The stock market meltup is over: Morgan Stanley

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There's a strong case 'that January was the melt-up, or at least the culmination of it': Wilson

The stock market's glory days may be over as Morgan Stanley suggests that the January rally might have marked the end of the feeding frenzy.

The stock market meltup is over.

At least, that's the prognosis of one prominent Wall Street strategist who believes the torrid January rally that gave way to a correction may have been the market's short-term apex. The S&P 500 jumped 7.5% between the end of 2017 and Jan. 26, when it notched the last in a string of record closes at 2,872.87.

"We think January was the top for sentiment, if not prices, for the year. With volatility moving higher we think it will be difficult for institutional clients to gross up to or beyond the January peaks," said Michael Wilson, chief U.S. equity strategist at Morgan Stanley Institutional Securities, in his weekly note on Monday. "Retail sentiment indicators also look to have peaked in January and we do not see anything on the horizon to get retail investors more bullish than they were following a tax cut."

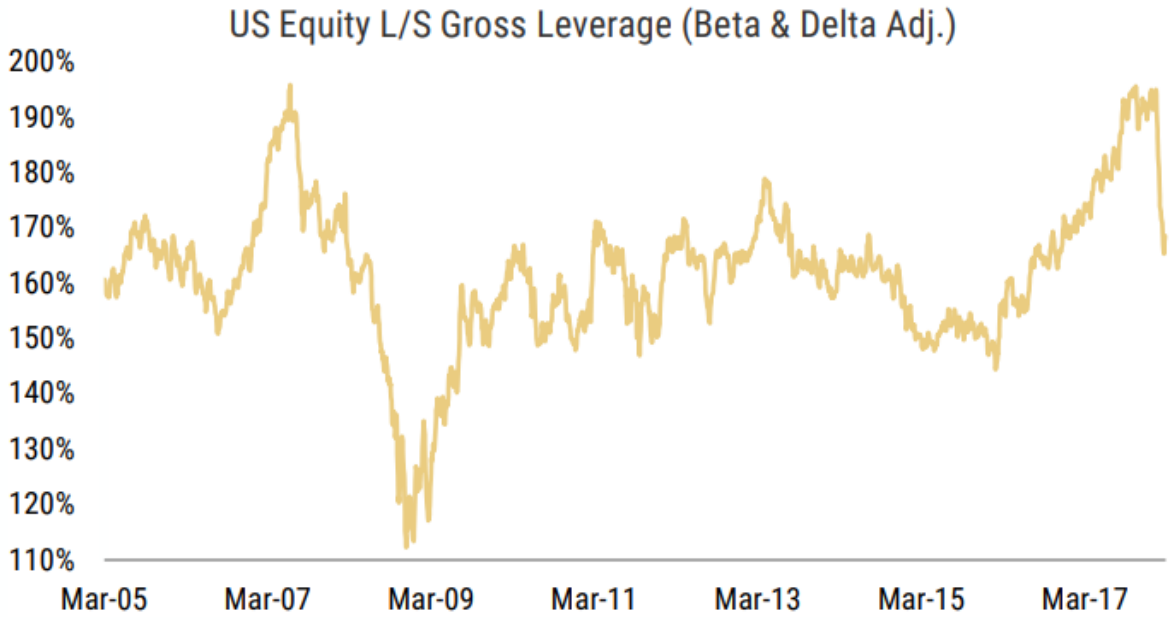
As a result, the much-anticipated meltup in stocks that numerous strategists had been forecasting since last year won't likely happen in 2018, he said.

A meltup is an unexpected rise in asset prices as investors surge into the market on fear of missing out.

"When we look at our internal data combined with industry flows and sentiment, we think there is a strong case that January was the melt-up, or at least the culmination of it," Wilson added.

