Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley Investment Funds

Emerging Markets Debt Fund

GLOBAL FIXED INCOME TEAM | MONTHLY COMMENTARY | 31 OCTOBER 2021

Important information

- The Fund invests primarily in the debt securities of government and government-related issuers located in emerging countries, and the Fund may also invest in debt securities of entities organised to restructure outstanding debt of such issuers, together with investing in the debt securities of corporate issuers located in or organised under the laws of emerging countries.
- Investment involves risks. Key risks for this fund include Emerging Market Risk, Credit Risk, Interest Rate Risk, High Yield Securities Risk, Derivatives Risk, Downgrading Risk, Unrated Securities Risk, Risk of Exposure to the Euro and the Eurozone and Risk of Discretionary Distributing Share Class.
- The Fund may pay distributions out of capital. Payment of dividends out of capital amounts to a return or withdrawal of part of a Shareholder's original investment or from any capital gains attributable to that original investment. Any distribution involving payment of dividends out of capital may result in an immediate decrease of the NAV per share.
- There is a risk that you may potentially lose your entire investment in this Fund.
- The investment decision is yours but you should not invest unless the intermediary who sells it to you has advised you that it is suitable for you and has explained why, including how buying it would be consistent with your investment objectives. You should not make any investment decision solely based on this document. Please read the relevant offering document carefully for further fund details including risk factors.
- The Fund may use derivatives for investment or efficient portfolio management (including hedging) purposes which may expose to higher counterparty, liquidity and valuation risks. The Fund may suffer losses from its derivatives usage.

Performance Review

In the one month period ending 31 October 2021, the Fund's A shares returned -0.41% (net of fees)[1], while the benchmark returned 0.02%.

Market Review

U.S. rates rose in October, with the U.S. 10-year Treasury closing the month 6 basis points (bps) higher at 1.55%. The U.S. dollar strengthened relative to other major currencies, oil prices rose further, and equity markets made new highs.

Emerging markets (EM) debt returns were negative in October. Hard currency sovereigns (proxied by the J.P. Morgan EMBI Global Diversified Index) were flat. Spreads were slightly wider while yields were marginally lower. EM corporates returns were negative for the month, returning -0.5%, according to the J.P. Morgan CEMBI Broad Diversified Index, with high yield (-0.6%) underperforming investment grade corporates (-0.3%). Local currency bonds (proxied by the J.P. Morgan GBI-EM Global Diversified Index) posted negative returns (-1.3%), primarily due to higher yields. From a broad market perspective, Suriname, Sri Lanka, Belize and El Salvador were the best performers in October, while bonds from Lebanon, Argentina and Ethiopia were laggards. From a sector perspective, metals & mining and tech-media-telecom (TMT) companies led the market, while those in the real estate, pulp & paper, and consumer sectors lagged.

In Latin America, the rate hike trend continues as policy makers strive to combat rising inflation. The Central Reserve Bank of Peru hiked 50 bps to 1.50%, in line with expectations. The statement acknowledged that monetary policy continued to be accommodative and reaffirmed that its decision did not imply the beginning of a hiking cycle. In Chile, the central bank surprised the market again with a 125 bp hike, bringing the benchmark interest rate to 2.75%, well above the 2.25% consensus. The board is concerned that inflation will reach the 3% target ahead of the end of the policy horizon, whereas the policy rate is expected to reach its neutral level sooner than previously forecast. In Brazil, the central bank was forced to raise its benchmark lending rate by a sizable 150 bps to 7.75% (in line with market expectations), signaling a hike of the same magnitude in December. The drastic move was in response to negative fiscal developments that led to a sharp sell-off in the currency and government bond markets. In particular, a larger-than-expected social program announcement and the shifting of expenditure items out of the spending cap may imply a higher primary deficit in 2022 and the loss of a key fiscal anchor, raising doubts about the sustainability of the country's debt trajectory. Colombia's central bank also increased the policy rate by 50 bps, to 2.5%, while raising its outlook for economic growth

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

this year to 9.8% year-over-year, from 8.6% previously.

In Asia, Bank Indonesia (BI) kept its policy rate unchanged at 3.50%, in line with expectations. In addition, BI eased macroprudential measures to boost credit in specific sectors, including auto and mortgages. The Reserve Bank of India kept interest rates steady at 4% as widely expected, as output was still below pre-pandemic levels while inflation was trending lower. Meanwhile, the Central Bank of Sri Lanka unveiled a six-month roadmap detailing sources of external funding that would ensure the repayment of upcoming sovereign debt maturities. The document lists, among other funding sources, a relatively large long-term loan facility worth $3.6 billion, which is said to be under negotiation with the Sultanate of Oman, though no official confirmation from the latter has been issued yet. The market rallied on this announcement and similar follow-up statements by Sri Lankan authorities. However, Moody's downgraded the sovereign debt to Caa2 from Caa1, arguing that the country had failed to come up with a comprehensive debt repayment plan and low foreign exchange reserves posed a heightened default risk.

