Morgan Stanley

Positioning Portfolios for Inflation

2023 IMAP Independent Thought Conference

September 5, 2023

For important disclosures, refer to the Disclosure section, located at the end of this report.

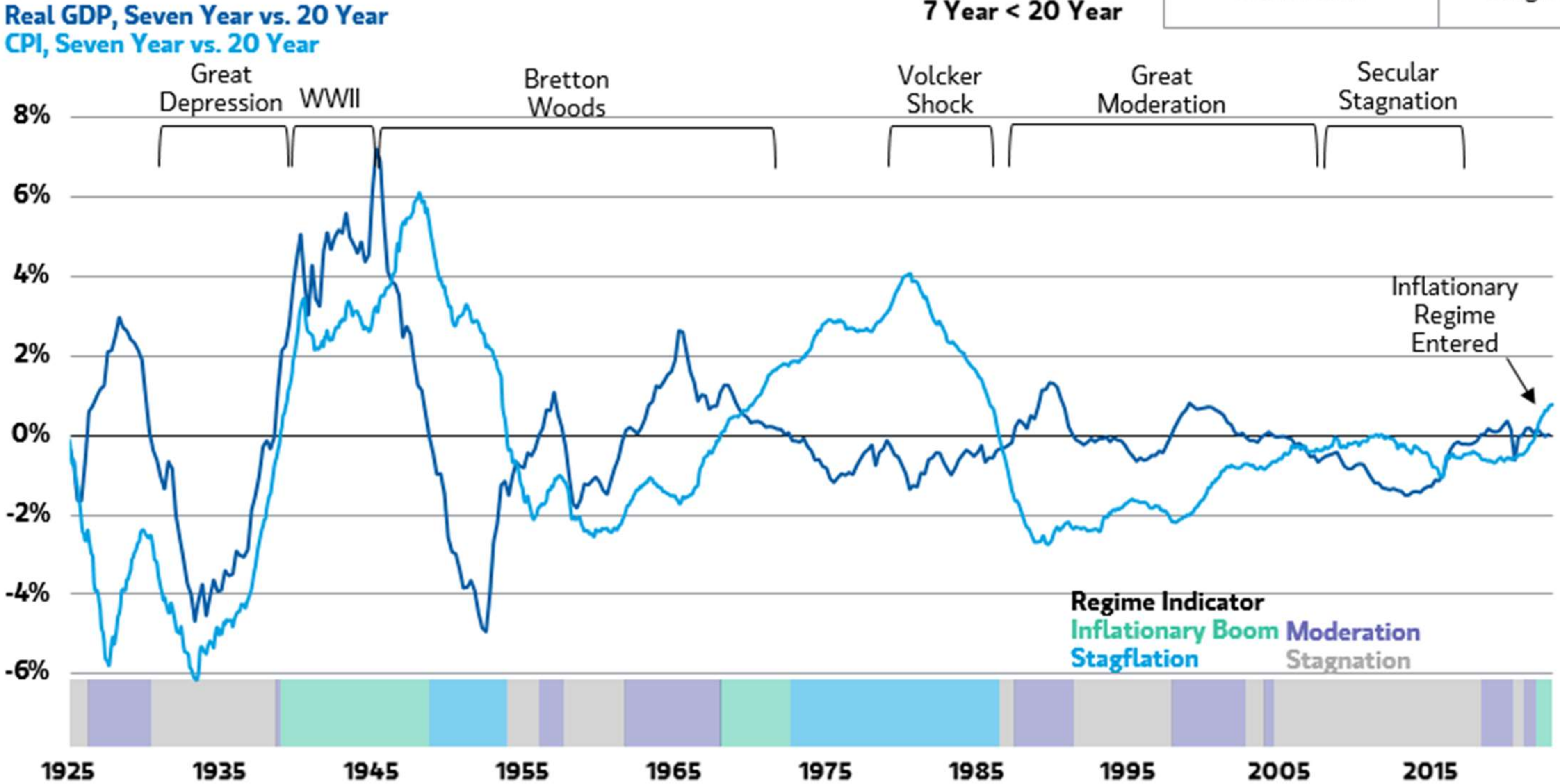
Positioning Portfolios for Inflation

Why inflation matters (an extreme example)

