

Morgan Stanley

The Boulevardier

A QUARTERLY INVESTORS REPORT FROM **THE VECTOR GROUP AT MORGAN STANLEY**

FEBRUARY 2022

EXECUTIVE SUMMARY

Fourth Quarter 2021

- **Equity Markets¹:** U.S. equities closed the year on a high note as the S&P 500 finished +11.03% for the quarter and +28.71% for the year. International equities did not perform as favorably as EAFE finished the quarter +2.40% and the year +8.78%, while Emerging Markets fell -1.68% in the final quarter and -4.59% on the year.
- **Bond Markets²:** On the year, High Yield outperformed throughout 2021 as Sub-Investment Grade bonds saw spreads fall by 77 bps to 2.83% over treasuries, while Investment Grade spreads fell modestly by 4 bps to 0.92% over Treasuries. The US 10-year bond saw yields increase substantially in 2021 rising by 60 bps to 1.51%. The yield curve, measured by 30 and 2 year rates, flattened with the spread decreasing by 35 bps throughout the year as the 2-year rate rose by 61 bps and the 30-year rate rose by a more modest 26 bps. The Fed did not move off the 0.00 lower bound in 2021, but indicated hikes are likely in 2022.
- **Economics³:** The fourth quarter was a bit of a mix in terms of economic indicators. Measured by the Citi Economic Surprise Index, aggregate expectations handily exceeded expectations. However, when looking at specific segments of the economy, dispersion is evident. Housing remained robust, Unemployment fell, Consumer Confidence accelerated, and Industrial Production was strong. Manufacturing moderated in aggregate but remained well in growth territory. Services accelerated through November but fell from growth highs in December due to a resurgence in Covid cases. Retail Sales performed well in the first two months of the quarter but gave back nearly all growth in the final month. Year over year Inflation grew by 4.70%, off intra-year highs, but the Federal Reserve noted that inflation may not be as transitory as originally anticipated.
- **Oil⁴** ended the quarter at \$75.21/barrel WTI, a +0.24% increase from last quarter's close.
- **Gold⁵** futures closed at \$1828.00/oz, a +4.08% increase for the quarter.

Outlook 2021

- US equities finish the year strong, tightening gap between earnings and price growth.
- Tax policy changes in Washington look unlikely as Midterms loom.
- Inflation remains a question mark as Fed changes tone.

ALSO IN THIS ISSUE:

Advisor's Perspective – Nothing to fear but...



“Buy at the sound of cannons, sell at the sound of trumpets.”

— Nathan Rothschild

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Tactical Ideas for Consideration

for the Appropriate Investor

ASSET CLASS CHOICE	SUB CLASS	IDEAS	CONVICTION ¹
US Equity/Debt/ Cash	Equity	Attractive	
US Equity Size	Larger	Attractive	
Equity Investment	Sectors: Info Tech, Communications, Financials	Attractive	
Developed Int'l Equity	EuroZone	Neutral	
Emerging Markets	China	Unattractive	
US Gov Bond Market	Long Term	Unattractive	
Municipal Bonds	Medium Duration	Attractive	
High Yield Debt	Various	Unattractive	
Preferred Stocks	QDI Financials	Unattractive	
Mortgage Bonds	Agency	Attractive	
Precious Metals	Gold	Attractive	

NOTE: We have discontinued ranking currencies and alternative investments as a group.

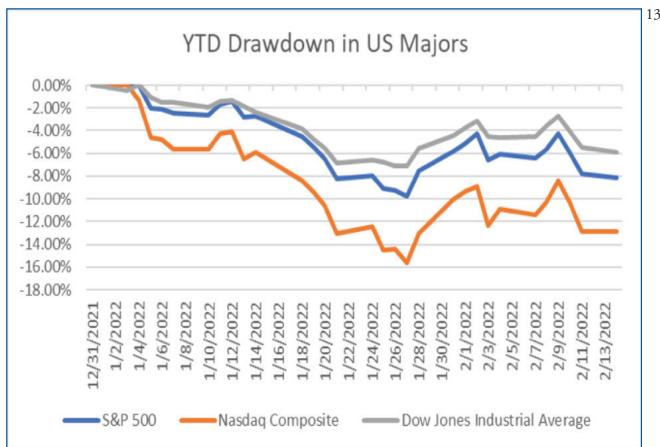
NOTES:

¹  Lowest,  Highest [Increasing number of top hats indicates increasing conviction to the idea]

If you are interested in exploring any of the ideas mentioned above, please call. We will discuss if it is appropriate for your specific situation as well as the different investment choices available to gain exposure.

