Good morning. This is Sharon Yeshaya, Head of Investor Relations. During today's presentation, we will refer to our earnings release and financial supplement, copies of which are available at morganstanley.com. Today's presentation may include forward-looking statements that are subject to risks and uncertainties that may cause actual results to differ materially. Please refer to our notices regarding forward-looking statements and non-GAAP measures that appear in the earnings release. This presentation may not be duplicated or reproduced without our consent.

I will now turn the call over to Chairman and Chief Executive Officer, James Gorman.

James Gorman

Thank you, Sharon. Good morning, everybody. Thank you for joining us. Over the last several years we have focused on a number of things. Firstly, taking actions necessary to fix the obvious and immediate problems that we faced, secondly putting a strategy in place, the right strategy which was focused on a balanced business with more effective risk controls, and thirdly, meaningfully investing in our culture to ensure we remain an important choice for top talent and manage our business with professionalism with whatever challenges we face.

These strategic choices were designed to ensure that as much as we can control, the firm does well in a strong market environment and demonstrates stability in a seasonally or structurally more difficult one and that is exactly how 2018 is shaping up. The first half of the year was characterized by strong market environment and increased levels of client activity. Commensurate with that backdrop we delivered returns above the top end of the ROE target range of 10% to 13% of that first half period.

The third quarter of course was impacted by the traditional summer slowdown and a more fragile trading environment. Even so, we delivered an ROE of 11.5% and an ROTCE of 13.2%. These are comfortably within our target ranges and firm revenues of $9.9 billion. In prior periods through 2008 when we delivered revenues of $9 billion to $10 billion we had a leverage ratio of 30 to 40 times. Obviously, we have dramatically changed the way we conduct our business.

What was most pleasing in Q3 was the stability across the whole franchise. Though we can clearly have aberrations in any one quarter, we believe that we have set a floor while at the same time created significant upside potentials. Investing in our talent and building out our leadership team is an essential ingredient to what we see as an exciting path forward. Our ability to attract talent from across the street, relatively low attrition levels, and high employee satisfaction are all hard evidence of the strong culture. Our challenge is to make sure this endures not the weeks, months or even years, but for decades to come.

With Q3 now behind us we look forward to spending more time discussing growth opportunities in the months and years ahead. In the meantime, we remain confident and optimistic about the near-term prospects with a strong finish through 2018.

I'll now turn it over to Jon who will discuss the quarter in detail.

Jonathan Pruzan

Thank you and good morning. The results in the third quarter demonstrated strengths despite the typical summer slowdown. Our performance illustrates the resiliency of our business model and the ability to perform across an array of market environments. We reported revenues of $9.9 billion and PBT of $2.9 billion. Diluted EPS was $1.17, ROE was 11.5% and ROTCE was 13.2%.

Institutional securities performed well. Investment banking benefited from continued strategic activity and new capital formation globally. Compared to historical third quarters equity's results were strong. Fixed income showed stability despite seasonally slower client flows and a lack of larger transactions. Wealth management delivered another solid quarter and investment management saw continued positive long term net flows although investment results were impacted by weaker emerging markets.

We continue to benefit from the inherent operating leverage of our business model. On a year-to-date basis, our efficiency ratio was 70% and almost 200 basis point improvement compared to the same period last year. Increased expenses have primarily been driven by higher compensation and execution related costs associated with the higher revenues.

Our discipline around discretionary spending has allowed us to continue to make investments across the firm especially in technology. Although we typically see a seasonal increase in expenses in the fourth quarter, we remain confident we will hit our full year efficiency ratio target.

Now to the businesses, institutional securities generated revenues of $4.9 billion in the third quarter. Year-to-date revenues of $16.7 billion are up 17% versus the same period last year benefiting from active global markets, increasing revenue pools and stable to improving wallet share. Non-compensation expenses were $1.7 billion for the quarter, an 8% sequential decrease, driven primarily by lower execution related expenses and compensation expenses were $1.6 billion, bringing the year-to-date compensation to net revenue ratio revenue to 34.5%.

Investment banking reported revenues of $1.5 billion down 14% relative to the second quarter reflecting a normal seasonal slowdown in activity. Notably this is our best third quarter in over a decade contributing to our record year-to-date revenues. Advisory revenues for the quarter were $510 million. M&A volumes remained at historically high levels supported by larger strategic transactions and cross border activity. Pipelines remained healthy and dialogues are active.

New issue market conditions remained favorable in the quarter supporting strong underwriting results. Equity underwriting revenues were $441 million. Activity remained healthy across products and regions with particular strength in IPOs. Americas were strong throughout the quarter while Asia and Europe saw some seasonal slowdown in August before a strong September.

Fixed income underwriting revenues were $508 million. Increased results in investment grade issuance partially offset a slowdown in high yield financing relative to a very active second quarter. Event driven transactions remain a significant driver supported by the active M&A backdrop and our ability to leverage our global franchise to provide holistic client solutions.

