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Morgan Stanley & Co.

MARCH 10, 2010

North America

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Events

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Utilities Conference
March 14–16, New York

MLP Corporate Access Day
March 16, New York

European Financials Conference
March 23–25, London

EMEA Conference
April 28–29, New York

US Economic Outlook

Value	2008	2009e	2010e	2011e
GDP Growth (%)	0.4	(2.4)	3.2	2.9
CPI Inflation (%)	3.8	(0.3)	2.3	2.4

e = Morgan Stanley Research estimates

NORTH AMERICA

Best Ideas

Best Ideas are our leading stock investment insights — the best combination of highly differentiated research, favorable risk-reward profiles, and clear catalysts.

Differentiated research. We seek out-of-consensus thinking that in-corporates fresh data and analysis. Analysts are expected to identify "what's in the price" and present a compelling challenge to market assumptions on key investment debates.

Favorable risk-reward profiles. Scenario analysis lies at the heart of our disciplined approach to research, so we look beyond single-point estimates and price targets. We examine the full risk-reward profile of the investment, assessing the range of plausible outcomes and the scenario skew as indicators of analyst conviction.

Clear catalysts. We require a clear roadmap for upcoming data and events in the following few months that can help corroborate our analysts' investment theses and drive a discernable change in market perceptions.

Additions and removals of stocks are published as part of regular, stock-specific reports. The complete list appears weekly in Investment Perspectives.

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Morgan Stanley Research
Stock Selection Committee

Company	Ticker	Mar 9 Price	Price Target	Bull	Base	Bear	EPS* 2010	EPS* 2011	Consensus EPS* 2010	Consensus EPS* 2011	Annual Growth in EPS* 2010-2012	P/E* 2010	P/E* 2011	P/B 2010	P/B 2011
Bank of America	BAC.N	16.80	28	35	28	12	1.63e	2.37e	0.93e	1.95e	40.3%	10.3	7.1	0.6	0.6
Baker Hughes	BHI.N	49.94	100	125	100	25	2.50e	4.00e	2.07e	3.15e	39.2%	20.0	12.5	1.7	1.5
Danaher	DHR.N	77.55	85	101	85	62	4.05e	4.70e	4.10e	4.62e	14.2%	19.2	16.5	2.0	1.8
Walt Disney Co	DIS.N	33.31	37	49	37	25	1.98e	2.35e	1.98e	2.28e	18.4%	16.8	14.1	1.6	1.5
GSI COMMERCE	GSIC.O	26.90	32	41	32	18	0.48e	0.83e	0.22e	0.44e	59.3%	56.4	32.5	3.2	2.8
The Home Depot	HD.N	31.68	35	45	35	20	1.64e	1.85e	1.66e	1.82e	19.6%	17.2	13.8	2.8	2.7
Hewlett-Packard	HPQ.N	51.88	62	68	62	46	4.49e	4.94e	4.44e	4.88e	11.8%	11.6	10.5	2.6	2.2
Lincoln National Corp	LNC.N	27.18	33	39	33	20	3.45e	3.90e	3.48e	3.90e	12.7%	7.9	7.0	0.8	0.7
Oracle Corporation	ORCL.O	24.88	31	38	31	17	1.60e	1.94e	1.58e	1.84e	-	12.8	10.9	2.9	2.4
Textron Inc.	TXT.N	21.62	30	40	30	16	0.69e	1.50e	0.43e	1.35e	69.8%	31.2	14.4	2.1	1.9
Union Pacific Corp.	UNP.N	70.84	81	97	81	53	4.61e	5.68e	4.24e	5.03e	18.8%	15.4	12.5	1.7	1.5

Company	Ticker	Dividend Yield 2010	Dividend Yield 2011	FCF Yield Ratio 2010	FCF Yield Ratio 2011	RNOA 2010	RNOA 2011	Net Debt/EBITDA 2010	Net Debt/EBITDA 2011	Interest Cover 2010	Interest Cover 2011
Bank of America	BAC.N	0.2%	1.8%	-	-	6.0%e	8.8%e	0.7e	0.5e	18.7e	27.9e
Baker Hughes	BHI.N	1.2%	1.2%	NM	1.8%	12.8%e	11.4%e	1.0e	0.6e	11.5e	15.4e
Danaher	DHR.N	0.1%	0.2%	5.8%	6.4%	10.9%e	10.9%e	1.0e	0.8e	11.7e	14.9e
Walt Disney Co	DIS.N	1.1%	1.1%	5.0%	4.7%	9.4%e	9.7%e	1.3e	1.0e	13.1e	14.8e
GSI COMMERCE	GSIC.O	0.0%	0.0%	5.6%	7.6%	4.7%e	7.9%e	0.1e	NM	1.1e	3.5e
The Home Depot	HD.N	3.0%	3.3%	6.9%	7.8%	9.8%e	11.0%e	1.9e	1.6e	4.7e	5.4e
Hewlett-Packard	HPQ.N	0.6%	0.6%	7.1%	9.1%	26.8%e	27.4%e	NM	NM	21.6e	22.8e
Lincoln National Corp	LNC.N	0.1%	0.7%	-	-	10.9%e	8.5%e	2.9e	2.8e	5.3e	6.8e
Oracle Corporation	ORCL.O	0.8%	0.8%	8.0%	9.4%	28.5%e	28.6%e	NM	NM	14.1e	17.2e
Textron Inc.	TXT.N	0.4%	0.4%	3.0%	NM	2.9%e	6.1%e	7.2e	4.7e	3.0e	5.5e
Union Pacific Corp.	UNP.N	1.5%	1.9%	4.3%	5.7%	11.5%e	13.0%e	0.6e	0.4e	11.3e	17.2e

** Uses consensus methodology; all other metrics use ModelWare methodology*

NORTH AMERICA

Best Ideas

Research Updates on Best Ideas

Baker Hughes (BHI, $49.94, Overweight, Attractive Industry view) *Ole Slorer*

Takeaways from recent Houston trip. We continue to believe that Baker Hughes is in the process of fixing its execution problems. Pressure pumping is approaching 25% EBIT margins by mid-year as recent price hikes filter through. Pricing power is going global as North America confidence morphs to other regions.

See "Oil Services, Drilling & Equipment: Pricing Power Goes Global", March 8, 2010

Danaher (DHR, $77.55, Overweight, Attractive Industry view) *Scott Davis*

China: Can US Industrials win? We think Danaher can. Our early-March trip to China brought more clarity to the China debate and yielded more bullish takes than our mid-2009 trip. Challenges remain and we are quite concerned about the long-term impact of potential property bubbles and excessive bank lending, but we believe that tailwinds into 2010 and probably 2011 are strong. Some US companies are winning — Winning strategies are coming from non-China companies that seek to become "the Chinese competitor" with products designed for China, made in China. We believe that Danaher stands out based on its products that are not on government planning radar and its attractive end-markets.

See page 27

Textron (TXT, $21.62, Overweight, In-Line Industry view) *Heidi Wood*

We believe 1Q likely marks the trough for this turnaround story, a view fortified by what we learned at Textron's small, fairly upbeat investor meeting on March 8. Cessna's losses have been roundly telegraphed, but in 2H10 a projected swing to the black atop better demand picture should confirm a normal cyclical upturn. Textron Financial's (TFC's) non-performing accruals are likely to peak in 1Q10 and decline in 2Q, which would confirm that the worst is largely behind the financial business. Combined with strong visibility at Bell, we believe TXT offers a compelling deep value opportunity.

See page 45

Union Pacific (UNP, $70.84, Overweight, Attractive Industry view) *William Greene*

Raising estimates/price targets and reiterating our bullish call on Railroad stocks. We believe rail volumes could grow at double-digit rates in 2010 and see recent weekly traffic data as thesis-confirming. In the coming months, we expect upside revisions to consensus driven by the following trends: (1) weekly volumes tracking better than expectations, (2) operating leverage to recovering volumes, and (3) sustained momentum on core price. UNP is positioned favorably with respect to these themes, in our view..

See page 23

Morgan Stanley is currently acting as financial advisor to a number of investors, led by First Republic's existing management, and including investment funds managed by Colony Capital, LLC and General Atlantic LLC with respect to their acquisition of First Republic Bank from Bank of America Corporation. The proposed transaction is subject to customary regulatory approvals, as well as certain customary closing conditions. Morgan Stanley expects to receive fees for its financial services that are subject to the consummation of the proposed transaction. Please refer to the notes at the end of the report.

Morgan Stanley is currently acting as financial advisor to Hewlett-Packard Company ("Hewlett-Packard") with respect to its proposed offer to acquire 3Com Corporation ("3Com"), as announced on November 11, 2009. The proposed transaction is subject to the consent of the 3Com shareholders and other customary closing conditions. This report and the information provided herein is not intended to (i) provide voting advice, (ii) serve as an endorsement of the proposed transaction, or (iii) result in the procurement, withholding or revocation of a proxy or any other action by a security holder. Hewlett-Packard has agreed to pay fees to Morgan Stanley for its financial advice, including transaction fees that are contingent upon the consummation of the proposed transaction. Please refer to the notes at the end of the report.

Strategy and Economics

March 5, 2010

US Economics
Payback Here, Snapback Coming

Morgan Stanley & Co. Incorporated

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Three temporary depressants. Three factors are weighing on first-quarter growth: 1) a consolidation in production; 2) paybacks from "bonus depreciation" and the first-time home-buyer tax credit; and 3) severe storms in much of the country that hobbled construction and employment. These factors likely will push annualized Q1 growth down to 2% or so, a full point lower than our estimate a month ago, and are casting doubt on the sustainability of recovery.

In our view, such fears are misplaced. Some of these factors are statistical, some are fundamental, but all are temporary. As a result, they do not change our view that the recovery is sustainable. And they will probably set the stage for a powerful, 4% spring snapback in the economy — one that could surprise with its force and for which markets are ill prepared.

Reviewing the case for sustainable growth. It's worth reviewing the four factors promoting sustainable growth through 2011: 1) Monetary policy has fostered improving financial conditions; 2) the impact of fiscal stimulus will last through 2011; 3) strong growth abroad will lift US exports and earnings; and 4) economic and financial excesses are abating. Most of these are playing out according to script. Markets are functioning, although demand for credit remains weak. Through refunds, tax credits should support consumer spending in the spring, and infrastructure outlays are only starting to show up. Exports are booming, earnings are beating expectations, and production is still catching up to final sales, while companies are reducing capacity and inventories. To be sure, headwinds to growth remain significant: Housing imbalances persist, and 2 million foreclosures are coming; job gains are still a forecast; and policy uncertainty clouds the outlook. The balance between those headwinds and tailwinds has kept our forecast for real growth in 2010 at 3¼% (Q4/Q4) for more than a year.

Classic consolidation. However, incoming data lately have weakened: New and existing home sales continued to slide, construction outlays and "core" durable goods orders and shipments turned down, and one measure of consumer sentiment tumbled in January. Vehicle sales slipped in February, and initial jobless claims have risen appreciably since the start of the year. In our view, this disappointing string of data partly represents a classic consolidation in the pace of recovery following the late-2009 surge. It does not represent the onset of a slowdown, much less a double dip. Recoveries never go in a straight line; even strong ones are characterized by surges followed by pauses in their early stages. The economy, especially at turning points, is far more volatile than any of our smooth forecasts anticipate. The culprits include the vagaries of the inventory cycle, the fact that traditionally lagging components of demand, like capital spending, are still contracting while others are growing, and the uneven effects of stimulative policies employed to promote recovery.

For example, the following table shows the contribution of inventory swings to the growth in real GDP in the early stages of past US recoveries. While on average, such swings show a time-honored cyclical pattern — they account for about a third of the advance in GDP in the first two quarters — the variation from one episode to the next is striking. Some of those differences reflect structural change in the economy — the birth and death of industries, the adoption of "just-in-time" inventory management techniques, and the advent of global supply chains. More importantly, the variation across cycles reflects cyclical factors like the extent and nature of the shocks that triggered the recession and whether inventories were top-heavy or lean going in.

In addition, if anything, the economy is actually more volatile than current estimates show, because the estimates are based on extrapolations of indicators that are only available with a lag. Successive revisions of GDP and associated aggregates tend to be more volatile than the preliminary estimates, because the Bureau of Economic Analysis substitutes the actual data for the trend extrapolations initially assumed. For example, BEA calculates that the standard deviation of "advance" estimates of quarterly GDP from 1993 to 2006 was 2.7%, but in the first annual revision, that variance rose to 3.9%.

Exhibit 1

Change in Real Private Inventories: Contribution Share of Real GDP Growth During Recoveries

All values in percentage terms

Recession	Recovery Start Date	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Average
1948Q4 - 1949Q4	1950Q1	58.6	13.3	8.5	155.8	59.1
1953Q2 - 1954Q2	1954Q3	13.5	17.5	33.0	21.3	21.4
1957Q3 - 1958Q2	1958Q3	37.3	19.7	4.6	34.2	23.9
1960Q2 - 1961Q1	1961Q2	42.8	52.9	-8.2	33.8	30.3
1969Q4 - 1970Q4	1971Q1	54.1	-21.0	-9.3	-329.4	-76.4
1973Q4 - 1975Q1	1975Q2	-39.8	44.7	10.7	40.8	14.1
1980Q1 - 1980Q3	1980Q4	50.2	74.3	127.8	88.3	85.2
1981Q3 - 1982Q4	1983Q1	18.6	37.7	7.4	36.2	25.0
1990Q3 - 1991Q1	1991Q2	-4.4	68.4	123.7	-39.6	37.0
2001Q1 - 2001Q4	2002Q1	75.5	47.2	12.9	567.6	175.8
2007Q4 - 2009Q2	2009Q3	30.9	65.5	4.7	-10.9	22.5
Average of Each Quarter		30.7	38.2	28.7	54.4	38.0

Note: Third and fourth quarter values of 2009 recovery represent Morgan Stanley Research estimates. Source: Bureau of Economic Analysis, Morgan Stanley Research.

Strategy and Economics

Policy paybacks. Two policy changes temporarily boosted demand last year: "bonus depreciation" investment incentives and a first-time homebuyer tax credit. When these "use-it-or-lose-it" policies expired, demand slipped below what it otherwise would have been. Such factors add volatility to the results: Just as the transitory demand increase represented an overshoot, the expiration of these incentives triggers a payback when demand undershoots the underlying pace. Bonus depreciation incentives may have contributed to a Q4 surge in capital spending, especially in trucks, at the expense of the first quarter. Real capital spending on light and heavy trucks accounted for nearly 40% of the Q4 surge in real equipment and software outlays, and the payback in Q1 is depressing growth. Fortunately, the infrastructure spending mandated by the American Recovery and Reinvestment Act of 2009 (ARRA) started to kick in late last year, and contractors have begun to order and replace construction equipment and trucks to meet that coming demand.

The first-time homebuyer tax credit is more complex. Despite its extension/expansion, a payback in housing demand seems to be underway, judging by the slide in sales and pending home sales through January. The impact of the credit was most prominent in existing home sales, which soared through November and then plunged in December and January. But gauging the payback requires a counterfactual baseline to calibrate the impact of the credit on demand. That is difficult, because the $8000 maximum tax credit represented only about 5% of the price of homes typically purchased by first-time homebuyers and because there is scant basis for comparison — there is only one example of a similar credit (in 1975, and that was for new homes only).

According to the National Association of Realtors (NAR), about 350,000 of the 1.8 to 2 million buyers who claimed the credit last year would not have purchased a home without it. But it is uncertain how much of that was genuine additional demand and how much was simply brought forward. Traditional measures of affordability soared, courtesy of the plunge in home prices and in mortgage rates. Last year lenders demanded bigger down payments, and with the credit not available until the deal closed, down payments and credit availability remained hurdles for many buyers, especially first-time ones. The terms of lending have since eased a bit, judging by the improvement in the Fed's Senior Loan Officer Survey.

Another complication in calculating the payback from the expiration of the initial homebuyer tax credit is the impact of the second tax credit that was enacted in November. Congress passed new legislation that extends the credit for first-time buyers and expands it to cover current homeowners purchasing a new or existing home (up to a maximum credit of $6500) between November 7, 2009 and April 30, 2010. Current homeowners must have used the home being sold or vacated as a principal residence for five consecutive years within the last eight. Married couples with incomes up to $225,000 are eligible for the maximum credit, higher than the $175,000 under the old credit. We assume that the new credit will promote a healthy pickup in sales as the April 30 signing deadline approaches (and sales of existing homes will likely rise with the approach of the June closing date).

Severe weather. We knew when Punxsutawney Phil saw his shadow back in early February that the rest of the winter would be tough, but this one has been unusually harsh. That's been especially the case in the Northeast and Mid-Atlantic states, which account for 24% of US GDP and 19% of nonfarm payrolls (measured on a sum-of-states basis). The back-to-back storms that hit the Northeast and Mid-Atlantic states on February 4 and February 9 appear to have had a major impact on jobs, hours worked and income. Dave Greenlaw notes that, absent special factors related to the census and the weather, payrolls likely would have risen by more than 100,000 (see "*Harsh Weather Masks Improvement in Jobs and Hours*," March 5, 2010).

Snowstorms probably hobbled sales of light vehicles and retailing activity in February as well. Here the impact may be smaller, because the sales figures measure activity over the entire month, in contrast to the snapshot of payrolls taken in the week of the storm, so that some bounceback during the month is possible. Nonetheless, industry sources suggest that weather trimmed vehicle sales by ¾ million annualized in February. And our retail analysts estimate that, although sales were strong in the month, they might have been 100-200 basis points stronger but for the weather. Not surprisingly, the effects on outdoor activities like construction and on industrial production have also been significant. Based on the decline in construction payrolls and workweek (hours tumbled 2.4% on the month), we estimate that housing starts sagged last month. And the 1% plunge in manufacturing hours worked suggests that industrial production declined temporarily in February (plant shutdowns for safety recalls at one manufacturer also depressed production).

Spring rebound coming. The important point is that the three factors depressing Q1 growth have largely been temporary. Fundamentals still point to sustainable growth and are gathering pace. Consequently, as the temporary factors dissipate, we believe that a spring rebound is coming and could surprise with its force. Indeed, we'd argue that the weaker is Q1, the stronger will be the snapback.

Strategy and Economics

March 5, 2010

US Credit Strategy
Cashing In

Morgan Stanley & Co. Incorporated

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We have recently argued that quickly strengthening corporate fundamentals will ultimately provide a bid to credit — despite such macro headwinds as growing sovereign risks and central-bank liquidity withdrawal. With 4Q reporting season ending, we dug through financial statements to gauge how much of the encouraging earnings news is translating into tangible balance-sheet improvement. Financial data for about 212 out of our ~250 name non-financial universe are currently available, so absolute numbers may change slightly, but the overall trend should remain intact. In short we find:

- After a full year of steady but sizable increases in leverage, non-financial leverage is finally dropping.
- Cash/debt for the IG universe, which is now just under 30% for the median corporate, is at record highs.
- EBITDA margins now sit right at the long-term average for our universe at 16.8%, up 0.8% in the last two quarters.

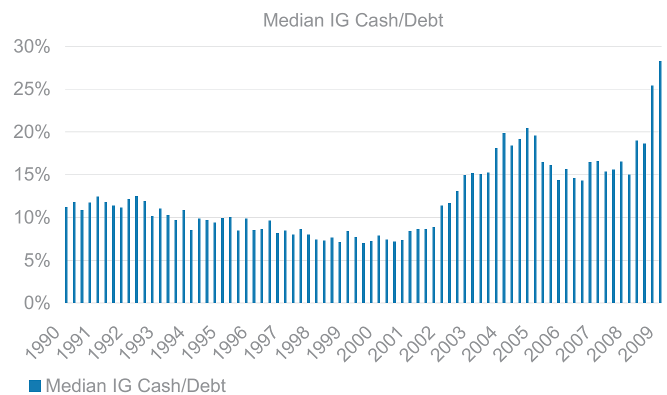
Delivering on deleveraging. One reason we believe US investment grade (IG) corporate credit markets are still cheap is that spreads adjusted for balance-sheet leverage remain above (though approaching) the long-term average. In addition, if we make the assumption that non-financial corporates will delever through 2010 (our base case), then risk-adjusted valuations will look that much more attractive, even assuming no change in spreads. After a full year of steady but sizable increases in leverage from 4Q08 through 3Q09, corporates have finally lived up to the delevering challenge in this past reporting period. Only 39% of IG corporates increased leverage QoQ, the lowest since the end of 2006. The net effect was a decrease in leverage from 2.05x to 2.03x in the past quarter. While this change is small, it is mitigated by the fact that leverage calculations use EBITDA for the last 12 months (LTM). With easier comps going forward, expectations for strong earnings growth in 2010, and restrained total debt growth (more on this below), leverage should continue to tick down over the coming quarters.

As for the main drivers of the decline in leverage, while total debt growth was basically flat YoY (up 0.86%), quarterly EBITDA grew by 9% compared to 4Q08. As we expected, delevering in this cycle should come from renewed profitability as opposed to large declines in debt growth. Among sectors, the biggest declines in leverage YoY came from Retail (-0.31x), Healthcare (-0.25x), and Paper/Packaging (-0.23x).

Cash/debt increasing to record levels. There are various reasons we believe debt growth will stay below average over the next year. First, as our economists put it, the BBB recovery — bumpy, below-par, and brittle — will keep aggressive corporate activity in check, muting the need to raise funds, and providing disincentives for corporates to ramp up leverage. Second, and maybe more important, cash stockpiles have grown to record levels. At the height of the recent downturn, companies prepared for the worst by aggressively trying to offset the decline in sales wherever possible. From cutting costs to reducing spending to managing working capital, all levers were pulled. However, as recession quickly turned into recovery, top-line growth resumed. Thus, while companies were still playing defense, cash balances quickly ballooned. For example, in the last two quarters, aggregate corporate cash has grown by 43% and 34% YoY, respectively.

In Exhibit 1 we show cash/debt for the IG universe, which is now just under 30% for the median corporate, at record highs. And the cash/debt numbers are not being skewed by any one sector or name. Year-over-year, cash/debt is higher for every sector in our universe except for Telecom, with Industrials, Healthcare, Metals/Mining, Paper/Packaging, and Tech all increasing cash/debt by more than 20% compared to 4Q08.

Exhibit 1
Cash Is King



Source: Morgan Stanley, Bloomberg

The questions that follow are: How have companies achieved this cash/debt growth? How much of it is sustainable? And when will companies start deploying these funds?

Though deducing the exact sources and uses of cash on an aggregate level is difficult, we come up with a rough approximation for the increase in cash/debt from four main drivers.

Strategy and Economics

1) Last-12-month EBITDA dropped by about $56 billion in 2009 versus 2008, but this drop was more than offset by the following items.

2) Working capital went from a $54 billion reduction in cash in 2008 to a $20 billion increase in cash in 2009, through things like better inventory management.

3) Share repurchases went from $155 billion for our universe in 2008 to only $37 billion in 2009.

4) Capex went from $290 billion in 2008 to $231 billion in 2009.

Finally, there were other small changes aiding the ramp in cash/debt last year, such as cuts to dividends and increases in equity issuance.

Clearly companies will not be able to grow cash at this rate forever, as some of the above factors are unsustainable. For example, at some point companies cannot continue cutting inventories, share repurchases cannot go below zero, and companies will have to begin ramping up capex eventually to drive sales. In addition, as the sustainability of the economic recovery grows, companies will have some incentive to boost shareholder value, evident from Qualcomm's announcement last week to buy back up to $3 billion in stock and boost the quarterly dividend. However, in our view, we are a long way away from large changes in capital structure and aggressive deployment of cash stockpiles. Yes, we are aware that memories are short-lived, but we believe after coming off of one of the deepest and longest downturns in modern history, corporates will stay conservative until they are completely sure the recovery is real. At the very least, until companies start hiring, we do not see aggressive spending. And while this corporate conservatism is not necessarily bullish for equities or the economy, it is quite an encouraging credit story.

The Best of the Rest

Margins: EBITDA margins now sit right at the long-term average for our universe at 16.8%, up 0.8% in the last two quarters. On a sector basis, the groups most successful at defending margins year over year include Metals & Mining (+5%), Transportation (+4%), Utilities (+4%), and Paper/ Packaging (+3%). The weakest sectors include Telecom (-1.1%) and Industrials (-0.2%).

Interest Coverage: Coverage for the investment-grade universe was late to peak, in the third quarter of 2008 at 11.2x. Since then, as EBITDA has dropped steadily, coverage has fallen to 8.6x as of 3Q09. The fourth quarter of 2009 was the first to see an increase in coverage (up to 8.8x) since the middle of 2008. The largest increases in interest coverage came from Paper/Packaging and Retail. The biggest drops in interest coverage were in Energy, followed by Media.

Single Name Fundamental Improvement

Finally, with non-financial deleveraging likely one of our biggest themes through 2010, we looked at which single names in our universe are expected to see the most deleveraging through 2010. To figure out 'forward leverage' and 'forward SPL' (spread per unit of leverage), we simply take projected EBITDA for 2010 according to Bloomberg estimates and assume total debt and CDS levels remain constant. All of the names on this screen should see leverage cut from 0.5x to 2x if the analysts are correct. In addition, we show what the SPL looks like currently for all of these names, as well as what it would look like using the forward leverage, assuming no change in spread. Clearly, some of the expected deleveraging in these names is in the price, but we focus on credits with relatively high forward SPLs, hopefully indicating somewhat attractive current valuations (again just focusing on leverage) if the companies live up to expectations.

Exhibit 2

Investment-Grade Credits Expected to Delever in 2010

Credit/Sector	Current Leverage	Forward Leverage*	Expected Leverage Change*	Current 5Y CDS	Current SPL	Forward SPL*
Potash Corp. (Chemicals)	3.60	1.60	-2.0x	84	23	53
Southwest Air. (Transport.)	4.00	2.23	-1.8x	157	39	70
PPL (Utilities)	4.27	2.51	-1.8x	134	31	53
Cytec (Chemicals)	3.18	1.91	-1.3x	103	32	54
Devon (Energy)	1.83	1.12	-0.7x	59	32	53
Noble Energy (Energy)	1.59	0.96	-0.6x	70	44	73
Sunoco (Energy)	4.12	3.59	-0.5x	283	69	79
Corning (Technology)	1.40	0.87	-0.5x	63	45	73
Martin Mar. Mat'ls (Gen. Ind.)	3.41	2.94	-0.5x	154	45	52
CenturyTel (Telecom)	3.51	2.17	-1.3x	107	30	49
Int'l Gam Tech. (Gaming/Leisr.)	3.06	2.49	-0.6x	100	33	40

*Note: Forward leverage, as well as spread per unit of leverage (SPL) calculations use Bloomberg EBITDA estimates for 2010.
Source: Morgan Stanley, Bloomberg

Fundamental corporate improvement is a tailwind that will ultimately provide a bid to US credit markets. With investors brushing off the broader macro issues for now, sentiment has once again turned bullish, pushing markets within reach of the early January tights/highs. In our view, these macro headwinds will keep risk-taking in check, and investors should not expect a straight shot tighter. Until investors are confident that removal of central-bank liquidity will not derail the economic recovery, these rallies will be met with caution. However, non-financial leverage is finally turning lower, companies have the highest cash/debt balances in decades, and top-line growth is finally starting to show through. (For details see our *Credit Basis Report* of March 5, 2010.)

Strategy and Economics

March 5, 2010

Equity & Credit Derivatives Strategy
Small Caps and High Yield Disconnect

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Note: Phanikiran Naraparaju and Ashley Musfeldt are Fixed Income Research Analysts and they are not opining on equity securities. Their views are clearly delineated.

Regarding valuation, small-cap equities and high-yield credit are two sides of the same coin, connected in theory by the strength of balance sheets and cash flows and the likelihood of default. But both markets are also higher-beta plays on the larger worlds, respectively, of large-cap equities and investment-grade credit — and the noise and flows of all four markets can affect both valuations and volatility.

On the equity side, since the cyclical lows in equities about a year ago, the Russell 2000 has experienced powerful outperformance over the S&P 500, making up for most of 2008's lost ground. Despite a flat return (0.7%) year to date for the S&P 500, Russell has continued to march higher (up 4.3%), and in options markets, the volatility premium of small caps over large has now shrunk to a modestly cheap level from one that was much wider. And on the credit side, high yield has underperformed investment grade by several measures this year (cash total returns, cash excess returns, and CDX index performance), while HY volatility is much higher on a relative basis than IG, even when we were last at these market levels.

Why this disconnect? We believe it relates to the credit nature of the European sovereign issues and overall valuations. From a valuation perspective, one must consider the capped upside of credit vs. theoretically unlimited upside in equities, especially in an environment where better-than-expected growth supports equities over credit. Indeed, with the average dollar price of HY bonds at $96.4 ($99 for BBs and Bs, and $86 for CCCs), we see the asymmetry in credit and equity upside at this point.

What's the opportunity? We summarize three portfolio hedging/investment themes here (for details see our *Derivatives Across the Capital Structure* report of March 5).

(1) Buy Russell options as a hedge. The Russell 2000 has significantly outperformed the S&P 500 this year, while Russell's implied volatility has drifted lower in both up and down markets. The Russell volatility term structure looks steep and the index remains high beta in a sell-off, suggesting short-dated options are attractive as hedges. We like 3-month 97.5%/81.5% put spreads for 2.8%, and a 4.6x profit in a small tail scenario (down 18%).

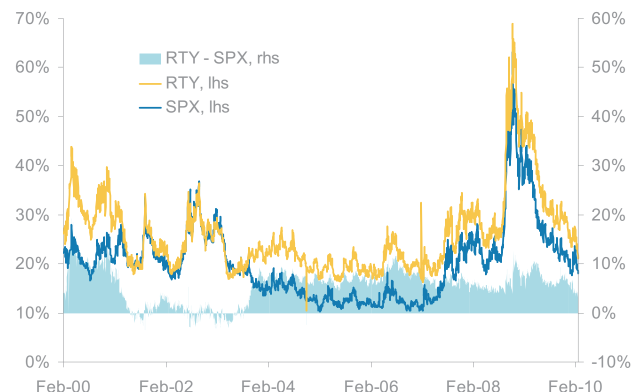
(2) Hedge high yield with Russell options too. The Russell 2000 is a good high-beta hedge in moderate downside scenarios, as options look cheaper than hedging in high yield directly, and better value than the S&P 500 given a tighter historical correlation to high yield and relatively cheaper implied volatility. We believe the hedge ratio for high yield bond investors should be about 60%.

(3) Write covered calls in high yield. With capped upside in high yield and still high levels of volatility, we like generating additional yield by selling covered calls on the CDX HY index. With CDX HY at 97.9 (555 bps), selling a 100 strike June call generates 80 cents, or about 270 bps on an annualized basis, about half the spread of CDX HY. The break-even would be an index level of 100.8, which we can think of as the call price, taking the premium earned into consideration.

Russell volatility falling vs. S&P 500. Small-caps have been outperforming large-caps in the US equity markets for the last three months, with the trend accelerating in the recent rally following the China/Greece correction. Naturally, at-the-money implied volatility has fallen more for the Russell 2000 than the S&P 500 given the outperformance, but YTD it has declined by more than one would expect from just the price return. Fixed-strike volatility, or the volatility of specific options, has declined more for the Russell than for the S&P 500.