Positioning Portfolios for Inflation

Defining Regimes

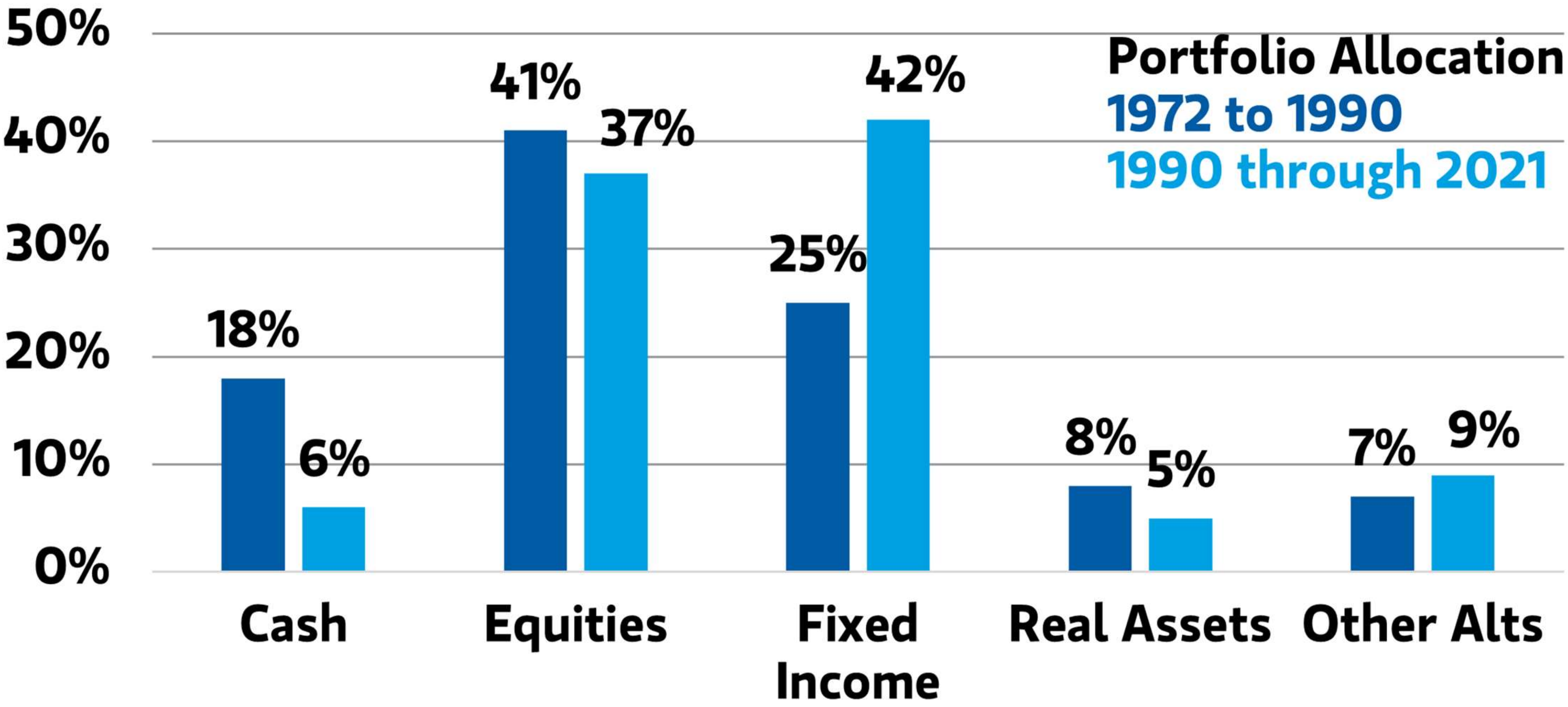
	Accelerating Growth 7 Year > 20 Year	Slowing Growth 7 Year < 20 Year
Accelerating Inflation 7 Year > 20 Year	Inflationary Boom	Stagflation
Slowing Inflation 7 Year < 20 Year	Moderation	Stagnation



