Morgan Stanley

INVESTMENT MANAGEMENT

Global Equity Observer

Access Active

INTERNATIONAL EQUITY TEAM | INVESTMENT INSIGHT | SEPTEMBER 2022

Falling markets, rising rates and inflation, pestilence, war, deglobalisation, drought, the energy crisis, acerbic politics and a less sanguine regulatory environment have our team glad of the benefits of our bottom-up stock picking approach. It affords cool heads and a clear focus where temperatures seem to be otherwise rising. The end of the summer in the Northern Hemisphere also heralds those "back to business" September winds; it therefore seems a good time to revisit our interpretation and the attractions of truly active investing.

AUTHORS

BRUNO PAULSON
Managing Director

LAURA BOTTEGA
Managing Director

What Active Management Means to Us

- **ACTIVE RESEARCH:** In addition to regular screens flagging companies with our preferred investment criteria, detailed initiation reports and models subject to the scrutiny of the whole team are supplemented with ESG (environmental, social and governance) risk analysis in our Material Risk Indicator reports.

- **ACTIVE DECISION-MAKING:** We interrogate the model and the investment thesis, cross-examining the proposal—not the proposer. We believe high quality decisions are more likely once any objections raised by others within the team are satisfied with research. Ultimately, even with diverse voices around the table, we are aligned behind the mission of identifying potential high quality compounders—companies with recurring revenues, sustainably high returns on operating capital, strong free cash flows, return of capital to shareholders, and all at reasonable valuations.

"Falling markets, rising rates and inflation, pestilence, war, deglobalisation, drought, the energy crisis, acerbic politics and a less sanguine regulatory environment have our team glad of the benefits of our bottom-up stock picking approach."

- **ACTIVE ENGAGEMENT:** Meeting with company management matters. That means thorough preparation and a pragmatic use of the chance to meet CEOs, CFOs and Chairs of some of the world's leading companies, and an opportunity to test the hypothesis, gauge integrity and understand management's strategy, incentives, capital allocation and commitment to returns on operating capital.

- **ACTIVE PORTFOLIO CONSTRUCTION:** This doesn't mean high churn. In fact, with disciplined research up front and a penchant for saying no when stocks do not make the grade, annual turnover should be minimised in the order of 20%-30%. High quality companies are rare; the portfolio should be as concentrated as conviction allows. In addition, our portfolios are designed to generate a particular asymmetric return profile, potentially capturing less upside in booms, but aiming to reduce downside participation in tough markets like those we are experiencing in 2022.

- **ACTIVE MONITORING:** We employ a centralised research repository, real-time data and news dashboards to stay current and share news of developing corporate events. Independent risk teams also offer a second line of defence beyond the investment team—also providing reporting as necessary on our high active share portfolios.

- **ACTIVE TEAM BUILDING:** With 10 portfolio managers and four research analysts, in addition to a team of portfolio specialists, the investment team is well resourced to focus on what matters and cover the universe of opportunity. We navigate between scientific enquiry and artistic licence, quantitative analysis and creative expression, learning from experience and being open-minded to new ideas—all to create a culture where team members imagine working here until they retire. Meanwhile, several team members are actively involved in recruitment to ensure we always have access to the best talent.

- **ACTIVE CLIENT SERVICE AND COMMUNICATION:** Our goal is world-class investment strategies matched by world-class communication with clients. Portfolio managers and portfolio specialists are available to update you with in-person meetings around the world and through a host of publications, webinars and events.

High quality is by its nature less exposed to potential adverse events. We cannot influence or even predict the macroeconomic or political or regulatory environment, but we can aim to ensure that the stocks we hold are the most robust we can find—and that the companies we select are under managements that are more likely anticipating, mitigating and managing resiliently through adversity. Active portfolio managers that own stocks for the long term rather than just rent them are used to filtering out short-term noise and data for relevant and material drivers of long-term return.

Meanwhile, regulators are getting active too, which will bring new challenges for companies. As governments around the world consider the impact of the changes of the last decade—technological, social and environmental—the threat of regulation has grown. Beyond this, we believe that markets have yet to fully reflect the phalanx of issues that will make the going tougher for companies from here on, and the fact that, longer term, all companies are likely to face greater structural cost pressures that may well pressure their earnings. As such, and as we have been signalling for some time, earnings resilience and pricing power are likely to become ever more significant assets. With our portfolios' primary skew to quality defensive sectors, it gives us some comfort going forward that the portfolios' earnings are likely to hold up better than the market as a whole, and that investors who choose active will be vindicated.

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 value of securities owned by the portfolio will decline. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in this strategy. Please be aware that this strategy may be subject to certain additional risks. Changes in the worldwide economy, consumer spending, competition, demographics and consumer preferences, government regulation and economic conditions may adversely affect global franchise companies and may negatively impact the strategy to a greater extent than if the strategy's assets were invested in a wider variety of companies. In general, **equity securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, and market risks. **Stocks of small- and mid-capitalisation companies** carry special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies. The risks of investing in **emerging market countries** are greater than risks associated with investments in foreign developed markets. **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. **Illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). Non-diversified portfolios often invest in a more limited number of issuers. As such, changes in the financial condition or market value of a single issuer may cause greater volatility. **ESG strategies** that incorporate impact investing and/or Environmental, Social and Governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance.

DEFINITIONS

Annual turnover measures the percentage of securities within the portfolio that changed during the most recent fiscal year.

IMPORTANT INFORMATION

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market.

A separately managed account may not be appropriate for all investors. Separate accounts managed according to the particular Strategy may include securities that may not necessarily track the performance of a particular index. A minimum asset level is required.

For important information about the investment managers, please refer to Form ADV Part 2.

