



Mutual Funds

Talking With Kristian Heugh

Manager, Morgan Stanley International
Opportunity Portfolio Fund

Taking Buffett Overseas

By Lewis Braham
Photograph by Morgan Stanley

The following has been excerpted

The first thing Kristian Heugh does when newcomers join his investment team is ask them to read a book of Warren Buffett's essays. "The book covers 50 years of Berkshire Hathaway's annual reports and focuses on those key kernels of wisdom that Buffett has graciously provided," says the manager of the **Morgan Stanley International Opportunity Portfolio**. "One of the great concepts he focuses on is that of time—not timing the market, but time in the market."

Like Buffett, Heugh believes in concentrated long-term investing, and that is what has given him his edge. His \$1.1 billion fund (ticker: MIOPX) has delivered a 9.3% five-year annualized return, besting 98% of its peers in Morningstar's Foreign Large Growth category, which have returned only 2.1% on average. To keep his focus long term, Heugh aligns his own financial future with fund shareholders: "80% of my financial assets are in the funds we manage," Heugh says.

Heugh, who grew up in Atlanta, New York, and London, spent his summers learn-

(over please)

ing “patience fishing” in Norway with his grandfather. Based in Hong Kong, Heugh also runs three other Morningstar-rated five-star funds—the more conservative **Morgan Stanley International Advantage Portfolio** (MFAPX), **Morgan Stanley Global Opportunity** (MGGPX), and **Morgan Stanley Asia Opportunity Portfolio** (MSAUX).

Heugh’s entire investment team is heavily invested in the funds. “Think like an owner,” he says. “That’s one of our mantras.” The team searches for companies with executives who have heavy insider ownership, as well, so the fund can invest long-term alongside them. What’s more, Heugh doesn’t call any of the 15-member investment team analysts or managers, but fellow investors. “We don’t like to use the terms ‘portfolio manager’ and ‘analyst’ because everyone is contributing,” he says.

Heugh favors high-quality companies with strong brands and low debt that consistently generate enough cash flow so they don’t need to borrow during economic downturns. He says this is what Buffett’s strategy evolved into over time, pointing out that when Buffett began investing in the 1950s, he was a traditional value investor, as there were a lot of cheap stocks, but less so as markets have become more efficient. The rampant inflation of the 1970s also taught Buffett that “companies with pricing power are critical because they can continue to grow and pass on the price increases of their inputs into the final price for their customers,” Heugh says. “They actually may be the beneficiaries of inflation.”

That’s why Heugh likes companies such as luxury-goods maker Hermès International (RMS.France), which has such a strong brand it has been in business since 1837. “Hermès is family controlled, and the family thinks long term,” Heugh

says. “They’re very careful about how they expand the business. They don’t discount their prices but instead very slowly raise them on an almost yearly basis. They really want to maintain that brand image of craftsmanship.”

While Heugh has a 26% weighting in consumer-staples companies such as Reckitt Benckiser Group (RB.UK), which makes popular health and cleaning products like Clearasil, Woolite, and Lysol, his largest sector exposure at 28% is in consumer-discretionary companies like Hermès. His No. 1 holding at 6.7% of his 36-stock portfolio is Moncler (MONC.Italy), an Italian apparel maker that specializes in coats and outerwear. While fashion retail can be fickle, such isn’t always the case in luxury brands. He notes that Moncler isn’t expanding too quickly like mainstream retailers, having about 200 stores and planning to increase them at a rate of 10 to 15 stores per year. “When you compare Moncler’s business to its peers in the luxury industry, its profit margins are at the very high end, around 30%, which is comparable to Hermès,” he says. The reason for that, Heugh says, is the company’s focus on quality in its specific niche: “The company’s not trying to be everything for everyone but to do what it does better than anybody else in the world.”

Given the resilient nature of the businesses he invests in, Heugh isn’t too worried about macroeconomic and individual country risk. Despite the U.S. trade war, Chinese stocks such as math-and-science tutoring company Tal Education Group (TAL) and soy-sauce maker Foshan Haitian Flavouring & Food (603288.China) account for 24% of his portfolio, versus just 8% for the fund’s benchmark, the MSCI All Country World Ex-U.S. Index.

One risk that Heugh faces is the po-

tential to overpay for these brand-name companies. According to Morningstar, his fund’s valuation metrics are all higher than those of its fund category peers. But Heugh would argue that current valuations don’t capture the long-term growth potential of great businesses, and the stock market seems to agree with him. In the past five years, this fund has produced 112% of its Morningstar benchmark’s upside when the market rose, with only 64% of its downside when it fell. Clearly, despite any valuation concerns, Heugh has been successful at playing defense. ■

Morgan Stanley International Opportunity

	Total Return		
	1-YR	3-YR	5-YR
MIOPX	-12.5%	13.6%	9.3%
Foreign Large Growth Fund Category	-14.5	6.3	2.0
Top 10 Holdings		% of Net Assets	
Company / Ticker			
Moncler / MONC.Italy	6.7		
Tal Education Group / TAL	6.2		
HDFC Bank / HDFCB.India	5.6		
DSV / DSV.Denmark	5.2		
Booking Holdings / BKNG	4.7		
Reckitt Benckiser Group / RB.UK	4.4		
EPAM Systems / EPAM	4.2		
Hermès International / RMS. France	4.1		
Fevertree Drinks / FEVR.UK	4.0		
Chocoladefabriken Lindt & Spruengli / LISN.Switzerland	3.6		
Total:	48.7		

