

Investmentfocus

December 2009

Managing Risk: Back to Basics

Executive Summary

Given the crisis that we saw in 2008 in the global capital markets, it seems like every client meeting I attend these days starts and ends with a discussion surrounding risk and the proper management of it. But what defines risk? Prior to the crisis, few folks had any idea that their money market funds could be their riskiest investments last year, or that their securities-lending books could be major risks. Some will argue that 2008 was a “100-year-flood” event in the global capital markets. Maybe, but it sure feels like these “floods” are happening more and more frequently these days. How else can one explain the fortunes journalists and academics have made off of books like *When Genius Failed* (Long Term Capital Management), *Irrational Exuberance* (Technology-Media-Telecom Bubble), and *Too Big to Fail* (Credit Crunch) in the last decade?

So, what is risk after all?

There are 17 definitions of “finance” risks in the business dictionary, but I thought the general definition of risk works best: “Probability or threat of a damage, injury, liability, loss, or other negative occurrence, caused by external or internal vulnerabilities, and which may be neutralized through pre-meditated action.”¹ We certainly do not have all the answers on neutralizing risk, but we do think that central to any risk management process is having a top-down framework for assessing strategic risk in a portfolio, not just monitoring daily market gyrations that often miss the importance of bigger underlying trends. Some of our key beliefs on risks are as follows:

- **Understand the risk regime you are in.** Most long-term detrimental decisions surrounding risk usually start with poor timing on implementation, particularly buying when valuations are unjustifiably rich, or when fundamentals are unsustainably strong. Within equities, it is recommended that one monitors a large dashboard of valuation metrics, but the easiest way to measure long-term upside/downside risks for strategic equity allocations might be simply to look at trailing price-to-earnings. Our research shows that buying US stocks when market P/Es are 16x or higher trailing earnings typically ensures long-term underperformance in equities. Another important rule of thumb is to avoid heavy allocations to equities when earnings are high relative to historical trends. A similar framework for risk management holds true for emerging market equities as well. Details on our framework are inside.

(continued on next page)



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¹BusinessDictionary.com

Executive Summary (cont'd)

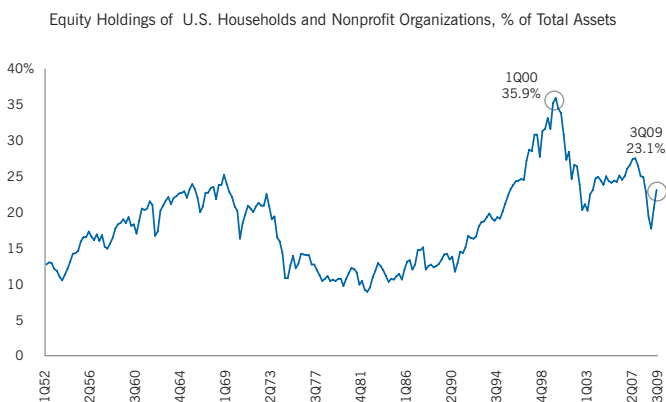
- **Stress-test your portfolio's diversification.** Test your portfolio for how it acts in a normal environment and, more importantly, in a stress environment. Too often portfolio managers focused on macro asset allocation appear too centered on getting to the “right” asset allocation, and not on what the changes mean for the volatility and risks associated with the new portfolio in various regimes. Also, we are increasingly spending time tracking the loss of diversification from non-traditional asset classes as they become more mainstream in the asset-allocation/macro overlay process.
- **Remember your priorities.** Our view is that endowments, pensions—and, as a result, the investment managers that serve them—should seek to achieve the following goals, in order of priority: 1) satisfy the beneficiaries’ near-term funding requirements; 2) meet or exceed the funds’ targeted discount rates via a diversified portfolio of assets; and 3) rank highly within comparable peer groups. Too often, however, it feels like portfolios are structured first to satisfy goal number 3, often at the expense of numbers 1 and 2. As a result of this inconsistency, we think that there is too little focus on liquidity risk management in the overall asset-allocation process.
- **Fat Tail flows.** Outsized returns and excessive net inflows are usually important warning signs that a certain asset class or investment style is on the cusp of a major shift in risk-reward. As such, we constantly watch for Fat Tails, or multi-standard deviation events that appear poised to mean-revert. While certainly not a scientific process, we spend a substantial amount of time tracking flows across the financial services industry in an attempt to identify Fat Tails. See inside for details, but several areas, including the yield curve relative to Treasury issuance, US taxable fixed income, and certain pieces of emerging markets sovereign debt, are fast approaching our “Fat Tails” radar screen.

As we discuss in greater depth in the remainder of this article, our top-down approach to risk is centered on some back-to-basics, common-sense principles. It is not that covariance, volatility, value-at risk and beta-adjustments no longer matter, or that we do not include them in our framework, but it is often over-confidence in these technical metrics and—more importantly—lack of attention to a simple blocking-and-tackling approach for risk management that lead to big downside shocks in portfolio management over an investment cycle.

Understanding the regime you are in

After nearly a decade of sub-par equity returns, many investors are now questioning whether, as Jeremy Siegel famously pronounced, “Stocks [Are] For the Long Run” in his book (1994). While it is true that stocks are great long-term inflation hedges, many readers of his book apparently failed to comprehend—and with serious ramifications—that the inflation hedging capability of stocks is easily undermined when the initial purchase price is too high. Sadly, equity allocations at US endowments and individual households hit a record high in 2000, which was ironically the blow-off peak of the 18-year bull market that had started in 1982 (*Exhibits 1 and 2*). At that time, the S&P 500 was trading at 29.4x trailing earnings, and it had just recorded the best back-to-back 20-year performance on record.

