Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley Global Brands Equity Income — Targeting 4%

ACTIVE FUNDAMENTAL EQUITY | INTERNATIONAL EQUITY TEAM | INVESTMENT INSIGHT | JUNE 2020

Finding reasonable income in a low rate world is a challenge. Ten-year U.S. Treasuries offer better developed market yields than most other Sovereigns, but at below 1% the problem is the absolute level. Allowing for inflation, the real return is actually negative.

Outside the United States, the French, German, Spanish and Japanese 10-year bonds all yield near to zero, again before inflation.

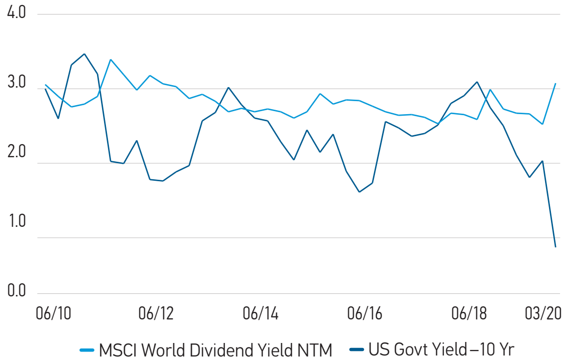
Higher fixed income yields can be found in more exotic debt instruments and markets, but these yields are typically tempered by greater volatility and risk.

So how about equities? As *Display 1* shows, in absolute terms equity yields are reasonable by historical standards, at 3% as of 31 March 2020. Relative to U.S. 10-year Treasuries however, given the very low treasury yield, equity yields are now particularly attractive.

Unlike bonds, equities have the ability to grow. This means they can potentially offer both income *and* capital appreciation. Illustrating this, the indexed price of the MSCI World Index over twenty years has risen from 100 to 131. The total return (with dividends reinvested) has risen from 100 to 212.[1]

DISPLAY 1

Equity Yields Are Historically and Relatively Attractive



Source: FactSet, March 2020.

What you see isn't necessarily what you get

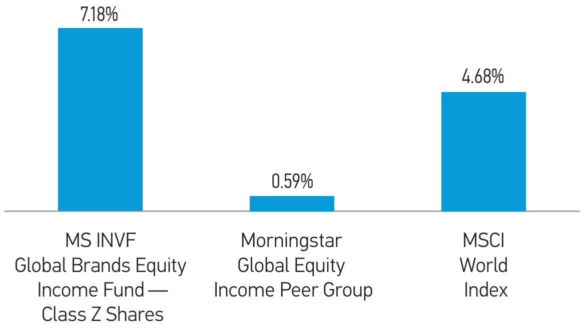
A number of companies offer dividend yields higher than the market — sometimes a fair bit higher. The problem here is that whilst these higher yields are attractive at face value, they typically disappoint. Our research tells us that forecast dividend yields much above 4% are rarely sustainable. Put another way, if a dividend yield is very high, the market probably doesn't believe in it. Potentially, there's a risk of a future dividend cut.

The real challenge for investors is finding equity income, but not at the expense of long-term capital growth. The global equity income universe has struggled relative to the market in recent years, with the Morningstar Global Equity Income peer group underperforming the MSCI World Equity Index over 1, 3, 5 and 10-year periods.

[1] FactSet, March 2020.

DISPLAY 2

Since inception, Global Brands Equity Income has delivered outperformance…

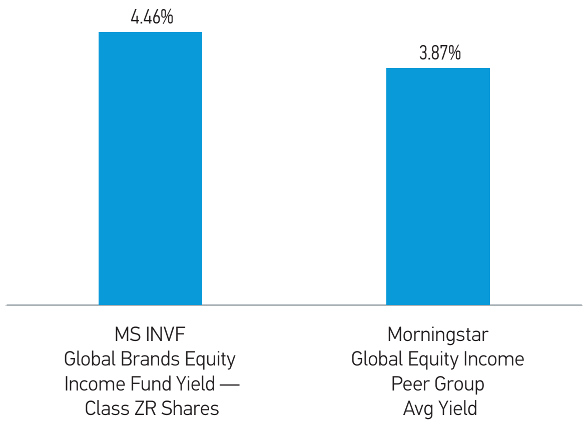


Source: MSIM, Factset.

