

Morgan Stanley

DEAR FELLOW SHAREHOLDERS:

2009 continued as a period of challenge and change—for Morgan Stanley and the entire financial services industry. It was a year of transition for us, as we struck a transformational joint venture, forged key strategic partnerships and executed a number of other important strategic initiatives. But Morgan Stanley has succeeded throughout its history by adapting and evolving its business while always staying true to the fundamental values on which this great Firm was founded 75 years ago.

Above all else, the people of Morgan Stanley always have looked to do what is best for our clients and have sought to do so with integrity, ingenuity and persistence. We strive to be industry leaders—by creating financial solutions for our clients and expanding into new markets. And we insist that our people conduct business with the highest standards of professionalism and respect.

As we celebrate our Firm's 75th anniversary in 2010 and look to build on that proud legacy, all of us at Morgan Stanley are intensely focused on a clear and simple strategy: We are a client-centered financial services firm that competes and wins on the breadth and depth of our client relationships, our unmatched global platform and our pre-eminent positions in the most attractive growth markets around the globe.

We have a powerful mix of businesses that, together, offer important strategic benefits—as well as the right balance of capital, earnings and risk to deliver strong, sustainable earnings over the long term. Now we need to execute. Our goal, as we move forward, is to rank in the top three in the key businesses in which we operate and to deliver to our shareholders the superior performance that the Morgan Stanley franchise and its people are capable of achieving.

Significant Progress on Key Strategic Initiatives

2009 was a year of transition for Morgan Stanley as we continued repositioning the Firm for long-term success through key strategic initiatives that included:

- *The completion of the Smith Barney transaction*, which gave us the world's leading wealth management network and is going to play an increasingly important role in our growth and profitability.
- *The continued expansion of our strategic alliance with Mitsubishi UFJ Financial Group (MUFG)*, one of the world's biggest commercial banks and the largest bank in Japan. This alliance includes the announced integration of our respective securities businesses, Morgan Stanley Japan Securities and Mitsubishi UFJ Securities, which will give us a unique ability to penetrate the Japanese domestic market with a leading domestic partner and the capability to provide our clients with expanded, world-class lending and capital markets services from both companies.
- *The announced sale of Van Kampen and our retail asset management business to Invesco*, which will allow us to focus on Morgan Stanley's historic strengths in institutional asset management while still benefiting from a stronger retail business through our 10 percent stake in the combined company.
- *The sale of our remaining MSCI stake*, which allowed us to realize significant value from an attractive but non-core asset.
- *The full repayment of Troubled Asset Relief Program ("TARP") capital and the repurchase of the associated warrant*. There is no question that the entire industry—including Morgan Stanley—benefited from TARP and the other initiatives undertaken by the government to stabilize financial markets. We are pleased to have repaid our TARP funds within six months with a 21 percent return for U.S. taxpayers.
- *The revitalization of our sales and trading business*, with the hiring of new senior talent as well as more than 350 professionals, who will help us build deeper and broader relationships with clients over the coming year.

We also executed a smooth, deliberate CEO succession process and have made key changes and additions to our leadership team. We moved several Morgan Stanley veterans into new roles—with Ruth Porat becoming Chief Financial Officer and Colm Kelleher and Paul Taubman becoming Co-Presidents of Institutional Securities. We also added to the team with new hires from outside the Firm such as Greg Fleming, the recently appointed President of our Asset Management business, and Charlie Johnston, President of Morgan Stanley Smith Barney. Overall, it is a team of seasoned executives with highly complementary skills, each averaging 25 years of experience in the industry.

Despite Strategic Progress and Improved Results, Not Satisfied with Our Financial Performance

While we achieved many of our strategic objectives for 2009 and our results improved significantly from the prior year, we are not satisfied with our performance. During this year of transition, we posted net revenues of \$23.4 billion and income from continuing operations applicable to Morgan Stanley of \$1.1 billion, or a loss of \$0.93 per dilutive share. Our results were muted in large part by the improvement in Morgan Stanley's debt-related credit spreads ("DVA"). Although this improvement was a long-term positive for Morgan Stanley and reflected the credit markets' increased confidence in the Firm, it reduced full-year net revenues and earnings per share by \$5.5 billion and \$2.84, respectively. Our results also were affected by the costs related to the repayment of TARP capital and the repurchase of the associated warrant.

