February was a good month for stocks and produced a broader set of gainers – while a couple of the magnificent 7 stocks led mega caps higher, a few others waivered and the Russell Mid-Cap and Russell 2000 actually outperformed the Russell 1000 for the month. Value stocks continued to underperform growth. Emerging markets, led by Chinese stocks which gained 8.4 percent in February, also rallied during the month. Bond prices fell as rates rose about 40 bps on the 10-year treasury.

So far, our beginning-of-the-year calls that 2% inflation would become a floor rather than a cap has proven true. The Fed's favorite measure of inflation, The Personal Consumption Expenditures index, did produce an acceptable result in February with year-over-year inflation falling to 2.4 percent. But the details of that report were not all that encouraging. The core PCE index, excluding food and energy, still increased 2.8% year over year. Alarmingly, the January monthly jump was 0.4 percent by itself, which would annualize at something akin to 4.8 percent. As we still see no signs of imminent recession or significant cracks in the strong labor market, it's hard for us to imagine a scenario where inflation doesn't prevent the Fed from lowering rates as much as markets would prefer.

Lisa Shalett, Chief Investment Officer, was also worried by February inflation data, writing in her March 4th GIC Weekly, " the first two months of 2024, however, have failed to confirm the consensus narrative, as economic growth has been much stronger than expected and major price indexes have suggested reaccelerating inflation. The 10-year US Treasury yield has risen more than 40 basis points since late December, with the real rate hovering close to 2.0%, near its pre-Great Financial Crisis level. As measured by the one-year swaps market, inflation expectations have risen from 1.9% last December to 2.5%. The consensus soft-landing narrative shifted on a dime to a "no-landing," midcycle reflation narrative, whereby profit growth is expected to justify equity prices."

We agree with Richard Bernstein, who wrote on February 21st, that "The current speculative environment seems to increasingly resemble the Technology Bubble of 1999/2000. Leadership is narrow, valuation dispersions are massive, relative strength and momentum are the primary drivers of performance, and investors are shunning diversification to take impulsive near-record portfolio risk." That's especially true when asset allocation, portfolio concentration, and equity beta are all considered together.

A strong case can be made that liquidity, rather than fundamentals, is driving the current rally – the Goldman Sachs Financial Conditions Index and the Bloomberg Financial Conditions Index both suggest financial conditions have become much looser in the last several months – reaching levels last seen in 2021 and early 2022 before the Fed began its rate-hiking plan in earnest. Liquidity fuels inflation. It correlates strongly with the price of crypto currency (currently hitting new highs) and momentum stocks. What's more, a positive feedback loop can be created at market highs between asset gains and liquidity conditions, as ever-higher prices produce a wealth effect and increase borrowing collateral. At this point, the team believes there is real risk of a surprise hawkish Fed statement or even action in the next month or two based on recent data. We worry that 2024 may prove historically analogous to the years between 1976 and

1979 – a second bout of increasing inflation after a period of relative calm and an all-clear signal from the Fed.

As always, if you have any questions or concerns, please don't hesitate to let any member of the team know.

NOTICE: Morgan Stanley is not acting as a municipal advisor and the opinions or views contained herein are not intended to be, and do not constitute, advice within the meaning of Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. If you have received this communication in error, please destroy all electronic and paper copies and notify the sender immediately. Mistransmission is not intended to waive confidentiality or privilege. Morgan Stanley reserves the right, to the extent permitted under applicable law, to monitor electronic communications. This message is subject to terms available at the following link:https://www.morganstanley.com/disclaimers. If you cannot access these links, please notify us by reply message and we will send the contents to you. By communicating with

Morgan Stanley you acknowledge that you have read, understand and consent, (where applicable), to the foregoing and the Morgan Stanley General Disclaimers.

Please see our **Privacy Pledge** for details about how Morgan Stanley handles personal information.

If you would like to update your email preferences or unsubscribe from marketing emails from Morgan Stanley Wealth Management, you may do so **here**. Please note, you will still receive service emails from Morgan Stanley Wealth Management.

Not all products and services may be available to persons living outside of the United States.

Morgan Stanley Wealth Management
2000 Westchester Avenue, Purchase, NY 10577-2530 USA

Morgan Stanley Smith Barney LLC. Member SIPC

Indices are unmanaged. An investor cannot invest directly in an index.

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

The views expressed herein are those of the author and do not necessarily reflect the views of Morgan Stanley Wealth Management or its affiliates. All opinions are subject to change without notice. Neither the information provided nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. Past performance is no guarantee of future results.

This material has been prepared for informational purposes only. It does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. Morgan Stanley Smith Barney LLC (''Morgan Stanley'') recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a Morgan Stanley Financial Advisor. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. Past performance is no guarantee of future results.

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

Please note that the URL(s) or hyperlink(s) in this material is not to a Morgan Stanley Smith Barney LLC website. It was created, operated and maintained by a different entity. Morgan Stanley Smith Barney LLC is not implying an affiliation, sponsorship, endorsement with/of the third party or that any monitoring is being done by Morgan Stanley of any information contained within the linked site; nor do we guarantee its accuracy or completeness. Morgan Stanley is not responsible for the information contained on the third party web site or the use of or inability to use such site.

Buying, selling, and transacting in Bitcoin or other digital assets, and related funds and products, is highly speculative and may result in a loss of the entire investment.

Diversification does not guarantee a profit or protect against loss in a declining financial market.