

Investmentfocus

January 2010

2010: Meaningful Mean Reversion

Executive Summary

Winston Churchill once said, “He has all the virtues I dislike and none of the vices I admire.” I’m not sure who he was talking about, but that is essentially the way I feel about the global capital markets heading into 2010. In the US, re-regulation is gaining momentum, taxes are rising and stimulus is the new consumption. The long-term story is clearly more compelling in the developing markets, but we believe that a lot of the good news is now reflected in the prices.

Given all the cross-currents in the market today, we thought it might make some sense to outline what we think looks interesting and what does not heading into 2010. Our major conclusions, which we examine in more detail inside this paper, are as follows:

- Regardless of whether you are bullish or bearish, growth and dividend growth equities represent the “Fat Pitches” of 2010.
- While emerging-market currencies still have the potential to outperform developed-market currencies, the yen—not the dollar—will again become the funding currency of choice in 2010.
- Emerging-market equities will likely take a pause, because valuation matters.
- High yield will likely perform better than investment grade.
- Style and capitalization bets will matter more than sector and country bets in 2010.
- An inflation barbell: Rising input costs (largely commodity driven) but falling output costs.
- A Haves-vs.-Have-Nots thesis will emerge in the sovereign debt market and currency markets. In the near-term, we believe that non-dollar related currency trades represent the best opportunity across all asset classes.

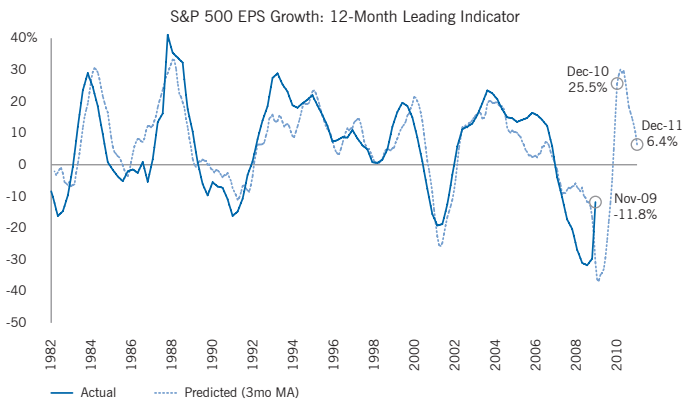
For the overall US equity market, we believe that our forecast for superior earnings growth (*Exhibit 1, next page*) will be largely offset by multiple contraction. In our view, 1994 and 2004 remain the best roadmaps to follow. One can see the comparisons we envision in *Exhibit 2 (next page)*. If we are correct in our comparison framework, we believe that a 10% positive return in 2010 would be a good outcome—but that is contingent upon the bond market remaining well behaved. We increasingly worry about that market, however, given our view that there is a greater risk of economic growth being too hot, not too cold, in 2010.

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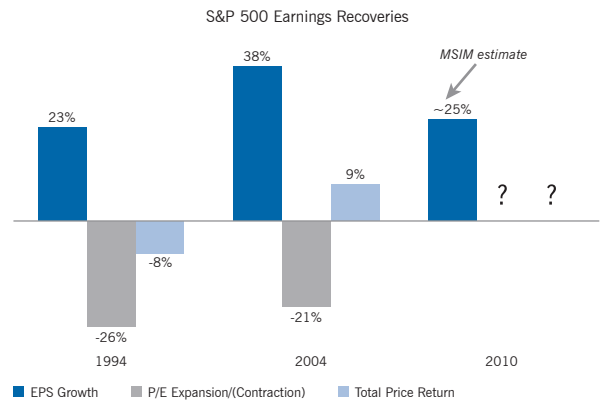
Exhibit 1: We expect strong EPS growth in 2010...



Data as of December 31, 2009. Past performance is no guarantee of future results. Forecasts/estimates are subject to change and may not necessarily come to pass.

Source: MSIM

Exhibit 2:But will performance follow?

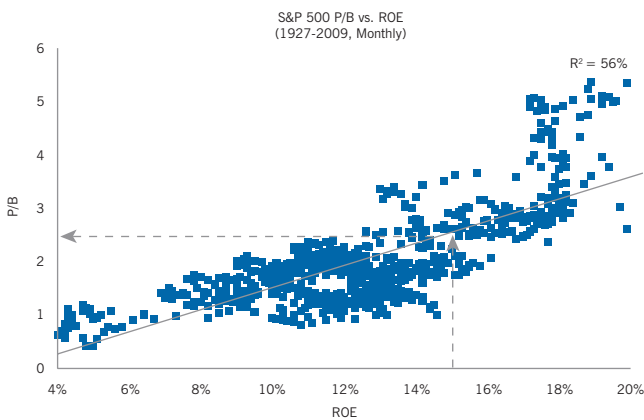


Data as of December 31, 2009. Past performance is no guarantee of future results. Forecasts/estimates are subject to change and may not necessarily come to pass.

Source: MSIM

Our “official” S&P 500 target for year-end 2010 is 1170, which assumes that the index could trade at 15.3x our 2010 EPS forecast of \$76.50. If we are correct in our forecasts, then US corporates will likely deliver a return on equity (ROE) of more than 15% this year. Our estimates are predicated upon a combination of our top-down macro models (*Exhibits 1 and 3*) and our bottom-up, company-by-company-analysis. Our target multiple of 15.3x is low versus historical norms (*Exhibit 4*), as we believe that a deflation scare could pose a risk to valuations in coming quarters. In addition, we think that there should be a higher risk premium associated with equities during periods of significant central bank liquidity withdrawals.

