November 30, 2014

MORGAN STANLEY RESEARCH

2015 Outlook

2015 Global Strategy Outlook
Onwards and Upwards

The Cycle Has Further to Go. Improving growth, bottoming inflation, and still-accommodative central banks present a supportive backdrop for equities and credit in 2015, in our view. Valuations, while above-average, are not extreme enough to spoil the party.

Melt Up > Melt Down. Amidst concern that global growth is too weak, markets are too dismissive of a scenario where improving growth, easy policy, and greater confidence lead valuations to overshoot. Outcomes for the next year, in our view, are positively skewed.

Equities: It Ain't a Bubble Yet. We raise our price targets for Japan and US equities and lower them in EM. We think our most differentiated views are at the sector level. In the US we are upgrading Energy, downgrading Healthcare, and are O/W Small Caps. In Europe, we are O/W Cyclicals and U/W Defensives. In EM, we are O/W China despite the slowing economy.

FX: Debt and Dollars. We see significant USD gains in the year ahead, especially against the EUR, JPY, and AUD. In EM, we think the fall in oil will help INR, while KRW, ZAR and BRL underperform.

Government Bonds: Know When to Walk Away. We forecast modest yield increases next year, but see the largest divergences at the long-end, where 30yr EUR rates are near their richest levels in history to the US and could materially underperform.

Corporate Credit: Contrasting Cycles. US credit lagged in 2014 on fears the cycle may be turning. It isn't, in our view, and this offers an attractive entry point in US IG and HY. Elsewhere, we upgrade Asia credit to E/W, forecast modestly wider spreads for EM debt, and see a high probability that the ECB buys corporate bonds next year.

Securitized Credit: CLOs and Non-Agency over CMBS. CLO AAAs, at L+155, offer attractive risk premium, while Non-Agency RMBS should benefit from continued healing in US housing. We downgrade CMBS to Neutral, on concerns of heavy supply in the year ahead.

Volatility: Buy it in Rates & FX, wait in Equities & Credit. We think equity and credit volatility could still move lower before the cycle ends, but see good opportunities to buy volatility in FX and Rates.

Top Trades – 15 for 2015. We list our top 15 global trades for the year ahead, spanning a variety of market exposures.

MORGAN STANLEY RESEARCH
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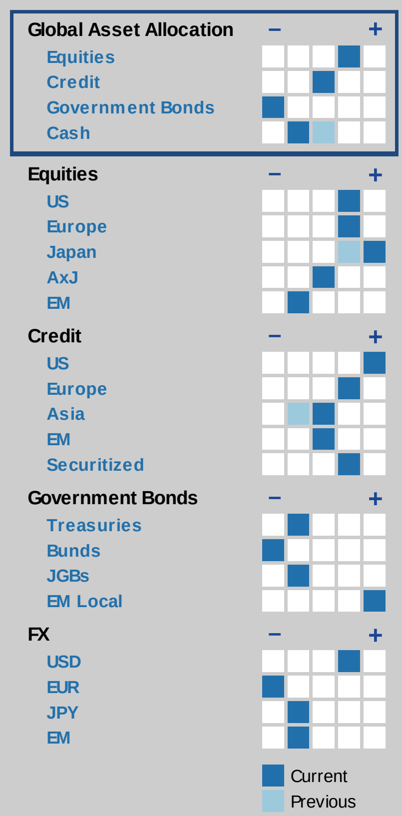
MS Cross Asset Allocations



Note: For a 6-12m view. See Page 31 for Details.

Note: Adam Parker, Graham Secker and Jonathan Garner are Equity Analysts and they are not opining on fixed income securities. Their views are clearly delineated.

Due to the nature of the fixed income market, the issuers or bonds of the issuers recommended or discussed in this report may not be continuously followed. Accordingly, investors must regard this report as providing stand-alone analysis and should not expect continuing analysis or additional reports relating to such issuers or bonds of the issuers.

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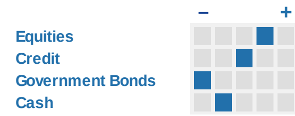


Cross-Asset Strategy: Melting into Winter

Andrew Sheets
Phanikiran Naraparaju
Serena Tang

Key Investment Themes

- Improving growth, bottoming inflation, still-easy policy, moderate valuations, and expectations of a long cycle lead to a generally **constructive base case for 2015**.
- Around this, we think outcomes **are positively skewed**; the risk of a "melt up" toward overvaluation is higher than a "melt down" from collapsing growth.
- **Weaker growth**, not higher rates, **is the key risk** to markets, and we are mindful that the disconnect between equity and rates markets is far from resolved.
- **Where we differ:** Relative to consensus, we expect higher US credit returns, larger moves in the dollar and key FX crosses, better performance in USD duration relative to EUR duration, and have materially different preferences for equity sector positioning.

At first glance, the problem with next year is how little the story has changed. The US is (still) in a modest recovery, Europe is (still) struggling to grow, Japan is (still) battling deflation, and China is (still) attempting a controlled slowdown amid difficult economic reforms. Valuations in stocks and credit have moved higher but are (still) not extreme, bond yields are (still) low, and central bank policy is (still) accommodative. In an investing world that lives on bold calls and big changes, it doesn't exactly light your socks on fire.

Yet below the surface a number of shifts may be at work. On our forecasts the trade-weighted US dollar finally breaks out of a 30-year bear market and rises by a further 7% (and even more against the EUR and the JPY). US credit, far from being late in the cycle, should post respectable gains. European long-end rates, at all-time lows and priced for full-fledged "Japanification", suffer a major reversal on our numbers. Volatility markets, bent out of shape by late-year price action, offer a number of interesting opportunities.

In short, there is much at stake. The next several pages provide a short summary of how we expect a number of the market's key debates to break, while the ensuing asset-class sections provide a more granular take on what we expect and how to position.

The Macro Backdrop Looks Supportive

Our economic forecasts for 2015 have global growth improving (from 3.2% to 3.5%), G3 inflation bottoming, and China managing a controlled slowdown to ~7% growth. Despite this easing of global growth fears, we think central banks maintain an accommodative bias, being more scared that growth and inflation will come in too low than too high. We expect the Fed to not hike until 1Q16, the odds of Sovereign QE by the ECB to rise to 50%, the BoJ to remain dovish, and the PBoC to ease further. Better growth, bottoming inflation, still-worried central banks, and low real rates present a supportive combination, especially in light of what we expect to be an unusually long and unsynchronized global cycle (see What the Cycle Means for Returns, November 19 2014)

Exhibit 1
Key Economic Forecasts for 2015

	GDP		CPI	
Region	**'14e**	**'15e**	**'14e**	**'15e**
Global	**3.2%**	**3.5%**	**3.5%**	**3.6%**
US	2.2%	2.9%	1.7%	1.3%
EA	0.8%	1.0%	0.5%	0.9%
JP	0.2%	0.6%	1.4%	1.5%
EM	**4.5%**	**4.6%**	**5.2%**	**5.3%**
CHN	7.3%	7.0%	2.0%	2.0%
IND	5.3%	6.3%	7.3%	6.0%

Source: Morgan Stanley Research Forecasts. Note: Inflation is headline inflation.

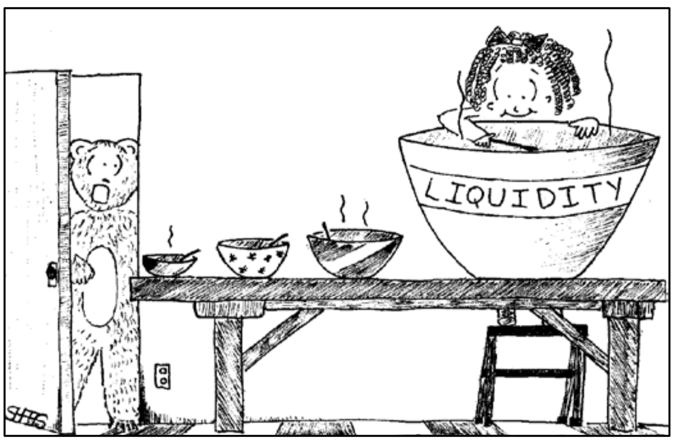
In addition, given our economists' long-running focus on "broken" EM growth models, it is worth noting important progress. China is *choosing* to run a high real rate policy – bad for indebted corporates but ultimately good for the longer-run allocation of capital. India has moved to market-driven fuel prices and is undertaking other reforms that should improve its current account. Indonesia cut fuel subsidies and raised real interest rates. While more challenging stories exist in Russia, Brazil, and South Africa, the first three examples offer a positive reform trajectory in nations that 2.9 billion people call home.

But recall that Goldilocks had *Three* Bears

Our economic base case presents an attractive middle road, with growth and inflation improving but central bank policy remaining highly accommodative. It smacks of "Goldilocks", but only if we consider the story's *full* cast of characters.

References to that fable (which are numerous in this business) tend to focus on baby bear, whose chair size, food temperature, and bed firmness offered an attractive middle ground. Less attention is given to Mama and Papa bear, who are incensed that someone broke into their house and force the intruder to flee into the woods. In similar fashion, our Outlook requires paying respect to risks that growth is hotter or colder than our benign base case.

Too Hot (Papa Bear): The US offers the greatest risk of activity surprising to the upside and triggering a central bank response, given economic conditions which look increasingly normal compared to the extraordinary Fed policy we have experienced. Vulnerability to this scenario has risen, as the market's expected timing of the first hike has been pushed out closer to our own longstanding 1Q16 view. We think the market's conviction around the timing of rate lift-off is low and could swing rapidly if data surprises to the upside. Recent weakness in US credit needs to be watched as another sign that the US cycle is more advanced than we believe it to be.



Too Cold (Mama Bear): Europe, Japan, and China present the risk that growth is "too cold", undermining confidence in the global recovery and central bank credibility. Europe is still struggling to regain economic momentum more than five years after Lehman failed; Japanese GDP contracted last quarter; and China continues to decelerate. Inflation breakevens, commodity prices, and long-end bond yields all sit near their year-to-date lows, suggesting a scenario where growth and inflation are too cold remains very much in play.

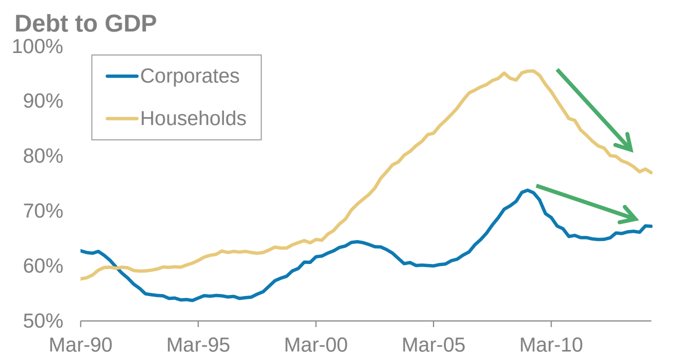
Between these risk scenarios, **we remain far more concerned about a growth disappointment**. Yes, an early first Fed rate hike would drive volatility. But ultimately (and perhaps heretically) we don't think an early rate rise will be all that damaging on a full-year view. There are three reasons:

First, in the last 30 years, credit and equity returns have tended to be *good* in periods when the dollar and 2yr yields move higher (see A Fistful of Dollars, September 23 2014). An early hike would only happen under stronger US growth, which history suggests frequently produces more positives than negatives.

Second, we do not believe higher yields are a "pain trade". Investors are cautious on duration given valuations. Insurers and pension funds, globally, are eager to buy bonds at higher yields. Both mitigate the pain of a move higher.

Third, we believe the US cycle has further to run and is robust enough to absorb higher rates without derailing the recovery. Consumers have paid down debt, corporate leverage looks manageable, and both have termed out their borrowing.

Exhibit 2
US Corporate & Consumer Debt / GDP Have Fallen



Source: Morgan Stanley Research, Federal Reserve, Datastream

In contrast, a further disappointment of growth and inflation is far more worrisome. It runs directly counter to our "equity over bond" positioning (where we have plenty of company). It is difficult to hedge, given how expensive deflation proxies (like long-dated bonds) have become. And it could trigger a crisis of confidence in central bank policy, as it would imply that even extraordinary levels of accommodation are still not enough.

For these reasons, **investors should place a *premium* on *reasonably priced* hedges against a growth or inflation disappointment**, a theme we'll address in more detail later.

"Melt Up" over "Melt Down"

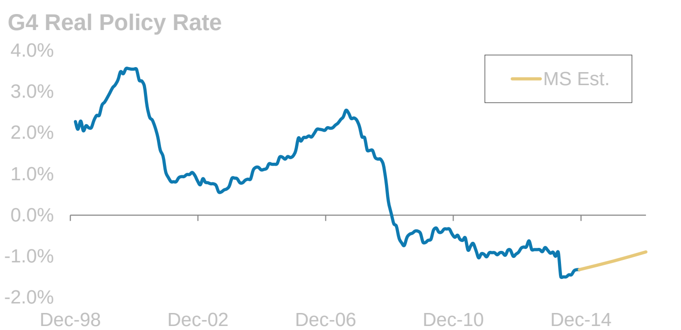
Troubling as these risks are, we think a defining factor of 2015 is that an *upside* scenario outweighs them. Thanks to the confluence of easy policy, improving growth, and not-yet-extreme valuations, a "melt up" scenario (where asset values move into clearly overvalued territory) is plausible and introduces a positive skew to our base case. With the S&P 500 at all-time highs, global borrowing costs near historical lows, and our forecasts of a much stronger dollar, some explanation is required. Our argument has four legs:

1) Our Forecasts Dangle a Positive 2nd Derivative … Long-end yields, inflation breakevens, commodity prices, and a fair share of investor meetings all suggest dismal long-term growth expectations. Yet as we move into next year, our forecasts suggest it will be increasingly clear that global growth and inflation have bottomed, which is important for a market that loves to extrapolate. **Our commodity team's expectation for some stability in oil prices next year** from current battered down levels could also help shift macro sentiment.

2) …Coupled with Easy Policy … This 'turn' in growth and inflation would collide with central bank policy that remains, by nearly all measures, highly accommodative. At the short end, the average G4 real policy rate is still 200bp below the *trough* of the 2000-2004 cycle. At the long end, G4 10yr bond yields remain *well* below nominal GDP.

Exhibit 3

Real Policy Rates to Stay Unusually Low into 2016



Source: Morgan Stanley Research Estimates, Bloomberg. Note: Based on core inflation.

3) …and Valuations Far from 'Extreme'

For all the talk of markets being 'manipulated' by central bank action, valuations have frequently been more extreme. In Exhibit 4, we plot valuation measures as a *percentile* of their 15-60 year range (depending on data available). The S&P 500's trailing P/E ratio has been higher for one-third of the last 60 years. US IG (BBB-rated) credit spreads have spent over half of the same period tighter than today. Markets may not be cheap, but neither are they frothy, with Japanese and EM equities even less extended versus history. Interestingly, government bonds stand out as the asset class where stretched valuations hint at a large central bank influence.

Exhibit 4

Valuations versus the Long-Run* Distribution

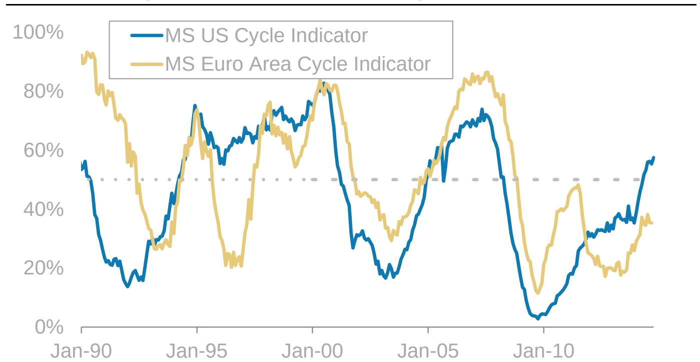
	US	Europe	Japan	EM
Equities (x)				
Trailing PE	17.5	16.8	16.1	12.9
P/B	2.8	1.8	1.4	1.5
CAPE	21.5	15.0	21.2	12.7
Rates (%)				
10Y	2.5	0.9	0.5	5.6
10Y Real	0.8	0.1	-1.8	n/a
10Y - CB Rate	2.2	0.9	0.4	n/a
Credit (bp)				
IG Sprd	166	102	n/a	325
HY Sprd	415	451	n/a	n/a

Source: Morgan Stanley Research. US IG Spread based on US BBB bond spreads. "Long Run" is based on historical data: US Equities: 1954 – Present, US Rates: 1962 – Present, US Credit: 1954 – Present, EU equities: 1969 – Present, EU rates: 1990 – Present, EUR Credit: 1999 – Present, Japan Equities: 1969 – Present, Japan Rates: 1989 – Prense, EM: 1995 – Present.

4) Activity Does Not Look Late Cycle: A counter argument is that conditions have *already* overshot, with little runway left for additional optimism. In response, we would note that our Cycle Models, which aggregate the sensitivity of activity across the macro, credit, and corporate environment, remain well below previous cycle peaks.

Exhibit 5

US & EU Cycle Indicators: Hardly Extreme



Source: Morgan Stanley Research, Bloomberg, Haver

What about recent underperformance of credit relative to equity markets, given that the same occurred (on a larger scale) in 1999 and 2007? Although worth watching, we see several reasons *not* to view this as a "canary in the coalmine". Corporate balance sheets are in better shape than during both those periods. The divergence between the two markets is still modest in historical terms. And on our credit team's forecasts, US spreads will reverse course and rally next year.

We don't mean to belittle the challenges of the year ahead. Valuations are not cheap, sentiment is not bearish, and global growth is still uncertain. Yet for a variety of reasons detailed above, we think the bull case for 2015 is larger than the bear.

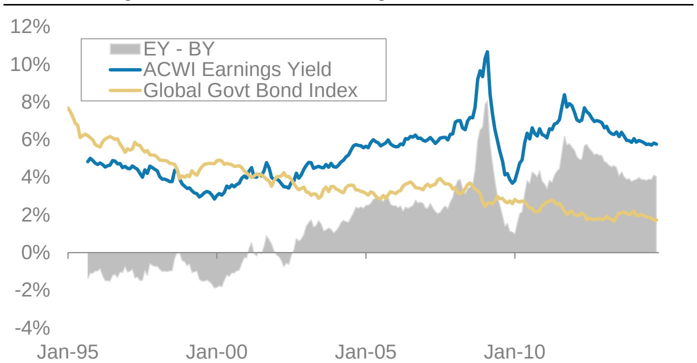
Strategies & Key Themes for 2015

Improving growth, bottoming inflation, and accommodative central bank policy present a constructive base case, and for reasons above we see a positive skew around this. From a portfolio perspective, we remain constructive, although several factors, especially our call for the dollar to strengthen by 7% next year, mean the devil is in the details.

