Morgan Stanley
Private Wealth Management

The Novelli Group
At Morgan Stanley
Private Wealth Management

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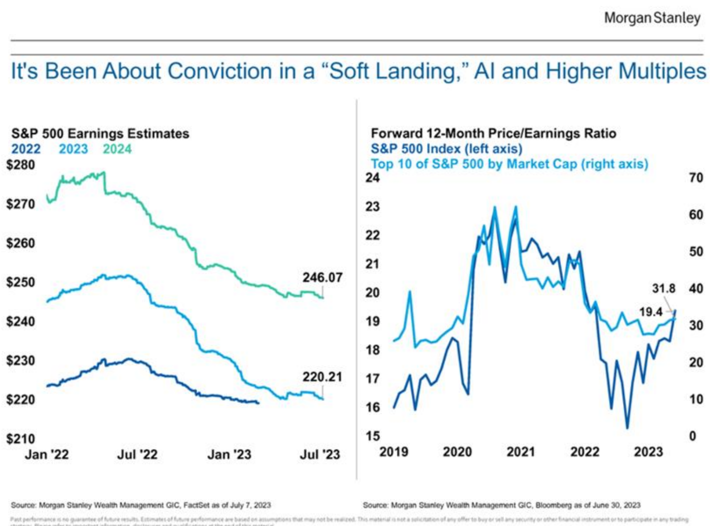
An *'Artificially Intelligent'* Rally!

I believe in AI (artificial intelligence) and believe there will be a lot of ways it could help advance society by aiding in a more complete and informed conclusion from a more thorough analysis of huge amounts of data. Over time, one can imagine professionals providing clearer conclusions leveraging this technology.

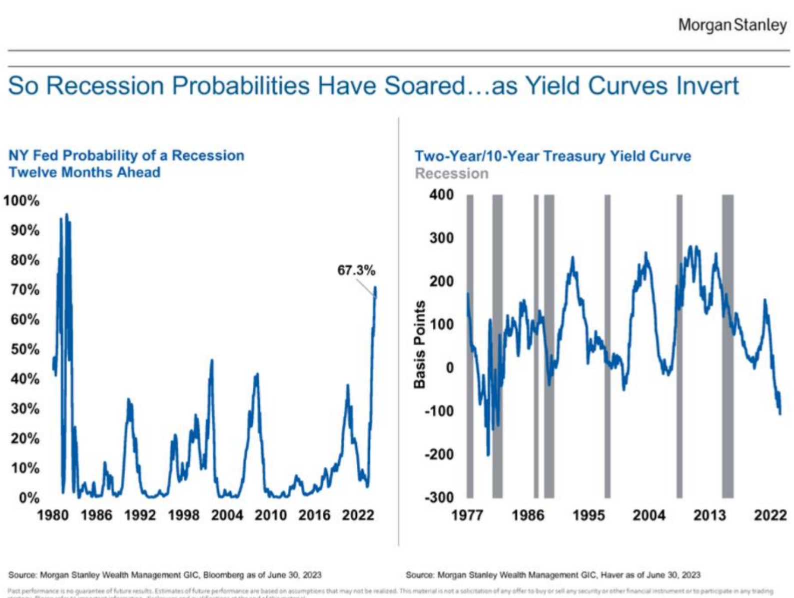
As for now, most would agree that human judgement remains superior. Just think of the last time you engaged with automated agent when calling your insurance carrier or getting a manufacturer to provide technical support!

What does not seem as intelligent, in our humble opinion, is the stretching of valuations in these recent past several weeks. Led largely by the investor excitement of the commercial impact of AI and its application in a lot of business activities, the market's rise has the top 10 companies in the S&P 500 back to valuations that seem, NOT that smart. Based on research from Morgan Stanley, the top 10 market cap companies in the S&P 500 are now trading at a 12-month forward PE Ratio of 31.8!



Greasing the Landing?

Morgan Stanley attributes some of this rally also to broad investor expectations that the economy will avoid recession and achieve a soft landing. In the same chart above you can see that earnings estimates for this year have been declining….so perhaps one might go further and say the investors are really expecting a ***greased landing***, you know, those airline travels where unexpectedly the entire passenger group applauds at the pilot's soft touchdown. It's been a long time since I've experienced that, and a rare event indeed!!!



What the data still indicates is something a little more concerning. As of June 30, based on a long-standing analysis published by the New York Federal Reserve Bank, the probability of recession 12 months out stands at 67.3% and has been rising all year long. This comes from the impact of higher interest rates, tighter monetary policy conditions and slowing economic growth as a result. Another observation, from the same data set is that the UST Treasury yield curve remains inverted, and the spread between longer dated bond yields vs. shorter data bond yields has become increasingly negative. An inverted yield curve has not *always* been a leading indicator of a recession, but when recessions have emerged, they've come on the heels of a yield curve inversion.

All this to say, this year's strong rally seems to have advanced beyond the fundamentals. Sure, the fundamentals could improve, and the market could prove right. But for now, we are balking at the *artificial intelligence* rally. With valuations reaching these levels, we'd like to announce: ladies and gentlemen, please ensure your seats belts are tightened, tray tables are raised and locked into position, and your belongings are stowed properly as we prepare for whatever kind of landing we may experience. This is what we can call, a fully human intelligence conclusion!