July 7, 2019 04:00 PM GMT

Cross-Asset Dispatches | Global

Downgrading Global Equities to Underweight

The risk/reward for global equities looks poor on our cross-asset framework, especially over the next three months. We lower our weight to -4, preferring Europe and Japan over EM and US.

Poor expected returns: Expected risk-adjusted returns for global equities have fallen sharply on our framework, under both Morgan Stanley forecasts and our top-down cycle-adjusted numbers. Combined, our average expected return for global stocks is near a six-year low.

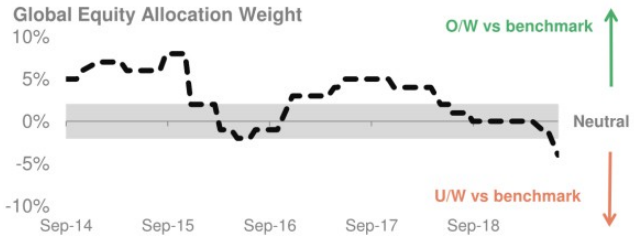
Challenging fundamentals: We think earnings estimates are generally too high, and 2Q earnings season could drive adjustments. Continued deterioration in global PMIs suggests a macro environment with plenty of downside risks. We think that the 'pause' in US/China trade tensions, post-G20, does little to address these. Meanwhile, expectations for central bank accommodation are high.

Middling sentiment, but worrisome leadership and seasonality: Investor optimism via positioning isn't excessive. But crowding *within* sectors and styles is high. And other 'technicals', including seasonality and defensive leadership, look more problematic.

Our lowest equity weight of the last five years: We're reducing our overall equity weight via reduction in US and EM equities, the regions with the lowest upside to our 12-month price targets. Our global equity weight is now -4 (on a scale of +10 to -10), the lowest since we initiated coverage in 2014. Regionally, we prefer Japan and Europe over EM over US. We add the proceeds to EM credit and JGBs.

Where could we be wrong: Further policy easing in line with our economists' call could boost markets, although we think that the effect could be offset by weaker data and already high central bank expectations. Elevated equity risk premiums mean that the cost of running underweight equities for *extended* periods is high; we think there are enough challenges for these premiums to be offset over the next 3-6 months.

Exhibit 1: We lower our overall equity weight to its lowest level since initiation



Source: Morgan Stanley Research.

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Recent Research:

Cross-Asset Brief: Cycle Indicator Update – June 2019: Still in 'Downturn' (2 Jul 2019)

Cross-Asset Dispatches: The Message in the Markets (23 Jun 2019)

Downgrading global equities to underweight

Over the last month we've discussed our doubts about the ability of policy easing to offset weaker data (Sunday Start: Bad Isn't Good). About the more negative readings from our cycle indicator (Our Cycle Indicator: Welcome to 'Downturn') and the very finely balanced recovery the market is now priced for (The Message in the Markets). About why we don't see the 'pause' at the G20 as a lasting positive (G20 Summit Takeaways: Fade the 'Pause').

It is time to act on those concerns. We are lowering our exposure to global equities to the range we consider 'underweight'. This follows a relatively long period of our equity weight in the +2/-2 range we consider 'neutral'. Our last major equity change, from overweight to equal-weight, was in May 2018 (see Global Strategy Mid-Year Outlook: The End of Easy). We continue to hold a modest underweight in global credit, a position we've held since November 2017.

More specifically, three broad dynamics drive a more cautious equity view:

1. **Valuations/expected return:** Higher prices now mean our expected 12-month returns for global equities are near their lowest levels in six years. That result is similar based on bottom-up Morgan Stanley forecasts or top-down approaches.

2. **Fundamentals:** Those valuations face additional pressure as we think consensus earnings in the US, Europe, Japan and emerging markets remain too high. Meanwhile, continued weakness in global PMIs and commodity prices suggests that the economic risks are real.

3. **Technicals:** While positioning *isn't* heavy and sentiment is far from 'euphoric', we see worrying signs in other 'technical' factors including market leadership and seasonality. Meanwhile, crowding does look significant *within* sector and style.

For these reasons, **we reduce global equities to underweight,** moving from -1 to -4. This is not 'maximum negativity'. But we do think it reflects the poor risk/reward we now see for global stocks, and a number of approaching challenges.

Where to put the money? **We add to EM sovereign credit and JGBs.** EM fixed income won't be immune in a larger equity sell-off, but we do think it will do better, supported by better valuations and our expectations for a weak USD and further central bank easing. JGBs have lagged the decline in core European yields and look attractive on a currency-hedged basis. Unhedged, they would stand to benefit from the large gains we are forecasting in JPY (see Revising USDJPY Lower).

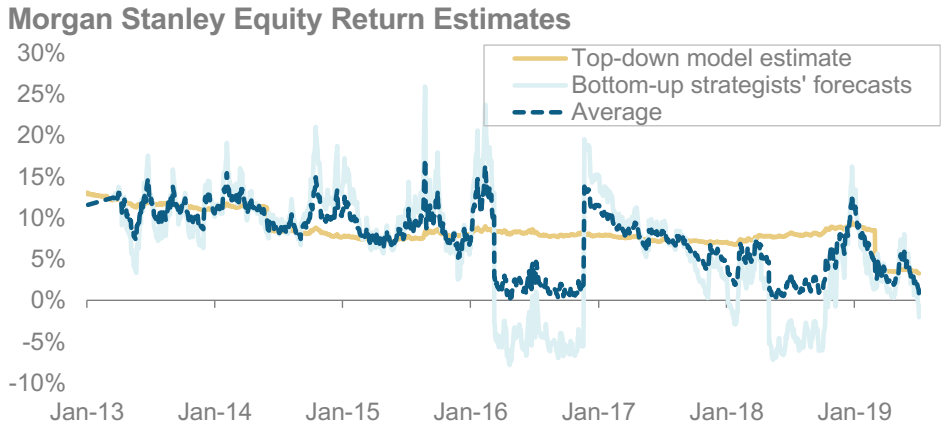
Valuation/expected return

The most straightforward reason why we're lowering equities is that, on our framework, it offers poor risk-adjusted return. We estimate return based on the *average*, relative to cash, of:

- The 'bottom-up' return forecasts to Morgan Stanley price targets;
- A 'top-down' cycle-adjusted return, based on valuations and current economic conditions.

