

# European Fixed Income Opportunities Fund

**FIXED INCOME | GLOBAL FIXED INCOME TEAM | MONTHLY FUND ANALYSIS | 31 August 2020**

#### Commentary

#### PERFORMANCE REVIEW

Macro decisions were negative overall. The exposure to European rates was negative, as was the exposure to Australian rates and U.S. Treasuries as yields rose. However, the exposure to European peripheral spreads was positive (Spain, Italy). The allocation to emerging markets (rates and currency exposures) both contributed negatively, particularly the exposure to Indonesian rupiah rates.

Performance from credit was positive, with most of the positive performance coming from the allocation to investment grade (IG), particularly the exposure to financials. Exposure to industrials also contributed, as did the allocation to utilities, albeit to a lesser extent. Elsewhere, the allocation to high yield bonds was positive, as was the exposure to non-agency residential and commercial mortgage-backed securities.

#### MARKET REVIEW

In August, risk assets continued to rally as economic activity continued to pick up, despite a further spike in cases across the U.S. and other parts of the developed markets. The U.S. dollar weakened against a backdrop of steepening sovereign yield curves and dovish tones from central banks. Inflation expectations globally continued to recover, with U.S. 10-year TIPS (Treasury inflation-protected securities) inflation breakevens in particular widening a further 25 basis points (bps), to their widest level since early 2019.

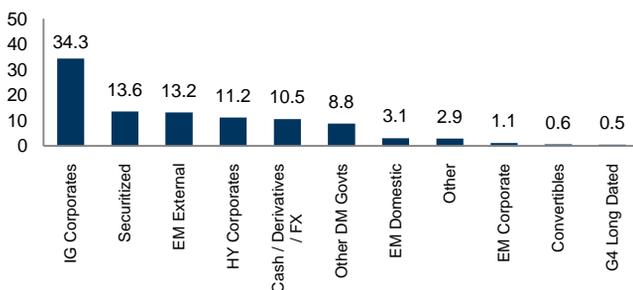
#### MAIN STRATEGY CHANGES

The Fund is long 4.21 years of duration.

The Fund is positioned to be long credit, particularly in the IG space, where most of the exposure is expressed through financials. In particular, it holds high-quality corporate hybrids and subordinated financials (a mixture of banks and insurance companies in the lower Tier 2 part of the capital structure of systematically important institutions). It is also long utilities and very selectively owns industrials.

Source: Morgan Stanley Investment Management. As of 31<sup>st</sup> August 2020.

#### Sector Breakdown (%)



#### Top 10 Country Exposures

Fund / Sector	% NAV of Portfolio
Netherlands	10.2%
Spain	7.7%
France	7.6%
United Kingdom	7.3%
United States	6.9%
Italy	5.3%
Ireland	4.8%
Germany	4.3%
China	3.6%
Luxembourg	3.2%

#### Risk Summary

Fund / Sector	Portfolio
Duration	4.21
Spread Duration <sup>^</sup>	4.32
Yield to Maturity	2.09
Option Adjusted Spread	177

Source: Morgan Stanley Investment Management. As of 31<sup>st</sup> August 2020.

Effective 30th August 2019, the Morgan Stanley Investment Funds Absolute Return Fixed Income Fund was renamed to Morgan Stanley Investment Funds European Fixed Income Opportunities Fund. Please refer to the fund's prospectus for further information on these changes.

#### Overall Asset Allocation

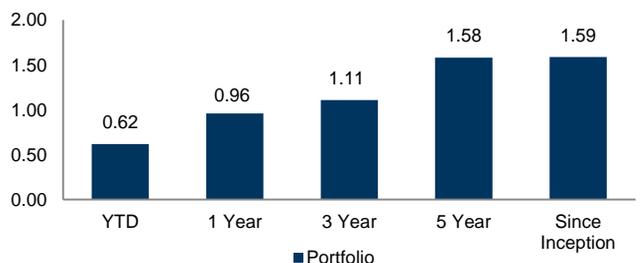
Fund / Sector	% NAV Portfolio	Spread Duration Contribution to Portfolio <sup>^</sup>
<b>Total Assets</b>	<b>100.0%</b>	<b>4.32</b>
<b>Credit (1)</b>	<b>47.3%</b>	<b>2.35</b>
Investment Grade Credit	34.3%	1.71
High Yield Credit	11.2%	0.58
Emerging Market Corporates	1.1%	0.04
Convertibles	0.6%	0.02
<b>Securitized (2)</b>	<b>13.6%</b>	<b>0.69</b>
RMBS / ABS	11.1%	0.61
CMBS	2.5%	0.08
<b>Government Bonds</b>	<b>25.7%</b>	<b>1.84</b>
G4 <sup>(3)</sup>	0.5%	0.09
Other Developed Markets	8.8%	0.88
Emerging Markets External Debt	13.2%	0.86
Emerging Markets Local Currency Debt	3.1%	0.00
<b>Cash/Derivatives/FX</b>	<b>10.5%</b>	<b>-0.69</b>
<b>Other (4)</b>	<b>2.9%</b>	<b>0.14</b>

