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MSSB Makes Sharp U-Turn to Bear Market Call

By Matt Gunn October 11, 2011

Though it has maintained a bullish outlook on equities for more than two years, **Morgan Stanley Smith Barney** has flipped its stance, in a tactical asset allocation change announced late last week.

The risk of recession in the U.S. and abroad has influenced the wirehouse to adopt an overweight position in safe-haven investments, shifting assets away from riskier global equities and commodities.

This is Morgan Stanley Smith Barney's biggest shift in market outlook since 2009, says CIO **Jeff Applegate**, and it's a shift made largely based on public policy. The wirehouse is generally recommending shifts away from global equities, commodities and REITs and into cash, managed futures and global bonds.

"If you think about what the economy happens to be, whether here or in Europe, the key call is based on the policy response to the issues," Applegate says.

The changes come as Europe is tightening its economic policies, and the U.S. economy appears largely stalled. At the same time, Applegate says, German chancellor Angela Merkel and French president Nicolas Sarkozy are preparing proposals for the recapitalization of banks in Europe, while the Federal Reserve's toolbox for U.S. economic stimulation is nearly empty.

"If, in fact, we're headed over the months ahead into recession, we think there's going to be more downside for the equity market than upside," Applegate says.

Applegate says his team has fielded a lot of questions from advisors since Morgan Stanley Smith Barney made the call, as it's a distinct shift from the wirehouse's outlook over the past couple of years.

"This is one of the calls you hate to make because you wouldn't wish for another recession," he says. "The unemployment rate is already pretty high. Here in the U.S., millions of people are unemployed. It's not a cheery call to make, but it's nonetheless our best judgment at this point."

Despite the fact that the largest brokerage is moving away from equities, one experienced advisor says institutional investors are sticking with their existing risk profiles. **Benjamin Valore Caplan**, managing partner at Denver-based independent investment advisor **Syntrinsic Investment Counsel**, says he hasn't seen a rush to de-risk among his firm's foundation and endowment clients.

"We're certainly not getting calls from institutions wanting to reduce their equity exposure," Valore Caplan says. "We're not seeing a fundamental shift in thought process that's clearly [different] today than what we saw three months ago."

Valore Caplan adds that, while institutional clients haven't necessarily reduced their exposure to equities, there has been activity toward shifting or adjusting allocations within that asset class. One area where he says he could see Morgan Stanley Smith Barney's tactical allocation change having impact, however, is in the separately managed account (SMA) space.

"If I was a wirehouse SMA manager, I'd be worried in this quarter regardless of Morgan Stanley," Valore Caplan says.

He says SMA managers could be in a difficult spot in part because of the retail sector's tendency toward having a shorter leash for managers who underperform. "If you're down 15% to 20%, you're going to have people who doubt you, even if on a long-term basis you've done pretty well," Valore Caplan says.

Applegate says he hasn't yet heard any feedback on the tactical allocation shift from Morgan Stanley Smith Barney's asset manager partners. Just a year ago, the wirehouse was campaigning to help its advisors overcome the risk-averse mindset of clients who toughed out the 2008 financial crisis, as reported. Applegate emphasizes that it's difficult to predict the duration of any market trend..

"You never know," he says. "When we got bullish in April 2009, people said it was impossible to know how long we would have a good equity market. It's impossible to know."

Valore Caplan contends that if a wirehouse is making a call now, institutional investors and asset managers have likely taken steps to react to the market already. Valore Caplan and his team themselves had split off from **UBS Wealth Management Americas** in 2008 to form Syntrinsic.

"The wirehouses are not known for being ahead of the curve," he says. "They tend to be following. If they'd come out in the second week of July and said, 'We think equities are overvalued, we think commodities have gotten too big,' that's one thing. To come out after it's happened seems to me more like following the crowd as opposed to leading."