

Morgan Stanley Investment Funds

NextGen Emerging Markets Fund

MARKETING COMMUNICATION | EMERGING MARKETS EQUITY TEAM | MONTHLY COMMENTARY | 30 JUNE 2022

Important information

- The Fund invests primarily in equity securities of issuers in Central, Eastern and Southern Europe, the Middle East and Africa.
- Investment involves risks. Key risks for this fund include Risk of Investment in Equity, Emerging Market Risk, Exchange Rate Risk and Risk of Exposure to the Euro and Eurozone.
- 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.

Performance Review

In the one month period ending 30 June 2022, the Fund's A shares returned -5.83% (net of fees)¹, while the benchmark returned -8.77%.

Our allocation to SEMrush was a top contributor to returns. The company is likely to continue to capitalize on increasing demand for digital marketing, especially from small and medium-sized enterprises (SME). Client growth and product development (app center and added functionalities) remains strong and the total addressable market is likely expanding. Management has reacted rapidly to the situation in Russia and Ukraine, closing the company's Russian operation and relocating engineers in Russia to other countries.

Our allocations to LiveChat and Grid Dynamics contributed positively to returns. Our thesis on LiveChat continues to track: automation of client communications is a secular trend that we believe can help the company deliver strong operational profit growth and return on invested capital over the next two years. User growth is gaining momentum while the average revenue per user continues to grow at a healthy pace. Despite higher inflation and recession fears in the company's core markets, LiveChat delivered solid sales data in the quarter ending in June.

Mobile World Group (MWG) in Vietnam contributed to returns. Vietnam is a NextGen market where we have found great businesses at a reasonable price. We believe MWG is the best consumer retail franchise in Vietnam, which is benefiting from higher incomes and the modernization of retail away from traditional wet markets and shops.

Our allocation to Indonesian traditional medicine and food products company Industri Jamu Dan Farmasi Sido (Sido) contributed positively to returns. The traditional medicine market in Indonesia is growing at a rapid pace, and younger generations are leaning towards more natural and healthy products. We believe Sido could see strong earnings growth in the next two to three years, as it continues to add new products to its valuable brand and increase distribution points to increase penetration.

Zero allocations to index heavyweights Colombia, the Philippines and Peru also contributed.

Our allocations to Capitec Bank and Anglo American detracted as investor concerns over global growth and demand for commodities continued in June. Capitec is the leading consumer bank in South Africa, serving 16 million clients. It has a superior business model that incumbents cannot emulate easily. We believe the company's EPS (earnings per share) can return to rapid growth after the COVID-19 pandemic and its simple and affordable banking model is likely to continue to disrupt the South African financial space.

Our allocation to fashion retailer LPP detracted as the stock underperformed. Even with the uncertainties surrounding inflation, demand has remained strong so far and the company has adjusted rapidly following the closing of its Russian operations. Given how much the stock has declined and considering its ability to still grow, we remain constructive on its outlook and have maintained our position. Allocations to Locaweb, Sea Ltd. and MercadoLibre (MELI) hampered returns as growth and technology names continued to see volatility during the month.

¹ Source: Morgan Stanley Investment Management Limited. Data as of 30 June 2022.

Overall, we hold a concentrated portfolio of what we believe are the best franchises in NextGen emerging markets, buying them at reasonable valuations. Some of these businesses, which are high conviction positions in the portfolio, have among the best return on invested capital across EM, yet some of them trade at very attractive valuations.

Market Review

The MSCI Frontier Emerging Markets Index returned -8.77% during the month, underperforming the MSCI Emerging Markets Index (-6.64%). Colombia (-27.23%), Peru (-14.87%), the Philippines (-11.49%) and Sri Lanka (-11.22%) were the worst performing markets in frontier EM in a month when Latin America equities pulled back given a backdrop of broad inflation acceleration, rising interest rates and fears of a global recession. Serbia (+7.99%), Slovenia (+3.56%), Oman (+2.64%), Jordan (+1.22%) and Tunisia (+0.40%) were the best performing markets among frontier EMs. Nigeria (-0.03%), Romania (-0.52%), Bahrain (-0.58%) and Estonia (-0.60%) also outperformed the Frontier EM Index.

Portfolio Activity

During the month of May, the Fund transitioned to the NextGen Emerging Markets strategy. Portfolio changes in June included trades involved in the Fund transition.²

We initiated a position in Systems Ltd., an IT services company based in Pakistan that offers services to clients around the world. Since going public eight years ago, the company has successfully gained share from current clients, rebranded and moved away from legacy services and into more complex offerings. We think earnings and free cash flow (FCF) should grow robustly in the next three to four years —meaning the company will likely substantially increase its headcount by 2025. Since its initial public offering, System's FCF has grown 34% CAGR (compound annual growth rate) in local currency terms (26% in U.S. dollars) and in the last five years headcount has nearly tripled. Given its rapid expansion, positive industry dynamics and the need for new talent hubs, we believe Systems can potentially outperform frontier emerging markets in the next 18 months.

