Engagement is our Edge

- In the first half of 2020 we engaged with company management on a range of themes, including decarbonisation, diversity, the impact of COVID-19 on employees and suppliers, executive pay and the circular economy, amongst others.

- In the 2020 UN PRI Assessment MSIM received a straight A score card, including A+ for Strategy & Governance. In Listed Equity, MSIM scored A+ for Incorporation and for Active Ownership, the latter for a second year running, reflecting the firm’s commitment to stewardship. MSIM is in the top scoring brackets (A and A+) for both investment managers globally and those based in North America across all of our PRI disclosure modules.

Inside this Issue:
Positive steps but still a way to go
A software company’s strong framework for data security, but an incentive plan that falls short
An eye on supply (chain)
Sustainable sourcing and mitigating supply chain risk in the apparel industry
You can only manage what you can measure
The software company helping companies measure their environmental impact
Here’s to change
A beverage company’s steps towards decarbonisation, sustainable agriculture and promoting responsible drinking

ESG IS INTEGRATED INTO ALL OUR TEAM’S STRATEGIES
- Our investment process focuses on the sustainability and direction of future returns on operating capital because we believe that companies with sustained high long-term returns should outperform.
- Material ESG risks and opportunities are more important than ever to companies’ future returns. ESG is an integral part of our assessment of long-term sustainability of returns.
- We have engaged directly with companies on issues of sustainability and governance for over 20 years, rather than outsourcing the process.

OUR ENGAGEMENT RECORD FOR 1H 2020
155 MANAGEMENT ENGAGEMENTS ON ESG ISSUES
946 RESOLUTIONS VOTED ON ACROSS ALL OF OUR STRATEGIES
104 THE NUMBER OF TIMES THAT WE VOTED AGAINST MANAGEMENT, INCLUDING 37 TIMES ON EXECUTIVE COMPENSATION
74 THE NUMBER OF TIMES WE DISAGREED WITH ISS PROPOSALS

1 The International Equity Team defines an engagement as an interaction with senior management or non-executive board members.
2 Data shown is for the 6 month period to 30 June 2020.
3 Any remuneration-related proposals.
ENgAgE°NAsk A MArAThOn, Not A sprint
All engagements are carried out by our portfolio managers and our Head of ESG Research. We don’t outsource engagement – we do it ourselves. We believe that direct and focused engagement helps us to build a more comprehensive picture of a company’s ESG profile. It also allows us to identify those behind the curve by comparing companies’ actions with those of their competitors.

By conducting our own analysis both before and after we engage, we are better able to assess the robustness of companies’ ESG and sustainability processes. In addition, it helps us to determine if the company is making progress.

Dialogue with companies on issues can take years and require multiple engagements. As long-term shareholders, we believe that engagement is a marathon and not a sprint. Accordingly, our engagement policy is aligned to our long-term investment approach.

Positive steps, but still a way to go
(Global Franchise, Global Quality, Global Sustain)

We engaged with one of our software holdings on data security, diversity and executive pay.

External recognition for its data security programme
The discussion with the chief security officer focused on the company’s data security management practices, essential given it handles large amounts of client information. Cyber threats are ever evolving, and the speed of detection, response and remediation of attacks is what differentiates robust data security programmes. In this context, we believe the company has sufficient processes in place to minimise cyber risks, including regular updates to senior management and running cyber-attack simulations. It has also received several industry awards in recognition of the maturity of its security programme, and receives external verification of security practices. The company’s data privacy policies have been assessed and accredited by the EU as part of the GDPR regulation.

Diversity and inclusion tools and software to encourage best practice
On the subject of diversity and inclusion, we were encouraged to learn that the company has started to use some practical tools to enhance diversity and equality in its hiring process. For example, it does not require candidates to disclose past pay information that can lead to the transfer of past pay gaps and it requires recruiters to present diverse slates of candidates. Some of the company’s new HR software products also help clients to reduce unconscious bias in hiring, for example by hiding name, geography or school characteristics to focus purely on the candidate’s skills and fit for the role.

