Morgan Stanley

INVESTMENT MANAGEMENT

20 Years of High Quality Investing

ACTIVE FUNDAMENTAL EQUITY

INTERNATIONAL EQUITY TEAM

SEPTEMBER 2016

Lessons learned over 20 years of quality investing

1

Pick great stocks and get out of the way of the compounding

More than anything else, our understanding of what constitutes a high quality company and our determination to maintain a high quality bar for our global portfolios sets us apart from the competition. We focus on companies demonstrating high return on operating capital employed with low volatility of margins, pricing power and limited leverage. Companies with these characteristics and that can also grow their top line and free cash flows steadily are more likely to compound wealth.

2

Know what you own

Our concentrated global portfolios focus on the highest quality companies in the world. Opaque business models are not worth the worry.

3

Trust your instincts on management

We meet management to understand whether they share our long term perspective, their desire to invest in long-term intangibles such as advertising and promotion, their ability to innovate, and how efficiently they allocate capital. Managers tend to do what they are paid to do. Are they paid to think about return on capital, or just grow earnings? See how they are paid and if you don't like it, try to change it.

4

Benchmarks are risky and tracking error is not particularly meaningful

While we understand that clients need something against which to measure our performance, we firmly believe that benchmarks themselves are inherently risky. Benchmarks do not care about quality or price. If you hug the benchmark, you'll deliver benchmark returns (at best) and probably not have a business in the long term. We don't care about benchmarks.

5

Risk management should be absolute not relative

We believe the industry is too focused on relative risk. We focus on absolute risk – the chance of losing money on an investment. By analyzing and debating the franchise, regulatory, management and valuation risks associated with our stocks, we believe we are more likely to pick winners and, arguably more importantly, avoid the losers.

WILLIAM LOCK, *Head of International Equity Team*

6

What you don't own is just as important as what you do

Anyone familiar with our global portfolios will know there are certain sectors which just don't make the grade such as banks, utilities, telecommunications and energy. Over two decades our skew to higher quality stocks in higher quality sectors such as staples, software and media has proved the best away to offer attractive returns and relative downside protection.

7

Express your conviction in concentrated position sizes

We make sure our conviction in a stock is reflected in the portfolio. We tend to manage meaningful position sizes.

8

Valuation matters

Even great companies are not great investments if you overpay. Valuation matters and we focus on free cash flows rather than earnings, as cash is real. Even if something is too expensive now, most things you want to own come your way eventually. Be patient.

9

Maintain a long-term perspective and seek to have clients who share this goal

Trying to beat the market every year is futile. What matters is winning across cycles, particularly so in tough years when clients need the performance most.

10

Remain curious

Samuel Johnson (1709-1784) said, "When a man is tired of London, he is tired of life." I feel the same about the markets, which provide an ever more interesting environment in which to try grow our clients' capital. The secret to longevity in this business is continuing to ask the right questions. Encourage your team to question everything and everyone, including yourself!

IMPORTANT INFORMATION | For Professional Clients Only

RISK WARNINGS

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