Morgan Stanley Investment Management

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Emerging Markets Equities – The Third Coming

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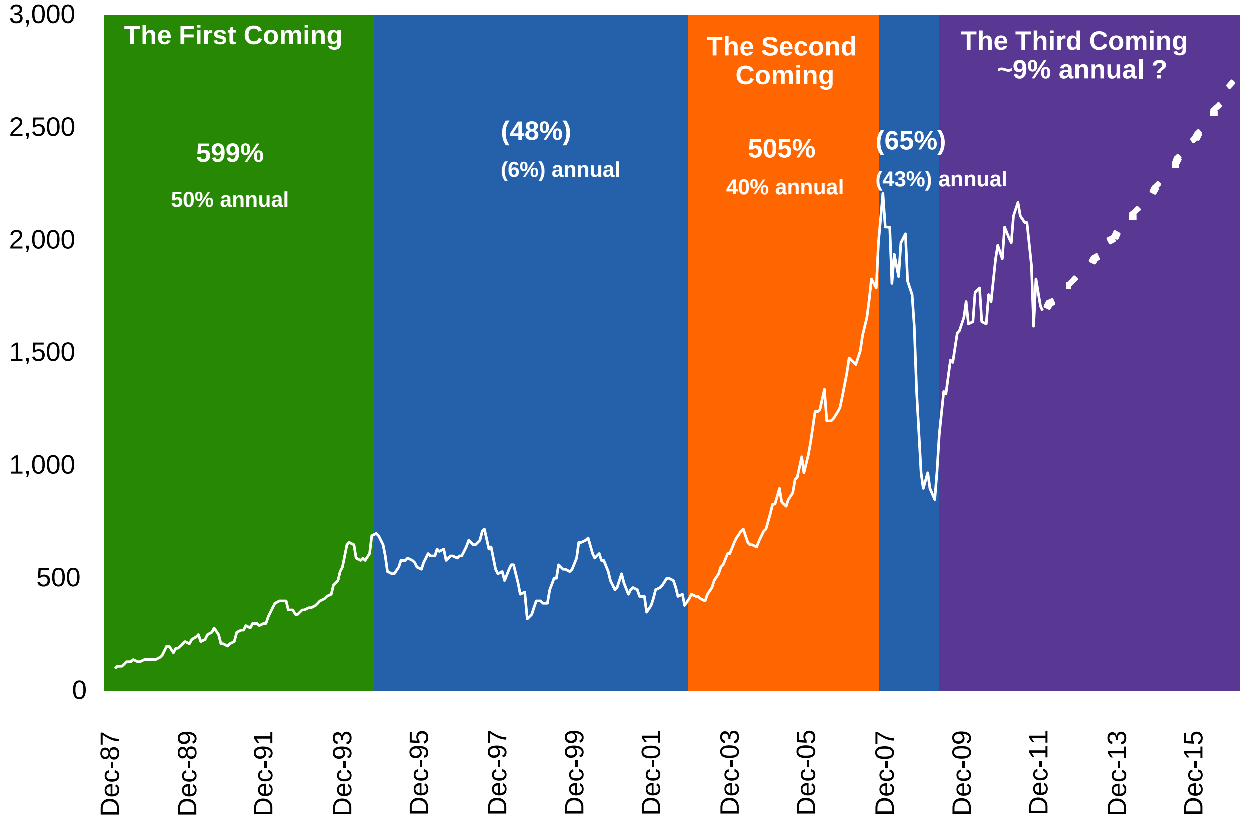
The Evolution Of Emerging Markets (EM)

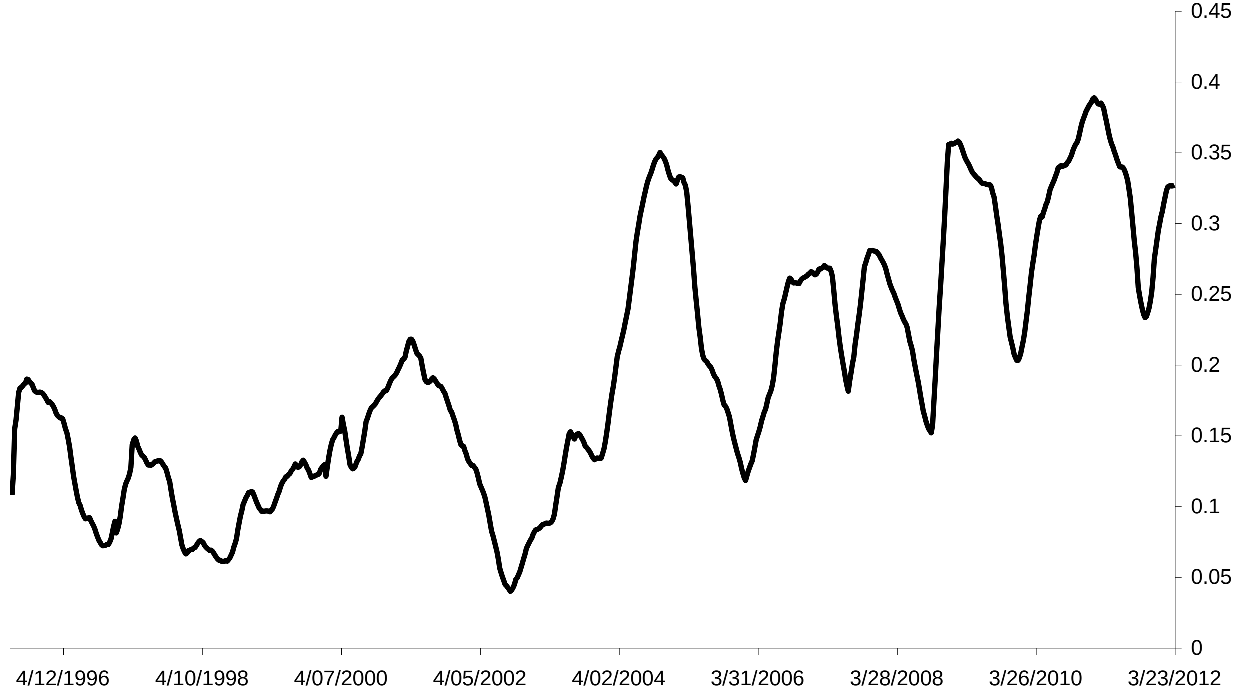


Source: MSCI, MSIM Emerging Markets and FactSet. Data as of December 31, 2011. Estimates are based on current market conditions, subject to change and may not necessarily come to pass.

Much Too Synchronous

High correlations are a sign of stress in the system and they typically tend to weaken in bull markets and increase in bear phases

Average Correlation - Cross Asset (rolling 3 month)



Source: Bloomberg, FactSet, MSIM, Data as of March 23, 2012.