Source: Ibbotson, Bloomberg, US Bureau of Labor Statistics, US Federal Reserve, Morgan Stanley Wealth Management Global Investment Office (GIO). Note: CPI as of Dec. 31, 2022; regime indicator and GDP as of Sept. 30, 2022. Accelerating and slowing trends are identified by comparing the geometric average rate over a seven-year horizon with that over a 20-year horizon.

Positioning Portfolios for Inflation

Inflationary Regimes Call for Very Different Portfolios



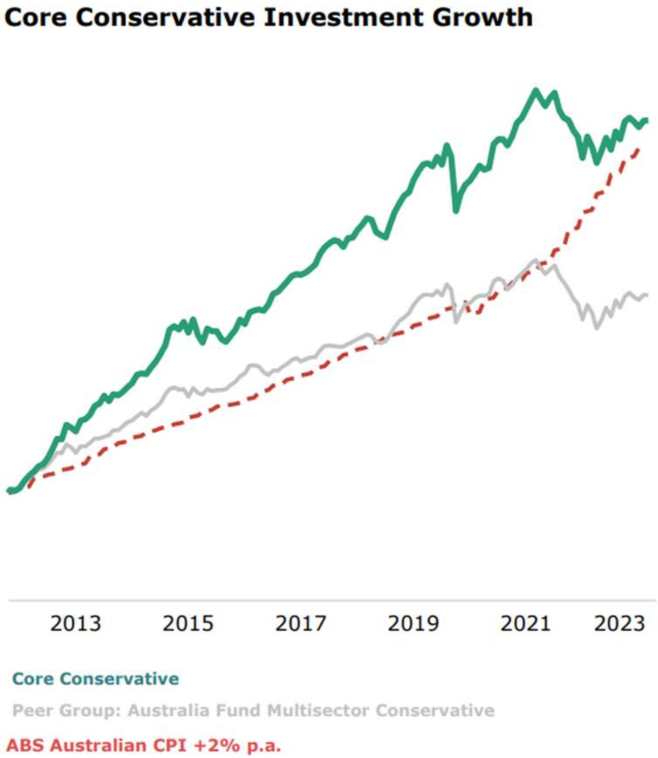
Source: Morgan Stanley Wealth Management t GIO. For further details see Global Investment Committee: What if the Future Is Inflation? Correcting Disinflationary Bias in Market Forecast: January 26, 2023.

