Performance Review

In the quarter period ending March 31, 2019, the Portfolio’s I shares returned 5.88% (net of fees), while the benchmark returned 6.87%.

Our stock selection in and underweight allocation to Morocco and allocations to Mercadolibre in Brazil, Saudi Arabia and Egypt contributed to returns. Our underweight allocation to Lebanon and stock selection in Nigeria also contributed. Our underweight allocation to Bahrain, stock selection in Vietnam and allocation to the United Arab Emirates detracted from performance. Our stock selection in and underweight allocations to Kuwait and Kenya also hampered returns.

Market Review

The MSCI Frontier Markets Index (+6.87%) underperformed the MSCI Emerging Markets Index (+9.92%) during the quarter. Bahrain (+23.59%), Kenya (+22.81%), Egypt (+15.94%), Saudi Arabia (+14.89%), Kuwait (+12.87%) and Vietnam (+12.86%) led market returns. Serbia (-21.79%), Morocco (-5.87%), Qatar (-3.51%), Tunisia (-3.21%) and Lebanon (-2.38%) were the worst performing markets in the region during the quarter.

Portfolio Activity

During the quarter we increased our exposure to Kenyan banks through Equity Bank (2.0% of the portfolio) and KCB Group (1.8% of the portfolio). It has been two years since the imposition of the rate cap on loans, and banks are poised to begin lending again. There is pent-up demand for borrowing, and we believe banks have learned to effectively operate with this restriction and will start to focus once again on growth.

We also introduced Gulf Bank (2.0% of the portfolio) in Kuwait to the portfolio. The bank has shifted to a growth mode over the past few years, having cleaned up their non-performing loans (NPLs) from the Global Financial Crisis. Gulf Bank experienced loan growth of 13% cumulatively over the last two years, led by management’s push into retail banking, and we believe it can continue to see strong growth in its loan book. We believe net interest margins are likely to rise slightly as the loan book reprices to higher rates, and the bank should see a lower cost of risk in the coming years due to excessive loan provisions.

We increased our position in Romanian banks by adding to Banca Transilvania (2.5% of the portfolio) and introducing BRD-Groupe Societe Generale (1.2% of the portfolio) to the portfolio. The government had proposed a bank tax on assets that does not allow for any asset exclusions. This announcement led to a large sell-off in the banking sector; however, we believe markets overreacted to the bank tax as the sector remains very healthy. Romania has not had a strong credit cycle and has de-levered. Credit is also at low levels in the economy so we do not believe the imposition of the tax would lead to systemic risk. Going into 2020, the new earnings base for these banks will have been established and earnings growth should return.

In Vietnam we sold Vinhomes as we became concerned on delays on one of its key projects in Ho Chi Minh. We believe management is over-guiding on the number of unit launches and sales for this year, and forecasts are extremely optimistic even though projects are behind in production. Elsewhere in Vietnam we sold HD Bank on concerns on the high private sector credit

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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.
to gross domestic product (GDP) levels, the growth in retail lending and the capitalization of the sector. We also exited our position in Vietjet on concerns regarding sale leasebacks, which have contributed to a large share of the company’s earnings.

**Outlook**

As policymakers—from the International Monetary Fund (IMF) to the Federal Reserve—are digesting how to respond to a slowdown in global growth centered on the U.S., China and Europe, frontier markets (FM) are expected to witness an acceleration in growth. Frontier GDP growth is expected to accelerate from 3.2% in 2018 to 3.5% in 2019 and further to 4.0% in 2020. A full 63% of countries in FM could witness growth acceleration. Over this same period, emerging markets (EM) ex-China economies aren’t expected to see any growth acceleration as it will be stable at 3.3%. Only 29% of EM countries are expected to witness growth acceleration. Historically, when FM growth differentials widen, such as during the 2013-2015 period, FM equities outperformed EM equities materially.

Given the above, it is no surprise that from a bottom-up perspective, frontier corporates are growing top-line faster with higher returns on equity and lower net debt-to-EBITDA than emerging and developed markets. As such, we expect frontier earnings per share (EPS) growth in aggregate to be near 15% for 2019, above the estimated 7% for EM after three straight years of FM EPS growth below that of EM.

Additionally, frontier markets balance sheets are much healthier both at the country level—45% private credit to GDP versus 81% for EM ex-China—and at the company level—17x net debt to EBITDA in aggregate versus 2.0x in EM ex-China. This should allow policymakers to use credit creation to support economic expansion. Frontier countries are also less exposed to a slowdown in China, given their low percentage of total exports to China. Excluding oil, total frontier exports to China is only 8% versus 15% for emerging markets countries. Given this, as China growth slows, especially if caused by trade tensions, FM countries should be more insulated, and some economies such as Vietnam could be net beneficiaries of manufacturing moving out of China over the medium term.

Frontier currencies are now in aggregate undervalued and back to the valuation levels of 2013, as the majority of FM currencies—from Argentina to Nigeria to Egypt and Pakistan—have had material adjustments with only two currencies left overvalued, the Bangladeshi taka and the Kenyan schilling. Apart from a better fundamental outlook, we believe FM equities currently offer portfolios greater diversification than EM. The correlation of frontier equities to other equity asset classes on a trailing five-year basis is now a very low 0.55-0.65 to MSCI EM Index, MSCI All Country World Index (ACWI) and MSCI EAFE Index equities. EM equities, on the other hand, have higher correlations to global equities at 0.80 and 0.78 for MSCI ACWI and EAFE, respectively.

