Morgan Stanley

INVESTMENT MANAGEMENT

Morgan Stanley Investment Funds

Emerging Markets Debt Fund

FIXED INCOME | GLOBAL FIXED INCOME TEAM | MONTHLY COMMENTARY | 30 JUNE 2018

Performance Review

In the one month period ending 30 June 2018, the Fund's I shares returned -1.62% (net of fees)[1], while the benchmark returned -1.00%.

Underweight positions in Lebanon, Turkey, Oman, Pakistan and Sri Lanka contributed to relative performance in the period. Conversely, Argentina was the largest detractor from a combination of currency exposure, an overall overweight position and security selection. Overweight positions in Ukraine, Ghana and Egypt also detracted from relative performance in the period.

Market Review

Emerging market (EM) fixed income assets continued to suffer with politics and policies weighing on sentiment. Within the dollar-denominated space, corporate debt outperformed sovereign debt and high yield assets outperformed investment grade. Investors (primarily retail) withdrew assets from hard currency strategies (-$0.5 billion), while local currency strategy assets were roughly flat during the month. While flows for the year remain in positive territory at +$20.8 billion, driven primarily by strategic investors, the tone has been negative in the second quarter with outflows dominating, especially from retail investors. Commodity prices were negative over the month, with only energy prices climbing higher on supply concerns with the U.S. pressuring countries to limit their Iranian oil purchases. This was in spite of an announcement that the Organization of the Petroleum Exporting Countries (OPEC) and Russia would increase production by 1 million barrels per day beginning in July despite objections from Iran. The deal is expected to keep prices just shy of $70 per barrel, which should quell protests from oil consumers. Both soft commodities and metals prices were weaker in the month as sanctions, trade tensions and fears of lower global growth weighed on the market.

In addition to ongoing trade quarrels with Mexico, Canada and Europe, the Trump administration announced tariffs on $50 billion worth of Chinese imports and potential additional restrictions on investments. Goods totalling $34 billion will be targeted effective July 6, while the remaining $16 billion still needs to be reviewed. China immediately announced that it would enact retaliatory measures, further dampening global trade sentiment. These concerns about trade and the subsequent impact on the Chinese economy weighed on the renminbi, which weakened against both the U.S. dollar and its stated basket of trading currencies. This also coincided with the People's Bank of China holding rates steady in its most recent meeting, while loosening overall monetary policy to combat the weaker growth outlook, as activity indicators eased in May with industrial production growth slowing.

EM external sovereign and quasi-sovereign debt returned -1.00% in the period, as measured by the JP Morgan EMBI Global Index. Higher-yielding, lower-rated credits underperformed investment grade bonds in the month, as smaller and energy-related credits underperformed as the worries over global growth outweighed the rise in energy prices. From a country perspective, bonds from Costa Rica, Belize, Colombia and Mexico outperformed the broader market the most, while bonds from Gabon, Argentina, Egypt, Nigeria, Venezuela and Lebanon lagged the broader market.

Portfolio Activity

During the month, we trimmed in Brazil and rotated into shorter-dated corporate exposure in Argentina.

---

1 Source: Morgan Stanley Investment Management Limited. Data as of 30 June 2018.

Strategy and Outlook

EM assets had a rough second quarter of the year, as the tail risks regarding trade wars are becoming more prominent amid a strengthening U.S. dollar and a marginally more hawkish tone from the Federal Reserve. The sharp depreciation of the renminbi in June also weighed on market sentiment, as markets struggle to determine whether it was engineered to boost sluggish growth due to tighter credit conditions, or as a response to Trump's tariffs on Chinese exports, or a combination of both. Furthermore, President Trump's trade agenda is not constrained to China, as evidenced by a lack of progress on North American Free Trade Agreement (NAFTA) negotiations and a brewing trade spat with the European Union (EU) over car exports to the U.S. In regard to the former, Trump himself has stated that he doesn't envision a NAFTA deal before the U.S. midterm elections, whereas the EU has outlined a response targeting $300 billion worth of U.S. goods in response to Trump's threats to impose import tariffs on U.S. car imports from the EU.

