Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

Emerging Markets Fixed Income Opportunities Fund

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

Performance Review

In the one month period ending 30 November 2018, the Fund's Z shares returned 0.32% (net of fees)[1], while the benchmark returned 0.75%.

Domestic debt holdings in Indonesia, Turkey, South Africa, Poland and Hungary contributed the most to performance in the month. Conversely, holdings in Mexico, Kazakhstan, Nigeria, Ukraine and Brazil detracted from performance.

Market Review

Emerging market (EM) fixed income asset performance was mixed in the month with local currency debt posting positive returns while hard currency debt returns ended in negative territory. While not calling for a recession in the near future, global growth estimates have been reduced as data has underperformed optimistic projections. The outlook for global growth has been overshadowed by the risks arising from trade disputes initiated by the U.S. and the implications for global trade. Despite an improved outlook for North American trade via the signing of the North American Free Trade Agreement's replacement, the U.S.-Mexico-Canada Agreement (USMCA), an ongoing dispute between the U.S. and China remains. The Asia-Pacific Economic Cooperation summit ended in disarray after the U.S. and China failed to agree on a joint statement, reflecting tensions due to the ongoing trade war. This is the first time since the summit began in 1993 that no joint statement was issued. Political risk in Europe increased during the period as Russia seized three naval vessels from Ukraine, prompting the imposition of martial law in Ukraine. Over the month, energy prices fell almost 20% as Brent crude prices fell to $58 per barrel. Soft commodities such as corn, wheat and soybeans rose in price, and metals were more mixed, with palladium leading the way while platinum fell. Investors withdrew $3.5 billion in assets from the EM debt asset class, primarily from hard currency strategies. While we recognize that year-to-date performance has been poor and the risks to the downside have grown, there has been limited contagion and no substantial uptick in the number of current or forecasted EM defaults. With the U.S. midterms complete, one headwind for the market has been removed, which should allow investors to focus on more idiosyncratic developments. Recent comments made by Federal Reserve (Fed) Chairman Powell prompted the market to question the number of rate hikes remaining in this hiking cycle, leading to a rally into the end of the month.

The broader EM debt market returned 0.75% in the month as measured by the Blended Index, an equal-weighted index comprised of the JP Morgan GBI-EM Global Diversified Index (domestic debt), JP Morgan EMBI Global Index (external debt) and the JP Morgan CEMBI BD Index (corporate debt). EM domestic debt led the way with a return of 2.81%, while external sovereign debt returned -0.39% and corporate debt returned -0.16%.

Portfolio Activity

During the month we reduced exposure in Turkey, Jamaica, Russia and Kazakhstan, while adding in Nigeria, Mexico, Costa Rica and Guatemala.

Strategy and Outlook

After a challenging year for EM fixed income, we hold a constructive outlook for 2019, driven by attractive valuations, a benign global backdrop of moderate growth/subdued inflation and a Fed that is likely approaching the end of its tightening cycle. We believe these factors and growing twin deficits in the U.S. limit the scope for material U.S. dollar appreciation. Our historical analysis indicates that EM fixed income tends to outperform when EM economies are closing negative output gaps and converging toward potential growth. Further support for local currency strategies should come from already adequately tight monetary policy in key EM economies and steep yield curves providing investors with excess term premium. Furthermore, overall EM foreign currency cheapness should enhance local currency returns from carry/duration, particularly if our expectation of a declining dollar and hawkish EM central banks were to materialize. Among credit, the hard currency EMBIG index screens as

[1] Source: Morgan Stanley Investment Management Limited. Data as of 30 November 2018.

cheap versus both its historical average and traditionally comparable asset classes such as U.S. high yield, while our sovereign spread model suggests there could be attractive spread compression potential from a fundamental perspective. Similar attractive opportunities can be found in EM corporates, where absolute and relative spreads have sharply underperformed other credit markets such as U.S. and European high yield in 2018, despite generally improving fundamentals that are reflected in a similarly (low) default profile.

Despite our overall constructive tone for EM debt next year, we acknowledge several risks that could undermine our thesis. The main risk concerns a worsening of U.S.-China trade relations. Though the recent truce reached at the G-20 meeting on December 1 is a step in the right direction, a final settlement of the ongoing disputes seems elusive in our view, as U.S. grievances involve issues that are critical to China's development model and that Chinese authorities may be reluctant to compromise on. We note, though, that a tariffs/counter-tariffs regime may also generate shifts in trade flows and relocation of supply chains to other countries, which could benefit several economies in EM. Moreover, the absence of synchronized global growth or loose global monetary policy implies that opportunities in EM will demand a discriminating approach to country/asset selection, especially with trade tensions and geopolitical risks on the rise. EM-specific drivers that are worth monitoring include policy signals from incoming administrations in systemically important EM countries such as Mexico and Brazil. Regarding the former, Mexican President Andres Manuel Lopez Obrador's recent decisions to scrap the Mexico City airport and to consult the population on certain initiatives via legally questionable referenda bode poorly for policy predictability going forward. On the other hand, statements from the incoming Brazilian President Bolsonaro are more constructive, as he unveils a market-friendly economic agenda prioritizing fiscal consolidation, and particularly a swift pension reform. Finally, elections will be held in several EM economies next year that, if resolved positively, could provide further impetus to reformist agendas. In particular, we highlight 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
03 August 2015	U.S. dollars	Blended Index

12 Month Performance Periods to Latest Month End (%)

	NOVEMBER '17 - NOVEMBER '18	NOVEMBER '16 - NOVEMBER '17	NOVEMBER '15 - NOVEMBER '16	NOVEMBER '14 - NOVEMBER '15	NOVEMBER '13 - NOVEMBER '14
MS INVF Emerging Markets Fixed Income Opportunities Fund - Z Shares	-6.89	13.39	8.36	--	--
Blended Index	-4.25	11.23	6.78	--	--

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.**

The Blended Index is comprised of 1/3 JPM GBI- EM Global Diversified Index, 1/3 JPM Emerging Markets Bond Index Global and 1/3 JPM Corporate Emerging Markets Bond Index-Broad Diversified.

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 30 November 2018 and subject to change daily.

INDEX INFORMATION

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.

The **JPM Emerging Markets Bond Index Global** 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.

The **JPM Corporate Emerging Markets Bond Index-Broad Diversified** is a global, liquid corporate emerging markets benchmark that tracks U.S. dollar denominated corporate bonds issued by emerging markets entities.The returns shown prior to September 28, 2015 are that of the JP Morgan Emerging Markets Bond Global Index, the fund's benchmark prior to the merger. Returns since the merger are that of the Blended Index.

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