Performance Review

In the quarter period ending March 31, 2019, the Portfolio’s I shares returned 7.28% (net of fees)\(^1\), while the benchmark returned 9.92%.

Korea was the largest contributor to returns for both the month of March and the quarter ending March 31, 2019 with our stock selection in Korea and the underweight country allocation both adding positive to returns. We attribute this to the changes we have made to the portfolio beginning in the third quarter of 2018. We have reduced the number of securities from 15 to nine and hold quality growth companies in which we have high conviction primarily within the consumer staples, communication services and information technology (IT) sectors.

In India, following a difficult year for the market and our portfolio, we maintained our conviction in our holdings, generating the second largest positive contributor during the month of March. The earlier pain still affected the full quarter (with India stock selection detracting).

Earlier in the quarter, India was impacted by a confluence of events that took place beginning in 2018: dominant and narrow market leadership from a few large index heavyweights, foreign investors showing little interest, a sharp spike in energy prices, and promoter funding issues leading to lenders invoking stock pledges and some of the pledged shares being sold in the market. As was the case for much of 2018, very few names outperformed in the index during this period—chiefly Reliance Industries, Axis Bank, Yes Bank and Infosys, which the portfolio did not hold. We have corporate governance concerns in regard to a company such as Reliance Industries; not owning such a name was a large drag on our performance in March.

Several macro events occurred during the month which we believe should benefit the portfolio in the future. Inflows from foreign portfolio investors in March were the highest into the country in the last eight years after a period in which foreign investors had largely stayed away. Debt markets also saw inflows after two consecutive months of outflows. While oil prices increased by 2.6% month on month in March in U.S. dollars per barrel, they rose only 0.4% month-on-month in rupees per barrel.\(^2\) We maintain conviction in our portfolio which is focused primarily on financials, consumer, transport and industrial names with many holdings in the small- to mid-cap range. For the portfolio in March, six of our top 10 contributors were India stocks.

Our Brazil stock selection contributed strongly in the quarter largely from our positions in companies benefiting from the renewal in business and consumer confidence as the country gradually recovers from deep recession and the Bolsonaro administration appears to remain dedicated to serious reform. During the quarter, we trimmed our position in Brazilian bank Bradesco (0.8% of the portfolio). It has outperformed the MSCI Brazil Index and MSCI Emerging Market Index over the last 12 months and particularly since the October 2018 presidential elections on expectation of accelerating loan growth, lower long-term rates, and further cost reductions/synergies from the integration of HSBC’s Brazil assets. Consensus forecasts now assume strong loan growth from 2019 to 2021 with a favorable loan mix offsetting narrower spreads. We think many of these positives are priced in. While the outlook continues to appear favorable for Bradesco, we see limited upside to expectations for Bradesco from here.

Our stock selection in Russia also contributed in the quarter, particularly our position in Yandex (1.1% of the portfolio), which has a strong franchise and an expanding position in high utility internet-based applications/businesses in Russia. It is retaking share in

\(^1\) Source: Morgan Stanley Investment Management. Data as of March 31, 2019.
\(^2\) Source: Bloomberg L.P.

This document constitutes a commentary and does not constitute investment advice nor a recommendation to invest. The value of investments may rise as well as fall. Independent advice should be sought before any decision to invest.
its core search business while continuing to grow its non-search user base (maps, navigator, images, classifieds) as well as scale its taxi business. We think the company can sustain its current high growth rate mainly via its search and portal business as it expands its potential ad inventory while the overall ad market grows and continues its conversion to digital.

In Russia, we think that the economic recovery can continue, though we note that the policy reforms (value added tax and pension) should lead to a deceleration this year. We also continue to believe the monetary and fiscal policies have not only reduced inflation to post-Soviet lows, but also are reducing materially the sensitivity of the Russian economy to oil and leading to a less volatile domestic economy. In terms of our portfolio, we are invested in companies that should benefit from these macro policies. We continue to like select domestic names for their secular growth opportunities, which should gain additional support from the economic recovery.