With much of the Russell outperformance driven by beta, there are reasons to be cautious. Our Global Equity Strategy team highlights lower EM exposure, higher weight of relatively

Exhibit 1
Russell Volatility Cheaper to S&P 500 Today



Source: Morgan Stanley Research, Morgan Stanley Quantitative and Derivative Strategies, Bloomberg

Strategy and Economics

weak financials, and less franchise and pricing power as risks to small-caps vs. large-caps, at least in a slow or negative growth environment. In a bull case economic scenario, small-caps would likely continue to outperform on beta alone. Given the narrowing small-cap/large-cap volatility premium and the relatively quick rebound in markets in February, we think Russell 2000 options are a good place to look for hedges on cyclical concerns.

High yield vs. Russell volatility. Most investors we speak with find high-yield credit options expensive today. At first glance, bearish HY options strategies do seem to offer lesser reward/risk (see "Resetting Tail Hedges: Contagion vs Differentiation," *Investment Perspectives,* February 24). But this is a high-yielding asset, one that has effectively a very high dividend yield (8% coupon vs. < 2% for S&P 500 or Russell 2000) plus the impact of shortening durations on the credit shorts. Naturally, it is expensive to hedge high yield from a hold-to-expiry perspective — which is reflected in the low risk-reward ratios on HY hedges at current levels. This is also a consequence of the spike in HY vols.

Hedging with small caps. Russell options are a particularly interesting hedge for HY credit portfolios. While HY has already underperformed recently (but outperformed over the past year), there is reason to continue to proceed cautiously. There is a basis or correlation risk between equities and high yield, but we think small-cap options are worth looking at to hedge a near-tail scenario. For large-tails where HY retraces performance of the last year, which has been in line with equities, credit options offer a better risk/reward.

With any cross-asset hedge, the ratio of the notionals on each leg is key. Unfortunately, picking the right ratio is more art than science, so we look at five different approaches to frame the potential range of choices (see Exhibit 2).

Overwriting HY. In credit, with the average dollar price of BBs and Bs nearly $99, and well over half the market made up of callable bonds, upside can be much more muted than in small cap equities. In an environment where carry may take on a stronger role in driving credit returns but volatility remains elevated, selling calls against long positions as a way to enhance yield should appeal to investors. In Exhibit 4, we show how much of an impact overwriting can have on yields.

Option strategy risk factors. *Put Spreads:* Overlaid on a long position, the position is protected between the strikes (but not below) at expiration. The maximum potential loss in isolation is the premium paid. *Overwriting* (selling calls over long stock positions): At expiry, the risk that the asset rallies through the short call strike, with the asset called away at the strike price, limits participation in further upside.

Exhibit 2

Beta for SPX, RTY on HY Index Excess and Total Returns Under Different Scenarios

	HY Excess		HY Total	
Scenario	SPX	RTY	SPX	RTY
Beta since 1989	0.4x	0.3x	0.3x	0.3x
Beta since Mar 2009	0.5x	0.5x	0.5x	0.4x
Avg of 9 Peak to Troughs	1.4x	0.9x	0.8x	0.6x
Replay of this Cycle	1.3x	1.1x	1.0x	0.8x
3M Periods Where HY Returns < -5%	0.8x	0.9x	0.7x	0.6x

Note: Avg of 9 Peak to Troughs are the ratio of returns in 9 significant HY declines since 1989; Replay of this Cycle is an average of the ratio of returns assuming both asset classes return to Feb 2010, July 2009, Mar 2009, and Nov 2008 lows; 3M Periods… is an average of the ratio of returns when high yield returns were -5% or below (roughly 150 bps wider).
Source: Morgan Stanley Research

Exhibit 3

Equity and Credit Hedging Menu

Trades	Price (% of Spot)	Max Option Profit	Reward / Risk	Hedge Ratio	Net Cost
Equity Trades					
RTY 3m 97.5/85% PS	2.5%	10.0%	3.9x	0.6x	1.5%
SPX 3m 97.5/85% PS	2.2%	10.3%	4.6x	0.6x	1.3%
RTY 3m 97.5/81.5% PS	2.8%	13.2%	4.6x	0.6x	1.7%
SPX 3m 97.5/81.5% PS	2.5%	13.5%	5.5x	0.6x	1.5%
HY Trades (Assuming beta of 0.3 to Equities)					
HY 3M 97/92 PS	1.7%	3.3%	1.9x	NA	1.7%
HY 3M 96/92 PS	1.3%	2.7%	2.1x	NA	1.3%
HY 3M 95/92 PS	1.0%	2.0%	2.0x	NA	1.0%
HY Trades (Assuming beta of 0.6 to Equities)					
HY 3M 97/89 PS	2.6%	5.4%	2.1x	NA	2.6%
HY 3M 96/89 PS	2.2%	4.8%	2.2x	NA	2.2%
HY 3M 95/89 PS	1.9%	4.1%	2.2x	NA	1.9%

Prices are indicative. Source: Morgan Stanley Research

Exhibit 4

Overwriting in CDX HY and XOver

	CDX HY	Call @ 99		Call @ 100		Call @ 101	
Expiry	Spread	Yield	Breakeven	Yield	Breakeven	Yield	Breakeven
Mar-10	5.6%	8.8%	99.4	3.4%	100.1		
Apr-10	5.6%	6.1%	99.8	3.8%	100.5	2.1%	101.3
Jun-10	5.6%	3.9%	100.2	2.7%	100.8	1.7%	101.5
Sep-10	5.6%	2.5%	100.4	1.8%	101.0	1.3%	101.7

	Xover	Call @ 102.9		Call @ 104.0		Call @ 105.0	
Expiry	Spread	Yield	Breakeven	Yield	Breakeven	Yield	Breakeven
Mar-10	4.4%	7.8%	103.2	1.7%	104.0		
Jun-10	4.4%	3.9%	104.0	2.7%	104.8	1.7%	105.5

Current CDX HY Index Price is 97.9. XOver Index Price is 102.3. Breakeven level is effectively the "call price" of the package. Prices are indicative. Source: Morgan Stanley Research

Strategy and Economics

March 8, 2010

Global Equity Strategy
Cute

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We've seen all we need to see to sell equities on a 6-month view. However, we're finessing the call and expect better levels to sell in the near term. Equities may move higher on firmer near-term US macro data and a 'solution' to Greek stress. If you think our tactical stance is all too cute, we have no problems selling on a 6-month view. Investors with a shorter horizon may hang on a little longer.

Remember our framework. We don't think developed world equities have started a secular bull market. Three preconditions for a multi-year bull market do not exist: (1) Valuations did not fall as low as they did at the start of prior multi-year bull markets; (2) we don't expect a strong, sustained macro expansion in developed economies; and (3) we don't expect investors will be able or willing to leverage up through the expansion.

Instead of a secular bull market, we're expecting an extended period of range-bound markets. 'Range bound' is short-hand for what is likely to be alternating bull and bear markets. We expect a bear market at some stage this year (using the short-hand definition of a 20%-plus peak-to-trough decline).

What will be the trigger for a renewed bear-market: indicators of growth and earnings, or liquidity and rates? We would focus on leading indicators for several reasons:

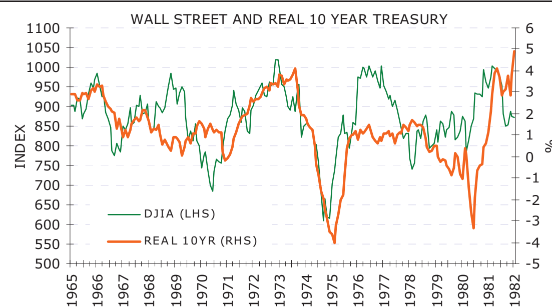
(1) Growth indicators seemed to drive equity markets in prior periods of range-bound trading (as we discussed last week in *Fight The Fed*, 26 February);

(2) We think that the end of the credit super-cycle means that equity markets will follow growth-driven swings in earning expectations rather than rate-driven changes in PE ratios. In that environment, equities and interest rates will likely be *positively* correlated. This happened in Japan from the early 1990s and also happened in the US in its last period of range-bound markets (Exhibit 1).

(3) Growth indicators have worked well this cycle.

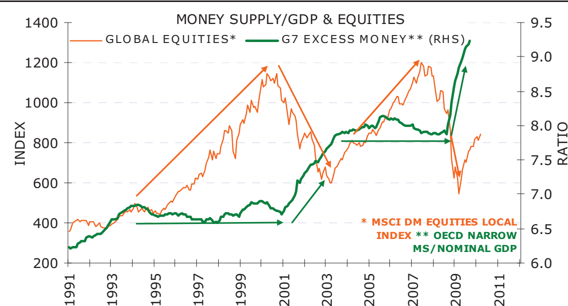
Conversely, we're not persuaded that rates or liquidity measures are critical (in the developed world, that is; emerging markets are arguably experiencing a plain vanilla developed-market cycle, so initial tightening can trigger a temporary setback). Central banks have pumped up narrow money supply measures. But we can't see any strong historical correlation between liquidity levels and developed-world equities. Often it's inverse (Exhibit 2).

Exhibit 1
The Old Way: Rates & Stocks Synchronized



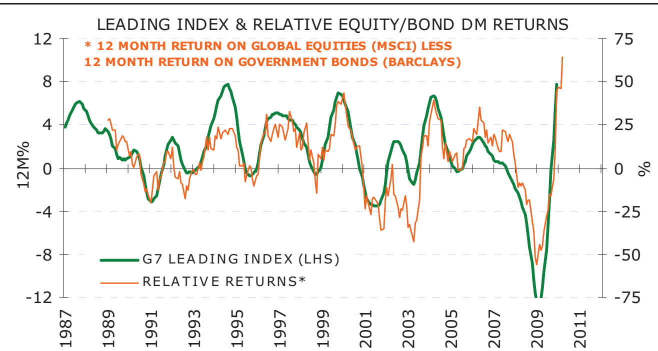
Source: Bloomberg, BLS, DataStream; Morgan Stanley Research

Exhibit 2
A Pile of Money Means a Hill of Beans



Source: MSCI, OECD; Morgan Stanley Research

Exhibit 3
Following the V



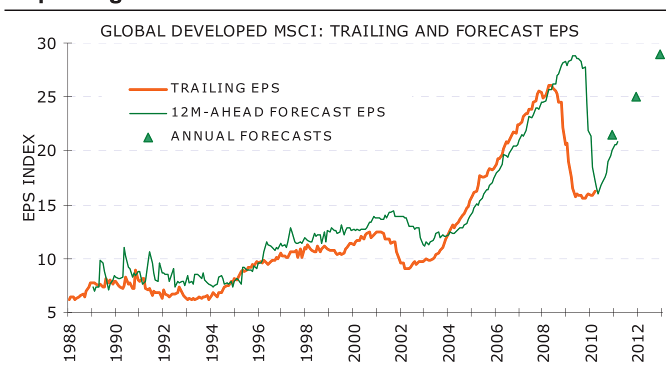
Source: Barclays, MSCI, OECD; Morgan Stanley Research

Strategy and Economics

Growth indicators matter because we think developed world equities have priced in the V-shaped recovery implied by some leading indicators. Exhibit 3 shows that the excess return from developed-world equities (equity return relative to the return on sovereign debt) has tracked the rebound in the OECD leading index. Likewise, the relative 'cheapness' of equities depends on the sell-side bottom-up forecasts, which currently imply a V-shaped recovery in earnings (Exhibit 4).

Exhibit 4

Expecting a V



Source: MSCI, DataStream, IBES, Morgan Stanley Research

Given this framework, we have focused on an inflection point in commonly-watched leading indicators as a warning that a bear-market is imminent. Most of the leading indicators have, or are close to, inflecting. Last week the US manufacturing ISM index declined month-on-month. The ISM is correlated to revisions in sell-side consensus earning forecasts; revisions also seem to have inflected for the S&P 500 (Exhibit 5).

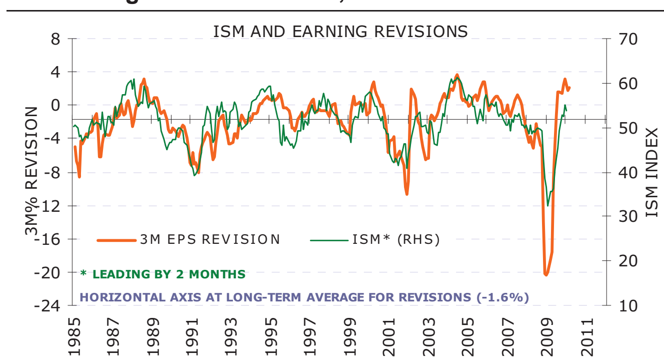
Given this framework, we've seen enough to recommend selling equities on a 6-month view. However, we think there could be a little more tactical upside.

- First, sovereign concerns may moderate in the near term if stress in Greece is resolved (perhaps only temporarily). We think sovereign stress is a big issue, but it may take time to become *the* key market driver.
- Second, US macro data may improve in the near term as unseasonably bad weather ends (Exhibit 6). The reaction to Friday's payroll report shows that better macro news can drive equities higher.

That said, we'll be happy sellers if the SPX heads towards our long-term stretch target of 1200.

Exhibit 5

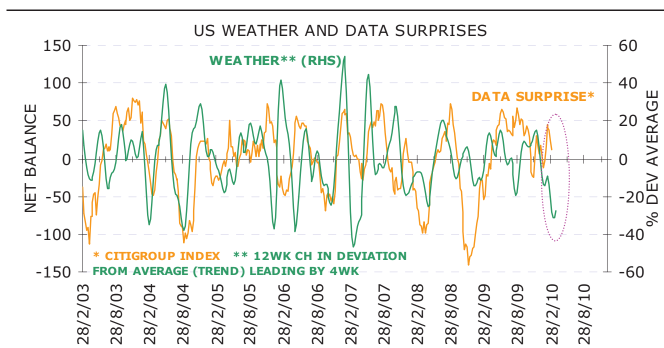
As Leading Indicators Inflect, So Do Revisions



Source: ISM, IBES, DataStream; Morgan Stanley Research

Exhibit 6

Cool Weather Cooled the News



Source: NOAA, Citibank, Morgan Stanley Research

Strategy and Economics

March 8, 2010

Europe Equity Strategy
Updating Our Search for High and Secure Dividend Yield

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Dividends are the most important driver of equity returns in the long term. In the long run, dividends are a far greater driver of equity returns than capital gains. Since 1926, we calculate the real price return on European stocks has been just 1.3% per year compared to a real total return of 5.6%. In the bull market of the 1980s and 1990s, investors' focus on dividends faded in the face of higher-than-usual capital gains; however, since 2000 this has reversed, with dividends accounting for a greater proportion of total equity returns.

Three strategic reasons why dividends are getting more important: We see three structural reasons why dividends will continue to be a key driver of equity returns going forward:

1. **High demand for income** given demographic changes – e.g., as baby boomers retire, income-related investment strategies become increasingly important.

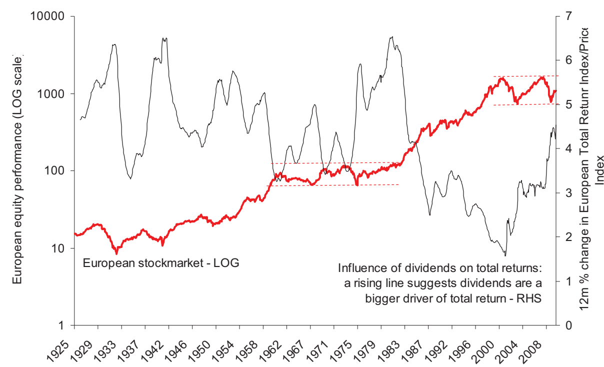
2. **Less income competition from fixed income:** Structural issues should keep official policy rates low over the next few years as the authorities look to mitigate the problems associated with a severe debt burden. Yields on longer-term fixed income instruments are/will be higher but offer no protection against inflation and are vulnerable to the poor state of sovereign balance sheets.

3. **Range-bound market:** We believe equities are locked in a range-bound (albeit wide) market for the next few years as we work through the severe structural macro headwinds. Previous range-bound markets have seen total return indices outperform pure price indices – i.e., income is more important than capital gains in driving total returns.

Recent fall in European dividends has been the biggest since the 1930s and driven by financials. In the last two recessions European dividends fell by less than 10%. In this downturn, they are down around 30%, which represents the biggest decline since the 1930s. The majority of the dividend

Exhibit 1

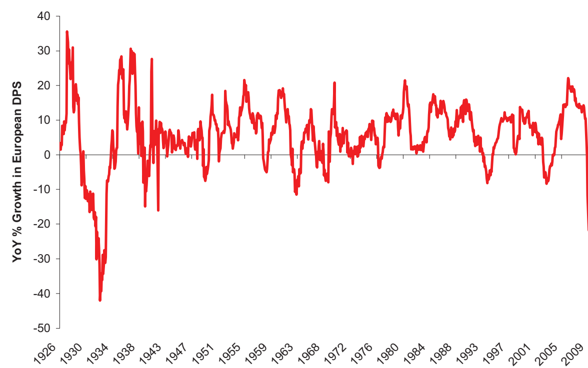
Dividends become a more important driver of equity returns when markets are range-bound



Source: Global Financial Data, Datastream, Morgan Stanley Research

Exhibit 2

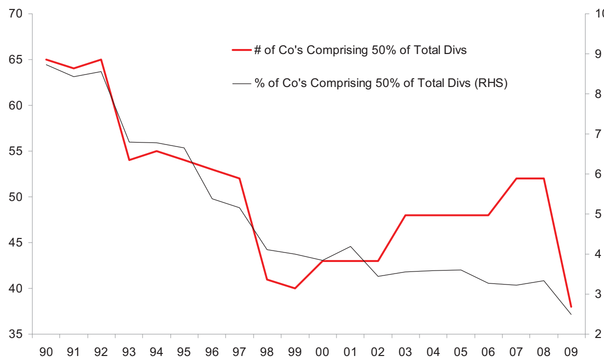
Recent fall in European dividends is the biggest decline since the 1930s



Source: Global Financial Data, Datastream, Morgan Stanley Research

Exhibit 3

Just 2.5% of European companies account for 50% of all European dividends – lowest ever



Source: FactSet, Worldscope, Morgan Stanley Research

Strategy and Economics

shortfall was caused by the financial sector, where payouts are down 72% from their peak.

Concentration risk has sharply increased. The significant fall in financials' payouts has driven a sharp rise in concentration risk with regard to overall market dividends. We estimate that just 2.5% of European companies (38 stocks by number) now account for 50% of all European dividend payments, and 6.3% of stocks (96 companies) pay out 70% of all distributions. These numbers represent the greatest concentration risk since our data started in 1990.

Over the next few years, a macro environment where uncertainty is high, growth is slow and short-term policy rates remain low suggests that stocks which offer investors a high and secure dividend yield should be in high demand. In addition, a rising cost of capital suggests that companies will be quite conservative in their use of cash and may well use internally generated funds, rather than debt, to fund investment as opposed to returning cash to shareholders (see our report *The Cost of Capital Is Going Up*, February 22, 2010).

We highlight 33 stocks offering a high and secure dividend yield. With the help of our research analysts, we have put together a list of stocks that offer a high dividend yield of 4% or more and where we see a low risk of a dividend cut. This last criterion is somewhat subjective – we asked our analysts to nominate stocks where they saw a strong probability that the dividend would not be cut in the next 1-2 years. We have taken a conscious decision to try to include stocks within a number of different sectors to reduce sector-specific risk within the context of an investable basket. The sectors with the highest number of representatives are: Utilities (6); Insurance (5), Telecoms (4), Energy (3), Pharmaceuticals (3) and Retailing (3).

We show the detailed list in Exhibit 4. Based on ModelWare data we calculate that the median stock in the basket offers a 2010 dividend yield of 5.6% that is covered 1.7x by EPS and 1.5x by FCF. This compares to the median stock in our overall European universe that offers a 2010 dividend yield of just 2.7%.

Of the 33 stocks in our list of high and secure dividend yielders, we own 12 in our European Model Portfolio – these are: A2A, Telefonica, KPN, National Grid, AstraZeneca, Admiral, Total, GlaxoSmithKline, BAT, Sanofi-Aventis, BAE and Imperial Tobacco.

Exhibit 4

Our Basket of Stocks with a High and Secure Dividend Yield

							Dividend Cover									
		MS Analyst		Market	Div Yld		EPS/DPS		FCF/DPS		Div Growth (%)		Net Int	Net Debt (LFY) to:		12m Abs
Stock	Sector	Recom	Price	Cap (€mn)	2010	2011	2010	2011	2010	2011	2010	2011	Cover 2010	Equity (LFY)	EBITDA (2010)	Perf (%)
A2A SpA	Utilities	Overweight	€ 1.33	4045	8.0	8.2	1.2	1.2	1.1	0.8	3.0	3.0	3.8	0.9	3.1	23
Telefonica	Telecommunication Services	Overweight	€ 17.99	81464	7.9	9.1	1.2	1.2	1.5	1.3	21.7	14.3	5.5	2.0	2.1	21
RSA	Insurance	Equalweight	£ 1.24	4699	6.9	7.0	1.5	1.5	NA	NA	3.8	2.0	6.4	0.4	2.2	-8
Zurich Financial Services	Insurance	Overweight	SFr 264.80	25817	6.8	7.1	1.9	2.0	NA	NA	5.1	3.9	5.8	0.4	1.6	73
KPN	Telecommunication Services	Overweight	€ 12.14	20376	6.7	7.3	1.4	1.3	1.8	1.7	17.6	9.8	4.4	2.8	1.8	21
Scottish & Southern	Utilities	Equalweight	£ 11.24	11227	6.5	7.0	1.5	1.6	1.5	1.7	6.8	7.0	4.7	2.5	4.1	8
Deutsche Post AG	Transportation	Equalweight	€ 13.01	15433	6.3	6.7	1.5	1.6	1.1	1.2	14.3	6.3	4.8	0.3	0.7	73
Royal Dutch Shell	Energy	Underweight	£ 18.02	124711	6.2	6.4	1.8	2.3	1.0	0.9	5.0	3.0	NA	0.2	0.5	36
Aviva	Insurance	Overweight	£ 3.92	11240	6.1	6.6	2.3	2.5	NA	NA	5.0	7.5	6.1	0.3	1.4	48
RWE AG	Utilities	Equalweight	€ 63.00	33739	5.9	6.3	1.9	2.0	2.3	2.5	8.3	6.2	4.2	0.4	0.4	35
National Grid plc	Utilities	Overweight	£ 6.57	17692	5.9	6.4	1.6	1.6	1.2	1.4	8.0	8.0	2.7	6.0	5.9	16
BP plc	Energy	Overweight	£ 6.12	124914	5.9	6.2	2.1	2.7	1.5	1.9	-9.0	4.8	61.8	0.3	0.6	49
Home Retail Group	Retailing	Underweight	£ 2.59	2519	5.7	5.7	1.6	1.8	1.8	1.5	0.0	0.0	-39.5	-0.1	NM	24
AstraZeneca	Pharmaceuticals	Overweight	£ 29.96	47455	5.7	5.9	2.4	2.4	2.4	2.6	21.5	4.0	18.1	0.0	NM	33
Admiral Group Plc	Insurance	Equalweight	£ 12.40	3660	5.6	6.4	1.0	1.1	NA	NA	21.1	14.0	NA	0.0	NM	39
TOTAL	Energy	Overweight	€ 42.41	98794	5.6	5.9	2.4	2.7	1.1	1.4	2.4	4.9	-138.9	0.3	0.5	21
Vodafone Group	Telecommunication Services	Overweight	£ 1.48	86681	5.6	5.8	1.9	1.8	2.2	2.1	3.9	4.8	6.2	0.3	2.1	24
Snam Rete Gas	Utilities	Overweight	€ 3.55	12658	5.5	5.7	1.3	1.3	-0.1	-0.1	3.0	3.0	4.6	1.4	2.6	15
GDF SUEZ	Utilities	Overweight	€ 27.34	60808	5.5	5.8	1.3	1.5	0.6	1.0	8.6	6.0	7.7	0.5	1.8	20
Unibail-Rodamco	Real Estate	Equalweight	€ 155.70	14207	5.4	5.5	1.1	1.1	1.0	1.0	3.8	2.4	3.4	0.6	6.1	60
GlaxoSmithKline	Pharmaceuticals	Equalweight	£ 12.39	69986	5.3	5.4	1.8	1.9	1.4	1.6	3.8	2.2	14.9	0.9	0.9	20
Allianz	Insurance	Equalweight	€ 88.01	40842	5.1	5.6	2.5	2.5	NA	NA	11.8	8.8	4.9	0.3	1.1	75
British American Tobacco Plc	Food Beverage & Tobacco	Overweight	£ 23.27	50536	4.8	5.2	1.5	1.5	0.6	0.6	10.3	8.8	11.3	1.5	1.8	38
BASF	Materials	Overweight	€ 43.10	38829	4.6	5.1	1.2	1.3	1.6	0.7	0.0	10.3	6.1	0.7	1.5	104
Atlantia S.p.A.	Transportation	Overweight	€ 18.25	10239	4.6	5.0	1.7	1.6	0.5	0.3	10.0	10.0	3.4	2.9	4.6	77
TeliaSonera	Telecommunication Services	Equalweight	SEK 51.25	23400	4.5	4.5	2.1	2.1	1.5	1.5	0.0	0.0	13.1	0.4	1.2	45
Wolters Kluwer	Media	Equalweight	€ 15.24	4369	4.5	4.6	2.2	2.3	2.2	2.3	4.6	2.9	5.5	1.2	2.0	26
Sainsbury	Food & Staples Retailing	Overweight	£ 3.36	6543	4.5	4.8	1.6	1.6	0.2	0.7	8.9	6.6	7.6	0.4	1.4	9
sanofi-aventis	Pharmaceuticals Biotechnology &	Equalweight	€ 55.76	72908	4.5	4.6	2.6	2.4	2.1	1.8	11.8	3.5	33.2	0.0	0.1	34
BAE SYSTEMS		Overweight	£ 3.87	14847	4.3	4.5	2.7	2.4	1.8	1.5	6.0	6.0	22.6	0.1	0.2	7
H&M	Retailing	Equalweight	SEK 450.20	37172	4.2	4.6	1.3	1.3	1.1	1.1	13.6	9.5	-47.5	-0.5	NM	35
Imperial Tobacco	Food Beverage & Tobacco	Overweight	£ 21.54	23925	4.1	4.6	2.1	2.0	2.1	2.2	15.1	12.7	5.1	1.6	3.2	34
PPR	Retailing	Overweight	€ 89.60	11182	4.0	4.6	1.8	1.8	1.6	1.8	8.4	13.3	5.1	0.6	2.9	94
Of this universe	**Median**			**23400**	**5.6**	**5.8**	**1.7**	**1.8**	**1.5**	**1.4**	**6.8**	**6.0**	**5.5**	**0.4**	**1.8**	**34**
Entire European Market	**Median**				**2.7**	**3.3**	**2.2**	**2.4**	**1.6**	**1.9**	**5.0**	**9.7**	**5.5**	**0.4**	**1.8**	**65**

Source: Morgan Stanley Research
For important disclosures regarding companies that are the subject of this screen, please see the Morgan Stanley Research Disclosure Website at www.morganstanley.com/researchdisclosures

Strategy and Economics

March 6, 2010

China Economics
Putting China's 'Over-investment' In Context

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Now that the most precarious phase of the economic crisis seems to be behind us, the need to support economic growth through boosting investment has become less imperative. However, to make a case for a policy shift, many market observers construct their arguments around a structural concept: 'over-investment' in China. While we see a need for slowing down fixed asset investment growth in China in 2010 compared to the high levels in 2009, a policy shift to help effect this slowdown is warranted primarily by the improved cyclical conditions of the economy, instead of such perceived structural problems as 'over-investment', in our view.

"Over-investment" in China: Popular evidence of 'over-investment' in China is its high investment-GDP ratio, which reached over 50% in 2008, higher than the peak levels of not only major economies, such as the US, Japan, and Germany, but also of other major emerging-market economies in the region. Although there is no theoretical benchmark for an optimal investment-GDP ratio, the fact that China has the highest level among countries is considered by many as a strong indication of over-investment in China. However, the investment-GDP (consumption-GDP) ratio based on the official statistics overstates (understates) the true ratio, in our view. With this caveat in mind, we take the official statistics at face value in this research note.

Hearty Appetite or Overweight? Flow vs. Stock: The concept of 'over-investment' makes sense only if there is a notion of what the optimal investment rate for China should be. Despite the popular stance that China's investment is now excessive, very few have convincingly provided a benchmark number. We argue that a more meaningful cross-country comparison should be the capital-labor ratio in the economy. This is a classic 'flow vs. stock' comparison. On this score, China's capital-labor ratio is way below those in either industrialized economies or advanced emerging-market economies.

The 'stock vs. flow' comparison and its implications can also be demonstrated by a specific case: consumption of steel. The total consumption of crude steel in China amounted to 500 million tons in 2008, which is 5x, 4x, and 10x as much as that in Japan, US, and Korea, respectively. This is considered by many as concrete evidence of 'over-investment' and 'over-production' in China. However, if we take a look at the amount of outstanding stock of steel per capita, or as we call it, the 'steel intensity of an economy', it paints a quite different picture: the steel intensify in China is only about 15%, 17%, and 20% of the levels in Japan, US, and Korea, respectively.

Efficiency of investment: ICOR: While there seems to be over-investment based on investment flows, China still has a low level of capital stock, characteristic of an early stage of development. This is consistent with the relatively high efficiency of investment in China, as measured by the Incremental Capital Output Ratio (ICOR). China's ICOR during 2001-2008 is roughly on par with that in Taiwan and Singapore, but substantially lower than those in Japan and the US. Moreover, China's ICOR has been broadly stable since the late 1990s, showing no sign of deterioration, despite investment growth having been very strong during that period.

Efficiency of investment: Return on capital: Investment decisions are ultimately made by entrepreneurs based on their own assessment of the expected rates of return on the capital in the business in which they are investing. The important variable is thus the rate of return on capital: A relatively low or declining rate of return on capital would indicate that investment may be excessive.

In an academic study measuring China's return on capital, the authors find that the rate of return fell from roughly 25% between 1979 and 1992 to about 20% between 1993 and 1998, and it remained in the vicinity of 20% since then through 2005. The authors' findings are broadly consistent with the pattern demonstrated by the ICOR that we have estimated. China's return on capital estimated by the authors compared favorably with that of most advanced and developing economies. The authors' estimate of return on capital is for the economy as a whole during 1979-2005. As an update, we estimate the ROA for industrial enterprises of above designated size, which rose further from the 2005 level before peaking in 2007 at 8% and posting a modest decline to 7% in 2008. The average ROE for the listed company space shares a similar pattern.

These pieces of evidence show that despite high investment rates, the return on capital has not fallen meaningfully. The notion that high investment leads to low returns is based on the law of diminishing returns to capital. Yet the impact of diminishing returns may be weaker for countries with the ability to trade. As a country accumulates physical and human capital, it

Strategy and Economics

can shift its industrial structure towards more capital- and skill-intensive industries, thereby becoming an exporter of physical and human-capital-intensive goods. As long as it can export capital-intensive products, accumulating capital does not translate into a fall in the rate of return on capital. Such was the experience of the East Asian “miracle” economies, which were initially importers of capital-intensive goods. They then saw a continuous process of capital accumulation and structural transformation towards becoming capital-intensive exporters. They were able to sustain high rates of investment and growth for more than three decades. China has moved in the same direction on an unprecedentedly large scale.

China invests simply because it can: To be sure, developing countries are generally characterized by low capital-labor ratios and high returns on investment, just like China. The question is why investment in these countries is not as strong as that in China?

