Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley Funds (UK)

Global Brands Equity Income Fund

INTERNATIONAL EQUITY TEAM | MONTHLY COMMENTARY | 31 JANUARY 2021

Performance Review

In the one month period ending 31 January 2021, the Fund's I ACC shares returned -1.90% (net of fees)[1], while the benchmark returned -1.44%.

As of 31 December 2020, the Fund had produced a distributed yield of 4.0% over the previous four quarters.

The underperformance was driven by both sector allocation and stock selection. Consumer staples weakness drove the negative sector allocation, while in stock selection underperformance in information technology, consumer staples and financials outweighed the health care outperformance. The overwrite (sale of index call options) added to performance for the month (+28 basis points [bps]).

The leading absolute contributors in January were Abbott Laboratories (+50 bps), Microsoft (+35 bps) and Thermo Fisher Scientific (+31 bps). The greatest detractors in the same time period were Visa (-67 bps), Reckitt Benckiser (-41 bps) and Procter & Gamble (-37 bps).

Market Review

Weakness in the final week of the month left the MSCI World Index down at -0.99% for January (-0.77% in local currency). Looking at geographies, the Asian markets outperformed the index, with Hong Kong +2% and Singapore +1% (in both U.S. dollars [USD] and local currencies). The weakest markets were in southern Europe, as Spain fell 5% in USD (-4% in local currency) along with Italy (-4%, -3%) and France (-3%, -2%). All the other major markets, including the U.S., the U.K. and Germany, were within a percent of the MSCI World Index. There was also limited variation by sector. The leaders in the month were energy (+3%) and health care (+1%), while consumer staples (-4%) and industrials (-3%) lagged. The other seven sectors were roughly in line with the overall index.

Portfolio Activity

Portfolio activity is reported at quarter end.

Strategy and Outlook

Insta-engagement

Effective engagement needs time. Expecting instant results from an engagement is as senseless as expecting instant alpha. Just as we look for steady and consistent growth in the companies we own, we value steady and consistent improvement in their approach to environmental, social and governance (ESG) issues over zigzagging in policy to satisfy short-term appetites and box-ticking.

As a team, we have engaged with company managements and their boards for over 20 years. In recent years, we have become more structured about our engagements, focusing on dual discussions with the C-suite as well as sustainability representatives of our investee companies. These engagements have provided useful insights, especially regarding company responses to and priorities during the pandemic. We have also become more systematic about the crucial area of management incentives, creating our proprietary Pay X-Ray scoring framework. This has enabled us to better compare and discuss company pay plans and inform our voting approach. In 2020 we voted against management on 30% of say-on-pay resolutions. In the bulk of these cases our stance was in disagreement with proxy advisory firm ISS, which supported management.

Our efforts to engage are helped by our long-term holdings of significant stakes in companies, given that we hold at least half a percent of the free float for 90% of the Global Brands Equity Income holdings.[2] The resulting access makes us less dependent on news presented at public Annual General Meetings or Investor Relations events. We reserve our hardest questions for

1 Source: Morgan Stanley Investment Management Limited. Data as of 31 January 2021.
2 Source: MSIM Analysis, FactSet. Data as of December 2020.

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private meetings, not the podium or the press. We believe the right questions asked in the right way can garner thoughtful consideration of our position and drive the agenda of future engagements. That said, we are not afraid to vote against management, as was demonstrated by the 68% of the 2020 shareholder proposals that we supported.

Remote working has meant that both asset managers and companies have had to get used to digital and video-conferenced engagement. We found, in the main, that companies were responsive to our requests during lockdown. We held some 369 meetings in 2020, and 205 of those specifically included an ESG engagement on topics ranging from decarbonisation, diversity and data security to supply chain questions from fast fashion to semiconductors. That said, we are looking forward to meeting companies face-to-face again whenever this becomes possible.

