

Morgan Stanley

INVESTMENT MANAGEMENT

1 May 2020 – Market Update

Coronavirus: A look at “safe havens”

SOLUTIONS & MULTI-ASSET | GLOBAL BALANCED RISK CONTROL TEAM | MARKET PULSE |

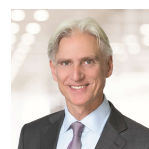
Many investors may be looking to shield their portfolios from renewed potential downside, by moving into defensive assets. The demand for “safe havens” is most likely to remain as we see further potential for downside, even as countries across the global are reaching their peaks in COVID-19 cases. This first phase may provide some reasons to feel short-term relief. However, after the initial economic shock, the second phase is likely to bring second-order effects such as increased unemployment and reduced consumption, which will weaken global economic growth.

We examine how traditionally defensive assets such as the US dollar and gold are behaving in this environment and how they are likely to continue to behave. We also consider the case of municipal bonds, which may face some challenges ahead.

US Dollar

The US dollar has so far outperformed most developed market and emerging market currencies in 2020. Support for the currency has been helped by a shortage of dollars that are needed to settle international transactions. The shortage has been so severe that the Federal Reserve had to act to provide US dollar FX swaps to foreign banks to increase the supply of dollars internationally. The Fed's total rate cut this year, which currently stands at 150bps, has removed some of the strong support for the dollar. That said, we expect the world's largest reserve currency to maintain its strength in the short to medium-term, until there is more visibility on how the global economy is recovering from the impact of the COVID-19 crisis.

With respect to the EUR/USD currency pair, compared with the US dollar the euro is facing multiple headwinds. First, before the crisis the US had stronger economic fundamentals than the eurozone. Second, the economic damage to the eurozone as a result of COVID-19 is likely to be more severe than the US, based on our forecast.



ANDREW HARMSTONE

*Managing Director,
Lead Global Portfolio Manager,
Global Balanced Risk Control
Team*



MANFRED HUI

*Managing Director,
Co-Lead Global Portfolio
Manager, Global Balanced Risk
Control Team*



CHRISTIAN GOLDSMITH

*Executive Director,
Portfolio Specialist,
Global Balanced Risk
Control Team*

Factors such as the eurozone's high exposure to tourism and manufacturing makes a deep recession almost inevitable. Third, the US has more monetary and fiscal power to lift the economy out of a recession. As a result, we are more constructive on the US dollar versus the euro, at least in the near-term.

Gold

Gold is generally negatively correlated to risk assets during times of crisis and is often used as a geopolitical hedge. However, as markets plunged in late February and through March, gold also sold off. We believe that gold's unusual behaviour was likely a result of liquidity pressures, as investors sought to sell any liquid assets to meet their obligations. This appears to have been a temporary effect and since the March sell-off, spot gold in US dollars has rallied more than 15%¹. This recovery has been supported by the ample liquidity provided by central banks and governments globally, as well as demand for "safe haven" assets. We expect real rates to remain in negative territory as central banks turn to unlimited quantitative easing. We now see the main headwind for gold to be the US dollar strength and are closely monitoring the Fed's forward guidance and upcoming US economic data for indication of how long the Fed intends to leave rates at the current low levels. This supports maintaining our overweight to gold.

Municipal Bonds

Finally, we believe it is worth highlighting another defensive asset, which has potential challenges on the horizon. US municipal bonds, which finance state and local governments, may require a potentially significant Federal bailout. Many states are currently facing large budget shortfalls, as they rely on retail sales and other transactions-linked revenue sources. New Jersey's Governor, Phil Murphy has stated that this revenue shortfall has added to the state's problems and it will run out of cash within four to six weeks. Initially, municipal bonds (which have a market size of \$3.8 trillion²) saw spreads widen sharply during the sell-off, but spreads narrowed again once the Fed supplied liquidity. However, the Fed cannot bail out a state or municipality from a budget shortfall. The US Treasury acting on a Congressional appropriation could provide a bailout, but so far Congress has not approved meaningful funding to states. We will continue to monitor developments as they unfold.

Our list of indicators to move into risk assets

Below is an update of our list of four factors which we are monitoring as indicators to move back into risk assets. There is little change in the status of these indicators as we see only the fourth of these indicators, effective monetary and fiscal policy, being truly in place:

1. **Credible steps to contain the virus and flattening of the infection rate curve:** This includes strategies such as test and trace, as successfully demonstrated by countries who have managed to contain the virus, such as South Korea. Some European countries are continuing to show signs of slowing the infection rate generally and easing lockdown. In contrast, US infection rates continue to trend sideways, hovering around their highs and breaching the 1 million mark of total cases. However, we are encouraged by the increased testing in the US.
2. **Extreme valuations:** Fixed income valuations were extreme in March, but were tempered after monetary policy intervention. Valuations, particularly in US large caps are back well above measures of our assessment of fair value, which we believe is a sign of excessive optimism. We continue to be far from valuation levels that we believe generally characterise a positive turning point in market direction.

