Caron's Corner Transcript – 6.24.2024

Caron's Corner: 2H24: Chasing the White Rabbit, but Where Will it Lead Investors?

- The white rabbit is a clear reference to Alice in Wonderland, symbolizing stresses and tensions, leading its ***willing*** follower into a strange world. The difference is that ***we*** in the market have no choice.
- In the context of the market, the metaphorical white rabbit may be leading investors into an **ambiguous** world, more so than an **uncertain** one.
- The big difference is that the market can **calculate** risks associated with uncertainty, but **cannot** with ambiguity.
- This presents a challenge in 2H 2024 as we enter a world with **political drivers** of market movements, **a key source of ambiguity**. This seems to have started with election results in Mexico, India, the EU and France.
- More to come with respect to the U.S. presidential election, but the projections for trade and foreign policy, tariffs and fiscal policy/2025 tax policy all represent **ambiguity**.
- And let's not forget monetary policy, inflation, employment situation and other fundamental factors, all representing **uncertainty**.
- What can investors do about this in 2H 2024? We discuss in this audiocast.

Jim Caron: Hello, this is Jim Caron, CIO of the Portfolio Solutions Group. Looking ahead into the second half of 2024 is like chasing the white rabbit – but where will it actually lead investors? This is a clear reference to Lewis Carroll's Alice in Wonderland where the white rabbit symbolizes stresses and tensions of the time and leads its willing followers into a strange world. The difference is that we in the market have no choice. Putting this into a market context, the metaphorical white rabbit may be leading investors into an ambiguous world more so than an uncertain world. The difference is that the market calculates risks associated with uncertainty, but cannot with ambiguity. This presents a challenge in the second half of 2024 as we enter a world with political drivers of market movements, a key source of ambiguity. Perhaps it's already started with the election results in Mexico, India, the Eu and France. More to come with the US presidential election. The projections for trade, foreign policy, tariffs, fiscal policy and tax policy all represent ambiguity. Let's also not forget monetary policy, inflation, employment and other fundamental factors that represent uncertainty. So what can investors do in the second half of 2024? Let's get into it.

Let's start with managing the uncertainty. As we like to say, all roads lead to inflation as the main source of uncertainty. If we can get that one right then Fed policy follows. Adding to the uncertainty are three measures of inflation which are sending signals, and I like to use a traffic light analogy as it relates to the possibility for rate cuts. I'm going to start with the Super Core inflation measure which I see as a red light. Super Core is still running hot at 4.8% and this is a no go for Fed rate cuts. The yellow light is symbolic of Core CPI year-over-year, which is cooling down to 3.4% on a year-over-year basis. It's heading lower, but it's keeping the Fed on the sidelines until they can gain more confidence. The green light is Core PCE which is expected to be around 2.6 - 2.7% and that's closer to the Fed's comfort zone for cutting rates.

So at what point does the Fed find confidence to cut rates? It likely stems from a weakening in the labor market. In other words, the Fed would likely go ahead with a cut despite Core CPI and Super Core, which are also remaining high. If the unemployment rate starts making steady progress higher, say if it goes to around 4.3%. Currently, the unemployment rate is at 4%. Why? Because this would signal a decline in wage inflation to come. If that happens, then the Fed will believe that inflation is not only falling, but it can become anchored. Our best guess is that this is a path we are on. That is a slowing economy with the Fed swooping in with rate cuts to make sure that the landing is actually soft.

In which case, the asset class implications for bonds are that we believe that it will be range-bound in interest rates as the yield curve is already inverted and pricing for this. We prefer high yield and bank loans as overweights, as we expect lower default risks. We will hold an overweight in Emerging Markets too. We like keeping our duration a bit short because of the inverted curve and the better carry that it provides in the front end

With respect to equities, we see more idiosyncratic and alpha opportunities over beta. In other words, it's not just about having exposure at the index level but creating tilts where we see pockets of value. We are overall neutral, but we have concentrations in European banks and more recently in French equities. We still prefer growth over value in large to small and underweight defensive sectors in the US. As we see it, the economic uncertainty is manageable. We are neutral but with positive alpha tilts.

Now on to managing the ambiguity. This is not an exact science, but we think the solution to ambiguity driven by politics lies in portfolio construction. That's to say we want to have ample liquidity and neutral exposure at the top down portfolio level so that we are unencumbered to act freely in response to market moves. So how do we think about ambiguity? Well, picture a normal bell-shaped probability distribution. This is a model of calculable uncertainty. Now instead of a bell shape, draw a horizontal line. This means that all events have an equal probability. In other words, anything can happen, this is what ambiguity is OK. Now I'm exaggerating a bit, but I think the reality lies somewhere in the middle of both these illustrations. Again, it’s not an exact science. I mean, how can it be when even the supposed experts get it very wrong? Not just in terms of how people vote, but also by how elected leaders will govern despite what they say on the campaign trail. So as we just said, if the truth lies somewhere in between the fundamental distribution of uncertainty and the ambiguous one driven by political outcomes, then we solve for this by portfolio construction. A durable, well-diversified portfolio that has a neutral starting point, so it can strike out at dislocations in the market that are perhaps driven by political ambiguity and market overshoots. This is the way we are thinking about managing the risks as we head into the second half of 2024.

