Morgan Stanley

WEALTH MANAGEMENT

INVESTMENT STRATEGY

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Global Insights

How Could the Eurozone Unlock Its Potential?

In this edition of *Global Insights,* we explore the eurozone's investment potential, looking into the likely drivers of its GDP growth as well as its favorable equity valuations, earnings outlook and risks related to higher government debt burdens.

Following several high-profile elections and related volatility, investors have focused on the eurozone's growth outlook. The European Central Bank (ECB) has started its easing cycle ahead of the Federal Reserve, while election results in France and the UK have brought greater clarity. Looking ahead, Morgan Stanley & Co. Research's economics team expects real GDP growth in the eurozone and the UK to pick up, accelerating from stall speed in late 2023. The team's forecast features a) eurozone real GDP growth of 1.1% and 1.3% in 2024 and 2025, respectively, and b) UK real GDP growth of 1.9% and 1.3% in 2024 and 2025, respectively. This pace would result in relative strengthening versus the US, where MS & Co. Research anticipates slowing from 3.1% in 2023 to 2.0% and 2.1% in 2024 and 2025, respectively.

While inflationary pressures have receded, the eurozone faces the same split forces as the US, with goods inflation declining while services inflation remains sticky (perhaps more so than in the US). Meanwhile, manufacturing and services PMI surveys have pointed to stronger activity, rebounding from late-2023, with services having entered expansionary territory. Moreover, given that international customers account for almost 60% of eurozone companies' sales, the euro's range-bound levels and relative weakness in purchasing-power-parity terms could help boost eurozone exports if global activity continues to improve, as it has since mid-2023.

In this context, and following the multi-quarter boost to large-cap US equities from the artificial intelligence (AI) theme, relative valuations appear favorable in the eurozone. Eurozone stock valuations trade well below their 10-year average and their discount to US equities is more than double the historical average. Any slowing in the AI theme could benefit the eurozone on a net basis.

Among country-specific risks, we note that Germany faces a structural shortage of skilled labor and a weakened auto industry, while France's nongovernment debt could pose a challenge.

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Special thanks to Van Hoang for his contributions to this report.

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Market Data

Equity Indexes

As of 7/19/2024 (USD)	MSCI ACWI	S&P 500	MSCI EAFE	MSCI Europe	MSCI Japan	MSCI EM	MSCI LatAm	MSCI China	MSCI India
Last Level	113.49	5,505.00	2,360.51	170.89	1,771.08	1,089.61	2,257.98	57.02	2,945.67
1M Change	0.6%	0.4%	1.9%	-1.1%	5.8%	1.3%	4.3%	-2.5%	2.7%
3M Change	9.5%	11.2%	6.8%	3.6%	9.6%	9.8%	-3.7%	7.7%	12.6%
YTD Change	12.5%	16.3%	7.9%	9.1%	23.6%	8.4%	-12.3%	4.3%	19.2%

Major Currencies

As of 7/19/2024	USD (DXY)	EUR/USD	GBP/USD	AUD/USD	USD/JPY	USD/CNH
Last Level	104.40	1.0882	1.2914	0.6685	157.48	7.2855
1M Change (FX)	-0.8%	1.3%	1.6%	0.4%	0.2%	-0.1%
3M Change (FX)	-1.7%	2.1%	4.4%	4.2%	-1.8%	-0.4%
YTD Change (FX)	3.0%	-1.4%	1.4%	-1.9%	-10.4%	-2.1%

Commodities

As of 7/19/2024	Crude Oil	Gold	Copper
Last Price	82.63	2,400.83	421.90
1M Change	-3.2%	3.1%	-6.0%
3M Change	-5.3%	0.4%	-6.2%
YTD Change	7.3%	16.4%	8.4%

Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 19, 2024

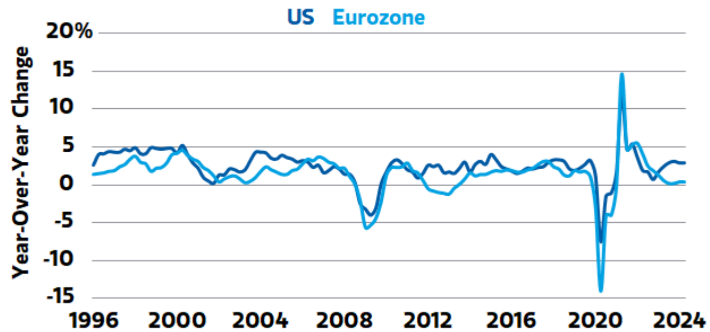
MACRO

Eurozone Relative Growth May Strengthen

Historically, the eurozone's growth has moved in step with that of the US, albeit typically at a slower pace; the US has pulled ahead in recent quarters, however.

While eurozone economic growth stalled in the second half of 2023, the region stands to benefit from potentially improved global growth outside the US. Broadly speaking, the eurozone economy has expanded and contracted in a pattern similar to that of the US, resulting in a 0.85 correlation since 1996. Morgan Stanley & Co. Research cites two factors that could boost eurozone growth in the coming quarters. First, if inflation continues to cool, the ECB could become more accommodative. Lower rates, in turn, could help increase consumption. As noted earlier, services sector Purchasing Managers' Indexes (PMIs) have pointed to positive contributions to real activity. Moreover, the euro, having weakened by more than 10% versus the US dollar since 2021, has remained range-bound. With almost 60% of eurozone companies' sales coming from international markets, compared to approximately 30% for the US, the softer euro could help European exporters maintain competitiveness. In the first quarter, the eurozone carried an aggregate current account surplus of 2% of GDP. Monthly exports to the US have surged from about €30 billion in 2019 to about €45 billion in 2024, leading to a more positive trade balance for the eurozone.

Eurozone Growth Has Historically Tracked but Fallen Short of US Growth

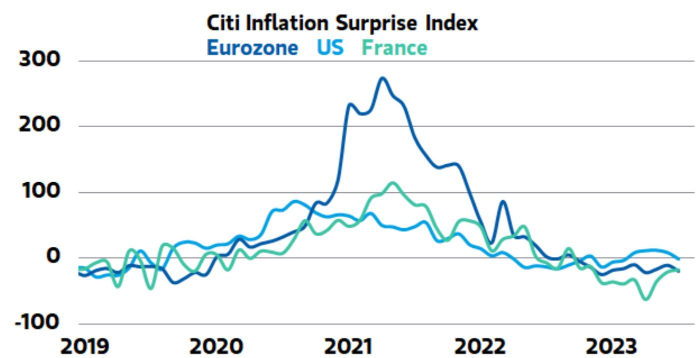


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 19, 2024.

Despite sticky services inflation, the eurozone's inflation outlook appears more favorable than that of the US.

In the eurozone, the disinflationary trend has proved clearer than in the US, with more downside inflation surprises, including in France. The chart to the right displays the Citi Inflation Surprise Index, which captures the direction and magnitude of inflation data relative to market expectations, for the US, France and the eurozone. Index readings have trended lower, and in a more consistent manner for France and the eurozone. So far in 2024, investors have welcomed the ongoing disinflationary trend, as it has translated into a greater likelihood of rate cuts from the ECB, which could, in turn, boost economic growth and support risky asset prices. Morgan Stanley & Co. Research expects eurozone inflation to slow to 2.4% in 2024 and to 2.1% in 2025.

Eurozone Inflation Surprises Have Declined Versus the US



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 19, 2024.

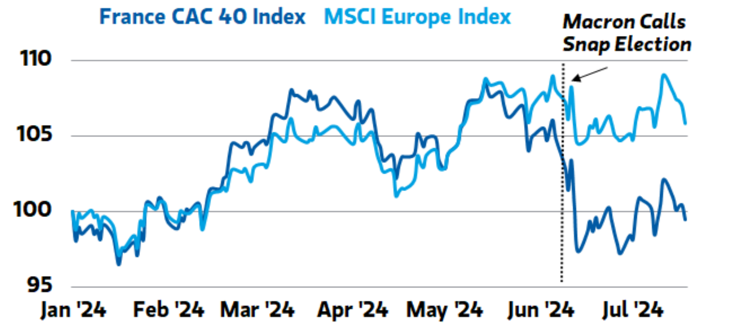
EQUITY

While Risks Persist, Election Outcomes Have Brought Some Clarity

The recent completion of French elections eased concerns over political gridlock, but equities have not fully recaptured their mid-May highs.

