Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

American Resilience Fund

MARKETING COMMUNICATION | INTERNATIONAL EQUITY TEAM | MONTHLY COMMENTARY | 30 APRIL 2023

Performance Review

As the Fund is less than a year old, we are constrained from commenting on its performance.

Market Review

The S&P 500 Index returned +1.6% in the month of April. The defensive sectors of consumer staples (+4%) and health care (+3%) were two of the top performers in the month, along with communication services (+4%), which continued its first quarter strength, and energy (+3%), which had struggled in the first quarter. The laggards of the month, and the only sectors to finish in the red, were industrials (-1%), consumer discretionary (-1%) and materials (-0%). The portfolio's largest sector, information technology (+0%), was slightly positive, but behind the index. All sectors finished within 300 basis points of the index.

Portfolio Activity

Portfolio activity is reported at quarter-end.

Strategy and Outlook

Building Resilience with Quality Capital Allocation

In the play Richard II, William Shakespeare referenced the strength of the moat: "This precious stone set in the silver sea, Which serves it in the office of a wall, Or as a moat defensive to a house…". And celebrated investor Warren Buffett is well known for using the moat analogy: "In business, I look for economic castles protected by unbreachable moats."

As a team, the high quality companies we look for exhibit deep, wide and well-managed economic moats. These moats bring long-term, sustainable competitive advantages, helping to protect and grow market share, sustain or improve profitability, and potentially deliver attractive long-term returns.

But maintaining these moats requires effective and sustained investment by management in the unique attributes of the company's offerings, ranging from brand recognition and pricing power, to patented technologies, high switching costs, network effects and scale and reach. Whether investment is in advertising and promotion, research and development (R&D) or other areas, we like it to be made through the profit and loss statement rather than via acquisitions — with a few notable exceptions.

The last few years have been especially challenging for all companies, high quality or not, given the large bumps in the road due to COVID-19, war in Europe, supply chain disruption, rampant inflation and tighter monetary policy. But through this, we've seen remarkable resilience in our holdings, along with continued investment to drive onward growth. In fact, we would argue that it is precisely because of the effective investments by management that we've seen this resilience play through, as they help their companies to successfully navigate the variety of cycles and events the market throws at them.

Strengthening the moat through investment

Consider our consumer staples holdings; COVID-19 appeared particularly punitive for them. Lockdowns basically closed half the distribution channel for beverage companies as bars, hotels and restaurants shuttered. Beauty companies saw traditional retail and duty-free grind to a halt, while household and personal care items on shop shelves faced lower footfall from housebound populations. However, having invested in digital capabilities ahead of time, our staples companies were able to sustain their brand recognition and connect directly with their customer base around the world.

Health care is another key sector for us, especially in life sciences and medical technology, where we typically find the highest quality names. Here, building out the moat means directing capital to innovation (R&D) and increasing scale (production capital expenditure [capex]). Last year, one of our highly diversified, U.S.-listed names invested in building out its mass-spectrometry platform to bring high-resolution analysis to toxicology and metabolomics (the large-scale study of small-scale molecules in cells, tissues and organisms). It launched its innovative new DualBeam scanning electron microscope to support the development of increasingly smaller and more complex semiconductors, and in genetic sciences it introduced a new system to help testing laboratories advance molecular diagnostics. To increase scale, it expanded capacity in China and Singapore, and in South Korea it launched innovation centres to support the semiconductor and biotech industry. Overall, the company invested $2.5 billion in capex across its businesses to strengthen partnerships and accelerate growth.[1]

In the information technology sector, investment has been — and continues to be — extremely strong. COVID-19 brought forward a rapid adoption and need for technology as businesses raced to digitise and connect. At the heart of this is our world-leading technology consulting business, with 9,000 clients and more than 75% of the Fortune Global 500 as customers. It spent $2.2 billion on R&D and training (nearly 4% of sales) last year. Since 2020, its investment in people has equated to a 40% increase in headcount in order to match demand. Its return on invested capital barely moved at all during the challenges of 2020, and has steadily risen since 2019, highlighting the resilience of the business.[2]

We also hold the world's largest software company in our global and American portfolios. This company, with a software platform — or network — that is the heartbeat of most people's workplace computing lives, brings together technologies and products that deliver experiences and solutions in an ecosystem of partners and customers. This is something exceptionally hard for any competitor to replicate and is arguably impossibly expensive to dislodge. The scale of its annual investments is eye-watering. At $24 billion last year, the company's capex spend is close to 70% of the whole of the MSCI World software industry spend put together.[3] Its strategy to build the intelligent cloud and intelligent edge platforms requires continued investment in data centres and technology infrastructure to support the services it offers, and by doing so it makes its moat deeper and wider. The company's scale brings efficiency. Its huge data centres deploy computational resources at lower cost per unit than smaller ones. Its vast cloud scale coordinates and aggregates diverse customer, geographic and application demands, and this scale improves the utilisation of computing, storage and network resources. There are environmental benefits too. Its cloud and artificial intelligence services and data centres help businesses cut energy consumption, reduce physical footprints and design sustainable products.

The above are a few isolated examples of our holdings investing in sustaining and building their competitive advantage and refining their relevance to their clients. We are always looking for this focused allocation of capital when we engage with the management teams we meet. While this commitment of capital isn't likely to change the next quarter's or even next year's results, what it will do is enhance the long-term prospects of the franchise. It will keep the moat deep and wide, which in turn should keep the fundamental compounding of earnings and cash flows steadily growing over the long term — which is exactly what we want to see.

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

FUND FACTS

Launch date	Base currency	Index
15 December 2022	U.S. dollars	S&P 500 Index

Share Class I 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, increased operational costs.
- There may be an insufficient number of buyers or sellers which may affect the funds ability to buy or sell securities.
- 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 30 April 2023 and subject to change daily.

[1] Source: Data taken from Thermo Fisher company reports
[2] Source: Data taken from Accenture company reports
[3] Source: FactSet

Registered Office of Morgan Stanley Investment Funds, European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxemburg B 29 192.

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