

Morgan Stanley

DEAR FELLOW SHAREHOLDERS:

The global financial crisis has had a profound and lasting impact on Morgan Stanley and every institution in our industry. Governments, seeking to restore economic equilibrium and reduce systemic risk, have raised capital standards and redrawn the regulatory boundaries determining what business activities are allowed and how they are to be conducted. At the same time, our society-at-large has an undiminished need for the core services we provide: the formation, distribution and management of capital.

Morgan Stanley anticipated many of the changes affecting financial services firms, seizing the strategic imperative to fundamentally change our business model. Forging the Morgan Stanley Smith Barney joint venture in 2009 was key to transforming our revenue profile. We also reduced risks in our institutional businesses by exiting proprietary trading and refocusing on the needs of clients. In addition, we meaningfully strengthened capital and liquidity. Today, the groundwork is in place for us to deliver stronger, more sustainable returns.

For the full year, Morgan Stanley reported net revenues of \$32.4 billion and earnings from continuing operations applicable to shareholders of \$4.2 billion, or \$1.26 per diluted share. These results fell short of expectations, reflecting muted market activity and the negative impacts associated with two significant actions to further strengthen our financial foundation. Nevertheless, Morgan Stanley ended 2011 in a much better position than where we started with the Firm's common equity and liquidity at the highest levels of our history. We also made significant progress toward our business objectives.

Against the backdrop of the European sovereign debt crisis and fiscal policy gridlock in the U.S., the Firm outperformed peers in our core businesses, gaining market share across Institutional Securities and attracting significant client asset flows into Global Wealth Management and Asset Management. We also remain focused on expense management across the Firm, with the Office of Reengineering on track to realize \$1.4 billion in annual run rate cost savings by 2014.

The investments we have made in our people and building out our businesses are yielding results. I am grateful to the men and women of Morgan Stanley for their dedication and continued commitment to serving clients. Clients tell me they are eager to hear from us and our relationships have never been more productive as our talented professionals helped navigate a volatile environment. I am confident that our strategy, less burdened by legacy issues, will deliver for both clients and shareholders.

Institutional Securities: Refocused on Clients and Building on Strength

We have remade our institutional businesses to reduce risk and reemphasize clients, investing to enhance our leadership positions in Investment Banking, build out our client flow businesses in Sales and Trading and restore the prominence of our Research group. Investment Banking is now unambiguously #1 or #2 in M&A and Equity Underwriting. In 2011, the Firm ranked #1 in completed M&A, advising on eight of the top 10 transactions. We continue to be the underwriter of choice for equity offerings and initial public offerings and led the largest U.S. equity offering and largest global IPO of the year. Additionally, we raised critical strategic debt capital for corporates and financial institutions and established a leading market position in acquisition finance.

Equity sales and trading surged, driven by market share gains in cash, financing and derivatives across all regions, while our largest global peers experienced relatively flat or declining revenues. Investment in Morgan Stanley Electronic Trading (MSET) also contributed to positive results. Excluding the positive impact of changes in Morgan Stanley's debt-related credit spreads ("DVA") and the MBIA settlement loss, Fixed Income sales and trading delivered among the best revenue performances relative to peers while transitioning to more stable flow businesses in rates and currencies.

We see opportunities to expand wallet share with existing clients in addition to serving smaller companies. Investment in our global network is providing cross-border opportunities serving multinational corporations doing business in emerging markets. For example, in June we announced the launch of our China securities joint venture, Morgan Stanley Huaxin Securities Company Limited. In addition, in November we reached an agreement subject to regulatory approval to launch an equities business in Indonesia, a country we see as a strategic priority as Southeast Asia's largest economy with one of the region's most dynamic financial markets.

Wealth Management and Asset Management: Scale and Synergies

Creating a leading wealth management platform through Morgan Stanley Smith Barney provides a stable source of revenues with low capital intensity that balances our Institutional Securities franchise. Importantly, we are able to leverage best-in-class origination with unrivaled distribution power to provide a wide range of opportunities to clients.

Global Wealth Management saw global fee-based asset flows of \$43 billion in 2011—the highest since the inception of Morgan Stanley Smith Barney—and is a clear industry leader with nearly \$500 billion in fee-based assets. We have set goals of doubling fee-based assets to \$1 trillion in five years and building out our private banking platform to meet client lending needs, both of which also provide stable and growing revenues.

We improved margin for the year, albeit modestly, to 10 percent from 9 percent, as the final groundwork was laid for full integration in 2012 of the technology and operations platform. The integration of all 17,000 U.S. financial advisors onto a single operating platform is an important step in our plan to ensure all clients are offered our full range of capabilities, while also improving margins by increasing productivity and reducing costs.

