Global Investment Committee Monthly

IN BRIEF

March Meeting Summary

MARKETS. While risk-asset markets have rallied since last autumn's lows, the more cautious tactical asset allocations we adopted at that time remain in place given the lack of policy response to the recession in Europe and subpar US growth. Even so, our model portfolios' performances have held up. We are overweight (OW) cash, short-duration bonds, investment grade bonds and managed futures. We are underweight (UW) to developed-country sovereign debt, high yield bonds, equities, commodities, global real estate investment trusts and inflation-linked securities. We are market weight emerging market (EM) bonds. Within global equities, we continue to OW both EM and US equities but UW other developed-market (DM) equities. Within US equities, our capitalization preference is large caps and our style preference is growth.

ECONOMICS. A recession is under way in Europe and growth is slowing in the US and the EM economies. We expect global growth to remain positive since the bulk of it comes from the emerging markets. The policy options to combat recession in DM economies are either limited, politically unlikely or too little, too late. Moreover, fiscal policy is tightening in Europe and the US. By contrast, the fundamentals and policy options in EM economies are much more robust. Globally, we expect inflation to abate.

PROFITS. Expectations for 52-week forward earnings per share (EPS) have remained fairly high. S&P 500 forward earnings peaked at $108 last summer, eased to $107 in the autumn and have now recovered to more than $108. Consensus forecasts are for robust growth in US and global EPS in 2012. If our cautious outlook is correct, those estimates should come down. Meanwhile, consensus global and regional net EPS revisions have turned up.

INTEREST RATES. DM central-bank policy rates are likely to remain low for years. A third round of Quantitative Ease (QE) in the US is likely later this spring. The European Central Bank's QE equivalent, the Long Term Refinancing Operation, has been a success. Meanwhile, a few EM central banks have already begun easing to offset slower DM growth.

CURRENCIES. In the short term, we expect US-dollar strength and euro weakness. Longer term, major DM currencies will likely decline relative to several EM currencies.

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Summary of Strategic & Tactical Allocations for Global Investment Committee Asset Allocation Models

The table below summarizes our best thinking on the construction of strategic portfolios and tactical asset allocation. These three portfolios are a sampling of our guidance for investors with more than $20 million of investable assets, and are a subset of the GIC asset allocation models that are shown starting on page 19. The strategic equity allocations in these portfolios are in proportion to their share of global market capitalization.

EFFECTIVE JAN. 20, 2012

Model	Moderate Balanced Strategic Weight	Tactical Relative Weight	Equity & Alternative Investments Strategic Weight	Tactical Relative Weight	Bond & Alternative Investment Strategic Weight	Tactical Relative Weight
Global Cash	5%	2%	0%	0%	25%	2%
Global Bonds	37	0	0	0	65	-1
Global Equities	32	-2	70	-4	0	0
Global Alternative/Absolute Return Investments	26	0	30	4	10	-1
Global Bonds						
Investment Grade	30	1	-	-	65	-1
Short Duration	5	2	-	-	10	2
Government/Government-Related	18	-8	-	-	39	-12
Corporate & Securitized	7	7	-	-	16	9
High Yield	4	-1	-	-	-	-
Emerging Markets	3	0	-	-	-	-
Total Bonds	**37**	**0**	**-**	**-**	**65**	**-1**
Total Cash & Short Duration Bonds	10	4	-	-	35	4
Global Equities						
US Large	12	2	24	3	-	-
Growth	6	2	12	4	-	-
Value	6	0	12	-1	-	-
US Mid	2	0	4	0	-	-
Growth	1	0	2	0	-	-
Value	1	0	2	0	-	-
Canada	1	0	3	0	-	-
Europe	6	-4	14	-10	-	-
Europe ex UK	4	-4	9	-8	-	-
UK	2	0	5	-2	-	-
Developed Asia	3	-2	8	-5	-	-
Japan	2	-2	5	-5	-	-
Asia Pacific ex Japan	1	0	3	0	-	-
US Small	2	0	4	0	-	-
Growth	1	0	2	0	-	-
Value	1	0	2	0	-	-
World ex US Small Cap	2	0	4	0	-	-
Emerging Markets	4	2	9	8	-	-
Total Equities	**32**	**-2**	**70**	**-4**	**-**	**-**
US Equity	16	2	32	3	-	-
Developed World ex US	12	-6	29	-15	-	-
Developed Market Equity	28	-4	61	-12	-	-
Emerging Market Equity	4	2	9	8	-	-
Global Alternative/Absolute Return Investments						
REITs	3	-1	2	0	-	-
Commodities	2	-1	5	-1	-	-
Inflation-Linked Securities	3	-1	-	-	10	-1
Managed Futures Funds	4	3	5	5	-	-
Hedge Funds	11	0	10	0	-	-
Private Real Estate	-	-	3	0	-	-
Private Equity	3	0	5	0	-	-
Total Alternative/Absolute Return Investments	**26**	**0**	**30**	**4**	**10**	**-1**

Source: Global Investment Committee as of Jan. 20, 2012

Tactical Asset Allocation Reasoning

Global Bonds	Relative Weight Within Bonds	
Short Duration	Overweight	Given the heightened risk of recession in many developed economies, we favor this safe-haven asset class.
Government	Underweight	With yields near historical lows in perceived safe havens and an unusual degree of uncertainty about additional credit downgrades and default risk in some countries, we see better value elsewhere within the bond market.
Investment Grade Corporates	Overweight	These bonds offer relative safety and quality. In the US, yield spreads versus Treasuries are above average.
High Yield	Underweight	In the event of another "growth scare," yield spreads are likely to widen.
Emerging Markets	Market Weight	Attractive yield spreads are offset by a desire to limit exposure to riskier asset classes.

Global Equities	Relative Weight Within Equities	
US	Overweight	We have a defensive stance that favors large-cap stocks at the capitalization level and growth stocks at the style level. Relative-valuation readings also support this positioning.
Developed Markets ex US	Underweight	At the regional level, we are market weight to Canada and the Asia Pacific ex Japan region (predominantly Australia) and underweight to Europe and Japan, where challenges to economic growth appear to be structural as well as cyclical.
Emerging Markets	Overweight	Fundamental factors such as economic and earnings growth, government balance sheets and indebtedness remain relatively favorable. Policymakers' focus has generally shifted away from containing inflation and toward supporting growth, and there is more scope for policy support than in the developed economies.

Global Alternative/ Absolute Return Investments	Relative Weight Within Alternative Investments	
REITs	Underweight	Given a backdrop of slowing global economic growth, and lacking a relative-valuation advantage, we are inclined to limit exposure to this asset class.
Commodities	Underweight	Demand for many commodities will be negatively affected by the slowing in global economic activity.
Inflation-Linked Securities	Underweight	With breakeven rates close to their long-term averages, we see better value elsewhere.
Managed Futures	Overweight	This asset class often performs well during extended periods of adverse equity market conditions.

In Like a Lion

Most risk assets have enjoyed strong rallies, but potential challenges remain.

Three years have passed since global equities bottomed on March 9, 2009. The first year saw a robust 79% return in the MSCI All Country World Index and 72% for the S&P 500 Index (see Chart 1). In the second year, global and US equities returned a still snappy 17% and 18%, respectively. The third year disappointed, with -1% for global equities and a 6% gain for the US. What will the fourth year bring?

Despite the markets' many positive reactions to the recent news flow and to easier global monetary policy, there are concerns that could dampen the mood for investors. Global economic growth is slowing. In Europe, cyclical indicators have already turned downward, with the continent now widely considered to be in recession—and with further fiscal austerity bearing down on a region lacking a growth-recovery strategy. For now, we expect that the European Central Bank (ECB) is on hold as the market impact of its Long Term Refinancing Operation (LTRO) initiative has been quite positive. Moreover, the ECB alone doesn't have the firepower to generate a European economic recovery even if it attempted to do so.

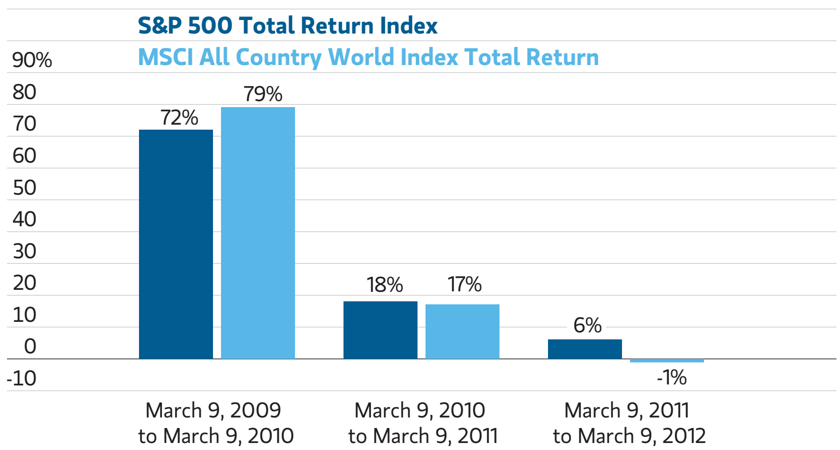
In the US, Morgan Stanley economists' real-time tracking of first-quarter data points to an economic deceleration to 1.7% GDP growth, down from the fourth quarter's 3.0% growth rate. Federal Reserve Board Chairman Ben Bernanke, in recent testimony before Congress, said the US economy remains vulnerable to shocks. Although the minutes and statements from the recent Federal Open Market Committee meeting show the members are not ready for a new round of monetary stimulus, we expect that they will act—probably later this spring—as growth falls short of expectations, producing the much awaited third round of Quantitative Ease, or QE3. Unfortunately, we expect that QE3 won't have much impact on the economy.

Emerging market (EM) economies aren't immune to the knock-on effects of slowing growth in the US and recession in Europe. China, for instance, now targets 7.5% economic growth, down from an 8.0% target in place since 2005. Still, we anticipate a solid 3.5% rate of global GDP growth. That growth, however, will likely be uneven, with 80% of global growth coming from the developing economies.

"WALL OF WORRY." An old Wall Street adage says bull markets climb a "wall of worry." This has again proven true as the European sovereign debt crisis loomed over the global markets even as they climbed. Now, the risk of an impending European liquidity crunch has faded with the European Central Bank's LTRO initiative and another rescue package aiding Greece. One of the outcomes of Greece's latest bailout is that the European public sector owns most of the nation's sovereign debt. As a result, the strongest and weakest parts of Europe are more fiscally integrated. The aid and reduction in the debt burden are helpful, but the country remains in a precarious solvency position and a

Chart 1: Diminishing Returns From an Equities Bull Market

Bull markets typically make their greatest gains in the first year, and the current cycle is a good example of that. While the second year still delivered returns well above average, the third year proved to be weak.



Source: Bloomberg as of March 9, 2012

deep recession; thus, this is probably not the end of the Greek drama.

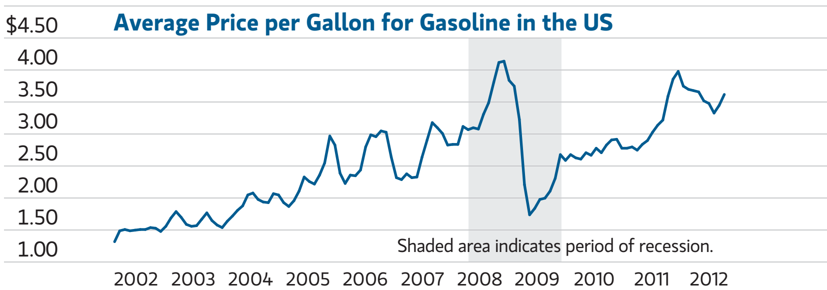
HEADWINDS TO GROWTH. Another "growth scare" is probably the most significant threat to risk assets right now. Growth scares during the spring-to-summer periods of 2010 and 2011 led to equity market corrections of between 15% and 20%. For 2012, the headwinds for the US are strong: Existing-home prices are 4% lower than a year ago, tensions in the Middle East have led to higher energy prices and US gasoline prices have never been higher for this time of year (see Chart 2). As prices continue to climb, they take a toll on discretionary consumer spending.

Further ahead, the US economy faces $525 billion in fiscal restraint in 2013 unless Congress acts to forestall scheduled spending cuts and revenue increases (see Table 1, page 6). We do not expect much to happen before the November elections, and it will be up to a postelection, lame-duck session of Congress to act to thwart much of the drag. This fiscal cliff effect, equal to about 3.4% of GDP, is likely to be an increasing concern to the markets as we approach the end of the year.