On June 9, French President Emmanuel Macron unexpectedly announced his decision to dissolve the National Assembly and hold snap elections. The news spooked investors, causing French stocks to decline and pushing the France-Germany 10-year government bond yield spread much wider. French equities account for nearly 40% of the MSCI Europe Index, which moved lower in sympathy. Since June 14, and through July 19, French equities have traded in a range-bound fashion and sit 7.4% below the mid-May all-time high, underperforming the EuroStoxx 50 Index by 4.7%.

France's Snap Election Announcement Triggered an Equity Selloff

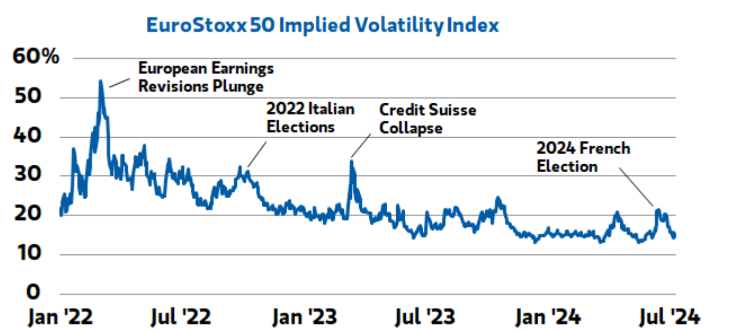


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 19, 2024.

Unsurprisingly, equity volatility has tended to increase around European elections before subsequently receding.

Historical analogues suggest that eurozone equity volatility has understandably risen during periods of greater uncertainty. Volatility levels have typically normalized after the driver of volatility has passed, such as when an election season has ended. Around the 2022 Italian elections, volatility ramped up in anticipation of unfavorable outcomes, causing eurozone equities to decline amid higher risk premiums. Soon afterward, however, volatility receded. Following the conclusion of 2024 elections, eurozone and French equity volatility could normalize amid signs of political stability.

Uncertainty Has Understandably Translated Into Volatility Spikes in the Eurozone



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 19, 2024.

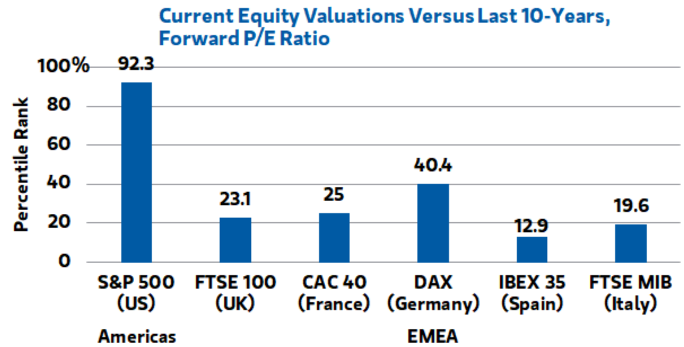
EQUITY

Stronger Eurozone Earnings Are Coupled With Favorable Valuations

Relative to those of US equities, European valuations appear attractive and could rerate given an appropriate catalyst.

Based on both trailing and forward earnings, US equity price/earnings (P/E) ratios are much higher than those of eurozone stocks. Major European equity index valuations are in the bottom quartile of their 10-year historical ranges. Forward P/Es in Italy and France, respectively, are 9.4 times and 13.6 times, compared with 23.4 times for the S&P 500 Index. A sharp differential in earnings growth has largely explained the valuation spread in recent years. Over the next 12 months, consensus forecasts call for 6% earnings growth for eurozone equities versus 24% for the S&P 500. The information technology sector makes up a much smaller portion of European indexes, which explains the differentiated fundamentals. Still, European valuations appear low, even relative to their own long-term averages. With US forward P/Es at approximately 23 and Europe P/E's near 13, the valuation discount is roughly 10 times, which is double the average historical level of four to five. For the discount to reverse, European companies must deliver on a positive earnings growth outlook