By Asset Class – Equities and Credit over Rates: Relative valuations and our expectation that the cycle extends further than usual support overweights in equities relative to government bonds, across DM. We think this argument is strongest in Europe and Japan despite a weaker economic backdrop, due to these two markets enjoying larger gaps in stock and bond valuation, currency tailwinds, and more dovish central bank policy.

Exhibit 6

Global Equities Remain Cheap to Global Bonds



Source: Morgan Stanley Research, MSCI, JPM, Datastream, RIMES

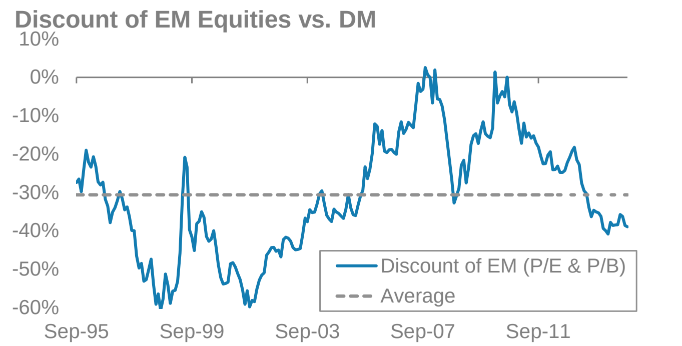
Credit is harder, but policy remains accommodative, rate volatility stays low on our forecasts, and demand for 'income' remains high. We keep credit slightly below equities but above government bonds, preferring US Leveraged Finance among lower-rated markets and Securitized Credit within higher ratings.

By Region – Stay with DM over EM: We see better risk-adjusted returns in Developed than Emerging Markets, in both credit and equities, in the year ahead. Our expectation for dollar strength (which we think will weigh more heavily on EM) is one reason, but so are relative valuations. Despite four years of EM underperformance, EM's discount to DM is not extreme, especially in light of continuing macro challenges.

In equities, for example, the "discount" of EM stocks relative to DM (averaging P/E and P/B) remains close to the 20-year average. In fixed income, the discount of EM credit to US high yield credit is similarly close to historical norms.

Exhibit 7

EM's Discount to DM Equities Isn't Extreme

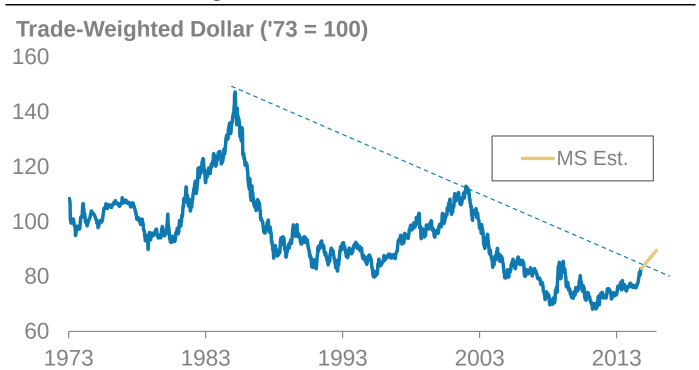


Source: Morgan Stanley Research, RIMES, MSCI, Bloomberg. Using trailing P/E.

The US Offers the Best Credit and Currency Markets: One of the biggest surprises for 2015 could be the strength of US credit returns. In contrast to fears around this asset class being late-cycle, we think modestly higher rates, tame inflation, better growth, and decent balance sheets can lead IG, high yield, and leverage loans spreads tighter. Forecast excess returns in both markets (3.1% and 6.2%, respectively) would be in the top 20% and 35% of observations, respectively, since 1989.

Exhibit 8

US Dollar Exiting 30-Year Bear Market



Source: Morgan Stanley Research Estimates. Bloomberg.

On the dollar, we expect it to appreciate next year. So do most analysts. Where we differ is the magnitude. We see the trade-weighted dollar appreciating by 7% in 2015, by 11% against the euro and by 7.2% against the yen. Historically extreme bond yield differentials, growth differentials, and expected policy paths are part of our bullish story. But so is valuation. The USD has been in a 30-year bear market, and we think it has much further to go.

Japan offers the best market for equities (currency-hedged) and rate volatility: Given tailwinds from both currency weakness and corporate reforms, we see double-digit earnings growth for the TOPIX in 2015, while the multiple could expand from its current level of 14.7x (the 10-year average is 15.6x). Together, they give us returns of ~20% in our base case, although we would hedge the currency.

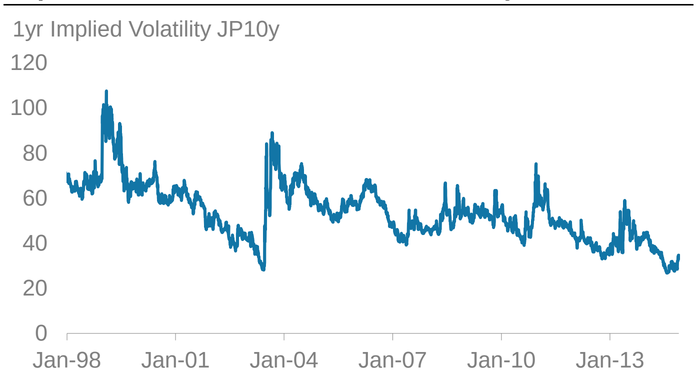
Exhibit 9
Global Equities: Valuations & Expected Growth

	MS EPS Growth*		Fwd PE		Fwd PE	Case
	2015e	2016e	Current	2015e	10Y Avg	Return
US (S&P 500)	7%	7%	15.1x	16.9x	13.8x	10.1%
Europe (MSCI)	10%	9%	13.1x	14.5x	11.7x	11.3%
Japan (TOPIX)	14%	11%	14.5x	14.7x	14.8x	20.1%
EM (MSCI)	6%	9%	10.4x	11.3x	10.9x	7.8%
APxJ (MSCI)	8%	10%	11.4x	12.7x	12.5x	13.3%

Source: Morgan Stanley Research Estimates. MSCI, Bloomberg

Japan also stands out as the most attractive market for buying interest rate volatility. That may sound odd, given a dovish central bank and weak growth, but it is a function of two factors. First, the level of volatility is so low that it won't take much to exceed it. One-year implied volatility on 10-year swap rates is near a 20-year low, *and that's by the standards of Japan*.

Exhibit 10
Japan Rate Vol: A Reversal from the 15yr+ Lows?



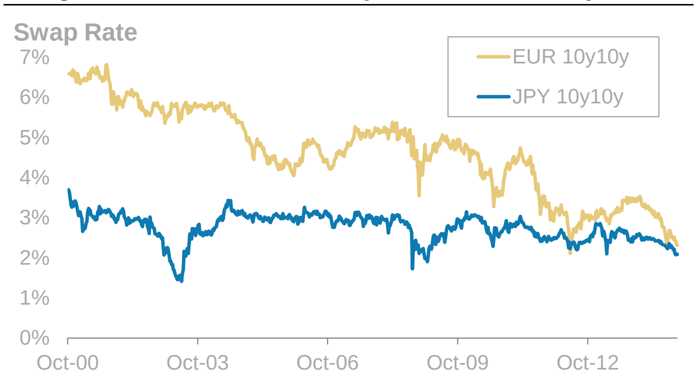
Source: Morgan Stanley Research

Second, Japan's macro environment may be more binary than markets are discounting. Both the government and central bank look highly committed to getting inflation expectations higher. They have committed enormous resources to this and engineered a 30%+ decline in the currency and an 90%+ appreciation in the stock market. Are markets really so confident that 10-year rates won't move at all?

Europe Offers the Most Inconsistency: Europe was a market darling this time last year, then became a pariah. As growth and inflations faded, hopes of a "reflation" trade have given way to the view that Europe is going the way of Japan in the 1990s. Interestingly, different markets appear to be cherry-picking different parts of this narrative.

30-year German rates at 1.7% imply *extremely* weak growth and inflation for an *extremely* long period of time, and European equities are similarly priced for low terminal growth and little margin improvement. Yet Eurozone inflation markets assume 5-year inflation will be back at 1.8% by 2019, only just shy of the ECB's target, and sovereign yields hardly suggest the fiscal stress that another ten years of terrible growth would produce.

Exhibit 11
Long-End EUR Rates *Already* Trade Flat to Japan



Source: Morgan Stanley Research, Bloomberg

Not only does the pricing of "Japanification" look inconsistent, but the scenario itself feels unlikely. Our forecasts for growth and inflation *suggest it will be avoided*, thanks (in part) to more central bank accommodation and faster banking sector cleanup than Japan employed in the 1990s.

If not avoided, "Japanification" does not seem as benign as sovereign spreads or rate volatility imply. A decade of negligible growth and inflation looks difficult for the Eurozone to withstand. Europe lacks the fiscal union, political cohesion, and internally-funded borrowing that all worked in Japan's favor. EU debt levels would deteriorate meaningfully under a "lost decade".

Against this backdrop, our views are closely linked to how much growth is already priced in. **We like European Equities (especially cyclicals) and European ABS**, the former already being priced for weak growth and the latter enjoying substantial protection in the event it occurs. We'd be short 5y5y EUR breakeven inflation at 1.8% (which looks too high) and EUR 20yr Swap Rates 10yrs forward, which already trade on top of

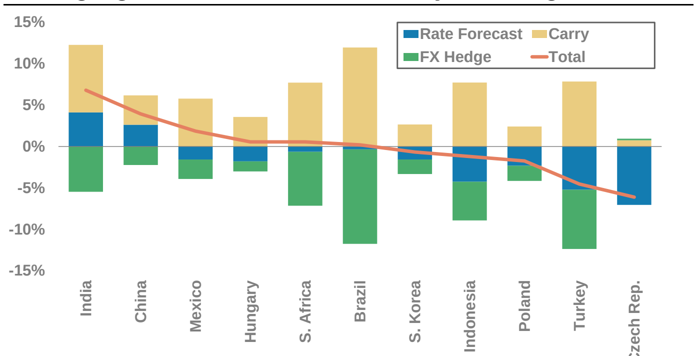
Japan. While we forecast peripheral spreads to tighten, we view them as less attractive on a risk/reward basis.

EM Offers Some of the Most Divergent Stories: Our return forecasts for EM equities, credit, and local rates are positive, but also uninspiring. Expected returns in all three asset classes are low, look worse once adjusted for volatility, and look unfavorable in light of **our strategy of wanting to be paid a *premium* for assets exposed to a growth disappointment.** Yet these numbers also show how misleading averages can be. There is major dispersion within EM on our forecasts, driven by a number of cross-currents.

One of these is oil prices. We see lower oil as a major boon for India, which as an oil importer should benefit from both lower inflation and improved terms of trade. Combined with the potential for optimism over reform, and reasonable valuations, India has a powerful narrative that should boost FX and local bonds. From a cross-asset perspective, **India's positive exposure to lower oil is an attractive complement to US High Yield,** which is vulnerable to crude heading lower.

Exhibit 12

Emerging Markets Should See Major Divergences



Source: Morgan Stanley Research Estimates, Bloomberg. Note: 10yr Bond

But it is not all so straightforward. We are cautious on Malaysia and Russia given commodity exposure, but we like local bonds in Colombia and Mexico (both oil exporters). Despite their being oil importers, we see Turkey and South Africa facing material headwinds from credit growth and commodity prices, respectively.

Our expectations within EM equity markets are similarly divergent. China should outperform on the back of reasonable valuations, continued reform, and targeted central bank easing, while we expect Korea and South Africa to underperform.

Volatility − Not Yet: Expectations of a long cycle, continued central bank accommodation and high implied volatility relative to realized make us believe it is too early to call for a cyclical upturn in credit or equity volatility. FX and rates markets, in contrast, offer better opportunity for volatility buying.

The key risk to our overall positioning remains global growth coming in weaker than expected. We hope, and believe, that this outcome will be avoided and that a positive skew will color the market outlook for the year ahead.

Top Trades for 2015 and Other Details…

In light of our new forecasts, we increase exposure to Japan Equities by 1% in our asset allocation using cash (see page 31). We provide a summary of our key trades (page 9), views on key questions for 2015 (page 10), volatility views (page 27), views on broader asset classes (pages 11-25), and our forecasts, expected returns, and 'risk reward' framework (pages 30-32). A list of 15 trades that provide attractively-priced exposure to different factors is presented overleaf. Below, we focus on a subset that we think differ most from the market consensus.

Long US Credit (IG, HY, Loans, CLO Debt): Fears around impending Fed rate hikes and "late cycle" activity have all weighed on sentiment toward US credit. We think this has set the market up for "one more good year", as our forecasts call for relatively modest yield rises, no Fed hike in 2015, and balance sheet health that looks far from extreme. We forecast IG excess returns near +300bp and High Yield near +600bp, **both high by the standards of the last 25 years**. We also expect Leveraged Loans to do well, in both outright and CLO form.

Expect Bigger FX Moves: Our FX forecasts stand out less for their direction (we, like many, are long the dollar), but for their *magnitude*. We think the dollar gains more, and EUR, AUD, and JPY fall more than forwards, investors, or option markets imply. This is why we like expressing long USD views via FX options.

US Government Bonds Aren't the Underperformer: We agree with the market that US growth should look increasingly divergent from the rest of DM next year. But we disagree that US rates will be the underperformer. Expectations of foreign demand, a later date of Fed 'lift-off', and a steep forward curve mean we see better total returns in US than EU rates, especially at the long end of the curve.

In Equities, note our Sector Views: We're O/W cyclicals versus U/W defensives in Europe, O/W Energy and Consumer Discretionary, Small-Caps versus Large-Caps and Staples in the US, and Overweight China within EM. We think all are (some shade of) anti-consensus, and many are consistent with owning growth at an attractive price.

Morgan Stanley

15 Trades for 2015

	Asset Class	Trade	Level (L) / Target (T)	Rationale	Exposure to Growth	Exposure to Carry	Risks
1	Equities	Long US Small vs. Large Cap	-	Small caps can catch-up as US growth remains reasonable. Small caps benefit more from M&A, have more margin expansion potential, and are less USD sensitive.	↑		US growth slows sharply, dollar weakens
2	Equities	Long EU Cyclicals vs. Defensives	-	Relative valuations are extreme, and cyclicals benefit most from an inflection in growth and/or a weaker euro. We like Industrials, Cons. Disc., dislike Staples, Healthcare, Utilities	↑		ECB disappoints, further commodity weakness affects growth sentiment
3	Equities	Long Japan Equities (TOPIX)	L: 1400 T:1680	Aggressive BoJ action, pension fund allocation shifts, Yen weakness makes Japan the most attractive equity market.	↑		Yen strengthens despite BOJ actions and global growth disappoints.
4	Credit	Long US High Yield	L: 478bp T: 378bp	HY has lagged the recovery in risk assets and valuations are not stretched. We have a window of good growth but a Fed that still hasn't started hiking yet on our forecasts	↑	↑	Further and sustained declines in energy prices; disappointing US growth
5	Credit	Long US Investment Grade	L:124bp T:101bp	US IG has underperformed global spread product and offers a 3%+ excess return driven by financials and consumer sectors and a flatter spread curve.		↑	Lower rates, and a delay in LDI activity, and/or uptick in late-cycle behavior
6	Credit	Greek Government Bonds	Yield L:8.5% T: 6.8%	Attractive yield in a DM currency, even making allowances for leverage. Political risk events in Q1 but recent price declines mean this is in the price.	↑	↑	A very uncertain election in 1Q looming ahead.
7	Securitized Credit	Long US CLO AAAs	Spread L+ L: 155bp T: 140bp	Defensive exposure to one of the attractive asset classes - US loans. Attractive spread product. Slower CLO issuance a favourable factor.		↑	Rates continue to remain low and loans see retail outflows.
8	DM Rates	30yr Rates: Long UST vs. DBR	L: 130bp T: 90bp	UST and Bund yield differentials near all-time high, UST should benefit from foreign flows in a low or sideways growth environment.	↓	↑	A sharp uptick in US growth/inflation
9	DM Rates	Short 5y5y Eurozone Inflation	L: 1.8%	Forward inflation is priced too "normal" given growth and deflation fears elsewhere. Get paid carry for having a deflation hedge.	↓		A weak EUR boosts growth and inflation
10	EM Rates	Long India 10y Local Bonds	Yield L:8.1% T: 7.5%	Attractive carry trades in what remains a low yield world. Decelerating inflation buys RBI room to ease and improving growth provides currency stability.		↑	A sharp improvement in US growth and rise in US yields. Access, liquidity a challenge
11	FX	Short AUDUSD	L: 0.86 T: 0.76	Slowing demand, lower commodity prices set to have further negative terms-of-trade impact alongside domestic economic challenges.	↓	↓	China easing offers some support, commodities bounce back
12	FX	Long INR vs. EUR (or SGD)	EURINR L:77.1 T:69.6	INR remains resilient on improving growth, while decelerating inflation gives RBI room to ease. Weak growth dynamics, low yields, accommodative ECB makes the EUR a funding currency. SGD is also a top choice for funding the INR long.		↑	Pace of India reforms disappoints, oil rises sharply.
13	Equity Volatility	Buy EM Equity Puts	Implied Vol L: 16%	EM equity vol pricing little premium to DM vols, especially Europe. EM earnings trends have been poor and vulnerable to sharp USD rally/rate rises.	↓	↓	A moderate cycle buys EM time through lower rates and limits tail risks .
14	Rate Volatility	Buy OTM Puts on Japanese Rates	Implied Vol L: 34bp	Japan rates vol the cheapest of all regions. BoJ aggressive actions if successful will reprice long-end significantly.		↓	Japanese growth only has a modest pick-up despite BoJ actions.
15	FX Volatility	Buy volatility on USD/ZAR	Implied vol L: 11%	Implied volatility on USD/ZAR near 10-year low and lower than commodity weakness and challenging SOAF macro conditions would suggest.	↓	↓	Accommodative global central banks reduce risks and vol for EM

Source: Morgan Stanley Research, Bloomberg. Note: "Up" arrows indicate an expected positive exposure to growth, or tighter spreads/lower volatility, respectively. "Down" arrows reflect the reverse.

