SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

☝ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended May 31, 1998

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 1-11758

Morgan Stanley Dean Witter & Co.

(Exact Name of Registrant as Specified in its Charter)

Delaware **(State of Incorporation)**	**36-3145972** **(I.R.S. Employer Identification No.)**
1585 Broadway **New York, NY** **(Address of Principal Executive Offices)**	**10036** **(Zip Code)**

Registrant's telephone number, including area code: (212) 761-4000

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☝ No ❺

As of June 30, 1998 there were 585,695,343 shares of Registrant's Common Stock, par value $.01 per share, outstanding.

MORGAN STANLEY DEAN WITTER & CO.
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Quarter Ended May 31, 1998

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MORGAN STANLEY DEAN WITTER & CO.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in millions, except share data)

	May 31, 1998 (unaudited)	November 30, 1997
ASSETS		
Cash and cash equivalents	$ 9,271	$ 8,255
Cash and securities deposited with clearing organizations or segregated under federal and other regulations (including securities at fair value of $4,613 at May 31, 1998 and $4,655 at November 30, 1997)	7,807	6,890
Financial instruments owned:		
U.S. government and agency securities	18,617	12,901
Other sovereign government obligations	18,003	22,900
Corporate and other debt	30,186	24,499
Corporate equities	14,955	10,329
Derivative contracts	21,226	17,146
Physical commodities	290	242
Securities purchased under agreements to resell	93,431	84,516
Receivable for securities provided as collateral(2)	19,569	—
Securities borrowed	88,414	55,266
Receivables:		
Consumer loans (net of allowances of $824 at May 31, 1998 and $884 at November 30, 1997)	17,089	20,033
Customers, net	15,552	12,259
Brokers, dealers and clearing organizations	13,989	13,263
Fees, interest and other	3,021	4,705
Office facilities, at cost (less accumulated depreciation and amortization of $1,376 at May 31, 1998 and $1,279 at November 30, 1997)	1,760	1,705
Other assets	7,485	7,378
Total assets	$ 380,665	$ 302,287
LIABILITIES AND SHAREHOLDERS' EQUITY		
Commercial paper and other short-term borrowings	$ 28,159	$ 22,614
Deposits	9,133	8,993
Financial instruments sold, not yet purchased:		
U.S. government and agency securities	16,370	11,563
Other sovereign government obligations	16,799	12,095
Corporate and other debt	2,357	1,699
Corporate equities	22,745	13,305
Derivative contracts	19,196	15,599
Physical commodities	563	68
Securities sold under agreements to repurchase	114,628	111,680
Obligation to return securities received as collateral(2)	17,208	—
Securities loaned	24,032	14,141
Payables:		
Customers	37,928	25,086
Brokers, dealers and clearing organizations	18,202	16,097
Interest and dividends	969	970
Other liabilities and accrued expenses	8,798	8,630
Long-term borrowings	28,354	24,792
	365,441	287,332
Capital Units	999	999
Preferred Securities Issued by Subsidiaries	400	—
Commitments and contingencies		
Shareholders' equity:		
Preferred stock	875	876
Common stock(1) ($0.01 par value, 1,750,000,000 shares authorized, 605,842,952 and 602,829,994 shares issued, 587,672,561 and 594,708,971 shares outstanding at May 31, 1998 and at November 30, 1997)	6	6
Paid-in capital(1)	3,818	3,952
Retained earnings	10,607	9,330
Cumulative translation adjustments	(16)	(9)
Subtotal	15,290	14,155
Note receivable related to sale of preferred stock to ESOP	(68)	(68)
Common stock held in treasury, at cost(1) ($0.01 par value, 18,170,391 and 8,121,023 shares at May 31, 1998 and at November 30, 1997)	(1,389)	(250)
Stock compensation related adjustments	(8)	119
Total shareholders' equity	13,825	13,956
Total liabilities and shareholders' equity	$ 380,665	$ 302,287

(1) Historical amounts have been restated to reflect the Company's two-for-one stock split.
(2) These amounts relate to the Company's adoption of SFAS No. 127.

See Notes to Condensed Consolidated Financial Statements.

\MORGAN STANLEY DEAN WITTER & CO.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(dollars in millions, except share and per share data)

	Three Months Ended May 31,		Six Months Ended May 31,	
	1998	1997	1998	1997
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 988	$ 581	$ 1,788	$ 1,103
Principal transactions:				
Trading	1,091	722	1,994	1,591
Investments	101	136	173	192
Commissions	611	484	1,158	974
Fees:				
Asset management, distribution and administration	741	610	1,417	1,197
Merchant and cardmember	404	424	832	860
Servicing	232	186	403	386
Interest and dividends	4,213	3,197	8,146	6,566
Other	47	36	102	67
Total revenues	8,428	6,376	16,013	12,936
Interest expense	3,554	2,478	6,699	5,187
Provision for consumer loan losses	275	378	680	755
Net revenues	4,599	3,520	8,634	6,994
Non-interest expenses:				
Compensation and benefits	2,017	1,505	3,805	2,995
Occupancy and equipment	143	127	283	255
Brokerage, clearing and exchange fees	132	113	251	208
Information processing and communications	275	267	542	537
Marketing and business development	286	274	580	562
Professional services	156	99	284	192
Other	190	178	356	360
Merger related costs	—	74	—	74
Total non-interest expenses	3,199	2,637	6,101	5,183
Income before income taxes	1,400	883	2,533	1,811
Provision for income taxes	546	356	988	713
Net income	$ 854	$ 527	$ 1,545	$ 1,098
Preferred stock dividend requirements	$ 14	$ 18	$ 29	$ 37
Earnings applicable to common shares(1)	$ 840	$ 509	$ 1,516	$ 1,061
Earnings per common share(2)				
Basic	$ 1.44	$ 0.88	$ 2.60	$ 1.84
Diluted	$ 1.37	$ 0.84	$ 2.47	$ 1.75
Average common shares outstanding(2)				
Basic	581,326,618	577,985,371	583,502,306	575,301,529
Diluted	612,625,354	610,430,898	614,179,415	607,771,801

(1) Amounts shown are used to calculate basic earnings per common share.
(2) Historical share and per share amounts have been restated to reflect the Company's two-for-one stock split.

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY DEAN WITTER & CO.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in millions)

	Six Months Ended May 31, 1998	Six Months Ended May 31, 1997
	(unaudited)	
Cash flows from operating activities		
Net income	$ 1,545	$ 1,098
Adjustments to reconcile net income to net cash used for operating activities:		
Non-cash charges included in net income	963	782
Changes in assets and liabilities:		
Cash and securities deposited with clearing organizations or segregated under federal and other regulations	(917)	(978)
Financial instruments owned, net of financial instruments sold, not yet purchased	5,943	5,659
Securities borrowed, net of securities loaned	(23,257)	(11,596)
Receivables and other assets	(2,661)	(4,822)
Payables and other liabilities	15,120	9,524
Net cash used for operating activities	(3,264)	(333)
Cash flows from investing activities		
Net (payments for) proceeds from:		
Office facilities	(193)	(52)
Net principal received (disbursed) on consumer loans	106	(1,773)
Sales of consumer loans	2,203	—
Other investing activities	—	(29)
Net cash provided by (used for) investing activities	2,116	(1,854)
Cash flows from financing activities		
Net proceeds related to short-term borrowings	5,489	85
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell	(5,967)	(2,547)
Proceeds from:		
Deposits	140	695
Issuance of common stock	136	62
Issuance of long-term borrowings	7,902	5,612
Issuance of Capital Units	—	134
Preferred Securities Issued by Subsidiaries	400	—
Payments for:		
Repurchases of common stock	(1,487)	(124)
Repayments of long-term borrowings	(4,184)	(2,261)
Redemption of cumulative preferred stock	—	(345)
Cash dividends	(265)	(179)
Net cash provided by financing activities	2,164	1,132
Elimination of Dean Witter, Discover & Co.'s net cash activity for the month of December 1996	—	(1,158)
Net increase (decrease) in cash and cash equivalents	1,016	(2,213)
Cash and cash equivalents, at beginning of period	8,255	6,544
Cash and cash equivalents, at end of period	$ 9,271	$ 4,331

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY DEAN WITTER & CO.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Introduction and Basis of Presentation

The Merger

On May 31, 1997, Morgan Stanley Group Inc. ("Morgan Stanley") was merged with and into Dean Witter, Discover & Co. ("Dean Witter Discover") (the "Merger"). At that time, Dean Witter Discover changed its corporate name to Morgan Stanley, Dean Witter, Discover & Co. ("MSDWD"). In conjunction with the Merger, MSDWD issued 260,861,078 shares of its common stock, as each share of Morgan Stanley common stock then outstanding was converted into 1.65 shares of MSDWD's common stock (the "Exchange Ratio"). In addition, each share of Morgan Stanley preferred stock was converted into one share of a corresponding series of preferred stock of MSDWD. The Merger was treated as a tax-free exchange.

On March 24, 1998, MSDWD changed its corporate name to Morgan Stanley Dean Witter & Co. (the "Company").

The Company

The condensed consolidated financial statements include the accounts of Morgan Stanley Dean Witter & Co. and its U.S. and international subsidiaries, including Morgan Stanley & Co. Incorporated ("MS&Co."), Morgan Stanley & Co. International Limited ("MSIL"), Morgan Stanley Japan Limited ("MSJL"), Dean Witter Reynolds Inc. ("DWR"), Morgan Stanley Dean Witter Advisors Inc. and NOVUS Credit Services Inc.

The Company, through its subsidiaries, provides a wide range of financial and securities services on a global basis and provides credit and transaction services nationally. Its securities and asset management businesses include securities underwriting, distribution and trading; merger, acquisition, restructuring, real estate, project finance and other corporate finance advisory activities; asset management; private equity and other principal investment activities; brokerage and research services; the trading of foreign exchange and commodities as well as derivatives on a broad range of asset categories, rates and indices; and global custody, securities clearance services and securities lending. The Company's credit and transaction services businesses include the operation of the NOVUS Network, a proprietary network of merchant and cash access locations, and the issuance of the Discover® Card and other proprietary general purpose credit cards. The Company's services are provided to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals.

Basis of Financial Information and Change in Fiscal Year End

The condensed consolidated financial statements give retroactive effect to the Merger, which was accounted for as a pooling of interests. The pooling of interests method of accounting requires the restatement of all periods presented as if Dean Witter Discover and Morgan Stanley had always been combined.

Prior to the Merger, Dean Witter Discover's year ended on December 31 and Morgan Stanley's fiscal year ended on November 30. Subsequent to the Merger, the Company adopted a fiscal year end of November 30. All information included herein reflects the change in fiscal year end.

The condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles, which require management to make estimates and assumptions regarding certain trading inventory valuations, consumer loan loss levels, the potential outcome of litigation and other matters that affect the financial statements and related disclosures. Management believes that the estimates utilized in the preparation of the condensed consolidated financial statements are prudent and reasonable. Actual results could differ materially from these estimates.

Certain reclassifications have been made to prior year amounts to conform to the current presentation. All material intercompany balances and transactions have been eliminated.

The condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K (the "Form 10-K") for the fiscal year ended November 30, 1997. The condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for the fair statement of the results for the interim period. The results of operations for interim periods are not necessarily indicative of results for the entire year.

Financial instruments, including derivatives, used in the Company's trading activities are recorded at fair value, and unrealized gains and losses are reflected in trading revenues. Interest revenue and expense arising from financial instruments used in trading activities are reflected in the condensed consolidated statements of income as interest revenue or expense. The fair values of trading positions generally are based on listed market prices. If listed market prices are not available or if liquidating the Company's positions would reasonably be expected to impact market prices, fair value is determined based on other relevant factors, including dealer price quotations and price quotations for similar instruments traded in different markets, including markets located in different geographic areas. Fair values for certain derivative contracts are derived from pricing models which consider current market and contractual prices for the underlying financial instruments or commodities, as well as time value and yield curve or volatility factors underlying the positions. Purchases and sales of financial instruments are recorded in the accounts on trade date. Unrealized gains and losses arising from the Company's dealings in over-the-counter ("OTC") financial instruments, including derivative contracts related to financial instruments and commodities, are presented in the accompanying condensed consolidated statements of financial condition on a net-by-counterparty basis, when appropriate.

Equity securities purchased in connection with private equity and other principal investment activities are initially carried in the condensed consolidated financial statements at their original costs. The carrying value of such equity securities is adjusted when changes in the underlying fair values are readily ascertainable, generally as evidenced by listed market prices or transactions which directly affect the value of such equity securities. Downward adjustments relating to such equity securities are made in the event that the Company determines that the eventual realizable value is less than the carrying value. The carrying value of investments made in connection with principal real estate activities which do not involve equity securities are adjusted periodically based on independent appraisals, estimates prepared by the Company of discounted future cash flows of the underlying real estate assets or other indicators of fair value.

Loans made in connection with private equity and investment banking activities are carried at cost plus accrued interest less reserves, if deemed necessary, for estimated losses.

The Company has entered into various contracts as hedges against specific assets, liabilities or anticipated transactions. These contracts include interest rate swaps, foreign exchange forwards, foreign currency swaps, and cost of funds agreements. The Company uses interest rate and currency swaps to manage the interest rate and currency exposure arising from certain borrowings and to match the refinancing characteristics of consumer loans with the borrowings that fund these loans. For contracts that are designated as hedges of the Company's assets and liabilities, gains and losses are deferred and recognized as adjustments to interest revenue or expense over the remaining life of the underlying assets or liabilities. For contracts that are hedges of asset securitizations, gains and losses are recognized as adjustments to servicing fees. Gains and losses resulting from the termination of hedge contracts prior to their stated maturity are recognized ratably over the remaining life of the instrument being hedged. The Company also uses foreign exchange forward contracts to manage the currency exposure relating to its net monetary investment in non-U.S. dollar functional currency operations. The gain or loss from revaluing these contracts is deferred and reported within cumulative translation adjustments in shareholders' equity, net of tax effects, with the related unrealized amounts due from or to counterparties included in receivables from or payables to brokers, dealers and clearing organizations.

Earnings Per Share

As of December 1, 1997, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share" ("SFAS No. 128"). SFAS No. 128 replaces the previous earnings per share ("EPS") categories of primary and fully diluted with "basic EPS," which reflects no dilution from common stock equivalents, and "diluted EPS," which reflects dilution from common stock equivalents and other dilutive securities based on the average price per share of the Company's common stock during the period. The EPS amounts of prior periods have been restated in accordance with SFAS No. 128. The adoption of SFAS No. 128 has not had a material effect on the Company's EPS calculations.

The calculations of earnings per common share are based on the weighted average number of common shares and share equivalents outstanding and give effect to preferred stock dividend requirements. All per share and share amounts reflect stock splits effected by Dean Witter Discover and Morgan Stanley prior to the Merger, as well as the additional shares issued to Morgan Stanley shareholders pursuant to the Exchange Ratio.

Accounting Pronouncements

As of January 1, 1998, the Company adopted SFAS No. 127, "Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125," which was effective for transfers and pledges of certain financial assets and collateral made after December 31, 1997. The adoption of SFAS No. 127 created additional assets and liabilities on the Company's condensed consolidated statement of financial condition related to the recognition of securities provided and received as collateral. At May 31, 1998, the impact of SFAS No. 127 on the Company's condensed consolidated statement of financial condition (excluding reclassifications) was an increase to total assets and total liabilities of $13,459 million.

In June 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 130, "Reporting Comprehensive Income" and SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." These statements, which are effective for fiscal years beginning after December 15, 1997, establish standards for the reporting and presentation of comprehensive income and the disclosure requirements related to segments.

In February 1998, the FASB issued SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," which revises and standardizes pension and other postretirement benefit plan disclosures that are to be included in the employers' financial statements. SFAS No. 132 does not change the measurement or recognition rules for pensions and other postretirement benefit plans, and is effective for fiscal years beginning after December 15, 1997.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The statement is effective for fiscal years beginning after June 15, 1999.

2. Consumer Loans

Activity in the allowance for consumer loan losses was as follows (dollars in millions):

	Three Months Ended May 31,		Six Months Ended May 31,	
	1998	1997	1998	1997
Balance, beginning of period	$ 905	$ 809	$884	$781
Provision for loan losses	275	378	680	755
Less deductions				
Charge-offs	348	415	794	817
Recoveries	(56)	(42)	(99)	(82)
Net charge-offs	292	373	695	735
Other(1)	(64)	7	(45)	20
Balance, end of period	$ 824	$ 821	$824	$821

(1) Primarily reflects transfers related to asset securitizations and the fiscal 1998 sale of the Company's Prime Option MasterCard portfolio.

Interest accrued on loans subsequently charged off, recorded as a reduction of interest revenue, was $47 million and $115 million in the quarter and six month period ended May 31, 1998 and $85 million and $160 million in the quarter and six months ended May 31, 1997.

The Company received net proceeds from asset securitizations of $1,835 million and $2,203 million in the quarter and six month period ended May 31, 1998. The uncollected balances of consumer loans sold through asset securitizations were $16,178 million at May 31, 1998 and $15,033 million at November 30, 1997.

3. Long-Term Borrowings

Long-term borrowings at May 31, 1998 scheduled to mature within one year aggregated $6,974 million.

During the six month period ended May 31, 1998, the Company issued senior notes aggregating $7,931 million, including non-U.S. dollar currency notes aggregating $778 million, primarily pursuant to its public debt shelf registration statements. The weighted average coupon interest rate of these notes was 5.6% at May 31, 1998; the Company has entered into certain transactions to obtain floating interest rates based primarily on short-term LIBOR trading levels. Maturities in the aggregate of these notes by fiscal year are as follows: 1999, $1,222 million; 2000, $2,456 million; 2001, $1,343 million; and thereafter, $2,910 million. In the six month period ended May 31, 1998, $4,184 million of senior notes were repaid.

4. Preferred Stock, Capital Units and Preferred Securities Issued by Subsidiaries

Preferred stock is composed of the following issues:

	Shares Outstanding at		Balance at	
	May 31, 1998	November 30, 1997	May 31, 1998	November 30, 1997
			(dollars in millions)	
ESOP Convertible Preferred Stock, liquidation preference $35.88	3,612,663	3,646,664	$ 130	$ 131
Series A Fixed/Adjustable Rate Cumulative Preferred Stock, stated value $200	1,725,000	1,725,000	345	345
7-3/4% Cumulative Preferred Stock, stated value $200	1,000,000	1,000,000	200	200
7-3/8% Cumulative Preferred Stock, stated value $200	1,000,000	1,000,000	200	200
Total			$ 875	$ 876

Each issue of outstanding preferred stock ranks in parity with all other outstanding preferred stock of the Company.

The Company has Capital Units outstanding which were issued by the Company and Morgan Stanley Finance plc ("MS plc"), a U.K. subsidiary. A Capital Unit consists of (a) a Subordinated Debenture of MS plc guaranteed by the Company and having maturities from 2013 to 2017 and (b) a related Purchase Contract issued by the Company, which may be accelerated by the Company beginning approximately one year after the issuance of each Capital Unit, requiring the holder to purchase one Depositary Share representing shares (or fractional shares) of the Company's Cumulative Preferred Stock. The aggregate amount of Capital Units outstanding was $999 million at May 31, 1998 and November 30, 1997.

On March 5, 1998, MSDW Capital Trust I, a Delaware statutory business trust (the "Capital Trust"), all of the common securities of which are owned by the Company, issued $400 million of 7.10% Capital Securities (the "Capital Securities") that are guaranteed by the Company. The Capital Trust issued the Capital Securities and invested the proceeds in 7.10% Junior Subordinated Deferrable Interest Debentures issued by the Company, which are due February 28, 2038.

5. Common Stock and Shareholders' Equity

MS&Co. and DWR are registered broker-dealers and registered futures commission merchants and, accordingly, are subject to the minimum net capital requirements of the Securities and Exchange Commission, the New York Stock Exchange and the Commodity Futures Trading Commission. MS&Co. and DWR have consistently operated in excess of these net capital requirements. MS&Co.'s net capital totaled $2,691 million at May 31, 1998, which exceeded the amount required by $2,200 million. DWR's net capital totaled $650 million at May 31, 1998, which exceeded the amount required by $568 million. MSIL, a London-based broker-dealer subsidiary, is subject to the capital requirements of the Securities and Futures Authority, and MSJL, a Tokyo-based broker-dealer, is subject to the capital requirements of the Japanese Ministry of Finance. MSIL and MSJL have consistently operated in excess of their respective regulatory capital requirements.

Under regulatory net capital requirements adopted by the Federal Deposit Insurance Corporation ("FDIC") and other regulatory capital guidelines, FDIC-insured financial institutions must maintain (a) 3% to 5% of Tier 1 capital, as defined, to total assets ("leverage ratio") and (b) 8% combined Tier 1 and Tier 2 capital, as defined, to risk weighted assets ("risk-weighted capital ratio"). At May 31, 1998, the leverage ratio and risk-weighted capital ratio of each of the Company's FDIC-insured financial institutions exceeded these and all other regulatory minimums.

Certain other U.S. and non-U.S. subsidiaries are subject to various securities, commodities and banking regulations, and capital adequacy requirements promulgated by the regulatory and exchange authorities of the countries in which they operate. These subsidiaries have consistently operated in excess of their local capital adequacy requirements.

