Performance Review

In the quarter period ending December 31, 2019, the Portfolio’s I shares returned 7.48% (net of fees), while the benchmark returned 8.56%.

The fourth quarter underperformance was driven by stock selection. Sector allocation was positive, as the benefits of the information technology and health care overweights and the avoidance of real estate and utilities were stronger than the hit from the overweight in consumer staples. For stock selection, the impact of underperformance in health care and information technology was greater than the effect of the financials and communications services outperformance.

Market Review

The MSCI World Index was up 8.6% in U.S. dollars (USD) in the fourth quarter (Q4) and a slightly lower 7.5% in local currency terms. The quarter started with a sharp value rally, as fears about the macro environment and trade wars faded, and the defensive and rate-sensitive names wound up as the laggards, with real estate up only 1%, utilities +2% and consumer staples +3%, while energy (+5%) was also weak. The two strongest sectors were healthcare (+14%), as political fears in the U.S. eased, and information technology (also +14%), particularly hardware and semiconductors. In terms of geography, the resource-intensive markets of Australia (+4% in USD, +0% in local currency), Norway (+4%, +1%) and Canada (+5%, +3%) struggled. Spain (+6%, +3%) was also behind the index given the political uncertainty, but all other major markets were within 2% of the MSCI World Index, with the U.S. (+9%) a touch ahead.

Outlook

As simple souls we attempt to disaggregate investing into earnings and multiples. Concerned as we are with the preservation of capital, we continue to maintain that there are only two ways to lose money in equities: if the earnings go away, or the multiple goes away. While our daily business is at the stock level, we also attempt to apply this logic to markets as a whole. At the end of 2017, our concern was multiples, with the MSCI World Index on 17.0x forward consensus estimates. This fear proved well founded, as 2018 was a down year despite double-digit earnings growth, as the market de-rated to 13.4x. Given this de-rating, our concern for 2019 switched to earnings... and we were a quarter right! We say a quarter, as we were half right on earnings, which mildly disappointed being down a fraction for the year rather than the expected 7% rise, but did not foresee that the multiple would bounce back to 17.0x. If we disaggregate the 2019 return of 28% for the MSCI World Index, a massive 26% came from the re-rating, -1% from earnings, and the remainder from dividends. This is an extreme example of the pattern we've been seeing since 2012, where more of the market return has come from multiple expansion than from earnings growth, with only 2017 offering a strong return year driven by earnings.

This significant re-rating implies a large increase in optimism during 2019. This was clearly not driven by the actual earnings, which disappointed in 2019 and have yet to revive, but rather by hopes for the future. Monetary policy was one clear shift. The U.S. Federal Reserve’s (the Fed) rate-raising cycle, which saw four rises in 2018 amidst talk of “normalisation,” ended in December of that year, and 2019 saw three cuts, along with more dovish noises, and a return to a growing balance sheet as it battled the crisis in the repo market. The European Central Bank (ECB) and the People’s Bank of China have followed suit in easing monetary conditions in an attempt to boost growth. Markets were also helped by a reduction in fears about a trade war between the U.S.

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2 Source: FactSet, December 2019

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and China, with talk of an imminent “Phase 1” deal, which would at least imply a truce.

So where does this revival of market morale leave us for 2020? Frankly, we are now nervous about both multiples and earnings. Our fear about multiples is natural enough, with the MSCI World Index back up to 17.0x, and this time without the benefit of the imminent earnings boost from the Trump tax cuts that it had in early 2018. Even putting the risk of multiple compression to one side, it is tough to see how there can be much mileage for the markets from expanding multiples – a 10% boost would require the MSCI World Index to be on close to 19x!

This leaves earnings as the main potential driver of any significant upside for markets, and here we are sceptical for the broad market in the medium term. It may well be that an industrial recovery can drive progress in 2020, but our structural concerns remain. Our anxiety is based on the fact that most of the levers for earnings growth have been pulled hard already, particularly in the U.S., leaving limited opportunity for them to help further and skewing the risk to the downside. Margins are high, as corporates have been advantaged relative to labour, given globalisation and the political move to the right over the last few decades, and also relative to consumers, given the falling role of anti-trust. Profits have also been boosted by low interest rates and increased leverage, decreasing interest payments and allowing earnings per share-boosting buybacks. On top of all this, the gap between the “adjusted” numbers, used for consensus and paying management, and the actual profit at the bottom of the income statement has ballooned, reaching $600 billion over the last three years in the U.S. alone. These were all tailwinds for earnings over the last few years that are unlikely to be repeated, and may turn into headwinds if they go into reverse.

