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Markets

Morgan Stanley's Top-Performing Fund Buys Undervalued Stocks

by Ishika Mookerjee
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- Consumer stocks are a focus; more than half of assets in China
- Meituan, Moutai among drivers of fund's 44% gain in past year

A top-performing Morgan Stanley fund is betting on cash-rich consumption-focused stocks in Asia, especially China, to manage risks in market cycles this year.

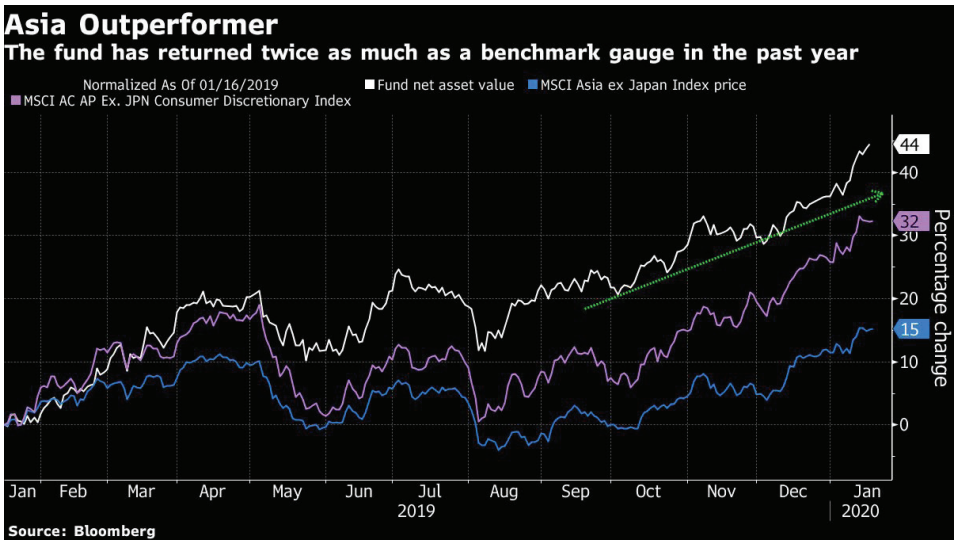
The Wall Street firm's Asia Opportunity Portfolio, which focuses on equities in the region excluding Japan, returned 44% in the past year, beating 99% of its peers, according to data compiled by Bloomberg. The portfolio focuses on undervalued companies with low debt or net cash on their balance sheets, many of which are found in consumer sectors, said Kristian Heugh, who has been co-managing the fund since its inception in 2016.

"We seek to protect investors' capital by focusing on high quality companies with sustainable competitive advantages and purchasing them at a discount to our estimate of intrinsic value," Heugh said. "We remain vigilant in selling names approaching our estimate of their intrinsic value and redeploying that capital in what we believe are the next big ideas."

China is the $1.5 billion fund's largest-weighted country, accounting for 57.7% of assets as of end-December. Heugh said the world's second-largest economy will remain a key focus this year despite its slower growth in 2019.

Asian consumer stocks provide "high returns on capital, low leverage and quality growth prospects," Hong Kong-based Heugh said. The region offers "the highest ratio" of high-quality companies that have generated both 15% return on invested capital and 15% revenue growth over the past three years, he added. The MSCI Asia ex Japan Index has gained 3.4% so far this year.

With more than 800 million people emerging from poverty since market reforms began in 1978, China is an especially attractive hunting ground for



consumption names, Heugh said. Key themes he's looking at include better quality food and drink as well as access to Internet services, health care and better education opportunities for children.

As a result, the Asia Opportunity Portfolio's largest positions in China focus on the education, food, beverages, restaurants and travel sectors. Food-delivery giant Meituan Dianping, distiller Kweichow Moutai Co. and soy sauce maker Foshan Haitian Flavouring & Food Co. were among the top contributors to the fund's peer-beating performance last year.

ASIA OPPORTUNITY PORTFOLIO'S TOP PERFORMERS	2019 RETURN
Meituan Dianping	132%
Hangzhou Tigermed Consulting Co.	122
Kweichow Moutai Co.	101
TAL Education Group	81
Foshan Haitian Flavouring & Food Co.	56

Source: Bloomberg

The top five performers are trading at an average valuation of more than 50 times earnings estimates for 2020, compared with about 14 times for the MSCI Asia excluding-Japan Index. All have net cash on their balance sheets.

While only about 1% of the portfolio is allocated to Southeast Asia due to expensive valuations, its Asean revenue exposure is higher thanks to investments in key regional Internet stocks Alibaba Group Holding Ltd., Tencent Holdings Ltd. and Naver Corp.

"Alibaba owns Southeast Asia's largest e-commerce platform Lazada, Tencent is the largest gaming company in this region, and Naver owns Line which is popular among Southeast Asian mobile Internet users," Heugh said.

– *With assistance by Yusuke Takeshita.*

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Morgan Stanley

INVESTMENT MANAGEMENT

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Please note the reprint was altered from its original form.

Morgan Stanley Institutional Fund Asia Opportunity Portfolio – Class I Shares

Top Ten Holdings (% of Total Net Assets)	**Fund**	**Index**
HDFC Bank Ltd	8.26	--
Meituan Dianping	5.69	0.25
Alibaba Group Holding Ltd	5.37	6.79
Shenzhou International Group	4.83	0.21
Naver Corp	4.80	0.43
AIA Group Ltd	4.76	2.40
Taiwan Semiconductor Mfg Co. Ltd	4.72	5.14
China Resources Beer Holdings	4.67	0.15
Huazhu Group Ltd	4.67	0.10
Tencent Holdings Ltd	4.61	5.23
Sector Allocation (% of Total Net Assets)	**Fund**	**Index**
Consumer Discretionary	37.87	14.95
Communication Services	13.13	11.53
Consumer Staples	13.08	5.12
Financials	13.02	23.02
Information Technology	7.88	18.49
Health Care	4.15	3.01
Real Estate	0.03	5.81
Other	0.54	--
Cash	10.91	--

As of December 31, 2019. 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 December 31, 2019 – Class I Shares	1 Year	3 Years	5 Years	Since Inception (12/29/2015)
MSAQX	44.74	30.25	--	21.57
MSCI All Country Asia Ex-Japan Index (%)	18.17	12.77	--	10.82
Lipper Category Average (%)	20.78	12.34	--	--
Morningstar Category Average (%)	19.98	12.03	--	--

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 Asia Opportunity Portfolio (Class I shares) is 1.67% and the net expense ratio is 1.10%. 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.

Morningstar Rankings as of 01/31/2020 – I Shares

	Percentile	**Rank/ Total in Category**
1 Year	**1**	**2/81**
3 Year	**1**	**2/72**

Rankings are based on total returns, are historical and do not guarantee future results.
Rankings: The percentile rankings are based on the average annual total returns for the periods stated and do not include any sales charges, but do include reinvestment of dividends and capital gains and Rule 12b-1 fees. The highest (or most favorable) percentile rank is 1 and the lowest (or least favorable) percentile rank is 100. The top-performing fund in a category will always receive a rank of 1. **Please visit morganstanley.com/im for Morningstar ratings and rankings (where appropriate) for the latest month-end period.**

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The MSCI All Country Asia Ex-Japan Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of Asia, excluding Japan. 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 MSIF Asia Opportunity Portfolio are $171.41 million as of February 13, 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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