EARNINGS RESILIENCY. Still, it is important to acknowledge that, despite all the jitters over the European and US economic outlooks, corporate profit growth expectations have held up very well—indeed, better than we would have imagined. The consensus estimate for S&P 500 52-week forward bottom-up earnings per share (EPS) peaked at $108 in August, eased back toward $107 in the autumn and has since rebounded back beyond the August high (see Table 3, page 10). In other words, EPS expectations—which, at the end of the day, are far more important to stock prices than GDP—are moving higher again.

Chart 2: An Uncomfortable Rise in Gasoline Prices

The average price per gallon of gasoline in the US is approaching the levels set last spring, and some predict it will hit the 2008 high. The increase exerts a drag on discretionary consumer spending.



Source: US Department of Labor as of Feb. 29, 2012

Our Model Performance Since the Last Tactical Change

The tactical allocation changes we made in October reduced the risk exposure within our well diversified asset allocation models. Although we dialed back our overweight position in the broad global equities asset class to a slight underweight in our balanced models (Model 2 through Model 6), most of the tactical allocation models have outperformed their strategic counterparts because of our positioning at the subasset-class level.

In particular, tactical overweight positions in emerging market equities and US large-cap growth stocks, as well as underweight positions in Japanese stocks and global government bonds, have more than offset the drag from overweight positions in investment grade corporate bonds, short-duration bonds and cash. The accompanying table shows the hypothetical performance of our Level 2 asset allocation models since our last tactical allocation change.

Hypothetical Performance of Global Investment Committee Level 2 Model Portfolios, Oct. 7, 2011 Through Feb. 29, 2012

	Tactical Allocation	Strategic Allocation	Difference
Model 1	2.14%	2.14%	0.00%
Model 2	4.56	4.99	(0.43)
Model 3	7.14	7.07	0.07
Model 4	8.86	8.71	0.15
Model 5	10.85	10.53	0.32
Model 6	13.30	12.74	0.56
Model 7	15.08	14.38	0.70
Model 8	15.49	14.96	0.53
S&P 500 Index		19.25	
MSCI All Country World ex US Index		15.20	
Barclays Capital Global Aggregate Bond Index		1.84	
Citigroup Three-Month T-Bill Index		0.01	

Note: Hypothetical performance should not be considered a guarantee of future performance or a guarantee of achieving overall financial objectives. Asset allocation and diversification do not assure a profit or protect against loss in declining financial markets. Hypothetical performance results have inherent limitations. The past performance shown here is simulated performance based on benchmark indices, not investment results from an actual portfolio or actual trading.

Source: Morgan Stanley Smith Barney Global Investment Committee, FactSet as of Feb. 29, 2012

Table 1: Unless Congress Acts, Considerable Fiscal Contraction Is Coming Next Year

Expiring/Starting Fiscal Measures, January 2013	US$ Billions	% of GDP
Bush Tax Cuts (top-two tax brackets)	55	0.4
Bush Tax Cuts—Other Measures	195	1.3
99-Week Unemployment-Insurance Benefits	50	0.3
2% Payroll-Tax Cut	110	0.7
3.8% Medicare Tax on Investment Income	20	0.1
Budget Control Act Sequester	95	0.6
Total Fiscal Contraction	525	3.4

Source: Congressional Budget Office, Citi Investment Research & Analysis as of Feb. 13, 2012

BETTER IN EMERGING MARKETS. Despite challenges in the developed-market (DM) economies, we anticipate continued growth in the emerging economies, increasingly driven by domestic demand. By many measures, EM fundamentals are generally healthier than those in DM nations. Also, EM policymakers have a more robust tool set to deploy, if needed, as compared with DM policymakers. The People's Bank of China has started to ease monetary policy, joining the prior actions of Russia, Turkey and Brazil. Because of the incremental growth generated by the EM economies, we still expect positive GDP growth at the global level in 2012.

PORTFOLIO IMPLICATIONS. The allocation changes we made in October reduced our risk posture within our well diversified portfolios that utilize multiple asset classes. Though we dialed back our overweight position in global equities to a 2% tactical underweight in our balanced portfolios, most of our models have tactically outperformed (see box, page 5).

STILL UNDERWEIGHT RISK ASSETS. For now, we remain underweight in our allocation to risk assets—equities, real estate investment trusts, commodities, high yield bonds and emerging market debt. Conversely, we are overweight in safe havens—cash, short-duration debt and investment grade bonds—as well as managed futures.

At a more detailed level, our positioning does take tactical risks. We are overweight to EM equities, for which dividend yields, valuations and relative-growth prospects remain favorable and where there is more policy flexibility. Within DM equities, we favor the US over Europe and Japan, both of which face structural and cyclical headwinds.

Within US equities, we continue to favor large-cap stocks. Large-cap stocks typically outperform during adverse market conditions and currently offer a relative-valuation advantage (see Chart 9, page 12). At the style level, we prefer growth stocks over value stocks. During the periods of decelerating corporate earnings, growth stocks—companies that have the ability to deliver relatively stable earnings growth regardless of the economic backdrop or those expected to post above-average earnings growth—often hold up better. Moreover, value stocks appear somewhat expensive relative to growth stocks on a historical basis.

ALTERNATIVE INVESTMENTS. Among the alternative/absolute return investments that we use in our model portfolios, we are maintaining a slight underweight tactical allocation to commodities. We believe it is prudent to limit exposure to this economically sensitive asset class in light of slowing global growth, the recession in Europe and vulnerabilities in the US. Another asset class with close ties to the economic cycle is real estate investment trusts. We believe it is judicious to maintain a reduced exposure there as well. In managed futures, we have a tactical overweight position. This asset class has low historical correlations to other asset classes, thereby providing a considerable degree of portfolio diversification. Managed futures have also historically performed well during adverse equity markets.

CASH AND FIXED INCOME. It is difficult to make a compelling valuation case for cash and short-duration bonds when their yields generally fall short of inflation and appear expensive relative to equities and other risk assets. However, given the cyclical risks we foresee, the defensive properties of these asset classes should provide ballast to a diversified portfolio during periods of market turbulence; thus, we are overweight in cash and short-duration debt.

Within bonds, we remain moderately underweight in DM sovereign debt. In prioritizing safety and quality over wide spreads, we are limiting our exposure to high yield corporate bonds and emerging market debt, while favoring exposure to investment grade corporate bonds.

IN CONCLUSION. As new challenges and opportunities appear, we continue to evaluate our risk exposure and tactical positioning. Our analyses suggest many safe havens would have less vulnerability in the likely challenging economic period ahead. As a result, at a high level, our asset allocation models overweight global cash, market weight global bonds and alternative/absolute return investments and underweight global equities. ■

Economic Outlook

Global Growth: Under the Speed Limit

With recession in Europe and subpar economic growth in the US, only the relatively strong emerging market (EM) economies are driving global growth. However, earlier this month, the EM outlook became a little less robust when China decided to cut its 2012 economic growth target to 7.5% from 8.0%. According to Chinese officials, this revision was the result of the European debt crisis and the knock-on effects it is expected to have on external markets, which are key for China's trade prospects.

That is unwelcome news, especially since economists now think that US GDP in the first quarter is expected to slow markedly from the 3.0% fourth-quarter gain; for all of 2012, both Morgan Stanley and Citi economists see GDP in the 2.1%-to-2.2% neighborhood (see Table 2). The Global Investment Committee remains concerned that policy mistakes, in the US and across the Atlantic, could push the domestic economy into a downturn later this year or in 2013. For instance, while getting scant attention now, the looming automatic tax increases and mandatory spending cuts that are already set to begin would add $525 billion in fiscal drag next year—or about 3.4% of GDP—unless Congress takes action soon to ward them off (see Table 1, page 6).

A FALSE SPRING? True, US economic data have been surprisingly positive of late, but we wonder if the growth that it seems to portend will actually come. Weather is the reason for our hesitation; it's playing a major role in the US economy this year, much as it did last year—only in reverse. In 2011, a good portion of the nation experienced one of the worst winters on record, as relentless snowstorms blanketed the country from late December through the end of March. This year, unseasonably warm winter weather swept much of the nation. As a result, at least according to one school of thought, certain activity that otherwise would have occurred in the spring was brought forward by the mild conditions. It follows, then, that a payback for that early start could come in the form of an underperforming second quarter.

While US employment figures have been solid so far this year, data for the remainder of the economy have actually revealed some deceleration. Thus, the economic commentary has been geared more toward what is happening in the labor markets than in the other cylinders of the growth engine. Both Citi and Morgan Stanley tracking estimates for first-quarter GDP look for a slowing to the 1.7%-to-2.0% range.

JOBS RECOVERY. There is no doubt the February jobs report was a winner. Total private payrolls rose by 233,000. At the same time, the prior two months' gains were revised upward by a combined 36,000. Proving

Table 2: Morgan Stanley and Citi Global GDP and Inflation Forecasts

(year-over-year percent change)

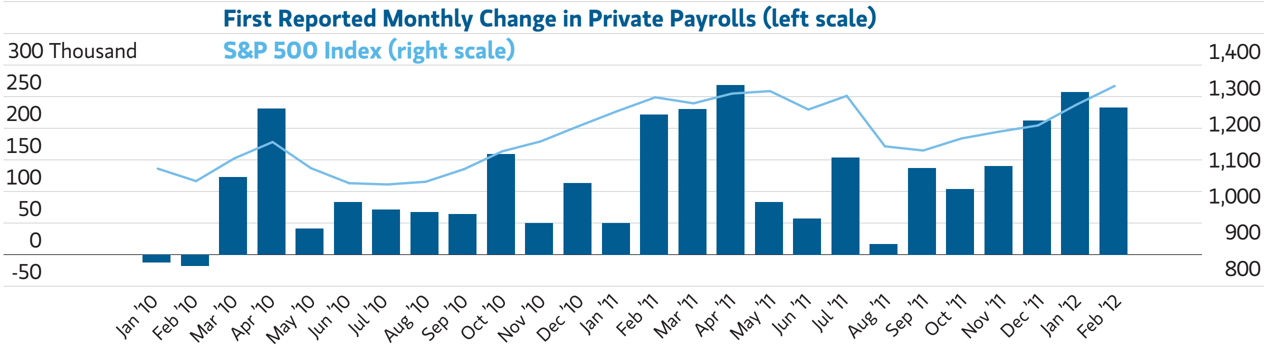
Morgan Stanley	2011	2012	2013	% Contribution to Growth 2012
Global GDP	**3.9**	**3.5**	**3.9**	
Developed Economies	**1.3**	**1.2**	**1.4**	**18**
US	1.7	2.2	1.8	12
Euro Zone	1.6	-0.3	0.9	-1
UK	0.8	0.5	1.8	0
Japan	-0.9	1.1	0.5	2
Developing Economies	**6.5**	**5.7**	**6.2**	**82**
Brazil	2.7	3.5	4.0	3
Russia	4.3	5.0	4.0	4
India	7.3	6.9	7.5	11
China	9.2	8.4	8.7	35
Global Consumer Prices				
Global Inflation	4.4	3.3	3.1	
Developed Economies	2.6	1.8	1.5	
Developing Economies	6.2	4.8	4.6	
US Core*	1.7	2.3	2.2	
US CPI	3.1	2.1	1.8	

Citi	2011	2012	2013	% Contribution to Growth 2012
Global GDP	**3.7**	**3.1**	**3.5**	
Developed Economies	**1.3**	**0.8**	**1.2**	**14**
US	1.7	2.1	2.0	14
Euro Zone	1.5	-1.2	-0.2	-6
UK	0.9	0.2	0.9	0
Japan	-0.7	1.5	1.4	3
Developing Economies	**6.1**	**5.3**	**5.9**	**88**
Brazil	2.7	3.3	4.5	3
Russia	4.3	3.5	4.0	14
India	6.9	7.0	7.5	15
China	9.2	8.4	8.6	43
Global Consumer Prices				
Global Inflation	4.2	3.5	3.4	
Developed Economies	2.3	1.9	1.6	
Developing Economies	6.1	5.1	5.2	
US Core*	1.4	1.8	1.7	
US CPI	2.5	2.1	1.8	

Note: Global forecasts are GDP-weighted averages, using Purchasing Power Parity estimates. That gives greater weights to developing economies.
*Personal Consumption Expenditures
Source: Morgan Stanley Research, Citi Investment Research & Analysis, Morgan Stanley Smith Barney as of March 21, 2012

Chart 3: Will Jobs Growth Roll Over Yet Again?