Note: Holdings as of 11/30; all returns as of 01/08; three- and five-year returns are annualized. U.S. holdings do most of their business overseas. Sources: Morningstar; Morgan Stanley

Morgan Stanley

INVESTMENT MANAGEMENT

IMPORTANT INFORMATION

The views and opinions are those of *Barron's* and Kristian Heugh as of the date of publication and are subject to change at any time due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all portfolio managers at Morgan Stanley Investment Management (MSIM) or the views of the Firm as a whole, and may not be reflected in all the strategies and products that the Firm offers.

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 MSIM product.

Certain information herein is based on data obtained from third party sources believed to be reliable. However, we have not verified this information, and we make no representations whatsoever as to its accuracy or completeness.

The information herein is a general communications which is not impartial and has been prepared solely for information 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 material contained herein has not been based on a consideration of any individual client 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.

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.

Information, including performance and holdings, herein are provided by *Barron's* and no representation or warranty can be given with respect to the accuracy or completeness of the information. **Past performance is not indicative of future results.**

The article is being provided by MSIM to highlight recent press concerning Kristian Heugh of the Counterpoint Global Team and its Portfolios. This is not an offer or a solicitation of an offer for any of the other funds mentioned in the article.

Please note the reprint was altered from its original form.

Morgan Stanley Institutional Fund International Opportunity Portfolio – Class A Shares

Top Ten Holdings (% of Total Net Assets)	Fund	Index
Moncler SPA	6.92	0.04
Tal Education Group	6.61	0.06
EPAM Systems Inc	5.25	--
HDFC Bank Ltd	5.17	--
DSV	4.68	0.08
Fevertree Drinks Plc	4.51	--
Hermès International S.A.	4.10	0.10
Foshan Haitian Flavouring	3.92	--
Booking Holdings Inc	3.21	--
Rightmove Plc	3.18	

Sector Allocation (% of Total Net Assets)	Fund	Index
Consumer Discretionary	37.29	11.13
Consumer Staples	21.11	9.92
Information Technology	11.93	8.39
Communication Services	8.00	7.05
Industrials	7.37	11.68
Financials	7.13	21.60
Health Care	3.10	8.38
Cash	4.12	--

As of March 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 above or securities within sectors shown below.

Average Annual Total Returns as of March 31, 2019 – Class A Shares	1 Year	3 Years	5 Years	Since Inception (3/31/2010)
MIOPX with max sales charge (%)	-2.86	16.83	11.62	11.27
MIOPX without max sales charge (%)	2.53	18.95	12.82	11.94
MSCI All Country World Ex-U.S. Index (%)	-4.22	8.09	2.57	4.22
Morningstar Category Average (%)	-3.20	8.05	3.86	--

Class A shares include maximum front-end sales charge of 5.25%. 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 International Opportunity Portfolio (Class A shares) is 1.36% and the net expense ratio is 1.29%. 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 and ratings as of 3/31/19. **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. **Ratings:** The Morningstar Rating™ for funds, or “star rating”, is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product’s monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. Ratings do not take into account sales loads.

International Opportunity: Class A Shares Foreign Large Growth Category 3 years 5 Stars out of 373 funds, 5 years 5 Stars out of 314 funds. Percentile Rank/Absolute Rank/Total in Category 1 Yr 11/45/442, 3 Yr 1/3/373, 5 Yr 1/4/314. **International Advantage:** Class A Shares Foreign Large Growth Category 3 years 5 Stars out of 373 funds, 5 years 5 Stars out of 314 funds. **Asia Opportunity:** Class A Shares Pacific/Asia ex-Japan Stock Category 3 years 5 Stars out of 77 funds. **Global Opportunity:** Class A Shares World Large Stock Category 3 years 5 Stars out of 732 funds, 5 years 5 Stars out of 617 funds.

Morningstar information is based on quarter-end data. Please visit morganstanley.com/im for the latest month-end Morningstar information. © 2019 Morningstar, Inc. All rights reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

Assets under management for MSIF International Opportunity Portfolio are \$1.34 billion as of March 31, 2019.

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**). **Exchange traded funds (ETFs)** shares have many of the same risks as direct investments in common stocks or bonds and their market value will fluctuate as the value of the underlying index does. By investing in exchange traded funds (ETFs), the portfolio absorbs both its own expenses and those of the ETFs it invests in. Supply and demand for ETFs may not be correlated to that of the underlying securities. **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. Investing in the securities of **smaller companies** involves greater risk and price volatility than investing in larger, more established firms. To the extent that the Fund invests in a limited number of issuers (**focused investing**), the Fund will be more susceptible to negative events affecting those issuers and a decline in the value of a particular instrument may cause the Fund’s overall value to decline to a greater degree than if the Fund were invested more widely.

The MSCI All Country World Ex-US Index is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and emerging markets, excluding the U.S. 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 indexes are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

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.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A BANK DEPOSIT