While the company reports on ethnic and gender diversity within the company, they do not report on pay gaps today. We encouraged them to start disclosing this information.

More to do on executive pay
On executive pay, we expressed our concern about the long-term incentive plan being linked 100% to net income, which we don’t believe is the best metric – we prefer return on capital based metrics and/or relevant organic metrics, and encouraged the company to consider improving their scheme.

TAKEAWAYS
While the company has a strong framework for the key material ESG risk of data security and has made meaningful strides in fostering diversity, we encouraged it to improve its pay plan and enhance its pay gap reporting.

An eye on supply (chains)
(International Equity)

We engaged with one of our consumer holdings, a diversified company with a large presence in fashion retail, to assess how the company was treating its employees and suppliers in the face of the global pandemic. In addition, we discussed social risks in the garment manufacturing supply chain, and the environmental footprint of apparel manufacture. These are high profile issues that we believe companies in the sector should prioritise.

Commitment to employees and suppliers during the pandemic
The company, unlike many of its peers, made no redundancies at its apparel stores during the crisis. It has committed to paying its garment suppliers for a large part of orders they had to cancel due to store closures, with priority given to factory workers’ wages. Its supplier audit team will be monitoring that these payments go directly to workers wherever possible. All managers took a pay cut this year.

Mitigating supply chain risks
Monitoring suppliers’ labour practices is an important area of focus for apparel brands given the risks inherent in the complex supply chain. The company has a large team that conducts extensive audits of garment factories, the majority of which are unannounced, improving their effectiveness. It is trialling a new smartphone technology to receive feedback on factory conditions directly from workers, as well as RFID (radio

The content of this publication has not been approved by the United Nations and does not reflect the views of the United Nations or its officials or Member States. For additional information, please see the United Nations Sustainable Development Goals website at https://www.un.org/sustainabledevelopment/sustainable-development-goals.
frequency subcontracting to unaudited factories, which has been an issue in the industry. We believe the company takes supply chain risks seriously, which is also evidenced by external assessments – for example, its apparel business has received a better than average ranking from Know The Chain, an NGO focusing on labour issues.

Sustainable farming and decarbonisation measures
The high environmental impact of apparel manufacturing (in terms of greenhouse gas emissions, water and pesticide use in cotton growing) has received increased attention recently. We were encouraged by the fact the company has created its own sustainable cotton programme, where cotton supplies are fully segregated and traceable, which is not the case with the largest alternative sustainable cotton standard. Through educating farmers on more sustainable farming methods, this initiative has helped reduce fertiliser and water use while improving yields and farmer incomes. The company aims to train 160,000 farmers by 2022 and source at least 50% of their cotton needs through this programme by next year.

The company’s apparel retail operations also have a lower carbon footprint than the industry average as it ships full containers, use more rail freight instead of trucks, and do not use air freight unlike some of their competitors. The company is also very positive on the potential for recycled polyester and is planning to significantly increase its use, as supply has expanded and the price premium to virgin polyester has come down.

We encouraged the company to improve its disclosure of its Scope 3 emissions, which currently do not capture many parts of its supply chain.

TAKEAWAYS
The company has sensible measures in place to tackle the material ESG risks for the industry, including supply chain management and sustainable sourcing. We will continue monitoring its progress on this.

You can only manage what you can measure
(Global Franchise, Global Quality, Global Sustain, International Equity)
In our latest engagement with a large software holding we discussed its contribution to decarbonising the economy, as well as employee diversity, engagement and welfare.

Helping clients to reduce their environmental impact
The company has seen a significant increase in interest from its clients in its suite of sustainability tools in the last 12-18 months, due to stakeholder and government demands. These software tools help reduce carbon footprint and other environmental impacts, such as water use or food waste, by optimising supply chain processes. This may become a significant differentiator for the company over time, given its software is used by most companies and covers many industries’ entire supply chains, giving it an edge over smaller competitors.

