

Morgan Stanley Investment Funds Japanese Equity Fund

ACTIVE FUNDAMENTAL EQUITY | MITSUBISHI UFJ ASSET MANAGEMENT (UK) LTD TEAM | MONTHLY COMMENTARY | 31 JANUARY 2019

Performance Review

In the one month period ending 31 January 2019, the Fund's Z shares returned 7.06% (net of fees)¹, while the benchmark returned 5.24%.

By sector, our underweight position in consumer staples and overweight position in information technology contributed positively to the portfolio. At the stock level, major positive contributors were SUMCO, a large supplier of semiconductor silicon wafers, and Open House, whose major business is the sale of new detached houses.

Market Review

Japan's equity market rose in January. The market started with a decline in the first half of January due to the low business confidence index in the U.S. and appreciation of the yen against the dollar. Subsequently, the market started to pick up as a result of robust U.S. employment statistics and softened expectations for rate hikes as Federal Reserve (Fed) Chairman Powell showed no intention to put a rush on tightening by the Fed. Vice-ministerial level trade talks were held between the U.S. and China, and expectations grew for making progress in trade negotiations, which also pushed up stock prices. The Japanese equity market closed January at a higher level than the end of December as it remained steady in the second half of the month, supported by expectations for the easing of trade frictions while the International Monetary Fund's downward revision of its world economic growth forecast was received negatively.

Real gross domestic product growth for the July-September 2018 period slowed by 2.5% year-over-year but is expected to turn positive after the October-December period, in part due to a recovery from the temporary fall due to natural disasters. For the October-December period, consumer spending and capital expenditures are expected to contribute positively as the impact of natural disasters is coming to an end, although external demand may have contributed negatively partly due to a slowdown in exports to China. While a sense of uncertainty remains in relation to future exports, we believe the economy will be robust on the back of steady domestic demand.

Portfolio Activity

This month, we initially purchased Shin-Etsu Chemical with a relatively attractive valuation partly due to concerns over the future price of semiconductor silicon wafers. Conversely, we sold our entire position in SG Holdings, a leading logistics company, because the share price appeared expensive on the back of steady earnings.

Among individual names, our top holdings include Nippon Telegraph and Telephone Corporation due to the expectation of steady earnings per share growth supported by its aggressive shareholder distribution policy including share repurchases; ITOCHU Corporation, whose forecast price-earnings ratio still remains below 10 despite further growth potential in non-resource businesses such as food and general products; and Toray Industries due to expectations of sales growth of separator films for lithium-ion batteries amid an expansion of the electric vehicle market.

Strategy and Outlook

While a slowdown of capital expenditures, inventory reduction of certain products and other factors triggered by U.S.-China trade friction have started dragging down the market, earnings forecasts for the domestic corporate sector continue a positive trend in earnings and income for the fiscal year ending March 2019. Looking toward 2019, while the effect of the U.S.-China trade friction on the real economy continues to be a focal issue, the consumption tax hike and economic policy of the government will be variable factors for corporate earnings in Japan. We believe the gap in earnings between companies which can keep profit growth and those which cannot will widen, and we will focus on more in-depth company study and stock selection.

¹ Source: Morgan Stanley Investment Management Limited. Data as of 31 January 2019.

From a longer-term perspective, we will continue to focus on initiatives to improve capital efficiency and enhance corporate value, which we believe can lead to upward pressure on Japanese equities.

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

FUND FACTS

Launch date	Base currency	Index
14 June 2010	Japanese yen	MSCI Japan Index

12 Month Performance Periods to Latest Month End (%)

	JANUARY '18 - JANUARY '19	JANUARY '17 - JANUARY '18	JANUARY '16 - JANUARY '17	JANUARY '15 - JANUARY '16	JANUARY '14 - JANUARY '15
MS INVF Japanese Equity Fund - Z Shares	-15.23	21.06	5.07	2.53	13.51
MSCI Japan Index	-11.88	21.22	7.59	1.27	17.67

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



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 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 may be an insufficient number of buyers or sellers which may affect the fund's ability to buy or sell securities.
- 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 January 2019 and subject to change daily.

INDEX INFORMATION

The **MSCI Japan Index** is a free-floated adjusted market capitalization weighted index that is designed to track the equity market performance of Japanese securities listed on the Tokyo Stock Exchange, Osaka Stock Exchange, JASDAQ and Nagoya Stock Exchange. The MSCI Japan Index is constructed based on the MSCI Global Investable Market Indices Methodology, targeting a free-float market capitalization coverage of 85%.

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