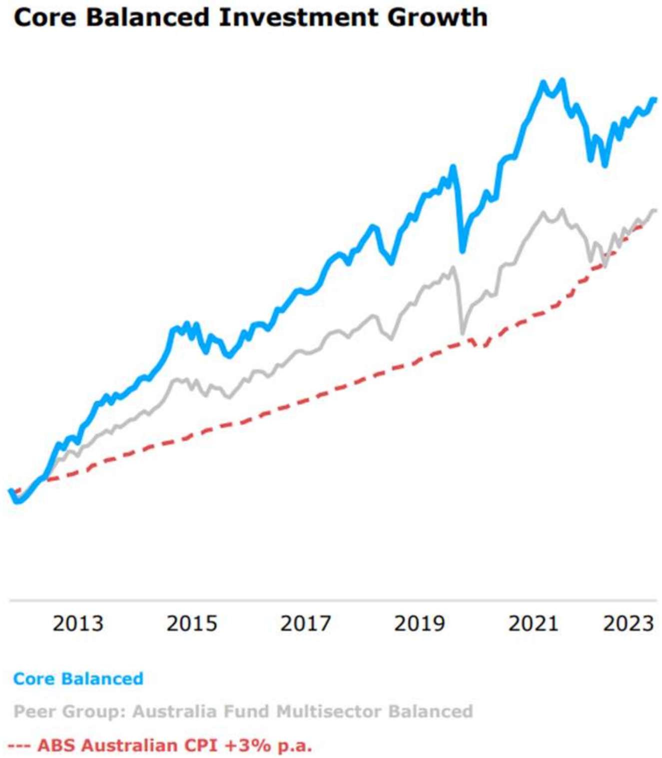
Positioning Portfolios for Inflation

Value of using Real Return targets in Portfolio Construction

Return since inception (annualised)	Conservative	Balanced	Growth
Core Model Portfolios	**4.90%**	**7.38%**	**9.58%**
Peer Group	3.02%	5.85%	8.78%
Excess return	**1.89%**	**1.53%**	**0.80%**

As at 31 July 2023





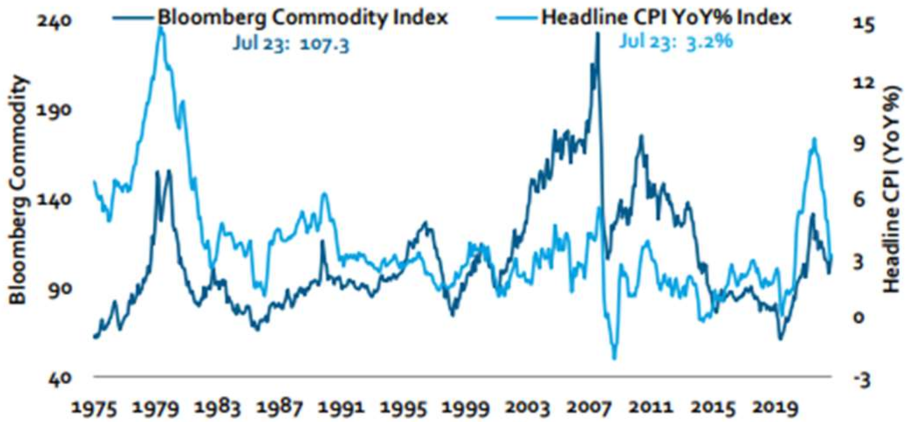
Morningstar, Morgan Stanley Wealth Management Research. Inception date is 18 April 2012. Results shown represent total return (including dividends). Return data from 18 April 2012 (inception) to 31 July 2023. Past performance is no guarantee of future results. The portfolio is hypothetical and does not include actual trades; results do not include transaction costs/fees. Tables may not sum due to rounding. For further details see Asset Allocation Insights: Core Conservative, Balanced and Growth Model Portfolio Performance Updates for July 2023.