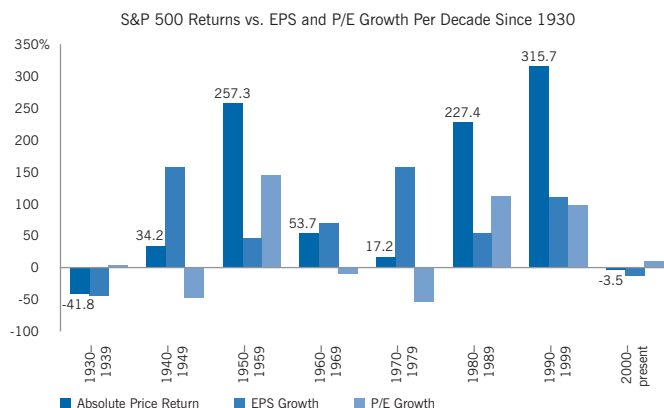
Exhibit 1: Equity allocations peaked in 1999-2000



Note: Includes direct equity holdings and indirect holdings via pension funds, mutual funds, and life insurance. Data as of 12/10/09.

Source: Federal Reserve and MSIM

Exhibit 2: The time to get long stocks is typically when P/E levels are expanding



Data through November 2009

Source: Factset, Ned Davis Research and MSIM

Given the debacle we have had in equities of late, we think investors who want to better monitor risks associated with their equity allocations may want to consider spending more time focusing on two variables: trailing price-to-earnings ratio and earnings relative to trend. As *Exhibit 3* shows, there is a huge benefit to being stingy on valuation. Specifically, on a five-year return basis, buying stocks when the trailing P/E was below 16x trailing earnings has yielded superior real returns over the long haul. Besides the staggering outperformance, there is no real substantial uptick in volatility (*Exhibit 4*).

Exhibit 3: Long-term subsequent real returns highly impacted by P/E ratio at entry point...

S&P 500 P/E Ratio at Entry and Subsequent Long-Term Average Real Returns

S&P P/E at Entry	Subsequent Average Real Return				
	1 Year	2 Year	3 Year	5 Year	10 Year
PE < 16	6.7%	15.1%	23.0%	40.6%	126.5%
16 < PE < 24	2.9%	6.4%	13.0%	24.8%	17.7%
PE > 24	-0.3%	-1.4%	-4.2%	3.3%	5.7%

Data from 1947 through October November 2009.

Based on 12-month trailing P/E ratio at month end. Real returns measured as nominal price return of S&P 500 minus the change in seasonally-adjusted US CPI index for same time period.

Source: Factset, Ned Davis Research and, MSIM

Exhibit 4: ...And you have not had to take on much more volatility for better returns

S&P 500 P/E Ratio at Entry and Subsequent Average Real Return Volatility

S&P P/E at Entry	Subsequent Monthly Real Return Volatility				
	1 Year	2 Year	3 Year	5 Year	10 Year
PE < 16	13.9%	14.2%	14.1%	14.3%	14.2%
16 < PE < 24	12.4%	13.0%	13.5%	14.1%	14.7%
PE > 24	16.3%	15.1%	14.7%	13.9%	15.1%

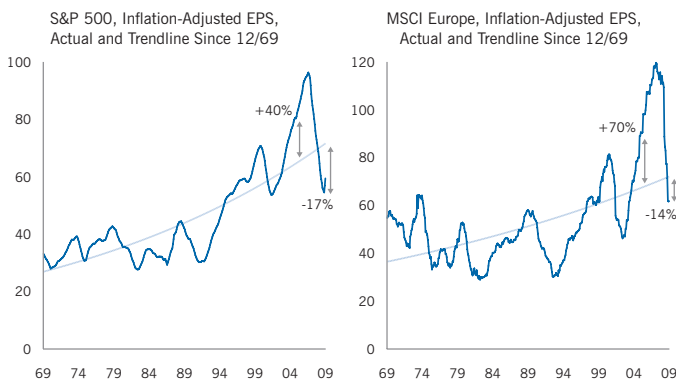
Data from 1928 through November 2009.

Based on 12-month trailing P/E ratio at month end. Real returns measured as nominal price return of S&P 500 minus the change in seasonally-adjusted US CPI index for same time period.

Source: Factset, Ned Davis Research and MSIM

On the earnings front, our advice is that overweighting equities when earnings are above trend significantly heightens the risk of a portfolio underperforming. Conversely, buying stocks when earnings for the market are below trend tends to yield better-than-expected results. Looking at the details in *Exhibit 5*, buying stocks when earnings are 10% or more below trend generates double-digit real returns in Europe and the US. These are not totally unexpected results, but they are an important part of the regime framework that we like to follow, especially in the long term (*Exhibit 6*).

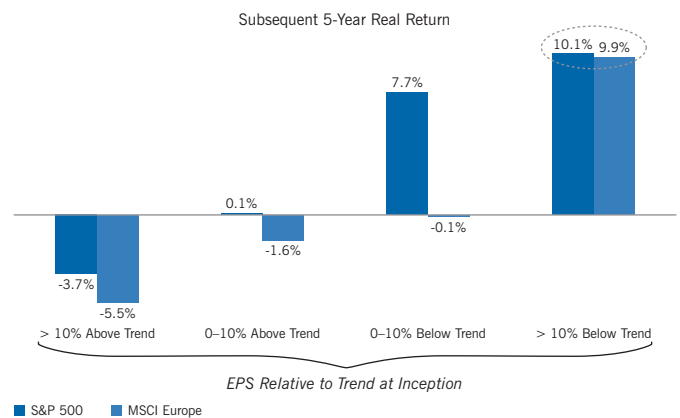
Exhibit 5: The earnings bubble has popped...