For developing countries, the process of catching up entails capital accumulation, or a high investment rate, which could be financed either from domestic savings or foreign savings. If markets were perfect, investment would not depend on domestic savings, as international capital markets would direct funds into these countries to capture higher returns. However, capital markets are far from perfect, so that most domestic investment is financed from domestic savings. In cases where foreign savings are involved, the funding is too unstable or expensive to sustain strong investment.

It is therefore no surprise that investment closely tracks domestic savings across countries and over time for both developed and emerging markets, except for the recent few years where US investment has exceeded its savings (and generated a high current account deficit). But there is reason to believe that the US holds a unique position, an ‘exorbitant privilege’ in financing its investment from abroad.

Put in this context, China invests simply because it can, in our view. Some related points:

First, given its high level of savings, the argument that China is overinvesting would be tantamount to saying that China’s current account surplus (i.e., the difference between national savings and domestic investment) should be even larger than it is now (through a reduction in investment). That hardly seems like a reasonable argument to us. Therefore, to assuage the current account surplus and at the same time reduce China’s investment to a “non-excessive” level would mean reducing both savings and investment, and savings by much more.

Second, China’s investment rate cannot be understood independently of its high savings. Savings need to be invested, either domestically or abroad. If the rate of return on capital is high in China, then much of its savings will be invested locally. The combination of large savings and high rates of return would make high investment rates a natural outcome.

Third, the unique feature of China’s savings and investment is that they are both much higher than anywhere else. While many factors can independently explain China’s high savings rate and high investment rate, there must also be factors that can simultaneously explain both. High income growth and high expectations of future rates of return on capital are predominant reasons, in our view.

Misallocation of investment – room for improvement: While the investment-to-GDP ratio tells us little about the adequacy or quality of investment, China’s relatively low ICOR and high returns on capital do suggest that investment efficiency in China has so far been quite high. This, however, does not mean misallocation of investment in China is unimportant. It is worth highlighting that while over 85% of financial intermediation is carried out by the banking sector, commercial banks’ lending behavior is not entirely commercially oriented. Moreover, bank deposits and lending interest rates are still subject to administrative controls, and credit still tends to be rationed, especially during boom times. Circumstantial evidence suggests that one should not simply dismiss the risk of misallocation of capital.

Conclusion: Looking at either capital stock or efficiency of investment, robust evidence suggests that investment in China is by no means an outlier in a historical or cross-country context. In general, we do not subscribe to the notion that there are serious structural imbalances (i.e., over-investment, under-consumption) in China’s economy. The concern about ‘over-investment’ seems overdone, and we expect strong investment growth in China for many years to come. The key challenge facing the Chinese economy is how to seize the window of opportunity that ‘over-savings’ offers. To create quality wealth through more efficient allocation of capital, China must get the key pricing and other incentive structure right.

Opinion Changes

March 5, 2010

Bristol-Myers Squibb
Upgrade to Overweight; Pipeline Should Drive Stock Higher

Morgan Stanley & Co. Incorporated

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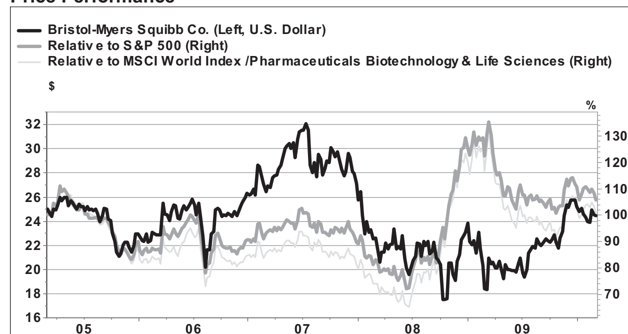
Stock Rating: Overweight	Reuters: BMY.N Bloomberg: BMY US
Price target	$28.00
Shr price, close (Mar 4, 2010)	$24.47
Mkt cap, curr(mm)	$48,420
52-Week Range	$26.50-17.50

Fiscal Year ending	12/08	12/09	12/10e	12/11e
ModelWare EPS($)	1.49	1.84	2.20	2.46
Prior ModelWare EPS($)	-	-	-	2.45
P/E	15.6	13.7	11.1	9.9
Consensus EPS($)§	1.74	1.85	2.22	2.44
Div yld(%)	5.3	4.9	5.2	5.2

§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Price Performance



Source: FactSet Research Systems Inc

Company Description
Bristol-Myers Squibb Company engages in the discovery, development, licensing, manufacture, marketing, distribution, and sale of pharmaceuticals products worldwide. The company's pharmaceuticals products are in several therapeutic categories: cardiovascular (PLAVIX, AVAPRO/AVALIDE, and PRAVACHOL); virology (REYATAZ, SUSTIVA, and BARACLUDE); oncology (ERBITUX, TAXOL, SPRYCEL, and IXEMPRA); affective and other psychiatric disorders (ABILIFY); immunoscience (ORENCIA); and others (includes EFFERALGAN, ASPIRINE UPSA, DAFALGAN, and FERVEX).

Industry View: In-Line — Large Cap & Specialty Pharmaceuticals
While valuations look attractive, we do not believe that the risk-reward outlook for the group warrants an aggressive view.

We are boosting our rating to Overweight with a $28 price target, which is 11x our 2011 estimate of $2.46 and 14x trough 2013 estimated earnings of $2.01 following BMY's March 4 meeting. More optimistic pipeline estimates drove up out-year EPS, culminating in growth from 2013 base (2013-2015E now +6% vs. prior -4%). Our 2015E EPS is 8% above consensus. We see attractive risk-reward, with downside risk limited by 5% dividend yield and potential for strategic activity.

We have greater conviction in Bristol's pipeline.... Bristol-Myers' meeting was one of the more encouraging corporate meetings we have attended in recent years (and certainly BMY's best pipeline update). Its pipeline is as good as some companies 2-3x its size. We are raising our total 2015 estimated pipeline from sales from $4.2B to $5.0B (up 19%).

…and are comfortable with our earnings estimates. Management expects to beat its 2013 guidance and views its 2013 EPS projection of $1.95 as a floor. New CEO Lamberto Andreotti stated "we went with floor guidance rather than providing a range." Both existing pipeline and external activity (BMY has $10B cash) could drive upside.

Exhibit 1

Changes to Our Estimates: Pipeline Revenue…

($M)	2010	2011	2012	2013	2014	2015
Old estimate	11	220	769	1,783	3,109	4,196
New estimate	11	245	837	1,924	3,602	5,059

…and Earnings Per Share

($)	2010	2011	2012	2013	2014	2015
Old estimate	$2.20	$2.45	$2.29	$1.96	$2.08	$1.88
New estimate	$2.20	$2.46	$2.31	$2.01	$2.24	$2.14

Source: Morgan Stanley Research

Ipilimumab could be a revolutionary cancer treatment and it's the primary driver of our higher pipeline projections. Ipi, a novel immunotherapy, stimulates the body's response to tumor cells. Although it is only likely to work in a certain percentage of patients, Bristol believes that it has the "potential for cure." We think this bullishness is based upon data management has seen (but not disclosed) that will be presented at the upcoming American Society of Clinical Oncology in June (Phase III survival data in second--line melanoma and Phase II data in lung cancer). We note BMY management has traditionally been conservative and has used good R&D judgment in recent years, in our view.

Opinion Changes

We also added three probability-adjusted Phase II products: Two in Hepatitis-C and one in Alzheimer's in 2014. BMY's Hep-C products are both first-in-class and could both be blockbusters.

Two late-stage pipeline assets to watch in 2010

- Ipilimumab (melanoma): Management was bullish on Phase III in second-line melanoma and Phase II in lung cancer data (to be presented at ASCO in June). BMY expects second-line filing in 2010. Study 024 (1st line melanoma) survival data are still expected in Fall 2010.
- Dapagliflozin (diabetes): Additional Phase III data will be presented at the ADA in June and EASD in September. We look forward to an update on infection risk. EU filing is on track for 4Q:10.

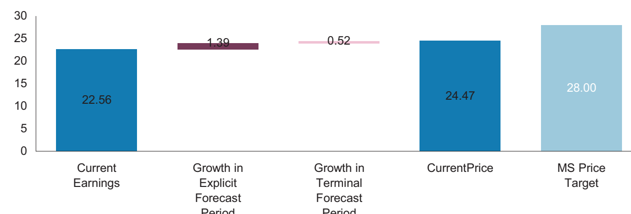
Three key development "platform" highlights

- Immuno-oncology: BMY's immunotherapies that aim to overcome tumor-induced immune suppression -- led by ipilimumab;
- Hepatitis C candidates moving into comprehensive Phase II development: NS5A inhibitor could be a eureka because it could eliminate the need for interferon therapy. Phase IIa study is fully enrolled and EVR data could be presented at EASL in April. Proof-of-concept data on the combination of NS3 (protease inhibitor) and NS5A inhibitors are expected at AASLD in October. We believe launch timeline is critical because patients being warehoused for boceprevir/telaprevir could be warehoused even longer for NS5A. PEG-interferon lambda is a hedge—it is a potential replacement for Peg Intron/Pegasys if better efficacy and tolerability are confirmed.
- Alzheimer's platform updates: Bristol believes its gamma secretase inhibitor is likely to be superior to Lilly's. Top-line Ph II (n=200) data in mild-to-moderate AD are expected in 4Q:10. BMY plans to initiate Phase III in 4Q:10.

Our 'What's in the Price' (WIP) analysis shows a price-implied flat growth beyond 2012. We used Morgan Stanley's WIP analysis to derive Bristol Myers's price implied terminal period value creation/destruction. Exhibit 2 shows the implied growth in the terminal period is 0%, i.e., near zero value creation. We are more optimistic that the company can return to growth longer-term, driven by its effective R&D organization.

Exhibit 2

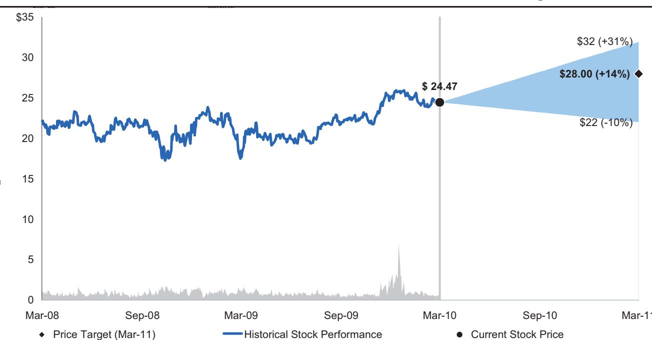
'What's in the Price' Analysis Reflects Lower Future Earnings Power than We Expect



Source: Morgan Stanley Research

Exhibit 3

BMY's Risk-Reward Potential Skewed to Upside



Source: FactSet, Morgan Stanley Research

Bull Case $32	DCF assuming 8.2% WACC/ 1.5% growth rate in perpetuity	**Positive M&A activity and pipeline surprises on upside.** BMY deploys its $10B cash wisely and announces value-creating partnerships/ acquisitions. Ipilimumab (melanoma) treatment-naïve survival data in 2H:10 are positive. Dapagliflozin (diabetes) Phase III data reflect a lower infection risk than feared.
Base Case $28	DCF assuming 8.2% WACC/ 0% growth rate in perpetuity	**Pipeline news, in particular ipilimumab, confirms superior R&D execution.** Ipilimumab (melanoma) treatment-experienced survival data at ASCO June 2010 are good enough to be filed and treatment-naïve data in 2H should be positive; we assume 75% odds of success. Dapagliflozin (diabetes) Phase III data continue to be mixed, with genitourinary infection risk an ongoing overhang. FDA approves belatacept (kidney transplant) in May 2010.
Bear Case $22	DCF assuming 8.2% WACC/ -4% growth rate in perpetuity	**Pipeline disappoints.** Ipilimumab survival data at ASCO are a let down. Dapagliflozin (diabetes) Phase III safety data are worse than expected. Belatacept approval is significantly delayed by FDA in May 2010. Support should be facilitated by 5.6% dividend yield at $22 plus potential for strategic activity.

Our $28 price target is 11.4x our 2011E EPS of $2.46. Downside risks include pipeline failures, dilutive M&A, and Abilify patent broken early. Upside risks include better-than-expected pipeline developments for Bristol-Myers and positive external transaction activity.

New Coverage

March 5, 2010

Discover Financial Services
Conservative Credit Card Play; Initiating at Equal-weight

Morgan Stanley & Co. Incorporated

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Stock Rating: Equal-weight	Reuters: DFS.N Bloomberg: DFS US
Price target	$17.00
Shr price, close (Mar 4, 2010)	$13.78
Mkt cap, curr(mm)	$7,754
52-Week Range	$17.35-4.73

Fiscal Year ending	11/09	11/10e	11/11e	11/12e
ModelWare EPS($)	0.16	0.52	1.12	1.58
P/E	98.0	26.4	12.3	8.7
Div yld(%)	0.8	0.6	1.2	2.3

e = Morgan Stanley Research estimates

Price Performance

Source: FactSet Research Systems Inc

Company Description
Discover Financial Services (DFS) is a credit card issuer and electronic payment services company. The company offers credit cards, personal and student loans, and deposit products. The company traditionally derives roughly two-thirds of its revenues from net interest income, with the remainder composed of loan fees, interchange, transaction fees, merchant fees, and other insurance/fee products.

Industry View: Attractive — Banking - Large Cap Banks
We believe the risk of the Bear Case has significantly decreased: (1) Stabilizing jobless claims increase our conviction that consumer non-performing loan (NPL) growth will peak sooner rather than later (2H09, not 1H10). (2) More liquid wholesale credit markets, greater competition among banks should lower corporate borrowing costs over the next several quarters, reducing commercial NPLs. (3) Bank pre-provision earnings above Bear Case, accelerating capital repair. We expect the debate to shift to normalized earnings power.

We have initiated coverage of DFS at Equal-weight with a $17 price target. We believe that Discover has significant credit improvement coming, but at 8.7x our 2012 "normalized" EPS estimate, we think more of this is priced into DFS than into our Overweight-rated stocks. We expect more upside in our credit-oriented Overweights (Bank of America, J.P. Morgan Chase, PNC, and Wells Fargo), as well as in American Express, whose affluent and corporate customer base should show higher Y/Y spending growth, in our view. We believe DFS's network growth and profitability is more fairly valued than American Express's.

Key Investment Debates for DFS

What is DFS's true earnings power?

We view our 2012 EPS estimate of $1.58 as the normalized EPS for DFS, with lower provisions driving 90% or $1.33 EPS increase vs. 2009. We expect DFS's card charge-off rate to decline from a likely peak of 8.81% in 4Q09 to 8% by year-end 2010, 7.1% in 2011E, and 6.5% by 2012E. We are cautiously optimistic on the other long-term drivers of network growth and expense ratio vs past levels.

Is funding diversification complete?

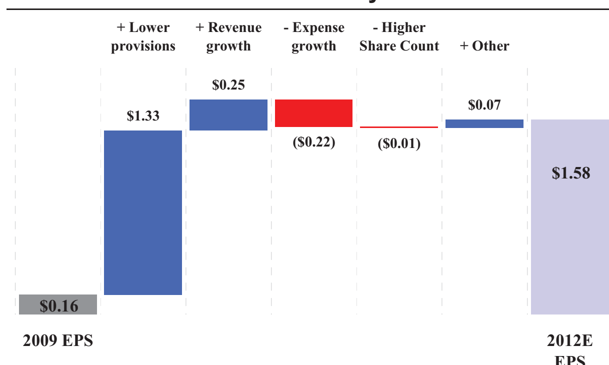
DFS relies on securitization for 37% of funding, though it has markedly reduced its dependence on ABS and moved toward deposit funding over the past eight quarters. Deposit gathering could boost the net interest margin (NIM), while a need for ABS issuance could be a drag. We calculate that DFS has excess capital (estimated 10.6% 1Q10 Common Tier 1), which could be a way to acquire deposits in the future.

What is the value of the Discover network?

We estimate a value of $6.23/share for the network based on our sum-of-the-parts (SOTP) analysis, assigning a 13x multiple to our 2012 derived EPS for the Discover network based on payment-network peers; we believe that Discover needs to increase network traffic to drive its multiple higher.

Exhibit 1

2009-12e EPS Growth: Driven by Lower Provisions

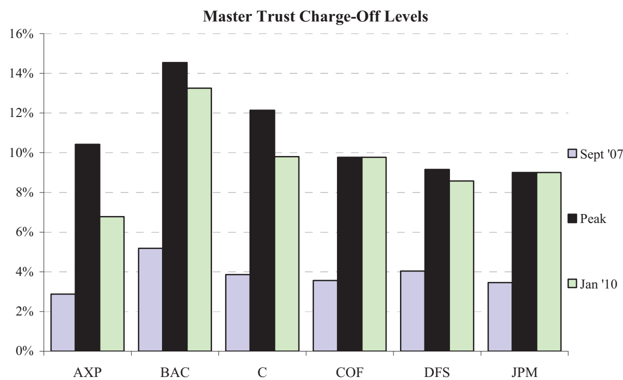


Source: Company data, Morgan Stanley Research

New Coverage

Exhibit 2

Trough to Peak Charge-Offs: *DFS Experienced the Lowest Increase from Sep. 2007 Trough to Peak Levels*



Source: Company data, Morgan Stanley Research.
Note: JPM January 2010 charge-offs adjusted to reflect payment holiday impact.

DFS's loan book drives the majority of revenues and we estimate is worth half the value of the company. Discover generates nearly two-thirds of its revenues from net interest and roughly 83% of total revenues from its loan book. Interchange and transaction processing fees on its PULSE network drive 17% of revenues if we gross up revenues for rewards expense.

Despite increased merchant acceptance, consumers are still spending less on Discover cards. Nilson data indicates that Discover continues to have a lower average purchase volume per account than Visa, MasterCard, and especially American Express. Nilson data also indicates that DFS has a higher portion of inactive accounts than peers, which likely skews spend per account numbers downward.

Our price target is $17. The primary valuation methodologies we utilized for DFS shares include price to 12-month forward earnings multiples, price-to-book, residual income, and our SOTP analysis. While we view a 12-month forward P/E as a meaningful gauge of firm value, we don't view 2010 as the most meaningful indicator of true earnings power at DFS given high credit costs; we find it most useful to use our 2012 earnings estimate, which we view as normalized.

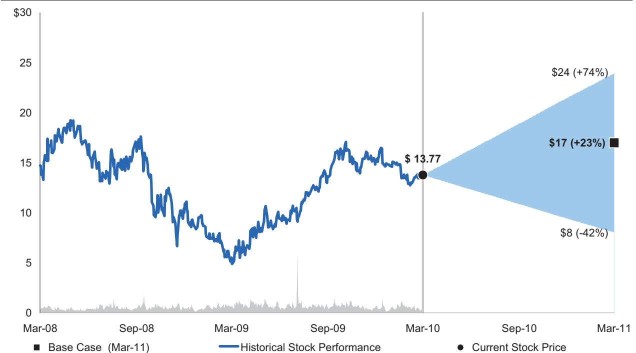
Downside risks include slower than expected credit improvement, increased reliance on ABS funding if deposit growth stalls, elimination of safe harbor on new credit card securitizations, and greater than expected impact of card legislation on NIM.

Please see the important disclaimer on page 4 regarding Bank of America.

Upside risks include faster than expected credit recovery, significant long-term growth in the network as a result of increased merchant acceptance and volumes and accelerating loan growth.

Exhibit 3

DFS: A Conservative Play on Card



Bull Case $24	11x Bull Case 2012 EPS of $2.26	**Sharp Economic Recovery.** Credit improves significantly faster than expected and DFS expands its loan portfolio faster than expected. Yield on card loans remain intact despite card legislative pressures, and DFS funding skews more towards deposits. Also incorporates a larger than expected increase in network spending volumes and acceptance, boosting fee income. Valuation based on bull case residual income.
Base Case $17	11x Base Case 2012 EPS of $1.58	**Slow Recovery.** Card charge-offs likely peaked in 4Q09, but improvement is slow in line with the economy. Normalized (2012) NCO rate of 6.5% in line with 2002-2004; lower provisions drive substantial earnings growth from 2009 levels. Valuation based primarily on residual income and sum-of-the-parts analysis.
Bear Case $8	13x Bear Case 2012 EPS of $0.62	Double Dip. Credit deteriorates and DFS forced to securitize loans at unattractive costs due to slower than expected deposit gathering. Lower reinvestment in network slows top line growth. Valuation based primarily on residual income, with beta increasing to reflect higher funding costs and deteriorating credit quality. Price target reflects a 0.7x P/B

DFS 2012 Estimates ($millions)	Bear	Base	Bull
Net Interest Income	4,203	4,693	5,232
Non-Interest Income	1,850	2,353	2,729
Provision Expense	3,383	3,260	3,102
Non-Interest Expense	2,119	2,396	2,866
Operating Income	342	862	1,236
2012 Operating EPS Estimate	**$0.62**	**$1.58**	**$2.26**
Price Target	**$8**	**$17**	**$24**
2012 Book Value	**$12.29**	**$12.60**	**$12.83**
2012 ROA est	**0.6%**	**1.3%**	**1.7%**
2012 ROE est	**5.3%**	**13.0%**	**18.3%**

Source: FactSet (historical price data), Company data, Morgan Stanley Research estimates

Prices of stocks mentioned (all are rated Overweight):
American Express (AXP, $38.89), Bank of America (BAC, $16.40), J.P. Morgan Chase (JPM, $41.92), PNC Financial (PNC, $54.20), and Wells Fargo (WFC, $28.43).

New Coverage

March 4, 2010

Dole Food

Bananas, Salad, and Deleveraging; Equal-weight

Morgan Stanley & Co. Incorporated

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Stock Rating: Equal-weight	Reuters: DOLE.N	Bloomberg: DOLE US
Price target		NA
Shr price, close (Mar 2, 2010)		$12.00
Mkt cap, curr(mm)		$1,049
52-Week Range		$12.56-10.75

Fiscal Year ending	12/09	12/10e	12/11e	12/12e
ModelWare EPS($)	0.99	1.60	1.79	1.93
P/E	12.6	7.5	6.7	6.2
Consensus EPS($)§	1.10	1.63	2.38	-
Div yld(%)	0.0	0.0	0.0	0.0

§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Company Description
Dole Food Company produces, markets, and distributes fresh fruit and fresh vegetables, including an expanding line of value-added products. Dole's key product categories include bananas, packaged salads, and packaged fruit.

Industry View : Cautious — Food & Food Service
We maintain a Cautious view on the US packaged food industry due to the challenging operating environment, ongoing retailer consolidation, increasing private label exposure, and pricing pressures.

We have initiated coverage of Dole Food with an Equal-weight rating; we prefer Chiquita Brands shares. We think Dole's core fruit business has limited upside from here and that expectations for salad penetration may be too optimistic. We prefer Chiquita Brands (CQB, $14.17, Equal-weight) as a fresh produce play due to its more attractive valuation (5.1 times 2010e EBITDA versus Dole at 5.9 times).

Drivers of earnings and share price

(1) Banana pricing, at worst, likely stable from here, but costs could present a risk. We see upside to costs from here as higher third-party sourcing, bunker fuel, resin, and containerboard costs appear set to increase during 2010. Dole will likely need to continue raising banana prices long term to offset potential cost increases, beyond 2010, but we believe that Dole may have limited ability to continue raising banana prices in excess of cost increases. Potential return of supply following multiple years of weather related production disruptions presents some risk.

(2) Too early to know how a lower EU banana tariff will play out. We think the tariff reduction offers upside if Dole can hang onto a sizable portion of the cost savings, but it is possible that Dole will see no EPS benefit. Dole should almost certainly see a lower cost of bananas shipped to Europe once the tariff reduction goes into effect. However, retailers are likely to compete for this benefit, and lower costs could bring new, smaller banana producers into the European market, which has recently seen weather-related price softness.

(3) The market is skeptical that bagged salad growth will accelerate; we concur. We are less optimistic than management about the potential for growth within the category. While salad has the potential to drive growth, we believe poor results since 2006 will make the market await multiple quarters of improved results before pricing in salad's full potential. We see upside if management can deliver on guidance of 6–7% fresh vegetables revenue growth and 2–3% EBIT margin, but we model 5% revenue growth and a 2% margin.

(4) We believe bunker fuel and FX pose $0.21 downside risk to our 2010 EPS. Dole is materially exposed to bunker fuel and FX, and we see potential for both to move substantially in the wrong direction. If bunker fuel prices were to remain at current levels, they would be ~27% higher in 2010 than in 2009. In our base case, we model a ~15% increase in bunker fuel costs and flat currency in 2010.

Key Risks

- Unpredictable weather events in product growing regions
- Rising input costs (i.e., bunker fuel, plastic, fertilizer, containerboard, etc.)
- Increased competitive banana production
- Product oversupply/undersupply, tariffs, food disease, and labor difficulties.

Exhibit 1
Comparable Produce Companies

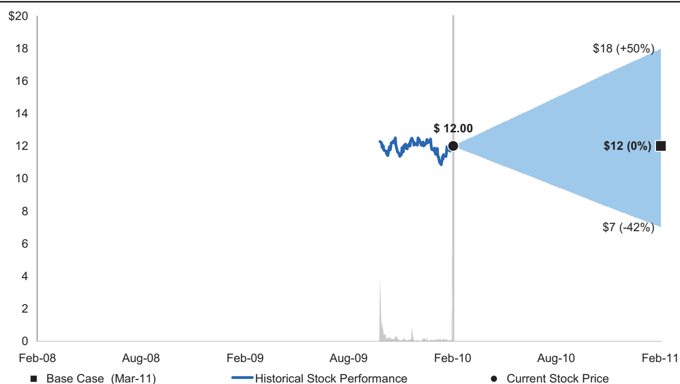
Ticker	Company name	Share Price	Market Cap	P/E 2009E	P/E 2010E	EV/EBITDA 2009E	EV/EBITDA 2010E	Net Debt / EBITDA 2009E	Net Debt / EBITDA 2010E
CQB.N	Chiquita Brands International Inc	$14.44	$600	6.3 x	5.4 x	5.3 x	5.1 x	2.4 x	1.5 x
FDP.N	Fresh Del Monte Produce Inc.	$19.85	$1,345	8.6 x	8.7 x	6.3 x	5.5 x	1.3 x	1.0 x
DOLE.N	Dole Food Company, Inc.	$12.00	$1,049	12.1 x	7.5 x	6.1 x	5.9 x	3.5 x	3.0 x

Source: FactSet, Morgan Stanley Research estimates

New Coverage

Exhibit 2

DOLE: Core Fruit Business May Have Limited Upside; Expectations for Salad May Be Too Optimistic

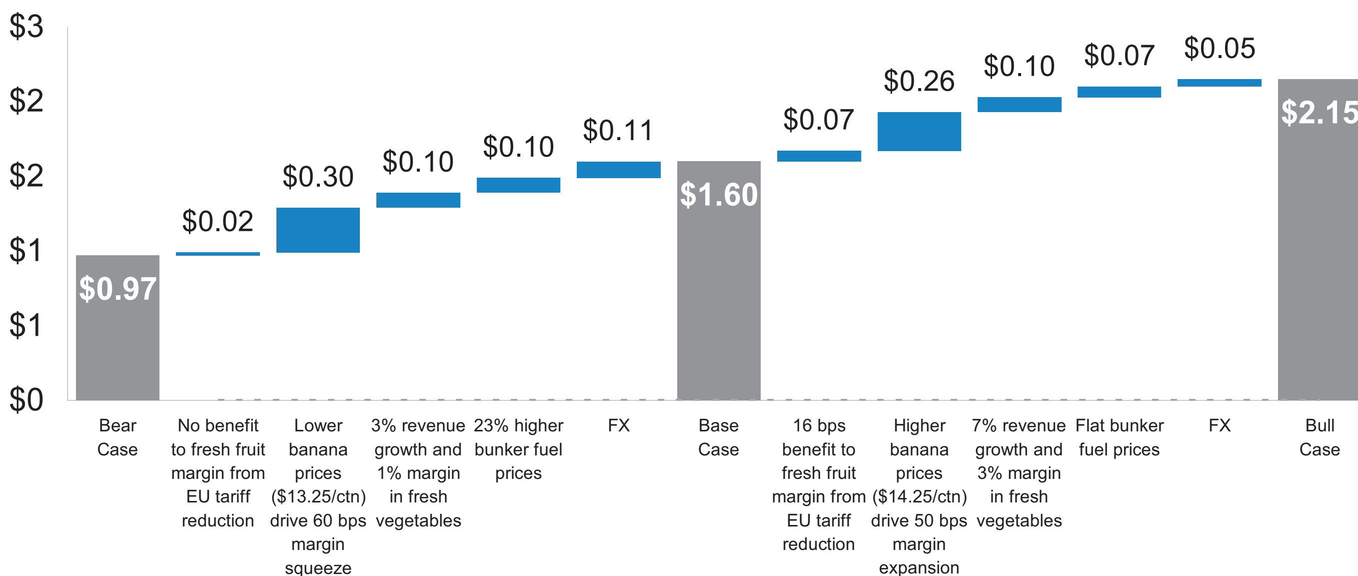


Bull Case $18	6.25x 2010 Bull Case EBITDA of $491 million	**Banana pricing power, salad grows in line with guidance.** (1) Banana supply tight, prices higher; (2) Wholesalers benefit more than retailers from EU tariff cut (0.16% fresh fruit margin benefit); (3) Salad improves in line with guidance (7% rev growth, 3% margin); (4) FX and bunker fuel prices are a tailwind
Base Case $12	6x 2010 Base Case EBITDA of $431 million (Current mult. is 5.9x.)	**Bananas flat, investors wait for improved salad results.** (1) Banana prices remain relatively flat ; (2) There is no net benefit from the EU banana tariff reduction; (3) Salad improves slightly less than management expects (5% revenue growth, 2% margin); (4) Flat FX and 10% higher bunker fuel costs.
Bear Case $7	5.75x 2010 Bear Case EBITDA of $365 million	**Multiple disappointments.** (1) Banana supply loosens, and prices decline; (2) A lower EU tariff increases banana production and pressure prices; (3) Salad improves less than management expects (3% revenue growth, 1% margin); V4) FX and bunker fuel prices are a substantial headwind

Source: Morgan Stanley Research, FactSet

Exhibit 3

Dole Food: 2010e Bear to Bull EPS



Source: Morgan Stanley Research, FactSet

New Coverage

March 9, 2010

Freight Transportation
Reiterating Bullish Stance on Rails; Initiating on CP and KSU at Equal-weight

Morgan Stanley & Co. Incorporated

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Raising estimates/price targets and reiterating our bullish call on Railroad stocks. We believe rail volumes could grow at double-digit rates in 2010 and see recent weekly traffic data as thesis-confirming. As a result, we have adjusted estimates slightly higher for many of the rails we cover and have raised our price targets for CNI, CSX and UNP (Exhibit 2); in all cases, we continue to be significantly above consensus. In the coming months, we expect upside revisions to consensus driven by the following trends: (1) weekly volumes tracking better than expectations, (2) operating leverage to recovering volumes, and (3) sustained momentum on core price. We reiterate our view that Overweight-rated CSX and Union Pacific (a Morgan Stanley Best Idea) are positioned most favorably with respect to these themes.

Initiating coverage of Canadian Pacific (CP) at Equal-weight. CP has a number of favorable characteristics that we look for in a recovery scenario, notably (1) exposure to higher-growth markets (i.e. CP's outsized export bulk commodity exposure) and (2) easy operating margin comps to support earnings growth. Unfortunately, there exist some offsetting negatives relative to other rails in the form of (1) relatively weak run-rate traffic forecasts and (2) relatively less upside vs. consensus estimates. As a result, we are initiating on CP at Equal-weight. That said, despite balanced risks relative to other rails, we see absolute upside through year-end.

