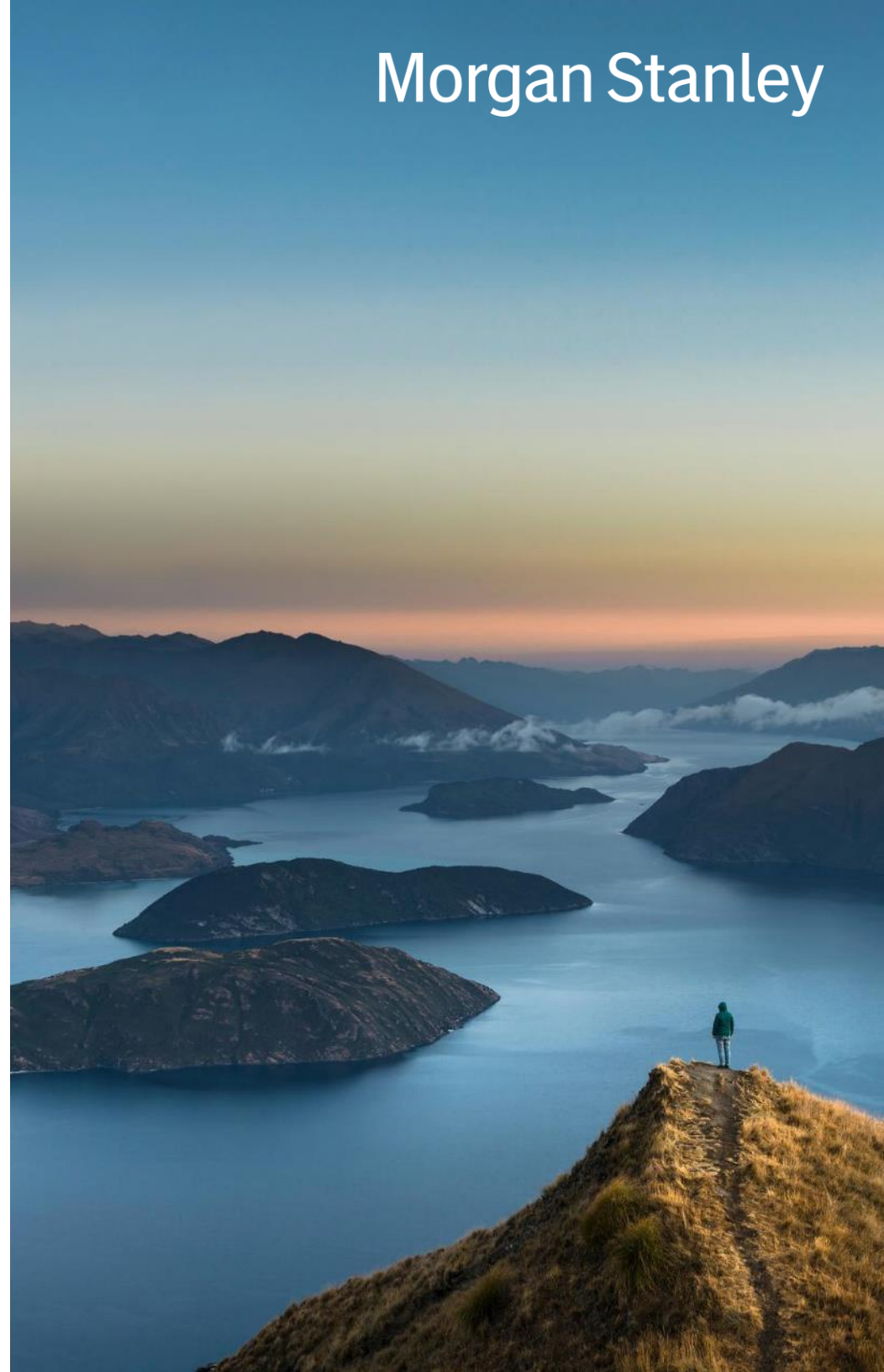


# Market Essentials

April 2025

Published April 9, 2025 and authored by Dan Hunt and Eve Pickhardt.

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# What You Need to Know About the Market This Quarter

We highlight the most significant market developments and put them in context for long-term investors. We also examine market corrections and the notoriously poor track record of market timing, some key portfolio construction techniques and themes that bear watching.



## STOCK INSIGHTS

The US market gave back some of its exceptional gains since 2022, as valuations fell and market leadership rotated.

## BOND INSIGHTS

Bond investments tend to be steadier than stocks, but which types of bonds and how much should depend on the investor.