Growth in private payrolls is off to a strong start for 2012. Then again, the labor market strengthened in early 2010 and 2011, only to disappoint later in the year.



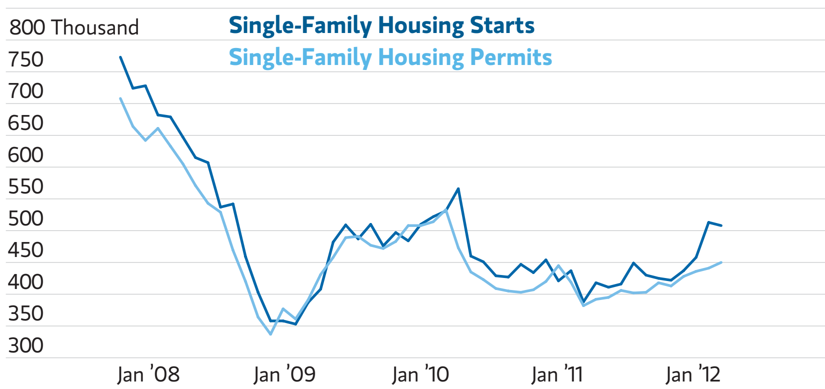
Source: Bureau of Labor Statistics, Citi Investment Research & Analysis as of Feb. 29, 2012

that the latest report was not a fluke, the average monthly gain for private payrolls over the last three months has been 251,000, a sizeable gain above the prior 12-month average of 168,000. In addition, the gains were widespread, with manufacturing posting another solid performance—along with three other sectors: professional and business services; education and health care; and leisure and hospitality. With 476,000 individuals entering the labor force, the unemployment rate remained unchanged and elevated at 8.3%.

Good monthly numbers are welcome, but what about their sustainability? As we saw in 2010 and 2011, robust early-in-the-year hiring did not carry through the rest of the year (see Chart 3). The 2011 experience is a case in point: Citi economists note that, even with a solid performance at the outset, there were three preliminary monthly payroll reports below 60,000. In addition, they also note "weather-sensitive employment has been a cumulative 98,000 above trend in the past three months." If the current calendar year follows 2011's seasonal pattern, job creation could decelerate in the not-too-distant future.

Chart 4: Mild Winter's Impact on Housing Starts

Unseasonably mild winter weather has allowed builders to break ground earlier in the year than is typical, which is why there is a large gap between starts and permits for single-family homes.



Source: US Census Bureau, Citi Investment Research & Analysis as of Jan. 31, 2012

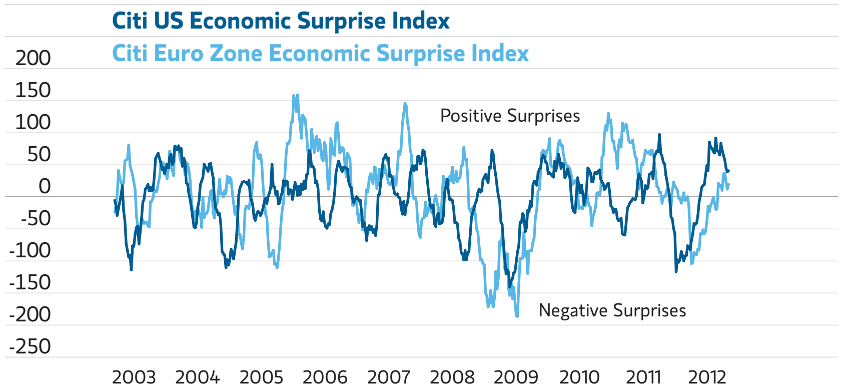
BUILDING IMPACT. Mild winter weather could be distorting housing construction. Typically, the linkage between single-family housing starts and permits tends to be tighter (see Chart 4).

However, the most recent trend reveals an unusually wide gap between permits and starts. Certainly, you could make the case that unseasonal conditions have allowed builders to break ground now rather than wait for warmer weather. Against this backdrop, you could conclude that the gap between starts and permits will narrow next quarter.

Another widely monitored gauge of future economic activity is the Citi Economic Surprise Index. Since reaching its most recent high in early February, the US gauge has been on a downward trajectory, with the index level cut in half (see Chart 5). The European version of the index, which was negative during much of 2011, turned positive in January but appears to have peaked in late February and has since headed south. ■

Chart 5: Positive Economic Surprises Are Declining in the US and Euro Zone

Better-than-expected US economic data helped to drive equities higher in recent months. Now, the positive surprises are falling. In the Euro Zone, the positive surprise index is declining, too, which could also be a headwind for equities there.



Source: Bloomberg as of March 13, 2012

Equities Outlook

A Rally With Vulnerabilities

Global equities have performed strongly during the past several months. From its 2011 low on Oct. 4, the MSCI All Country World Index has gained about 24% in US-dollar terms. Although we did not anticipate this move, the relative performance across regions—with the emerging markets (EM) and the US outperforming Europe and Japan—has been consistent with our tactical positioning within equities (see Chart 6).

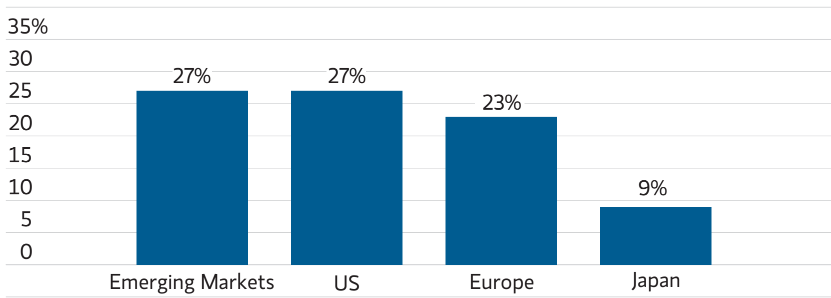
Can this rally continue? In the next few months, we believe equities are vulnerable to a pullback—if only because the rally has gone such a long way in a relatively short time. In addition, sentiment and volatility measures indicate that complacency is high, and we believe that US economic data are likely to soften as we experience a payback from distortions that have been boosting the data in recent months. One example is distortion from the milder-than-normal winter weather across much of the nation, which has pulled forward some activity that normally would have occurred in the spring.

RECESSION LEGACY. The other primary distortion in the equity markets is a legacy of the Great Recession. Analysts at the Economic Cycle Research Institute point out that the plunge in economic activity during the two most severe quarters of the Great Recession—the fourth quarter of 2008 and the first quarter of 2009—were misinterpreted by standard seasonal-adjustment algorithms as signaling, in part, a lasting shift in seasonal patterns. Thus, the seasonal-adjustment factors have been providing a boost to data during the fourth and first quarters and then suppressing the data for the second and third quarters. This partially explains both the recent improvement in a wide range of economic data and the "growth scares" that occurred during the springs of 2010 and 2011, prompting notable equity market pullbacks.

Beyond this potential near-term decline, a key variable for us is whether the US economy will continue to grow at a lackluster pace—which is the consensus view—or slip back into a recession. After all, a downturn in economic activity in the Euro Zone is under way, and, given the substantial trade linkages within the global economy, it is difficult to envision any downturn being confined to one region. Thus, our base-case assumption is that the risk of a US recession remains uncomfortably high. History

Chart 6: Equity Market Gains Since the Recent Lows*

Since the Oct. 4, 2011 low in global equities, most markets have shown strong gains. Japan has lagged notably.



*Oct. 4, 2011 through March 20, 2012
Source: MSCI as of March 20, 2012

Table 3: Earnings Forecasts for the Standard & Poor's 500, MSCI All Country World and MSCI Emerging Markets Indexes

	S&P 500				Consensus of Wall Street Analysts					
	Morgan Stanley		Citi		S&P 500		MSCI All Country World		MSCI Emerging Markets	
	Operating EPS	YOY Change	Operating EPS	YOY Change	Operating EPS	YOY Change	Operating EPS	YOY Change	Operating EPS	YOY Change
2011	$97.00	14%	$99.25	16%	$97.96	15%	$24.38	9%	$100.16	17%
2012	$100.00	3%	$101.00	2%	$105.98	8%	$28.17	16%	$111.84	12%
2013	$103.00	3%	$105.50	4%	$119.63	13%	$31.65	12%	$126.15	13%
52-Week Forward					$108.44		$28.14		$103.78	

Note: Citi estimates are before write-offs.
Source: Citi Investment Research & Analysis, Morgan Stanley Research, Thomson Financial, Datastream as of March 15, 2012

shows that recessionary environments pose significant challenges to equity markets, at least until investors start to anticipate the end of the downturn.

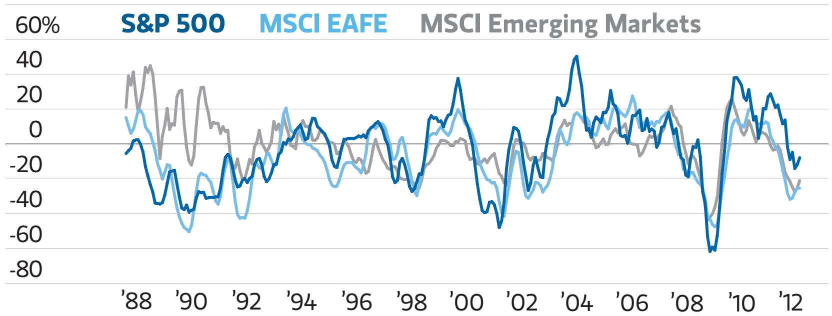
AN EARNINGS UPTURN? To be sure, in the absence of a recession, there are reasons to believe that the equity market rally can continue. Valuation is not an impediment, and there are early indications of stabilization in the trend of corporate earnings revisions (see Chart 7). A continuation of this development into positive territory would bode well for market performance. However, we caution that earnings expectations, which presumably are synched to consensus expectations about the economic outlook, are vulnerable if growth expectations sour. We show the current state of earnings expectations in the accompanying table (see Table 3, page 10).

All things considered, we are maintaining our modest tactical underweight position in stocks, with a continued preference for emerging markets and the US at the regional level. Although EM valuation has increased with the recent rally, it remains low by historical standards (see Chart 8). Moreover, EM central banks generally have shifted their policy focus toward supporting economic growth rather than fighting inflation—a stance that hindered EM equity market performance for the better part of 2011.

Among developed markets, we expect investors to favor the US, at least until there is a sense that Europe and Japan are overcoming structural headwinds that augur extended periods of subpar economic growth or until valuations become more compelling. From a valuation perspective, Europe seems closer

Chart 7: Global Net Earnings Revisions Show Signs of Stabilization

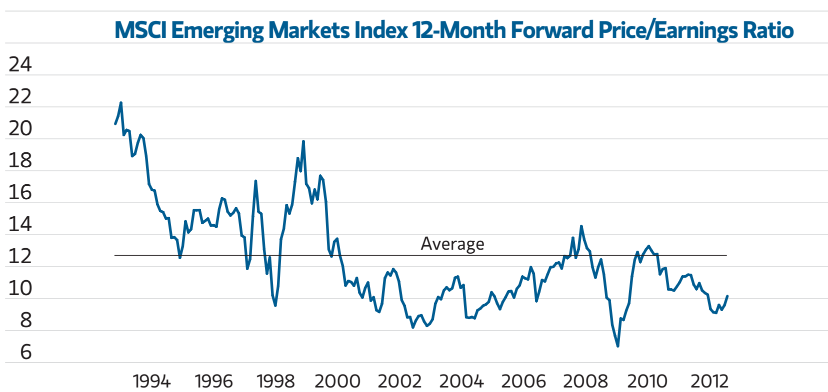
There are early indications of an upturn in the trend of corporate earnings revisions in the US, the other developed economies and the emerging markets. If the trend lines continue to move toward positive territory, it would bode well for equity market performance.



Note: Net earnings revisions are based on individual-company analysts' forecasts for the next calendar year and are calculated as the number of upgrades minus the number of downgrades divided by the total number of revisions using a three-month sliding window.
Source: FactSet, Morgan Stanley Smith Barney as of Feb. 29, 2012

Chart 8: Emerging Market Equities Are Attractively Valued Relative to Their History

Even though emerging market equities have enjoyed a powerful rally in recent months, the forward price/earnings ratio is still well below average.