The company shared plans to enhance its offering, for example, by automating carbon data flows between companies and their suppliers. This would help track and manage a product’s complete environmental impact throughout its lifecycle. The company recently collaborated with others on a study which concluded that through such digitisation of businesses, the IT industry as a whole can potentially help abate 7.6 gigatons of greenhouse gas emissions (around 14% of global total) in carbon-heavy industries (e.g. utilities, transport and agriculture).

Industry-leading employee engagement and welfare practices
On employee engagement and welfare, we believe the company tracks it in a more frequent and granular fashion than most companies. During our meeting it shared an example of how this recently helped them identify and address employee concerns and prevent potential acquisition integration issues. It has also quantified the positive impact of improving inclusion and engagement on underlying business performance, e.g. operating profit.

During the course of our engagement, we noted that it does not report gender pay gap data. We encouraged them to do so, highlighting potential reputational issues if they do not.

TAKEAWAYS
We believe the company is ahead of others in their sustainability and diversity efforts, and could further enhance their approach through reporting.

Here’s to change
(Global Franchise/Brands, Global Quality, International Equity)
We arranged a follow-up meeting with one of our beverage holdings to discuss their measures to encourage responsible drinking. This also provided the opportunity to discuss a broader range of topics including decarbonisation, the circular economy, sustainable agriculture and diversity.

Encouraging more disclosure on responsible drinking efforts
We view the subject of responsible drinking as a potential risk for the industry’s returns on capital, should more restrictive regulation be introduced by governments. The company has sponsored many campaigns to encourage responsible drinking, however in our view it doesn’t report on its efforts or positive impact in a clear, aggregated fashion. We encouraged it to provide more disclosure on this, which would help stakeholders understand the company it is making and help the company to mitigate this social risk.

Strong progress and new targets for carbon emissions
On decarbonisation, having achieved a 34% reduction in Scope 1 and 2 carbon emissions per unit of production in the last
decade, the company recently announced new targets, in line with the SBT (science-based targets) approach. The company now aims for a further 30% reduction in absolute Scope 1 and 2 emissions (its own emissions), as well as a 50% Scope 3 (supply chain emissions) carbon intensity reduction by 2030. In terms of own emissions, the company plans to convert its plants from natural gas to renewable electricity, among other measures, and has disclosed the amount of investment earmarked for this. The Scope 3 target is closely linked to the company’s circular packaging and sustainable agriculture initiatives.

Firm steps towards a circular economy
On circular packaging, glass bottles are the largest source of upstream emissions for the company. It is increasing the amount of recycled glass it uses to 50% by 2030, compared with 35% today, which should lower the carbon footprint of its products. It is also working with its glass suppliers to electrify and decarbonise glass production over time. In addition, it is trialling returnable bottle schemes in both Asia and Europe.

Innovation in sustainable agriculture
Sustainable agriculture is an important emerging topic for consumer staples companies. Such companies sit at the top of the agricultural supply chain and can potentially influence and improve agricultural practices, provided they have the right tools and focus on this. While this company sources most of its agricultural inputs externally, it does own some land that provides for a small percentage of its needs. The company has been using it as a testing ground for new regenerative farming methods. For example, it has managed to reduce the usage of agrochemicals (herbicides, insecticides and fungicides) by nearly 50% since 2013. All of its owned vineyards now use drip irrigation, reducing water intensity. The company plans to further share these models with its suppliers and is in the process of mapping 100% of its terroirs to assess the impact of existing methods on the environment. It has also committed to have 100% of the key raw materials it sources certified to selected sustainability standards by 2030.

Greater diversity than five years ago
On diversity, several positive changes are underway. The headquarters employs 33 nationalities among a staff of 300 and meetings are now conducted in English, versus French five years ago. Four women now sit on the Board versus one five years ago. In 2020, the company recruited its first American (a woman) to head the U.S. spirits business (the company’s largest market).

