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Strategy: Euroletter

Bear Market Is Not Over: Selling Today

We are selling equities from neutral to underweight. We continue to prefer cash over equities as we have done throughout most of this bear market, and we continue to prefer earnings stability, strong balance sheets and low valuations. After the recent strength in equities, with European equities up 17% and the S&P 500 up 25% from their troughs, we now move 5% out of equities into bonds. Thus, our new asset allocation is +5% OW cash, neutral bonds, -5% UW equities.

The bear market is not over. Our three signposts to identify the end of the bear market do not flash green. We wish to wait for fundamentals to be close to trough before turning more bullish. The three fundamentals we look at are: 1) earnings; 2) US housing; and 3) banks' balance sheets. Our three preferred measures are: 1) reported ROE ex Financials below its long-run average of 12.8% (latest 17.4%); 2) inventories of unsold homes below 8 months of sales (latest 12 months); and 3) senior loan officer (SLO) survey better than -20% of SLOs tightening lending standards (latest -64%).

Other reasons to sell. After the biggest valuation overshoot ever, in 2000, we have not had a meaningful valuation undershoot. Sentiment has turned more positive, with AAII bulls minus bears turning positive and the most bullish futures positioning on the NASDAQ in over three years. Weekly unemployment claims have continued to rise. Some fixed income markets have fallen to new lows even recently: RPX futures market for US house prices and the subprime ABX market.

Where could we be wrong? Our move today could easily be too early as the rally could continue for positioning and 'second derivative' reasons. In addition, if policy action is successful in repairing banks' balance sheets and putting a floor under house prices, the next bull market may have already started. Two of our signposts – the SLO survey and inventories of unsold homes – would tell us at some point that we have missed the turn and we should stop being bearish.

Bear Market Is Not Over: Selling Into Strength

It's decision time. There are some signs of economic stabilization, possibly even signs of the next bull market: commodity prices (Dr Copper), second-hand car sales, improvement in some leading indicators (Dr KOSPI, ISM new orders, China PMI), uninvested cash, bearish sentiment, very strong global policy action. As a result, equities have already rallied since March 9, and seem to be drawing more investors in. Now we have to decide whether this is towards the *end* of another bear market rally that we should sell into now that hope has grown, or the *start* of a much larger advance, maybe even a new bull market. Our decision is to sell into strength now.

We are selling into strength. We continue to prefer cash over equities as we have done throughout most of this bear market, and we continue to prefer earnings stability, strong balance sheets and low valuations. After the recent strength in equities, with European equities up 17% and the S&P 500 up 25% from their troughs, we now move a further 5% out of equities, into bonds this time, because we think bonds will do well as a result of Quantitative Easing as well as debt-deflation considerations. Thus, our new asset allocation is +5% OW cash, neutral bonds, -5% UW equities.

1) Fundamentals are not turning. Our three signposts to identify the end of the bear market do not flash green. Our mantra continues to be patience, as we believe that the market is less forward looking in bigger crises. See also *"Japan" Until Further Notice*, 9 March 2009. We wish to wait for fundamentals to be close to trough before turning more bullish. The three fundamentals we look at are: 1) earnings; 2) US housing; and 3) banks' balance sheets. Our three preferred measures to judge this are: 1) reported ROE ex Financials below its long-run average of 12.8% (latest 17.4%); 2) inventories of unsold homes below 8 months (latest 12 months); and 3) senior loan officer (SLO) survey better than -20% of SLO's tightening lending standards (latest -64%).

Take for instance housing activity. Some of the recent numbers have shown some signs of life, and the policy actions taken are impressive, leading to lower mortgage rates and high affordability. However, our analysis suggests that housing does not turn on affordability, especially not when negative equity is widespread. We expect further weakness, as does the futures market for the Case-Shiller index, which, like us, expects US house prices to trough by the middle of 2010, 50% lower from its peak on that index. The three main worries we have are the following. First, US house prices have never bottomed while unemployment is still rising: our US economists expect the unemployment rate to peak at 9.9% in 1Q10.

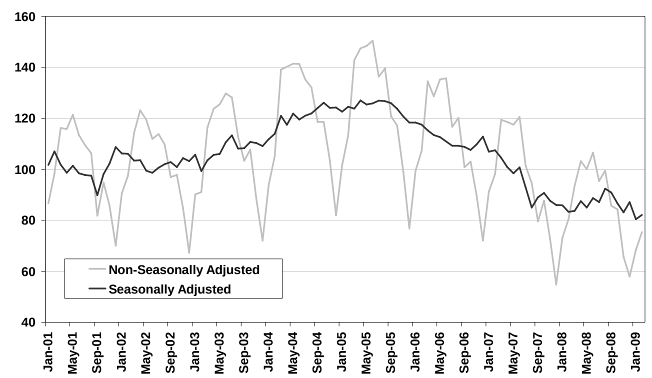
Second, in the 12 house price recessions since 1890 in the US (in real terms), the average duration was three and a half years, versus barely two and a half years of falling prices now. Given that the 2006 US house bubble was the biggest ever, we think the house price recession should be at least average in duration. Third, the inventories of unsold homes (which does not account for foreclosures which may add up to 4 months of sales to the numerator) is too high still, at 12 months of sales for new single-family homes, and 9 months of sales for existing ones. For more detail see *Stay Cautious As US House Prices Will Not Bottom Until Mid-2010*, 12 January 2009.