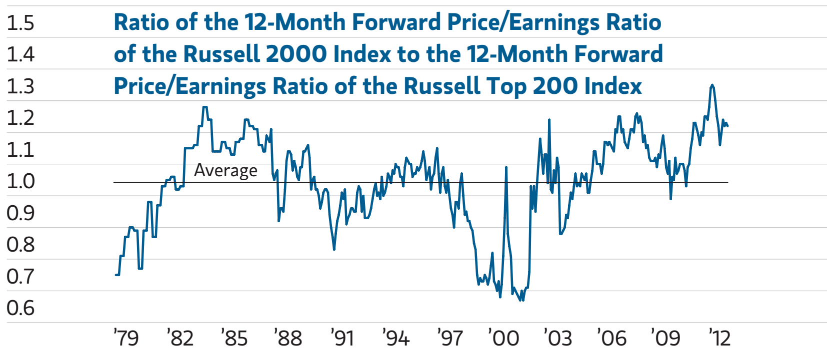
Source: MSCI, Thomson Financial, FactSet as of Feb. 29, 2012 to that point than Japan. The Japanese stock market has performed well of late, up 11% in February. However, because of the sharp depreciation of the yen, that gain was only 5% in US dollars. The MSCI Emerging Markets Index increased by about 6% during February.

LARGE-CAP PREFERENCE. Within US stocks, we continue to favor large caps. We initiated this tactical preference in April 2011 largely based on relative valuation, which had reached extreme readings (see Chart 9). Although the valuation advantage is no longer extreme, it remains elevated by historical standards. Since we initiated our preference for large caps, they have outperformed the other two capitalization-size categories (see Chart 10).

At the style level, we still have a preference for growth stocks over value stocks—a position we initiated in July 2010. By historical standards, value stocks continue to appear expensive relative to growth stocks, especially in the large-cap sector. During periods of decelerating corporate earnings, growth stocks—companies that have the ability to deliver relatively stable earnings growth regardless of the economic backdrop or those expected to post above-average earnings growth—typically outperform. ■

Chart 9: Relative Valuation Favors US Large-Cap Stocks

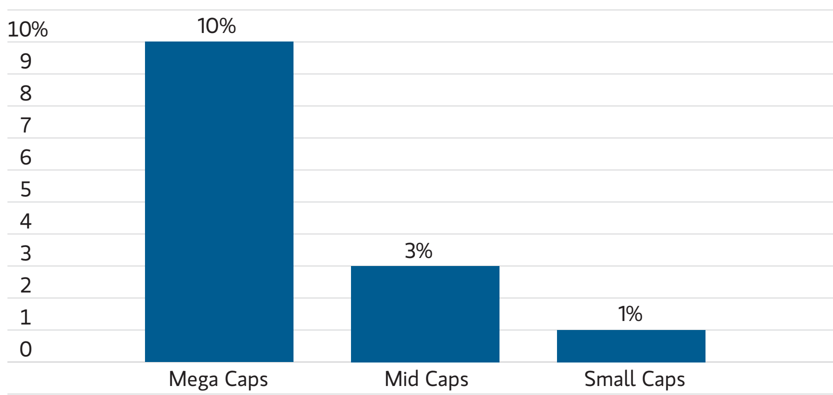
Comparing the price/earnings ratios of small-cap stocks to large-cap stocks is a way to measure their relative value. By this measure, small-cap stocks are still expensive relative to large-cap stocks, which makes large caps more attractive.



Source: Thomson Financial, FactSet as of Feb. 29, 2012

Chart 10: US Equity Performance by Market Capitalization*

The Global Investment Committee recommended an overweight in large-cap US stocks in April 2011. Since then, mega-cap stocks, or the 200 largest by market capitalization, have outperformed mid- and small-cap equities.



*Based on Russell indexes between April 15, 2011 and March 20, 2012
Source: Russell Investments as of March 20, 2012

Fixed Income Outlook

Is QE3 Off the Table?

Just a few months ago, the Federal Reserve announced that, given the fragile state of the US economy, it would likely keep the fed funds rate "exceptionally low" well into 2014. The statement also seemed to indicate that a third round of Quantitative Ease (QE3) would be part of that effort. With the recent stronger economic data, the thinking in the money and bond markets is that the Fed may not be so quick to launch another round of asset purchases. While the announcement following the recent Federal Open Market Committee (FOMC) meeting acknowledged improvement in labor market conditions, it was very similar to what Chairman Ben Bernanke said in his congressional testimony a few weeks prior. Nevertheless, the market's interpretation was that the Fed is now less dovish.

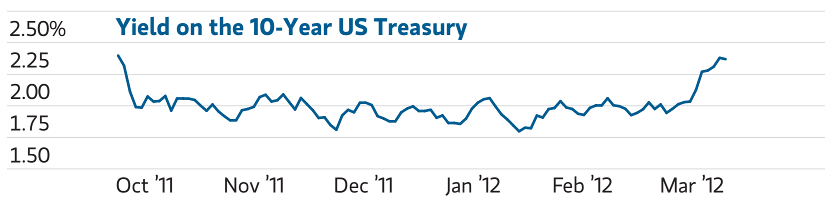
If there is another initiative, it could be one that does not add to the Fed's balance sheet. One option is to continue Operation Twist, a program the Fed adopted last year in which it buys long-term securities and sells short-term securities. Another approach is "sterilization"—offsetting bond purchases by draining an equivalent amount of reserves from the system. When the Fed floated the sterilization idea earlier this month, the US stock market took its worst one-day fall in more than three months.

In our opinion, the Fed should consider the law of unintended consequences. With sterilization, it is possible that short-term rates could increase, thereby negating the policy objective of keeping rates "exceptionally low." We still believe that the Fed's "Big Three"—Bernanke, Vice-Chairman Janet Yellen and New York Federal Reserve Bank President William Dudley—want to do more easing but have now become more dependent on incoming economic data. If the Fed were to take action, we believe the members would prefer to do so at or before the June FOMC meeting. Any later date and the policy move could become an issue in the presidential campaign.

TREASURY YIELDS. Amid debate about the Fed's next move, Treasuries have sold off, sending the yield on the 10-year US Treasury to more than 2.3%—its highest level since late-October 2011 (see Chart 11). In this move, we believe that the bond market is responding to the near-term positives—US job growth, a Greek debt deal and the announcement of the Fed's bank stress tests. The last consideration could be the most important of the three, as it could reduce concerns of potential banking contagion here in the US being triggered by any further problems in the Euro Zone.

Chart 11: 10-Year US Treasury Yield Starts to Climb

Range bound for months, the yield on benchmark 10-year US Treasury notes recently surged. This is a sign the economy is strengthening and risk aversion is ebbing.



Source: Bloomberg as of March 20, 2012

Table 4: Morgan Stanley and Citi Policy Rate and Government Bond Yield Forecasts

Morgan Stanley	Current Rate	2Q12	2Q13
Policy Rate (%)			
US	0.00–0.25	0.08	0.08
Euro Zone	1.00	0.75	0.75
Japan	0.10	0.05	0.05
UK	0.50	0.50	0.50
China	6.56*	6.56*	6.56*
10-Year Government Bond Yield (%)			
US	2.37	2.00	1.90
Euro Zone	2.07	2.00	2.60
Japan	1.05	1.00	1.20
UK	2.43	2.10	2.90

Citi	Current Rate	2Q12	2Q13
Policy Rate (%)			
US	0.00–0.25	0.25	0.25
Euro Zone	1.00	0.75	0.50
Japan	0.10	0.10	0.10
UK	0.50	0.50	0.50
China	3.50**	3.50**	3.75**
10-Year Government Bond Yield (%)			
US	2.37	2.40	2.65
Euro Zone	2.07	1.90	2.25
Japan	1.05	0.95	1.40
UK	2.43	2.50	2.50

*Morgan Stanley's current and forecast policy rates use the one-year lending rate.
**Citi's current and forecast policy rates use the one-year deposit rate.
Source: Morgan Stanley Research, Citi Investment Research & Analysis as of March 21, 2012

However, our interest rate outlook is predicated on a continued sluggish growth setting and a "post-peak" in inflation, combined with ongoing flight-to-quality flows emanating from the continuing debt saga in the Euro Zone (see Table 4, page 13). Those forces have led to historically low Treasury yields, and we expect the market drivers to persist.

EMERGING MARKETS CUT RATES. Low yields are increasingly becoming a global phenomenon. While until recently most of the monetary easing was happening in the developed markets, the emerging markets now are joining in. Brazil is leading the charge on this front, as illustrated by its recent 75-basis-point rate cut. Slowing inflation also gives the People's Bank of China some room to ease. One caveat: If oil prices do not stabilize, they could be an impediment to further monetary accommodation.

Credit Markets: Little Room to Improve

Perhaps it was the mild winter and signs of an early spring, but there is a prevailing sense of optimism in the credit markets. Obviously, better-than-expected US economic data and a successful bailout of Greece, at least in the sense that a disorderedly default is off the table for now, have helped tremendously. In addition, back-to-back Long Term Refinancing Operations by the European Central Bank have effectively flooded the European banking system with liquidity, thus removing the specter of a European banking crisis. These positive factors are the primary reasons we have experienced a five-month-plus rally in risk assets. With valuations much richer than they were at the rally's onset, investors need to ask: Do any catalysts remain that could drive the market higher?

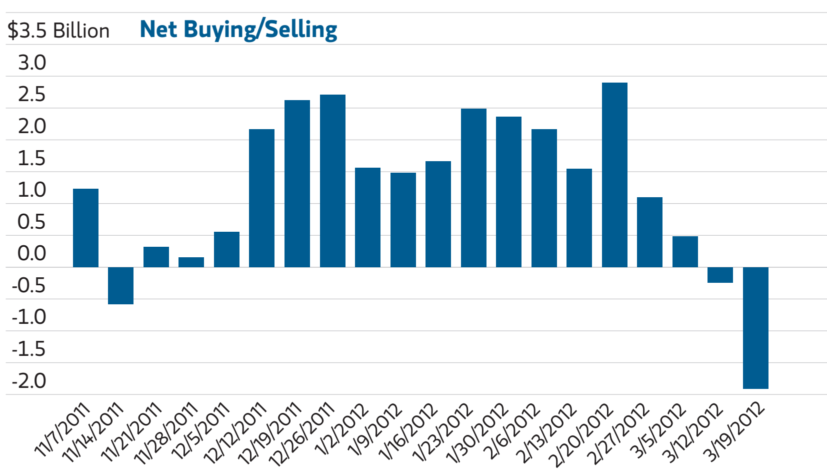
SUPPORTIVE FUNDAMENTALS. The fundamental backdrop is still supportive. Corporate funding costs are at historically low levels, and maturities have been spread out over several years. Interest coverage remains high and leverage is very low, though we expect the rate of improvement to slow down this year as profit margins compress. Corporate conservatism should ensure that high cash balances remain in place, and, finally, the high yield corporate default rate—perhaps rising only to the 3%-to-4% range during the next 12 months—is unusually low given the slow pace of GDP growth.

Technical factors have become less positive. The credit market is going through a period of consolidation; coupon income, maturities and fund inflows are combining to outpace the volume of new issues, which is helping to keep spreads intact. However, according to data on dealer flows, average daily volume is trending lower, which can lead to wider bid-offer spreads. Finally, and not surprisingly, according to the same data, though we have seen more buying than selling this year, the inflows have declined and recently turned negative (see Chart 12). Corporate fundamentals can take several quarters to change meaningfully, while technical factors can shift very quickly. We question how long the positive technical backdrop can last with several potential problems on the horizon.

SOVEREIGN ISSUES. An agreement on Greece's second bailout was announced on Feb. 20, and the requisite majority of private bondholders has since agreed to the bond exchange. Following the exchange, privately held debt will be around €70 billion, which is roughly

Chart 12: Investors Start Selling Corporate Bonds

These data track the net buying and selling of corporate bonds at the dealer level. The strong net buying of the last few months has turned negative, which, if it continues, could be a problem for the market going forward.



