#### The Hudson River Group at Morgan Stanley

80 State Street, 12<sup>th</sup> Fl • Albany, NY 12207 • 518-463-4111 / 800-541-0601 https://advisor.morganstanley.com/the-hudson-river-group

April 2024

"When you come to a fork in the road, take it"

-Yogi Berra

Spring is in the air meaning it's baseball time. No better way to honor the start to the season than by donning this letter with a "Yogi-ism"; a unique saying from the legendary, Hall of Fame Yankee's catcher. The story goes that these were the exact directions he gave his friend and fellow catcher Joe Garagiola to his house in Montclair, NJ. It so just happened that both paths ironically led to his house. Unlike the Berra's residence, the fork in the road for the markets post the Federal Reserve's tightening campaign in 2022-2023 was expected to have two very different possible paths: soft landing or hard landing. Soft landing was the guess that the FOMC raised rates enough to lower inflation while also slowing the economy just enough to avoid a recession. Think of a plane landing smoothly after a choppy descent. A hard landing would be the opposite ending, turbulence followed by an emergency landing or pronounced decline in economic activity. Entering 2023, based on the current economic data of that time and historical patterns we saw a greater probability of the latter. We were of course wrong.

We now understand what we overlooked. Private credit being a large lender while traditional banks slowed. Excess Covid savings plus assets appreciation lasting much longer than we would have guessed buoying the consumer. Less sensitivity to higher rates due to both individuals and corporations locking in lower rates via their respective mortgage/ corporate debt and the dynamics immigration have had in the labor market. Looking ahead the biggest question now is what happens if there is no landing? Economic growth stays strong with no large upward movement in unemployment while inflation stays above the Federal Reserve's 2% target. This economic fork now has three prongs versus Yogi's two.

The markets started to discount this possible path during the first quarter. Entering the year, the number of implied policy cuts were seven<sup>1</sup>. By the end of February that fell to roughly four cuts<sup>2</sup>. By the end of March, it was closer to three and a half<sup>3</sup>. Risk assets digested this rapid repricing without a glitch and the post Halloween rally continued while the 10yr US Treasury increased by roughly 30bps<sup>4</sup>. The five-month move in the broader market; as defined by the S&P 500, from November to March ending up being historic notching a 25% gain<sup>5</sup>. This was the seventh best five month stretch in over 70 years. As the table on the next page highlights prior rallies tended to have staying power with some notable events further down the road (1987 crash, dotcom bubble busting).

		S&P 500 forward total return		
Date of Signal	5-month price return	3 months	6 months	12 months
02/1975	28.4%	12.9%	5.3%	27.3%
11/1982	26.4%	8.1%	19.9%	25.6%
03/1986	25.9%	5.9%	-1.5%	26.2%
01/1999	33.7%	4.7%	4.5%	16.2%
07/2009	34.3%	5.5%	9.9%	13.8%
08/2020	35.4%	3.9%	9.9%	13.8%
03/2024	25.3%	??	??	??

Source: Bloomberg

It was not until the quarter ended that the bond market started to play catchup as economic data stayed hot and the 10yr US Treasury reacted by adding another 40bps in a few weeks on top of the 30bps during the first quarter<sup>6</sup>. This meaningful delta/rate of change along with a rise in tensions in the Middle East was enough to stoke fear putting an end to the rally. The first "pothole" of 2024.

Potholes should be expected when you are an investor. What we witnessed from November-March is the outlier. The median intra-year decline/drawdown post WWII is 10.8%<sup>7</sup>. Our generic pothole playbook has the following rules (Note these are generic. Individual recommendations will be made based on your respective goals and level of risk tolerance):

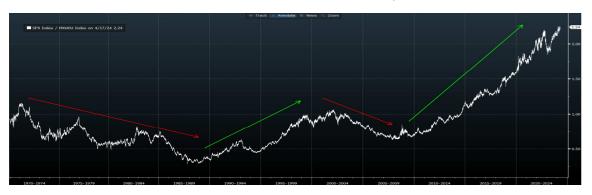
- Do not try to avoid the pothole. Market timing in and out during a relatively short window is extremely difficult. While a broken clock is right twice a day doing this constantly is a fool's errand in our opinion.
- Long term investors with a higher level of risk tolerance should add to risk assets particularly if underweight and/or have excess cash.
- Ensure your portfolio is behaving as you would expect while driving through the pothole.
   Your portfolio's asset allocation should match your goals and risk tolerance. There is no better checks and balances than a drawdown.