Data as of 11/30/09.

Source: S&P, MSCI, Thomson Financial, BLS, OECD, Factset, Haver and MSIM.

Exhibit 6: ...Which can be constructive for longer-term equity returns

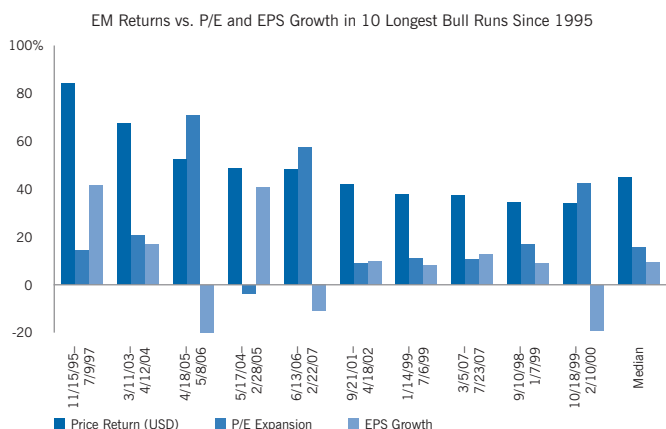


Data from December 1969 through November 2009.

Source: MSCI, OECD, Factset, Haver and MSIM.

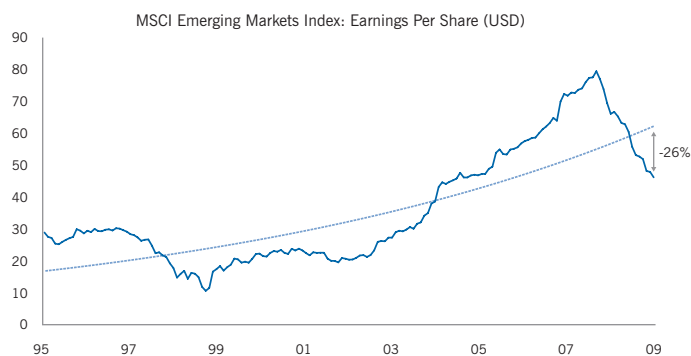
Within the emerging markets, a surprisingly similar “playbook” to the developed markets works. Specifically, as one can see in *Exhibit 7*, the lion’s share of gains in EM bull markets is actually linked to multiple expansion, not earnings growth (which everyone seems to cite as *the* reason to buy EM!). When analyzing earnings growth, however, the key is—similar to the developed markets—to focus on where earnings are relative to trend. As one can see in *Exhibit 8*, EM earnings per share are currently about 26% below their trend line since 1995, which suggests fundamentals in the region do *not* look troublingly unsustainable from a longer-term perspective. From a P/E perspective, as of November 2009, EM markets are somewhat expensive at 20.6, which is slightly greater than one standard deviation above their historical average of 16.0.

Exhibit 7: EM bull markets are typically driven by P/E expansion



Please see Appendix for details of our analysis.
 Data as of November 2009
 Source: MSCI and MSIM

Exhibit 8: Emerging markets earnings are currently below trend

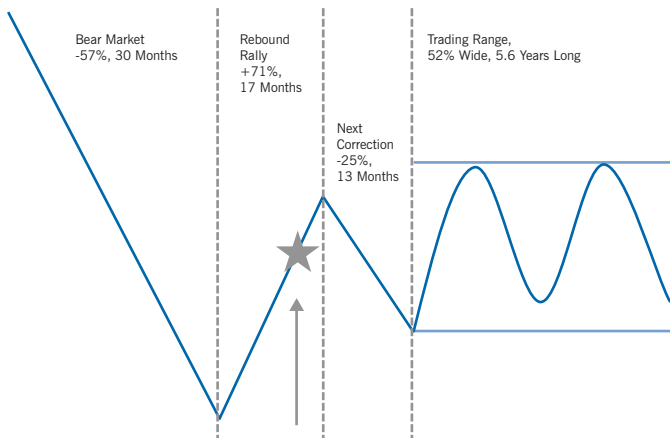


As of November, 2009.
 Source: MSCI and MSIM

So, where are we now? We still think that we are in the aftermath of a secular bear market that started in 2000. Our basic premise is that equity regimes move in 15- to 18-year cycles and that the recent rally in stocks represents a cyclical bounce, not the beginning of a new bull market. Using our risk framework from above, we conclude that, while earnings are depressed relative to trend, valuation—as measured by the trailing PE on the S&P 500—is not. As such, we view our current overweight in equities as tactical, not strategic, and fully expect to move towards a neutral to underweight position in the coming months.