Even with these headwinds, the Firm did deliver strong full-year results in many of our individual businesses. Our share price rose 85 percent during 2009, and we saw increasing momentum across our business during the second half of the year.

Our capital position today is strong—with a Tier 1 capital ratio of 15.3 percent and leverage of 15.5x at year-end. We have diversified and stabilized our funding sources and remain focused on the strength of our capital and liquidity positions. Firmwide deposits totaled \$62.2 billion at the end of 2009, and we are seeking to extend the average maturities on our outstanding debt. In addition, we are putting in place a disciplined and effective process to help ensure we are allocating our capital based on risk-adjusted returns.

A Powerful Mix of Client-Centered Businesses

As a result of the strategic initiatives we have pursued, we now have a highly complementary mix of client-centered businesses:

- **Institutional Securities** is one of the world's leading client-centered institutional businesses. In 2009, we ranked #1 in global M&A, and we have best-in-class capabilities across a broad array of businesses, including commodities, credit, cash equities and capital markets. Given these strengths, it is no surprise that clients consistently tell me they want to see more of Morgan Stanley's capabilities. We are focused on growing our client flow businesses, driving better coordination across the Firm and broadening our relationships with clients—all of which will help us gain market share, particularly in areas such as interest rates, foreign exchange and equity derivatives.
- **Morgan Stanley Smith Barney**, with 18,000 financial advisors and \$1.6 trillion in assets, is the industry's leading wealth management network. We are focused on continuing to integrate the joint venture—having already achieved, through the end of 2009, approximately \$445 million of the targeted \$1.1 billion in cost savings. We also are continuing to attract the highest quality financial advisors and client assets. Turnover among our top financial advisors was at historic lows at year-end. In addition, we are leveraging our world-class origination capability with our world-class distribution capability to provide our retail clients with best-in-class investment opportunities.
- **Asset Management** now is refocused on our institutional businesses, where we have distinct competitive advantages. Under the strong leadership of Greg Fleming, who joined the Firm this past February, we are building out our long-only business, continuing to strengthen our alternative investment and fund-of-funds businesses, restructuring our real estate business and expanding the private equity funds business.
- **Internationally**, we have long been a leader—Morgan Stanley was one of the first banks to establish a presence in key emerging markets over the years. In 2009, under the leadership of Walid Chammah, Chairman and CEO of Morgan Stanley International, we built on that strong position through our strategic alliance with MUFG and our strategic relationship with China Investment Corporation. Those relationships offer unique opportunities for collaboration, both in Asia and around the world. In turn, these collaborations complement our leading positions

in Europe and in China—where we ranked #1 in M&A and #2 in equity underwriting in 2009—and our growing presence in emerging markets such as India, Russia, Latin America and the Middle East.

I am confident these complementary businesses—and smart, disciplined risk management—will help us deliver strong, sustainable risk-adjusted returns. As we look to do that, we will continue to benefit from our significantly strengthened risk management capability, drawing on information and insights across the Firm worldwide. We have a seasoned industry veteran, Ken deRegt, who has served as our Chief Risk Officer for two years, and he has added nearly 100 people to the risk function during that time. Ken’s deep experience is supported by the complementary skills of Ruth Porat and Colm Kelleher, who, together, form a powerful triumvirate that is ideally positioned to manage our risk exposures.

Leading the Way in Compensation Reform

Over the past two years, we have fundamentally restructured our compensation programs so that a significantly greater portion of total compensation now is tied to long-term Firm performance, subject to clawback, and at-risk.

