Morgan Stanley Investment Funds

Emerging Markets Fixed Income Opportunities Fund

FIXED INCOME | GLOBAL FIXED INCOME TEAM | MONTHLY FUND ANALYSIS | 30 September 2020

Commentary

MARKET REVIEW

Global yields declined in September, with 10-year U.S. Treasury yields dropping by 2 basis points (bps) to 0.68%, and the yield curve flattening amid risk-off sentiment. September was the first month since this spring during which risk aversion drove price action. Economic data lost some of the momentum built up over the summer, as rising levels of infection stoked fears of greater restrictions and the consequent economic damage. This put pressure on risky assets and pushed the U.S. dollar (USD) higher, providing an unfavorable backdrop for emerging markets (EM).

EM performed negatively in September, with local currency underperforming. Hard currency sovereigns (proxied by the JPM EMBI Global Diversified Index) lost 1.9%, driven by spread widening, as U.S. Treasuries posted positive returns. EM corporates were also negative, returning -0.5%, according to the JPM CEMBI Broad Diversified Index, on the back of spread widening as high yield corporates (-0.9%) underperformed investment grade (-0.2%). Local currency bonds (proxied by the JPM GBi-EM Global Diversified Index) also posted negative returns (-2.0%), primarily due to a depreciation of EM currencies versus USD (-2.1%). From a broad market perspective, Venezuela, Suriname, Romania and Georgia were the best performers in September. Conversely, bonds in Sri Lanka, Argentina, El Salvador and Ecuador were the worst performers. From a sector perspective, companies in the pulp & paper, transport and diversified sectors led the performance, while oil & gas, consumer and metals & mining underperformed.

PERFORMANCE REVIEW

During the month, negative returns were driven by USD-denominated sovereign and quasi-sovereign debt, followed by exposure to corporate debt and domestic debt. Most of the negative performance derived from overweight positions in hard currency sovereign and quasi-sovereign debt in Mexico and Ecuador, as well as overweight positions in corporates in China and Argentina. Overweight exposure to local currency bonds in Indonesia also detracted from returns. However, the underweight exposure to hard currency sovereign and quasi-sovereign bonds in Sri Lanka and Oman contributed positively.

MAIN STRATEGY CHANGES IN THE MONTH

During the month, we reduced exposure to Angola following a strong recovery from the lows, as well as to Azerbaijan following resurgence of conflict with Armenia. We participated in a new issue in Egypt and added to Dominican Republic, which we expect to outperform in a lower-oil scenario. We also reduced our underweight to Turkey following significant underperformance and participated in a new issue in Mongolia.


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

12 Month Performance Periods to Latest Month End (%)\(^1\)\(^2\)

- Class Z Gross (without deduction of max sales charge)\(^1\)
- Class Z Net (with the deduction of max sales charge)\(^2\)
- Blended Index

Portfolio inception date: 3rd August 2015. Effective June 8th, 2020, the Fund’s primary benchmark index has changed to J.P. Morgan Emerging Markets Blended Index (JEMB) - Equal Weighted. 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/m to see the latest performance returns for the fund’s other share classes.

\(^1\) Figure shows assumes reinvestment of all distributions and deduction of fund level costs, but does not reflect the deduction of any sales charge applicable at investor level.

\(^2\) Figure shows assumes reinvestment of all distributions and deduction of fund level costs, and includes the deduction of the maximum sales charge applicable at investor level that may be taken out of your money before it is invested.

*Example: An investor wishes to purchase shares of USD 100. At the maximum sales charge of 5.75% the investor has to expend USD 106.10. The sales charge is only incurred upon subscription.

Sector Breakdown %TNA

Country - Top 10 %TNA

Source: Morgan Stanley Investment Management, Blackrock, J.P. Morgan. Data as of 30 September 2020. United States allocation is typically cash holdings. 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. Views expressed herein are the opinions of the Team and are subject to change based on market and economic conditions. These views are not necessarily representative of Morgan Stanley Investment Management (MSIM) or the firm as a whole.
Investment Approach
- Holistic approach to gain exposure to the broad spectrum of dollar-denominated and local currency sovereign, quasi-sovereign and corporate debt.
- Process integrates bottom-up security selection with top-down macroeconomic, sovereign, sector and currency analysis.
- The team conducts fundamental sovereign analysis using frameworks that combine economic, political and social assessments. The prime objective of this analysis is to distinguish between those countries exhibiting positive and negative rates of change. We analyze a country’s ability and willingness to service its debt obligations, domestic factors which impact interest rates and exchange rates, and how these elements may influence the overall business environment and therefore the fundamentals of public and private sector credit. We use a variety of spread, currency, interest rate, and yield curve models to guide our view of “fair value” and compare our views with the market’s to identify value opportunities.
- Interest rate and currency decisions are made independently and each potential security is analyzed through a variety of valuation metrics. The team’s models provide perspective on market valuations in different cycles and time periods, enabling them to identify potential mispricing and alpha opportunities, as well as determine the relative value between corporate, sovereign, or quasi-sovereign debt.
- 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
Cash & Equivalents are assets that are cash or can be readily converted into cash. Effective Interest Rate 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. 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. Sharpe Ratio is a risk-adjusted measure calculated as the ratio of excess return to standard deviation. The Sharpe ratio determines reward per unit of risk. The higher the Sharpe ratio, the better the historical risk-adjusted performance. Spread Duration is a measurement of the spread of a fixed-income security rate and the risk-free rate of return. Volatility (Standard deviation) measures how widely individual performance returns, within a performance series, are dispersed from the average or mean value. Weighted average life (WAL) is a measure of sensitivity to liquidity and/or credit risk. Weighted average life takes into account all call options exercised by the issuer as well as permissible maturity shortening devices such as demand features. 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.

Index Information
Custom Benchmark refers to performance of Fund's benchmarks since inception - August 3rd, 2015 to June 8th, 2020: 1/3 J.P. Morgan EMBI Global Index, 1/3 J.P. Morgan GBI-EM Global Diversified Index, 1/3 J.P. Morgan CEMBI Broad Diversified Index; June 8th, 2020 and beyond - J.P. Morgan Emerging Markets Blended Index (JEMB) - Equal Weighted. The J.P. Morgan Emerging Markets Blended Index (JEMB) - Equal Weighted is comprised of 1/3 J.P. Morgan Emerging Markets Bond Global Diversified Index (tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the EMBI+). As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million, 1/3 J.P. Morgan GBI-EM Global Diversified Index (a comprehensive global local emerging markets index that consists of regularly traded, liquid fixed-rate, domestic currency government bonds and includes only the countries which give access to their capital market to foreign investors (excludes China, India), and 1/3 J.P. Morgan CEMBI Broad Diversified Index (a global, liquid corporate emerging markets benchmark that tracks U.S.-denominated corporate bonds issued by emerging-markets entities).

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