Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

Global Balanced Income Fund

SOLUTIONS & MULTI-ASSET | GLOBAL BALANCED RISK CONTROL TEAM | MONTHLY COMMENTARY | 31 DECEMBER 2018

Performance Review

In the one month period ending 31 December 2018, the Fund's Z shares returned -2.63% (net of fees)[1].

Most major asset classes traded lower in December. Emerging market equities were somewhat more resilient than those of developed markets in the month. The MSCI Emerging Markets Index fell 2.66% in U.S. dollars (USD) while the MSCI World Index slumped 7.60% in USD in December. Risk aversion drove a rally in safe-haven government bonds. Corporate bonds underperformed government bonds, as corporate profits remained under pressure from a weakening global growth outlook, rising cost pressures and political uncertainty. Our allocations to European government bonds and gold added to performance, whereas allocations to U.S., Japanese and European equities detracted.

Market Review

United States

The MSCI USA Index returned -9.05% in U.S. dollar terms and -10.14% in euro terms. Third-quarter U.S. gross domestic product (GDP) growth was marginally downgraded to an annualized 3.4% in the government's most recent update. The Institute for Supply Management (ISM) Manufacturing PMI fell to 54.1 in December from 59.3 in November, as demand weakened and concerns about the U.S.-China trade war increased. The U.S. services sector gauge also weakened by more than expected, with the December ISM Non-Manufacturing Index decreasing to 57.6 from November's 60.7 reading. The retail sales estimate was up 4.2% from November 2017 thanks to rising wages, robust consumer confidence and falling gasoline prices. The U.S. Bureau of Labor Statistics (BLS) said 312,000 jobs were added in December and the unemployment rate increased by 0.2 percentage points to 3.9%. Wages grew 3.2% over the year ended December 2018. Consumer price index (CPI) was unchanged in November at 0.3% and up 2.2% year on year. Core inflation, which excludes food and energy prices, also increased 2.2%.

Europe

The MSCI Europe Index returned -5.53% in euro terms and -4.38% in USD terms. Eurozone economic growth slowed to 0.2% in the third quarter, down from 0.4% growth in the second quarter, as reported by Eurostat. 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. 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. 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.

Japan

The MSCI Japan Index returned -9.83% in yen terms and -7.80% in euro terms. Japan's third quarter GDP growth rate was sharply revised down to a 2.5% contraction, significantly below the 1.2% expansion previously estimated by the government. The Japanese manufacturing sector registered an improvement in December. The Nikkei Japan Manufacturing PMI rose to 52.6 from the 15-month low of 52.2 in November. However, the services sector lost momentum in December as demand cooled. The Nikkei Japan Services PMI fell to 51.0 in December from 52.3 in November. Industrial production declined 1.1% during November, a reversal from October's gain of 2.9%, according to the Ministry of Economy, Trade and Industry. Inflation remained subdued during November. The core inflation rate, which excludes fresh food, was up 0.9%, and the CPI without food and energy was up 0.3% for the year. The unemployment rate ticked higher to 2.5% in November from 2.4% in October as more workers were leaving their jobs to seek better opportunities. In December, the Diet passed legislation allowing more foreign workers into the country to help offset the ageing population and declining workforce.

1 Source: Morgan Stanley Investment Management Limited. Data as of 31 December 2018.

This document constitutes a commentary and does not constitute investment advice nor a recommendation to invest. The value of investments may rise as well as fall. Independent advice should be sought before any decision to invest.

Portfolio Activity

We increased equity exposure moderately at the beginning of December in anticipation of easing trade attention to take advantage of cheap valuations in emerging market assets. We add to emerging market equities and local debt and reduced exposure to global high yield bonds. On 24 December we reduced portfolio volatility in view of elevated market volatility and rising political risk in Washington as a result of the intensified Muller investigation and a government shutdown. The effective equity exposure at the end of December was 20.8%.

Strategy and Outlook

Going into 2019, we continue to face the headwind of slowing growth, tighter monetary policy and political uncertainty. The U.S. approach to trade policy has dampened sentiment, hurt U.S. capex and slowed growth prospects around the globe, worsening the situation in a number of key economies. Meanwhile, China's recent attempts to reduce leverage – a sensible policy with unfortunate timing – are at the root of the weakness we are currently seeing there. It is not difficult to find dysfunctional policies in Europe, with Brexit in the U.K., a populist government bringing back fiscally unsustainable policies in Italy, riots in France and loss of political stability in Germany. This conjunction of dysfunctional policies has created a lot of volatility and corrected much of the excesses in pricing, but forward-looking volatility is unlikely to be as high as it has been in the recent past. We see three potential upside catalysts that might re-stimulate the global economy: (1) in the U.S., a more dovish Federal Reserve and/or a significant fiscal stimulus such as an infrastructure package, (2) a targeted Chinese stimulus programme or (3) an easing of trade tensions. In the absence of a positive stimulus of this sort, 2019 is likely to see continued weakness from policy until prices get to a point where valuations become attractive enough to spur demand. In fact, valuations outside the U.S. are already close to a point where investors might start looking to invest cautiously back in the market. We remain defensively positioned and aim to be nimble with our positioning. Our base case is that there is little recession risk in 2019, which implies that market has overshot on the downside. This is especially the case in non-U.S. markets, so there is meaningful upside potential. Amongst them we favour emerging market equities due to cheap valuations and improved sentiment. Fundamentals should stabilise and improve given hopes of fiscal stimulus in the U.S. and policy support in China. Within fixed income, we favour emerging market local credit as the valuations have improved and the USD headwind should also dissipate in 2019.

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

FUND FACTS

Launch date	Base currency
31 July 2014	Euro

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 INVF Global Balanced Income Fund - Z Shares	-6.23	4.75	4.83	5.08	--

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 a range of assets with different levels of risk 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 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.
- There are increased risks of investing in emerging markets as political, legal and operational systems may be less developed than in developed markets.
- The derivative strategy aims to increase the income paid to investors, but there is potential for the fund to suffer losses.
- 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 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%.

The **MSCI World Index** is a free float adjusted market capitalization weighted index that is designed to measure the global equity market performance of developed markets. 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 Emerging Markets Net Index** is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging markets. 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 MSCI Emerging Markets Net Index currently consists of 23 emerging market country indices. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

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