## THINGS TO CONSIDER

- Corrections happen (a lot) more often than bear markets
- AI and the Cybersecurity “arms race”
- Defense spending may rise due to great power competition

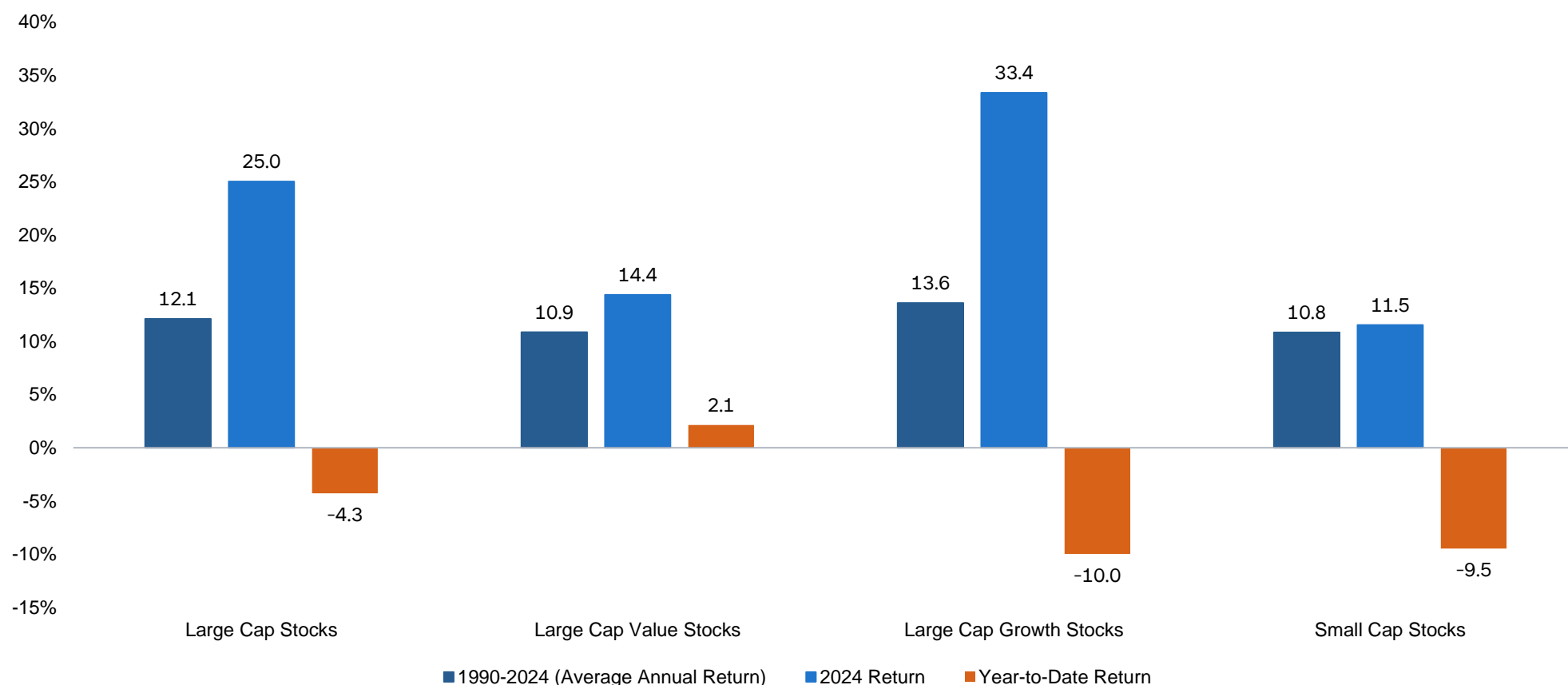
Source: Morgan Stanley Wealth Management GIO.

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# Stocks Have Been Strong, But Recently Gave Back Some Gains

## PERFORMANCE OF SELECT U.S. STOCK MARKET INDEXES (%)

AS OF MARCH 31, 2025



Note: Large Cap stocks represented by the S&P 500 Index. Large Cap Value and Large Cap Growth stocks represented by the Russell 1000 Value Index and the Russell 1000 Growth Index, respectively. Small Cap stocks represented by the Russell 2000 Index. Total returns shown. Source: Morgan Stanley Wealth Management GIO, Bloomberg.

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# Stock Market Leadership Changed in the First Quarter

## PERFORMANCE OF SELECT STOCK MARKET INDEXES (%)

AS OF MARCH 31, 2025

	2024 RETURN	YEAR-TO-DATE RETURN
US Stocks	25.7%	-4.3%
International Stocks	6.5%	5.2%
S&P 500 Sectors	Communication Services	-6.2%
	Technology	-12.7%
	Consumer Discretionary	-13.8%
	Real Estate	3.6%
	Health Care	6.5%
	Materials	2.8%

Note: Total returns shown. US Stocks represented by the S&P 500. International stocks represented by the MSCI All Country World Ex US Index. Top and bottom 3 sectors of the S&P 500 in 2024 shown.  
Source: Morgan Stanley Wealth Management GIO, Bloomberg.

