A Sub-Fund of Morgan Stanley Funds (UK)

Global Quality Select Fund

INTERNATIONAL EQUITY TEAM

Performance Review

In the one month period up until 31 March 2025, the Fund's I ACC shares returned -5.22% (net of fees)[1], while the benchmark returned -6.79%.

For the first quarter overall, the portfolio outperformed the MSCI World Index, delivering a return of -2.18% versus the index's -4.71%. As a reminder, we expect the portfolio to offer attractive absolute long-term returns with lower volatility than the broader market.

For the quarter, the three largest contributors to absolute performance were all financials stocks, driven by fundamentals following strong stock-specific updates: **AJ Gallagher** (+38 basis points [bps]) returned a remarkable +18% in sterling (+22% USD) in a falling market following a strong operating quarter, which saw the company beat earnings per share (EPS) estimates and reaffirm healthy organic growth guidance; **Visa** (+37 bps) performed well on the back of a good set of first quarter results, which saw the company raise full-year 2025 guidance, helped by strong growth in payments and the company's increasing breadth of products and services; while **Intercontinental Exchange** (+33 bps) was bolstered by data reporting strong trading activity – particularly in energy products and fixed income – and realised cost synergies from the Black Knight integration.

In terms of the largest absolute detractors during the first quarter, **Microsoft** (-71 bps) and **Alphabet** (-61 bps) fell -13% and -21%, respectively (-11% and -18% USD), as investors appeared to question the sustainability of the Magnificent Seven's (Mag 7) dominance, given uncertainty regarding the payoff of higher capital expenditure being made by the artificial intelligence (AI) hyperscalers. The other key detractor in the first quarter was **Accenture** (-44 bps), whose shares have continued to slide despite solid results, given the limited visibility on global discretionary spending trends and potential headwinds to its Department of Government Efficiency (DOGE) exposed business.

In terms of the **relative performance** picture, March saw positive stock selection and neutral sector allocation. Positive selection was on account of outperformance in IT, financials, health care, consumer discretionary and industrials. Meanwhile for sector allocation, the drag from the lack of exposure to energy and the drag from the IT overweight was balanced by the consumer discretionary underweight and a combination of smaller positive allocation effects.

For the first quarter overall, positive stock selection was primarily due to IT strength, where positive performers such as SAP and Roper drove the significant outperformance versus the index. In a reversal from previous quarters, relative IT performance was helped by the portfolio's underweight to the weaker performing IT subsectors, notably semiconductors and hardware. Outperformance in financials and consumer discretionary was also notable: in financials, the portfolio's sector-level return was +9% versus the index's +3%, while consumer discretionary was over 10 percentage points ahead of a very weak sector. Outperformance in these sectors more than made up for health care weakness. In terms of sector allocation, the portfolio benefited from its overweight to health care and financials, as well as its underweight to consumer discretionary, which more than outweighed the drag from the IT overweight and not owning energy.

As of 31 March 2025, the portfolio's carbon footprint was 83% lower than the MSCI All Country World Index.[2]

Market Review

A particularly volatile March rounded out a bumpy first quarter for global equity markets, with the MSCI World Net Index returning -4.5% in U.S. dollars (USD) in the month and -1.8% in the quarter (local currency returns of -5.0% in March and -2.7% in the quarter). Political uncertainty and concerns over a slowing U.S. economy defined market sentiment, although interestingly, the fall in equity markets in the first quarter appeared to be largely down to the high-profile AI plays – the Mag 7 – rather than widespread deterioration in other sectors. The IT and consumer discretionary sectors were down -9% and -8%, respectively, in the month and double digits in the first quarter (-12% and -10%, respectively), mainly due to Nvidia, Apple and Tesla, which each saw several hundred billion dollars wiped off their market capitalisations. The other Mag 7-exposed sector, communication services, delivered -7% in March and a slightly less severe -4% in the quarter, held back by Alphabet. Outside of these Mag 7-exposed sectors underperforming, there was little differentiation between defensive and cyclical sectors with all other sectors delivering positive returns. Energy and utilities led in the month (+5% and +3%, respectively) and quarter (+10% and 7%, respectively), while consumer

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 March 2025.
[2] Source: Trucost. WACI is calculated using Scope 1 & 2 emissions per $million of company revenue. The term carbon refers to greenhouse gas (GHG) emissions, measured in metrics tonnes of carbon dioxide equivalent (CO_2e) emissions. Our data provider's methodology follows the GHG protocol and includes carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), sulphur hexafluoride (SF_6) and Nitrogen Trifluoride (NF_3), calculated in metric tonnes of CO_2 equivalent. Some carbon/carbon equivalents data may be estimated by the data provider. Data excludes cash.

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staples, health care and financials were also ahead of the overall index in March and delivered positive quarterly returns (+5%-6%). Sector performance is shown in USD unless otherwise noted.

