The Hudson River Group at Morgan Stanley

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

January 2024

"Mimicking the herd invites regression to the mean."

-Poor Charlie's Almanack; The Wit and Wisdom of Charles T. Munger

Wall Street lost three legends in 2023. First was Laszlo Birinyi, a longtime Salomon Brothers researcher and analyst until opening his own shop Birinyi associates. He was known for his analysis of money flows and the psychology of markets. Then there was Byron Wien the long time Morgan Stanley strategist who ended his career at Blackstone. Known for his "Ten Surprises" list; If he were around today, he would just have wrapped up his media tour discussing the list…. the 39th of his outstanding career. Lastly, just weeks shy of his 100th birthday was Charlie Munger. Known as Warren Buffet's right-hand man he was a driving force behind the success at Berkshire Hathaway. Anytime these three men spoke, we listed. Anytime they wrote, we read. As we start a new year, we are reminded of Charlie Mungers nugget of wisdom that dons this letter since the herd has been stampeding since Halloween.

For the first ten months of 2023 the internals of the stock market were not that great. As we discussed in prior letters the "Magnificent Seven" stole the show. Then Jay Powell and the FOMC discussed the probability for rate cuts in 2024 and the herd started to gather steam playing a bit of catchup to the kings of the market cap weighted index. It was an "everything rally" with many asset classes joining the parade and some flipping from red to green.

	12/30/22 – 10/31/23	Nov - Dec
S&P 500: Market Cap Weighted	10.7%	14.1%
S&P 500: Equal Weighted	-2.4%	16.6%
NASDAQ 100: Market Cap Weighted	32.6%	16.7%
NASDAQ 100: Equal Cap Weighted	12.6%	19.1%
Russell 2000	-4.5%	22.3%
Bloomberg Aggregate Bond Index	-2.9%	8.6%

Source: Bloomberg

This massive two-month rally left account balances higher and sentiment overstretched. According to the CNN Fear & Greed Index; a gauge compiling seven different indicators that measure some aspect of stock market behavior; the year ended sitting in "extreme greed". To compare; after a dismal 2022 the year started in "Fear"[1].

We are fully cognizant of the power of momentum or as Laszlo Birinyi would recommend to this client; “follow the money”. Though history has shown many times that Newton’s first law of motion often holds somewhat true during short periods (ex. November & December); we do not see it as prudent to chase now. Our investment principals are geared to buying when we see a risk/reward that is favorable and at today’s current valuation with green eyed monsters seemingly everywhere we are inclined to sit on our hands to start the year knowing that markets move fast, and sentiment/valuation can change in a blink of an eye.

While we wait, the chorus of predictions on where asset classes will be on 12/31/2024 grows loud in the background. We find it extremely silly to “guess” what will happen in one years’ time as there are so many known and unknown variables at play. Nor do we know anyone that has a one-year investment time horizon. Byron Wien’s in all his wisdom even defined his Ten Surprises list, as an event that the average investor would only assign a one out of three chance of taking place each year. A baseball player who gets a hit one out of three times is put in the Hall of Fame. An investor/investment manager who has the same record is not fairing as well.

As we are sitting patiently for a better buying opportunity; we are not advocating to outright sell aside from normal pruning/re-balancing. Another wonderful saying from Charlie Munger is “The big money is not in the buying and the selling but in the waiting”. It is a simple, straight forward acknowledgement to the power of being a long-term investor. Since 1929 which includes the awful Great Depression years the average return for the S&P 500 is a bit north of 11% annualized with just twenty years or 20% of the time with an annual loss of 5%+[2]. Time has always been on the side of the patient investor.

While waiting we ponder what can cause an “air pocket” that can take the steam out of this market in the short term. The current geopolitical landscape is number one. It is constantly discussed and has been a top headline for well over a year: Russia/Ukraine, Israel/Hamas, China/Taiwan etc. When a living legend like Paul Tudor Jones says that the geopolitical environment is the “most threating and challenging” he has ever seen[3]; it accentuates the risk. The problem with geopolitics is that they are always around and very hard to handicap. While they can create very large potholes; trying to front run the possibility of increased escalation is very difficult. Another highly discussed topic is and will continue to be the US presidential election. Though every election is important; from an investment standpoint they tend to be non-starters. We believe the highest probability reason to shift from “extreme greed” is a change in consensus expectations.

The current consensus expectation is a goldilocks environment: not to hot; not to cold. A slowing economy with disinflationary second-half growth while the Fed cuts rate five times and stocks in general see a dash of margin expansion. Sounds like a perfect story book ending after Jay Powell and company took fed fund from near zero to 5.5% in under 18 months. While we would love that narrative to play, we are skeptical. Jeremy Grantham, another living legend recently said “The Fed has a wonderful track record of being wrong in its recession predictions”[4].

When consensus expectation changes; market usually adjust in a blink of an eye. As we wait to see if this plays out, we will continue to monitor the landscape looking for those risk/reward pockets that we discussed earlier. The "Magnificent Seven", as a whole; would not be on this list. After contributing almost two-thirds of the S&P 500's return last year they now represent roughly 25% of the S&P 500 and a bit under 50% of the NASDAQ Composite[5]. These "masters of the universe" are absolute juggernauts with wide moats, cash rich balance sheets and amazing cash flow. They are feasting in this digital age and have earned the premium valuation assigned to them. Will this premium hold for the five to ten years? No one knows. What we do know is that there is no better time to review your exposure than now.

The Hudson River Group

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

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

[1] Fear and Greed Index - Investor Sentiment | CNN January 2, 2023

[2] pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

[3] Paul Tudor Jones says it's hard to like stocks given geopolitical risks, weak U.S. fiscal position (cnbc.com)

[4] Investing Great Jeremy Grantham on Bubbles, Climate Change, and Market Outlook - Article | Crux Investor

[5] Morgan Stanley. Global Investment Committee Special Report: Consequences of Concentration

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.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index. An investment cannot be made directly in a market index.

The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. An investment cannot be made directly in a market index.

The US Aggregate Index covers the dollar-denominated investment-grade fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS pass-through securities, asset-backed securities, and commercial mortgage-based securities. An investment cannot be made directly in a market index

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: https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions

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

CRC6302064 1/24