

## Morgan Stanley Investment Funds

# European Equity Alpha Fund

ACTIVE FUNDAMENTAL EQUITY | EUROPEAN EQUITY TEAM | MONTHLY COMMENTARY | 31 DECEMBER 2018

### Performance Review

In the one month period ending 31 December 2018, the Fund's I shares returned -6.80% (net of fees)<sup>1</sup>, while the benchmark returned -5.53%.

The portfolio's stock selection in consumer discretionary (EssilorLuxottica, Compass) contributed positively to performance in the month. Detractors from performance included the stock selection in financials (AXA, ING, BNP), industrials (Deutsche Post, Siemens Gamesa) and communication services (ITV). The underweight allocation to utilities also detracted from performance in the month.

### Market Review

Manufacturing activity in the eurozone continued to slow through the end of the year. The IHS Markit Eurozone Manufacturing PMI registered 51.4 in December, down from 51.8 in November. Goods production contracted in Italy and France, while Germany and Spain recorded the slowest expansions of the eight countries represented in the index. Business conditions in the services sector also deteriorated. Falling to a four-year low, the IHS Markit Eurozone PMI Services Business Activity Index read 51.2 in December, down from 53.4 in November. The French services sector was disrupted by the fuel protest, German activity cooled further and Italy's conditions registered a slight improvement. Spain's services sector, in contrast, remained relatively robust.

Eurozone inflation weakened in December. According to Eurostat's flash estimate, consumer prices fell to 1.6% in the month from 1.9% in November, almost entirely due to a slowdown in energy prices. Core inflation, which excludes food and energy prices, came in at 1%. Separately, Eurostat's unemployment report indicated eurozone joblessness fell below 8% for the first time in a decade. At 7.9% in November, euro area unemployment rate dropped from October's 8.1% reading. The European Union's jobless rate held steady at 6.7% in November.

The European Central Bank's (ECB) asset purchase programme ended on schedule in December. While acknowledging that the balance of risks to growth is shifting to the downside, the ECB said cash from maturing bonds will be reinvested to help keep borrowing costs down and interest rates will remain unchanged at least through the summer of 2019.

In the U.K., GDP increased by 0.4% in the August to October 2018 period, a slightly slower pace from the 0.6% rate over the July to September 2018 period as measured by the Office for National Statistics (ONS). Manufacturing conditions improved to a six-month high in December. The IHS Markit/CIPS U.K. Manufacturing PMI rose to 54.2 in December from 53.6 in November. Demand was strong from both domestic and export markets as clients sought to mitigate potential Brexit-related disruptions. Business confidence remained positive overall but tempered by Brexit and exchange rate uncertainties. The U.K. services sector was also constrained by Brexit concerns. A marginal rise in the IHS/CIPS U.K. Services PMI to 51.2 in December from 50.4 in November reflected a slight improvement in new work and easing pressure on operating expenses from lower fuel prices.

The labour market remained strong, with unemployment holding at 4.1% in the August to October 2018 period, the same rate in the May to July 2018 period. Wage growth was the fastest in a decade, rising 3.3% (both including and excluding bonuses) in nominal terms from a year earlier. Adjusting for inflation, pay increased by 1.0% excluding bonuses and 1.1% including bonuses compared to a year earlier, levels not seen since 2016. The ONS separately reported a slight decline in consumer prices in November, with CPI at 2.3% over the past 12 months, versus 2.4% for the 12 months ended October 2018.

The Bank of England's Monetary Policy Committee meeting went as expected. Policy rates were unchanged, and officials cautioned that Brexit uncertainties had 'intensified considerably' in the past month.

European equities declined over the month as macro data weakened and political turmoil dominated headlines. Capping a two-month stand-off, Italy and the European Commission agreed to a narrower deficit projection for Italy's 2019 budget. Fuel protests across France, some of which turned violent, prompted President Macron to suspend the planned tax increase.

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

In the U.K., Prime Minister May postponed the parliamentary vote on a Brexit deal on the expectation it would be defeated, then survived a no confidence vote a week later. European equities fell 5.53% in December, closing the year down 10.57% as represented by the MSCI Europe Index in euro terms.

## Portfolio Activity

There were no material transactions during the month.

## Strategy and Outlook

We continue to believe that careful stock selection can be an important source of investment performance. We apply a disciplined and proven investment process to identify individual stocks that we feel are attractively valued relative to their future prospects. Typically, the companies on which we focus are characterised by strong business models, financial strength and management teams of demonstrable competence.

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

### FUND FACTS

<b>Launch date</b>	<b>Base currency</b>	<b>Index</b>
05 March 1991	Euro	MSCI Europe (Net) 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 INV European Equity Alpha Fund - I Shares	-14.24	8.84	-0.27	5.23	3.46
MSCI Europe (Net) Index	-10.57	10.24	2.58	8.22	6.84

**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.**

### Share Class I 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 fund's ability to buy or sell securities.
- 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 Europe (Net) Index** is a free float-adjusted market capitalization index that is designed to measure developed market equity performance in Europe. As of September 2002, the MSCI Europe Index consisted of the following 16 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

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