

Morgan Stanley Investment Funds

Multi-Asset Risk Control Fund

SOLUTIONS AND MULTI-ASSET | GLOBAL MULTI-ASSET TEAM | MONTHLY COMMENTARY | 31 AUGUST 2020

Performance Review

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

Market Review

United States

The MSCI USA Index returned 7.46% in U.S. dollar terms (USD) and 6.08% in euro terms. The Institute for Supply Management (ISM) Manufacturing Index rose to 56.0 in August from 54.2 in July, driven by a large pick-up in new orders and increased output. However, growth in the services sector lost some momentum as some localities paused reopening and the weekly \$600 additional unemployment benefit expired. The ISM Services PMI fell to 56.9 in August from 58.1 in July. The pace of new orders, although still strong, receded from the record high recorded in July, and service firms continued to cut staff but at a slower rate. The U.S. unemployment rate dropped to 8.4% in August from 10.2% in July with the addition of 1.4 million jobs, according to the Bureau of Labor Statistics (BLS). Jobs growth has continued to slow since June, and payrolls remain 11.5 million below February levels. A separate report from the BLS showed consumer prices continued an upward trend through July. Headline (all items) inflation increased 1.0% in the annual period ended July 2020, up from 0.6% in the June 2020 period. Excluding food and energy prices, core inflation rose 1.6% in the 12 months ending July 2020, compared to 1.2% in the year ended June 2020.

Europe

The MSCI Europe Index returned 2.94% in euro terms and 4.28% in USD terms. Mid-way through the third quarter, eurozone economic activity held steady, even as a second wave of COVID-19 infections arose. The IHS Markit Eurozone Manufacturing PMI registered 51.7 in August, relatively stable from 51.8 in July and marking the second straight month of expansion. The improvement in output and new orders contrasted with sharp staffing reductions. The July surge in the services side of the economy dissipated in August. The IHS Markit Eurozone PMI Services Business Activity Index slowed to 50.5 from 54.7 in July. New business decelerated in France and contracted in Spain and Italy, where coronavirus containment measures were stricter. Service firms continued to cut headcount amid a dimming outlook. Eurozone annual inflation weakened in August, falling -0.2%, versus an increase of 0.4% in the July, according to Eurostat estimates. Core inflation, which excludes energy, food, alcohol and tobacco, increased at an annual rate of 0.4% in August, down from 1.2% in July. Unemployment rose to 7.9% in July from 7.7% in June in the eurozone.

Japan

The MSCI Japan Index returned 7.93% in yen terms and 6.23% in euro terms. The au Jibun Bank Japan Manufacturing PMI improved to 47.2 in August from 45.2 in July, as declines in output and new orders eased and job losses continued. The au Jibun Bank Japan Services PMI pulled back slightly in August to 45.0 from 45.4 in July. Business activity remained muted, due to softer new orders and staffing cuts. Industrial production gathered pace in July. The Ministry of Economy, Trade and Industry reported an 8.0% gain in production in July from the previous month, although it remained down -16.1% year-over-year. Inflation remained muted amid declining energy prices and concerns about second wave of coronavirus infections. The all-items consumer price index rose 0.3% in the year ended July 2020, a small increase from 0.1% in the June 2020 period. The core-core index (excluding fresh food and energy) was up 0.4% in the July annual period, unchanged from June. Japan's unemployment rate nudged higher in July to 2.9%, from 2.8% in June, as the government's furlough scheme was extended to year-end.

Portfolio Activity

We kept the equity and fixed income mix broadly unchanged; however, we made some adjustments in positioning to reflect our latest asset class views. In early August, we reduced the portfolio's growth bias in the U.S., as we feel that investors are overly optimistic and valuations for growth stocks are very stretched. We initiated a position in German equities due to improvement in fundamentals and still reasonable valuation. Last, but not least, we added to the clean energy trade we

initiated last month, as we continue to see upside potential, with the sector set to benefit from a decarbonisation transition. The effective equity exposure at the end of the month was 23.5%.

Strategy and Outlook

Price action in U.S. equities (in particular) over recent months has become increasingly representative of investor over-optimism about the best-case scenario for the U.S. economy (and a disregard for all other possible outcomes). In other words, investors appear to be overestimating returns and underestimating risks. Another possibility is that we are in a “bubble” type of environment, characterised by heterogeneous investor groups operating in the market. In addition to institutional investors, the most obvious group having a key influence on markets is the retail investor. Retail investors have, it is safe to believe, different return expectations than institutional investors. In our view, retail investors’ return expectations are determined more by momentum, as opposed to fundamentals that are the case for typical institutional investors. FAAMG valuations are at a new all-time high: One obvious consequence of momentum-based return expectations is that winners continue to win, resulting in a heavy concentration of market cap in a small number of names – currently over 20% of the S&P 500 Index market cap is concentrated in the five largest stocks. Valuations for these stocks have also continued to climb and are now at a new all-time high of a 12-month forward price-earnings (PE) ratio of 38x. Moreover, relative to the broader market (MSCI USA Index), these stocks are trading at a 60% premium, also a new high. The investment implication is that there is no margin of safety. Not only are the most popular stocks in the U.S. market trading at lofty valuations, but equity market valuations globally are in the 87th percentile (based on 25 years of 12-month forward PE data). The problem with such elevated valuations is that they remove the “margin of safety” investors should look for when making capital allocations. For example, will the FAAMGs face any anti-trust action or other legal/regulatory headwinds? There are many unknowns over the coming months, ranging from progress on the vaccine, to how long those who are unemployed today (around 16 million in the U.S. alone) will remain jobless, to the details and timing of the next U.S. fiscal stimulus, to U.S. election uncertainty and whether there will be a “hard Brexit” in Europe. Consequently, we continue to focus on maintaining an appropriate risk level. Noting the wide differential between realised and implied volatility, we expect realised volatility to correct higher in the near term.