These changes, which reflect our discussions with investors and regulators, include:

- *More Deferred Compensation, Less Cash:* To promote the long-term view among our employees, in 2009, we substantially increased the ratio of compensation that was deferred and reduced the portion paid out in cash. For our Operating Committee, the percent deferred was increased to 75 percent of year-end incentive pay.
- *Stronger Clawback:* In 2008, Morgan Stanley was the first U.S. bank to institute a clawback provision. In 2009, we further strengthened that clawback to apply to substantial losses on trading positions, investments, commitments or other holdings. It also applies when risk parameters, compliance or ethics standards are violated.
- *At-Risk Performance Units:* For our senior executives, we created at-risk performance units that represent a significant portion of compensation. These units pay out only if the Firm meets specific performance targets—return on equity and relative shareholder return—after three years.

While our compensation-to-revenue ratio in 2009 was much higher than historically has been the case, it primarily was due to the \$5.5 billion impact of the improvement in Morgan Stanley's debt-related credit spreads ("DVA"). But I believe those headwinds are largely behind us, and I've made it clear that I am committed to never again seeing that sort of compensation ratio.

Supporting Regulatory Reform and Economic Recovery

In the wake of the financial crisis, we believe that fundamental regulatory reform is critical for our industry—and the global capital markets. We need to ensure that nothing like the financial crisis of 2008 ever happens again, and we are committed to working cooperatively with policymakers and to playing a constructive role in building a new regulatory framework.

While the reform debate remains fluid, we believe the entire industry must work as partners with regulators and legislators to forge practical and workable solutions to the challenges we face. That is why we support the establishment of a strong systemic risk regulator with the ability and the responsibility to prevent excessive risk taking and other practices that threaten the stability of the financial system. We also believe investors and regulators need a clearer picture of the risks posed by increasingly complex financial instruments. In addition, we believe the United States must work with other nations to coordinate standards and enforcement and prevent "regulatory arbitrage," through which some market players seek competitive advantage by exploiting regulatory differences.


We are committed as well to doing everything we can to support economic recovery. We have helped connect issuers with investors and have advised institutions and individuals through some of the most challenging times they have faced. In total last year, we assisted companies and governments in raising more than \$142 billion in debt and equity to grow and create new jobs. We also have been moving quickly to help homeowners under the Home Affordable Modification Program, or HAMP. As of February 2010, Saxon, our mortgage servicer, ranked #4 of the 30+ servicers on the U.S. Treasury Department's Servicer Performance Report. Through our Environment, Social Finance and Community Reinvestment Group, Morgan Stanley also committed \$110 million to finance construction of affordable rental housing, which will help create 6,500 jobs and revitalize low-income neighborhoods across the country.

Seventy-five years ago, Morgan Stanley was founded in another moment of great economic challenge and uncertainty—as the United States and many other countries faced a painful and enduring economic downturn. Henry Morgan and Harold Stanley opened their doors for business in September 1935 undeterred by these challenges. They—and those who followed in their footsteps—adapted and innovated, but they always stayed true to their core values, and they always put their clients first.

In recent years, no one did more to continue and enrich that legacy—and the culture of Morgan Stanley—than John Mack. Since coming to work at Morgan Stanley as a 28-year-old bond salesman in 1972, John has been a driving force in shaping the Firm, serving our clients and strengthening our partnership culture. It is a true honor for me to follow in his footsteps and assume the leadership of this organization—working alongside John, who is continuing as Chairman, the rest of the Board of Directors and our incredibly talented management team. I also am grateful to our employees worldwide, who through their daily efforts embody Morgan Stanley’s founding principle: to do first-class business in a first-class way.

As we begin a new decade and a new era in the Morgan Stanley story, we are poised to extend the leadership and innovation that have long defined our Firm. We have a focused, disciplined strategy and a powerful mix of businesses. We have deep client relationships across the Firm and new strategic partners that can help us extend our global reach and seize even greater opportunities. That is why I am so confident that we can—and will—realize the enormous power and potential of Morgan Stanley’s global franchise.

Sincerely,

A handwritten signature in cursive script that reads "James P. Gorman". The signature is written in black ink and is positioned above the printed name.

James P. Gorman

President and Chief Executive Officer

April 7, 2010

Morgan Stanley

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