Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

Global Property Fund

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

Performance Review

In the one month period ending 31 December 2018, the Fund's I shares returned -5.28% (net of fees)[1], while the benchmark returned -4.27%.

The Fund underperformed the benchmark for the month. During the period, the market experienced significant volatility and a broad-based sell-off on concerns over an economic slowdown, among other factors, and companies with perceived defensive characteristics generally benefited. Performance within the Asian region was relatively neutral, while the North American and European regions detracted from relative performance. Top-down regional allocation and cash held in the Fund were relatively neutral. In the Asian region, the Fund benefited from the overweight to Hong Kong; this was partially offset by the underweight to Singapore. In the European region, the Fund benefited from stock selection in Continental retail and the U.K. Majors, and the underweight to German residential; this was more than offset by the overweight to Continental retail, which declined on concerns over retail challenges despite stable operating results by the companies, and underweights to Sweden, Belgium and Switzerland. In the North American region, the Fund benefited from the underweight to the U.S. industrial sector; this was more than offset by stock selection within and the overweight to the U.S. primary central business district (CBD) office sector, which is facing significant negative investor sentiment; the overweight to the U.S. mall sector; the underweight to the U.S. net lease and health care sectors, which were viewed as defensive by investors; and stock selection within and the overweight to the U.S. hotel sector.

Market Review

In Hong Kong, there is continued strength in valuations for commercial assets as evidenced by elevated transaction volumes. The Hong Kong office market features low vacancy levels and continued rental growth, while there has been a recent slowdown in strong growth of retail sales in Hong Kong. The Hong Kong real estate operating companies (REOCs) continue to represent a significant overweight in the global portfolio, as the stocks offer highly attractive value with the widest overall discrepancy between public and private valuations among public listed global property markets despite healthy operating fundamentals, solid recurring cash flow growth and continued strength in asset values in the private markets, as well as improving corporate governance and capital management. The discounted valuations are further accentuated as the Hong Kong REOCs maintain very modest leverage levels. These net asset value (NAV) discounts could eventually narrow for companies that are willing to recycle assets on the balance sheet to realize their latent gains and engage in corporate restructuring to improve transparency and capital management, and potentially eliminate any holding company discounts, as well as any improvement in recent negative sentiment. In Japan, the investment market remains active but there is some caution due to all-time low cap rates and continued policy uncertainty. There is a significant disparity in valuations with the Japan REOCs trading at discounts to NAVs and the Japan REITs (J-REITs) trading at premiums to NAVs. The J-REITs generally own lower-quality assets as compared to the J-REOCs, but J-REIT share prices have been bolstered by investors' search for yield, the Bank of Japan's commitment to monetary easing and the asset purchase program, and the perception of REITs as a bond proxy. The Fund is underweight Japan overall, driven primarily by the large underweight to the J-REITs. In Australia, key office markets are experiencing improved rental growth, while operating fundamentals in the Australian retail sector remain lackluster relative to historical levels. The Australian REIT sector ended the period trading at a premium to NAVs and remains far less attractive relative to the Hong Kong REOCs within Asia.

In the U.K., the Brexit vote created expectations for declines in NAVs but office market transaction and leasing activity to date have indicated far more modest declines than initially expected. Although uncertainty over Brexit persists (and became more acute in the fourth quarter of 2018), there remains continued investor interest in London assets, especially from foreign investors showing a willingness to pay prices that reflect values at or above pre-Brexit levels, although the value of U.K. retail assets are weakening. Overall, property stocks in the U.K. ended the period trading at a 21% discount to NAVs. There is attractive value in the large-cap U.K. Majors, which trade at a 35% discount to NAVs, and London office specialists, which trade

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

at a 25% discount. These discounts are well in excess of expected asset value declines and reflect a disparity in value versus Other U.K. stocks. On the Continent, valuations are being supported by stable property fundamentals. Property stocks on the Continent ended the period trading at a 15% discount to NAVs overall, although there is meaningful disparity in valuations, with the Continental retail stocks trading at a 35% discount to NAVs following accelerated share price weakness on concerns over retail challenges despite stable operating results by the companies. Within Europe, we remain overweight the U.K. Majors and London office specialists and Continental retail, and underweight Germany and other segments in the U.K.

In the U.S., the REIT market ended the period trading at a 5% discount to NAVs, with various segments trading at meaningful discounts. There is an enormous disparity in relative valuations among the various REIT sectors. We see the most attractive value in the owners of NYC office assets. We also see attractive value in high-quality retail, CBD office, hotel and apartment stocks. These companies provide exposure to high-quality core assets at significant discounted valuations. Our company-specific research leads us to an overweighting in the Fund to a group of companies that are focused in the ownership of NYC office assets as well as high-quality retail, CBD office, hotel and apartment assets and a number of out of favor companies, and an underweighting to companies concentrated in the ownership of net lease and health care assets. The Fund is underweight Canada given less attractive relative valuations.

Portfolio Activity

The global portfolio is comprised of three regional portfolios with a global allocation which weights each of the three major regions (North America, Europe and Asia) relative to the index based on our view of the relative attractiveness of each region in terms of underlying real estate fundamentals and public market valuations. Moreover, each of the regional portfolios reflects our core investment philosophy as a real estate value investor, which results in the ownership of stocks that we believe provide the best valuation relative to their underlying real estate values, while maintaining portfolio diversification. Our company-specific research leads us to specific preferences for sub-segments within each of the property sectors and countries. For the period ended December 31, 2018, the Fund was modestly overweight the Asian listed property sector, relatively neutral to the North American listed property sector and modestly underweight the European listed property sector.

We would note that regional bets are currently relatively muted due to a lack of large valuation disparities among the regions and due to macro uncertainties which may impact regional share prices far more than underlying fundamentals and valuations, and we have instead focused on the enormous disparities in valuations among market segments within each of the major regions. We see the most attractive expected return prospects from companies concentrated in U.S. CBD office (especially NYC office), the Hong Kong commercial property companies, U.S. and Continental high-quality retail, the U.K. Majors and London office specialists, U.S. hotels and select opportunities to invest in other core assets at attractive discounted valuations in a number of other global markets.

Strategy and Outlook

Investment values for prime real estate assets have generally remained stable due to very strong capital flows to the sector as investors have embraced real estate within their multi-asset portfolios. There are concerns that values may have peaked or are even poised to decline after significant appreciation. Despite these concerns, asset values have generally remained steady, but lower-quality properties remain most at risk of price declines. Generally, current cap rates have been supported by historically wide cap rate spreads versus financing costs and continued strong demand for real estate. Moreover, real estate asset values and transaction volumes remain well supported by the record amount of investor allocation to the real estate sector. According to Prequin, global private equity real estate investment funds had over $240 billion of committed but currently uninvested equity capital as of the third quarter of 2018 (62% in North America), which represents a new record of available equity capital.

While there are pockets of the global listed property market that are trading at premium valuations relative to peers due to their perceived defensive characteristics, the public markets appear to be pricing in prospective asset value declines in select sectors despite transactional evidence continuing to demonstrate strength in asset values. This significant negative investor sentiment has resulted in very wide discounts such that many of the stocks are offering a large buffer to this risk in key market segments, including NYC office, Hong Kong commercial property companies, U.S. and Continental high-quality retail, the U.K. Majors and London office specialists, and U.S. CBD office and hotels. While some overall discount may be warranted given the latter phase of the property and valuation cycle, certain market segments are exceptionally discounted and offer opportunistic valuations. As a result, we believe there is a compelling case for active management to take advantage of wider than typical valuation disparities on a global basis, particularly within the U.S.

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

FUND FACTS

Launch date	Base currency	Index
31 October 2006	U.S. dollars	FTSE EPRA Nareit Developed Real Estate (Net) Equally Weighted Between North American, European and Asian Regions 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 Property Fund - I Shares	-9.15	13.97	-0.47	-1.40	11.07
FTSE EPRA Nareit Developed Real Estate (Net) Equally Weighted Between North American, European and Asian Regions Index	-6.42	15.34	1.66	-0.18	11.91

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 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:

- 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 real estate.
- 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 **FTSE EPRA Nareit Developed Index** is a free float-adjusted market capitalization weighted index designed to reflect the stock performance of companies engaged in specific aspects of the major real estate markets/regions of the developed world.

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