

## Morgan Stanley Investment Funds

# Global Balanced Defensive Fund

**PORTFOLIO SOLUTIONS GROUP**

### Performance Review

In the one month period ending 31 October 2023, the Fund's Z shares returned -1.78% (net of fees)<sup>1</sup>.

Global equities and bonds both headed lower again in October. The "higher for longer" interest rates narrative remained a headwind while U.S. economic growth surprised to the upside and eurozone and U.K. economic data showed further weakening. This, along with sticky inflation readings and concerns about the U.S. fiscal deficit, drove government bond yields toward multi-year highs during the month. Geopolitical conflict in the Middle East also weighed on market sentiment, triggering a flight to the U.S. dollar and gold.

Our allocations to European ESG (environmental, social and governance) corporate bonds and European high yield corporate bonds were the top contributors to the Fund's performance over the month of October. Our allocations to U.S. equities, Japanese equities and European equities detracted from the Fund's performance.

### Market Review

#### United States

The MSCI USA Index returned -2.33% in U.S. dollar terms (USD) and -2.30% in euro terms in October. The government's initial estimate showed U.S. gross domestic product (GDP) grew an annual rate of 4.9% in the third quarter, increasing from 2.1% in the second quarter. At the start of the fourth quarter, the U.S. manufacturing sector saw its contraction intensifying. The Institute for Supply Management (ISM) Manufacturing PMI dropped to 46.7%, from 49.0% in September. New orders declined at a faster pace, production remained expansionary but lost momentum, and employment resumed contraction after growing the prior month. The service sector was more resilient and continued to grow, albeit with less vigour. An acceleration in new orders growth was offset by slower expansions in business activity and hiring. As a result, the ISM Services PMI fell to 51.8% in October, from 53.6% in September. The headline all-items consumer price index (CPI) rose 3.7% in the year ended September 2023, unchanged from August 2023, according to the U.S. Bureau of Labor Statistics (BLS). Core CPI, which excludes food and energy, was up 4.1% in the 12 months ended September 2023, slowing from 4.3% in August 2023. The BLS separately reported the unemployment rate rising slightly to 3.9% in October 2023, from 3.8% the prior month, and a slower monthly jobs gain of 150,000.

#### Europe

The MSCI Europe Index returned -3.57% in euro terms and -3.60% in USD terms in October. Eurostat's flash GDP estimate for the third quarter of 2023 showed the euro area economy contracting -0.1% quarter-over-quarter and the European Union economy growing 0.1% quarter-over-quarter. By comparison, in the second quarter euro area GDP grew 0.2% and EU GDP was stable. Manufacturing activity in the eurozone remained on a downtrend, with the HCOB Eurozone Manufacturing PMI falling further to 43.1 in October, from 43.4 in September. New orders, production and headcounts fell sharply. The service sector's health also continued to deteriorate. The HCOB Eurozone Services PMI fell to 47.8 in October, from 48.7 in September, reflecting a faster decline in new business as demand weakened. Service firms continued to hire at a modest rate, but it was slower than in September. Inflation in the eurozone declined markedly in October. Eurostat estimates annual headline inflation rose 2.9% in October, down from 4.3% in September. Annual core inflation (excluding energy, food, alcohol and tobacco) was up 4.2% in October, slowing from 4.5% in September. In a separate report, Eurostat said the euro area unemployment rate increased to 6.5% in September, from 6.4% in August, and the European Union jobless rate registered 6.0% in September, which was stable versus August.

#### Japan

The MSCI Japan Index returned -3.08% in yen terms and -4.48% in euro terms in October. Japan's manufacturing sector continued to see deteriorating conditions. The au Jibun Bank Japan Manufacturing PMI was nearly unchanged at 48.7 in October, versus 48.5 in September, amid ongoing declines in new orders and production and the first bout of job losses since 2021. The service sector, however, continued to grow although momentum was subdued. The au Jibun Bank Japan Services PMI slipped to 51.6 in October, from 53.8 in September, as new business grew at the slowest pace in nine months and employment resumed growth. Industrial production, as tracked by the Ministry of Economy, Trade and Industry, declined -4.6% year-over-year in September 2023. Japan's headline consumer price index rose 3.0% in the year ended September 2023, easing from 3.2% in August 2023, according to government data. The unemployment rate was 2.6% in September, down slightly from 2.7% in August 2023. Household spending fell -2.8% in the year ended September 2023.

