

## The Markets – A Review

ACTIVE FUNDAMENTAL EQUITY | EUROPEAN EQUITY TEAM | MACRO INSIGHT | NOVEMBER 2017

MSCI Europe Index finished the month in negative territory at -2%. The market was dragged down by health care equipment (-7%), consumer durables (-6%) and retailing (-6%); food & staples retailing (+5%), transportation (+1%) and real estate (+1%) outperformed.<sup>1</sup>

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Brexit negotiations continued and, at the beginning of December, the U.K. and the European Union (EU) found an agreement on the first part of the negotiations. They found compromise on the Brexit bill, citizens' rights and the Irish border. With these points now settled, the dialogue can now move to the second stage, which will continue over the coming months. We believe that the U.K. pound and U.K. equities, in particular, will remain volatile depending on the progress of the negotiations.

European macro-economic data remains strong, with manufacturing PMI, industrial production and employment figures continuing their upward trend. Eurozone inflation temporarily slipped and, with oil prices up 40% over the past six months, it will not take long before it returns to the 2% European Central Bank (ECB) target.

The euro outperformed across the board, as the European growth outlook remained positive and the eurozone break-up risk from Catalonia's referendum seemed to reduce. Though initial German coalition talks have fallen through, the markets seem optimistic about some possible return of the grand coalition.

<sup>1</sup> FactSet, December 2017. 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.

Sterling continued to be volatile, as the Bank of England's first hike in November was well priced in by the market. In addition, the government budget failed to impress investors, resulting in some Sterling strengthening when progress on Brexit negotiations were made.

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**IN NOVEMBER, THE BEST-PERFORMING SECTORS IN THE EUROPEAN EQUITY MARKETS WERE:<sup>2</sup>**

- Real estate (+1%)
- Telecommunications (+0%)
- Energy (-1%)

**NOVEMBER KEY LAGGARDS:<sup>2</sup>**

- Consumer Discretionary (-3%)
- Industrials (-3%)
- Technology (-3%)

**FOR THE YEAR TO DATE, THE BEST-PERFORMING SECTORS IN THE EUROPEAN EQUITY MARKETS ARE:**

- Technology (+20%)
- Industrials (+15%)
- Materials (+14%)

**YEAR-TO-DATE KEY LAGGARDS:**

- Telecommunications (+1%)
- Energy (+3%)
- Health Care (+3%)

**MSIM European Equities**

The MS INVF European Equity Alpha Fund remains overweight in health care, technology, telecommunications and consumer staples; it remains underweight in energy, financials, industrials, consumer discretionary, materials and utilities.

During the month, we completely exited our position in U.K. bank Barclays and took some profit in retail Dutch bank ING, U.K. insurance company Prudential, Dutch semiconductor company ASML, French industrial companies Airbus and Schneider, and Danish pharmaceutical company Novo Nordisk. We initiated a position in Switzerland-based bank UBS, Dutch food retail company Ahold Delhize and continued to build our desired position in Siemens Gamesa.

UBS offers wealth management, asset management and investment banking services for private, corporate and institutional clients worldwide. We believe that UBS Wealth Management – which represents the lion's share of UBS earnings – offers stable and consistent cash flow generation along with earnings visibility. The Wealth Management Division is particularly strong in key regions like the U.S. and Asia. UBS has been able to successfully shrink its volatile investment banking activity and to settle the majority of its subprime litigation exposure, becoming a cleaner investment proposition.

Ahold Delhize is an international food retail group, operating supermarkets mainly in Benelux, the U.S. and some selective countries in Eastern Europe. The company generates significant cash flow and the merger with Delhaize should deliver cost synergies, improving the group's profitability. Recently, Ahold stock has been excessively penalised by Amazon and hard discounts entering its competitive space in the U.S., providing an attractive long-term buying opportunity for patient investors.

The MS INVF Eurozone Equity Alpha Fund is currently overweight in health care, telecommunications and technology. On the contrary, the portfolio is underweight in utilities, real estate, consumer discretionary, financials and materials.

During the month, we took some profit in Irish building materials firm CRH, Dutch retail bank ING, German software company SAP and French industrial companies Airbus and Schneider. We topped up our position in Dutch food retailer Ahold Delhize and Spanish industrial company Siemens Gamesa. We also initiated a position in French real estate company Unibail-Rodamco.

Unibail is the largest commercial real estate company in Europe and it specialises in shopping centres, convention centres and offices. Positive

economic outlook, rising consumer confidence and employment should continue to support rental lease increases, improving Unibail's revenues growth. We believe that Unibail will be resilient to any potential disruption caused by constant growth in online retail, based on the company's focus on prime and large retail spaces.