Investment banking pipelines remained constructive across products and regions. For the remainder of the year strategic activity should support both our advisory and underwriting businesses. Of course client activity could be affected by continued or new macroeconomic and geopolitical uncertainties. In addition, protracted periods of heightened volatility may impact issuers financing plans.

In Equity Sales and trading, we retained our leadership position and expect to be number one globally. Revenues were $2 billion down 18% quarter-over-quarter. Sequential revenues declined across each business line as the quarter was characterized by low market volumes and more subdued volatility compared to the first half of the year. Still, activity remained robust across products relative to historical third quarters particularly in Europe and Asia. Prime brokerage had a strong quarter benefiting from our investment in our global client footprint and derivative results were also strong aided by a diversified product set and client mix.

Fixed income revenues of $1.2 billion were down 15% versus the second quarter. Seasonality and low rate volatility in the quarter impacted Europe in particular which contributed to the sequential decline. Overall, revenues remained solid and are up 8% year-to-date. In our macro business we saw strong client activity in FX, supported in part by idiosyncratic events across emerging markets. Rate was negatively impacted by range-bound yields and low volatility globally.

Our credit business saw a sequential decline on lower client activity across product areas. Our institutional lending franchise continues to demonstrate good balance sheet velocity. In commodities revenues were up as client activity remained robust. The results were supported by macro movements within the energy complex. The fixed income results reinforced that this business is well-positioned. Despite seasonal headwinds this quarter our revenues remained solid.

Turning to wealth management, organic growth drivers of the business remained strong. In the quarter we saw net fee-based inflows, higher fee-based assets, and a continued increase in lending balances. The growth in these metrics supported higher asset management and net interest revenues contributing to the 2% sequential increase of total quarterly revenues of $4.4 billion. The business continues to demonstrate significant operating leverage. On a year-to-date basis, revenues of $13.1 billion are up 5%. Non-compensation expenses were up only 1% over the same period and total non-interest expenses are up 3% resulting in PBD growth of 11%. In the quarter the margin exceeded 27%.

Total client assets of $2.5 trillion is up $85 billion or 4% compared to last quarter as markets showed gains and clients continued to add new money to their accounts. Net fee-based flows also remained strong at $16 billion contributing to 3% growth in fee-based assets which now stand at $1.1 trillion or 45% of total client assets. This quarter represents the 12th consecutive quarter of fee-based assets growth.

Asset management revenues for the quarter were $2.6 billion up 2% on the higher asset levels. Net interest income was $1.1 billion for the quarter up 3% sequentially. Higher NII was primarily driven by increased earning assets as higher asset yields were offset by higher funding costs. This includes the impact of the cash sweep program redesign.

Wealth lending in the U.S. banks grew by $1.1 billion to $71.1 billion with increases across each major product line. Year-over-year loan growth stands at approximately 7%. While the transition to our in-house mortgage platform impacted production earlier this year, we are currently in line with pre-conversion levels. We saw growth in the mortgage portfolio for the first time since this transition.

In addition to the traditional decline in retail engagement during the summer months, we saw clients continue to focus more of their fixed income investing into shorter duration products at lower commission rates. However, due to the impact of positive mark-to-market on deferred compensation plans total transaction of revenues of $698 million remained essentially unchanged. It is worth noting that the contribution of transactional revenues have steadily declined. On a year-to-date basis transactional revenues represent approximately 16% of total net revenues versus 22% in the same period three years ago.

This quarter's results once again demonstrate the stability and health of our wealth business. Segment revenues grew supported by annuitized revenue drivers and pretax profit reached new highs. Year-to-date results demonstrate that we can steadily grow this business while continuing to make investments into tools to support asset growth, increase client engagement, and improve cost efficiencies.

In investment management, we saw continued positive long-term flows $3 billion in the quarter supported by strength in overseas distribution. Total net revenues were $653 million, a 5% decline relative to last quarter. Asset management fees of $604 million were essentially flat sequentially. The increased fees on higher average long-term AUM were offset by lower feels and liquidity primarily driven by the wealth management cash sweep redesign.

Our overall fee rate in this business remained stable. On a year-to-date basis, asset management revenues are up 13% on strong investment performance and positive flows particularly in our active fundamental equity strategies. Investment revenues were $40 million down 27% sequentially impacted by continued market volatility in FX and emerging market equity performance. Overall expenses of $551 million were essentially unchanged.

Turning to the balance sheet, on a sequential basis total spot assets of $866 billion are down $10 billion. Our standardized RWAs of $370 billion decreased by $17 billion over the quarter driven primarily by lower credit RWAs on reduced lending and commitments through syndications and pay-downs in the quarter. As a result, our Basel III standardized common equity tier-1 ratio is expected to be approximately 16.7%. Our supplementary leverage ratio remained flat at 6.4%.

During the quarter we repurchased approximately $1.2 billion of common stock or 24 million shares. Our Board declared a $0.30 dividend per share and our tax rate in the third quarter was $24.4%. As we look ahead to the first quarter we are cognizant of the seasonal headwinds, but we are encouraged that we are off to a good start. Strong volumes and increased client engagement associated with the recent pick up in volatility, have benefited the franchise thus far. Of course while bouts of volatility can support revenues, sustained volatility can erode confidence and close market access. We have not seen that to date.

