In December, MSCI Europe Index finished up 0.79%, bringing the total gain for 2017 to a hefty 10.2%. The market was led by consumer services (+6%), materials (+4%) and real estate (+3%); utilities (-4%), retailing (-4%) and technology (-2%) underperformed.¹

Markit’s PMI for the euro area’s manufacturers rose to a record high in December. Operating conditions continue to improve in all of the eight countries for which separate data is gathered, including Greece (where the manufacturing PMI is at a 114-month high). Once again, the survey highlighted strong growth in output, jobs and new orders.

In early December, Eurostat published estimates of gross domestic product (GDP) growth for 3Q17. Relative to 3Q16, growth is estimated at 2.6%².

The European Central Bank (ECB) meeting in December ended as expected, with upward revisions to both growth and inflation. Ten-year Bund yields underperformed both treasuries and U.K. gilt, finishing the month five basis points (bps) higher.³

Oil prices continued to rally, making December the fourth consecutive month of price increases. The Brent ended 2017 18% higher.⁴

On the political front, the three pro-Catalan independence parties won a majority of parliamentary seats, but they fell short of a parliament majority. The Italian government has

¹ FactSet, January 2018. The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. Past performance is no guarantee of future results. See disclosures for more information.
² Eurostat.
³ Morgan Stanley Research, January 2018.
⁴ MSIM, January 2018.
announced that the next election will take place on March 4. The new electoral system is proportional for the most part. The polls say that no single or party coalition is projected to win, and it will likely need support to form a grand coalition to rule the country. In the meanwhile, the Italian economy picked up speed and our economists revised GDP growth numbers upward for 2018.¹

During the month, we took some profit in Dutch tech company ASML and Italian asset management company Azimut. We continued to build up our position in French real estate company Unibail-Rodamco.

The MS INVF European Champions Fund remains overweight in consumer discretionary, consumer staples, technology, healthcare and industrials. It remains underweight in materials, utilities, energy, telecommunications and financials.

We topped up our position in German health care company Fresenius SE, following recent stock price weakness. Information in this section is as at 31 December 2017 and is subject to change on a daily basis. This data is provided for informational purposes and is not intended to be an investment recommendation in regards to any securities, sectors or countries mentioned herein.

Consider This

European equities and global equities had another strong year in 2017, with the former ending the year up more than 10% (in euro). The key question now is whether it is time to become more bearish in 2018 as the U.S. cycle is nine years old and central bank liquidity may turn gradually.

We remain constructive on European equities for the coming months, although we acknowledge that absolute valuations are not as compelling as they used to be and the market might become more cautious for the second half of 2018 when it may start to discount the first hike in European interest rates. We want to flag the following supportive points for the coming months:

- European earnings growth for 2018 is positive, with consensus expectations around 6-8% growth.
- GDP growth momentum is likely to continue, with consumer sentiment, unemployment, PMIs and other leading indicators at multi-year highs. The U.K. is the only major country in Europe where our economists predict a strong contraction year-on-year of the economy, but not a recession.
- ECB tightening is not imminent, as our economists expect the first hike only to happen in March 2019.⁷
- Global inflation is on the rise, but it is still well below central banks’ targets. Oil prices are up 40% over the past six months, and this will certainly have consequences on inflation over the coming months.⁷

The U.S. curve (10-2 years) is flattening, but it is not inverted yet. The U.S. curve has been a good indicator of future recessions, and when inverted, it has always signalled an imminent recession. Crucially, U.S. stocks never peaked before yield curve inverts.⁶

From a macro perspective, we will carefully watch any potential slowdown in global growth; a significant rise of inflation forcing the Federal Reserve to accelerate the pace of interest rate hikes; political instability (German government; Catalonia; Italian and Swedish elections; Brexit negotiations).

