

Commentary

MARKET REVIEW

EM corporate debt returned 0.89% in the month, as measured by the JP Morgan CEMBI Broad Diversified Index. Higher yielding, lower-rated companies outperformed higher-rated companies as risk-taking continued. From a sector perspective, companies in the transport, oil & gas, utilities, metals & mining, and pulp & paper sectors outperformed the broader market, while those in the consumer, financial, diversified, and TMT sectors lagged. From a regional perspective, companies in Europe (Ukraine, Turkey, Russia and Georgia), Africa (Zambia, Nigeria) and the Middle East (Morocco, Oman, Saudi Arabia) outperformed the market, while those in Asia (Indonesia, Taiwan, South Korea and Singapore) and Latin America (Jamaica, Argentina, Dominican Republic and Mexico) lagged.

STRATEGY REVIEW

Security selection in Mexico, South Korea and Colombia, as well as in the financials and consumer sectors, contributed to relative returns in the month. Overweight positions in Nigeria, the U.A.E. and Peru, as well as in the financials sector also contributed to relative performance. Conversely, underweight positions in Saudi Arabia, Macau, Qatar and Russia, as well as in the tech-media-telecom (TMT) sector detracted from relative performance, as did security selection in China and in the real estate and industrial sectors.

MAIN STRATEGY CHANGES IN THE MONTH

During the month we continued to marginally reduce risk in the portfolio. During the period we added to relative positions in Peru, Kuwait, Mexico and South Korea, while reducing in Indonesia, Togo, the U.A.E., Brazil, Panama, Turkey, India and South Africa.

Source: Morgan Stanley Investment Management. As of 31st July 2019.

Investment Performance (% net of fees) in USD - Z Class Shares



12 Month Performance

Periods to Latest Month July '19- July '18- July '17- July '16- July '15- End (%) July '18 July '17 July '16 July '15 July '14

Class Z Shares (Net) 8.39 -0.72 8.90 7.29 -0.19

Portfolio inception date: 7th March 2011. The index is JP Morgan CEMBI Broad Diversified Index.

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.

Top Country Overweights

	Portfolio (%)	Index (%)	Active (%)
UAE	6.97	4.48	2.49
Nigeria	3.00	0.88	2.13
China	10.07	7.96	2.10
South Korea	5.37	4.36	1.01
India	5.53	4.52	1.01

Source: Morgan Stanley Investment Management. All data and commentary in this document is as of 31st July 2019.

Sector Allocation

	Portfolio (%)	Index (%)	Active (%)
Other	8.07	0.00	8.07
Real Estate	8.53	5.64	2.89
Industrial	8.10	5.55	2.55
Infrastructure	3.46	2.20	1.26
Transport	1.58	0.78	0.80
Healthcare	0.40	0.00	0.40
Pulp & Paper	0.45	1.17	-0.71
Financials	28.64	29.61	-0.96
Utilities	10.35	11.52	-1.17
Diversified	0.86	2.10	-1.23
Consumer	7.61	9.15	-1.55
Metals & Mining	4.99	6.62	-1.63
Oil & Gas	10.62	14.02	-3.40
Technology, Media & Telecommunications	6.32	11.64	-5.32

Regional Allocation

	Portfolio (%)	Index (%)	Active (%)
United States	6.37	0.00	6.37
Latin America	29.67	28.68	0.98
Asia	36.30	37.22	-0.92
Europe	7.97	10.90	-2.92
Middle East & Africa	19.68	23.20	-3.51
Total	100	100	-

Top Country Underweights

	Portfolio (%)	Index (%)	Active (%)
Russia	2.07	4.77	-2.69
Saudi Arabia	0.44	2.91	-2.47
Qatar	0.85	3.11	-2.26
Macau	0.25	2.51	-2.26
Chile	2.35	4.17	-1.81

Top 10 Issuers

Issuer Name	Portfolio (%)
YPF SA	1.33
ABU DHABI NATIONAL ENERGY COMPANY PJSC	1.04
KOOKMIN BANK	1.01
KOREA (REPUBLIC OF)	1.00
PETROBRAS GLOBAL FINANCE BV	0.99
HUARONG FINANCE 2019 CO LTD	0.94
LLPL CAPITAL PTE. LTD.	0.93
GMR HYDERABAD INTERNATIONAL AIRPORT LTD	0.91
UNITED BANK FOR AFRICA PLC	0.91
PARKWAY PANTAI LTD	0.90

Source: Morgan Stanley Investment Management. All data and commentary in this document is as of 31st July 2019.