Exhibit 3: ROE vs. P/B regression points to S&P 500 price target of 1170 in 2010



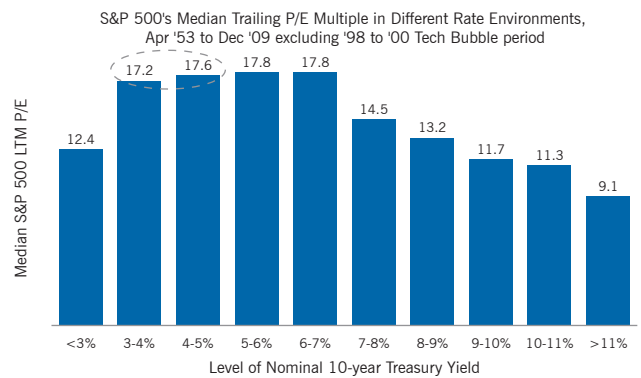
| | | | |
|--|------|-------|------|
| Price-to-Book | 2.0x | 2.34x | 2.6x |
| S&P 500 for BVPS ¹ of \$500 | 1000 | 1170 | 1300 |

¹Book value per share

Data as of September 30, 2009, excluding outlier periods around 1950 and 1980. Past performance is no guarantee of future results. Forecasts/estimates are subject to change and may not necessarily come to pass.

Source: Morgan Stanley, Thomson Financial, Compustat, S&P and Factset

Exhibit 4: Our 15.3x target P/E is conservative for a 3-5% 10-year Treasury yield environment



Data as of December 31, 2009.

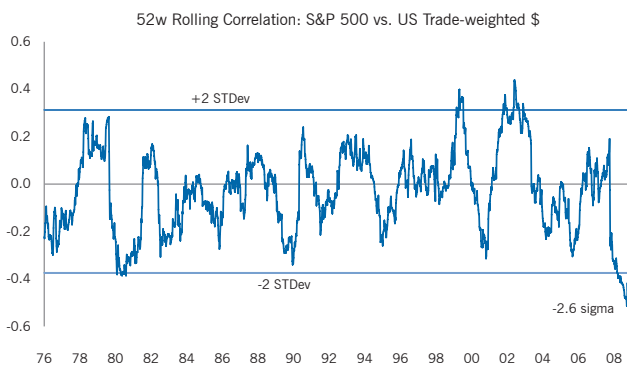
Source: S&P, Thomson Financial, Haver and MSIM

Importantly, we expect a wide trading range during 2010, with significant sector rotation and the potential for a 10-15% correction at some point, albeit from higher levels in the near-term (i.e., the trend is still your friend). Our bottom line is that we believe investors should expect a trading range of 1050 to 1225 on the S&P 500 in 2010.

Our bigger-picture conclusion is that the recent regime of a falling dollar, rising commodities prices, extraordinary emerging market outperformance and wide sector dispersion is now over. *This statement is significant, as these trades were all highly correlated and, as such, defined the massive rally off the bottom that started in March 2009.* Stabilization in the dollar is likely to be the key catalyst for the regime change that we are envisioning, but other potential drivers include re-regulation in developed markets, a turning point in global monetary conditions, and recognition that not all risk assets are created equal.

Ultimately, we believe that 2010 will be about mean reversion (*Exhibit 5*). Unlike 2009, the greatest opportunities in 2010 will not be the obvious secular, long-term opportunities such as rising consumption in emerging markets or further declines in the dollar. Many of those investments, in our view, are now crowded trades. *Rather, 2010 will be about taking advantage of cyclical, mean-reversion trades, many of which will be predicated upon identifying cheap valuations (both relative and absolute) and a turn in “less-bad fundamentals” in certain parts of the global capital markets* (*Exhibit 6*).

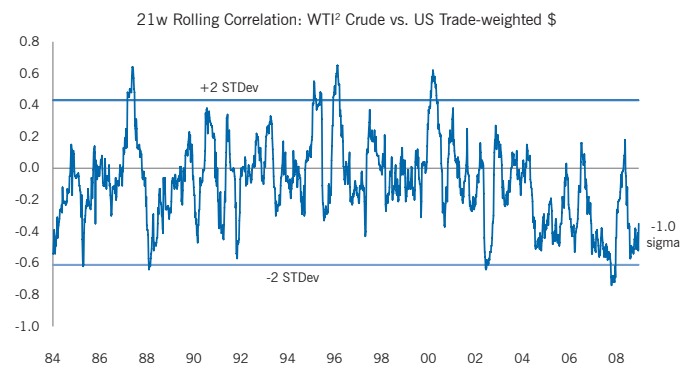
Exhibit 5: We see mean reversion as the theme in 2010...



Data as of November 30, 2009. US trade-weighted \$ based on Bloomberg DXY Index.

Source: Haver, FactSet, Morgan Stanley Sales and Trading

Exhibit 6: ...And it should occur across a variety of asset classes



²West Texas Intermediate

Data as of December 23, 2009. US trade-weighted \$ based on Bloomberg DXY Index.

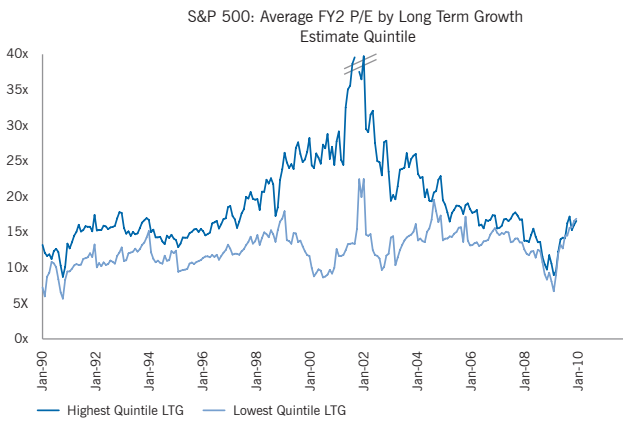
Source: Bloomberg and MSIM

Fat Pitches for 2010: Growth and dividend growth

In terms of growth stock investing, our thesis is unchanged. Moving beyond the March-to-November “junk” rally, investors are now getting the opportunity to buy growth stocks at no premium (*Exhibit 7*). We see this opportunity, which we detailed in our October note (*Changing of the Guard*), as one of the single best market opportunities, or Fat Pitches, across all asset classes in 2010. Importantly, to participate in this trade requires no strong view on overall market direction.