1. Based on correlation of Copper (active future contract), Gold (active future contract), JPMorgan Emerging Market FX Index, 10yr U.S. Treasury Total Return Index, Barclays Capital Global High Yield, MSCI Emerging Markets, JP Morgan EMBI, S&P 500 Index, Australian Dollar, CRB Continuous Commodity Index. Past performance is no guarantee of future results.

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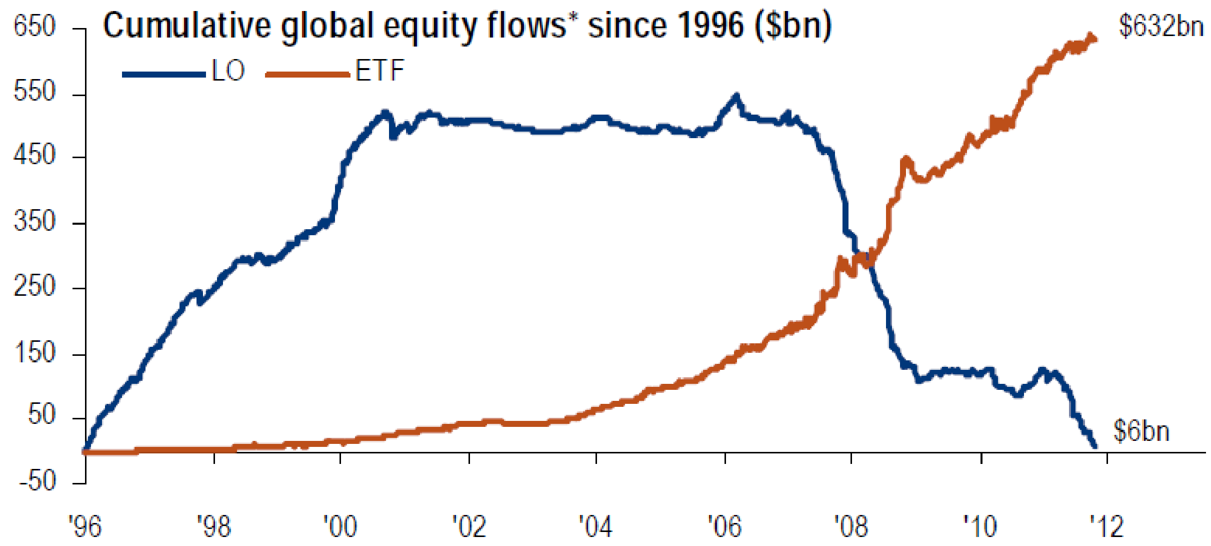
Herd Behavior

Cumulative inflows in global ETFs have matched outflows in long only funds since the mid-90s

Long-Only Equity Flows vs. Equity ETF Flows



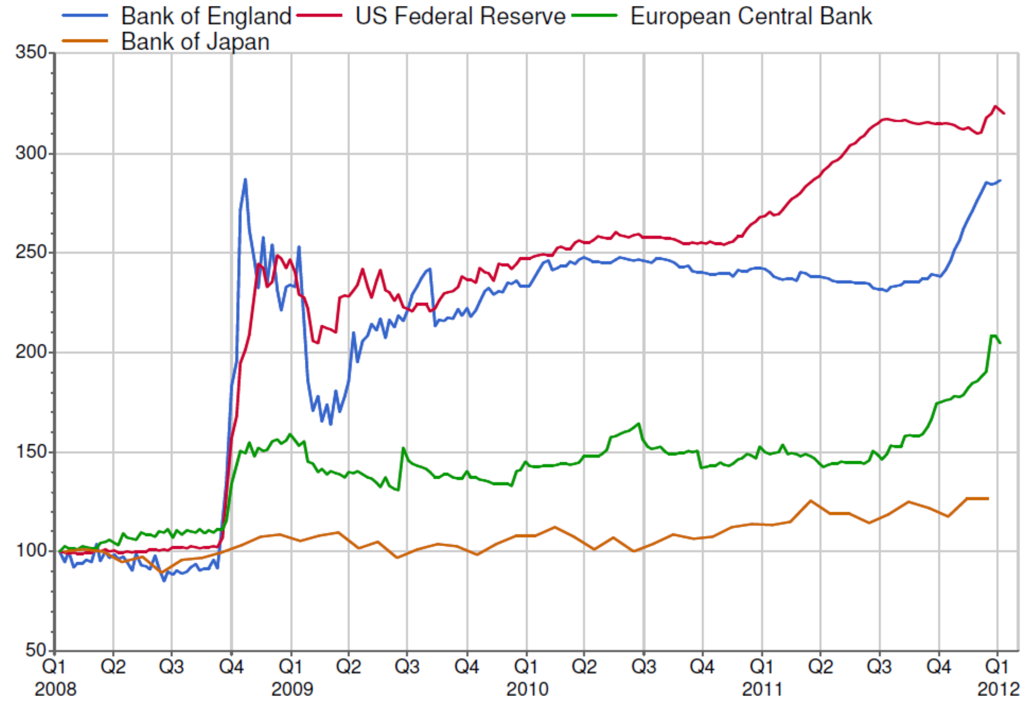
Source: BofA Merrill Lynch Global Equity Strategy, EPFR Global, Lipper FMI MSIM Emerging Markets Research, FactSet. Data as of December 31, 2011.
Past performance is no guarantee of future results.

* Data 1996 – 2002 from Lipper FMI; 2002 – Onwards from EPFR Global.

The Great Liquidity Flood

Liquidity Injections by the Major Central Banks

(Size of Balance Sheet. Jan 2008=100)



Source: Gavyn Davies, “The unprecedented behaviour of the central banks,” Financial Times, January 8, 2012.

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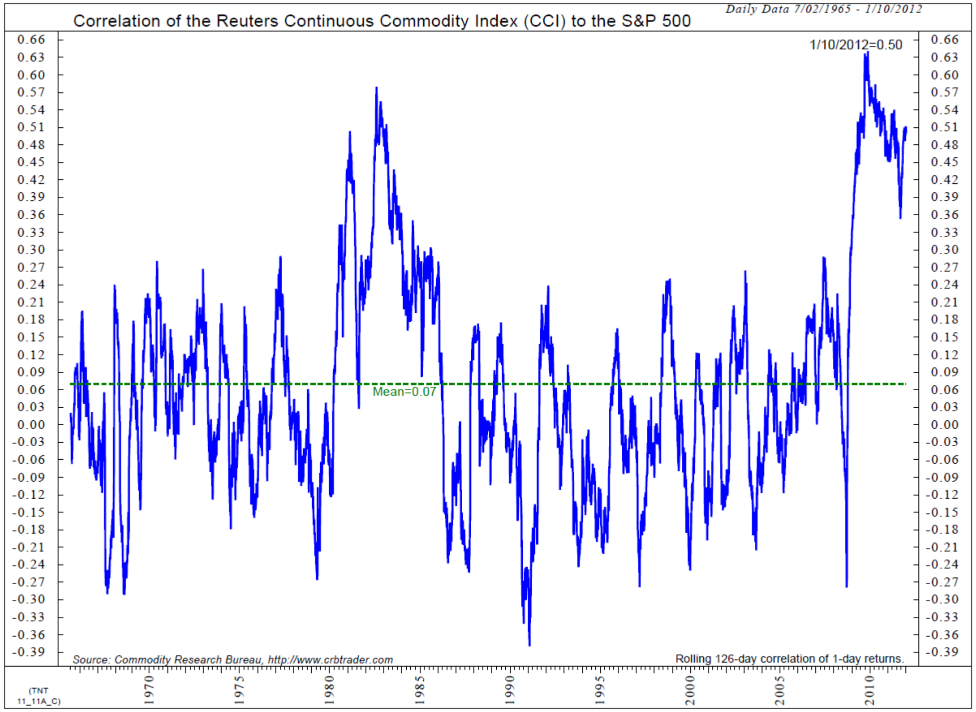
Time for Separation For New Regime To Take Hold