This may not matter in 2020. It is quite possible that the U.S. can continue to steer between the Scylla of recession and the Charybdis of inflation, delivering economic and earnings growth without the Fed having to tighten and end the party. With the MSCI U.S.A. Index earnings multiple now at 18.7x, and double-digit earnings growth forecast for 2020 after the slight fall in 2019 success seems to be what the market is expecting. Europe looks distinctly cheaper, in relative terms at least, at a “mere” 14.6x as there is far less optimism about growth. Part of this is down to the relative shortage of fast growing technology companies, but it is also down to the continent as a whole being mired in very slow growth. Here, there could be a positive story if there is a move towards fiscal reflation in 2020. The block, as ever, is Germany, given its balanced budget requirement. But if this is eased, perhaps using the need for infrastructure to deal with the climate emergency as an excuse to issue green bonds, then this could drive faster growth, or at the very least the hope of faster growth, which may be all that is needed to drive a rally. The ECB under Christine Lagarde is likely to remain helpful. By contrast, it is probably fruitless to expect structural change in Japan, which at 14.3x is marginally cheaper than Europe. However, having suffered a double-digit earnings fall in 2019, as industrial production struggled, it may well be a beneficiary of any industrial bounce-back.

Alongside the U.S. premium to the rest of the developed world, growth is thriving relative to value, trading at a relative multiple not seen since the tech-media-telecom (TMT) bubble at the start of the millennium. We are agnostic on the growth versus value debate, since we are wary of both of them! The valuations for fast growing companies make us nervous, and we have moved around 500 basis points of the portfolio since the strategy’s inception from the faster growing companies, with estimated sales growth of 6% or higher, to the “duller” side of the portfolio with 3-5% top-line growth, where valuations are more reasonable. As for value, it is the companies’ prospects that often look relatively dim, with several of the struggling sectors facing genuine threats, be it trapped assets for energy, the rise of electric vehicles for autos and low interest rates for financials.

As ever, we advocate the case for quality. We look for companies with the intangible assets to give them the combination of recurring revenue and pricing power, along with the ability to sustain high returns on operating capital. One of the pluses they offer is resilience in tough times: the recurring revenue protects sales and the pricing power protects margins. 2019 was yet another time that the portfolio’s companies displayed this economic resilience, with the earnings continuing to compound steadily all year while the market as a whole failed to deliver any earnings growth at all. At a time of raised multiples and high uncertainty (uncertainty that is arguably not properly reflected in the markets), we would argue that it makes sense to go with the relative safety and durability of high-quality compounders.

### FUND FACTS

<table>
<thead>
<tr>
<th>Launch date</th>
<th>Base currency</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 30, 2013</td>
<td>U.S. dollars</td>
<td>MSCI World Net Index</td>
</tr>
</tbody>
</table>

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2 Source: FactSet, December 2019  
3 Source: FactSet, Morgan Stanley Investment Management, December 2019  
4 Source: Morgan Stanley Investment Management, December 2019
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 emerging market countries are greater than risks associated with investments in foreign developed countries. 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. Nondiversified portfolios often invest in a more limited number of issuers. As such, changes in the financial condition or market value of a single issuer may cause greater volatility. 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).

The gross expense ratio is 2.82% for Class I shares and the net expense ratio is 0.90%. 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.

Please keep in mind that high double-digit returns are highly unusual and cannot be sustained. Investors should also be aware that these returns were primarily achieved during favorable market conditions. MSIF Global Quality Portfolio is changing to MSIF Global Sustain Portfolio effective April 30, 2018.

RISK CONSIDERATIONS

INDEX INFORMATION

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 performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

The MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market. With 631 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US.

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

### Performance (%)  
**As of date December 31, 2019 (Class I Share at NAV)**

<table>
<thead>
<tr>
<th>Index</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>
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<tbody>
<tr>
<td>MSIF Global Sustain Portfolio - I Shares</td>
<td>2.71</td>
<td>7.48</td>
<td>30.03</td>
<td>30.03</td>
<td>17.13</td>
<td>12.00</td>
<td>--</td>
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<td>MSCI World Net Index</td>
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<td>27.67</td>
<td>27.67</td>
<td>12.57</td>
<td>8.74</td>
<td>--</td>
<td>9.81</td>
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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.
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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.

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