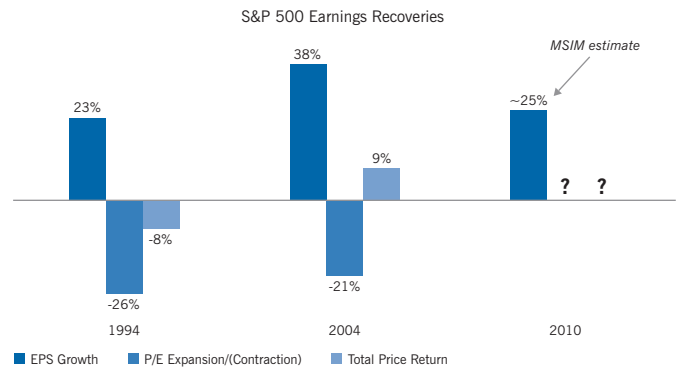
Our colleague Teun Draaisma, who heads European Equity Strategy for the institutional division of Morgan Stanley, has done some excellent work on bear markets. His conclusion, after looking at 19 secular bear markets, is that the aftermath of the first leg down is usually a range-bound market, “full of sound and fury, signifying nothing.” One can see that in *Exhibit 9*. If there is good news on the horizon, it is that we do expect a significant earnings rebound in 2010 (*Exhibit 10*). However, we also believe that the multiples on many global markets are now full, and could fall as rates begin to rise. A similar phenomenon occurred in both 1994 and 2004, leading to lackluster returns for equities overall, although certain stocks delivered strong returns.

Exhibit 9: The usual aftermath of secular bear markets implies a wide trading range for many years



Source: MSCI, Datastream and Morgan Stanley Research

Exhibit 10: We expect strong EPS growth in 2010. Will performance follow?



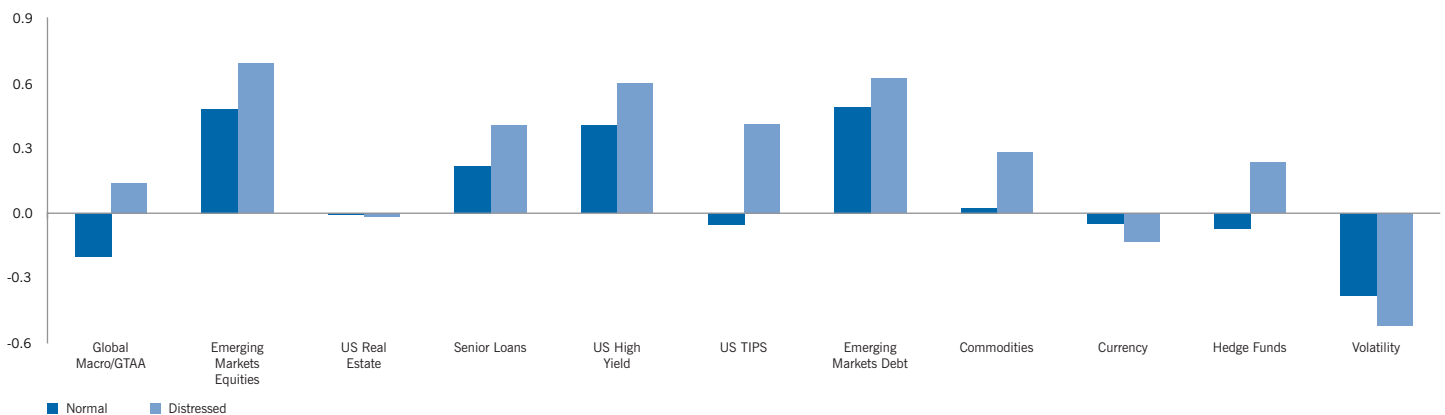
Source: MSIM

Stress test your portfolio

As someone who spends a fair amount of time interacting with a variety of well-run investment committees, I am still always surprised how much time is spent on trying to get the asset allocation “right” without fully understanding what particular changes are doing to the overall risk profile of the portfolio, particularly if markets head south. To this end, we have been working with our client base to identify how many “new” asset classes, including our core GTAA product, interact with the traditional 60/40 equity/bond mix not only during normal markets but also during periods of stress.

Not surprisingly, one can see in *Exhibit 11* that, during normal market periods, most non-traditional asset classes do demonstrate a reasonably low correlation with a traditional 60/40 equity/bond portfolio and, as such, act as compelling diversifiers. That’s the good news.

Exhibit 11: Where are the true diversifiers when we desperately need them?

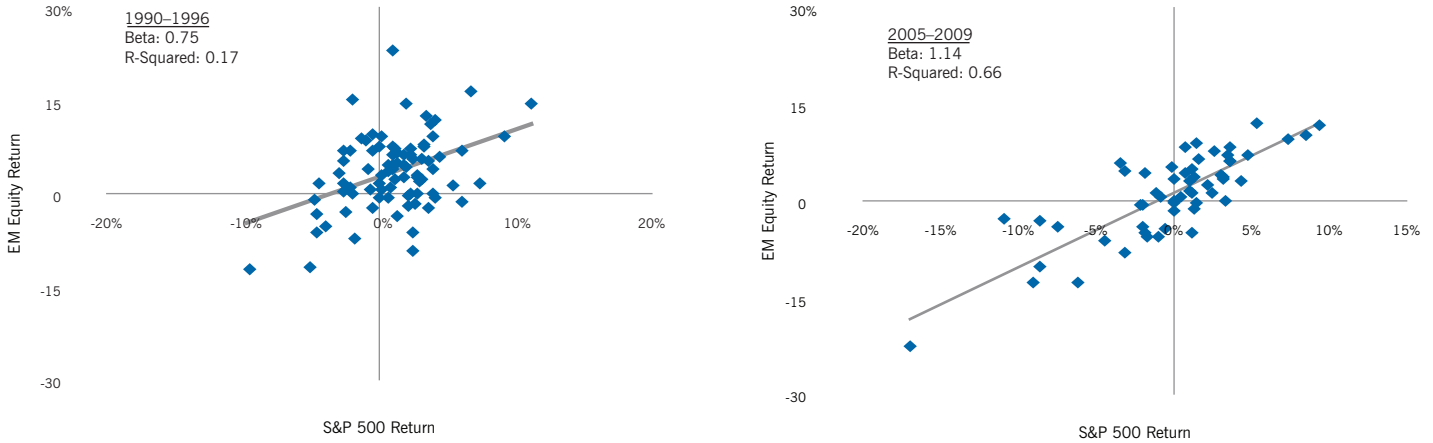


Data from January 1990 through November 2009. See asset-class proxies in the Disclosures section of this paper. Source: Datastream, Bloomberg and MSIM

