Morgan Stanley
Private Wealth Management

The Novelli Group
At Morgan Stanley
Private Wealth Management

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October is Breast Cancer Awareness Month. For all of you who've been touched by breast cancer, whether personally or through a loved one, our prayer is for continued advances in diagnosis and treatment and long fulfilling lives for those having been diagnosed with the disease!

October 2023 will also be known as the month in which the second military conflict involving advanced nations emerged. While there may be hotspots often across our globe, Ukraine and now Israel are two modern societies with access to advanced military capabilities which have been attacked bringing death and destruction to too many lives of innocent civilians.

Geopolitical Risks Rising

When advanced countries engage in war, there are many more countries acting as allies and friends who are drawn into the conflict, as we've witnessed in both wars. This affirms our concerns shared first by John Vander Voort last summer that we are witnessing the emergence a new world order where a bifurcation occurs creating a more complicated dynamic than witnessed in recent years. In his piece which you can read here, John suggests investors consider a possible future where "Russia, China, North Korea, Iran and African Military Juntas, and their extended protectorates seek to create their own trading block outside US interference. In such a world order, perhaps this new trading block's reserve currency becomes the Chinese Yuan; Russia and Iran easily finance their economies by providing energy to this new block; and a multipolar world emerges with two distinctly separate eco-systems. It would lead to greater geopolitical risks taking us back to a time dominated by two competing world-powers as in the days of nuclear arms race. Nations who don't trade together might have less incentive to play nice with each other in the geopolitical sandbox."

Well said John! This conflict now draws both Russia and Iran, both an ally and likely backer of Hamas into an advanced warfare. Could more hotspots emerge?

Tectonic Shifts

We believe we are witnessing tectonic shifts that will most assuredly require investors to begin operating with a different landscape in mind. We'll be speaking more about this in future commentaries both in our Perspectives and in our Most Notables, but there are many streams to consider which affect how our team is thinking about investment positioning and asset allocation. Among the many considerations include the following:

- Rate Normalization –risk free benchmark rates settle into a long-term range of 4.5% to 5.5% after more than 15 years of abnormally easy money and liquidity.
- Geopolitical Divisions and Risks –described above with less stability globally as populist protectionist agendas further erode the benefits of globalization and friendly trading alliances.
- Greater Cyber Risks –pirates and nations conduct terrorism and warfare with an aim to undermine advanced nations through fraud and disruption, weakening nations and creating vulnerabilities.

- US Political Disfunction and Less Fiscal Support –risks to our system of government continue and lead to a potential end of the dual-party system bringing a period of higher taxes and less government spending going forward.
- Tighter Regulatory Regime – developing as Federal authorities exert new powers and oversight to businesses, hurting small business owners at the expense of larger businesses with deeper resources for compliance.
- Artificial Intelligence Led Productivity Gains – the one positive: companies develop tools that can more efficiently draw conclusions from large data pools, first broad based and then in industry and functional specialties.

Strategic Considerations

With these factors in mind, we are outlining some core tenets that we believe investors will need to be more imminently attentive to:

- Greater cash flow and less leverage generally in considering investment options.
- Greater levels of volatility than in the past 15 years, especially in public capital markets.
- Higher tax rates and even more critical consideration for after tax returns.
- Identifying haves and have nots in areas of cyber security, where a company's protective mote needs to be larger
- Credit cycle considerations as rate normalization reverses more than 15 years of easy access to capital at low rates with higher leverage, which affects both real estate and private equity.
- Identifying winners and losers from both early and smart adoption of artificial intelligence tools, emphasis on smart adoption!

We believe that many of these considerations are driving us to re-evaluate broadly our asset allocation decisions, partially informed this year by our willingness to remain defensive in lower valuation stocks that pay dividends and cash which is paying higher returns and not chase the big tech rally of the magnificent seven, which has largely been the source of returns this year.

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