Positioning Portfolios for Inflation

Key Drivers of Inflation are falling in the US

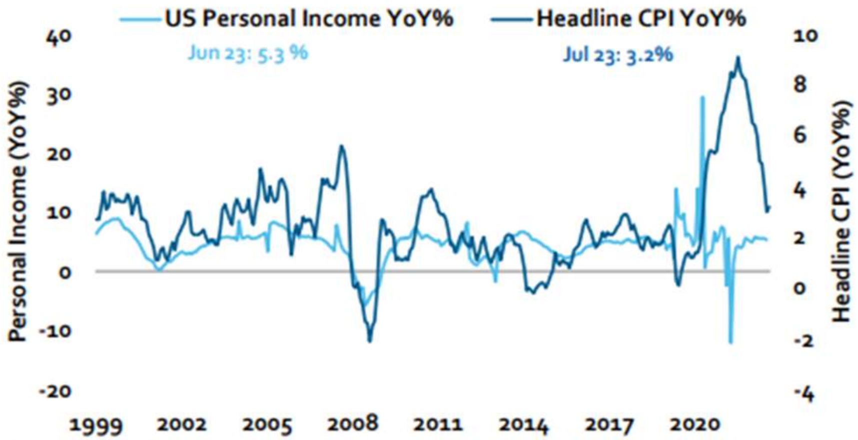
Commodity and Raw Material Prices

Bloomberg Commodity data as of July 31, 2023 and CPI data as of July 31, 2023



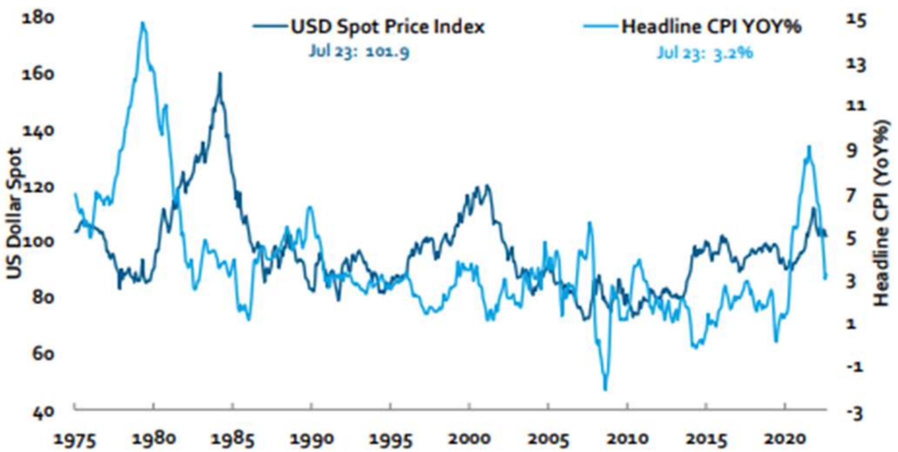
Wages

Personal Income Monthly Data as of June 30, 2023 and Headline CPI data as of July 31, 2023



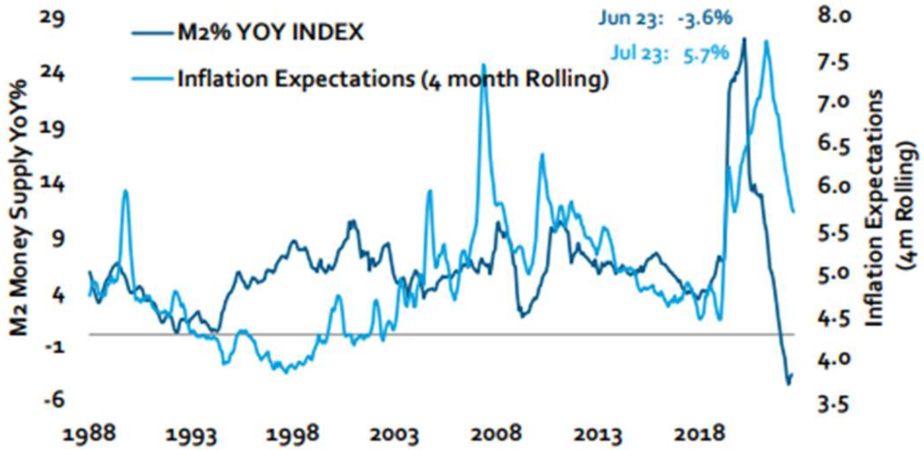
US Dollar

USD Spot Monthly Data as of July 31, 2023 and Headline CPI Monthly Data as of July 31, 2023