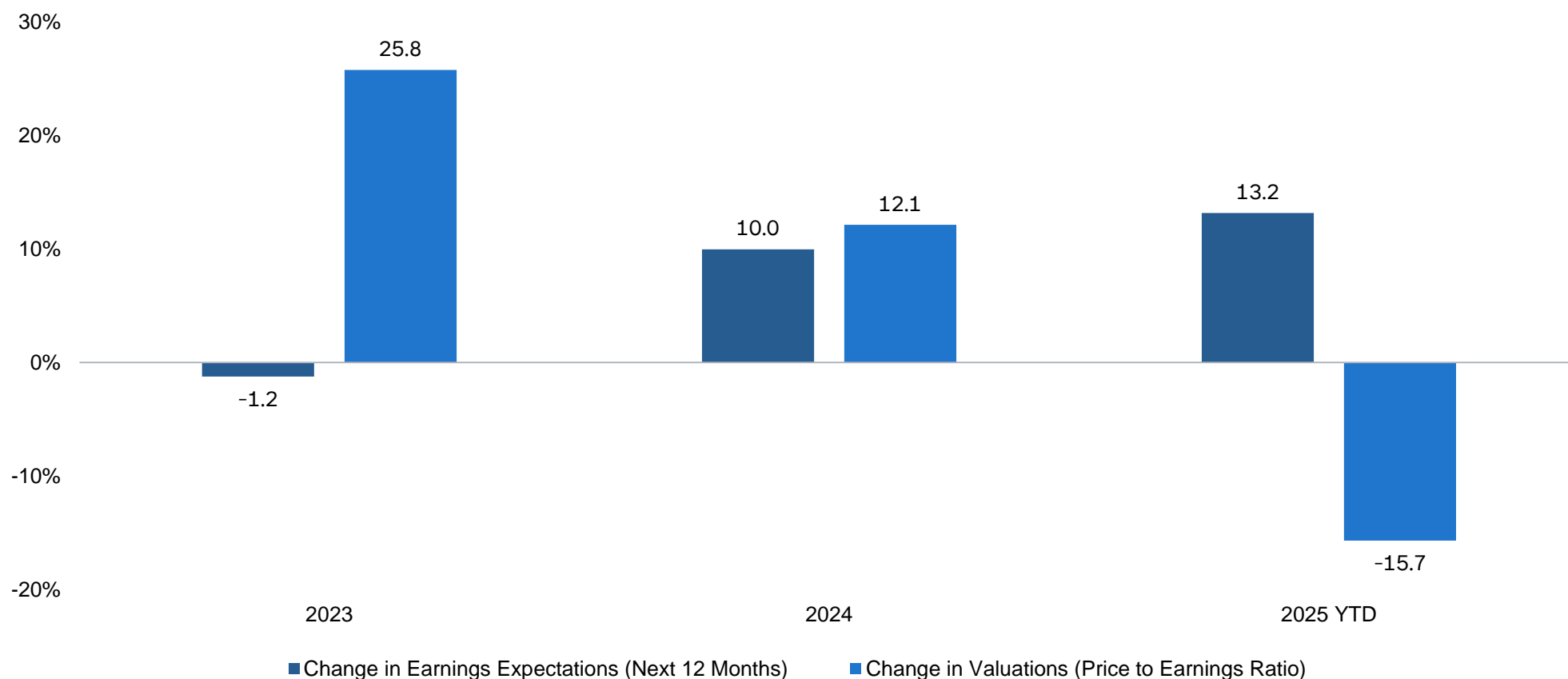
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# Stocks Declined Due to Falling Valuations; Expectations of Near-Term Earnings Increased

Increasing perceptions of risk or decreasing long-term growth expectations can drive lower valuations

## S&P 500: CHANGE IN ESTIMATED EARNINGS AND VALUATIONS (%)

AS OF MARCH 31, 2025



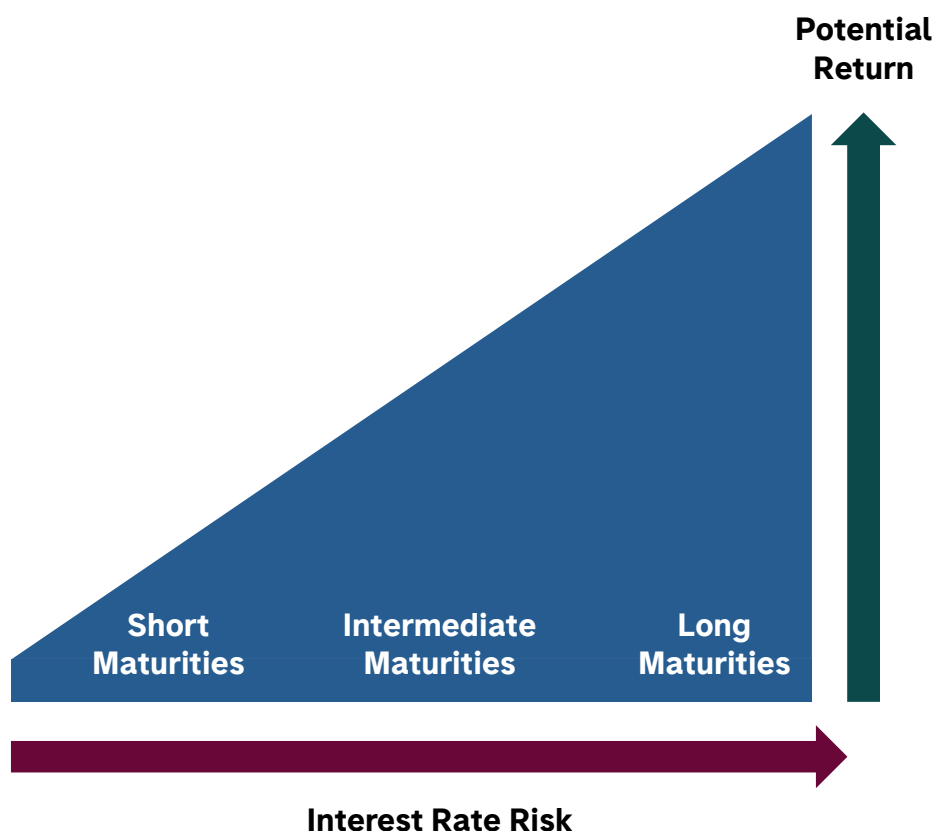
Note: Earnings estimates and valuations based on consensus estimates sourced by Bloomberg. Source: Morgan Stanley Wealth Management GIO, Bloomberg.

