

Kristian Heugh

Morgan Stanley's star manager tells Nicole Piper why he thinks – and drinks – like Warren Buffett and explains the benefits of investing beyond the US

NICOLE PIPER

It's good enough for Warren Buffett, it's good enough for me.

As a rule to live by for a portfolio manager, this is not a bad one. And it is one that Kristian Heugh adhered to long before he began his career as a professional investor.

The Morgan Stanley fund manager, who has held a Citywire AAA-rating for every month since April 2019, claims that he and the Sage of Omaha both bought into Coca Cola at the same time. The key difference being that Heugh was only 10 years old.

Growing up, Heugh learned about investing by watching CNBC with his grandfather, who wanted to finesse his pension investments from a career as an educator in public schools. Heugh says he viewed the markets like a big puzzle, and in 1988, he gathered his allowance money and made his first big investment: five shares in Coca Cola.

'In the next four years, it went up about 400%. I was 10, and I thought that the more

Coca Cola I drank, the more profit they would have, so I got addicted to investing and I got addicted to Coca Cola, unfortunately,' he says.

And like Buffett, he is still partial to a can or two. 'If five Cherry Cokes a day are good enough for Warren Buffet, I think maybe if I have three or four Cherry Coke Zeros, I'll be okay,' he jokes.

DRINKING TO SUCCESS

While Heugh has since learned that his affinity for a product shouldn't dictate his due diligence, he maintains the same passion he had when he made his first investment.

'It's still a puzzle to solve, and that's what makes it so interesting, exciting and motivating,' he says. '[I view markets] just like when I was a kid looking at CNBC and those tickers going across – although hopefully it's a little bit more sophisticated and systematic in how we're trying to add value,' he jokes.

Heugh lives in Hong Kong full time, which

he views as the perfect place for a global equity manager to build a base. He moved there in 2008, seven years after joining Morgan Stanley.

'It was only going to be for two years, but I've really enjoyed the experience out there. Sixty percent of the world's population is in Asia, it's where the fastest economic growth is happening, there's a lot of innovation,' he says.

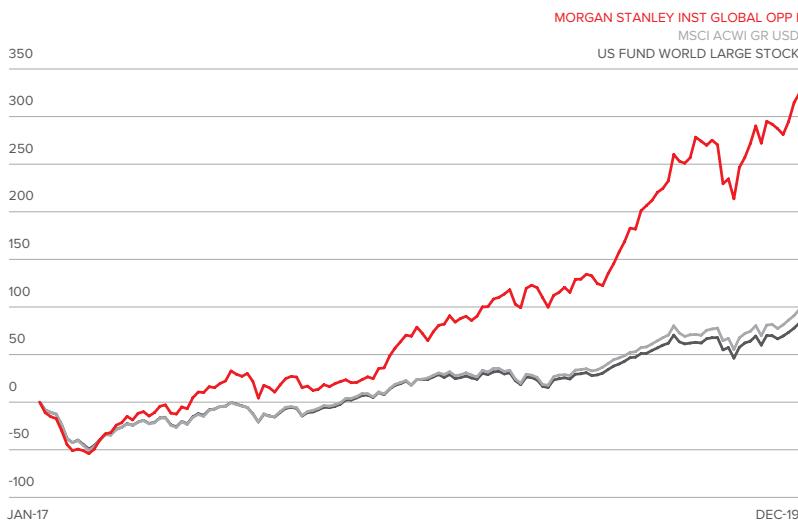
He joined Morgan Stanley Investment Management's (MSIM) multi-cap growth team in 2001, having graduated from Duke University that year. He has been with the firm ever since and spent time covering communication equipment and Asian technology in its central research team, before joining MSIM's Counterpoint Global group in 2006. The 26-member equity investment team is led by star manager Dennis Lynch, Heugh's mentor, who also runs the \$7.4bn Morgan Stanley Institutional Growth fund.



