

Morgan Stanley

INVESTMENT MANAGEMENT

MORGAN STANLEY INVESTMENT FUNDS (MS INVF)

Emerging Markets Small Cap Equity Fund

**ACTIVE
FUNDAMENTAL EQUITY**
GLOBAL EMERGING MARKETS
INVESTMENT IDEA
DECEMBER 2020

SYMBOLS

Class A	LU0898765168
Class I	LU0898765242
Class Z	LU0898765598

Why now for emerging markets small caps?

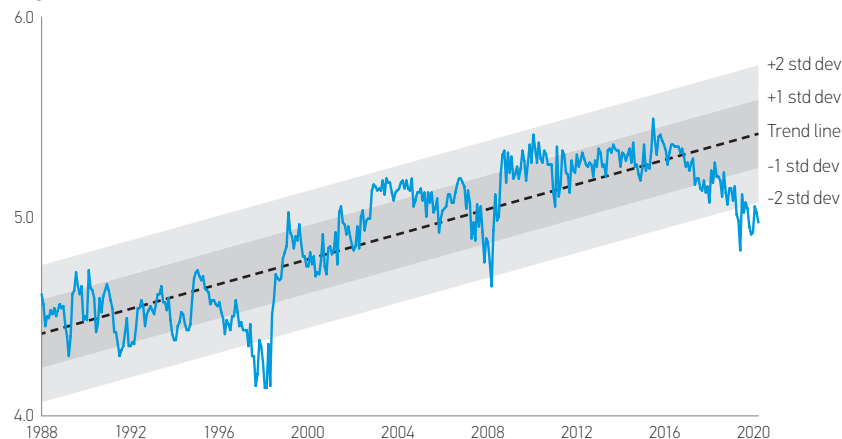
More than ever, we believe the time is right for emerging markets small cap companies. Valuations for the asset class are historically low and small caps are poised to benefit from the next leg of growth in emerging markets. Emerging markets appear to be in the early phases of recovery, and policymakers continue to stimulate the domestic economy because the global export model is broken. Emerging markets small caps' growth largely comes from domestic demand with nearly 60% exposure to these sectors. The performance of the smallest quintile of the universe is currently two standard deviations below performance of the larger-cap index. The dislocation was fueled by a massive run-up in technology and mega-cap stocks in 2017-2018, which caused the big to get bigger. Relative valuations have dropped this low only twice in the past 30 years (1998 and 2008). Both cases were marked by crises and were followed by a significant run-up in relative performance.

A rare entry point

Cumulative price performance ratio: The smallest quintile of stocks in MSCI EM IMI versus the MSCI EM Index. Indexed to 1 at 1988 and shown on a log scale.

31 December 1988 - 31 December 2020

Log scale



Source: MSIM, Factset, Haver, as of 31 December 2020. Total return indexes, USD. Smallest quintile of emerging markets stocks (cap weighted) versus the MSCI Emerging Markets Index. Performance indexed to 1. **Past performance should not be construed as a guarantee of future performance.**

1

A compelling asset class

Emerging markets small caps provide portfolio diversification benefits with lower volatility¹ than emerging markets stocks, and the potential for higher returns. Emerging markets small caps are also an under-researched asset class, an inefficiency that can lead to mispricings we actively seek to exploit. We also have a history of expertise in frontier markets and include them in our investment universe to take advantage of the positive investment opportunities and diversification benefits of the region.

2

Deep roots in macro research

The fund is overseen by 25 experienced investors. Within this group, a team devoted to macroeconomic research identifies global themes that drive countries' growth. Country allocation has been the largest contributor to emerging markets returns, and it is where we aim to generate 50% of our excess returns.

3

Concentrated, quality growth

In small caps, a focus on quality is crucial. In the past five years, companies we define as high quality (those with high ROE and low debt) have returned nearly +2% versus -4% for lower quality companies.² We take a concentrated approach to managing our portfolio of 70-90 names that meet our criteria, resulting in a high active share of over 90%.³

¹Source: MSIM, FactSet, as of December 2020

²FactSet as of 31 December 2018 (due to company reporting); based on index price performance. High quality was defined as a return on equity (ROE) of over 10% and a net debt to EBITDA ratio of less than 2.5 times.

³The number of securities provided are a typical range, not a maximum number. The portfolio may exceed this from time to time due to market conditions and outstanding trades. The active share represents a target; there is no assurance this target will be attained.

Investment Team



OMAIR ANSARI
Lead Portfolio Manager
Joined MSIM in 2016
15 years of financial industry experience



STEVEN QUATTRY
Portfolio Manager
Joined MSIM in 2011
17 years of financial industry experience

Investment Performance (% net of fees) in USD

Average Annual Total Return (Periods ending 31 December 2020)

	4Q20	1 YEAR	3 YEAR	5 YEAR	SINCE INCEPTION (28/03/2013)
Class Z Shares	11.80	5.10	-3.73	2.41	3.13
MSCI Emerging Markets Small Cap Net Index^{4,5}	22.22	19.29	3.60	8.52	6.25

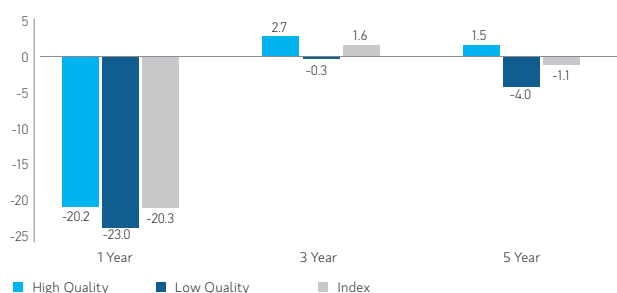
Source: Morgan Stanley Investment Management. Periods less than 1 year are not annualized.