We believe that the economic backdrop is strong characterized by broad global growth. Assuming these macro conditions persist, clients are active and markets remain open and functioning. We will press our advantages and look to continue to gain wallet share.

With that, we will now open the line to questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Our first question comes from Brennan Hawken with UBS. Your line is open.

Brennan Hawken

Good morning. Thanks for taking the question. My first one is on deposits, they've been definitely in focus for the wealth management side and I know you gave some comments on that Jon, thanks for that, but we had the first wave I believe of CDs, your CD program that was scheduled to mature over the summer, so it would be great if you could maybe let us know what sort of customer behavior you've noticed with that money and what portion of that cash are you retaining and what kind of products are customers moving into with that cash?

Jonathan Pruzan

Sure, so as you mentioned we did have some CDs mature during the period. What we're generally seeing although this is all new for us since we've just gotten into these products over the last 18 months, is that a good amount of those dollars go into the investments accounts of those clients while some portion gets retained in the savings product. So while that hasn’t been retained in the bank it has been retained in the system. Those dollars continue to go into both equities and fixed income. We have seen a little bit more of a shift into the fixed income investing than we did probably what we saw in 2017, but all in all it has been sort of both a nice way to supplement liquidity in the bank, but also bring in new assets to the firm.

Brennan Hawken

Terrific, thanks for that. And then on the equity side you guys – trends and the share gains have been really impressive. I know this might be somewhat of a high class problem, but do you have any thoughts or insights into how your customers are thinking about concentration risks? Are there any limits to thinking about further share gains particularly in the financing side of the business?

James Gorman

Listen Brennan, as you mentioned we've gained significant share over the last four or five years. I think what we're benefiting from now is more of a stable share in a growing market. The equity product this year is up pretty dramatically over last year and it has been down for a couple of years in a row, so this is a good positive play. And I think we do believe that we can continue to growth share, although at slower paces.

We continue to invest in the franchise particularly around both product, people, geographies, international footprint and technology. So I would say that we feel very comfortable with our share. We feel very comfortable we will be able to maintain that share and there are pockets where we continue to believe that we can grow that share but it would be at a slower pace than we've seen in the last five years.

Operator

Thank you. Our next question comes from Mike Mayo with Wells Fargo. Your line is open.

Mike Mayo

Hi, can you hear me?

James Gorman

We can Mike.

Mike Mayo

Okay, good. Just could you elaborate a little bit more on the deposit strategy in growth and it just seems to be getting a little bit more competitive with more of the banks pursuing a national digital banking strategy. What are you seeing, at what point would you pivot your strategy based on what you're saying?

And then a separate question, I don’t recall, do you disclose net interest margin and if you do what has it done and what you expect it to do?

Jonathan Pruzan

I'll go with the second one first. The answer is no. Again, we try to focus on the net interest income in the wealth business and you can see that that business the NII has grown about 4% to 5% year-to-date.

On the first question, it's a good question Mike, and we continued to make investments in the liability structure. We've talked about promotional CDs and savings. We're working on new premier cash management products and we continued to enhance our digital strategies around both payments and deposits for our client base.

We're at historical low levels of cash and client accounts and our deposits are really more impacted by sort of our clients asset allocation than actual rates. The debate is on our deposits have actually outperformed our models and continue to outperform our models, but what we've seen whereas cash levels had been sort of 8% to 10% for quite some time. They're now down at about 6% and what those do after or -- in light of some of the market volatility is really a question that we'll have to see as the markets evolve, but we've been in a prolonged bull market if you will and we've seen those cash levels go down.

So at this point I don't think we're thinking about changing the strategy. We're continuing to invest in the product suite. You can see that we have grown deposits a little bit quarter-over-quarter. Our clients are very open to the products that we've been offering and when we run promotional products and rollout new offerings we seem to see a very good take up. So again at this point competitive business, but we feel good with our position.

Mike Mayo

And then just one followup, that's interesting about the cash levels from 8% to 10% down to 6%, what's been the range of those cash levels like over last 5 or 10 years?

James Gorman

I think over 5 I would say 8 to 10 but not down to 6 on 10 I don't have that data, but it's been in that 8% to 10% range for a while.

Operator

Thank you. Our next question comes from Matt O'Connor with Deutsche Bank. Your line is open.

Matt O'Connor

Good morning.

James Gorman

Good morning.

Matt O'Connor

The revenue obviously was strong this quarter. It’s been strong year-to-date. It sounds like it’s off to a good start this quarter, but as you look at the stock it's obviously been under a lot of pressure this year and I think its concern over the sustainability of revenue. But as you think about the cost side and if you can just talk about how much flexibility there is to bring in costs if the revenues come in weaker say next year than you expect?

James Gorman

Matt it's James and I think I’ll take that question because I too have been wondering about the price action on the stock. It’s interesting the ROE and ROTCE are up 40% year-over-year. Revenues, on annualized basis were up 12%. We’re hitting all the pre-tax margin numbers that we said were above the ROE range we said we’re comfortably within the range that we talk about below 73% on total compensation and the stock is down at least pre-market this morning it was down or last night 7% to 8% year-to-date.

