A Sub-Fund of Morgan Stanley Investment Funds

Global Brands Fund

INTERNATIONAL EQUITY TEAM

Investors should note that, relative to the expectations of the Autorité des Marchés Financiers, this UCITS presents disproportionate communication on the consideration of extra-financial criteria in its management.

Performance Review

In the one month period ending 31 December 2024, the Fund's Z shares returned -2.24% (net of fees)[1], while the benchmark returned -2.61%.

Following a strong third quarter, which saw the portfolio display its defensive characteristics, the portfolio delivered -2.75% in the fourth quarter. The MSCI World Index returned -0.16% in the quarter. For the full year 2024, the portfolio provided a respectable absolute return of +9.12%, in keeping with the investment team's long-term compounding expectation of circa 9%-10% per annum; however, it was unable to match another impressive year from the MSCI World, which returned +18.67%. Given the portfolio is designed for long-term capital appreciation through steady and predictable compounding, lagging the index in years of such extraordinary returns is not unusual, as witnessed in 2013 and 2023.

For the quarter, the largest contributors to absolute performance were: **Visa** (+83 basis points [bps]), as the company surpassed third quarter earnings expectations; **SAP** (+47 bps), which reported strong cloud revenue growth in the quarter and raised its 2024 full-year guidance; and **Booking Holdings** (+45 bps), which has continued to see momentum following robust third quarter earnings with growth in core revenue streams.

The largest absolute detractor during the quarter was **L'Oréal** (-79 bps), as the share price continued to decline following weak third quarter results due to a deterioration in China's beauty market. We took advantage of the depressed share price and added to our position. We see China's slowdown as cyclical rather than structural and believe the stock is attractively valued. Other key detractors in the fourth quarter include **Pernod Ricard** (-52 bps), which continues to contend with soft demand for spirits in the U.S. and anti-dumping duties on Cognac imports in China, and **Thermo Fisher** (-41 bps), which we added to after the company reported unremarkable third quarter results, given the industry's post-pandemic challenges are now beginning to show signs of easing.

In terms of fourth quarter relative performance, outperformance in health care helped stock selection, while information technology (IT), consumer staples and consumer discretionary were relatively weaker. In terms of sector allocation, the portfolio benefited from not owning the lower quality, capital-intensive sectors, notably materials, which somewhat mitigated the hit from the overweight to consumer staples and health care and the underweight to consumer discretionary and communication services.

For 2024 overall, the largest contributors to absolute performance were primarily IT and financials names: **SAP** (+320 bps) continued to reap the benefits from its transition to the cloud, returning a remarkable +60%, **Visa** (+118 bps) benefited from robust consumer spending and a rise in cross-border transaction volumes, and **Microsoft** (+103 bps) had modest double-digit performance combined with its large position size.

The three largest detractors in 2024 were consumer staples names. **Pernod Ricard** (-86 bps) and **L'Oréal** (-85 bps) were down for the year due to weakening U.S. and China demand and the threat of tariffs. We see the current trading weakness as cyclical. Both of these global businesses are pivoting to where growth is robust and are backed by well-invested brands. We expect improving sales growth trends in 2025 and a return to attractive compounding over the medium term. **Constellation Brands** (-43 bps) was weak due to Mexican tariff fears, although the operating performance remains solid with its U.S. beer brands continuing to grow share, underpinning its mid-single-digit sales and high-single-digit profit growth in 2024.

For 2024, the underperformance relative to the index was primarily due to stock selection in IT and consumer staples. Within IT, the portfolio's respectable +16% sector return, helped by strong absolute performers such as SAP, failed to match the substantial +33% IT sector index return, given the portfolio's skew toward software and IT services, which make up over 90% of the portfolio's IT exposure; in 2024, this lagged the more cyclical artificial intelligence (AI)-fuelled semiconductors and hardware subsectors. Another way of looking at allocation is considering the impact of the "Magnificent Seven":[2] the portfolio owns Microsoft and, from the third quarter, held Alphabet; however, the investment team's high quality bar and strict valuation discipline precluded it from owning the other five. This cost the portfolio over 500 bps of relative performance, with more than half of this attributable to Nvidia alone. Within consumer staples, relative weakness was primarily down to the handful of stock-specific issues noted above. Meanwhile for sector allocation, the portfolio benefited from the financials overweight and not owning the low quality, cyclical sectors, specifically materials, energy and real estate, although this was outweighed by the drag from the defensive sector overweights and the communication services underweight.