A similar process is run for all other major asset classes. The problem for equities is that, at present, both 'bottom-up' *and* 'top-down' approaches say the same thing.

Exhibit 2: Our top-down and bottom-up global equity return estimates over time



Source: Morgan Stanley Research forecasts; Note: We equally weight S&P 500, MSCI Europe, Topix and MSCI EM forecasts.

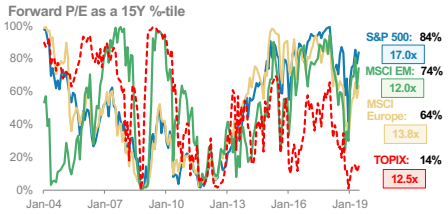
Let's start 'bottom up', with the return investors will achieve if Morgan Stanley's equity price targets have perfect accuracy. The light blue line in Exhibit 2 shows the simple average of expected returns to our US, Europe and EM equity forecasts over time. Going solely on Morgan Stanley strategists' numbers, this matches the worst expected returns of the last six years. If weighted by market cap, the line would look worse.

How about a second opinion? Another way to estimate equity returns is to start with a rate that's historically supported by valuations, and then add to or subtract from that based on what current economic data have meant for returns. The yellow line shows our 'top-down' number: start with our cross-asset long-run return forecasts, and then add to or subtract from this based on the current reading of our cycle indicator.

Both approaches suggest a poor medium-term return outlook.

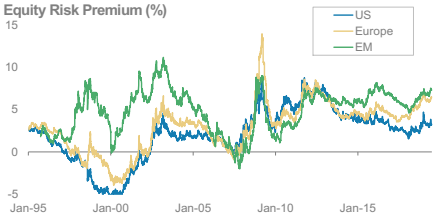
The above is what we use as our cross-asset framework. But we'd argue that simple measures paint a similar picture. While global equities (MSCI ACWI) are up ~16.5% year-to-date, their forward P/E ratio is up *18%*. Yes, central banks have turned more accommodative in 2019. But with that sort of multiple expansion, we find it hard to argue that it isn't already in the price.

Exhibit 3: Global equity multiples have expanded considerably this year except Japan



Source: Datastream, IBES, Morgan Stanley Research

Exhibit 4: Equities are 'cheap' to bonds. But this is hardly a new development



Source: Morgan Stanley Research

The most compelling argument for equity valuation is that they are attractive *relative* to bonds: This is true. There are many different ways to estimate the 'Equity Risk Premium' (ERP), and we'd venture that almost all these various models currently paint a picture of better long-run return potential in stocks than bonds – i.e., equity 'cheapness'.

This matters for *long-run* asset allocation decisions, where valuations dominate. This matters for *how* underweight one should be (this would be an easier call if other assets were cheaper). But we don't think that it is sufficient to make equities a buy. Consider the following:

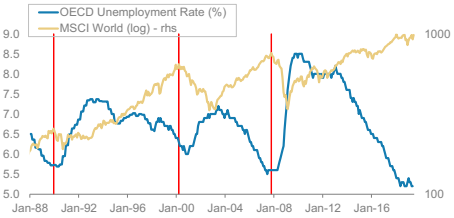
- ERP is a pure function of valuation, which tends to work very well on longer time horizons, but more poorly over the next 6-12 months.
- Buying 'what's cheap based on ERP' *hasn't worked well within the equity market*. For example, European stocks have looked cheaper versus bonds than US stocks for the entire post-crisis period. Growth matters.
- If bond yields are falling because of growth concerns, ERPs can be misleading. Recall that ERPs failed to provide much of a warning in 2008 or, more recently, before equity bear markets in 2011 and 2015.

Fundamentals

That last point is important. Poor estimates for risk-adjusted return is a central part of our argument. But around this, we see a market too sanguine about what lower bond yields may be suggesting – a worsening growth outlook.

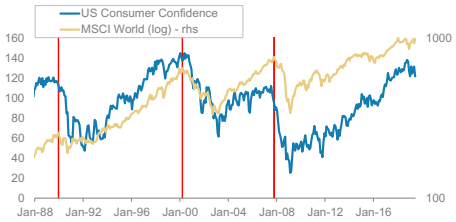
A variety of indicators we follow have been flashing more cyclical caution. **Our US cycle indicator** has moved to 'downturn' (see Cross-Asset Dispatches: Our Cycle Indicator: Welcome to 'Downturn'), which feeds directly into our return framework. **Global PMIs** continue to move lower, rapidly approaching levels seen under much worse equity conditions in 2011, 2012 and 2016 (see Global Manufacturing PMI: Sentiment Dips Further to 2015-16 Cycle Lows). **Commodity prices** have conspicuously lagged the equity rebound. And neither the **yield curve** nor **inflation expectations** reflect much bond market confidence that central bank easing will 'work', reviving growth and realised inflation.

Exhibit 5: Global equities have historically peaked when unemployment troughs



Source: Bloomberg, Haver Analytics, OECD, Morgan Stanley Research: Note: Red line shows peak in MSCI World.

Exhibit 6: Very confident consumers are usually a bad sign (not a good one)

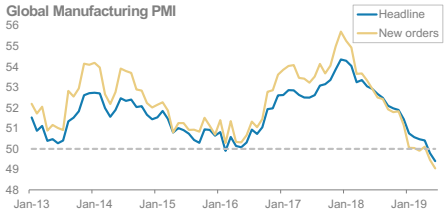


Source: Haver Analytics, Conference Board, Bloomberg, Morgan Stanley Research; Note: Red line shows peak in MSCI World.

Meanwhile, the 'pause' in US/China trade tensions out of the G20 is not sufficient to undo the damage *already* inflicted on corporate confidence and investment, leading our economists to lower their prior estimates for global growth (see Global Economics: Uncertainty Still Prevails).

Is there a catalyst to focus the market on these dynamics? We think it might be **2Q earnings season,** which kicks off in earnest next week. We are below-consensus on earnings growth, and believe that 2Q reporting could act as a catalyst to bring numbers down. Layoff announcements and capex guidance will be other features to watch through reporting season. However, if earnings and employment prove more resilient than we expect, and if global growth starts to inflect higher through 2H19, we may need to reevaluate our view.