6. Earnings per Share

Earnings per share was calculated as follows (in millions, except for per share data):

	Three Months Ended May 31,		Six Months Ended May 31,	
	1998	1997	1998	1997
Basic EPS:				
Net income	$ 854	$ 527	$1,545	$1,098
Less: preferred stock dividend requirements	(14)	(18)	(29)	(37)
Net income available to common shareholders	$ 840	$ 509	$1,516	$1,061
Weighted-average common shares outstanding	581	578	584	575
Basic EPS	$1.44	$0.88	$ 2.60	$ 1.84
Diluted EPS:				
Net income	$ 854	$ 527	$1,545	$1,098
Less: preferred stock dividend requirements after assumed conversion of ESOP preferred stock	(13)	(17)	(26)	(34)
Net income available to common shareholders	$ 841	$ 510	$1,519	$1,064
Weighted-average common shares outstanding	581	578	584	575
Effect of dilutive securities:				
Stock options	20	20	18	21
ESOP convertible preferred stock	12	12	12	12
Weighted-average common shares outstanding and common stock equivalents	613	610	614	608
Diluted EPS	$1.37	$0.84	$ 2.47	$ 1.75

7. Commitments and Contingencies

In the normal course of business, the Company has been named as a defendant in various lawsuits and has been involved in certain investigations and proceedings. Some of these matters involve claims for substantial amounts. Although the ultimate outcome of these matters cannot be ascertained at this time, it is the opinion of management, after consultation with outside counsel, that the resolution of such matters will not have a material adverse effect on the consolidated financial condition of the Company, but may be material to the Company’s operating results for any particular period, depending upon the level of the Company’s net income for such period.

The Company had approximately $6.9 billion and $5.5 billion of letters of credit outstanding at May 31, 1998 and at November 30, 1997 to satisfy various collateral requirements.

8. Derivative Contracts

In the normal course of business, the Company enters into a variety of derivative contracts related to financial instruments and commodities. The Company uses swap agreements in managing its interest rate exposure. The Company also uses forward and option contracts, futures and swaps in its trading activities; these financial instruments also are used to hedge the U.S. dollar cost of certain foreign currency exposures. In addition, financial futures and forward contracts are actively traded by the Company and are used to hedge proprietary inventory. The Company also enters into delayed delivery, when-issued, and warrant and option contracts involving securities. These instruments generally represent future commitments to swap interest payment streams, exchange currencies or purchase or sell other financial instruments on specific terms at specified future dates. Many of these products have maturities that do not extend beyond one year; swaps and options and warrants on equities typically have longer maturities. For further discussion of these matters, refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations—Derivative Financial Investments" and Note 8 to the consolidated financial statements for the fiscal year ended November 30, 1997, included in the Form 10-K.

These derivative instruments involve varying degrees of off-balance sheet market risk. Future changes in interest rates, foreign currency exchange rates or the fair values of the financial instruments, commodities or indices underlying these contracts ultimately may result in cash settlements exceeding fair value amounts recognized in the condensed consolidated statements of financial condition, which, as described in Note 1, are recorded at fair value, representing the cost of replacing those instruments.

The Company's exposure to credit risk with respect to these derivative instruments at any point in time is represented by the fair value of the contracts reported as assets. These amounts are presented on a net-by-counterparty basis (when appropriate), but are not reported net of collateral, which the Company obtains with respect to certain of these transactions to reduce its exposure to credit losses.

The credit quality of the Company's trading-related derivatives at May 31, 1998 and November 30, 1997 is summarized in the tables below, showing the fair value of the related assets by counterparty credit rating. The credit ratings are determined by external rating agencies or by equivalent ratings used by the Company's Credit Department:

	AAA	AA	A	BBB	Collateralized Non-Investment Grade	Other Non-Investment Grade	Total
				(dollars in millions)			
At May 31, 1998							
Interest rate and currency swaps and options (including caps, floors and swap options) and other fixed income securities contracts	$ 1,007	$ 3,533	$ 2,864	$ 949	$ 108	$ 930	$ 9,391
Foreign exchange forward contracts and options	691	2,275	1,150	253	—	115	4,484
Mortgage-backed securities forward contracts, swaps and options	100	11	22	6	—	5	144
Equity securities contracts (including equity swaps, warrants and options)	1,673	1,350	529	301	1,466	125	5,444
Commodity forwards, options and swaps	70	343	448	682	2	218	1,763
Total	$ 3,541	$ 7,512	$ 5,013	$ 2,191	$ 1,576	$ 1,393	$ 21,226
Percent of total	17%	35%	24%	10%	7%	7%	100%
At November 30, 1997							
Interest rate and currency swaps and options (including caps, floors and swap options) and other fixed income securities contracts	$ 754	$ 2,761	$ 2,544	$ 436	$ 33	$ 568	$ 7,096
Foreign exchange forward contracts and options	788	2,504	1,068	72	—	176	4,608
Mortgage-backed securities forward contracts, swaps and options	156	90	50	2	—	10	308
Equity securities contracts (including equity swaps, warrants and options)	1,141	917	567	233	780	152	3,790
Commodity forwards, options and swaps	70	425	380	312	12	145	1,344
Total	$ 2,909	$ 6,697	$ 4,609	$ 1,055	$ 825	$ 1,051	$ 17,146
Percent of total	17%	39%	27%	6%	5%	6%	100%

A substantial portion of the Company's securities and commodities transactions are collateralized and are executed with and on behalf of commercial banks and other institutional investors, including other brokers and dealers. Positions taken and commitments made by the Company, including positions taken and underwriting and financing commitments made in connection with its private equity and other principal investment activities, often involve substantial amounts and significant exposure to individual issuers and businesses, including non-investment grade issuers. The Company seeks to limit concentration risk created in its businesses through a variety of separate but complementary financial, position and credit exposure reporting systems, including the use of trading limits based in part upon the Company's review of the financial condition and credit ratings of its counterparties.

See also "Risk Management" in the Form 10-K for discussions of the Company's risk management policies and procedures for its securities businesses.

9. Dispositions

In the quarter ended May 31, 1998, the Company entered into several transactions that reflect its strategic decision to focus on growing its core Securities and Asset Management and Credit and Transaction Services businesses.

During the quarter ended May 31, 1998, the Company completed the sale of its Prime Option SM MasterCard® portfolio ("Prime Option"), a business it had operated with NationsBank Corporation. The gain resulting from the sale was not material to the Company's financial condition or results of operations.

On April 18, 1998, SPS Transaction Services, Inc. ("SPS") and Associates First Capital Corporation ("Associates") entered into a stock purchase agreement (the "Purchase Agreement") pursuant to which SPS agreed to sell substantially all of its assets to Associates. SPS is a 73% owned, publicly held subsidiary of the Company which provides a range of technology outsourcing services, including the processing of credit and debit card transactions, consumer private label credit card programs, commercial account processing services, and call center customer service activities in the U.S. The transaction is subject to certain conditions contained in the Purchase Agreement, including certain regulatory approvals and approval by SPS's shareholders, and is expected to close by the end of fiscal 1998.

On May 7, 1998, the Company and Chase Manhattan Corporation ("Chase") announced that they had reached a definitive agreement pursuant to which the Company agreed to sell its Global Custody business to Chase. The transaction is subject to certain closing conditions, including certain regulatory approvals, and is expected to close by the end of fiscal 1998.

On May 28, 1998, the Company and NationsBanc Montgomery Securities, LLC ("NationsBanc"), a subsidiary of NationsBank Corporation, announced that they had reached a definitive agreement pursuant to which the Company agreed to sell its Correspondent Clearing business to NationsBanc. The transaction is subject to certain closing conditions, including certain regulatory approvals, and is expected to close by the end of fiscal 1998.

The expected gains resulting from the sale of SPS, the Global Custody business and the Correspondent Clearing business will be recognized by the Company during the period in which the respective transactions are completed.

INDEPENDENT ACCOUNTANTS' REPORT

To the Directors and Shareholders of
Morgan Stanley Dean Witter & Co.

We have reviewed the accompanying condensed consolidated statement of financial condition of Morgan Stanley Dean Witter & Co. and subsidiaries (formerly Morgan Stanley, Dean Witter, Discover & Co.) as of May 31, 1998, and the related condensed consolidated statements of income for the three and six month periods ended May 31, 1998 and 1997, and cash flows for the six month periods ended May 31, 1998 and 1997. These condensed consolidated financial statements are the responsibility of the management of Morgan Stanley Dean Witter & Co. We were furnished with the report of other accountants on their review of the interim financial information of Morgan Stanley Group Inc. and subsidiaries for the quarter ended February 28, 1997, which statements reflect total revenues of $4,076 million for the three month period ended February 28, 1997.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review and the report of other accountants, we are not aware of any material modifications that should be made to such condensed consolidated financial statements for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the consolidated statement of financial condition of Morgan Stanley Dean Witter & Co. and subsidiaries as of November 30, 1997, and the related consolidated statements of income, cash flows and changes in shareholders' equity for the fiscal year then ended (not presented herein), included in Morgan Stanley Dean Witter & Co.'s Annual Report on Form 10-K for the fiscal year ended November 30, 1997; and in our report dated January 23, 1998, we expressed an unqualified opinion on those consolidated financial statements based on our audit and the report of other auditors.

/S/ DELOITTE & TOUCHE LLP

New York, New York
July 14, 1998

INDEPENDENT ACCOUNTANTS' REVIEW REPORT

The Stockholders and Board of Directors of
Morgan Stanley Group Inc.

We have reviewed the condensed consolidated statement of financial condition of Morgan Stanley Group Inc. and subsidiaries (the "Company") as of February 28, 1997 and the related condensed consolidated statements of income and cash flows for the three-month period ended February 28, 1997 (not presented separately herein). These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, which will be performed for the full year with the objective of expressing an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated financial statements referred to above for them to be in conformity with generally accepted accounting principles.

/S/ ERNST & YOUNG LLP

New York, New York
March 27, 1997

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

The Merger

On May 31, 1997, Morgan Stanley Group Inc. ("Morgan Stanley") was merged with and into Dean Witter, Discover & Co. ("Dean Witter Discover") (the "Merger"). At that time, Dean Witter Discover changed its corporate name to Morgan Stanley, Dean Witter, Discover & Co. ("MSDWD"). In conjunction with the Merger, each share of Morgan Stanley common stock then outstanding was converted into 1.65 shares of MSDWD's common stock and each share of Morgan Stanley preferred stock was converted into one share of a corresponding series of preferred stock of MSDWD. The Merger was treated as a tax-free exchange.

On March 24, 1998, MSDWD changed its corporate name to Morgan Stanley Dean Witter & Co. (the "Company").

Basis of Financial Information and Change in Fiscal Year End

The condensed consolidated financial statements give retroactive effect to the Merger, which was accounted for as a pooling of interests. The pooling of interests method of accounting requires the restatement of all periods presented as if Dean Witter Discover and Morgan Stanley had always been combined.

Prior to the Merger, Dean Witter Discover's year ended on December 31 and Morgan Stanley's fiscal year ended on November 30. Subsequent to the Merger, the Company adopted a fiscal year end of November 30. All information included herein reflects the change in fiscal year end.

Results of Operations*

Certain Factors Affecting Results of Operations

The Company's results of operations may be materially affected by market fluctuations and economic factors. In addition, results of operations in the past have been and in the future may continue to be materially affected by many factors of a global nature, including economic and market conditions; the availability of capital; the level and volatility of interest rates; currency values and other market indices; the availability of credit; inflation; and legislative and regulatory developments. Such factors may also have an impact on the Company's ability to achieve its strategic objectives, including (without limitation) profitable global expansion.

