Morgan Stanley

MORGAN STANLEY RESEARCH

Global Cross-Asset Strategy Team

Morgan Stanley & Co. LLC
Gregory Peters
+1 212 761-1488

Morgan Stanley & Co. International plc+
Neil McLeish
+44 (0)20 7677-7481

Morgan Stanley Australia Limited+
Gerard Minack
+61 2 9770-1529

Morgan Stanley & Co. LLC
Jason Draho
+1 212 761-7893

November 17, 2011

Global

Outlook

Global Cross-Asset Strategy

Cross-Asset Navigator

Global Implications of Deleveraging

The ramifications of European bank deleveraging will extend broadly, but the actual impact depends on exactly which assets are sold. We highlight recent work done by our strategy and analyst colleagues to address this issue. Our European banks team has done a deep-dive examination of what assets are likely to constitute the estimated €1.5 - €2.5 trillion in deleveraging they expect. Our Asia team suggests that a broad-based exit of European banks would not be enough to lead to a credit crunch if orderly, but it could still pose a significant challenge and funding risks. Last, our securitized products team estimates that European banks hold $474 billion in securitized product, a potential supply overhang weighing on the market.

Conference Call Friday November 18th, at 2.30pm GMT / 3.30pm CET / 9.30am EST with:

We will host a conference call to discuss the implications for the global economy and asset classes in the wake of deleveraging. Join:

- Huw van Steenis – Head of European Banks Equity Research
- Greg Peters – Head of Global Cross-Asset Strategy
- Viktor Hjort – Head of Fixed Income Research, Asia
- Hans Redeker – Global Head of FX Strategy
- Vishwanath Tirupattur – Global Head of Securitised Products Research

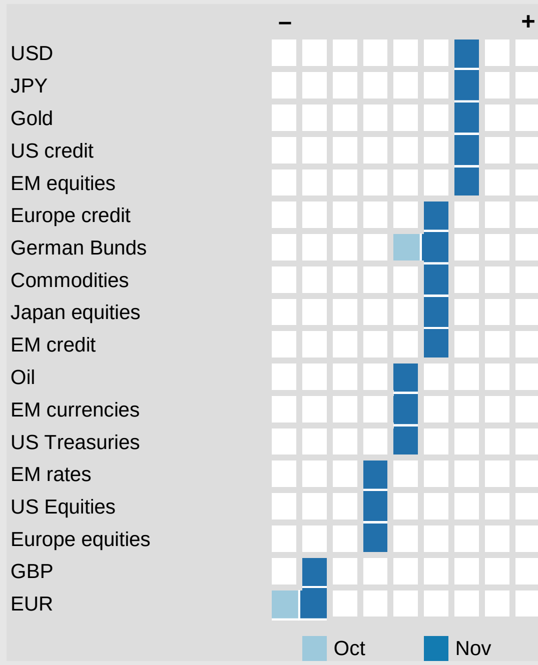
DIAL - IN DETAILS:

All participants MUST register for this conference call using the URL below:
https://www-emea.tcconline.com/registration/event/28784670

4 charts: 1) impact to AxJ from European bank deleveraging; 2) impact to securitized products from European bank deleveraging; 3) how investors will seek yield in a low-return world; and 4) China to follow a path of steady and moderate growth (pg 9).

Asset Class Views (3-6 months)

Base Case: Maintain a cautious strategic stance and defensive positioning



Source Morgan Stanley Research

Page

Global Cross-Asset Strategy Overview

Base Case (3-6 months)

On a long-term strategic perspective, we are bearish on developed market equities, while bullish on emerging market assets. DM is now in the midst of what is likely to be an extended period of deleveraging, leading to a subpar economic expansion. In contrast, the strong secular fundamentals for EM economies should continue.

The tactical outlook is now more balanced, but we wouldn't alter our defensive view. Compared to a month ago, the case for tactical upside is less compelling, given the strong rally. While growth data are better and policy developments are moving in the right direction, Europe is far from resolved and the US debt debate will be back in the spotlight shortly.

A G10 recession is not our base case for 2012, but the impact of fiscal and monetary policy responses to weak growth is likely to be limited. If there is a DM recession in the next year, then risk assets have significantly further to fall.

The "comprehensive solution" announced this month by European officials is not a "silver bullet" on the debt crisis. While we have seen incremental progress, the details on bank recaps are lacking, and a levered-up EFSF looks increasingly in doubt. The key step remains a statement and timeline for moving toward fiscal integration, which would enable other policy measures to bridge the gap.

Slowing growth in EM is a risk, but growth should stabilize by year-end. A soft landing in EM still looks on track, and EM policy makers have some flexibility. However, EM is vulnerable to funding market stress and DM deleveraging, in addition to a DM recession.

Risk Factors / Catalysts

- **Italy sovereign yields stay above 7%.** Debt costs that high are not sustainable and if they persist, the odds of a bailout increase significantly.
- **The US economy stays at "stall speed."** If growth stays around 2%, recession is dangerously close; job growth close to 150k per month is needed for growth sustainability.
- **Fiscal policy proves counter-productive.** With US stimulus set to expire and fiscal consolidation elsewhere in DM, fiscal policy could tip a weak recovery into recession.
- **Slower growth in Asia/EM.** The risk is that policy cannot respond fast enough or in sufficient size. Although inflation remains high, Turkey, Brazil and others have already cut rates.
- **Upside risk: China policy.** Faster CNY appreciation and fiscal stimulus could contain downside growth risks in Asia, and boost markets.
- **Upside risk: Coordinated policy response.** Decisive monetary action by G10 central banks, with matching fiscal support.

Asset Class Views

We continue to favor a cautious strategic stance. The bear market rally could last through year-end, but we wouldn't alter our defensive positioning. In DM, we favor credit over government bonds and equities, as credit is pricing in worse scenarios. Flight-to-safety assets (USD, JPY, gold) are attractive, given the number of events risks remaining in 4Q11.

Stay UW DM equities, OW EM equities on a 6-month view. DM equities, particularly in Europe, are not as cheap and compelling after the rally, while the risks remain largely the same. EM equities are cheap and have underperformed DM, but continue to face near-term funding stress risk.

