
"Liquidity is Alive and Kicking": Morgan Stanley

By Michael Wilson Mon, Aug 5, 2013

"We suspect there will be occasional corrections in equities as they adjust to higher rates, but we would use those pullbacks to add to growth stocks in the US, as well as to European and Japanese equities," writes the chief investment officer of Morgan Stanley Wealth Management.

Sell-off? What sell-off? The global downdraft in risk markets that followed Federal Reserve Chairman Ben Bernanke's initial discussion of tapering asset purchases has receded into history. Interestingly enough, the correction ended on June 24, the day China's central bank provided a liquidity backstop to its markets. Ten days later, the European Central Bank (ECB) decided to start providing forward guidance on monetary policy. [Click [here](#) for Morgan Stanley's entire August wealth management report.]

Then, on July 10, Bernanke assured investors that the tapering process would be slow and dependent on continued improvement in the economic data. He also separated the decision to trim asset purchases from raising short-term interest rates, strongly suggesting such hikes are still years away.

All told, growth-related assets have rebounded sharply, with stocks, commodities and credit recouping 50% to 100% of their losses. Interest rates, which spiked in May and June following the first talk of tapering, recovered about 10%, as measured by the benchmark 10-year US Treasury bond. Furthermore, new leadership has emerged in US equities: Since May 1, when rates began to move higher, growth-oriented stocks, such as financials, industrials, consumer discretionary and health care, have performed best while dividend yield/defensive stocks, such as utilities, telecom services and consumer staples, faltered.

All of these moves are consistent with our view that the recent rise in rates is simply a mid-cycle correction rather than the end of the economic recovery. As the economy improves, rates are supposed to increase and stocks move higher on the expectation of better growth. We suspect there will be occasional corrections in equities as they adjust to higher rates, but we would use those pullbacks to add to growth stocks in the US, as well as to European and Japanese equities. Correlations also continue to fall, which is another sign the economy is healing.

One final note: Europe has been the best-performing equity market since the June 24 lows. This is likely due to the ECB's decision to give forward guidance on monetary policy while also implying that it will remain supportive for several more years—and likely longer than the Fed. This is very much in line with our thesis that easier monetary and fiscal policy in Europe should result in better growth. As a result, we believe European equities will continue to do better than the consensus thinks, which is why they remain a significant part of our asset allocation. Here we favor value over growth.