TAKEAWAYS
We believe the company has strong sustainability governance in place and is taking concrete actions on key ESG topics including diversity. We will continue monitoring their progress on this.

Monitoring corporate behaviour in response to COVID-19
The global pandemic descended upon the world with little notice and long-term ramifications that continue to play out. From an ESG perspective, COVID-19 exposed both saints and sinners across the corporate world, particularly in terms of management treatment of employees. We don’t believe that the crisis has given corporates a reprieve from taking ESG matters seriously. On the contrary: over the medium and long term, we believe that ESG factors have become more, rather than less, important. Companies face increasing pressure to progress faster – primarily from governments, but also from their investors, consumers, employees and other stakeholders.

We have been tracking our companies’ responses to the pandemic, both in terms of their workforce actions as well as contributions to fighting the virus, and have engaged where we had concerns.

The crisis has acted as a reminder that leading software and health care companies provide indispensable, critical tools and products that help businesses and broader society to stay resilient.

For example, a software company we own has been supporting the UK’s National Health Service in its efforts to analyse the epidemic, as well as supplying free remote learning software to schools.

In health care, companies we own have been working with governments to extend the access to diagnostics and are developing rapid tests and potential treatments for the virus.

Meanwhile, leading consumer brands companies have recognised the need to shift from marketing to consumers to mattering to people – having real purpose. The pandemic has highlighted the value of essential hygiene products and protective equipment, but companies which also lead on matters such as payment flexibility and environmentally-friendly packaging should benefit in the long run.

Finally, COVID-19 has governance implications as well. This crisis is a real test of companies’ risk management and capital allocation strategies. Companies with prudent balance sheet management and long-term focused executive pay plans should be better positioned to withstand the challenges ahead.

* Source: http://smarter2030.gesi.org/#
Pay X-Ray
The International Equity Team has always engaged with companies on their pay plans – we believe management remuneration is key to good governance.

Individual portfolio managers are responsible for analysing and voting on ‘say-on-pay’ resolutions. We believe that the in-depth company and industry knowledge that informs our decisions gives us an information advantage.

The Pay X-Ray is our proprietary scoring tool, used to better compare company pay plans, facilitate team discussions and inform our voting approach. A streamlined scoring system, it enables us to flag good and bad practices and rank our holdings’ remuneration plans. Each element of the plan receives a positive or negative score, rolled up into an overall company score.

**DISPLAY 1**
Proxy voting overview (6 months to 30 June 2020)

| Number of meetings voted | 82 |
| Total proposals voted   | 1,252 |
| Votes against management | 6% |

Source: ISS Proxy Exchange; MSIM

Our team voted on 57 say-on-pay management proposals during the six months to 30 June 2020:

- 32% of the votes were cast against the proposal

Reasons the team voted against say-on-pay proposals included: excessive levels of pay, insufficient weight of performance-based remuneration, subjective or undisclosed targets for management, or performance incentives that are, in our view, not aligned with shareholders.

**DISPLAY 2**
Votes on management say-on-pay proposals voted 2014 – 1H 2020

<table>
<thead>
<tr>
<th>Year</th>
<th>Vote For (%)</th>
<th>Vote Against (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>11%</td>
<td>89%</td>
</tr>
<tr>
<td>2015</td>
<td>12%</td>
<td>88%</td>
</tr>
<tr>
<td>2016</td>
<td>17%</td>
<td>83%</td>
</tr>
<tr>
<td>2017</td>
<td>22%</td>
<td>78%</td>
</tr>
<tr>
<td>2018</td>
<td>13%</td>
<td>87%</td>
</tr>
<tr>
<td>2019</td>
<td>24%</td>
<td>76%</td>
</tr>
<tr>
<td>2020</td>
<td>32%</td>
<td>68%</td>
</tr>
</tbody>
</table>

Source: ISS Proxy Exchange; MSIM

Proxy voting policy
MSIM votes proxies in a prudent and diligent manner and in the best interest of our clients, including beneficiaries of, and participants in a client’s benefit plan(s) for which the subadvisor manages assets, consistent with the objective of maximising long-term investment returns. MSIM has retained research providers to analyse proxy issues and to make vote recommendations on those issues. While we are aware of the recommendations of one or more research providers, we are in no way obligated to follow such recommendations. The investment teams vote all proxies based on MSIM’s proxy voting policies in the best interests of each client.