Other elements of recent improved newsflow. Increased funding for the IMF is a genuine positive. Yes, some leading indicators, such as the important ISM new orders, have increased recently, but we do not believe that is what matters at the moment, nor do we believe that they will continue to rise. We think the recent apparent trough in leading indicators is similar to the Jan-01 and Oct-01 troughs, which did not mark the turn in equities. See also *The Delusional Second Derivative*, 2 February 2009. Our US economist Dick Berner has written about how he does not expect a lasting turn in the consumer data in *Perfect Consumer Storm Not Over*, 31 March 2009 as sinking income, home and equity prices and still-tight credit imply anaemic spending growth for now. Indeed, weekly unemployment claims have continued to increase, recently, and the only notable surprise in the terrible payroll number from last week was a light dip in the average workweek, which is considered to be a leading indicator of labour demand. This does not augur well for a turnaround in employment growth anytime soon.

Our European Banks analyst, Huw van Steenis, believes suspending mark-to-market could have made a big difference last year in relation to securities on banks' balance sheets, but is not a game changer now. European accounting rules (IAS 39) already allowed for this under some circumstances, and suspending mark-to-market does not extend to loan portfolios, which make up ~60% of banks' balance sheets and will deteriorate along with the nascent NPL cycle. This is particularly true in the US where it is now the loan books where we have concerns. However, it could be helpful at the margin given continuing declines in CMBS and CLOs in Q1, which could adversely hit some large cap banks. We also think that some banks will keep on marking-to-market regardless, as they wish to keep transparency and confidence in their balance sheets (e.g. Credit Suisse has so far not used IAS 39 and is one of the highest valued banks today).

Exhibit 1

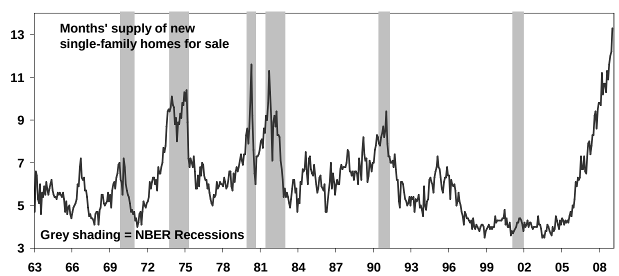
We are not particularly impressed by this improvement - US pending home sales



Source: National Association of Realtors, Morgan Stanley Research

Exhibit 2

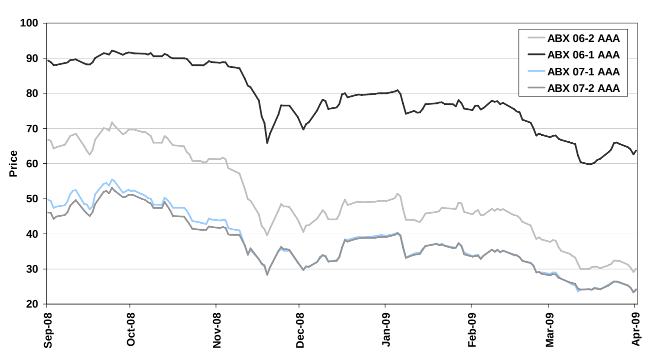
Still too large an overhang of unsold properties in US



Source: Consensus Bureau, Morgan Stanley Research

Exhibit 3

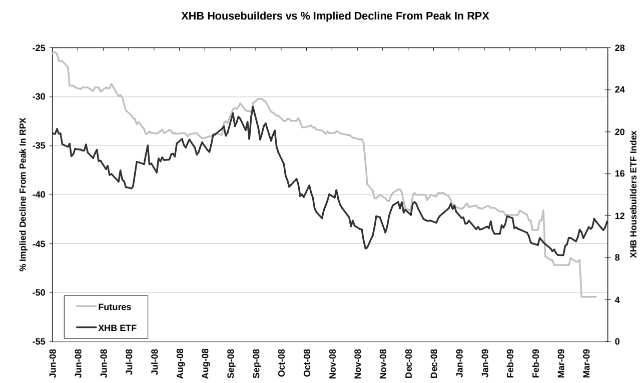
This could be a worrying sign – ABX Indices made new lows



Source: MS Quotient, Morgan Stanley Research

Exhibit 4

The RPX Futures Market (percentage implied decline from peak in US house prices) has deteriorated further recently



Note: XHB ETF is the Housebuilders Index in the US.
Source: Bloomberg, RPX, Morgan Stanley Research

Exhibit 5

The average past duration of US house prices falls has been 43 months, versus only 28 months so Far