And if anything becomes unclear along the way, then just go ask Alice.

RISK CONSIDERATIONS

Diversification does not eliminate the risk of loss. There is no assurance that the Strategy will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in this portfolio. Please be aware that this strategy may be subject to certain additional risks. There is the risk that the Adviser's **asset allocation methodology and assumptions** regarding the Underlying Portfolios may be incorrect in light of actual market conditions and the Portfolio may not achieve its investment objective. Share prices also tend to be volatile and there is a significant possibility of loss. The portfolio's investments in **commodity-linked notes** involve substantial risks, including risk of loss of a significant portion of their principal value. In addition to commodity risk, they may be subject to additional special risks, such as risk of loss of interest and principal, lack of secondary market and risk of greater volatility, that do not affect traditional equity and debt securities. **Currency fluctuations** could erase investment gains or add to investment losses. **Fixed-income securities** are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest-rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. **Longer-term securities** may be more sensitive to interest rate changes. **Equity and foreign securities** are generally more volatile than fixed income securities and are subject to currency, political, economic and market risks. Equity values fluctuate in response to activities specific to a company. Stocks of **small-capitalization companies** carry special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies. The risks of investing in **emerging market** countries are greater than risks associated with investments in foreign developed markets. **Exchange traded funds (ETFs)** shares have many of the same risks as direct investments in common stocks or bonds and their market value will fluctuate as the value of the underlying index does. By investing in exchange traded funds ETFs and other **Investment Funds**, the portfolio absorbs both its own expenses and those of the ETFs and Investment Funds it invests in. Supply and demand for ETFs and Investment Funds may not be correlated to that of the underlying securities. **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the portfolio's performance. A **currency forward** is a hedging tool that does not involve any upfront payment. The use of **leverage** may increase volatility in the Portfolio.

IMPORTANT DISCLOSURES:

Past performance is no guarantee of future results. The returns referred to in the audio are those of representative indices and are not meant to depict the performance of a specific investment.

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market.

A separately managed account may not be appropriate for all investors. Separate accounts managed according to the particular Strategy may include securities that may not necessarily track the performance of a particular index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required.

For important information about the investment managers, please refer to Form ADV Part 2.

The views and opinions and/or analysis expressed are those of the author or the investment team as of the date of preparation of this material and are subject to change at any time without notice due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all investment personnel at Morgan Stanley Investment Management (MSIM) and its subsidiaries and affiliates (collectively "the Firm"), and may not be reflected in all the strategies and products that the Firm offers.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors or the investment team. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific strategy or product the Firm offers. Future results may differ significantly depending on factors such as changes in securities or financial markets or general economic conditions.

This material has been prepared on the basis of publicly available information, internally developed data and other third-party sources believed to be reliable. However, no assurances are provided regarding the reliability of such information and the Firm has not sought to independently verify information taken from public and third-party sources.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

The indexes are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an index. Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

This material is not a product of Morgan Stanley's Research Department and should not be regarded as a research material or a recommendation.

The Firm has not authorised financial intermediaries to use and to distribute this material, unless such use and distribution is made in accordance with applicable law and regulation. Additionally, financial intermediaries are required to satisfy themselves that the information in this material is appropriate for any person to whom they provide this material in view of that person's circumstances and purpose. The Firm shall not be liable for, and accepts no liability for, the use or misuse of this material by any such financial intermediary.

This material may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this material in another language, the English version shall prevail.

Eaton Vance is part of Morgan Stanley Investment Management. Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

DISTRIBUTION

This material is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

MSIM, the asset management division of Morgan Stanley (NYSE: MS), and its affiliates have arrangements in place to market each other's products and services. Each MSIM affiliate is regulated as appropriate in the jurisdiction it operates. MSIM's affiliates are: Eaton Vance Management (International) Limited, Eaton Vance Advisers International Ltd, Calvert Research and Management, Eaton Vance Management, Parametric Portfolio Associates LLC and Atlanta Capital Management LLC.

This material has been issued by any one or more of the following entities:

EMEA:

This material is for Professional Clients/Accredited Investors only.

In the EU, MSIM and Eaton Vance materials are issued by MSIM Fund Management (Ireland) Limited ("FMIL"). FMIL is regulated by the Central Bank of Ireland and is incorporated in Ireland as a private company limited by shares with company registration number 616661 and has its registered address at The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland.

Outside the EU, MSIM materials are issued by Morgan Stanley Investment Management Limited (MSIM Ltd) is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

In Switzerland, MSIM materials are issued by Morgan Stanley & Co. International plc, London (Zurich Branch) Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland.