Exhibit 7: Global PMIs continue to move lower

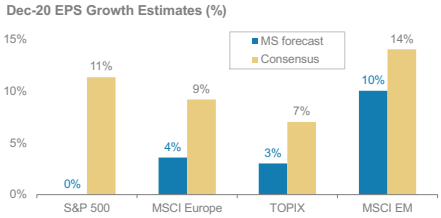


Source: Haver Analytics, Morgan Stanley Research

Exhibit 8: Commodity prices have lagged the equity rebound

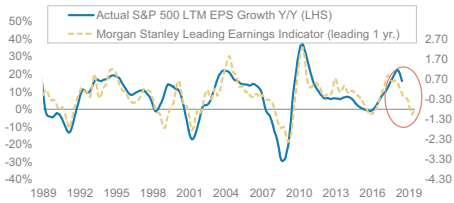
Source: Bloomberg, Morgan Stanley Research

Exhibit 9: Morgan Stanley is generally below-consensus on earnings growth



Source: MSCI, IBES, Datastream, FactSet, Morgan Stanley Research forecasts

Exhibit 10: US earnings growth leading indicator suggests more weakness ahead



Source: Thomson Reuters, Morgan Stanley Research

Technicals

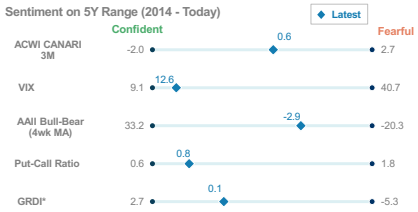
We forecast poor risk-adjusted equity returns and near-term fundamental risks. But a final question needs to be addressed – what about 'technicals'? This term is used to cover all manner of sins, but here it represents what won't be reflected in valuations or economic data, often with a more near-term, tactical angle.

Positioning: While this note mostly focuses on concerning aspects of the current equity set-up, *there is one positive – sentiment*. Neither retail investors nor hedge funds look particularly optimistic and, more anecdotally, our recent client meetings hardly suggest anything approaching euphoria.

The idea of 'light positioning' is frequently held up, along with the ERP, as one of the best arguments for a positive equity stance. Caution is certainly preferable to optimism (for a bull), but we think that this risks overstating the case.

'Light' positioning hasn't stopped weakness before, with current US hedge fund net leverage similar to what we saw last September/October. And not every positioning measure looks 'light'. For example, net length in S&P 500 futures has risen notably. And positioning *within* certain strategies (for example, Growth versus Value) does look full by historical standards.

Exhibit 11: Sentiment: Not 'bearish', but far from 'fearful'



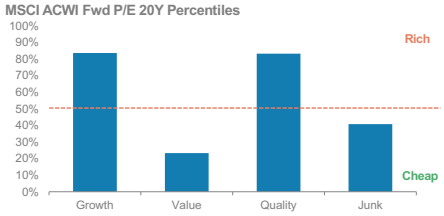
Source: Bloomberg, Morgan Stanley Research; Note: *Global Risk Demand Index – US Pat. 7,617,143.

Exhibit 12: Asset managers have finally been adding to equity futures

Source: CFTC, Bloomberg, Morgan Stanley Research

Leadership: Equity leadership continues to look consistent with serious growth concerns. In the US, small-cap and cyclical stocks have lagged badly while defensives have outperformed. The Dow Transportation index, which correctly foreshadowed growth weakness in 2015, is still ~9% below its September 2018 high.

Exhibit 13: Growth and quality stocks are expensive now



Source: Bloomberg, Morgan Stanley Research; Note: Shaded regions show months in which small caps have underperformed and staples have outperformed versus ACWI.

Exhibit 14: Equity seasonality: Entering the most challenging three-month 'zone'

Source: Bloomberg, Morgan Stanley Research

Seasonality: 'Sell in May and go away' is a familiar refrain. But looking at seasonality more quantitatively, since 1990 *the worst three-month stretch for global equity returns has been July 13 to October 12*. The tendency for 2Q earnings season to be weaker than 1Q, and poor summer liquidity to amplify bad news, are both reasons why.

Risks to our call, especially the central bank response

There are plenty of risks to this downgrade. For all the challenges facing equities, the lack of other investment options could mean that these concerns simply don't matter. Light investor positioning could make it harder for stocks to decline and easier for them to squeeze higher. 2Q earnings season could be better than we expect.

But the largest risk, in our view, is a scenario where growth recovers while central banks continue to pile on the stimulus: This is especially relevant given what, on the surface, appear to be very dovish 'house' calls for central bank action: We think that the Fed cuts by 50bp later this month, followed by the ECB embarking on another round of QE.

If the Fed and ECB both ease policy *and data improve*, this would be equity-positive, having more in common with easing in 1995, 1998, 2012 or 2016. Such a scenario would likely drive stocks higher and yield curves steeper, as investors see current weakness as nothing more than a mid-cycle slowdown.

But an essential caveat to **our forecasts of further policy easing by the Fed and ECB is that they are linked to expectations that growth *disappoints*:** In this scenario, we think that growth concerns could overwhelm the impact of further easing. And with global equity markets up 18% year-to-date, it seems plausible that *some* expectations of central bank action are already in the price.

