Morgan Stanley

INVESTMENT MANAGEMENT

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Morgan Stanley Investment Funds

Global Property Unconstrained 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 Z shares returned -6.95% (net of fees)[1], while the benchmark returned -9.03%.

The Fund underperformed the benchmark for the month. Contributors to relative performance were the Fund's overweight exposure to Hong Kong real estate operating companies (REOCs) and underweight exposure to U.S. industrial stocks. This was more than offset by the Fund's exposure to the U.S. primary central business district (CBD) office sector as the sector is facing significant negative investor sentiment; underweight exposure to Japan and Australian REITs as there is significant investor preference for these market segments which are viewed as more defensive, and the Fund is underweight due to less attractive premium share private valuations; and the overweight to U.S. mall stocks.

Market Review

We see the most attractive expected return prospects from companies concentrated in Hong Kong commercial properties, U.S. CBD office (especially NYC office), U.S. and Continental Europe high-quality retail, and the U.K. Majors and London office specialists.

In the U.S., the REIT market ended the period trading at a 5% discount to net asset values (NAVs),[1] with various segments trading at meaningful discounts. 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.

In Hong Kong, the Hong Kong REOCs continue to represent a significant overweight in the global portfolio, as we believe 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 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 the U.K., overall, property stocks in the U.K. ended the period trading at a 21% discount to NAVs.[1] There is attractive value in the large-cap U.K. Majors, which trade at a 35% discount to NAVs,[1] and London office specialists, which trade at a 25% discount.[1] 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[1] overall, although there is meaningful disparity in valuations, with the Continental retail stocks trading at a 35% discount to NAVs[1] following accelerated share price weakness on concerns over retail challenges despite stable operating results by the companies.

Portfolio Activity

Our research process is driven by our bottom-up analysis of each public real estate company. We maintain a strong conviction that a disciplined, bottom-up investment methodology will result in the highest returns and outperformance over the long term. As such, the stock selection process for the Fund is based on our bottom-up analysis of real estate companies. Pursuant to determining which real estate securities, in our view, offer the best value (versus peers and direct real estate valuations) based on our NAV models and other real estate valuation metrics (implied price per square foot, implied capitalization rate,

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

etc.), we apply our analysis to select those securities that we believe offer the highest total expected returns on a risk-adjusted basis. This rigorous portfolio construction process is strictly implemented so that we include only our highest conviction ideas in the portfolio. Diversification is also a significant consideration in constructing and managing the Fund.

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.

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

FUND FACTS

Launch date	Base currency	Index
17 November 2017	U.S. dollars	FTSE EPRA Nareit Developed 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 Unconstrained Fund - Z Shares	-10.70	--	--	--	--
FTSE EPRA Nareit Developed Index	-4.38	--	--	--	--

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 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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