In addition to our growth thesis, we believe that there is a significant opportunity to buy dividend growth stories as well. In particular, we view 2-5% dividend yield stocks with 5-15% earnings growth as the “sweet spot” in the market. One can see this concept illustrated in *Exhibit 8*. This thesis is a “redo” of our *Brave New World* thesis, which we first originated in US Strategy at Morgan Stanley in May 2005. Our base view is that, with absolute rates at low levels, demographic forces will pull developed-market constituents towards equities with growth and yield. Importantly, we do *not* view high dividend yield in isolation as a compelling investment strategy. Rather, we believe that it is the marriage of earnings growth, rising dividends, reasonable valuation and strong fundamentals that generates long-term outperformance.

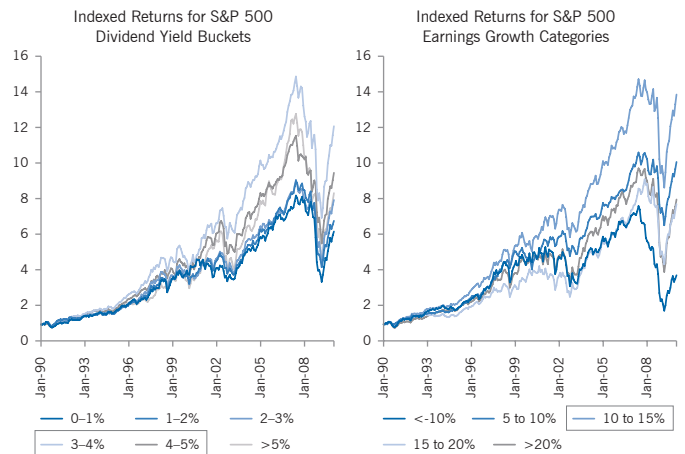
Exhibit 7: Investors are currently paying little premium for growth



Data as of December 31, 2009.

Source: S&P, Thomson Financial, Factset and MSIM

Exhibit 8: Stocks with moderate yield and growth characteristics represent the top performing buckets of the S&P 500 in recent years



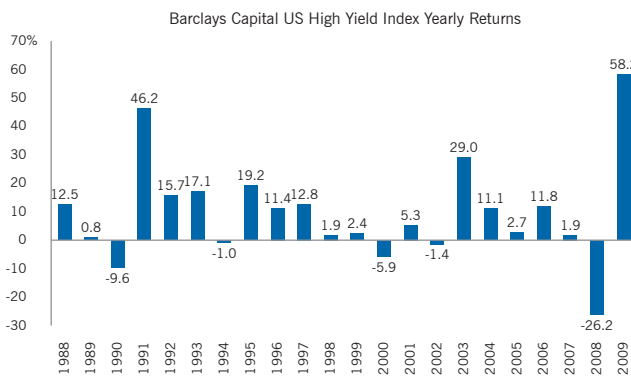
Data as of December 31, 2009. Earnings growth = FY2e/FY1e EPS. Bucket constituents rebalanced monthly. Past performance is no guarantee of future results.

Source: MSIM

High yield over investment grade

Contrary to what we are saying in equities, we are actually going further out on the risk curve in terms of credit. Morgan Stanley's Chief Credit Strategist, Greg Peters, sparked our interest in this call, and our analytics support a similar investment strategy. In particular, we favor junk bonds over high-quality investment-grade bonds (*Exhibit 9*). In the low-inflation environment we envision, we think that outsized yield will be something special in the bond market (*Exhibits 10 and 11*), particularly if government bond yields back up in response to stronger-than-expected economic growth the way we think that they will.

Exhibit 9: Recoveries in high yield generally have momentum...



Data as of December 31, 2009.

Source: MSIM and Barclays

Exhibit 10: ...High-yield spreads over Treasuries remain elevated

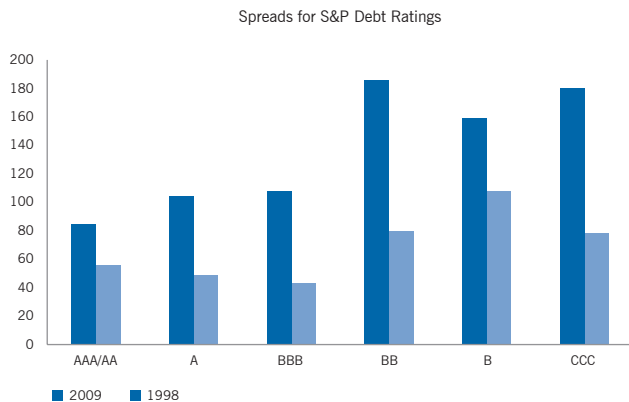


Data as of December 31, 2009.

Source: Merrill Lynch

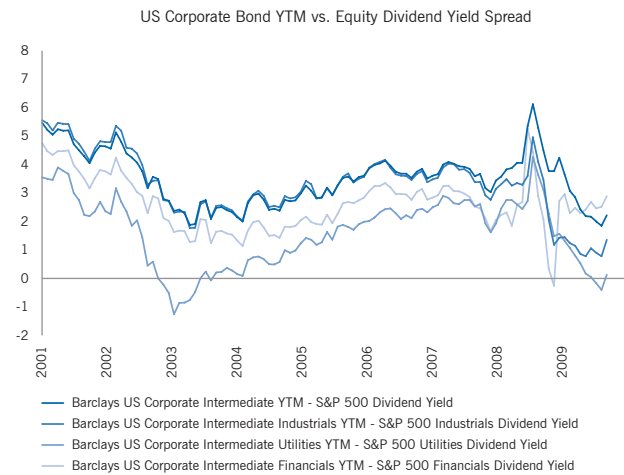
Unlike in high yield, in investment grade we are now finding too many examples where the yield on the bonds is not much more than the dividend yield on the equities. One can see some examples of this anomaly in *Exhibit 12 (next page)*. Bottom line, spreads can come in further on a relative basis, but from an absolute perspective, equities appear more compelling in many instances, particularly where any coupon loss can be offset by dividend income.