The Company's Securities and Asset Management business, particularly its involvement in primary and secondary markets for all types of financial products, including derivatives, is subject to substantial positive and negative fluctuations due to a variety of factors that cannot be predicted with great certainty, including variations in the fair value of securities and other financial products and the volatility and liquidity of trading markets. Fluctuations also occur due to the level of market activity, which, among other things, affects the flow of investment dollars into mutual funds, and the size, number and timing of transactions or assignments (including realization of returns from the Company's private equity investments).

In the Company's Credit and Transaction Services business, changes in economic variables may substantially affect consumer loan growth and credit quality. Such variables include the number of personal bankruptcy filings, the rate of unemployment and the level of consumer debt as a percentage of income.

The Company's results of operations also may be materially affected by competitive factors. In addition to competition from firms traditionally engaged in the securities business, there has been increased competition

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* This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements, as well as a discussion of some of the risks and uncertainties involved in the Company's business that could affect the matters referred to in such statements.

from other sources, such as commercial banks, insurance companies, mutual fund groups and other companies offering financial services both in the U.S. and globally. As a result of recent and pending legislative and regulatory initiatives in the U.S. to remove or relieve certain restrictions on commercial banks, competition in some markets that have traditionally been dominated by investment banks and retail securities firms has increased and may continue to increase in the near future. In addition, recent and continuing convergence and consolidation in the financial services industry will lead to increased competition from larger diversified financial services organizations.

Such competition, among other things, affects the Company's ability to attract and retain highly skilled individuals. Competitive factors also affect the Company's success in attracting and retaining clients and assets by its ability to meet investors' saving and investment needs through consistency of investment performance and accessibility to a broad array of financial products and advice. In the credit services industry, competition centers on merchant acceptance of credit cards, credit card account acquisition and customer utilization of credit cards. Merchant acceptance is based on both competitive transaction pricing and the volume of credit cards in circulation. Credit card account acquisition and customer utilization are driven by the offering of credit cards with competitive and appealing features such as no annual fees, low introductory and attractive interest rates, and other customized features targeting specific consumer groups and by having broad merchant acceptance.

As a result of the above economic and competitive factors, net income and revenues in any particular period may not be representative of full-year results and may vary significantly from year to year and from quarter to quarter. The Company intends to manage its business for the long term and help mitigate the potential effects of market downturns by strengthening its competitive position in the global financial services industry through diversification of its revenue sources and enhancement of its global franchise. The Company's ability and success in maintaining high levels of profitable business activities, emphasizing fee-based assets that are designed to generate a continuing stream of revenues, managing risks in both the Securities and Asset Management and Credit and Transaction Services businesses, evaluating credit product pricing and monitoring costs will continue to affect its overall financial results. In addition, the complementary trends in the financial services industry of consolidation and globalization present, among other things, technological, risk management and other infrastructure challenges that will require effective resource allocation in order for the Company to remain competitive.

Economic and Market Conditions in the Quarter Ended May 31, 1998

The favorable economic and market conditions that characterized the global financial markets in fiscal 1997 continued through much of the second quarter of fiscal 1998. Despite turmoil and uncertainty relating to the economic and political situation existing in Southeast Asia, the U.S. economy continued to exhibit signs of growth. The levels of inflation and interest rates remained relatively low, and during the quarter the Federal Reserve Board decided to leave the overnight lending rate unchanged. While the overall performance of U.S. financial markets continued to be favorable, such performance was, at times, volatile. Investors also became concerned about lower corporate earnings resulting from the financial instability in the Asia-Pacific region, as well as from the potential impact of domestic wage inflation.

Conditions in European markets were generally favorable during the quarter. Many European stock exchanges recorded sizable gains, primarily due to strong corporate earnings, merger and consolidation activity, and stable economic conditions. The region's performance also benefited from positive investor sentiment relating to the approaching European Economic and Monetary Union ("EMU"), as the member nations and bilateral currency conversion rates for the first phase of the EMU were announced during the quarter. Market conditions in Russia were less favorable. Investor concerns regarding the state of the Russian economy led to significant declines in the nation's financial markets, which prompted the government to significantly increase interest rates in order to stabilize the ruble and to reduce the outflow of capital.

Market conditions in the Far East continued to be weak due to the ongoing economic and financial difficulties existing in the region since the latter half of fiscal 1997. The continued lack of economic growth in Japan led its government to approve a 16.65 trillion yen fiscal stimulus package during the quarter. However, the ability of these fiscal policies to significantly improve the nation's future economic performance was viewed with skepticism by many investors. Market conditions were also unstable elsewhere in Asia. In Indonesia, difficult economic conditions and anti-

government sentiment led to significant political and social unrest. Other Southeast Asian markets also suffered fallout from the Indonesian crisis.

Results of the Company for the Quarter and Six Month Periods ended May 31, 1998 and 1997

The Company's net income of $854 million and $1,545 million in the quarter and six month period ended May 31, 1998 represented increases of 62% and 41% from the comparable periods of fiscal 1997. Diluted earnings per common share were $1.37 and $2.47 in the quarter and six month period ended May 31, 1998 as compared to $0.84 and $1.75 in the quarter and six month period ended May 31, 1997. The Company's annualized return on common equity was 25.0% and 22.6% for the quarter and six month period ended May 31, 1998, as compared with 18.3% and 19.5% for the comparable periods of fiscal 1997.

The increase in net income in the quarter and six month period ended May 31, 1998 from the comparable prior year periods was primarily due to higher revenues from securities activities, including investment banking, principal transactions and commissions, increased asset management, distribution and administration fees, as well as improved operating results from the Company's Credit and Transaction Services business. These increases were partially offset by lower gains from the Company's private equity portfolio, coupled with higher incentive-based compensation and other non-interest expenses.

In the quarter ended May 31, 1998, the Company entered into several transactions that reflect its strategic decision to focus on growing its core Securities and Asset Management and Credit and Transaction Services businesses.

During the quarter ended May 31, 1998, the Company completed the sale of its Prime Option SM MasterCard® portfolio ("Prime Option"), a business it had operated with NationsBank Corporation. The gain resulting from the sale was not material to the Company's financial condition or results of operations.

On April 18, 1998, SPS Transaction Services, Inc. ("SPS") and Associates First Capital Corporation ("Associates") entered into a stock purchase agreement (the "Purchase Agreement") pursuant to which SPS agreed to sell substantially all of its assets to Associates. SPS is a 73% owned, publicly held subsidiary of the Company which provides a range of technology outsourcing services, including the processing of credit and debit card transactions, consumer private label credit card programs, commercial account processing services, and call center customer service activities in the U.S. The transaction is subject to certain conditions contained in the Purchase Agreement, including certain regulatory approvals and approval by SPS's shareholders, and is expected to close by the end of fiscal 1998.

On May 7, 1998, the Company and Chase Manhattan Corporation ("Chase") announced that they had reached a definitive agreement pursuant to which the Company agreed to sell its Global Custody business to Chase. The transaction is subject to certain closing conditions, including certain regulatory approvals, and is expected to close by the end of fiscal 1998.

On May 28, 1998, the Company and NationsBanc Montgomery Securities, LLC ("NationsBanc"), a subsidiary of NationsBank Corporation, announced that they had reached a definitive agreement pursuant to which the Company agreed to sell its Correspondent Clearing business to NationsBanc. The transaction is subject to certain closing conditions, including certain regulatory approvals, and is expected to close by the end of fiscal 1998.

The expected gains resulting from the sale of SPS, the Global Custody business and the Correspondent Clearing business will be recognized by the Company during the period in which the respective transactions are completed.

The remainder of Results of Operations is presented on a business segment basis. Substantially all of the operating revenues and operating expenses of the Company can be directly attributable to its two business segments: Securities and Asset Management and Credit and Transaction Services. Certain reclassifications have been made to prior period amounts to conform to the current year's presentation.

Securities and Asset Management

Statements of Income (dollars in millions)

	Three Months Ended May 31,		Six Months Ended May 31,	
	1998	1997	1998	1997
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 988	$ 581	$1,788	$1,103
Principal transactions:				
Trading	1,091	722	1,994	1,591
Investments	101	136	173	192
Commissions	602	476	1,141	965
Asset management, distribution and administration fees	741	610	1,417	1,197
Interest and dividends	3,540	2,416	6,690	5,018
Other	44	33	97	62
Total revenues	7,107	4,974	13,300	10,128
Interest expense	3,303	2,191	6,155	4,617
Net revenues	3,804	2,783	7,145	5,511
Non-interest expenses:				
Compensation and benefits	1,870	1,369	3,516	2,724
Occupancy and equipment	125	112	247	225
Brokerage, clearing and exchange fees	127	109	243	204
Information processing and communications	161	149	308	291
Marketing and business development	121	100	232	196
Professional services	132	83	237	158
Other	132	114	253	240
Total non-interest expenses	2,668	2,036	5,036	4,038
Income before income taxes	1,136	747	2,109	1,473
Income tax expense	449	286	830	567
Net income	$ 687	$ 461	$1,279	$ 906

Securities and Asset Management net revenues of $3,804 million and $7,145 million in the quarter and six month period ended May 31, 1998 represented an increase of 37% and 30% from the comparable periods of fiscal 1997. Securities and Asset Management net income of $687 million and $1,279 million in the quarter and six month period ended May 31, 1998 represented an increase of 49% and 41% from comparable periods of fiscal 1997. In both periods, the increases reflected higher levels of investment banking revenues; asset management, distribution and administration fees; and principal transaction trading revenues and commissions, partially offset by higher incentive-based compensation and other non-interest expenses.

Investment Banking

Investment banking revenues are derived from the underwriting of securities offerings and fees from advisory services. Investment banking revenues in the quarter ended May 31, 1998 increased 70% from the quarter ended May 31, 1997, primarily reflecting higher revenues from merger and acquisition transactions and debt and equity underwritings. Revenues from merger, acquisition and restructuring activities increased to record levels, as the global market for such transactions continued to be robust during the quarter. Nearly $1 trillion of transactions were announced during the first five months of the calendar year, which was approximately twice the volume reported in the comparable period of 1997. The high levels of transaction activity reflected the continuing trend of consolidation and globalization

across many industry sectors, as companies attempted to expand into new markets and businesses through strategic combinations. Advisory fees from real estate transactions also increased during the quarter. A stable financing environment, favorable economic conditions and a strong real estate market, including accelerated consolidation activity among real estate investment trusts and high investor demand for the securities of public real estate companies, contributed to the increase. Fixed income underwriting revenues also increased, primarily attributable to higher revenues from issuances of global high yield and investment grade fixed income securities. The market for high yield fixed income securities continued to benefit from strong investor demand and from the favorable market and economic conditions that existed during much of the quarter which enabled certain non-investment grade issuers to obtain attractive financing rates. Underwriting revenues from investment grade securities also benefited from the favorable economic conditions in the U.S. and Europe as certain investors increased their demand for higher credit quality financial instruments. Equity financing revenues also increased, primarily due to a higher volume of equity offerings as compared to the prior year's quarter, coupled with the Company's strong market share.

In the six month period ended May 31, 1998, investment banking revenues increased 62% from the comparable period of 1997, reflecting higher revenues from merger and acquisition transactions as well as from both debt and equity underwritings as volumes in the primary markets continued to be strong.