The connection between easier financial conditions and higher oil prices needs to break

It took a double-dip recession in the 1980s to kill the commodity bull market and set the stage for a sustainable recovery to begin in 1982

Correlation of the Reuters Continuous Commodity Index (CCI) to the S&P 500



Source: Commodity Research Bureau, time period of 7/2/1965 to 1/10/2012

Past performance is no guarantee of future results.

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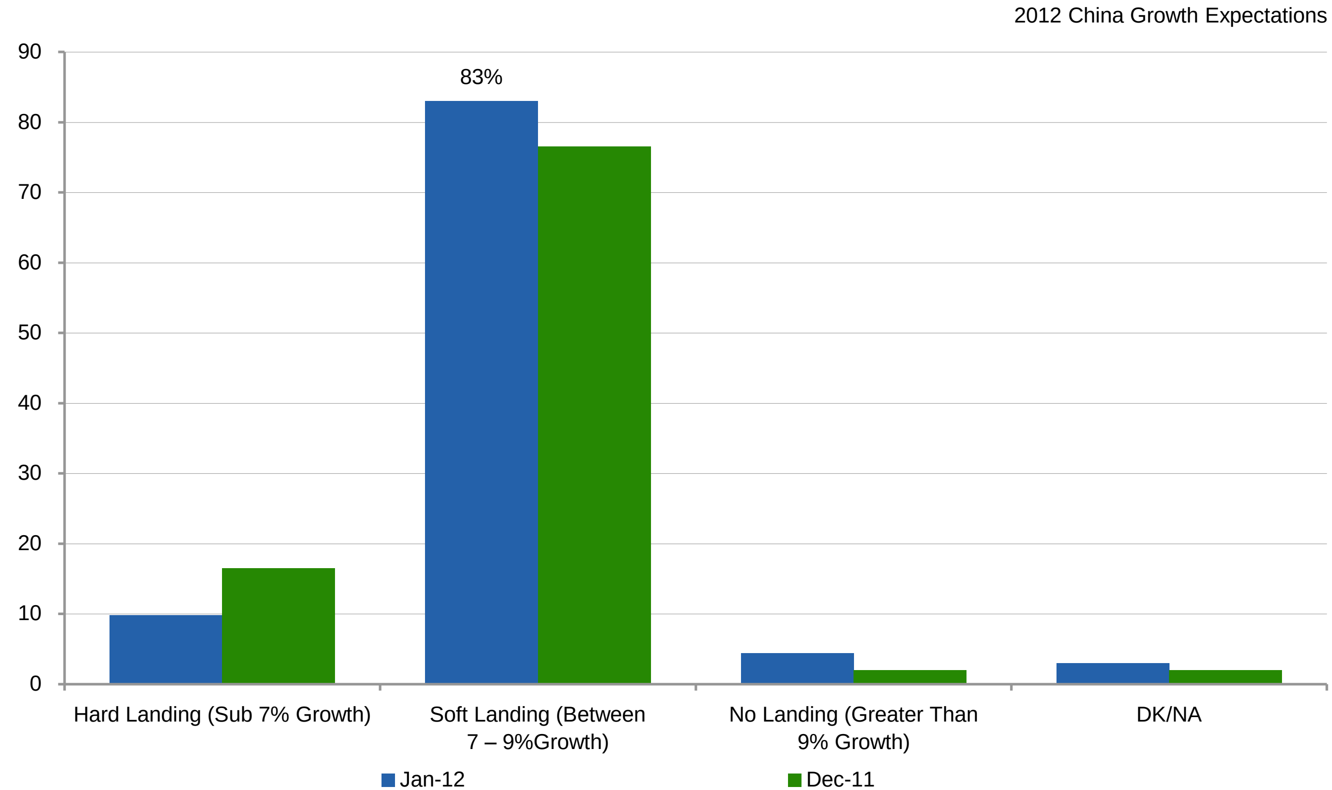
Unbridled Optimism on China