¹ From 19 March to 29 April 2020 as measured by the XAU Curncy, spot gold expressed in USD terms.

² Source: Municipal Securities Rulemaking Board. Muni Facts, published March 2019. Data is as of December 2018. www.msrb.org/msrb1/pdfs/MSRB-Muni-Facts.pdf

3. **Extreme positioning:** We continue to believe that many investors are too positive about the future market direction, driven by “fear of missing out”, which we interpret as part of the first phase, or short term relief, referenced at the beginning of this update. However, overall fear, characteristic of the second phase, has not yet replaced greed. We believe that at a market bottom, investor sentiment generally reflects “fear” not “greed” and equity positioning would be falling not rising.
4. **Effective monetary and fiscal policy:** Policies are largely in place, but despite the unprecedented and continuous measures by central banks and governments to support the global economy, there are challenges surrounding the implementation. There may be more to come, but still may not be sufficient to prevent lasting damage to many areas of the economy. This week the Fed, ECB and BoJ each had their scheduled policy meetings. Notably, the BoJ extended its corporate debt purchases and announced unlimited bond purchases. We expect that the majority of available actions have now been announced, though central banks and policymakers may continue refining them.

We have provided the latest effective asset allocation weights of each of our five Luxembourg SICAV funds in the following table, as of 29 April 2020.

	VOLATILITY P.A. ¹	EQUITY %	FIXED INCOME %	COMMODITIES %	CASH %*	
					PHYSICAL	SYNTHETIC*
MS INV F Global Balanced Risk Control Fund of Funds (EUR)	4% – 10%	19.4	51.0	4.4	12.5	12.8
MS INV F Global Balanced Income Fund (EUR)	4% – 10%	20.6	49.1	4.5	13.0	12.8
MS INV F Global Balanced Fund (EUR)	4% – 10%	20.0	47.4	4.4	7.3	20.9
MS INV F Global Balanced Defensive Fund (EUR)	2% – 6%	7.1	67.3	3.4	8.9	13.3
MS INV F Multi-Asset Risk Control Fund (USD)	4% - 10%	20.9	60.2	4.2	2.4	12.4

*Synthetic cash created from derivatives positions.

We have provided the effective weights for 29 April 2020 at the time of publication. Weights may deviate marginally from these weights after publication due to data revisions.

Source: Global Balanced Risk Control team, Morgan Stanley Investment Management. Allocations are subject to change on a daily basis and without notice. For information only and not a recommendation to buy or sell specific investment strategy. MS INV F standards for Morgan Stanley Investment Funds. ¹ Volatility targets are indicative ranges. There is no assurance that these targets will be attained.

RISK CONSIDERATIONS

There is no assurance that the Strategy will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Accordingly, you can lose money investing in this portfolio. Please be aware that this strategy may be subject to certain additional risks. There is the risk that the Adviser's **asset allocation methodology and assumptions** regarding the Underlying Portfolios may be incorrect in light of actual market conditions and the Portfolio may not achieve its investment objective. Share prices also tend to be volatile and there is a significant possibility of loss. The portfolio's investments in **commodity-linked notes** involve substantial risks, including risk of loss of a significant portion of their principal value. In addition to commodity risk, they may be subject to additional special risks, such as risk of loss of interest and principal, lack of secondary market and risk of greater volatility, that do not affect traditional equity and debt securities. **Currency fluctuations** could erase investment gains or add to investment losses. **Fixed-income securities** are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest-rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall. **Equity and foreign securities** are generally more volatile than fixed income securities and are subject to currency, political, economic and market risks. Equity values fluctuate in response to activities specific to a company. 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. The risks of investing in **emerging market** countries are greater than risks associated with investments in foreign developed markets. **Exchange traded funds (ETFs)** shares have many of the same risks as direct investments in common stocks or bonds and their market value will fluctuate as the value of the underlying index does. By investing in exchange traded funds ETFs and other **Investment Funds**, the portfolio absorbs both its own expenses and those of the ETFs and Investment Funds it invests in. Supply and demand for ETFs and Investment Funds may not be correlated to that of the underlying securities. **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the portfolio's performance. A **currency forward** is a hedging tool that does not involve any upfront payment. The use of **leverage** may increase volatility in the Portfolio. **Diversification** does not protect you against a loss in a particular market; however, it allows you to spread that risk across various asset classes.

DISCLOSURES

The views and opinions are those of the author as of the date of publication and are subject to change at any time due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all portfolio managers at Morgan Stanley Investment Management (MSIM) or the views of the firm as a whole, and may not be reflected in all the strategies and products that the Firm offers.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific Morgan Stanley Investment Management product.