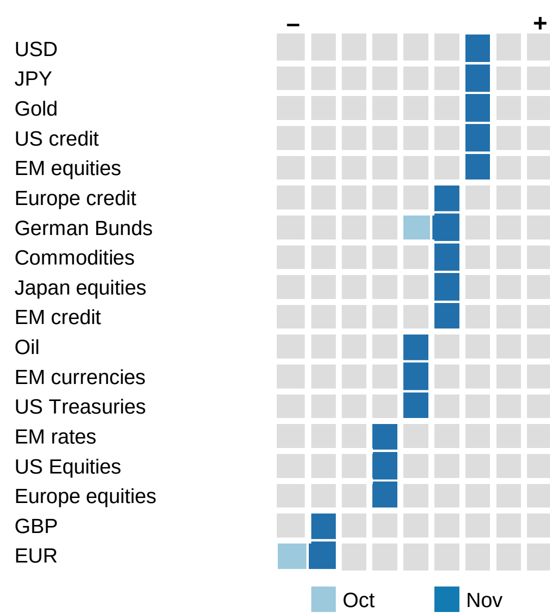
Neutral on Treasuries, going long Bunds. Better growth data have led to a Treasury sell-off, but talk of QE3 should keep rates range-bound. Bunds have cheapened up in the past month, and the market is not even pricing in 25bps in rate cuts by the ECB.

Stay constructive on credit. DM credit has rallied, but is still pricing in a fairly high probability of recession.

USD, JPY strength, EUR weakness. Expect USD and JPY strength as a risk-off trade; after rallying, risks to the EUR are to the downside on the unresolved debt crisis, a more dovish ECB and less capital repatriation.

A more neutral view on commodities. Our commodities strategists have moved to neutral on oil, given slowing demand growth and better supply. After correcting, gold remains an attractive medium-term defensive play.

Relative Preferences



Source Morgan Stanley Research

Global Implications of Deleveraging

- We continue to review the implications of European bank deleveraging by highlighting recent work done by our strategy and analyst colleagues.
- Our European banks team estimates between €1.5 - €2.5 trillion in deleveraging, with the greatest risks to asset leasing, securitized assets, assets in Central and Eastern Europe (CEE) and Southern Europe, and commercial real estate assets.
- Our colleagues in Asia suggest that a broad-based exit of European banks would, on its own, not be enough to lead to a credit crunch if orderly, but it could still pose a significant challenge and funding risks.
- European banks hold $474 billion in securitized product. Only a portion of this may be sold, but the supply overhang is a weight on the market.

European banks are the epicenter of the current stage of global deleveraging. Our European banks equity analyst Huw van Steenis has been arguing since before the summer that deleveraging and a potential credit crunch were likely because of the banks' exposure to sovereign risk, stress in the funding markets, uneconomic financing terms, and the need to recapitalize and shrink balance sheets. Now with the Italian 10Y bond yield hovering around 7%, weak Eurozone sovereign debt auctions, and the crisis infecting France, the escalating debt crisis is likely to accelerate bank deleveraging. Huw and team now expect between about €1.5 and €2.5 trillion deleveraging by European banks, with risks for bank earnings, lending and economic recovery.

As we've written recently, the implications of European bank deleveraging are far reaching, affecting credit access and potentially growth in emerging markets and contributing to financial market segmentation along regional lines (*Banking on Borders*, November 10 and *DM Deleveraging, EM Stressing*, November 1). Over the past week, our colleagues in Research have published a number of reports that look more deeply into what and how many assets that European banks might divest and the impact on AxJ and other regions and asset classes.

This week we want to highlight this work because of the broad and significant consequences of deleveraging. What follows is a shorter version of the report published by Huw and his team that provides details on potential European bank deleveraging and the associated risks. In particular, they see the greatest risks to asset leasing, securitized assets, assets in Central and Eastern Europe (CEE) and Southern Europe, and commercial real estate assets. In contrast, while they see growing risks to global trade finance, their assessment is that in a more orderly scenario this will be passed to local or global banks, although risks remain.

The withdrawal of trade credit reflects one of the bigger risks to EM, though more for CEE than Asia. Indeed, our Asia colleagues suggest that a broad-based exit of European banks from Asia would, on its own, not be enough to lead to a credit crunch if orderly and the exposures are less than commonly perceived (*The Challenge to Asia of European Deleveraging*, November 14). However, it would still pose a significant challenge, as the cost of capital rises and credit conditions weaken. In all scenarios, China is likely to play an important role. At 8% of total deposits (4% including China), the team believes that Asian banks could absorb European bank claims, if required. Moreover, policy-makers could alleviate credit constraints and respond to funding market stress by introducing cuts in cash reserve or required reserve ratios, conducting more open market operations and re-capitalizing state-owned banks.

The securitized market could also be potentially impaired by deleveraging. Our strategy team estimates that European banks hold €348 billion ($474 billion) in securitized assets that are potentially subject to sale (*European Bank Deleveraging: Implications for Securitized Products*, November 14). This consists of USD assets in the range of €169 - €249 billion ($230 - $339 billion) and EUR-denominated assets in the range of €99 - €179 billion ($135 - $244 billion). Whether these assets are sold will depend on funding as well as capital relief considerations. The effects of potential asset sales will not be uniform across asset classes. Asset classes such as CLOs and prime European RMBS (particularly in the senior tranches) are positioned to be less disrupted. However, others such as US RMBS (particularly subprime, alt-A and option ARMs) are more sensitive to supply pressures – and they may see further price declines as a result of the asset sales. In the latter cases, even if there are no actual sales, the threat of potential sales would be an enduring overhang.

What Are the Risks of €1.5-2.5tr Deleveraging?

Huw van Steenis
Francesca Tondi
Magdalena L Stoklosa
Alice Timperley
Anil Agarwal
Betsy L. Graseck

Download the complete original report

We still see multi-year balance sheet retrenchment and challenging fundamentals – with risks to credit supply, bank earnings, ability to achieve new capital ratios and economic recovery. This note with our global and credit colleagues takes our previous work forward a few steps in assessing the risks to the real economy and bank earnings – as well as who may pick up the lending being shed by European banks.