Over 80% of investors surveyed recently expect China to have a soft landing

In 2012 Will China Have a…

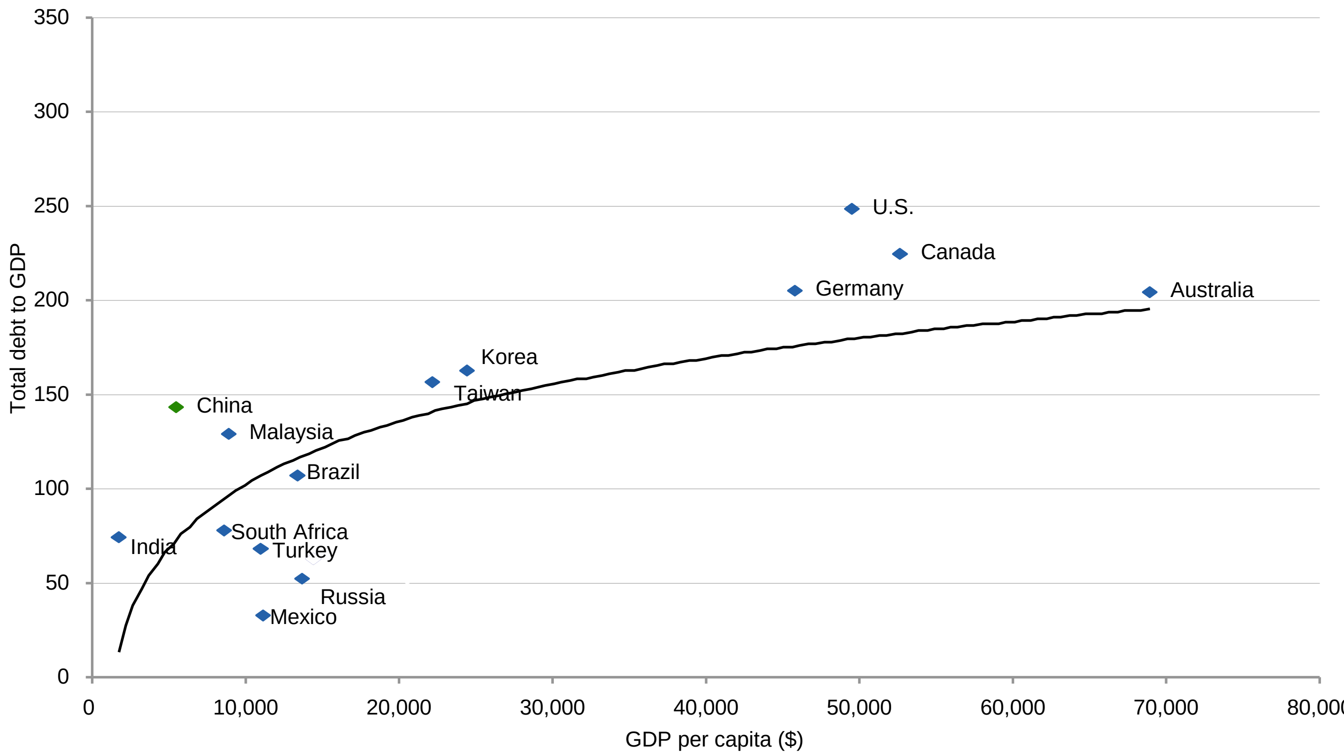


Source: Bank of America Merrill Lynch. As of January 31, 2012.

Structural Risks to Soft Landing Scenario

Extent of China's Indebtedness is Not Properly Understood

Total Debt/GDP vs. GDP per capita



Source: MSIM, UBS, Merrill Lynch. Data as of December 31, 2011.

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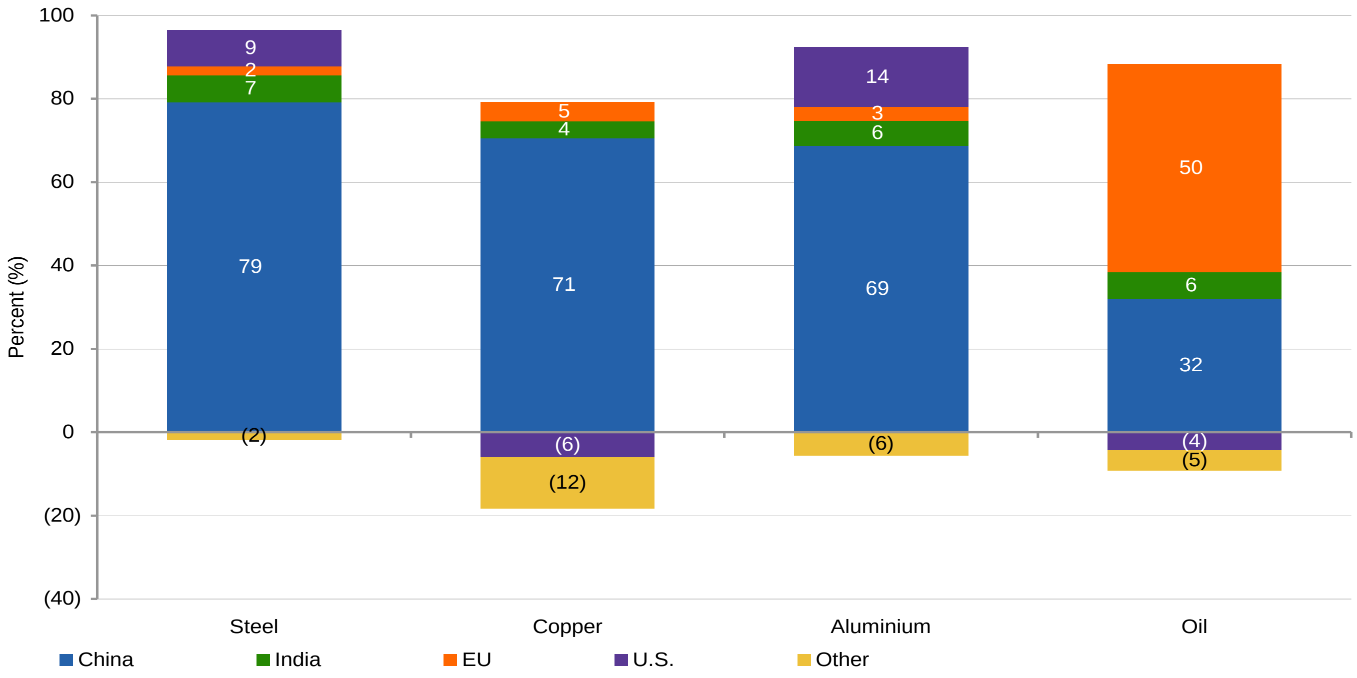
China's Appetite For Commodities Unsustainable

China Has Overwhelmed Demand Growth for Metals and Oil

China accounts for only 10 percent of total global output but a large share of commodity consumption

Even though China's share of global manufacturing has risen dramatically in the last two decades, from 4 to 17 percent, the manufacturing share of the global economy has fallen in the same period, from 23 to 17 percent, largely at the expense of Europe, Japan, and the United States