Exhibit 11: Tail risk remains attractive on a relative-value basis



Data as of December 31, 2009.
Source: Morgan Stanley Research, Yield Book and Bloomberg

Exhibit 12: Bond yields have narrowed considerably relative to equity dividend yields in recent months



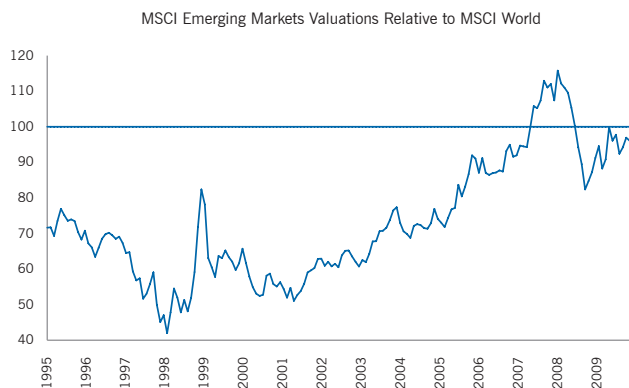
Data as of December 31, 2009.
Source: MSIM, Barclays and Factset

Emerging-market equities take a pause because valuation matters

I began traveling to China in 1995, and have had the good fortune of visiting many different emerging-market countries during my tenure on the sell-side and buy-side. What is clear to me—and, unfortunately, to most other folks at this point in the cycle—is that growth in developing markets will likely be superior to growth in developed markets during the next five to 10 years. That’s the good news.

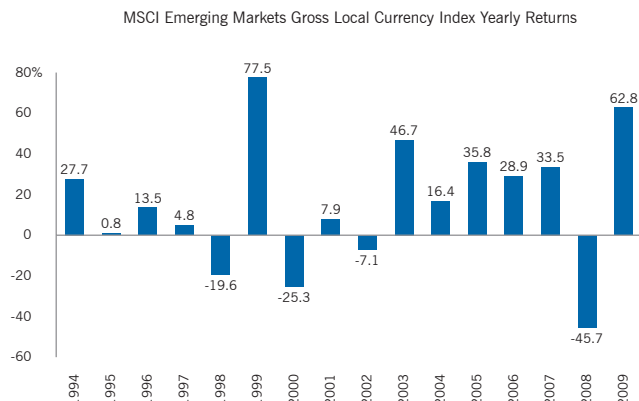
The bad news is that many of the prospects for excess relative growth may already be reflected in the prices. As one can see in *Exhibit 13*, emerging-market equities have been revalued upward substantially in recent years. Over time, we believe that the emerging markets (EM) could trade at parity or even at a multiple premium to developed markets (DM) in some instances. However, this re-rating will not happen overnight. *Exhibit 14* shows that years of strong EM performance are often followed by years of sub-par performance, as happened in 1994-1995, 1999-2000, and 2007-2008. We think EM valuations could be particularly at risk if EM inflation trends creep up in 2010 versus DM—a scenario that we think is likely to occur in the second half of the year. As a result, we believe investors with outsized overweight positions in EM equities should consider being more selective in 2010. In addition, given that we believe a cyclical bounce in the dollar could occur in 2010, it is worth mentioning that of the 51 percentage points of outperformance generated by the MSCI EM Index versus the S&P 500 in 2009, fully 16 points (i.e., 31% of the total) came courtesy of currency appreciation.³

Exhibit 13: Emerging markets are no longer trading at a significant valuation discount to developed markets



Data as of December 31, 2009. Data represents the emerging-market valuation composite relative to developed-market valuation composite in % terms (MSCI EM relative valuations to MSCI World). The composite is an average of DM trailing PE and P/BV relative to EM market trailing PE and P/BV.
Source: Factset

Exhibit 14: Momentum in EM equities after a year of outstanding returns is not strong



Data as of December 31, 2009.
Source: Factset

³Source: Bloomberg

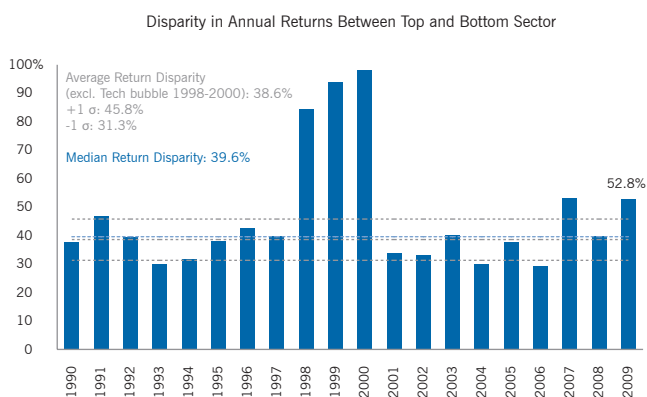
Capitalization and style will be more important than sector and country bets

One of the key trades in 2009 was to differentiate a portfolio via sector selection. As of December 31, 2009, the technology sector had appreciated 61.7% (including dividends), while the telecom sector was up a modest 8.9% (including dividends).⁴ The spread between the two was 52.8%, the second-largest since 1990 excluding the tech bubble years of 1998-2000 (*Exhibit 15*). A similar story played out on the country front as certain developed and developing countries massively outperformed the laggards in their peer groups.

Looking ahead, we still expect sector differentiation, but we think that it could be much more muted than last year. Why? Because we expect much more rolling sector rotation in 2010 as investors wrestle with the benefits of a stronger economy, largely offset by a stronger dollar and potential multiple contractions in many cyclical industries. In addition, we believe that dollar stabilization will limit some of the massive differentiation we saw between domestic and international-facing US firms in 2010. In terms of country weightings, our quantitative work is showing that trading multiples are now much less differentiated, and as such, represent much less of an opportunity than in 2009.

By comparison, we believe that there is a growing opportunity to differentiate by market capitalization and style. Specifically, we are bullish on large-cap growth at the expense of small-cap value (*Exhibit 16*). Implicit in our bet is that financials, which constitute large percentages of the small-cap value index, should underperform this year.

