Global Fixed Income Opportunities Fund

Performance Review

In the one month period ending 29 February 2020, the Fund’s Z shares returned 0.00% (net of fees)¹.

During the month, the portfolio’s performance benefited from duration, as yields fell in February, specifically rates in developed markets such as the U.S. and Europe, while holdings in emerging market (EM) local rates debt detracted from performance. Exposure to dollar-denominated EM sovereign debt detracted from performance, as did holdings in corporate debt, both high yield and investment grade.

Market Review

February marked a watershed in the evolution of the coronavirus (COVID-19) outbreak and its ramifications. Through February 19 (the day the S&P 500 Index hit its all-time high), optimism reigned. The world thought this health crisis was likely to be contained to Asia, predominantly China, with a relatively small impact on the U.S. and European economies. It was a temporary supply shock, a disruption in supply chains, but importantly, it would not materially affect 2020 cumulative economic performance, either in the U.S. or China. Lost output could be made up without lasting impact on demand. So much for wishful thinking! By the end of the month, the 10-year U.S. Treasury yield was at a record low, equities were down close to double digits and high yield debt now had a negative return year-to-date.

The failure to contain the spread of the coronavirus to China (and Asia) changed the game. The world now faces an aggregate demand shock (above and beyond a short-term collapse in Chinese demand) on top of the original Asian supply shock.

Economic growth will take a bigger hit (although there is nothing really evident in the data yet). The hit will last longer. It will be global. And, maybe worst of all, no one knows when it will end. The Brookings Institution has come up with SEVEN potential scenarios. There are probably a lot more than that! This uncertainty will weigh on economies and financial markets until there is evidence that infection rates are likely to have peaked. Recession is likely in countries already facing weak economic prognoses and weak policy frameworks. Other countries, probably the U.S., may escape recession but at the cost of a stagnating economy. Volatility will stay high, government bonds will continue to be well supported and risky assets should struggle (financial markets were not well positioned for the plethora of bad news delivered post February 19). In the medium term, we believe this crisis should pass and economies return to normal. When and how much pain is felt along the way will determine how low yields go and how wide credit spreads move. As long as the virus’s impact remains disruptive rather than destructive, we should be fine, eventually. Buckle your seat belts!

In February, yields fell to historic levels across the globe as markets braced for the social and economic impact of the coronavirus, as the virus continued to rapidly spread outside of China. Other geopolitical risks around the globe took a back seat as the coronavirus was the main driver of market moves, particularly at the end of the month. The Organisation for Economic Co-operation and Development slashed its global growth forecasts for 2020 from 2.9% to 2.4%. Ten-year global yields across the developed markets dropped, including 36 basis points on the U.S. Treasury, 25 basis points in New Zealand and 17 basis points in Germany.² The VIX volatility index closed the month at 40, which was close to a five-year high, signaling increased concern among investors of the impacts the coronavirus will have on the global economy. U.S. inflation breakeven rates fell, with the 10-year breakeven ending the month at 1.43.² The reinversion of the Treasury yield curve and collapse of real yields were also indicative of uncertainty about the economy.

EM fixed income asset performance was negative in the month, as investors reduced risk due to the uncertainty surrounding the spread and economic impact of COVID-19. EM currencies weakened versus the U.S. dollar, while local bond returns were flat as bond yields failed to match the decline in Treasury yields. Inflows into the asset class ($4.4 billion) continued for most of the month, primarily into hard currency strategies ($4.1 billion), while local currency strategies gained $0.2 billion. Many central banks cut rates or enacted other easing measures to combat the slowdown in economic activity.

² Source: Bloomberg L.P. Data as of 29 February 2020.

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Unsurprisingly, the key driver of credit spreads in February was the uncertainty surrounding the coronavirus and its impact on economic activity and market/business confidence. Additional weak economic data that began before the virus, corporate results for the fourth quarter of 2019 that were ahead of lowered expectations, and the start of U.S. election news were all discussed, but were not material market movers.

