Morgan Stanley

INVESTMENT MANAGEMENT

Selective China share investing can offset the risks of an opaque market, Morgan Stanley says

ARTICLE REPRINT | APRIL 2018

Reproduced with permission of:

South China Morning Post

KAREN YEUNG
karen.yeung@scmp.com

04/29/2018

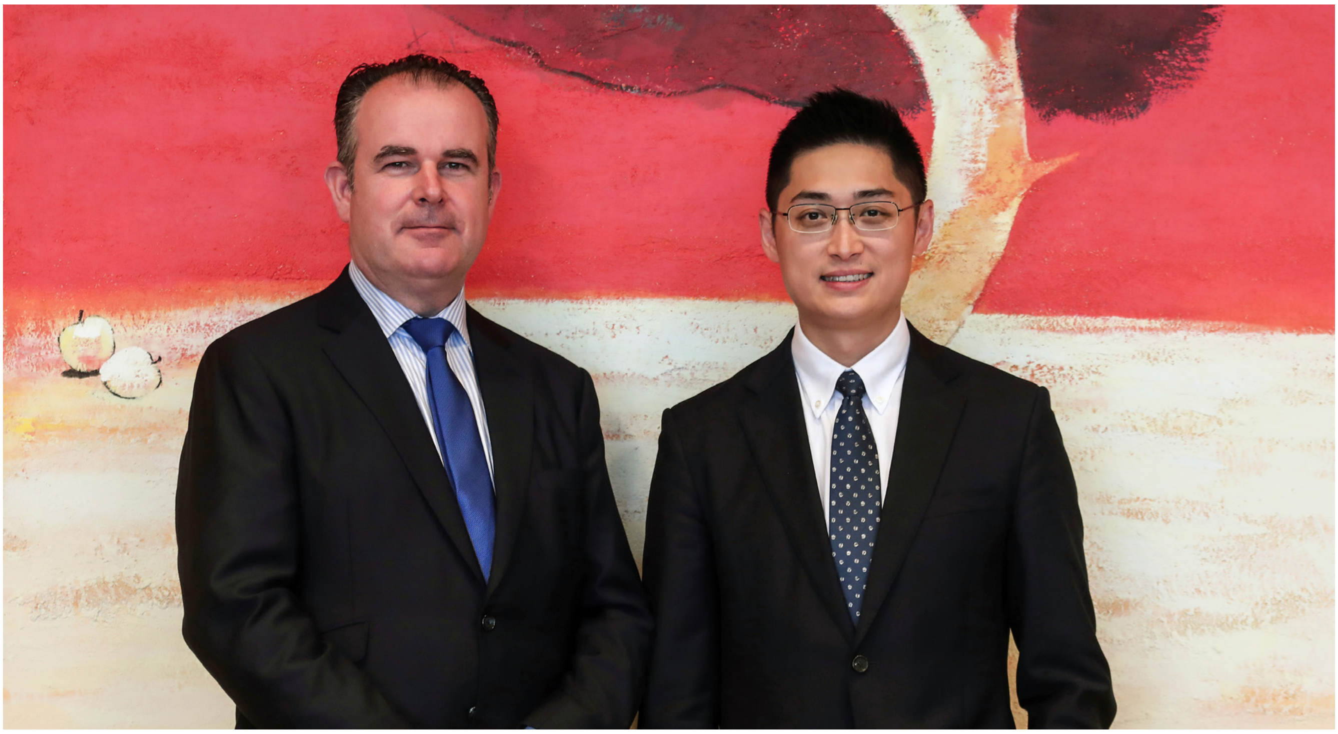
Companies that offer services to China's growing middle class, along with tourism and environmental technology are areas where growth prospects can be easily seen, the investment bank say.

International investors wary of Chinese domestic shares because of the opaqueness of the market and its vulnerability to global tensions may want to consider a thematic approach to unlock pockets of value, according to Morgan Stanley Investment Management.

The A-share market offers more than 3,000 stocks, meaning there are opportunities to find companies with attractive valuations and growth potential, potentially delivering strong returns and market outperformance, according to Paul Price, London-based global head of distribution at the investment bank's asset management unit.

"From a portfolio perspective, investors may want to find active managers making discerning judgment calls between the different pockets of value and trying to concentrate on the most lucrative areas," Price said during a visit to Hong Kong last week.

Even though global stock index provider MSCI decided last year to include 222 Chinese A shares in its Emerging Markets Index, using a two-step process beginning on June 1, many global investors are wary of issues including the quality of corporate governance at companies, as well as the retail investor driven nature of the market that causes volatility and the impact of global political problems such as trade tensions between China and the US.



Paul Price (left), global head of distribution for Morgan Stanley Investment Management, and Gary Cheung, managing director at Morgan Stanley Asia and China A equities portfolio manager, suggest a selective approach to investing in Chinese stocks. Photo: Jonathan Wong

Nevertheless, the attraction of the market to investors is growing, and investors can succeed if they are selective.