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

FUND FACTS

Launch date

30 September 2019

Base currency

U.S. dollars

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



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 a range of assets with different levels of risk and the fund's simulated and/or realised return has experienced medium 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 value of bonds are likely to decrease if interest rates rise and vice versa.
- The value of financial derivative instruments are highly sensitive and may result in losses in excess of the amount invested by the Sub-Fund.
- Issuers may not be able to repay their debts, if this happens the value of your investment will decrease. This risk is higher where the fund invests in a bond with a lower credit rating.

- 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.
- Commodity investments can change significantly and quickly in value as a large variety of factors affect them.
- 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 August 2020 and subject to change daily.

INDEX INFORMATION

The **MSCI USA Index** is designed to measure the performance of the large and mid cap segments of the US market. With 631 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US.

The **MSCI Europe Index** is a free float-adjusted market capitalization index that is designed to measure developed market equity performance in Europe. 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 **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%.

The **Standard & Poor's 500® Index (S&P 500®)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 80% of the U.S. equities market. The Index includes 500 leading companies in leading industries of the U.S. economy.

DISTRIBUTION

This communication is only intended for and will only be distributed to persons resident in jurisdictions where such

distribution or availability would not be contrary to local laws or regulations. In particular, the Shares are not for distribution to US persons.

Ireland: Morgan Stanley Investment Management (Ireland) Limited. Registered Office: The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, Ireland. Registered in Ireland under company number 616662. Regulated by the Central Bank of Ireland. **United Kingdom:** Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA, authorised and regulated by the Financial Conduct Authority. **Dubai:** Morgan Stanley Investment Management Limited (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). **Germany:** Morgan Stanley Investment Management Limited Niederlassung Deutschland, Grosse Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Italy:** Morgan Stanley Investment Management Limited, Milan Branch (Sede Secondaria di Milano) is a branch of Morgan Stanley Investment Management Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), and whose registered office is at 25 Cabot Square, Canary Wharf, London, E14 4QA. Morgan Stanley Investment Management Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 08829360968. **The Netherlands:** Morgan Stanley

Investment Management, Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of Morgan Stanley Investment Management Limited. Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **Switzerland:** Morgan Stanley & Co. International plc, London, Zurich Branch. Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-115415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41 (0) 44 588 1074.

Australia: This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accepts responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. **Hong Kong:** This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This publication should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"), (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. In particular, for investment funds that are not authorized or recognized by the MAS, units in such funds are not allowed to be offered to the retail public; any written material issued to persons as aforementioned in connection with an offer is not a prospectus as defined in the SFA and, accordingly, statutory liability under the SFA in relation to the content of prospectuses does not apply, and investors should consider carefully whether the investment is suitable for them. This publication has not been reviewed by the Monetary Authority of Singapore.

IMPORTANT INFORMATION

EMEA: This marketing communication has been issued by Morgan Stanley Investment Management Limited ("MSIM"). Authorised and regulated by the Financial Conduct Authority. Registered in England No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

This document contains information relating to the sub-fund ("Fund") of Morgan Stanley Investment Funds, a Luxembourg domiciled Société d'Investissement à Capital Variable. Morgan Stanley Investment Funds (the "Company") is registered in the Grand Duchy of Luxembourg as an undertaking for collective investment pursuant to Part 1 of the Law of 17th December

2010, as amended. The Company is an Undertaking for Collective Investment in Transferable Securities ("UCITS").

Applications for shares in the Fund should not be made without first consulting the current Prospectus, Key Investor Information Document ("KIID"), Annual Report and Semi-Annual Report ("Offering Documents"), or other documents available in your local jurisdiction which is available free of charge from the Registered Office: European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxemburg B 29 192. In addition, all Italian investors should refer to the 'Extended Application Form', and all Hong Kong investors should refer to the 'Additional Information for Hong Kong Investors' section, outlined within the Prospectus. Copies of the Prospectus, KIID, the Articles of Incorporation and the annual and semi-annual reports, in German, and further information can be obtained free of charge from the representative in Switzerland. The representative in Switzerland is Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva. The paying agent in Switzerland is Banque Cantonale de Genève, 17, quai de l'Île, 1204 Geneva. The document has been prepared solely for informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy.

Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

The views and opinions expressed are those of the portfolio management team at the time of writing/of this presentation and are subject to change at any time due to market, economic, or other conditions, and may not necessarily come to pass. These comments are not representative of the opinions and views of the firm as a whole. Holdings, countries and sectors/region weightings are subject to change daily. All information provided is for informational purposes only and should not be deemed as a recommendation to buy or sell securities in the sectors and regions referenced. Information regarding expected market returns and market outlook is based on the research, analysis, and opinions of the team. These conclusions are speculative in nature, may not come to pass, and are not intended to predict the future of any specific Morgan Stanley Investment Management investment. Past performance is no guarantee of future results.

All investments involve risks, including the possible loss of principal. The material contained herein has not been based on a consideration of any individual client circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable European or Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

MSIM has not authorised financial intermediaries to use and to distribute this document, unless such use and distribution is made in accordance with applicable law and regulation. MSIM shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary. If you are a distributor of the Morgan Stanley Investment Funds, some or all of the funds or shares in individual funds may be available for distribution. Please refer to your sub-distribution agreement for these details before forwarding fund information to your clients.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without MSIM's express written consent.

All information contained herein is proprietary and is protected under copyright law.

This document may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this document in another language, the English version shall prevail.