One key point in Wilson's thesis is that gross leverage by Morgan Stanley's hedge fund clients hit an all-time high in January. Gross leverage, according to the strategist, is a good measure

Exhibit 9: Gross Leverage Reached All Time highs in January - A Top Two Years in the Making



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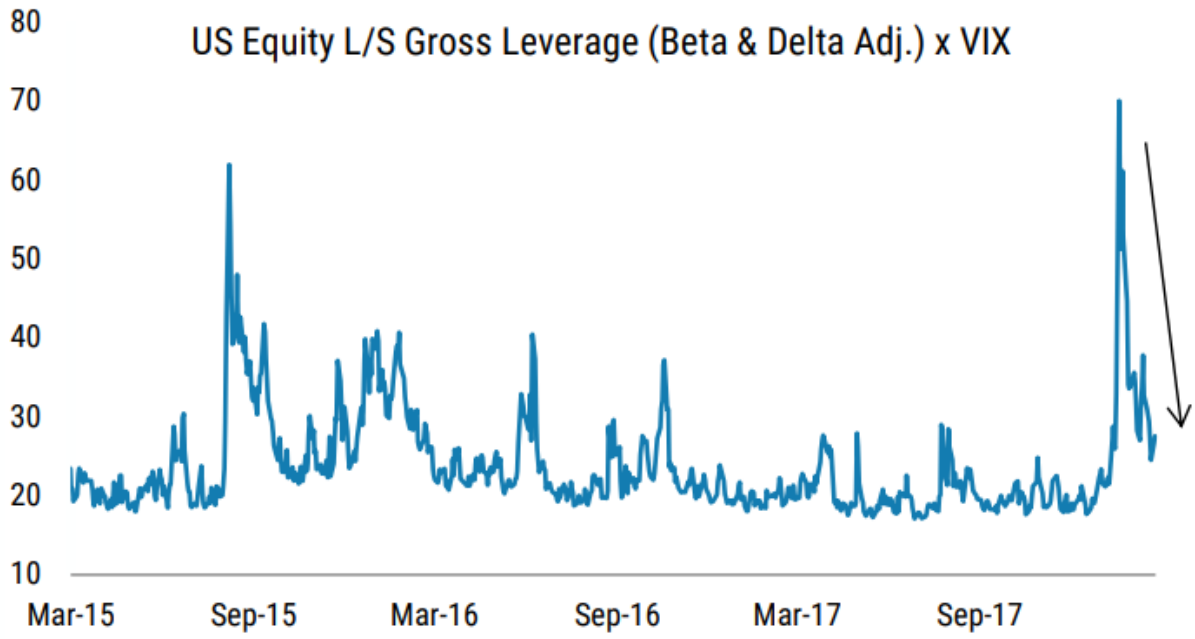
The record was also set right before the early February "volatility shock" forced investors to scale back their exposure to risk and Wilson does not expect gross leverage to return to January levels any time in the near future.

Exhibit 10: The Volatility Shock Forced Investors to Reduce Risk



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as the economy continues to expand at a steady clip.

Going forward, Wilson expects U.S. stock returns to be mostly driven by increase in earnings estimates.

"If we just roll forward the current bottom-up estimates, the forward earnings per share would be $166 and $170 by June 30 and September 30, respectively. That is approximately 3% and 5% higher than today's $161. Not exciting, but not very bad either," he said.

"However, those numbers might need to come down if we start to see some evidence of lower margins since consensus forecasts assume no operating margin degradation. That is another reason why we think the S&P 500 makes its highs for the year this summer. It's also a wild card that has big idiosyncratic risk at the stock level in our view."

Wilson has predicted the S&P 500 **SPX, +0.23%** to close out the year at 2,750. The large cap index closed at 2,712.92 Monday, falling in tandem with the Dow Jones Industrial **DJIA, +0.60%** and the Nasdaq **COMP, +0.30%** on the back of a selloff in technology shares sparked by a slump in Facebook Inc. **FB, -2.76%**

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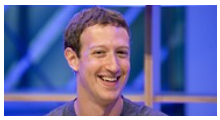

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