- We introduce a 'heat map' of risks we are watching, and with our credit and global colleagues we will keep an ongoing track of how these play out.
- We have done a deep dive on the four main buckets of assets that banks are looking to shrink – as well as what they cannot shrink. It has firmed up our top down views of the risks of €1.5-2.5tr potential shrinkage in banking assets. We have spent extensive time meeting with non-European banks, private equity and non-core bank units to assess the potential of European assets being sold to other players – and on the whole we think there will be considerable potential for asset buyers.
- This work gives added conviction to our concerns for bank earnings in some areas: our numbers are significantly below market expectations for Spanish and Italian banks, and gives us caution on many restructuring stories (we are UW CBK – which we add to our least preferred with this note – and RBS, and for example we think CS will need to cut the dividend over 60%). We also remain cautious on Central & Eastern Europe (CEE)/Southern & Eastern Europe (SEE) and we feel relative winners will be the national champions.

Our thesis has been that we think banks could delever by ~€1.5-2.5 trillion over the next 18 months with risks to SME lending, trade finance, syndicated lending, asset leasing, CEE banking and parts of wholesale/investment banking. This is why we have argued since July that we see the risks of a 'grinding' credit crunch in Southern/peripheral Europe/SEE, although we hope intense policy response will reduce this risk.

It is also why in August we put out a think piece arguing the case for a pan-European temporary bank guarantee (See *European Banks: The Stress in Bank Funding and Policy Options*).

A key issue is that we think policy makers – and some investors – have underestimated the importance of bank funding on banks' ability to lend profitably. Regular readers will know that we argue funding is as big a concern as asset quality given the €1.7 trillion of bank funding rolling in the next three years, which is a remarkable challenge to achieve in today's market. Simply put, the euro-zone sovereign crisis is repricing all bank liabilities – from equity to repo, with major knock-on implications.

Why shrink balance sheets rather than raise equity?

The self-reinforcing loop of stress in sovereign funding, stress in bank funding and stress in bank solvency is likely to overhang European economic recovery and lead to material balance sheet shrinkage. We see the drivers as three-fold:

- the approach of Basel 2.5/3 shifting risk weights;
- the stress in bank funding ($ funding for euro-zone banks and unsecured term funding more broadly); and
- weakened balance sheets from the euro-zone crisis (and EBA recap simply adds to this).

Even before the European sovereign crisis intensified, future regulation (Basel 2.5 and 3) was forcing banks to reconsider their business models (see *Wholesale & Investment Banking Outlook: Reshaping the Model*, Huw van Steenis et al, March 23, 2011). This process has accelerated for European banks as the sovereign crisis has increased the cost and scarcity of unsecured funding (particularly USD) and raised pressure on banks to raise capital to protect against systemic risk in the region.

In addition, in October, the European Banking Authority announced that European banks must reach 9% Core Tier 1 by June 2012 including notional losses on euro-zone sovereign books. Per EBA calculations, a total of ~€106 billion of new capital will be required to bring the system up to this threshold. However, our European team's analysis suggests the €106bn will only really drive €50-70bn of fresh capital – of which €38bn is already committed to Greece and Portugal. The large listed banks have said many would rather shrink than raise equity (see *Recap Rally,* Jackie Ineke et al, 28 October 2011 and *European Banks: Some progress supports our national champion call* by Huw van Steenis et al, October 28, 2011 for more details). A less promising earnings outlook makes the ability to earn into new Basel 3/G-SIFI and other regulations far more challenging, and credit and equity markets' impatience on trajectories will likely drive behaviour.

Bank funding roll is considerable – €1.7tr of debt due to refi for the major banks in the next three years. We think a step change in the pricing and availability of senior unsecured debt as well as dollar funding challenge many businesses. Whilst intense ECB support has helped, lack of a temporary bank debt guarantee plan is unfortunate, we feel.

Funding is no small issue. European banks lost $100bn of CP over the summer alone – making some major European banks more dependent on the ECB for funding. Given the dollar is the functional currency of global trade, this will impact European banks' ability to be global lenders – and hence why we and our Asian colleagues Fiona Simpson and Anil Agarwal and global colleagues Greg Peters and Neil McLeish have been so intensely focused on the risks to emerging market lending – see for instance Greg's recent note Cross-Asset Navigator – November 1, 2011 – DM Deleveraging, EM Stressing. In addition, we think a raising of say €1-2bn of extra equity for a French or Italian bank would not change the minds of dollar investors to provide cheap dollars if the investors are worried about a poorly managed sovereign crisis with insufficient firewalls. See *European Banks: Euro-TARP - 10 things you need to know* and *European Banks: ECB Lending Survey & funding strains underscore policy challenge*.

We think banks will in any case shrink and may delever ~EUR1.5-2.5tr in two years with risks to CEE/EM lending, SME lending, trade finance, leasing, commodity finance and wholesale banking. We think shrinkage is likely to focus on wholesale and financing assets in the Northern banks – we think much of some categories will be picked up by foreign banks. But we also see the risk of a 'grinding credit crunch' in Southern Europe and SEE, although we hope intense policy response will reduce this risk.

Whilst we came up with our estimate with a combination of bottom up and top down work, we were struck that Mark Carney – Governor of the Canadian central bank and newly appointed head of the FSB – said in a speech last week that he also saw the risk of €1.4-2.5tr asset shrinkage. He noted in his speech in London: "Current difficulties in the European banking sector should be seen in this light. Stresses there could trigger sharp swings in global liquidity, with consequences across financial systems and economies. The deterioration in funding markets in Europe has had important spillover effects on broader European financial conditions. Lending standards for businesses and households have tightened significantly and, partially as a consequence, economic momentum has slowed. Indeed, despite the major steps taken in recent weeks by European authorities, the Bank of Canada now expects the euro area to experience at least a brief recession as a result".