Q1 2022 Outlook

Given the start to the year for Equities, dissecting the way in which they've drawn down should provide some insight into what's driving performance and where opportunities may present themselves. The first 24 days of the year were the fastest -10% drawdown the S&P 500 has seen in its history using intraday measures¹³. On a closing basis, the index has yet to reach official correction territory, typically defined as a -10% fall from highs, thus far bottoming at a -9.80% drawdown on January 27th from its closing high set on January 4th¹³. The technology heavy Nasdaq Composite has fared significantly worse than its more broad-based counterpart, falling -19.23% between its November 22nd intraday high and January 24th intraday low¹³. On a year-to-date closing basis, the Nasdaq fell as far -15.65% on January 27th¹³. Conversely, the more cyclically focused Dow Jones Industrial Average, bottomed at a -7.10% year-to-date decline through January 27th¹³. At a rudimentary level, it's clear that technology has been the point of the spear during the current drawdown.

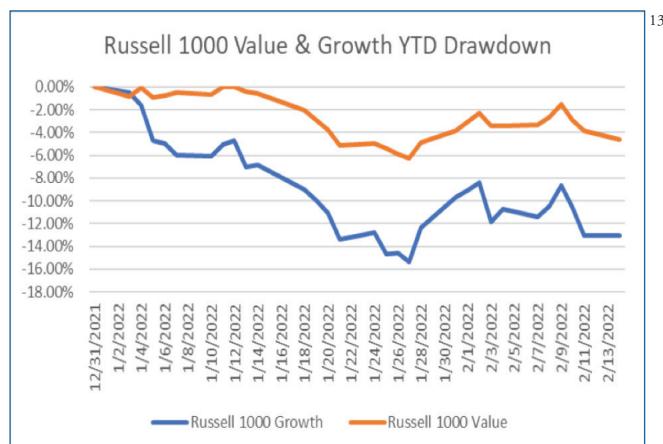


Zooming in further, sector dispersion from the start of 2022 through January 27th illustrates a similar picture. Using the S&P 500, as it is the broadest of the three aforementioned indices, on a sector level Energy saw a substantial positive return of +19.21% as oil prices soared, while financials, consumer staples, utilities, and industrials had negative returns but materially outperformed the aggregate benchmark¹³. Financials benefited from catalyst of rapid increases in the US 10-year rate. Utilities and Staples are both defensive in nature and are in a potential position to benefit from inflation. Industrials are a notable inclusion without a clear macro tailwind. On the other side, Communication Services, Real Estate, Information

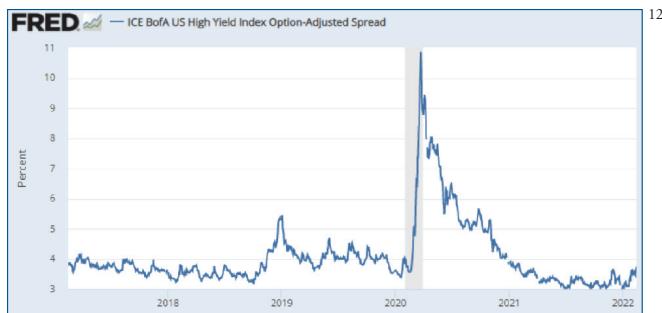
Technology, and Consumer Discretionary underperformed by varying degrees¹³. Unlike Financials, the Real Estate sector was hurt by interest rate spikes, while Communication Services, Information Technology, and Consumer Discretionary have all benefited from the growth trade that has driven markets the better part of the past 5 years. What stands out here is how sectors with lower aggregate valuations (Financials, Industrials, Materials, and Health Care) led sectors with higher growth and higher aggregate valuations (Communication Services, Information Technology, and Consumer Discretionary).

Sector	Drawdown 12.31.2021 - 1.27.2022
Energy	19.21%
Financials	-2.11%
Consumer Staples	-2.98%
Utilities	-6.18%
Industrials	-6.41%
Materials	-8.68%
Health Care	-9.26%
S&P 500	-9.73%
Communication Services	-11.00%
Real Estate	-12.61%
Information Technology	-13.10%
Consumer Discretionary	-14.96%

Exploring the performance of the Russell 1000 Value and Russell 1000 Growth further demonstrates this point. The growth index effectively drew down in lockstep with the Nasdaq Composite from the start of the year while the value index outperformed all other discussed indices falling -6.27% on a year-to-date basis through January 27th¹³. It's clear that the value and growth factors have been key drivers of returns in 2022 in opposite manners.