"There is a growing propensity for the need to have a stand-alone investment in China A shares as a portfolio allocation to one of the fastest growing economies in the world," Price said.

> "The attraction of the market to investors is growing, and investors can succeed if they are selective."

Gary Cheung, managing director at Morgan Stanley Asia and China A equities portfolio manager, said he liked Chinese consumer discretionary, consumer staple, health care and technology companies that cater to the nation's expanding middle class, an investment theme that is very strong and long lasting.

Cheung also likes companies targeting new trends around environmental protection and domestic tourism, while companies that provide software and IT tools for courts and prosecutors to enhance the productivity and efficiency of the legal system may also do well, given China's focus on the development of the system.

Morgan Stanley's A-share funds have seen returns of 19.3 per cent since they began in 2006, compared to 12 per cent for an aggregate of all its China equity funds. Over the past five years the returns have been about 22 per cent versus the aggregate benchmark's 8.6 per cent.

The article was originally published in *South China Morning Post* on April 29, 2018.

DISCLAIMER

The opinions expressed in the article are those of South China Morning Post and Morgan Stanley Investment Management as of April 29, 2018 and are subject to change at any time due to changes in market or economic conditions and may not necessarily come to pass. The comments are for informational purposes only and should not be construed as a recommendation of individual holdings or market sectors. The material does not purport to address the financial objectives, situation or specific needs of any individual reader. The use of this article is not a solicitation, or an offer to buy or sell any security or investment product. Moreover, the opinions expressed in this article are not necessarily those of Morgan Stanley or its employees.

RISK CONSIDERATIONS

Past performance is not a guarantee of future performance. There is no assurance that a portfolio will achieve its investment objective. Investment in this strategy involves a high degree of risk, including the risk that the entire amount invested may be lost. In general, portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline. Accordingly, you can lose money investing in this portfolio. Please be aware that this portfolio is subject to certain additional risks. **Emerging market securities.** Investments in foreign markets entail special risks such as currency, political, economic, and market risks. The risks of investing in emerging-market countries are greater than the risks generally associated with investments in foreign developed countries. The portfolio's investments may be denominated in foreign currencies and therefore, to the extent unhedged, the value of the investment will fluctuate with the U.S. dollar exchange rates. To the extent hedged by use of foreign currency forward exchange contracts, the precise matching of foreign currency forward exchange contract amounts and the value of the securities involved will not generally be possible because the future value of such securities in foreign currencies will change as a consequence of market movements in the value of those securities between the date on which the contract is entered into and the date it matures. There is additional risk that such transactions reduce or preclude the opportunity for gain if the value of the currency should move in the direction opposite to the position taken and that foreign currency forward exchange contracts create exposure to currencies in which the portfolio's securities are not denominated. **Frontier emerging markets.** The risks associated with emerging markets are magnified when investing in frontier emerging market countries, accordingly, investments in the portfolio must be viewed as highly speculative in nature and may not be suitable for an investor who is not able to afford the loss of the entire investment. **Derivative Instruments/Strategic Transactions.** Derivative Instruments/ Strategic Transactions involve risks, including the imperfect correlation between the value of the such instruments and the underlying assets, possible default by the other party to the transaction, illiquidity of the derivative instrument and, to the extent the Adviser's prediction as to certain market movements is incorrect, the risk that the use of such Strategic Transactions could result in losses greater than if they had not been used. These losses may have a potentially large negative impact on the strategy's performance. Equity securities are more volatile than other investments. **Nondiversification.** Nondiversified Portfolios often invest in a more limited number of issuers. As such, changes in the financial condition or market value of a single issuer may cause greater volatility.

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Prior to investing, investors should carefully read the relevant offering document(s).

DISTRIBUTION

This communication is only intended for and will be only distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

UNITED KINGDOM: Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA. **DUBAI:** Morgan Stanley Investment Management Limited (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). **GERMANY:** Morgan Stanley Investment Management Limited Niederlassung Deutschland Junghofstrasse 13-15 60311 Frankfurt Deutschland (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **ITALY:** Morgan Stanley Investment Management Limited, Milan Branch (Sede Secondaria di Milano) is a branch of Morgan Stanley Investment Management Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), and whose registered office is at 25 Cabot Square, Canary Wharf, London, E14 4QA. Morgan Stanley Investment Management Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 08829360968. **THE NETHERLANDS:** Morgan Stanley Investment Management, Rembrandt Tower, 11 Floor Amstelplein 1 1096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of Morgan Stanley Investment Management Limited. Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **SWITZERLAND:** Morgan Stanley & Co. International plc, London, Zurich Branch Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-115.415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41(0) 44 588 1074. **AUSTRALIA:** This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accept responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. **HONG KONG:** This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **SINGAPORE:** This document should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"), (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

IMPORTANT INFORMATION

Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

All investments involve risks, including the possible loss of principal. 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.

The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable European or Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.