Eurozone Equities Trading at a Discount



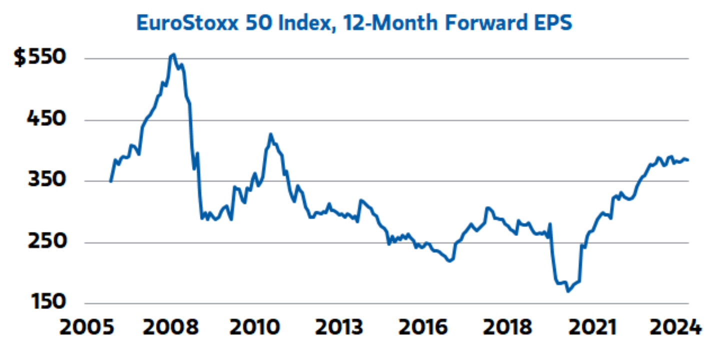
Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 19, 2024.

Morgan Stanley & Co. Research forecasts European earnings to increase by a healthy 7.5% in 2024 and 9.0% in 2025, marking an important break from the 2010s.

European earnings have largely languished in the 15 years following the Great Financial Crisis (GFC), due to ongoing headwinds from a sclerotic financials sector, the overhang of sovereign debt and limited fiscal stimulus. Looking ahead, however, MS & Co. Research expects the European earnings rebound to continue. Breadth of European earnings revisions has turned sharply higher. Improving business and consumer confidence and a turn toward more accommodative monetary policy could solidify the earnings growth recovery.

For its part, the Morgan Stanley Wealth Management Global Investment Committee (GIC) currently maintains roughly neutral exposure to European equities on an equity-only basis within its tactical portfolios. The positioning modestly favors Japan over Europe within international developed equities.

Eurozone Forward Earnings Have Broken From 2010s' Doldrums



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 19, 2024.

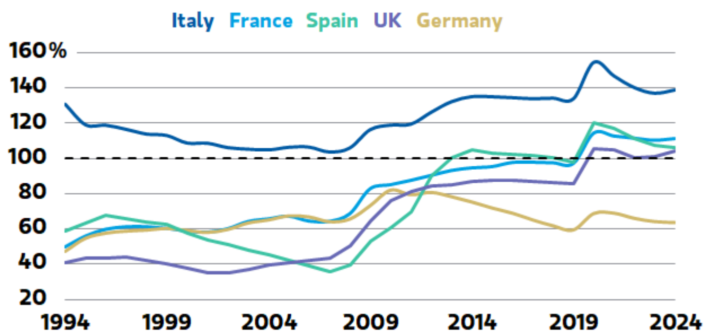
FIXED INCOME

S&P's Recent Downgrade Has Focused Attention on France's Debt Level

In an attempt to recharge economic activity following COVID, European nations deployed fiscal stimulus, which has contributed to higher inflation, rising interest rates and heavier debt loads.

In France, Spain and the UK, government debt-to-GDP ratios now exceed 100%. As in the US, higher deficits and debt levels could threaten to embed higher rates in sovereign debt markets amid unfavorable supply and demand dynamics. In turn, higher yields on government debt could flow through to corporations and consumers, resulting in higher borrowing costs for both. These realities have raised the stakes for fiscal policy, particularly where the costs of greater debt levels outweigh any benefits from sustained higher growth.