Principal Transactions

Principal transaction trading revenues, which include revenues from customer purchases and sales of securities in which the Company acts as principal and gains and losses on securities held for resale, including derivatives, increased 51% in the quarter ended May 31, 1998 from the comparable period of fiscal 1997. The increase was due to higher revenues from all of the Company's trading businesses: equities; fixed income; foreign exchange; and commodities.

Equity trading revenues in the quarter ended May 31, 1998 increased to record levels and were significantly higher than the comparable prior year period. Revenues from trading in equity cash products increased, primarily due to higher activity in European markets. Most European stock exchanges benefited from favorable market conditions, low interest rates and positive investor sentiment regarding the EMU. European revenues also benefited from the Company's increased sales and research coverage of the region that began in mid-1997, as well as from higher customer trading volumes as investors sought to increase their positions in these markets. The increased volume of equity issuances in the primary markets, as well as higher revenues from equity derivative securities, also contributed to the increase in equity trading revenues.

Fixed income trading revenues increased in the quarter ended May 31, 1998 from the quarter ended May 31, 1997, primarily due to higher revenues from trading in investment grade, high yield and derivative fixed income securities. Revenues from trading investment grade fixed income securities benefited from favorable market conditions in the U.S., including stable economic growth and relatively low rates of interest and inflation. Trading activity also increased as investors sought to decrease their positions of securities issued by Asian entities due to higher levels of market and credit risk. In contrast, market conditions during the second quarter of fiscal 1997 were less favorable due to the Federal Reserve Board's decision to raise the overnight lending rate in March 1997. Revenues from high yield fixed income securities benefited from the low interest rate environment and from strong investor demand. Derivative trading revenues benefited primarily from higher levels of customer trading volume. These increases were partially offset by lower revenues from trading securitized fixed income securities.

Foreign exchange trading revenues also increased in the quarter ended May 31, 1998. The increase was attributable to high levels of customer transaction volumes and volatility in the foreign exchange markets, particularly in the currencies of Southeast Asian nations. The political and economic turmoil in that region, coupled with the continued weakness in the Japanese yen, increased the levels of customer transaction volume and market volatility. Certain European currencies also experienced higher levels of volatility due to expectations of interest rate fluctuations in anticipation of the EMU.

Trading revenues from commodity products increased in the quarter ended May 31, 1998, primarily driven by higher revenues from trading in precious metals, which benefited from increased volatility in the gold market. Higher palladium prices, resulting from a significantly lower quantity of Russian exports, also had a favorable impact on precious metals trading revenues. Higher revenues from trading in commodity derivative products and electricity also

contributed to the increase. These increases were partially offset by lower revenues from trading in crude oil and natural gas products. Crude oil prices continued to decline due to relatively high inventory levels and lower levels of customer demand, while natural gas prices fell as the result of unseasonably warm weather, causing a reduction in the demand for home heating fuel.

Principal transaction investment gains aggregating $101 million were recorded in the quarter ended May 31, 1998, as compared to $136 million in the comparable prior year period. Fiscal 1998's revenues primarily reflected the complete or partial sales of certain private equity investments, including CAT Ltd.

Principal transaction trading revenues for the six month period ended May 31, 1998 increased 25% from the comparable prior year period. Equity trading revenues increased, primarily due to higher revenues from European equity cash products and equity derivative securities. European equity markets were characterized by strong performances by most of the major indices and high customer transaction volumes due to favorable market conditions and positive investor sentiment regarding the approaching EMU. Fixed income trading revenues increased as higher revenues from high yield and derivative fixed income securities were partially offset by lower revenues from securitized instruments. Foreign exchange trading revenues also increased, benefiting from high levels of volatility in the currency markets, particularly in Asia, and strong customer trading volumes. Commodities trading revenues increased due to higher revenues from precious metals, refined energy products and electricity.

Principal transaction investment gains aggregating $173 million were recorded in the six month period ended May 31, 1998 as compared to $192 million in the comparable prior year period. Both periods' revenues reflect realized gains from sales of the Company's positions in Fort James Corporation, which were more significant in fiscal 1997, as well as gains from increases in the carrying values of other private equity investments.

Commissions

Commission revenues primarily arise from agency transactions in listed and over-the-counter equity securities, and sales of mutual funds, futures, insurance products and options. Commission revenues increased 26% in the quarter ended May 31, 1998 from the comparable period of fiscal 1997. In U.S. markets, the Company benefited from a higher volume of customer securities transactions. Revenues from markets in Europe benefited from the continuance of high trading volumes due to the strong performance of many equity markets within that region. The Company's addition of over 1,000 financial advisors since May 31, 1997 also contributed to the increase.

Commission revenues increased 18% in the six month period ended May 31, 1998 from the comparable period in fiscal 1997. The increase primarily reflects increased customer trading activity in the global markets for equity securities.

Asset Management, Distribution and Administration Fees

Asset management, distribution and administration revenues include fees for asset management services, including fund management fees which are received for investment management, fees received for promoting and distributing mutual funds ("12b-1 fees"), and other administrative fees and non-interest revenues earned from correspondent clearing and custody services. Fund management fees arise from investment management services the Company provides to registered investment companies (the "Funds") pursuant to various contractual arrangements. The Company receives management fees based upon each Fund's average daily net assets. The Company receives 12b-1 fees for services it provides in promoting and distributing certain open-ended Funds. These fees are based on either the average daily Fund net asset balances or average daily aggregate net Fund sales and are affected by changes in the overall level and mix of assets under management and administration. The Company also receives fees from investment management services provided to segregated customer accounts pursuant to various contractual arrangements.

Asset management, distribution and administration revenues increased 21% in the quarter ended May 31, 1998 from the comparable period of fiscal 1997, reflecting strong fund performance, a comprehensive product line and favorable market conditions which continue to attract inflows of net new business and growth in assets under management. Higher fund management and 12b-1 fees, as well as increased revenues from international equity and U.S.

fixed income products resulting from inflows of client assets and market appreciation, had a favorable impact on these revenues.

In the six month period ended May 31, 1998, asset management, distribution and administration revenues increased 18% from the comparable period in fiscal 1997. The increase primarily reflects higher fund management and 12b-1 fees as well as other revenues resulting from the continued growth in assets under management.

Customer assets under management or supervision increased to $374 billion at May 31, 1998 from $303 billion at May 31, 1997. The increase in assets under management or supervision reflected continued inflows of customer assets and appreciation in the value of existing customer portfolios. Customer assets under management or supervision included products offered primarily to individual investors of $206 billion at May 31, 1998 and $174 billion at May 31, 1997. Products offered primarily to institutional investors were $168 billion at May 31, 1998 and $129 billion at May 31, 1997.

Net Interest

Interest and dividend revenues and expense are a function of the level and mix of total assets and liabilities, including financial instruments owned, reverse repurchase and repurchase agreements and customer margin loans, and the prevailing level, term structure and volatility of interest rates. Interest and dividend revenues and expense should be viewed in the broader context of principal trading and investment banking results. Decisions relating to principal transactions in securities are based on an overall review of aggregate revenues and costs associated with each transaction or series of transactions. This review includes an assessment of the potential gain or loss associated with a trade, the interest income or expense associated with financing or hedging the Company's positions, and potential underwriting, commission or other revenues associated with related primary or secondary market sales. Net interest revenues increased 5% and 33% in the quarter and six month period ended May 31, 1998 from the comparable periods of fiscal 1997. In both periods, the increases were primarily attributable to higher levels of revenues from net interest earning assets, including financial instruments owned and customer margin receivable balances. Higher levels of securities lending transactions also had a positive affect on net interest and dividend revenues. These increases were partially offset by higher interest expense associated with a higher level of interest bearing liabilities, including long-term debt.

Non-Interest Expenses

Total non-interest expenses increased 31% and 25% in the quarter and six month period ended May 31, 1998 from the comparable periods of fiscal 1997. Within that category, compensation and benefits expense increased 37% and 29%, principally reflecting increased incentive compensation based on higher levels of revenues and earnings. Excluding compensation and benefits expense, non-interest expenses increased 20% and 16%. Occupancy and equipment expenses increased 12% and 10%, primarily due to increased office space in New York and Hong Kong, higher occupancy costs in London, and the addition of 30 new branch locations. Brokerage, clearing and exchange fees increased 17% and 19%, primarily related to the higher level of securities trading volume. The increase in the six month period also reflects the Company's acquisition of the institutional global custody business of Barclays Bank PLC on April 3, 1997. Information processing and communications expense increased 8% and 6%, primarily due to the impact of increased rates for certain data services as well as other telecommunications and information systems costs. A higher number of employees also contributed to the increase. Marketing and business development expenses increased 21% and 18%, reflecting increased travel and entertainment costs associated with the continued high levels of activity in the global financial markets as the Company continues to develop new business. Professional services expenses increased 59% and 50%, primarily reflecting higher consulting costs associated with information technology initiatives and the Company's increased global business activities. Higher temporary staff, legal costs and employment fees also contributed to the increase. Other expenses increased 16% and 5%, primarily reflecting increases in various expense items resulting from the Company's higher level of global business and trading activities.

Credit and Transaction Services

Statements of Income (dollars in millions)

	Three Months Ended May 31,		Six Months Ended May 31,	
	1998	1997	1998	1997
	(unaudited)		(unaudited)	
Fees:				
Merchant and cardmember	$ 404	$424	$ 832	$ 860
Servicing	232	186	403	386
Commissions	9	8	17	9
Other	3	3	5	5
Total non-interest revenues	648	621	1,257	1,260
Interest revenue	673	781	1,456	1,548
Interest expense	251	287	544	570
Net interest income	422	494	912	978
Provision for consumer loan losses	275	378	680	755
Net credit income	147	116	232	223
Net revenues	795	737	1,489	1,483
Compensation and benefits	147	136	289	271
Occupancy and equipment	18	15	36	30
Brokerage, clearing and exchange fees	5	4	8	4
Information processing and communications	114	118	234	246
Marketing and business development	165	174	348	366
Professional services	24	16	47	34
Other	58	64	103	120
Total non-interest expenses	531	527	1,065	1,071
Income before income taxes	264	210	424	412
Provision for income taxes	97	81	158	157
Net income	$ 167	$129	$ 266	$ 255

Credit and Transaction Services net income of $167 million and $266 million in the quarter and six month period ended May 31, 1998 represented an increase of 29% and 4% from the comparable periods of 1997, primarily attributable to a lower provision for loan losses, partially offset by a lower yield on consumer loans. The results of operations for the quarter and six month period ended May 31, 1998 were also positively affected by the sale of Prime Option, which occurred during the second quarter.

As a result of enhancements made to certain of the Company's operating systems in the fourth quarter of fiscal 1997, the Company began recording charged off cardmember fees and interest revenue directly against the income statement line items to which they were originally recorded. Prior to the enhancements, charged off cardmember fees and interest revenue were both recorded as a reduction of interest revenue. While this change has no impact on net revenues, the Company believes that the revised presentation better reflects the manner in which charge-offs affect the Credit and Transaction Services statements of income. However, since prior periods have not been restated to reflect this change, the comparability of merchant and cardmember fees and interest revenues between the quarter and six month period ended May 31, 1998 and the quarter and six month period ended May 31, 1997 has been affected. Accordingly, the following sections will also discuss the changes in these income statement categories excluding the impact of this reclassification.