Exhibit 1

We think that there are four broad buckets of bank deleveraging likely for banks(1). We think €1.5-2.5tr likely, depending on degree of sovereign stress

Category	NPLs/Distressed *(1)*	Performing loans and high grade securities *(2)*	Run-offs *(3)*	Non-core divisions *(4)*
Assets in focus	• Securitised assets (heavily downgraded/impaired) • Repossessed CRE • Legacy Assets • Other impaired credits (i.e Icelandic banks, Lehman, Greece) • Synthetic CDOs	• Asset leasing (aircraft, car etc) • International syndicated loans • Unsecured consumer finance • AAA securitized products • infrastructure/project finance loans • Leveraged, SME (non core regions), real estate, shipping loans • commodity financing	• Syndicated lending • Trade Finance • Working capital for SMEs • Market making • CEE lending • Commodity financing • German public sector lending • Insurance Operations	• Custody • International – especially EM units • Asset mgmt/private banking • EU mandated divestments • Insurance operations • Trading and derivatives business
Rationale/pricing	• Capital relief clearly the objective – both today and under B2.5/3. • Large provisions already taken. Material work out needed or risk view	• Aspire to sell for 95-99c/$ to free-up funding – especially to free $ funding • Funding relief is of high importance	• Focus on not consuming $ funding and term unsecured funding but capital relief clearly the objective too	• Wide variation in pricing • Capital relief clearly the objective • Basel 3 and capital relief of insurance operations a consideration.
Recent examples	• RBS: CRE to Blackstone/CIC • UBS: Student loan sales • AIB: CRE to Wells Fargo for $3.3bn • Dexia: fin assets pf • LLOY: sec product pf	• ING: Car leasing to BMW • RBS: Aviation finance • SAN: 25% of US consumer finance to private equity • State Street: Sec products ($11bn)	• BNP to shrink cash B/S by 5%, Soc Gen by 10%, Cred Ag by 5% • UBS to shrink FICC RWAs by SFr 100-125bn & CS by 100bn (ie~10%) •No landmark deals but more anecdotal about reduced lines • Commerz/Eurohypo ending new CRE lending & reducing CEE	•HSBC: US cards business • Numerous EM units (Poland, Turkey etc) • CBK, Lloyds, Dexia, RBS, ING all have mandated programmes • SAN stated they are considering sale of Spanish insurance ops (€2-3bn). About to close sale of Latam Insurance business to Zurich for $1.5-2.5bn.
Buyers	• Hedge funds, credit funds, private equity and some US banks	• Asian/Japanese and some US banks • PE/unlevered buyers far more limited given funding issues.	• US banks for $ finance • US/Asian banks for trade finance	• Wide variety of financial players and some private equity
Risks to economy/markets	• Lower, although overhang will impact asset prices	• Pricing and Supply, but also with risks to the economy if grid lock in many asset finance markets and also if haircuts to sell are much higher	• The biggest risk to economy/markets, although many lines to good corporates should be picked up by non-EU banks	• Material given impact on core equity of sellers if weak prices
Sizing	€50-100bn	€500-1000bn	€500-1000bn	€100-700bn

Source. Company data, Bloomberg, Reuters, Morgan Stanley Research. (1) Excludes “restructuring” banks set up by governments e.g., Germany, where deleveraging process will be less rapid.

Exhibit 2
Where we see the greatest risks from European banks deleveraging – our heat map

Emerging Markets – we see greatest risks to CEE	High in SEE/CEE	We see major risks in CEE/SEE where European banks represent ¾ of the banking system. 12 of the 16 major European banks in CEE (representing ~78% of these banking assets) either had a capital shortfall in the recent 9% test or are TARP recipients. We expect the greatest strain in SEE although EBRD helping.
EM – Asia/latam	Much lower than CEE	We see growing risks to global trade finance – French banks looking to reduce $ dependency represent 25% of outstanding trade finance. In an orderly scenario we think this will be passed to local banks or selected global banks (HSBC, STAN, JPM, C). If the deleveraging were to become disorderly, we could see a repeat of what happened in 2008-09 when European banks reduced their exposures by 20%. Within this, STAN and HSBC – which today are over ½ of the European banks lending to the region – were far more stable – (7)% vs (31)% for non-UK banks.
Southern and Peripheral Europe	High	We are concerned that stresses in bank and sovereign funding as well as capital challenges will impact Spain and Italian banking markets. We note the largest capital deficits in the EBA stress tests outside of the programme countries were in Spain and Italy. We also note the significant increase in Italian bank usage of ECB lines – standing at €105bn (or 2.7% of bank assets).
$ assets e.g. commodity finance & parts of syndicated lending	Likely to be passed to US/global banks	Continental European banks, notably the French, are looking to reduce their need for $ funding by not renewing or limiting new loans. Our deal by deal analysis of the last 3 months suggests some are being picked up by leading US large cap banks (such as JPM, C, USB, WFC) as well as some Asian and international banks.
Structured credit and securitised assets	High on overhang	~€0.5tr of existing structured credit assets (about 2/3 in $) held by European banks will continue to act as an overhang in the market, impacting asset prices. We also think European investment banks may look to shed 1/4-1/2 of their Basel 3 RWAs in fixed income and legacy assets over the coming years, e.g. we forecast CS to shrink theirs by 48% and UBS by 55%.
Commercial Real Estate	Mixed, some weak spots	We see some lenders constraining CRE lending (e.g. CBK's Eurohypo announced it has suspended all lending outside Germany). Asset quality and large concentrations in portfolios, particularly in UK banks to Ireland and within Spanish banks, remain a focus.
Leasing (aircraft, car, shipping)	Possible buyers to replace	Over 25% of outstanding aircraft leasing is reportedly for sale*. We think Japanese banks could be buyers and beneficiaries given their funding profiles. Asian & some US banks could find opportunities too. Private equity should be rarer given funding.
Non-core Units (various)	Mixed	Assets that can be sold to private equity & non-funding heavy (private banking, custody, asset management, & some parts of insurance) look reasonably supported, but those that require heavy bank funding – including EM bank units – may not see such compelling pricing, impacting those banks dependent on large asset sales – hence our caution on RBS, CBK etc

* according to Dow Jones News 6th November 2011 (unconfirmed). Source: Morgan Stanley Research

<u>Clearly policy response is the key swing – macro and bank related</u>.

The reason we have been focused on this since July was our realisation that the Greek default process started before an adequate firewall was put in place. This is not to say that parts of the firewall aren't there – for instance, we have regularly spoken on the role the ECB is playing in aiding weak banks in the South/periphery. 21% of Greek bank lending, 15% of Irish bank lending, and 8% of Portuguese bank lending is dependent on ECB repo facilities. What we have been highlighting, though, is that this dependency from loss of faith in the sovereign has started to infect Italian and, to a lesser extent, French and Spanish banks, where usage of the ECB facility is at new highs of 2-3%. However, we feel parts of the firewall are simply inadequate.