Dates (Mths)		%Change in Real House Prices			Duration (Mths)	
Peak	Trough	Last Trough to Peak	Peak to Trough	1yr from Trough	Last Trough to Peak	Peak to Trough
1894.12	1895.12	39.4	-17.9	4.7	48	12
1897.12	1900.12	9.9	-29.7	15.1	24	36
1903.12	1904.12	17.2	-14.3	16.0	36	12
1906.12	1909.12	19.7	-17.6	4.2	24	36
1911.12	1920.12	10.4	-33.3	7.9	24	108
1924.12	1931.12	15.5	-14.5	6.3	48	84
1939.12	1941.12	23.0	-12.4	2.2	96	24
1946.12	1948.12	64.5	-13.0	3.6	60	24
1956.12	1963.12	13.5	-7.7	2.4	96	84
1973.06	1975.03	7.9	-7.3	1.8	114	21
1979.06	1982.12	15.7	-13.5	0.7	51	42
1989.12	1993.03	16.0	-6.8	1.3	84	39
2006.11	**2009.01**	**50.6**	**-12.8**	**-**	**164**	**26**
Median		**15.8**	**-13.9**	**3.9**	**49**	**36**
Average		**21.0**	**-15.7**	**5.5**	**59**	**43**

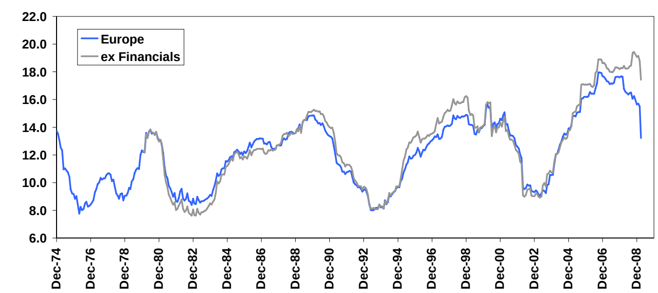
Note: House price correction defined as real prices falling by 10%+ during any time period, or real prices falling by more than 12 months. Real house prices measured by Shiller's house price data, CMHPI (Purchase+Refiance, NSA) & FHFA HPI (Purchase-only, SA), deflated by US headline CPI. Nominal rent time series calculated based on CPI-U shelter index, and a point estimate of median gross rent of $602 per month, as per 2000 Census. Nominal house price time series calculated using a hybrid house price index based on Shiller data, CMHPI & FHFA HPI, and a point estimate of house price of $20,900 in Dec68, as per NAR median house prices. Source: Shiller, Freddie Mac, OFEHO, Census Bureau, NAR, BLS, Haver, Morgan Stanley Research

2) A normal bear market rally, certainly painful but not unusual. We are currently in one of those classical 20%+ bear market rallies on the hopes of successful policy action. For instance, in the US between 1930 and 1932, there were five 20%+ such rallies (up to 35%) lasting 35 days on average. We hear people use adjectives such as biggest, strongest, fastest and other superlatives to describe this rally. We believe this is quite a normal bear market rally. What would be more painful is a 6 or even 12 month move of over 50% as happened a few times in Japan. The current one has so far been 25 calendar days, and 25% in the US, 17% in Europe. Anyway, with the S&P at 843 closing in on its 150-day moving average of 900 (200-day moving average of 992) we feel the risk-reward of further upside is not compelling.

3) Sentiment: the greater fool theory. Sentiment has turned more optimistic witnessed by AAII, NASDAQ net futures positioning, skew and conversations we have with investors. We believe that the way market participants are approaching this rally and its potential to go further is akin to the greater fool theory, stating that a benchmark chase may develop as investors are drawn into the rally. We do not wish to invest on that basis. We could be wrong on fundamentals, that is quite possible, but we would not like to be rightly bearish on fundamentals and yet be a buyer because of this kind of thinking.

We note that selling a bit as soon as bulls outnumber bears in the weekly AAII survey has been a successful strategy in this bear market, and that is what we are doing. The 3-week moving average of AAII is now +3. The skew (which compares the price of a 10% out-of-the-money put option to the equivalent call option) is very low suggesting surprisingly little demand for protection. The net futures positioning on the NASDAQ, which we take as a contrarian indicator for European equities, is the most bullish in over three years at 1.4 standard deviations long. After such readings the market has been down in about two-thirds of observations in the next 6 months. We also note that several smart colleagues and investors believe it is too early to sell today – who would have thought 4 weeks ago that selling today after such a market move would be out-of-consensus?

Exhibit 6
MSCI Europe Return on Equity % for the market ex Financials is still close to a peak



Source: MSCI, Datastream, Morgan Stanley Research

4) No valuation undershoot yet. Valuations were some 23% below our estimate of fair value on March 9, but after the rally there is only 10% upside to our estimate of fair value. And we believe fair value is unlikely to be reached anytime soon given weak fundamentals, while there is at least 33% downside to levels of 7x Shiller PE (inflation-adjusted, latest number 10.4) at which we would start to consider buying based on valuations alone. The latest US Shiller PE (inflation-adjusted) of 14.5 is also >30% above single-digit levels that has been seen many times, and >60% above the trough of 5x, which has been sometimes at the end of big bear markets. We have not seen the customary undershoot in valuations yet, following the biggest overshoot ever in equity valuations in 2000. See *Valuations Are Not Cheap Enough To Ignore Fundamentals,* 30 March 2009.