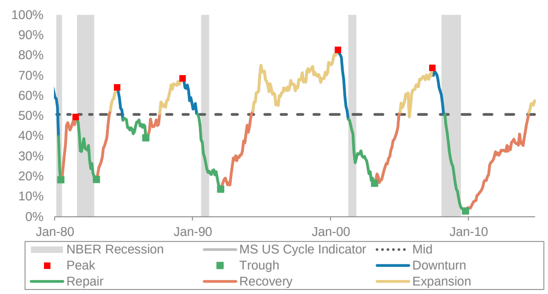
Four Big-Picture Questions for 2015

Is the US "Late Cycle"? *NO*

Like US equities and credit

We do not think the US is 'late cycle', and believe the current expansion still has years to run. Capex remains historically restrained, M&A volumes look less extreme after adjusting for tax-based details, and still-low borrowing costs keep US corporates' interest coverage healthy. Indeed, our US Cycle Indicator suggests that the region has just entered early 'Expansion' phase and that the cycle has much longer to run. This is one reason we are constructive on both US equities and credit.

Morgan Stanley US Cycle Indicator



Source: Morgan Stanley Research, Bloomberg, Haver, NBER

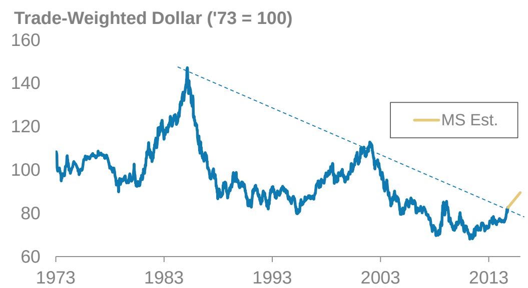
Is the USD breaking out of a 30-year Bear Market? *YES*

Remain bullish on USD

We believe the USD will make further gains, with the trade-weighted dollar appreciating by 7% in 2015, by 11% against the euro and by 7.2% against the yen.

Yes, bullish USD is a consensus trade. But on a trade-weighted basis, valuation does not look extreme at all. Valuations, coupled with historically wide bond yields and growth differentials to other regions, make us continue to see broad-based USD strength in 2015.

Trade-Weighted US Dollar Index



Source: Morgan Stanley Research estimates, Bloomberg

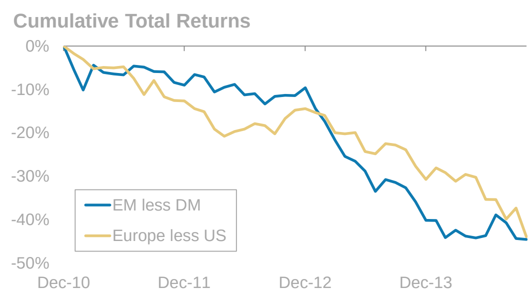
Will EM Stop Underperforming DM? *NO*
Will Europe Stop Underperforming the US? *Potentially in 2H15*

DM > EM, US~Europe in Equities

We see EM earnings growth running well below consensus this year and next, based on our economists' downgrades to the region's GDP forecasts for 2015 and forecasts of a stronger USD. All of this is in stark contrast to our relatively bullish stance on DM markets, where we are more bullish on the earnings outlook (particularly for Japan) and see some scope for moderate multiple expansion.

Our expected returns for US and EU equities are similar next year. We think the best chance the EU to reverse 5+ years of underperformance will be in the 2H, where our forecasts of a weaker EUR and higher inflation should help.

EM/DM and EU/US Stocks Relative Returns



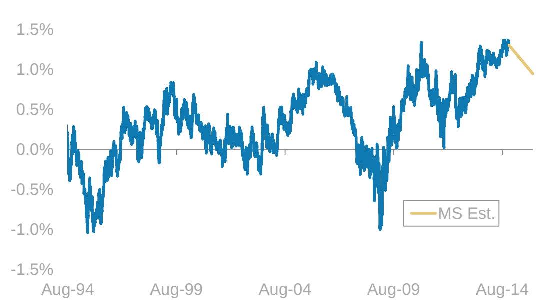
Source: Morgan Stanley Research, MSCI, RIMEs

Will Bunds Stop Outperforming USTs? *YES*

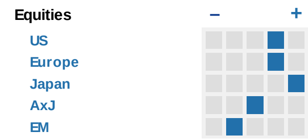
USTs > Bunds

Despite stronger US growth data, we think the UST long-end will outperform DBR long-end in 2015. This is partly driven by how the latter currently prices in a much higher probability of ECB sovereign QE than we think, as well as valuations – the yield differential between UST 30Y and DBR 30Y, for example, is close to the widest it's been historically.

UST30Y and DBR30Y Yield Differential



Source: Morgan Stanley Research estimates, Bloomberg



Equities: It Ain't a Bubble Yet

Jonathan Garner Asia/GEMs
Adam S. Parker, Ph.D. United States
Graham Secker Europe

Key Investment Themes for 2015

- We see further upside ahead for equities, but the gains are driven more by earnings growth and less by multiple expansion.
- We reiterate our OW for Japan where we see about 19% upside to our new price target. We maintain our UW stance on EM, where we have just 6% upside to our 12-month price target and a negative bull-bear skew.
- In US and Europe we have a bias towards growth-sensitive sectors. We are O/W Consumer Discretionary and Energy in US and Consumer Discretionary, Industrials and Financials in Europe.

United States

Price target: We head into 2015 bullish for the 3rd straight year. Our 12-month forward target for year-end 2015 is 2275, offering about 10% upside to today's price, based on 7% earnings growth in 2015 and 2016 and modest further multiple expansion to near 17x forward earnings. Our bear case assumes a 4% earnings decline in 2015 with no recovery in 2016, causing the market to retreat to 1700. Our bull case embeds 11% earnings growth in both 2015 and 2016, and a price-to-earnings ratio near 19x, leading us to 2750.

Exhibit 1
Our Year-End 2015 Price Target Is 2275

Morgan Stanley 12-Month S&P 500 Price Target Methodology

EPS Landscape	Probability of Scenario	2014E	2015E	2016E	Multiple	Scenario Target	Upside / (Downside)
Bull Case	20%	120.0	133.2	147.9	18.6x	2750	33.0%
Growth			*11%*	*11%*			
Base Case	60%	118.4	126.1	134.3	16.9x	2275	10.1%
Growth			*7%*	*7%*			
Bear Case	20%	117.0	112.3	112.3	15.1x	1700	(17.8%)
Growth			*(4%)*	*0%*			
Expected Target						2255	
Current S&P 500 Price						**2067**	

Source: Morgan Stanley Research

We have long maintained that forecasting the price-to-earnings ratio for the S&P 500 over a short time frame (less than a few years) is basically impossible. Hence, our outlook by definition is a guess at the price-to-earnings ratio, knowing that we can't provide empirical evidence for our view. So how do we inform our guess?

Multiple higher? The core of our thesis is that we are in the middle of a long US expansion, one that may last until 2020. Economic factors like consumer confidence, financial obligations, and delinquencies are all improving and the consumer may be more insulated than investors think from a back-up in yields, given 75% of their financial obligations are in the form of a mortgage, close to 90% of all mortgages are 30-year fixed, and the average mortgage is termed out at the lowest rate ever. Corporate behavior may also favor a long expansion. Capital spending remains constrained, inventory levels look under control, hiring remains muted, and M&A is still nascent. Furthermore, credit metrics generally look benign. Financial obligations have been pushed out several years, and the interest-bearing portion of today's loans looks quite manageable given high interest coverage. Taking these factors into account, we generally think it pays to remain sanguine.

Incorporating the Morgan Stanley macro view: Our global economics team forecasts accelerating GDP and low inflation, which should ultimately push real yields into a range that has often been associated with higher multiples over a longer time frame. This, combined with ample evidence that multiples can overshoot and aren't yet extreme and that activity (economics, corporate, credit) clearly isn't late cycle, supports our optimistic stance.

Risks: Besides the appearance of signs of late-cycle behavior, the biggest risk in our view to the US market outlook is a slowdown in the US economy. A run of bad data on jobs or ISM surveys would leave us dealing with less liquidity (post tapering) and less growth, likely instilling some incremental fear of an earnings plateau or decline. A second risk, which may emerge as 2015 transpires, is that the pace of Fed rate hikes post the first one becomes a concern. Given our house view that the Fed's first action isn't until January 2016, we think we will have some time to digest Fed commentary on the pace of hikes. This should help dampen investors' fears since the market's views on pace are generally related to views on timing of the first hike this early in the game.

Size matters: For 2015, we think small-cap stocks can still catch up. After lagging the most in 15 years relative to mega caps in 2014 through earlier this fall, small caps have modestly outperformed over the past several weeks. Looking ahead, the promise of an increase in M&A, particularly tender offers for small-capitalization stocks, more margin expansion potential, and better relative revisions (fueled by a stronger dollar and lower oil, where small caps are more insulated) drives our preference for small caps.

Style and Substance and Cyclicality: We are moving to a barbell outlook for style. The sharp growth rotation of 2014 was the key microstructure event of the year. While there are pockets of growth at a reasonable price remaining, we generally think high-beta stocks and cyclicals look cheap and attractive enough to add. We are balanced on style this year, after recommending a GARP approach for the second half of 2014. In running a number of optimal simulations on portfolios derived from our alpha models, style was not a large differentiator of subsequent performance across the simulations today. On the other hand, quality is an important differentiator today.

Sector changes: We are making a number of sector and stock changes for the 2015 outlook. We are overweight Consumer Discretionary and Energy, and underweight Utilities, Industrials, and Staples.

Europe

Investor sentiment toward European equities fell significantly through 2H as concerns grew about the lack of economic growth and inflation. Consequently the region's 6-month relative underperformance, valuation de-rating and fund outflows are close to the negative extremes of the historical range, consistent with prior periods of Eurozone crisis. While the macro backdrop isn't good, we don't believe the situation now is as bad as that seen in 2008, 2H11 or mid-2012.

Looking forward, the key driver of Europe's relative performance is likely to be the pace of economic growth and the extent of further policy response, either monetary or fiscal. The prospect of further intervention by the ECB should continue to support equity valuations, potentially lifting them relative to the US if relative monetary policy diverges further.

Looking forward we expect Europe's macro news flow to pick up, reflecting the recent easing of financial conditions (a sharp fall in the oil price, the euro, and bond yields) coupled with ongoing ECB policy initiatives. We are already seeing an improvement in corporate earnings, with double-digit EPS growth reported over the last two quarters. Some of this rebound is due to the depreciating euro, which looks set to continue through 2015.

We keep our base case EPS growth forecast unchanged at 10% for 2015 and apply a 12m PE of 14.5 (also unchanged) to that to arrive at our 12m price target of 1562. This scenario reflects a moderate improvement in economic growth next year, coupled with moderate further policy response from the ECB.

We see two potential catalysts for our bull case. First, Europe enjoys its own version of 'Abenomics' with a combination of aggressive monetary policy, fiscal stimulus and/or economic reform. Second, we see a 'deflationary boom' across economies as the lower oil price feeds into higher real disposable income while also pushing out the timing of higher rates. The main catalyst for our bear case is that Europe follows the 1990s Japan template rather than the 2013 version and that the region starts to decouple from the global economy as growth and inflation slide further.

Our key investment recommendations for 2015 are:

1) OW Cyclicals – This group should benefit from a positive inflection point in economic data and has the greatest exposure to a weaker euro. Valuations are now attractive after their weak performance this year. We are overweight Consumer Discretionary and Industrials, while underweight Materials, which is negatively exposed to a stronger USD and EM more generally.

2) OW Financials – Financials remain the cheapest cyclical sector in Europe and stand to benefit the most from any positive traction related to ongoing ECB policy initiatives. They would likely be the biggest beneficiaries if the ECB were to launch a government bond purchase program, given the confidence boost it would give to peripheral risk and economic sentiment.

3) UW Defensives – We are underweight all defensive sectors (Consumer Staples, Healthcare, Telecoms and Utilities) as the group looks very expensive relative to the wider market. For example, their relative trailing valuation across four combined metrics is at a 30% premium to the market. Such a premium has only been observed 4% of the time in the last 40 years. It is also noteworthy that defensives no longer yield more than the market in Europe.

Other themes we recommend for next year include buying weaker-EUR beneficiaries, Energy − which we think is currently oversold − and UK consumer cyclicals.

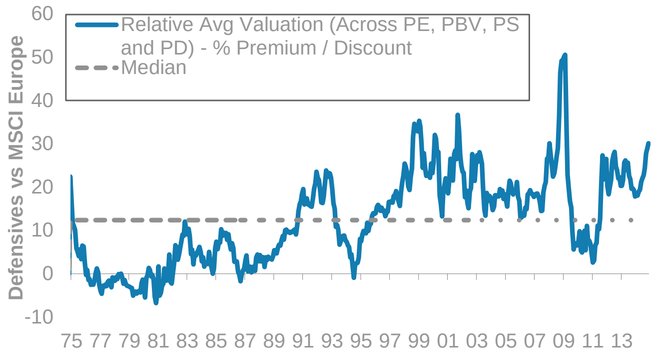
Exhibit 2

European Equities: EPS and Price Targets

	Probability Weight (%)	EPS Growth (%) 2014e	2015e	2016e	PE (2016 EPS)	Index Target	Implied Upside (%)
Base	**60**	**3.0**	**10.0**	**9.0**	**14.5**	**1,562**	**11.3**
Bear	20	0.0	-5.0	2.0	12.5	1,057	-24.7
Bull	20	5.0	15.0	15.0	15.5	1,878	33.8

Source:, Morgan Stanley Research estimates

Exhibit 3
Defensives at a 30% Premium to the Market; Only Been Higher 4% of the Time in Last 40 Years



Source: MSCI, Morgan Stanley Research. Note: On trailing P/E, PBV, PS, PD.

EM/ Asia

Continued strong preference for Japan over APXJ over EM

We continue with a strong preference for Japan within the Asia / EM universe, with EM as our least preferred area and APxJ in the middle.

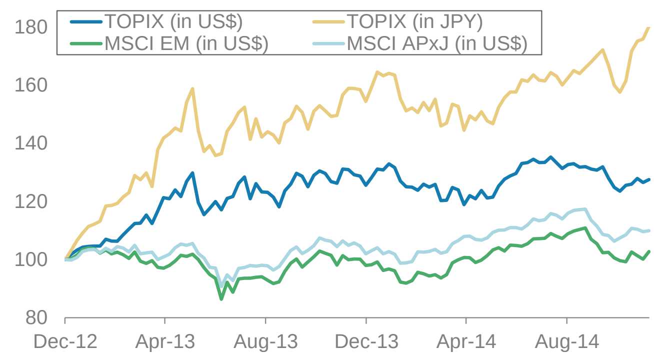
Exhibit 4 charts the US$ total returns for these three regions within global equities back to the launch of Abenomics in December 2012. We also show the yen performance of the Topix index, as hedging currency risk for Topix is an implementable strategy but is far less feasible for EM and APxJ.

Topix Target Price raised substantially

We raise our Topix target from 1500 to 1680, 19% above current levels. Our calendar year-end 2015 base case earnings estimate for Topix is raised from ¥ 100.3 to ¥103.1 versus the bottom-up consensus of ¥97.4. For calendar year 2016 we forecast base earnings of ¥114.3 versus bottom-up consensus of ¥107.2. We expect little change in the forward PE multiple one year from now at 14.7x (using our forward top-down EPS) versus 14.5x currently and a 10-year average of 14.8x.

Our base case for Japan is a) a continuation of the recent expansion of its QE programme, b) an Abe victory in the upcoming snap election and hence near-term fiscal easing versus our prior base line (due to the consumption tax hike delay and a supplementary budget), and c) ongoing GPIF and BoJ purchases of equities. This macro backdrop is consistent with a substantial weakening of the yen to 127 in Q4 2015. The level of the yen is the most important factor in our earnings model for Topix. However, we also anticipate improvement in the other two factors driving Japan earnings in our model – global PMI and the domestic Japan Economy Watchers index of business economists' sentiment.

Exhibit 4
Total Return since PM Abe Was Elected – We Expect TOPIX to Further Outperform EM & APxJ



Source: Bloomberg, Morgan Stanley Research

Overall we expect Japan corporate ROE to reach a new 26-year high of around 9.8% by the end of 2016. The recent run of eight straight quarters of earnings beats versus bottom-up consensus estimates should continue. Within Japan we continue to prefer exporters and domestic asset price reflation beneficiaries, namely banks and real estate.

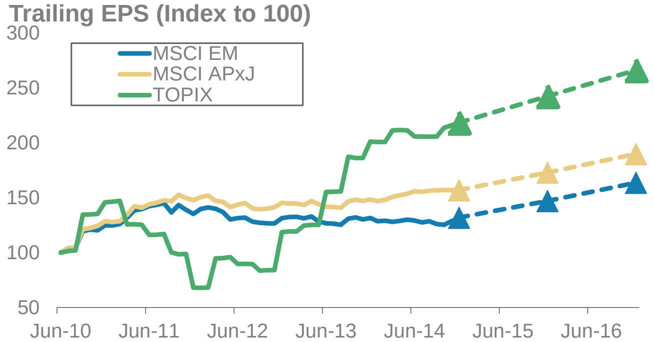
We have also raised our bear case target for Topix substantially on this occasion to 1195, reflecting the likely support for the equity market from GPIF buying as it targets a 25% domestic equities weighting going forward. This further enhances the attractiveness of Japan equities from a risk / reward perspective.

A key risk to our Topix view lies in new elections scheduled for December 14th. For more details on the election and the uncertainties it could produce, please see Japan Economics: Abe's Art of War: What's Next? November 21, 2014.

Target Price downgrades for EM and APxJ

Our positive stance on Japan is in stark variance to our continued negative view on EM and to a lesser extent APxJ. Weak recent earnings data, our economists' downgrades to GDP forecasts for 2015, and downgrades to FX forecasts versus a stronger US dollar lead us to further downgrade our earnings estimates. As a result we cut our MSCI EM target by 8.0% to 1,067, which is only 5.4% above current levels.

Exhibit 5
Trailing EPS for Our Coverage Universe and Our Top-Down EPS Forecasts



Source: Datastream, MSCI, Rimes, Morgan Stanley Research.