What happens over the next three quarters is anyone's guess. Economic predictions of rate cuts are a prime example of why the guessing game is difficult. The "known-knowns" of this marketplace have all been well publicized:

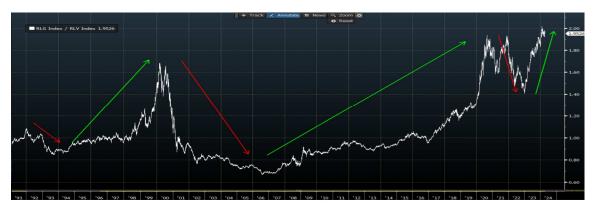
- The Federal Reserve will continue to be data dependent and inflation is sticky. Forget about
  the definition of CPI (consumer prince index) or the Fed's favorite PCE (Personal
  Consumption Expenditure) for now. Grocery bills are still high. Filling up your tank is more
  expensive. Car insurance has had a large jump. Housing prices have yet to correct.
- Market concentration is at an extreme: The top largest companies represent over 30% of the S&P 500 a level not seen since the early 1970's<sup>8</sup>.
- Equity risk premiums: the excess return that investing in stock market provides over a risk-free rate is the lowest since 2002<sup>9</sup>.

• The trend for a while now has been US over international, growth over value and large over small. Owning the relative laggards have been frustrating though that is the give and take with diversification.

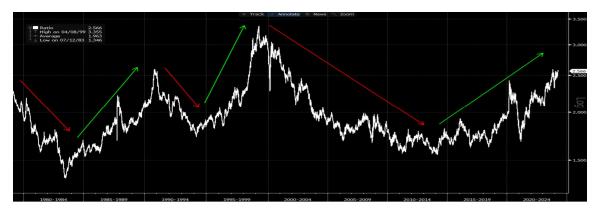
S&P 500 relative to MSCI World ex US (1970-present)



Russel 1000 Growth relative to Russell 1000 Value (1991-present)



S&P 500 relative to Russell 3000 (late 1970's – present)



Page 3 of 7

Over the course of the next four to six quarter we would expect to see changes which will most likely provide times of fear, greed, hope and despair. Though the Fed's first cut is being pushed out; it will happen at some juncture either proactively or reactively (the latter would not be a shock). It would be difficult for us to imagine unemployment staying this low for much longer. While immigration has been a large variable to keep the US at full employment; it will most likely also be the cause of a large jump in unemployment when labor demand declines.

Whatever is conjured up for the future will not alter our goal of investing and/or making investment recommendations that we see as prudent based on your goals and risk tolerance while keeping a high level of service and transparency.

The Hudson River Group

Brian Schlaks, CMT
Senior Vice President
Financial Advisor
Portfolio Management Director
NMLS# 1252940

Bert Trombly
Senior Vice President
Financial Advisor
Portfolio Management Director
NMLS # 1272995

This material is intended only for clients and prospective clients of the Portfolio Management program. It has been prepared solely for informational purposes only and is not an offer to buy or sell or a solicitation of any offer to buy or sell any security or other financial instrument, or to participate in any trading strategy.

The individuals mentioned as the Portfolio Management Team are Financial Advisors with Morgan Stanley participating in the Morgan Stanley Portfolio Management program. The Portfolio Management program is an investment advisory program in which the client's Financial Advisor invests the client's assets on a discretionary basis in a range of securities. The Portfolio Management program is described in the applicable Morgan Stanley ADV Part 2, available at www.morganstanley.com/ADV or from your Financial Advisor.

Past performance of any security is not a guarantee of future performance. There is no guarantee that this investment strategy will work under all market conditions.

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.

The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization US stocks. An investment cannot be made directly in a market index.

