Morgan Stanley
Private Wealth Management

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The Novelli Group
At Morgan Stanley
Private Wealth Management

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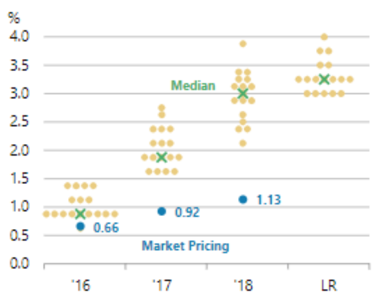
March Madness

No, not basketball. We speak of the madness of an unprovoked war and slaughter of innocent civilians. It is hard to watch the death, destruction and mayhem brought on in these circumstances, but sitting an ocean away, perhaps prayers and financial support to refugees is one way we can help in these trying times.

The war substantially complicates the path for the Federal Reserve and the projection of interest rates. Rate increases compromise the economic expansion but are necessary to arrest inflation. Inflation on its own can wreak havoc on economies. We've shared many comments over these past few weeks in our *Most Notables* series about these concerns worth repeating. As the Federal Reserve seeks to tamp down inflation, the cadence and scope of interest rate hikes, as well as the potential reduction of a portion of their $9 trillion bond portfolio, will play a major role in navigating a 'soft landing' in this expansion. Add to this, the potential for war sanctions to further disrupt supply chains prolonging inflationary conditions and pressuring business margins for companies caught between paying more for supplies and managing their end prices so as not to squash demand.

Exhibit 3: Appropriate pace of policy firming vs. market pricing



Source: Morgan Stanley Research, Federal Reserve, Bloomberg

In late March, Morgan Stanley's US Economic Team published an adjustment to their Fed Funds forecast, targeting two 50 basis point moves in May and June and a 25 basis point move in each of the successive meetings this year.[1]

It is growing more certain that this will indeed be a faster, hotter and *shorter* recovery, emphasis on shorter. Prior to the war, we thought a recession was several years out, but these complications are causing us to consider a nearer timeline.

Upsetting the Apple Cart

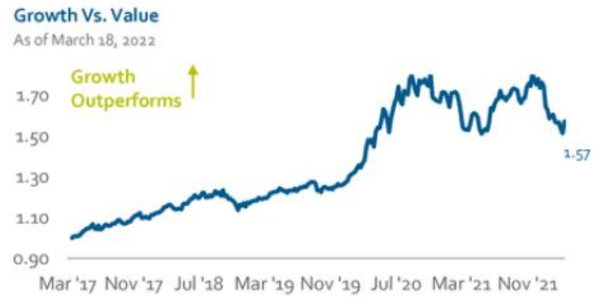
All of this builds on our comments from our January Perspectives, in which we suggested this will be a difficult and complicated year for investors. On some levels, it's simply too early to tell how things unfold. Our technical analysis is suggesting the market correction which began in January might be ending. But we'd be hard pressed to suggest we can see new highs in equities soon and we also remain concerned that intermediate term interest rates will need to rise much higher through the course of the year as the Fed tries to tackle inflation.

For this reason, we remain cautious. Investors would be wise to deploy capital only in those weeks and periods when markets seem most distressed, which is when the news will appear most difficult. It takes enormous emotional fortitude to step in when news reports are literally about blood in the streets. But this is the kind of year we are in for, unfortunately.

[1] Ellen Zentner *US Economics & Global Macro Strategy: FOMC Reaction,* March 2022

Green Shoots

There do seem to be some positives in these uncertain times. First, old energy is likely to regain its favor after literally being thrown out with the bathwater and left for dead. More are coming around to the thesis that while green energy is important, the path to alternative sources of energy is a bridge built on healthy investments in old 'fossil fuels'. Second, value stocks are finally primed to a long favorable cycle in comparison to high PE growth stocks. After more than five years dominance in growth-oriented investments, we believe the value side of the ledger will continue to enjoy their day in the sun. Third, perhaps we will finally see better returns on cash, which has broad implications for portfolios and asset allocation, especially for the most conservative investors.



This spring should bring more clarity on the path forward, but we won't be surprised if the road remains bumpy for the balance of the year!