

# Morgan Stanley China A Equity Strategy

ACTIVE FUNDAMENTAL EQUITY | GLOBAL EMERGING MARKETS TEAM | STRATEGY PROFILE | 2017

The **Morgan Stanley China A Equity Strategy** is a concentrated strategy focusing on seeking stocks with high secular growth and tactical positions in cyclical stocks with attractive valuation and/or good fundamentals and dynamics. To achieve its objective, the strategy combines top-down sector allocation with bottom-up stock selection and disciplined risk management.

## Investment Philosophy

The investment team believes that there are inefficiencies in the China A-share equity market that it can systematically take advantage of through a disciplined investment process. The team believes that over the next decade China is likely to embark upon long-term change to its economic growth model. Some of the team's long-term themes are based on this. These long-term themes act as anchors and provide a framework upon which we structure our strategy. We seek to generate alpha as these themes develop.

Our investment philosophy emphasizes dynamics and attempts to find multiple ways that a stock can outperform by identifying the macro and company fundamentals and catalysts that will drive performance. The investment team focuses on stocks that have a sustainable growth profile and a high or increasing return to the shareholder and looks for sectors/themes that consensus may overlook, but where we believe positive change may yet occur.

## Investment Process

The team follows a disciplined investment process that integrates both top-down and bottom-up perspectives.

- **TOP-DOWN ANALYSIS:** We focus on dynamics such as macroeconomic indicators, social and political trends, fiscal and monetary policy and currency movements. This is combined with an in-depth analysis of market sentiment and valuation analysis (based on price/book (P/B) value, price/ earnings (P/E) and price/cash flow (P/CF) ratios as well as intrinsic value models such as discounted cash flow (DCF) and Sum of the Parts). This process provides a framework for thematic/sector analysis.
- **BOTTOM-UP STOCK SELECTION:** At the stock level, our bottom-up fundamental analysis based on dynamics, valuation and sentiment is integral in understanding the companies in which we invest. We focus on companies with what we consider strong management and good earnings visibility. Interviewing company management gives us important information about their ability to execute, their integrity and the risks inherent in their business models. As a result, the China Equity team conducts approximately 400 company visits/meetings with corporate and government entities as well as sector and industry specialists each year, spending at least a week per month on the ground throughout China.
- We spend, approximately, 30% of our time on top-down macro (including macro economic analysis and macro portfolio themes) and sector analysis and 70% on bottom-up security selection and analysis.

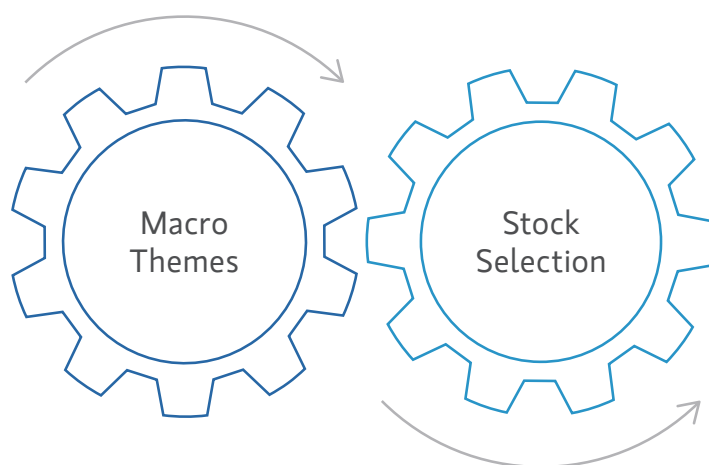
## STRATEGY AT A GLANCE

Inception	September 2006
Benchmark	MSCI China A Index <sup>1</sup>
Industry weight <sup>2</sup>	Typically within +/- 10% of the benchmark
Security weight <sup>2</sup>	Typically within +/-2% of the benchmark
Typical number <sup>2</sup> of holdings	25 – 40 stocks

<sup>1</sup> The MSCI China A Index captures large and mid cap representation across China securities listed on the Shanghai and Shenzhen exchanges. It is not possible to invest directly in the index.

<sup>2</sup> Weights and 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.

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**DISPLAY****Macro-thematic research integrated with bottom-up stock selection helps drive competitive performance**

The information presented represents how the portfolio management team generally applies their investment management process under normal market conditions.

**Competitive Advantages**

- **LEVERAGING THE EXPERTISE OF A HIGHLY EXPERIENCED AND STABLE GLOBAL INVESTMENT TEAM:** China's domestic market has unique macroeconomic characteristics that require experienced and dedicated professionals who can provide first hand knowledge of China's domestic market and the companies that operate there. Morgan Stanley Investment Management's (MSIM) China investment team has a solid institutional history and good track record and is committed to the long-term success of China A-share investing. The diversity, experience and intense interaction of our Asian Equity and Global Emerging Markets investment team is a significant factor in our process.
- **PROVEN PROCESS:** MSIM is a pioneer in China A-share, Asia and emerging markets investing and has demonstrated expertise and commitment to the investment universe through all market cycles. Having been investing in Asia since 1986 and in China A Equity since 2006, we believe that our time-tested investment philosophy and investment process can help deliver attractive performance.
- **GOVERNMENT AND INDUSTRY RELATIONSHIPS:** Due to Morgan Stanley's global presence, reputation and extensive resources, the strategy's investment team is able to access company management and senior government leaders. Such access helps the team perform original research and rigorous analysis, gain insights into country, industry and business fundamentals, and establish long-term relationships on behalf of the strategy.

**Investment Team<sup>3</sup>**

Gary Cheung, May Yu and Chelsea Hua directly manage the China A Equity strategy. The team also leverages on the macroeconomic and sector level research of the broader Asia Equity and Global Emerging Market teams, as well as inputs from the Global Multi-Asset (GMA), Asian Real Estate and International Equity teams.

<sup>3</sup> Team members may change from time to time without notice.

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Past performance is not a guarantee of future performance. There is no assurance that a portfolio will achieve its investment objective. Investment in this strategy involves a high degree of risk, including the risk that the entire amount invested may be lost. In general, 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 portfolio. Please be aware that this portfolio is subject to certain additional risks. **Emerging market securities.** 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. The portfolio's investments may be denominated in foreign currencies and therefore, to the extent unhedged, the value of the investment will fluctuate with the U.S. dollar exchange rates. To the extent hedged by use of foreign currency forward exchange contracts, the precise matching of foreign currency forward exchange contract amounts and the value of the securities involved will not generally be possible because the future value of such securities in foreign currencies will change as a consequence of market movements in the value of those securities between the date on which the contract is entered into and the date it matures. There is additional risk that such transactions reduce or preclude the opportunity for gain if the value of the currency should move in the direction opposite to the position taken and that foreign currency forward exchange contracts create exposure to currencies in which the portfolio's securities are not denominated. **Frontier emerging markets.** The risks associated with emerging markets are magnified when investing in frontier emerging market countries, accordingly, investments in the portfolio must be viewed as highly speculative in nature and may not be suitable for an investor who is not able to afford the loss of the entire investment. **Derivative Instruments/Strategic Transactions.** Derivative Instruments/Strategic Transactions involve risks, including the imperfect correlation between the value of the such instruments and the underlying assets, possible default by the other party to the transaction, illiquidity of the derivative instrument and, to the extent the Adviser's prediction as to certain market movements is incorrect, the risk that the use of such Strategic Transactions could result in losses greater than if they had not been used. These losses may have a potentially large negative impact on the strategy's performance. Equity securities are more volatile than other investments.

**Nondiversification.** 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.

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