The incentive to delever is considerable (and why we feared a "crash diet"). It is also why we argued in a think-piece the case for a pan-European temporary bank funding guarantee scheme (August 15th: *European Banks: The stress in bank funding and policy options)*. It is why we share Arnaud Mares, Elga Bartsch, Daniele Antonucci, Neil McLeish's views on the inadequacies of the firewall to Italy, Spain and beyond and the logic of eurobonds or ECB unlimited support for Italy/Spain as key elements of a successful firewall.

Impact on stock calls

Clearly, bank deleveraging has been a theme we have been running with for a long while and so we are not making major changes to earnings with this note – however, we are making two changes to our most/least preferred – taking HSBC out of most preferred and adding DnB, and adding Commerzbank to our least preferred (replacing RI).

Most preferred: Whilst we have earnings expectations below the market for ¾ of the stocks we cover – and have found a strong relationship between earnings revisions and bank stock moves over the last year – we feel relative winners will be the national champions who have franchises which over time should become reasonably profitable again. The 6 we highlight are SBER, BNP, BARC, DnB (replacing HSBC), KBC and Deutsche. We appreciate these calls will only work if Europe finds a decisive way to support Italy and Spain via the ECB. Should we be wrong on this, we think these stocks will disappoint. We take HSBC out, after Steve Hayne cut estimates materially following a disappointing Q3 trading statement. Whilst we still think it is a strong long-term idea, given uncertainties on Household charge offs, we take out and replace with DnB, which remains an Overweight.

We have also spent quite a bit of time debating across the global team how material a theme this could be for some players – notably Japanese banks, some of the well funded large cap US banks and also some non-bank financials. For the moment, our view is clear that this should help the alternative asset mangers the most – although we should be clear that the deleveraging process will also be negative for parts of their business. For the Japanese and US banks, we think this could be an interesting theme to watch, although today not material enough to move the dial given the profound macro headwinds.

Least preferred: In the last month we downgraded Commerzbank and RBS. Whilst the specifics differ materially, at the core was the deleveraging process, which will likely be more challenging and costly than we and the market would have hoped for, as well as weaker growth meaning the core business is less profitable (for example, in the case of RBS, the investment bank). We add Commerzbank to our least preferred list replacing Raiffeisen, which no longer has any downside to our base case and has the most upside of the 6 stocks in our least preferred list. It remains Underweight rated.

Our least preferred are MPS, BP, Bankinter, RBS, Lloyds, CBK. It is worth highlighting that the deleveraging theme has also had an impact on the way we view many other stocks. For instance, we wrote recently that we thought it would prove more costly for UBS and Credit Suisse to shrink their fixed income and legacy assets by 45-55% – with UBS having SFr 80bn of legacy risk weighted assets and CS having SFr 60bn of structured credit RWAs to downsize. It also informs Bruce Hamilton's downgrade of retail focused asset managers (for example, Schroders UW) on the risks to retail flows as banks seek to cannibalise funds for funding.

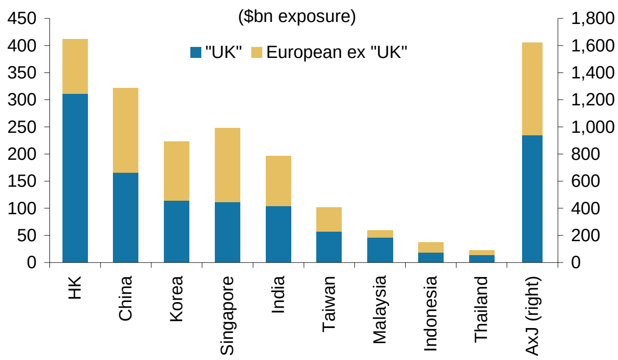
Morgan Stanley & Co Ltd is currently acting as exclusive financial advisor to Banco Pastor SA ("Banco Pastor") with respect to Banco Popular Espanol SA's announced proposed acquisition of Banco Pastor. The proposed offer is subject to the consummation of the tender offer for shares of Banco Pastor SA and required regulatory approvals and other customary closing conditions. This report and the information provided herein is also not intended to (i) provide advice with respect to the tender offer, (ii) serve as an endorsement of the tender offer, or (iii) result in the procurement, withholding or revocation of a tender in the exchange or any other action by a security holder. Please refer to the notes at the end of the report.

Global Cross-Asset Chart Corner

AxJ Credit

Viktor Hjort

If European bank deleveraging is orderly, we do not believe an AxJ credit crunch would ensue. We feel that AxJ's exposure to European banks is manageable, particularly as 58% of all European exposures to AxJ are actually due to UK banks, for which AxJ is largely a core growth market. Risks include adverse impacts to credit conditions and supply, and pressuring deposit gathering for financials. To alleviate pressures, AxJ policymakers could cut cash reserve or required reserve ratios, conduct more open market operations, or re-capitalize state-owned banks.



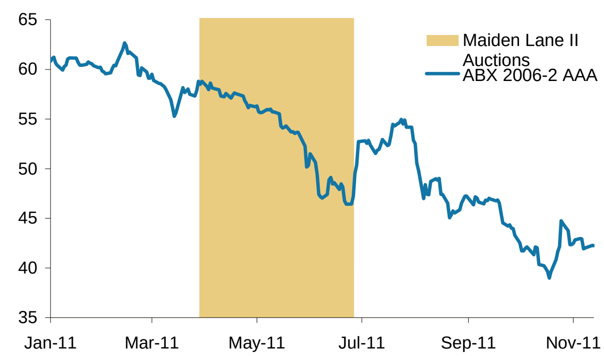
Source: BIS, CEIC, Morgan Stanley Research

Cross-Asset Research: Asia Insight - The Challenge to Asia of European Deleveraging, November 14

Securitized Products

Vishwanath Tirupattur

European bank deleveraging may have a substantial impact on securitized products. By our estimates, European banks hold €348bn ($474bn) of securitized products that are candidates for asset sales. The decision to sell or hold is dependent on funding and capital relief considerations. US RMBS may be most at risk, even if there are no actual sales, due to their supply sensitivity. The ABX 2006-2 AAA index dropped by ~$12 points during the Maiden Lane II sale, while European banks hold subprime and alt-A RMBS with ~$50bn of total carrying value.