Discussions with companies in the fourth quarter of 2020 included carbon emissions targets, deforestation, diversity and inclusion, board risk controls and safety. For example:

- With Reckitt Benckiser, we probed how their recent pledge to be **net zero carbon** by 2040 can be achieved. We were encouraged by their policies and actions around **palm oil**.
- We had a very detailed discussion on **deforestation** with Procter & Gamble, to understand their initiatives in sustainable paper product sourcing. They have taken a number of concrete actions, but we voted for the shareholder resolution to improve disclosure.
- Our discussions with Baxter International centred on **product safety** given past concerns. They aim to be in the top quartile on safety among global companies and have achieved a good reduction in product complaints through improvement to their inspections. We also examined their **diversity and inclusion** measures and encouraged them to disclose their gender pay gap. We believe Baxter is making progress and will continue to monitor them.

We encourage you to learn more about these and our other engagements through our Engage newsletter, published semi-annually, available at the Insights section of www.morganstanley.com/im.

The question of "whose opinion matters?" has never been more germane. Ultimately, while all stakeholders matter, the top line starts with the customer. Any major concerns relevant to the customer should be high on the agenda of company management. In this context, it is important to be clear about one's own principles, priorities and values. For our carbon-light, high quality global portfolios, we pay particular attention to companies' efforts to meet low or net zero carbon targets.

We're also pragmatists. We recognise that universal problems may require collaborative solutions to hasten progress. MSIM's support of the One Planet Summit asset manager initiative since January 2020, which aims to advance the understanding of climate-related risks and opportunities in long-term investment portfolios, is an excellent example. In the United Nations Principles for Responsible Investment 2020 Annual Report, MSIM scored "A" across modules and "A+" in Listed Equities for both Active Ownership and Incorporation, a result we are delighted with.[3]

As companies look to emerge from the crisis, we will continue to ask the hard questions. Many of them are company or industry specific, be it around plastics for consumer staples, product safety for health care or data security for information technology, but there are some more universal themes coming out of the crisis:

- What are the main lessons from the pandemic? How have companies evolved their attitude to risk as a result of the crisis?
- Will the company's supply chain be the same as or different from before the pandemic? Has the company accepted that it is deemed responsible for its supply chain – from employee health and safety to resourcing?
- How will capital allocation and balance sheet decisions differ going forward?
- How have remuneration decisions been affected by the shock of the pandemic? Will the Board take into account any capital raising, dividend cuts or take-up of government support?
- How is the company placed for the new era of greater government intervention? Is there significant exposure to potential new tax regimes?
- How does the company perceive the impact of remote working on innovation or product safety, or prioritise topics such as gender and racial diversity under tougher economic conditions?
- How are companies weighing up the balance between the ever-increasing demands for sustainability and their long-term returns on operating capital employed?

Globally, the call for greater transparency and disclosure of companies' and fund managers' activities, as well as in-depth portfolio reporting, is finding its way into industry bodies and regulation. As we navigate the ESG journey, we believe it pays to avoid faddy "tickboxery" and instead to maintain investment discipline, to focus on robust stocks and on relevant, meaningful long-term engagement.

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

FUND FACTS

Launch date	Base currency	Index
30 August 2016	Sterling	MSCI World Net Index

[3] To be ranked "A", a company must receive a combined score between 75-95/100 in the core and additional assessed indicators. To be ranked "A+", a company must score >95/100.

12 Month Performance Periods to Latest Month End (%)

	JANUARY '20 - JANUARY '21	JANUARY '19 - JANUARY '20	JANUARY '18 - JANUARY '19	JANUARY '17 - JANUARY '18	JANUARY '16 - JANUARY '17
OEIC Global Brands Equity Income Fund - I ACC Shares	2.22	24.76	6.67	6.04	--
MSCI World Net Index	10.83	17.49	1.03	11.32	--

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 simulated historic performance 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 value of financial derivative instruments are highly sensitive and may result in losses in excess of the amount invested by the fund.
- 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.
- 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.
- The derivative strategy aims to increase the income paid to investors, but there is potential for the fund to suffer losses.
- 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 January 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 Cabot Square, Canary Wharf, London E14 4QA.

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