1. Beta calculation is based on trailing 12 months. Provided for informational purposes only, not to be construed as investment recommendations for securities, sectors or countries listed herein. Holdings data is subject to change on a daily basis .

Investment Approach

- Long-term mind-set that is focused on identifying companies that exhibit unique features, such as
 - Market leaders in a given EM country/sector and/or are positioned to benefit from EM's growing middle class
 - Developing into global market leaders with defensible market niches
 - Special situations where we have a strong view of the company's prospects
- Process integrates bottom-up security selection with top-down macroeconomic, sovereign, and sector analysis
- Our dedicated credit team engages in ongoing in-depth analysis, utilising proprietary fundamental research, which is a cornerstone of our rigorous credit investment process
- Analysts are able to cover the entire sector (investment-grade and high-yield) to provide a full view of industry fundamentals
- Risk management is integrated into our entire investment process

Risk Considerations

- 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 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.

Definitions

Alpha is the excess return or value added (positive or negative) of the portfolio's return relative to the return of the benchmark. **Average maturity** represents the weighted average maturity for all bonds held in the portfolio. A bond's **average price** is calculated by adding its face value to the price paid for it and dividing the sum by two. The average price is sometimes used in determining a bond's yield to maturity where the average price replaces the purchase price in the yield to maturity calculation. **Beta** is a measure of the relative volatility of a security or portfolio to the market's upward or downward movements. A beta greater than 1.0 identifies an issue or fund that will move more than the market, while a beta less than 1.0 identifies an issue or fund that will move less than the market. The beta of the market is always equal to 1. **Current yield** is a measure that looks at the current price of a bond instead of its face value and represents the return an investor would expect if he or she purchased the bond and held it for a year. Calculated by dividing the Annual Cash Inflows / Market Price. **Effective Duration** is a measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices.

Portfolio Characteristics

Characteristics	Portfolio	Index
Average Price	102.71	102.36
Average Coupon	5.81	5.34
Number of Holdings	245	1,466
Yield to Maturity	5.28	4.90
Current Yield	5.53	5.23
Spread Duration	4.45	4.60
Effective Duration	4.31	4.48
Average Maturity	5.90	6.50
Beta	1.01	1.00
Average S&P Rating	BB+	BBB-
Average Moody's Rating	Baa3	Baa3

Fund Characteristics Summary

Benchmark	• JPM Corporate Emerging Markets Bond Index-Broad Diversified Index
Fund Launch	• March 2011
Investment Universe (Alpha Source)	• Debt securities of Emerging Market corporate issuers (sovereign non-brady, corporate bonds, quasi sovereign)
Size of Universe	• Approximately \$800bn USD
Denominated in	• U.S. dollar, and to a lesser extent, non U.S. or EM local currencies
Effective Duration	• In the range of 5.0 – 5.5 years
Yield to Maturity	• Typically 5 – 6%
Average Credit Quality (Moody's/S&P/Fitch)	• Typically: BB – BBB
Expected Tracking Error	• 150 to 250 bps
Principal Portfolio Managers*	• Warren Mar, Eric Baurmeister, Sahil Tandon

*Managers may change from time to time without notice.

Fundamental research is the analysis of overall economic, industry and company metrics. **NAV** is the Net Asset Value per share of the Fund (NAV), which represents the value of the assets of a fund less its liabilities. **Number of holdings** is the total number of securities that make up a portfolio. **Spread Duration** is a measurement of the spread of a fixed-income security rate and the risk-free rate of return. **Tracking error** is the standard deviation of the difference between the returns of an investment and its benchmark. **Yield to maturity** (YTM) measures the annual return on interest-bearing securities. In this it is assumed that they will be held to maturity. This metric includes both the coupon payments received during the term of the security and the repayment of the capital on maturity.

