Morgan Stanley expects fiscal cliff to be hardly a speed bump

By Editor Test *Wed, Dec 19, 2012*

Central banks in developed countries are holding short-term rates down to induce investors to shift into riskier, higher-yielding assets, says Morgan Stanley's Global Investment Committee Monthly report for December. The bank says it doesn't intend to 'fight the Fed.'

Morgan Stanley Wealth Management's Global Investment Committee has issued its monthly markets, economics and asset allocation overview for December. The asset manager is overweighting emerging market and U.S. equities. According to the report:

Markets

- We expect Washington to mitigate and delay the looming fiscal cliff and make progress on a credible multiyear deficit-reduction plan.
- We remain **underweight** cash, inflation-linked securities and global real estate investment trusts, as well as short duration and developed-market sovereign and high yield debt.
- We are **overweight** equities, commodities and investment grade and emerging market bonds, as well as managed futures.
- We continue to **overweight** both emerging market and US equities. We are **market weight** in European equities and **underweight** in Japanese equities. Within the US, our capitalization preference is large caps and our style preference is growth.

Economies

We expect another year of positive but subpar global growth in 2013, even with Europe in recession and slower growth in the US and Japan. In aggregate, developed market (DM) economies should post 1% growth while emerging market (EM) economies advance by 5%, yielding global growth of 3%. DM inflation should remain quiescent, whereas EM inflation will remain close to 5%.

Profits

We expect consensus S&P 500 earnings-per-share (EPS) growth of 9% in 2013, up from 6% this year. Profit-margin expansion has likely peaked, but EPS should grow slightly faster than sales given still positive productivity growth and share buybacks. Profit growth will likely reaccelerate in 2014 on better global growth.

Interest rates

DM central-bank policy rates are likely to remain low into 2015. The Federal Reserve has embarked on an open-ended third round of Quantitative Ease. The European Central Bank has committed open-ended support to EU sovereign debt markets. Finally, several EM central banks are still easing to offset slower global growth.

Currencies

In the short term, we expect US-dollar strength versus the euro. Longer term, major developed market currencies will likely decline against several emerging market currencies.