[1] Source: Morgan Stanley Investment Management Limited. Data as of 31 December 2024.
[2] Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla.

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Strategy and Outlook

Navigating certain markets in an uncertain world

2024 was a very strong year for markets overall, with the MSCI World up 19% in USD, making it five out of the last six years with returns above 15%.[3] However, this success was far from equally shared, with the "Magnificent Seven" delivering close to half the global index's returns, and the "Magnificent One", Nvidia, generating 20% of them all on its own. There was also a serious variation by geography, with the U.S. returns of 24% a full 20 percentage points ahead of EAFE's 4%.[4]

Earnings explain much of this hierarchy in 2024 returns. The S&P 500 Index's forward earnings rose 12% in the year, but this was made up of the "Magnificent One's" 38% earnings' surge alongside a mere 6% for the "S&P 493". However, even this long tail of the U.S. market was well ahead of EAFE's 2% earnings fall. The strength of the dollar helped the U.S., as did the country's stronger economic growth. U.S. gross domestic product (GDP) growth reached a very healthy 2.7% in 2024, in contrast with the shrinking German and Japanese economies.[5] There was also a significant multiple gap. The U.S. market rerated by 10% to almost 22x forward earnings, and 19x even without the "Magnificent Seven", while EAFE's multiple edged up by just 3% to 13.8x, a record 36% discount to the U.S.

Looking forward, the U.S. economy continues to look healthier than other developed markets. Its 2%+ expected GDP growth for 2025 is twice that of EAFE, despite the continued softness in some areas such as low mortgage issuance and weak manufacturing PMIs (purchasing managers' indexes). However, positive surprises for the U.S. economy may be tougher to find than in the last two years, given the higher starting base for economic growth. Optimists point to the potential for further corporate tax cuts, deregulation, and mergers and acquisitions liberalisation to boost corporate profitability under the incoming Trump presidency. The flip side is fears that his policies may aggravate already sticky inflation, be they tariffs increasing consumer prices or deportations raising labour costs. The U.S. policy environment is unusually fluid at present, with a lack of clarity about the incoming administration's plans, never mind their ability to actually implement them.

The economic factor not receiving as much attention as it should is the U.S. budget deficit, which is running at an unprecedented 6%-7% of GDP at a time when the economy is at close to full employment. The macro purists cite the Kalecki-Levy equation, pointing out how U.S. fiscal profligacy boosts corporate profitability. To put it less abstractly, either the U.S. budget deficit will be cut significantly by the DOGE's (Department of Government Efficiency) efforts outpacing tax cuts, which could suck demand out of the economy, acting as a major dampener on economic growth and thus corporate profits, or the deficit will remain very high, growing debt further from the current $36 trillion, which could put pressure on long-term Treasury yields and even the mighty dollar. The 10-year Treasury rate rising 100 basis points as the U.S. Federal Reserve has cut policy interest rates by 100 basis points is perhaps an ominous sign.

Our real concern is how the expected 2025 earnings growth of 15% for the U.S. gets delivered. The expectation is not that we are dependent on the "Magnificent Seven" to deliver this but that the earnings growth will be broad-based, with the "493", excluding the "Magnificent Seven", growing earnings at 13%. Given revenues are only expected to grow 5%, in line with nominal GDP growth expectations, this double-digit earnings per share (EPS) growth implies a sharp further improvement in margins from what are already at near-record levels, even excluding the "Magnificent Seven".