We added to high conviction positions Sea Ltd., Brac Bank and MercadoLibre (MELI). Sea's first quarter results were overall better than expected given the uncertainty surrounding gaming and e-commerce, and we used the recent share price weakness to add to the position, which we think has a compelling risk/reward profile. We believe Brac emerges as a strong franchise and a leading SME lender with a quality management team. bKash (a Brac Bank company) is, in our view, one of the few high growth digital payments companies remaining and has largely been ignored so far in a post-COVID world. Brac has a clear ecosystem advantage versus peers and continues to grow their ecosystem and expand into providing small loans to micro merchants to bring them onto the platform.

We believe MELI is displaying strong growth while delivering improved profitability against a challenging macroeconomic environment. MELI is building a sticky ecosystem with many different building blocks, including logistics, payments, credit and shops, and increasingly advertising in a region where e-commerce and innovative financial products are likely to continue to take share.

To fund the above trades, we took profits on recent outperformers such as Mobile World Group, Grupa Kety and Grid Dynamics.

Strategy and Outlook

Markets appear concerned about the prospect of stagflation and higher costs of capital throughout the world, but we believe the long-term potential of frontier and small emerging markets remains positive. Frontier/small EMs remain sizable: more than half of the 15 countries in the world with a population greater than 100 million are overlooked frontier and small EM countries, such as Vietnam, Indonesia, Bangladesh and Nigeria. The internet-enabled futures of these countries are changing rapidly as millions of entrepreneurs create new opportunities for the large and growing consumer class.

We have invested in a collection of outstanding businesses with high return on invested capital and healthy balance sheets, which are trading at reasonable valuations. Our bottom-up focus on competitive moats and strategy dynamics provides us comfort, given weaker players often get shaken out when capital becomes scarce, while stronger companies survive and thrive. We are seeing continued strong execution from the businesses that make up our portfolio, and if anything, recent market movements have given us a better entry point to some of these opportunities.

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

FUND FACTS

Launch date

16 October 2000

Base currency

Euro

Index

Blended Benchmark

MSCI Frontier Emerging Markets Net Index

² Effective 16 May 2022, the MS INVF Emerging Europe Middle East and Africa Fund was renamed the MS INVF NextGen Emerging Markets Portfolio. The Blended Index performance is calculated using the MSCI EM EMEA Index from inception through 15 May 2022, the MSCI Frontier Emerging Markets Net Index thereafter. The Morgan Stanley Emerging Europe Middle East and Africa Fund may perform differently due to the change in investment strategy and approach. Past performance is not a guide to future performance.

Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012
Class A Shares	-31.32	33.60	-6.08	23.58	-15.33	15.03	10.71	5.73	-7.59	10.48	19.38
Blended Benchmark	-21.20	26.97	-14.60	17.64	-11.81	9.40	23.53	-10.93	-3.41	-9.26	19.99
MSCI Frontier Emerging Markets Net Index	-10.71	12.21	-10.70	16.19	-10.29	11.37	8.14	--	--	--	--

Investment involves risks. 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.

Effective 16 May, 2022, the Morgan Stanley Investment Funds Emerging Europe Middle East and Africa Fund was renamed to Morgan Stanley Investment Funds Next Gen Emerging Markets Fund, with an expanded investment universe to include equity securities of companies operating in emerging market countries, which include frontier emerging market countries, and an updated investment approach to reflect top-down allocations are made at the macro and thematic levels. Please see the prospectus for more details.

INDEX INFORMATION

The **Blended Index** performance shown is calculated using the **MSCI EM Europe, Middle East Gross Index** from inception through 31 December 2000, the **MSCI EM Europe Middle East Net Index** through 16 April 2008, the **MSCI Emerging Europe, Middle East and Africa Net Index** through 15 May 2022 and the **MSCI Frontier Emerging Markets Net Index** thereafter.

The **MSCI EM Europe, Middle East Index** captures large and mid-cap representation across 8 Emerging Markets (EM) countries in Europe and Middle East.

The **MSCI Emerging Markets Europe, Middle East and Africa Net Index** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the emerging market countries of Europe, the Middle East & Africa.

The **MSCI Frontier Emerging Markets Net Index** is a free float adjusted market capitalization index designed to serve as a benchmark covering all countries from the MSCI Frontier Markets Index and the lower size spectrum of the MSCI Emerging Markets Index.

The indexes are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

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.

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