

## Morgan Stanley Investment Funds

# Asian Equity Fund

ACTIVE FUNDAMENTAL EQUITY | EMERGING MARKETS TEAM | MONTHLY COMMENTARY | 31 DECEMBER 2018

### Performance Review

In the one month period ending 31 December 2018, the Fund's I shares returned -2.27% (net of fees)<sup>1</sup>, while the benchmark returned -2.71%.

An underweight allocation and stock selection in China along with the overweight allocations to India and Indonesia contributed, while stock selection in Korea detracted during the month.

At the stock level, overweight selection to Alibaba, Marico and Shree Cement contributed, while our overweight selection to Ashok Leyland detracted.

### Market Review

Trade war has remained a large concern throughout the quarter. China's market rallied following the developments at the G20 meeting in the beginning of December. However, the surge did not last long as the market soon came off the rally given the uncertainty surrounding the U.S.-China trade negotiations. Chinese markets were even weaker in the following days amid concern over relations with the U.S. and the health of the domestic economy with Huawei Technologies CFO Meng Wanzhou being arrested in Canada for violating Iran sanctions. Going towards the economic planning meeting, Chinese stocks jumped as the market bet it would signal further easing but then went down again because of weak macro data. Beyond trade, the gap between the two countries on intellectual property protection, industrial policy and geopolitical basis remains significant and is likely to remain a source of market risk over the next 12 months.

On the policy front, China is calling on local governments to complete debt disposals of zombie companies and those with excessive production capacity by 2020, and Chinese government agencies have started to screen and clean up regulations that include restrictions on foreign investments beyond the so-called negative list for foreign investments. The annual Central Economic Work Conference (CEWC) was held on December 19-21, which laid out key tasks and economic policies in 2019. The conference emphasised that the economy is facing downward pressure amid a complicated external environment, driven by both cyclical and structural factors and near- and long-term issues. We expect policy support will further step up in 2019 in response to downward pressure on economic growth.

The Reserve Bank of India (RBI) retained the repo rate at 6.5%. The dovish tone of the RBI was expected given the consistently low inflation prints and moderating crude prices. RBI Governor Urjit Patel resigned, marking a rare event in the institution's history, with the government announcing former bureaucrat Shaktikanta Das as his successor. The market will keenly watch future government and RBI interactions for signs of continued independence of the RBI. Politics took the centre stage as India had five of its largest states go to polls in December. The Opposition Party, the Indian National Congress (INC), emerged victorious in the three states of Madhya Pradesh, Rajasthan and Chhattisgarh with an incumbent Bharatiya Janta Party (BJP, the ruling party) Government. While a loss of three states is sentimentally negative for the ruling party, it is important to keep in perspective that the State Election outcomes do not affect the continuity of the Central Government, and are usually contested more on local issues. The key positives in the month were the improvement in capacity utilization (best level in 18 quarters in the second quarter of fiscal 2019), increase in inward remittances (highest flow ever at \$19.5 billion), improvement in credit growth to 15% and moderate inflation.

The Philippines saw improvement in the latest data release with inflation slowing to 6% in November from the 6.7% level seen in the previous month. The Philippine central bank kept the rate unchanged in the last meeting at 4.75%. October also saw overseas work remittance rise 8.7% in the month, bringing the year-to-date figure to 3.1%.

Singapore saw growth risk to the downside as the exports slowed with the November non-oil domestic exports dropping 2.6% year-over-year and also November loan growth slowing from 3.8% in October to 2.8%. We expect the slowing economy to remain a concern as we start 2019. The foreign exchange reserve remained resilient at \$289.5 billion in November.

<sup>1</sup> Source: Morgan Stanley Investment Management Limited. Data as of 31 December 2018.

The Bank of Thailand raised the policy rate for the first time since August 2011 by 25 basis points to 1.75%. Thailand has remained relatively more resilient with overall private consumption growing 4.4% in November after 6.85% in October. We are monitoring the important farm income, which fell 5% year-over-year as price and production both saw declines. But overall domestic demand has helped manufacturing production record positive growth of 1%.

### Portfolio Activity

We added to ST Engineering. We believe it can achieve decent earnings growth for this year and see an additional 5% contribution growth from acquisition. With a valuation now below the two-decade average and a 4% dividend yield, we believe the company is well positioned.