5) Worrying signs from credit markets. Credit markets have been lagging in this rally, which has been very much equity-led. The futures market of house prices in the US, the RPX index, has continued to fall in recent weeks, indicating a lower trough despite the policy initiatives. Our US economists point out that what had been only a meager rebound in the subprime ABX

Exhibit 7
MSCI Europe ROE % – The recession for the market ex financials has only just started

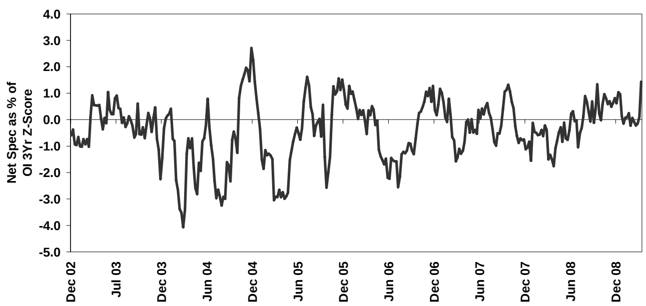
	ROE %									Downside To Earnings Assuming Average Trough ROE %	IBES Consensus EPS Growth 2009 %	Potential Further Downgrades %
	Last 3Y Peak			Full History	Average	IBES Consensus		MS Modelware				
	Level	Date	Latest	Average	Trough	2009e	2010e	2009e	2010e			
MSCI Europe	**18.0**	**Sep-06**	**13.2**	**12.2**	**8.5**	**10.7**	**11.9**	**8.9**	**10.2**	**-36**	**-12**	**-24**
MSCI Europe ex Financials	19.4	Nov-08	17.4	12.8	8.2	12.6	13.6	10.2	11.2	-53	-22	-31
Consumer Discretionary	17.2	Dec-08	13.3	13.5	4.9	7.6	9.5	3.7	4.4	-63	-37	-26
Consumer Staples	21.8	Feb-09	21.4	17.2	13.0	16.1	16.2	16.1	16.8	-39	-2	-37
Energy	27.3	Oct-06	21.7	14.6	7.1	13.5	15.8	10.6	13.5	-67	-39	-28
Financials	16.7	Jan-08	6.4	12.4	9.1	6.8	8.2	6.0	7.9	43	61	-17
Health Care	24.1	Oct-06	20.7	18.0	13.7	19.4	19.2	13.4	13.4	-34	10	-44
Industrials	19.0	Sep-08	15.4	11.1	6.8	11.6	11.8	10.3	10.8	-56	-16	-40
Information Technology	18.4	Nov-06	12.4	13.1	3.3	10.6	14.1	9.0	11.8	-73	-34	-39
Materials	19.9	Jan-08	19.2	12.9	7.0	9.1	10.7	7.6	9.6	-64	-49	-14
Telecommunication Services	15.1	Dec-08	14.8	9.9	3.2	14.8	15.2	9.9	10.0	-79	3	-81
Utilities	17.7	Jan-08	12.7	11.4	8.7	13.7	13.8	12.0	11.6	-31	2	-33

Source: MSCI, IBES, Modelware, Worldscope, Datastream, Morgan Stanley Research

Exhibit 8

Indication of more bullish sentiment: highest net long in over 3 years

CFTC Net Futures on the Nasdaq



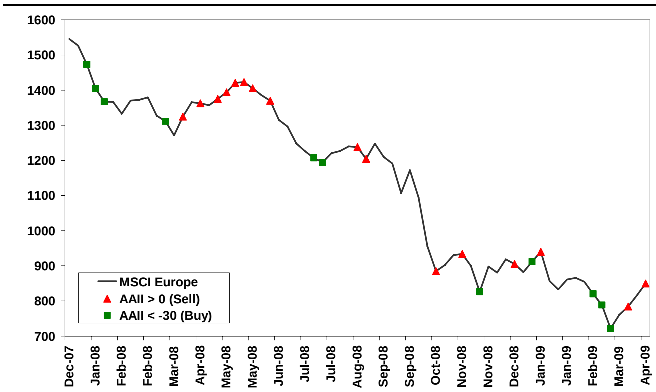
Backtest Results - Next 6M Performance in MSCI Europe

	<-2	<-1.5	<-1	<0	>0	>+1	>+1.5	>+2.0	Avg. Period
Avg 6M Perf %	+7.7	+9.4	+9.9	+6.6	-3.9	-3.7	-4.2	-2.6	+4.6
Hit Ratio %	89	87	91	79	38	38	33	33	66

