

Morgan Stanley Investment Funds **Asia Opportunity Fund**

ACTIVE FUNDAMENTAL EQUITY | GLOBAL OPPORTUNITY TEAM | QUARTERLY COMMENTARY | 31 DECEMBER 2018

Performance Review

In the three month period ending 31 December 2018, the Fund's Z shares returned -9.63% (net of fees)¹, while the benchmark returned -8.66%.

The long-term investment horizon and conviction-weighted approach embraced by the Global Opportunity team can result in periods of performance deviation from the benchmark and peers. Over time, this has led to the strong record we have developed over our product set. The Fund underperformed the MSCI All Country ("AC") Asia ex Japan Index this period due to unfavourable stock selection and sector allocation.

Our team continues to focus on bottom-up stock selection and the long-term outlook for companies owned in the portfolio; accordingly, we have had very little turnover in the portfolio to date, and we continue to find new ideas for inclusion in the portfolio which meet our strict criteria for quality and long-term value creation.

Asia ex Japan equities declined during the period prompted by macro concerns including trade tensions and the potential effects of rising interest rates. The health care, energy, information technology and consumer discretionary sectors led the declines. Only utilities and real estate delivered positive returns, while consumer staples and financials also outperformed the MSCI AC Asia ex Japan Index. At the country level, China, South Korea and Taiwan detracted, while India, Indonesia and the Philippines were the greatest contributors to the performance of the benchmark.

Stock selection in consumer staples was the greatest detractor from the relative performance as shares in baijiu manufacturers Jiangsu Yanghe and Kweichow Moutai, and soy sauce brand Foshan Haitian declined. A sector overweight position contributed positively. We believe both baijiu makers, Jiangsu Yanghe and Kweichow Moutai, which focus on mid-end and high-end markets, respectively, are well-positioned to capitalise on the secular growth in high-end beverages driven by Chinese consumption upgrade. We believe that Foshan Haitian can deliver stable revenue growth driven by strong consumer loyalty and taste preference.

A sector overweight position in consumer discretionary was the second greatest detractor, while stock selection contributed positively as shares in Chinese math tutor TAL Education and restaurant Jollibee Foods advanced, offset partially by the weakness in shares of Ctrip.com. Ctrip.com is the largest online travel agency in China. We believe that Ctrip may continue to benefit from the consumption upgrade, which is driving rising domestic travel spending, as well as the growing network effect of the widest hotel coverage and largest customer base in China.

Stock selection in communication services also detracted from relative performance as Naver declined. Naver is the leading search engine in Korea as well as a leading mobile social network through LINE in Japan. We believe the company can benefit from the network effect with continuous growth in the advertisement segment, and the next leg driven by e-commerce and payments in Korea, leveraging user traffic to transition its business model from meta search to an e-commerce marketplace.

Stock selection in financials was the greatest overall contributor to the relative performance of the portfolio as shares in HDFC Bank Limited, Housing Development Finance Corporation and Kotak Mahindra Bank advanced. HDFC Bank is India's largest private bank by assets. It has an outstanding liability and deposit franchise, driven by its long operating history, strong brand, extensive branch network and focus on customer service. HDFC Bank also has the largest personal loan and credit card franchise with strong risk management processes. We believe that HDFC Bank's cost leadership advantage coupled with industry-leading digital capabilities can enable it to continue taking loan and deposit market share amid public sector bank weakness. Housing Development Finance Corporation Limited ("HDFC Ltd") is a specialised housing finance company and the leading provider of mortgages in India. We believe that HDFC Ltd is unique due to its strong mortgage lending franchise driven by its low cost of funds, cost efficiency and superior risk management. It also has diversified holdings in leading banking, life insurance, asset management and other financial services franchises under the respected HDFC brand. Kotak Mahindra Bank is one of the leading private sector retail banks in India with a strong presence in the securities, insurance, asset management and

¹ Source: Morgan Stanley Investment Management Limited. Data as of 31 December 2018.

auto finance businesses. We believe that Kotak Mahindra Bank is unique due to its cost focus advantage driven by its strong deposit franchise, granular high yield retail book and prudent risk management process. Based on our industry analysis, we believe Kotak Mahindra Bank can continue to take loan and deposit market share due to its integrated and diversified business model, mobile banking initiatives and public sector bank weaknesses.

The portfolio's sector overweight in information technology and underweight in energy also contributed to the relative performance of the portfolio, while sector underweight positions in real estate and utilities detracted.

Outlook

As a team, we continue to focus on bottom-up stock selection and the long-term outlook for companies owned in the portfolio. We assess company prospects over a three- to five-year time horizon and own a portfolio of what we believe are undervalued, high quality companies with diverse business drivers not tied to any particular market environment.

FUND FACTS

Launch date

31 March 2016

Base currency

U.S. dollars

Index

MSCI All Country Asia ex Japan 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 Asia Opportunity Fund - Z Shares	-14.68	74.92	--	--	--
MSCI All Country Asia ex Japan Index	-14.37	41.72	--	--	--

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 to see the latest performance returns for the fund's other share classes.**

Share Class Z Risk and Reward Profile

Lower Risk

Higher Risk



Potentially Lower Rewards

Potentially Higher Rewards

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 All Country Asia Ex-Japan Index** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of Asia, excluding Japan. 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 directly invest in an index.

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