Initiating Coverage of Kansas City Southern (KSU) at Equal-weight. Not only should KSU benefit from all of the cyclical and secular trends we expect top continue driving Class I rails, but the company also should benefit from a number of unique positives, including: (1) the recent re-pricing of a major contract driving industry-leading pricing growth in 2010, and (2) unique volume growth opportunities (such as cross-border intermodal). However, we believe that much of this is already reflected in the stock's substantial premium vs. the group (KSU trades at ~24x our 2010 EPS estimate vs. a Class I Rail average ex-KSU of about 14.5x).

Exhibit 1

Key Rail Themes Emerging from the Debates

Theme	Best	Better	Good
Volume Rebound	CNI / KSU / UNP	NSC / CP	CSX
Operating Leverage	KSU / CSX	CP / NSC / UNP	CNI
Pricing Trends	UNP / KSU	CP / CSX / NSC / UNP	CNI
Valuation	CSX	CNI / CP / NSC / UNP	KSU

Source: Company data, Morgan Stanley Research

Exhibit 2

Morgan Stanley EPS and Fair Value Estimates Suggest Upside

Ticker	2011			Price Target			Rating
	Cur MS Est.	Cons. Est.	MS vs. Cons.	Old	Current	% Upside	Current
CNI	$4.56	$4.17	Higher	58*	63*	13%	EW
CP	$4.05	$3.85	Higher	NA	57*	5%	EW
CSX	$4.30	$3.85	Higher	57	60	22%	OW
KSU	$2.00	$1.77	Higher	NA	40*	13%	EW
NSC	$4.58	$4.02	Higher	64*	64*	21%	EW
UNP	$5.68	$5.03	Higher	80	81	17%	OW

Source: Morgan Stanley Research, * = YE2010 Base Case Valuation, Not a Price Target
Current prices of stocks mentioned: CNI ($55.87); CP ($54.19); CSX ($49.03); KSU ($35.55); NSC ($52.97); UNP ($69.49).

Valuation and Risks: For CSX and UNP we apply ~14x multiple to our 2011 EPS estimates to generate year-end 2010 price targets of $60 and $81, respectively. Our ~14x 2010 year-end forward P/E is derived from historical P/E multiples and comparable company multiples across Class I rails.

Key risks for CSX include: long history of subpar operational efficiency vs. peers; secular decline trend a risk to eastern coal franchise; aggressive pricing tactics may backfire if pro-shipper

Industry View : Attractive — Freight Transportation
We believe rail volumes could grow at double-digit rates in 2010 and see recent weekly traffic data as thesis-confirming. In the coming months, we expect upside revisions to consensus driven by the following trends: (1) weekly volumes tracking better than expectations, (2) operating leverage to recovering volumes, and (3) sustained momentum on core price.

New Coverage

legislation is passed; and volume growth causes service levels to deteriorate, causing productivity to disappoint.

Key risks for UNP include: legacy contract re-pricing can lead to surprise volume losses if too aggressive; contract renewals during deep downturn could limit 2010 pricing; history of poor execution around volume rebounds could be risk for 2010/11; and lower fuel surcharge coverage limits upside to higher fuel prices.

Exhibit 3

2010 Run-Rate Based Volume Growth Forecasts Outstrip Our Estimates (Which We Think Are Bullish)

2010 Seasonally Adj. Straight-Line Forecast

	1Q10	2Q10	3Q10	4Q10	FY10
CNI	16%	30%	15%	11%	18%
UNP	12%	19%	10%	9%	12%
KSU	15%	20%	7%	7%	12%
CP	6%	16%	7%	9%	10%
NSC	6%	16%	7%	5%	8%
CSX	2%	10%	1%	4%	4%

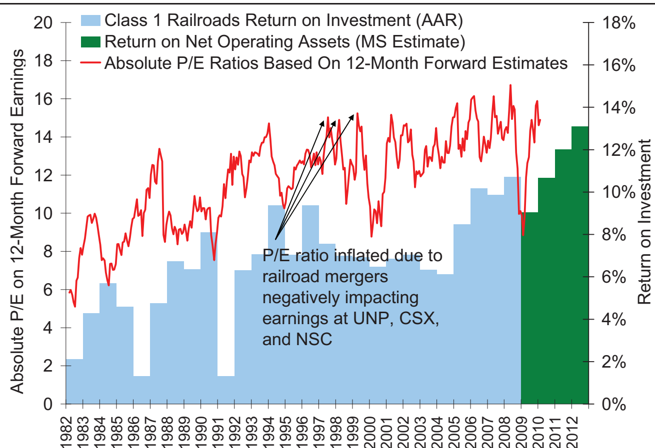
MS Assumptions: Broadly More Conservative Than Trend

	1Q10	2Q10	3Q10	4Q10	FY10
CNI	13%	24%	11%	8%	14%
KSU	12%	16%	5%	5%	9%
UNP	9%	15%	7%	6%	9%
NSC	4%	13%	7%	5%	7%
CP	4%	13%	5%	7%	7%
CSX	4%	11%	3%	5%	6%

Source: Company data, Morgan Stanley Research

Exhibit 4

Re-rating Trend Likely to Continue on the Back of Improving Rail Asset Returns



Source: Morgan Stanley Research, FactSet

Summary of Key Debates

1. **Are rails an attractive way to play economic recovery?**
   Market View: *Rails are well positioned to benefit from the broader economic recovery, but other large-cap transports are likely better plays* on the economic recovery, namely the parcel stocks (FedEx specifically).
   Our View: Consensus is too cautious on volume growth and EPS in 2010 across the rails broadly. Recent trends alone suggest a much more optimistic volume outlook is warranted and the potential for further momentum on the economic recovery suggests volume and earnings surprises are likely in the coming months. Notably, UNP and CNI are best positioned with respect to this theme.

2. **Are rails well positioned to benefit from operating leverage to rebounding volumes?**
   Market View: *Rail margins held in throughout the downturn as volumes declined by double digits.* Lack of operating leverage as volumes declined suggests that rails will also lack operating leverage as volumes rebound.
   Our View: Rails are in the midst of a long-term price and productivity improvement story. Lack of negative operating leverage in the downturn speaks to rail success at improving productivity rather than lack of operating leverage. Though we don't expect the rails to benefit from operating leverage with each bit of volume that returns, we believe rails will experience high incremental margins on at least the first 5-10% of rebounding volumes. Furthermore, we view rail earnings growth as significantly more sustainable than at other large-cap transports. Notably, KSU and CSX are best positioned on this theme.

3. **Is rail pricing likely to hold firm over the coming years and is there a threat of re-regulation?**
   Market View: *Pricing growth has decelerated in recent quarters and could remain depressed* due to slowing momentum on legacy re-pricing. The impact of regulatory threats remains uncertain.
   Our View: We believe the long-term rail pricing story is very much intact. Indeed, we believe pricing could begin to reaccelerate in 2010 as a result of (1) inflation-linked escalators reaccelerating and (2) truck pricing improving in 2H10. Furthermore, we believe that recent events in the Senate, which are causing a power shift, make controversial, Democrat-led legislation more difficult to pass (such as the rail bill). Notably, UNP and KSU are best positioned with respect to the pricing story, in our view.

Industry Analysis

March 8, 2010

Diversified Financials

Online Brokers: Sizing the Impact of a Rate Increase

Morgan Stanley & Co. Incorporated

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We have been asked by a number of investors on the impact of a Fed rate increase that matches Morgan Stanley's economists' views (i.e., increases starting in 3Q10, with Fed Funds reaching 150 bps by year-end 2010) on Schwab and Ameritrade. For Schwab, we forecast $1.5 billion of revenue growth in 2011 (+36%), and ~60% is rate-related. For Ameritrade, we forecast $860 million of revenue growth in F2011 (+32%), and ~45% is rate-related. We expect 2012 EPS represents "normalized earnings" for both companies, though more so for Ameritrade than Schwab due to (1) the duration of its assets in money market deposit accounts — recently renamed Insured Deposit Accounts, or IDAs (two-plus years); and (2) because Ameritrade's fiscal year ends September 30. For Schwab, our 2011 EPS estimate is $1.28, while the Street is at $1.11. For Ameritrade, we forecast F2011 earnings of $1.72, while the Street is at $1.53.

Shares of both Charles Schwab and TD Ameritrade look attractive on 2011e earnings. Due to the significant increase in revenue and earnings for both companies in 2011, their earnings multiples on our estimates for 2011 decrease dramatically over 2010. While SCHW is trading at 27.5 times Morgan Stanley's 2010 estimate, it is trading at 14.8 times 2011e EPS. AMTD is trading at 16.0 times our F2010e EPS and 10.5 times F2011e.

We reiterate our Overweight ratings on SCHW and AMTD. AMTD's valuation looks attractive with or without a rate increase later this year, while we view SCHW as fully valued if rates do not increase until mid-2011 or beyond.

Schwab: ~60% of 2011e revenue increase rate-related. Schwab management refers to the "latent earnings power" of the current interest rate cycle, and believes the company is "spring-loaded" for revenue growth. Certain of its assets are invested in shorter-dated products that will re-price almost immediately, while others will take time to re-price. During Schwab's November investor day, management stated that for the first two 100bps change in interest rates, the company's net interest margin would increase by 70bps each time.

Exhibit 1

SCHW Interest-Earning Assets / Funding Sources

	2009			2010E			2011E		
	Assets	Rate	Revenue	Assets	Rate	Revenue	Assets	Rate	Revenue
Assets									
Cash and Cash Equivalents	$7,848	0.42%	$33	$8,364	0.39%	$33	$9,597	1.65%	$158
Cash and Investments Segregated	16,291	0.49%	80	17,456	0.39%	68	14,288	1.40%	200
Broker-related Receivables	363	0.28%	0	420	0.40%	2	464	1.40%	6
Receivables from Brokerage Clients	6,749	5.20%	351	9,476	5.07%	481	13,057	5.90%	770
Other Securities Owned	126	0.79%	1	372	1.43%	5	411	2.40%	10
Securities Available for Sale	18,558	2.81%	521	20,017	2.47%	495	22,683	3.30%	749
Securities Held to Maturity	1,915	3.86%	74	7,334	3.62%	266	8,568	3.90%	334
Loans to Banking Clients	6,671	3.61%	241	8,766	3.55%	311	11,707	3.90%	457
Loans Held for Sale	110	2.73%	3	108	4.91%	5	118	4.91%	6
Other Interest-earning Assets	0	N/A	124	0	N/A	120	0	N/A	124
Total Interest-Earning Assets	$58,631	2.44%	$1,428	$72,313	2.47%	$1,785	$80,894	3.48%	$2,814
Funding Sources									
Deposits from Banking Clients	$31,249	0.34%	($107)	$41,630	0.39%	($164)	$48,634	0.65%	($316)
Payables to Brokerage Clients	18,002	0.02%	(3)	21,464	0.10%	(21)	21,603	0.75%	(162)
Long-term Debt	1,231	5.77%	(71)	1,337	5.04%	(67)	1,312	5.00%	(66)
Non-interest-bearing Sources	8,149	0.00%	(2)	7,882	0.00%	0	9,344	0.00%	0
Provision for Credit Losses	N/A	N/A	(38)	N/A	N/A	(20)	N/A	N/A	(15)
Total Funding Sources	$58,631	0.38%	($221)	$72,313	0.38%	($272)	$80,894	0.69%	($559)
Net Interest Revenue	$58,631	2.06%	$1,207	$72,313	2.09%	$1,513	$80,894	2.79%	$2,256

Source: Morgan Stanley Research; Company data E = Morgan Stanley Research estimates

Schwab is relatively risk averse when it comes to investing its clients' cash. Management has stressed it is willing to pass on yield if a move risks damaging its reputation with clients. Schwab's interest earned on client assets (excluding interest paid out to clients) has historically been less than the prime rate. While this would imply upside, we believe Schwab will continue to be conservative in the future.

Most of Schwab's interest-earning assets and funding sources are split between the bank and the brokerage business.

- *We expect Schwab's bank earnings to grow driven by increases in deposits / rates recovery.* Schwab's bank earnings have grown during the low interest-rate environment because the decline in its net interest margin (NIM) was offset by increased deposits; we expect bank earnings to grow as NIM returns to normalized levels and SCHW continues to grow deposits.
- *We expect brokerage net revenue to increase significantly as the Fed raises rates.* Brokerage revenue is interest earned on cash in clients' brokerage accounts and on cash held from other brokers, dealers and clearing organizations (typically collateral). Schwab earns interest by offering margin loans to its clients, posting collateral with other institutions, or "segregated" in lower-risk securities. As the Fed Funds rate rises, Schwab should generate more upside from segregated cash than downside from interest on brokerage cash. The interest rate Schwab receives on its margin loans is typically in line with or slightly higher than the prime rate. The increase in the margin loan balances / rates recovery should drive strong revenue growth for the brokerage business.

Industry View: In-Line — Diversified Financials
We see greater upside to our Base Cases, on average, vs. Morgan Stanley's strategy team's expectation for the S&P 500 in 2010; however, our In-Line view is driven more by the disparate group of companies we cover than by the relative outlook.

Industry Analysis

Ameritrade: ~45% of 2011e revenue increase rate-related. Ameritrade's interest/fee-earning assets revenue lines are affected directly or indirectly by interest rates. We believe interest rates will be the biggest driver of earnings variability in 2011 for Ameritrade. As rates increase, we will see an almost immediate benefit for net interest in the shorter-dated interest-earning/fee-based assets (segregated and other cash/ interest-earning investments, client credit, money market funds). However, we believe it will take two years before IDA balances run off and are fully re-priced.

Management has stated that with interest-earning assets where they are, EPS would increase $0.07 with every 25bps hike in the Fed Funds rate for the first 100bps — in the first year after the increase (due to the two-year plus duration of Ameritrade's IDA assets results in a delay in the full earnings benefit to the company). If rates are at the levels Morgan Stanley economists expect by year-end 2010, it won't be until 2012/2013 that Ameritrade's earnings reflect the full benefit. This estimate is "point of time;" as assets grow and asset allocations shift between interest-earning/fee-based products, the impact can change.

Exhibit 2

Ameritrade Interest/Fee-Earning Revenue Drivers

FYE 9/30	F2009			F2010E			F2011E		
	Assets	Rate	Revenue	Assets	Rate	Revenue	Assets	Rate	Revenue
Segregated Cash	$3.9	0.17%	$6.6	$3.3	0.14%	$4.7	$0.4	1.23%	$4.8
Client Margin Balances	4.5	5.14%	234.2	7.4	4.81%	354.0	10.3	5.58%	574.7
Securities Borrowing	0.5	23.42%	105.4	1.0	9.85%	98.1	2.8	7.00%	196.5
Securities Lending	1.2	-0.24%	(2.9)	2.0	-0.16%	(3.1)	4.6	-0.83%	(37.9)
Other Cash and Investments	1.1	0.33%	3.4	1.1	0.21%	2.4	1.3	1.58%	21.3
Client Credit	6.2	-0.07%	(4.0)	7.4	-0.05%	(3.7)	5.2	-0.50%	(26.2)
Conduit Business	1.2	0.86%	10.8	1.1	0.63%	7.1	2.2	2.00%	44.9
Securities Lending - Conduit	1.2	-0.53%	(6.7)	1.1	-0.50%	(5.6)	2.2	-1.87%	(42.0)
IDA	22.0	2.55%	568.1	38.1	1.78%	676.8	43.0	2.22%	954.0
Money Market Funds	23.4	0.51%	119.8	13.2	0.15%	20.4	13.1	0.65%	85.0
Mutual Funds / Other	36.1	0.18%	64.5	50.7	0.21%	104.8	58.0	0.20%	116.0
Total Interest/Fee-Earning	$92.6	1.19%	$1,099.2	$115.8	1.08%	$1,255.8	$131.2	1.44%	$1,891.2
Year-over-year Growth	-9.0%	-18.8%	-26.1%	25.1%	-8.7%	14.2%	13.3%	32.9%	50.6%

Only includes interest/fee-earning assets, so excludes securities lending (incl. conduit) / client credit

Source: Morgan Stanley Research estimates; Company Reports

Margin balances are typically Ameritrade's highest revenue generator given the wide spreads Ameritrade is able to charge for margin loans. As the stock market has recovered, Ameritrade has experienced sequential growth in client margin balances of 17–20% in the past two quarters. We model margin balances as a percentage of overall client assets, increasing as investor risk appetite rises. We expect margin balances to continue to grow as clients take more risk, topping out at 2.75% of client assets, in line with where they were in late 2006/early 2007.

Exhibit 3

Ameritrade Client Margin Balances

FYE 9/30	F2007	F2008	F2009	F2010E	F2011E
Avg. Client Margin Balances ($b)	$7.5	$8.1	$4.5	$7.4	$10.3
Year-over-year Growth	17.2%	8.5%	-44.8%	63.8%	39.9%
% of Avg Client Assets	2.6%	2.7%	1.8%	2.2%	2.8%
Avg. Interest Rate	8.07%	6.37%	5.14%	4.81%	5.58%
Interest Revenue	$615.2	$527.1	$234.2	$354.0	$574.7

Saw a significant decline in F2009 margin balances as account values declined and investors were more wary of risk

Source: Morgan Stanley Research estimates; Company Reports

Securities Borrowing/Lending is a wildcard that long term we don't expect will be a major driver but will likely benefit Ameritrade near term. Ameritrade is currently paying low rates on its securities lending balances and receives high rates for borrowing.

We forecast Ameritrade's IDA fees as an eight-quarter waterfall to reflect the duration of investments. IDA balances have grown significantly since the cash management strategy was announced in the March 2009 quarter; Ameritrade plans to continue marketing its deposit program as an alternative to money market funds in the future. Near-term, Ameritrade's IDA balances will be a drag on NIM recovery given the duration of the assets. Longer term, we believe the Street underestimates the growth in Ameritrade's IDA revenue. With an average over two years duration on its investments, Ameritrade is generating attractive returns in more normalized interest rate environments. In addition, as Ameritrade grows its share of client wallets, more assets will be in cash and money market funds.

Investment product fees likely to grow again in F2011 as MMF waivers roll off, but likely never to return to 2008 levels as Ameritrade has transitioned the majority of MMF to IDA. The key drivers of investment product fees are assets and yield, both of which have come under pressure and we expect will continue to be pressured near-term.

Stocks mentioned: Charles Schwab (SCHW.N, $18.96, Overweight) and TD Ameritrade (AMTD, $18.09, Overweight).

Industry Analysis

March 9, 2010

Electrical Equipment & Industrial Conglomerates

China: Can US Industrials Win? We Think 3M, Danaher, and Honeywell Can

Morgan Stanley & Co. Incorporated

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China trip conclusions: Short-term tailwinds, long-term challenges for US industrials. Our early-March trip to China brought more clarity to the China debate and yielded more bullish takes than our mid-2009 trip. Challenges remain and we are quite concerned about the long-term impact of potential property bubbles and excessive bank lending, but we believe that tailwinds into 2010 and probably 2011 are strong. Relative to our trip in 2009 demand is stronger in a broader cross-section of end-markets including previously weak markets like construction and healthcare. Our sense is that excesses still exist and excess capacity is widespread, but demand remains strong and government tightening is having little effect on Industrial to date. Excess capacity is largely being mopped up locally and pricing holding in better than we would have thought (i.e. flattish).

We were encouraged by order books: Book/bill for 2010 will likely be in the range of 1.1 to 1.25 for US Industrials, with particular strength in local consumer-based markets including healthcare and transportation, and still-solid markets for construction and infrastructure. Export markets are improving sequentially with modest growth rates. Strange seasonal/calendar timing make for a lumpy March quarter, with strong January and weak February activity but stabilization in March. The June quarter should be good despite recent Chinese government efforts to slow growth.

However, in China US companies (generally) continue to lose market share to local Chinese competitors, which are now impressive, with rapidly expanding technology, improving manufacturing techniques, and aggressive pricing. They generally have good local distribution and strong political support. Foreign bidders are likely at a disadvantage.

Internationally, though, Chinese competitors struggle with global distribution shortcomings and global competitors seem less than willing to help in that regard. Having said that, Chinese competitors are making inroads where distribution is less established, less loyal, and less brand-conscious. We believe Chinese quality remains a “show me” and it remains well behind in areas that take a lot of trial and error, notably metallurgy, factory efficiency, supply chain management, etc. Chinese Industrials are making some progress with international expansion, particularly in the rest of Asia, India, Latin America, Africa — essentially all the growth regions. We find it unlikely joint venture technology “sharing” will be successful long-term for US and European industrials.

The lion’s share of growth in China has pushed off the coasts from familiar areas like Beijing and Shanghai and toward urban, yet undeveloped, regions in western China. Local Chinese companies are doing extremely well and gaining share across the board — a similar trajectory to what caused us alarm in 2009. However, we believe there is at present enough business to keep everyone happy and profitable.

Lonking is an impressive Chinese construction equipment company that we’d suggest US investors visit when in China, as are Sany and Shanghai Electric.

Some US companies are winning — we believe that 3M and Danaher stand out. Both offer products that are not on government planning radar and have attractive end-markets.

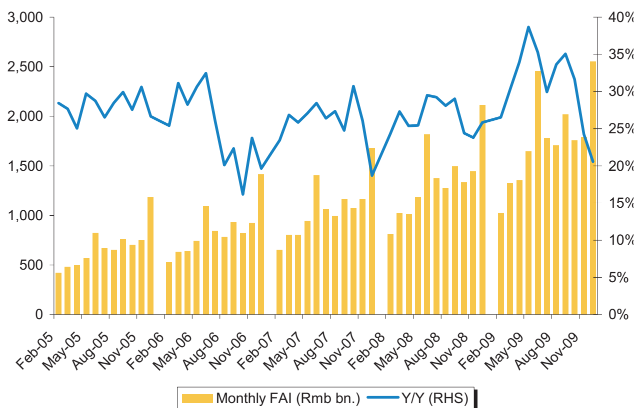
…but Honeywell was the big positive surprise of our visit. For context, we always found Honeywell to have an unimpressive and largely disorganized China effort. This has changed, in our view — we now consider Honeywell best in class in China — and a new theme in energy efficiency has been the biggest catalyst. Attendees of our trip were all in agreement — Honeywell’s rate of change in China is exceptional. With upgraded management and R&D efforts that we view as best in class, Honeywell is gaining share. The company’s R&D facility is turning out promising products in LED, Solar, and energy efficiency. Its turbo business looks well positioned, as is UOP. Now Environmental Controls is a big driver of growth. Aerospace is a new opportunity, and Honeywell is claiming big wins with new Chinese Aero efforts.

Concern about Chinese monetary tightening and the effect on industrial demand is over-emphasized and over-discounted, we believe. Post-tightening, order books remain strong and infrastructure spend tailwinds are too large to be impacted in 2010, maybe some impact in 2011 but export markets should be picking up by then and take up the slack.

Industry View: Attractive - Electrical Equip. & Industrial Conglom.
We believe that fundamentals have surpassed multiples that have contracted recently to highly attractive levels. Stronger-than-expected order books provide visibility through 2010 and into 2011 on a sustainable industrial upcycle that we expect to exceed consensus views.

Industry Analysis

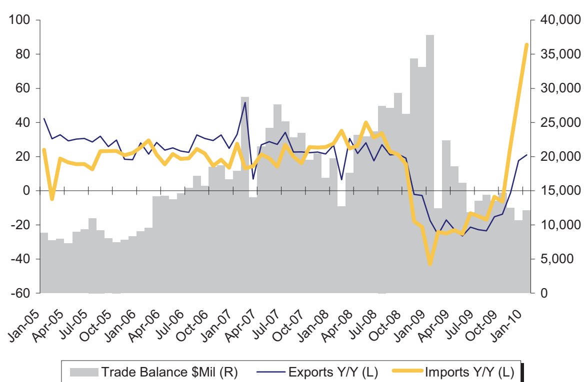
Exhibit 1
China Fixed Asset investment: Strong Growth Continues



Source: National Bureau of Statistics, CEIC and Morgan Stanley Research

The bigger issue remains the notably rapid development of Chinese product and manufacturing capabilities, in our opinion. Industries once thought to be "bulletproof" — like excavators, cranes, aerospace, high-efficiency gas and wind powergen, elevators, automation —all face increased competition. Much foreign technology has been bought (through JVs) or internally developed. We believe that a new global reality will include Chinese competitors with improving technology capabilities and an increasing appetite for export.

Exhibit 2
Export Markets Should Strengthen Through 2011: China Exports Up 17.7% in Dec 2009, 21.0% in Jan 2010

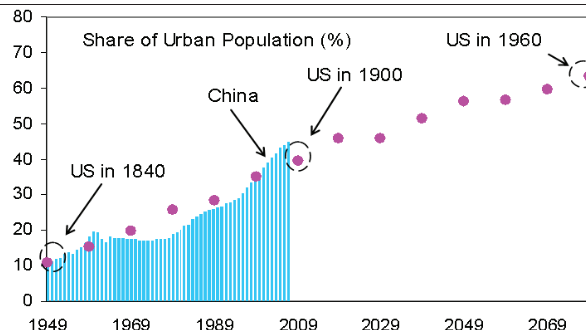


Source: CEIC, Morgan Stanley Research

For most major global industrial companies that entered China, the cost has been higher than the P&L might indicate. A 2009 tax increase on global multinationals changed the economics. Much capital has been put into China but little cash has found its way back. Labor inflation and higher logistic expenses are proving greater than expected. Local "buy China" preferences affect competitive balance. In industries considered "nationally critical" Chinese competition has become fierce; China aims to be strong in Aerospace.

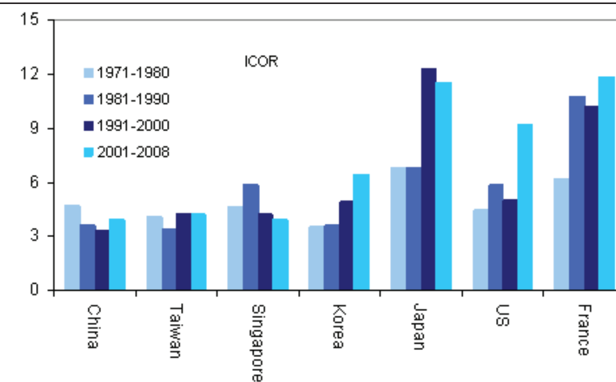
Winning strategies are coming from non-China companies that seek to become 'the Chinese competitor' with products designed for China, made in China. US companies are generally better able to lever automation products with the intention of creating higher quality, lower material waste, lower energy use, etc. We believe it will take some time for Chinese competitors to catch up in these areas. Rising local labor inflation and a work force that increasingly desires safe employment and quality of employment largely favor US companies that can bring best practices into Chinese factories.

Exhibit 3
China Urbanization Still Has Long Way to Go



Source: Morgan Stanley Research

Exhibit 4
Incremental Capital/Output Ratio Looks Sound from a Long-Term Perspective



Source: Morgan Stanley Research

Companies mentioned: 3M (MMM, $81.31, Overweight), Danaher (DHR, $76.60, Overweight), Honeywell (HON, $41.49, Overweight).

Lonking (3339.HK, HK$5.31, rated Overweight/In-Line China Capital Goods industry view by Kate Zhu), SANY Heavy Industry (600031.SS, Rmb32.29, rated Underweight//In-Line China Capital Goods industry view by Kate Zhu), and Shanghai Electric (2727.HK, HK$3.73, rated Underweight/Cautious China Power Equipment industry view by Helen Wen).

Industry Analysis

March 8, 2010

Exploration & Production
Natural Gas — Begging for Capex Cuts

Morgan Stanley & Co. Incorporated

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Weakness in natural gas pricing has reached multi-year lows. While prices for front-month and the 12-month strip have declined over the past month by 17% and 13% respectively, we think what's more significant — especially for the equities — has been the capitulation of longer-dated prices. The 48-month (four-year) strip is currently $5.81/mmbtu — down 9% in a month and at the lowest levels since 2004. Our view is that the commodity market is pricing significant supply/demand imbalances (high injections to storage) once seasonal demand recedes. In addition, the growth in the rig count (the Baker Hughes gas-directed rig count is up to 926, up ~40% from the trough) suggests supply trends may remain bearish for the balance of 2010.

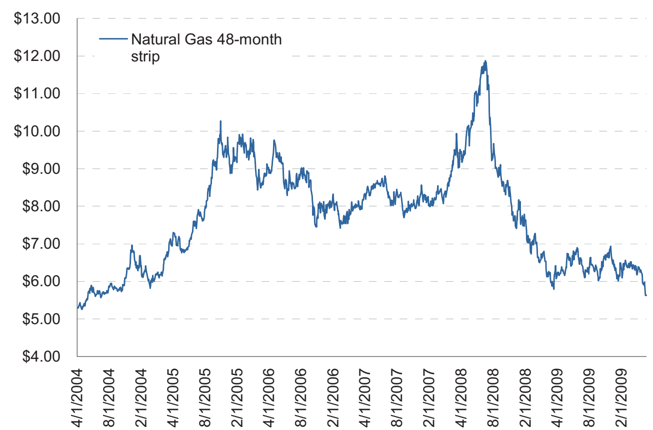
Look for a pullback in upstream activity if prices remain at current levels. With the workout in the backlog of completions in 1Q10 among producers, and with sub-$5/mmbtu natural gas pricing at the hub, we expect E&Ps to reconsider natural gas activity levels for 2010. At current strip pricing, over 50% of our coverage universe cannot fund planned drilling programs from organic cash flow including the impact of hedges (see Exhibit 3, next page). While balance sheets are much improved today and many companies hold significant cash positions and remain financially flexible, we look for a reconsideration of spending levels particularly in light of weak longer-dated pricing.

We see these trends as ultimately bullish for the group, though the direction of near-term revisions is negative (e.g. commodity price, growth &, earnings/cash flow). Expectations for the commodity are low and while likely warranted, a potential for reduced activity and our view that long-dated natural gas prices are at or below the marginal cost of supply is supportive for the cycle.

We prefer the shares of low-cost, higher-growth producers — e.g., Southwestern Energy and Ultra Petroleum — where we see little risk to the outlook even if the commodity outlook remains lackluster. We are Overweight shares of Southwestern (SWN, $42.59) and Ultra (UPL, $46.07).

Exhibit 1

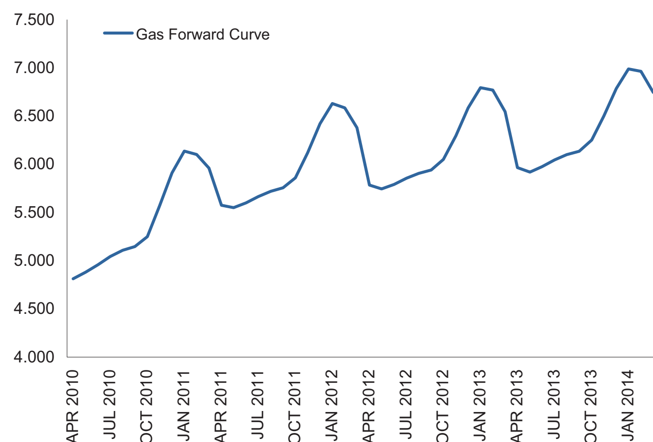
Long-Term, Gas Price Expectations Determine Equity Value, and Gas Commodity Sentiment Is at Multi-Yr. Low



Source: Company data, Morgan Stanley Research

Exhibit 2

Expectations Reset: The 48-Month Strip is at ~$5.81/mcf, and No Contract Is Above $7/mcf — We See Upside Risk

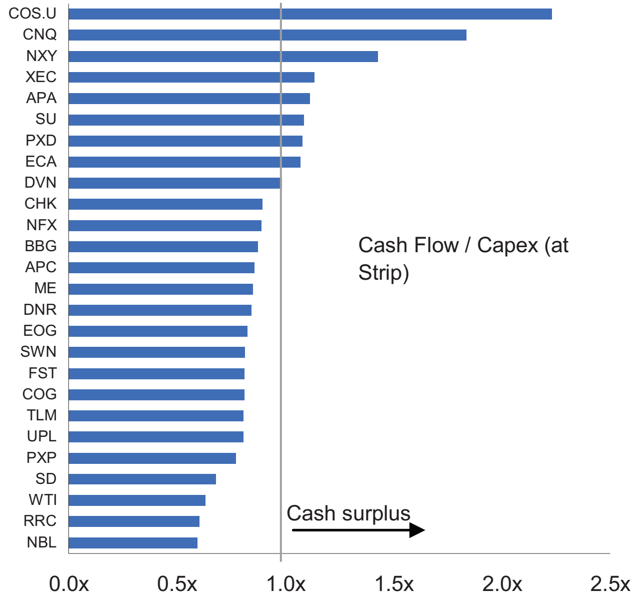


Source: Company data, Morgan Stanley Research

Industry View : In-Line — Exploration & Production
While investor interest is high (particularly with front month gas around $4.50/Mcf), we remain of the view that risk-reward is skewed more neutral for the group due to current valuation. While storage dislocations will cloud the near-term commodity outlook, the operating environment for E&Ps in 2010 continues to look supportive. We would look for volatility before adding to positions of higher-quality names on this theme.

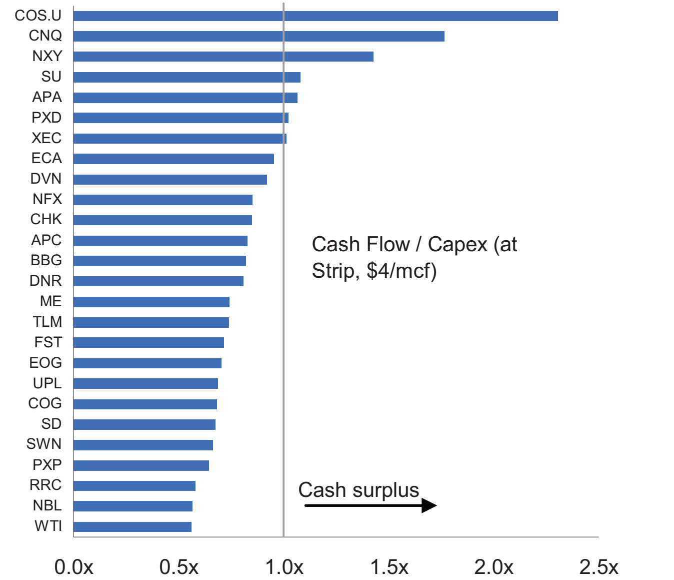
Industry Analysis

Exhibit 3
2010e FCF at the Strip ($83 Oil/$5 Natural Gas)



Source: Company data, Morgan Stanley Research

Exhibit 4
2010e FCF at $4 Natural Gas (and $83 Oil)



Source: Company data, Morgan Stanley Research

Morgan Stanley alphawise proprietary research

Industry Analysis

March 3, 2010

Healthcare Svcs. & Distribution

CRO Preclinical Survey Points to Limited Downside

Morgan Stanley & Co. Incorporated

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Charles River upgraded to Equal-weight based on improved visibility around preclinical outsourcing trends. Our February AlphaWise Pharmaceutical R&D survey of 60 managers involved in R&D outsourcing decisions from pharmaceutical and biotechnology companies provides some incremental positive data points, particularly from large pharma companies, which drive three-quarters of industry spend.

The results point to a flat preclinical spending environment, according to 62% of respondents: survey participants were generally more positive on outsourcing trends. While the survey results do not point to a broad-based recovery, given the increased visibility around demand levels, the incremental data points suggest that downside risk at this stage is limited. This provides us with greater confidence in our base case EPS estimates for Charles River (CRL, $38.49) and lowers the likelihood of our bear case coming to fruition. As such, we have removed the discount previously applied to our target multiple, and have upgraded shares of CRL to Equal-weight from Underweight.

Change was mostly driven by respondents representing large pharma companies, supported by 80% of participants having already received this year's budget. The biggest difference between the current survey and the November/December survey is an increase in Major Pharma responses. Specifically, 72% of R&D managers at Major Pharma companies that responded expect preclinical spending to increase by more than 10% in 2010. Since 75% of R&D spend typically comes from large pharma, we view these responses as particularly encouraging.

One-third of respondents expect preclinical outsourcing levels to improve in 2010, up from 27% in our November/December survey as visibility around budgets has improved. Of those expecting spending to increase, 94% have already received their 2010 budgets (80% of all respondents) versus 25% in our earlier survey. This provides us a higher level of confidence in the survey results and our estimates.

Exhibit 1

Improvement in the Outlook for Preclinical/Toxicology Outsourcing Demand

In 2010 as compared to 2009, you expect your preclinical/toxicology outsourcing to:		
	February 2010 Survey	**Nov/Dec 2009 Survey**
Increase	**33%**	**27%**
Stay the Same	62%	67%
Decrease	5%	7%

Source: Company data, Morgan Stanley AlphaWise, Morgan Stanley Research

alphawise Evidence

The Debates

Has the decline in preclinical spending bottomed? When will growth reaccelerate?

The Findings

Survey respondents were more positive on preclinical outsourcing trends compared to a few months ago. The change was mostly driven by respondents representing large pharma companies.

33% of respondents expect preclinical outsourcing levels to improve in 2010 versus only 27% in our November/December survey.

72% of respondents from Major Pharma expect to spend more on preclinical/toxicology outsourcing in 2010 versus 2009.

82% of respondents indicated pricing hasn't declined further from 2009 levels.

What Gives Us Confidence

This is our second survey of 60 clinical research outsourcing decision-makers from pharmaceutical and biotechnology companies, with a good representation from Major Pharma (15%), which typically drives three-quarters of industry spend.

Most respondents were able to provide realistic spending plans as their budgets had been finalized at the time of the survey.

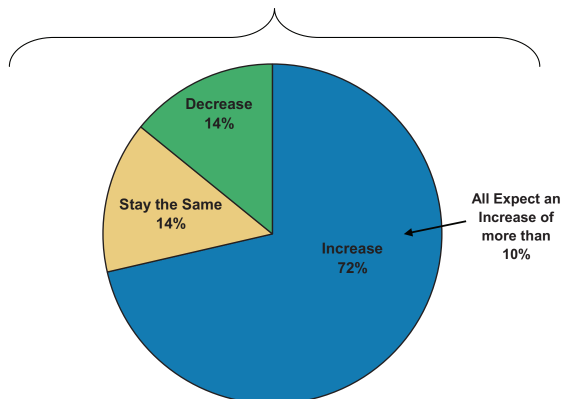
Industry View: Attractive — Healthcare Services & Distribution
Our universe looks set to accelerate earnings growth over the next three years, with superior visibility for our Overweight-rated stocks. Valuations do not fully reflect the earnings potential, in our view.

Industry Analysis

Exhibit 2

72% of Major Pharma Managers Expect Preclinical Outsourcing to Increase by More than 10%

Major Pharma Preclinical Outsourcing Expectations

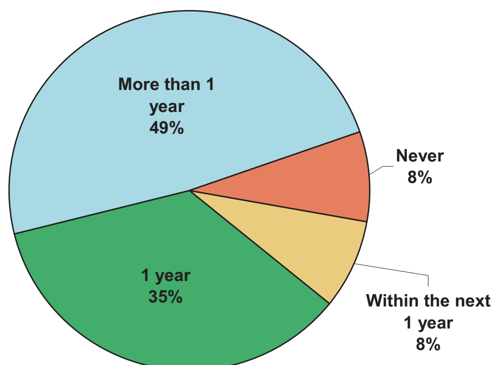


Note: n=7 Source: Company data, Morgan Stanley AlphaWise, Morgan Stanley Research

Exhibit 3

Broad Based Recovery Still 12 Months Away

Improvement in Preclinical Environment (respondents who expect outsourcing to stay the same or decline in 2010)



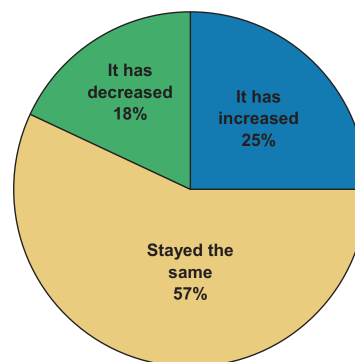
Source: Company data, Morgan Stanley AlphaWise, Morgan Stanley Research

Pricing seems to have stabilized. 57% of respondents indicated preclinical pricing has stayed the same in the last three months. 25% of respondents pointed to price increases. While we do not expect pricing to come back meaningfully over the next 12 months, stabilization in pricing limits the downside risk to margin and earnings growth.

Exhibit 4

Preclinical Pricing Appears to Have Stabilized

Preclinical Pricing Expectations (last 3 months)

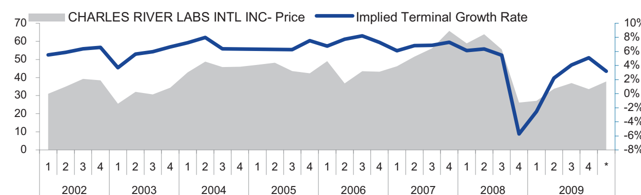


Source: Company data, Morgan Stanley AlphaWise, Morgan Stanley Research

For CRL, the current valuation and consensus estimates imply a terminal growth rate of 3.18%, based on Morgan Stanley's *What's in the Price* tool. This is below CRL's eight-year historical average of 5.42%. Roughly 58% of the current market price represents the forecast value while the remaining 42% is from growth in earnings after 2012.

Exhibit 5

CRL Implied Terminal Growth Rate Below 8-Yr Avg.



Source: Company data, Morgan Stanley Research

Industry Analysis

March 4, 2010

Medical Technology
Tools' Macro Correlation Is Overlooked — Positive for TMO

Morgan Stanley & Co. Incorporated

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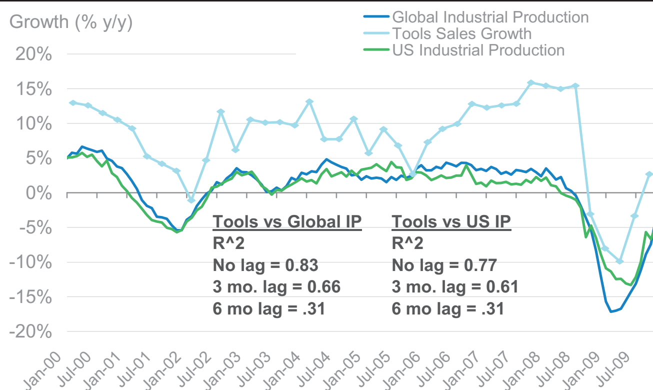
Revenue growth for life science tools tracks more closely with global economic and manufacturing indices than consensus appreciates in our view. Average tools reported revenue trends correlate well with growth in global industrial production (R^2=0.8) over the last decade. While the Merck-Millipore transaction has shifted the investment debate on the group toward M&A, our analysis is encouraging for fundamentals suggesting potential upside to second half expectations for the group as investors; and management teams have taken a cautious approach to 2010 recovery (beyond stimulus), especially for instrumentation and industrial end markets.

Exhibit 1
Tools Growth Correlates with Industrial Production



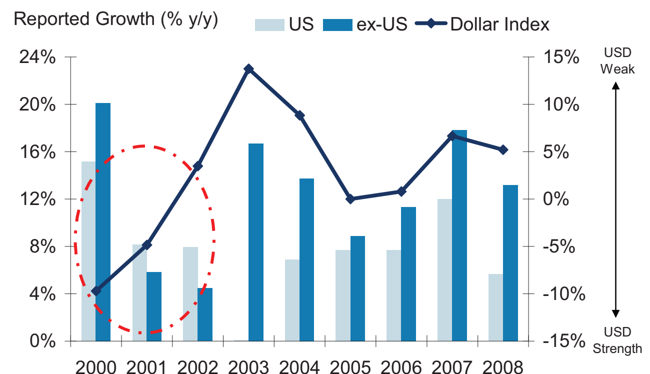
Source: OECD, Federal Reserve, Morgan Stanley Research, FactSet

Correlation supportive of our positive fundamental thesis on TMO. Despite the recent focus on M&A for Thermo, 32% of revenue is from industrial markets (and 30% of total revenue from instrumentation), where mix favors the higher incremental margin Analytical Technologies segment (40-50%+) suggesting margin upside in a recovery could be greater than anticipated. For **TMO**, the correlation analysis supports our positive thesis given the combination of 1) exposure to instrumentation (30% of revenue) and industrial end markets (32% of revenue) where mix favors the higher incremental margin Analytical Technologies segment (46% in 2008 vs 19% in Lab Products and Services) leading to underappreciated leverage and margin upside with a recovery and 2) a discounted valuation (14.5x vs 18-19x for the group). That said, our positive thesis on TMO does not assume a brisk recovery in industrial and instrumentation end markets.

In our universe, **WAT** (30% of revenue in industrial/ applied end markets, ~65% instruments) has the strongest single stock correlation of reported revenue growth with industrial indices (R^2=0.8). While this analysis is supportive and our bias is positive, we see outperformance as more purely dependent on organic revenue growth upside. Overweight-rated **LIFE** and **ILMN** are more insulted from these trends in our view.

USD Appreciation and oUS Growth. In our analysis, currency and oUS revenue growth have not necessarily trended together historically, suggesting that, beyond the impact of negative currency translation, a stronger USD is not a major impediment to constant currency growth, which is generally a strong driver of stock performance and thus multiples for the life science tools group. That said, at current levels, we see 1-2% risk to EPS to currency-exposed names (**LIFE**, **MIL**, **TMO**, **WAT** in our universe) from USD appreciation.

Exhibit 2
US vs ex-US Growth and USD Trends



Source: FactSet, Morgan Stanley Research, TMO, VARI, SIAL, MTD, BIO, WAT, TECH, MIL, QGEN (North America, US not available), PKI, BRKR, DNEX

Industry View: Attractive — Medical Technology
Analysis of previous recessions shows: (1) Healthcare multiples tend to initially price in deeper revisions than warranted by fundamentals, creating opportunities for outperformance; (2) Med Tech returns beat the S&P 500 going into recession and beat both the S&P and the Healthcare sector as a whole coming out.

Industry Analysis

Exhibit 3

1-2% EPS Risk for 2010 from USD Appreciation

	Sales (%)	FX Impact Sales (%)		FX Impact EPS ($)	
Company	ex-US	1Q10	2010	1Q10	2010
LIFE	53%				
MSe		4%	1%	$0.02	$0.03
Current		3%	0%	$0.02	$0.00
Variance		-1%	-1%	0%	-1%
MIL	67%				
MSe		5%	2%	$0.07	$0.09
Current		2%	0%	$0.03	$0.01
Variance		-3%	-1%	-4%	-2%
TMO	41%				
MSe		4%	1%	$0.04	$0.07
Current		3%	0%	$0.03	$0.00
Variance		-1%	-1%	-1%	-2%
WAT	70%				
MSe		3%	1%	$0.02	$0.03
Current		3%	1%	$0.02	$0.03
Variance		0%	0%	0%	0%

Source: FactSet, Morgan Stanley Research, Company Data

Forward-looking economic indicators show a similar trend, but tools tend to lag directional changes by 3-6 months. Looking at the US data over the last decade from late 2000 to early 2002, when the Global Purchasing Managers Index (PMI) stayed in the 40-50 range (suggesting economic contraction), the tools industry saw sales tumble from ~10% at the end of 2000 to <0% by early 2002. In contrast, from late 2003 to early 2008, the index was at a healthy level above 50 and tools saw a period of sustained growth as well. Thus, PMI appears to provide an informative *directional* signal for tools growth.

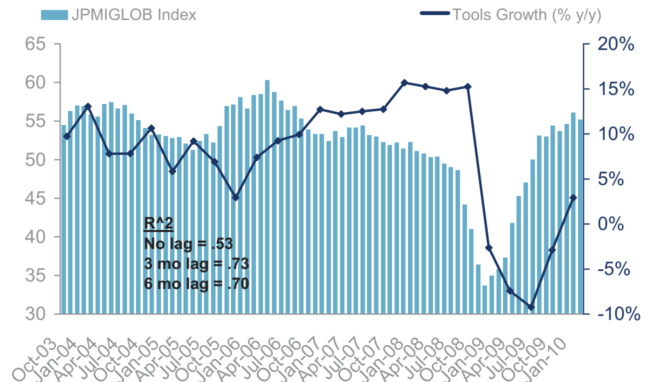
What does this mean for 2010? Index readings >50 consistently since August 2009 and reaching the highest level in January 2010 since August 2004 argue for an upside bias to life science tools growth rates in 2010. The group is already showing some signs of recovery with sales growth trends for tools recovering towards flat in 2H09.

…but risk remains. Industrial production growth is just turning positive meaning that while leading indicators suggested economic expansion since August '09, actual production was in negative territory until January so that additional positive movement in these trends will strengthen our conviction.

USD not a risk to organic growth, only reported growth
One explanation for the correlation with global industrial data appears to be that the US is becoming an increasingly smaller contributor to incremental revenue growth for the tools group. Our analysis is not comprehensive, but oUS regions — and in particular the Asia Pacific region — are becoming the group's primary growth driver. In the tools universe, US sales have shifted from ~46% of revenue growth in 2000 to ~19% in 2008, a trend that we expect to continue going forward. While

Exhibit 4

Tools Lags Global Forward Looking Indicators by 3-6 Mo.



Source: Bloomberg, Company data, FactSet, Morgan Stanley Research, JPMorgan Global PMI

currency played a role in 2008, we estimate ex-US sales drove -70-80% of revenue growth in 2007 and 2008, in comparison to just over 50% in 2000. Similarly, over the last decade, oUS growth rates have eclipsed US growth rates supporting this trend (see Exhibit 8 in our full report). In our coverage, **Waters** and **Millipore** have the greatest ex-US exposure, each with ~70% of sales generated outside of the US.

Given our discussion of the potential for demand recovery over 2010 and oUS exposure, a more important question is the potential impact of a stronger USD on oUS *organic* sales growth given how important these geographies have become to revenue growth. Put another way, is there risk that a weak dollar is an important fundamental driver of oUS demand?

Our analysis shows that while a weak USD likely helps organic growth overseas modestly, currency dynamics are likely not the primary driver. There have been periods (2000-2002 for example) where USD movement and overseas growth trends did not move in tandem (See Exhibit 7 in full report – some correlation is expected given the fact that our analysis uses reported revenue growth for simplicity). Thus, while worth watching, a stronger USD environment does not appear to be a major risk to organic growth and therefore multiples for the group. This makes some fundamental sense given that the majority of companies have direct distribution outside the US.

Stocks mentioned: Life Technologies (LIFE, $51.92, Overweight), Millipore (MIL, $104.98, Equal-weight), Thermo Fisher Scientific (TMO, $49.14, Overweight), Waters Corp. (WAT, $62.24, Equal-weight) and Illumina (ILMN, $38.88, Overweight).

Industry Analysis

March 5, 2010

Semiconductors
TMT Conference Wrap:
Semis Commentary Positive

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In general, commentary from managements of semiconductor device companies was positive. We hosted 33 semiconductor device companies at our annual TMT conference in San Francisco. Consistent with commentary at this part of the cycle in 2004 (Exhibit 2), companies generally said:

- lead times remained extended,
- there was low risk of double ordering,
- supply chain inventories remained lean, even if inventory dollars are increasing, and
- semiconductor companies were trying to increase inventories themselves.

Semi visibility better than OEMs? While semiconductor companies seem to have good visibility into 2Q10, we did not hear a similar level of visibility from their OEM customers at our conference. We find it concerning that semiconductor company visibility into 2Q10 is better than their customers'.

Growing list of 'company-specific' issues: We note that there is a growing list of data points that, looked at in a vacuum, could appear to be company specific – such as commentary around growing inventories from Bell Microproducts ($5), Arrow Electronics ($28), Brocade ($6) and Sanmina-SCI ($17). However, when viewed in aggregate, the issues paint a picture that is consistent with our Cautious semiconductor industry view (Exhibit 1).

Remain Positive on Product Cycles: Despite the cautious industry signals, we heard positive presentations from several management teams that reinforced our conviction in their product cycles and our belief that they would outperform the group. We reiterate our Overweight ratings on:

1) MXIM — with a 4.25% div yield — product cycle in wireless, distributor Avnet is ramping which helps revenues and margins;

2) PMCS — product cycles in servers and storage translates into visibility in 2010;

3) BRCM — increased confidence in Samsung 3G in 2010, enterprise networking picking up (higher margin biz).

Industry View: Cautious — Semiconductors
Our EPS estimates have gone from 25% above consensus in the spring to below consensus today, and EPS, gross margins, utilization, and growth metrics tell us we are in the final innings of the semi cycle.

Exhibit 1
Recent Company Commentary Scorecard – Company Specific?

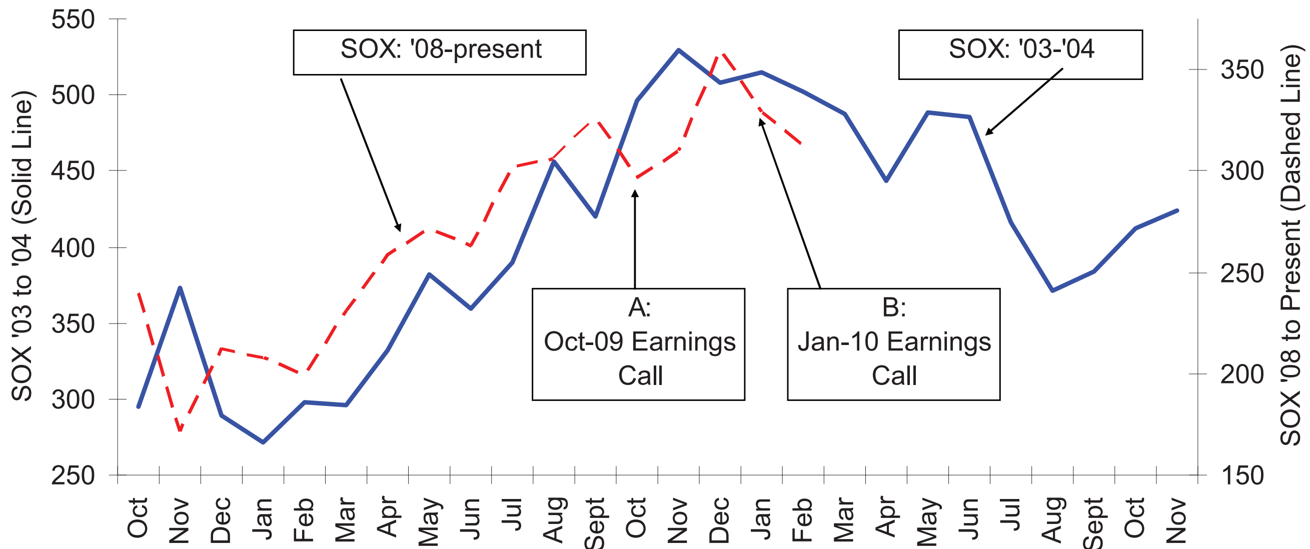
Company	Company-specific commentary
Arrow	Expect to build inventory because it is a competitive advantage
Bell Micro	Inventory increased $60m QoQ, due to opportunistic of HDD & Enterprise supply
Brocade	Lower gross margins and inventory build of SAN equipment at OEMs
Cisco	Raw materials up 49% QoQ, inventory + purchase commitments highest level ever
Dell	HDD supply has loosened up
IDTI	Below seasonal MarQ in DRAM, customer working down DDR3 inventories from Q4 build
Isilon	Drives supply appears to be loosening up
Palm	Lower expectations, VZ not supporting as expected
Qualcomm	Lower than expected shipments of high-end handsets and ASP pressure
Sanmina-SCI	$50m-$75m of inventory held waiting for other components to arrive
TechData	Guiding to below seasonal, channel inventories lean, seeing very few shortages

Source: Company data, Morgan Stanley Research

Industry Analysis

Exhibit 2

Semiconductor Company Commentary on Inventories in '09–'10: With SOX '09-'10 and '03-'04 — Similar to Commentary Made During Oct-03 and Jan-04 Earnings Call



A	**Q3'09 Earnings Calls: 12 out of 30 semi companies built inventories**	
	Company A:	Inventory in the channel remains slightly below normal levels, reflecting both good sell through as well as disciplined inventory management
	Company B:	"we have found ourselves in the need to go ahead and adjust some of the lead times on a few of our products because of the demand that we've had"; "we're not seeing where there's bubbles of inventory building"
	Company C:	We feel our inventory is – we're pretty comfortable where it's at right now.
	Company D:	And when we went into this downturn I think the expectations were a lot more rational, and there was a huge focus on inventory management
	Company E	I didn't mean to convey necessarily inventory builds in the channels. Rather, simply a lot of PCs have been built.

B	**Q4'09 Earnings Calls: 20 out of 28 semi companies built inventories**	
	Company A:	Inventory levels remain in good shape' ; 'We saw an increase in inventory. It's entirely due to the new 32-nanometer products'
	Company B:	"with that increased demand our lead times have generally moved out as that demand has outpaced our supply"; "I don't know that we have great visibility into our customer and our customers and their supply chain"
	Company C:	We continue to closely control our inventory at distribution to properly position the inventory without any unneeded build-up'; 'Inventory increased this quarter to accommodate our increasing sales'
	Company D:	So I would guess there could be a little bit of inventory replenishments left in a few of those markets, but I'd say the highest percentage of that activity was worked out this quarter.
	Company E:	inventories look to be in good shape. So we don't see any dangerous pile-up of inventories across the areas of the downstream supply chain that we can see.

Source: Company reports, Morgan Stanley Research

Companies mentioned in this report: Arrow Electronics (ARW, $28, NC), Bell Microproducts (BELM, $5, NC), Brocade Communications (BRCD, $6, rated Equal-weight/Attractive view of Systems and PC Hardware by Katy Huberty), Broadcom (BRCM, $30.98, Overweight), Maxim Integrated Products (MXIM, $18.7, Overweight), PMC-Sierra (PMCS, $8.85, Overweight) and Sanmina-SCI (SANM, $17, NC).

Company Analysis

March 3, 2010

CMS Energy
Business Plan Supports 6-8% Long-Term EPS Growth, Consistent with Our View

Morgan Stanley & Co. Incorporated

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CMS continues to trade at an unwarranted discount to its peer group, in our view, given the company's growth profile and constructive regulatory environment. Currently, CMS trades at less than 10 times our new 2012 EPS estimate of $1.60, which is a 12% discount to the regulated peer group average of 11.1 times. Despite CMS's below-average dividend yield and above-average leverage, we believe the shares should trade at a higher valuation, because of:

(1) A reduced risk profile due to mechanisms limiting economic exposure in Michigan;

(2) An 8% rate base growth trajectory driven by mandated spending on environmental, smart grid, and renewable generation technologies; and

(3) A favorable $750 million net operating loss (NOL)/ Alternative Minimum Tax (AMT) tax credit position that will allow for internally funded growth through at least 2012.

Initial 2010 guidance — EPS of $1.35, long-term earnings growth of 6-8% is affirmed. At its March 2 Investor Day, CMS provided an update largely in line with expectations. We have lowered our 2010–2012 earnings forecast to $1.35/$1.45/$1.60 from $1.40/$1.50/$1.65 to reflect a higher share count assumption due to the impact of convertible securities, the pre-funding of debt maturities in 2010 for 2011/12, and our assumption — which we view as conservative — that CMS will pre-fund debt maturities again in 2011.

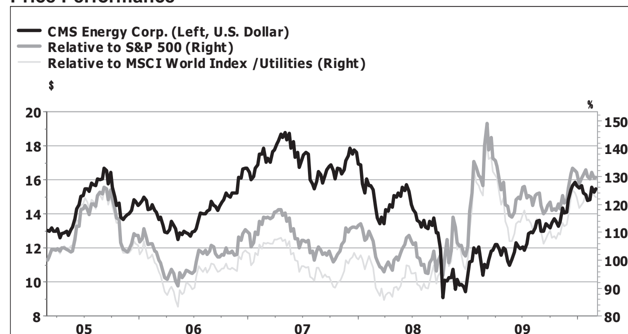
CMS has pending gas and electric rate cases; gas decision could come as soon as March 24. CMS should have proposed decision in its gas case on March 24, with a final order by May 21. The electric case, in which the company is seeking a $178 million rate hike, will have Staff testimony filed by June 10 and a self-implemented rate hike on July 22. A final decision is due in January 2011.

Stock Rating: Overweight	Reuters: CMS.N	Bloomberg: CMS US
Price target		$17.25
Shr price, close (Mar 2, 2010)		$15.63
Mkt cap, curr(mm)		$3,798
52-Week Range		$16.13-10.40

Fiscal Year ending	12/08	12/09	12/10e	12/11e
ModelWare EPS($)	1.27	1.26	1.35	1.45
Prior ModelWare EPS($)	-	1.20	1.40	1.50
P/E	8.0	12.4	11.6	10.8
Consensus EPS($)§	1.25	1.24	1.36	1.43
Div yld(%)	3.5	3.1	3.9	4.4

§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Price Performance



Source: FactSet Research Systems Inc

Company Description

CMS Energy is primarily a regulated utility company operating in Michigan. The company's principal subsidiary is Consumers Energy, which provides electricity and/or natural gas utility to almost 6.5 million of Michigan's 10 million residents. CMS also owns CMS Enterprises which is engaged primarily in domestic independent power production in Michigan and other areas of the US.

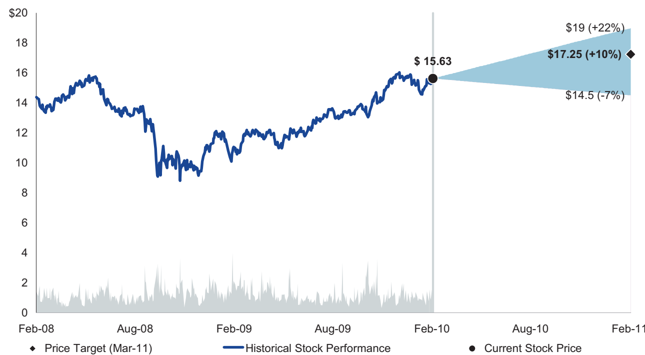
Industry View: In-Line — Electric Utilities/Regulated
Regulated utilities are capital-intensive and tend to earn slim but predictable regulated returns over their cost of capital. Investors generally believe that regulateds typically outperform in recessions but do not generate alpha in a recovery, yet our work shows that in all but two of the past 20 years, it was possible to outperform the market through stock selection.

Investment Thesis

- CMS is growing rate base by 8% annually. We expect growth to fall to the bottom line, without the need for near-term equity issuance, due to constructive regulatory mechanisms, rate relief, and CMS's favorable tax position.
- With EPS expected to grow 8% annually in 2009–13, and a 3.9% projected yield, CMS's yield + growth profile is comparable to the group but at a valuation discount of more than 12%. "Michigan exposure" is misunderstood, in our view, depressing the stock price despite a stable regulatory regime.

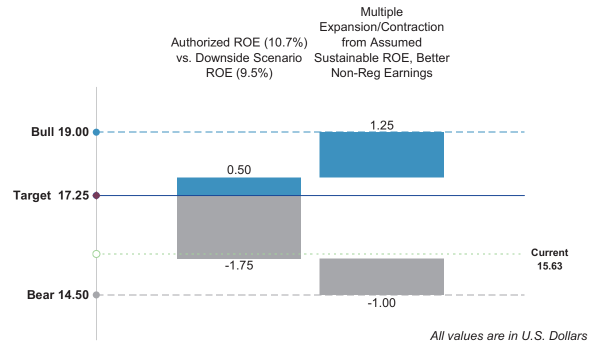
Company Analysis

CMS: Stable Regulation and Rate Base Growth Continue to Be Drivers Despite Tough Local Economy



Price Target $17.25		P/E target multiples are derived using our proprietary DDM. .
Bull Case $19.00	11.6.x Bull Case 2011 EPS of $1.65	**Consumers earns its allowed ROE, Consumers Gas and Electric rate case outcomes are constructive, better earnings at Enterprises:** Rate decision drives 10.7% ROE at utilities, cost escalation remains in check.
Base Case $17.25	10.8x Base Case 2012 EPS of $1.60	**Decoupling and bad debt expense are implemented as per recent rate order, Consumers Gas/Electric rate outcome is constructive.** Consumers Electric / Gas earn a 10.5% ROE in 2012
Bear Case $14.50	10.4x Bear Case 2012 EPS of $1.40	**O&M growth exceeds our expectation preventing the utilities from earning the authorized ROE. Negative Gas /Electric rate case outcomes.** Consumers Electric / Gas earn a 9.5% ROE in 2012.

Bear to Bull



Source: FactSet, Morgan Stanley Research estimates

- The dividend payout ratio is another factor depressing the stock. We expect the ratio to grow to 50% from 40% in 2009–13, better but still low versus CMS's peers.
- CMS is highly levered. At year-end 2009 it had $1.8 billion of parent debt related to failed diversification. Even considering the balance sheet, however, we think the stock is undervalued given the rate base growth/ROE opportunity at CMS's utilities.

Investment Risks/Opportunities

- A confiscatory gas and/or electric rate case decision could be a modest negative.
- Cost control will be a key issue to whether or not CMS can earn its authorized ROE. We assume 3% Y/Y growth in operation and maintenance (O&M) expense; growth materially faster than this could produce an earnings level below our forecast.

Company Analysis

March 7, 2010

J.P. Morgan Chase & Co.
Meeting with IB Head Drives Home Share-Taking Goals

Morgan Stanley & Co. Incorporated

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We are Overweight JPM with 38% upside to our $59 price target. We continue to believe that we are in the beginning stages of economic healing with powerful credit improvement coming in the banks. As credit costs fade, we believe EPS for the large cap banks will rise as delinquencies decelerate (we expect 1Q10) and as nonperforming loans (NPLs) decline meaningfully (we expect 2H10). We expect JPM will be one of the first banks with materially declining NPLs given its skew to early cycle card and below-average exposure to Commercial Real Estate (CRE).

An estimated $3.57 (or 106%) of JPM's EPS growth from 2009-12 comes from lower credit costs. In 2010, we expect JPM's earnings to increase 17% Y/Y, and over the next three years to increase 130%, driven primarily by declining credit costs. Further, accretion from the WaMu acquisition should boost earnings growth going forward. JPM's relatively stronger balance sheet should enable it to take share.

We met with Jes Staley, Chief Executive of JPM's Investment Bank, on March 5 and discussed his plans and goals for how to grow the IB from its already No. 1 position (roughly 14-15% share of global IB fees). Mr. Staley is focused on technology investments driving share gains in the IB, expanding its Asian operations, and talent management. Mr. Staley is bullish on future deal volume, driven by CEO sentiment and the excess cash on corporate balance sheets. We estimate EPS for the IB of $1.49 in 2010, $1.69 in 2011 and $1.97 in 2012 for JPM's IB segment (15-18% ROE).

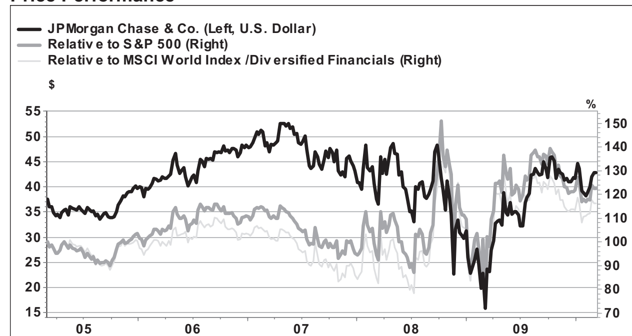
In the IB, 2009 was already a "normalized" year with earnings of $6.9 billion and an ROE of 21% (17% on its new equity allocation, in line with its current ROE target). We recently met with Jes Staley, head of JPM's Investment Bank, and discussed his plans and goals for how to grow the IB from its already #1 position (14-15% share of global IB fees). Mr. Staley is focused on the technology investments in the IB, expanding its operations in Asia, and talent management.

Stock Rating: Overweight	Reuters: JPM.N Bloomberg: JPM US
Price target	$59.00
Shr price, close (Mar 5, 2010)	$42.81
Mkt cap, curr(mm)	$169,496
52-Week Range	$47.47-14.96

Fiscal Year ending	12/08	12/09	12/10e	12/11e
ModelWare EPS($)	0.41	2.58	3.02	4.78
P/E	77.8	16.2	14.2	9.0
Consensus EPS($)§	1.37	2.24	3.08	4.74
Div yld(%)	4.8	0.5	1.9	3.7

§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Price Performance



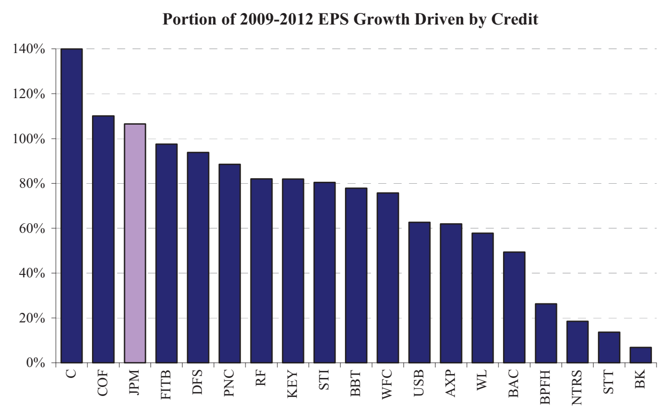
Source: FactSet Research Systems Inc

Company Description
JPMorgan Chase is one of the largest diversified financial companies globally.

Industry View: Attractive — Banking - Large Cap Banks
We look for aggregate nonperforming loans to peak in 1Q10 and for early cycle credit card losses to peak first. We favor early-cycle card and consumer lenders, rate rise beneficiaries, and banks that have significant expected acquisition-driven earnings accretion. We also expect a decline in regulatory and political uncertainty as capital rules and financial services reform are determined.

Exhibit 1

EPS Growth Driven by Credit Improvement:
JPM Among The Biggest Beneficiaries in Our Coverage



Source: Company data, Morgan Stanley Research

Company Analysis

IB earnings power: We estimate 15-18% ROE in 2010-12. JPM's investment bank generated $6.9 billion of earnings in 2009, an ROE of 21% (or 17% based on its new $40b equity allocation to the IB). We expect normalized earnings of roughly $7.4 billion, or roughly 18% ROE, in line with management's goal of a 17% ROE. IB margins should be flat-to-up with expectations for further lift as larger M&A comes back as larger transactions take hold.

Exhibit 2

JPM Investment Bank Earnings Power:

Estimate 15-18% ROE in 2010-2012

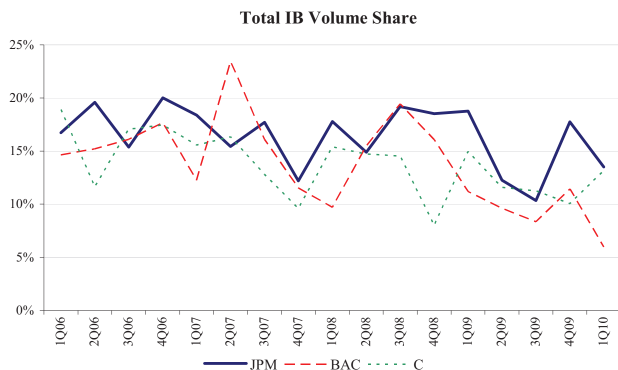
($ millions)	2005	2006	2007	2008	2009	2010E	2011E	2012E
Revenue	14,613	18,833	18,004	12,305	28,109	28,581	29,895	32,128
Net Income	3,674	3,860	3,036	(1,175)	6,899	5,935	6,579	7,360
Allocated Equity	20,000	20,750	21,000	28,500	33,000	39,607	39,494	41,469
New Equity Allocation	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000
EPS	$ 1.04	$ 1.08	$ 0.87	$(0.33)	$ 1.78	$ 1.49	$ 1.69	$ 1.97
Actual/Est ROE	18.4%	18.6%	14.5%	-4.1%	20.9%	15.0%	16.7%	17.7%
ROE on new equity	9.2%	9.7%	7.6%	-2.9%	17.2%	14.8%	16.4%	18.4%

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research Estimates

Exhibit 3

JPM a Mainstay Atop the League Tables

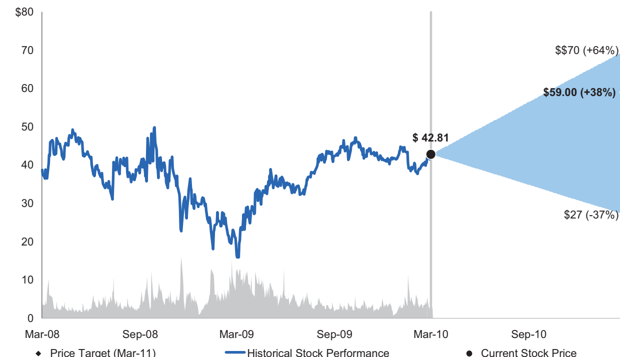
2009 IB Volumes (M&A, Equity & Debt Capital Markets): JPM captured roughly a 14.9% share for 2009



Source: Dealogic, Morgan Stanley Research

Exhibit 4

JPM: Next Leg Up on Declining Delinquencies, NPLs



Price Target $59		Based on base case residual income assuming normalized ROE of 13% and a normalized cost of equity of 10.4%.
Bull Case $70	P/TB 2.5x 2010 Bull Case Tang BV	**Sharp Economic Recovery**. Credit improves more rapidly than our base case. Valuation based on bull case residual income.
Base Case $59	P/TB = 2.1x 2010 Base Case Tang BV	**Modest Recovery.** NPL growth moderates in 1H10 and declines in 2H10. Unemployment grinds down from to 10% to 9.6% in 4Q10 and 9.3% in 4Q11. Valuation based on residual income valuation, using the normalized cost of capital.
Bear Case $27	P/TB = 1.0x 2010 Bear Case Tang. BV	**Double Dip Recession**. Current stimulus and inventory restock is not replaced by corporate reinvestment or consumer demand. Unemployment increases to 12%. Market does not look through to normalizing EPS, nor does it discount strategic options. Valuation based on TBV.

Source: Morgan Stanley Research, FactSet

Upside risks include faster expense reductions, faster card improvement, slower deterioration in housing credit losses.

Downside risks include larger reserve hikes and higher credit losses than we are currently anticipating and thinner net interest margins, which is possible if rates don't start to rise in August, as our economists are currently forecasting.

Company Analysis

March 9, 2010

MetLife

Transaction Strengthens ROE and Growth Outlook

Morgan Stanley & Co. Incorporated

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Hayley Busell
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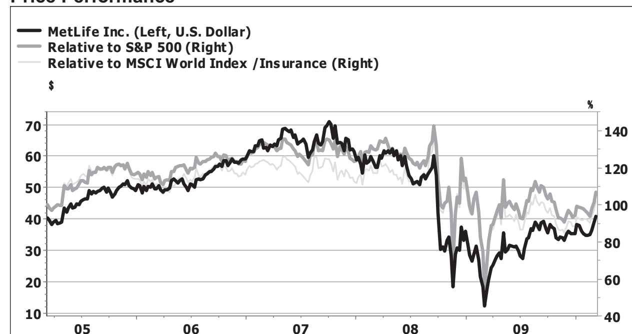
Stock Rating: Overweight	Reuters: MET.N	Bloomberg: MET US
Price target		$49.00
Shr price, close (Mar 8, 2010)		$40.90
Mkt cap, curr(mm)		$33,489
52-Week Range		$41.45-11.37

Fiscal Year ending	12/09	12/10e	12/11e	12/12e
ModelWare EPS($)	2.87	4.15	5.15	5.90
Prior ModelWare EPS($)	-	4.10	4.65	5.35
P/E	12.3	9.9	7.9	6.9
Consensus EPS($)§	2.87	4.22	4.91	5.54
Div yld(%)	2.1	1.8	2.0	2.3

§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Price Performance



Source: FactSet Research Systems Inc

Company Description
MetLife is one of the country's largest life insurers. Its major product lines include individual life insurance and non-medical group insurance. The company also sports a sizeable property-casualty operation and a large mutual fund business.

Industry View: Attractive — Insurance - Life/Annuity
With recent results showing what we consider to be encouraging earnings, capital, and credit trends, our confidence in the fundamental outlook for the sector has strengthened, while the pullback in valuation levels is providing an attractive entry point, in our view. Although declining equity markets, regulatory and taxation proposals, and still fragile economic conditions remain risk factors, our view is that these factors are now overly discounted in the stocks.

Pending Alico acquisition enhances growth and returns outlook — we reiterate our Overweight rating on MET. MetLife announced it had reached an agreement to purchase Alico from AIG for $15.5 billion. The transaction is expected to close in the fourth quarter of this year. We believe the acquisition of Alico has the potential to meaningfully improve MetLife's growth and return profile, which we believe is not sufficiently reflected in the current stock price — which in our view justifies future multiple expansion. Beyond the projected immediate boost to the EPS and return on equity, we believe MetLife will be transformed into a more stable, less equity-sensitive, broadly diversified global insurance company.

While there are execution risks associated with a transaction of this size, and while the overhang that AIG will sell shares following the lock-up remains a risk factor looking further out, we believe there remains solid potential upside and the risk reward profile on the stock remains attractive.

We have increased our earnings estimates and 12-month price target to $49, with potential upside beyond this level as execution risks dissipate. We have raised our 2011 EPS estimate to $5.15 (up $0.50) which equates to an ROE of 11.7%. Similarly, we have raised our price target by $4 to $49, which equates to 1.1 times pro-forma year-end book value of $43.

What We Like:

- *Strategic rationale:* Following the acquisition, MetLife should generate over 40% of its earnings from international sources, including solid positions in various higher growth markets that should help drive superior growth for the company. Japan is Alico's largest operation, accounting for 70% of its overall earnings in 2009.

- *EPS and ROE accretion:* The 10-12% accretion from the transaction was above what we believe most investors expected, although this could be trimmed upon conversion of the equity units in 2013 and 2014.

- *Capital position:* The expected risk-based capital of Alico at time of closing should be in excess of 400%, which coupled with MetLife's sizable excess capital, implies the combined entity should be more than adequately capitalized. On the margin, this makes stock repurchases more likely as we look to the back half of 2011.

- *Alico stability:* Contrary to investor concerns, it appears Alico's recent results have been holding up better than many had feared, with relatively stable earnings and diminishing lapses.

Company Analysis

Key Concerns

- *Execution risks:* Even for a company of MetLife's size, this is a very large transaction with little overlap of existing operations. In our view, this leads to higher potential execution risks compared to more traditional bolt-on acquisitions.
- *Overhang of stock:* Upon the deal's close, in aggregate, AIG will own $5.7 billion of MetLife stock plus another $3.0 billion of equity units, that under the terms of the lock-up, it can begin disposing of 9 months after the closing.
- *Investment portfolio:* The investment portfolio supporting Alico appears somewhat higher risk than MetLife's current portfolio. Alico's investment portfolio has larger concentrations has greater exposure to financials, lower rated CMBS and sovereign debt.

Valuation and Risks

We arrive at a 12-month price target of $49 for MET stock, which suggests ~ 20% upside from the stock's current level. Our price target equates to 1.14 times expected year-end book value, which we view as a fair multiple for the stock given our expectation of a 11-13% ROE looking forward and an estimated cost of capital of around 10%.

Risks to our estimates and price target include the company's volatile nature of one-time items, its exposure to equity markets, its high level of exposure to real estate, and the risks associated with the Alico transaction, as discussed above.

Morgan Stanley is acting as financial advisor to the Federal Reserve Bank of New York with respect to American International Group, Inc. ("AIG")'s agreement with MetLife, Inc. for the acquisition of AIG's subsidiary, American Life Insurance Company (ALICO), as announced on March 8, 2010. The proposed transaction is subject to certain regulatory approvals and other customary closing conditions. The Federal Reserve Bank of New York has agreed to pay fees to Morgan Stanley for its financial advice, including transaction fees that are contingent upon the consummation of the proposed transaction. Please refer to the notes at the end of the report.

Exhibit 1

Expected Change in MetLife's Key Fundamentals

	Prior	New	$ Chg	% Chg
Operating EPS ($)				
2011e	4.65	5.15	0.50	10.8
2012e	5.35	5.90	0.55	10.3
2013e	6.00	6.65	0.65	10.8
Book Value per Share ($)				
2011e	46.96	46.05	-0.92	-2.0
2012e	50.71	50.17	-0.54	-1.1
2013e	55.01	54.90	-0.10	-0.2
Return on Equity (%)				
2011e	10.2	11.7	1.5	14.7
2012e	11.0	12.4	1.4	12.8
2013e	11.4	12.7	1.3	11.7

Source: Morgan Stanley Research

Exhibit 2

Deal Financing Heavily Weighted to Equity

	$Bn	Pct of Total
Common Equity and Units to AIG	5.7	38%
Common Equity Issuance to Others	2.0	13%
Total Common Equity	**7.7**	**51%**
Convertible Preferred Stock	3.0	20%
Senior Debt	3.1	21%
Cash on Hand	1.7	11%
Total	**15.0**	**100%**

Source: Company data

Exhibit 3

Revised Earnings Estimates

	2011e	2012e	2013e
Prior EPS	4.65	5.35	6.00
Post-Acquisition EPS	5.15	5.90	6.65
$ Chg	0.50	0.55	0.65
% Chg	10.8	10.3	10.8

Source: Morgan Stanley Research

Company Analysis

March 8, 2010

Sempra Energy
Should Continue to Appreciate into March 25 Analyst Day

Morgan Stanley & Co. Incorporated

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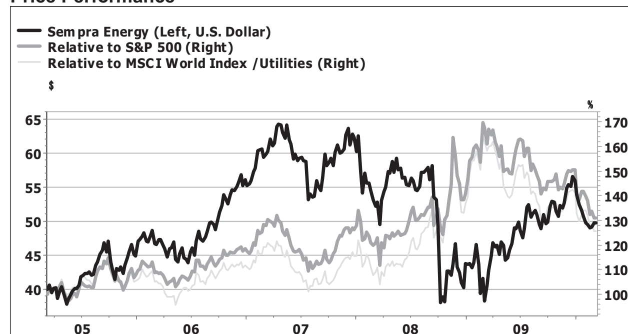
Stock Rating: Equal-weight	Reuters: SRE.N	Bloomberg: SRE US
Price target		$53.00
Shr price, close (Mar 5, 2010)		$49.73
Mkt cap, curr(mm)		$12,283
52-Week Range		$57.18-36.43

Fiscal Year ending	12/09	12/10e	12/11e	12/12e
ModelWare EPS($)	4.78	4.50	4.40	4.50
Prior ModelWare EPS($)	-	4.45	4.45	4.55
P/E	11.7	11.1	11.3	11.0
Consensus EPS($)§	4.78	4.60	4.72	4.55
Div yld(%)	2.5	3.4	3.8	4.2

§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Price Performance



Source: FactSet Research Systems Inc

Company Description

Sempra Energy, based in San Diego, is an energy services holding company.

Industry View: In-Line — Electric Utilities/Diversifies
We view these stocks are a derivative call on a US economic recovery. We think an upturn in power markets is the necessary catalyst for the group, but we do not expect it near term.

We think SRE could trade back to our price target ahead of the company's March 25 analyst conference. We expect management to reiterate its preference for selling the remaining portion of the RBS Sempra commodities JV and outline its plan to reinvest proceeds in utility and infrastructure investments. We believe management will put more structure behind its 2011 EPS guidance of $4.35–4.65, which assumes +/-$2.0 billion in total JV proceeds and share repurchases of $500 million to $1.0 billion.

Sempra will become a rate base and infrastructure growth story. Management has already helped address capital redeployment concerns by announcing the purchase of Mexican pipeline assets from El Paso for $260 million, which should contribute about $0.10 to 2011e EPS. It plans to spend $10.6 billion over the next five years for utility investments in renewable energy, advanced meters, and transmission infrastructure and $4 billion at its non-utility subsidiaries for pipeline, storage, and renewable energy projects.

Earnings power now approximately $4.50/share: Our EPS forecasts are now $4.50 for 2010, $4.40 for 2011, and $4.50 for 2012. This reflects the sale of the entire JV for +/-$2.0 billion, the Mexican pipeline purchase, $1.0 billion of share buybacks at the end of 2010, the assumption of $750 million of new investments made in 2011–12 period, and $250 million of debt reduction. One reason for the relatively flat EPS growth profile is the expected decline in earnings from Sempra's California-based merchant power assets when above-market contracts expire in 2012.

Investment Debates
What Are SDG&E and SoCal Gas Worth?

Investors are concerned that current ROEs are not sustainable. We agree that this is an issue that needs to be dealt with in valuation. However, incentive awards, tax and regulatory settlements, and AFUDC earnings on CWIP contribute to some of the overearning at the utilities. Factoring in these items would reduce 2009 estimated ROEs by 150 bp at SDGE and 180bp at SoCal Gas. Utility cost management accounts for much of the rest of the differential between earned and authorized ROE. We also note that there is risk that the incentive awards could be modified in the future.

We account for the regulatory uncertainty by assigning only a 12x P/E multiple to these businesses even though they are growing rate base at >10.5% annually and earning a >15% average ROE; this is because we assume long-run rate base growth and ROEs moderate substantially. In our DDM we assume rate base growth of 5% longer term and earned ROEs moderating to 12.5%. Our ROE expectation is 100–200bp higher than what we think will be authorized in California longer term, but SRE has systematically achieved higher returns by booking performance incentives and controlling costs between rate reviews. A 50-bp change in assumed long-term ROE at the utilities moves our target multiple by three-quarters of a point. At 12x 2011e EPS of $3.20, we value SRE's utilities at $38.50.

Company Analysis

What Is Sempra Global Worth?

Investor debate focuses on the outlook for RBS/SRE commodities trading joint venture. Investors appear concerned that SRE will not be able to sell remainder of the business that has not already been sold to J.P. Morgan. On February 16, 2010, Sempra Energy and its JV partner, RBS, announced the sale of its Global Oil and Metals and European natural gas and power to J.P. Morgan Chase for around $1.7 billion. The sale is expected to close 2Q10. Sempra expects to receive $940 million for its portion, and plans to extract another $250+ million of equity at some point after the JV agreement is modified, reducing their equity stake to around $800 million. On its February 25, 2010 earnings call, management stated its preference to sell the remaining portion of the JV. We are prone to believe that the pool of potential buyers for the domestic power and gas trading business is robust now that the European oil and metals businesses have been monetized. SRE expects to receive total proceeds of around $2.0 billion for its portion the trading businesses and we think this number is reasonable.

We derive a total value for Global, post-JV divestiture, of $3.3 billion, or $14.5/share. We arrive at our base case using a sum of the parts approach valuing the LNG business at 8.5x EBITDA, the generation business at 7.5x EBITDA, and the pipeline and storage business at 13.5x EPS. This results in estimated valuations of $2.2 billion for the LNG, $2.0 billion for generation, and $3.1 billion for pipeline and storage, for a total valuation of $7.3 billion from which we subtract $3.9 billion of global and parent debt.

Exhibit 1

Sum of Parts Valuation – Post JV Disposition

Segment Valuation	Bear	Base	Bull
SDGE	21.00	24.50	25.00
SoCalGas	11.50	14.00	17.00
Generation (+ Renewables)	7.50	8.50	10.00
Pipelines and Storage	13.50	13.50	13.50
LNG	9.50	9.50	9.50
(Less) Unallocated Global Debt	-16.50	-16.50	-16.50
Total Global	14.00	15.00	16.50
Plus / (Less) Parent Net Debt	-0.50	-0.50	-0.50
Total Value	**46.00**	**53.00**	**58.00**

Source: Morgan Stanley Research

Sempra has a number of infrastructure projects that should support earnings growth in 2010–12, including the 48 MW Copper Mountain Solar project in Nevada, Gulf Coast storage development opportunities, and the recently acquired Mexican pipeline assets from El Paso Energy. We expect management to provide additional details of the costs and timing of these and future projects at its March 25, 2010, analyst conference.

Exhibit 2

Transforming into an Infrastructure Growth Story

Case	Utility	Merchant
Bull Case $58	**High earned ROEs persist long term** 16% ROE in 2011, 13% post-2011 12.5% rate base growth to 2013, 5% LT 12.5x 2012 utility EPS of $3.45 = $42	**Strengthening conditions for merchant generation** Pipelines, storage, LNG, and generation worth $19 net of debt.
Base Case $53	**ROE declines but stays above avg.** 16% ROE in 2011, 12.5% post-2011 12.5% rate base growth to 2013, 5% LT 12x 2012 utility EPS of $3.20 = $38.50	**Merchant generation fundamentals as expected** Pipelines, storage, LNG, and generation worth $18 net of debt.
Bear Case $46	**ROE declines to CA average.** 16% ROE in 2011, 11.5% post-2011 12.5% rate base growth to 2013, 5% LT 10.2x 2012 utility EPS of $3.15 = $32	**Merchant generation conditions continue to weaken** Pipelines, storage, LNG, and generation worth $18 net of debt.

Source: Morgan Stanley Research

Constellation Energy (CEG, $35, Equal-weight)
— Greg Gordon/Jonathan Cohen, March 8, 2010

We have increased our price target by $4.50, to $41. The key components are: 1) a higher value for BGE reflecting an improved earnings outlook and the rolling forward of our target to focus on 2012 (+$2.50) and 2) a higher value for the generation business mainly due to a stronger forecast balance sheet (+$2.50), offset by 3) a modestly lower value for the Competitive Supply business. Our new target values the utility using our dividend discount model (with a 9.5% ROE earned in 2012e) and the genco on "open" EBITDA (7.5x "open EV/EBITDA). Risks include the potential that margins on new retail contracts will fall faster than we forecast.

MORGAN STANLEY
BEST IDEA

Company Analysis

March 9, 2010

Textron
Upbeat Meeting; 1Q Likely Marks Trough for Turnaround Story

Morgan Stanley & Co. Incorporated

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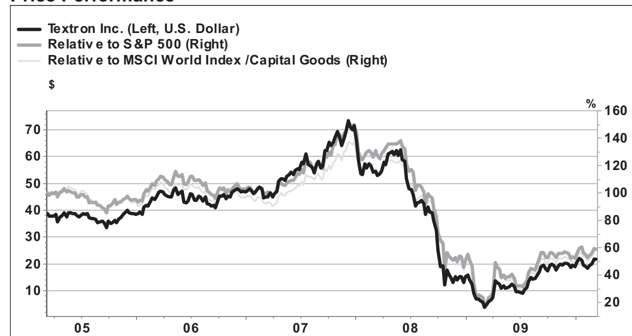
Stock Rating: Overweight	Reuters: TXT.N Bloomberg: TXT US
Price target	$30.00
Shr price, close (Mar 8, 2010)	$21.74
Mkt cap, curr(mm)	$6,059
52-Week Range	$23.46-3.57

Fiscal Year ending	12/08	12/09	12/10e	12/11e
ModelWare EPS($)	1.95	(0.12)	0.62	1.50
P/E	7.1	NM	35.0	14.5
Consensus EPS($)§	3.17	(0.28)	0.43	1.35
Div yld(%)	8.3	0.4	0.4	0.4

§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Price Performance



Source: FactSet Research Systems Inc

Company Description
Textron is a leading multi-industry company with leadership in aerospace and defense areas including business jets (Cessna), helicopters, and leading industrial brands such as EZ-Go (golf carts), Lycoming (engines), and Greenlee (wire, cable installation tools).

Industry View: In-Line – Aerospace & Defense
Defense has sizably missed the S&P 500 rally this year, but we believe that a bearish view on defense is now consensus and has more or less played out. For Aerospace names, we remain neutral.

We believe 1Q likely marks the trough for this turnaround story, a view fortified by what we learned at Textron's small, fairly upbeat investor meeting on March 8. Cessna's losses have been roundly telegraphed; but in 2H10, a projected swing to the black atop better demand picture should confirm a normal cyclical upturn. Secondly, Textron Financial's (TFC's) non-performing accruals are likely to peak in 1Q10 and decline in 2Q, confirming the worst is largely behind for the financial business. We came away with greater confidence in the outlook for the most worrisome parts of TFC: golf and parts of the real estate portfolio. New construction loan commitments are *de minimis*. Further, 70% of the real estate timeshares will be in amortization phase by 2011; even a modestly better economy should improve the chances of successful run off.

Our full year 2010 EPS estimate remains unchanged, but we have adjusted the quarterly estimates. Cessna deliveries look even more than seasonally light in 1Q (our 36 jet estimate is above management's guidance of 30–35; we forecast 235 for the year) and losses reflect volume and restructuring. For 1Q, we project EPS estimates of $0.00 versus consensus of ($0.02). Going forward, we project Cessna deliveries bounce back in 2Q with a slight acceleration through the remaining of the year. While 1Q expectations have been widely telegraphed, we'd be buyers into any potential weakness post April's results.

Reiterate Overweight: TXT remains inexpensive, on our estimates, and is one of Morgan Stanley's 'Best Ideas.' TXT is trading at ~11x our 2011 EPS estimate (excluding TFC). Assuming zero value for TFC, TXT trades at ~11x our adjusted 2011 EPS estimate of $2 versus our Aerospace universe average of ~14x (and 14.5x with TFC). We believe that TFC remains a drag on TXT's valuation, with a near-term negative impact on earnings. We would expect this overhang will diminish in concert with management's progress on liquidating the portfolio. Our TFC model implies positive book equity after all receivables with the exception of captive finance have been liquidated or written off. Turnarounds at both Cessna and Industrial combined with strong visibility at Bell offers a compelling deep value opportunity.

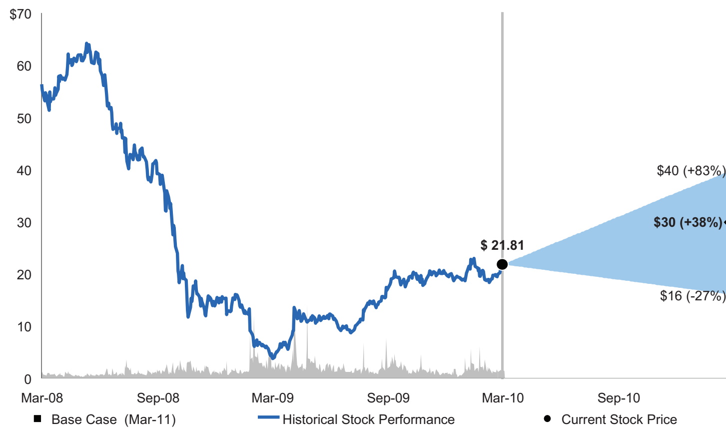
We view Bell as a 'crown jewel' that could add $4 per TXT share of value. The US Department of Defense's recent Quadrennial Defense Review supported the need for a military helicopter recapitalization, and commercial helo demand should improve over the next few years. Our Base Case values Bell at 7-8 times EBITDA, but we argue that this defense "crown jewel" could warrant a multiple as high as 10, adding up to $1 billion of incremental value ($4 per Textron share).

Investment risks: Liquidity concerns could resurface in 2010 if Cessna and the TFC unwind disappoint; Cessna may be unable to reduce costs, resulting in negative margins into 2010; business jet declines could accelerate, leading to Cessna inventory builds on the balance sheet.

Company Analysis

Exhibit 1

TXT: Cessna Upturn Likely 2H10; Bell Looks Intrinsically Undervalued, TFC/Industrial Improving



Bull Case $40	15X Bull Case 2011 EPS of $2.70 (Excl. TFC)	**Liquidity plan ahead of schedule, Cessna production ramp better than expected with improved margins, incremental Bell defense wins.** TFC collection exceeds expectations as general market conditions improve. Cessna demand returns sooner than expected with operating margin improvement ahead of schedule. Manufacturing business exceeds cash flow expectations, with Bell continuing to perform well. Value of TFC slightly positive.
Base Case $30	Sum-of-the-Parts Valuation Midpoint of 5-year DCF, 15x 2011 EPS (ex TFC) of ~$2	**Liquidity plan remains on track, Cessna production levels continue to decline, 'white tails' (planes without customers) manageable.** Textron's liquidity plan remains on track as deterioration at TFC stabilizes. TFC's drag on earnings is reduced in 2010 as portfolio charge-offs exceed loss provisions. Cessna margins trough in 1H with growing signs of improvement 2H thanks to earlier cost initiatives and improved volume. Bell continues to perform, providing cash flow to Textron and offsetting some of the declines in the other businesses. Base case assumes zero value for TFC.
Bear Case $16	Significant negative value for TFC; Cessna recovery pushed out; 15x Bear Case 2011 EPS of $1.08	**Liquidity fears play out:** Liquidity concerns rise as the TFC unwind lags expectations and the manufacturing business, specifically Cessna, becomes a large drag on free cash flow. Increased inventory at Cessna, including white tails, and poor operating performance eats into cash reserves. Cessna margins turn negative, further weighing on the stock. Market sentiment on financial exposure turns negative once again and 2010 liquidity outlook be-comes increasingly uncertain.

Source: FactSet, Morgan Stanley Research

Exhibit 2

Cessna & Bell Remain Key Drivers to Valuation

Sum-of-the-Parts / 2011 EBITDA

				Multiple Range		Value Range		% Revenue		Per Share	
	Sales	**EBITDA**	**Margin**	**Low**	**High**	**Low**	**High**	**Low**	**High**	**Low**	**High**
Cessna	3,503	434	12.4%	7.0x	9.0x	3,025	3,900	86%	111%	$10.40	$13.40
Bell	3,785	522	13.8%	7.0	8.0	3,650	4,175	96%	110%	12.55	14.35
TXT Systems	2,158	329	15.2%	6.0	7.0	1,975	2,300	92%	107%	6.80	7.90
Industrial	2,292	183	8.0%	3.0	4.0	550	725	24%	32%	1.90	2.50
Total	**11,738**	**1,468**	**12.5%**	**6.3x**	**7.6x**	**9,200**	**11,100**	**78%**	**95%**	**$31.65**	**$38.15**
Corporate		(83)		2.0x	1.0x	(166)	(83)			(0.55)	(0.30)
Total Value	**11,738**	**1,385**	**11.8%**	**6.5x**	**8.0x**	**9,034**	**11,017**			**$31.10**	**$37.85**
Net Debt						(1,721)	(1,721)			(5.92)	(5.92)
Equity Value Assumes No Value for TFC						**7,313**	**9,296**			**$25.18**	**$31.93**

Sum-of-the-Parts / 2011 EPS

		Multiple Range		Value Range	
	EPS	**Low**	**High**	**Low**	**High**
Cessna	$0.56	14.0x	20.0x	$7.83	$11.18
Bell	0.73	14.0	16.0	10.18	11.64
TXT Systems	0.49	10.0	14.0	4.86	6.80
Industrial	0.14	8.0	12.0	1.09	1.63
Total	**$1.91**	**12.6x**	**16.4x**	**$23.96**	**$31.25**

Source: Morgan Stanley Research

International

March 4, 2010

Elpida Memory
Raise Price Target: Expect Continued Tight S/D in June Quarter

Morgan Stanley Japan Securities Co., Ltd.+
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What's Changed	
Price Target	**¥2,200 to ¥2,300**
F3/10e OP	**From ¥23.1 bn to ¥26.3 bn**
F3/11e OP	**From ¥89.6 bn to ¥100.0 bn**

Raising Price Target: DDR3 prices remain stable after the Lunar New Year sales season. With demand shifting to DDR3 while migration to 4x/5x nano and yield improvement are slower than expected at most DRAM producers, we think current conditions will likely continue in June quarter. We thus revise our ASP forecasts for 1H CY2010 and raise our PT to ¥2,300 (3.5x F3/11e EV/EBITDA and 1.6x F3/11e BPS) from ¥2,200.

We believe the market remains skeptical of Elpida's capability to generate positive FCF. We expect the company to generate FCF of ¥76.5 bn in F3/11, as it focuses on efficient technology migration. If our scenario's probability rises, we can expect multiple expansion to reflect earnings and B/S improvements, even if DRAM prices peak out.

What's changed: We change our ASP forecasts to +5% QoQ from -4% for March quarter and to -7% QoQ from -10% for June quarter (page 3). Our end-2010 price forecast for 1Gb DDR3 is unchanged at $1.6. (Realistically, the market mainstream will gradually shift to 2Gb products, and we expect 2Gb DDR3 at $3.2-$3.5 at end-2010.) Meanwhile, we change our currency assumption to ¥90/$ from ¥95/$ to reflect the risk of continued yen strength.

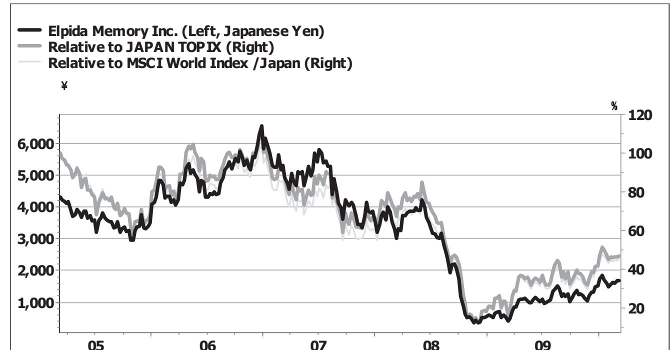
We raise our forecasts to reflect these changes: our OP forecasts are now 30% above consensus for F3/11, and 60% below for F3/12.

Stock Rating: Overweight	Reuters: 6665.T Bloomberg: 6665 JP
Price target	¥2,300
Upside to price target(%)	42
Shr price, close (Mar 3, 2010)	¥1,619
Mkt cap, curr, basic(bn)	¥229.3
Div yld (03/10e)(%)	0.0

Fiscal Year ending	03/09	03/10e	03/11e	03/12e
Revenue, net(¥bn)	331.0	475.5	584.0	538.8
Operating profit(¥bn)*	(147.4)	26.3	100.0	28.3
Recurring profit(¥bn)*	(168.8)	9.8	87.0	17.5
Net income(¥bn)*	(178.9)	(3.2)	66.4	5.7
EPS, basic(¥)*	(1,349.1)	(18.7)	334.5	26.0
Prior EPS, basic(¥)*	-	(28.2)	319.0	27.7
ModelWare EPS(¥)	(1,258.6)	9.6	319.8	43.7

* = GAAP or approximated based on GAAP
e = Morgan Stanley Research estimates

Price Performance



Source: FactSet Research Systems Inc

Company Description
Japanese DRAM maker. Competitive in mobile and digital consumer DRAM. Rexchip, a joint company with Powerchip has started operating in 2007. Ties up with Powerchip, ProMos, and Winbond in Taiwan.

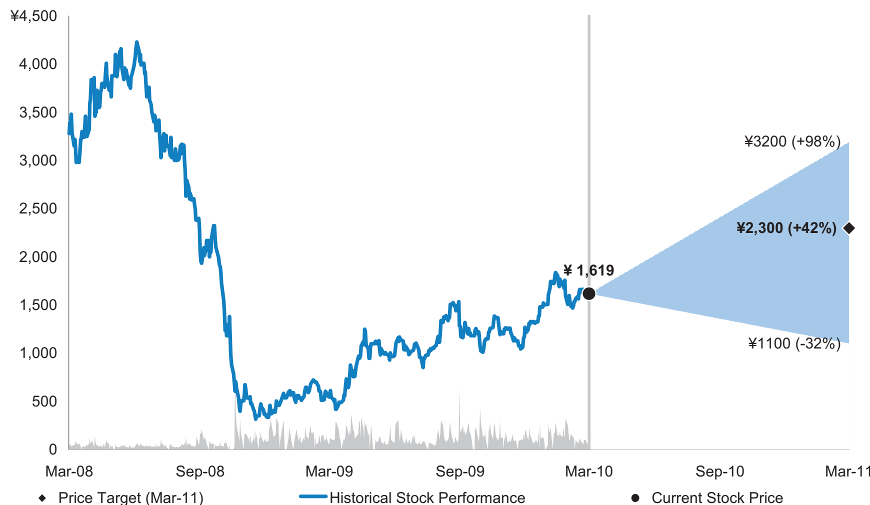
Japan Semiconductors/Japan
Industry View: In-Line
In 2010, we expect healthy supply/demand for both DRAM and NAND flash, due to double-digit unit growth of PC and mobile handset. While capex will recover significantly, we expect equipment order growth to slow down, as we see limited activities to expand DRAM capacity.

What's next: Elpida is scheduled to host a technology seminar on March 12. We expect it to offer a clearer view of the development roadmap and the direction of next-generation technology (TSV, new memory).

International

Risk-Reward Snapshot: Elpida Memory (6665, ¥1,619, OW, PT ¥2,300)

Risk-Reward Snapshot: Efficient 40nm shift while DRAM supply/ demand remains favorable allows positive FCF in successive years



Price Target ¥2,300		Set at EV/EBITDA of 3.5x on our F3/11 estimates (based on previous mid-cycle valuation), as in our base case, and equivalent to 1.6x F3/11e BPS.
Bull Case ¥3,200	F3/11e bull case EV/EBITDA 3.8x	**PC shipment units increase over 20% YoY in 2010** **DRAM supply shortage for extended period** F3/10e sales ¥479.0 bn (+45%), OP ¥29.7 bn. F3/11e sales ¥630.0 bn (+32%), OP ¥140.0 bn.
Base Case ¥2,300	F3/11e base case EV/EBITDA 3.5x	**PC shipment units increase 15% YoY in 2010** **DRAM supply/demand remains favorable** F3/10e sales ¥475.5 bn (+44%), OP ¥26.3 bn . F3/11e sales ¥584.0 bn (+23%), OP ¥100.0 bn.
Bear Case ¥1,100	F3/11e bear case P/B 1.0x	**PC shipment units increase by just a single digit in 2010** **DRAM oversupply from mid-2010** F3/10e sales ¥445.7 bn (+35%), OP ¥13.5 bn. F3/11e sales ¥456.3 bn (+2%), OP ¥21.8 bn.

Note: Share price as at March 3, 2010, close
e = Morgan Stanley Research estimates
Source: FactSet, Morgan Stanley Research

Investment Thesis

- DRAM supply/demand to remain favorable in 2010, even as technology spending accelerates, due to solid PC demand.
- Elpida will migrate to 40nm and 65nm XS process in 2010 with efficient investment, potentially recapturing competitiveness as a result.
- Elpida remains highly competitive in premier DRAMs.

Key Value Drivers

- Outlook for DRAM supply/demand (PC demand, production/capex at DRAM producers).
- Cost reductions through technology migration and productivity improvement.
- Premier DRAM demand (outlook for mobile phones and digital consumer products).

Potential Catalysts

- Solid PC demand around the Chinese new year.
- Full-start of mass production with 40nm and 65nm XS process technology.

Price Target Risk Factors

- Upside: DRAM supply/demand improvement above expectation (corporate PC upgrade demand recovery with launch of Windows 7).
- Downside: Unexpected degree of deterioration in DRAM supply/demand.
- Yen appreciation: a ¥1/US$ rise pares ¥1bn plus from annual OP

International

March 8, 2010

Europe Capital Goods
Morgan Stanley China Summit 2010: Opportunities for Capital Goods Stocks

Morgan Stanley & Co. International plc+

Guillermo Peigneux
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Vidya Adala
Kasedith Vardhanabhuti

Companies Featured

Company (Ticker, Price, Rating)	Price Target Old	Price Target New
Atlas (ATCOa.ST, SKr107, OW)	SKr114	SKr125
Outotec (OTE1V.HE, €24.0, OW)	€29	€29
Sandvik (SAND.ST, SKr83, OW)	SKr98	SKr94
Siemens (SIEGn.DE, €67.5, EW)	€73	€73
Schneider (SCHN.PA, €82.5, OW)	€90	€90
Philips (PHG.AS, €23.3, EW)	€24.5	€24.5

For valuation methodology and risks associated with the price targets mentioned, please refer to the full report, which is available through your sales representative, Client Link at www.morganstanley.com, or other electronic systems.

Main conclusion from our trip: China's 2010-11 growth potential is real and will support a broad-based recovery in earnings across global industrials. Last week, we met with domestic and multi-national companies in Shanghai, Changsha and Taiyuan. All companies noted strong growth rates for 1Q10 and strong growth targets for 2010-11 despite the stimulus progressively fading.

The mid-value market segment is the heart of the battle. Domestic and international players reported increased investment plans in the mid-value segment, with locals moving up their quality standards and targeting export markets (developing), and international companies highlighting that it's not only high-value market segments that are interesting from a China value proposition point of view.

Key issues are the sustainability of investment and construction growth. The government is concerned by bank credit quality and by property speculation; it pledged to pare spending on roads, railways and airports, but boost health and social security. Change in the growth bias will be gradual, with China still targeting very ambitious infrastructure investments up to 2015-20, but we think that such announcements could weigh on the sector later in 2010.

Most of our companies benefit from growth in China, but Atlas and Schneider look best positioned. Given its exposure to underground mining, infrastructure investment and 'energy efficient' industrial capex, we see now 17% upside to Atlas, on a 2011e P/E of 12.2x, driven by capacity additions in profitable segments and solid demand across all its end markets in China. Among Electricals, we would own Schneider as we expect it to benefit from improving industrial capex, infrastructure spend and the urbanisation theme. Its localised cost base should support margins in the near term. We see ~10% upside to our PT, which puts Schneider on 14x 2011e P/E.

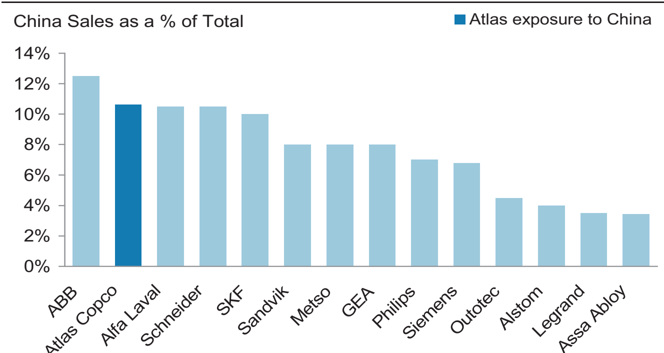
Despite the positive tone, we would be selective in buying stocks. It is clear that the performance of international companies selling into China will vary widely in the coming years – we see Atlas and Schneider as relative winners.

Atlas Copco: OW, PT SKr125

1) **We think its large exposure to China,** and focus on growth segments that should outperform on a 2010-11 investment horizon, leave Atlas best placed versus peers.

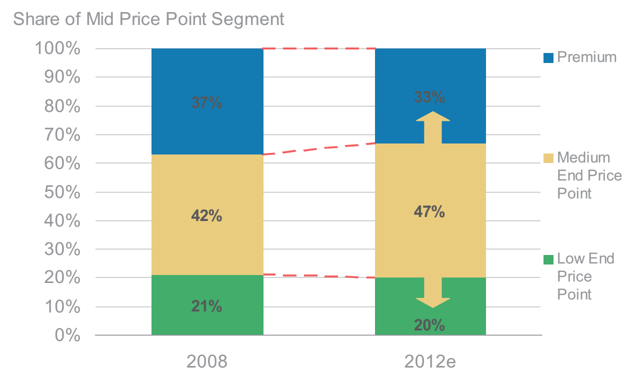
2) **Atlas benefits from its technology and low cost base,** enabling it to compete in premium and mid-market segments.

Exhibit 1
Atlas exposure to China vs peers



Source: Company data, Morgan Stanley Research (2009)

Exhibit 2
Local market growth in the medium-quality segment is an opportunity for Atlas



Source: Ingersoll Rand, Bain and Company, e = Morgan Stanley Research estimates

International

Most of the European industrials sector sells to the Chinese "premium" market segments with technologies that can't yet be replicated, other than with a local manufacturing presence (70% of the Chinese sales at Atlas are produced in China). We also see Atlas's portfolio as best positioned to play an active role in the mid-market segment where its technological capabilities and local manufacturing presence should provide a competitive advantage over domestic players.

3) We see Atlas's portfolio focused on the right growth areas in China.

- Chinese authorities have identified air compressors as the second most inefficient process within Chinese industrial activities, and government policies will incentivize investment in new, more efficient compressors. Atlas is the industry leader.
- Infrastructure investment (rail and road) is likely to continue with strong growth rates. For large construction equipment used for road and rail infrastructure development, Atlas continues to hold a strong market position, with some local competition emerging but failing to deliver product to the premium market range, for now.
- On mining equipment investment, the current consolidation and integration mandate to the mining industry by the government means there is an implicit focus on mechanisation.

4) We see Atlas benefiting from its capacity expansion in Chinese local and other emerging markets. Atlas may add factories in emerging markets as mining investment resumes and Chinese demand grows. It currently has ~70 factories globally (11 in China), and plans to increase this to 100 by 2012. During 2010 Atlas will add 2 more plants in China (gas & process in Shanghai and large blasthole drill rigs – open pit mining). In our opinion, new investment in large gas and process compressors is transformational. The new assembly unit will have 36,000sqm and will be operational by the end of 2010. Currently, Atlas operates 4 factories for compressors in China, which account for more then 10% of CT group sales. Gas & process equipment margins and service intensity are higher than those for small and medium-sized compressors. We think this addition is growth and margin accretive.

Schneider: OW, PT €90

Among the Electricals, Schneider remains our top pick as we see it benefiting from improving fundamentals in China:

1) Schneider offers substantial exposure to China. Its products serve a broad range of industries, benefitting from growth in construction and infrastructure. We think growth from China can surprise on the upside in 2010-11.

2) Schneider is already positioned in the mid-market segment, which will benefit from urbanisation. Most corporates were bullish about government expectations that ~300m Chinese people will migrate to cities over the coming years. Schneider is already entrenched in this segment and continues to broaden its product footprint through inorganic growth. We note that Schneider serves nearly all the high-profile industries – construction, power generation, power transmission and distribution.

3) 43% of the company's costs are located in low-cost countries. Schneider's cost base is heavily skewed to the low-cost countries, which allows it a level playing field with domestic players. It is able to produce goods at the same price as the locals, giving it a significant advantage during tough times, and a technological edge through R&D spend, while aggressively maintaining a lower cost base.

Schneider looks best positioned to benefit from early cycle growth, emerging market exposure and margin resilience in 2010-11. We expect Schneider to post at least 4% organic growth in 2010, driven by a recovery in Discrete Automation, Residential construction and Critical Power end-markets. We think its exposure to developing countries and matched low cost base will help drive profitability above ~14% operating margin guidance. As management executes on the restructuring plan, operating leverage should flow through to offset raw material inflation and pricing pressure. The stock trades on 13x 2011e P/E, 1.4x EV/Sales and 10x EV/EBIT. While not the cheapest in our universe, we see ~10% upside to our base case of €90 and 33% to our bull case of €110.

Morgan Stanley (France) SAS is currently acting as financial advisor to Schneider Electric ("Schneider") in connection with the possible acquisition of Areva T&D by Schneider and Alstom, as announced on 30 November 2009. This report and the information herein are not intended to serve as an endorsement of the proposed transaction. This report was prepared solely upon information generally available to the public. No representation is made that it is accurate and complete. This report is not a recommendation or an offer to buy or sell the securities mentioned. Please refer to the notes at the end of this report.

International

March 8, 2010

Hong Kong Multi-Industry
Jardine Group: Excellent Proxy for Asian Growth

Morgan Stanley Asia Limited+

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We have upgraded our rating on Jardine Matheson (JMH) to Overweight and raised our price target to US$35.0. We retain our Overweight rating on Jardine Strategic Holdings and raise our price target to US$20.5. Our 2010/2011 EPS estimates changes are based on stronger performance for the businesses in 2H09. Upside surprises should come mainly from Jardine Motors, HK Land development property, and a quicker-than-expected turnaround for Astra. We are currently 7-25% ahead of consensus estimates for JMH and JSH.

Expect Strong 2010 Growth with Global Recovery

- **Firm CPO prices are positive for Astra International (AALI):** AALI's earnings were constrained by weak CPO prices in 2009, but this was mitigated by strong performance from motorcar sales and the contract mining business. Our Indonesian Agricultural Products analysts, Miang Chuen Koh and Conrad Werner, see firm CPO prices continuing, which should be positive for AALI's subsidiary, Astra Agro Lestari. We expect 23% growth in underlying profit in 2010.

- **Dairy Farm to benefit from inflationary environment:** Our Hong Kong economist, Denise Yam, has lifted her 2010 Hong Kong CPI inflation forecast to 2.8% from 2% to reflect the pick-up in underlying inflation pressure amid continued recovery in the economy. Earnings from Dairy Farm's super-/hypermarket segments should remain resilient, while other segments, such as convenience stores and restaurant associate Maxim's, are likely to benefit from improved consumer confidence.

- **Net debt still remains low despite the consolidation of Hongkong Land:** Despite the consolidation of Hongkong Land for the first time, gearing for JMH remains at less than 10%, with net debt of US$2.2 bn. JMH's cash position has also increased to US$4.1 bn from US$3.7 bn in 1H09. With ample cash, we believe that Jardine can seek opportunities to expand its business.

- **Hong Kong office rents expected to recover in 2010:** Overall, office rents declined approximately 20%. Although we have seen a recovery in retail rents, office rents have yet to improve. We expect Central rents to recover faster, due to more demand as the economy improves and office space remains limited.

Further Upside Potential From:

- **Vietnam and Cambodia – the next frontier:** At the end of 2009, JSH increased its stake in Truong Hai Auto Corporation (THACO) to 29% from its initial stake of 12%. We expect JSH to complete the acquisition of a 12% shareholding in ACLEDA Bank, Cambodia's second-largest bank, shortly.

  Management is of the view that the rapidly developing markets of these countries offer growth prospects. We believe the group could potentially invest in other businesses in these countries when the opportunities arise.

Risks:

- **Hongkong Land might see negative rental reversions:** Rents in Hong Kong's Central Grade A market declined 34.4% in 2009, and Hongkong Land's commercial property net rental income was down slightly in 2H09 to US$318 mn (1H09: US$322 mn). We are likely to see lower commercial property earnings contribution in 2010, but this could be mitigated by new office space coming on stream, as well as recognition of profit for residential property development projects.

We Prefer Jardine Matheson to Jardine Strategic

Last year, JSH outperformed JMH by 5%, in line with our expectations, as we believed the company offered more growth potential. Year-to-date, the stocks have performed in line with each other. However, we see a more likely scenario of JMH outperforming in 2010 and have switched our preference from JSH to JMH.

We believe JMH will outperform JSH for the following reasons:

- **Higher discount to NAV for JMH:** JMH is currently trading at a 32% discount, vs. its long-term average of 23%, while JSH is currently trading at 44% discount to NAV, vs. its long-term average of 39%.

International

- **Higher dividend yield for JMH:** For 2009, JMH declared a dividend of US$0.90 (+20% YoY), implying a dividend yield of 3%, higher than JSH's dividend yield of 1.1%.

- **Shareholder interests aligned with owners of Jardine Matheson:** As the Keswick family privately owns ~15.1% of the shares of Jardine Matheson, we believe that the strategy undertaken by the company will be more aligned with shareholders' interests.

- **Jardine Matheson is more liquid:** JMH's stock has an average trading value of US$6 mn, while JSH has an average trading value of US$3 mn. The free float of JSH will also decline further after the share repurchase programme announced on March 5, 2010, as JMH's stake would increase to ~82%.

However, share buyback of JSH could lead to its outperformance: JSH announced its intention to repurchase up to 13.9 mn shares (1.3% of issued share capital) at a cost of US$250 mn. The tender price range of US$18.0-19.0/share implies a 5-10% premium from the closing share price. Historically, the share price has increased more than 20% in the 12 months after a share repurchase (except in 1997). As such, JSH's share could trend higher in the next 3-12 months.

2009 Results Review & 2010 Earnings Outlook

Jardine Matheson – Flat revenue but 23% growth in earnings: JMH registered turnover of US$22.5 bn (+0.6% YoY). Declines in revenue of Jardine Pacific and Jardine Motors Groups were offset by a first-time contribution of US$801 mn from Hongkong Land following its consolidation as a subsidiary. Although the increase in revenue was marginal, underlying profit attributable to shareholders grew 23% to US$1.0 bn. The strong result was due mainly to Hongkong Land's property trading activities, as well as strong performance from AALI and Dairy Farm, which made up for the weak performance from hotels and other businesses more affected by the recession.

Gains from assets disposals and property revaluations: Including a revaluation of Hongkong Land's investment property portfolio, profits on disposal of JSH's stake in Tata Industries, and Mandarin Oriental's 50% interest in its Macau property, total attributable profit to shareholders was US$1.6 bn.

Jardine Strategic – JSH reported 2009 earnings of US$1.8 bn (+166% YoY) with an increase in the valuation of investment properties. Other non-trading items included gains on property disposals, gains arising from the accounting treatment for the acquisition of additional shares in Hongkong Land and the recapitalization of Rothschild. Excluding these non-trading items, underlying profit was US$1.1 bn (+26% YoY).

Dividend increase throughout crisis: The Jardine Group is one of the few companies that have continued to raise dividends despite the downturn. We believe that this signals management's confidence about prospects for the firm as well as strong treasury management.

Changes to 2010/2011 Earnings Estimates

We have increased our 2010/2011 earnings estimates by 27% for JMH and by 22% for JSH. Our estimates are 7-25% higher than consensus for the following reasons:

1) Strong orderbook and improved outlook for JMH's non-listed subsidiaries: Earnings for Jardine Pacific and Jardine Motors were better than forecast in 2009, due to tight costs controls and government stimulus plans. We have revised our estimates for 2010/2011 accordingly, based on strong order book for Gammon and recovery for transportation-related businesses.

2) Hongkong Land – earnings visibility on development property, new rental contribution from MBFC: We remain positive on the company, given its prime exposure to the Hong Kong office market. We expect strong sales and ASP to be achieved for its Hong Kong residential project, Serenade, as well as new rental contribution from Phase 1 of Marina Bay Financial Centre in Singapore.

3) Astra International – beneficiary of firm CPO prices: Subsidiary Astra Agro Lestari's palm oil production continues to grow and should benefit from higher CPO prices. Our analysts also expect improving margins from higher cost efficiency and management.

Closing prices: Jardine Matheson (US$29.00), Jardine Strategic (US$17.08).

Note: For details of price target methodology and risks for individual stocks, see full report.

International

March 4, 2010

Mitsubishi Electric

Initiate at Overweight: Capex Pickup, Power & Railway Business to Drive Strong Profit Recovery

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Initiate at Overweight/Attractive industry view with a ¥1,000 price target. Though often seen as an electronics firm, we include Mitsubishi in our machinery & capital goods coverage as (1) FA systems, social infrastructure, and air-conditioning generate most of its earnings, and (2) many of its domestic and overseas competitors occupy this space.

Strong earnings rebound not yet in the price: We look for earnings to rebound more strongly than the market expects, with OP bottoming at ¥95bn in F3/10 then reaching ¥180bn (consensus: ¥147bn) in F3/11 and ¥230bn (consensus: ¥199bn) in F3/12. FA systems, tied to capex, are the largest driver, accounting for ¥59bn of this ¥135bn OP growth in F3/10-3/12. We also expect social infrastructure (includes power and railway business) profits, which have turned up since F3/07, to rise to 26% (¥60bn) of total OP in F3/12.

Capex to rebound from 2010: Capex in 2009 fell below even replacement/maintenance minimums to keep production going. But manufacturing output is up again now, and capex will return to replacement/ maintenance levels, at least. Mitsubishi is well placed to gain, having many high global market share products (programmable logic controllers, servomotors, inverters, etc).

Why focus on Mitsubishi for electric power and railways? (1) Mitsubishi is one of few companies with profit growth potential in both power and railway business; (2) risk of loss-making projects is relatively low, as business covers turbine generators and control systems in power generation, and electrical products plus core parts and system in railways; (3) the firm has opportunities not available to other Japanese firms: from nuclear power control systems in China, upgrade demand for structured substations in N. America, scope to expand supply of electronics to railcar makers abroad.

Stock Rating: Overweight	Reuters: 6503.T Bloomberg: 6503 JP
Price target	¥1,000
Upside to price target(%)	33
Shr price, close (Mar 3, 2010)	¥753
Mkt cap, curr, basic(bn)	¥1,616.2
Div yld (03/09)(%)	1.4

Fiscal Year ending	03/09	03/10e	03/11e	03/12e
Revenue, net(¥bn)	3,665.1	3,360.0	3,543.0	3,707.0
Operating profit(¥bn)*	139.7	95.0	180.0	230.0
Recurring profit(¥bn)*	107.9	48.0	155.0	205.0
Net income(¥bn)*	12.2	10.0	88.0	117.0
EPS, basic(¥)*	5.7	4.7	41.0	54.5
ModelWare EPS(¥)	5.7	4.7	41.0	54.5
P/E, basic*	77.8	161.6	18.4	13.8

* = GAAP or approximated based on GAAP
e = Morgan Stanley Research estimates

Price Performance

Source: FactSet Research Systems Inc

Company Description
Conglomerate rooted in energy and electric systems/machinery and with a range of operations, including in satellites, power semiconductors, home appliances and photovoltaic power systems. Many products in energy and electric systems areas (FA, auto, and railway equipment) with strong market share globally, too.

Machinery and Capital Goods/Japan
Industry View: Attractive
Our industry view remains Attractive. (1) Industry firms are expanding overseas, particularly in emerging markets, and profits have considerable room to grow once the global economy recovers. (2) We see signs that demand is bottoming after a sharp, severe correction.