In addition to India, the largest detractor from performance in the quarter was our underweight allocation to China as well as stock selection. We maintain our conviction in the underweight to China, where we continue to expect growth to slow as a result of its massive credit expansion, demographic overhang and weakening trade.

During the quarter, EM markets once again rewarded tech as was the case in the previous three years prior to the fourth quarter 2018 when tech globally experienced a major drawdown. Our aggregate overweight to stocks within the consumer discretionary sector contributed strongly, as it was the best performing sector in EM. Our stock selection within consumer staples contributed positively as did our stock selection within materials. The aggregate overweight to consumer staples, however, detracted while the aggregate underweight to materials contributed. Our overweight allocations to financials detracted as did our aggregate underweight to information technology.

**Market Review**

The MSCI Emerging Markets (EM) Index returned +9.92% during the quarter, underperforming the MSCI World Index, which returned +12.48%. Colombia returned +24.80% during the quarter to lead all countries in the index, followed by China (+17.69%), Egypt (+15.82%), Greece (+12.78%) and Russia (+12.18%). Qatar fell -3.51%, which was the largest decline in the index, followed by Turkey (-3.15%), Poland (-0.58%), Malaysia (+0.33%) and Czech Republic (+3.82%).

**Portfolio Activity**

We initiated a position in pharmaceutical company Richter Gedeon (0.8% of the portfolio) of Hungary. We see Richter as an attractive medium-term growth story, with its earnings and cash flow growth driven by its new antipsychotic drug cariprazine, plus stabilization in its core business of branded generics.

In China, we added to China A share beverage company Kweichow Moutai (1.0% of the portfolio). We are taking the recent China A share market pullback to further build up our position in Kweichow Moutai. Moutai is the number one luxury liquor brand in China, with brand awareness and recognition much higher than any other brand nationwide. We believe Moutai’s brand image and unique flavor allow it to command and sustain premium pricing and deliver strong return on invested capital.

In Korea, we further reduced our position in IT company Samsung Electronics (2.0% of the portfolio). A recent trip to Korea helped confirm our view that the DRAM (dynamic random-access memory) cycle continues to remain weak. Stocks had an extreme reaction to earnings downgrades in the fourth quarter of 2018, which was followed by strong foreign portfolio flows into Korea and short-covering in early 2019. Consensus continues to hope that Samsung will announce some shareholder-friendly measures (such as a buyback) in mid-2019. We continue to increase our underweight in the DRAM sector. Our call remains that we are past the super-cycle in DRAM and what we are seeing now is noise as demand-supply and pricing attempt to find some equilibrium.

**Outlook**

While 2019 has started with positive returns in emerging markets, much of what has driven the rally is taking its cue from the United States. Investors are still focused on the U.S., and when looking at emerging markets, they have mainly bought companies similar to those they would buy in the U.S., such as large-cap techs. The U.S. is at all-time highs relative to the rest of the world in terms of trailing price-to-earnings ratios—levels that historically led to a mean reversion. The U.S. dollar, which has been an important driver of these relative trends, also seems to be peaking. The interest rate differential between the U.S. and the rest of the world is also near an all-time high.
In our view, we are close to an inflection point in markets. The performance gap between the U.S. and the rest of the world is bound to narrow in the coming decade. The U.S. today is about 55% of global market cap while its share of the global economy is 25%. The last time such a large gap existed was in the late 1980s, when the Japanese market was 45% of global market cap and its economy was about 15% of the world total. Of course, the U.S. and Japanese economies have many differences and U.S. equities do not necessarily face a similar path as that suffered by Japan that past few decades. However, the notion that the U.S. economy can grow at 3% to 4% a year does not appear likely, in our view. Even with the 2018 tax cuts, growth could not rise above 3%. The latest projections have been reduced to just about 2% for this year. As we have noted in previous commentaries, the three Ds—demographics, debt and deglobalization—are holding growth down.

As a share of the global economy, debt is higher than at the peak of the cycle in 2008, which is why interest rate forecasts have been so wrong. Given such high levels of debt, raising rates is a huge hit to the economy—in the U.S. and in China. The world cannot handle higher interest rates; that is why any rate increase that happens is repelled by the market.

