Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

Global Focus Property Fund

MARKETING COMMUNICATION | GLOBAL LISTED REAL ASSETS TEAM | QUARTERLY COMMENTARY | 30 JUNE 2022

Performance Review

As the Fund is less than a year old we are constrained from commenting on its performance.

Global real estate securities (FTSE EPRA Nareit Developed Extended Net Index, -15.88%, the “Index”) outperformed the broader equity markets (MSCI World Net Index, -16.19%) for the quarter. The markets posted negative returns as the impact of high inflation, rapidly rising interest rates and weaker sentiment moderated growth, increasing the odds for a recession in 2023. Ongoing global supply chain disruptions from the war in Ukraine and COVID-related lockdowns in China also weighed on the market. COVID-19 cases continued to rise due to omicron variants, although economies are working to resume business as usual, and China’s “zero-COVID” policy slowly began to loosen at the end of the quarter starting with the quarantine policy for incoming travelers.

In the U.S., the Federal Reserve (Fed) approved an interest rate hike of 75 basis points[1] in June. Fed Chair Powell’s testimony to Congress implied the Fed would raise rates to whatever level necessary to bring inflation down. Increased COVID-19 cases due to omicron subvariants continue to remain mild overall and businesses continued to operate normally. Within the Index, less economically sensitive sectors with more defensive cash flow growth profiles and strong balance sheets outperformed. Specifically, student housing outperformed on the heels of a take-private transaction by Blackstone[2] and the net lease sector outperformed given the relative stability of its cash flows. The more economically sensitive sectors of office (West Coast and NYC), billboards, regional malls, industrial and hotels underperformed.

In Europe, the ongoing war in Ukraine has led to record high inflation, pushing food and fuel prices higher and stretching consumer wallets and confidence. Similar to the U.S., “risk-free” rates continue to rise almost unabated. Consistent with this backdrop, companies within the Index with the highest leverage and shortest debt maturity schedules underperformed in the quarter. Sweden, Norway and Germany were all underperformers for the quarter.

In Asia, continued tight pandemic policies and the Shanghai lockdown in mainland China negatively impacted economic activity. Geopolitical tensions further weighed on investor sentiment, exacerbating supply chain disruptions and aggravating inflation issues. Within the Index, Australian REITs (real estate investment trusts) underperformed as rising and volatile bond yields were a headwind for the sector and impacted investor confidence. Japan real estate operating companies outperformed as they continue to be viewed as inflation proxies, though the industrial/logistics J-REITs (Japan real estate investment trusts) continued to underperform due to interest rate concerns. Singapore companies outperformed, benefiting from successful residential launches at strong prices.

Strategy and Outlook

The team uses internal proprietary research to invest in public real estate companies that we believe offer the best value relative to their underlying assets and growth prospects. The team combines a bottom-up approach, assessing the intrinsic value, equity multiples and growth prospects of each security, with a top-down view that incorporates fundamental inflection points, macroeconomic considerations, and geopolitical and country risk, and actively selects positions in a limited number of equity securities. By incorporating both an equity market valuation and a more traditional real estate valuation with a top-down overlay, we believe the Fund will be better prepared to identify securities with the best expected total returns.

Forecasted returns for the asset class have deteriorated in the intermediate term given the more challenging macro backdrop. However, we believe relative strength in cash flows can be expected given the unique nature of listed real estate. Specifically, the contracted rental streams with inflation-linked escalations and the necessity-based nature of real estate, coupled with limited new real estate supply additions, may portend limited downside in cash flows, despite near-term macro uncertainty. Additionally, we believe the relative valuation of real estate securities is attractive, specifically when compared to direct property investment, and could lead to continued merger and acquisition activity and privatizations, thereby crystalizing value and potentially outsized returns for investors.

1 Source: Morgan Stanley Investment Management Limited. Data as of 30 June 2022. One basis point = 0.01%
2 Not held in the portfolio as of 30 June 2022.

Within North America, secular trends that have been unfolding over the past several years and that were accelerated in the face of COVID-19 will result in winners and losers for real estate.