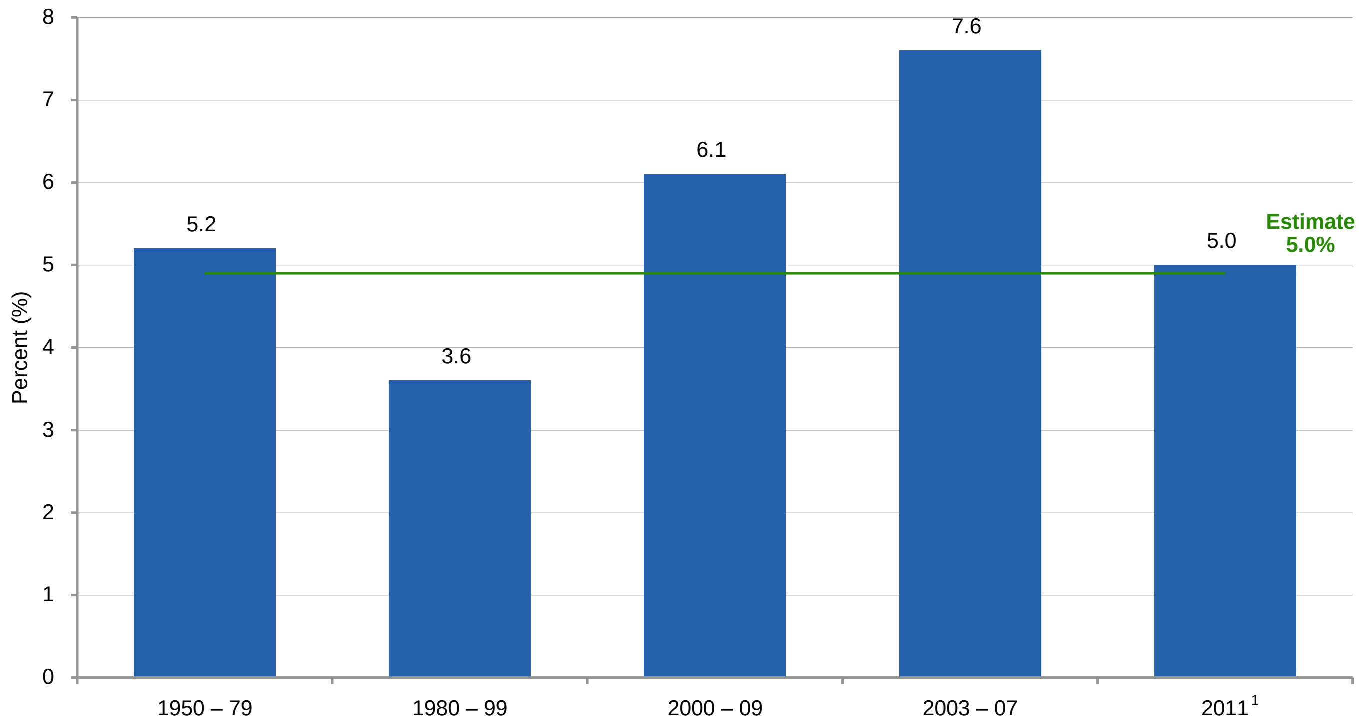
2000 – 2011 Share of Incremental Demand



Source: Macquarie as of 12/31/11

Back To The Future

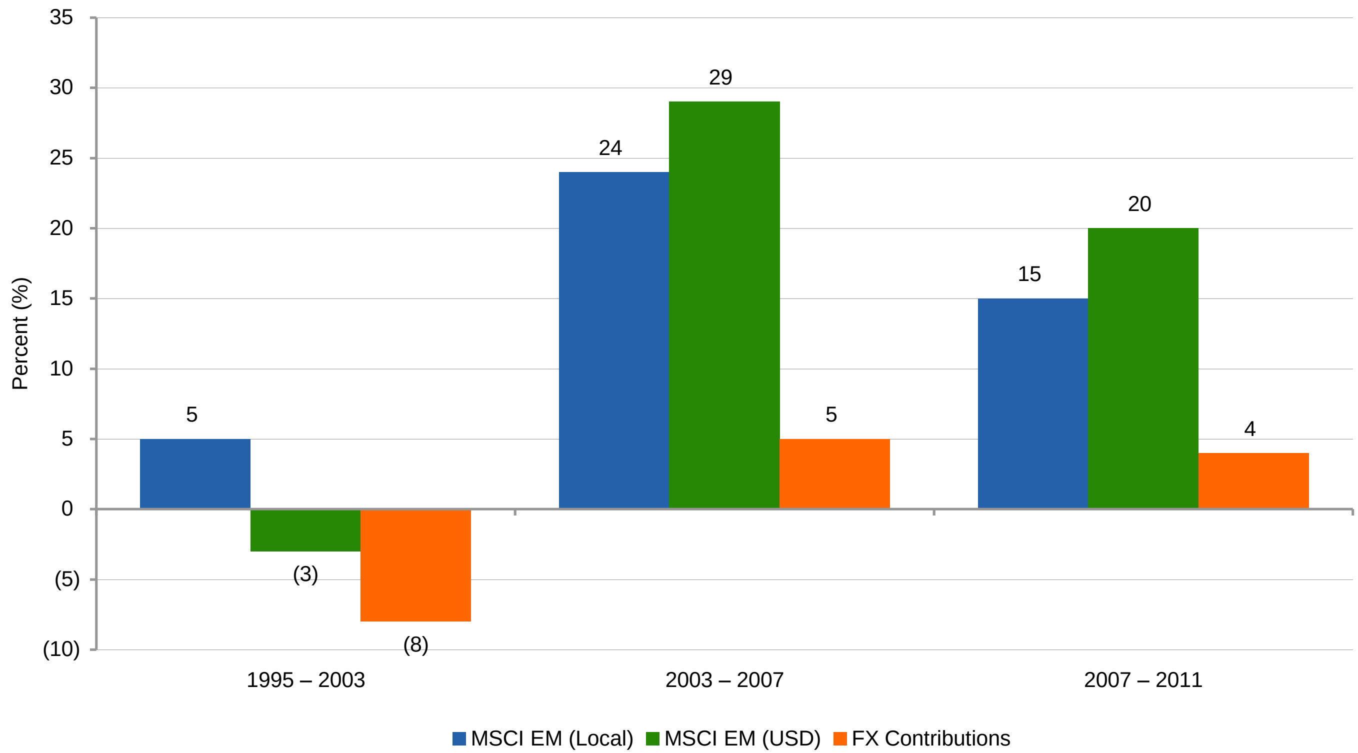
Global Emerging Markets (GEM) Average Real GDP Growth



Source: Conference Board, IMF 2011. The estimate is that of MSIM Emerging Markets team, is subject to change, and may not necessarily come to pass.

Currency Can Be An Important Factor for EM Equity Returns

Average Annual Return



Source: FactSet. Return based on average of 12m rolling returns. Past performance is no guarantee of future results.

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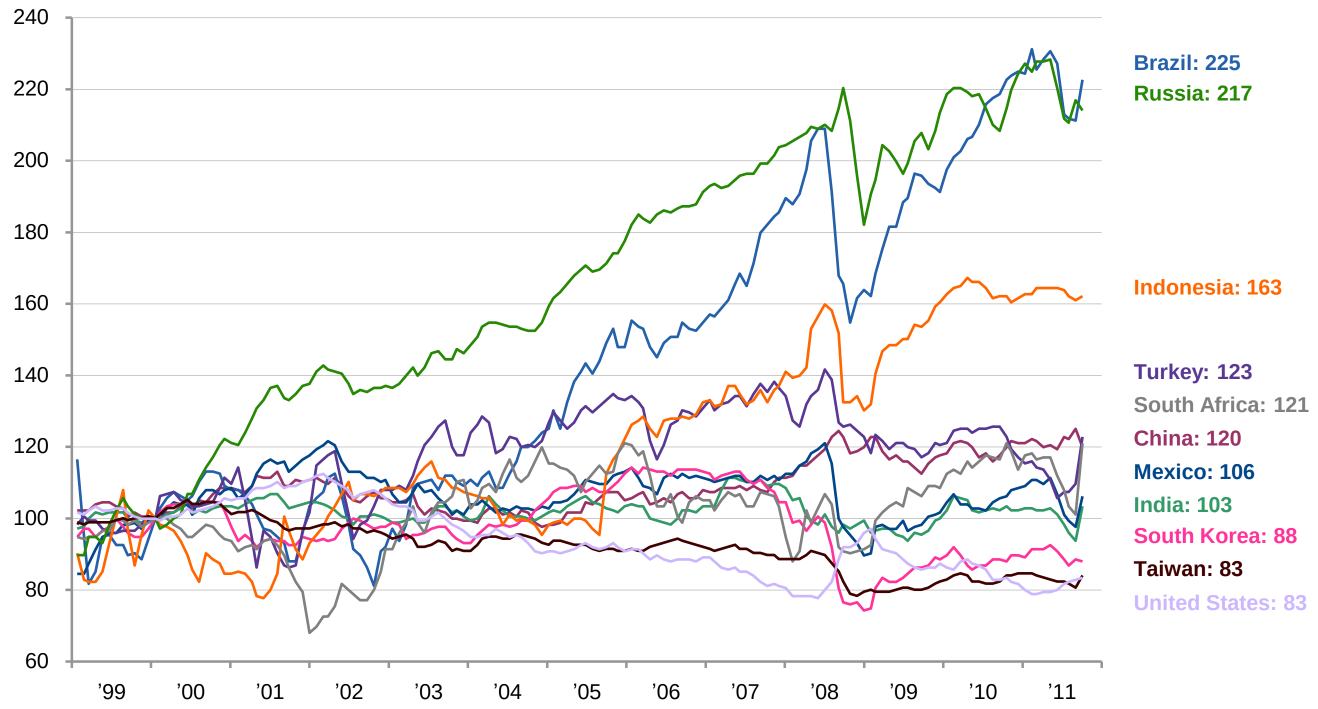
Commodity Currencies Losing Competitiveness