Our earnings forecast for 2015 for EM is cut from USD94.7 to 86.8, which is substantially below bottom-up consensus at 92.7. For 2016 we forecast EPS of USD94.4 versus consensus of 102.6. Our earnings forecasts for APxJ are also cut, but to a lesser extent, reflecting smaller reductions in our house GDP growth rates and FX forecasts and lower earnings sensitivity to declining commodity prices than is the case for EM. On the multiple side we expect both EM and APxJ to remain close to current levels in forward PE terms, which in turn are close to long-run average levels. Although these forward PE multiples for EM and APxJ are now well below DM equities, we expect this discount to persist given the relatively subdued outlook for growth and earnings that we forecast. EM ROE is likely to fall to 11.8% by end 2015 from a peak of 15.2% in 2011.

At the country level our key overweights in the APxJ / EM space are China and Singapore, whilst our key underweights are Korea and South Africa. At the industry level for APxJ / EM we are overweight Banks, Insurance, Pharma, Healthcare Equipment, Real Estate and Energy . We are underweight Telecom, Materials, Food Retailing, Transportation, Food Beverage and Tobacco, and Capital Goods.

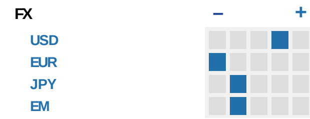
The recent China rate cut is an important demonstration that the current administration is willing to pursue countercyclical policy when inflation is below target and growth momentum remains questionable. Valuations for MSCI China remain around 15% below EM on a forward PE basis at a time when other EM such as Brazil, Russia, South Africa and Indonesia have been tightening monetary policy due to adverse terms of trade shocks and US dollar strength. We therefore expect China's valuation discount to narrow in the short to medium term and now see a clear near-term catalyst for a key plank of our OW stance on MSCI China. Whilst the asymmetric loan and deposit rate adjustments imply some margin pressure on the key bank index constituents, we think the bigger picture is a reduced tail risk of a property sector hard landing and higher rates of NPL formation. At the margin the rate cut may benefit the more leveraged old economy parts of the China equity market that have lagged substantially this year, but our overall stance remains to overweight Financials and new economy names.

We also reiterate two key themes which have worked this year and should continue to perform in 2015:1) EM firms with relatively high DM revenue exposure; and 2) Quality in the form of our Best Business models approach (superior RNOA in an industry context allied with balance sheet strength).

Exhibit 6
Trailing EPS for Our Coverage Universe and Our Top-Down EPS Forecasts

Index	Target Price, Dec 2015			Target fwd P/E, Dec 2015			MS Forecast EPS CY2016			Consensus EPS CY 2016
	Bull	Base	Bear	Bull	Base	Bear	Bull	Base	Bear	
TOPIX	1,961	1,680	1,195	15.7x	14.7x	13.2x	124.9	114.3	90.5	107.2
PT Upside	*40.9%*	*20.7%*	*-14.2%*							
MSCI EM	1,272	1,067	686	12.0x	11.3x	9.8x	106.0	94.4	70.0	102.6
PT Upside	*25.7%*	*5.4%*	*-32.2%*							
MSCI APxJ	636	536	361	13.6x	12.7x	11.2x	46.8	42.2	32.2	43.6
PT Upside	*32.6%*	*11.7%*	*-24.9%*							

Source: Datastream, MSCI, Rimes, Morgan Stanley Research. As of Nov. 27, 2014.



FX: Debt and Capacity Rule FX

Hans Redeker

Key Investment Themes for 2015

- For now, FX volatility should remain subdued, but broadening USD strength would undermine global liquidity conditions and could push volatility markedly higher. USD strength to gain momentum as projected return differentials turn USD bullish.
- We maintain our view that EUR/USD declines towards 1.12 by end 2015.
- We take our USD/JPY projections higher, to 127 for end 2015, on renewed Japanese policy impetus.
- Debt and deflation are set to remain major themes for FX markets, especially for AxJ, where KRW and THB look most vulnerable.
- We maintain a bearish commodity currency view given terms of trade shocks, with AUD and NZD most exposed, as well as BRL, COP, CLP and PEN in LatAm and ZAR.

Bullish USD Trend

We maintain our bullish USD view for 2015 and see gains being extended and broadened, not just against the other G10 currencies, but also against EM. Currencies which have kept pace with USD gains so far are now likely to be more at risk. The primary driver of our bullish USD view remains growth differentials. Globally, the US continues to stand out as providing the most attractive relative growth outlook, and hence potentially the more attractive investment opportunities and returns. We believe that these conditions will persist, providing the backdrop for a sustained multi-year USD recovery.

Overall, the USD has transitioned to an asset currency in the past year, as evidenced by the change in currency market behavior in response to developments in US (and global) yields. The USD has continued to gain support despite US yields remaining suppressed. This is a function of USD gaining support from investment inflows, we believe. Inflows to the US are likely to keep yields lower and the USD supported simultaneously, implying the USD will continue to rally even if yields remain more subdued than originally assumed. We are projecting a 7% USD rally on a trade-weighted basis for 2015.

However, the relative growth divergence that forms our analytical framework is not so much a reflection of improvement on the US side of the equation, but in many cases deterioration in the growth environment elsewhere. European growth dynamics remain weak, but the most significant change is likely to be Asia, where the outlook faces increasing challenges and prompts our more bearish stance towards AxJ currencies.

We maintain our bearish EUR/USD view, with a decline to 1.12 anticipated for end 2015. We hold this bearish EUR/USD view even if the ECB does not extend easing measures beyond those already announced. We believe the steps taken by the ECB so far will be enough to fuel the EUR decline.

Continued disinflationary pressure in EMU and a sustained EUR decline will have implications for regional currencies. The SEK and CHF are still exposed to these factors. But with SNB policy (EUR/CHF floor) set to remain intact, the SEK and increasingly the NOK should be the underperformers. Likewise, CEE currencies such as PLN and HUF will need to maintain competiveness versus the EUR in the face of deflation risks. This will keep USD/CEE crosses well supported over the forecast horizon. ILS also fits into this camp.

Overall, we see a much steeper decline for EM and AxJ currencies in particular. Within the G10, commodity-related currencies should see continued weakness next year.

Exhibit 1
Major FX Forecast Changes

	1Q15	2Q15	3Q15	4Q15
USD/JPY	**122**	**123**	**126**	**127**
Before	*109*	*110*	*112*	*114*
GBP/USD	**1.51**	**1.47**	**1.45**	**1.47**
Before	*1.63*	*1.6*	*1.56*	*1.51*
USD/BRL	**2.68**	**2.73**	**2.92**	**2.95**
Before	*2.55*	*2.6*	*2.75*	*2.8*
USD/KRW	**1190**	**1210**	**1230**	**1230**
Before	*1070*	*1075*	*1080*	*1085*
USD/ZAR	**11.5**	**11.75**	**11.85**	**12**
Before	*11.5*	*11.75*	*11.65*	*11.5*
EUR/PLN	**4.3**	**4.33**	**4.35**	**4.35**
Before	*4.2*	*4.15*	*4.12*	*4.08*

Source: Morgan Stanley Research estimates

JPY Weakness to Persist

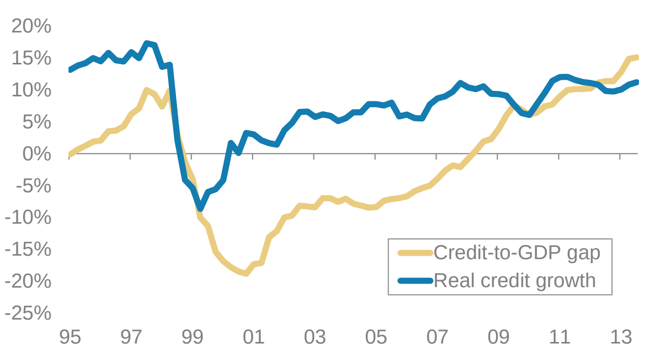
The largest change to our forecasts is for USD/JPY. The stepping up of policy action by the BoJ and PM Abe's commitment to the reform process − calling a snap election to reaffirm his mandate to push through reforms − implies continued JPY weakness, albeit at a slower pace than seen recently. During the initial stages of the reform process the Japanese economy is likely to need a buffer against the deflationary side effects. Hence, Japan may require some further JPY weakness. We have now taken our USD/JPY forecast higher to 127 for the end of 2015.

Debt Overhang Weighs on AxJ

Debt and deflation are likely to remain major themes globally that many countries will have to contend with, having significant currency implications. These themes were initially focused on Europe, resulting in the decline of the EUR that we expect to continue. However, deflation and debt are likely to be broader themes in 2015, with Asia the next region to be exposed, in our view.

Asia's prolonged credit-fueled investment over the past few years has resulted in significant misallocation of capital. Rising investment to GDP ratios have unfortunately been accompanied by falling returns on investment. Low investment returns have in turn reduced the efficiency of credit, resulting in shrinking credit multipliers. Where credit efficiency has suffered most, currencies are at risk. Under this scenario we see KRW and THB as most vulnerable within EM. We have lowered most of our AxJ forecasts, especially for KRW. We have taken our USD/KRW projection for end 2015 up to 1230. INR is the exception in AxJ, where we see relative support.

Exhibit 2
AxJ's Credit Gap Exceeds 1997 Levels



Source: Haver Analytics, Morgan Stanley Research

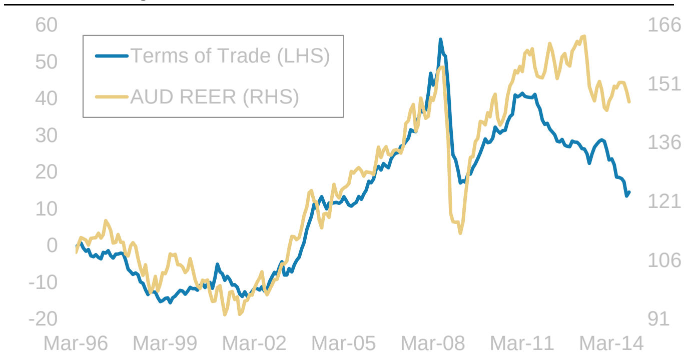
Commodity Currencies

It is not just AxJ where the impact of debt and overinvestment is likely to be seen. The commodity-related currencies also fall into this category, and here we maintain our bearish view. Slowing demand and lower commodity prices are set to have further negative terms-of-trade impact on AUD and NZD, and both Australia and New Zealand also face domestic economic challenges as they rebalance their economies. Indeed, the second-round effects of declining commodity price − falling business investment in the resource and commodity sectors − are likely to prove significant negative factors for AUD, NZD.

However, it is not all bad news for the commodity currencies. We have become less negative towards the CAD as Canada, after a lag, now appears to be feeling the benefit of the US recovery. We have reduced our projected pace of USD/CAD gains and believe the CAD can outperform on many of the crosses, especially against its commodity currency peers.

Other commodity currencies in LatAm – BRL, COP, CLP and PEN − and ZAR will face similar challenges from continued terms-of-trade weakness amidst a subdued growth outlook. We have taken our USD/ZAR forecast up to 12 for next year as weak terms of trade along with labour issues in key exporting sectors add to downside risks. We have also pushed our USD/BRL forecast higher to 2.95 by end 2015, as tighter fiscal and monetary policy without structural reforms weigh on growth and are unlikely to be enough to rebuild investor confidence. Not all LatAm currencies will face such pressures. Although we expect USD/MXN to trade higher, we still believe MXN is likely to continue to outperform its EM peers on the back of increasing productivity and positive spillover from the US.

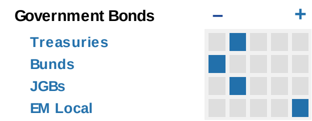
Exhibit 3
Negative Terms of Trade Shock Still Drives Commodity Currencies Lower



Source: Morgan Stanley Research, Bloomberg

Conclusion

Our analysis leads us to conclude that EM currencies will see some of the largest depreciation in 2015, led by AXJ (with INR the main exception to the rule). Within the G10 space, European and commodity-linked currencies are likely to face the largest losses. We remain steadfast USD bulls and expect strength against nearly every currency globally.



Government Bonds: Know When to Walk Away

Matthew Hornbach United States
Paolo Batori Emerging Markets

Walk away from developed market government bonds before you need to run away. We forecast steeper yield curves as central banks keep policy rates low while inflation rebounds. We expect Bunds to suffer the most, followed by gilts, USTs, and then JGBs in 2015. What little spread tightening we forecast should not offer much protection to semi-core Europe, but peripheral spread tightening seems like an asymmetric outcome. EM bonds should offer mixed performance, with positive returns in LatAm and negative returns for CEEMEA and AXJ in 2015. China and India local bonds should outperform, followed by Mexico and Colombia, while CEE is set to underperform.

- **In core developed markets,** we had lowered our yield forecasts in mid-October, and now we lower then slightly more. We see 10y UST yields at 2.85% at the end of 2015, 10y Bunds at 1.35%, 10y gilts at 2.70%, and 10y JGBs at 0.70%. The path to achieving these year-ahead forecasts will be bumpy with the largest increases coming in 2Q15. The driver of the increase is a pickup in realized inflation in the Euro area that causes Bund yields to move higher, dragging Treasury yields along for the ride. For now, we forecast yields remaining low as realized inflation outcomes allow central banks to signal continued accommodation.
- **In Euro-sovereigns**, we still forecast a differentiated spread tightening across semi-core and peripheral bonds. We see the most spread tightening in Greece, Portugal, and Spain in 2015, which we forecast will outperform Bunds in 10y by 187bp, 70bp, and 46bp, respectively. We expect tightening in part because of attractive carry in a low-yield environment. In the semi-core of Europe, we see much more limited tightening, with Austria, Netherlands, France and Belgium all tightening by 10bp or less to Bunds over the next year.
- **In EM,** we are constructive local rates with additional downside risks to growth and scope for more policy easing. We recommend tactically hedging EMFX weakness and forecast local rates will return 1.2% on average (in USD) for 1Q15. In **LatAm**, we see NTNF'25 above the forwards at 12.0% and Mbono'24 below them at 6.0% for end-2015. In **CEEMEA**, we expect R186 to outperform the forwards next year with yields at 7.80%. We also maintain a cautious stance on OFZ, while disinflation risks should support yields in CEE. In **AXJ**, we forecast bonds in China and India to outperform, with 10y yields at 3.20% and 7.50%, respectively.

Key Rates Market Themes for 2015

- Despite stronger US data, the Fed delays rate hikes and UST 2y is the best performer on the UST curve in 2015. UST 10y yields move higher as markets price in a lower probability of ECB sovereign QE, but long-end Bunds underperform outright and relative to USTs. We favor 30y USTs over 30y Bunds.
- Semi-core European sovereigns are no longer attractive, but 10y BTP and Bono spreads could tighten 40-50bp on the announcement of an ECB purchase program. Our preference remains for Spain, Portugal and Belgium vs. France and Italy.
- In EM, we expect the asset class to perform well, though recommend hedging FX exposure tactically throughout the year. Local bonds should average 1.2% gains (in USD), with Colombia, Mexico, China and India outperforming and Russia and Korea underperforming.

Developed Market Yields

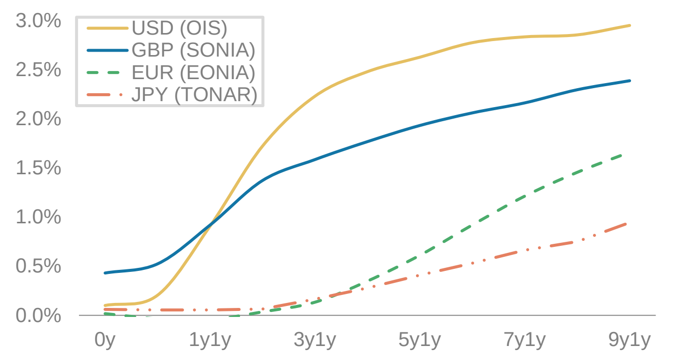
The asynchronous nature of developed market cycles continued to weigh on government bond yields since we published our Back-to-School outlook in September. Important cycle indicators from our cross-asset strategists show the US in the early stages of 'expansion', the Euro area mired in a prolonged 'recovery', and Japan entering a 'downturn'.[1] Given the short-lived nature of Japan's expansionary phase and the Euro area's lethargic recovery, any signs that the US cycle may be moving from 'expansion' to 'downturn' will place additional downward pressure on developed market bond yields. During the first half of October, investors had a taste of this dynamic when a short-lived but powerful growth scare made its way across the pond.

Exhibit 1 (following page) shows that the asynchronous nature of these cycles has created asynchronous policy paths priced into markets – paths that we proxy with forward 1-year rates. Markets price 1-year rates in the Euro area and Japan to remain below 0.5% for the next four to five years. At the same time, markets price 1-year rates in the US and UK near 1.0% just one year from now. The extent of the divergence has, in our view, led to a kink in the forward curve for one-year US OIS rates and a similar bend in the forward Sterling SONIA curve for one-year

[1] See Cross-Asset Dispatches: What the Cycle Means for Returns, November 18, 2014

rates. The bends occur between two and three years into the future and have significantly altered expected terminal rates.

Exhibit 1
Forward 1-Year Rates Across G4 Markets



Source: Morgan Stanley Research, Bloomberg

The extremely shallow path for forward 1-year rates in the Euro area and Japan made the much higher forward 1-year rates in the US and UK look attractive to global investors in search of yield. These investors, unwilling to stand in the way of the near-term policy outlook for the Fed and BoE for most of the year, put money to work in longer-maturity bonds on the yield curve, where implied forward 1-year rates were highest. The buying placed downward pressure on US and UK 1-year rates implied from four years into the future and beyond – what investors would associate with terminal rates for policy. Thus, given the outsized impact in 2014, the 2015 outlook for developed market rates will continue to be shaped by the asynchronicity of developed market cycles – both economic and policy-related.

In the **US,** our base case for Treasury yields keys off two factors in particular: (1) the outlook for the US economy and Fed monetary policy, and (2) the outlook for core European rate markets and ECB monetary policy – discussed later. Despite 2015 real US growth of 2.7% Q4/Q4 and core PCE inflation rising to 1.9% by year-end, our US economists maintain their longstanding, out-of-consensus call that the Fed will delay rate hikes until January 2016. This delayed start to rate hikes prevents UST 2y yields from rising to meet or surpass the forwards. 10y yields rise to 2.85% in 2015, higher than the forwards, on the back of higher Bund yields, but 2y yields only rise to 1.20%, some 30bp below the forwards.

