Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

Global Infrastructure Fund

REAL ASSETS | GLOBAL LISTED REAL ASSETS TEAM | MONTHLY COMMENTARY | 31 DECEMBER 2018

Performance Review

In the three month period ending 31 December 2018, the Fund's Z shares returned -6.21% (net of fees)[1], while the benchmark returned -5.88%.

As a result, the Fund's Z shares ended down 8.02%[1] for full year 2018, in line with the benchmark's return of -7.87%.

The Fund underperformed the benchmark in the fourth quarter of 2018 primarily due to top-down considerations. From a bottom-up perspective, the Fund benefited from favorable stock selection in gas midstream, diversified, communications, airports and pipeline companies, offset by adverse stock selection in toll roads, electricity transmission & distribution and gas distribution utilities. From a top-down perspective, the Fund benefited from an overweight to toll roads and an underweight to gas midstream, but this was more than offset by underweights to gas distribution utilities and communications, as well as maintaining out-of-benchmark positions in renewables and railroads.

Market Review

Infrastructure shares decreased 5.88% in the quarter ending December 31, 2018, as measured by the Dow Jones Brookfield Global Infrastructure Index. Quarterly returns were heavily impacted by a sharp decline in December (-4.83%), coincident with a broad, global financial market sell-off during the month (the S&P Global BMI, a proxy for global equities, declined 7.18% in December alone and 13.13% for the quarter). Given the relative resiliency of the asset class during the final quarter of the year, infrastructure ended 2018 by outperforming global equities on a relative basis (-7.87% for infrastructure versus -9.67% for global equities).

During the fourth quarter of 2018, subsector performance exhibited a wide dispersion of returns. Water, communications, toll roads, gas distribution utilities and European regulated utilities outperformed the index and posted positive absolute returns, while gas midstream, airports, electricity transmission & distribution, ports, diversified and pipeline companies underperformed and were negative from an absolute return perspective.

Financial market participants took a decidedly more risk-averse turn in the fourth quarter of 2018 in the face of mounting global challenges: rising U.S. Federal Reserve rates, indications of economic slowdown in the eurozone and China, ongoing geopolitical concerns in the U.K. and Italy, and trade conflict between the U.S. and China, to name a few. Infrastructure share price performance in the fourth quarter was in part influenced by this retrenchment, with generally strong performance by network utilities and wireless towers, reflecting both the defensive, stable nature of their cash flows as well as long-term secular growth drivers not easily influenced by the economic cycle or political noise (trade-related or otherwise). Conversely, energy infrastructure shares declined meaningfully, despite very strong fundamentals, due to concerns over future energy demand relative to resilient supply in a moderating global economy.

Away from top-down, non-infrastructure specific factors, infrastructure performance in the fourth quarter was also driven by company-specific developments. Most notable was the significant weakness in California-based utilities PG&E and Edison International, which suffered following new wildfires in their jurisdictions in the fourth quarter. Also in the utility space, U.K. network operator National Grid declined in mid-December following regulator Ofgem's release of its view of National Grid's potential allowed returns for the next regulatory period. The nominal 6.1% base return on equity (ROE) proposal was lower than prior consultation estimates, which indicated a mid-point ROE of 7.0%. While National Grid will be allowed to earn in excess of its base return in future regulatory periods and has historically done so, investors nonetheless temporarily reacted negatively to the lower potential return.

Looking at other sectors, a number of airports suffered in the fourth quarter due to investor concerns over the future direction of allowed tariffs on the airports' regulated aeronautical businesses, as well as concerns over a moderation in the growth rate

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

of traffic. In the diversified sector, shares of infrastructure conglomerate Vinci SA declined on the back of broad disruption in France associated with the *Gilet Jaunes* protests, coupled with concerns on potential government intervention on tariffs, which proved unjustified after the end of the quarter.

Portfolio Activity

Given the heightened levels of volatility in the fourth quarter, the Fund was active from a trading perspective. Purchases were made across a number of sectors, with the largest amounts executed in the utility and communications sectors. Sales were concentrated in rails, where we looked to reduce our positions following material year-to-date outperformance.

Strategy and Outlook

We remain committed to our core investment philosophy as an infrastructure value investor. As a value-oriented, bottom-up driven investor, our investment perspective is that over the medium and long term, the key factor in determining the performance of infrastructure securities will be underlying infrastructure asset values. Given the large and growing private infrastructure market, we believe that there are limits as to the level of premium or discount at which the public sector should trade relative to its underlying private infrastructure value. These limits can be viewed as the point at which the arbitrage opportunity between owning infrastructure in the private versus public markets becomes compelling. In aiming to achieve core infrastructure exposure in a cost effective manner, we invest in equity securities of publicly listed infrastructure companies we believe offer the best value relative to their underlying infrastructure value and Net Asset Value growth prospects.

Our research currently leads us to an overweighting in the Fund to a group of companies in the toll roads, European regulated utilities, electricity transmission & distribution and diversified sectors, and an underweighting to companies in the gas distribution utilities, communications, gas midstream, pipeline companies, water, airports and ports sectors. Finally, we continue to retain an out-of-benchmark position in renewables.

In terms of outlook for 2019, we enter the year more constructive on the asset class, given the magnitude of declines in 2018. While we acknowledge there are wide ranges in valuations within individual subsectors and the asset class is not universally cheap, we believe there are many instances where the market has overreacted to recent top-down or company-specific developments. In particular, energy infrastructure and certain areas of transportation are notable given the very healthy fundamental environment. Also, renewable assets in the listed equity space continue to trade at steep discounts relative to where assets trade in the private markets, as evidenced by the robust private-market transaction activity (renewables remained greater than half the private market infrastructure transactions in 2018 according to Prequin). In 2019, we view the prospects for healthy cash flow and dividend growth for the asset class overall as sound.

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

FUND FACTS

Launch date	Base currency	Index
14 June 2010	U.S. dollars	Dow Jones Brookfield Global Infrastructure Index

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 Infrastructure Fund - Z Shares	-8.02	12.71	15.23	-14.61	15.84
Dow Jones Brookfield Global Infrastructure Index	-7.87	15.79	12.52	-14.40	16.34

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 the infrastructure industry 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 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 are additional risks associated with investing in infrastructure.
- 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.
- 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 **Dow Jones Brookfield Global Infrastructure Index:** is a float-adjusted market capitalization weighted index that measures the stock performance of companies that exhibit strong infrastructure characteristics. The Index intends to measure all sectors of the infrastructure market.

The **S&P Global BMI Index** is a broad market index designed to capture exposure to equities in all countries in the world that meet minimum size and liquidity requirements. The index includes developed and emerging market countries.

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