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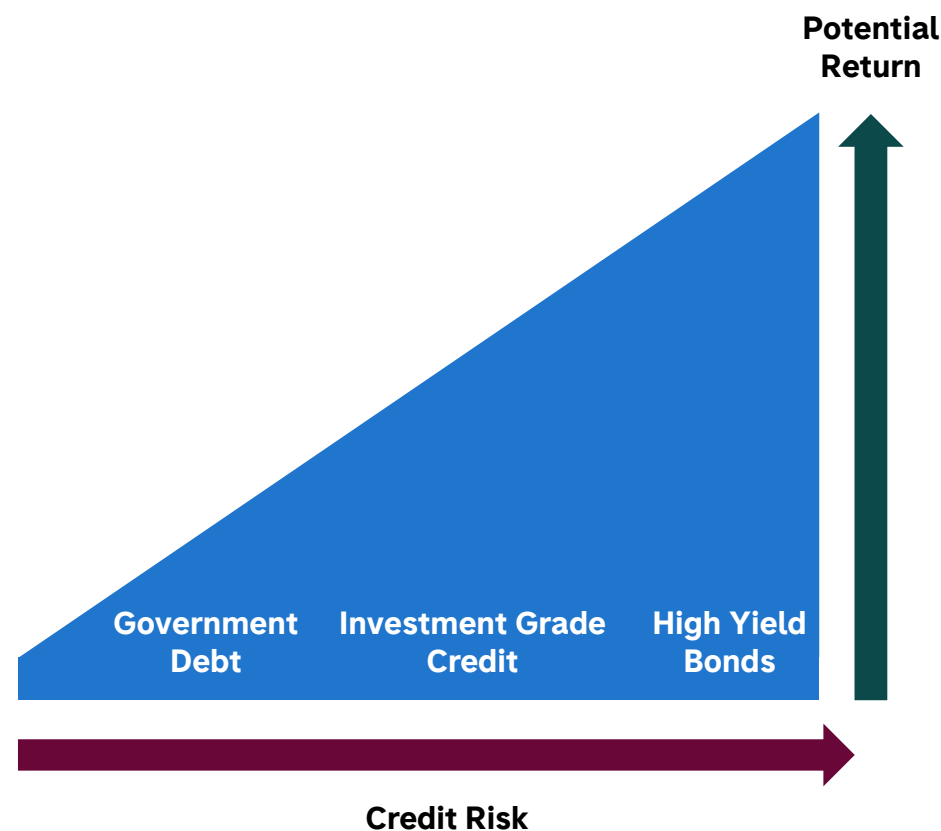
# Not All Bonds Are Created Equal: Consider Interest Rate and Credit Risks When Investing

The two primary sources of bond risk, interest rate and credit risk, vary a lot depending on bond type

**SENSITIVITY TO INTEREST RATE CHANGES**



**EXPOSURE TO POSSIBLE DEFAULT OR RESTRUCTURING**



Source: Morgan Stanley Wealth Management GIO.

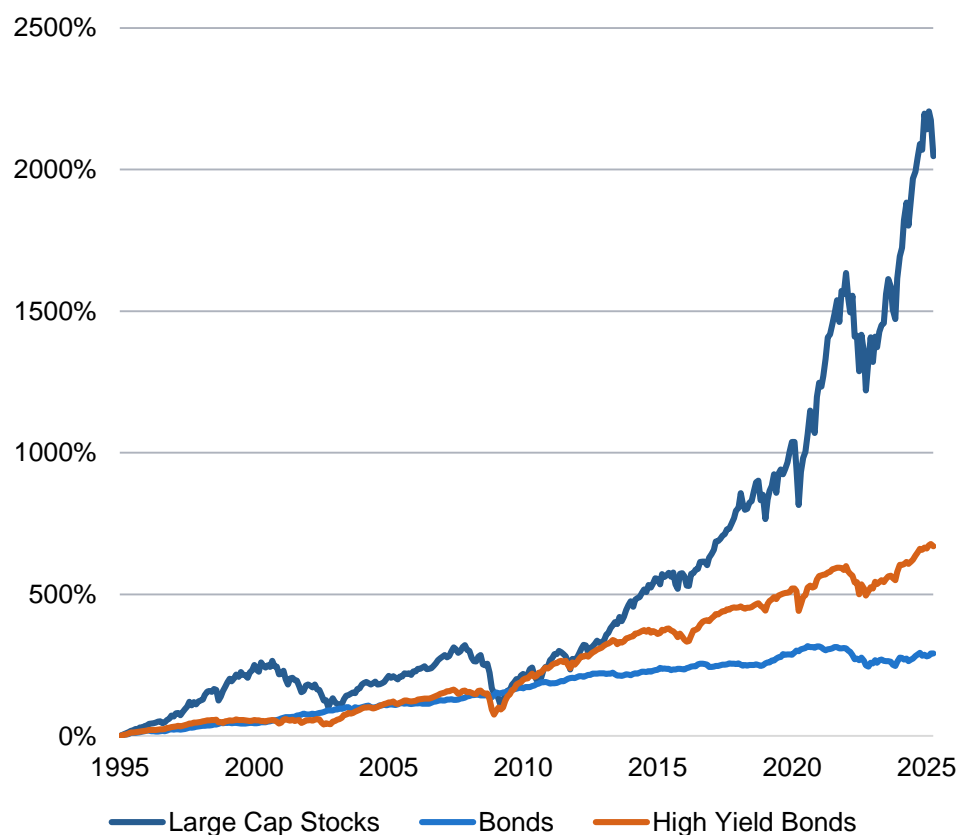
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# The Role of Bonds in a Portfolio

