Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

Emerging Markets Corporate Debt Fund

FIXED INCOME | GLOBAL FIXED INCOME TEAM | MONTHLY COMMENTARY | 31 JANUARY 2019

Performance Review

In the one month period ending 31 January 2019, the Fund's Z shares returned 2.93% (net of fees)[1], while the benchmark returned 2.72%.

Security selection and overweight positions in Indonesia, China, Brazil and Nigeria contributed to relative performance, as did security selection in the real estate, financials and utilities sectors. Conversely, an overweight position and security selection in Argentina detracted from relative performance, as did underweight positions in Chile, Israel and Zambia, as well as in the tech-media-telecom (TMT) and oil & gas sectors.

Market Review

Emerging market (EM) fixed income assets rebounded in January, following a volatile 2018. Domestic debt led the way, driven by currency strength versus the U.S. dollar (USD) and local bond performance. Within the hard currency segment, high yield outperformed investment grade, and sovereigns outperformed corporates. An improvement in EM sentiment was driven by attractive valuations, optimism around U.S.-China trade talks, easing measures announced by the People's Bank of China (PBOC) and a growing perception that the U.S. Federal Reserve (Fed) hiking cycle may be over. Commodity prices also rose in the period, with double-digit returns registered for crude oil, followed by agricultural commodities and metals. Investment flows were positive, primarily into hard currency strategies, followed by local currency and blended strategies. Issuers took advantage of the favorable market backdrop, as a variety of sovereign, quasi-sovereign and corporate deals were priced during the month.

EM corporate debt returned 2.72% in the month, as measured by the JP Morgan CEMBI Broad Diversified Index. Higher yielding, lower-rated companies outperformed higher-rated companies. From a sector perspective, companies in the metals & mining, consumer, oil & gas, and pulp & paper sectors outperformed the broader market, while those in the financial, diversified and infrastructure sectors underperformed. From a regional perspective, companies in Africa (South Africa and Zambia), Latin America (Argentina, Jamaica and Dominican Republic), and Europe (Turkey and Ukraine) outperformed the market, while those in Asia (Indonesia) and the Middle East (Israel) underperformed.

Portfolio Activity

During the month we added to active positions in Mexico, Chile, Colombia, Egypt, China and Thailand, while trimming in India, Singapore, Hong Kong and Ukraine.

Strategy and Outlook

The EM debt outlook we envisioned at the end of last year has materialized, for the most part, in the first month of 2019. At the time, we argued that attractive valuations and a global backdrop of moderate growth/subdued inflation, coupled with a dovish Fed and USD weakness would support EM debt assets in 2019. The strong year-to-date performance inevitably raises questions about the sustainability of the rally. We remain cautiously optimistic on EM fixed income, as the underlying premises still apply, though valuations have adjusted. On the fundamental front, our moderate global growth view has become slightly more entrenched (without prompting recession worries), as shown by continued weakness in Chinese growth, subdued activity indicators in the eurozone and the recent U.S. government shutdown that will likely trim roughly 30 basis points off first quarter 2019 growth in the U.S. Against this backdrop, the scope for tighter monetary policy has narrowed significantly, as recently evidenced by key central banks' dovish statements (Fed, European Central Bank, Bank of Japan) and actions (most notably, the PBOC's liquidity injection via an additional 100 basis point cut in reserve requirements and a Central Bank Bills Swap facility aimed at facilitating bank credit to the real economy). Accommodative global monetary conditions should eventually impact EM economies, many of which are small, open and subject to external influences. Thus, we expect several EM

1 Source: Morgan Stanley Investment Management Limited. Data as of 31 January 2019.

central banks to either cut rates later in the year (most likely in Asia) or maintain their simulative monetary policy stance for longer than previously envisioned (for example, in Central and Eastern Europe and several Latin American economies). This should bode well for long duration positions in local currency bonds, where we see room for rates to outperform currencies (in fact, only one-third of the year-to-date rally in EM local currency bonds is explained by carry/duration, with the bulk of it explained by EM currency strength versus the USD). Furthermore, our expectation for a weakening dollar still has ample room to play out: the USD remains one of the most expensive currencies in the world, and the combination of weakening growth and a less hawkish Fed should weigh on the currency going forward. Finally, despite a strong performance, EM debt has not outperformed other asset classes. For example, January's performance in EM hard currency debt, as measured by the EMBIG, was in line with U.S. high yield, as measured by the Bloomberg Barclays U.S. Corporate High Yield Index (+4.4% versus +4.5%, respectively), while EM local currency debt returned 5.5%, as measured by the JP Morgan GBI-EM Global Diversified Index. Thus, both relative and absolute valuations should provide a supportive backdrop for continued inflows into the asset class in the near future.

Notwithstanding our positive outlook, several risks on the horizon prevent us from being uniformly bullish about EM fixed income assets. The main risk concerns a negative outcome in ongoing trade talks between the U.S. and China, which could lead to a resumption of tariff hikes by the U.S. and a retaliatory response by China. Though we have no particular insight on the ultimate result, from a structural point of view, a sharper slowdown in Chinese activity and the risk of another U.S. stock market rout should drive both parties to some near-term compromise. On the other hand, legal actions by the U.S. against Huawei executives, as well as reprisals by Chinese authorities (most notably against Canadian citizens) raise the odds of negative market surprises occurring. Another external risk stems from Brexit negotiations, as the British pound rally this year may be already pricing a favorable outcome. On EM-specific events, the risks are not necessarily skewed to the downside. In fact, there is scope for continued strength in Venezuelan assets on rising odds of a successful transition towards a more market-friendly government. Similarly, the Brazilian government is set to unveil its pension reform proposal, which could remove uncertainties about the sovereign's long-term fiscal outlook. Finally, elections to be held in several EM economies in 2019 could provide further impetus to reformist agendas. In particular, we are closely following important electoral contests in Indonesia, Ukraine, India, South Africa and Argentina.

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

FUND FACTS

Launch date	Base currency	Index
07 March 2011	U.S. dollars	JPM Corporate Emerging Markets Bond Index-Broad Diversified Index

12 Month Performance Periods to Latest Month End (%)

	JANUARY '18 - JANUARY '19	JANUARY '17 - JANUARY '18	JANUARY '16 - JANUARY '17	JANUARY '15 - JANUARY '16	JANUARY '14 - JANUARY '15
MS INVF Emerging Markets Corporate Debt Fund - Z Shares	-1.93	8.34	14.23	-0.58	4.60
JPM Corporate Emerging Markets Bond Index-Broad Diversified Index	0.95	6.71	11.40	0.26	5.25

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
1	2	**3**	4	5	6	7
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 fixed income securities from emerging markets and the fund's simulated and/or realised return has experienced medium 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 value of bonds are likely to decrease if interest rates rise and vice versa.
- The value of financial derivative instruments are highly sensitive and may result in losses in excess of the amount invested by the Sub-Fund.
- Issuers may not be able to repay their debts, if this happens the value of your investment will decrease. This risk is higher where the fund invests in a bond with a lower credit rating.
- 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 Fixed Income Securities via the China Interbank Bond Market may also entail additional risks, such as counterparty and liquidity risk.
- 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 January 2019 and subject to change daily.

INDEX INFORMATION

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

The **Bloomberg Barclays U.S. Corporate High Yield Index** is a multi-currency measure of the global high yield corporate debt market.

The **JPM GBI-EM Global Diversified Index** is 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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