Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

Frontier Markets Equity Fund

ACTIVE FUNDAMENTAL EQUITY | EMERGING MARKETS TEAM | MONTHLY COMMENTARY | 30 NOVEMBER 2018

Performance Review

In the one month period ending 30 November 2018, the Fund's Z shares returned 2.82% (net of fees)[1], while the benchmark returned 2.17%.

Our stock selection in Kuwait and Vietnam were top contributors to performance. Our allocation to Panama and stock selection in Bangladesh also contributed. Our underweight allocation to Bahrain also added to performance. Our allocation to the United Arab Emirates and stock selection in Argentina and Nigeria detracted from returns. From a sector perspective, our stock selection in consumer staples and consumer discretionary added to returns, while our stock selection in financials and real estate hampered returns.

Market Review

The MSCI Frontier Markets Index (2.17%) underperformed the MSCI Emerging Markets (EM) Index (4.12%) during the month. Estonia (+16.93%), Argentina (+5.62%), Slovenia (+3.99%) and Morocco (+3.99%) led market returns. Pakistan (-5.46%), the U.A.E. (-5.34%), Jordan (-4.40%) and Tunisia (-4.03%) underperformed the region.

Portfolio Activity

During the month we increased our weight to Nigeria as we see the economy further improving in 2019. At the beginning of November, a tripartite of Nigerian trade unions, senior government officials and corporates agreed to a new minimum wage proposal from 18,000 naira to 30,000 naira. There has not been an increase in the minimum wage for many years, and with double-digit inflation, real wages have declined. An increase in wages is necessary to help stimulate consumer demand, which has remained weak even as higher oil prices have boosted foreign exchange reserves and reined in the fiscal deficit.

Strategy and Outlook

We remain positive on the opportunity in frontier as demographics continue to be more favorable relative to EM and the developed world, frontier markets are less leveraged than EM and are less exposed to technology and China. The current account for frontier in aggregate has improved and real rates are now positive. In addition, historically frontier has offered better risk-adjusted returns than EM. The gross domestic product (GDP) growth differential and equity index performance differential for frontier markets versus emerging markets has improved from 2013-2015. Since 2016, these differentials have leveled as frontier currencies needed to devalue and GDP growth decelerated. Now, growth is picking up in the region and we expect it to be around 4% in aggregate in 2019-2020, driven by Kuwait, Morocco, Nigeria, the U.A.E. and Saudi Arabia.

From a bottom-up perspective, frontier corporates are growing top-line faster with better returns than those in emerging markets. Frontier corporates are seeing higher sales growth and return on equity, and corporate debt to EBITDA (earnings before interest, taxes, depreciation and amortization) are at lower levels than EM and developed markets.

We continuously assess the growth levers providing tailwinds to frontier economies such as strong demographics with labor force growth sufficient for high GDP growth, an underpenetrated credit cycle, a relatively low level of private debt to GDP and healthy domestic demand. Many of the frontier markets are recovering off a low in GDP growth and experienced significant resets in the economy, including markets like Nigeria and select markets across the Middle East.

From a thematic perspective, we continue to own and seek companies benefiting from healthy domestic demand, particularly regarding health care, and select consumer discretionary and staples. We also see demand for financial services in countries with low credit penetration. We are seeking to minimize our exposure to countries highly dependent on trade as protectionism is increasingly part of the platform on new populist leaders.

1 Source: Morgan Stanley Investment Management Limited. Data as of 30 November 2018.

We are beginning to turn positive on **Argentina** as we believe dynamics between the currency depreciation and its effect on the trade balance, inflation and growth will be relatively limited on the downside from here. The new monetary policy regime and higher interest rates are having the desired effect on inflation, which peaked in September at 6% month-over-month and has steadily declined to around 3%. The central bank placed very high cash reserve requirements on the banking system and the trade balance is back in surplus with the fiscal deficit steadily reducing. With Argentina's external liabilities reduced, assets should be relatively more insulated from a risk-off external event. Growth is likely to bottom in the first or second quarter of next year as better wheat and soy harvests and wage increases should help to offset the impact of high interest rates. Politics remain front and center ahead of the 2019 elections and the potential of former President Cristina Fernandez de Kirchner running against Macri is contributing to headline risk.

We have become a bit more cautious on the **Middle East** in the near term. In the **U.A.E.**, we worry about an overhang in the property markets of both Dubai and Abu Dhabi, driven by excessive supply and what we see as fairly weak demand for property. In **Saudi Arabia** the outlook has been clouded slightly due to the unfortunate events in Istanbul and the geopolitical implications, including the risk of sanctions. Nonetheless, we believe the events will lead to more centralized decision-making in the country, as well as a potential de-escalation of the war in Yemen and the more normalized relations with Qatar, which we view as positives. Additionally, Saudi authorities are more likely to increase government spending domestically in the near term to stimulate the economy.