So it’s kind of little bewildering against the backdrop of a very strong U.S. economy and we’re overweight the U.S. and gaining share across each of the institutional businesses. So I guess there are smarter investors than myself out there who have got this figured out. But to me it seems like with the ROE up 40% and the revenue trend that we've got it’s a little hard to reconcile with the stock being down. So what I care about frankly is the long-term positioning of the firm.

This firm is positioned for resilience through cycles, that’s exactly what we demonstrated in this quarter, to deliver $9.9 billion of revenue in a summer quarter that was unheard of a couple of years ago. And look at some of the metrics where the resilience are, I was just looking some numbers this morning around the assets that are in wealth management sitting inside the $10 million plus household and many of those households are many multiples of $10 million.

Back in 2009 that number was slightly over $400 billion. As of today it’s well over $1 trillion and that money is not going to go away, that’s very sticky stable money than the next segment of million to 10 million the same. So if you look at the share question that came up about the - particularly the prime brokerage part of equities, I mean the reason we’ve gained share in equities is it’s hard to make money if you're not in the top three.

The industry is consolidated. In fact those with superior technology and great franchises have gained share because clients want that far from there being concentration risk clients have wanted to be with two or three players and we have obviously been a huge beneficiary because we have in my humble opinion best-in-class equities business across the street.

So yes, back to the sort of near-term on your question, if the market turns then we respond. We do what we needed to do on the expense side and we obviously have some cushion given that we're running with an ROE currently of 13.1% year-to-date. So I'm very confident about the outlook. I'm confident about our ability to respond if the market turns if we're going through a complete major crisis environment which I do not expect at all, then obviously we'd be affected along with everybody else. But in a normal downtick in the market, yes we pick up some volatility and then over time our revenues would trail off a little bit, but the fundamentals are very strong.

Matt O'Connor

Thank you. And I think the other concern obviously is the capital deployment and the results from 2018 CCAR, but it seems like you're addressing that or trying to building capital, I don't know if that was simply the – what's going on in the market or specifically response to the CCAR results if you could comment on that and then if there is still further optimization that you can do to the CET-1 after going up 90 bps this quarter?

James Gorman

Well, it's obviously, it's kind of a platform where goes the market from here, the second question is what is likely to evolve on the regulatory front, not just in 2019 but over the next three or four years. And if you look at what we did last year obviously, we did a distribution equivalent to what we did -- what we're approved for the previous year, since then year-to-date we have accreted $6.9 billion net income to common. By the way full year last year was 6.6, so through three quarters we're at 6.9. Our capital distribution should go up. There is just, I mean that why wouldn't it, our dividend is still below reasonable payout ratio, I think it's in the low 20s, 23% or something, it is $0.30 a quarter, so that is about 20%.

Frankly, we're making too much money to keep holding it there. Now, at the same time and at the stock, good news is stock trading at 43 bucks, you are buying back a lot of stock with that distribution. Now over time if the stock trades back to where I think the value is reflected in the ROE performance, then you have got different strategic choices as to how you distribute the capital.

But I can't imagine a scenario over the next several years where we don't have significant buyback programs just because we are accreting so much capital and we're – and unless you can find ways to invest that in the business to generate those kinds of returns, I think it is shareholder friendly to have a strong dividend, have strong buyback and make the appropriate investments to build growth into the business. But we can kind of do all three when you're producing nearly $7 billion in net income in nine months.

Operator

Thank you. Our next question comes from Mike Carrier with Bank of America/Merrill Lynch. Your line is open.

Unidentified Analyst

Hey, good morning guys. This is [indiscernible] on for Michael Carrier. Just sort of quick question, I'm wondering your peers highlighted the increased competitive environment in ISG, I think specifically in FICC with tighter spreads. I don't know, can you let us know what you are seeing, is this just the usual strong players just competing more aggressively given the lower volatility or are you seeing some more like reinvigorated competition from maybe the European peers?

Jonathan Pruzan

Well, I would just again, I don't know if this quarter is any different than any other quarter, ISG across the complex of Fed, equity as in investment banking is very competitive, it's always been competitive and we continue to either maintain our share or grow our share. In the fixed income space we have picked up share over the last several years since the restructuring which is why we're so confident that the position of the business is in such good shape. We are running probably 10% to 12% share when we use to run 6 to 8 and we've seen our ability to grow that share even though the pool of revenues are not really growing.

As I mentioned earlier in equity is very competitive business but we have a comprehensive business in offering and as James mentioned best-in-class and we continue to maintain our share and capture growing revenue pool. And then in banking the global footprint and the stability of our franchise has led to some really strong results and we picked up share in banking. So again, a very competitive environment. We expect to continue to maintain and grow our share given the stability and the momentum in the franchise and it's always going to be a competitive market.

Unidentified Analyst

Okay, thanks for the detail. I guess as a quick followup, given the volatility that we're seeing in like the EM and Asian markets start 4Q, can you give us an update on what how this impacts your business maybe specifically in IM or it's like the investment line?

