

Morgan Stanley
Subprime Analysis 2007
10/31/2007

(in billions)	Statement of Financial Condition 8/31/07	Statement of Financial Condition 10/31/07	8/31/07		10/31/07		Net Exposure ⁽¹⁾ 08/31/07	Net Exposure ⁽¹⁾ 10/31/07
			Profit and (Loss) Three Months Ended	Profit and (Loss) Nine Months Ended	Profit and (Loss) Two Months Ended	Profit and (Loss) Eleven Months Ended		
<i>Super Senior Exposure</i>								
High- Grade	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Mezzanine	(\$1.8)	(\$5.2)	(\$1.9)	(\$2.2)	(\$3.4)	(\$5.6)	\$11.4	\$8.3
CDO-Squared	\$0.0	(\$0.0)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.1
Total ABS CDO Super Senior Exposure	(\$1.8)	(\$5.2)	(\$1.9)	(\$2.2)	(\$3.4)	(\$5.6)	\$11.4	\$8.4
<i>Other Retained and Warehouse Exposure</i>								
ABS CDO CDS	\$1.1	\$1.7	\$0.8	\$1.0	\$0.5	\$1.5	(\$2.9)	(\$3.1)
ABS CDO Bonds	\$1.6	\$1.7	(\$0.4)	(\$0.3)	(\$0.0)	(\$0.3)	\$1.6	\$1.7
CDO Warehouse	\$0.0	\$0.0	(\$0.0)	(\$0.0)	\$0.0	(\$0.0)	\$0.0	\$0.0
Total Other Retained and Warehouse Exposure	\$2.7	\$3.4	\$0.4	\$0.7	\$0.5	\$1.2	(\$1.3)	(\$1.4)
Subtotal ABS CDO Related Exposure (2)	\$0.9	(\$1.8)	(\$1.5)	(\$1.5)	(\$2.9)	(\$4.4)	\$10.1	\$7.0
<i>U.S. Subprime Mortgage Related Exposure</i>								
Loans	\$2.9	\$1.5	(\$0.0)	(\$0.1)	(\$0.0)	(\$0.1)	\$2.9	\$1.5
Total Rate of Return Swaps	\$0.1	(\$0.0)	\$0.0	\$0.1	\$0.0	\$0.1	(\$0.7)	(\$0.0)
ABS Bonds	\$4.2	\$3.0	(\$0.7)	(\$0.9)	(\$1.9)	(\$2.8)	\$4.0	\$3.0
ABS CDS	\$4.2	\$6.6	\$2.3	\$3.4	\$1.1	\$4.5	(\$5.9)	(\$5.5)
Subtotal U.S. Subprime Mortgage Related Exposure (3)	\$11.4	\$11.1	\$1.6	\$2.5	(\$0.8)	\$1.7	\$0.3	(\$1.0)
Total ABS CDO / Subprime Exposure	\$12.3	\$9.3	\$0.1	\$1.0	(\$3.7)	(\$2.7)	\$10.4	\$6.0

Notes:

- (1) Net Exposure is defined as potential loss to the Firm in an event of 100% default, assuming zero recovery. Positive amounts indicate potential loss (long position) in a default scenario. Negative amounts indicate potential gain (short position) in a default scenario.
- (2) In determining the fair value of the Firm's ABS CDO-related exposures – which represent the most senior tranches of the capital structure of subprime ABS CDOs – Morgan Stanley took into consideration observable data for relevant benchmark instruments in synthetic sub prime markets. Deterioration of value in the benchmark instruments as well as the market developments referred to above have led to significant declines in the estimates of fair value. These declines reflect increase in implied losses across this portfolio. These implied loss levels are consistent with the losses in the range between 11% - 19% implied by the ABX indices. These cumulative loss levels, at a severity rate of 50%, imply defaults in the range of 40 - 50% for 2005 and 2006 outstanding mortgages.
- (3) In calculating the fair value of the Firm's U.S. sub-prime mortgage related exposures – including loans, total rate-of-return swaps, ABS bonds (including subprime residuals) and ABS CDS – Morgan Stanley took into consideration observable transactions, the continued deterioration in market data, as reflected by the sharp decline in the ABX indices, and other market developments, including updated cumulative loss data. The fair value of the ABS Bonds declined significantly, which were driven by increases in implied cumulative losses for subprime residuals to levels equivalent to those now seen in the market.