International investing may not be appropriate for every investor and is subject to additional risks, including currency fluctuations, political factors, withholding, lack of liquidity, the absence of adequate financial information, and exchange control restrictions impacting foreign issuers. These risks may be magnified in emerging markets.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate

For index, indicator and survey definition referenced in this report please visit the following: <a href="https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions">https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions</a>

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

The investments listed may not be appropriate for all investors. Morgan Stanley Smith Barney LLC recommends that investors independently evaluate particular investments, and encourages investors to seek the advice of a financial advisor. The appropriateness of a particular investment will depend upon an investor's individual circumstances and objectives.

Morgan Stanley Smith Barney LLC offers a wide array of brokerage and advisory services to its clients, each of which may create a different type of relationship with different obligations to you. Please visit us at http://www.morganstanleyindividual.com or consult with your Financial Advisor to understand these differences.

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.

The sole purpose of this material is to inform, and it in no way is intended to be an offer or solicitation to purchase or sell any security, other investment or service, or to attract any funds or deposits. Investments mentioned may not be appropriate for all clients. Any product discussed herein may be purchased only after a client has carefully reviewed the offering memorandum and executed the subscription documents. Morgan Stanley Wealth Management has not considered the actual or desired investment objectives, goals, strategies, guidelines, or factual circumstances of any investor in any fund(s). Before making any investment, each investor should carefully consider the risks associated with the investment, as discussed in the applicable offering memorandum, and make a determination based upon their own particular circumstances, that the investment is consistent with their investment objectives and risk tolerance.

When Morgan Stanley Smith Barney LLC, its affiliates and Morgan Stanley Financial Advisors and Private Wealth Advisors (collectively, "Morgan Stanley") provide "investment advice" regarding a retirement or welfare benefit plan account, an individual retirement account or a Coverdell education savings account ("Retirement Account"), Morgan Stanley is a "fiduciary" as those terms are defined under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and/or the Internal Revenue Code of 1986 (the "Code"), as applicable. When Morgan Stanley provides investment education, takes orders on an unsolicited basis or otherwise does not provide "investment advice", Morgan Stanley will not be considered a "fiduciary" under ERISA and/or the Code. For more information regarding Morgan Stanley's role with respect to a Retirement Account, please visit www.morganstanley.com/disclosures/dol. Tax laws are complex and subject to change. Morgan Stanley does not provide tax or legal advice. Individuals are encouraged to consult their tax and legal advisors (a) before establishing a Retirement Account, and (b) regarding any potential tax, ERISA and related consequences of any investments or other transactions made with respect to a Retirement Account.

Past performance is no guarantee of future results. Actual results may vary. Diversification does not assure a profit or protect against loss in a declining market.

This material contains forward looking statements and there can be no guarantees they will come to pass. The information and statistical data contained herein have been obtained from sources believed to be reliable but in no way are guaranteed by Morgan Stanley as to accuracy or completeness.

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.

Morgan Stanley Smith Barney LLC. Member SIPC

CRC 6566966 April 2024

<sup>&</sup>lt;sup>1</sup> Bloomberg: Number of Hikes/Cuts Priced in as of 12/31/23: -6.95

<sup>&</sup>lt;sup>2</sup> Bloomberg: Number of Hikes/Cuts Priced in as of 2/29/24: -3.95

<sup>&</sup>lt;sup>3</sup> Bloomberg: Number of Hikes/Cuts Priced in as of 3/31/24: -3.42

<sup>&</sup>lt;sup>4</sup> Bloomberg: Ten Year US Treasury Yield 12/31/23 to 3/31/24: 3.87% to 4.21%

<sup>&</sup>lt;sup>5</sup>Bloomberg: S&P 500 total return 10/31/23-03/31/24: 26.1%

<sup>&</sup>lt;sup>6</sup> Bloomberg: Ten Year US Treasury Yield 3/31/24 to 4/18/2024: 4.21% to 4.65%

<sup>&</sup>lt;sup>7</sup> Morgan Stanley: Intra-Year Declines and Rises. Monthly Data from December 1944 to March 2024

<sup>&</sup>lt;sup>8</sup> Market Concentration And The Magnificent Seven: Where Next? | Russell Investments

<sup>&</sup>lt;sup>9</sup>Morgan Stanley Equity Risk Premium – S&P 500