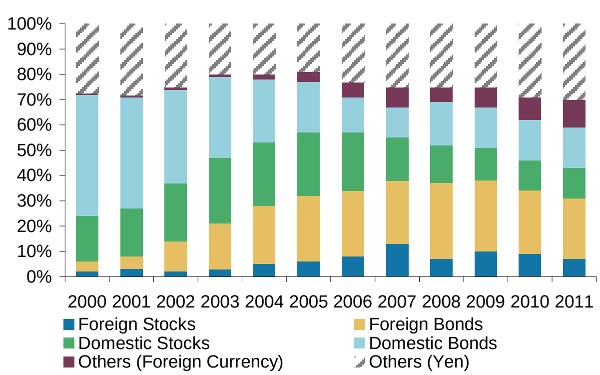
Source: Mark-It, Federal Reserve of New York, Morgan Stanley Research

Securitized Market Insights: European Bank Deleveraging: Implications for Securitized Products, November 14

Asset Managers

Bruce Hamilton

As investors search for yield in a low-return world, EM/global debt allocations are likely to increase by >50% over ~3 years. Due to the low rates/returns in DM, investors will likely turn to (i) international, (ii) real asset, and (iii) income product. Japan saw a 6x rise in foreign debt allocations in the decade ended 2010, which may be instructive for Western markets in future years. Multi-asset and absolute return will provide the best opportunities, in our view, as benchmark-relative product takes a second seat to outcome-oriented product. As investor/regulator scrutiny reduces interest in synthetics, we also expect a rotation towards physical product.



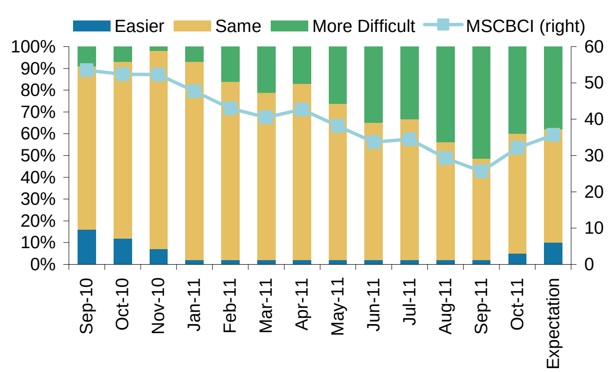
Source: Bank of Japan, Investment Trust Association, Morgan Stanley Research

Global Asset Managers: How asset managers grow in a low return world, November 14

China Economics

Helen Qiao

China should follow a path of steady and moderate growth, in our view. China's economy will likely grow below its underlying trend in the months to come, but ongoing policy un-tightening and targeted easing should provide some countervailing support. The MS China Business Conditions Indices largely stabilized in October while inflation continues to ease and credit conditions improved. The latter improvement reflects the State Council's package of measures to help small companies in response to a liquidity crunch in SMEs, and we expect credit conditions to gradually improve.



Source: AlphaWise, Morgan Stanley Research

Greater China Economics: Issues in Focus, November 15

Disclosure Section

The information and opinions in Morgan Stanley Research were prepared or are disseminated by Morgan Stanley & Co. LLC and/or Morgan Stanley C.T.V.M. S.A. and/or Morgan Stanley Mexico, Casa de Bolsa, S.A. de C.V. and/or Morgan Stanley & Co. International plc and/or RMB Morgan Stanley (Proprietary) Limited and/or Morgan Stanley MUFG Securities Co., Ltd. and/or Morgan Stanley Capital Group Japan Co., Ltd. and/or Morgan Stanley Asia Limited and/or Morgan Stanley Asia (Singapore) Pte. (Registration number 199206298Z) and/or Morgan Stanley Asia (Singapore) Securities Pte Ltd (Registration number 200008434H), regulated by the Monetary Authority of Singapore (which accepts legal responsibility for its contents and should be contacted with respect to any matters arising from, or in connection with, Morgan Stanley Research) and/or Morgan Stanley Taiwan Limited and/or Morgan Stanley & Co International plc, Seoul Branch, and/or Morgan Stanley Australia Limited (A.B.N. 67 003 734 576, holder of Australian financial services license No. 233742, which accepts responsibility for its contents), and/or Morgan Stanley Smith Barney Australia Pty Ltd (A.B.N. 19 009 145 555, holder of Australian financial services license No. 240813, which accepts responsibility for its contents), and/or Morgan Stanley India Company Private Limited and their affiliates (collectively, "Morgan Stanley").
For important disclosures, stock price charts and equity rating histories regarding companies that are the subject of this report, please see the Morgan Stanley Research Disclosure Website at www.morganstanley.com/researchdisclosures, or contact your investment representative or Morgan Stanley Research at 1585 Broadway, (Attention: Research Management), New York, NY, 10036 USA.
For valuation methodology and risks associated with any price targets referenced in this research report, please email morganstanley.research@morganstanley.com with a request for valuation methodology and risks on a particular stock or contact your investment representative or Morgan Stanley Research at 1585 Broadway, (Attention: Research Management), New York, NY 10036 USA.

Analyst Certification

The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report: Greg Peters, Neil McLeish, Gerard Minack, Jason Draho.
Unless otherwise stated, the individuals listed on the cover page of this report are research analysts.

Global Research Conflict Management Policy

Morgan Stanley Research has been published in accordance with our conflict management policy, which is available at www.morganstanley.com/institutional/research/conflictpolicies.

Important US Regulatory Disclosures on Subject Companies

The equity research analysts or strategists principally responsible for the preparation of Morgan Stanley Research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors, firm revenues and overall investment banking revenues.
Morgan Stanley and its affiliates do business that relates to companies/instruments covered in Morgan Stanley Research, including market making, providing liquidity and specialized trading, risk arbitrage and other proprietary trading, fund management, commercial banking, extension of credit, investment services and investment banking. Morgan Stanley sells to and buys from customers the securities/instruments of companies covered in Morgan Stanley Research on a principal basis. Morgan Stanley may have a position in the debt of the Company or instruments discussed in this report.
Certain disclosures listed above are also for compliance with applicable regulations in non-US jurisdictions.

STOCK RATINGS

Morgan Stanley uses a relative rating system using terms such as Overweight, Equal-weight, Not-Rated or Underweight (see definitions below). Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, Not-Rated and Underweight are not the equivalent of buy, hold and sell. Investors should carefully read the definitions of all ratings used in Morgan Stanley Research. In addition, since Morgan Stanley Research contains more complete information concerning the analyst's views, investors should carefully read Morgan Stanley Research, in its entirety, and not infer the contents from the rating alone. In any case, ratings (or research) should not be used or relied upon as investment advice. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations.