Jonathan Pruzan

Sure. As I mentioned earlier the investment line was impacted this quarter because of some of the volatility in both the rates in emerging markets. As you know some of our alternatives and equity strategies are in Asia, so I think it will continue to see some impact from that. But I think again that's the sort of the tail on the dog, the primary driver of revenue growth for us in that business is going to be around the fee-based assets and we continue to see continued good flows into our long-term assets. The last seven quarters, we have seen $20 billion of inflows and active management, active strategies are working for us. So again it will have some impact, but we feel very good about the overall health of that business and we have seen very stable fee rates there too which is another reason we feel good about that.

Operator

Thank you. Our next question comes from Guy Moszkowski with Autonomous Research. Your line is open.

Guy Moszkowski

Good morning. There was a comment in your press release on institutional securities that the other sales and trading net losses were down quite a bit versus year-ago reflecting lower net funding costs and I was just wondering, I mean it was a big enough numbers that it's meaningful and it sounds like a great thing but how do you reconcile that with higher interest rates?

Jonathan Pruzan

So you read our press release, I'm impressed. So listen Guy, there is a lot of things in that line, some of which is the hedging activity and other things that flow through that. We also have some assets in that business, basically the businesses have been optimizing their balance sheet and their funding and that sort of collectively the net result being the statement we made in the press release that the net funding costs are down, it's really based on usage not rate.

Guy Moszkowski

And is there any sustainability to that or just in terms of overall funding costs or it was just something that was helpful this quarter?

Jonathan Pruzan

I think it was helpful this quarter. That number is going to be volatile because there are a couple of things in there, that sometimes offset each other, sometimes they don't but really it's a function of how much liquidity that businesses require and how we optimize the balance sheet and again that has some variability to it. So I wouldn't necessarily bank on it.

Operator

Thank you. Our next question comes from Glenn Schorr with Evercore ISI. Your line is open.

Glenn Schorr

Hi, thank you. Further on the conversation of stability, I mean wealth management, investment management are half the firm's revenues. Considering 45% is in fee based accounts and you're lending efforts or deposit efforts, the comp trends the only offset I see is the lower transactions. I mean this is a market sensitive business obviously, but can pre-tax and that combines business grow in a flattish market environment?

Jonathan Pruzan

Yes, I mean it depends how you manage the business. I mean as you pointed out a lot of the revenues come from non-market related activities. And secondly there is shift in market related activities. So money moving from transaction accounts hurts the transaction revenue but as it moves into asset management accounts, it improves the revenues. So the net is actually net gain on the switch of assets as they occur clients move out of transactions into managed money.

So there is a lot of stuff going on in that business and obviously next year we're seeing the recruiting deals coming off which relating to the merger with Smith Barney and we've also been doing just less big ticket recruiting for the last several years. So the annual to cover the deferred recruiting expenses is coming down each year.

So, yes I would say, I mean modestly I wouldn't there is not some massive jump likely across wealth and asset management in a flat market environment, but there is definitely operational improvements that can be made.

Glenn Schorr

Okay. And believe it or not I also read the press release. There was something in there in the institutional business on a modest gain on the sale of the business just curious on how big and what business that was?

James Gorman

Yes, that was deal that was announced I believe in the second quarter, it closed in the third quarter. We were an owner of a business called the MuniCenter and it was a good, I am just trying to see the line item, it was a good percentage of that line item. It was about $60 million, $61 million, $62 million.

Operator

Thank you. Our next question comes from Steven Chubak with Wolfe Research. Your line is open.

Steven Chubak

Hi good morning.

James Gorman

Good morning.

Steven Chubak

So I just wanted to start off with a question on equity market sensitivity and James it was interesting to hear your perspective on some of the factors weighing on the stock and maybe some of the underappreciated revenue stability. It appears to us that one of the big concerns is your higher sensitivity to movement in equity markets and equity market declines which certainly comes to mind given the latest move. I was hoping you can give us some insight about how you think about earnings resiliency in a sustained market correction and given some of the commentary around the movement in cash balances how much of an offset you think that can provide if equity market weakness persists?

James Gorman

I mean listen, we had a more challenging third quarter, both from market activity and just seasonal volumes and we delivered an ROE of 11.5% in that environment, so and tax adjusted that's probably [10% to 0.25%] [ph] for what it would have been last year. The best we've done up until then was on an annual basis it was 9.4%. So that's in a pretty subdued trading market and not - definitely not robust equity market environment.

I think though if you look across the franchise there is still M&A transactions getting done. The prime brokerage business is very resilient. There's still trading across the fixed income businesses whatever's going on in the equities and we've improved our share in the macro space. We've always been a little stronger in the macro.

And then in micro SPG and the other credit businesses well positioned. So we're not as correlated to equity market movements as I think is sort of believed if you actually look at the stability of the franchise across each of the businesses. Now clearly if you have a sustained correction call it 20% every year, we're affected by that. I mean I'm not naive about it, but as we just saw or in a quarter which wasn't a great equity market quarter we had $9.9 billion of revenue and we've only ever had two quarters of more than $10 billion in revenue and that was the first and second quarter of this year.

