

## Morgan Stanley Investment Funds Saudi Equity Fund

**EMERGING MARKETS EQUITY TEAM**

### Performance Review

In the three month period ending 31 December 2023, the Fund's Z shares returned 13.62% (net of fees)<sup>1</sup>, while the benchmark returned 10.27%.

### Market Review

In the fourth quarter of 2023, the rally in small- and mid-cap stocks continued and was joined by banking stocks. This drove the Tadawul All Share Index (TASI) higher by 8.6% in the fourth quarter (total return) to close the year up 18.1% (total return). Even with the year-end rally, however, the banking sector (5.7%) lagged the broader market return in 2023. The market rally was partly driven by revaluation that needs to be justified by higher future earnings. Positive investor sentiment due to Saudi Arabia winning the bid to host Expo 2030 and the FIFA World Cup 2034 was perhaps also in play.

Non-oil economic activity in Saudi Arabia remains robust. Riyadh Bank Saudi Arabia's PMI stood at 57.5 in December 2023, unchanged from the previous month, according to S&P Global data. Output continued to rise while new orders increased to the fastest pace since June. On the price front, input cost inflation accelerated due to higher material prices and staff costs. As a result, output cost inflation rose as firms shared their cost burdens with customers. Finally, sentiment weakened and was below the trend recorded this year.

General Authority for Statistics, Saudi Arabia data showed the annual inflation rate in Saudi Arabia edging higher to 1.7% in November 2023 from the previous month's figure of 1.6%. The key drivers were higher prices for food and beverages (1.4% vs. 0.8% in October), and restaurants and hotels (2.3% vs. 1.9%). This was not completely surprising, as we have seen local companies increasing prices to pass on the inflationary impact as demand stabilized.

Even after the OPEC+ production cuts, oil prices have mostly remained range-bound. Increasing production from the U.S. and other non-OPEC countries led to higher supply, while the demand pick-up from China remain muted.

The geopolitical situation is fluid with the Israel-Palestine war continuing beyond 90 days. The U.S. and its allies are trying to ensure that the conflict does not spread. So far, the economic impact on Saudi Arabia and the region remains limited. Although some companies selling international brands and some media companies are indicating sales weakness.

The Saudi government announced a fuel and feedstock price increase effective January 2024. The timing of this announcement was unexpected. Based on the initial assessment, cement company earnings are most negatively impacted, followed by chemical companies. Unfortunately, both sectors are facing an unfavorable demand and supply environment. In January 2024, the retail diesel price for 2024 was increased by 53% to 1.15 riyals per liter, and a wide range of companies are expected to see minor impact on their cost of operations. These changes are part of earlier announced government policy to bring fuel and feedstock prices closer to international market prices. In the future, we may possibly see more fuel and feedstock price increases, but the timing and magnitude are unclear.

### Portfolio Activity

During the quarter, our allocations to the oil, gas & consumables and health care sectors inched higher on the back of strong market price movement. We increased exposure to the insurance sector, which is expected to benefit from enforcement of mandatory insurance as well as improving investment contribution.

We marginally pared back exposure to the chemicals sector, the recovery of which is now pushed into the latter half of 2024.

### Strategy and Outlook

Post the recent rally in banking stocks and change in interest rate expectations, positioning has become tricky. Our focus will be mostly on bottom-up stock selection as we seek to position across stocks that offer better value. Corporate loan growth guidance points to strong growth while margins vary given the expected cuts in interest rates later in 2024 and continuing into 2025.

The chemicals sector earnings recovery remains elusive. Now consensus is calling for recovery in the a second half of 2024. We have selective positioning in the sector where valuation has hit historical lows or a company-specific catalyst is in play.

Health care, education, infrastructure and tourism exposed companies that we have carried overweight continued to perform well. We are carefully assessing these positions given the strong rally and will reduce allocation where valuation is stretched.

Key Risks: adverse changes in government targets/spending plans and lower oil prices/global recession.

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

<sup>1</sup> Source: Morgan Stanley Investment Management Limited. Data as of 31 December 2023.

## Fund Facts

Launch date	24 March 2021
Base currency	U.S. dollars
Benchmark	S&P Saudi Arabia USD Total Return Index

## Calendar Year Returns (%)

Past performance is not a reliable indicator of future results.

	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class Z Shares	30.91	30.91	2.89	--	--	--	--	--	--	--	--
S&P Saudi Arabia USD Total Return Index	15.97	15.97	-7.21	--	--	--	--	--	--	--	--

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](http://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:

- There are additional risks associated with investing in real estate.
- 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.

- Sustainability factors can pose risks to investments, for example: impact asset values, increased operational costs.
- There may be an insufficient number of buyers or sellers which may affect the Fund's 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 2023 and subject to change daily.

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## INDEX INFORMATION

The **S&P Saudi Arabia Total Return Index (USD)** is a comprehensive benchmark that defines and measures the investable universe of publicly traded companies domiciled in Saudi Arabia.

The **Tadawul All Share Index (TASI)** is the major stock market index which tracks the performance of all companies listed on the Saudi Stock Exchange. The Index is disseminated by the Saudi Stock Market. Volume in the index excludes small trades (trades with value less than Saudi Arabian Riyal 15000).

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