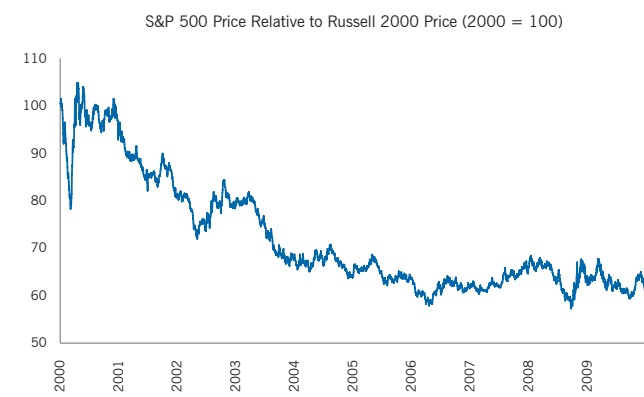
Exhibit 15: Wide disparity between top and bottom sector performers expected to mean revert in 2010



Data as of December 31, 2009. Data represents the spread between the top- and bottom-performing sectors annually between 1990 and 2009. Past performance is no guarantee of future results. Forecasts/estimates are subject to change and may not necessarily come to pass.

Source: DRI and MSIM

Exhibit 16: Large-cap equities to break downward trend against small-cap equities?



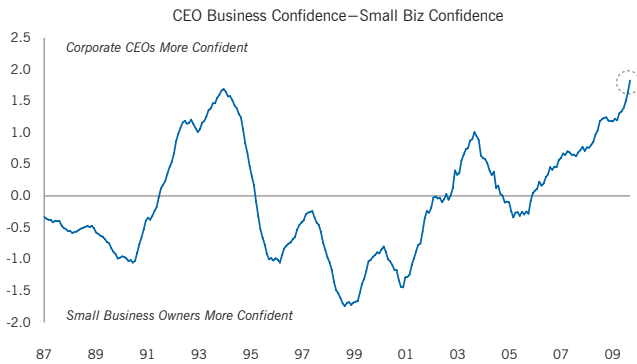
Data as of December 31, 2009. Data represents relative price performance since 2000 indexed to 100.

Source: Factset

Our bigger-picture conclusion is that large-cap companies will exert pricing pressure in the coming months. Please see our November 2009 note, *Inflation Outlook: On the Razor's Edge*, for further details, but we call this trade “The Revenge of the Establishment.” That is, we see large-cap companies acting as price makers in the global economy, mostly at the expense of smaller enterprises. Recent trends seem to support our position, as *Exhibits 17* and *18* both show challenging headwinds for small businesses.

⁴Source: Factset

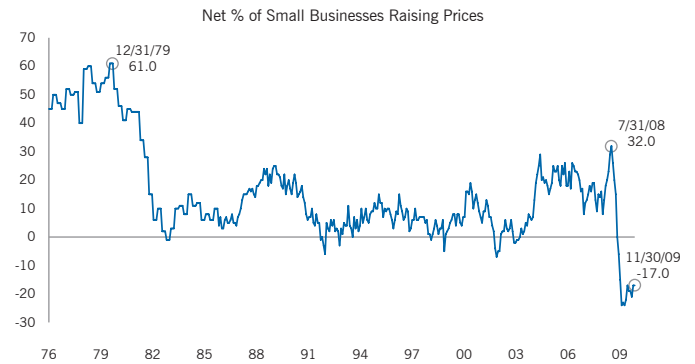
Exhibit 17: The spread between corporate and small-business confidence is the widest we have seen



Data as of 3Q09. Index compares the z-score of the Conference Board CEO Confidence Index minus the z-score of the NFIB Small Business Optimism Index, both versus their 10-year trailing averages.

Source: NFIB, Conference Board, Haver and MSIM

Exhibit 18: Small-business pricing power remains poor



Data as of November 30, 2009.

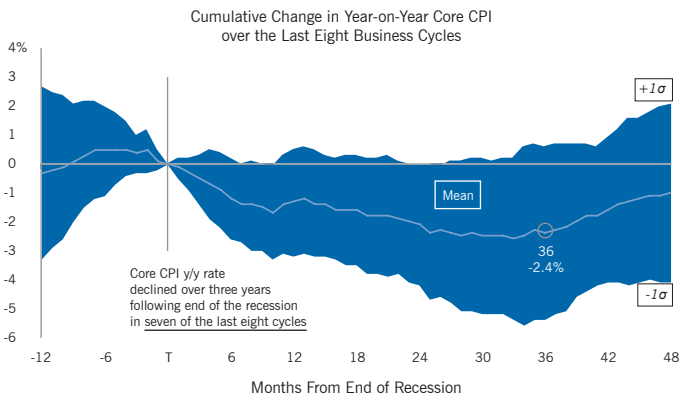
Source: NFIB and Haver

Inflation barbell

While we are on record as residing in the low-inflation camp in 2010 (see our note, *Razor's Edge*, as well as *Exhibit 19*), we do want to add a wrinkle to our existing thesis. Specifically, we expect low finished-goods prices, but we *do* expect rising input costs, namely in the form of higher oil and raw material prices. We see oil prices benefitting from stronger-than-expected demand in the global economy, as well as its “new” role as a “storer of value” within large pensions and endowments.

As a result, we believe that we could endure both inflation and deflation trends at the same time. A key variable on which to focus is the spread between CPI (output pricing) and PPI (input costs), and its relationship with profitability. When input cost inflation outpaces pricing power to the consumer, corporate margins tend to suffer. One can see the downward trajectory that our historical framework is suggesting in *Exhibit 20*. Thus, if history repeats itself or even rhymes, then the ability to sustain margins via pricing power (and hence, the support for our aforementioned “Revenge of the Establishment” thesis) could become the critical differentiation variable across regions, countries and sectors at some point in 2010.