Money Supply

M2 data as of June 30, 2023 and Inflation Expectations data as of July 31, 2023



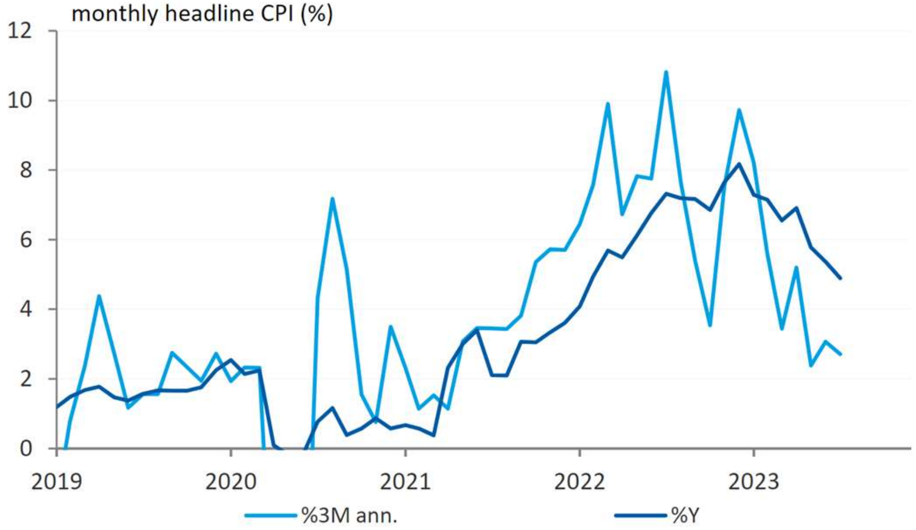
Source: Bloomberg, Morgan Stanley Wealth Management GIO. M2 is a measure of the money supply that includes all elements of M1 as well as "near money." M1 includes cash and checking deposits while near money refers to savings deposits, money market securities, mutual funds and other time deposits

Positioning Portfolios for Inflation

Similar Progress on Fighting Inflation in Australia

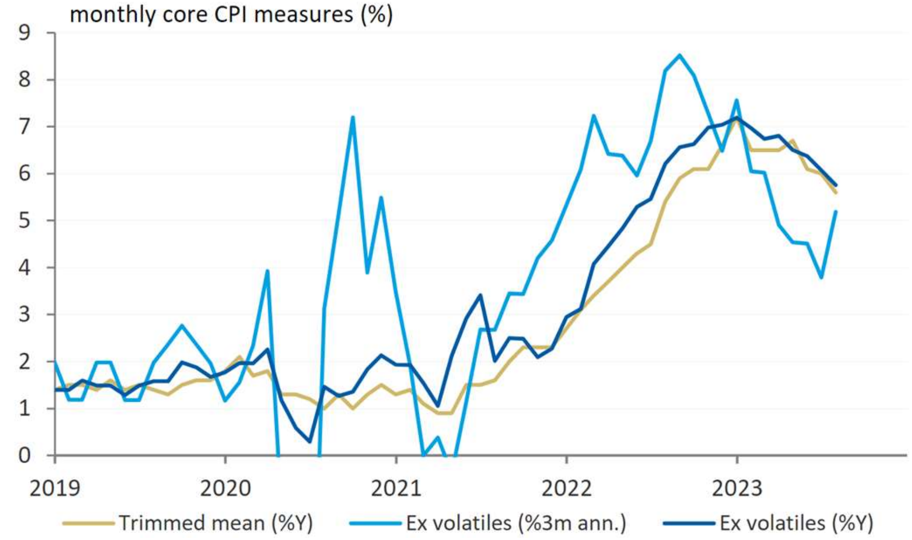
- July headline CPI surprised to the downside, slowing from 5.4% yoy to 4.9% yoy.
- However core measures are much stickier - with trimmed mean inflation of 5.6% yoy and ex volatiles inflation of 5.8% yoy.
- Morgan Stanley believes the core inflation trends, wages and unemployment remain key to RBA policy.