Pakistan continues to suffer from twin deficits, with the current account deficit reaching its highest level since the Global Financial Crisis. Though the currency has devalued, it falls in the higher range compared to other frontier markets. The currency may have another round of devaluation before a possible International Monetary Fund (IMF) program, which is now being questioned given Prime Minister Imran Khan's more populist agenda since taking office in August. The latest finance bill does not place appropriate austerity measures at a high priority, which could place the IMF package at risk and lengthen the economic reform required in the country.

We remain underweight **Kenya** as the macro outlook continues to weaken. Kenya suffers from twin deficits and its growth is fiscal-led, which we believe cannot be funded further. The Kenyan macro situation, from a consumer, private sector and banking perspective, remains under pressure. Second quarter GDP growth came in higher than estimates, but this was largely due to a weak year in 2017. The latest finance bill did not remove the rate cap law, which limits interest charged on a loan to a maximum of 4% above the central bank's policy rates. Industry loan growth is likely to remain subdued. The Kenyan shilling screens expensive according to our analysis and is the third most expensive frontier market currency.

We believe **Vietnam** growth, though revised higher this year, is at a peak and improvement at the margin seems unlikely as growth is set to mildly slow while inflation is set to increase. Foreign direct investment has been strong especially in the tech sector, and an improving fiscal balance has led to lower public debt. However, investor sentiment is at a high given all the positives and the market is trading expensive even relative to its historical premium against frontier markets. Vietnam has increasingly become linked to the global supply chain and has become a high-beta play on U.S. capex growth, which is likely to begin deceleration. The liquidity environment is likely to tighten because of slowing exports, emerging markets risk aversion affecting portfolio flows, and lower credit growth targets by the central bank.

For further information, please contact your Morgan Stanley Investment Management representative.

FUND FACTS

Launch date	Base currency	Index
28 March 2013	U.S. dollars	MSCI Frontier Markets Index

12 Month Performance Periods to Latest Month End (%)

	NOVEMBER '17 - NOVEMBER '18	NOVEMBER '16 - NOVEMBER '17	NOVEMBER '15 - NOVEMBER '16	NOVEMBER '14 - NOVEMBER '15	NOVEMBER '13 - NOVEMBER '14
MS INVF Frontier Markets Equity Fund - Z Shares	-18.56	21.18	3.04	-14.50	11.97
MSCI Frontier Markets Index	-11.20	31.34	-0.35	-17.65	13.75

Past performance is not a reliable indicator of future results. Returns may increase or decrease as a result of currency fluctuations. All performance data is calculated NAV to NAV, net of fees, and does not take account of commissions and costs incurred on the issue and redemption of units. The sources for all performance and Index data is Morgan Stanley Investment Management. **Please visit our website www.morganstanley.com/im to see the latest performance returns for the fund's other share classes.**

Share Class Z Risk and Reward Profile

Lower Risk						Higher Risk
1	2	3	4	**5**	6	7
Potentially Lower Rewards						Potentially Higher Rewards

The risk and reward category shown is based on historic data.

- Historic figures are only a guide and may not be a reliable indicator of what may happen in the future.
- As such this category may change in the future.
- The higher the category, the greater the potential reward, but also the greater the risk of losing the investment. Category 1 does not indicate a risk free investment.
- The fund is in this category because it invests in shares of companies from frontier emerging markets and the fund's simulated and/or realised return has experienced high rises and falls historically.
- The fund may be impacted by movements in the exchange rates between the fund's currency and the currencies of the fund's investments.

This rating does not take into account other risk factors which should be considered before investing, these include:

- The fund relies on other parties to fulfill certain services, investments or transactions. If these parties become insolvent, it may expose the fund to financial loss.
- There may be an insufficient number of buyers or sellers which may affect the funds ability to buy or sell securities.
- There are increased risks of investing in frontier emerging markets as political, legal and operational systems may be less developed than in developed markets.
- Past performance is not a reliable indicator of future results. Returns may increase or decrease as a result of currency fluctuations. The value of investments and the income from them can go down as well as up and investors may lose all or a substantial portion of his or her investment.
- The value of the investments and the income from them will vary and there can be no assurance that the Fund will achieve its investment objectives.
- Investments may be in a variety of currencies and therefore changes in rates of exchange between currencies may cause the value of investments to decrease or increase. Furthermore, the value of investments may be adversely affected by fluctuations in exchange rates between the investor's reference currency and the base currency of the investments.

Please refer to the Prospectus for full risk disclosures. All data as of 30 November 2018 and subject to change daily.

INDEX INFORMATION

The **MSCI Frontier Index** is not a perfect benchmark as the Morgan Stanley fund's investment opportunity set incorporates different countries than this index; the MSCI Emerging Markets Index is shown as a guide to movements in the overall emerging markets.The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. The MSCI Frontier Markets Index represents those markets that tend to be relatively small and illiquid even by emerging market standards.Indexes are unmanaged and should not be considered an investment. It is not possible to invest directly in an index. Indexes do not include any expenses, fees or sales charges, which would lower performance.

The **MSCI Emerging Markets Index (MSCI EM)** is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging markets.

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