Source: Bloomberg as of March 19, 2012

one-quarter of the total debt outstanding, and will mature in 10 to 30 years. Coupon payments will be large, but funds earmarked for this are to be held in an escrow account beyond the Greek government's control, and roughly 75% of the remaining debt will be in official-sector hands. The exchange significantly lowers the risk of a near-term default by Greece. Still, the Greek presidential election is scheduled for late April. The result will likely be the formation of a coalition government, which will be faced with having to implement the fiscal reforms required to receive quarterly cash installments. Despite the recent bailout, an eventual Greek exit from the euro—while not our base case—remains a risk.

As for Portugal, even as other peripheral European bond yields have fallen since the bailout, Portuguese bond yields have continued to jump around (see Chart 13). Although the country currently has no near-term refunding issues, we note that Greece also appeared relatively stable in this regard before it ran into trouble last summer. Clearly, the market does not believe there is a credible firewall in place, nor does it believe Portugal is solvent.

VALUATION CONCERNS. Then there's the matter of valuation. The Barclays Capital US Aggregate Corporate Investment Grade Index is 60 basis points tighter for the year to date (as of March 20), with a current spread of 174 basis points and a yield-to-worst of 3.51%. That's not much above the all-time low of 3.27%. The Barclays Capital US Aggregate High Yield Index is 138 basis points tighter for the year to date, with a current spread of 561 basis points and a yield-to-worst of 7.19%. The investment grade index for the year to date is up 1.28%, and the high yield index is up 5.32%.

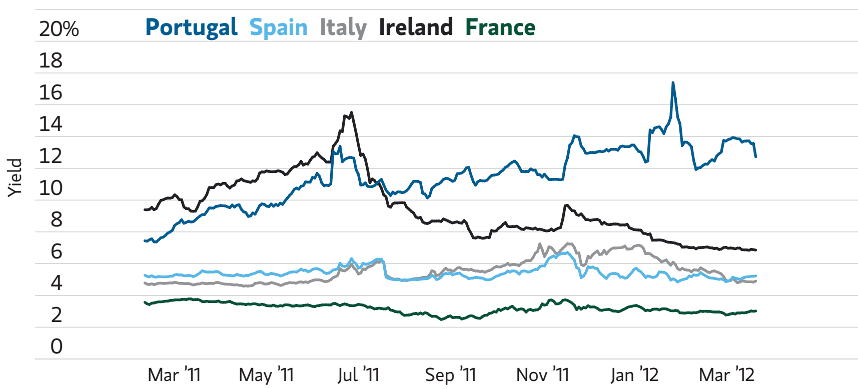
From a spread perspective, both the investment grade and high yield sectors are trading wide of long-term averages and could potentially tighten further from current levels. However, the yield on investment grade bonds is less compelling for investors looking for income; also, the price on the high yield index, at nearly 102, offers total-return investors little upside potential. Essentially, both asset classes are trading relatively rich.

CHANGING EXPOSURES. All told, we believe that spreads are likely to be flat to modestly wider in the next one to three months. The best performers in the rally have been higher-beta sectors and asset classes—a trend that we believe is at risk of reversing. We continue to recommend reducing exposure to higher-beta credits and moving up in quality or waiting on the sidelines for better valuations. For investors who cannot wait, we continue to see long-term value in BBBs, in some crossover credits and for higher-beta financials. We continue to like duration extension in investment grade, where we see better value in the five-to-eight-year range, especially in the financial sector.

We believe investment grade credit provides one of the most attractive investment opportunities, on a risk-adjusted basis, across fixed income asset classes over the next 12 to 18 months. We see the high yield market generating full-year returns in the 4%-to-6% area, similar to investment grade but with a much higher level of volatility and more scope for downside if the bear case materializes. We also expect high yield spreads to trade within a range this year but believe they are now at the lower end of that range. Moreover, they are vulnerable to widening if weaker data materialize or an external shock occurs, both of which are likely in our view. Stick with shorter-duration, higher-quality high yield issuers.

Chart 13: European Sovereign Bond Yields Are Coming Down

Since the latest bailout for Greece was announced last month, sovereign bond yields in Europe have generally declined. The exception is Portugal, where yields have continued to jump around.



Note: All yields are for 10-year bonds, except for Ireland, for which we use a nine-year bond because of the lack of an actively traded 10-year issue.
Source: Bloomberg as of March 20, 2012

Value Returns to the Muni Market

The municipal bond market has had a rough ride of late, with prices declining rapidly in the face of record year-to-date new-issue supply and, more recently, a sharp sell-off in the US Treasury market. Given our prior expectations for downside volatility, we believe that the bulk of the near-term price adjustments have been realized. Thus, we anticipate incremental muni-specific price adjustments ahead as the market recalibrates to accommodate a weekly new-issue calendar of about $6 billion to $8 billion, slightly above what we would consider a normal, more digestible flow of $5 billion to $7 billion.

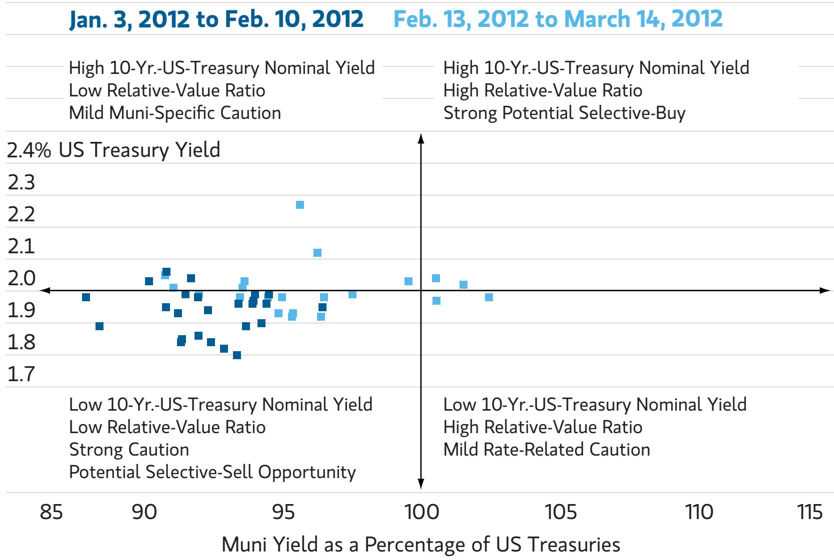
The market experienced a substantial rise in benchmark municipal yields across the yield curve. As of March 20, yields for benchmark AAA-rated securities in five-, 10- and 30-year maturities sat well above recent record lows by 37, 66 and 33 basis points, respectively, according to Thomson Reuters Municipal Market Data. Going forward, we expect that tax exempts will track US Treasuries more closely than we have experienced in recent months, especially in the middle of the yield curve, where the majority of price adjustments and new-issue supply has occurred.

HIGHER ABSOLUTE YIELDS. The upside of this difficult period of adjustment is that higher absolute yields have returned value to the muni market (see Chart 14). Indeed, we now view the market as well positioned for the coming months. During the last 18 months, the pendulum of sentiment in the muni market has reversed. What began as substantial mutual fund outflows, amid the fear of a "Muni Armageddon," the Fed's second round of Quantitative Ease and the expiration of the Build America Bonds program, has now swung to sizeable inflows following the market's general dismissal of the muni doomsday thesis, continued anxiety regarding Greece and political gridlock in Congress. Our experience is that these situations are rarely as dire, or as positive, as they first appear. It is with this sense of moderation that we approach the current market.

We believe the tax-exempt market is in a better place than it was just a month ago. Our cautionary tone of the prior two months is now removed, and we continue to favor our focus maturity range of six to 14 years, which is where the largest yield increases have transpired. With regard to credit quality, we reiterate our preference for bonds rated mid-tier A and above for general-obligation bonds and essential-service revenue bonds, as well as AA-rated hospital bonds. Bonds with above-market coupons are the favored structure in the marketplace, and we agree with that assessment. ■

Chart 14: Muni Bond Values Start to Improve

Each square represents one day's nominal yield and relative-value ratio in the municipal bond market. The chart shows that the muni market sell-off that began in mid February has improved relative valuation, thus making the bonds more attractive.



Source: Thomson Reuters Municipal Market Data as of March 14, 2012

Global Alternatives/ Absolute Return Investments Outlook

Commodities Rally Along With Most Risk Assets

Broadly speaking, commodities rallied during February along with most other risk assets. The Dow Jones-UBS Commodity Total Return Index, our benchmark, increased nearly 3%. As usual, performance spanned a wide range. At the sector level, the best performer was energy, which was up nearly 5%; the worst performer was precious metals, which, on balance, posted a slight decline after a late-month sell-off. Among individual commodities, the best-performing futures contract for the month was sugar, which gained more than 9%; the worst performer was nickel, which lost nearly 8%. Wide dispersion in performance such as this is why we believe that most long-term investors will be better served if they use vehicles that provide broad-based exposure to the asset class rather than those that target sectors or individual commodities.

We also believe it is prudent to limit exposure to this economically sensitive asset class in light of the ongoing recession in the Euro Zone and the likely spillover effects on other countries. The demand for many commodities is negatively affected by a downturn in economic activity.

BEARISH ON BASE METALS. Hussein Allidina, head of commodity strategy at Morgan Stanley and a member of the Global Investment Committee, lists certain base metals—zinc, lead, nickel and aluminum—and crude oil among his least-favored commodities, primarily because of their ties to industrial activity. Though oil prices have surged recently, Allidina estimates that the per-barrel price of Brent crude oil, now about $124, will average $105 in 2012. In his view, tension in the Middle East is imparting a risk premium to prices that is masking a weakening in demand.

Allidina's favorite commodity is gold. After a sharp pullback in February, the precious metal now trades around $1,650 per ounce. Still, he expects the per-ounce price for the metal will average $1,845 in 2012 and $2,175 in 2013, with sustained low real interest rates providing underlying investment demand.

Hedge Funds Ride the Risk Rally

Hedge funds continued their strong start to the year, with the HFRI Fund of Funds Composite Index returning 1.6% in February as Euro Zone debt-crisis fears abated and major central banks indicated their bias toward loose monetary policy. Both developments supported equities and other risk assets.

EQUITY SURGE. Equity long/short managers were the greatest beneficiaries of the strong equity markets, with the HFRI Equity Hedge Index gaining 3.0%—taking the total to 6.9% for 2012's first two months. Interestingly, whereas many equity managers were hurt in 2011 by mistiming markets, both overall and at the sector level, many managers who suffered the most have had the sharpest gains this year. In addition, this year's rally has evened out the disparate returns in trading styles that developed over the last few years. Fundamentally driven systematic equity funds benefitted from strong returns to growth and value factors, even as most momentum factors produced poor results. The significant rally in the emerging markets continued, with the HFRI Emerging Markets Index gaining 4.3% in February and 9.0% for the year to date (through Feb. 29). At the regional level, the best gains have been in funds specializing in Russia and Eastern Europe—up 12.7% in the first two months of the year.

CREDIT RALLIES. Credit markets trended higher as Europe's Long Term Refinancing Operation bolstered financial institutions, central banks pointed toward easy monetary policy and the market accepted the Greek debt restructuring. High yield bonds and loans continued to rally, benefitting from these improving macro conditions and the lowering of risk aversion, with the Credit Suisse High Yield Index and the Credit Suisse Leveraged Loan Index gaining 2.3% and 0.7%, respectively. Overall, managers of distressed-securities funds found strength from postreorganization equities and lower-quality high yield credit, as well as realized gains from idiosyncratic drivers such as liquidations in anticipation of near-term distributions. Specialist managers in the market for residential mortgage-backed securities benefitted from the continued recovery. In aggregate, the HFRI Event Driven Index finished up 1.9% in February, with credit-sensitive strategies and equity mergers and acquisitions posting the strongest gains. Managers who failed to participate in the market rally tended to have entered the month with low net exposure and heavy market hedges.

MACRO VIEWS. Discretionary macro funds performed well in February. The HFRI Macro Index returned 1.0%, bolstered by solid returns in fixed income and energy. Fixed income gains were driven by the steepening of the yield curve in European markets—Germany, in particular—as well as by long positions in US financial credit. Energy gains stemmed from long exposure to crude oil and precious metals. Typically, losses were felt in short equity positions, while short exposure to the euro also detracted as the outlook on the currency improved after the Greek bailout. Most systematic macro funds delivered positive results, benefitting from long positions in equities, commodities and commodity-linked currencies. Short-term trading funds underperformed as the month-end reversals in the energy and gold markets hurt them.