IT'S WARREN BUFFET INVESTMENT PRINCIPLES APPLIED TO GROWING COMPANIES GLOBALLY

HEUGH'S FLAGSHIP FUND IS WELL AHEAD OF ITS PEERS AND BENCHMARK SINCE INCEPTION

DATA TO DECEMBER 31, 2019 / SOURCE: MORNINGSTAR



Heugh quickly found he had a natural passion for analyzing global stocks, enjoying the due diligence involved in evaluating companies beyond his doorstep.

'I was covering Asian technology companies anyway when I was in the central research group – I naturally had a proclivity towards finding ideas that weren't US-centric,' he says.

THE FAVORITE

Heugh has been the sole manager of what he views as his Global Opportunity team's flagship fund, the \$3.9bn Morgan Stanley Institutional Fund Global Opportunity Portfolio, since its inception in 2008. He reluctantly admits that it holds a special place in his heart.

'It's where about three quarters of our assets are, but all of your children are your

favorite,' Heugh says of the fund.

The fund invests in global companies that have been deemed by Heugh and his team to be undervalued with strong potential for growth.

As of December 31, 2019, the fund's heaviest sector allocations were in information technology, at 31.6%, and consumer discretionary, at 26.9%. These allocations far outweighed the benchmark, the MSCI All World Country index, which allocated 17.2% to information technology and 10.8% to consumer discretionary.

Heugh and the wider Counterpoint Global team don't take sector allocation into account when vetting funds, so these allocations happen more by virtue of the stocks they contain.

'When we do some very rudimentary screens in the market for quality, we see some sectors show up more often than others,' he says. 'Those are the sectors that typically have the highest growth rates and the highest returns on capital.'

Geographically, the fund has more than

50% of its assets in North America, a little less than the index, which had 58.6% of its assets in North America at the end of last year.

The fund's three top holdings at the end of December were MasterCard, with a 7.2% allocation, TAL Education Group, with a 7.1% allocation, and Amazon, with a 6.0% allocation. Heugh and his team have had Amazon in the fund since the strategy's launch. Other Counterpoint Global funds have owned it since 2003.

'The thesis on Amazon has been that they have very high returns on capital, very low penetration level and a tremendous culture of innovation, which can sometimes lead to unexpected successes,' he says.

He says the company still has room to grow if it taps into the online retail market, which is only about 10% penetrated. Although Amazon is a US company, Heugh touts the benefits of having a global portfolio.

'To understand what's going on in one part of the world, you really have to understand what's happening in all parts of the world. The US is a wonderful country, a very exciting place, but the world is much larger than just the United States. And even to understand the prospects of the American companies, we have to look at the companies that are doing business all around the world,' he says.

FOLLOWING THE STARS

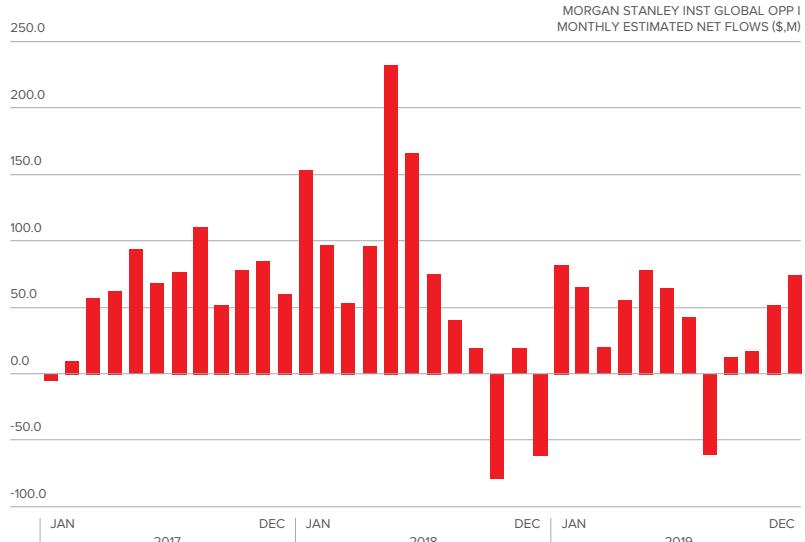
In October 2019, Morgan Stanley filed with the Securities and Exchange Commission to launch a new fund for Heugh: the Morgan Stanley Institutional Fund Developing Opportunity Portfolio, which will invest in emerging or developing market stocks. The fund launched on February 14, 2020, and, as of the end of the year, its top three holdings were HDFC Bank, with 8.7%, TAL Education Group, with 8.5%, and Taiwan Semiconductor Mfg Co, with 6.6%.