Non-Interest Revenues

Total non-interest revenues increased 4% in the quarter ended May 31, 1998 and remained level in the six month period ended May 31, 1998 from the comparable periods of 1997. Excluding the effect of the reclassification of charged off cardmember fees discussed above, non-interest revenue would have increased 8% and 4% in the quarter and six month period ended May 31, 1998.

Merchant and cardmember fees include revenues from fees charged to merchants on credit card sales, late payment fees, overlimit fees, insurance fees, cash advance fees, and fees for the administration of credit card programs and transaction processing services. Merchant and cardmember fees decreased 5% and 3% in the quarter and six month period ended May 31, 1998 from the comparable periods of 1997. Excluding the effect of the reclassification of charged off cardmember fees discussed above, merchant and cardmember fees would have remained level in the quarter and six month period ended May 31, 1998. In both periods, higher merchant discount revenue associated with increased sales volume was offset by decreases in overlimit, late payment and cash advance fees. Overlimit and late payment fees decreased due to a lower average level of owned consumer loans. Cash advance fees decreased as a result of decreased cash advance transaction volume.

Servicing fees are revenues derived from consumer loans that have been sold to investors through asset securitizations. Cash flows from the interest yield and cardmember fees generated by securitized loans are used to pay investors in these loans a predetermined fixed or floating rate of return on their investment, to reimburse investors for losses of principal through charged off loans and to pay the Company a fee for servicing the loans. Any excess cash flows remaining are paid to the Company. The servicing fees and excess net cash flows paid to the Company are reported as servicing fees in the condensed consolidated statements of income. The sale of consumer loans through asset securitizations therefore has the effect of converting portions of net credit income and fee income to servicing fees. The Company completed asset securitizations of $1,842 million in the quarter ended May 31, 1998 and $2,211 million in the six month period ended May 31, 1998. No asset securitizations were completed during the comparable periods of fiscal 1997. These asset securitizations have expected maturities ranging from 3 years to 5 years from the date of issuance.

The table below presents the components of servicing fees (dollars in millions):

	Three Months Ended May 31,		Six Months Ended May 31,	
	1998	**1997**	**1998**	**1997**
Merchant and cardmember fees	$ 115	$105	$ 220	$ 216
Interest revenue	648	518	1,227	1,036
Interest expense	(251)	(204)	(485)	(407)
Provision for consumer loan losses	(280)	(233)	(559)	(459)
Servicing fees	$ 232	$186	$ 403	$ 386

Servicing fees increased 25% in the quarter and 4% in the six months ended May 31, 1998 from the comparable periods of 1997. The increase in both periods was due to higher levels of net interest cash flows, partially offset by increased credit losses from securitized consumer loans. The increases in net interest and credit losses were primarily a result of higher levels of average securitized loans. In addition, the quarter ended May 31, 1998 benefited from a modest decrease in the rate of consumer loans charged off.

Commission revenues arise from customer securities transactions associated with Discover Brokerage Direct, Inc. ("DBD"), the Company's provider of electronic brokerage services acquired in January 1997. The increase in commission revenues in the quarter ended May 31, 1998 reflected an increase in the number of DBD customer accounts and a higher level of customer transaction volume. The increase in the six month period ended May 31, 1998 was due to higher customer transaction volume as well as the inclusion of DBD's results for six months in 1998 as compared to four months in 1997.

Net Interest Income

Net interest income is equal to the difference between interest revenue derived from Credit and Transaction Services consumer loans and short-term investment assets and interest expense incurred to finance those assets. Credit and Transaction Services assets, consisting primarily of consumer loans, earn interest revenue at both fixed rates and market-indexed variable rates. The Company incurs interest expense at fixed and floating rates. Interest expense also includes the effects of interest rate contracts entered into by the Company as part of its interest rate risk management program. This program is designed to reduce the volatility of earnings resulting from changes in interest rates and is accomplished primarily through matched financing, which entails matching the repricing schedules of consumer loans and related financing. Net interest income decreased 15% and 7% in the quarter and six month period ended May 31, 1998 from the comparable periods of 1997. Excluding the effect of the reclassification of charged off cardmember fees discussed above, net interest income would have decreased 19% and 12% from the comparable prior year periods. The decrease in both periods was predominately due to lower average levels of owned consumer loans and a lower yield on general purpose credit card loans. In addition, the results reflect lower net interest income as a result of the sale of Prime Option during the quarter. The lower yield on general purpose credit card loans was primarily due to a larger number of cardmembers taking advantage of lower promotional rates.

The following tables present analyses of Credit and Transaction Services average balance sheets and interest rates for the quarter and six month period ended May 31, 1998 and 1997 and changes in net interest income during those periods:

Average Balance Sheet Analysis (dollars in millions)

	Three Months Ended May 31,					
	1998			1997		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
ASSETS						
Interest earning assets:						
General purpose credit card loans	$16,732	13.59%	$ 574	$19,098	14.20%	$ 684
Other consumer loans	1,561	16.24	64	1,839	15.57	72
Investment securities	597	7.95	12	188	5.39	2
Other	1,460	6.41	23	1,488	6.08	23
Total interest earning assets	20,350	13.12	673	22,613	13.70	781
Allowance for loan losses	(845)			(909)		
Non-interest earning assets	1,630			1,557		
Total assets	$21,135			$23,261		
LIABILITIES & SHAREHOLDER'S EQUITY						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	$ 975	4.83%	$ 12	$ 1,013	4.05%	$ 10
Brokered	6,075	6.65	102	4,035	6.69	68
Other time	2,208	6.14	35	2,207	6.15	34
Total interest bearing deposits	9,258	6.34	149	7,255	6.15	112
Other borrowings	6,928	5.91	102	11,451	6.05	175
Total interest bearing liabilities	16,186	6.15	251	18,706	6.09	287
Shareholder's equity/other liabilities	4,949			4,555		
Total liabilities & shareholder's equity	$21,135			$23,261		
Net interest income			$ 422			$ 494
Net interest margin			8.22%			8.66%
Interest rate spread		6.97%			7.61%	

Average Balance Sheet Analysis (dollars in millions)

	Six Months Ended May 31,					
	1998			1997		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
ASSETS						
Interest earning assets:						
General purpose credit card loans	$18,391	13.77%	$1,263	$19,227	14.16%	$1,357
Other consumer loans	1,612	16.57	133	1,904	15.33	146
Investment securities	422	7.33	15	186	5.65	5
Other	1,379	6.51	45	1,363	5.93	40
Total interest earning assets	21,804	13.39	1,456	22,680	13.69	1,548
Allowance for loan losses	(866)			(881)		
Non-interest earning assets	1,658			1,568		
Total assets	$22,596			$23,367		
LIABILITIES & SHAREHOLDER'S EQUITY						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	$ 916	4.75%	$ 22	$ 1,025	4.33%	$ 22
Brokered	5,995	6.63	198	3,890	6.71	130
Other time	2,282	6.12	70	2,187	6.10	67
Total interest bearing deposits	9,193	6.32	290	7,102	6.18	219
Other borrowings	8,421	6.07	254	11,749	6.00	351
Total interest bearing liabilities	17,614	6.20	544	18,851	6.07	570
Shareholder's equity/other liabilities	4,982			4,516		
Total liabilities & shareholder's equity	$22,596			$23,367		
Net interest income			$ 912			$ 978
Net interest margin			8.39%			8.65%
Interest rate spread		7.19%			7.62%	

Rate/Volume Analysis (dollars in millions)

	Three Months Ended May 31, 1998 vs. 1997 Increase/(Decrease) Due to Changes in			Six Months Ended May 31, 1998 vs. 1997 Increase/(Decrease) Due to Changes in		
	Volume	Rate	Total	Volume	Rate	Total
INTEREST REVENUE						
General purpose credit card loans	$ (84)	$ (25)	$(109)	$ (59)	$(35)	$(94)
Other consumer loans	(11)	2	(9)	(23)	10	(13)
Investment securities	6	4	10	7	3	10
Other ..	(1)	1	—	1	4	5
Total interest revenue	(78)	(30)	(108)	(60)	(32)	(92)
INTEREST EXPENSE						
Interest bearing deposits						
Savings	—	3	3	(2)	2	—
Brokered	35	(1)	34	70	(2)	68
Other time	—	—	—	4	—	4
Total interest bearing deposits	32	5	37	64	8	72
Other borrowings	(71)	(2)	(73)	(101)	3	(98)
Total interest expense	(38)	2	(36)	(37)	11	(26)
Net interest income.	$ (40)	$ (32)	$ (72)	$ (22)	$(44)	$(66)

The supplemental table below provides average managed loan balance and rate information which takes into account both owned and securitized loans:

Supplemental Average Managed Loan Balance Sheet Information (dollars in millions)

	Three Months Ended May 31,					
	1998			1997		
	Avg. Bal.	Rate %	Interest	Avg. Bal.	Rate %	Interest
Consumer loans	$34,479	14.79%	$1,286	$34,032	14.85%	$1,274
General purpose credit card loans	32,249	14.64	1,190	31,524	14.72	1,169
Total interest earning assets	36,537	14.35	1,321	35,709	14.44	1,299
Total interest bearing liabilities	32,373	6.16	502	31,802	6.13	491
Consumer loan interest rate spread		8.63			8.72	
Interest rate spread		8.19			8.31	
Net interest margin		8.89			8.98	

	Six Months Ended May 31,					
	1998			1997		
	Avg. Bal.	Rate %	Interest	Avg. Bal.	Rate %	Interest
Consumer loans	$35,641	14.76%	$2,623	$34,277	14.85%	$2,538
General purpose credit card loans	33,359	14.60	2,429	31,703	14.74	2,331
Total interest earning assets	37,441	14.37	2,683	35,826	14.47	2,584
Total interest bearing liabilities	33,251	6.21	1,029	31,997	6.12	977
Consumer loan interest rate spread		8.55			8.73	
Interest rate spread		8.16			8.35	
Net interest margin		8.86			9.00	

Provision for Consumer Loan Losses

The provision for consumer loan losses is the amount necessary to establish the allowance for loan losses at a level the Company believes is adequate to absorb estimated losses in its consumer loan portfolio at the balance sheet date. The Company's allowance for loan losses is regularly evaluated by management for adequacy on a portfolio-by-portfolio basis and was $824 million and $821 million at May 31, 1998 and 1997. The provision for consumer loan losses, which is affected by net charge-offs, loan volume and changes in the amount of consumer loans estimated to be uncollectable, decreased 27% and 10% in the quarter and six month period ended May 31, 1998 due to a decrease in net charge-offs. The decrease in net charge-offs in the quarter and six month period ended May 31, 1998 was due to lower average levels of owned consumer loans, primarily attributable to an increased level of securitized loans, and a decrease in the rate of charge-offs primarily due to the sale of Prime Option. Net charge-offs as a percentage of average owned consumer loans outstanding decreased to 6.33% and 6.96% in the quarter and six month period ended May 31, 1998 from 7.07% and 6.97% in the comparable periods of 1997. In fiscal 1997, the Company intensified efforts designed to reduce the impact of increased net charge-offs and continues to implement measures designed to improve the credit quality of both new and existing credit card accounts. The Company's expectations about future charge-off rates and credit quality are subject to uncertainties that could cause actual results to differ materially from what has been discussed above. Factors that influence the level and direction of consumer loan delinquencies and charge-offs include changes in consumer spending and payment behaviors, bankruptcy trends, the seasoning of the Company's loan portfolio, interest rate movements and their impact on consumer behavior, and the rate and magnitude of changes in the Company's consumer loan portfolio, including the overall mix of accounts, products and loan balances within the portfolio.