In Europe, more central banks are joining in the monetary tightening as inflation pressures build up. Poland's central bank surprised the market with a 40 bp rate hike to 0.50%, citing that pressures from higher agricultural and energy prices would remain in the coming quarters. The zloty appreciated and the yield curve flattened following the policy announcement. In Romania, the central bank delivered its first hike after three years of unchanged rates, raising the policy rate by 25 bps (to 1.50%), surprising the market, which was expecting a hold decision. The rate hike was predicated on high inflation. In Hungary, the central bank raised its policy rate by 15 bps to 1.80%, as expected, and reiterated its hawkish forward guidance. Elsewhere in the region, the Central Bank of Russia (CBR) surprised the market by hiking its policy rate by 75 bps to 7.50%, versus market expectations for a more modest 25 bp hike. The CBR kept its forward guidance unchanged, keeping the door open for more hikes if inflation evolved along the baseline forecast path.

In Africa, the Central Bank of Egypt has left rates unchanged, a decision it deemed consistent with achieving the inflation target of 7% on average by the fourth quarter of 2022 and price stability over the medium term.

Strategy and Outlook

We have a cautious stance towards emerging market debt in the weeks ahead, as the asset class continues to face multiple disruptive forces. Prospects of diminished monetary policy accommodation in the developed world, and its impact on real yields and the U.S. dollar, may weigh on EM asset performance. Moreover, high frequency indicators pointing to a more pronounced growth slowdown in China, as well as negative news on its real estate market, could contribute to a deteriorating market sentiment, as well as adversely impact commodity exporters in the EM world. Therefore, we continue to hold a conservative approach towards risk in the near term, despite valuations being generally attractive, favoring a subset of EM high yield credits featuring positive idiosyncratic stories, relatively solid fiscal stances, and/or exposed to higher oil prices (similarly, in EM currencies). In rates, we prefer yield curves that are already pricing in aggressive monetary policy tightening.

Despite this near-term cautious backdrop, there are potential developments that could revive our optimism towards the asset class. These include a more detailed plan by Chinese authorities to address real estate market woes, as well as policy easing measures that could curb the weak growth of their domestic economy. In addition, an easing of supply bottlenecks could provide a respite to rising inflationary pressures globally, reducing the need for tighter monetary policy. This could also be facilitated by higher COVID-19 vaccination rates globally, which are already allowing many countries in the EM world to reopen their economies (such as selected countries in Asia and Latin America), thus supporting the supply response. However, domestic politics could deliver both negative and positive surprises. Key events include midterm elections in Argentina, presidential elections and the constitutional reform process in Chile, as well as fiscal developments in Brazil (further fiscal expenditures and erosion of the fiscal anchor) and Sri Lanka (in particular, whether or not the 2022 budget, to be unveiled on 12 November, includes measures to increase tax revenues).

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

FUND FACTS

Launch date	Base currency	Index
01 April 1995	U.S. dollars	Blended Benchmark

12 Month Performance Periods to Latest Month End (%), Presented in USD Terms

	OCTOBER '20 - OCTOBER '21	OCTOBER '19 - OCTOBER '20	OCTOBER '18 - OCTOBER '19	OCTOBER '17 - OCTOBER '18	OCTOBER '16 - OCTOBER '17
MS INVF Emerging Markets Debt Fund - A Shares	4.09	1.22	12.32	-7.83	6.26
Blended Benchmark	4.41	2.31	13.69	-5.27	5.89

Investment involves risks. 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 assume the reinvestment of all dividends and income. The sources for all performance and Index data is Morgan Stanley Investment Management. Please refer to the relevant offering documents for fund details, including risk factors.

INDEX INFORMATION

Blended Benchmark refers to performance of Fund's benchmark since inception - April 1st, 1995 to June 8th, 2020 – J.P. Morgan Emerging Markets Bond Index Global; June 8th, 2020 and beyond – J.P. Morgan Emerging Markets Bond Index Global Diversified.

J.P. Morgan Emerging Markets Bond Index Global Diversified – tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million.

The **JP Morgan CEMBI Broad Diversified Index** is a global, liquid corporate emerging-markets benchmark that tracks U.S.-denominated corporate bonds issued by emerging-markets entities.

JP Morgan GBI-EM Global Diversified Index: a comprehensive global local emerging markets index that consists of regularly traded, liquid fixed-rate, domestic currency government bonds and includes only the countries which give access to their capital market to foreign investors (excludes China, India). The index is market capitalization weighted, with a cap of 10% to any one country.

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