EM currencies have steadily reduced their competitiveness relative to the USD over the past decade

REER: EM vs. USD



Source: FactSet, JPMorgan, MSIM. Data as of December 31, 2011. Past performance is no guarantee of future results.

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Breakout Nations Of The Coming Decade

Individual stories, not a homogenous class

GDP per Capita	Country	Expected Growth Rate
~$20,000	Czech Republic	3%+
	South Korea	
$10,000 – 1 5,000	Turkey	4%–5%
	Poland	
	Chile	
$5,000 – 10,000	Thailand	5%
	Peru	
<$5,000	India	5%+
	Indonesia	
	Philippines	
	Sri Lanka	
	Nigeria	

Source: IMF, MSIM. Estimates are based on current market conditions, subject to change and may not necessarily come to pass, as of 12/31/11.

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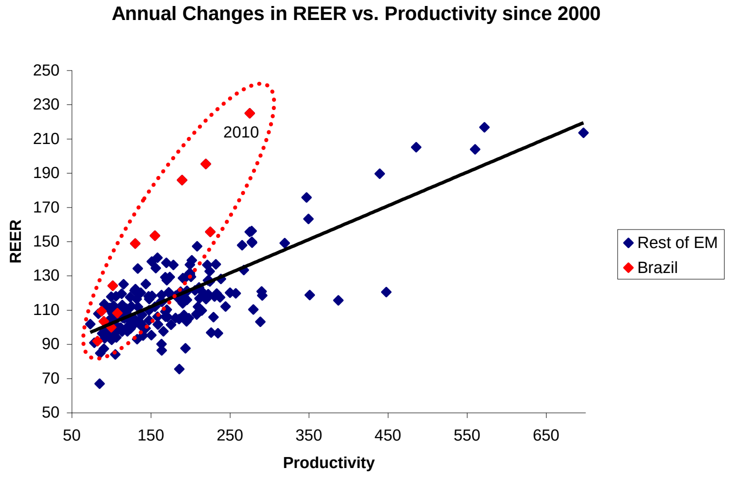
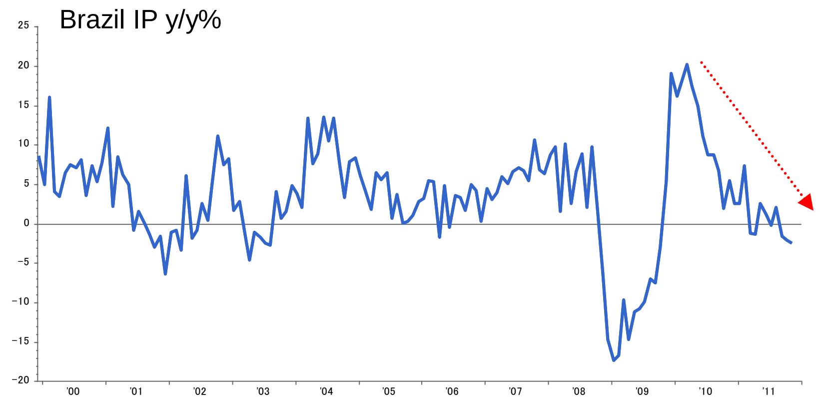
Brazil

On a number of metrics Brazil's currency appears overvalued

Brazil's government spending as a share of its economy has climbed steadily from nearly 20 percent to around 40 percent today

Growth in Brazil has recently shown signs of weakness as industrial production growth is currently at its lowest level since 2003





Source: FactSet, IMF. As of December 2010

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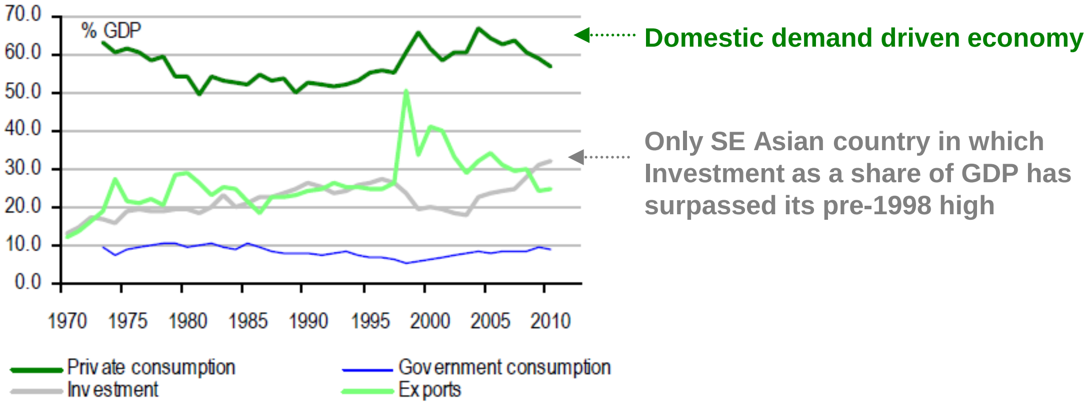
Indonesia

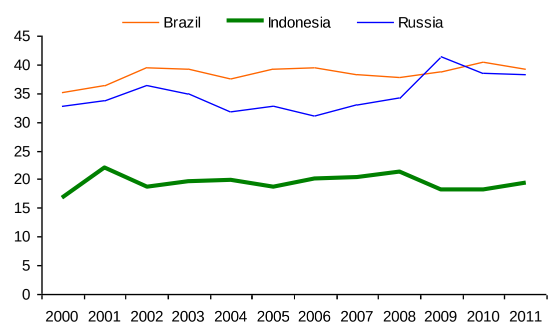
Indonesia has demonstrated that it has a large enough domestic market to generate demand even when global demand was weak