**PORTFOLIO SPREAD DURATION<sup>^</sup>:** 4.32 years.

- Includes the following credit default swap exposure. ITRAXX EUR: -6.6%; ITRAXX.XO: -6.1%
- Includes agency and non-agency RMBS and CMBS.
- Defined as government bonds from U.S., UK, Germany and Japan. May include TIPS.
- Others include Covered Security.

In December 2017, the Blackrock Aladdin system changed its methodology for calculating spread duration. All European government bonds except those issued by Germany are now deemed to have spread duration.

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



#### 12 Month Performance Periods to Latest Month End (%)

Class Z Shares (Net)	Aug '20- Aug '19	Aug '19- Aug '18	Aug '18- Aug '17	Aug '17- Aug '16	Aug '16- Aug '15
Class Z Shares (Net)	0.96	3.03	-0.64	3.83	0.79

Portfolio inception date: 30th September 2014. 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](http://www.morganstanley.com/im) to see the latest performance returns for the fund's other share classes.**

**Principal Currency Positions as of 31 August 2020**

Currency	% NAV of Portfolio
EUR	100.27%
NOK	0.75%
ZAR	0.50%
MXN	0.50%
PLN	0.50%
GBP	-0.49%
USD	-1.95%

**Investment Approach**

- Maximise the benefits of our global approach across all sectors of Fixed Income to ensure "best ideas" are represented
- Target attractive yield and total return over a market cycle (three- to five-year horizon)
- Focus on absolute and risk-adjusted returns (versus Tracking Error relative to an Index)
- Invest across global fixed income sectors, interest rate markets, and currency markets
- Include exposures to sectors such as emerging markets, high yield and investment grade credit, securitized (RMBS/CMBS/ABS), global government bonds, and convertibles
- Incorporate risk management into entire portfolio construction 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. **Cash & Equivalents** are assets that are cash or can be readily converted into cash. **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. **Option Adjusted Spread** is a measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst would use the Treasury securities yield for the risk-free rate. The spread is added to the fixed-income security price to make the risk-free bond price the same as the bond. **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. **Spread Duration** is a measurement of the spread of a fixed-income security rate and the risk-free rate of return. **Securitized assets** are instruments whose income payments and value are derived from a specified pool of underlying collateral. **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.

**Principal Interest Rate Positions as of 31 August 2020**

Currency	Duration Contribution to Portfolio
<b>Total</b>	<b>4.21</b>
EUR	3.05
USD	0.48
AUD	0.31
NZD	0.16
IDR	0.05
MXN	0.05
CNY	0.04
ZAR	0.03
GBP	0.02

**Fund Characteristics Summary**

<b>Strategy</b>	• Total Return, Unconstrained
<b>Investment Universe (Alpha Source)</b>	• Credit: Investment Grade, High Yield, Emerging Market, Convertibles • Securitized (RMBS/CMBS/ABS) • Government bonds: Developed and Emerging Market
<b>Currency Risk (Alpha Source)</b>	• Minimum 80% in EUR. Maximum: 20% USD, 10% GBP, 10% JPY, 5% others
<b>Duration</b>	• In the range of 0-6 years
<b>Derivatives</b>	• Can use derivatives (futures / swaps) consistent with investment guidelines / UCITS
<b>Credit Quality</b>	• Minimum 70% investment grade
<b>Principal Portfolio Managers*</b>	• Leon Grenyer, Michael Kushma, Richard Class, Richard Ford

\*Team members may be subject to change at any time without notice.

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