This annual report by the Global Opportunity team discusses ESG integration within the investment process, the carbon intensity of the portfolios, company engagement, participation in collaborative initiatives and relevant Morgan Stanley Investment Management policies.

**ESG and the Sustainability of Competitive Advantage**

The Global Opportunity team’s investment process integrates analysis of sustainability with respect to disruptive change, financial strength and environmental and social externalities and governance (also referred to as ESG). We view ESG as a component of quality and consider the valuation, sustainability and fundamental risks inherent in every portfolio position. As bottom-up investors, we do not apply top-down ESG positive/negative screens to a benchmark. Nor do we utilize ESG scorecards from third parties which rank companies versus industry peers. In other words, ESG in isolation is not a principal driver of our investment thesis; it is but one component of our quality assessment.

Our ESG analysis focuses on a company’s ability to sustain competitive advantage over the long term. Areas assessed include environmental management to minimize externalities, reduce consumption of energy, water and other resources and mitigate costs thereby improving profitability; social factors such as consumer product safety, human capital management, supply chain management and regulatory impacts; and governance issues such as management incentives, capital allocation, independent boards and transparent accounting.

For more information on how the Global Opportunity team integrates ESG into investment decision-making, please see:

**ESG and the Sustainability of Competitive Advantage (2017)**


1 The Global Opportunity team is led by Kristian Heugh in Hong Kong and manages highly differentiated, concentrated portfolios that invest across geographies, sectors and market capitalizations. Our strategies are available on a global, regional and customizable basis and seek long-term capital appreciation by investing in high quality companies that the investment team believes are undervalued at the time of purchase.
Within the developing markets, where rule of law and corporate governance standards can be lower than advanced economies, additional due diligence steps are necessary. Risks stemming from corruption, political instability, governance and accounting issues must be thoroughly investigated. For developing market companies, we typically commission a full due diligence report, including a background check on company management, board directors and cross-holdings, court and tax filings, and local language press to assess governance risk.

Incorporating ESG-related potential risks and opportunities within an investment process is about ensuring long-term stewardship of capital. Over extended time horizons, we believe that ESG risks are more likely to materialize and externalities not borne by the company are more likely to be priced into the value of securities. Therefore, we continue to innovate and evolve our process and believe that integrating ESG within our investment analysis improves the risk and reward profile of client portfolios.

Carbon Intensity

Our portfolios typically have less than half of the weighted average carbon intensity of benchmark indices. This is a result of our view that solar will likely disrupt value for fossil fuel companies as costs become more competitive based on our disruptive change research. Our lower carbon intensity is also due to our view that there is a negative externality that is not reflected in the income statement of high-emitting companies. In addition, our preference for lower capital intensity industries skews away from carbon-intensive businesses such as utilities, coal, oil and gas.

As of December 31, 2019, the Asia Opportunity, Developing Opportunity, Global Opportunity and International Opportunity strategies held no coal, oil or gas companies involved in the extraction of fossil fuel reserves and no holdings in the utilities sector. The International Advantage strategy held no coal, oil or gas companies involved in the extraction of fossil fuel reserves and had limited exposure to the utilities sector.

Our carbon intensity is typically <50% of the index

Source: Morgan Stanley Investment Management, Carbon Disclosure Project, MSCI ESG Research LLC. Data as of December 31, 2019. For illustrative purposes only and subject to change without notice.
Engagement with Portfolio Companies

Our research has identified both ESG opportunities as well as risks that may diminish the investment thesis and resulted in the sale of (or decision not to invest in) a company’s securities. We engaged with several portfolio companies over the course of the year in 2019. Examples of engagement topics included:

ADDRESSING CLIMATE CHANGE AND WASTE MANAGEMENT IN ONLINE RETAIL

MSIM engaged an online retail leader on the topics including climate change, waste, and content management. MSIM learned that the Board is regularly briefed on ESG initiatives by the Global Head of Sustainability. In response to shareholder proposals on climate change and food waste, the company outlined plans to disclose its carbon footprint for the first time and plans to address food sustainability as the owner of a large U.S. grocer noting its packaging waste reduction initiative. MSIM also discussed emerging issues including the ethical implications of facial recognition software and review of platform content to remove potentially offensive products. The company was receptive to our concerns on these topics and indicated that its management of these areas was evolving.

IMPROVING DIVERSITY AND INCLUSION IN FINANCIAL SERVICES

MSIM engaged a global payment network to discuss topics related to shareholder proposals regarding human rights, diversity and inclusion. The company established a Global Inclusion Council that helps the company attract and retain diverse talent. Women comprise 39% of the company’s global workforce, 29% of senior management and 27% of Board directors. The company also reports on pay equity and has demonstrated progress towards full pay equality. MSIM encouraged the company to set gender diversity goals consistent with financial services peer companies and will monitor progress going forward.

MSIM engaged the founding Chairman of the leading Japanese mergers and acquisitions intermediary to discuss enhanced female participation in the workforce. The firm has established a target of 30% female employees across the group (from less than 10%), and it is striving to recruit a female non-executive director. As a demonstration of its commitment to gender diversity, the firm established a subsidiary in 2012 that promotes work-life balance and flexible work schedules. This subsidiary in turn achieved a 91% female employee ratio. The company continues to prioritize human resource development to attract and retain outside talent. In addition, the firm’s activities address the twin issues of aging population and lack of successors amongst small and medium enterprises in Japan. Through facilitating 339 M&A deals in 2018, the firm helped Japan avoid economic losses that totaled JPY 338 billion of sales by ensuring the continued operations of the acquired businesses.