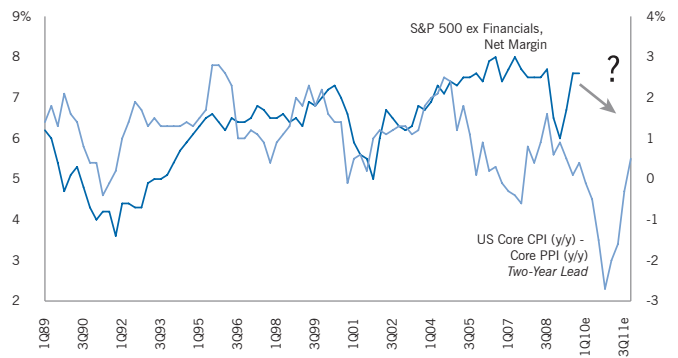
Exhibit 19: US core CPI inflation typically collapses following the end of US recessions



Based on US recessions ended 5/1958, 3/1961, 12/1970, 4/1975, 8/1980, 12/1982, 4/1991 and 12/2001.

Source: NBER, Bureau of Labor Statistics, Goldman Sachs Research and MSIM

Exhibit 20: Weak pricing power is a headwind to corporate profit margins



Data as of November 30, 2009. Past performance is no guarantee of future results. Forecasts/estimates are subject to change and may not necessarily come to pass.

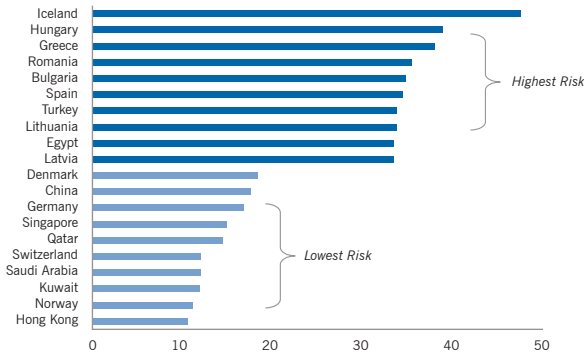
Source: Thomson Financial, Compustat, S&P, Bureau of Labor Statistics, Bloomberg, Factset and MSIM

Haves vs. Have-Nots in sovereign debt and currency

Unlike 2009, 2010 should expose those countries that have not been budget-disciplined in recent years. Already, we have seen imbalances manifest themselves in Dubai, Greece and Vietnam. The catalyst for the bifurcation we envision will be driven primarily by two factors, in our view: 1) a slowdown in the rate of change of global growth; and 2) the removal of the vast liquidity pool by “higher-quality” central banks at the same time that weaker central banks are unable to pay down their debts and normalize their short-term interest rates.

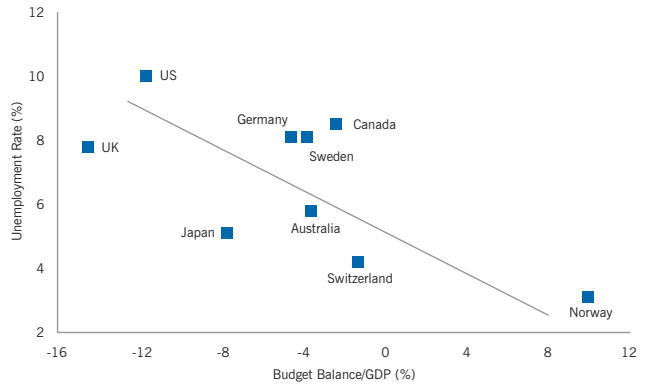
As shown in *Exhibits 21* and *22*, countries that have managed to maintain their fiscal soundness and refrain from massive borrowing should maintain their leading edges as the global recovery unfolds. To the contrary, countries that were not fiscally responsible and took bigger hits during the recession will likely continue to face headwinds as differentiation begins to matter more.

Exhibit 21: Country vulnerability scorecard



Inputs to country scores include current account balance, fiscal balance, government debt, private sector credit, and net external assets (all as a % of GDP). Credit default swap spreads and credit ratings are also inputs.
Source: Credit Suisse Equity Research November 27, 2009

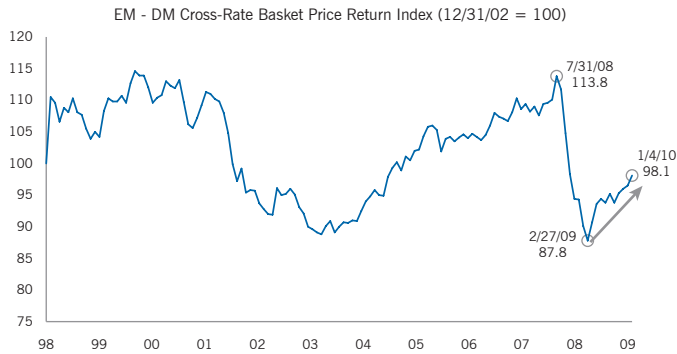
Exhibit 22: Haves and Have-Nots on the deficit front



Data as of December 31, 2009.
Source: MSIM, Datastream and Economist

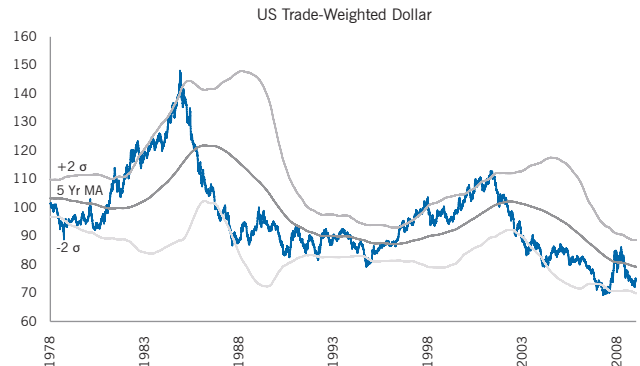
We envision a similar outcome in the currency markets. In particular, we still see more upside in the valuation of emerging-markets currencies versus developed currencies. In fact, a basket of EM currencies relative to DM currencies has one of the best potential risk/reward profiles that we see in 2010 (*Exhibit 23*). We also like many of the “growthier” developed market currencies versus many of the traditional G-7 currencies.