RELATIVE VALUE. The HFRI Relative Value Index finished the month up 1.8%. Mortgage credit markets performed well, helped by a 2.0% month-over-month gain in pending home sales. Within mortgage derivatives, interest-only securities provided profits, too. After strengthening in January, US Treasury bonds weakened across the curve as yields rose on two-year, five-year, 10-year and 30-year securities. Corporate credit tightening in the US provided a slight positive contribution to returns, while short European sovereign-credit positioning detracted.

Looking forward, we see value in participating in the global markets but we remain mindful of potentially negative outcomes. To that end, we believe it is prudent to maintain healthy exposure to discretionary macro strategies. Such funds may act as a shock absorber if there are corrections in the current upward market trend, or if there are broader tremors in the global macroeconomy in response to outcomes in China and Europe. In terms of equity strategies, we support a balance between fundamental, trading and quantitative strategies while taking a moderate approach, at best, to net exposure. Finally, despite the recent upswing in the mortgage markets, we see opportunities for managers to add value in mortgage-backed securities. ■

Global Investment Committee Asset Allocation Models

The Global Investment Committee (GIC) is made up of senior professionals from Morgan Stanley LLC Research, Morgan Stanley Smith Barney, Citi Investment Research & Analysis and outside financial market experts. The committee provides guidance on investment allocation decisions through the creation and maintenance of various model portfolios.

The GIC's Asset Allocation Models shown on the following pages represent its best thinking on strategic and tactical asset allocation. In these portfolios, the strategic equity allocations are in proportion to their share of global market capitalization based on the MSCI All Country World Investable Market Index. As such, the strategic allocation to non-US stocks is more than 50% of the total equity allocation.

There are three sets of models designed to provide guidance for investors with less than $1 million (Level 1), between $1 million and $20 million (Level 2) and more than $20 million in investable assets (Level 3). Accordingly, the portfolio sets have varying levels of allocations to traditional asset classes, liquid alternative investments and illiquid investments. The GIC constructs each set of portfolios on a scale of increasing risk—that is, expected volatility—and expected return. Each set consists of eight risk-tolerance levels. In each case, model 1 is the least risky and is composed mostly of bonds. As the model numbers increase, the models introduce higher allocations to equities and thus, become riskier. Alternative/absolute return investments are present in all models and provide increased asset-class diversification.

The GIC has also created and maintains strategic and tactical allocations for several other model portfolios used in various advisory programs. Most of these model portfolios incorporate a home-country bias toward the US. Under this subjective constraint, the strategic equity allocations have a 70%/30% split between US and non-US markets, and the strategic fixed income allocations have an 80%/20% split.

Global Investment Committee Asset Allocation Models for Investors With Less Than $1 Million in Investable Assets (Level 1)

Effective Jan. 20, 2012

Model Portfolios	Global Bonds and Inflation-linked Securities		Global Bonds, Global Equities and Alternative/Absolute Return Investments										Global Equities and Alternative/Absolute Return Investments			
	Model 1		Model 2		Model 3		Model 4		Model 5		Model 6		Model 7		Model 8	
	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Global Cash	30%	32%	15%	17%	10%	12%	8%	10%	5%	7%	3%	5%	-	5%	-	5%
Global Bonds																
Investment Grade	60	59	55	59	42	46	30	34	21	25	6	10	-	-	-	-
Short Duration	15	18	15	18	10	13	7	10	5	8	2	2	-	-	-	-
Government/ Government-Related	32	24	28	20	22	16	16	10	11	5	3	0	-	-	-	-
Corporate & Securitized	13	17	12	21	10	17	7	14	5	12	1	8	-	-	-	-
High Yield	-	-	2	1	3	2	5	4	6	5	8	7	-	-	-	-
Emerging Markets	-	-	-	-	2	2	4	4	5	5	6	6	-	-	-	-
Total Bonds	**60**	**59**	**57**	**60**	**47**	**50**	**39**	**42**	**32**	**35**	**20**	**23**	**-**	**-**	**-**	**-**
Total Cash & Short Duration Bonds	45	50	30	35	20	25	15	20	10	15	5	7	-	5	-	5
Global Equities																
US Large	-	-	6	8	12	14	16	18	18	21	22	26	30	34	26	30
Growth	-	-	3	5	6	8	8	11	9	13	11	16	15	20	13	18
Value	-	-	3	3	6	6	8	7	9	8	11	10	15	14	13	12
US Mid	-	-	2	2	2	2	2	2	4	4	4	4	6	6	6	6
Growth	-	-	1	1	1	1	1	1	2	2	2	2	3	4	3	4
Value	-	-	1	1	1	1	1	1	2	2	2	2	3	2	3	2
Canada	-	-	1	1	1	1	2	2	2	2	3	3	4	4	3	3
Europe	-	-	4	1	8	2	9	2	11	3	14	5	18	8	15	5
Europe ex UK	-	-	3	0	5	0	6	0	7	0	9	2	12	4	10	2
UK	-	-	1	1	3	2	3	2	4	3	5	3	6	4	5	3
Developed Asia	-	-	2	1	5	2	5	2	6	2	8	3	10	3	9	2
Japan	-	-	1	0	3	0	3	0	4	0	5	0	6	0	6	0
Asia Pacific ex Japan	-	-	1	1	2	2	2	2	2	2	3	3	4	3	3	2
US Small	-	-	2	2	2	2	4	4	4	4	4	4	6	6	8	8
Growth	-	-	1	1	1	1	2	2	2	2	2	2	3	4	4	5
Value	-	-	1	1	1	1	2	2	2	2	2	2	3	2	4	3
World ex US Small	-	-	1	1	2	2	2	2	3	3	4	4	5	5	7	7
Emerging Markets	-	-	3	3	4	9	5	11	6	13	9	17	11	20	16	25
Total Equity	**-**	**-**	**21**	**19**	**36**	**34**	**45**	**43**	**54**	**52**	**68**	**66**	**90**	**86**	**90**	**86**
Total US Equity	-	-	10	12	16	18	22	24	26	29	30	34	42	46	40	44
Total Developed ex US Equity	-	-	8	4	16	7	18	8	22	10	29	15	37	20	34	17
Total Developed Market Equity	-	-	18	16	32	25	40	32	48	39	59	49	79	66	74	61
Total Emerging Market Equity	-	-	3	3	4	9	5	11	6	13	9	17	11	20	16	25
Global Alternative/Absolute Return Investments																
REITs	-	-	2	1	2	1	3	2	4	3	4	3	5	5	5	5
Commodities	-	-	2	1	2	1	2	1	2	1	3	2	5	4	5	4
Inflation-Linked Securities	10	9	3	2	3	2	3	2	3	2	2	1	-	-	-	-
Managed Futures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Hedge Funds	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Private Real Estate	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Private Equity	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Alternative/ Absolute Return Investments	**10**	**9**	**7**	**4**	**7**	**4**	**8**	**5**	**9**	**6**	**9**	**6**	**10**	**9**	**10**	**9**

Global Investment Committee Asset Allocation Models for Investors With $1 Million to $20 Million in Investable Assets (Level 2)

Effective Jan. 20, 2012

	Global Bonds and Inflation-linked Securities		Global Bonds, Global Equities and Alternative/Absolute Return Investments										Global Equities and Alternative/Absolute Return Investments			
Model Portfolios	Model 1		Model 2		Model 3		Model 4		Model 5		Model 6		Model 7		Model 8	
	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Global Cash	25%	27%	13%	15%	8%	10%	5%	7%	3%	5%	2%	4%	-	-	-	-
Global Bonds																
Investment Grade	65	64	55	56	40	41	30	31	20	21	6	7	-	-	-	-
Short Duration	15	17	12	14	7	9	5	7	2	4	3	1	-	-	-	-
Government/ Government-Related	35	26	30	22	23	15	18	10	13	6	2	0	-	-	-	-
Corporate & Securitized	15	21	13	20	10	17	7	14	5	11	1	6	-	-	-	-
High Yield	-	-	2	1	3	2	4	3	5	4	6	5	-	-	-	-
Emerging Markets	-	-	-	-	2	2	3	3	4	4	4	4	-	-	-	-
Total Bonds	**65**	**64**	**57**	**57**	**45**	**45**	**37**	**37**	**29**	**29**	**16**	**16**	**-**	**-**	**-**	**-**
Total Cash & Short Duration Bonds	40	44	25	29	15	19	10	14	5	9	5	5	-	-	-	-
Global Equities																
US Large	-	-	6	7	10	11	12	15	14	16	20	24	26	29	22	25
Growth	-	-	3	4	5	6	6	9	7	10	10	14	13	17	11	15
Value	-	-	3	3	5	5	6	6	7	6	10	10	13	12	11	10
US Mid	-	-	-	-	2	2	2	2	2	2	4	4	4	4	4	4
Growth	-	-	-	-	1	1	1	1	1	1	2	2	2	2	2	2
Value	-	-	-	-	1	1	1	1	1	1	2	2	2	2	2	2
Canada	-	-	1	1	1	1	1	1	2	2	2	2	3	3	3	3
Europe	-	-	4	1	5	1	7	1	9	2	12	4	15	6	12	2
Europe ex UK	-	-	3	0	3	0	4	0	6	0	8	1	10	4	8	0
UK	-	-	1	1	2	1	3	1	3	2	4	3	5	2	4	2
Developed Asia	-	-	2	1	3	1	4	1	5	2	6	2	8	2	7	2
Japan	-	-	1	0	2	0	3	0	3	0	4	0	5	0	4	0
Asia Pacific ex Japan	-	-	1	1	1	1	1	1	2	2	2	2	3	2	3	2
US Small	-	-	-	-	2	2	2	2	4	4	4	4	6	6	8	8
Growth	-	-	-	-	1	1	1	1	2	2	2	2	3	4	4	5
Value	-	-	-	-	1	1	1	1	2	2	2	2	3	2	4	3
World ex US Small	-	-	1	1	2	1	2	1	2	2	3	2	4	4	5	5
Emerging Markets	-	-	2	3	3	7	5	10	6	12	7	14	9	17	14	22
Total Equity	**-**	**-**	**16**	**14**	**28**	**26**	**35**	**33**	**44**	**42**	**58**	**56**	**75**	**71**	**75**	**71**
Total US Equity	-	-	6	7	14	15	16	19	20	22	28	32	36	39	34	37
Total Developed ex US Equity	-	-	8	4	11	4	14	4	18	8	23	10	30	15	27	12
Total Developed Market Equity	-	-	14	11	25	19	30	23	38	30	51	42	66	54	61	49
Total Emerging Market Equity	-	-	2	3	3	7	5	10	6	12	7	14	9	17	14	22
Global Alternative/Absolute Return Investments																
REITs	-	-	2	1	2	1	3	2	4	3	4	3	5	5	5	5
Commodities	-	-	2	1	2	1	2	1	2	1	3	2	5	4	5	4
Inflation-Linked Securities	10	9	3	2	3	2	3	2	3	2	2	1	-	-	-	-
Managed Futures	-	-	2	5	4	7	4	7	4	7	5	8	5	10	5	10
Hedge Funds	-	-	5	5	8	8	11	11	11	11	10	10	10	10	10	10
Private Real Estate	-	-	-	-	-	-	-	-	-	-	-		-	-	-	-
Private Equity	-	-	-	-	-	-	-	-	-	-	-		-	-	-	-
Total Alternative/ Absolute Return Investments	**10**	**9**	**14**	**14**	**19**	**19**	**23**	**23**	**24**	**24**	**24**	**24**	**25**	**29**	**25**	**29**

Please refer to important information, disclosures and qualifications at the end of this material.