Consumer loans are considered delinquent when interest or principal payments become 30 days past due. Consumer loans are charged off when they become 180 days past due, except in the case of bankruptcies and fraudulent transactions, where loans are charged off earlier. Loan delinquencies and charge-offs are primarily affected by changes in economic conditions and may vary throughout the year due to seasonal consumer spending and payment behaviors.

From time to time, the Company has offered and may continue to offer cardmembers with accounts in good standing the opportunity to skip a minimum monthly payment, while continuing to accrue periodic finance charges, without being considered to be past due ("skip-a-payment"). The comparison of delinquency rates at any particular point in time may be affected depending on the timing of the skip-a-payment program. The delinquency rates for consumer loans 90-179 days past due at May 31, 1998 and 1997 were favorably impacted by skip-a-payment offers made in January 1998 and 1997. The delinquency rates for consumer loans 30-89 days past due at November 30, 1997 were favorably impacted by a skip-a-payment offer made in October 1997.

The following table presents delinquency and net charge-off rates with supplemental managed loan information. Information at May 31, 1998 includes the effects of the sale of Prime Option.

Asset Quality (dollars in millions)

	May 31,				November 30,	
	1998		1997		1997	
	Owned	Managed	Owned	Managed	Owned	Managed
Consumer loans at period-end	$17,913	$34,091	$21,143	$34,167	$20,917	$35,950
Consumer loans contractually past due as a percentage of period-end consumer loans:						
30 to 89 days	4.26%	4.33%	4.24%	4.20%	3.96%	3.91%
90 to 179 days	2.71%	2.73%	2.77%	2.70%	3.11%	3.07%
Net charge-offs as a percentage of average consumer loans (year-to-date)	6.96%	7.05%	6.97%	6.98%	6.78%	6.95%

Non-Interest Expenses

Non-interest expenses remained level in the quarter and six month period ended May 31, 1998 from the comparable periods of 1997.

Compensation and benefits expense increased 8% and 7% in the quarter and six month period ended May 31, 1998 from the comparable periods of 1997 due to an increase in the number of employees. Brokerage, clearing and exchange fees relate to the trading activity associated with DBD. The increase in the quarter ended May 31, 1998 was due to an increased level of customer transaction volume. The increase in the six month period ended May 31, 1998 was due to an increased level of customer transaction volume and a full six months of operations of DBD. Information processing and communications expense decreased 3% and 5% primarily due to lower transaction processing costs, an adjustment resulting from the sale of the Company's indirect interest in one of the Company's transaction processing vendors and favorable repricing of certain data communication contracts. Marketing and business development expense decreased 5% in the quarter and the six month period ended May 31, 1998. The decreases in both periods were due to lower advertising and promotional expenses partially offset by increases in Cardmember rewards expense. Lower advertising and promotional expenses were associated with the Company's discontinuance of the BRAVO® card, partially offset by an increase in expenses related to partnership programs. Cardmember rewards expense includes the Cashback Bonus® award, pursuant to which the Company annually pays Discover® Cardmembers and Private Issue® Cardmembers electing this feature a percentage of their purchase amounts. Commencing March 1, 1998, the terms of the Private Issue Cashback Bonus were amended by limiting the maximum bonus amount to $500 and by increasing the amount of purchases required to receive this bonus amount. The Company believes that its Cardmember rewards expense in future periods will not be materially impacted by these changes. Professional services expense increased 50% and 38%, primarily due to increased costs associated with account collections and consulting fees. Other expenses decreased 9% and 14% due to a continuing decrease in fraud losses.

Liquidity and Capital Resources

The Company's total assets increased from $302.3 billion at November 30, 1997 to $380.7 billion at May 31, 1998, reflecting growth in financial instruments owned, resale agreements and securities borrowed, partially attributable to higher volumes in the global securities markets, as well as additional assets recognized due to the adoption of Statement of Financial Accounting Standards No. 127. A substantial portion of the Company's total assets consists of highly liquid marketable securities and short-term receivables arising principally from securities transactions. The highly liquid nature of these assets provides the Company with flexibility in financing and managing its business.

The Company's senior management establishes the overall funding and capital policies of the Company, reviews the Company's performance relative to these policies, monitors the availability of sources of financing, reviews the foreign exchange risk of the Company and oversees the liquidity and interest rate sensitivity of the Company's asset and liability position. The primary goal of the Company's funding and liquidity activities is to ensure adequate financing over a wide range of potential credit ratings and market environments.

The Company views return on equity to be an important measure of its performance, both in the context of the particular business environment in which the Company is operating and its peer group's results. In this regard, the Company actively manages its consolidated capital position based upon, among other things, business opportunities, capital availability and rates of return together with internal capital policies, regulatory requirements and rating agency guidelines and therefore may, in the future, expand or contract its capital base to address the changing needs of its businesses. The Company returns internally generated equity capital which is in excess of the needs of its businesses to its shareholders through common stock repurchases and dividends.

The Company funds its balance sheet on a global basis. The Company's funding for its Securities and Asset Management business is raised through diverse sources. These include the Company's capital, including equity and long-term debt; repurchase agreements; U.S., Canadian, Euro, French and Japanese commercial paper; letters of credit; unsecured bond borrows; German Schuldschein loans; securities lending; buy/sell agreements; municipal re-investments; master notes; and committed and uncommitted lines of credit. Repurchase transactions, securities lending and a portion of the Company's bank borrowings are made on a collateralized basis and therefore provide a more stable source of funding than short-term unsecured borrowings.

The funding sources utilized for the Company's Credit and Transaction Services business include the Company's capital, including equity and long-term debt; asset securitizations; commercial paper; deposits; asset-backed commercial paper; Fed Funds; and short-term bank notes. The Company sells consumer loans through asset securitizations using several transaction structures. Riverwoods Funding Corporation ("RFC"), an entity included in the condensed consolidated financial statements of the Company, issues asset-backed commercial paper.

The Company's bank subsidiaries solicit deposits from consumers, purchase federal funds and issue short-term bank notes. Interest bearing deposits are classified by type as savings, brokered and other time deposits. Savings deposits consist primarily of money market deposits and certificate of deposit accounts sold directly to cardmembers and savings deposits from individual securities clients. Brokered deposits consist primarily of certificates of deposits issued by the Company's bank subsidiaries. Other time deposits include institutional certificates of deposits. The Company, through Greenwood Trust Company, an indirect subsidiary of the Company, sells notes under a short-term bank note program.

The Company maintains borrowing relationships with a broad range of banks, financial institutions, counterparties and others from which it draws funds in a variety of currencies. The volume of the Company's borrowings generally fluctuates in response to changes in the amount of repurchase transactions outstanding, the level of the Company's securities inventories and consumer loans receivable, and overall market conditions. Availability and cost of financing to the Company can vary depending upon market conditions, the volume of certain trading activities, the Company's credit ratings and the overall availability of credit.

The Company's reliance on external sources to finance a significant portion of its day-to-day operations makes access to global sources of financing important. The cost and availability of unsecured financing generally are dependent on the Company's short-term and long-term debt ratings. In addition, the Company's debt ratings have a significant impact on certain trading revenues, particularly in those businesses where longer term counterparty performance is critical, such as over-the-counter derivative transactions.

As of June 30, 1998, the Company's credit ratings were as follows:

	Commercial Paper	Senior Debt
Dominion Bond Rating Service Limited	R-1 (middle)	n/a
Duff & Phelps Credit Rating Co.	D-1+	AA-
Fitch IBCA Inc.	F1+	AA-
Japan Rating & Investment Information, Inc.	A-1+	AA-
Moody's Investors Service(1)	P-1	A1
Standard & Poor's	A-1	A+
Thomson BankWatch, Inc.	TBW-1	AA

(1) On June 5, 1998, Moody's Investors Service announced that it had placed the Company's senior debt credit rating on review for possible upgrade.

As the Company continues its global expansion and as revenues are increasingly derived from various currencies, foreign currency management is a key element of the Company's financial policies. The Company benefits from operating in several different currencies because weakness in any particular currency is often offset by strength in another currency. The Company closely monitors its exposure to fluctuations in currencies and, where cost-justified, adopts strategies to reduce the impact of these fluctuations on the Company's financial performance. These strategies include engaging in various hedging activities to manage income and cash flows denominated in foreign currencies and using foreign currency borrowings, when appropriate, to finance investments outside the U.S.

During the six month period ended May 31, 1998, the Company issued senior notes aggregating $7,931 million, including non-U.S. dollar currency notes aggregating $778 million, primarily pursuant to its public debt shelf registration statements. These notes have maturities from 1998 to 2024 and a weighted average coupon interest rate of 5.6% at May 31, 1998; the Company has entered into certain transactions to obtain floating interest rates based primarily on short-term LIBOR trading levels. At May 31, 1998, the aggregate outstanding principal amount of the Company's Senior Indebtedness (as defined in the Company's public debt shelf registration statements) was approximately $45.0 billion.

On February 12, 1998, the Company's Board of Directors authorized the Company to purchase, subject to market conditions and certain other factors, up to $3 billion of the Company's common stock. During the six month period ended May 31, 1998 the Company purchased $1,487 million of its common stock. Subsequent to May 31, 1998 and through June 30, 1998, the Company purchased an additional $204 million of its common stock.

On February 25, 1998, the Company's shelf registration statement for an additional $8 billion of debt securities, warrants, preferred stock or purchase contracts or any combination thereof in the form of units, became effective.

On March 5, 1998, MSDW Capital Trust I, a Delaware statutory business trust (the "Capital Trust"), all of the common securities of which are owned by the Company, issued $400 million of 7.10% Capital Securities (the "Capital Securities") that are guaranteed by the Company. The Capital Trust issued the Capital Securities and invested the proceeds in 7.10% Junior Subordinated Deferrable Interest Debentures issued by the Company, which are due February 28, 2038.

The Company maintains a senior revolving credit agreement with a group of banks to support general liquidity needs, including the issuance of commercial paper (the "MSDW Facility"). Under the terms of the MSDW Facility, the banks are committed to provide up to $6.0 billion. The MSDW Facility contains restrictive covenants which require, among other things, that the Company maintain shareholders' equity of at least $8.3 billion at all times. The Company believes that the covenant restrictions will not impair the Company's ability to pay its current level of dividends. At May 31, 1998, no borrowings were outstanding under the MSDW Facility.