Indonesia has not frittered away the profits of the commodity boom of the last decade as Russia and Brazil ultimately did, and has the savings to potentially increase investment in the economy

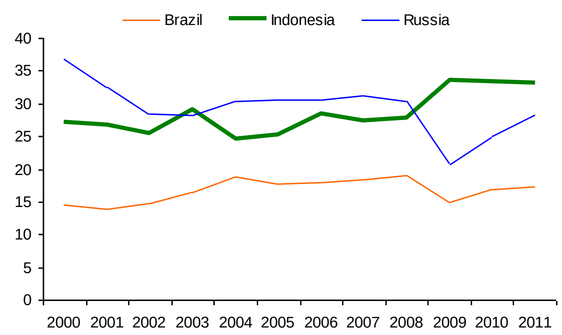
Nominal GDP – Expenditure Shares



General government total expenditure to GDP



Gross National Savings to GDP



Source: UBS, IMF. Data as of October, 2011

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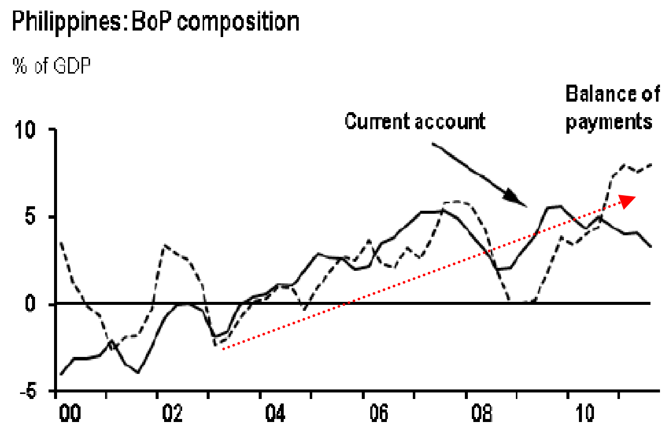
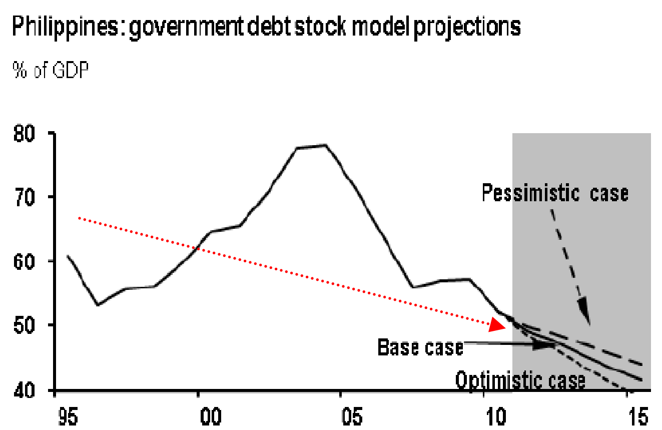
Philippines

President Benigno Aquino III appears to have enough support to generate reform momentum that would allow the Philippines to resume a period of strong growth

The balance of payments' position continues to be strong, driven by a current account surplus and a steady growth in workers' remittances

The objective of the government is to reduce the debt/GDP ratio to 42% in 2015 from 52% in 2010, which would strengthen Philippine's case for investment grade status





Source: National Statistics Office, Central Bank, IMF, JP Morgan. Data as of 12/31/11.

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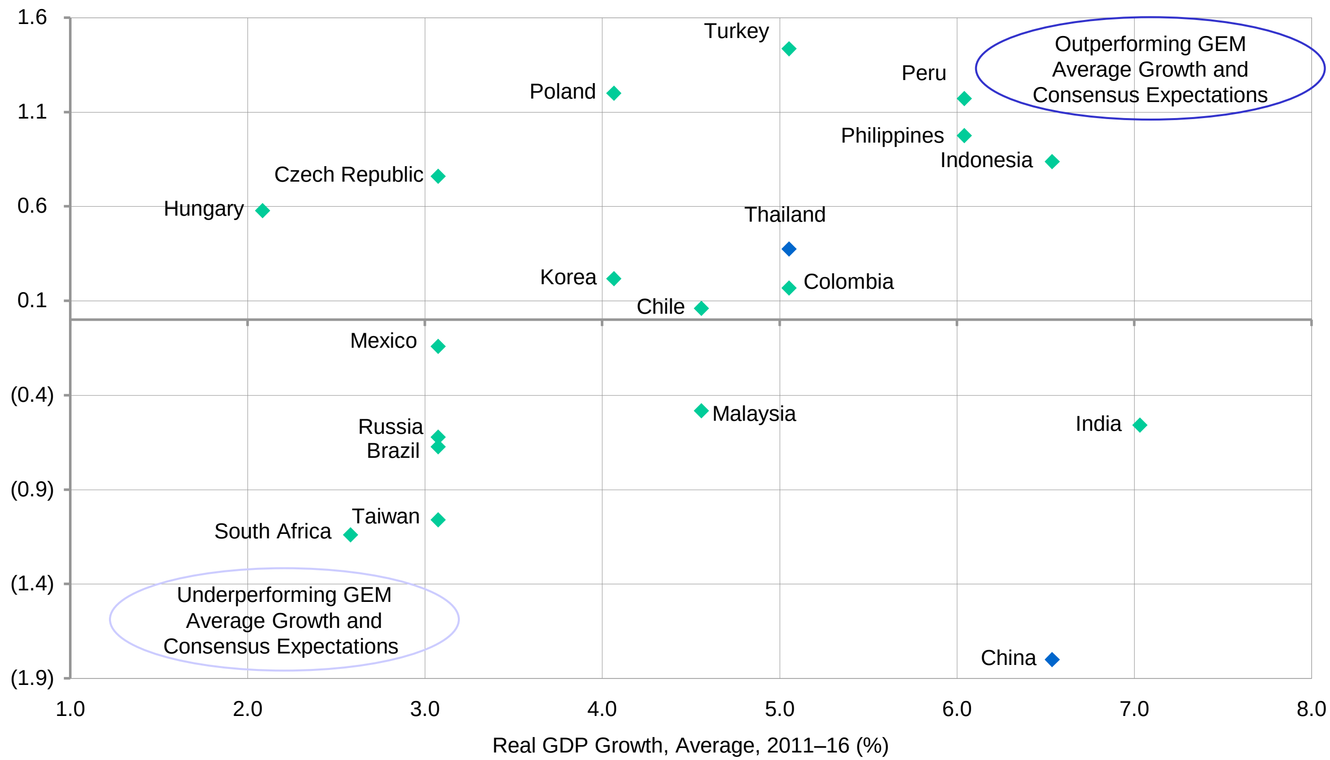
Growth Game Is All About Expectations