Turning to geographies, the rollout of the Trump administration's protectionist policies saw the greenback weaken against international currencies, with the U.S. the only major market to lag the MSCI World in March (-6%) and the first quarter (-5%), in USD terms. Major markets in continental Europe were strong, outperforming the overall index in the month and delivering double-digit USD returns in the quarter (+6%-12% local). Performance in Asia was more mixed: for the quarter overall, Singapore (+10% USD, 8% local) and Hong Kong (+4%, +5%) held up well despite tariff fears, while the appreciation of the yen saw weaker performance by Japan (0%, -5%).

Portfolio Activity

We initiated two new positions in the quarter, **Oracle** and **Amadeus**, and made one final sale, **AIA**.

Oracle is a software company with a semi-monopolistic position in the enterprise-grade relational database market and the second largest player in enterprise resource planning (ERP). These are mission critical applications characterised by predictable and sticky revenue streams, very high switching costs and considerable pricing power. We believe the company's growth should be supported by its latest cloud offering, Oracle Cloud Infrastructure, which has the potential to be a successful niche offering in a large and growing market. A recent pullback in the share price provided us with the opportunity to initiate a position at an attractive mid-20s price-to-earnings (PE) multiple.[3]

The other purchase was **Amadeus IT Group**, a specialist travel technology company that sells mission critical software to airlines, airports and increasingly the hospitality industry. It operates in three business units: Air Distribution, which connects over 400 airlines and travel agents and handles almost a half of indirect industry air bookings; Air IT Solutions, which develops and implements mission-critical software for airlines and airports; and Hospitality, which does the same for the hospitality industry, especially hotels. The company demonstrates high gross margins and high returns on operating capital, and has seen very high retention rates since 2000. We believe its new generation Order Management System product, Nevio, has the potential to increase airlines' pre-tax per passenger earnings and drive growth over the medium term. The stock was attractively valued, trading at a discount to its 10-year average.

Finally, we completed our exit from **AIA** after a reasonable first quarter. After a period of particularly weak share price performance, mainly on account of negative China sentiment, the company reported its full year 2024 results in the quarter, which saw book-build continue to grow, with double-digit growth in new business value, especially higher in Hong Kong (+23%) and China (+17%).[4] The partial recovery in share price, coupled with the fact that the stock has appeared more cyclical than we had initially anticipated, led to our decision to exit the position.

Over the first quarter, strong share price performance by the likes of **Abbott Laboratories, SAP, Visa, CME** and **AutoZone** saw us trim the positions and take profit. We also reduced our exposure to **Alphabet,** due to expected near-term volatility, and **IQVIA,** given the difficult operating environment and expected volatility over the next few quarters as the company's earnings normalise to historic ranges. We recycled this capital by taking advantage of valuation opportunities, adding to **S&P Global,** which had derated from a peak +30x PE multiple,[3] **AJ Gallagher,** where there was upside to our price target, and **Booking Holdings,** which had derated over AI-related concerns despite robust operational performance. We also added to **TSMC**, as the stock price had fallen following speculation of the group acquiring Intel's chip plants, and continued to build the position in **ASML** given the share price pullback in the first quarter, which left upside to our price target.

Strategy and Outlook

Life after the "Liberation Day" tariff announcement

Publishing an outlook in early April 2025 is a hostage to fortune, given the current fluid and fast-moving environment driven by the substantial uncertainties around the path of U.S. economic policy and its effects, not to mention the volatility of equity prices. We do not attempt to make any kind of definitive prediction about economic outcomes right now, but instead analyse what kind of outcomes are discounted in equity prices. We would argue that even after the circa 10% fall in the first two days after the "Liberation Day" tariff announcements, the markets are implicitly assuming that much of the tariff hikes will soon be reversed, before they have significant impacts on the U.S. economy.

Looking at the state of the markets before the "Liberation Day" tariff announcement, there had been much sound and fury about the slide in equity indexes in the first quarter, but the MSCI World Index finished down just 2%, and the S&P 500 only fell 4%. The first quarter drawdown was focused on the tech-plus sectors: information technology itself, communication services, dominated by Alphabet and Meta, and the consumer discretionary sector housing Amazon and Tesla. The other eight sectors in MSCI World were all up in the quarter, with a lack of significant performance differential between the defensive and cyclical sectors. We would argue this implies the market was not pricing in major concerns about an economic slowdown, outside some select pockets of consumer discretionary such as airlines, hotels and the tariff-hit autos industry. This sanguine attitude was also shown in the market earnings forecasts for 2025 and 2026, which stayed roughly flat in the first quarter, admittedly helped at the margin by the weakening dollar, still booking in double-digit earnings growth for 2025 and 2026.

[3] Source: FactSet.
[4] Source: AIA Annual Results for the Year Ended 31 December 2024.