Stocks have grown faster than bonds historically but are also more susceptible to episodes of short-term losses. An investor's chosen mix should account for growth needs and tolerance for losses.

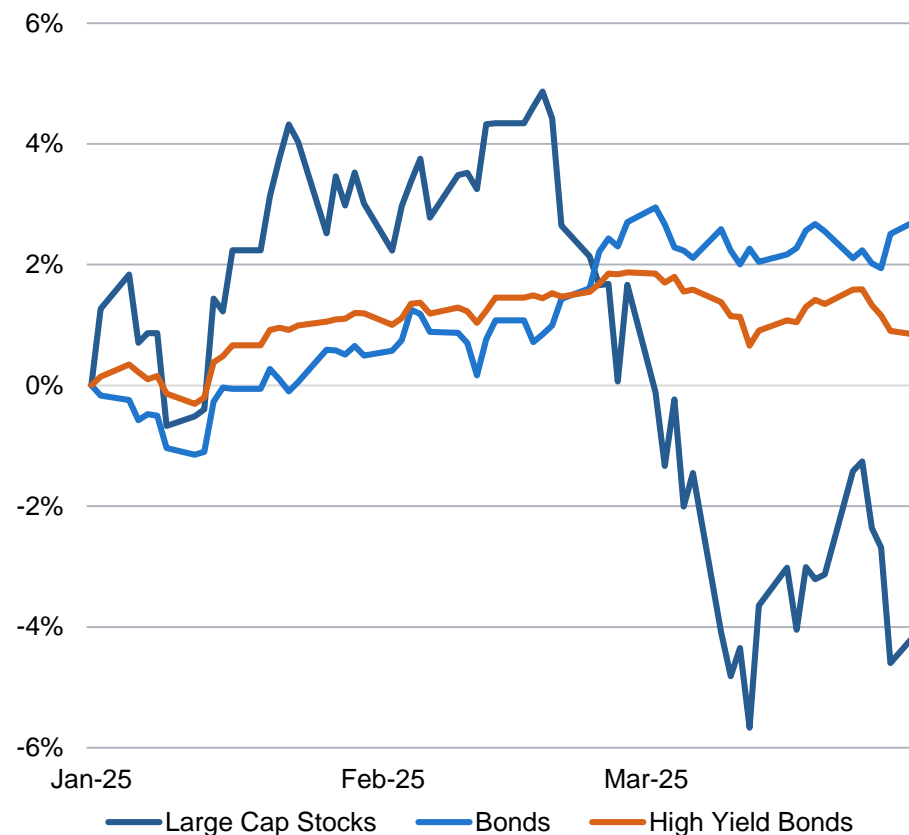
## STOCKS HAVE SHOWN GROWTH OVER THE LONG TERM (%)

JANUARY 1, 1995 TO MARCH 31, 2025; CUMULATIVE TOTAL RETURN



## BONDS CAN BE LESS SUCCEPTIBLE TO SHORT-TERM LOSSES (%)

JANUARY 1, 2025 TO MARCH 31, 2025; CUMULATIVE TOTAL RETURN



Note: Large Cap stocks represented by the S&P 500 Index. Bonds represented by the Bloomberg US Aggregate. Bonds represented by the Bloomberg US Corporate High Yield Index. Total returns shown. Source: Morgan Stanley Wealth Management GIO, Bloomberg.

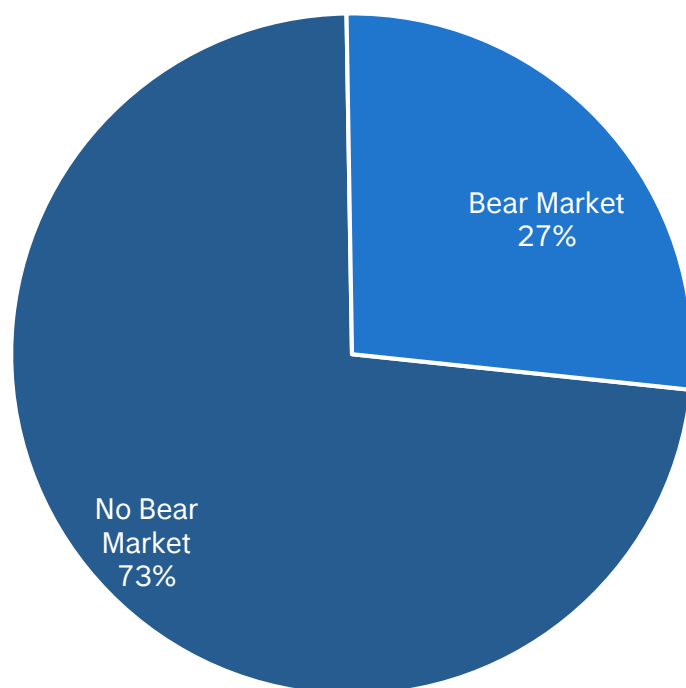
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# Corrections Are Frequent And Often Short-Lived

