Morgan Stanley

MORGAN STANLEY RESEARCH
ASIA/PACIFIC

Morgan Stanley Australia Limited+
Gerard Minack
Gerard.Minack@morganstanley.com
+61 2 9770 1529

December 5, 2007

Downunder Daily

Götterdämmerung

Bear markets are not simply bull markets where prices go down rather than up. The 'rules' are different. Morgan Stanley's European strategy team has just set out its very cautious views on 2008 (please see Teun Draaisma, *2008: Regime Change*), and highlights the characteristics of a bear market. Here are my thoughts on how a bear market would behave:

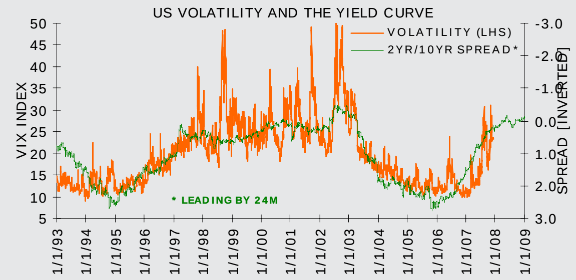
First, bear markets tend to be more volatile than bull markets. Moreover, the bull market that started in 2003 was notably unvolatile, so the contrast heading into 2008 may be particularly noteworthy. The yield curve – which may again prove its value as a leading indicator for growth – leads volatility (Exhibit 1). It is pointing to sustained high volatility in 2008.

Second, the sharpest rallies tend to be bear market corrections, just as the sharpest falls tend to be bull-market corrections. This is true even on a large scale: The 1987 crash was, on the long view, a sharp correction in an extended bull market. Likewise, several of the sharpest 'bull markets' were in the midst of bigger-picture bear trends (Exhibit 2).

Third, in a bear market, you must fight the Fed. Of course, Fed cuts may trigger short-covering rallies, and, as noted in the previous point, these can be sharp affairs. But in a bear market, rallies are for selling.

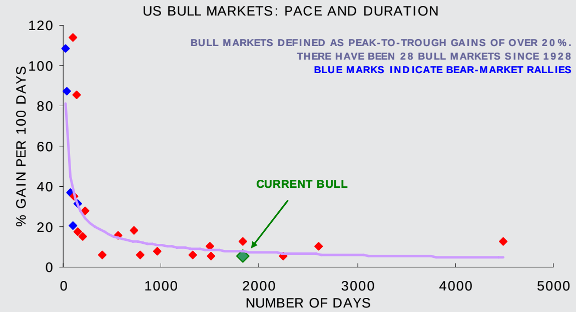
Even over a shorter time-scale, the usual relationship between equities and rate expectations tends to break down. In a bull market – when investors take growth as a given – hopes for easier Fed policy are positive for equities. In a bear market – when confidence in growth is low – hopes for easier policy tend to be associated with weaker equities. Exhibit 3 shows the short-term change in market expectations for Fed policy (as reflected in the change in the 2-year Treasury-Fed funds spread) and the change in the S&P 500.

Exhibit 1
Volatility Tends to Rise



Source: Bloomberg; Morgan Stanley Research

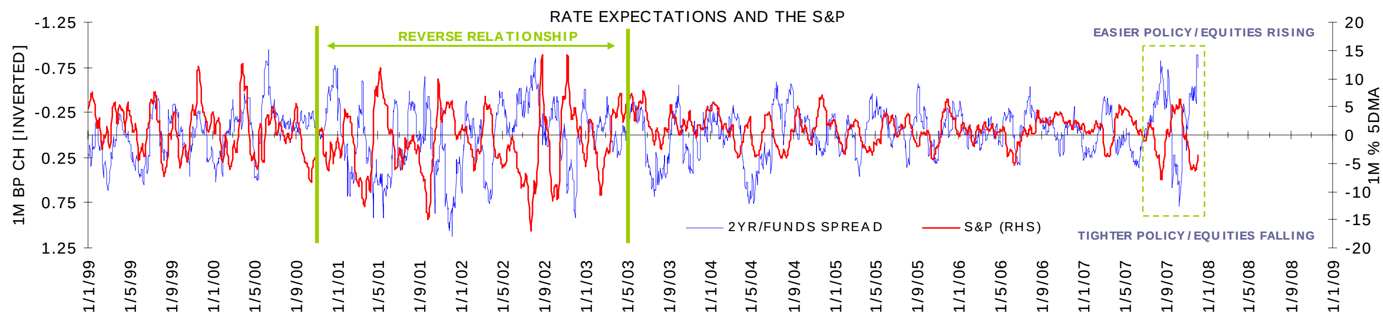
Exhibit 2
Sharpest Bounces Are in Bear Markets