The Company maintains a master collateral facility that enables Morgan Stanley & Co. Incorporated ("MS&Co."), one of the Company's U.S. broker-dealer subsidiaries, to pledge certain collateral to secure loan arrangements, letters of credit and other financial accommodations (the "MS&Co. Facility"). As part of the MS&Co. Facility, MS&Co. also maintains a secured committed credit agreement with a group of banks that are parties to the master collateral facility under which such banks are committed to provide up to $1.875 billion. At May 31, 1998, no borrowings were outstanding under the MS&Co. Facility.

The Company also maintains a revolving committed financing facility that enables Morgan Stanley & Co. International Limited ("MSIL"), the Company's U.K. broker-dealer subsidiary, to secure committed funding from a syndicate of banks by providing a broad range of collateral under repurchase agreements (the "MSIL Facility"). Such banks are committed to provide up to an aggregate of $1.85 billion available in 12 major currencies. At May 31, 1998, no borrowings were outstanding under the MSIL Facility.

RFC also maintains a $2.55 billion senior bank credit facility which supports the issuance of asset-backed commercial paper. RFC has never borrowed from its senior bank credit facility.

The Company anticipates that it will utilize the MSDW Facility, the MS&Co. Facility or the MSIL Facility for short-term funding from time to time.

At May 31, 1998, certain assets of the Company, such as real property, equipment and leasehold improvements of $1.8 billion, and goodwill and other intangible assets of $1.4 billion, were illiquid. In addition, certain equity investments made in connection with the Company's private equity and other principal investment activities, high-yield debt securities, emerging market debt, certain collateralized mortgage obligations and mortgage-related loan products, bridge financings, and certain senior secured loans and positions are not highly liquid.

In connection with its private equity and other principal investment activities, the Company has equity investments (directly or indirectly through funds managed by the Company) in privately and publicly held companies. At May 31, 1998, the aggregate carrying value of the Company's equity investments in privately held companies (including direct investments and partnership interests) was $170 million, and its aggregate investment in publicly held companies was $262 million.

In addition, at May 31, 1998, the aggregate value of high-yield debt securities and emerging market loans and securitized instruments held in inventory was $1,820 million (a substantial portion of which was subordinated debt) with not more than 6%, 15% and 8% of all such securities, loans and instruments attributable to any one issuer, industry or

geographic region, respectively. Non-investment grade securities generally involve greater risk than investment grade securities due to the lower credit ratings of the issuers, which typically have relatively high levels of indebtedness and are, therefore, more sensitive to adverse economic conditions. In addition, the market for non-investment grade securities and emerging market loans and securitized instruments has been, and may in the future be, characterized by periods of volatility and illiquidity. The Company has credit and other risk policies and procedures to control total inventory positions and risk concentrations for non-investment grade securities and emerging market loans and securitized instruments.

The Company acts as an underwriter of and as a market-maker in mortgage-backed pass-through securities, collateralized mortgage obligations and related instruments, and as a market-maker in commercial, residential and real estate loan products. In this capacity, the Company takes positions in market segments where liquidity can vary greatly from time to time. The carrying value of the portion of the Company's mortgage-related portfolio at May 31, 1998 traded in markets that the Company believed were experiencing lower levels of liquidity than traditional mortgage-backed pass-through securities approximated $2,727 million.

The Company may, from time to time, also provide financing or financing commitments to companies in connection with its investment banking and private equity activities. The Company may provide extensions of credit to leveraged companies in the form of senior or subordinated debt, as well as bridge financing on a selective basis (which may be in connection with the Company's commitment to the Morgan Stanley Bridge Fund, LLC). At May 31, 1998, the Company had six commitments to provide an aggregate of $1,025 million primarily in connection with its high-yield underwriting activities. Subsequent to May 31, 1998, the Company had one loan outstanding in the amount of $93 million, and its aggregate commitments decreased to $15 million.

The Company also engages in senior lending activities, including origination, syndication and trading of senior secured loans of non-investment grade companies. Such companies are more sensitive to adverse economic conditions than investment grade issuers, but the loans are generally made on a secured basis and are senior to any non-investment grade securities of these issuers that trade in the capital markets. At May 31, 1998, the aggregate value of senior secured loans and positions held by the Company was $1,428 million, and aggregate senior secured loan commitments were $761 million.

At May 31, 1998, financial instruments owned by the Company included derivative products (generally in the form of futures, forwards, swaps, caps, collars, floors, swap options and similar instruments which derive their value from underlying interest rates, foreign exchange rates or commodity or equity instruments and indices) related to financial instruments and commodities with an aggregate net replacement cost of $21.2 billion. The net replacement cost of all derivative products in a gain position represents the Company's maximum exposure to derivatives related credit risk. Derivative products may have both on- and off-balance sheet risk implications, depending on the nature of the contract. It should be noted, however, that in many cases derivatives serve to reduce, rather than increase, the Company's exposure to losses from market, credit and other risks. The risks associated with the Company's derivative activities, including market and credit risks, are managed on an integrated basis with associated cash instruments in a manner consistent with the Company's overall risk management policies and procedures. The Company manages its credit exposure to derivative products through various means, which include reviewing counterparty financial soundness periodically; entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances; and limiting the duration of exposure.

Year 2000 and EMU

Many of the world's computer systems currently record years in a two-digit format. Such computer systems will be unable to properly interpret dates beyond the year 1999, which could lead to business disruptions in the U.S. and internationally (the "Year 2000" issue).

The Company continues to review its computer systems and programs in order to prepare for Year 2000 compliance. Based upon current information, the Company believes that its Year 2000 expenditures for fiscal 1998 and through the project's completion will be approximately $125 million. Costs incurred relating to this project are being expensed by the Company during the period in which they are incurred. The Company's expectations about future costs associated with the Year 2000 issue are subject to uncertainties that could cause actual results to differ materially from

what has been discussed above. Factors that could influence the amount and timing of future costs include the success of the Company in identifying systems and programs that contain two-digit year codes, the nature and amount of programming and testing required to upgrade or replace each of the affected programs, the nature and amount of testing, verification and reporting required by the Company's regulators around the world, including securities exchanges, central banks and various govermental regulatory bodies, the rate and magnitude of related labor and consulting costs, and the success of the Company's external counterparties and suppliers, as well as worldwide exchanges, clearing organizations and depositaries, in addressing the Year 2000 issue.

Modifications to the Company's computer systems and programs are also being made in order to prepare for the upcoming EMU. The EMU, which will ultimately result in the replacement of certain European currencies with the "Euro," will primarily impact the Company's Securities and Asset Management business. Costs associated with the modifications necessary to prepare for the EMU are also being expensed by the Company during the period in which they are incurred.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings.

The following developments have occurred with respect to certain matters previously reported in the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 1997 and/or the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended February 28, 1998.

Term Trust Class Actions. On June 1, 1998, the plaintiff's motion to certify the class was granted as to a California statewide class and denied as to a nationwide class.

Global Opportunity Fund Litigation. On April 1, 1998, Morgan Stanley & Co. International Limited ("MSIL") filed a notice of removal of the action brought by The Growth Fund to the United States District Court for the Southern District of New York. On May 6, 1998, plaintiffs moved to remand the action to state court.

County of Orange and Moorlach v. Morgan Stanley & Co., Inc. Morgan Stanley & Co. Incorporated ("Morgan Stanley") supported a motion that was filed by Merrill Lynch seeking partial summary judgment as to the *ultra vires* claims that were asserted by Orange County in its action against Merrill Lynch. That motion has now become moot due to the County's settlement with Merrill Lynch, which was announced on June 2, 1998. The County's action against Morgan Stanley is proceeding.

Litigation Regarding Merger. On April 9, 1998, the Court so ordered a stipulation dismissing the action.

In re Merrill Lynch, et al. Securities Litigation. On April 30, 1998, a petition for certiorari in the United States Supreme Court was filed by the defendants. On June 12, 1998, the plaintiffs filed a motion for permission to file an amended complaint to extend the class period end from November 4, 1994 to August 28, 1996 and to name new class representatives.

Item 4. Submission of Matters to a Vote of Security Holders.

The annual meeting of stockholders of the Company was held on March 24, 1998.

The stockholders voted on proposals to (1) elect directors, (2) amend the Company's Certificate of Incorporation to change the Company's name to Morgan Stanley Dean Witter & Co. and (3) ratify the appointment of Deloitte & Touche LLP as independent auditors. The vote of the stockholders resulted in the approval of the amendment to the Certificate of Incorporation and the ratification of the appointment of the independent auditors. In addition, all nominees for election to the board were elected to the terms of office set forth in the Proxy Statement dated February 20, 1998. The number of votes cast for, against or withheld, and the number of abstentions and broker non-votes with respect to each proposal, is set forth below.

	For	Against/ Withheld	Abstain	Broker Non-vote
Election of Directors:				
Nominee:				
Robert P. Bauman	526,648,558	5,137,430	*	*
Edward A. Brennan	523,283,248	8,502,740	*	*
Diana D. Brooks	526,389,859	5,496,129	*	*
Clarence B. Rogers, Jr.	526,272,599	5,513,389	*	*
Approval of the Amendment to the Certificate of Incorporation to change the Company's Name:	528,546,698	1,986,423	1,235,165	*
Ratification of Independent Auditors:	529,449,108	1,104,859	1,231,751	*

* Not Applicable.

Item 5. Other Information

Pursuant to the Company's By-Laws, stockholder proposals submitted outside the processes of Securities and Exchange Commission Proxy Rule 14a-8 (17 CFR Section 240.14a-8) intended to be presented at the Company's 1999 annual meeting of stockholders shall be considered timely if they are delivered to the Secretary of the Company, 1585 Broadway, New York, New York 10036 on or after November 24, 1998 and on or before December 24, 1998.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

An exhibit index has been filed as part of this Report on Page E-1.

(b) Reports on Form 8-K

Form 8-K dated March 26, 1998 reporting Items 5 and 7.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MORGAN STANLEY DEAN WITTER & CO.
(Registrant)

/S/ EILEEN K. MURRAY

By: ____________________

Eileen K. Murray, Controller and
Principal Accounting Officer

Date: July 14, 1998

EXHIBIT INDEX

MORGAN STANLEY DEAN WITTER & CO.

Quarter Ended May 31, 1998

	Description
10.1	Tax Deferred Equity Participation Plan, Amended and Restated as of June 26, 1998.
10.2	Amendment to Dean Witter START Plan (Saving Today Affords Retirement Tomorrow) (effective May 31, 1997).
10.3	Amendment to Dean Witter START Plan (Saving Today Affords Retirement Tomorrow) (adopted April 14, 1998).
11	Computation of earnings per share.
12	Computation of ratio of earnings to fixed charges.
15.1	Letter of awareness from Deloitte & Touche LLP, dated July 14, 1998, concerning unaudited interim financial information.
15.2	Letter of awareness from Ernst & Young LLP, dated July 14, 1998, concerning unaudited interim financial information.
27	Financial Data Schedule.