When considering the effects of deglobalization, supply chains are already being disrupted everywhere. A CEO who formerly was planning to set up three factories in China may now be considering setting up one in Vietnam, one in Indonesia and one in Thailand. For a number of reasons, these countries are increasingly the beneficiaries of such investments. Mexico could be another beneficiary because wages are falling relative to China and the peso is cheap relative to the renminbi.

We also expect regulation to burden the technology sector. The manufacturing sector has 10 times more regulation than the tech sector. But now regulators are catching on. Every day there are stories about so-called techlash—whether it is about privacy, data sharing or company size. The tech sector’s profit margins are three times as large as the margins of the rest of the U.S. corporate sector, which already has very high margins. The momentum of regulation seems to be aligning against technology. Toward the beginning of this past decade, we had considered tech to be the “anti-bubble” sector. Growth was occurring within the sector, but investors were not really paying that much attention. Now that is the case with certain emerging markets. For example, consumer staples companies in emerging markets are trading at the lowest levels we have ever seen relative to broader emerging markets.

As we look forward, we remain cautious on China. Its demographics are less favorable than the U.S., its households are more leveraged, and in a world of deglobalization, it has more to lose. We are also cautious on countries like Korea and Taiwan, where the markets had outperformed just because of a few large-cap tech stocks.

We continue to favor countries that have carried out some macroeconomic adjustments in recent years and have relatively low but rising gross domestic product (GDP) per capita with an underpenetrated financial sector and relatively cheap currencies—markets such as Indonesia, Poland, Peru, Mexico, Brazil and Egypt. In our EM portfolio, we remain overweight such countries and invested in good quality, growth-oriented companies capable of sustaining or expanding their earnings as a result of healthy or improving domestic demand, resistance to declines in global trade, and resilience in an environment brought about by the higher interest rates that accompanied the Federal Reserve’s tightening cycle.

Our aggregate sector overweights are in the financials and consumer staples sectors—which generally benefit from the economic recovery and expansion phase that most EM countries only began to enter in the past couple years. Most EM economies are in the early stages of a five-year expansion cycle in contrast to the U.S., which is at the peak of a nearly 10-year economic expansion and bull market.

**Overweight strategy:**

We continue to overweight the Central and Eastern European region. We think that growth in Central and Eastern Europe should remain healthy, albeit decelerating, supported by strong consumption and investment. We see the region as offering attractive investment opportunities through a combination of this solid economic growth and overlooked equity markets. We continue to like stocks that are exposed to secular growth opportunities in consumer markets in the region. We have a material, though reduced, position in financials in the region, as the probability of rate hikes has declined, particularly in Poland. We have focused the portfolio on stocks with earnings driven by volume growth and operating leverage independent of policy rates.

We remain overweight Mexico. A year ago we visited Mexico and came away thinking that the cheap peso and stable finances made it an attractive market, so long as newly elected president Andrés Manuel López Obrador (AMLO) did not prove as radically left-wing as many people feared. We returned to Mexico City just as AMLO’s tenure was reaching the 100-day milestone, to see whether he was justifying or putting to rest those fears. For now, we saw no reason to get rattled because...
monetary policy is still in credible hands, with rates high enough to keep inflation low and the peso stable, at a level that is still cheap. AMLO has appointed two new governors out of the five at the Central Bank, and his choices, Jonathan Heath and Gerardo Esquivel, are widely respected. Overall, their message is that despite weakening growth and low inflation, Mexico’s high risk premium requires the bank to remain hawkish.

Mexico’s fiscal situation also raises no immediate cause for concern, in part because Finance is one of the ministries still in capable hands and it has signaled its intent not to break the budget. Mexico is also poised to be one of the key beneficiaries in a period of deglobalization. As tariff battles undercut trade between the U.S. and China, Mexico’s exports stand to gain, given how competitive its wages and the peso now look relative to China. The current account is already in good shape. We are nevertheless watching political developments closely, particularly the fate of Pemex, and watching for any signs that AMLO might reverse his predecessor’s plan to open the state oil company to foreign investors. This decision will be seen as a litmus test of AMLO’s stated plans to revert to a state-run economic model, with dramatic implications for growth in the economy.