We have restructured Morgan Stanley Investment Management to focus on our core institutional client franchise, exit peripheral businesses and reorient our merchant banking activities toward clients and away from proprietary positions. We also have invested in growth platforms and recruitment of outstanding talent to drive investment performance, net flows and growth in assets under management. Solid performance provides the opportunity to raise new funds.

After several years of outflows, Asset Management delivered positive flows of \$26 billion in 2011. Flows ended the year with strong momentum in alternatives and liquidity funds. Seventy-five percent of our Long-Only strategies outperformed their benchmarks on a 3-, 5- and 10-year basis.

Continuing to Strengthen Our Sound Financial Foundation

Underpinning our focus on serving clients are the many strategic steps we have taken to further strengthen our capital levels, enhance liquidity and resolve legacy issues. Our capital is solid, with a Tier 1 common ratio of 13.0 percent under Basel I—among the highest in the industry. We have also increased the size of our global liquidity reserve to \$182 billion at year-end. Although the safety and stability that comes with this incremental capital and liquidity reduces return on equity in the near term, the net result is additional capacity to deliver for clients in all environments.

In 2011, we negotiated two significant transactions that further strengthened our balance sheet. I am particularly pleased with the conversion by Mitsubishi UFJ Financial Group, Inc. (MUFG) of its preferred investment, which meaningfully increased our common equity capital by \$8 billion. Our unique strategic alliance has been highly underappreciated in the marketplace, in my view.

The interests of our two companies are now more closely aligned with MUFG having Board representation and sharing in our earnings through equity accounting. These provide further incentives to enhance our relationship over the decades to come, demonstrated already by establishing our securities joint venture and integrated investment banking operations in Japan as well as a loan marketing joint venture in the Americas. Our joint initiatives to deepen client relationships and leverage our balance sheets to deliver financial solutions are proving beneficial. For example, if combined, MUFG and Morgan Stanley would constitute one of the largest lenders to major U.S. corporations with total loan commitments of more than \$210 billion in 2011. We also collaborate through regional business referral agreements and continue to develop additional mutually attractive opportunities with global scope.

We also eliminated our largest remaining legacy exposure through a comprehensive settlement with MBIA. This settlement meaningfully reduced risk-weighted assets and released the equivalent of approximately \$5 billion of capital under the proposed Basel III framework.

The steps we have taken successfully position the Firm to achieve the required Basel III capital levels well in advance of implementation. While these actions reduced returns in 2011, we have eliminated an annual earnings drag of nearly \$800 million in preferred dividend payments to MUFG as well as the volatile hedging risks associated with MBIA. A more durable funding base and lower risk profile also give us greater flexibility to deploy capital as we pursue our client strategy.

Constructively Engaging on Regulation and Reform

We are actively engaged with regulators around the world to achieve reforms that increase certainty in the markets and restore trust to our industry. Consistent with the main intent of the Volcker Rule enacted in the Dodd Frank legislation, we have significantly reduced the capital we invest within our Merchant Bank while exiting proprietary trading.

In the final drafting of regulations, care must be taken not to inhibit the ability of financial intermediaries to provide global liquidity by putting capital at risk as market makers. Governments around the world already have raised an alarm about any actions that would impair a global, liquid market for sovereign debt. Among other risks are rules that would make U.S. markets uncompetitive, shift activity to the unregulated shadow banking system or disrupt the ability of issuers to raise capital. Such unintended consequences were surely not the legislative intent of Congress.

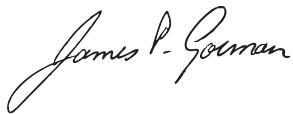
On the question of compensation, we are determined to balance adequate returns for shareholders with practices that encourage responsible behavior while appropriately rewarding talented, hardworking professionals in a market where competition for the best talent remains intense.

Confident in Our Future

I am cautiously optimistic about 2012, as our prospects today look better than they have at any point in the last two years. Our to-do list no longer looks backward to fix problems; it looks ahead to capitalize on opportunities while continued economic challenges cause some peers to withdraw from businesses where we are leaders.

Some 75 years ago, Morgan Stanley was created in the aftermath of an earlier economic upheaval, when the financial industry was also being remade by regulation. Its founding partners had a single objective: to help new industries made possible by modern advances in science and technology come into being. Through access to capital in the public markets, these industries could create employment and contribute to economic growth. Investors, in turn, could share in that prosperity.

The new Morgan Stanley is increasingly looking like the old Morgan Stanley in how we value collaboration to deliver all our resources to the client. Our dedication to helping clients realize their vision in a changing world was behind our success then, as it will be tomorrow. We look forward to demonstrating our ability to create value for clients and shareholders this year and across the cycle.



JAMES P. GORMAN
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
APRIL 5, 2012

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