



# Morgan Stanley set for Q2 loss

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- \* Analysts expect Q2 loss of 62 cents/shr
- \* MUFG conversion, weak trading to weigh on results
- \* More cost cutting possible at Smith Barney franchise

By [Lauren Tara LaCapra](#)

NEW YORK, July 21 (Reuters) - Morgan Stanley is set to report a second-quarter loss on Thursday, as costs caused by a leftover item from the financial crisis compound the effects of a weak trading environment and stubbornly high expenses.

Analysts are forecasting a loss of 62 cents per share, on net revenue of \$8.04 billion, according to Thomson Reuters I/B/E/S. That compares with earnings of \$1.09 per share on net revenue of \$7.95 billion a year earlier.

The bleak estimates reflect a charge of \$1.17 per share, and a dilution of the bank's share base, from the conversion of a \$7.8 billion preferred stock investment by Japan's Mitsubishi UFJ Financial Group made at the height of the crisis in 2008 to throw Morgan Stanley a much-needed lifeline.

But beyond the expected one-time effect -- the conversion had been announced in late June -- the estimates also reflect growing investor concern that Morgan Stanley is facing serious difficulties making money in an increasingly tough market, which has made life tough for bankers across Wall Street.

Weakness in the global economy and an overly risk-averse trading approach caused Morgan Stanley's chief competitor, Goldman Sachs Group Inc, to badly miss earnings expectations on Tuesday.

The surprise was largely due to poor performance in FICC trading, a lucrative area that Goldman had dominated in recent years.

But other rivals, including JPMorgan Chase & Co, Citigroup Inc and Bank of America Corp, reported relatively strong quarterly FICC results over recent days, fueling a belief that commercial banking heavyweights have been using their broad platforms to steal business from pure-play investment banking rivals.

"They have a huge advantage and you've seen it in the numbers so far," said Mac Plumart, president of Atlanta-based money management firm Narwhal Capital Management, which manages \$400 million in assets, including a stake in Goldman.

Nonetheless, Morgan Stanley's Chief Executive James Gorman has been on an aggressive campaign to increase market share in FICC trading, trying to woo clients away from competitors and getting existing customers to trade more on its platform.

Morgan Stanley produced net revenues of \$1.8 billion in that business last quarter, down from an exceptionally strong year-ago period and better than some analysts had expected.

## BAD BET?

But after an unconfirmed report that Morgan Stanley lost tens of millions of dollars on a bad bet on the direction of U.S. inflation, some investors have begun to wonder whether Morgan Stanley might underperform even Goldman's results this quarter. FICC revenue at Goldman dropped by more than half.

"Goldman's disappointment on Tuesday brings expectations as low for Morgan Stanley if not lower," said Keith Elflein, head of domestic equity research for Boston-based money management firm Silver Bridge Advisors, which has \$2 billion of assets under management, including shares of Morgan Stanley.

"I think you could see a loss this quarter because of the trading alone," he added.

So far this year, Morgan Stanley shares are down 20.2 percent, compared with a 21.1 percent decline for Goldman and a 6.3 percent decline for the S&P 500 Financials Sector Index.

Adding to the pressure on Morgan Stanley is its costly integration of the Smith Barney wealth management business, which it is gradually acquiring from Citigroup.

While Chief Executive Gorman has high hopes for the business -- including a 20 percent pretax profit margin once fully integrated -- the exercise so far has been expensive.

Morgan Stanley's ratio of compensation and benefits to net revenue stood at 56.8 percent in the first quarter, much higher than industry peers, due in part to pay packages for Smith Barney's giant brokerage force of 17,800 financial advisers.

Morgan Stanley's finance chief Ruth Porat has already outlined cost cuts, including layoffs of underperforming advisers and much stricter monitoring of expenses.

For its part, Goldman on Tuesday set plans to cut \$1.2 billion of expenses through layoffs and other measures. Investors will be keen to hear whether Morgan Stanley will similarly announce extended cost-saving measures when it briefs analysts on its results on

Thursday at 10 a.m. ET. (Reporting by Lauren Tara LaCapra, editing by Knut Engelmann, [Bernard Orr](#))

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