PURSUING MORE SUSTAINABLE SUPPLY CHAINS IN LUXURY RETAIL

MSIM engaged the management team and two board members of a European luxury goods company to understand how sustainability is integrated into the company’s governance structure. The company includes sustainability key performance indicators (“KPIs”) in executive compensation plans and has formally integrated sustainability into the Audit and Risk Committee charter. The company demonstrated a strong approach to supply chain governance by doubling the number of supplier audits in 2018 from 2017. We also discussed the company’s commitment to environmental initiatives and to promoting gender diversity in the workforce through maternity programs and onsite childcare facilities. The engagement provided an opportunity for us to learn more about the company’s leading sustainability practices and to provide suggestions for continual improvement. As long term investors, we are committed to working in partnership with our portfolio companies to improve their sustainable competitive advantage.
TARGETING SINGLE-USE PLASTIC WASTE IN ONLINE FOOD DELIVERY

MSIM engaged a Chinese social commerce platform to discuss waste management practices in the company’s local services including online food delivery and bike-sharing. Given the rapid growth of food delivery services in China, the company delivered over 6 billion food delivery transactions in 2018, an annual increase of 50%. Our collaborative engagement with management centered on the trend of incremental waste disposal including single-use plastic food utensils. We explored potential alternatives to single-use plastics such as encouraging restaurants to offer customers the option to not receive disposable plastic utensils as implemented by the company. In addition, we discussed the company’s program to address waste management in the ride-sharing segment by launching a program to reduce, reuse and recycle bike components.

We do not invest in consumer staples companies involved in the manufacture of cigarettes and other tobacco products. Our analysis has concluded that the competitive advantage of tobacco producers is not sustainable as the healthcare costs of cancer treatment are externalized upon society and therefore, tobacco companies are generally over-monetized while reliant on pricing growth due to declining unit volumes.

MSIM Global Stewardship

MSIM takes a holistic approach to integrating ESG in ways that promote long-term value for our business and clients. Our differentiated investment teams lead this process, with support from the MSIM Sustainability Council. An advisory forum, the Council convenes cross-functional leaders, including portfolio managers and investment analysts. Members guide MSIM’s framework for integrating ESG into investment processes, product development, ESG measurement, education, client engagement and reporting. The Council is supported by MSIM’s Global Stewardship team, which is comprised of ESG professionals who facilitate proxy voting and collaborate with our investment teams on company engagements and ESG integration.

Our Engagement Record

<table>
<thead>
<tr>
<th>Data Point</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unique Meetings</td>
<td>224</td>
</tr>
<tr>
<td>Total Proposals Voted</td>
<td>2,337</td>
</tr>
<tr>
<td>Votes with Management</td>
<td>92%</td>
</tr>
<tr>
<td>Votes against Management</td>
<td>8%</td>
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</tbody>
</table>


3 Source: ISS Proxy Exchange, Morgan Stanley Investment Management. Data shown is for the 12 month period to December 31, 2019 and represents all the strategies managed by the Global Opportunity team. The Global Opportunity team defines an engagement as an interaction with senior management or non-executive board members.
Proxy Voting
MSIM views proxy voting as an integral part of the investment process and ownership oversight. All proxy voting decisions are made in-house based on collaboration between members of the investment team and the Global Stewardship team and in line with the principles addressed in our policy. Consequently, we do not automatically support management recommendations. The Global Stewardship team has an internal voting system that facilitates communication with the investment teams and that documents vote rationale. We combine the in-depth knowledge of the investment teams with the global governance expertise of the Global Stewardship team to make informed voting decisions, rather than relying on external advisory firms or making proxy voting a rote, box-ticking exercise. The Global Stewardship team oversees the proxy voting process to ensure a consistent set of policies and procedures are applied across our global portfolios. Controls are in place to help ensure that meetings are voted in a timely manner and are consistent with our policies across global portfolios. In most cases, we do not view attendance at portfolio company annual general meetings as productive and instead prefer to engage in one to one meetings or conference calls with our portfolio companies. The Global Stewardship team provides clients with proxy voting records relating to votes held and voted on their behalf and also publishes an annual stewardship report that summarizes global voting and engagement activity.

Collaboration and Reporting
MSIM is a signatory of the UN Principles for Responsible Investing (“UNPRI”), the UK Stewardship Code, the Japan Stewardship Code, and the Hong Kong Stewardship Code. MSIM also participates in the Sustainability Accounting Standards Board (SASB) Investor Advisory Group and is an investor member of GRESB. In addition, Morgan Stanley is a member of the Global Impact Investing Network, the Ceres Investor Network and supports the Task Force on Climate-Related Financial Disclosures. We view our involvement in these initiatives as opportunities to stay abreast of industry developments and best practices, which help us to continually refine our ESG approach. They are also opportunities for us to share our ESG story with the broader ESG community.

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. 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). 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. To the extent that the Strategy invests in a limited number of issuers (focused investing), the Strategy will be more susceptible to negative events affecting those issuers and a decline in the value of a particular instrument may cause the Strategy’s overall value to decline to a greater degree than if the Strategy were invested more widely.

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