Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley Funds (UK)

Global Brands Fund

INTERNATIONAL EQUITY TEAM | MONTHLY COMMENTARY | 31 OCTOBER 2021

Performance Review

In the one month period ending 31 October 2021, the Fund's I ACC shares returned 1.17% (net of fees)[1], while the benchmark returned 3.94%.

The portfolio has underperformed for the year-to-date, returning +14.73% versus +19.11% for the index.

Sector allocation was a negative in the month due to the strong performance by cyclical sectors. In particular, the overweight in consumer staples and the underweight in consumer discretionary were both drags on performance, mitigated to an extent by the lack of communication services stocks. Stock selection was positive due to the outperformance in financials, information technology and industrials.

The top contributors to absolute performance during the month were Microsoft (+146 basis points [bps]), Intercontinental Exchange (+59 bps) and Accenture (+51 bps). The top absolute detractors were Visa (-33 bps), Fidelity National Information Services (-22 bps) and Becton Dickinson (-17 bps).

Market Review

October was a very strong month, more than making up for September's weakness. The MSCI World Index returned 5.7% in U.S. dollars (USD) during the month (+5.5% in local currency). As is usually the case in such markets, it was the cyclical sectors that performed best, with consumer discretionary, energy and information technology all up 8% (in USD) and financials gaining 6%. By contrast, the more defensive sectors were weaker, with consumer staples only rising 3% and health care up just 4%. Communication services (+1%) was the weakest sector. Looking at geography, North America performed well, with the U.S. up 7% and Canada gaining 8% in USD and 5% in local currency. The flip side is that most major European and Asian markets finished behind the index, barring Switzerland (+6% USD, +4% local). Political uncertainty took its toll on Japan (-3% in USD, -1% local) and Germany (+2% in USD and local), while Hong Kong (+1% in USD and local) was also weak.

Portfolio Activity

Portfolio activity is reported at quarter-end.

Strategy and Outlook

Supply chain squeeze

It's not demand, it's supply: Eighteen months ago, demand for goods and services collapsed as the COVID-19 pandemic swept over the globe. Many countries suffered their largest gross domestic product contractions ever recorded.

Today, with some exceptions (e.g., the travel industry), demand for goods and services in the corporate world is stronger than ever. But companies are facing more operational challenges due to a squeeze in supply chains resulting from shortages in labour, raw materials and components, as well as tight logistics capacity, all putting upward pressure on costs and restricting product availability.

We are now observing something unusual: profit warnings due to a lack of supply, rather than an unexpected drop in demand.

How did we get here? Put simply, COVID-19 has led to a dramatic shift in the types of goods and services people want over a relatively short space of time. This isn't a huge surprise because the way we live and operate, for the broad population, has changed dramatically. Such rapid shifts in demand are not easily matched by supply chains, which take longer to build up.

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 October 2021.

If we take a specific example, demand for sporting goods has surged. Over the past 18 months, we have seen an acceleration of a fairly established trend as people have looked to stay fit and healthy in new ways due to the pandemic. The importance of being fit and healthy has been brought to the front of mind for many people.

Sporting goods manufacturers are largely based in Southeast Asia, specifically Vietnam, Cambodia and China. Vietnam is a clear reminder that the pandemic remains with us, almost two years after it began. A government-ordered lockdown in Vietnam has resulted in factory closures, causing many weeks of lost production, and many weeks to ramp back up. Footwear and apparel, which need to travel across the globe to reach consumers, have been delayed due to a lack of shipping containers and port capacity, resulting in goods taking twice as long to reach their destination. This is a knock-on effect from the collapse in air travel, which has eliminated a significant proportion of air freight capacity, pushing up costs and encouraging businesses to switch to ocean freight. The result? Lost sales as fewer shoes and clothes make it to shelves.

How big a problem is this? As the entire industry uses outsourced production, largely from the same suppliers, it is an industry-wide problem, not a company-specific one. On balance, they all lose out. Profits will take a hit, ironically because fewer goods will ultimately be sold. There may be some partial compensation from net pricing because there will be limited unsold inventory to discount. This is something the industry is striving for to improve gross margins and return on capital. So, one silver lining is that this could be another step forward in conditioning consumers to not wait for discounts. The risk? People spend their money on something else, i.e., consumption shifts elsewhere and it does not all come back when supply resumes.