Outside the US and EU, Eaton Vance materials are issued by Eaton Vance Management (International) Limited ("EVMI") 125 Old Broad Street, London, EC2N 1AR, UK, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority.

Italy: MSIM FMIL (Milan Branch), (Sede Secondaria di Milano) Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy. The **Netherlands:** MSIM FMIL (Amsterdam Branch), Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. **France:** MSIM FMIL (Paris Branch), 61 rue de Monceau 75008 Paris, France. **Spain:** MSIM FMIL (Madrid Branch), Calle Serrano 55, 28006, Madrid, Spain. **Germany**: MSIM FMIL, Frankfurt Branch, Grosse

Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Denmark:** MSIM FMIL (Copenhagen Branch), Gorrissen Federspiel, Axel Towers, Axeltorv2, 1609 Copenhagen V, Denmark.

MIDDLE EAST:
Dubai: MSIM Ltd (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158).

This document is distributed in the Dubai International Financial Centre by Morgan Stanley Investment Management Limited (Representative Office), an entity regulated by the Dubai Financial Services Authority (DFSA). It is intended for use by professional clients and market counterparties only. This document is not intended for distribution to retail clients, and retail clients should not act upon the information contained in this document.

This document relates to a financial product which is not subject to any form of regulation or approval by the DFSA. The DFSA has no responsibility for reviewing or verifying any documents in connection with this financial product. Accordingly, the DFSA has not approved this document or any other associated documents nor taken any steps to verify the information set out in this document, and has no responsibility for it. The financial product to which this document relates may be illiquid and/or subject to restrictions on its resale or transfer. Prospective purchasers should conduct their own due diligence on the financial product. If you do not understand the contents of this document, you should consult an authorised financial adviser**.**

U.S.: NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT

Latin America (Brazil, Chile Colombia, Mexico, Peru, and Uruguay)

This material is for use with an institutional investor or a qualified investor only. All information contained herein is confidential and is for the exclusive use and review of the intended addressee, and may not be passed on to any third party. This material is provided for informational purposes only and does not constitute a public offering, solicitation or recommendation to buy or sell for any product, service, security and/or strategy. A decision to invest should only be made after reading the strategy documentation and conducting in-depth and independent due diligence.

ASIA PACIFIC

Hong Kong: This material is disseminated by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to “professional investors” as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this material have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this material shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This material is disseminated by Morgan Stanley Investment Management Company and should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore (“SFA”); (ii) to a “relevant person” (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This publication has not been reviewed by the Monetary Authority of Singapore. **Australia:** This material is provided by Morgan Stanley Investment Management (Australia) Pty Ltd ABN 22122040037, AFSL No. 314182 and its affiliates and does not constitute an offer of interests. Morgan Stanley Investment Management (Australia) Pty Limited arranges for

MSIM affiliates to provide financial services to Australian wholesale clients. Interests will only be offered in circumstances under which no disclosure is required under the Corporations Act 2001 (Cth) (the "Corporations Act"). Any offer of interests will not purport to be an offer of interests in circumstances under which disclosure is required under the Corporations Act and will only be made to persons who qualify as a "wholesale client" (as defined in the Corporations Act). This material will not be lodged with the Australian Securities and Investments Commission.

Japan: For professional investors, this material is circulated or distributed for informational purposes only. For those who are not professional investors, this material is provided in relation to Morgan Stanley Investment Management (Japan) Co., Ltd. ("MSIMJ")'s business with respect to discretionary investment management agreements ("IMA") and investment advisory agreements ("IAA"). This is not for the purpose of a recommendation or solicitation of transactions or offers any particular financial instruments. Under an IMA, with respect to management of assets of a client, the client prescribes basic management policies in advance and commissions MSIMJ to make all investment decisions based on an analysis of the value, etc. of the securities, and MSIMJ accepts such commission. The client shall delegate to MSIMJ the authorities necessary for making investment. MSIMJ exercises the delegated authorities based on investment decisions of MSIMJ, and the client shall not make individual instructions. All investment profits and losses belong to the clients; principal is not guaranteed. Please consider the investment objectives and nature of risks before investing. As an investment advisory fee for an IAA or an IMA, the amount of assets subject to the contract multiplied by a certain rate (the upper limit is 2.20% per annum (including tax)) shall be incurred in proportion to the contract period. For some strategies, a contingency fee may be incurred in addition to the fee mentioned above. Indirect charges also may be incurred, such as brokerage commissions for incorporated securities. Since these charges and expenses are different depending on a contract and other factors, MSIMJ cannot present the rates, upper limits, etc. in advance. All clients should read the Documents Provided Prior to the Conclusion of a Contract carefully before executing an agreement. This material is disseminated in Japan by MSIMJ, Registered No. 410 (Director of Kanto Local Finance Bureau (Financial Instruments Firms)), Membership: the Japan Securities Dealers Association, The Investment Trusts Association, Japan, the Japan Investment Advisers Association and the Type II Financial Instruments Firms Association.

CRC 6639193 Exp. 5/31/2025