Global Investment Committee Asset Allocation Models for Investors With $20 Million or More in Investable Assets (Level 3)

Effective Jan. 20, 2012

Model Portfolios	Global Bonds and Inflation-linked Securities		Global Bonds, Global Equities and Alternative/Absolute Return Investments										Global Equities and Alternative/Absolute Return Investments			
	Model 1		Model 2		Model 3		Model 4		Model 5		Model 6		Model 7		Model 8	
	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Global Cash	25%	27%	13%	15%	8%	10%	5%	7%	3%	5%	2%	4%	-	-	-	-
Global Bonds																
Investment Grade	65	64	55	56	40	41	30	31	20	21	6	7	-	-	-	-
Short Duration	10	12	7	9	7	9	5	7	2	4	3	1	-	-	-	-
Government/ Government-Related	39	27	34	24	23	15	18	10	13	6	2	0	-	-	-	-
Corporate & Securitized	16	25	14	23	10	17	7	14	5	11	1	6	-	-	-	-
High Yield	-	-	2	1	3	2	4	3	5	4	6	5	-	-	-	-
Emerging Markets	-	-	-	-	2	2	3	3	4	4	4	4	-	-	-	-
Total Bonds	**65**	**64**	**57**	**57**	**45**	**45**	**37**	**37**	**29**	**29**	**16**	**16**	**-**	**-**	**-**	**-**
Total Cash & Short Duration Bonds	35	39	20	24	15	19	10	14	5	9	5	5	-	-	-	-
Global Equities																
US Large	-	-	6	7	8	10	12	14	14	16	18	22	24	27	20	23
Growth	-	-	3	4	4	6	6	8	7	10	9	13	12	16	10	14
Value	-	-	3	3	4	4	6	6	7	6	9	9	12	11	10	9
US Mid	-	-	-	-	2	2	2	2	2	2	4	4	4	4	4	4
Growth	-	-	-	-	1	1	1	1	1	1	2	2	2	2	2	2
Value	-	-	-	-	1	1	1	1	1	1	2	2	2	2	2	2
Canada	-	-	1	1	1	1	1	1	2	2	2	2	3	3	3	3
Europe	-	-	4	1	6	2	6	2	8	2	11	3	14	4	12	2
Europe ex UK	-	-	3	0	4	0	4	0	5	0	7	0	9	1	8	0
UK	-	-	1	1	2	2	2	2	3	2	4	3	5	3	4	2
Developed Asia	-	-	2	1	3	1	3	1	5	2	6	2	8	3	7	2
Japan	-	-	1	0	2	0	2	0	3	0	4	0	5	0	4	0
Asia Pacific ex Japan	-	-	1	1	1	1	1	1	2	2	2	2	3	3	3	2
US Small	-	-	-	-	2	2	2	2	2	2	4	4	4	4	6	6
Growth	-	-	-	-	1	1	1	1	1	1	2	2	2	2	3	4
Value	-	-	-	-	1	1	1	1	1	1	2	2	2	2	3	2
World ex US Small	-	-	1	1	1	1	2	2	2	2	3	3	4	4	5	5
Emerging Markets	-	-	2	3	3	5	4	6	5	10	6	12	9	17	13	21
Total Equity	**-**	**-**	**16**	**14**	**26**	**24**	**32**	**30**	**40**	**38**	**54**	**52**	**70**	**66**	**70**	**66**
Total US Equity	-	-	6	7	12	14	16	18	18	20	26	30	32	35	30	33
Total Developed ex US Equity	-	-	8	4	11	5	12	6	17	8	22	10	29	14	27	12
Total Developed Market Equity	-	-	14	11	23	19	28	24	35	28	48	40	61	49	57	45
Total Emerging Market Equity	-	-	2	3	3	5	4	6	5	10	6	12	9	17	13	21
Global Alternative/Absolute Return Investments																
REITs	-	-	2	1	2	1	3	2	2	1	2	1	2	2	2	2
Commodities	-	-	2	1	2	1	2	1	2	1	3	2	5	4	5	4
Inflation-Linked Securities	10	9	3	2	3	2	3	2	3	2	2	1	-	-	-	-
Managed Futures	-	-	2	5	4	7	4	7	4	7	5	8	5	10	5	10
Hedge Funds	-	-	5	5	8	8	11	11	11	11	10	10	10	10	10	10
Private Real Estate	-	-	-	-	-	-	-	-	2	2	2	2	3	3	3	3
Private Equity	-	-	-	-	2	2	3	3	4	4	4	4	5	5	5	5
Total Alternative/ Absolute Return Investments	**10**	**9**	**14**	**14**	**21**	**21**	**26**	**26**	**28**	**28**	**28**	**28**	**30**	**34**	**30**	**34**

Endnotes

1. The strategic allocation refers to the long-term investment weightings for the major asset classes that best fit an investor's specific circumstances, a risk profile including their ability and willingness to tolerate risk, and return objectives, and that take into account the asset returns, standard deviations of returns, and correlations of returns under varying economic and financial conditions.

2. The tactical allocation incorporates active decisions to overweight or to underweight asset classes in the near-term relative to their strategic allocation based on: (i) the current and projected financial and economic environment; (ii) evaluations of risk in global asset markets; and (iii) other fundamental, valuation, and psychological, technical, liquidity factors.

3. The eight portfolios displayed in the accompanying matrix are arranged from left to right in a general progression from conservative through moderate to aggressive risk profiles.

4. A conservative asset allocation risk profile tends to encompass: (i) relatively lower, or in some cases zero, levels of exposure to equities and to investments outside the investor's home country and currency; and (ii) relatively higher levels of exposure to cash, fixed income, and investments inside the investor's home country and currency. A conservative asset allocation risk profile style may generally be expected to exhibit lower price volatility as measured by the standard deviations of annual returns from the portfolio and generally seeks to generate a somewhat greater proportion of its returns from income as compared with capital gains.

5. A moderate asset allocation risk profile tends to encompass: (i) relatively moderate levels of exposure to equities and to investments outside the investor's home country and currency; and (ii) relatively moderate levels of exposure to cash, to fixed income and investments inside the investor's home country, and to currency. A moderate asset allocation risk profile may generally be expected to exhibit moderate price volatility as measured by the standard deviations of annual returns from the portfolio and generally seeks to generate a somewhat balanced proportion of its returns from income as well as from capital gains.

6. An aggressive asset allocation risk profile tends to encompass: (i) relatively higher levels of exposure to equities and to investments outside the investor's home country and currency; and (ii) relatively lower, or in come cases zero, levels of exposure to cash, to fixed income and investments inside the investor's home country, and to currency. An aggressive asset allocation risk profile may generally be expected to exhibit higher price volatility as measured by the standard deviations of annual returns from the portfolio and generally seeks to generate a somewhat lower proportion of its returns from income as compared with capital gains.

7. The cash/cash equivalent asset class may include US dollar-based short-term investments as well as non-US dollar-based short-term investments, and/or Exchange-Traded Funds (ETFs) or other instruments dedicated to US and/or to non-US cash and cash equivalents. In a rising US dollar environment, the return to US dollar-based investors from unhedged non-US dollar investments will be lower than US dollar returns. In a falling US dollar environment, the return to US dollar-based investors from unhedged non-US dollar investments will be higher than US dollar returns.

8. Fixed income holdings may be either taxable or tax exempt, depending on the instrument and/or the investor's current and future tax status. As a matter of practice, many investors tend to hold certain types of investments in their taxable accounts, such as: (i) tax-exempt municipal bonds; and (ii) assets that generate a significant proportion of their total return from long-term capital gains. Similarly, many investors tend to hold certain other types of investments in their tax-deferred, tax-exempt, or low-tax accounts, such as: (i) taxable bonds; (ii) assets that generate a significant proportion of their total return in the form of dividends, taxable interest income, accredited income and/or short-term trading profits. It may thus be helpful for investors to mentally and/or computationally combine the assets held in their taxable and their tax-exempt accounts to gain perspective on the overall asset allocation of their investments.

9. Duration is a measure of the average cash-weighted term-to-maturity of a bond. It is a frequently used measure of the sensitivity of a bond's price and the present value of its cash flows relative to interest rate movements. The specific desired duration of investment grade, high yield and emerging markets bond holdings will usually be influenced by the investor's interest rate expectations. In a rising interest rate environment, investors may choose to generally shorten the duration of their fixed income holdings, and in a falling interest rate environment, investors may choose to generally lengthen the duration of their fixed income holdings.

10. Depending on the interest rate environment and other factors, certain fixed income securities, such as preferred stocks and convertible securities trading near their bond equivalent value, may be included within the fixed income asset category.

11. Global investment grade bonds include: (i) US dollar denominated or non-US dollar denominated US Treasury securities; (ii) US dollar denominated or non-US dollar denominated US Federal Agency and other Government-related securities; (iii) many US dollar denominated or non-US dollar denominated securitized and/or mortgage-backed securities carrying investment grade quality ratings from the major credit rating services; (iv) US dollar denominated or non-US dollar denominated corporate and/or municipal bonds carrying investment grade quality ratings from the major credit rating services; and (v) certain other US dollar denominated or non-US dollar denominated instruments. For tax-related and/or other reasons, some investors may implement their investment grade bond exposure through tax-exempt securities. In periods of deteriorating credit conditions, investors may choose to improve the credit quality of their bond holdings by focusing on higher-rated sectors of the global investment grade bond universe, and in periods of improving credit market conditions, investors may choose to lessen the credit quality of their bond holdings by focusing on a broader range of credit ratings, possibly including lower-rated issues, within the global investment grade bond universe. Non-US dollar Fixed Income Securities holdings are considered to be hedged into US dollars, unless otherwise noted. In a rising US dollar environment, the return to US dollar-based investors from unhedged non-US dollar investments will be lower than US dollar returns. In a falling US dollar environment, the return to US dollar-based investors from unhedged non-US dollar investments will be higher than US dollar returns.

12. Short duration investment grade bonds are considered here to be fixed income instruments with a Moody's/Standard & Poor's credit quality rating of Baa3/BBB- or higher with duration of two years or less. Duration is a measure of the average cash-weighted term to maturity of a bond and is a frequently used measure of the sensitivity of a bond's price and the present value of its cash flow relative to interest rate movements.

13. Certain equity industry groups and their specific component companies may entail exposure to the forces and factors affecting alternative/absolute return investments, including: (i) real estate and/or energy infrastructure assets, such as pipelines and storage facilities; (ii) commodities (including energy, agriculturals, base metals, and precious metals); and (iii) direct ownership in timber and/or oil and gas properties. Such equity industry groups may be included within the equity asset category.

14. For investors with investable assets greater than $1 million, the absolute equity weighting, as well as the relative degree of tactical versus strategic equity exposure, may be somewhat lower than total equity weightings for those investors with investable assets of less than $1 million. This is primarily due to the

greater degree of accessibility that investors with investable assets greater than $1 million may have to the alternative/absolute return investments asset classes, which tend to be characterized by high investment minimums, possibly lower liquidity, and special capital entry and exit provisions.

15. Currency exposure for the non-US equity and non-US alternative/absolute return investments asset classes is generally not hedged into US dollars unless otherwise noted. In a rising US dollar environment, the return to US dollar-based investors from unhedged non-US dollar investments will be lower than US dollar returns. In a falling US dollar environment, the return to US dollar-based investors from unhedged non-US dollar investments will be higher than US dollar returns.

16. As an alternative to investing in specific non-US countries, investment styles, market capitalization levels and companies, investors with investable assets of less than $1 million may choose to implement non-US equity asset class exposure through investment vehicles linked to a non-US broad market index. In a rising US dollar environment, the return to US dollar-based investors from unhedged non-US dollar investments will be lower than US dollar returns. In a falling US dollar environment, the return to US dollar-based investors from unhedged non-US dollar investments will be higher than US dollar returns.

17. For some investors, small percentage allocations to certain asset classes may entail inefficient considerations of cost, monitoring and liquidity; in such cases, investors may choose to aggregate these small-percentage allocations with similar asset classes within the same asset category.

18. The alternative/absolute return investments asset category is considered here to include asset classes that tend to respond to a range of influences in addition to and/or instead of the fundamental underlying forces such as interest rates, economic conditions, and corporate profitability affecting equities, fixed income securities, and cash asset categories. Such influences include: (i) supply-demand considerations for the underlying asset(s); (ii) investor preferences relating to store-of-value considerations; (iii) unconventional investment techniques involving short selling, the borrowing or lending of securities and/or investment capital; (iv) the use of swaps, options, futures and other derivatives; and/or (v) investment manager skill. Within an asset allocation context, alternative/absolute return investments are intended to provide some degree of exposure to returns and standard deviations of returns that tend generally not to be highly correlated with the investment performance of the equity, fixed income and cash asset categories. Due to the fact that many alternative/absolute return investments may have, compared to conventional asset classes: (i) less liquidity; (ii) higher investment vehicle minimums; (iii) unconventional frequency and methodology of pricing; (iv) extended investment timeframes and/or lockup periods; (v) unusual risk/reward profiles; (vi) less predictable timing for capital inflows and outflows; (vii) higher fee structures; (viii) greater or fewer regulatory, tax reporting, and/or compliance requirements; and (ix) more leverage, investors should consider the asset allocations set forth here in light of: (a) their own specific circumstances, risk profile including their ability and willingness to tolerate risk, and return objectives; (b) their short-term and long-term investment outlook; and (c) the universe of investments that are suitable for and appropriate to their investment temperament and wealth level.