Exhibit 15: There are key differences between today and a 'mid-cycle slowdown'

	Metric	Dec-85	Aug-89	Jun-95	Sep-98	Sep-00	Aug-07	Jan-16	Jul-19	Check?
Expensive Valuations	S&P 500 P/B Level	1.5	2.1	2.7	**3.7**	**4.9**	2.8	2.8	3.4	Y
Profits Above Trend	ROE 5yr Zscore	0.0	**1.7**	**1.8**	1.0	**1.3**	**1.0**	-2.8	1.7	Y
High Corp. Leverage	US Corporate Debt to GDP	58%	63%	55%	58%	63%	68%	**71%**	**74%**	Y
Flat Yield Curve	3m/10y Curve		**-18**	54	**16**	**-58**	**-9**	208	-25	Y
Yields Declining	6m Chg in 10yr	-39	**-123**	**-160**	**-71**	**-71**	-2	5	-72	Y
Stocks Rallying	6m Chg in S&P 500	10%	**21%**	**20%**	-4%	**12%**	4%	-2%	23%	Y
PMI Sub 50	ISM Mfg. PMI	52.0	**45.9**	**46.7**	**49.3**	**49.9**	51.8	**48.4**	51.7	
PMI Falling Sharply	ISM Mfg. PMI 6m Chg	4.2	**-8.2**	**-9.4**	-3.6	**-5.0**	-2.3	-3.4	-4.9	Y
Low Unemployment	US Unemployment Rate	7.0	5.2	5.6	4.5	4.1	4.7	5.0	**3.6**	Y
High Consumer Conf.	Conference Board Index	98	**120**	102	133	**141**	112	96	122	Y
Small Caps U/P	Russell 2000 vs. S&P 500*	-1%	**-3%**	**-6%**	**-20%**	**-17%**	**-5%**	**-8%**	**-4%**	Y
What Happened Next?	**Next 6m Chg in S&P 500**	23%	**-5%**	13%	25%	**-17%**	**-9%**	4%	**?**	

Source: Bloomberg, Morgan Stanley Research; Note: *6m relative performance. Metrics more extreme than today are marked in bold. 2014 and 2015 are shown as mid-cycle periods as the market was pricing in several Fed hikes and reduced them over the next few months.

Exhibit 16: Conditions today have more in common with '89/'00/'07 ('late-cycle' periods)...

	Metric	Late Cycle Avg	Today	Check?
Expensive Valuations	S&P 500 P/B Level	3.2	3.4	Y
Profits Above Trend	ROE 5yr Zscore	1.3	1.7	Y
High Corp. Leverage	US Corporate Debt to GDP	64%	74%	Y
Flat Yield Curve	3m/10y Curve	-28	-25	Y
Yields Declining	6m Chg in 10yr	-65	-72	Y
Stocks Rallying	6m Chg in S&P 500	12%	23%	Y
PMI Sub 50	ISM Mfg. PMI	49.2	51.7	
PMI Falling Sharply	ISM Mfg. PMI 6m Chg	-5.2	-4.9	Y
Low Unemployment	US Unemployment Rate	4.7	3.6	Y
High Consumer Conf.	Conference Board Index	124	122	Y
Small Caps U/P	Russell 2000 vs. S&P 500*	-9%	-4%	Y
What Happened Next?	**Next 6m Chg in S&P 500**	-11%		

Source: Morgan Stanley Research

Exhibit 17: ...and less in common with '85/'95/'98/'16 (comparatively benign 'mid-cycle' periods)

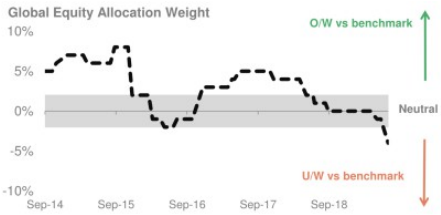
	Metric	Late Cycle Avg	Today	Check?
Expensive Valuations	S&P 500 P/B Level	2.7	3.4	Y
Profits Above Trend	ROE 5yr Zscore	0.0	1.7	Y
High Corp. Leverage	US Corporate Debt to GDP	60%	74%	Y
Flat Yield Curve	3m/10y Curve	91	-25	Y
Yields Declining	6m Chg in 10yr	-70	-72	Y
Stocks Rallying	6m Chg in S&P 500	6%	23%	Y
PMI Sub 50	ISM Mfg. PMI	49.1	51.7	
PMI Falling Sharply	ISM Mfg. PMI 6m Chg	-3.1	-4.9	Y
Low Unemployment	US Unemployment Rate	5.5	3.6	Y
High Consumer Conf.	Conference Board Index	107	122	Y
Small Caps U/P	Russell 2000 vs. S&P 500*	-9%	-4%	Y
What Happened Next?	**Next 6m Chg in S&P 500**	16%		

Source: Morgan Stanley Research

Regional preferences, and where to put the money

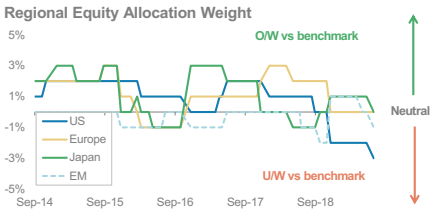
US and EM equities have the worst risk-adjusted expected returns on our framework, whether judged 'top down' or 'bottom up'. We think that it therefore makes sense to reduce from both. This leaves our regional order of preference (with weights) as follows: Japan (+0) and Europe (+0) over EM (-1) over US (-3), and our overall weight at -4, the lowest since we initiated in 2014. We retain a RoW > US equity preference.

Exhibit 18: We lower our overall equity weight to the lowest since initiation



Source: Morgan Stanley Research

Exhibit 19: Most bearish on US equities since initiation in 2014



Source: Morgan Stanley Research

Exhibit 20: We reduce our overall equity allocation to -4%

		(A) Long-Run Valuations		(B) Cycle		(C) 12M Outlook	(D) Avg (A+B,C) - Cash	(E) (D)/ Vol	MS Asset Allocation vs Benchmark
		LT Expected Rtn		Cycle Rtn Boost/Drag		MS 12M Rtn Forecast	Forecast Excess Rtn	Framework Expected Rtn/ Vol	
Equities	US	5.5%	▲	-4.0%	◆	-6.3%	-4.3%	-0.3	-3%
	Europe	6.3%	▲	-3.9%	▲	4.5%	4.1%	0.3	+0%
	Japan	7.2%	▲	-1.7%	▲	5.0%	5.5%	0.3	+0%
	EM	9.6%	▲	-5.9%	◆	-0.5%	-0.3%	0.0	-1%
Bonds	Treasuries	2.4%	◆	+1.3%	●	1.9%	0.9%	0.2	+2%
	Bunds	0.3%	◆	-0.7%	▲	-2.9%	-1.0%	-0.2	-2%
	JGBs	0.8%	◆	+0.4%	●	0.5%	1.0%	0.5	+1%
	EM Local*	-	-	-	-	-0.7%	-0.7%	-0.5	+1%
Credit	US IG	1.3%	▲	-3.4%	◆	-0.7%	-1.4%	-0.3	-3%
	US HY	1.1%	◆	-7.1%	◆	-3.5%	-4.8%	-1.4	
	EUR IG	0.8%	▲	-2.9%	◆	-0.2%	-1.2%	-0.6	-2%
	EUR HY	1.1%	◆	-7.1%	◆	-1.0%	-3.5%	-1.0	
	EM $	2.0%	▲	+0.1%	●	2.9%	2.5%	0.8	+2%
	Securitised^	-	-	-	-	0.7%	0.7%	0.2	+0%