Global Stock Ratings Distribution

(as of October 31, 2011)

For disclosure purposes only (in accordance with NASD and NYSE requirements), we include the category headings of Buy, Hold, and Sell alongside our ratings of Overweight, Equal-weight, Not-Rated and Underweight. Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, Not-Rated and Underweight are not the equivalent of buy, hold, and sell but represent recommended relative weightings (see definitions below). To satisfy regulatory requirements, we correspond Overweight, our most positive stock rating, with a buy recommendation; we correspond Equal-weight and Not-Rated to hold and Underweight to sell recommendations, respectively.

	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	**1126**	**40%**	**449**	**44%**	**40%**
Equal-weight/Hold	**1176**	**42%**	**431**	**42%**	**37%**
Not-Rated/Hold	**108**	**4%**	**23**	**2%**	**21%**
Underweight/Sell	**418**	**15%**	**115**	**11%**	**28%**
Total	**2,828**		**1018**		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.
Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.
Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.
.

Important Disclosures for Morgan Stanley Smith Barney LLC Customers

Citi Investment Research & Analysis (CIRA) research reports may be available about the companies or topics that are the subject of Morgan Stanley Research. Ask your Financial Advisor or use Research Center to view any available CIRA research reports in addition to Morgan Stanley research reports.

Important disclosures regarding the relationship between the companies that are the subject of Morgan Stanley Research and Morgan Stanley Smith Barney LLC, Morgan Stanley and Citigroup Global Markets Inc. or any of their affiliates, are available on the Morgan Stanley Smith Barney disclosure website at www.morganstanleysmithbarney.com/researchdisclosures.

For Morgan Stanley and Citigroup Global Markets, Inc. specific disclosures, you may refer to www.morganstanley.com/researchdisclosures and https://www.citigroupgeo.com/geopublic/Disclosures/index_a.html.

Each Morgan Stanley Equity Research report is reviewed and approved on behalf of Morgan Stanley Smith Barney LLC. This review and approval is conducted by the same person who reviews the Equity Research report on behalf of Morgan Stanley. This could create a conflict of interest.

Other Important Disclosures

Morgan Stanley is not acting as a municipal advisor and the opinions or views contained herein are not intended to be, and do not constitute, advice within the meaning of Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Morgan Stanley produces an equity research product called a "Tactical Idea." Views contained in a "Tactical Idea" on a particular stock may be contrary to the recommendations or views expressed in research on the same stock. This may be the result of differing time horizons, methodologies, market events, or other factors. For all research available on a particular stock, please contact your sales representative or go to Client Link at www.morganstanley.com.

Morgan Stanley Research does not provide individually tailored investment advice. Morgan Stanley Research has been prepared without regard to the circumstances and objectives of those who receive it. Morgan Stanley recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. The appropriateness of an investment or strategy will depend on an investor's circumstances and objectives. The securities, instruments, or strategies discussed in Morgan Stanley Research may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them. Morgan Stanley Research is not an offer to buy or sell any security/instrument or to participate in any trading strategy. The value of and income from your investments may vary because of changes in interest rates, foreign exchange rates, default rates, prepayment rates, securities/instruments prices, market indexes, operational or financial conditions of companies or other factors. There may be time limitations on the exercise of options or other rights in securities/instruments transactions. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. If provided, and unless otherwise stated, the closing price on the cover page is that of the primary exchange for the subject company's securities/instruments.

The fixed income research analysts, strategists or economists principally responsible for the preparation of Morgan Stanley Research have received compensation based upon various factors, including quality, accuracy and value of research, firm profitability or revenues (which include fixed income trading and capital markets profitability or revenues), client feedback and competitive factors. Fixed Income Research analysts', strategists' or economists' compensation is not linked to investment banking or capital markets transactions performed by Morgan Stanley or the profitability or revenues of particular trading desks.

Morgan Stanley Research is not an offer to buy or sell or the solicitation of an offer to buy or sell any security/instrument or to participate in any particular trading strategy. The "Important US Regulatory Disclosures on Subject Companies" section in Morgan Stanley Research lists all companies mentioned where Morgan Stanley owns 1% or more of a class of common equity securities of the companies. For all other companies mentioned in Morgan Stanley Research, Morgan Stanley may have an investment of less than 1% in securities/instruments or derivatives of securities/instruments of companies and may trade them in ways different from those discussed in Morgan Stanley Research. Employees of Morgan Stanley not involved in the preparation of Morgan Stanley Research may have investments in securities/instruments or derivatives of securities/instruments of companies mentioned and may trade them in ways different from those discussed in Morgan Stanley Research. Derivatives may be issued by Morgan Stanley or associated persons.

With the exception of information regarding Morgan Stanley, Morgan Stanley Research is based on public information. Morgan Stanley makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. We have no obligation to tell you when opinions or information in Morgan Stanley Research change apart from when we intend to discontinue equity research coverage of a subject company. Facts and views presented in Morgan Stanley Research have not been reviewed by, and may not reflect information known to, professionals in other Morgan Stanley business areas, including investment banking personnel.

Morgan Stanley Research personnel may participate in company events such as site visits and are generally prohibited from accepting payment by the company of associated expenses unless pre-approved by authorized members of Research management.

Morgan Stanley may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

To our readers in Taiwan: Information on securities/instruments that trade in Taiwan is distributed by Morgan Stanley Taiwan Limited ("MSTL"). Such information is for your reference only. Information on any securities/instruments issued by a company owned by the government of or incorporated in the PRC and listed in on the Stock Exchange of Hong Kong ("SEHK"), namely the H-shares, including the component company stocks of the Stock Exchange of Hong Kong ("SEHK")'s Hang Seng China Enterprise Index is distributed only to Taiwan Securities Investment Trust Enterprises ("SITE"). The reader should independently evaluate the investment risks and is solely responsible for their investment decisions. Morgan Stanley Research may not be distributed to the public media or quoted or used by the public media without the express written consent of Morgan Stanley. To our readers in Hong Kong: Information is distributed in Hong Kong by and on behalf of, and is attributable to, Morgan Stanley Asia Limited as part of its regulated activities in Hong Kong. If you have any queries concerning Morgan Stanley Research, please contact our Hong Kong sales representatives. Information on securities/instruments that do not trade in Taiwan is for informational purposes only and is not to be construed as a recommendation or a solicitation to trade in such securities/instruments. MSTL may not execute transactions for clients in these securities/instruments.