In 26 corrections since 1975, 73% never became “bear markets” (declines of 20% or more). On average, markets recovered from corrections within 5 months, whereas recovery after bear markets took longer.

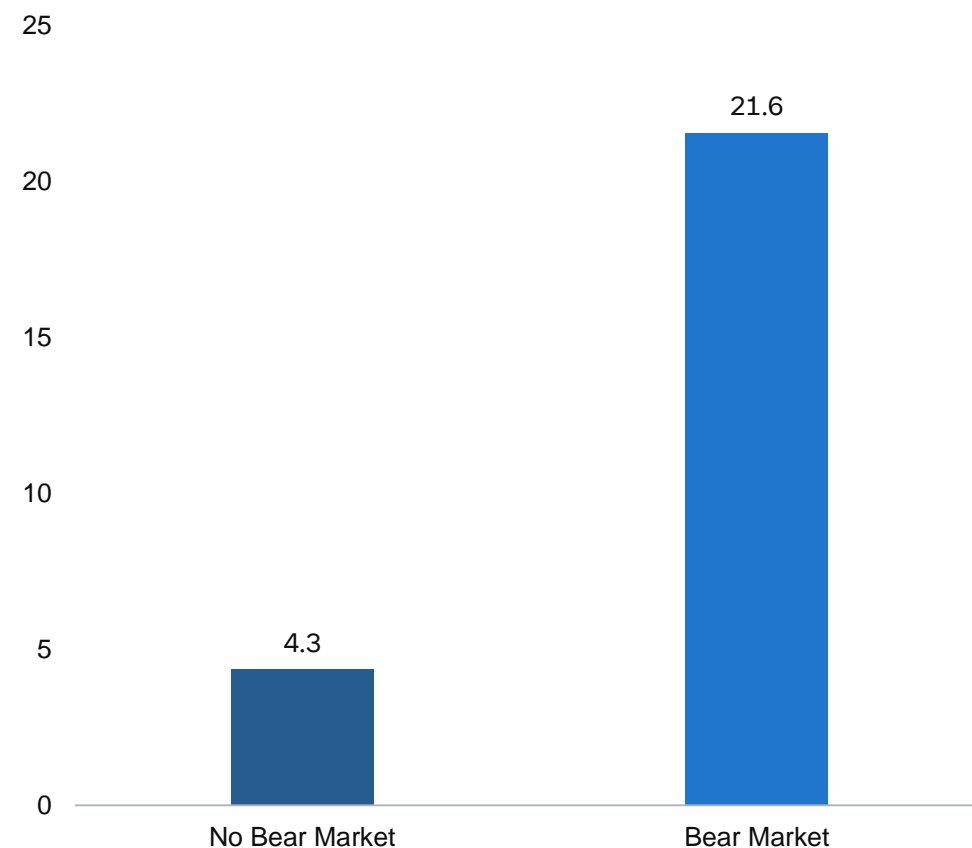
## S&P 500 DECLINES OF 10% OR MORE

1975-2024; PEAK TO TROUGH



## AVERAGE TIME UNTIL S&P 500 RECOVERS PRIOR PEAK (MONTHS)

1975-2024



Note: Does not include current decline, as the market has not yet recovered the prior peak. Source: Morgan Stanley Wealth Management GIO, Bloomberg.

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# Many People Sell During Downturns, Fearing More Losses. The Vast Majority End Up Worse Off.

What would have happened if an investor bought and sold when many real-world investors did?

## 60/40 STOCK/BOND PORTFOLIO; MARKET TIMING SCENARIO BASED ON ACTUAL PEAK TARGET DATE FUND REDEMPTIONS (\$)

OCTOBER 2007 TO DECEMBER 31, 2010



Note: Measured using daily total return data, assuming daily rebalancing. Investment grade bonds represented by the Bloomberg US Aggregate Index, equities by the S&P 500, and cash by three-month T-bills. Timing of selling and re-entering the market backed as historical fund flow data for Target Date Funds as measured by Morningstar. Source: Morgan Stanley Wealth Management GIO, Bloomberg, Morningstar. 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.

# Diversification Is a Steadier Ride

Things to Consider

The characteristics of each asset class, or type of investment, make them more or less appropriate for different economic environments.