In our bear case, US wage growth accelerates toward 3% as fiscal policy becomes even more supportive of growth. The Fed hikes rates in June 2015 as core PCE inflation reaches 2.0% during the second quarter. The Treasury curve bear flattens as 2y yields reach 2.5% and 10y yields reach 3.25%. In our bull case, core PCE inflation halts its progress toward 2.0% and real GDP grows below trend in 2015. Investors push the first rate hike well into 2017 and 10y yields fall to 1.80%.

In the **Euro area,** our base case is that the ECB does not resort to QE – i.e., a broad-based purchase program that includes government bonds. This causes Bund yields beyond 5y to rise as realized inflation picks up and term premiums, once driven lower by QE expectations, expand. Hence, we forecast 10y Bund yields reaching 1.35% by end of 2015. However, the sell-off is conditional on realized inflation rising, which would ease pressure on the ECB to implement further accommodative measures. We do not expect inflation to rise until 2Q15, so 10y and longer yields should remain low until that time. In shorter maturities, we expect the ECB's commitment to keep rates low for an extended period of time, along with the fragile growth and inflation picture, to keep 5y and shorter rates well anchored.

In our bull case scenario (which is our economists' bear case), the macro picture deteriorates and the ECB eventually does QE, but is slow to do so. Nevertheless, the market correctly anticipates purchases are coming and pushes 10y Bund yields down to 0.50%. The announcement of QE itself should not push yields much lower, as it will have been priced into Bunds already. But the market starts to price a higher probability of a sustained "Japanification" of the Eurozone economy. In the bear case, QE expectations unwind completely as growth and inflation surprise to the upside, and 5y yields also rise as the market prices in a shorter period of accommodation.

In the **UK,** we expect tighter fiscal policy post-election and slower GDP growth to slow the pace at which slack in the economy diminishes (elections expected to be held in May). This places downward pressure on inflation and allows the BoE to delay the first rate hike until 4Q15. Gilt yields continue to be influenced by Bunds, with yields remaining range-bound in 1Q15, first rising gradually during the uncertainty of the general election and then rising due to expectations of monetary tightening. We believe the UKT 2s/10s curve should steepen into the election, but flatten thereafter as Bank Rate hikes are priced in. Cross-market, gilts should underperform Bunds, but not materially when compared with the forwards.

Our bear case for gilts involves a meaningful pickup in pay growth driving consumption higher. The MPC would raise the Bank Rate in 3Q15 and at a quicker pace than is priced into markets. UKT 10y yields rise to 3.3% by year-end 2015. In our bull case, the 'haunting specter' of European stagnation continues to dominate and UKT 10y yields fall to 1.5%.

In **Euro-sovereign spreads,** our forecasts are largely unchanged from 3 months ago: we see little (10bp or less) spread compression in the semi-core, and only 30-40bp in Spain and Italy. While the growth outlook has surprised on the downside, we do not think it is so weak that it will cause serious concerns about fiscal sustainability. However, the credit rating cycle continues to be negative in the semi-core (where ratings and outlooks continue to be revised down), especially for France, where we are concerned by the weak growth outlook and lack of structural reform. The supply picture is more positive, with zero net issuance expected from Germany (because it is not expected to have a fiscal deficit) and Italy (smaller funding requirement and pre-funding in 2014).

We think negative real German yields will displace demand into other higher-yielding sovereigns (as investors receive Bund redemptions), especially in the 5y and shorter portion of the curve. The lack of spread compression potential means it is no longer very attractive to be long Euro sovereign spreads, but the sideways market we anticipate means we still have a bias to be overweight the periphery, especially given we do not think QE is fully priced into spreads and would expect 10y BTP and Bono spreads to tighten 40-50bp on the announcement of a purchase program. As before, our preference remains for Spain, Portugal and Belgium vs. France and Italy.

In **Japan,** we expect long-term JGB yields to remain generally stable through the first half of 2015, with the curve bull-flattening significantly as the 10y yield falls to around 0.4% by mid-year. Much is likely to depend on whether inflation expectations start to build in 2H as the actual inflation rate moves gradually higher. But, with the inflation rate set to fall through 1H 2015 as a consequence of recent declines in oil prices, we expect JGBs to be driven mostly by a continued tightening of supply/demand associated with the BoJ's massive purchase program.

It is possible that faster inflation could start to generate upward pressure on interest rates at some point, but we do not expect this to happen before 2H15 at the earliest. We suggest positioning for a flatter yield curve, a decline in volatility at the long end, and a widening of super-long asset swap spreads.

Our bull case for JGBs involves a combination of weaker economic growth and faster inflation. Assuming that "hyperinflation" can be ruled out, we would expect slower growth to inhibit inflation expectations and thereby lower JGBs yields.

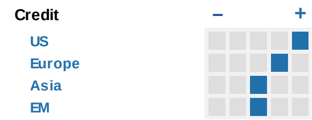
In **Australia** and **New Zealand**, we have pushed back rate hikes in both Australia and New Zealand as domestic conditions have softened. In **Australia,** the drain from a softer China continues, resulting in even softer terms of trade than before. In **New Zealand**, the milk price decline has been joined by a continued lack of inflationary pressures. As a result, the RBNZ has done enough for now. At the front end of both curves, we should see a gradual sell-off broadly in line with the US, as our economists look for the next hike out of the RBA and RBNZ to occur in 1Q16. At the back end, we look for further spread compression with both AU and NZ 10y expected to outperform US rates through 2015. This is partly due to the softer local backdrop, but also due to the increased potential for supportive inflows from Japanese investors following the QQE2/GPIF announcements, particularly in Australia's case. We expect the ACGB-UST 10y spread to break below its 2014 low to around 75bp by the end of 2015.

Emerging Market Yields

CEEMEA should benefit from the market pricing additional ECB stimulus in the near term, but increasing medium-term inflation expectations are likely to challenge **Poland**, **Hungary** and **Czech** in the second part of 2015. The possibility of additional monetary policy easing in **Turkey** despite heightened inflation expectations could support the front-end of the curve in Q1, though we suspect this could be reversed later in the year. **South Africa** local bonds should outperform in the region as the SARB postpones hikes, while **Russia** OFZs continue to look vulnerable as long as the sanctions push the FX weaker.

There is scope for differentiation in **LatAm**. As long as inflationary expectations remain well-contained, **Colombia** and **Peru** bonds could gain from a lower equilibrium growth rate and the possibility for additional rate cuts, despite their deteriorating fiscal balance due to lower commodity prices. Since **Mexico** monetary policy is tied to that of the US, the Mbono curve is likely to flatten, supported as well by institutional flows given the country's positive reform backdrop. **Brazil** on the other hand could see its curve steepen if inflation expectations deteriorate and fiscal policy remains very loose. However, we expect the new government will pursue some of the necessary macro adjustments, supporting the local bond curve in H1. Our call for the BCB to become more dovish and unwind its hiking cycle would also help the front-end of the curve in Q2.

In **AXJ**, the external backdrop remains positive for bonds, particularly for those countries with scope for additional policy easing and that are less sensitive to currency weakness. We expect **India, Korea** and **China** bonds to outperform on this basis, while, given **Indonesia** bonds are highly sensitive to FX weakness, we are neutral despite prospects for reforms possibly supporting the local market. Lastly, **Malaysia** bonds have little risk premium embedded into the curve and are exposed to external risks. Hence we expect the short-end to outperform.



Credit: Contrasting Credit Cycles

Sivan Mahadevan United States
Srikanth Sankaran Europe
Viktor Hjort Asia
Paolo Batori Emerging Markets

Key Credit Market Themes for 2015

- **US Investment Grade –** We are Overweight US IG with a 3.1% excess return forecast, significantly more than historical averages. We expect the 5-7 and 10+ year sectors to outperform; we favor Financials on strong credit quality, and the Consumer sector based on employment, inflation and commodity prices.
- **US Leveraged Finance –** We are constructive on US HY with the belief that risk/reward is attractive. High-beta high yield has cheapened and we think will outperform late into the cycle. Leveraged loans offer value, and as rates begin creeping higher, we believe funds will flow back into the asset class.
- **US Municipals –** We expect small positive total and excess returns with asymmetric risks from tax reform, liquidity, and convexity. Additionally, we see credit quality plateauing. Despite that unforgiving environment, better valuations from recent weakness means we favor adding duration and credit risk, but only to get back from a short to a neutral bias.
- **European Credit –** We expect IG to outperform in the low-growth environment, with potential upside from ECB stimulus. We favour Financials and corporate hybrids. Within HY, we maintain a cautious outlook and expect the BB-B basis to widen.
- **Asia Credit** – We upgrade to Equal-weight, forecasting 3.0% excess returns. We have a preference for Asia IG non-financials which are now supported by improving credit metrics, wide spreads and improving credit conditions.
- **Emerging Markets Sovereign Credit –** We believe EM sovereign credits will remain supported in the near term, until 1Q15, before higher UST yields, a stronger dollar, and still weak macro fundamentals will drive widening for the remainder of the year. Carry, however, keeps 12m EM excess returns positive.
- **Global Credit Derivatives –** After years of focus on regulation, we believe the market will finally look forward. We see modest growth in full capital structure synthetics, preferring mezzanine and senior risk. TRS volumes will grow, and we would position for entry points to monetize volatility.

As we entered 2014, we opined that global credit was a "Market of Many" with different dynamics driving the various regions. As we look back, we certainly saw diverging performance, and as we look forward into 2015 we think it continues, driven in part by how the credit cycle plays out in the various regions.

In a nutshell, we favor DM credit over EM credit, and expect US credit to outperform European credit in both IG and HY given stronger growth and better valuations. We favor Financials in the US, Europe and China. We like long-duration risk in both the US IG and Municipals markets, but also find that 5-7 year risk in US IG, HY and EU IG to be a sweet spot for risk taking. In terms of credit quality, we have a low quality bias in the US and within European IG, but a higher quality bias in EU HY and Asia.

Our economists expect global growth to pick up moderately from 3.2% in 2014 to 3.5% in 2015, but importantly the global economy remains out of sync. The US and UK are doing best in the developed markets, and we expect US growth to rise to 2.9% in 2015 vs. 2.2% in 2014, the latter an exceptionally low number driven in part by the harsh winter. Specifically, in the US, we expect both lower energy costs and fiscal policy to be more supportive of growth in 2015. The good news includes significant job growth, firming wage growth, and stronger equity and real estate prices, which can be weighed against an aging population and tighter mortgage standards. EU and Japan are behind, growing at 1.0% and 0.6%, respectively. EM growth remains subpar, with India a bright spot on expected reforms.

Exhibit 1
Global Credit Forecasts

	US IG	US HY	EU IG	EU HY	Asia	EM	Munis
Current Spread (bp)	124	480	103	450	254	354	83
12m Spread Target	101	378	90	425	244	375	--
12M Forward Excess Return (%)	3.1%	6.2%	1.6%	4.0%	3.0%	2.6%	1.5%
Return Over	UST	UST	Benchmark Sov	Benchmark Sov	UST	UST	UST
Best Sector	Financials / Consumer	Telecom	Financials / Utilities	--	India IG / China SOE	--	Transport. / Tobacco
Best Rating	BBB Non-Fin	CCC	BBB Non-fin	BB Non-fin	BBB Non-Fin	BBB	A
Best Maturity	5-7Y / 10Y+	5-10Y	3-7 Y	1-3 Y	10Y+	10Y	20Y+
Supply Risk	Medium	High	Low	Medium	Low	Low	Medium

Source: Morgan Stanley Research, Markit, Yieldbook. Note: Muni index spread calculates spread of the muni index yield to worst to the duration-matched UST (5-year UST). This is an approximation and does not factor in the call option associated with the majority of municipal bonds. EM here includes only the sovereigns.

The US has the strongest economy and perhaps the most mature credit cycle. There is no place where this is clearer than in the Energy sector, where oil market woes and perhaps a long-term industrial revolution are re-racking a sector that has been accustomed to high commodity prices. At the opposite end in the US is Financials, where the cycle feels much earlier owing to tremendous amounts of regulation creating conservative bank business models and capital structures, all of which is credit positive. The US cycle still has legs to it in our view, and we maintain our overweight recommendations on IG and HY and feel valuations present a better entry point today than they did a year ago, given the economic backdrop.

The European cycle is in an earlier stage, where low growth and ECB stimulus remain supportive for higher-quality credit. However, growth is not secure enough to support HY credit, and we maintain a cautious outlook, expecting lower-quality HY to underperform. In Asia, we expect sluggish growth but no recession, and in 2015 we now expect credit quality trends to start to improve. We upgrade our stance to Equal-weight with a high-quality bias.

For the major credit markets, we see mid-cycle characteristics broadly, but caution that pockets of the market have late-cycle characteristics. Nevertheless, we do not see an end of cycle occurring in 2015. Additionally, as we pen this outlook, credit markets are underperforming other risk assets, which can be a signal of a turning credit cycle. We, however, think that the unexpected and unusually low level of yields has created a supply/demand imbalance in the markets, where corporates are happy to issue debt at such low all-in yield levels while yield-based buyers (LDI in particular) are finding it a difficult environment to hedge liabilities. This has given investors a bit of a yield premium in spread terms, which we believe will set credit markets up well for a 2015 rally.

If there is a common global concern, it is the Energy sector, which has quietly grown to become a substantial portion of the global credit markets. In the US, at 12% and 17% of the IG and HY markets, respectively, Energy has contributed quite significantly to the YTD spread widening of both markets. And in Europe and Asia, Energy is an even larger part of the IG world, at 19% and 16%, respectively. The weakness is driven by the potential for changing business models and unrealized gains on capex resulting from the radical shift in oil prices. In terms of what to expect in 2015, it is likely to be all about oil prices again. An improvement in oil prices would help mitigate some of the pain. However, if oil prices remain at current levels, we will need to watch for real credit risk, in the form of downgrades at a minimum, with the potential for several IG issuers to fall to HY.

Exhibit 2
Energy Sector Will Contribute More Than Its Fair Share of Risk

ENERGY SECTOR	US		Europe		Asia	
	IG	HY	IG	HY	IG	HY
YTD Issuance (USD)						
Energy ($bn)	99.7	62.3	74.1	11.4	20.2	3.6
Share of total	10%	15%	10%	6%	18%	9%
Size in Index						
Nominal ($bn)	455.8	190.1	250.7	14.0	72.1	2.3
% of Index	12%	17%	19%	5%	16%	2%
Valuations						
Energy Spread (bps)	174	530	108	326	154	691
YTD Spread chg	39	109	(19)	15	(29)	131
Index YTD Spread chg	13	58	(23)	19	(12)	45

Source: Morgan Stanley Research, Yieldbook, Thomson, Markit iBoxx, Bondradar, Note: Issuance includes, but is not limited to, index eligible issues; US Index – Citi Yieldbook, EUR Index – Markit, Asia Index - JACI

US Investment Grade – Adding Credit in a Cynical Cycle

From a US credit market perspective, the most disappointing event of 2014 was the significant rally in long-term interest rates. That slowed the huge liability-driven investment (LDI) machine for the investment grade markets and created headline yield problems for the high yield world. While rates remain low today, we are entering 2015 with better credit valuations. Although we believe the credit cycle has some legs to it with a stronger US growth outlook, we are somewhat wary of the cycle given that low rates serve as a significant headwind over time (given muted LDI flows), and idiosyncratic risk is certainly skewed to the downside.

US IG View: For US IG, we are Overweight, expecting spreads to tighten over 23bp to 101bp (on the cash index we follow), which translates into a 3.1% excess return, significantly higher than the historical average. We also expect some flattening in the 10s30s credit curve, which is a meaningful contributor to our excess return forecast.

The Curve: As rates markets re-priced significantly in 2014, we are ending the year with quite a bit of return dispersion along the curve. We believe that continues in 2015, and we adjust our views and curve segmentation as well. We are underweight the 1-5 year sector of the IG market, mainly driven by rich valuations (richest part of the curve relative to history) and an eventual concern that front-end money may find a new home (deposits, money market funds) when front-end rates rise. We are overweight the 5-7 year sector, a part of the curve that has good spread roll-down dynamics in rising or falling rate environments. We are equal-weight the 7-10 year sector, the more agnostic view being that rising rates may lead to reduced bond fund inflows (or even outflows), and this is a sweet spot for bond fund management vs. traditional benchmarks. Finally, we are overweight the long-end (10+) sector on the expectation that

LDI flows will ultimately pick up, given both our rates and equity market forecasts. Note that the long-end was the worst-performing sector of 2014 and is a part of the market that we believe is cheap on an absolute basis.

IG Sectors: We remain Overweight Financials on the continued expectation that Banks in particular are the better credit quality story within the IG universe, especially as the credit cycle feels later for Industrial sectors with plenty of idiosyncratic risk. We believe banks will also hold up well in risk-off environments, a lower-beta behavior that was exhibited quite vividly in 2014. We are OW the Consumer sector based both on valuations and on consumer oriented factors that inform our view. The fall in oil prices, if sustained, should continue to provide a strong boost to retail sales.

US Leveraged Finance – Seventh Inning Stretch

We are constructive on US High Yield credit for 2015, with the belief that risk/reward is modestly attractive at current valuations, particularly relative to the alternatives. High-beta high yield has cheapened and we think will outperform as investors again reach for yield in the final innings of this cycle. In addition, leveraged loans offer value, in our view, and as rates begin creeping higher, we believe funds will flow back into the asset class.

For the first three quarters of 2014, we had a cautious view on high yield and recommended investors overweight BBs. Among other factors, we believed the Fed would be a source of volatility, as markets adjusted to a 'less easy' liquidity environment, sentiment around the asset class was very bullish (with investors positioned accordingly), and valuations for most of the year did not justify these risks.

Progress has been made on all these fronts, and hence high yield is set up better heading into 2015. First, we will likely see more bumps leading up to the first rate hike, but we think changing expectations around the Fed (combined with the end of QE) triggered the volatility in HY in 2014, and 'less easy' liquidity is already in the price. What began with the Fed transitioned into a global growth scare, especially as oil prices fell, but we believe those worries will fade. Second, given recent volatility, sentiment is much less complacent, and third, valuations are attractive – particularly relative to most of the alternatives within fixed income.

Where We Could Be Wrong: The biggest risk is that the credit cycle is turning. We do not yet see a catalyst for this scenario (i.e., restrictive monetary policy or too much 'overheating' in the economy) and hence believe it has a bit longer to run. In addition, if oil prices keep declining, medium-term default risks clearly increase.