Exhibit 23: A basket of EM currencies remains well below its 2008 peak vs. DM currencies



Data as of January 4, 2010. Long and short baskets are equal-weighted and rebalanced monthly. Long EM currencies: KRW, INR, MXN, BRL, RUB, PLN. Short DM currencies: USD (2x), EUR, JPY, GBP, NZD.
Source: MSIM

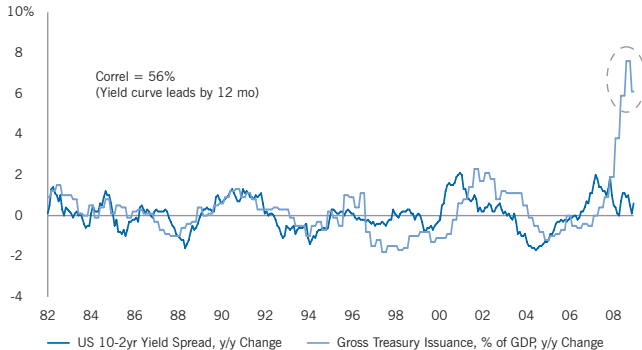
Exhibit 24: The trade-weighted dollar sits near the lower end of the fair-value range



Data as of December 31, 2009. US trade-weighted \$ represented by the Bloomberg DXY Index. The chart illustrates the five-year moving average of the DXY Index, the five-year moving average plus one standard deviation, and the five-year moving average minus one standard deviation.
Source: MSIM and Bloomberg

One outlier in the developed currency market, however, could be the dollar staging a cyclical rebound in 2010 (*Exhibit 24, previous page*). We think the likelihood of a surprise bounce is high, and recommend that investors hedge against this outcome by considering long positions in the US dollar at the expense of the yen. The catalysts for the shift we envision will be: 1) a stronger US economy; and 2) US bond yields climbing relative to Japan's yields at both the long end (*Exhibit 25*) and short end (*Exhibit 26*) of the yield curve.

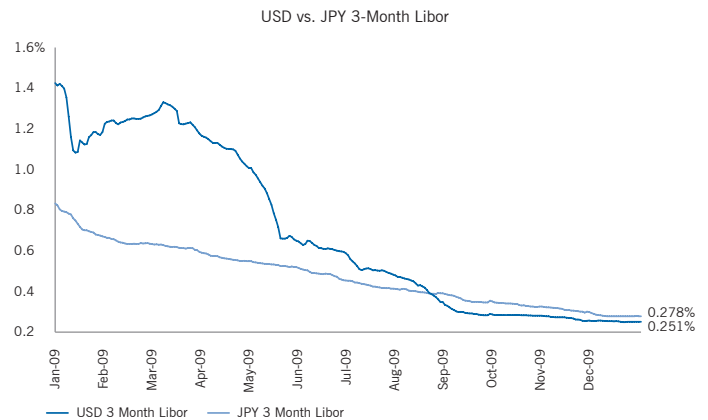
Exhibit 25: The Treasury calendar represents a risk to the long end of US yield curve



Data as of November 30, 2009. The blue line represents the year-over-year change in the spread between the 10-year and two-year Treasury yields.

Source: Bureau of Public Debt, Bloomberg, and MSIM

Exhibit 26: We believe that USD LIBOR will rise back above JPY LIBOR in 2010



Data as of December 31, 2009.

Source: MSIM and Bloomberg

If we are correct that the dollar does not “fall out of bed” again in 2010 and actually remains somewhat well bid, then we think that a significant regime change—including a breakdown in correlations across asset classes—could finally occur. In particular, we believe that the correlations between the dollar and 2009’s Four Horsemen—EM, commodities, sector dispersion and P/E expansion—could crumble. In our opinion, any such reversal would catch more than a few folks off guard, particularly if a few cyclical mean-reversion trades overpower the “obvious” secular trades that now feel crowded to us.

Disclosures

The views expressed are those of the author as of January 11, 2010. The author’s views are subject to change at any time due to market or economic conditions without notice to the recipients of this document. The views expressed does not reflect the opinions of all portfolio managers at MSIM, or the views of the firm as a whole, and may not be reflected in the strategies and products that the Firm offers.

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All investments involve risks, including the possible loss of principal. Please be aware that certain asset classes and investments are more volatile than others, such as: Commodities are more volatile than stocks. Commodities and company stocks are more volatile than bonds, and Government bonds and Treasury Bills are guaranteed as to the timely payment of principal and interest, if held to maturity. Stocks of small-sized companies carry special risks and greater market volatility than securities of larger, more-established companies. Foreign stocks are more volatile than domestic stocks. Emerging Markets country investments entail greater risks than those generally associated with foreign investments. Investments in securities rated below investment grade (commonly known as “junk bonds”) present greater risk of loss to principal and interest than investment in higher-quality securities.

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Morgan Stanley Investment Management Publications

Following are recent thought-leadership papers covering a range of investment issues

Institutional CIO Confidence Index

January 2010—Morgan Stanley Investment Management is proud to introduce its Institutional CIO Confidence Index. Developed through a partnership with Greenwich Associates, the Index measures how confident chief investment officers are in meeting return targets for their portfolios over the next 12 months. As a result, we believe that the Index provides an accurate gauge of the post-crisis sentiment among CIOs at US public funds, corporations, endowments and foundations.

Managing Risk: Back to Basics

December 2009—In the wake of the crisis in global capital markets, investors are understandably focused on the issue of risk and the proper management of it. But how exactly should risk be defined and approached? MSIM's Henry McVey argues that an effective risk management process should center around a top-down framework for assessing strategic risk in a portfolio.

Scenario Analysis of Illiquidity Surges

December 2009—For investors holding illiquid assets, 2009's equity market rally poses an interesting dilemma: How do investors manage high growth in illiquid allocations that occur as a result of strong stock market returns? In this paper, we address this and other key questions on portfolio liquidity, and potential illiquidity surges, in periods of stable and extreme equity market returns.

Inflation Outlook: On the Razor's Edge

November 2009—As many investors worldwide fret about potentially rising inflation, MSIM's Henry H. McVey posits that market fears might be misplaced, arguing instead that uncomfortably low inflation is a much bigger risk to global markets in 2010.

Charting the Comeback Trail in Japan via Small-Cap Equities

November 2009—As world economies stay on the path to recovery, Japan remains either forgotten or avoided by most investors. Is this strategy correct? Or are investors risking being underexposed to a potentially significant period of outperformance for Japanese stocks? If so, what presents the most attractive opportunity: large or small caps? In this paper, we tackle these questions, and examine Japanese stocks in general and small caps in particular.

Recovery Myths

October 2009—As the US economy continues to show signs of improvement, many investors have begun to wonder about the sustainability and strength of the recovery. In this research report, Richard Berner tackles this issue, and identifies what he believes are three myths currently fueling this economic debate.

A Changing of the Guard

October 2009—The global equity market recovery has so far been defined by a strong rally in high-beta stocks. But history suggests that these “junk rallies” have typically lasted, on average, about six months from the markets' trough. In this paper, Henry H. McVey argues that we are now on the cusp of a major shift in global equity market leadership.

Investing in a Horizontal World

October 2009—Correlations among world economies and asset classes have increased dramatically as of late. But is this situation sustainable in the long run? In this article, Ruchir Sharma argues that the case for differentiation based on local factors is strong and getting stronger.

The New Landscape for Fixed Income: From Treasuries to TALF

October 2009—As the global credit crisis shows signs of easing, institutional investors confront a crucial issue: How to exploit the new investment landscape to generate the higher potential returns of equities, while striving to maintain the lower volatility often associated with fixed income? In this white paper, we address this question, and propose a framework through which investors can set up opportunistic fixed-income portfolios.

Financials: Less Bang for Your Beta

September 2009—The Great Recession has undoubtedly taken a heavy toll on financials. But now that the downturn has begun to show signs of abating, how can investors best explore potential opportunities within the sector? In this paper, Henry McVey tackles this key issue, and shares his outlook for financials.

Convertible Bonds: Back in the Spotlight

August 2009—While optimism appears to have returned to global capital markets, uncertainty surrounding the timing of the economic recovery has led some investors to remain sidelined until a sustainable recovery process becomes more clearly defined. But how do you determine optimal market entry points? In this paper, we investigate convertible bonds as a potential solution to the current market-timing dilemma.

US Corporate Profitability—Support on the Margin

August 2009—Although US corporate earnings have dropped steeply since the start of the Great Recession, net margins for non-financial firms have been surprisingly resilient compared to previous downturns. What does that mean to equity trading levels? Does this represent a tactical opportunity? Henry McVey provides answers in this article.

Challenges to Rebalancing the US Economy

July 2009—The global financial crisis has exposed the vulnerability of unbalanced US and global growth. The ensuing recession, however, is now helping to rebalance the US economy. The question now is: Will this rebalancing process be benign for economies and markets, or will it be disruptive? In this paper, we tackle this difficult question by examining the challenges ahead for the US economy.

The “Renaissance” of Global Macro Investing

July 2009—In his inaugural article since returning to Morgan Stanley, Henry McVey, MSIM’s Head of Global Macro and Asset Allocation, highlights his current views on the direction of financial markets, and argues that a key upshot of the Great Recession will be an augmented role for the traditional top-down, macro-investing approach.

Operational Improvement: The Key to Value Creation in Private Equity

July 2009—The global financial crisis is reshaping the private equity landscape. While lingering tight credit has increased competition for new deals, opportunities for “home runs” to offset underperforming investments are now limited. As a result, private equity firms have become even more dependent on their ability to improve operational performance in every deal to generate attractive returns. But what is the best way to enhance operations and unlock value from portfolio companies?

In this paper, we examine the many approaches firms can take in deploying operational expertise.

Surplus Targets and Percentile Fans

June 2009—While an investment fund’s level of surplus (or deficit) should not, by itself, determine its investment strategy, any informed portfolio decision should take that number into consideration. But even so, questions remain: How can fund managers determine, for example, that the level of equity beta exposure of their portfolios is adequate to their future needs? In this paper, we address this and other issues, providing a framework for understanding beta exposures.

How the Tight Credit Market Is Augmenting the Investment Opportunity for Private Debt Capital

May 2009—The dislocation in the credit markets has set the stage for a widening gap between the supply of, and demand for, capital.

What solution could potentially fill this gap? This paper suggests that a combination of traditional and non-traditional sources of debt capital should emerge in response to this imbalance. Specifically, we believe that private credit capital targeting middle-market issuers is likely to be an important focus for investors.

Return Targets and Percentile Fans

May 2009—A portfolio’s beta exposure has traditionally been a key factor influencing the prospects for reaching return targets. But how much beta does one need to increase one’s chances of exceeding the risk-free rate over a one-year period? Conversely, how much beta risk is necessary to satisfy target returns in the long run? In this paper, we address these issues, and provide a compelling framework for understanding beta exposures.

Looking Beyond the Valley: Identifying Cross Asset-Class Opportunities

May 2009—The global economic crisis has taken a heavy toll on asset prices across the investment spectrum, including equities, credit and commodities, creating a number of distressed investment opportunities. Yet, many investors are still wondering how to best assess these opportunities, and how to rebalance their portfolios for optimal potential returns. This paper addresses these questions, and lays out a comprehensive roadmap for investors to gauge the current opportunities and place them in the proper historical context.

Accessing Investment Opportunities in a Real Estate Recession

May 2009—We believe that the most severe economic crisis since World War II is creating the most compelling commercial real estate opportunities in a generation. In this paper, we examine the causes of the ongoing market correction, quantify the impact of the crisis to date, and compare the current real estate recession to past market downturns. Due to the unique combination of events that precipitated the current slowdown, investors could have the chance to purchase the debt and/or equity of real estate at what we view as historically attractive terms.

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