In addition, the volatility of frontier equities remains significantly lower than EM equities at 12% versus 15% in EM on a trailing five-year basis, and as such, frontier markets have offered both higher returns and lower volatility when compared to EM over the past five years. In short, FM equities have historically been a good way to diversify and reduce risk in global equity allocations, and we believe this benefit is now even stronger.

We continuously assess the growth levers providing tailwinds to frontier economies such as strong demographics with labor force growth sufficient for high GDP growth, an underpenetrated credit cycle, a relatively low level of private debt-to-GDP and healthy domestic demand. Many of the frontier markets are recovering off a low in GDP growth and experienced significant resets in the economy, including markets like Nigeria and select markets across the Middle East.

In Argentina, the economy is likely to bottom in the second quarter of this year due to better wheat and soy harvests and increased wages post the March wage negotiations, and these should help to offset the impact of high interest rates. The IMF expects 2019 growth at -1.7% and while this is still negative growth, we place a higher importance on the second derivative of growth as it is headed in the right direction. Agriculture, tourism, oil & gas, and other export sectors should pick up first. It is expected that most corporates are providing salary increases early this year to help counteract the high inflation from 2018, while inflation is expected to gradually fall again. The improvement in purchasing power should act as an additional growth driver for an economic recovery. Inflation is expected to head lower due to tighter monetary policy. Argentina is committed to a 0% monetary base through June and is conducting open market operations via a set amount of Leaiq bills, allowing local banks to set the market rate. Politics remain front and center ahead of the 2019 elections and the potential of Cristina Fernandez de Kirchner running against Macri, which are contributing to headline risk.

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3 Source: IMF
4 Source: IMF, Haver Analytics
5 EBITDA = earnings before interest, taxes, depreciation and amortization
6 Source: Bloomberg LP, FactSet
7 Source: Bloomberg LP, FactSet, Haver Analytics
8 Source: Haver Analytics
9 Source: FactSet
2019 is shaping up to be a good year for Egypt. Growth is expected to continue to accelerate to 5.5% this year and closer to 6% in the years thereafter according to the IMF. The central bank has cut rates 100 basis points (bps) already and we think there is potentially scope for a further 150 to 250 bps depending on the path of inflation. The external balance continues to improve as the current account deficit is around 2% of GDP currently, and we think there is room for further improvement as tourism rebounds from historically low levels (4% of GDP currently versus 8% historically) and the gas production increases and ultimately turns into an export story. We are monitoring what the government will do once the IMF package expires in the summer of 2019. The IMF stated that it will go into post-program monitoring if the government does not request more funding to monitor that the government is keeping to its reform. Much of the foreign domestic investment in 2018 stemmed from the consumer sector, and several corporates believe the uptick in spending will continue, particularly on the premium and low-end segments. Politics remain a risk as it seems unlikely that President Sisi will give up power and pull something similar to Erdogan, but this would not occur until 2022.

In Saudi Arabia, real GDP is estimated to grow at 1.9% in 2019. The IMF expects growth to rise in the medium term due to reforms and oil output, but unemployment remains an issue. The outlook has been clouded slightly due to the unfortunate events in Istanbul and the geopolitical implications, including the risk of sanctions. Nonetheless, we believe the events will lead to more centralized decision-making in the country, as well as a potential de-escalation of the war in Yemen and the more normalized relations with Qatar, which we view as positives. Additionally, authorities in Saudi are more likely to increase government spending domestically in the near-term in order to stimulate the economy. The fiscal deficit has continued to narrow and recent fiscal reform through the introduction of a value added tax and lower energy price subsidies were steps in the right direction.

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<thead>
<tr>
<th>FUND FACTS</th>
<th>Launch date</th>
<th>Base currency</th>
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<tr>
<td>Launch date</td>
<td>August 25, 2008</td>
<td>U.S. dollars</td>
<td>MSCI Frontier Markets Index</td>
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3 Source: IMF
8 Source: Haver Analytics
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 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 Portfolio 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 frontier emerging markets are greater than risks associated with investments in other foreign or U.S. issuers and they are often considered highly speculative in nature. Investment opportunities in many frontier emerging markets may be concentrated in the banking industry, which could have a disproportionate impact on the portfolio's performance. Stocks of small- and medium-capitalization companies entail special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies. By investing in investment company securities, the portfolio is subject to the underlying risks of that investment company's portfolio securities. In addition to the Portfolio's fees and expenses, the Portfolio generally would bear its share of the investment company's fees and expenses. Derivative instruments may disproportionately increase losses and have a significant impact on performance. They also may be subject to counterparty, liquidity, valuation,
Correlation and market risks. Illiquid securities may be more difficult to sell and value than public traded securities (liquidity risk).

INDEX INFORMATION

The MSCI Frontier Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of frontier 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 Frontier Markets Index currently consists of 29 frontier market country indices. The performance of the Index is calculated in U.S. dollars and assumes reinvestment of net dividends. "Net dividends" reflects a reduction in dividends after taking into account withholding of taxes by certain foreign countries represented in the Index.

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 All Country World Index (ACWI) is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and 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 performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the international equity market performance of developed markets, excluding the US & Canada. 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 EAFE Index currently consists of 21 developed market country indices. 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

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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.

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