Source: DataStream, Bloomberg; Morgan Stanley Research

Fourth, with the relationship between rates and equities breaking down, that implies that 'standard' valuation tools either need to be recalibrated or, in extreme circumstances, break down. Our European team highlights how in a bear market the buy/sell levels on its composite valuation indicator (CVI) change. In a bull market, a CVI of zero is taken as a buy signal; in a bear, the buy signal is more likely to be around -1/-2. The same holds true for conventional bond yield/equity yield indicators. In extreme circumstances, such as Japan since the early 1990s, the bond/equity comparison has given false signals for a decade.

Exhibit 3
The Link Between Rate Expectations and Stocks Changes

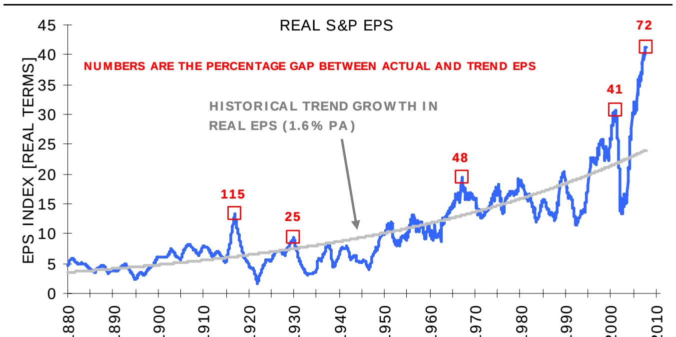


Source: Bloomberg, Morgan Stanley Research

Fifth, the breakdown in bond/equity relationship implies that bonds and equities shift from being positively correlated to negatively correlated. This is part of a bigger picture story: Correlations tend to fall in a bear market. This is an important point to note: Bear markets are not simply extended corrections. As we have seen over the past few years, in bull-market corrections, correlations have risen. In a bear market, I would not expect correlations to stay at a high level.

Sixth, the old favourite: This has been an earnings bubble, rather than a P/E bubble, which means that the big danger in the following bear market is value traps – under-estimating the extent to which earnings can fall.

Exhibit 4
Earnings Way Above Trend



Source: Bloomberg; Morgan Stanley Research

Exhibit 4 shows a long-term series of US earnings per share. EPS are now farther above trend than at any time in 90 years. My view is that margins and returns do mean-revert (which implies that equities are now very expensive). But earnings will take time to fall, meaning that investors may fall into value traps.

The final point may seem like a statement of the obvious: Bear markets tend to be nasty affairs. No, really, they are: There have been 23 bear markets (defined as 20%-plus falls) in the US since 1929. In 11 of those bear markets, the market decline completely erased the bull market gain that preceded it. Put another way, on this very simple measure, there is almost a 50% probability that a bear market could erase the gains seen since the 2003 lows. That, to me, seems a fair assessment.

Disclosure Section

The information and opinions in Morgan Stanley Research were prepared or are disseminated by Morgan Stanley Asia Limited (which accepts the responsibility for its contents) and/or Morgan Stanley Asia (Singapore) Pte. (Registration number 199206298Z, regulated by the Monetary Authority of Singapore, which accepts the responsibility for its contents), and/or Morgan Stanley Asia (Singapore) Securities Pte Ltd (Registration number 200008434H, regulated by the Monetary Authority of Singapore, which accepts the responsibility for its contents), and/or Morgan Stanley Taiwan Limited and/or Morgan Stanley & Co International plc, Seoul Branch, and/or Morgan Stanley Australia Limited (A.B.N. 67 003 734 576, holder of Australian financial services license No. 233742, which accepts responsibility for its contents), and/or Morgan Stanley India Company Private Limited and their affiliates (collectively, "Morgan Stanley").

Analyst Certification

The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report: Gerard Minack.

Unless otherwise stated, the individuals listed on the cover page of this report are research analysts.

Global Research Conflict Management Policy

Morgan Stanley Research has been published in accordance with our conflict management policy, which is available at www.morganstanley.com/institutional/research/conflictpolicies.

Important US Regulatory Disclosures on Subject Companies

The research analysts, strategists, or research associates principally responsible for the preparation of Morgan Stanley Research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors, firm revenues and overall investment banking revenues.

Certain disclosures listed above are also for compliance with applicable regulations in non-US jurisdictions.