Third Coming will be about understanding emerging markets as individual nations

GEM Outlook & Expectations

Real GDP Growth, Deviation from MSIM Consensus Expectations, bps

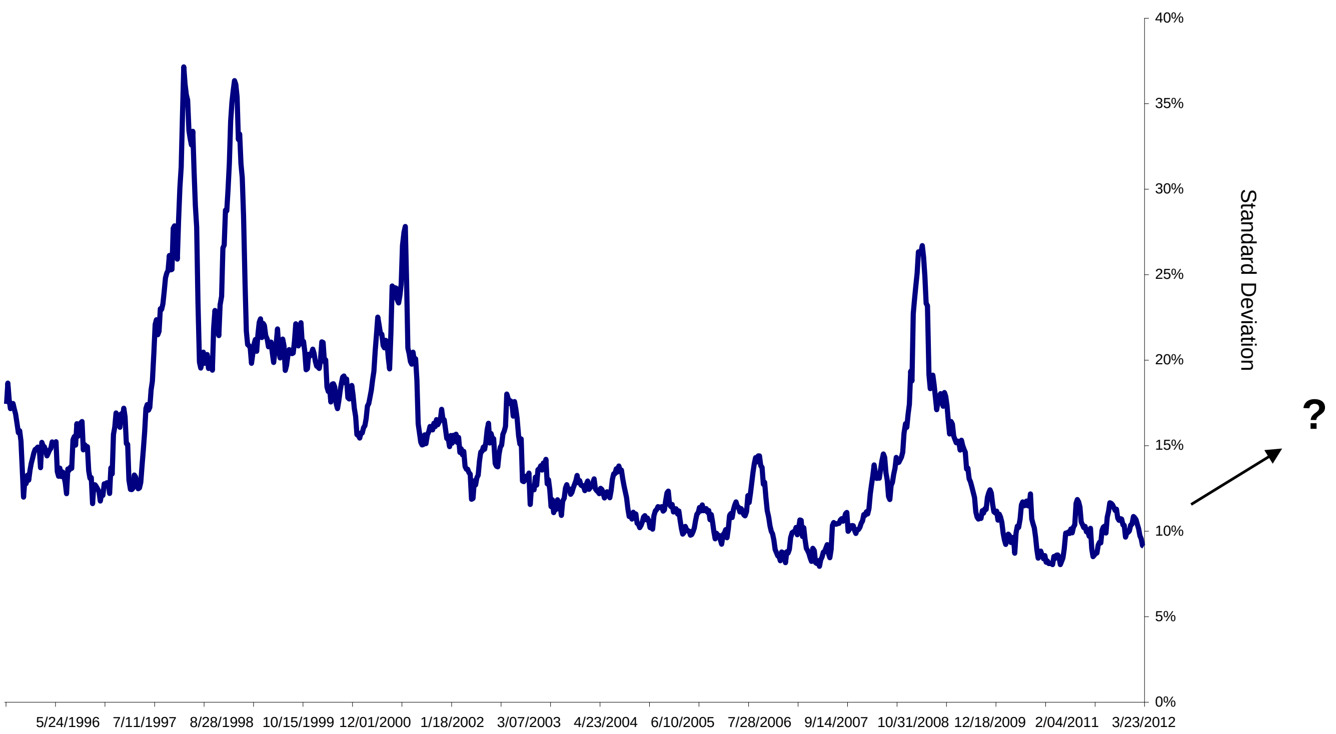


Source: IMF, Bloomberg, MSIM. Note: y-axis broken to fit China on graph. China y-axis value is (3.2).

Markets Not Distinguishing Between Countries

Macro environment led to low dispersion in EM country returns

EM Dispersion



Source: FactSet, Bloomberg, MSIM Emerging Markets Research (Top 20 countries in the MSCI EM Index). Past performance is no guarantee of future results. Data as of 3/23/12.

Summary

- The third coming of EM could be an era defined by moderate growth, volatile business cycles, and the breakup of herd behavior
- A breakdown in correlations or disappointment with China growth could be regime changers
- Commodity importing nations could be big beneficiaries in the new regime
- EM growth may be reverting back to the historical average growth rate of 5%
- Many commodity currencies have become significantly less competitive over the past decade
- Country dispersion is still near historical lows but case for rising dispersion is only increasing

Important Disclosure

Definitions:

Barclays Capital Global High Yield Index – An unmanaged index considered representative of fixed rate, noninvestment-grade debt of companies in the U.S., developed markets and emerging markets.

MSCI Emerging Markets Index – The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of the following 21 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

JPM EMBI Global Index - The JP Morgan Emerging Markets Bond Global (“EMBG”) Index tracks total returns for U.S. dollar-denominated debt instruments issued by emerging markets sovereign and quasi-sovereign entities: Brady Bonds, loans, Eurobonds and local market instruments for over 30 emerging market countries.

JPM GBI-EM Diversified Bond Index - The JP Morgan GBI-EM Diversified Bond Index is an index which tracks local currency government bonds issued by emerging markets.

S&P 500 Index - The Standard & Poor’s 500® Index (S&P 500®) measures the performance of the large cap segment of the U.S. equities market, covering approximately 75% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

The Thomson Reuters/Jefferies CRB Index - The index is comprised of 19 commodities: Aluminum, Cocoa, Coffee, Copper, Corn, Cotton, Crude Oil, Gold, Heating Oil, Lean Hogs, Live Cattle, Natural Gas, Nickel, Orange Juice, Silver, Soybeans, Sugar, Unleaded Gas and Wheat. The Index uses a four-day rollover schedule for each commodity beginning on the first business day of the month and ending on the fourth business day.

Exchange Traded Fund (ETF) - A security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange. ETFs experience price changes throughout the day as they are bought and sold.

Gross Domestic Product (GDP) - The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

GDP per Capita - A measure of the total output of a country that takes the gross domestic product (GDP) and divides it by the number of people in the country. The per capita GDP is especially useful when comparing one country to another because it shows the relative performance of the countries. A rise in per capita GDP signals growth in the economy and tends to translate as an increase in productivity.

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Definitions continued:

Real GDP - An inflation-adjusted measure that reflects the value of all goods and services produced in a given year, expressed in base-year prices. Often referred to as "constant-price", "inflation-corrected" GDP or "constant dollar GDP".

Nominal GDP – A gross domestic product (GDP) figure that has not been adjusted for inflation. Also known as “current dollar GDP” or “chained dollar GDP.”

USD – In currencies, this is the abbreviation for the U.S. dollar.

Real Effective Exchange Rate (REER) - The weighted average of a country's currency relative to an index or basket of other major currencies adjusted for the effects of inflation. The weights are determined by comparing the relative trade balances, in terms of one country's currency, with each other country within the index.

The JPMorgan Emerging Markets Currency Index (EMCI) provides investors with a tradable benchmark of Emerging Markets currency markets. The EMCI tracks excess returns for EM FX forwards in 8 of the most liquid emerging markets countries. The EMCI trails ELMI+ with very high correlation (above 90%) and low tracking error.

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