Heugh says the new fund has been designed to tap into emerging markets, which only represent about 11% of the MSCI All Country World index.

'That's part of why we're launching the

HEUGH'S FUND HAS WON INFLOWS IN ALL BUT FOUR MONTHS IN THE LAST THREE YEARS

DATA TO DECEMBER 31, 2019 / SOURCE: MORNINGSTAR



Developing Opportunity strategy, because there is a lot of potential in these markets. There's a lot of interesting companies that haven't really been discovered by the rest of the market,' he says. 'When you don't have a very competitive environment, because these companies are not reflected in the index anywhere near to what the GDP contribution is, it provides a very fertile ground to find stocks that are very mispriced.'

Like most of the funds Heugh manages, the Developing Opportunity Portfolio applies an investment philosophy inspired by the Coca Cola-loving magnate Heugh so admires.

'In my own words, it would be Warren Buffet investment principles applied to growing companies globally,' he says of his investment philosophy.

For those unfamiliar with Buffett's approach to investing, Heugh offers a more by-the-book take: 'We believe that value-added investment results can be derived from owning high-quality

companies purchased at a large discount to intrinsic value.'

But the Berkshire Hathaway chairman hasn't been Heugh's only hero. He cites Peter Lynch, who managed the Fidelity Magellan fund between 1977 and 1990, as another industry idol. According to Heugh, Lynch's books *One Up on Wall Street* and *Beating the Street* were critical to his financial education, and when asked how macroeconomic and geopolitical factors affect his investment process, he paraphrases the iconic investor: "If on January 1, I spend 12 minutes on macro for the entire year, I've wasted 10 minutes." We pay almost no attention to interest rates and macroeconomic oscillations,' he says.

The foundation of Heugh's investment approach is in stock-specific factors, and while certain sectors have boosted his funds – tech services stocks have done well, he says – his funds have not owned much healthcare stock, which has hurt them.

'We had some positives, we had some negatives, but the vast majority of outperformance since inception has been due to stock-specific factors, which is what we would expect, given that we are taking very stock-specific risk,' he says.

'We really want our companies to be able to control their own destiny.'

WE PAY ALMOST NO ATTENTION TO INTEREST RATES AND MACROECONOMIC OSCILLATIONS

RISK CONSIDERATIONS

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Accordingly, you can lose money investing in this portfolio. Please be aware that this portfolio may be subject to certain additional risks. In general, **equities securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, market and liquidity risks. The risks of investing in **emerging market countries** are greater than risks associated with investments in foreign developed countries. To the extent that the Fund invests in a limited number of issuers (**focused investing**), the Fund will be more susceptible to negative events affecting those issuers and a decline in the value of a particular instrument may cause the Fund's overall value to decline to a greater degree than if the Fund were invested more widely. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). **Derivative instruments** may disproportionately increase losses and have a significant impact on performance. They also may be subject to counterparty, liquidity, valuation, correlation and market risks. **Privately placed and restricted securities** may be subject to resale restrictions as well as a lack of publicly available information, which will increase their illiquidity and could adversely affect the ability to value and sell them (liquidity risk).

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The article is being provided by Morgan Stanley Investment Management to highlight recent press concerning Kristian Heugh of the Counterpoint Global Team and its Portfolios. This is not an offer or a solicitation of an offer for any of the other funds mentioned in the article.

Please note the reprint was altered from its original form.