AS OF MARCH 31, 2025

2016	2017	2018	2019	2020	2021	2022	2023	2024	1Q 2025	ANNUALIZED RETURN SINCE 2016
Small Value Stocks 31.7%	Emerging Market Stocks 37.8%	Bonds 0.0%	Large Growth Stocks 36.4%	Large Growth Stocks 38.5%	Small Value Stocks 28.3%	Large Value Stocks -7.5%	Large Growth Stocks 42.7%	Large Growth Stocks 33.4%	Foreign Stocks 7.0%	Large Growth Stocks 16.2%
Large Value Stocks 17.3%	Large Growth Stocks 30.2%	Large Growth Stocks -1.5%	Small Growth Stocks 28.5%	Small Growth Stocks 34.6%	Large Growth Stocks 27.6%	High Yield Bonds -12.7%	Foreign Stocks 18.9%	Small Growth Stocks 15.2%	Emerging Market Stocks 3.0%	Large Value Stocks 9.9%
High Yield Bonds 14.3%	Foreign Stocks 25.7%	High Yield Bonds -4.1%	Large Value Stocks 26.5%	Emerging Market Stocks 18.8%	Large Value Stocks 25.2%	Bonds -13.0%	Small Growth Stocks 18.7%	Large Value Stocks 14.4%	Bonds 2.8%	Diversified Portfolio 8.1%
Diversified Portfolio 12.2%	Small Growth Stocks 22.2%	Diversified Portfolio -7.9%	Foreign Stocks 22.8%	Diversified Portfolio 15.3%	Foreign Stocks 11.9%	Foreign Stocks -13.9%	Diversified Portfolio 17.0%	Diversified Portfolio 11.7%	Large Value Stocks 2.1%	Small Value Stocks 7.7%
Emerging Market Stocks 11.8%	Diversified Portfolio 18.9%	Large Value Stocks -8.3%	Small Value Stocks 22.4%	Foreign Stocks 8.4%	Diversified Portfolio 11.6%	Small Value Stocks -14.5%	Small Value Stocks 14.6%	High Yield Bonds 9.2%	High Yield Bonds 1.8%	Small Growth Stocks 7.6%
Small Growth Stocks 11.3%	Large Value Stocks 13.7%	Small Growth Stocks -9.3%	Diversified Portfolio 22.1%	Bonds 7.5%	Small Growth Stocks 2.8%	Diversified Portfolio -17.1%	High Yield Bonds 14.0%	Small Value Stocks 8.1%	Diversified Portfolio -1.5%	Foreign Stocks 7.1%
Large Growth Stocks 7.1%	High Yield Bonds 10.4%	Small Value Stocks -12.9%	Emerging Market Stocks 18.8%	High Yield Bonds 7.0%	High Yield Bonds 1.0%	Emerging Market Stocks -19.8%	Large Value Stocks 11.5%	Emerging Market Stocks 8.0%	Small Value Stocks -7.7%	Emerging Market Stocks 6.5%
Bonds 2.6%	Small Value Stocks 7.8%	Foreign Stocks -13.3%	High Yield Bonds 12.6%	Small Value Stocks 4.6%	Bonds -1.5%	Small Growth Stocks -26.4%	Emerging Market Stocks 10.2%	Foreign Stocks 4.4%	Large Growth Stocks -10.0%	High Yield Bonds 5.4%
Foreign Stocks 1.6%	Bonds 3.5%	Emerging Market Stocks -14.3%	Bonds 8.7%	Large Value Stocks 2.8%	Emerging Market Stocks -2.3%	Large Growth Stocks -29.1%	Bonds 5.5%	Bonds 1.3%	Small Growth Stocks -11.1%	Bonds 1.7%

Note: Large Growth Stocks represented by the Russell 1000 Growth Total Return Index. Large Value Stocks represented by the Russell 1000 Value Total Return Index. Small Growth Stocks represented by the Russell 2000 Growth Total Return Index. Small Value stocks represented by the Russell 2000 Value Total Return Index. Bonds represented by the Bloomberg US Aggregate Total Return. High Yield Bonds represented by the Bloomberg Global High Yield Index total return. Emerging Market stocks represented by the MSCI Emerging Markets index total return. Foreign Stocks represented by the MSCI EAFE index total return. Diversified portfolio represented by equally-weighted portfolio of asset classes shown. Source: Morgan Stanley Wealth Management GIO, Bloomberg.

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# Active or Passive Management?

Both approaches have strengths and weaknesses that can complement one another in an overall portfolio.