- In retail, secular headwinds remain given the continued focus on omnichannel distribution; however, retailers have a renewed appreciation for physical storefronts. Discretionary spending is declining amid record high inflation and growing bankruptcy watch lists.
- In office, work-from-home (WFH) policies will continue to be an overhang. Increased focus on health, wellness and safety could serve as an offset to demand impairment; layoff announcements and jobless claims are increasing with new job listings declining.
- In lodging, leisure demand is exceeding expectations. Business travel is likely secularly impaired, and increasing recession odds are a negative for corporate capex and lodging demand.
- In residential, affordability concerns regarding homeownership given increasing mortgage rates and home price appreciation will likely lead to increasing renter demand. Supply growth, regulation, weaker jobs and wage growth remain key risks for rental residential markets.
- In industrial/storage, fundamentals remain robust resulting in record low vacancy and double-digit rent growth. Demand should prove more insulated and resilient to macro noise.
- In health care, the necessity-based nature of seniors housing demand is anticipated to insulate fundamentals from macro headwinds. Labor shortages and expense pressures are expected to dissipate.

Within Europe, we see many similar trends unfolding.

- In office, the WFH impact on the Continent is expected to be more modest and long-tailed than U.S. or U.K. impacts. Continental landlords are reporting rising tenant demand, particularly for higher quality stock, supported by improving return-to-office levels. London office tenant demand is increasingly pointing to a bifurcated market, with "green" best-in-class space significantly outperforming.
- In retail, the Continent's traffic and retail sales are not far off pre-pandemic levels, although secular challenges remain. In the U.K., further deterioration in shopping center rents and values is anticipated, but there are signs of stabilization for retail parks. Given continued high inflation and recession fears, discretionary spending has deteriorated in both the U.K. and Continent.
- Industrial demand remains robust, as logistics and supply chain remain front of mind and capital flows into the sector continue to drive up valuations.

Within Asia:

- In Japan, global capital continues to be attracted to Tokyo office assets. Grade A office vacancy rates remain among the lowest globally. In Japan hotels, expectations of a reopening have led to improving sentiment toward the sector; however, leisure hotels are expected to perform better than purely business-oriented hotels.
- In Australia office, capital values are holding firm as evidenced by continued activity in the transaction market and office leasing activity is beginning to slowly recover. In Australia retail, while secular challenges remain, capital values appear to have bottomed, with several large transactions being announced at pricing better than feared, although central business district retail is likely to be under pressure for some time due to the decreased amount of international travel.
- In China, fundamentals remain below trend; however, supportive property policies have aided stabilization, specifically with residential sales in higher tier cities. Renewed COVID-19 fears, continued concerns of contagion from Evergrande[2] troubles and related solvency issues warrant an elevated level of scrutiny.
- In Hong Kong, geopolitical risks remain front of mind. Non-discretionary retail landlords are likely to outperform discretionary landlords given continued uncertainty regarding border reopenings.

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

FUND FACTS

Launch date	Base currency	Index
15 October 2021	U.S. dollars	FTSE EPRA Nareit Developed Extended Net Total Return Index

[2] Not held in the portfolio as of 30 June 2022.

Share Class I 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 property 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:

- There are additional risks associated with investing in real estate.
- 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.
- There are increased risks of investing in emerging markets as political, legal and operational systems may be less developed than in developed markets.
- 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. All data as of 30 June 2022 and subject to change daily.

Applications for shares in the Fund should not be made without first consulting the current Prospectus and the Key Investor Information Document ("KIID"), which are available in English and in the official language of your local jurisdiction at 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. Luxemburg B 29 192. A summary of investor rights is available in English at the same website.

Information in relation to sustainability aspects of the Fund and the summary of investor rights is available at the aforementioned website.

If the management company of the relevant Fund decides to terminate its arrangement for marketing that Fund in any EEA country where it is registered for sale, it will do so in accordance with the relevant UCITS rules.

INDEX INFORMATION

The **FTSE EPRA Nareit Developed Extended Net Total Return Index** is a market capitalization weighted index designed to represent general trends in eligible real estate stocks worldwide. Relevant real estate activities are defined as the ownership, trading and development of income-producing real estate. The FTSE EPRA Nareit Developed Extended Index represents the extension of real estate property sectors (e.g. Infrastructure and Timber) and additional securities beyond what is currently eligible for the FTSE EPRA Nareit Developed Index. The performance of the Index is listed in U.S. dollars and assumes reinvestment of dividends.

The **MSCI World Net 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 index is unmanaged and does not include any expenses, fees or sales charges. It is not possible to invest directly in an index.

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