Given the evidence above, it appears that a valuation reset has driven selling pressure to begin 2022, where companies associated with growth factors that typically hold higher valuations materially underperformed their cheaper value factor counterparts. One thing that we would expect to see if something more economically sinister were at the core of this drawdown would be for high yield credit spreads to quickly and drastically move higher. This has yet to materialize. Whether the root cause of the reset be the abrupt move in treasury rates, the significant move in commodity prices, inflation and the drastic shift in Federal Reserve policy outlook, or something else entirely, evidence suggest that economic distress has yet to materialize. This should create opportunity.



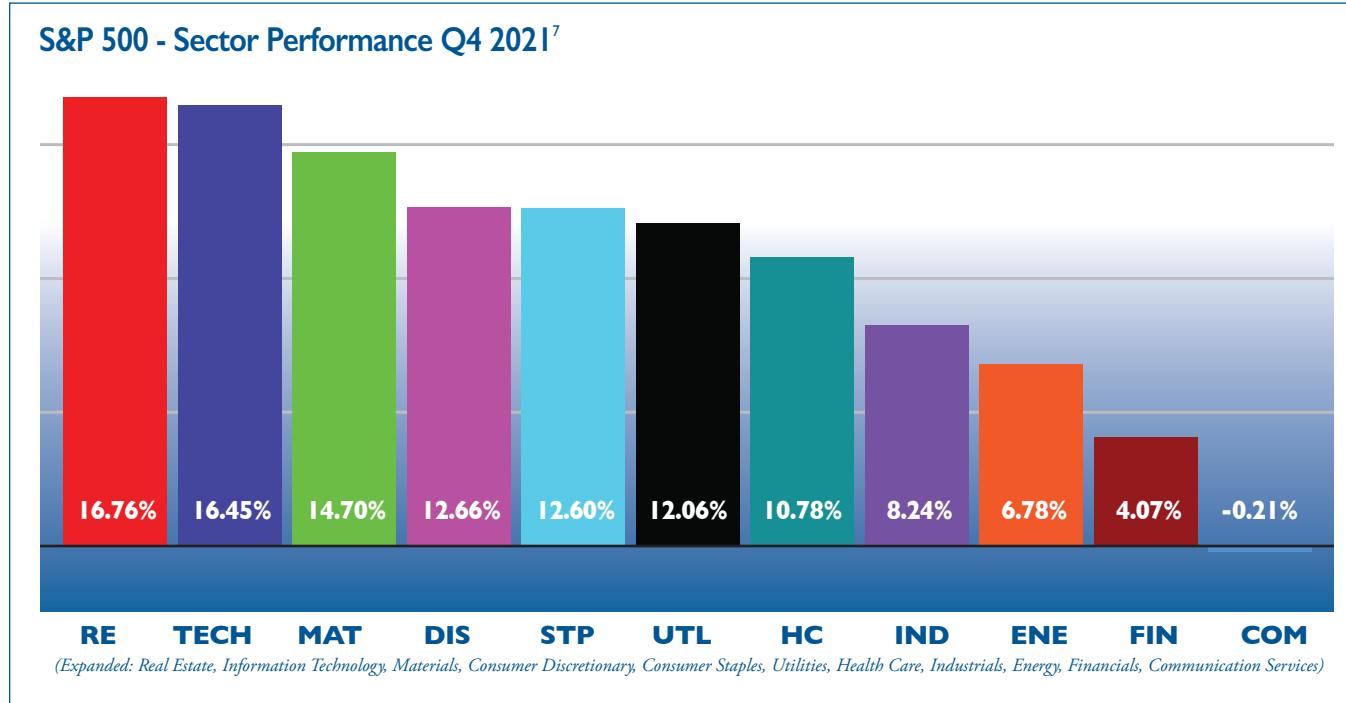
Historically speaking, the Value factor has been a driver of returns over the long-term¹³. While more difficult to quantify, the Growth factor has as well, especially in recent history¹³. A third factor, Quality, which can be measured by the S&P 500 High Quality Rankings Index, has shown to also help drive long-term returns. As the market currently sits, 60.87% of Russell 1000 Growth constituents by index weight overlap with the first quintile of the Quality factor¹³. By the same method, Value's overlap is 30.79%¹³. Given the factor interaction and that growth has drawdown much deeper than Value and the aggregate market, the current drawdown looks to have created opportunity to upgrade the quality of equity holdings at a discount.

