scenario has baked high expectations into 2026 earnings forecasts. Notably, projections begin with the market already at a historically rich price/earnings ratio of 22.5 times on earnings-per-share-growth assumptions of 14%–15%.....In sum, we believe 2026 sets up to be a rewarding but volatile year, when active risk management is advised for the fourth year of the bull market and second year of the presidential term. We stay at maximum portfolio diversification, and maximum active management in equities and fixed income, with blended portfolios likely to deliver another 7% to 12% for the year."

Source

We also expect the broadening theme to continue as "The Rolling Recovery Is Here" expands into more sectors, We favor quality stocks heading into next year and think the small and mid-cap rally may extend. We're starting to see data confirmation of our team's thesis that Q3 economic growth and earnings will surprise to the upside. Mike Wilson, Morgan Stanley's Equity Strategist, writes that there is "early supporting evidence an earnings recovery can be found in 3Q results – a 2.2% S&P 500 revenue beat rate (2x average) and 8% EPS growth for the median stock in the Russell 3000 (the strongest growth in four years)."



Source: 2026 US Equities Outlook: The Rolling Recovery Is Here

We hope that you and your whole family had a blessed Thanksgiving and will enjoy the happiest of Holiday Seasons to close out 2025. We look forward to continuing to work with you and your family in 2026 and beyond. As always, if any member of our team can do anything for you at all, please don't hesitate to let us know.

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