The bad news, however, is that during periods of market stress, several of these “diversifiers” may see their correlations with a traditional portfolio increase significantly. To illustrate this, we take the 15% worst-performing months by S&P 500 between January 1990 and November 2009, and define them as the “distressed periods.” As shown in *Exhibit 11*, emerging market equities, high-yield bonds and emerging-market debt are among those asset classes which experienced higher sensitivities during market downturns. This change in correlations is significant as not only do some intended diversifiers fail to protect the portfolio just when one needs it, they also increase the beta of the portfolio just as one does not need it.

Another related issue to consider while testing your portfolio is a possible shift in its beta characteristics. Some markets may start out having low betas, but over time, as they increasingly become integrated segments of investor portfolios, their betas creep up. An example at hand is emerging market equities. As shown in *Exhibit 12*, the beta of emerging market equities with the S&P 500 has gone from 0.75 in the early 1990s to 1.14 in recent years. If this trend represents a structural shift, which we believe it does, then emerging market equities are no longer likely to deliver the diversification benefits to the overall asset allocation process that they did in the past.

Exhibit 12: Emerging markets equity: This is not your parents' beta



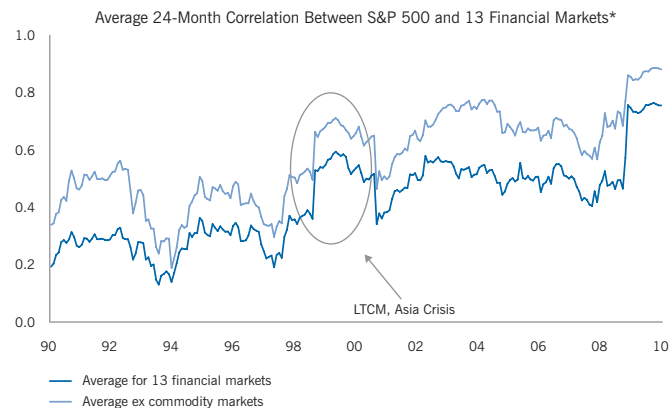
Data as of November 2009. Source: Datastream, Bloomberg and MSIM Research

So, where are we now in terms of correlations and what is the current opportunity set?

At the moment, our base view is that correlations will fall sharply in 2010, driven by a disparity of growth among regions, countries, sectors and stocks. As *Exhibit 13* shows, correlations are abnormally high and should mean-revert. Importantly, the catalysts, we believe, will be a fall in liquidity and the recognition of growth differentials among countries, sectors and stocks.

This viewpoint is consistent with what we laid out in detail in our recent note “A Changing of the Guard” (October 2009). Our recommendation is to be long “True Growth,” or stocks with significant underlying organic growth (which we typically define as three-year compound revenue growth at 8% or better and three-year EPS growth of 15% or better) for two primary reasons. One, True Growth is scarce and will be harder to find after liquidity begins to exit the system. Two, given the compression of valuations among growth parts of the market, one does not have to spend much of a premium to buy faster-growing companies (*Exhibit 14*). A similar phenomenon occurred after the 1973-1974 and 2001-2002 bear markets, and as such, we have confidence that our current outsized bet on True Growth is a good one.

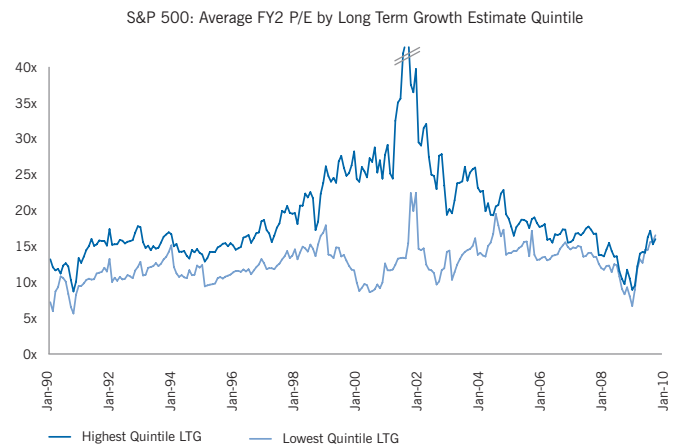
Exhibit 13: We believe that the market of one will subside in 2010



*MSCI UK, Germany, France, Japan, Singapore, Australia, EM Asia, Latin America, EM Europe, Russell 2000, Gold Futures, Crude Oil Futures, and CRB Index Futures.

Data as of November 30, 2009. Source: Morgan Stanley Trading

Exhibit 14: Investors are currently paying hardly any premium for growth



Data as of November 30, 2009. Source: S&P, Thomson Financial, Factset and MSIM

Remember your priorities

Our view is that endowments and pensions—and, as a result, the investment managers that serve them—should seek to achieve the following goals, in order of priority: 1) satisfy the beneficiaries’ near-term funding (i.e., cash flow) requirements; 2) meet or exceed the funds’ targeted discount rates via a diversified portfolio of assets; and 3) rank highly within comparable peer groups. Too often, however, it feels like portfolios are structured first to satisfy goal number 3, sometimes at the expense of numbers 1 and 2. As a result, we think that there is too little focus on liquidity risk management in the overall asset-allocation process.