MARKET ACTION

US Equity Markets



The S&P 500 rose +11.03% in the fourth quarter of 2021¹. Outperforming sectors include Real Estate, Information Technology, and Materials while Industrials, Energy, Financials, and Communication Services underperformed.



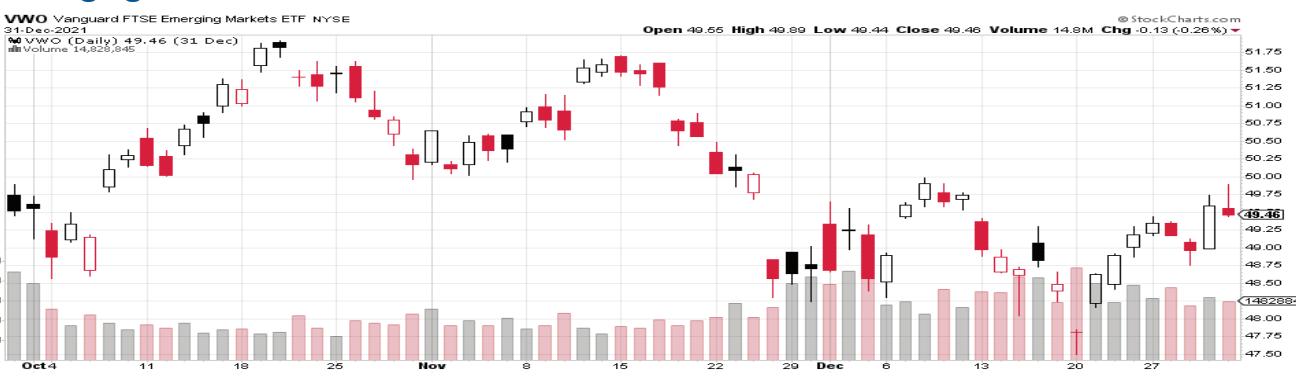
Other Equity Markets

MSCI EAFE underperformed the US by 863 basis points in the fourth quarter, rising 2.40%¹.

EAFFE - Q4 2021⁸

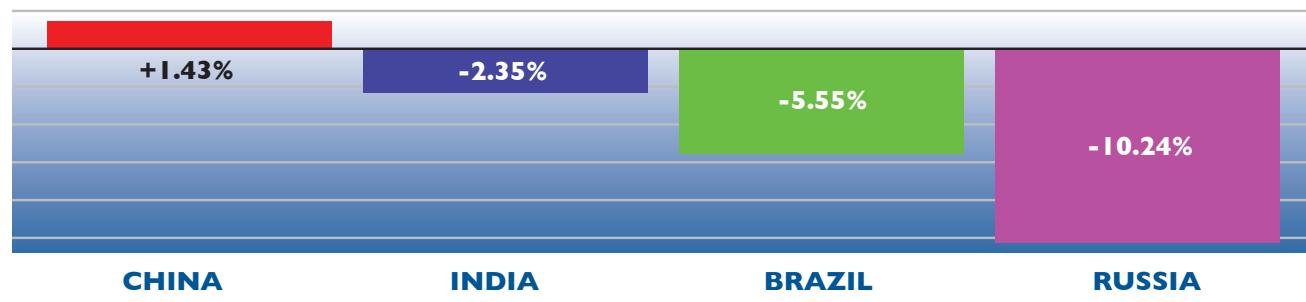


Emerging Markets - Q4 2021⁹



Emerging Markets underperformed the US by 1271 basis points while also underperforming Developed International Markets by 408 basis points in the third quarter, falling -1.68% by the MSCI EM Index¹.

Russia, Brazil, India & China - Q4 2021¹⁰



Energy Markets

WTI Crude Price/Barrel & Gasoline Price/Gallon Q4 2021⁴



Energy prices were volatile in the fourth quarter as WTI rose 0.24% while Gasoline futures rose +1.41%⁴.

Precious Metals

Gold ended the quarter gaining +4.08% while Silver ended with a gain of +5.90%⁵.

Gold & Silver - Q4 2021⁵



Bond Markets

Ten-Year Treasury Yields rose modestly by 2 bps throughout the quarter while the Two-Year Rate rose sharply by 45 bps to 0.73%².



High Yield spreads fell by 6 bps³.

High Yield Corporate Debt Option-Adjusted Spread - Q4 2021¹²



Advisor's Perspective: Nothing to fear but...

