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# Morgan Stanley Global Macro Forum

## Post-Inauguration: How to Trade the Markets

January 23, 2017

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**Hans Redeker**

*Global Head of FX Strategy*

# USDJPY Driven by Real Yield Differentials



Source: Bloomberg, Macrobond, Morgan Stanley Research

## FX De-Hedging and Move Back into Carry Should Weaken JPY



Source: Company Disclosures, Bloomberg, Morgan Stanley Research

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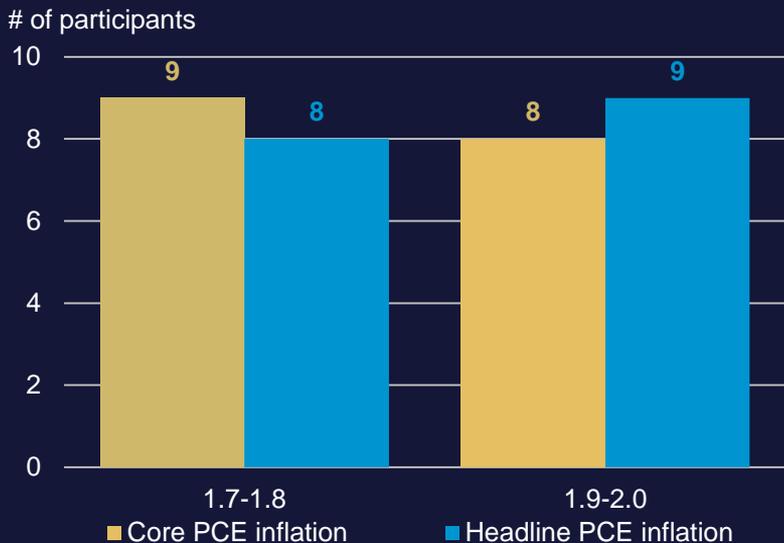
**Matthew Hornbach**

*Global Head of Interest Rate Strategy*

# Watch Core PCE Inflation into the March and June Fed Meetings

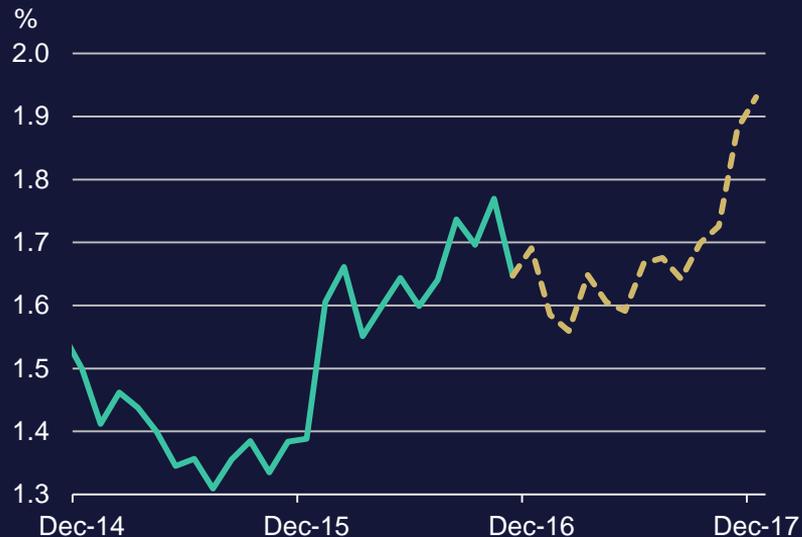
## FOMC participant projections for headline and core PCE inflation rate at the end of 2017

As expected at the December 2016 FOMC meeting



## Core PCE inflation from 2015-16 and the MS forecast in 2017

Year-on-year



Source for both: Morgan Stanley Research forecasts, Federal Reserve

# Buy the US 5-year Note as/if March Approaches 50%

## Probability of a hike by March 2017 and expected trading levels of 2- to 5-year notes

Based on regression analysis

Probability of a Hike by March	2-Year	3-Year	5-Year
<b>Friday Close</b>	<b>1.21</b>	<b>1.50</b>	<b>1.94</b>
50%	1.35	1.67	2.22
40%	1.29	1.58	2.08
30%	1.22	1.49	1.95
20%	1.16	1.41	1.82
10%	1.09	1.32	1.68