In the securitized markets, as with the other sectors, coronavirus was the dominant story in February, with U.S. interest rates rallying sharply to new lows and equities selling off materially. In an ironic twist, the securitized markets had essentially an opposite reaction, where government-guaranteed agency mortgage-backed securities (MBS) was the worst performing asset class, while credit-oriented securitized asset performed well. While this sounds counterintuitive, this market dynamic actually makes sense when one drills a little deeper. Credit-oriented securitized assets performed well during the month driven by the continued demand for yield and also supported by continued strong fundamental market conditions. Agency MBS underperformed as lower rates increased prepayment concerns and limited how much agency MBS prices could rise.

**Portfolio Activity**

During the month, we reduced exposure to emerging markets, primarily in local currency debt, as well as in peripheral developed market debt and high yield corporate debt. We added to cash positions, investment grade corporate debt and securitized debt.

**Strategy and Outlook**

February has been a match of two halves: pre-February 19 the outlook was still optimistic, and post the 19th, goldilocks has been postponed, maybe indefinitely. Prior to the 19th, the outlook was a continuation of the steady recovery which characterized the end of 2019, with equities and government bonds rallying and credit performing well in spite of some minor spread widening due to the tight levels at the end of 2019 and risks surrounding the coronavirus. By the end of February, markets had had their worst week since the 2008 financial crisis and the yield on the 10-year Treasury note hit historic lows, as the coronavirus continued to spread across the globe. By now it’s clear the virus will have a meaningful impact on the global economy. While the consensus view had been that the worst impact would be felt in the first quarter and a recovery would follow in the second quarter, this is now likely overly optimistic. We increasingly believe uncertainty is unlikely to be resolved until at least late in the second quarter.

Thus, thinking about the outlook for the next few months is tricky to say the least. The coronavirus creates a fluid situation for markets, with no one certain about how long and far it will run. On the positive side, it appears to be receding in China, where it started, allowing the economy to start to recover; some other Asian economies – Japan, Singapore and Taiwan – have been remarkably successful at containing the virus. On the negative side, infections outside of China, particularly in Europe, have been accelerating and are only just starting to pick up in the U.S. and many other countries. A public health failure in just one or two major economies could be severely disruptive to the entire global economy.

Fixed income markets have reacted to the increased risk sentiment with risk-free duration rallying and credit spreads widening (investment grade, high yield and emerging markets). With government bond yields making new all-time lows in many advanced economies, it is not clear how much further they can fall, unless economies move into recession. Central banks have responded with emergency easing – rate cuts, as well as measures to ease monetary conditions and keep liquidity flowing – but the market was quick to anticipate this response and significant rate cuts have been priced for every developed economy central bank.

Looking forward, the debate is whether the impact will merely be ‘disruptive’ to the global economy, with a rebound in economic activity following the current slowdown, or ‘destructive’, with the timeline uncertain and longer-term damage inflicted. Our base case is still for it to be disruptive, with open questions over (1) the timeline to the peak in the infection rate, (2) the impact on consumer/business confidence and (3) the level where markets offer extreme value. The good news is that we are seeing both central banks and governments moving into action, with combined monetary and fiscal stimulus, but it remains to be seen if the response will be enough to calm markets.

While monetary accommodation is not a solution to a medical problem and will have limited effect in cushioning the economy from a supply-side shock, it can help prevent monetary conditions from tightening. The Federal Reserve’s surprise emergency rate cut (50 basis points) in early March was extremely important in this regard. Moreover, we expect central banks and fiscal authorities to deliver on credit easing measures to support corporate/household cash flows and their access to credit.

*For further information, please contact your Morgan Stanley Investment Management representative.*
FUND FACTS
Launch date
07 November 2011
Base currency
U.S. dollars

12 Month Performance Periods to Latest Month End (%)

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<tr>
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<th>FEBRUARY '19</th>
<th>FEBRUARY '18</th>
<th>FEBRUARY '17</th>
<th>FEBRUARY '16</th>
<th>FEBRUARY '15</th>
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<tr>
<td>Z Shares</td>
<td>8.15</td>
<td>2.31</td>
<td>6.96</td>
<td>8.83</td>
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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

<table>
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<th>Lower Risk</th>
<th>Higher Risk</th>
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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 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 29 February 2020 and subject to change daily.

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 Volatility Index (VIX) is the ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. It represents one measure of the market's expectation of stock market volatility over the next 30-day period. The VIX is quoted in percentage points and translates, roughly, to the expected movement in the S&P 500 index over the next 30-day period, which is then annualized.
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