STOCK RATINGS

Different securities firms use a variety of rating terms as well as different rating systems to describe their recommendations. For example, Morgan Stanley uses a relative rating system including terms such as Overweight, Equal-weight or Underweight (see definitions below). A rating system using terms such as buy, hold and sell is not equivalent to our rating system. Investors should carefully read the definitions of all ratings used in Morgan Stanley Research. In addition, since Morgan Stanley Research contains more complete information concerning the analyst's views, investors should carefully read Morgan Stanley Research, in its entirety, and not infer the contents from the rating alone. In any case, ratings (or research) should not be used or relied upon as investment advice. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations.

Global Stock Ratings Distribution

(as of November 30, 2007)

For disclosure purposes only (in accordance with NASD and NYSE requirements), we include the category headings of Buy, Hold, and Sell alongside our ratings of Overweight, Equal-weight and Underweight. Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, and Underweight are not the equivalent of buy, hold, and sell but represent recommended relative weightings (see definitions below). To satisfy regulatory requirements, we correspond Overweight, our most positive stock rating, with a buy recommendation; we correspond Equal-weight and Underweight to hold and sell recommendations, respectively.

	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	**987**	**43%**	**324**	**45%**	**33%**
Equal-weight/Hold	**981**	**42%**	**311**	**43%**	**32%**
Underweight/Sell	**348**	**15%**	**88**	**12%**	**25%**
Total	**2,316**		**723**		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Underweight (U or Under) - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V) - We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

Stock price charts and rating histories for companies discussed in Morgan Stanley Research are available at www.morganstanley.com/companycharts or from your local investment representative. You may also request this information by writing to Morgan Stanley at 1585 Broadway, (Attention: Equity Research Management), New York, NY, 10036 USA.

Other Important Disclosures

For a discussion, if applicable, of the valuation methods used to determine the price targets included in Morgan Stanley Research, and the risks related to achieving these targets, please refer to the latest relevant published research on these stocks. Research is available through your sales representative or on Client Link at www.morganstanley.com and other electronic systems.

Morgan Stanley Research does not provide individually tailored investment advice. Morgan Stanley Research has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The securities/instruments discussed in Morgan Stanley Research may not be suitable for all investors. Morgan Stanley recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. The securities, instruments, or strategies discussed in Morgan Stanley Research may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them.

Morgan Stanley Research is not an offer to buy or sell or the solicitation of an offer to buy or sell any security/instrument or to participate in any particular trading strategy. The "Important US Regulatory Disclosures on Subject Companies" section in Morgan Stanley Research lists all companies mentioned where Morgan Stanley owns 1% or more of a class of common securities of the companies. For all other companies mentioned in Morgan Stanley Research, Morgan Stanley may have an investment of less than 1% in securities or derivatives of securities of companies and may trade them in ways different from those discussed in Morgan Stanley Research. Employees of Morgan Stanley not involved in the preparation of Morgan Stanley Research may have investments in securities or derivatives of securities of companies mentioned and may trade them in ways different from those discussed in Morgan Stanley Research. Derivatives may be issued by Morgan Stanley or associated persons

Morgan Stanley and its affiliate companies do business that relates to companies/instruments covered in Morgan Stanley Research, including market making and specialized trading, risk arbitrage and other proprietary trading, fund management, commercial banking, extension of credit, investment services and investment banking. Morgan Stanley sells to and buys from customers the securities/instruments of companies covered in Morgan Stanley Research on a principal basis.

With the exception of information regarding Morgan Stanley, research prepared by Morgan Stanley Research personnel are based on public information. Morgan Stanley makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. We have no obligation to tell you when opinions or information in Morgan Stanley Research change apart from when we intend to discontinue research coverage of a subject company. Facts and views presented in Morgan Stanley Research have not been reviewed by, and may not reflect information known to, professionals in other Morgan Stanley business areas, including investment banking personnel.

Morgan Stanley Research personnel conduct site visits from time to time but are prohibited from accepting payment or reimbursement by the company of travel expenses for such visits.

Morgan Stanley

MORGAN STANLEY RESEARCH

The Americas
1585 Broadway
New York, NY 10036-8293
United States
Tel: +1 (1) 212 761 4000

Europe
25 Cabot Square, Canary Wharf
London E14 4QA
United Kingdom
Tel: +44 (0) 20 7 425 8000

Japan
4-20-3 Ebisu, Shibuya-ku
Tokyo 150-6008
Japan
Tel: +81 (0) 3 5424 5000

Asia/Pacific
Three Exchange Square
Central
Hong Kong
Tel: +852 2848 5200