Morgan Stanley is not incorporated under PRC law and the research in relation to this report is conducted outside the PRC. Morgan Stanley Research does not constitute an offer to sell or the solicitation of an offer to buy any securities in the PRC. PRC investors shall have the relevant qualifications to invest in such securities and shall be responsible for obtaining all relevant approvals, licenses, verifications and/or registrations from the relevant governmental authorities themselves.

Morgan Stanley Research is disseminated in Brazil by Morgan Stanley C.T.V.M. S.A.; in Japan by Morgan Stanley MUFG Securities Co., Ltd. and, for Commodities related research reports only, Morgan Stanley Capital Group Japan Co., Ltd; in Hong Kong by Morgan Stanley Asia Limited (which accepts responsibility for its contents); in Singapore by Morgan Stanley Asia (Singapore) Pte. (Registration number 199206298Z) and/or Morgan Stanley Asia (Singapore) Securities Pte Ltd (Registration number 200008434H), regulated by the Monetary Authority of Singapore (which accepts legal responsibility for its contents and should be contacted with respect to any matters arising from, or in connection with, Morgan Stanley Research); in Australia to "wholesale clients" within the meaning of the Australian Corporations Act by Morgan Stanley Australia Limited A.B.N. 67 003 734 576, holder of Australian financial services license No. 233742, which accepts responsibility for its contents; in Australia to "wholesale clients" and "retail clients" within the meaning of the Australian Corporations Act by Morgan Stanley Smith Barney Australia Pty Ltd (A.B.N. 19 009 145 555, holder of Australian financial services license No. 240813, which accepts responsibility for its contents; in Korea by Morgan Stanley & Co International plc, Seoul Branch; in India by Morgan Stanley India Company Private Limited; in Canada by Morgan Stanley Canada Limited, which has approved of and takes responsibility for its contents in Canada; in Germany by Morgan Stanley Bank AG, Frankfurt am Main and Morgan Stanley Private Wealth Management Limited, Niederlassung Deutschland, regulated by Bundesanstalt fuer Finanzdienstleistungsaufsicht (BaFin); in Spain by Morgan Stanley, S.V., S.A., a Morgan Stanley group company, which is supervised by the Spanish Securities Markets Commission (CNMV) and states that Morgan Stanley Research has been written and distributed in accordance with the rules of conduct applicable to financial research as established under Spanish regulations; in the US by Morgan Stanley & Co. LLC, which accepts responsibility for its contents. Morgan Stanley & Co. International plc, authorized and regulated by the Financial Services Authority, disseminates in the UK research that it has prepared, and approves solely for the purposes of section 21 of the Financial Services and Markets Act 2000, research which has been prepared by any of its affiliates. Morgan Stanley Private Wealth Management Limited, authorized and regulated by the Financial Services Authority, also disseminates Morgan Stanley Research in the UK. Private UK investors should obtain the advice of their Morgan Stanley & Co. International plc or Morgan Stanley Private Wealth Management representative about the investments concerned. RMB Morgan Stanley (Proprietary) Limited is a member of the JSE Limited and regulated by the Financial Services Board in South Africa. RMB Morgan Stanley (Proprietary) Limited is a joint venture owned equally by Morgan Stanley International Holdings Inc. and RMB Investment Advisory (Proprietary) Limited, which is wholly owned by FirstRand Limited.

The information in Morgan Stanley Research is being communicated by Morgan Stanley & Co. International plc (DIFC Branch), regulated by the Dubai Financial Services Authority (the DFSA), and is directed at Professional Clients only, as defined by the DFSA. The financial products or financial services to which this research relates will only be made available to a customer who we are satisfied meets the regulatory criteria to be a Professional Client.

The information in Morgan Stanley Research is being communicated by Morgan Stanley & Co. International plc (QFC Branch), regulated by the Qatar Financial Centre Regulatory Authority (the QFCRA), and is directed at business customers and market counterparties only and is not intended for Retail Customers as defined by the QFCRA.

As required by the Capital Markets Board of Turkey, investment information, comments and recommendations stated here, are not within the scope of investment advisory activity. Investment advisory service is provided in accordance with a contract of engagement on investment advisory concluded between brokerage houses, portfolio management companies, non-deposit banks and clients. Comments and recommendations stated here rely on the individual opinions of the ones providing these comments and recommendations. These opinions may not fit to your financial status, risk and return preferences. For this reason, to make an investment decision by relying solely to this information stated here may not bring about outcomes that fit your expectations.

The trademarks and service marks contained in Morgan Stanley Research are the property of their respective owners. Third-party data providers make no warranties or representations relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages relating to such data. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and S&P. Morgan Stanley bases projections, opinions, forecasts and trading strategies regarding the MSCI Country Index Series solely on public information. MSCI has not reviewed, approved or endorsed these projections, opinions, forecasts and trading strategies. Morgan Stanley has no influence on or control over MSCI's index compilation decisions. Morgan Stanley Research or portions of it may not be reprinted, sold or redistributed without the written consent of Morgan Stanley. Morgan Stanley research is disseminated and available primarily electronically, and, in some cases, in printed form. Additional information on recommended securities/instruments is available on request.

Morgan Stanley Research, or any portion thereof may not be reprinted, sold or redistributed without the written consent of Morgan Stanley.

Morgan Stanley Research is disseminated and available primarily electronically, and, in some cases, in printed form.

Additional information on recommended securities/instruments is available on request.

11-17-11 po

The Americas
1585 Broadway
New York, NY 10036-8293
United States
Tel: +1 (1)212 761 4000

Europe
20 Bank Street, Canary Wharf
London E14 4AD
United Kingdom
Tel: +44 (0) 20 7 425 8000

Japan
4-20-3 Ebisu, Shibuya-ku
Tokyo 150-6008
Japan
Tel: +81 (0)3 5424 5000

Asia/Pacific
1 Austin Road West
Kowloon
Hong Kong
Tel: +852 2848 5200