Source: CFTC, Datastream, Morgan Stanley Research

Exhibit 9

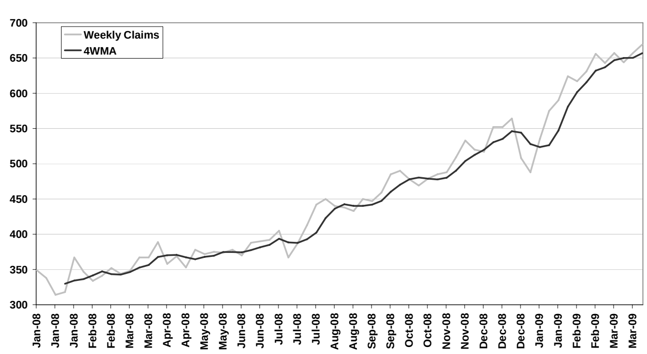
AAII>0 now: bear market rally nearing its end?



Source: AAII, Morgan Stanley Quantitative & Derivative Strategy, Morgan Stanley Research

Exhibit 10

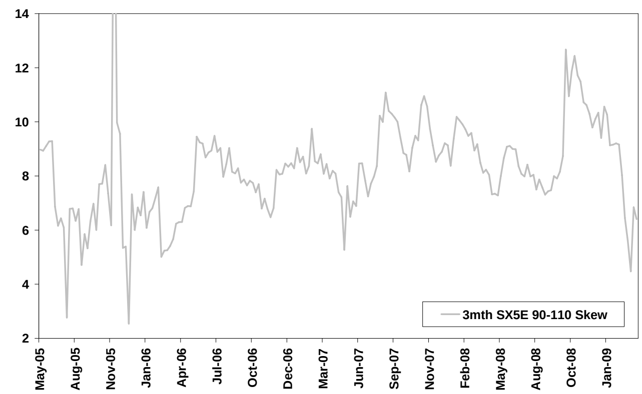
What second derivative improvement? – us unemployment initial claims (000s)



Source: Weekly Claims Report, Department of Labour, Morgan Stanley Research

Exhibit 11

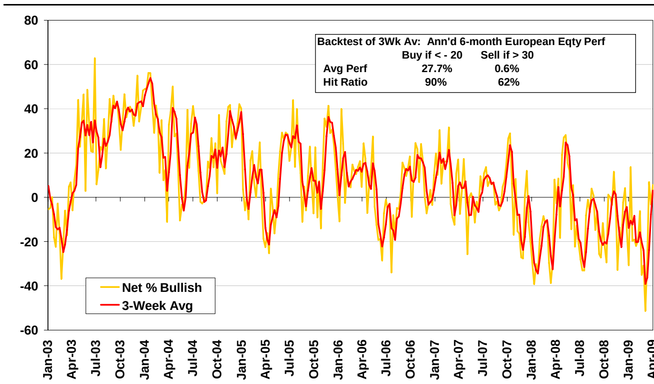
SX5E skew is low: bearish signal



Source: Bloomberg, Morgan Stanley Research

Exhibit 12

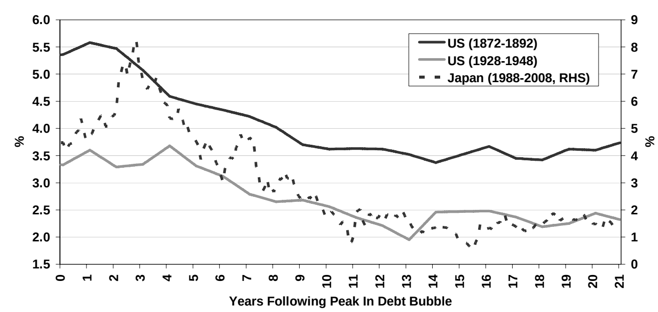
AAII Survey – net % of respondents that are bullish



Source: AAII, Datastream, Morgan Stanley Research

Exhibit 13

Bond yields reached their low point >10 years after the crisis started in 3 examples of debt-deflation periods. Long-term interest rates during debt deflations



Source Global Financial Data, Shiller, Federal Reserve, Datastream, Hoisington, Morgan Stanley Research market following the Treasury's legacy asset purchase plan announcement has now reversed all the way to new lows. They also point out that the AAA index in the commercial mortgage CMBX market has now widened to 637 bp from the recent lowest spread of 525 bp hit last Thursday, moving about halfway back to the 747 bp close on March 20. Sentiment was certainly not helped by the foreclosure auction of the John Hancock Tower in Boston last week for $600 million, compared to a $1.3 billion transaction for the same building in late 2006. We also observe the failed government bond auctions in the UK and the US last week, as well as the negative short-term t-bill reading – although our fixed income specialists urge us to not read too much into these.