Loans faced several headwinds in 2014. Technicals were weak, given steady retail outflows for much of the year, the announcement of risk-retention rules introduced an overhang for CLOs (the biggest buyers of loans), and credit quality continued to deteriorate. However, in part because of these challenges, loans are cheap. In addition, volatility of loans should remain low for now, and if rates begin to rise, we see flows migrating back into the asset class.

US Municipals – You Broke It, You Bought It, Now Own It

Following a weak 2013 and a strong 2014, we expect unspectacular but positive total and excess returns for munis in 2015. Yet the market should be more eventful in practice than on paper given asymmetric risks from plateauing credit quality, tax reform, market liquidity, and convexity. What is our advice? Own the volatility by taking what the market gives you. While we think macro conditions support taking duration and credit risk in munis, there is too much optimism on both these factors in the price currently. Thus, we'd take advantage of recent market softness to add back duration and credit risk, but only back to neutral weightings vs. the market.

Valuations – Where's the Value? Our outlook for fundamentals suggests we're reaching a plateau in muni credit quality at the same time credit spreads are pushing into pre-crisis ranges. Despite the healing in muni credit, we do not think pre-crisis levels are a fair benchmark given new post-crisis norms in munis, with higher volatility, lower recovery value, and less market liquidity. Thus, we do not advise investing with an eye toward spread compression in the market. Rather, given that our economists expect a lengthy growth cycle from here, the plateau in muni credit quality could be long lasting. Thus, targeting credit and curve sectors with extra carry value and sound fundamental stories is likely the most reliable way to create alpha.

Strategy: We would open the year moving back to neutral from short on duration. Given an expectation for flatter curves, we like adding 20+ year maturities, swapping from shorter maturities into longer-dated FRNs, and keeping an allocation to 7-10 year maturities and cash for flexibility. In credit, we'd move back to a neutral bias by swapping high grades for mid-grades given the former's richness vs. intrinsic value. We upgrade our view on tobacco bonds to overweight, continue to favor transportation, and underweight state and local credit on pension challenges.

European Credit – Between Growth and Stimulus

Europe remains caught between the opposing forces of low growth and inflation on the one hand, and increasing central bank stimulus on the other. We expect investment grade spreads to move in a narrow range with a tightening bias in 2015. Although absolute returns are likely to be modest by historical standards, the attractiveness of IG lies in its ability to outperform other risk assets in a low-growth, low-inflation and higher-stimulus backdrop. A modest revenue outlook is also likely to keep corporate aggression in check, leaving European corporates incentivized to be friendly towards bondholders.

Within investment grade, we favor Financials over Non-Financials and prefer AT1s over legacy LT2 and Seniors. In terms of sectors, we maintain a preference for defensives over cyclicals. Despite the recent underperformance of the latter, we see scope for further increase in cyclical premiums.

We maintain a cautious outlook on HY and see it as a market for credit picking rather than taking directional views. Within HY, we expect the benefits of broad-based QE or targeted corporate bond purchases to be selective and largely limited to the stronger BBs. As a result, the BB-B basis is likely to widen in 2015. However, the persistent HY selloff post summer is beginning to make the more distressed credits look attractive from a valuation standpoint. We therefore see value in a quality barbell strategy – combining strong BBs as a beta play with more distressed credits as the alpha overlay.

Asia Credit – The End of Releveraging

The end of releveraging in Asia. We see a chance of stability in the leverage cycle for Corporate Asia in 2015 after four years of steady erosion. This is an important, and positive, inflection point and we are upgrading Asia credit to EW (from UW).

Market stance: Upgrade Asia credit to Equal-weight, but maintain a defensive up-in-quality stance. Sluggish growth but no recession, tight-but-stabilizing credit conditions, deleveraging by those who are able to but deterioration for those who are not – that's an environment which favours up-in-quality, in particular IG over HY. Within the former we now shift to favour IG corporates over Financials, reflecting better valuations and supply/demand profile, although within China banks are our most favoured: Specifically we prefer T1 China financials over China HY corporates.

Our China view is bifurcated: cyclical risks are high but systemic risks are arguably low. PBoC easing has two implications for credit. First, it protects against downside risks and makes the bear case less bearish. Second, it will improve credit conditions, including for weaker borrowers, many of which are in the sectors that dominate Asia HY. On the other hand, leverage is higher and so is the excess capacity overhang compared to previous easing cycles, and HY spreads are towards the tighter end of the range. As such we favour IG over HY.

Forecasts. (i) Spread forecast: 244bp for the Asia credit index (+3.0% excess returns)**. Default rate forecast** for overall Asia: 2% (up from 1% in 2013) (in HY terms that would be around 6%). **Supply forecast**: $172bn (gross).

The macro outlook for Asia remains sluggish but no longer deteriorating. Growth is still weak but a recession is unlikely, credit conditions are still tight although improving, default rates are rising, but systemic risks remain low. As such, 2015 represents a continuation of 2014, but with an important difference: We think that corporate balance sheets stabilize in the coming 12 months after four years of deterioration. That's a positive inflection point for corporate credit but benefits mostly those who are able to deleverage, which in Asia are IG corporates whose bonds will benefit not only from looking attractively wide for what are now stabilizing credit profiles, but also from less supply overhang – we are now forecasting lower YoY non-financial corporate supply for the first time in years.

Such an environment also favors Financials, although following another strong year of spread tightening we no longer consider them to be as attractive as IG corporates. Financials benefit from diversification and capital, and nowhere is that more true than in China, where we see systemic risks declining at the same time cyclical risks are rising. Hence, we are constructive on banks and cautious on HY corporates. China banks are slowing asset growth, deleveraging, recognizing NPLs, and differentiating more aggressively among borrowers – all of which makes for a compelling credit story.

EM Sovereign Credit – Diverging Destinies

Near-term upside: We believe that the benign external backdrop, valuations that are no longer rich, and supportive technicals can lead EM sovereign credit spreads to tighten until 1Q15, led by the mid-tier credits.

Weakness further out: While we expect a positive 12-month EM excess return of 2.6%, we still expect spreads to widen in 2H15. This is on the back of rising US Treasury yields, a stronger dollar, and still weak EM macro fundamentals. On a 12-month basis we therefore stick to an up-in-quality bias, favouring the low-beta credits and the CEE region.

Mind the increasing country-specific stories: Other than the above global factors, 2015 is likely to be another challenging year for many of the larger credits due to more idiosyncratic reasons. Russia is unlikely to tighten significantly as long as sanctions remain in place – our base case. We also believe that investors will increasingly focus on the willingness of the Brazilian administration to carry through the required reforms, particularly on the fiscal side. Among the high yielders, Argentina has the best chances to unlock its long-term potential by resolving the longstanding holdout saga. However, volatility may persist, especially if the resolution needs to be undertaken by the new administration, with elections taking place towards the end of 2015. A rebound or at least stability in oil prices, combined with some policy adjustments early next year, could trigger a rebound in Venezuela. However, we believe that this is likely to fade as adjustments are unlikely to be sufficient to correct imbalances and approaching National Assembly elections bring uncertainty. In Ukraine we expect sufficient weakness in the near term to justify a portfolio underweight.

Global Credit Derivatives – Finally Looking Forward

Much of the post-crisis era has coincided with a vast restructuring of the landscape for credit derivatives. Regulation forced standardization, change, and significant shifts in the market owing to capital rules. Dodd-Frank-driven standardized trading and clearing in CDS (which has been implemented at the index level but still a work in progress at the single-name level) is a significant step in making the market transparent and fungible while reducing systemic risk concerns. The credit options markets have been a bright area of growth, driven, in our view, entirely by the lessons learned during and since the crisis that credit is a volatile asset class requiring risk management.

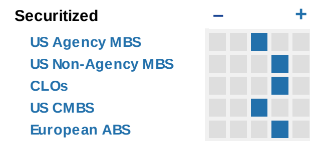
But all in all, we have spent much of the past 7 years looking back at what went wrong, and what can be done to rectify it. In 2014, two other areas showed the promise of growth: the market for total return swaps on bond indices, and what we believe is the future of the synthetic structured credit market, namely full capital structure synthetics, which has implications for the single-name CDS market as well.

Structured Credit: Full Cap Comes Full Circle: We expect modest growth in full capital structure synthetic deals, which should provide one path to developing a natural seller of protection. A mature cycle argues for subordination.

TRS as a Fund Management Tool: Market liquidity improved in 2014 and we are close to critical mass. We expect strong flows in TRS (total return swaps), the swap alternative for management of bond portfolios. Volumes and directionality will be correlated to fund outflow volatility in bonds and loans, which we expect to be high as the market prices in rate hikes.

Credit Volatility: While we expect credit markets to slowly move out of the “low volatility” world that has dominated, there will still be strategic opportunities to monetize volatility.

Focus Longs in Mezzanine and Senior: With the value of subordination growing later in the credit cycle, and the market offering us even better relative valuations for such risk, we favor mezzanine and senior risk in index and bespoke portfolios.



Securitized Products: Fair Winds and Following Seas

Vishwanath Tirupattur Global Securitized Products
Richard Hill US CMBS and CLOs
Vipul Jain Agency MBS
Srikanth Sankaran European ABS
James Egan US Non-Agency RMBS

From the perch of securitized products, the 2015 economic outlook for the US – base case GDP growth of 3%, unemployment rate declining to 5.3% by year-end, and interest rates remaining low and relatively range-bound – bodes favorably. Collateral fundamentals continue to be supportive across the securitized products universe. We expect that US home prices will continue to appreciate at levels higher than CPI. While measures of housing activity such as sales and starts will likely remain short of the robust levels of the pre-crisis, pre-bubble period, we expect them to improve in 2015 relative to 2014. Mortgage credit availability remains a substantial headwind for a more robust pickup, yet the overall trajectory for US housing is positive on the margin. On the CRE front, prices have returned to pre-crisis levels and credit availability remains plentiful.

In several sectors, most notably non-agency RMBS, market technicals remain strong, as indicated by relative resiliency during recent bouts of market volatility across risk assets. On the other side of the pond in Europe, the ECB has finally started the ABS purchase program, which we continue to see as a game changer for European ABS if mezzanine purchases are incorporated. Against this backdrop, the structural leverage embedded in securitized products and the continued opportunities for yield pickup versus other spread products, such as corporate bonds, make a strong case for finding attractive carry across the securitized products universe. Hence, our invocation of a nautical blessing in the title of our 2015 outlook.

Broadly speaking, in light of the ECB-driven technical, we remain constructive on European ABS, particularly in the peripheral space. Eligible Spanish RMBS paper has already tightened in excess of 10 bps during the first week of purchases and we expect another 15 bps compression in our base case. Even ABS not eligible for ECB purchases should benefit from a relative value perspective. However, we caution that to ensure healthy investor participation at tighter levels, the regulatory framework has to improve further.

In Agency MBS, although spreads are tight, we believe that Fed policy, cross asset valuations, and limited net issuance will keep spreads in a tight range. Also, the end of QE will allow investors to revisit the asset class without fear of a looming risk event. Similar to what happened in October, we expect Agency MBS to outperform other spread products, particularly corporates, in the event of a broader selloff, due to their better liquidity and supply technicals. Tactically, if 10-year rates stay at or drop below 2.2%, we expect Agency MBS spreads to widen. That said, into any selloff we would expect Agency MBS spreads to tighten further from here.

Key Securitized Product Views for 2015

- **US Agency RMBS – Neutral** relative to Treasuries. Even though from a valuation perspective, mortgages appear fair to rich, as long as interest rates (10 UST) remain above 2.20% we think that Agency MBS are a good carry play and likely to outperform rates during episodes of rate selloffs. Much better liquidity and benign supply technicals despite the end of QE argue for not being underweight MBS relative to corporate credit.
- **US Non-Agency RMBS – Overweight.** Collateral performance benefits from positive home price appreciation, outlook for low rates, and seasoning. Strong technicals from negative net issuance and the bid from insurers driven by NAIC levels lend support. to the market at these prices. The sector is also long option-like features from settlement payouts and credit box opening leading to higher prepays.
- **CLOs – Overweight.** We are more positive about the debt versus equity. Optionality in CLO equity from LIBOR floors and refinancing of debt tranches has become less valuable and tempers our enthusiasm for equity. Expect new issuance in the US to slow (to $75-85 billion in 2015 from about $120 billion in 2014).
- **US CMBS – Neutral.** Wall of maturities starts to pick up in 2015 and will continue until 2017. We expect substantial pickup in new issues (to $125 billion in 2015 from about $90 billion in 2014). Relative value versus corporates has become less compelling. We expect spreads to remain range-bound.
- **European ABS – Overweight.** ECB ABS purchases are likely to be a game changer if mezzanine tranches are incorporated. Eligible Spanish paper has already tightened >10 bps during the first week of purchases and we expect another 15 bps compression in our base case. Even ABS not eligible for ECB purchases should benefit from a relative value perspective.

The Non-Agency RMBS sector is experiencing large negative net issuance, driven more by unscheduled principal payments rather than realized losses, as was the case not so long ago. On top of that, favorable NAIC ratings support a strong and consistent bid from insurance companies. We also think that the fundamental story for legacy resi credit is becoming better understood by the investor base. As the universe of outstanding legacy mortgages shrinks and the remaining mortgages age, the likely range of outcomes continues to narrow, thus reducing some of the variability that has plagued this asset class in the years since the crisis. Further, optionality pertaining to mortgage settlements and a pickup in voluntary prepayments make legacy Non-Agency RMBS an attractive investment opportunity with carry and potential upside.

While new issuance in resi credit remains dormant, GSE credit risk transfer (CRT) has gone from a mere concept to programmatic issuance during 2014, with about $11 billion of CRT-related issuance year-to-date. We expect that the CRT sector will grow and that more innovative forms of taking on leveraged mortgage credit risk from recent vintages of high-quality, conforming collateral will emerge in 2015.

The relative value proposition in CMBS versus corporates is less compelling and we expect a substantial increase in new issue supply. We recommend that longer-term investors consider moving up the credit curve on recently issued deals given declining credit quality. Shorter-term investors may find value in BBB- bonds given yields of approximately 6%, which may be enhanced via leverage. We think these bonds are one of the few remaining scalable CMBS opportunities where market participants can consistently find higher returns over the next couple of years with limited risk of near-term principal loss.

We continue to like CLOs, consistent with the preference of our leverage finance strategists for high yield bonds and leveraged loans. The finalization of risk retention rules has reduced the value of the refinancing optionality that the equity tranches are long and debt tranches are short. In addition, the LIBOR floor optionality for the equity tranches has declined as we move closer to rate hikes. The combination of these factors makes us favor CLO debt tranches versus equity, both for their potential for spread tightening over the course of next year and for attractive carry. In US CMBS, we expect spreads to remain relatively range-bound.

Return Performance Expectations

In Exhibit 1, we show our base, bull and bear case expectations for the performance of select securitized products expressed as 12-month spread/yield targets.

Exhibit 1

Expected Spread Targets Across Key Securitized Products (12-Month View)

	Current	Base	Bear	Bull
US Agency MBS	15	20	30	8
US Non-Agency Legacy (Alt-A)	270	240	350	225
US CMBS AAA	87	80	95	72
US CMBS BBB-	350	325	375	275
US CLO AAA	155	140	165	125
US CLO BBB	460	440	500	400
UK Prime RMBS Senior	35	30	35	28
UK Non Conforming Senior	90	75	105	70
ES RMBS Senior (ECB Eligible)	65	50	70	45

Source: Morgan Stanley Research
Note: US Agency MBS spread is LIBOR OAS; CMBS spreads expressed as spreads to Swap rate; all spreads in bps.

Volatility: Not All Volatility Is Equal

Phanikiran Naraparaju

Key Volatility Themes for 2015

- An unusually long, unsynchronized global cycle and easy central bank policy should keep equity and credit vol low. In contrast, FX and Rate volatility underprices commodity exposure and binary macro outcomes.
- FX remains a key transmission mechanism of global stresses and an attractive place to buy volatility. Commodity currency vol is significantly lower than commodity vols for example.
- Japan stands out as a region offering vol opportunity across assets given the pricing of upside and downside tails and the scale of the central bank balance sheet expansion.
- We view US/UK rates volatility as underwhelming, but we see an opportunity to buy gap risk hedges in multi-decade lows in rates and rates vol in Europe / Japan.

In 2015, we expect accommodative central banks, still-low rates, and a positive consumer oil shock to stave off deflation and prevent a major volatility spike. With the cycle intact, volatility should remain below average in 2015 (see [What the Cycle Means for Returns]) and we expect equity and credit vol spikes to be short-lived and relatively small in size. On the other hand, we don't see growth as being so strong that US rate volatility becomes a concern. Instead, against this backdrop of moderate global growth, we think the FX market offers some of the best vol opportunities.

Exhibit 1
Volatility and Percentiles

	IV Percentile on 10yr IV Range	IV Percentile on Historical RV Range	Current IV3m/RV1m
EURUSD			0.99
USDJPY			0.88
AUDUSD			0.88
USDZAR			1.06
US 10yr			1.54
EUR 10yr			1.27
JPY 10yr			0.85
S&P 500			2.35
Eurostoxx			1.07
EM Equities			1.00
US IG			1.89
US HY			2.29

Note: Source: Morgan Stanley Research, Bloomberg

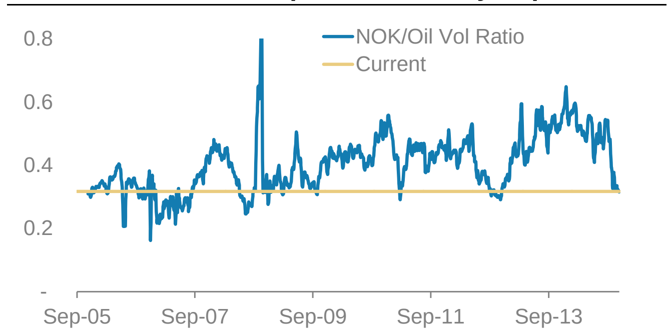
FX – Center of the Market Stresses

FX remains an important transmission mechanism for correcting global imbalances and (in some cases) an implicit policy tool. FX volatility did rise in 3Q14, but this was off a 20-year low, and current levels are still modest by previous cycles' standards. We see two themes in FX volatility:

i) **Commodities/Growth:** NZD, NOK and AUD are set to be the weakest currencies within the G10 on our forecasts, thanks in part to heavy commodity exposure. Downside hedges in these currencies look inexpensive in comparison to commodity volatility, which can be *three times* as high.