Legend: ● (A): LT Z-score > 0.5 (B): Phase with best returns for the asset ◆ (A): LT Z-score < -0.5 (B): Phase with worst returns for the asset

Source: Morgan Stanley Research forecasts; Note: *EM Local is FX-hedged and columns C and D are the same as we do not have a LT expected return for EM local. 'Long-Run Valuations' based on 10Y expected returns. 'Cycle Rtns Boost/Drag' shows historical forward 12-month returns relative to average when US cycle is in current phase (expansion). All returns for credit are excess returns. Vol is average of 1Y and 10Y vol.

Where to add? We like EM credit: Valuations generally look less stretched than other asset classes and our expected returns are higher, supported by our forecasts for a dovish Fed and a weaker US dollar. JGBs have lagged the decline in core European yields and should benefit from the hunt for carry in high-quality duration.

Equity regional preferences – Europe and Japan > EM > US

Graham Secker, Jonathan Garner and Daniel Blake

Europe looks 'less bad' than elsewhere and ECB QE2 is coming: Having performed in line with global equities through the first five months of the year, European equities underperformed in June as they lagged the stronger rises seen elsewhere. In the context

of our global equity downgrade we think that the *relative* investment case for Europe looks attractive here, given:

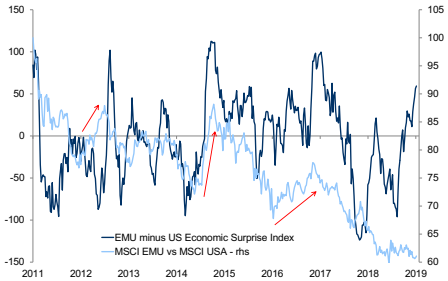
1. We forecast the ECB to relaunch QE in 4Q19 as discussed here. Historically domestic equity markets have always risen in the 4-6-month period after QE announcements; ceteris paribus more QE could drive a 5-10% P/E re-rating for MSCI EMU.

2. Macro newsflow in Europe is currently disappointing less than in other regions, as illustrated by a superior relative economic surprise index (Exhibit 21). Historically European equities have enjoyed double-digit price outperformance in these circumstances.

3. Earnings revisions for Europe are currently less negative than they are elsewhere; versus MSCI ACWI, European revisions are at a two-year high.

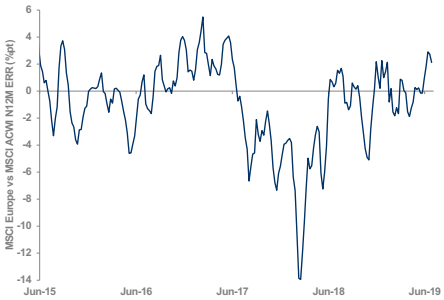
4. Europe is unloved and undervalued. It is the only region that has seen strong and persistent equity outflows over the last 12-18 months, which have helped to drive Europe's relative N12M P/E down close to its post-2012 lows.

Exhibit 21: EMU has a materially superior economic surprise index – previously this has coincided with >10% EMU equity outperformance



Source: Bloomberg, RIMES, Morgan Stanley Research

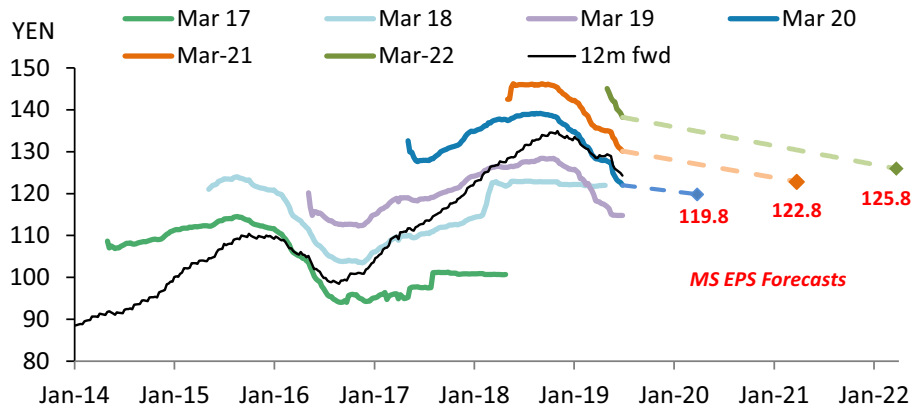
Exhibit 22: Europe's earnings revisions ratio is close to a two-year high relative to MSCI ACWI



Source: IBES, RIMES, Morgan Stanley Research

Lower Topix target, but still prefer Japan to EM and China: Our downgraded outlook for global and Japanese growth, JGB yields and a materially stronger JPY profile have increased the macro challenges for Topix earnings, which we downgrade by 5% today. However, valuations are cheap, particularly relative to EM (at a historically low 0.3x forward P/E premium), and we see Japan delivering on our thesis of structurally improving productivity, profitability and corporate reform. As a result of the earnings changes, we have lowered our Topix target to 1630 from 1700, but this leaves 3% price upside in JPY terms, and ~8% total return over the next 12 months on a USD-hedged basis.