We did not make any significant changes in the MS INVF European Champions Fund during the month as we believe it is well positioned in the current environment.

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

*Information in this section is as at 30 November 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**

- Global equities have had a strong run year-to-date, up 20% (in USD).<sup>2</sup> Europe, in particular, pending a major sell-off during December, is likely to end the year with an annual performance of around 9-10%. It is tempting to turn bearish given the big move, the fact that the U.S. cycle is nine years old and that central bank liquidity will be turning. We remain constructive on European equities for the coming months. In particular, we believe:
- European earnings are set to continue their growth trend.
- Gross domestic product growth momentum is likely to continue, with consumer sentiment, unemployment, PMIs and other leading indicators at multi-year high. The U.K. is the only

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<sup>2</sup> FactSet, MSCI Europe Index; December 2017.

major country in Europe where our economists predict a strong contraction of the economy.

- ECB tightening is not imminent, as our economists expect the first hike to happen only in March 2019.
- Global inflation is on the rise but still well below central banks' targets. Oil prices are up 40% over the past six months,<sup>3</sup> and this will certainly have consequences on inflation over the coming months. The eurozone unemployment rate has fully unwound all the downturn caused by the recession, although significant pockets of capacity utilisation rates remain in some parts of southern Europe. This means that wage pressure is not uniform across Europe.
- Relative valuations of European equities remain undemanding.

- In the U.S., while we acknowledge that the U.S. curve (10-2 years) is flattening, it is still not inverted. The U.S. curve has been a good indicator of future recessions, and when inverted, it has always signalled an imminent recession. Crucially, on a historical basis, U.S. stocks have never peaked before the yield curve inverts.<sup>3</sup>
- Geopolitical risks (North Korea, Catalonia, Italian and U.S. mid-term elections, Germany), inflation and U.S. Federal Reserve policy will be key factors to watch in the coming year.

### RISK CONSIDERATIONS

- The funds rely on other parties to fulfill certain services, investments or transactions. If these parties become insolvent, it may expose the funds to financial loss.

- There may be an insufficient number of buyers or sellers which may affect the funds 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 his or her investment.
- The value of the investments and the income from them will vary and there can be no assurance that the funds 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

### Performance in % – Morgan Stanley Investment Funds (MS INVF)

Data as at 30 November 2017.

	1 MONTH	YTD	1 YEAR	3 YEARS ANN.	5 YEARS ANN.	10 YEARS ANN.
MS INVF European Equity Alpha Fund	-1.47	7.98	14.23	3.53	7.59	3.09
MSCI Europe Index	-2.08	9.37	15.77	6.18	9.53	3.14
<b>ALPHA</b>	<b>0.61</b>	<b>-1.39</b>	<b>-1.54</b>	<b>-2.65</b>	<b>-1.94</b>	<b>-0.05</b>
MS INVF Eurozone Equity Alpha Fund	-2.31	11.46	18.71	7.70	11.39	3.88
MSCI EMU Index	-2.04	13.49	21.37	8.33	11.38	1.98
<b>ALPHA</b>	<b>-0.27</b>	<b>-2.03</b>	<b>-2.66</b>	<b>-0.63</b>	<b>0.01</b>	<b>1.90</b>
MS INVF European Champions Fund <sup>4</sup>	-2.91	9.02	13.66	-	-	-
MSCI Europe Index	-2.08	9.37	15.77	-	-	-
<b>ALPHA</b>	<b>-0.83</b>	<b>-0.35</b>	<b>-2.11</b>	<b>-</b>	<b>-</b>	<b>-</b>

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. Performance is shown net of fees and for the I share class, in base currency of EUR.

<sup>3</sup> JP Morgan Equity Research, December 2017.

<sup>4</sup> Inception date of the Fund is 8 April 2016.

**12 Month Performance Periods to Latest Month End (Class I, %)**

	<b>NOV '12 – NOV '13</b>	<b>NOV '13 – NOV '14</b>	<b>NOV '14 – NOV '15</b>	<b>NOV '15 – NOV '16</b>	<b>NOV '16 – NOV '17</b>
MS INVF European Equity Alpha Fund	21.17	7.25	8.46	-10.44	14.23
MSCI Europe Index	20.30	9.47	12.64	-8.20	15.77
MS INVF Eurozone Equity Alpha Fund	29.47	6.00	13.95	-7.64	18.71
MSCI EMU Index	25.27	7.62	13.84	-8.00	21.37
MS INVF European Champions Fund	-	-	-	-	13.66
MSCI Europe Index	-	-	-	-	15.77

**INDEX INFORMATION**

The MSCI Europe Index is a free float-adjusted market capitalization index that is 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.

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