19. Owing to the characteristics of alternative/absolute return investments, many asset classes within this asset category may not be available to investors at all wealth levels. Asset classes that may generally be unavailable to certain investor wealth levels because of minimum investor asset requirements and/or minimum instrument purchase requirements have blank percentage allocation weightings.

20. The global real estate investment trust (REIT) asset class, which tends toward investment exposure to commercial real estate properties (including, but not limited to, office buildings, apartment buildings, hotels and shopping centers), may also include publicly traded companies engaged in the ownership, development and/or management of real estate, and is considered here to exclude an investor's primary residence(s).

21. Real estate investment exposure may be achieved through private equity real estate interests. The private equity real estate asset class may involve special investment considerations, including: (i) investor net asset minimum criteria; (ii) investment vehicle entry and exit conditions; (iii) regulatory, tax reporting and/or compliance requirements; (iv) suitability guidelines; and (v) other risk factors.

22. The commodities asset class is considered here to include precious metals, base metals, agriculturals, energy and/or partnership or direct ownership interests in oil-, gas- and timber-related properties. Commodities exposure may also be implemented through holdings of Equity securities of precious metals-, base metals-, agricultural-, energy- and/or oil-, gas- and timber-related companies.

23. The US Treasury form of inflation-linked securities (known as Treasury Inflation-Protected Securities, or TIPS) is generally exempt from state and local income taxes. Each semiannual interest payment, including: (i) the coupon; and (ii) the accrued inflation adjustment amount, is subject to federal taxes on ordinary income each year. Ordinary income taxes are due on the inflation adjustments of the principal component of the security, even though the inflation adjustment portion is not realized until maturity or until the security is sold. The taxation of this "phantom income" may cause a misalignment between the investor's tax liabilities and actual cash coupon payments received from the investment. Morgan Stanley Smith Barney does not offer tax advice for investors. Investors should consult their tax counsel for specific advice regarding tax matters. Investment exposure to US or to non-US inflation-linked securities can be implemented on an individual instrument basis and/or through Exchange-Traded Funds (ETFs) specializing in such assets.

24. The private equity asset class is considered here to include several subcategories, such as: (i) leveraged buyout and management buyout activity; (ii) direct ownership of equity stakes in privately held firms; and (iii) venture capital investing. For the private equity asset class, special investment considerations may include: (i) investor net asset minimum criteria; (ii) investment vehicle entry and exit conditions; (iii) regulatory, tax reporting and/or compliance requirements; (iv) suitability guidelines; and (v) other risk factors that may vary by private equity subcategory.

25. Managed futures funds typically are operated by commodity trading advisors utilizing commodity and financial (equity, interest rate, foreign exchange) futures contracts, forwards, and options. For the managed futures asset class, special investment considerations include: (i) investor net asset minimum criteria; (ii) manager fees; and (iii) regulatory, tax, reporting and/or compliance requirements. Managed futures funds may not be appropriate for all investors. In view of the relatively high standard deviations of returns that may be associated with any single managed futures manager, investors may choose to implement their allocation to managed futures using a fund of funds approach and/or a broadly diversified group of managed futures managers and strategies.

26. For the hedge funds asset class, including funds of hedge funds, special investment considerations include: (i) investor net asset minimum criteria; (ii) investment vehicle entry and exit conditions; (iii) regulatory, tax reporting and/or compliance requirements; (iv) suitability guidelines; and (v) other risk factors that may vary by investor category. Hedge funds may not be suitable for all investors. In view of the potentially high standard deviations of returns that may be associated with any single hedge fund manager, investors may choose to implement their allocation to hedge funds using a fund of funds approach and/or a broadly diversified group of hedge fund managers and strategies. Funds of funds generally have higher fee structures than single hedge fund manager strategies. Certain FX/currency managers that employ a fundamentally driven investment process may be viewed as a subset of the hedge fund (global macro) asset class. Certain FX/currency managers that employ trend-following, quantitatively-driven techniques may be viewed as a subset of the managed futures asset class.

Index Definitions

MSCI ALL COUNTRY WORLD INDEX This free-float-adjusted market-capitalization index is designed to measure equity market performance in the developed and emerging markets.

S&P 500 INDEX Widely regarded as the best single gauge of the US equities market, this capitalization-weighted index includes a representative sample of 500 leading companies in leading industries of the US economy.

BARCLAYS CAPITAL GLOBAL AGGREGATE INDEX This index provides a broad-based measure of the global investment grade, fixed-rate bond markets.

CITIGROUP THREE-MONTH T-BILL INDEX This index measures monthly return equivalents of yield averages that are not marked to market. The index consists of the last three three-month Treasury bill issues.

MSCI EMERGING MARKETS INDEX This is a free-float-adjusted, market-capitalizaton-weighted index designed to measure equity market performance in the global emerging markets.

MSCI EAFE INDEX This index tracks performance of developed markets outside of North America: Europe, Australasia and the Far East.

RUSSELL TOP 200 INDEX This index measures the performance of the largest segment of the US equity universe represented by the stocks of the largest 200 by market capitalization.

RUSSELL MIDCAP INDEX This index measures the performance of the especially mid-cap segment of the US equity universe.

RUSSELL 2000 INDEX This index measures the performance of the especially small-cap segment of the US equity universe. It includes Russell 2000 companies with higher price/book ratios and higher forecast growth rates.

BARCLAYS CAPITAL US AGGREGATE CORPORATE INVESTMENT GRADE INDEX This index represents securities that are investment grade, SEC registered, taxable and dollar denominated.

BARCLAYS CAPITAL US AGGREGATE CORPORATE HIGH YIELD INDEX The index includes publicly issued US-dollar-denominated non-investment grade, fixed-rate, taxable corporate bonds that have a remaining maturity of at least one year, are rated high yield using the middle rating of Moody's, S&P and Fitch, respectively, and have $600 million or more of outstanding face value.

DOW JONES-UBS COMMODITY INDEX This index comprises futures contracts on 19 physical commodities. They include energy, industrial metals, precious metals and agricultural commodities.

HFRI FUND OF FUNDS COMPOSITE INDEX This is an equal-weighted index of 650 hedge funds with at least $50 million in assets and 12 months of returns. Returns are reported in US dollars and are net of fees.

HFRI EQUITY HEDGE INDEX Equity hedge strategies maintain positions both long and short in primarily equity and equity-derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of the levels of net exposure, leverage, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios.

HFRI EMERGING MARKETS INDEX The constituents of the index are selected according to their regional investment focus. There is no investment strategy criteria for inclusion in the index.

CREDIT SUISSE HIGH YIELD INDEX This index is designed to mirror the US-dollar-denominated high yield debt market. The index frequency is weekly and monthly. Issues must be rated no higher than Baa1/Ba1 by Moody's or BB+ or BBB+ by S&P.

CREDIT SUISSE LEVERAGED LOAN INDEX This index is designed to mirror the investable universe of the US-dollar-denominated leveraged loan market.

HFRI MACRO INDEX These funds trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard-currency and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis and combinations of top-down and bottom-up analyses.

HFRI RELATIVE VALUE INDEX This index tracks managers that maintain positions in which the investment thesis is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed income, derivative or other security types.

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International investing entails greater risk, as well as greater potential rewards compared to US investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economies.

Alternative investments which may be referenced in this report, including private equity funds, real estate funds, hedge funds, managed futures funds, funds of hedge funds, private equity, and managed futures funds, are speculative and entail significant risks that can include losses due to leveraging or other speculative investment practices, lack of liquidity, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification, absence and/or delay of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than mutual funds and risks associated with the operations, personnel and processes of the advisor.

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Investing in commodities entails significant risks. Commodity prices may be affected by a variety of factors at any time, including but not limited to, (i) changes in supply and demand relationships, (ii) governmental programs and policies, (iii) national and international political and economic events, war and terrorist events, (iv) changes in interest and exchange rates, (v) trading activities in commodities and related contracts, (vi) pestilence, technological change and weather, and (vii) the price volatility of a commodity. In addition, the commodities markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity, participation of speculators and government intervention.

Physical precious metals are non-regulated products. Precious metals are speculative investments, which may experience short-term and long term price volatility. The value of precious metals investments may fluctuate and may appreciate or decline, depending on market conditions. If sold in a declining market, the price you receive may be less than your original investment. Unlike bonds and stocks, precious metals do not make interest or dividend payments. Therefore, precious metals may not be suitable for investors who require current income. Precious metals are commodities that should be safely stored, which may impose additional costs on the investor. The Securities Investor Protection Corporation ("SIPC") provides certain protection for customers' cash and securities in the event of a brokerage firm's bankruptcy, other financial difficulties, or if customers' assets are missing. SIPC insurance does not apply to precious metals or other commodities.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

Interest on municipal bonds is generally exempt from federal income tax; however, some bonds may be subject to the alternative minimum tax (AMT). Typically, state tax-exemption applies if securities are issued within one's state of residence and, if applicable, local tax-exemption applies if securities are issued within one's city of residence.

Build America Bonds described herein are backed by the credit quality of the issuer, and not the federal government. These Build America Bonds are structured as direct payment bonds, in which a direct Federal subsidy is paid to the state or local government issuer.

A taxable equivalent yield is only one of many factors that should be considered when making an investment decision. Morgan Stanley Smith Barney and its Financial Advisors do not offer tax advice; investors should consult their tax advisors before making any tax-related investment decisions.

Rebalancing does not protect against a loss in declining financial markets. There may be a potential tax implication with a rebalancing strategy. Investors should consult with their tax advisor before implementing such a strategy.

Treasury Inflation Protection Securities' (TIPS) coupon payments and underlying principal are automatically increased to compensate for inflation by tracking the consumer price index (CPI). While the real rate of return is guaranteed, TIPS tend to offer a low return. Because the return of TIPS is linked to inflation, TIPS may significantly underperform versus conventional US Treasuries in times of low inflation.

Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment.

Investing in smaller companies involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity.

Asset allocation and diversification do not assure a profit or protect against loss in declining financial markets.

The indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

The indices selected by Morgan Stanley Smith Barney to measure performance are representative of broad asset classes. Morgan Stanley Smith Barney retains the right to change representative indices at any time.

REITs investing risks are similar to those associated with direct investments in real estate: property value fluctuations, lack of liquidity, limited diversification and sensitivity to economic factors such as interest rate changes and market recessions.

Because of their narrow focus, sector investments tend to be more volatile than investments that diversify across many sectors and companies.

Principal is returned on a monthly basis over the life of a mortgage-backed security. Principal prepayment can significantly affect the monthly income stream and the maturity of any type of MBS, including standard MBS, CMOs and Lottery Bonds. Yields and average lives are estimated based on prepayment assumptions and are subject to change based on actual prepayment of the mortgages in the underlying pools. The level of predictability of an MBS/CMO's average life, and its market price, depends on the type of MBS/CMO class purchased and interest rate movements. In general, as interest rates fall, prepayment speeds are likely to increase, thus shortening the MBS/CMO's average life and likely causing its market price to rise. Conversely, as interest rates rise, prepayment speeds are likely to decrease, thus lengthening average life and likely causing the MBS/CMO's market price to fall. Some MBS/CMOs may have "original issue discount" (OID). OID occurs if the MBS/CMO's original issue price is below its stated redemption price at maturity, and results in "imputed interest" that must be reported annually for tax purposes, resulting in a tax liability even though interest was not received. Investors are urged to consult their tax advisors for more information.

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Value investing does not guarantee a profit or eliminate risk. Not all companies whose stocks are considered to be value stocks are able to turn their business around or successfully employ corrective strategies which would result in stock prices that do not rise as initially expected.

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Performance of indices may be more or less volatile than any investment product. The risk of loss in value of a specific investment is not the same as the risk of loss in a broad market index. Therefore, the historical returns of an index will not be the same as the historical returns of a particular investment a client selects.

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Investing in the market entails the risk of market volatility. The value of all types of securities may increase or decrease over varying time periods.

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