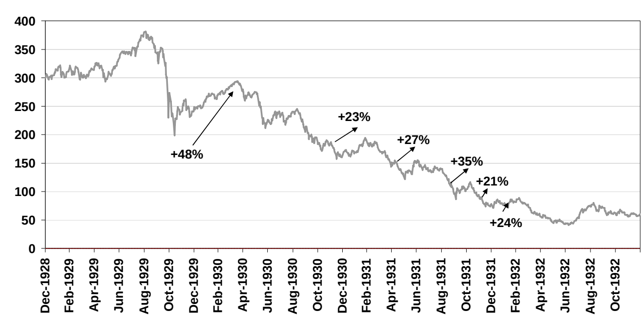
Where could we be wrong? Our move today could easily be a few weeks or even months too early. In addition, if policy action is successful in repairing banks' balance sheets and putting a floor under house prices, the next bull market may have already started. Given the problems and the corresponding policy actions are unprecedented in scope and size, we keep an open mind regarding policy initiatives, and we reassess every day whether successful policy action is possible. Two of our signposts – the SLO survey and inventories of unsold homes – would tell us at some point that we have missed the turn and we should stop being bearish. We could also be right on the fundamentals but too early in exiting the rally. Near-term triggers include: reporting season; US banks' stress test; PPIP implementation; possible industrial bankruptcies, housing data rolling over again, continuously weak unemployment data (the weekly claims, the best coincident indicator of economic growth, have continued to deteriorate).

European Model Portfolio: sector and stock changes. Sectorwise we continue to be 7% OW Defensives (mainly Telcos), 3% UW Cyclicals (mainly Industrials), 4% UW Financials. Stockwise, we switch Thomas Cook into TUI Travel as per Jamie Rollo's recent recommendation. See his *Tour Operators: Switching Thomas Cook into TUI Travel* from 31 March, 2009.

Some popular notions we would caution against. Finally, here are some popular notions we hear from some investors and that we think are not useful approaches at this stage. We would NOT...

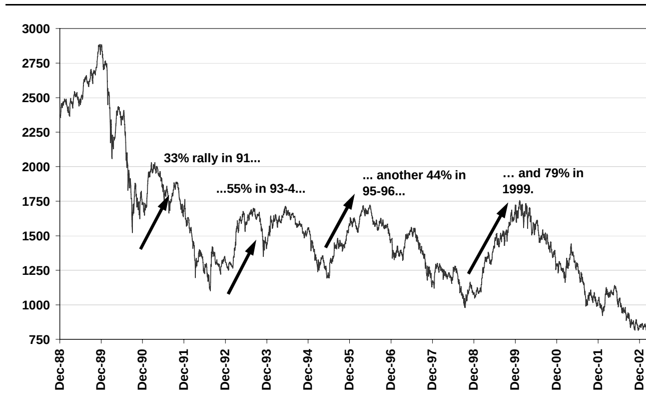
- … expect inflation anytime soon. Our stance is that growth should come back first, then inflation may follow a few quarters later. See *Deflation Scare To Persist For Now*, 26 January 2009.
- … try to assess fair value of markets by putting a multiple on trough earnings. For all we know earnings may be non-existent at the trough and the multiple infinity. The more cyclical the stock, the higher the trough multiple.
- … be bullish on the basis of liquidity and uninvested cash out there. The highest ever cash weighting in equity-only portfolios was Jan-01 and that was a bad time to turn bullish. When fundamentals turn the uninvested cash will come back to the market, and the up move will be large, but not before.
- … compare equity valuations to the level of rates. In times of deflation this is not a valid approach. For instance in Japan equities kept on falling as bond yields fell to almost 0% in 2003

Exhibit 14
Investors should have ignored bear market rallies in the Great Depression, DJIA 1929-32



Source: Dow Jones, Morgan Stanley Research

Exhibit 15
Investors could have played bear market rallies in Japan, Topix 1988-2003



Source: Tokyo Stock Exchange, Morgan Stanley Research

Exhibit 16

10.4x Europe Shiller P/E (inflation adjusted)

Note: Shiller PE = Inflation adjusted price to 10 year average EPS ratio
Source: Standard & Poor's, Shiller, MSCI, FTSE, Morgan Stanley Research

Exhibit 17

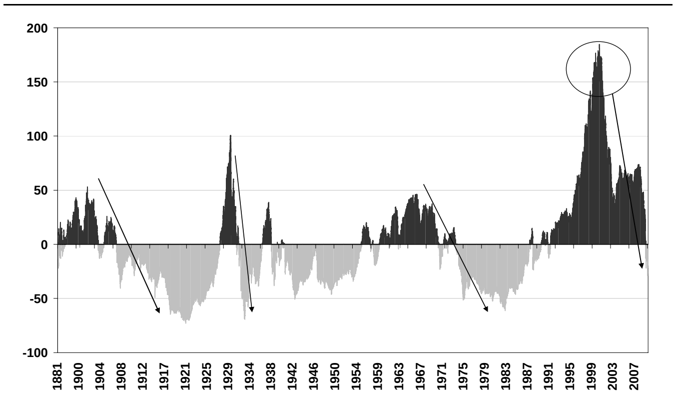
Valuation at troughs in European bear markets since 1919: often below 10x