¹ Morgan Stanley Research, December 2017.
² FactSet, November 2017.
³ Morgan Stanley Research, December 2017.
⁴ JP Morgan Equity Research, S&P 500 Index; December 2017.
Data as at 31 December 2017 for Class I (%)

Investment Performance (% net of fees) for Morgan Stanley Investment Funds (MS INVF) in EUR

<table>
<thead>
<tr>
<th>Fund/Index</th>
<th>1 MONTH</th>
<th>YTD</th>
<th>1 YEAR</th>
<th>3 YEARS ANN.</th>
<th>5 YEARS ANN.</th>
<th>10 YEARS ANN.</th>
</tr>
</thead>
<tbody>
<tr>
<td>MS INVF European Equity Alpha Fund</td>
<td>0.80</td>
<td>8.84</td>
<td>8.84</td>
<td>4.53</td>
<td>7.78</td>
<td>3.18</td>
</tr>
<tr>
<td>MSCI Europe Index</td>
<td>0.79</td>
<td>10.24</td>
<td>10.24</td>
<td>6.96</td>
<td>9.40</td>
<td>3.36</td>
</tr>
<tr>
<td>ALPHA</td>
<td>0.01</td>
<td>-1.40</td>
<td>-1.40</td>
<td>-2.43</td>
<td>-1.62</td>
<td>-0.18</td>
</tr>
<tr>
<td>MS INVF Eurozone Equity Alpha Fund</td>
<td>-0.74</td>
<td>10.63</td>
<td>10.63</td>
<td>8.27</td>
<td>10.81</td>
<td>3.75</td>
</tr>
<tr>
<td>MSCI EMU Index</td>
<td>-0.89</td>
<td>12.49</td>
<td>12.49</td>
<td>8.84</td>
<td>10.66</td>
<td>1.94</td>
</tr>
<tr>
<td>ALPHA</td>
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<td>-1.86</td>
<td>-1.86</td>
<td>-0.57</td>
<td>0.15</td>
<td>1.81</td>
</tr>
<tr>
<td>MS INVF European Champions Fund</td>
<td>1.53</td>
<td>10.69</td>
<td>10.69</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>MSCI Europe Index</td>
<td>0.79</td>
<td>10.24</td>
<td>10.24</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>ALPHA</td>
<td>0.74</td>
<td>0.45</td>
<td>0.45</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

12 Month Performance Periods to Latest Month End

<table>
<thead>
<tr>
<th>Fund/Index</th>
<th>DEC ’12 – DEC ’13</th>
<th>DEC ’13 – DEC ’14</th>
<th>DEC ’14 – DEC ’15</th>
<th>DEC ’15 – DEC ’16</th>
<th>DEC ’16 – DEC ’17</th>
</tr>
</thead>
<tbody>
<tr>
<td>MS INVF European Equity Alpha Fund</td>
<td>23.06</td>
<td>3.46</td>
<td>5.23</td>
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<td>8.84</td>
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<td>MSCI Europe Index</td>
<td>19.82</td>
<td>6.84</td>
<td>8.22</td>
<td>2.58</td>
<td>10.24</td>
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<tr>
<td>MS INVF Eurozone Equity Alpha Fund</td>
<td>29.50</td>
<td>1.67</td>
<td>10.73</td>
<td>3.59</td>
<td>10.63</td>
</tr>
<tr>
<td>MSCI EMU Index</td>
<td>23.36</td>
<td>4.32</td>
<td>9.81</td>
<td>4.37</td>
<td>12.49</td>
</tr>
<tr>
<td>MS INVF European Champions Fund</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>10.69</td>
</tr>
<tr>
<td>MSCI Europe Index</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>10.24</td>
</tr>
</tbody>
</table>

Past performance is not a reliable indicator of future results. 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.

Risk Considerations

- 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 fund’s ability to buy or sell securities.
- 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 their 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.

* Inception date of the Fund is 8 April 2016.
INDEX INFORMATION

The MSCI Europe Index is a free float-adjusted market capitalization index designed to measure developed market equity performance in Europe. 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 S&P 500 Index measures the performance of the large-cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy. The S&P Index is one of the most widely used benchmarks of U.S. equity performance.

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