Except as otherwise indicated, the views and opinions expressed herein are those of the portfolio management team, are based on matters as they exist as of the date of preparation and not as of any future date, and will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date hereof.

Certain information herein is based on data obtained from third party sources believed to be reliable. However, we have not verified this information, and we make no representations whatsoever as to its accuracy or completeness.

The information herein is a general communications which is not impartial and has been prepared solely for information and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy.

The material contained herein has not been based on a consideration of any individual client circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

Past performance is no guarantee of future results. Charts and graphs provided herein are for illustrative purposes only. This communication is not a product of Morgan Stanley's Research Department and should not be regarded as a research recommendation. The information contained herein has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This commentary is only intended for, and will be only distributed to, persons resident in jurisdictions where distribution or availability would not be contrary to local laws or regulations.

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Prior to investing, investors should carefully review the product's relevant offering document. There are important differences in how the strategy is carried out in each of the investment vehicles.

DISTRIBUTION

This communication is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

Ireland: Morgan Stanley Investment Management (Ireland) Limited. Registered Office: The Observatory, 7-11 Sir John Rogerson's, Quay, Dublin 2, Ireland. Registered in Ireland under company number 616662. Regulated by the Central Bank of Ireland. **United Kingdom:** Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority.

Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA, authorised and regulated by the Financial Conduct Authority.

Dubai: Morgan Stanley Investment Management Limited (Representative Office, Unit Precinct 3-7th Floor- Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). **Germany:** Morgan Stanley Investment Management Limited Niederlassung Deutschland 4th Floor Junghofstrasse 18-26, 60311 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Italy:** Morgan Stanley Investment Management Limited, Milan Branch (Sede Secondaria di Milano) is a branch of Morgan Stanley Investment Management Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), and whose registered office is at 25 Cabot Square, Canary Wharf, London, E14 4QA. Morgan Stanley Investment Management Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni

Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 08829360968. **The Netherlands:** Morgan Stanley Investment Management, Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of Morgan Stanley Investment Management Limited. Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **Switzerland:** Morgan Stanley & Co. International plc, London, Zurich Branch. Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-115.415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41(0)44 588 1074.

Hong Kong: This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This publication should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"), (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This publication has not been reviewed by the Monetary Authority of Singapore. **Australia:** This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accepts responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.

LatAm

BRAZIL. This document does not constitute a public offering of securities for the purposes of the applicable Brazilian regulations and has therefore not been and will not be registered with the Brazilian Securities Commission (Comissão de Valores Mobiliários) or any other government authority in Brazil. All information contained herein is confidential and is for the exclusive use and review of the intended addressee of this document, and may not be passed on to any third party.

CHILE. Neither the Fund nor the interests in the Fund are registered in the Registry of Offshore Securities (el Registro de Valores Extranjeros) or subject to the supervision of the Commission for the Financial Market (la Comisión para el Mercado Financiero). This document and other offering materials relating to the offer of the interests in the Fund do not constitute a public offer of, or an invitation to subscribe for or purchase, the Fund interests in the Republic of Chile, other than

to individually identified purchasers pursuant to a private offering within the meaning of Article 4 of the Chilean Securities Act (la Ley del Mercado de Valores) (an offer that is not "addressed to the public at large or to a certain sector or specific group of the public").

COLOMBIA. This document does not constitute an invitation to invest or a public offer in the Republic of Colombia and is not governed by Colombian law. The interests in the Fund have not been and will not be registered with the National Register of Securities and Issuers (el Registro Nacional de Valores y Emisores) maintained by the Financial Supervisory Authority of Colombia (la Superintendencia Financiera de Colombia) and will not be listed on the Colombian Stock Exchange (la Bolsa de Valores de Colombia). The interests in the Fund are being offered under circumstances which do not constitute a public offering of securities under applicable Colombian securities laws and regulations. The offer of the interests in the Fund is addressed to fewer than one hundred specifically identified investors. Accordingly, the interests in the Fund may not be marketed, offered, sold or negotiated in Colombia, except under circumstances which do not constitute a public offering of securities under applicable Colombian securities laws and regulations. This document is provided at the request of the addressee for information purposes only and does not constitute a solicitation. The interests in the Fund may not be promoted or marketed in Colombia or to Colombian residents unless such promotion and marketing is carried out in compliance with Decree 2555 of 2010 and other applicable rules and regulations related to the promotion of foreign financial and securities related products or services in Colombia.

Colombian eligible investors acknowledge that the interests in the Fund (i) are not financial products, (ii) are transferable only in accordance with the terms of the Fund's constitutional documents and (iii) do not offer any principal protection.