Against this backdrop, the outlook for EM remains challenging. Though we see the different trade announcements as part of a negotiating process, many of the trade measures will likely become effective before any progress in trade talks is realized. As a result, we should see a negative, though marginal, impact on gross domestic product and trade flows for targeted countries but, more importantly, an overall deterioration in business and consumer confidence. Though EM economies are differently exposed to a trend towards more protectionism, with less open economies in a more solid position to withstand it, a worsening global trade picture should weigh on global growth and have negative implications for all risky assets, and EM in particular. On the positive side, the EM policy response has been more proactive as of late, with many economies deemed as vulnerable reacting more forcefully to market turbulence, as evidenced by a shift towards tighter monetary policy in countries such as Argentina, Turkey and Indonesia, among others. Furthermore, the sharp sell-off we witnessed in the second quarter appears to be overdone in countries with improving fundamentals (such as South Africa and Indonesia), thus offering attractive entry points should we see a de-escalation in trade war rhetoric. Finally, EM politics may contribute to heightened uncertainty in the second half of the year, with upcoming elections in Mexico and Brazil, which feature competitive anti-establishment candidates.

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

FUND FACTS

Launch date	Base currency	Index
01 April 1995	U.S. dollars	JP Morgan Emerging Markets Bond Index Global

12 Month Performance Periods to Latest Month End (%)

	JUNE '17 - JUNE '18	JUNE '16 - JUNE '17	JUNE '15 - JUNE '16	JUNE '14 - JUNE '15	JUNE '13 - JUNE '14
MS INVF Emerging Markets Debt Fund - I Shares	(3.45)	6.90	6.69	(3.97)	9.03
JP Morgan Emerging Markets Bond Index Global	(2.45)	5.52	10.32	(1.57)	11.05

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 I 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 30 June 2018 and subject to change daily.

INDEX INFORMATION

JP Morgan Emerging Markets Bond Global Index tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million.

DISTRIBUTION

access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. **Hong Kong:** This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This document should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"), (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. In particular, for investment funds that are not authorized or recognized by the MAS, units in such funds are not allowed to be offered to the retail public; any written material issued to persons as aforementioned in connection with an offer is not a prospectus as defined in the SFA and, accordingly, statutory liability under the SFA in relation to the content of prospectuses does not apply, and investors should consider carefully whether the investment is suitable for them.

IMPORTANT INFORMATION

EMEA: This marketing communication has been issued by Morgan Stanley Investment Management Limited ("MSIM"). Authorised and regulated by the Financial Conduct Authority. Registered in England No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

This document contains information relating to the sub-fund ("Fund") of Morgan Stanley Investment Funds, a Luxembourg domiciled Société d'Investissement à Capital Variable. Morgan Stanley Investment Funds (the "Company") is registered in the Grand Duchy of Luxembourg as an undertaking for collective investment pursuant to Part 1 of the Law of 17th December 2010, as amended. The Company is an Undertaking for Collective Investment in Transferable Securities ("UCITS").

Applications for shares in the Fund should not be made without first consulting the current Prospectus, Key Investor Information Document ("KIID"), Annual Report and Semi-Annual Report ("Offering Documents"), or other documents available in your local jurisdiction which is available free of charge from the Registered Office: European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxemburg B 29 192. In addition, all Italian investors should refer to the 'Extended Application Form', and all Hong Kong investors should refer to the 'Additional Information for Hong Kong Investors' section, outlined within the Prospectus. Copies of the Prospectus, KIID, the Articles of Incorporation and the annual and semi-annual reports, in German, and further information can be obtained free of charge from the representative in Switzerland. The representative in Switzerland is Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva. The paying agent in Switzerland is Banque Cantonale de Genève, 17, quai de l'Ile, 1204 Geneva. The document has been prepared solely for informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy.

Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

The views and opinions expressed are those of the portfolio management team at the time of writing/of this presentation and are subject to change at any time due to market, economic, or other conditions, and may not necessarily come to pass. These comments are not representative of the opinions and views of the firm as a whole. Holdings, countries and sectors/ region weightings are subject to change daily. All information provided is for informational purposes only and should not be deemed as a recommendation to buy or sell securities in the sectors and regions referenced. Information regarding expected market returns and market outlook is based on the research, analysis, and opinions of the team. These conclusions are speculative in nature, may not come to pass, and are not intended to predict the future of any specific Morgan Stanley Investment Management investment. Past performance is no guarantee of future results.

All investments involve risks, including the possible loss of principal. The material contained herein has not been based on a consideration of any individual client circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable European or Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

MSIM has not authorised financial intermediaries to use and to distribute this document, unless such use and distribution is made in accordance with applicable law and regulation. MSIM shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary. If you are a distributor of the Morgan Stanley Investment Funds, some or all of the funds or shares in individual funds may be available for distribution. Please refer to your sub-distribution agreement for these details before forwarding fund information to your clients.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without MSIM's express written consent.

All information contained herein is proprietary and is protected under copyright law.

This document may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this document in another language, the English version shall prevail.