Brent volatility has doubled from the lows to around 30% (what oil options imply as a 20% tail scenario now would be a price of about $60/bbl for Brent). While Brent vol can trade higher, we believe further commodity weakness is hedged at cheaper levels through asset classes with high correlations (AUD, NZD and NOK and even lower-beta currencies should be correlated in the tail scenarios). In FXEM, we see individual currencies with high commodity exposure/ growth as attractive places to buy vol (ZAR, BRL), although vols may be expensive relative to G10 FX. We also see the potential to play the commodity weakness theme through the beneficiaries − buy calls on INR and TRY.

Exhibit 2
NOKUSD Vol Low despite Commodity Exposure

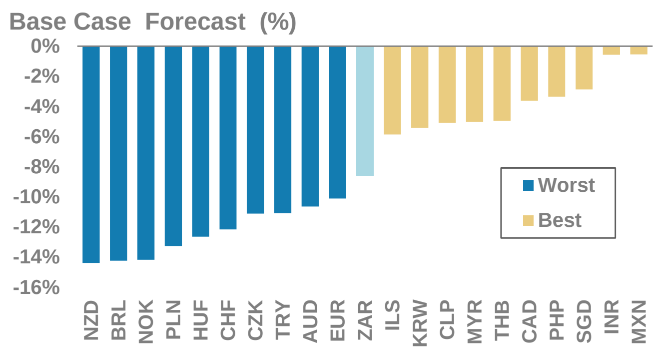


Source: Morgan Stanley Research

ii) **Easy Policy in Growth-Challenged Currencies:** Dovish central banks should cause significant weakness in EUR, JPY and CHF on our forecasts. Despite the recent spike in volatility, we see longer-duration downside volatility hedges as a core position from a portfolio point of view and would sell 1m options to monetize spikes in vol and moves in the spot − for example, in Japan recently. A key risk to the FX vol views is a bounce back after recent sharp declines in these currencies and commodities.

Exhibit 3

Broad-based USD Strength, More vs. G10 than EM



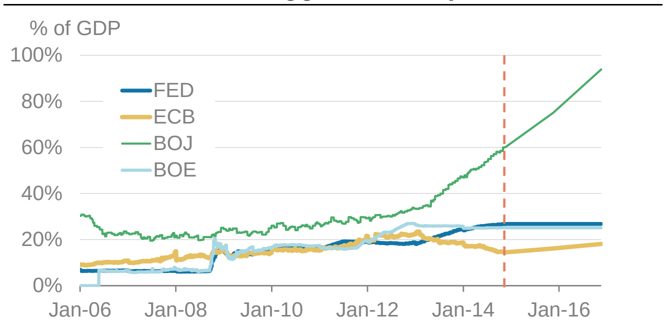
Source: Morgan Stanley Research Forecasts

Japan – Sink or Swim

Geographically, Japan is the clearest volatility opportunity – in the sense of the sharp tail scenarios on our forecasts. The key driver of this is the aggressive BoJ program to expand its balance sheet. BoJ has committed to increase its current balance sheet by 25% each year. If delivered, the BoJ balance sheet would be 90%+ of Japanese GDP at the end of 2016 (currently just under 60%). While the BoJ in theory is expected to expand its balance sheet for as many years as necessary, QE of this scale may pose a credibility challenge and raise questions about debt sustainability, although this is less of an issue for 2015.

Exhibit 4

BoJ Balance Sheet: Aggressive Expansion



Source: Morgan Stanley Research, Bloomberg

Thus we see the net balance of scenarios being quite binary. Our base case is that the aggressive efforts of the BoJ will raise the probability of success and boost growth and inflation. But if growth does not improve after this level of balance sheet expansion, there is little ammunition left in the BoJ armoury, and the bear case could be severe post 2015. We like owning long-dated vol across several asset classes: equities (upside), rates (higher), FX (JPY weaker) and CDS as an extreme tail hedge. A key risk to our Japan vol view lies in new elections scheduled for December 14th.

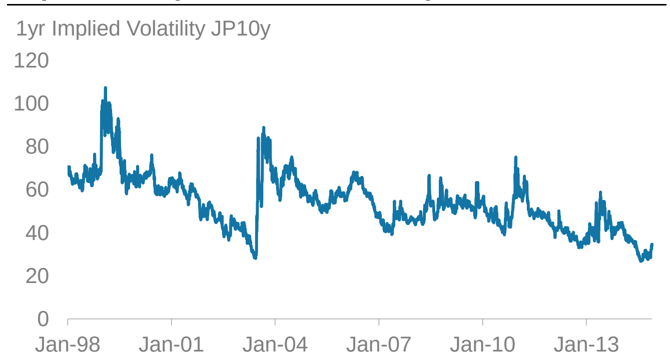
Rates Volatility – Hedge Gap Risk in Japan, Europe

We expect the ECB and BoJ to remain accommodative, keeping front-end yields anchored even as the Fed delays the first hike to 2016. Volatility buyers in US and UK rates could be disappointed as growth fails to break out in either direction and rates fail to move as much as forwards and consensus imply. Vol opportunities are largely about relative value here (Europe vs. US, Long-end vs. Front-end).

But given the absolute low level of volatility and the scale of the central bank effort, we would own gap risk hedges in Euro and Japan rates. The vol opportunity here is in buying long-dated (1yr+) vol on Europe and Japan 10yr+ sector. We favour selling 1x2 Payer Spread as a cheap vol and gap risk hedge in both regions – either rates lower or a lot higher. Key risk is a modest widening in yields without a vol spike.

Exhibit 5

Japan – A 15year Low in Volatility



Source: Morgan Stanley Research

Equity– Upside Opportunities, Relative Value
Credit Volatility – Tactical and Small Tail Hedges

We expect equity vol spikes will be short-lived and hard to monetize in 2015 as an improving growth picture keeps the downside in check. That said, current vol levels are not particularly attractive to sell into, and there may be tactical opportunity to hedge with relatively basic vol-neutral strategies such as put spreads. We like buying vols in EM, where the tail scenario is a sharp dollar appreciation that puts stress on the EM debt trajectory. In contrast we like buying upside tails in Europe and Japan, for example buying calls or call spreads. A sharp weakening of global growth is a key risk to our equity as well as the credit vol view below.

Credit vol themes are similar to equity – vol spikes are meant to be sold into, and our base case is that the cycle does not turn yet. However, volatility is reasonably low and we favour buying simple put spreads and put spread collars as a hedge for largely small tail scenarios (defined as a 30-40bp move in IG credit and 150bp move for high yield credit).

Oil Price Risk: Looking for Asymmetry

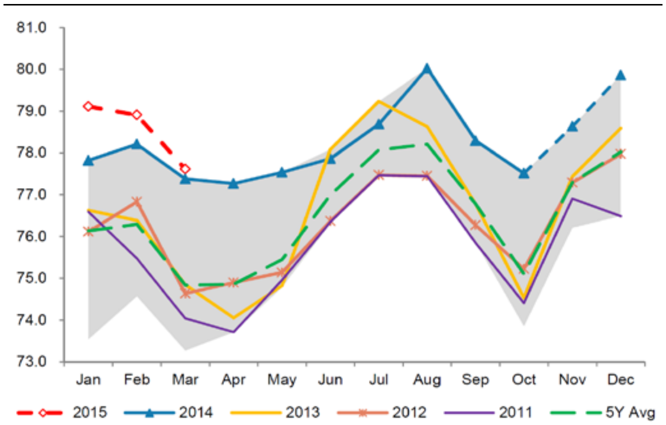
Andrew Sheets

Key Energy Sector Themes for 2015

- OPEC's failure to cut production adds uncertainty, but our base case assumes that oil ends 2015 higher.
- Outcomes, of course, are uncertain. Investors should look for a positive skew of outcomes, driven by how much oil weakness is already "in the price".
- Consumer Discretionary stocks, India FX and Rates, and Japanese Equities can do well in our base-case scenario and also if oil prices continue to decline.
- RUB, MYR, and NOK enjoy a less favorable skew, while buying oil volatility looks expensive relative to oil-exposed currencies.

The price of crude oil has fallen by over 31% since the start of 2014. Following OPEC's decision not to cut production, the outlook remains volatile, with risk that prices continue to slide. However, we think demand is set to improve seasonally (Exhibit 1), global excess capacity isn't as high as widely feared, and the more oil falls *near term*, the more it may rise *longer term*, given that current weakness discourages future investment.

Exhibit 1
Global Crude Demand Entering Seasonal Strength: Runs & Direct Use, mmb/d



Source: IEA, Morgan Stanley Commodity Research Estimates

Our base case assumes that oil ends the year higher than current levels, based on a reasonable level of global demand and a realistic probability of some supply removal in the year ahead, through either disruption or producer response (see Near Term Fundamentals Not As Bad As Suggested, November 26, 2014). There is a wide band around this, which is also, incidentally, what oil options markets are pricing (markets price a roughly 1-in-5 probability that Brent ends 2015 below $60/bbl, versus the YE15 forward currently pricing at $78/bbl).

Looking for Asymmetry

For investors, we think this means trying to source cheap optionality through assets that do well both in our base case and one of the tail scenarios.

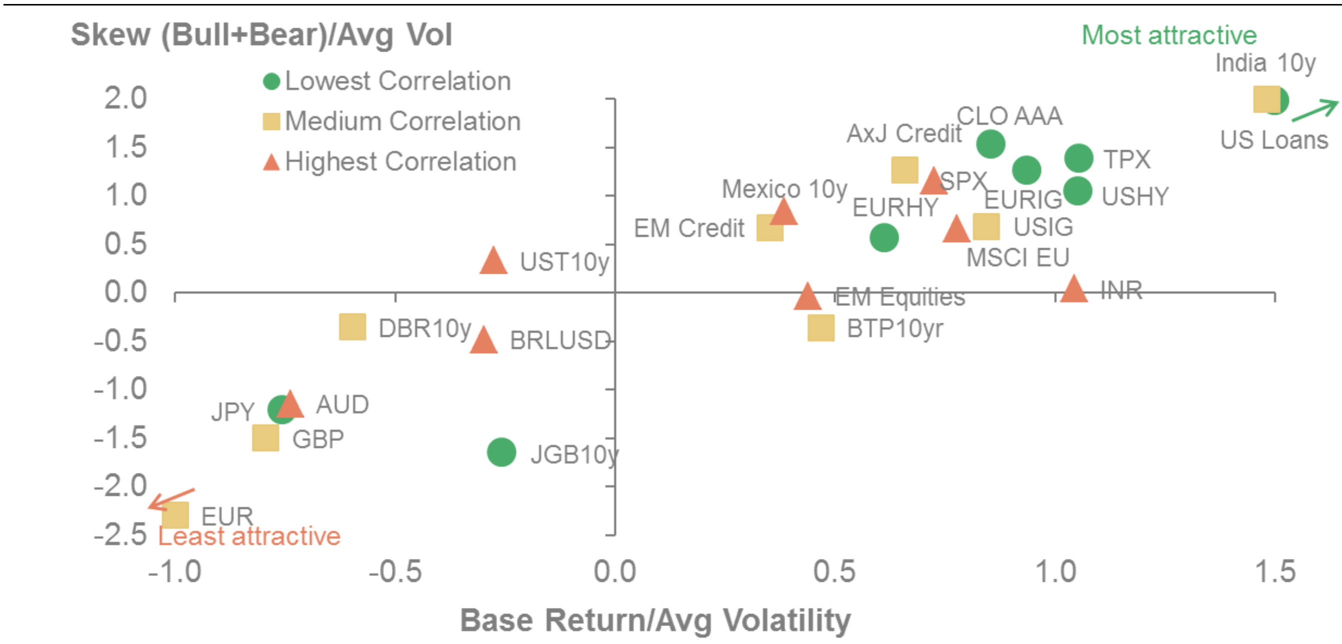
Protection against Further Declines: Consumer Discretionary stocks in the US and Europe, Japanese Equities, India FX/Rates and securitized product are all outperformers in our base-case economic and energy forecasts. But all three also enjoy above-average protection from further declines in oil, thanks to positive offsets for consumer spending (for Discretionary), India being an oil importer, and Japan being both an oil importer and having little energy exposure in its equity market.

Optionality on a Stronger Snapback: The decline in oil has weighed heavily on sentiment and performance for both US high yield bonds and US energy equities. We think valuations have adjusted enough that all three could outperform if oil simply stabilizes, given the severity of the move down and shift in investor sentiment. Mexican and Colombia local rates are two additional oil-exposed stories that already do well in our base case.

Poor Risk/Reward: Conversely, there are markets that likely struggle even under our forecasts of a modest rebound and remain vulnerable to a lower-than-expected outcome for oil prices. Russia and Malaysia, in both FX and local rates, stand out in EM, while NOK trades lower in our baseline scenario and with additional risk if oil prices stay lower for longer. We think oil volatility looks expensive (see page 27), and see better value buying downside volatility in commodity currencies.

Asset Allocation for 2015

All Assets – 1yr Expected Return vs. Return Skew (Vol-Adjusted)



Source: Morgan Stanley Research, Bloomberg, Yield Book; Correlation is one-year, relative to a portfolio of 50%/50% US stocks and US Treasuries. Credit returns used are excess returns.

Morgan Stanley Key Market Forecasts

	As of Nov 25, 2014	Q4 2015 Forecast Bear	Base	Bull
Equities				
S&P 500	2,067	1,700	2,275	2,750
MSCI Europe	1,407	1,011	1,557	1,872
Topix	1,409	1,195	1,680	1,961
MSCI EM	1,009	686	1,067	1,272
MSCI Asia Pacific ex-Japan	476	361	536	636
FX				
USD/JPY	117.9	110	127.0	145
EUR/USD	1.25	1.00	1.12	1.29
GBP/USD	1.57	1.35	1.47	1.60
AUD/USD	0.85	0.65	0.76	0.90
USD/BRL	2.53	2.70	2.95	3.20
USD/INR	61.9	59.0	62.2	65.0
Rates (% percent)				
UST 10yr	2.26	3.25	2.85	1.80
DBR 10yr	0.75	1.72	1.35	0.50
UKT 10yr	2.01	3.30	2.70	1.50
JGB 10yr	0.45	1.40	0.70	0.45
Credit (bps)				
US IG	124	168	101	80
US HY	480	646	378	322
EUR IG	104	125	90	80
EUR HY	435	580	425	375
EM Sovs	353	485	375	277
Asia Overall	252	287	244	205
US Loans	505	587	424	382

Source: Markit, MSCI, Bloomberg, The Yield Book, Morgan Stanley Research forecasts

Morgan Stanley 1-year Return/Risk Forecasts

Asset	12m Return Bear Case	Base Case	Bull Case	Volatility Metrics Forecast Implied	Option Implied	Return/Risk Base case Return/Vol
Equities						
S&P 500	-16%	12%	35%	18%	16%	0.72
MSCI Europe	-25%	14%	37%	21%	18%	0.78
Topix	-13%	21%	41%	24%	21%	1.06
MSCI EM	-29%	8%	29%	19%	19%	0.44
FX						
JPY/USD	-19%	-7.3%	7%	12.2%	10.9%	-0.75
EUR/USD	-25%	-15.4%	-2%	11.9%	8.3%	-1.85
GBP/USD	-13%	-5.8%	3%	8.1%	7.7%	-0.79
AUD/USD	-21%	-7.9%	9%	13.8%	10.0%	-0.74
BRL/USD	-10%	-3.3%	5%	17.7%	13.8%	-0.30
Rates						
UST 10yr	-5.2%	-1.6%	7.1%	4.6%	6.9%	-0.28
DBR 10yr	-5.3%	-2.6%	3.8%	5.0%	5.0%	-0.60
UKT 10yr	-6.7%	-2.4%	7.1%	6.2%	7.1%	-0.42
JGB 10yr	-6.0%	-0.8%	1.1%	3.7%	3.4%	-0.26
Credit (Excess Return)						
Italy 10yr	-7.9%	2.6%	5.9%	5.4%	5.9%	0.47
US IG	-2.2%	2.9%	4.5%	2.7%	4.3%	0.85
US HY	-2.4%	6.5%	8.8%	4.6%	8.2%	1.05
EUR IG	0.1%	1.5%	1.8%	0.9%	2.7%	0.90
EUR HY	-2.1%	3.3%	5.1%	3.1%	8.6%	0.61
EM Sovs	-5.0%	2.1%	8.9%	5.2%	5.0%	0.35
AxJ Credit	0.1%	2.3%	4.4%	1.6%	3.4%	0.66
US CMBS	1.0%	-0.4%	1.7%	1.1%	4.8%	-0.08
US Loans	0.8%	4.8%	5.3%	4.4%	2.8%	1.73

Source: Bloomberg, Morgan Stanley Research forecasts; Note: Option-implied volatility is 1yr options (6m for credit) implied volatility and, if absent, 1yr realised volatility (value shown in grey if so). Forecast implied is the volatility of our bull/base /bear case forecast. A red flag indicates the forecast implied vol is 20% greater than options volatility. A green flag indicates the forecast implied vol is 20% lesser than options volatility.

Current Morgan Stanley Asset Allocations

MS Asset Allocation Views	Top-Down Allocation	Relative Allocation	O/W vs. Benchmark
Equites	4.0%	3.0%	7.0%
US	1.0%	1.0%	2.0%
Europe	1.0%	1.0%	2.0%
Japan	1.0%	2.0%	3.0%
EM	1.0%	-1.0%	0.0%
Govt. Bonds	-8.0%	-2.0%	-10.0%
Treasuries	-2.0%	-1.0%	-3.0%
Bunds	-2.0%	-2.0%	-4.0%
JGBs	-2.0%	-1.0%	-3.0%
EM Local	-2.0%	2.0%	0.0%
Credit	0.0%	4.0%	4.0%
US Corp.	0.0%	2.0%	2.0%
EU Corp.	0.0%	1.0%	1.0%
EM Sov.	0.0%	0.0%	0.0%
Securitized	0.0%	1.0%	1.0%
Other			-1.0%
Cash			-1.0%

Current
Previous

Notes: Securitized credit is currently defined as 50/50 Agency MBS and CMBS AAA and the dot refers to view on these two assets only. There are opportunities within securitized credit which we might consider more attractive.

We hold a modest overweight in equities (+1 on the five-point scale from -2 to +2). This adds a +1% weight for each region (US, Europe, Japan, EM), relative to benchmark. Next, we make adjustments based on sector-specific views. MSCI EM is a modest underweight within equities (-1 on the five-point scale), reducing its allocation by -1%. Combined with the strategic overweight of +1%, this nets to a 0% deviation from benchmark.