**DISPLAY 3**
Carbon light portfolios
Our global portfolios typically have less than a fifth of the average carbon intensity of the benchmark.

*Percentage shown is lower than the benchmark.

Source: MSCI ESG Research; Morgan Stanley Investment Management. Data as at 30 June 2020. MSCI ESG Research defines a portfolio’s carbon footprint as the carbon emissions (Scope 1 and 2) of a portfolio per $1 million invested or per $1 million of portfolio companies’ sales. They sum up all emissions in a portfolio based on the investor’s ownership share, using reported or estimated emissions data.
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-capitalization 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. 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.

Any questions or comments? Please contact:

VLADIMIR DEMINE
Head of ESG Research, International Equity Team
Vladimir.Demine@morganstanley.com
DISTRIBUTION: This communication 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.


Germany: Morgan Stanley Investment Management Limited Niederlassung Deutschland, Grosse Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG).

Italy: Morgan Stanley Investment Management Limited, Milan Branch (Sede Secondaria di Milano) is a branch of Morgan Stanley Investment Management Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), and whose registered office is at 25 Cabot Square, Canary Wharf, London, E14 4QA. Morgan Stanley Investment Management Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 08829360968.


U.S.: A separately managed account may not be suitable 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 manager, 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 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

Hong Kong: This document has been issued 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 document 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 document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. Singapore: This document 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 (ii) 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 publication 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.

Japan: For professional investors, this document is circulated or distributed for informational purposes only. For those who are not professional investors, this document is provided in relation to Morgan Stanley Investment Management (Japan) Co., Ltd. ("MSIMJ")’s business with respect to discretionary investment management agreements ("IMA") and investment advisory agreements ("IAA"). This is not for the purpose of a recommendation or solicitation of transactions or offers any particular financial instruments. Under an IMA, with respect to management of assets of a client, the client prescribes basic management policies in advance and commissions MSIMJ to make all investment decisions based on an analysis of the value, etc. of the securities, and MSIM accepts such commission. The client shall delegate to MSIMJ the authorities necessary for making investment. MSIMJ exercises the delegated authorities based on investment decisions of MSIMJ, and the client shall not make individual instructions. All investment profits and losses belong to the clients; principal is not guaranteed. Please consider the investment objectives and nature of risks before investing. As an investment advisory fee for an IIA or an IMA, the amount of assets subject to the contract multiplied by a certain rate (the upper limit is 2.20% per annum (including tax)) shall be incurred in proportion to the contract period. For some strategies, a contingency fee may be incurred in addition to the fee mentioned above.

IMPORTANT INFORMATION

EMEA: This marketing communication has been issued by Morgan Stanley Investment Management Limited ("MSIM"). Authorised and regulated by the Financial Conduct Authority. Registered in England No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

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. Prior to investing, investors should carefully review the strategy’s / product’s relevant offering document. There are important differences in how the strategy is carried out in each of the investment vehicles.

A separately managed account may not be suitable 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.

This material is a general communication, which is not impartial and 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.

Except as otherwise indicated herein, the views and opinions expressed herein are those of the portfolio management team, are based on matters as they exist as of the date of preparation and not as of any future date, and will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date hereof.
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. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific Morgan Stanley Investment Management product.

MSIM has not authorised financial intermediaries to use and to distribute this document, 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 document is suitable for any person to whom they provide this document in view of that person’s circumstances and purpose. MSIM shall, not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without MSIM’s express written consent.

All information contained herein is proprietary and is protected under copyright law.