Colombian eligible investors acknowledge Colombian laws and regulations (in particular, foreign exchange, securities and tax regulations) applicable to any transaction or investment consummated in connection with an investment in the Fund, and represent that they are the sole liable party for full compliance with any such laws and regulations. In addition, Colombian investors acknowledge and agree that the Fund will not have any responsibility, liability or obligation in connection with any consent, approval, filing, proceeding, authorization or permission required by the investor or any actions taken or to be taken by the investor in connection with the offer, sale or delivery of the interests in the Fund under Colombian law.

MEXICO. Any prospective purchaser of the interests in the Fund must be either an institutional investor (inversionista institucional) or a qualified investor (inversionista calificado) within the meaning of the Mexican Securities Market Law (Ley del Mercado de Valores) (the "Securities Market Law") and other applicable Mexican laws in effect.

The interests in the Fund have not and will not be registered in the National Registry of Securities (Registro Nacional de Valores) maintained by the Mexican Banking and Securities Commission (Comisión Nacional Bancaria y de Valores). The interests in the Fund may not be offered or sold in the United Mexican States by any means except in circumstances which constitute a private offering pursuant to Article 8 of the Securities Market Law and its regulations. No Mexican

regulatory authority has approved or disapproved the interests in the Fund or passed on the solvency of the Fund. All applicable provisions of the Securities Market Law must be complied with in respect of any sale, offer or distribution of, or intermediation in respect of, the Fund interests in, from or otherwise involving Mexico, and any resale of the interests in the Fund within Mexican territory must be made in a manner that will constitute a private offering pursuant to Article 8 of the Securities Market Law and its regulations.

PERU. The interests in the Fund have not been and will not be registered in Peru under Decreto Legislativo 862: Ley de Fondos de Inversión y sus Sociedades Administradoras or under Decreto Legislativo 861: Ley del Mercado de Valores (the "Securities Market Law"), and are being offered to institutional investors only (as defined in article 8 of the Securities Market Law) pursuant to a private placement, according to article 5 of the Securities Market Law. The interests in the Fund have not been registered in the securities market public registry (Registro Público del Mercado de Valores) maintained by, and the offering of the Fund interests in Peru is not subject to the supervision of, the Superintendencia del Mercado de Valores. Any transfers of the Fund interests shall be subject to the limitations contained in the Securities Market Law and the regulations issued thereunder.

URUGUAY. The offering of the Interests qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. The Interests will not be offered or sold to the public (Individuals or Companies) in Uruguay, except in circumstances which do not constitute a public offering or distribution through a recognized Exchange under Uruguayan laws and regulations,. Neither the Fund nor the Interests are or will be registered with la Superintendencia de Servicios Financieros del Banco Central del Uruguay. The Fund corresponds to an investment fund that is not an investment fund regulated by Uruguayan law 16,774 dated September 27, 1996, as amended.

IMPORTANT INFORMATION

EMEA: This marketing communication has been issued by Morgan Stanley Investment Management Limited ("MSIM"). Authorised and regulated by the Financial Conduct Authority. Registered in England No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

This document contains information relating to the sub-fund ("Fund") of Morgan Stanley Investment Funds, a Luxembourg domiciled Société d'Investissement à Capital Variable. Morgan Stanley Investment Funds (the "Company") is registered in the Grand Duchy of Luxembourg as an undertaking for collective investment pursuant to Part 1 of the Law of 17th December 2010, as amended. The Company is an Undertaking for Collective Investment in Transferable Securities ("UCITS").

Applications for shares in the Fund should not be made without first consulting the current Prospectus, Key Investor Information Document ("KIID"), Annual Report and Semi-Annual Report ("Offering Documents"), or other documents available in your local jurisdiction which is available free of charge from the Registered Office: European Bank and Business Centre, 6B route de Trèves, L-2633 Senningerberg, R.C.S. Luxembourg B 29 192. In addition, all Italian investors should refer to the 'Extended Application Form', and all Hong Kong investors should refer to the 'Additional Information for

Hong Kong Investors' section, outlined within the Prospectus. Copies of the Prospectus, KIID, the Articles of Incorporation and the annual and semiannual reports, in German, and further information can be obtained free of charge from the representative in Switzerland. The representative in Switzerland is Carnegie Fund Services S.A., 11, rue du Général-Dufour, 1204 Geneva. The paying agent in Switzerland is Banque Cantonale de Genève, 17, quai de l'Île, 1204 Geneva. The document has been prepared solely for informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy.

The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable European regulation or Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

MSIM has not authorised financial intermediaries to use and to distribute this document, unless such use and distribution is made in accordance with applicable law and regulation. MSIM shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary. If you are a distributor of the Morgan Stanley Investment Funds, some or all of the funds or shares in individual funds may be available for distribution. Please refer to your sub-distribution agreement for these details before forwarding fund information to your clients.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without MSIM' express written consent.

All information contained herein is proprietary and is protected under copyright law.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley. This document may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this document in another language, the English version shall prevail.