Steven Chubak

Thanks for that color James. It's very helpful. And maybe just one follow up on operating leverage, clearly demonstrated strong expense discipline in the quarter 200 bps of efficiency improvement year-on-year. It seems like the Street is contemplating some revenue growth from here in line with GDP, but numbers suggest that there is some skepticism that will translate into positive operating leverage. I was just wondering from your perspective, how you think about balancing the need to continue to deliver margin improvement versus some of the higher investment needs as you look out to other growth opportunities?

James Gorman

Yes, I don't - I honestly I think you're raising a very good point and I don't - if that's the view of some people on the Street I don't understand that view. I mean, there's obviously operating leverage in a business that has the scale that we've got across wealth management, across the prime [brokerage] [ph] space, the core large investment banking businesses the incremental dollar revenue is coming on at a much higher rate than the embedded dollar revenue across all of our businesses.

So unless you get - yes we've going to have to invest, but that's part of what's called the incremental dollar of revenue to come on at 30% margin rather than a 50% margin, that's part of the investment profile. But to the assumption that you would not generate operating leverage with revenue growth it just doesn't add up to me and it just hasn't been the experience. We've had year-to-date 12% revenue growth and the expense ratio has dropped from 73% to 70.3%. We haven't done anything to consciously reduce expenses.

We haven't shut businesses, we haven't sold businesses, we haven't had a major [ref] [ph]. In fact we've had huge investments. We opened - just opening another fusion center for our cyber in Singapore. I was out there a couple of weeks ago and we continue to invest in the cyber space. We're continuing to invest across all of our technology platforms, in automation, in AI and big data or cloud computing, digital, our whole digital initiative across wealth management expansion across the asset management businesses and building out new platforms, raising new funds. All of these are investments that we're making continuously and we've been hiring talent. So there's just no way if we produce another $3 billion of revenue that you're not bringing that on at a high margin than the existing margin that is just not going to happen.

Operator

Thank you. Our next question comes from Jim Mitchell with Buckingham. Your line is open.

Jim Mitchell

Hey good morning. Maybe just following up James on the stability of earnings and revenue and how that translates to capital, because I think the, I guess one of the issues I struggled with I think investors have struggled with is you have sort of the biggest drop in the stress test in CET1. And that obviously could have an impact if and when we moved to the SCP. So how has dialogue gone, how do you convince or think about stress tests and how that impacts your ability to return even more capital given that your ratios are dramatically higher than your peers?

James Gorman

Yes, well Jim it is the question and I'll start and we should spend some time on it and I want Jon to weigh in on this because he's been pivotal to all the discussions we've had in DC and with our regulators. The first question is, are you capital sufficient? And that was addressed squarely last year with notwithstanding the results of the test under what most would suggest were unusually stressful scenarios, let me just put it that way, that we and other banks we're all committed to distribute the same level of capital that we distribute in 2017. So that basically says check, you are capital sufficient.

The second question is are you accreting capital above what you need to support the investment of the businesses whether it's investments you're making, whether it's growing sheet in different parts of the business and as I said with net income this year already at $6.9 billion, we're heading for an $8 billion plus net income the record I believe was $6.6 million last year. So clearly, we are accreting capital above what our investment needs are.

The third question is what will the regulatory environment the rules permit you to do? And we're in a transition period. I mean we're going from a pure CCAR structure to an SEB structure. I don't believe that change - in fact I'm sure that change is not going to happen for 2019. So 2020 on it will. There remain several open questions, how do you calculate so on just a more narrow that sort of 2019 CCAR, will there be changes to the scenarios that would generate a different kind of outcome from 2018?

In other words was 2018 the high watermark in terms of scenario severity. I believe it was, but until we see the scenarios, we - I don't know. I mean we don't have access to that information, but I would suggest it is highly likely that we have seen the high watermark. And by the way that high watermark translates into us suffering losses many times the size of what we actually did during the crisis, so it is a high watermark.

The second is then how does the model apply themselves to the particular make up of individual firms and that translates into your stress losses, your PPP&I et cetera and again I don't want to prejudge that. I'd like to just sort of see that play out, but worst case is we will not be worse than last year and we have accreted more money than last year. So by definition we should be in a better position than last year.

The more interesting has been 2020 on will there be accounted cyclical buffer put in as some have suggested, I doubt it. Is the stress test buffer, the SEB buffer likely to remain at the initial levels that were put at that remains to be seen it won't get worse. It could come down a little bit to make it more consistent with what the Europeans and foreign banks are dealing with.

So I guess my simple summary and I'll shut up and turn to Jon is we've hit the high watermark in terms of stress scenarios. I mean at some point, you can stress anything. You could have capital equal to the size of your balance sheet, have a leverage ratio of 1 to 1, but obviously it'd shut down your economy. So at what level do you pass the inflection point where you're doing, you are affecting economic growth rather than generating it? And I think we've peaked at that level. That's my guess. And in this transition it will play out that we will as we keep accreting at this level we should be able to increase that capital distributions. Exactly how much, we have to see what the models produce. Jon?