The views and opinions and/or analysis expressed are those of the author or the investment team as of the date of preparation of this material and are subject to change at any time without notice due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all investment personnel at Morgan Stanley Investment Management (MSIM) and its subsidiaries and affiliates (collectively "the Firm"), and may not be reflected in all the strategies and products that the Firm offers.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors or the investment team. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific strategy or product the Firm offers. Future results may differ significantly depending on factors such as changes in securities or financial markets or general economic conditions.

This material has been prepared on the basis of publicly available information, internally developed data and other third-party sources believed to be reliable. However, no assurances are provided regarding the reliability of such information and the Firm has not sought to independently verify information taken from public and third-party sources.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

Charts and graphs provided herein are for illustrative purposes only. **Past performance is no guarantee of future results.**

The representative account has employed the investment strategy in a similar manner to that employed in the team's separately managed accounts ("SMAs") and other investment vehicles, i.e., they were generally operated in a consistent manner. However, portfolio management decisions made for such representative account may differ (i.e., with respect to liquidity or diversification) from the decisions the portfolio management team would make for SMAs and other investment vehicles. In addition, the holdings and portfolio activity in the representative account may not be representative of some SMAs managed under this strategy due to differing investment guidelines or client restrictions.

The indexes are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an index. Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

This material is not a product of Morgan Stanley's Research Department and should not be regarded as a research material or a recommendation.

The Firm has not authorised financial intermediaries to use and to distribute this material, unless such use and distribution is made in accordance with applicable law and regulation. Additionally, financial intermediaries are required to satisfy themselves that the information in this material is appropriate for any person to whom they provide this material in view of that person's circumstances and purpose. The Firm shall not be liable for, and accepts no liability for, the use or misuse of this material by any such financial intermediary.

This material may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this material in another language, the English version shall prevail.

is for personal and non-commercial use. All information contained herein is proprietary and is protected under copyright and other applicable law.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

DISTRIBUTION

This material is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

MSIM, the asset management division of Morgan Stanley (NYSE: MS), and its affiliates have arrangements in place to market each other's products and services. Each MSIM affiliate is regulated as appropriate in the jurisdiction it operates. MSIM's affiliates are: Eaton Vance Management (International) Limited, Eaton Vance Advisers International Ltd, Calvert Research and Management, Eaton Vance Management, Parametric Portfolio Associates LLC, Atlanta Capital Management LLC, Eaton Vance Management International (Asia) Pte. Ltd.

This material has been issued by any one or more of the following entities:

EMEA

This material is for Professional Clients/Accredited Investors only.

In the EU, MSIM and Eaton Vance materials are issued by MSIM Fund Management (Ireland) Limited ("FMIL"). FMIL is regulated by the Central Bank of Ireland and is incorporated in Ireland as a private company limited by shares with company registration number 616661 and has its registered address at The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, D02 VC42, Ireland.

Outside the EU, MSIM materials are issued by Morgan Stanley Investment Management Limited (MSIM Ltd) is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

In **Switzerland,** MSIM materials are issued by Morgan Stanley & Co. International plc, London (Zurich Branch) Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland.

Outside the US and EU, Eaton Vance materials are issued by Eaton Vance Management (International) Limited ("EVMI") 125 Old Broad Street, London, EC2N 1AR, UK, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority.

Italy: MSIM FMIL (Milan Branch), (Sede Secondaria di Milano) Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy. **The Netherlands:** MSIM FMIL (Amsterdam Branch), Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. **France:** MSIM FMIL (Paris Branch), 61 rue de Monceau 75008 Paris, France. **Spain:** MSIM FMIL (Madrid Branch), Calle Serrano 55, 28006, Madrid, Spain. **Germany:** MSIM Fund Management (Ireland) Limited Frankfurt Branch, Grosse Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG).

MIDDLE EAST

Dubai: MSIM Ltd (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158).

EVMI utilises a third-party organisation in the Middle East, Wise Capital (Middle East) Limited ("Wise Capital"), to promote the investment capabilities of Eaton Vance to institutional investors. For these services, Wise Capital is paid a fee based upon the assets that Eaton Vance provides investment advice to following these introductions.

U.S.

A separately managed account may not be appropriate for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required. For important information about the investment managers, please refer to Form ADV Part 2.

Please consider the investment objectives, risks, charges and expenses of the funds carefully before investing. The prospectuses contain this and other information about the funds. To obtain a prospectus for the Morgan Stanley funds please download one at morganstanley.com/im or call 1-800-548-7786. Please read the prospectus carefully before investing.

Morgan Stanley Distribution, Inc. serves as the distributor for Morgan Stanley Funds.

NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT

Latin America (Brazil, Chile Colombia, Mexico, Peru, and Uruguay)

This material is for use with an institutional investor or a qualified investor only. All information contained herein is confidential and is for the exclusive use and review of the intended addressee, and may not be passed on to any third party. This material is provided for informational purposes only and does not constitute a public offering, solicitation or recommendation to buy or sell for any product, service, security and/or strategy. A decision to invest should only be made after reading the strategy documentation and conducting in-depth and independent due diligence.

ASIA PACIFIC

Hong Kong: This material is disseminated by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this material have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this material shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This material is disseminated by Morgan Stanley Investment Management Company and should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"); (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This publication has not been reviewed by the Monetary Authority of Singapore. **Australia:** This material is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accept responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. Calvert Research and Management, ARBN 635 157 434 is regulated by the U.S. Securities and Exchange Commission under U.S. laws which differ from Australian laws. Calvert Research and Management is exempt from the requirement to hold an Australian financial services licence in accordance with class order 03/1100 in respect of the provision of financial services to wholesale clients in Australia.

Explore our site at **www.morganstanley.com/im**

CRC 4965106 Exp. 9/30/2023 10275243_KC_0922
A4