We remain overweight Brazil. We expect continued volatility related to the reform process, though we note that investor sentiment now seems more realistic regarding the pension reform timing/total savings and growth outlook. Earnings revisions are still positive, driven by operating leverage and lower interest rates, and the market valuation seems reasonable. General optimism is based on the unprecedented support for pension reform from the general public, congress, municipalities and a relevant portion of the media. The bill is currently being deliberated in the Lower House Justice Committee and the next phase is the Lower House Special Commission. This is where more compromise and savings dilution are expected to occur, but in contrast to prior reform attempts, including Temer’s in 2017, a number of governors are now supportive as many states face acute fiscal crises driven by pension and health care obligations. With unprecedented support for reform, the risks stem from the Bolsonaro team’s political inexperience, controversies and non-traditional political approach. A successful pension reform could provide the political and economic momentum to push through tax, trade and other reforms. Unlike pension and tax reforms, which entail constitutional amendments, some other reforms could be passed relatively quickly through a simple majority in the Lower House and Senate. We continue to emphasize domestic Brazil and underweight the exporters.

Underweight strategy:

China continues to rebalance from an investment-led economy to a consumption-based economy. We continue to expect growth to slow as a result of its credit expansion over the past 10 years, weakening trade and demographic overhang. While the rest of EM has seen its non-financial debt climb by 20 percentage points as a share of GDP since the global financial crisis of 2008, China’s debt has grown by more than 100 percentage points. As we have noted previously, the world began to enter a deglobalization phase with the Global Financial Crisis in 2008. And as trade flows have fallen from their 2008 peak, they have also begun to shift. China’s share of global manufacturing exports peaked at more than 17% in 2014 and began to fall, particularly in cheap, labor-intensive sectors like apparel.

China’s tech firms are also facing new scrutiny from a bureaucracy that used to focus less on regulating their business behavior than on protecting them from U.S. competitors. In an environment where regulators left tech firms free to lay their golden eggs, they came to dominate global markets. Of the world’s 10 largest companies by market cap, seven are in tech. And of the 20 largest internet companies, public and private, 11 are American and the other nine are Chinese. In an age of tightening rules, this kind of dominance will be much harder to sustain.

Despite these challenges, we think the wage growth of highly skilled, well-educated Chinese workers will continue to gradually improve, considering their large differential with developed country peers. The consumption power within this segment will continue to expand, providing ample room for companies to conceive of new products and services to satisfy the demand of this expanding middle class. In our portfolio positions in China, we are actively focused on good quality structural growth stories involving upgrades to consumption and greater demand for services broadly.

We remain underweight Taiwan as we view it as a mature economy lacking the dynamic growth characteristics of other EM countries and is vulnerable to further disruptions in global trade.

Our large underweight to Korea contributed positively to performance in the quarter. Korea scores on the low end by our rules of the road, in large part on its mature economy, expensive currency, strong dependence on global trade and heavier state spending under the Moon administration. While we are comfortable with the underweight, we note that at the margin certain stocks have become cheaper and more neglected. We believe that the market may be increasingly driven by improving relations with China and the government becoming less socialist as it realizes its policies have not yielded the desired results. Our

---

2 Source: Bloomberg L.P.
5 Source: Morgan Stanley Investment Management, Bloomberg L.P., FactSet, Haver Analytics
changes to the portfolio have included focusing on select cosmetics—to meet rising China cosmetic demand—and retail, which should benefit from the minimum wage hike. We also added to the refining sector as sentiment has been beaten down. Lower oil prices in our view will be actually supportive for refining margins.