This resilience of the market ex-Mag 7 in the first quarter suggests investors were not yet focusing on the potential negative headwinds from tariffs but rather had continued to focus on the potential benefits to corporate profitability of the new administration policies, such as deregulation. As a result, the "Liberation Day" tariff announcement came as a shock. Multiple analysts[5] have suggested that the scale of the proposed tariffs, 20%-plus on leading trade partners, if they are indeed sustained, could reduce U.S. gross domestic product (GDP) growth by more than 1%, while adding up to a couple of points to inflation, not to mention cutting corporate profit margins. Such a stagflationary shock could also restrict the U.S. Federal Reserve's (Fed) ability to reduce interest rates, at a time when fiscal policy needs to be tight to start to deal with a deficit at 7% of GDP. While still relatively healthy before the tariff announcement, there were already some signs of the U.S. economy slowing down, while inflation was still above the Fed's 2% target. Aside from the mechanical impact of the tariffs, there is also the impact on both corporate and consumer confidence, both of which had already declined in March in anticipation of tariffs. Importantly, regardless of the end destination of this policy initiative, it is increasingly clear that the current administration has other populist priorities beyond large corporate profitability and the level of the S&P 500. Looking at the targets of the tariffs, major exporters to the U.S. face significant challenges, more likely to be a deflationary than an inflationary shock.

Even after the circa 10% drop in markets in the two days after the tariff announcement (up to the close on 4 April), markets look far from cheap by historical standards, with MSCI World on over 16x forward earnings and the S&P 500 still above 19x.[3] These multiples are on earnings still assumed to be rising double digits in each of the next two years, a pace we worried about even before the announcement. Both the multiple and earnings will be very vulnerable if the U.S. economy slows to sub-1% growth. This implies that even at its lowered level, the market seems to be pricing in sharp reductions in the tariff rates over the next few months, presumably on the back of successful negotiations with the likes of the EU and China. While not impossible, this tariff de-escalation is certainly not a given, particularly after China's retaliation.

As we explained in our recent Global Equity Observer article – The New Tariff Landscape – in terms of the potential impact of tariffs across our portfolio, we would split them between the direct effects and the more uncertain indirect effects from any retaliation or macroeconomic impacts. At the time of writing, given that our portfolio is skewed towards services rather than goods, we believe most of our companies should face limited direct impact from these U.S. tariffs, while local manufacturing, high gross margins, pricing power and recurring revenues should help dampen the extent of the impact for the goods producers.

It is possible that retaliation may spread beyond the goods sector, perhaps even with sanctions placed on U.S. technology giants by the EU — but again we believe their high gross margins, pricing power and recurring revenues should help mitigate the impacts on the portfolio. These same factors should also help the portfolio in the case that the tariffs trigger a significant slowdown and/or recession, given the portfolio companies' economics and the portfolio's history of earnings' robustness in tough economic times in the past. In addition, it also has limited exposure to the "Trough of Disillusionment" risk in AI. While the portfolio owns Microsoft and Alphabet, where we believe the adoption of GenAI can provide an extra driver of growth on top of the ongoing transition to cloud, it does not own the other five of the Mag 7. Being in the "not owning" business has been a significant tailwind to the portfolio's strong relative performance so far this year. If markets are indeed not reflecting a sustained high tariff environment and the sharp economic slowdown it implies, then not owning could continue to be a positive as the year progresses.

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

Fund Facts

Launch date	23 September 2019
Base currency	Sterling
Benchmark	MSCI World Net Index

12 Month Performance Periods to Latest Month End (%)

Past performance is not a reliable indicator of future results.

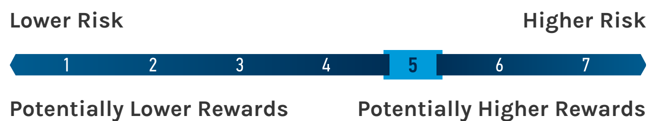
	MARCH '24 - MARCH '25	MARCH '23 - MARCH '24	MARCH '22 - MARCH '23	MARCH '21 - MARCH '22	MARCH '20 - MARCH '21
OEIC Global Quality Select Fund - I ACC Shares	4.71	18.46	-3.74	12.32	22.98
MSCI World Net Index	4.76	22.45	-0.99	15.39	38.43

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 shares. The sources for all performance and index data is Morgan Stanley Investment Management ('MSIM Ltd'). **Please visit our website www.morganstanley.com/im to see the latest performance returns for the fund's other share classes.**

Effective 29 November 2024 the MS Funds (UK) Global Sustain Fund was renamed the MS Funds (UK) Global Quality Select Fund. There was no change to the Fund's investment philosophy and process or ESG approach.

[3] Source: FactSet.
[5] For instance, Goldman Sachs, UBS, Deutsche Bank, Yale Budget Laboratory.

Share Class I ACC Risk and Reward Profile



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.
- Sustainability factors can pose risks to investments, for example: impact asset values and increased operational costs.
- 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.
- 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 31.03.2025 and subject to change daily.

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Charts and graphs provided herein are for illustrative purposes only and subject to change.

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.

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The **MSCI All Country World Index (ACWI)** is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and emerging 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 **Standard & Poor's 500® Index (S&P 500®**) measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

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