12 Month Performance Periods (% net of fees) in USD

	DEC '19 – DEC '20	DEC '18 – DEC '19	DEC '17 – DEC '18	DEC '16 – DEC '17	DEC '15 – DEC '16
Class Z Shares	5.10	9.69	-22.60	19.92	5.25
MSCI Emerging Markets Small Cap Net Index^{4,5}	19.29	11.50	-16.41	31.86	2.66

High quality matters in EM small caps⁶

Performance by Quality
As of 31 December 2018 (%)



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.

Data as of 31 December 2020, unless indicated otherwise. Source: Factset, Morgan Stanley Investment Management.

⁴ The Blended Index performance shown is calculated using the MSCI Frontier Index from inception through 2 January 2019 and the MSCI Emerging Markets Small Cap Index thereafter.

⁵ Effective 12th September 2017, the Morgan Stanley Investment Funds Frontier Emerging Markets Equity Fund was renamed to Morgan Stanley Investment Funds Frontier Markets Equity Fund. Subsequently, effective 2nd January 2019, the Morgan Stanley Investment Funds Frontier Markets Equity Fund was renamed to the Morgan Stanley Investment Funds Emerging Markets Small Cap Equity Fund, and the fund's benchmark changed from the MSCI Frontier Index to the MSCI Emerging Markets Small Cap Index, and the fund's investment objective changed. Please refer to the fund's prospectus for further information on these changes.

⁶ Source: FactSet, As of December 31, 2018 (due to company reporting). Based on price index performance. Performance was calculated on stocks in the MSCI EM Small Cap Index. High quality was defined as a return on equity (ROE) of 10% or greater and a net debt to EBITDA ratio of less than 2.5x. Low quality was defined as ROE of less than 5% and a net debt to EBITDA ratio of greater than or equal to 4x. MSCI EM Small Cap represents the price return of the entire index. The composites were rebalanced each calendar year and scaled up to a 100% portfolio based on the original weight from the previous year in the index. Returns shown are annualized figures. The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is not indicative of future results.**

Risk Considerations

- 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.
- Investment in China A-Shares via Shanghai-Hong Kong Stock Connect program may also entail additional risks, such as risks linked to the ownership of shares.
- 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.
- Investments in **foreign markets** entail special risks such as currency, political, economic, and market risks. The risks of investing in **emerging market** countries are greater than the risks generally associated with investments in foreign developed countries.
- Stocks of **small-capitalization companies** carry special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies.

Portfolio characteristics

The portfolio invests in a blend of emerging market and frontier countries.

As of 31 December 2020	FUND	INDEX ³
Holdings	71	1,693
Price/Earnings (NTM)	20.01	12.16
5 Year EPS Growth (%)	13.33	6.38
Standard Deviation (%)	22.61	23.42
Tracking Error (%)	5.71	–
Active Share (%)	97.54	–
Beta	0.94	1.00

Tracking error is monitored but not managed.

INDEX INFORMATION:

The **MSCI Emerging Markets Investable Market Index (IMI)** captures large, mid and small cap representation across 24 Emerging Markets (EM) countries. With 2,712 constituents, the index covers approximately 99% of the free float-adjusted market capitalization in each country. The **MSCI Emerging Markets Index (MSCI EM)** is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging markets. The **MSCI Emerging Markets Small Cap Index** includes small cap representation across 23 Emerging Markets countries. With 1,864 constituents, the index covers approximately 14% of the free float-adjusted market capitalization in each country. The small cap segment tends to capture more local economic and sector characteristics relative to larger Emerging Markets capitalization segments

DEFINITIONS:

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. **Next Twelve Months (NTM)** refers to any financial measure that is being forecasted for the immediate next twelve months from the current date. **Price-To-Book Ratio (Price/Book)** compares a stock's market value to the book value per share of total assets less total liabilities. This number is used to judge whether a stock is undervalued or overvalued. **Price-to-Earnings (P/E)** is the price of a stock divided by its earnings per share for the next 12 months. Sometimes called the multiple, P/E gives investors an idea of how much they are paying for a company's earning power. The higher the P/E, the more investors are paying, and therefore the more earnings growth they are expecting. **Standard deviation** shows how much variation or dispersion from the average exists. In finance, standard deviation is applied to the annual rate of return of an investment to measure the investment's volatility. Standard deviation is also known as historical volatility and is used by investors as a gauge for the amount of expected volatility. **The 5-Year EPS Growth Rate** is the weighted average of earnings per share growth for all securities in the portfolio projected for the past five fiscal years. Earnings per share for a company is defined as total earnings divided by shares outstanding. **Portfolio turnover** is a measure of how frequently assets within a fund are bought and sold by the managers. Portfolio turnover is calculated by taking either the total amount of new securities purchased or the amount of securities sold - whichever is less - over a particular period, divided by the total net asset value of the fund. **Tracking error** is the amount by which the performance of the portfolio differs from that of the benchmark. **Active Share** is the fraction of the portfolio or fund that is invested differently than its benchmark as of the last day of the reporting period. A portfolio with a high degree of Active Share does not assure a fund's relative outperformance. Active Share calculation may consolidate holdings with the same economic exposure.

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