Date of Market		Peak to Trough		Shiller PE
Peak	Trough	Duration (months)	Decline %	At Trough
16-Apr-1920	05-Jan-1922	21	-30	-
14-Oct-1929	08-Jul-1932	33	-65	-
11-Jun-1947	28-Jun-1949	25	-29	9.5
17-May-1961	07-Oct-1966	65	-34	7.9
13-Feb-1969	26-May-1970	15	-29	10.9
14-Aug-1972	02-Jan-1975	29	-47	6.6
05-Oct-1987	10-Nov-1987	1	-35	12.2
18-Jul-1990	16-Jan-1991	6	-24	11.8
20-Jul-1998	08-Oct-1998	3	-31	22.4
04-Sep-2000	12-Mar-2003	30	-58	12.9
01-Jun-2007	09-Mar-2009	21	-57	8.4
Average		23	-40	11.4
Median		21	-34	10.9

Source: MSCI, Dow Jones, Datastream, Standard & Poor's, Global Financial Data, Shiller, Morgan Stanley Research
Note: Bear market defined as minimum peak to trough fall of 20% following new all-time high in MSCI Europe price index
Pre-1979 UK Shiller PE data used as European data not available
Shiller PE defined as inflation adjusted price to 10 year average EPS

Exhibit 18

Big Undershoots Follow Big Overshoots. No Undershoot Yet. % above/below long-term average: S&P 500 Shiller PE



Note: Shiller PE = Inflation Adjusted Price to 10Y Average Reported EPS
Source: Shiller, Dow Jones, Global Financial Data, BLS, Morgan Stanley Research

Exhibit 19

14.5x US S&P Shiller P/E (inflation adjusted)

Note: Shiller PE = Inflation adjusted price to 10 year average EPS ratio
Source: Standard & Poor's, Shiller, Morgan Stanley Research

Exhibit 20

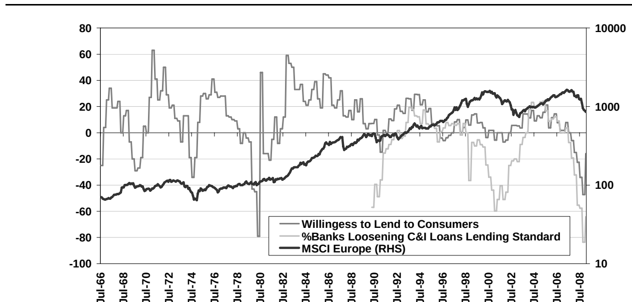
Valuation At troughs in US bear markets since 1795: often below 10x, sometimes 5x

Date of Market		Peak to Trough		Shiller PE
Peak	Trough	Duration (months)	Decline %	At Trough
Feb-1796	Sep-1798	31	-30	-
Nov-1802	Jun-1829	319	-31	-
May-1835	Oct-1857	269	-67	-
Apr-1864	Apr-1865	12	-26	-
Apr-1872	Jun-1877	62	-47	-
Jun-1881	07-Aug-1896	182	-46	14.7
05-Sep-1899	18-Dec-1899	3	-22	16.0
19-Sep-1902	09-Nov-1903	14	-35	14.4
09-Oct-1906	22-Nov-1907	13	-43	9.8
19-Nov-1909	15-Dec-1914	61	-42	8.5
21-Nov-1916	24-Aug-1921	57	-42	4.9
19-Sep-1929	08-Jul-1932	34	-86	5.1
02-Aug-1956	22-Oct-1957	15	-21	13.5
13-Dec-1961	26-Jun-1962	6	-28	15.8
09-Feb-1966	07-Oct-1966	8	-22	20.0
29-Nov-1968	26-May-1970	18	-36	13.2
05-Jan-1973	03-Oct-1974	21	-48	9.6
25-Aug-1987	04-Dec-1987	3	-34	13.7
24-Mar-2000	09-Oct-2002	31	-49	22.9
09-Oct-2007	09-Mar-2009	17	-57	11.7
Average		59	-41	12.9
Median		19	-39	13.5

Source: Dow Jones, Datastream, Standard & Poor's, Global Financial Data, Shiller, Morgan Stanley Research. Note: Bear market defined as minimum peak to trough fall of 20% following new all-time high in S&P 500 price index. In nominal terms there were actually two bear markets between 1973 an 1982, but due to high inflation during this period, we have considered them as one continuous bear market. Shiller PE defined as inflation adjusted price to 10 year average reported EPS

Exhibit 21

A sustained bull market won't start until credit conditions become significantly looser



Note: Chart shows the net percentage of US banks tightening the lending standards for commercial and industrial loans, based on the Fed Senior Loan Officer Opinion Survey.
Source: Federal Reserve Board, MSCI, Morgan Stanley Research

- … think that a valuation trough exists as long as fundamentals deteriorate. The lesson from the past is that the valuation floor is very very low indeed. Today's Shiller PE for the US is 14.5, for Europe 10.4. It has been as low as 5x in 1921 and 1932 in the US, and as low as 7x in 1975 in Europe.
- … try to guess the inventory cycle in order to determine swings in equity markets – that is just too volatile and too risky. It may lead to short-term swings, for sure.
- … be too tactical about investment positions as the bear market rallies are too short.