These are tough times for securities investors. We find ourselves facing current threats:

- **Inflation**
- **An aggressive Russia**
- **An aggressive China**

Not to mention last year's concerns:

- **Taxes**
- **Growth of the global economy**

Which piled on to the previous year's concerns (which never actually went away):

- **Pandemic & Global Health**
- **Mental health**
- **New Social norms**

Wow. Even Hollywood couldn't have scripted this as anything other than a 1970s catastrophe movie. It seems the caution we spoke of last issue was well warranted.

While I do think inflation has built its way back into the picture for a while, I suspect it alleviates in coming 6-18 months. I worry about conflict in Eastern Europe and our response. The biggest concern is the potential for human tragedy.

But our biggest enemy is apprehension of the outcomes we fear. Yes, we need to think strategically about investments and long and short term results, but we need to keep perspective on valuation and investment long term returns.

Of all things I am most confident of one: as we go through this time, there will be great bargains to be had – in specific investments but also in dislocated asset classes.

I look forward to discussing this more in depth with those of you who would like my insights.

—MDS

NOTES:

- 1 Morgan Stanley Investment Resources. Month-End Asset Return Analysis published 3 January 2022. Sources: Morgan Stanley & Co. Research, Bloomberg, and FactSet. Index returns reflect total return as of 12/31/2021.
- 2 Morgan Stanley Research. US Credit Strategy Chartbook published 5 January 2021. Sources: Morgan Stanley & Co. Research, Bloomberg, Citigroup Index LLC, and iBoxx. Index returns reflect total return as of 12/31/2021.
- 3 Factset Research Systems. Economics: United States. Data as of 12/31/2021.
- 4 StockCharts.com, Inc., Market data provided by Interactive Data Corporation, StockCharts.com, SharpChart of (\$WTIC) Light Crude Oil – Continuous Contract (EOD) and (\$GASO) Gasoline Unleaded – Continuous Contract (EOD), data as of 12/31/2021.
- 5 StockCharts.com, Inc., Market data provided by Interactive Data Corporation, StockCharts.com, SharpChart of Gold (\$GOLD) Gold – Continuous Contract (EOD) and (\$SILVER) Silver - Continuous Contract (EOD), data as of 12/31/2021.
- 6 StockCharts.com, Inc., Market data provided by Interactive Data Corporation, SharpChart of S&P 500 (\$SPX), data as of 12/31/2021.
- 7 StockCharts.com, Inc. Market data provided by Interactive Data Corporation, StockCharts.com, PerfChart of S&P 500 Information Technology Sector Index (\$SPT), S&P 500 Consumer Discretionary Sector Index (\$SPCC), S&P 500 Health Care Sector Index (\$SPHC), S&P 500 Information Utilities Sector Index (\$SPU), S&P 500 Consumer Staples Sector Index (\$SPST), S&P 500 Materials Sector Index (\$SPM), S&P 500 Industrials Sector Index (\$SPI), S&P 500 Financial Index (\$SPF), S&P 500 Communication Services Sector Index (\$SPTS), S&P 500 Energy Sector Index (\$SPEN), and S&P 500 Real Estate Sector Index (\$SPRE), data from 9/30/2021 through 12/31/2021.
- 8 StockCharts.com, Inc. Market data provided by Interactive Data Corporation, iShares MSCI EAFE Index (\$MSEAFE), StockCharts.com, data as of 12/31/2021.
- 9 StockCharts.com, Inc., Market data provided by Interactive Data Corporation, SharpChart of MSCI Emerging Markets Free Index (\$MSEMF), data as of 12/31/2021.
- 10 PerfCharts of Shanghai Composite Index (\$SSEC), Brazil Bovespa Index (\$BVSP), Nifty 50 Index (\$NIFTY), and Russia TS Index (\$RTSI), data from 9/30/2021 through 12/30/2021.
- 11 StockCharts.com, Inc., Market data provided by Interactive Data Corporation, StockCharts.com, SharpChart of CBOE 10-Year US Treasury Yield Index (\$TNX) & (\$UST2Y) 2-Year US Treasury Yield (EOD), data as of 12/31/2021.
- 12 FRED. ICE BofA US High Yield Index Option-Adjusted Spread. Data as of 12/31/2021.
- 13 Factset Research Systems. Data as of 12/31/2021.

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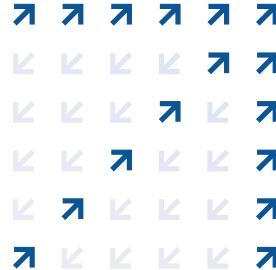
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