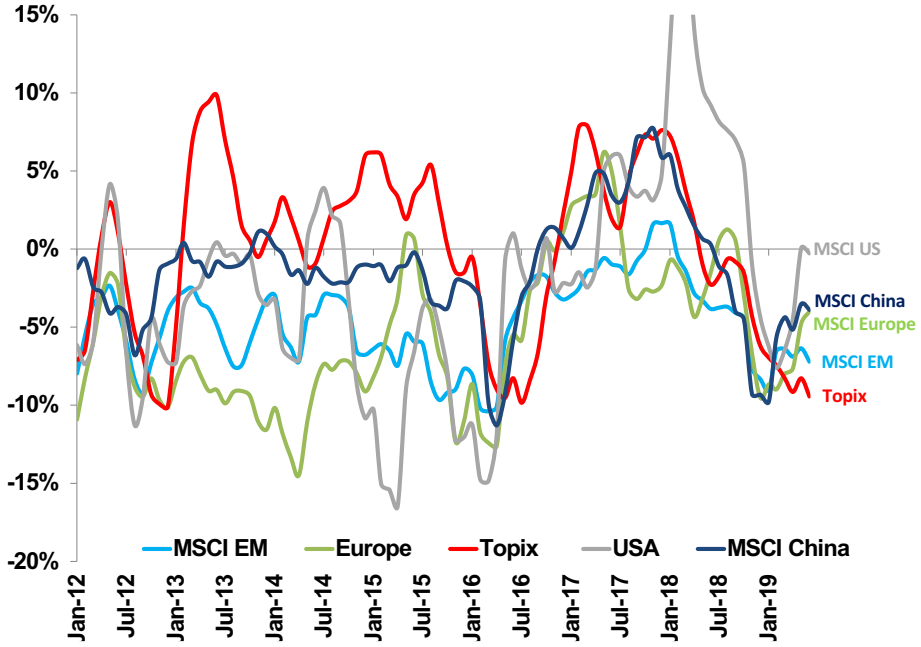
Exhibit 23: Topix consensus EPS waterfall – two steps forward, one step back as we lower our earnings forecasts on cyclical and JPY headwinds



Source: IBES Consensus, Datastream, Morgan Stanley Research forecasts; Data as of June 27, 2019.

In contrast, we see 3% downside to our June 2020 target of 1030 for MSCI EM, as the region has less valuation support (trading at 12.3x versus our target multiple of 11.0x). A relatively upbeat house view on EMFX amid a Fed easing cycle is a tailwind for earnings, given that the index is largely local currency-earning but quoted in USD. However, we see ongoing uncertainty posed by unresolved trade tensions and key industries facing end-demand challenges – most notably in semiconductors, tech hardware and autos. Our preference is for markets that are less trade-exposed or have domestic reform drivers, including Brazil, India and Indonesia.

Exhibit 24: Earnings revision breadth remains negative across EM and Topix, although Japan has more valuation support, in our view



Source: IBES, Refinitiv Eikon, Morgan Stanley Research

Macro event calendar – next two weeks

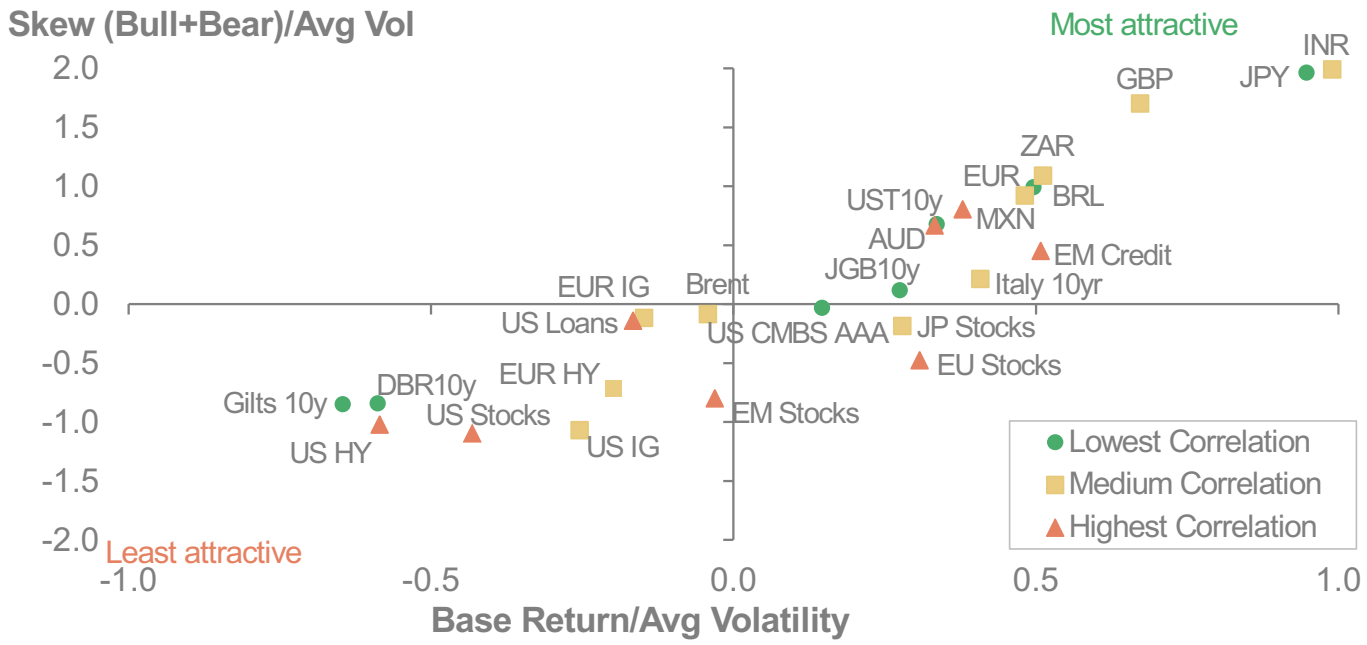
Exhibit 25: Key global events over the next two weeks, with Morgan Stanley forecasts where applicable