Themes and Investment Ideas

Market	Segment	Sub-Segment	Risk Considerations
Credit Spectrum	HY Bias	<p>IG: Favour 5-10 year mid-low BBB, AT1 and corporate perps with punitive step-up provisions.</p> <p>HY: Favour 3-7 year B and BB Idiosyncratic stories.</p>	Global Macro (financial conditions, US\$/EM FX, growth and inflation, trade disputes and negotiations, geopolitics, oil/OPEC); Credit fundamentals, (credit ratings trends and default expectations), Demand and supply technicals (investment flows, net financing needs).
	UW Asia	<p>OW: China (Balanced between HY Industrials and China Property, centrally-owned SOEs, and renewables); Indonesia (property developers with recurrent income streams).</p> <p>MW: India (Focus on BB/BBB crossover names, Renewables and Government-linked oil and gas/utilities); Tactical in potential fallen angels where downgrade risk has/is receding but not fully reflected in valuations.</p> <p>UW: Korea, Singapore and Thailand (Valuations, Trade, Rates)</p>	China Macro (outlook for the CNY/growth and policy response to on-going US-China trade dispute and eventual deal), China deleveraging (potential defaults in real estate, non-core SOE/LGFV sector); China demand and supply technicals (return of China institutional demand, domestic vs. off-shore financing); Geopolitics; Regional elections (India, and the Philippines). Indonesia and Thailand election results in line with market expectations.
Region/country	OW LatAm	<p>OW: Brazil (Focus on strong domestic plays, export oriented/commodity/protein sectors, infrastructure plays); Panama/El Salv. (financials); Mexico (BBB, HY non-bank Financials, and Real Estate).</p> <p>MW/UW: Favor Andean credits for carry but valuations fair/rich; Argentina (IMF/structural reform).</p>	Brazil and Argentine reforms (Brazil, social security reform, Argentina austerity); Mexico (finalization of USMCA; AMLO's policy focus and direction); Demand technicals supporting regional spreads (US crossover as US credit weakens); Argentina: on-going regional elections and Presidential election in the fall.
	MW Europe	<p>Idiosyncratic: UW: Russia (Financials and Oil & Gas sectors),</p> <p>OW single names: Georgia, Latvia, Ukraine</p> <p>MW: Turkey (blue chip corporates and banks).</p>	US/Russia relations and ongoing sanctions risk. Turkey (Politics—re-run of Istanbul local elections; (lack of structural reform; Central Bank independence, tightening financial conditions and implications for wholesale funding).
	UW M.E. & Africa	<p>UW: Across the region with exception of:</p> <p>OW Nigeria and Tanzania (banks and TMT)</p> <p>OW UAE (Real Estate, Financials, Infrastructure, Utilities)</p>	Direction of oil prices which has helped ME and Nigerian credit sectors stabilize/outperform. Geopolitics across the Middle East (Saudi/GCC/Qatar).
Industry/Sector	OW Real Estate	OW China & HK (small OW favoring higher quality HY China developers over established unrated HK), Indonesia developers (single names), Mexico REITs.	China property, pick up in 1Q refi risk vs. broader monetary policy response, loosening financial conditions.
	OW Financials	<p>OW: Countries: Nigeria, Turkey and UAE</p> <p>UW: Asia broadly (exposure through China, India, Korea)</p>	
	OW Infra & Transport	OW: Ports, infrastructure/ engineering, green energy.	Pace of the economic recovery and regulatory reform.
	OW Industrials	OW: Basic materials and agricultural commodities.	Pace of the economic recovery and China demand.
	UW Consumer, Oil and Gas, M&M, and TMT	UW: Idiosyncratic positioning in smaller upstream players in Argentina, Chile, Kazakhstan and Russia and SOE majors. UW iron ore/coal.	Change in oil and commodity demand or supply technicals leading to renewed price instability. High beta and vulnerable to crossover flows.

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