It has not been the easiest time to invest in steady, high quality compounders in relative terms, due to the twin issues of GenAI excitement and the elevated level of profitability in lower quality companies. In fact, these lower quality companies have closed the margin gap with the portfolio. This is highly unusual as normally the portfolio consistently has higher and more stable margins than the index given our companies' superior pricing power. The 2024 challenge was around multiples. The portfolio grew its forward EPS by 7%, in line with the overall index and respectable given the headwind from the strengthening dollar, but performance lagged the MSCI World as the portfolio only rerated by 1%, versus the 9% for the index. Looking forward, this leaves the portfolio relatively well placed on valuation, as the PE premium has fallen to 22%, towards the bottom end of the range over the last decade, and the free cash flow premium has virtually disappeared, now at only 1%, despite the far higher quality and better top-line growth prospects.

Credible earnings growth given healthy top line

The portfolio also looks well placed in terms of earnings. They are very likely to be far more resilient than those of the index in any economic downturn, given the holdings' strong pricing power and recurring revenues, as was shown most recently in the COVID crisis, the only recession in the last 15 years. Arguably more importantly, the portfolio looks well placed in both absolute and relative terms even in the absence of a downturn. Consensus puts the portfolio's EPS growth at 11% per year over the next two years. We believe this looks achievable, based on the estimated 7% annual revenue growth, with some modest help from operational leverage, acquisitions and buybacks making up the other 4% of EPS growth. This seems much more credible than the margin-driven 12% annual EPS growth expected for the index, which is supposed to come off revenue growth of only 5%, a 7% delta when margins are already close to peaks.

The claim that "prediction is very difficult, particularly about the future" is attributed to both the Nobel Prize winning physicist Niels Bohr and the baseball Hall of Fame member Yogi Berra. Despite their differing backgrounds, they would probably both agree that prediction is particularly difficult in 2025 given the heightened geopolitical and U.S. policy uncertainty combined with wildly varying prognostications for GenAI. However, the markets do not seem to be afflicted by any such doubt, given the elevated equity

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[3] Source for markets and stock performance, multiples, earnings and revenue data cited in this commentary: FactSet, as of 31 December 2024.
[4] U.S. and EAFE market performance is represented by the MSCI USA Index and MSCI EAFE Index.
[5] Source for GDP and Treasury rates data cited in this commentary: Bloomberg L.P., as of 31 December 2024.

multiples, modest VIX and, most starkly, BBB-rated bond spreads at their lowest this century. Given this market obliviousness to the world's volatility, we believe a strategy that seeks to deliver steady compounding through decent top-line growth and resilient earnings, which is trading at a reasonable multiple, offers an important role to play in clients' portfolios.

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

Fund Facts

Launch date	30 October 2000
Base currency	U.S. dollars
Benchmark	MSCI World Net Index

Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015
Class Z Shares	9.12	9.12	16.53	-17.31	22.35	12.75	29.32	-2.01	26.06	5.16	5.75
MSCI World Net Index	18.67	18.67	23.79	-18.14	21.82	15.90	27.67	-8.71	22.40	7.51	-0.87

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 shares. The sources for all performance and index data is Morgan Stanley Investment Management ('MSIM Ltd'). **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

- The fund may be impacted by movements in the exchange rates between the fund's currency and the currencies of the fund's investments.
- 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.
- Investment in China A-Shares via Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect programs may also entail additional risks, such as risks linked to the ownership of shares.
- 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, available at www.morganstanleyinvestmentfunds.com. All data as of 31.12.2024 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 language of countries authorized for fund distribution and is available online at Morgan Stanley Investment Funds Webpages or free of charge from the Registered Office at European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxemburg B 29 192.

The summary of investor rights is available in the aforementioned languages and website location under the General Literature section.

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The **Standard & Poor's 500® Index (S&P 500®)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

The **MSCI EAFE Index (Europe, Australia, Far East)** is a free float-adjusted market capitalization index that is designed to measure the international equity market performance of developed markets, excluding the US & Canada. 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 EAFE Index currently consists of 21 developed market country indices. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

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.

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