Performance data is based on average annualized returns and net of fees. Time frame reflects the inception date of the Global Brands Equity Income Fund (29 April 2016) through 31 March 2020. The Global Brands Equity Income Fund is not part of its Morningstar peer group. Performance for the peer group is based on the median of peer group returns.

DISPLAY 3

…and superior distributed income



Source: MSIM, Factset.

Data is based on average annualized dividend yields. Time frame reflects the inception date of the Global Brands Equity Income Fund (29 April 2016) through 31 March 2020.

Past performance is not indicative of future results. The value of the investments and the income from them can go down as well as up and an investor may not get back the amount invested. Returns may increase or decrease as a result of currency fluctuations. Performance of other share classes, when offered, may differ. Please consider the investment objectives, risks, charges and expenses of the fund carefully before investing.

In contrast, since inception on 29 March 2016, the Global Brands Equity Income Fund has performed ahead of the MSCI World Index, outperforming the Morningstar Global Equity Income peer group *(Display 2)*, as well as providing superior distributed income *(Display 3)*.

In difficult economic conditions, both income and capital can be at risk as the current economic slowdown is beginning to reveal. Companies with volatile sales, weak cash conversion, stretched balance sheets and stretched pay-out ratios, as well as those that operate in areas that are economically or politically sensitive, are struggling to maintain their dividend payments, or even pay a dividend at all. Many of these companies can be found in the more cyclical financials, energy, materials, industrials and consumer discretionary sectors, parts of the market where traditional income funds often have holdings.

Focus on the Compounding

Unlike many income funds, we do not select companies because of their dividend yield. We have always believed the best way to achieve attractive long-term returns is from owning high quality, well-managed, reasonably priced companies able to maintain or improve their high returns on operating capital. We typically find these companies in the more defensive consumer staples, healthcare and technology sectors.

These strong fundamentals underpin the compounding of returns—the core principle of long-term investing in our view. Since inception, Global Brands Fund, which has exactly the same holdings as those in the Global Brands Equity Income Fund (with the notable exception of derivatives used in Equity Income), has achieved an annualised compound rate twice that of the MSCI World Index, leading to more than 3x the total return. $100 invested in the year 2000 has compounded to $770 today. The same $100 invested in the Index would now be worth $219 *(Display 4)*.

Quality Matters

In tough times, the market recognises the value of reliable, durable, high quality fundamentals, and companies whose earnings hold up. Managing for downside risk is a signature of our long-standing Global Brands Fund. Since the inception of its underlying strategy in 1996, the portfolio has outperformed the MSCI World in each of the eight years that Index had a negative USD return.

In the most recent setback for markets, driven by the spread of the coronavirus and the economic impact from containing it—including national lockdowns and social distancing—Global Brands Equity Income has done what it was designed for; minimising relative downside participation compared to the broader market. The strategy has outperformed the MSCI World Index by 8.1% in the first quarter this year, as well as its Morningstar Global Equity Income peer group by 7.45%. The first quarterly distribution was a little over 25% of the expected annual distribution and the annual run rate is a little above the 4% target.

Generating 4% Income[2]

The dividend yield of our Global Brands Equity Income Fund, which has exactly the same holdings as those in our Global Brands Fund (with, as mentioned, the exception of the derivatives held in Equity Income), is close to 2%. The annualised target income is 4%, which the fund has consistently delivered.