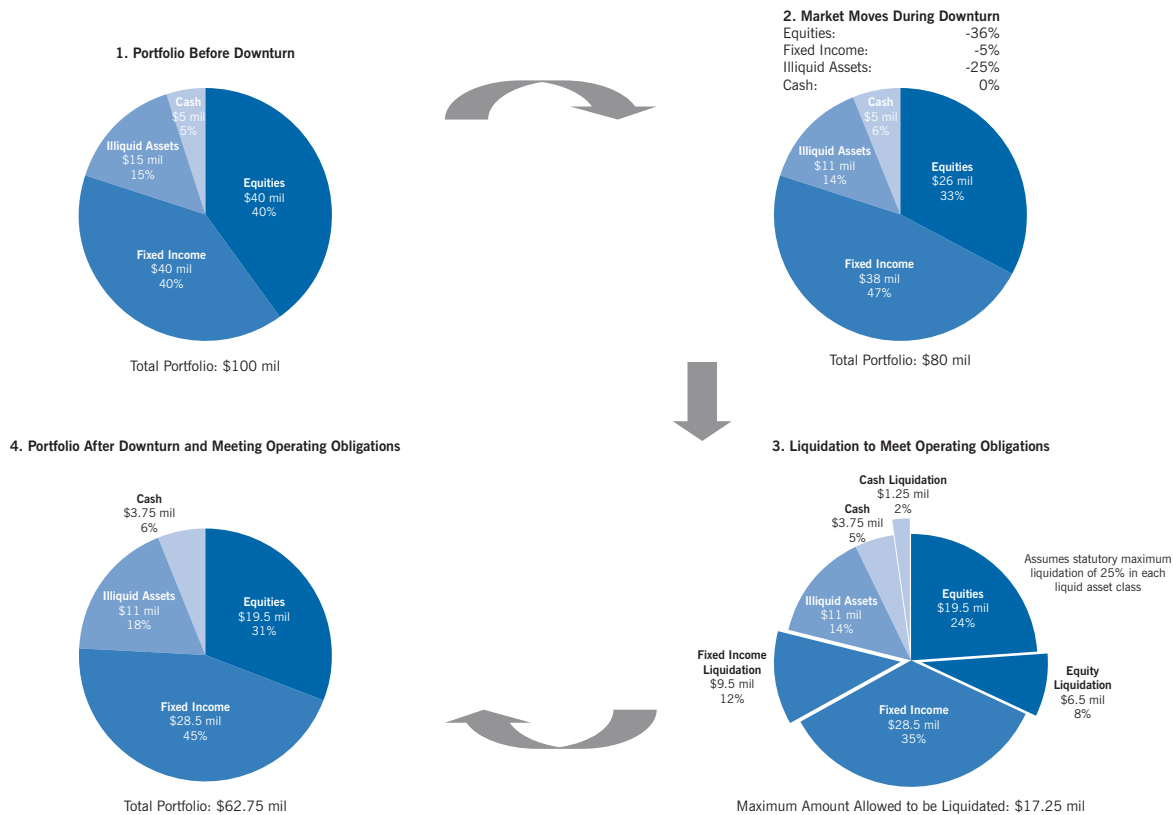
When it comes to incorporating liquidity into the asset-allocation process, we always try to focus on several key metrics and ratios. In particular, we try to assess: 1) how much a sponsor is relying on its investments to meet annual operating obligations; and 2) what percentage of the investment portfolio is being allocated to illiquid versus liquid investments?

The key is to think about how overall portfolios might react in a market downturn and what it might mean for overall portfolio liquidity. *Exhibit 15* below provides one case study of the importance of adequate liquidity. In this hypothetical example, we start with a simple \$100 million portfolio that contains \$40 million of equities, \$40 million of debt, \$15 million of illiquid investments and \$5 million of cash. We assume that portfolio bi-laws impose a statutory maximum liquidation of 25% in each liquid asset class. Finally, in our example, the hypothetical foundation relies on its investment portfolio to fund 20% of annual operating expenses, or \$20 million.

We then assume a market downturn that affects all asset classes (equity shares fall 36%, fixed income declines 5%, and illiquid investments tumble 25%). On average, the portfolio contracts 20% in value to \$80 million from \$100 million. With a statutory maximum liquidation of 25% in each liquid asset class, the new portfolio is only able to provide \$17.25 million of capital, which is insufficient to fulfill the \$20 million liquidity needs.

Our scenario analysis is obviously too simplistic and has many potential shortcomings, but we find it valuable for several reasons. First, it underscores how illiquid assets can often overwhelm a portfolio, exacerbating liquidity issues during periods of market stress. Second, it underscores the importance of understanding the funding schedule of non-liquid investments because it can dramatically affect the overall asset-allocation process. In particular, folks seem to have forgotten that most alternative investments, private equity in particular, are in many ways similar to premium mortgage securities: they prepay when prices are high and reinvestment yields are low (i.e., the most inopportune time). On the other hand, their duration extends and prices fall at the time when one would like to actually be receiving capital back from an investment manager.