<table>
<thead>
<tr>
<th>FUND FACTS</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Launch date</td>
<td>September 25, 1992</td>
<td>U.S. dollars</td>
</tr>
<tr>
<td>Base currency</td>
<td>U.S. dollars</td>
<td>MSCI Emerging Markets Net Index</td>
</tr>
<tr>
<td>Index</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Performance (%)**

*As of date March 31, 2019 (Class I Share at NAV)*

<table>
<thead>
<tr>
<th></th>
<th>MTD</th>
<th>QTD</th>
<th>YTD</th>
<th>1 YR</th>
<th>3 YR</th>
<th>5 YR</th>
<th>10 YR</th>
<th>SINCE INCEPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>MSIF Emerging Markets Portfolio - I Shares</td>
<td>0.62</td>
<td>7.28</td>
<td>7.28</td>
<td>-12.93</td>
<td>6.90</td>
<td>1.93</td>
<td>8.26</td>
<td>7.32</td>
</tr>
<tr>
<td>MSCI Emerging Markets Net Index</td>
<td>0.84</td>
<td>9.92</td>
<td>9.92</td>
<td>-7.41</td>
<td>10.68</td>
<td>3.68</td>
<td>8.94</td>
<td>7.36</td>
</tr>
</tbody>
</table>

Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown. For the most recent month end performance figures, please visit morganstanley.com/im. Investment returns and principal value will fluctuate and fund shares, when redeemed, may be worth more or less than their original cost.

The gross expense ratio is 1.07% for Class I shares and the net expense ratio is 1.04%. Where the net expense ratio is lower than the gross expense ratio, certain fees have been waived and/or expenses reimbursed. These waivers and/or reimbursements will continue for at least one year from the date of the applicable fund's current prospectus (unless otherwise noted in the applicable prospectus) or until such time as the fund's Board of Directors acts to discontinue all or a portion of such waivers and/or reimbursements. Absent such waivers and/or reimbursements, returns would have been lower. Expenses are based on the fund's current prospectus. The minimum initial investment is $5,000,000.

Returns are net of fees and assume the reinvestment of all dividends and income. They are compared to an unmanaged market index. Returns for less than one year are cumulative (not annualized). Performance for one year or more is based on average annual total returns. The returns are reported for Class I shares. Performance for other share classes will vary.

**RISK CONSIDERATIONS**

There is no assurance that a portfolio 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. Accordingly, you can lose money investing in this strategy. Please be aware that this strategy may be subject to certain additional risks. In general, equities securities’ values also fluctuate in response to activities specific to a company. Investments in foreign markets entail special risks such as currency, political, economic, market and liquidity risks. The risks of investing in emerging market countries are greater than the risks generally associated with investments in foreign developed countries. Derivative instruments can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the portfolio’s performance. Illiquid securities may be more difficult to sell and value than publicly traded securities (liquidity risk).

**INDEX INFORMATION**

The MSCI Emerging Markets Net Index is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging markets. The term “free float” represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The MSCI Emerging Markets Index currently consists of 24 emerging market country indices. The performance of the index is listed in U.S. dollars and assumes reinvestment of net dividends.

The MSCI Brazil Index is designed to measure the performance of the large and mid cap segments of the Brazilian market. With 68 constituents, the index covers about 85% of the Brazilian equity universe.

The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the
global equity market performance of developed markets. The term “free float” represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The MSCI World Index currently consists of 23 developed market country indexes. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

The Indexes are unmanaged and do not include any expenses, fees or sales charges. It is not possible to invest directly in an Index.

IMPORTANT INFORMATION

The views and opinions expressed are those of the investment team at the time of writing and are subject to change at any time due to market, economic, or other conditions, and may not necessarily come to pass. These comments are not representative of the opinions and views of the firm as a whole. Holdings and sectors/region weightings are subject to change daily. All information provided is for informational purposes only and should not be deemed as a recommendation to buy or sell securities in the sectors and regions referenced.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational 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 information herein has not been based on a consideration of any individual investor 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.

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.

Please consider the investment objectives, risks, charges and expenses of the fund carefully before investing. The prospectus contains this and other information about the fund. To obtain a prospectus, contact your financial advisor or download one at morganstanley.com/im. Please read the prospectus carefully before investing.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT