

Markets Review

What Happened Last Month

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1. Returns

- **Sovereign crisis concerns pushed risk assets lower** – Europe led global equities in a substantial fall, driven by Spain and Italy; in EM, Russia and Brazil led the way down. Defensive sectors and large caps generally fared better in the broad-based sell-off. Government bonds and the USD strengthened in May as investors sought shelter from the storm. IG cash credit saw small gains but synthetic credit widened across the board. While the USD received a sizable boost from safe-haven flows and the JPY also rose, on the other side, EEMEA currencies were hit especially hard. Commodities faltered with the global economy, energy in particular.

2. Performance

- **Poor performance plagued more assets in May** – The continued and intensified sell-off saw the US fall about as much as other regional markets despite more resilience in the former in prior months. Investors are rotating back towards defensives but financials are still one of the outperformers YTD. Escalating concerns in Europe show in the bear-flattening of peripheral sovereign curves, weakening EUR and cross-currency basis swaps, while EM FX is also struggling. The risk-off was bullish for Treasuries and Bunds but may spell trouble for EM funding stress. Gold is at depressed levels and commodities softened further. The USD strengthened as volatility rose; EM currencies fell. There was a slight breakdown in financial conditions but funding stress is far from crisis levels.

3. Valuation

- **Valuations adjusted accordingly to the sell-off** – Shiller P/Es moved closer to the low end of 1-year ranges while credit moved closer to wides and Treasuries and Bunds hit lows. The recent run of weakness has moved P/Es lower from long-term averages, with trailing multiples generally around a standard deviation below. In forward P/E terms, the US is less cheap than Europe relative to history. Dividend yields are still relatively high outside of the US. However, earnings revisions are starting to dip back below zero in Europe. May's corporate debt issuance came in lower than last year, particularly in the high yield space. Sovereign curves bull-flattened in the US and Germany, in contrast with Italy and Spain.

4. Risk Measures

- **Risk measures rose noticeably** – Volatility climbed across asset classes, with implied rising more quickly than realized in US equities. Credit volatility is particularly higher in European high yield, and rate volatility jumped up from subdued levels. Risk-off is driving up correlations within the S&P 500.

5. Sentiment

- **Sentiment turned from cautious to bearish** – Risk is not in high demand as sentiment aligns with the bears and suggests that the sell-off may have further to go. The equity put/call ratio spiked, the AAI Bull-Bears measure stayed negative in the past few weeks, and the Morgan Stanley Standardized Global Risk Demand Index recovered slightly from a steep drop.

6. Positioning

- **Positioning reflects growing fears** – Inflows continued into US fixed income and out of equity funds. Dealers have increased their holdings of US Treasuries as yields fell to lows. Investors are positioned close to flat IG protection but are longer SovX WE risk. Net speculative positions declined in the S&P, gold, oil, EUR, AUD, NZD and CHF, but shot up in the USD.

1. Returns

Equities Nose-dived in May, Led by the Periphery in Europe and Russia and Brazil in EM

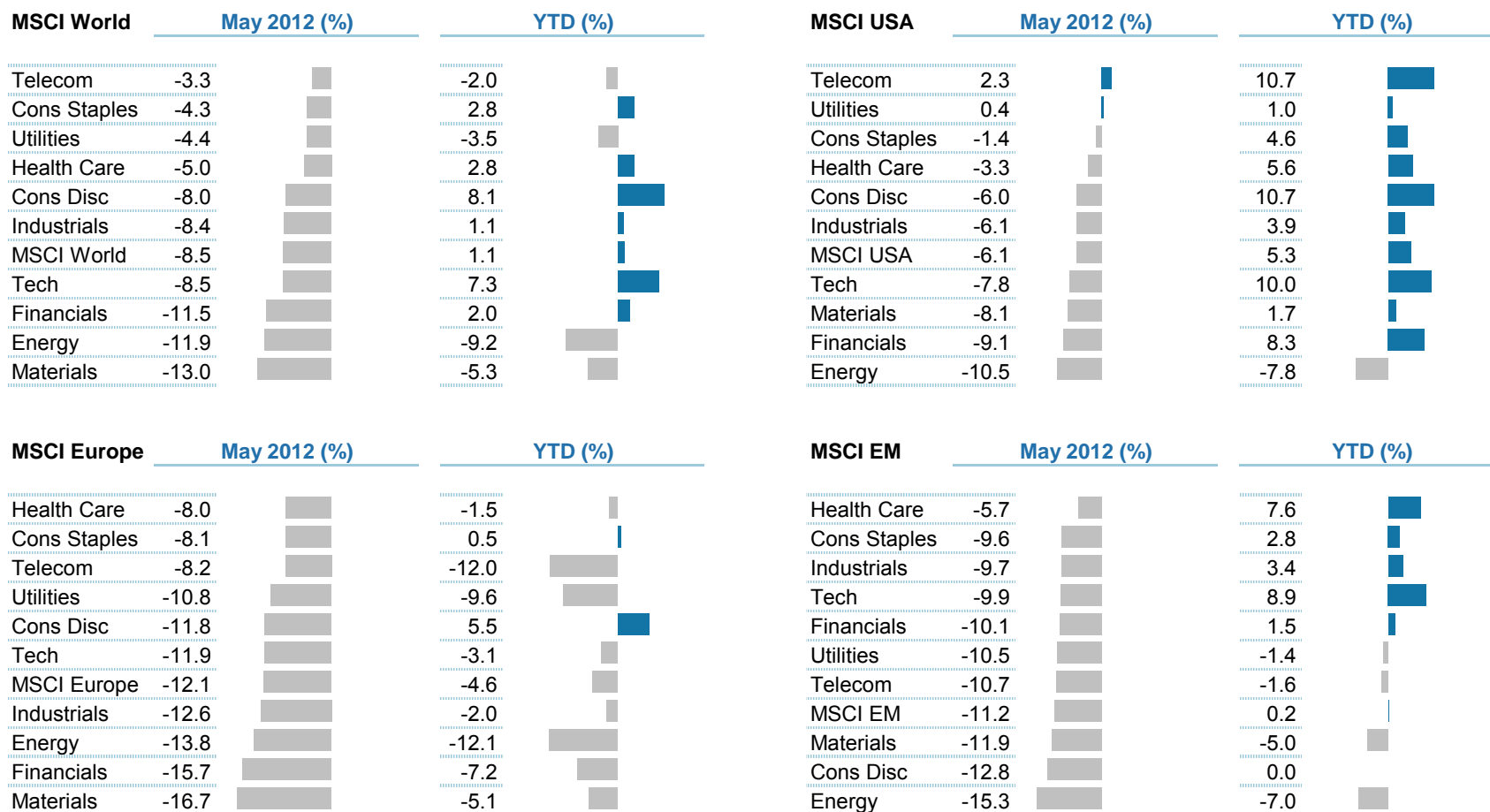
	May 2012 (%)				YTD (%)			
	USD		Local		USD		Local	
World								
S&P 500	-6.3		-6.3		4.2		4.2	
MSCI World	-9.0		-7.1		-0.4		0.9	
MSCI AC World	-9.3		-7.1		-0.5		0.9	
MSCI EM	-11.7		-7.2		-1.1		1.5	
Euro Stoxx	-14.2		-8.1		-12.9		-8.5	
Developed Markets								
Japan Nikkei 225	-8.6		-10.3		-0.9		1.0	
Switzerland SMI	-10.4		-4.0		-5.2		-1.4	
Singapore FTSE	-10.6		-6.9		5.4		4.8	
Canada S&P/TSX Composite	-10.7		-6.3		-5.3		-3.7	
Hong Kong Hang Seng	-11.7		-11.7		1.1		1.1	
Netherlands AEX	-12.1		-5.9		-11.6		-7.2	
UK FTSE 100	-12.1		-7.3		-5.4		-4.5	
France CAC 40	-12.3		-6.1		-9.1		-4.5	
Germany DAX	-13.4		-7.3		1.2		6.2	
Australia ASX All Ordinaries	-13.8		-7.5		-4.9		0.6	
Italy FTSE MIB	-17.6		-11.8		-18.7		-14.7	
Spain IBEX 35	-18.9		-13.1		-32.3		-28.9	
Emerging Markets								
China Shanghai SE Composite	-1.9		-1.0		6.6		7.8	
Taiwan TAIEX	-4.8		-2.7		4.7		3.2	
Indonesia SE Composite	-10.3		-8.3		-3.3		0.3	
Korea KOSPI Composite	-10.9		-7.0		-1.3		1.0	
Thailand SET 100	-11.3		-8.2		9.5		10.4	
India SENSEX	-12.1		-6.4		-0.8		4.9	
South Africa JSE	-12.8		-3.7		-2.3		3.6	
Mexico IPC	-12.9		-4.0		-0.5		2.1	
Turkey ISE National 100	-13.3		-8.2		8.9		7.5	
Brazil Bovespa	-17.5		-11.9		-11.5		-4.0	
Russia RTS	-22.1		-22.1		-10.1		-10.1	

Source: Datastream, Morgan Stanley Research

Note: Price return

1. Returns

In the Broad May Sell-Off, Defensive Sectors Fared Better



Source: MSCI, Datastream, Morgan Stanley Research

Note: Total return in USD

1. Returns

In May, Large Caps Fell Less Across Growth and Value Brackets in DM

<i>MSCI World</i>	May 2012 (%)	YTD (%)
Growth		
Large Cap	-8.3	3.5
Small Cap	-9.1	2.8
Mid Cap	-9.4	1.7
Value		
Large Cap	-8.4	-1.0
Small Cap	-8.7	2.9
Mid Cap	-9.6	-0.7
Large Cap	-8.3	1.2
Small Cap	-8.9	2.8

<i>MSCI USA</i>	May 2012 (%)	YTD (%)
Growth		
Large Cap	-6.2	8.1
Mid Cap	-7.4	5.0
Small Cap	-7.4	4.7
Value		
Large Cap	-5.6	3.2
Small Cap	-6.2	5.2
Mid Cap	-7.6	2.4
Large Cap	-5.9	5.5
Small Cap	-6.8	5.0

<i>MSCI Europe</i>	May 2012 (%)	YTD (%)
Growth		
Large Cap	-11.7	-1.1
Small Cap	-11.9	6.0
Mid Cap	-12.1	-0.5
Value		
Large Cap	-12.1	-8.6
Mid Cap	-14.2	-5.8
Small Cap	-14.3	-0.2
Large Cap	-11.9	-5.1
Small Cap	-13.1	2.9

<i>MSCI EM</i>	May 2012 (%)	YTD (%)
Growth		
Small Cap	-8.4	3.9
Mid Cap	-9.2	2.8
Large Cap	-11.6	0.8
Value		
Small Cap	-9.5	4.6
Mid Cap	-9.7	3.2
Large Cap	-11.3	-1.3
Small Cap	-8.9	4.3
Large Cap	-11.4	-0.3

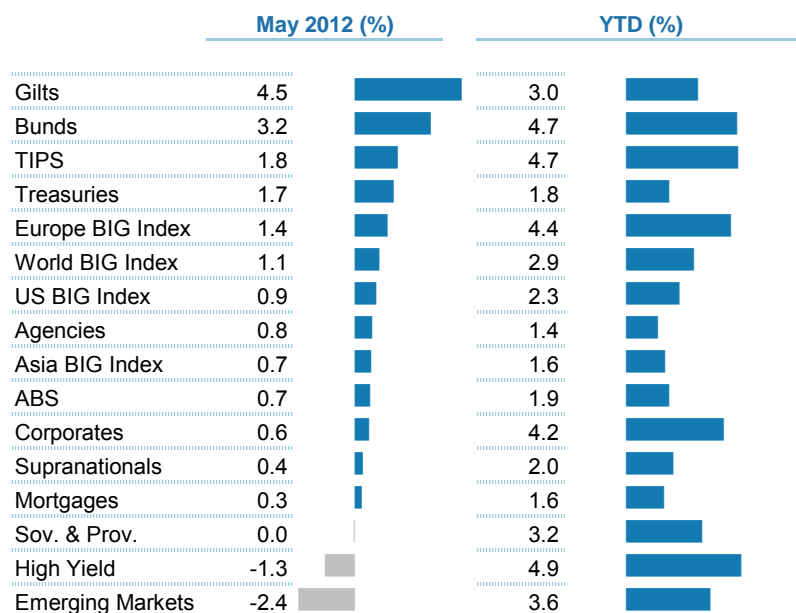
Source: MSCI, Datastream, Morgan Stanley Research

Note: Total return in USD

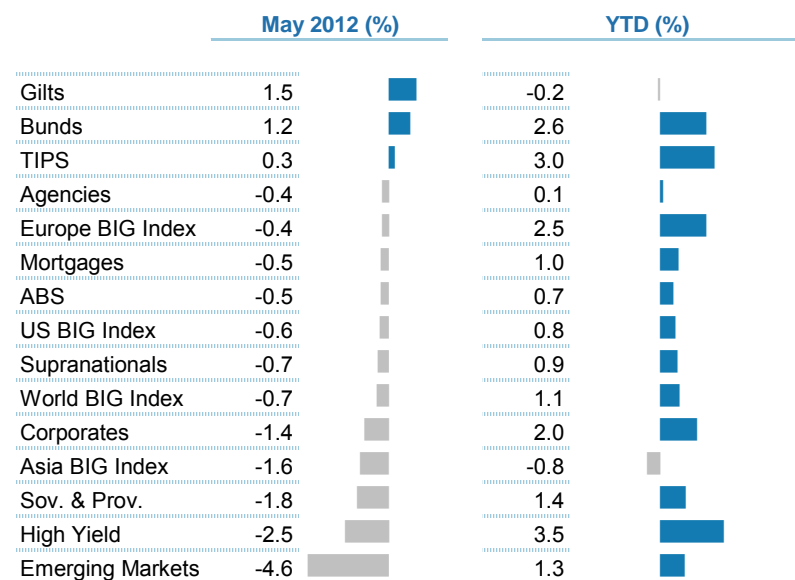
1. Returns

Government Bonds Strengthened in May as Investors Sought Shelter from the Storm

Total Returns



Duration-Adjusted Returns



1. Returns

Higher-Rated Cash Credit Saw Small Gains in May While Lower-Rated Buckets Declined

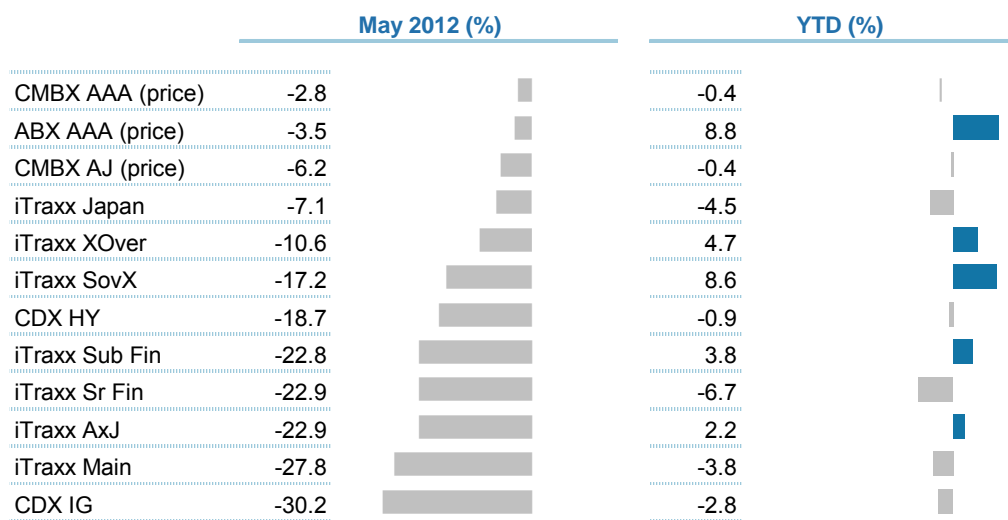
	May 2012 (%)		YTD (%)	
US AAA/AA	1.1	■	3.2	■
US IG	0.6	■	4.2	■
US A	0.6	■	4.1	■
US BBB	0.5	■	4.5	■
US BB	-0.7	■	3.9	■
US HY	-1.3	■	4.9	■
US B	-1.3	■	5.1	■
US CCC	-2.8	■	7.3	■
EUR AAA/AA	1.4	■	5.5	■
EUR A	0.7	■	6.1	■
EUR IG	0.5	■	5.9	■
EUR BBB	-0.2	■	5.9	■

Source: The Yield Book, Morgan Stanley Research

Note: Total return

1. Returns

Synthetic Credit Widened Dramatically in May, Notably in US and Europe IG Corporates



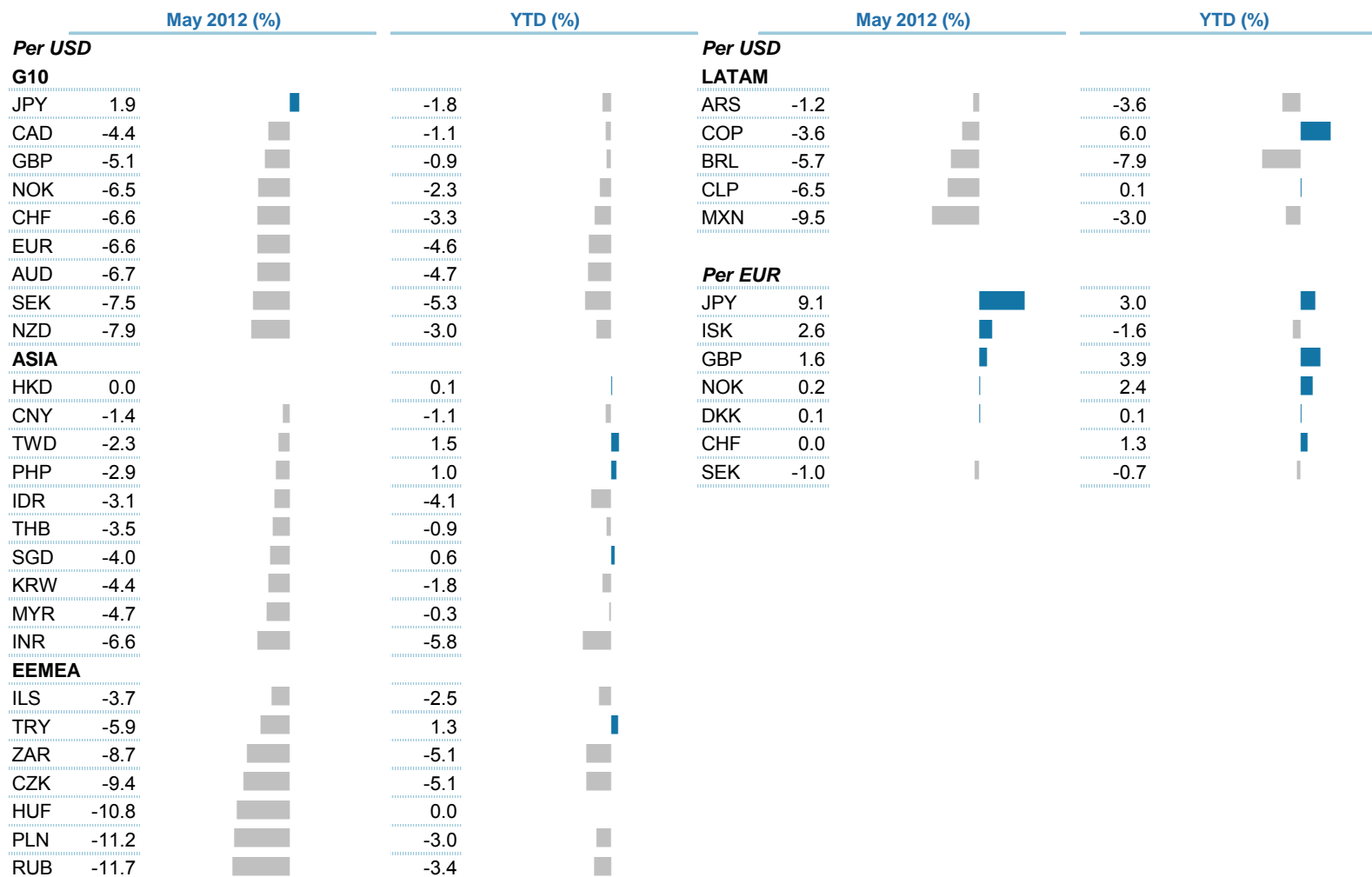
Source: Bloomberg, Morgan Stanley Research

Note: Spread returns, positive indicates spread tightening.

iTraxx SovX includes Greek default in March 2012.

1. Returns

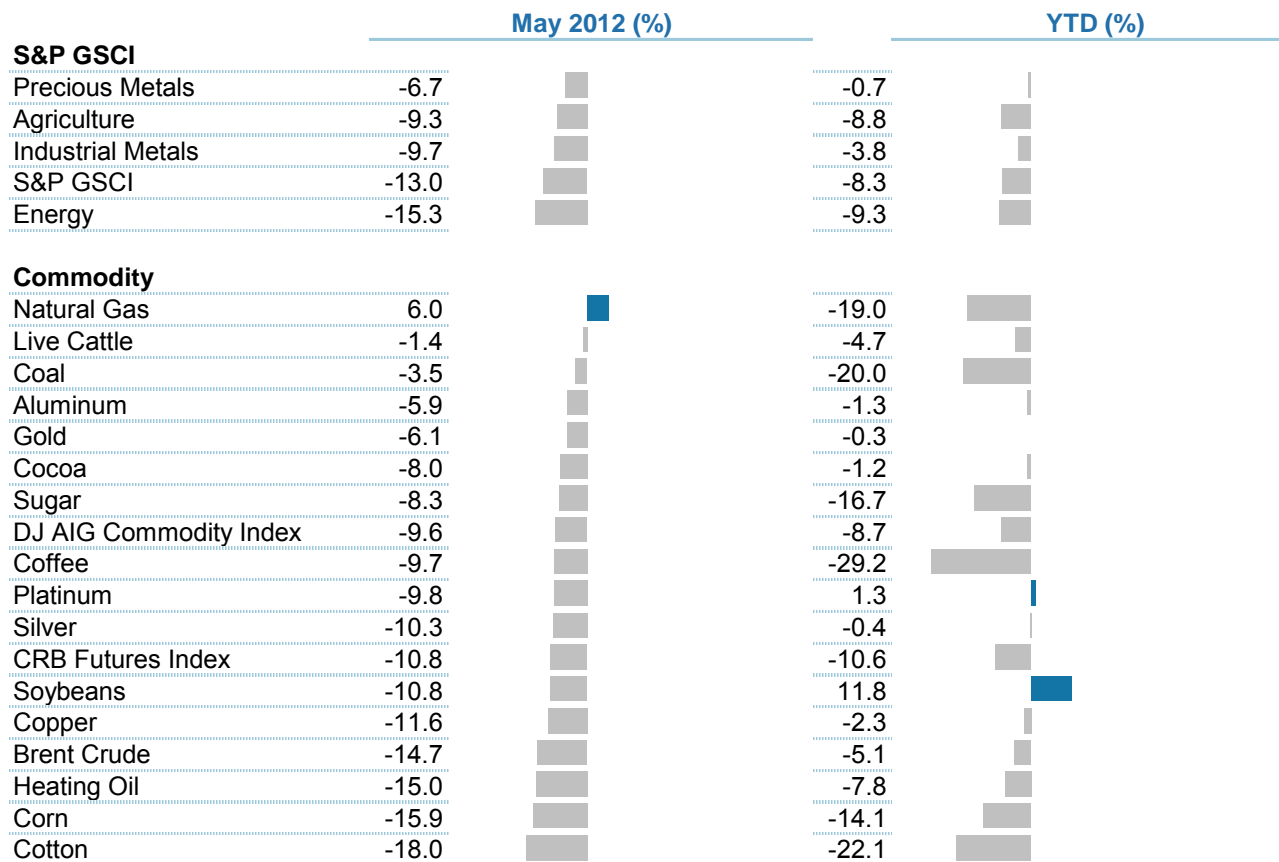
In May, the USD Gained Against Most Currencies and the JPY Also Rose



Source: Thomson Reuters, Morgan Stanley Research

1. Returns

Commodities Faltered Along With the Global Economy in May, Energy in Particular



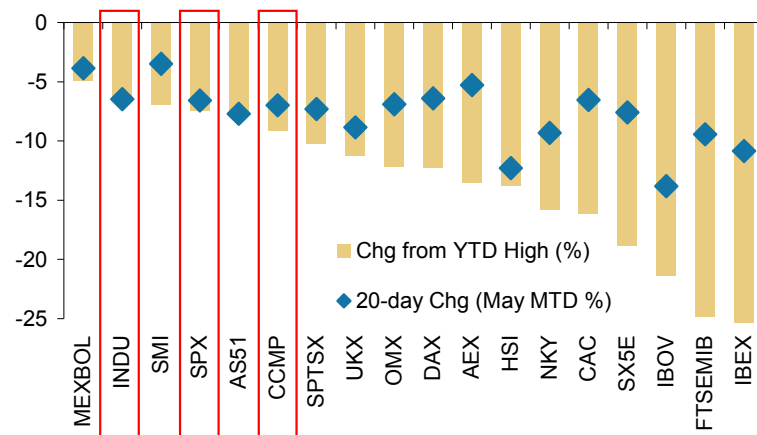
Source: Bloomberg, Morgan Stanley Research

2. Performance

The Latest Sell-Off Is Claiming More Casualties

US equities are now selling off about as much as other regional markets

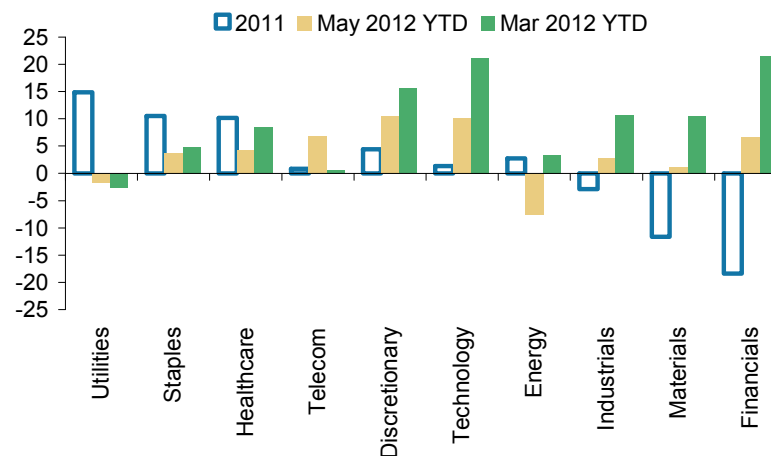
Index Return (%)



Source: Bloomberg, Morgan Stanley Research

Investors are rotating back towards defensives after favoring cyclicals earlier in the year

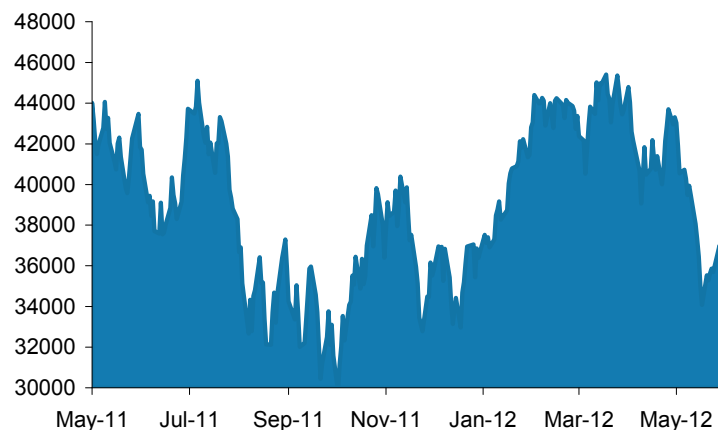
S&P 500 Sector Return (%)



Source: Bloomberg, Morgan Stanley Research

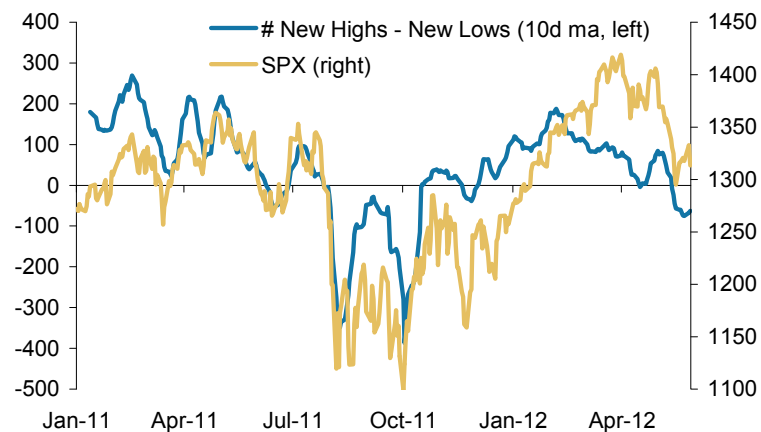
2. Performance

NYSE Stocks Had More Decliners and Net New Lows

Cumulative Advance-Dcline for NYSE Stocks

Cumulative advance-decline for NYSE stocks took a plunge this month

Source: Bloomberg, Morgan Stanley Research

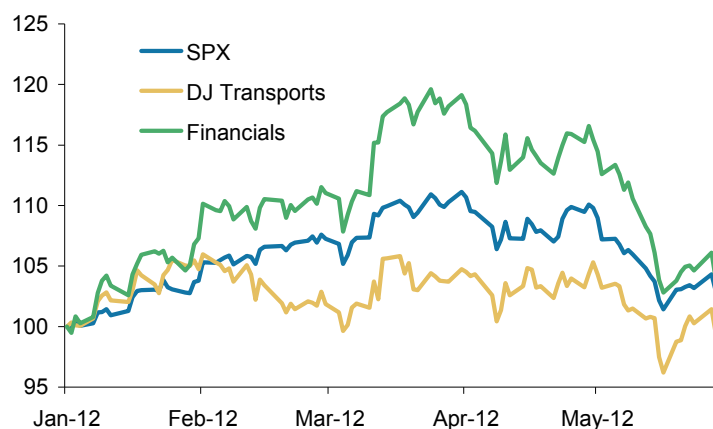
NYSE Net New Highs, SPX

Net new highs for NYSE stocks are now negative

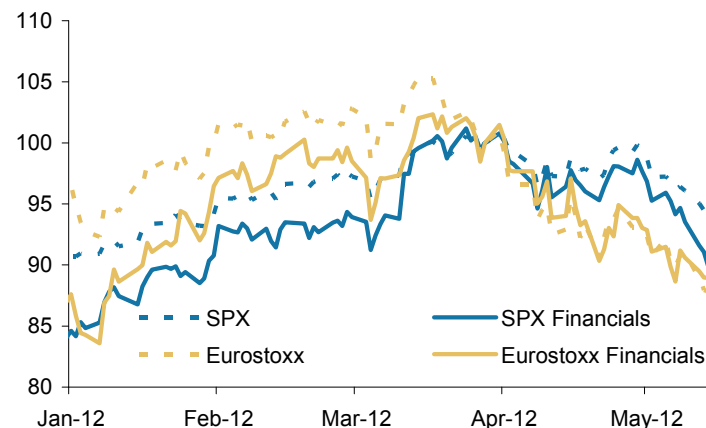
Source: Bloomberg, Morgan Stanley Research

2. Performance**Financials Performed Poorly in the Sell-Off But Are Relatively Outperforming YTD**

Financials led the sell-off...

SPX, Transportation, Financials (2012=100)

Source: Bloomberg, Morgan Stanley Research

Financial Equities vs. Market (31-Mar-12 = 100)

Source: Bloomberg, Morgan Stanley Research

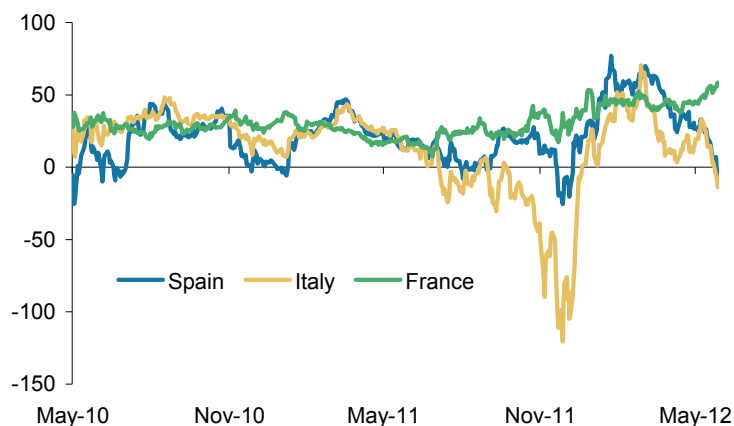
...But are still outperforming YTD

2. Performance

Europe's Escalating Crisis Shows in Bear-Flattening of Peripheral Sovereign Curves

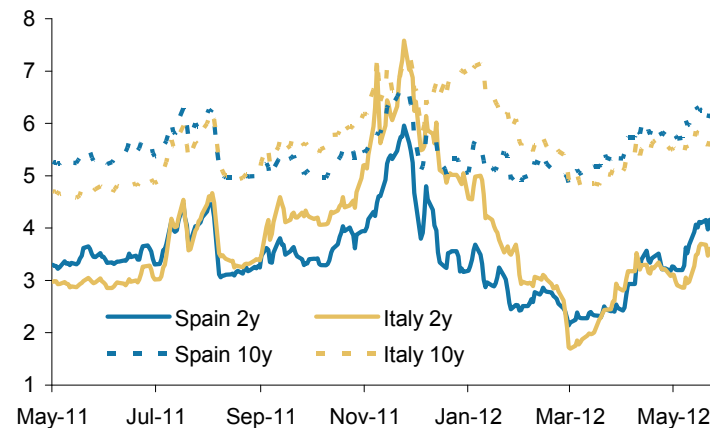
Peripheral front-end sovereign yields rose rapidly...

ASW 5s10s (bp)



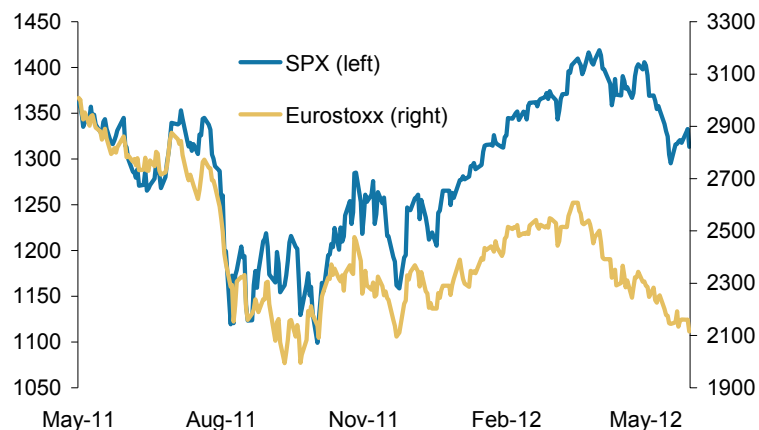
Source: Morgan Stanley Research

Sovereign Yield (%)



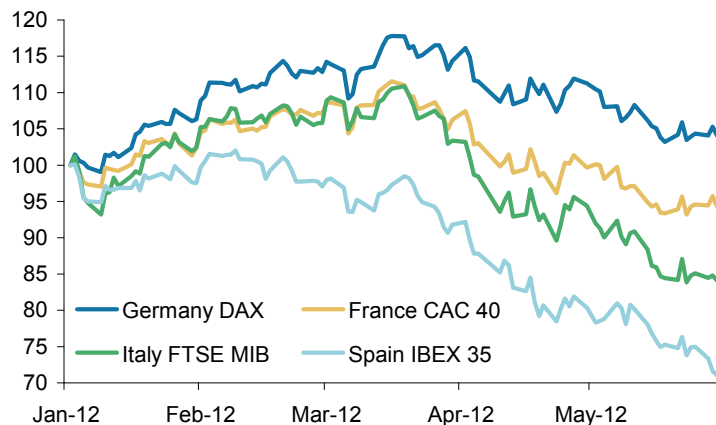
Source: Bloomberg, Morgan Stanley Research

...While the core maintained strength

2. Performance**Sovereign Weakness Shows Up in Equity Markets Too****SPX, Eurostoxx (level)**

US equities recovered slightly near month-end but Europe fell straight through the month

Source: Bloomberg, Morgan Stanley Research

Equity Index (2012=100)

The stock market knows how to differentiate between sovereigns

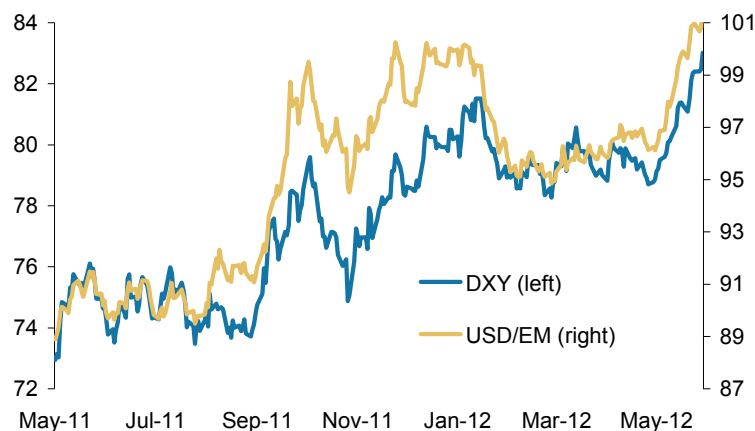
Source: Bloomberg, Morgan Stanley Research

2. Performance

Safe-Haven Flows Favor the USD, Leaving EM FX to Struggle

The USD is boosted by safe-haven flows while EM FX suffers

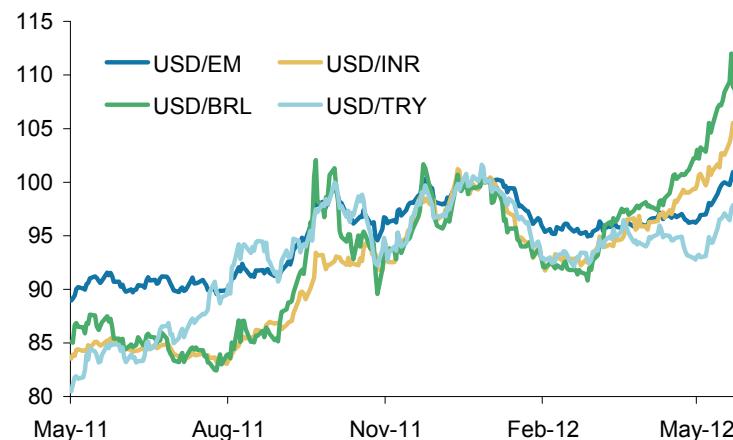
DXY, EM FX



Source: Bloomberg, Morgan Stanley Research

The BRL and INR have been particularly shaky this year

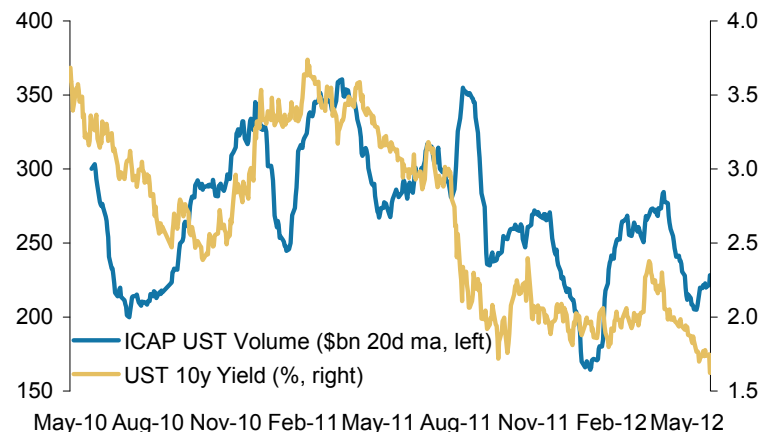
EM FX, INR, BRL, TRY (2012=100)



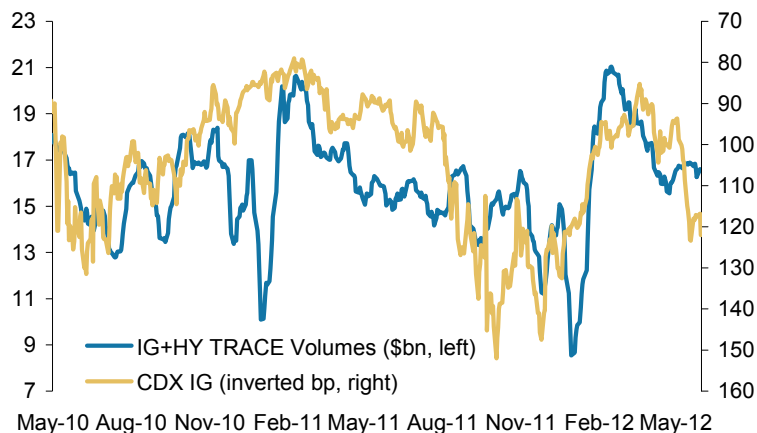
Source: Bloomberg, Morgan Stanley Research

2. Performance**Volumes Are Supporting Treasuries and Hesitating on Corporate Credit**

UST volumes rose recently as demand drove down yields...

UST Volume, Yield

Source: ICAP, Bloomberg, Morgan Stanley Research

Credit Volume, CDX Spread

Source: FINRA, Bloomberg, Morgan Stanley Research

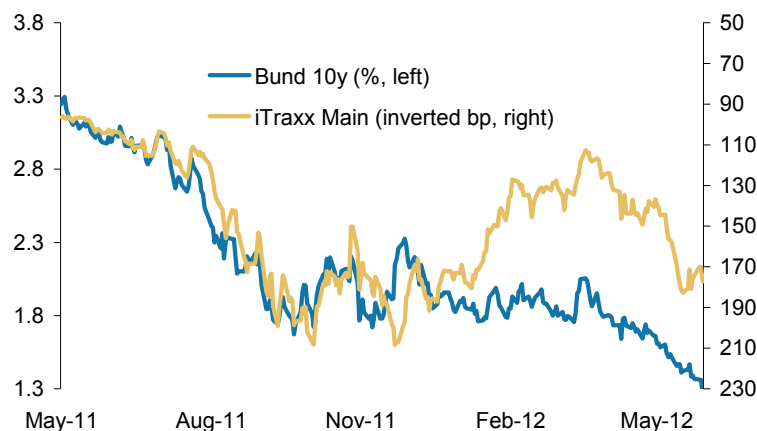
...But corporate credit volumes were flat on the month as spreads widened

2. Performance

European Risk Is Bullish for Bunds But Bad News for EM Funding Stress

Safe-haven Bunds rallied while European corporate credit widened

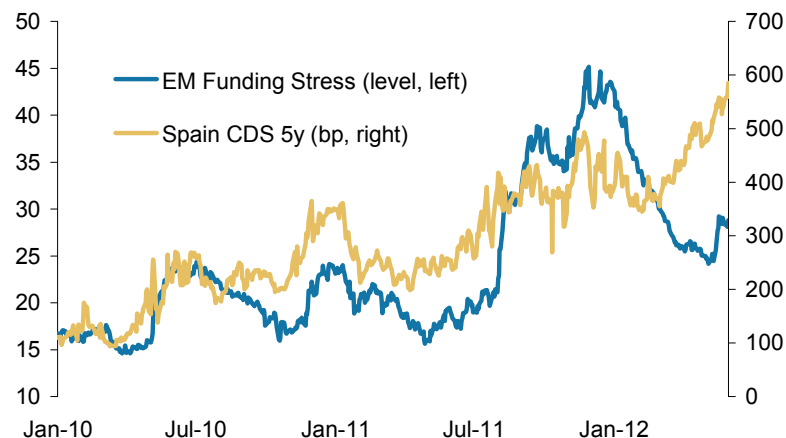
Bund, iTraxx Main



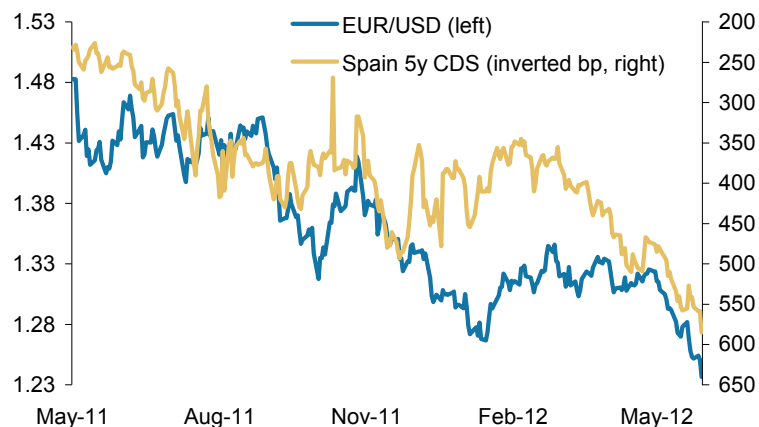
Source: Bloomberg, Morgan Stanley Research

Sovereign risk is starting to push EM funding stress upward

EM Funding Stress, Spain CDS

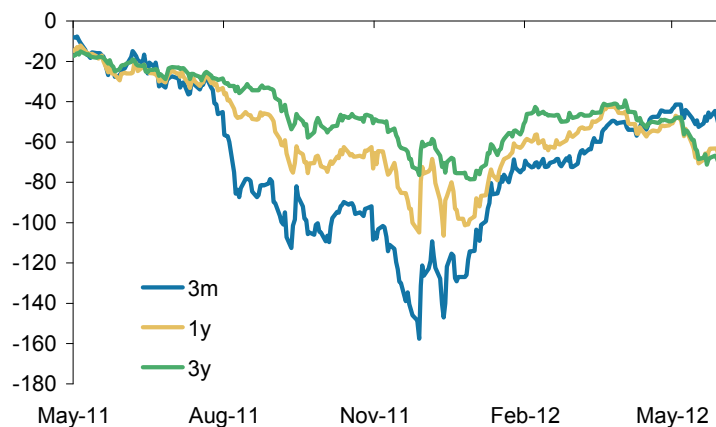


Source: Bloomberg, Morgan Stanley Research

2. Performance**Sovereign Concerns Showing Up in the EUR and Cross-Currency Basis Swaps****EUR, Spain CDS**

The EUR is falling with rising sovereign risk

Source: Bloomberg, Morgan Stanley Research

EUR/USD Cross-Currency Basis Swap (bp)

The EUR/USD cross-currency basis swap is flashing red for longer-dated maturities

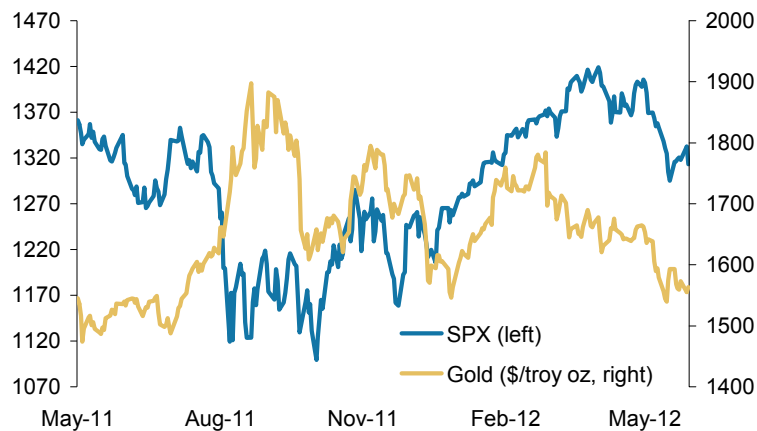
Source: Bloomberg, Morgan Stanley Research

2. Performance

Gold Has Struggled in the Risk-off Environment; Technicals Are a Factor

Gold managed to follow equities down

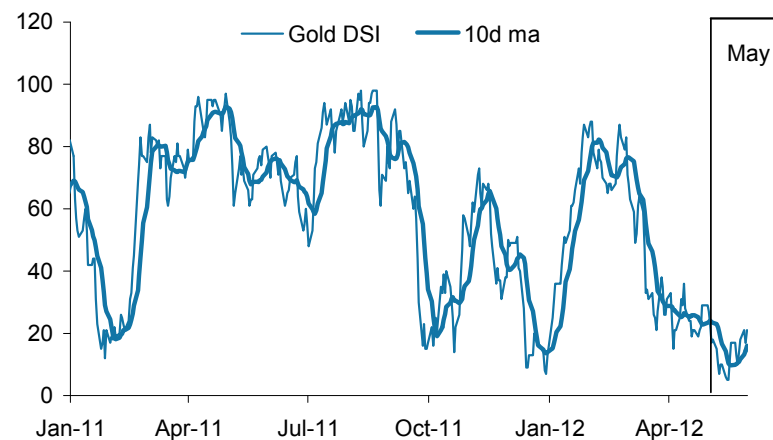
SPX, Gold



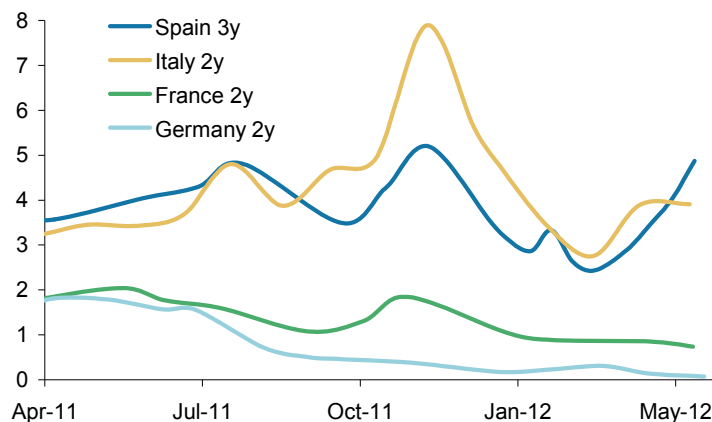
Source: Bloomberg, Morgan Stanley Research

Gold sentiment is at bearish lows

Gold Sentiment (% bullish)

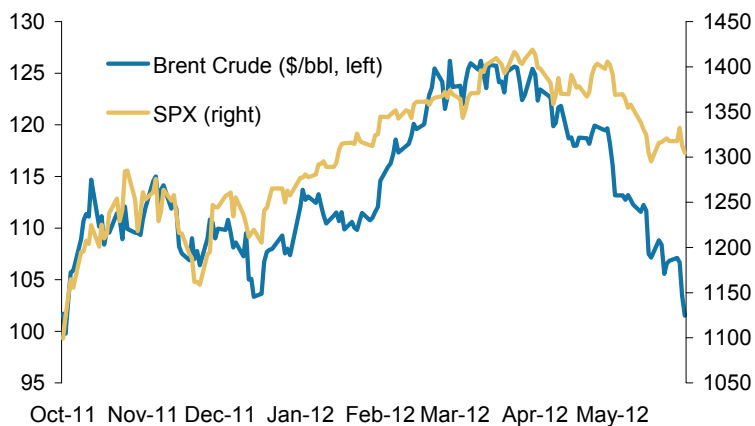


Source: DSI, Morgan Stanley Research

2. Performance**Sovereign Auction Weakness in Spain and Softness in Oil****Average Accepted Auction Yield (%)**

Spain had another significantly weak bond auction

Source: Bloomberg, Morgan Stanley Research

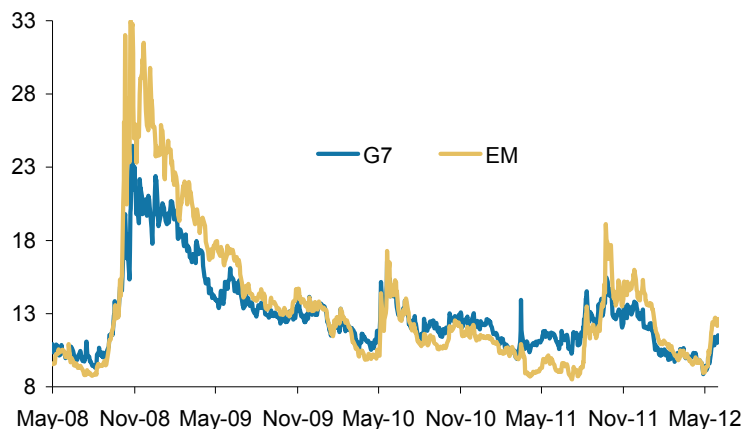
Brent Crude, SPX

Brent dropped on soft fundamentals and macro worries

Source: Bloomberg, Morgan Stanley Research

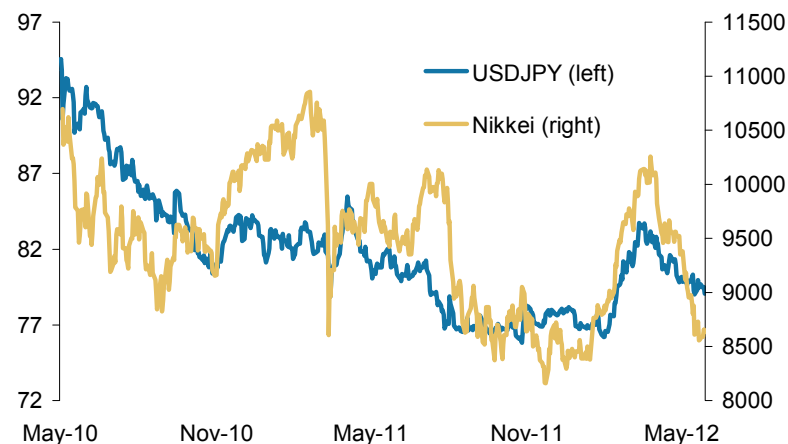
2. Performance**FX Volatility and JPY Both Rising**

FX volatility is at last climbing up from subdued levels

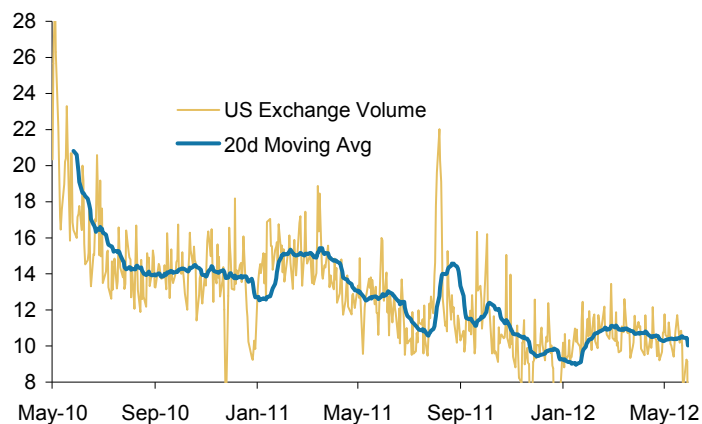
FX Volatility (%)

Source: JP Morgan, Bloomberg, Morgan Stanley Research

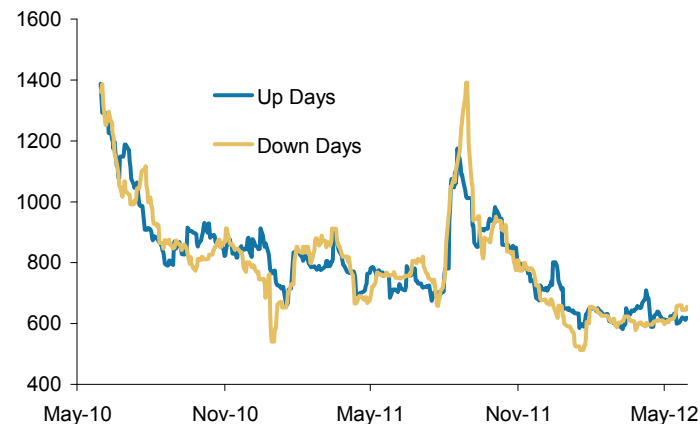
The JPY strengthened while Japanese equities sold off

JPY, Nikkei

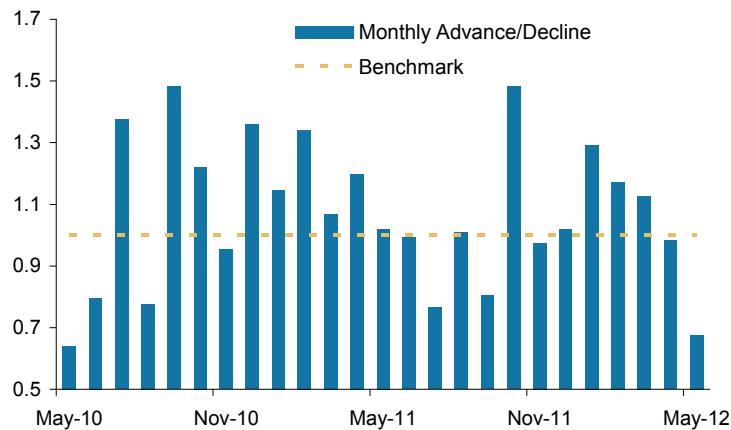
Source: Bloomberg, Morgan Stanley Research

2. Performance**US Equity Prices and Volumes Took a Fall****Total Volume Traded on US Exchanges (bn shares)**

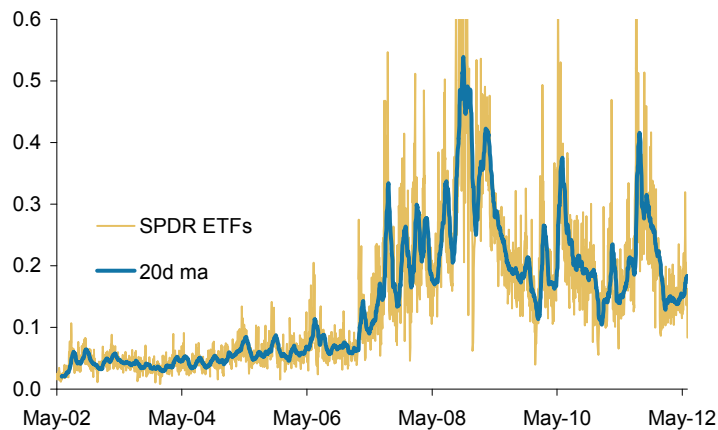
Source: Bloomberg, Morgan Stanley Research

S&P 500 Volume on Up, Down Days (mm shares)

Source: Bloomberg, Morgan Stanley Research

S&P 500 Monthly Advance/Dcline

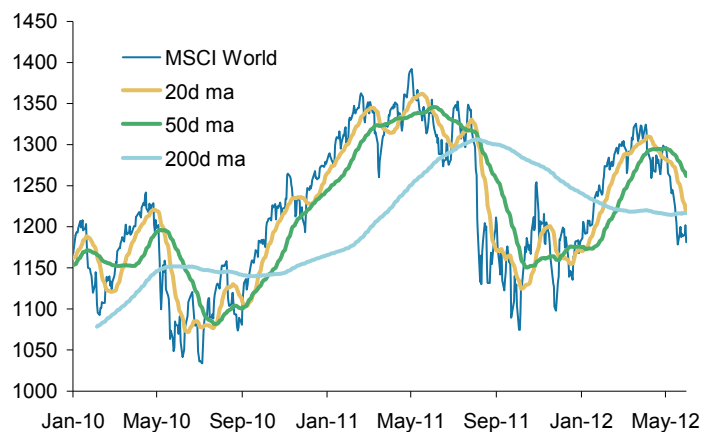
Source: Bloomberg, Morgan Stanley Research

ETF Volume (bn shares)

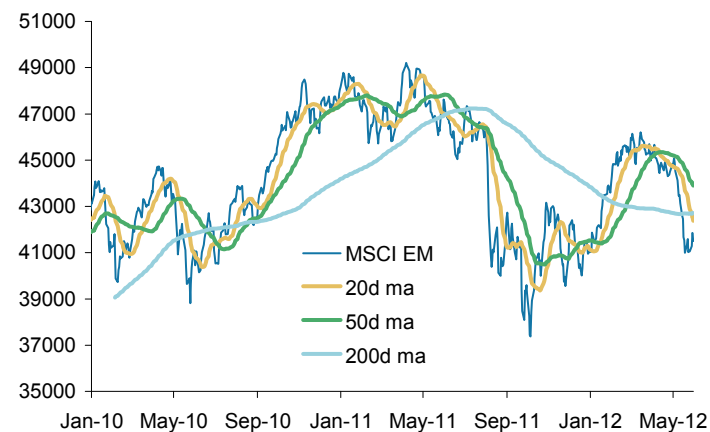
Source: Bloomberg, Morgan Stanley Research

2. Performance

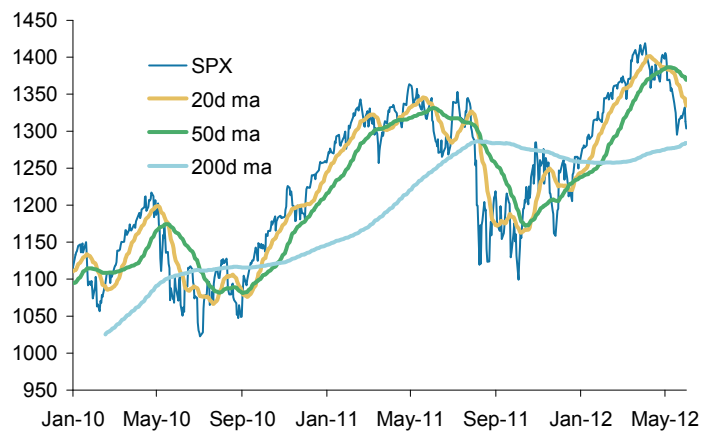
European Equities Dropped Below Various Moving Averages

Equity Index and Moving Averages: DM

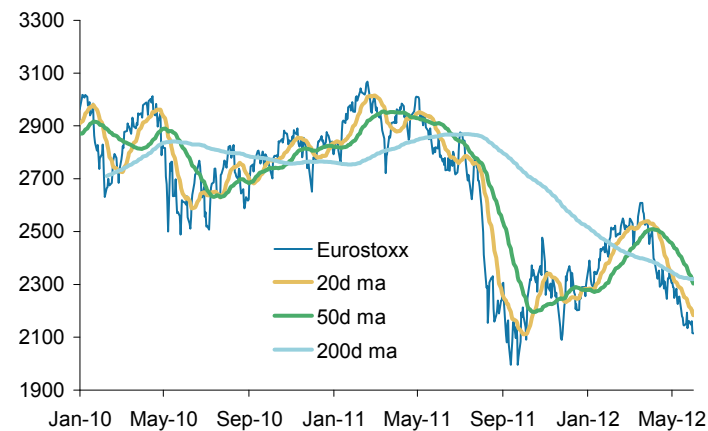
Source: Bloomberg, Morgan Stanley Research

Equity Index and Moving Averages: EM

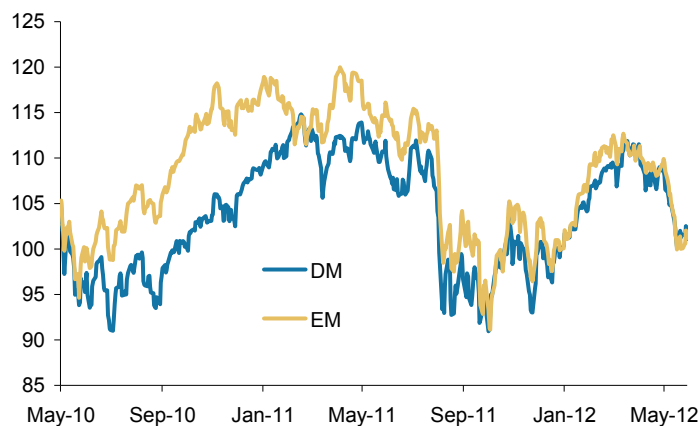
Source: Bloomberg, Morgan Stanley Research

Equity Index and Moving Averages: US

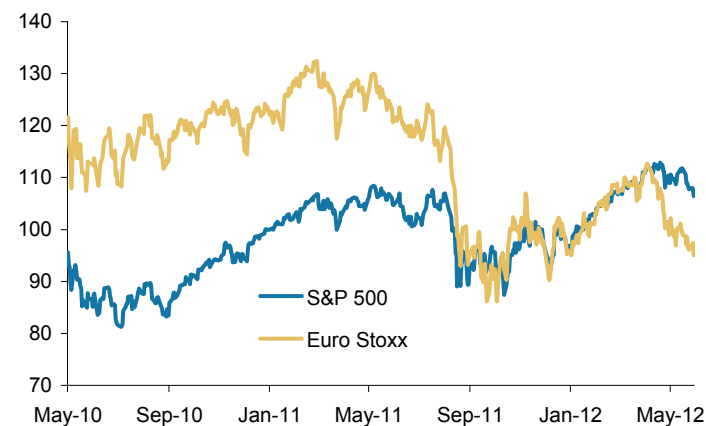
Source: Bloomberg, Morgan Stanley Research

Equity Index and Moving Averages: Europe

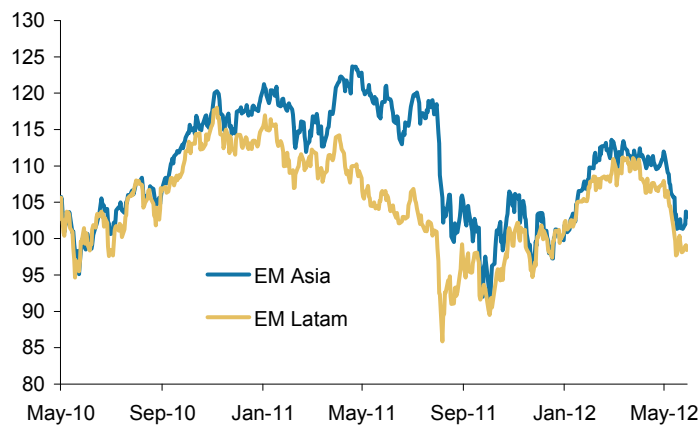
Source: Bloomberg, Morgan Stanley Research

2. Performance**Latam Underperformed EM Asia and Europe Underperformed the US****MSCI World, EM (2012=100)**

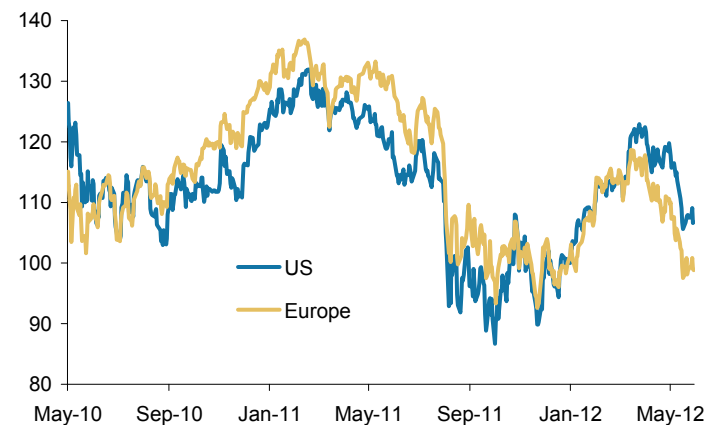
Source: Bloomberg, Morgan Stanley Research

S&P 500, Euro Stoxx (2012=100)

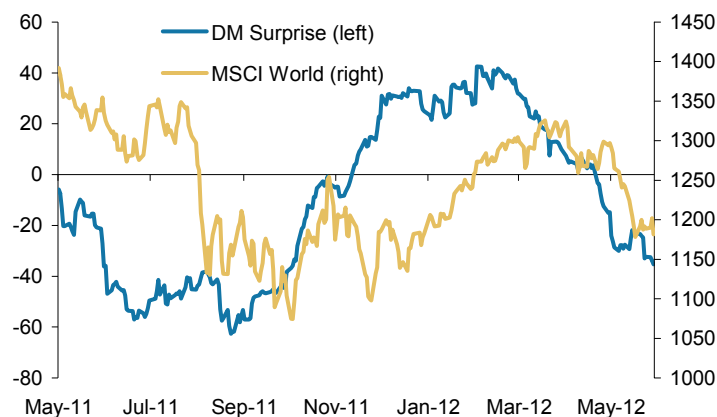
Source: Bloomberg, Morgan Stanley Research

EM Asia, Latam (2012=100)

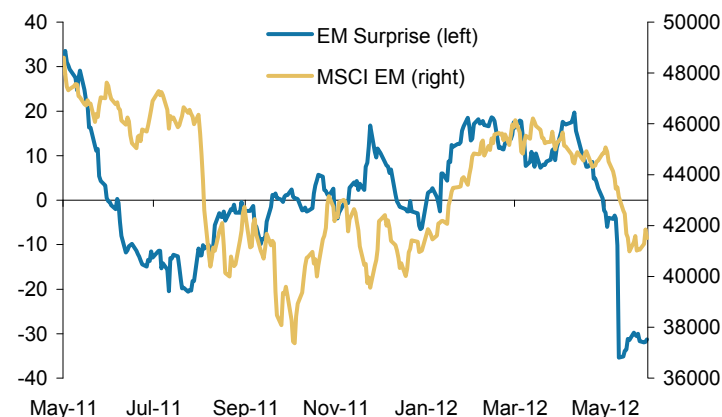
Source: Bloomberg, Morgan Stanley Research

US, European Banks (2012=100)

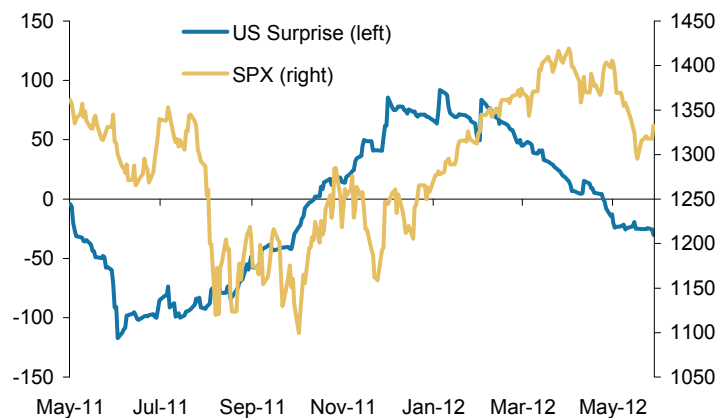
Source: Bloomberg, Morgan Stanley Research

2. Performance**Economic Surprise Moved Lower Across Regions, Nose-diving in EM****Economic Surprise, Equities: DM**

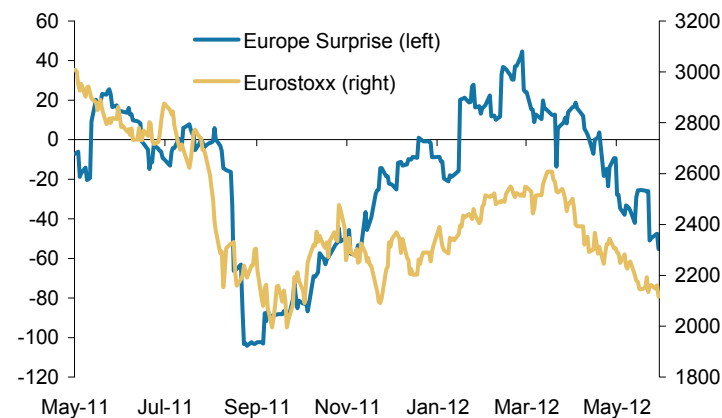
Source: Citigroup, Bloomberg, Morgan Stanley Research

Economic Surprise, Equities: EM

Source: Citigroup, Bloomberg, Morgan Stanley Research

Economic Surprise, Equities: US

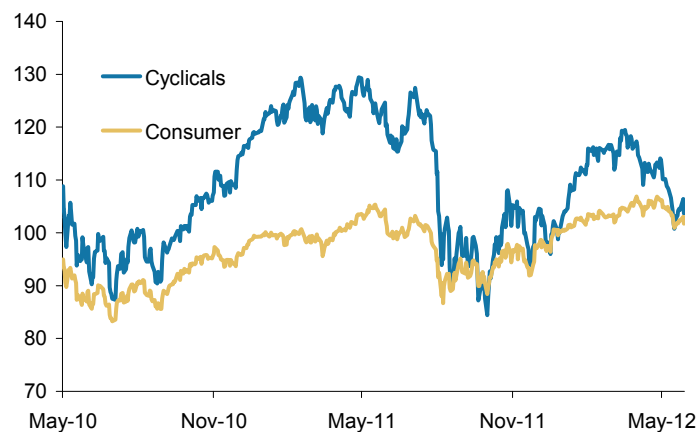
Source: Citigroup, Bloomberg, Morgan Stanley Research

Economic Surprise, Equities: Europe

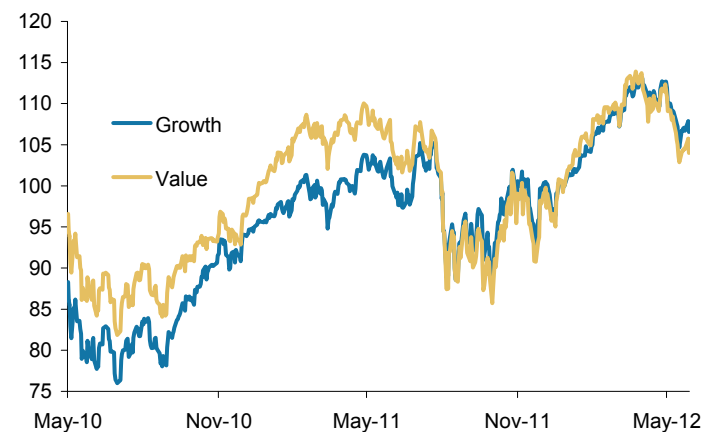
Source: Citigroup, Bloomberg, Morgan Stanley Research

2. Performance

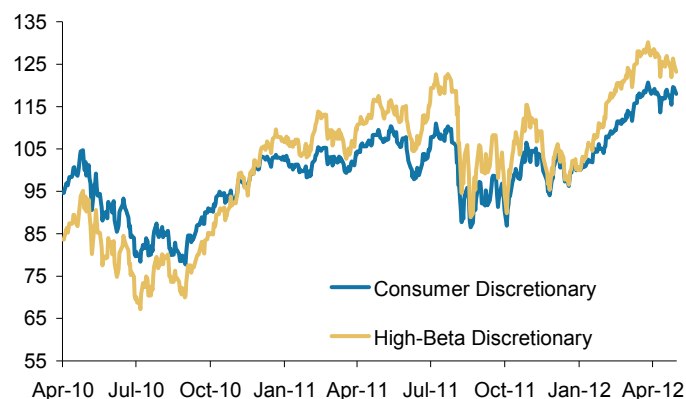
Cyclicals Are Retracing Early-2012 Outperformance Against Defensives

Morgan Stanley Cyclical, Consumer Indices (2012=100)

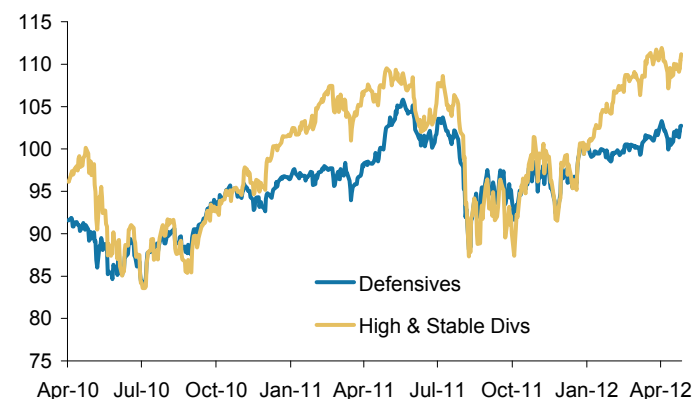
Source: Bloomberg, Morgan Stanley Research

S&P 500 Growth, Value Total Return (2012=100)

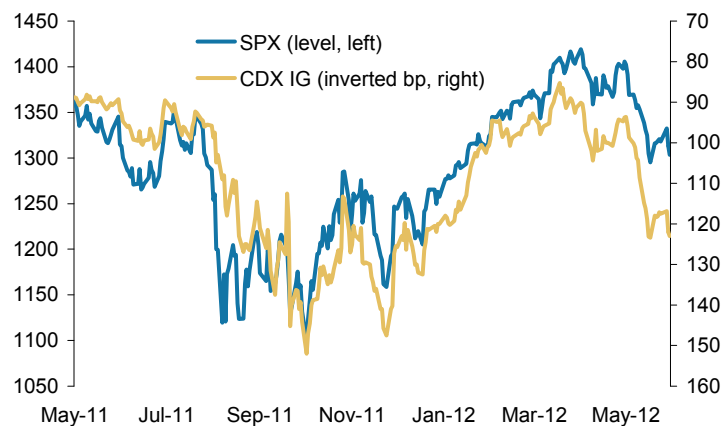
Source: Bloomberg, Morgan Stanley Research

Morgan Stanley Discretionary Baskets (2012=100)

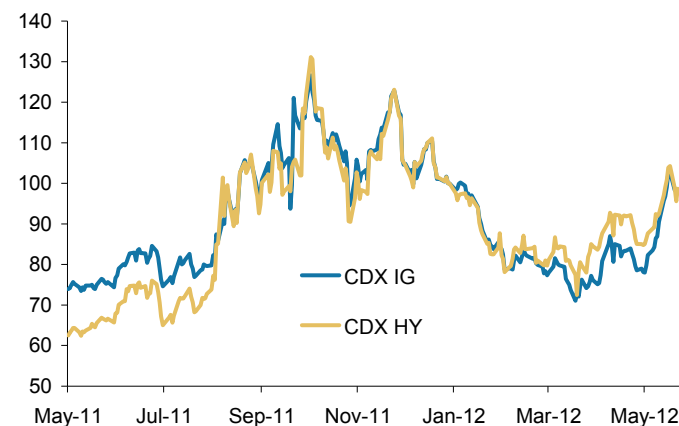
Source: Bloomberg, Morgan Stanley Research

Morgan Stanley Defensive, Dividend Baskets (2012=100)

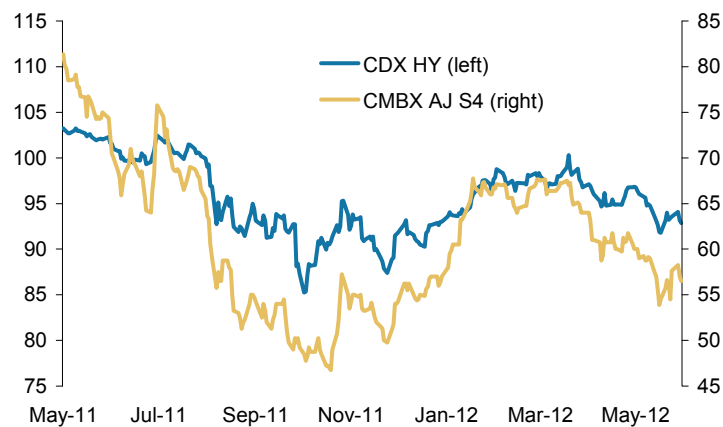
Source: Bloomberg, Morgan Stanley Research

2. Performance**Synthetic Credit Widened in Response to Macro Turmoil****SPX, CDX IG**

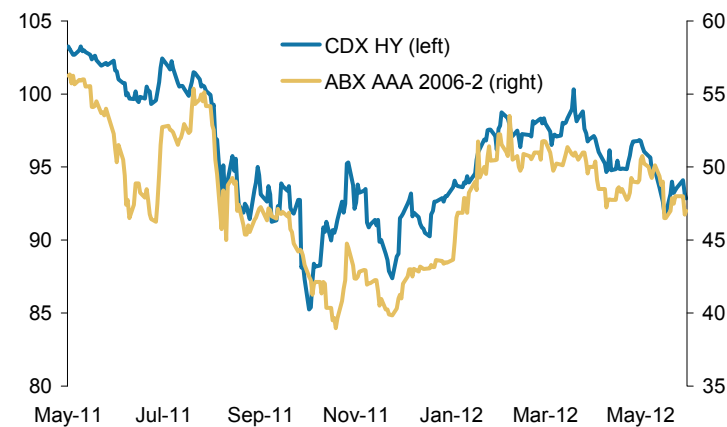
Source: Bloomberg, Morgan Stanley Research

CDX IG, HY (bp, 2012=100)

Source: Bloomberg, Morgan Stanley Research

CDX HY, CMBX (price)

Source: Bloomberg, Morgan Stanley Research

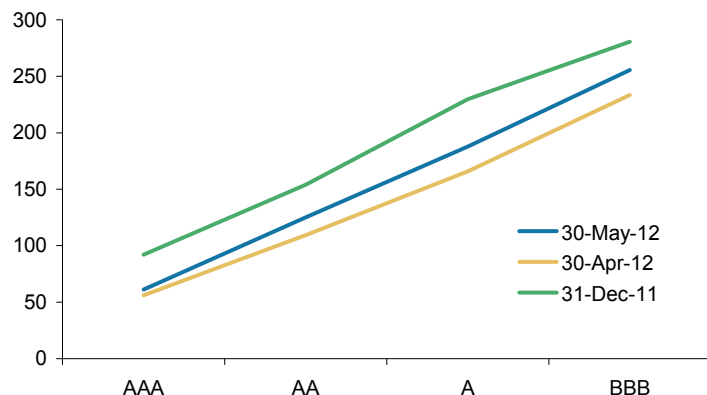
CDX HY, ABX (price)

Source: Bloomberg, Morgan Stanley Research

2. Performance

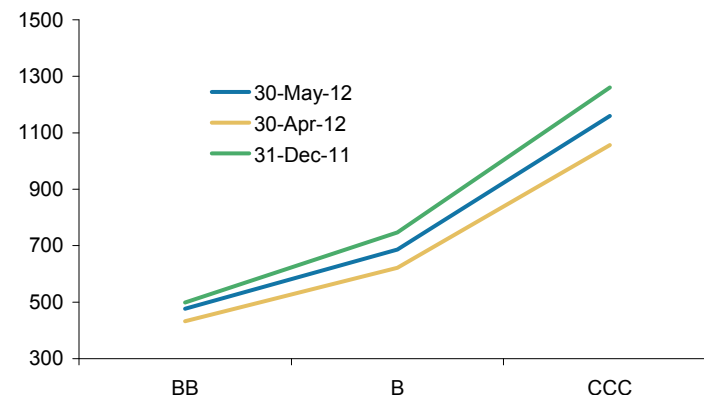
Cash Credit Quality Curves Bear-Steepened and Shifted Wider

US IG Corp Credit Quality Curve (bp)



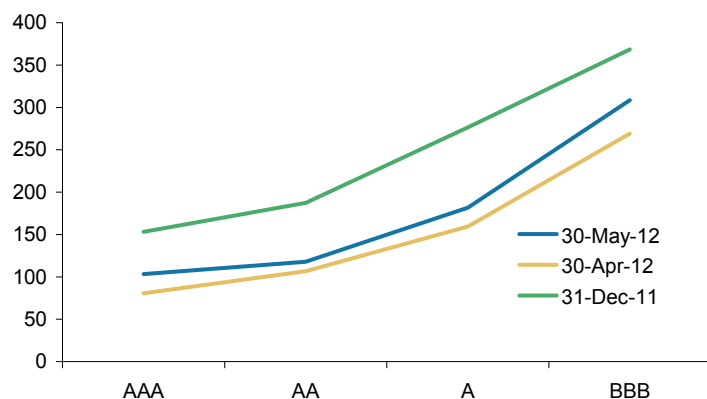
Source: The YieldBook, Morgan Stanley Research

US HY Corp Credit Quality Curve (bp)



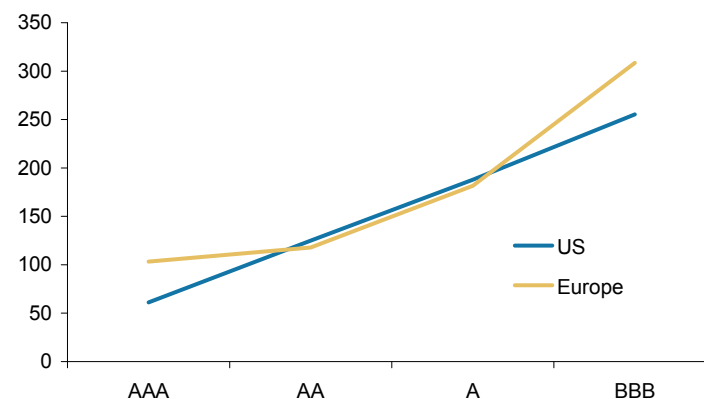
Source: The YieldBook, Morgan Stanley Research

Europe IG Corp Credit Quality Curve (bp)



Source: The YieldBook, Morgan Stanley Research

US, Europe IG Corp Credit Quality Curves (bp)

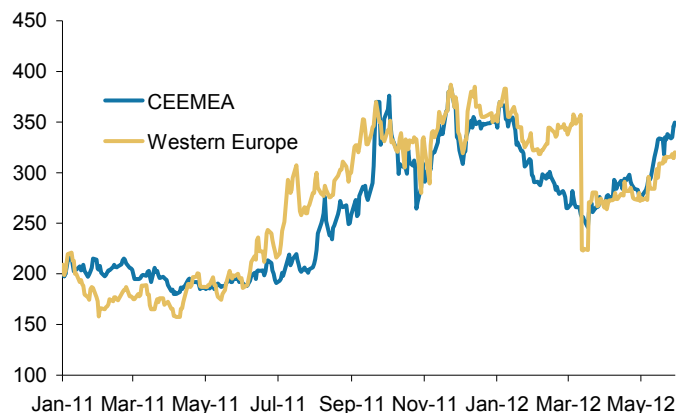


Source: The YieldBook, Morgan Stanley Research

2. Performance

Rising Risks in the European Periphery Drove Up Sovereign Spreads

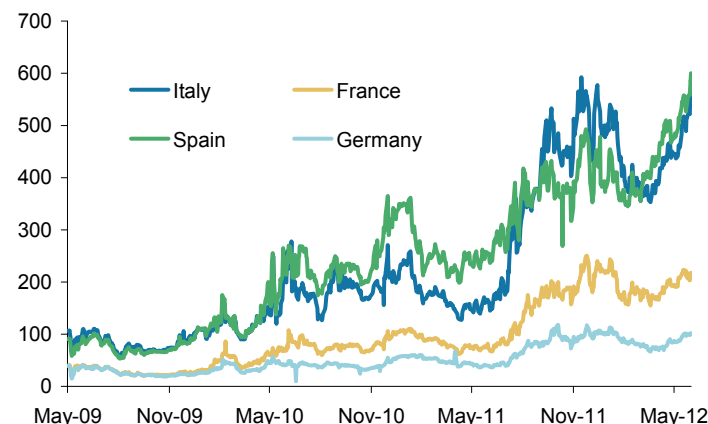
iTraxx SovX (bp)



Source: Bloomberg, Morgan Stanley Research

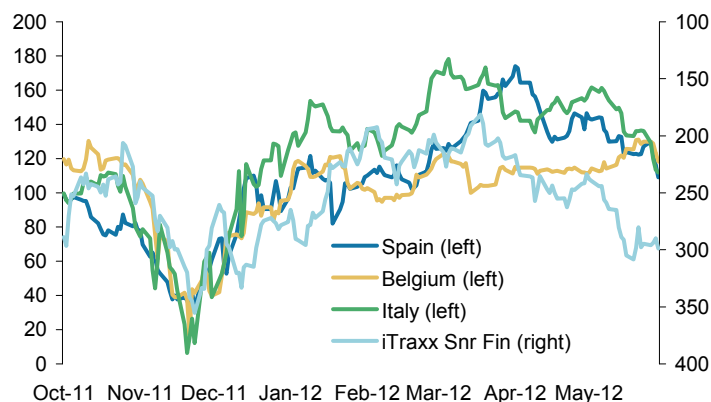
Note: Drop in Western Europe series due to Greek default

Sovereign 5y CDS (bp)



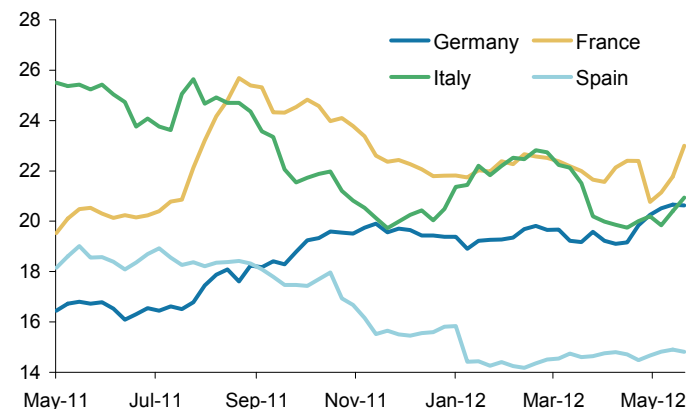
Source: Bloomberg, Morgan Stanley Research

Sovereign 2s5s, European Financial CDS (bp)

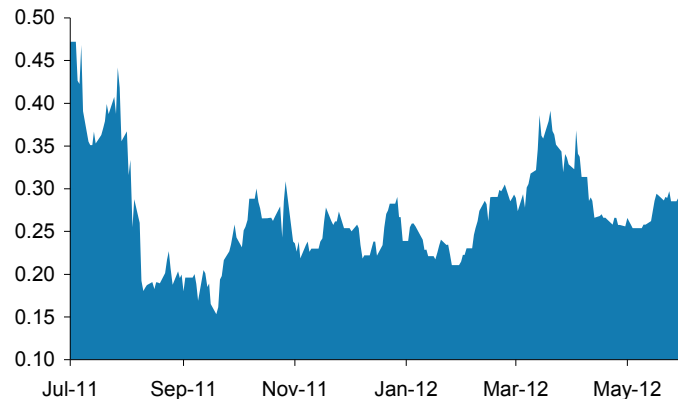


Source: Bloomberg, Morgan Stanley Research

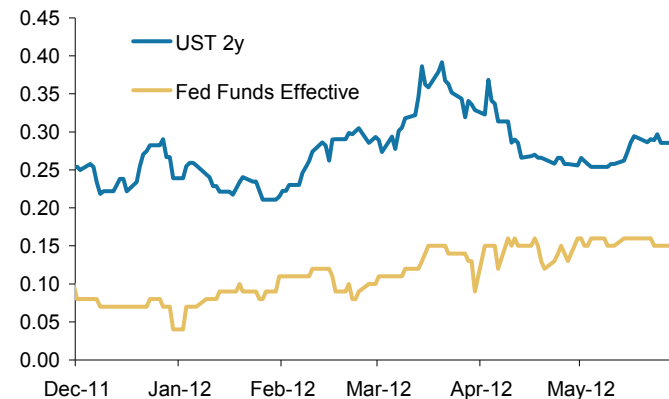
CDS Net Notional Outstanding (\$bn)



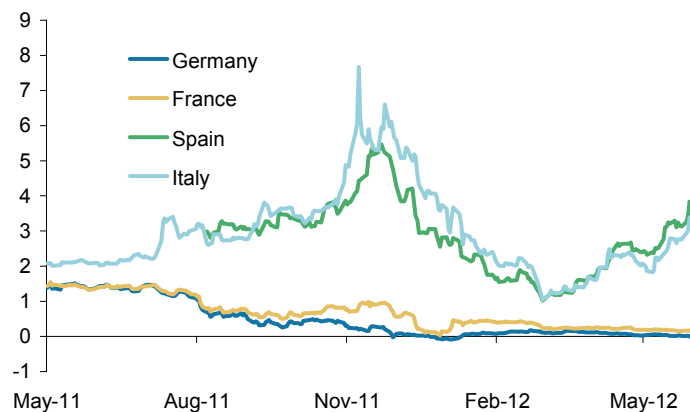
Source: DTCC, Bloomberg, Morgan Stanley Research

2. Performance**Short-End Sovereign Yields Rose in the European Periphery But Stayed Flat in the US****UST 2y (%)**

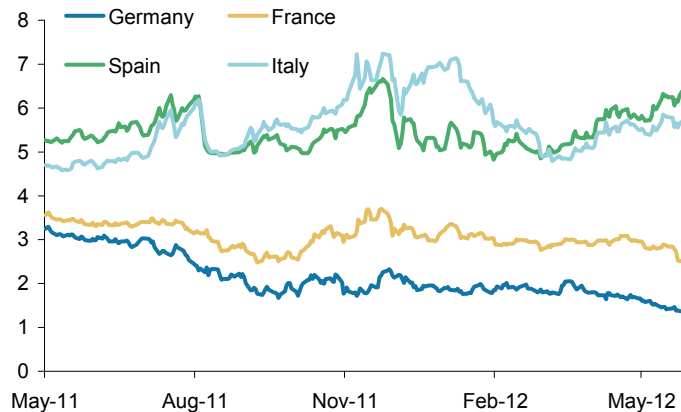
Source: Bloomberg, Morgan Stanley Research

UST 2y, Fed Funds Effective (%)

Source: Bloomberg, Morgan Stanley Research

European 1y Government Yield (%)

Source: Bloomberg, Morgan Stanley Research

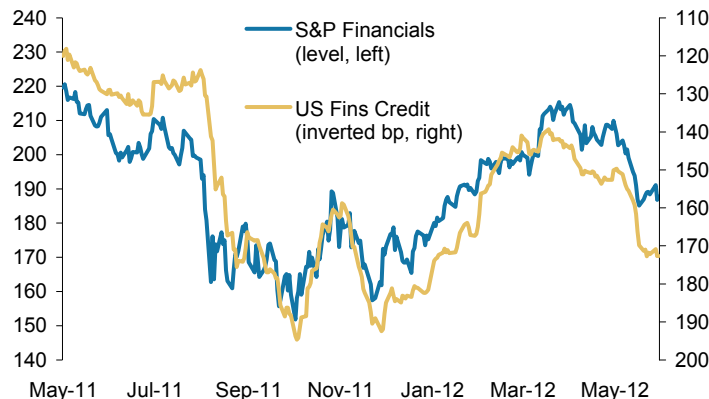
European 10y Government Yield (%)

Source: Bloomberg, Morgan Stanley Research

2. Performance

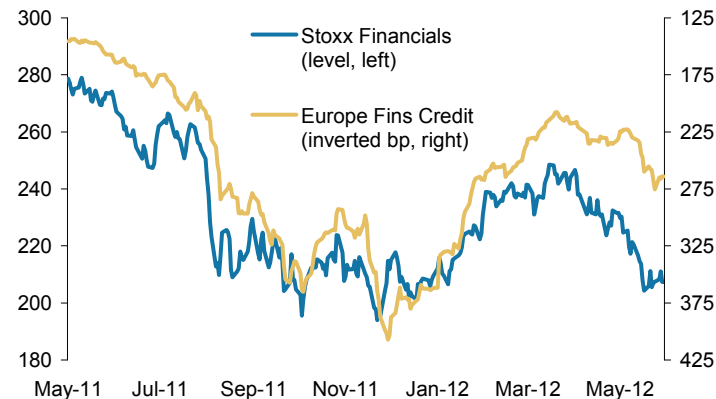
Financials Also Sold Off Across Equities and Credit

US Financial Equity, Cash Credit



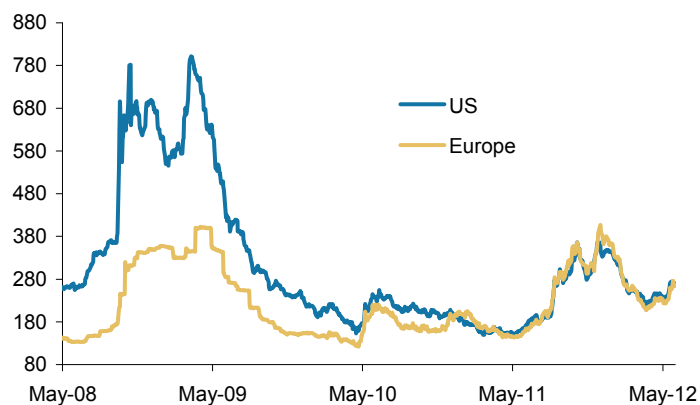
Source: The Yield Book, Bloomberg, Morgan Stanley Research

Europe Financial Equity, Cash Credit



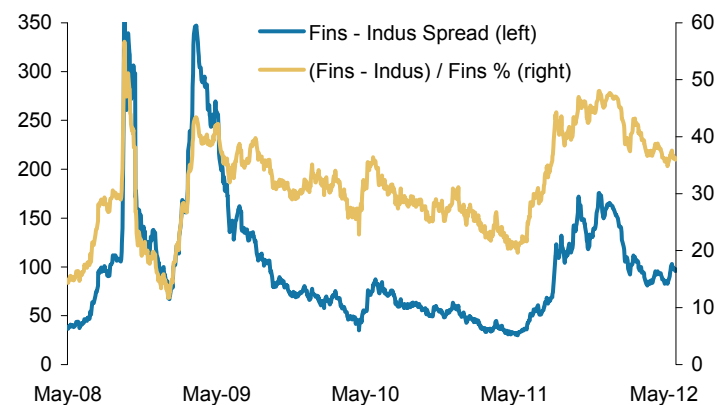
Source: The Yield Book, Bloomberg, Morgan Stanley Research

US, Europe Financial Cash Credit (bp)

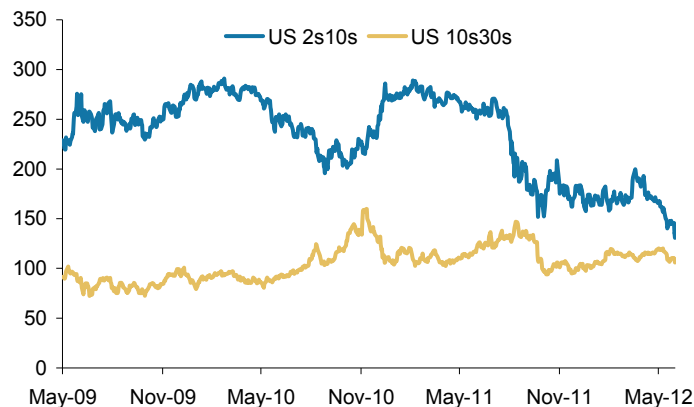


Source: The Yield Book, Morgan Stanley Research

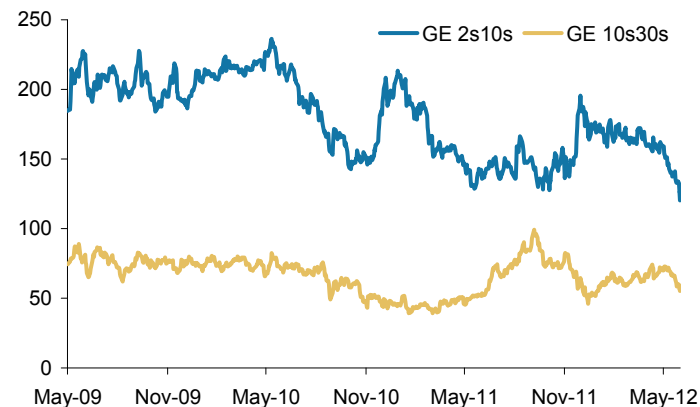
US Financial, Industrial Cash Credit (bp)



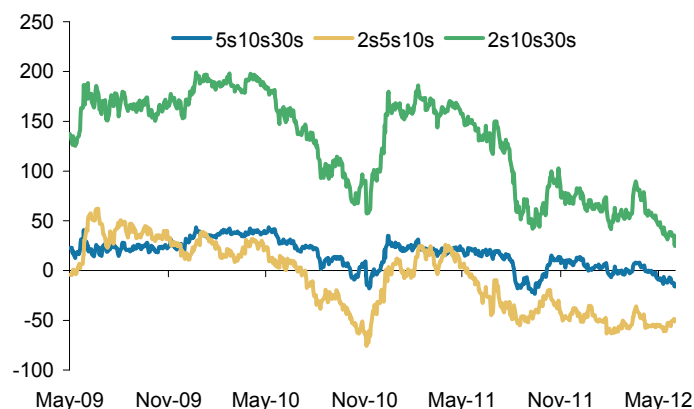
Source: The Yield Book, Morgan Stanley Research

2. Performance**Safe-Haven Flows Flattened Front-End Sovereign Curves in the US and Germany****US Spread Curve (bp)**

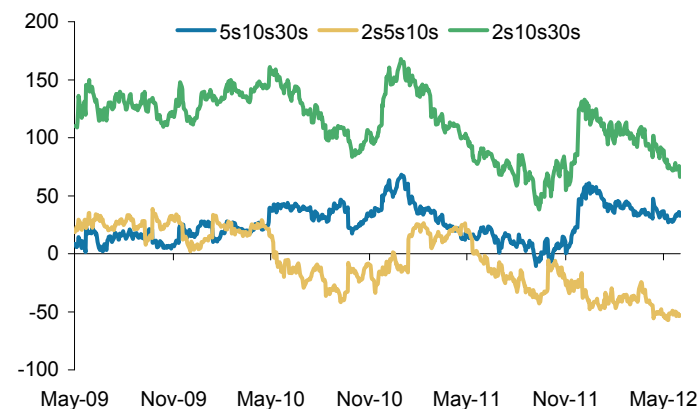
Source: Bloomberg, Morgan Stanley Research

Germany Spread Curve (bp)

Source: Bloomberg, Morgan Stanley Research

US Butterfly Spread (bp)

Source: Bloomberg, Morgan Stanley Research

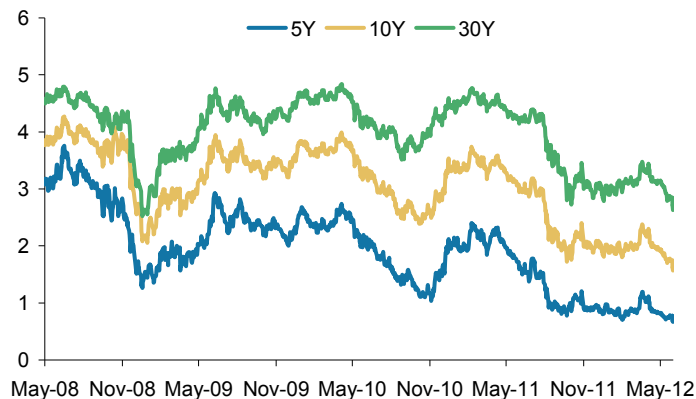
Germany Butterfly Spread (bp)

Source: Bloomberg, Morgan Stanley Research

2. Performance

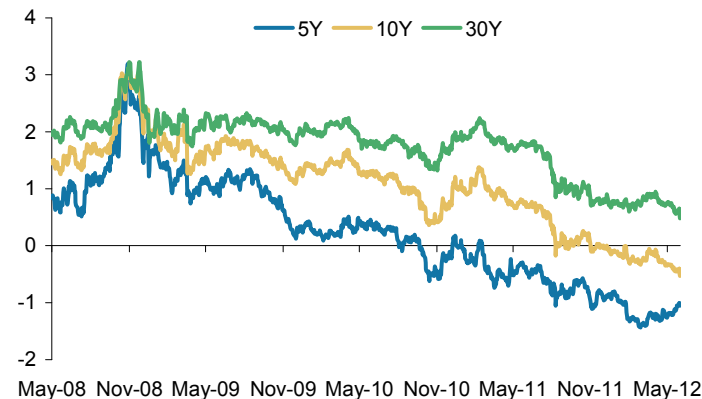
Longer-Maturity US Real Rates Trended Lower

US Nominal Rate (%)



Source: Bloomberg, Morgan Stanley Research

US Real Rate (%)



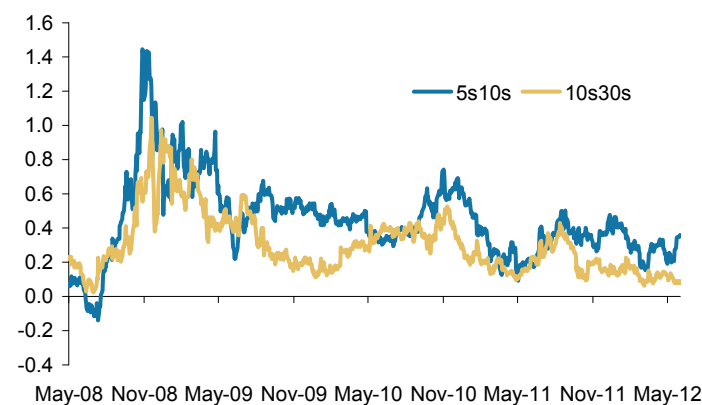
Source: Bloomberg, Morgan Stanley Research

US 10y Breakeven, Real Rate (%)

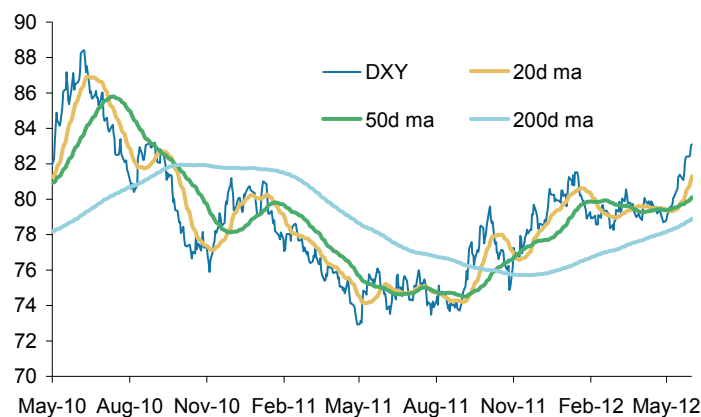


Source: Bloomberg, Morgan Stanley Research

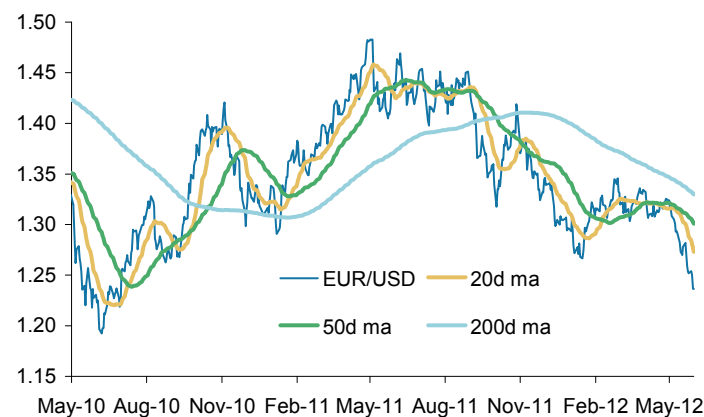
US Breakeven Spread (%)



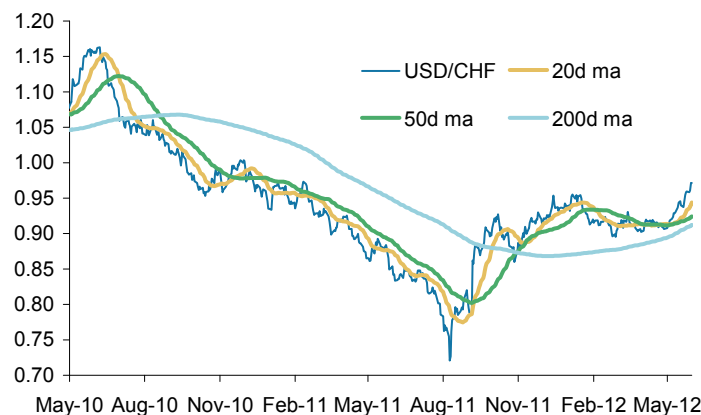
Source: Bloomberg, Morgan Stanley Research

2. Performance**The Safe-Haven USD Rallied While the EUR Sold Off****FX Index and Moving Averages: USD**

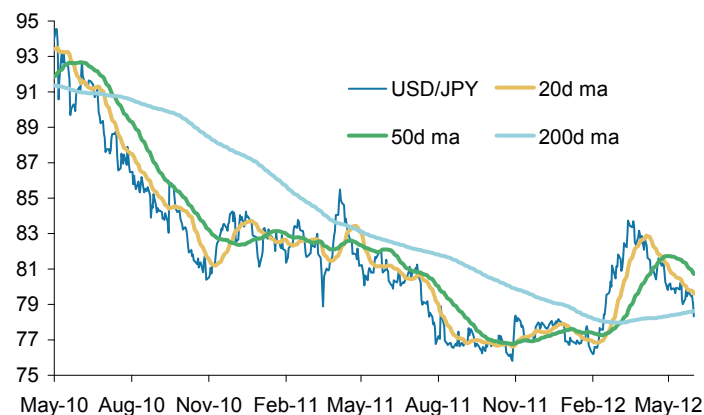
Source: Bloomberg, Morgan Stanley Research

FX Cross and Moving Averages: EUR/USD

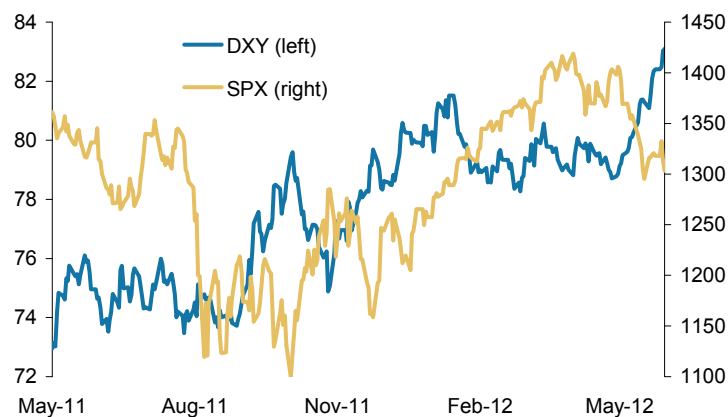
Source: Bloomberg, Morgan Stanley Research

FX Cross and Moving Averages: CHF

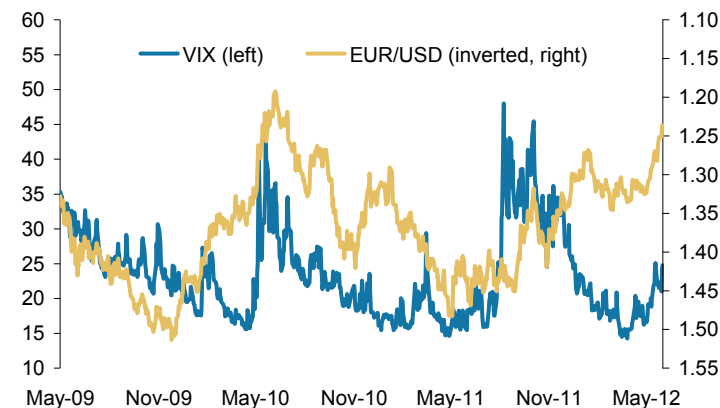
Source: Bloomberg, Morgan Stanley Research

FX Cross and Moving Averages: JPY

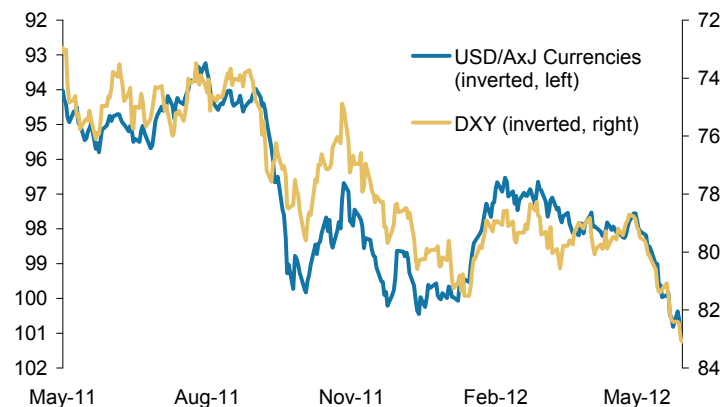
Source: Bloomberg, Morgan Stanley Research

2. Performance**The USD Strengthened as Volatility Rose and EM Currencies Fell****DXY, SPX**

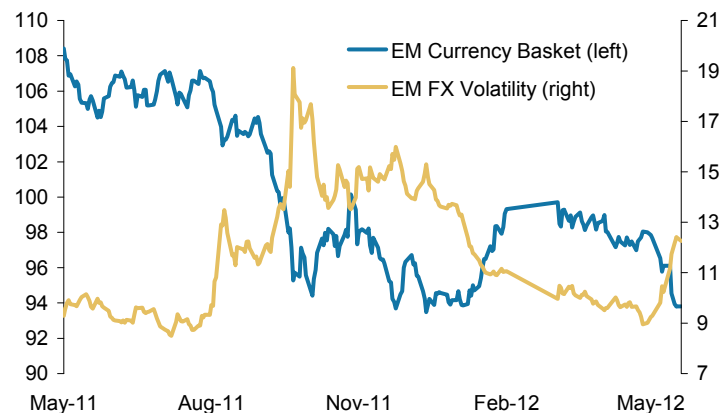
Source: Bloomberg, Morgan Stanley Research

EUR, VIX

Source: Bloomberg, Morgan Stanley Research

Asian Currencies, DXY (level)

Source: Bloomberg, Morgan Stanley Research

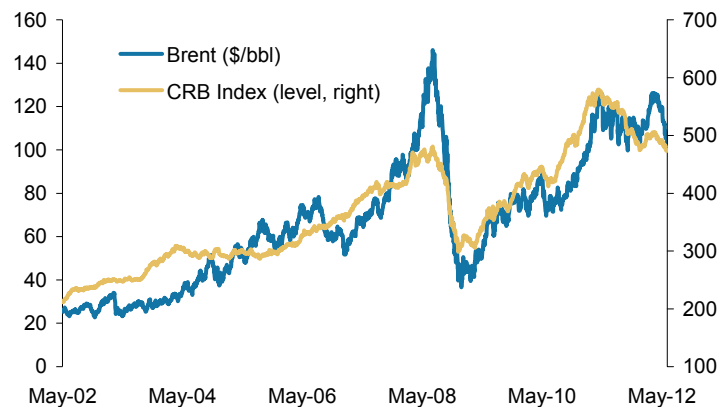
EM Currencies, Volatility (level)

Source: JP Morgan, Bloomberg, Morgan Stanley Research

2. Performance

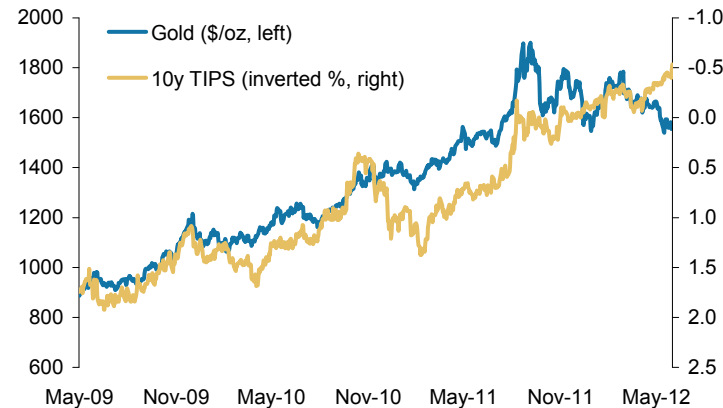
Commodities Softened Amidst Intensifying Global Stress

Brent, Commodity Index



Source: CRB, Bloomberg, Morgan Stanley Research

Gold, Real Rates



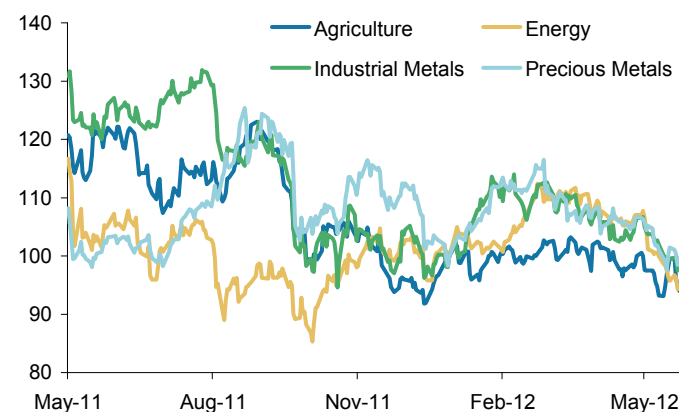
Source: Bloomberg, Morgan Stanley Research

GSCI, SPX



Source: Bloomberg, Morgan Stanley Research

GSCI Indices (2012=100)

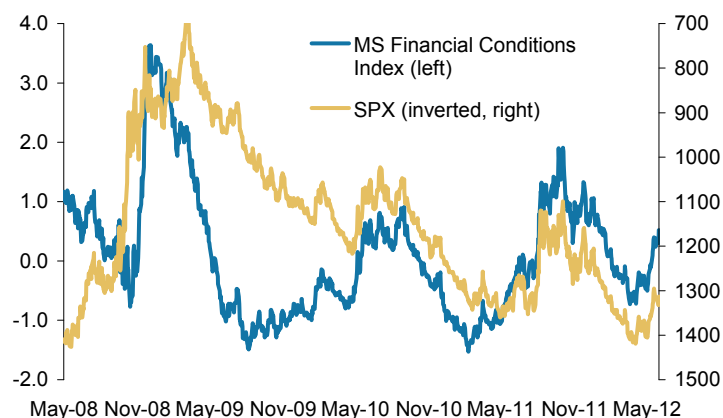


Source: Bloomberg, Morgan Stanley Research

2. Performance

A Slight Breakdown in Financial Conditions But Funding Stress Far From Crisis Levels

MS Financial Conditions Index, SPX



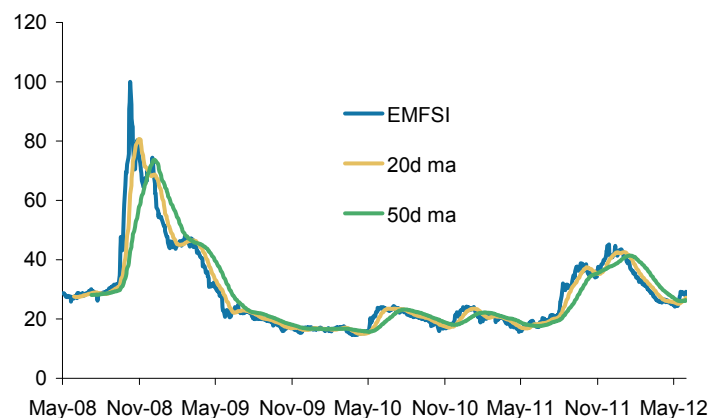
Source: Bloomberg, Morgan Stanley Research

Citi Liquidity Index, St. Louis Fed Stress Index



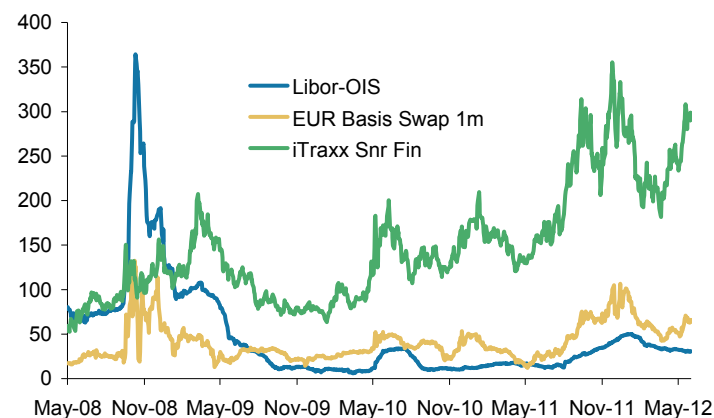
Source: Citigroup, St. Louis Federal Reserve, Bloomberg, Morgan Stanley Research

MS EM Funding Stress Index

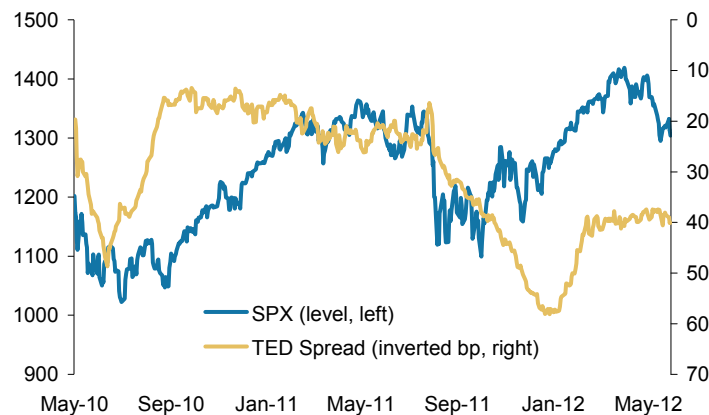


Source: Bloomberg, Morgan Stanley Research

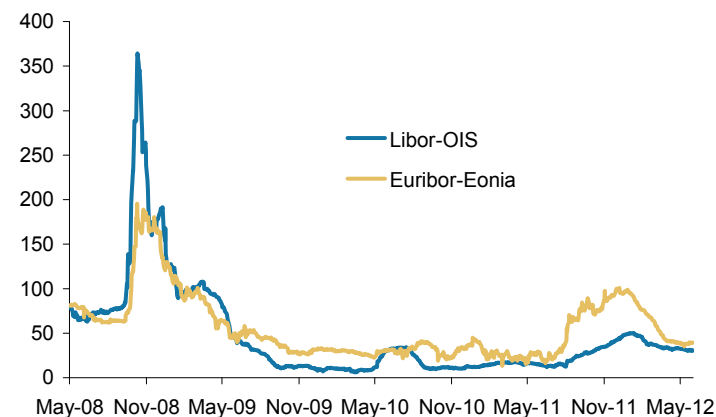
Funding Markets, European Financial Credit Spreads (bp)



Source: Bloomberg, Morgan Stanley Research

2. Performance**TED Spread Still Range-Bound and Euribor-Eonia Still Muted****TED Spread, SPX**

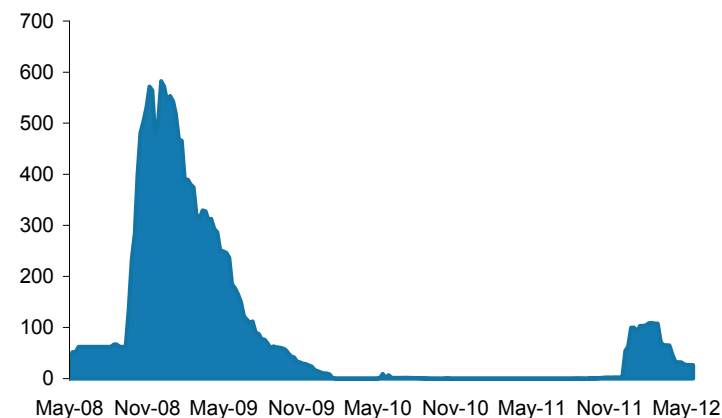
Source: Bloomberg, Morgan Stanley Research

Libor-OIS, Euribor-Eonia

Source: Bloomberg, Morgan Stanley Research

US CP at Foreign Banks (\$bn)

Source: Federal Reserve, Bloomberg, Morgan Stanley Research

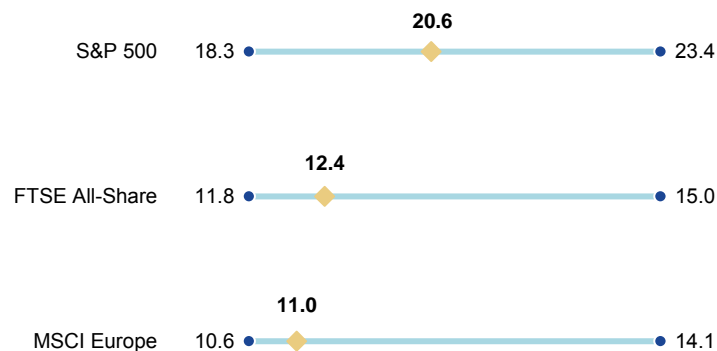
Dollar Value of Liquidity Swaps (\$bn)

Source: Federal Reserve, Bloomberg, Morgan Stanley Research

3. Valuation

Risk Valuations Followed the Sell-Off While Treasury and Bund Yields Hit Lows

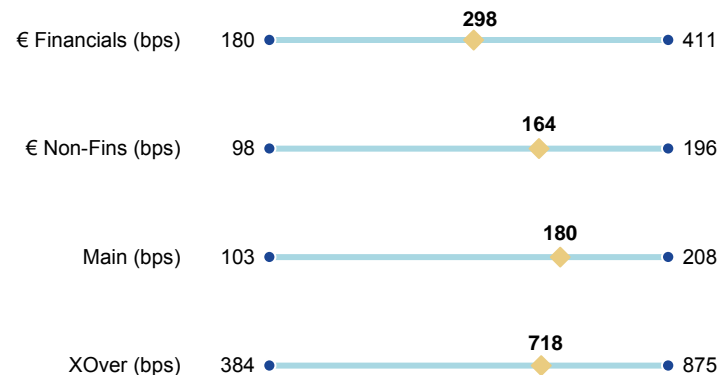
Global Shiller P/Es (Low, Spot, High)



Source: S&P, Shiller, MSCI, NBER, Bloomberg, Morgan Stanley Research

Note: 1-year range

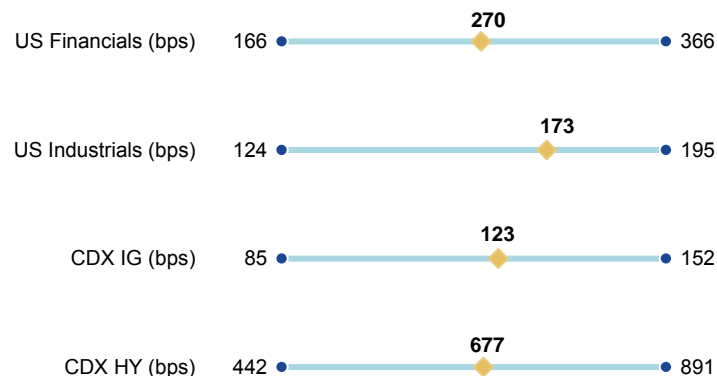
European Credit (Low, Spot, High)



Source: iBoxx, Bloomberg, Morgan Stanley Research

Note: 1-year range

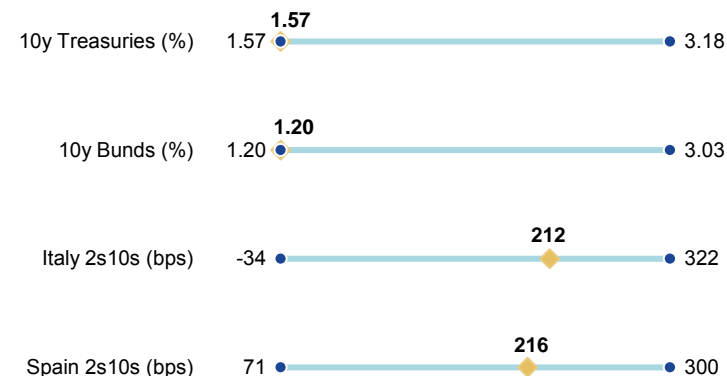
US Credit (Low, Spot, High)



Source: YieldBook, Bloomberg, Morgan Stanley Research

Note: 1-year range

US and European Rates (Low, Spot, High)

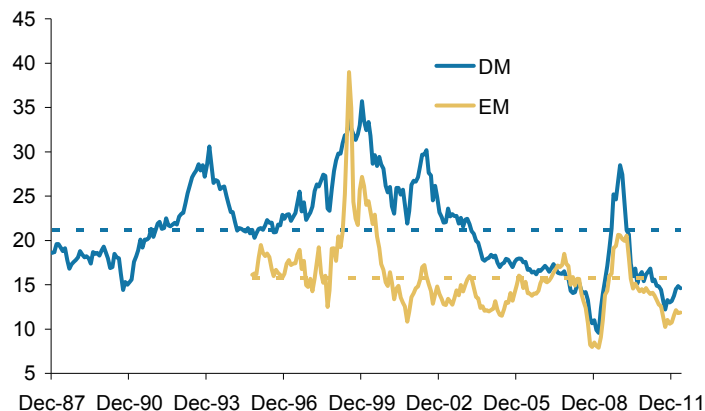


Source: Bloomberg, Morgan Stanley Research

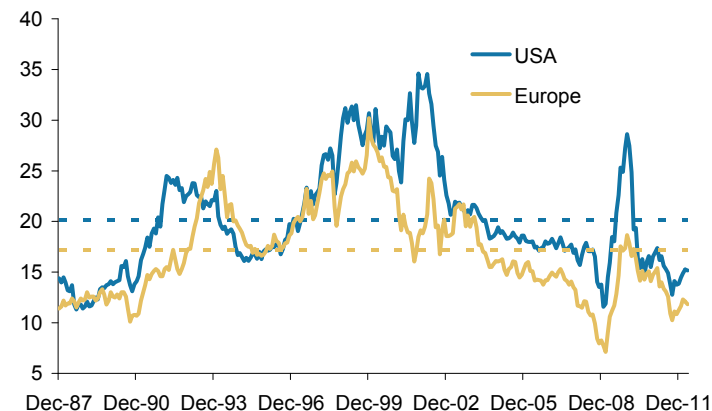
Note: 1-year range

3. Valuation

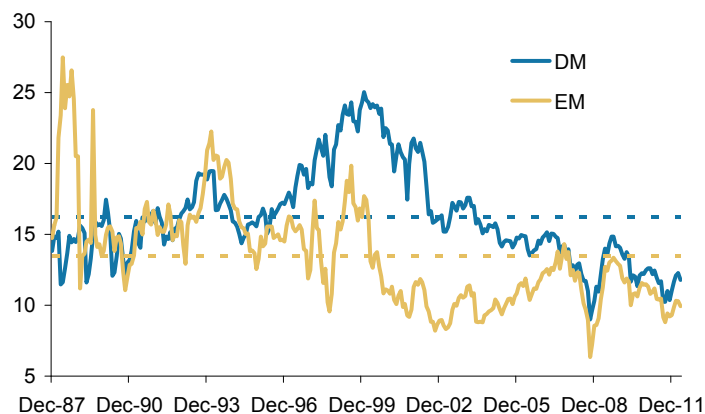
Recent Weakness Has Moved Multiples Lower From Long-Term Averages

Trailing P/E: DM vs. EM

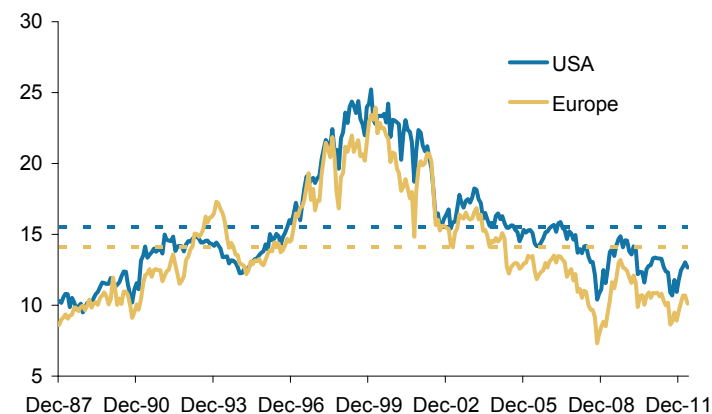
Source: MSCI, Datastream, Morgan Stanley Research

Trailing P/E: US vs. Europe

Source: MSCI, Datastream, Morgan Stanley Research

NTM P/E: DM vs. EM

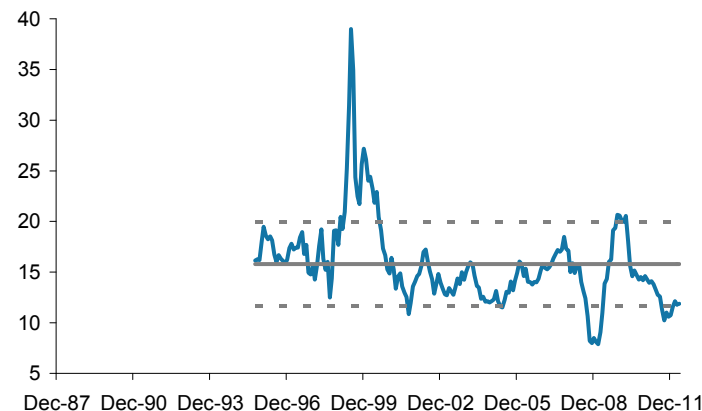
Source: IBES, MSCI, Datastream, Morgan Stanley Research

NTM P/E: US vs. Europe

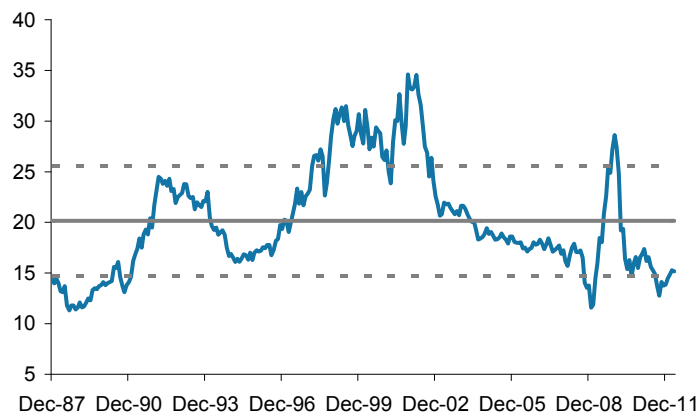
Source: IBES, MSCI, Datastream, Morgan Stanley Research

3. Valuation**Trailing P/Es Are Generally Around a Standard Deviation Below Historical Averages****Trailing P/E: DM**

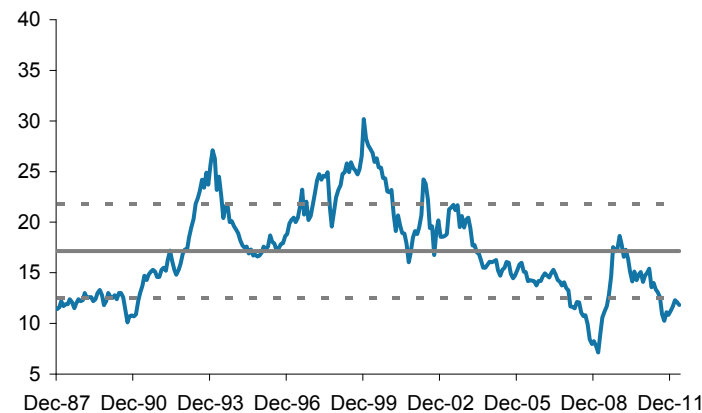
Source: MSCI, Datastream, Morgan Stanley Research

Trailing P/E: EM

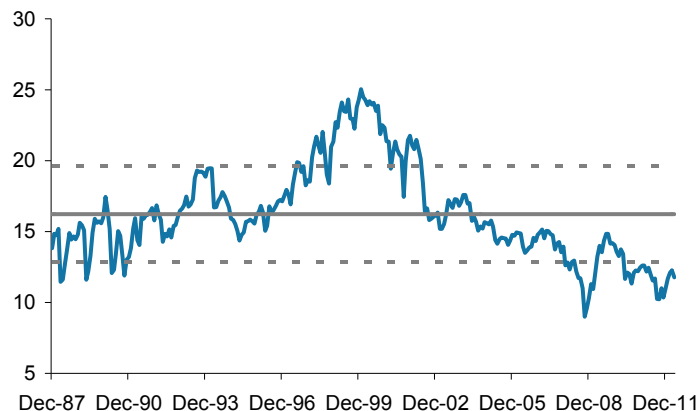
Source: MSCI, Datastream, Morgan Stanley Research

Trailing P/E: US

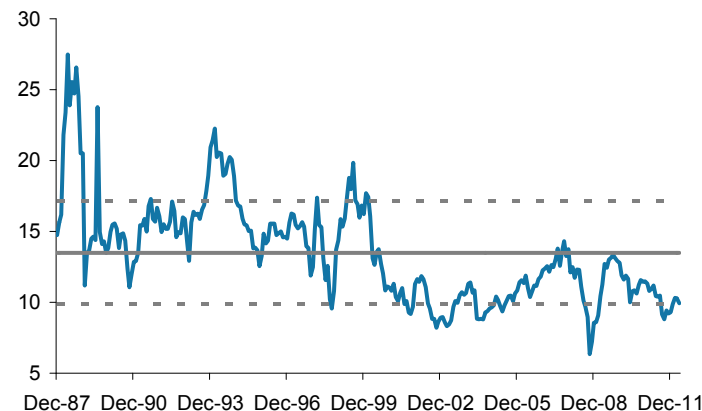
Source: MSCI, Datastream, Morgan Stanley Research

Trailing P/E: Europe

Source: MSCI, Datastream, Morgan Stanley Research

3. Valuation**In Forward P/E Terms, the US Is Less Cheap than Europe Relative to History****NTM P/E: DM**

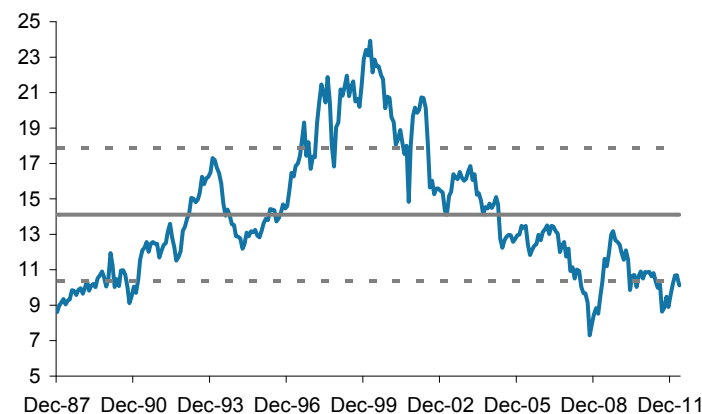
Source: IBES, MSCI, Datastream, Morgan Stanley Research

NTM P/E: EM

Source: IBES, MSCI, Datastream, Morgan Stanley Research

NTM P/E: US

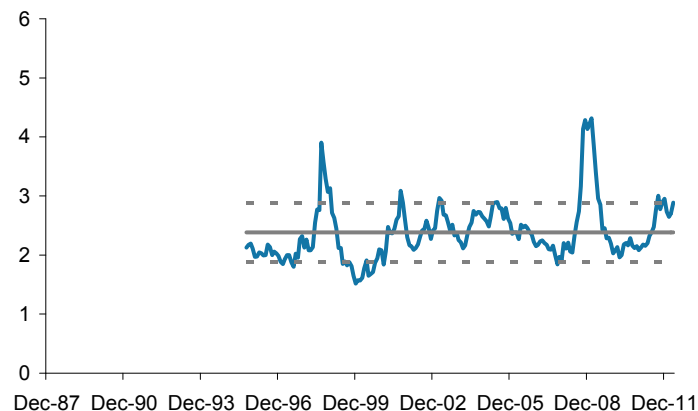
Source: IBES, MSCI, Datastream, Morgan Stanley Research

NTM P/E: Europe

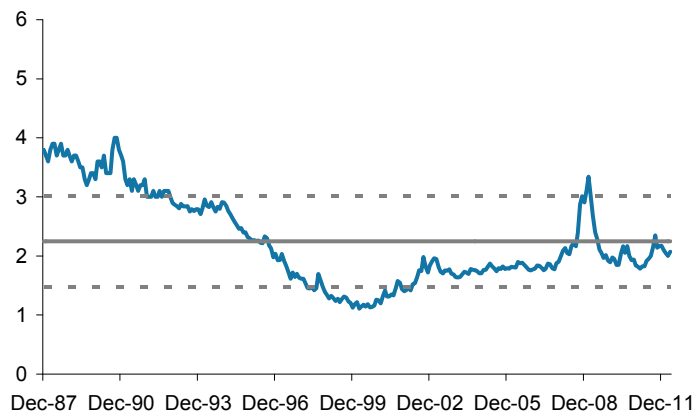
Source: IBES, MSCI, Datastream, Morgan Stanley Research

3. Valuation**Dividend Yields Are Still Relatively High Outside of the US****Dividend Yield: DM**

Source: MSCI, Datastream, Morgan Stanley Research

Dividend Yield: EM

Source: MSCI, Datastream, Morgan Stanley Research

Dividend Yield: US

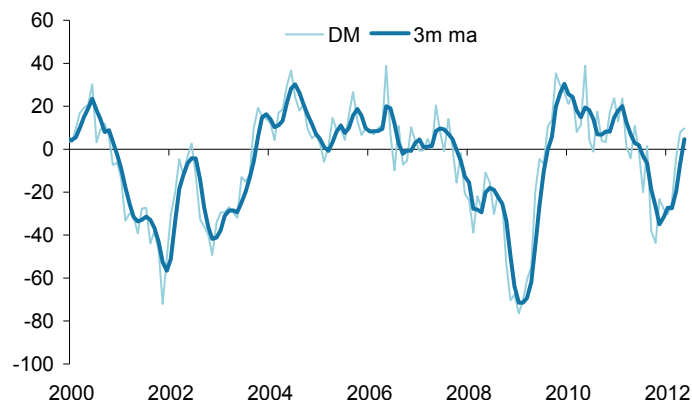
Source: MSCI, Datastream, Morgan Stanley Research

Dividend Yield: Europe

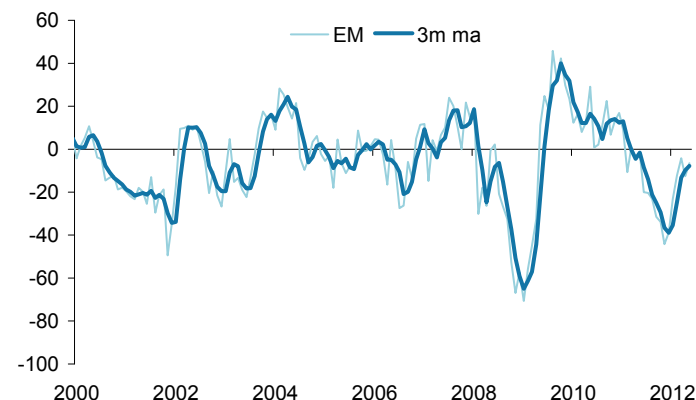
Source: MSCI, Datastream, Morgan Stanley Research

3. Valuation

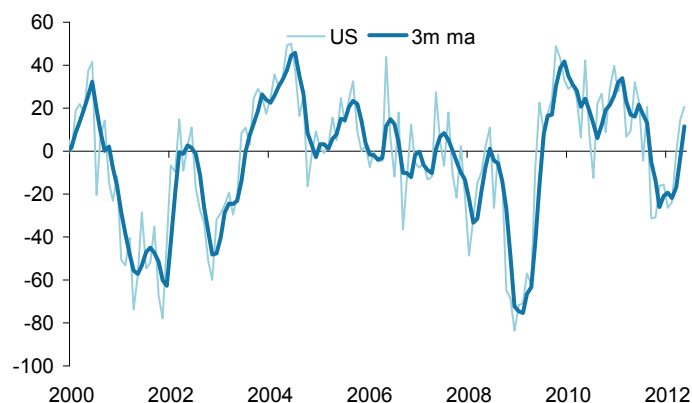
Earnings Revisions Are Starting to Dip Back Below Zero in Europe

DM NTM Earnings Revisions Ratio (%)

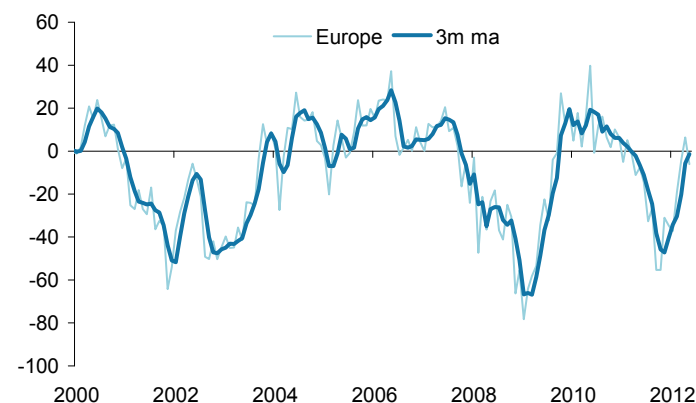
Source: IBES, MSCI, Datastream, Morgan Stanley Research

EM NTM Earnings Revisions Ratio (%)

Source: IBES, MSCI, Datastream, Morgan Stanley Research

US NTM Earnings Revisions Ratio (%)

Source: IBES, MSCI, Datastream, Morgan Stanley Research

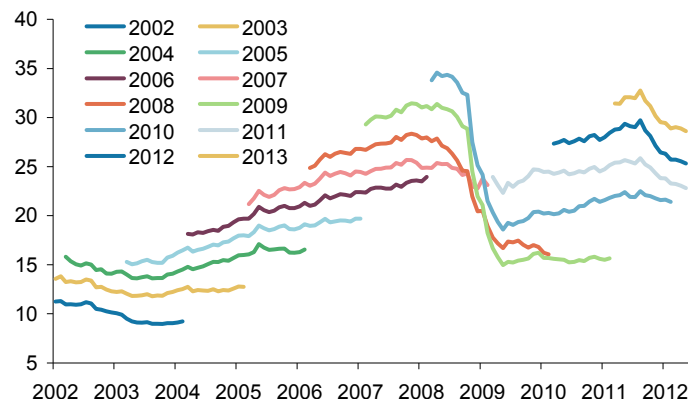
Europe NTM Earnings Revisions Ratio (%)

Source: IBES, MSCI, Datastream, Morgan Stanley Research

3. Valuation

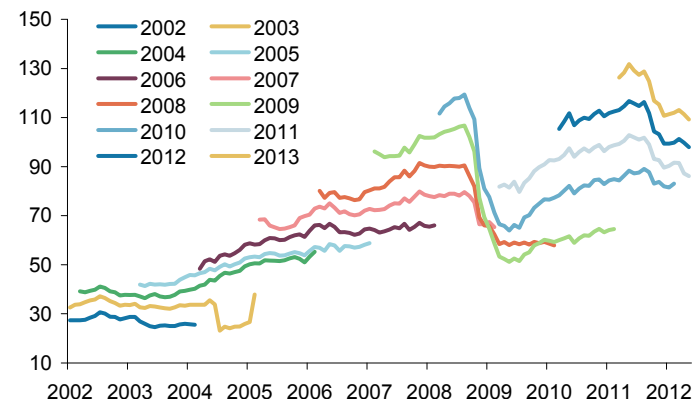
Consensus EPS Is Once Again Turning Down

DM FY Consensus EPS



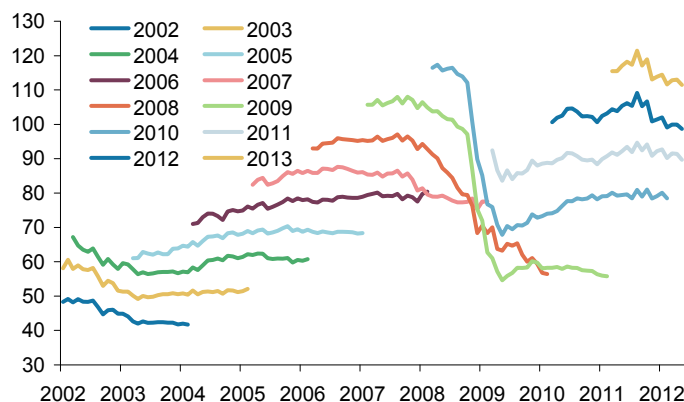
Source: IBES, MSCI, Datastream, Morgan Stanley Research

EM FY Consensus EPS



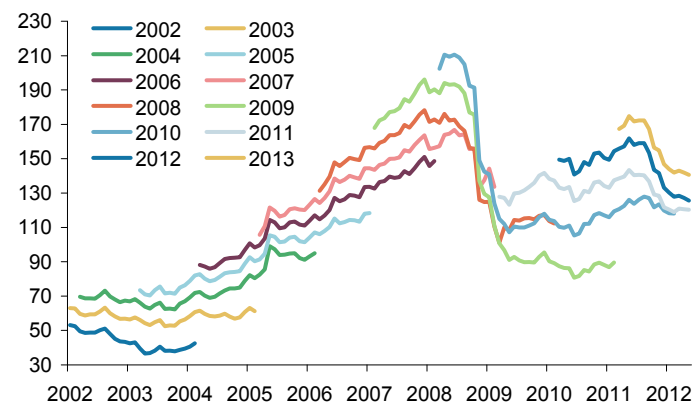
Source: IBES, MSCI, Datastream, Morgan Stanley Research

US FY Consensus EPS



Source: IBES, MSCI, Datastream, Morgan Stanley Research

Europe FY Consensus EPS

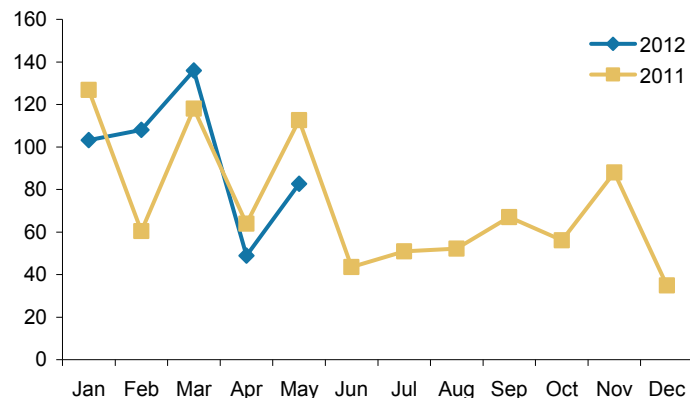


Source: IBES, MSCI, Datastream, Morgan Stanley Research

3. Valuation

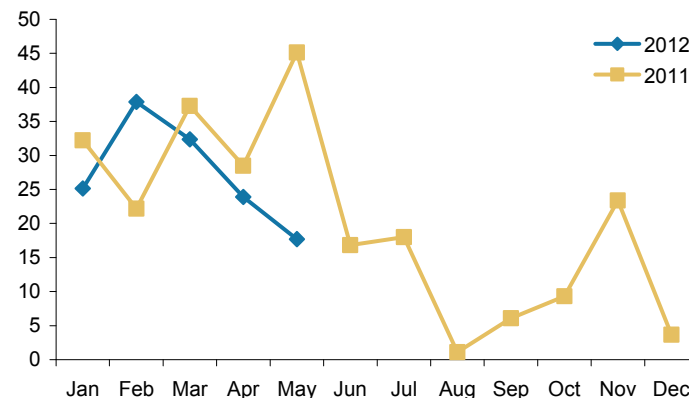
May's Corporate Debt Issuance Came in Lower than Last Year, Particularly in High Yield

US IG Corporate Debt Issuance (\$bn)



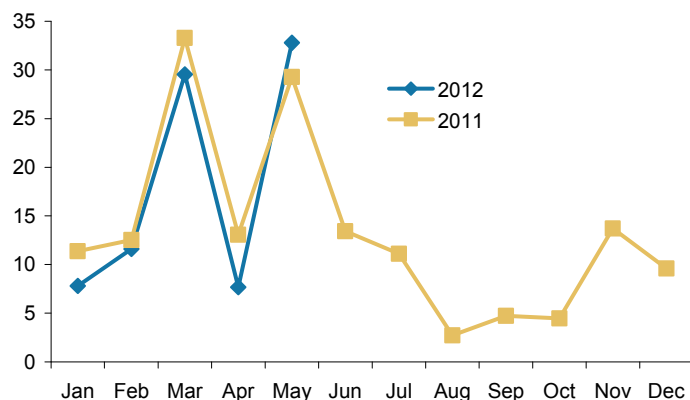
Source: Bloomberg, Morgan Stanley Research

US HY Corporate Debt Issuance (\$bn)



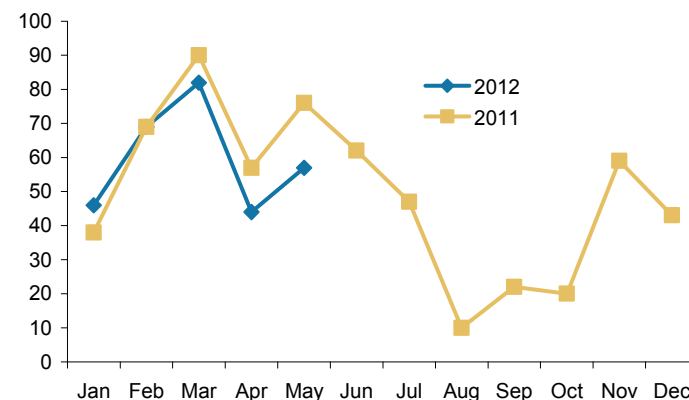
Source: Bloomberg, Morgan Stanley Research

US Equity IPO (\$bn)



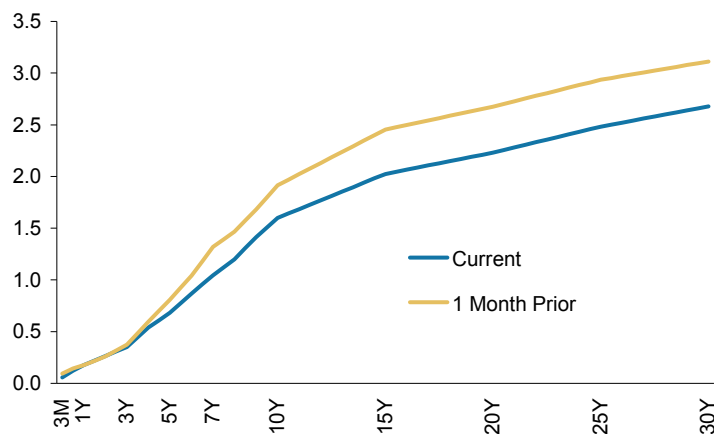
Source: Bloomberg, Morgan Stanley Research

US Equity IPO (# issues)

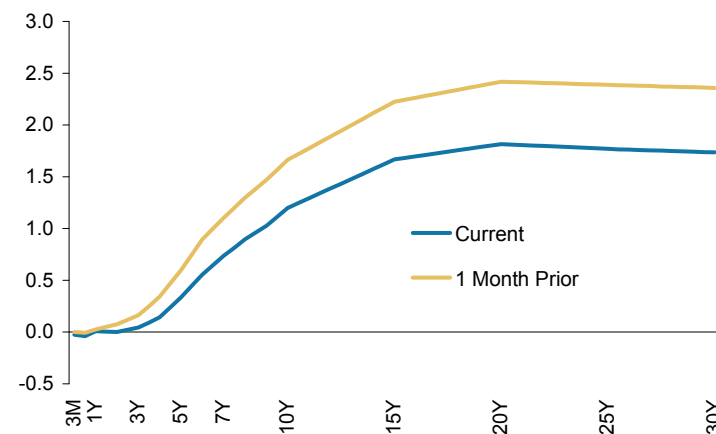


Source: Bloomberg, Morgan Stanley Research

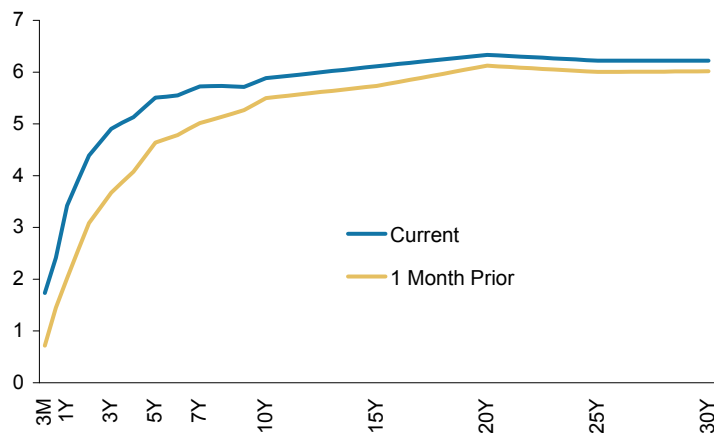
3. Valuation

Bull-Flattening in the US and Germany; Bear-Flattening in Italy and Spain**US Yield Curve (%)**

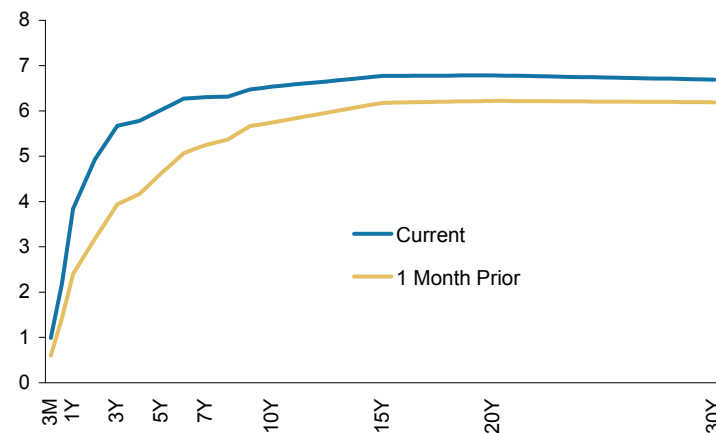
Source: Bloomberg, Morgan Stanley Research

Germany Yield Curve (%)

Source: Bloomberg, Morgan Stanley Research

Italy Yield Curve (%)

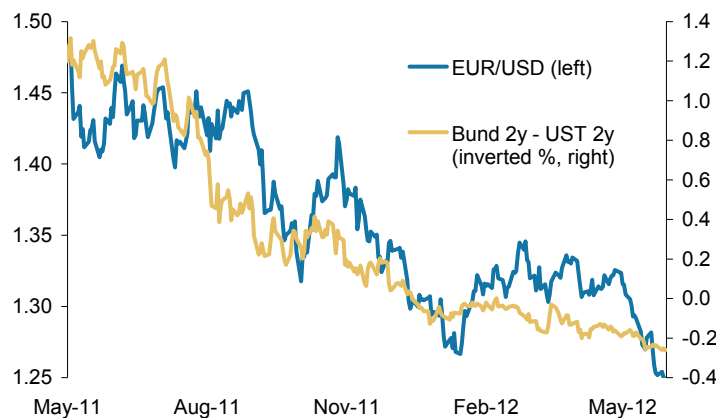
Source: Bloomberg, Morgan Stanley Research

Spain Yield Curve (%)

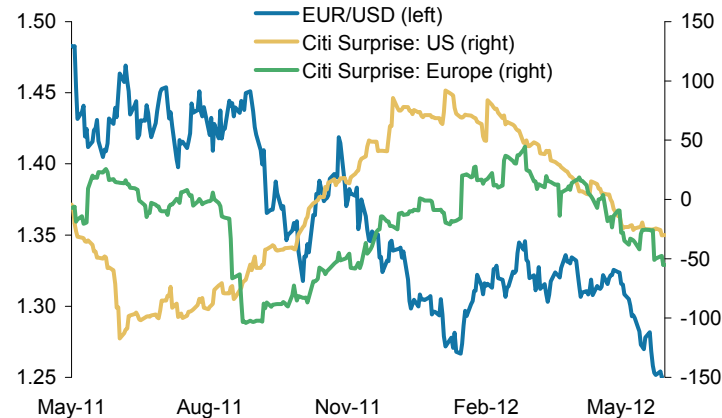
Source: Bloomberg, Morgan Stanley Research

3. Valuation

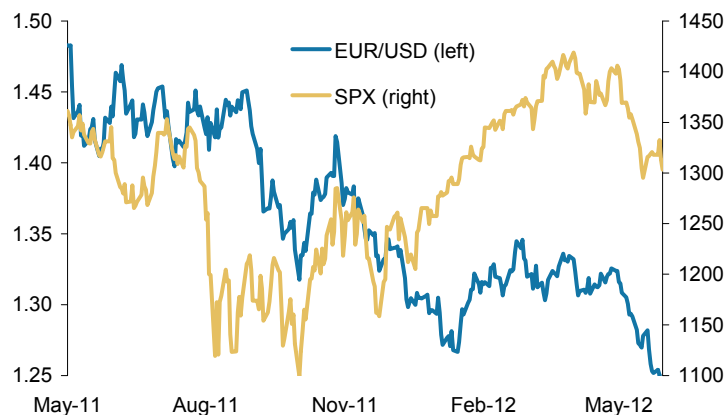
The EUR Depreciated While Bund Yields, Economic Surprise and Risk Assets Fell

EUR, 2y Yield Differential

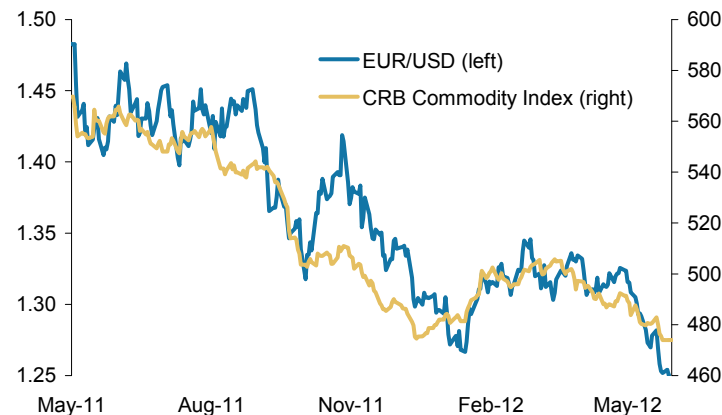
Source: Bloomberg, Morgan Stanley Research

EUR, Economic Surprise

Source: Citigroup, Bloomberg, Morgan Stanley Research

EUR, SPX

Source: Bloomberg, Morgan Stanley Research

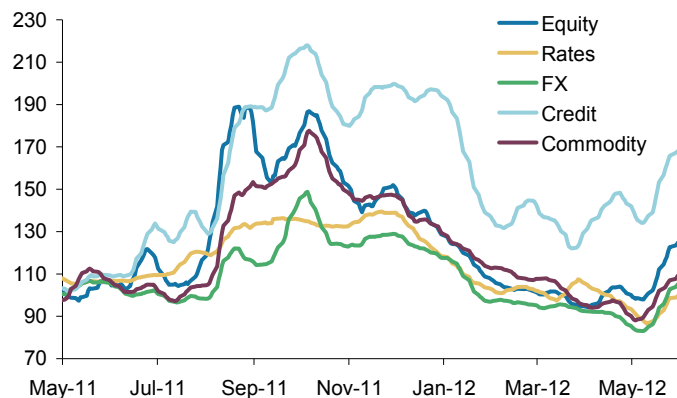
EUR, Commodities

Source: CRB, Bloomberg, Morgan Stanley Research

4. Risk Measures

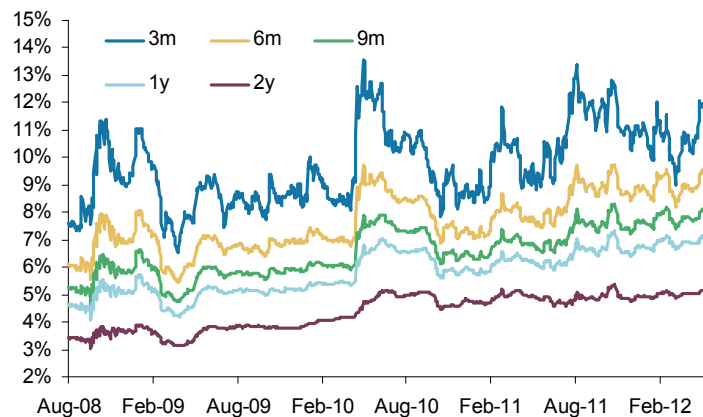
Volatility Rose Across Asset Classes; Implied Rose Higher Than Realized in US Equities

Volatility (indexed)



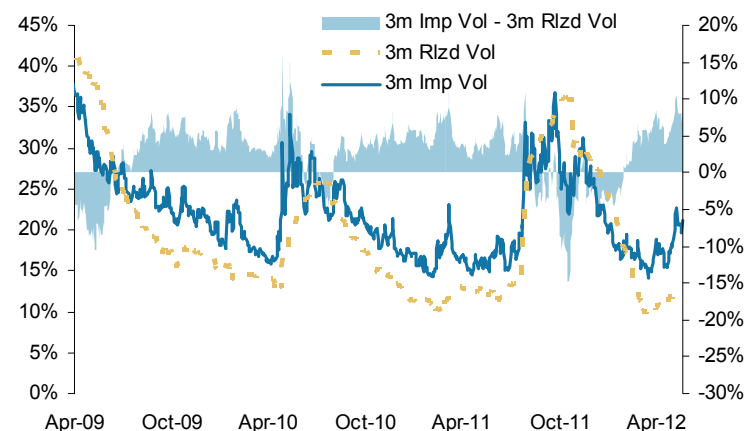
Source: Bloomberg, Morgan Stanley Research
 Note: Equity includes S&P, EuroStoxx, Nikkei, Kospi, Bovespa, Hang Seng. Commodity includes gold, oil. FX includes EURUSD, JPYUSD, USDKRW, AUDUSD. Rates includes USD Libor, Euribor, JPY Libor 3m 10y vol. Credit includes CDX IG, iTraxx Main.

Skew (90-110) by Maturity



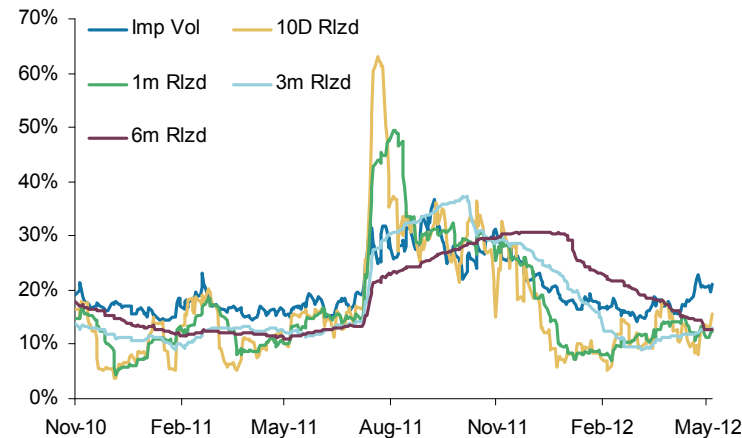
Source: Bloomberg, Morgan Stanley Research, Quantitative & Derivative Strategies

3m Implied, Realized Volatility

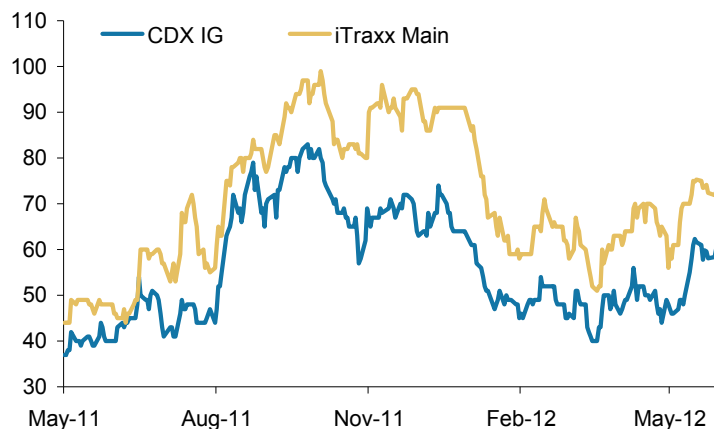


Source: Bloomberg, Morgan Stanley Research, Quantitative & Derivative Strategies

Realized vs. Implied Equity Volatility

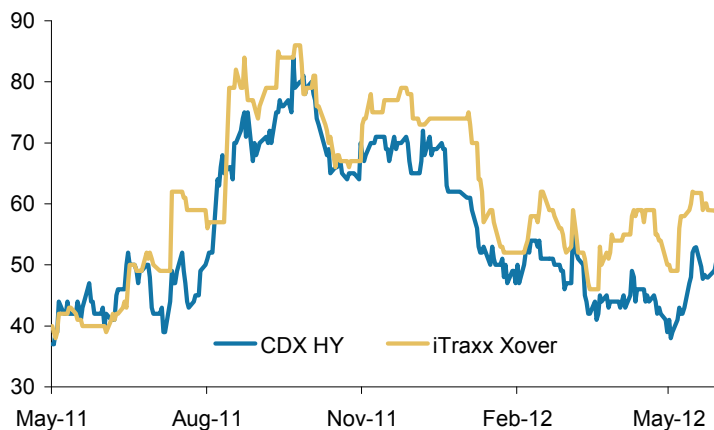


Source: Bloomberg, Morgan Stanley Research, Quantitative & Derivative Strategies

4. Risk Measures**Greater Volatility in Credit Markets****3m ATM Implied Volatility**

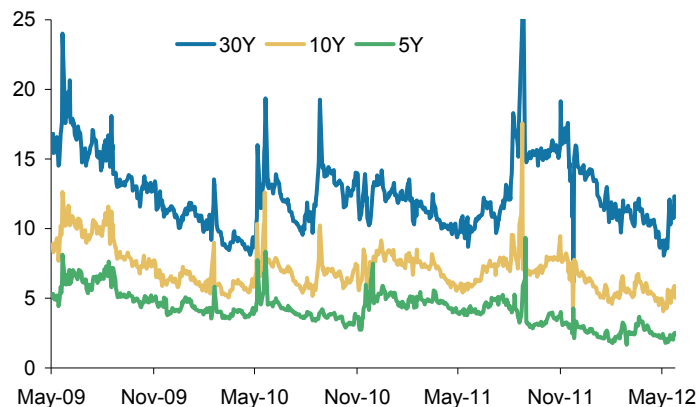
Source: Morgan Stanley Research

Volatility is higher in IG credit
across regions...

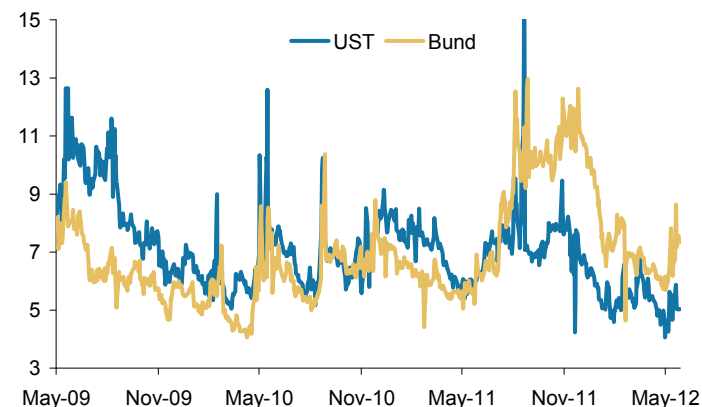
3m ATM Implied Volatility

Source: Morgan Stanley Research

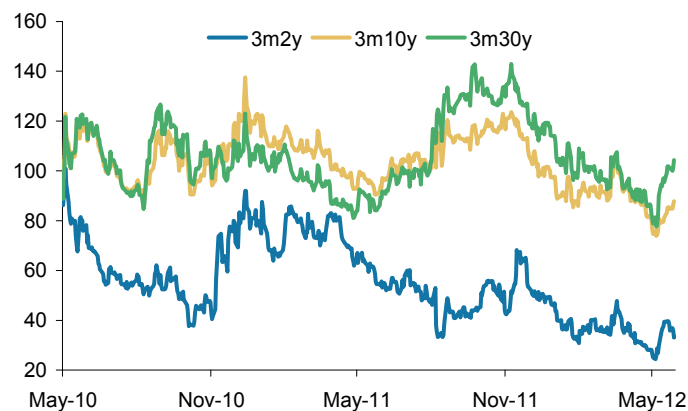
...As well as in high yield
credit, particularly in Europe

4. Risk Measures**Implied Rate Volatility Jumped Up from Subdued Levels****UST Implied Volatility**

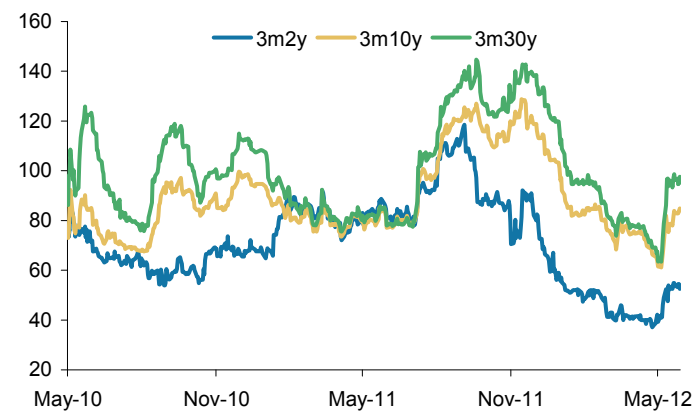
Source: Bloomberg, Morgan Stanley Research

UST, Bund 10y Implied Volatility

Source: Bloomberg, Morgan Stanley Research

US Swaption Volatility

Source: Bloomberg, Morgan Stanley Research

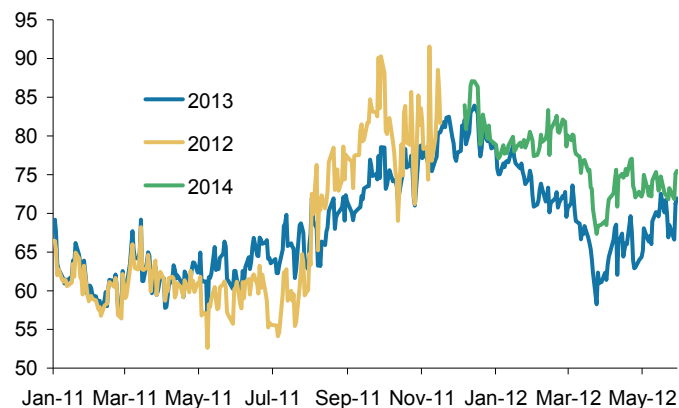
EU Swaption Volatility

Source: Bloomberg, Morgan Stanley Research

4. Risk Measures

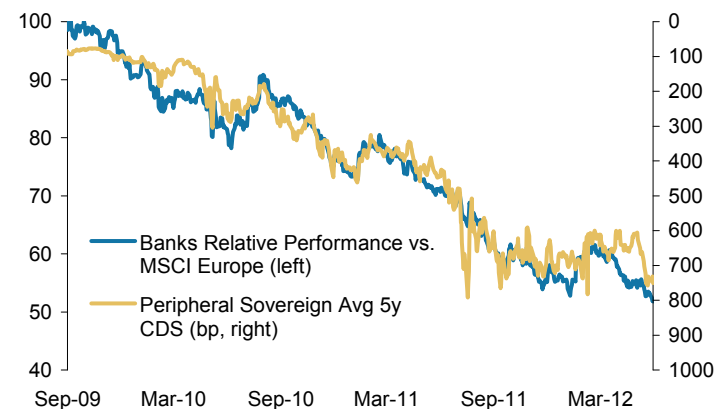
Risk-Off Driving Higher Correlations Within the S&P 500

S&P 500 Implied Correlation



Source: CBOE, Bloomberg, Morgan Stanley Research

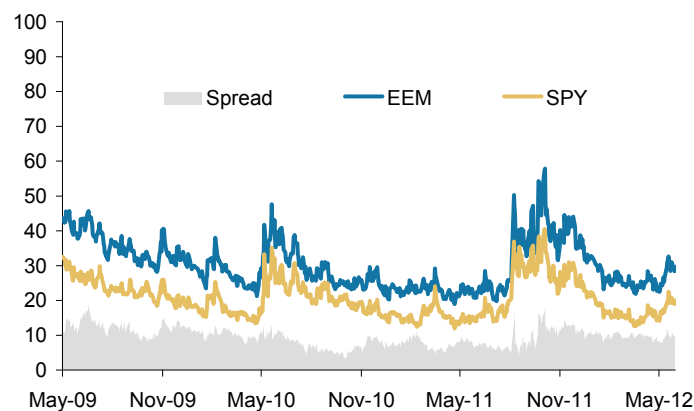
European Banks Relative Performance, Peripheral CDS



Note: Peripheral Sovereign Avg includes Ireland, Italy, Portugal, Spain

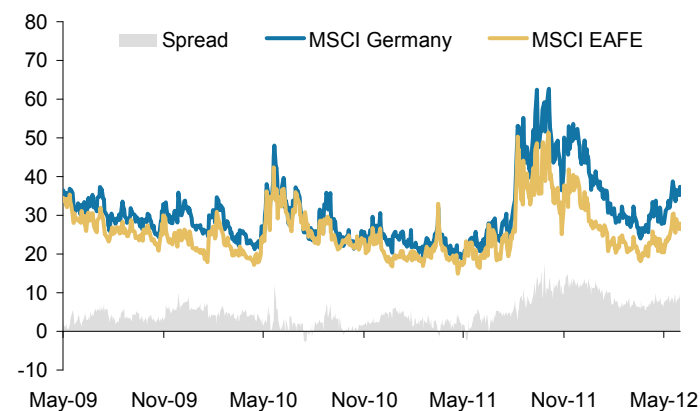
Source: MSCI, Bloomberg, Morgan Stanley Research

MSCI EM, S&P 500 ETF Implied Volatility



Source: Bloomberg, Morgan Stanley Research

MSCI Germany, EAFE ETF Implied Volatility

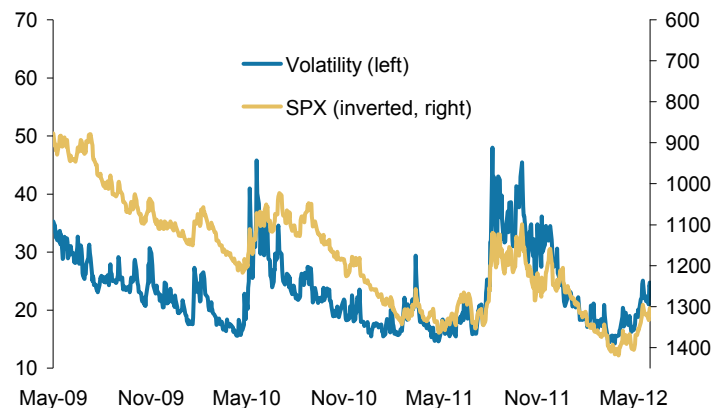


Source: Bloomberg, Morgan Stanley Research

4. Risk Measures

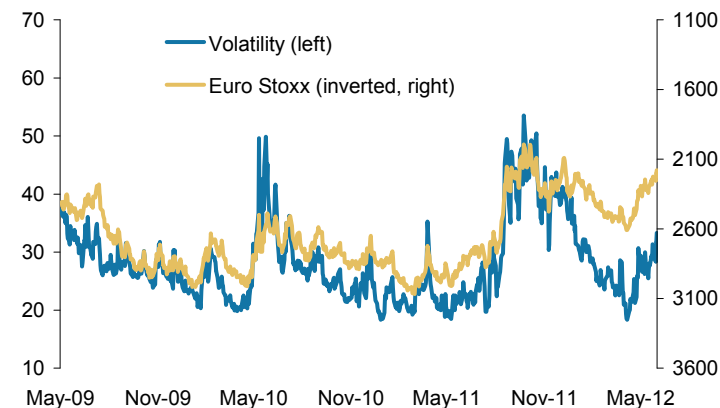
Heightened Risk Feeds Through to Higher Volatility and a Higher USD

SPX, Volatility



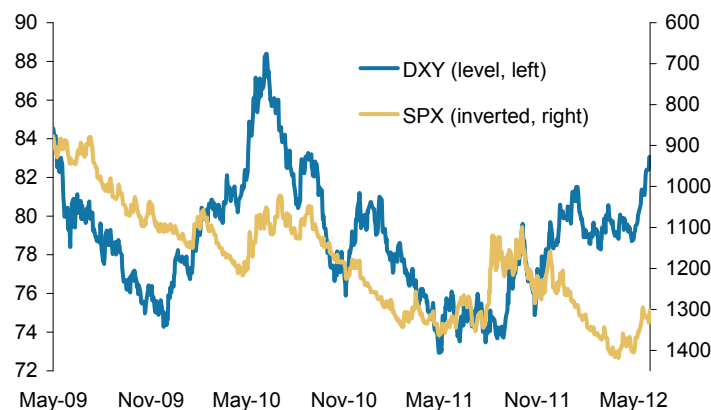
Source: Bloomberg, Morgan Stanley Research

Euro Stoxx, Volatility



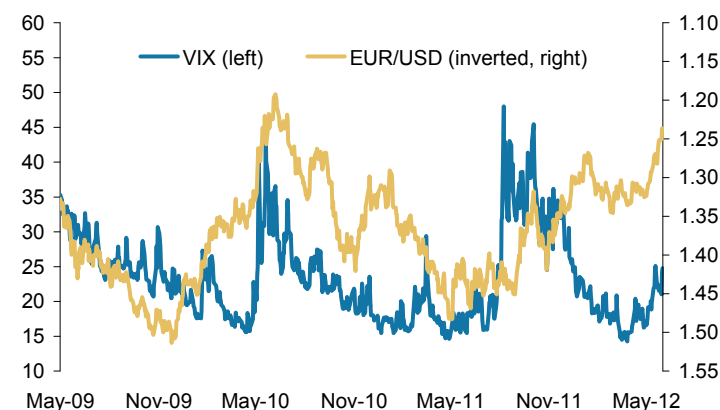
Source: Bloomberg, Morgan Stanley Research

DXY, SPX



Source: Bloomberg, Morgan Stanley Research

VIX, EUR/USD



Source: Bloomberg, Morgan Stanley Research

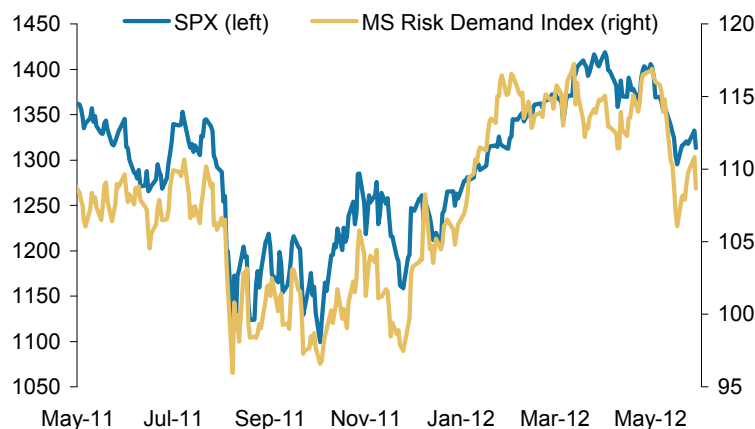
5. Sentiment

Risk Not in High Demand as Sentiment Aligns With the Bears

Risk sentiment ended the month slightly higher than bearish lows earlier in the month

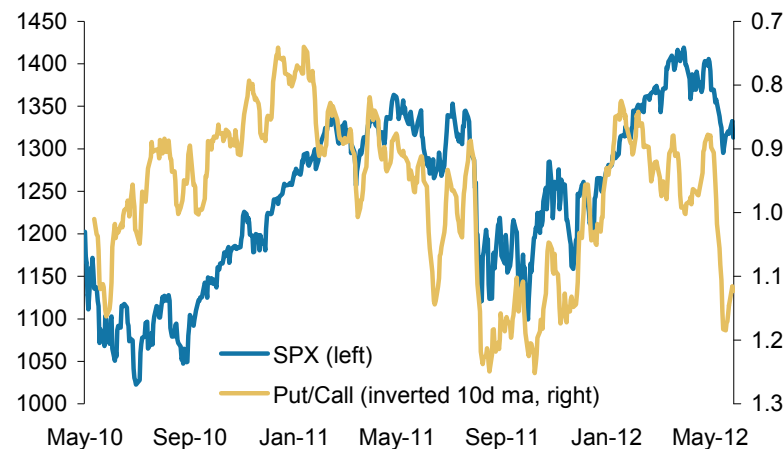
The US equity put/call ratio is notably bearish, suggesting the sell-off may go further

SPX, Risk Demand



Source: Bloomberg, Morgan Stanley Research

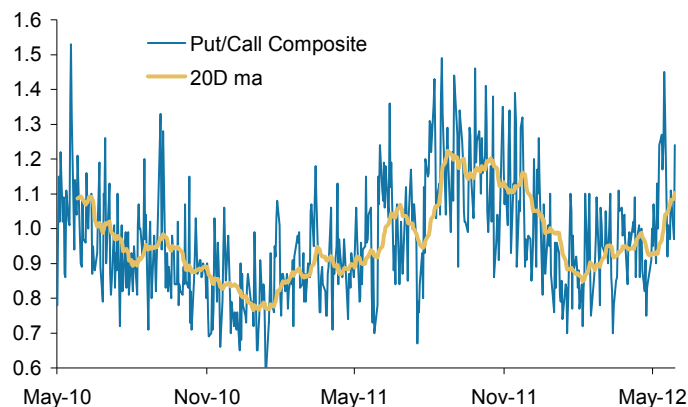
SPX, Put/Call



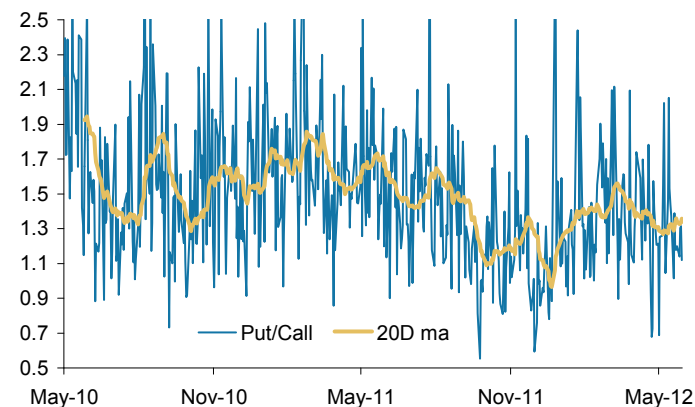
Source: CBOE, Bloomberg, Morgan Stanley Research

5. Sentiment

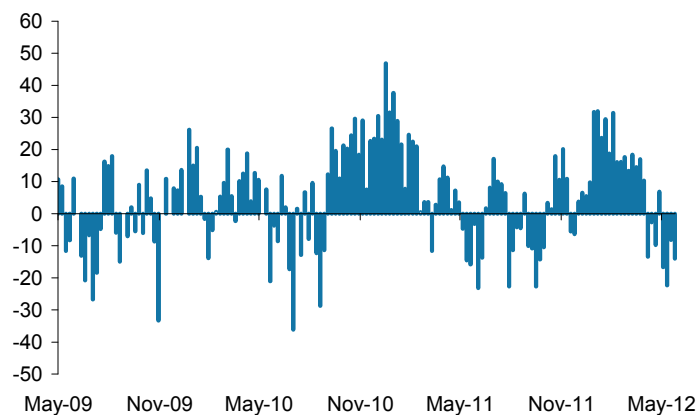
A Weakening Global Backdrop Lends to Rising Investor Caution

US Equity Put/Call Ratio

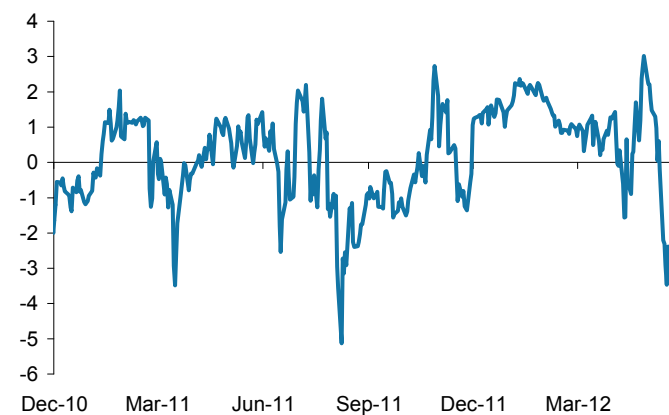
Source: CBOE, Bloomberg, Morgan Stanley Research

Europe Equity Put/Call Ratio

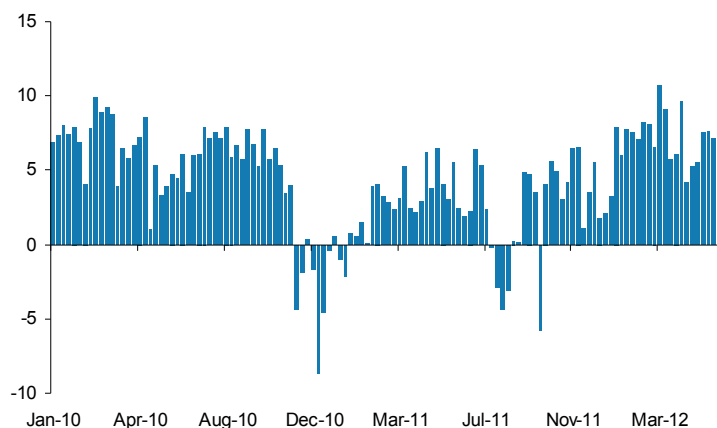
Source: Bloomberg, Morgan Stanley Research

AAII Bulls-Bears

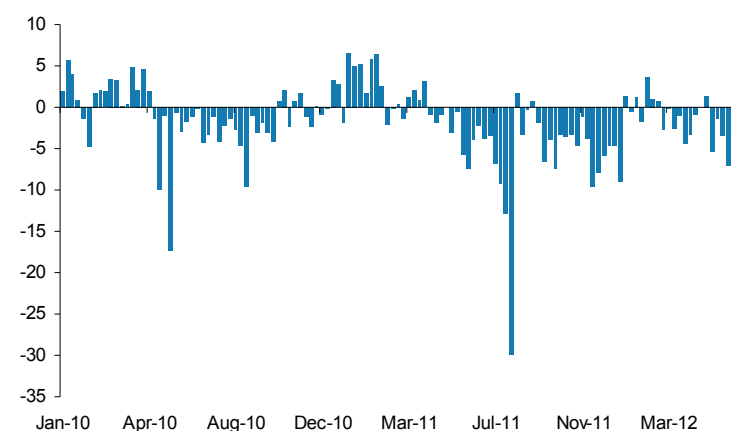
Source: AAII, Bloomberg, Morgan Stanley Research

Morgan Stanley Standardized Global Risk Demand Index

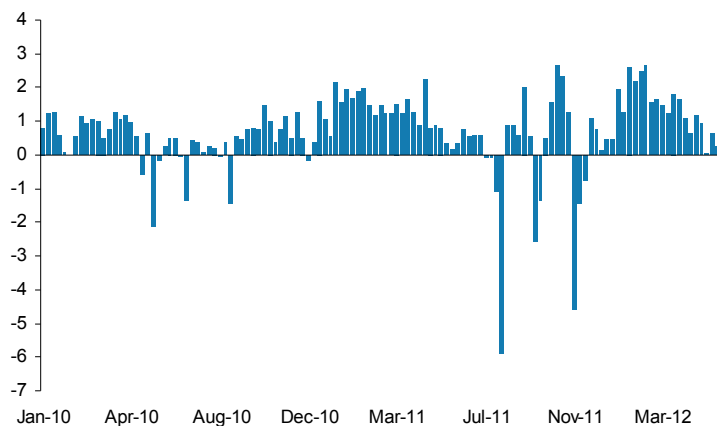
Source: Bloomberg, Morgan Stanley Research

6. Positioning**Inflows Continued Into US Fixed Income and Out of Equity Funds****US Fixed Income Fund Flows, Weekly (\$bn)**

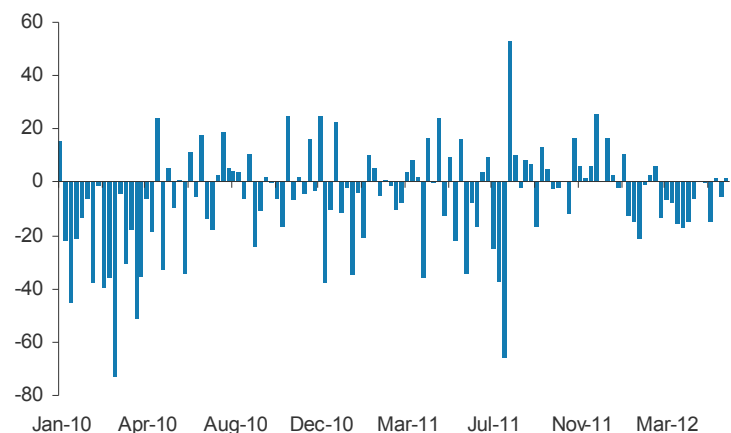
Source: ICI, Morgan Stanley Research

US Equity Fund Flows, Weekly (\$bn)

Source: ICI, Morgan Stanley Research

US Hybrid Fund Flows, Weekly (\$bn)

Source: ICI, Morgan Stanley Research

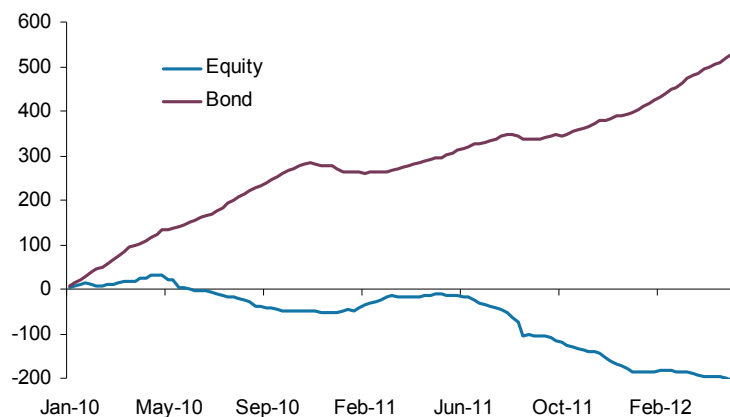
US Money Market Fund Flows, Weekly (\$bn)

Source: ICI, Morgan Stanley Research

6. Positioning

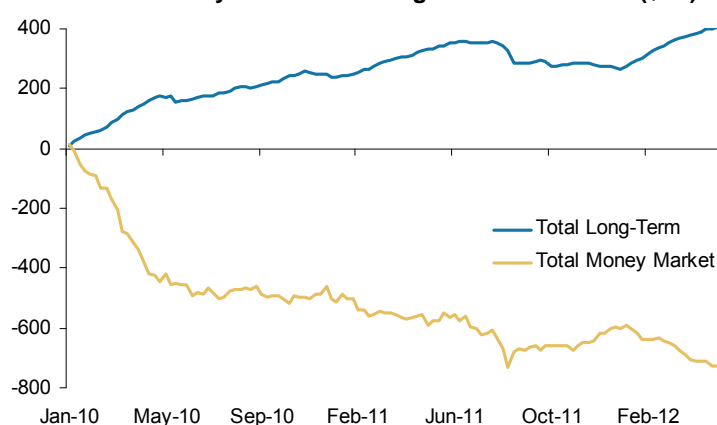
Cumulative Flows Still Moving Out of Equities and Into Bonds

Cumulative US Fixed Income and Equity Fund Flows (\$bn)



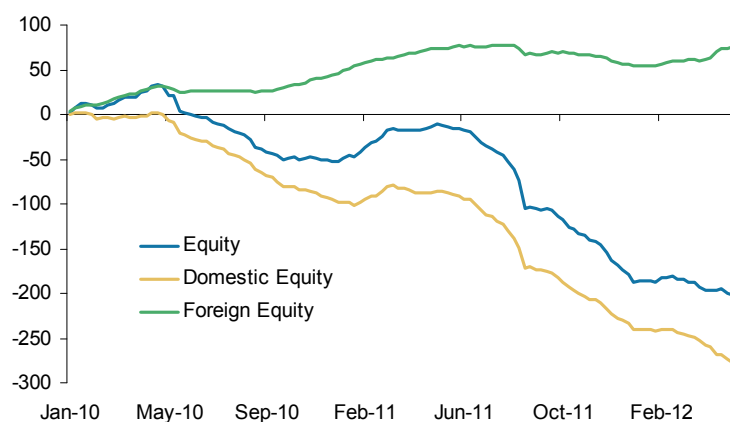
Source: ICI, Morgan Stanley Research

Cumulative Money Market and Long Term Fund Flows (\$bn)



Source: ICI, Morgan Stanley Research

Cumulative US Equity Fund Flows (\$bn)

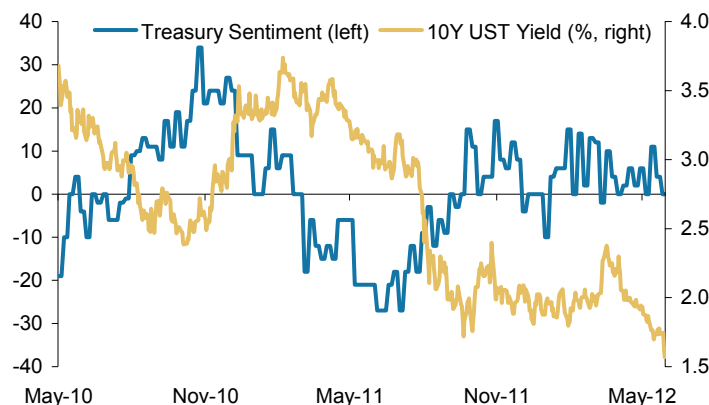


Source: ICI, Fund Flows Database, Morgan Stanley Research

6. Positioning

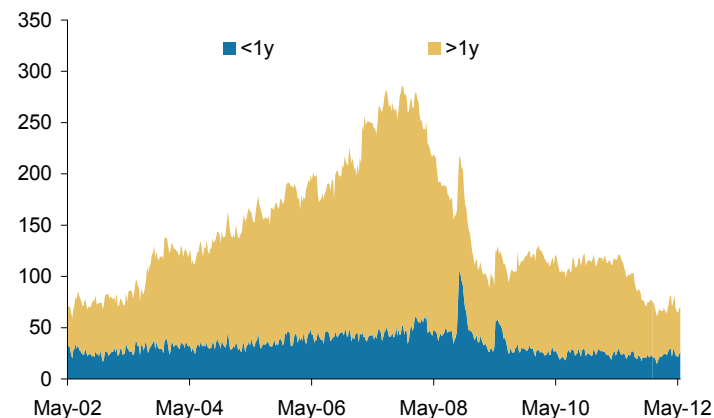
Dealers Have Increased Their Holdings of US Treasuries

UST Sentiment, 10y Yield



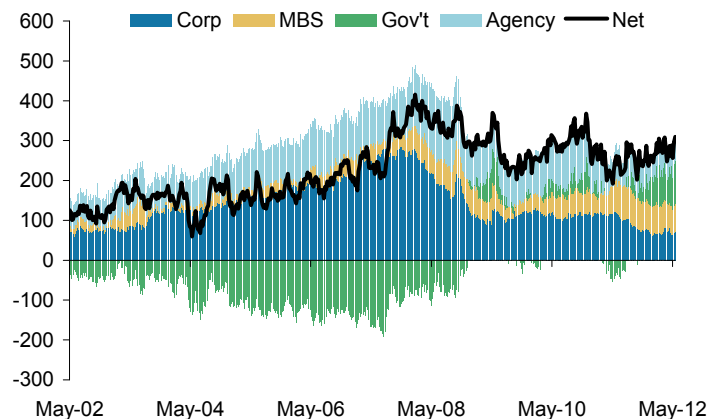
Source: JP Morgan, Bloomberg, Morgan Stanley Research

Primary Dealer Positions in Corporate Securities (\$bn)



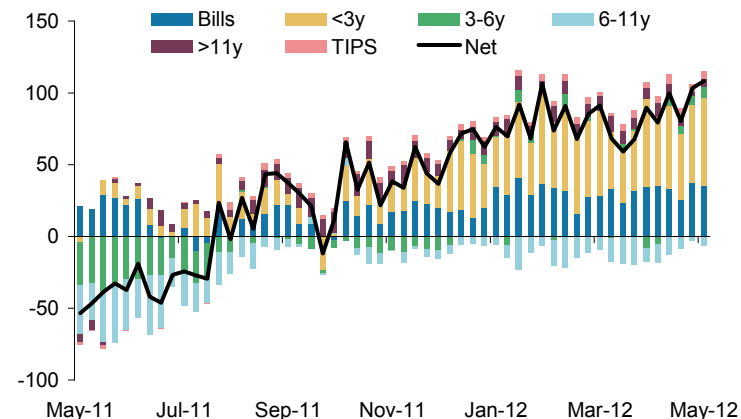
Source: Federal Reserve, Bloomberg, Morgan Stanley Research

Primary Dealer Positions (\$bn)



Source: Federal Reserve, Bloomberg, Morgan Stanley Research

Primary Dealer Positions in US Treasuries (\$bn)

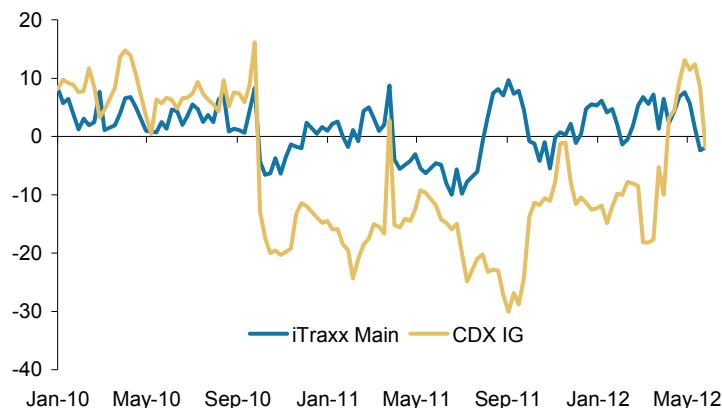


Source: Federal Reserve, Bloomberg, Morgan Stanley Research

6. Positioning

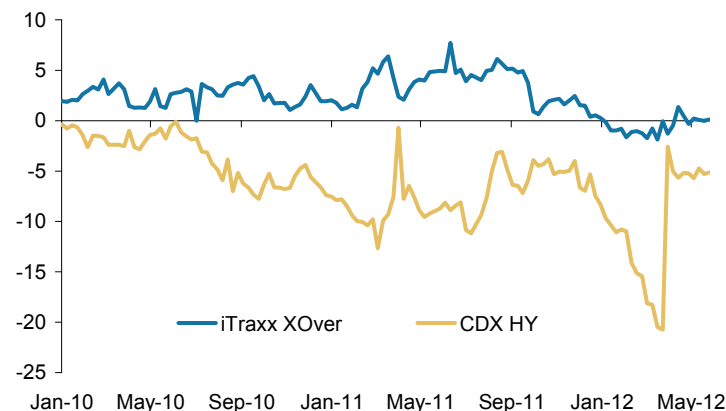
Investors Are Positioned Close to Flat IG Protection But Are Longer SovX WE Risk

Net IG CDS Protection Bought by Clients (\$bn notional)



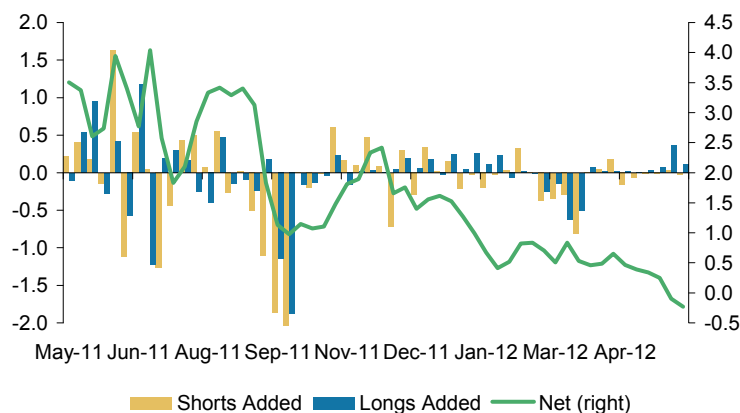
Source: DTCC, Morgan Stanley Research

Net HY CDS Protection Bought by Clients (\$bn notional)



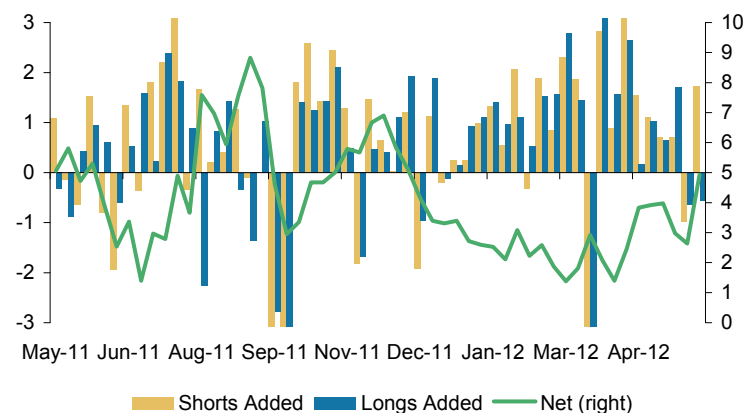
Source: DTCC, Morgan Stanley Research

Net iTraxx SovX WE Protection Bought by Clients (\$bn notional)



Source: DTCC, Morgan Stanley Research

Net iTraxx Snr Fin Protection Bought by Clients (\$bn notional)

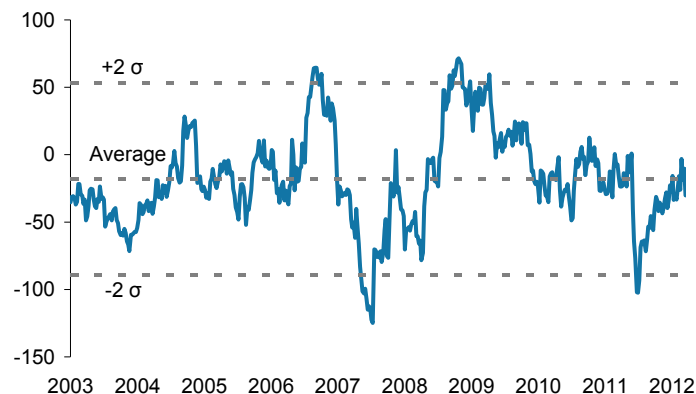


Source: DTCC, Morgan Stanley Research

6. Positioning

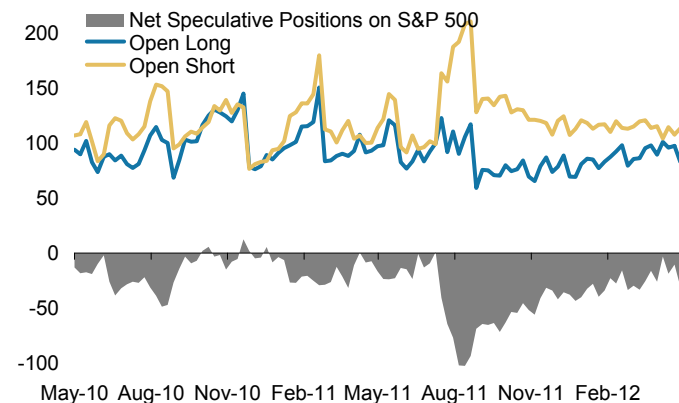
Net Speculative Positions Declined in the S&P, Gold and Oil

Net Speculative Positions in S&P 500 (k contracts)



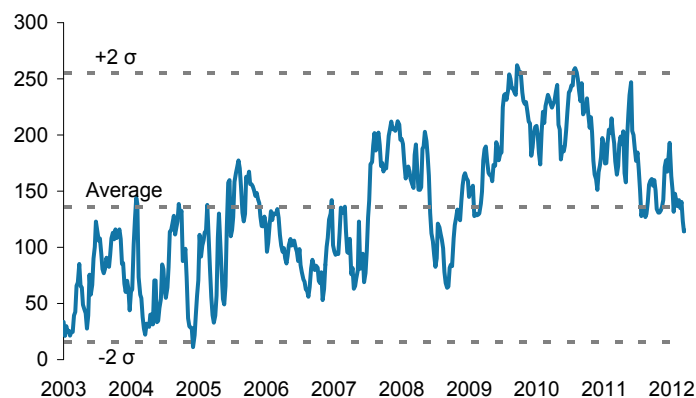
Source: CFTC, Haver Analytics, Morgan Stanley Research

Speculative Positions in S&P 500 (k contracts)



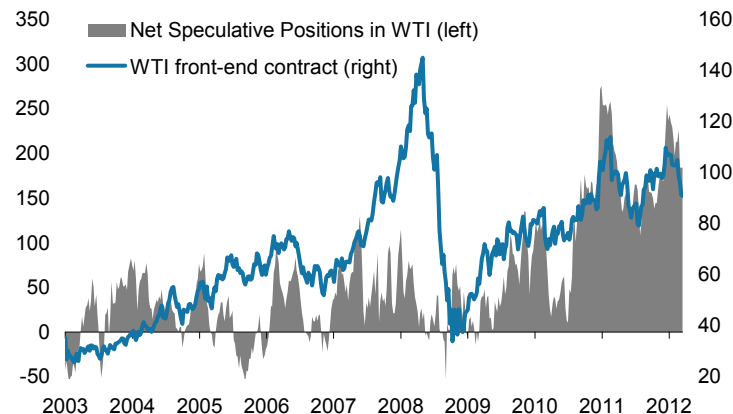
Source: CFTC, Haver Analytics, Morgan Stanley Research

Net Speculative Positions in Gold (k contracts)



Source: CFTC, Haver Analytics, Morgan Stanley Research

Net Speculative Positions in WTI (k contracts)

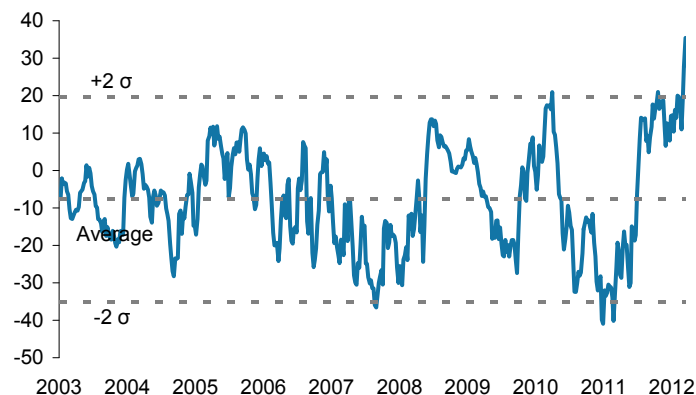


Source: CFTC, Haver Analytics, Morgan Stanley Research

6. Positioning

Speculative Positioning Shot Up in the USD, Down in the EUR, AUD, NZD and CHF

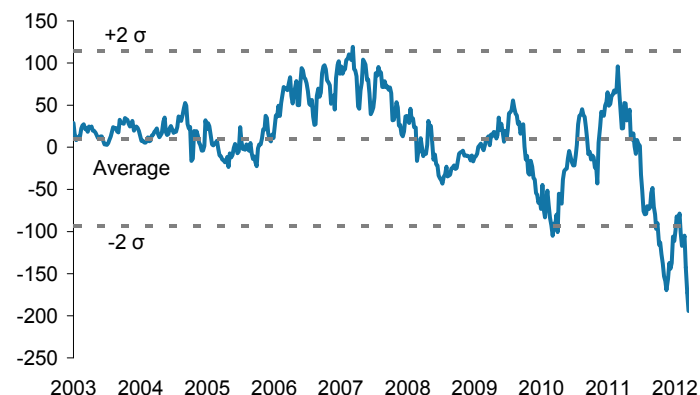
Net Speculative Positions in USD (bn contracts)



Note: Morgan Stanley's FX strategy team combines IMM positioning on the AUD, CAD, CHF, EUR, GBP, JPY, MXN, and NZD to calculate an aggregate USD index to measure overall net positioning.

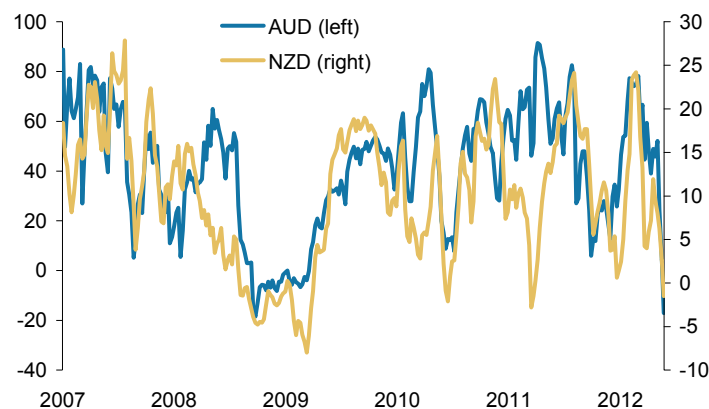
Source: CFTC, Haver Analytics, Morgan Stanley Research

Net Speculative Positioning in EUR (bn contracts)



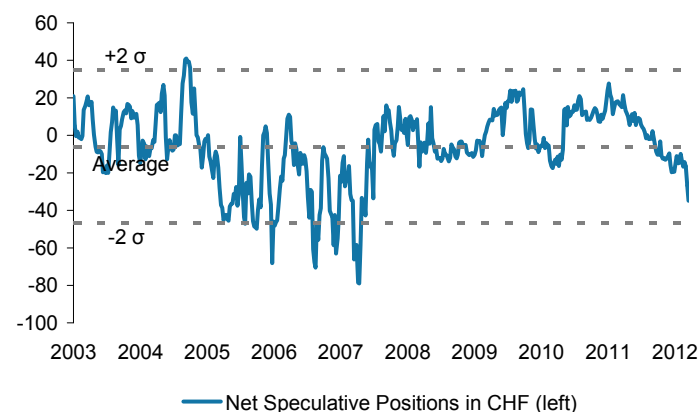
Source: CFTC, Haver Analytics, Morgan Stanley Research

Net Speculative Positions in AUD, NZD (k contracts)



Source: CFTC, Haver Analytics, Morgan Stanley Research

Speculative Positions in CHF (k contracts)



Source: CFTC, Haver Analytics, Morgan Stanley Research

Global Economics Review

What Happened Last Month

What Happened Last Month

1. Global Economy Needs Support

A struggling global economy – With Europe deteriorating further and growth floundering in the US, China, and other countries, both DM and EM central banks may need to employ supportive tactics. EM is currently the main driver of global growth, but to maintain this trend, the region must address fiscal vulnerabilities and rebalancing. Feeble PMIs indicate the global economy is in a slump. To make matters worse, inflation is no longer falling in EM and world trade has yet to shake off sluggishness. EM exports are still soft but price pressures are receding.

2. US Recovery Still to Come

US data remains varied – Economic data in the US continues to be mixed. Once again, this month's payrolls report was weak, causing consumer confidence to soften on the back of increased worries about the faltering labor market. On the more positive side, autos led manufacturing strength and production data held up. In addition, the housing market may at least be nearing its bottom, as housing starts and home sales beat expectations and home prices ticked higher.

3. Europe's Risks Boiling Over

Greece and Spain intensifying the crisis – Although 1Q12 GDP was better than expected for both the Eurozone and Germany, the rising risk of a Greek exit could derail any progress made. Uncertainty has dragged down business sentiment while PMIs signal contraction risks. Aside from reducing funding stress, LTROs have passed little liquidity on to bank lending. Meanwhile, the UK has returned to technical recession in 1Q12, but more QE is not "off the table" as inflation also declined.

4. Japan Recovering in a Shaky World

Japan still improving, but the world is a scarier place – Business sentiment continues to improve and indicate a domestic demand-led recovery, while core machinery orders are still in an overall upward trend. Economic outlook sentiment is more positive, but weak exports to Asia raise some concerns. Inflation is subdued and domestic demand remains decent on better confidence and weather. Bank lending is still on track for a mild recovery while loan demand showed a marked improvement.

5. China's Poor Data Urges Easing

Feeble data releases stoke the fires of easing – Industrial production failed to extend its March rebound and fixed asset investment was likewise pulled down. Retail sales disappointed and trade growth momentum is slowing, but pro-consumption policy measures should help domestic demand and inflation should stay well-anchored in the coming months. New loan creation and money supply growth are both challenged, but the recent 50bp RRR cut came earlier than expected and signals more aggressive easing.

6. EM Moderating Further

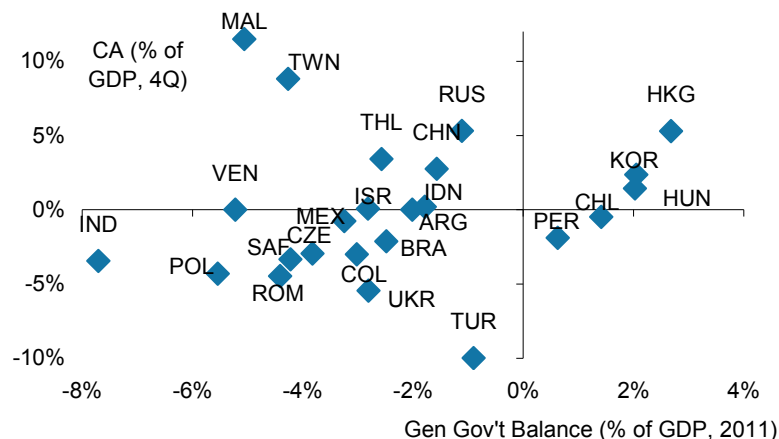
Disappointing growth in various EM countries – PMIs dropped in Singapore and Taiwan, and dipped below 50 in Brazil and Poland. Industrial production slowed across countries and showed broad weakness in Taiwan. Taiwan's export growth declined further while India's turned negative for the first time since 2009. Upside risks to inflation may be alive; price pressure crept up in Singapore, Taiwan, and India. Domestic demand is a crucial component to longer-term rebalancing but thus far remains uninspiring.

1. Global Economy Needs Support

To Keep Driving Global Growth, EM Must Address Slowdown Risks and Rebalancing

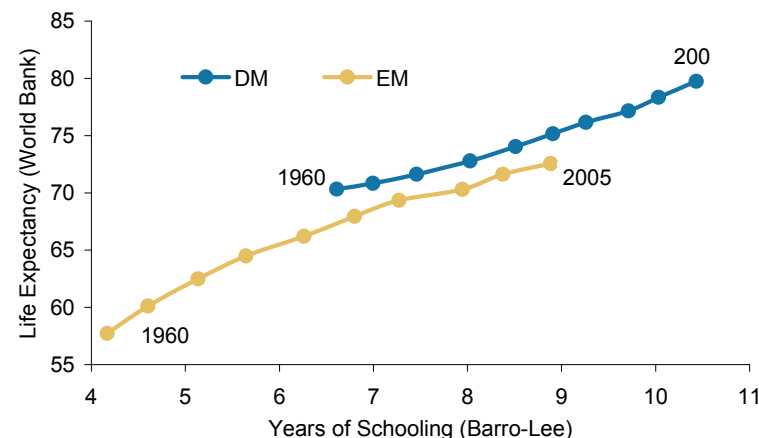
Longer-term, socio-economic catch-up forms the basis for EM outperformance

EM General Gov't Balance, Current Account (% GDP)



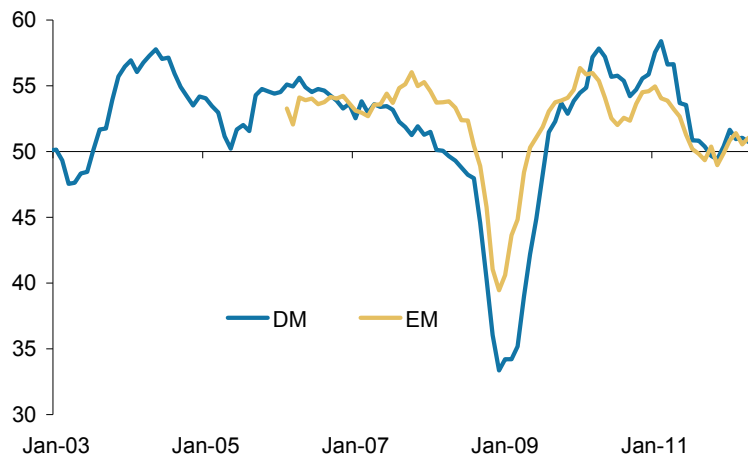
Source: National sources, Haver Analytics, Morgan Stanley Research

Education, Life Expectancy



Source: Barro-Lee database, World Bank, Haver Analytics, Morgan Stanley Research
Note: Country weights

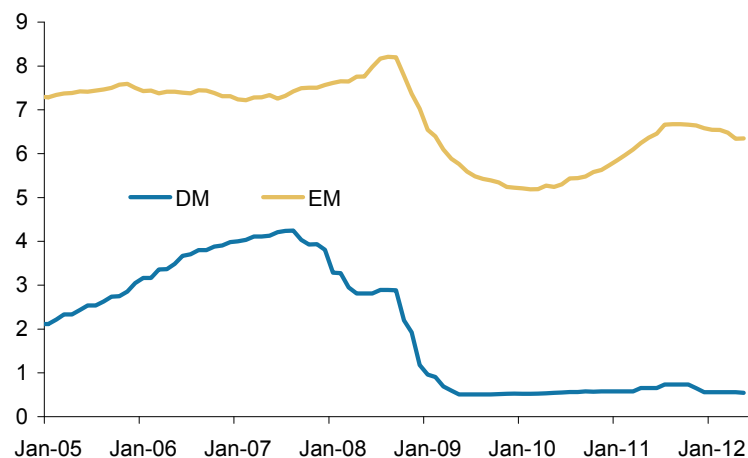
However, weak balance of payments makes some EM countries vulnerable to funding stress and reduces policy flexibility

1. Global Economy Needs Support**Feeble PMIs Indicate the Global Economy Is in a Slump****PMI (level)**

Global PMIs are around contraction territory

Source: IMF, Markit, national sources, Haver Analytics, Morgan Stanley Research

Note: Methodology change yields slightly different results from previous month's report

Policy Rate (%)

In May, Australia cut rates in DM while Poland hiked in EM

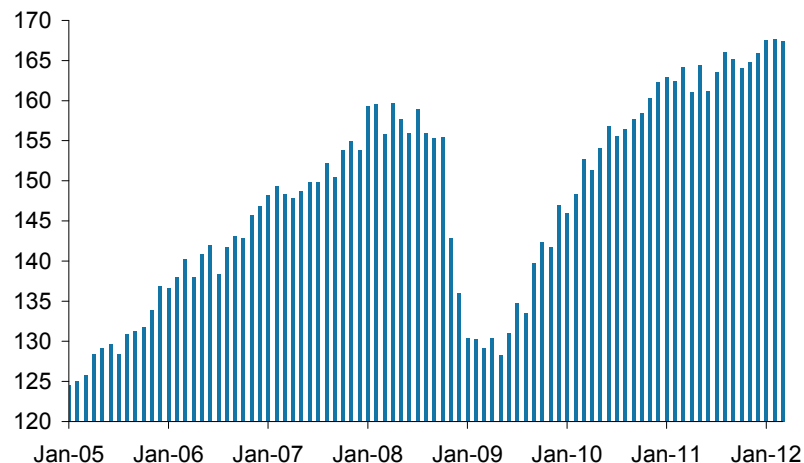
Source: IMF, national sources, Haver Analytics, Morgan Stanley Research

1. Global Economy Needs Support

Inflation No Longer Falling in EM While World Trade Hasn't Shaken Off Sluggishness

Inflation pressures are receding in DM but not continuing to relax in EM

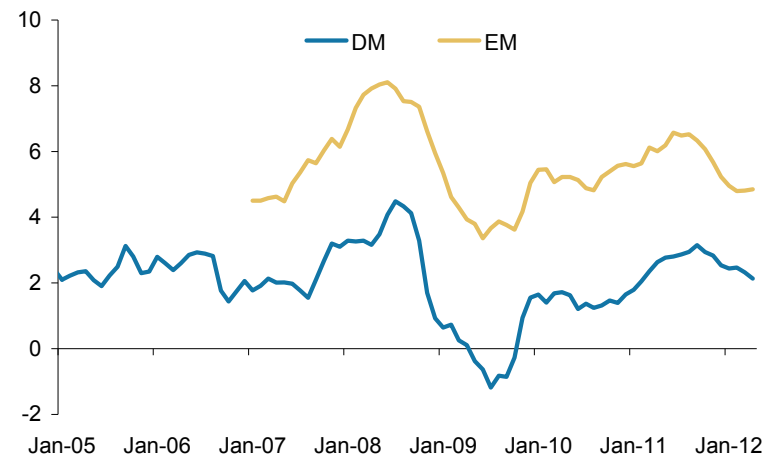
World Trade Volume (index level)



Source: CPB Netherlands BEPA, Morgan Stanley Research

Note: Data reported with lag

CPI (YoY %)



Source: IMF, national sources, Haver Analytics, Morgan Stanley Research

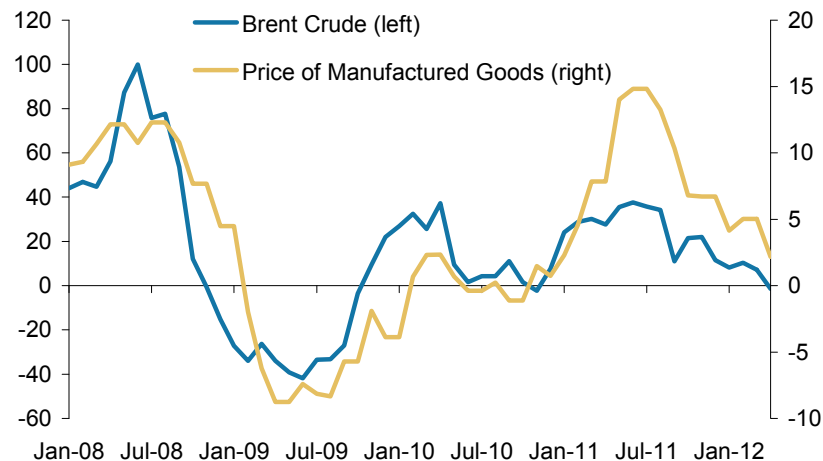
World trade volume decreased for another month

1. Global Economy Needs Support

Still-Soft EM Exports But Receding Price Pressures

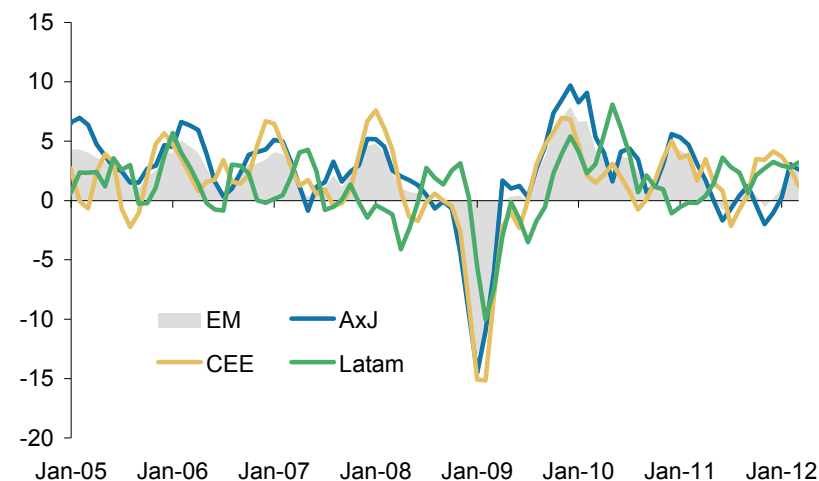
On a 3m/3m basis, EM export volumes remain soft...

Oil, World Prices Manufactured Goods (YoY %)



Source: CPB Netherlands BEPA, Bloomberg, Morgan Stanley Research

EM Export Volume (3m/3m %)



Source: CPB Netherlands BEPA, Morgan Stanley Research

Note: Data reported with lag

...Though falling oil prices may help manufactured goods prices relax

2. US Recovery Still to Come

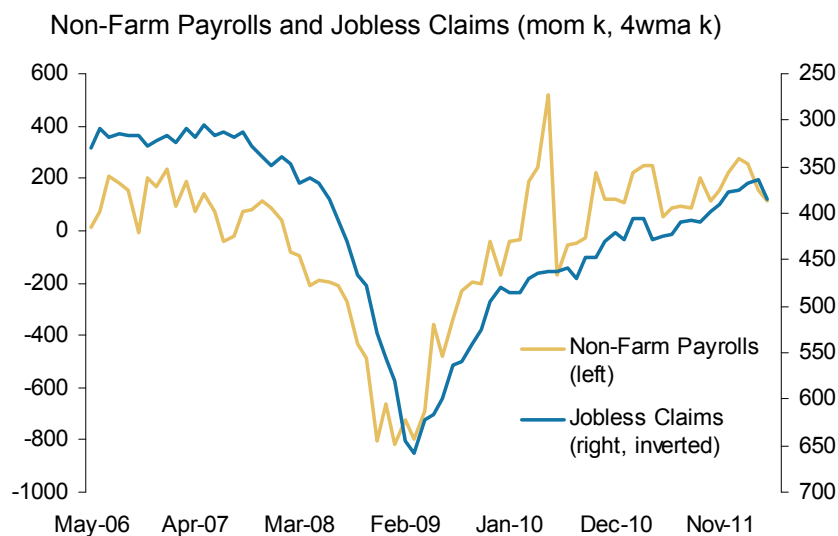
Economic Dashboard: US

	6-mo Trend	Prev.	Latest
Leading Indicators			
OECD Leading Indicator (index) (Mar)		101.1	↗ 101.3
Conf. Board Leading Indicator (yoy %) (Apr)		2.0	↘ 1.9
Business Conditions			
ISM Composite Index (Apr)		55.7	↘ 53.7
ISM Non-Manufacturing Index (Apr)		56.0	↘ 53.5
Chic. Fed Natl Activity Index (3-mo avg) (Apr)		0.02	↘ -0.06
Philly Fed Business Conditions Index (May)		52.4	↘ 48.6
Empire Mfg. Business Conditions Index (May)		53.8	↗ 55.8
Richmond Fed Mfg. Index (May)		14	↘ 4
Fed Beige Book (May)		112	↗ 199
Chicago Purchasing Managers Index (May)		56.2	↘ 52.7
Economic Activity			
Industrial Production (yoy %) (Apr)		3.5	↗ 5.2
Capacity Utilization (%) (Apr)		78.4	↗ 79.2
Factory Orders (mom %) (Mar)		1.5	↘ -1.9
Durable Goods Orders (yoy %) (Apr)		1.8	↗ 6.9
Durable Goods Inventories (yoy %) (Apr)		7.4	↘ 6.8
Trade			
Exports (yoy %) (Mar)		9.5	↘ 7.3
Imports (yoy %) (Mar)		7.5	↗ 8.4
Prices			
Consumer Price Index (yoy %) (Apr)		2.65	↘ 2.30
CPI ex-Food & Energy (yoy %) (Apr)		2.25	↗ 2.31
PPI Finished Goods (yoy %) (Apr)		2.81	↘ 1.89
PPI ex-Food & Energy (yoy %) (Apr)		2.89	↘ 2.77
Core PCE Price Index (yoy %) (Apr)		1.92	↗ 1.96

	6-mo Trend	Prev.	Latest
Labor Market			
Initial Jobless Claims (weekly, k) (Apr)		373	↗ 383
Initial claims 4-wk ma (curr, last mo) (Apr)		371	↗ 375
Continuing Claims (weekly) (Apr)		3,278	↘ 3,242
Chg. in NonFarm Payrolls (mom, k) (Apr)		154	↘ 115
Avg. Weekly Hours (Private Employees) (Apr)		34.5	34.5
Challenger Job Cut Announce. (yoy %) (May)		11.2	↗ 66.7
ADP Employment Chg. (mom, k) (May)		1.69	↗ 1.77
Avg. Hourly Earnings (yoy %) (Apr)		1.81	↘ 1.70
Personal Income (yoy %, sa) (Mar)		3.3	↘ 3.2
Personal Savings Rate (%) (Mar)		3.7	↗ 3.8
Consumer Confidence			
Conference Board Index (sa) (May)		68.7	↘ 64.9
U. of Mich. Consumer Confidence (May)		76.4	↗ 79.3
Retail Sector			
Retail Sales (yoy %) (Apr)		6.6	↘ 6.4
ICSC Chain Store Sales (yoy %) (Apr)		3.9	↘ 0.6
Total Vehicle Sales (mn, sa) (Apr)		14.7	14.7
Personal Expenditure (yoy %, sa) (Apr)		4.3	↘ 4.0
Housing Market			
Housing Starts (k, saar) (Apr)		699	↗ 717
New Home Sales (k, saar) (Apr)		332	↗ 343
Existing Home Sales (k, saar) (Apr)		4,470	↗ 4,620
S&P/Case-Shiller, 20-City Indx (yoy %) (Mar)		-3.5	↗ -2.6
MBA Mortgage Applications (wkly %) (May)		0.4	↗ 3.1

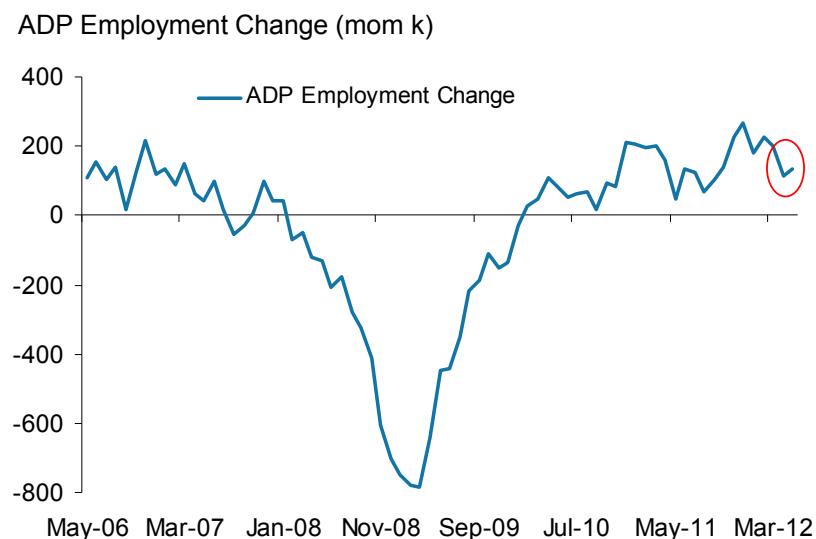
2. US Recovery Still to Come**Labor Market Weakness Continues, As US Payrolls Disappointed Again**

In April, non-farm payrolls fell back and jobless claims rose...



Source: Department of Labor, Haver Analytics, Morgan Stanley Research

...And this could continue, as ADP's muted rebound implies May's payrolls may be below consensus.



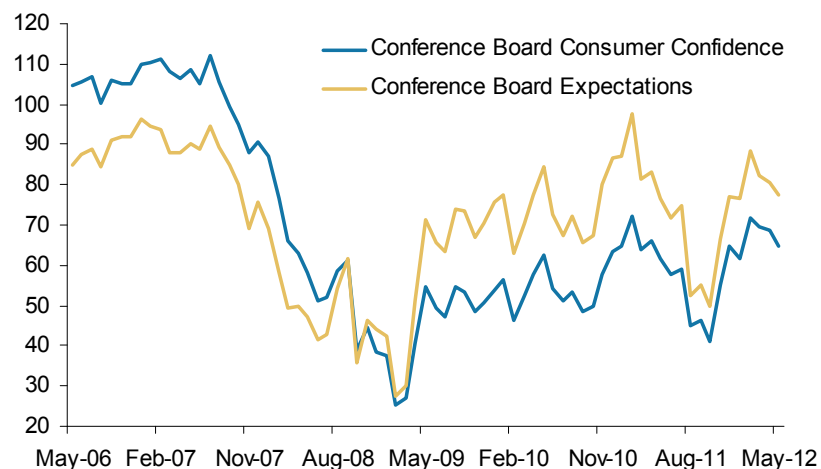
Source: ADP, Macroeconomic Advisors, Haver Analytics, Morgan Stanley Research

2. US Recovery Still to Come

This Weakness Led to Mixed Signals from Consumer Confidence Metrics

The Conference Board's consumer confidence index fell 4 points to the worst level of the year...

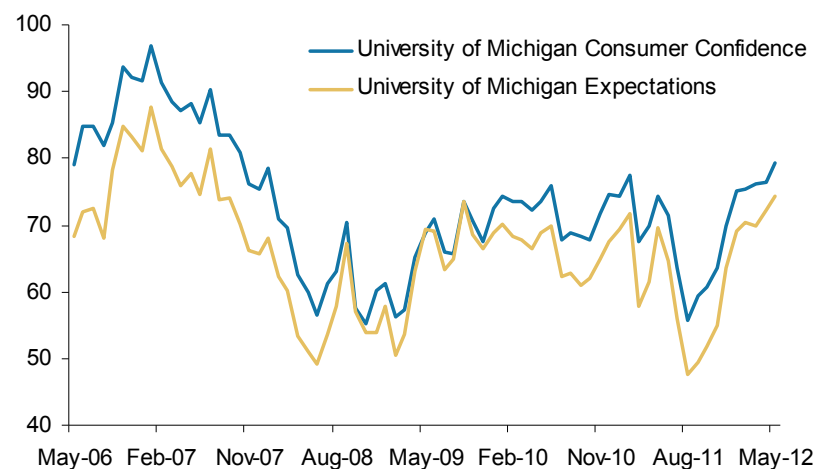
Conference Board Consumer Confidence & Expectations Indices (level)



Source: Conference Board, Haver Analytics, Morgan Stanley Research

...While the Michigan index hit a 4 year high, driven by labor views the authors saw as "overly optimistic."

University of Michigan Consumer Confidence & Expectations Indices (level)



Source: University of Michigan, Haver Analytics, Morgan Stanley Research

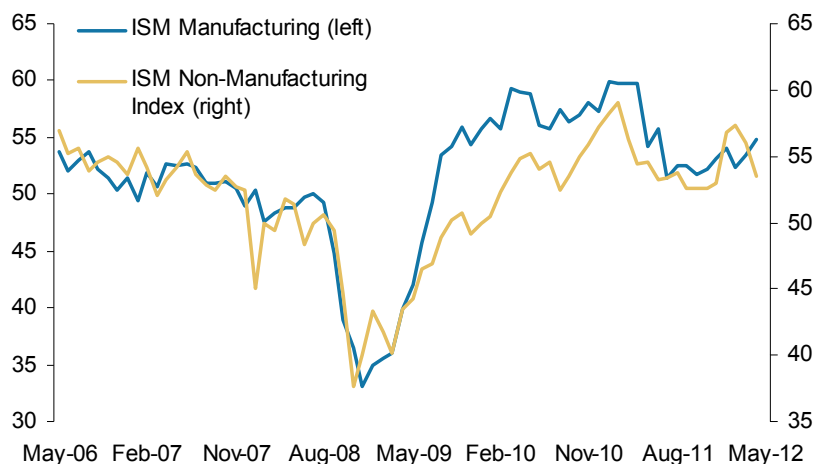
2. US Recovery Still to Come

Though Manufacturing and Production Continue to Be Sources of Outperformance

ISM manufacturing saw strength led by autos, though non-manufacturing hit a 4-month low...

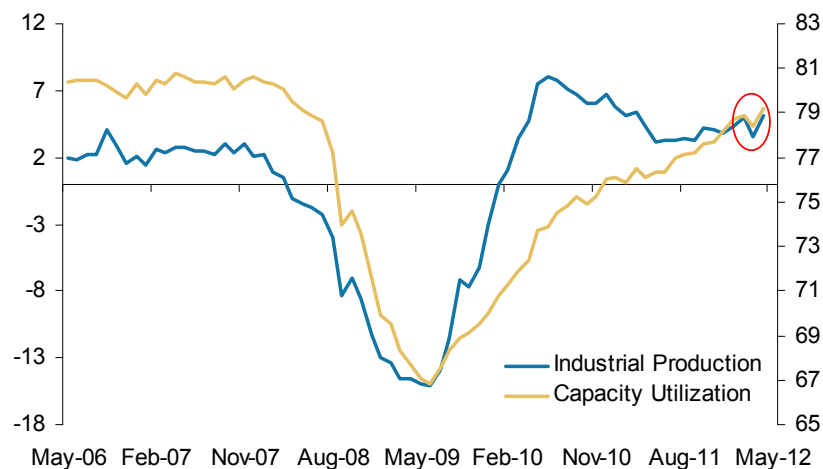
...And industrial production was better than expected, though the underlying details were somewhat mixed.

ISM Manufacturing & ISM Non-Manufacturing (level, 50+ inc.)



Source: Institute for Supply Management, Haver Analytics, Morgan Stanley Research

Industrial Production & Capacity Utilization (YoY %, %)



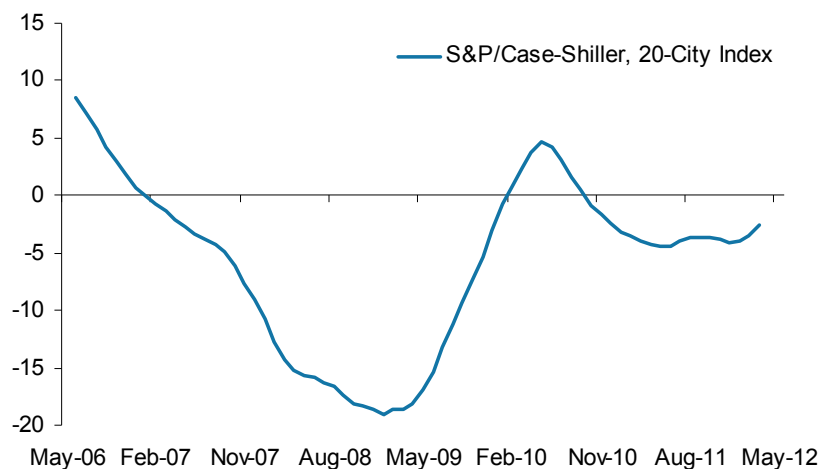
Source: Federal Reserve Board, Haver Analytics, Morgan Stanley Research

2. US Recovery Still to Come**Along With the Housing Market, Which Remains Not Very Far from Bottom**

Home prices rose and leading indicators suggest this may continue...

...And housing starts were very robust, with home sales becoming increasingly strong.

S&P/Case-Shiller Index (yoy%)



Source: S&P, Fiserv, MacroMarkets LLC, Haver Analytics, Morgan Stanley Research

Housing Starts (k, saar), New Home Sales (k, saar)



Source: Census Bureau, Haver Analytics, Morgan Stanley Research

3. Europe's Risks Boiling Over

Economic Dashboard: Europe

	6-mo Trend	Prev.	Latest
PMI Mfg			
Eurozone (Jun)		45.9	45.1
Germany (Jun)		46.2	45.2
France (Jun)		46.9	44.7
Italy (Jun)		43.9	44.8
Spain (Jun)		43.5	42.0
Greece (Jun)		40.7	43.1
U.K. (Jun)		50.2	45.9
Industrial Production (YoY %)			
Eurozone (Mar)		-1.5	-2.2
Germany (Mar)		0.0	1.6
France (Mar)		-1.4	-0.9
Italy (Mar)		-6.8	-5.8
Spain (Mar)		-3.2	-10.4
Greece (Mar)		-8.5	-8.5
U.K. (Mar)		-2.3	-2.6
Imports (YoY %)			
Eurozone (Nov)		7.1	-0.4
Germany (Mar)		4.9	3.3
France (Mar)		5.8	2.1
Italy (Mar)		-2.5	-9.2
Spain (Mar)		6.6	-4.6
Greece (Mar)		19.5	1.0
U.K. (Mar)		3.8	5.6
Exports (YoY %)			
Eurozone (Nov)		11.0	4.4
Germany (Mar)		6.9	2.0
France (Mar)		6.9	3.9
Italy (Mar)		4.4	4.0
Spain (Mar)		4.9	1.2
Greece (Mar)		-9.5	-6.6
U.K. (Mar)		-0.4	4.4

¹Harmonized inflation (HICP) is shown for member countries³Eurozone M3 growth rates no longer account for portfolio shifts

	6-mo Trend	Prev.	Latest
Inflation (YoY %)¹			
Eurozone (Apr): CPI		2.7	2.6
Germany (May): HICP		2.2	2.1
France (Apr): HICP		2.6	2.4
Italy (May): HICP		3.7	3.5
Spain (May): HICP		2.0	1.9
Greece (Apr): HICP		1.4	1.5
Business Confidence			
Belgium: NBB Bus. Confidence (May)		-10.7	-11.2
France: INSEE Bus. Confidence (May)		95	93
Italy: ISAE Bus. Confidence (May)		89	86
Germany: Ifo Business Survey (May)		110	107
Economic Sentiment			
Eurozone: ZEW Econ. Sentiment (May)		13.1	-2.4
Greece: Economic Sentiment (Apr)		75.7	77.3
Germany: ZEW Econ. Sentiment (May)		23.4	10.8
Retail Sales (YoY %)			
Eurozone (Mar)		-2.0	0.4
Germany (Mar)		2.1	2.3
France (Mar)		0.2	2.7
Italy (Mar)		0.5	1.7
Spain (Apr)		-4.0	-11.3
U.K. (Apr)		2.7	-0.3
Orders (YoY %)²			
Germany: Manufacturing Orders		-6.0	-1.3
Lending and Money Supply (YoY %)³			
Eurozone: M3 (Apr)		3.1	2.5
Eurozone: Lending to Priv. Sector (Apr)		1.8	1.4

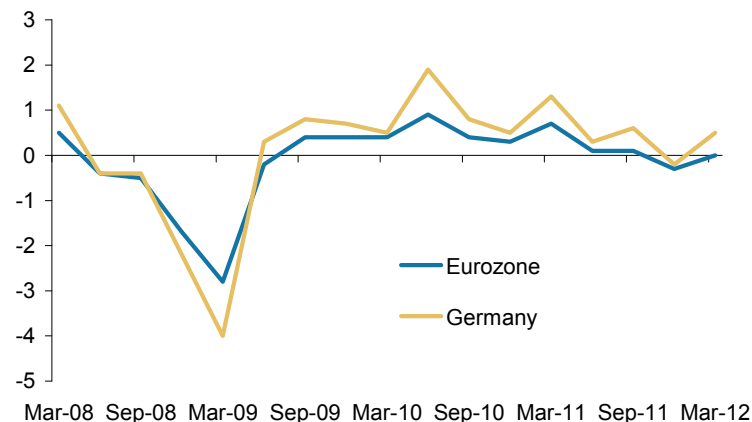
²Orders are working day adjusted

3. Europe's Risks Boiling Over

While Europe Staggers On, Rising Risk of a Greek Exit Could Derail Any Progress Made

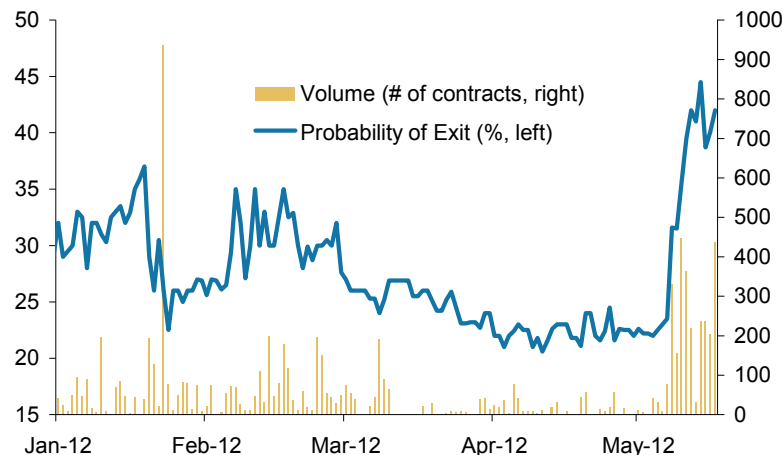
1Q12 Eurozone and Germany GDP both surprised on the upside...

GDP (QoQ %)



Source: Eurostat, Destatis, Bloomberg, Morgan Stanley Research

Probability of Greek Exit



Source: Intrade, Morgan Stanley Research

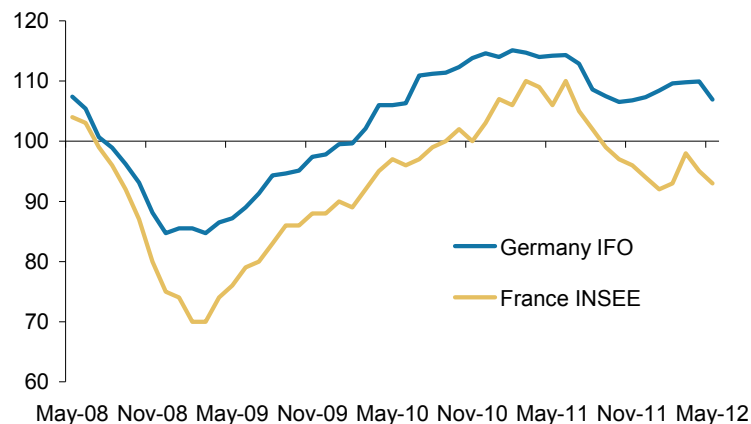
Note: Implied probability is not Morgan Stanley's projection. The source is Intrade, which is used by major news media for probability projections.

...But the probability of a Greek exit has jumped

3. Europe's Risks Boiling Over

Uncertainty Weighs on Business Sentiment; PMIs Signal Risk of Contraction

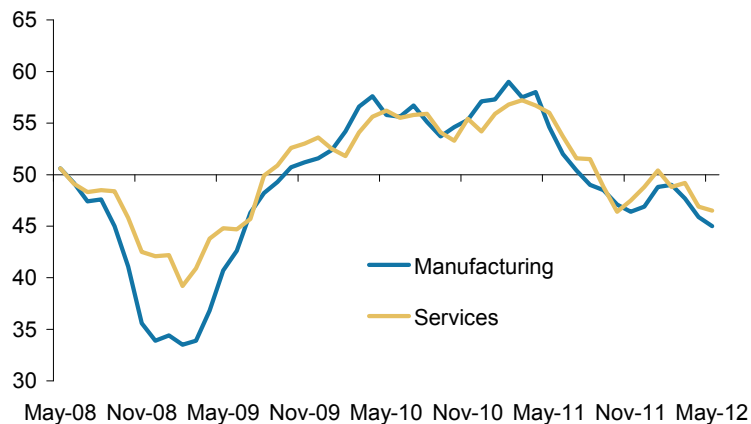
Germany, France Business Sentiment (index)



Business sentiment in Germany and France plunged

Source: IFO, INSEE, Bloomberg, Morgan Stanley Research

Eurozone PMI (index)



Eurozone PMIs declined unexpectedly against market expectations

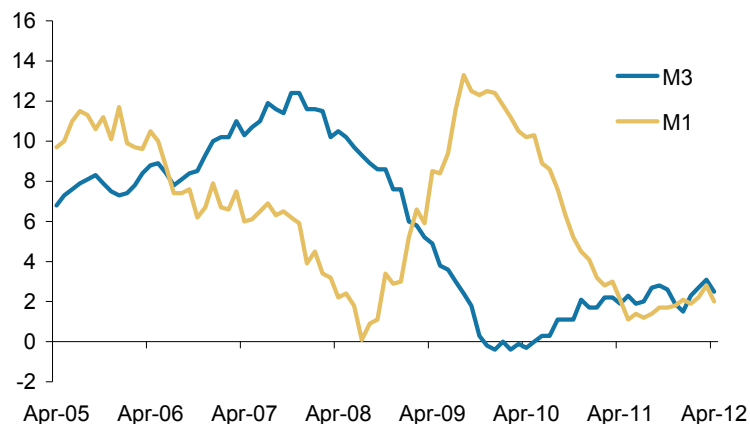
Source: Markit, Bloomberg, Morgan Stanley Research

3. Europe's Risks Boiling Over

LTROs Reduced Funding Stress But Little Liquidity Is Being Passed Onto Bank Lending

Money supply growth decelerated markedly and is very subdued by historical standards

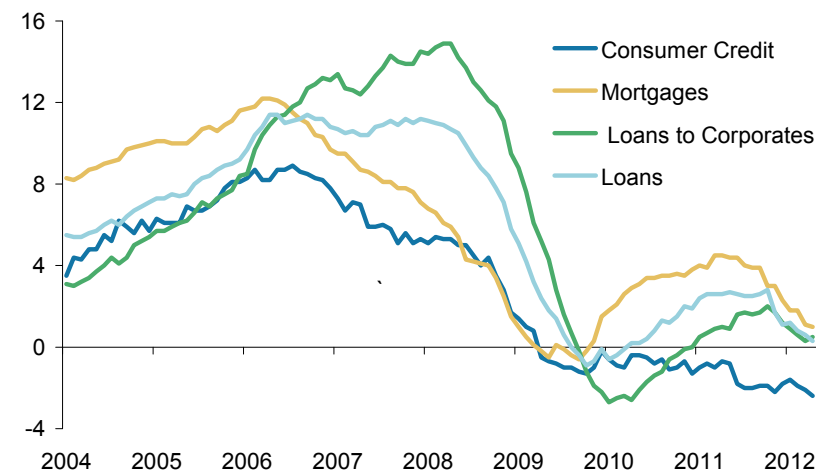
Eurozone M3, M1 (YoY %)



Source: ECB, Bloomberg, Morgan Stanley Research

Loan growth in the private sector recorded a drop and remains below the rates of early 2011

Eurozone MFI Lending to Private Sector (YoY %)



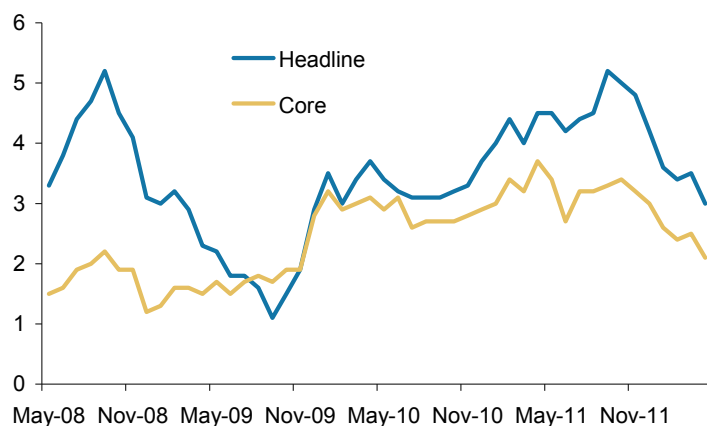
Source: ECB, Morgan Stanley Research

3. Europe's Risks Boiling Over

More QE Is Not “Off the Table” as Inflation Falls in the UK

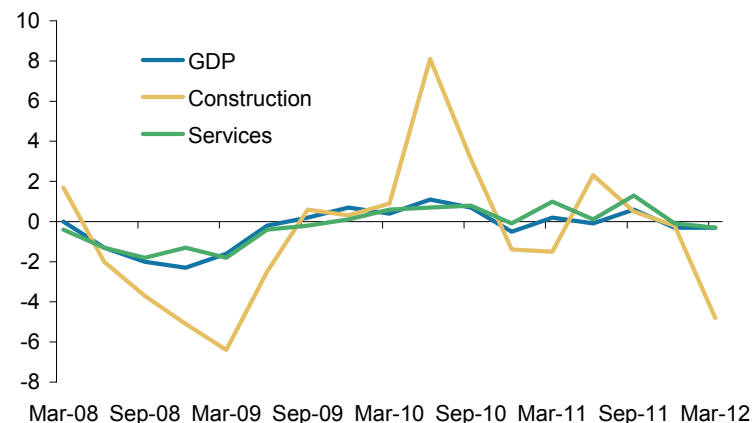
The UK returned to technical recession in 1Q12, with particular weakness in the construction and services components

UK CPI (YoY %)



Source: ONS, Bloomberg, Morgan Stanley Research

UK GDP and Components (QoQ %)









































Source: ONS, Bloomberg, Morgan Stanley Research

Inflation declined, though partially driven by Easter timing effects

4. Japan Recovering in a Shaky World

Economic Dashboard: Japan

	6-mo Trend	Prev.		Latest
Indicators				
Leading Indicator (Mar)		96.1	↗	96.4
Coincident Indicator (Mar)		95.2	↗	96.7
Business Conditions				
Eco Watchers: Current (Apr)		51.8	↘	50.9
Eco Watchers: Outlook (Apr)		49.7	↗	50.9
Tankan Mfg: Current (May)		1.0	↗	2.0
Tankan Non-Mfg: Current (May)		10.0	↗	11.0
Tankan Mfg: Outlook (May)		6.0	↗	8.0
Tankan Non-Mfg: Outlook (May)		16.0	↗	18.0
All Industry Index (Mar)		-0.1	↘	-0.3
Small Business Confidence (May)		47.6	↘	47.2
PMI (May)		50.7		50.7
Economic Activity				
Industrial Production (MoM %) (Apr)		1.3	↘	0.2
Industrial Production (YoY %) (Apr)		14.2	↘	13.4
Vehicle Production (YoY %) (Apr)		143.7	↗	173.8
Machinery Orders (YoY %) (Mar)		8.9	↘	-1.1
Machine Tool Orders (YoY %) (Apr)		1.6	↘	0.4
Capacity Utilization (MoM %) (Mar)		-1.7	↗	1.3
Trade				
Current Account Balance (¥bn) (Mar)		1177.8	↗	1589
Merch Trade Balance (¥bn) (Apr)		-87.1	↘	-522
Merch Trade Imports (YoY %) (Apr)		10.6	↘	8.1
Merch Trade Exports (YoY %) (Apr)		5.9	↗	7.9

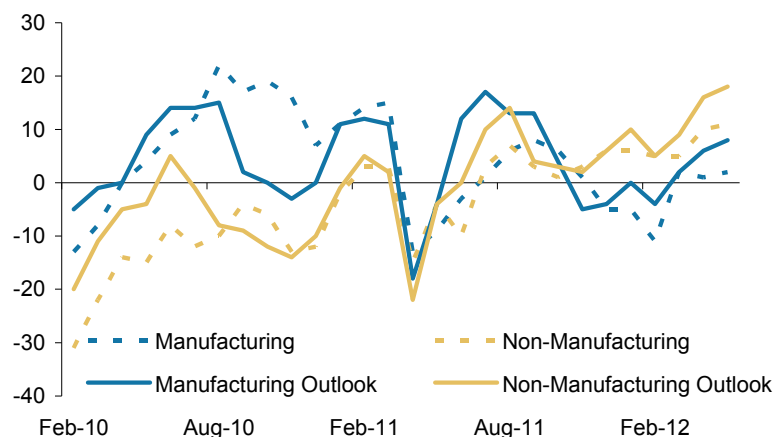
	6-mo Trend	Prev.		Latest
Prices				
CGPI (YoY %) (Apr)		0.5	↘	-0.2
CPI (YoY %) (Apr)		0.5	↘	0.4
Core CPI (YoY %) (May)		-1.0	↘	-1.3
Labor Market				
Jobless Rate (%) (Apr)		4.5	↗	4.6
Job-to-Applicant Ratio (Apr)		0.8	↗	0.8
Consumer				
Consumer Confidence (Apr)		40.3	↘	40.0
Household Spending (YoY %) (Apr)		3.4	↘	2.6
Retail				
Vehicle Sales (YoY %) (May)		92.0	↘	66.3
Department Store Sales (YoY %) (Apr)		14.1	↘	1.3
Convenience Store Sales (YoY %) (Apr)		0.4	↗	6.1
Housing				
Tokyo Condo Sales (YoY %) (Apr)		-6.1	↗	81.7
Construction Orders (YoY %) (Apr)		-0.3	↗	16.2
Housing Starts (YoY %) (Apr)		5.0	↗	10.3
Tokyo Avg Office Vacancies (%) (Apr)		9.0	↗	9.2
Financial				
Bank Lending ex-Trusts (YoY %) (Apr)		0.9	↘	0.4
M2 (YoY %) (Apr)		3.0	↘	2.6
Target Rate (%) (May)		0.1		0.1

4. Japan Recovering in a Shaky World

Business Sentiment Continues to Improve

The solid non-manufacturing Tankan indicates an ongoing domestic demand-led recovery

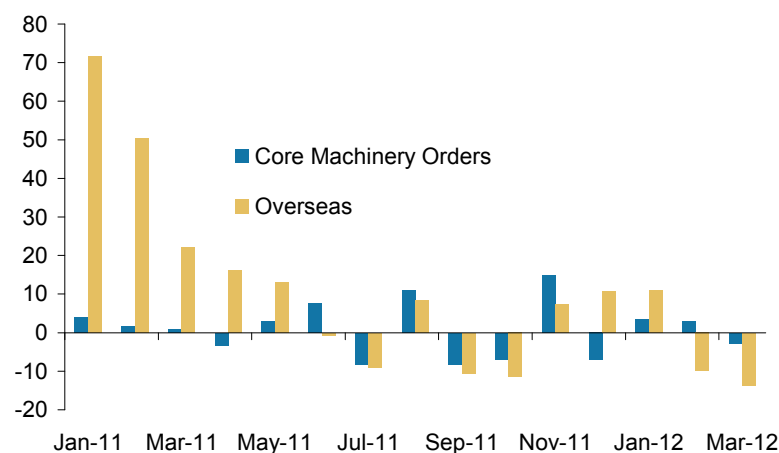
Reuters Tankan (level)



Source: Reuters, Datastream, Morgan Stanley Research

Core orders declined but are maintaining a mild upward trend; declining overseas orders doesn't necessarily signal downtrend

Machinery Orders (MoM %)



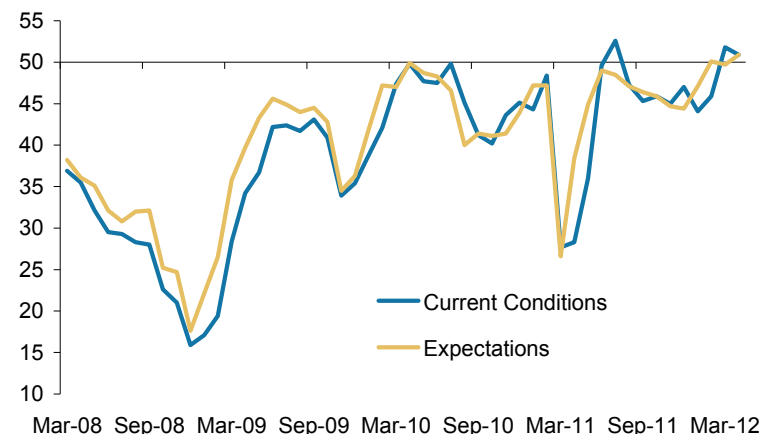
Source: ESRI, Bloomberg, Morgan Stanley Research

4. Japan Recovering in a Shaky World

Economic Outlook Sentiment More Positive, Though Exports to Asia Are Weak

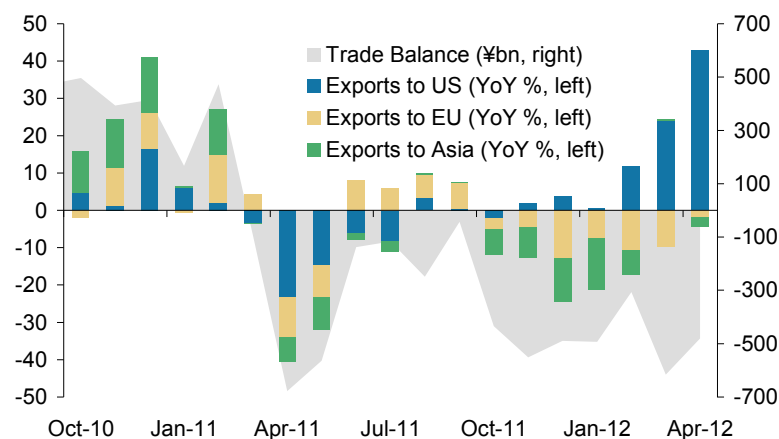
Eco Watchers current conditions declined marginally while outlook is up slightly