Government Debt-to-GDP Ratios Exceed 100% for Multiple Eurozone Members and the UK

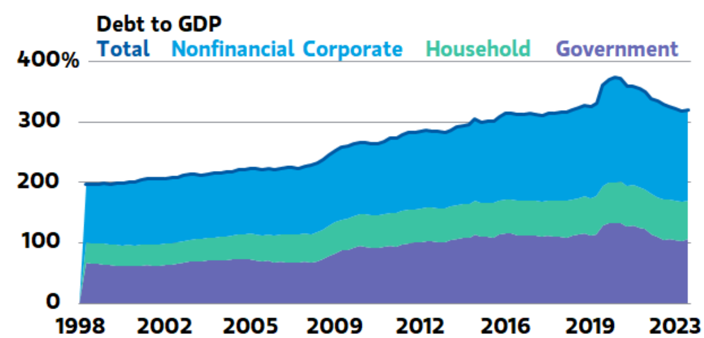


Source: IMF, Morgan Stanley WM Global Investment Office as of July 19, 2024

France's Nongovernment Debt Has Increased in the Post-GFC Period.

S&P Global Ratings recently downgraded France's sovereign credit rating, sharpening investor focus on overall creditworthiness. Sovereign debt in France sits at 110% of GDP, almost double the threshold authorized by the European Union (EU). In 2023, the country ran a fiscal deficit of 5.5% of GDP, well above the 3% EU deficit limit. Notably, as European nations responded to the economic fallout from COVID and the conflict in Ukraine, the European Commission had relaxed its limits. In addition, France's nongovernment debt had risen more quickly than that of any other eurozone country from 2018 to 2023. Growing nongovernment debt, especially for corporations, suggests vulnerability to persistent inflation, broad economic weakness and further geopolitical shocks. At the same time, Mediterranean neighbors Italy and Spain have been deleveraging.

France's Debt Level Pulled Back From Post-COVID Highs but Remains Elevated

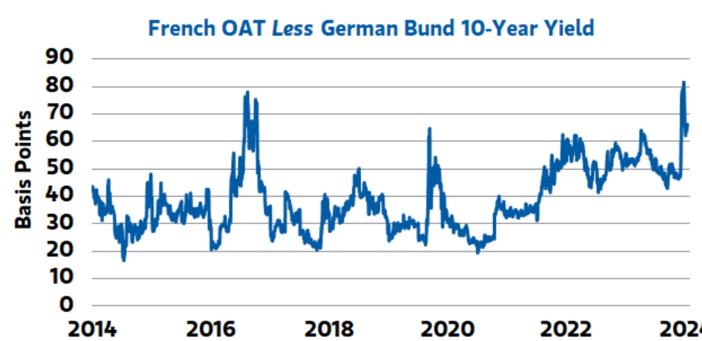


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 19, 2024.

France-Germany 10-Year Bond Yield Spreads Widened in the Lead-Up to French Elections but Have Since Pulled Back Partially.

The yield spread between France's 10-year government bond (OAT) and Germany's 10-year government bond widened to a 12-year high in June. This risk premium faced upward pressure from 1) political uncertainty stemming from the snap election and 2) broader concerns over France's growing debt. While receding bond volatility suggests that this spread could move lower in a mean-reverting fashion, without a move toward tighter fiscal policy, France's risk premium could remain elevated.

French-German Government Bond Yield Spread Recently Exceeded a Decade High



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 19, 2024.

Disclosure Section

Index Definitions

CAC 40 Index: This index represents a capitalization-weighted measure of the 40 most significant values among the 100 highest market caps traded on Euronext Paris.

Euro STOXX 50 Index: Provides a blue-chip representation of supersector leaders in the Eurozone.

MSCI Europe Index - The MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in Europe. The MSCI Europe Index consists of the following 16 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

Purchasing Managers Index (PMI): Tracks sentiment among purchasing managers at manufacturing, construction and/or services firms. An overall sentiment index is generally calculated from the results of queries on production, orders, inventories, employment, prices, etc.

S&P 500 Index is an index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is meant to reflect the risk/return characteristics of the large cap universe. Companies included in the index are selected by the S&P Index Committee, a team of analysts and economists at Standard & Poor's. The S&P 500 is a market value weighted index - each stock's weight is proportionate to its market value.