The larger companies, which our global portfolios tend to own, have the scale to weather the storm and to continue investing in their digital platforms; however, smaller companies, which were already playing catch up, may find themselves further behind in the digital race.

The rush to "not miss out" on demand creates environmental, social and governance risks, as well. There are well-documented supply chain controversies for the sporting goods industry; its constituents need to be careful not to add to the list with the pressure to ramp up production quickly while balancing labour welfare. This could be a good test of how much progress a company has made in making people a priority in their way of doing business.

Of course, while sporting goods are a recent victim, semiconductors were perhaps the earliest category where there was a clear mismatch in supply and demand. Here, increased demand as a result of COVID-19 (working from home, home schooling, etc.) hit up against relatively fixed near-term supply. This has had a knock-on effect in many parts of the economy, most notably stalling the automotive sector, which goes to show just how pervasive technology is becoming within the global economy. There is no easy fix to the semiconductor shortage – it can only be addressed by new manufacturing capacity. Here the leading Taiwanese foundry has indicated it will invest $100 billion over the next three years. The shortage has also shone a light on just how narrow and globalised the semiconductor supply chain has become, with capacity provided by only a handful of major chipmakers and equipment manufacturers.

For companies with pricing power, cost inflation can be passed on to the end customer. The strong demand environment today means many companies, even those with historically weak pricing power, are confident they can pass on cost increases, minimising the impact on profits. The difference is, for those with weak pricing power, pricing may not stick once this period of supply squeeze abates.

Pricing power is a vital attribute we seek in the companies we own in our global portfolios. So, while there may be some short-term volatility for their earnings and returns, we think the earnings potential of these higher quality companies should be rebased higher once this episode is complete, and the gap between the high quality and low quality companies widened.

For further information, please contact your Morgan Stanley Investment Management representative.

FUND FACTS

Launch date	Base currency	Index
03 February 2003	Sterling	MSCI World Net Index

12 Month Performance Periods to Latest Month End (%)

	OCTOBER '20 - OCTOBER '21	OCTOBER '19 - OCTOBER '20	OCTOBER '18 - OCTOBER '19	OCTOBER '17 - OCTOBER '18	OCTOBER '16 - OCTOBER '17
OEIC Global Brands Fund - I ACC Shares	20.64	7.77	15.97	10.64	11.22
MSCI World Net Index	32.46	4.45	11.28	5.13	12.88

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. **Please visit our website www.morganstanley.com/im to see the latest performance returns for the fund's other share classes.**

Share Class I ACC Risk and Reward Profile

Lower Risk						Higher Risk
1	2	3	4	**5**	6	7
Potentially Lower Rewards						Potentially Higher Rewards

The risk and reward category shown is based on historic data.

- Historic figures are only a guide and may not be a reliable indicator of what may happen in the future.
- As such this category may change in the future.
- The higher the category, the greater the potential reward, but also the greater the risk of losing the investment. Category 1 does not indicate a risk free investment.
- The fund is in this category because it invests in company shares and the fund's simulated and/or realised return has experienced high rises and falls historically.
- The fund may be impacted by movements in the exchange rates between the fund's currency and the currencies of the fund's investments.

This rating does not take into account other risk factors which should be considered before investing, these include:

- 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 funds ability to buy or sell securities.
- Investment in China A-Shares via Shanghai-Hong Kong Stock Connect program may also entail additional risks, such as risks linked to the ownership of shares.
- 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 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.

Please refer to the Prospectus for full risk disclosures. All data as of 31 October 2021 and subject to change daily.

INDEX INFORMATION

The **MSCI World Net 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 index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

The index has been chosen for performance comparison purposes because it is a broad global equity index that represents large and medium sized company performance across developed countries.

IMPORTANT INFORMATION

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Applications for shares in Morgan Stanley Funds (UK) should not be made without first consulting the current Prospectus, Key Investor Information Document (KIID), Annual Report and Semi-Annual Report ('Offering Documents'), or other documents available in your local jurisdiction, which are available free of charge from the Registered Office: 25

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