Source: Morgan Stanley Research

What's in Our Benchmark?

Asset	Sub-Asset	Weight	Returns Index	Sub-Weights
Equities	US Equities	25%	SPX Index	25%
	European Equities	10%	MSCI Europe	10%
	Japan Equities	5%	TOPIX	5%
	EM Equities	10%	MSCI EM	10%
Rates	US Rates	10%	UST 10yr	10%
	European Rates	10%	DBR 10yr	10%
	Japan Rates	5%	JGB 10yr	5%
	EM Local	5%	MS EM Local Index*	5%
Credit	US Corporates	6%	US BIG Corp index (Yield Book)	4%
			US HY Market (Yield Book)	2%
	European Corporates	3%	iBoxx EUR IG Corporate Index	2%
			iBoxx EUR HY Index	1%
	EM Sovereigns	3%	EMBI Global Index	3.0%
	Securitized Credit	3%	Agency MBS	1.5%
			Non-Agency MBS	0.5%
			CLO	0.5%
			CMBS	0.5%
Other	Commodities	2%	Bloomberg Commodity Index	2%
	Cash	3%	US Libor 1m	3%

Note: * MS constant-weighted basket of 10yr Local bonds. Source: Morgan Stanley Research

Morgan Stanley Key Market Forecasts

	As of Nov 25, 2014	Q4 2015 Forecast		
		Bear	Base	Bull
Equities				
S&P 500	2,067	1,700	**2,275**	2,750
MSCI Europe	1,407	1,011	**1,557**	1,872
Topix	1,409	1,195	**1,680**	1,961
MSCI EM	1,009	686	**1,067**	1,272
MSCI Asia Pacific ex-Japan	476	361	**536**	636
FX				
USD/JPY	117.9	110	**127.0**	145
EUR/USD	1.25	1.00	**1.12**	1.29
GBP/USD	1.57	1.35	**1.47**	1.60
AUD/USD	0.85	0.65	**0.76**	0.90
USD/BRL	2.53	2.70	**2.95**	3.20
USD/INR	61.9	59.0	**62.2**	65.0
USD/ZAR	10.9	11.0	**12.0**	13.0
Rates (% percent)				
UST 10yr	2.26	3.25	**2.85**	1.80
DBR 10yr	0.75	1.72	**1.35**	0.50
UKT 10yr	2.01	3.30	**2.70**	1.50
JGB 10yr	0.45	1.40	**0.70**	0.45
Credit (bps)				
US IG	124	168	**101**	80
US HY	480	646	**378**	322
EUR IG	104	125	**90**	80
EUR HY	435	580	**425**	375
EM Sovs	353	485	**375**	277
Asia Overall	252	287	**244**	205
US Loans	505	587	**424**	382

Source: Markit iBoxx, MSCI, Bloomberg, The Yield Book, Morgan Stanley Research

Morgan Stanley Key Economic Forecasts

Global Economics Team

	Quarterly												Annual		
	2014				2015				2016				2014E	2015E	2016E
Real GDP (%Q, SAAR)	**1Q**	**2Q**	**3QE**	**4QE**	**1QE**	**2QE**	**3QE**	**4QE**	**1QE**	**2QE**	**3QE**	**4QE**			
Global*	**2.3**	**3.4**	**3.6**	**2.8**	**3.6**	**3.1**	**3.5**	**3.5**	**3.7**	**3.7**	**3.9**	**3.8**	**3.2**	**3.5**	**3.9**
G10	**0.6**	**1.7**	**2.0**	**1.4**	**2.6**	**1.7**	**2.1**	**2.1**	**2.1**	**2.0**	**2.0**	**2.1**	**1.6**	**2.0**	**2.0**
US	-2.1	4.6	3.9	1.7	4.1	1.8	2.6	2.5	2.3	2.2	2.1	2.1	2.2	2.9	2.3
Euro Area	1.2	0.3	0.6	0.6	0.9	1.2	1.6	1.6	1.7	1.8	1.8	1.6	0.8	1.0	1.7
Japan	6.7	-7.3	-1.6	0.6	1.8	2.3	0.9	1.5	1.9	2.0	2.1	3.0	0.2	0.6	1.8
UK	3.0	3.7	2.8	2.6	2.5	2.0	2.5	2.0	2.0	1.2	1.6	2.1	3.0	2.5	1.9
EM (%Y)	**4.7**	**4.6**	**4.5**	**4.3**	**4.6**	**4.6**	**4.7**	**4.9**	**5.0**	**5.3**	**5.4**	**5.5**	**4.5**	**4.6**	**5.3**
China	7.4	7.5	7.3	7.2	7.4	7.1	6.9	6.8	6.8	7.0	7.3	7.5	7.3	7.0	7.2
India	4.6	5.7	5.3	5.6	6.0	6.1	6.5	6.6	6.8	6.8	6.9	6.9	5.3	6.3	6.8
Brazil	1.9	-0.9	0.1	-0.2	-0.5	-0.5	-0.3	0.0	0.7	1.5	1.6	1.6	0.2	-0.3	1.3
Russia	0.9	0.8	0.7	-0.6	-1.2	-2.0	-2.4	-1.3	-0.5	0.5	1.3	1.5	0.4	-1.7	0.8
Consumer price inflation (%Y)															
Global	**3.4**	**3.8**	**3.6**	**3.4**	**3.5**	**3.4**	**3.6**	**3.7**	**3.6**	**3.7**	**3.7**	**3.8**	**3.5**	**3.6**	**3.7**
G10	**1.2**	**1.8**	**1.5**	**1.3**	**1.2**	**1.0**	**1.2**	**1.6**	**1.8**	**1.9**	**1.9**	**1.9**	**1.3**	**1.2**	**1.9**
US	1.4	2.1	1.8	1.4	1.1	1.0	1.3	1.8	2.2	2.3	2.2	2.2	1.7	1.3	2.2
Euro Area	0.7	0.6	0.4	0.4	0.5	0.8	1.0	1.4	1.4	1.4	1.4	1.4	0.5	0.9	1.4
Japan	1.3	3.3	3.2	2.8	2.8	0.9	0.9	1.3	1.5	1.5	1.6	1.8	2.7	1.5	1.6
UK	1.7	1.7	1.5	1.2	1.1	1.3	1.6	1.8	1.8	1.8	1.8	1.9	1.5	1.4	1.8
EM	**5.2**	**5.4**	**5.2**	**5.0**	**5.4**	**5.3**	**5.3**	**5.3**	**5.0**	**5.0**	**5.0**	**5.2**	**5.2**	**5.3**	**5.1**
China	2.3	2.2	2.0	1.7	1.8	1.9	2.0	2.1	2.1	2.3	2.5	2.9	2.0	2.0	2.4
India	8.4	8.1	7.4	5.3	6.4	6.1	5.4	6.2	6.2	6.2	5.9	5.9	7.3	6.0	6.0
Brazil	5.8	6.4	6.6	6.6	6.7	6.4	6.5	6.2	6.1	6.1	5.9	6.0	6.3	6.5	6.0
Russia	6.4	7.6	7.7	8.7	9.6	9.1	9.1	8.2	7.6	7.0	6.8	6.6	7.6	9.0	7.0
Monetary policy rate (% p.a.)															
Global	**3.4**	**3.4**	**3.4**	**3.4**	**3.4**	**3.3**	**3.3**	**3.3**	**3.4**	**3.5**	**3.6**	**3.7**	**3.4**	**3.3**	**3.7**
G10	**0.3**	**0.3**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.5**	**0.7**	**1.0**	**1.2**	**0.2**	**0.2**	**1.2**
US	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.625	1.125	1.625	2.125	0.125	0.125	2.125
Euro Area	0.25	0.15	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
UK	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	0.50	0.75	1.25
EM	**6.1**	**6.1**	**6.1**	**6.1**	**6.1**	**5.9**	**5.9**	**5.8**	**5.8**	**5.8**	**5.8**	**5.8**	**6.1**	**5.8**	**5.8**
China	6.00	6.00	6.00	5.60	5.35	5.10	5.10	5.10	5.10	5.10	5.10	5.10	5.60	5.10	5.10
India	8.00	8.00	8.00	8.00	7.75	7.50	7.50	7.50	7.50	7.50	7.50	7.50	8.00	7.50	7.50
Brazil	10.75	11.00	11.00	11.50	12.00	12.00	11.50	10.50	10.00	10.00	10.00	10.00	11.50	10.50	10.00
Russia	7.00	7.50	8.00	9.50	10.00	10.00	10.00	9.50	9.00	8.50	8.00	7.50	9.50	9.50	7.50

Note: Global and regional aggregates are GDP-weighted averages, using PPPs; as of this report, they are based on new PPP weights and are not comparable to the aggregates published in the September *Back-to-School*. Japan CPI includes VAT; Japan policy rate is the interest rate on excess reserves; CPI numbers are period averages. *G10+BRICs+Korea.

Source: Morgan Stanley Research forecasts

Morgan Stanley Global Currency Forecasts

	2014	2015				2016			
	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16
EUR/USD	1.24	1.20	1.18	1.14	1.12	1.12	1.13	1.14	1.15
USD/JPY	120	122	123	126	127	126	125	123	125
GBP/USD	1.55	1.51	1.47	1.45	1.47	1.49	1.48	1.47	1.46
USD/CHF	0.98	1.01	1.03	1.07	1.10	1.11	1.12	1.12	1.13
USD/SEK	7.54	7.88	7.92	8.16	8.21	8.13	7.96	7.98	7.83
USD/NOK	6.85	7.13	7.29	7.59	7.77	7.81	7.70	7.59	7.48
USD/CAD	1.13	1.14	1.15	1.16	1.17	1.19	1.20	1.21	1.22
AUD/USD	0.84	0.82	0.80	0.78	0.76	0.77	0.78	0.80	0.79
NZD/USD	0.76	0.74	0.71	0.69	0.67	0.66	0.65	0.65	0.64
EUR/JPY	149	146	145	144	142	141	141	140	144
EUR/GBP	0.80	0.79	0.80	0.79	0.76	0.75	0.76	0.78	0.79
EUR/CHF	1.21	1.21	1.22	1.22	1.23	1.24	1.26	1.28	1.30
EUR/SEK	9.35	9.45	9.35	9.30	9.20	9.10	9.00	9.10	9.00
EUR/NOK	8.50	8.55	8.60	8.65	8.70	8.75	8.70	8.65	8.60
USD/CNY	6.14	6.16	6.13	6.12	6.09	6.14	6.09	6.07	6.07
USD/HKD	7.80	7.80	7.80	7.80	7.80	7.80	7.80	7.80	7.80
USD/IDR	12200	12400	12600	12800	13000	12800	12700	12600	12500
USD/INR	62.0	62.5	62.5	62.3	62.2	62.0	62.0	62.0	62.0
USD/KRW	1140	1190	1210	1230	1230	1200	1190	1170	1190
USD/MYR	3.38	3.42	3.45	3.48	3.53	3.50	3.47	3.43	3.40
USD/PHP	45.0	45.5	46.0	46.3	46.5	46.3	46.3	46.1	46.0
USD/SGD	1.30	1.31	1.32	1.33	1.34	1.33	1.32	1.31	1.30
USD/TWD	30.6	30.8	31.0	31.1	31.2	31.0	30.8	30.6	30.5
USD/THB	33.0	33.4	33.8	34.2	34.5	34.2	34.0	33.8	33.5
USD/BRL	2.60	2.68	2.73	2.92	2.95	3.00	3.05	3.10	3.15
USD/MXN	13.60	13.70	13.70	13.70	13.80	13.80	13.70	13.70	13.75
USD/ARS	10.00	10.63	11.25	11.88	12.50	12.50	12.50	12.50	12.50
USD/VEF	12.0	12.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0
USD/CLP	595	600	615	635	630	630	625	625	620
USD/COP	2166	2195	2210	2310	2315	2370	2350	2360	2345
USD/PEN	2.96	2.98	3.07	3.16	3.21	3.19	3.18	3.18	3.16
USD/ZAR	11.20	11.50	11.75	11.85	12.00	12.00	11.95	11.75	11.70
USD/TRY	2.30	2.35	2.40	2.45	2.50	2.50	2.47	2.44	2.40
USD/ILS	3.88	3.95	4.00	4.05	4.10	4.10	4.05	4.00	4.00
USD/RUB	48.0	49.0	50.0	50.2	50.2	49.8	49.3	49.3	49.0
EUR/PLN	4.26	4.30	4.33	4.35	4.35	4.34	4.28	4.24	4.18
EUR/CZK	27.8	27.8	27.8	27.9	27.9	27.9	27.6	27.4	27.0
EUR/HUF	308	310	312	314	315	315	310	304	300
EUR/RON	4.45	4.46	4.48	4.50	4.50	4.45	4.45	4.40	4.40
MS Dollar Index	89.12	91.17	92.57	94.64	95.36	95.26	95.08	94.77	95.17
MS AXJ Index	103.78	102.30	101.66	101.05	100.81	101.54	102.13	102.85	102.75

Source: Morgan Stanley Research

Morgan Stanley Government Bond Yield / Spread Forecasts

	2-Year					5-Year					10-Year				
	4Q14	1Q15	2Q15	3Q15	4Q15	4Q14	1Q15	2Q15	3Q15	4Q15	4Q14	1Q15	2Q15	3Q15	4Q15
US	0.60	0.70	1.10	1.10	1.20	1.70	1.80	2.10	2.15	2.35	2.40	2.50	2.65	2.65	2.85
Germany	-0.05	-0.05	-0.05	-0.05	-0.05	0.11	0.15	0.20	0.25	0.30	0.80	0.85	1.15	1.25	1.35
Japan	0.02	0.02	0.02	0.02	0.05	0.10	0.10	0.10	0.10	0.15	0.45	0.40	0.45	0.50	0.70
UK	0.60	0.65	0.70	0.90	1.10	1.40	1.50	1.60	1.85	2.00	2.15	2.25	2.45	2.60	2.70
Australia	2.78	2.88	2.97	3.06	3.16	2.93	3.00	3.10	3.11	3.24	3.35	3.40	3.50	3.45	3.60
New Zealand	3.81	3.94	4.06	4.19	4.31	3.72	3.79	3.89	3.89	4.03	4.15	4.20	4.30	4.25	4.40
Austria*	4	3	3	2	2	3	3	3	2	2	17	16	16	14	14
Netherlands*	4	3	3	2	2	10	8	6	5	5	16	14	12	12	12
France*	4	4	3	3	3	16	14	12	10	8	35	32	31	30	28
Belgium*	3	3	3	3	3	10	8	6	6	6	28	25	23	22	20
Ireland*	9	5	4	4	4	36	30	25	20	20	76	70	65	60	60
Spain*	45	30	25	20	18	90	75	65	60	55	131	105	100	90	85
Italy*	62	50	45	40	38	99	85	80	75	70	152	140	135	130	125
Portugal*	47	30	25	25	20	159	135	120	115	115	235	200	190	175	165
Greece**	654	625	550	400	300	706	650	600	480	405	737	700	650	600	550
Russia	10.40	10.40	10.40	10.00	9.50	10.35	10.35	10.30	10.00	9.65	10.30	10.30	10.20	10.00	9.80
Poland	1.85	1.65	1.70	1.75	1.80	2.15	1.90	2.00	2.10	2.20	2.60	2.30	2.50	2.60	2.70
Czech Rep.	0.10	0.15	0.20	0.30	0.40	0.20	0.30	0.40	0.50	0.60	0.80	0.95	1.30	1.45	1.60
Hungary	2.60	2.50	2.60	2.65	2.70	2.95	2.80	2.95	3.00	3.10	3.50	3.30	3.50	3.60	3.80
Turkey	7.80	7.60	7.70	7.80	7.90	8.00	8.00	8.20	8.30	8.45	8.10	8.10	8.40	8.50	8.70
Israel	0.30	0.35	0.50	0.55	0.60	0.95	1.05	1.20	1.25	1.35	2.15	2.30	2.40	2.50	2.60
S. Africa	6.30	6.10	6.20	6.30	6.40	6.95	6.70	6.85	7.00	7.10	7.60	7.30	7.50	7.70	7.80
China	3.25	3.10	2.95	2.80	2.60	3.40	3.25	3.12	2.99	2.89	3.50	3.35	3.25	3.15	3.20
India	8.20	7.90	7.80	7.70	7.45	8.20	7.94	7.76	7.66	7.47	8.20	8.00	7.70	7.60	7.50
Hong Kong	0.42	0.52	0.90	0.90	1.00	1.28	1.38	1.67	1.67	1.81	1.90	2.00	2.15	2.15	2.35
S. Korea	2.20	1.95	2.05	2.15	2.30	2.41	2.18	2.36	2.51	2.69	2.75	2.50	2.60	2.70	2.85
Taiwan	0.55	0.56	0.57	0.58	0.60	1.14	1.16	1.19	1.20	1.25	1.65	1.69	1.75	1.76	1.85
Indonesia	7.50	7.65	7.80	7.90	8.00	7.76	7.87	8.01	8.13	8.28	7.90	7.96	8.07	8.20	8.40
Malaysia	3.50	3.52	3.54	3.56	3.58	3.77	3.82	3.87	3.90	3.97	3.95	4.05	4.15	4.20	4.35
Thailand	2.13	2.15	2.20	2.35	2.55	2.40	2.42	2.47	2.60	2.80	3.10	3.12	3.15	3.25	3.45
Brazil	12.50	12.80	12.00	11.50	11.00	11.50	12.00	11.25	11.50	12.00	11.50	12.00	11.25	11.50	12.00
Mexico	3.40	3.50	3.60	3.70	3.80	4.90	4.70	4.80	4.90	5.00	5.70	5.50	5.80	5.90	6.00
Chile	-	-	-	-	-	4.30	4.50	4.70	4.90	5.10	4.30	4.50	4.70	4.90	5.10
Peru	3.60	3.60	3.70	3.80	4.00	4.60	4.70	4.80	4.90	5.00	5.25	5.40	5.50	5.60	5.70
Colombia	4.50	4.20	4.00	4.10	4.20	5.20	4.90	4.90	5.00	5.10	6.20	5.90	6.00	6.20	6.40

*Yield spread to Bunds
Source: Morgan Stanley Research forecasts

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Underweight/Sell	**582**	**18%**	**100**	**11%**	**17%**
Total	**3,242**		**879**		

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