Morgan Stanley Institutional Fund Global Opportunity Portfolio – Class I Shares

Top Ten Holdings (% of Total Net Assets)	Fund	Index
Amazon.com Inc	6.96	2.07
MasterCard Inc	6.43	0.55
TAL Education Group	6.24	0.05
ServiceNow Inc	4.98	0.14
Uber Technologies Inc	4.81	0.03
Alphabet Inc	4.45	1.78
Visa Inc	4.07	0.69
Adobe Inc	4.05	0.39
DSV Panalpina A/S	4.05	0.05
Facebook Inc	3.85	1.01
Sector Allocation (% of Total Net Assets)	Fund	Index
Information Technology	33.25	18.84
Consumer Discretionary	27.63	10.83
Communication Service	13.72	9.31
Industrials	8.93	9.64
Health Care	3.30	13.25
Financials	3.20	14.45
Consumer Staples	2.64	8.82
Materials	0.96	4.40
Other	0.07	--
Cash	6.29	--

As of March 31, 2020. Subject to change daily and are provided for informational purposes only and should not be deemed as a recommendation to buy or sell the securities shown or securities within sectors shown above.

Average Annual Total Returns as of March 31, 2020 – Class I Shares	1 Year	3 Years	5 Years	10 Years	Since Inception (5/30/2008)
MGGIX	0.94	13.30	13.37	14.64	11.82
MSCI All Country World Index (%)	-11.26	1.50	2.85	5.88	3.25
Lipper Category Average (%)	-7.09	4.75	4.54	7.63	--
Morningstar Category Average (%)	-11.91	1.13	2.45	5.72	--

The minimum initial investment is \$5,000,000 for Class I shares. Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown. For the most recent month-end performance figures, please visit morganstanley.com/im or call 1-800-548-7786. Investment returns and principal value will fluctuate and fund shares, when redeemed, may be worth more or less than their original cost.

The gross expense ratio for the Global Opportunity Portfolio (Class I shares) is 0.95% and the net expense ratio is 0.95%. Where the net expense ratio is lower than the gross expense ratio, certain fees have been waived and/or expenses reimbursed. These waivers and/or reimbursements will continue for at least one year from the date of the applicable fund's current prospectus (unless otherwise noted in the applicable prospectus) or until such time as the fund's Board of Directors acts to discontinue all or a portion of such waivers and/or reimbursements. Absent such waivers and/or reimbursements, returns would have been lower. Expenses are based on the fund's current prospectus.

MSCI All World Country index is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and emerging markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends. The index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

Assets under management for Global Opportunity Portfolio are \$3.4 billion as of March 31, 2020.

Morgan Stanley Institutional Fund Developing Opportunity Portfolio – Class I Shares – Inception date: 2/14/2020

Top Ten Holdings (% of Total Net Assets)	Fund	Index
TAL Education Group	7.89	0.43
HDFC Bank Ltd	6.56	--
Foshan Haitian Flavouring	5.73	0.05
Meituan Dianping	5.47	0.26
Alibaba Group Holding Ltd	4.75	7.08
Taiwan Semiconductor Mfg Co. Ltd	4.59	4.68
Naver Corp	4.59	0.41
Tencent Holdings Ltd	4.43	5.89
GSX Techedu Inc	4.26	--
Trip.com Group Ltd	4.18	0.23

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The gross expense ratio for the Developing Opportunity Portfolio (Class I shares) is 1.62% and the net expense ratio is 1.15%. Where the net expense ratio is lower than the gross expense ratio, certain fees have been waived and/or expenses reimbursed. These waivers and/or reimbursements will continue for at least one year from the date of the applicable fund's current prospectus (unless otherwise noted in the applicable prospectus) or until such time as the fund's Board of Directors acts to discontinue all or a portion of such waivers and/or reimbursements. Absent such waivers and/or reimbursements, returns would have been lower. Expenses are based on the fund's current prospectus.

Assets under management for Developing Opportunity Portfolio are \$13.5 million as of April 17, 2020.

Please consider the investment objective, risks, charges and expenses of the Fund carefully before investing. The prospectus contains this and other information about the Fund. To obtain a prospectus, download one at morganstanley.com/im or call 1-800-548-7786. Please read the prospectus carefully before investing.

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