Jonathan Pruzan

Yes, I think James actually was pretty comprehensive. I do agree that we're in this transition period. We've been encouraged by the comments regarding tailored supervision. We've been encouraged by the comments by both

Chairman Powell, and Governor Quarles around the industry being appropriately capitalized which we have said since 2016, we believe we are sufficiently capitalized and we are starting to accrete more capital and currently in the forward 12 months going to payout less than 100%.

So over time we will continue to either invest in our business or return that capital. So again we think we’re capital sufficient. We think the regime is going to go through some changes and we believe we'll be able to continue to offer our shareholders an attractive capital return profile.

James Gorman

And the last thing I'll just add to this is, two bugaboos that I had for a long time and communicated very directly is it’s hard for me to imagine a scenario where your balance sheet grows during a time of financial stress and deflation of financial assets. And secondly, I don't understand why boards would continue to do a full capital distribution for nine quarters after an economic crisis, financial crisis has occurred.

Under the current thinking around the SEB structure, our balance sheets would not grow, that obviously makes both intellectual and intuitive sense, and secondly I believe that the capital what you would be required to continue to distribute would be just dividends for one year. Now these rules are in, they are in some state of development and comment period, so I don't know where it ends up.

But both of those things would suggest that the constraint that has been most powerful for Morgan Stanley which has been our leverage ratio because that balance sheet grows, if your balance sheet is not growing, then that opens up a whole different kind of discussion and as you pointed out at the beginning we get back to CET1 or total capital ratios our numbers are phenomenal. So we've got we got to see how this thing plays out, but the bottom line I believe we've hit the high watermark and move past it.

Jim Mitchell

All right, well that was comprehensive, I appreciate it. If I could just maybe ask one thing unrelated to capital, just on the - I think there has been a lot of concern about NII growth from here, is your sense that at least could you update us on kind of the pick-up in yields in growing the loan book versus the securities portfolio as you kind of see that loan growth, should we expect and margin can continue to move a little higher?

James Gorman

Yes, I think that is the right characterization. I think the last quarter we mentioned that we saw NII growth in the 4% to 5% range for the year, we are still comfortable with that. We also said that it would be driven by average earning asset growth or loan growth and that's really what's been driving it. If you look over year-to-year, average earning assets are up about $7 billion or $8 billion and that is really primarily driven by the loan growth and that's primarily driving the NII growth.

We have seen healthy increase in asset yields, but as we mentioned earlier, that's really been offset really by the change in mix of our liability structure not beta’s per se. But if you go back in time we used to have one product which was a suite product. In the third quarter of 2017 that represented closer to 90% of our deposits, today it represents closer to 75% of our deposits.

So that increasing asset yield has been sort of absorbed by the increase in the liability costs and therefore average earning asset growth will be the primary driver and we're still pretty comfortable with our ability to grow loans and our wealth business in the last couple of quarters, we've been growing at $1 billion to $2 billion a quarter and that feels healthy to us and that also feels sustainable.

Operator

Thank you. Our next question comes from Devin Ryan with JMP Securities. Your line is open.

Devin Ryan

Thanks. Good morning. I guess a follow-up question here just on the growth strategy and outlook in wealth management. I know some of the things you've highlighted are gaining more wallet from existing customers in the high net worth channel which you’re obviously growing, expanding relationships with younger customers through technology and then marketing to the stock plan participants. So I'd just love it if you could maybe touch on all those channels in terms of the longer term potential and then any anecdotes that maybe is making you feel good about where you are with some of the newer initiatives like the younger customers who are penetrating kind of the stock plan, I'm assuming that's where we'll see growth accelerate as well?

James Gorman

I think you've done a nice job of articulating where we think we're going to get growth from in the business and really I think the biggest opportunity long-term and either or medium to long-term is really around asset aggregation our ability to attract incremental assets from our customers. We know they have a lot of money outside of the firm and some of the encouraging anecdotal stories as we roll out some of these new strategies is that our clients are much more open to sharing their financial information with us.

I think years ago it was sort of you didn't want to aggregate all your assets at one firm, I think we are seeing a little bit of a shift in that and as we roll out asset aggregation and the next best action and some of the programs that we've been rolling out to the FA community, we are seeing good take up in that.

I would say the stock plan growth and the younger client growth, both of those are also sort of in their infancy in terms of the strategies and the implementation and they should long-term be attractive ways to aggregate assets. Remember a lot of the young clients don't have as much wealth as our older clients, so it's going to be a slow build, but we continue to make the investments in the digital strategies and the stock plan program to be able to position ourselves to bring in more assets over time. So I think the most immediate opportunity is really trying to attract incremental assets from our existing client base.

Devin Ryan

Okay, great. And then just a followup here would be maybe good to get a little bit more perspective on just the investment banking activity levels in the various businesses and then clearly, some concern in the market just around kind of being late cycle. And so, I'm just curious if you guys are actually seeing those kind of normal signs of late cycle activity whether it would be over extending on deals or over paying or just indiscriminate buying, just anything that would tell you that we're kind of little late cycle in those businesses?

