Morgan Stanley

INVESTMENT MANAGEMENT

Why Invest Internationally: A Conversation

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With volatility on the rise, why are you suggesting that investors consider markets outside of the U.S.?

PORTFOLIO SOLUTIONS GROUP (PSG): Two key reasons are the increased opportunity set and the potential for risk mitigation. More than half of the world's investable markets are outside the U.S., and investors who focus exclusively on the U.S. may be missing out on 60% of the world's investment opportunities.[1] In certain segments of the market, the gap is even greater—the international small cap universe, for example, is double that of the U.S.[2] International investing allows for a wider breadth of investments and potentially more rewarding investment opportunities.

Increased geographic diversification may also offer some downside risk mitigation, as the relative performance of U.S. vs. international stocks has historically alternated. While U.S. equity markets have done remarkably well since 2008, recency bias may cause investors to forget that 2000-2010 was referred to as "the lost decade" due to their poor performance (*Display 1*). With low international correlations, diversified portfolios have provided more consistent and stable investment results over the long run than narrower domestic markets.

[1] Source: Bloomberg as of March 31, 2019 - Global Equities Market - market capitalization

[2] Source: FactSet as of 12/31/18. "US Small Cap" is represented by the Russell 2000 Index and "International Small Cap" by the Morgan Stanley Capital International (MSCI) All Country World Index (ACWI). Past performance is no guarantee of future results. Russell 2000 is an index designed to measure the performance of the small capitalization companies in the United States equities market. It is a composite of roughly 2,000 securities issued by companies with market capitalization values averaging $2 billion.

DISPLAY 1

Regional Annualized Returns

Performance for non-overlapping periods. Data January 1, 2001 through June 30, 2019.

2015	2016	2017	2018	2019 (as of June 30, 2019)
MSCI Japan 9.6%	MSCI EM LatAM 31.0%	MSCI EM 37.3%	S&P 500 -4.4%	S&P 500 18.5%
S&P 500 1.4%	S&P 500 12.0%	MSCI AC Asia Pacific Ex Japan 37.0%	MSCI EM LatAM -6.6%	MSCI World 17.0%
MSCI World -0.9%	MSCI EM 11.2%	MSCI Europe 25.5%	MSCI World -8.7%	MSCI Europe 15.8%
MSCI Europe -2.8%	MSCI World 7.5%	MSCI Japan 24.0%	MSCI Japan -12.9%	MSCI EM LatAM 12.6%
MSCI AC Asia Pacific Ex Japan -9.4%	MSCI AC Asia Pacific Ex Japan 6.8%	MSCI EM LatAM 23.7%	MSCI AC Asia Pacific Ex Japan -13.9%	MSCI AC Asia Pacific Ex Japan 12.2%
MSCI EM -14.9%	MSCI Japan 2.4%	MSCI World 22.4%	MSCI EM -14.6%	MSCI EM 10.6%
MSCI EM LatAM -31.0	MSCI Europe -0.4%	S&P 500 21.8%	MSCI Europe -14.9%	MSCI Japan 7.7%

Source: PSG Analysis, Bloomberg. **Past performance is no guarantee of future results.** The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. Please refer to important information, disclosures and qualifications at the end of this paper. Investing involves risks including the possible loss of principal. Indexes do not include any expenses, fees or sales charges, which would lower performance. Indexes are unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

Further, the current macro political backdrop with trade wars across the globe is having an impact on globalization. One of the consequences of countries putting up new barriers to cross-border trade and investment is that countries' economies, and therefore markets, move in a less asynchronous manner. With correlations among regions declining, the ability to move in and out of markets is increasingly important; as is the ability to assess the relative value of each market and potential for alpha generation.

In regards to implementation, are there benefits to choosing a single global manager as opposed to, say, a number of regional managers?

PSG: As previously alluded to, we believe geographic diversification is both prudent and timely. A global manager has the ability to rotate geographies in a way that can smooth out volatility, improve diversification and enhance returns. The ability to diversify may be particularly useful today: Morgan Stanley Research suggests there is a 70% chance that the U.S. will move from expansion to downturn in the next 12 months, while forward-looking consensus expectations suggest attractive returns for non-U.S. equities.

With the ability to tactically allocate between U.S. and non-U.S. equities, a global manager removes the need for asset owners to make a series of regional asset allocation decisions that they may not be better suited to make and may not fully take into account overall portfolio balance. A global implementation, coupled with specialist managers for certain inefficient segments of the market, is thus likely to be a more optimal portfolio construction approach.

Thank you for sharing your views. With more market volatility, there is a view that international diversification increasingly makes sense and the benefits and actionable insights that you offered may be useful in helping advisors and their clients achieve their goals.

*The **Portfolio Solutions Group** specializes in designing and managing custom multi-asset, multi-manager investment solutions with an open architecture framework on behalf of some of the most sophisticated investors around the world.*

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 value of securities owned by the portfolio will decline. Accordingly, you can lose money investing in this strategy. Please be aware that this strategy may be subject to certain additional risks. In general, **equity securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, and market risks. Stocks of **small-capitalization companies** carry special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies. The risks of investing in **emerging market countries** are greater than risks associated with investments in foreign developed markets. **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. **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. **Illiquid securities** may be more difficult to sell and value than public traded securities (liquidity risk).

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The S&P 500® Index measures the performance of the large cap segment of the U.S. equities market, covering approximately 75% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

The **MSCI Japan Index** is a free-floated adjusted market capitalization weighted index that is designed to track the equity market performance of Japanese securities listed on the Tokyo Stock Exchange, Osaka Stock Exchange, JASDAQ and Nagoya Stock Exchange. The MSCI Japan Index is constructed based on the MSCI Global Investable Market Indices Methodology, targeting a free-float market capitalization coverage of 85%.

The **MSCI World Index** is a free float adjusted market capitalization weighted index that is designed to measure the global equity market performance of developed markets. 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 **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.

The **MSCI Emerging Markets Index (MSCI EM)** is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging markets.

The **MSCI Emerging Markets Latin America Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets within Latin America. The MSCI Emerging Markets Latin America Index consists of the following 5 emerging market country indices: Brazil, Chile, Colombia, Mexico and Peru.

The **MSCI All Country Asia Pacific Ex-Japan Index** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of Asia, excluding Japan. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

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