## US Treasury 5-year yield history

Year-on-year



Source for both: Morgan Stanley Research, Bloomberg

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**Adam Parker**

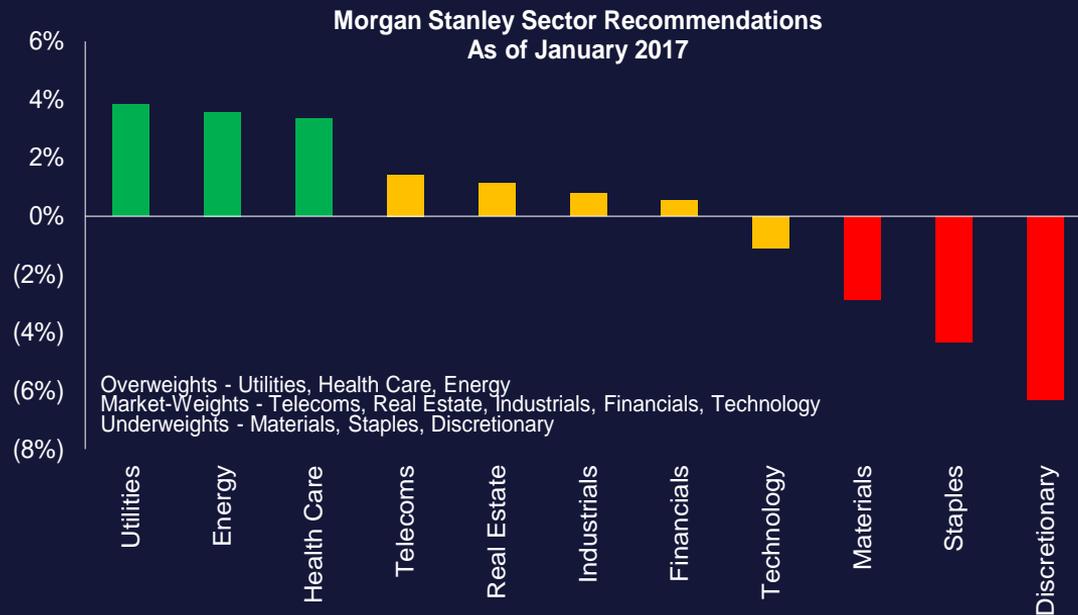
*Chief US Equity Strategist*

## Market Views Have Changed

- Earnings Expectations Are High
- Multiples Are Above Average
- Fed Outcomes Are More Hawkish
- Washington Uncertainty Is Higher
- There Is Investor Complacency on China
- Europe Politics Are Skewed to the Negative

**Conclusion:** The price-to-earnings ratio likely trends down. The market can still appreciate as long as earnings offset the multiple contraction, but the opportunities are more underneath the surface.

# We Are Overweight Utilities, Energy, and Health Care



## Investment ideas:

- Favor Oil Services over Infrastructure Stocks
- Favor Utilities over Consumer Staples
- Favor Biotechnology
- Avoid Consumer Discretionary

Source: FactSet, Thomson Reuters, Morgan Stanley Research

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**Andrew Sheets**

*Chief Cross-Asset Strategist*

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## **Key Takeaways**

## Post-Inauguration: How to Trade Markets

### We are cautious about trading 'reflation' via US assets

- **FX: USD to strengthen, even if the new administration 'wants' it weaker**
  - *Yield differentials and protectionist policies to boost USD. Buy USDJPY.*
- **Rates: Buy front-end Treasuries when March hike probability hits 50%**
  - *We think that would be too high. Focus on 2yr and 5yr points.*
- **Equities: Higher EPS but a lower market multiple. Little overall upside**
  - *Lower multiple consistent with more hawkish Fed and policy uncertainty.*
  - *OW Utilities, Energy, and Health Care within US equities*
- **Cross-asset: Look elsewhere to trade 'reflation'**
  - *Japan & European equities to outperform US stocks*
  - *Steeper yield curves in Europe and Japan*

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	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
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<b>Equal-weight/Hold</b>	<b>1442</b>	<b>43%</b>	<b>299</b>	<b>45%</b>	<b>21%</b>	<b>702</b>	<b>45%</b>
<b>Not-Rated/Hold</b>	<b>69</b>	<b>2%</b>	<b>8</b>	<b>1%</b>	<b>12%</b>	<b>9</b>	<b>1%</b>
<b>Underweight/Sell</b>	<b>668</b>	<b>20%</b>	<b>85</b>	<b>13%</b>	<b>13%</b>	<b>286</b>	<b>18%</b>
<b>Total</b>	<b>3,321</b>		<b>663</b>			<b>1569</b>	

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