Date	Time (Ldn)	Region	Event	Ref. Period	MS forecast	Market	Previous
7-Jul	N/A	CNY	Foreign Reserves	Jun		3110B	3101B
8-Jul	00:50	JPY	Current Account Balance	May P		¥1596.9B	¥1707.4B
8-Jul	01:30	JPY	BoJ's Kuroda spks				
8-Jul	07:00	EUR	German Industrial Production (MoM)	May		0.5%	-1.9%
9-Jul	00:30	JPY	Labor Cash Earnings (YoY)	May		-0.6%	-0.3%
9-Jul	13:45	USD	Fed's Powell (voter) spks (Stress Testing)				
9-Jul	15:10	USD	Fed's Bullard (voter) spks				
9-Jul	19:00	USD	Fed's Quarles (voter) spks (Stress Testing)				
07/09-07/15	N/A	CNY	M2 (YoY)	Jun		8.6%	8.5%
07/09-07/15	N/A	CNY	New Yuan Loans	Jun		1725B	1180B
10-Jul	02:30	CNY	PPI (YoY)	Jun		0.3%	0.6%
10-Jul	09:00	EUR	Italian Industrial Production (MoM)	May			-0.7%
10-Jul	09:30	GBP	Trade Balance	May		-3200m	-2740m
10-Jul	15:00	USD	Fed's Powell (voter) spks (Monetary Policy, House)				
10-Jul	18:30	USD	Fed's Bullard (voter) spks				
11-Jul	12:30	EUR	ECB Minutes	Jun-6			
11-Jul	13:30	USD	CPI (YoY)	Jun	1.7%	1.6%	1.8%
11-Jul	15:00	USD	Fed's Powell (voter) spks (Monetary Policy, Senate)				
11-Jul	16:10	USD	Fed's Williams (voter) spks (Community Revitalisation)				
12-Jul	N/A	CNY	Trade Balance	Jun		$45B	$41.66B
12-Jul	N/A	CNY	Exports (YoY)	Jun		-0.5%	1.1%
12-Jul	05:30	JPY	Industrial Production (MoM)	May F			2.3%
15-Jul	03:00	CNY	Fixed Assets Ex Rural YTD (YoY)	Jun		5.6%	5.6%
15-Jul	03:00	CNY	Industrial Production (YoY)	Jun		5.3%	5%
15-Jul	03:00	CNY	Retail Sales (YoY)	Jun		8.4%	8.6%
15-Jul	03:00	CNY	GDP (YoY)	2Q		6.2%	6.4%
16-Jul	09:30	GBP	ILO Unemployment Rate 3Mths	May			3.8%
16-Jul	10:00	EUR	Eurozone ZEW Survey Expectations	Jul			-20.2
16-Jul	13:30	USD	Retail Sales Advance (MoM)	Jun		0.1%	0.5%
16-Jul	13:30	USD	Retail Sales Ex Auto (MoM)	Jun		0.1%	0.5%
16-Jul	14:15	USD	Industrial Production (MoM)	Jun		0.2%	0.4%
16-Jul	14:15	USD	Capacity Utilization	Jun	-0.4%	78.1%	78.1%
16-Jul	20:30	USD	Fed's Evans (voter) spks (Monetary Policy)				
17-Jul	09:30	GBP	CPI (YoY)	Jun			2%
17-Jul	10:00	EUR	CPI Core (YoY)	Jun F			1.1%
17-Jul	10:00	EUR	CPI (YoY)	Jun F			1.2%
18-Jul	00:50	JPY	Exports (YoY)	Jun			-7.8%
18-Jul	15:00	USD	Leading Index	Jun			0%
19-Jul	00:30	JPY	CPI (YoY)	Jun	-0.40%		0.7%
19-Jul	15:00	USD	Univ. of Michigan Confidence	Jul P			98.2
19-Jul	16:05	USD	Fed's Bullard (voter) spks (Technology)				
19-Jul	21:30	USD	Fed's Rosengren (voter) spks (Central Bank Independence)				

Source: Morgan Stanley Research forecasts, Bloomberg. Note: P = Preliminary, F = Final.

Asset class forecasts and risk/reward

Global asset classes – expected 12-month return vs. risk



Source: Morgan Stanley Research. Note: 'Expected returns' based on MS Strategy 12m forecasts and current market prices. Correlation is six-month relative to global equities (MSCI ACWI). Credit returns are excess returns.

Exhibit 26: Morgan Stanley key market forecasts

	As of Jul 04, 2019	Q2 2020 Forecast		
		Bear	Base	Bull
Equities				
S&P 500	2,996	2,400	2,750	3,000
MSCI Europe	1,628	1,160	1,640	1,860
Topix	1,590	1,150	1,630	1,900
MSCI EM	1,065	700	1,030	1,225
FX				
USD/JPY	108	93	98	103
EUR/USD	1.13	1.14	1.20	1.26
GBP/USD	1.26	1.28	1.35	1.46
AUD/USD	0.70	0.69	0.73	0.77
USD/INR	68.5	62.7	66.0	69.3
USD/ZAR	14.0	12.6	13.6	14.6
USD/BRL	3.79	3.45	3.65	3.90
Rates (% percent)				
UST 10yr	1.95	2.25	2.00	1.50
DBR 10yr	-0.40	0.30	0.00	-0.55
UKT 10yr	0.68	1.45	1.20	0.70
JGB 10yr	-0.16	-0.05	-0.23	-0.30
Credit (bps)				
US IG	117	208	143	100
US HY	420	736	555	337
EUR IG	68	115	85	50
EUR HY	378	600	465	360
Italy 10yr	208	310	190	140
EM Sovs	339	450	340	280
US CMBS AAA	87	125	90	70
Commodities				
Brent	63	52.5	62.5	72.5

Source: Markit, MSCI, Bloomberg, The Yield Book, Morgan Stanley Research forecasts