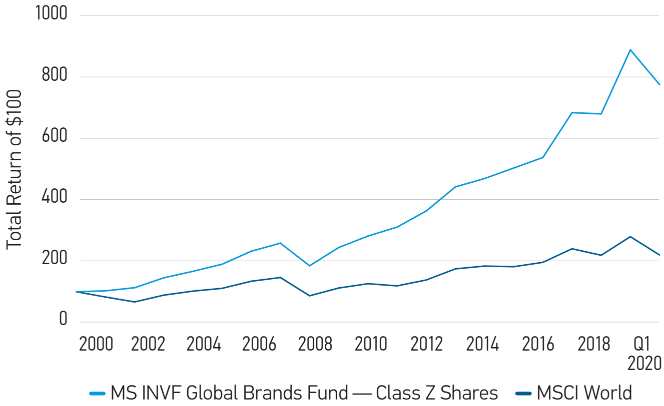
In partnership with MSIM's Portfolio Solutions Group, we seek to add roughly 2% per annum to the portfolio dividend yield through a payment (or premium) received from selling out-of-the-money call options (the overwrite) on equity indices in developed markets. This is a mechanical, formula-driven process. Note the calls are on the equity indices, not the stocks in the portfolio.

How the overwrite works

- The fund receives a payment for the option, whether the indices rise or fall.
- If an index rises beyond a certain level, known as the strike price, then any upside above and beyond the strike price over the period the option is open is paid to the call option purchaser.
- *Importantly, the fund retains all the performance of the underlying holdings.* This performance usually more than compensates for any payout.
    - Between March 2006 to March 2020, 63 months (39%) have experienced a call-away.
    - Of these months, 55 (87%) were compensated for by portfolio performance.
    - For three of the months, portfolio performance was positive but the performance was outweighed by call-away losses. Five of the months experienced both a call-away and negative portfolio performance, with an average call-away of 11 bps.

DISPLAY 4

Since 2000, Global Brands Fund has delivered a superior return



Source: Factset.

Growth of investment illustration is quoted in U.S. dollars, based on an initial investment of $100 made since fund inception (30 October 2000) through 31 March 2020, assumes reinvestment of dividends and capital gains, but does not include sales charges and fees. Performance would have been lower if sales charges and fees had been included. Results are hypothetical.

Past performance is not indicative of future results. The value of the investments and the income from them can go down as well as up and an investor may not get back the amount invested. Returns may increase or decrease as a result of currency fluctuations. Performance of other share classes, when offered, may differ. Please consider the investment objectives, risks, charges and expenses of the fund carefully before investing. The comparison index is the MSCI World Index with Net dividends reinvested. It is not possible to invest directly in an index.

- Should the indices fall, then there's nothing to forego, and we still receive the premium. *So in down markets, the relative defensiveness of the fund is enhanced.*

Income the right way

The combination of the high quality underlying Global Brands Fund and the overwrite offers the ability to generate a reasonable level of income without sacrificing long-term performance; in our view, that's income the right way.

12 Month Performance Periods to Month End (%) in USD

	MAR '19 - MAR '20	MAR '18 - MAR '19	MAR '17 - MAR '18	MAR '16 - MAR '17	MAR '15 - MAR '16
Global Brands Fund - Class I	-1.75	14.65	12.58	11.50	9.40
Global Brands Equity Income Fund - Class Z	-3.90	14.41	8.63	–	–
MSCI World Net Index	-10.39	4.01	13.59	14.77	-3.45

Past performance is not a reliable indicator of future results. Data as of 31 March 2020. 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.

[2] The current overall income objective is c.4% per annum but is subject to change depending on market factors, including the current income and volatility of general equity markets, the current income of the underlying equity strategy, inflation and interest rates. The relative contributions to the overall income objective of the two income components (dividends and call option premiums) may vary. The target is less likely to be achieved in periods of strong markets and very low volatility.

Risk Considerations:

Global Brands Equity Income Share Class Z Risk and Reward Profile

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

- 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 company shares 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 value of financial derivative instruments are highly sensitive and may result in losses in excess of the amount invested by the Sub-Fund.
- 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.
- Investment in China A-Shares via Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect programs may also entail additional risks, such as risks linked to the ownership of shares.
- The derivative strategy aims to increase the income paid to investors, but there is potential for the fund to suffer losses.
- 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.

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