International

Risk-Reward Snapshot: Mitsubishi Electric (6503, ¥753, OW, PT ¥1,000)

Risk-Reward View: Power & Railway Business together with Capex Pickup to Drive Earnings

Price target ¥1,000		Derived from the base case.
Bull Case ¥1,300	P/B 2.6 x F3/12e BPS ¥490 P/E 20 x F3/12e EPS ¥66	**Capex in emerging markets rebounds up, especially in China, and investment in capacity expansion resumes in Japan, Europe and the US. Capex recovers powerfully overall.** OP rebounds close to the peak level in F3/12, as auto capex also recovers well, and earnings from building and airconditioning business exceed our expectations. ROE rises to 14.2%. Fair value P/B is 2.6x (P/E 20x)
Base Case ¥1,000	Average of: P/B 2.1 x F3/11e BPS ¥435 P/B 2.3 x F3/12e BPS ¥480	**Capex in emerging markets increases, especially in China. Investment also returns to replacement/maintenance levels in Japan, Europe and the US.** Limited recovery in auto capex in Japan, Europe and US, but efforts to tap non-auto investment demand contribute. Expansion in emerging markets drives earnings, and F3/12 OP returns to nearly 90% of the peak. ROE is 9.8% in F3/11, 11.9% in F3/12. Fair value P/B 2.1x on F3/11, 2.3x on F3/12 (price target uses the average of these figures).
Bear Case ¥600	P/B 1.4 x F3/11e BPS ¥440	**Capex slump in industrialized world drags on, and emerging market recovery disappoints.** OP stays flat, close to the F3/10 level. ROE about 3.9% in F3/11. Fair value P/B falls to 1.4x.

Note: Share price as at Mar. 3, 2010, close e = Morgan Stanley Research estimates
Source: FactSet, Morgan Stanley Research

Investment Thesis

- FA systems, the biggest profit contributor, benefits most from capex recovery.
- Electric power and railway business grows, backed by increased power demand and infrastructure investment mainly in emerging markets.
- Retooling of the business portfolio has shed most of the vulnerable businesses that would be at risk of heavy losses. We look now for an offensive strategy, making use of acquisitions etc.

Key Value Drivers

- Strength in FA systems, the earnings driver, is the ability to provide comprehensive solutions that combine wide-ranging product fields and integrated management systems. This differentiates Mitsubishi from firms like Yaskawa that compete in similar product areas in Japan.
- Our OP forecasts of ¥180bn for F3/11 and ¥230bn for F3/12 are ahead of consensus. We look for a recovery to nearly 90% of peak profit in F3/12.
- Risks include capex trends, changes in financing conditions affecting major electric power and railway projects, forex swings, and automobile production trends.

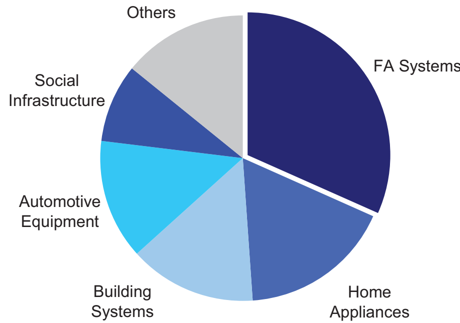
Potential Catalysts

- Unexpectedly strong machine tool demand recovery.
- Advancing mechanization/automation in emerging markets like China.

International

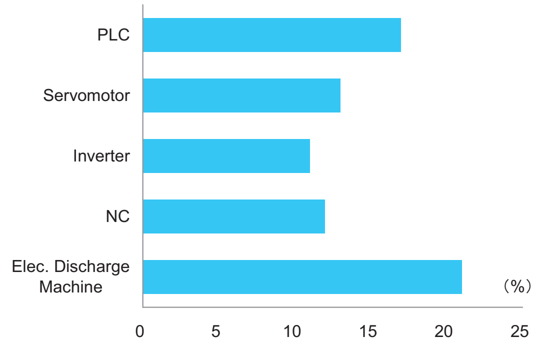
Report Summary: Initiating Mitsubishi Electric Coverage at OW

1. Adding to our machinery & capital goods universe – FA systems the biggest profit generator in last 5 years



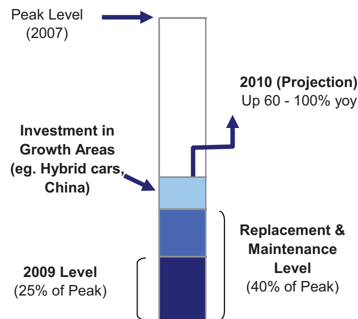
Note: Data show breakdown by business of Mitsubishi Electric's OP last 5 years.
Source: Company data, Morgan Stanley Research

2. Many FA system products have high global share



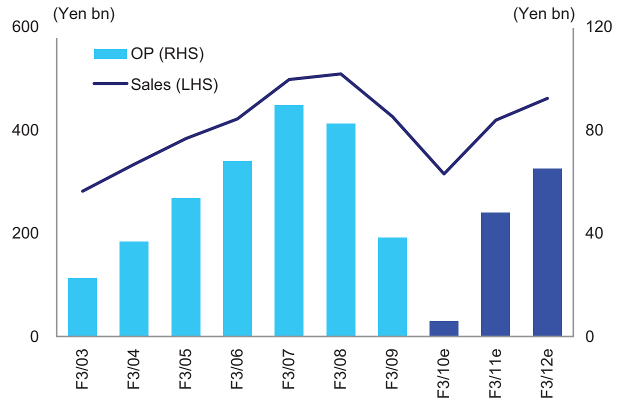
Note: Data show estimated market share of Mitsubishi Electric's main FA products.
PLC = Programmable Logic Controllers
Source: Company data, Morgan Stanley Research

3. Capital investment in 2010 will recover at least to levels that cover replacement/maintenance



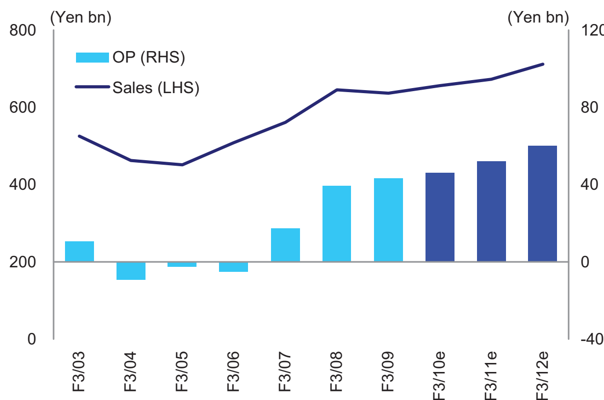
Note: Data show machine tool order value. 2010 projection by Morgan Stanley Research
Source: Japan Machine Tool Builders' Association, Morgan Stanley Research

4. FA systems profit recovery a key driver of earnings



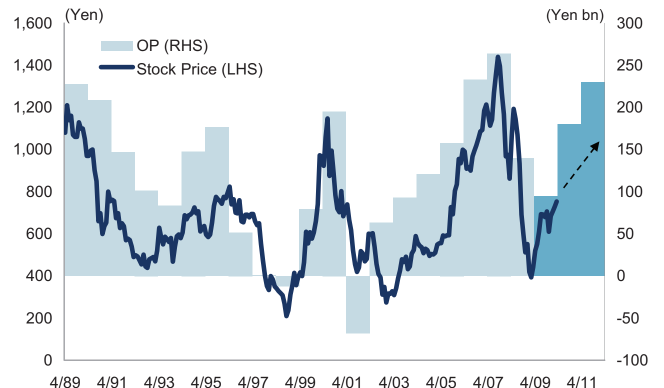
Note: Data show earnings trend of FA systems business.
e = Morgan Stanley estimates; Source: Company data, Morgan Stanley Research

5. Social infrastructure ranks alongside FA systems as second earnings pillar



Note: Data show earnings trend of social infrastructure systems business.
e = Morgan Stanley estimates ; Source: Company data, Morgan Stanley Research

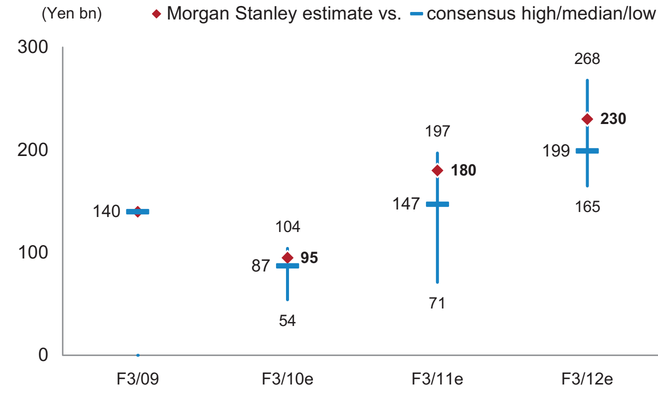
6. Rebound in OP to drive stock price



Note: OP for F3/10 – F3/12 is Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

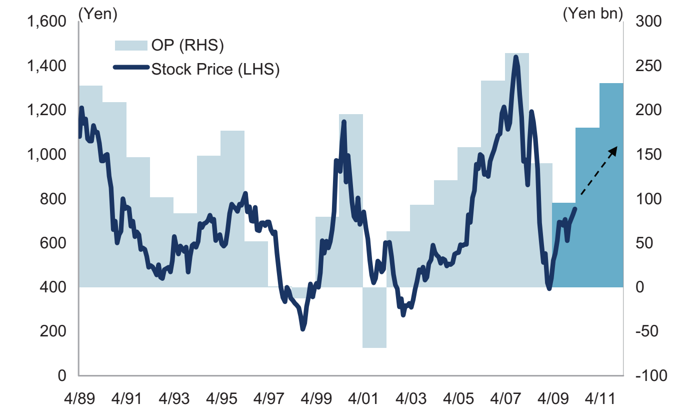
International

Exhibit 1
Our estimates are above consensus



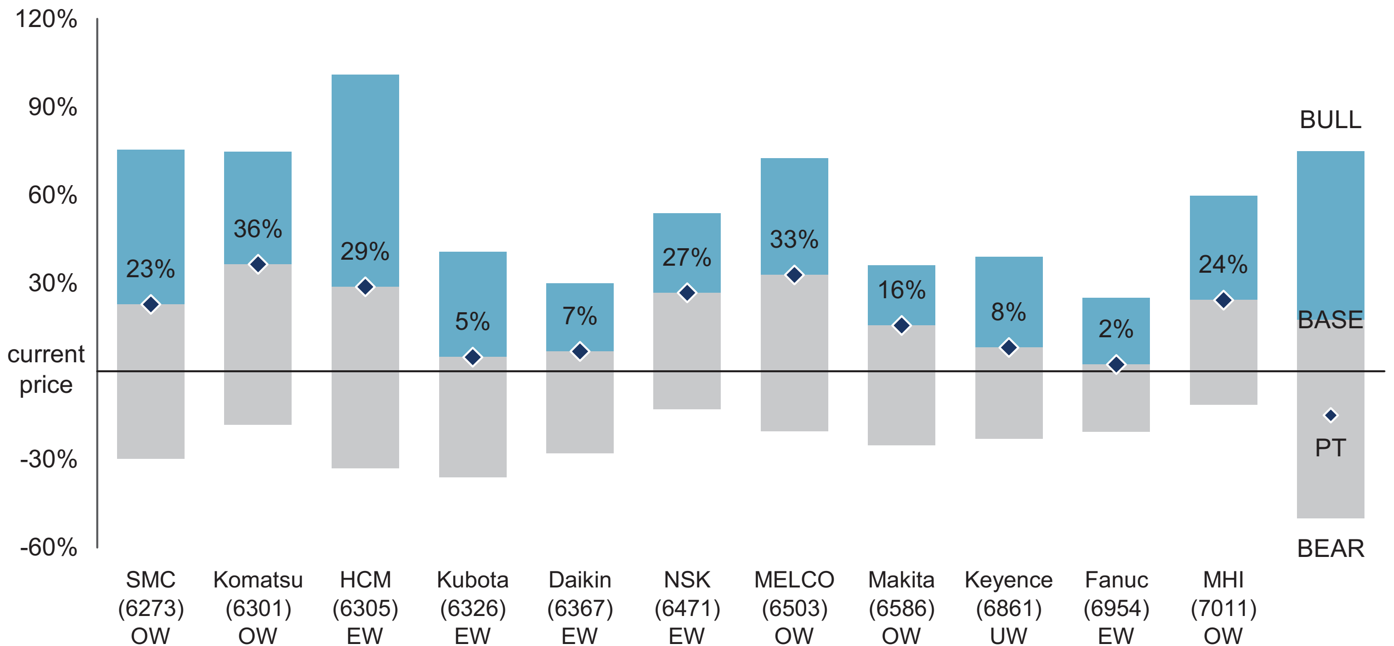
Note: Bloomberg consensus;
Source: Company data, Bloomberg, Morgan Stanley

Exhibit 2
Mitsubishi Electric's Stock Price and OP Trends: Rebound in OP levels to drive stock price



Note: OP for F3/10 – F3/12 is Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Exhibit 3
Risk reward snapshot of machinery and capital goods industry



Note: Stock price as at Mar. 3 close. Source: Morgan Stanley Research

International

March 8, 2010

Schroders
In the Sweet Spot – Stay Overweight

Morgan Stanley & Co. International plc+

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Raising estimates by 7% for 2010e; raising price target from 1,425p to 1,565p. Schroders' 4Q09 results confirmed our thesis of outsized flows as strong performance and distribution aligned with investors' (1) Thirst for yield; and (2) Demand for growth (EM/Global) to raise the NNM rate to 18% in the quarter, some 4-5x the industry average. Increased sales assumptions drive our EPS forecast change, and we see best-in-class 10% NNM growth given cross-asset product performance, which still implies a level 40% lower than 2H09. Sustained momentum at 2H09 levels would imply ~10% upside. At 10.5x 2011e (adjusted for surplus cash) versus the sector on ~11x, we think the current valuation is undemanding given our growth expectations.

Best play on recovering retail/institutional risk appetite in our coverage universe – reiterate Overweight. Schroders' NNM growth of 20% in the past six months compares to ~5% for the global industry. Further, the company's strong capabilities in yield (corporate bond, equity income), inflation hedge (commodities), liability driven investment (LDI) and growth (EM/Global) and fund performance place the stock in the sweet-spot, in our opinion. As such, we reiterate our Overweight stance.

Broadening sales mix supports sustainability: As we have argued before, sales momentum has broadened from the corporate bond focus of 2Q/3Q09, with equities leading but commodity, alternatives and multi-asset also strong YTD. Whilst Europe continues to be the key performer, all regions are now contributing positive flows across institutional and retail (reflecting 79% fund outperformance on 3-year).

Revenue margin guidance reflects confidence in institutional sales outlook. We see company guidance that top-line margins could drift lower as reflecting management confidence in institutional sales (including lower margin LDI) and conservatism on retail rather than pricing risk. On the basis of reasonable retail sales, an uptick in performance fees and decent markets, we expect the revenue margins outcome to be closer to flat at ~62bps. We see a ~200bps decline in compensation/revenues in 2010, which still implies >20% growth in staff costs; but given our top-line growth expectations, this would imply margin expansion from 23% to 30%. We expect reducing loan loss to broadly offset investment spend in private bank, with recovery potential for 2011.

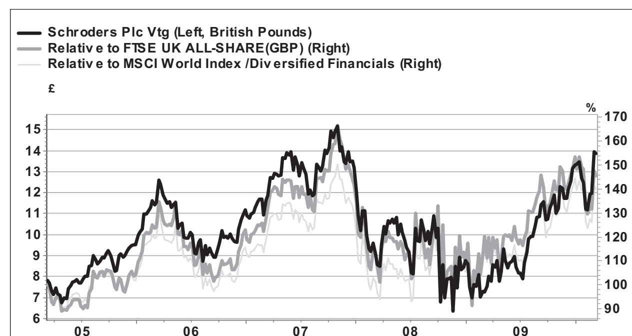
Strong balance sheet confers options, though payout unchanged: Schroders' focus remains on organic growth, but a ~£1.06 billion surplus confers options, supports institutional sales and removes wildcard regulatory risk around waivers.

Stock Rating: Overweight	Reuters: SDR.L	Bloomberg: SDR LN
Price target		1,565p
Shr price, close (Mar 5, 2010)		1,396p
52-Week Range		1,396-684p
Mkt cap, curr (mn)		£4,014

Fiscal Year ending	12/08	12/09e	12/10e	12/11e
ModelWare EPS (p)	77	54	88	115
Prior ModelWare EPS (p)	-	48	83	110
Consensus EPS (p) §	65	47	79	97
P/E**	11.1	24.6	15.8	12.1
Div per shr (p)	31	31	37	45
Div yld (%)	3.6	2.3	2.7	3.2

** = Based on consensus methodology
§ = Consensus data is provided by FactSet estimates.
e = Morgan Stanley Research estimates

Price Performance



Source: FactSet Research Systems Inc

Company Description
Schroders is a UK-based fund manager with operations in Continental Europe, US and the Far East. The group's main business is the management of Institutional pension funds (mainly UK) which accounts for 68% of AUM and 53% of revenues.

Diversified Financials/United Kingdom
Industry View: In-Line

GICS Sector: Financials
Strategists' Recommended Weight: 20.5%
MSCI Europe Weight: 23.5%

International

Valuation methodology

Our new price target of £15.65 is derived from a 20/60/20 weighting of our bull/base/bear scenarios consistent with our coverage universe. For our base case we apply a 15x multiple to asset management and private banking earnings, broadly in line with the longer-term sector average, and add the value of the surplus cash at £800m.

Price target risks

The market outlook is the key risk to our Overweight call; hence investors may wish to play SDR as a relative call – for example, vs. Aberdeen, F&C and Man, all of which we rate Equal-weight or in the broader financials space against LSE (Underweight) or vs. Underweight recommendations within our European banks universe. Other risks include fund performance, flow data, broader industry performance and flows, and M&A.

Exhibit 1

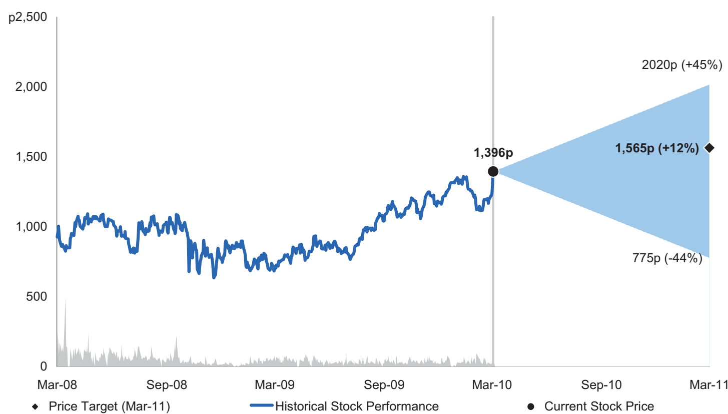
Underlying risk-reward assumptions

£	2009e	2010e	2011e
Bull Case			
AUM (bn)	148	190	218
Net Sales (m)	15.1	18.6	14.0
Net Sales (%)	13.7%	12.5%	7.4%
AM & PB Op Margin (%)	27%	36%	39%
EPS (p)	54.0	101.2	133.6
EPS (p) AM & PB	46.9	92.2	119.2
Base Case			
AUM (bn)	148	174	195
Net Sales (m)	15.1	15.5	10.1
Net Sales (%)	13.7%	10.4%	5.8%
AM & PB Op Margin (%)	27%	34%	37%
EPS (p)	54.0	88.3	115.4
EPS (p) AM & PB	46.9	79.4	101.0
Bear Case			
AUM (bn)	148	130	142
Net Sales (m)	15.1	-0.2	3.4
Net Sales (%)	13.7%	-0.1%	2.6%
AM & PB Op Margin (%)	27%	29%	31%
EPS (p)	54.0	62.6	72.2
EPS (p) AM & PB	46.9	53.7	57.7

Source: Morgan Stanley Research estimates

Exhibit 2

Strong 2010e EPS recovery given leverage to sales improvement



PT £15.65	We assign a 20% weight to the bull case, 60% to the base case and 20% to the bear case in line with our coverage universe.
Bull case £20.20	**Stronger flow pipeline; FTSE 100 bounces to 6400 by end 2010.** We adjust for full value (~£1060m) of surplus capital. 15x 2010 P/E for AM and PB earnings.
Base case £16.75	**Equity return 7.5% pa (FTSE at 5800 year end) £15bn inflow in 2010 (~10%)** on thirst for yield/returning risk appetite. 15x 2010 P/E for AM and PB earnings (10% premium to sector avg vs. 15x longer term),11% CoE and adjust for surplus cash (~£800m).
Bear case £7.75	**FTSE 100 drops to 3800 by end 2010.** Net group outflows £(0.2)bn 2010e as institutional and retail move sharply negative H210e. Lower P/E multiple of 10x 2010 AM and PB earnings, adjusting for only 50% of surplus cash.

Source: FactSet (historical share price data), Morgan Stanley Research estimates. Share prices as of March 5, 2010: Aberdeen Asset Management 120p, F&C Asset Management 61p, Man Group 246p, LSE 708p

International

March 8, 2010

South Korea Chemicals
Inflection Point Up Ahead — Upgrade to Attractive

Morgan Stanley & Co. International plc, Seoul Branch+

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We have raised our Industry View on Korean petrochemicals to Attractive: We believe possible margin corrections in 1H10 offer investors a chance for long-term share price appreciation until 2012. We anticipate stronger petrochemical margins amid much tighter than expected supply-demand balances. We realign our argument to focus on the long-term improvement of supply-demand balances; we project that the burden of capacity expansion should ease from 2Q10. We believe there could be further share price outperformance to come based on historical trends.

We have raised Honam Petro (W119,000) and Hanwha Chem (W14,700) to OW and maintain OW on LG Chem (W223,000): We have also raised our 2010 earnings estimates for all three companies, reflecting better overall macro conditions for the petrochemical industry. Our view remains in line with our economists' global GDP growth forecast of 4.4% in 2010, up from -1.1% in 2009. Accordingly, we have adjusted our price targets for each company.

Exhibit 1
Raising Price Targets and Earnings Forecasts

Stock	Ticker	NEW		
		Rating	Price Target	EPS FY10E
Honam Petrochemical	011170.KS	OW	167,000	18,660
Hanwha Chemical	009830.KS	OW	21,000	2,098
LG Chem	051910.KS	OW	340,000	24,000
Stock	**Ticker**	**OLD**		
		Rating	Price Target	EPS FY10E
Honam Petrochemical	011170.KS	UW	64,000	13,912
Hanwha Chemical	009830.KS	UW	9,200	1,828
LG Chem	051910.KS	OW	330,000	22,689
Stock	**Ticker**		**EPS Change (%)**	
			FY10E	FY11E
Honam Petrochemical	011170.KS		34%	83%
Hanwha Chemical	009830.KS		15%	36%
LG Chem	051910.KS		6%	5%

Source: Company data, Morgan Stanley Research

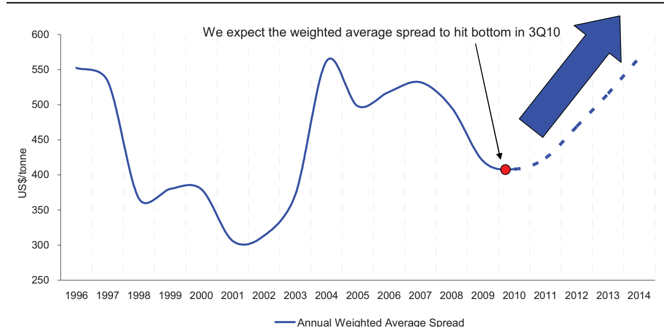
How we differ from consensus: In general, our numbers are in line with consensus for 2010 and higher than consensus for 2011. For both Honam Petro and LG Chem, we believe their product portfolios should benefit most from the up-cycle we project. We see the market following our bullish earnings guidance as the cycle kicks in. Our estimate for Hanwha Chem is lower than consensus for 2010, as we believe the market has already factored many of the positives into the stock price already.

We now believe a cyclical upturn is imminent in 2010 as opposed to 2011: In fact, as the industry approaches its final hurdle, our analysis shows that we are currently near the bottom of the petrochemical cycle. Along with a fiscal year shift to 2010, we see an inflection point for margins in 3Q10. We believe our revised estimates capture more of the positive earnings power for the companies in our coverage.

Capacity expansion slowdown after 2Q10: We recognize that global ethylene capacity growth of 8% in 2010 outpaces our 4.2% demand growth forecast. But chronic delays, ranging from mechanical failures to issues related to raw material supply, have consistently led to slower expansion and lower operating rates than we expected in the recent past. If the trend endures throughout this year as it did in the past, we can expect to see further improvements in petchem margins from our previous forecasts. In our view, the bigger picture shows that petrochemical product demand growth should outpace supply growth from 2011 onwards.

Note: For details of price target methodology and risks, see our full report.

Exhibit 2
Petchem Weighted Average Spreads to Bottom Out

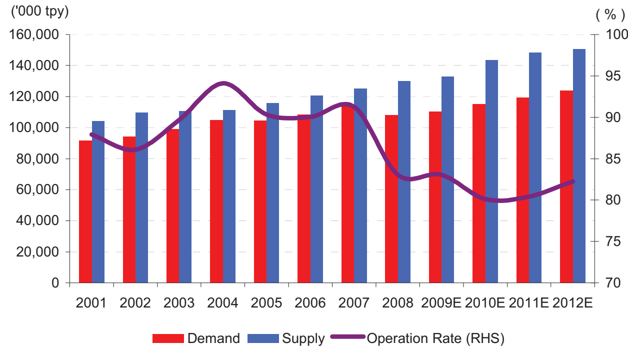


Source: Datastream, E = Morgan Stanley Research estimates

International

Exhibit 3

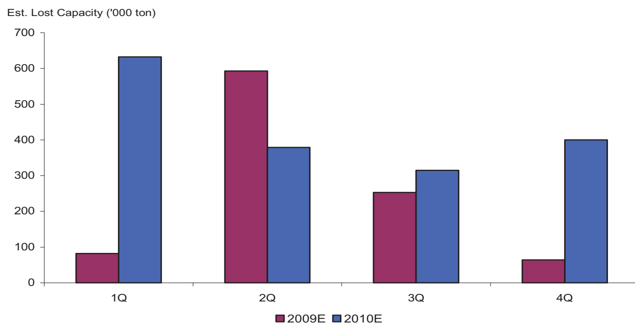
Operating Rates: Early Stage of Recovery



Source: CMAI, E = Morgan Stanley Research estimates

Exhibit 4

Estimated Lost Capacity Greater in 2010 than 2009



Source: ICIS, CMAI, Morgan Stanley Research

Exhibit 5

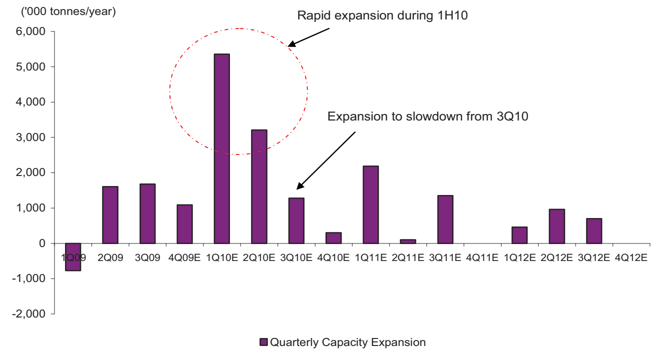
Asian Cracker Maintenance Schedule for 2010

Month	Company Name	Location	Capacity (t)	Turnaround dates
Feb	PTT Chemical	Mab Ta Phut, Thailand	460,000	mid-Feb for 35 days
	Sanyo PC	Mizushima, Japan	470,000	mid-Feb for mid-Apr
	ExxonMobil	Jurong Island, Singapore	900,000	mid-Feb for 2 wks
Mar	CNOOC-Shell	Huizhou, China	800,000	early Mar for 2 mths
	Showa Denko	Oita, Japan	675,000	13 Mar - 26 Apr
	Tosoh Corp	Yokkaichi, Japan	527,000	14 Mar - 16 Apr
	LG Chem	Yeocheon, Korea	900,000	3 Mar - 8 Apr
Apr	BASF-YPC	Nanjing, China	600,000	Apr-May
May	Keiyo Ethylene	Chiba, Japan	740,000	11 May to 17 June
	YNCC	Yeocheon, Korea	400,000	17 May to 20 June
Jun	Mitsui	Osaka, Japan	450,000	17 Jun to 26 Jul
	Mitsubishi	Kashima, Japan	375,000	8 May to 26 June
	PTT Chemical	Mab Ta Phut, Thailand	515,000	30 days
Jul	Mitsubishi	Kashima, Japan	453,000	17 May to 12 Jul
Aug	Tonen	Kawasaki, Japan	515,000	1 mth (TBC)
	Yangzi Petchem	Nanjing, China	650,000	1 mth (TBC)
Sep	Formosa	Mailiao, Taiwan	1,030,000	Sep-Oct
Oct	YNCC	Yeochen, Korea	850,000	4 Oct to 2 Nov
	SK Energy	Ulsan, Korea	690,000	4 Oct to 2 Nov
	Maoming	Maoming, China	380,000	around 30 days
	Titan	Pasir Gudang, Malaysia	400,000	1 mth (TBC)
	CPC	Linyuan, Taiwan	385,000	mid-Oct to H2 Nov
Nov	Rayong Olefins	Mab Ta Phut, Thailand	800,000	TBC
Dec				

Source: ICIS

Exhibit 6

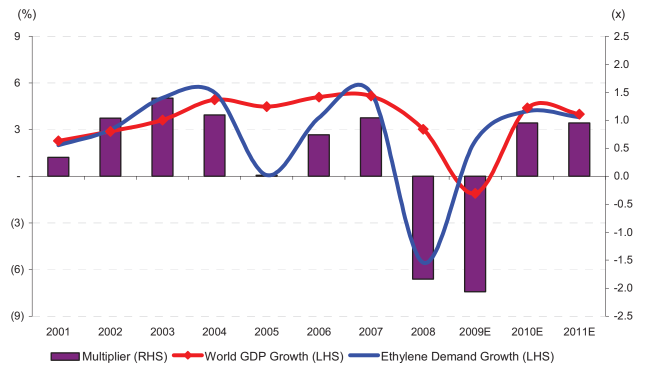
Global Capacity Expansion: We See Burden Easing from 2H10



Source: CMAI, Morgan Stanley Research

Exhibit 7

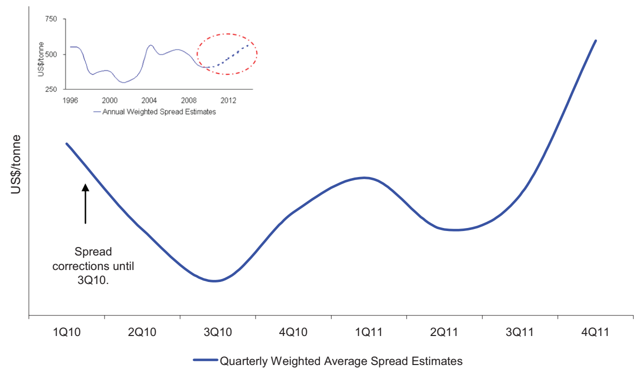
Petchem Demand Better – Brighter Outlook



Source: Morgan Stanley Research

Exhibit 8

Quarterly Spreads: Nearing the Inflection Point



Source: Morgan Stanley Research

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