Exhibit 27: 12m return and risk forecasts

	12m Return			Volatility		Return/Risk
Asset	Bear Case	Base Case	Bull Case	Option Implied	LT Average	Base case Return/Vol
Equities						
S&P 500	-18%	-6.3%	2%	14%	15%	-0.43
MSCI Europe	-25%	4.5%	18%	13%	16%	0.31
Topix	-25%	5.0%	22%	16%	20%	0.28
MSCI EM	-32%	-0.5%	18%	19%	16%	-0.03
FX						
JPY/USD	2%	7.6%	13%	6.6%	9.3%	0.95
EUR/USD	-2%	3.7%	9%	5.9%	9.0%	0.50
GBP/USD	0%	6.0%	15%	8.9%	8.9%	0.67
AUD/USD	-2%	3.1%	8%	7.8%	11.0%	0.33
INR/USD	3%	8.4%	14%	6.4%	7.3%	1.22
ZAR/USD	1%	8.0%	16%	15.3%	15.8%	0.51
BRL/USD	0%	6.9%	13%	13.5%	15.3%	0.48
Rates						
UST 10yr	-2.2%	1.9%	6.1%	5.6%	6.0%	0.34
DBR 10yr	-5.4%	-2.9%	1.2%	5.0%	5.0%	-0.59
UKT 10yr	-5.7%	-3.6%	1.0%	5.6%	5.5%	-0.65
JGB 10yr	-0.9%	0.5%	1.1%	1.6%	2.3%	0.28
Credit (Excess Return)						
US IG	-5.2%	-0.7%	2.5%	3.4%	1.8%	-0.25
US HY	-12.7%	-3.5%	6.5%	7.0%	5.1%	-0.58
EUR IG	-1.8%	-0.2%	1.6%	1.4%	1.6%	-0.15
EUR HY	-6.8%	-1.0%	3.1%	5.9%	4.4%	-0.20
Italy 10yr	-6.0%	3.5%	7.9%	7.4%	10.0%	0.41
EM Sovs	-5.0%	2.9%	7.6%	5.2%	6.4%	0.51
US CMBS AAA	-2.4%	0.5%	2.3%	2.0%	5.5%	0.15
Commodities						
Brent	-17%	-1.3%	15%	30%	30%	-0.04

Source: Note: Brent returns are vs.the forward.
Source: Bloomberg, Morgan Stanley Research forecasts

Morgan Stanley long-run returns forecasts

Exhibit 28: Morgan Stanley 10-year expected return forecasts across asset classes

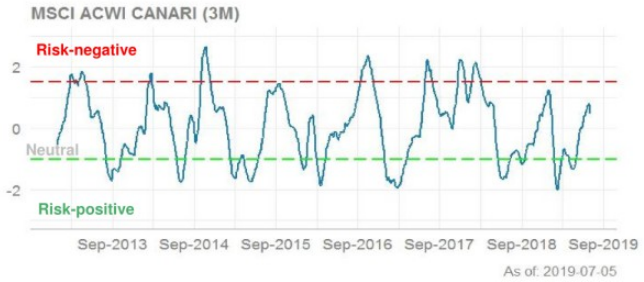
04-Jul-19

	10Y Nominal Expected Rtns		Risk Premium	
	Current	Z-score	Current	Z-score
EQUITIES				
S&P 500	5.5		3.1	
MSCI Europe	6.3		6.1	
MSCI UK	9.6		8.6	
MSCI Japan	7.2		6.4	
MSCI EM	9.6		7.1	
	Current	**Z-score**	**Current**	**Z-score**
GOV'T BONDS				
UST 5Y	2.3		0.6	
UST 10Y	2.4		0.7	
DBR 5Y	0.0		-0.7	
DBR 10Y	0.3		-0.4	
UKT 5Y	1.0		-2.2	
UKT 10Y	0.9		-2.3	
JGB 5Y	0.4		0.2	
JGB 10Y	0.8		0.6	
FIXED INCOME & CREDIT				
USD Agg	2.9		0.6	
USD IG	3.7		1.3	
USD HY	3.4		1.1	
USD BBB	3.9		1.5	
USD BB	3.1		0.8	
EUR Agg	0.6		0.4	
EUR IG	0.8		0.8	
EUR HY	1.1		1.1	
EUR BBB	1.0		0.9	
EUR BB	0.6		0.6	
EM $ CREDIT				
Global	4.4		2.0	
Asia	4.0		1.6	

Source: Bloomberg, Morgan Stanley Research forecasts

Morgan Stanley CANARIs

Exhibit 29: ACWI CANARI 3M



Source: Morgan Stanley Research

Exhibit 30: ACWI CANARI 12M

Source: Morgan Stanley Research

Exhibit 31: Morgan Stanley CANARIs

	CANARI				Avg Fwd Performance Given Bucket				% Better Than Avg Given Bucket			
	1M	3M	6M	12M	1M	3M	6M	12M	1M	3M	6M	12M
EQUITIES												
MSCI ACWI					0%				54%			
S&P 500												
MSCI Europe					0%				51%			
TOPIX												
MSCI EM												
BONDS												
UST												
DBR					-5				52%			
JGB							0				40%	
CREDIT												
US IG												
US HY												
EU IG												
EM $					-20				58%			
US Securitized					-2				48%			
FX												
DXY					1%				55%			
EUR								-7%				15%
GBP												
JPY*					0%		-6%	-7%	52%		74%	74%
AUD					0%				54%			
COMMODITIES												
Gold					0%				40%			
Copper												
Crude					-2%				41%			

As of: 2019-07-04

Note: For equity, we show price performance; bonds, yield change in bps, credit, spread change in bps

Source: Morgan Stanley Research; Note: Boxes with black border indicate that CANARI has triggered risk-positive or risk-negative. Red boxes indicate that CANARI is associated with worse-than-average forward returns; green is associated with better-than-average returns. "Next XM Performance" show realized performance from stated date. For USDBRL, average spot change is * as data break means averages over that horizon look extreme. 'Vs Avg' indicates Next XM Performance minus average performance up to stated date. Greyed out numbers indicate where the CANARI signal produced the 'wrong' signal, and realized performance was worse than average.

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(as of June 30, 2019)

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STOCK RATING CATEGORY	COVERAGE UNIVERSE COUNT	COVERAGE UNIVERSE % OF TOTAL	INVESTMENT BANKING CLIENTS (IBC) COUNT	INVESTMENT BANKING CLIENTS (IBC) % OF TOTAL IBC	INVESTMENT BANKING CLIENTS (IBC) % OF RATING CATEGORY	OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC) COUNT	OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC) % OF TOTAL OTHER MISC
Overweight/Buy	**1110**	**36%**	**282**	**42%**	**25%**	**515**	**37%**
Equal-weight/Hold	**1404**	**45%**	**312**	**47%**	**22%**	**656**	**47%**
Not-Rated/Hold	**13**	**0%**	**2**	**0%**	**15%**	**2**	**0%**
Underweight/Sell	**581**	**19%**	**73**	**11%**	**13%**	**229**	**16%**
TOTAL	**3,108**		**669**			**1402**	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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