For other index, indicator and survey definitions referenced in this report please visit the following: https:/ www.morganstanley.com/wealthinvestmentsolutions/wmir-definitions

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Glossary

Correlation This is a statistical measure of how two securities move in relation to each other. This measure is often converted into what is known as correlation coefficient, which ranges between -1 and +1. Perfect positive correlation (a correlation coefficient of +1) implies that as one security moves, either up or down, the other security will move in lockstep, in the same direction. Alternatively, perfect negative correlation means that if one security moves in either direction the security that is perfectly negatively correlated will move in the opposite direction. If the correlation is 0, the movements of the securities are said to have no correlation; they are completely random. A correlation greater than 0.8 is generally described as strong, whereas a correlation less than 0.5 is generally described as weak.

Nominal Gross Domestic Product (GDP) is the GDP of the country measured at current market prices and not adjusted for inflation or deflation.

Mean reversion is the theory suggesting that prices and returns eventually move back toward the mean or average. This mean or average can be the historical average of the price or return, or another relevant average such as the growth in the economy or the average return of an industry.

Risk premium is the return in excess of the risk-free rate of return an investment is expected to yield.

Volatility This is a statistical measure of the dispersion of returns for a given security or market index. Volatility can either be measured by using the standard deviation or variance between returns from that same security or market index. Commonly, the higher the volatility, the riskier the security.

Risk Considerations

Investing in foreign markets entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks. **Investing in currency** involves additional special risks such as credit, interest rate fluctuations, derivative investment risk, and domestic and foreign inflation rates, which can be volatile and may be less liquid than other securities and more sensitive to the effect of varied economic conditions. In addition, international investing entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with **emerging markets and frontier markets**, since these countries may have relatively unstable governments and less established markets and economies. Yields are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment.

Investing in commodities entails significant risks. Commodity prices may be affected by a variety of factors at any time, including but not limited to, (i) changes in supply and demand relationships, (ii) governmental programs and policies, (iii) national and international political and economic events, war and terrorist events, (iv) changes in interest and exchange rates, (v) trading activities in commodities and related contracts, (vi) pestilence, technological change and weather, and (vii) the price volatility of a commodity. In addition, the commodities markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity, participation of speculators and government intervention.

Physical precious metals are non-regulated products. Precious metals are speculative investments, which may experience short-term and long-term price volatility. The value of precious metals investments may fluctuate and may appreciate or decline, depending on market conditions. If sold in a declining market, the price you receive may be less than your original investment. Unlike bonds and stocks, precious metals do not make interest or dividend payments. Therefore, precious metals may not be appropriate for investors who require current income. Precious metals are commodities that should be safely stored, which may impose additional costs on the investor. The Securities Investor Protection Corporation ("SIPC") provides certain protection for customers' cash and securities in the event of a brokerage firm's bankruptcy, other financial difficulties, or if customers' assets are missing. SIPC insurance does not apply to precious metals or other commodities.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

Environmental, Social and Governance ("ESG") investments in a portfolio may experience performance that is lower or higher than a portfolio not employing such practices. Portfolios with ESG restrictions and strategies as well as ESG investments may not be able to take advantage of the same opportunities or market trends as portfolios where ESG criteria is not applied. There are inconsistent ESG definitions and criteria within the industry, as well as multiple ESG ratings providers that provide ESG ratings of the same subject companies and/or securities that vary among the providers. Certain issuers of investments may have differing and inconsistent views concerning ESG criteria where the ESG claims made in offering documents or other literature may overstate ESG impact. ESG designations are as of the date of this material, and no assurance is provided that the underlying assets have maintained or will maintain and such designation or any stated ESG compliance. As a result, it is difficult to compare ESG investment products or to evaluate an ESG investment product in comparison to one that does not focus on ESG. Investors should also independently consider whether the ESG investment product meets their own ESG objectives or criteria. There is no assurance that an ESG investing strategy or techniques employed will be successful. Past performance is not a guarantee or a dependable measure of future results.

Because of their narrow focus, **sector investments** tend to be more volatile than investments that diversify across many sectors and companies. **Technology stocks** may be especially volatile.

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Growth investing does not guarantee a profit or eliminate risk. The stocks of these companies can have relatively high valuations. Because of these high valuations, an investment in a growth stock can be more risky than an investment in a company with more modest growth expectations.

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