Exhibit 22

European Model Portfolio

OVERWEIGHTS	Benchmark Weight (%)	Portfolio Over + / Under - Weight	Portfolio Position
Telco (SXKP) KPN, Telefonica, Vodafone, Deutsche Telekom, France Telecom,	8.0	+5.0	13.0
Cons Discr (Autos SXAP & Media SXMP*) Pearson, TUI Travel, Whitbread, Carnival, SES	8.2	+3.0	11.2
Cons Staples (SX3P*) Henkel, Nestle, Diageo, Imperial Tobacco, Carrefour, British American Tobacco, Cadbury	12.2	+2.0	14.2
Tech (SX8P) SAP, Nokia	3.2	+0.0	3.2
Healthcare (SXDP) Novartis, Roche, Bayer, Sanofi	11.0	+0.0	11.0
Materials (Basic Resources SXPP & Chemicals SX4P) Rio Tinto[2], Akzo Nobel, BASF, ENRC	7.8	+0.0	7.8

UNDERWEIGHTS	Benchmark Weight (%)	Portfolio Over + / Under - Weight	Portfolio Position
Utilities (SX6P) Scottish & Southern Energy, EDF, International Power	6.8	+0.0	6.8
Insurance (SXIP) Sampo, Admiral	5.0	+0.0	5.0
Energy (SXEP) BG, Total, Tullow Oil, BP	12.4	-1.0	11.4
Banks (SX7P) Intesa Sanpaolo, Santander, Societe Generale, Banco Popolare, BNP[2]	11.1	-2.0	9.1
Div Fin & Real Estate (SXFP* & SX86P) Credit Suisse	1.7	-2.0	-0.3
Industrials (SXNP) Kuehne + Nagel, Ryanair	9.8	-5.0	4.8

MSCI Sectors

MSCI Sector	Benchmark Weight (%)	Portfolio Over + / Under - Weight	Portfolio Position	MSCI Sector	Benchmark Weight (%)	Portfolio Over + / Under - Weight	Portfolio Position
Telecommunication Services	8.0	+5.0	13.0	Materials	7.8	+0.0	7.8
Consumer Discretionary	8.2	+3.0	11.2	Utilities	6.8	+0.0	6.8
Consumer Staples	12.2	+2.0	14.2	Energy	12.4	-1.0	11.4
Information Technology	3.2	+0.0	3.2	Financials	17.8	-4.0	13.8
Health Care	11.0	+0.0	11.0	Industrials	9.8	-5.0	4.8

* The mapping between GICS Sectors (such as Healthcare) and DJ Stoxx SuperSectors - Level 3 (such as SXDP) is imperfect at places. In particular, less than two-thirds of market cap of Consumer Discretionary, Consumer Staples and Diversified Financials is covered by the corresponding DJ Stoxx Supersectors.
1. This stock is currently not covered in Europe by a Morgan Stanley industry analyst. 2. Although the shares of this company remain in the model portfolio, Morgan Stanley & Co. International plc policy precludes the exercise of investment management discretion or the rendering of investment advice on the shares at this time by the strategist and/or the Morgan Stanley analyst who follows the shares. 3. The equity position is allocated as the European Equity Model Portfolio. Bonds are allocated equally between France, Germany, the Netherlands and the UK. The bond position is invested in ten-year paper of these countries. Source: MSCI/Exshare, Morgan Stanley Research

Prices as of 3 April 2009: KPN (KON.) (€9.933) Telefonica (€15.17) Vodafone Group (125.1 P) Deutsche Telekom (€9.43) France Telecom (€16.745) Pearson (718 P) Thomas Cook Group (265.75 P) Whitbread (879 P) Carnival Plc (1713 P) SES (€14.00) Sampo A (€12.4) Admiral Group (889.5 P) BG Group (1104 P) Total (€37.685) Tullow Oil (790 P) BP (457.5 P) Novartis (Sfr 42.74) Roche Holding Genuss (Sfr 152.9) Bayer (€36.52) Sanofi-Aventis (€41.5) Rio Tinto Plc (2490 P) Akzo Nobel (€31.29) BASF (€25.96) Eurasian Natural Res (487.25 P) Scottish & South. Energy (1087 P) EDF (€30.06) Int'l Power (222.5 P) SAP Stamm (€27.6) Nokia Corp (€9.57) Henkel Vorzug (€21.37) Nestle (Sfr 38.48) Diageo (790 P) Imperial Tobacco Group (1543 P) Carrefour (€30.31) British American Tobacco (1565 P) Cadbury (525.5 P) Intesa Sanpaolo Ord (€2.165) Banco Santander (€5.9) Societe Generale (€33.495) Banco Popolare (€4.275) BNP Paribas (€35.78) Credit Suisse (Sfr 37.34) Kuehne & Nagel Int'l (Sfr 75.55) Ryanair Holdings (€3) TUI Travel (255.5 P)

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