Headline inflation in 3-month annualised terms now sits within the RBA's



Source: ABS, Morgan Stanley Research

Core measures remain stickier, and reaccelerated sequentially in July



Source: ABS, Morgan Stanley Research

Positioning Portfolios for Inflation

Global Inflation Forecasts: Headline CPI

	Base Case Forecasts														
	Quarterly												Annual		
	2022				2023E				2024E						
Consumer Price Inflation (%Y)	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2022	2023E	2024E
Global*	**5.0**	**6.3**	**6.7**	**6.3**	**5.4**	**3.9**	**3.6**	**3.0**	**2.6**	**2.6**	**2.3**	**2.4**	**6.0**	**4.0**	**2.5**
G10	**6.3**	**7.7**	**8.1**	**8.0**	**6.6**	**5.1**	**4.2**	**3.1**	**2.7**	**2.5**	**2.3**	**2.1**	**7.5**	**4.7**	**2.4**
US	8.0	8.6	8.3	7.1	5.8	4.1	3.5	2.9	2.5	2.4	2.1	2.0	8.0	4.0	2.2
Euro Area	6.1	8.0	9.3	10.0	8.0	6.2	4.9	3.2	2.6	2.5	2.3	2.2	8.4	5.6	2.4
Japan	0.9	2.4	2.9	3.9	3.6	3.3	3.0	2.7	2.4	2.5	2.1	1.4	2.5	3.2	2.1
UK	6.2	9.2	10.0	10.8	10.2	8.4	6.8	4.4	4.0	2.7	2.8	2.6	9.0	7.5	3.0
Australia	**5.1**	**6.1**	**7.3**	**7.8**	**7.1**	**6.3**	**5.2**	**4.0**	**3.5**	**3.2**	**3.1**	**3.1**	**6.6**	**5.6**	**3.3**
EM*	**3.8**	**5.1**	**5.5**	**4.9**	**4.4**	**3.0**	**3.1**	**2.9**	**2.6**	**2.6**	**2.4**	**2.7**	**4.8**	**3.3**	**2.6**
AXJ	**2.7**	**3.9**	**4.3**	**3.5**	**3.2**	**1.9**	**2.3**	**2.2**	**2.0**	**2.1**	**1.9**	**2.4**	**3.6**	**2.4**	**2.1**
China	1.1	2.2	2.7	1.8	1.3	0.1	-0.1	0.4	0.5	0.7	1.1	1.4	2.0	0.4	0.9
India	6.3	7.3	7.0	6.1	6.2	4.6	7.3	6.0	4.9	5.2	3.5	4.8	6.7	6.0	4.6
LatAm*	**9.0**	**10.1**	**9.2**	**8.0**	**7.5**	**5.8**	**5.5**	**5.4**	**4.7**	**4.2**	**4.2**	**4.0**	**9.1**	**6.0**	**4.3**
Brazil	10.7	11.9	8.7	6.1	5.3	3.8	4.7	5.1	4.7	4.2	4.3	4.1	9.3	4.7	4.3

Source: IMF, Morgan Stanley Research forecasts. Data as of August 25, 2023.
*Note: Global and regional aggregates are GDP-weighted averages, using PPP weights. Global core inflation includes G4 and BRIC. CPI numbers are period averages. Japan headline inflation includes VAT and free education impact. *Global, EM, and LatAm aggregates exclude Argentina. ^Japan's core CPI is excluding energy and fresh food, and ex VAT and Free child education impact.

Positioning Portfolios for Inflation

Key Points

1. Real Economic Growth and Inflation are the two key macroeconomic variables that drive portfolio design and asset allocation decisions.

2. Defining different regimes can help to orientate portfolio decisions.

3. Inflationary regimes call for very different portfolios with more cash, equities as well as real assets and less fixed income.

4. Headline inflation continues to fall with many of the key drivers retracting though core inflation measures are stickier.

5. On a 3-month annualised basis, domestic headline inflation in July 2023 remained in the Reserve Bank of Australia's target band. Headline disinflation has been faster than core but Morgan Stanley believes this will likely reverse in the next few months given oil dynamics, and core remains quite persistent above target.

6. Morgan Stanley forecasts US headline inflation to fall to approximately the central bank target band by Q4 2024.

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