Exhibit 15: Liquidity case study

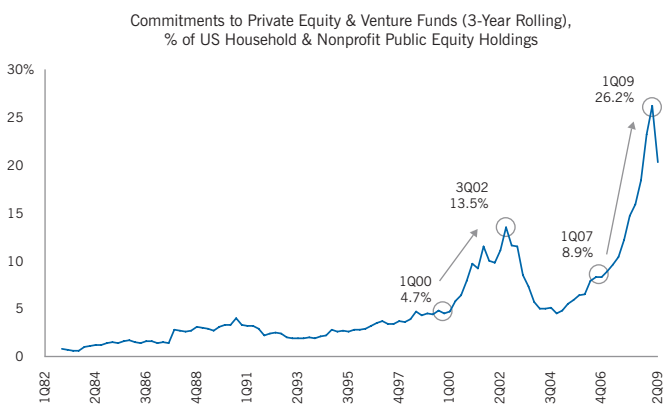


For illustrative purposes only. Provided solely to illustrate general concepts and not intended to predict the performance of any investment. Source: MSIM

Further complicating the liquidity and cash-flow outlook is that capital calls as a percentage of available cash and liquid securities are often lowest at market peaks and highest at market troughs. *Exhibit 16* illustrates this point on a macro scale, showing how investor commitments to private equity funds spiked up dramatically as a percentage of US equity assets during the past two bear markets.

So, for our nickel, unless better transparency emerges or non-traditional liquidity features are added, we are much less sanguine than the current consensus about the use of illiquid investments in the overall asset-allocation process, particularly for smaller clients that rely on their investments to fund more than 15% to 20% of their annual operating budget.

Exhibit 16: Commitments to illiquid funds often become outsized relative to liquid assets during periods of market stress



Private equity commitments measured on a three-year rolling basis, using this interval as a rough proxy for the capital calling period in the lifecycle of a typical fund.

Data as of November 30, 2009.

Source: Venture Economics Association, Federal Reserve and MSIM.

Exhibit 17: Treasury calendar a risk to long end of US yield curve



Data as of November 2009. Source: Bureau of Public Debt, Bloomberg, MSIM.

Fat Tail Flows

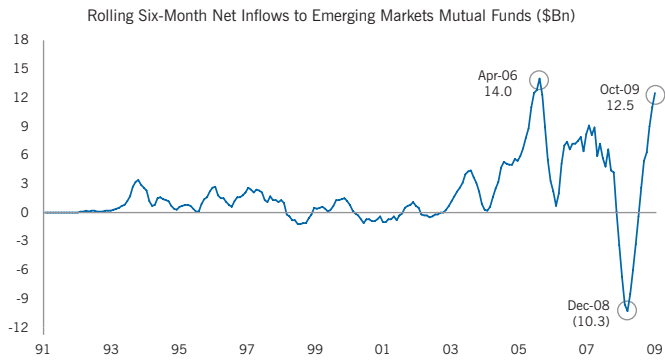
As a former financial services analyst who covered asset management companies and investment banks for a decade, one thing I learned is there is a lot of information in flows and the new issuance calendar. In particular, when it looks too good, it usually is. One needs only to think about the outsized flows into fixed income funds, GNMA products in particular, in 1993 (right before the bond market debacle of 1994) or the obsession with technology IPOs and growth investing in 1999 to appreciate the risk signals inherent in easily accessible flow data.

At the moment, there are quite a few Fat Tail dark clouds that we see forming. As *Exhibit 17* shows, the yield curve could get a lot steeper if gross Treasury issuance is really going to continue at current trends. To this end, it probably makes sense to spend some premium on protecting a back up in long-term rates.

Interestingly, my recent trip to Asia underscored how worried global investors, including Asian investors themselves, are about emerging markets equities. Indeed, almost every conversation included a discussion of whether we are in an emerging markets equity “bubble.” We do not see it this way because flows do not look particularly stretched relative to past equity bubbles (*Exhibit 18*). Also, as we mentioned in an earlier section, earnings are below trend, and valuations, while above trend, do not yet appear excessive (*Exhibit 20*).

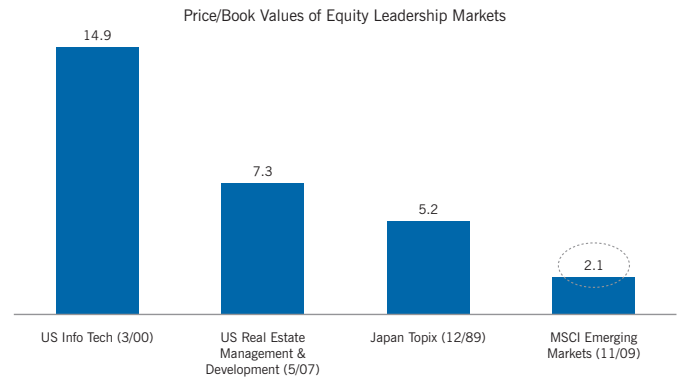
What does concern us, however, is the growing role of government debt in mitigating the debacle in financial services and stimulating growth in certain parts of the developed and developing markets. We mentioned this earlier with our comments about US Treasuries, but as we recently saw with Dubai, there are emerging countries that face strong headwinds as well. To this end, *Exhibit 20* provides a good “snapshot” of countries that do, and do not, seem to have their fiscal houses in order and are probably worth watching.