<sup>1</sup> Source: Morgan Stanley Investment Management Limited. Data as of 31 October 2023.

## Portfolio Activity

We started to add back to portfolio duration in early October as 10-year U.S. Treasury bond yields moved close to 5%. In addition, we moderately reduced allocation to equities, given increased volatility, to ensure the portfolio remains aligned to its volatility target. The effective equity exposure at the end of the month was 28.6%.

## Strategy and Outlook

Unsurprisingly, the Federal Open Market Committee (FOMC) left rates unchanged in its 1 November meeting. That said, we believe the market is still underpricing the risk of another rate hike in December. Pricing reflects a scenario where the Federal Reserve (Fed) holds rates until mid-2024 and then cuts. However, markets have got it wrong before and if, as we suspect, there is a hike in December, valuations will need to adjust.

Why do we believe we are in store for one more rate hike? The issue is in the stronger-than-expected data in recent weeks — and the Fed may be losing patience. The Fed indicated back in September that they would be patient, allowing time for prior rate hikes to filter into the economy.

However, the U.S. economy grew faster than expected, with GDP coming in at 4.9% in the third quarter (versus an expected 4.5%), driven by robust consumer spending. This is despite rising interest rates, persistent inflationary pressures, geopolitical tensions and a host of other domestic and international headwinds. The GDP increase marked the biggest gain since the fourth quarter of 2021. The U.S. labour market remains strong, with September's nonfarm payroll vastly outstripping expectations and the U.S. CPI for September was also higher than expected. With all this in mind, we believe that the chances of another rate hike in December should be higher, perhaps closer to 50/50, as the current situation stands, higher than reflected in current valuations.

The bear steepening of the yield curve pressured risk asset valuations, resulting in a sell-off in equities. We reduced our U.S. small caps underweight, reallocating to U.S. equities. As bond yields moved close to 5% for the 10-year U.S. Treasury, we think this is a good opportunity to reduce the duration underweight. We did this by moving from neutral to overweight U.S. Treasuries. We also removed the underweight to German bunds and French OATs. We moved from overweight to neutral emerging markets local currency sovereign debt, given differentials in developed market versus emerging market (EM) policy movements. EM 10-year rates have come down sharply relative to developed markets and the "spread" between them is very tight by historical standards.

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

## Fund Facts

Launch date	23 August 2016
Base currency	Euro

## Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Class Z Shares	-0.72	-8.74	4.33	-0.38	5.59	-2.26	0.63	--	--	--	--

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 Z Risk and Reward Profile

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 a range of assets with different levels of risk 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.

- Sustainability factors can pose risks to investments, for example: impact asset values, increased operational costs.
- There may be an insufficient number of buyers or sellers which may affect the funds ability to buy or sell securities.
- Commodity investments can change significantly and quickly in value as a large variety of factors affect them.
- 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 October 2023 and subject to change daily.

Applications for shares in the Fund should not be made without first consulting the current Prospectus and the Key Information Document ("KID") or Key Investor Information Document ("KIID"), which are available in English and in the official language of your local jurisdiction at [morganstanleyinvestmentfunds.com](http://morganstanleyinvestmentfunds.com) or free of charge from the Registered Office of Morgan Stanley Investment Funds, European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxembourg B 29 192.

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### INDEX INFORMATION

The **MSCI USA Index** is designed to measure the performance of the large and mid cap segments of the US market. With 631 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US.

The **MSCI Europe Index** is a free float-adjusted market capitalization index that is designed to measure developed market equity performance in Europe. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

The **MSCI Japan Index** is a free-floated adjusted market capitalization weighted index that is designed to track the equity market performance of Japanese securities listed on the Tokyo Stock Exchange, Osaka Stock Exchange, JASDAQ and Nagoya Stock Exchange. The MSCI Japan Index is constructed

based on the MSCI Global Investable Market Indices Methodology, targeting a free-float market capitalization coverage of 85%.

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