We added New World Development (NWD). The transition of senior management to the third generation seems to be going well. Both the Hong Kong and China property development businesses are doing well this year. NWD management has been able to navigate the recent volatility in the Hong Kong residential property market, leading to a significant jump in development profit in fiscal year 2019 with respectable margins.

We reduced Inox Leisure, selling into strength in December. Its ad revenue growth seems to be doing well, although growth is expected to slow after a strong fiscal 2018.

We exited Brilliance China Automotive. The change in the joint venture holdings with BMW, as Brilliance lowered its stake from 50% to 25%, should be incrementally negative as the BMW joint operation has been the only profitable segment. While the implementation of the lower stake will not be until 2022, we believe this should pose structural issues with its core operations and profitability. The company has been offering more significant promotions for the X3 model even as its 5 Series discounts remain still relatively high in the mid-teens. While the valuation of the company has de-rated, we eliminated our small position in this name to focus our positions on companies with relatively stronger growth outlooks.

### Strategy and Outlook

We continue to focus on companies with high earnings visibility and quality growth that is less geared to the continuous macro slowdown and trade headwinds. We also believe that industry consolidation is a structural theme. China, as an example, is already a \$13 trillion economy, the second largest in the world. Many sectors have passed the rapidly rising penetration stage. Industry consolidation has become a key investment theme in the next stage. During this process, industry leaders with strong competitive advantages and financial power are gaining market share and becoming bigger and stronger.

We also expect more companies that are innovators and disruptors in their industries, and the recent reset of growth expectation provides a great opportunity. So far this year, there has been significant correction in many of these companies in the region due to a combination of rising U.S. rates impacting their high valuation, regulatory uncertainties and downward earnings revisions. That said, the long-term structural trend has not changed in our view. While we remain underweight China, we expect the market appetite resuming for "New China" names when the growth expectation and valuation find their footing and regulatory overhang is cleared.

Our aggregate weight for the financial sector—based on stock selection choices driven by company fundamentals and the macro and credit dynamics of individual countries—comprises nearly 30% of the Asia portfolio. The financial sector in aggregate has outperformed during the month. As we have noted throughout 2018, when a leading sector or country has dominated returns historically, they tend to move to the middle of the pack in subsequent one-, three- and five-year periods. This appears to have begun to play out in the past couple months.

We have overweight allocations to India and Indonesia and underweight allocations to Korea, China and Hong Kong. At the sector level, we have overweight exposure to the financials and consumer staples sectors. We have underweight exposure to the utilities, energy, industrials, materials, consumer discretionary and health care sectors.

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

#### FUND FACTS

**Launch date**

01 October 1991

**Base currency**

U.S. dollars

**Index**

Blended Index

## 12 Month Performance Periods to Latest Month End (%)

	DECEMBER '17 - DECEMBER '18	DECEMBER '16 - DECEMBER '17	DECEMBER '15 - DECEMBER '16	DECEMBER '14 - DECEMBER '15	DECEMBER '13 - DECEMBER '14
MS INVF Asian Equity Fund - I Shares	-18.25	37.05	1.74	-6.96	1.71
Blended Index	-14.37	41.72	6.11	-9.51	3.16

**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](http://www.morganstanley.com/im) to see the latest performance returns for the fund's other share classes.**

**The Blended Index performance shown is calculated using the MSCI AC Far East Free Ex-Japan Index (Gross Returns) from inception through 31 December 2000, the MSCI AC Far East Free Ex-Japan Index (Net Returns) from 1 January 2001 through 29 February 2016 and the MSCI AC Asia ex Japan Index (Net Returns) thereafter.**

### 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.

- There may be an insufficient number of buyers or sellers which may affect the funds ability to buy or sell securities.
- Investment in China A-Shares via Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect programs may also entail additional risks, such as risks linked to the ownership of shares.
- There are increased risks of investing in emerging markets as political, legal and operational systems may be less developed than in developed markets.
- 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 December 2018 and subject to change daily.

### INDEX INFORMATION

The **MSCI AC Far East ex Japan Index**: captures large and mid cap representation across 2 Developed Markets countries (excluding Japan) and 7 Emerging Markets countries in the Far East\*. With 553 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The **MSCI AC Asia ex Japan Index**: captures large and mid cap representation across 2 of 3 Developed Markets (DM) countries\* (excluding Japan) and 9 Emerging Markets (EM) countries\* in Asia. With 637 constituents, the index covers approximately 85% of the free float adjusted market capitalization in each country.

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