Exhibit 18: EM fund flows look robust, but not yet “off the charts”



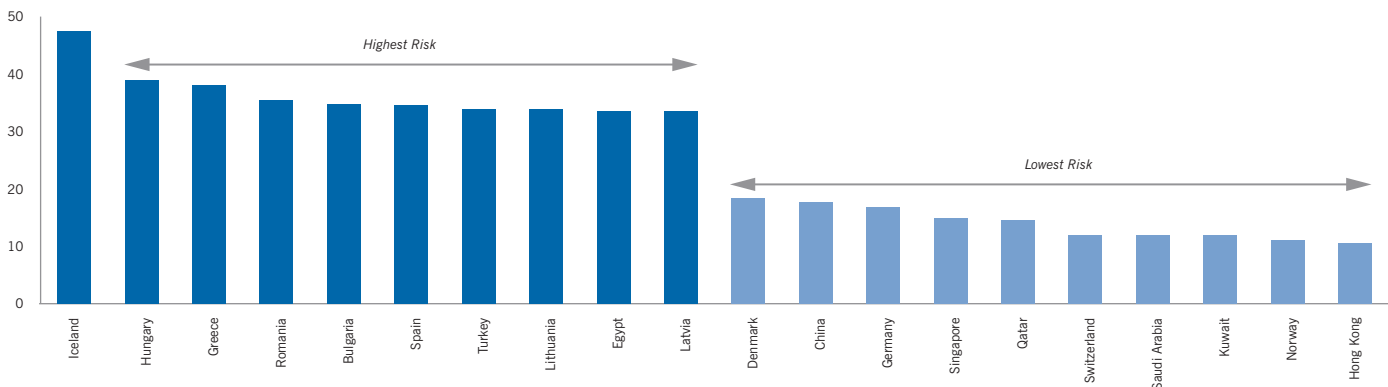
Data as of 12/10/09.
Source: ICI and MSIM.

Exhibit 19: We believe EM valuations are not in “bubble” territory, compared to prior case studies



Data as of November 30, 2009.
Source: MSCI, Goldman Sachs Research, Factset and MSIM.

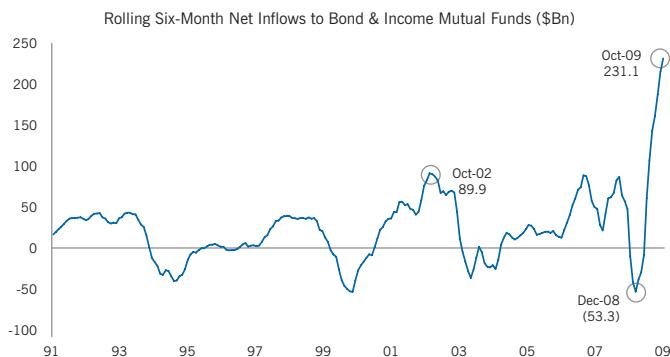
Exhibit 20: Country vulnerability scorecard



Inputs to country scores include current account balance, fiscal balance, government debt, private sector credit, and net external assets (all as a % of GDP). CDS spreads and credit ratings are also inputs. The scorecard is based on the stated factors and is subject to change at any time due to changes in market or economic conditions.

Source: Credit Suisse Equity Research November 27, 2009.

Exhibit 21: Bond-fund flows at an all-time peak



Data as of 12/10/09. Source: ICI, MSIM.

Separately, we are also increasingly concerned about a potential Fat Tail in the US taxable fixed income market. One can gain an appreciation of the significant increase in flows into this asset class in *Exhibit 21*. By comparison, EM equity flows remain reasonably within the longer-term range established in 2005-2007 (*Exhibit 18*).

Our central concern surrounding high grade fixed income is that retail investors are increasingly being told to buy the asset class because spreads can tighten further and may be missing the point that absolute yields are no longer as attractive, particularly relative to the comparable equity dividend yields on the same enterprises.

Appendix

Appendix: (1) We define 'long running bull markets' here as the 10 longest periods since September 1995 where the MSCI Emerging Markets USD index has traded without a peak-to-trough correction of 10% or more. (2) EPS and dividends measured on a last 12 months basis. MSCI EM EPS are measured on a reported basis. (3) P/E and EPS growth rates measured from end of first month of bull market through end of last month of bull market.

Disclosures

The views expressed are those of the author as of December 15, 2009. 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 MS IM, or the views of the firm as a whole, and may not be reflected in the strategies and products that the Firm offers. This document has been prepared solely for informational purposes and is not an offer, or a solicitation of an offer, to buy or sell any security or instrument or to participate in any strategy. Information in this presentation does not contend to address the financial objectives, situation or specific needs of any individual investor. Please consider the investment objectives, risks and fees of the financial instrument along with your personal unique situation prior to making any investment decision. In addition, any decision to invest should be made in reliance upon the relevant offering documents of the product concerned. A financial professional can help assess investors with their individual situation prior to making any investment decisions.

Asset-class proxies utilized in Exhibit 11 of this paper are as follows:

Global Macro: HFRX Macro Index

EM Equities: MSCI Emerging Market Index

REITs: FTSE/NAREIT Equity REITS Index

Senior Loans: S&P/LSTA Leveraged Loan Index

US HY: Barclays US Corporate High Yield Index

TIPS: Barclays Global Inflation-Linked Bonds - US TIPS

EM Debt: JPM EMBI

Global Commodities: S&P GSCI

FX: Barclays Trader Indexes Currency

Hedge Funds: HFRI Fund of Funds Composite Index

Volatility: CBOE SPX Volatility Index

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. 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. Real estate risks can include fluctuations in the value of underlying properties; changes in general and local economic conditions; and other economic, political or regulatory occurrences affecting the real estate industry.

Past performance is no guarantee of future results. Charts and graphs provided herein are for illustrative purposes only. This material has been prepared using sources of information generally believed to be reliable but no representation can be made as to its accuracy. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass. Performance of all cited indices is calculated on a total return basis with dividends reinvested. The indices do not include any expenses, fees or charges and are unmanaged and should not be considered investments. An investor can not invest directly in any index.

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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.

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