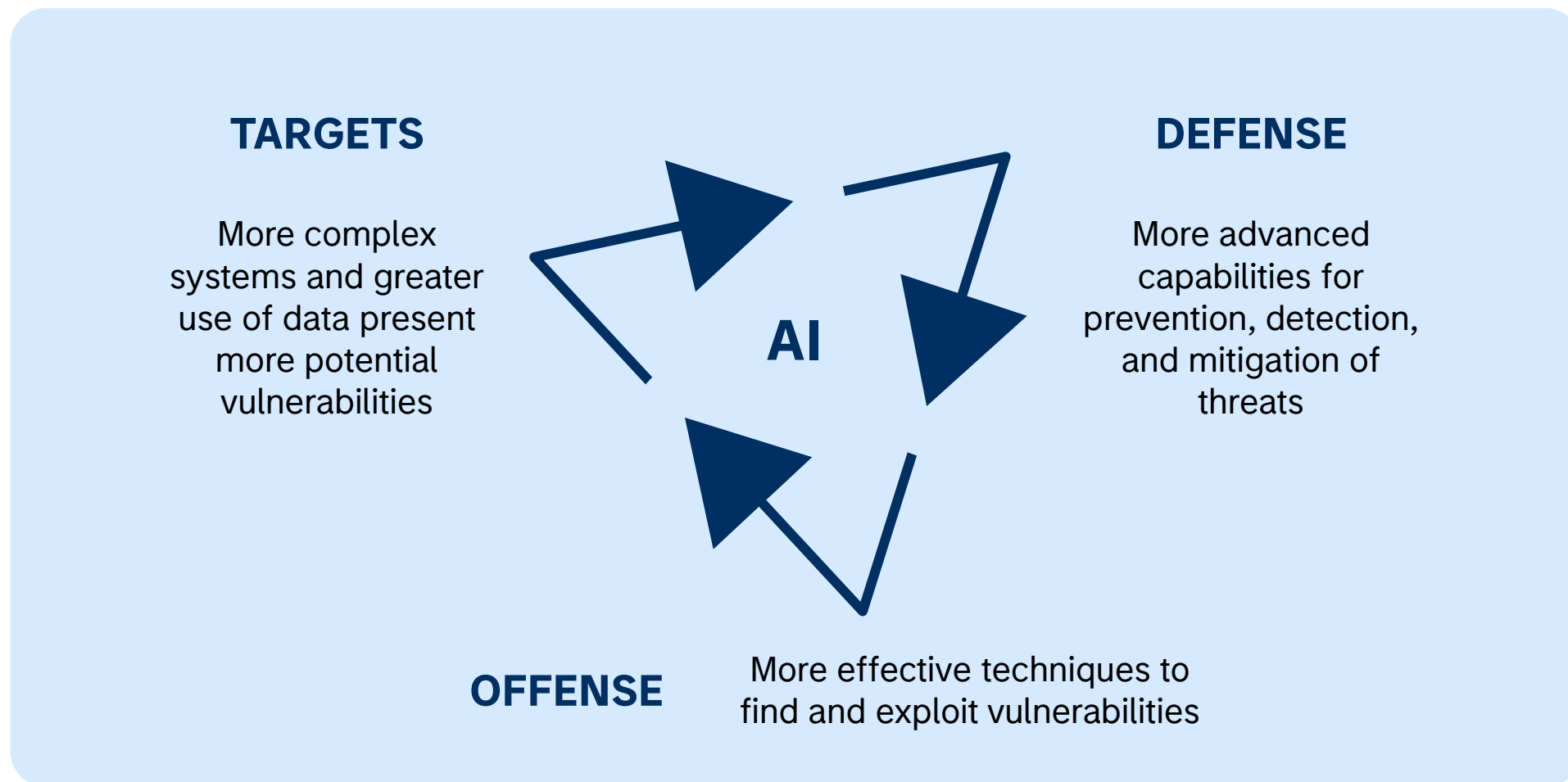
	PASSIVELY MANAGED FUNDS	ACTIVELY MANAGED FUNDS
<b>HOW DOES IT WORK?</b>	Typically holds all the securities which compose the index they track; minimal trading	Typically applies proprietary research and trading strategies to identify potential investment opportunities
<b>PROS</b>	<ul style="list-style-type: none"> <li>• Typically offer lower fees</li> <li>• Can be more efficient in taxable account</li> </ul>	<ul style="list-style-type: none"> <li>• Can help manage risks, including index concentration risk</li> <li>• Potential to outperform index</li> </ul>
<b>CONS</b>	<ul style="list-style-type: none"> <li>• Lacks proactive risk control (may hold highly concentrated positions)</li> <li>• No potential to outperform the market</li> </ul>	<ul style="list-style-type: none"> <li>• Typically require higher fees</li> <li>• Potential to underperform market index</li> </ul>
<b>WHERE HAVE THEY USUALLY BEEN MORE EFFECTIVE?</b>	<ul style="list-style-type: none"> <li>• Highly-traded, transparent markets</li> <li>• When underlying index delivers diversified exposure</li> </ul>	<ul style="list-style-type: none"> <li>• Complex, less-liquid markets</li> <li>• During periods of elevated volatility and changes in market leadership</li> </ul>

Source: Morgan Stanley Wealth Management GIO.

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# We Expect Artificial Intelligence (AI) to Spark a Cybersecurity “Arms Race”

AI is revolutionizing cyber operations, creating a self-reinforcing demand for innovation



Source: Morgan Stanley Wealth Management GIO

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# Defense Stocks Are Anticipating Significantly More Demand

Geopolitical tensions and new technologies appear set to increase defense spending across the globe

## GLOBAL AEROSPACE AND DEFENSE STOCK RETURNS RELATIVE TO GLOBAL STOCKS (%)

JANUARY 1, 2024 THROUGH MARCH 31, 2025



Note: Global Aerospace and Defense represented by the MSCI World Aerospace and Defense. Global stocks represented by the MSCI All Country World Index. Relative performance measured by the difference in total returns. Source: Morgan Stanley Wealth Management GIO, Bloomberg.

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**Investing in smaller companies** involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity.

**Stocks of medium-sized companies** entail special risks, such as limited product lines, markets, and financial resources, and greater market volatility than securities of larger, more-established companies.

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