Economy Watchers Survey (level)



Source: ESRI, Bloomberg, Morgan Stanley Research

Merchandise Trade



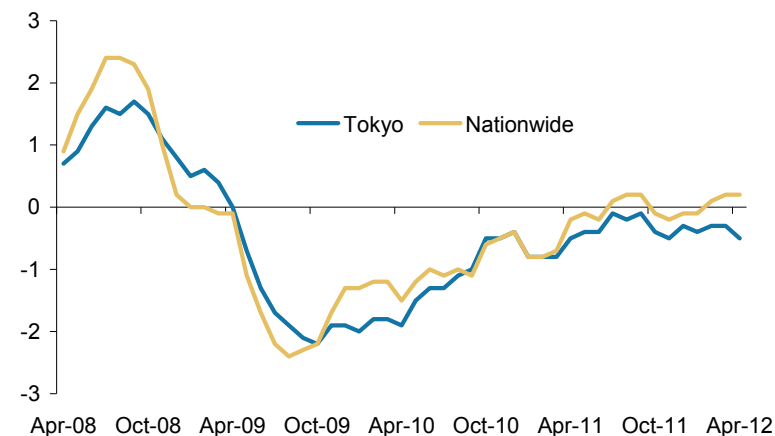
Source: MOF, Bloomberg, Morgan Stanley Research

The trade deficit narrowed slightly but weak exports to Asia raise concerns

4. Japan Recovering in a Shaky World

Subdued Price Trends; Decent Domestic Demand on Better Confidence and Weather

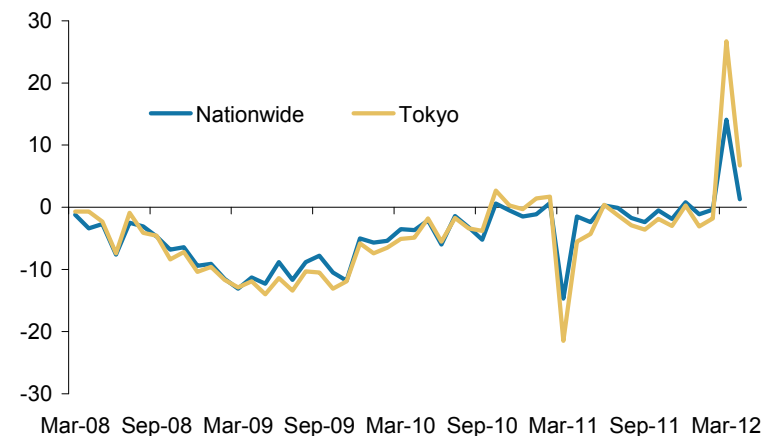
Core CPI (YoY %)



Source: MIC, Bloomberg, Morgan Stanley Research

Tokyo's wider negative inflation indicates a slowdown ahead for the nationwide figure

Department Store Sales (YoY %)



Source: JDSA, Bloomberg, Morgan Stanley Research

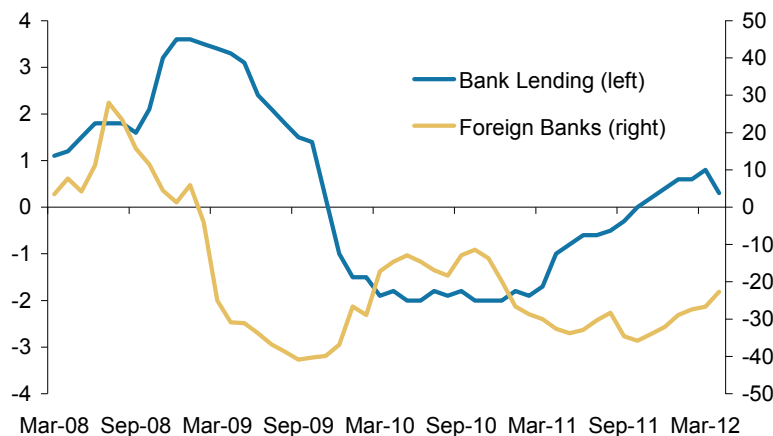
Department store sales rose for the second straight month, though at a slower pace

4. Japan Recovering in a Shaky World

Lending Activity in Mild Recovery Amidst Rising Loan Demand

Bank lending pulled back but is overall in mild recovery

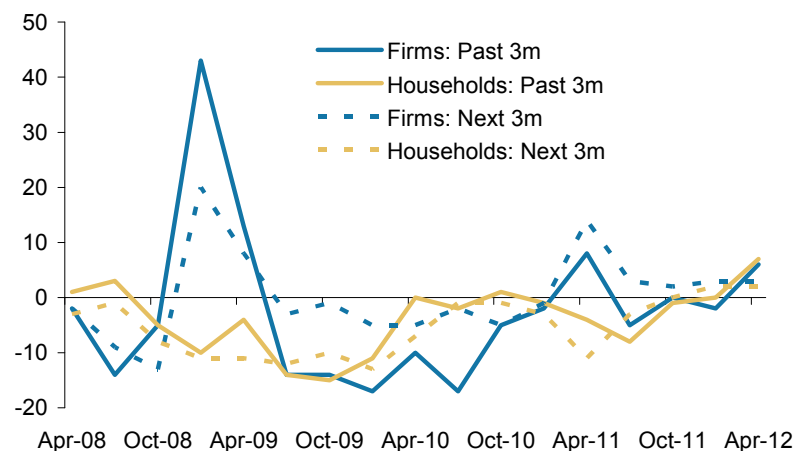
Bank Lending (YoY %)



Source: BoJ, Bloomberg, Morgan Stanley Research

The Senior Loan Officer Survey showed a large improvement in demand for funds

Senior Loan Officer Survey



Source: BoJ, Bloomberg, Morgan Stanley Research

5. China's Poor Data Urges Easing

Economic Dashboard: China

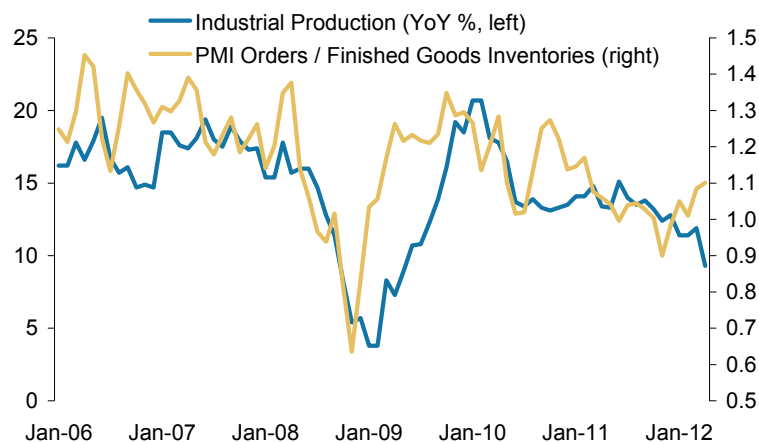
	6-mo Trend	Prev.		Latest
Indicators				
Leading Indicator (Apr)		100.5	↘	99.9
Coincident Indicator (Apr)		98.4	↘	97.8
Business Conditions				
CFLP PMI Mfg (May)		53.3	↘	50.4
CFLP PMI Non-Mfg (Apr)		58.0	↘	56.1
HSBC PMI Mfg (Apr)		48.3	↗	49.3
HSBC PMI Services (Mar)		53.9	↘	53.3
Economic Activity				
Val-Added of Industry (YoY %) (Apr)		11.9	↘	9.3
FAI ex-Rural (YTD YoY %) (Apr)		20.9	↘	20.2
Trade				
Trade Balance (\$bn) (Apr)		5.4	↗	18.4
Imports (YoY %) (Apr)		5.3	↘	0.3
Exports (YoY %) (Apr)		8.9	↘	4.9
FDI (YoY %) (Apr)		-6.1	↗	-0.7

	6-mo Trend	Prev.		Latest
Prices				
CPI (YoY %) (Apr)		3.6	↘	3.4
PPI (YoY %) (Apr)		-0.3	↘	-0.7
Consumer				
Consumer Confidence (Apr)		100.0	↗	103.0
Retail				
Retail Sales (YoY %) (Apr)		15.2	↘	14.1
Passenger Car Sales (YoY %) (Apr)		3.9	↗	11.7
Housing				
70-City Property Price Index Avg (Apr)		103.5	↘	103.2
Financial				
M2 (YoY %) (Apr)		13.4	↘	12.8
New Loans (RMB bn) (Apr)		1011.4	↘	681.8
Total Loan Growth (YoY %) (Apr)		15.7	↘	15.4
Policy Rate (%) (May)		6.6	↘	6.6
RRR (%) (May)		20.5	↘	20.0

5. China's Poor Data Urges Easing**Industrial Production and Fixed Asset Investment Signal Growth Moderation**

Industrial production failed to extend its March rebound, reflecting weakening real demand

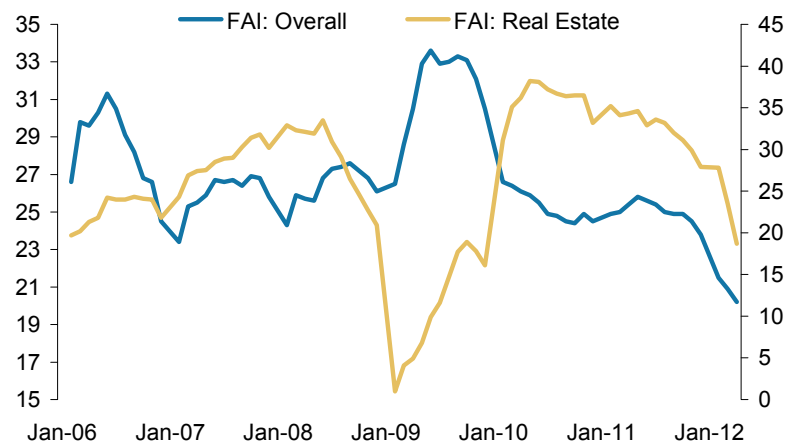
Industrial Production, PMI Orders / Finished Goods Inventories



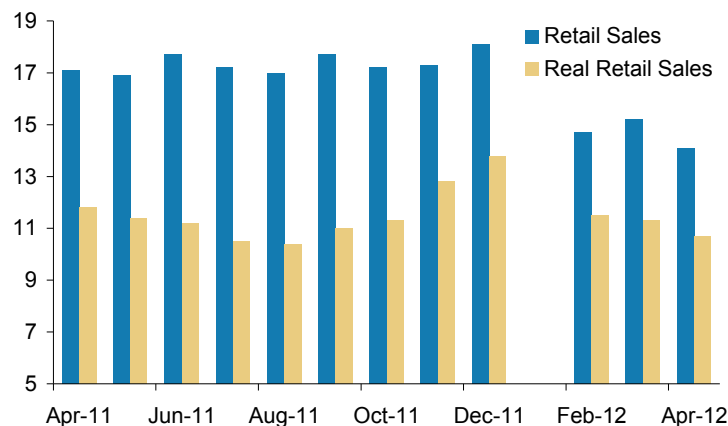
Source: NBS, CFLP, Haver Analytics, Morgan Stanley Research

Fixed asset investment slowed from a sharp fall in property investment growth

Fixed Asset Investment (YoY %)

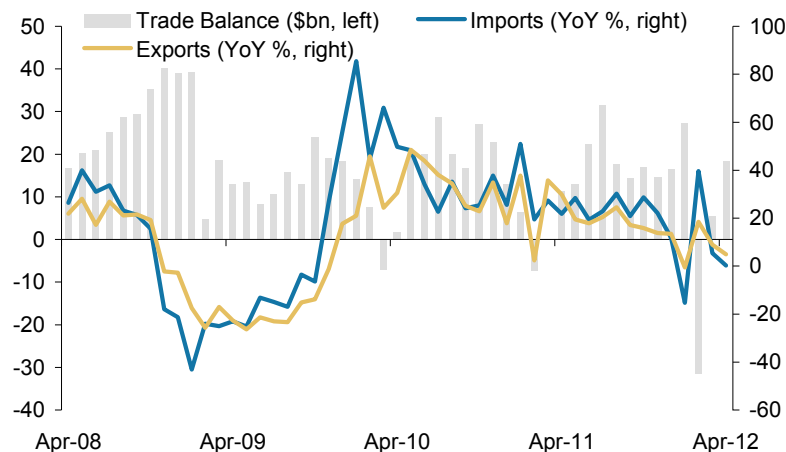


Source: NBS, Haver Analytics, Morgan Stanley Research

5. China's Poor Data Urges Easing**Domestic Demand Unimpressive But Pro-Consumption Policy Measures Should Help****Retail Sales (YoY %)**

Retail sales were disappointing, particularly given the favorable backdrop of pre-Golden Week promotional sales

Source: NBS, CEIC, Morgan Stanley Research

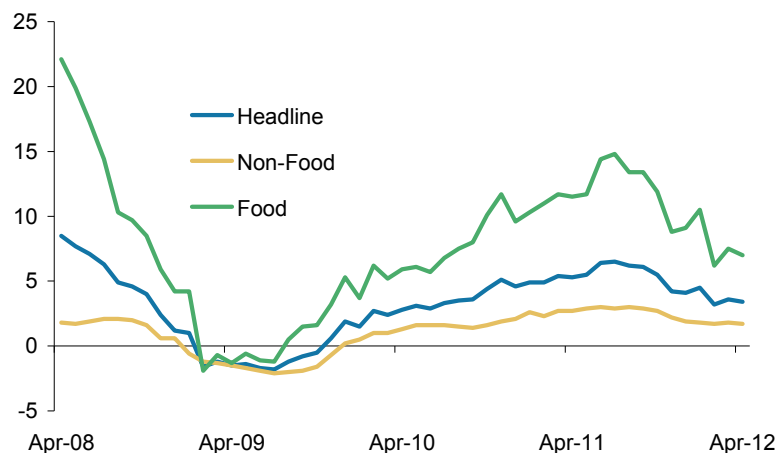
Trade Balance

Trade growth momentum is slowing, though seasonally adjusted sequential growth in imports accelerated

Source: CEInet, Bloomberg, Morgan Stanley Research

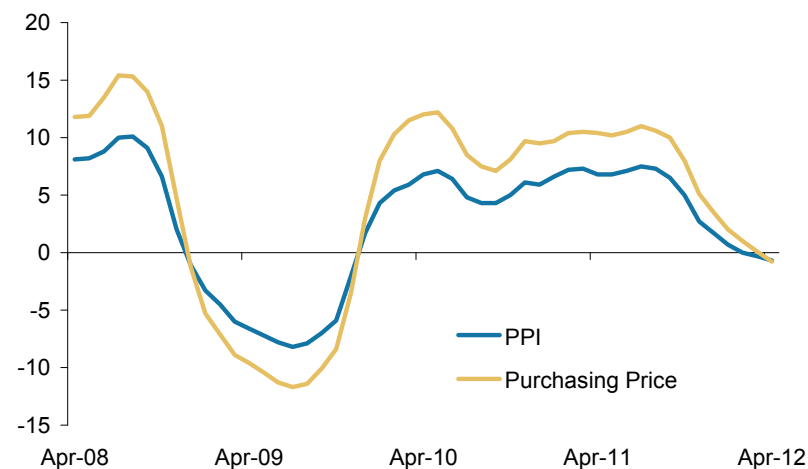
5. China's Poor Data Urges Easing**Inflation Should Remain Well-Anchored in Coming Months**

Headline CPI inflation eased while non-food continued to stay suppressed

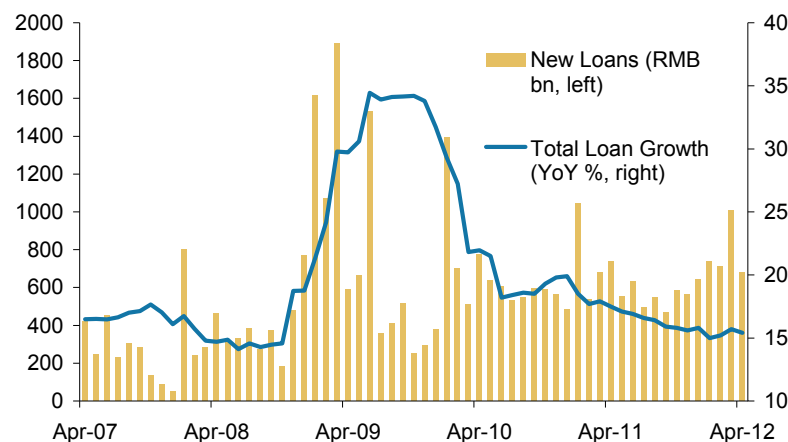
CPI (YoY %)

Source: CEInet, Bloomberg, Morgan Stanley Research

PPI inflation dipped significantly from moderating demand and falling commodity prices

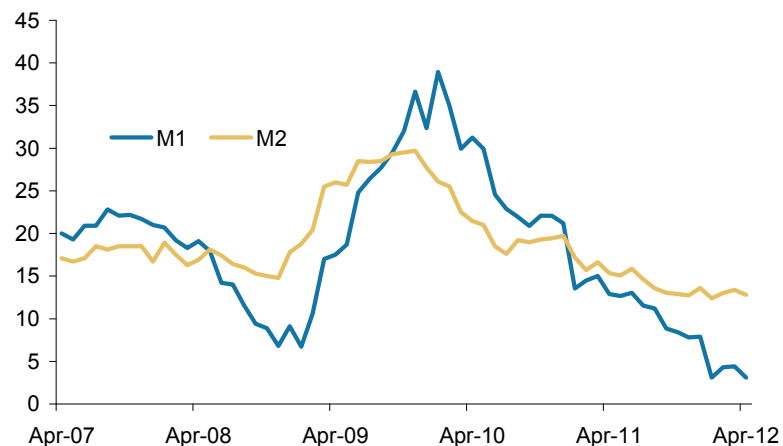
PPI, Purchasing Price (YoY %)

Source: CEInet, CFLP, Bloomberg, Morgan Stanley Research

5. China's Poor Data Urges Easing**Slowdown in New Loans, Total Loans, and Money Supply****Lending**

Source: CEInet, Bloomberg, Morgan Stanley Research

New loan creation is challenged despite adequate inter-bank liquidity; short-term loans are still dominating due to moderating growth

Money Supply (YoY %)

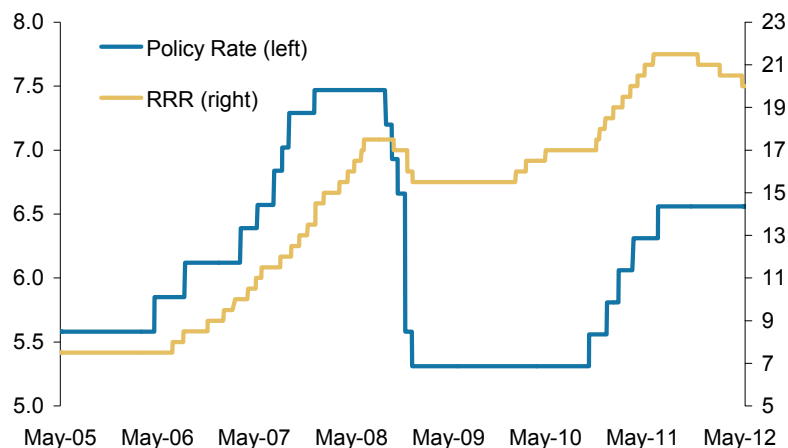
Source: PBoC, Bloomberg, Morgan Stanley Research

M2 growth slowed on seasonal effects while M1 growth slowed from overall economic sluggishness

5. China's Poor Data Urges Easing**Disappointing Data Releases Pave the Way for More Urgent and Effective Easing**

The PBoC's 50bp RRR cut came earlier than expected, signaling more aggressive easing

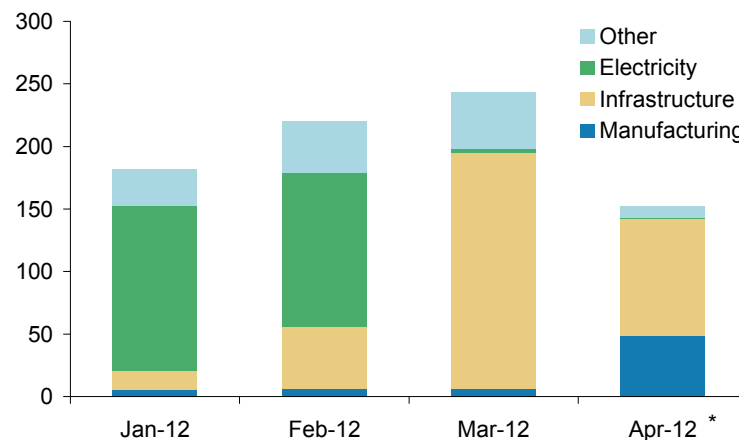
Policy Rate, RRR (%)



Source: PBoC, Bloomberg, Morgan Stanley Research

The NDRC has sped up project approval during recent months, with a bias towards infrastructure investment

NDRC Project Approvals (#)



Source: NDRC, Morgan Stanley Research

*Note: April data not yet complete

6. EM Moderating Further

Economic Dashboard: EM

	6-mo Trend	Prev.		Latest
PMI Mfg				
India (May)		54.9	↘	54.8
Korea (May)		51.9	↘	51.0
Taiwan (May)		51.2	↘	50.5
Brazil (May)		49.3	↘	49.3
Mexico (Apr)		52.1	↗	52.3
Turkey (May)		52.4	↘	50.2
Poland (May)		49.2	↘	48.9

Industrial Production (YoY %)

India (Mar)		4.1	↘	-3.5
Korea (Apr)		0.7	↘	0.0
Taiwan (Apr)		-3.4	↗	-2.3
Brazil (Apr)		-1.9	↘	-2.9
Mexico (Mar)		6.1	↘	3.1
Turkey (Mar)		1.6	↗	2.5
Poland (Apr)		0.7	↗	2.9

Imports (YoY %)

India (Apr)		24.3	↘	3.8
Korea (May)		-0.2	↘	-1.2
Taiwan (Apr)		-5.8	↗	2.1
Brazil (Apr)		-4.0	↘	-7.5
Mexico (Apr)		3.2	↗	12.1
Turkey (Apr)		-4.8	↘	-8.0
Poland (Mar)		6.9	↘	3.3

Exports (YoY %)

India (Apr)		-5.7	↗	3.2
Korea (May)		-4.8	↗	-0.4
Taiwan (Apr)		-3.2	↘	-6.4
Brazil (Apr)		9.8	↘	1.6
Mexico (Apr)		3.4	↗	11.6
Turkey (Apr)		12.2	↘	6.8
Poland (Mar)		6.2	↘	5.9

	6-mo Trend	Prev.		Latest
CPI (YoY %)				
India (WPI) (Apr)		6.9	↗	7.2
Korea (May)		2.5		2.5
Taiwan (Apr)		1.3	↗	1.4
Brazil (Apr)		5.2	↘	5.1
Mexico (Apr)		3.7	↘	3.4
Turkey (Apr)		10.4	↗	11.1
Poland (Apr)		3.9	↗	4.0

Retail (YoY %)

India: Auto Sales (Apr)		19.7	↘	3.4
Korea: Dept Store Sales (Apr)		1.6	↘	-3.4
Taiwan: Comm Sales (Apr)		-0.9	↘	-2.4
Brazil: Retail Sales (Mar)		10.6	↗	12.5
Mexico: Retail Sales (Mar)		7.6	↘	4.3
Turkey: Auto Sales (Apr)		-17.4	↘	-19.6
Poland: Retail Sales (Apr)		10.7	↘	5.5

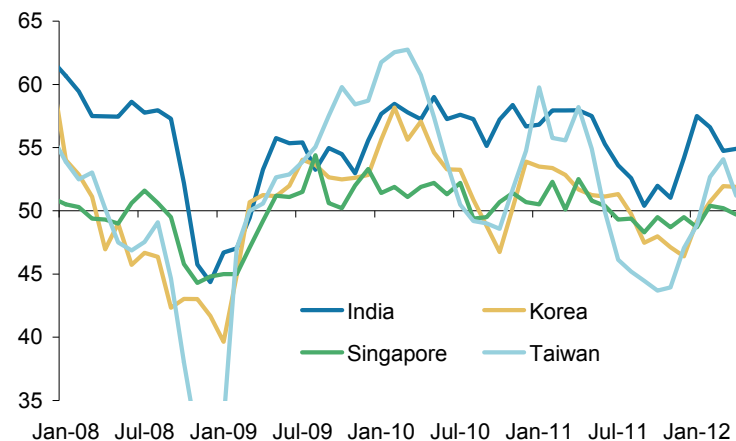
Policy Rate (%)

India (May)		7.0		7.0
Korea (May)		3.3		3.3
Taiwan (Mar)		1.9		1.9
Brazil (May)		9.0	↘	8.5
Mexico (May)		4.5		4.5
Turkey (May)		5.8		5.8
Poland (May)		4.5	↗	4.8

6. EM Moderating Further

PMIs Point to Slowing Manufacturing Activity

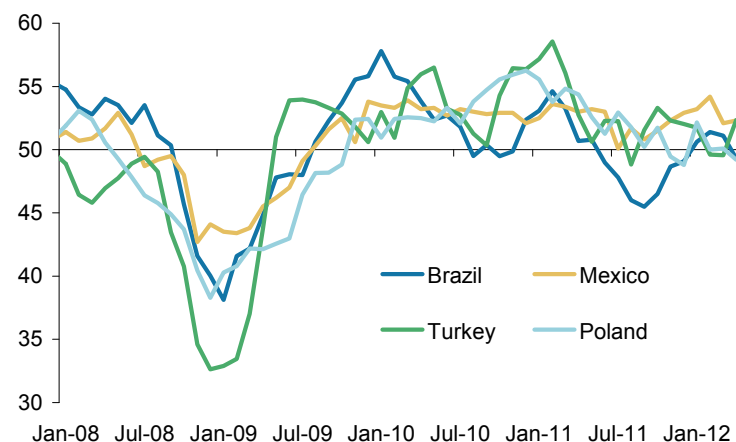
PMI Manufacturing (level)



PMIs improved slightly in India and Korea but dropped in Singapore and Taiwan

Source: HSBC, Markit, Haver Analytics, Morgan Stanley Research

PMI Manufacturing (level)



PMIs in Brazil and Poland dipped below 50 while Turkey's is back above 50

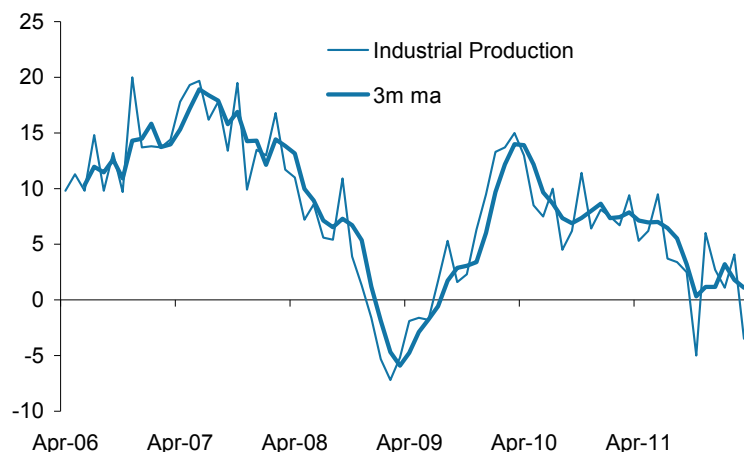
Source: HSBC, Markit, Haver Analytics, Morgan Stanley Research

6. EM Moderating Further

Moderating Industrial Production Across Countries

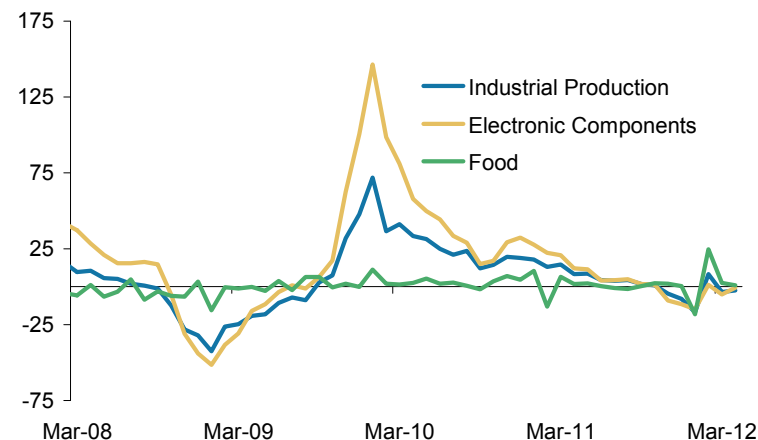
Industrial production in Taiwan more or less slowed across all manufacturing categories...

India Industrial Production (YoY %)



Source: CSO, Bloomberg, Morgan Stanley Research

Taiwan Industrial Production (YoY %)



Source: MOEA, Haver Analytics, Morgan Stanley Research

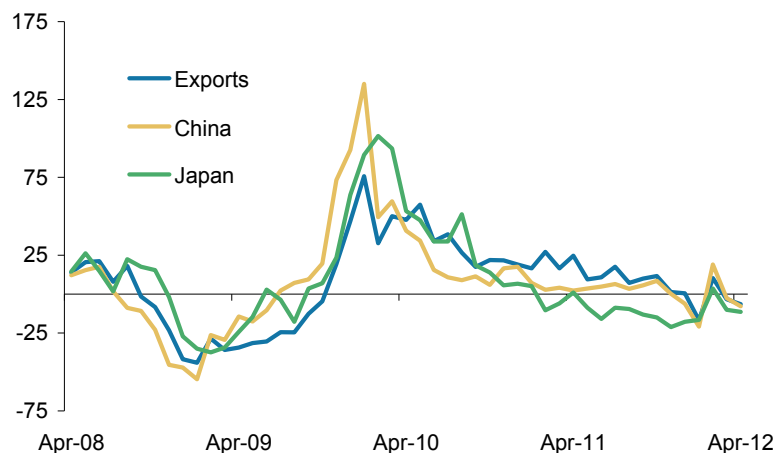
...But India's print may be overstating growth deceleration as other indicators (e.g., corporate revenue growth) do not fully agree

6. EM Moderating Further

Trade Numbers Underscore Underwhelming External Demand

Taiwan's declining exports highlight the weak macro environment in mainland China

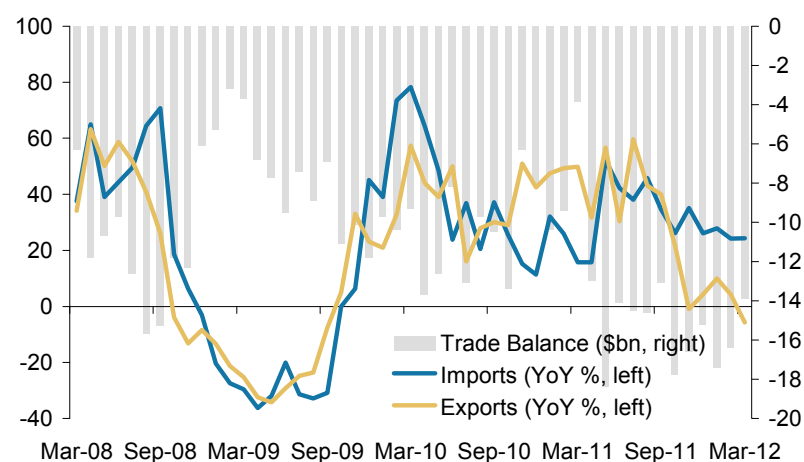
Taiwan Exports (YoY %)



Source: MOEA, Bloomberg, Morgan Stanley Research

India's export growth turned negative for the first time since 2009 on shaky DM demand

India Trade

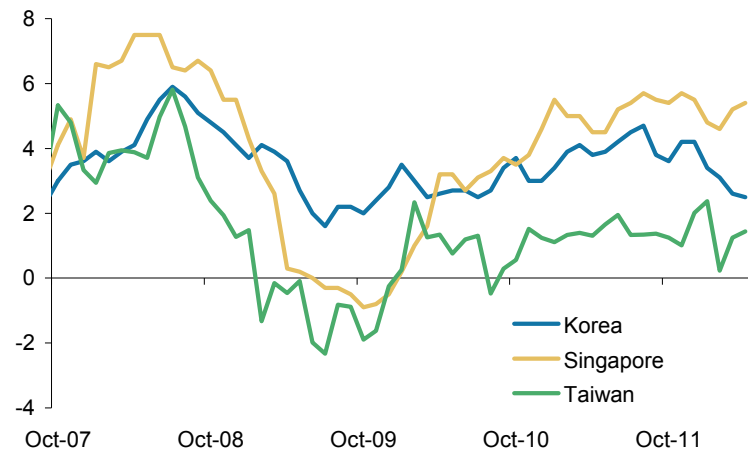


Source: DGCI&S, Bloomberg, Morgan Stanley Research

6. EM Moderating Further

Upside Risks to Inflation May Be Alive

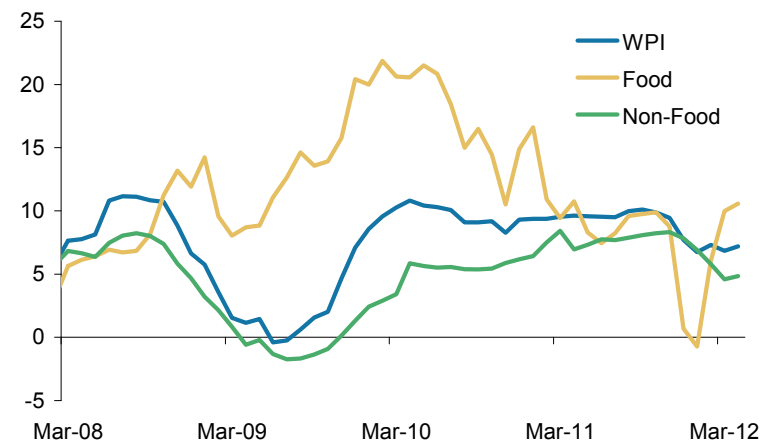
CPI (YoY %)



Source: National sources, Bloomberg, Morgan Stanley Research

Inflation crept up in Singapore and Taiwan but fell in Korea due to government subsidies

India WPI (YoY %)



Source: Ministry of Commerce & Industry, Haver Analytics, Morgan Stanley Research

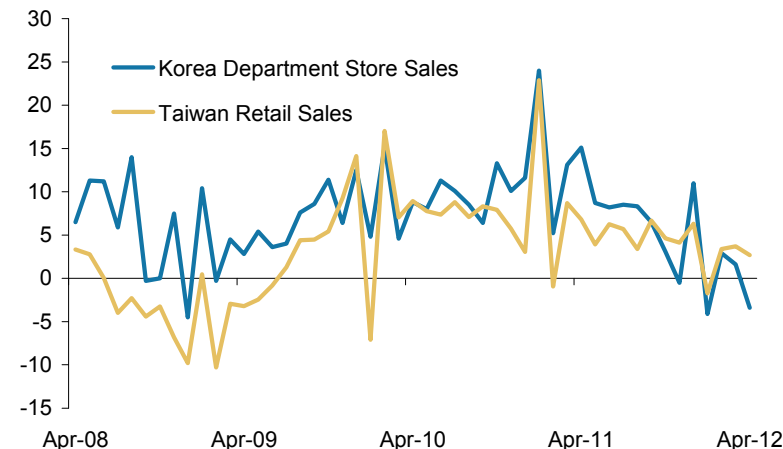
India's inflation accelerated and may continue to rise on FX depreciation and fiscal deficit amidst weak private investment

6. EM Moderating Further

Domestic Demand Remains Uninspiring

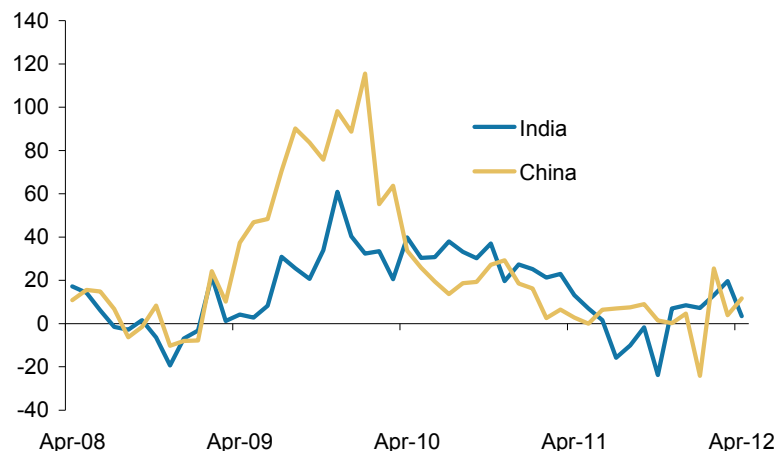
Korea's department store sales plunged while Taiwan's retail sales are backed by decent consumer confidence, a resilient labor market and tourism

Korea, Taiwan Department Store, Retail Sales (YoY %)



Source: KNSO, MOEA, Bloomberg, Morgan Stanley Research

India, China Passenger Car Sales (YoY %)



Source: SIAM, CAIN, Bloomberg, Morgan Stanley Research

India's passenger car sales were hit by higher interest rates and fuel prices, on top of excise duty hikes