James Gorman

Other than the fact that it’s late cycle, we actually haven't really seen any real indications. The healthy, pipelines are very healthy. If you look at the pace of announcements in M&A, they haven’t slowed down. The capital markets are open. Our IPO and debt underwriting backlogs are healthy and we're bringing things to market. Now if we get into a period of prolonged volatility, that might close access, but we haven't really seen it.

In the leverage loan market, it's been liquid and orderly. You know that’s the cash flow driven market and cash flows are quite healthy, so a lot of activity in that space. There's been some repricing, but deals are still getting done inside of flex and for good deals, we see a lot of good support. So other than we’re late in a cycle, we haven't really seen any real indications at least from our business perspective.

Operator

Thank you. Our next question comes from Gerard Cassidy with RBC. Your line is open.

Gerard Cassidy

Thank you, good morning.

James Gorman

Good morning.

Gerard Cassidy

I apologize if you guys addressed this, I had to jump on and off your call, but the first question is how quickly do your customers in wealth management expect to see higher interest rates passed on to them in there, I know you mentioned Jon that I think cash is down to about 6% of everybody’s portfolios, but how quickly do they expect when the Fed funds raises rates, do you have to rise your rates within days of that to keep them satisfied?

Jonathan Pruzan

You know again, I think you've got to think about these deposits for what they are and historically these are really transactional, people have them in the bottom of their investment accounts to transact, to buy and sell securities, to have a little extra liquidity and what we’ve seen is as an investment thesis the percentage of cash that people are holding is lower and that is what we’ve seen reflected in the system.

In terms of rate rises, we’re very competitive with our primary competitors in this space. We have our beta tab outperformed our model betas, so it's really not as rate sensitive if you will, it's really asset allocation sensitive. And as people reduce their cash amounts we'll see continue outflows. That being said we're in a prolonged market rally here and historically if we go into a different market environment we've seen people pull cash out and put it back in their accounts. It is very similar to sort of checking accounts, I mean it's the same sort of dynamic. So the answer is betas have outperformed and it’s really an asset allocation versus a rate sensitivity.

Gerard Cassidy

Very good, and then the second question is more of a qualitative question from what you guys are seeing out in the markets, clearly credit quality across the banking industry is very strong today. Your consumer wealth management area high quality, you don't have much trading risk anymore with the VAR being where it is, but what are you guys seeing or what are your folks telling you that they are seeing in the so-called shadow banking sector the leverage lending area. We're hearing that there seems to be some aggressive underwriting going on, is that a concern for you folks 12, 24 months down the road or just any color you can give us on what you guys are seeing out in the markets?

James Gorman

I mean my gut, Jon is going to say something we're going to have to wrap up in a couple minutes , but my gut is I - if other people want to engage in dumb practices God bless them, but we're not and that's what I'm focused on. So yes, there's always somebody out there right who's doing the marginal deal. What I care about is and that's not going to blow up the market, but what I care about is overall asset bubbles or not and we're not in one and then how we’re participating.

Jonathan Pruzan

Yes, and so I mean, I think specifically I agree with James specifically and our portfolios we've actually seen improving metrics in the ISC credit quality. We’ve got good velocity there, so we've been very active securitizer in some of our product, and then on the wealth side you said it's been very stable. We've not been impacted by some of these unfortunate hurricanes that we've seen across the country and very, very stable metrics for us.

Operator

Thank you. Our next question comes from Brian Kleinhanzl with KBW. Your line is open.

Brian Kleinhanzl

Okay, thanks. Yes, just a followup question on the corporate lending. It looks like the non-investment grade exposures are down quite meaningfully year-on-year and then you also saw some drop downs too in the commitments sequentially. Are you guys actively de-risking in the loans and lending business and in the institutional securities business?

Jonathan Pruzan

The answer is we're not actively de-risking. We saw a couple of dynamics in the September numbers we were fronting some deals which is why it looks like that we had a much higher exposure to non-investment grade when in reality we didn't really have those exposures because they were syndicated across the bank lending, excuse me, the bank syndicate.

And then on the de-risking point we just saw a lot of activity around the event book and as I mentioned earlier we're also active in the commercial real estate securitization market. We skewed more of our business in that area towards securitization versus held for investment just given the profiling where we are in the cycle. So again, we've been very disciplined around it. That was really a function of just a lot of activity in the third quarter and we expect to continue to sort of rebuild those pipelines and be active in those markets.

Brian Kleinhanzl

Okay and then just one followup real quick, you mentioned the clients are moving a fewer providers within the equities business and I thought that trend started a few years back for the prime brokerage business, is it still early innings for cash business as well as derivatives business?

Jonathan Pruzan

Yes and I think we are the number one provider of those services. We've got a very strong franchise there. We have seen a little bit of consolidation with MiFID going into places people to reduce the number of counterparties they deal with, but I think the general comment was generally the top providers, top three or top four or top five depending on the market where the products have generally been gaining share and we would expect that trend will continue.